

China Moves to the Backseat

■ **Qin Shengxian** February 4, 2016

- ▶ **Government supports generated** most of the 7.2% growth in the auto market in 2015, which otherwise might have seen a flat year. We forecast growth under 4% for 2016, driven by government promotion of the 1.6 L engine category.
- ▶ **Chinese consumers** are becoming thriftier. Prices are falling, imports are on the decline, and OEMs are providing more financing on more advantageous terms. We expect all the international auto majors to report lower profit out of China in 2016.
- ▶ **Given the looming possibility** of a financial crisis, we believe 2017 sales could decline sharply.
- ▶ **China's organic demand** is for cars retailing under RMB 150,000. Luxury categories will continue to compress. Plug-in electrics should grow rapidly, but there is a lot of fraud in the category, as "buyers" report phantom purchases in order to obtain generous government subsidies.
- ▶ **This year's best category** will continue to be SUVs but from discount automakers like Chang'an and Hafei. We see sales of SUVs rising by nearly 19% in 2016 due to their low price for the size, making budget SUVs attractive to lower-income consumers and farmers who use them as utility vehicles. To some extent, small SUVs are replacing the once popular minibus models.
- ▶ **We are negative** on foreign luxury brands such as BMW, Jaguar Land Rover (Tata Motors), and Audi, which do not benefit from the purchase tax cut and suffer most from a slowing economy.
- ▶ **Overall, we forecast** PV sales growth at 3.9% YoY in 2016 with the help of the vehicle tax cut. Sedans will decline 2% YoY while SUVs will increase 18.7%.

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Table 1. Selected Automotive Companies

Name	Tkr & Exch	CUR	Mkt Cap (Bln)	Last Price	Average Volume M-3	P/E	ROE (%)	ROA (%)	2015 China Sales Volume	2015 YoY Growth (%)	J Cap Price Target	Last Update
BMW	BMW GR	EUR	49.4	74.6	1,707,453	8	15.7	3.9	463,736	1.7	EUR 81.20	8/16/2015
TATA MOTORS LTD	TTMT IN	INR	1,080.30	329.6	9,058,281	7.7	23	6.1	92,474	-24	INR 380	8/13/2015
GEELY AUTOMOBILE	175 HK	HKD	26.9	3.1	59,011,872	13.2	9.7	4.8	542,715	27.5	HKD 2.81	2/17/2015
HONDA MOTOR	7267 JP	JPY	6,138.90	3389	4,808,257	12.1	7.2	2.8	1,006,332	32.5	Unrated	
BYD	1211 HK	HKD	126.2	36.1	7,175,355	138.9	2.1	0.6	455,376	4	Unrated	
GREAT WALL	2333 HK	HKD	75.7	5.7	30,910,346	5	27	15.7	753,230	23	Unrated	
GENERAL MOTORS	GM US	USD	46.9	30.1	13,572,828	6.4	12.1	3	3,612,635	5.2	Unrated	
HYUNDAI MOTOR	005380 KS	KRW	28,525.80	129500	497,894	5.4	8.8	4.3	1,062,826	-5.1	Unrated	
TOYOTA MOTOR	7203 JP	JPY	24,380.70	7304	9,659,515	10	14.2	5	1,122,500	8.7	Unrated	
VOLKSWAGEN	VOW GR	EUR	56.4	118.6	192,700	9.6	6.7	1.8	3,548,600	-3.4	Unrated	
DAIMLER	DAI GR	EUR	67.9	63.4	4,427,050	8.8	16.4	3.9	373,459	32.6	Unrated	
AUDI AG	NSU GR	EUR	28.3	659	238	6.3	22.6	8.7	570,889	-1.4	Unrated	

Source: Company data, Bloomberg, J Capital Research

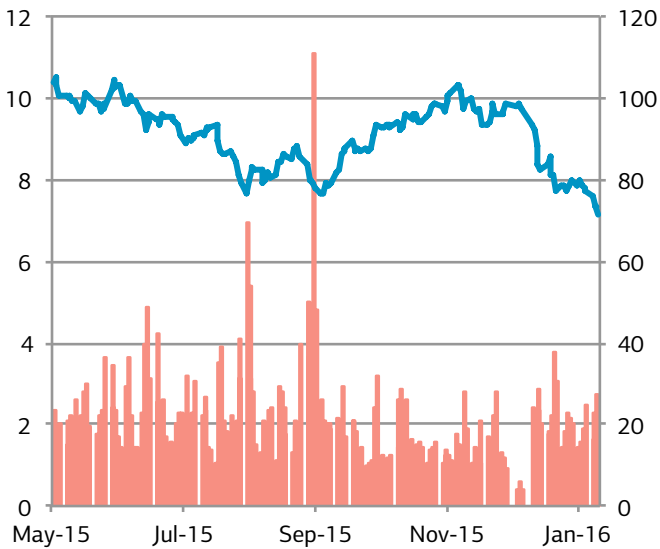
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Our Views: BMW, Geely, and Tata Motors

BMW (BMW GR)

Price	71.29
Rating	SELL
Price Target	EUR 81.20
Difference	13.9%

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



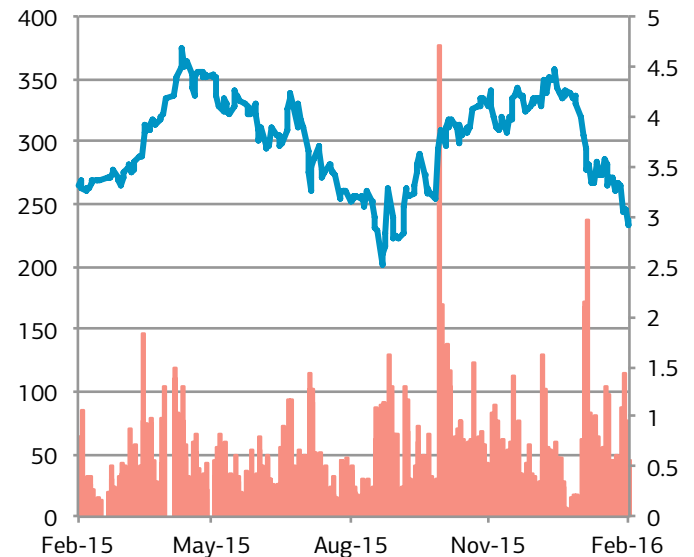
Source: Bloomberg

We expect no significant improvement of sales in 2016 as the most popular 5-series model is approaching the end of the product cycle. As the Chinese economy remains uncertain in 2016, we forecast a decrease of BMW imports in mainland China and a slight increase of sales of JV models. In addition, a depreciating RMB against the Euro and pricing pressure are also hurting the company's profits.

Geely (175 HK)

Price	HKD 2.97
Rating SELL	SELL
Price Target	HKD 2.81
Difference	-5.4%

BMW (BMW GR) last share price in HKD (blue) and volume (pink, in mln shares)



Source: Bloomberg

The upcoming launches of Geely's models may improve its sales in 2016-2017. However, we believe the company will keep playing the game of obtaining government subsidies, and this includes the case of ZD, for which we suspect Geely is faking transactions to receive subsidies on new energy vehicles. In addition, the ongoing RMB depreciation will continue to impact Geely's profits in 2016.

Tata Motors (TTMT IN; TTM US)

JLR is suffering from a falling import market of -24.5% YoY, and competition from other luxury brands will become fiercer in 2016.

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Once tax cuts expire, we believe the sector will slip into decline.

A Shift in the World Market

World automakers have come to depend on high streams of profit coming from the Chinese market, which, at 21 mln vehicles per year, has grown to be the world's largest in terms of units. But 2015 represented a turning point. Even though unit volumes rose by 7.3%, price compression and a shift toward cheaper models presaged the market of China's future.

The industry is very sensitive to government policies like the tax cut on smaller vehicles in Q4 2015. But the industry faces a weak macro economy and volatility in the stock market, whose gains fuel a hefty chunk of luxury auto sales. Once the tax cuts expire at the end of 2016, we believe the auto sector will again slip into decline.

Around the world, automobile purchases track per capita income growth, and Chinese have been spending a higher proportion of salary income than is rational or sustainable. That is because the stimulus years saw so much investment-related income growth, from investment returns, bonuses, contract commissions, and windfall sales of land and property. The rapid decline in those forms of income is the fundamental driver reducing auto sales growth in China.

