24 October, 2017

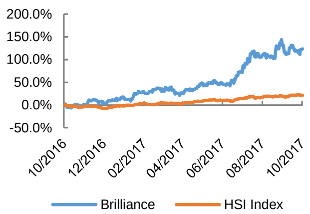
买入

首次覆盖

Market Data: October 23, 2017

Closing Price (HK$)	21.60
Price Target (HK$)	27.80
HSCEI	11,491
HSCCI	4,394
52-week High/Low (HK$)	23.73 /9.00
Market Cap (USD Mn)	13,926
Market Cap (HK$ Mn)	108,795
Shares Outstanding (Mn)	5,037
Exchange Rate (RMB-HK$)	0.850

Price Performance Chart:



Source: Bloomberg

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落地生根

Brilliance China (1114 HK)

Financial summary and valuation

	2015	2016	2017E	2018E	2019E
Revenue (Rmbm)	4,863	5,125	5,163	5,223	5,442
YOY (%)	-11.8	5.4	0.7	1.2	4.2
Net income (Rmbm)	3,495	3,682	5,011	7,848	9,677
YOY (%)	-35.3	5.4	36.1	56.6	23.3
EPS (Rmb)	0.70	0.73	0.99	1.56	1.92
Diluted EPS (Rmb)	0.69	0.73	0.99	1.56	1.92
ROE (%)	18.3	16.3	18.7	23.5	23.3
Debt/asset (%)	29.6	27.2	24.2	20.7	17.6
Dividend Yield (%)	0.5	0.5	0.7	1.1	1.4
P/E (x)	31.1	29.5	21.7	13.9	11.2
P/B (x)	5.7	4.8	4.1	3.3	2.6
EV/EBITDA (x)	31.0	30.0	23.0	13.9	11.3

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised. P/E is calculated as closing price divided by each year's EPS..

投资要点：

华晨中国成立于 1992 年，主要经营实体包括合资公司华晨宝马，及生产轻客、MPV 的子公司沈阳金杯。受益于国产宝马产品强周期，公司 2017-2019 年宝马业务收入将实现快速增长，盈利水平明显改善。我们预计 17 年 EPS 为人民币 0.99 元（同比增长 36.1%），18 年 EPS 为人民币 1.56 元（同比增长 56.6%），19 年 EPS 为人民币 1.92 元（同比增长 23.3%）。我们给予目标价 27.80 港币（15x 18E PE），对应 28.7%的上升空间，首次覆盖给予买入评级。

豪华车稳健增长。受益于中产阶级群体扩大，以及人均可支配收入的增长，2016 年豪华车销量达 220 万台，5 年复合增长率高达 18.2%。我们预期，2017 年中国豪华车销量同比增长 17.4%，乘用车市场占有率由 16 年 8.8%升至 17 年 10.0%。

宝马强产品周期。华晨宝马将于 17-19 年集中推出多款重磅车型，包括 17 年 6 月上市的第七代宝马 5 系，18 年上半年国产引进中型 SUV X3，19 年换代新宝马 3 系等。由于宝马 X3 是豪华品牌中级 SUV 中拳头产品，国产化后售价降低，将促进华晨宝马 18 年销量增长。我们预计，华晨宝马 17 年销量达 38.6 万台（同比增长 24.5%），18 年 47.7 万台（同比增长 23.6%），19 年 53.4 万台（同比增长 11.9%）。由于高售价的 5 系及 X3 车型销量占比上升，华晨宝马产品结构有望上移，我们预期 18 年平均单车售价同比增长 3.9%，19 年增长 3.0%。

盈利水平扩张。由于产能利用率改善、国产发动机配套比例上升，17-19 年华晨宝马盈利水平有望持续扩张。随着新 5 系及 X3 产能爬坡，我们预期华晨宝马三间工厂的产能利用率由 17 年 70.2%升至 18 年 86.7%。同时，华晨宝马新车型改用国产发动机，有助于降低成本，我们预计华晨宝马毛利率由 16 年 21.5%升至 17 年 22.4%，18 年 24.0%，19 年 24.7%。

携手雷诺。2017 年 7 月 4 日，华晨中国宣布出售全资子公司沈阳金杯 49%股权予雷诺，且交易完成后，双方将共同为沈阳金杯增资人民币 15 亿元。由于轻客及 MPV 产品销量不佳，沈阳金杯长期处于亏损状态，持股比例下降将减轻沈阳金杯对公司业绩的负面影响。长期来看，雷诺将为沈阳金杯导入成熟的轻客车型，并提高沈阳金杯产品竞争力。我们预计，公司营业损失将由 17 年人民币 11 亿元降至 18 年 6.7 亿元，19 年 6.2 亿元。

首次覆盖，给予买入评级。由于宝马销量增长强劲，盈利水平明显改善，我们预计 17 年 EPS 为人民币 0.99 元（同比增长 36.1%），18 年 EPS 为人民币 1.56 元（同比增长 56.6%），19 年 EPS 为人民币 1.92 元（同比增长 23.3%）。我们给予目标价 27.80 港币（15x 18E PE），对应 28.7%的上升空间，首次覆盖给予买入评级。

Investment highlight:

Brilliance China, founded in 1992, produces BMW-branded vehicles through a joint venture with the German manufacturer, BMW Brilliance Automotive (BBA), and produces minibuses and components via subsidiary Shenyang Brilliance Jinbei. We anticipate rapid growth in revenue and profitability in its BMW business, backed by a strong product cycle in 17-19E, and margin expansion. We forecast EPS of Rmb0.99 in 17E (+36.1% YoY), Rmb1.56 in 18E (+56.6% YoY) and Rmb1.92 in 19E (+23.3% YoY), and derive a target price of HK$27.80 (15x 18E PE). We initiate coverage with a BUY rating.

Solid demand for luxury vehicles. A growing middle class and rising disposable incomes is driving aspirational demand for higher-end consumer items. As a result, China luxury vehicle sales have expanded at an 18.2% Cagr in the past five years to top 2.2m units in 16A. We forecast luxury vehicle sales growth of 17.4% YoY in 17E, to account for 10.0% of the overall market in 17E (16A: 8.8%).

BMW upcycle. The company will launch new models in the following three years, including the 7th-generation *5 Series* launched in June 2017, the *X3* to be released in China in 1H18, and the next-gen *3 Series* in 2019. We expect the launch of a localised BMW *X3* model to boost BMW sales in China in 18E, given its leading position in mid-range luxury SUV market and much lower selling price than the imported version. We expect BBA sales to reach 386k units in 17E (+24.5% YoY), 477k units in 18E (+23.6% YoY) and 534k units in 19E (+11.9% YoY). Driven by ramping up sales of new *5 Series* products and the launch of the *X3*, the firm's product mix will shift to higher-end models and its blended average selling price (ASP) will pick up, expanding 3.9% YoY in 18E and 3.0% YoY in 19E.

Margin expansion. We expect BBA to see its margins expand in 17-19E, based on our assumption of improving utilisation of major plants and rising use of locally produced engines. As the firm ramps up new *5 series* and *X3* capacity, we expect aggregate utilisation of the three vehicle plants will improve from 70.2% in 17E to 86.7% in 18E. Meanwhile, with the construction of a domestic engine plant in Shenyang, BBA will increasingly use locally produced engines and we expect associated cost savings to drive up gross margin. We examine the margin expansion achieved by Mercedes Benz's venture in China after switching to locally produced engines; on this basis, we expect BBA gross margin to pick up from 21.5% in 16A to 22.4% in 17E, 24.0% in 18E and 24.7% in 19E.

Cooperation with Renault. On 4 July, 2017, Brilliance China agreed to sell a 49.0% stake in its wholly owned minibus subsidiary Shenyang Brilliance JinBei Automobile to Renault (RNO:FP), the largest light commercial vehicle (LCV) maker in Europe. In the short term, the reduced equity interest in Shenyang JinBei will reduce the negative impact on Brilliance China's bottom line from the indebted subsidiary, while longer-term, we expect Shenyang JinBei to benefit from Renault's LCV experience by improving competitiveness; we forecast an operating loss for the firm's overall minibus segment of Rmb1.1bn in 17E, Rmb674m in 18E and Rmb618m in 19E.

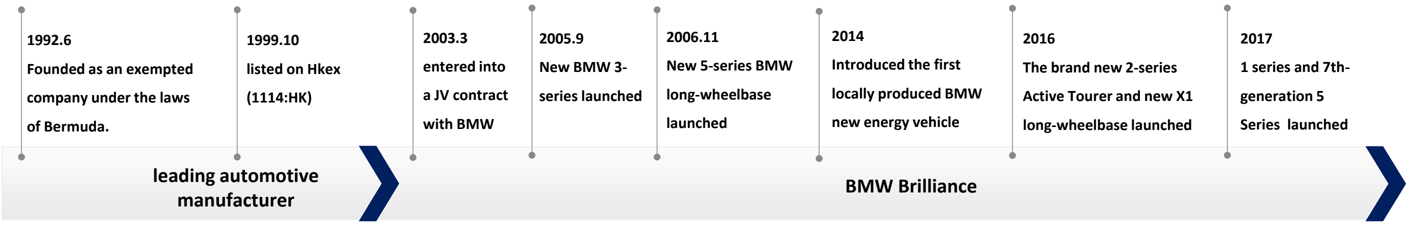
Initiate with BUY. Given strong BMW product cycle and margin expansion, we forecast EPS of Rmb0.99 in 17E (+36.1% YoY), Rmb1.56 in 18E (+56.6% YoY) and Rmb1.92 in 19E (+23.3% YoY). We apply a 15x 18E PE multiple, in line with global peers' typical upcycle valuation of 15-20x PE, to derive a target price of HK$27.80. With 28.7% upside, we initiate coverage with a BUY rating.

Local powertrain

Brilliance China, founded in 1992, is one of the leading automotive manufacturers in China. It was listed on main board of Hong Kong Stock Exchange in 1999. The group consists of two main business segments: the first, Shenyang Automotive, is principally engaged in the manufacture and sale of minibuses and automotive components; the other is BMW Brilliance, which concentrates on the manufacture and sale of BMW vehicles in China.

In 2003, Brilliance established a joint venture with Bayerische Motoren Werke (BMW:GR) in which both parties hold 50%, BMW Brilliance Automotive (BBA), to produce BMW *3-* and *5 Series* sedans in China. BMW Brilliance commenced production and sale of BMW sports-utility vehicles (SUVs) in China in early 2012. In November 2013, BMW Brilliance launched *ZINORO 1E*, its first new-energy vehicle (NEV), in China. At the end of year 2014, BMW Brilliance introduced the first localised BMW NEV, a *5 Series* long-wheelbase plug-in hybrid.

