

# Dongfeng Motor (489 HK)

## Hold

Target price (HKD)	12.40
Share price (HKD)	11.80
Upside/Downside (%)	5.1

Dec	2013 a	2014 e	2015 e
HSBC EPS	1.02	1.41	1.51
HSBC PE	9.2	6.7	6.2
Performance	1M	3M	12M
Absolute (%)	-3.9	7.1	13.5
Relative <sup>A</sup> (%)	-3.4	3.1	-8.4

26 March 2015

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## Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Hold: Seemingly in-line results despite distorted YoY comparison

- **FY14 reported NPAT -5.9%YoY to Rmb12,845m, largely in line with consensus. Dividend proposed was Rmb0.2/sh**
- **Based on limited disclosure it seems that company started to consolidate DPCA from 4Q14**
- **Establish Hold rating and set fair value TP of HKD12.4 based on 6.5x 2015e PE**

**Seemingly in-line results but one-off item distorted the consensus.** While the reported FY14 NPAT of Rmb12,845m was largely in line with consensus forecast of Rmb12,594m (HSBCe: 13,649m), we believe part of the consensus have adjusted for the Rmb1.5bn one-off gain arising from company's 14% PSA shareholding which made the adjusted earnings below consensus forecasts.

**Consolidation of DPCA made YoY comparison difficult.** According to the limited disclosure the company started to consolidate Dongfeng Peugeot Citroen Automobile (DPCA) and we estimate the consolidation started from 4Q14 after setting up the DPCA sales company. This has distorted the revenue and JV contribution of the passenger vehicles segment and made YoY and HoH comparison very difficult. Driven by the change of the shareholding structure of its JV and subsidiaries, the company experienced various change of consolidating business throughout the past 3 years. This includes changing its accounting treatment of its JV as required by IFRS for FY12, acquisition and consolidation of the Commercial Vehicle business in FY13 and consolidation the DPCA business in FY14.

**Our concerns lie with the weakness of Japanese brands.** We believe the two Japanese brands DF Nissan and DF Honda would still be facing pressure arising from aging models and high inventory levels at the beginning of the year. In addition the base of wholesale delivery in 1H14 was high last year driven by inventory push. We think the share price will be dragged at least until YoY sales improvement in 2H15.

**Establish Hold rating and set fair value TP of HKD12.4.** The company would hold an analyst briefing at Grant Hyatt Hong Kong at 4:30pm on 26 Mar 2015. We expect the management to reveal more details of the change of the accounting treatment of DPCA and DPCA Sales Co and the breakdown of profitability and earnings contribution of the key JVs. Next catalysts include monthly sales volume and quarterly results at the end of Apr.

Index <sup>A</sup>	HSCEI
Index level	12,005
RIC	0489.HK
Bloomberg	489 HK

Source: HSBC

Enterprise value (CNYm)	19,076
Free float (%)	33
Market cap (USDm)	13,160
Market cap (HKDm)	102,069

Source: HSBC

## Financials & valuation

### Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Profit &amp; loss summary (CNYm)</b>				
Revenue	37,263	60,692	67,426	70,207
EBITDA	-309	2,090	2,615	2,860
Depreciation & amortisation	-782	-1,270	-1,402	-1,528
Operating profit/EBIT	-1,091	820	1,213	1,332
Net interest	374	144	-136	95
PBT	10,712	14,690	13,821	15,320
HSBC PBT	10,712	14,690	13,821	15,320
Taxation	-109	-966	-269	-357
Net profit	10,528	13,649	13,041	14,422
HSBC net profit	8,768	12,140	13,041	14,422

### Cash flow summary (CNYm)

Cash flow from operations	-9,675	-960	953	1,519
Capex	-1,268	-2,667	-2,513	-2,701
Cash flow from investment	17,982	-1,349	12,612	7,797
Dividends	-1,521	-1,551	-2,047	-1,956
Change in net debt	-2,661	3,859	-11,518	-7,360
FCF equity	-10,137	-2,094	-903	-294

### Balance sheet summary (CNYm)

Intangible fixed assets	4,019	4,147	4,406	4,691
Tangible fixed assets	18,454	22,603	24,451	26,435
Current assets	57,622	70,134	85,665	95,314
Cash & others	24,282	35,423	46,940	54,300
Total assets	115,998	144,924	166,445	182,645
Operating liabilities	46,089	49,498	53,095	55,297
Gross debt	5,875	20,875	20,875	20,875
Net debt	-18,407	-14,548	-26,065	-33,425
Shareholders funds	63,135	73,577	85,383	98,839
Invested capital	9,724	11,964	14,487	16,842

### Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Y-o-y % change</b>				
Revenue	511.9	62.9	11.1	4.1
PBT	17.0	37.1	-5.9	10.9
HSBC EPS	-2.9	37.5	7.4	10.6