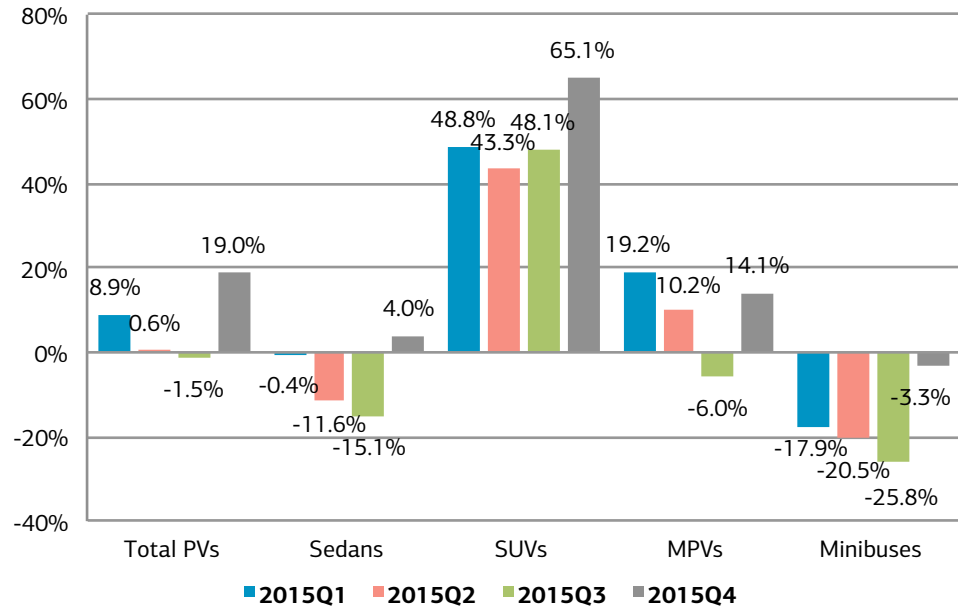
This shift spells the end of the extraordinary luxury auto purchases that have characterized the China market. But there is good news as well: autos are no longer a luxury item in China but have become conventional consumer durables; the average person expects to purchase a car along with a home. He or she, though, will be choosing much more affordable cars, and the margins of the international automakers will shrink.

The 2015 Numbers

The auto market shadowed the stock market in reaching both surprising highs and shocking lows in 2015. Sales went from 10.4% growth in January to a 6.6% decline in July and then a surge of 23.7% in November. Luxury auto sales plummeted in the first half of the year then recovered in Q4. Total sales of passenger vehicles reached 21.1 mln units for the year, up 7.3% YoY. Within those numbers, sedans fell by 5.3%, the first drop in years, and SUVs rose an astonishing 52.5% YoY. Sedan and minibuses led the drop January-September, down 8.8% and 21% YoY respectively, while SUV sales contributed all the growth. Q4 became the magic quarter, when sales rebounded: total PV sales grew 48% QoQ and 19% YoY.

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Chart 1. 2015 YoY Quarterly Sales Growth by Auto Type

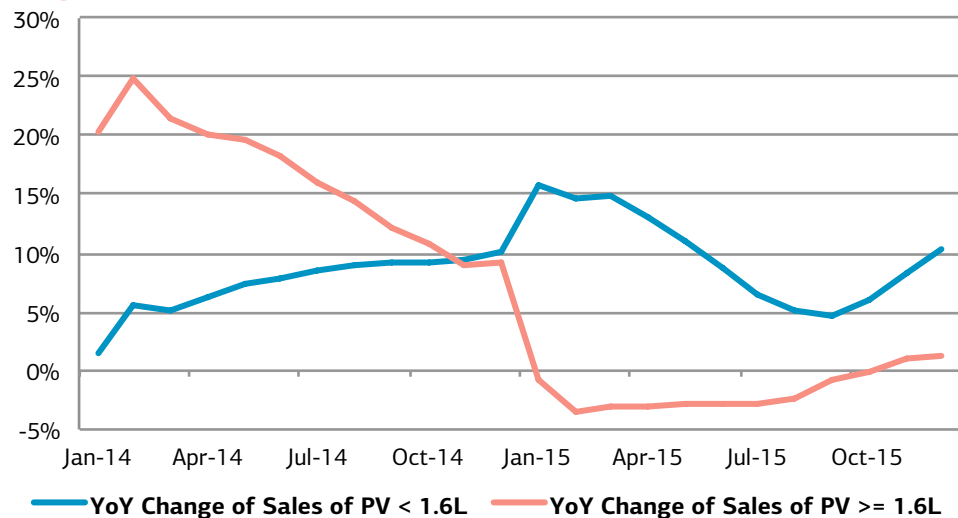


Source: CAAM, J Capital Research

The Q4 Recovery

What saved the auto market in Q4 was the tax cut for vehicles with engines under 1.6 L. According to data from CAAM, China's auto association, December sales volume of those vehicles rose 10.4% YoY, while vehicles with displacement above 1.6 L saw sales volume increase 1.2% YoY.

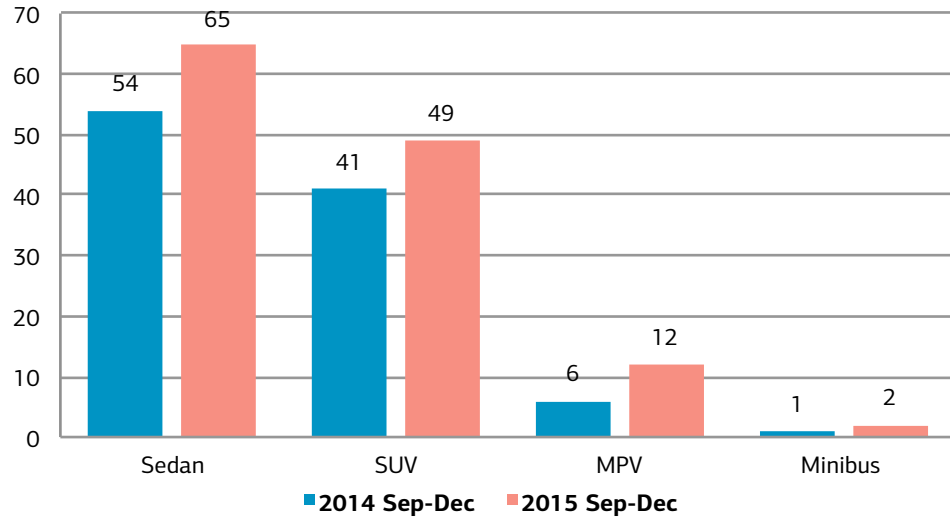
Chart 2. YoY Change in Monthly Sales, Vehicles with Displacement Above and Below 1.6 L



Source: CAAM, J Capital Research

The tax cuts came in the peak season for auto sales, when 128 new models were unveiled, compared with 102 in the 2014 season. Dealers pushed out the new models and fairly aggressive discounts in order to catch up to annual sales targets.

Chart 3. No. of Models Launched from Sept. to Dec. in 2014 and 2015



Source: Auto163, J Capital Research

The Fickle Stock Market

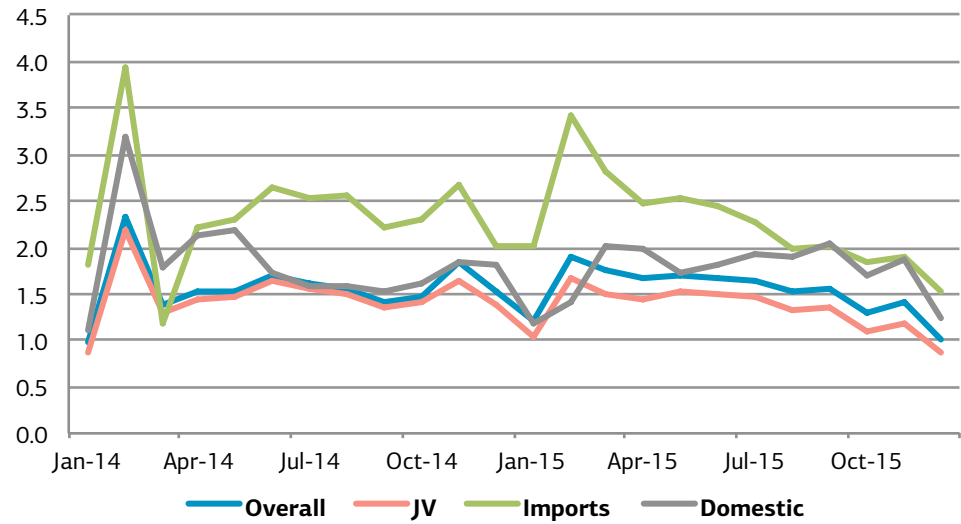
Dealers we interviewed all blamed investors' agony and ecstasy in the stock market for both rising and falling sales in 2015. In April, the Shanghai Comp was up by more than 100% over the previous autumn, yet dealers saw a sharp drop in visitors, and they attributed this drop to customers diverting their cash into the bull market. In July, when the market crashed, the dealers said their customers were reneging on contracted purchases because they had lost money in A shares. Price cuts in September brought these foot-draggers back to the showrooms to complete their purchases. So the Q4 spurt came partly from customers who had delayed purchases.

Improving Inventory

By yearend, information from the Chinese dealers' association, CADA, indicated that dealers' inventory had decreased to 1.02 months from 1.40 months in November and 1.53 months one year previously. Inventory of JV brands fell to 0.87 months in December and domestic-brand inventory 1.24 months, in the normal range of 0.8-1.2 months. Imported-vehicle inventories were still high, 1.52 months in December.

