

Geely Automobile (175 HK)

Low earnings quality; Not an inflection point yet

Maintain HOLD. Geely Automobile Holdings' FY21 net profit fell 12% YoY to RMB 4.8bn, below our prior expectation. Earnings quality should be even worse than it shows, as profits associated with connected transactions rose significantly. Despite its recent share price plunge that makes its valuation appear to be attractive, we believe that the company still faces challenges in FY22E (raw-material price hike, chip shortage, legacy burden for high fixed costs etc.) and Zeekr has not proven its capabilities in both sales and technologies which still needs heavy investments in R&D and infrastructure to catch up. We are of the view that the inflection point may have not arrived yet, although FY23E could be more attractive. We maintain our HOLD rating and cut our target price to HK\$ 13.50 from HK\$ 21.00, based on sum-of-the-parts (SOTP) valuation.

- **About 1/3 of FY21 net profit came from R&D services and IP licensing.** We estimate that about 34% of Geely's FY21 net profit was contributed by R&D support services and IP licensing and 12% was from auto parts sales (excluding battery packs, as such revenue was from Zeekr's subsidiary Viridi E-Mobility). In other words, more than half of Geely's FY21 net profit was highly associated with connected transactions, as such revenue was mainly from Lotus, Proton, Smart, Lynk & Co, Volvo, etc.

As Zeekr's net loss attributable to Geely was about RMB 0.5bn and equity income (mainly from Lynk & Co and Genius Auto Finance) was about RMB 1.1bn, Geely- and Geometry-brand businesses only contributed about RMB 1.5bn to the total net profit in FY21, or about RMB 1,300 per vehicle. Our FY22E outlook for Geely below is also comprised of these four businesses.

- **Zeekr: Key driver for Geely's valuation but picture is still unclear.** Although Zeekr achieved 3.7% gross margin in FY21 with only 6,007 vehicles delivered, its contract manufacturing nature, along with 40% of its revenue (RMB 1.1bn) from battery pack sales and R&D services, makes such gross margin with little indication of future profitability.

We project FY22E sales volume of 70,000 units, in line with its sales target. Deliveries in Mar 2022 should still be disappointing based on our retail sales tracker, whereas recent new orders are improving with industrywide order rush before new-energy vehicle (NEV) price hikes, based on our channel checks. Nevertheless, we believe investors may need to wait until 2H22 to confirm their views whether FY22E sales target will be met or not.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue (RMB mn)	97,401	92,114	101,611	139,073	151,600
YoY growth (%)	(8.6)	(5.4)	10.3	36.9	9.0
Net income (RMB mn)	8,190	5,534	4,847	6,628	8,256
EPS (RMB)	0.89	0.56	0.48	0.66	0.82
YoY growth (%)	(34.8)	(32.4)	(12.4)	36.7	24.6
P/E (x)	11.9	17.8	20.3	14.7	11.8
P/B (x)	1.8	1.6	1.4	1.3	1.2
Yield (%)	1.9	1.2	0.8	1.8	2.3
ROE (%)	16.5	9.4	7.3	9.2	10.5
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

HOLD (Maintain)

Target Price	HK\$ 13.50
(Previous TP)	HK\$ 21.00)
Up/Downside	+12.9%
Current Price	HK\$ 11.96

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Stock Data

Mkt Cap (HK\$ mn)	119,849
Avg 3 mths t/o (HK\$ mn)	914
52w High/Low (HK\$)	29.80/10.00
Total Issued Shares (mn)	10,021
Source: Bloomberg	

Shareholding Structure

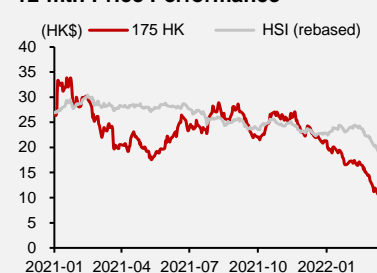
Li Shufu	43.2%
Others	56.8%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	-23.5%	-17.7%
3-mth	-45.5%	-40.9%
6-mth	-48.0%	-39.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: GrantThornton

More importantly, investments for R&D and infrastructure (showrooms and charging stations) at Zeekr should be high in FY22-23E in a bid to aid sales and catch up in autonomous driving, smart cockpit and battery related technologies. We project Zeekr's net loss to widen from RMB 10bn in FY21 to RMB 16bn in FY22E.

