

Geely Automobile (175 HK)

Buy

Target price (HKD)	4.80
Share price (HKD)	3.87
Upside/Downside (%)	24

Dec	2014 a	2015 e	2016 e
HSBC EPS	0.16	0.30	0.35
HSBC PE	19.1	10.4	8.7
Performance	1M	3M	12M
Absolute (%)	-6.7	-1.0	42.8
Relative ^a (%)	2.1	-8.8	12.6

22 June 2015

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Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

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This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Buy: GC9 plant visit: shifting up a gear

- **We met with management and test-drove the new GC9 during Chunxiao plant visit**
- **New models with good quality improvement showed the company has been progressing in the right direction**
- **Reiterate Buy with TP of HKD4.80 (from HKD5.10) based on 12.8x 2015e PE from 13.0x on lower 2015e ROE**

GC9 has been well received. Management commented that the initial reception of the new mid size sedan has been better than their expectation and the demand is skewed towards the higher end variants. They cannot fulfil all the order within a month as production is still in ramp-up stage. They expect the monthly production could gradually ramp up from c2,000 unit per month in May to c5,000 units per month in 3Q15. The pace of ramp up is faster than our expectation which drove us to revise up our GC9 sales volume forecast by 39% to 32k units in 2015e and 50k units in 2016e.

Our GC9 test drive experience. We believe that the market is aware of the improvements to the exterior design and interior quality/finishing of the GC9 compared with Geely's older products. We had the opportunity to test drive a GC9 and we were impressed with the automatic gearbox which felt smooth and the active safety features in the high end variants. We note some investors have highlighted lack of height at the back seat as a drawback of the sportier/coupe design and the power-train performance.

Seeking breakthrough in the fast-growing SUV segment. The sales performance of Geely's first generation of SUV GX7 did not live up to management's expectation therefore the company has an aggressive new SUV model launch schedule starting from end of 2015. Three brand new SUV models would hit the market in the coming 18 months. In our view the new compact SUV with code-name NL-3 (scheduled to launch at end 2015) shared similar design with GC9 and was substantially better than Geely's existing SUVs. We believe this could be a volume drive for the company in 2016e.

Reiterate Buy with TP revised from HKD5.1 to HKD4.80. We fine tune our sales volume forecasts and adjusted our earnings by -5.8%/+0.4% in 2015e/16e as we factor in higher initial costs associated with new model launches after getting better visibility on new model launches in 2015 and 2016, and the potential quicker than expected phase out of existing models. Our 12.8x 2015e PE is derived from ROE-based PE method. The plant visit reaffirms our view that the company has been progressing in the right direction. Geely is our preferred pick in China Auto sector.

Index ^a	HSCEI
Index level	13,186
RIC	0175.HK
Bloomberg	175 HK

Source: HSBC

Enterprise value (CNYm)	22409
Free float (%)	49
Market cap (USDm)	4,394
Market cap (HKDm)	34,063

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (CNYm)				
Revenue	21,738	30,415	38,931	47,095
EBITDA	2,808	4,357	5,095	5,969
Depreciation & amortisation	-874	-1,119	-1,219	-1,312
Operating profit/EBIT	1,935	3,238	3,876	4,657
Net interest	-24	12	-28	-22
PBT	1,943	3,295	3,910	4,723
HSBC PBT	1,943	3,295	3,910	4,723
Taxation	-494	-641	-761	-919
Net profit	1,431	2,628	3,118	3,766
HSBC net profit	1,431	2,628	3,118	3,766

Cash flow summary (CNYm)

Cash flow from operations	1,385	2,560	3,714	4,439
Capex	-2,437	-2,750	-3,000	-3,000
Cash flow from investment	-1,892	-2,750	-3,000	-3,000
Dividends	-320	-171	-315	-374
Change in net debt	-179	361	-399	-1,065
FCF equity	-1,107	-210	687	1,423

Balance sheet summary (CNYm)