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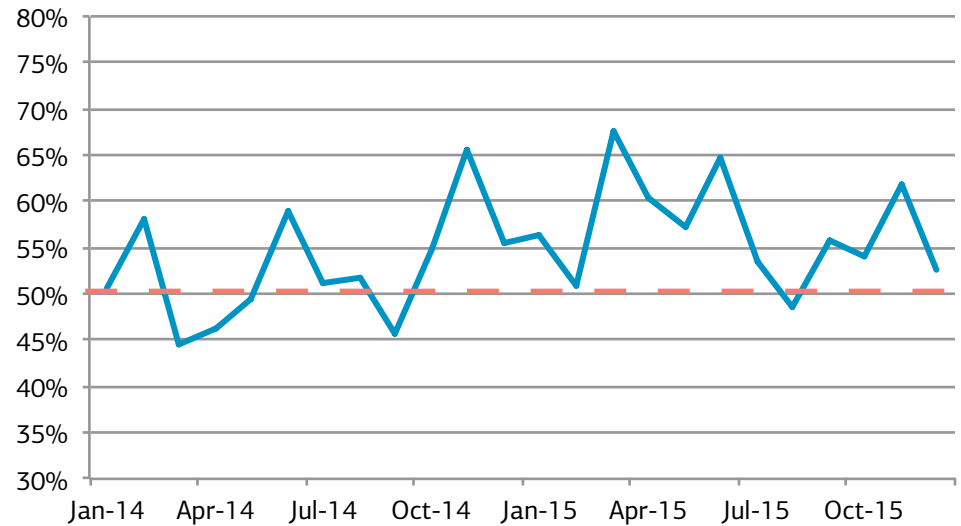
Chart 4. Inventory Level (Months)



Source: CADA

China Automobile Dealer Association (CADA) publishes a Vehicle Inventory Alert (VIA) every month. A reading above 50% indicates stress. The VIA in 2015 was over 50% every month except August but by December, it had dropped to 52.6% from a high of 61.8%.

Chart 5. Vehicle Inventory Alert



Source: CADA

Our checks with dealers indicated improving inventory.

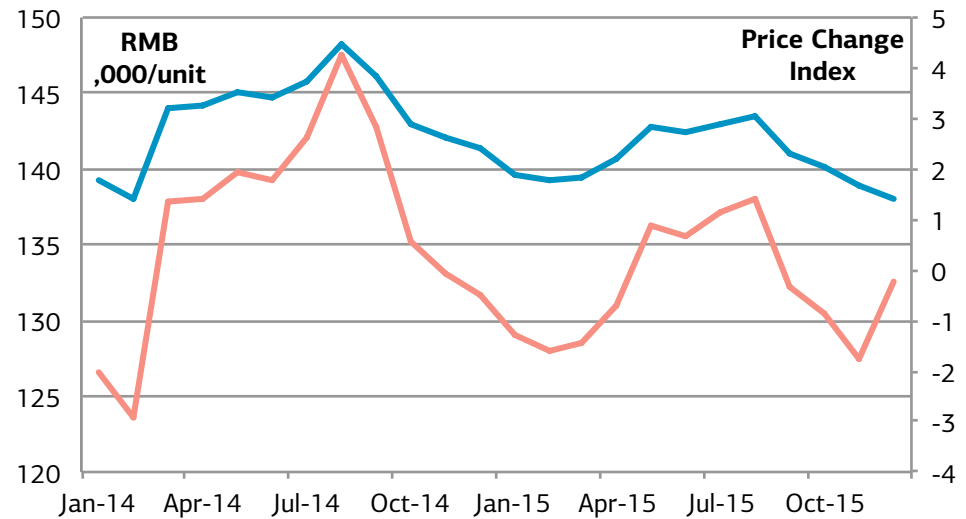
Our checks with dealers also indicated improving inventory because of the increasing bargaining power of dealers. Dealers told us their inventories were in the 1-1.5 month range. Luxury brand inventories were a bit higher, at about 1.5 months. We attribute the relatively healthy level of inventories

to the spate of disputes between OEMs and dealers in 2014, leading to a shift in the relationship between the two. Manufacturers began offering inventory subsidies, and dealers got more leeway to make decisions on inventory levels. Manufacturers are applying more flexible performance standards than just raw sales.

More Price Cuts

By December, inventories were down and sales up, and yet dealers were cutting prices. December prices declined, according to the Chinese Passenger Car Association (CPCA), which conducts a survey of retail pricing of over 250 passenger vehicle brands in 46 Tier 1 and Tier 2 cities. In December, ASPs fell 0.6% MoM from RMB 138,900 to RMB 138,100. Sedans declined by 0.4-2.3% in price. MPVs and SUVs saw growth in ASPs of 0.1 and 0.8% MoM respectively.

Chart 6. Gain: Overall ASP (RMB/unit, Blue) and Price Change Index (Pink)

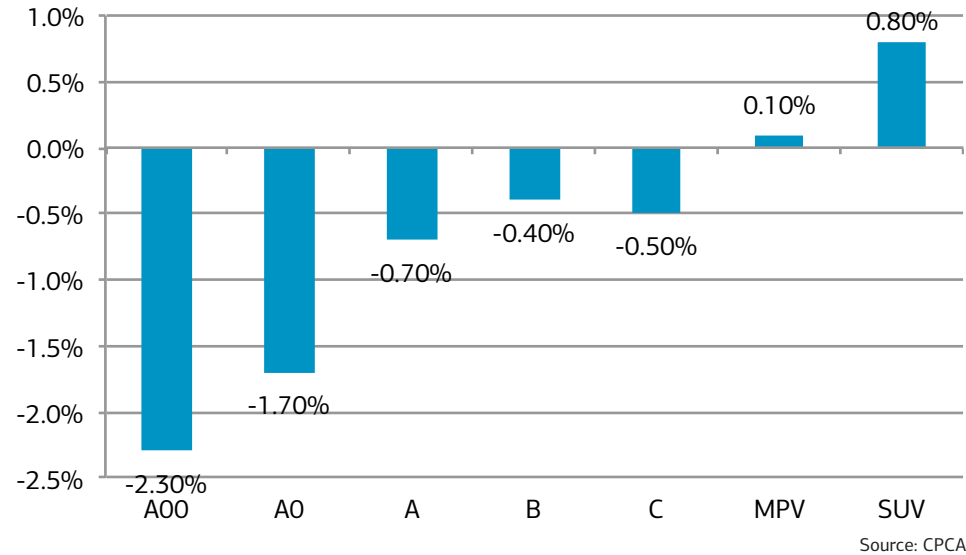


Source: CPCA

Price cuts tend to create expectations for further cuts. According to our checks with dealers and regional sales staff of OEMs, discounts widened by 3-8% YoY in H2 2015. Most dealers we interviewed expect there will be more discounts in 2016. Japanese brands are relatively resilient, and are seeing less discounting.

December in particular tends to bring discounts because dealers need to make their annual targets. In the second half of 2015, manufacturers subsidized at least 60% of dealers' discounts, as dealer margins had shrunk to the vanishing point.

Chart 7. MoM of ASP by Class of Passenger Vehicles



We expect pricing to continue under pressure. In 2016, in addition to subsidizing dealers, OEMs will cut their MSRPs. Already in January, some brands have announced price declines of 5-20%. Volvo has promised to compensate early buyers of the XC90 who did not get discounts now being offered.

Table 2. Official Price Cuts in Jan 2016

Brand	Model	Official Price Before Price Cut (RMB ,000)	Price Cut (RMB ,000)
Fiat	Ottimo	108.8-162.8	8.0-14.0
	Viaggio	108.8-158.8	8.0-14.0
Chang'an	Honor	39.8-66.9	2.9-11.0
Volvo	XC90	798.0-1,017.8	59.2-79.2
Audi	Q3	266.8-318.9	15.0

Source: Chinese news reports

Deteriorating Outlook for Dealers

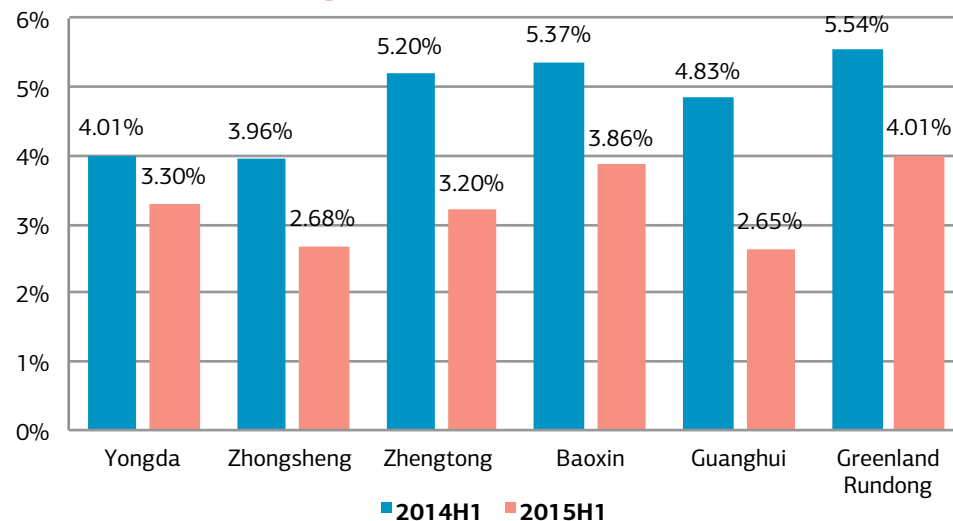
We see the market shifting downward in price point, model preference, and, ultimately, in profits for automakers. The first wave in that structural change has been the deterioration of profitability for dealers. Gross profit margins reported by dealers are now under 4% with significant deterioration for most in 2015.