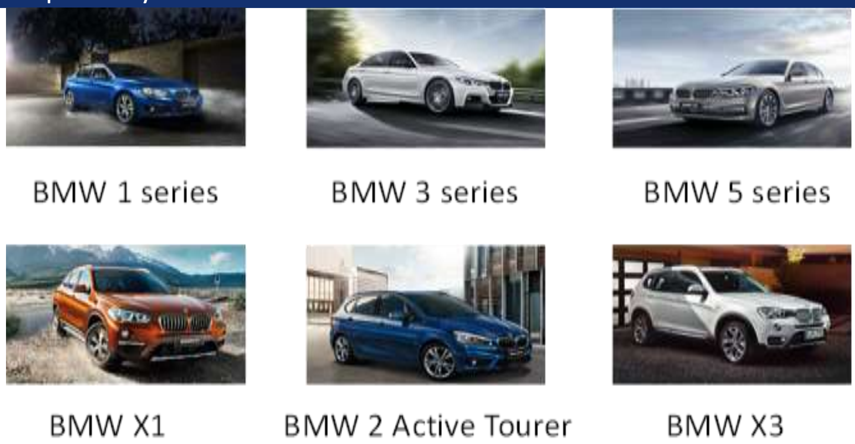
Fig 1: Milestones of Brilliance China



Source: Company website, SWS Research

BBA has a production base in Shenyang as well as a branch company in Beijing and an extensive national sales and service network. At present, BBA produces five BMW models: the *3 Series* (including standard and long wheelbase versions), the *5Li*, the *2 Series Active Tourer*, the *1 Series* sedan and the new *X1*. All models are produced between two plants, Dadong and Tiexi, both in Shenyang. In May 2017, BBA established a new Dadong Plant, in preparation for the launch of the new *5 Series* in June. Besides, BBA has an engine plant and produces the BMW Group's advanced 3- and 4-cylinder engines.

Fig 2: Models produced by BMW Brilliance



Source: Company website, SWS Research

Between its three plants, the firm has total annual production capacity of 550k units. The Tiexi Plant mainly produces *1-*, *2-* and *3 Series* models as well as the *X1*. With the localisation of production of the *1 Series* in February 2017, we expect the Tiexi plant's utilisation rate to improve in 2017E. The Dadong plant produced 6th-generation *5 Series* models and is currently retooling for localised production of the *X3* from 1H18. BBA finished construction of the new 100kpa-capacity Dadong plant in May 2017, where it will produce the 7th-generation *5 Series*. With capacity ramping up, we expect to see improving utilisation rates from 18E.

Fig 3: BMW Brilliance's production capacity

Plant	Designed annual capacity (units)	Model	Utilisation rate 16A	17E	18E
Tiexi	300,000	1 series/2 series/3 series/X1	57.7%	85.3%	90.7%
Dadong	150,000	6th-gen 5 series/X3	95.7%	35.9%	43.3%
New Dadong	100,000	7th-gen 5 series		76.1%	140.0%
Total	**550,000**		**70.4%**	**70.2%**	**86.7%**

Source: Company data, SWS Research

Shenyang Brilliance JinBei Automobile is the company's major operating subsidiary, and commenced operation in 1991. In a transaction announced in September 2017, Brilliance China plans to acquire the remaining 39.1% of equity in JinBei from Shenyang municipal government-owned Shenyang JinBei Automotive (600609:CH – N-R), before transferring a 49% stake in the subsidiary to Renault. Shenyang JinBei produces vehicles under three main marques: *Haise*, *Granse* and *Huasong*.

Shenyang JinBei sold 33.6k minibuses and MPVs in 1H17, up 6.6% YoY, among which Haise accounted for 85.2% of units sold.

Fig 4: Models produced by Shenyang Jinbei automobile

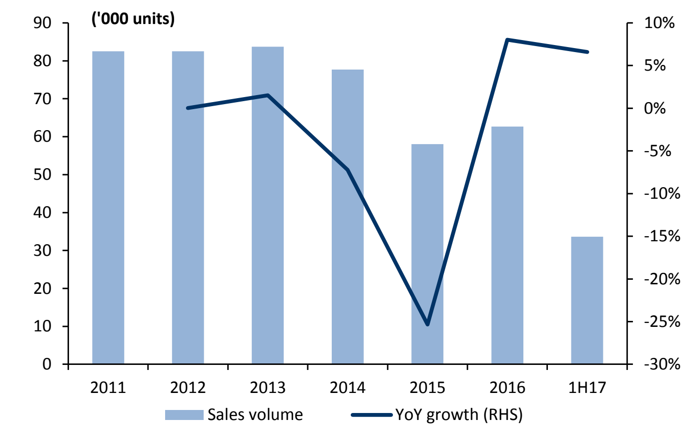
Haise

Granse

Huasong

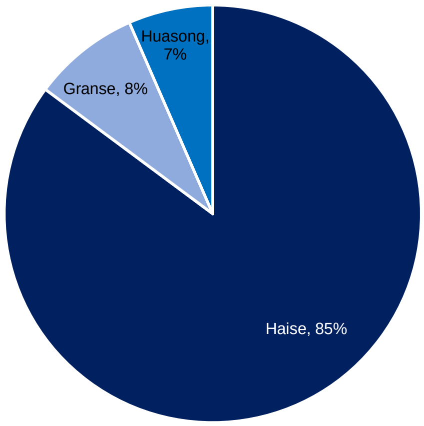
Source: Company website, SWS Research

Fig 5: Sales volume of Shenyang Jinbei



Source: Company data, SWS Research

Fig 6: 1H17 Shenyang Jinbei sales volume breakdown, by models



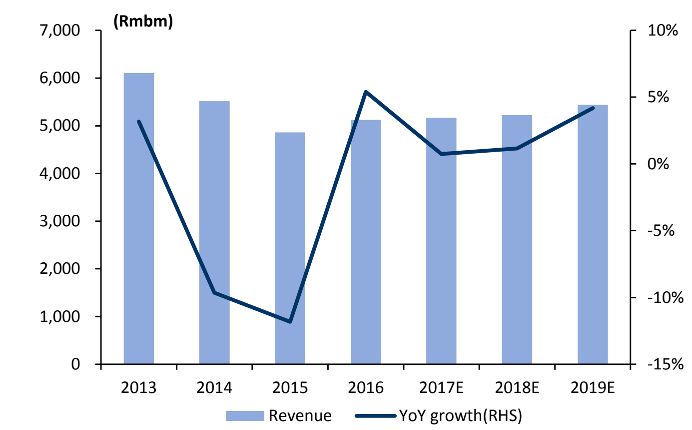
Source: Company data, SWS Research

Brilliance consolidates results from its 61%-controlled subsidiary JinBei (its minibuses business) and applies the equity method to account for contribution from its 50%-owned BMW joint venture, recognising a share of profits from the JV as investment income.

As a result, the firm booked total revenue of Rmb2.8bn in 1H17 (+14.1% YoY), and profit before tax (and before investment income from its BMW JV) of negative Rmb611.6m, as minibus sales in the period were weak. Adding a contribution of Rmb2.7bn from the firm's share of profits from its BMW JV, the firm reported a profitable first half.

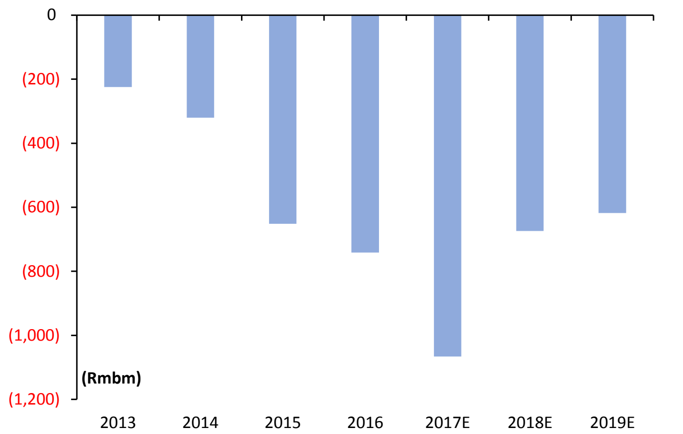
We see continued weakness in the company's minibus/MPV sales in the coming years, although we expect 17E to represent the nadir, with the firm booking an operating loss for the year of Rmb1.1bn, given an impairment loss of Rmb350m from Huasong booked in 1H17, before moderating in the coming two years. Nevertheless, we expect the share of profits from the firm's BMW business to more-than offset its consolidated business performance.

Fig 7: Brilliance China's revenue



Source: Company data, SWS Research

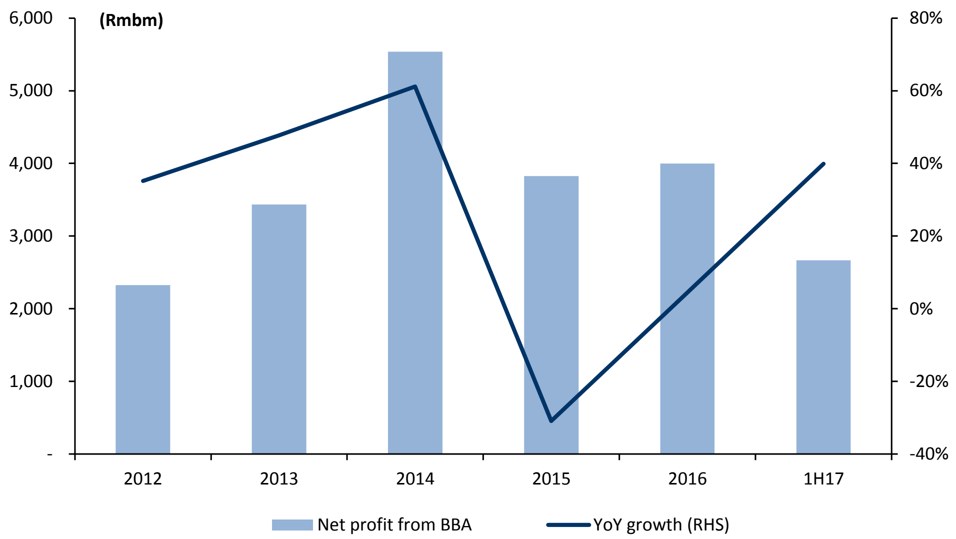
Fig 8: Brilliance China's operating profit



Source: Company data, SWS Research

As such, BMW Brilliance is the main contributor of net profit to the firm. Profit contributed by BBA was Rmb2.7bn in 1H17, increasing from Rmb1.9bn in 1H16 by 39.9%, mainly due to strong sales growth of BMW models and lower selling cost.

Fig 9: Net profits contribution from BBA



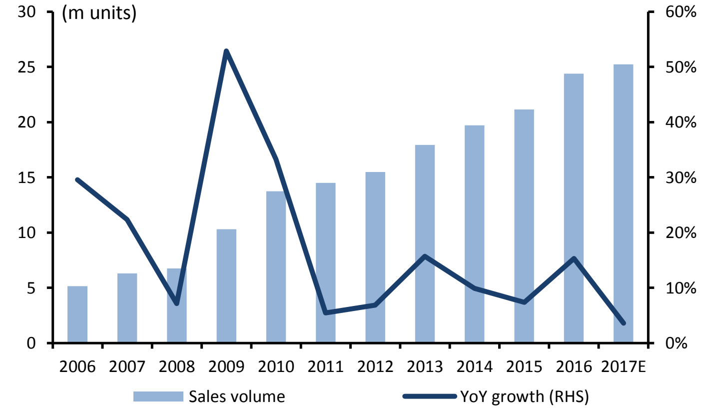
Source: Company data, SWS Research

Market outlook

According to the China Association of Automobile Manufacturers (CAAM), passenger vehicles sales in China reached 11.3m units in 1H17, up 1.6% YoY. Sedan sales dropped 3.2% YoY in 1H17, accounting for 48.0% of sales (vs 49.8% in 2016). Multi-purpose vehicle (MPV) sales contracted 15.8% YoY, while crossover sales dropped 25.3% YoY. By contrast, China's sports-utility vehicle (SUV) market has grown steadily since 2011, with its share of total passenger vehicles expanding from 6.4% in 2009 to 40.2% in 1H17.

