

GAC Group (2238 HK)

Expect earnings rebound from 2Q20E

GAC announced its 1Q20 results. Revenue achieved RMB10.9bn, a decrease of 24%YoY. NP was RMB118mn, a decline of 96%YoY. EPS decreased by 96%YoY to RMB0.01. Even though the FY19 results disappointed the market, we believe GAC has several catalysts include 1) strong model pipeline in 2020E; 2) local policy support in Guangdong; 3) inventory replenishment; 4) excellent performance of GAC Toyota/Honda. These will underpin its performance from 2Q20E. We maintain BUY rating and downgrade our TP to HK\$8.6 from HK\$10.9.

- Market share continues to rise by 0.56ppt in 1Q20.** As of the end of Apr, total production resumed to 100% plan capacity. All upstream parts supplier/logistics partner resume to work on 20 Mar. In terms of supply chain risk, the Company has adequate parts inventory until the end of May and does not expect any production disruption for now. For downstream, all 2,542 4S dealer stores have fully resumed working. GAC Group's overall inventory was 188K at the end of 1Q20, a decrease of 39% YoY. As we mentioned in our previous reports, we believe the Company has space for replenishing its inventory from 2Q20E.
- GAC Motor was improving in 1Q20.** In 4Q19, GPM from local brands sales dropped to a historical lowest level given 1) operating deleverage; 2) official price cut because of destocking; 3) reclassify amortization of intangible assets into COGS from admin exp. In 1Q20, the new GS4 sales volume reached 26.2K, an increase of 28.4% YoY compared with a 45% YoY drop in the overall PV market. As a result, the core profit has a QoQ improvement (RMB -1.1bn in 1Q20 vs RMB -2.5bn in 4Q19). Furthermore, the one-time warranty exp/decoration exp recognized in 2019 will not affect the performance in 2020E. We believe the local brands will continue to improve in the rest of 2020E.
- GAC Toyota has restored swiftly while GAC Honda has lagged behind due to the large supply exposure of Hubei.** In the last week of Apr, the online referral data of GAC Toyota went up 33%YoY/foot traffic up 13%YoY while the online referral data of GAC Honda was up 10%/foot traffic up 21% YoY. The two new models of GAC Toyota and GAC Honda also had good sales in 1Q20 (Breeze 20K/Month and Willander 15K/Month). We believe the two Japanese JVs will swiftly rebound to the normal condition when COVID-19 was controlled in China given 1) high cost-effectiveness and 2) good brand recognition.
- The fast growth of GAC NEV may raise valuation multiple in the future.** In 1Q20, GAC NEV sold 4.4K, an increase of 83% YoY. On 27 Apr 2020, Aion V, the third model under GAC NEV, was rolled out. There is an A0 class SUV in the pipeline that will also be released at the end of 2020E. Together with Aion S/LX, GAC NEV will cover the price range from RMB100K to 300K with good product recognition. We expect the profitability will critically improve as GAC NEV meets its target of 60K in 2020E.

BUY (Maintain)

Target Price	HK\$8.6
(Previous TP)	HK\$10.9)
Up/Downside	+22.4%
Current Price	HK\$7.0

China Auto Sector

Jack Bai

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

Stock Data

Mkt Cap (HK\$ mn)	95,154
3-mth average daily turnover (HK\$ mn)	228.61
52-week high/low(HK\$)	10.14/ 6.16
Equity share – (mn)	
2238 HK	3,099
601238 CH	7,139

Source: Bloomberg

Shareholding Structure

Guangzhou Automobile Industry Group Co., Ltd	53.74%
Brown Brothers Harriman & Co.	6.02%
Citigroup Inc.	5.90%

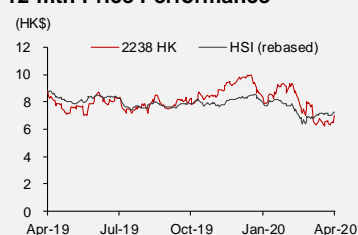
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-17.8%	-21.5%
3-mth	-24.9%	-14.6%
6-mth	-21.6%	-14.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers

