

June 23, 2015

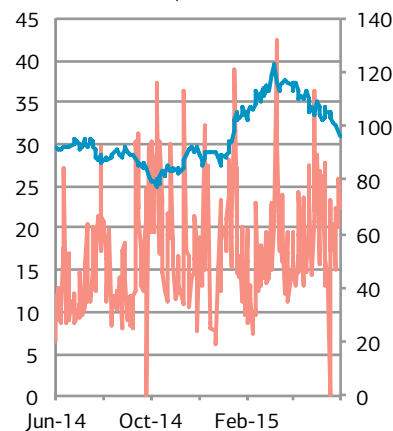
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BMW (BMW GR)

Price	EUR 102.42
Rating	SELL
Price Target	EUR 84.80
Market Cap	EUR 63.3 bln
Outstanding Shares	602 mln
Avg. Volume	28,000

BMW (BMW GR) last share price in EUR (blue) and volume (pink, in 100,000 shares)



Source: Bloomberg June 22, 2015

Bayerische Motoren Werke AG (BMW GR)

End of an Era

- ▶ **We believe that BMW China's slowing sales** are just the start of a slide that will see the company in negative growth for at least a year to come. The company's projection of more than 7% growth in China's luxury auto sales for six years to come is simply fantasy.
- ▶ **March was a turning point**, and sales for BMW have gone negative, while inventories stand at twice their normal level.
- ▶ **Our base case is a 5% decline** in sales in 2015 and a drop from 7.2% to 6.7% profit margin. Dealers will offer higher discounts in order to achieve sales targets.
- ▶ **As price-sensitive buyers go to cheaper models**, the Chinese government is also undermining pricing by supporting the import of BMWs by companies not authorized by BMW. This will further erode the company's margins. We estimate that such "parallel imports" account for about 10% of BMW's imported models.
- ▶ **Our target price of EUR 84.8** is 9.87x our forecast 2015 EPS of EUR 8.59. This assumes BMW China sales are down 5% in 2015 compared with a 17% YoY increase in 2014.

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Declining Sales in China

Founded in 1916, BMW (Bayerische Motoren Werke AG) produces premium automobiles under three brands, BMW, MINI, and Rolls Royce, as well as motorcycles under BMW Motorrad. The company is listed on the Frankfurt Stock Exchange.

BMW offers over 20 models in Mainland China. Three of these models (3-series, 5-series and X1 SUV) are currently produced by BMW Brilliance, the JV entity, while the rest are imported by BMW China. China is BMW's largest market for the 5-Series and 7-Series models, contributing 41.6% and 45.1% of these two models' global sales volume respectively in 2014.

Local Manufacturing Growing in Importance

BMW Group operates its Chinese business through a joint venture with Brilliance Auto and its China sales company, which sells imported models in Mainland China. From 2005 to 2014, the Chinese market grew very fast, at a CAGR of 33.9%, reaching 456,700 vehicles sold in 2014. BMW's sales network expanded to 460 sales and service centers and 110 Mini dealers as of 2014, from 60 in 2005. China has become the largest single market for the Group, accounting for 21.6% of total sales volumes and 25.2% for the BMW brand.

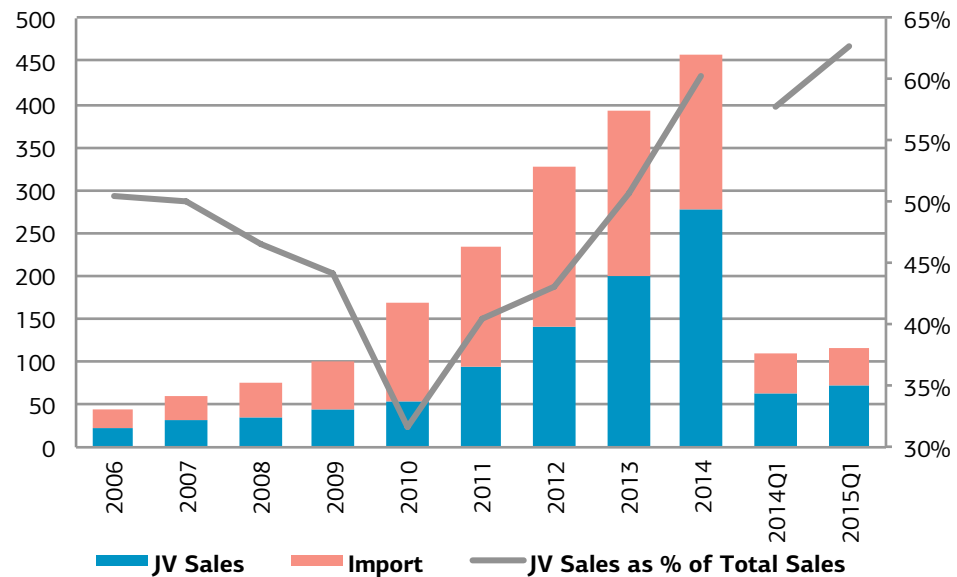
BMW formed a 50-50 joint venture company in 2003 with Brilliance, and that company is now responsible for about 13.2% of BMW's global sales. The JV produces three BMW models: the 3-series, 5 series, and the X1 SUV, as well as a recently developed electronic vehicle called ZINORO, which is based on the X1. BMW Brilliance operates two plants in Dadong and Tiexi, both in Liaoning Province. Total production capacity is 300,000 units as of end-2014, and capacity is expected to increase to 400,000 units by 2016.

The Tiexi plant started production in 2012, and sales of BMW Brilliance vehicles reached 275,9000 units in 2014, nearly double the 141,200 units of FY 2012. At the same time, the joint venture entity became more important to BMW Group. As of 2014, BMW Brilliance represented 60.4% of BMW Group's sales volume in Mainland China. The JV's net profit margin also rose to 11.7% in 2014.

BMW's China JV margins have risen steadily since 2009.

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Chart 1. Sales of Imports and of JV Cars (,000 Units)



Source: Company data

Table 1. Financials of BMW Brilliance (in RMB mln)

	2009	2010	2011	2012	2013	2014
Manufacture and Sale of BMW Vehicles	14,674	21,485	37,532	56,151	73,173	94,545
Net Results	711	1,792	3,441	4,650	6,871	11,072
Profit Margin	4.8%	8.3%	9.2%	8.3%	9.4%	11.7%

Source: Company data, J Capital Research

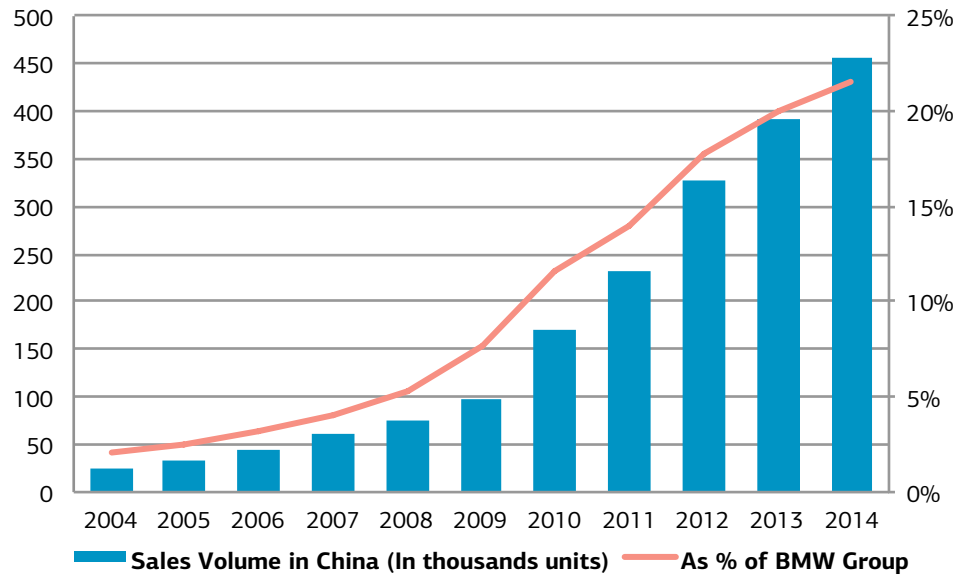
Brilliance has managed since 2013 to maintain higher pricing than has BMW for its imported models. Its higher sales volumes also help keep costs low.

