



Key Data

Share price (27/7/2012)	HK\$1.49
Target price	HK\$1.55
Upside potential	4.0%
52Wk H/L(HK\$)	4.05 / 1.23
Issued shares (mn)	4,280
Market cap (HK\$mn)	6,377
30-day avg vol (HK\$mn)	31.3
Auditors	Ernst & Young
Major shareholder:	
Li San Yim and spouse	55.69%

Source: Company & Bloomberg

Revenue breakdown (%)

Wheel loader	69.7
Excavator	13.5
Forklift	7.3
Others	9.5

Source: Company

*Based on FY11 results

Share performance

	Absolute	Relative*
1-mth	-29.9%	-29.6%
3-mth	-52.1%	-47.4%
6-mth	-56.4%	-52.8%

Source: Bloomberg

*Relative to Hang Seng Index

1 year price performance



Source: Bloomberg

Report Date: 31 July, 2012

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Lonking (3339) – HOLD (Initiation)
12-month target price at HK\$1.55

Conservative wheel loader maker in tough environment

Lonking, a market leader in wheel loader segment, suffered from the slowdown of construction activities in infrastructure industry in 1H12. Although we observe the recovery signals of the industry, our analysis indicates the Group's sales take longer time to regain growth momentum. Its high gearing ratio implies higher chance to look for equity finance and to have earnings dilution risk in 2H12. Its valuation is bargain but the counter lacks upside catalyst in the short-term.

Sales dropped on product demand tumble. As over 80% of its total revenue generated from the sales of wheel loaders and excavators, which the overall market sales volume plunged by 25.6% YoY and 36.9% YoY for the 1H12 respectively, a poor results are expected in 1HFY12. Even worse, industry statistics showed the Group is losing its market share in wheel loader segment. We predict its sales to decline by 40% YoY for 1HFY12.

Financial position worsens. Its net gearing ratio ("Net debt/total equity") was 55.1% high at end of FY11 and its interest expenses accounted for 3.1% of revenue. Although the PBOC has cut the lending interest rates twice this year, we anticipate its interest coverage ratio ("EBIT/interest cost") to drop from 6.2x at end of FY11 to 4.2x at end of FY12. To maintain solvency of the business operation, the group deliberately constrains its sales growth or seeks equity finance.

Recovery is hindered. The high gearing hinders the Group to fully capture the market recovery expected to start in 2H12. We estimate revenue and net income will tumble by 25.3% and 44.2% YoY in FY12, respectively, since we expect the Group will take a longer period to recover the sales decline compared with the market leading construction machinery manufacturers, such as Zoomlion (1157 HK, BUY).

Its share price has been down 40% in 3 months, the counter is trading at 5.4x FY12E PE. Our 12-month target price of HK\$1.55 is based on 5.6x of our FY12E EPS, 40% discount to the mean of peers'. We believe this valuation is justified as its EPS will plunge 44.2% YoY to Rmb0.225 in FY12 and it takes a longer time to recover. **We initiate Lonking with a "HOLD" rating.**

Results and forecast

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue (Rmb mn)	12,020	12,720	9,504	11,555	14,205
Chg (%YoY)	74.2	5.8	(25.3)	21.6	22.9
Gross Profit (Rmb mn)	3,427	3,213	2,327	2,876	3,600
Chg (%YoY)	111.8	(6.2)	(27.6)	23.6	25.2
Net Income (Rmb mn)	1,766	1,730	965	1,265	1,651
Chg (%YoY)	120.8	(2.1)	(44.2)	31.0	30.6
EPS (Rmb)	0.413	0.404	0.225	0.295	0.386
Chg (%YoY)	120.8	(2.1)	(44.2)	31.0	30.6
PE (x)	--	3.0	5.4	4.1	3.1
PB (x)	--	0.81	0.73	0.65	0.57
Yield (%)	--	10.1	5.6	7.3	9.6
ROAA (%)	15.2	11.7	6.1	7.8	9.3
ROAE (%)	39.1	29.7	14.3	16.8	19.3
Net gearing (%)	57.1	55.1	58.4	55.9	49.3

Source: Company data, ABCI Securities estimates

*We assume Rmb1 = HK\$1.23



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A Leading Wheel Loader Manufacturer in China

Focus on wheel loader manufacturing

Business composition of Lonking

Product	Contribution to revenue [^] (%)	Market share* (%)
Wheel loader	69.7	18.1
Excavator	13.5	2.3
Forklift	7.3	5.1
Others	9.5	

Source: Company, ABCI Securities

[^]: Based on FY11 revenue

*: In terms of sales volume of corresponding product segment in 2011

Lonking is one of the leading wheel loader makers in China. The wheel loader segment contributed 69.7% of Group's total revenue in FY11. According to the sales data from China Construction Machinery Association ("CCMA"), the total sales volume of Lonking was 44,602 units in FY11 with 18.1% of market share. The second and the third largest wheel loader makers were Liugong (000528 CH) and Shandong Lingong Construction Machinery Co ("SDLG", unlisted), which were possessing 17.7% and 15.8% of market share, respectively.

Lonking carries out the manufacturing activities mainly in Shanghai and Fujian Province. The Songjiang Plant in Shanghai serves as the headquarters and main manufacturing base and is strategically located in the Songjiang Industrial Zone, Shanghai, with easy access to major roads and railways connected to the national transportation systems.

The Group vertically integrated parts of the production chain. The mechanical components developed and manufactured by Lonking include axles and transmission, hydraulic cylinder, gear pump and tank piping. These components are critical components for wheel loaders.

Lonking has about 360 first-tier domestic sales agents and about 1,900 points of sales.

Other major products besides wheel loader

Besides wheel loaders, the Group manufactures excavators and forklifts as well. Excavator is the second largest segment of the Group, which contributed 13.5% of total revenue in FY11. The Group is a small player of this product segment, (market share of 2.3% in FY11). Its total sales volume of excavator was 3,995 units in FY11.

In order to diversify the business risk induced from the construction cycle in China, the Group strategically develops forklift manufacturing business. The portion of sales of forklifts to total revenue increased from 4.9% in FY10 to 7.3% in FY11. The market share of forklift of Lonking increased from 4.5% in FY10 to 5.1% in FY11. For more information on the major products of Lonking, please refer to Appendix I.

Geographical breakdown of revenue of Lonking in 2010-2011

Breakdown (%)	FY10	FY11	Chg (ppt)
Domestic market			
Northwest	12.6	15.4	2.8
Northern	19.7	29.4	9.7
Northeast	6.8	6.1	(0.7)
Southwest	12.3	13.4	1.1
Central	16.6	12.4	(4.2)
Eastern	12.6	10.6	(2.0)
Southern	11.3	7.3	(4.0)
Overseas market	4.7	4.0	(0.7)
Other income	3.4	1.4	(2.0)

Source: Company data



Industry Analysis

Sales of wheel loaders, excavators and forklifts accounted for 69.7%, 13.5% and 7.3% of total revenue of the group for FY11 respectively. In the short to medium terms, business performance of the group will be affected by the sales performance of these three product segments. In the following section, we will analyze the markets of these three product segments.

Wheel loader market

According to CCMA, the total sales volume of wheel loaders in China grew by CAGR of 25.2% from 20,857 units in 2000 to 246,604 units in 2011.

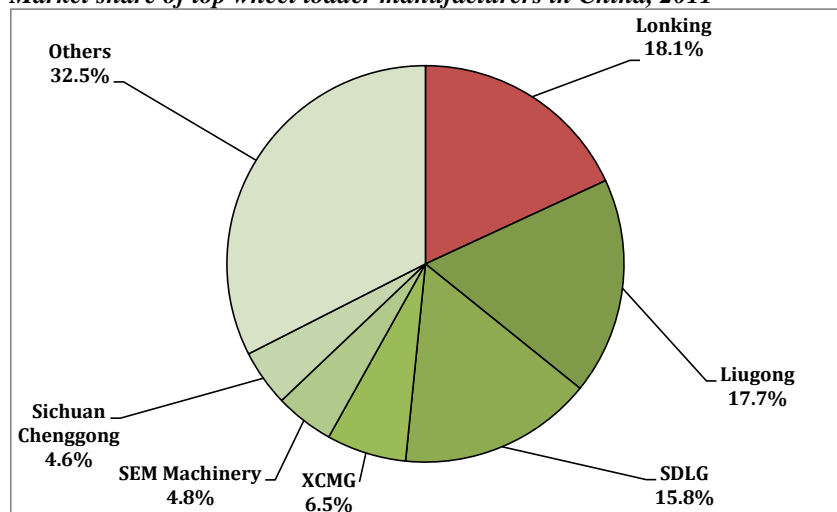
Wheel loader is one of the types of construction machinery for lifting, loading and carrying heavy loads during building, construction, mining or other industrial-related activities. They can be used in a wide array of industrial tasks, ranging from relatively simple and small scale construction work to industrial projects of high complexity.

Wheel loaders are also highly adaptable machinery that can be modified and upgraded to perform different industrial tasks ranging from road building and mining to building tunnels and other infrastructure projects. Hence, they can serve in a broad spectrum of the Chinese economy.

