

Reform of Marketing Mode

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175.HK | 175.HK | 175.HK

Industry: Automobile

5M 2012 sales and 2011 result review

Rating: Accumulate CP: 2.73HKD TP: 2.98HKD

Company Profile

Headquartered in Hangzhou, Geely is one of big-3 Chinese local brand car producers, with manufacture bases in Linhai, Ningbo and Luqiao, Shanghai, Lanzhou, Xiangtan, Jinan Chengdu, and a R&D center/production base from DSI in Australia. It has more than 30 car models under three sub-brands -- Emgrand, Gleagle and Englon.

Summary

- With Chinese car market slowdown in 2012, Geely sales rose by only 2.3% yoy to 187,895 units in the first five months of 2012, achieving 40.8% of the full year target of 460,000 units, among which, exports shot up by 181% from a year ago (domestic sales were in fact a negative growth with export sales excluded). Geely will release seven new models in 2012 with which the management is confident in accomplishing the yearly sale goal of 460,000-unit, growing by about 9% over 2011.

- Following Gleagle GC7, Geely's many models including Gleagle GX7, Emgrand EC7, EC8 and Englon SC7 will be installed with the Geely's 6AT gear box by Q4 2012, which is expected to drive up performance-price ratio and sales of Geely.

- Geely adjusted its marketing architecture, transforming the vertical management of three sub-brands divisions (Emgrand, Gleagle and Englon), to the three regional divisions: South Region, Central Region and North Region. We believe amidst the overall depressed car market, the transformation into regional marketing of Geely will benefit marketing penetrating in the tier-3 and tier-4 cities.

- Geely's turnover increased by 4.3% in 2011 to RMB 20.965 billion. Profits attributed to the parent company's shareholders for the year were recorded RMB1.54 billion, up by 13% yoy. But despite the effects of reduction in share payment cost to employees, profits in 2011 will slightly rise by 2% to RMB 1.681 billion.

- We believe the subsequent cooperation of Geely and Volvo will include JV factory producing Volvo XC60 in China, technical export to Geely and development of higher grade models of Geely, etc. It will be positive to improving Geely product quality and product mix, and Volvo marketing channel in Europe will bring help for Geely export expansion.

- We forecast its net profit in FY2012 and FY2013 to RMB 1.754billion and RMB 2.074billion, diluted EPS of HK\$0.26 and HK\$0.31. Given the potential expectation for its cooperation with Volvo, we give 12-month TP of HK\$2.98 on 11.3x and 9.6x P/E of 2012 and 2013E diluted EPS respectively, 9% higher than the close, rating Accumulate.



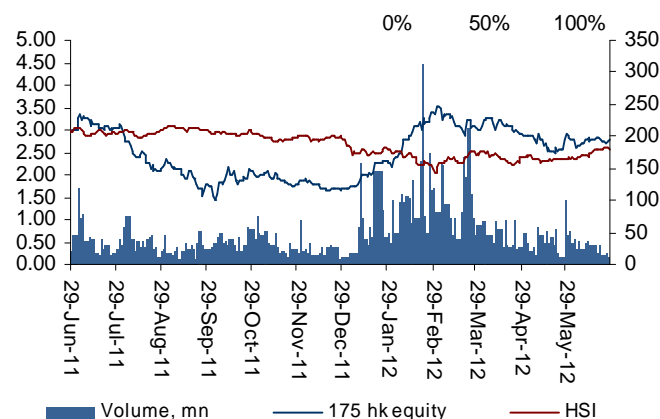
Phillip Securities (HK) Ltd

Phillip Securities Research

28 June 2012

Geely

Rating	2.00	Accumulate
- Previous Rating	2.00	Accumulate
Target Price (HKD)	2.98	
- Previous Target Price (HKD)	2.03	
Closing Price (HKD)	2.73	
Expected Capital Gains (%)	9.2%	
Expected Dividend Yield (%)	1.5%	
Expected Total Return (%)	10.7%	
Raw Beta (Past 2yrs w weekly data)	1.38	
Market Cap. (HKD bn)	20,408	
Enterprise Value (HKD mn)	20,135	
52 week range (HKD)	1.42 - 3.56	
Closing Price in 52 week range		



