

Industrials
Machinery
 Equity – China

Reduce

Target price (HKD)	3.40		
Share price (HKD)	4.86		
Upside/Downside (%)	-30		
Performance	1M	3M	12M
Absolute (%)	-4.5	-12.0	-12.0
Relative ^A (%)	-2.1	-14.6	-27.2
Index ^A	HSCEI		
RIC	1157.HK		
Bloomberg	1157 HK		
Market cap (USDm)	7,869		
Market cap (HKDm)	61,015		
Enterprise value (CNYm)	47311		
Free float (%)	100		

27 March 2015

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Zoomlion Heavy Industry (1157 HK)

Reduce: Need time to digest past dues

- ▶ **The company FY14 NPAT declined 84.6% YoY to Rmb594m, below the company guidance of likely to be down 70-80%**
- ▶ **Increased delinquency for finance lease receivable and machine repurchases were key concerns. Proposed H-share repurchase may help sentiment**
- ▶ **Establish Reduce rating. Set fair value TP of HKD3.4; no change to earnings**

FY14 earnings as bad as expected, but still facing problems with receivables - The company generated a net loss of Rmb406m in 4Q14 due to poor machinery sales. The FY14 NPAT declined 84.6% YoY to Rmb594m which is below the company guidance of likely to be down 70-80% given in late January 2015. Delinquency rate for finance lease receivable picked up in 2H14 to about 30% of total outstanding finance lease receivable. The over 1 year overdue finance receivable amounted to cRmb1.5bn. Impairment provision remained almost flat. The company also had to repurchase Rmb2.5bn worth of second machines from banks to which Zoomlion previously factored its finance lease receivable without recourse. The operating cash outflow was Rmb7.8bn for FY14. Net debt to equity was 42.0% as at the end of 2014 versus 10.7% as at the end of 2013.

The company proposed a 10% share repurchase program for H-share which would require shareholder approval. This was probably the only positive in the result announcement and may help the sentiment somewhat.

In the company's announcement, they set a revenue target of Rmb30.8bn which would see about 19% YoY growth due to overseas sales, better environmental machinery sales and incorporation of the recently acquired agriculture machinery business.

Post result analyst briefing will be held at 9:30am HK time on Monday 30 March at Island Shangri la Hotel.

Challenging outlook in 2015 and depends on property construction activity – We remain cautious on the 2015 outlook for construction machinery industry in China and the demand recovery depends on property construction activity which remains soft. We think the company's share price may weaken on Monday due to the lower than expected results.

Zoomlion FY14 result summary

RMB m	1H14A	2H14A	FY14	FY13	YoY%
Concrete machinery sales	6,030	4,525	10,555	17,191	-39%
Crane machinery sales	4,011	3,412	7,423	12,479	-41%
Environmental and sanitation machinery sales	1,643	2,381	4,024	3,282	23%
Road construction and pile foundation machinery sales	603	423	1,026	1,731	-41%
Earth working machinery sales	409	289	698	772	-10%
Material handling and systems and others	629	566	1,195	1,626	-27%
Finance lease services	664	266	930	1,461	-36%
Total turnover	13,989	11,862	25,851	38,542	-33%
COGS	(9,937)	(8,705)	(18,642)	(27,300)	-32%
Gross Profit	4,052	3,157	7,209	11,242	-36%
Other revenues and net income	(33)	197	164	(49)	-435%
Selling expenses	(1,165)	(1,871)	(3,036)	(3,631)	-16%
Administration expenses	(1,158)	(1,189)	(2,347)	(2,701)	-13%
R&D expenses	(216)	(227)	(443)	(570)	-22%
EBIT	1,480	67	1,547	4,291	-64%
Net Finance costs	(372)	(320)	(692)	195	-455%
Share of profits and losses of Associates and JCE	14	(6)	8	41	-80%
Profit before tax	1,122	(259)	863	4,527	-81%
Tax expense	(196)	(39)	(235)	(570)	-59%
Net income	926	(298)	628	3,957	-84%
Profit attributable to					
Shareholders	904	(310)	594	3,844	-85%
minority interest	22	12	34	113	-70%
EPS (RMB)	0.12	-0.04	0.08	0.50	-76%

