

Hyundai Construction Equipment (267270)

BUY (Initiate), TP W260,000

		Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
		Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
Stock price (May 4, KRW)	NM	2016A	1,693	118	81	NM	NM	NM	NM	NM	NM	NM	0.4
Market cap (USD mn)	NM	2017F	2,104	139	87	24,312	7.7	NM	NM	NM	NM	11.3	NM
Shares outstanding (mn)	358	2018F	2,314	155	106	29,470	21.2	NM	NM	NM	NM	12.1	NM
52W High/Low (KRW)	NM	2019F	2,430	168	117	32,559	10.5	NM	NM	NM	NM	11.9	NM
6M avg. daily turnover (USD mn)	NM	2020F	2,551	176	124	34,700	6.6	NM	NM	NM	NM	11.3	NM
Free float (%)	NM												
Foreign ownership (%)	NM												
Major shareholders (%)													
Hyundai Robotics	13.4												

Note: NP in equity-method accounting; Value per share may change according to split ratio to be finalized on May 10

Top-tier excavator supplier in emerging markets

68% upside from pre-trading suspension market cap: We initiate coverage of Hyundai Construction Equipment (Hyundai CE) with BUY and a TP of W260,000 that equals 1.1x 2017F PB (2017F PB for Doosan Infracore excl. hybrid securities; ROE 10.3%) while the global peer average stands at 2x. The price equals 10.8x 2017F PE and implies 68% upside from the market cap before trading was suspended.

Hyundai CE is Korea's leading construction machinery company along with Doosan Infracore. Its main products are midsize/large excavators that account for 50% of revenue while the rest breaks down to industrial vehicles (20%), wheel loaders (9%) and mini excavators (8%). While Hyundai CE was under Hyundai Heavy Industries (HHI), there were five overseas subsidiaries – three for production in Brazil, India and China and two for sales in Belgium and the US. The production subsidiaries have been realigned into HHI's remaining entity while the sales subsidiaries are wholly owned by Hyundai CE. Accordingly, consolidated financial statements to be released from 2Q17 will include the combined sales of the headquarters and the sales subsidiaries (excl. internal transactions) and complete knock-down (CKD) sales to the production subsidiaries.

Big 3 in emerging markets: By region, 2016 separate sales broke down to 41% for emerging markets, 21% Korea, 16% Europe and 15% G2. In emerging markets, Hyundai CE is one of the big three excavator suppliers along with Caterpillar (US) and Komatsu (Japan). It is not only backed by the competitiveness of the company's own products but the strong awareness of the Hyundai brand stemming from the excellent sales power of group affiliates for autos, heavy industry, construction, etc. in the emerging markets. Supported by higher commodity prices and increasing infrastructure investment in 2017, target market sales are growing rapidly. Sales to the CIS have recently been increasing, including a collective order receipt from Russia for 36 ultra-large excavators worth USD20mn.

Rising domestic market share: Hyundai CE's domestic market share fell from 32% in 2014 to 26% in 2016 and then rose to 34% in 1Q17, claiming second place after Doosan Infracore's 37%. The rising share is backed by efforts to focus on sales while enlarging and specializing the distribution networks. Of note, Hyundai CE tried to reinforce domestic market share by operating a distribution center for used equipment where the company built a complex and dealers moved in. As dealers resell or export used equipment after purchase and maintenance, this naturally promotes the purchase of new vehicles from Hyundai CE.

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2017F sales W2.1tn with OPM 6.6% and NP W87.1bn: The YoY comparison is impossible due to the absence of 2016 financial statements using the same standards of consolidated statements slated for release from 2Q17. But using the former consolidated basis, 2017 sales are projected to rise 18% YoY (Table 21).

Table 19. Valuation: Apply PE for Doosan Infracore (excl. hybrid securities) (W bn, %, x)

	2016	2017
Shareholders' equity	717	819
ROE		11.3
Target PB		1.1
Fair market cap		939.8
Fair share price		260,000
PE based on fair market cap		10.8
Pre-trading suspension market cap	591	554
Upside		67.7

Source: Korea Investment & Securities

Table 20. Global peer valuation

(x, %)

