

# GAC Group (2238 HK)

## 3Q20 performance update

**GAC Group announced its 3Q20 results.** In the first three quarters of 2020, top-line achieved RMB43.2bn, an increase of 0.3% YoY while NP was RMB5.0bn, a decrease of 21% YoY. In 3Q20, top-line was RMB17.5bn, an increase of 19% YoY while NP was RMB2.7bn, an increase of 90% YoY. 3Q20 performance beat market estimation. We raise our TP to HK\$12.1 (based on 15.0x 2021E P/E) with an upside of 52.8% from initial TP HK\$10.0 (based on initial 16.0x average 2020E/21E P/E). Reiterate BUY.

■ **In 3Q20, GAC achieved total sales of 98,860 units, an increase of 10% YoY.** Unit revenue increased by 9% YoY, which led to a 19% YoY growth in top-line. GPM was 5.2%, down 0.8ppt YoY/1.5ppt QoQ. Exp ratio achieved a YoY decline thanks to strong cost control measures (S&D ratio -1.3ppt YoY, Admin ratio -1.5ppt YoY, R&D ratio -1.2ppt YoY). Due to top-line growth and expense saving, 3Q20 core profit (loss) narrowed by 13% YoY. Benefiting from the rapid sales growth of GAC Honda (+29% YoY) and GAC Toyota (+20% YoY) in 3Q20, investment income from JVs and associates in 3Q20 achieved RMB3.4bn, an increase of 35% YoY. We expect that GAC Group's sales and NP in the 4Q20E will continue to deliver rapid growth.

■ **Even though GACM is undergoing a 3-year transition period, sales volume has begun to recover after its new flagship model GS4 rollout at the end of 2019.** Especially GS4 has achieved a monthly sales volume more than 10K units for the last five consecutive months. We expect that the launch of GS3 Power will continue to drive the recovery of GACM. MPV series (M6 and M8) have earned good market awareness, with an increase of 36% YoY in Sep. The new model pipeline includes a new A+ sports sedan and the brand new GS8 model in 2021E. We believe GACM will bottom out as intelligent technologies (AGIDO 3.0) are gradually installed in its new models. We expect GAC Trumpchi to achieve a 6% sales growth in 4Q20E.

■ **We raise our bottom-line forecast to RMB5.9bn in 2020E to reflect the strong 3Q20 result.** Our revised NP forecast suggests that GWM's bottom-line will grow 191% YoY in 4Q20E. At the same time, we revised up our NP forecast to RMB7.3bn in 2021E to reflect a more positive forecast on GACM. We raise our TP to HK\$12.1 (based on 15.0x 2021E P/E) with an upside of 52.8% from initial TP HK\$10.0 (based on initial 16.0x average 2020E/21E P/E). Reiterate BUY.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	72,380	59,704	61,521	66,009	69,751
YoY growth (%)	1.12%	-17.51%	3.04%	7.30%	5.67%
Net income (RMB mn)	10,900	6,616	5,825	7,271	8,433
EPS (RMB)	1.07	0.65	0.57	0.71	0.82
YoY growth (%)	-29%	-39%	-12%	25%	16%
Consensus EPS(RMB)	NA	NA	0.65	0.85	0.97
P/E (x)	6.55	10.79	12.25	9.82	8.46
P/B (x)	0.92	0.87	0.82	0.78	0.73
Yield (%)	5.30%	2.87%	2.48%	3.10%	3.59%
ROE (%)	14.93%	8.44%	7.08%	8.37%	9.12%
Net gearing (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, Bloomberg, CMBIS estimates

**BUY (Maintain)**

Target Price	HK\$12.1
(Previous TP	HK\$10.0)
Up/Downside	+52.8%
Current Price	HK\$8.0

### China Auto Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	135,195
Avg 3 mths t/o (HK\$ mn)	220.35
52w High/Low (HK\$)	9.85/5.48
Equity share – 2238.HK	3,099
Equity share - 601238.SH	7,139

Source: Wind

#### Shareholding Structure

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

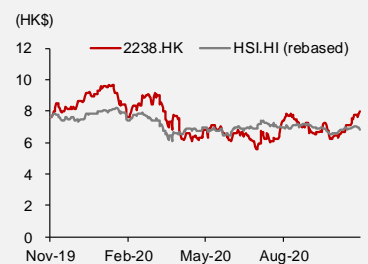
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	23.3%	19.9%
3-mth	9.8%	12.5%
6-mth	17.1%	19.7%

