

June 12, 2015

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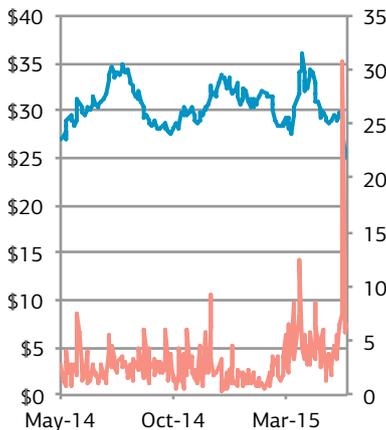
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Weichai (2338 HK)

Price	HKD 25.40
Rating	SELL
Price Target	Closing coverage
Market Cap	USD 10.2 bln
Avg. Volume	7.4 mln
P/E	8.1x
Free Float	100%

Weichai (2338 HK) last share price in HKD (blue) and volume (pink, in mln shares)



Source: Bloomberg June 11, 2015

Weichai Power Co. Ltd. (2338 HK) Driving into the Abyss

▶ 2015 has been grim for the Heavy Duty Truck (HDT) industry

Industry sales were down 50% YoY in April and 43% YTD.

▶ No escape for Weichai

A Beiqi Foton purchaser told us his Weichai engine purchases were down 70% YoY.

▶ Losing competitiveness

Beiqi Foton is increasingly sourcing from other competitors and cutting engine purchases from Weichai.

▶ Shaanxi Heavy sales managers negative

Interviewees were all negative and one said his sales were down 20-30% YoY.

▶ Closing coverage

Since our initiation, Weichai has fallen 21%. We think the outlook remains negative.

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The HDT Maelstrom Won't Spare Weichai

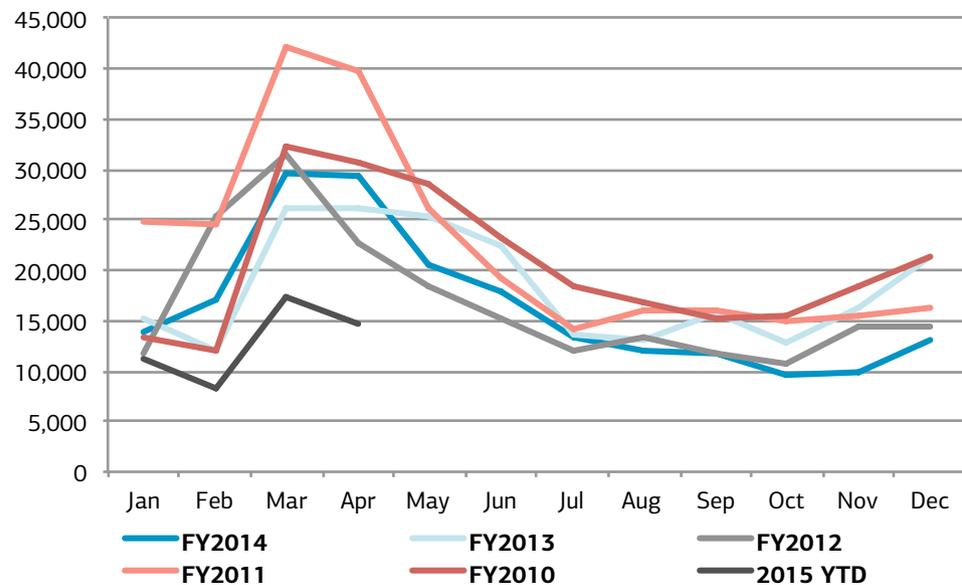
2015 will definitely be the worst year in HDT sales over the last 6 years and will probably be lower than the financial crisis years of 2008 and 2009.

Weichai is faced with a shocking Chinese heavy duty truck (“HDT”) environment and we see little hope for positive news in 2015.

2015 has been grim. Industry numbers are horrific with April HDT sales down 50% YoY and 43% YTD (based on China Automobile Association data from the Wind database).

2015 will definitely be the worst year in HDT sales over the last 6 years and will probably be lower than the financial crisis years of 2008 and 2009.

