

Dragon Hill Wuling

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CB loss hides true value

Not Rated

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	2,856	7,112	8,622	10,157	11,115
Net Profit (RMBm)	11.1	32.6	(20.0)	59.9	69.0
EPS (RMB)	0.013	0.036	(0.022)	0.065	0.075
EPS Δ%	n.a.	182.5	(161.1)	(400.2)	15.1
P/E (x)	60.4	21.4	n.a.	11.7	10.1
P/B (x)	0.93	4.76	5.51	3.74	2.73
EV/EBITDA (x)	2.4	1.0	0.8	0.6	0.6
Yield (%)	1.6	0.0	0.0	0.0	0.0
ROE (%)	20.5	25.6	(14.6)	38.2	31.2
ROCE (%)	28.3	22.7	16.0	29.9	27.0
N. Gear. (%)	(345.8)	(170.1)	0.0	0.0	0.0

Source: SBI E2-Capital

Ticker:	0305.HK	12 mth range:	HK\$0.35-1.37
Price:	HK\$0.86	Market cap:	US\$101.1m
Target:	n.a.	Daily t/o, 3 mth:	<US\$0.1m
		Free float %:	26.9%

Key points:

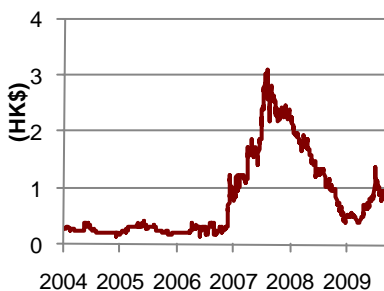
- * SGMW's sales volume jumped 50% in 1H and 105.7% in Jul-Aug, signaling strong demand for DHWL's products.
- * 16,000 special vehicles sold in 1H and full-year target at 30,000 Units, up from 20,000 units last year.
- * Gross margin narrowed 0.7pcp due to overloaded operation. Long-term trend heading up unchanged.
- * Bottom line ruined by RMB61.4m non-cash loss. Long-term outlook intact.

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-31.9	+3.9	-25.4
Actual price changes (%)	-23.3	+29.6	-30.3

	09F	10F	11F
Consensus EPS (RMB)	n.a.	n.a.	n.a.
Previous forecasts (RMBm)	74.8	104.0	111.4
Previous EPS (RMB)	0.082	0.113	0.121

Price Chart



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Strong growth of specialized vehicle division., Revenue increased 31.0% in 1H FY12/09A to RMB4,813.9m, which is broadly in line with our expectation. Segment wise,

- Engine and parts (EP) – capped by both the capacity constraint (600,000 units) and SGMW's intention to build up its own in-house supply, sales edged up 9.0% to RMB1,622.4m.
- Automotive components and accessories (ACA) – buoyed by the robust minicar market, turnover increased 51.8% to RMB2,508.5m (volume: ~480,000 sets).
- Specialized vehicle (SV) – sales volume jumped from 9,000 units one year ago to 16,000 units in 1H with corresponding value surging 87.8% to RMB490.5m. We were a bit over-cautious and have revised up our full-year forecast from RMB624.8m to RMB929.2m based on the company's sales target of 30,000 units (FY12/08A: 20,000 units).
- Trading of raw materials, water and power supply (trading) – external sales dropped 29.2% to RMB191.7m, which should be maintain attributed to a general decline in selling prices, in our view.

Energetic minicar market. In 1H, SGMW, the sole major customers, sold 525,050 cars, up 50.0% YoY. The momentum retained in Jul (87,925 units, up 90.7% YoY) and Aug (89,410 units, up 123% YoY). We have penciled up our estimate on SGMW's full-year sales from 850,000 units to 900,000 units, representing a full utilization of existing capacity.

Unexpected margin squeeze but structural trend still upwards. Blended gross margin narrowed unexpectedly in 1H by

0.7pcp to 8.4%. The main reason was the extra cost incurred by overloaded operation in the new Qingdao plant. Nevertheless, we reckon the blended gross margin should trend up in mid-term (2-3 years), given:

- favourable impact is anticipated from rising contribution from SP segment (gross margin: 12.7% in FY12/08A for the segment versus 10.9% blended). Meanwhile, the growth of SP division will also create internal demand for both engines and components, resulting in additional profit (i.e. margin enhancement) to EP and ACA segments on apparent basis.
- EP segment – to benefit from the decline in raw material cost (short-term factor) and technical improvement / upgrade (mid-term factor). A cylinder production line has commenced operation. The company plans another cylinder casting project to further enhance segmental profitability.