Can't Overstate China's Impact

China is the profit driver for BMW. BMW does now break out profit for China, but our estimates indicate that China contributes over 30% of BMW's total pre-tax profit, including profits from the BMW Brilliance Joint Venture. China is also driving sales growth. In 2014, nearly 42% of BMW Group's sales growth came from China, and the region still maintained double-digit YoY growth in 2014. BMW's filings claim that China's premium auto segment will grow at a CAGR of 7.8% over the coming six years, to 2.87 mln units in 2020, from 1.83 mln units in 2014.

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Chart 2. China Has Been BMW's Growth Engine

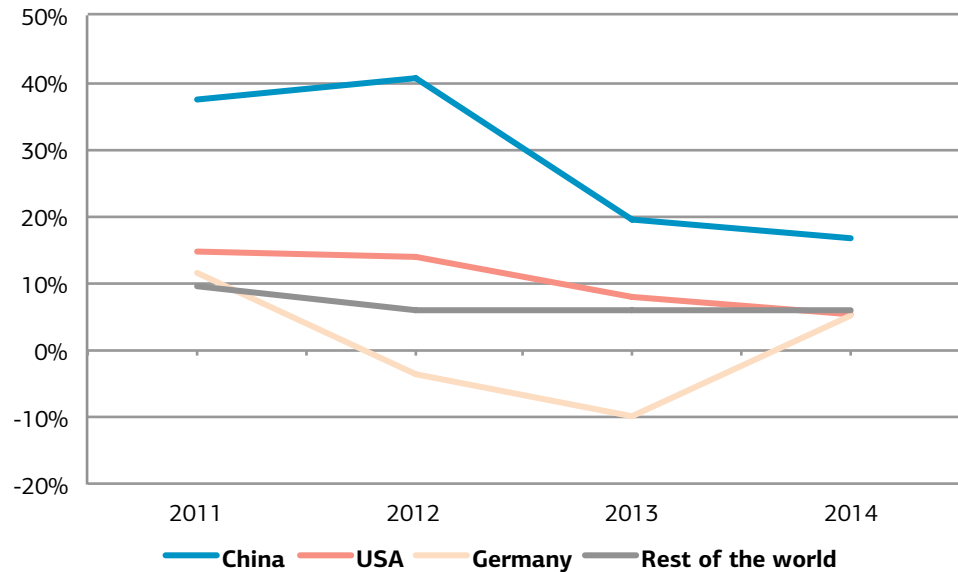


Source: Company data, J Capital Research

All indications are that the growth story is over.

But all indications are that the growth story is over. Auto manufacturers, including luxury brands such as BMW, will no longer be able to assume fast-growing sales and never-ending profits from China.

Chart 3. China Has Had the Largest Sales Growth



Source: Company data, J Capital Research

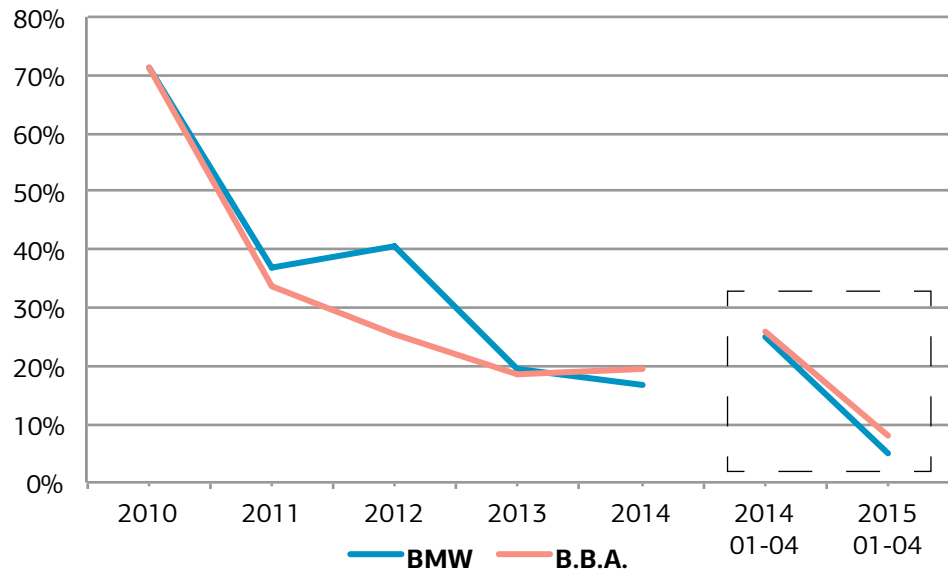
2015: The Great Downshift

In the first four months of 2015, the “German Big 3” saw their YoY growth

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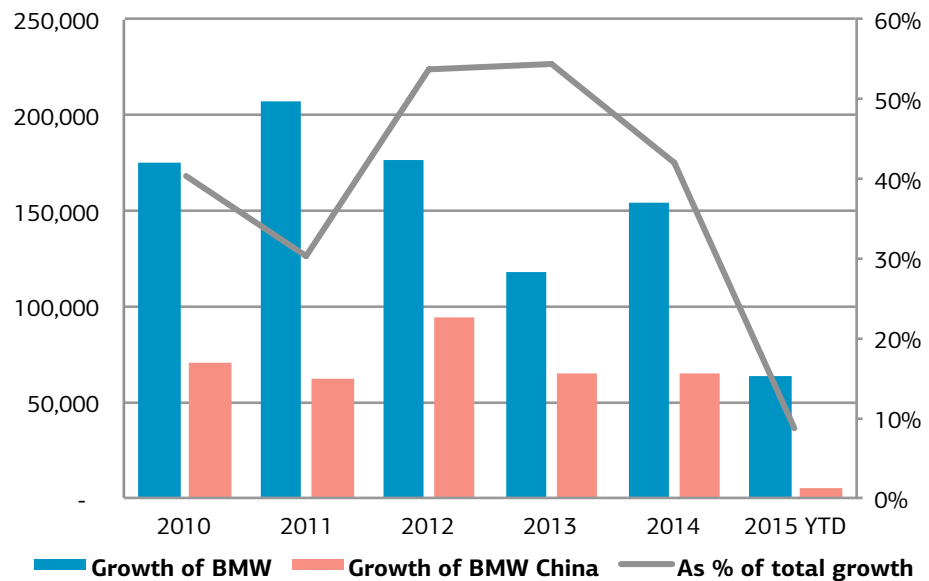
rate slide to 7.9% compared with 25.8% during the same period of 2014. After having enjoyed consistently surging sales for almost a decade in China, BMW China slowed to 3% YoY in the first five months of 2015, and its May sales were down, at 4.2% YoY versus 22.4% in May 2014. China's growth shrank to only 14% of the global growth of BMW in terms of sales volume. This is especially significant, as Chinese growth has been the critical driver of BMW's share price.

