



Company Report

First Tractor (38 HK) – Buy Construction & Farm Industry 12-month target price: HK\$6.83

Key data

H-share price (HK\$) (10/9/2012)	5.92
Target price (HK\$)	6.83
Upside potential (%)	15.4
52Wk H/L(HK\$)	9.39/3.75
Issued shares (mn)	995
H-share	402
A-share	150
Domestic share	443
H-share market cap (HK\$m)	2,380
30-day avg vol (HK\$m)	11.6
Auditors	BAKER TILLY
Major shareholder (%)	
YTO Group*	44.52

* Domestic share

Source: Company & Bloomberg

Revenue breakdown by product (%)

Agricultural machinery	82.6
Power machinery	11.7
Other machinery	5.0
Financial operations	0.8

*Based on 1HFY12 results

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	(10.1)	(8.5)
3-mth	(7.4)	(11.3)
6-mth	(32.0)	(27.6)

*Relative to Hang Seng Index

Source: Bloomberg

1 year price performance



Source: Bloomberg

Analyst

Report Date: 11 September 2012 (Initiation)

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Previous report

Date: N/A

Rating: N/A

Target price: N/A

Deep discounted leading agricultural machinery maker

Government keeps increasing subsidies for farming machineries to enhance mechanization and production yield of the farming industry. First Tractor, the largest player in tractor industry, leverages its comprehensive sales network and expands its local market share. Its A-share IPO further strengthened its capital to capture long-term growth potential in high-power tractor segment. We initiate “Buy” recommendation with TP:HK\$6.83

Benefit from government policies. Central government encourages the agricultural mechanization in order to secure the food supply in the urbanization trend. The government’s subsidies for agricultural machineries increased from Rmb70mn in 2004 to Rmb17.5bn in 2011. We estimate the total subsidies will go to Rmb20bn in 2012. The Group, the largest manufacturer of hi-powered agricultural tractors and diesel engine for agricultural machineries, set to benefit from the policies.

Expect sales to jump in FY13. Revenue of the Group dropped by 12.0% YoY in 1HFY12 due to the delay in subsidies for agricultural machineries this year and the prolongation of winter in 1Q12. With the subsidies injected to the market during 2H12, we expect the sales growth to rebound in FY13.

GPM improved. GPM increased 1.3ppts to 14.0% in 1HFY12. After getting Rmb770mn net proceeds from A-share issuing, we estimate the Group to spend 72.5% of the proceeds on R&D to develop high-margin large tractors.

The counter is trading at 10.2x FY12E PE. Our 12-month target price of HK\$6.83 is based on 9.3x, which is the mean of PE of the Group minus 1 standard deviation in the past five years, of our FY13E EPS. Although we expect an earnings decline in FY12, the sales growth will rebound in FY13. We roll over our valuation to FY13 and **initiate a “Buy” rating to the Group.**

Risk factors: Product concentration risk; Agricultural machinery industry subject to policy risk; Raw material inflation risk

Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue (Rmb mn)	10,266	11,328	11,206	13,202	17,893
Chg (%YoY)	14.0	10.3	(1.1)	17.8	35.5
Net Income (Rmb mn)	543	411	433	595	883
Chg (%YoY)	118.3	(24.3)	5.4	37.3	48.5
EPS (Rmb)	0.642	0.486	0.470	0.597	0.887
Chg (%YoY)	118.3	(24.3)	(3.2)	27.0	48.5
PE (x)	-	9.9	10.2	8.1	5.4
PB (x)	-	1.25	1.23	1.24	1.13
Yield (%)	-	-	2.9	3.7	5.5
ROAA (%)	7.3	4.5	4.3	5.3	6.9
ROAE (%)	16.4	11.2	11.0	14.0	19.3
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

*We assume Rmb1 = HK\$1.23

Source: Company, ABCI Securities estimates



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The Largest Maker of Agricultural Tractors

Focus on agricultural machinery manufacturing

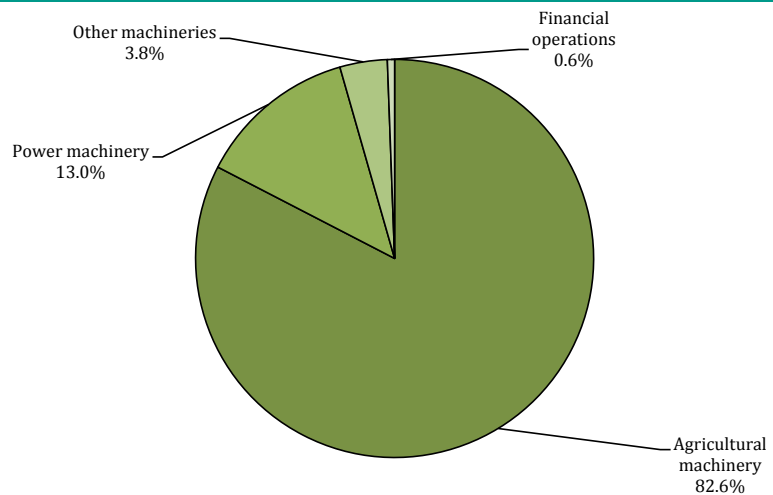
First Tractor is the first listing agricultural machinery manufacturer in Hong Kong. The Group was founded in 1955 under the 1st 5-Year Plan. The products of the Group are sold under the brand of “Dong Fang Hong” (東方紅), which is popular in China. The major product of the Company is agricultural tractor, which is ranging from 12.5kW to 280kW.

The Group is the largest hi-powered tractors manufacturer in China based on the sales volume. It is the third largest mid-powered and low-powered tractors manufacturers in China at the same time. Agricultural machinery contributed 82.6% of the total revenue in FY11, among which, we estimate the total revenue from tractors was 64.9% of the total revenue.

The Group had 12,296 workpeople by end-FY11. Thanks to the strong sales network of the Company, the products are not only sold within China, but also the overseas market. First Tractor sells and delivers its products to over 140 countries and places.

Under the non-competing agreement with the construction machinery makers of the holding group of First Tractor, it has disposed its construction machineries business segment (including bulldozer and road roller). The Group is now focusing on the manufacturing and the corresponding maintenance and after sales services for agricultural tractors and diesel engines for agricultural machinery.

Product-mix pie chat of the Group



Source: Company

Benefit from government policy

Revenue of the Group was Rmb11,329mn in FY11, representing a growth of 10.3% YoY from Rmb10,266mn in FY10. The China’s Government released a document in January 2012 on the encouragement of the automation and mechanization of agricultural industries. We estimate that the total sum of the stimulation packages could reach Rmb200bn in 2012. It will boost the sales of tractors, and hence benefits the Group.



Industry Analysis

Total sales of agricultural and power machinery accounted for 89.4%, 91.2% and 95.6% of total revenue of the group for FY09, FY10 and FY11 respectively. In the short to medium terms, business performance of the group will be affected by the sales performance of these two product segments. In the following section, we will analyze the markets of these two product segments.

Agricultural machinery segment

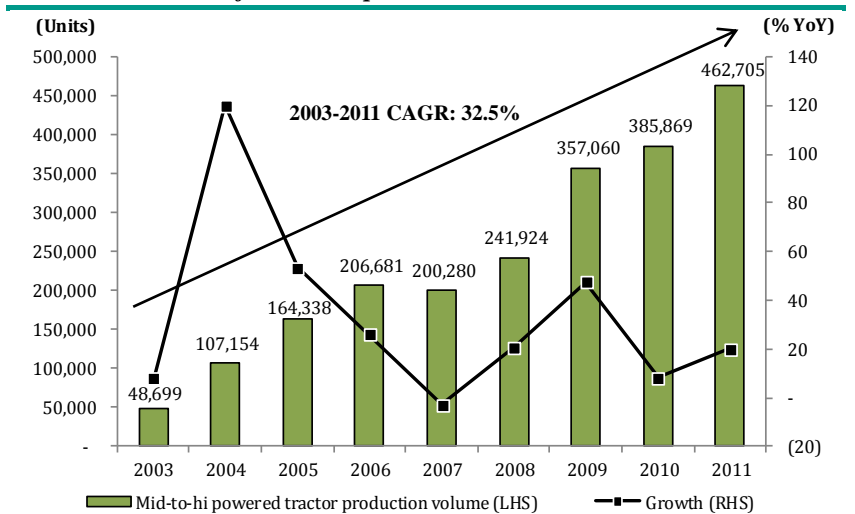
The Group produced agricultural tractors, of which we estimate they contributed 59.8%, 60.4% and 64.9% (78.6%, 76.1% and 78.5%) of the total revenue (agricultural segment revenue) in FY09, FY10 and FY11, respectively. Although the Group provides other agricultural machinery, such as harvest machinery as well besides tractors, we see the corresponding contribution as a percentage of revenue is shrinking.

Agricultural tractor is an engineering vehicle specifically designed to deliver a high tractive effort (or torque) at slow speeds, for the purposes of hauling a trailer or machinery used in agriculture. Most commonly, the term is used to describe a farm vehicle that provides the power and traction to mechanize agricultural tasks, especially (and originally) tillage. Agricultural implements may be towed behind or mounted on the tractor, and the tractor may also provide a source of power if the implement is mechanized.

According to National Bureau of Statistics of China (“NBS”), the total production volume of mid-to-hi-powered tractors in China grew by CAGR of 32.5% from 48,699 units in 2003 to 462,705 units in 2011. The production volume of mini-to-low-powered tractors in China grew by CAGR of 1.9% from 2.04mn units in 2003 to 2.37mn units in 2011.

The growth of sales of mini-to-low powered tractors was far less than the mid-to-hi-powered tractors’. We believe it is because of the selective subsidies for mid-to-hi-powered tractors by China’s government.

Production volume of mid-to-hi-powered tractors in China



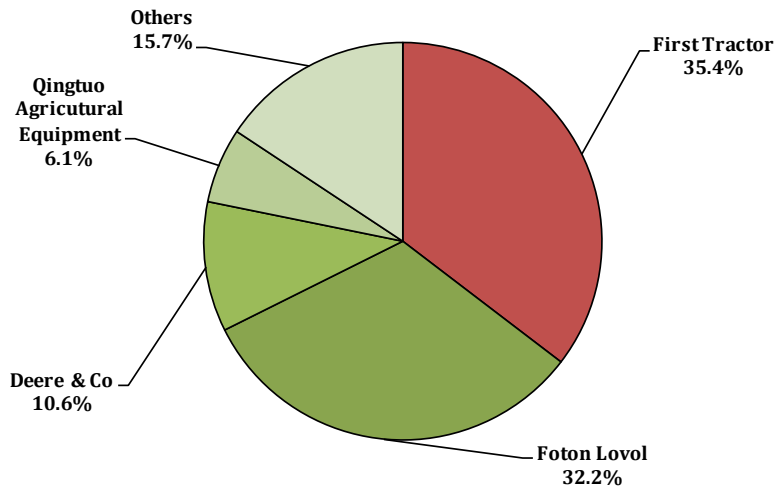
Source: NBS



Competitive landscape

According to the Tractors Industry Statistics Association (機械工業拖拉機行業統計學會), The Group is the largest hi-powered agricultural tractors manufacturer in China based on the sales volume in 2011. It captured 35.4% of market share in volume. The Group is also one of the leading players of mid-powered and low-powered tractors. The Group is the third largest player in both of the mid-powered and low-powered tractors market based on the sales volume in 2011, occupied 15.0% and 11.9% of market share, respectively.

