

## Sector Rating: Overweight

### Key data

Average FY13 PER (x)	9.39
Average FY13 PBV (x)	1.22
Average FY13 Dividend Yield (%)	2.30
Sector 3 months avg vol (HK\$mn)	1,285

Source: Bloomberg, ABCI Securities

### Net income growth in 1QFY13 (% YoY)

Zoomlion	-71.66
Lonking <sup>1</sup>	-91.27
First Tractor	-18.84
Sany Int'l <sup>1</sup>	-35.49
ZMJ	-8.35
Sany Heavy	-43.90
XCMG	-38.84

1: The growth is as at FY12

Source: Companies

### Average share performance (%)

	Absolute	Relative <sup>1</sup>
1-mth	29.06	28.60
3-mth	8.43	7.95
6-mth	17.91	14.05

1: Relative to Hang Seng Index

Source: Bloomberg

### 1 year sector performance



Source: Bloomberg

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Sector rating: Overweight

## Construction and Farm Machinery Capital Goods

### Improving Profitability

The profit margin of special equipment industry was improving on the back of stable revenue growth in the first four months this year, according to latest NBS survey. We believe the earnings recovery was the result of the continued increase in investment in infrastructure sector during the same period. However, market concerns on the earnings quality of major players in the industry. Machinery makers such as Zoomlion and Lonking have tightened their credit sales this year to improve the receivable situation. We expect to see improvement of their financial healthiness in upcoming interim reports.

**Earnings recovery in special equipment industry.** The latest NBS survey indicated revenue and profit of the special equipment industry (which includes construction machinery makers and coal mining machinery makers) kept recovering in the first four months this year. The industry's revenue was up 10.40% YoY in 1-4M2013, accelerating from 10.08% YoY in 1Q2013. The industry's profit decline shrunk from -11.40% YoY in 1Q2013, and to -2.10% YoY in 1-4M2013. The profit margin was improving from 5.58% in 1Q2013, and to 5.97% in 1-4M2013. We believe the recovery of the profitability of the industry was the result of the accelerated growth of FAI in the transportation sector which registered FAI growth of 23.7% YoY in 1-4M2013 from 22.0% YoY in 1Q2013.

**Concern on the earnings quality.** Although the special equipment industry shows recovery signal, the market concerns on the cash flow and earnings quality of major players in the industry. The total receivable turnover days for the special equipment industry was 74.04 days in 1Q2013, which was longer than that in 1Q2013 at 68.11 days. A recent rumor on the market casts doubt on the sales credibility of Zoomlion (1157 HK). Trading of Zoomlion A and H-shares are suspended on May 27 subsequently.

**Place more emphasis on cash flow.** During the early recovery stage of special equipment industry, we believe the market will pay more emphasis on earnings quality, reflected by the operating cash flow. Looking forward, the machinery makers will continue to tighten the credit sales in order to contain credit risk and strengthen their operating cash flow.

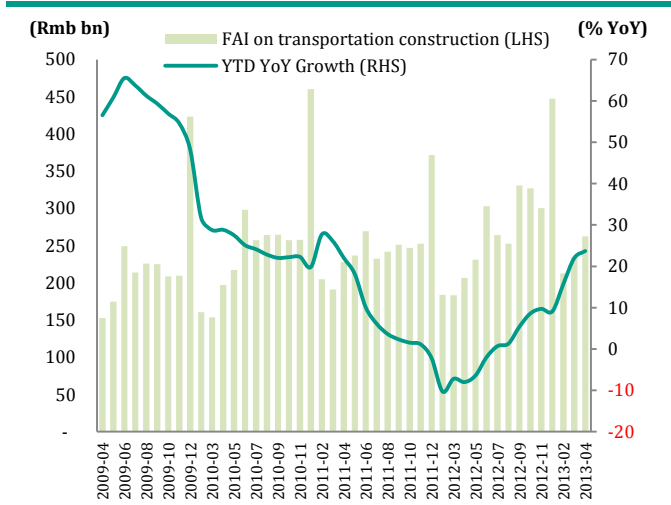
**Risk factors:** Competition from international players; Credit and liquidity risk; suspension of shares trading