Chart 4. The 2015 Growth Slide



Source: Company data, J Capital Research

Chart 5. BMW China Sales Growth Sliding

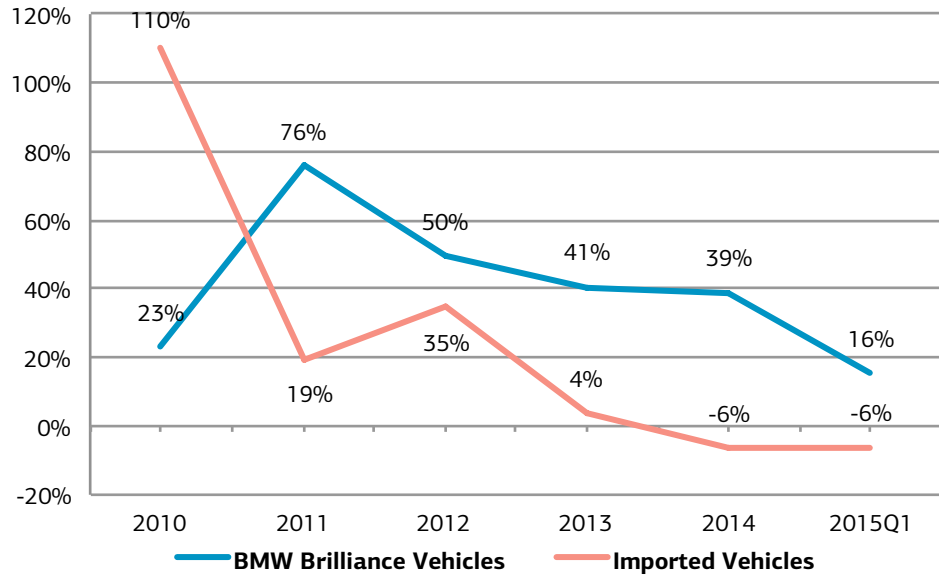


Source: Company data, J Capital Research

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BMW Brilliance’s YoY sales of both imported vehicles and vehicles produced in China began to slow from 2013. Imported BMW models were the first to see growth decline in 2014, with minus 6% YoY growth.

Chart 6. Slowdown in Both Domestic and Imported BMWs



Source: Company data, J Capital Research

BMW Brilliance has maintained double-digit growth thanks to the expansion of production capacity of the JV entity, the popularity of the three models, and also because dealers have been piling up inventory in the channel. However, things changed in 2015. While the company shows continuing, albeit slower growth in BMW Brilliance, industrial data from the China Passenger Car Association (CPCA) show that JV model sales went negative in March 2015. In April, total monthly sales of the three models dropped 9.8% YoY, according to the CPCA. Given that dealers are carrying so much inventory that may look like sales, the CPCA data look more accurate. (See the chart at the top of the next page.)

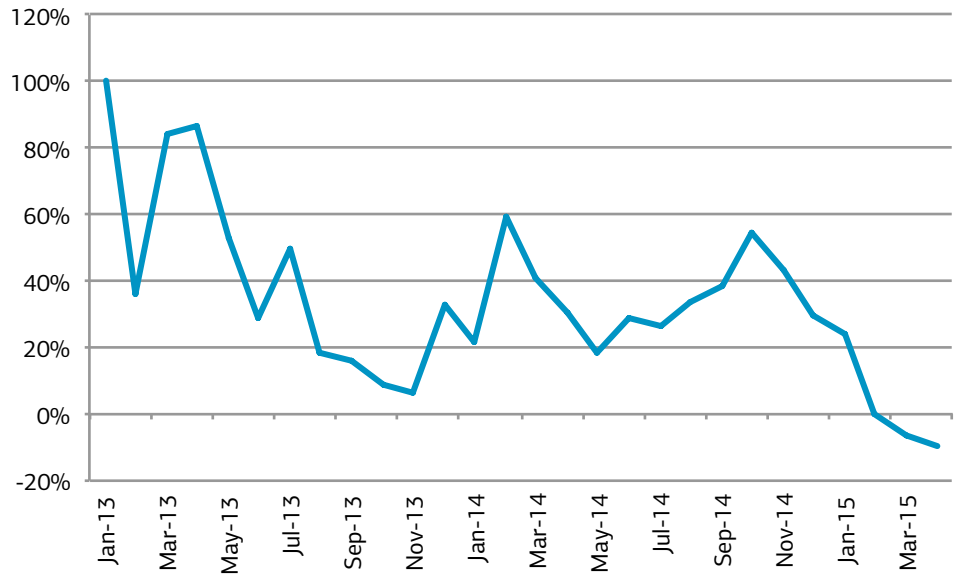
Negative Dealer Checks

Our recent checks with 15 BMW dealers around the country confirmed the downward trend and found that most dealers are seeing YTD sales volume flat or down. The most extreme case came from a northeastern China dealer who claimed a 50% decrease YoY this year. Only two dealers reported growth, of 10%. In-depth dealer responses can be found in the Appendix.

April industrial data provided by the China Automobile Dealers Associa-

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Chart 7. Same Chart, Different Data



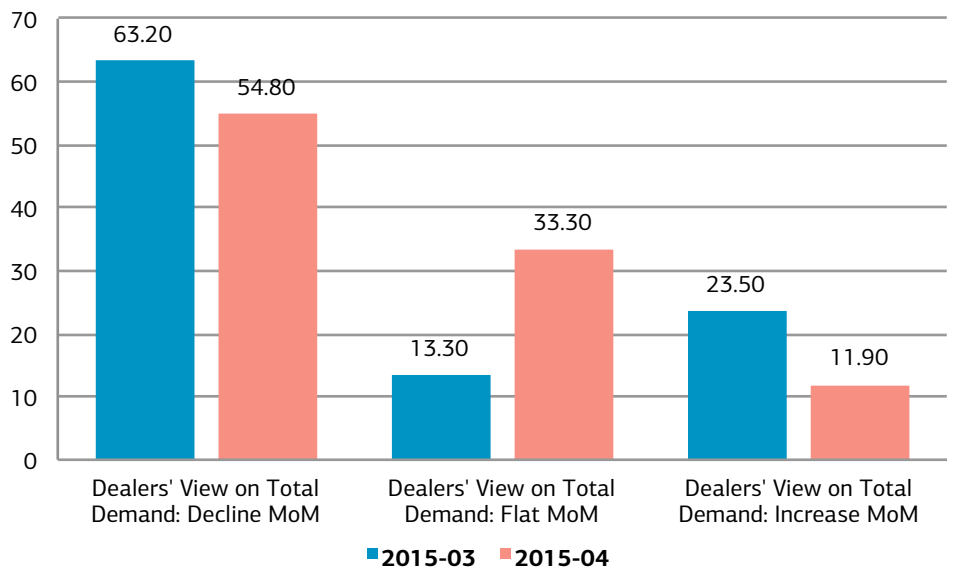
Source: CPCA, J Capital Research

tion (CADA) also show dealer sales under pressure. According to CADA:

- ▶ 88.1% of dealers are seeing total demand flat or declining on MoM basis.
- ▶ Only 11.9% of dealers think demand is increasing MoM in April, down from 23.5% of March.

