

20 November 2014

Brilliance China (1114.HK)

It may slow down in a short time, but will not impact the long term advantage

Rating:

Buy

HONG KONG | AUTOMOBILE | COMPANY UPDATES

- BMW group announced the result in the third quarter of 2014. Its investment returns up 37% yoy to 170 million Euros, corresponding to RMB 1.3 billion Yuan. According to our estimation, the investment returns contributed by BMW Brilliance in the third quarter will amount to RMB 1.4 billion Yuan, and the cumulative investment returns contributed in the first three quarters will exceed 5 billion Yuan, corresponding to EPS before tax about 1.01 Yuan, which indicates that the result in the first three quarters has already exceeded the result in the full year of last year by around 40%.
- BMW Brilliance has totally delivered about 70 thousand units in the third quarter of 2014, strongly upping 33% yoy, while the growth in the first two quarters was respectively 51% and 26%. SUV model X1 ups 94% yoy to 11.9 thousand units and 3-SERIS ups 73% yoy to 24.8 thousand units, while 5-SERIS was basically flat, slightly upping 3.2% to 33.6 thousand units.

How we view this

Based on three causes, we believe that the growth ratio of BMW Brilliance will slow down in a short term. However, in terms of a middle and long run, benefited from the major background of improving localization and updating consumption, we are still positive about premium cars' future development in China. We think that at the moment, it is hard to substantially change the approach of domestic premium cars' sales system in a short time, namely, the anti-monopoly investigation and parallel import have a slight influence on the powerful position of OEM car manufacturers, which, on the opposite, is good for BMW Brilliance to speed up its nationalization so as to highlight its cost advantage

Investment Action

According to above, we lowered our target price to HK\$15.67, based on 12.3/10.7/8.8xP/E in 2014/2015/2016, but raise the rating to "buy".

Key Financial Summary

FYE	12/13	12/14F	12/15F	12/16F
Revenue (RMB mn)	6103	6090	6321	6781
Net Profit, adj. (RMB mn)	3374	5046	5785	6976
EPS, adj. (RMB)	0.67	1.00	1.15	1.39
P/E (X),adj.	14.7	9.9	8.6	7.1
BVPS (RMB)	2.59	3.46	4.56	5.60
P/B (X)	3.8	2.9	2.2	1.8
DPS (RMB)	0.08	0.11	0.13	0.17
Div. Yield (%)	0.8%	1.1%	1.3%	1.7%

Source: Bloomberg, PSR est.

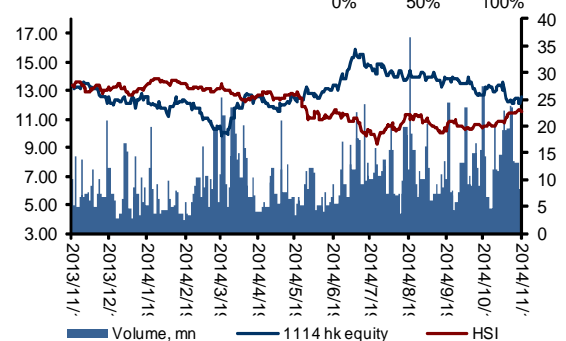
*All multiples & yields based on current market price

Upgrade to Buy	
Target Price (HKD)	15.67
Forecast Dividend (HKD)	0.14
Closing Price (HKD)	12.58
Potential Return	25.7%

Company Description

Brilliance mainly engaged in manufacturing and selling light trucks and components, the main products is Jinbei Haise, with the largest shares consistently, and high-end saloon car BMW 3&5 series, SUV X1 from BMW Brilliance Automobile(BBA), its 50%-50% JV, which is the main source of the Group's profits.

Raw Beta (Past 2yrs w weekly data)	0.90
Market Cap. (HKD bn)	63,224
Enterprise Value (HKD mn)	49,762
52 week range (HKD)	9.5 - 16.14
Closing Price in 52 week range	



Major Shareholders

1. Huachen Automotive Group Holdings	42.48%
2. Templeton Asset Management Ltd	18.02%

Valuation Method

P/E

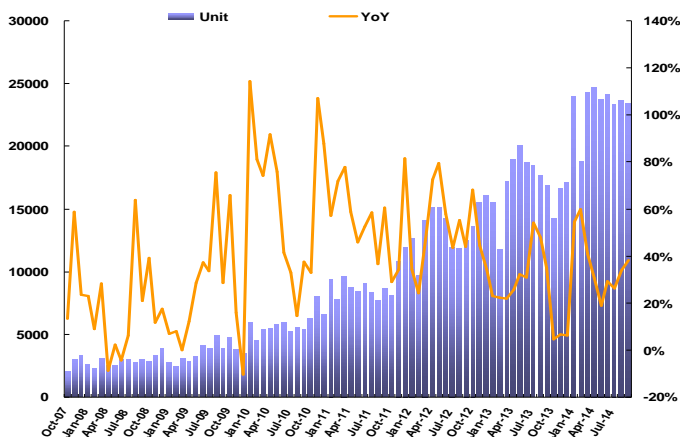
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Result of BMW Brilliance in the third quarter continues to have a rapid growth