Competitive landscape

According to the CCMA, Lonking was the largest wheel loader manufacturer in China based on the sales volume in 2011. It captured 18.1% of market share in volume. However, we estimate its market share dropped to 16.0% in 1H12 based on the sales statistics from CCMA. The loss of market share of the Group may come from: 1) the conservative credit sales control of the Group; and 2) the improvement of competitors' product advancement lowering the competitive edge of the Group's.

Market share of top wheel loader manufacturers in China, 2011



Source: CCMA

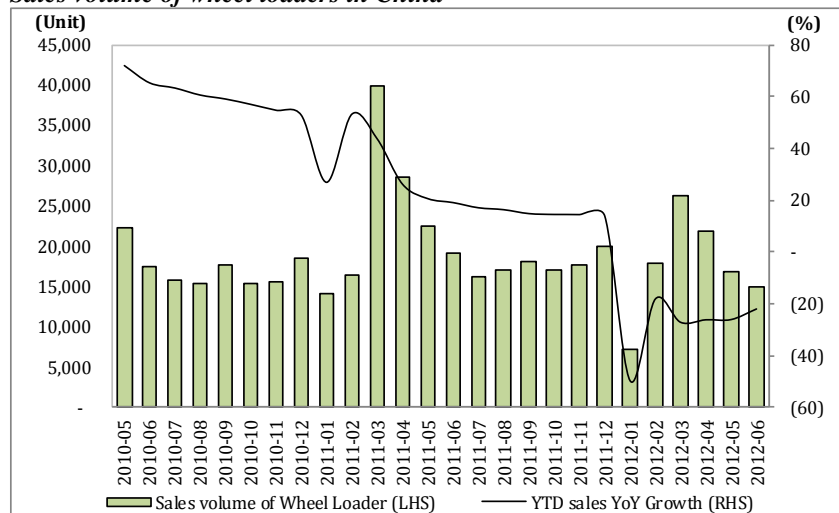


Market sales volume decline in 1H12

Due to the inflation-curbing policies in China, the monetary environment was tightened last year. The infrastructure construction projects slowed down, and the demand for the construction machineries, including wheel loaders, shrunk in 2H11 and 1H12. The total sales volume of wheel loaders in China for the 1H12 was 104,836 units, down 25.6% YoY.

The sales volume decline of Lonking was deeper than the market's. The estimated total sales volume of the Group, according to our channel check, was down 37.0% YoY in 1HFY12. We believe the deeper-than-market decline of Lonking is mainly due to its conservative business strategy, which made the Group to carry out a tighter credit control compared with its peers, and it eventually lost the market share to competitors. The other reason, which is the worst case, on such decline, is the improvement of competitors' product advancement which thinned the competitive edge of the Group. If that is the case, the market share of the Group would keep falling to the peer and the competitive landscape of wheel loader market will change and threaten the Group.

Sales volume of wheel loaders in China



Source: CCMA

Segment outlook 2012

The China's government has already launched efforts to stabilize the economy by 1) cutting interest rates twice since early June, 2) boosting bank lending and 3) approving more infrastructure projects. The PBOC announced that the one year lending interest rate benchmark was cut 25bps and 31bps on June 8, 2012 and July 5, 2012, respectively.

We expect that the growth of infrastructure construction will regain during 2H12. The demand for earth-moving machinery is expected to recover subsequently. However, under steep drop of sales in 1H12, we estimate that the full year sales growth will be negative in 2012.

As the high gearing and liquidity pressure of the Group, we believe Lonking is unable to fully capture the recovery of the market. It is expected that the Group needs to take a longer period to back on the long term growth track. For the detail of gearing and liquidity pressure, please refer to the chapter: "Financial Analysis and Projection"



Excavator market

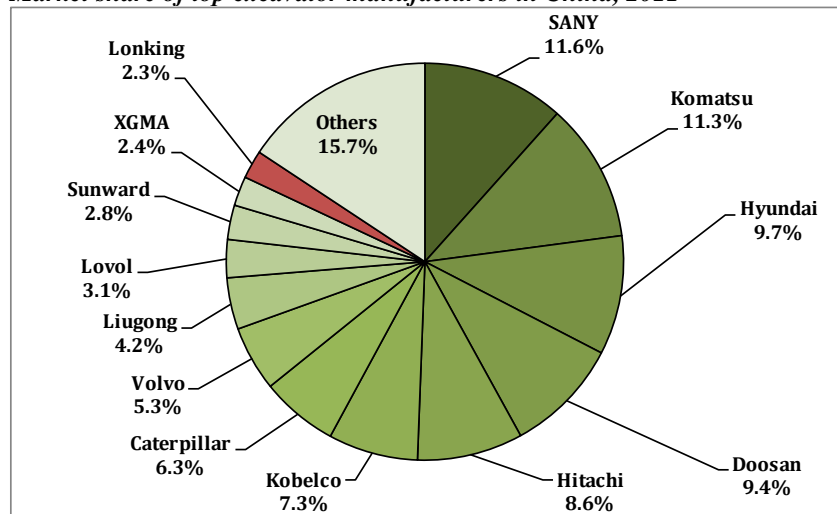
According to CCMA, the total sales volume of excavators in China increased at a CAGR of 32.6% from 7,926 units in 2000 to 176,074 units in 2011. However, sales volume of excavators was down 36.9% YoY in 1H12.

Excavators are highly versatile. Excavators are primarily used in earth moving applications such as foundation building and trench digging. By attaching different tools, however, excavators can be transformed for other uses including hoisting, pile driving, ramming, casting, assembly, crushing and demolition. They can also be used to lift heavy materials and objects when cranes are not available. Excavators are available in several designs, the most popular being hydraulic excavators.

Competitive landscape

Similar to the wheel loader market, the excavator market in China is competitive, which is dominated by Sany (600031 CH) and foreign companies, in particular Korean and Japanese companies such as Doosan, Komatsu, Hitachi and Hyundai Heavy Industry. Lonking is a small player on the market. The total sales volume of excavator of Lonking was 3,995 units in FY11, which represented 2.3% of market share in 2011.

Market share of top excavator manufacturers in China, 2011



Source: CCMA

Market sales volume decline in 1H12

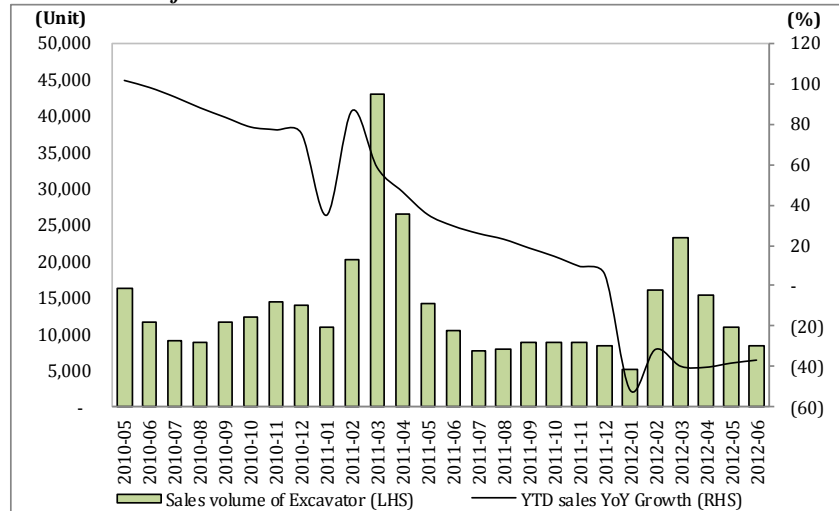
The excavator market was also suffering in 1H12. The total sales volume of excavators in China for the 1H12 was 79,041 units, down 36.9% YoY due to the machinery leasing agents delaying their purchases under tight monetary environment and the concern over the growth of downstream construction projects.

Segment outlook 2012

We expect that the market will start to regain in 2H12 after the recovery of infrastructure construction in China. However, under the keen market competition, we believe the Group, as a small player of the market, will not be the major beneficiary.



Sales volume of excavators in China



Source: CCMA

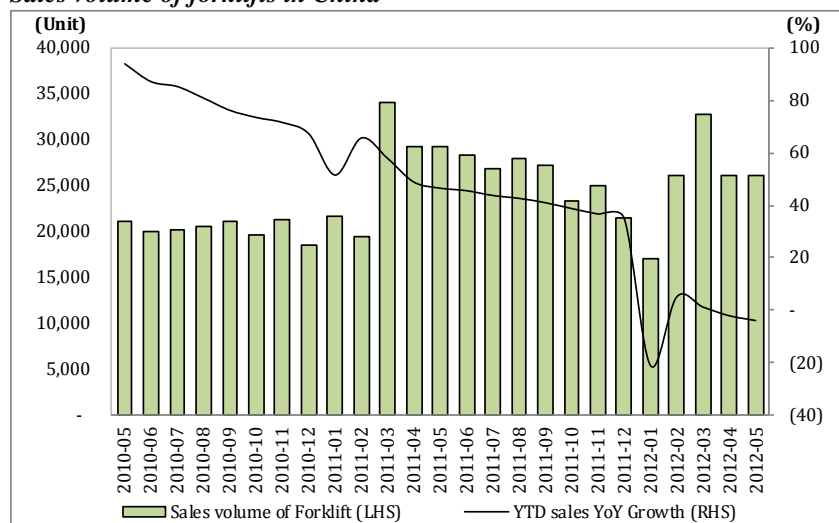
Forklift market

Unlike wheel loaders and excavators, forklifts are mainly used in the logistic industry. The Group intends to develop this business segment for the sake of diversifying the business risk on the construction cycle in China. Its sales volume of forklifts was 16,089 units in FY11, or 5.1% of market share based on sales volume in China.