Key Financial Summary

FYE	12/10	12/11	12/12F	12/13F
Revenue (RMB mn)	20,099	20,965	24,060	28,036
Net Profit, adj. (RMB mn)	1,368	1,543	1,754	2,074
EPS, adj. (RMB)	0.19	0.21	0.24	0.28
P/E (X),adj.	12.0	10.8	9.5	8.0
BVPS (RMB)	1.09	1.29	1.49	1.71
P/B (X)	2.1	1.7	1.5	1.3
DPS (RMB)	0.03	0.03	0.03	0.03
Div. Yield (%)	1.2%	1.3%	1.3%	1.5%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

PE

Research Analyst

Zhang Jing

zhangjing@phillip.com.cn

+86 63512937

Slowing momentum in total sales since 2012, with the bright spot of Emgrand

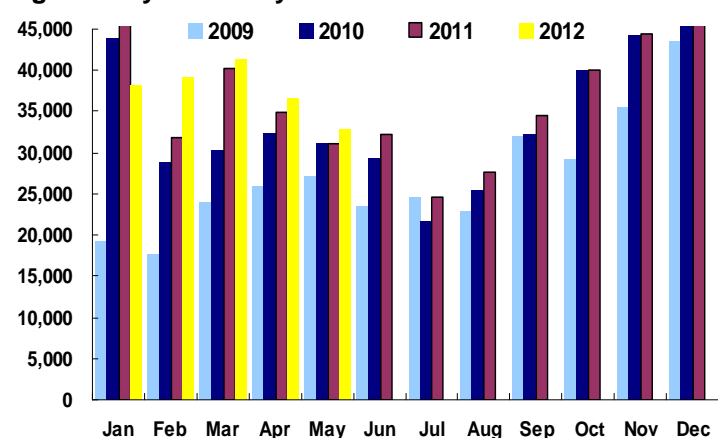
With Chinese car market slowdown in 2012, local brands severely impacted by demand slowdown, Geely sales are not up to expectations this year.

Sales grew by 5.5% yoy in May 2012, among which Emgrand and Englon brand sales rose by 15.9% and 26.1% respectively yoy, while Gleagle brand sales fell by 16.0% yoy. On a mom basis, Emgrand brand sales increased by 5.1%, while Englon and Gleagle sales fell by 1.7% and 26% respectively.

For the first five months of 2012, Geely sales rose by only 2.3% yoy to 187,895 units, achieving 40.8% of the full year sales target of 460,000 units, among which, exports shot up by 181% from a year ago (domestic sales were in fact a negative growth with export sales excluded).

Due to excellent performance, the sales of its high-end model Emgrand brand increased by 60% in the first five months of 2012 from the same period of last year.

Fig 1. Geely's monthly sales



Source: Company reports, Phillip Securities

The Management still Confident in Achieving the Sales Target

Geely will release seven new models in 2012, including medium-sized sedan GC7 and SUV GX7 under Gleagle, large-sized SUV EX8 and MPV EV8 under Emgrand, economy sedan SC3, SUV SX7 and economy sedan SC6 under Englon.

There are also upgrade versions Free Cruiser, Geely Panda, Vision and SC5-RV as well as new version of EC7 and EC8 with new engines and new transmissions.

The management is confident in accomplishing the yearly sale goal of 460,000-unit with the release of new models, growing by about 9% over 2011. As regular, the company H1 finishes 45% of the yearly sales and H2 finishes the rest 55%.

Geely Gleagle's GC7 and GX7 came into local markets on patrol recently. GC7 splits into 1.8CVVT and 1.8DVVT engines, with prices ranging from RMB 66,900-89,900. GX7 is Geely's first SUV model, with prices ranging from RMB 92,900-129,900.

6AT to be installed in batches: Effect of Scale to show up

Due to the short supply caused by the lack of AT (automatic transmissions) in 2011, Emgrand EC7 demand was not fully reflected. According to the press, following Gleagle GC7, Geely's many models including Gleagle GX7, Emgrand EC7, EC8 and Englon SC7 will be installed with the Geely's 6AT gear box by Q4 2012, which is expected to drive up performance-price ratio and sales of Geely.

Currently, the company started the mass production of such 6-speed AT at its new plant in Xiangtan with yearly capacity of about 100,000 units. In addition, Geely is building another two gear box plants in Chongqing and Jinan in 1 or 2 years. We believe with massive application of 6AT on its cars, unit cost will naturally see a substantial decline, and effects of scale will be increasingly obvious, boosting the gross margin.