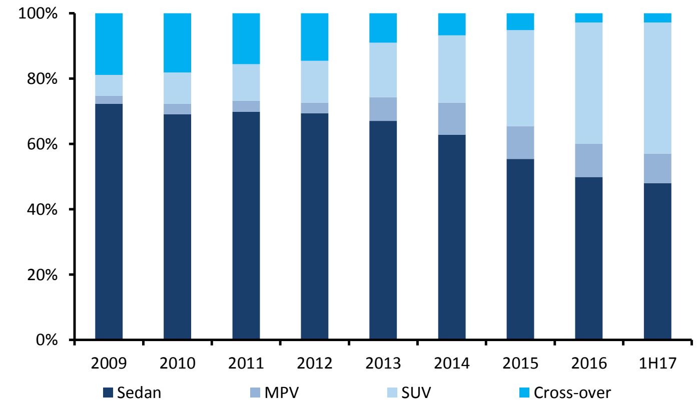
We expect passenger vehicle unit sales to grow 3.6% YoY to 25.9m in 17E, with 3.0% YoY decline in the sedan segment, 15% YoY growth in SUVs and a 20.0% YoY decline in MPVs.

Fig 10: Passenger vehicle sales forecast



Source: CAAM, SWS Research

Fig 11: Passenger vehicle sales volume breakdown

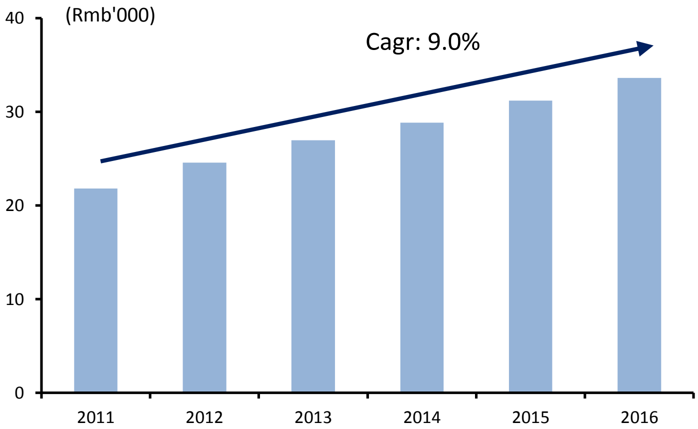


Source: CAAM, SWS Research

In the past few years, urban per capita disposable income in China has increased steadily, reaching Rmb33.6k in 2016, a five-year Cagr of 9.0%, driving purchasing power, which we see as being behind a trend in recent years of consumer upgrading. As a result, we have witnessed faster growth in demand for luxury cars, retail prices of which have stayed roughly stable (in addition to which, we also note an expanding roster of entry-level premium auto options catering to the newly affluent and up-and-coming buyers), expanding at an 18.2% Cagr over the past five years to reach 2.2m units in 2016.

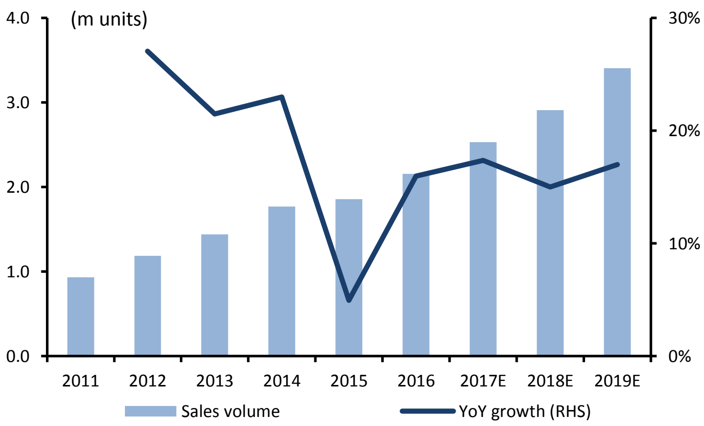
We note a sharp uptick in luxury vehicle sales growth in 16A, due to a low base in 15A, when luxury car sales were hit by a prolonged anti-corruption crackdown. Looking forward, we expect the luxury vehicle market will continue to benefit from a sustained consumer upgrading demand as well as increasing use of auto finance by buyers. We expect luxury vehicle sales to post solid growth in 17E, reaching 2.5m units (+17.4% YoY), and sustaining double-digit growth for the next three years.

Fig 12: Disposable income realised a 9.0% Cagr in 2011-16



Source: NBS, SWS Research

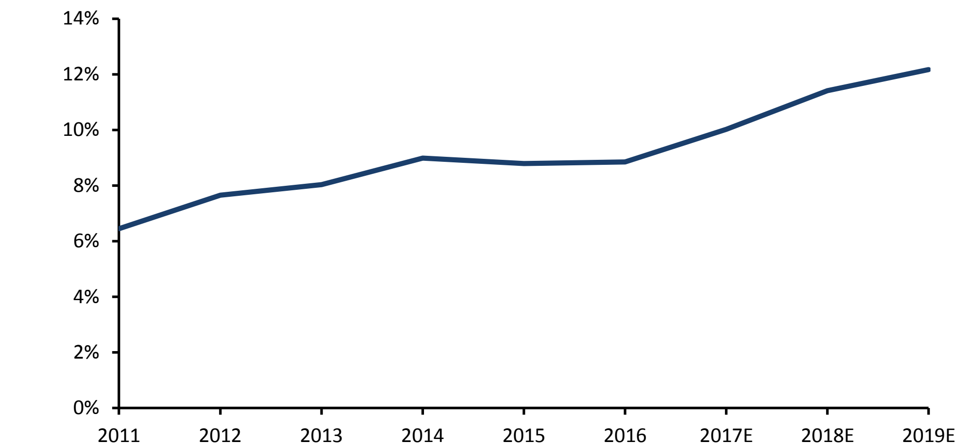
Fig 13: China's luxury vehicle sales volume



Source: CAAM, Autohome, SWS Research

Luxury cars constituted approximately 9% of total passenger vehicle sales by volume in the past three years. With luxury vehicle sales outpacing overall car sales, we expect the market share for luxury vehicles to reach 10.0% in 17E and 11.4% in 18E.

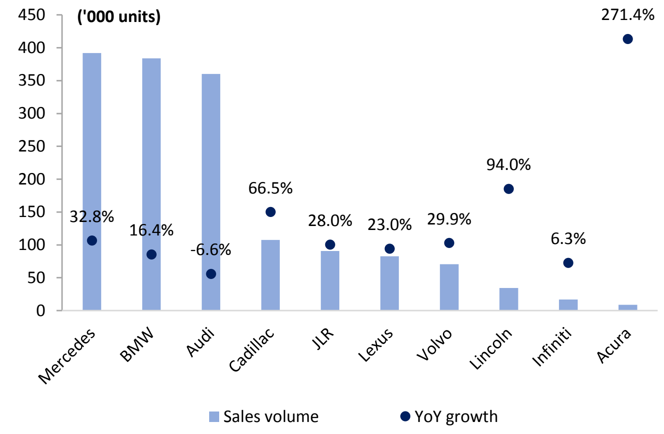
Fig 14: Market share of luxury vehicles



Source: CAAM, autohome, SWS Research

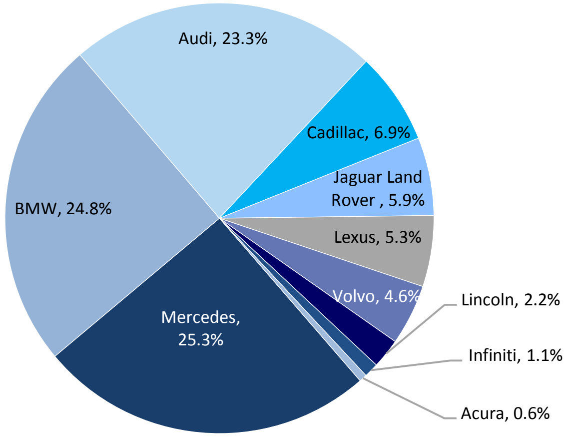
Among the top-10 luxury brands, *Acura* recorded the most rapid growth (at +271% YoY) in first eight months of 2017. For the top-three brands in terms of sales volume, *Audi* suffered due to an aging product line, recording a 6.6% YoY decline in sales volume in first eight months of 2017, while both *Mercedes Benz* and *BMW* recorded strong sales volume growth. The top-three luxury brands – *Mercedes*, *BMW* and *Audi* – accounted for c.73% of the luxury autos market in the first eight months of the year, according to the CAAM data.

Fig 15: Luxury brand sales, January-August 2017



Source: Autohome, SWS Research

Fig 16: Market share of luxury brands, January-August 2017



Source: Autohome, SWS Research

BMW upcycle

BMW Brilliance plans to strengthen its product line and gain market share through launching new models in 2017-19E. Brilliance already introduced a localised version of *1 Series* in February, and of the 7th generation *5 Series* in late June 2017. The company also plans to launch a domestic version of the *X3* in 1H18, and a new generation *3 Series* in 2019. With the launch of key models, we see strong sales for BMW Brilliance in 2017-19E.

Fig 17: 2017-2019 BMW localisation plan

ource: Company data, SWS Research

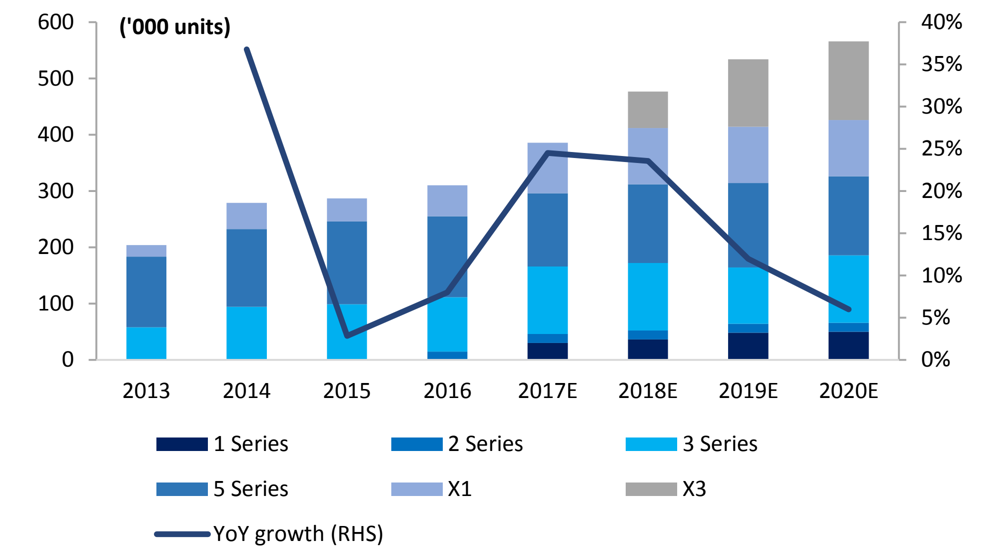
We expect BMW Brilliance to reach 386k units in 17E (+24.5% YoY), 477k units in 18E (+23.6% YoY) and 534k units in 19E (+11.9% YoY), driven by ramping up sales of new *5 Series* and the launch of the *X3*.

