

## Geely Automobile Holdings [175.HK]

**Initiate with BUY: Growth story warranted by strong model cycle**

We initiate our coverage on Geely with a BUY rating and a PER-based target price of HK\$8.6 (based on 12x 2017E PER, equivalent to ~0.25x 2017E PEG). Through persistent efforts in brand consolidation and constant investment in R&D capability in the past decades, Geely, China's first privately owned automaker, has gradually developed an impressive reputation and kicked off a high-growth path featuring a strong product-renewal cycle. Its recently launched models have already proved to be very competitive and have received a warm market reception. We project a 47% bottom line CAGR and 38.2% revenue CAGR in 2016-2018E (compared with the average 21% EPS CAGR of its HK-listed peers based on Bloomberg consensus, justifying a valuation premium over its peers' average 9.6x 2017E PER), thanks to its product-renewal cycle, sales mix upgrade, and better expense absorption and operating leverage. Geely's solid cash position compared to its peers, strong cash flow going forward, and firm support from its parent company will also support its future growth and warrant a BUY rating. Near-term catalysts include high YoY growth in monthly sales figures and more updates on products from its compact modular architecture (CMA) platform.

### Investment Highlights

- Strong model cycle to support volume growth.** After its dealer network reshuffle and brand consolidation efforts, we believe Geely has embarked on a high-volume growth path going forward, with 2016E/17E sales volume expected to be up by 33.5%/25.6% YoY on the back of a strong model cycle. A better-than-expected ramp-up of *NL-3/Emgrand GS/Vision SUV* contributed to strong sales in the past few months, while a strong order backlog underpins momentum in the coming months. We expect to see Geely exceed its 2016E sales target. Its CMA-platform products and synergy with Volvo will further sustain its growth momentum going forward. We forecast ~38.2% topline CAGR in 2016-2018E.
- Sales mix upgrade in progress.** After diversifying into the SUV segment in 2012, Geely has gradually improved its SUV recognition through a series of well-branded models, while the synergy from Volvo (e.g. active safety systems) has lifted the quality of Geely's new models. We expect a rising SUV proportion and product upgrades to offer ASP progression and room for margin expansion for the company in the coming years. We project the unit selling price to achieve 10.5% 2016-2018E CAGR on the back of a rising SUV proportion of sales from 11.8% in 2015 to 45.5% in 2018E.
- Resilient capacity expansion and platform strategy.** The Shaanxi Baoji plant, which opened in late September, will have capacity of 16,000~18,000 cars/month in the initial stage and will shoulder 90% of the production of the new *Boyue SUV*. After ramping up production, total capacity of the Borui sedan and Boyue is expected to reach ~30,000/month by end-2016. The Taizhou Linhai plant (for the *Emgrand GS and GL*) has capacity of 14,000/month (~18,000/month by early 2017). With the Shanxi Jinzhong plant starting operations this October, total capacity for the *GS and GL* is expected to reach 25,000~30,000/month by end-2016. Geely has adhered to its streamlined platform and shared modularization strategy to reduce business complications and boost production efficiency when launching multiple new products in a short period of time.

Year ended Dec-31	2014	2015	2016E	2017E	2018E
Turnover (RMB m)	21,738	30,138	46,975	64,318	79,525
Recurring net profit (RMB m)	1,401	2,204	3,620	5,341	7,007
Recurring Net margin (%)	6.5%	7.4%	7.8%	8.4%	8.9%
Basic Reporting EPS (RMB)	0.16	0.26	0.44	0.60	0.79
% Change	(48.6)	57.4	63.7	47.5	31.2
Dividend Yield	0.3%	0.5%	0.8%	1.4%	2.0%
PER (x)	36.0	23.5	14.8	10.0	7.7
PBR (x)	3.1	2.7	2.3	1.9	1.6
Recurring ROE (%)	8.4	12.0	16.9	20.8	22.4

Sources: Company, CGIS Research

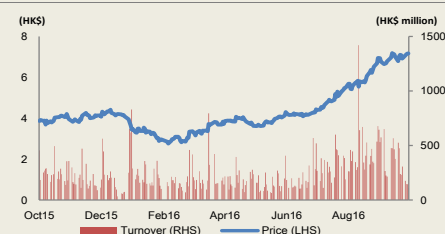
### China Auto Sector

# BUY

Close: HK\$7.17 (Oct 6, 2016)

Target Price: HK\$8.6 (19.5%)

### Price Performance



Source: Bloomberg

Market Cap	US\$8,172m
Shares Outstanding	8,841m
Auditor	Grant Thornton
Free Float	56.55%
52W range	HK\$2.76-7.29
3M average daily T/O	US\$50m
Major Shareholding	Li Shu Fu & associates (42.71%)

Sources: Company, Bloomberg

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## Key financials

### Income Statement

(RMB million, except for per share amount)

Year ended Dec-31	2014	2015	2016E	2017E	2018E
Revenue	21,738	30,138	46,975	64,318	79,525
COGS	(17,776)	(24,668)	(38,355)	(52,017)	(63,466)
Gross profit	3,962	5,470	8,621	12,301	16,059
Operating expenses	(1,967)	(2,678)	(3,775)	(5,694)	(7,435)
Operating profit	1,995	2,792	4,846	6,607	8,624
Share based payments	(60)	(62)	(80)	(90)	(100)
EBIT	1,935	2,730	4,766	6,517	8,524
Net finance costs	(24)	(6)	16	42	73
Profits from associates and JCEs	32	150	(70)	50	60
Non-recurrent items	41	74	326	(20)	(50)
Income before tax	1,944	2,874	4,712	6,609	8,657
Income tax expense	(494)	(586)	(811)	(1,226)	(1,611)
Minority interests	(19)	(28)	(36)	(54)	(71)
Net income	1,431	2,260	3,865	5,329	6,975
Recurring net profit	1,401	2,204	3,621	5,344	7,012
Basic EPS (RMB)	0.163	0.257	0.438	0.603	0.790
DPS (RMB)	0.025	0.038	0.060	0.100	0.141
Depreciation and amortization	874	1,143	1,277	1,581	2,066
EBITDA	2,850	4,036	5,807	8,257	10,797
Unit selling price (RMB)	51,536	56,562	66,033	72,859	76,227
Sales volume	417,851	510,097	681,102	855,329	1,017,030
<b>Growth Rates:</b>					
Revenue	-24%	39%	56%	37%	24%
EBIT	-42%	41%	75%	37%	31%
EBITDA	-35%	42%	44%	42%	31%
Recurring net profit	-46%	57%	64%	48%	31%
Recurring EPS	-49%	57%	64%	48%	31%
<b>Margins and Ratios:</b>					
Gross margin	18.2%	18.2%	18.4%	19.1%	20.2%
Recurring net margin	6.5%	7.4%	7.8%	8.4%	8.9%
EBIT margin	8.9%	9.1%	10.1%	10.1%	10.7%
EBITDA margin	13.1%	13.4%	12.4%	12.8%	13.6%
Effective tax rate	26.0%	20.9%	18.5%	18.5%	18.5%

