

GAC Group (2238 HK)

Several catalysts support the valuation lift

GAC Group announced its 1H20 results. 1H20 top-line dropped by 10% YoY to RMB25.6bn, among which revenue from auto sales decreased by 11%YoY to RMB14.9bn. NP declined by 53% YoY to RMB2.3bn. It implies that the top-line achieved a 6% YoY increase while the bottom-line had a 3% YoY increase in 2Q20. The Company declared an interim dividend of RMB0.03 per share, representing a 13% payout ratio.

■ **1H20 GACM sales volume was 138K in 1H20, a decline of 26% (-29%YoY in 1Q/-24%YoY in 2Q).** However, the unit price has risen by 20% YoY to RMB108K due to low base in 1H19. Other business segments (auto-parts -10% YoY /commercial services -7%YoY /financial services +1%YoY) remain resilient in terms of revenue. Expense ratio declined by 0.5ppt YoY to 14.7% due to less advertising expenses in 1H20. The core profit had a slight QoQ deterioration in 2Q20 (-RMB1.14bn in 2Q20 vs -RMB1.08bn in 1Q20). The earning surprise comes from nearly an RMB1bn investment income from investing in financial instruments in 1H20.

■ **2Q20 GPM has recovered to 4.7%, an increase of 0.9ppt YoY/2.2ppt QoQ.** In 1H20, GPM decreased by 3.4ppt YoY to 3.8%, among which GPM from auto sales dropped by 1.7ppt YoY to 1.1%. It was mainly due to 1) the reclassification of amortization of intangible assets into COGS from admin exp in 4Q19 (-1.9ppt YoY) and 2) operating deleverage from sales volume decline (-1.5ppt YoY). Taking out the accounting change, GPM achieved 6.5% in 2Q20, an increase of 2.7ppt YoY. We believe that GPM will have a YoY expansion in 2H20E driven by 1) the increase in operating leverage as the sales volume picks up and 2) low base in 2H19.

■ **Strong investment income was supported by GAC Toyota/GAC Honda.** PL from JVs increased by 33% to RMB3.1bn in 2Q20 as the two Japanese JVs delivered great sales performance (GAC Toyota +33%YoY/GAC Honda +3% YoY in 2Q20). In Jul, GAC Toyota/ GAC Honda achieved a 20% YoY/ 35% YoY growth, respectively, which still largely outperformed the market. We believe two JVs will maintain momentum given the strong product recognition and new models rollout. In 2H20E, we believe GAC Toyota will have a growth rate of 14% YoY while GAC Honda will record a growth rate of 28% YoY. We expect the loss from GAC Fiat Chrysler will stabilize in 2H20E given the efforts on brand rebuilding. As a result, we expect the share of profit from JVs/associates will achieve RMB5.7bn in 2H20E, an increase of 25% YoY.

Earnings Summary

| (YE 31 Dec) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---------------------|----------|----------|----------|----------|----------|
| Revenue (RMB mn) | 72,380 | 59,704 | 61,864 | 65,595 | 68,648 |
| YoY growth (%) | 1.12% | -17.51% | 3.62% | 6.03% | 4.65% |
| Net income (RMB mn) | 10,900 | 6,616 | 4,689 | 6,530 | 8,052 |
| EPS (RMB) | 1.07 | 0.65 | 0.46 | 0.64 | 0.79 |
| YoY growth (%) | -29% | -39% | -29% | 39% | 23% |
| Consensus EPS(RMB) | NA | NA | 0.66 | 0.85 | 0.97 |
| P/E (x) | 5.74 | 9.46 | 13.35 | 9.58 | 7.77 |
| P/B (x) | 0.80 | 0.76 | 0.73 | 0.69 | 0.65 |
| Yield (%) | 6.05% | 3.27% | 2.28% | 3.17% | 3.91% |
| ROE (%) | 14.93% | 8.44% | 5.73% | 7.61% | 8.85% |
| Net gearing (%) | net cash | net cash | net cash | net cash | net cash |