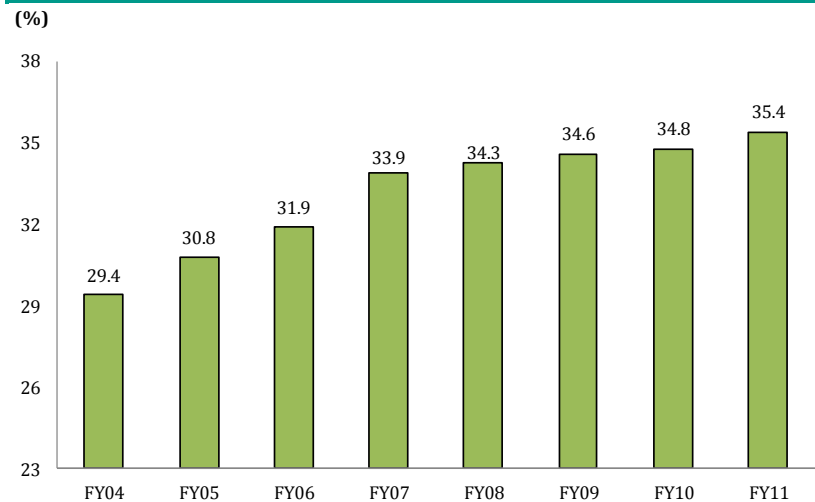
Market share of top hi-powered tractors manufacturers in China, 2011



Source: Tractors Industry Statistics Association

With the input of R&D and promotion & sales channel expansion, the technological advancement and comprehensive sales network of the Group let it capture the market share from its peers'. The market share of hi-powered tractors of the Group grew from 29.4% in FY04 to 35.4% in FY11.

Market share of hi-powered tractors market of the Group



Source: Tractors Industry Statistics Association



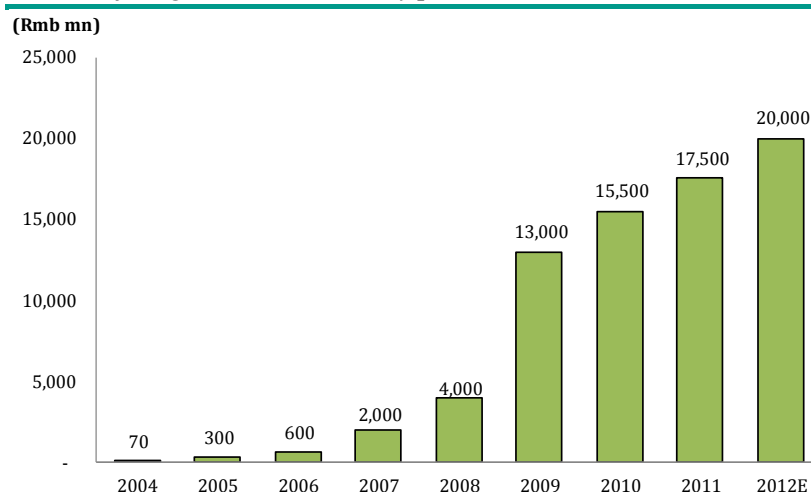
Segment outlook

China is a large farming nation. Agriculture is the foundation of the national economy. The China's government has been paying great attention on rural development, as emphasized under the 12th 5-Year Plan. Agricultural machinery is one of the requirements for achieving modernized agriculture.

Under the urbanization of China, the workforce of rural area was decreasing as a percentage of total population. Furthermore, the food output is expected to lift, while the plantation area will shrink under the economic development. In order to secure the supply of food in China, mechanization was introduced in the agricultural industries for the sake of enhancing the production efficiency. Under the 12th 5-Year Plan, the agricultural mechanization rate is targeted to be 60% by 2015, up from 52% in 2010.

The subsidies for agricultural machinery purchases in China increased from Rmb70mn in FY04 to Rmb17.5bn in FY11. We estimate the total subsidies will be Rmb20.0bn in FY12.

Subsidies for agricultural machinery purchases in China



Source: China Agricultural Machinery Industry Yearbook, ABCI Securities estimates

The demand for the agricultural machinery is expected to accelerate in the future. It benefits the sales growth of the Group as the leading agricultural tractor maker position in China.

Summary of agricultural development under 12th 5-Year Plan of China

	2005	2010	2015E	Change from 2010 to 2015E (%)	
Agriculture products supply	Total plantation area of grains (mn hectares)	104.3	109.9	106.7	(2.9)
	Production capacity of grains (mn tons)	484.0	500.0	540.0	8.0
	Total output of meat (mn tons)	69.4	79.3	85.0	7.3
	Total output of milk (mn tons)	28.7	37.8	50.0	32.3
	Total output of aquatic product (mn tons)	44.2	53.7	60.0	11.7
Agricultural machinery & equipment	Total agricultural machinery power (mn KW)	68.0	92.0	100.0	8.7
	Agricultural mechanization rate (%)	36.0	52.0	60.0	8.0
	Effective irrigation area (mn hectares)	55.0	55.2	62.5	13.3

Source: Chinese Academy of Agricultural Sciences



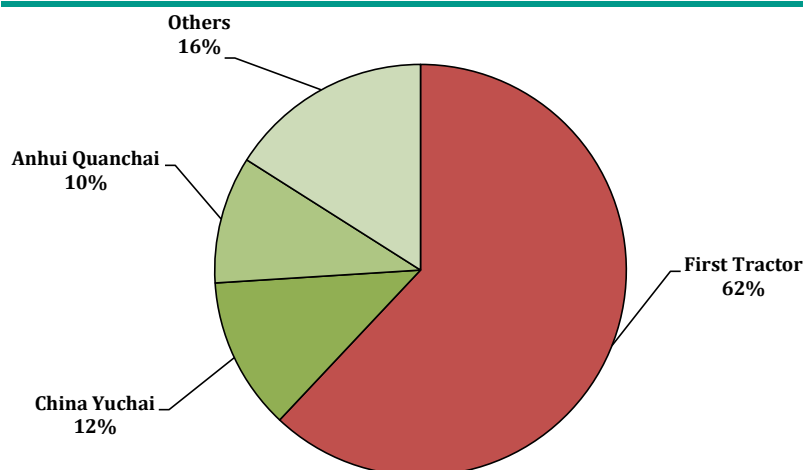
Power machinery market

Power machinery is the second largest business segment of the Group. This segment revenue (from external customer) contributed 13.0% of total revenue in FY11. The Group is the largest maker of large horsepower diesel engine in China according to Chinaauto.net.

Competitive landscape

The market share of the Group was 62% in 2011, 50ppts ahead the second largest player at 12%. The market position of the Group in large horsepower diesel engine market is strong and solid. With leveraging with the leading position of tractors market and the comprehensive sales network across China, we believe the market share of agricultural diesel engines will increase in the future.

Market share of the top agricultural diesel engines makers in China, 2011



Source: Chinaauto.net

Market share was increasing

The market share of the Group was increasing from 60% in 2009 to 62% in 2011. It reflected that the Group took out the market share from its peers. We believe of its strong R&D helping the Group to differentiate its products with the others’.

Thanks for the economies of scales, the Group maintained a competitive pricing power, such that the market position of the Group remained strong.

Growth of market share of different products of the Group

	Ranking	FY09 Market share (%)	Ranking	FY10 Market share (%)	Ranking	FY11 Market share (%)
Hi-powered tractors	1	35	1	35	1	35
Mid-powered tractors	4	12	4	13	3	15
Low-powered tractors	2	15	2	11	3	12
Crawler tractors	1	94	1	96	1	96
Diesel engines	1	60	1	61	1	62

Source: Tractors Industry Statistics Association



Profitability Comparison of Leading Manufacturers of Farm Machinery

Profitability of leading farm machinery manufacturers

		FY08	FY09	FY10	FY11	CAGR (FY08-11)
38 HK Equity	Revenue (Rmb mn)	7,933	9,005	10,266	11,329	12.6%
First Tractor	Gross profit (Rmb mn)	824	1,287	1,517	1,559	23.7%
	Net income (Rmb mn)	69	249	543	411	81.7%
	<i>Gross margin</i>	10.4%	14.3%	14.8%	13.8%	
	<i>Net margin</i>	0.9%	2.8%	5.3%	3.6%	
	<i>ROAA</i>	1.2%	4.2%	7.3%	4.5%	
	<i>ROAE</i>	2.7%	9.2%	18.1%	12.7%	
2338 HK Equity	Revenue (Rmb mn)	32,567	35,261	62,985	59,797	22.5%
Weichai Power	Gross profit (Rmb mn)	5,659	7,632	15,280	12,991	31.9%
	Net income (Rmb mn)	1,929	3,407	6,782	5,597	42.6%
	<i>Gross margin</i>	17.4%	21.6%	24.3%	21.7%	
	<i>Net margin</i>	5.9%	9.7%	10.8%	9.4%	
	<i>ROAA</i>	7.3%	10.3%	15.3%	9.8%	
	<i>ROAE</i>	26.8%	34.5%	44.8%	27.0%	
600218 CH Equity	Revenue (Rmb mn)	1,272	2,110	2,650	2,491	25.1%
Anhui Quanchai	Gross profit (Rmb mn)	106	216	251	210	25.8%
	Net income (Rmb mn)	22	13	51	93	61.6%
	<i>Gross margin</i>	8.3%	10.2%	9.5%	8.4%	
	<i>Net margin</i>	1.0%	2.4%	3.5%	1.0%	
	<i>ROAA</i>	0.9%	3.1%	4.8%	1.2%	
	<i>ROAE</i>	1.5%	5.6%	9.6%	2.5%	
CYD US Equity	Revenue (USD mn)	1,519	1,930	2,472	2,451	17.3%
China Yuchai	Gross profit (USD mn)	267	373	611	546	27.0%
	Net income (USD mn)	37	92	170	130	52.1%
	<i>Gross margin</i>	17.6%	19.3%	24.7%	22.3%	
	<i>Net margin</i>	2.4%	4.8%	6.9%	5.3%	
	<i>ROAA</i>	2.6%	5.5%	7.7%	4.7%	
	<i>ROAE</i>	7.5%	16.8%	24.9%	15.7%	
DE US Equity	Revenue (USD mn)	28,053	22,793	25,548	31,547	4.0%
Deere & Co	Gross profit (USD mn)	7,470	5,613	7,479	9,007	6.4%
	Net income (USD mn)	2,053	874	1,865	2,800	10.9%
	<i>Gross margin</i>	26.6%	24.6%	29.3%	28.5%	
	<i>Net margin</i>	7.3%	3.8%	7.3%	8.9%	
	<i>ROAA</i>	5.3%	2.2%	4.4%	6.1%	
	<i>ROAE</i>	30.0%	15.4%	33.6%	42.8%	
MM IN Equity*	Revenue (INR mn)	189,865	231,987	368,638	594,176	46.3%
Mahindra & Mahin	Gross profit (INR mn)	29,394	46,766	51,537	56,227	24.1%
	Net income (INR mn)	14,054	24,786	30,797	31,267	30.5%
	<i>Gross margin</i>	15.5%	20.2%	14.0%	9.5%	
	<i>Net margin</i>	7.4%	10.7%	8.4%	5.3%	
	<i>ROAA</i>	4.9%	7.4%	7.1%	5.5%	
	<i>ROAE</i>	21.3%	28.8%	25.2%	20.1%	
ESC IN Equity	Revenue (INR mn)	26,532	25,980	33,242	40,503	15.1%
Escortis Ltd	Gross profit (INR mn)	406	1,403	1,895	1,282	46.7%
	Net income (INR mn)	(372)	286	1,320	1,264	N/A
	<i>Gross margin</i>	1.5%	5.4%	5.7%	3.2%	
	<i>Net margin</i>	-1.4%	1.1%	4.0%	3.1%	
	<i>ROAA</i>	-1.3%	0.9%	4.2%	3.7%	
	<i>ROAE</i>	-4.0%	2.4%	8.5%	7.3%	