Net profit margins of the six listed dealers also decreased. Zhongsheng,

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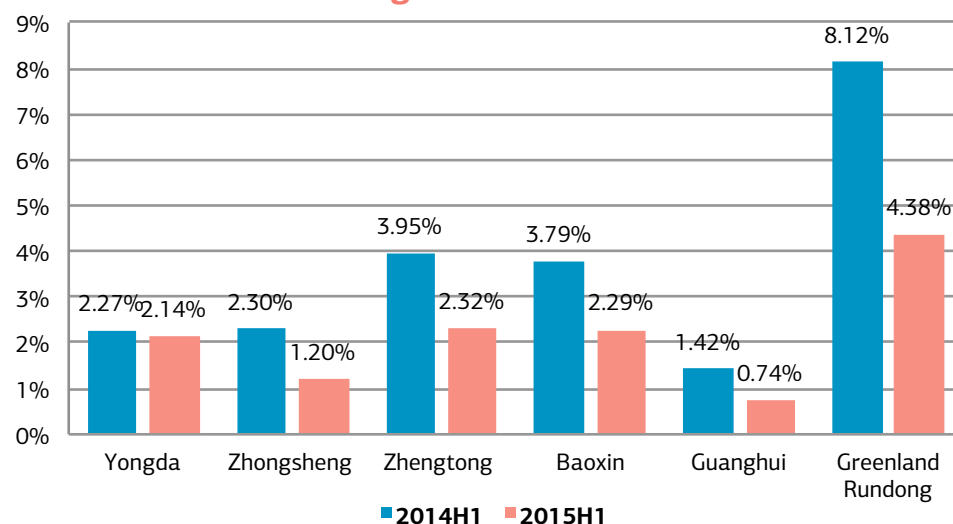
Guanghui and Rundong saw their net profit drop by half.

Chart 8. Gross Margin of New Vehicle Sales



Source: Company data, J Capital Research

Chart 9. Net Profit Margin



Source: Company data, J Capital Research

Table 3. H1 2015 Revenue from Selling New Vehicles

(RMB '000)	2014H1	2015H1	YoY Change
Yongda	13,190,033	14,472,311	9.7%
Zhongsheng	23,265,323	23,241,798	-0.1%
Zhengtong	13,777,980	11,910,113	-13.6%
Baoxin	14,602,903	12,275,502	-15.9%

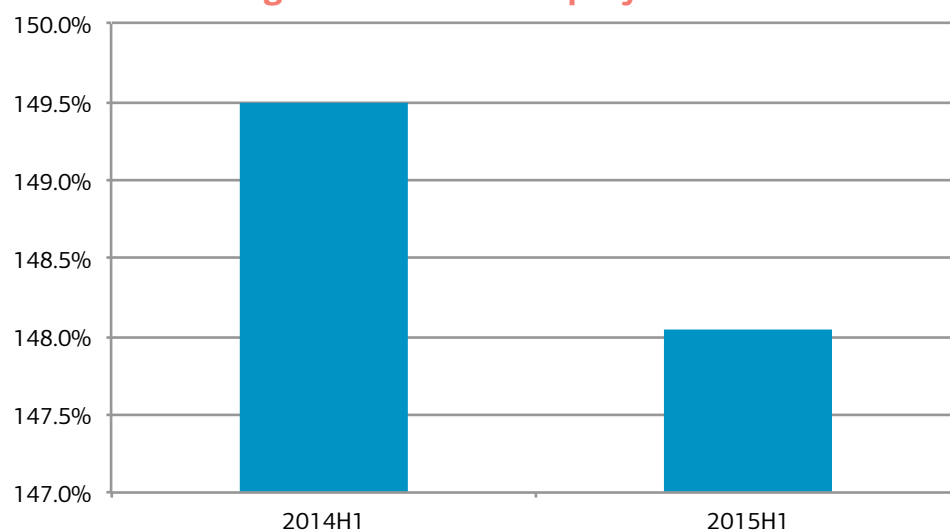
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Guanghui	38,574,185	37,792,054	-2.0%
Greenland Rundong	6,792,807	6,410,704	-5.6%
Total	133,252,415	126,058,960	-5.4%

Source: Company data, J Capital Research

Debt to equity is a miserable 148% for the listed dealers, very slightly improved from 149.5% to 148% at the end of 2014.

Chart 10. Average Total Debt to Equity Ratio



Source: Company data, J Capital Research

In addition, some dealers have outstanding USD or HKD debts, like Zhengtong and Baoxin, which have relatively higher foreign debts and will be more vulnerable to the RMB depreciation. If RMB depreciates by 10% in 2016, the potential loss from foreign exchange will eat up their net profits.

Table 4. Impact from RMB's Depreciation on Net Profit

Impact on Net Profit	Foreign Debt as % of Total Debt	RMB Depreciates By 5%	RMB Depreciates By 10%	RMB Depreciates By 15%
Yongda	14.1%	7.0%	14.0%	21.1%
Zhongsheng	9.9%	18.0%	35.9%	53.9%
Zhengtong	34.1%	15.4%	30.9%	46.3%
Baoxin	41.3%	25.1%	50.3%	75.4%
Greenland Rundong	23.7%	37.2%	74.4%	111.6%

Source: Company Data, Bloomberg, J Capital Research

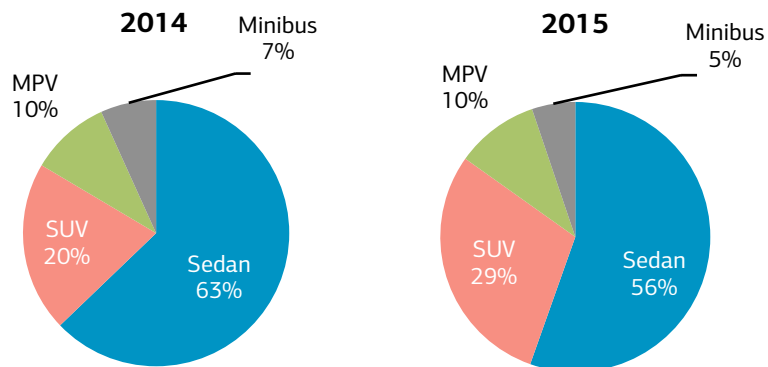
SUV's are the new "bread box" minibuses.

The Strange Case of the SUV

SUVs are the new “miandi” or “bread box” minibuses that were once the vehicle of choice for lower-income buyers who needed an income stream to support their auto purchases. The miandi were ubiquitous in Chinese cities in the 1990s and were the lower end of taxis. They got regulated out of the market in the early 2000s on the grounds that they could not meet emission standards.

Now, lower-end SUVs are the utility vehicle of the Chinese countryside, much as pick-up trucks are in the West, popular for durability. SUV sales led the sector to growth last year, rising 52.5% YoY over the year, accelerating from 36.4% growth in 2014. SUVs accounted for 29.4% of total PV

Chart 11. Market Share by Auto Type



Source: CAAM, J Capital Research

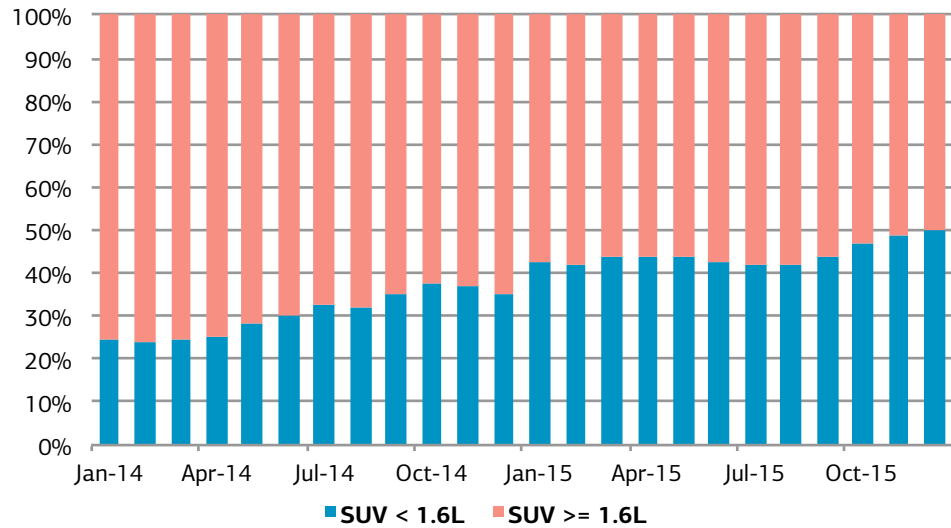
sales in 2015 versus 20.7% in 2014 and took share from sedans. The growth came mainly from smaller SUVs with engines under 1.6 L. This category went from 1.3 mln units in 2014 to 2.8 mln in 2015. Sales of SUVs with larger engines, so not supported by tax cuts, increased 21.6% YoY, the same growth rate as 2014. We believe there is a shift of demand for SUVs from upper-tier cities to lower-tier cities as well as the lower pricing trend. (See chart 12 on the next page.)

