

Geely Auto (175 HK)

China / Auto / Company Report

Target price: HK\$4.90

Previous TP: N/A

Last price: HK\$4.14

Potential Return: +18.4%

Happy ride on economy car market

- Leverage on strong PV demand
- Leading local brand in mid-to-low end sedan market
- Product mix improvement to further lift ASP
- BUY on sustained medium-term growth

BUY

6 September 2013

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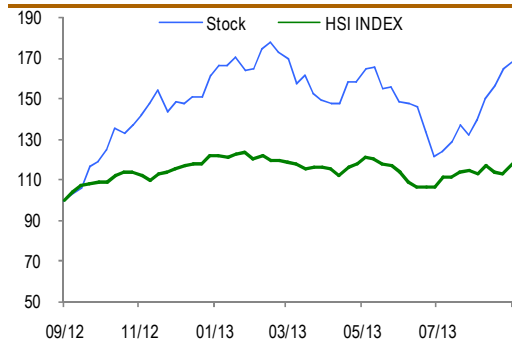
Forecast revision (%)

Year to 31 Dec	13F	14F	15F
Revenue change	-	-	-
Net profit change	-	-	-
EPS change	-	-	-

Key Share Data

52-week High / Low	HK\$4.75/2.40-
30D avg volume	65.26m
Issued share	8,273m
Market cap	34,251m
Major Shareholder	Li Shufu (45.43%)

Share Price Performance



Key Financials

Year to 31 Dec	2012	2013F	2014F	2015F
Revenue (RMB mn)	24,628	32,320	37,754	44,597
Growth (%)	17.5	31.2	16.8	18.1
Net profit (RMB mn)	2,040	2,720	3,141	3,635
Growth (%)	32.2	33.3	15.5	15.7
EPS (RMB)	0.26	0.31	0.36	0.41
Growth (%)	37.2	17.1	15.5	15.7
P/E (x)	12.6	10.7	9.3	8.0
P/B (x)	2.2	1.9	1.5	1.3
DPS(RMB)	0.04	0.05	0.05	0.06
Yield (%)	1.2	1.4	1.6	1.8

Source: Core Pacific Yamaichi

What's New

- ✎ **Better-than-expected growth in PV market.** China's passenger vehicle (PV) market delivered better-than-expected volume growth year-to-date. As per CAAM data, year-to-Jul sales volume in PV market expanded 13.4% yoy to 9,902k units. Sales volume in sedan, MPV, 2WD SUV, and 4WD SUV segments rose 11.1%, 123.7%, 57.0%, and 13.5% yoy to 6,681k, 639k, 1,135k and 429k units, respectively.
- ✎ **Leveraging on strong PV demand.** Geely Auto (175 HK) (Geely) is well known for its proprietary technology, focused product offering in mid-to-low end sedan products, and high price-to-performance ratio. The Company benefited from burgeoning PV demand in domestic market. In addition, it also expanded export sales to 37 overseas markets. Geely sold a total of 484,483 units of automobiles in 2012, translating into market share of 3.1% for PV market.
- ✎ **PV products offering in mid-to-low end market.** Geely has developed 14 major sedan products targeting at mid-to-low end market. The products are featured with its own 1.0-2.4L engines and sold in the names of three brands, i.e. GLEagle, Emgrand, and Englon.
- ✎ **1H13 NPAT beat market expectation on ASP improvement and margin expansion.** The Company posted strong 1H13 earnings growth on satisfactory sales volume growth, ASP improvement, and margin expansion. Total revenue was up 32.9% yoy in 1H13 as total sales volume increased 18.5%. ASP lifted 12.1% yoy or 9.4% hoh in 1H13 as the new models delivered higher selling prices. Meanwhile, gross margin improved 1.8 pts yoy to 19.2% in 1H13.
- ✎ **Continuous R&D investment to lift product technology and brand equity.** Looking ahead, the Management indicated they aimed to maintain adequate investment in R&D in new models and key components. It will help to lift Geely's product quality and brand image, which will reduce the pricing gap between Geely and foreign brand cars.

Our View

- ✎ **BUY on steady medium-term growth.** We anticipate 33.3%/15.5%/15.7% NPAT growth for FY13-15F on sustained volume growth and ASP improvement. We set our target price at HK\$4.9, translating into 11/10x P/E for FY14/15F. BUY. Major upside risks are better-than-expected sales growth and mix improvement.