Intangible fixed assets	4,214	5,227	6,161	7,024
Tangible fixed assets	7,044	7,413	7,759	8,084
Current assets	25,303	25,098	30,576	36,506
Cash & others	7,203	6,842	7,241	8,306
Total assets	37,280	38,456	45,215	52,333
Operating liabilities	17,153	16,120	20,580	24,840
Gross debt	2,512	2,512	2,512	2,512
Net debt	-4,691	-4,331	-4,729	-5,794
Shareholders funds	17,288	19,453	21,716	24,526
Invested capital	12,205	14,775	16,675	18,468

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	-24.3	39.9	28.0	21.0
EBITDA	-36.6	55.2	16.9	17.1
Operating profit	-42.3	67.4	19.7	20.1
PBT	-41.4	69.5	18.7	20.8
HSBC EPS	-46.5	83.7	18.7	20.8

Ratios (%)

Revenue/IC (x)	1.9	2.3	2.5	2.7
ROIC	14.4	21.8	22.4	23.9
ROE	8.6	14.3	15.1	16.3
ROA	4.3	7.2	7.8	8.0
EBITDA margin	12.9	14.3	13.1	12.7
Operating profit margin	8.9	10.6	10.0	9.9
EBITDA/net interest (x)	118.5		185.3	277.3
Net debt/equity	-26.9	-22.1	-21.6	-23.5
Net debt/EBITDA (x)	-1.7	-1.0	-0.9	-1.0
CF from operations/net debt				

Per share data (CNY)

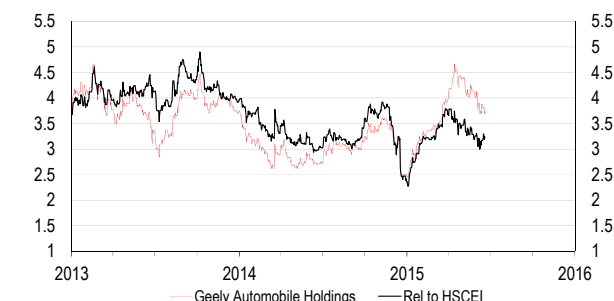
EPS reported (fully diluted)	0.16	0.30	0.35	0.43
HSBC EPS (fully diluted)	0.16	0.30	0.35	0.43
DPS	0.02	0.04	0.05	0.06
Book value	1.96	2.21	2.47	2.79

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	1.0	0.7	0.6	0.4
EV/EBITDA	7.9	5.1	4.3	3.5
EV/IC	1.8	1.5	1.3	1.1
PE*	19.1	10.4	8.7	7.2
P/Book value	1.6	1.4	1.3	1.1
Dividend yield (%)	0.6	1.3	1.5	1.8

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 22 Jun 2015

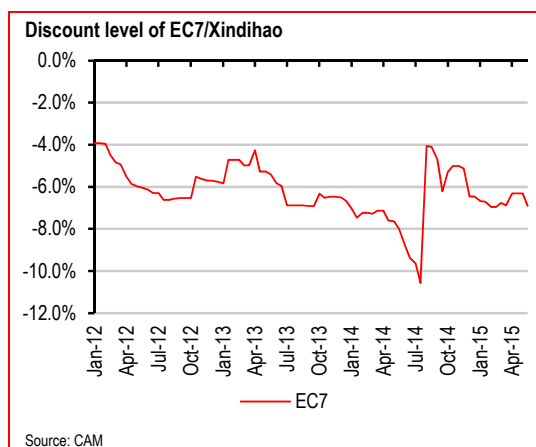
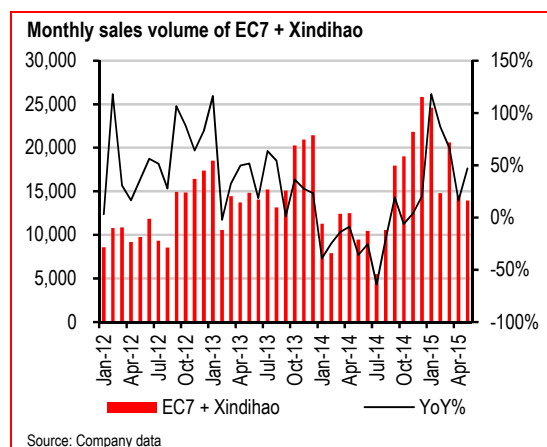
Analysis

