EQUITY RESEARCH

Dongfeng (489.HK)

Weighting of SUV continued to boost

Hong Kong | Automobile | Update Report

28 October 2015

• Dongfeng recorded 15% yoy growth in total revenue in 2015H1. Such growth is mainly due to the change in basis of consolidation and the increase in sales of new models of passenger vehicles. The increase of total cost (+18.6%) surpassed the growth of revenue. The comprehensive gross profit margin decreased by 2.5 ppts to approximately 18.5%, as compared to approximately 21.0% of the corresponding period last year.

• Profit attributable to shareholders dropped 19% yoy to RMB6.885 billion, because of the absence of the one-off earning of RMB2.3 billion incurred in the corresponding period last year from the acquisition of equity of PSA Group. If such influence is excluded, the net profit would slightly increase about 3.5% yoy.

• The increase in selling and administrative expenses is relatively stable: up 11.4% yoy to RMB8.9 billion. The increase in selling expenses was mainly attributable to the additional advertisement expenses for new products; while the increase in administrative expenses was mainly due to the increase in labor cost and D&A. The Company recorded gain on foreign exchange as a result of the depreciation of Euro; and the financial expenses dropped significantly from RMB311 million in the corresponding period last year to RMB302 million.

• Passenger vehicle segment performed better than commercial vehicle segment. The profitability of commercial vehicle segment declined drastically, with revenue dropped 16% yoy. Gloomy market demand caused profits contribution from segment of commercial vehicles sharply shrank approximately 70%. On the other hand, profits contribution from segment of passenger vehicles grew approximately 9% yoy. Benefitted from low comparison benchmark and keen demand, the Company`s financing service segment maintained its rapid growth.

• Upon intensive launching of new models of SUVs, the Company`s sale turnover of SUVs grew rapidly. In the previous 9 months, the Company`s total sale turnover of SUVs increased 85% yoy, which accounted for nearly 40% among passenger vehicles (higher than 21% in 2014 and 35% in 2015H1). In 2015H2, the Company would continue to introduce highlighted new models of SUVs, including the compacted SUVs “new Murano” and the compact SUV “New Qashqai” of Dongfeng Nissan. We anticipated the sale momentum of the passenger vehicle segment would still come from SUVs.

• We think the sale of vehicles of both the Company`s own brands and the French brands would highly benefitted from the 50% reduction of purchase tax recently implemented by the Chinese authority as automobile consumption stimulating policy, followed by Dongfeng Nissan and then Dongfeng Honda. The Company`s sale turnover of passenger vehicles would experience a strong rebound, and this would facilitate the re-evaluation of the Company`s valuation.

Investment Thesis

As a large-scale SOE, the run-in period caused by the recent change of management level, as well as the hinder caused by the business of commercial vehicles in the doldrums, are the major risks faced by Dongfeng in short term. According to the latest data, we adjusted the 2015 and 2016 EPS to RMB1.42 and RMB1.64 respectively. We also adjusted our target price as HKD12.59, which is equivalent to prospective 2015/2016 PE ratios of 7.3x/6.3x P/E, and we recommend an "Accumulate" rating. (Closing price as at 26 October 2015)

Accumulate (Maintain)

CMP: HKD 11.20

(Closing price as at 26 October 2015)

TARGET: HKD 12.59 (+12.4%)

COMPANY DATA

O/S SHARES (MN) :	8616
MARKET CAP (HKD MN) :	31984
52 - WK HI/LO (HKD):	14.48 / 7.02

SHARE HOLDING PATTERN, %

Dongfeng Motor Corporation	66.86

PRICE VS. HSI

Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	161253	195211	222721	245289
Net Profit	10528	12845	12263	14108
EPS, CNY	1.22	1.49	1.42	1.64
P/E, x	7.2	5.9	6.5	5.6
BVPS, CNY	7.33	8.24	9.29	10.09
P/BV, x	1.2	1.1	1.0	0.9
DPS (CNY)	0.18	0.20	0.20	0.23
Div. Yield (%)	2.0%	2.3%	2.2%	2.5%

Source: Company reports, Phillip Securities Est.