* The financial year of Mahindar & Mahin was ended in March. (Eg. FY11 refers to April 1, 2011 to March 31, 2012)

Source: Companies, Bloomberg, ABCI Securities



A comparable growth on revenue

The growth of net income of the Group grew at a CAGR of 81.7% from FY08 to FY11. The fast growth on the net income was mainly distorted by the low based in FY08. The CAGR of net income of the Group from FY09 to FY11 was 28.6%, which was comparable of the growth rate of the other international players, such as Deere & Co at 10.9%.

A moderate profitability

The return of average assets (“ROAA”) of the Group improved from 4.5% in FY11 to 5.8% in 1HFY12, and the return on average equity (“ROAE”) improved from 12.7% in FY11 to 16.6% in 1HFY12. The ratios are comparable to the peers’.

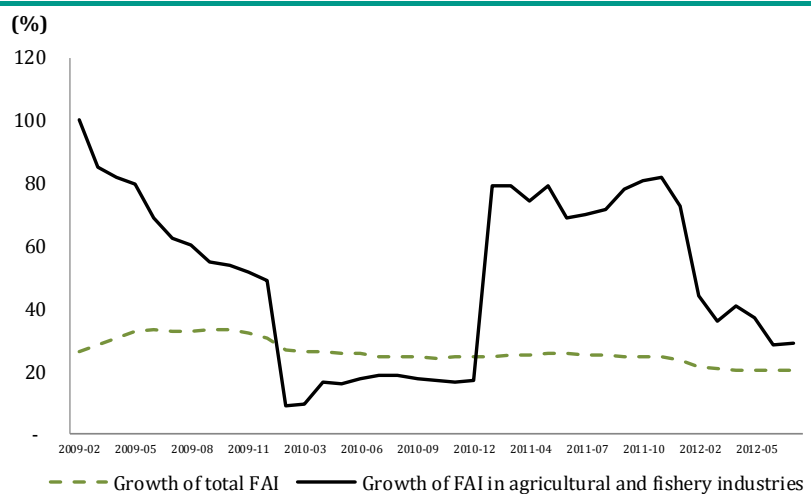
The Group planned to spend about one-third of net proceeds from the A-share issuing in July 2012, estimated at Rmb770mn, on R&D in order to develop the parts for agricultural machinery, such that the profit margin can be enhanced via vertical integration. We estimate that the ROAA and ROAE will lower to 4.3% and 11.0% in FY12, respectively because of the dilution effect from A-share issuing. We estimate ROAA will be improved to 5.3% and 6.9% in FY13 and FY14, respectively, and ROAE will be improved to 14.0% and 19.3% in FY13 and FY14, respectively.

Growth of the sector is expected to speed up

Under the encouraging policies on “agricultural, rural area and farmer” or known as “Sannong”, China’s government will ensure an adequate supply of agricultural products, and increase farmers’ incomes. Government makes safeguarding food security as the primary goal. In order to enhance agricultural productivity, we believe the automation of the agricultural industry will be carried on. The demand for agricultural tractors will be sustain subsequently.

The FAI on agricultural and fishery industries was up 25.0% YoY in 2011, and the growth rate accelerated to 28.6% YoY in 1H12, which was outpacing the total FAI in China at 23.5% in 2011 and 20.4% in 1H12.

Growth of total FAI vs FAI in agricultural and fishery industries



Source: NBS

Financial Analysis and Projection

Revenue Analysis and Projection

The Group is mainly operating agricultural machinery manufacturing business. The sales of agricultural machinery (including hi-powered, mid-powered, low-powered and crawler tractors) to total revenue were increasing from 70.2% in FY08 to 82.6% in FY11. The Group has disposed the construction machineries manufacturing business in FY11. We believe the concentration on agricultural machinery manufacturing business will increase in the future. We estimate the sales of agricultural machinery businesses will go to 85.6% of total revenue in FY14. The growth of hi-powered and mid-powered tractors were outpacing in FY08 to FY11.

CAGR of different segments of First Tractor

	CAGR in FY08-FY11	CAGR in FY11-FY14E
Agricultural machinery	18.9	17.9
Hi-powered tractors	26.4	17.7
Mid-powered tractors	34.2	23.0
Low-powered tractors	(7.0)	(5.3)
Crawler tractors	(6.1)	8.0
Power machinery	23.7	4.3
Other machineries	(34.4)	17.4
Overall Revenue	12.6	16.5

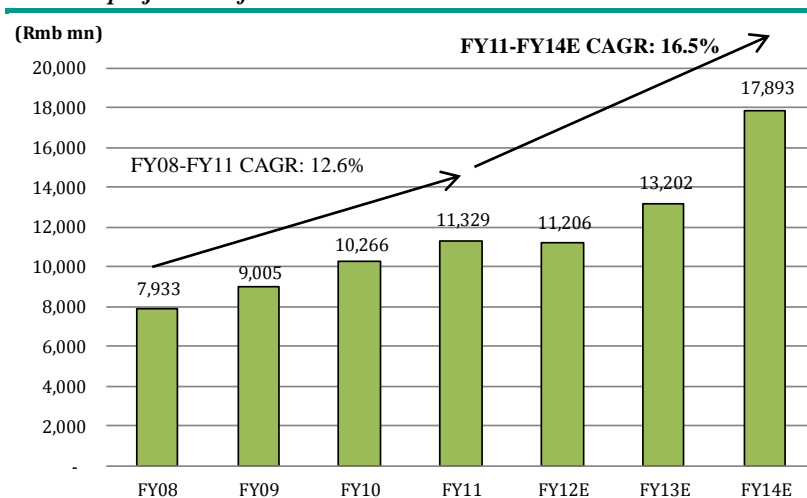
*Excluding internal sales

Source: Company, ABCI Securities estimates

Revenue expected to retreat in FY12

Under the impact of cyclical fluctuation of purchases of equipment, the sales situation of the tractor of the Group is expected to slowdown in FY12 and back to fast growth track in FY13. Revenue of the Group grew at a CAGR of 12.6% in FY08 to FY11. We estimate that the Group's revenue will grow at a CAGR of 16.5% in FY11 to FY14.

Revenue projection of First Tractor



Source: Company, ABCI Securities estimate

Agricultural machinery segment

The agricultural machinery segment is the major business segment of the Group contributing 82.6% of the total revenue in FY11. The segment of agricultural machinery of First Tractor mainly comprises of sales of tractors with different horsepower (hi-powered, mid-powered, low-powered and crawler tractors) and the related parts and components. The Group also offers after sales repairing and maintaining services.

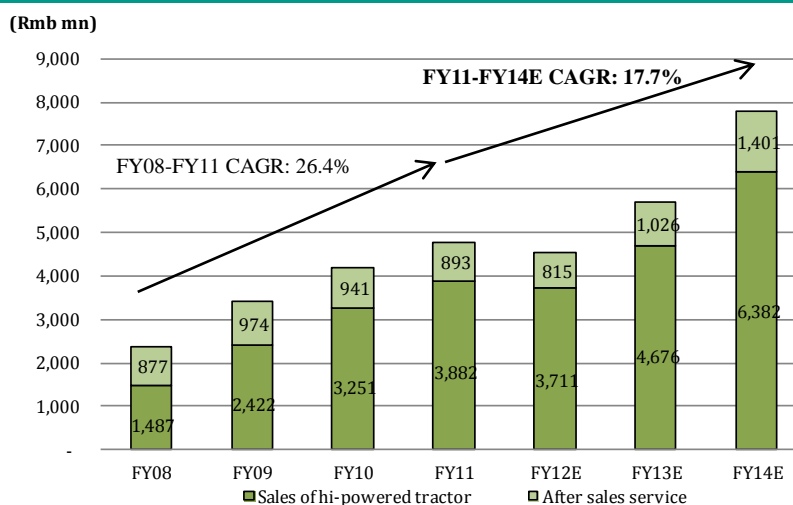
Hi-powered tractor sub-segment

Under the mechanization of agricultural activities, we believe it will be a growth driver of hi-powered tractors. The Group posted a sales volume of 47,633 units of hi-powered tractors in FY11, up 8.4% YoY. Due to the prolong winter during 1Q12, the sales volume dropped by 17.0% YoY in 1HFY12. We estimate the full year sales volume of hi-powered tractors of the Group will be down 6.3% YoY to 43,363 units in FY12. However, under the gradual increase of government's subsidies on tractors, we estimate that the sales volume will be up 20.0% YoY to 52,036 units in FY13 and 30.0% YoY to 67,647 units in FY14.

According to our channel check, we estimate that the average selling price of the hi-powered tractors was up from Rmb74,000/unit in FY10 to Rmb81,500/unit in FY11. Thanks for the solid market position of the Group, we believe it can transfer a large part of the inflated production cost to its customers. We assume the selling price of the product will increase by 5% p.a. during FY12 to FY14.

The sales revenue growth of the hi-powered tractors is relatively strong due to the replacement demand for hi-powered tractors from the lower-powered tractors induced by the mechanization of agricultural activities. We estimate that the revenue from hi-powered tractors will grow at a CAGR of 17.7% during FY11 to FY14. The growth was slowed down compared with that from FY08 to FY11 due to the high based effect. The sub-segment revenue growth will be dragged down by the poor sales performance in 1QFY12, but we believe the growth will back to the long term growth trend in FY13.

