

Weichai Power-H (2338 HK)

3Q19 profit +10% YoY in line; Expect further demand growth in 4Q19E

Weichai's net profit grew 10% YoY to RMB1.77bn, in line with our expectation. Net profit in 9M19 accounted for 72% of our full year estimates, which we feel comfortable. We maintain our positive stance on Weichai, with near term catalysts coming from a higher growth of HDT engine in 4Q19E on the back of infrastructure spending growth. Besides, we believe the expansion into excavator powertrain and engine for industrial power are new growth drivers over the coming years. Our 2019E/20E earnings estimates remain 4%/8% above consensus. Maintain **BUY**.

- **Key highlight of 3Q19 results.** Revenue remained stable (YoY) at RMB35.8bn in 3Q19. Gross margin expanded 1.6ppt YoY to 22.9%. Weichai recognized net finance income of RMB0.25mn, versus RMB43mn net expense in 3Q18. Other gain surged 120% YoY, helped by a fair value gain of RMB102mn. Excluding the fair value gain, net profit would increase by 4% YoY.
- **Core business (excluding KION) remained solid in 3Q19.** KION Group (KGX GR, NR) reported its 3Q19 results earlier with revenue and pre-tax profit increased by 14% and 20% respectively. Stripping out KION's contribution, we estimate Weichai's core business (including engine, HDT, gearbox) revenue and pretax profit dropped 10% YoY and 1% YoY respectively. This is largely expected as we understand that Weichai's mid-to-large size engine sales were only stable in 3Q19 while Shaanxi Heavy Duty Motor's HDT sales volume underperformed the industry growth of ~3.5% during the period.
- **Consensus earnings estimate implies 10% earnings decline in 4Q19 which looks too conservative.** Net profit in 9M19 grew 18% YoY to RMB7bn. We see potential upside to the consensus estimates as we believe the demand for HDT and engine will be stronger in 4Q19E, on the back of infrastructure construction activities and rising demand for logistic trucks due to stringent implementation of anti-loading policies following the Wuxi accident.
- **Risk factors:** (1) weakness in HDT and engine demand; (2) technology risk.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	151,569	159,256	174,391	178,997	178,630
YoY growth (%)	62.7	5.1	9.5	2.6	(0.2)
Net income (RMB mn)	6,808	8,658	9,824	10,366	10,305
EPS (RMB)	0.85	1.08	1.24	1.31	1.30
YoY growth (%)	178.9	27.2	14.4	5.5	(0.6)
P/E (x)	12.6	10.1	9.2	8.7	8.7
EV / EBITDA (x)	5.8	5.1	4.6	4.4	4.5
P/B (x)	2.4	2.2	2.0	1.8	1.6
Yield (%)	3.0	4.2	6.0	6.3	6.3
ROE (%)	20.3	23.2	23.2	21.6	19.5
Net gearing (%)	1.2	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price **HK\$16.2**
 (Previous TP **HK\$16.2**)
 Up/Downside **+29%**
 Current Price **HK\$12.58**

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Stock Data

Mkt Cap (HK\$ mn)	100,605
Avg 3 mths t/o (HK\$ mn)	88
52w High/Low (HK\$)	15.1/7.51
Total Issued Shares (mn)	7,934

Source: Bloomberg

Shareholding Structure

Weichai Holdings Group	16.8%
Weifang Investment Group	3.7%
Free float (H-share)	24.2%
Free float (A-share)	55.3%

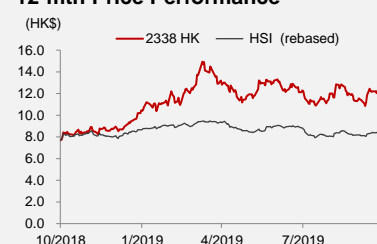
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	+12%	+8.5%
3-mth	+4.8%	+9.9%
6-mth	-3.8%	+7.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