Fig 18: BWM localisation sales forecast

Model	2013	2014	2015	2016	2017E	2018E	2019E
1 Series					30,000	36,000	48,000
2 Series				14,406	16,000	16,000	16,000
3 Series	58,052	93,935	98,625	97,112	120,000	120,000	100,000
5 Series	125,218	138,481	147,202	143,594	130,000	140,000	150,000
X1	20,826	46,719	41,246	54,914	90,000	100,000	100,000
X3						65,000	120,000
Total sales	204,096	279,135	287,073	310,026	386,000	477,000	534,000
YoY growth		36.8%	2.8%	8.0%	24.5%	23.6%	11.9%

Source: Company data, SWS Research

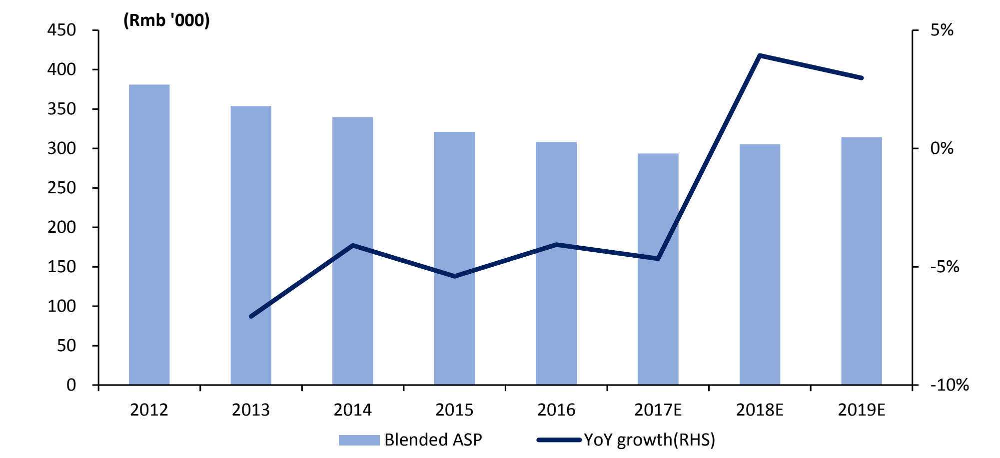
Fig 19: BMW China sales, breakdown by product series



Source: Company data, Autohome, SWS Research

As the product mix will shift to higher ASP models, such as the new *5 Series* and *X3*, we expect the blended ASP for BBA to cease declining from 18E, with 3.9% YoY growth.

Fig 20: BBA's blended ASP



Source: Company data, Autohome, SWS Research

7th-generation *5 Series*

The BMW new *5 Series* model, released in June 2017 in China, refreshes the series as it was coming to the end of its previous product cycle. Compared to the previous model, the new *5 Series* made a progress in many aspects, from auto body structure to car link system, while maintaining a similar selling price. Therefore, the new *5 Series* has generated substantial orders since its official launch, with a waiting period now at approximately three months.

Audi's *A6L* and the Mercedes Benz's *E-class* are the two main rivals for the BMW *5 Series*. The BMW models tend to emphasise its sporty credentials, as well as comfort.

Fig 21: Comparable models of BMW 5 series

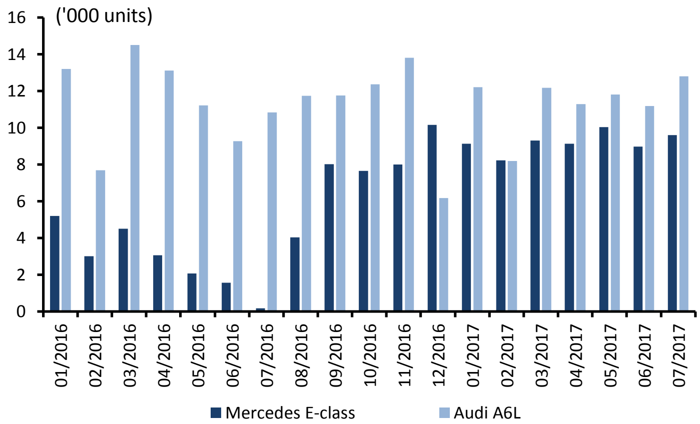
Model	BMW 7th-gen 5 series	BMW 6th-gen 5 series	Mercedes E-class	Audi A6L
MSRP ('000 Rmb)	449.9-663.9	435.6-778.6	422.8-629.8	418.8-746.0
Engine displacement	2.0T/3.0T	2.0T/3.0T	2.0T/3.0T	1.8T/2.5L/3.0T
Max horsepower (Ps)	224/252/340	184/218/245/306	184/245/272	190/204/272/333
Max torque (Nm)	301/350/450	270/310/350/400	300/370/400	250/320/400/440

Wheel base (mm)	3108	3108	2939/3079	3012
Transmission	8AT	8AT	9AT	CVT/7DCT
Drive mode	FWD/4WD	FWD/4WD	FR/4WD	FWD/4WD
Selected version	**530Li xDrive**	**525Li**	**E 300 L**	**TFSI**
MSRP ('000 Rmb)	498.9	499.6	499.8	339.0
Engine displacement	2.0T	2.0T	2.0T	1.8T
Max horsepower (Ps)	252	218	245	190
Max torque (Nm)	350	310	370	320
Maximum torque speed (rpm)	1450-4800	1350-4801	1300-4000	1400-4100
Max power(kw)	185	160	180	140
Length*width*height (mm)	5087*1868*1500	5055*1860*1491	5065*1860*1467	5036*1874*1466
Drive mode	FWD/4WD	FWD	FR	FWD
Tyre(Front)	245/40 R19		245/45 R18	225/55 R17
Steering wheel memory	●		●	-
Rearview mirror memory	●		●	○
Adaptive endurance	○	-	○	○
Panoramic sunroof	●	-	●	○
Wheel shift	●	-	●	●
Wireless phone charging	○	-	●	-
Mobile Internet mapping	●	-	●	●
Back screen	○	-	●	-
Loudspeaker	8-9	6-7	8-9	10-11
Headlight	LED	Xenon	LED	Xenon

Source: Autohome, SWS Research

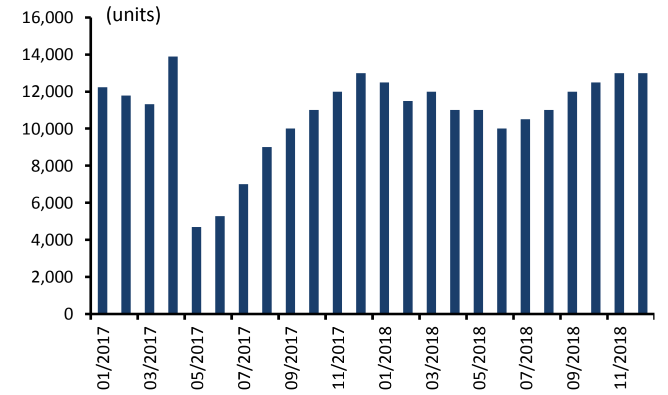
Audi's *A6L* and the Mercedes Benz's *E-class* record monthly sales at a stable 10k units. Therefore, with capacity ramping up, we expect the total sales of the new *5 Series* to reach 140k units in 18E, or monthly sales of 11.7k units.

Fig 22: Monthly sales of competing models of BMW 5 Series



Source: CAAM, SWS Research

Fig 23: BMW *5 Series* China monthly sales forecast



Source: CAAM, company data, SWS Research

X3

BMW's 3rd-geneneration *X3* was released in the US in late June 2017. Compared with the previous version, the new *X3* has upgraded LED headlights, assisted driving systems, and a more aerodynamic body structure. To date, more than 1.5m *X3* units have been sold worldwide, making the vehicle a major success for the carmaker. We expect the new *X3* to extend the model's popularity further, particularly after production is localised in China.

Fig 24: The 3-gen BMW X3 vs its predecessor (front)

Source: BMW group, SWS Research

Fig 25: The 3-gen BMW X3 vs its predecessor (rear)

Source: BMW group, SWS Research

At present, the *X3* is available only in imported versions in the Chinese market, resulting in pricing at a much higher level than competing models such as Mercedes' SUV *GLC-Class* and Audi's *Q5*. As the manufacturer's suggested retail price (MSRP) of Mercedes-Benz's *GLC* dropped c.Rmb100k after Mercedes localised production of the *GLC* via its JV with BAIC, we expect the localised BMW *X3* model, to be launched in mid-2018, will be priced at a more attractive level for domestic consumers.

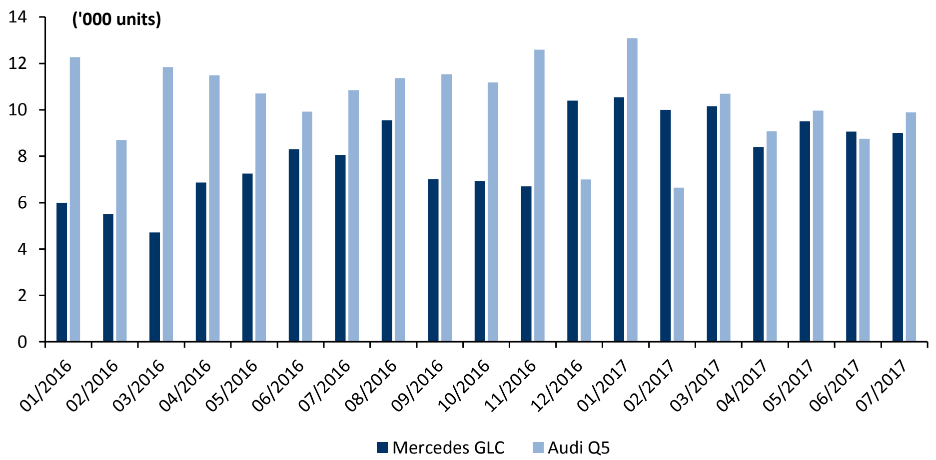
Fig 26: Comparable models of BMW X3

Model	BMW X3 (Imported)	Benz GLC (Imported)	Benz GLC	Audi Q5
MSRP ('000 Rmb)	421.0-750.0	496.0-638.0	396.0-579.0	399.6-525.3
Engine displacement	2.0T/3.0T	2.0T	2.0T	2.0T
Max horsepower (Ps)	184/245/306	184/211/245	184/211/245	230
Max torque (Nm)	270/350/400	300/350/370	300/350/370	350
Wheel base (mm)	2810	2873	2873	2807
Transmission	8AT	9AT	9AT	8AT
Drive mode	FR/4WD	4WD	4WD	4WD
Selected version	**BMW X3 sDrive20i**	**GLC 200 4MATIC (imported)**	**GLC 200 4MATIC**	**Q5 Plus 40 TFSI (aggressive)**
MSRP ('000 Rmb)	421	496	371	347.7
Engine displacement	2.0T	2.0T	2.0T	2.0T
Max horsepower (Ps)	184	184	184	230
Max torque (Nm)	270	300	300	350
Maximum torque speed (rpm)	1250-4500	1200-4000	1200-4000	1500-4200
Max power(kw)	135	135	135	169
Length*width*height (mm)	4665*1890*1690	4734*1890*1603	4661*1889*1664	4629*1898*1655
Drive mode	FR	4WD	4WD	4WD
Tyre	225/60 R17	235/55/R19	235/55/R19	235/55/R19
Power seat memory	●	○	-	-
GPS	-	●	-	-
Rearview mirror memory	●	○	-	-
Panoramic sunroof	●	-	●	●
Loudspeaker	8-9	8-9	8-9	10-11
Headlight	Xenon	LED	LED	Xenon
Highbeam	Xenon	LED	LED	Xenon
Front fog lamp	●	-	-	●

Source: Autohome, SWS Research

In recent years, SUVs have gained in popularity among Chinese buyers. The localised Mercedes *GLC* and Audi *Q5* record monthly sales of approximately 10k units. We expect the total sales of localised *X3* to reach 65k units in 18E and 120k in 19E (+84.6% YoY).

