

# GAC Group (2238 HK)

## Expect earnings rebound in 2020E

**KEY HIGHLIGHT:** On 29 Oct 2019, GAC Group announced its 3Q19 results with a significant earning miss. Revenue achieved RMB14,680mn in 3Q19, down 10% YoY while NP was RMB1,416mn, down 52% YoY. 9M19 revenue was RMB 43bn (-20% YoY) whereas NP was RMB6.3bn (-36% YoY). GPM dropped to 6.1% (vs 9.1% in 1H19/ vs 18.9% in 3Q18), which is the single reason for the bottom line miss. We cut our TP to HK\$9.05 but maintain BUY rating due to a potential performance rebound in 2020E.

- **In 3Q19, the total sales volume of GAC Group was 508K units, a decline of 5.4% YoY.** GAC Motor's sales volume in 3Q19 was 90K units, down 28.6% YoY. GAC Honda's sales volume in 3Q19 was 179K units, down 1.6% YoY. GAC Toyota's sales volume in 3Q19 was 185K units, up 11.1% YoY.
- **GPM dropped to 6.1% (vs 9.1% in 1H19/vs 18.9% in 3Q18).** The 12ppt decline in GPM come from: GS4 official retail price cut (-1.7%)/ destocking of Stage-5 inventory, Dealership renovation, NEV capacity build-up (-12.3%) / depreciation of the new factories in Yichang and Hangzhou (-1.0%)/ auto parts, financial, logistic and other businesses (+1.8%). We believe the margin will NOT significantly improve in 4Q19E due to 1) rebate policy continuation; 2) the pressure of remaining 30% stage-5 inventory; and 3) traditional season for the sales volume competition in 4Q. We expect the margin and earnings performance will stabilize and rebound in 2Q20E because of 1) new products to start rolling out in late Nov 2019; 2) the completion of destocking for Stage -5 inventory; and 3) the completion of sales channel upgrades.
- **The Company was not well prepared for Stage 5/6 switch which erodes the bottom line earnings of about RMB600mn to RMB700mn in total.** Even though the Company manages to bring the proportion of the Stage-5 inventory to 30% from 70%, we believe the overall margin will be still under pressure until 1Q19 as the retail discounts will remain.
- **GAC Motor is in the middle of an adjustment period and will have a potential rebound in 2020E.** GAC Motor's sales volume in the 9M19 was 277K units, down 29.8% YoY. Affected by excessive inventory in 2018 and less-prepared Stage5/6 switch, the primary goal for GAC Motor was destocking in 2019. The total inventory was successively reduced by 580K units while the inventory index reverted back to less than 2 as of Sep 2019. As the destocking task completes and the new generation of star products such as the new GS4 rolls out, we believe GAC Motor will start to rebound in 2Q20E.
- **GAC JVs with Honda and Toyota will maintain its momentum in 4Q19E and 2020E.** GAC Honda will launch Breeze (皓影) in late 2019 while GAC Toyota will roll out Wildlander (威兰达) in Mar 2020. In addition, GAC Honda and GAC Toyota will both expand the production capacity of each by 120K units in 2020. We believe new products and capacity build-up will help the two JVs keep their great performance in the near term.

**BUY (Maintain)**

<b>Target Price</b>	<b>HK\$9.05</b>
(Previous TP)	HK\$9.67
<b>Up/Downside</b>	<b>+16.36%</b>
<b>Current Price</b>	<b>HK\$7.78</b>

### China Auto Sector

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#### Stock Data

Mkt Cap (mn)	114,464
3-mth average daily turnover (mn)	188.81
52-week high/low	10.60/ 6.95
Total Issued Shares (mn)	<b>3,099 (H)</b> 7,139 (A)

Source: Bloomberg

#### Shareholding Structure

Guangzhou Automobile Industry Group Co., Ltd	53.71%
HKSCC Nominees Limited	30.23%
Guangzhou Huiyin Tianyue Equity Investment Fund Management Co., Ltd.	4.12%

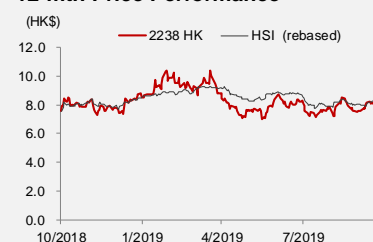
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	8.4%	5.1%
3-mth	0.1%	5.1%
6-mth	-6.3%	4.6%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