### Ratios (%)

Revenue/IC (x)	4.7	5.6	5.1	4.5
ROIC	-12.9	9.5	11.2	10.4
ROE	13.9	16.5	15.3	14.6
ROA	12.1	10.9	9.2	9.0
EBITDA margin	-0.8	3.4	3.9	4.1
Operating profit margin	-2.9	1.4	1.8	1.9
Net debt/equity	-29.2	-19.8	-30.5	-33.8
Net debt/EBITDA (x)	59.6	-7.0	-10.0	-11.7

### Per share data (CNY)

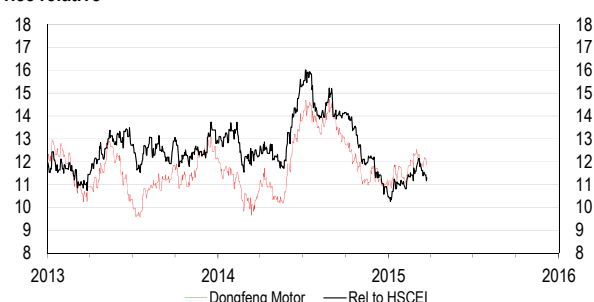
EPS reported (fully diluted)	1.22	1.58	1.51	1.67
HSBC EPS (fully diluted)	1.02	1.41	1.51	1.67
DPS	0.18	0.24	0.23	0.25
Book value	7.33	8.54	9.91	11.47

### Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
PE*	9.2	6.7	6.2	5.6
P/Book value	1.3	1.1	1.0	0.8
FCF yield (%)	-22.2	-6.2	-3.0	-1.2
Dividend yield (%)	1.9	2.5	2.4	2.7

Note: \* = Based on HSBC EPS (fully diluted)

### Price relative



Source: HSBC

Note: price at close of 25 Mar 2015

# FY14 results summary

- ▶ FY14 reported NPAT -5.9%YoY to Rmb12,845m, largely in line with consensus. Dividend proposed was Rmb0.2/sh
- ▶ Based on limited disclosure it seems that company started to consolidate DPCA from 4Q14
- ▶ Establish Hold rating and set fair value TP of HKD12.4 based on 6.5x 2015e PE

## FY14 results summary

(RMBm)	FY14	FY13	YoY%	HSBC FY14e	Var%	Cons FY14	Cons vs actual
<b>Revenue</b>	<b>80,954</b>	<b>37,263</b>	<b>117.3%</b>	<b>60,692</b>	<b>33.4%</b>	<b>60,934</b>	<b>32.9%</b>
Cost of sales	(70,244)	(32,582)	115.6%	(51,884)	35.4%	(52,513)	33.8%
<b>Gross Profit</b>	<b>10,710</b>	<b>4,681</b>	<b>128.8%</b>	<b>8,807</b>	<b>21.6%</b>	<b>8,421</b>	<b>27.2%</b>
Gross margin %	13.2%	12.6%		14.5%		13.8%	
Other income/other gains and losses	856	737	16.1%	537	59.3%		
Selling and distribution expenses	(4,134)	(2,268)	82.3%	(3,309)	24.9%		
Administrative expenses	(3,281)	(2,179)	50.6%	(3,179)	3.2%		
Other expenses	(3,408)	(2,062)	65.3%	(2,036)	67.4%		
<b>EBIT</b>	<b>743</b>	<b>(1,091)</b>	<b>N.A.</b>	<b>820</b>	<b>N.A.</b>		
EBIT Margin %	0.9%	-2.9%		1.4%			
Interest income	685	544	25.9%	652	5.0%		
Finance costs	504	(170)	N.A.	(508)	N.A.		
<b>Share of profit of joint ventures</b>	<b>10,662</b>	<b>11,176</b>	<b>-4.6%</b>	<b>11,156</b>	<b>-4.4%</b>		
Share of profit of associates	2,089	253	725.7%	2,570	-18.7%		
<b>Profit before tax</b>	<b>14,683</b>	<b>10,712</b>	<b>37.1%</b>	<b>14,690</b>	<b>-0.1%</b>	<b>14,661</b>	<b>0.2%</b>
Income tax	(1,365)	(109)	1152.3%	(966)	41.3%		
Net profit after tax	13,318	10,603	25.6%	13,724	-3.0%		
Attributable to							
<b>Owner of company</b>	<b>12,845</b>	<b>10,528</b>	<b>22.0%</b>	<b>13,649</b>	<b>-5.9%</b>	<b>12,594</b>	<b>2.0%</b>
Non-controlling interests	473	75	530.7%	75	530.7%		