Fig 27: Monthly sales of competing models of BMW X3



Source: CAAM, SWS Research

Margin expansion

In January 2016, the firm fired up its new engine plant in Shenyang, with initial capacity of 400k units per year, becoming the only BMW engine plant outside of Europe. At present, the new engine plant produces the latest-generation 3-cylinder (B38) and 4-cylinder (B48) BMW TwinPower Turbo engines for use in *1 Series*, *2 Series Tourer*, *3 Series*, 7th-gen *5 Series* and *X1* models.

Looking forward, as the firm prepares to localise production of the *X3*, we expect the plant's capacity to grow to 600k units in 2017E, while, as a result of rising production, we see utilisation rate of the firm's capacity as likely to improve from 20.9% in 2016A to 40.3% in 17E and 79.5% in 18E.

Fig 28: Production capacity of new engine plant

Year	Designed capacity (units)	Model	Utilisation rate
16A	400,000	2 series tourer, 3 series, X1	20.9%
17E	600,000	1 series, 2 series tourer, 3 series, X1, new 5 series	40.3%
18E	600,000	1 series, 2 series tourer, 3 series, X1, new 5 series, X3	79.5%
19E	600,000	1 series, 2 series tourer, 3 series, X1, new 5 series, X3	89.0%

Source: Company data, SWS Research

Fig 29: Launch plan of localised engines

Model	Time	Engine type	Engine displacement	Max horsepower (Ps)
1 series	Feb-17	B38A15C/B48A20C/B48A20D	1.5T/2.0T	136/192/231
2 series Tourer	Mar-17	B38/B48A20A	1.5T/2.0T	136/192
3 series	Oct-17	B38B15C/B48B20C/B48B20D	1.5T/2.0T	136/182/252
5 series	Jun-17	B48B20D	2.0T/3.0T	224/252/340
X1	May-17	B38A15C/B48A20C/B48A20O0	1.5T/2.0T	136/192/231
X3	1H18	B48	2.0T/3.0T	224/252/340

Source: Company data, Autohome, SWS Research

Compared with imported vehicles, we expect the localisation of engine production to lead to cost savings and notable margin expansion.

Mercedes' JV with BAIC, Beijing Benz Automotive Company (BBAC), experienced significant margin expansion since 2015, after the company localised production of the M270, M274 and M276 engines.

Fig 30: Launch plan of Mercedes Benz localised engines

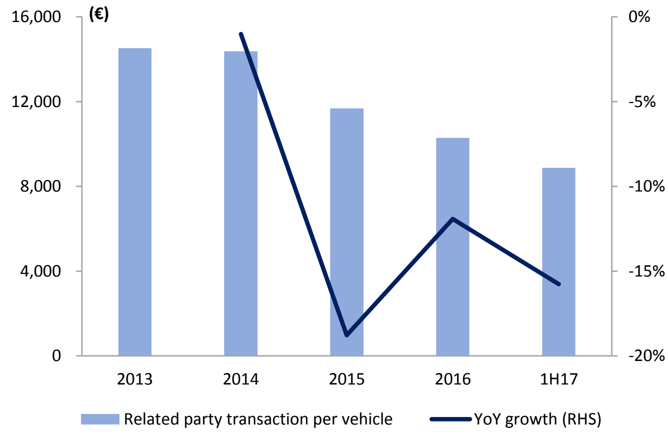
Model	Time	Platform	Engine type	Engine displacement
C class	Jul-14	MRA	M274	1.6T/2.0T
E class	Aug-16	MRA	M274/M276	2.0T/3.0T
GLA	Apr-15	MFA	M270	1.6T/2.0T
GLC	Nov-15	MRA	M274	2.0T
GLK	2012-2015	MRA	M274	2.0T/3.0L

Note: MRA represents Mercedes Rear-wheel-drive Architecture; MFA represents Mercedes Front-wheel-drive Architecture

Source: Company data, Autohome, SWS Research

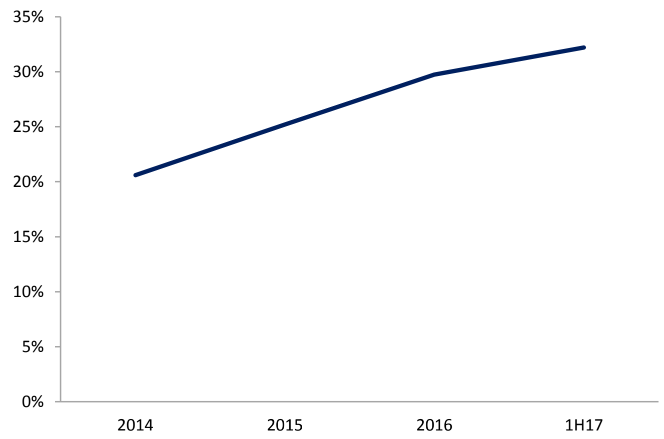
We note the related party transaction, regarding sales of goods and services from Daimler (DAI:GR) to BBAC, decreased significantly since 2015, which we believe was mainly due to the localisation of engine production. The related transaction per vehicle of BBAC dropped from €14.4k in 2014 to €8.9k in 1H17 by 38.3%, and BBAC recorded a corresponding improvement in gross margin, from 20.6% in 2014 to 32.2% in 1H17.

Fig 31: Unit related party transaction from Daimler to BBAC



Source: Company data, SWS Research

Fig 32: Gross margin of BBAC

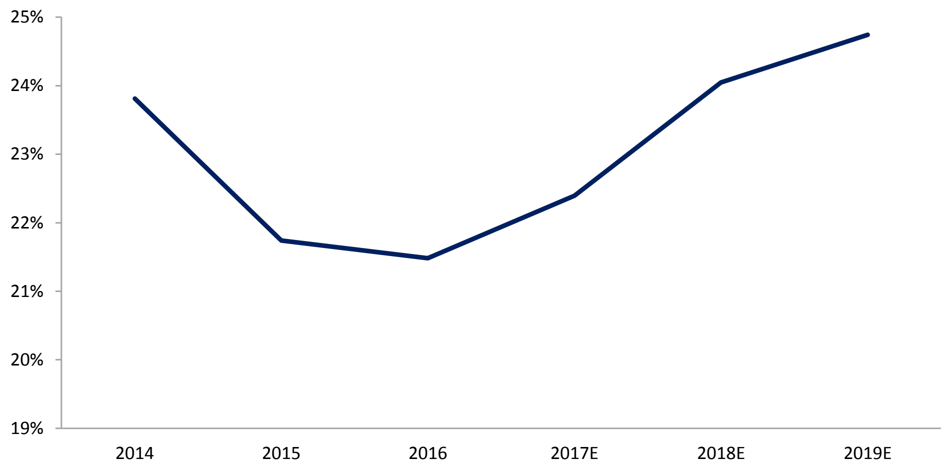


Source: Company data, SWS Research

We estimate the cost of engines for BBAC was c.Rmb30k-40k, with a localisation ratio of c.40%, but that full localisation of engine production allowed a cost saving of Rmb5k per unit, primarily due to import tariff and value-added tax savings.

With a similar cost structure, we believe BBA will experience an expansion of margins as its engines are increasingly sourced from local plants in 17-19E. Therefore, we expect BBA's gross margin to pick up from 21.5% in 16A to 22.4% in 17E, 24.0% in 18E and 24.7% in 19E.

Fig 33: Gross margin forecast of BBA



Source: Company data, SWS Research

With better sales and higher prices, we believe the *5 Series* and *X3* models will enjoy higher gross margin. Furthermore, as engine production is localised, we expect gross margin for new *5 Series* to improve from 22% in 16A to 23% in 17E, before climbing to 27% in 18E, as economies of scale and narrowing retail discounts backed by strong demand begin to take effect. We expect *X3* gross margin to reach 25% in 18E and 27% in 19E, as the firm's new capacity ramps up.

As *3 Series* will reach the end of its current product cycle in 2018 and the new *3 Series* model is scheduled for launch in 2019, we anticipate a widening retail discount for the *3 Series* in 18E, placing the series' profitability under pressure, before recovering in 19E.

The new *X1* model was launched in 3Q16, and we see the model as likely to increase in profitability as localised engine production reduces costs; we forecast gross margin for the model will be lifted 2ppts YoY to 23% in 17E.

However, we highlight our conservative view on sales of *1-* and *2- Series* models, limiting potential margin improvement and we forecast gross margin for the two models as remaining at c.18% in 17-19E.

Fig 34: Gross margin forecast, by model

Model	2014	2015	2016	2017E	2018E	2019E
1 series				18%	18%	18%
2 series		18%	18%	18%	18%	18%
3 series	23%	22%	21%	22%	20%	21%
5 series	25%	22%	22%	23%	27%	27%
X1	20%	20%	21%	23%	23%	22%
X3					25%	27%
Blended GPM	**23.8%**	**21.7%**	**21.5%**	**22.4%**	**24.0%**	**24.7%**

Source: Company data, SWS Research

Cooperation with Renault

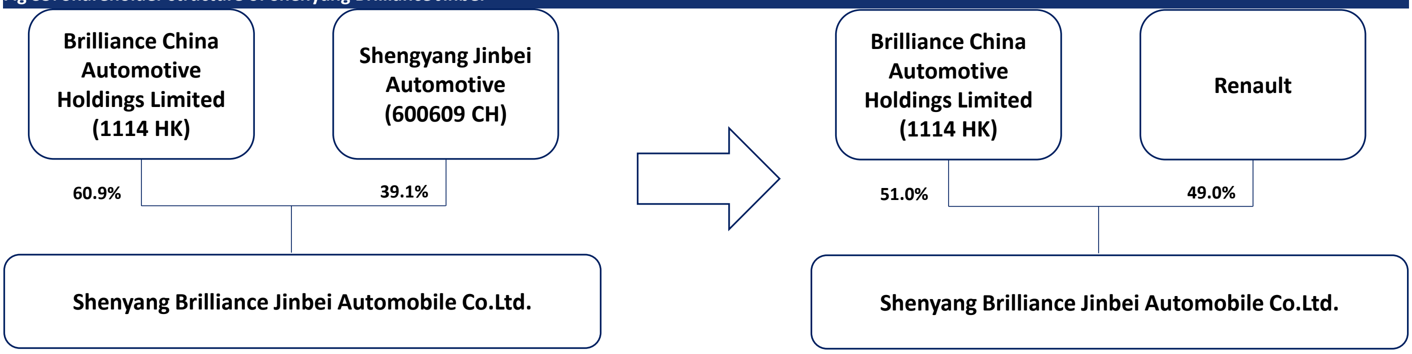
Brilliance China mainly manufactures and sells several minibus and MPV models through its 60.9% owned subsidiary, Shenyang Brilliance JinBei Automobile, in China. The key models include mid- to low-end minibus brand of *Haise* and *Granse* and premium MPV brand of *Huasong*, which was officially launched at the end of 2014.