Source: Company

Zoomlion – Quarterly result summary

(RMB m)	1Q14	2Q14	3Q14	4Q14	FY14	FY13	YoY
Gross Revenue	5,366	8,623	5,777	6,085	25,851	38,542	-33%
Business Tax	(20)	(92)	(20)	(95)	(228)	(271)	-16%
Cost of sales	(3,691)	(6,246)	(4,181)	(4,524)	(18,642)	(27,300)	-32%
Gross profit	1,654	2,285	1,576	1,466	6,981	10,971	-36%
Gross profit margin (% of net revenue)	30.9%	26.8%	27.4%	24.5%	27.2%	28.7%	
Other income and gains, net	(94)	(296)	(77)	(148)	(615)	(1,030)	-40%
Selling and distribution costs	(508)	(657)	(784)	(1,086)	(3,036)	(3,631)	-16%
Administrative expenses	(407)	(438)	(409)	(675)	(1,930)	(1,953)	-1%
Other expenses	42	(75)	15	218	200	(12)	-1724%
Profit/(loss) from operations [EBIT]	686	819	321	(226)	1,601	4,344	-63%
OP margin (% of net revenue)	12.8%	9.6%	5.6%	-3.8%	6.2%	11.4%	
Net Finance costs	(230)	(163)	(174)	(178)	(745)	136	-646%
Share of profits /losses of Associates and JCE	-	7	-	1	7	42	-83%
Profit before tax	456	662	148	(403)	863	4,522	-81%
Tax	(52)	(144)	(44)	4	(235)	(570)	-59%
Net profit after tax	404	519	104	(399)	628	3,952	-84%
less: minority interest	(8)	(14)	(4)	(7)	(34)	(113)	-70%
Net profit attributable to shareholders	396	504	100	(406)	594	3,839	-85%

Source: Company

Valuation and risks

We use Gordon Growth method to value the stock. Our fair value target PE is derived using the following formula: $PE = [(ROE - g) \div (ROE \times COE - g)]$

Based on a 2015e ROE of 5.4%, g of 0.5%, and cost of equity of 12%, we derive a target PE of 7.9x (all unchanged). Based on 2015e EPS of Rmb0.3 per share, we derive a fair value TP of HKD3.4 and we establish a Reduce rating for the stock (versus Underweight (V) rating previously under our old model).

Key upside risks: Additional increase in infrastructure investment, monetary policy easing to help the property sector which in turn may help property construction activity.

Disclosure appendix

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

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Rating distribution for long-term investment opportunities

As of 27 March 2015, the distribution of all ratings published is as follows:

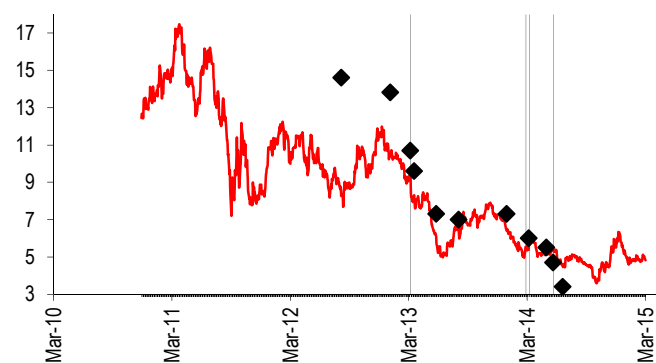
Buy	41%	(29% of these provided with Investment Banking Services)
Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

Zoomlion Heavy Industry (1157.HK) Share Price performance HKD Vs HSBC

rating history



Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	01 April 2013
Neutral (V)	Overweight (V)	23 March 2014
Overweight (V)	Neutral (V)	01 April 2014
Neutral (V)	Underweight (V)	15 June 2014
Target Price	Value	Date
Price 1	14.60	30 August 2012
Price 2	13.80	28 January 2013
Price 3	10.70	01 April 2013
Price 4	9.60	12 April 2013
Price 5	7.30	20 June 2013
Price 6	7.00	28 August 2013
Price 7	7.30	23 January 2014
Price 8	6.00	01 April 2014
Price 9	5.50	25 May 2014
Price 10	4.70	15 June 2014
Price 11	3.40	14 July 2014

Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
ZOOMLION HEAVY INDUSTRY	1157.HK	4.83	27-Mar-2015	6, 7

Source: HSBC

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