Source: Wind

#### 12-mth Price Performance



Source: Wind

#### Auditor: PricewaterhouseCoopers

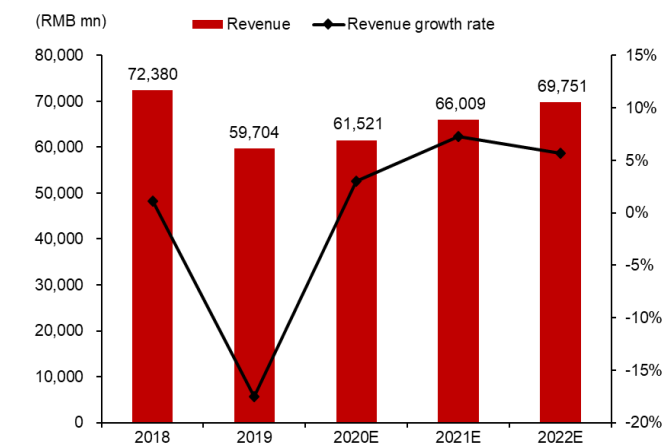
#### Related Reports

- "GAC Group (2238 HK) – Several catalysts support the valuation lift " – 2 Sep 2020
- "GAC Group (2238 HK) – Expect earnings rebound from 2Q20E " – 4 May 2020
- "GAC Group (2238 HK) – Promising performance after the epidemic " – 26 Feb 2020

- **Toyota will provide hybrid technology to GAC Group.** The latest version of "Energy-saving and New Energy Vehicle Technology Roadmap 2.0" encourages hybrid development, and specifically proposes the development of HEV (different from the traditional BEV/48V/PHEV/FCV classification). Among the HEV technologies, the Japanese brand, namely Toyota and Honda, has the strongest technical accumulation and is especially known for its fuel economy. We expected that GACM will take advantage of technological cooperation to further boost its GACM brands. Accelerating the introduction of related HEV models will also help alleviate the market's concerns about double-credit regulation as the double-credit regulation will be strictly enforced since 2021E. For Toyota, promoting hybrid technology with its Chinese partners can form a scale effect and amortize the relevant cost.
- **GAC NEV sold 7,006 units in Sep, an increase of 75% YoY.** Cumulative sales from Jan to Sep 2020 were 38,000 units, an increase of 75% YoY. Among them, the Aion series sold 6,875 units in Sep, up 72% YoY. From the perspective of product competitiveness, the first-generation Aion series has a good reputation among NEV customers. We expect GAC NEV will launch a variety of models in the future to enrich the product matrix based on its third-generation BEV platform of GEP3.0. The profitability of GAC NEV has gradually improved given 1) economies of scale brought by sales growth and 2) battery cost control given the introduction of new battery supplier CALB. Market is speculating the Aion will operate independently in Nov and will form two major brands of Aion and Trumpchi under GACG. At present, the capital market poses higher valuations for NEV than ICE. For GAC Group, the independent GAC NEV will help the capital market re-price its NEV segment and raise the overall valuation of the GAC Group.