In the past five years, Shenyang JinBei has reported deepening loss, due to weak brand recognition and worse-than-expected *Huasong* sales. Shenyang JinBei sold 33.6k units of minibuses and MPVs in 1H17, with 6.6% YoY growth. However, profit from operating activities remains negative in the past few years, and operating loss reached Rmb699mn in 1H17, given impairment loss of Rmb350mn from *Huasong*.

We note Brilliance China has been seeking for further cooperation since 2016, to turnaround its minibus operation over time. On June 4, 2017, Brilliance China and Renault entered into a Framework Cooperation Agreement, regarding the disposal and purchase of equity interest in Shenyang JinBei.

Brilliance China will acquire the 39.1% of Shenyang Brilliance JinBei from Shenyang JinBei Automotive (600609:CH) through its wholly owned subsidiary, after which it will sell a 49% stake in the now wholly owned unit to Renault, retaining a 51% interest. Upon the completion of transaction, Brilliance China and Renault will raise registered capital of Shenyang JinBei to a total of Rmb1.5bn.

Fig 35: Shareholder structure of Shenyang Brilliance Jinbei

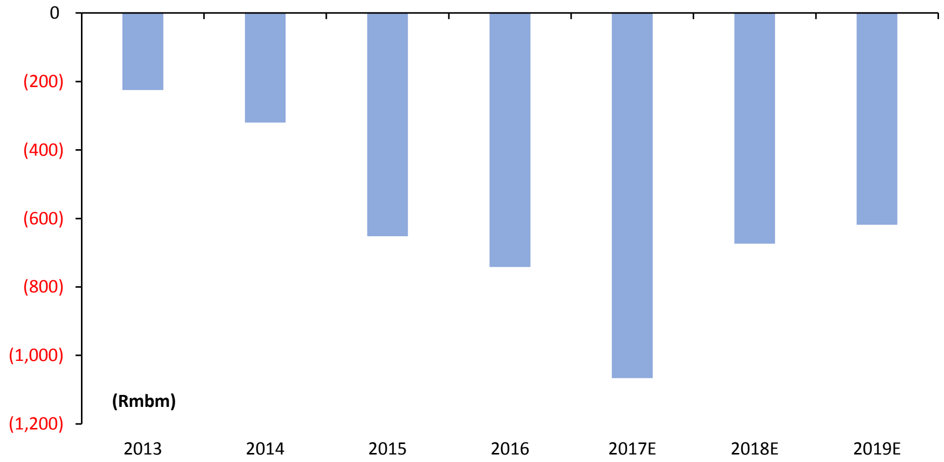


Source: Company data, SWS Research

Renault is the largest light commercial vehicle (LCV) maker in Europe, which has sophisticated experiences in management and developing electric LCV models. Renault also has a proven track record of exploring partners with other auto makers in LCV market, including Nissan, Daimler Europe, General Motors Europe and Fiat Europe. By cooperating with Renault, Brilliance is likely to turnaround the minibus operations.

We view cooperation with Renault as a critical move for Brilliance China, as we believe the company's minibus business will benefit substantially from the cooperation with the leading producer. In the near-term, the reduced equity interest in Shenyang JinBei will help reduce the negative impact on Brilliance China's bottom line. In the long-term, we expect Shenyang JinBei to increase in competitiveness, thanks to Renault's technology, design and management expertise in the LCV segment. Although we conservatively forecast an operating loss of Rmb1.1bn in 17E, narrowing to losses of Rmb674m in 18E and Rmb618m in 19E, we highlight our expectation of recovering minibus sales and a heightened possibility of a turnaround in next 2-3 years with Renault's help.

Fig 36: Brilliance China operating loss forecast



Source: Company data, SWS Research

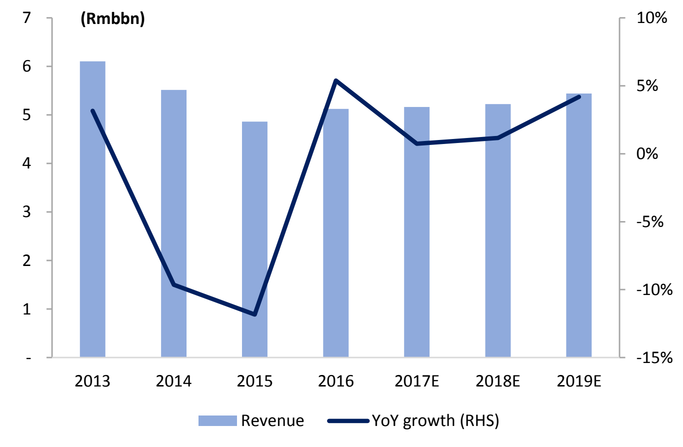
Financial analysis

Brilliance China operates two main entities, Shenyang JinBei, which, as the only fully consolidated subsidiary contributes the firm's revenue but is lossmaking at present; and BBA, accounted for under the equity method and contributing the majority of the firm's profit.

We expect Brilliance China to generate revenue of Rmb5.2bn in 17E (+0.7% YoY), Rmb5.2bn in 18E (+1.2% YoY) and Rmb5.4bn in 19E (+4.2% YoY), given weak minibus sales forecast.

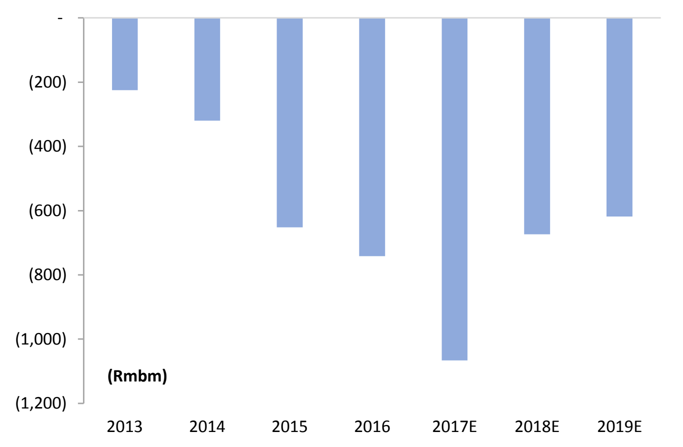
We expect the Brilliance's operating loss to narrow from Rmb1.1bn in 17E to Rmb674mn in 18E and Rmb618mn in 19E, on the assumption that it records no further impairment losses in 18E and 19E.

Fig 37: Brilliance China's total revenue forecast



Source: Company data, SWS Research

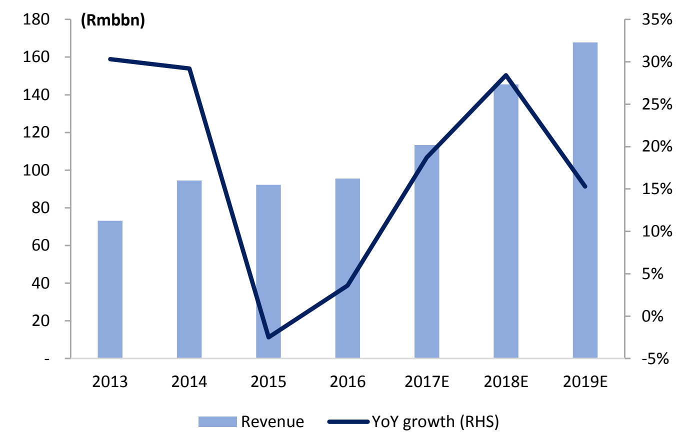
Fig 38: Brilliance China's operating profit forecast



Source: Company data, SWS Research

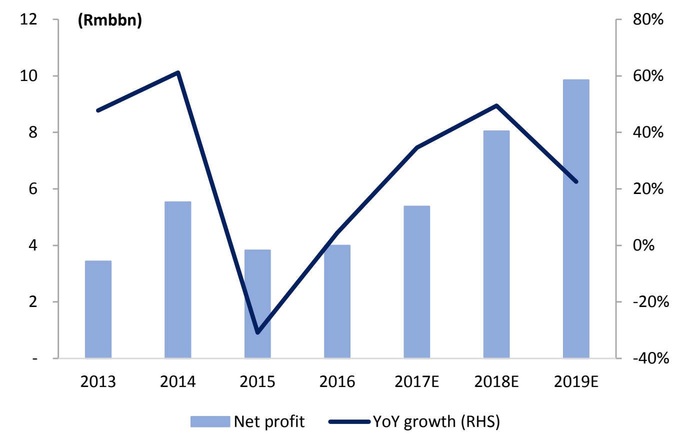
Primarily driven by a resurgent product cycle from BMW and rising blended ASP, we forecast BBA to generate total revenue of Rmb113.4bn in 17E (+18.7% YoY), Rmb145.6bn in 18E (+28.4% YoY) and Rmb167.9bn in 19E (+15.3% YoY). Meanwhile, we also see firm-wide gross margin improving, as production of the firm's engines is localised, and we thus forecast net profit for BBA of Rmb10.8bn in 17E (+34.6% YoY), Rmb16.1bn in 18E (+49.5% YoY) and Rmb19.7bn in 19E (+22.5% YoY). This translates into a contribution to Brilliance China's bottom line of Rmb5.4bn in 17E, Rmb8.0bn in 18E and Rmb9.9bn in 19E.

Fig 39: BBA's total revenue forecast



Source: Company data, SWS Research

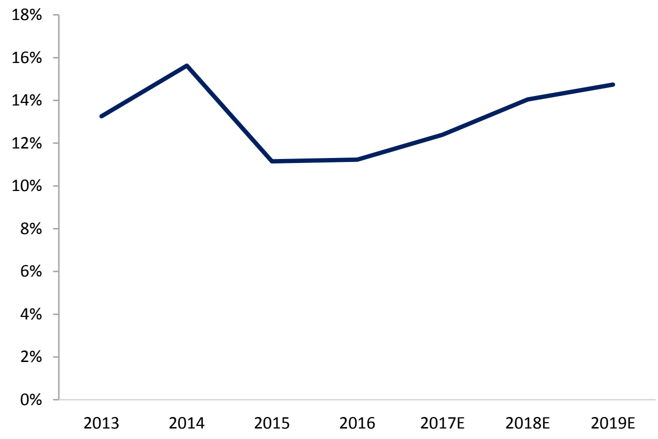
Fig 40: BBA's net profit attributable to Brilliance China



Source: Company data, SWS Research

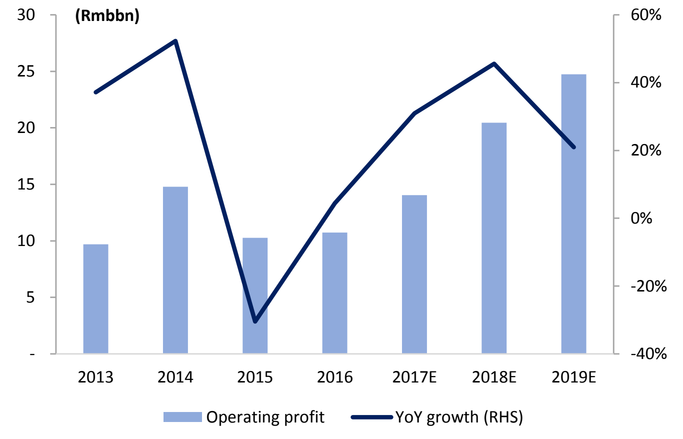
Following price cuts for BMW models in 2015, BBA's 15A operating margin dropped to 11.2% from 15.6% in 14A. However, given improving utilisation rate of the firm's major plants, localised production of engines and a reduced ratio of selling expenses to revenue, we forecast BBA's operating margin to rise from 11.2% in 16A to 12.4% in 17E, 14.0% in 18E and 14.7% in 19E, and operating profit of Rmb14bn in 17E (+30.9% YoY), Rmb20.4bn in 18E (+45.6% YoY) and Rmb24.7bn in 19E (+21.0% YoY).

