

July 22, 2015

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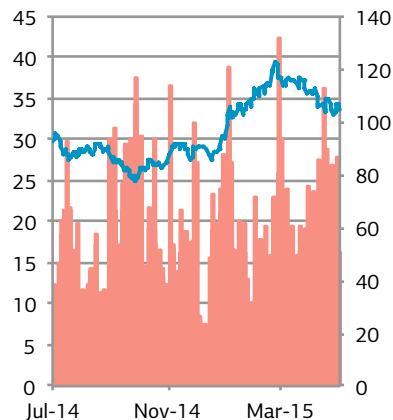
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BMW (BMW GR)

Price	EUR 96.16
Rating	SELL
Price Target	EUR 84.8
Market Cap	EUR 61.97 bln
Outstanding Shares	602 mln
Avg. Volume	2,299,271

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



Source: Bloomberg July 22, 2015

Bayerische Motoren Werke AG (BMW GR)

Less Brilliant

- ▶ **Brilliance, which manufactures and sells BMWs in China**, issued a warning that its H1 net profit would decline by 40% YoY. That indicates a drop of over Euro 100 mln in 2015 H1 pretax profit for BMW, representing its share of the profit from BMW Brilliance. The dramatic decrease is due to lower demand, which means lower prices, and the need for manufacturers to prompt demand by giving more commissions to dealers.
- ▶ **Our checks in July showed** a sharp acceleration of sales declines, with dealers reporting anywhere from 5-60% lower sales for the first half.
- ▶ **We believe dealers are now losing** on every car sold, and indications from auto websites and dealers carrying high inventories suggest that more price cuts in H2 are inevitable.
- ▶ **The volatile stock market seems** to be a negative for BMW: some buyers cancelled orders following the sharp drop in the A-share index in June.
- ▶ **After the implementation of plate restrictions** in Shenzhen in December 2014, BMW saw a 41.4% YoY decrease in registrations in Shenzhen and a 32.4% YoY decrease in all of Guangdong Province. In 2014, Guangdong accounted for over 9% of total BMW registrations.
- ▶ **We reiterate our target price** of EUR 84.8, based on 9.87x our forecast 2015 EPS of EUR 8.59. This assumes BMW China sales will be down 5% in 2015 compared with a 17% YoY increase in 2014.

Brilliance's Dire H1

On July 13, BMW's Chinese JV partner, Brilliance, issued a profit warning indicating that net profit for the first half of the year would decline by a staggering 40%, and the company blamed BMW Brilliance. This JV manufactures BMW's 3 Series, 5 Series, and X1 and contributes nearly all of Brilliance's profit. Brilliance claimed higher selling costs as a result of the slowing economy and a weak automotive industry, and we believe most costs came from additional subsidies to its dealers.

Table 1. Portion of Profit from BMW Brilliance Shared Between BMW and Brilliance

Shared Profits from BMW Brilliance	2014 H1	2015 H1	Difference
Shared Profits in RMB mln	3,691	2,215	-1,476
YoY Change		-40%	
Shared Profits in Euro mln	436	314	-123
Avg Euro/CNY Exchange Rate	8.46	7.06	

Source: Company data, Bloomberg, J Capital Research

Some Euro 314 million is the profit for BMW.

Falling Sales at Dealers

Our most recent checks with six BMW dealers also indicate bad sales in H1 2015. The most extreme decline for a dealer was a more-than 60% sales decline YoY due to plate restrictions; the best dealer saw flat sales. More customers are relying on loans, and now half of buyers use financial services to buy.

Table 2. Dealer Checks H1 2015

Dealers	Region	Change of Sales	Discounts of ASP	Current Inventory (Month)	Financial Service Penetration
Dealer A	South	> - 60% YoY	18-30%	1.5	60-70%, 100% at peak
Dealer B	North	Flat YoY	NA	NA	NA
Dealer C	North	2% down MoM	NA	3	50-60%
Dealer D	West	Down 20% YoY	17%	1.3	40-50%

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Dealer E	North	Down 30% in Tier 2 cities, significant drop in cities relying on mining and property sectors	NA	NA	NA
Dealer F	North	Down 5%	8%	NA	60-70%

Source: J Capital Research

More Subsidies to Auto Dealers

In January, BMW and Brilliance paid over RMB 5 bln to authorized dealers in China to ease them in the downturn, but dealers quickly spent all the money in order to offer more discounts and move inventory. Just months after the payments, BMW and Brilliance agreed to offer RMB 2 bln more to the dealers. Based on an announcement released in early July, BMW and BMW Brilliance will provide a special Q2 2015 rebate. For imported vehicles, dealers can receive RMB 13,000-16,000 for every unit sold depending on sales target completions. JV vehicles can get RMB 16,000-18,000 per unit.

