3 Oct 2019

CMB International Securities | Equity Research | Sector Update

招银国际 CMB INTERNATIONAL
招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

Auto OEM sector

Market bottoms with potential policy stimulus

MARKET-PERFORM (Initiation)

China Auto Sector

Jack Bai
(852) 3900 0835
jackbai@cmbi.com.hk

We analyze the recent development of the auto sector and summarize some critical changes happened recently. These structural changes include low investment return, used-car market development and so on, which present us with an analytical framework for auto stock selection. We believe that the decline in Auto market was a structural phenomenon rather than a short-term effect. Accordingly, we recommend investors to choose companies that have strong JVs with foreign brands, great competitive local brand awareness while maintaining certain exposure on the oversea market. Our top picks are GAC (2238 HK) and Geely (175 HK).

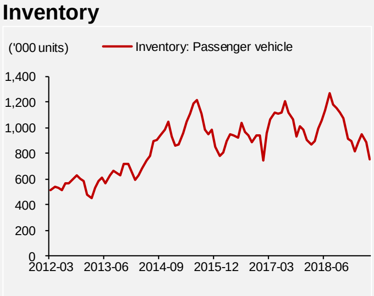
- **Overall market continued to decline in Aug.** The auto market has slowed down since 2018 and continued its unpleasant performance in 1H19. In Aug, the production and sales volume of passenger vehicle were 1.69mn and 1.65mn, down by 0.7% and 7.7% YoY respectively. The decline in production and sales was slightly narrower than the previous month.
- **An inflection point is expected to appear in 4Q19.** We did not anticipate any major changes in our structural analysis. However, in our analysis, we strongly believe the specific consumption-boosting policy will be rolled out soon later this year. With potential policy stimulus and seasonal effect, we expect a moderate sales recovery in 4Q19.
- **Low prevailing investment return is the most critical constraint for resident spending.** In our analysis, we found that even though residents have the willingness to spend more, the low return prevailing in the market does not provide adequate spending power.
- **Low capacity utilization rate with amass of loss entities prompts for potential policy stimulus.** Recent public news states that some OEMs and auto parts producers are experiencing difficulties and even stopped production in 3Q19. This suggests that overall auto market condition was at the critical point affecting the overall employment market. We anticipate the government will potentially launch stimulus policy to support auto consumption.
- **We present a methodology to select auto stocks in the following years.** Factoring in near-term and medium-term potential, we recommend investors to select companies with strong JVs and reputable local brands while having the capability to expand abroad. A strong financial condition is a plus for the company.
- **Valuation/Key risks.** 1) Continued slowdown in the Chinese economy. 2) Policy support was less than expected.

Valuation Table

Company	Ticker	Rating	Mkt Cap (LC mn)	Last Px (LC)	TP (LC)	P/E(x) FY19E	P/E(x) FY20E	P/B(x) FY19E	ROE FY19E
GAC	2238 HK	Buy	119,488	7.55	9.67	7.08	5.08	0.78	11.76%
Geely	175 HK	Buy	122,185	13.40	16.35	9.87	8.61	1.82	21.83%
Dongfeng	489 HK	Hold	64,535	7.49	8.20	3.91	3.47	0.44	11.72%
GWM	2333 HK	Hold	67,157	5.24	4.99	13.92	11.54	0.79	5.73%
SAIC	600104 CH	Hold	277,833	23.78	25.59	9.25	8.55	1.17	5.69%

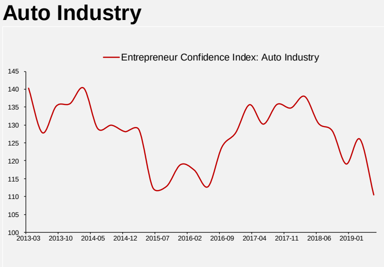
Source: Bloomberg, CMBIS estimates

Inventory



Source: Wind, CMBIS

Entrepreneur Confidence Index: Auto Industry



Source: Wind, CMBIS

Contents

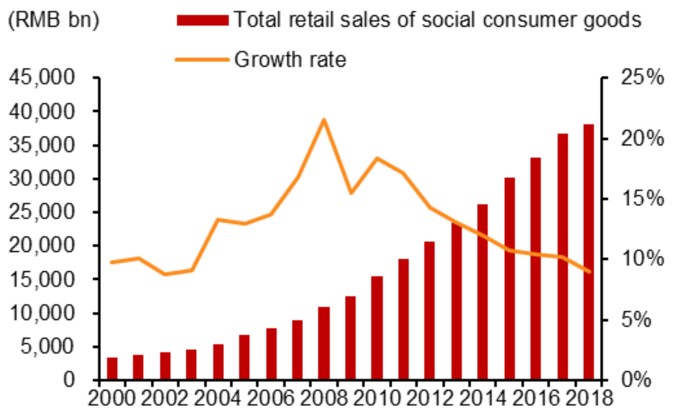
The inflection point is approaching? Automotive industry near-term forecast

1. What has happened to consumer spending?

According to the data released by the National Bureau of Statistics, the total retail sales of consumer goods in 2018 was RMB 38.1tn, an increase of 9.0% YoY. However, the growth rate in 2018 was the lowest since 2003.

A recent good news is that consumer spending was on a recovery track in Jun 2019. In 1H19, the total retail sales of consumer goods reached RMB 19.5tn, a nominal increase of 8.4% YoY (the real increase of 6.7% after factoring inflation). Among them, the total retail sales of consumer goods in Jun was RMB 3.9tn, an increase of 9.8% YoY. We believe the overall growth rate of consumer spending will have a slight YoY decrease in 2019.

Figure 1: Total retail sales of social consumer goods



Source: NBS, CMBIS

In our analysis, we try to answer the following question which directly affect the auto sales: *What are the main factors that causing the slowdown in consumer spending?*

1.1 Spending willingness – residents are willing to spend more

Is the slowdown of total retail sales growth rate caused by the decline of spending willingness among residents? In Jun 2019, PBOC officially released the 2Q19 result of the *Urban Depositors Questionnaire Report*. According to this report, among all the candidates, 26.4% of which chose the 'more spending' option, up by 0.5ppt from the first quarter; 45.4% of which chose 'more savings', up by 0.4ppt from the first quarter, 28.2% of which chose 'more investment', down by 1.0ppt from the first quarter. In terms of spending, the rankings of candidate choices from high to low are: tourism (33.6%), education (29.3%), health care (25.3%), housing (21.0%), and discretionary goods. (20.2%), social culture and entertainment (17.2%), insurance (15.4%).

We can conclude from the data that consumers' willingness of spending more continues to increase whereas the willingness of investing more decreases accordingly. Two factors contribute to this phenomenon. First, as the level of social development increases, the resident's willingness to consume will gradually increase. Also, with a great amount of new generation joining the consumer groups, the aggregate of spending willingness among the total population was much higher than it used to be. From the perspective of investment willingness, we have noticed the prevalence and continuing decline in domestic asset yields (Money market, Stock market and Real estate market), which has led to a decline in residents' willingness to invest. We can draw the following conclusions: First, in the short term, residents' willingness to consume will gradually increase due to economic growth and demographic changes. Second, the financial market condition affects the rate of return on investment, resulting in a decline in residents' willingness to invest.

1.2 Spending power - low investment return restricts spending power

Then why does the growth rate of spending continue to decline in recent years? Does the high housing price squeeze out consumption? We can find out the secret from the balance sheet of the residential sector.

The debt ratio of the residential sector in China continues to rise, driven by the real estate mortgage. As of Dec 2018, 39% of resident debt came from real estate loans. Considering that some consumer loans and short-term loans eventually flow into the housing market as the form of down-payment, the actual real estate sector debt ratio should be higher than the data. Conventional wisdom shows that high debt not only erodes current spending but also reduces future spending power due to the high interest burden. Statically, the residents' consumption at a given point of time has been squeezed by having a high mortgage. However, given the asset attribute of real estate, we believe that the dynamic wealth effect due to the slowdown in real estate prices is the main reason behind this round of consumption slowdown. Furthermore, as stated above, the decline in the rate of return on other asset category exacerbates the situation.

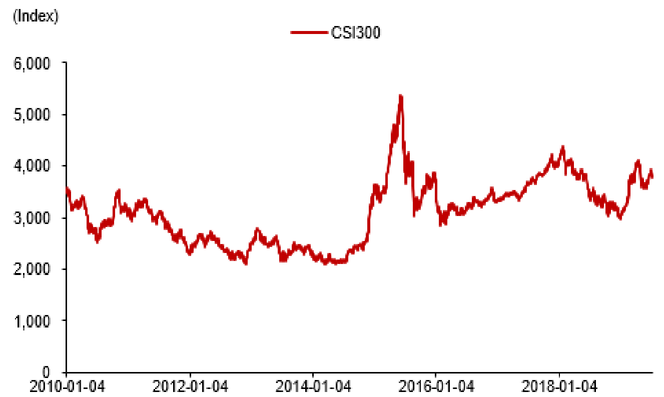
Economic theory tells us that household consumption depends not only on current disposable income but also on future expected income. An individual will smooth its consumption based on current income and future income. When residents expected high future income, more debt will be raised in the current period. Therefore, the actual current consumption power depends on the future income plus the credit from debt.

According to the China National Balance Sheet 2018 published by the Chinese Academy of Social Sciences at the end of 2018, the growth of social net wealth mainly comes from investment and value revaluation. Two major components of asset basket for Chinese resident are real estate and financial investment. Due to the de-leverage of the market in the past two years, the decrease in the asset return directly leads to the slow growth of residents' wealth, which in turn is transmitted to the final consumption. In recent years, due to the slowdown in real estate price growth and the general decline in return on assets, the quality of residents' balance sheets has continued to deteriorate. The consequence is that spending power is restricted.

We also observe that the shantytown renovation project in China was gradually shrinking in the past two years. Under the circumstance of restriction order in tier 1 cities, the slowdown of shantytown renovation project limits the spending power in tier 2 and tier cities. Therefore the housing policy has put auto sales into great pressure.

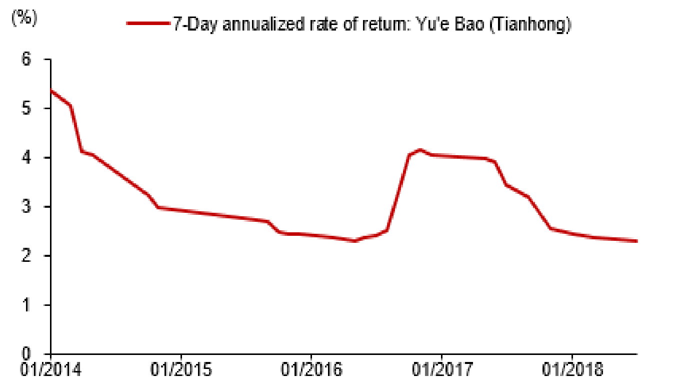
However, with the medium-term effect of the supply-side reform gradually emerged, the domestic economy will stabilize. The balance sheet will be restored and consumption will start a new round of growth.

Figure 2: CSI300



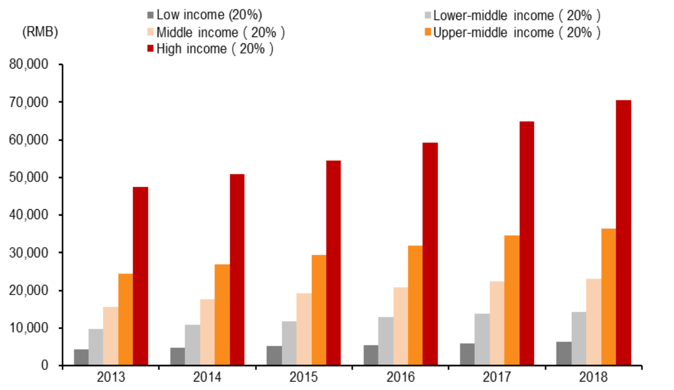
Source: Wind, CMBIS

Figure 3: 7-Day annualized rate of return (Yu'e Bao)



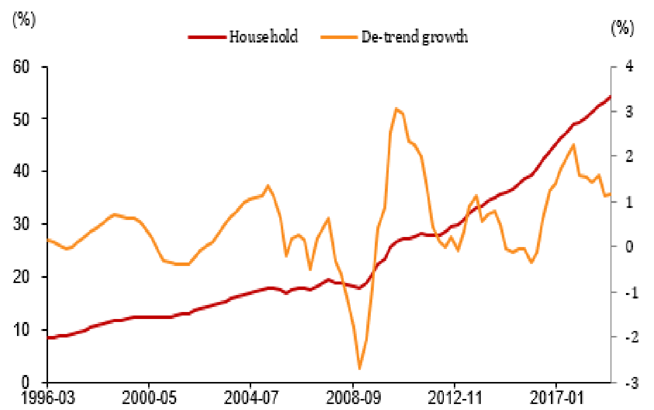
Source: Wind, CMBIS

Figure 4: Income growth by income level



Source: Wind, CMBIS

Figure 5: Household leverage ratio



Source: Wind, CMBIS

Figure 6: House price

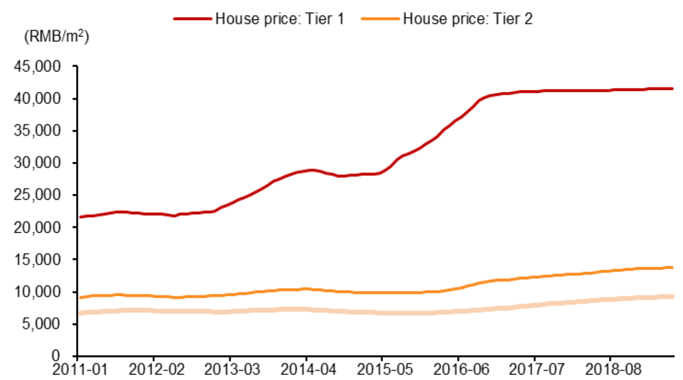
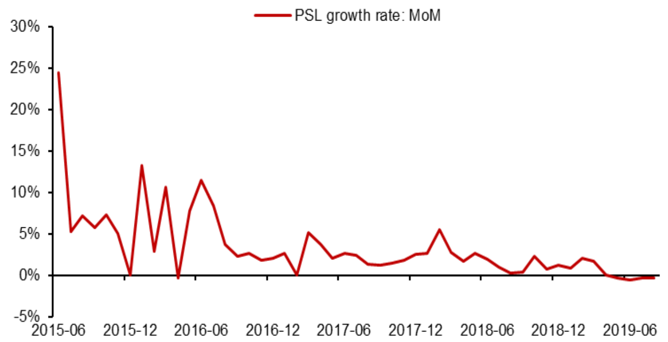


Figure 7: PSL growth rate



Source: Wind, CMBIS

Source: Wind, CMBIS

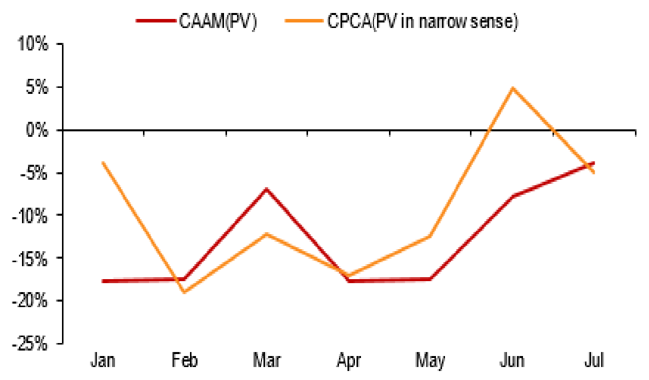
2. Industry Overview

2.1 Sales and inventory

In Aug, according to the data published by the China Association of Automobile Manufacturers (CAAM), the production and sales of passenger vehicle were 1.69mn and 1.65mn, up by 10.9% and 7.9% MoM or down by 0.7% and 7.7% YoY respectively. From Jan to Aug, the production and sales of passenger cars were 13.2mn and 13.3mn, respectively. The production and sales volume decreased by 13.9% and 12.3% YoY respectively.

In the 1H2019, the production and sales volume were 12.132mn and 12.323mn, respectively. The number decreased by 13.7% and 12.4% YoY. Chinese auto production and sales have shown a YoY decline for 12 consecutive months, but the decline has narrowed.

Figure 8: CAAM vs CPCA



Source: Wind, CMBIS

However, we found that the data released by CPCA (China Passenger Car Association) was significantly better than the passenger car data released by the CAAM in May and Jun 2019. This shows that dealers underwent the destocking process in the retail end in the last two months of 1H19. The CPCA announced that the narrow PV sales volume fell by 5% in Jul, while the data from CAAM showed that the sales volume of PV fell by 3.9% in Jul. We believe that the dealers' destocking task was nearly completed in May and Jun. Together with the data in Aug, we believe that OEM is replenishing its inventory in Jul and Aug. We forecast that the OEMs will continue to distribute the inventory to dealers in the next two months.

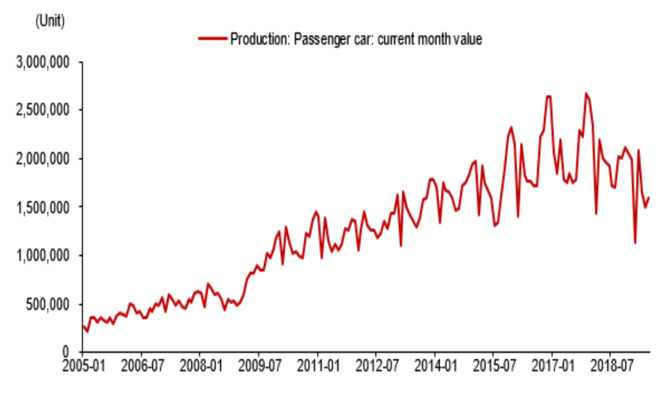
2.1.1 NEV market condition

The transition period for new energy vehicle subsidies ended on 25 Jun 2019 but the growth of new energy vehicles is still very strong. In the 1H19, the production and sales volume of new energy vehicles were 614,000 and 617,000, respectively, an increase of 48.5% and 49.6%. Among them, the production and sales volume of pure electric vehicles were 493,000 and 490,000 respectively, an increase of 57.3% and 56.6% YoY. The production and sales of plug-in hybrid vehicles were 119,000 and 126,000, an increase of 19.7% and 26.4% YoY.

2.1.2 Reason behind the data

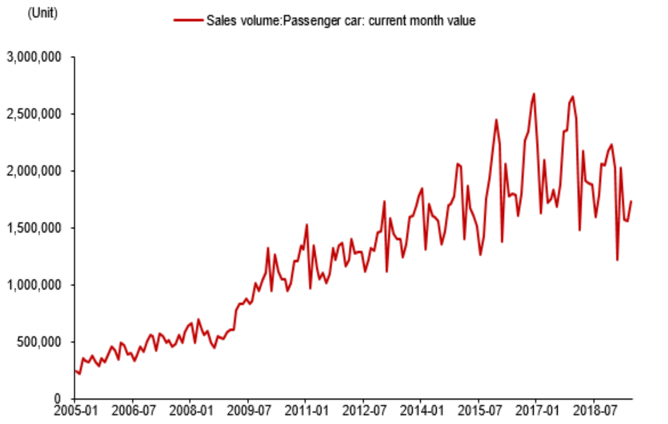
The reason behind this condition is not as appealing as it shows. In 1H19, vehicle manufacturers and dealers adopted a price reduction and de-stocking strategy, with the aim of completing the de-stocking of stage-5 standard vehicle by 1 Jul 2019. In terms of inventory levels, OEM inventory fell to its lowest point since Jul 2014. Taking into account that Jul and Aug are the off-season months for the auto market, and the price reduction promotion in 1H19 also overdrafted certain sales volume, we expect the retail sales is not likely to rebound back in 3Q19. The inflection point will likely to appear at the beginning of 4Q19.

Figure 9: Total production: Passenger car



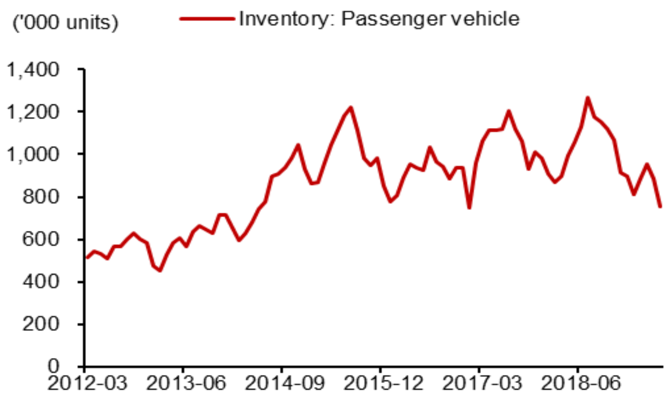
Source: Wind, CMBIS

Figure 10: Total sales volume: Passenger car



Source: Wind, CMBIS

Figure 11: Inventory: Passenger vehicle



Source: Wind, CMBIS

2.2 Stage-6 implementation

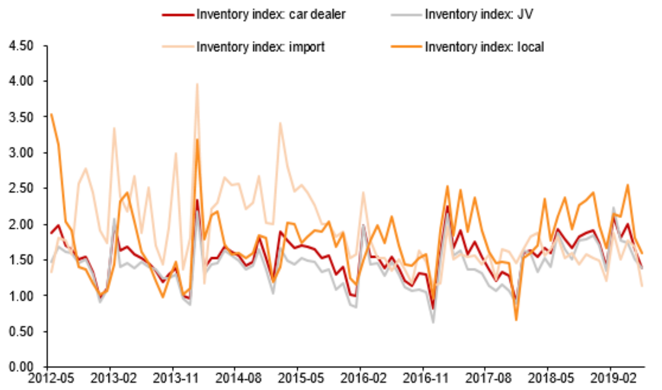
While the slowdown of economy and the trade war with the United States were initially held responsible for slides in sales since Apr 2019, most of the blame now lies on the disorder of new rules adopted by the 15 cities and provinces, which account for more than 60% of sales in the domestic auto market.

From the perspective of destocking, the inventory warning index began to decline slightly from its local peak. From the inventory data, we see clearly that the implementation of the

Stage-6 standard has made all auto manufacturers in 1H19 focus on the de-stocking of the Stage-5 standard vehicle.

At the same time, the policy uncertainty from implementing stage-6 standards makes a portion of retail consumers delay the purchase. The major uncertainty includes the actual time for implementation, the price cut magnitude for stage-5 standard vehicle and used-car market trading policy. With the official implementation of the first batch of cities on 1 Jul 2019, the uncertainty was alleviated which will underpin near-term sales recovery.

Figure 12: Inventory index



Source: Wind, CMBIS

In order to meet the Stage-6 standard, an auto manufacturer needs to upgrade its engine and exhaust gas treatment component, resulting in an increase in the cost. At present, some production capacity for the Stage-6 standard vehicles is not in place. According to data from CAAM, as of the end of Jun, there were only 99 companies in the market with a total of 2,144 models, accounting for about half of the models currently sold on the market. We expect the supply of the Stage-6 vehicle products to achieve the initial scale at the end of 3Q19. Considering dealers will begin to replenish stage-6 stocks after the 1H19 de-stocking process, the retail sales are expected to rebound slightly in 4Q19.