**Auditor: PricewaterhouseCoopers**

#### Related Reports

"GAC Group (2238 HK) – Outperformed the overall market in 1H19" – 4 Oct 2019

- **NEV segment posed excellent performance in 2019 and will have a promising future.** In 9M19, GAC's NEV sales volume was 22K, up 100% YoY. The current planning capacity of NEV is 200K units, with a break-even point at 100K units. GAC Group will roll out two NEV models per year by exploiting its NEV platform.
- **We revised down our top-line forecast in 2019E/20E/21E by 10%/6%/5% to reflect the GAC Motor adjustment.** We revised down our bottom line forecast in 2019E/20E/21E by 22%/26%/19% to reflect the short-term margin pressure. Our TP is revised down to HK\$9.05 (based on revised 8.2x 2020E PE) from HK\$9.67 (based initial 6.50x 2020E P/E) with an upside of 16.36%. Reiterate BUY.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	71,575	72,380	62,593	66,663	70,431
YoY growth (%)	44.84%	1.12%	-13.52%	6.50%	5.65%
Net income (RMB mn)	11,005	10,900	7,492	9,901	11,581
EPS (RMB)	1.51	1.07	0.74	0.97	1.14
YoY growth (%)	55%	-29%	-31%	32%	17%
P/E (x)	4.52	6.40	9.31	7.05	6.03
P/B (x)	0.71	0.90	0.82	0.73	0.65
Yield (%)	3.88%	5.40%	5.55%	4.86%	5.47%
ROE (%)	19.43%	14.93%	9.32%	11.11%	11.60%
Net gearing (%)	17%	34%	28%	27%	29%

Source: Company data, CMBIS estimates

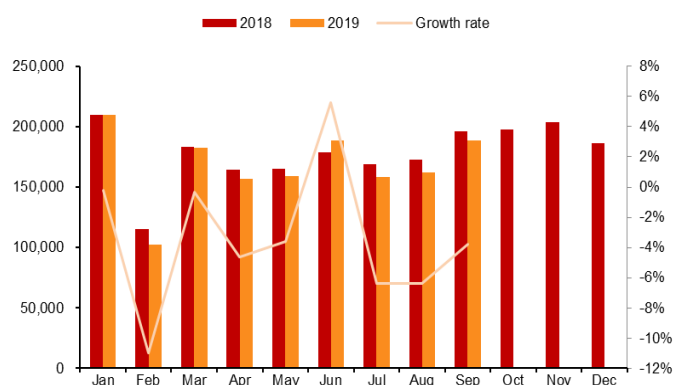
## Focus Charts

**Figure 1: Earnings revision**

	Old			New			Change (%/ppt)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenue	69,231	71,124	74,299	62,593	66,663	70,431	-9.6%	-6.3%	-5.2%
Net income	9,570	13,342	14,227	7,492	9,901	11,581	-21.7%	-25.8%	-18.6%
EPS	0.94	1.31	1.40	0.74	0.97	1.14	-21.7%	-25.8%	-18.6%
GPM	10.3%	14.5%	14.3%	8.6%	11.6%	13.3%	-1.7	-2.9	-1.0
NPM	13.8%	18.8%	19.1%	12.0%	14.9%	16.4%	-1.9	-3.9	-2.7

