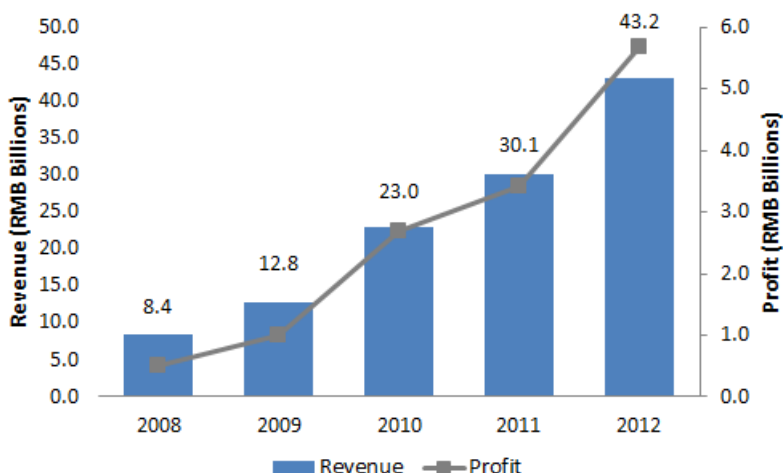

EMERGING MARKET CONSUMER GROWTH IN AUTOMOBILES: GREAT WALL MOTOR COMPANY

Jeremy Schwartz – Global Chief Investment Officer
12/02/2013

As I highlighted in a [previous blog post](#), automobile ownership in China represents a major theme of [emerging market consumer growth](#), as more people enter the middle class and see their disposable income rise. In this post, I profile a Chinese automobile company in the [WisdomTree Emerging Markets Consumer Growth Index](#) (WTECMG) that has the potential to capitalize from this trend: the Great Wall Motor Company (GWM). The Great Wall Motor Company, as a brand, is to China what General Motors or Ford is to the United States. • GWM is currently the number one SUV brand in China and has had the top-selling domestic SUV model for 10 consecutive years.¹ • The company's pick-up truck sales have ranked first in the Chinese market in terms of sales volume of pick-up trucks for 15 consecutive years.² During the six-month reporting period ending June 2013, the Great Wall Motor Company sold 370,000 units of automobiles, representing a 41.33% increase from the same period in 2012.³ This was outsized growth compared to the Chinese auto industry in general, which saw 10.7 million units sold in the first half of 2013, or a 12.3% increase.⁴ According to the Great Wall Motor Company, "SUV models, especially those that boasted high price-performance, brand equity and stunning exterior design, continued to maintain a relatively high growth, with aggregate sales volume growth surpassing the overall growth rate of the PRC [People's Republic of China] automobile market for several years in a row."⁵ Great Wall Motor's Haval H6 model continues to provide strong sales, while the newly launched Haval M4, a smaller SUV model, has also seen robust demand. Overall, the group's SUV models saw a 77.96% increase in sales during the first six months of 2013 compared to the same period in 2012. **Historical Sales and Profitability** To put the recent growth in context, it is interesting to also note the company's historical growth rate in sales and profitability: **Figure 1: Great Wall Motor Company Sales and Profitability (RMB Billions)**



Source: Great Wall Motor Co. 2012 Annual Report. Past performance is not indicative of future results.

• **Impressive Historical**

Growth – Similar to its most recent reporting period, the Great Wall Motor Company has seen impressive growth in sales and profitability over the past five years. Revenue is up by a factor of 5, while profits have grown by a factor of 11. Even more impressive than the annual growth rate was Great Wall’s ability to grow profitability twice as fast as sales over the period. Typically, when profitability increases faster than revenues, it’s a sign that a company is experiencing higher [margins](#) and increased efficiency, which is also beneficial for future growth.

• **Profit Growth Exceeded Stock Return** – As a result of these impressive results, Great Wall Motor Company stock appreciated over 511%, or 43.6% on an average annual basis, from December 31, 2007, to December 31, 2012. This is even a more impressive considering the [MSCI China](#) was down 16% over the period, or -3.5% on an average annual basis. Although some might be concerned that [valuations](#) have become stretched, I think it is important to remember that profitability grew even faster than price over the period, essentially indicating that the valuations have actually improved from a price-to-earnings perspective.

