EQUITY RESEARCH

Weichai (2338 HK)

Momentum beat! Lift the TP

Hong Kong | Automobile Parts | Update Report

28 July 2020

Accumulate (Maintain)

CMP HKD 16.9
(Closing price as at 24 July)
TARGET HKD 20 (+18%)

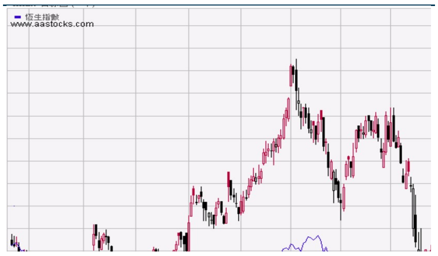
COMPANY DATA

O/S SHARES (MN) :	7934
MARKET CAP (HKD MN) :	32837
52 - WK HI/LO (HKD):	18.6/10.56

SHARE HOLDING PATTERN, %

Weichai Group Holdings Limited	17.58

PRICE VS. HSI



Source: Aastock, Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	12/18	12/19	12/20F	12/21F
Net Sales	**159256**	**174361**	**187034**	**196530**
Net Profit	14593	14709	16321	18715
EPS, CNY	1.08	1.15	1.29	1.49
P/E, x	13.7	13.1	11.8	10.2
BVPS, CNY	4.92	5.70	6.68	7.73
P/BV, x	3.0	2.6	2.3	2.0
DPS (CNY)	0.46	0.29	0.45	0.52
Div. Yield (%)	3.1%	1.9%	2.9%	3.4%

Source: Company reports, Phillip Securities Est.

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Investment Summary

Increase by 60% yoy in Q2, Verifying the Industry's Prosperity

In H1 of 2020, there was a V-shaped curve of China's heavy truck market: In January, the sales volume hit a record high with a growth of 18.2% yoy, which was a good start. In February and March, due to the impact of the COVID-19 pandemic, it plunged by 51.8% and 19.3%, respectively. In April, the sales volume showed a rapid recovery, setting a new record by reaching 191,000 units, up 61% yoy. In May, nearly 180,000 (179,000) heavy trucks were sold, up 66% yoy. In June, the heavy truck market continued to show a strong momentum of production and sales. Although the monthly sales volume declined slightly by 8% mom, it continued to grow by 59% yoy, reaching 165,000 units. In H1 of 2020, the total number of heavy truck reached about 816,200, up 24% yoy, which proves that the high prosperity of heavy truck industry continues.

The reason why the heavy truck industry exceeded expectations in Q2 was that, in addition to the delay in vehicle purchase demand during the pandemic, the strong policy of the early phasing out of the trucks under or below the China III emission standard, which caused the sales volume to increase greatly yoy. Meanwhile, the resumption of work and production in Q2 prompted a blowout of heavy truck orders, and the policies of overload treatment in different places have become stricter, which also boosted the sales volume.

Countercyclical Policy to Support High Demand of Heavy Truck

Facing the grim economic situation after the pandemic, the government authorities have strengthened the countercyclical adjustment policies. The Ministry of Finance has expanded the issuance scale of local government special bonds, and multiple provinces and municipalities have introduced an intensive range of investment plans. According to the financing arrangements for government bonds of this year and the requirement of the executive meeting of the State Council on June 17 to "strengthen monetary and financial policies to support the real economy", it is expected that the growth rate of social financing will have further upward space in H2. Infrastructure investment growth is expected to pick up, and will boost the development of engineering heavy truck later.

At the end of March, the State Council announced a policy of bonus for compensation from the central budget for supporting the phasing out of the diesel cargo trucks under or below the China III emission standard in key areas such as Beijing-Tianjin-Hebei. Meanwhile, a value added tax at the rate of 0.5% based on the sales revenue will be imposed from May 1 to the end of 2023 for the used vehicle sales of second-hand automobile dealers. A high drive of heavy truck sales is expected from the demand upgrade caused by the phasing out of diesel trucks and gears falling on or below the China III emission standard.

We estimated that with the continuous prosperity of heavy truck industry in H2, the sales volume of heavy truck in 2020 is expected to reach about 1.4 million units.

Resilience in Q1 under the Pandemic, and Accelerated Recovery to Be Expected in Q2