Dealers reported fewer client visits at 4S stores. In April, only 18.5% of

Chart 8. Dealers' View on Total Demand (%)—In Decline

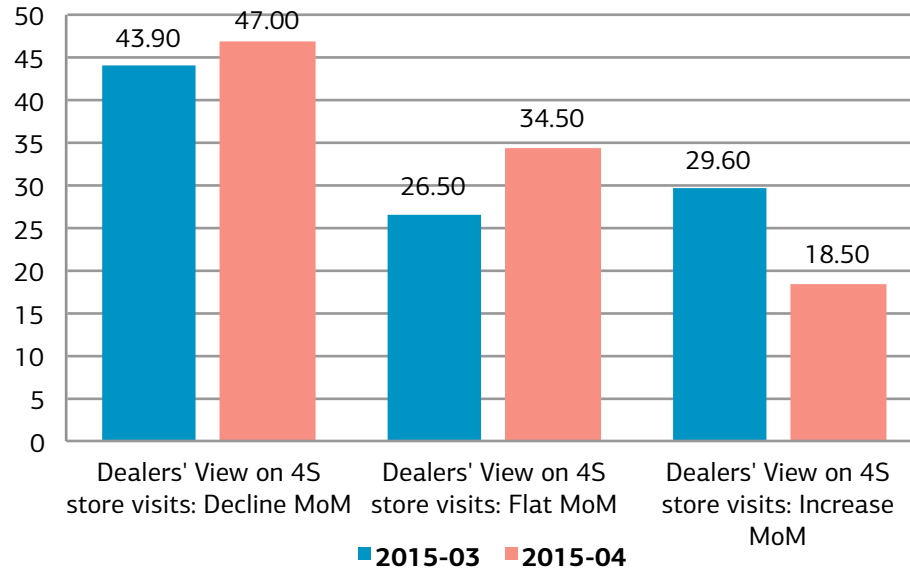


Source: CADA, J Capital Research

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dealers saw an increase in client visits, down from 29.6% in March. 47% thought client visits declined, with 34.5% saying visits were flat.

Chart 9. Dealers' View on 4S Store Visits (%)



Source: CADA, J Capital Research

Not a Short-Term Blip

Consumers have changed their purchasing behavior. Part of that is due to the anti-corruption campaign, which more or less ended institutional purchasing of luxury vehicles for official use. Partly, it stems from less wealth all around as investment capital is not coursing through the economy as it once did. Individuals are more conscious of thrift and are delaying replacement cars and buying more economical models.

Meanwhile, inventories have piled up from BMW's aggressive dealership expansion over the last two years. In order to catch up with Audi in China, BMW has been very aggressive in assigning sales targets to its dealers. We learned from checks with dealers that sales targets are set based on twice China's estimated GDP for the year. In 2015, dealers, especially those with new outlets, are being asked to increase sales volumes by 10-15% in order to win rebate payments.

But the OEM's leverage is waning. In late 2014, dealers' successfully made a public demand for a subsidy of RMB 5.1 bln from BMW. This year, some dealers have chosen to cut purchases from the manufacturer to improve their bloated inventory.

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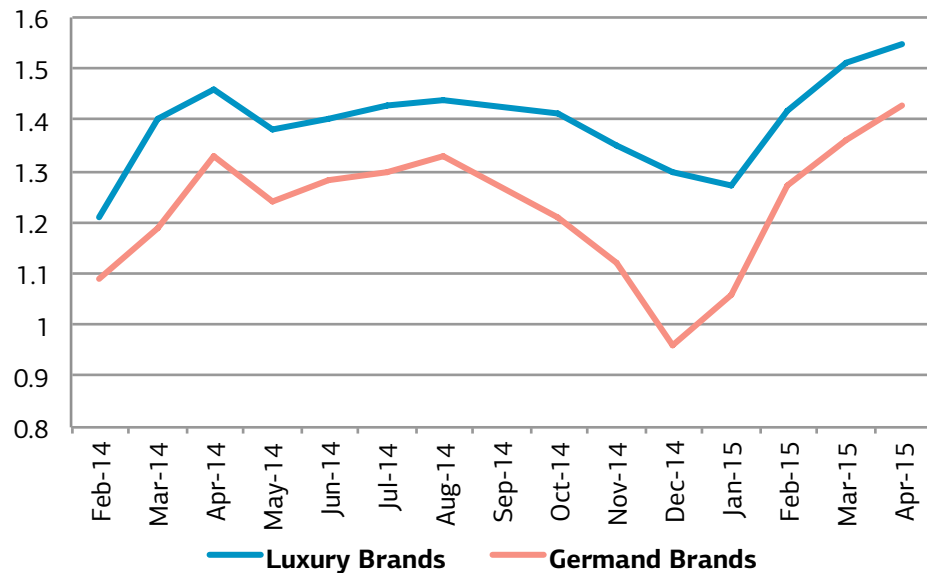
BMW has responded by cutting dealer sales targets and making it easier to obtain subsidies. According to an [announcement](#) sent by BMW and BMW Brilliance to BMW's dealers in April, Q2 2015 wholesale targets were adjusted down by 15% and dealers given rebates for making 90% of their Q1 sales target.

Dealers and industrial experts also told us the JV will consider cutting production by more than 10%. **These moves will surely lead to a further decline in Chinese sales volumes.** Therefore we expect that, from June, the off-season months will see sales declines, and not just slowing growth.

High Inventory Pressure

Inventory pressure remains high. According to CPCA's data, dealers' inventory days are rising, with luxury and German brands up 3% and 5% MoM to 1.55 and 1.43 months in April 2015.

Chart 10. Not the Type of Rise You Want: Monthly Inventory Levels of Luxury and German Brands



Source: CPCA

Inventory pressure remains high.

Our dealer interviews also indicate high inventories. Of the 10 respondents who told us their current inventory levels, seven had more than two months of inventory, above the six-week red line. Only three said they had low inventory.

Table 2. Dealers' Inventory Level

Dealers	Inventory Level (In Months)
Distributor A	>2
Distributor B	~3
Distributor C	3
Distributor D	1.1-1.2
Distributor E	0.5
Distributor F	1
Distributor G	2.3
Distributor H	4
Distributor I	2.5
Distributor J	2

Source: J Capital Research

We estimate BMW's average inventory level is about 2.2 months as of May 2015, which is higher than CPCA's April inventory data on luxury and German brands.

Another luxury brand dealer informed us that imported vehicle inventories are even higher. When dealers do not have enough space to store these cars, manufacturers will provide parking places in the bonded zones for dealers. Thus sales will be recorded for manufacturers, but they don't require full cash payment from dealers and they will not get cash until dealers sell the vehicles. Although we did not verify that BMW engages in this practice, we expect it is like other luxury automakers in recording sales based on inventory in bonded zones.

Price War

BMW's ASPs are dropping for both domestic produced models and imported models. The company is shifting its product portfolio toward smaller and less pricey cars in Mainland China, and this has moved the ASP down over the last two years. Another important reason for the falling prices is the large discounts first offered by dealers in 2014. This turned into a price war among BMW dealers in 2014, when really large discounts emerged.

In 2015, the price war continues. For dealers facing high inventories, discounts can be as high as 21% for the most popular 5 series model. This is a large contrast to four years ago when buyers needed to pay a premium of up to RMB 100,000 to order a car.