The total sales volume of forklifts was 128,371 units in the first 5-month in China, edged down 3.9% YoY. We believe the drop is because of the logistic operators concern their sales growth in 2012 and 2013. The total trade of China was up 8.0% YoY in 1H12, decelerated from 25.8% YoY in 1H11, according to China Customs Statistics.

But the decline of sales volume of forklifts was far less than that of the construction machinery, such as excavators and wheel loaders.

Sales volume of forklifts in China



Source: CCMA



Downstream industries analysis

Both excavator and wheel loader are earth-moving machinery which not only used in construction industry, but also in the mining industry. According to the China Construction Machinery Business Online, the demand for construction machinery is the highest in the infrastructure, real estate and mining industries in China. In 2011, the infrastructure, real estate and mining industries accounted for approximately 72% of the total demand for construction machinery in China. We estimate the 40.0%, 30.0% and 40.0% of the Group's revenue was attributable to entities involved in infrastructure projects, real estate construction and coal mining operation, respectively. Although these three downstream industries are not related, they are capital-intensive and affected by the monetary and fiscal policy vitally.

Infrastructure construction industry

FAI situation in China

Growth (% YoY)	1H12	1H11
Infrastructure industry		
Roadway	0.0	12.0
Railway	(36.9)	3.5
Water engineering	15.0	25.4
Investment in real estate	16.6	32.9
Coal mining industry	23.1	21.2

Source: NBS

According to 12th 5-Year Plan for roadway construction released by Ministry of Transport of the PRC, the Ministry targets to have approximately 4.5mn km of roadway by 2015. The total length of roadway was 4.1mn km in 2011. We estimate that the total investment on construction for the additional length of roadway will grow at a CAGR of 14.0% from 2011 to 2015.

According to 12th 5-Year Plan for Railway Construction released by Ministry of Railway of the PRC, the Ministry targets to have approximately 120,000km of rail tracks in operation by 2015. After the railway industry opens up to private investment during 2Q12, the Ministry can raise funds via multiple channels to support its key investment projects. We believe that the growth of railway construction will regain in 2H12, and estimate the total investment on railway construction for the additional track will grow at a CAGR of 16.3% from 2011 to 2015.

According to the 12th 5-Year Plan for the Power Industry issued by China Electricity Council, the hydropower installed capacity across China was expected to increase from approximately 212 GW in 2011 to 300 GW by 2015. China's government planned to make investments in water engineering projects of approximately Rmb4,000bn in aggregate for the 10 years starting from 2011. We estimate the FAI on water engineering project will grow at a CAGR of 15.2% from 2011 to 2015.

Real estate industry

The investment on real estate industry increased at a CAGR of 25.4% from Rmb1,591bn in 2005 to Rmb6,174bn in 2011. We estimate the growth of the real estate construction in China is able to sustain under the urbanization and the economic growth in China. We estimate the growth of the real estate construction in China will grow at a CAGR of 20.0% from 2011 to 2015.

Coal mining operation

Demand for coal is remained high and stable in China. According to National Bureau of Statistics of China ("NBS"), the exploitation volume of coal in China was 3,754mn tons in 2011. China's government targets to enhance the mechanization rate to 75% by 2015 from 65% in 2010 under the guideline of 12th 5-Year Plan. We estimate that the exploitation amount is about 4.5bn tons in 2015, and the FAI for coal mining industry will grow to Rmb859bn in 2015, representing a CAGR of 15.1% from 2011 to 2015.



Profitability of Leading Construction Machinery Manufacturers

Profitability of leading construction machinery manufacturers

		2008	2009	2010	2011	Average
China GDP	Growth (% YoY)	9.0	8.7	10.3	9.2	9.3
		FY08	FY09	FY10	FY11	CAGR (FY08-11)
1157 HK	Revenue (Rmb mn)	13,548	20,762	32,193	46,323	50.7%
ZOOMLION	Gross profit (Rmb mn)	3,706	5,340	9,769	15,007	59.4%
	Net income (Rmb mn)	1,544	2,447	4,666	8,066	73.5%
	Gross profit margin (%)	27.4	25.7	30.3	32.4	
	Net margin (%)	11.4	11.8	14.5	17.4	
	ROAA (%)	9.7	8.6	9.6	12.0	
	ROAE (%)	35.5	39.0	26.8	25.7	
3339 HK	Revenue (Rmb mn)	6,145	6,901	12,020	12,720	27.5%
LONKING	Gross profit (Rmb mn)	1,174	1,618	3,427	3,213	39.9%
	Net income (Rmb mn)	666	800	1,766	1,730	37.5%
	Gross profit margin (%)	19.1	23.4	28.5	25.3	
	Net margin (%)	10.8	11.6	14.7	13.6	
	ROAA (%)	9.3	9.1	15.2	11.7	
	ROAE (%)	22.3	23.0	39.1	29.7	
38 HK	Revenue (Rmb mn)	7,934	9,005	10,132	11,329	12.6%
FIRST TRACTOR	Gross profit (Rmb mn)	825	1,287	1,463	1,560	23.6%
	Net income (Rmb mn)	69	249	542	458	88.3%
	Gross profit margin (%)	10.4	14.3	14.4	13.8	
	Net margin (%)	0.9	2.8	5.4	4.0	
	ROAA (%)	1.2	4.2	7.3	5.1	
	ROAE (%)	2.7	9.2	18.1	14.1	
600031 CH	Revenue (Rmb mn)	13,727	18,917	33,824	50,517	54.4%
SANY HEAVY INDUS	Gross profit (Rmb mn)	4,096	6,668	12,334	18,199	64.4%
	Net income (Rmb mn)	1,232	2,640	5,615	8,649	91.5%
	Gross profit margin (%)	29.8	35.2	36.5	36.0	
	Net margin (%)	9.0	14.0	16.6	17.1	
	ROAA (%)	9.8	14.6	21.0	20.9	
	ROAE (%)	23.3	35.8	55.4	55.8	
000425 CH	Revenue (Rmb mn)	15,840	20,618	25,126	32,850	27.5%
XCMG	Gross profit (Rmb mn)	2,920	3,909	5,364	6,708	32.0%
	Net income (Rmb mn)	1,496	1,741	2,926	3,379	31.2%
	Gross profit margin (%)	18.4	19.0	21.3	20.4	
	Net margin (%)	9.4	8.4	11.6	10.3	
	ROAA (%)	20.4	13.0	14.5	11.3	
	ROAE (%)	66.5	45.2	35.3	24.7	
000528 CH	Revenue (Rmb mn)	9,246	10,134	15,304	17,798	24.4%
GUANGXI LIUGONG	Gross profit (Rmb mn)	1,461	2,089	3,379	3,330	31.6%
	Net income (Rmb mn)	340	866	1,544	1,321	57.2%
	Gross profit margin (%)	15.8	20.6	22.1	18.7	
	Net margin (%)	3.7	8.5	10.1	7.4	
	ROAA (%)	6.3	10.9	11.0	6.4	
	ROAE (%)	13.4	25.7	24.6	14.9	

Source: Companies, Bloomberg, ABCI Securities



A comparable growth on revenue

The growth of revenue of the Group grew at a CAGR of 27.5% from FY08 to FY11. Although the growth rate of the Group was lower than that of the leading construction machinery manufacturers, such as Zoomlion at 50.7%, its growth was comparable with many of the peers, such as Liugong at 24.4% and XCMG at 27.5%.

A moderate profitability

The ROAA of the Group was 11.7% in FY11, which was lower than the leading players, such as Zoomlion at 12.0%, but higher than XCMG at 11.3% and Liugong at 6.4%.

Growth of the sector is expected to slowdown

The sector experienced a fast growth during 2008 to 2011 due to the strong economic growth in China. The average annual GDP growth during the period was 9.3%. However, due to the global economic downturn and the weakening export of China, the growth of manufacturing activities is slowing down. Furthermore, under the curbing policies toward the China properties market, the growth of the real estate construction was cooled down.

The GDP was up 7.6% YoY in 2Q12 in China. It is the slowest pace in three years. All these increase the uncertainties of the construction growth in the near future. We believe it is the main reason of which the downstream construction machinery leasing agents delay their purchases in FY12.

Besides, the fast growth in 2009 to 2010 of the construction machinery sector was distorted by the government economic stimulus policy with total amount of approx. Rmb4,000bn in 2009-10. Under the high-based effect, we expect the growth of the sector and Lonking will slow down in FY12.

Under the gradual relaxing monetary and the infrastructure construction recovery, we expect the sales to recover in FY13 and FY14.

Against this backdrop, we expect that the growth of the construction machinery sector, especially the earth-moving machinery (including wheel loader) sub-sector will decelerate from the fast growth stage to the trough and gradually regain to the sector's long term growth rate.