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price HK\$10.0
 (Previous TP) HK\$8.6)
Up/Downside +43.4%
Current Price HK\$7.0

China Auto Sector

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Stock Data

| | |
|--------------------------|----------|
| Mkt Cap (HK\$ mn) | 107,644 |
| Avg 3 mths t/o (HK\$ mn) | 260.34 |
| 52w High/Low (HK\$) | 9.9/5.51 |
| Equity share – 2238.HK | 3,099 |
| Equity share – 601238.SH | 7,139 |

Source: Bloomberg

Shareholding Structure

| | |
|-------------------------------|--------|
| Guangzhou Automobile | 72.96% |
| Industry Group Co., Ltd | |
| Brown Brothers Harriman & Co. | 7.23% |
| AEGON-Industrial Fund | 5.90% |

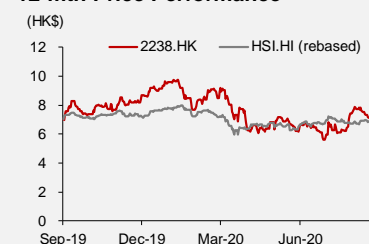
Source: HKEx

Share Performance

| | Absolute | Relative |
|-------|----------|----------|
| 1-mth | -6.2% | -8.4% |
| 3-mth | 13.0% | 6.5% |
| 6-mth | -18.1% | -15.0% |

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers

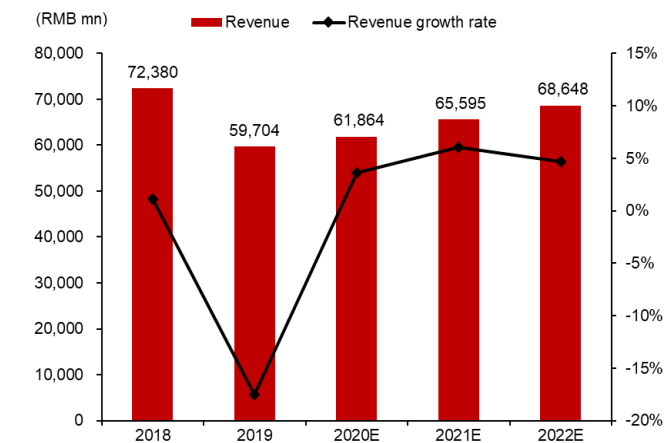
Related Reports

1. "GAC Group (2238 HK) – Expect earnings rebound from 2Q20E" – 4 May 2020
2. "GAC Group (2238 HK) – Promising performance after the epidemic" – 26 Feb 2020
3. "GAC Group (2238 HK) – Expect earnings rebound in 2020E" – 31 Oct 2020

- **We revised our full-year sales volume forecast to 2.06mn units, an increase of 0.1% YoY.** It implies a 17% YoY increase in 2H20E (GACM +11%/GAC Toyota +14% YoY/ GAC Honda +28% YoY). We raise our top-line forecast to RMB61.9bn in 2020E to reflect ASP expansion brought by 1) new models roll out in 1H20 and 2) higher sales proportion of GAC NEV. However, we revised down our bottom-line forecast to RMB4.7bn given a lower GPM forecast, which still implying a 40% YoY increase in 2H20E.
- **Valuation multiple may rise given 1) strong 2H20E performance; 2) leading position of GAC NEV in NEV market; 3) capacity expansion plan for GAC Toyota/GAC Honda; and 4) cutting-edge technology accumulation.** In the short term, we expect the Company will deliver a 40% YoY bottom-line increase in 2H20E, the best among its peers. GAC NEV sold 22K units from in the first seven months, ranking No.4 in China's NEPV sector. With the launch of Aion V, we believe that GAC NEV will maintain its leading position. In the medium-term, GAC Group plans to expand the production capacity of both GAC Toyota/GAC Honda to 1mn units by 2022E in order to support the rapid demand growth of two JVs. In terms of technology accumulation, the Company has a new GPMA architecture and an EV platform GEP. The frontier technology, such as ADiGO 3.0/Aion LX Fuel Cell/3DG graphene technology, reflects its advanced position in the 'CASE' field. We believe that the above short-/medium-/and long-term catalysts will uplift the valuation multiple of GAC Group.
- **Therefore, we raise our TP to HK\$10.0 (based on new 16.0x average 2020E/21E P/E) with an upside of 43.4% from initial TP HK\$8.6 (based on initial 9.6x 2020E P/E).** Reiterate BUY rating.