Sales revenue projection of hi-powered tractors



Source: Company, ABCI Securities estimate



Mid-powered tractor sub-segment

Similar to the sales situation of hi-powered tractors, the mid-powered tractors is benefited from the replacement demand included from mechanization of agricultural activities.

The Group posted a sales volume of 34,880 units of mid-powered tractors in FY11, up 38.6% YoY. The sales volume edged down by 3.1% YoY in 1HFY12, and started to rebound in 2H12. We estimate that the sales volume will grow by 12.7% YoY to 39,305 units in FY12, 15.0% YoY to 45,200 units in FY13 and 25.0% YoY to 56,500 units in FY14. We believe the growth rate of sales volume of mid-powered tractor in FY13 and FY14 is likely to be lower than of the hi-powered tractors because of the lower in government's subsidies.

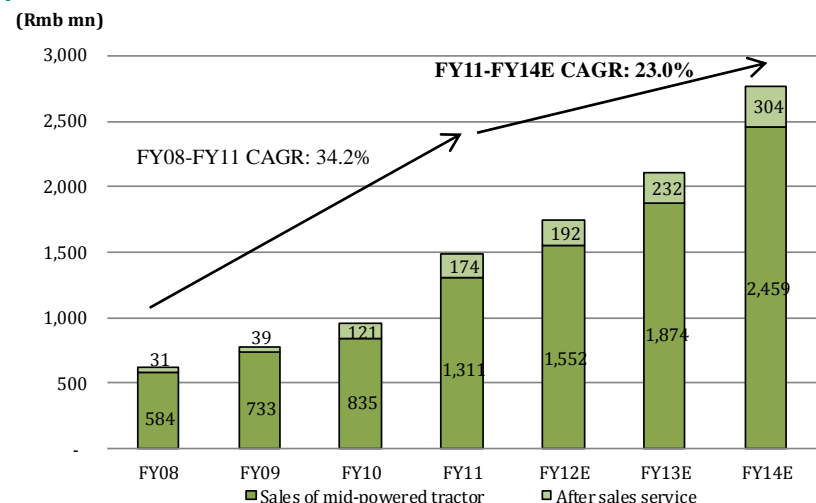
The after sales services for mid-powered tractors fast developed since FY10. It let the total revenue of the mid-powered tractors sub-segment grew at CAGR of 34.2% in FY08 to FY11, outpacing that of the other segments of the Group

We estimate that the average selling price of the mid-powered tractors was up from Rmb33,200/unit in FY10 to Rmb37,600/unit in FY11. We assume the selling price of the product will increase by 5% p.a. during FY12 to FY14.

The growth of the mid-powered tractor sub-segment maintained at a fast pace during FY10 and FY11 (58.5% YoY in FY10 and 55.2% YoY in FY11). We believe the growth of the sales of mid-powered tractors will lower in FY12 because of the prolong winter in 1Q12.

We estimate that the revenue from mid-powered tractors will grow at a CAGR of 23.0% in FY11 to FY14. The growth is expected to be lower than that in FY08 to FY11 at CAGR of 34.2% due to the high based effect.

Sales revenue projection of mid-powered tractors



Source: Company, ABCI Securities estimate

Low-powered tractor sub-segment

The sales volume of low-powered tractors reduced from 95,015 units in FY07 to 45,678 units in FY11. The reduction in sales volume of low-powered tractor of the Group was mainly due to 1) the concentration of government's subsidies in mid-to-hi-powered tractors discouraging the purchases of low-powered tractors, and 2) the strategic pale out the business due to the lower in profit margins. The GPM of the low-powered tractors was 3.7%, which is far lower than that of mid-powered tractors at 6.9% and hi-powered tractors at 15.3% in FY11.

Gross profit margin breakdown of the agricultural machinery segment

GPM (%)	FY08E*	FY09	FY10	FY11
High power tractor	14.10	17.62	17.91	15.29
Mid power tractor	6.34	7.93	7.52	6.86
Low power tractor	2.60	3.25	3.77	3.73
Crawler tractor	10.89	13.61	13.97	14.03
Other agricultural machinery	4.21	5.26	4.38	5.63
Overall agricultural machinery segment GPM	8.49	11.66	11.66	10.71

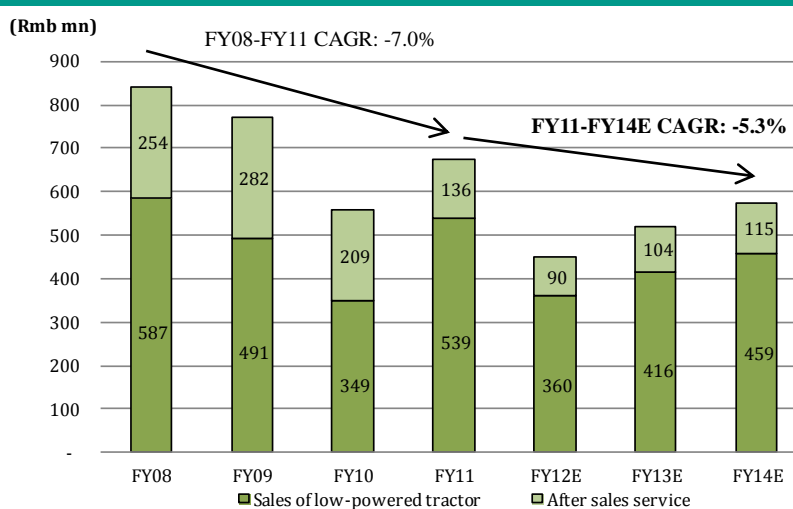
*The breakdown of GPM in FY08 was estimated by ABCI Securities

Source: Company, ABCI Securities estimate

Under the economic downturn, the sales volume of low-powered tractors was decline significantly by 42.7% in 1H FY12. We expect the sales volume will decline by 36.4% YoY in FY12 to 29,068 units. Since the Group strategically place more resources and emphasis on mid-to-hi-powered tractors, we believe the growth of the low-powered tractors will lower than that of other segments in the Group. We estimate the sales volume will grow by 10.0% YoY in FY13 and 5.0% YoY in FY14.

We assume the services income is stable as a percentage of total sub-segment revenue. We estimate the sub-segment revenue will dropped in FY12 and recover gently in FY13 and FY14.

Sales revenue projection of low-powered tractors



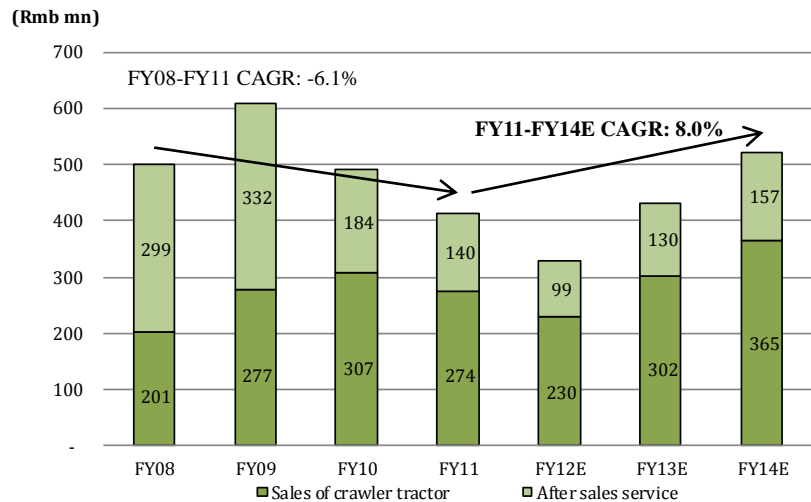
Source: Company, ABCI Securities estimate



Crawler tractor sub-segment

Crawler tractors contributed 4.4% of the segment income of agricultural machinery segment (or 3.65% of the total revenue) in FY11. The sales volume of crawler tractors stayed flat from 2,920 units in FY07 to 2,325 units in FY11. We estimate the sub-segment revenue will be Rmb329mn, down 20.5% YoY, in FY12, Rmb432mn, up 31.3% YoY, in FY13 and Rmb522mn, up 20.8% YoY, in FY14.

Sales revenue projection of crawler tractors



Source: Company, ABCI Securities estimate

Other agricultural machineries

Besides sales of tractors, the Group provides sales of related parts and components for other agricultural machineries, such as harvest machinery as well.

We assume the sales of component business will remain stable as percentage of sales of agricultural machinery in FY12 to FY14. Therefore we estimate the sub-segment revenue will be Rmb2,819mn, up 11.4% YoY, in FY12, Rmb2,737mn, down 2.9% YoY, in FY13 and Rmb4,442mn, up 62.8% YoY, in FY14.

The sales-mix of the other agricultural machineries (related parts and components) was fluctuated because of the repairing and maintenance cycle of the industry.

Sales mix of agricultural machinery

Sales mix (%)	FY08	FY09	FY10	FY11
High power tractor	42.4	49.6	51.5	51.0
Mid power tractor	8.3	8.8	11.8	15.9
Low power tractor	15.1	11.3	6.9	7.2
Crawler tractor	9.0	8.9	6.0	4.4
Other agricultural machineries	35.6	29.0	31.9	27.0
Intersegment elimination	-10.4	-7.6	-8.1	-5.6

Source: Company



Power machinery segment

The Group provides high-end diesel engines for agricultural (hi-powered tractors) and other machineries. The sales of diesel engines are classified as power machinery in the Group. Benefiting from sales of agricultural machinery and production structural adjustment, the Group consolidated the market share in the conventional business of ancillary equipment, stepped up efforts in the market development.

The sales volume of the Group was 168,896 units in FY11, increased 16.7% YoY from 144,777 units in FY10. Among the total sales volume of diesel engines from the Group, there were 54,360 units sold to internal customers in FY11. However, due to the decline in the sales of tractor market, the sales volume of power machinery dropped by 10.9% in 1HFY12.

We assume the average selling price for internal customers was the same as external customers. The sales to external customers are stable as a percentage of the total segment revenue. The contribution from external customers was 66.5% in FY11.