The sales and profitability pickup process of the Group will be a significant indicator showing how much competitive edge retained in the Group and how much market share of the Group is maintaining. This is one of the greatest uncertainties of the Group which need to take time to observe.

Financial Analysis and Projection

Revenue Analysis and Projection

The Group's revenue highly concentrated in the wheel loader segment. Therefore the cyclical downturn of wheel loader market adversely affects the sales performance of the Group. In order to lower the dependence on the wheel loader segment, it strategically diversifies into excavator segment and forklift segment. We estimate that revenue in FY12, FY13 & FY14 are Rmb9,504mn, Rmb11,555mn and Rmb14,205mn, respectively.

Revenue growth slowdown in FY11

Revenue of Lonking grew at a CAGR of 31.3% from Rmb5,309mn in FY07 to Rmb12,020mn in FY10. However, the growth on revenue slowed down in FY11 due to the cyclical downturn of the wheel loader market, which is the major product of the Group. The correlation on the growth of market sales volume and Lonking's sales volume on wheel loader are 94.7%

Contribution of wheel loader within the Group

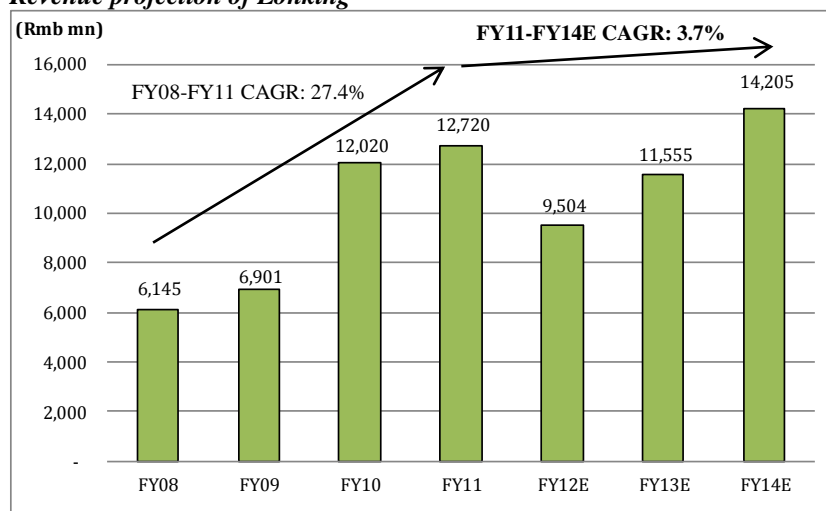
	Segment Revenue of Wheel Loader (Rmb mn)	Total Revenue of Lonking (Rmb mn)	Contribution of Wheel Loader (%)
2007	4,937	5,309	93.0
2008	5,262	6,145	85.6
2009	5,078	6,901	73.6
2010	8,343	12,020	69.4
2011	8,867	12,721	69.7

Source: Company data

The retreat takes time to recover

We estimate that total revenue of the Group will grow at a CAGR of 3.7% from FY11 to FY14, cooled down from 27.4% from FY08 to FY11. The slowdown of the sales growth is due to the high-base effect and the loss of market share in the wheel loader market.

Revenue projection of Lonking



Source: Company data, ABCI Securities estimate

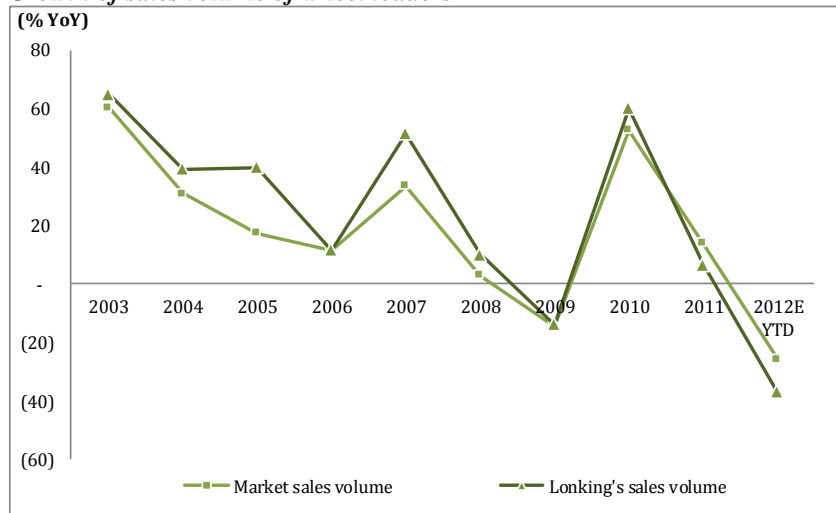


Wheel loader segment

Under the fast growth of infrastructure and real estate construction and the mechanization of coal mining industry in China, the sales volume of wheel loaders of Lonking surged from 4,845 units in 2002 to 42,886 units in 2011.

The sales volume of wheel loaders of Lonking grew at a CAGR of 27.4% from FY02 to FY11. It is faster than the market growth, which grew at a CAGR of 21.3% from 2002 to 2011.

Growth of sales volume of wheel loaders



Source: CCMA, Company data, ABCI estimate

According to CCMA, the total sales volume of the Group was 11,386 units in the first 4 months in 2012, which dropped 36.0% YoY from 17,788 units during the same period in 2011. The decline in sales of Lonking was severer than the market.

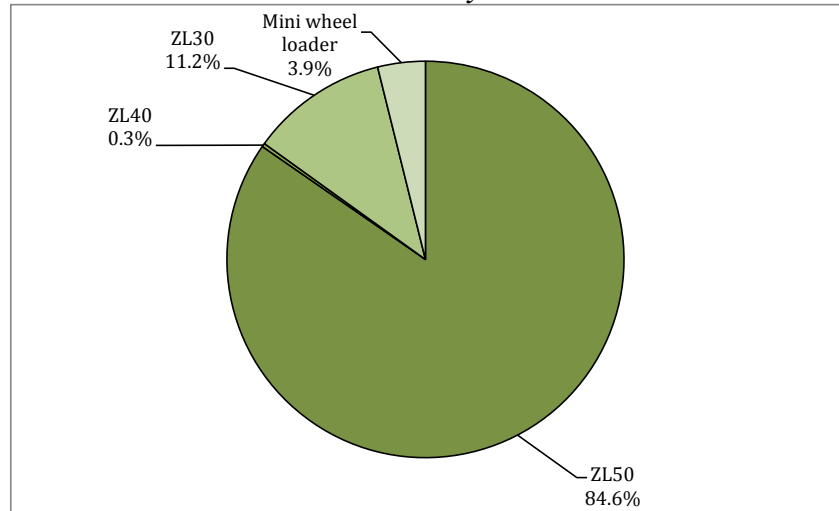
Although we believe the wheel loader manufacturing market will start to turn around during 2H12 under the monetary stimulation policy imposed by China's government, the recovery of sales of Lonking is expected to slower than the market due to the liquidity pressure which hindering the Group to fully capture the market recovery.

Within the wheel loader segment, the large-to-mid size wheel loaders ("ZL50" & "ZL40") contributed 84.9% of the segment revenue for the Group in FY11. The small ("ZL30") and mini-size wheel loaders provided 11.2% and 3.9% of the segment revenue in FY11, respectively.

As the relatively stable purchases behaviour of coal mining operators, which mainly consume large-size wheel loaders, we believe the sales volume drop of large-size wheel loaders of the Group will be milder than that of the small-size wheel loaders. We estimate that the sales volume of large-to-mid size wheel loaders will drop 18.7% YoY in FY12, while that of the small size wheel loaders will drop 29.0% YoY in FY12 and that of mini-size wheel loaders will drop 36.5% YoY in FY12.



Wheel loaders sales revenue breakdown by size in FY11

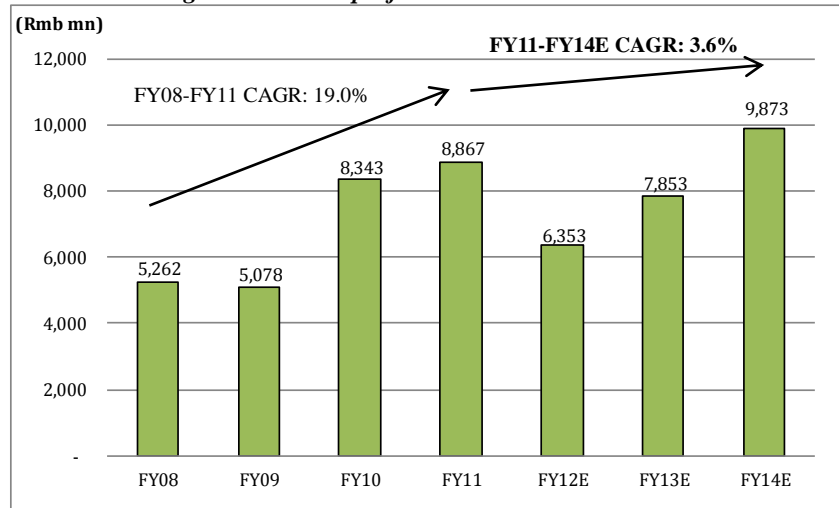


Source: Company data, ABCI Securities estimate

We project that the total sales volume of the Group was 34,585 units in FY12, 40,685 units in FY13 and 48,677 units in FY14. Under the keen market competition, we believe the Group will reduce the selling price to recapture the market share. We estimate that average selling price (“ASP”) of the Group will decrease in FY12, but gradually recover in FY13 and FY14 with the market demand.