In our view, Zeekr should be the key driver for Geely's valuation, as Geely's traditional business and low-end NEV brand Geometry may hardly lift its valuation. While these technological capabilities and brand building could not be done overnight, we suggest investors wait until clearer signals. We value 60% of Zeekr held by Geely at HK\$ 40bn, based on 3x our FY22E core P/S (excluding connected transactions such as battery pack sales and R&D services). We think such valuation is fair given that NIO (NIO US, BUY), Xpeng (XPEV US, BUY) and Li Auto (LI US, BUY) are now trading at 3-4x our FY22E P/S.

■ **Geely and Geometry brands: We expect marginal improvement in FY22E net profit.**

We forecast sales volumes for Geely and Geometry brands to rise 12% YoY to 1.23mn units in FY22E, largely driven by Geometry, *Xingyue L* and new *Boyue*-equivalent SUV, which also lifts average selling price (ASP). Improved model mix likely widens gross margin. On the other hand, we estimate Geometry to widen its net loss in FY22E, especially with rising battery prices and declining NEV credit price. Accordingly, we project gross margin for Geely and Geometry brands to be flat YoY at 15.4% in FY22E, also accounting for other headwinds including raw-material price hike and rising depreciation from previous aggressive capacity expansion.

Although we kept mentioning in our notes that Geely's legacy depreciation and amortization burden from its previous heavy investments should linger during FY21-22, we still underestimated its SG&A expenses in FY21, partially due to the investments for Zeekr. Based on our estimates, amortization of intangible assets would rise by about RMB 1bn in FY22E and R&D expenses would increase by RMB 0.7bn. Accordingly, we project the consolidated SG&A expenses (including Zeekr's) to rise by RMB 3.8bn in FY22E to RMB 18.1bn, with the majority of the increment contributed by Zeekr. Therefore, we estimate a net profit of RMB 2.1bn in FY22E for Geely and Geometry brands, or RMB 0.6bn higher than that in FY21. **Should Geely tighten its investments in these businesses, we may see a smaller increment in depreciation and amortization in FY23E, and thus we expect a better marginal improvement in net profit in FY23E.**

■ **Equity income from Lynk & Co and Genius Auto Finance.** The Lynk & Co joint venture (JV) experienced a worse-than-expected 2H21 (operating margin: 2.4% in 2H21 versus 4.3% in 1H21), partially due to rising fixed costs, in our view. Five models at Lynk & Co are produced in three plants (Ningbo Yuyao plant for the *01* and *05*, Zhangjiakou plant for the *02* and *03* and the parent's Chengdu plant to contract manufacture the *06*), resulting in lower capacity utilization. The more-premium *Lynk & Co 09*, which is currently contract manufactured at its parent's plant in Ningbo Meishan, should enjoy a higher margin. That should outweigh fixed cost pressure from other models in FY22E, in our view, as long as Lynk & Co has no plan to acquire this plant in FY22E.

We project FY22E sales volume of 240,000 units, lower than its sales target of 300,000 units, as we think it may take some time to pick up the momentum, as it has been cutting its high inventories from Jan 2022. Accordingly, we expect net profit to surge 45% YoY in FY22E for Lynk & Co.

We expect strong net profit growth at Genius Auto Finance to continue in FY22E, following its 3-year CAGR of 70% during FY19-21, partially due to better model mix. However, Geely's stake at Genius Auto Finance may be cut from 80% to 50%, as disclosed earlier.

■ **R&D support services, IP licensing and auto parts sales: Likely even higher contribution to net profit in FY22E.** We project IP licensing income to double in FY22E based on the previous contracts signed. Similar pattern should be applied to R&D

support services in FY22E, with more collaborations between Geely's parent and its partners. Auto parts revenue is likely to grow as sales volume of Lynk & Co rises. We assume net margin of 12% for both auto parts business and R&D support services, and 100% net margin for IP licensing. We therefore estimate a net profit of RMB 4.3bn in FY22E for these three businesses combined, or 64% of our projected total net profit for Geely.

- **Valuation/Key risks.** We cut our net profit estimates by 25% and 27% in FY22-23E, respectively, as illustrated in details above. Accordingly, we maintain our HOLD rating and cut our target price from HK\$ 21.00 to HK\$ 13.50.

Our target price is based on our SOTP valuation. We value 60% of Zeekr held by Geely at HK\$ 40bn, based on 3x our FY22E core P/S, as noted above. We value Geely's all other businesses at 10x our FY22E P/E (HK\$ 93bn), in line with Geely's historical average P/E for its internal-combustion engine (ICE) business. That arrives at our target price of HK\$ 13.50.