Sources: Company data, CGIS Research estimates

## Key financials

**Balance Sheet** (RMB million, except for per share amount)

Year ended Dec-31	2014	2015	2016E	2017E	2018E
Inventories	1,620	1,226	3,150	3,194	5,085
Accounts receivable	12,816	11,797	15,230	20,013	23,563
Others	3,664	3,158	3,066	3,066	3,066
Bank balances and cash	7,203	9,167	11,559	13,457	17,105
<b>Total current assets</b>	<b>25,303</b>	<b>25,348</b>	<b>33,004</b>	<b>39,730</b>	<b>48,819</b>
PPE, net	5,861	8,034	8,968	10,762	13,282
Prepaid lease payments	-	-	-	-	-
Others	6,116	8,910	8,797	10,041	11,986
<b>Total non-current assets</b>	<b>11,977</b>	<b>16,945</b>	<b>17,765</b>	<b>20,804</b>	<b>25,268</b>
<b>Total assets</b>	<b>37,280</b>	<b>42,292</b>	<b>50,769</b>	<b>60,533</b>	<b>74,086</b>
Deferred revenue	-	-	-	-	-
Other payables	5,898	8,909	8,822	11,444	13,328
Bank and other borrowings	692	-	320	200	240
Others	11,256	11,540	15,991	18,212	23,519
<b>Total current liabilities</b>	<b>17,845</b>	<b>20,449</b>	<b>25,133</b>	<b>29,856</b>	<b>37,087</b>
Long term debt	1,820	1,929	1,977	2,087	2,117
Other long term liabilities	149	175	175	180	182
<b>Total non-current liabilities</b>	<b>1,969</b>	<b>2,104</b>	<b>2,151</b>	<b>2,267</b>	<b>2,299</b>
<b>Total liabilities</b>	<b>19,814</b>	<b>22,553</b>	<b>27,284</b>	<b>32,122</b>	<b>39,386</b>
Shareholders' equity	17,288	19,524	23,252	28,130	34,357
Minority interests	178	216	233	281	344

**Statement of Cash Flow**

Year ended Dec-31	2014	2015	2016E	2017E	2018E
Profit before tax	1,944	2,874	4,712	6,609	8,657
Depreciation & Amortization	874	1,143	1,277	1,581	2,066
Change in working capital	(554)	5,238	(953)	15	1,751
Others / adjustments	(231)	(1,846)	(725)	(1,511)	(1,989)
<b>Net operating cash flow</b>	<b>2,033</b>	<b>7,409</b>	<b>4,310</b>	<b>6,695</b>	<b>10,485</b>
Capex	(1,829)	(2,623)	(2,989)	(4,225)	(5,815)
Others	361	(1,911)	1,009	(20)	(30)
<b>Net investing cash flow</b>	<b>(1,468)</b>	<b>(4,534)</b>	<b>(1,981)</b>	<b>(4,245)</b>	<b>(5,845)</b>
Change in debt	(274)	(692)	320	(120)	40
Dividends	(320)	(174)	(274)	(450)	(1,052)
Others	1,766	(65)	16	19	20
<b>Net financing cash flow</b>	<b>1,172</b>	<b>(931)</b>	<b>62</b>	<b>(551)</b>	<b>(992)</b>
<b>Increase / Decrease in cash</b>	<b>1,725</b>	<b>1,964</b>	<b>2,392</b>	<b>1,899</b>	<b>3,648</b>
<b>Net cash/(debt)</b>	<b>6,512</b>	<b>9,167</b>	<b>11,239</b>	<b>13,257</b>	<b>16,865</b>

**Finance Ratios**

	2014	2015	2016E	2017E	2018E
<b>Valuation</b>					
PE(x)	36.0	23.5	14.8	10.0	7.7
Diluted Reporting EPS Growth (%)	-48.6	57.4	63.7	47.6	31.2
Yield (%)	0.3	0.5	0.8	1.4	2.0
PEG (x)	-0.74	0.41	0.23	0.21	0.24
EV/EBITDA (x)	15.0	10.6	7.3	5.2	3.9
PB(x)	3.1	2.7	2.3	1.9	1.6
<b>Operational</b>					
Revenue growth (%)	-	24	39	56	37
Gross margin (%)	18.2	18.2	18.4	19.1	20.2
Adjusted Net profit margin (%)	6.5	7.4	7.8	8.4	8.9
Days receivables	207	149	105	100	100
Days payables	233	169	131	120	120
Days inventories	35	21	17	18	19
Current ratio (x)	1.4	1.2	1.3	1.3	1.3
Quick ratio (x)	1.1	1.0	1.1	1.1	1.1
Asset/Equity (x)	2.1	2.1	2.2	2.1	2.1
Net debt/equity (%)	-37	-46	-48	-47	-49
EBITDA interest coverage (x)	35.0	39.1	59.1	77.5	100.0
Recurring ROE (%)	8.4	12.0	16.9	20.8	22.4

Sources: Company data, CGIS Research estimates

## Valuation and Recommendation

**Initiating coverage with a BUY rating.** We initiate our coverage on Geely (175.HK) with a BUY rating, based on a target price of HK\$8.6 using the PER valuation method (based on 12x 2017E PER, equivalent to ~0.25x 2017E PEG). Considering Geely's 46.9% 2016E-2018E core EPS CAGR, compared with its HK listed peers' average 21% EPS CAGR based on Bloomberg consensus, we believe Geely deserve a valuation premium compared with its HK-listed peers' average 9.6x 2017E PER. The Company is currently trading at a 2017E PER of 10x. Future catalysts include high YoY growth in monthly sales figures, good market response to new models, and more updates on products from the CMA platform. Although our target PER of 12x is higher than its 5-year average of 9.5x by 26%, it is justifiable on the back of its robust and above-industry-average EPS growth between 2016E and 2018E.

Through persistent efforts in brand consolidation and constant investment in R&D capability in the past decades, Geely, China's first privately owned automaker, has gradually developed an impressive reputation and kicked off a high-growth path featuring a strong product-renewal cycle. We believe Geely is well positioned to capitalize on the booming opportunities in the domestic SUV market. Its recently launched models have already proved to be highly competitive and have received a warm market reception. We project that Geely's recurring net profit will grow at a ~47% CAGR and that the top line will deliver a ~38.2% CAGR in 2016-2018E, thanks to its product renewal cycle, sales mix upgrade, and better expense absorption and operating leverage. Meanwhile, Geely's solid cash position compared to its peers, strong cash flow going forward, firm support from its parent company and synergy with Volvo will also back its future growth story and warrant a BUY rating.