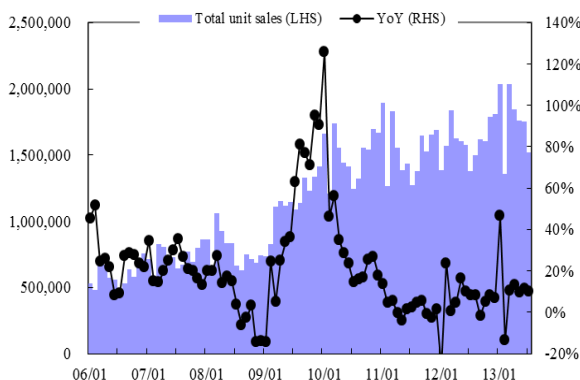
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Better-than-expected growth in PV market

Better-than-expected volume growth in China PV market. China's passenger vehicle (PV) market delivered better-than-expected volume growth in this year. As per CAAM data, year-to-Jul sales volume in PV market expanded 13.4% yoy to 9,902k units. Sales volume in sedan, MPV, 2WD SUV, and 4WD SUV segments rose 11.1%, 123.7%, 57.0%, and 13.5% yoy to 6,681k, 639k, 1,135k and 429k units respectively. The strong growth momentum was ahead of market expectation as private car ownership become increasing prevalent in China. Given China's policy makers' determination to maintain adequate economic growth and encourage car consumption, we expect China's PV sales to remain its growth momentum over the medium term.

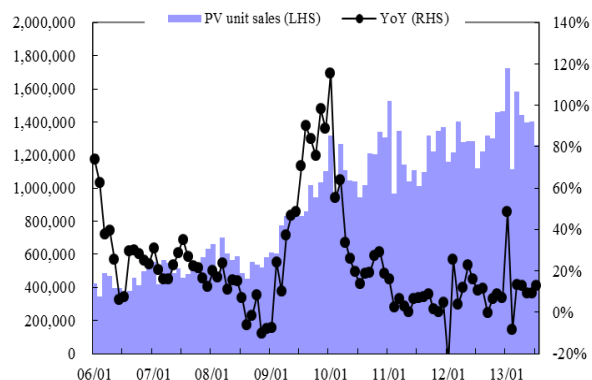
Leveraging on strong PV demand. Geely Auto (175 HK) (Geely) is one of the leading local brand PV manufacturers in China. It is well known for its proprietary technology, focused product offering in mid-to-low end sedan products, and high price-to-performance ratio. As China's PV market maintained double-digit growth over the past years, the Company benefited from burgeoning PV demand in domestic market. In addition, it also expanded export sales to 37 overseas markets (mainly Russia, Iraq, Saudi Arabia, and Ukraine). Geely sold a total of 484,483 units of automobiles in 2012, translating into market share of 2.5% for total auto market and 3.1% for PV market.

Figure 1: China auto market monthly unit sales



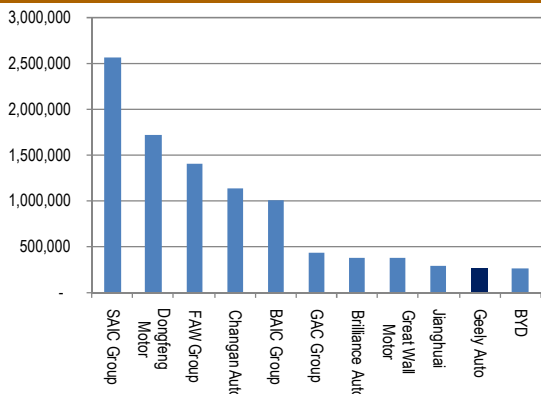
Source: CAAM

Figure 2: China PV market monthly unit sales



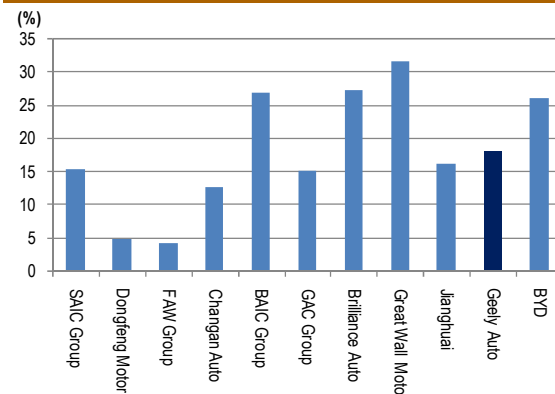
Source: CAAM

Figure 3: 1H2013 unit sales of major automakers



Source: CAAM

Figure 4: Unit sales growth (1H2013)