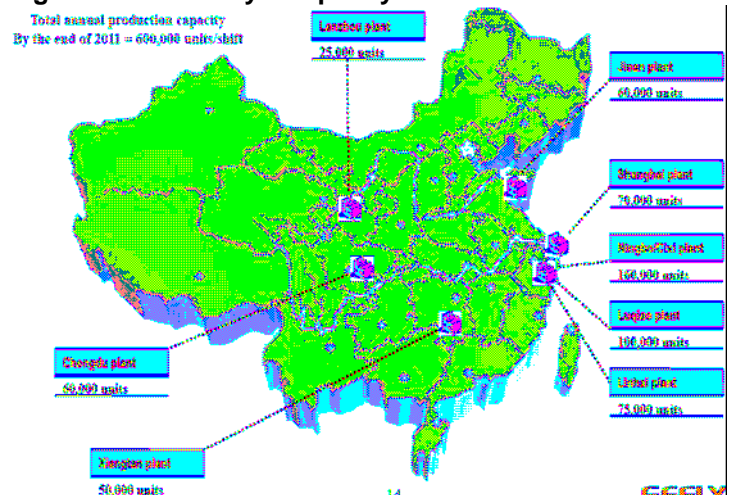
Reform of Marketing Mode: Vertical to Horizontal

Not long ago, Geely adjusted its marketing architecture, transforming the vertical management of three sub-brands divisions (Emgrand, Gleagle and Englon), to the three regional divisions: South Region, Central Region and North Region. Each takes charge of marketing and after-sales of all the three sub-brands in the region.

Regional marketing is marked by flexibility, high efficiency, close to the demand of local markets with more flexible and coping tactics, but with the defect of focusing on near-term sales rather than brand building.

We believe amidst the overall depressed car market, the transformation into regional marketing of Geely will benefit marketing penetrating in the tier-3 and tier-4 cities.

Fig 2. View of Geely's capacity and sales net



Source: Company reports, Phillip Securities

After 5 years, Geely's multi-brand strategy since 2007 has paid off, and as of the end of 2011, the sales network of three independent sub-brands for Geely in China (Emgrand, Gleagle and Englon) consisted of 976 shops, including 570 independent franchised stores and 406 4S stores. For the export market, the company still sold cars in name of Geely brand and had 63 sale agents in 52 countries.

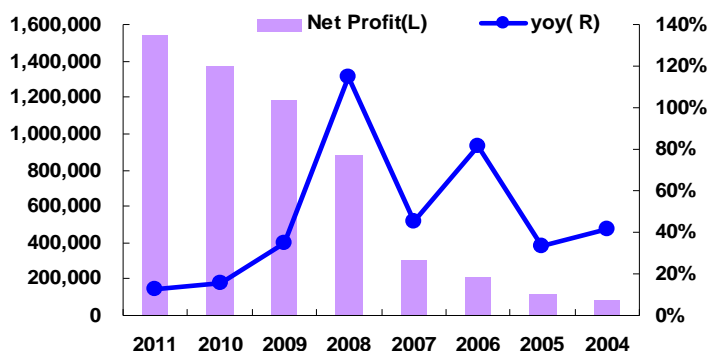
Currently, Geely Jinan plants produces Emgrand EC8 under B-class cars platform, Ningbo base and Cixi base produce Emgrand EC7 under A-class cars platform, and Chengdu base produces SUV model under C-class cars platform.

With Flat Performance in 2011

Geely's turnover increased by 4.3% in 2011 to RMB 20.965 billion, costs rose by 4.5% yoy. Profits attributed to the parent company's shareholders for the year were recorded RMB1.54 billion, up by 13% yoy. EPS stood at RMB 0.207, up by 11.4%, performance was in line with our estimate but better than consensus, and the company proposed distributing year-end dividend RMB 0.028.

The better-than-expectation performance was mainly attributed to reduction in share payment cost to employees; despite the effects, profits in 2011 will slightly rise by 2% to RMB1.681 billion.

Fig 3. Qingling's net profit and growth




Source: Company reports, Phillip Securities

Geely sold 421,611 cars in 2011, similar to the 2010 level, but 12% less than the year-round goal of 480,000.

