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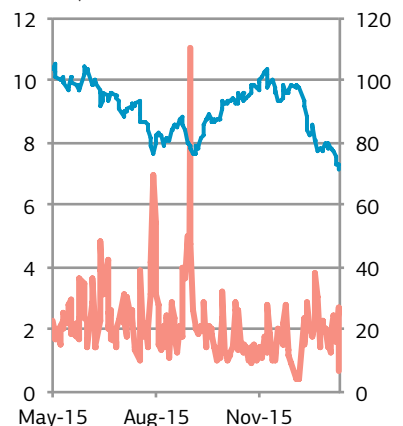
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BMW (BMW GR)

Price	EUR 71.29
Rating	SELL
Price Target	EUR 58.42
Difference	-18.1%
EPS 2016e	7.54
Forward P/E	7.775x

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



Bayerische Motoren Werke AG (BMW GR) Trouble Ahead

- ▶ **Growth of BMW's** total sales volume in Mainland China slowed to 1.7% YoY in 2015 from 16.7% YoY in 2014. The most popular model, the JV 5-series, is approaching the end of the product cycle and imports are declining. We estimate that total sales volume will drop 3.4% in 2016, with imports down 17% YoY.
- ▶ **Pricing pressure** will push down margins this year, with older BMW models sold at deeper discounts.
- ▶ **If the RMB** depreciates 10% against the Euro this year, that will drive down BMW's pre-tax income by 11%.
- ▶ **Given all these headwinds,** we reduce our target price to EUR 58.42 from EUR 81.2 based on estimated 2016 EPS of EUR 7.54 VS and a forward P/E of 7.75x.

Luxury Sales in Trouble

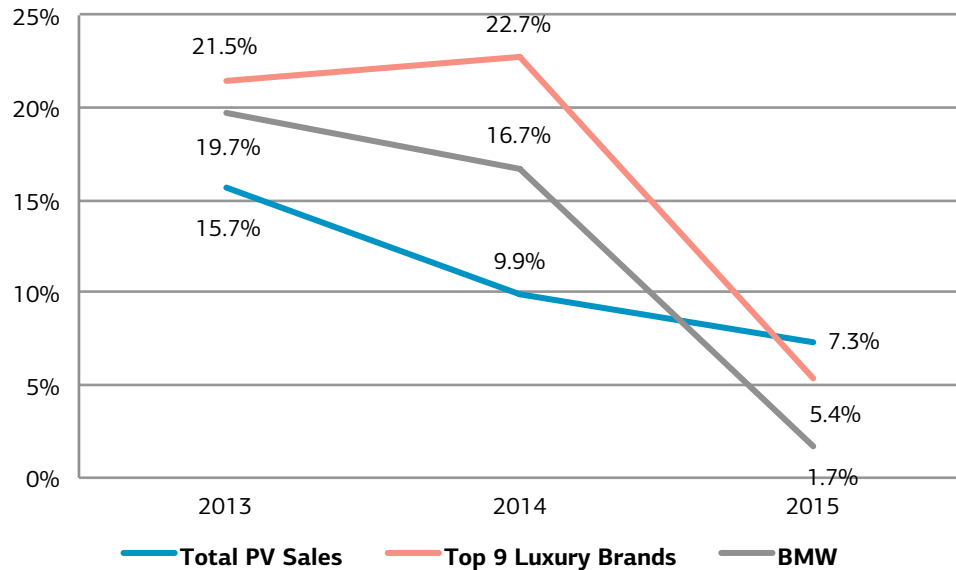
When economy slows, luxury vehicle sales slow more. Sales of the top luxury brands in 2015 under-performed the market, and 2016 will continue the trend.

Total sales of passenger vehicles in 2015 grew 7.3% YoY, slowing from the previous year's 9.9% growth rate, but sales of Audi, BMW, Mercedes, JLR, Lexus, Volvo, Cadillac, Porsche, and Infiniti grew only 5.4% YoY for the year. This was down from growth of 22.7% in 2014. Audi, the top-selling luxury name, recorded its first YoY decline, of 1.4%, in China.