Most small SUVs are produced by domestic brands with official selling prices range from RMB 46,000-162,800, which matches the range of domestic sedans. Demand is strongest in rural areas and cities with lower income ranges.

Rapid Rise in Financing

The 2015 market grew more dependent on financing, and the penetration

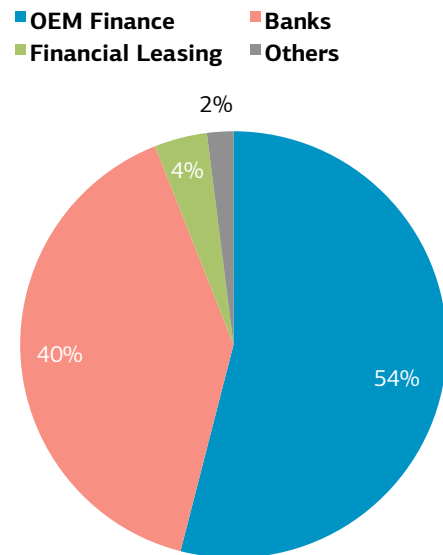
Chart 12. Market Share of SUV <1.6L & SUV >=1.6L



Source: CAAM, J Capital Research

rate of financing rose from 20% in 2014 to 33% in 2015. According to an auto financing research group, 2015 saw 7 mln vehicles sold with financing, with 3.8 mln of those units supported by auto finance established by OEMs and dealers, 2.8 mln financed with bank loans, and the balance by other were types of financing.

Chart 13. Market Share of Auto Finance by Type



Source: CAAM, J Capital Research

From our checks with 38 dealers of different brands, 48% of vehicles were purchased using financial services, including loans provided by OEMs and dealers as well as bank loans. Auto loans from banks tend to be hard to get since autos depreciate rapidly, and automotive companies can boost their sales by offering easier credit and interest subsidies. – higher than the reported penetration of credit. (See table 5 on the next page.)

Auto loans from banks tend to be hard to get.

Imports Decline by More than 20%

According to Customs, imported vehicles and chassis totaled 990,000 units

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Table 5. No. of Units Purchased Via Auto Finance Companies Established by OEMs and Dealers

Company Name	2015 (1,000 units)	2014 (1,000 units)	YoY Change
GM Finance	570	440	29.50%
SAIC Finance	430	260	65.40%
FAW Finance	250	150	66.70%
CSI Group Finance	220	90	144.40%
Dongfeng Finance	150	90	66.70%
BYD Finance	16		NA
Fortune Auto	126	60	110.00%
Chery Huiyin Motor Finance	250	190	31.60%
BAIC Finance	40	10	300.00%
JMC Finance	5	2	150.00%
DPC Auto Finance	145	100	45.00%
Toyota Finance	230	190	21.10%
Beijing Hyundai Finance	260	190	36.80%
Dongfeng-Nissan	230	170	35.30%
BMW Finance	130	80	62.50%
GAC-SOFINCO	124	110	12.73%
Ford Finance	120	120	
Volkswagen Finance	360	430	
Mercedes-Benz Financial	80	60	
FIAT Financial Service	20	10	
Haima Finance	10		
Great Wall Binyin	20		
Dongzheng Finance	20		
Huatai Finance	10		
Brilliance-Bea Auto Finance	10		
Genius AFC	10		
Total	3836	2750	38.0%

Source: KK Auto Finance

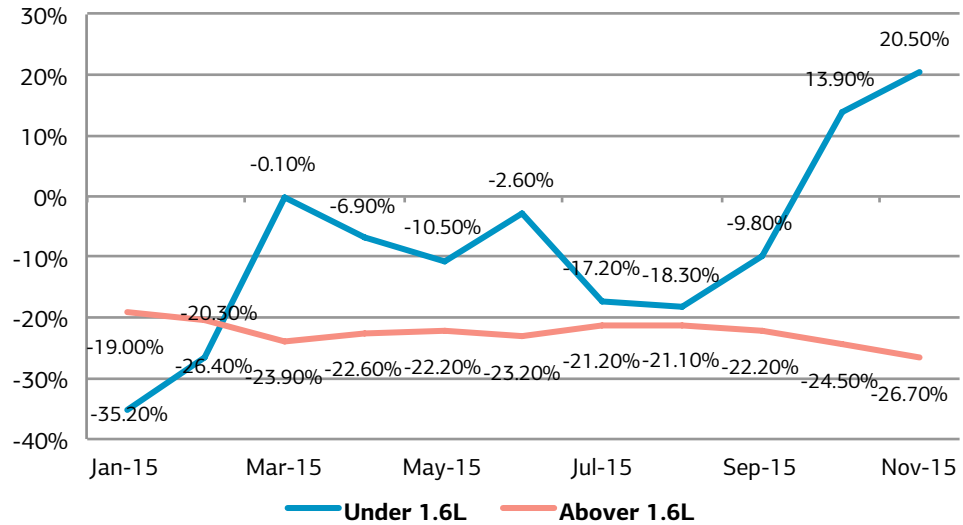
for the first 11 months of 2015, down 22.7% YoY. The value of the imported vehicles and chassis dropped even more, by 25.5% YoY, to USD 40.8 bln through November.

The composition of imports moved toward smaller and lower-priced models. Back in 2011, the volume of imported A-class or small sedans was 29.8% of the total, and this portion increased to 39.5% in 2015. Imported

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vehicles with engines under 2.0 L grew to 44.6% compared with 24.4% in 2009.

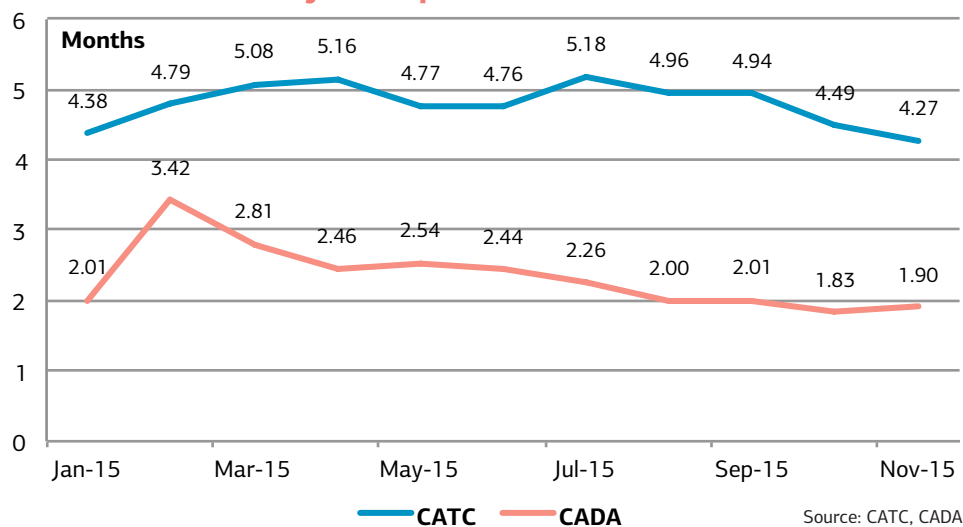
Chart 14. YoY Growth of Imported Vehicles by Engine Size



Source [here](#)

Sales of models under 1.6 L jumped 20.5% YoY thanks to the vehicle purchase tax cut, but the other categories declined. Inventory of imported vehicles stood at 1.9 months in November, well above the warning level of 1.5 months. This CADA data reflects the inventory already in dealer channels, while China Automotive Technology & Research Center) data reflects inventory including vehicles at bonded zones. In November, inventory reported by CATC stood at 4.3 months.

Chart 15. Inventory of Imported Vehicles of CATC vs CADA

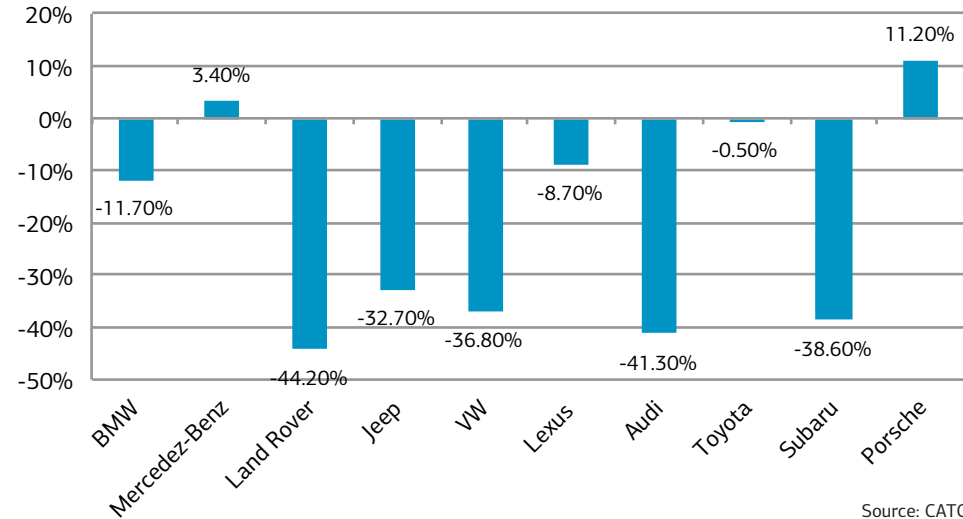


Source: CATC, CADA

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Despite the low 2015 base, we expect imported vehicles to continue falling.