	PE			PB			EV/EBITDA			ROE		
	2016	2017F	2018F	2016	2017F	2018F	2016	2017F	2018F	2016	2017F	2018F
Caterpillar	28.9	26.3	20.1	4.1	4.1	3.9	16.4	10.8	9.3	(0.5)	15.3	18.9
Volvo	16.4	16.9	15.7	2.3	2.8	2.5	8.9	10.4	9.9	14.6	17.8	17.3
Doosan Infracore	NA	11.3	9.3	0.9	0.9	0.8	9.1	8.7	8.2	2.2	7.8	8.9
Kubota	15.7	15.4	14.3	1.7	1.7	1.5	12.0	11.8	10.9	11.5	11.2	11.2
Hitachi Construction Machine	73.6	30.0	22.5	1.5	1.5	1.4	14.3	11.3	9.7	2.0	5.5	7.1
Komatsu	24.1	22.3	18.5	1.7	1.7	1.6	11.1	10.6	9.4	7.3	7.7	9.2
Sany Heavy	228.5	35.0	21.5	2.0	2.2	2.0	34.5	15.1	12.3	0.9	6.8	9.6
Zoomlion Heavy	NA	47.3	24.5	0.6	0.9	0.9	46.0	25.4	20.0	(2.4)	1.5	2.8
Avg.	64.5	25.6	18.3	1.9	2.0	1.8	19.0	13.0	11.2	4.5	9.2	10.6
Avg. excl. Caterpillar and Chinese players	32.4	19.2	16.0	1.6	1.7	1.6	11.1	10.6	9.7	7.5	10.0	10.7

Source: Bloomberg, Korea Investment & Securities

Table 21. Earnings forecast

(W bn, %)

	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17F	3Q17F	4Q17F	2016	2017F
Consolidated sales (from 2Q17; incl. CKD) – ③=⑤+⑥	440	470	417	365	543	609	518	434	1,693	2,104
Previous consolidated sales (though 1Q17; excl. CKD) - ⑤	440	470	417	365	543	564	480	402	1,693	1,988
Separate sales	484			410	600				1,852	
Construction machinery (separate)	345				450					
Industrial vehicles(separate)	107				107					
Parts (separate)	33				43					
CKD and parts sales to production subsidiaries - ⑥						45	38	32		116
Sales % YoY					23.3	29.6	24.2	18.8		24.3
Sales % YoY (previous consolidated)					23.3	20.0	15.0	10.0		17.5
OP	35	32	36	15	50	33	38	17	118	138.9
OPM	8.0	6.7	8.5	4.2	9.2	5.5	7.3	4.0	6.9	6.6
Non-operating balance	1	11	(24)	9	(10)	(4)	(4)	(4)	(3)	(23)
EBT	30	43	11	24	40	29	34	13	108	116
NP	25	29	9	18	30	22	25	10	81	87.1

Note: Incl. CKD sales to production subsidiaries (India, Brazil, China) from 2Q17 consolidated earnings

Source: Korea Investment & Securities

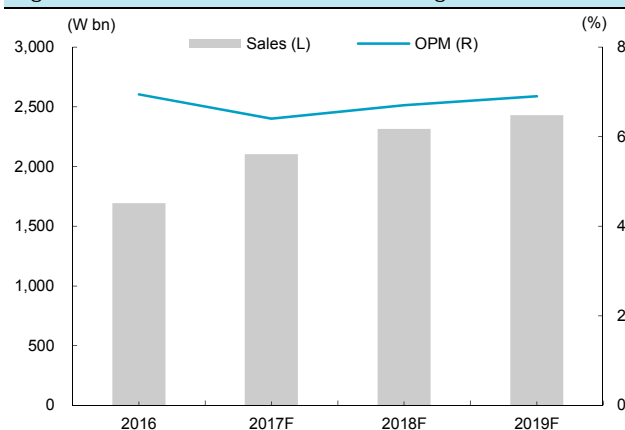
Table 22. Balance sheet estimates

(W bn)

	2016	1Q17	2017F
Current assets	1,169	1,196	1,325
Cash & cash equivalents	264	296	316
Accounts & other receivables	287	385	337
Inventory	618	515	673
Non-current assets	633	634	664
Investment assets	0	0	0
Tangible assets	613	614	644
Intangible assets	20	20	20
Total assets	1,802	1,830	1,989
Current liabilities	542	575	577
Accounts & other payables	330	351	314
ST debt & bonds	3	2	3
Current portion of LT debt	209	222	260
Non-current liabilities	543	493	594
Debentures	466	416	443
LT debt & financial liabilities	77	77	151
Total liabilities	1,086	1,068	1,171
Paid-in equity	18	18	18
Other capital accounts	699	744	744
Retained earnings	0	0	57
Non-controlling-interest	0	0	0
Shareholders' equity	717	762	819
Liabilities and shareholders' equity	1,803	1,830	1,989
Net debt	532	471	441

