

## Nexteer Automotive Group Limited

Steering ahead

Nexteer's FY14 results, as expected, beat consensus moderately by 3% although they were shy of JPMe by 3% mainly on higher depreciation charges. Management's call reaffirms our thesis that a strong and quality backlog will be a key factor driving the company's top line and margin through mix improvement. We stay OW on the stock.

- Five structural drivers to focus on:**
  - 1) US\$9bn backlog** by end-14 implies not only three years of future revenue stream but potential upside to current margin as 65% of backlog is high-margin and high-ASP product: electric power steering (EPS). This compares with 56% revenue in FY14 from EPS (Table 3).
  - 2) China** sales outgrew (+79% yoy) other geographies and accounted for 16% of revenue in FY14 - one year earlier than our anticipation of exceeding 15%. Key OEM customers such as SAIC and its key models definitely play a key role.
  - 3) N. America** should benefit from robust momentum in light truck sales (i.e., SUV and pickup) thanks to low fuel price. Nexteer is a key supplier to both GM and Ford's light truck models.
  - 4) Free cash flow** turned positive in 2H14 - this is one year earlier than management's guidance when the company was listed in 2013. We believe Nexteer will be in a position to raise its dividend payout moderately from FY16 and maintain the current payout of 20% this year.
  - 5) Diversifying customer** away from GM, which accounted for 54% of revenue in FY14 but GM only comprises 41% of Nexteer's US\$9bn backlog, a clear result of the company's diversification efforts as businesses of other OEMs outgrow GM.
- FY14 results read-through and earnings revisions:** Higher depreciation charge (incrementally \$44mn higher than FY13) is the main reason for the small margin miss aside from minor one-off provision charge (\$18mn) but this is offset by lower tax. The significant top-line growth (25%) is in line with our view. We trim our FY15 estimates slightly by 3% to reflect FY14 results.
- Recommendation:** We maintain our OW rating and Dec-15 PT of HK\$8.0 on 12.5x PER and 7x EV/EBITDA, the global average.

### Overweight

1316.HK, 1316 HK

Price: HK\$7.76

Price Target: HK\$8.00

Hong Kong

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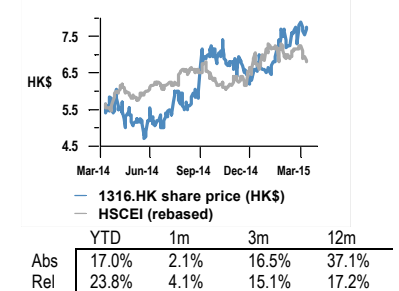
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#### Price Performance



#### Nexteer Automotive Group Limited (Reuters: 1316.HK, Bloomberg: 1316 HK)

\$ in mn, year-end Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue (\$ mn)	2,168	2,387	2,978	3,564	4,095
Net Profit (\$ mn)	57	109	161	205	241
EPS (\$)	-	0.06	0.06	0.08	0.10
DPS (\$)	-	0.00	0.00	0.01	0.01
Revenue growth (%)	(3.6%)	10.1%	24.8%	19.7%	14.9%
EPS growth (%)	-	-	10.5%	27.2%	17.3%
ROE	40.5%	29.6%	25.8%	26.7%	25.2%
P/E (x)	-	17.1	15.5	12.2	10.4
P/BV (x)	-	3.3	3.7	2.9	2.4
Dividend Yield	-	0.0%	0.0%	0.9%	1.3%

Source: Company data, Bloomberg, J.P. Morgan estimates.

#### Company Data

Shares O/S (mn)	2,498
Market Cap (\$ mn)	2,497
Market Cap (\$ mn)	2,497
Price (HK\$)	7.76
Date Of Price	11 Mar 15
Free Float(%)	25.2%
3M - Avg daily vol (mn)	2.12
3M - Avg daily val (HK\$ mn)	15.04
3M - Avg daily val (\$ mn)	1.9
HSCEI	11,417.34
Exchange Rate	7.76
Price Target End Date	31-Dec-15
Price Target (HK\$)	8.00

