Equity Research l China l Auto

26 April 2017

China Auto Sector

Rising inventory pressure in near term

	Ticker	Rec	Mkt cap (US$m)	Ccy	Price	PT	Up/ dn (%)	PER 2017E	PER 2018E	PBR 2017E	PBR 2018E	EV/EBITDA 2017E	EV/EBITDA 2018E
Geely	0175 HK	Buy	13,020	HKD	10.8	12.5	15.7%	12.0	9.4	3.0	2.4	7.3	5.9
GAC	2238 HK	Buy	18,936	HKD	11.82	14.1	19.3%	15.3	13.3	1.3	1.2	24.2	21.0
BAIC	1958 HK	Buy	7,742	HKD	7.9	10	26.6%	7.2	6.4	1.1	1.0	3.5	3.2
GWM	2333 HK	Hold	15,441	HKD	9.05	9.9	9.4%	10.1	9.5	1.4	1.2	7.2	6.6
BYD	1211 HK	Buy	19,191	HKD	45.95	53	15.3%	25.2	19.5	2.0	1.8	10.9	9.2
Brilliance	1114 HK	NR	8,331	HKD	12.84	NA		12.0	9.1	2.1	1.8		

Source: Bloomberg, CSCI estimates

- **The average inventory at the Chinese auto dealers rose to 56 days in March-17, a record high since 2014, with the S. Korean brands maintaining the highest inventory level of 84 days, followed by the French brand and domestic brands with a 64 day and 59 day average inventory level respectively, according to CPCA.**
- **Given the uncertainty of subsidy qualification prior to announcement of the subsidy approval list in 1Q17 and 20% cash subsidy cut from FY17 onwards, NEV sales have declined 7.7% YoY in 1Q17 versus a 122% YoY upsurge in 1Q16, which, as expected, had brought about dramatic declines in earnings for NEV upstream suppliers in 1Q17.**
- **We remain cautious on the OEM segment in 2Q17. In stock picks, we reiterate our Buy rating on Geely (175.HK Buy) given its capacity constraints from AT gearbox suppliers will be alleviated after Jun-Jul this year, and we also reiterate our Buy rating on GAC (2238.HK Buy) on the back of the improving margins of the *Trumpchi* brand and strong model cycle of its JVs.**

Weak sales in 1Q17 bring about the rising inventory. In view of a 5.4% YoY wholesale sales growth of PVs in 1Q17, which has significantly outperformed total PV retail sales growth of -0.5% YoY, we believe the laggard retail sales growth has reflected the truly weak demand from the end-consumers while the higher wholesale growth suggested inventory was piling up for dealers. Furthermore, we noticed that the average inventory level at the Chinese auto dealers has risen to a 3-year high of 56 days , mainly attributable to the troubled South Korean brands with the highest average stock levels of 84 days, as well as the French and domestic brands with a 69 days and 59 days inventory, respectively.

Slowing NEV sales growth weighed on the upstream suppliers' 1Q17 results. Total NEV sales in 1Q17 amounted to 55,939 units, down 4.7% YoY, primarily due to the delayed announcement of the list of subsidy-approved NEVs this year, which has resulted in the reduced production of OEMs in 1Q17 and also dampened the sales of NEV upstream suppliers and thus, it is not surprising that majority of the suppliers have witnessed a dramatic decline in earnings post their 1Q17 preliminary results. Though NEV sales growth is gradually picking up, upstream suppliers' profitability will remain under pressure as a result of the 20% subsidy cut this year, in our view.

Stock picks. We remain cautious on OEM segment in 2Q17. In stock picks, we reiterate our Buy rating on Geely (175.HK Buy) given its capacity constraints from AT gearbox suppliers will be largely alleviated in Jun-Jul this year, and we also reiterate our Buy rating on GAC (2238.HK Buy) on the back of the improving margins of the *Trumpchi* brand and strong model cycle of its JVs.

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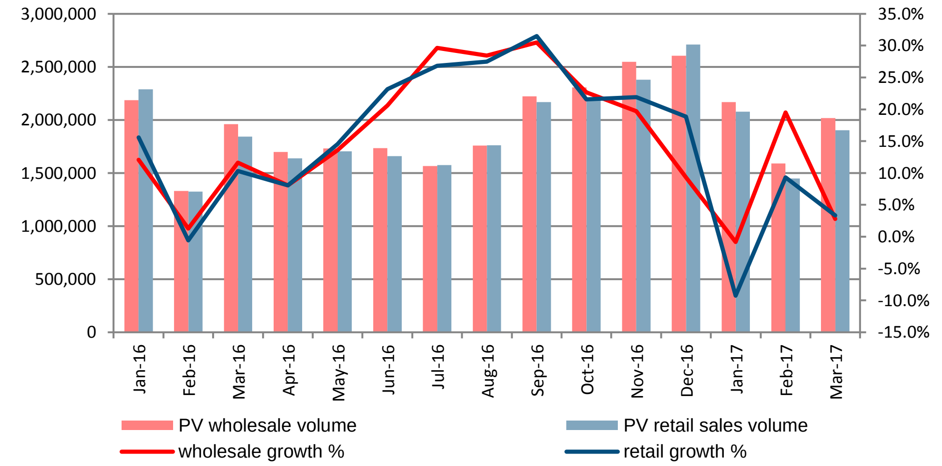
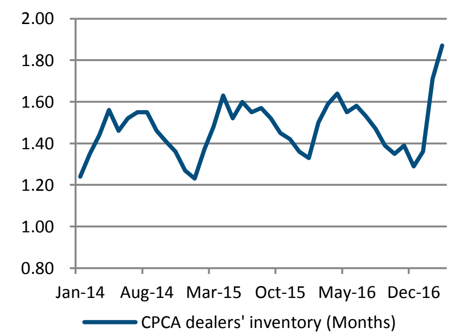
Figure 1: PV wholesale and retail sales growth