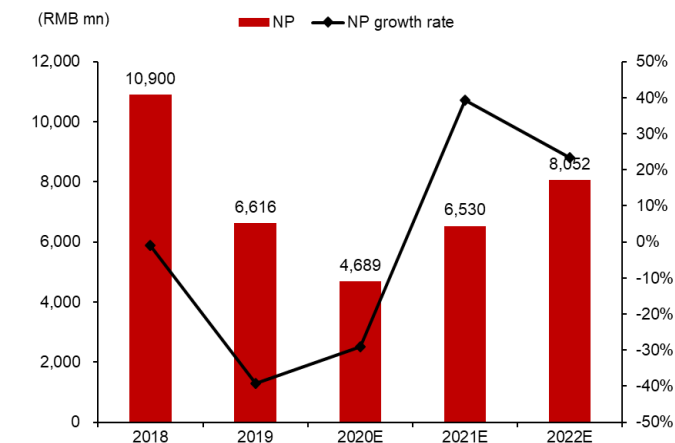
Focus chart

Figure 1: Revenue forecast



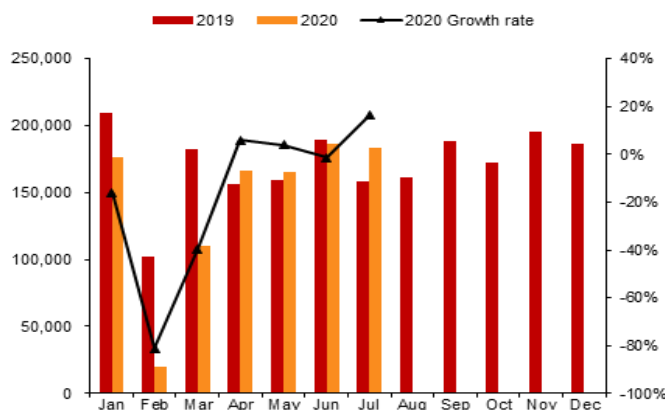
Source: Company data, CMBIS estimates

Figure 2: Bottom-line forecast



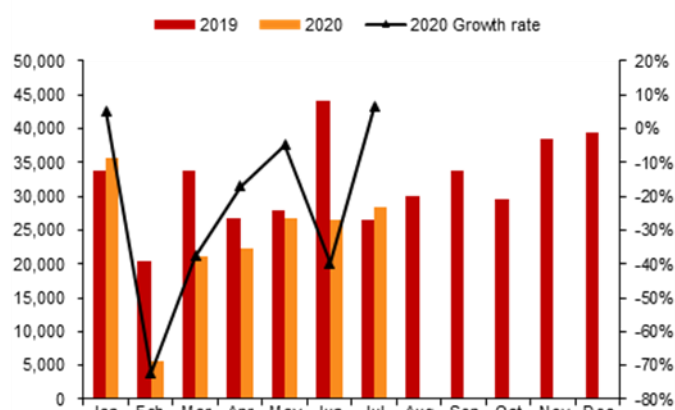
Source: Company data, CMBIS estimates

Figure 3: GAC Group sales volume



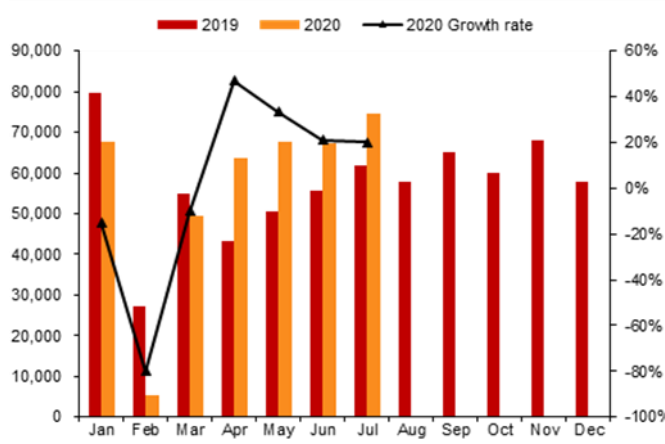
Source: Company data, CMBIS estimates

Figure 4: GACM sales volume



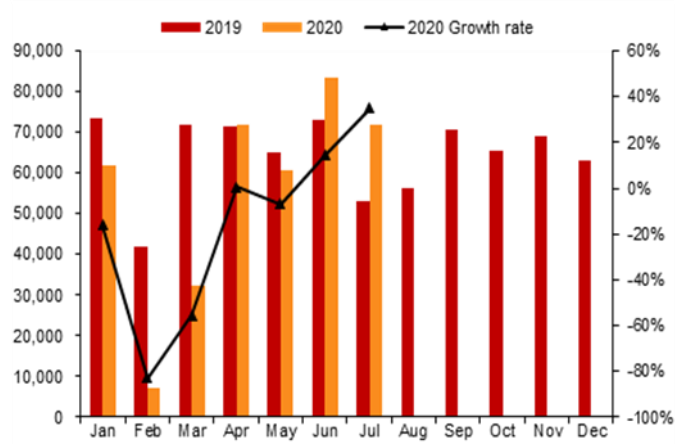
Source: Company data, CMBIS estimates

Figure 5: GAC Toyota sales volume



Source: Company data, CMBIS estimates

Figure 6: GAC Honda sales volume



Source: Company data, CMBIS estimates

Earnings Revision

Figure 7: Earnings revision

| (RMB mn) | New | | Old | | Change (%) | |
|--------------|--------|--------|--------|--------|------------|----------|
| | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E |
| Revenue | 61,864 | 65,595 | 60,392 | 63,620 | 2% | 3% |