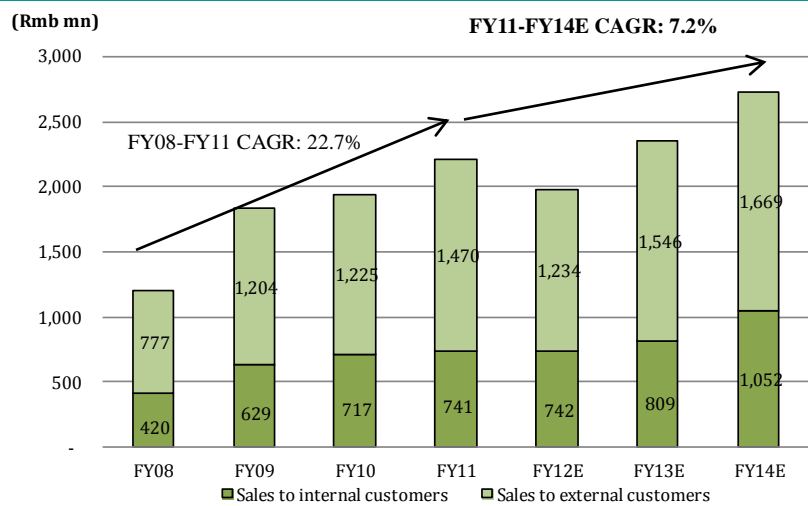
Breakdown of sales of power machinery

Sales mix (%)	FY08	FY09	FY10	FY11
External customer	64.9	65.7	63.1	66.5
Internal customer	35.1	34.3	36.9	33.5

Source: Company

With the growth of hi-powered tractor market under the government's subsidies, we estimate the total sales of power machinery will grow at a CAGR of 7.2% from FY11 to FY14, and the sales to external customers will grow at a CAGR of 4.3% from FY11 to FY14.

Sales revenue projection of crawler tractors



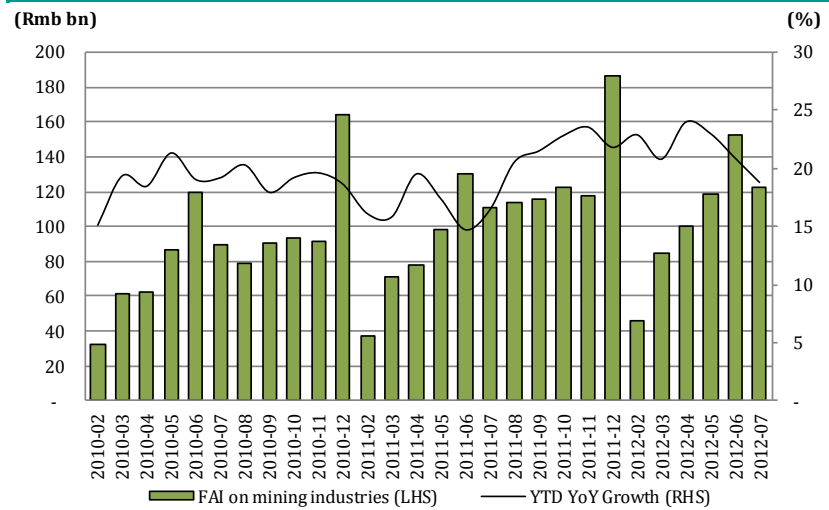
Source: Company, ABCI Securities estimate



Other machineries segment

The other machineries segment was comprised with forklifts and mining trucks manufacturing. The Group has disposed construction machineries manufacturing business in FY11. The sales volume of mining trucks of the Group was 605 units in FY11, increased 42.0% YoY from 426 units in FY10. With the solid FAI growth in mining industries at 20.9% YoY in 1H12, we estimate the sales volume of mining trucks of the Group will grow at 30% p.a. during FY11 to FY14.

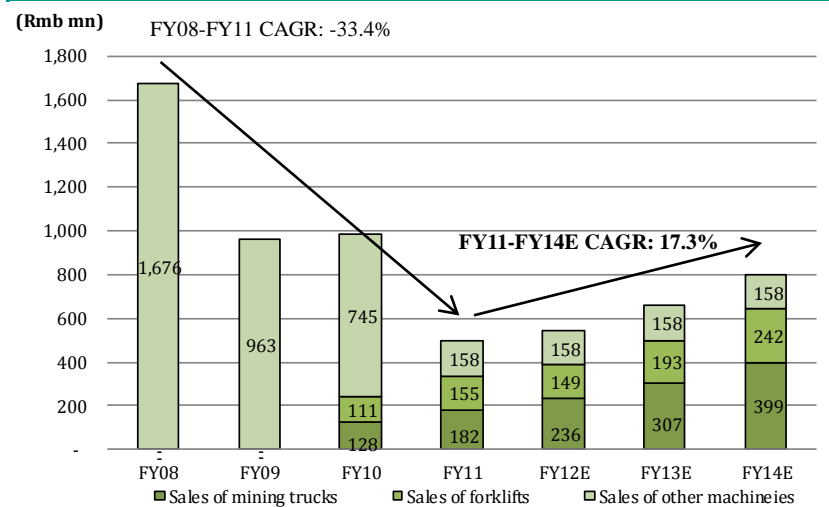
Monthly FAI of mining industries in China



Source: National Bureau of Statistics of China

The sales volume of forklifts of the Group was 2,677 units in FY11, increased 34.6% YoY from 1,989 units in FY10. Under the global economic downturn, we estimate the sales volume will decline to 2,565 units, down 4.2% YoY in FY12. However, we believe the sales will rebound with in FY13 with economic stimulation policies. We estimate the sales volume will grow at a CAGR of 15.9% from FY11 to FY14.

Sales revenue projection of other machineries



* Other machineries include construction machinery

Source: Company, ABCI Securities estimate



Gross profit margin analysis projection

Gross profit margin (“GPM”) of the Group increased 3.4ppts from 10.4% in FY08 to 13.8% in FY11, and it surged to 14.0% in 1HFY12. We believe that the increase of GPM was because of the increase in sales of the hi-powered and mid-powered tractors segments which had a higher GPM as a percentage of total revenue and the reduction in unit production cost due to economies of scales.

We expect the GPM will keep increasing in 2HFY12 and the GPM will be 14.2% in FY12. With more subsidies by government, we believe the demand for mid-to-hi-powered tractors will lift in following years. We believe that the profitability of the Group will regain with the macro economy in China. We estimate that GPM will keep surging, and go to 14.9% in FY13 and stays flat in FY14.

Hi-powered tractor sub-segment

We estimate that GPM of hi-powered tractors enhanced from 14.1% in FY08 to 17.9% in FY10, mainly due to the economies of scale lower the unit production cost. However, its GPM dropped to 15.3% in FY11. It was because of the Group strategically maintain the selling price in order the capture more market share while the cost of raw material kept surging during 2011. We expect the GPM will recover in FY12.

We estimate that the sub-segment GPM is 17.5%, 17.8% and 18.0% in FY12-14, respectively.

Mid-powered tractor sub-segment

Due to the lower in technological requirement of mid-powered tractors compared with the hi-powered tractors, GPM of mid-powered tractors is lower than that of hi-powered tractor. Its GPM was ranging from 6% to 8% in FY08 to FY11. With leveraging on the sales network and improvement of products quality via technological advancement, we believe the GPM will increase gradually.

We estimate that the sub-segment GPM is 8.0%, 8.2% and 8.5% in FY12-14, respectively.

Low-powered tractor sub-segment

The GPM of low-powered tractors is far lower than that of hi-powered and mid-powered tractors of the Group. The GPM was 3.3%, 3.8% and 3.7% in FY09-FY11 respectively. The major reason of its low profitability is because of the low technological barrier inducing keen market competition. The competitive market environment hinders the Group and its peers to lift up the selling price.

With the economies of scale, we expect the GPM of low-power will increase. But under the shrink of low-powered tractor market, we believe the GPM improvement is limited

We estimate that the sub-segment GPM is 4.0%, 4.2% and 4.5% in FY12-FY14, respectively.



Crawler tractor sub-segment

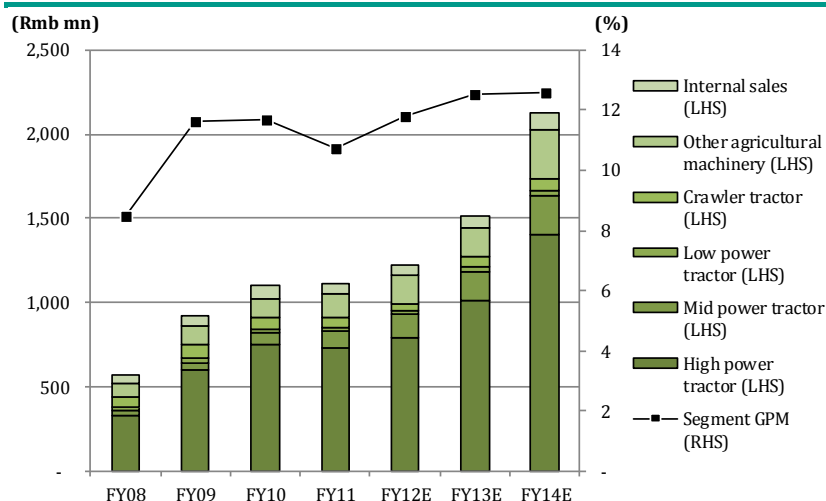
GPM of crawler tractor improved from 10.9% in FY08 to 14.0% in FY11. As the special feature of crawler tractors, they are used for certain task, such as soil preparation and maintenance on very steep slopes. Leveraging on the technological advancement, First Tractor can maintain the GPM of crawler tractor during the unfavorable business environment.

We estimate that the sub-segment GPM will be 14.5%, 14.8% and 15.0% in FY12-FY14, respectively.

Overall agricultural machinery segment

We assume the GPM of intersegment sales is the same as the overall tractor segment. We estimate that the segment GPM is 11.8% in FY12, 12.6% in FY13 and 12.6% in FY14.

Gross profit projection of agricultural machinery segment



Source: Company, ABCI Securities estimate

Our GPM projection of agricultural machinery sub-segments

GPM (%)	FY08E*	FY09	FY10	FY11	FY12E	FY13E	FY14E
High power tractor	14.1	17.6	17.9	15.3	17.5	17.8	18.0
Mid power tractor	6.3	7.9	7.5	6.9	8.0	8.2	8.5
Low power tractor	2.6	3.3	3.8	3.7	4.0	4.2	4.5
Crawler tractor	10.9	13.6	14.0	14.0	14.5	14.8	15.0
Other agricultural machinery	4.2	5.3	4.4	5.6	6.0	6.2	6.5
Overall agricultural machinery segment GPM	8.5	11.7	11.7	10.7	11.8	12.6	12.6

*The GPM data in FY08 was estimated by ABCI Securities

Source: Company, ABCI Securities estimates

Power machinery segment

The GPM of power machinery of the Group maintained at a level of 20%. The Group focuses on the high-end market. However, we see the segment GPM lower to 18.5% in FY11 from 20.2% in FY10, mainly because of the raw materials inflation. We estimate the GPM will recover to 19.0% in FY12 with the hi-powered tractor market. With the launch of new generation of diesel engine, we expect that the segment GPM will further up in FY13 and FY14. We estimate GPM will be recovered to 19.5% in FY13 and 20.0% in FY14. We assume the GPM for internal sales is the same as external sales.

Comparing with other leading player of diesel engine market, the segment GPM of the Group is relatively lower. There is still room for the Group to improve the profitability.