- ACA segment – to improve gradually with ramping-up operation in the Qingdao plant. The company expects segmental gross profit margin to pick up in 2H.
- SV segment – to harvest more economy of scale following expected increase in sales volume.

Delay in injecting capital into WLI. The company has postponed RMB225.9m capital injection into WLI in exchange for the latter’s 20.6% interest. As the negotiation is still under processing and exact date for the capital injection has not been decided yet, we adopted a simple assumption of unchanged profit sharing of DHWL in WLI at 30.4% perpetually.

Earnings projection revised down, long-term prospect intact. The company booked RMB61.4m non-cash loss in IH Y12/09F from change in fair value of HK\$100m convertible bonds issued in Jan 09 with initial conversion price of HK\$0.74, which turned bottom line to red at RMB41.4m from a net profit of RMB8.4m one year ago. Also considering the squeezed gross margin, we have slashed our FY12/09F earnings forecast from RMB73.8m profit to RMB20.0m loss. Nevertheless, profit (before minority interest) for FY12/10F and FY12/11F has been pencilled up by 1.5% and 9.9%, respectively, to reflect the encouraging growth of SV segment.

Table 1: Peers comparison

Company	Ticker	Market cap (US\$m)	Historical P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	P/B (x)	ROE (%)
Auto parts & components							
Mintb	425 HK	835.1	12.7	11.0	9.5	1.7	13.6
Xinyi Glass	868 HK	1,268.4	17.8	11.4	9.5	2.2	16.9
Weichai Power	2338 HK	5,724.1	19.9	12.4	11.1	3.1	26.8
Average			16.8	11.6	10.0	2.3	19.1
Whole car							
Denway	203 HK	3,287.0	11.1	10.3	9.2	1.8	17.3
Geely Automobile	175 HK	1,670.2	8.4	10.2	8.8	2.1	26.9
Dongfeng Motor	489 HK	9,002.7	14.8	12.8	11.4	2.6	20.7
AVI China Industrial	2357 HK	1,607.4	n.a.	72.1	19.8	3.9	(39.7)
Average			11.4	26.3	12.3	2.6	6.3
DH Wuling	305 HK	101.1	21.4	n.a.	11.7	6.6	25.6

Source: Bloomberg

Table 2: P&L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Revenue	2,856.5	7,111.9	8,621.6	10,157.0	11,114.6
Cost of sales	(2,591.9)	(6,339.7)	(7,728.5)	(9,019.4)	(9,814.4)
Gross profit	264.5	772.2	893.1	1,137.6	1,300.2
Other income	36.5	85.1	84.0	103.8	117.1
Distribution costs	(51.7)	(187.2)	(205.1)	(248.8)	(277.7)
General and administrative expenses	(100.6)	(422.8)	(463.3)	(561.9)	(627.3)
Research and development expenses	(48.5)	(40.3)	(66.0)	(98.1)	(129.6)
Profit from operation	100.1	207.1	242.6	332.5	382.7
Net (loss) gain on held-for-trading investment	9.0	(0.2)	-	-	-
Change in fair value of derivative financial instrument	-	-	(61.4)	-	-
Share of results of an associate	0.2	0.8	0.8	0.9	1.0
Increase in fair value of investment properties	5.2	2.2	0.3	-	-
Finance costs	(17.2)	(45.0)	(54.9)	(60.8)	(63.0)
Profit before taxation	97.2	164.8	127.4	272.6	320.7
Income tax expenses	(22.6)	(27.9)	(32.6)	(47.1)	(55.8)
Profit for the period	74.6	136.9	94.7	225.5	265.0
Attributable to:					
Equity holders of the Company	11.1	32.6	(20.0)	59.9	69.0
Minority interests	63.5	104.2	114.7	165.6	196.0

Source: Company data, SBI E2-Capital

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