Figure 1: Peer comparison

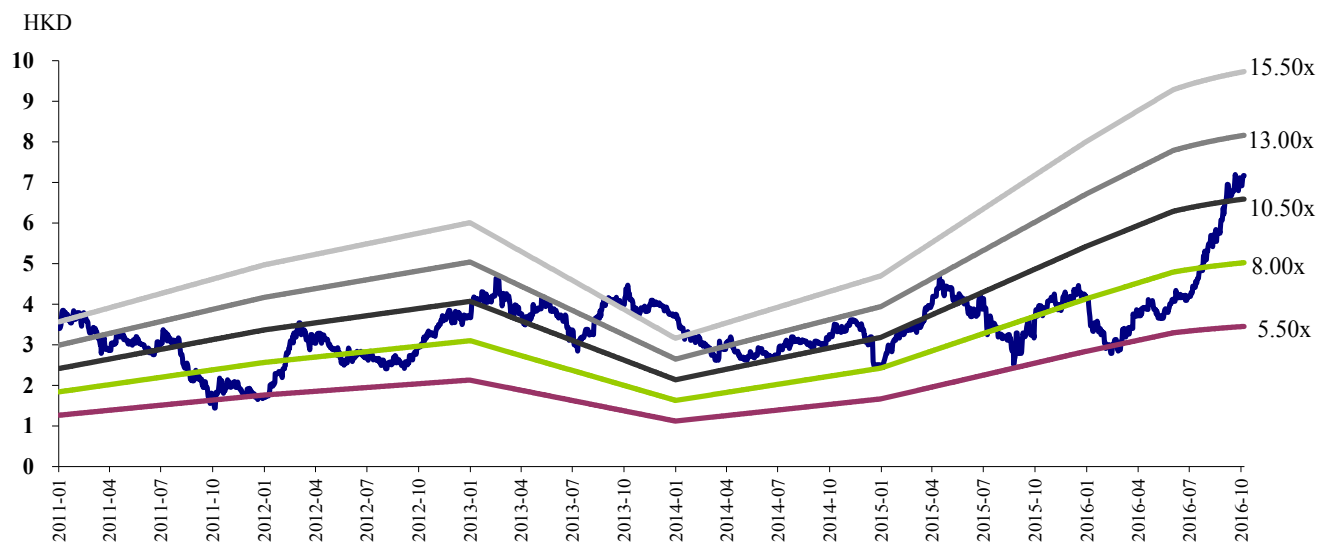
Ticker	Company	Price Lcy	Market Cap US\$m	PE			EV/EBITDA			P/B		ROE		ROA		Div yield	
				2016E	2017E	2018E	2016E	2017E	2018E	2015	2016E	2015	2016E	2015	2016E	2015	2016E
1317 HK	Geely	7.17	8,172	14.8	10.0	7.7	7.0	5.2	3.9	2.7	2.3	12.0	16.9	5.5	7.8	0.5	0.8
2333 HK	Great Wall Motor	7.94	12,789	7.1	6.9	7.0	6.8	6.5	6.5	1.5	1.4	26.2	21.2	12.4	11.6	n.a.	4.4
1958 HK	BAIC Motor	8.23	8,058	10.7	8.9	8.2	6.3	4.9	4.4	1.5	1.4	15.8	13.5	2.8	4.3	2.1	3.3
489 HK	Dongfeng Motor	7.94	8,819	4.9	4.7	4.5	21.0	19.0	16.6	0.7	0.6	18.8	13.3	7.0	6.8	2.9	3.2
1211 HK	BYD	51.50	21,116	24.9	21.2	18.1	14.0	12.3	11.3	3.5	2.5	1.8	11.2	4.3	4.2	n.a.	1.2
1114 HK	Brilliance China	8.8	5,715	11.0	9.0	7.4	n.a.	n.a.	n.a.	1.7	1.7	36.1	16.5	12.2	12.1	1.2	1.1
2238 HK	Guangzhou Automobile	10.3	16,994	8.1	7.2	6.7	24.9	19.2	n.a.	1.4	1.3	9.3	16.6	9.1	8.7	n.a.	3.5
3808 HK	Sinotruk Hong Kong	4.40	1,566	24.8	18.8	16.4	4.5	4.1	3.9	0.5	0.5	2.1	2.2	0.5	1.5	0.7	1.3
2338 HK	Weichai Power	11.00	5,538	20.1	16.8	14.5	6.3	5.8	5.3	1.2	1.2	16.6	5.7	1.2	2.1	2.1	1.7
<b>Average</b>				<b>14.1</b>	<b>11.5</b>	<b>10.0</b>	<b>11.4</b>	<b>9.6</b>	<b>7.4</b>	<b>1.6</b>	<b>1.4</b>	<b>15.4</b>	<b>13.0</b>	<b>6.1</b>	<b>6.6</b>	<b>1.6</b>	<b>2.3</b>

Sources: Bloomberg, CGIS Research estimates

**Catalysts:**

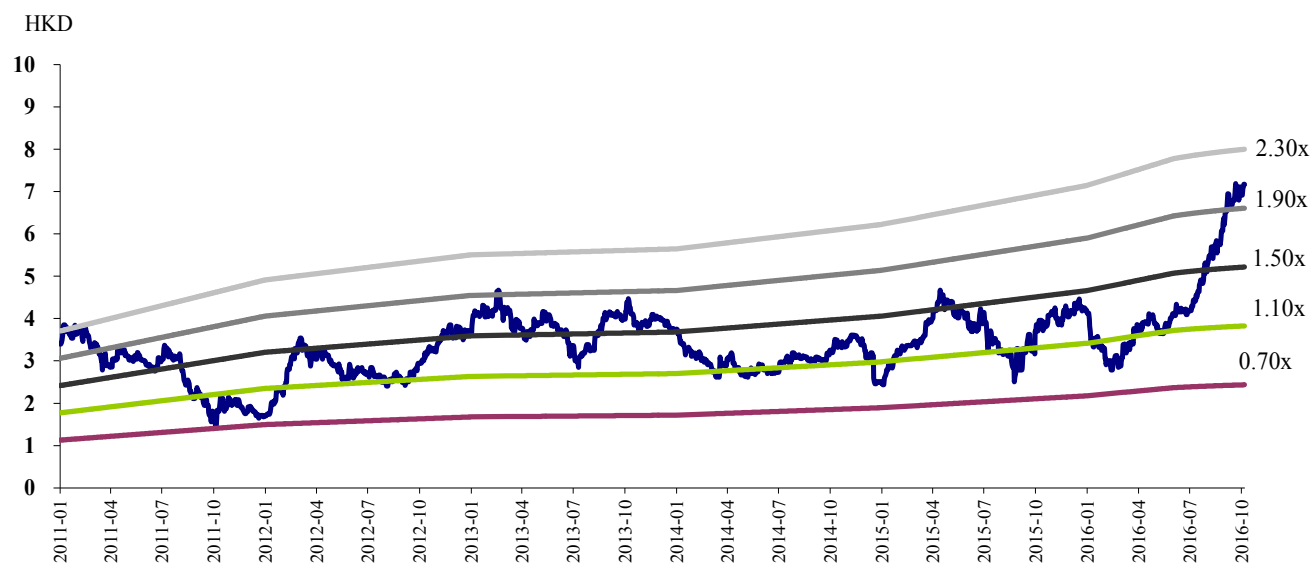
- 1) High YoY growth in monthly sales
- 2) Good market response and order backlog for new models
- 3) More updates on the products from its CMA platform