Table 3. New Subsidies from BMW

Type of Vehicles	Completion of Sales Target	Subsidy per Unit (RMB)
Imported Vehicles	100%	16,000
	85%	13,000-14,000
JV Vehicles	100%	18,000
	85%	16,000-17,000

Source [here](#)

The new subsidies cannot change the fact that dealers are making losses on every unit they sell. Besides, to receive the subsidies, which are based on sales volume, they need to take on inventory. Even for the most popular BMW model, the 5 series, a rough estimate of gross loss per unit is about RMB 34,020 based on our checks and current discounts. In the meantime, as more online auto websites are promoting discounts and dealers with higher inventory pressure are offering large discounts, more price cuts are expected in the second half, which will then further hurt dealers' profitability.

Cash Flow Problem at Dealers

Many BMW dealers this year are facing insolvency. Dealers and industry

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Table 4. Estimated Loss from the Sale of a BMW 525Li (RMB/Unit)

Selling Price per Unit	In RMB
Official Price	499,600
Price after Discount	424,600
5% Rebates	24,980
The New Subsidies	16,000
Loss per Unit	-34,020

Source: Autohome, J Capital Research

experts say that more than half of BMW dealers are losing money and some have serious cash-flow problems.

Dealers often use the ownership documents for new vehicles as collateral for bank borrowings. If they fail to repay to the bank and cannot get the documents back, they cannot make delivery of autos to their customers. Longdebao in Foshan, Guangdong Province, is involved in lawsuits for around 40 vehicles for which they failed to make delivery.

BMW Buyers Protesting at Foshan Longdebao Sales Over Delivery Delay: "Give Me Back My BMW!"



Source [here](#)

We believe the financial position of BMW's dealers will deteriorate in the second half, as auto sales are not improving and prices cuts are larger as competition grows fiercer. According to a survey by the China Automobile

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Dealers Association (CADA), only 3.8% of dealers say their operations are sound.

No “Wealth Effect” Relief

We have found that, contrary to expectation, auto sales are suffering from A share volatility. When the index was rising, people preferred to invest their extra cash in the market. When the stock market started to plunge, people turned less positive on their future and many buyers lost money; dealers said many were canceling purchases. We learned from dealer checks in mid-July that some buyers cancelled orders placed in June. In Tianjin, according to a market director of a leading BMW dealer, about 10-20% customers decided against purchasing and in Xi’an, dealers gave a similar estimate. Dealers believed that cancellations in South China would be more dramatic, since more people in the South speculate in stocks.

Increasing Restrictions

Following Beijing, Shanghai, and Guangzhou, Shenzhen become the last Tier 1 city to impose purchasing restrictions on cars, at end of 2014. Shenzhen will now grant only 100,000 plates per year, compared with 400,000 in the first 10 months of 2014. The direct impact on auto sales is significant. Based on online statistics for auto registration in Guangdong Province, one of the biggest regions for luxury auto sales, registrations of BMWs dropped 41.4% YoY in Shenzhen and 32.4% YoY in Guangdong

Table 5. Cities with License Plate Restrictions

City	Starting Date	No of Plates (Units/Year)	Method	Area with Restriction
Beijing	12/24/2010	150,000	Licence-Plate Lottery	Entire City
Shanghai	1994	NA	Auction	Within the Outer Ring
Guangzhou	6/30/2012	120,000	50% Lottery / 50% Auction	Entire City
Shenzhen	12/29/2014	100,000	50% Lottery/50% Auction	Entire City
Tianjin	12/15/2013	100,000	60% Lottery / 40% Auction	Entire City
Hangzhou	3/26/2014	80,000	80% Lottery / 20% Auction	Entire City
Guiyang	7/16/2011	NA	Licence-Plate Lottery	Within the 1st Ring

Source [here](#)

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Table 6. Registration Volume of BMWs in Guangdong Province

Registration Volume (Units)	Shenzhen			Guangdong Province		
	YTD May 2014	YTD May 2015	YoY	YTD May 2014	YTD May 2015	YoY
1 Series	350	98	-72.0%	851	504	-40.8%
2 Series	0	13	NA	0	173	NA
3 Series	1474	734	-50.2%	3866	3835	-0.8%
Imported 3 Series	0	91	NA	660	524	-20.6%
4 Series	0	12	NA	89	83	-6.7%
5 Series	2455	1597	-34.9%	6411	6663	3.9%
Imported 5 Series	320	138	-56.9%	971	812	-16.4%
X1	836	414	-50.5%	5100	1846	-63.8%
X3	768	321	-58.2%	4146	1254	-69.8%
X4	0	127	NA	385	684	77.7%
X5	451	416	-7.8%	3834	1920	-49.9%
X6	279	100	-64.2%	1490	507	-66.0%
Total	6933	4061	-41.4%	27803	18805	-32.4%

Source [here](#)

Province. Our checks with a Shenzhen BMW dealer confirmed that sales tumbled in H1 2015, down about by 50% YoY, due to the restriction.

Valuation

We reiterate our target price of EUR 84.8, based on 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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