BMW group announced the result in the third quarter of 2014. Its investment returns up 37% yoy to 170 million Euros, corresponding to RMB 1.3 billion Yuan. According to our estimation, the investment returns contributed by BMW Brilliance in the third quarter will amount to RMB 1.4 billion Yuan, and the cumulative investment returns contributed in the first three quarters will exceed 5 billion Yuan, corresponding to EPS before tax about 1.01 Yuan, which indicates that the result in the first three quarters has already exceeded the result in the full year of last year by around 40%.

Fig 1. BBA's monthly sales (units)



Source: Company, PSR

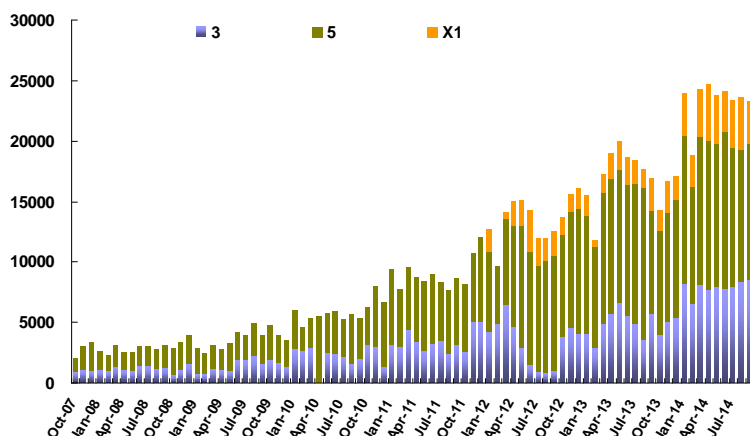
Sales momentums remain robust

BMW Brilliance has totally delivered about 70 thousand units in the third quarter of 2014, strongly upping 33% yoy, while the growth in the first two quarters was respectively 51% and 26%. Benefiting from the expanded production capacity, 3-SERIS and X1 were the detailed segments which had the rapidest growth judging from vehicle models. SUV model X1 ups 94% yoy to 11.9 thousand units in the third quarter this year, and 3-SERIS ups 73% yoy to 24.8 thousand units.

On the other hand, due to the limited production capacity of Dadong plant, the sales volume of 5-SERIS in the third quarter was basically flat, slightly upping 3.2% to 33.6 thousand units. Before the expansion project is put into operation, we believe that the increment of BMW Brilliance's sales volume will be still mainly contributed by 3-SERIS and X1 in a short period of time.

The company's sales target in 2014 is 260 thousand units, up over 30% yoy, and the sales volume achieved in the first three quarters has accounted for 80.8% of the target, so it will be a high probability event to outperform the target for the year.

Fig 2. BBA's monthly sales by models (units)



Source: Company, PSR

Production capacity expansion advances steadily

In order to successfully implement the new future strategy planning issued in July this year and expand the production line of domestic car models, the promotion work of BMW Brilliance's total production capacity is being steadily carried out. The expansion engineering of Dadong plant is planned to be accomplished in April next year. By the end of 2015, the total production ability of BMW Brilliance in Shenyang will be raised from the current 300 thousand units per year to 400 thousand units per year. And it is hopefully to be continuously raised to 600 thousand units approximately in 2016.

After the new engine factory of BMW Brilliance is built, three-cylinder and four-cylinder gasoline engines will be officially put into production in 2016, supporting the new future small cars' introduction. This will have positive promotion effects on Brilliance BMW's production amount and profits.

It may slow down in a short time, but will not impact the long term advantage

Based on the following causes, we believe that the growth ratio of BMW Brilliance will slow down in a short term:

- 1) The nearest new model, 2-series, will not be released until the fourth quarter of 2015; the new generation of X1 is likely to be launched in 2016; the new generation of the fifth series is planned to be launched in 2017. In a short period, there is a lack of new models.
- 2) Confronted with competitors' challenges, (for instance, competitive new models of Benz and Audi are released one after another), BMW's dealers are under a growing pressure of de-stocking and price-off promotions.
- 3) The expansion project of Dadong factory is in progress, which may affect the 5-series' ' production ability.

However, in terms of a middle and long run, benefited from the major background of improving localization and updating consumption, we are still positive about premium cars' future development in China. We think that at the moment, it is hard to substantially change the approach of domestic premium cars' sales system in a short time, namely, the anti-monopoly investigation and parallel import have a slight influence on the powerful position of OEM car manufacturers, which, on the opposite, is good for BMW Brilliance to speed up its nationalization so as to highlight its cost advantage.