See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p><b>Key catalysts for the stock price:</b></p> <ol style="list-style-type: none"> <li>1. Fast-growing China market</li> <li>2. Rising EPS penetration</li> <li>3. Diversifying customer base</li> <li>4. Continued growth or recovery in developed markets</li> </ol>	<p><b>Upside risks to our view:</b></p> <p>Better-than-expected sales from the US, Europe or China</p>	<p><b>Downside risks to our view:</b></p> <ol style="list-style-type: none"> <li>1) Worse-than-expected sales in EU and US markets; 2) High client concentration- worse-than-expected sales performance from top customers would be a swing factor to Nexteer's sales; 3) Unexpected moves in raw material costs and FX exposure. 4) Unexpected deceleration in Chinese auto market.</li> </ol>
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Key financial metrics	FY13A	FY14E	FY15E	FY16E
Revenues (LC)	2,387	2,978	3,564	4,095
Revenue growth (%)	10%	25%	20%	15%
EBITDA (LC)	247	326	380	439
EBITDA margin (%)	10%	11%	11%	11%
Tax rate (%)	27%	24%	24%	24%
Net profit (LC)	109	161	205	241
EPS (LC)	0.06	0.06	0.08	0.10
EPS growth (%)		11%	27%	17%
DPS (LC)	-	-	0.01	0.01
BVPS (LC)	0.30	0.27	0.34	0.42
Operating cash flow (LC mn)	223	254	289	276
Free cash flow (LC mn)	68	97	135	143
Interest cover (X)	11.3	15.1	17.7	19.9
Net margin (%)	5%	5%	6%	6%
Sales/assets (X)	1.6	1.5	1.5	1.6
Debt/equity (%)	85%	96%	89%	77%
Net debt/equity (%)	32%	43%	33%	23%
ROE (%)	30%	26%	27%	25%
Key model assumptions	FY13A	FY14E	FY15E	FY16E
Sales volume growth	2%	7%	5%	3%
Gross margin	14%	14%	15%	15%

Source: Bloomberg, Company data and J.P. Morgan estimates.

Sensitivity analysis	Impact on EBIT		Impact on EPS	
	FY14E	FY15E	FY14E	FY15E
Sensitivity to				
1% decrease in sales volume growth	-1.5%	-3.2%	-1.6%	-3.5%
1% decrease in gross margin	-12.3%	-13.7%	-13.5%	-14.7%

Source: Bloomberg, Company data and J.P. Morgan estimates.

### Global auto parts valuation summary

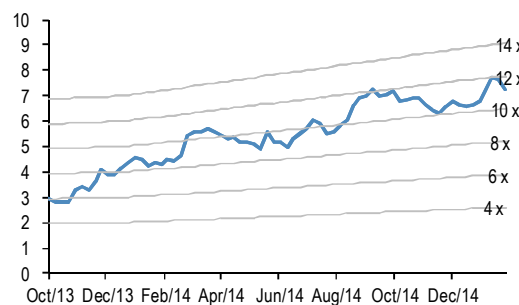
Company	Code	Cover analyst	Rec	Price(LC) 11th Mar	Mkt Cap (US\$ Mn)	PE(x) 15E	PB(x) 15E	ROE 15E	Div 15E	EV/EBITDA 15E
Nexteer Automotive	1316 HK	Nick Lai	OW	7.8	2,497	11.8	2.8	27%	0.9%	6.6
Minth Group	425 HK	Nick Lai	N	14.9	2,108	10.3	1.3	14%	3.1%	9.1
Mando Corp	204320 KS	Wan Sun Park	OW	168,000	1,395	7.6	0.8	11%	0.6%	4.8
Faurecia	EO FP	Jose M Asumendi	OW	43.4	5,693	14.4	n/a	20%	n/a	4.1
Valeo Sa	FR FP	Jose M Asumendi	OW	138.5	11,642	15.1	n/a	24%	n/a	6.6
Autoliv Inc	ALV US	Ryan Brinkman	N	110.8	9,826	16.7	2.8	17%	2.0%	7.9
Borgwarner Inc	BWA US	Ryan Brinkman	OW	59.1	13,385	16.9	3.3	21%	0.9%	10.3
Delphi Automotive	DLPH US	Ryan Brinkman	OW	77.6	22,564	14.3	8.6	61%	1.4%	8.5
Gentex Corp	GNTX US	Ryan Brinkman	N	17.5	5,153	17.4	2.8	18%	1.9%	15.2
Harman Intl	HAR US	Ryan Brinkman	NR	131.5	9,022	22.2	4.5	22%	1.0%	10.0
Johnson Controls	JCI US	Ryan Brinkman	N	48.6	31,918	13.4	2.8	21%	2.1%	10.4
Lear Corp	LEA US	Ryan Brinkman	N	106.1	8,277	10.5	3.2	27%	0.8%	5.9
Magna Intl	MGA US	Ryan Brinkman	N	104.2	21,379	11.1	2.5	22%	1.7%	8.3
Tenneco Inc	TEN US	Ryan Brinkman	OW	55.2	3,382	11.0	4.9	51%	0.0%	6.2
TRW Automotive	TRW US	Ryan Brinkman	N	104.6	12,022	13.1	2.5	21%	0.0%	7.5
<b>Global auto parts average</b>						<b>13.1</b>	<b>2.7</b>	<b>23%</b>	<b>1.1%</b>	<b>7.6</b>