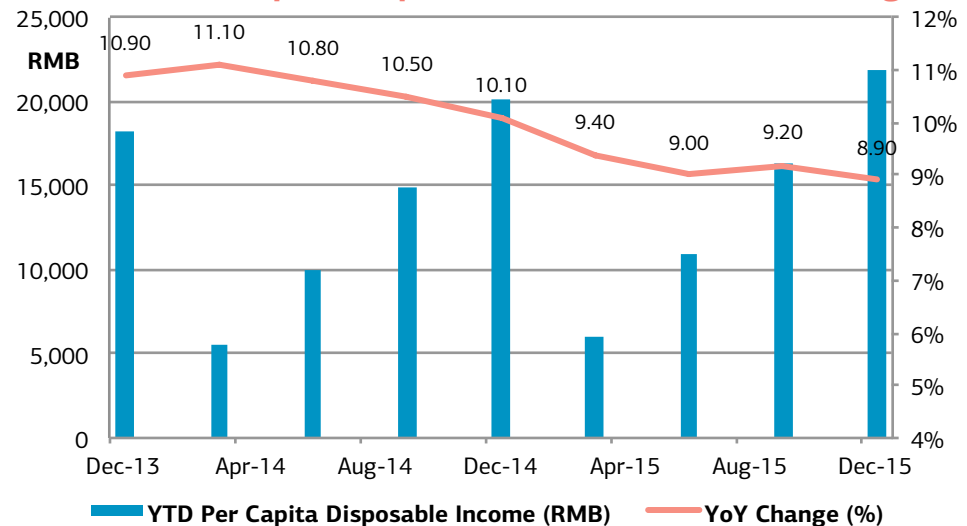
Chart 16. YoY Change of Import Volumes



Forecasting from Here

The runway for Chinese auto sales is shorter than immediately apparent from the low penetration. Vehicles per thousand people in China in 2015 numbered a bit more than 120 units, only one-seventh of the number in the United States. But per capita disposable income in China was USD 3,294 per year in 2015, only 8% of the USD 40,461 in the United States,

Chart 17. Per Capita Disposable Income and YoY Change



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and growing, (according to suspicious official statistics) by 8.9% YoY, down from 10.1% in 2014. Growth is stepping down just as a steep increase is required to bring incomes of all but the top decile to a level commensurate with car ownership.

In addition, we believe there will be more restrictions on purchases of traditional vehicles. The urbanization and property development of new zones that started years ago are moving people quickly out of city centers, but public transportation and road infrastructure have not kept pace. This social change has been adding to traffic, and cars are adding to serious air pollution problems. By 2015, eight cities had implemented license plate restrictions, including the four Tier 1 cities. More cities are rumored to be planning restrictions.

Table 6. 2016 Sales Volume Estimate (Units)

Sales Volume Estimate (Unit)	2013	2014	2015	2016F
Total Passenger Vehicles	17,928,858	19,700,569	21,146,320	21,962,393
YoY Change	15.7%	9.9%	7.3%	3.9%
Sedan	12,009,704	12,376,702	11,720,184	11,486,051
YoY Change	11.8%	3.1%	-5.3%	-2.0%
As % of Total PV Sales	67.0%	62.8%	55.4%	52.3%
SUV	2,988,758	4,077,897	6,220,279	7,384,939
YoY Change	49.6%	36.4%	52.5%	18.7%
As % of Total PV Sales	16.7%	20.7%	29.4%	33.6%
MPV	1,305,181	1,914,255	2,106,729	2,212,065
YoY Change	164.6%	46.7%	10.1%	5.0%
As % of Total PV Sales	7.3%	9.7%	10.0%	10.1%
Cross or Minibus	1,626,328	1,332,101	1,099,172	879,338
YoY Change	-27.9%	-18.1%	-17.5%	-20%
As % of Total PV Sales	9.1%	6.8%	5.2%	4.0%

Source: CAAM, J Capital Research

With these headwinds, we expect the boost from the tax cuts to dissipate after Spring Festival in February and overall passenger vehicle sales to slow to single-digit growth. SUVs will grow more quickly but will moderate compared with 2015.

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China's new energy vehicle market has shifted to fast growth.

Buyers of luxury brands are shifting down to lower-priced models. Dealers observe that luxury brands tend to grow at about half the rate of GDP. Automakers are beginning to realize this: Audi looks to sell 520,000 units in 2016, only 1.5% higher than 2015 sales, which recorded the brand's first YoY decline, of 1.4%.

New Technologies and the Innovation Curve

After years of promises and speculation, China's new energy vehicle market has finally shifted into fast growth. Yet policymakers' single-minded focus on unit volumes seems misplaced. Just as the advent of smartphones changed the way we use telephones and established a new technological platform for innovation in everything from mobile security to online payments, so automation and the shared economy are changing the personal-mobility landscape. The transformation involves a technological change from simpler vehicles to cars that have much more sophisticated technology platforms, are constantly connected to GPS systems, contain elements of autonomous driving systems, and may be used on a shared basis rather than simply owned. As China focuses on increasing unit volumes of "alternative" automobiles, regulators have ignored the social and physical infrastructure that might enable Chinese automakers to get on this innovation curve.

Alternative Propulsion

Ironically, now that gasoline costs are so low, China's electrics market is starting to get volume. In 2015, total sales of new energy passenger vehicles totaled 177,000 units, tripling the 58,000 units sold in 2014.

The 13th Five-Year Plan set a total sales target of new energy vehicles at 5 mln units in the five years from 2016-2020, achieving an annual run rate of 850,000 units in 2020. If the plan is realized, that would be [3.3% of total PV sales](#) in 2020 of 25.8 mln units.

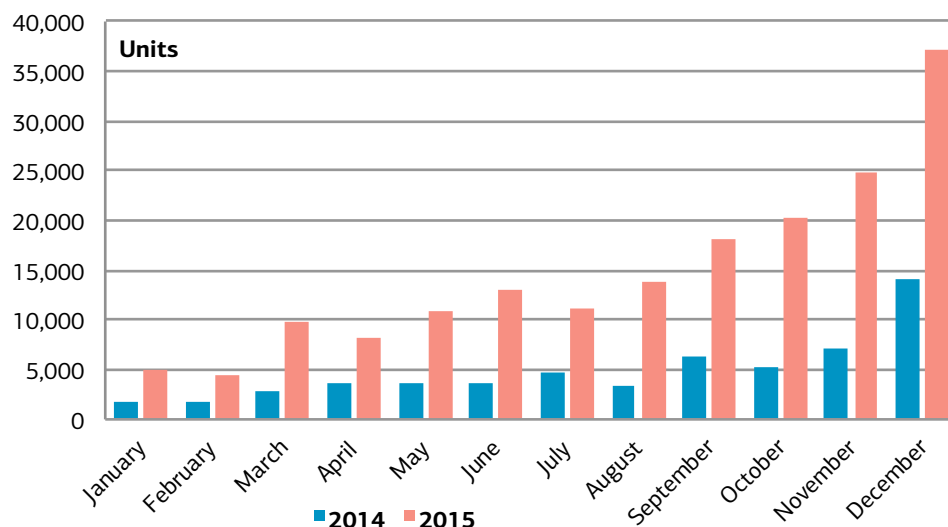
Table 7. New Energy PV Sales Estimates (Units)

	2015	2020E
New Energy PV Sales	176,734	849,172
Total PV Sales	21,146,320	25,790,711
New Energy PV Sales as % of Total PV Sales	0.8%	3.3%

Source: CAAM, J Capital Research

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Chart 18. Monthly Sales Volume of New Energy Passenger Vehicles



Source: CAAM

Table 8. Annual Sales of New Energy Vehicles (Units)

Company Name	EV Model	2014	2015	YoY
BAIC	BAIC E Series	5,534	16,488	197.9%
BAIC	Senova D50		329	
BAIC	Senova D70	15	243	1520.0%
Kangdi	Kangdi Panda	8,564	20,390	138.1%
Geely	Geely ZD		6,164	
JAC	JAC IEV	2,694	10,420	286.8%
ZOTYE	ZOTYE Yun 100	2,311	15,647	577.1%
ZOTYE	ZOTYE E20	7,341	6,385	-13.0%
ZOTYE	ZOTYE Sesame E30		572	
ZOTYE	TT EV		2,092	
Chery	Chery QQ EV	9,096	6,885	-24.3%
Chery	Chery eQ EV	542	7,262	1239.9%
BYD	BYD e6	3,767	7,029	86.6%
BYD	BYD e5		1,426	
BYD	BYD T3		106	
JMC	JMC E100		5,268	
Denza	Denza	132	2,888	2087.9%
Dongfeng	Venucia EV	582	1,273	118.7%
Dongfeng	Fengshen E30		511	
Changan	Changan EADO EV		1,500	