Figure 2: PER Band



Sources: CGIS Research estimates

Figure 3: PBR Band



Sources: CGIS Research estimates

## Investment Thesis

### *Strong model cycle to back volume growth*

*First private automaker in China ...*

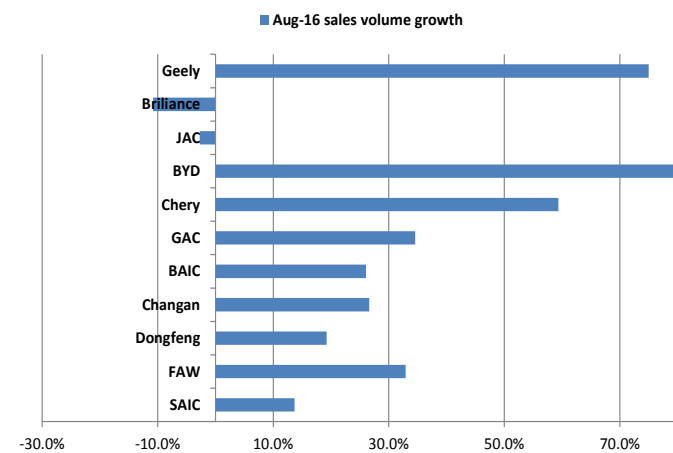
Geely was founded in 1986 as a refrigerator maker, and started manufacturing motorcycles in the mid-1990s. After purchasing a failing state-run auto manufacturer, Geely got a production license to manufacture small vans in 1997. In 2001, Geely became the first privately owned automaker in China to get state approval to manufacture sedans. The acquisitions of DSI (the second-largest global independent automatic transmission maker) by its parent company in 2009 and Sweden's Volvo Car Corporation in 2010 helped Geely improve its car quality and prestige. For a clearer market image and better execution, Geely consolidated its three brands (Emgrand, Englon and Gleagle) under the Geely umbrella in 2014.

As Figures 4 and 5 show, private automakers such as Geely have seen strong sales volume growth. Less influence from SOE background, higher self-dependency, quicker market response and faster execution because of greater flexibility have all contributed to the progress made by private manufacturers compared with state-owned ones. Geely's market share grew from 2.2% in 2015 to 2.4% in 8M16, in terms of sales volume.

*Encouraging volume growth underpinned by competitive models ...*

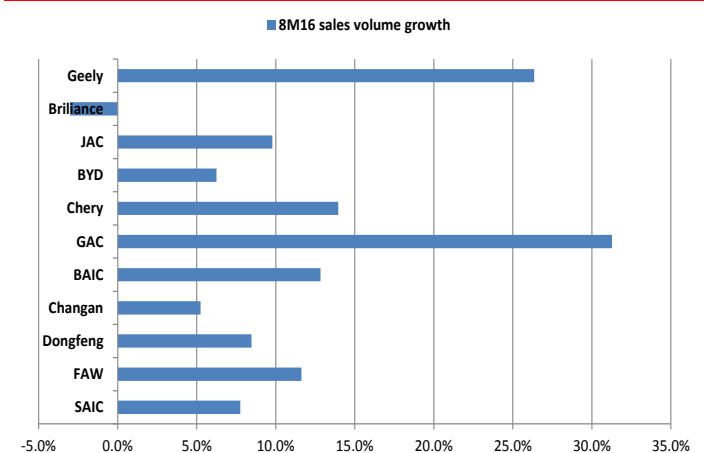
**Encouraging 8M16 sales so far, Q4 sales likely sustainable.** Geely' August sales volume reached 53,638 units (+69% YoY, the highest YOY growth in the past 19 months); 8M16 sales volume totaled 382,497 units (+22% YoY), achieving 58% of the revised full-year sales volume target of 660,000. In August, Geely sold 3,572 GC9s, 10,130 Boyue, 7,541 Emgrand GS SUV, and 7,051 new Vision SUV. So far, the order book for Vision SUV has been better than the management's initial expectations. Geely launched its mid-sized Emgrand GL sedan on 20 September. This is likely to be another key volume driver because of its preliminary competitive price range (RMB80k~120k). Moreover, with exposure to cars with an engine size of  $\leq 1.6L$ , Geely might also benefit from potential rush orders before the possible expiry of the tax cut policy at end-2016 (not yet confirmed), which would add fuel to already inspiring Q4 sales.