Source: J.P. Morgan estimates, Bloomberg. Notes: (1) Global auto parts averages are simple averages of all auto parts companies covered by J.P. Morgan.

### Valuation and price target basis

Our PT of HK\$8.0/shr (Dec-15) is based on 12.5x forward PER and 7.0x EV/EBITDA, similar to the average of global auto part suppliers. We believe assigning a similar valuation is fair given ~70% of Nexteer's revenue is from the US and ~15% from EU.

### Nexteer forward PER band



Source: Bloomberg, Company data and J.P. Morgan estimates.

### JPM vs. consensus

EPS (USD)	FY15E	FY16E
JPM	205	241
Consensus	199	242
% difference	3%	0%

Source: Bloomberg, Company and J.P. Morgan estimates.

Table 1: Nexteer FY14 result summary

	FY13A	FY14A	diff	FY14 JPMe	diff
Revenue	2,387	2,978	25%	3,027	2%
COGS	2,047	2,558	25%	2,587	1%
Gross profit	339	420	24%	441	5%
Gross margin	14.2%	14.1%		14.6%	
Operating profit	173	237	37%	261	10%
Operating margin	7.2%	8.0%		8.6%	
Pretax profit	151	215	42%	229	7%
Net profit	111	163	47%	169	4%
Net profit after minority	109	161	48%	167	3%
Net margin	4.6%	5.4%		5.5%	
EPS	0.06	0.06	11%	0.07	3%

Source: Company data.

Table 2: Nexteer earnings revisions

US\$m	2015E			2016E		
	Revised	Previous	Change %	Revised	Previous	Change %
Net Sales	3,564	3,634	-2%	4,095	4,173	-2%
Sales growth (%)	19.7%	20.0%		14.9%	14.80%	
COGS	3,033	3,069	-1%	3,476	3,514	-1%
Gross profit	530	565	-6%	618	660	-6%
Gross margin (%)	14.9%	15.6%		15.1%	15.80%	
Operating profit	291	324	-10%	339	383	-12%
Operating margin (%)	8.2%	8.9%		8.3%	9.20%	
Pre-tax profit	270	290	-7%	316	348	-9%
Pretax margin (%)	7.6%	8.0%	-5%	7.7%	8.30%	-7%
Net profit	205	212	-3%	241	254	-5%
Net margin (%)	5.8%	5.8%		5.9%	6.10%	
Net profit growth (%)	27.2%	26.8%		17.3%	20.00%	
EPS (basic)	0.08	0.08	-3%	0.10	0.1	-5%
EPS growth (%)	27%	27%		17%	20%	

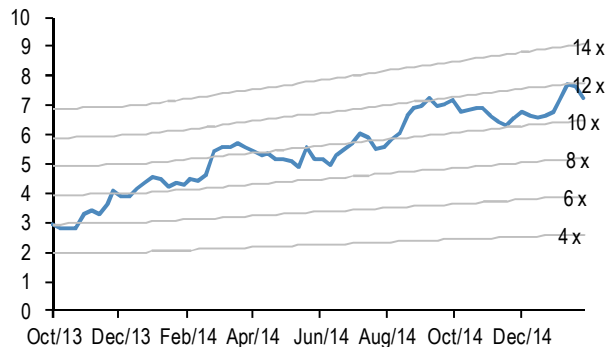
Source: J.P. Morgan.