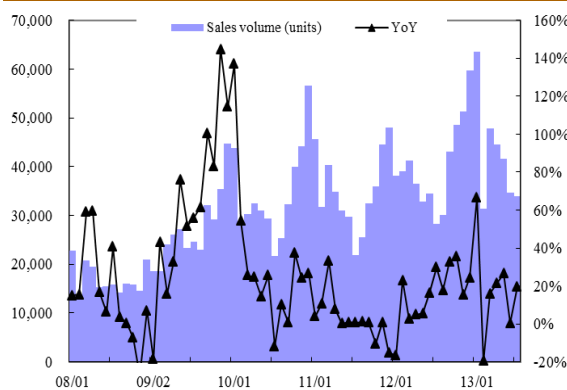
Source: CAAM

Enriching product offering in economy PV market

PV product offering in mid-to-low end market. Geely is headquartered in Hangzhou with 9 production plants in Linhai, Ningbo, Luqiao, Shanghai, Lanzhou, Xiangtan, Jinan, Chengdu and Cixi in China. Geely has developed 14 major sedan products targeting at mid-to-low end market. The products are featured with its own 1.0-2.4L engines and sold in the names of three brands, i.e. GLEagle, Emgrand, and Englon. GLEagle and Emgrand branded vehicles remained its major brands. The two brands accounted for two thirds of total sales in 1H13.

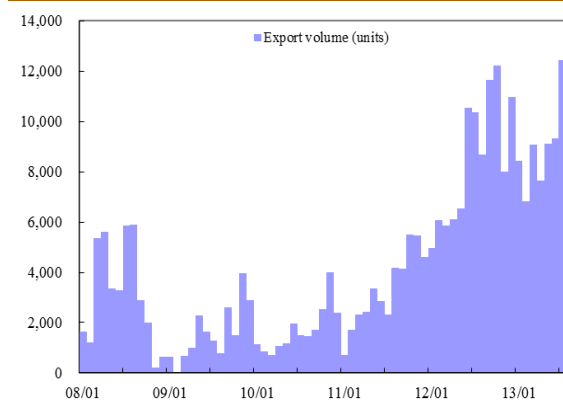
New models in 2013. The Company introduced SX7 mid-end SUV products in 2012. It is scheduled to launch EV8 MPV, SC5 sedan, new versions of EC8 and EC7, and EX8 high-end SUV in 2013. We expect new models in SUV and MPV will remain the major growth drivers in the near term.

Figure 5: Geely Auto: monthly sales volume



Source: Company data

Figure 6: Geely Auto: monthly export sales volume



Source: Company data

Table 1: Geely Auto: sales mix

	2009	2010	2011	2012	7M2013
Free Cruiser	110,700	95,189	82,702	66,481	22,008
LG-1	83,590	85,063	84,969	78,444	28,202
SC515	0	432	5,015	2,144	814
Vision	52,702	63,421	51,478	33,306	24,584
Panda	28,500	40,588	43,250	31,471	24,432
TX4	263	1,033	872	725	96
Emgrand EC7	10,198	71,360	91,693	142,503	101,324
Emgrand EC8	0	1,300	14,983	12,771	6,478
GC7	0	0	138	14,948	11,402
GX7	0	0	36	30,793	23,905
SX7	0	0	0	0	8,765
SC3	0	0	0	12,952	7,775
SC6	0	0	0	11,377	12,620
Maple	39,814	57,360	46,349	45,569	25,061
Other	943	97	126	0	0
Total	326,710	415,843	421,611	483,483	297,466