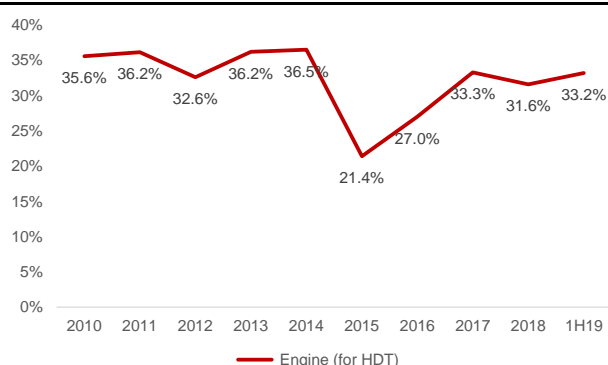
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1. China HDT Sector – HDT sales +7% YoY in Sep; the highest growth since Mar – 9 Oct 2019
2. Weichai Power (2338 HK, BUY) – 2Q19 earnings +9% YoY; within expectation – 30 Aug 2019
3. China HDT Sector - 3Q19 HDT sales +2% YoY; better than expectations – 5 Aug 2019
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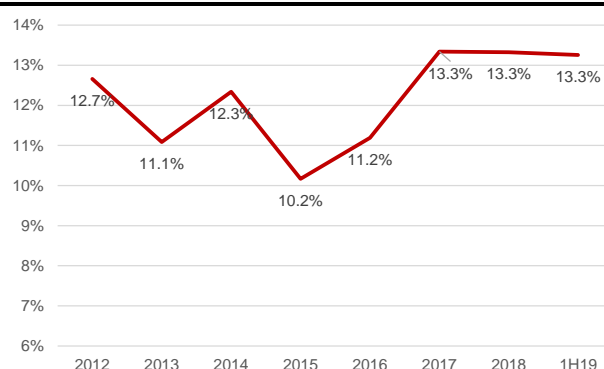
Figure 1: 3Q19 results highlights

(RMB mn)	1Q18	1Q19	Change (YoY)	2Q18	2Q19	Change (YoY)	3Q18	3Q19	Change (YoY)
Revenue	39,212	45,212	15%	43,052	45,651	6%	35,919	35,846	0%
Cost of sales	(30,159)	(35,420)	17%	(34,177)	(35,681)	4%	(28,272)	(27,653)	-2%
Gross profit	9,053	9,792	8%	8,875	9,969	12%	7,647	8,193	7%
Other income	117	128	9%	26	211	711%	92	99	7%
Other gains and losses	(67)	113	n/a	240	60	-75%	102	225	120%
S&D expenses	(2,638)	(2,736)	4%	(2,835)	(2,634)	-7%	(2,406)	(2,575)	7%
Administrative and R&D expenses	(2,280)	(2,560)	12%	(2,667)	(3,119)	17%	(2,347)	(2,800)	19%
Taxes and surcharges	(217)	(189)	-13%	(182)	(186)	2%	(107)	(95)	-12%
Impairment loss of assets	(515)	(226)	-56%	230	(226)	n/a	(144)	(77)	-46%
EBIT	3,453	4,323	25%	3,687	4,075	11%	2,837	2,970	5%
Other expenses	(27)	(43)	61%	(26)	13	n/a	(50)	(22)	-56%
Net finance cost	(200)	(108)	-46%	144	(33)	n/a	(43)	0	-101%
Finance income and others	-	-	-	-	-	-	-	0	-
Finance expenses	-	-	-	-	-	-	-	0	-
Share of profit of JV and associates	19	11	-38%	118	112	-5%	23	19	-17%
Pretax profit	3,244	4,183	29%	3,923	4,167	6%	2,767	2,967	7%
Income tax	(684)	(811)	19%	(601)	(647)	8%	(602)	(531)	-12%
After tax profit	2,561	3,373	32%	3,322	3,520	6%	2,165	2,436	13%
MI	(641)	(781)	22%	(849)	(824)	-3%	(556)	(666)	20%
Net profit	1,920	2,591	35%	2,473	2,696	9%	1,609	1,771	10%
Key ratios	Change (ppt)			Change (ppt)			Change (ppt)		
Gross margin	23.1%	21.7%	-1.4	20.6%	21.8%	1.2	21.3%	22.9%	1.6
S&D expenses ratio	6.7%	6.1%	-0.7	6.6%	5.8%	-0.8	6.7%	7.2%	0.5
Administrative and R&D expenses ratio	5.8%	5.7%	-0.2	6.2%	6.8%	0.6	6.5%	7.8%	1.3
Effective tax rate	21.1%	19.4%	-1.7	15.3%	15.5%	0.2	21.8%	17.9%	-3.9