Table 3: Revenue and backlog breakdown by product

	FY13 Revenue	FY14 Revenue	Backlog
EPS	45%	56%	65%
HPS	13%	6%	3%
Steering Column (CIS)	21%	20%	12%
Driveline/Halfshaft	20%	18%	20%

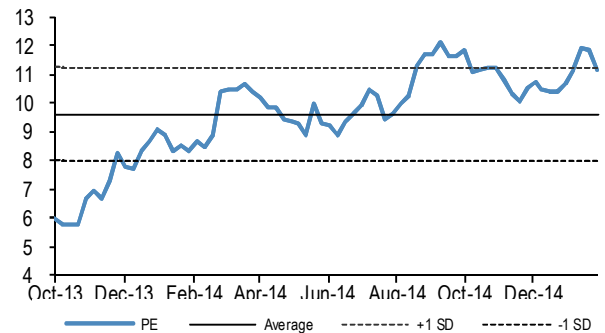
Source: Company data.

Figure 1: Nexteer- forward PER band



Source: Bloomberg, J.P. Morgan estimates.

Figure 2: Nexteer- forward PER band with +/-1.0 standard deviation



Source: Bloomberg, J.P. Morgan estimates.

## Investment Thesis, Valuation and Risks

### Nexteer Automotive Group Limited (*Overweight; Price Target: HK\$8.00*)

#### Investment Thesis

1) China market continues to grow strongly and reached 16% of Nexteer's global revenue in 2014 vs. 11% in 2013. China's stricter regulation on car warranties is likely to further push OEMs to adopt better-quality foreign suppliers in our view. 2) Nexteer announced in 1Q14 that it has successfully penetrated BMW's supply chain and will supply EPS to BMW's "i3" electric vehicle. This is a positive move showcasing Nexteer's technology and capability. 3) Order wins and launches of new product are the main revenue drivers in the US and other markets. 4) In the US, Nexteer's largest market by revenue, the company is anticipated to benefit from a strong momentum in SUV and pickup sales this year given the level of oil price, per forecast of our US auto analyst Ryan Brinkman.

#### Valuation

Our PT of HK\$8.0/shr (Dec-15) is based on 12.5x forward PER and 7.0x EV/EBITDA, similar to the average for global auto part suppliers. We believe assigning a similar valuation of US or global parts is fair given ~70% of Nexteer's revenue is from the US and ~15% is from EU.

#### Risks to Rating and Price Target

1) Worse-than-expected sales in EU and US markets; 2) High client concentration- currently top three OEM customers account for ~70% of revenue. Worse-than-expected sales performance from these customers would be a swing factor to Nexteer's sales; 3) Unexpected move in raw material costs and FX exposure. 4) Unexpected deceleration in Chinese auto market.