Key risks to our rating and target price include lower or higher sales volumes and gross margins than we expect, uncertainties in either direction for Zeekr and sector re-rating or de-rating.

Figure 1: Interim results

RMB mn	1H19	2H19	1H20	2H20	1H21	2H21	YoY	HoH
Sales volume (units)	651,680	709,880	530,446	789,771	630,237	697,792	-11.6%	10.7%
ASP (RMB)	75,494	73,489	70,888	74,870	75,258	82,689	10.4%	9.9%
Total revenue	47,559	49,843	36,820	55,294	45,032	56,579	2.3%	25.6%
Gross profit	8,469	8,448	6,302	8,435	7,759	9,653	14.4%	24.4%
Selling exp.	(2,256)	(2,076)	(2,190)	(2,864)	(2,554)	(3,769)	31.6%	47.5%
Admin exp.	(2,455)	(2,667)	(2,675)	(3,079)	(3,251)	(4,785)	55.4%	47.2%
Operating profit	4,371	4,316	2,108	2,861	2,754	1,638	-42.7%	-40.5%
Net profit	4,009	4,180	2,297	3,237	2,381	2,466	-23.8%	3.6%
Gross margin	17.8%	16.9%	17.1%	15.3%	17.2%	17.1%	1.8 ppt	-0.2 ppt
Operating margin	9.2%	8.7%	5.7%	5.2%	6.1%	2.9%	-2.3 ppt	-3.2 ppt
Net margin	8.4%	8.4%	6.2%	5.9%	5.3%	4.4%	-1.5 ppt	-0.9 ppt

Source: Company data, CMBIGM

Figure 2: Earnings revision

RMB mn	New		Old		Diff (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	139,073	151,600	125,390	135,200	10.9%	12.1%
Gross profit	23,354	25,115	21,580	23,804	8.2%	5.5%
Operating profit	6,394	6,739	9,389	10,580	-31.9%	-36.3%
Net profit	6,628	8,256	8,789	11,237	-24.6%	-26.5%
Gross margin	16.8%	16.6%	17.2%	17.6%	-0.4 ppt	-1.0 ppt
Operating margin	4.6%	4.4%	7.5%	7.8%	-2.9 ppt	-3.4 ppt
Net margin	4.8%	5.4%	7.0%	8.3%	-2.2 ppt	-2.9 ppt

Source: CMBIGM estimates

Figure 3: CMBI estimates vs consensus

RMB mn	CMBIGM		Consensus		Diff (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	139,073	151,600	131,879	156,846	5.5%	-3.3%
Gross profit	23,354	25,115	23,128	28,320	1.0%	-11.3%
Operating profit	6,394	6,739	9,552	12,270	-33.1%	-45.1%
Net profit	6,628	8,256	9,799	12,514	-32.4%	-34.0%
Gross margin	16.8%	16.6%	17.5%	18.1%	-0.7 ppt	-1.5 ppt
Operating margin	4.6%	4.4%	7.2%	7.8%	-2.6 ppt	-3.4 ppt
Net margin	4.8%	5.4%	7.4%	8.0%	-2.7 ppt	-2.5 ppt

Source: Bloomberg, CMBIGM estimates

Figure 4: Geely's SOTP valuation table

	FY22E (RMB mn)	Target P/E Multiple	Target P/S Multiple	Geely's Stake	Target Market Cap (RMB mn)	Target Price (HK\$)
Estimated Core Revenue of Zeekr	18,900	-	3x	60%	34,020	4.2
Estimated Earnings of Geely's Other Businesses	7,572	10x	-	-	75,720	9.3
SOTP					109,740	13.5

Source: CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue	97,401	92,114	101,61	139,07	151,60
Cost of sales	(80,485)	(77,377)	(84,199)	(115,719)	(126,485)
Gross profit	16,917	14,737	17,412	23,354	25,115
Selling exp.	(4,332)	(5,053)	(6,323)	(8,232)	(8,535)
Admin exp.	(5,122)	(5,754)	(8,036)	(9,878)	(11,092)
Other income	1,225	1,039	1,339	1,150	1,250
Operating profit	8,687	4,969	4,393	6,394	6,739
Share-based payments	(5)	(4)	(1,213)	(1,350)	(900)
Net finance costs	108	208	280	350	447
Profit share of asso.&JVs	664	875	1,205	1,356	1,881
Other non-oper exp.	183	392	-	-	-
Pre-tax profit	9,636	6,441	4,665	6,750	8,167
Tax	(1,375)	(866)	(312)	(701)	(817)
Minority interests	(72)	(41)	494	580	907
Net profit	8,190	5,534	4,847	6,628	8,256

