

Key Data

Share price (HK\$)	1.89
Target price (HK\$)	1.48
Upside potential (%)	-21.7
52Wk H/L(HK\$)	3.50 / 1.01
Issued shares (mn)	4,280
Share market cap (HK\$m)	8,089
30-day avg vol (HK\$m)	78.8
Major shareholder (%): Li San Yim and spouse	55.69

Source: Company, Bloomberg, ABCI Securities

Sales breakdown in 1HFY12 (%)

Wheel loader	67.9
Excavator	11.2
Fork lift	8.9
Others	11.9

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	40.6	34.6
3-mth	27.6	16.7
6-mth	(27.6)	(32.4)

*Relative to Hang Seng Index

Source: Bloomberg

1 year price performance



Source: Bloomberg

Analyst

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Previous report
Date: 3 October 2012
Rating: Sell
Target price: HK\$1.01

Lonking (3339 HK) – Sell Construction & Farm Machinery Industry

Falling sales and losing market share

The counter has rebounded sharply last two months on the expectations of business recovery. After we discussed with the Group in respect of its financial status and the business cycle of wheel loader market, we maintain our cautious attitude on its business outlook. Our analysis indicates its recovery pace is slow and will come later than market expected. Business turnaround may happen after 1QFY13. We revise up its TP from HK\$1.01 to HK\$1.48 due to the anticipated business recovery in mid-13. However, downside risk remains high.

Expect margin further contract. Total sales volume of wheel loader in China declined by 28.5% YoY in 1-9M12, according to CCMA. After we had discussed with the Group, we revise down the GPM of the Group by 1.9ppts from 22.5% to 20.6% in FY12 mainly due to the weak demand for wheel loader, which is its key product and contributed 79.5% of its total gross profit in FY12. Moreover, ASP is under downward pressure. We estimate that its sales revenue and gross profit of wheel loader segment will decline by 26.8% YoY and 35.0% YoY, respectively in FY12.

Take a longer time to recover. Although Premier Wen Jiabao reiterates to increase infrastructure spending during his opening speech on 18th Congress, we believe that the Group needs to take a longer time to recover. Owing to its highly leveraged financial position (est. net debt/equity of 59.9% at end FY12), the Group is hard of offer competitive credit terms to customers and it is losing market share to peers subsequently. We estimate that the market share of the Group drops from 18.1% at end-2011 to 15.1% as of end-3Q12.

Maintain “Sell” rating. Although we revise up its earnings forecasts for FY13 and FY14, because of the expectation on the recovery of wheel loader market next year. The new target price of HK\$1.48 represent of 6.2x FY13 EPS at ROAE of 11.8%, implying 21.7% downside risk. We maintain “Sell” rating to the Group.

Risk factors: Prolong weakening construction industry; Losing market share to peers; Credit and liquidity risk.

Forecast and Valuation

FY ended Dec 31	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue (Rmb mn)	12,020	12,720	9,310	11,318	13,940
Chg (%YoY)	74.2	5.8	(26.8)	21.6	23.2
Net Income (Rmb mn)	1,766	1,730	496	832	953
Chg (%YoY)	120.8	(2.1)	(71.3)	67.5	14.6
EPS (Rmb)	0.413	0.404	0.116	0.194	0.223
Chg (%YoY)	120.8	(2.1)	(71.3)	67.5	14.6
PE (x)	-	3.8	13.2	7.9	6.9
PB (x)	-	1.03	0.97	0.90	0.82
Yield (%)	-	7.9	2.3	3.8	4.3
ROAA (%)	15.2	11.7	3.2	5.3	5.7
ROAE (%)	39.1	29.7	7.5	11.8	12.4
Net debt/total equity (%)	57.1	55.1	59.9	34.5	24.0

Source: Company, ABCI Securities estimates

Growth spread of sales volume growth of wheel loader of Lonking and the industry

The spread = (growth of total market sales volume of wheel loader in China) – (Growth of the sales volume of wheel loader of the Group). The spread fell below zero most of the time since 2011.

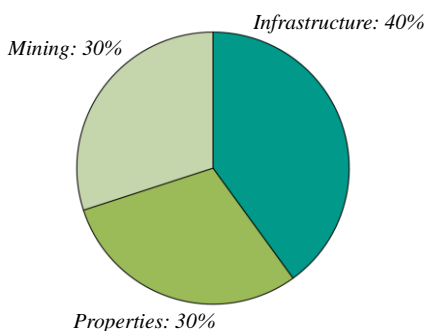
It reflected that the Group declined at a faster way compared with the average of peers'. The market share of the Group is reducing toward its competitors. We estimate that the market share of the Group drops from 18.1% at end-2011 to 15.1% as of end-3Q12.