Under these circumstances, we project that the wheel loader segment revenue of the Group is Rmb6,353mn in FY12, Rmb7,853mn in FY13 and Rmb9,873mn in FY14.

Wheel loader segment revenue projection



Source: Company data, ABCI Securities estimates

Wheel loader segment is the largest segment of Lonking, which contributing 69.7% of the total sales revenue in FY11. Under the product diversification of the Group, the contribution of wheel loader segment being replaced by excavator segment and forklift segment gradually since FY08. The contribution of wheel loader segment of the Group reduced from 85.6% in FY08 to 69.7% in FY11.



Excavator segment

The excavator segment was the second largest business segment of Lonking. However, the contribution of the segment decreased from 16.3% in FY10 to 13.5% in FY11.

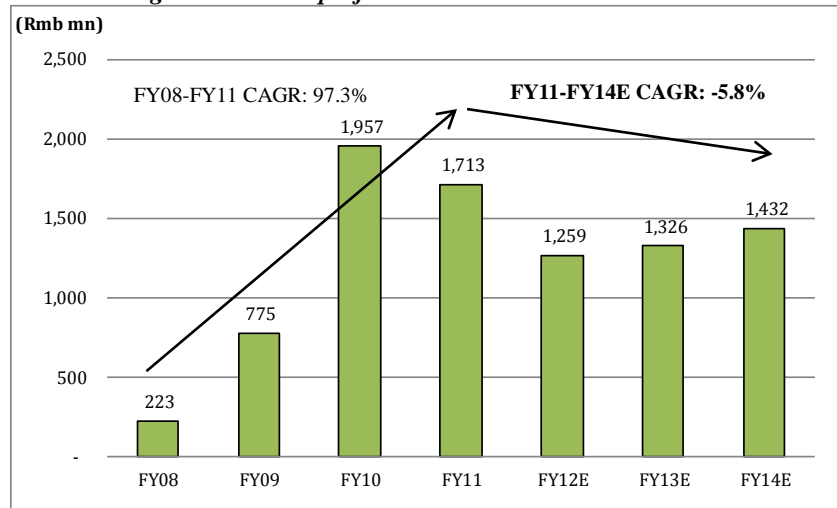
Under the keen market competition, the market share of Lonking dropped from 2.5% in FY10 to 2.3% in FY11. The segment revenue of the Group declined 12.4% YoY from Rmb1,957mn in FY10 to Rmb1,713mn in FY11. The sales volume and the ASP of the excavators sold by the Group in FY11 slid 3.0% YoY and 9.7% YoY, respectively.

The total market sales volume of excavators dropped 36.9% YoY in 1H12. According to our channel checking, the Group's sales volume of excavators dropped approx. 42% during the same period. We estimate that the market share of the Group further shrink to 2.2% in 1H12.

Similar to the situation of wheel loader segment, the Group is losing market share to the peers in the industry. We foresee that the competition of excavator market will become keener due to the enter of other leading construction machinery manufactures following the top player, Sany (600031 CH). The Chairman of Zoomlion expressed that they will put more effort on developing its excavator segment. With considering with the stronger selling and distribution channel of the leading construction manufacturers, such as Sany and Zoomlion, we believe market share of Lonking will further decrease in FY12. We estimate that the total sales volume of the Group decrease from 3,995 units in FY11 to 3,327 units in FY12, and recover at a rate of 5.3% to 3,503 units in FY13 and 8.0% to 3,784 units in FY14.

With the lower bargaining power against customers in the fragmented excavator market, we believe its ASP will further decrease in FY12. We estimate the segment revenue is Rmb1,259mn in FY12, Rmb1,326mn in FY13 and Rmb1,432mn in FY14.

Excavator segment revenue projection



Source: Company data, ABCI Securities estimates



Forklift segment

Forklift segment is the new star of the Group. The segment revenue was Rmb929mn in FY11, representing 7.3% of the total revenue of Lonking in FY11. It is the third largest segment of the Group. The market share of the Group surged by 0.5ppts from 4.0% in FY09 to 4.5% in FY10, and further up 0.6ppts to 5.1% in FY11. According to CCMA and our channel checking toward sales situation of the Group, we estimate that the market share of Lonking is 7.7% as of June, 2012.

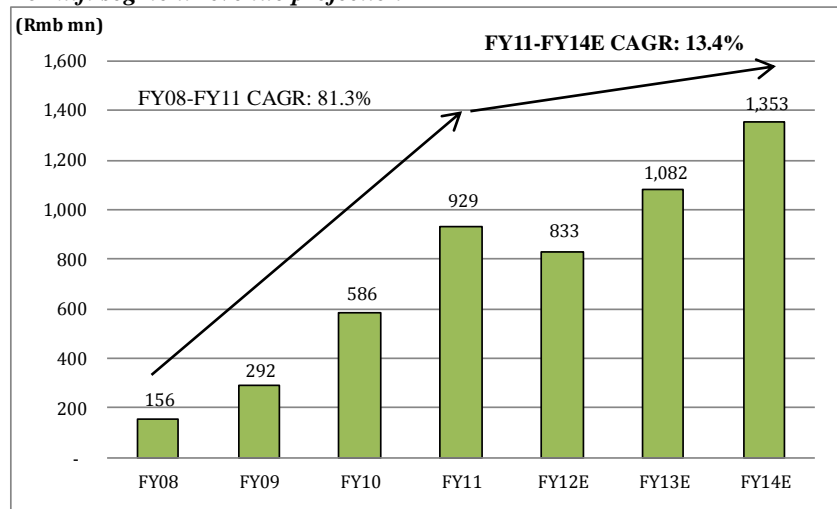
The segment of the Group grew at a CAGR of 97.1% from Rmb62mn in FY07 to Rmb929mn in FY11. The total sales volume almost tripled from 5,518 units in FY09 to 16,100 units in FY11. It was mainly attributable to the gradual establishment of the brand presence in the industry thanks to the continuous expansion of the sales channels.

However, by considering with the slowdown of overseas trade of China due to the deteriorating economies in the US and Europe, the growth of the demand for forklifts in China will slow down accordingly. The total sales volume of forklifts in the first 5- month in China, according to CCMA, was 128,371 units, edged down 3.9% from 133,607 units during the same period in 2011.

We estimate the total sales volume of forklifts of Lonking was 15,423 units in FY12, edged down 4.2% YoY. We expect that the sales growth of forklifts will regain in FY13. Under the low base effect, we estimate the sales volume of forklifts of the Group would increase to 20,050 units and 25,062 units in FY13 and FY14, respectively.

We expect the ASP of forklifts of the Group would edge down in FY12 due to the slowdown of the industry growth. Furthermore, in order to maintain its competitiveness, we believe the Group will not significantly enhance the selling price of its forklifts in the following years. Therefore, we estimate the segment revenue is Rmb833mn in FY12, Rmb1,082mn in FY13 and Rmb1,353mn in FY14.

Forklift segment revenue projection



Source: Company data, ABCI Securities estimates



Gross profit margin analysis projection

Gross profit margin (“GPM”) of the Group increased 5.1ppts from 23.4% in FY09 to 28.5% in FY10. We believe that the increase of GPM was because of more sales from the excavator segment which generally contribute a higher GPM represent an increasing percentage of the total revenue and the reduction in unit production cost due to economies of scales.

With the slowdown of infrastructure and real estate construction, the demand for earth moving machinery reduced in 1H12. Under the keen competition in the wheel loader and excavator market, we project that the overall GPM of Lonking will drop from 25.3% in FY11 to 24.5% in FY12. However, we believe that the profitability of the Group will regain with the earth moving machinery demand following the recovery of construction project in China. We estimate that GM will surge to 24.9% in FY13 and 25.3% in FY14.

Wheel loader segment

We expect that the GPM of wheel loader segment will decrease in FY12. With the recovery of the construction industry and coal mining activities, we believe the growth of large-size wheel loaders will recover in FY13 and FY14 in a quicker way. Therefore the segment GPM is expected to rebound in FY13 to FY14.

We estimate that the segment GPM is 25.5%, 26.0% and 26.5% in FY11-14, respectively.

Excavator segment

We believe the keen competition of excavator market will lower the segment GPM in FY12.

With market construction works enhancing in China started in 2H12, we expect that the demand for excavator will increase gradually. We estimate the GPM of the excavator segment is 25.0%, 25.5% and 26.0% in FY11-14, respectively.