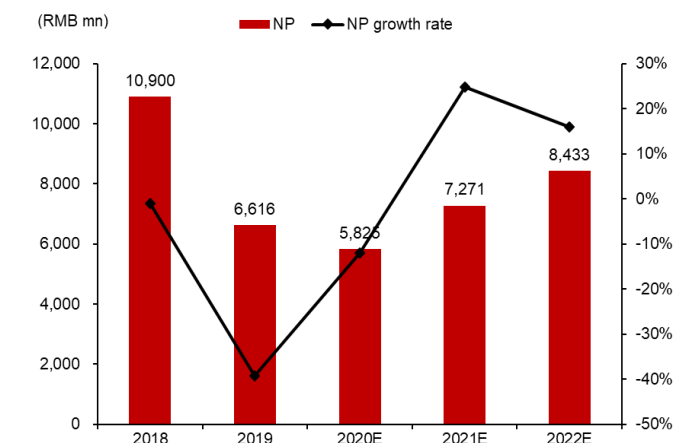
## Focus chart

**Figure 1: Revenue forecast**



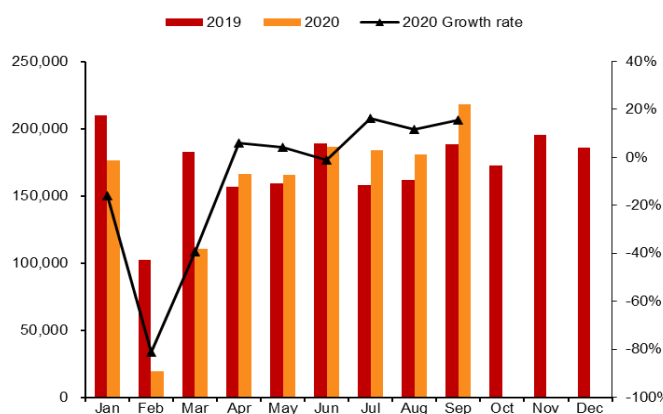
Source: Company data, CMBIS estimates

**Figure 2: Bottom-line forecast**



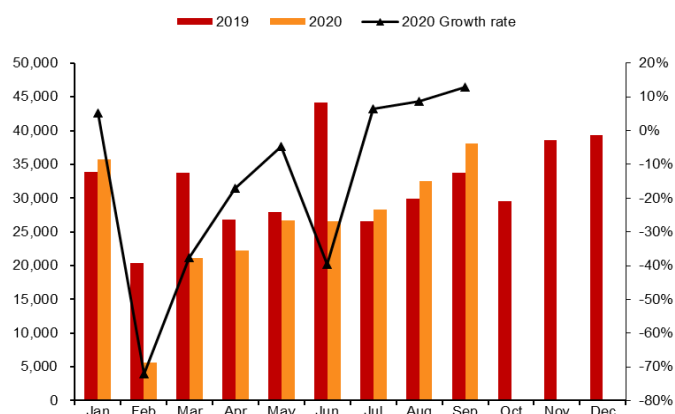
Source: Company data, CMBIS estimates

**Figure 3: GAC Group sales volume**



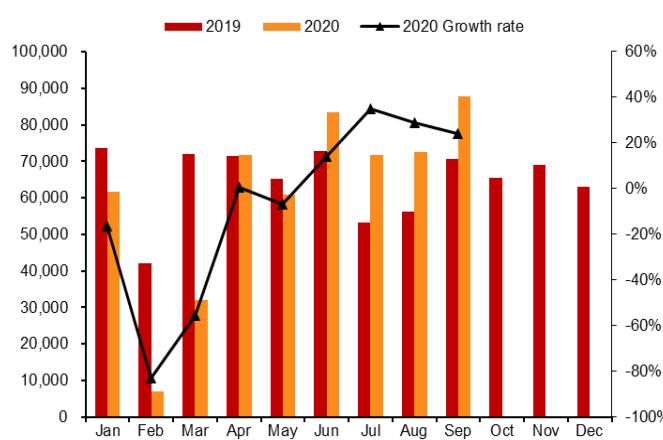
Source: Company data, CMBIS

**Figure 4: GACM sales volume**



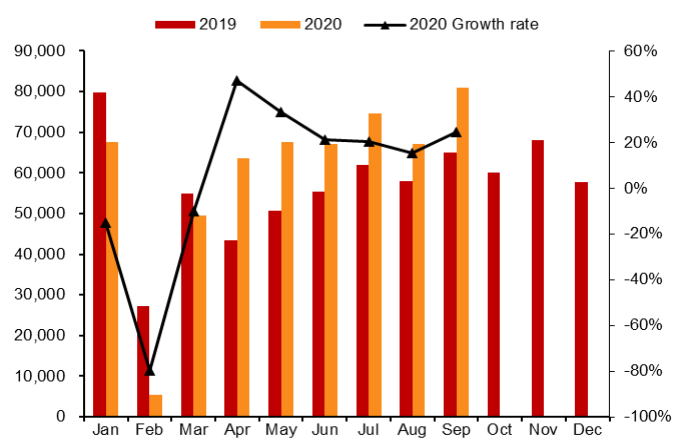
Source: Company data, CMBIS

**Figure 5: GAC Toyota sales volume**



Source: Company data, CMBIS

**Figure 6: GAC Honda sales volume**



Source: Company data, CMBIS

## Earnings Revision

Figure 7: Earnings revision

(RMB mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	61,521	66,009	61,864	65,595	-1%	1%
Gross profit	3,356	3,977	2,291	3,632	46%	10%
Net profit	5,825	7,271	4,689	6,530	24%	11%
EPS (RMB)	0.57	0.71	0.46	0.64	24%	11%
Gross margin	5.46%	6.03%	3.70%	5.54%	1.8 ppt	0.5 ppt
Net Margin	9.47%	11.02%	7.58%	9.96%	1.9 ppt	1.1 ppt