Fig 3. BMW's SUV X3



Source: Company, PSR

Fig 4. BMW's 2 series Active Tourer



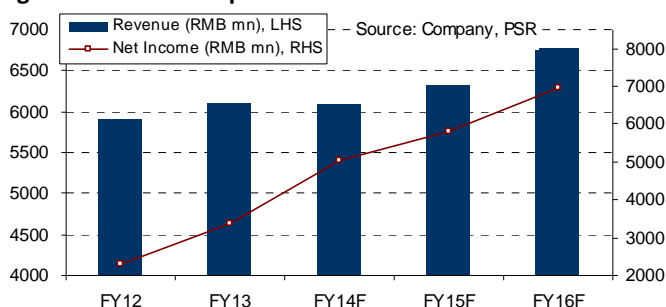
Source: Company, PSR

Valuation

We believe that, after experiencing the explosive growth in past few years, the increase rate of China's luxury car market begins to slow down, with structure-based and pluralism market development trend becoming apparent, so BMW's accelerated introduction of segmentation products is conducive to continuous development of new segment markets.

According to above, we lowered our target price to HK\$15.67, based on 12.3/10.7/8.8xP/E in 2014/2015/2016, but raise the rating to "buy".

Fig 5. View of BC's top line and bottom line in IS



Source: Company, PSR

Fig 6. Peer's comparison

Name	Ticker	Mkt Cap (USD M)	BEst P/B	BEst P/E 2FY	BEst P/E 1FY	BEst P/E 2FY	BEst Curr EBITDA	ROA P/B	ROA LF	ROE	Dvd Yld	OPM LF	GM LF	PM LF
Average		83748	1.1	1.0	8.5	8.0	8.3	1.2	3.7	14.4	0.0	9.1	19.2	6.3
VOLKSWAGEN AG	VOW	100645	0.8	0.8	7.7	7.1	7.2	0.9	3.2	12.3	N/A	6.6	17.3	6.0
BAYERISCHE MOTORENBW		66851	1.4	1.3	9.4	8.9	9.5	1.5	4.1	16.6	N/A	11.5	21.2	6.7
Average		15322	0.7	0.7	9.0	8.5	9.1	0.7	-0.7	-8.1	0.0	2.7	18.1	1.7
RENAULT SA	RNO	21814	0.7	0.6	9.0	6.6	9.5	0.7	1.7	5.6	N/A	3.7	19.0	3.8
PEUGEOT SA	UG	8829	0.7	0.7	N/A	10.4	8.7	0.7	-3.0	-21.7	N/A	1.7	17.1	-0.4
Average		9621	2	2	9	8	28	2	13	24	2	4	16	38
BRILLIANCE CHINA AUT1114		7881	2.8	2.2	9.8	8.5	N/A	2.9	24.5	35.1	0.9	-5.6	8.7	145.4
BYD CO LTD-H	1211	16280	3.5	3.0	92.8	47.8	22.2	3.5	0.6	2.1	0.1	5.1	14.9	1.4
GREAT WALL MOTOR C2333		15223	2.5	2.1	10.5	8.2	8.1	2.9	16.9	30.3	2.9	16.9	26.0	14.4
DONGFENG MOTOR GF489		12289	1.0	0.9	5.9	5.5	37.4	1.1	10.9	21.0	2.1	3.5	14.4	27.5
CHONGQING CHANGAN200625		10787	2.4	1.8	8.5	6.3	18.8	2.6	11.6	32.6	N/A	-1.0	16.2	15.2
GUANGZHOU AUTOMOE2238		7495	1.0	0.9	10.3	7.9	72.0	1.1	5.7	9.5	3.2	-1.1	9.9	16.0
GEELY AUTOMOBILE H 175		4052	1.3	1.2	10.7	9.0	5.4	1.5	7.6	15.4	1.3	13.8	20.3	11.0
Average		26414	2.1	1.7	9.4	8.0	4.2	2.7	7.2	27.1	0.4	10.3	0.0	6.1
TATA MOTORS LTD	TTMT	26414	2.1	1.7	9.4	8.0	4.2	2.7	7.2	27.1	0.4	10.3	0.0	6.1
Average		42980	1.7	1.6	12.2	10.9	7.4	1.9	6.6	19.4	2.3	7.3	22.7	5.6
TOYOTA MOTOR CORP 7203		204628	1.4	1.3	10.5	9.4	10.5	1.4	4.8	13.5	N/A	10.1	19.9	8.2
HONDA MOTOR CO LTD7267		56997	1.0	1.0	10.6	9.4	8.9	1.1	4.0	10.5	2.3	5.5	24.7	4.7
NISSAN MOTOR CO LTC7201		41721	1.0	0.9	9.9	8.8	9.7	1.0	3.1	10.2	N/A	5.2	18.1	4.7
DENSO CORP 6902		41288	1.5	1.4	16.0	14.4	7.3	1.5	5.9	9.6	N/A	7.3	17.1	5.1
FUJI HEAVY INDUSTRIE 7270		28067	3.2	2.7	12.5	11.0	6.1	3.7	11.9	27.8	N/A	14.9	29.4	8.5
SUZUKI MOTOR CORP 7269		17386	1.4	1.3	16.0	14.7	5.1	1.5	4.0	8.4	N/A	5.5	26.5	2.3
MAZDA MOTOR CORP 7261		14386	1.9	1.7	9.1	9.2	6.4	2.2	9.4	31.3	N/A	6.4	26.7	5.9
MITSUBISHI MOTORS C 7211		10167	1.9	1.6	9.7	9.3	4.6	2.0	8.1	39.6	N/A	6.1	21.9	6.3
HINO MOTORS LTD 7205		7772	2.3	2.0	12.3	10.8	6.9	2.5	8.4	24.6	N/A	6.1	18.2	4.3
YAMAHA MOTOR CO L17272		7384	1.9	1.8	15.0	12.0	8.9	2.0	6.2	17.9	N/A	5.9	24.6	5.5
Average		28016	0.9	0.8	6.1	5.7	5.6	0.8	7.6	14.0	0.0	6.4	20.3	6.4
HYUNDAI MOTOR CO 005380		35483	0.8	0.7	5.7	5.4	6.5	0.7	5.7	11.3	N/A	7.7	21.2	7.1
KIA MOTORS CORP 000270		20548	1.0	0.9	6.5	6.0	4.6	1.0	9.4	16.8	N/A	5.0	19.4	5.8
Average		24001	2.2	2.1	21.9	14.3	12.0	2.1	1.6	7.0	0.0	3.3	22.7	2.1
VOLVO AB-B SHS	VOLVB	24001	2.2	2.1	21.9	14.3	12.0	2.1	1.6	7.0	N/A	3.3	22.7	2.1
Average		64571	2	1	12	9	6	2	3	17	3	4	16	5
DAIMLER AG-REGISTEFDDAIF		81992	1.4	1.3	9.5	9.1	9.1	N/A	4.2	17.6	N/A	8.5	22.6	8.3
FORD MOTOR CO F		59809	2.2	1.8	14.0	9.6	5.3	2.3	3.0	26.5	3.7	1.4	11.6	2.4
GENERAL MOTORS CO GM		51912	1.3	1.1	12.2	7.4	3.4	1.3	1.7	7.6	2.8	3.1	13.2	3.7