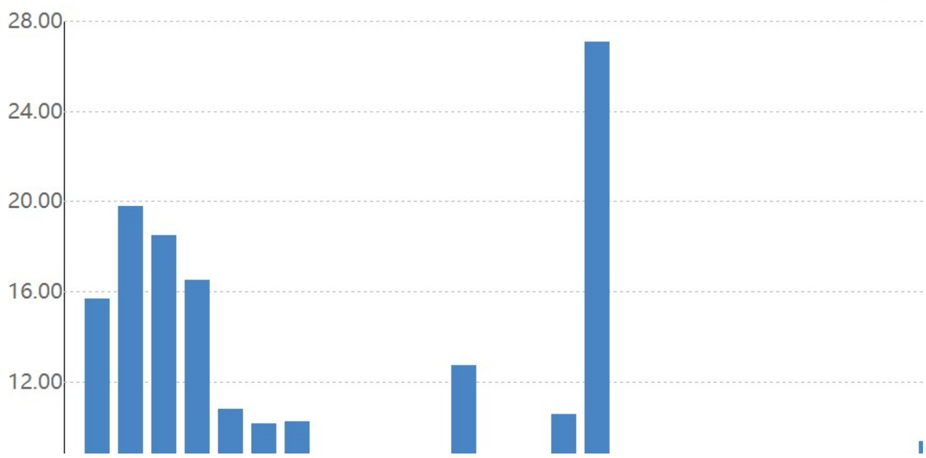
According to the 2020Q1 Result, Weichai recorded revenue of RMB39 billion, down by 14% yoy, and a net profit attributable to the parent company of RMB2.06 billion, down by 20% yoy, mainly due to the disruption of production caused by the pandemic in Q1. Overall gross margin reached 22.44%, up by 0.78 ppts yoy and 1.3 ppts qoq, respectively, which showed the better mix of products with higher gross profit margin. In Q1, the headquarter still recorded a revenue growth of 3%, showing strong resilience. The net profit declined by 12% yoy, and the gross profit margin was about 25%, down by 3.8 ppts yoy and up by 4 ppts qoq, which, we estimated, was mainly due to the changes in the raw materials of precious metals. In addition, Kion Group, the overseas subsidiary, recorded a revenue down by 2.7%. The net profit declined by 24% yoy, which was a drag on overall profits. Since the end of April, almost all overseas factories have resumed production, and the business conditions are expected to improve significantly in Q2.

Investment Thesis

From the perspective of the current heavy truck industry structure, Sinotruk Group, Shaanxi Heavy Duty, like other leading enterprises continue to expand their market share, the two accounting for 28% on aggregate in H1, which is conducive to the steady growth of heavy truck engine business of Weichai. From the middle term, the company has a clear strategic framework of "power engine+hydraulics+new energy" and the access to both the foreign and domestic market. Its profitability is expected to rise further.

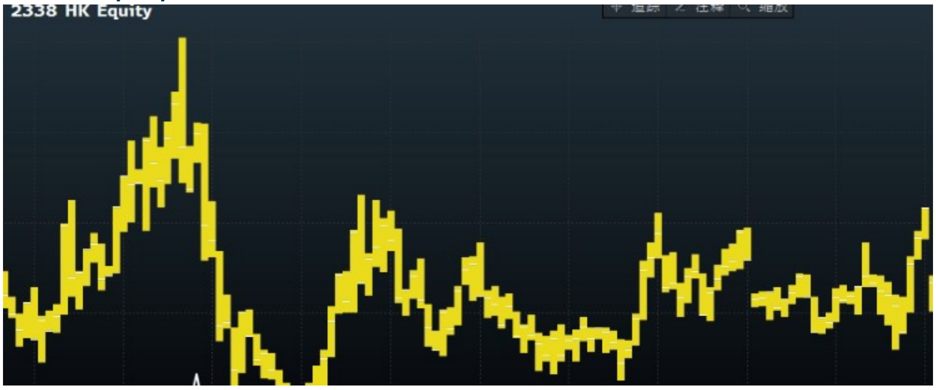
We revise the profit forecast of the company in 2020/2021 to EPS of RMB 1.29/1.49. We will also revise target price to 20 HKD (14/12.1x for 2020/2021 P/E) and Accumulate rating. (Closing price as at 24 July)

Quarterly Net Profit



Source: Wind, Company, Phillip Securities Hong Kong Research

Forward P/E P/B trend



Source: Bloomberg, Company, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY17	FY18	FY19	FY20F	FY21F
Valuation Ratios					
P/E (X), adj.	16.5	13.7	13.1	11.8	10.2
P/B (X)	3.2	3.0	2.6	2.3	2.0
Dividend Payout Ratio (%)	47.0%	42.5%	24.9%	34.9%	34.8%
Dividend Yield (%)	2.9%	3.1%	1.9%	2.9%	3.4%
Per share data (RMB)					
EPS, (Basic)	0.85	1.08	1.15	1.29	1.49
EPS, (Diluted)	0.85	1.08	1.15	1.29	1.49
DPS	0.40	0.46	0.29	0.45	0.52
BVPS	4.41	4.92	5.70	6.68	7.73
Growth & Margins (%)					
Growth					
Revenue	62.7%	5.1%	9.5%	7.3%	5.1%
EBIT	129.8%	25.4%	4.6%	11.4%	14.8%
Net Income, adj.	178.9%	27.2%	0.8%	11.0%	14.7%
Margins					
Gross margin	21.4%	21.9%	21.4%	22.0%	22.0%
EBIT margin	7.3%	8.7%	8.4%	8.7%	9.5%
Net Profit Margin	7.6%	9.2%	8.4%	8.7%	9.5%
Key Ratios					
ROE	20.3%	23.2%	21.5%	20.8%	20.7%
Income Statement (RMB mn)					
Revenue	**151569**	**159256**	**174361**	**187034**	**196530**
Gross profit	32363	34846	37344	41054	43237
EBIT	11113	13933	14572	16234	18636
Profit before tax	10522	13858	14352	16020	18406
Tax	-1344	-2233	-2445	-2739	-3129
Profit for the period	9178	11625	11907	13280	15277
Minority interests	2370	2968	2802	3041	3437
Total capital share	7997	7995	7934	7934	7934
Net profit	**11548**	**14593**	**14709**	**16321**	**18715**

Source: PSR

(Closing price as at 24 July)

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 ± 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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