| Gross profit | 2,291 | 3,632 | 3,969 | 5,001 | -42% | -27% |
| Net profit | 4,689 | 6,530 | 7,913 | 8,485 | -41% | -23% |
| EPS (RMB) | 0.46 | 0.64 | 0.78 | 0.84 | -41% | -24% |
| Gross margin | 3.70% | 5.54% | 6.57% | 7.86% | -2.9 ppt | -2.3 ppt |
| Net Margin | 7.58% | 9.96% | 13.10% | 13.34% | -5.5 ppt | -3.4 ppt |

Source: Company data, CMBIS estimates

Figure 8: CMBIS estimates vs consensus

| (RMB mn) | CMBIS | | Consensus | | Diff (%) | |
|--------------|--------|--------|-----------|--------|----------|----------|
| | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E |
| Revenue | 61,864 | 65,595 | 57,730 | 64,651 | 7% | 1% |
| Gross profit | 2,291 | 3,632 | 4,146 | 5,805 | -45% | -37% |
| Net profit | 4,689 | 6,530 | 6,743 | 8,678 | -30% | -25% |
| EPS (RMB) | 0.46 | 0.64 | 0.66 | 0.85 | -30% | -25% |
| Gross margin | 3.70% | 5.54% | 7.18% | 8.98% | -3.5 ppt | -3.4 ppt |
| Net Margin | 7.58% | 9.96% | 10.85% | 11.15% | -3.3 ppt | -1.2 ppt |

