EQUITY RESEARCH

CAERI (601965 CH)

Continued to Benefit from the Rising Proportion of High Value-added Business

27 October 2022

China | Automobile | Company Update

Company profile

CAERI is the only listed company in the A-share automotive industry that is engaged in automotive technology service business. It has strong automotive R&D and testing capabilities. The businesses involved can be divided into automotive technology service business and industrialized manufacturing business. Among them, the technical service business includes automobile research and development and consultation, and automobile testing and evaluation. The industrialized manufacturing business includes three parts: special vehicles, key parts of rail transit, automobile gas system and its key parts.

Investment Summary

The Improvement of Sales Structure Drives the Growth of Results in H1

In H1 of 2022, CAERI reported a revenue of RMB1,340 million, down 25.58% yoy. The decline in revenue was mainly due to the Company's initiative to control the scale of the equipment manufacturing business with declining market prosperity, resulting in a sharp decline in its revenue by nearly 80% yoy. However, the significant improvement of the sales structure led to a sharp increase in the gross margin during the reporting period, which greatly improved the profitability. The Company reported a net profit attributable to the parent company of RMB300 million, up 14.1% yoy, and a net profit attributable to the parent company excluding non-recurring items of RMB299 million, up 19.26% yoy.

On a closer look at the business segments, 1) the Company reported a revenue of RMB1,139 million in the automotive technical service business, up 30.16% yoy, mainly due to the effectiveness of the Company's strategy of strengthening market development, as well as the continuous optimization of the business structure, which led to a year-on-year improvement in the non-regulatory business such as wind tunnel, new energy and intelligent connected business; 2) the Company reported a revenue of RMB201 million in the equipment manufacturing business, down 78.27% yoy, mainly because under the impact of the market quotation on the SPV modification and sales business, the Company strengthened risk management and controlled the scale of the business, resulting in a year-on-year decrease in the revenue.

Higher Proportion of the Business with High Gross Margin Facilitates a Strong Improvement in the Gross Margin

With the entry of Internet companies and new car-making forces, the vehicle architecture has evolved to "intelligent cockpit + autonomous driving + skateboard chassis", and the integration of automotive technology and cross-sector technology has accelerated. Automobiles have become an important carrier of consumer electronics, and the demand for technical services has further increased. The Company's New Energy Center quickly responded to market changes, and seized the development opportunities of domestic new energy and intelligent connected business. By taking the EIC system and vehicle R&D as the lever, the effect of market development was obvious: During the reporting period, the Company continued to make breakthrough in the innovative business, and the revenue proportion of the automotive technical service business with high gross margin (gross margin of 51%) expanded by 36.4 ppts to 85%.

Accumulate (Maintain)

CMP CNY 18.19

(Closing price as at 25 October)

TARGET CNY 21.6 (+18.75%)

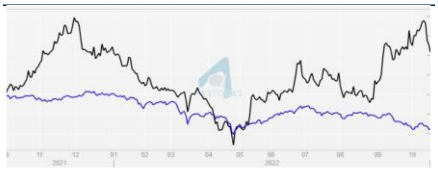
COMPANY DATA

O/S SHARES (MN) :	1005
MARKET CAP (CNY MN) :	18278
52 - WK HI/LO (CNY):	21.23/10.89

SHARE HOLDING PATTERN, %

China General Technology (Group)	51.75

PRICE VS. SHCOMP



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY21	FY22E	FY23E	FY24E
Net Sales	**3835**	**3437**	**4213**	**4810**
Net Profit	692	805	945	1081
EPS, CNY	0.70	0.80	0.94	1.08
P/E, x	26.0	22.7	19.3	16.9
BVPS, CNY	5.54	5.98	6.58	7.26
P/BV, x	3.3	3.0	2.8	2.5
DPS (CNY)	0.30	0.35	0.40	0.50
Div. Yield (%)	1.6%	1.9%	2.2%	2.7%

Source: Company reports, Phillip Securities Est.