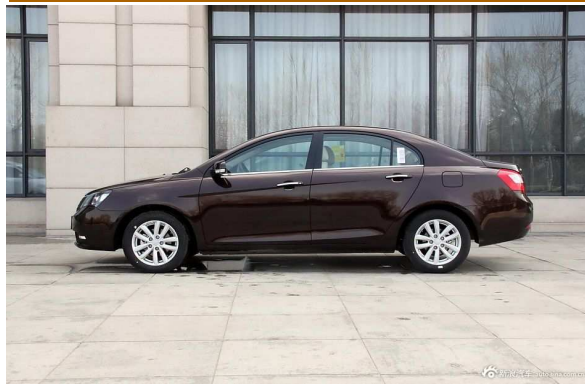
Source: CAAM and company data

Table 2: Geely Auto: product information

	Retail price (RMB)	Engine displacement	Gearbox	Size(mm)
Free Cruiser	38,900-41,900	1.0L/1.3L/1.5L	5MT	4152/1680/1440
LG-1	45,800-50,800	1.5L	5MT	4342/1692/1435
Vision	52,900	1.5L	5MT	4602/1725/1485
Panda	37,900-54,900	1.0L/1.3L	5MT/4AT	2598/1630/1465
Emgrand EC7	71,800-101,800	1.5L/1.8L	5MT/CVT	4635/1789/1470
Emgrand EC8	99,800-209,800	2.0L/2.4L	5MT/6MT/6AT	4905/1830/1495
GC7	62,900-89,900	1.5L/1.8L	6AT	4547/1734/1470
GX7	92,900-129,900	1.8L/2.0L/2.4L	5MT/6AT	4541/1833/1700
SX7	92,800-129,800	1.8L/2.0L/2.4L	5MT/6AT	4553/1833/1700

Source: Company data and Core Pacific - Yamaichi

Emgrand EC7



Source: Sina Auto

Englon SX7 SUV



Source: Sina Auto

GLEagle GX7 SUV



Source: Sina Auto

Satisfactory mix improvement in 1H13

1H13 NPAT beat market expectation on ASP improvement and margin expansion. The Company posted strong 1H13 earnings growth on satisfactory sales volume growth, ASP improvement, and margin expansion. Total revenue was up 32.9% yoy in 1H13 as total sales volume increased 18.5%. Sales volume of the new version EC7 soared 41.1% yoy to 86,103 units in 1H13, while sales of GX7 (launched in 1Q12) and SX7 (launched in 1Q13) contributed to the strong volume growth. In addition, the Company introduced series of model upgrade and renewal in 2012. Therefore, ASP lifted 12.1% yoy or 9.4% hoh in 1H13 as the new models delivered higher selling prices. Meanwhile, gross margin improved 1.8 pts yoy to 19.2% in 1H13.

Effective expense control in 1H13. Selling expense and administrative expense was up 24.5% and 29.2% yoy. The Management indicated rising R&D expenses and increasing sales were the main drivers. However, the Company maintained effective expense control amid strong sales. Selling expense/sales ratio dipped 0.4 pts yoy to 5.5% on strong sales growth. Administrative expense/sales ratio was down 0.2 pts yoy to 5.0%. Other income fell 24.0% yoy mainly on lower government subsidy. Government subsidy decreased 23.6% yoy as the Company paced its expansion steps.

Continuous R&D investment to lift product technology and brand equity. Looking ahead, the Management indicated they aimed to maintain adequate investment in R&D in new models and key components (such as engine and gearbox). We expect continuous R&D investment will deliver sustained improvement in product technology. As local brand cars are mainly regarded as superior in price/performance, the Company targets at bring its product technology in line with that of foreign brand economy car makers over the medium term. We expect it will help to lift Geely's product quality and brand image, which will reduce the pricing gap between Geely and foreign brand cars.

