

Brilliance Auto (1114 HK)

Hold

Target price (HKD)	15.50
Share price (HKD)	14.40
Upside/Downside (%)	7.6

Dec	2014 a	2015 e	2016 e
HSBC EPS	1.07	1.14	1.40
HSBC PE	10.8	10.2	8.2
Performance	1M	3M	12M
Absolute (%)	-5.3	17.1	43.4
Relative ^A (%)	-4.5	13.1	16.1

27 March 2015

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Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

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: Largely in line results; conservative outlook statement

- ▶ **FY14 NPAT +60.1%YoY to Rmb5,403m, 3%/5% higher than our forecasts/consensus**
- ▶ **Company targets BMW Brilliance (BBA) sales volume to increase 10%YoY in 2015e**
- ▶ **Establish Hold rating with fair value TP of HKD15.5 based on 11.1x 2015e PE**

Largely in-line contribution from BBA. The share of income of BBA rose 61.2%YoY, to Rmb11.1bn, in line with our forecast of Rmb11.0bn. The slightly better than expected results were driven by the less than expected loss for the mini-bus business (LBIT of Rmb320m versus HSBCe of 420m in 2014).

Conservative sales target in 2015e. The sales growth target for BBA is 10%YoY in 2015e. Although the management commented that this is a very conservative target and sees upside risks to this number, we believe this showed the pressure on the sales growth in a weak product cycle. We forecast sales volume to grow by 13%YoY in 2015e but see pressure on pricing as the model continues to age in 2015.

Don't expect immediate FX benefits. Management commented that BMW Brilliance employs rolling hedging strategy for its FX exposure. 90% of the 2015 EUR exposure was hedged earlier therefore they expect limited FX benefits for the JV in 2015. Although the company does not disclose the durations of the hedge, we believe we would only see potential benefits from FX starting from 3Q15 (as EUR began to depreciate rapidly in 3Q14). From a pure FX perspective the JV would benefit from the FX in 2016 and this could be the upside risks to our 2016e forecast, but it is not sure whether BMW will be able to capture some of the FX benefits from the JV through charging higher prices for the components/services.

Establish Hold rating with fair value TP of HKD15.5. We raised our earnings forecast for Brilliance by 2%/4% in 2015e/16e. We establish a Hold rating with fair value TP of HKD15.5 based on ROE-based target 11.1x 2015e PE. Previously, under our old model, our TP was HKD15.2. We think BMW Brilliance would face rising competition from rivals such as Beijing Benz and FAW Audi in 2015/16 but it is at least partially reflected at the current valuation. However we believe that Brilliance's slowdown in growth would be quicker than market expectation and see limited positive catalysts ahead.

Index ^A	HSCEI
Index level	11,969
RIC	1114.HK
Bloomberg	1114 HK

Source: HSBC

Enterprise value (CNYm)	37904
Free float (%)	44
Market cap (USDm)	9,330
Market cap (HKDm)	72,371

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (CNYm)				
Revenue	5,515	7,287	8,298	9,886
EBITDA	-181	-158	17	-52
Depreciation & amortisation	-139	-289	-291	-293
Operating profit/EBIT	-320	-447	-273	-345
Net interest	-103	-106	-89	-83
PBT	5,343	5,631	6,977	8,040
HSBC PBT	5,343	5,631	6,977	8,040
Taxation	-43	-17	-29	-34
Net profit	5,403	5,734	7,068	8,126
HSBC net profit	5,403	5,734	7,068	8,126

Cash flow summary (CNYm)

Cash flow from operations	345	-176	151	408
Capex	-806	-322	-323	-324
Cash flow from investment	661	1,474	1,593	1,942
Dividends	-553	-631	-778	-894
Change in net debt	-572	-682	-966	-1,456
FCF equity	-36	-455	-161	95

Balance sheet summary (CNYm)

Intangible fixed assets	996	985	974	963
Tangible fixed assets	3,060	3,104	3,147	3,189
Current assets	6,345	7,444	8,847	11,026
Cash & others	2,526	3,207	4,174	5,629
Total assets	23,207	28,727	35,586	43,999
Operating liabilities	5,888	6,302	7,002	8,313
Gross debt	1,365	1,365	1,365	1,365
Net debt	-1,161	-1,842	-2,809	-4,264
Shareholders funds	16,931	22,157	28,437	35,658
Invested capital	1,986	2,023	1,792	1,235