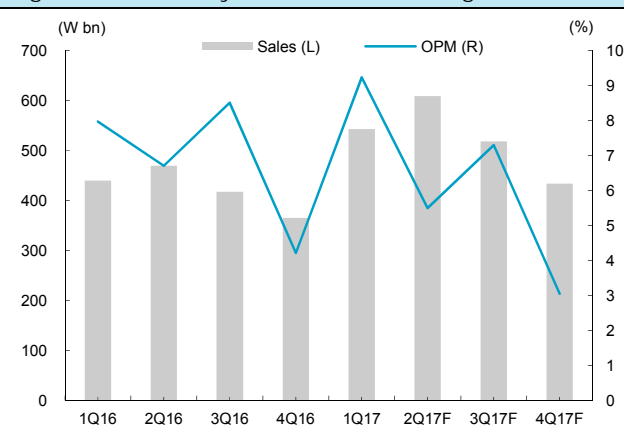
Source: Korea Investment & Securities

Figure 55. Annual consolidated earnings



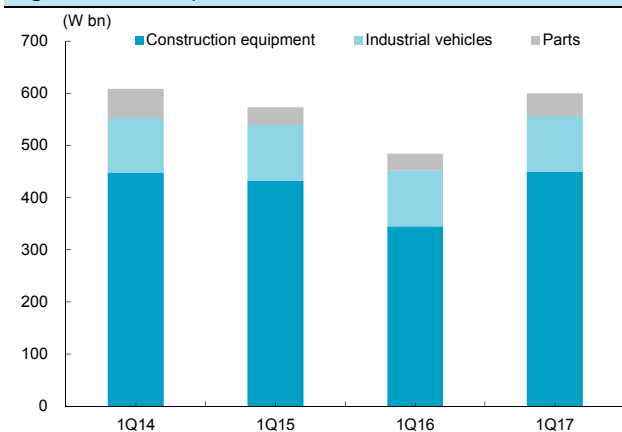
Note: Incl. CKD sales to production subsidiaries (India, Brazil, China) from 2Q17 consolidated earnings
Source: Korea Investment & Securities

Figure 56. Quarterly consolidated earnings



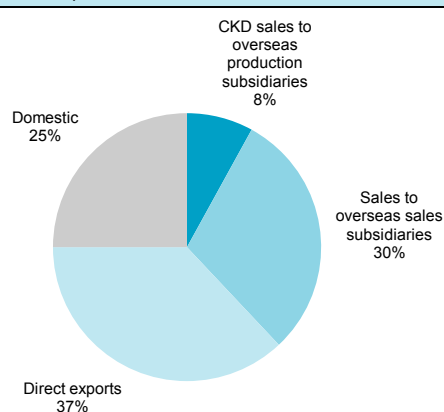
Note: Incl. CKD sales to production subsidiaries (India, Brazil, China) from 2Q17 consolidated earnings
Source: Korea Investment & Securities

Figure 57. 1Q separate sales breakdown



Source: Company data, Korea Investment & Securities

Figure 58. 2016 separate sales breakdown



Source: Company data, Korea Investment & Securities

Formidable competitiveness in emerging markets led by India (CKD)

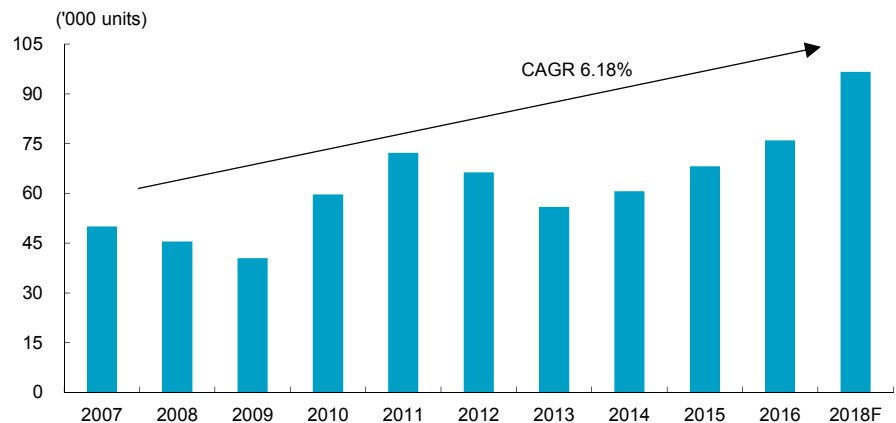
According to Off-Highway Research, a statistics/analysis consultancy specializing in international construction machinery, global construction equipment sales are forecast to grow 7% YoY in 2017 by volume. This will mark the beginning of a full-fledged turnaround from reduced sales by 6% in 2016. In particular, the Indian market, the fourth-largest after North America, China and Europe, is growing the fastest worldwide. According to the latest report from the India Brand Equity Foundation (IBEF), construction equipment sales in India will increase from 76,000 units in FY16 to 967,000 in FY18.