- ▶ We met with management and test-drove the new GC9 during Chunxiao plant visit
- ▶ New models with decent quality improvement showed the company has been progressing in the right direction
- ▶ Reiterate Buy with TP of HKD4.80 (from HKD5.10) based on 12.8x 2015e PE (from 13.0x)

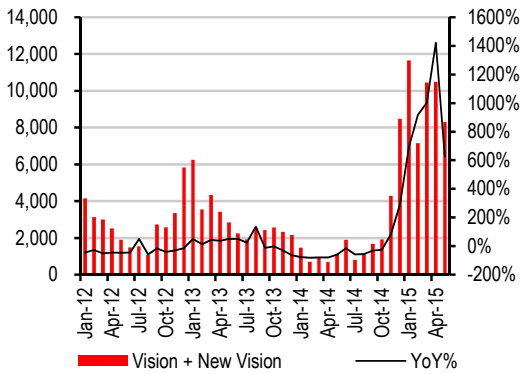
Key planned new model launches

- ▶ Compact SUV NL-3 in end 2015
- ▶ New generation of Emgrand and Emgrand Cross in early 2016
- ▶ SUV NL-4 in 1H16
- ▶ CX11, the first CMA platform based SUV, in end 2016

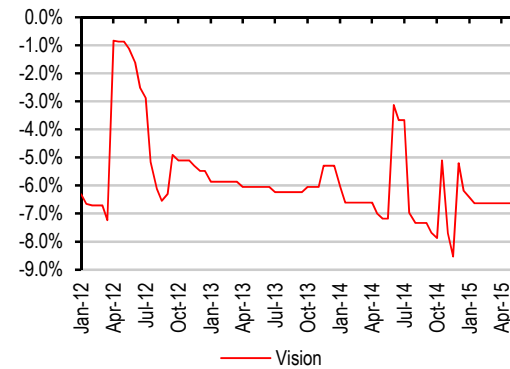
Key model monthly volume and discount



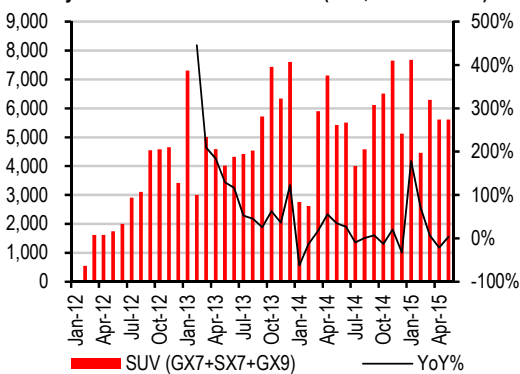
Monthly sales volume of Vision + New Vision



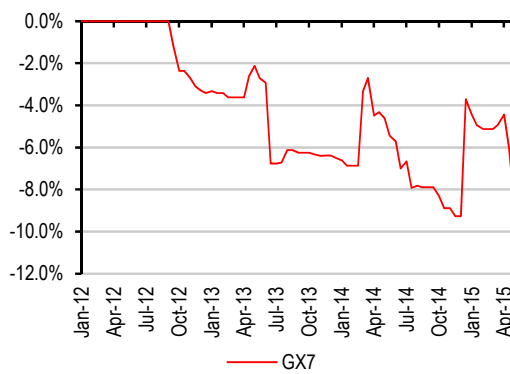
Discount level of Vision/New Vision



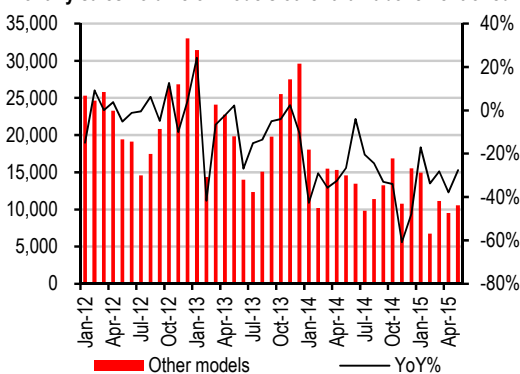
Monthly sales volume of SUV models (GX7, SX7 and GX9)