Figure 4: Aug-2016 sales volume growth for domestic auto players



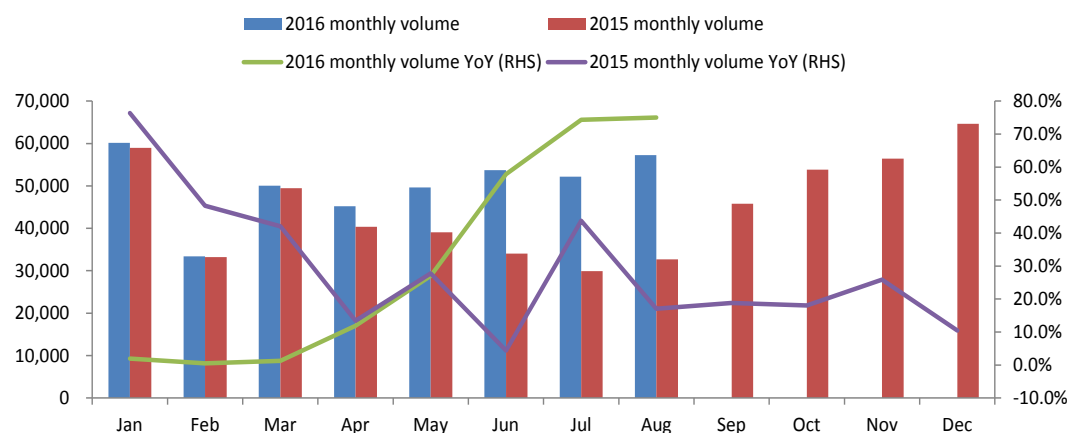
Source: Company data, CGIS Research

Figure 5: 8M16 sales volume growth for domestic auto players



Source: Company data, CGIS Research

Figure 6: Geely monthly sales volume



Source: Company data, CGIS Research

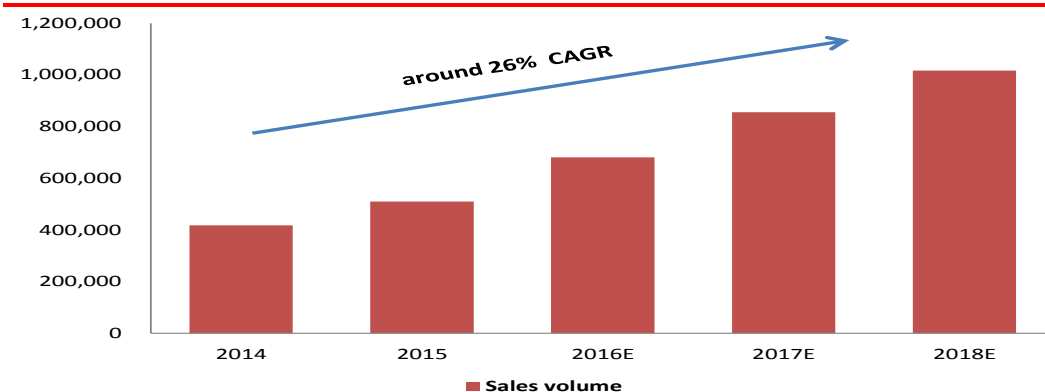
**We expect Geely to exceed its 2016E sales target.** Better-than-expected sales of NL-3/Emgrand GS/Vision SUVs contributed to strong sales in past few months, while a strong order backlog underpins momentum in the coming months. Currently, there is an order backlog of >50,000 units for the Boyue, 30,000 for the Emgrand GS, and 10,000 for the Vision SUV (debut end-Aug). New models to be launched from September to December include the Emgrand GL (A+ class sedan) and Emgrand hybrid, while the more advanced CMA-platform-based products will be launched in 2017. Potential rush orders before the possible expiry of the purchase tax cut policy will also spur sales momentum in Q4. Taking all these into account, we project full-year sales volume of 676,000 units, 2.4% above the company's previous sales target of 660,000 units.

**2016 sales volume likely to exceed target...**

**Major models expected to contribute 78.5% of 2017E volume....**

The upcoming new model pipeline in 2017 and 2018 includes a new version of the small-size Panda sedan (in 2017); ~6 new models under the L-brand on the CMA platform to be launched in FY17~18 (covering sedans, SUVs and crossovers); the King Kong SUV (in 2018); and the MPV (in 2017 & 2018). Amid this strong product renewal cycle, we estimate a 25.7% CAGR in 2015-2018E sales volume, while New Emgrand/Emgrand GL, New Vision/GC-7, NL-3, NL-4, Emgrand GS should combine to contribute ~78.5% of total sales volume in 2017E.

Figure 7: Geely sales volume forecast



Source: Company data, CGIS Research estimate

## Sales mix upgrade in progress

### Entering the SUV market...

Geely launched its first SUV, the GX7 back in 2012, and then launched another SUV model, the GX9, in October 2014, which received a good market response, and helped it tap into the domestic SUV market. The market is concerned about the potential expiry of purchase tax cut for cars of engine size  $\leq 1.6L$  by end-2016, which may have an impact on the growth outlook of the sedan market in the coming years. Currently, there is limited information regarding possible changes to the tax cut. However, we believe Geely's efforts in upgrading its sales mix, with a complete product offering to be launched and a rising contribution from the SUV segment, will serve as cushion for the potential impact of the policy expiry and help the Company capitalize on opportunities in the booming domestic SUV market.

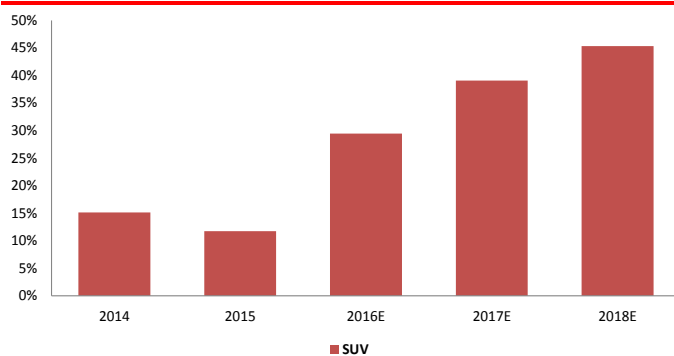
### SUV models to drive overall sales volume growth in 2015-17E.

We estimate a significant increase in Geely's SUV sales volume mix in 2016E-2018E. As Figure 8 shows, the SUV percentage will rise from 11.8% in 2015 to 45.5% in 2018. The NL-3, NL-4, Emgrand GS and CMA platform SUVs will become major growth drivers. So far, the better-than-expected ramp-up of new SUV/cross models reflects inspiring market acceptance of the company's auto design and technology, which will continue to benefit its ongoing product renewal cycle.

### Rising SUV proportion to offer room for ASP and margin progression...

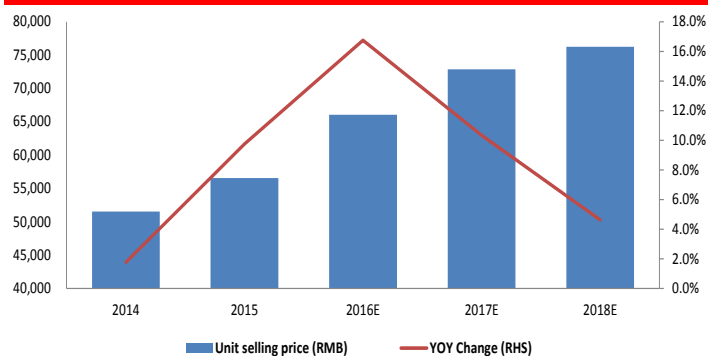
The rising proportion of SUV sales and product upgrades also offer room for ASP progression and margin expansion. Although there is concern about more intense competition in the SUV segment weighing on the profitability of Geely's new SUV models, inherent higher ASP and rising gross margins (after the initial ramp-up in newly opened manufacturing plants) offered by the SUV segment and the upcoming CMA platform products will help lift the overall ASP and margins. What's more, according to the Company, declining auto-component purchase costs will help absorb the negative impact of selling price cuts on the gross margin. Based on these factors, we estimate the overall ASP will increase from 2015's RMB56.6k to RMB76.2k in 2018E (Figure 9). The surging SUV mix will make a significant contribution to strong ASP growth in 2016-17E. We have also factored in a potential ASP cut resulting from rising industry competition going forward. However, we believe Geely's competitive advantages over its peers in product pricing, settings and cost-effectiveness, will partially alleviate the impact of an ASP cut as a result of industry competition.

Figure 8: SUV volume mix estimate for Geely



Source: Company data, CGIS Research estimate

Figure 9: Geely's overall ASP trend



Source: Company data, CGIS Research estimate

**Cutting edge over competitors...**

The Emgrand GL, launched on Sep 20<sup>th</sup>, is part of the A+ sedan series, with 1.3T and 1.8L engine options. Both engines are mated to a six-speed manual or a six-speed DCT. The Emgrand GL is priced from RMB78,800-113,800. The overall design follows that of the NL-3 and Emgrand GS, while it has its own specialized details. Compared with its direct competitors, such as the Chery ARRIZO 7 and Chang'an EADO, the NL-3 has more interior space and many additional driving safety measures which are unavailable in competitors' models. We believe the gross margin for this model should be satisfactory, as it shares the same platform as the previously launched Emgrand GS. Orders for the Emgrand GL already exceed 20,000.

