

Brilliance China Automotive

Don't throw the towel at the bottom

Brilliance China's cautious stance on FY15 volume growth at BBA JV (10%) in the briefing today was an unpleasant surprise. While this coincides with BMW's earlier guidance that its overall China sales (including imports) will decelerate to single digits this year from 17% in FY14, we believe Brilliance's guidance is very conservative- we are looking for 15% growth this year followed by a rebound to 20% in 2016. The company's FY14 result today is a non-event as we can draw such conclusion from BMW's result a week ago (see our read-through [here](#)). Brilliance's share price could see a negative knee-jerk reaction in the near term- we would take that opportunity to accumulate for a stronger model cycle from 2H15. Indeed, as our BMW analyst, Jose Asumendi noted in his recent report: "[Own the product cycle](#)" on March 23 ([click here](#)).

- **Three investment catalysts:** 1) FY15 is an inflection point for BMW's broader model cycle globally. For Brilliance, after localization of 2-series in 2H15, a modification of 2-series, likely 3-series facelift and whole new long wheel base XI SUV will all arrive in 2016. As such, we forecast Brilliance will see a rebound in volume in FY16. 2) Weak EUR should benefit Brilliance in 1H15 from both lower procurement cost, i.e. higher margins, and decreasing hedging cost if EUR continues to depreciate or stay weak despite the company aiming to lock in 80-90% of FX exposure. 3) Own brand business should see much reduced loss this year to ~Rmb100mn from over Rmb200mn in FY14, thanks to coming launch of MPV model in Mar-15.
- **Earnings revisions:** We trim our FY15/16 estimates by 4-5% to reflect more cautious volume and margin assumptions. Our FY15 estimate remains moderately above street consensus.
- **Rating, risks:** We stay OW on Brilliance as we expect a stronger model cycle and volume from 2H15 to lead the stock performance. Our revised PT is HK\$16.5 on a more conservative 11x forward PER vs. previous HK\$19 (12x). Key risks: worse than expected sales/ profit and a sharper-than-expected price competition in luxury segment.

Brilliance China Automotive (Reuters: 1114.HK, Bloomberg: 1114 HK)

Rmb in mn, year-end Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue (Rmb mn)	5,916	6,103	5,515	6,929	7,290
Net Profit (Rmb mn)	2,301	3,374	5,403	6,055	6,889
EPS (Rmb)	0.46	0.67	1.08	1.20	1.37
DPS (Rmb)	0.00	0.00	0.08	0.09	0.10
Revenue growth (%)	(8.2%)	3.2%	(9.6%)	25.6%	5.2%
EPS growth (%)	26.3%	46.6%	60.1%	12.1%	13.8%
ROE	27.1%	29.3%	36.1%	31.4%	27.8%
P/E (x)	24.9	17.0	10.6	9.5	8.3
P/BV (x)	5.7	4.4	3.4	2.7	2.0
Dividend Yield	0.0%	0.0%	0.7%	0.8%	0.9%

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

Overweight

1114.HK, 1114 HK

Price: HK\$14.24

▼ **Price Target: HK\$16.50**
Previous: HK\$19.00

China

Head of Asia Auto Research

Nick Lai ^{AC}

(852) 2800 8543

nick.yc.lai@jpmorgan.com

Bloomberg JPMA LAI <GO>

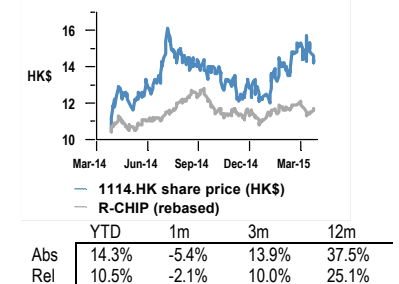
Rebecca Y Wen

(852) 2800-8505

rebecca.y.wen@jpmorgan.com

J.P. Morgan Securities (Asia Pacific) Limited

Price Performance



Please note BMW (BMW GR, OW rating) is covered by our EU auto research head, Jose Asumendi.