Table 23. Off-Highway forecast of global construction machinery market (unit)

	2016	2017F	2018F	2019F	2020F	2021F
China	119,218	134,655	144,380	153,375	161,420	168,750
Europe	140,511	140,430	143,801	141,778	144,495	146,267
India	52,619	59,295	65,770	66,270	69,895	73,470
Japan	59,700	64,245	67,410	74,960	75,460	74,960
North America	158,925	168,600	183,785	199,150	209,910	196,900
All others	119,160	127,917	136,572	143,511	149,147	149,340
Total	650,133	695,142	741,718	779,044	810,327	809,687
YoY growth (%)	(5)	7	7	5	4	0

Source: Off-Highway, Korea Investment & Securities

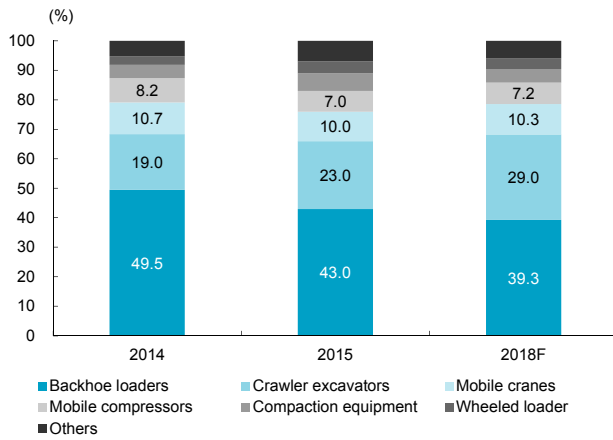
Figure 59. Construction equipment sales forecast in India



Source: IBEF, Korea Investment & Securities

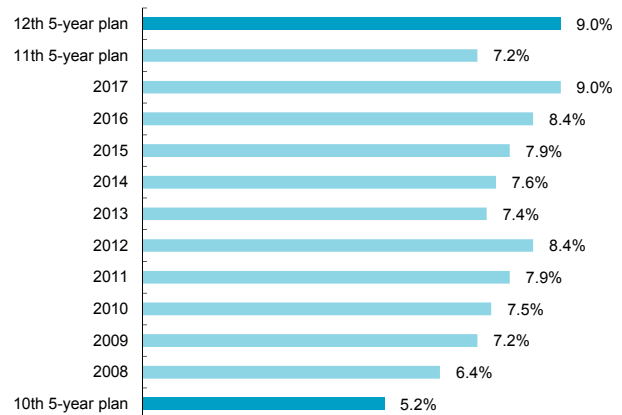
The growth of India's construction machinery market is mainly driven by the government's aggressive infrastructure investment policy. The share of infrastructure investment in India as a percentage of GDP rose from 5.2% in the 10th five-year plan to 7.2% in the 11th and 9% in the 12th (FY13 to FY17) plans. By value, FY17 investment amounted to USD260.2bn. In particular, excavator sales volume is rising sharply among construction equipment. The main growth engine would be midsize (20 tonnes or heavier) excavators. The proportion of excavators in the overall construction machinery market has increased from 19% in 2014 to 23% in 2015 and should further rise to 29% in 2018.

Figure 60. Indian construction machinery sales weighting



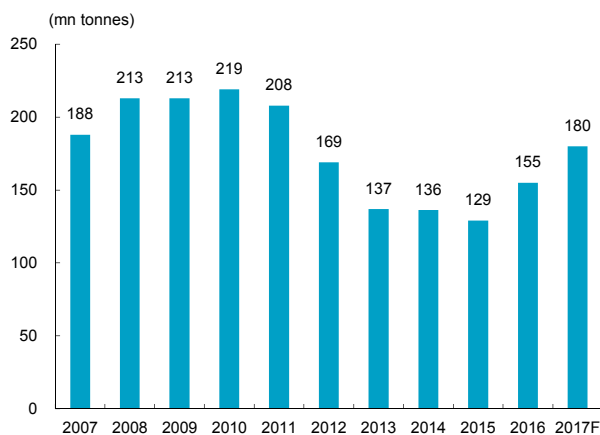
Source: IBEF, Korea Investment & Securities

Figure 61. Infrastructure investment as % of GDP



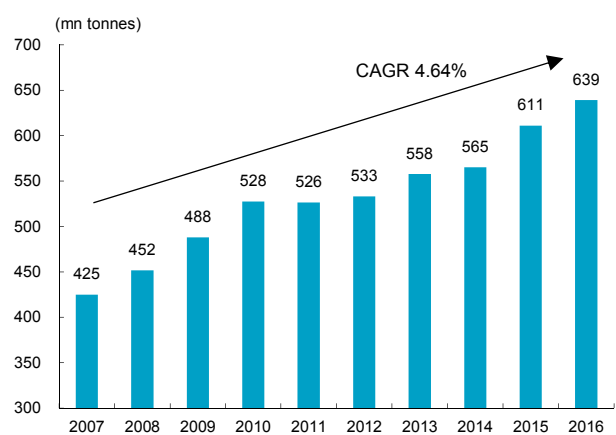
Source: IBEF, Korea Investment & Securities