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Table 3. Dealer Discounts Are Already Large and Getting Larger

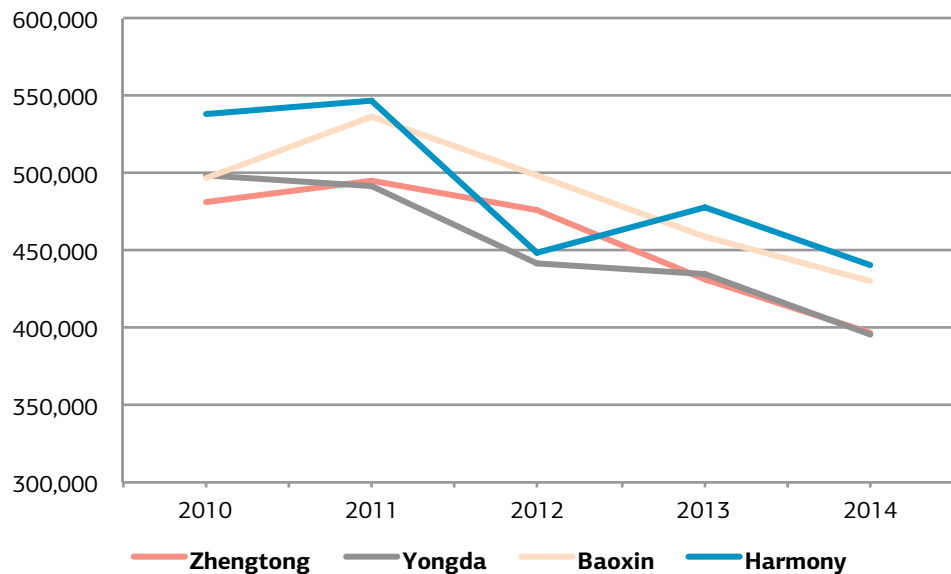
Series	Official Selling Prices (RMB)	Discounts at Early May 2015	Discounts at End of May 2015
3 Series	296,800-607,800	19-26%	10-26%
5 Series	435,600-778,600	16-21%	10-21%
7 Series	933,500-2,703,500	17-30%	25-31%
X1	259,000-436,000	18-26%	15-32%
X3	479,000-750,000	10%	8-10%
X5	852,800-1,773,000	10-15%	13-15%

Source [here](#)

Four dealers account for over 30% of BMW's sales in Mainland China.

Zhengtong, Yongda, Baoxin and Harmony all sell premium brands vehicles and run BMW 4S stores. Based on historical sales volume, we estimate the four dealers account for over 30% of BMW's total sales in Mainland China. We could not learn the BMW ASP at those dealers, so we calculated the ASP of premium brands they sell and found that prices had fallen 19.7% on average to RMB 415,600 in 2014 from RMB 517,600 in 2011.

Chart 11. Another Sliding Chart: ASP of Premium Brands of Dealers (in RMB/Unit)

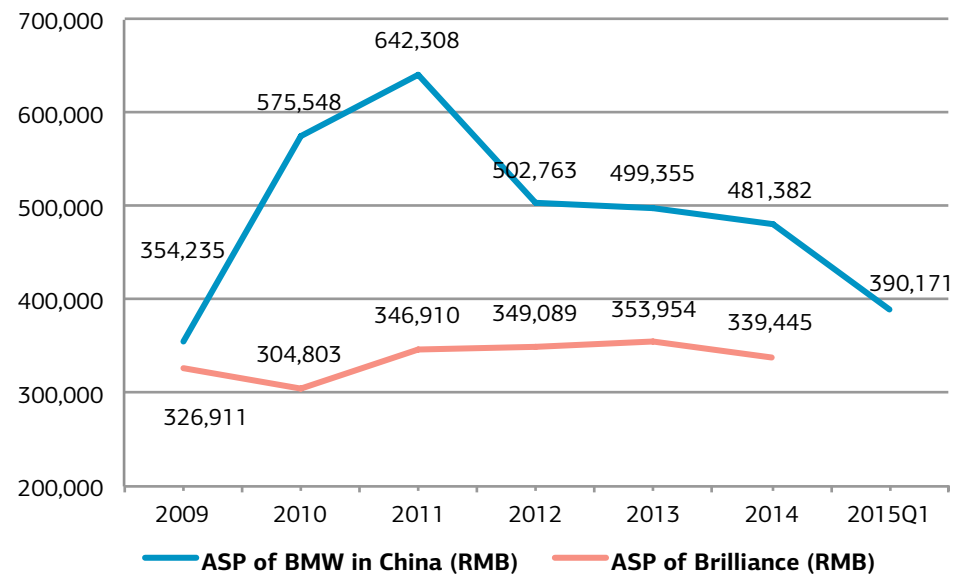


Source: Company data, J Capital Research

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The falling ASP trend will continue to erode dealers' margins in 2015 and BMW must also gradually feel the impact. Though BMW and BMW Brilliance have not officially announced price cuts yet, we believe they have already started to provide more subsidies, rebates and discounts to dealers. We calculated the average prices by dividing the revenue of that market by the number of units sold for BMW and BMW Brilliance and we found the same falling trend of BMW vehicles. In particular in Q1 2015, the ASP of imported BMW vehicles declined by 18.9% to RMB 390,200 from 481,400 in 2014.

Chart 12. ASP of Imported BMW and BMW Brilliance Models



Source: Company data, J Capital Research

BMW is also facing pricing pressure from competitors in China. Official price cuts will be one important step for BMW to stem a demand slow-down.

Starting from April, some foreign brands have already made official price cuts in China. The most notable are General Motors (Buick, Chevrolet, and Cadillac), Ford, and Volkswagen. GM's official price cuts range from 3% to 19.3%. Chevrolet made the biggest cut, of 19.3% on average for its Captiva models. We believe when the competition is becoming more fierce in 2015, and BMW will have to follow.

Another blow to the auto market is the rumor that FAW-Volkswagen is offering its employees a large 27% discount for their car purchases, much higher than the 12% of the past. A more flexible purchasing plan now allows FAW-Volkswagen's employees to buy two units and transfer the

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Table 4. Official Price Cuts by GM in Mainland China

Brand	Model	Avg. Discounts
Cadillac	ATS-L Series	5.00%
	XTC	3.00%
	SRX	5.80%
	CTS	6.10%
	Excelle	9.30%
Buick	Encore	5.90%
	Lacrosse	3.50%
	Regal CS	4.90%
Chevrolet	Captiva	19.30%
	Trax	7.30%
	Cruze	9.10%

Source: News, J Capital Research

ownership to others immediately after their application gets approved. All vehicles will be delivered through FAW’s dealerships and recorded as sales generated by dealers. If this is really moving forward, the entire auto market will initiate a new round of price cuts.

Given all of these competitive market dynamics, BMW, (especially BMW Brilliance models) will face high pressure to lower their selling prices this year.

The Strained Channels

Tensions with Chinese Dealers

After BMW group set up its sales company in China in 2005, the number of BMW dealers grew from 60 in 2005 to 572 as of Q1 2015, including 462 BMW dealers and 110 Mini dealers in Mainland China.