Company Data

Shares O/S (mn)	5,026
Market Cap (Rmb mn)	57,337
Market Cap (\$ mn)	9,229
Price (HK\$)	14.24
Date Of Price	26 Mar 15
Free Float(%)	57.4%
3M - Avg daily vol (mn)	12.12
3M - Avg daily val (HK\$ mn)	172.57
3M - Avg daily val (\$ mn)	22.3
R-CHIP	4515.05
Exchange Rate	7.75
Price Target End Date	30-Dec-15

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

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<p>Key catalyst for the stock price: Strong sequential volume growth including coming 2-series in 2H15 and whole new X1 long wheel base and likely 3-series facelift in 2016 will be important driver.</p>	<p>Upside risks to our view: On BMW JV: better-than-expected sales and higher-than-expected margins of BMW cars; stronger-than-expected sales momentum in luxury segment resulting from solid growth in China's household income. On minivan: smaller than expected loss from higher sales and lower expenses.</p>	<p>Downside risks to our view: Key risks include weaker-than-expected sales volume of BMW's cars in China, and a sharper-than-expected price cut in China's auto market, including luxury segment where Brilliance focuses. We are also cautious on any higher than anticipated loss from mini bus and future new energy car business.</p>
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Key financial metrics	FY13	FY14E	FY15E	FY16E
Revenues (LC)	6,103	5,515	6,929	7,290
Revenue growth (%)	3%	-10%	26%	5%
EBITDA (LC)	(39)	(76)	53	183
EBITDA margin (%)	-1%	-1%	1%	3%
Tax rate (%)	0%	1%	2%	2%
Net profit (LC)	3,374	5,403	6,055	6,889
EPS (LC)	0.67	1.08	1.20	1.37
EPS growth (%)	47%	60%	12%	14%
DPS (LC)	-	0.08	0.09	0.10
BVPS (LC)	2.59	3.36	4.30	5.58
Operating cash flow (LC mn)	(154)	(114)	(268)	(285)
Free cash flow (LC mn)	(602)	(558)	(715)	(731)
Interest cover (X)	26	37	42	47
Net margin (%)	55%	98%	87%	94%
Sales/assets (X)	0.35	0.26	0.27	0.23
Debt/equity (%)	13%	9%	7%	5%
Net debt/equity (%)	-5%	-6%	-7%	-6%
ROE (%)	29%	36%	31%	28%

Key model assumptions	FY13	FY14E	FY15E	FY16E
BMW sales volume growth	29%	35%	15%	21%
BMW gross margin	24%	26%	26%	25%
BMW net margin	9%	12%	12%	12%

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

Sensitivity analysis	Impact on EBIT (%)		Impact on EPS (%)	
Sensitivity to	FY14E	FY15E	FY14E	FY15E
1% decrease in BMW sales volume growth	-1.0%	-1.1%	-1.0%	-1.1%
1% decrease in BMW gross margin assumption	-1.0%	-1.0%	-1.1%	-1.0%

Source: J.P. Morgan estimates.

China auto valuation summary

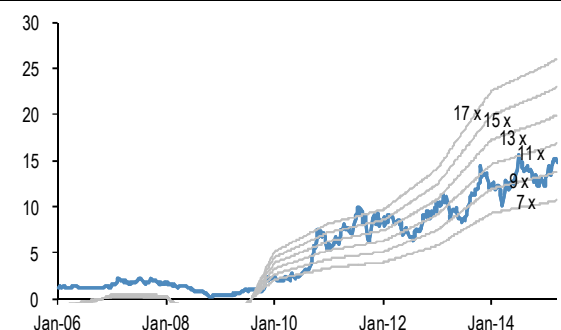
Company	Code	Rec	Price (LC)		Mkt cap (US\$ M)	P/E (x)		P/B (x)		ROE		Div. yield	
			26-Mar			15E	16E	15E	16E	15E	16E	15E	16E
Brilliance	1114 HK	OW	14.24		9,229	9.5	8.3	2.7	2.0	31%	28%	0.8%	0.9%
ZhengTong Auto	1728 HK	OW	3.79		1,080	5.3	4.5	0.7	0.6	14%	14%	3.1%	3.8%
DongFeng Motor	489 HK	OW	12.16		13,511	5.6	5.0	1.1	1.0	19%	20%	2.7%	3.0%
Great Wall Motor	2333 HK	OW	50.65		23,675	10.9	8.9	2.9	2.3	30%	29%	2.0%	2.8%
Geely	175 HK	OW	3.95		4,483	11.3	7.3	1.4	1.2	13%	18%	0.6%	0.9%
GAC	2238 HK	UW	7.10		8,709	9.6	8.3	1.0	0.9	10%	11%	2.8%	3.4%
MintH Group	425 HK	OW	15.16		2,150	9.9	8.1	1.4	1.2	15%	16%	3.4%	4.0%
Baoxin Auto	1293 HK	N	4.32		1,425	7.1	6.4	1.3	1.0	19%	18%	3.6%	4.2%
Zhongsheng	881 HK	UW	5.26		1,456	6.6	6.0	0.9	0.8	13%	13%	2.3%	2.7%
Sinotruk	3808 HK	UW	4.46		1,588	15.0	12.7	0.5	0.5	3%	4%	1.5%	2.0%
Nesteer	1316 HK	N	8.03		2,587	12.6	10.7	3.0	2.4	27%	25%	0.8%	1.3%
Sunfonda	1771 HK	UW	3.17		245	5.9	4.5	0.8	0.7	14%	16%	0.0%	0.0%
SAIC Motor	600104 CH	OW	24.78		43,992	8.7	7.8	1.6	1.5	20%	20%	5.5%	6.1%
Weichai Power (1)	2338 HK	OW	28.55		9,197	9.0	7.9	1.3	1.1	15%	15%	1.6%	1.8%
BYD (2)	1211 HK	OW	37.20		18,018	28.4	15.0	2.3	2.0	10%	16%	0.0%	0.0%
Average (3)						10.4	8.9	1.5	1.2	17%	18%	2.0%	2.4%
Average exclude BYD(3)						9.4	8.1	1.4	1.2	18%	18%	2.2%	2.6%