Source: Company, HSBC estimates, Bloomberg consensus

Disclosure by proportionate consolidation

	Consolidated			Joint ventures			Proportionate consolidation		
	FY14	FY13	YoY%	FY14	FY13	YoY%	FY14	FY13	YoY%
<b>Revenue</b>									
Passenger vehicles	36,701	11,905	208.3%	104,976	104,915	0.1%	141,677	116,820	21.3%
Commercial vehicles	42,672	24,557	73.8%	10,314	19,948	-48.3%	52,986	44,505	19.1%
Financing service and others	1,710	855	100.0%	1,903	1,419	34.1%	3,613	2,274	58.9%
Intra-segment elimination	(129)	(54)		(2,936)	(2,292)		(3,065)	(2,346)	
<b>Total</b>	<b>80,954</b>	<b>37,263</b>	<b>117.3%</b>	<b>114,257</b>	<b>123,990</b>	<b>-7.8%</b>	<b>195,211</b>	<b>161,253</b>	<b>21.1%</b>
<b>COGS</b>	<b>(70,244)</b>	<b>(32,582)</b>	<b>115.6%</b>	<b>(86,646)</b>	<b>(96,771)</b>	<b>-10.5%</b>	<b>(156,890)</b>	<b>(129,353)</b>	<b>21.3%</b>
<b>Gross profit</b>	<b>10,710</b>	<b>4,681</b>	<b>128.8%</b>	<b>27,611</b>	<b>27,219</b>	<b>1.4%</b>	<b>38,321</b>	<b>31,900</b>	<b>20.1%</b>
Gross margin%	13.2%	12.6%		24.2%	22.0%	10.1%	19.6%	19.8%	
Other income & interest income	1541	1281	20.3%	3,149	3,473	-9.3%	4,690	4,754	-1.3%
Selling and distribution costs	(4,134)	(2,268)	82.3%	(7,034)	(7,322)	-3.9%	(11,168)	(9,590)	16.5%
Administrative expenses	(3,281)	(2,179)	50.6%	(3,479)	(3,348)	3.9%	(6,760)	(5,527)	22.3%
Other expenses	(3,408)	(2,062)	65.3%	(5,145)	(4,248)	21.1%	(8,553)	(6,310)	35.5%
Finance costs	504	(170)	N.A.	(114)	(61)	86.9%	390	(231)	N.A.
<b>Share of profit of associates</b>	<b>2,089</b>	<b>253</b>	<b>725.7%</b>	<b>188</b>	<b>199</b>	<b>-5.5%</b>	<b>2,277</b>	<b>452</b>	<b>403.8%</b>
Share of profit of JV	10,662	11,176	-4.6%						
Profit before tax	14,683	10,712	37.1%	15,176	15,912	-4.6%	19,197	15,448	24.3%
Income tax	(1,365)	(109)	1152.3%	(3,872)	(3,880)	-0.2%	(5,237)	(3,989)	31.3%
Net profit	13,318	10,603	25.6%	11,304	12,032	-6.1%	13,960	11,459	21.8%
<b>Net profit to shareholders</b>	<b>12,845</b>	<b>10,528</b>	<b>22.0%</b>	<b>10,662</b>	<b>11,176</b>	<b>-4.6%</b>	<b>12,845</b>	<b>10,528</b>	<b>22.0%</b>
Non-controlling interests	473	75	530.7%	642	856	-25.0%	1,115	931	19.8%

Source: Company

# Segmental breakdown

(RMB m)	FY14	FY13	YoY%	HSBC FY14e	Var%
<b>Revenue</b>					
Passenger vehicles	36,701	11,905	208.3%	16,447	123.1%
Commercial vehicles	42,672	24,557	73.8%	42,915	-0.6%
Financing service and others	1,581	801	97.4%	1,330	18.9%
<b>Total</b>	<b>80,954</b>	<b>37,263</b>	<b>117.3%</b>	<b>60,692</b>	<b>33.4%</b>
<b>EBIT</b>					
Passenger vehicles	204	(1,071)	-119.0%	(905)	-122.5%
Commercial vehicles	1,037	506	104.9%	1,459	-28.9%
Financing service and others	(498)	(526)	-5.3%	266	-287.3%
<b>Total</b>	<b>743</b>	<b>(1,091)</b>	<b>-168.1%</b>	<b>820</b>	<b>-9.4%</b>
<b>EBIT margin %</b>					
Passenger vehicles	0.6%	-9.0%		-5.5%	
Commercial vehicles	2.4%	2.1%		3.4%	
Financing service and others	-31.5%	-65.7%		20.0%	
<b>Overall</b>	<b>0.9%</b>	<b>-2.9%</b>		<b>1.4%</b>	
<b>Share of profits of JV</b>					
Passenger vehicles	11,314	9,290	21.8%		
Commercial vehicles (ex-one-off gain)	464	864	-46.3%		
Financing service and others	(1,116)	(738)	51.2%		
<b>Total</b>	<b>10,662</b>	<b>9,416</b>	<b>13.2%</b>	<b>11,156</b>	<b>-4.4%</b>
<b>Sales volume (units)</b>					
Dongfeng Nissan	954,151	926,229	3.0%		
Dongfeng Honda	308,216	321,409	-4.1%		
DPCA	704,016	550,007	28.0%		
Dongfeng PV	80,107	80,077	0.0%		
Dongfeng Liuzhou	240,899	180,189	33.7%		
Zhengzhou Nissan	50,635	55,291	-8.4%		
Dongfeng Holdings	1,097	5,249	-79.1%		
<b>Total passenger vehicles</b>	<b>2,339,121</b>	<b>2,118,451</b>	<b>10.4%</b>		
Commercial vehicles	394,388	449,204	-12.2%		
<b>Total vehicle sales volume</b>	<b>2,733,509</b>	<b>2,567,655</b>	<b>6.5%</b>		