GPM Comparison of leading diesel engine makers

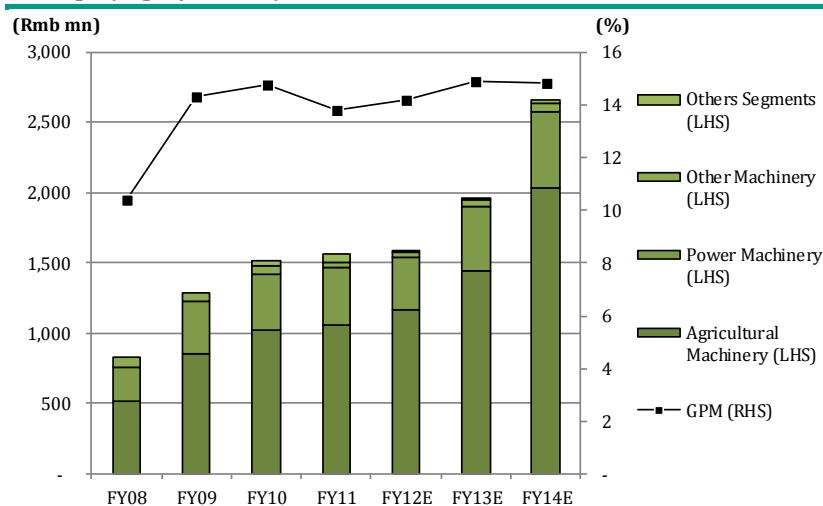
GPM (%)	Ticker	FY08	FY09	FY10	FY11
First Tractor*	38 HK	20.0	20.2	20.2	18.5
Weichai Power	2338 HK	17.4	21.6	24.3	21.7
Anhui Quanchai	600218 CH	8.3	10.2	9.5	8.4
China Yuchai	CYD US	17.6	19.3	24.7	22.3
Cummins Inc	CMI US	20.5	20.1	24.0	25.4

* GPM of power machinery segment of the Group
Source: Companies, ABCI Securities estimates

Other machinery segment

After disposal of construction machineries manufacturing business, the other machinery segment of the Group mainly source from the sales forklifts and mining trucks. We assume the GPM other machinery segment will stay flat in FY12 and gradually improve in FY13 to FY14.

Gross profit projection of First Tractor



Source: Company, ABCI Securities estimate

Net margin analysis and projection

The net margin of the Group was squeezed from 5.3% in FY10 to 3.6% in FY11 mainly due to 1) the GPM reduction from 14.8% in FY10 to 13.8% in FY11; and 2) increase in effective tax rate from 13.0% in FY10 to 14.7% in FY11. We assume the tax rate stays flat at 14.0% in FY12 to FY14, while the GPM is expected to increase to 14.2% in FY12.

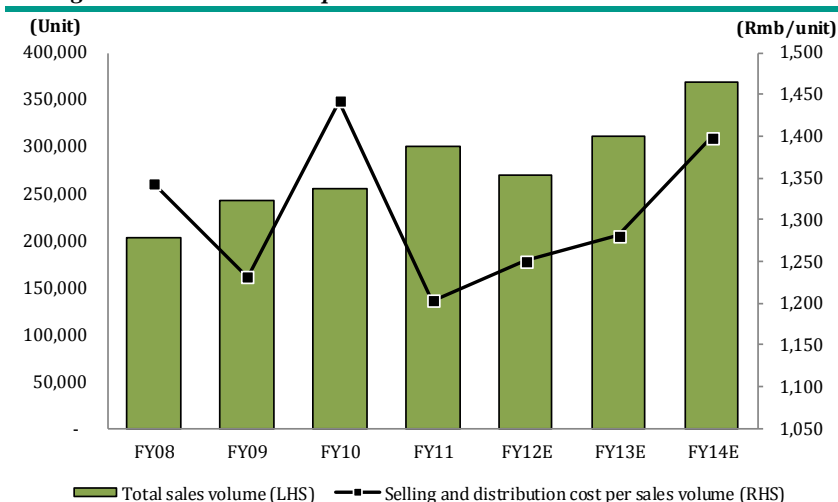
With the recovery of GPM, we estimate net income margin will recover to 3.9% in FY12, 4.5% in FY13 and 4.9% in FY14.

Selling and distribution cost per revenue

The ratio of “selling and distribution cost per revenue” decreased from 3.9% in FY07 to 3.2% in FY11. The cost control on the distribution network of the Group was improving. The selling and distribution cost ratio of First Tractor is lower than the leading machinery manufacturers’, such as Zoomlion at 6.8% and Weichai Power at 4.8% in FY11.

The selling and distribution cost per sales volume was Rmb1,203/unit in FY11, which was stayed flat in 1HFY12. We expect the unit sell cost will increase to Rmb1,250/unit in FY12 due to the expansion of marketing campaign.

Selling and distribution cost per sales volume



Source: Company, ABCI Securities estimate

By leveraging the strong sales network of the Group in across different places in China, we believe it can further reduce the selling and distribution cost as percentage of revenue. We estimate the selling and distribution cost per revenue ratio is 3.0% in FY12 and FY13, and reduce to 2.9% in FY14.

Selling and distribution cost as a percentage of revenue

Cost ratio (%)	Ticker	FY08	FY09	FY10	FY11
First Tractor	38 HK	3.4	3.3	3.6	3.2
Weichai Power	2338 HK	2.9	2.9	4.6	4.8
Zoomlion	1157 HK	7.1	6.0	6.7	6.8
Lonking	3339 HK	7.0	6.1	5.1	4.7

Source: Companies, ABCI Securities



Total administrative cost per revenue

The ratio of “*administrative cost per revenue*” increased from 5.1% in FY08 to 6.0% in FY11 because of the increase in investment on R&D. We expect that the administrative cost per revenue will increase as a percentage of revenue in FY12.

Furthermore, the listing expenses for A-share issuing are expected to be booked in 2HFY12. We estimate the total net expenses are Rmb7mn. Therefore the administrative cost per revenue ratio is estimated to surge to 6.4% in FY12.

We believe the cost administrative cost will stay flat in FY13 at 6.4% as percentage of revenue. By considering with the fixed cost per unit production will be lowered when the production capacity expansion for hi-powered tractors accomplished in FY14, we estimate the ratio will edge down to 6.0% in FY14.

Cost ratio assumption and net margin projection

(%)	SG&A	Administrative Cost	Selling & Distribution	Tax Rate	Net Margin
FY08	8.5	3.4	5.1	10.5	0.9
FY09	10.2	3.3	6.9	23.2	2.8
FY10	9.9	3.6	6.3	13.0	5.3
FY11	9.2	3.2	6.0	14.7	3.6
FY12E	9.4	3.0	6.4	14.0	3.9
FY13E	9.4	3.0	6.4	14.0	4.5
FY14E	8.9	2.9	6.0	14.0	4.9

Source: Company, ABCI securities estimates



Capex and utilization

We estimate capex is Rmb373mn, Rmb540mn and Rmb619mn in FY12, FY13 and FY14, respectively. 35.8% of the capex is expected to be spent on the new production lines for component and parts manufacturing for hi-powered tractors, which has the highest GPM at 15.3% in FY11 among the machineries provided by the Group except power machinery at 18.5%. 36.7% of capex would be used on the new products development. The rest of capex is expected to be used for capacity expansion of power machinery and other agricultural machineries.

The utilization rate of the Group is high. We estimate that the utilization rates of hi-powered tractors and mid-powered tractors were 108.4% and 157.2% in FY12.

As the weak demand for crawler tractors and low-powered tractors, the Group has freeze the capacity expansion on them. In the meanwhile, it put more resources on the hi-powered and mid-powered tractors in the future.

Utilization rate of the Group

		Production capacity (Unit)	Production volume (Unit)	Utilization rate (%)
	Hi-powered tractors	40,000	43,363	108.4
	Mid-powered tractors	25,000	39,305	157.2
FY12E	Low-powered tractors	55,000	29,068	52.9
	Crawler tractors	3,500	1,860	53.1
	Power machinery	130,000	156,047	120.0
	Average			98.3
	Hi-powered tractors	40,000	43,082	107.7
	Mid-powered tractors	25,000	35,211	140.8
FY11	Low-powered tractors	55,000	45,671	83.0
	Crawler tractors	3,500	2,113	60.4
	Power machinery	130,000	164,919	126.9
	Average			103.8
	Hi-powered tractors	40,000	46,366	115.9
	Mid-powered tractors	18,000	27,679	153.8
FY10	Low-powered tractors	55,000	38,755	70.5
	Crawler tractors	3,500	2,879	82.3
	Power machinery	130,000	147,396	113.4
	Average			107.2
	Hi-powered tractors	35,000	38,496	110.0
	Mid-powered tractors	15,000	22,236	148.2
FY09	Low-powered tractors	60,000	49,102	81.8
	Crawler tractors	3,500	2,393	68.4
	Power machinery	120,000	139,365	116.1
	Average			104.9

Source: Company, ABCI Securities estimates

Total receivable and cash conversion cycle

One of our major concerns on the machinery makers was the liquidity and cash conversion capability. As the Group has issued 150 shares in A-share market with net proceed of Rmb770mn, we expect the net cash position is able to remain in FY12.

Financial lease receivables

The financial lease receivables of the Group stayed flat as a percentage of total current assets at 0.9%-1.6%. As the Group planned to expand the mid-to-hi-powered tractors markets in the future, we expect it will relax the credit terms and the level of financial lease will increase gradually. We estimate it will grow to Rmb111mn in FY12, Rmb131mn in FY13 and Rmb177mn in FY14. But the level of the financial lease assets of the Group was far lower than that of other leading machinery makers in China.

The level of receivables (trade and bill receivables plus financial lease assets) of the Group is lower than that of other machinery maker as the percentage of total equity.

The level of contingent liabilities of the Group is far lower compared with the peers. The total contingent liabilities of the Group were Rmb352mn (9.3% of total equity) as of end-FY11. Although it surged to Rmb696mn (23.7%) as of June 2012, but the level was still lower than its peers'

Receivables comparison on the machinery makers

(Rmb mn)	First Tractor	Lonking	Zoomlion
Trade and bill receivable	2,391	3,130	12,701
Financial lease assets	95	1,298	19,869
Contingent liabilities*	352	2,072	9,092
To total equity ratio (%)			
Trade and bill receivable	63.3	48.9	35.7
Financial lease assets	2.5	20.3	55.8
Contingent liabilities	9.3	32.4	25.5

Source: Companies data

*Contingent liabilities include the sales of the Group which is funded by PRC domestic banks. The Group provides guarantees for dealers and customers purchasing products of the Group in the form of an undertaking letter or agreement.

Cash conversion cycle elongated

The trade and bill receivables turnover days increased from 63.6 days in FY11 to 77.3 days in 1HFY12. The inventory turnover days decreased from 46.5 days in FY11 to 37.4 days in 1HFY12. The trade and bill payables turnover days decreased from 78.8 days in FY11 to 73.8 days in 1HFY12.

We see the cash conversion cycle of the Group lengthened in 1HFY12 under the business expansion period.