Table 5. Number of BMW Dealerships in China

BMW Dealership in China at the End of Q1 2015	BMW	MINI
East	102	23
North	89	25
South	104	24

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Southeast	72	15
West	95	23
Total	462	110

Source: Company data

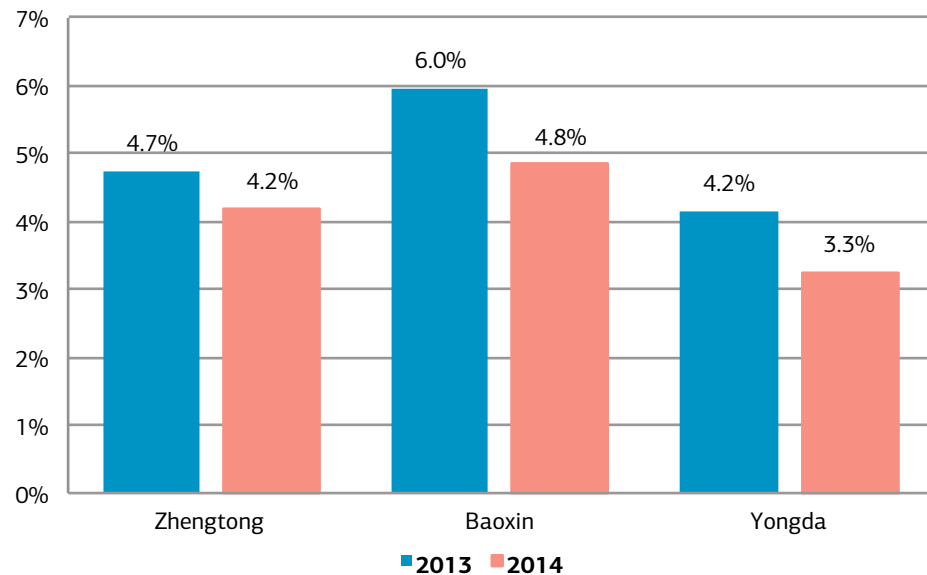
BMW and its dealers have benefited from the five-year sales boom in China. However, when growth first started to slow in Q2 2014 and continued to decline in 2015, the harmonious long-term cooperation changed. Now, dealers are less focused on sales targets than on reducing inventory to avoid cash-flow problems.

At the end of 2014, Chinese dealers took an unprecedented step, publicly demanding—and reportedly receiving—RMB 5.1 bln from BMW Group in rebate payments as well as lower sales targets. Then just four months later, BMW and BMW Brilliance announced they would lower the Q2 2015 sales target by 15% YoY for Mainland dealers.

So what made dealers so upset? We looked at the financials of three major listed BMW dealers, Zhengtong, Baoxin, and Yongda, and found that all of them have shrinking gross margins from selling premium autos and have increasing debt-to equity ratios. In interviews in the recent quarter, some said their gross margins on vehicle sales had gone negative.

Three major dealers have shrinking gross margins from premium models.

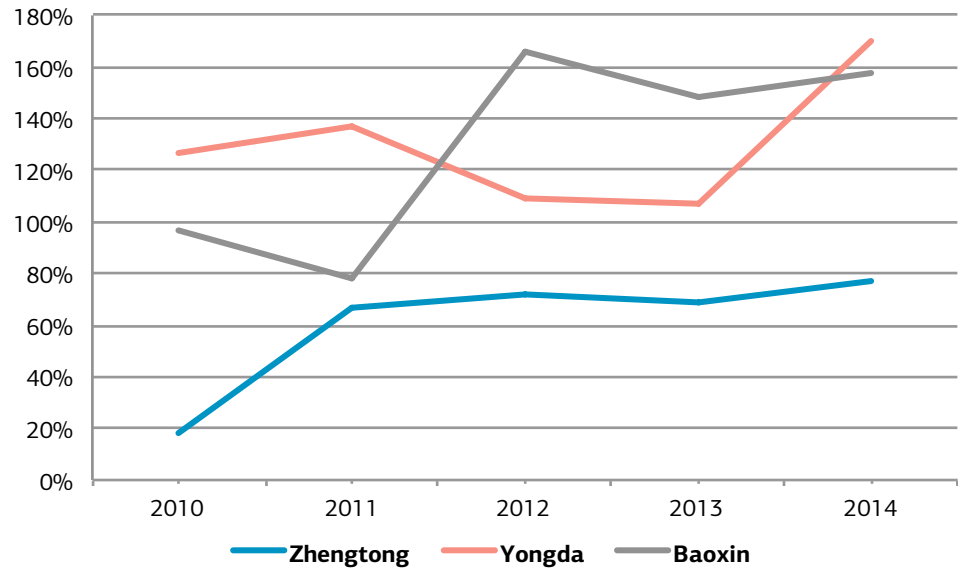
Chart 13. Gross Margins Falling for Dealers



Source: Company data, J Capital Research

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Chart 14. Debt-to-Equity Ratios Increasing



Source: Company data, J Capital Research

Dealers complained about BMW's sales requirements.

The majority of dealers we interviewed told us they had lowered ASPs by 3-5% on average. They expressed concern about profitability, as their gross margins from selling new vehicles have gone negative. They make their spread on sales rebates and must offer large discounts at the expense of their gross margins in order to make the targets.

Dealers complained about BMW's sales requirements. Not only do the dealers have to achieve targets set by BMW in order to get rebates, but they also have to take on some unpopular models, which then sit on the showroom floors for much longer. We were told that, to get the 5 Series, which is customers' favorite model, dealers need to accept a certain number of X1 and 3-Series. Likewise, to get X3 and X5, dealers need to stock some 7-series vehicles as well. Sometimes, dealers may receive autos that were produced a year ago, and those must be sold at large discounts.

Investments in Dealerships

We believe automakers' investments in dealerships may be leading to channel stuffing.

Brilliance's domestic filings indicate that Brilliance has invested in distribution channels, and we think inventory levels in those channels could be very high. For example, Shanghai Baohe runs 15 BMW 4S stores. The company was established in 2012 and is 50% controlled by A-share listed

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Chart 15. Showing Brilliance Subsidiaries and Investments (Zhengtong Circled)

上海丽途汽车维修服务有限公司	50.00%	50.00%
成都通瑞置业有限公司	25.00%	25.00%
昆山银华实业有限公司	20.00%	20.00%
上海技术产权交易会员费	-	-
江苏绿利来股份有限公司	-	-
中国正通控股有限公司	48.00%	48%
陕西申华永立置业有限公司	44.50%	44.50%
上海东昌汽车投资有限公司	-	-
富卓华祥汽车零部件(绵阳)有限公司	40.00%	40%
华晨卡伊卡诺巴士制造技术(大连)有限公司	50.00%	50.00%
华晨罗斯罗卡环卫车辆装备(大连)有限公司	31.07%	31.07%
合计	--	--

Source: Brilliance Group 2014 annual report

Shanghai Shenhua (600653 SH), which itself is 17.3% owned by Brilliance Auto—the parent company of BMW Brilliance. Sales staff at one of Baohe’s 4S stores informed us that inventories have risen to two months this year.

Brilliance also invested in Zhengtong Auto (1728 HK), a key BMW dealer, and now owns 48% of that company.

Parallel Imports

“Parallel” imported vehicles are cars imported by non-authorized agents. In China, imported gray-market cars have existed for many years, but it was not until 2014 that the government officially authorized sales of parallel imports in several “free trade zones.” The idea is that cars can be imported duty-free and sold only within the very small bonded zones without incurring taxes. When the cars leave the zones they are supposed to be taxed, but there are all sorts of ways to finesse this part of the equation.

BMW is one brand is potentially threatened by parallel imports. There has been a gap between imported sales volume by BMW and imported sales volume from industrial data, and the gap could be parallel imports sitting in the FTZs.

For BMW, we estimate that about 10% or more of imported models registered in Mainland China are purchased in the gray market. That portion may rise, because the government is currently promoting the parallel imported vehicle program.