Figure 13: Stage-6 adoption schedule

Region	Type of vehicle	Time of implementation	Stage
Beijing	Bus/Sanitation vehicle	1/7/2019	Stage 6-B
	The rest	1/7/2020	Stage 6-B
Shenzhen	Gasoline vehicle	1/7/2019	Stage 6-B
	Diesel vehicle	1/11/2018	Stage 6-B
Shanghai	light-duty vehicle	1/7/2019	Stage 6
Tianjin	light-duty vehicle	1/7/2019	Stage 6
Chongqing	light-duty vehicle	1/7/2019	Stage 6
Hebei	light-duty vehicle	1/7/2019	Stage 6
Henan	light-duty vehicle	1/7/2019	Stage 6
Guangdong	light-duty vehicle	1/7/2019	Stage 6-B
Shandong	light-duty vehicle	1/7/2019	Stage 6
Shanxi	light-duty vehicle	1/7/2019	Stage 6
Hainan	light-duty vehicle	1/7/2019	Stage 6
Anhui	light-duty vehicle	1/7/2019	Stage 6
ShaanXi	light-duty vehicle	1/7/2019	Stage 6
Sichuan	light-duty vehicle	1/7/2019	Stage 6
Zhejiang	light-duty vehicle	1/7/2019	Stage 6
Nanjing	light-duty vehicle	1/7/2019	Stage 6
Jiangsu	light-duty vehicle	1/7/2019	Stage 6
The rest	light-duty vehicle	1/7/2020	Stage 6-A
	light-duty vehicle	1/7/2023	Stage 6-B

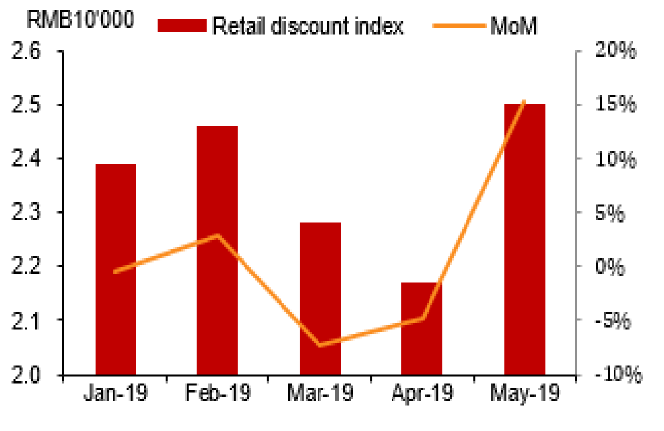
Source: Public information, CMBIS

2.3 Price war

The price war has caused serious losses in the industry, and small businesses are under pressure. We expect the net profit of major auto manufacturers to decline in 1H19.

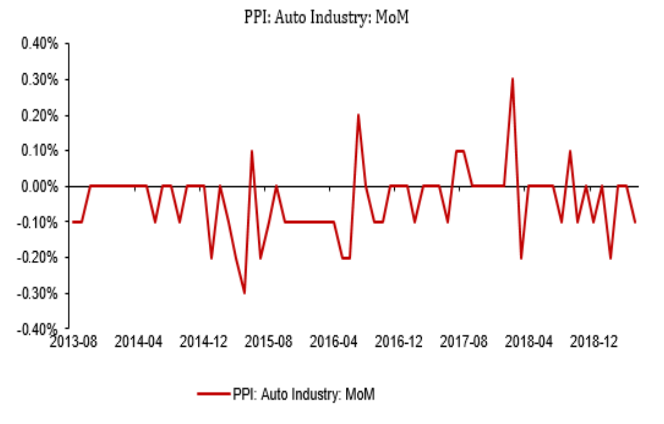
Vehicle manufacturers and dealers have experienced high inventory due to recent sales slowdown in 2018. In order to achieve rapid destocking task before the implementation of Stage-6, manufacturers and dealers started price war in 1H19. The major consequence was the decline of gross margins which resulted in net loss.

Figure 14: Retail discount index



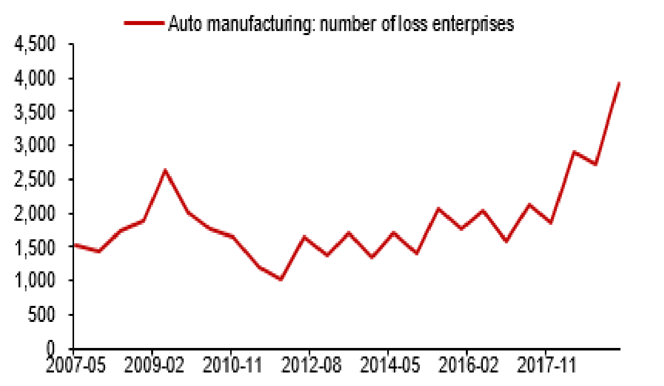
Source: Wind, CMBIS

Figure 15: PPI (Auto industry)



Source: Wind, CMBIS

Figure 16: Number of loss enterprises



Source: Wind, CMBIS

The inventory index of joint venture brands and imported brands began to decline in Mar 2019. Local brands have a two-month delay which began to decline in May 2019. Meanwhile, a universe deterioration of gross profit margin happened in the whole industry. The gross profit margin of some enterprises has dropped to negative territory. Through the above two indicators, we can see that the whole industry has adopted de-stocking by cutting the price. We anticipate YoY net profit decline in major OEMs, especially for small enterprises. But for those which have strong JV brands and capital reserve, they have an opportunity to expand their market share.

2.4 Why is the market share of local brands falling? – The impact from used-car market

Statistics from the China Automobile Dealers Association show that in 2018, the cumulative number of used cars sold in 2018 exceeded 13.82mn, an increase of over 11% YoY. According to the "*2018 Annual Survey Report on Used Car E-Commerce*" issued by Youxin Research Institute, the used-car market has undergone structural changes in the region constitute. The proportion of first-tier cities decreased by 5.5%, the proportion of second-tier cities decreased by 8.9%, while the proportion of third-tier cities increased by 10.4%, and the proportion of first-tier cities decreased by 5.5%.

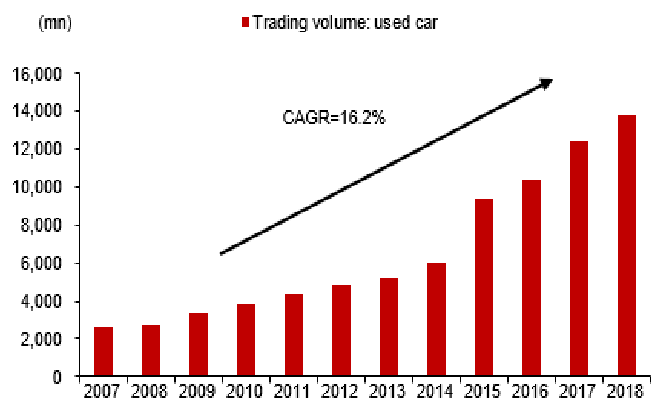
The rapid growth of the used-car market has changed the playing field of new car market. The used car sellers are more likely to choose a medium and high-end to replace the used cars. Given the current strategy of local brands, the replacement needs will more likely shift to joint venture brands and imported brand instead of local brands. Therefore, we see that since 2018, although the overall passenger car sales have been declining, joint venture brands and imported brands are still growing at a small rate.

Meanwhile, the rise of used-car trading in tier 3 and tier 4 cities has squeezed the demand for new cars, especially for local brands. Due to the active trading in the used car market, some consumers who purchase cars for the first time choose to buy medium-to-high-end used cars with a short usage age, leading to the loss of demand in the low-end market. Affected by this, the development of used car trading e-commerce has led to the differentiation of local brands and joint venture brands.

Therefore, the market share of local brands has declined as the used-car market flourished.

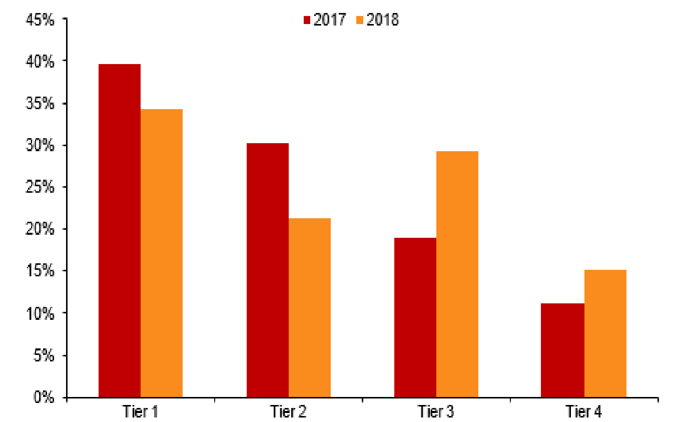
We can conclude that two factors will determine the future performance of local brands. The first is the speed of urbanization process. The urbanization speed will directly affect the income growth and capital gain of residents in tier 3 and tier 4 cities. A high urbanization growth rate will create vehicle demand by enabling residents to earn stable income and by raising loans. The second is the speed of brand recognition. A great branding and marketing strategy will create customer loyalty in medium- and long-term. Before local brands succeed in building brand awareness, the growth of the local brands will largely depend on the speed of urbanization.

Figure 17: Used-car trading volume



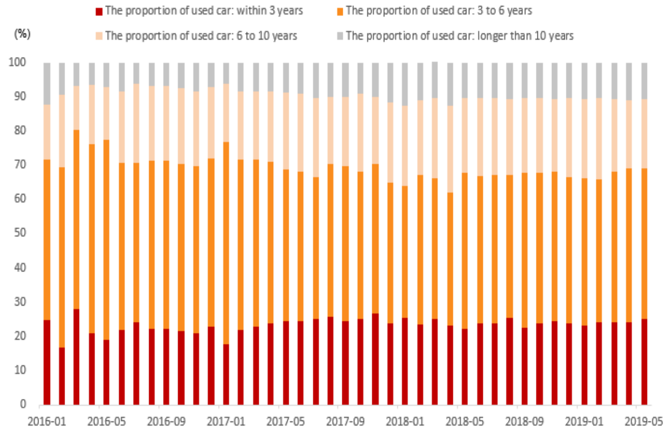
Source: Wind, CMBIS

Figure 18: % of trading volume in term of city level



Source: Youxin, CMBIS

Figure 19: Used-car age proportion



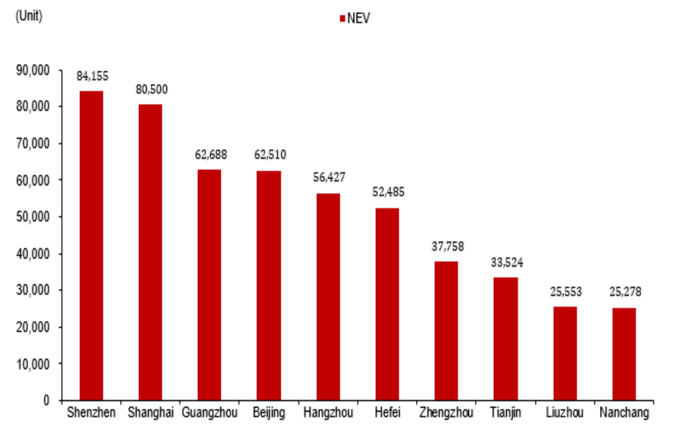
Source: Wind, CMBIS

2.5 Why does NEV grow at unprecedented rate?

According to the data from the China Automobile Association, NEV sales volume reached 617,000 units in 1H19, an increase of 49.6% YoY despite overall market slowing down. The vehicle plate limitation prompts strong sales of NEV in top tier cities. In addition, commercial vehicle demand partially contributes to strong growth. From the data, we found the Top 5 cities of NEV sales are Shenzhen, Shanghai, Guangzhou, Beijing and Hangzhou. The convenience of using makes the top reason for NEV purchasing.

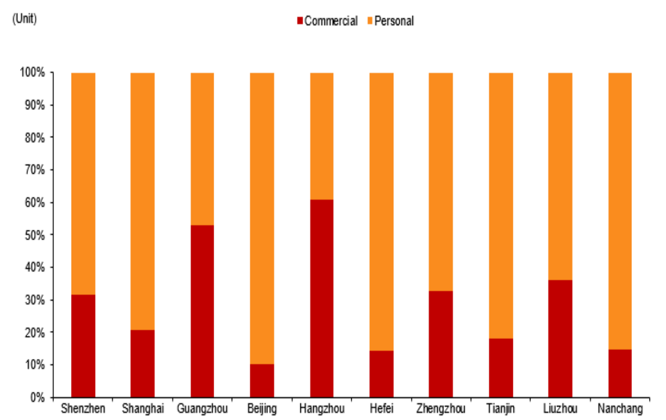
Looking into the future, in tier 3 and tier 4 cities, the overall procession rate remains at a low level which is mainly related to the consumption habit. It does not enjoy the relative convenience which has motived NEV widespread in top tier cities. The inadequacy of charging piles which have been placed in tier 3 and tier 4 cities has impeded resident from purchasing NEV. If the above concerns were solved in the near term, NEV will have huge potential accompanying with the urbanization process in tier 3 and tier 4 cities.

Figure 20: Top 10 cities of NEV sales in 2018



Source: Wind, CMBIS

Figure 21: Commercial NEV vs Personal NEV in 2018

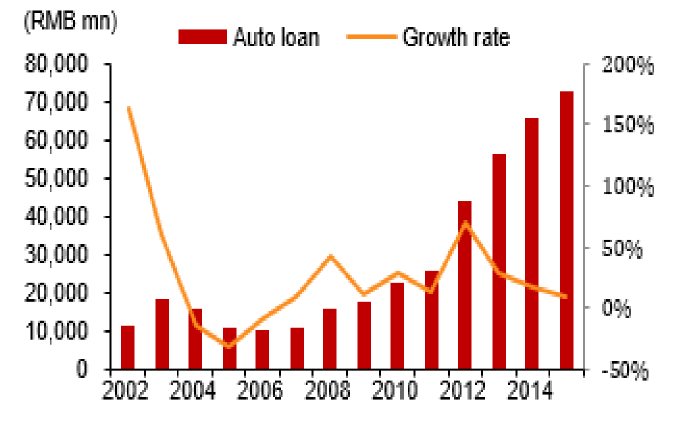


Source: Wind, CMBIS

2.6 The growth rate of auto loan is slowing down

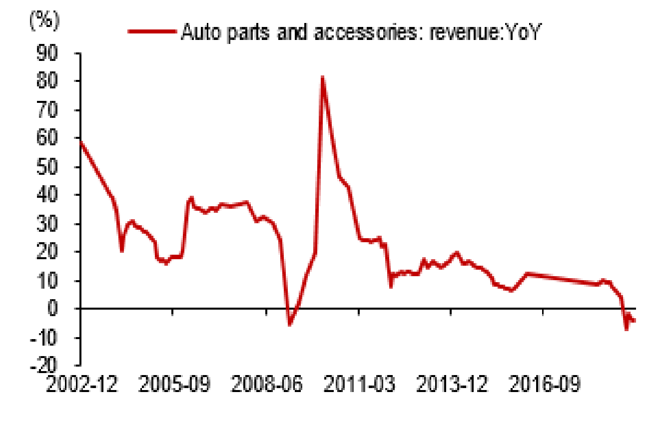
As shown in the figure, the growth rate of the auto loan was slowing down in recent years. Credit shrank directly affected the purchasing power of retail consumers. A future relieve of residential sector credit will boost auto sales. However, given current monetary policy environment, we are not expect any policy easing on residential credit.

Figure 22: Retail auto loan



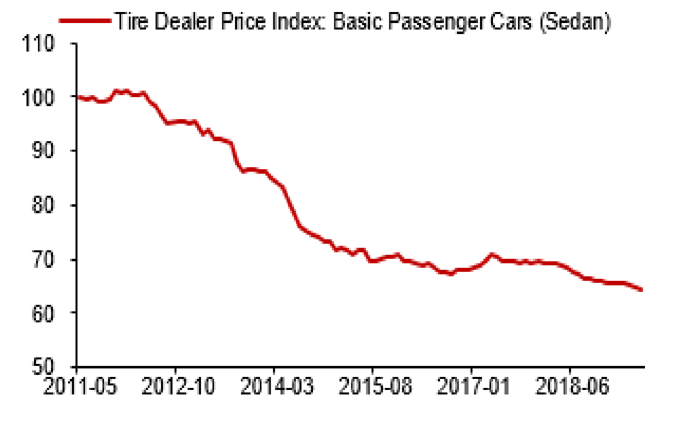
Source: Wind, CMBIS

Figure 23: Auto parts and accessories revenue YoY



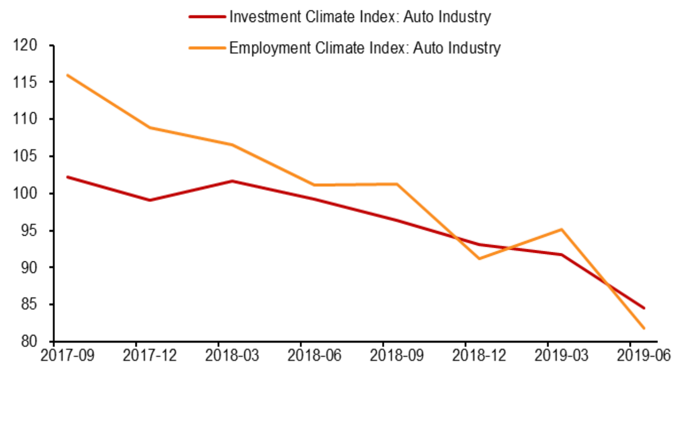
Source: Wind, CMBIS

Figure 24: Tire Dealer Price Index



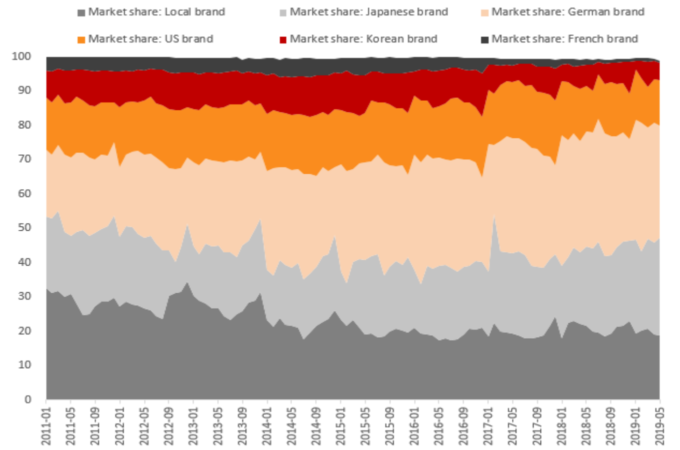
Source: Wind, CMBIS

Figure 25: Auto climate index



Source: Wind, CMBIS

Figure 26: Market share by brand country



Source: Wind, CMBIS

3. Market Prediction

3.1 Short-term

3.1.1 Manufacturing confidence

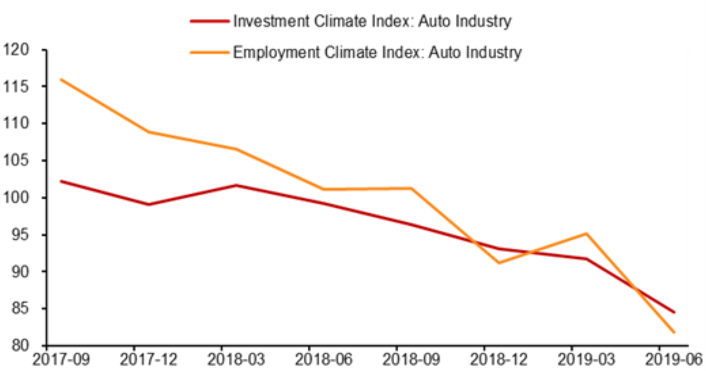
We have seen a rebound in the auto industry entrepreneur confidence index in 1Q19, which comprehensively reflects a slight rise of confidence in auto industry. However, it turned to a sharp decline in 2Q19. The employment climate index, a leading indicator for auto manufacturing, has rebounded in 1Q19 and turned to a sharp decline in 2Q19. At the same time, we also see that the decline in fixed-asset investment.

3.1.2 Consumer confidence

We believe that the decline in OEM revenues in recent years is accompanied by the deterioration of balance sheets in the residential and corporate sectors. With the benefit of the supply-side reform gradually appearing, the balance sheet restoration will come together with a stabilized domestic economy. Consumer confidence will gradually recover accordingly.

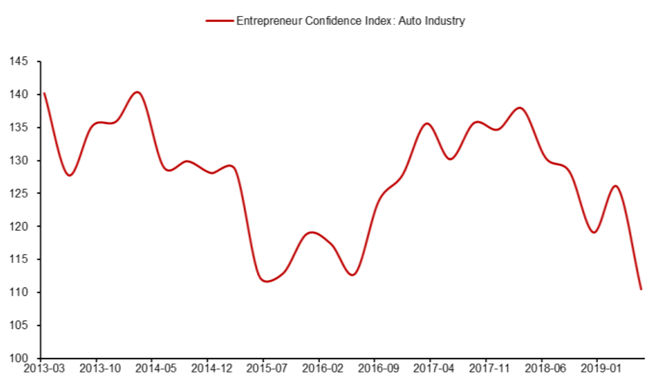
According to relevant statistics, it roughly takes two to three months for consumers from initial thought to make the final purchase. Taking into account the potential policy stimulus, we expect retail sales would improve in the 4Q19.

Figure 27: Auto Climate Index



Source: Wind, CMBIS

Figure 28: Entrepreneur Confidence Index (Auto)

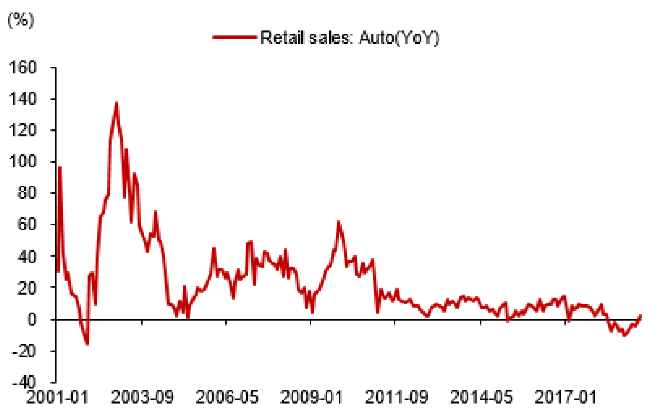


Source: Wind, CMBIS

3.1.3 Inventory replenishment after the implementation of the Stage-6

With the official implementation of the Stage-6, we expect dealers to replenish the inventory of the Stage-6 vehicle at the end of 3Q19, stimulating the wholesale sales volume to rise. The process to gain regulatory approval for car models can take six months to a year and vehicle testing agencies such as the China Automotive Technology and Research Center (CATARC) do not have enough labs to meet the sudden surge in demand. In this sense, Japanese automakers have the technical reserve are better prepared for a switch in emission standard. At the same time, they are offering more affordable products.

Figure 29: Retail sales YoY



Source: Wind, CMBIS

3.1.4 Policy guess

We expect that the YoY decline in sales volume will become inevitable in 2019. As previously stated, a portion of auto manufacturers are experiencing a loss due to the negative effects of weak sales.

The automobile industry chain covers more upstream and downstream enterprises than any other industries. In the case of large-scale losses for the whole industry, it will further increase the burden on upstream and downstream enterprises, resulting in potential systematic risk on employment.

Given our analysis, we believe that the decline in the auto market was a structural phenomenon rather than a short-term effect. Therefore, we highly expect the government to introduce specific consumption stimulus policies by the end of the year or early next year. Industry leaders will utilize their financing advantages to seek M&A opportunity to expand their market share meanwhile.

3.2 Medium term

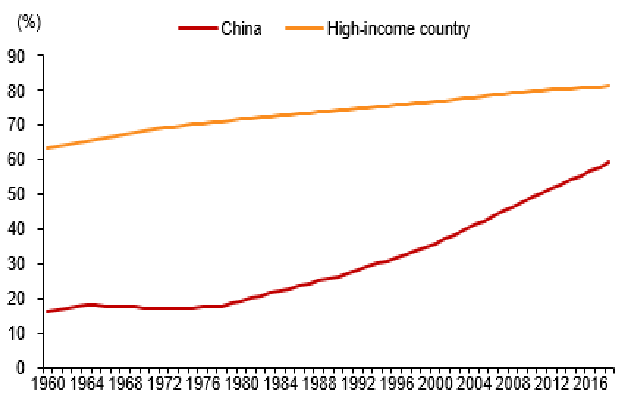
3.2.1 Next phase in urbanization

Given the current policy on urban planning, the growth rate of China's top tier cities will be slower in the future. Due to the relatively imperfect public transportation and infrastructure in the tier 2 and tier 3 cities, the rigid demand for automobiles remains. At the same time, along with urbanization, tier 3 and tier 4 cities will further unleash vehicle demand. China's urbanization rate is about 60%, and there is still a certain distance from the urbanization rate of developed countries. With the gradual advancement of urbanization in the medium term, the demand for car purchase will be released, especially for the demand for local brand cars.

3.2.2 NEV

Given several environmental policies adopted by the Chinese government, both production capacity and sales volume hikes during the past three years. We expect the rising trend will continue in the future given the determination of the Chinese government in curbing pollutions. Enterprises which can expand market share will bring down the cost first and gain the advantage over the race.