Source: Bloomberg, CMBIS estimates

Figure 9: P&L forecast

| (RMB mn) | FY18 | FY19 | FY20E | FY21E | FY22E |
|-------------------------|---------------|----------------|----------------|----------------|----------------|
| Revenue | 72,380 | 59,704 | 61,864 | 65,595 | 68,648 |
| ...YoY | 1.12% | -17.51% | 3.62% | 6.03% | 4.65% |
| Cost of sales | (60,836) | (57,181) | (59,573) | (61,963) | (64,292) |
| Gross profit | 11,544 | 2,523 | 2,291 | 3,632 | 4,356 |
| GPM (%) | 15.95% | 4.23% | 3.70% | 5.54% | 6.35% |
| ...YoY | -10.23% | -78.14% | -9.21% | 58.57% | 19.93% |
| Selling Exp | (5,073) | (4,553) | (4,609) | (4,920) | (5,183) |
| ...% of rev | -7.01% | -7.63% | -7.45% | -7.50% | -7.55% |
| Admin Exp | (4,519) | (3,590) | (3,588) | (3,772) | (3,913) |
| ...% of rev | -6.24% | -6.01% | -5.80% | -5.75% | -5.70% |
| Operating profit | 3,466 | (2,763) | (4,112) | (3,482) | (3,162) |
| OPM (%) | 4.79% | -4.63% | -6.65% | -5.31% | -4.61% |
| ...YoY | -22.84% | -179.72% | 48.83% | -15.33% | -9.17% |
| Net profit | 10,900 | 6,616 | 4,689 | 6,530 | 8,052 |
| NPM (%) | 15.06% | 11.08% | 7.58% | 9.96% | 11.73% |
| ...YoY | -0.95% | -39.30% | -29.13% | 39.28% | 23.30% |

Source: Company data, CMBIS estimates

Figure 10: Revenue breakdown

| (RMB mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|--|---------------|---------------|---------------|---------------|---------------|
| Automobile manufacturing industry | 50,394 | 36,060 | 36,814 | 38,132 | 38,424 |
| ...YoY | 0% | -28% | 2% | 4% | 1% |
| Sedans | 5,264 | 5,473 | 5,297 | 5,403 | 5,133 |
| ...YoY | 31% | 4% | -3% | 2% | -5% |
| SUV | 42,046 | 25,078 | 25,517 | 26,547 | 27,078 |
| ...YoY | -9% | -40% | 2% | 4% | 2% |
| MPV | 3,083 | 5,510 | 6,000 | 6,181 | 6,212 |
| ...YoY | 5578% | 79% | 9% | 3% | 0% |
| 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 | 61,864 | 65,595 | 68,648 |
| ... YoY | 1% | -18% | 4% | 6% | 5% |

Source: Company data, CMBIS estimates

Figure 11: Semi-/full-year results breakdown

| (RMB mn) | 1H19 | 1H20 | YoY | 2H19 | 2H20E | YoY | FY19 | FY20E | YoY |
|-------------------------------------|---------------|----------------|--------------|----------------|----------------|-------------|----------------|----------------|-------------|
| Revenue | 28,351 | 25,642 | -10% | 31,353 | 36,222 | 16% | 59,704 | 61,864 | 4% |
| Cost of sales | (26,310) | (24,675) | -6% | (30,871) | (34,898) | 13% | (57,181) | (59,573) | 4% |
| Gross profit | 2,041 | 966 | -53% | 482 | 1,324 | 175% | 2,523 | 2,291 | -9% |
| S&D costs | (1,735) | (1,430) | -18% | (2,818) | (3,179) | 13% | (4,553) | (4,609) | 1% |
| Admin expenses | (1,781) | (1,643) | -8% | (1,809) | (1,945) | 8% | (3,590) | (3,588) | 0% |
| Impairment loss on financial assets | (10) | (44) | 334% | (44) | (10) | -77% | (54) | (54) | 0% |
| Interest income from time deposits | 171 | 206 | 20% | 120 | 96 | -20% | 291 | 302 | 4% |
| Other gains – net | 1,671 | 392 | -77% | 949 | 1,154 | 22% | 2,620 | 1,547 | -41% |
| Operating profit/(loss) | 358 | (1,552) | -533% | (3,121) | (2,560) | -18% | (2,763) | (4,112) | 49% |
| Interest income from cash | 43 | 51 | 17% | 129 | 107 | -16% | 172 | 158 | -8% |
| Finance costs | (292) | (235) | -19% | (224) | (394) | 76% | (516) | (630) | 22% |
| PL from JVs and associates | 4,866 | 3,987 | -18% | 4,533 | 5,655 | 25% | 9,399 | 9,642 | 3% |
| Profit before income tax | 4,976 | 2,250 | -55% | 1,316 | 2,808 | 113% | 6,292 | 5,058 | -20% |
| Income tax expense | (2) | 92 | -4462% | 419 | (396) | -194% | 417 | (303) | -173% |
| Profit for the year | 4,974 | 2,342 | -53% | 1,735 | 2,412 | 39% | 6,709 | 4,755 | -29% |
| MI | 55 | 25 | -55% | 38 | 41 | 9% | 93 | 66 | -29% |
| Net profit | 4,919 | 2,318 | -53% | 1,697 | 2,371 | 40% | 6,616 | 4,689 | -29% |