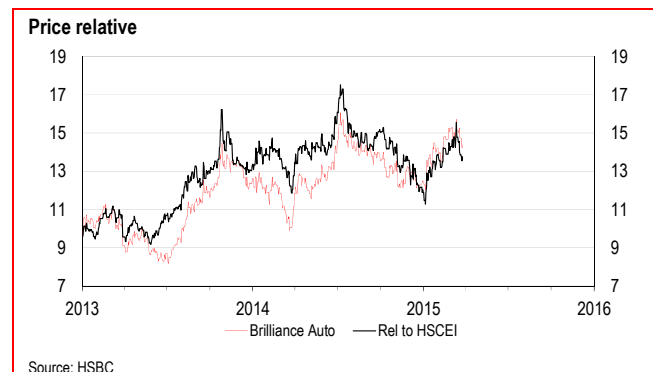
Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	-9.6	32.1	13.9	19.1
PBT	60.1	5.4	23.9	15.2
HSBC EPS	59.5	6.1	23.3	15.0
Ratios (%)				
Revenue/IC (x)	2.7	3.6	4.3	6.5
ROIC	-15.5	-22.2	-14.3	-22.7
ROE	36.1	29.3	27.9	25.4
ROA	25.9	22.2	22.1	20.5
EBITDA margin	-3.3	-2.2	0.2	-0.5
Operating profit margin	-5.8	-6.1	-3.3	-3.5
Net debt/equity	-7.3	-8.7	-10.3	-12.4
Net debt/EBITDA (x)	6.4	11.7	-162.5	81.5
Per share data (CNY)				
EPS reported (fully diluted)	1.07	1.14	1.40	1.61
HSBC EPS (fully diluted)	1.07	1.14	1.40	1.61
DPS	0.11	0.13	0.15	0.18
Book value	3.37	4.41	5.66	7.10

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
PE*	10.8	10.2	8.2	7.2
P/Book value	3.4	2.6	2.0	1.6
Dividend yield (%)	1.0	1.1	1.3	1.5

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



Note: price at close of 25 Mar 2015

FY14 results highlights

- ▶ FY14 NPAT +60.1%YoY to Rmb5,403m, 3%/5% higher than our forecasts/consensus
- ▶ Company targets BMW Brilliance (BBA) sales volume to increase 10%YoY in 2015e
- ▶ Establish Hold rating with fair value TP of HKD15.5 based on 11.1x 2015e PE

Sales target

BMW Brilliance

- ▶ Brilliance targets sales growth of 10% for BMW Brilliance in 2015. Management commented that the target is conservative and see potential upside.
- ▶ We are more positive on the volume growth and forecast sales volume to grow by 13%YoY to 316k units

Mini-bus business

- ▶ The company sets a target of 28% growth for its domestic brand mini-van business in 2015, driven by the launch of new Huasong 7 MPV. Management targets to sell 20k units of the MPV in 2015 and believe the model could achieve total sales of 160-180k units during its 7-year model cycle.

While we are impressed with the performance of the BMW N20 engine which would be equipped on Huasong 7, we are more conservative on the sales volume of this brand new model and forecast sales volume to be 16k units in 2015e.

Volume growth guidance by company for 2015 and our forecast

(units)	2014	Company guidance for 2015	HSBC 2015e
BMW Brilliance	278,529	306,382	315,730
YoY%		10%	13.4%
Brilliance mini-van	77,710	99,469	92,376
YoY%		28%	18.9%

Source: Company data, HSBC estimates

New model launches schedule of BMW Brilliance

New product launching schedule of BMW Brilliance and domestically produced German premium brands