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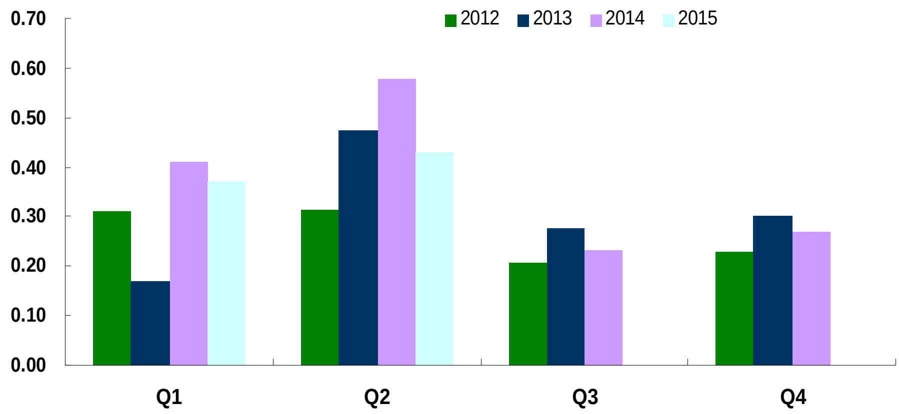
Review on H1 results

Based on the proportionate consolidation method (applicable in the text below), Dongfeng Motor recorded 15% yoy growth in total revenue in 2015H1. Such growth is mainly due to the change in basis of consolidation and the increase in sales of new models of passenger vehicles. The increase of total cost (+18.6%) surpassed the growth of revenue. The comprehensive gross profit margin decreased by 2.5 ppts to approximately 18.5%, as compared to approximately 21.0% of the corresponding period last year. We considered the drop of gross profit margin as the result of the decline of commercial vehicle business.

The increase in selling and administrative expenses is relatively stable: up 11.4% yoy to RMB8.9 billion. The increase in selling expenses was mainly attributable to the additional advertisement expenses for new products; while the increase in administrative expenses was mainly due to the increase in labour cost and depreciation and amortization. The Company recorded gain on foreign exchange as a result of the depreciation of Euro; and the financial expenses dropped significantly from RMB311 million in the corresponding period last year to RMB302 million.

Profit attributable to shareholders dropped 19% yoy to RMB6.885 billion, because of the absence of the one-off earning of RMB2.3 billion incurred in the corresponding period last year from the acquisition of equity of PSA Group. If such influence is excluded, the net profit would slightly increase about 3.5% yoy.

Dongfeng`s EPS by quarters



Source: Company, Phillip Securities Hong Kong Research

An inventory turnover day was approximately 36 days, representing a decrease of 2 days as compared to the corresponding period last year. The turnover days of receivables decreased by approximately 8 days to 72 days. The Company`s cash flow significantly improved, with net cash and cash equivalents increased RMB11.49 billion. Net cash flow from operating activities increased 145% yoy to RMB13.1 billion. Equity ratio of the Company dropped 4.6 ppts to 27.1%; while the liquidity ratio increased from 1.08 times to 1.15 times.

Business of commercial vehicles segment declined, but passenger vehicles segment improved; and financing service segment surged

In 2015H1, the Company`s total sale of vehicles dropped 3.6% yoy to 1.34 million, of which passenger vehicle segment performed better than commercial vehicle segment. The sale turnover of passenger vehicles in H1 generally kept stable, with a slight decrease of 1.6% to 1.16 million; while sale turnover of commercial vehicles declined 14.4% yoy, to approximately 180,000 units.

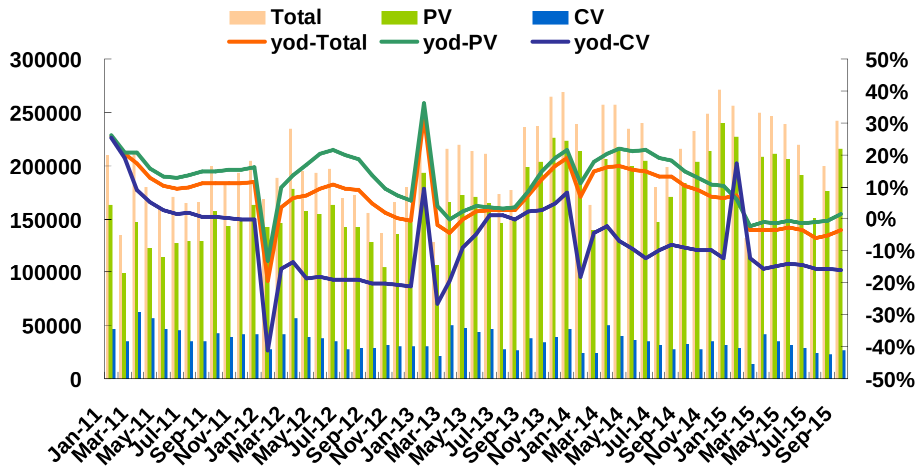
In view of the business results of various segments, the profitability of commercial vehicle segment declined drastically, with revenue dropped 16% yoy. Gloomy market demand caused profits contribution from segment of commercial vehicles sharply shrank approximately 70%. On the other hand, profits contribution from segment of passenger vehicles grew approximately 9% yoy.