Source: Company, HSBC estimates

## Valuation and risks

### Key assumptions

<b>ROE 2015e</b>	<b>15.3%</b>
Cost of equity	13.9%
Rf	3.5%
Equity risk premium	6.5%
Equity beta	1.6
g	0%

Source: HSBC estimates

- ▶ Our key assumptions remain unchanged.
- ▶ We use historical PE method with one standard deviation below the 5-year historical average forward PE, which is 6.5x 2015e PE for Dongfeng.
- ▶ Applying to our 2015e diluted EPS forecast of RMB1.51, our TP is HKD12.4.
- ▶ Our fair value target price of HKD12.4 implies 5.1% upside to the current share price; therefore we establish a Hold rating.

### Key upside risks

**Faster than expected sales recovery of DF Nissan and DF Honda.**

**Higher than expected operating leverage.**

### Key downside risks

**CV business.** Following the re-structuring of the CV business, the earnings disclosure was distorted by the change of percentage of ownership. Given the industry growth of the commercial vehicle market was still under pressure, there is risk that the CV business profitability came at lower than expectation.

**Margin of DF Honda.**

# Disclosure appendix

## Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Carson Ng and Mike Yip

## Important disclosures

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### **From 23rd March 2015 HSBC has assigned ratings on the following basis:**

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

### **Prior to this date, HSBC's rating structure was applied on the following basis:**

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile\*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile\*). Stocks between these bands were classified as Neutral.

\*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

## Rating distribution for long-term investment opportunities

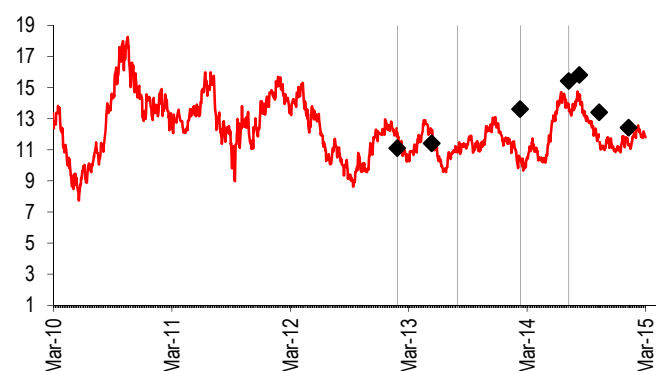
As of 25 March 2015, the distribution of all ratings published is as follows:

Buy	41%	(30% of these provided with Investment Banking Services)
Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

## Share price and rating changes for long-term investment opportunities

Dongfeng Motor (0489.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

### Recommendation & price target history

From	To	Date
N/A	Underweight (V)	17 February 2013
Underweight (V)	Neutral	21 August 2013
Neutral	Overweight	03 March 2014
Overweight	Neutral	31 July 2014
Target Price	Value	Date
Price 1	11.10	17 February 2013
Price 2	11.40	04 June 2013
Price 3	13.60	03 March 2014
Price 4	15.40	31 July 2014
Price 5	15.80	02 September 2014
Price 6	13.40	02 November 2014
Price 7	12.40	01 February 2015

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
DONGFENG MOTOR	0489.HK	11.80	25-Mar-2015	4, 5, 6, 7, 11

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 28 February 2015 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
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- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
- 11 At the time of publication of this report, HSBC is a non-US Market Maker in securities issued by this company and/or in securities in respect of this company

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### Additional disclosures

- 1 This report is dated as at 26 March 2015.
- 2 All market data included in this report are dated as at close 25 March 2015, unless otherwise indicated in the report.
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