Chart 1. 2015 HDT Sales—Horrific



Source: CAAM, J Capital Research

Beiqi Foton Checks Very Negative

Beiqi Foton operates the “BFDA” JV with Daimler AG to produce Auman-branded medium and heavy-duty trucks. Beiqi Foton and BFDA are very important to Weichai:

- ▶ **Beiqi Foton is a related party:** Weichai holds 1.42% or 40 mln share in Beiqi Foton since investing in 2008. While Beiqi Foton is listed as a related party in Weichai’s.
- ▶ **Important customer:** In 2014, Beiqi Foton accounted for RMB 481

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A Beiqi Foton engine purchaser stated that their Weichai engine purchases were down a whopping 70% YoY!

mln or 6.43% of Weichai's total sales. These were mainly engine sales.

We spoke to a Beiqi Foton engine purchaser, who stated that their Weichai engine purchases were **down a whopping 70% YoY!**

We were unable to speak to other Beiqi Foton purchasers to corroborate the massive 70% drop. However Beiqi Foton's published numbers do provide some back-up to the extremely negative sentiment.

- ▶ Beiqi Foton's April HDT sales were down 41% YoY and 41% YTD.
- ▶ Daimler also noted that BFDA sales were down 40% YoY in 1Q 2015. As a major engine supplier to BFDA, Weichai would thus be facing similar sales declines.
- ▶ **Beiqi sales checks:** A Changsha sales manager told us Beiqi trucks with Weichai engines were down 5-10% YoY. Another Wuhan-based sales manager told us that Beiqi HDT truck sales were down 40-50%. He also said that the much-vaunted "One Belt, One Road" infrastructure stimulus was simply a slogan as little action had been taken so far. However if real action eventuated, it would be beneficial for the HDT industry.

Table 1. BFDA Sales Cratering

Quarter	Sales Volume	YoY Growth
Q3 2012	13,942	
Q4 2012	17,430	
Q1 2013	23,001	
Q2 2013	28,229	
Q3 2013	24,129	73%
Q4 2013	27,939	60%
Q1 2014	26,643	16%
Q2 2014	31,242	11%
Q3 2014	18,051	-25%
Q4 2014	23,294	-17%
Q1 2015	15,902	-40%

Source: Daimler financials, J Capital Research

Is Weichai Losing Competitiveness?

The Beiqi Foton purchaser said that apart from Weichai, they also procure engines from Yuchai and Cummins. Moreover, in the future Beiqi Foton

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will reduce the amount of outside engine purchases as they develop their own in-house R&D.

This is a major challenge for Weichai – its important customers are looking to develop their own technology and / or use competitor engines. Furthermore, Beiqi Foton has already started sourcing more from competitors.

- ▶ **Weichai purchases cut:** Beiqi Foton's 2014 annual report shows that purchases from Weichai Power Yangzhou Diesel Engine Co. were down 40% YoY to RMB 269 mln in FY2014 from 453 mln in FY2013.
- ▶ **While Cummins was increased:** Beiqi Foton has a JV with Cummins and the amount of purchases from this JV has increased markedly, from RMB 527 mln (FY2012), to 959 mln (FY2013), to 2.17bn (FY2014). This is almost 10x the amount purchased from Weichai.
- ▶ **Weichai isn't used for higher emission trucks:** In our initiation report we noted that Beiqi Foton was using Cummins engines for higher-emission standard trucks and Weichai for lower standard trucks. For the Auman Heavy-Duty Flatbed Truck, Cummins provides engines which meet Euro-IV emissions standard, while Weichai engines are only Euro-II. (See [here](#).)
- ▶ The fact that a major customer is not using Weichai for higher emission standard engines is very negative for Weichai's future sales and ability to compete.

Shaanxi Heavy Duty Automobile Checks Negative

We spoke with four sales managers at Shaanxi Heavy Duty Automobile (Shanqi). Shanqi is Weichai's HDT subsidiary.

- ▶ **All said the HDT industry was not good.** They are all waiting for meaningful policy or stimulus to save the industry. One respondent thought that 2015 was already the bottom of the cycle and that there might be a recovery from October. However he did not provide a reason why the industry would recover.
- ▶ One of the interviewees said his sales were down 20-30% YoY. He noted that the introduction of Euro-V emissions standards has had little impact on the industry. The other 3 interviewees didn't provide an estimate on how much their sales had fallen.

Closing Coverage

Since our initiation, Weichai's stock price has fallen 25%. We continue to think Weichai's outlook is negative. It's also likely that Weichai's price could fall even more, especially given the underlying credit risk in the HDT eco-system. However it is difficult to gain visibility on the credit issues in the HDT industry, particularly as Weichai is a sprawling SOE. Therefore we close our coverage of Weichai.

We continue to think Weichai's outlook is negative.

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