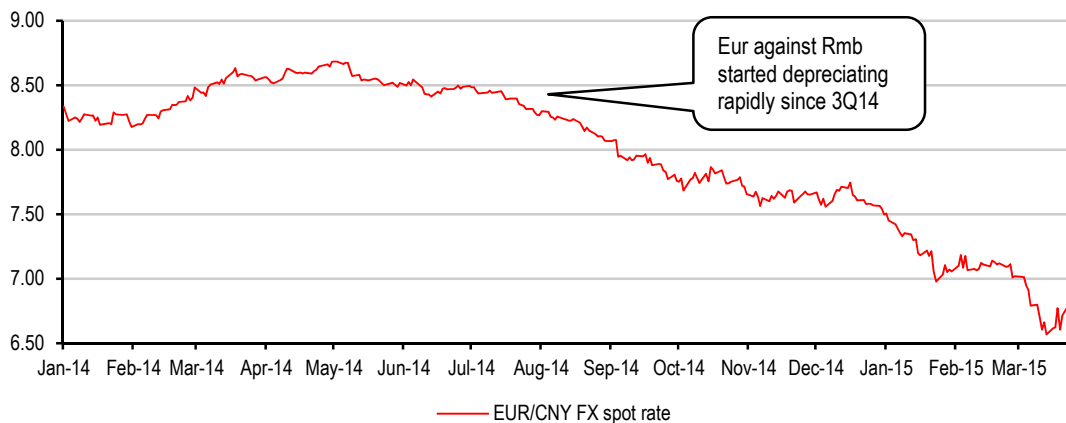
	2014	2015e	2016e	2017e	2018e
BMW		2 Series Active Tourer, C, N/Oct-15 3 Series, D, F/Oct-15	X1, SUV-C, S/Mid-16	2 Series sedan, B/C, N/2017 X3, SUV-D, N/2017 5 Series, E, S/2017	3 Series, D, N/2018
Audi	A3, C, N/1H14 A3 sedan, C, N/2H14	A6, E, F/2015	A4, D, S/2016	Q2, SUV-B, N/2017 Q5, SUV-D, N/2017	
Mercedes	C-Class LWB, D, S/Sep-14	GLA, SUV-C, N/Mar-15 GLC, SUV-D, S/4Q15 C Class, D, S/2015	CLA, C, N/2016 E-Class, E, S/2016		

Source: Company data, HSBC estimates, IHS Auto

Localisation and FX exposure

- ▶ BBA established a rolling hedging strategy for its FX exposure on estimated procurement amount in Eur each year. It has already hedged 90% of its 2015 FX exposure and expects minimum benefit from EUR depreciation this year.
- ▶ Management commented that if the downtrend of EUR against Rmb continues in the long run, BBA should have cost benefit from procurement but the effect would not be immediate.
- ▶ Localisation ratio would increase upon the completion of the engine production plant. As localisation increases, the impact from FX fluctuation would be reduced gradually.

Depreciation of EUR against Rmb started in 3Q14



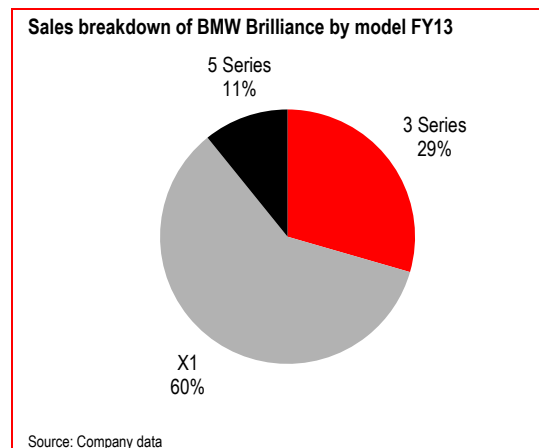
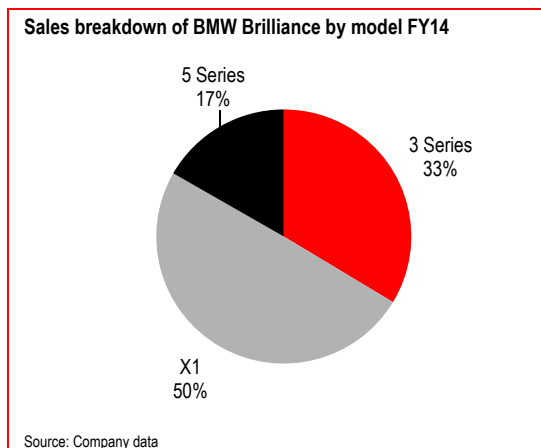
Source: Bloomberg