Figure 30: Urbanization rate



Source: World Bank, CMBIS

3.3 Long term

Technological progress will finally reconstruct the automotive industry. In the long run, advances in technology will reshape the automotive industry in a way that we cannot imagine now. However, a few keywords are expected to be the future trend, namely *intelligence, lightweight, connected* and *sharing.* It will transform the sole OEM into a dual "manufacturer plus services" business model.

Intelligence is required for AI technologies such as advanced assisted driving and automatic driving. *Lightweight* requires new carbon fiber reinforced plastic, a mixed body of aluminum and high-strength steel. With the promotion of the 5G *network connected* in the future, consumers' demand for automobiles will change. In the future, the car will become part of the human intelligent terminal, interconnecting multiple scenarios such as travel, work, life and entertainment. The core connotation of *sharing* is the transformation of automobile consumption mode, achieving cost savings while improving travel efficiency.

The long-term changes in the automotive industry above will present completely different technical requirements for auto manufacturers. In the long run, we focus on auto manufacturers that have laid out cutting-edge technologies and services.

4. Stock pick

Given our analytical framework, we believe the consumption policy will be rolled out as early as in 4Q19. A policy stimulus for tier 3/4 cities and rural area will help the strong local brands such as Geely. A policy stimulus for tier 1/2 cities will help the strong JVs such as GAC Toyota. Therefore, based on our policy expectation and financial forecast, we recommend GAC (2238 HK) and Geely (175 HK).

3 Oct 2019

CMB International Securities | Equity Research | Company Update

招銀国际 CMB INTERNATIONAL

招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

GAC Group (2238 HK)

Outperformed the overall market in 1H19

The overall performance of GAC was spectacular compared with market performance driven by JV with Japanese brands. In 1H19, the sales volume of passenger cars was 10.127mn, down by 14.0% YoY, and the decline was narrower than that from Jan through May. The sales volume for GAC in 1H19 was 999,560, down by 1.69% YoY, compared with 1,016,779 in the same period last year. GAC successfully accomplished inventory destocking in 1H19. We believe that the official enforcement of Stage – 6 will relieve the market uncertainty. It is expected that the dealers will gradually replenish the stocks at the end of 3Q. Overall market recovery was anticipated in 4Q19.

- **High product quality as core strength.** During the interview, 'high quality' was mentioned in the highest frequency by GAC staff from different departments. We may emphasize on quality makes. The J.D.Power new car quality report has witnessed the growth trajectory of Chinese local auto brands. Since 2013, GAC Chuanqi has won the championship among local brands for six consecutive years, leading the continuous improvement of Chinese car quality. Plan to enter US market showcase the confidence of management team on Trumpchi.
- **Automated assembly as first-mover advantage in Industrialization 4.0.** We visit assembly line of GAC NE and was impressed by its automation level. By using industrial robot, the assembly line was able to get rid of human labor in Stamping, Welding, and Painting process improving the overall productivity. Furthermore, robotization can realize the customized production in so-called Make-to-order (MTO) manner which will consequently improve inventory management and cost-saving.
- **Divisions restructured for better management.** Even though GAC has a good overall performance in the first half of the year, it actively sought institutional reforms and implemented a so-called business division structure. Three newly established divisions, namely *Manufacture division*, *Parts and component division*, and *Commercial services division* were formed recently in order to better manage each business segment in headquarters.
- **Valuation/Key risks.** The Company is currently trading at 7.08x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 6.50x. Our Target Price is HK$9.67 per share with 28.07% upside potential. Initiate with Buy.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	71,575	72,380	69,231	71,124	74,299
YoY growth (%)	44.84%	1.12%	-4.35%	2.73%	4.46%
Net income (RMB mn)	11,005	10,900	9,570	13,342	14,227
EPS (RMB)	1.51	1.07	0.94	1.31	1.40
YoY growth (%)	55%	-29%	-12%	39%	7%
P/E (x)	4.39	6.21	7.08	5.08	4.76
P/B (x)	0.69	0.87	0.78	0.67	0.59
Yield (%)	4.00%	5.57%	5.72%	5.01%	5.64%
ROE (%)	19.43%	14.93%	11.76%	14.36%	13.33%
Net gearing (%)	17%	34%	29%	23%	22%

Source: Company data, CMBIS estimates

BUY (Initiation)

Target Price	**HK$9.67**
Up/Downside	**+28.07%**
Current Price	**HK$7.55**

China Auto Sector

Jack Bai
(852) 3900 0835
jackbai@cmbi.com.hk

Stock Data

Mkt Cap (HK$ mn)	119,488
Avg 3 mths t/o (HK$ mn)	191.33
52w High/Low (HK$)	10.60/ 6.82
Total Issued Shares (mn)	10232.5

Source: Bloomberg

Shareholding Structure

Guangzhou Automobile Industry Group Co.,Ltd.	9.43%
Citigroup Inc.	8.06%
BlackRock, Inc.	6.65%

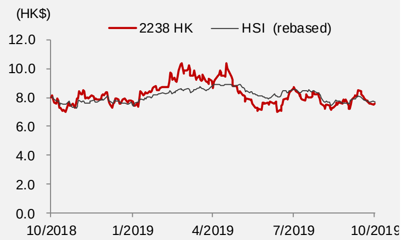
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-5.1%	-6.4%
3-mth	-10.1%	-1.6%
6-mth	-18.2%	-7.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers

- **Three pillars for the business growth.** GAC Honda and GAC Toyota are the first pillar of GAC Group. The former sold 394,508 vehicles in 1H19, an increase of 16.41% YoY. GAC Toyota sold 311,224 vehicles in 1H19, an increase of 21.86% YoY. In the general environment of the slow-down market, the JV showcase that the two companies are highly competitive in the market. As formerly mentioned, the second pillar is GAMC product which among the best local brands in China. The third pillar is NE market which GAC has demonstrated great market presence.
- **Upgrading dealership store with new model coming up.** As of end of May 2019, GAC has upgraded nearly 500 dealership stores through brand-new design and renovation. An upgrading in sales terminal showcases the effort of GAC management toward customer-oriented sale strategy. Compounded with new model coming to the market, we expect a growth recovery for local brand, notably Trumpchi, in 2H19. In the China Automotive After-sales Customer Satisfaction Survey (CAACS), GAC has won the first place in China for three consecutive years. In the China Automotive Sales Satisfaction Index (SSI) survey released by J.D. Power, GAC Trumpchi has been awarded the No. 1 brand in China for two consecutive years.
- **Most of new models for 2019 will come up to the market in 2H19.** Local brand experienced difficult time in 1H19 affecting GAC as well. However, for the first 1H19, GAC Trumpchi has not released its new models which is the major reason for undesirable sales volume. In 2H19, there are a list of new model waiting in the pipeline for market release including GA6 sedan, GS8 SUV, Aion LX NEV SUV and so on.

Company Overview

Three pillars with high growth potential

GAC Group is mainly engaged in the design and manufacture of automobile and parts, automobile sales and logistics, automobile finance, insurance and related services. At present, the Company owns GAC Motor, GAC Honda, GAC Toyota, Honda (China), GAC Mitsubishi, GAC Fiat Chrysler, GAC Hino Motor and so on. Besides of its famous JVs brand, Trumpchi is an automotive marque owned by GAC Group which is recognized by Chinese consumers as one of the best local brands according to JD power. The GAC New Energy Automobile Co., Ltd. (GAC NE) is the NEV arm of GAC. GAC New Energy produces their own EV brand, Aion, and sells the EV and PHEV Trumpchi models. Trumpchi, JVs and NEV constitute the three pillars of GAC group.

GAC Toyota

GAC Toyota is located in Guangzhou, covering an area of 2.82mn sq m and a building area of 740,000 sq m. Currently, there are 10,029 employees. The production models include CAMRY, Highlander, C-HR, YARiS L, LEVIN, YARiS L. GAC Toyota has three production lines, and the overall production capacity reached 500,000 units per year. Among them, the production capacity of the first and second production lines reached 400,000 units per year, and the initial production capacity of the third production line reached 100,000 units per year. In the future, it can be rapidly expanded to 200,000 units per year according to market demand. By then, the total production capacity of GAC Toyota can exceed 600,000 units per year. In Jul 2019, GAC Honda sold 62,000 units, an increase of 21.29% YoY. In 1H19, GAC Toyota had a total sales of 311,224 units, an increase of 21.86% YoY.

GAC Honda

GAC Honda Automobile Co Ltd is a Chinese automobile manufacturing joint venture company based in Guangzhou, Guangdong province. Co-owned by Honda and GAC Group, GAC Honda produces Honda-branded models. Its products comprise the Everus S1, Honda Accord, Honda Crider, Honda City, Honda Crosstour, Honda Vezel, Honda Fit, and Honda Odyssey. In Jul 2019, GAC Honda sold 51,871 units, a decrease of 8.6% YoY. In 1H19, GAC Honda had a total sales of 394,508 units, an increase of 16.41% YoY.

Focus Charts

Figure 31: GAC NE production line

Source: Autohome, CMBIS

Figure 32: GAC NE production line

Source: Autohome, CMBIS

Figure 33: New models launch schedule

Name	Type	Expected time to launch
GA6	Mid-size sedan	07/2019
GS8	Mid-size SUV	06/2019
GA8	Full-size sedan	End of year
GA4	Compact sedan	End of year
GS5	Compact SUV	End of year
GS4	Compact SUV	06/2019
GM8	MPV	09/2019
GS3	Small SUV	07/2019
GS7	Mid-size SUV	07/2019
Aion LX	NEV SUV	10/2019

Source: Autohome, CMBIS

Figure 34: New GS8 model coming up to the market

Source: Autohome, CMBIS

Figure 35: New GS6 model coming up to the market

Source: Autohome, CMBIS

Figure 36: New NEV SUV coming up to the market

Source: Autohome, CMBIS

Figure 37: New dealership store for GAC Trumpchi

Source: Autohome, CMBIS

Financial Analysis

Revenue

The Company generates revenue through automobiles, automobile parts and components, commercial services and financial services. In 2018, revenue from sales of automobiles increased by 0.4% YoY to RMB 50,394mn while revenue from sales of automobile parts and components decreased by 1% YoY to RMB 2,882mn. Revenue from commercial service decreased by 0.2% YoY to RMB 16,374mn whereas revenue from financial service increased by 34.3% YoY to RMB 2,730mn. We forecast in 2019E/20E/21E revenue from sales of automobiles will reach RMB 45,231mn/44,483mn/44,986mn with growth rate of -10.2%/-1.7%/1.1%. We forecast in 2019E/20E/21E revenue from sales of automobile parts and components will reach RMB 3,314mn/3,712mn/4,083mn with growth rate of 15%/12%/10%. We forecast in 2019E/20E/21E revenue from commercial service will reach RMB 18,503mn/20,723mn/23,002mn with growth rate of 13%/12%/11%. We forecast in 2019E/20E/21E revenue from financial service will reach RMB 2,184mn/2,206mn/2,228mn with growth rate of -4.4%/2.7%/4.5%.

Net Income/EPS/Dividend

In 2018, net income attributable to equity holders of the Company declined by 1% to RMB 10,900mn whereas ROE was 14.93%. The Company declared 3,887mn cash dividend in 2018 representing 36% payout ratio. We forecast that the Company's overall profitability will rebound in 2020E/21E after a decline in 2019E. Specifically, we expect the net income will decline to 9,608mn, a decrease of 12% YoY. However, we forecast in 2020E/21E, net profit will increase by 39%/7% YoY to RMB 13,394mn/14,284mn. The corresponding ROE will be 11.76%/14.36%/13.33% respectively in 2019E/20E/21E.

Operating ratios

- **Profitability Ratios**

We forecast that GPM in 2019E/20E/21E will be 10.31%/14.55%/14.28% respectively. We forecast that NPM in 2019E/20E/21E will be 13.88%/18.83%/19.22% respectively.

- **Liquidity Ratios**

We forecast that current ratio in 2019E/20E/21E will be 1.65/1.61/1.48 respectively. We forecast that net gearing ratio in 2019E/20E/21E will be 29%/23%/22% respectively.

- **Efficiency Ratios**

We forecast that inventory days in 19E/20E/21E will be 28.36/26.16/25.98 respectively. We forecast that accounts receivable days in 19E/20E/21E will be 88.56/74.54/70.17 respectively.

Valuation

Initiate with TP HK$9.67 (28.07% upside)

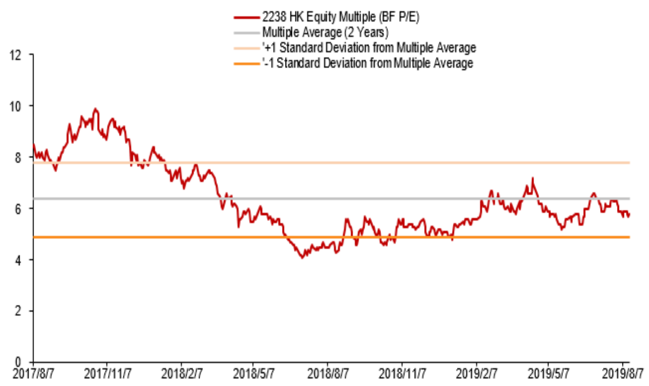
The Company is currently trading at 7.08x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 6.50x. Our Target Price is HK$9.67 per share with 28.07% upside potential. Initiate with Buy.

Figure 38: Peers' valuation

Ticker	Name	Mkt Cap (HKD)	PE			ROE	Dvd Yld
			FY19	FY20	FY21	FY19	FY19
2238 HK Equity	GUANGZHOU AUTOMOBILE GROUP-H	119,488	7.1	5.1	4.8	11.76	6%
175 HK Equity	GEELY AUTOMOBILE HOLDINGS LT	122,185	9.9	8.6	8.1	21.83	2%
489 HK Equity	DONGFENG MOTOR GRP CO LTD-H	64,535	3.9	3.5	3.1	11.72	6%
2333 HK Equity	GREAT WALL MOTOR COMPANY-H	67,157	13.9	11.5	9.4	5.73	3%
1114 HK Equity	BRILLIANCE CHINA AUTOMOTIVE	35,367	6.9	6.1	5.8	19.60	2%
1958 HK Equity	BAIC MOTOR CORP LTD-H	34,546	8.8	7.7	7.0	9.20	4%
1211 HK Equity	BYD CO LTD-H	139,380	41.4	34.8	31.0	4.57	0%
Median	Median	70,237	8.8	7.7	7.0	11.72	3%
Ticker	Name	Mkt Cap (RMB)	PE			ROE	Dvd Yld
			FY19	FY20	FY21	FY19	FY19
600104 CH Equity	SAIC MOTOR CORP LTD-A	277,833	9.3	8.6	8.0	5.69	5%
000927 CH Equity	TIANJIN FAW XIALI AUTOMOBI-A	5,216	N/A	N/A	N/A	N/A	N/A
000800 CH Equity	FAW CAR COMPANY LIMITED-A	13,817	N/A	N/A	N/A	2.15	0%
600006 CH Equity	DONGFENG AUTOMOBILE CO LTD-A	8,840	19.5	17.7	18.0	6.90	2%
000572 CH Equity	HAIMA AUTOMOBILE CO LTD -A	2,697	N/A	N/A	N/A	N/A	N/A
200625 CH Equity	CHONGQING CHANGAN AUTOMOBI-B	34,669	(38.5)	8.7	6.4	0.55	4%
Median	Median	24,243	9.3	8.7	8.0	3.9	3%

Source: Bloomberg, CMBIS

Figure 39: P/E Chart



Source: Bloomberg, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**71,575**	**72,380**	**69,231**	**71,124**	**74,299**
Cost of sales	(58,716	(60,836)	(62,096)	(60,777)	(63,692)
Gross profit	**12,858**	**11,544**	**7,136**	**10,347**	**10,608**
S&D costs	(5,250)	(5,073)	(4,896)	(5,030)	(5,255)
Administrative expenses	(4,022)	(4,519)	(4,017)	(4,126)	(4,311)
Net impairment losses	0	(7)	(1)	(1)	(1)
Interest income*	343	453	483	496	519
Other gains – net	562	1,068	677	695	726
Operating profit/(loss)	**4,492**	**3,466**	**-618**	**2,381**	**2,286**
Finance costs	(646)	(459)	(498)	(549)	(539)
Interest income**	53	103	85	85	85
Share of profit of joint	8,296	8,753	11,418	12,564	13,610
Profit before income tax	**12,194**	**11,863**	**10,387**	**14,480**	**15,442**
Income tax expense	(1,154)	(921)	(779)	(1,086)	(1,158)
Profit for the year	**11,040**	**10,942**	**9,608**	**13,394**	**14,284**
Less: MI	35	43	38	53	56
Net Profit	**11,005**	**10,900**	**9,570**	**13,342**	**14,227**

Cash flow

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	**11,040**	**10,942**	**9,608**	**13,394**	**14,284**
D&A	2,397	3,140	2,416	3,171	4,387
Change in working capital	(16,601)	703	301	382	581
Others	8,661	1,427	4,714	4,263	4,564
Net cash from operating	**5,498**	**16,213**	**17,039**	**21,210**	**23,816**
Capex & investments	(7,659)	(9,108)	(10,119)	(12,744)	(16,348)
Associated companies	(3,085)	(3,252)	(4,311)	(4,814)	(5,569)
Others	7,661	14,172	-	-	-
Net cash from investing	**(3,082)**	**1,811**	**(14,430)**	**(17,559)**	**(21,917)**
Equity raised	840	2,939	-	-	-
Change of Debts	(3,911)	1,528	1,278	(244)	1,932
Dividend paid	(1,936)	(3,786)	(3,887)	(3,407)	(3,832)
Others	6,651	8,887	-	-	-
Net cash from financing	**1,644**	**9,568**	**(2,609)**	**(3,651)**	**(1,899)**
Net change in cash	**4,060**	**27,592**	**-**	**-**	**-**
Cash at the beginning	35,294	39,355	31,572	31,572	31,572
Exchange difference	-	(35,375)	-	-	-
Cash at the end	**39,355**	**31,572**	**31,572**	**31,572**	**31,572**
Less: pledged cash	2,156	3,842	3,842	3,842	3,842

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	**55,171**	**65,963**	**75,895**	**89,682**	**106,696**
Fixed asset	13,405	16,318	19,544	22,857	26,198
Intangible assets	5,861	8,540	11,618	16,376	23,580
Interest in joint	25,743	28,995	33,306	38,121	43,689
Other non-current assets	10,161	12,109	11,426	12,328	13,229
Current assets	**64,485**	**66,211**	**64,499**	**61,757**	**61,694**
Cash	39,355	31,572	31,572	31,572	31,572
Account receivable	10,638	16,605	16,797	14,525	14,284
Inventory	3,347	6,730	4,825	4,356	4,534
Other current assets	11,146	11,304	11,304	11,304	11,304
Current liabilities	**36,618**	**40,291**	**39,096**	**38,306**	**41,664**
Borrowings	2,640	2,829	4,107	3,864	5,796
Account payables	33,071	35,786	33,109	32,363	33,797
Other payables	0	1,336	1,336	1,336	1,336
Tax payables	907	340	544	743	735
Non-current liabilities	**12,570**	**13,908**	**13,715**	**12,157**	**11,466**
Borrowings	8,273	9,611	9,611	9,611	9,611
Provisions	915	675	649	693	766
Deferred income tax	108	161	91	130	146
Others	3,275	3,461	3,364	1,721	943
Minority Interest	**1,044**	**1,371**	**1,371**	**1,371**	**1,371**
Total net assets	**69,424**	**76,604**	**86,212**	**99,606**	**113,890**
Shareholders' equity	**69,424**	**76,604**	**86,212**	**99,606**	**113,890**

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Automobile	70%	70%	65%	63%	61%
Parts and Components	4%	4%	5%	5%	5%
Commercial services	23%	23%	27%	29%	31%
Financial services	3%	4%	3%	3%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
P&L ratios (%)					
Gross profit margin	18%	16%	10%	15%	14%
Pre-tax margin	17%	16%	15%	20%	21%
Net margin	15%	15%	14%	19%	19%
Effective tax rate	9%	8%	8%	8%	8%
Balance sheet ratios					
Current ratio (x)					
Quick ratio (x)					
Cash ratio (x)					
Debtors turnover days	6.73	4.36	4.12	4.90	5.20
Total debt / total equity	70%	70%	60%	50%	46%
Net debt / equity ratio	17%	34%	29%	23%	22%
Returns (%)					
ROE	19%	15%	12%	14%	13%
ROA	13%	10%	8%	10%	10%
Per share					
EPS (RMB)					
DPS (RMB)					
BVPS (RMB)	9.66	7.62	8.56	9.87	11.26

Source: Company data, CMBIS estimates
Interest income* represents the interest income from time deposits
Interest income** represents the interest income from restricted cash, cash and cash equivalents

Geely (175 HK)

Darkness before the dawn

The Company has experienced operation turbulence due to the slowdown in overall market condition. We expect the Company will likely to rebound in 2020 after a sharp decline in 2019. The forecast revenue will increase to RMB 121bn/129bn in 2020/21E. Given the positive outlook in its JVs, we forecast net profit will increase by 15%/7% YoY to RMB 12bn/13bn in 2020/21E. Initiate with BUY, TP HK$16.35.

- **New target reflects the Company's view on the overall market.** The Company adjusted downward its sales target for FY19 from 1.51mn to 1.36mn units. In 1H19, the sales volume reached 652,000, a decrease of 15% YoY. It represents that 48% of the adjusted target was completed. We expect the total sale volume target will slightly beat its revised target in the year.
- **Darkness before the dawn.** We expected a decline in EPS to RMB 1.19 in 2019 due to sales slowdown. However, as Lynk&Co and its financial service are getting up to speed, we expect the Geely will ignite a new round of growth in 2020. We forecast that EPS in 20E/21E will be RMB 1.37/1.46.
- **Reinforce the 2020 sales target.** In a media conference hosted on Jul 30th, 2019, An Huicong, the CEO of Geely, restated that its target sales volume of 2mn units in 2020 has not changed. It suggests that the company has great confidence in its growth in 2020. The company will have to achieve 47% of growth rate in 2020 based on its revised target sales volume.
- **Valuation/Key risks.** The Company is currently trading at 9.87x 2019 P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 10.50x. Our Target Price is HK$16.35 per share with 22.02% upside potential. Initiate with Buy.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	92,761	106,595	99,040	121,259	128,633
YoY growth (%)	72.67%	14.91%	-7.09%	22.43%	6.08%
Net income (RMB mn)	10,634	12,553	10,720	12,300	13,118
EPS (RMB)	1.19	1.40	1.19	1.37	1.46
YoY growth (%)	105%	17%	-15%	15%	7%
P/E (x)	9.90	8.43	9.87	8.61	8.07
P/B (x)	2.81	2.16	1.82	1.54	1.33
Yield (%)	2.05%	2.61%	2.25%	2.58%	2.75%
ROE (%)	36.11%	31.62%	21.83%	21.18%	19.30%
Net gearing (%)	106%	67%	53%	56%	51%

Source: Company data, CMBIS estimates

BUY (Initiation)

Target Price	**HK$16.35**
Up/Downside	**+22.02%**
Current Price	**HK$13.40**

China Auto Sector

Jack Bai
(852) 3900 0835
jackbai@cmbi.com.hk

Stock Data

Mkt Cap (HK$ mn)	122,185
Avg 3 mths t/o (HK$ mn)	665.01
52w High/Low (HK$)	19.14/ 10.08
Total Issued Shares (mn)	8,981.6

Source: Bloomberg

Shareholding Structure

Geely Holding	45.09%
Norges Bank Investment Management	1.87%
The Vanguard Group, Inc.	1.86%

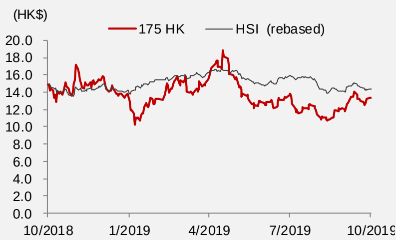
Source: Company data

Share Performance

	Absolute	Relative
1-mth	9.7%	8.2%
3-mth	-0.4%	8.9%
6-mth	-14.5%	-3.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Grant Thornton

Investment Thesis

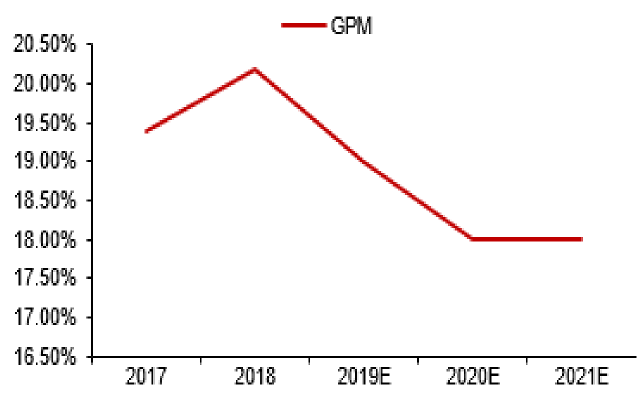
Exceptional cost management capability

Geely has managed to keep its manufacturing cost at a relatively low level among the peer companies in the local auto industry. The GPM in 2017 and 2018 were 19.38% and 20.18% respectively. It reflects Geely has excellent cost control technique by effectively managing its upstream suppliers and downstream dealers. Moreover, in the market consolidating stage, Geely has actively helped its suppliers and dealers to destock by taking more pressure from the market.