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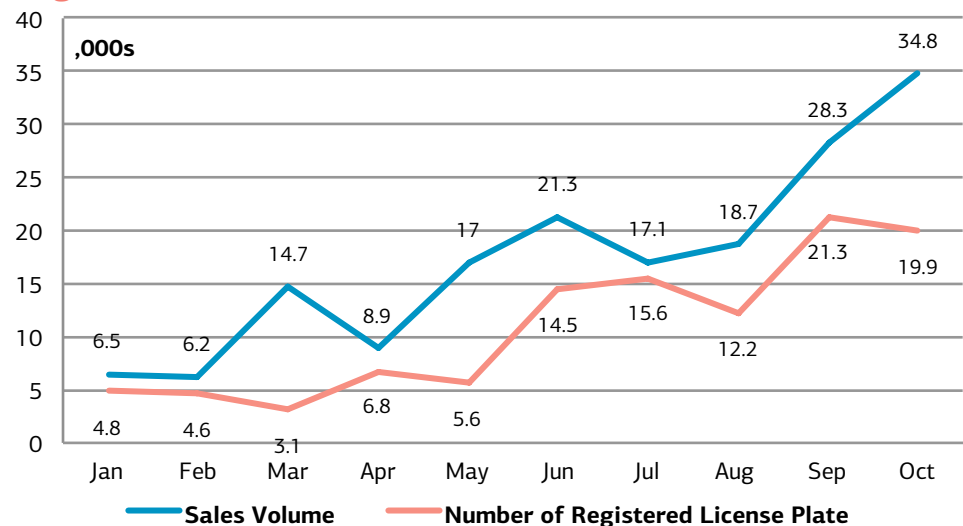
SAIC	Roewe E50	191	412	115.7%
GM	SAIL EV	37	68	83.8%
Electric Cars		40,806	113,358	177.8%
BYD	QIN	14,704	31,898	116.9%
BYD	TANG		18,375	
SAIC	Roewe 550	2,705	10,711	296.0%
GAC	Trumpchi GA5 EV	80	1,266	1482.5%
BMW	530Le		800	
Volvl	Volvo S60L		470	
Mercedes-Benz	Mercedes-Benz C350		1	
Hybrid Cars		17,489	63,521	263.2%
Total New Energy Vehicles		58,295	176,879	203.4%

Source: CPCA

Currently, most sales are to governments, for fleets of taxis or government vehicles. Among the consuming population, despite a general belief that a more ubiquitous charging infrastructure will turn things around, we think there is just not a lot of interest. According to CPCA, purchases of new energy PVs are still concentrated in Tier 1 cities such as Beijing, Guangzhou, and Shanghai, where buying an EV sidesteps the restriction on new registrations.

Other cities have anemic demand. December applications for EV purchases in Tianjin and Shenzhen accounted for only 7.3% and 10.9% respectively

Chart 19. Sales Volume of Electronic Cars & Number of Registered License Plates



Source [here](#)

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of the monthly quota for those cities. And [in Beijing](#), although a total of 48,000 license plates for plug-in electric cars and hybrids were granted in 2015, actual registration of EVs amounted to only 15,600 units, which means over 32,000 units are not in use.

The gap seems to represent gaming the subsidies. Sales of new energy vehicles for the first 10 months of 2015 amounted to 174,000 units, while the number of registered license plates reached only 108,000, according to Xu Changming, director of information resource development department at the State Information Center. There was a gap of 70,000 cars. We know [of cases](#) in which people obtain subsidies for electric cars and apply them to conventional engines.

Starting in 2016, the 13th Five-Year Plan subsidy rule will be put in place, cutting subsidies for plug-in electrics with a range of 100-150 km to RMB 25,000 per unit from the previous RMB 32,000 per unit and cutting the hybrid subsidy from RMB 32,000 to RMB 30,000 per car. Subsidies in 2017 and 2018 will decline by 20% from 2016's level and then will be 40% less in 2019 and 2020. As subsidies gradually decline in the following years, we believe EV sales will slow.

Even for such a limited market, domestic OEMS have released aggressive investment plans. Geely signed a contract with the government of Yiwu, Zhejiang to invest RMB 30 bln to build an auto industrial park for electric car production and claimed that it will increase the portion of EV sales to 90% of total sales by 2020.

Connectivity

Developments in connectivity so important to automotive technology overseas are being thwarted by weak GPS systems in China and a politicized information regime that impoverishes the range of data available for auto designers. Although mapping applications have improved a good deal in the last decade, they are far behind those in the developed world and lack commercial tie-ups to businesses that would allow Chinese drivers to find “points of interest” on their GPS systems.

In other aspects of the car's information platform, whether backing cameras, connected entertainment systems, temperature control, or technologies that require grid connection, China is also lagging.

Autonomous Vehicles

The development of autonomous vehicles is likely to be much slower in China than in the developed world, hampered by weak traffic manage-

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ment, the heterogeneity of vehicles sharing the street, and the different rule regimes for them all. Autonomous vehicles are most likely to make their debut on the streets of international cities as supplements to public transportation networks. In China, this would compete with the massive investment made by cities in their new light rail and subway systems. But autonomous driving has the potential to change driving and consequently manufacturing patterns rapidly, and if Chinese manufacturers fail to absorb the new technologies they will fall behind that innovation curve.

The Sharing Economy

A third innovation driving automotive change is the sharing economy, pioneered by Uber and Zip Car and now making a splashy entrance in China with services like Didi. China's shared economy seems to offer more promise, as it is being created by new, independent players unencumbered by legacy systems. Car-sharing services have grown quickly, and they have grown largely at the expense of taxi services, which, of course, generally object. Most major taxi companies in China belong to the municipal governments, so local regulators will work to protect their financial interests. But now, regulations proposed by the Ministry of Transport would define the business as a hailing service by banning the use of private cars in the sharing services. That proposal looks like it will fail, but it can be expected that regulators will curtail the ambit of the services, allowing the platforms to improve the efficiency of city-owned taxi services but not to supplant them.

The Chinese vision of an automotive future, a vision that looks much like an electrified version of today, seems short sighted. Chinese companies are gearing up to mass produce plug-in electrics. But treating electric cars as a volume business could create the same value trap into which Chinese electronics companies sank back when cellular phones were the most promising new business. The manufacturing capacity created, in terms of both capital assets and skilled workforce, served the interests of foreign brand owners, and did not propel Chinese brands to the forefront of the industry.

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Appendix 1. Surveys

Table 9A. Manufacturer Survey (Section 1)

Region	Brand	Sales	2016 Target	Prices	Inventory	Financing
North West	Changan	YOY increase (can't tell %); tax cut policy has limited influence. Major reason is seasonal bounce.	YOY increase (can't tell %)	OEM will subsidize all the discounts as dealers have little room for profitability.	low pressure	based on a certain amount of deposit and will offer different financing service according to the quality of dealers.
Shaanxi Province and Qingyang city in Gansu Province	VW	YOY 15%; tax cut policy	YOY 5%	stronger discount in the future and OEM will subsidize 70% discount for dealers.	dealers have 80% inventory	30% deposit; OEM and bank loan
South	SAC	YOY 70%; Branding and tax cut policy.	YOY 30%	weak discount because of good sales performance.	low pressure	full payment with financial service from OEM and banks
North	GM Cadillac	YOY -2-3% overall; YOY increasing in North region. Main reason is because of seasonal bounce.	YOY 20%; overall luxury car sector will be pessimistic	greater discount level; lower price in 2H. Old models will have price cut in 2016. subsidize 60-100% of discount.	OEM: 1-1.5; Dealer: 2-3	OEM financing company or bank loan
Jiangxi Province	Trumpchi	Q4 has YOY 50% increase. Main reason is new models are matching with consumers habits. The tax cut policy also has great influence. Q4 is a traditional sales peak.	negative	Old model will have an official price cut.	n/a	n/a
Jiangxi Province	Changan Ford	Q4 has YOY 50% increase. Main reasons are stable channels, new model and brand effect. Tax cut policy also helps a lot.	up 10-30%	Price depends on brand positioning. Step up discounting in 2016.	High level	For dealers, 10% deposit and take loan from OEM finance company. Demand is huge.
Shandong Province	Dongfeng Nissan	Dec. YOY 10%. Major reason is tax cut policy. Seasonal bounce is another reason.	Flat	OEM will subsidize most of the discounts in the region. Hard to estimate discounts in 2016.	n/a	n/a

Source: J Capital survey

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Table 9B. Manufacturer Survey (Section 2)

Region	Brand	Popular Model	Customers	Production	Others
North West	Changan	CS75 and 35. SUV accounts for more than 50%	dealers 90%; 50% city residents and 50% rural residents	n/a	SUV is the main force of Changan. This model has great development potential in the future.
Shaanxi Province and Qingyang City in Gansu Province	VW	Lavida (high sales amount); Tiguan (high margin)	dealers 80% (80% private buyers, 20% key account clients). Major buyers are city residents. Institutions are government and taxi companies.	few models are cutting production and few are stopping production	Second-hand car market has little impact on new car sales because it is a chaotic market. SUV has great potential as long as the price is at right position.
South	SAC	Highlander and Accord. SUV accounts for major ratio	n/a	it's impossible to reduce production as everyone is fighting for market share.	
North	GM Cadillac	SUV and MPV. SUV accounts for 1/3-1/4 sales.	dealers 90-95%; major buyers are residents in tier 1&2 cities (50-60%)	only reduce production under extreme cases, such as an economic crisis.	Domestic brands will have multi-channels. Government still purchases Buicks but fewer than before. Second-hand cars will not have a great impact on new car sales as this industry needs to be standardized.
Jiangxi Province	Trumpchi	n/a	n/a	n/a	n/a
Jiangxi Province	Changan Ford	Middle to high end C level car, compact type and SUV	Rural area has great potential	Depends on the brand strategy. Ford is at the later phase of growth period and normally will consider to reduce production to keep profitability.	Second-hand car and replacement sector will have high speed growth in the future.
Shandong Province	Dong-feng Nissan	n/a	n/a	n/a	n/a