Source: Company data, CMBIS estimates

Figure 8: CMBIS estimates vs consensus

(RMB mn)	CMBIS		Consensus		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	61,521	66,009	56,814	63,661	8%	4%
Gross profit	3,356	3,977	3,499	5,067	-4%	-22%
Net profit	5,825	7,271	6,681	8,723	-13%	-17%
EPS (RMB)	0.57	0.71	0.65	0.85	-13%	-17%
Gross margin	5.46%	6.03%	6.16%	7.96%	-0.7 ppt	-1.9 ppt
Net Margin	9.47%	11.02%	11.67%	13.65%	-2.2 ppt	-2.6 ppt

Source: Bloomberg, CMBIS estimates

Figure 9: P&L forecast

(RMB mn)	FY18	FY19	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>72,380</b>	<b>59,704</b>	<b>61,521</b>	<b>66,009</b>	<b>69,751</b>
...YoY	1.12%	-17.51%	3.04%	7.30%	5.67%
Cost of sales	(60,836)	(57,181)	(58,165)	(62,032)	(65,282)
<b>Gross profit</b>	<b>11,544</b>	<b>2,523</b>	<b>3,356</b>	<b>3,977</b>	<b>4,469</b>
GPM (%)	15.95%	4.23%	5.46%	6.03%	6.41%
...YoY	-10.23%	-78.14%	33.02%	18.50%	12.35%
Selling Exp	(5,073)	(4,553)	(4,583)	(4,918)	(5,196)
...% of rev	-7.01%	-7.63%	-7.45%	-7.45%	-7.45%
Admin Exp	(4,519)	(3,590)	(3,568)	(3,763)	(3,941)
...% of rev	-6.24%	-6.01%	-5.80%	-5.70%	-5.65%
<b>Operating profit</b>	<b>3,466</b>	<b>(2,763)</b>	<b>(3,011)</b>	<b>(3,115)</b>	<b>(3,081)</b>
OPM (%)	4.79%	-4.63%	-4.90%	-4.72%	-4.42%
...YoY	-22.84%	-179.72%	8.99%	3.44%	-1.10%
<b>Net profit</b>	<b>10,900</b>	<b>6,616</b>	<b>5,825</b>	<b>7,271</b>	<b>8,433</b>
NPM (%)	15.06%	11.08%	9.47%	11.02%	12.09%
...YoY	-0.95%	-39.30%	-11.95%	24.82%	15.98%

Source: Company data, CMBIS estimates

**Figure 10: Revenue breakdown**

(RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Automobile manufacturing industry</b>	<b>50,394</b>	<b>36,060</b>	<b>36,471</b>	<b>38,546</b>	<b>39,527</b>
...YoY	0%	-28%	1%	6%	3%
Sedans	5,264	5,473	5,163	5,530	5,585
...YoY	31%	4%	-6%	7%	1%
SUV	42,046	25,078	25,192	26,467	27,261
...YoY	-9%	-40%	0%	5%	3%
MPV	3,083	5,510	6,116	6,550	6,681
...YoY	5578%	79%	11%	7%	2%
<b>Auto-parts manufacturing industry</b>	<b>2,882</b>	<b>2,474</b>	<b>2,227</b>	<b>2,338</b>	<b>2,525</b>
...YoY	-1%	-14%	-10%	5%	8%
<b>Commercial services</b>	<b>16,374</b>	<b>18,851</b>	<b>20,736</b>	<b>23,017</b>	<b>25,549</b>
...YoY	0%	15%	10%	11%	11%
<b>Financial services and others</b>	<b>2,730</b>	<b>2,319</b>	<b>2,087</b>	<b>2,108</b>	<b>2,150</b>
...YoY	34%	-15%	-10%	1%	2%
<b>Total</b>	<b>72,380</b>	<b>59,704</b>	<b>61,521</b>	<b>66,009</b>	<b>69,751</b>
...YoY	<b>1%</b>	<b>-18%</b>	<b>3%</b>	<b>7%</b>	<b>6%</b>