Related Reports

- GAC Group (2238 HK) – “Expect earnings rebound in 2020E” – 31 Oct 2019
- GAC Group (2238 HK) – “Outperformed the overall market in 1H19” – 4 Oct 2019
- GAC Group (2238 HK) – “Promising performance after the epidemic” – 26 Feb 2020

- **GAC Group remains as our top pick.** The share price has a correction after GAC announced its FY19 results, providing a good entrance point given 1) local brand improvement and 2) swift recovery of two JVs. We revised down our bottom-line forecast to RMB7.9bn (a 22% cut from previous forecast) in order to reflect the GPM drop from COVID-19 impact/operating deleverage. Therefore, we cut our TP to HK\$8.6 (based on initial 9.6x 2020E P/E) with an upside of 22.4% from initial TP HK\$10.9 (based on initial 9.6x 2020E P/E). Reiterate BUY rating.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	72,380	59,704	60,392	63,620	66,628
YoY growth (%)	1.12%	-17.51%	1.15%	5.35%	4.73%
Net income (RMB mn)	10,900	6,616	7,913	8,485	9,853
EPS (RMB)	1.07	0.65	0.78	0.84	0.98
Consensus EPS(RMB)	1.07	0.75	0.77	0.95	1.02
YoY growth (%)	-29%	-39%	21%	7%	16%
P/E (x)	5.77	9.52	7.84	7.32	6.30
P/B (x)	0.81	0.76	0.72	0.68	0.63
Yield (%)	6.02%	3.25%	3.82%	4.10%	4.76%
ROE (%)	14.93%	8.44%	9.54%	9.57%	10.36%
Net gearing (%)	34%	38%	32%	39%	47%

Source: Company data, Bloomberg, CMBIS estimates

Earnings Revision

Figure 1: FY19 results review

RMB mn	FY18A	FY19A	YoY	CMBI		Consensus	
				FY19E	Diff (%)	FY19E	Diff (%)
Revenue	72,380	59,704	-18%	58,404	2%	59,105	1%
Gross profit	11,544	2,523	-78%	5,491	-54%	5,431	-54%
EBIT	12,322	6,808	-45%	9,566	-29%	NA	NA
Net profit	10,900	6,616	-39%	8,356	-21%	7,957	-17%
EPS (RMB)	1.07	0.65	-39%	0.82	-21%	0.75	-14%
Gross margin	15.95%	4.23%	-11.7 ppt	9.40%	-5.2ppt	9.19%	-5.0 ppt
EBIT margin	17.02%	11.40%	-5.6 ppt	16.38%	-5.0 ppt	-2.75%	14.2 ppt
Net margin	15.06%	11.08%	-4.0 ppt	14.31%	-3.2 ppt	13.46%	-2.4 ppt

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Earnings revision

(RMB mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	60,392	63,620	62,548	66,205	-3%	-4%
Gross profit	3,969	5,001	7,464	8,787	-47%	-43%
EBIT	9,144	9,687	11,559	12,898	-21%	-25%
Net profit	7,913	8,485	10,192	11,425	-22%	-26%
EPS (RMB)	0.78	0.84	1.00	1.12	-22%	-25%
Gross margin	6.57%	7.86%	11.93%	13.27%	-5.4 ppt	-5.4 ppt
EBIT margin	15.14%	15.23%	18.48%	19.48%	-3.3 ppt	-4.3 ppt
Net Margin	13.10%	13.34%	16.29%	17.26%	-3.2 ppt	-3.9 ppt

Source: CMBIS estimates

Figure 3: CMBIS estimates vs consensus

(RMB mn)	New		Consensus		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	60,392	63,620	59,351	65,977	2%	-4%
Gross profit	3,969	5,001	5,257	6,899	-25%	-28%
EBIT	9,144	9,687	NA	NA	NA	NA
Net profit	7,913	8,485	7,665	9,576	3%	-11%
EPS (RMB)	0.78	0.84	0.77	0.95	2%	-12%
Gross margin	6.57%	7.86%	8.86%	10.46%	-2.3 ppt	-2.6 ppt
EBIT margin	15.14%	15.23%	NA	NA	NA	NA
Net Margin	13.10%	13.34%	10.56%	10.93%	2.5 ppt	2.4 ppt

