

Weichai Power

PRC company Largest Acquisition in German

To summarize...

- Weichai Power will own 25% of enlarged issued share capital of KION and 70% interest of Linde Hydraulics.
- Forklift market remains robust.
- Establish strategic partnership with Linde and gain a significant step up in technology platform of hydraulics.

What happened. The company announced on 31 August that Weichai has formed a strategic alliance with KION, the second largest forklift manufacture worldwide on hydraulic pumps, motors, valves and gears, as well as the supply of parts and components via subscription of new shares and would own 25% of enlarged issued share capital of KION (amounted to EUR 467m) and acquisition of 70% interest of Linde Hydraulics (amounted EUR 271m), which is the hydraulics business of KION Group. Weichai would share the assets, certain intellectual property rights and/or licenses, permits, contracts, employees, obligations, as well as liabilities. This action would be completed before this year-end and using the company's own funds. This is the third acquisition of Weichai Group after acquisition assets of France-based Moteurs Baudouin in 2009 from Weichai Power and acquisition of 75% interest of Ferretti Group (the world's largest luxury yacht maker) from Weichai Group in Jan 2012.

As LHY (Linde Hydraulics) is famous for its productions' high efficiency, high load capacity, smooth in motion, high precision and quality, Weichai would benefit the technology promotion in hydraulics machine.

Our view. This acquisition is significant on a number of fronts. China is the world's largest forklift market and according to China Construction Machinery Association, grew 26% CAGR from 2006 to 2011. Domestic players dominate the industry with more than 72% market share, with Heli (安徽叉车集团), HC (浙江杭叉工程机械集团) being major players. However, there is a large technology gap with MNC brands (electric engines, high tonnage etc).

Even in the current economic slowdown, the sector has outperformed other construction machinery, such as excavators. For the first 6 months of 2012, the forklift industry was generally flat, down 5.6% YoY while excavator industry plunged 39.4% YoY. This is because the forklift industry is more correlated with manufacturing and less by infrastructure. In the current economic slowdown, the largest decline is in real estate and infrastructure FAI, while manufacturing FAI has held up better. Year to June manufacturing FAI was up 24.5% YoY while infrastructure FAI was only up 8.3%.

The market is likely to remain robust on a key number of drivers:

- continuing development of the logistics industry, which require warehouse and material handling equipment support;
- relocation of manufacturing facilities from high labour coastal areas to lower labour inland areas
- increase in domestic consumption, especially in western region, requiring logistics support
- continuing mechanization trend to increase productivity and offset rising labour costs

Meanwhile, hydraulics is considered a critical component in the manufacturing of forklifts and other construction machinery such as excavators, bulldozers etc. Despite China already being the largest construction equipment maker in the world, they still require to import critical components such as hydraulics. Compared to 100% buyout, Weichai's 70% acquisition of LHY allow the company establish a strategic partnership and gain a significant step up in technology platform, allow it to win status within this lucrative market in China. This is the breakthrough of the long-term monopoly situation of hydraulics from foreign companies.

Please refer to important disclosures at the end of this report

Ticker	2338 HK
Rating	Not Rated
Price (HK\$)	21.1
Target Price (HK\$)	n/a
12m Price Range (HK\$)	17.6 – 38.3
Market cap. (US\$m)	5,531.3
Daily t/o (US\$m)	8.1
Free float (%) (H share)	99.9

Financial summary

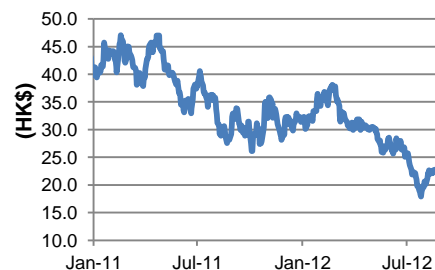
Year to Dec	09A	10A	11A
Turnover (RMBm)	35,260.962,984.559,797.3		
Net Profit (RMBm)	394,6.9	799,9.1	632,0
EPS (RMB)	1.7	3.4	2.8
P/E (x)	12.4	6.2	7.5
P/B (x)	2.8	1.8	1.5
EV/EBITDA (x)	10.6	7.8	5.9
Yield (%)	0.3%	1.1%	0.9%
ROE (%)	25.2%	34.2%	21.9%
ROCE (%)	22.6%	31.1%	19.4%
N. Gear. (%)	15.8%	N. Cash	N. Cash

Source: SBI E2

	12F	13F	14F
Consensus EPS (RMB)	2.4	2.7	-
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	6.0	(26.7)	(33.4)
Actual price changes (%)	4.7	(21.7)	(36.0)



Source: Bloomberg

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Valuation. Weichai is currently trading at 7.35 FY12/12F P/E. Other HK-listed companies with exposure to the forklift industry is Good Friend International (2398 HK, HK\$2.79), which is trading at current P/E of 11.42. Good Friend manufactures forklifts under their own "Feeler" brand.

Table 1. KION Financial Information

FY End Dec (EUR M)	2010A	2011A
Revenue	3,534.50	4,368.4
EBITDA	462	665
Profit before taxation	(231.4)	(58.9)
Profit after taxation	(196.7)	(92.9)
	2011A	1H2012A
Total asset	6,066.30	6,037.6
Total debt	6,553.90	6,569.9
NAV	(487.6)	(532.3)
Revenue	4,368.40	2,310.5
Net profit/loss	(92.9)	25.7
Cash flow from operating activities	386.8	68.7

Source: SBI E2-Capital

Table 2. Linde Financial Information

FY End Dec (EUR M)	2010A	2011A
Revenue	201	275.6
EBITDA	12.8	38.7
Profit before taxation	(4)	24.2
Profit after taxation	N/A	N/A
	2011A	
Total asset		129
Total debt		70.5
NAV		58.5
Revenue		275.6
Cash flow from operating activities		22

Source: SBI E2-Capital

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