Source: J Capital survey

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Table 10A. Dealer Survey (Section 1)

City	Region	Brand	Sales	2016 Target	Prices	Gross Margin	Inventory
Xuzhou	Jiangsu Province	JLR	Nov. sales less than 40 cars. MOM -15%; YOY increase.	n/a	Overall flat; small car drop 5%; large car drop 10-15%.	Loss (including rebates, 5%)	40 cars, less than last year. Stop piling up stocks to dealers because of the protest.
Chongqing	West	Cadillac	Nov. sales 35. MOM 5-10%; YOY -15%	Down 10-20%	RMB 10,000 - 20,000 more discount than last year. RMB 10,000 than 1H. More discount in 2016.	Break-even (including rebates)	30-40 cars about 1. Peak time is after Spring Festival to May. Chongqing will hold international car exhibition in June.
Chongqing	West	Benz, Porsche, Audi, VW, Dongfeng Nissan	Nov. sales 30 cars MOM 5%; YOY -20%	up 15%	More discounts than last year	Audi: loss; Benz: slightly profit. Rebates: 5-7%	Overall level is decreasing. After Spring Festival, inventory level reaches to peak.
Hohhot	Northwest	Jeep, KIA, Dongfeng Peugeot; Changan; JAC	MOM -10-15%; YOY 8-9%.	up 5-8%	5-8% more discount than last year; flat; more discount in 2016.	3% (including rebates)	up 40-50%; increase since June and maintain 3-4 months. Will be better in the future
Changzhou	Jiangsu Province	Lexus	Nov. 50 cars; MOM -5%; YOY 15%	up 30%	10% less discount than last year; 5% more discount than 1H. More discount in 2016.	n/a	n/a
Chengdu	Sichuan Province	BMW	Nov. 200 cars. MOM flat; YOY -10%;	up 10%	more discount; 3-4% more than 1H	Loss (include the rebates)	200 cars a month; flat. Peak time from Mar. to Jun. and Dec.
Shanghai	East	Audi	Nov. sales 140 cars. MOM 27%; YOY 70% (new store)	Flat	3-5% more discount than last year; 2-3% than 1H. Flat in 2016.	no profit even including rebates (15-18% in total)	1.4 last year; average 1.6-1.7 this year
Nantong	Jiangsu Province	Volvo	Nov. sales about 30 cars MOM -10%; YOY -20%	Flat	3-5% more discount than last year; 3% more than 1H. 2-3% more in 2016.	- RMB 2000-3000/car (including rebates, 10.5%)	1.5-2, highest 2.5; last year highest point was 4.8.
Jincheng	Shanxi Province	Benz	Nov. sales about 30 cars MOM flat; YOY 300% (new store)	up 20%	1% more discount than last year; 0.8% than 1H.	0.8-1% (including rebates, 6-7%)	overall 1.5, well control and same as last year
Hefei	Anhui Province	Bentley	annual sales is 30 cars. Flat	drop	More discount than 1H and last year.	Loss (include the rebates)	5-6 cars. Flat

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Tianjin	North	Aston Martin	YOY -20-30%	Flat is a good performance	Discount is more than 1H and last year. downward in the future.	Four stores nation wide. Some are making money and others are losing money. Hard to say.	Less than last year and the pressure comes from OEM
Jinan	Shandong Province	Rolls-Royce Lamborghini	Slightly worse than 2014.	Flat	RR: Flat 5 mn Lamborghini:3-10 mn stronger discount than last year	n/a	Decreasing all the time and price might go up in 2016.
Hohhot	Northwest	multi-brand	Nov. MOM -3% YOY increasing is because of tax cut policy	YOY 6% up 6-7%	YOY 5-6% increasing of discount and will be 5-6% stronger in 2016.	10% rebates (includes all subsidies)	10% lower than last year. High level from Feb. to Aug. Average level is 1.6-1.7 High peak will be 2. Inventory will be more reasonable in 2016. 1.8-1.9 for high peak and lower than 1 when sales is strong.

Source: J Capital survey

Table 10B. Dealer Survey (Section 2)

City	Region	Brand	Financing	Popular Model	Customers	Other Comments
Xuzhou	Jiangsu Province	JLR	70% full payment. We had cash issue before and can only work with Bank of China	Evoque, price between RMB 800,000 to 1.8mn. SUV accounts for 95%.	Bosses and vendors of construction projects. Major buyers are from county area. Replacement and second-time purchasers.	Not much subsidies but we get money at a fast pace. No expansion plans or closings.
Chongqing	West	Cadillac	40% full payment; 60% bank loan (OEM will subsidize interests, three years 2.5%)	SUV accounts for 30-40%; ATSL basic is below RMB 300,000.	Middle level management in large companies or private business owners. Income between RMB 300,000 to 500,000. Motivation is replacement purchase.	Will subsidize 50-60% event fee. Tier 2 dealers close down not for 4S stores. No new stores and expansion.
Chongqing	West	Benz, Porsche, Audi, VW, Dongfeng Nissan	70% full payment; 8% OEM financing (Benz subsidy interest but charge handling fee)	Price is about RMB 200,000. SUV demand will increase after the implementation of two-child policy	65% wage-earning class; 20% small business boss; 10% C level of large company. 55% first purchase.	Overall net profit was down 15%. Audi and VW has been cutting production. KIA has been expanding heavily. VW is opening new stores as well. Guangzhou Honda closed down many stores.

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Hohhot	Northwest	Jeep, KIA, Dongfeng Peugeot; Changan; JAC	n/a	SUV accounts for 70% with slow growth rate in the future.	Income between RMB 50,000 to 100,000. Major first purchase.	County residents' purchasing power was growing. Finance support for marketing event, about 50% subsidy
Changzhou	Jiangsu Province	Lexus	n/a	n/a	n/a	Not much help from the tax cut policy. Less cars this year with more models which attracts customers to buy.
Chengdu	Sichuan Province	BMW	20% full payment; 70% OEM financing; 10% bank loan	Series 3 & 5, between RMB 300,000 to 700,000. SUV accounts for 40%, 45-50% in the future.	Income between RMB 200,000 to 300,000. city residents with second even third purchase.	Not much help from the tax cut policy. OEM required dealers to pile up stock at the end of year but no more pressure in 2016 as tight cash flow.
Shanghai	East	Audi	30% full payment; 35% bank loan; 35% OEM financing (OEM subsidize one year interest 4%; two years 8%; three years 12%)	A4 & A6, between RMB 300,000-400,000. SUV accounts for 20% which has great room for growth.	Income between RMB 300,000 to 500,000. From rural area. Major is first purchase group.	Not much help from the tax cut policy. Rebates return to the dealer faster in order to help with financial pressure. Part of rebates will return to the cash account. If there is 1 mn cash, we can use it as a deposit to buy cars worth 5 mn.
Nantong	Jiangsu Province	Volvo	50% full payment; 50% financing (OEM subsidize one year interests)	60 series between RMB 250,000 to 500,000. SUV accounts for 30% (current price is about RMB 400,000)	Civil servant; staff working at public institutions. Major factor is replacement demand.	Not much help from tax cut policy. 2016 will not launch new inexpensive SUV.
Jincheng	Shanxi Province	Benz	60% full payment; 40% OEM financing	RMB 300,000-400,000. SUV accounts for 30%, up 50% in 2016 because new model launching (GLC)	Management level, small company boss. Major is replacement and second car purchase group.	Not much help from the tax cut policy. Little financial support from OEM. Every brand has an expansion plan, at a slow pace. Close down only when financially strained.
Hefei	Anhui Province	Bentley	20-30% loan (no interests subsidy)	n/a	various	Economic situation is terrible and demand is weak.
Tianjin	North	Aston Martin	n/a	price is about 3.5 mn	Boss of companies or corporate purchases. Mostly first-time purchases.	About 50% sales staff left in the cities having vehicle restriction scheme.

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Jinan	Shandong Province	Rolls-Royce Lamborghini	Mostly full payment; fewer financing	For Lamborghini, price is between 3-4 mn	RR: business class Lamborghini: various group. First and second purchase (hard to give ratio)	There are dealers closing down, expansion is rare case. BMW and Benz are heavily expanding. Overall luxury market is shrinking as many rich people are immigrating.
Hohhot	Northwest	multi-brand	50% OEM financing; 20% bank loan; 30% full payment.	Price is between RMB 70,000 to 150,000, such as Hyundai, VW and Buick. Car 80%; SUV 20% might increase 8-10% in 2016.	City residents have RMB 100,000 annual salary. First-time purchase group is about 30%, second purchase or replacement is about 70%.	n/a

Source: J Capital survey

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