Figure 10: Emgrand GL



Source: Company data, CGIS Research

Figure 11: Emgrand GL's interior



Source: Company data, CGIS Research

**Wide product range offering diversification ....**

By body type, Geely currently covers the A0 class sedan (King Kong); A- class sedan and SUV (Vision and Vision SUV); A class sedan and SUV (Emgrand and Emgrand GS); A+ class sedan (Emgrand GL); B class sedan (GC9); and A+ class SUV (NL-3). It will further develop its A0 & A00 class vehicles to replace the traditional Panda and KingKong, and develop some advanced A+ class models on the CMA platform and a series of MPVs on the CV platform. We believe the wider product range will offer diversification for the company and flexibility for Geely's customers, helping to build brand loyalty.

## Resilient capacity expansion and platform strategy

### Capacity expansion to fuel growth...

The Baoji plant in Shaanxi province (designed annual capacity of 200,000 vehicles) began to produce the Boyue and Borui in late September. This will help solve the capacity constraints of the Chunxiao plant and support the upcoming peak sales season of the Boyue. The Baoji plant will have 16,000~18,000 car/month capacity in the initial stage. After ramping up production, the total capacity for the Borui and Boyue is expected to reach ~30,000/month by end-2016 through work shift adjustments.

The Taizhou Linhai plant in Zhejiang province has a current capacity of 14,000/month for the Emgrand GS (with plans to increase this to ~18,000/month by early 2017). Recently launched Emgrand GL is also made in Linhai plant. With the Shanxi Jinzhong plant (FE platform designed for annual capacity of 100,000) commencing operations this Oct, the total capacity for the GS is expected to be 25,000~30,000/month by end-2016.

Figure 12: Major production capacity distribution in the future

Plant	Designed Annual Car Capacity ('000 units)	Comments
Shaanxi - Baoji	200	To be opened in Oct-2016, KC platform for GC-9 and NL-3
Shanxi - Jinzhong	100	To be opened in Oct-2016, FE platform for Emergrand GS
Taizhou - Luqiao	100	Old plant for King Kong to be replaced with CMA platform in 2017 with initial design 100,000 annual capacity
Taizhou - Linhai	100	Old plant for Panda & GX2 to be replaced with FE platform in 2016 with initial design 100,000 annual capacity
Hunan - Xiangtan	100	FE platform for New Vision, SC7, GC7
Sichuan - Chengdu	100	Previously GX7, to be replaced by FE platform for Vision SUV
Ningbo - Hangzhouwan	200	Emgrand EC7
Ningbo - Chunxiao	120	KC platform for GC-9 and NL-3

Sources: Company data, CGIS Research

### Platform strategy to boost efficiency...

Regarding the platform strategy, currently the company has both self-developed platforms and a co-developed platform. The former includes the Framework Extendable (FE) platform, KC platform and MPV platform. The FE platform handles mainly A/A+ class cars, such as the Emgrand and Vision series. The FE platform can also handle the HEV/PHEV/EV. The B class sedan Borui GC-9 is made on the KC platform, with improved security and air quality. The KC-2 is an upgraded version of the KC platform, catering for new energy vehicles, such as the hybrid version of the Borui. Geely started its MPV R&D division last year and will launch a series of MPV products on its CV platform in the next few years.

The Compact Modular Architecture (CMA) platform was co-developed with Volvo. There are ~6 new models under the L-brand on the CMA platform to be launched in FY17-18 (including sedans, SUVs and cross). The first two new models will be SUVs (including a cross), followed by a compact sedan model. According to the Company, with Volvo's advanced technology, the CMA platform products will be able to compete with global mass-market brands.

Figure 13: Geely's major platforms and related products

Platform	Sedan	SUV	MPV
FE	Emgrand GL	Emgrand GS (crossover)	
	Vision sedan	NL - 4 (Vision SUV)	
KC	GC-9 (Borui)	NL - 3 (Boyue)	
CV			7-seat MPV
CMA	Geely CS11/CH11	Geely CX11/CC11(crossover)	
	Volvo S40	Volvo XC40/V40	

Sources: Company data, CGIS Research

The capex of the development of the CMA platform is currently funded by the parent group. Details of the cost-sharing plan between Geely and Volvo are still unknown at present. Management believes that the plan will ensure the most competitive R&D cost per new model among its peers.

**EV strategy another long-term point.** To achieve the Corporate Average Fuel Consumption (CAFC) standard of 5.0L/100km by end-2020 ahead of the government schedule, Geely announced its 'Blue Geely Initiative' in November 2015, i.e. 90% volume mix of new energy vehicles (NEVs) by 2020E, including 65% PHEV (plug-in hybrid)/HEV (hybrid) and 35% pure EV. Geely will leverage CEVT and Volvo Car's leading technology for NEVs to speed up its NEV product offerings, starting from pure electric vehicles (EVs), followed by a gradual transition to PHEVs and petro hybrid electric vehicles (HEVs). It launched its Emgrand EV (a pure EV model) in Q4 2015, and plans to launch the Emgrand hybrid EV later this year.

In 2014, Geely's parent set up a JV (49% Geely) with Hunan-based battery component supplier Corun, called China Hybrid System (CHS). CHS has leveraged Corun's strength in battery and hybrid technology to create a scalable platform to produce power trains for hybrids and plug-in hybrids. The planned hybrid Emgrand is expected to be equipped with CHS' hybrid EV system.

Geely previously announced the disposal of its entire stake in its two low-priced mini-size electric vehicle JVs (a 50% stake in Kandi EV and 45% stake in Ninghai Zhidou) to its parent group for a total consideration of ~RMB1.346bn. The deal is expected to contribute a disposal gain of ~RMB176m for Geely. The Group plans to consolidate and enhance its EV product portfolio and brand image by focusing on its wholly owned "Geely" brand EV (e.g. the Dihao EV on the FE platform, etc.), while the stake unloaded in Zhidou will facilitate Zhidou's own license application process for NEV production.

## Financial Analysis

### Strong earnings growth in 2016-2018E

Owing to a strong model renewal cycle and sales mix upgrade, we project that Geely's recurring net profit will grow at a 44.2% CAGR and that revenue will grow at a 34.2% CAGR between 2016 and 2018E, driven mainly by (i) auto sales volume growing at a 25.9% three-year CAGR; (ii) a 10.5% unit selling price hike of a three-year CAGR; and (iii) gradual improvement in the net margin from 7.4% in 2015 to 8.9% in 2018E, due to a sales mix upgrade, and better expense absorption and operating leverage.