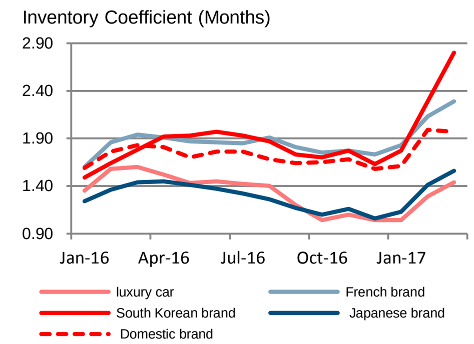
Source: CPCA, CSCI Research

Figure 2: Dealers' inventory



Source: CPCA, CSCI Research

Figure 3: Inventory by brands



Source: CPCA, CSCI Research

Figure 4: NEV upstream suppliers posted declines in earnings in 1Q17

Category	RMBmn	FY16 revenue YoY %	FY16 earnings YoY %	1Q17 performance and preliminary results
Battery packs	002074.SZ	73.3%	76.3%	Preliminary results: 1Q17 earnings down by 28% - 41% YoY due to weak orders.
	300014.SZ	73.4%	66.4%	Preliminary resluts: 1Q17 earnings will be increased by 40% - 70% YoY.
	000839.SZ	39.8%	-34.5%	N/A
Electrolytes	002709.SZ	94.3%	298.1%	1Q17 revenue grew by 10% YoY, net profits slided 10% YoY, gross margin dropped to 36% from 41% in 1Q16
	002407.SZ	30.7%	1119.1%	1Q17 have posted 25% YoY growth of revenue and 38% YoY decline of net profits, gross margin dropped to 27% from
	002759.SZ	21.1%	29.3%	N/A
	300037.SZ	70.1%	100.5%	1Q17 have posted 30% YoY growth of revenue and 27% YoY growth of net profits, gross margin dropped to 39% (41% in
	002411.SZ	84.3%	65.0%	Preliminary results: the NEV business revenue slide may result in the 5%-35% YoY decline of the total net profits in 1Q17.
	603026.SH	26%*	294.0%	N/A
	002091.SZ	14.3%	20.3%	Preliminary results: 1Q17 earnings up by 43% - 61% YoY
	600884.SH	27.3%	-50.3%	Preliminary results: 1Q17 earnings up by 60% - 110% YoY due to strong NEV battery business.
Positive Electrode	002070.SZ	28.3%	139.3%	Preliminary results: 1Q17 earnings will be ranged between -RMB20mn and -RMB15mn compared to -RMB4.6mn in 1Q16.
	000760.SZ	2.8%	123.8%	Preliminary results: The losses in 1Q17 will be c.RMB44mn compared to loss of RMB35mn in 1Q16.
	002466.SZ	109.1%	510.0%	The renvenue and earnings grew by 41% and 42% YoY respectively in 1Q17.
	002460.SZ	110.1%	271.0%	N/A
	000762.SZ	-23.6%	-31.4%	Preliminary results: the earnings of 1Q17 will turn to be loss-making in the range between RMB19mn to RMB29mn compared to RMB23.4mn profits in 1Q16.
	002176.SZ	234.3%	400.9%	N/A
	600773.SH	261.2%	17.5%	N/A
	300224.SZ	16.2%	21.1%	Preliminary results: 1Q17 NEV revuenue will post a dramatic slide due to new policy strike, earnings will down by 70% - 90% YoY.
Separator	300568.SZ	19.0%	31.3%	Both the revenue and eanrnings in 1Q17 have posted dramatic decline of 13.2% YoY and 34.1% YoY respectively due to weak demand.
	002108.SZ	27.1%	127.0%	Preliminary results: revenue up by 43% YoY and lead to earnings jump by 32% YoY.
Negative Electrode	835185.OC	42.3%	47.1%	N/A

*Source: WIND, CSCI Research. * represents the market consensus.*

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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: >=10%
Hold	12-month absolute total return: >-10% but <10%
Sell	12-month absolute total return: <=-10%

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