### Valuation summary of the sector

Company	Ticker	Rating	Share Price	Target Price (HK\$)	FY13 PER (x)	FY13 PBR (x)	FY13 Yield (%)
Zoomlion	1157 HK	Buy	HK\$7.92	9.45	6.87	1.02	2.91
Lonking	3339 HK	Buy	HK\$1.77	1.86	10.09	0.87	2.48
First Tractor	38 HK	Hold	HK\$5.67	6.14	10.63	0.99	2.82
Sany Int'l	631 HK	Hold	HK\$2.94	3.42	12.88	1.23	1.55
ZMJ	564 HK	Hold	HK\$7.45	7.02	8.50	0.99	3.53
Sany Heavy	600031 CH	N/A	Rmb9.34	N/A	9.75	2.36	1.55
XCMG	000425 CH	N/A	Rmb10.43	N/A	6.99	1.11	1.25

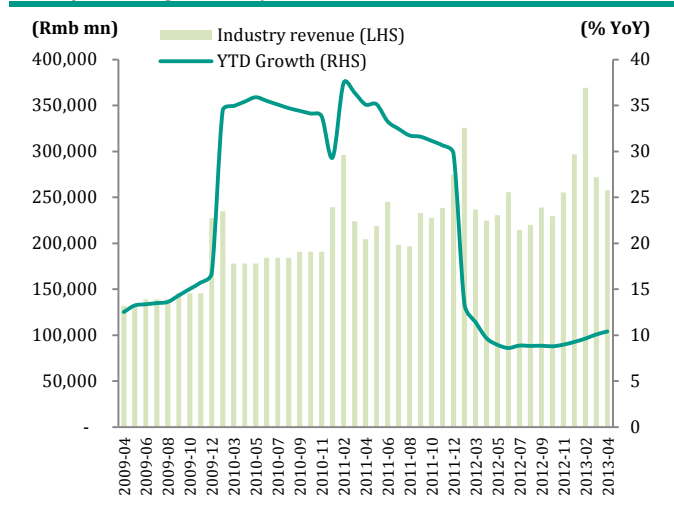
Source: Companies, Bloomberg, ABCI Securities estimates