Benefitted from low comparison benchmark and keen demand, the Company`s financing service segment maintained its rapid growth. Revenue of financing service segment increased 33% yoy; with profits contribution grew 50% as compared to the corresponding period last year. We regarded the profitability of financing service segment as excellent, with profit margin being as high as approximately 50%. The current scale of operation is rather small and only accounted for about 10% in the core profit of the Company. However, it has great development potentials.

Weighting of SUV continued to boost

Upon intensive launching of new models of SUVs, the Company`s sale turnover of SUVs grew rapidly. The total sale turnover of SUVs in H1 surged 77% yoy, or 54% mom, to 409,000 units, and offset the downturn of sale of sedans and MPVs. In the previous 9 months, the Company`s total sale turnover of SUVs increased 85% yoy, which accounted for nearly 40% among passenger vehicles (higher than 21% in 2014 and 35% in 2015H1). In 2015H2, the Company would continue to introduce highlighted new models of SUVs, including the compacted SUVs “new Murano” and the compact SUV “New Qashqai” of Dongfeng Nissan. The Company planned to introduce 13 new vehicle models in 2016, among which 5 models are SUVs. With the recently launched and sales volume increasing Dongfeng Honda XRV and C3—XR of Dongfeng Peugeot Citroën, we anticipated the sale momentum of the passenger vehicle segment would still come from SUVs.

Dongfeng`s monthly sales



Source: Company, Phillip Securities Hong Kong Research

In regard to vehicles of the French brands, the Company is speeding up the collaboration with Peugeot Citroën Group which acquired Dongfeng`s equity previously, and moving towards a full value chain. On the other hand, the recovery of the European vehicle market would assist PSA group to stay away from plight and is expected to bring investment gain for the Company. What`s more, Dongfeng Renault started trial production and is expected to commence production as scheduled. Two models of SUVs are expected to be produced in 2016. We think the sale of vehicles of both the Company`s own brands and the French brands would highly benefitted from the 50% reduction of purchase tax recently implemented by the Chinese authority as automobile consumption stimulating policy, followed by Dongfeng Nissan and then Dongfeng Honda. The Company`s sale turnover of passenger vehicles would experience a strong rebound, and this would facilitate the re-evaluation of the Company`s valuation.

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Financials

FYE DEC	FY12	FY13	FY14	FY15F	FY16F
Valuation Ratios					
P/E (X), adj.	8.6	7.2	5.9	6.5	5.6
P/B (X)	1.4	1.2	1.1	1.0	0.9
Dividend payout Yield (%)	14.2%	14.7%	13.4%	14.1%	14.0%
Dividend Yield (%)	1.7%	2.0%	2.3%	2.2%	2.5%
Per share data (RMB)					
EPS, reported	1.06	1.22	1.49	1.42	1.64
EPS, adj.	1.06	1.22	1.49	1.42	1.64
DPS	0.15	0.18	0.20	0.2	0.23
BVPS	6.3	7.3	8.2	9.3	10.1
Growth & Margins (%)					
Growth					
Revenue	-5.6%	30.0%	21.1%	14.1%	10.1%
EBIT	-12.0%	20.7%	20.0%	-6.3%	18.7%
Net Income, adj.	-13.3%	15.8%	22.0%	-4.5%	15.0%
Margins					
EBIT margin	10.5%	9.7%	9.6%	7.9%	8.5%
Net Profit Margin	7.3%	6.5%	6.6%	5.5%	5.8%
Key Ratios					
ROE (%)	18.13%	17.99%	19.15%	16.23%	16.90%
ROA (%)	7.83%	7.36%	6.90%	5.83%	6.04%
Income Statement (RMB mn)					
Revenue	**124036**	**161253**	**195211**	**222721**	**245289**
Gross profit	23876	31900	38321	40313	45869
EBIT	12986	15679	18807	17614	20907
Profit before tax	12758	15448	19197	18248	21160
Tax	(2919)	(3989)	(5237)	(4562)	(5502)
Profit for the period	9779	11459	13960	13686	15659
Minority interests	(687)	(931)	(1115)	(1423)	(1550)
Total capital share	8616	8616	8616	8616	8616
Net profit	**9092**	**10528**	**12845**	**12263**	**14108**

Source: PSR

(Financial figures as at 26 October 2015)

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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