Capex and R&D expenses

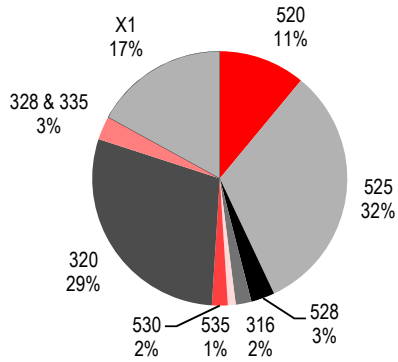
- ▶ The 3rd phase of the Tiexi plant is under construction. In addition to the current generation of 3 series, the plant would product models based on the front wheel drive UKL platform including X1 and 2 series.
- ▶ Total capacity of Tiexi plant would be 400k units per annum and that of Dadong plant would be 200k per annum in medium term. The next generation of X3 would be produced in Dadong plant in 2017.
- ▶ The JV incurred Rmb9bn of capex in 2014 and plan to spend Rmb11bn of capex in 2015. This would be funded by internal cash flow.
- ▶ Depreciation of BBA in 2014 was Rmb1.8bn and expected to be Rmb2.3bn in 2015.
- ▶ R&D expenses in 2014 were Rmb1.6bn, budget in 2015 is about Rmb1.5bn.

Further comments on subsidies to dealers

- ▶ BMW Brilliance and BMW China provided subsidies for their dealers in 2014 as some of them encountered negative gross margin on new car sales.
- ▶ Management commented that the subsidies were within the company's budget and did not have extra negative impact on the margin.
- ▶ We believe the booking of the subsidies would be spread in 2014 and 2015.