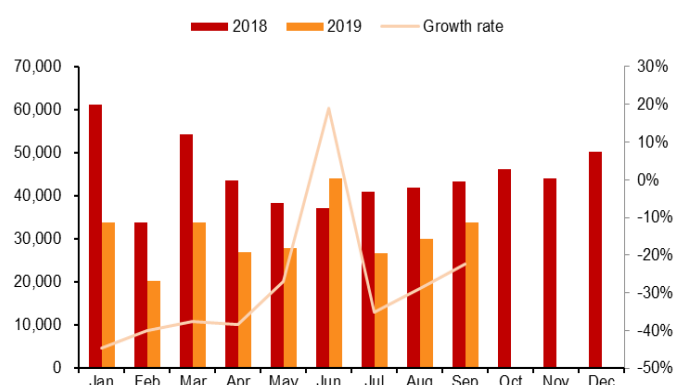
Source: Company, CMBIS

**Figure 2: GAC Group sales volume**



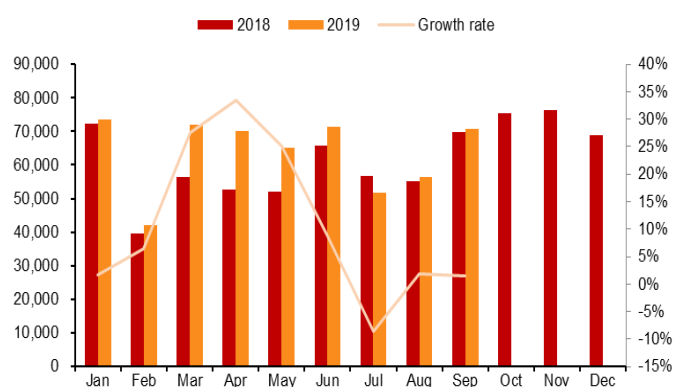
Source: Wind, CMBIS

**Figure 3: GAC Motor sales volume**



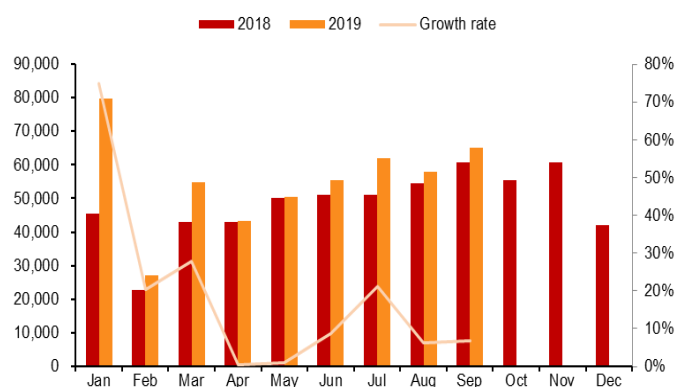
Source: Wind, CMBIS

**Figure 4: GAC Honda sales volume**



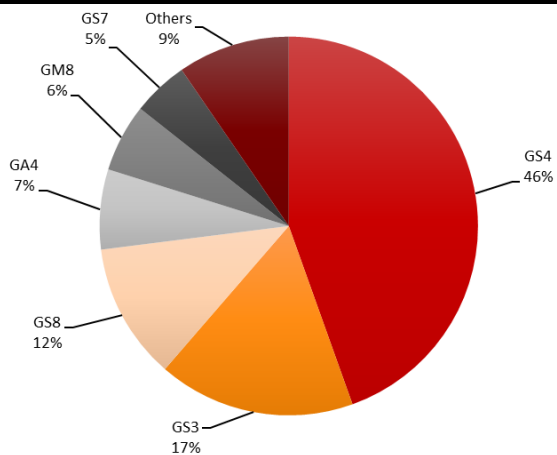
Source: Wind, CMBIS

**Figure 5: GAC Toyota sales volume**



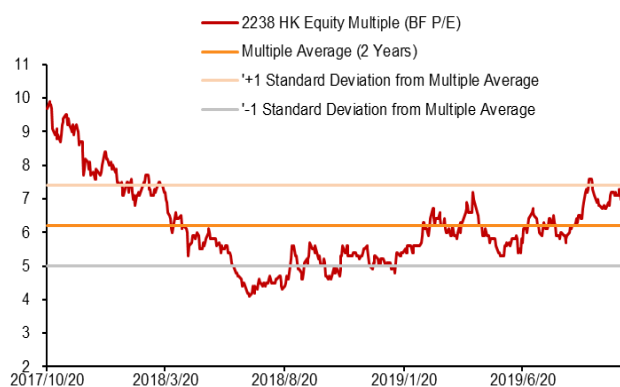
Source: Wind, CMBIS

**Figure 6: GAC Motor sales mix**



Source: Wind, CMBIS

**Figure 7: P/E Band**



Source: Bloomberg, CMBIS

## Financial Summary

### Income statement

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>71,575</b>	<b>72,380</b>	<b>62,593</b>	<b>66,663</b>	<b>70,431</b>
Cost of sales	(58,716)	(60,836)	(57,216)	(58,915)	(61,066)
<b>Gross profit</b>	<b>12,858</b>	<b>11,544</b>	<b>5,377</b>	<b>7,748</b>	<b>9,365</b>
Selling and distribution	(5,250)	(5,073)	(4,427)	(4,715)	(4,981)
Administrative expenses	(4,022)	(4,519)	(3,631)	(3,868)	(4,086)
Net impairment losses on	0	(7)	(1)	(1)	(1)
Interest income from time	343	453	437	465	492
Other gains – net	562	1,068	612	651	688
<b>Operating profit/(loss)</b>	<b>4,492</b>	<b>3,466</b>	<b>(1,633)</b>	<b>281</b>	<b>1,477</b>
Finance costs	(646)	(459)	(498)	(627)	(713)
Interest income from cash	53	103	85	85	85
Share of profit of joint	8,296	8,753	10,178	11,008	11,721
<b>Profit before income tax</b>	<b>12,194</b>	<b>11,863</b>	<b>8,132</b>	<b>10,746</b>	<b>12,569</b>
Income tax expense	(1,154)	(921)	(610)	(806)	(943)
<b>Profit for the year</b>	<b>11,040</b>	<b>10,942</b>	<b>7,522</b>	<b>9,940</b>	<b>11,627</b>
Less: MI	35	43	30	39	46
<b>Net Profit</b>	<b>11,005</b>	<b>10,900</b>	<b>7,492</b>	<b>9,901</b>	<b>11,581</b>