Table 3: Geely Auto: 1H13 results summary

(RMB mn)	1H12	1H13	YoY	Comment
Revenue	11,177	14,855	32.9%	Better-than-expected ASP improvement
COGS	(9,237)	(12,008)	30.0%	
Gross profit	1,940	2,847	46.7%	Gross margin improved 1.8pts yoy
Other income	727	552	-24.0%	Lower government subsidy
Selling expenses	(659)	(821)	24.5%	
Admin expenses	(578)	(747)	29.2%	
EBIT	1,429	1,831	28.1%	
Finance cost	(103)	(57)	-45.3%	
Pre-tax profit	1,261	1,725	36.8%	
Net profit	1,020	1,398	37.2%	Sustained volume growth and ASP improvement

Source: Company data

Table 4: Sales volume and market share in sedan segment

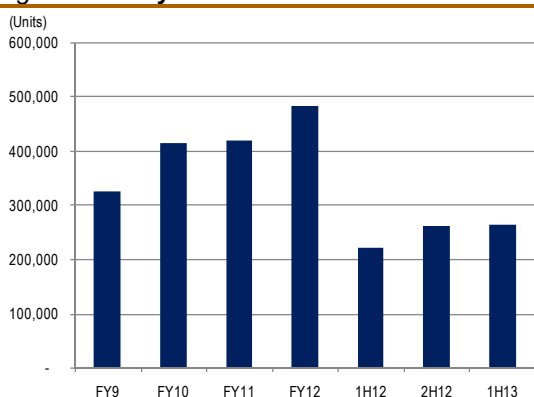
(Units)	1H12	1H13	YoY	1H12 market share	1H13 market share
Sedan	5,229,947	5,841,270	11.7%	-	-
FAW Volkswagen	576,280	672,764	16.7%	11.0%	11.5%
SAIC Volkswagen	522,758	663,495	26.9%	10.0%	11.4%
Beijing Hyundai	306,627	382,861	24.9%	5.9%	6.6%
Dongfeng Nissan	369,670	336,144	-9.1%	7.1%	5.8%
SAIC GM	619,958	686,222	10.7%	11.9%	11.7%
Dongfeng Peugeot	208,649	252,334	20.9%	4.0%	4.3%
Geely Auto	216,606	236,637	9.2%	4.1%	4.1%
Changan Ford	175,272	231,058	31.8%	3.4%	4.0%
BYD	160,725	218,959	36.2%	3.1%	3.7%
Dongfeng Kia	170,210	212,455	24.8%	3.3%	3.6%

Source: Company data

Expect stable margins going forward

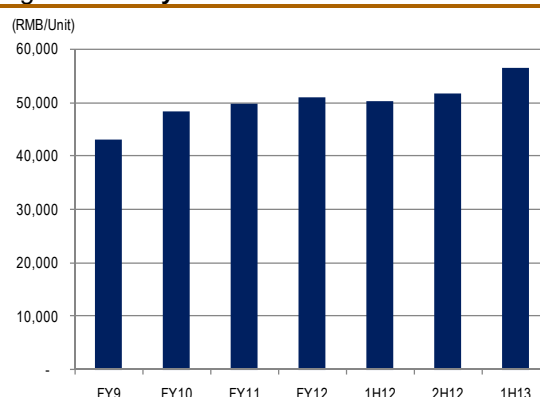
Expect stable gross margins on fierce competition. Geely's gross margins improved 0.3pts and 1.8 pts yoy in FY12 and 1H13 respectively. While we are positive on further mix upgrade and ASP advancement, we expect stable gross margins for FY13-15F on account of fierce competition going forward. As China become the largest automobile market in the world, global auto makers are increasingly keen on China market. In addition to introduce more high-end products to achieve high profitability, global giants also intend to capture more market share with localized and low-priced models. Moreover, in compliance with the government's industry policy, major domestic auto makers try to develop their proprietary brand cars. The newly developed cars also aim at taking market share in mid-to-low end market. Though we expect local brand cars will maintain its price competitiveness, intensifying competition will put pressure on further margin expansion.