Source: Company data, CMBIS estimates

**Figure 11: 3Q20 Result summary**

	3Q19	3Q20	YoY	First three quarters 19	First three quarters 20	YoY
<b>Revenue</b>	<b>14,680</b>	<b>17,507</b>	<b>19%</b>	<b>43,031</b>	<b>43,149</b>	<b>0%</b>
Cost of sales	(13,806)	(16,596)	20%	(39,450)	(40,726)	3%
<b>Gross profit</b>	<b>874</b>	<b>911</b>	<b>4%</b>	<b>3,581</b>	<b>2,422</b>	<b>-32%</b>
Taxes and levies	(288)	(371)	29%	(968)	(916)	-5%
S&D	(968)	(934)	-4%	(2,703)	(2,364)	-13%
Administrative expenses	(658)	(528)	-20%	(1,956)	(1,953)	0%
R&D expenses	(382)	(246)	-35%	(1,125)	(638)	-43%
Finance expenses	(52)	(113)	118%	(111)	(50)	-55%
Impairment losses on assets	11	3	-73%	0	(41)	-9050%
Impairment losses on credit	15	15	1%	30	15	-50%
Other income	273	460	69%	1,561	772	-51%
Investment income	2,549	3,548	39%	7,509	7,664	2%
PL from JVs	2,530	3,417	35%	7,397	7,404	0%
GL from changes in fair values	21	29	39%	62	100	60%
GL on disposal of subsidiaries	2	(55)	-2609%	4	(51)	-1512%
<b>Operating profit</b>	<b>1,397</b>	<b>2,719</b>	<b>95%</b>	<b>5,884</b>	<b>4,959</b>	<b>-16%</b>
Non-operating income	21	14	-33%	524	48	-91%
Non-operating expenses	(4)	(16)	280%	(18)	(39)	117%
<b>Profit before tax</b>	<b>1,414</b>	<b>2,717</b>	<b>92%</b>	<b>6,390</b>	<b>4,968</b>	<b>-22%</b>
Income tax expense	33	8	-74%	30	101	231%
Profit for the year	1,446	2,726	88%	6,421	5,069	-21%
Non-controlling interests	30	42	40%	86	67	-22%
NP	1,416	2,684	90%	6,335	5,002	-21%

Source: Company data, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>72,380</b>	<b>59,704</b>	<b>61,521</b>	<b>66,009</b>	<b>69,751</b>
Cost of sales	(60,836)	(57,181)	(58,165)	(62,032)	(65,282)
<b>Gross profit</b>	<b>11,544</b>	<b>2,523</b>	<b>3,356</b>	<b>3,977</b>	<b>4,469</b>
Selling & distribution costs	(5,073)	(4,553)	(4,583)	(4,918)	(5,196)
Admin expenses	(4,519)	(3,590)	(3,568)	(3,763)	(3,941)
Impairment loss on financial assets	(7)	(54)	(54)	(54)	(54)
Interest income from time deposits	453	291	300	322	322
Other gains – net	1,068	2,620	1,538	1,320	1,320
Operating profit/(loss)	<b>3,466</b>	<b>(2,763)</b>	<b>(3,011)</b>	<b>(3,115)</b>	<b>(3,081)</b>
Finance costs	(459)	(516)	(628)	(817)	(881)
Interest income from cash	103	172	158	158	158
PL from JV & associates	8,753	9,399	9,765	11,703	13,049
<b>Profit before income tax</b>	<b>11,863</b>	<b>6,292</b>	<b>6,284</b>	<b>7,928</b>	<b>9,245</b>
Income tax expense	(921)	417	(377)	(555)	(693)
<b>Profit for the year</b>	<b>10,942</b>	<b>6,709</b>	<b>5,907</b>	<b>7,373</b>	<b>8,552</b>
Less: MI	43	93	82	102	119
<b>Net Profit</b>	<b>10,900</b>	<b>6,616</b>	<b>5,825</b>	<b>7,271</b>	<b>8,433</b>