Figure 62. Iron ore output



Source: Ministry of Mines, Korea Investment & Securities

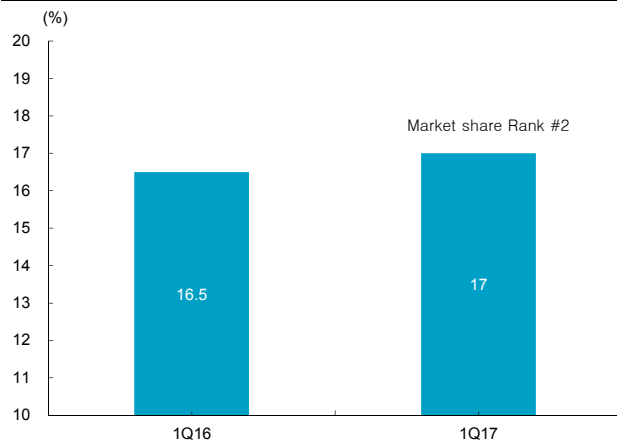
Figure 63. Coal output



Source: Ministry of Mines, BP, Korea Investment & Securities

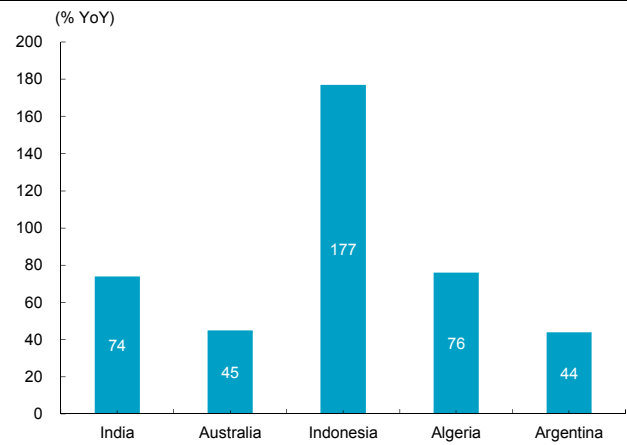
Hyundai CE commands the second-largest share of the Indian market after the Tata-Hitachi joint venture. Its share inched up to 17% in 1Q17, up 16.5% YoY, while demand in said excavator market grew 27% YoY. Of note, in 2Q17 the company is scheduled to release eight series tailored to local demand. In markets other than India, sales volume is steadily increasing as well. In particular, Hyundai CE has been reinforcing the sales of midsize/large equipment mainly in resource-rich countries such as Russia, Algeria and Australia. Backed by these efforts, the company in April received orders from Russia for 36 ultra-large (80/120 tonnes) excavators. Excavators ordered for use in mining development are worth USD20mn.

Figure 64. Ranks second in India with 17% share following Tata-Hitachi



Source: Company data, Korea Investment & Securities

Figure 65. Major emerging market sales growth: To benefit the most from emerging market growth



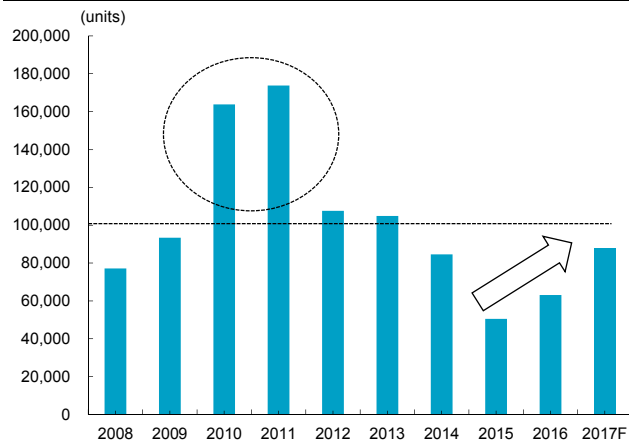
Source: Company data, Korea Investment & Securities

Chinese (CKD) market: Rapid recovery on actual demand growth and advent of replacement cycle

The Chinese government continues to emphasize the importance of infrastructure investment in 2017. Although the government's fiscal deficit target compared to GDP has not changed much, the nation's excavator sales are growing faster than last year. In the peak season of 1H16, expectations for the market's recovery have not materialized into new purchases as users with actual demand doubted the sustainability of the government's policy. But from 2H16, with mounting confidence in the government's policy on the increased hours of excavator use and greater issue of municipal bonds, excavator purchases picked up. This combined with the advent of a six to seven-year replacement cycle and led to a steep increase in sales volume. In addition, the establishment of a special economic zone, Xiongan New Area, should directly or indirectly bolster demand growth over the mid/long-term.