Source: Bloomberg, CMBIS estimates

Figure 4: P&L forecast

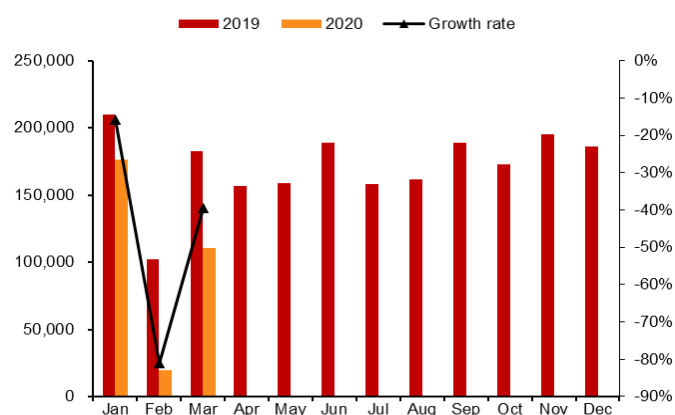
RMB mn	FY18	FY19	FY20E	FY21E	FY22E
Revenue	72,380	59,704	60,392	63,620	66,628
...YoY	1.12%	-17.51%	1.15%	5.35%	4.73%
Cost of sales	-60,836	-57,181	-56,423	-58,619	-60,030
Gross profit	11,544	2,523	3,969	5,001	6,598
GPM (%)	15.95%	4.23%	6.57%	7.86%	9.90%
...YoY	-10.23%	-78.14%	57.29%	26.01%	31.95%
Selling Exp	-5,073	-4,553	-4,605	-4,852	-5,081
...% of rev	-7.01%	-7.63%	-7.63%	-7.63%	-7.63%
Admin Exp	-4,519	-3,590	-3,503	-3,690	-3,864
...% of rev	-6.24%	-6.01%	-5.80%	-5.80%	-5.80%
EBIT	12,322	6,808	9,144	9,687	11,237
EBIT Margin (%)	17.02%	11.40%	15.14%	15.23%	16.87%
...YoY	-4.04%	-44.75%	34.31%	5.94%	16.00%
Net profit	10,900	6,616	7,913	8,485	9,853
NPM (%)	15.06%	11.08%	13.10%	13.34%	14.79%
...YoY	-0.95%	-39.30%	19.60%	7.22%	16.13%

Source: Company data, CMBIS estimates

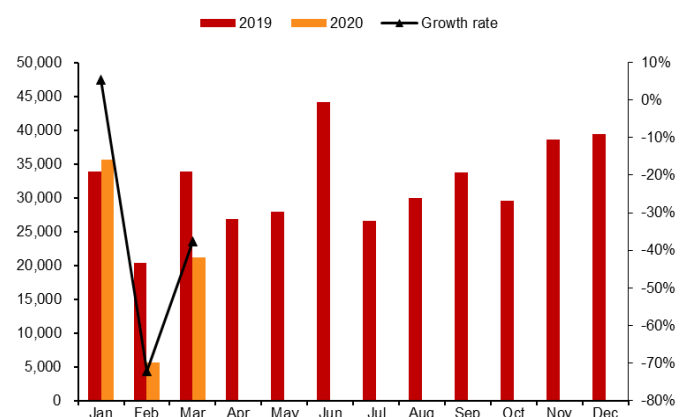
Figure 5: Revenue breakdown

(RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Automobile manufacturing industry	50,394	36,060	35,342	36,157	36,404
...YoY	0%	-28%	-2%	2%	1%
Sedans	5,264	5,473	4,438	4,279	4,065
...YoY	31%	4%	-19%	-4%	-5%
SUV	42,046	25,078	25,122	26,008	26,529
...YoY	-9%	-40%	0%	4%	2%
MPV	3,083	5,510	5,782	5,869	5,810
...YoY	5578%	79%	5%	1%	-1%
Auto-parts manufacturing industry	2,882	2,474	2,227	2,338	2,525
...YoY	-1%	-14%	-10%	5%	8%
Commercial services	16,374	18,851	20,736	23,017	25,549
...YoY	0%	15%	10%	11%	11%
Financial services and others	2,730	2,319	2,087	2,108	2,150
...YoY	34%	-15%	-10%	1%	2%
Total	72,380	59,704	60,392	63,620	66,628
... YoY	1%	-18%	1%	5%	5%