### Cash flow

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Net income</b>	<b>10,900</b>	<b>6,616</b>	<b>5,825</b>	<b>7,271</b>	<b>8,433</b>
D&A	3,140	4,184	4,613	5,314	5,957
Change in working capital	(6,263)	9,344	(9,949)	5,705	(5,167)
Others	11,921	(13,179)	4,850	(10,135)	(413)
<b>Net cash from operating</b>	<b>19,698</b>	<b>6,965</b>	<b>5,340</b>	<b>8,155</b>	<b>8,810</b>
Capex & investments	(9,107)	(12,725)	(9,985)	(10,434)	(11,175)
Associated companies	(3,252)	(3,010)	(1,886)	(2,598)	(2,775)
Others	2,319	10,045	3,656	5,999	7,356
<b>Net cash from investing</b>	<b>(10,040)</b>	<b>(5,689)</b>	<b>(8,214)</b>	<b>(7,034)</b>	<b>(6,595)</b>
Equity raised	360	1,116	-	-	-
Change of debts	1,528	2,830	5,650	2,886	1,847
Dividend paid	(3,786)	(2,047)	(1,772)	(2,212)	(2,565)
Others	(4,603)	(1,995)	-	-	-
<b>Net cash from financing</b>	<b>(6,501)</b>	<b>(95)</b>	<b>3,878</b>	<b>674</b>	<b>(719)</b>
<b>Net change in cash</b>	<b>3,157</b>	<b>1,181</b>	<b>1,003</b>	<b>1,795</b>	<b>1,497</b>
Cash at the beginning	39,355	31,572	25,283	26,286	28,082
Exchange difference	(10,940)	(7,469)	-	-	-
<b>Cash at the end</b>	<b>31,572</b>	<b>25,283</b>	<b>26,286</b>	<b>28,082</b>	<b>29,578</b>
Less: pledged cash	3,842	1,678	1,678	1,678	1,678

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>65,963</b>	<b>80,599</b>	<b>88,559</b>	<b>95,087</b>	<b>102,715</b>
Fixed asset	16,318	19,396	21,749	24,059	26,112
Intangible assets	8,540	10,810	13,015	15,055	16,983
Interest in JV /associates	28,995	32,005	33,891	36,488	39,264
Other non-current assets	12,109	18,388	19,905	19,485	20,355
<b>Current assets</b>	<b>66,211</b>	<b>56,865</b>	<b>62,359</b>	<b>60,828</b>	<b>63,424</b>
Cash	31,572	25,283	26,286	28,082	29,578
Account receivable	16,605	16,844	20,507	17,371	18,355
Inventory	6,730	6,928	7,755	7,565	7,680
Other current assets	11,304	7,810	7,810	7,810	7,810
<b>Current liabilities</b>	<b>40,291</b>	<b>41,776</b>	<b>52,139</b>	<b>51,981</b>	<b>55,185</b>
Borrowings	2,829	6,347	11,570	13,774	15,052
Account payables	35,786	33,616	38,776	36,490	38,401
Other payables	1,336	1,529	1,529	1,529	1,529
Tax payables	340	284	263	189	203
<b>Non-current liabilities</b>	<b>13,908</b>	<b>13,180</b>	<b>12,135</b>	<b>12,129</b>	<b>13,162</b>
Borrowings	9,611	8,924	9,351	10,033	10,602
Provisions	675	1,015	923	990	1,046
Deferred income tax	161	183	75	111	139
Others	3,461	3,058	1,786	994	1,375
<b>Shareholders' equity</b>	<b>76,604</b>	<b>80,188</b>	<b>84,324</b>	<b>89,485</b>	<b>95,471</b>
<b>Minority Interest</b>	<b>1,371</b>	<b>2,320</b>	<b>2,320</b>	<b>2,320</b>	<b>2,320</b>
<b>Total net assets</b>	<b>77,975</b>	<b>82,508</b>	<b>86,644</b>	<b>91,805</b>	<b>97,791</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Automobile manufacturing	70%	60%	59%	58%	57%
Auto-parts manufacturing	4%	4%	4%	4%	4%
Commercial services	23%	32%	34%	35%	37%
Financial services	4%	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	16%	4%	5%	6%	6%
Pre-tax margin	16%	11%	10%	12%	13%
Net margin	15%	11%	9%	11%	12%
Effective tax rate	8%	-7%	6%	7%	8%
<b>Balance sheet ratios</b>					
Current ratio (x)	1.64	1.36	1.20	1.17	1.15
Quick ratio (x)	1.48	1.20	1.05	1.02	1.01
Cash ratio (x)	0.78	0.61	0.50	0.54	0.54
Debtors turnover days	4.36	3.54	3.00	3.80	3.80
Total debt/ total equity ratio (%)	70%	67%	74%	70%	70%
Net debt/ equity ratio (%)	net cash	net cash	net cash	net cash	net cash
<b>Returns (%)</b>					
ROE	15%	8%	7%	8%	9%
ROA	10%	5%	5%	6%	6%
<b>Per share</b>					
EPS (RMB)	1.07	0.65	0.57	0.71	0.82
DPS (RMB)	0.37	0.20	0.17	0.22	0.25
BVPS (RMB)	7.62	8.06	8.46	8.97	9.55

Source: Company data, CMBIS estimates



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