### Cash flow

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Net income</b>	<b>11,040</b>	<b>10,942</b>	<b>7,522</b>	<b>9,940</b>	<b>11,627</b>
D&A	2,397	3,140	2,416	3,171	4,387
Change in working capital	(16,601)	703	(165)	1,036	49
Others	8,661	1,427	4,714	4,263	4,564
<b>Net cash from operating</b>	<b>5,498</b>	<b>16,213</b>	<b>14,486</b>	<b>18,410</b>	<b>20,627</b>
Capex & investments	(7,659)	(9,108)	(10,119)	(12,744)	(16,348)
Associated companies	(3,085)	(3,252)	(3,726)	(4,392)	(5,031)
Others	7,661	14,172	-	-	-
<b>Net cash from investing</b>	<b>(3,082)</b>	<b>1,811</b>	<b>(13,845)</b>	<b>(17,136)</b>	<b>(21,379)</b>
Equity raised	840	2,939	-	-	-
Change of Debts	(3,911)	1,528	3,245	2,134	4,584
Dividend paid	(1,936)	(3,786)	(3,887)	(3,407)	(3,832)
Others	6,651	8,887	-	-	-
<b>Net cash from financing</b>	<b>1,644</b>	<b>9,568</b>	<b>(641)</b>	<b>(1,274)</b>	<b>752</b>
<b>Net change in cash</b>	<b>4,060</b>	<b>27,592</b>	<b>-</b>	<b>-</b>	<b>-</b>
Cash at the beginning	35,294	39,355	31,572	31,572	31,572
Exchange difference	-	(35,375)	-	-	-
<b>Cash at the end</b>	<b>39,355</b>	<b>31,572</b>	<b>31,572</b>	<b>31,572</b>	<b>31,572</b>
Less: pledged cash	2,156	3,842	3,842	3,842	3,842

### Balance sheet

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>55,171</b>	<b>65,963</b>	<b>74,956</b>	<b>88,268</b>	<b>104,824</b>
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	32,721	37,113	42,144
Other non-current assets	10,161	12,109	11,073	11,922	12,902
<b>Current assets</b>	<b>64,485</b>	<b>66,211</b>	<b>62,509</b>	<b>60,713</b>	<b>60,763</b>
Cash	39,355	31,572	31,572	31,572	31,572
Account receivable	10,638	16,605	15,187	13,614	13,540
Inventory	3,347	6,730	4,446	4,223	4,347
Other current assets	11,146	11,304	11,304	11,304	11,304
<b>Current liabilities</b>	<b>36,618</b>	<b>40,291</b>	<b>38,343</b>	<b>41,467</b>	<b>47,130</b>
Borrowings	2,640	2,829	6,074	8,208	12,792
Account payables	33,071	35,786	30,507	31,372	32,404
Other payables	0	1,336	1,336	1,336	1,336
Tax payables	907	340	426	552	598
<b>Non-current liabilities</b>	<b>12,570</b>	<b>13,908</b>	<b>13,625</b>	<b>12,077</b>	<b>11,394</b>
Borrowings	8,273	9,611	9,611	9,611	9,611
Provisions	915	675	586	650	726
Deferred income tax	108	161	71	97	119
Others	3,275	3,461	3,356	1,719	937
<b>Minority Interest</b>	<b>1,044</b>	<b>1,371</b>	<b>1,371</b>	<b>1,371</b>	<b>1,371</b>
<b>Total net assets</b>	<b>69,424</b>	<b>76,604</b>	<b>84,126</b>	<b>94,066</b>	<b>105,693</b>
<b>Shareholders' equity</b>	<b>69,424</b>	<b>76,604</b>	<b>84,126</b>	<b>94,066</b>	<b>105,693</b>

### Key ratios

YE Dec 31	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Automobile	70%	70%	62%	60%	58%
Auto-parts	4%	4%	5%	6%	6%
Commercial services	23%	23%	30%	31%	33%
Financial services	3%	4%	3%	3%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>P&amp;L ratios (%)</b>					
Gross profit margin	18%	16%	9%	12%	13%
Pre-tax margin	17%	16%	13%	16%	18%
Net margin	15%	15%	12%	15%	16%
Effective tax rate	9%	8%	8%	8%	8%
<b>Balance sheet ratios</b>					
Current ratio (x)	1.76	1.64	1.63	1.46	1.29
Quick ratio (x)	1.67	1.48	1.51	1.36	1.20
Cash ratio (x)	1.07	0.78	0.82	0.76	0.67
Debtors turnover days	6.73	4.36	4.12	4.90	5.20
Total debt / total equity	70%	70%	61%	56%	55%
Net debt / equity ratio	17%	34%	28%	27%	29%
<b>Returns (%)</b>					
ROE	19%	15%	9%	11%	12%
ROA	13%	10%	6%	8%	8%
<b>Per share</b>					
EPS (RMB)	1.51	1.07	0.74	0.97	1.14
DPS (RMB)	0.27	0.37	0.38	0.33	0.37
BVPS (RMB)	9.66	7.62	8.36	9.33	10.46

Source: Company data, CMBIS

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