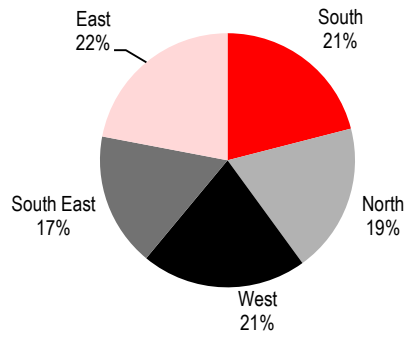


Sales breakdown of BMW Brilliance by variants FY14



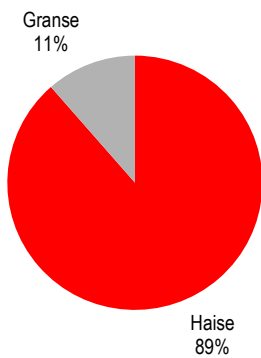
Source: Company data

Sales breakdown of BMW Brilliance by geographic location FY14



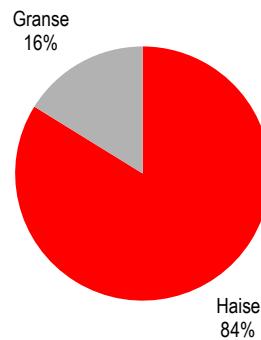
Source: Company data

Sales breakdown of Brilliance minivan FY14



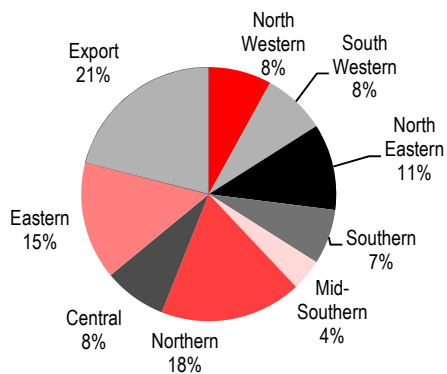
Source: Company data

Sales breakdown of Brilliance minivan FY13



Source: Company data

Sales breakdown of Brilliance minivan by geographic location FY14



Source: Company data

FY14 results review

FY14 results summary

(Rmb m)	1H14	2H14	2014	2013	YoY%	HSBCe 2014e	Var%	Cons 2014	Cons vs actual
Revenue	2,496	3,019	5,515	6,103	-9.6%	5,448	1.2%	6,005	-8.2%
Cost of sales	(2,278)	(2,674)	(4,952)	(5,417)	-8.6%	(4,964)	-0.2%	(5,397)	-8.2%
Gross profit	218	345	562	687	-18.1%	485	16.0%	608	-7.5%
GP Margin %	8.7%	11.4%	10.2%	11.2%	-9.3%	8.9%		10.1%	
Other net income	27	77	104	96	8.3%	50	108.4%		
Selling expenses	(230)	(355)	(585)	(608)	-3.8%	(572)	2.3%		
Administrative expenses	(188)	(214)	(402)	(399)	0.5%	(383)	4.9%		
EBIT	(173)	(147)	(320)	(225)	42.2%	(420)	-23.8%		
EBIT margin %	-6.9%	-4.9%	-5.8%	-3.7%		-7.7%			
Interest income	23	30	54	47	14.4%	42	26.6%		
Finance costs, net	(77)	(80)	(156)	(139)	12.8%	(150)	4.0%		
Share of results of:									
Associates	122	107	229	206	11.0%	242	-5.5%		
Jointly controlled entities	3,689	1,848	5,537	3,448	60.6%	5,464	1.3%		
Profit before tax	3,585	1,758	5,343	3,338	60.1%	5,179	3.2%	5,139	4.0%
Income tax credit (expense)	(5)	(38)	(43)	(8)	412.7%	(16)	171.0%		
Net profits after tax	3,579	1,720	5,300	3,329	59.2%	5,163	2.7%		
Equity holders of the Company	3,628	1,776	5,403	3,374	60.1%	5,243	3.1%	5,146	5.0%
Non-controlling interests	(48)	(55)	(103)	(58)	78.9%	(80)	29.3%		

Source: Company data, HSBC estimates, Bloomberg consensus

FY14 results of BMW Brilliance (whole entity basis)

(Rmb m)	2014	2013	YoY%	HSBCe	Var %
Revenue	94,545	73,173	29.2%	94,772	-0.2%
Pre-tax profit	14,778	9,222	60.2%	15,105	-2.2%
Pre-tax margin %	15.6%	12.6%			
Net profit	11,072	6,871	61.2%	10,929	1.3%
Net margin %	11.7%	9.4%		11.5%	
ASP	339,445	353,954	-4.1%	340,238	-0.2%
Sales volume					
-5 series	93,679	60,954	53.7%		
-3 series	138,287	123,463	12.0%		
-X1	46,563	22,312	108.7%		
Total	278,529	206,729	34.7%		

Source: Company data, HSBC estimates

Earnings revision

Earnings revision

(RMB m)	2014	2015e			2016e		
	Announced	Revised	Old	Chg%	Revised	Old	Chg%
Revenue	5,515	7,287	6,041	20.6%	8,298	6,469	28.3%
Cost of sales	(4,952)	(6,340)	(5,437)	16.6%	(7,054)	(5,692)	23.9%
Gross profit	562	947	604	56.8%	1,245	776	60.4%
GP Margin %	10.2%	13.0%	10.0%		15.0%	12.0%	
Other net income	104	100	50	100.0%	100	50	100.0%
Selling expenses	(585)	(874)	(665)	31.6%	(913)	(712)	28.3%
Administrative expenses	(402)	(619)	(514)	20.6%	(705)	(550)	28.3%
EBIT	(320)	(447)	(524)	-14.8%	(273)	(435)	-37.2%
EBIT margin %	-5.8%	-6.1%	-8.7%		-3.3%	-6.7%	
Interest income	54	51	42	20.0%	64	55	15.8%
Finance costs, net	(156)	(156)	(143)	8.8%	(153)	(148)	3.8%
Share of results of:							
Associates	230	269	279	-3.5%	283	279	1.3%
Jointly controlled entities	5,536	5,914	5,898	0.3%	7,057	7,004	0.8%
Profit (Loss) before tax	5,343	5,631	5,552	1.4%	6,977	6,755	3.3%
Income tax credit (expense)	(43)	(17)	(19)	-11.7%	(29)	(16)	83.3%
Profit (Loss) for the year	5,300	5,614	5,533	1.5%	6,948	6,739	3.1%
Attributable to:							
Equity holders of the Company	5,403	5,734	5,613	2.2%	7,068	6,819	3.7%
Non-controlling interests	(103)	(120)	(80)	50.0%	(120)	(80)	50.0%