Source: Company data, CMBIS estimates

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 | 61,864 | 65,595 | 68,648 | Net income | 10,900 | 6,616 | 4,689 | 6,530 | 8,052 |
| Cost of sales | (60,836) | (57,181) | (59,573) | (61,963) | (64,292) | D&A | 3,140 | 4,184 | 4,613 | 5,314 | 5,957 |
| Gross profit | 11,544 | 2,523 | 2,291 | 3,632 | 4,356 | Change in working capital | (6,263) | 9,344 | (11,010) | 7,268 | (4,081) |
| | | | | | | Others | 11,921 | (13,179) | 6,808 | (12,176) | (1,635) |
| | | | | | | Net cash from operating | 19,698 | 6,965 | 5,100 | 6,937 | 8,293 |
| Selling & distribution costs | (5,073) | (4,553) | (4,609) | (4,920) | (5,183) | Capex & investments | (9,107) | (12,725) | (9,985) | (10,434) | (11,175) |
| Admin expenses | (4,519) | (3,590) | (3,588) | (3,772) | (3,913) | Associated companies | (3,252) | (3,010) | (1,855) | (2,496) | (2,704) |
| Impairment loss on financial assets | (7) | (54) | (54) | (54) | (54) | Others | 2,319 | 10,045 | 3,595 | 5,795 | 7,214 |
| Interest income from time deposits | 453 | 291 | 302 | 320 | 320 | Net cash from investing | (10,040) | (5,689) | (8,245) | (7,135) | (6,666) |
| Other gains – net | 1,068 | 2,620 | 1,547 | 1,312 | 1,312 | Equity raised | 360 | 1,116 | - | - | - |
| Operating profit/(loss) | 3,466 | (2,763) | (4,112) | (3,482) | (3,162) | Change of debts | 1,528 | 2,830 | 5,712 | 3,678 | 2,044 |
| Finance costs | (459) | (516) | (630) | (849) | (920) | Dividend paid | (3,786) | (2,047) | (1,426) | (1,987) | (2,449) |
| Interest income from cash | 103 | 172 | 158 | 158 | 158 | Others | (4,603) | (1,995) | - | - | - |
| PL from JV & associates | 8,753 | 9,399 | 9,642 | 11,293 | 12,751 | Net cash from financing | (6,501) | (95) | 4,286 | 1,691 | (406) |
| Profit before income tax | 11,863 | 6,292 | 5,058 | 7,121 | 8,827 | Net change in cash | 3,157 | 1,181 | 1,141 | 1,492 | 1,221 |
| | | | | | | Cash at the beginning | 39,355 | 31,572 | 25,283 | 26,424 | 27,916 |
| Income tax expense | (921) | 417 | (303) | (498) | (662) | Exchange difference | (10,940) | (7,469) | - | - | - |
| Profit for the year | 10,942 | 6,709 | 4,755 | 6,622 | 8,165 | Cash at the end | 31,572 | 25,283 | 26,424 | 27,916 | 29,137 |
| Less: MI | 43 | 93 | 66 | 92 | 113 | Less: pledged cash | 3,842 | 1,678 | 1,678 | 1,678 | 1,678 |
| Net Profit | 10,900 | 6,616 | 4,689 | 6,530 | 8,052 | | | | | | |

