

15 December 2014  
**Weichai(2338.HK)**  
**Official launch of its transition strategy**

Hong Kong | AUTOMOBILE | COMPANY UPDATES

Rating: **Accumulate**

Upgraded to Accumulate

- Q3's revenue upped 77.5% yoy to 22.034 billion, and the net profit attributable to the parent company was 680 million, an increase of 9.8% yoy, with EPS of 0.34 YUAN, which was 0.31 YUAN over the same period of last year. The Weichai revenue rate of increase was 26.5% yoy in first quarter and was -1.6% yoy in the second quarter. The growth rates of net profits attributable to the parent company were 29.7% and 113% respectively, with a corresponding EPS of 0.53 YUAN and 1.36 YUAN respectively.
- The revenue of the first three quarters increased nearly 30% yoy to 56.148 billion. The net profit attributable to the parent company was 4.445 billion, upping 64% yoy, with EPS of 2.22 yuan, which was 1.35 yuan in 2013M9. If the disposable investment income brought by consolidating financial statements with KION was excluded, the net profit of the first three quarters was approximately 3.156 billion, upping 16.7% yoy, with corresponding EPS of 1.58.
- The overall gross margin of Weichai of the first three quarters improved by 0.74 pts to 20.93%; and the gross margin of each of the first three quarters are 21.4%, 19.5% and 21.7%.
- However, headquarters' heavy truck engine's profitability does not appear to be positive. Although the headquarters' income still maintains a slightly increase, the gross margin apparently worsens.

**How we view this**

The greatly increased profit of the second quarter was mainly caused by the disposable investment income of 1.67 billion brought by including KION in the consolidated financial statement, and the income of the third quarter increased greatly was largely because that KION started the financial statement consolidation in this quarter.

In November of this year, the construction project of Linde Hydraulics Weifang Plant was officially launched. With benefits from the upgrade trend to import substitution of Chinese high-end equipment manufacturing industry, we are optimistic about the profit contribution generated by launch of Linde Hydraulics equipment.

**Investment Action**

According to the analysis above, we revised our target price to HK\$35, based on 10.2/11.8/9.7xP/E and 1.7/1.6/1.3xP/B in 2014/2015/2016, and the suggestions of "Accumulate" rating be given.

**Key Financial Summary**

FYE	12/13	12/14F	12/15F	12/16F
Revenue (RMB mn)	58,312	70,276	77,131	84,706
Net Profit, adj. (RMB mn)	3,571	5,406	4,663	5,671
EPS, adj. (RMB)	1.79	2.70	2.33	2.84
P/E (X),adj.	13.9	9.2	10.6	8.7
BVPS (RMB)	13.87	16.29	17.55	20.70
P/B (X)	1.8	1.5	1.4	1.2
DPS (HKD)	0.25	0.37	0.50	0.65
Div. Yield (%)	1.0%	1.5%	2.0%	2.6%

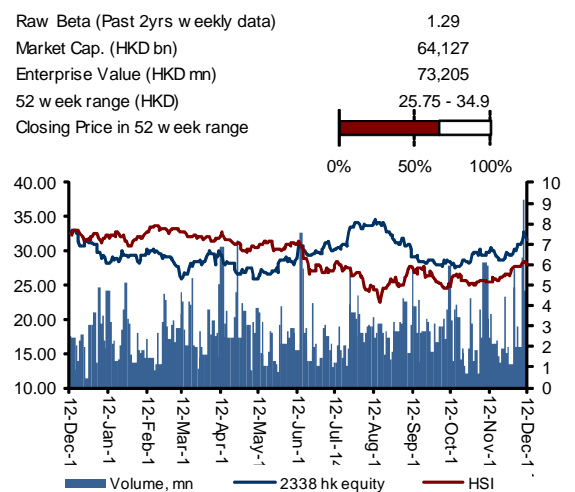
Source: Bloomberg, PSR est.

\*All multiples & yields based on current market price

<b>Target Price (HKD)</b>	<b>35.0</b>
Forecast Dividend (HKD)	0.47
Closing Price (HKD)	31.85
<b>Potential Return</b>	<b>11.4%</b>

**Company Description**

Weichai Power is a leading manufacturer of diesel engines (contributes 80%+ profit), which are widely applicable to heavy-duty vehicles, coaches, construction machines, vessels and power generator. It also holds a 51% stake in Shaanxi Heavy-Duty Auto and Shaanxi Fast Gear, which are leading producers in their segments.