Source: Company data, CMBIS

Figure 2: Weichai's HDT engine market share

Source: Company data, CMBIS

Figure 3: Shaanxi Heavy Duty Motor's market share

Source: Company data, Wind, CMBIS

Figure 4: SOTP valuation

SOTP valuation	Valuation methodology	Target multiple (x)	EBITDA 2019E (RMB mn)	Estimated EV (RMB mn)	Net cash / (Net debt)	Equity value (RMB mn)
Weichai core business	EV/EBITDA	5.5	13,201	72,604	21,565	94,169
KION Group	Proportionate market value	-	-	-	-	25,038
Share of JV/associates	PB	1.5	-	-	-	6,695
Minority interest (Weichai core business)						(9,342)
Total NAV						116,560
NAV per share (RMB)						14.7
NAV per share (HK\$)						16.2

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	151,569	159,256	174,391	178,997	178,630
Cost of sales	(118,468)	(123,686)	(135,327)	(138,901)	(138,617)
Gross profit	33,102	35,569	39,064	40,095	40,013
Operating expenses	(21,912)	(21,757)	(23,376)	(23,987)	(24,399)
EBIT	11,189	13,812	15,687	16,108	15,614
Other expenses	(161)	(52)	(209)	(215)	(214)
Net finance cost	(591)	(75)	(10)	436	827
Finance income and others	957	1,060	1,275	1,596	1,990
Finance expenses	(1,548)	(1,135)	(1,285)	(1,160)	(1,163)
profit of JV & associates	85	174	225	230	235
Pretax profit	10,522	13,858	15,693	16,560	16,462
Income tax	(1,344)	(2,233)	(2,542)	(2,683)	(2,667)
After tax profit	9,178	11,626	13,151	13,877	13,795
MI	(2,370)	(2,968)	(3,327)	(3,511)	(3,490)
Net profit	6,808	8,658	9,824	10,366	10,305
D&A	7,365	7,404	7,937	8,207	8,476
EBITDA	18,554	21,216	23,624	24,315	24,090

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Pretax profit	10,522	13,858	15,693	16,560	16,462
Finance cost	1,548	1,135	1,285	1,160	1,163
Interest income	(957)	(1,060)	(1,275)	(1,596)	(1,990)
Share of profit or loss of associates	(85)	(174)	(225)	(230)	(235)
Depreciation	5,088	5,321	5,670	5,940	6,209
Amortization of intangible assets	2,185	2,016	2,267	2,267	2,267
Income tax paid	(1,344)	(2,233)	(2,542)	(2,683)	(2,667)
Change in working capital	(2,887)	2,363	241	(391)	403
Others	2,188	1,035	1,275	1,596	1,990
Cash flow from operation	16,258	22,262	22,388	22,622	23,602
Net capex on PP&E	(2,775)	(16,665)	(5,000)	(3,500)	(3,500)
Investment in JV/associates	(1,038)	(1,655)	0	0	0
Investment in subsidiaries	(34)	0	0	0	0
Dividend received	51	181	135	138	141
Others	(1,241)	10,958	0	0	0
Cash flow from investing	(5,037)	(7,181)	(4,865)	(3,362)	(3,359)
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	(7,459)	635	(4,000)	100	100
Dividend paid	(1,599)	(4,039)	(3,661)	(5,403)	(5,701)
Interest paid	0	0	(1,285)	(1,160)	(1,163)
Others	2,461	(3,577)	0	0	0
Cash flow from financing	(6,598)	(6,980)	(8,946)	(6,463)	(6,764)
Change in cash	4,623	8,100	8,578	12,798	13,478
Cash at beginning of the year	27,123	34,222	38,210	46,788	59,585
Exchange gains/(losses) and others	2,475	(4,112)	0	0	0
Cash at the end of the year	34,222	38,210	46,788	59,585	73,064