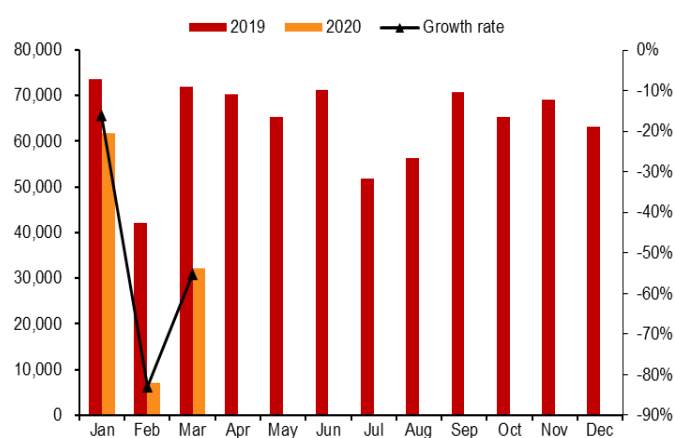
Source: Company data, CMBIS estimates

Figure 6: GAC Group sales volume

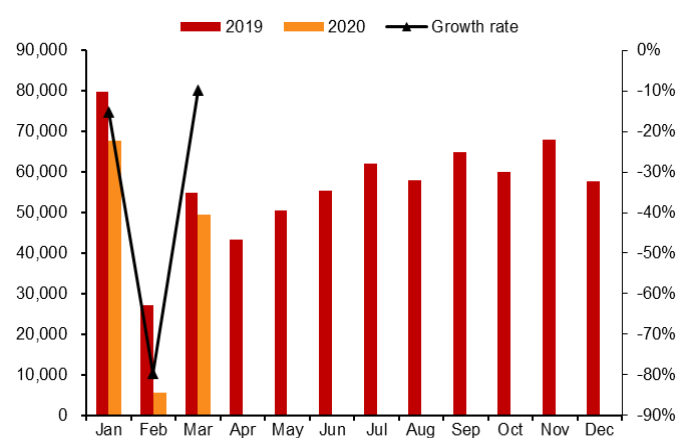
Source: Wind, CMBIS

Figure 7: GAC Motor sales volume

Source: Wind, CMBIS

Figure 8: GAC Honda sales volume

Source: Wind, CMBIS

Figure 9: GAC Toyota sales volume

Source: Wind, CMBIS

Financial Summary

Income statement						Cash flow					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	72,380	59,704	60,392	63,620	66,628	Net income	10,942	7,292	8,024	8,604	9,991
Cost of sales	(60,836)	(57,181)	(56,423)	(58,619)	(60,030)	D&A	3,140	4,184	3,215	4,245	5,630
Gross profit	11,544	2,523	3,969	5,001	6,598	Change in working capital	703	(517)	26,157	135	994
Selling & distribution costs	(5,073)	(4,553)	(4,605)	(4,852)	(5,081)	Others	1,427	(3,995)	(15,627)	649	550
Administrative expenses	(4,519)	(3,590)	(3,503)	(3,690)	(3,864)	Net cash from operating	16,213	6,965	21,769	13,633	17,166
Net impairment loss on financial assets	(7)	(54)	(54)	(54)	(54)	Capex & investments	(9,108)	(11,407)	(12,739)	(15,427)	(18,865)
Interest income from time deposits	453	291	294	310	310	Associated companies	(3,252)	(3,010)	(3,042)	(3,466)	(3,998)
Other gains – net	1,068	2,620	2,416	1,909	1,909	Others	14,172	8,727	-	-	-
Operating profit/(loss)	3,466	(2,763)	(1,484)	(1,376)	(182)	Net cash from investing	1,811	(5,689)	(15,781)	(18,894)	(22,863)
Finance costs	(459)	(516)	(607)	(435)	(435)	Equity raised	2,939	6	-	-	-
Interest income from cash	103	172	158	298	196	Change of debts	1,528	2,830	(7,801)	-	5,791
Share of profit of JV & associates	8,753	9,399	10,469	10,765	11,223	Dividend paid	(3,786)	(2,047)	(2,407)	(2,581)	(2,997)
Profit before income tax	11,863	6,292	8,536	9,251	10,801	Others	8,887	(884)	-	-	-
Income tax expense	(921)	417	(512)	(648)	(810)	Net cash from financing	9,568	(95)	(10,209)	(2,581)	2,793
Profit for the year	10,942	6,709	8,024	8,604	9,991	Net change in cash	27,592	1,181	(4,221)	(7,842)	(2,904)
Less: MI	43	93	111	119	138	Cash at the beginning	39,355	31,572	25,283	21,062	13,220
Net Profit	10,900	6,616	7,913	8,485	9,853	Exchange difference	(35,375)	(7,469)	-	-	-
						Cash at the end	31,572	25,283	21,062	13,220	10,316
						Less: pledged cash	3,842	1,678	1,678	1,678	1,678