Potential Outlook Despite market concerns over China’s economic growth prospects, it is expected that domestic consumption will continue to grow steadily due to the country’s colossal potential [purchasing power](#).⁴ The Great Wall Motor Company is aggressively investing in its brand, trying to grow market share through constant improvement of its product mix via yearly updates and by launching new products such as the Haval H2, H7 and H8 models. Since investors are easily enamored with the theme of consumer growth in emerging markets, we believe that [valuation risk](#) is one of the single greatest risks to consumer-oriented stocks and sectors in the emerging markets today. Even after discussing the above profitability growth, one might consider Great Wall Motor Company as potentially overvalued after it has grown over 90% for the first 10 months of the year, but we would point to both the [price-to-earnings ratio](#) and [growth expectations](#) for perspective. Although it is currently trading at a higher valuation than both the domestic and broader emerging markets from a price-to-earnings ratio, it doesn’t look overvalued after incorporating its expected growth expectations, displayed through the [PEG ratio](#).

Name	YTD Performance	P/E Ratio	Long-Term Growth Estimate	PEG Ratio
Great Wall Motor Co.	93.96%	14.7x	25.5%	0.58
MSCI China Index	-0.25%	9.7x	12.1%	0.80
MSCI Emerging Markets Index	0.28%	12.2x	10.1%	1.21

Sources: Bloomberg, WisdomTree. Information as of 10/28/13. Year-to-date performance (12/31/12–10/28/13). Past performance is not indicative of future results. Subject to change. You cannot invest directly in an index.

Conclusion

Regardless of WTEMCG’s current positioning, the biggest ongoing benefit of the methodology, I believe, comes from the ongoing disciplined rebalancing process. The fast growth rates of autos in emerging countries and large numbers of possible purchases are two elements that have the potential to make investors forget some of the more basic elements of investing—such as valuation. From a selection standpoint, for constituents

to maintain inclusion, higher [earnings yields](#) will be favored over lower earnings yields. From a weighting standpoint, qualifying firms whose price levels rise but whose earnings stay stable or decline will tend to see reductions in weight. At each annual rebalance, depending on the market environment, the natural focus of the Index will continue to be sensitive to valuation. The Great Wall Motor Company exemplifies the theme of the WTEMCG, as it is a company well positioned to benefit from a major macroeconomic trend of a rising consumer and middle class in China—but the investment strategy has a disciplined focus on valuations, and GWM does not appear expensive, given its growth trajectory. *For current holdings of the WisdomTree Emerging Markets Consumer Growth Index, please click [here](#).* ¹Source: <http://www.gwm-global.com/company/index.html>. ²Source: <http://www.gwm-global.com/company/index.html>. ³Source: Great Wall Motor Company 2013 Interim Report. ⁴Sources: Great Wall Motor Company and China Association of Automobile Manufacturers. ⁵Source: Great Wall Motor Company 2013 Interim Report.

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DEFINITIONS

WisdomTree Emerging Markets Consumer Growth Index: A fundamentally weighted index designed to measure the performance of emerging market equities that have a potential heightened sensitivity to increased emerging market consumption. Weighting is by earnings.

Profit margins: Net income divided by total sales. Higher values indicate a greater fraction of each dollar of sales being left to the firm and its owners after expenses are accounted for.

MSCI China Index: A free float-adjusted, market capitalization-weighted equity index designed to measure the performance of the Chinese equity market.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Purchasing power parity: Academic concept stating that exchange rates should adjust so that equivalent goods and services cost the same across countries, after accounting for exchange-rate differences.

Valuation risk: The risk of buying or over-weighting a particular stock that has appreciated significantly in price relative to its dividends, earnings or any other fundamental metric.

Long-Term Earnings Growth Expectations: Compilation of analyst estimates of the growth in operating earnings expected to occur over the next full business cycle, typically 3 to 5 years, sourced from Bloomberg.

PEG ratio: A stock's price-to-earnings ratio divided by the growth rate of its earnings.

Earnings yield: The earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company.