Source: J.P. Morgan estimates, Bloomberg. Notes: (1) Weichai Power is covered by Karen Li. (2) BYD covered by Alvin Kwock. (3) Average P/E is calculated as aggregated sector market cap divided by FY14/15E aggregated sector earnings; averages of P/B, ROE and dividend yield are simple average of the companies listed above.

Valuation and price target basis

We trim our PT to HK\$16.5, based on 11x FY15E earnings (vs. previously Dec-15 HK\$19 on 12x). Considering Brilliance's historical trading band and growth outlook as well as model cycle especially from 2H15, we believe 11x is achievable.

Brilliance China forward PE band



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

JPM vs. consensus, change in estimates

Earnings after minority	FY15E	FY16E
JPM	6,055	6,888
Consensus	5,904	6,943
% Difference	3%	-1%

Source: Bloomberg, J.P. Morgan estimates.

Table 1: Brilliance China FY14 results summary

	FY13A	FY14A	FY14 vs. FY13	FY14 JPMe	FY14A vs. JPMe
Revenue	6,103	5,515	-10%	6,033	-9%
Sales growth (%)	3.2%	-9.6%	-12.8pts	-1.2%	-8.5pts
COGS	(5,417)	(4,952)	-9%	(5,330)	-7%
Gross profit	687	562	-18%	703	-20%
Gross margin (%)	11.2%	10.2%	-1pts	11.7%	-1.5pts
Operating profit	(178)	(266)	50%	(105)	153%
Operating margin (%)	-2.9%	-4.8%	-1.9pts	-1.7%	-3.1pts
JV investment income	3,641	5,766	58%	5,575	3%
Growth (%)	44.2%	58.3%	14.2pts	53.1%	5.2pts
Pre-tax profit	3,325	5,343	61%	5,319	0%
Net profit	3,374	5,403	60%	5,298	2%
Net margin (%)	55.3%	98.0%	42.7pts	87.8%	10.2pts
Net profit growth (%)	46.6%	60.1%	13.5pts	57.0%	3.1pts
EPS (basic)	0.67	1.08	60%	1.05	2%
EPS (fully diluted)	0.67	1.07	60%	2.05	-48%

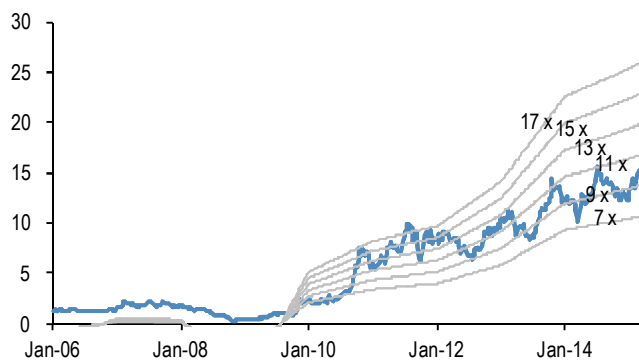
Source: J.P.Morgan.