Source: Company data, HSBC estimates

Assumptions change for BMW Brilliance

	2014	Revised		Old	
		2015e	2016e	2015e	2016e
Sales volume					
Total sales (units)	278,529	315,730	382,611	315,748	377,632
YoY%	34.7%	13.4%	21.2%	13.4%	19.6%
By models					
- 3 series	93,679	111,478	120,396	111,485	120,404
- 5 series	138,287	153,499	168,848	153,501	168,851
- X1	46,563	50,754	58,367	50,762	58,377
- Others	-	-	35,000	-	30,000
Financials (RMB m)					
Revenue	94,545	106,013	125,485	106,018	124,389
YoY%	29.2%	12.1%	18.4%	11.9%	17.3%
Operating profits	14,778	15,770	18,819	15,728	18,677
Operating margin (%)	15.6%	14.9%	15.0%	14.8%	15.0%
Net profits after tax	11,072	11,827	14,114	11,796	14,007
Net profit margin (%)	11.7%	11.2%	11.2%	11.1%	11.3%

Source: Company data, HSBC estimates

Valuation and risks

- ▶ Target PE based on ROE and long-term growth
- ▶ Formula for calculating our ROE-based PE:

$$PE = (ROE - g) \div (ROE \times [COE - g])$$

Fig 11: Key assumptions

ROE 2015e	25.9%
Cost of equity	11.0%
Rf	3.5%
Equity risk premium	6.5%
Equity beta	1.15
g	3.0%

Source: HSBC estimates

- ▶ We use 3-year historical beta of 1.15 according to Bloomberg. Our growth and COE assumptions remain unchanged.
- ▶ Applying our 2015e ROE assumption of 25.9% (previously 24.6%) to the above formula, we derive a fair ROE-based PE multiple of 11.1x (previously 10.9x) for Brilliance.
- ▶ Applying our 2015e diluted EPS estimate of RMB1.14 (previously RMB1.11) to our target PE, our fair value target price is HKD15.5 (previously, under our old ratings model, it was HKD15.2)
- ▶ We established a Hold rating versus the previous Neutral rating.

Key downside risks: slowdown in premium segment growth, lower-than-expected margin expansion, and market share losses to major competitors.

Key upside risks: Lower than expected procurement costs benefiting from depreciating Euro against Rmb.

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

Equities: Stock ratings and basis for financial analysis

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

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.

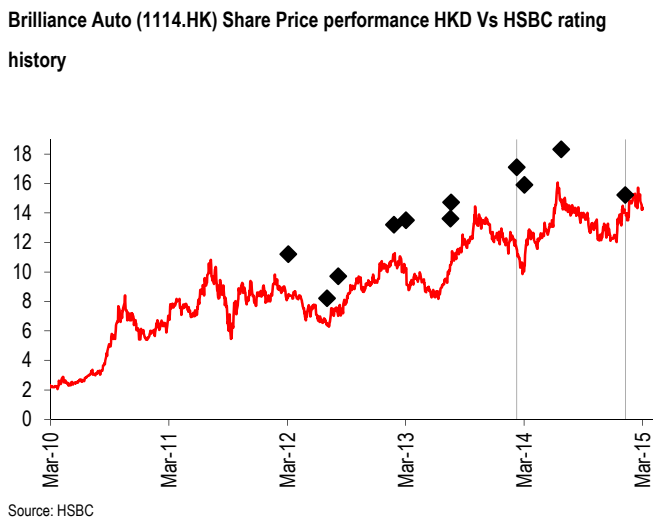
Rating distribution for long-term investment opportunities

As of 26 March 2015, the distribution of all ratings published is as follows:

Buy	41%	(30% of these provided with Investment Banking Services)
Hold	39%	(27% 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



Recommendation & price target history		
From	To	Date
Overweight (V)	Overweight	03 March 2014
Overweight	Neutral	01 February 2015
Target Price	Value	Date
Price 1	11.20	28 March 2012
Price 2	8.20	26 July 2012
Price 3	9.70	29 August 2012
Price 4	13.20	17 February 2013
Price 5	13.50	27 March 2013
Price 6	13.60	11 August 2013
Price 7	14.70	13 August 2013
Price 8	17.10	03 March 2014
Price 9	15.90	27 March 2014
Price 10	18.30	18 July 2014
Price 11	15.20	01 February 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BRILLIANCE AUTO	1114.HK	14.24	26-Mar-2015	6, 7

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.
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