**FAI on overall transportation industry, 4M2009-4M2013**



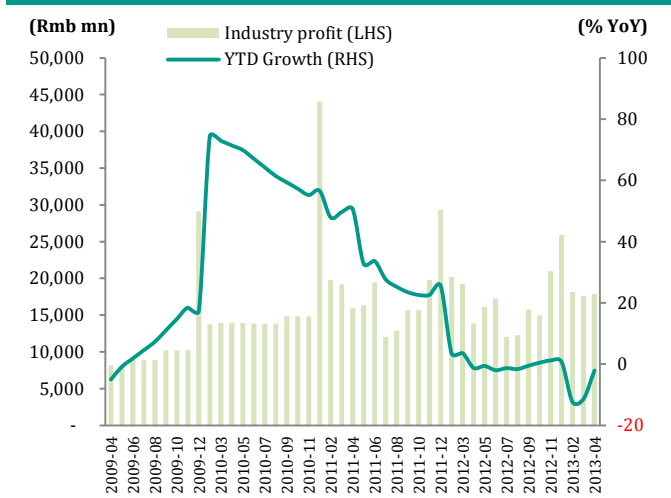
Source: NBS

**Total revenue and the YTD growth of special equipment manufacturing industry, 4M2009 – 4M2013**



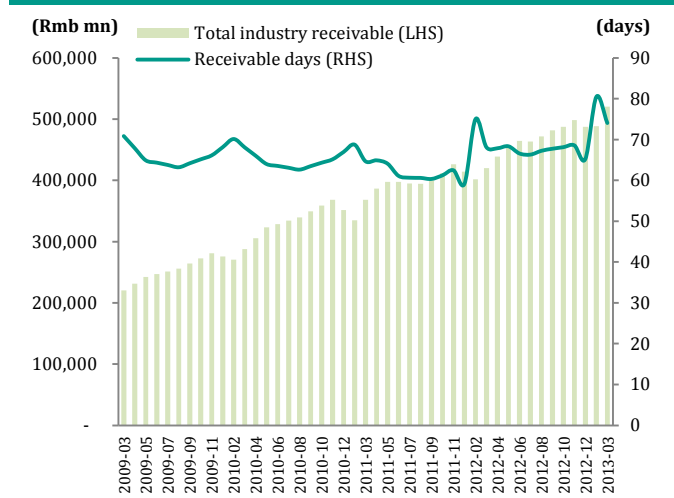
Source: NBS

**Total profit and the YTD growth of special equipment manufacturing industry, 4M2009 – 4M2013**



Source: NBS

**Total receivable and the receivable turnover days of special equipment manufacturing industry, 3M2009 – 3M2013**



Source: NBS

**Peer group valuation and earnings forecasts summary of construction and farm machinery sectors**

Company	Ticker	MKT CAP <sup>1</sup> (HKD mn)	Share Price	PER (x)		EPS Change (%)		PBR (x)		ROAE (%)		
				FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	
<b>Construction Machinery Makers</b>												
CATERPILLAR INC	CAT US	440,162	USD	86.21	12.56	10.75	-21.19	16.83	2.79	2.35	30.08	38.04
KOMATSU LTD	6301 JP	196,080	JPY	2595	13.34	12.24	46.61	9.06	1.99	1.80	13.28	15.55
SANY HEAVY INDUS	600031 CH	90,215	RMB	9.34	9.75	7.79	25.33	27.55	2.36	1.81	25.59	27.46
ZOOMLION HEAVY-H <sup>2</sup>	1157 HK	11,426	HKD	7.92	6.87	5.75	-2.65	20.57	1.02	0.87	16.06	16.45
ZOOMLION HEAVY-A <sup>2</sup>	000157 CH	57,921	RMB	7.29	7.87	6.53	-2.65	20.57	1.17	0.99	16.06	16.45
XCMG CONSTRUCT-A	000425 CH	27,284	RMB	10.43	6.99	6.61	24.42	5.63	1.11	0.96	15.46	15.76
GUANGXI LIUGONG	000528 CH	11,915	RMB	8.35	11.76	8.19	184.00	43.66	0.96	0.90	4.97	7.70
TEREX CORP	TEX US	28,841	USD	33.41	13.02	9.66	167.40	34.75	1.52	1.30	12.68	13.96
TADANO	6395 JP	12,451	JPY	1251	16.88	14.97	28.16	12.72	1.79	1.63	7.95	11.42
SHANTUI CONST-A	000680 CH	6,239	RMB	4.32	27.00	20.28	433.33	33.13	1.16	1.14	4.31	5.68
XIAMEN XGMA-A	600815 CH	6,409	RMB	5.27	42.16	18.82	-21.88	124.00	1.05	1.00	-1.82	5.43
LONKING HOLDINGS <sup>2</sup>	3339 HK	7,576	HKD	1.77	10.09	7.15	299.47	41.03	0.87	0.77	9.09	11.37
<b>Sector Weighted Average</b>					<b>12.28</b>	<b>10.40</b>	<b>16.49</b>	<b>18.12</b>	<b>2.28</b>	<b>1.93</b>	<b>22.64</b>	<b>27.48</b>
<b>Agricultural Machinery Makers</b>												
DEERE & CO	DE US	260,950	USD	86.29	10.13	9.76	10.32	3.78	3.43	2.74	38.80	29.72
MAHINDRA & MAHIN	MM IN	80,992	INR	945.30	14.82	12.56	19.92	18.01	2.78	2.38	17.73	15.96
CNH GLOBAL NV	CNH US	80,423	USD	42.75	8.53	8.19	7.14	4.11	1.08	0.95	15.58	16.51
FIRST TRACTOR-H <sup>2</sup>	38 HK	2,279	HKD	5.67	10.63	7.61	22.19	39.69	0.99	0.86	9.55	12.14
FIRST TRACTOR-A <sup>2</sup>	601038 CH	6,839	RMB	9.08	21.19	15.17	22.19	39.69	1.98	1.72	9.55	12.14
ESCORTS LTD	ESC IN	1,025	INR	59.95	6.01	5.24	61.05	14.71	0.39	0.36	7.64	7.15
<b>Sector Weighted Average</b>					<b>10.88</b>	<b>10.06</b>	<b>11.90</b>	<b>7.29</b>	<b>2.83</b>	<b>2.31</b>	<b>29.85</b>	<b>24.26</b>
<b>Mining Machinery Makers</b>												
JOY GLOBAL INC	JOY US	45,692	USD	55.42	8.95	8.91	-13.99	0.39	1.93	1.63	27.54	26.48