In 2010, Hyundai CE claimed 11% of the Chinese market with annual sales volume of more than 18,000 units. But with the steep decline of the market's total sales volume since 2012, Hyundai CE's market share plunged to 3.2% with sales volume of 1,233 units as of 1Q17. Recently, its subsidiary in Beijing (small equipment) was incorporated to a subsidiary in Jiangsu (midsize/large). Backed by the reorganized production subsidiary, Hyundai CE should focus on building up market share from 2Q17.

Figure 66. China annual excavator sales volume: Six to seven-year replacement cycle has arrived



Source: China Construction Machinery Association (CCMA), Korea Investment & Securities

Figure 67. Hyundai CE sales volume and market share

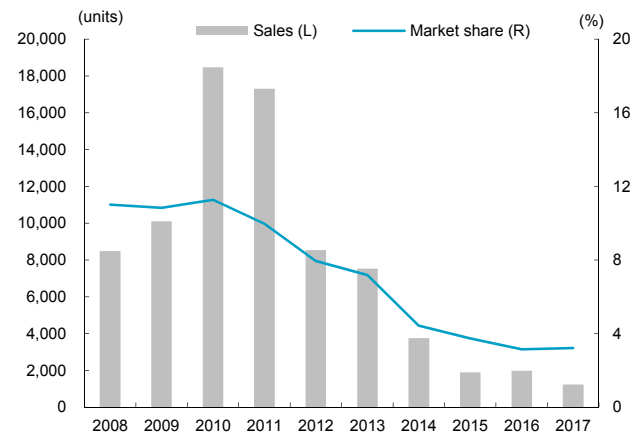
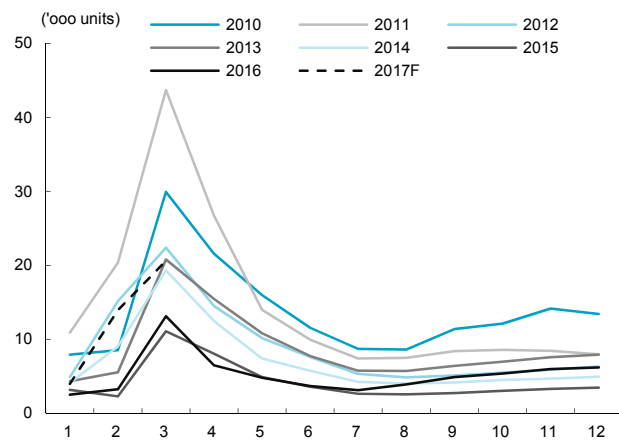
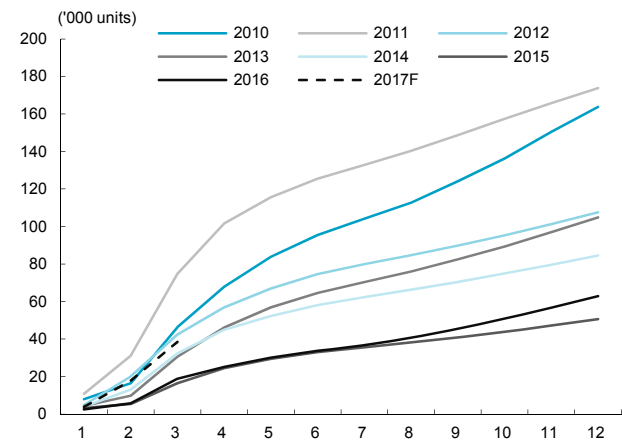
Note: YTD March 2017
Source: CCMA, Korea Investment & Securities

Figure 68. Monthly sales: Third-largest in March 2017 since 2010



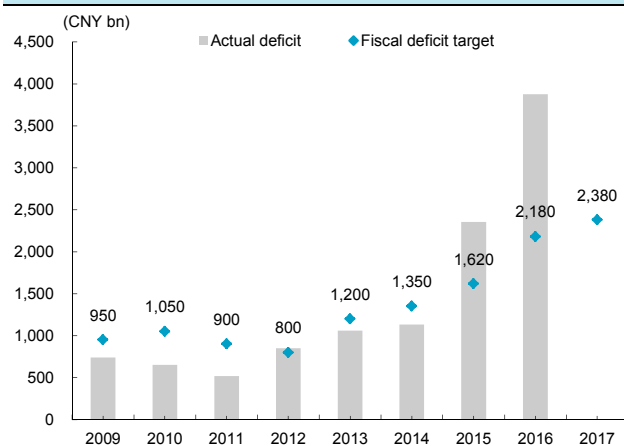
Source: CCMA, Korea Investment & Securities

