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Jiangsu Hengli Hydraulic - A

3Q26 briefing: FA/robotics ramp and global supply chain drive next phase, margin headwinds ease; stay OW

Overweight

601100.SS, 601100 CH
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We attended Hengli's 3Q26 results briefing on 27 October, where management delivered a more constructive outlook across both core and new businesses. Management emphasized that the traditional machinery and hydraulic business remains a solid foundation, with stable growth in cylinders, pumps, valves and motors, and continued strong demand from both domestic and overseas markets. Management highlighted robust order growth from major North American OEMs, including CAT and Deere, and noted that overseas customers are increasingly recognizing the value of Hengli's global supply chain and local production in Mexico and Indonesia. At the same time, management confirmed that the FA/ball screw gross margin turned positive in 3Q26 and is on track to exceed the full-year Rmb300MM revenue target, while robotics is entering mass production for a major US-led humanoid robot program. These developments support the view that new business lines are beginning to contribute more visibly to group results. With both core and new business momentum accelerating into 4Q and 2027, we see the current stock weakness as a disconnect from the improving fundamentals and stay OW.

- **Management emphasized that margin pressure from new business ramp and Mexico is being digested, with group GPM improving sequentially from Q1 to Q3.** GPM declined 2.38ppts Y/Y for 9M26, but management noted that core business GPM is slightly up when excluding the impact of ball screw, guide rail and Mexico. Op-CF for 9M26 grew 83% Y/Y, to Rmb1.94B, and reported recurring profit for 3Q26 was up c.39% Y/Y. Management expects further margin recovery as new business scales and cost absorption improves, and noted that the worst of the margin drag is likely behind it. Management also pointed to improving ROE and strong cash conversion as evidence of underlying earnings quality.

- **The FA/ball screw business is now a clear growth engine**, with management confirming that segment gross margin turned positive in 3Q26 and that the business is on track to exceed the full-year Rmb300MM revenue target. 9M26 FA/ball screw revenue reached over Rmb250MM (+400% Y/Y), with 3Q26 revenue at Rmb130MM. Management reiterated the goal for FA/ball screw to achieve profitability in 2027, with next year's revenue guidance unchanged at Rmb800MM-1B. The split between ball screw and guide rail is roughly 1:2, with guide rail demand especially strong. Management noted that c.80% of downstream demand is from industrial automation, with additional exposure to robotics, medical and semiconductor, and price increases of 10-20% have been implemented across the product line.

See page 4 for analyst certification and important disclosures, including non-US analyst disclosures.

- **Robotics is entering a commercial inflection, with mass production for a major US-led humanoid robot program further ramped up in October.** Management addressed prior market skepticism about Chinese supplier participation in the US robotics supply chain, stating that customer engagement is strong and that Hengli is well positioned as a core supplier for both ball screws and body rails. The company is also expanding its robotics product portfolio, including electric motors, and is actively exploring new opportunities with both domestic and overseas customers. While management did not disclose a separate revenue figure for robotics, it confirmed that electric motors are now in initial batch supply and that the product mix will expand as customer needs evolve. Management is optimistic about further growth in 2027 as the sector moves into mass adoption, and it is investing in capacity and technology to support global leadership ambitions in robotics.

- **Mexico and Indonesia are increasingly strategic in Hengli's global supply chain, with management highlighting that overseas customers, especially North American OEMs, are recognizing the value of local production.** Mexico's 9M26 revenue reached Rmb176MM (+480% Y/Y), with 3Q26 revenue at cRmb80MM, and management targets turning profitable next year as annual revenue exceeds Rmb500MM. Indonesia is also ramping up, with additional investment planned to serve Southeast Asia and Japanese OEMs, and current local output at 5,000-7,000 units. Management sees the global supply chain as a key lever for mitigating trade risk, supporting customer localization and capturing incremental market share as global expansion accelerates. Hengli also noted that the Mexico plant is now supplying a significant portion of US demand and that customer feedback on local production has been positive, with further volume ramp expected in 2027.

- **On the US anti-dumping investigation,** management reiterated that Hengli's diversified supply chain and local production in Mexico and Indonesia provide a strong buffer against policy risk and that the company is actively working with North American customers to ensure supply continuity. Management believes the trade environment could actually become a catalyst for further market share gains, as less-diversified competitors face greater challenges in adapting to new tariffs and localization requirements. Management also highlighted that the investigation is targeted mainly at midrange and low-end products, while Hengli's focus remains on higher-value segments with strong customer relationships and pricing power.



Investment Thesis

Hengli Hydraulic (Hengli) is a leading supplier of excavator hydraulic cylinders in China, with a market share exceeding 40% and a strong position in the pumps and valves market. The company is well positioned to leverage its leadership in the domestic cylinder market, in our view, with opportunities for further market share gains in segments with relatively low penetration, such as larger-sized excavator cylinders, valves and pumps. Hengli has strategically prioritized business diversification since 2022 to reduce its reliance on excavator products and supply chain concentration within China. The company's expansion into linear motion products, particularly in the humanoid robot and machine tool segments, is expected to contribute to revenue. This aligns with Hengli's strategy to tap into high-growth areas and capitalize on the increasing demand for precision components in advanced manufacturing processes. Maintain OW.

Valuation

Our DCF-based Dec-27 PT is Rmb126. The WACC rate used in our DCF analysis is 8.4%, with assumptions as follows: risk-free rate: 2.5%; market risk premium: 6.8%; Beta: 1.1x (based on Bloomberg); after-tax cost of debt: 4.3%; terminal growth: 5%; and target gearing: 25%.

Risks to Rating and Price Target

Key downside risks include: (1) lower-than-expected excavator sales volumes; (2) slower-than-expected market share gains for pumps and valves; (3) a deterioration in GP margin; and (4) escalating trade tensions and higher-than-expected tariffs for China's products.