| 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 | 88,263 | 94,814 | 102,390 | Sales mix (%) | | | | | |
| Fixed asset | 16,318 | 19,396 | 21,749 | 24,059 | 26,112 | Automobile manufacturing | 70% | 60% | 60% | 58% | 56% |
| Intangible assets | 8,540 | 10,810 | 13,015 | 15,055 | 16,983 | Auto-parts manufacturing | 4% | 4% | 4% | 4% | 4% |
| Interest in JV /associates | 28,995 | 32,005 | 33,860 | 36,356 | 39,060 | Commercial services | 23% | 32% | 34% | 35% | 37% |
| Other non-current assets | 12,109 | 18,388 | 19,639 | 19,344 | 20,235 | Financial services | 4% | 4% | 3% | 3% | 3% |
| | | | | | | Total | 100% | 100% | 100% | 100% | 100% |
| Current assets | 66,211 | 56,865 | 62,798 | 60,544 | 62,576 | P&L ratios (%) | | | | | |
| Cash | 31,572 | 25,283 | 26,424 | 27,916 | 29,137 | Gross profit margin | 16% | 4% | 4% | 6% | 6% |
| Account receivable | 16,605 | 16,844 | 20,621 | 17,262 | 18,065 | Pre-tax margin | 16% | 11% | 8% | 11% | 13% |
| Inventory | 6,730 | 6,928 | 7,943 | 7,556 | 7,564 | Net margin | 15% | 11% | 8% | 10% | 12% |
| Other current assets | 11,304 | 7,810 | 7,810 | 7,810 | 7,810 | Effective tax rate | -8% | 7% | -6% | -7% | -8% |
| | | | | | | Balance sheet ratios | | | | | |
| Current liabilities | 40,291 | 41,776 | 53,036 | 52,838 | 55,812 | Current ratio (x) | 1.64 | 1.36 | 1.18 | 1.15 | 1.12 |
| Borrowings | 2,829 | 6,347 | 11,580 | 14,690 | 16,270 | Quick ratio (x) | 1.48 | 1.20 | 1.03 | 1.00 | 0.99 |
| Account payables | 35,786 | 33,616 | 39,716 | 36,449 | 37,819 | Cash ratio (x) | 0.78 | 0.61 | 0.50 | 0.53 | 0.52 |
| Other payables | 1,336 | 1,529 | 1,529 | 1,529 | 1,529 | Debtors turnover days | 4.36 | 3.54 | 3.00 | 3.80 | 3.80 |
| Tax payables | 340 | 284 | 212 | 169 | 194 | Total debt/ total equity ratio (%) | 70% | 67% | 76% | 72% | 72% |
| | | | | | | Net debt/ equity ratio (%) | net cash | net cash | net cash | net cash | net cash |
| Non-current liabilities | 13,908 | 13,180 | 12,187 | 12,048 | 12,967 | Returns (%) | | | | | |
| Borrowings | 9,611 | 8,924 | 9,403 | 9,970 | 10,434 | ROE | 15% | 8% | 6% | 8% | 9% |
| Provisions | 675 | 1,015 | 928 | 984 | 1,030 | ROA | 10% | 5% | 4% | 5% | 6% |
| Deferred income tax | 161 | 183 | 61 | 100 | 132 | Per share | | | | | |
| Others | 3,461 | 3,058 | 1,795 | 994 | 1,370 | EPS (RMB) | 1.07 | 0.65 | 0.46 | 0.64 | 0.79 |
| | | | | | | DPS (RMB) | 0.37 | 0.20 | 0.14 | 0.19 | 0.24 |
| Shareholders' equity | 76,604 | 80,188 | 83,517 | 88,153 | 93,868 | BVPS (RMB) | 7.62 | 8.06 | 8.38 | 8.84 | 9.40 |
| Minority Interest | 1,371 | 2,320 | 2,320 | 2,320 | 2,320 | | | | | | |
| Total net assets | 77,975 | 82,508 | 85,837 | 90,473 | 96,188 | | | | | | |

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

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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

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