According to data from the Automobile Circulation Association, the current Geely inventory index remains at a low level. Compared with the average inventory index of more than 2.1 in other passenger car companies in the industry, the Geely inventory index is lower than 2.0.

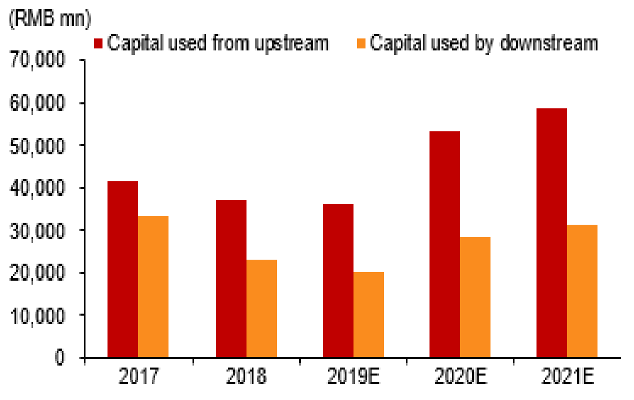
When the overall destocking stage is completed, we forecast that Geely will continue to maintain its bargaining power over the suppliers and dealers. We forecast it maintain the GPM at 18% in 2019E/20E/21E.

Figure 40: Gross profit margin



Source: Company data, CMBIS estimates

Figure 41: Capital used from/by up/downstream



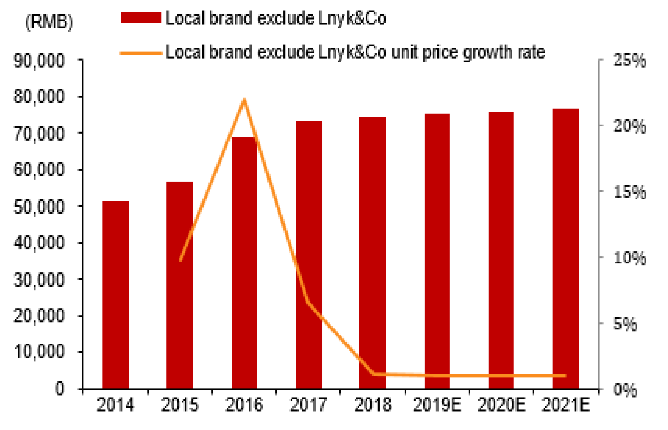
Source: Company data, CMBIS estimates

Medium/High-end brand strategy

Geely aims to have the medium- and high-end brand which will increase its overall brand power. By creating Lynk&Co with Volvo, Geely aims to gain more market share in the medium/high-end PV market. In 2018, Lynk&Co 01 has a weighted average price of RMB 181k. Lynk&Co 03+ was launched on 2 Aug 2019, with a price range of RMB 186k to 229k. Through the establishment of the Lynk&Co brand, Geely will have more brand power in medium/high-end market, resulting in more price premium, which will provide strong support for its investment income growth. We expect the growth rate of joint venture investment income of 2019E/20E/21E to be 54%/23%/20% respectively.

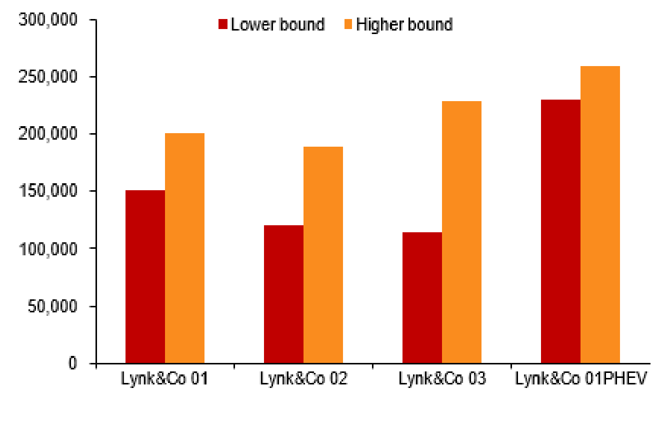
Looking back on the history of Geely in the past five years, the unit price (excluding Lynk&Co) increased from RMB 51,536 in 2014 to RMB 74,362 in 2018, with a CAGR of 9.6%. We expect unit prices to continue to grow at a CAGR of 1% in the next three years due to the rise of brand power.

Figure 42: Local brand unit price/growth rate



Source: Company data, CMBIS estimates

Figure 43: Lynk&Co unit price in 2019

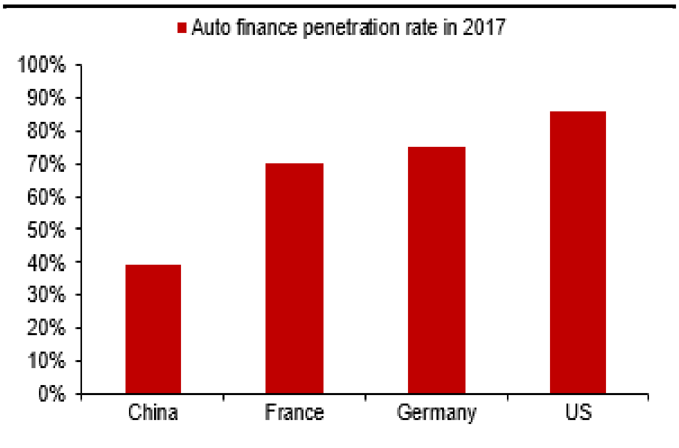


Source: AutoHome, CMBIS estimates

Auto finance

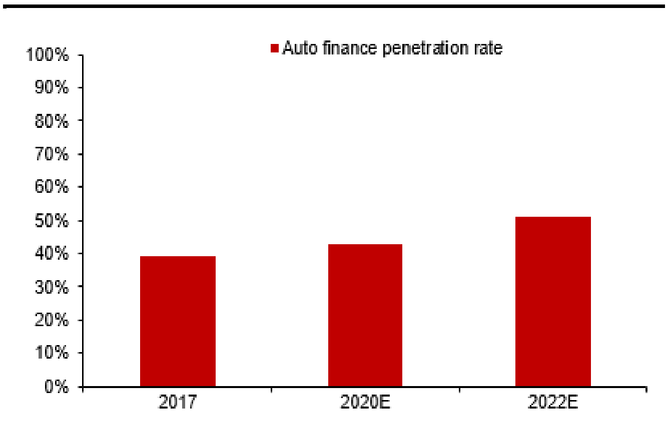
Geely has formed a JV with BNP Paribas Personal Finance, namely Genius Auto Finance Company Limited ("Genius AFC"), in order to enter into the auto finance market. Being located in Shanghai, Genius AFC is principally engaged in the provision of auto wholesales financing solutions to auto dealers and retail financing solutions to end customers, mainly supporting three key auto brands in Geely Holding Group, including "Geely", "Lynk&Co" and "Volvo Car". Helped by the growth in the overall sales volume of the Geely Group and the increase in retail financing businesses, Genius AFC's auto finance business registered significant growth in the year of 2018 with its total outstanding loan assets increased from RMB 9.65bn at the end of 2017 to RMB19.26bn at the end of year 2018. Genius AFC achieved good earnings performance with its net profit increasing 352% YoY to RMB 216.65mn during 2018. We expect future auto finance business will continue to develop steadily given the low penetration rate in the Chinese overall auto finance market.

Figure 44: Auto finance penetration rate



Source: Roland Berger

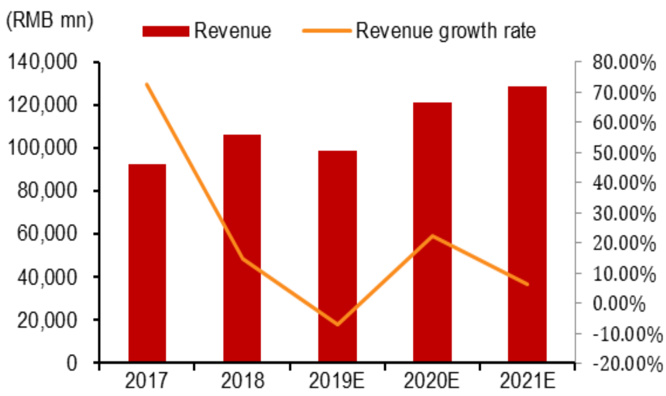
Figure 45: Estimated auto finance market growth rate



Source: Roland Berger

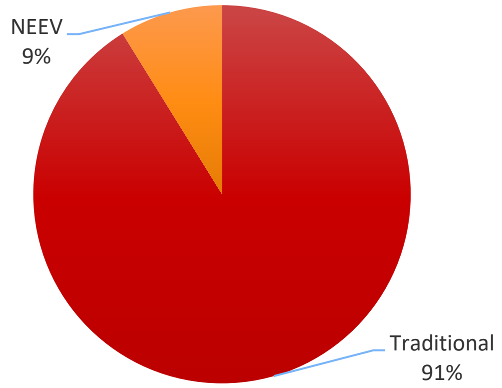
Focus Charts

Figure 46: Revenue/growth rate



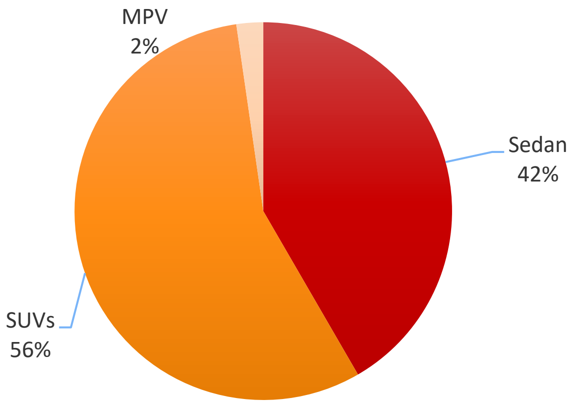
Source: Company data, CMBIS estimates

Figure 47: Traditional vs NEEV in 1H19



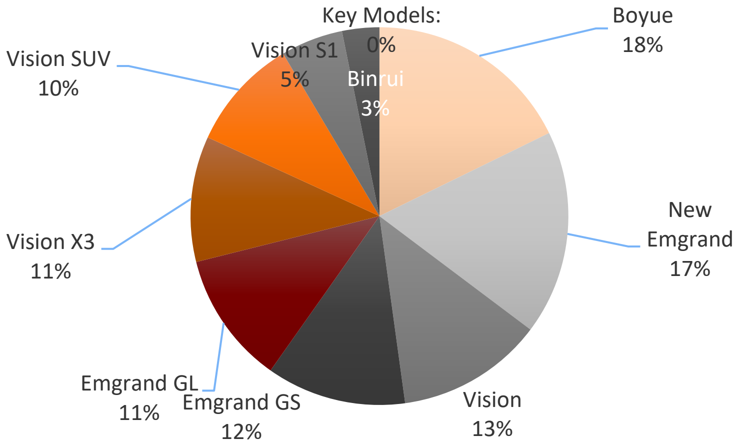
Source: Company data, CMBIS

Figure 48: Vehicle type proportion in 1H19



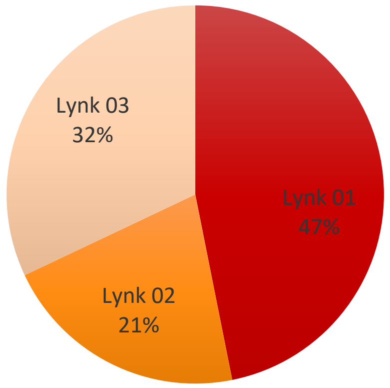
Source: Company data, CMBIS

Figure 49: Brand type in 1H19



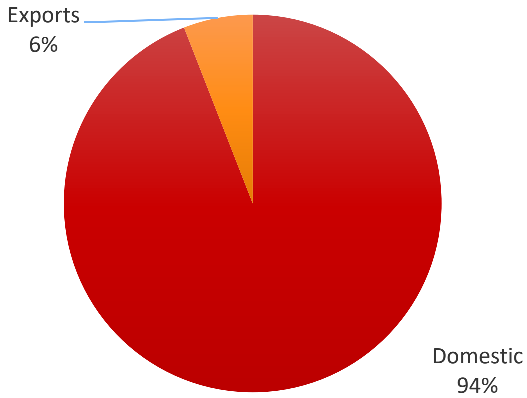
Source: Company data, CMBIS

Figure 50: Lynk sales proportion in 1H19



Source: Company data, CMBIS

Figure 51: Domestic vs Export in 1H19



Source: Company data, CMBIS

Company Overview

The leading local player in auto industry

Geely Auto Group is a leading automobile manufacturer based in Hangzhou, China and was founded in 1997 as a subsidiary of Zhejiang Geely Holding Group. Geely Auto Group sells vehicles under the Geely Auto brand and holds a 50% stake in the LYNK&CO brand.

The Company employs more than 50,000 people, operates 12 vehicle manufacturing plants, 9 powertrain plants, 6 knockdown kit plants, and manufactures vehicles under the Geely Auto brand. Geely vehicles are sold through a network of over 850 dealerships in China and some 350 sales and service outlets in overseas markets. Geely Auto is also committed to world-class research and development in the auto industry. It has established the Geely Automotive Research Institute in Hangzhou and the world-leading Geely Research Institute in Hangzhou Bay, Ningbo to focus on the development of vehicles, engines, transmission and vehicle bound electronics. Other facilities include Design Centres in Barcelona, Gothenburg, California and Shanghai, and the China Euro Vehicle Technology (CEVT) in Gothenburg.

In Jun 2019, Geely Auto sold 90,875 units, an increase of 0.63% MoM. In 1H19, Geely sold 651,680 units, a decrease of 15% YoY, achieving 43% of the Group's full-year before-revised sales volume target of 1.51mn units in 2019. The Company released its preliminary financial results that the total estimated net profit for 1H19 will be approximately RMB 6.67bn, representing a decrease of 40.0% YoY.

Brand

- **Geely Auto**

Geely brand is the Group's mainstream mass-market brand. During the year,"Geely Boyue","New Emgrand","New Vision", "Emgrand GS" and "Emgrand GL" were the Group's top five models in terms of sales volume in 2018.

Figure 52: Boyue

Source: AutoHome, CMBIS

Figure 53: Emgrand GS

Source: AutoHome, CMBIS

■ **LYNK&CO**

Founded in 2016, Lynk&Co is positioned between those of the Geely Auto brand and Volvo, targeting at the global high-end market segment. The brand has so far rolled out four models, namely, the Lynk&Co 01, 02, 03 and the Lynk&Co 01 PHEV. All models are produced based on the Compact Modular Architecture (CMA) platform developed by Volvo. Lynk&Co will launch the Lynk&Co 04 and 05 in 2019 while the Lynk&Co 02 PHEV and the 03 PHEV will also hit the market in 2019.

In 2018, Lynk&Co reported sales of 120,414 units. In 1H19, the total sales volume of Lynk&Co was 55,877 units, an increase of 20.81% YoY. The total sales volume of the Lynk&Co brand has reached 182,303 units since the first model was officially launched at the end of 2017.

By the end of Jun 2019, the number of dealers operating reached 260, and 69 are under construction, covering more than 230 cities in China. We expected that Lynk&Co would continue its growth despite overall auto market decline.

Figure 54: Lynk&Co 01

Source: AutoHome, CMBIS

Figure 55: Lynk&Co 03

Source: AutoHome, CMBIS

Strong parent company with other sister brands

Geely Automobile's parent company Geely Holding Group owns a number of automobile brands, including Proton Auto, Lotus Auto, Volvo Car Group, and Geely New Energy Commercial Vehicle. Taking advantage of its parent company's strong operation capabilities, Geely Auto Holdings has achieved synergy between itself and other subsidiaries. Lynk&Co is a good example of synergy between Geely and Volvo.

Financial Analysis

Revenue

The Company generates revenue through automobiles and automobile parts and components. In 2018, revenue from sales of automobiles increased by 12% YoY to RMB 102,651mn while revenue from sales of automobile parts and components increased by 167% YoY to RMB 3,944mn. We forecast in 2019E/20E/21E, sales of automobiles will reach RMB 94bn/114bn/119bn respectively whereas revenue from sales of automobile parts and components will reach RMB 5,522mn/7,454mn/9,318mn respectively.

Net Income/EPS/Dividend

In 2018, net income attributable to equity holders of the Company maintained an 18% growth rate to RMB 12,553mn whereas ROE was 36.12%. The Company declared 2,767mn cash dividend in 2018, representing 22% payout ratio. We forecast that the Company's overall profitability will experience a sharp decline in 2019E and rebound in 2020E/21E. Specifically, in 2019E, we forecast that net profit will decrease by 15% YoY to RMB 10,720 whereas ROE will be 21.83%. In 2020E/21E, we expect that net profit will increase by 15%/7% YoY to RMB 12,300mn/13,118mn whereas ROE will reach 21.18%/19.30% respectively.

Operating ratios

- Profitability Ratios

We forecast that GPM in 2019E/20E/21E will be 19%/18%/18% respectively. We forecast that NPM in 2019E/20E/21E will be 10.82%/10.14%/10.20% respectively.

- Liquidity Ratios

We forecast that current ratio in 2019E/20E/21E will be 0.94/0.93/0.93 respectively. We forecast that net gearing ratio in 2019E/20E/21E will be 53%/56%/51% respectively.

- Efficiency Ratios

We forecast that inventory days in 19E/20E/21E will be 18.25/20.28/20.28 respectively. We forecast that accounts receivable days in 19E/20E/21E will be 91.25/86.90/86.90 respectively.

Valuation

Initiate with TP HK$16.35 (20.02% upside)

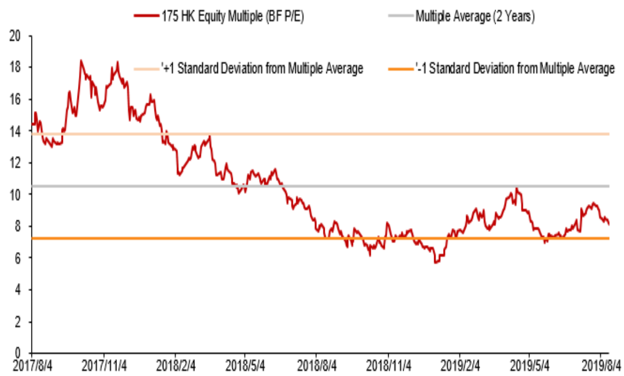
The Company is currently trading at 9.87x 2019 P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 10.50x. Our Target Price is HK$16.35 per share with 20.02% upside potential. Initiate with Buy.

Figure 56: Peers' valuation

Ticker	Name	Mkt Cap (HKD)	PE FY19	PE FY20	PE FY21	ROE FY19	Dvd Yld FY19
2238 HK Equity	GUANGZHOU AUTOMOBILE GROUP-H	119,488	7.1	5.1	4.8	11.76	6%
175 HK Equity	GEELY AUTOMOBILE HOLDINGS LT	122,185	9.9	8.6	8.1	21.83	2%
489 HK Equity	DONGFENG MOTOR GRP CO LTD-H	64,535	3.9	3.5	3.1	11.72	6%
2333 HK Equity	GREAT WALL MOTOR COMPANY-H	67,157	13.9	11.5	9.4	5.73	3%
1114 HK Equity	BRILLIANCE CHINA AUTOMOTIVE	35,367	6.9	6.1	5.8	19.60	2%
1958 HK Equity	BAIC MOTOR CORP LTD-H	34,546	8.8	7.7	7.0	9.20	4%
1211 HK Equity	BYD CO LTD-H	139,380	41.4	34.8	31.0	4.57	0%
Median	Median	70,237	8.8	7.7	7.0	11.72	3%
Ticker	**Name**	**Mkt Cap (RMB)**	**PE FY19**	**PE FY20**	**PE FY21**	**ROE FY19**	**Dvd Yld FY19**
600104 CH Equity	SAIC MOTOR CORP LTD-A	277,833	9.3	8.6	8.0	5.69	5%
000927 CH Equity	TIANJIN FAW XIALI AUTOMOBI-A	5,216	N/A	N/A	N/A	N/A	N/A
000800 CH Equity	FAW CAR COMPANY LIMITED-A	13,817	N/A	N/A	N/A	2.15	0%
600006 CH Equity	DONGFENG AUTOMOBILE CO LTD-A	8,840	19.5	17.7	18.0	6.90	2%
000572 CH Equity	HAIMA AUTOMOBILE CO LTD -A	2,697	N/A	N/A	N/A	N/A	N/A
200625 CH Equity	CHONGQING CHANGAN AUTOMOBI-B	34,669	(38.5)	8.7	6.4	0.55	4%
Median	Median	24,243	9.3	8.7	8.0	3.9	3%

Source: Bloomberg, CMBIS

Figure 57: P/E Chart



Source: Bloomberg data, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**92,761**	**106,595**	**99,040**	**121,259**	**128,633**
Cost of sales	(74,779)	(85,082)	(80,222)	(99,432)	(105,479)
Gross profit	**17,981**	**21,513**	**18,818**	**21,827**	**23,154**
S&D expenses	(4,056)	(4,523)	(4,337)	(5,267)	(5,567)
Administrative expenses	(2,923)	(3,777)	(3,715)	(4,303)	(4,628)
Share-based payments	(28)	(15)	(34)	(34)	(33)
Finance expenses	(35)	79	(5)	26	50
PL from JV	3	505	779	955	1,147
PL from Associates	39	(60)	(72)	(94)	(122)
Other income	1,229	1,237	1,424	1,625	1,697
Other expense	0	0	0	0	0
Gain on disposal of	563	0	0	0	0
Profit before income tax	**12,774**	**14,959**	**12,858**	**14,735**	**15,699**
Income tax expense	(2,039)	(2,285)	(2,030)	(2,314)	(2,452)
Profit for the year	**10,735**	**12,674**	**10,828**	**12,421**	**13,247**
Less: MI	102	121	108	121	129
Net Profit	**10,634**	**12,553**	**10,720**	**12,300**	**13,118**

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	**10,634**	**12,553**	**10,720**	**12,300**	**13,118**
D&A	1,196	2,213	2,620	2,940	3,533
Change in working capital	2,244	3,754	3,180	1,339	25
Others	(2,080)	(4,595)	(2,032)	2,275	(28)
Net cash from operating	**11,994**	**13,925**	**14,488**	**18,853**	**16,648**
Capex & investments	(8,819)	(17,179)	(11,507)	(13,209)	(13,052)
Associated companies	(65)	(35)	(40)	(45)	(49)
Others	(3,028)	5,895	-	-	-
Net cash from investing	**(11,911)**	**(11,319)**	**(11,547)**	**(13,253)**	**(13,101)**
Equity raised	2	0	-	-	-
Change of Debts	(946)	2,127	(311)	752	559
Dividend paid	(2,160)	(2,767)	(2,382)	(2,733)	(2,914)
Others	1,420	334	-	-	-
Net cash from financing	**(1,685)**	**(306)**	**(2,693)**	**(1,981)**	**(2,356)**
Net change in cash	**(1,602)**	**2,300**	**248**	**3,619**	**1,192**
Cash at the beginning	15,053	13,451	15,757	16,005	19,624
Exchange difference	-	6	-	-	-
Cash at the end	**13,451**	**15,757**	**16,005**	**19,624**	**20,816**
Less: pledged cash	36	19	19	19	19

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	**31,973**	**48,676**	**58,275**	**69,719**	**80,613**
Fixed asset	14,053	23,423	30,358	38,160	45,610
Intangible assets	10,552	14,993	15,967	17,384	18,373
Interest in joint	4,805	6,322	7,231	8,344	9,665
Other non-current assets	2,563	3,937	4,718	5,831	6,964
Current assets	**53,008**	**42,785**	**40,144**	**48,913**	**51,899**
Cash	13,451	15,757	16,005	19,624	20,816
Account receivable	33,478	22,865	20,056	23,674	25,114
Inventory	6,027	4,097	4,011	5,524	5,860
Other current assets	52	67	72	91	109
Current liabilities	**49,902**	**43,760**	**42,494**	**52,541**	**55,666**
Borrowings	1,296	1,375	1,303	1,595	1,698
Account payables	47,533	41,438	40,111	49,716	52,740
Other payables	0	0	0	0	0
Tax payables	1,073	947	1,080	1,231	1,229
Non-current liabilities	**268**	**2,326**	**2,111**	**2,612**	**3,062**
Borrowings	0	2,048	1,810	2,269	2,725
Provisions	0	0	0	0	0
Deferred income tax	268	278	301	343	337
Others	0	0	0	0	0
Minority Interest	**344**	**431**	**533**	**628**	**731**
Total net assets	**34,467**	**44,944**	**53,282**	**62,849**	**73,053**
Shareholders' equity	**34,467**	**44,944**	**53,282**	**62,849**	**73,053**

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Automobiles	98%	96%	94%	94%	93%
Parts and components	2%	4%	6%	6%	7%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
P&L ratios (%)					
Gross profit margin	19%	20%	19%	18%	18%
Pre-tax margin	14%	14%	13%	12%	12%
Net margin	11%	12%	11%	10%	10%
Effective tax rate	16%	15%	16%	16%	16%
Balance sheet ratios					
Current ratio (x)	1.06	0.98	0.94	0.93	0.93
Quick ratio (x)	0.94	0.88	0.85	0.82	0.83
Cash ratio (x)	0.27	0.36	0.38	0.37	0.37
Debtors turnover days	132	78	91	87	87
Total debt / total equity	144%	102%	83%	87%	80%
Net debt / equity ratio	106%	67%	53%	56%	51%
Returns (%)					
ROE	36%	32%	22%	21%	19%
ROA	17%	17%	14%	14%	12%
Per share					
EPS (RMB)	1.19	1.40	1.19	1.37	1.46
DPS (RMB)	0.24	0.31	0.27	0.30	0.32
BVPS (RMB)	4.20	5.47	6.48	7.64	8.88

Source: Company data, CMBIS estimates

Dongfeng Motor (489 HK)

Ambiguous future with PSA

In Jun 2019, Dongfeng Motor Group sold 248,000 vehicles, down by 0.2% YoY. Among them, the sales volume of passenger vehicles was 219,200 units, an increase of 0.2% YoY. The sales volume of commercial vehicles was 37,800 units, a decrease of 2.2% YoY. In 1H19, the cumulative sales volume was 1,374,400 units, a decrease of 8.89% YoY. The cumulative sales of PV was a total of 1.1mn units, down by 11.32% YoY while the cumulative sales of the commercial vehicle was 240,500 units, an increase of 3.91% YoY.