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	89,298	97,171	94,324	89,709	84,827
PP&E	27,067	29,453	28,783	26,343	23,634
Investment in JV/associates	2,639	4,464	4,554	4,646	4,740
Goodwill	22,583	23,037	23,037	23,037	23,037
Long term receivables	5,198	6,483	6,483	6,483	6,483
Intangible assets	23,840	23,299	21,033	18,766	16,499
Others	7,971	10,434	10,434	10,434	10,434
Current assets	100,340	108,105	122,182	131,413	148,304
Prepayments	560	1,109	1,109	1,109	1,109
Inventories	19,851	20,674	23,817	21,849	23,723
Trade receivables	13,573	13,155	15,512	13,912	15,451
Notes receivables	25,291	24,993	24,993	24,993	24,993
Others	6,844	9,964	9,964	9,964	9,964
Cash	34,222	38,210	46,788	59,585	73,064
Current liabilities	78,474	88,617	92,357	88,499	92,415
Trade and bills payables	30,655	30,869	36,609	32,651	36,467
Notes payable	12,361	15,925	15,925	15,925	15,925
Bank borrowings	8,771	12,371	10,371	10,471	10,571
Others	26,686	29,451	29,451	29,451	29,451
Non-current liabilities	54,810	54,400	52,400	52,400	52,400
Bank borrowings	26,138	23,174	21,174	21,174	21,174
Long term payables	18,455	19,475	19,475	19,475	19,475
Others	10,216	11,751	11,751	11,751	11,751
Equity	56,355	62,259	71,749	80,223	88,317
Shareholders' equity	35,240	39,314	45,477	50,440	55,043
MI	21,115	22,946	26,273	29,784	33,274

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Diesel engines	28.9	28.2	28.4	28.6	27.9
Automobiles and major components	39.1	39.7	40.2	38.9	37.2
Other components	2.4	2.1	2.3	2.6	3.1
Import & export services	0.1	0.2	0.1	0.1	0.1
Forklift trucks & supply chain solution	38.6	38.0	36.5	37.3	39.2
Intersegment sales	(9.1)	(8.2)	(7.5)	(7.5)	(7.5)
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratio (%)					
Gross margin	21.8	22.3	22.4	22.4	22.4
EBIT margin	7.4	8.7	9.0	9.0	8.7
After tax profit margin	6.1	7.3	7.5	7.8	7.7
Growth (%)					
Revenue	62.7	5.1	9.5	2.6	(0.2)
Gross profit	57.0	7.5	9.8	2.6	(0.2)
EBIT	128.3	23.4	13.6	2.7	(3.1)
Net profit	178.9	27.2	13.5	5.5	(0.6)
Balance sheet ratio					
Current ratio (x)	1.3	1.2	1.3	1.5	1.6
Receivable turnover days	30	31	30	30	30
Inventory turnover days	55	60	60	60	60
Payable turnover days	81	91	91	91	91
Net debt / total equity (%)	1.2	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	5.2	5.9	6.2	6.3	6.1
ROE	20.3	23.2	23.2	21.6	19.5
Per share data					
EPS (RMB)	0.85	1.08	1.24	1.31	1.30
BVPS (RMB)	4.41	4.96	5.73	6.36	6.94
DPS (RMB)	0.33	0.46	0.68	0.72	0.71

Source: Company data, CMBIS estimates

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