Cash conversion cycle of the Group

(Rmb mn)	FY10	FY11	1HFY12
Trade and bill receivable turnover days	44.6	63.6	77.3
Inventory turnover days	50.8	46.5	37.4
Trade and bill payable turnover days	78.4	78.8	73.8
Cash conversion cycle	17.0	31.2	40.9

Source: Company, ABCI Securities



Valuation

Revenue decline in 1HFY12

The Group posted a declining revenue in 1HFY12. Top line dropped by 12.0% YoY in 1HFY12 because of the cyclical fluctuation of agricultural machinery purchases. However, the bottom line increased by 5.6% YoY in 1HFY12, mainly because of the better in cost control.

We see the selling and distribution cost reduced as a percentage of revenue. It was because the sales volume slid from 185,411 units (agricultural machinery plus power machinery) in 1HFY11 to 157,655 units in 1HFY12. The unit selling cost of the Group edge down from Rmb1,226/unit in 1HFY11 to Rmb1,203/unit in 1HFY12.

Key financial summary on 1HFY12 results of the Group

	1HFY10	2HFY10	FY10	1HFY11	2HFY11	FY11	1HFY12	Change (% YoY)	Change (% HoH)
Turnover (Rmb mn)	5,938	4,328	10,266	7,165	4,164	11,329	6,304	<i>(12.0)</i>	<i>51.4</i>
Agricultural machinery	4,765	3,375	8,141	5,999	3,357	9,356	5,208	<i>(13.2)</i>	<i>55.1</i>
Power machinery	636	589	1,225	866	604	1,470	735	<i>(15.1)</i>	<i>21.6</i>
Other machinery	519	336	855	274	162	436	313	<i>14.2</i>	<i>93.2</i>
Financial leasing income	18	28	45	26	40	66	49	<i>87.3</i>	<i>21.3</i>
Gross Profit (Rmb mn)	869	648	1,517	913	646	1,560	884	<i>(3.3)</i>	<i>36.7</i>
GPM (%)	14.6	15.0	14.8	12.7	15.5	13.8	14.0	<i>1.3ppts</i>	<i>(1.5)ppts</i>
Major cost (Rmb mn)									
Selling cost	(208)	(160)	(368)	(227)	(133)	(360)	(190)	<i>(16.6)</i>	<i>42.7</i>
Admin cost	(312)	(334)	(646)	(343)	(334)	(677)	(351)	<i>2.2</i>	<i>5.0</i>
Finance cost	(12)	(16)	(28)	(28)	(26)	(54)	(36)	<i>30.0</i>	<i>38.5</i>
Cost/revenue (%)									
Selling cost	3.5	3.7	3.6	3.2	3.2	3.2	3.0	<i>(0.2)ppts</i>	<i>(0.2)ppts</i>
Admin cost	5.3	7.7	6.3	4.8	8.0	6.0	5.6	<i>0.8ppts</i>	<i>(2.5)ppts</i>
Finance cost	0.2	0.4	0.3	0.4	0.6	0.5	0.6	<i>0.2ppts</i>	<i>(0.1)ppts</i>
Net income	270	273	543	271	140	411	286	<i>5.6</i>	<i>105.2</i>
NM (%)	4.5	6.3	5.3	3.8	3.4	3.6	4.5	<i>0.8ppts</i>	<i>1.2ppts</i>
Total sales volume (unit)	145,093	110,278	255,371	185,411	114,001	299,412	157,655	<i>(15.0)</i>	<i>38.3</i>
Agricultural machinery	62,759	47,835	110,594	82,251	48,265	130,516	65,719	<i>(20.1)</i>	<i>36.2</i>
Power machinery	82,334	62,443	144,777	103,160	65,736	168,896	91,936	<i>(10.9)</i>	<i>39.9</i>
Unit selling cost	(1,431)	(1,454)	(1,441)	(1,226)	(1,165)	(1,203)	(1,203)	<i>(1.9)</i>	<i>3.2</i>

Source: Company, ABCI Securities



Outlook 2012

Following the economic recovery and the gradual relaxing monetary environment, the sales of the Group is expected to regain in 2HFY12. The Group is the leading agricultural tractors and agricultural diesel engines manufacturer in China. By leveraging on its strong market position, we believe the Group can fully capture the growth of agricultural machinery industry.

The FAI growth of agricultural and fishery industries outpaced the average FAI growth in China. With the favorable policies on “agricultural, rural area and farm”, we expect more subsidies will be injected in agricultural mechanization development. We estimate the total subsidies for agricultural machinery will increased from Rmb17.5bn in 2011 to Rmb20.0bn in 2012.

After issuing new share in A-share market in July 2012, net proceeds of Rmb770mn was injected to the Group. We estimate 72.5% of the net proceeds will be spent on R&D and component and parts manufacturing for vertical integration. It will bring a higher profitability to the Group via improving the GPM of its products.

Long run benefited from the agricultural mechanization in China

Although the tractors market was suffering a sales decline in 1H12, we expect the government subsidies for agricultural machinery will back on track in 2H12, and the sales of the Group will rebound in 2H12. In long run, the labor shortage in China is main driver of urbanization. The urbanization in China creates demand for agricultural machinery such that the working efficiency will increase to offset the drop of rural workforce input as a percentage of total population in China. The Group benefits from the growth trend of agricultural development in long run.

Initiate “Buy” rating with TP: HK\$6.83

We estimate the net income of the Group is Rmb433mn (EPS: Rmb0.470) in FY12 and Rmb595mn (EPS: Rmb0.597) in FY13. First Tractor is trading at 10.2x FY12E PE, which is below the peers’ mean at 12.6x FY12E PE (about the same as weighted average of peers’ at 10.1x). **Our target price of HK\$6.83 is based on 9.3x of FY13E EPS** of which 9.3x is the mean of PE of the Group minus 1 standard deviation in the past five years. We believe the valuation is justified as the government subsidies are subject to change. Compared with the current price at HK\$5.92, we estimate the upside gain was 15.4% in the next 12-month. **We initiate “Buy” rating to First Tractor.**

Valuation comparison against closest peers

We classify the closest peers of the Group are Deere & Co (DE US), Mahindra & Mahin (MM IN), Escorts (ESC IN) and China Yuchai (CYD US). All of them have agricultural machinery manufacturing businesses in China. Their weighted average FY12E PE is 11.2x, which is higher than that of the Group at 10.2x.

The H-share of the Group is trading at 42.1% discount on its A-share. Although A-share market and H-share market cannot directly comparison, it reflects that A-share investors are bullish on this stock.



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

First Tractor Company Limited

Peer Group Valuation

Peer group valuation

Company	Ticker	MKT CAP (HKD mn)	Share Price	PE (x)		EPS Change (%)		ROE (%)	
				Current Year	Next Year	Current Year	Next Year	Current Year	Next Year
ZOOMLION HEAVY-H	1157 HK	82,025	HK\$ 9.03	6.32	5.19	11.62	21.85	21.94	21.05
LONKING HOLDINGS	3339 HK	5,650	HK\$ 1.32	7.33	4.64	(63.58)	57.86	9.50	13.80
FIRST TRACTOR-H	38 HK	8,419	HK\$ 5.92	10.2	8.1	(3.2)	27.0	11.0	14.0
SANY HEAVY EQUIP	631 HK	13,217	HK\$ 4.25	11.7	9.8	19.2	19.5	16.1	16.9
WEICHAI POWER-H	2338 HK	48,871	HK\$ 21.15	9.5	8.0	(26.4)	19.0	15.1	15.7
Weighted Average				8.0	6.6	(3.0)	22.3	18.3	18.4
SANY HEAVY INDUS	600031 CH	94,959	RMB 10.22	**	**	**	**	**	**
ZOOMLION HEAVY-A	000157 CH	82,025	RMB 9.00	7.7	6.3	11.6	21.9	21.9	21.1
XCMG CONSTRUCT-A	000425 CH	28,798	RMB 11.41	6.8	5.9	2.1	15.6	26.2	23.7
GUANGXI LIUGONG	000528 CH	12,860	RMB 9.34	11.4	9.0	(30.0)	27.2	12.1	12.7
FIRST TRACTOR -A	601038 CH	8,419	RMB 8.31	17.7	13.9	(3.2)	27.0	11.0	14.0
TAIYUAN HEAVY-A	600169 CH	10,173	RMB 3.43	22.3	18.6	(4.4)	19.5	6.8	7.7
SHANTUI CONST-A	000680 CH	7,399	RMB 5.31	26.6	16.6	(52.4)	60.0	3.0	4.9
XIAMEN XGMA-A	600815 CH	7,058	RMB 7.22	12.0	12.0	(18.4)	(0.7)	11.0	10.0
ANHUI HELI CO-A	600761 CH	5,277	RMB 8.39	11.1	9.2	1.2	20.7	13.5	13.9
SUNWARD INTELL-A	002097 CH	4,125	RMB 8.00	26.2	18.2	(36.9)	44.3	7.0	9.3
Weighted Average				9.8	7.9	3.4	22.6	26.1	23.9
CATERPILLAR INC	CAT US	446,375	US\$ 88.10	9.2	8.4	25.9	9.1	39.1	34.1
DEERE & CO	DE US	237,611	US\$ 78.22	10.0	9.3	16.3	7.4	39.3	34.5
CUMMINS INC	CMI US	148,522	US\$ 100.57	10.5	9.5	0.3	10.5	30.3	27.2
CNH GLOBAL NV	CNH US	78,533	US\$ 42.24	9.3	8.8	15.6	6.0	12.1	11.0
TEREX CORP	TEX US	19,875	US\$ 23.36	12.0	9.0	373.4	33.4	10.1	12.7
MANITOWOC CO	MTW US	14,665	US\$ 14.30	17.2	10.2	(1,136.3)	68.6	20.5	27.0
CHINA YUCHAI	CYD US	3,784	US\$ 13.09	5.8	5.2	(35.0)	11.9	9.1	9.6
Weighted Average				9.8	8.9	7.7	10.1	34.5	30.6
VOLVO AB-B	VOLVB ST	222,528	SEK 89.40	11.0	9.6	(7.5)	14.7	18.6	19.1
ATLAS COPCO-A	ATCOA ST	215,286	SEK 154.90	13.4	13.0	8.1	3.0	42.1	35.1
SANDVIK AB	SAND ST	136,357	SEK 93.00	11.4	10.7	76.5	6.6	27.9	25.7
Weighted Average				12.0	11.1	18.3	8.4	29.6	26.7
HITACHI LTD	6501 JP	210,457	JPY 458	7.6	9.6	(21.4)	(20.8)	16.8	11.4
KOMATSU LTD	6301 JP	160,042	JPY 1,643	8.8	8.6	7.6	2.1	18.5	16.1
TADANO	6395 JP	7,314	JPY 570	41.7	14.5	(44.8)	187.6	2.3	6.3
Weighted Average				8.8	9.3	(9.6)	(7.1)	17.3	13.3
DOOSAN HEAVY	034020 KS	43,779	KRW 60,200	9.7	7.6	224.6	26.9	15.1	16.5
HYUNDAI HEAVY	009540 KS	124,531	KRW 238,500	8.0	7.9	(6.0)	0.6	11.8	12.5
Weighted Average				8.4	7.9	54.0	7.4	12.6	13.5
MAHINDRA & MAHIN	MM IN	65,822	INR 766.45	15.7	13.8	(8.1)	13.9	21.1	19.3
ESCORTS LTD	ESC IN	912	INR 61.75	6.4	4.7	(30.0)	36.7	5.5	7.1
Weighted Average				15.6	13.6	(8.4)	14.2	20.9	19.1
Weighted Average				10.1	9.3	9.1	9.1	27.2	24.3
Median				10.4	9.1	(3.2)	19.5	15.1	14.9

** : We are restricted to provide forecast of Sany Heavy Industry (600031 CH) and please refer to the disclosure in the back page.