- **Local brand has a slight positive profit.** Even though we forecast revenue from local PV brand will decline by 30%, the CV and financial service will likely to grow by 5% and 26% respectively. Overall, the Company will keep its core profit in the positive territory, achieving RMB 1.78bn of core profit in 2019E. It will account for 11% of total profit.
- **Investment in Dongfeng is equivalent to a diversified portfolio.** Dongfeng Motor has JVs with Nissan, Honda, PSA, Renault and Volvo. The Company also owns 12.23% of PSA, which is listed in France. Amid the overall market slowdown, to invest in Dongfeng is equivalent to invest in diversified country brands while enjoying the earnings from PSA globally.
- **Potential earnings surprise in 2019E.** In 2018, there was an unusual RMB 1bn net impairment and RMB 1.6bn tax loss not yet recognized. The two non-operating losses dragged overall net income by almost RMB 2.6bn. We expect net profit will rebound excluding these items. We forecast that EPS in 2019E/21E/22E will be RMB 1.68/1.90/2.15.
- **Valuation/Key risks.** The Company is currently trading at 3.91x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 3.80x. Our Target Price is HK$8.20 per share with 9.48% upside potential. Initiate with Hold.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	125,980	104,543	93,564	94,130	93,412
YoY growth (%)	2.81%	-17.02%	-10.50%	0.60%	-0.76%
Net income (RMB mn)	14,061	12,979	14,513	16,361	18,557
EPS (RMB)	1.63	1.51	1.68	1.90	2.15
YoY growth (%)	5%	-8%	12%	13%	13%
P/E (x)	4.04	4.38	3.91	3.47	3.06
P/B (x)	0.52	0.48	0.44	0.40	0.37
Yield (%)	5.01%	5.31%	6.39%	7.20%	8.17%
ROE (%)	13.70%	11.44%	11.72%	12.09%	12.53%
Net gearing (%)	51%	46%	27%	25%	24%

Source: Company data, CMBIS estimates

HOLD (Initiation)

Target Price	**HK$8.20**
Up/Downside	**+9.48%**
Current Price	**HK$7.49**

China Auto Sector

Jack Bai
(852) 3900 0835
jackbai@cmbi.com.hk

Stock Data

Mkt Cap (HK$ mn)	64,535
Avg 3 mths t/o (HK$ mn)	129.69
52w High/Low (HK$)	8.80/ 5.87
Total Issued Shares (mn)	8,616.1

Source: Bloomberg

Shareholding Structure

Donfeng Motor Corporation	66.89%
STANDARD CHARTERED	2.81%
REYNOLDS MARGARET (MEG)	2.41%

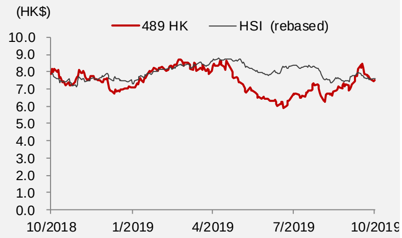
Source: Company data

Share Performance

	Absolute	Relative
1-mth	2.3%	0.9%
3-mth	16.4%	27.3%
6-mth	-7.6%	4.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers Zhong Tian

Investment Thesis

Multiple brands with diversified performance

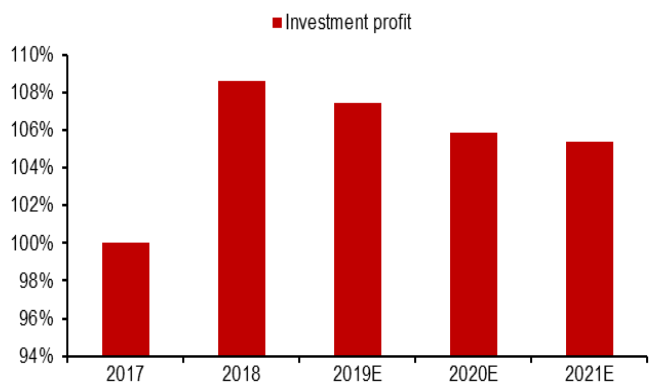
Dongfeng Motor has four major subsidiaries and four major JVs. The performance of its subsidiaries and JVs is divergent. In 2019E, we estimate that the local brands will contribute around 11% of net income while investment income from JV will contribute around 105% of net income. Other loss and expense offset the extra 16% of net income. We expect the trend will continue in the following years. In cooperation with many foreign companies in the form of JVs, Dongfeng is over-reliant on technology from its business partners. Lack of innovation and quality control has restricted its overall performance. The Company needs reform in its traditional business to boost its local brand.

Figure 58: Main subsidiary/JV lists

Main subsidiary	Share Proportion
DFL	50%
Dongfeng Honda	50%
Dongfeng Renault	50%
Dongfeng PSA	50%
Dongfeng Liuqi	75%
Dongfeng Fengshen	100%
Dongfeng Commercial Vehicle	55%
Dongfeng Special Commercial Vehicle	75%

Source: Company data, CMBIS

Figure 59: Profit from JV/Associate



Source: Company data, CMBIS

Alternative way to innovate - Intelligent and Automated Connected Vehicles

Dongfeng launched the Sharing-VAN service platform integrating L4 autopilot + 5G remote driving + V2X+ remote dispatching by cooperating with Huawei. Sharing-VAN has become the first L4-class autopilot vehicle in China that incorporates 5G remote driving technology.

In 2018, Dongfeng Company and Huawei jointly created the first LTE-V/5G vehicle networking demonstration zone in Central China. On 2 Apr 2019, Dongfeng Motor, Xiangyang Municipal Government, and Huawei officially signed the “Smart Travel in Longzhong” strategic cooperation framework agreement. The three parties announced that they will work together to create a smart car valley, smart travel, smart logistics and smart traffic clouds to jointly open a new era of smart transportation.

On 28 Jun 2019, Dongfeng Motor and Tencent Company formally signed a strategic cooperation agreement in Shenzhen to jointly build a new ecosystem of "automobile industry Internet".

Figure 60: Sharing Van

Source: Sina, CMBIS

Figure 61: Cooperation with Huawei

Source: Company data, CMBIS

Alternative way to innovate – Comprehensive service

Dongfeng's travel service platform “Dongfeng Travel” was launched in Wuhan on 16 Apr 2019. “The 'Dongfeng Travel' program has invested 1,000 vehicles in the first batch, and plans to expand another 4,000 units by the end of this year. In the future, “Dongfeng Travel” will launch 500,000 vehicles nationwide, serving 100mn users and providing 10mn passengers per day according to its news announcement. The “Dongfeng Travel” network car service will also be connected to the DiDi platform according to an announcement from DiDi.

On 22 Jul 2019, the smart travel platform T3, which was co-invested by Dongfeng, FAW, and Changan, was officially unveiled. It will focus on the operation of the ridesharing service in the short term. Under the initial plan, T3 will gradually enter into Nanjing, Chongqing, Wuhan, Guangzhou, Hangzhou and Tianjin by the end of 2019. In 2020, it will cover most provincial capital cities. Before the end of 2019, T3 will launch 20,000 operating vehicles and plans to reach 300,000 in three years according to a news announcement. After six years, it will strive to exceed one million. From 2021 to 2025, it will steadily expand its business into NEV battery charging, maintenance, repair and so on.

A relatively small portion of oversea exposure

In 2018, Dongfeng Company exported a total of 73,579 vehicles, an increase of 14% YoY. In 1H19, Dongfeng Motor Co., Ltd. exported 30k units. Dongfeng set its export sales volume target for 2019 as 77,500 units. According to Dongfeng's 2018 overseas medium-term business plan, the Company set the export target volume in 2023 as 300,000 units. It also tries to expand its presence to three to five new markets by 2023.

NEV market

In 1H19, Dongfeng's NEV sold 33,000 units, an increase of 259.8% YoY. The first Dongfeng NEV industrial park with an investment of nearly RMB 10bn was completed and put into operation in 2018, gradually forming capacity of 800,000 sets of electronic control systems and 200,000 sets of battery system. The second industrial park is under construction with a capacity of 2mn sets of various electric drives and fuel cells.

Figure 62: DF go

Source: Sina, CMBIS

Figure 63: DF NEV industrial park

Source: Company data, CMBIS

Operating summary of main subsidiary/JVs - DHAC will lead the growth while others decline

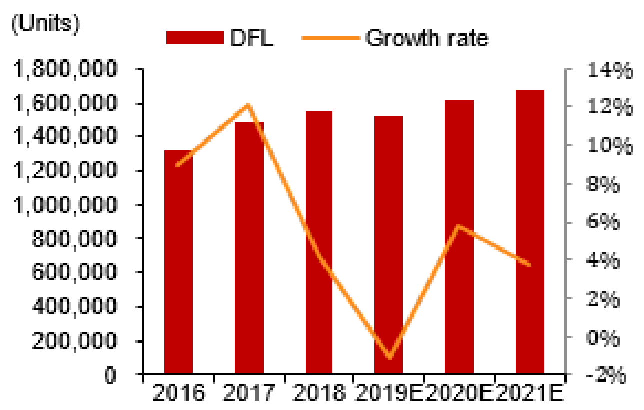
DFL

Dongfeng Motor Company Limited (“DFL”) is an automobile manufacturing company headquartered in Wuhan, China. It is a 50–50 joint-venture between Dongfeng Motor Group and Nissan Motors. It produces passenger cars under the Nissan marque and commercial vehicles under the Dongfeng marque. In Jun 2019, Dongfeng Motor Co. sold 127,072 units, a decrease of 3.05% YoY. In 1H19, Dongfeng Motor Co. had a total sales of 713,290 units, a decrease of 1.68% YoY. We forecast that the sale volume growth rate for DFL will be 1.12%/6.40%/4.57%in 2019E/20E/21E.

DHAC

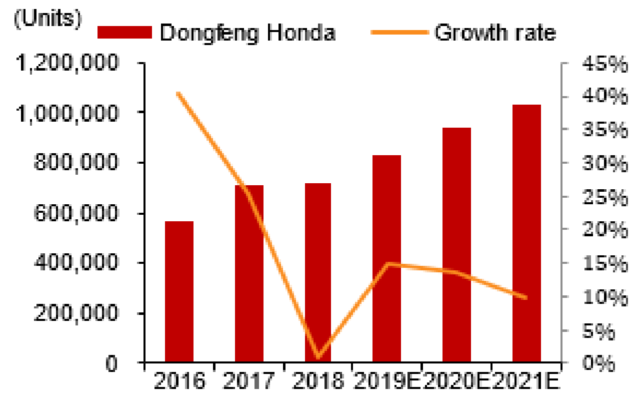
Dongfeng Honda Automobile Co., Ltd. is a 50:50 joint-venture between Dongfeng Motor Group and Honda Motor Company. It currently produces a variety of Honda models which are also available in other markets and a handful of China-only products. The Company sells vehicles under the Honda and Ciimo marques. In Jun, Dongfeng Honda sales totaled 66,203 units, up by 20.3% YoY. In 1H19, Dongfeng Honda had a total sales of 364,131 units, an increase of 13.34% YoY. We forecast that the sale volume growth rate for Dongfeng Honda will be 15.00%/13.73%/9.88%in 2019E/20E/21E.

Figure 64: DFL sales volume/growth rate



Source: Company data, CMBIS

Figure 65: DHAC sales volume/growth rate



Source: Company data, CMBIS

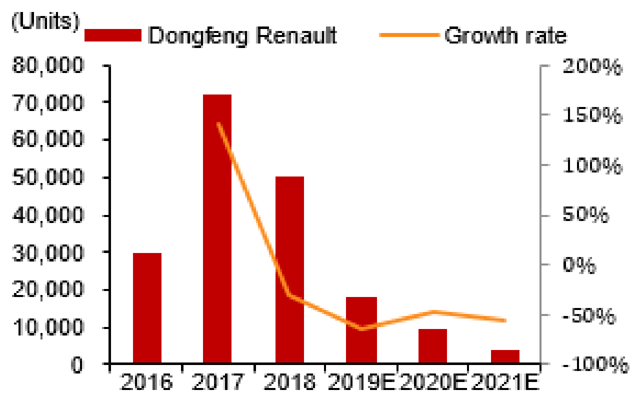
Dongfeng Renault

Established in 2013, Dongfeng Renault Automobile Company (DRAC) is an equally owned Chinese joint venture between car manufacturers Dongfeng Motor Group and Renault, aiming to produce and sell Renault-badged vehicles. In Jun 2019, Dongfeng Renault only sold 1,503 units, a decrease of 67.21% YoY. In 1H19, Dongfeng Renault had a total sales of 8,901 units, a decrease of 75.97% YoY. We forecast that the sales volume growth rate for Dongfeng Renault will be -64.00%/-47.29%/-55.65%in 2019E/20E/21E.

DPCA

Dongfeng Peugeot-Citroën Automobile Co., Ltd. (DPCA) is a joint venture between Dongfeng Motor Group and PSA Peugeot Citroën. Based in Wuhan, capital of Hubei province, it manufactures Peugeot and Citroën models for sales in China. In Jun, Dongfeng Peugeot Citroën Automobile sales totaled 10,128 units, down by 54.3% YoY. In 1H19, Dongfeng Peugeot Citroën Automobile had a total sales of 63,027 units, a decrease of 60.05% YoY. We forecast that the sales volume growth rate for Dongfeng Peugeot Citroën Automobile will be -50.00%/-40.29%/-45.15%in 2019E/20E/21E.

Figure 66: DF Renault sales volume/growth rate



Source: Company data, CMBIS

Figure 67: DF PSA sales volume/growth rate

Source: Company data, CMBIS

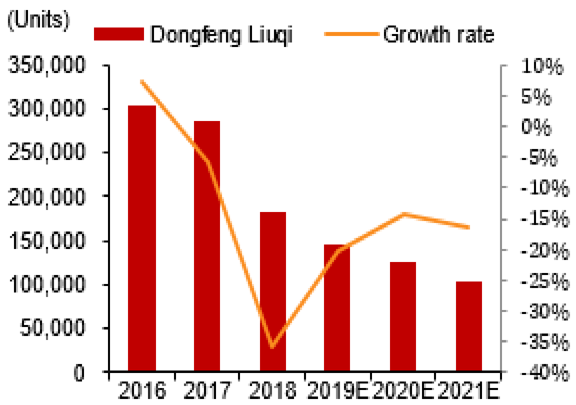
Dongfeng Liuzhou Motor

Dongfeng Liuzhou Motor Co., Ltd. is a subsidiary of Dongfeng Motor Group, located in the city of Liuzhou, Guangxi, China. It manufactures passenger cars sold in China under the brand Dongfeng Fengxing. In Jun, Dongfeng Liuzhou Motor sales totaled 18,059 units, up by 68.9% YoY. In 1H19, Dongfeng Liuzhou Motor had a total sales of 81,555 units, a decrease of 20.82% YoY. We forecast that the sale volume growth rate for Dongfeng Liuzhou Motor will be -20.40%/-14.08%/-16.52%in 2019E/20E/21E.

Other subsidiaries

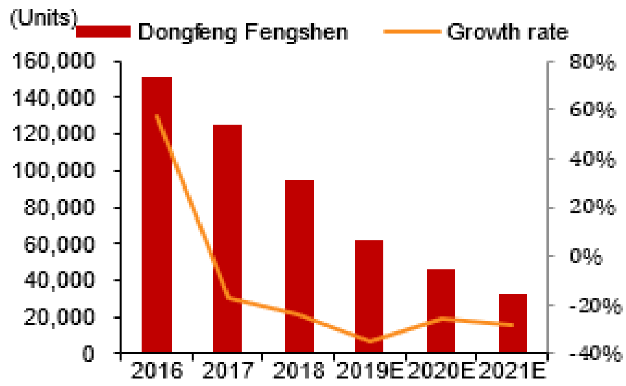
We forecast the sale volume growth rate for Passenger Vehicle Company will be -35.00%/-25.38%/-28.05% in 2019E/20E/21E. We forecast that the sale volume growth rate for Dongfeng Commercial Vehicle will be 1.00%/10.06%/3.62% in 2019E/20E/21E. We forecast that the sale volume growth rate for Special Commercial Vehicle will be -20.00%/-15.06%/-26.24%in 2019E/20E/21E.

Figure 68: DF Liuqi sales volume/growth rate



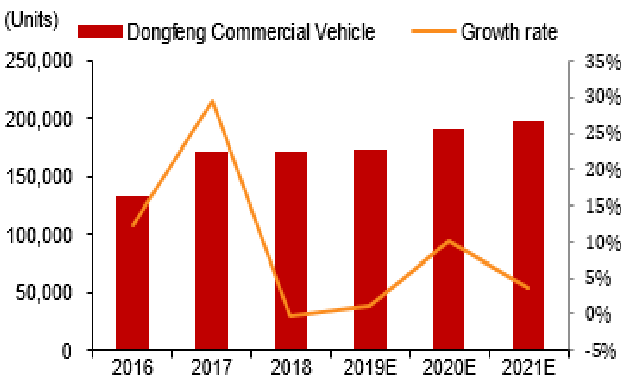
Source: Company data, CMBIS

Figure 69: DF fengshen sales volume/growth rate



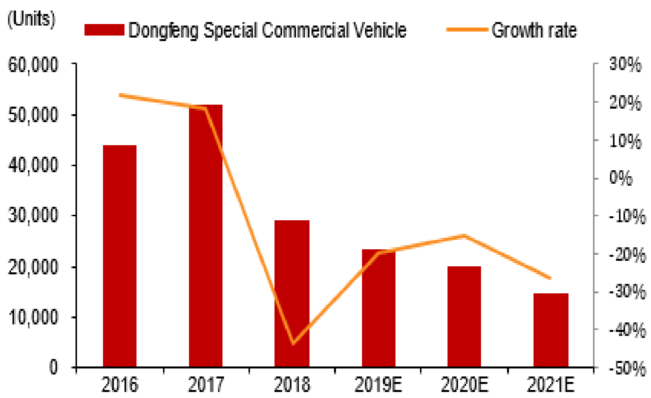
Source: Company data, CMBIS

Figure 70: DF CV sales volume/growth rate



Source: Company data, CMBIS

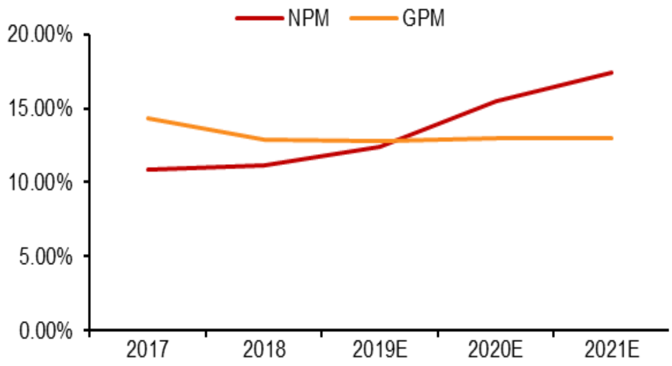
Figure 71: DF Special CV sales volume/growth rate



Source: Company data, CMBIS

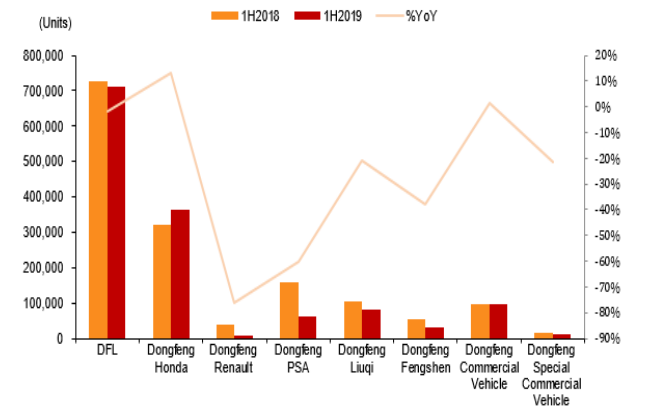
Focus Charts

Figure 72: NPM vs GPM



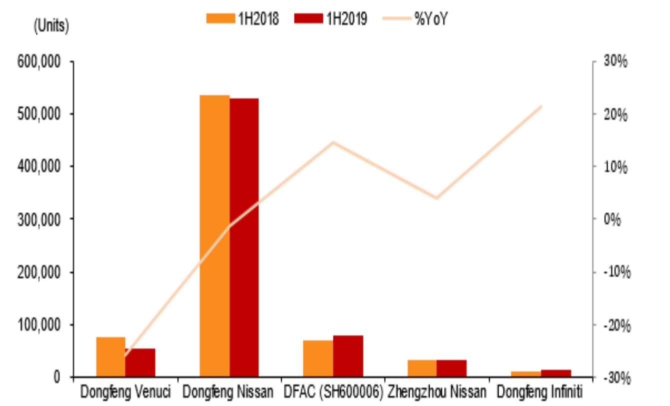
Source: Company data, CMBIS

Figure 73: 1H18 vs 1H19



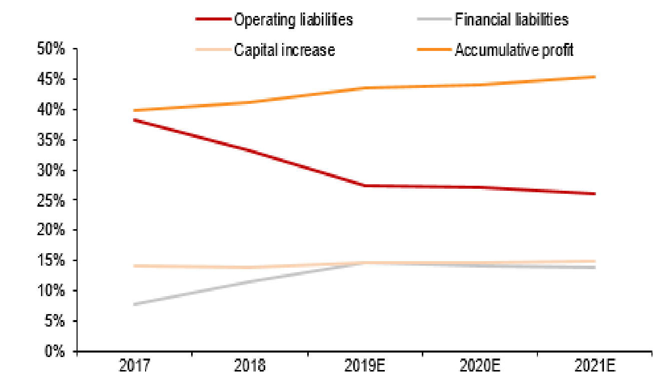
Source: Company data, CMBIS

Figure 74: DFL 1H18 vs 1H19



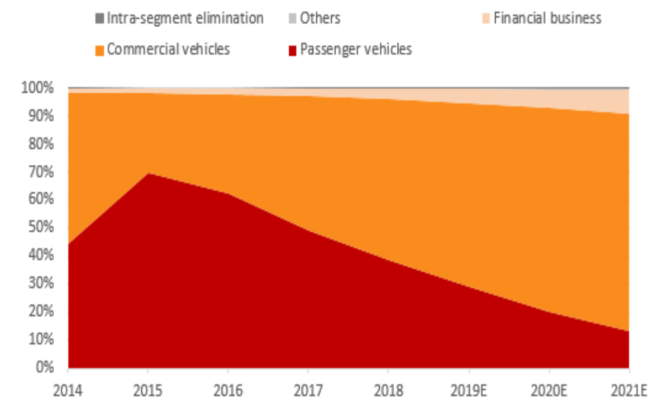
Source: Company data, CMBIS

Figure 75: Financing sources



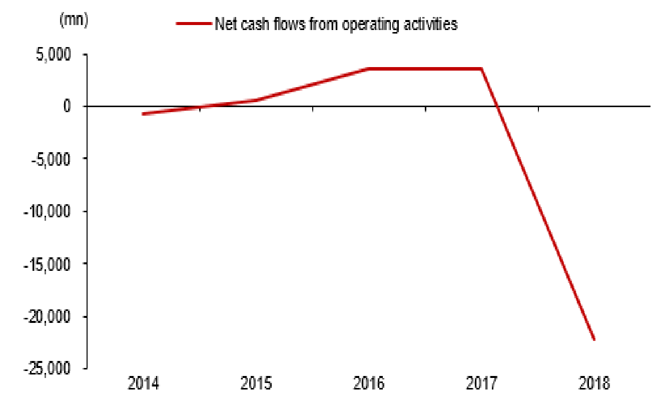
Source: Company data, CMBIS

Figure 76: Revenue structure



Source: Company data, CMBIS

Figure 77: CF from operating activities



Source: Company data, CMBIS

Company Overview

One of China's three largest automobile manufacturers

State-owned Dongfeng Motor Group operates as one of China's three largest automobile manufacturers, headquartered in Hubei province. As of 31 Dec 2018, the Company had 23 subsidiaries, jointly controlled entities and other companies in which the Company has direct equity interests. Dongfeng Motor Group is primarily engaged in the manufacture and sale of commercial vehicles, passenger vehicles and auto engines and parts, equipment manufacturing business, finance businesses as well as other automotive-related businesses.