Figure 69. Annual cumulative sales: Sales through March 2017 on pace to sell 100,000 units



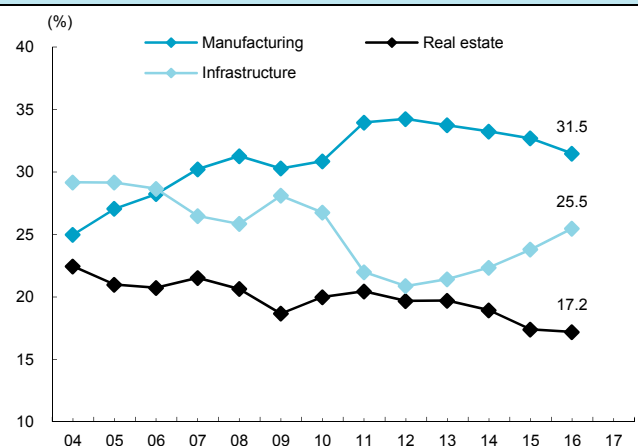
Source: CCMA, Korea Investment & Securities

Figure 70. China fiscal deficit target vs. actual deficit



Source: CEIC, Korea Investment & Securities

Figure 71. China fixed capital investment breakdown



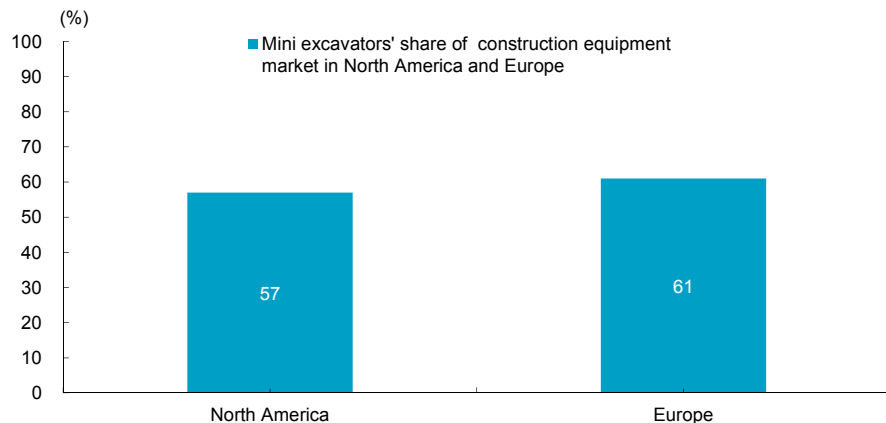
Source: CEIC, Korea Investment & Securities

Seeking to enter mini excavator market in partnership with CNHI

While Hyundai CE has strengths in midsize/large excavators, the North American and European markets are specialized toward small excavators because equipment is often used to replace manpower in developed countries with heavy labor costs.

In 2015, the company signed an OEM and license agreement with CNH Industrial (CNHI) and is set to produce mini excavators to meet the contract from 1H17. Upon the contract signing with CNHI along with strong brand power in North America and Europe, it is preparing to supply 5-6-tonne excavators (OEM) and 1-4-tonne excavators (CKD). While CNHI's similar contracts with Japan's Sumitomo and Kobelco in the past ended up falling through due to sluggish market conditions, the recent deal is projected to run smoothly on the rebound of global construction equipment market conditions. Hyundai CE expects sales from the contract with CNHI to be worth more than W510bn over the next five years.

Figure 72. Larger weighting of mini excavator sales than midsize/large in Europe



Source: Company data, Korea Investment & Securities

Company overview

Established in 1987, Hyundai Construction Equipment (Hyundai CE) produces and sells construction equipment and industrial vehicles (incl. parts). With the headquarters in Ulsan, Korea, the company has sales subsidiaries in Geel (Belgium) and Atlanta (US) and production subsidiaries in China, India and Brazil. Of note, earnings of overseas sales subsidiaries, which are wholly owned by Hyundai CE, are included in the consolidated financial statements of the post-divestiture entity (spun off April 1) but those of overseas production subsidiaries, owned by Hyundai Heavy Industries, a remaining entity, are not included.