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Meanwhile, the revenue proportion of the equipment manufacturing business with low gross margin decreased to 15%. Specifically, due to the decline in the infrastructure demand, the revenue proportion of SPV modification and sales business, which had a gross margin of only about 4.5%, shrank sharply by 36 ppts to 7.7%. A better sales structure has driven a sharp increase in the profitability: In H1, the Company's comprehensive gross margin reached 43.68%, up 14.69 ppts yoy, and the net profit margin climbed to 23.4%, up 8.3 ppts yoy.
Meanwhile, due to the rising employee compensation, the Company continued to increase the R&D investment in key and core technologies. The selling expense ratio, administration expense ratio and R&D expense ratio saw a year-on-year increase of 1.06 ppts, 2.22 ppts and 1.49 ppts, respectively, driving a year-on-year increase of 4.62 ppts in the period expense ratio.

Continued to Benefit from the Rising Proportion of High Value-added Business
On July 27, the Company's Board of Directors reviewed and approved the East China Headquarters Base construction project, which plans to invest RMB2,349 million to build a new energy vehicle testing and R&D laboratory, an electronic communication and software testing and R&D laboratory, a parts, military supplies and match goods testing and R&D laboratory, and an automotive performance testing and R&D laboratory in Suzhou, Jiangsu Province, and plans to invest RMB33 million to build a hydrogen vehicle testing and R&D laboratory in Changzhou, Jiangsu Province. The completion of the new project will further improve the Company's national strategic layout of the technical service business and comprehensively enhance its technical service capabilities in East China. In the future perspective of the overall slow development and the existing competition in the automotive industry, and the rapid development of new energy vehicles and intelligent applications, automakers will accelerate the launch of new vehicles with more intelligent connected competitiveness. In terms of the policies, the release and implementation of the Medium and Long-term Plan for the Development of Hydrogen Energy Industry (2021-2035), and the Regulations on the Administration of Intelligent Connected Vehicles in the Shenzhen Special Economic Zone will accelerate the development of the domestic automotive industry towards a trend of new energy and intelligence. The Company's high value-added business is expected to enter the fast lane, and its future results will also benefit from the rising proportion of high value-added business.

Investment Thesis

CAERIs state-owned enterprises reform has been continuously advanced. After the launch of the share incentive plan, the incentive mechanism and the degree of marketisation will be significantly improved, such as the forward-looking layout of the intelligent networked electric vehicles.
Considering the high monopoly barrier of the counter-cyclical automotive technology service business of the company, as well as the turning point of result brought by the operation of the new capacity, we give target price of RMB 21.6 yuan, respectively 27/23/20x P/E of our expected EPS for 2022/2023/2024 and an "Accumulate" rating. (Closing price as at 25 October)

Forward P/E P/B trend

Source: Bloomberg, Company, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY20	FY21	FY22F	FY23F	FY24F
Valuation Ratios					
P/E (X), adj.	31.8	26.0	22.7	19.3	16.9
P/B (X)	3.6	3.3	3.0	2.8	2.5
Dividend Yield (%)	1.6%	1.6%	1.9%	2.2%	2.7%
Per share data (RMB)					
EPS, (Basic)	0.57	0.70	0.80	0.94	1.08
EPS, (Diluted)	0.57	0.70	0.80	0.94	1.08
DPS	0.30	0.30	0.35	0.40	0.50
BVPS	5.10	5.54	5.98	6.58	7.26
Growth & Margins (%)					
Growth					
Revenue	24.1%	12.2%	-10.4%	22.6%	14.2%
EBIT	17.8%	40.8%	17.2%	17.8%	14.8%
Net Income, adj.	19.7%	23.9%	16.4%	17.4%	14.4%
Margins					
Gross margin	29.7%	32.4%	41.3%	40.5%	40.5%
EBIT margin	15.4%	19.3%	25.3%	24.3%	24.5%
Net Profit Margin	16.3%	18.0%	23.4%	22.4%	22.5%
Key Ratios					
ROE	11.5%	13.1%	13.9%	15.0%	15.5%
Income Statement (RMB mn)					
Revenue	**3418**	**3835**	**3437**	**4213**	**4810**
Gross profit	1014	1241	1419	1706	1946
EBIT	527	742	870	1024	1176
Profit before tax	671	843	982	1153	1324
Tax	87	114	128	151	174
Profit for the period	585	729	854	1002	1150
Minority interests	26	38	49	57	69
Total capital share	989	989	1005	1005	1005
Net profit	**558**	**692**	**805**	**945**	**1081**

Source: PSR

(Closing price as at 25 October)

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 ± 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

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

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