The commercial vehicle business of the Dongfeng Motor Group was mainly operated by Dongfeng Commercial Vehicle Co., Ltd. (a joint venture between the Company and Volvo Cars), Dongfeng Motor Co., Ltd. (a joint venture between the Company and Nissan Motor Co., Ltd. (through Nissan (China) Investment Co., Ltd.)), Dongfeng Liuzhou Motor Co., Ltd. and Dongfeng Special Commercial Vehicle Co., Ltd.

Dongfeng Motor Group's passenger vehicle business is currently operated by Dongfeng Passenger Vehicle Company, Dongfeng Liuzhou Motor Co., Ltd. and Dongfeng Motor Co., Ltd. (through Dongfeng Nissan Passenger Vehicle Company, Dongfeng Infiniti Motor Co., Ltd. and Dongfeng Venucia Motor Co., Ltd. (東風啟辰汽車公司)), Dongfeng Peugeot Citroën Automobile Co., Ltd. (a joint venture between the Company and the PSA Peugeot Citroën Group), Dongfeng Honda Automobile Co., Ltd. (a joint venture between the Company and Honda Motor Co., Ltd.), Dongfeng Renault Automobile Co., Ltd. (a joint venture between the Company and Renault S.A.).

In recent years, Dongfeng Motor Group has strengthened its new energy vehicle business, which is principally operated by Dongfeng Motor Co., Ltd., Dongfeng Special Commercial Vehicle Co., Ltd., Dongfeng Passenger Vehicle Company, Dongfeng Electric Vehicle Co., Ltd. and eGT New Energy Automotive Co., Ltd..

Financial Analysis

Revenue

The Company generates revenue through automobiles, automobile parts and components, and financial business. In 2018, revenue from sales of automobiles decreased by 35% YoY to RMB 40,239mn while revenue from sales of automobile parts and components decreased by 1% YoY to RMB 60,136mn. Revenue from financial business increased by 27% YoY to RMB 3,876mn. We forecast in 2019E/20E/21E, sales of PV decreased by 38%/36%/38% YoY to RMB 25,010mn/16,078mn/10,007mn whereas revenue from sales of CV increased by 5%/13%5% YoY to RMB 63,290mn/71,268mn/74,708mn. The financial business will increase by 25.71%/26.17%/26.96% to RMB 4,872mn/6,147mn/7,805mn.

Net Income/EPS/Dividend

In 2018, net income attributable to equity holders of the Company declined by 8% growth rate to RMB 12,979mn whereas ROE was 11.44%. The Company declared 3,106mn cash dividend in 2018, representing 23% payout ratio. We forecast that the Company's overall profitability will rebound in 2019E/20E/21E. Specifically, in 2019E, we expect net profit will increase by 12% YoY to RMB 14,513 whereas ROE will be 11.72%. In 2020E/21E, we expect net profit will increase by 13%/13% YoY to RMB 16,361mn/18,557mn whereas ROE will reach 12.09%/12.53% respectively.

Operating ratios

- Profitability Ratios

We forecast that GPM in 2019E/20E/21E will be 13.00%/13.00%/13.00% respectively. We forecast that NPM in 2019E/20E/21E will be 15.74%/17.90%/20.41% respectively.

- Liquidity Ratios

We forecast that current ratio in 2019E/20E/21E will be 1.54/1.52/1.49 respectively. We forecast that net gearing ratio in 2019E/20E/21E will be 27%/25%/24% respectively.

- Efficiency Ratios

We forecast that inventory days in 19E/20E/21E will be 45.63/45.63/45.63 respectively. We forecast that accounts receivable days in 19E/20E/21E will be 61.62/60.04/63.18 respectively.

Valuation

Initiate with TP HK$8.20 (9.48% upside)

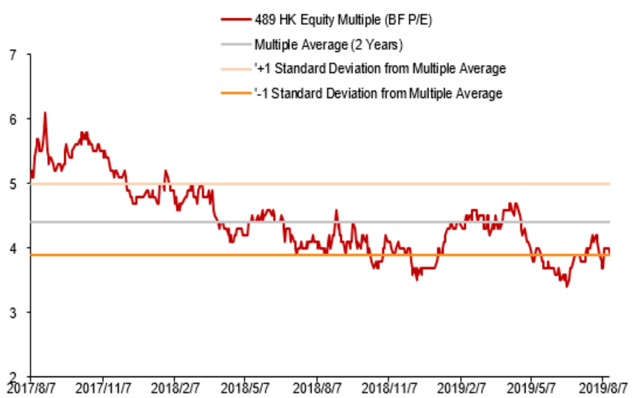
The Company is currently trading at 3.91x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 3.80x. Our Target Price is HK$8.20 per share with 9.48% upside potential. Initiate with Hold.

Figure 78: Peers' valuation

Ticker	Name	Mkt Cap (HKD)	PE FY19	PE FY20	PE FY21	ROE FY19	Dvd Yld FY19
2238 HK Equity	GUANGZHOU AUTOMOBILE GROUP-H	119,488	7.1	5.1	4.8	11.76	6%
175 HK Equity	GEELY AUTOMOBILE HOLDINGS LT	122,185	9.9	8.6	8.1	21.83	2%
489 HK Equity	DONGFENG MOTOR GRP CO LTD-H	64,535	3.9	3.5	3.1	11.72	6%
2333 HK Equity	GREAT WALL MOTOR COMPANY-H	67,157	13.9	11.5	9.4	5.73	3%
1114 HK Equity	BRILLIANCE CHINA AUTOMOTIVE	35,367	6.9	6.1	5.8	19.60	2%
1958 HK Equity	BAIC MOTOR CORP LTD-H	34,546	8.8	7.7	7.0	9.20	4%
1211 HK Equity	BYD CO LTD-H	139,380	41.4	34.8	31.0	4.57	0%
Median	Median	70,237	8.8	7.7	7.0	11.72	3%
Ticker	**Name**	**Mkt Cap (RMB)**	**PE FY19**	**PE FY20**	**PE FY21**	**ROE FY19**	**Dvd Yld FY19**
600104 CH Equity	SAIC MOTOR CORP LTD-A	277,833	9.3	8.6	8.0	5.69	5%
000927 CH Equity	TIANJIN FAW XIALI AUTOMOBI-A	5,216	N/A	N/A	N/A	N/A	N/A
000800 CH Equity	FAW CAR COMPANY LIMITED-A	13,817	N/A	N/A	N/A	2.15	0%
600006 CH Equity	DONGFENG AUTOMOBILE CO LTD-A	8,840	19.5	17.7	18.0	6.90	2%
000572 CH Equity	HAIMA AUTOMOBILE CO LTD -A	2,697	N/A	N/A	N/A	N/A	N/A
200625 CH Equity	CHONGQING CHANGAN AUTOMOBI-B	34,669	(38.5)	8.7	6.4	0.55	4%
Median	Median	24,243	9.3	8.7	8.0	3.9	3%

Source: Bloomberg, CMBIS

Figure 79: P/E Chart



Source: Bloomberg, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**125,98**	**104,543**	**93,564**	**94,130**	**93,412**
Cost of sales	(109,71	(91,128)	(81,401)	(81,893)	(81,268)
Gross profit	**16,264**	**13,415**	**12,163**	**12,237**	**12,144**
Selling and distribution	(7,460)	(6,342)	(5,506)	(5,577)	(5,582)
Administrative expenses	(4,610)	(4,506)	(3,618)	(3,462)	(3,459)
Net impairment losses on	0	(1,006)	(1,154)	(1,039)	(981)
Other income	2,817	3,164	2,283	2,155	2,179
Other expenses	(6,425)	(5,683)	(4,714)	(4,701)	(4,694)
Finance expenses	(592)	(265)	(675)	(713)	(747)
Share of profits and losses	13,574	12,280	13,784	14,785	15,749
Associates	2,207	3,182	3,818	4,964	6,453
Profit before income tax	**15,775**	**14,239**	**16,382**	**18,649**	**21,061**
Income tax expense	(1,148)	(1,661)	(1,659)	(1,799)	(1,995)
Profit for the year	**14,627**	**12,578**	**14,723**	**16,850**	**19,067**
Less: MI	566	(401)	210	489	510
Net Profit	**14,061**	**12,979**	**14,513**	**16,361**	**18,557**

Cash flow

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	**14,061**	**12,979**	**14,513**	**16,361**	**18,557**
D&A	2,178	2,455	2,689	2,961	3,245
Change in working capital	(7,307)	(8,144)	1,824	2,933	363
Others	(5,286)	(29,539)	(8,196)	(7,721)	(11,929)
Net cash from operating	**3,646**	**(22,249)**	**10,831**	**14,534**	**10,236**
Capex & investments	(4,340)	(4,395)	(4,223)	(4,573)	(4,976)
Associated companies	(2,016)	(3,068)	(2,652)	(3,457)	(4,044)
Others	8,064	20,143	-	-	-
Net cash from investing	**1,708**	**12,680**	**(6,875)**	**(8,030)**	**(9,020)**
Equity raised	-	-	-	-	-
Change of Debts	2,382	9,374	7,590	1,920	1,696
Dividend paid	(2,843)	(3,016)	(3,628)	(4,090)	(4,639)
Others	(3,034)	(3,455)	-	-	-
Net cash from financing	**(3,495)**	**2,903**	**3,962**	**(2,170)**	**(2,944)**
Net change in cash	**1,859**	**(6,666)**	**7,918**	**4,335**	**(1,728)**
Cash at the beginning	42,199	44,058	30,904	38,822	43,156
Exchange difference	-	(6,488)	-	-	-
Cash at the end	**44,058**	**30,904**	**38,822**	**43,156**	**41,428**
Less: pledged cash	10,617	3,653	3,653	3,653	3,653

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	**97,759**	**111,294**	**121,679**	**135,905**	**154,427**
Fixed asset	15,088	15,835	16,160	16,669	17,293
Intangible assets	4,237	4,809	5,206	5,592	5,977
Interest in joint	54,472	62,329	66,710	72,451	80,192
Other non-current assets	23,962	28,321	33,603	41,192	50,964
Current assets	**116,14**	**115,223**	**111,803**	**116,634**	**115,913**
Cash	44,058	30,904	38,822	43,156	41,428
Account receivable	21,084	22,522	13,743	13,471	14,067
Inventory	10,657	10,710	10,175	10,237	10,159
Other current assets	40,350	51,087	49,064	49,770	50,259
Current liabilities	**91,770**	**84,457**	**72,448**	**76,688**	**77,901**
Borrowings	14,381	15,424	14,556	14,786	14,605
Account payables	44,134	37,140	27,777	30,450	30,785
Other payables	32,427	31,263	29,269	30,486	31,440
Tax payables	828	630	846	967	1,071
Non-current liabilities	**6,814**	**17,135**	**23,983**	**26,062**	**28,321**
Borrowings	2,398	10,729	19,187	20,878	22,754
Provisions	652	659	608	631	626
Deferred income tax	1,555	2,086	1,822	2,127	2,439
Others	2,209	3,661	2,367	2,427	2,502
Minority Interest	**6,809**	**6,569**	**7,758**	**8,479**	**9,290**
Total net assets	**108,51**	**118,356**	**129,293**	**141,310**	**154,828**
Shareholders' equity	**108,51**	**118,356**	**129,293**	**141,310**	**154,828**

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Passenger vehicles	49%	38%	27%	17%	11%
Commercial vehicles	48%	58%	68%	76%	80%
Financial business	2%	4%	5%	7%	8%
Others	0%	0%	1%	1%	2%
Intra-segment	0%	0%	0%	0%	-1%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
P&L ratios (%)					
Gross profit margin	13%	13%	13%	13%	13%
Pre-tax margin	13%	14%	18%	20%	23%
Net margin	11%	12%	16%	17%	20%
Effective tax rate	7%	12%	10%	10%	9%
Balance sheet ratios					
Current ratio (x)	1.27	1.36	1.54	1.52	1.49
Quick ratio (x)	0.71	0.66	0.75	0.76	0.74
Cash ratio (x)	0.48	0.37	0.54	0.56	0.53
Debtors turnover days	61	79	62	60	63
Total debt / total equity	85%	81%	70%	69%	65%
Net debt / equity ratio	51%	46%	27%	25%	24%
Returns (%)					
ROE	14%	11%	12%	12%	13%
ROA	8%	7%	7%	8%	8%
Per share					
EPS (RMB)	1.63	1.51	1.68	1.90	2.15
DPS (RMB)	0.33	0.35	0.42	0.47	0.54
BVPS (RMB)	12.59	13.74	15.01	16.40	17.97

Source: Company data, CMBIS estimates

CMB International Securities | Equity Research | Company Update

Great Wall Motor (2333 HK)

Maintain growth in decline market

In 1H19, the Company achieved a total sales volume of 493,500 units, an increase of 4.67% YoY compared with a 14% decline in the overall market. In the declining market, the Company has a delicate trade-off between expanding market share and net profit margin. However, as the market leader in the industry, the Company has more flexibility when an overall market condition improves. We expect the Company will likely to grow in term of sales volume and net profit in 2020. The forecast revenue will be to RMB 94.8/97.6/106.8bn in 2019/20E/21E, representing a growth rate of -4.5%/3.0%/9.4%. Given a positive outlook in its oversea market, we forecast in 2020E/21E net profit will increase by 21%/23% YoY to RMB3.7/4.5bn. However, the stock is currently overvalued. Initiate with Hold, TP HK$5.22.

- **Cutting retail price to maintain market share.** The Company adjusted its sales target for 2019 from 1.20mn to 1.07mn units. In 1H19, sales reached 493k, an increase of 4.7% YoY, and 46% of the adjusted target was completed. In Jul, the sales volume reached 59,856 units, an increase of 11%YoY. It is expected that the Company will meet its sales target by cutting the retail price.
- **Globalization strategy will be the new growth catalyst.** As the domestic auto market gradually slowdown, the Company accelerated its pace on overseas market expansion. On 5 Jun, the Tula factory in Russia was put into production, suggesting that the Company's globalization strategy has entered a new era. It will mainly produce Haval H9 and F7 models boosting the sales volume in Russia and Eastern European market. However, GPM from the oversea market was 11.85%, significantly lower than that of 16.74% in the domestic market in 2018. Therefore, as the production capacity and sales channel build up in short term, the bottom line growth will not be as shining as top line growth.
- **Valuation/Key risks.** The Company is currently trading at 13.92x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 11.00x. Our Target Price is HK$4.99 per share with 4.70% downside potential. Initiate with Hold.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	101,170	99,230	94,816	97,633	106,807
YoY growth (%)	2.59%	-1.92%	-4.45%	2.97%	9.40%
Net income (RMB mn)	5,025	5,207	3,024	3,646	4,482
EPS (RMB)	0.55	0.57	0.33	0.40	0.49
YoY growth (%)	-52%	4%	-42%	21%	23%
P/E (x)	8.37	8.08	13.92	11.54	9.39
P/B (x)	0.86	0.80	0.79	0.76	0.72
Yield (%)	3.69%	6.29%	2.89%	3.48%	4.28%
ROE (%)	10.42%	10.24%	5.73%	6.71%	7.86%
Net gearing (%)	115%	98%	99%	96%	102%

Source: Company data, CMBIS estimates

招銀国际 CMB INTERNATIONAL
招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

HOLD (Initiation)

Target Price	**HK$4.99**
Up/Downside	**-4.70%**
Current Price	**HK$5.24**

China Auto Sector

Jack Bai
(852) 3900 0835
jackbai@cmbi.com.hk

Stock Data

Mkt Cap (HK$ mn)	67,157
Avg 3 mths t/o (HK$ mn)	124.76
52w High/Low (HK$)	7.26/ 4.02
Total Issued Shares (mn)	9,127.3

Source: Bloomberg

Shareholding Structure

Baoding Innovation Great Wall Asset Management Company Limited	56.04%
HKSCC Nominess Limited	33.78%
China Securities Finance Corporation Limited	2.16%

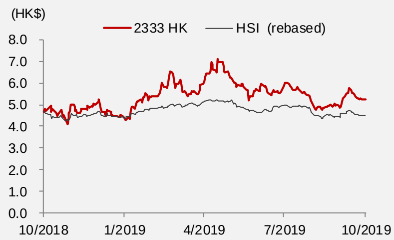
Source: Company data

Share Performance

	Absolute	Relative
1-mth	5.4%	3.9%
3-mth	-6.1%	2.7%
6-mth	-11.8%	0.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte Touche Tohmatsu

Investment Thesis

Sales volume maintains the increase while revenue declines

In Jul 2019, Great Wall Motor sold a total of 59,856 units, an increase of 11% YoY. In 1H19, Great Wall Motor sold a total of 493,538 units, an increase of 4.7% YoY.

The Company also released its 1H19 financial results at the end of Aug 2019. The total revenue for 1H19 was RMB 41.38bn, representing a decrease of 15.0% YoY. The unit price in 1H19 decreased by approximately 17%. It suggests that the Company has chosen to keep its market share by sacrificing the retail price. It also reflects the brand was losing its customer loyalty in 1H19. We estimate that the overall price cutting in 2019E would be 9% if GWM tries to achieve its sales target.

Net profit will was RMB1.5bn, a decrease of 58% YoY. Net profit attributable to shareholders of listed companies was approximately RMB 1.51bn, a decrease of 59% YoY.

Globalization strategy

On 13 Jan 2019, Great Wall Motor released the Haval "521" globalization strategy, suggesting it will spend the next five years to achieve an annual sales volume of 2mn units.

- **Overall Chinese auto export**

According to the data released by the China Automobile Association, the decline in automobile exports in Jun 2019 has narrowed. Total exported vehicles reached 96,000 units, up 22.6% from the previous month and down by 3.3% YoY. In terms of models, passenger cars exported 69,000 units this month, up 24.2% from the previous month and down 1.6% from the same period of last year. Commercial vehicles exported 27,000 units, up 18.8% from the previous month and down 7.4% from the same period of the previous year.

- **Oversea market**

In 1H19, auto companies exported 488,000 vehicles, down 4.7% YoY. In terms of model, passenger cars exported 328,000 units, down 12.2% YoY; commercial vehicles exported 160,000 units, up 15.5% YoY.

In Jun 2019, Great Wall Motor Russia Tula factory was completed and put into production, reflecting that GWM's globalization strategy has entered a new stage. In Jun, Great Wall Motor exported a total of 6,711 new cars, an increase of 83.3% YoY. In 1H19, Great Wall Motors exported a total of 30,305 new cars, a 29.4% increase YoY.

Intelligent Networking - GTO Global Wisdom Ecological Strategy

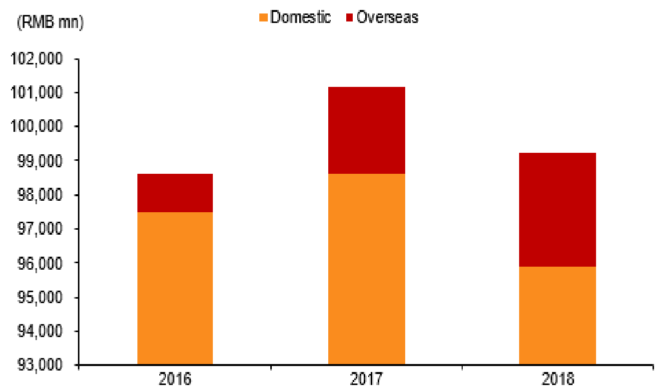
Regarding the V2X experience service, Great Wall Motor announced that it will jointly build a global smart ecosystem with eight strategic partners: Tencent, Ali, Baidu, China Telecom, China Unicom, China Mobile, Huawei and Qualcomm. By working together with its partners, GWM will create future vehicle based on 5G+AI technology. It will embed the idea of “experience-driven”, “life-cycle experience and service”, and “GTO (Great Wall Totally Online) smart ecology” into its future development.

Auto finance

As consumers' consumption habits change, more consumers use auto finance to purchase cars and promote the continued growth of the Group's auto finance business in 2018. The loan scale of the auto finance business reached RMB 17.785bn, and the interest income was RMB 1.385bn. It represents an increase of 105.76% YoY. We expect the auto finance business will continue to develop steadily.