Figure 7: Geely Auto: unit sales



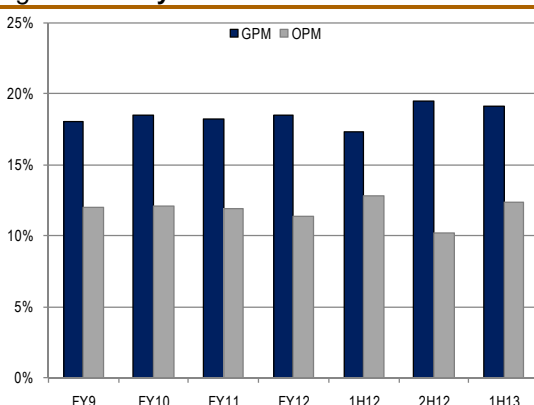
Source: Company data

Figure 8: Geely Auto: ASP



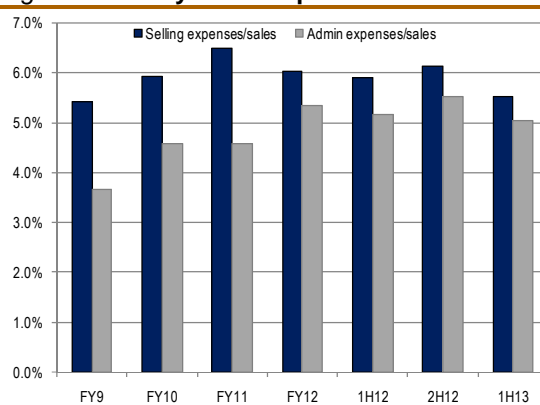
Source: Company data

Figure 9: Geely Auto: GPM & OPM



Source: Company data

Figure 10: Geely Auto: expense/sales ratios



Source: Company data

BUY on sustained growth outlook

Capacity expansion and export sales to deliver sustained growth. Total production capacity was 625,000 units p.a. as of Dec2012. The Management indicated it would expand capacity to 665,000 units p.a. as of Dec2013. Moreover, the Company will invest in overseas markets to promote export sales. Presently, export sales represented about 20% of total sales volume. The Management indicated stronger volume growth in export sales over the medium term.

BUY on sustained growth outlook. We are positive on Geely's leading brand name in local brand economy car market, continuous improvement in product technology and brand image, strict expense control, and strong growth in export sales. We expect the Company to enhance its position as a leading local brand car maker in the medium term. We anticipate 33.3%/15.5%/15.7% NPAT growth for FY13-15F on sustained volume growth and ASP improvement. The share price is trading at 10.7/9.3/8.0x FY13-15F P/E and 1.9/1.5/1.3x FY13-15F P/B, which is relatively low compared with other China auto makers. We initiate coverage on Geely with a BUY recommendation. We set our target price at HK\$4.9, translating into 11/10x P/E for FY14/15F. Major upside risks are better-than-expected sales growth and mix improvement. Major investment concerns are: (1) intensifying competition, (2) possible government car restriction policy, (3) ongoing anti-trust investigation on foreign brand cars, and (4) fluctuation in foreign exchange rates.

Table 5: Auto sector valuation matrix

Company	Code	Price	MktCap	P/E(x)			P/B(x)			Yield(%)	
		(HK\$)	(HK\$m)	12	13F	14F	12	13F	14F	13F	14F
Dongfeng Motor Group	489 HK	11.26	97,018	9.1	7.7	7.2	1.5	1.2	1.1	2.1	1.9
Brilliance China Auto	1114 HK	11.20	56,289	19.0	13.5	11.1	4.8	3.4	2.6	1.1	1.3
GAC	2238 HK	8.72	64,937	31.9	17.8	11.9	1.5	1.3	1.2	1.7	2.4
Great Wall Motor	2333 HK	41.10	160,079	17.7	12.5	10.5	4.6	3.6	2.9	2.2	2.6
Geely Auto	175 HK	4.14	34,251	12.6	10.7	9.3	2.2	1.9	1.5	1.4	1.6
Weichai Power	2338 HK	30.75	51,612	15.0	13.2	11.3	1.8	1.7	1.5	1.2	1.4
Sinotruk	3808HK	3.94	10,878	33.1	18.7	12.7	0.5	0.5	0.4	1.5	2.1
		(RMB)	(RMBm)								
SAIC Motor	600104 CH	13.02	143,553	5.3	4.8	4.3	1.0	0.8	0.7	5.5	5.9
Changan Auto	000625 CH	10.73	47,956	28.3	12.1	8.8	2.6	2.1	1.7	0.8	1.6
Yutong Bus	600066 CH	18.39	23,424	13.0	10.5	8.9	3.0	2.1	1.8	2.9	3.3
Foton Motor	600166 CH	5.26	14,779	7.2	10.1	8.3	0.8	0.7	0.7	1.4	1.6

Source: Bloomberg and Core Pacific – Yamaichi estimates

Profit & loss(Consolidated)