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21A	FY22E	FY23E
Profit before taxation	9,636	6,441	4,665	6,750	8,167
Depreciation/amortization	3,733	5,491	6,893	8,367	9,527
Change in working capital	28	(8,947)	3,964	(957)	1,189
Others	(859)	(1,389)	(174)	(356)	(1,429)
Net cash from operating	12,538	1,597	15,348	13,804	17,454
Capex	(7,575)	(7,042)	(6,100)	(9,459)	(9,817)
Others	(3,216)	1,612	(1,059)	(444)	1,452
Net cash from investing	(10,791)	(5,430)	(7,159)	(9,904)	(8,365)
Share issuance	639	6,135	31	10	-
Dividend paid	(2,821)	(2,121)	(1,677)	(1,642)	(1,898)
Others	3,945	(253)	2,562	(2,238)	(294)
Net cash from financing	1,763	3,761	916	(3,870)	(2,192)
Net change in cash	3,510	(72)	9,105	31	6,898
Cash at beginning of the year	15,737	19,281	18,977	28,014	28,045
Exchange difference	34	(232)	(68)	-	-
Cash at the end of the year	19,281	18,977	28,014	28,045	34,942

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21A	FY22E	FY23E
Current assets	50,014	50,935	65,296	76,616	87,884
Cash & equivalents	19,281	18,977	28,014	28,045	34,942
Account receivables	25,845	27,868	31,549	40,655	44,317
Inventories	4,821	3,691	5,522	7,609	8,317
Other current assets	67	399	211	307	307
Non-current assets	57,914	59,881	69,046	72,860	74,325
PP&E	27,070	26,574	30,859	31,008	30,265
Intangibles	17,640	18,653	20,959	21,730	22,690
Deferred income tax	866	970	2,435	2,435	2,435
Other non-current assets	12,337	13,684	14,793	17,687	18,934
Total assets	107,928	110,816	134,341	149,476	162,209
Current liabilities	48,526	41,887	60,351	69,753	76,145
Bank borrowings	-	-	1,907	-	-
Account payables	47,873	41,516	57,393	68,702	75,094
Tax payable	616	340	853	853	853
Other current liabilities	37	30	198	198	198
Non-current liabilities	4,477	4,716	3,770	3,854	3,952
Bank borrowings	2,089	1,960	-	-	-
Long-term payables	2,060	2,335	2,863	2,947	3,045
Other non-current liabilities	327	421	907	907	907
Total liabilities	53,003	46,602	64,120	73,608	80,097
Share capital	168	180	183	183	183
Reserves	50,855	60,038	65,010	71,179	78,238
Non-controlling interests	489	582	1,615	1,093	277
Shareholders' equity	54,436	63,631	68,606	74,775	81,834
Total equity and liabilities	107,928	110,816	134,341	149,476	162,209

Key ratios

YE 31 Dec	FY19A	FY20A	FY21A	FY22E	FY23E
Sales mix (%)					
Automobile	94.3	91.0	86.3	86.8	86.5
Auto parts	5.3	7.6	9.2	8.3	8.6
IP licensing & R&D support	0.4	1.4	4.5	4.9	4.9
Growth (%)					
Revenue	(8.6)	(5.4)	10.3	36.9	9.0
Gross profit	(21.4)	(12.9)	18.2	34.1	7.5
Operating profit	(39.9)	(42.8)	(11.6)	45.6	5.4
Net profit	(34.8)	(32.4)	(12.4)	36.7	24.6
Profit & loss ratio (%)					
Gross margin	17.4	16.0	17.1	16.8	16.6
Operating margin	8.9	5.4	4.3	4.6	4.4
Net profit margin	8.4	6.0	4.8	4.8	5.4
Balance sheet ratio					
Net cash/total equity (x)	0.3	0.2	0.3	0.3	0.4
Current ratio (x)	1.0	1.2	1.1	1.1	1.2
Receivable turnover days	98	115	117	110	110
Inventory turnover days	22	17	24	24	24
Payable turnover days	218	198	254	220	220
Profitability (%)					
ROE	16.5	9.4	7.3	9.2	10.5
ROA	8.2	5.1	4.0	4.7	5.3
Per share data (RMB)					
EPS	0.89	0.56	0.48	0.66	0.82
DPS	0.23	0.17	0.17	0.20	0.25

Source: Company data, CMBIGM estimates

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