Source: Bloomberg, ABCI Securities estimates (The data in the table is as at 10-September-2012)



Financial Statements Projection

Consolidated income statements forecast

FY ended Dec 31 (Rmb mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue	10,266	11,329	11,206	13,202	17,893
Agricultural machinery	8,141	9,356	9,398	10,949	15,318
Power machinery	1,225	1,470	1,234	1,546	1,669
Other machinery	855	437	480	582	706
Financial operations	45	66	94	125	200
Cost of sales	(8,749)	(9,769)	(9,614)	(11,235)	(15,236)
Gross profit	1,517	1,559	1,592	1,967	2,657
Other income and gains	170	68	60	65	65
Selling and distribution	(368)	(360)	(337)	(399)	(514)
Administrative expenses	(646)	(677)	(715)	(841)	(1,079)
EBIT	673	590	600	792	1,129
Finance costs	(28)	(54)	(67)	(69)	(70)
Associates	1	-	-	-	-
Pre-tax profit	646	536	533	723	1,059
Profits tax	(84)	(79)	(75)	(101)	(148)
Minority interests	(20)	(47)	(26)	(27)	(28)
Net profit	543	411	433	595	883

Source: Company, ABCI Securities estimates

Income statement key ratios forecast

FY	FY10A	FY11A	FY12E	FY13E	FY14E
Sales mixed (%)					
Agricultural machinery	79.3	82.6	83.9	82.9	85.6
Power machinery	11.9	13.0	11.0	11.7	9.3
Other machinery	8.3	3.8	4.3	4.4	3.9
Financial operations	0.5	0.6	0.8	1.0	1.2
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratios (%)					
Gross profit margin	14.8	13.8	14.2	14.9	14.8
EBIT margin	6.6	5.2	5.4	6.0	6.3
Pre-tax margin	6.3	4.7	4.8	5.5	5.9
Net margin	5.3	3.6	3.9	4.5	4.9
Selling & distribution cost / revenue	(3.6)	(3.2)	(3.0)	(3.0)	(2.9)
Admin cost / revenue	(6.3)	(6.0)	(6.4)	(6.4)	(6.0)
Effective tax rate	13.0	14.7	14.1	14.0	14.0
Growth (%)					
Revenue	14.0	10.3	(1.1)	17.8	35.5
Gross profit	17.9	2.8	2.1	23.6	35.1
EBIT	73.0	(12.3)	1.7	32.0	42.6
Net income	118.3	(24.3)	5.4	37.3	48.5

Source: Company, ABCI Securities estimates



Consolidated balance sheets forecast

As of Dec 31 (Rmb mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Non-current assets	2,463	3,118	3,379	3,785	4,297
Property, plant and equipment	1,831	2,064	2,323	2,762	3,170
Intangible assets	-	62	63	63	63
Investment properties	35	34	36	37	39
Other non-current assets	389	273	282	259	371
Current assets	6,155	6,369	7,241	7,835	9,550
Cash and equivalent	1,183	1,389	2,480	2,068	2,807
Restricted cash	180	123	130	136	143
Trade and other receivables	1,656	2,486	2,632	3,035	3,155
Inventories	1,377	1,111	1,155	1,616	2,141
Other	1,759	1,260	844	980	1,304
Total assets	8,618	9,487	10,620	11,620	13,847
Current liabilities	4,262	5,355	5,909	6,695	8,590
Trade and other payables	2,998	2,987	3,421	3,953	5,577
Borrowings	426	969	949	1,049	1,149
Other	838	1,399	1,539	1,693	1,864
Non-current liabilities	811	356	586	536	486
Borrowings	600	186	386	336	286
Other	211	170	200	200	200
Total liabilities	5,073	5,711	6,495	7,231	9,076
Minority Interest	393	452	453	452	452
Shareholders' equity	3,152	3,324	3,672	3,937	4,319

Source: Company, ABCI Securities estimates

Balance sheets key ratios forecast

FY	FY10A	FY11A	FY12E	FY13E	FY14E
Balance sheet ratios					
Current ratio (x)	1.4	1.2	1.2	1.2	1.1
Quick ratio (x)	1.1	1.0	1.0	0.9	0.9
Cash ratio (x)	0.3	0.3	0.4	0.3	0.3
Total receivable turnover days	60.8	84.0	105.2	98.6	82.2
Trade & bill receivables turnover days	44.6	63.6	80.0	75.0	60.0
Total payable turnover days	111.9	111.8	121.6	119.8	114.1
Trade & bill payables turnover days	78.4	78.8	90.0	90.0	90.0
Inventory turnover days	50.8	46.5	43.0	45.0	45.0
Total debt / equity ratio (%)	32.6	34.7	36.4	35.2	33.2
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROAA	7.3	4.5	4.3	5.3	6.9
ROAE	18.1	12.7	11.0	14.0	19.3
Payout ratio	31.2	-	30.0	30.0	30.0
Per share data (Rmb)					
EPS	0.642	0.486	0.470	0.597	0.887
BVPS	3.726	3.856	3.919	3.890	4.274
DPS	0.200	-	0.141	0.179	0.266

Source: Company, ABCI Securities estimates



Consolidated cash flow statements forecast

YE Dec 31 (Rmb mn)	FY10A	FY11E	FY12E	FY13E	FY14E
Profit before income tax	646	536	533	723	1,059
Depreciation and amortization	158	138	155	178	227
Change in working capital	(134)	43	244	(332)	979
Income tax paid	(95)	(76)	(72)	(98)	(143)
Others	(114)	(6)	(293)	(249)	(567)
Net cash from operating activities	461	635	567	222	1,555
Capex	(871)	(398)	(404)	(606)	(626)
Other	(153)	(367)	(21)	52	(64)
Net cash from investing activities	(1,024)	(765)	(425)	(554)	(690)
Capital injection	-	-	770	-	-
Net debt financing	419	955	180	50	50
Dividend payout	(206)	(74)	-	(130)	(178)
Others	358	(617)	-	-	1
Net cash from financing activities	571	264	950	(80)	(127)
Net change in cash	8	134	1,092	(412)	738
Cash at the beginning of the year	1,260	1,363	1,389	2,480	2,068
Adjustment	95	(108)	(1)	-	1
Cash at the end of the year	1,363	1,389	2,480	2,068	2,807

Source: Company, ABCI Securities estimates

Risk factors

Concentration of product type

The Group focuses on the agricultural tractors manufacturing business segment which accounted by 64.9% in FY11. The sales performance of tractors is cyclical and strongly subject to government subsidies and economic growth in China. If the government withdraws, reduces, postpones or changes the terms of subsidies, demand for agricultural tractors will be affected and the business performance of the Group will subsequently be affected.

Financial and liquidity risk

The trade and bill receivables turnover days increased from 63.6 days in FY11 to 77.3 days in 1HFY12. The inventory turnover days decreased from 46.5 days in FY11 to 37.4 days in 1HFY12. The trade and bill payables turnover days decreased from 78.8 days in FY11 to 73.8 days in 1HFY12.

We see the cash conversion cycle of the Group lengthened in 1HFY12 under the business expansion period. But the cash conversion cycle of the Group is shorter than that of other machinery makers.

Cash conversion cycle of First Tractor and peers in FY11

	Total Receivables Turnover (day)	Inventory Turnover (day)	Total Payables Turnover (day)	Cash Conversion Cycle (day)
First Tractor	84.0	46.5	111.8	18.7
Lonking	138.2	152.1	145.2	145.1
Sany	74.0	78.2	119.2	33.0
Zoomlion	222.4	106.8	212.8	116.4
XCMG	104.4	88.1	124.0	68.5
Liugong	110.5	113.9	114.0	110.4

Source: Companies data

Concentration of customers and suppliers

The five largest customers and suppliers of the Group respectively accounted for less than 30% of the sales and total purchase of the Group in FY11.

None of the Directors, Supervisors, their associates or any shareholder of the Group, who own 5% or above of the share capital of the Company, had an interest in the major customers of the Group in FY11.






Product and market development risks

The Group is going to develop more high-power products to meet the anticipated market demand in the future. Part of the net proceeds issued from the A-share market is to finance R&D and new product development. The increase in R&D expenses is inevitable and will have negative impact to the Group's profitability in the short-term. The new product development also incurs risk. The anticipated demand for new products in the future is also subject to market risk.



Appendix I – Major Products Analysis of First Tractor

Major products of First Tractor

Product	Key Features	Sample model
Agricultural Tractors	It is designed to deliver a high tractive effort at slow speeds, for the purposes of hauling a trailer or machinery used in agriculture. It is a farm vehicle that provides the power and traction to mechanize agricultural tasks, especially tillage. Agricultural implements may be towed behind or mounted on the tractor, and the tractor may also provide a source of power if the implement is mechanized.	
Hi-powered Tractors	Horsepower: 70 – 220 Price range: Rmb66,100 – Rmb508,000 ASP in FY11: Rmb81,500 Sales volume in FY11: 47,633 units	
Mid-powered Tractors	Horsepower: 32 – 70 Price range: Rmb13,400 – Rmb87,200 ASP in FY11: Rmb37,600 Sales volume in FY11: 34,880 units	
Low-powered Tractors	Horsepower: 16 – 32 Price range: Rmb8,600 – Rmb36,500 ASP in FY11: Rmb11,800 Sales volume in FY11: 45,678 units	
Crawler Tractors	Horsepower: 18 – 120 Price range: Rmb77,000 – Rmb24,950 ASP in FY11: Rmb118,000 Sales volume in FY11: 2,325 units	
Diesel Engine	Diesel engine is an internal combustion engine that uses the heat of compression to initiate ignition to burn the fuel, which is injected into the combustion chamber. The Group provides diesel engine for high end agricultural machineries, such as hi-power tractors and harvest machineries. Price range in FY11: Rmb4,800 – Rmb56,000 ASP in FY11: 12,200 Sales volume in FY11: 168,896 units - Internal sales: 54,360 units - External sales: 114,536 units	

Source: Company data



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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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