Year to 31 Dec (Rmb mn)	2011	2012	2013F	2014F	2015F
Turnover	20,965	24,628	32,320	37,754	44,597
COGS	(17,145)	(20,069)	(26,111)	(30,439)	(35,956)
Gross profit	3,820	4,559	6,209	7,315	8,641
Other income, net	997	1,048	873	917	963
Distribution costs	(1,359)	(1,483)	(1,869)	(2,171)	(2,564)
Administrative expenses	(963)	(1,319)	(1,664)	(1,982)	(2,341)
EBIT	2,495	2,804	3,550	4,079	4,698
Share-based payments	(137)	(79)	(61)	(64)	(67)
Net interest	(167)	(195)	(125)	(131)	(138)
Associates	(7)	(2)	(4)	(4)	(5)
Pre-tax profit	2,183	2,529	3,360	3,879	4,488
Taxation	(467)	(479)	(634)	(732)	(846)
Minorities	(172)	(10)	(6)	(6)	(7)
Net profit	1,543	2,040	2,720	3,141	3,635

Balance sheet(Consolidated)

Year to 31 Dec (RMB mn)	2011	2012	2013F	2014F	2015F
Non-current assets	10,591	11,525	12,943	13,948	15,044
PPE	6,796	7,008	7,576	8,202	8,890
Intangible assets	2,222	2,814	2,955	3,103	3,258
Interest in associates	84	195	205	215	226
Prepaid lease payments	1,480	1,461	1,644	1,808	1,989
Other	10	46	563	619	681
Current assets	17,006	19,855	23,184	28,416	34,506
Prepaid lease payments	38	38	40	44	48
Inventories	1,358	1,822	2,187	2,515	2,892
Receivables	12,215	13,476	11,791	13,560	15,594
Other	12	16	20	22	24
Cash	3,384	4,502	9,146	12,276	15,948
Total assets	27,597	31,380	36,127	42,364	49,551
Current liabilities	14,985	16,693	19,021	21,777	24,986
Payables	12,114	15,183	17,933	20,623	23,717
Borrowings	2,532	1,379	872	959	1,055
Taxation	339	131	216	195	214
Non-current liabilities	2,462	1,483	1,385	1,433	1,483
Convertible bonds	1,527	849	862	883	906
Borrowings	843	525	400	420	441
Tax liabilities	92	109	124	130	136
Total liabilities	17,447	18,176	20,407	23,210	26,468
Total equity	10,150	13,204	15,720	19,154	23,082
Share capital	140	153	153	153	153
Reserves	9,443	12,734	15,407	18,834	22,756
Minority interests	568	317	160	167	173
Total liabilities & equity	27,597	31,380	36,127	42,364	49,551

Cash flow(Consolidated)

Year to 31 Dec (RMB mn)	2011	2012	2013F	2014F	2015F
Pre-tax profit	2,183	2,529	3,360	3,879	4,488
Tax paid	(281)	(711)	(634)	(732)	(846)
Depreciation & amortization	642	860	948	1,043	1,147
Associates	(7)	(2)	(4)	(4)	(5)
Change in working capital	(1,647)	1,503	4,150	566	695
Others	318	258	(511)	476	518
Operating cash flow	1,208	4,438	7,309	5,228	5,998
Capex	(1,420)	(1,076)	(1,517)	(1,668)	(1,835)
Disposals	199	102	(323)	(312)	(336)
Investment cash flow	(2,953)	(2,071)	(1,840)	(1,980)	(2,171)
Share issues	14	618	32	40	50
Change in debts	716	(1,460)	(619)	129	139
Dividend paid	(170)	(170)	(239)	(286)	(343)
Others	(166)	(193)	0	0	0
Financing cash flow	393	(1,206)	(825)	(117)	(154)
Free cash flow	(1,745)	2,367	5,469	3,247	3,826
Net cash flow	(1,352)	1,160	4,644	3,130	3,672

Sources: Company data and Core Pacific – Yamaichi

Definitions of Recommendations:
For stock recommendations:

Buy:	+15% or above of expected return over the next 12 months.
Hold:	Between +15% and -5% of expected return over the next 12 months.
Sell:	Potential downside of more than 5% over the next 12 months.

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