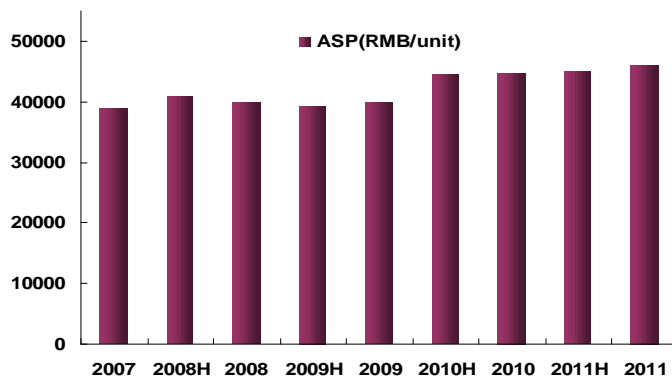
Robust demand for high-end models Emgrand EC7 and EC8 and rapid growth of export sales offset sales slide of old models such as Free Cruiser and Vision, heralded continuous enhancement of product portfolio during the period and drove up the average ex-factory price by 3% to RMB 46,153.

Fig 4. Geely's sales by segments

Brand	Models	2011 sales volume	No. of dealers (Y/E 2011)
 GLEagle	Geely Panda GX2 Free Cruiser Vision GC7 GX7	177,730	336
 Emgrand	EC7 EC7-RV EC8	106,676	245
 Englon	Kingkong SC7 SC5-RV	137,205	395

Source: Company reports, Phillip Securities

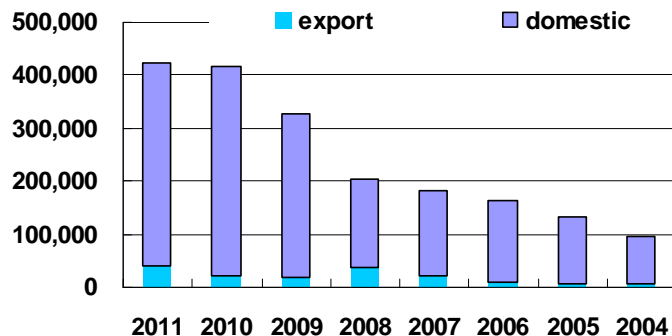
Fig 6. Qingling's ASP trend (RMB/unit)



Source: Company reports, Phillip Securities

By region, Geely domestic sales declined by 3% to 382,011 units, while the nationwide sedan sales grew by 7% during the period. Geely's export sales boomed by 93% to 39,600 units, accounting nearly 10% of its total sales.

Fig 5. Geely's sales by regions



Source: Company reports, Phillip Securities

The overall gross margin slightly fell by 0.3 ppts to 18.2% in 2011 from the 18.5% of 2010. Subsidy revenue increased by 37% yoy to RMB 877 million offset the increase of 14.2% in sales expenses.

Total capital expenditure amounted to RMB 2 billion in 2011, but total cash level (bank balance and cash + bank saving under mortgage) declined by 27% to RMB 3.384 billion, total borrowing increased by 27% to RMB3.375 billion, and net debt/equity ratio was 16%.

Geely capital expenditure budget stands at RMB 1 billion in 2012, including the funding of new models, parts R&D and production base expansion and upgrade.

Cooperation with Volvo Expected

The acquisition of Volvo in 2010 and the turnaround of Volvo from the red to the black improved Geely's image substantially. On March 9 2012, Geely's parent company signed a license MOU with Volvo, and the cooperation items will include development of small-emission environment-friendly engine, small car and electric car and hybrid vehicles and relevant technology.

We believe the subsequent cooperation of Geely and Volvo will include JV factory producing Volvo XC60 in China, technical export to Geely and development of higher grade models of Geely, etc. It will be positive to improving Geely product quality and product mix, and Volvo marketing channel in Europe will bring help for Geely export expansion. Emgrand EC7 obtained Euro-NCAP 4-star safety certification, overtook some of European and American brands and won the highest achievement in Euro-NCAP safety collision test for Chinese producers, which fully affirmed the company's rapid progress in product quality and safety and considerably improved the Emgrand brand image.

Valuation

We forecast its net profit in FY2012 and FY2013 to RMB 1.754billion and RMB 2.074billion, diluted EPS of HK\$0.26 and HK\$0.31.