**Major Shareholders**

1.HKSCC Nominees Limited	24.22%
2.JPMorgan Chase & Co.	18.01%
3.Weichai Group Holdings Limited	16.83%

**Valuation Method**

PE & PB

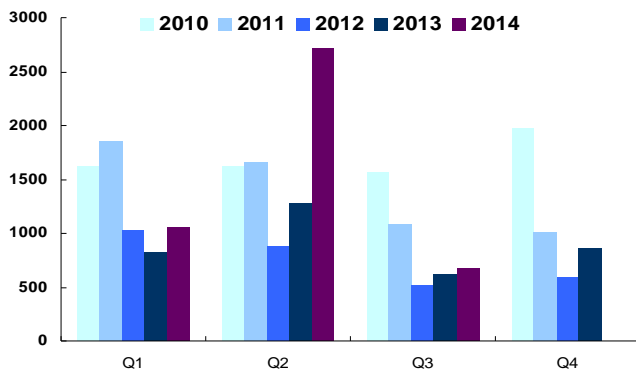
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**Review of Q3's performance**

Q3's result of Weichai Power grew steadily. The revenue upped 77.5% yoy to 22.034 billion, and the net profit attributable to the parent company was 680 million, an increase of 9.8% yoy, with EPS of 0.34, which was 0.31 over the same period of last year. The Weichai revenue rate of increase was 26.5% yoy in first quarter and was -1.6% yoy in the second quarter. The growth rates of net profits attributable to the parent company were 29.7% and 113% respectively, with a corresponding EPS of 0.53 and 1.36 respectively. The greatly increased profit of the second quarter was mainly caused by the disposable investment income of 1.67 billion brought by including KION in the consolidated financial statement, and the income of the third quarter increased greatly was largely because that KION started the financial statement consolidation in this quarter. The revenue of the first three quarters increased nearly 30% yoy to 56.148 billion. The net profit attributable to the parent company was 4.445 billion, upping 64% yoy, with EPS of 2.22 yuan, which was 1.35 yuan over the same period of last year. If the disposable investment income brought by consolidating financial statements with KION was excluded, the net profit of the first three quarters was approximately 3.156 billion, upping 16.7% yoy, with corresponding EPS of 1.58.

**Fig 1. Weichai's net profit by Quarters (mil)**

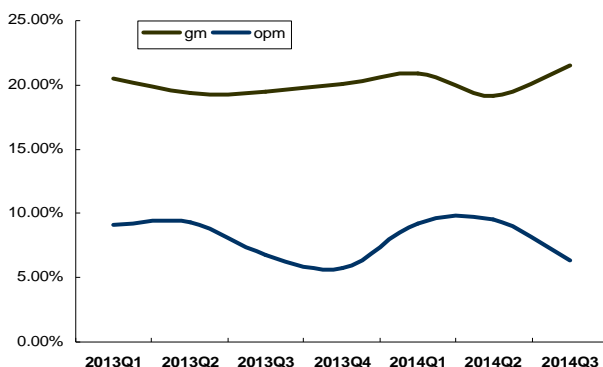


Source: Company, PSR

**Although overall gross margin increased, the overhead rate also went up**

Benefited from the improved sales structure brought about by KION consolidated supervision and updated emission standard, the overall gross margin of Weichai of the first three quarters improved by 0.74 ppts to 20.93%; speaking from the third quarter's conditions, the whole gross margin's improvement is remarkable, and the gross margin of each of the first three quarters are 21.4%, 19.5% and 21.7%. However, on the other hand, the expense ratio also rose after it. The growth of the first three quarters' sell + administrate expense upped 43.5% yoy or 2.1 billion, and the proportion of the sum of the two in the total income also improved by 1.2 ppts.

**Fig 2. Weichai's gross margin and operation margin**



Source: Company, PSR

### The headquarters' engine business shrinks

However, with the background of heavy truck industry keeping going down due to the soft macro economy at home, headquarters' heavy truck engine's sales volume also decreases, and the profitability does not appear to be positive. Although the headquarters' income still maintains a slightly increase, the gross margin apparently worsens. And in the third quarter, the headquarters' gross margin sharply declined to about 20% from about 30% in the past. Although the company strictly controlled the expense cost, in the third quarter, the headquarters' profit has downed 21% yoy.

### Construction of Linde Project began: official launch of its transition strategy

In November of this year, the construction project of Linde Hydraulics Weifang Plant owned by Weichai Group was officially launched, marking the official set-up of high-end hydraulic localization project that will change the condition of long-term dependence on the import of Chinese high-end hydraulic product. The project is expected to be commissioned at the end of May next year, the production of 8000 units will be for Phase 1 and it is expected to be 80,000 units in 2018. With benefits from the upgrade trend to import substitution of Chinese high-end equipment manufacturing industry, we are optimistic about the profit contribution generated by launch of Linde Hydraulics equipment.