Balance sheet

FY-ending Dec. (W bn)	2016A	2017F	2018F	2019F	2020F
Current assets	1,169	1,325	1,446	1,531	1,607
Cash & cash equivalent	264	316	347	364	383
Accounts & other receivables	287	337	382	413	434
Inventory	618	673	717	753	791
Non-current assets	633	664	696	730	765
Investment assets	0	0	0	0	0
Tangible/Intangible assets	613	644	676	710	745
Others	20	20	20	20	20
Total assets	1,802	1,989	2,143	2,261	2,373
Current liabilities	542	577	587	590	591
ST debt	330	314	298	283	269
Advanced	3	3	3	3	3
Others	209	260	285	304	319
Non-current liabilities	543	594	631	630	616
LT debt & financial liabilities	466	443	421	400	380
Others	77	151	211	230	237
Total liabilities	1,086	1,171	1,218	1,220	1,208
Controlling int. shareholders' equity	18	18	18	18	18
Capital stock	18	18	18	18	18
Other components of equity	699	744	744	744	744
Retained earnings	0	57	163	279	404
Non-controlling int. shareholders' equity	0	0	0	0	0
Total shareholders' equity	717	819	924	1,041	1,165
Total liabilities and shareholders' equity	1,803	1,989	2,143	2,261	2,373

Cash flow

FY-ending Dec. (W bn)	2016A	2017F	2018F	2019F	2020F
C/F from operating	NM	NM	NM	NM	NM
Net profit	NM	NM	NM	NM	NM
Depreciation	NM	NM	NM	NM	NM
Amortization	NM	NM	NM	NM	NM
Net incr. in W/C	NM	NM	NM	NM	NM
Others	NM	NM	NM	NM	NM
C/F from investing	NM	NM	NM	NM	NM
CAPEX	NM	NM	NM	NM	NM
Decr. in fixed assets	NM	NM	NM	NM	NM
Incr. in investment	NM	NM	NM	NM	NM
Net incr. in intangible assets	NM	NM	NM	NM	NM
Others	NM	NM	NM	NM	NM
C/F from financing	NM	NM	NM	NM	NM
Incr. in equity	NM	NM	NM	NM	NM
Incr. in debts	NM	NM	NM	NM	NM
Dividends	NM	NM	NM	NM	NM
Others	NM	NM	NM	NM	NM
C/F from others	NM	NM	NM	NM	NM
Increase in cash	NM	NM	NM	NM	NM

Note: Based on K-IFRS (consolidated)

Income statement

FY-ending Dec. (W bn)	2016A	2017F	2018F	2019F	2020F
Sales	1,693	2,104	2,314	2,430	2,551
COGS	1,302	1,620	1,777	1,859	1,952
Gross profit	391	484	537	571	600
SG&A expense	279	345	382	403	424
Operating profit	118	139	155	168	176
Net financial cost	19	17	14	12	10
Other non-operating profit	22	(6)	0	0	0
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	108	116	141	156	166
Income taxes	27	29	35	39	41
Net profit	81	87	106	117	124
Controlling int. NP	81	87	106	117	124
Other comprehensive profit	NM	NM	NM	NM	NM
Total comprehensive profit	NM	NM	NM	NM	NM
Total comprehensive profit of controlling interest	NM	NM	NM	NM	NM
EBITDA	NM	NM	NM	NM	NM

Key financial data

FY-ending Dec.	2016A	2017F	2018F	2019F	2020F
per share data (KRW)					
EPS	NM	24,312	29,470	32,559	34,700
BPS	NM	228,411	257,881	290,440	325,140
DPS	0	0	0	0	0
Growth (%)					
Sales growth	NM	24.3	10.0	5.0	5.0
OP growth	NM	18.2	11.7	8.1	5.0
NP growth	NM	7.7	21.2	10.5	6.6
EPS growth	NM	NM	21.2	10.5	6.6
EBITDA growth	NM	NM	NM	NM	NM
Profitability (%)					
OP margin	6.9	6.6	6.7	6.9	6.9
NP margin	4.8	4.1	4.6	4.8	4.9
EBITDA margin	NM	NM	NM	NM	NM
ROA	NM	4.6	5.1	5.3	5.4
ROE	NM	11.3	12.1	11.9	11.3
Dividend yield	0.4	NM	NM	NM	NM
Dividend payout ratio	5.7	NM	NM	NM	NM
Stability					
Net int. bearing debt (W bn)	532	441	372	318	266
Net in. bearing D/E ratio (%)	111.1	92.4	77.8	65.6	55.7
Valuation (X)					
PE	NM	NM	NM	NM	NM
PB	NM	NM	NM	NM	NM
EV/EBITDA	NM	NM	NM	NM	NM

■ **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on 12-month forward share price performance relative to the market index**

- BUY: Expected to outperform the market index by 15%p or more
- Hold: Expected to underperform or outperform the market index by less than 15%p
- Underweight: Expected to underperform the market index by 15%p or more
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

■ **Guide to Korea Investment & Securities Co., Ltd. stock rating allocation (as of Mar 31, 2017)**

BUY	Hold	Underweight (Sell)
77.4%	21.7%	0.9%

Note: % of companies under coverage with this rating

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**

- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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