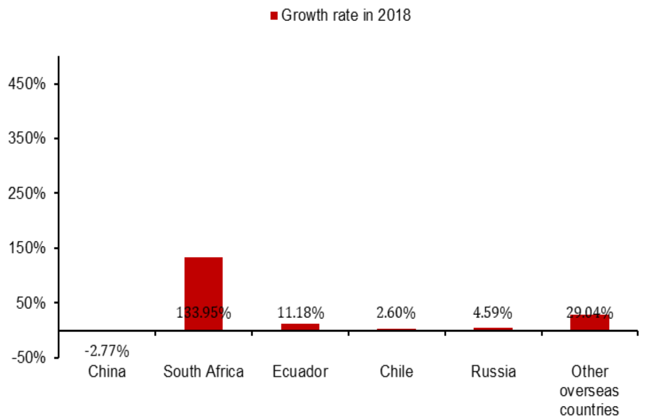
Focus Charts

Figure 80: Revenue domestic vs oversea



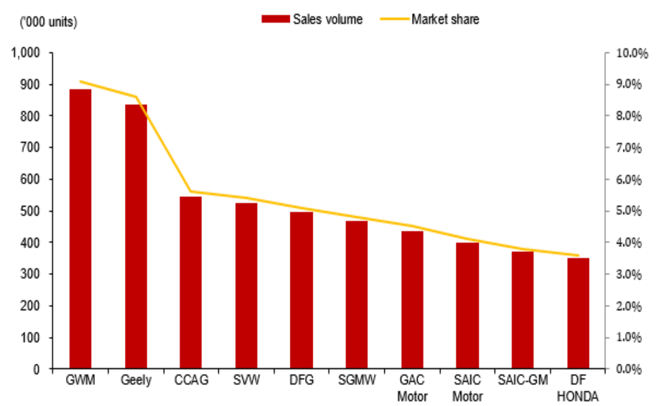
Source: Company data, CMBIS

Figure 81: Growth rate by country



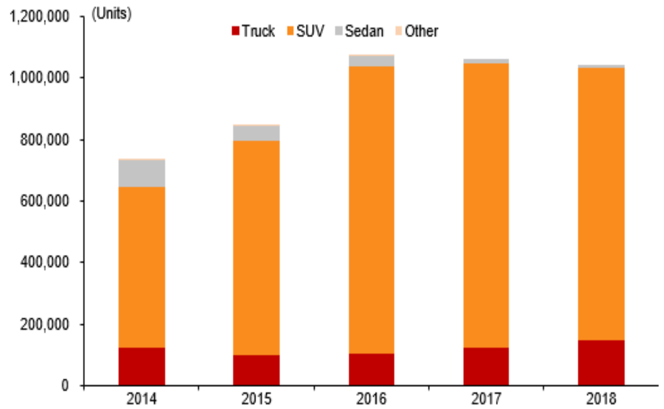
Source: Company data, CMBIS

Figure 82: Top 10 SUV maker in 2018



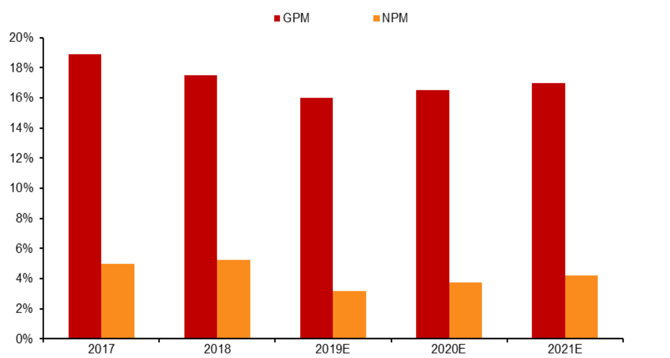
Source: Company data, CMBIS

Figure 83: Sales volume structure



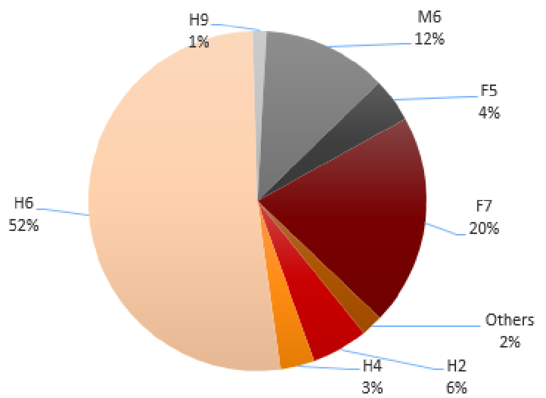
Source: Company data, CMBIS

Figure 84: GPM vs NPM



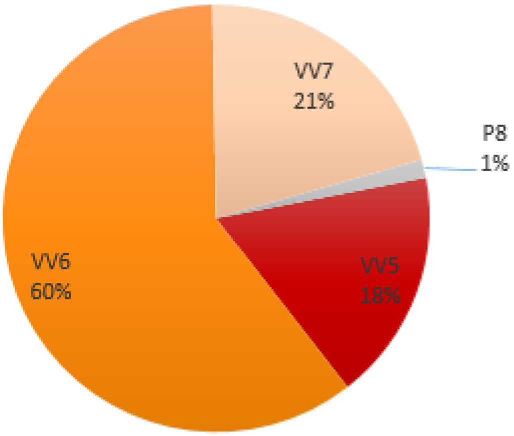
Source: Company data, CMBIS estimates

Figure 85: Haval sales structure in 1H19



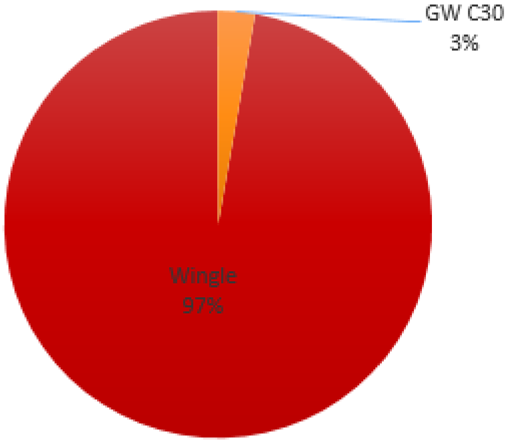
Source: Company data, CMBIS

Figure 86: WEY sales structure in 1H19



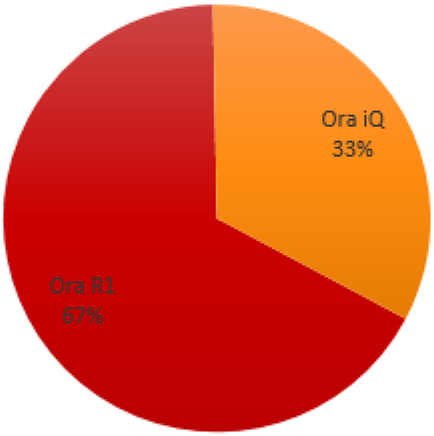
Source: Company data, CMBIS

Figure 87: GW pickup truck sales structure in 1H19



Source: Company data, CMBIS

Figure 88: Ora sales structure in 1H19



Source: Company data, CMBIS

Company Overview

The leading local player in the auto industry

Great Wall Motor is one of the largest SUV manufacturers in China. At present, it owns four brands: Haval, WEY, Great Wall Pickup Truck, and Ora. In cooperation with BMW, GWM signed a joint venture contract in 2018 to establish a joint venture company, Spotlight Automobile, which covers SUV, sedan, pickup truck and related automotive parts and components. The first model of the joint venture is expected to be MINI Rocketman and will be launched in 2022.

The Company persists on focused development with the brand concept of "focus, dedication and specialization". GWM chooses to specialize in SUV brands within the passenger vehicle sector through specialized operation and management. GWM was listed on the Hong Kong Stock Exchange in 2003 and the Shanghai Stock Exchange in 2011.

Brand

- **Haval**

Haval is a sub-brand of Great Wall Motor and it was established on 29 Mar 2013. The Haval brand, which is mainly based on SUV models use independent logos, independent product development, production, service and other systems. With respect to the “Haval” brand, the Group launched the F series models in 2018, achieving simultaneous operation of the H series, the F series and M series. It now consists of three series of H series, M series and F series. By increasing the differences among the three series, GWM has boosted the overall sales volume of the “Haval” brand.

The total sales volume of Haval SUV in Jun 2019 was 45,256 units, an increase of 7.44% YoY. In 1H19, the total sales volume of Haval SUVs reached 352,872 units, an increase of 8.47% YoY. It was a phenomenal achievement while a sharp decline happened in the overall domestic SUV market. Among all the Haval models, Haval H6 is the signature product and continues to maintain its leading position in the industry. In Jun, it sold 27,052 vehicles, a 6% increase MoM and a 3% increase YoY. The Company's total SUV sales volume continued to rank first.

Figure 89: Haval H6

Source: Company data, CMBIS

Figure 90: Haval F7

Source: Company data, CMBIS

■ WEY

WEY is a luxury SUV brand independently built by GWM and was officially rolled out on 16 Nov 2016. Its main products include VV5, VV6, VV7 and P8. In 2018, WEY brand sold 139,486 units, an increase of 61.4% YoY. It is ranked No.1 in the high-end SUV with a price range of RMB 150k to 200k. Specifically, VV5 had a total sales volume of 62,968 units, an increase of 87% YoY; VV6 reached its total sales of 18,460 vehicles in four months after it was launched; VV7 also achieved a total sale of 54,671 vehicles, while P8 total sales was 3,387 units. In 1H19, the total sales volume of WEY was 46,900 units, down by 39.62% YoY.

Figure 91: WEY VV6

Source: Company data, CMBIS

Figure 92: WEY VV7

Source: Company data, CMBIS

■ Great Wall Pickup

The Great Wall pickup truck sold 7,166 units in Jun 2019 and continues to be the champion in the pickup truck market. In 1H19, the total sales volume of the Great Wall pickup truck reached 64,878 units, nearly the same as that of last year. The Great Wall pickup truck has a market share of 35.2% in the domestic pickup truck market, which is equivalent to the sum of sales volume of the companies ranked at second and third. With the Great Wall P series officially launched in Sep 2019, the Great Wall pickup truck is expected to achieve a new round of growth in the pickup truck market.

Figure 93: Wingle 7

Source: Company data, CMBIS

Figure 94: P Series

Source: Company data, CMBIS

- **Ora**

Ora is a NEV brand owned by GWM that includes Ora iQ and Ora R1. The third model, namely Ora R2, has also entered the directory of the Ministry of Industry and Information Technology and is expected to be rolled out in the 2H19.

In 1H19, the sales volume of the Ora brand reached 27,013 units and it reached the top 10 in the NEV market in China at an alarming rate. In Jun, Ora sold 3,762 new cars, of which the sales volume of Ora R1 reached 3,198. With its innovative design, Ora R1 is deeply loved by young consumers. The release of Ora brand further enriched the Company's product portfolio of new energy vehicles.

Figure 95: Ora R1

Source: Company data, CMBIS

- **Spotlight Automotive**

In Jul 2018, the Group and BMW Holding entered into a joint venture contract for the establishment of Spotlight Automotive Ltd. (光束汽車有限公司), which would be held as to 50% by each party.

The JV will develop a new generation all-electric vehicle platform, which will produce BMW's MINI electric vehicles as well as self-owned brand electric vehicles. As the first automobile joint venture project after the State's reform on joint venture ownership policy, the previously mentioned cooperation not only provides strong support to the Group's development of the new energy market, but also entrenches the Group's leading position in the new energy sector. In addition, it will facilitate the Group's completion of a blueprint for internationalization.

According to the plan, the first product of the beam car is a pure electric compact SUV with a cruising range of 500 kilometers. It is expected to be launched in 2021 and will be sold by the Great Wall Motor dealers. The second model is a product of the MINI brand, which is owned by BMW.

Financial Analysis

Revenue

The Company generates revenue through automobiles, automobile parts and components, and interest income. In 2018, revenue from sales of automobiles decreased by 4.57% YoY to RMB 91.6bn while revenue from sales of automobile parts and components increased by 38% YoY to RMB 6.2bn. Revenue from interest income increased by 106% YoY to RMB 1.4bn. We forecast in 2019E/20E/21E, sales of automobiles will be RMB 86bn/88bn/95bn with the growth rate of -6.20%/2.04%/8.73% whereas revenue from sales of automobile parts and components will reach RMB 7bn/8bn/9bn with growth rate of 13%/11%/11%. We forecast that interest income will increase by 36%/16%/30% to RMB 1.9bn/2.2mn/2.9bn.

Net Income/EPS/Dividend

In 2018, net income attributable to equity holders of the Company increased by 4% to RMB 5,207mn whereas ROE was 10.24%. The Company declared 2,647mn cash dividend in 2018, representing 50% payout ratio. We forecast that the Company's overall profitability will rebound in 2020E/21E after a sharp decline in 2019E. Specifically, in 2019E, net profit will decrease by 42% YoY to RMB 3,039mn whereas ROE will be 5.73%. In 2020E/21E, net profit will increase by 21%/23% YoY to RMB 3,665mn/4,507mn whereas ROE will reach 6.71%/7.86% respectively.

Operating ratios

- Profitability Ratios

We forecast that GPM in 2019E/20E/21E will be 16.00%/16.50%/17.00% respectively. We forecast that NPM in 2019E/20E/21E will be 3.91%/4.61%/5.18% respectively.

- Liquidity Ratios

We forecast that current ratio in 2019E/20E/21E will be 1.23/1.29/1.31 respectively. We forecast that net gearing ratio in 2019E/20E/21E will be 99%/96%/102% respectively.

- Efficiency Ratios

We forecast that Days sales of inventory in 2019E/20E/21E will be 18/20/20 respectively. We forecast that Accounts receivable days in 2019E/20E/21E will be 36/45/60 respectively.

Valuation

Initiate with TP HK$4.99 (4.70% downside)

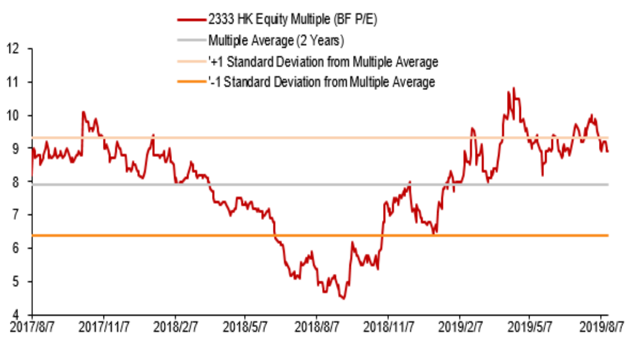
The Company is currently trading at 13.92x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 11.00x. Our Target Price is HK$4.99 per share with 4.70% downside potential. Initiate with Hold.

Figure 96: Peers' valuation

Ticker	Name	Mkt Cap (HKD)	PE FY19	PE FY20	PE FY21	ROE FY19	Dvd Yld FY19
2238 HK Equity	GUANGZHOU AUTOMOBILE GROUP-H	119,488	7.1	5.1	4.8	11.76	6%
175 HK Equity	GEELY AUTOMOBILE HOLDINGS LT	122,185	9.9	8.6	8.1	21.83	2%
489 HK Equity	DONGFENG MOTOR GRP CO LTD-H	64,535	3.9	3.5	3.1	11.72	6%
2333 HK Equity	GREAT WALL MOTOR COMPANY-H	67,157	13.9	11.5	9.4	5.73	3%
1114 HK Equity	BRILLIANCE CHINA AUTOMOTIVE	35,367	6.9	6.1	5.8	19.60	2%
1958 HK Equity	BAIC MOTOR CORP LTD-H	34,546	8.8	7.7	7.0	9.20	4%
1211 HK Equity	BYD CO LTD-H	139,380	41.4	34.8	31.0	4.57	0%
Median	Median	70,237	8.8	7.7	7.0	11.72	3%
Ticker	**Name**	**Mkt Cap (RMB)**	**PE FY19**	**PE FY20**	**PE FY21**	**ROE FY19**	**Dvd Yld FY19**
600104 CH Equity	SAIC MOTOR CORP LTD-A	277,833	9.3	8.6	8.0	5.69	5%
000927 CH Equity	TIANJIN FAW XIALI AUTOMOBI-A	5,216	N/A	N/A	N/A	N/A	N/A
000800 CH Equity	FAW CAR COMPANY LIMITED-A	13,817	N/A	N/A	N/A	2.15	0%
600006 CH Equity	DONGFENG AUTOMOBILE CO LTD-A	8,840	19.5	17.7	18.0	6.90	2%
000572 CH Equity	HAIMA AUTOMOBILE CO LTD -A	2,697	N/A	N/A	N/A	N/A	N/A
200625 CH Equity	CHONGQING CHANGAN AUTOMOBI-B	34,669	(38.5)	8.7	6.4	0.55	4%
Median	Median	24,243	9.3	8.7	8.0	3.9	3%

Source: Bloomberg, CMBIS

Figure 97: P/E Chart



Source: Bloomberg, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**101,17**	**99,230**	**94,816**	**97,633**	**106,807**
Cost of sales	(82,047	(81,864)	(79,646)	(81,524)	(88,650)
Gross profit	**19,123**	**17,366**	**15,171**	**16,110**	**18,157**
Taxes and levies	(3,906)	(3,627)	(3,570)	(3,672)	(3,990)
S&D expenses	(4,406)	(4,575)	(4,409)	(4,458)	(4,911)
Administrative expenses	(1,598)	(1,676)	(1,511)	(1,576)	(1,738)
R&D expenses	(3,365)	(1,743)	(1,810)	(1,925)	(2,091)
Finance expenses	(139)	494	(707)	(660)	(732)
Impairment losses	(317)	(318)	(229)	(236)	(256)
Other income	166	176	123	147	162
P/L from Joint ventures	0	0	0	0	0
Investment income	124	219	263	342	445
P/L from disposal	171	(82)	241	248	269
Non-operating income	391	253	155	190	230
Non-operating expenses	(12)	(8)	(6)	(7)	(9)
Profit before income tax	**6,232**	**6,477**	**3,711**	**4,501**	**5,535**
Income tax expense	(1,190)	(1,229)	(673)	(837)	(1,028)
Profit for the year	**5,042**	**5,248**	**3,039**	**3,665**	**4,507**
Less: MI	16	40	14	19	25
Net Profit	**5,025**	**5,207**	**3,024**	**3,646**	**4,482**

Cash flow

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	**5,025**	**5,207**	**3,024**	**3,646**	**4,482**
D&A	3,548	4,227	4,675	4,795	5,121
Change in working capital	(3,064)	(7,067)	46,994	1,222	(1,914)
Others	(6,568)	17,331	(48,433)	1,720	(180)
Net cash from operating	**(1,059)**	**19,698**	**6,260**	**11,383**	**7,509**
Capex & investments	(10,280)	(11,044)	(5,689)	(5,467)	(5,340)
Associated companies	-	-	-	-	-
Others	7,207	1,004	-	-	-
Net cash from investing	**(3,073)**	**(10,040)**	**(5,689)**	**(5,467)**	**(5,340)**
Equity raised	-	-	-	-	-
Change of Debts	(50)	13,162	1,496	(4,079)	343
Dividend paid	(1,552)	(2,647)	(1,215)	(1,466)	(1,803)
Others	7,691	(17,016)	-	-	-
Net cash from financing	**6,089**	**(6,501)**	**281**	**(5,545)**	**(1,460)**
Net change in cash	**1,957**	**3,157**	**851**	**370**	**709**
Cash at the beginning	2,874	4,831	7,682	8,533	8,903
Exchange difference	-	(306)	-	-	-
Cash at the end	**4,831**	**7,682**	**8,533**	**8,903**	**9,613**
Less: pledged cash	-	-	-	-	-

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	**41,253**	**45,674**	**44,515**	**43,374**	**43,263**
Fixed asset	27,718	28,993	28,023	26,529	24,881
Intangible assets	3,268	3,391	3,223	2,985	2,799
Interest in joint	-	-	-	-	-
Other non-current assets	10,267	13,290	13,269	13,860	15,584
Current assets	**69,294**	**66,126**	**70,066**	**74,587**	**84,767**
Cash	4,831	7,682	8,533	8,903	9,613
Account receivable	49,949	3,343	7,965	10,190	14,775
Inventory	5,575	4,445	3,982	4,529	4,925
Other current assets	8,939	50,656	49,585	50,964	55,454
Current liabilities	**58,882**	**54,618**	**57,038**	**57,805**	**64,540**
Borrowings	13,038	12,800	9,332	8,787	11,148
Account payables	31,842	29,401	39,823	40,762	44,325
Other payables	11,694	9,866	6,753	6,851	7,172
Tax payables	2,308	2,551	1,130	1,405	1,895
Non-current liabilities	**2,408**	**4,493**	**4,292**	**4,450**	**4,752**
Borrowings	424	2,158	2,345	2,435	2,520
Provisions	0	0	0	0	0
Deferred income tax	21	253	50	63	96
Others	1,963	2,082	1,896	1,953	2,136
Minority Interest	**123**	**164**	**165**	**172**	**182**
Total net assets	**49,134**	**52,525**	**53,086**	**55,533**	**58,557**
Shareholders' equity	**49,134**	**52,525**	**53,086**	**55,533**	**58,557**

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Automobiles	95%	92%	91%	90%	89%
Parts and components	4%	6%	7%	8%	8%
Interest income	1%	1%	2%	2%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
P&L ratios (%)					
Gross profit margin	19%	18%	16%	17%	17%
Pre-tax margin	6%	7%	4%	5%	5%
Net margin	5%	5%	3%	4%	4%
Effective tax rate	19%	19%	18%	19%	19%
Balance sheet ratios					
Current ratio (x)	1.18	1.21	1.23	1.29	1.31
Quick ratio (x)	0.94	0.26	0.34	0.39	0.43
Cash ratio (x)	0.08	0.14	0.15	0.15	0.15
Debtors turnover days	180	12	37	46	61
Total debt / total equity	124%	112%	115%	112%	118%
Net debt / equity ratio	115%	98%	99%	96%	102%
Returns (%)					
ROE	10%	10%	6%	7%	8%
ROA	6%	5%	4%	4%	5%
Per share					
EPS (RMB)	0.55	0.57	0.33	0.40	0.49
DPS (RMB)	0.17	0.29	0.13	0.16	0.20
BVPS (RMB)	5.38	5.75	5.82	6.08	6.42

Source: Company data, CMBIS estimates

3 Oct 2019

SAIC Motor (600104 CH)

China's largest automobile group with great resilience

In Jul 2019, the Company completed a sales volume of 439,794 units, a decrease of 9.3% YoY. Among them, SAIC-Volkswagen sales volume was 145,100, a decrease of 4.6% YoY while SAIC-GM sales volume was 11,567, a decrease of 17.6%. SAIC passenger vehicle sales volume was 52,025, an increase of 8.2% YoY whereas SAIC-GM-Wuling sales volume was 108,500, a decrease of 16.8%. In 1H19, the Company achieved a total sales volume of 2,937,296 units, a decrease of 16.62% YoY compared with a 14% decline in the overall market. We forecast the revenue will be RMB 886/899/935bn in 2019E/20E/21E with the growth rate of -1.76%/1.39%/4.07%. The corresponding net profit will be RMB 30/33/35bn. Initiate with HOLD and TP RMB25.59.

- **Management team renewed that sales volume target will likely to be met.** The Company adjusted its sales target for 2019 from 7.05mn to 6.54mn units. In 1H19, sales volume reached 2.94mn units, representing 44.91% of the adjusted target. On 22 Jul 2019, SAIC Motor issued a public announcement, stating that Wang Xiaoqiu officially succeeded Chen Zhixin as the group president. In addition, SAIC has also added three new vice presidents. As the new management team was getting aboard, it is expected that the final sales volume of the year will likely to beat the sales target by increasing S&D expense or by reducing the price.
- **External financing for technology innovation and business development.** Under the structure of storage shelves, the Company plans to issue no greater than RMB 20bn debt to supplement operation, R&D, and project construction. In the announcement, the fund raised will be used in developing NEV, intelligent and connected network technology; speeding up the development of digital and customized production methods; focusing on the new business model in smart travel platforms, intelligent logistics, financial services and other new business models; establishing brand competitiveness in the international market. The net gearing ratio in 2018 was 17% which is well below the market average. We do not anticipate any major liquidity risk associated with this particular financial liability.
- **Valuation/Key risks.** The Company is currently trading at 9.25x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 9.20x. Our Target Price is RMB25.59 per share with 7.62% upside potential. Initiate with Hold.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	870,639	902,194	886,335	898,680	935,235
YoY growth (%)	15.10%	3.62%	-1.76%	1.39%	4.07%
Net income (RMB mn)	34,410	36,009	30,049	32,500	34,799
EPS (RMB)	2.96	3.08	2.57	2.78	2.98
YoY growth (%)	2%	4%	-17%	8%	7%
P/E (x)	8.04	7.72	9.25	8.55	7.98
P/B (x)	1.23	1.19	1.17	1.16	1.14
Yield (%)	6.94%	7.70%	5.30%	5.57%	5.40%
ROE (%)	7.18%	6.83%	5.69%	5.93%	6.03%
Net gearing (%)	5%	17%	17%	26%	37%

Source: Company data, CMBIS estimates

HOLD (Initiation)

Target Price	RMB25.59
Up/Downside	+7.62%
Current Price	RMB23.78

China Auto Sector

Jack Bai
(852) 3900 0835
jackbai@cmbi.com.hk

Stock Data

Mkt Cap (HK$ mn)	277,833
Avg 3 mths t/o (HK$ mn)	606.80
52w High/Low (HK$)	32.30/ 22.69
Total Issued Shares (mn)	11,683.5

Source: Bloomberg

Shareholding Structure

Shanghai Automotive Industry (Group) Corporation	71.24%
Yuejin Automobile Group Corporation	3.54%
Hong Kong Central Clearing Company Limited	3.07%

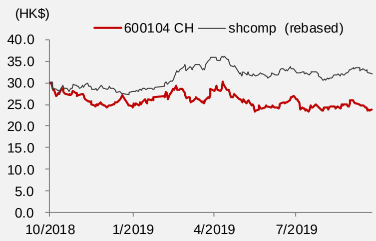
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-5.2%	-5.8%
3-mth	-8.7%	-4.3%
6-mth	-10.6%	-2.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte Touche Tohmatsu

Investment Thesis

Oversea market

From 2016 to 2018, SAIC Group's overseas sales volume increased from 126,000 to 277,000, ranking the first place among local brands for three consecutive years. In 2018, SAIC Group's overseas sales increased by 62.5% YoY, accounting for 23% of total overseas sales in China. SAIC is accelerating its “internationalization” through differentiated competition, with an overseas sales target of 350,000 units in 2019, a target growth rate of 26%. At present, SAIC has established three overseas vehicle manufacturing bases in Thailand, Indonesia and India with more than 500 overseas dealerships. SAIC also established its presence in Thailand, UK, Indonesia, Chile, Australia and the Middle East.