Source: Bloomberg, PSR

FYE DEC	FY12	FY13	FY14F	FY15F	FY16F
Valuation Ratios					
P/E (X), adj.	22.1	14.7	9.9	8.6	7.1
P/B (X)	5.1	3.8	2.9	2.2	1.8
Dividend payout Yield (%)	0.0%	11.7%	11.0%	11.3%	12.3%
Dividend Yield (%)	0.0%	0.8%	1.1%	1.3%	1.7%
Per share data (RMB)					
EPS, (Basic)	0.458	0.671	1.004	1.151	1.388
EPS, (Diluted)	0.456	0.669	1.000	1.147	1.382
DPS	0.00	0.08	0.11	0.13	0.17
BVPS	1.99	2.59	3.46	4.56	5.60
Growth & Margins (%)					
Growth					
Revenue	-8.2%	3.2%	-0.2%	3.8%	7.3%
EBIT	15.9%	42.7%	70.4%	11.4%	20.2%
Net Income, adj.	27.0%	46.6%	49.6%	14.6%	20.6%
Margins					
Gross margin	11.8%	11.2%	10.2%	10.5%	10.9%
EBIT margin	40.5%	56.0%	95.6%	102.5%	114.8%
Net Profit Margin	38.9%	55.3%	82.9%	91.5%	102.9%
Key ratios (%)					
ROE	27.1%	29.3%	33.2%	28.7%	27.3%
ROA	15.9%	19.3%	24.2%	22.6%	22.6%
Income Statement (RMB mn)					
Revenue	5916	6103	6090	6321	6781
Gross profit	696	687	621	664	739
EBIT	2395	3416	5820	6481	7787
Profit before tax	2295	3325	5696	6341	7646
Tax	-58	-8	-456	-438	-528
Profit for the period	2237	3316	5240	5903	7118
Minority interests	-64	-58	194	118	142
Total capital share	5024	5026	5026	5026	5026
Net profit	2301	3374	5046	5785	6976

Source: PSR



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

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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