Table 6. Gap in Imported Vehicles: BMW Reported and Industrial Data

(in units)	2012	2013	2014	Q1 2014	Q1 2015
Imported Vehicles from BMW	185,279	192,171	180,088	45,649	42,893
Imported vehicles from Industrial data	185,000	198,000	192,000	55,000	50,000
Difference	-279	5,829	11,912	9,351	7,107

Source: Sohu auto, Company data, J Capital Research

There is no doubt that selling imported vehicles in China is a fat-margin business. Car prices at authorized dealers are often 20-50% higher than those in other countries. Ostensibly this is due to high taxes, but there are many methods for optimizing taxes, and the high rates provide cover for a high pricing strategy for foreign vehicles in China.

According to BMW's financials, even though ASPs of both imported BMW models and BMW Brilliance-produced models dropped 4.5% and 4.0% YoY respectively in 2014, prices are still higher than in other countries. BMW-imported models had an ASP of EUR 58,800 per unit in 2014, vs EUR 35,900 in other countries, while domestically produced models by BMW Brilliance were sold at EUR 41,400 per unit, still 15.5% higher than the ASP in other countries. It is not clear precisely how much of the difference goes to the government as taxes, but we believe that a good chunk is collected by the industry players rather than government.

Taxes on imported models include an import tax rate of 25%, consumption tax ranging from 1% to 40% based on engine displacement, and a VAT of 17% on prices after import tax and consumption tax. The table below shows the price difference for three models.

Table 7. Price Premium of Imported Models

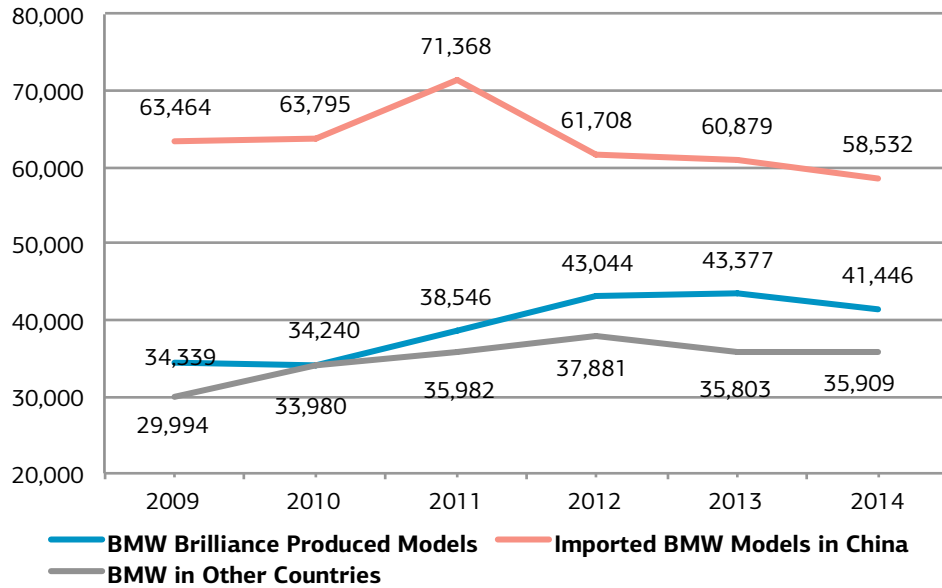
Model	UK Price (GBP)	UK Price + Tax (GBP)	CNY Price + Tax (RMB)	China Retail Price (RMB)	Premium (GBP)	Margin to After-Tax Price	Current Prices After Discounts (RMB)	Difference
7 Series	65,070	100,208	945,059	1,023,500	8,657	8.30%	839,300	-11.20%
X5 xDrive30d	48,850	78,302	709,484	877,000	18,488	23.60%	756,900	6.70%

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X5	64,800	126,360	1,144,937	1,773,000	69,316	54.90%	1,666,600	45.60%
xDrive50i								
M Sport								

Source: Company data, J Capital Research

Chart 16. Average Selling Prices Comparison (Euros/Unit)



Source: Company data, J Capital Research

With current discounts, selling the 7-series is not profitable for either authorized dealers or dealers in bonded zones. But, at present, the most popular parallel imported BMWs are SUVs such as the X3 and X5, and they remain very lucrative for dealers. A dealer told us they would look for the country with lowest pricing and looser distribution regulations.

Even authorized BMW dealers are excited about parallel imported vehicles. Baoxin (1293 HK) is one of the largest dealers of BMW, accounting for 8.9% of BMW China’s total sales volume in 2014. The company announced that in 2014 it became one of the officially authorized automobile parallel importers.

This is a threat to BMW’s wholesale business. A BMW dealer told us that he will decide based on pricing whether to purchase imported vehicles from bonded zones or from BMW China. When selling cars from BMW China loses money, dealers will go to free trade zones, where prices allow them to maintain positive gross margins. According to our checks, selling a parallel X5 or X6 model imported from Mexico generates about 5%, but dealers often make a loss of 3-5% by selling BMW vehicles in authorized channels.

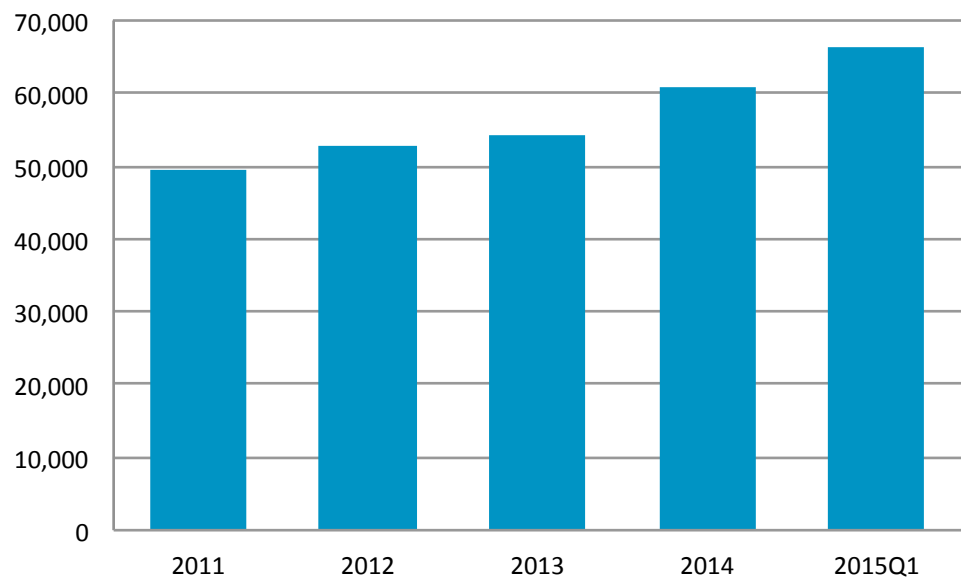
Financing Sales

Credit financing and leasing have become important tools for BMW to sell vehicles. Growth of credit and leasing is particularly strong in Asia, resulting in an 18.6% increase in the contract portfolio in Q1 2015. We believe Mainland China contributed the most.

Based on our checks, currently, 40-50% customers use BMW's financial services when buying a BMW vehicle. In some provinces in eastern and southern China, the proportion is closer to 60%, higher than the Group's reported 44.9% as of Q1 2015. Dealers informed us that financial services help generate sales, and some dealers expect the portion of customers using financial services to grow to a 60% average. To encourage retail customers to buy, BMW is subsidizing interest costs, which is now a common practice among luxury brands in China.