In valuation, the Hong Kong listed peers are traded on 10.5/8.5x PE for 2012/2013, given the potential expectation for its cooperation with Volvo, we give 12-month TP of HK\$2.98 on 11.3x and 9.6x P/E of 2012 and 2013E diluted EPS respectively, 9% higher than the close, rating Accumulate.

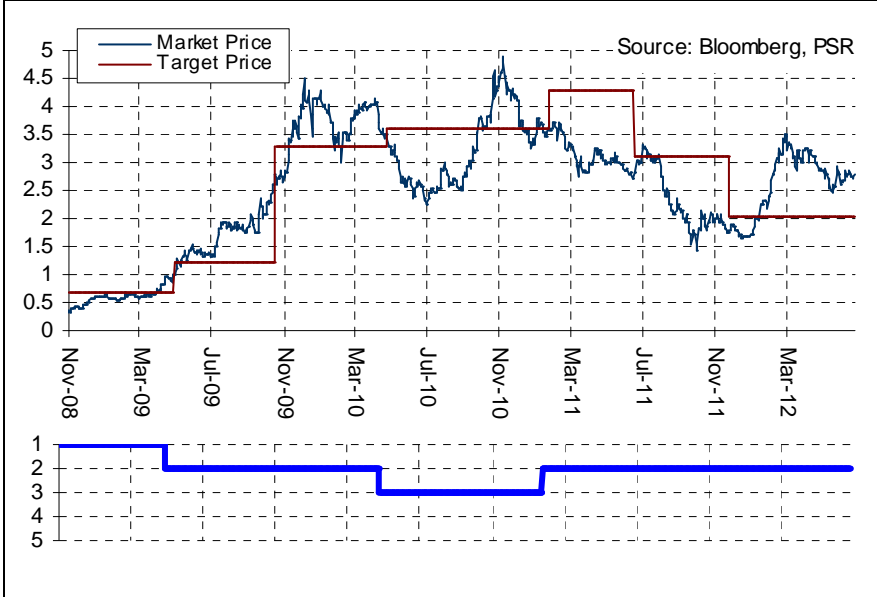
Risk

RM price surge or Economy decline would cut vehicle demand
Price war undermines its cost advantages
Overseas market risk for its export
Whether its new launched models are widely acknowledged
Big funding demand may encounters bottleneck limiting its expanding.

FYE DEC	FY09	FY10	FY11	FY12F	FY13F
Valuation Ratios					
P/E (X), adj.	13.4	12.3	11.0	9.7	8.2
P/B (X)	2.5	2.1	1.8	1.5	1.3
Dividend Yield (%)	0.9%	1.1%	1.2%	1.3%	1.5%
Per share data (RMB)					
EPS, (Basic)	0.171	0.186	0.207	0.235	0.278
EPS, (Diluted)	0.167	0.171	0.192	0.217	0.255
DPS	0.020	0.026	0.028	0.030	0.034
BVPS	0.92	1.09	1.29	1.49	1.71
Growth & Margins (%)					
Growth					
Revenue	NA	42.9%	4.3%	14.8%	16.5%
EBIT	NA	29.5%	11.6%	11.4%	17.4%
Net Income, adj.	NA	15.7%	12.8%	13.7%	18.3%
Margins					
Gross margin	18.1%	18.4%	18.2%	18.2%	18.6%
EBIT margin	11.8%	10.7%	11.4%	11.1%	11.2%
Net Profit Margin	8.4%	6.8%	7.4%	7.3%	7.4%
Key Ratios					
ROE (%)	22.4%	19.0%	17.5%	17.0%	17.4%
ROA (%)	6.3%	5.9%	5.7%	5.9%	6.0%
Income Statement (RMB mn)					
Revenue	14,069	20,099	20,965	24,060	28,036
Gross profit	2,541	3,700	3,820	4,388	5,217
EBIT	1,657	2,145	2,394	2,668	3,133
Profit before tax	1,550	1,900	2,183	2,399	2,846
Tax	(231)	(351)	(467)	(458)	(544)
Profit for the period	1,319	1,550	1,716	1,940	2,302
Minority interests	(136)	(181)	(172)	(186)	(228)
Total capital share	6,927	7,363	7,450	7,450	7,450
Net profit	1,183	1,368	1,543	1,754	2,074

Source: PSR

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 37, 530 Collins Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96298380
Fax (613) 96148309
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel (86-21) 51699200
Fax (86-21) 63512940
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005