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	65,963	80,599	87,777	101,829	118,254	Sales mix (%)					
Fixed asset	16,318	19,396	23,135	26,758	30,463	Automobile manufacturing industry	70%	60%	59%	57%	55%
Intangible assets	8,540	10,810	15,994	22,079	30,337	Auto-parts manufacturing industry	4%	4%	4%	4%	4%
Interest in JV /associates	28,995	32,005	35,852	39,318	43,316	Commercial services	23%	32%	34%	36%	38%
Other non-current assets	12,109	18,388	12,796	13,673	14,138	Financial services	4%	4%	3%	3%	3%
Current assets	66,211	56,865	46,140	38,582	37,138	Total	100%	100%	100%	100%	100%
Cash	31,572	25,283	21,062	13,220	10,316	P&L ratios (%)					
Account receivable	16,605	16,844	12,928	13,016	14,120	Gross profit margin	16%	4%	7%	8%	10%
Inventory	6,730	6,928	4,339	4,536	4,892	Pre-tax margin	16%	11%	14%	15%	16%
Other current assets	11,304	7,810	7,810	7,810	7,810	Net margin	15%	11%	13%	13%	15%
Current liabilities	40,291	41,776	34,900	36,073	43,643	Effective tax rate	-8%	7%	-6%	-7%	-8%
Borrowings	2,829	6,347	2,829	2,829	8,620	Balance sheet ratios					
Account payables	35,786	33,616	30,524	31,703	33,507	Current ratio (x)	1.64	1.36	1.32	1.07	0.85
Other payables	1,336	1,529	1,336	1,336	1,336	Quick ratio (x)	1.48	1.20	1.20	0.94	0.74
Tax payables	340	284	211	205	181	Cash ratio (x)	0.78	0.61	0.60	0.37	0.24
Non-current liabilities	13,908	13,180	12,020	11,318	11,735	Debtors turnover days	4.36	3.54	4.67	4.89	4.72
Borrowings	9,611	8,924	9,611	9,611	9,611	Total debt/ total equity ratio (%)	70%	67%	54%	51%	55%
Provisions	675	1,015	676	759	784	Net debt/ equity ratio (%)	34%	38%	32%	39%	47%
Deferred income tax	161	183	4	-6	-24	Returns (%)					
Others	3,461	3,058	1,728	953	1,364	ROE	15%	8%	10%	10%	10%
Minority Interest	1,371	2,320	1,371	1,371	1,371	ROA	10%	5%	7%	7%	8%
Shareholders' equity	76,604	80,188	85,626	91,649	98,643	Per share					
Total net assets	77,975	82,508	86,997	93,020	100,014	EPS (RMB)	1.07	0.65	0.78	0.84	0.98
						DPS (RMB)	0.37	0.20	0.24	0.25	0.29
						BVPS (RMB)	7.62	8.06	8.50	9.09	9.77

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.

For recipients of this document in the United States

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.