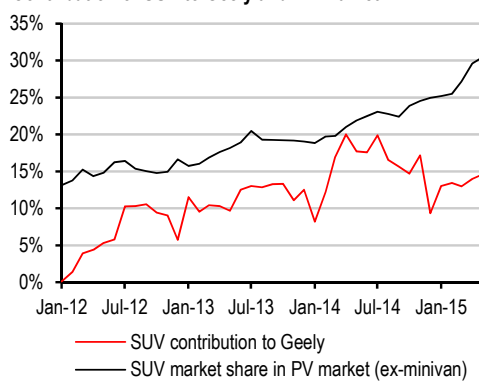
Discount level of GX7



Monthly sales volume of models other than abovementioned



Contribution of SUV to Geely and PV market



Sales volume forecasts

Sales volume assumptions revision

	2015e			2016e			2017e		
	Revised	Old	Chg%	Revised	Old	Chg%	Revised	Old	Chg%
EC7 + Xindihao	213,685	222,333	-3.9%	233,521	252,087	-7.4%	233,521	252,087	-7.4%
Vision + New Vision/GC7	103,459	103,459	0.0%	82,767	103,459	-20.0%	74,490	103,459	-28.0%
GC9	32,000	23,000	39.1%	50,000	36,000	38.9%	50,000	36,000	38.9%
NL-3	-	-	N.A.	60,000	-	N.A.	72,000	-	N.A.
NL-4	-	-	N.A.	40,000	-	N.A.	50,000	-	N.A.
CMA platform models	-	-	N.A.	5,000	5,000	0.0%	72,000	72,000	0.0%
Other sedans	118,658	119,401	-0.6%	95,169	119,401	-20.3%	65,889	86,639	-24.0%
Other SUVs	65,219	68,262	-4.5%	40,443	81,512	-50.4%	40,443	81,512	-50.4%
Total sales volume	533,021	536,455	-0.6%	606,900	597,458	1.6%	658,343	631,696	4.2%

Source: HSBC estimates

- ▶ We separately forecast the sales volume of the two new SUVs NL-3/NL-4 in our sales volume forecasts as we get more clarity on the new model launch schedule.
- ▶ We believe the launch of new models would speed up the phase out of older models in 2016-17.

Earnings revisions

Changes to our estimates

Rmb m	2015e			2016e			2017e		
	Revised	Old	Chg%	Revised	Old	Chg%	New	Old	Chg%
Revenue	30,415	30,293	0.4%	38,931	34,723	12.1%	47,095	39,185	20.2%
Cost of sales	(24,632)	(24,351)	1.2%	(31,471)	(27,814)	13.1%	(37,985)	(31,341)	21.2%
Gross profit	5,783	5,942	-2.7%	7,461	6,909	8.0%	9,110	7,844	16.1%
GP margin (%)	19.0%	19.6%		19.2%	19.9%		19.3%	20.0%	
Other income	952	952	0.0%	952	952	0.0%	952	952	0.0%
Selling expenses	(1,734)	(1,742)	-0.5%	(2,277)	(2,049)	11.2%	(2,755)	(2,312)	19.2%
Administrative expenses	(1,703)	(1,651)	3.2%	(2,200)	(1,892)	16.2%	(2,590)	(2,136)	21.3%
Share-based payments	(60)	(60)	0.0%	(60)	(60)	0.0%	(60)	(60)	0.0%
EBIT	3,238	3,441	-5.9%	3,876	3,860	0.4%	4,657	4,289	8.6%
EBIT margin (%)	10.6%	11.4%		10.0%	11.1%		9.9%	10.9%	
Finance income	108	108	0.0%	103	104	-1.0%	109	113	-4.0%
Finance cost	(96)	(96)	0.0%	(130)	(130)	0.0%	(130)	(130)	0.0%
Share of associate and JV	44	44	0.0%	61	61	0.0%	87	87	0.0%
Profit before tax	3,295	3,498	-5.8%	3,910	3,895	0.4%	4,723	4,360	8.3%
Taxation	(641)	(680)	-5.8%	(761)	(758)	0.4%	(919)	(848)	8.3%
Net profits after tax	2,654	2,818	-5.8%	3,149	3,137	0.4%	3,804	3,511	8.3%
Attributable to:									
Owners of the Company	2,628	2,790	-5.8%	3,118	3,107	0.4%	3,766	3,477	8.3%
Non-controlling interests	26	28	-5.9%	31	31	0.4%	37	34	8.5%

Source: HSBC estimates

- ▶ We lower our GP margin assumption in 2015-17 to factor in the new models' lower GP margin during the ramp up phase in late 2015 to 2017.
- ▶ The increase in overhead is mainly driven by the commencement of operation of new plants in 2016-2017.
- ▶ Our 2015e EPS is 3% above consensus.