Fig 3. Peer's comparison

Name	Ticker	Mkt Cap (HKD)	BEst				Curr EV/BEst	ROA			Dvd Yld	OPM		
			BEst P/B	BEst FY	BEst Y	BEst Y		LF	ROE	LF		GM LF	PM LF	
WEICHAI POWER	12338 HK	63923	1.5	1.4	10.9	10.8	8.7	1.6	5.1	18.1	1.0	8.7	20.1	11.1
ZOOMLION HEAVY	1157 HK	55762	0.8	0.8	19.0	15.0	17.4	0.8	2.0	4.4	3.4	11.2	29.0	6.5
SINOTRUK HONG	13808 HK	11983	0.5	0.5	18.7	14.1	4.7	0.5	0.8	2.1	1.2	4.1	16.6	1.9
SANY HEAVY EQU	631 HK	6265	0.8	0.8	12.0	12.3	9.4	0.8	3.0	4.5	0.0	18.5	38.0	14.1
VOLVO AB-B SHS	VOLVB	183354	2.2	2.1	23.1	14.6	12.0	2.1	1.6	7.0	N/A	3.3	22.7	2.1
MAN SE	MAN GR	129136	2.8	2.9	113.4	47.5	20.0	2.4	1.0	3.6	N/A	2.3	19.0	0.6
KION GROUP AG	KGX GR	28850	1.7	1.6	13.8	11.7	6.2	1.9	2.9	11.0	N/A	3.1	29.7	5.1
KUBOTA CORP	6326 JP	145715	2.1	1.9	16.5	14.7	11.6	2.2	6.3	13.9	N/A	12.4	29.6	8.5
HINO MOTORS LTD	7205 JP	57021	2.3	1.9	11.8	10.3	6.7	2.4	8.4	24.6	N/A	6.1	18.2	4.3
HITACHI CONSTRU	6305 JP	36637	1.3	1.3	17.1	14.7	8.9	1.4	2.7	7.6	N/A	6.8	27.0	2.8
DAEWOO SHIPBUI	042660	25213	0.7	0.7	15.7	9.4	15.7	0.7	1.1	4.2	N/A	3.2	7.9	0.8
HYUNDAI MIPO DC	010620	9836	0.6	0.6	N/A	29.6	N/A	0.7	(7.3)	(28.3)	N/A	(64.3)	(53.5)	(44.1)
CATERPILLAR INC	CAT US	435038	3.0	2.9	14.3	13.2	7.2	3.0	4.6	21.3	N/A	10.3	27.7	7.5
CUMMINS INC	CMI US	204238	3.3	2.9	15.8	13.2	9.2	3.4	10.9	22.1	1.8	11.5	26.3	8.7
WABCO HOLDING	WBC US	47116	5.8	5.3	18.8	16.2	12.4	5.9	29.7	70.6	0.0	12.4	31.1	11.6
ALLISON TRANSMI	ALSN US	45212	4.3	3.9	13.0	12.1	11.4	4.3	4.6	16.2	1.5	26.6	46.9	12.4
CHINA YUCHAI INT	CYD US	4923	0.6	0.6	6.3	6.8	3.5	0.6	3.7	11.3	5.3	6.1	19.1	3.8

Source: Bloomberg, PSR

### Investment Action

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FYE DEC	FY12	FY13	FY14F	FY15F	FY16F
<b>Valuation Ratios</b>					
P/E (X), adj.	17.2	14.0	9.3	10.7	8.8
P/B (X)	2.1	1.8	1.5	1.4	1.2
Dividend Yield (%)	1.3%	1.0%	1.5%	2.0%	2.6%
Dividend payout ratio (%)	22.1%	14.0%	13.7%	21.4%	22.9%
<b>Per share data (RMB)</b>					
EPS, reported	1.50	1.79	2.70	2.33	2.84
EPS, adj.	1.50	1.79	2.70	2.33	2.84
DPS	0.33	0.25	0.37	0.50	0.65
BVPS	12.4	13.87	16.29	17.5	20.7
<b>Growth &amp; Margins (%)</b>					
<b>Growth</b>					
Revenue	-19.8%	21.1%	20.5%	9.8%	9.8%
EBIT	-47.0%	22.2%	67.2%	-19.4%	20.1%
Net Income, adj.	-46.6%	19.4%	51.4%	-13.7%	21.6%
<b>Margins</b>					
Gross Margin	19.1%	20.2%	20.2%	20.2%	20.8%
EBIT margin	8.2%	8.3%	11.5%	8.4%	9.2%
Net Profit Margin	6.2%	6.1%	7.7%	6.0%	6.7%
<b>Key Ratios</b>					
ROE (%)	13.54%	14.52%	19.2%	14.9%	16.0%
ROA (%)	4.7%	4.9%	6.4%	5.0%	5.7%
<b>Income Statement (RMB mn)</b>					
<b>Revenue</b>	<b>48,165</b>	<b>58,312</b>	<b>70,276</b>	<b>77,131</b>	<b>84,706</b>
<b>Gross profit</b>	9,203	11,751	14,161	15,557	17,619
Operating profit	3,777	5,045	7,839	6,746	8,148
EBIT	3,949	4,825	8,070	6,506	7,813
Profit before tax	3,959	4,609	7,632	6,523	7,877
<b>Tax</b>	<b>(726)</b>	<b>(791)</b>	<b>(1,832)</b>	<b>(1,500)</b>	<b>(1,772)</b>
Profit for the period	3,234	3,818	5,800	5,023	6,105
Minority interests	(243)	(247)	(394)	(360)	(433)
Total capital share	1,999	1,999	1,999	1,999	1,999
<b>Net profit</b>	<b>2,991</b>	<b>3,571</b>	<b>5,406</b>	<b>4,663</b>	<b>5,671</b>

Source: PSR



**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm$ 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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