Fig 41:BBA's operating margin



Source: Company data, SWS Research

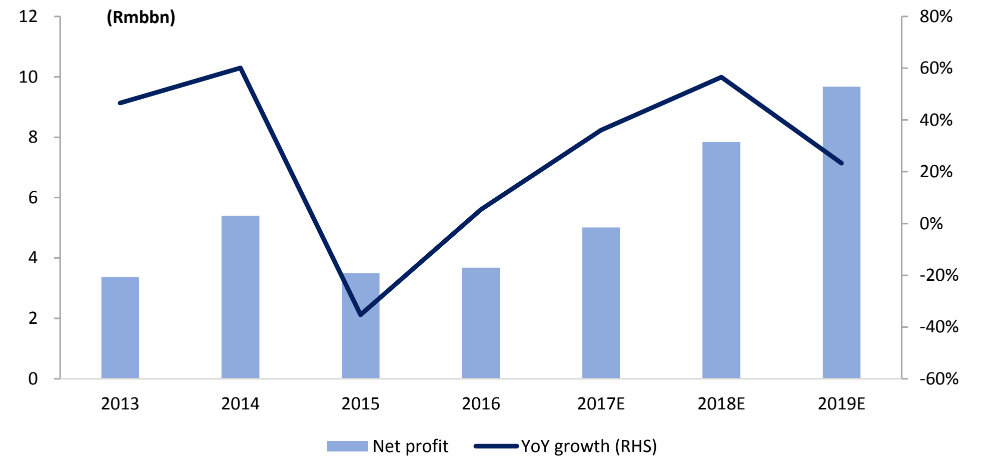
Fig 42: BBA's operating profit forecast



Source: Company data, SWS Research

Overall, we forecast Brilliance China's net profit to reach Rmb5.0bn in 17E (+36.1% YoY), Rmb7.8bn in 18E (+56.6% YoY) and Rmb9.7bn in 19E (+23.3% YoY). This translates into the basic EPS of Rmb0.99 in 17E (+36.1% YoY), Rmb1.56 in 18E (+56.6% YoY) and Rmb1.92 in 19E (+23.3% YoY).

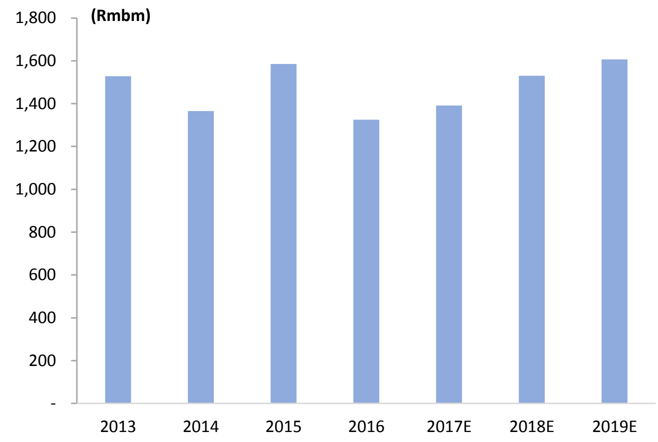
Fig 43: Brilliance China's net profit forecast



Source: Company data, SWS Research

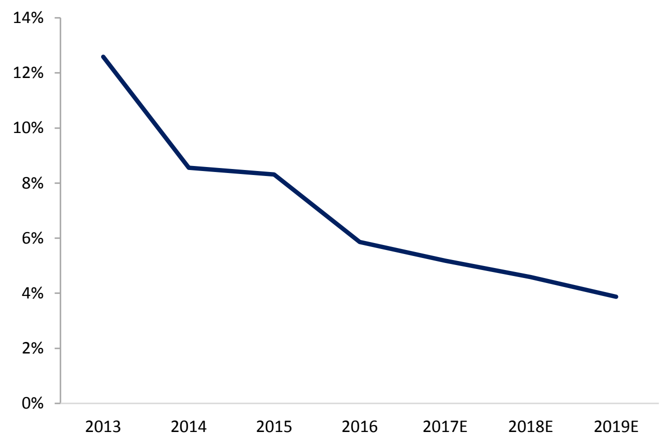
We expect total debt to increase to Rmb1.4bn in 17E (+5.0% YoY), Rmb1.5bn in 18E (+10.0% YoY) and Rmb1.6bn in 19E (+5.0% YoY), to satisfy the firm's planned increase in investment in its minibus segment, especially after agreeing to cooperation with Renault. However, as equity will also grow rapidly, we see the firm's debt-to-equity ratio as likely to decline, from 5.9% in 16A to 5.2% in 17E, 4.6% in 18E and 3.9% in 19E.

Fig 44:Brilliance China's short-term debt



Source: Company data, SWS Research

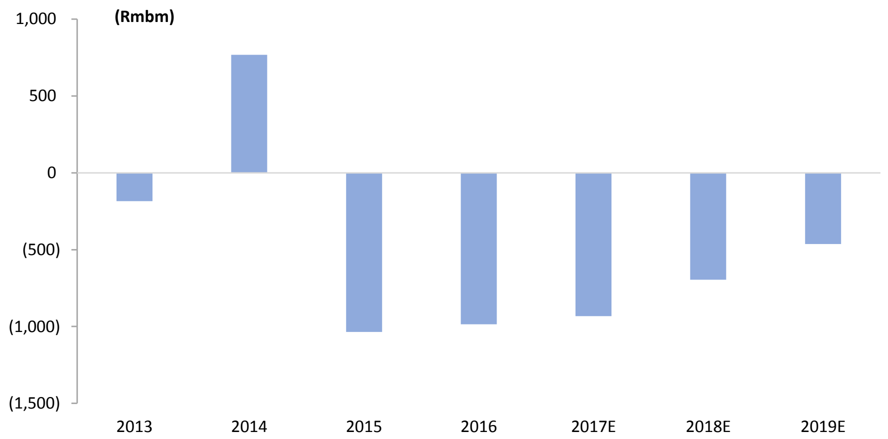
Fig 45: Brilliance China's debt-to-equity ratio



Source: Company data, SWS Research

We forecast Brilliance China's operating cash outflow to decline from Rmb9.8bn in 16A to Rmb9.3bn in 17E, Rmb7.0bn in 18E and Rmb4.6bn in 19E, mainly driven by narrowing operating loss.

Fig 46: Brilliance China's operating cash flow forecast



Source: Company data, SWS Research

Valuation

Given strong BWM cycle and recovering minibus segment, we apply a 15x 18E PE multiple, at approximately the lower bound of the normal range seen among global peers during a product upcycle, of 15x-20x. We derive a target price of HK$27.80.

Fig 47: Comparable peers

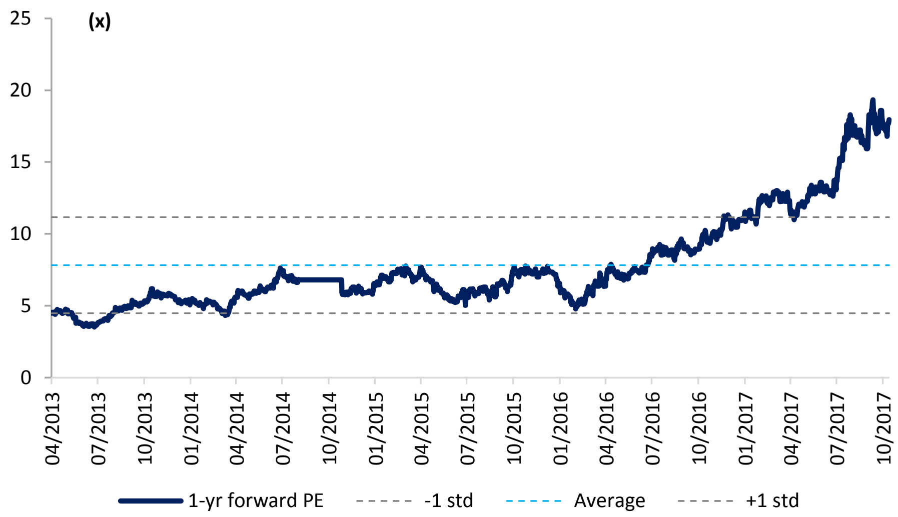
Code	Company	Rating	Target price (HK$)	Mkt cap (Rmbbn)	Net income (Rmbm)		YoY	PE (x)		PB (x)	
					17E	18E	18E	17E	18E	17E	18E
1114 HK	Brilliance	BUY	27.80	93	5,011	7,848	56.6%	17.9	12.0	3.3	2.7
175 HK	Geely	Hold	21.00	196	9,035	12,155	34.5%	21.4	16.0	6.0	4.6
2333 HK	GWM	BUY	13.60	105	6,964	8,960	28.7%	11.9	9.1	1.6	1.4
1958 HK	BAIC	NA	NA	58	5,437	7,100	30.6%	10.8	8.1	1.3	1.2
2238 HK	GAC	NA	NA	159	10,224	12,249	19.8%	11.3	9.5	2.1	1.8
489 HK	DFG	NA	NA	79	13,548	14,051	3.7%	5.8	5.6	0.7	0.6
1211 HK	BYD	Outperform	54.00	178	4,736	6,846	44.6%	35.5	24.7	3.1	2.8
Industry								**16.4**	**12.2**	**2.6**	**2.2**

Source: Bloomberg, SWS Research

Although, held against its five-year average, Brilliance is trading at a demanding PE valuation, we view the relative method is the most appropriate to value original equipment manufacturers (OEMs), and we see Brilliance in particular as likely to benefit from a transformative change in its earnings from the localisation of engine production, offering an opportunity to re-rate - we forecast earnings growth of 57% YoY in 18E, and as such, see our conservative 15x 18E PE valuation as reasonable given the c.25% YoY growth in earnings offered by the broader auto sector.

Our application of a conservative multiple, compared with the 15-20x multiple enjoyed by peers during their respective upcycles, reflects our recognition of market concerns over the firm's minibus segment. However, we expect losses from the business to moderate in coming years as it books reduced impairment losses from 18E and due to the closer partnership with Renault. As a result, we believe the market underestimates the company. With 28.7% upside to our target price, we initiate coverage with a BUY rating.