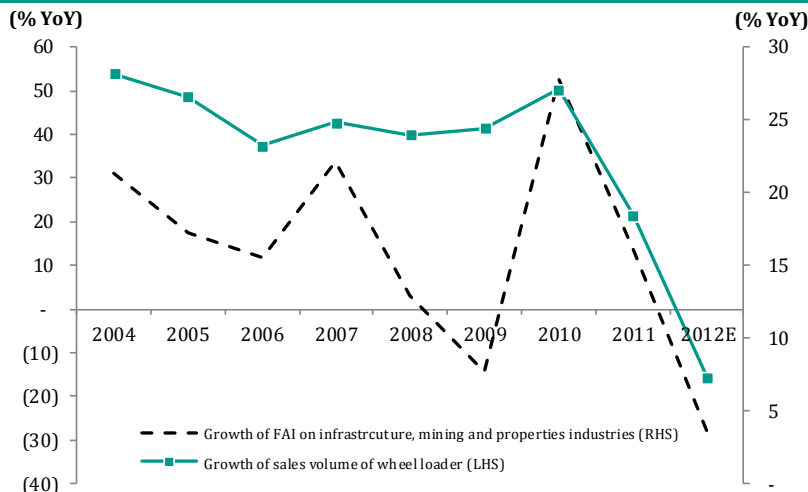
Source: CCMA, ABCI Securities

Relationship between growth of sales of wheel loader and FAI on infrastructure, mining and properties industry

Infrastructure construction, properties construction and mining uses are the three major sources of demand for the Group's wheel loader, of which we estimate that they contribute 40%, 30% and 30% of the total revenue in FY12, respectively.



Properties: 30%



Source: CCMA, National Bureau of Statistics of China, ABCI Securities estimates

We see a positive relationship between the growth of FAI on infrastructure, properties & mining and the growth of sales of wheel loader.

Major changes of our forecast

	FY12E			FY13E			FY14E		
	Previous	New	Chg (%)	Previous	New	Chg (%)	Previous	New	Chg (%)
Revenue (Rmb mn)	9,310	9,310	-	10,423	11,318	8.6	12,064	13,940	15.6
Wheel loaders	6,194	6,194	-	6,771	7,656	13.1	7,775	9,626	23.8
Excavators	1,259	1,259	-	1,326	1,326	-	1,432	1,432	-
Forklifts	833	833	-	1,082	1,082	-	1,353	1,353	-
Road rollers	160	160	-	201	201	-	243	243	-
Other machineries	767	767	-	920	920	-	1,104	1,104	-
Financial lease income	97	97	-	133	133	-	182	182	-
Gross profit (Rmb mn)	2,095	1,915	-8.6	2,287	2,429	6.2	2,680	2,945	9.9
GPM (%)	22.5	20.6	-1.9ppts	21.9	21.5	-0.5ppts	22.2	21.1	-1.1ppts
Net income (Rmb mn)	630	496	-21.3	692	832	20.2	914	953	4.2
Net margin (%)	6.8	5.3	-1.4ppts	6.6	7.4	0.7ppts	7.6	6.8	-0.7ppts
EPS (Rmb)	0.147	0.116	-21.2	0.162	0.194	20.1	0.214	0.223	4.2
BVPS (Rmb)	1.599	1.578	-1.4	1.713	1.714	0.1	1.863	1.870	0.4
DPS (Rmb)	0.044	0.035	-21.2	0.049	0.058	20.1	0.064	0.067	4.2

Source: ABCI Securities estimates

Half-year results of the Group

	1HFY10	2HFY10	1HFY11	2HFY11	1HFY12	2HFY12E
Revenue (Rmb mn)	6,566	5,454	8,398	4,322	4,724	4,586
Gross Profit	1,656	1,771	2,201	1,012	978	937
GPM (%)	25.22	32.47	26.21	23.42	20.70	20.43
Major cost (Rmb mn)						
Selling and distribution cost	(395)	(222)	(385)	(208)	(211)	(182)
General Administrative cost	(115)	(132)	(139)	(155)	(132)	(129)
Net finance cost	(86)	(110)	(165)	(202)	(219)	(124)
Cost / revenue ratio (%)						
Selling and distribution cost	-6.02	-4.06	-4.58	-4.81	-4.47	-3.98
General Administrative cost	-1.75	-2.42	-1.66	-3.60	-2.79	-2.80
Net finance cost	-1.31	-2.02	-1.96	-4.68	-4.64	-2.70
Net profit before MI (Rmb mn)	926	841	1,154	576	276	220
Net profit (Rmb mn)	926	840	1,154	576	276	220
Net profit margin (%)	14.10	15.41	13.74	13.32	5.84	4.80
Growth (%)						
Revenue			27.90	(20.76)	(43.75)	6.11
Net profit			24.62	(31.51)	(76.08)	(61.77)

Source: Company, ABCI Securities estimates

Disclosures

Analyst Certification

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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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