Table 2: Brilliance China earnings revision

RMB mn	2015E			2016E		
	Revised	Previous	Change %	Revised	Previous	Change %
Revenue	6,929	6,102	14%	7,290	6,099	20%
Sales growth (%)	25.6%	1.1%	24.5pts	5.2%	0.0%	5.3pts
COGS	(6,129)	(5,384)	14%	(6,299)	(5,354)	18%
Gross profit	800	717	11%	991	745	33%
Gross margin (%)	11.5%	11.8%	-0.2pts	13.6%	12.2%	1.4pts
Operating profit	(115)	(100)	15%	29	(72)	-140%
Operating margin (%)	-1.7%	-1.6%	0pts	0.4%	-1.2%	1.6pts
JV investment income	6,416	6,662	-4%	7,156	7,908	-10%
Growth (%)	11.3%	19.5%	-8.2pts	11.5%	18.7%	-7.2pts
Pre-tax profit	6,147	6,408	-4%	7,029	7,680	-8%
Net profit	6,055	6,312	-4%	6,889	7,219	-5%
Net margin (%)	87.4%	103.4%	-16.1pts	94.5%	118.4%	-23.9pts
Net profit growth (%)	12.1%	19.1%	-7.1pts	13.8%	14.4%	-0.6pts
EPS (basic)	1.20	1.26	-4%	1.37	1.44	-5%

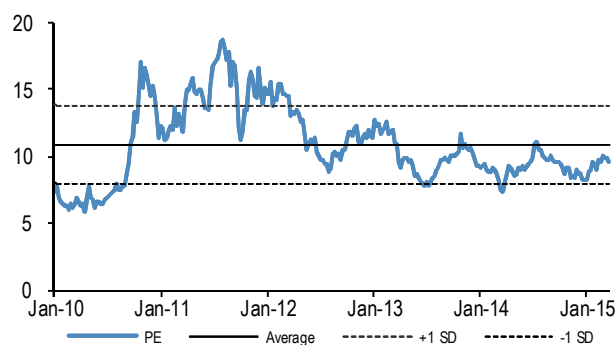
Source: J.P.Morgan estimates.

Figure 1: Brilliance China forward PE band



Source: Bloomberg, J.P. Morgan estimates.

Figure 2: Brilliance China forward PE with +/-1.0 standard deviation



Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Brilliance China Automotive *(Overweight; Price Target: HK\$16.50)*

Investment Thesis

We like Brilliance China, given its distinctive position in the premium car market in China. Its expected volume growth of 15%/20% in 2015/16 is also well above the broader passenger vehicle market based on our forecasts. Following localization of 2-series in 2H15, Brilliance plans to bring additional modification of 2-series, likely 3-series facelift and whole new long wheel base X1 SUV in 2016. All these shall drive volume and earnings.

Valuation

Our Dec-15 price target is HK\$16.5 on 11x forward PER. Considering Brilliance's historical trading band and growth outlook but a more cautious industry outlook, we believe 11x is reasonable and achievable- which is around a 10% premium over the sector average.

Risks to Rating and Price Target

Risks include worse-than-expected sales volume and higher-than-anticipated expenses in the Brilliance-China JV.

Brilliance China Automotive: Summary of Financials

Income Statement						Cash flow statement					
Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenues	5,916	6,103	5,515	6,929	7,290	EBIT	2,533	3,521	5,603	6,301	7,185
% change Y/Y	(8.2%)	3.2%	(9.6%)	25.6%	5.2%	Depreciation & amortization	140	139	191	168	154
Gross Profit	696	687	562	800	991	Change in working capital	(133)	4	761	(229)	(327)
EBIT	2,533	3,521	5,603	6,301	7,185	Others	(2,304)	(3,622)	(6,409)	(6,354)	(7,141)
% change Y/Y	22.7%	39.0%	59.1%	12.5%	14.0%	Cash flow from operations	(2)	(154)	(114)	(268)	(285)
EBIT Margin	42.8%	57.7%	101.6%	90.9%	98.6%	Capex	(526)	(616)	(600)	(600)	(600)
Net Interest	(174)	(139)	(156)	(154)	(156)	Free cash flow	(355)	(602)	(558)	(715)	(731)
Earnings before tax	2,295	3,325	5,343	6,147	7,029	Equity raised/(repaid)	5	0	0	0	0
% change Y/Y	17.7%	44.9%	60.7%	15.0%	14.4%	Debt raised/(repaid)	27	151	147	64	57
Tax	(58)	(8)	(43)	(92)	(141)	Dividends paid	0	(394)	(403)	(443)	(496)
Net income (core)	2,301	3,374	5,403	6,055	6,889	Other	(143)	(7)	52	0	0
% change Y/Y	27.0%	46.6%	60.1%	12.1%	13.8%	Cash flow from financing	(110)	(250)	(204)	(379)	(439)
Shares Outstanding	5,024	5,026	5,026	5,026	5,026	Beginning cash	586	837	903	1,179	1,243
EPS (core) (Rmb)	0.46	0.67	1.08	1.20	1.37	Ending cash	837	903	1,179	1,243	1,361
% change Y/Y	26.3%	46.6%	60.1%	12.1%	13.8%						
Balance sheet						Ratio Analysis					
Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Cash and cash equivalents	1,949	2,117	2,380	2,912	3,190	Net margin	38.9%	55.3%	98.0%	87.4%	94.5%
Accounts receivable	1,812	2,220	1,964	1,937	2,334	Sales growth	(8.2%)	3.2%	(9.6%)	25.6%	5.2%
Inventories	838	769	797	840	863	Net profit growth	27.0%	46.6%	60.1%	12.1%	13.8%
Others	1,818	1,418	1,205	1,364	2,314	Sales/assets	0.4	0.3	0.3	0.3	0.2
Current assets	6,417	6,524	6,345	7,052	8,700	Assets/equity	169.8%	152.2%	140.9%	132.2%	125.1%
Net fixed assets	1,745	1,686	1,551	1,422	1,307	ROE	27.1%	29.3%	36.1%	31.4%	27.8%
Intangibles	424	731	1,055	731	731						
Other LT assets	611	612	1,460	612	612						
Total Assets	16,058	18,990	23,207	27,782	34,325						
ST loans	1,119	1,528	1,365	1,429	1,486						
Payables	4,828	4,289	4,821	4,608	4,701						
Others	910	975	948	975	975						
Total current liabilities	6,857	6,793	7,134	7,012	7,163						
Long-term debt	0	0	0	0	0						
Other LT liabilities	2	56	119	119	119						
Total non-current liabilities	2	56	119	119	119						
Total Liabilities	6,859	6,849	7,253	7,131	7,282						
Shareholders' equity	10,015	13,015	16,931	21,628	28,021						
Minorities	(816)	(874)	(977)	(977)	(977)						
BVPS	1.99	2.59	3.36	4.30	5.58						