BMW not only provides credit financing and leasing to its retail customers but also to its dealers to support their inventory financing. As of Q1 2015, the total volume of dealership financing climbed to EUR 15,719 mln, up 19.5% from the end of 2014. Dealers did not share the information about this with us, but we believe some of them also have been receiving dealer financing from BMW Brilliance, which led to the significant 20.1% YoY increase in the Asia-Pacific contract portfolio in 2014.

Chart 17. Credit Receivables Rise (EUR mln)



Source: Company data

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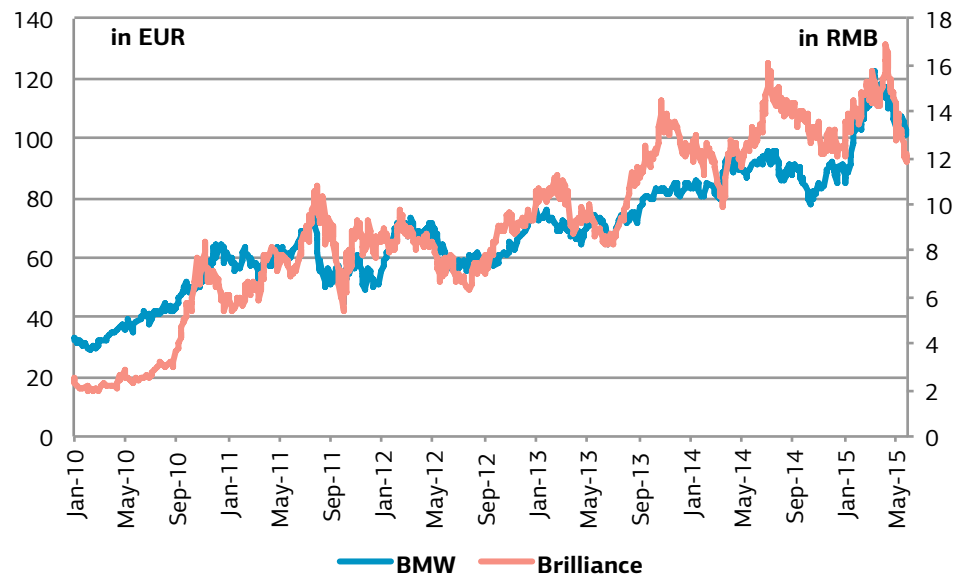
In Q1, receivables also increased. In Q1 2015, outstanding receivables from credit financing and leasing rose to EUR 66.3 bln from EUR 61.0 bln at end of 2014.

Valuation

- ▶ We estimate China contributed over 30% of BMW's pre-tax profit, so a coming sales decline in China will lead to a lower valuation.
- ▶ Our target price is EUR 84.8, based on 9.87x our forecast 2015e EPS of EUR 8.59. 9.87x PE is BMW's historical median forward earnings multiple. This assumes:
 - ▶ BMW China sales down 5% in 2015
 - ▶ ASPs fall by 5% in 2015
 - ▶ The JV facility fails to complete its expansion in 2016

There has been a strong correlation between BMW and Brilliance's share prices since end-2010. Both started to climb in 2010, thanks to a strong 71.4% YoY growth of BMW sales in Mainland China. As China goes, so goes BMW's share price.

Chart 18. Share Price Comparison of BMW and Brilliance



Source: Bloomberg, J Capital Research

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EPS Sensitivity to YoY Change in Sales Volume by %

Sensitivity analysis	YoY Change in Imported Vehicles			
	8.59	-10%	-5%	0%
YoY Change in JV Volume	-10%	8.5	8.56	8.61
	-5%	8.54	8.59	8.64
	0%	8.57	8.62	8.68

Source: Company data, J Capital Research

EPS Sensitivity to YoY Change in Sales by Units

EPS Estimate	2014	2015e	2016e
Imported Vehicles (Units)	180,841	171,799	167,504
JV Vehicles (Units)	278,529	264,603	251,372
BMW China (Units)	459,370	436,402	418,876
ASP of Imported Vehicles (EUR)	58,532	55,605	52,825
ASP of JV Vehicles (EUR)	339,445	322,473	306,349
EPS (EUR)	8.83	8.59	8.43

Source: Company data, J Capital Research

Our Valuation

EPS 2015e	8.59
PE (x)	9.87
Target Price (EUR)	84.8
Current Share Price (EUR)	98.6
Difference	-14.00%

Source: Company data, J Capital Research

Risks

- ▶ The central government is likely to continue stimulating the economy, and the new cash could generate sales growth, possibly because of wealth effect from the stock market.

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- ▶ The government may grant subsidies to JV manufacturers, which then would benefit BMW Brilliance.
- ▶ Markets outside of China may outperform.

Appendix A. Dealer Checks

City	Region	Sales	Prices	Gross Margin	Inventory	Financing
Xuancheng	East	YTD sales volume down 5%-8% YoY	Prices have been sliding strongly after the CNY	Loss of 3-4% for every unit they sell; they estimate a net loss of RMB10 mln in 2015	High inventory pressure. Inventory has been kept above 2 months, while the level was controlled under 2 last year. Even after adjusting annual sales target by 15%, they still have high inventory	30-35% clients use financial services, but BMW does not subsidize much. In Nanjing, the ratio is 40%, while it can reach 50-60% in Zhejiang Province
Dongguan	South	Nearly Flat	Prices down 4-5% YoY	NA	High inventory pressure, especially the 3-series model, which is still rising. They still have the same sales target	50% clients choose financial services, no leasing clients. They borrow on average 40-50%
Shanghai	East	Down slightly	Prices down slightly	NA	same as last year but estimated at 3 months	40% clients use financial service, but expects 50% as economy is bad
Yiwu	East	Flat sales	NA	After rebates, loss of 3% and estimate down to -4% in May	1.1-1.2 months now, while 1.6-1.8 last year. As sales deteriorate, pressure remains high	60% clients use financial service. Without financial service, they would die quickly. Borrowing cost is about 3.88%-4.88%, subsidized by manufacturers

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Guangzhou	South	10-20% YoY Growth	Prices are down 3-5% YoY, and they have been increasing the discounts since this year	NA	NA	NA
Guangzhou	South	Down in Guangzhou region, but they have 10% YoY growth. Sales of domestic produced vehicles are better than imported ones	Larger discounts for new 5-Series	NA	Inventory pressure is not very high, but still has over 100 units. The auto show in Guangzhou last month helped consumed some inventory	More financing service to domestic produced vehicles. 60% clients use financial services, which is already very high.
Qingdao	East	Flat	Larger discounts, ASP down 2-3%	NA	0.5-month inventory	40-50% clients use financial service, and will increase the portion to 60% in 2015
Jinan	East	Flat	No big change	NA	Inventory pressure is not high, better than last year. About 1 month inventory, while 0.5 month in previous months	90% use financial service, interest costs varie from 3.88-6.88%
Tianjin	North	Licence plate restriction had an impact on sales last year. Sales target grew 10% YoY	ASP down	loss	About 2.3 months, same as last year	20-30% choose financial service; manufacturers subsidize the interest costs
Shanghai	East	Flat	NA	NA	NA	NA
Dalian	NE	-50%	Very large discounts	loss	NA	NA
		Flat	NA	bad profitability	Inventory at 4 months, versus 2 months last year	NA
Beijing	North	Increase of 10%, X1 models slid	No big change	NA	Current inventory level at 2.5 months	NA

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