## Nexteer Automotive Group Limited: Summary of Financials

Income Statement						Cash flow statement					
\$ in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	\$ in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenues	2,168	2,387	2,978	3,564	4,095	EBIT	84	173	236	291	339
% change Y/Y	(3.6%)	10.1%	24.8%	19.7%	14.9%	Depreciation & amortization	58	74	90	89	101
Gross margin	12.5%	14.2%	14.1%	15.0%	15.1%	Change in working capital	(34)	(56)	(85)	(38)	(101)
EBITDA	142	247	326	380	439	Others	78	61	87	33	36
% change Y/Y	(1.0%)	74.0%	32.1%	16.7%	15.6%	Cash flow from operations	158	223	254	289	276
EBITDA margin	6.5%	10.3%	10.9%	10.7%	10.7%	Capex	(172)	(184)	(173)	(170)	(150)
EBIT	84	173	236	291	339	Cash flow from investing	(273)	(277)	(276)	(184)	(164)
% change Y/Y	(5.9%)	106.2%	36.5%	23.3%	16.2%	Equity raised/(repaid)	0	295	0	0	0
EBIT Margin	3.9%	7.2%	7.9%	8.2%	8.3%	Debt raised/(repaid)	133	47	214	62	51
Net Interest	(22)	(22)	(22)	(21)	(22)	Other	(31)	(38)	(123)	(56)	(66)
Earnings before tax	62	151	215	270	316	Dividends paid	(3)	0	0	0	0
% change Y/Y	(15.3%)	143.2%	41.9%	25.7%	17.3%	Cash flow from financing	99	305	91	6	(15)
Tax	(4)	(40)	(51)	(65)	(76)	Beginning cash	78	64	314	380	491
as % of EBT	5.7%	26.7%	23.9%	23.9%	23.9%	Ending cash	64	314	380	491	588
Net income (reported)	57	109	161	205	241						
% change Y/Y	(14.4%)	91.2%	47.8%	27.2%	17.3%						
Shares outstanding (MM)	0	1,867	2,498	2,498	2,498						
EPS reported \$	-	0.06	0.06	0.08	0.10						
% change Y/Y	-	-	10.5%	27.2%	17.3%						
Balance sheet						Ratio Analysis					
\$ in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	\$ in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Cash and cash equivalents	64	314	380	491	588	EBITDA margin	6.5%	10.3%	10.9%	10.7%	10.7%
Accounts receivable	324	364	525	516	595	Operating margin	3.9%	7.2%	7.9%	8.2%	8.3%
Inventories	174	185	226	249	286	Net margin	2.6%	4.6%	5.4%	5.8%	5.9%
Others	65	76	94	117	95	Sales per share growth	-	-	(6.7%)	19.7%	14.9%
Current assets	628	939	1,226	1,374	1,563	Sales growth	(3.6%)	10.1%	24.8%	19.7%	14.9%
LT investments	-	-	-	-	-	Net profit growth	(14.4%)	91.2%	47.8%	27.2%	17.3%
Net fixed assets	434	563	626	721	784	EPS growth	-	-	10.5%	27.2%	17.3%
Other LT assets	18	32	41	43	44	Assets/equity	7.92	4.15	3.23	3.07	2.75
Total Assets	1,259	1,805	2,236	2,495	2,764	ROE	40.5%	29.6%	25.8%	26.7%	25.2%
Liabilities											
ST loans	97	43	48	48	48						
Payables	296	336	439	415	429						
Others	114	212	195	192	189						
Total current liabilities	507	592	682	655	665						
Long term debt	442	458	634	734	785						
Other liabilities	52	96	134	132	130						
Total Liabilities	1,067	1,214	1,534	1,614	1,683						
Shareholders' equity	171	568	684	856	1,056						
Minorities	21	23	24	24	24						
BVPS	0.00	0.30	0.27	0.34	0.42						

Source: Company reports and J.P. Morgan estimates.

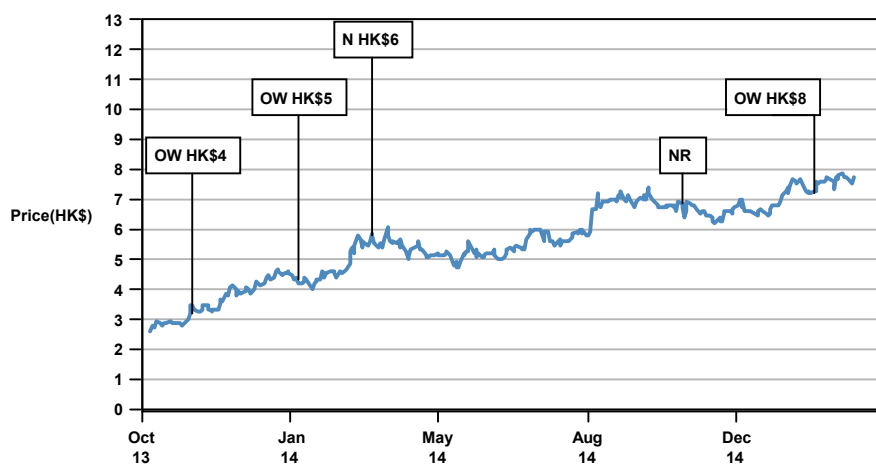
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Nexteer Automotive Group Limited (1316.HK, 1316 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
07-Nov-13	OW	3.21	4.00
24-Jan-14	OW	4.30	5.00
20-Mar-14	N	5.79	6.00
04-Nov-14	NR	6.89	--
09-Feb-15	OW	7.23	8.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
 Break in coverage Nov 04, 2014 - Feb 09, 2015.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

J.P. Morgan ratings or designations: OW = Overweight, N= Neutral, UW = Underweight, NR = Not Rated

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IB clients*	56%	49%	33%
JPMS Equity Research Coverage	45%	48%	7%
IB clients*	75%	67%	52%

\*Percentage of investment banking clients in each rating category.

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