Fig 48: Forward PE ratio



Source: Bloomberg, SWS Research

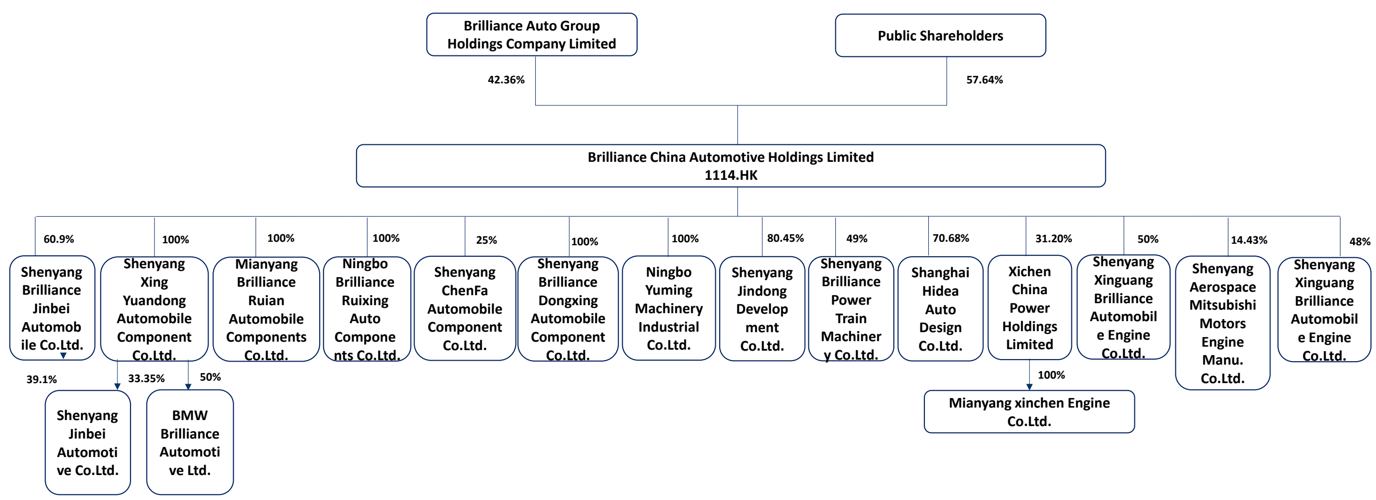
Appendix

Fig 49: Brilliance China's management

Name	Position	Experience
Wu Xiao An	Chairman	Mr. Wu Xiao An, aged 55, has been the chairman of the Board since 18th June, 2002 and executive director since 11th January, 1994. Mr. Wu has over 22 years of experience in the automotive industry and is primarily responsible for the overall strategic planning and business development of the Group. He was the vice chairman and the chief financial officer of the Company from January 1994 to June 2002. He has been a director of Huachen since October 2002, the chairman of BMW Brilliance since May 2003, and the chairman of BBAFC since April 2015. He was a director of Shenyang Automotive from January 1994 to August 2016. From 1988 to 1993, he was the deputy manager of the Bank of China, New York Branch. Currently, Mr. Wu is the chairman of the board of directors of Power Xinchen (stock code: 1148). In March 2011, Mr. Wu was appointed as a director and in April 2012 designated as an executive director of Power Xinchen.
Qi Yumin	President, executive director & CEO	Mr. Qi Yumin, aged 58, has been an executive director, the president and the chief executive officer of the Company since 6th January, 2006. Mr. Qi was the chairman and president of Huachen during the period from December 2005 to January 2016 and has served as the chairman of Huachen since January 2016. Since November 2006, Mr. Qi has been a director of BMW Brilliance. He was the chairman and a director of Shenyang Automotive from January 2006 to August 2016. From 1982 to 2004, Mr. Qi held various positions in Dalian Heavy Industries Co., Ltd., including chairman and general manager. From October 2004 to December 2005, he was the vice mayor of Dalian municipal government. He was qualified as a senior engineer (professor level) by the Personnel Department of Liaoning Province in December 1992. Since April 2009, Mr. Qi has been appointed as the chairman and a director of Shanghai Shenhua (stock code: 600653). Mr. Qi was a director of Power Xinchen from November 2011 to September 2016, and the chairman of the board and a director of JinBei (stock code: 600609) from May 2009 to August 2016.
Qian Zuming	Executive director &CFO	Mr. Qian Zuming, aged 54, has been an executive director of the Company since 12th September, 2016. Mr. Qian has been the chief financial officer of the Company since 1st July, 2008. He has around 34 years of experience in finance and accounting practice. Mr. Qian has been appointed as an assistant to the president of Huachen since December 2009. Mr. Qian has been a director of Shenyang Automotive since January 2010 and a director of BBAFC since March 2017. From 1982 to 1996, Mr. Qian was the deputy section head of the finance section of Shanghai Maritime Bureau of Ministry of Transport. From 1996 to 1998 and from 1998 to 2000, he was the finance manager of Shanghai Tai Li Shipping Co., Ltd. and Shanghai Xiao Song Packaging Machinery Co., Ltd.), respectively. From January 2006 to March 2007, Mr. Qian was the chief financial officer of Shanghai Hua Sheng Group Co., Ltd. Since August 2016, Mr. Qian has been appointed as a director of Shanghai Shenhua.
Zhang Wei	Executive director	Mr. Zhang Wei, aged 43, has been an executive director of the Company since 12th September, 2016. Mr. Zhang has been a director of SJAI, a subsidiary of the Company, since June 2014. Mr. Zhang joined Huachen in 2003 and has since held various positions in Huachen, including but not limited to senior project manager of assets operation department, secretary of president, division leader of human resources department, deputy manager of administrative office and assistant to president. Mr. Zhang has been the secretary of the board of directors of Huachen since March 2016. From July 1996 to February 1997, and from February 1997 to January 2003, Mr. Zhang was a specialist of import and export department and a project manager, respectively, of Liaoning Branch of China Metallurgical Import and Export Company. Since August 2016, Mr.Zhang has been appointed as a director of Shanghai Shenhua.

Source: Company data, SWS Research

Fig 50: Brilliance China's shareholder structure



Source: Company data, SWS Research

Company financials

Consolidated income statement

Rmbm	2015	2016E	2017E	2018E	2019E
Revenue	4,863	5,125	5,163	5,223	5,442
Cost of Sales	4,655	4,954	4,905	4,962	5,115
Gross Profit	208	172	258	261	326
Other Income	81	82	83	84	87
Distribution expenses	547	612	594	601	599
Administrative expenses	394	383	813	418	435
EBITDA	3,530	3,644	4,749	7,892	9,661
EBIT	3,391	3,504	4,568	7,622	9,489
Finance Costs	147	133	125	135	145
Profit before tax	3,325	3,425	4,493	7,552	9,424
Income tax expense	45	36	45	76	94
Minority interests	(214)	(293)	(563)	(371)	(347)
Profit for the year	3,495	3,682	5,011	7,848	9,677

Source: SWS Research

Consolidated Balance Sheet

Rmbm	2015	2016E	2017E	2018E	2019E
Current Assets	7,175	7,009	7,283	7,999	8,607
Bank balances and cash	1,071	941	1,040	1,519	1,932
Trade and other receivables	1,757	1,880	1,940	2,029	2,052
Inventories	1,211	1,104	1,152	1,230	1,328
Other current assets	3,136	3,084	3,151	3,221	3,295
Long-term investment	657	633	633	633	633
PP&E	2,042	2,250	2,577	2,906	3,249
Intangible and other assets	17,198	21,150	24,923	30,544	37,881
Total Assets	27,072	31,043	35,416	42,082	50,371
Current Liabilities	7,872	8,323	8,465	8,584	8,755
Borrowings	1,585	1,325	1,391	1,530	1,607
Trade and other payables	5,195	5,654	5,725	5,687	5,771
Other current liabilities	1,092	1,343	1,349	1,366	1,377
Long-term liabilities	137	122	122	122	122
Total Liabilities	8,009	8,444	8,587	8,706	8,877
Minority Interests	(832)	(1,125)	(1,254)	(1,534)	(1,836)
Shareholder Equity	19,064	22,599	26,830	33,377	41,494
Share Capital	396	397	397	397	397
Reserves	19,500	23,327	27,687	34,514	42,933
Equity attributable	19,896	23,724	28,083	34,911	43,330
Total Liabilities and equity	27,072	31,043	35,416	42,082	50,371

Source: SWS Research

Cash Flow Statement

Rmbm	2015	2016E	2017E	2018E	2019E
Profit before taxation	3,325	3,425	4,493	7,552	9,424
Plus： Depreciation. and amortisation	181	270	172	183	194
Finance cost	147	133	125	135	145
Losses from investments	0	0	0	0	0
Change in working capital	(524)	(413)	(37)	(204)	(38)
Others	(4,165)	(4,399)	(5,684)	(8,361)	(10,188)
CF from operating activities	(1,035)	(985)	(932)	(695)	(463)
CAPEX	(606)	(480)	(527)	(534)	(556)
Other CF from investing activities	967	1,595	2,063	2,559	2,556
CF from investing activities	361	1,114	1,535	2,026	2,000
Equity financing	0	0	0	0	0
Net change in liabilities	651	170	17	44	3
Dividend and interest paid	(592)	(617)	(526)	(885)	(1,113)
Other CF from financing activities	493	135	0	0	0
CF from financing activities	553	(312)	(510)	(841)	(1,110)
Net cash flow	(122)	(182)	94	489	427

Source： SWS Research

Key Financial Ratios

	2015	2016E	2017E	2018E	2019E
Ratios per share (RMB)					
Earnings per share	0.70	0.73	0.99	1.56	1.92
Diluted earnings per share	0.69	0.73	0.99	1.56	1.92
Operating CF per share	(0.20)	(0.19)	(0.18)	(0.14)	(0.09)
Dividend per share	0.09	0.09	0.13	0.20	0.25
Net assets per share	3.79	4.49	5.33	6.63	8.24
Key Operating Ratios(%)					
ROIC	(2.99)	(2.93)	(3.58)	(1.83)	(1.36)
ROE	18.33	16.29	18.68	23.51	23.32
Gross profit margin	4.28	3.35	5.00	5.00	6.00
EBITDA Margin	72.60	71.10	91.98	151.10	177.54
EBIT Margin	69.73	68.38	88.47	145.94	174.39
Growth rate of Revenue(YoY)	(11.82)	5.39	0.74	1.16	4.19
Growth rate of Profit(YoY)	(35.32)	5.36	36.08	56.62	23.31
Debt-to-asset ratio	29.58	27.20	24.24	20.69	17.62
Turnover rate of net assets	0.26	0.23	0.19	0.16	0.13
Turnover rate of total assets	0.18	0.17	0.15	0.12	0.11
Effective tax rate (%)	1.34	1.05	1.00	1.00	1.00
Dividend yield (%)	0.49	0.51	0.70	1.10	1.36
Valuation Ratios (X)					
P/E	31.1	29.5	21.7	13.9	11.2
P/B	5.7	4.8	4.1	3.3	2.6
EV/Sale	22.5	21.4	21.2	21.0	20.1
EV/EBITDA	31.0	30.0	23.0	13.9	11.3

Source: SWS Research

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