Figure 14: Key Assumptions and Projections

#### Key assumptions:

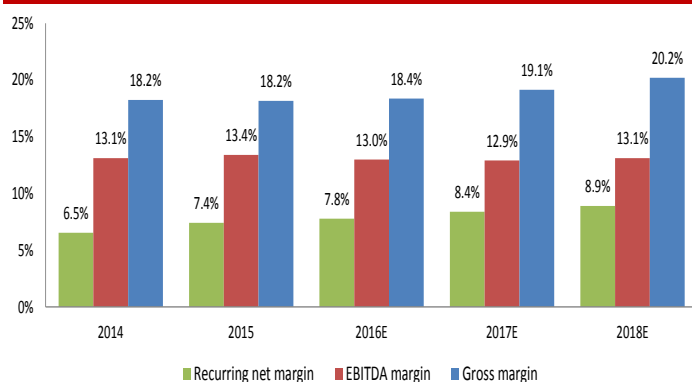
(RMBmillion except otherwise stated)

Year ended Dec-31	2014	2015	2016E	2017E	2018E
<b>Revenue</b>	<b>21,738</b>	<b>30,138</b>	<b>46,975</b>	<b>64,318</b>	<b>79,525</b>
YOY change	-24.3%	38.6%	55.9%	36.9%	23.6%
<b>Gross Profit</b>	<b>3,962</b>	<b>5,470</b>	<b>8,621</b>	<b>12,301</b>	<b>16,059</b>
Gross Margin	18.2%	18.2%	18.4%	19.1%	20.2%
<b>Operating profit</b>	<b>1,995</b>	<b>2,792</b>	<b>4,846</b>	<b>6,607</b>	<b>8,624</b>
Operating Margin	9.2%	9.3%	10.3%	10.3%	10.8%
<b>Recurring net profit</b>	<b>1,401</b>	<b>2,204</b>	<b>3,620</b>	<b>5,341</b>	<b>7,007</b>
YOY change	-46%	57%	64%	48%	31%
Net Margin	6.5%	7.4%	7.8%	8.4%	8.9%
<b>Unit selling price (RMB)</b>	<b>51,536</b>	<b>56,562</b>	<b>66,033</b>	<b>72,859</b>	<b>76,227</b>
YOY Change	1.8%	9.8%	16.7%	10.3%	4.6%
<b>Sales volume</b>	<b>417,851</b>	<b>510,097</b>	<b>681,102</b>	<b>855,329</b>	<b>1,017,030</b>
YOY Change	-24.0%	22.1%	33.5%	25.6%	18.9%

Source: Company data, CGIS Research estimate

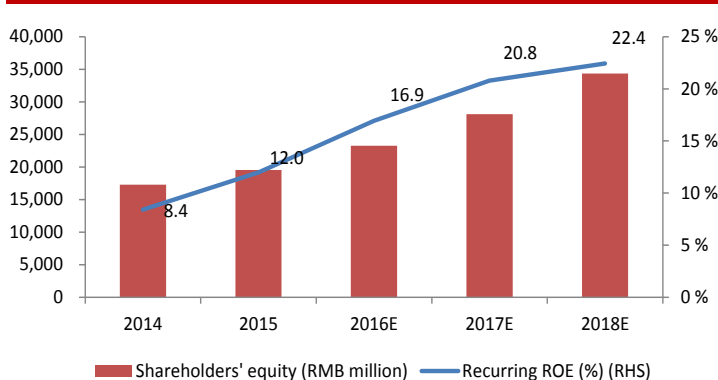
We expect Geely's gross margins to gradually improve because of its rising SUV volume mix and gradual ramp-up of new capacity. Operating margins should also improve, resulting largely from improving gross margins, although we project a rising marketing expense to sales ratio, given the new product launch pipeline. The admin expense to sales ratio should remain largely stable (the company has classified all of its R&D expenses in COGS since 1H15 instead of recognizing part of them as admin expenses as before).

Figure 15: Margin analysis



Source: Company data, CGIS Research estimate

Figure 16: Recurring ROE analysis



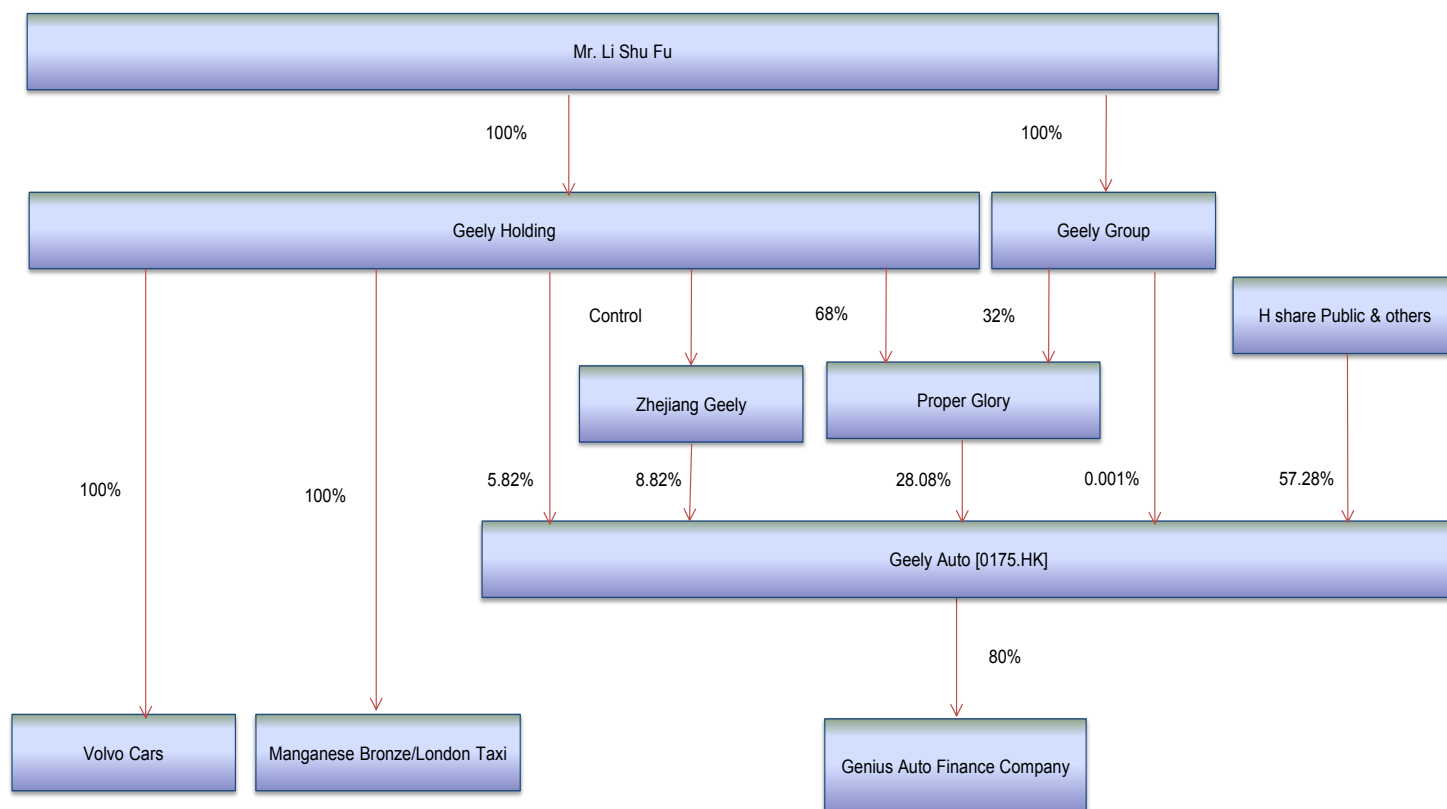
Source: Company data, CGIS Research estimate