NEV

In 1H19, the production and sales of NEV completed were 614,000 and 617,000 respectively, an increase of 48.5% and 49.6% YoY. Among them, the production and sales of EV were 445,000 and 444,000 respectively, up 70.0% and 69.8% respectively YoY. The production and sales of plug-in hybrid vehicles were 117,000 and 123,000 respectively, up by 21.6% and 28.5% YoY. The production and sales of FCEV were 1,170 and 1,102 respectively, up by 7.2% and 7.8% YoY.

In 2018, SAIC sold 142,000 units of NEV, an increase of 120% YoY. The local brands Roewe and MG’s NEV sales reached 97,000 units, an increase of 119%. The SAIC sales target for NEV in 2019 was 200,000 units. In 1H19, SAIC's NEV sales volume exceeded 80,000 units, an increase of 40% YoY, representing 40% of the annual target.

New models coming up in 2H19

Roewe RX5 is the key project of SAIC local brand. The new Roewe RX5 MAX will be available for pre-sale on 18 Aug 2019. Improvements have been made to the rectify the deficiency in the existing RX5 model while the size, design and technology configuration were enhanced. It is believed that the upgrades have equipped Roewe RX5 MAX with a brand new strength, which will promote the total sales volume.

MG will launch two models in 2H19, namely the new MG ZS and the plug-in hybrid MG Ehs. The new MG ZS, which was core product of MG, will be powered by a 1.3T-turbocharged engine with a maximum power of 120kW.

Figure 98: RX5 MAX

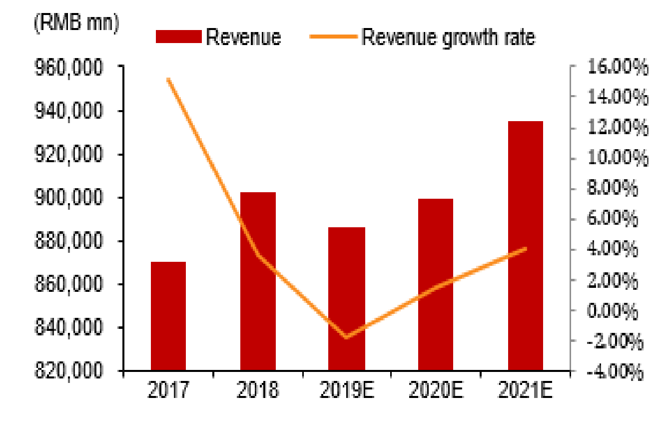
Source: Company data, CMBIS

Figure 99: MG ZS

Source: Company data, CMBIS

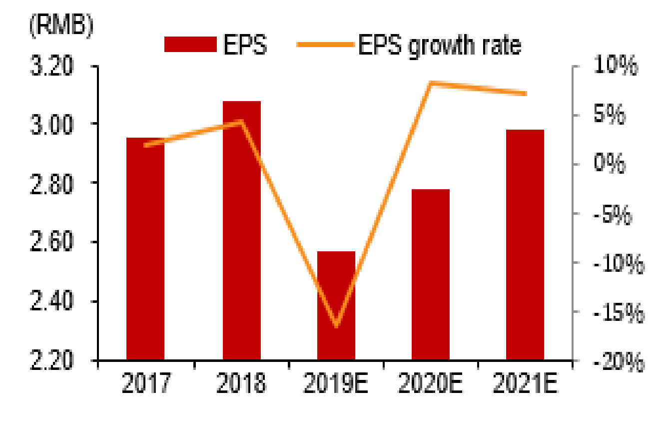
Focus Charts

Figure 100: Revenue/growth rate



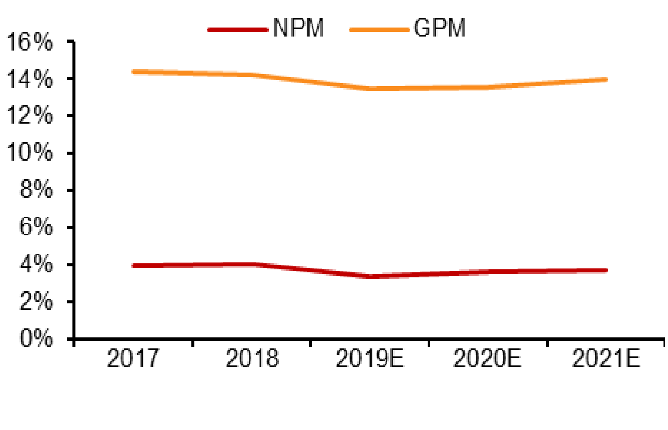
Source: Company data, CMBIS estimates

Figure 101: EPS/growth rate



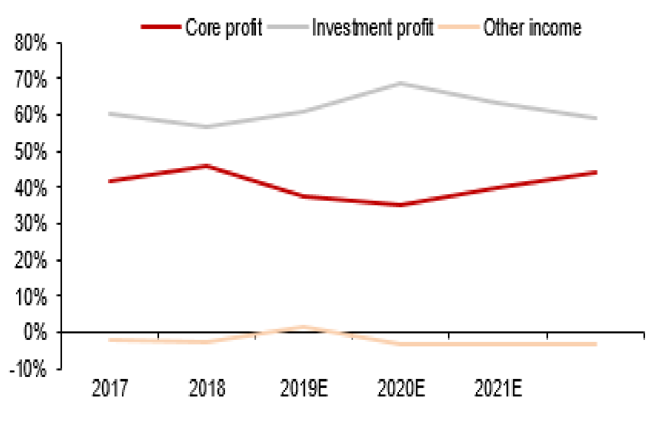
Source: Company data, CMBIS estimates

Figure 102: GPM vs NPM



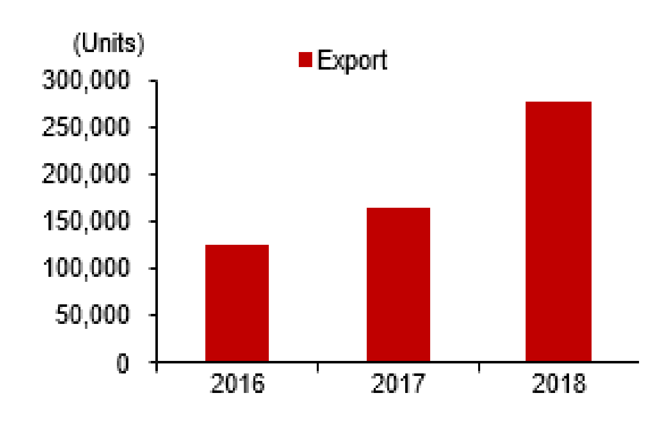
Source: Company data, CMBIS estimates

Figure 103: Profit structure



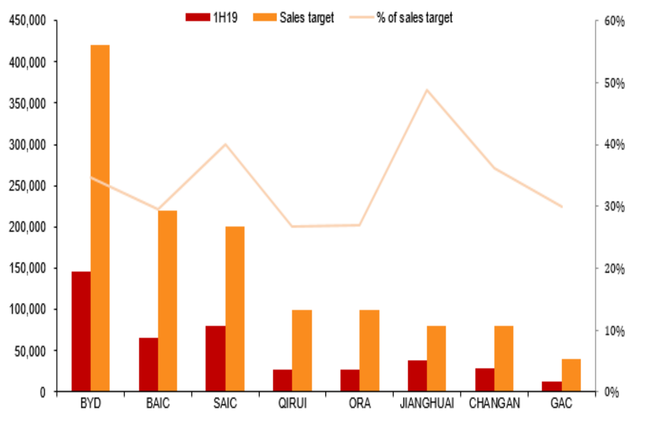
Source: Company data, CMBIS estimates

Figure 104: Export



Source: Company data, CMBIS

Figure 105: 1H19 performance



Source: Company data, CMBIS

Company Overview

The largest auto company in China

SAIC Motor is the largest auto company on China's A-share market. SAIC Motor's business covers the research, production and sales of both passenger and commercial vehicles. SAIC Motor is actively promoting the commercialization of new energy vehicles and connected cars, exploring the research and industrialization of intelligent technology. SAIC Motor is also engaged in the R&D, production and sales of auto parts; auto-related services such as logistics, e-commerce, mobility and new energy service; auto-related finance, insurance and investment; overseas business and international trade; and big data and artificial intelligence.

In 2018, SAIC Motor achieved a sales volume of 7.05mn, an increase of 1.75% YoY, accounting for 24.1% of the Chinese market, making itself the first Chinese auto company with annual sales over 7mn. With consolidated revenue of RMB136.39bn, SAIC Motor took the 39th place on the 2019 Fortune Global 500 list, ranking 7th among all auto makers on the list and 10th among all Chinese companies.

SAIC Motor's affiliated OEMs include SAIC Passenger Vehicle Branch, SAIC Maxus, SAIC Volkswagen, SAIC General Motors, SAIC-GM-Wuling, Naveco, SAIC-IVECO Hongyan and Sunwin.

Brands

- **SAIC Volkswagen**

SAIC VOLKSWAGEN is a joint venture between SAIC Motor and the Volkswagen Group. Founded in Oct 1984, SAIC VOLKSWAGEN is one of the first automobile joint ventures in China. At present, SAIC VOLKSWAGEN produces and sells products that come under the Volkswagen and SKODA brands, covering the A0-class, A-class, B-class, C-class, as well as SUV and MPV segments. Among them, Volkswagen brand models include the Polo Family, New Santana Family, Lavida Family, New Lamando, All-New Passat, PHIDEON, Tiguan Silk Road, New Tiguan L, Teramont, Tharu and Touran; SKODA brand models include theRAPID, RAPID Spaceback, OCTAVIA, OCTAVIA Combi, SUPERB, KODIAQ, KAROQ and the KAMIQ.

In 1H19, SAIC VOLKSWAGEN sold 919,106 units, a decrease of 9.94% YoY. In 2018, SAIC VOLKSWAGEN had a total sales of 2,065,077 units, an increase of 0.10% YoY.

Figure 106: Lavida

Source: Company data, CMBIS

Figure 107: Santana

Source: Company data, CMBIS

■ SAIC General Motors

SAIC General Motors Co., Ltd. (SAIC-GM) is a joint venture between GM and SAIC that was established on 12 Jun 1997. SAIC-GM has four major manufacturing bases – Jinqiao in Shanghai, Dong Yue in Yantai, Norsom in Shenyang and Wuhan – with eight vehicle plants and four powertrain plants. SAIC-GM offers over 20 product lines under the Buick, Chevrolet and Cadillac brands. Its products include luxury vehicles, economy and premium sedans, MPVs and SUVs, and hybrid and electric vehicles.

In 1H19, SAIC-GM sold 834,079 units, a decrease of 12.91% YoY. In 2018, SAIC-GM had a total sales of 1,970,117 units, a decrease of 1.50% YoY.

Figure 108: Buick GL8

Source: Company data, CMBIS

Figure 109: Cadillac XT4

Source: Company data, CMBIS

■ SAIC-GM-Wuling

SGMW was established on 18 Nov 2002, which is a three-shareholder joint venture with share capital from two domestic partners - SAIC Motor Corporation Limited and Liuzhou Wuling Motors Co Limited, and a foreign one, GM China. SAIC-GM-Wuling has two brands, namely Wuling and Baojun.

In 1H19, SAIC-GM-Wuling sold 744,712 units, a decrease of 13.18% YoY. In 2018, SAIC-GM-Wuling had a total sales of 2,071,551 units, a decrease of 3.65% YoY.

Figure 110: Baojun 510

Source: Company data, CMBIS

Figure 111: Wuling Hongguang

Source: Company data, CMBIS

Financial Analysis

Revenue

The Company generates revenue through automobiles, automobile parts and components, commercial services, other service, and financial business.

In 2018, revenue from sales of automobiles increased by 1.6% YoY to RMB 667,308mn while revenue from sales of automobile parts and components increased by 10.7% YoY to RMB 175,460mn. Revenue from commercial service decreased by 17.5% YoY to RMB 9,521mn whereas revenue from other services increased by 13.6% YoY to RMB 35,337mn. Revenue from financial service increased by 15.1% YoY to RMB 14,568mn

We forecast in 2019E/20E/21E, sales of automobiles will be RMB 628,832mn/616,616mn/626,045mn with the growth rate of -5.8%/-1.9%/1.5%YoY to whereas revenue from sales of automobile parts and components to RMB 192,128mn/210,380mn/230,367mn with a CAGR of 9.5%. We forecast in 2019E/20E/21E, revenue from commercial service to RMB 9,045mn/8,593mn/8,163mn with a CAGR of -5.0% whereas revenue from other services to RMB 39,577mn/44,327mn/49,646mn with a CAGR of 12.0%. We expect the financial business will increase by 15%/12%/12% to RMB 16,753/18,763/21,015mn.

Net Income/EPS/Dividend

In 2018, net income attributable to equity holders of the company increase by 5% growth rate to RMB 36,009mn whereas ROE was 6.83%. The Company declared RMB 21,381mn cash dividend in 2018, representing 62.14% payout ratio. We forecast that the Company's overall profitability will experience a sharp decline in 2019E and rebound in 2020E/21E. Specifically, in 2019E, net profit will decrease by 17% YoY to RMB 30,049 whereas ROE will be 5.69%. In 2020E/21E, net profit will increase by 8%/7% YoY to RMB 32,500mn/34,799mn whereas ROE will reach 5.93%/6.03% respectively.

Operating ratios

- Profitability Ratios

We forecast that GPM in 2019E/20E/21E will be 14.2%/14.7%/15.2% respectively. We forecast that NPM in 2019E/20E/21E will be 3.39%/3.62%/3.72% respectively.

- Liquidity Ratios

We forecast that current ratio in 2019E/20E/21E will be 1.08/1.03/0.99 respectively. We forecast that net gearing ratio in 2019E/20E/21E will be 124%/135%/148%% respectively.

- Efficiency Ratios

We forecast that inventory days in 19E/20E/21E will be 68.38/69.53/70.26 respectively. We forecast that accounts receivable days in 19E/20E/21E will be 24.33/23.55/22.81 respectively.

Valuation

Initiate with TP RMB25.59 (7.62% upside)

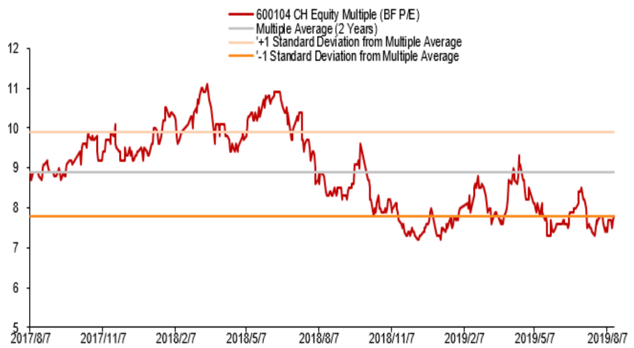
The Company is currently trading at 9.25x 2019E P/E. Taking into account the growth rate, we use fair 2020 P/E ratio of 9.20x. Our Target Price is RMB25.59 per share with 7.62% upside potential. Initiate with Hold.

Figure 112: Peers' valuation

Ticker	Name	Mkt Cap (HKD)	PE FY19	PE FY20	PE FY21	ROE FY19	Dvd Yld FY19
2238 HK Equity	GUANGZHOU AUTOMOBILE GROUP-H	119,488	7.1	5.1	4.8	11.76	6%
175 HK Equity	GEELY AUTOMOBILE HOLDINGS LT	122,185	9.9	8.6	8.1	21.83	2%
489 HK Equity	DONGFENG MOTOR GRP CO LTD-H	64,535	3.9	3.5	3.1	11.72	6%
2333 HK Equity	GREAT WALL MOTOR COMPANY-H	67,157	13.9	11.5	9.4	5.73	3%
1114 HK Equity	BRILLIANCE CHINA AUTOMOTIVE	35,367	6.9	6.1	5.8	19.60	2%
1958 HK Equity	BAIC MOTOR CORP LTD-H	34,546	8.8	7.7	7.0	9.20	4%
1211 HK Equity	BYD CO LTD-H	139,380	41.4	34.8	31.0	4.57	0%
Median	Median	70,237	8.8	7.7	7.0	11.72	3%
Ticker	**Name**	**Mkt Cap (RMB)**	**PE FY19**	**PE FY20**	**PE FY21**	**ROE FY19**	**Dvd Yld FY19**
600104 CH Equity	SAIC MOTOR CORP LTD-A	277,833	9.3	8.6	8.0	5.69	5%
000927 CH Equity	TIANJIN FAW XIALI AUTOMOBI-A	5,216	N/A	N/A	N/A	N/A	N/A
000800 CH Equity	FAW CAR COMPANY LIMITED-A	13,817	N/A	N/A	N/A	2.15	0%
600006 CH Equity	DONGFENG AUTOMOBILE CO LTD-A	8,840	19.5	17.7	18.0	6.90	2%
000572 CH Equity	HAIMA AUTOMOBILE CO LTD -A	2,697	N/A	N/A	N/A	N/A	N/A
200625 CH Equity	CHONGQING CHANGAN AUTOMOBI-B	34,669	(38.5)	8.7	6.4	0.55	4%
Median	Median	24,243	9.3	8.7	8.0	3.9	3%

Source: Bloomberg, CMBIS

Figure 113: P/E Chart



Source: Company data, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**870,639**	**902,194**	**886,335**	**898,680**	**935,235**
Cost of sales	(745,212)	(773,878)	(760,106)	(766,177)	(793,158)
Gross profit	**125,427**	**128,316**	**126,229**	**132,502**	**142,077**
Taxes and levies	(7,882)	(7,463)	(8,931)	(9,096)	(9,372)
S&D expenses	(61,122)	(63,423)	(62,487)	(63,208)	(65,820)
Administrative expenses	(18,286)	(21,336)	(22,158)	(23,366)	(25,251)
R&D expenses	(13,015)	(15,385)	(16,550)	(16,781)	(17,840)
Finance expenses	(143)	(195)	(484)	(658)	(1,029)
Impairment losses	(3,740)	(3,490)	(3,666)	(3,717)	(3,868)
Other income	2,025	3,126	1,707	1,731	1,801
P/L from Joint ventures	30,812	33,126	30,731	30,629	30,749
Investment income	18	371	195	197	205
P/L from disposal	16	29	22	22	23
Non-operating income	869	1,125	173	175	183
Non-operating expenses	(718)	(455)	(15)	(15)	(16)
Profit before income tax	**54,261**	**54,344**	**44,765**	**48,418**	**51,842**
Income tax expense	(7,145)	(5,939)	(4,700)	(5,084)	(5,443)
Profit for the year	**47,116**	**48,405**	**40,065**	**43,334**	**46,399**
Less: MI	12,706	12,395	10,016	10,833	11,600
Net Profit	**34,410**	**36,009**	**30,049**	**32,500**	**34,799**

Cash flow

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	**34,410**	**36,009**	**30,049**	**32,500**	**34,799**
D&A	6,213	9,160	8,713	10,140	11,801
Change in working capital	13,588	(34,502)	15,009	(3,165)	(949)
Others	(29,910)	(1,691)	107,954	117,633	120,005
Net cash from operating	**24,301**	**8,976**	**161,725**	**157,109**	**165,655**
Capex & investments	(4,051)	(1,470)	(487)	(521)	(557)
Associated companies	(130,158	(138,431	(145,407	(152,678	(160,312
Others	123,297	149,745	-	-	-
Net cash from investing	**(10,912)**	**9,845**	**(145,894**	**(153,199**	**(160,869**
Equity raised	658	-	-	-	-
Change of Debts	46,160	36,428	3,063	9,547	14,848
Dividend paid	(19,278)	(21,381)	(14,721)	(15,478)	(15,014)
Others	(28,031)	(34,161)	(1,476)	123	115
Net cash from financing	**(491)**	**(19,114)**	**(13,134)**	**(5,807)**	**(51)**
Net change in cash	**12,898**	**(293)**	**2,697**	**(1,897)**	**4,736**
Cash at the beginning	108,713	121,611	123,771	126,469	124,572
Exchange difference	-	2,453	-	-	-
Cash at the end	**121,611**	**123,771**	**126,469**	**124,572**	**129,307**
Less: pledged cash	-	-	-	-	-

Balance sheet

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	**333,585**	**329,394**	**346,096**	**374,887**	**410,425**
Fixed asset	58,227	69,187	81,716	96,312	113,316
Intangible assets	11,745	14,008	16,343	19,262	22,663
Interest in joint	67,500	70,930	74,477	78,201	82,111
Other non-current assets	196,112	175,268	173,560	181,112	192,334
Current assets	**389,949**	**453,376**	**425,783**	**433,437**	**451,922**
Cash	121,611	123,771	126,469	124,572	129,307
Account receivable	64,310	61,090	59,089	57,979	58,452
Inventory	50,042	58,943	49,969	53,167	55,658
Other current assets	153,986	209,572	190,257	197,720	208,504
Current liabilities	**390,973**	**414,323**	**394,688**	**419,153**	**457,802**
Borrowings	121,134	140,385	132,950	152,237	179,297
Account payables	137,661	154,827	142,407	145,945	152,671
Other payables	132,178	119,111	119,330	120,972	125,834
Tax payables	-	-	-	-	-
Non-current liabilities	**60,455**	**83,726**	**88,612**	**97,662**	**108,677**
Borrowings	13,966	32,533	41,839	49,312	58,018
Provisions	13,461	15,266	14,347	14,549	15,368
Deferred income tax	3,085	2,267	2,653	2,711	2,657
Others	29,943	33,661	29,774	31,091	32,635
Minority Interest	**46,771**	**50,352**	**51,206**	**51,130**	**52,239**
Total net assets	**225,335**	**234,369**	**237,373**	**240,378**	**243,628**
Shareholders' equity	**225,335**	**234,369**	**237,373**	**240,378**	**243,628**

Key ratios

YE Dec 31	FY17A	FY18A	FY19E	FY20E	FY21E
Profit mix (%)					
Automobile	75%	74%	71%	69%	67%
Auto-parts	18%	19%	22%	23%	25%
Commercial services	1%	1%	1%	1%	1%
Labor services	4%	4%	4%	5%	5%
Financial services	1%	2%	2%	2%	2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
P&L ratios (%)					
Gross profit margin	14%	14%	14%	14%	14%
Pre-tax margin	6%	6%	5%	5%	6%
Net margin	4%	4%	3%	4%	4%
Effective tax rate	13%	11%	11%	11%	11%
Balance sheet ratios					
Current ratio (x)	1.00	1.09	1.08	1.03	0.99
Quick ratio (x)	0.49	0.51	0.54	0.50	0.47
Cash ratio (x)	0.31	0.30	0.32	0.30	0.28
Debtors turnover days	27	25	24	24	23
Total debt / total equity	166%	175%	167%	177%	191%
Net debt / equity ratio	121%	131%	124%	135%	148%
Returns (%)					
ROE	7%	7%	6%	6%	6%
ROA	8%	7%	6%	6%	6%
Per share					
EPS (Rmb)	2.96	3.08	2.57	2.78	2.98
DPS (Rmb)	1.65	1.83	1.26	1.32	1.29
BVPS (Rmb)	17.42	19.38	20.06	20.32	20.58

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIS
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I)falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time)("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.,) of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.