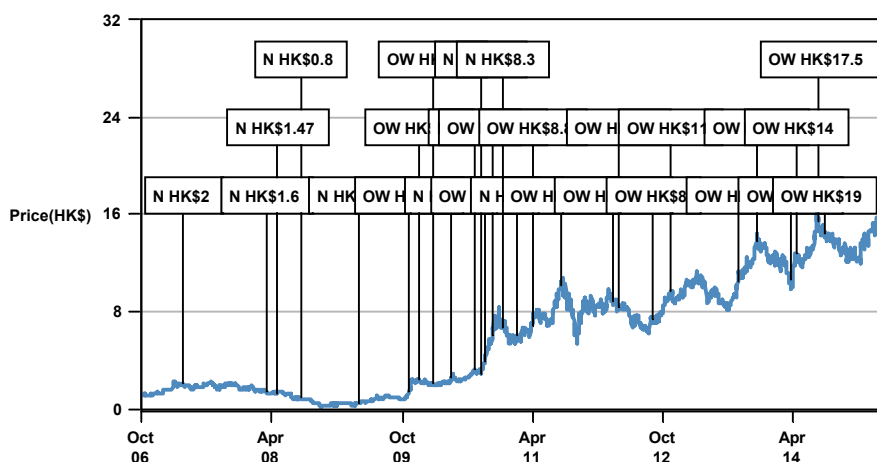
Source: Company reports and J.P. Morgan estimates.

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Brilliance China Automotive (1114.HK, 1114 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Mar 27, 2007.

Date	Rating	Share Price (HK\$)	Price Target (HK\$)
27-Mar-07	N	2.13	2.00
11-Mar-08	N	1.54	1.60
22-Apr-08	N	1.38	1.47
29-Jul-08	N	0.92	0.80
05-Apr-09	N	0.56	0.75
30-Oct-09	OW	1.45	1.80
09-Dec-09	OW	2.40	2.80
03-Feb-10	OW	2.10	2.80
21-Apr-10	N	2.61	2.80
30-Jul-10	N	3.26	3.30
27-Aug-10	N	3.02	3.50
14-Sep-10	OW	3.99	5.20
15-Oct-10	OW	6.00	9.60
26-Nov-10	N	6.71	8.30
28-Jan-11	N	6.00	7.50
29-Mar-11	OW	6.97	8.80
29-Jul-11	OW	10.18	12.50
29-Feb-12	OW	8.93	11.60
29-Mar-12	OW	8.32	11.00
14-Aug-12	OW	7.37	8.00
02-Nov-12	OW	9.68	11.00
13-Aug-13	OW	10.52	13.00
24-Oct-13	OW	13.86	20.00
20-Mar-14	OW	10.62	13.00
15-Apr-14	OW	12.78	14.00
11-Jul-14	OW	15.46	17.50
05-Aug-14	OW	14.40	19.00

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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	Overweight (buy)	Neutral (hold)	Underweight (sell)
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IB clients*	56%	49%	33%
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