Capex to rise amid new product cycle.

We expect the listed company would have to acquire new plants from parent co as the new models gradually roll out and begin production. We estimate the next plant to be transferred to the listed company would be the new plant in Baoji city, Shaanxi province.

We factored Rmb3bn capital expenditure in 2016e and 2017e in our forecasts.

Valuation and risks

PE method for a cyclical stock

We continue to use a single-stage PE method to value Geely, based on ROE and long-term growth. We employ the following formula to derive our target valuation for the company:

$$\text{Target PE} = (ROE - g) \div (ROE \times [COE - g])$$

Key assumptions

ROE 2015e	13.5%
Cost of equity	9.1%
Rf	3.5%
Equity risk premium	5.5%
Equity beta	1.01
g	3.0%

Source: HSBC estimates

- ▶ Our assumptions for beta, cost of equity and growth remain unchanged.
- ▶ Our ROE assumption for 2015e is 13.5% (previously 14.2%, the fall is due to the 6% cut in 2015e earnings). Using the above formula, our ROE-derived target PE for 2015e is 12.8x (previously 13.0x).
- ▶ We have a Buy rating for Geely. Applying our 2015e diluted EPS forecast of RMB0.299 (previously RMB0.317), our fair value target price is HKD4.80 (previously HKD5.10) based on HSBC FX team forecast RMB/USD exchange rate of 1.25.

Downside risks include further deterioration in exports market and rising competition in the domestic market.

Disclosure appendix

Analyst Certification

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 22 June 2015, the distribution of all ratings published is as follows:

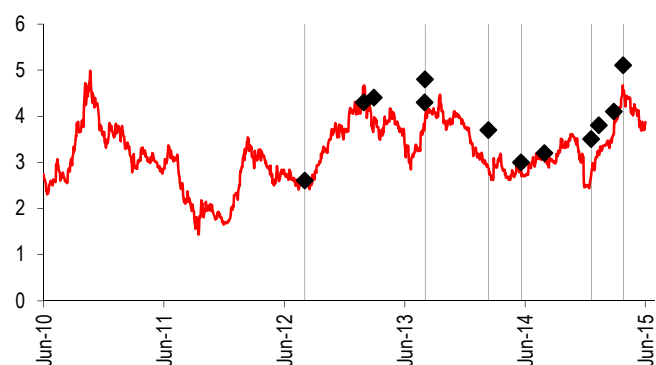
Buy	40%	(29% of these provided with Investment Banking Services)
Hold	43%	(28% of these provided with Investment Banking Services)
Sell	17%	(21% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see "Stock ratings and basis for financial analysis" above.

Share price and rating changes for long-term investment opportunities

Geely Automobile Holdings (0175.HK) Share Price performance HKD Vs

HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Neutral (V)	22 August 2012
Neutral (V)	Overweight (V)	22 August 2013
Overweight (V)	Overweight	03 March 2014
Overweight	Neutral	10 June 2014
Neutral	Overweight	08 January 2015
Overweight	Buy	16 April 2015
Target Price	Value	Date
Price 1	2.60	22 August 2012
Price 2	4.30	17 February 2013
Price 3	4.40	20 March 2013
Price 4	4.30	21 August 2013
Price 5	4.80	22 August 2013
Price 6	3.70	03 March 2014
Price 7	3.00	10 June 2014
Price 8	3.20	20 August 2014
Price 9	3.50	08 January 2015
Price 10	3.80	01 February 2015
Price 11	4.10	18 March 2015
Price 12	5.10	16 April 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
GEELY AUTOMOBILE HOLDINGS LTD	0175.HK	3.87	22-Jun-2015	6, 7, 11

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
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- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
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- 1 This report is dated as at 22 June 2015.
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