We expect ROE to rebound from 12% in 2015 to 22.4% in 2018 due to improving profit margins and asset turnover. The Company had a net cash position of over RMB9bn at end-June 2016, while the company's interest bearing debt consists mainly of a US\$300m senior note due 2019 Oct. We have already factored in the potential effect of RMB depreciation against the US\$. Since capex for the development of the CMA platform is currently funded by the parentco and management expects a stable overall capex level for the listco in next 2-3 years, we believe that strong free cash flow generated from solid business operations will continue to support Geely's strong balance sheet going forward. As export volume accounted for only ~4% of 8M16 volume (RMB144m net FX gain in 1H16), and the company is intentionally controlling export volume to minimize the forex impact at the current stage and speed up localization of production in its major export markets, we expect a stable FX impact in the near term. With ~RMB11.2bn cash on hand in June 2016, and strong future cash flow, we expect to see an increasing dividend payout ratio going forward.

## Company Background

Geely was founded in 1986 as a refrigerator maker and started manufacturing motorcycles in the mid-1990s. After purchasing a failing state-run auto manufacturer, Geely got a production license to manufacture small vans in 1997. In 2001, Geely became the first privately owned automaker in China to get state approval to manufacture sedans. Geely entered the SUV market in late 2011. The acquisitions of DSI (the second-largest global independent automatic transmission maker) by its parent company in 2009 and Volvo Car Corporation in 2010 helped Geely improve its car quality and prestige. In 2013, Geely and Volvo established the China-Europe Vehicle Technology (CEVT) Center, an independent R&D center in Europe to facilitate the joint development of vehicles between the two companies. For a clearer market image and better execution, Geely consolidated its three brands (Emgrand, Englon and Gleagle) under the Geely umbrella in 2014, and also cut the number of dealers from 1,068 in 2013 to 691 at end-June 2016. Geely got a backdoor listing on the main board of the Hong Kong Stock Exchange in 2003.

Figure 17: Shareholder structure



Source: Company data, CGIS Research

## Management Profiles

**Li Shu Fu**, aged 52, Chairman, joined the group on 9 June 2005 as Chairman of the Board of Directors of the Company and Executive Director. Mr. Li holds a Master's Degree in Engineering from Yan Shan University. Presently, he is the controlling shareholder, founder, and Chairman of the Board of Zhejiang Geely Holding Group Company Limited ("Geely Holding"). Mr. Li has over 29 years of experience in investment and management in the automobile manufacturing business in the PRC.

**Mr. Yang Jian**, aged 54, Vice Chairman, joined the Group on 9 June 2005 as an Executive Director. Mr. Yang was appointed Vice Chairman of the Board on 1 July 2008 and was appointed Vice Chairman of the Board of Directors of Geely Holding on 29 December 2011. Mr. Yang graduated from Zhejiang Radio and Television University with a focus on production management, and holds senior economist and senior engineer designations.

**Mr. Gui Sheng Yue**, aged 52, CEO, joined the Group on 9 June 2005 as an Executive Director. He was appointed CEO of the Company with effect from 23 February 2006. He is an independent Non-Executive Director of Radford Capital Investment Ltd. [901.HK]. Mr. Gui has over 29 years of experience in administration and project management. He holds a Bachelor of Science Degree in Mechanical Engineering from Xi'an Jiaotong University and a Master's Degree in Business Administration from University of San Francisco.

**Mr. An Cong Hui**, aged 46, President of Geely Holding, joined the Group on 30 December 2011 as an Executive Director. He has been with Geely Holding since 1996 after graduating from Hubei University of Economics and Management with a Diploma in Contemporary Accounting. From 1996 to the present, Mr. An has held various key positions in Geely Holding, including Chief Engineering Officer and General Manager.

**Mr. Ang Siu Lun, Lawrence**, aged 56, joined the Group on 23 February 2004 as an Executive Director, and is responsible mainly for the international business development, capital markets and investor relationships of the Group. Mr. Ang holds a Bachelor of Science Degree in Physics and Computer Science and a Master of Business Administration Degree from the Chinese University of Hong Kong. Mr. Ang is a Non-Executive Director of Honbridge Holdings Limited [8137.HK] and an independent Non-Executive Director of Genvon Group Limited [2389.HK].

**Mr. Cheung Chung Yan, David**, aged 40, joined the Group as the Financial Controller and Company Secretary on 17 May 2005. Mr. Cheung holds a Bachelor's Degree in Business Administration in Accounting from the Hong Kong University of Science and Technology.

**Mr. Dai Yang, Daniel**, aged 61, joined the Group as Vice President (International Business) on 5 May 2005 and is responsible mainly for investor relations and international business in Hong Kong. Mr. Dai started his career with China Resources (Holdings) Co. Ltd. in Hong Kong in 1986 and then joined Da Fang Investment Co. Ltd. in Hong Kong as General Manager. Mr. Dai holds a Master's Degree of Linguistics from Beijing Foreign Language Institute and a Bachelor's of Arts Degree from Beijing Normal College.

**Mr. Poon Chi Kit**, aged 36, joined the Group on 1 July 2011. He was appointed Head of Internal Audit of the Company with effect from 1 October 2015 and is in charge of the risk assessment and monitoring, internal audits, and internal control infrastructure development of the Group. Mr. Poon holds a Bachelor's Degree in Civil Engineering from the National University of Singapore.

## Investment Risks

- The market is concerned about the potential expiry of purchase tax cuts for cars with engine size  $\leq 1.6\text{L}$  by end-2016, which may have an impact on the growth outlook of the sedan market in the coming years. The potential expiry of the preferential policy may exert top-down pressure on the overall sedan market.
- As the major players are constantly launching new SUV models in the market, the domestic SUV market may face tougher-than-expected competition going forward, with greater-than-expected intensified pricing pressure from Geely's peers. Keen competition among domestic brands and JV brands in China may lead to higher-than-expected price discounting, and may negatively impact the Company's gross margin.
- More effort is needed for the Company to accomplish its NEV development plan by 2020, including investment in technology and capacity.
- Uncertainty in market reception of new models.
- Slower-than-expected ramp-up of its new capacity.
- Adverse movement in foreign exchange rate.

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