BMW increased sales only 1.7% YoY compared with 16.7% in 2014. In 2015, there was a big change in the relationship between BMW and its Chinese dealers and BMW agreed to adjust its sales targets, causing dealers to stop piling up inventory in order to make unrealistic numbers.

BMW increased sales only 1.7% YoY in 2015.

Chart 2. YoY Change in Annual Sales Volume

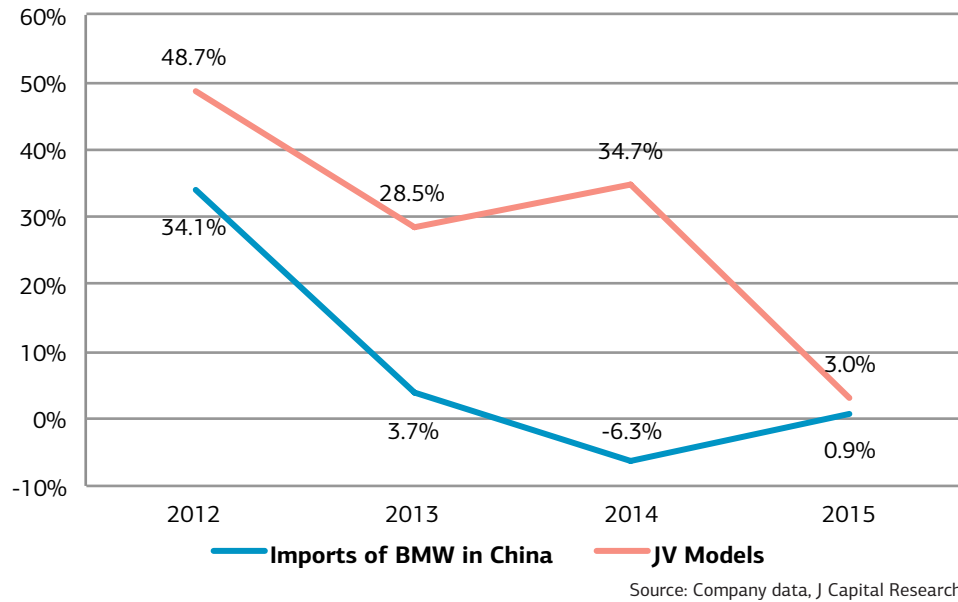


Source: Company financials, J Capital Research

Despite the disappointing growth, the 463,736 cars BMW sold in China in 2015 make China still the most important market for the company, contributing 24.3% of total sales volume of BMW Group. Sales of the joint venture models produced in China slowed to 3% YoY from 2014's 34.7%, missing the JV company's sales target of 4.0%. Imports performed better than our estimates, up 0.9% YoY in 2015, mainly thanks to the launches of

new models including the 2-series and the X4 in late 2014. Helping BMW's sales of imports was its good selection of SUV models, making up 40.9% of BMW's total imports. Its SUV models include the X3, X4, X5 and X6.

Chart 2. YoY Sales Volume Growth of Imported vs. JV Models



Imported sedan models declined 14% YoY. The 7 series introduced in late 2015 failed to offer attractive new features, and dealers say that they are finding it hard to move vehicles with selling prices above RMB 700,000-800,000 per unit; the new 7-series retails at RMB 1.19-1.99 mln. Although the old 7 series has an MSRP of RMB 1.11-2.06 mln, the cars are being discounted by 31-34%. Even with these price cuts, we estimate that the sales volume of the 7 series fell 40% in 2015, and we expect the decline to continue in 2016 unless discounts cut more deeply.