Forklift segment

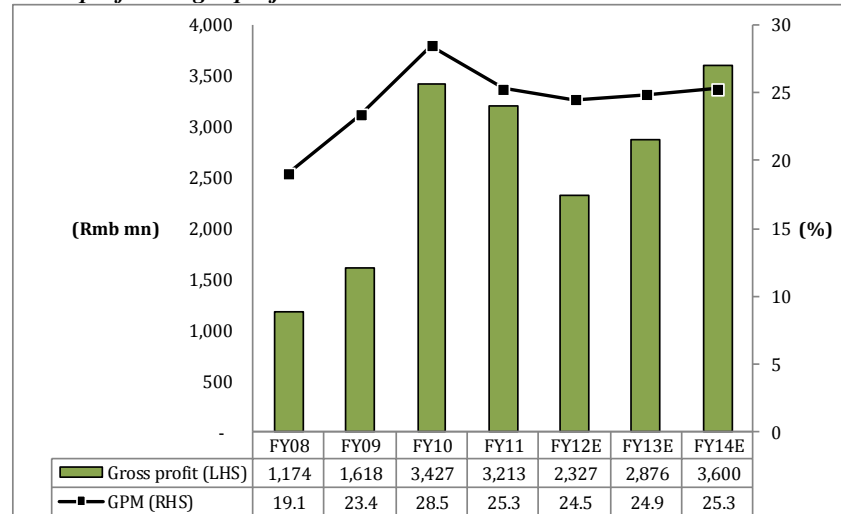
GPM of forklift segment is lower than that of wheel loader and excavator. We estimate the GPM of forklift segment was 13.0% in FY11. Due to the weakening trade figure, we expect that the growth of forklift market sales will continue slowing down in 2H12. We estimate the GPM of the segment will drop 1ppt to 12.0% in FY12.

The turmoil of global economic decline speeds up the imposition of the rescue policies in China, as well as the overseas countries. We assume the GPM of forklifts of Lonking will rebound 1ppt to 13.0% in FY13, and another 0.5ppts to 13.5% in FY14, following the recovery of the transportation industry induced by the rescue policies.

Since the portion of revenue of forklifts increase, which GPM is lower than that of wheel loader and excavator in the Group, we believe it will drag down the overall Group’s GPM growth in the short future.



Gross profit margin projection



Source: Company data, ABCI securities estimates

Estimated GPM of major business segment of the Group

	Wheel loader	Excavator	Forklift	Overall GPM
FY11E*	26.4	26.0	13.0	25.3
FY12E	25.5	25.0	12.0	24.5
FY13E	26.0	25.5	13.0	24.9
FY14E	26.5	26.0	13.5	25.3

Source: Company data, ABCI Securities estimates

*: The Group segment GPM in FY11 is estimated by us, while the overall GPM in FY11 was disclosed in the annual report of the Group



Net margin analysis and projection

We believe the net margin of the Group will lower from 13.6% in FY11 to 10.2% in FY12. The total net fair value gain (Rmb479mn) of the Group boosted up the net margin in FY11. If we exclude the fair value gain of the Group, we estimate that the adjusted net margin was 11.4% in FY11. We estimate the net margin will slide 1.2ppts to 10.2% in FY12 from our adjusted net margin in FY11. We assume fair value gain of the Group is zero in FY12.

Selling and distribution cost per revenue

The ratio of “selling and distribution cost per revenue” decreased from 6.8% in FY07 to 4.7% in FY11. The cost control on the distribution network of the Group was improving. The selling and distribution cost ratio of Lonking is lower than the leading construction machinery manufacturers’, such as Zoomlion at 6.8% and Sany at 8.3% in FY11. We believe the lower in distribution cost per revenue ratio of Lonking is because of less aggressive expansion in overseas markets. The portion of export sales to total revenue decreased from 4.7% in FY10 to 4.0% in FY11. As the Group has no explicit expansion plan on the overseas market, we assume the selling and distribution cost per revenue ratio remain steady at 4.6% in FY12, 4.6% in FY13 and 4.7% in FY14.

Total administrative cost per revenue

The ratio of “administrative cost per revenue” decreased from 2.8% in FY08 to 2.3% in FY11. We expect that the administrative cost per revenue will surge to 2.9% in FY12 due to the expected decline in revenue this year while the fixed cost, such as depreciation of PP&E remaining at a steady level as FY11. We estimate the ratio will edge down to 2.8% and 2.7% in FY13 and FY14, respectively.

Research and development cost

Lonking’s R&D cost increased at a CAGR of 175.5% from Rmb16mn in FY08 to Rmb342mn in FY11. The “R&D per revenue” ratio increased from 0.3% in FY08 to 2.7% in FY11. The ratio was same as Sany at 2.7% but higher than Zoomlion at 0.9% in FY11. However, under the sales declining situation, we believe the R&D cost per revenue ratio will lower to 1.5% in FY12.

Net margin breakdown and assumption

	SG&A	General Admin Cost	R&D	Selling & Distribution	Tax Rate	Net Margin
FY08	10.0	2.8	0.3	7.0	9.9	10.8
FY09	9.4	2.7	0.6	6.1	11.7	11.6
FY10	9.2	2.1	2.0	5.1	17.5	14.7
FY11	9.7	2.3	2.7	4.7	16.3	13.6
FY12E	8.9	2.9	1.5	4.6	16.0	10.2
FY13E	9.2	2.8	1.8	4.6	16.0	10.9
FY14E	9.5	2.8	2.0	4.7	16.0	11.6

Source: Company data, ABCI securities estimates

Capex and utilization

We estimate capex in FY12 is Rmb597mn. Half of the capex is expected to be spent on expanding the production bases for forklifts and wheel loaders. The rest of the planned capex will be spent on plant and equipment purchases.

The utilization rate of the Group is high. Some product lines' are over 80%, such as wheel loader and forklift segment. The overall utilization was 82% in FY11.

According to the production capacity plan of the Group, the Group planned to expand the production capacity of wheel loaders (from 48,000 units as of 2011 to 50,000 units as of 2012) and forklifts (from 20,000 units as of 2011 to 28,000 units as of 2012). The utilization rate of wheel loaders and forklifts was 90% and 80% in FY11, respectively. It is expected the Group will place more emphasis on the wheel loader segment, the major revenue income source of the Group, and the forklift segment, the new growing star.

On the other hand, the Group freezes the capacity expansion on excavators and road construction machineries.

Production capacity and utilization rate of Lonking in 2011 and 2012

Segment	Actual Production capacity in FY11 (Unit)	Expected production capacity in FY12 (Unit)	Change (%)
Wheel loader	48,000	50,000	4.2
Excavator	8,000	8,000	-
Forklift	20,000	28,000	40.0

Segment	Actual Production volume in FY11 (Unit)	Expected production Volume in FY12 (Unit)	Change (%)
Wheel loader	43,089	49,000	13.7
Excavator	4,429	5,000	12.9
Forklift	16,089	26,000	61.6

Segment	Utilization rate in FY11 (%)	Utilization rate in FY12 (%)	Change (ppts)
Wheel loader	89.8	98.0	8.2
Excavator	55.4	62.5	7.1
Forklift	80.4	92.9	12.4

Source: Company data, ABCI Securities

Total receivable and cash conversion cycle

One of our major concerns on the construction and earth working machinery manufacturers is the credit risk. During the fast expansion period after the influx of stimulating money of Rmb4,000bn in 2009, the cost of financing was reduced significantly. The small-to-mid construction and earth working machinery manufacturers, in order to capture more market share and boost the sales, relaxed their credit sales to customers. The down payment of the machinery purchases was largely cut. Down payment from some small manufacturers was even cut to zero. In the meanwhile, the repayment period was elongated up to 36 months from 6 to 24 months. The credit risk surged subsequently.

Financial lease receivables transferred to third parties

The total financial lease receivables reduced significantly in FY11. The current portion of financial lease receivable reduced from Rmb2,344mn at end-FY10 to Rmb446mn at end-FY11, while the non-current portion of financial lease receivable reduced from Rmb936mn at end-FY10 to Rmb852mn at end-FY11.

The major reason on the huge cut of financial lease receivable is that the Group sold the financial lease receivables to third party, other finance leases provider or domestic banks in China. Under the agreements, where the end-user customers and their guarantors fail to perform their payment obligations, the Group will repurchase the equipment from the banks or other finance leases provider. The amount of contingent liabilities increased 11.3 times from Rmb156.8mn as of end-2010 to Rmb1,766.8mn as of end-2011.

The total receivables of the Group

The total receivables (trade and bill receivable plus financial lease receivable plus due from related parties) of the Group reduced from Rmb5,115mn at end-FY10 to Rmb4,518mn at end-FY11. However, the average total receivables increase from Rmb3,858mn in FY10 to Rmb4,817mn in FY11, and the total receivable days increase from 117.1 days to 138.2 days. The cash conversion cycle increased from 104.6 days in FY10 to 145.1 days in FY11.

We see the liquidity pressure hinders the Group taking a more aggressive credit sale to customers. We believe it was one of the reasons on which it lost the market shares in the wheel loader and excavator markets.

Receivable comparison of Lonking and the peers in FY11

(Rmb mn)	Lonking	Zoomlion	Sany
Trade and bill receivable	3,130	12,701	8,564
Financial lease asset	1,298	19,869	931
Contingent liabilities*	2,072	9,092	34,659
To total equity ratio (%)			
Trade and bill receivable	48.9	35.7	41.3
Financial lease asset	20.3	55.8	4.5
Contingent liabilities	32.4	25.5	167.0

Source: Companies data

*Contingent liabilities includes the sales of the Group which is funded by finance leases entered into by the end-user customers and PRC domestic banks or other finance leases provider. The Group is required to repurchase the equipment from the banks or other finance leases provider when end-user customers and their guarantors fail to repay the obligations.