ZHENGZHOU COAL-H <sup>2</sup>	564 HK	1,810	HKD	7.45	8.50	6.28	-28.15	35.26	0.99	0.88	12.02	14.80
ZHENGZHOU COAL-A <sup>2</sup>	601717 CH	14,610	RMB	8.36	11.87	8.78	-28.15	35.26	1.38	1.23	12.02	14.80
TIAN DI-A	600582 CH	13,701	RMB	8.90	8.62	7.54	10.48	14.23	1.29	1.10	23.20	15.73
SANY HEAVY EQUIP <sup>2</sup>	631 HK	9,030	HKD	2.94	12.88	10.84	14.21	18.85	1.23	1.13	9.78	10.73
LINZHOU HEAVY-A	002535 CH	4,833	RMB	7.08	10.03	7.41	64.19	35.41	1.59	1.33	17.19	19.58
SUNWARD INTELL-A	002097 CH	3,793	RMB	7.27	31.61	48.47	955.05	-34.78	1.71	1.67	5.66	3.49
<b>Sector Weighted Average</b>					<b>10.70</b>	<b>10.35</b>	<b>33.21</b>	<b>10.71</b>	<b>1.64</b>	<b>1.41</b>	<b>21.04</b>	<b>20.04</b>
<b>Machinery Part Makers</b>												
CUMMINS INC	CMI US	171,317	USD	116.31	14.45	11.94	-7.38	21.00	2.86	2.44	22.82	22.06
WEICHAI POWER-H	2338 HK	59,159	HKD	28.70	12.65	10.82	21.53	16.84	1.60	1.41	13.83	14.07
TAIYUAN HEAVY-A	600169 CH	9,406	RMB	3.06	22.67	30.60	-198.47	-25.93	1.30	1.25	3.72	4.17
CHINA YUCHAI	CYD US	4,748	USD	16.41	5.92	5.05	14.94	17.33	0.65	0.60	11.32	12.33
<b>Sector Weighted Average</b>					<b>14.16</b>	<b>12.26</b>	<b>-7.30</b>	<b>18.12</b>	<b>2.45</b>	<b>2.11</b>	<b>19.69</b>	<b>19.25</b>
<b>Industrial Machinery Makers</b>												
VOLVO AB-B	VOLVB SS	239,653	SEK	96.30	20.74	11.86	-14.63	74.78	2.40	2.15	11.39	20.57
ATLAS COPCO-A	ATCOA SS	247,646	SEK	178.30	16.42	15.24	-5.18	7.75	5.29	4.54	34.16	31.41
HYUNDAI HEAVY	009540 KS	105,636	KRW	201,000	7.67	6.37	45.28	20.38	0.81	0.76	10.53	12.23
SANDVIK AB	SAND SS	136,215	SEK	92.85	14.25	12.00	0.11	18.75	3.13	2.73	20.59	20.71
DOOSAN HEAVY	034020 KS	33,746	KRW	461,000	5.74	5.22	-447.41	10.00	1.01	0.94	19.45	18.67
MANITOWOC CO	MTW US	20,344	USD	19.63	16.94	11.68	50.52	45.04	3.49	2.91	24.04	29.73
ANHUI HELI CO-A	600761 CH	5,788	RMB	8.88	10.48	9.29	24.56	12.87	1.37	1.24	13.04	13.51
<b>Sector Weighted Average</b>					<b>15.70</b>	<b>11.90</b>	<b>-17.64</b>	<b>32.79</b>	<b>3.18</b>	<b>2.78</b>	<b>20.69</b>	<b>22.98</b>
<b>Weighted Average</b>					<b>13.26</b>	<b>11.01</b>	<b>2.98</b>	<b>20.64</b>	<b>2.66</b>	<b>2.27</b>	<b>22.93</b>	<b>24.36</b>
<b>Median</b>					<b>11.87</b>	<b>9.66</b>	<b>19.92</b>	<b>18.75</b>	<b>1.38</b>	<b>1.25</b>	<b>13.28</b>	<b>15.55</b>

\* The data in the table is as at May 27, 2013;

1: The market capital value of the companies are translated into HKD;

2: ABCI Securities estimates;

Source: Bloomberg, ABCI Securities estimates

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### Definition of equity rating

Rating	Definition
Buy	Stock return $\geq$ Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2007-2011

Time horizon of share price target: 12-month

### Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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