Valuation

Profit warning in 1HFY12

The Group announced a profit warning on June 3, 2012. It is expected to record a substantial decline in its net profit in 1HFY12. According to the sales data of CCMA, we estimate revenue of the Group dropped 40.0% YoY in 1HFY12. Under the declining market environment and the keen competition in wheel loader and excavator markets, the GPM of the Group is expected to shrink.

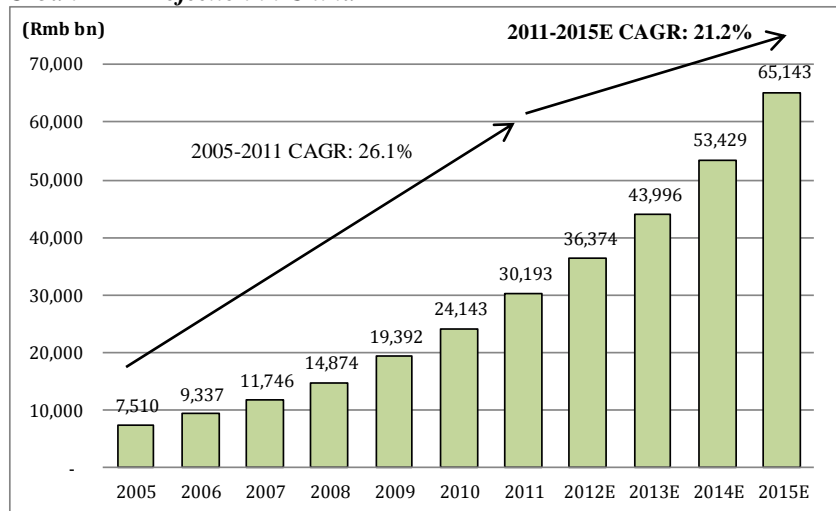
Outlook 2012

Following the infrastructure recovery and the gradual relaxing monetary environment, the sales of the Group is expected to regain in 2HFY12. Owing to its conservative business strategy, it lost market share in the wheel loader and excavator markets during 1HFY12. So, we believe the Group needs to take a longer time to recover the growth momentum. With the drag of the poor performance in 1HFY12, we estimate that the full year revenue and net income of the Group will drop 25.3% YoY and 44.2% YoY in FY12, respectively.

Long run benefited from the construction in China

Although the Group suffers a short-term decline, under the urbanization and the economic growth in China, we believe the Group is able to be benefited. We estimate the urban fixed-asset investment (“FAI”) will grow at a CAGR of 21.2% from 2011 to 2015.

Urban FAI Projection in China



Source: NBS, ABCI Securities estimates

Financial pressure

We see the high net gearing ratio (“Net debt/equity”), which was 55.1% as of end-FY11, and the low cash balance induces a financial pressure to the Group. The Group may seek equity financing to solve the liquidity pressure. If that is the case, it will dilute the earnings of the Group. It is one of our major concerns toward the stock.



Initiate “HOLD” with TP: HK\$1.55

Lonking is trading at 5.4x FY12E PE, which is 42.6% discount to the mean of its peers at 9.4x. As the Group has a high gearing and low cash balance, these create pressure on the Group to go equity financing. The earnings dilution brings a risk to accumulating the stock at this moment.

Our 12-month target price of HK\$1.55 is based on 5.6x of our FY12E EPS. Our valuation of 5.6x is 40% discount to the peers’ mean FY12E PE at 9.4x. We believe this valuation is justified as the estimated decline in earnings in FY12 and the risk of earnings dilution. Our estimated FY12E EPS is Rmb0.225 (before dilution). **we initiate Lonking with a “HOLD” rating.**

Valuation comparison against closest peers

We classify the closest peers of the Group are Liugong and XCMG, which are the major listed competitors of the Group in wheel loader market. Liugong and XCMG are trading at 9.5x and 7.2x of FY12E EPS, respectively.

Although the peers are trading at a higher FY12E PE, A-share market and H-share market cannot directly comparison. By considering with the A-H discount of Zoomlion, the market leading player, we estimate that the A-H share discount of the construction machinery sector is 35%.

By applying such A-H discount on the current market valuation on Liugong and XCMG, we believe the current market valuation of Lonking is about at par with our estimated fair value on the Group.



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 INDUSTRY - H	1157 HK	83,918	HK\$	8.59	6.0	4.9	11.6	21.9	23.4	23.6
LONGING HOLDINGS LTD	3339 HK	6,377	HK\$	1.49	5.4	4.1	(44.2)	31.0	14.3	16.8
FIRST TRACTOR CO-H	38 HK	4,965	HK\$	5.87	7.7	6.2	28.9	24.3	14.1	15.0
Weighted Average					6.0	4.9	8.8	22.6	22.3	22.7
SANY HEAVY INDUSTRY CO LTD-A	600031 CH	107,906	RMB	11.69	**	**	**	**	**	**
ZOOMLION HEAVY INDUSTRY S-A	000157 CH	83,918	RMB	9.39	7.6	6.4	17.2	19.3	21.8	21.5
XCMG CONSTRUCTION MACHIN-A	000425 CH	30,992	RMB	12.36	7.2	6.2	4.7	15.5	26.2	23.7
GUANGXI LIUGONG MACHINERY-A	000528 CH	15,333	RMB	11.21	9.5	7.9	1.2	20.4	17.0	16.9
TAIYUAN HEAVY INDUSTRY CO-A	600169 CH	8,898	RMB	3.02	18.6	16.4	0.6	13.6	7.1	8.1
SHANTUI CONSTMACHI-A	000680 CH	7,212	RMB	5.21	14.6	11.3	(14.8)	29.3	8.2	11.0
XIAMEN XGMA MACHINERY CO L-A	600815 CH	7,109	RMB	7.32	11.5	10.2	(14.2)	13.1	14.6	14.2
ANHUI HELI CO LTD-A	600761 CH	5,030	RMB	8.05	10.5	8.7	2.7	20.6	13.5	13.9
SUNWARD INTELLIGENT EQUIPM-A	002097 CH	3,919	RMB	7.65	19.4	15.6	(18.3)	24.1	10.1	12.5
INNER MONGOLIA NORTH HAULE-A	600262 CH	2,471	RMB	11.96	17.1	15.0	(5.4)	14.3	14.3	16.3
Weighted Average					9.3	7.8	8.1	18.6	19.8	19.5
CATERPILLAR INC	CAT US	421,637	US\$	83.30	8.6	7.8	26.1	11.5	39.2	34.3
DEERE & CO	DE US	231,496	US\$	75.03	9.1	8.6	22.9	5.5	40.7	35.0
CNH GLOBAL N.V.	CNH US	70,403	US\$	37.86	8.2	7.7	17.6	6.6	12.0	11.0
TEREX CORP	TEX US	15,513	US\$	18.23	10.0	6.9	343.9	44.2	9.6	13.0
MANITOWOC COMPANY INC	MTW US	11,704	US\$	11.41	14.7	7.9	(1,071.3)	84.9	19.1	27.7
Weighted Average					8.9	8.0	13.8	11.0	36.2	31.8
VOLVO AB-B SHS	VOLVB ST	196,877	SEK	82.20	10.1	8.7	(6.7)	16.1	18.7	19.4
ATLAS COPCO AB-A SHS	ATCOA ST	197,752	SEK	148.30	12.8	12.3	8.2	4.1	42.2	35.5
SANDVIK AB	SAND ST	131,091	SEK	92.75	11.4	10.5	75.2	8.7	27.8	26.0
Weighted Average					11.4	10.5	19.3	9.7	29.8	27.1
HITACHI LTD	6501 JP	209,073	JPY	454	7.5	9.4	(21.4)	(20.0)	11.7	12.4
KOMATSU LTD	6301 JP	172,105	JPY	1,763	9.4	8.8	7.6	7.8	17.8	16.9
TADANO LTD	6395 JP	7,021	JPY	546	40.0	13.9	(44.8)	187.6	6.3	7.7
Weighted Average					9.0	9.2	(9.0)	(3.9)	14.3	14.3
DOOSAN HEAVY INDUSTRIES	034020 KS	43,004	KRW	59,700	10.8	8.4	189.7	27.7	9.6	12.1
HYUNDAI HEAVY INDUSTRIES	009540 KS	117,146	KRW	226,500	7.8	7.5	(8.2)	4.1	11.6	11.8
Weighted Average					8.6	7.7	44.9	10.5	11.0	11.9
Weighted Average					9.4	8.7	12.7	9.0	26.6	24.4
Median					9.7	8.5	3.7	15.8	15.8	16.6

Source: Bloomberg, ABCI Securities estimates (The data in the table is as at 27-July-2012)

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



Financial Statements Projection

Consolidated income statements forecast

FY ended Dec 31 (Rmb mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue	12,020	12,720	9,504	11,555	14,205
Wheel loader	8,343	8,867	6,353	7,853	9,873
Excavator	1,957	1,713	1,259	1,326	1,432
Forklift	586	929	833	1,082	1,353
Road roller	469	367	160	201	243
Finance lease interest income	203	205	132	173	200
Others	462	639	767	920	1,104
Cost of sales	(8,593)	(9,507)	(7,177)	(8,679)	(10,605)
Gross profit	3,427	3,213	2,327	2,876	3,600
Other income and gains (loss)	27	479	29	29	32
Selling and distribution	(617)	(593)	(436)	(534)	(663)
Administrative expenses	(247)	(294)	(273)	(323)	(386)
Research and development cost	(241)	(342)	(143)	(208)	(284)
EBIT	2,349	2,463	1,504	1,840	2,299
Finance costs	(206)	(395)	(355)	(334)	(333)
Associates	-	-	-	-	-
Pre-tax profit	2,143	2,068	1,149	1,506	1,966
Profits tax	(376)	(338)	(184)	(241)	(315)
Minority interests	(1)	-	-	-	-
Net profit	1,766	1,730	965	1,265	1,651

Key ratios

FY	FY10A	FY11A	FY12E	FY13E	FY14E
Sales mixed (%)					
Wheel loader	69.4	69.7	66.8	68.0	69.5
Excavator	16.3	13.5	13.2	11.5	10.1
Forklift	4.9	7.3	8.8	9.4	9.5
Road rollers	3.9	2.9	1.7	1.7	1.7
Finance lease interest income	1.7	1.6	1.4	1.5	1.4
Others	3.8	5.0	8.1	7.9	7.8
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratios (%)					
Gross profit margin	28.5	25.3	24.5	24.9	25.3
EBIT margin	19.5	19.4	15.8	15.9	16.2
Pre-tax margin	17.8	16.3	12.1	13.0	13.8
Net margin	14.7	13.6	10.2	10.9	11.6
Selling & distribution cost / revenue	5.1	4.7	4.6	4.6	4.7
Admin cost / revenue	2.1	2.3	2.9	2.8	2.7
Effective tax rate	17.5	16.3	16.0	16.0	16.0
Growth (%)					
Revenue	74.2	5.8	(25.3)	21.6	22.9
Gross profit	111.8	(6.2)	(27.6)	23.6	25.2
EBIT	115.3	4.9	(38.9)	22.3	24.9
Net income	120.8	(2.1)	(44.2)	31.0	30.6

Source: Company data, ABCI Securities estimates



Consolidated balance sheets forecast

As of Dec 31 (Rmb mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Non-current assets	5,943	4,793	5,131	5,507	6,178
Land use rights	195	206	200	194	187
Property, plant and equipment	3,034	3,638	3,985	4,564	5,096
Other non-current assets	2,714	949	946	749	895
Current assets	7,520	11,347	10,317	11,532	12,378
Cash and equivalent	306	1,684	1,130	835	804
Restricted cash	328	471	494	519	545
Trade and other receivables	2,770	4,072	3,933	5,289	5,849
Inventories	3,539	4,380	4,272	4,288	4,428
Other	577	740	488	601	752
Total assets	13,463	16,140	15,448	17,039	18,556
Current liabilities	5,742	4,808	3,425	4,086	4,394
Trade and other payables	3,862	3,697	2,183	2,797	3,046
Borrowings	1,472	820	1,020	1,020	1,020
Provision	179	151	113	137	168
Other	229	140	109	132	160
Non-current liabilities	2,479	4,926	4,940	4,985	5,036
Borrowings	1,742	4,542	4,542	4,542	4,542
Other	737	384	398	443	494
Total liabilities	8,221	9,734	8,365	9,071	9,430
Minority Interest	2	1	2	2	2
Shareholders' equity	5,240	6,405	7,081	7,966	9,124

Key ratios

FY	FY10A	FY11A	FY12E	FY13E	FY14E
Balance sheet ratios					
Current ratio (x)	1.3	2.4	3.0	2.8	2.8
Quick ratio (x)	0.7	1.4	1.8	1.8	1.8
Cash ratio (x)	0.1	0.4	0.5	0.3	0.3
Total receivable turnover days	117.1	138.2	177.5	167.1	159.5
Total payable turnover days	137.3	145.2	149.5	104.7	100.6
Inventory turnover days	124.8	152.1	220.0	180.0	150.0
Total debt / equity ratio (%)	61.3	83.7	78.5	69.8	61.0
Net gearing (%)	57.1	55.1	58.4	55.9	49.3
Returns (%)					
ROAA	15.2	11.7	6.1	7.8	9.3
ROAE	39.1	29.7	14.3	16.8	19.3
Payout ratio	31.7	31.3	30.2	30.0	30.0
Per share data (Rmb)					
EPS	0.413	0.404	0.225	0.295	0.386
BVPS	1.224	1.496	1.654	1.861	2.132
DPS	0.129	0.122	0.068	0.089	0.116

Source: Company data, ABCI Securities estimates



Consolidated cash flow statements forecast

FY ended Dec 31 (Rmb mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Profit before tax	2,143	2,068	1,149	1,506	1,966
DD&A	208	292	256	309	374
Change in working capital	(2,492)	(718)	(1,609)	(539)	(584)
Income tax paid	(297)	(392)	(206)	(269)	(352)
Others	217	49	774	(130)	(158)
CF Operating	(221)	1,299	364	877	1,246
Capex	(483)	(937)	(597)	(883)	(899)
Other	(137)	(309)	-	-	-
CF Investing	(620)	(1,246)	(597)	(883)	(899)
Capital injection	-	-	-	-	-
Net debt financing	668	2,149	200	-	-
Dividend payout	(254)	(553)	(522)	(290)	(379)
Others	(288)	(270)	-	-	1
CF Financing	126	1,326	(322)	(290)	(378)
Net change in cash	(715)	1,379	(555)	(296)	(31)
Cash at the beginning	1,021	306	1,684	1,130	835
Exchange difference	-	(1)	1	1	-
Cash at the end	306	1,684	1,130	835	804

Source: Company data, ABCI Securities estimates

Risk factors

Concentration of product type

The Group focuses on the wheel loader segment which accounted by 69.7% in FY11. The sales performance of wheel loaders is cyclical and strongly subject to monetary policy and macroeconomics.

Loss of market share

The market share of the Group in the wheel loader market decreased from 18.4% in FY10 to 18.1% in FY11, and we estimate it further dropped to 16.0% as of June, 2012. The market share of the Group in the excavator market dropped from 2.5% in FY10 to 2.3% in FY11, and we estimate it further dropped to 2.2% as of June, 2012.

Financial and liquidity risk

The Group has a relatively high gearing (“net debt/total equity”) ratio of 55.1% as of end-FY11. The total interest cost was Rmb395mn in FY11. The interest coverage ratio (“EBIT/interest cost”) was 6.2x in FY11. With China’s government cutting the lending interest rate, the interest rate burden of the Group is expected to be lower in FY12.

The total receivable turnover days increased from 117.1 days in FY10 to 138.2 days in FY11. The total cash conversion cycle increased from 104.6 days in FY10 to 145.1 days in FY11.

The high gearing and liquidity pressure of the Group may push it to seek equity financing, which will dilute the earnings.

Cash conversion cycle of Lonking and peers in FY11

	Total Receivables Turnover (day)	Inventory Turnover (day)	Total Payables Turnover (day)	Cash Conversion Cycle (day)
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 accounted for approx. 22% (approx. 20% in FY10) of the Group’s total turnover in FY11. The five largest suppliers accounted for approx. 31% (approx. 24% in FY10) of the Group’s total purchases in FY11 and the largest supplier accounted for approx. 10% (approx. 9% in FY10) of the total purchases in FY11.

Mr. Li San Yim, the executive director of the Company, has approx. 4% of the issued shares of Weichai Power Co., Ltd (2338 HK) as of end-2011, which was one of the Group’s five largest suppliers in FY11.



Appendix I – Major Products Analysis of Lonking

Major products of Lonking

Product	Key Features	Sample model
Wheel loader	The Group manufactures three principal series of wheel loaders, the ZL30, ZL40 and ZL50 series, with designed loading power ranging from three to five tons. Its wheel loaders are multi-purpose infrastructure machines that can shovel, load and deliver bulky materials. They can perform loading and unloading, delivery, bulldozing, digging, hoisting as well as dragging functions	
ZL30	Designed loading power: 3 tons Loading capacity: 1.7m ³ Approx. loading height: 2.90m Approx. loading reach: 1.05m	
ZL40	Designed loading power: 4 tons Loading capacity: 2.3m ³ Approx. loading height: 2.90m Approx. loading reach: 1.11m	
ZL50	Designed loading power: 5 tons Loading capacity: 3.0m ³ Approx. loading height: 3.10m Approx. loading reach: 1.20m	
Excavator	Excavators are heavy construction machinery. They are primarily used in earth moving applications such as foundation building and trench digging. By attaching different tools, excavators can be transformed for other uses including hoisting, pile driving, ramming, casting, assembly, crushing and demolition.	
Forklift	Forklift is machinery that is powered to lift and transport heavy loads and material. They are used in an airport, a building supply company or in a warehouse. Forklift can be powered by gasoline, diesel, batteries and propane. The Group's forklifts are found in most commercial settings and are fairly easy to use.	

Source: Company data



農銀國際

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