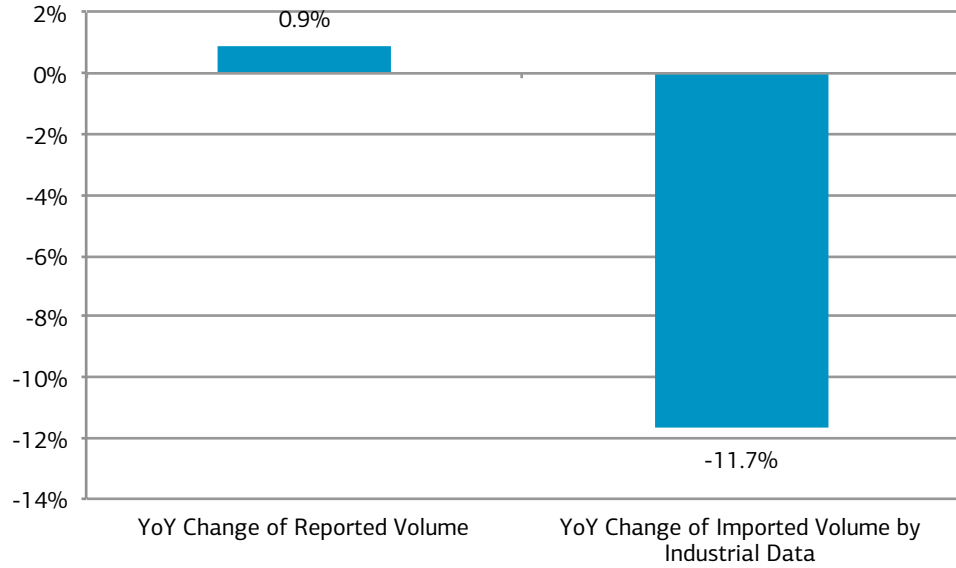
BMW reported 0.9% YoY growth in sales in imported cars in 2015, but the China Automobile Trading Co., the largest importer of foreign cars, reported that BMW imports fell 11.7%. The discrepancy could be due to gray-channel imports. (See chart 3 at the top of the next page.)

More Competition

In addition to a slowing economy and less demand, BMW suffers from more intense competition among luxury brands. While BMW sales slowed in 2015, brands with a lower base of sales, such as Mercedes, Lexus, Porsche, and Infiniti reported double-digit growth.

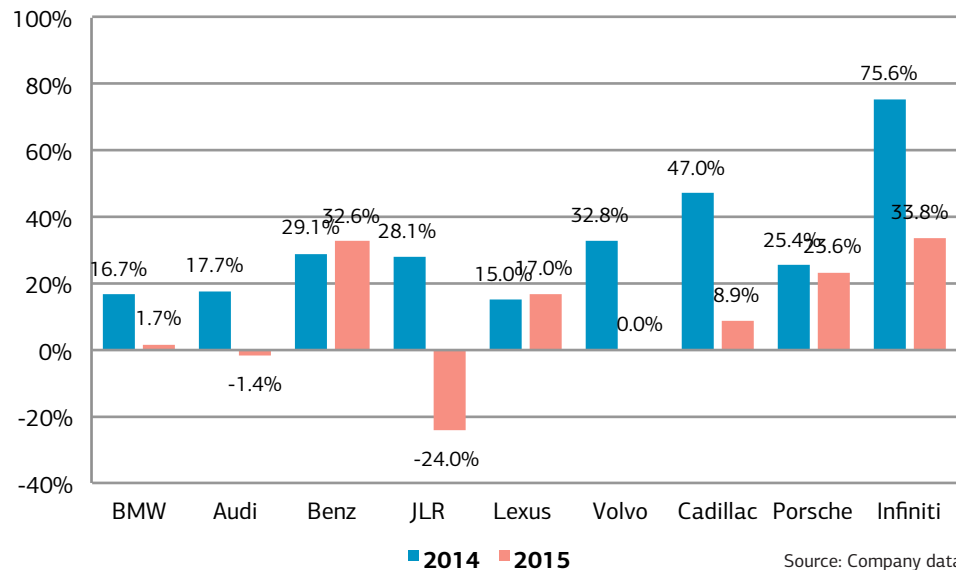
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Chart 3. BMW's Reported Import Growth vs 3rd-Party Reports on BMW Imports



Source: Company data, So Hu online (available in Chinese [here](#)), J Capital Research

Chart 4. YoY Change of Sales Volume of Top 9 Luxury Brands in China



Source: Company data

Clogging the Channels

Registrations are underperforming sales, suggesting that a lot of BMWs are stuck in the sales channels. Guangdong Province accounts for over 10% of total PV sales in Mainland China and is representative of overall sales performance. Registration volumes reported through October last year generally underperformed the company’s reported sales.

Table 1. Guangdong Registration vs Sales Growth 1-10 2015

	YoY Change in Registration Volume	YoY Change in Sales Volume from Company
BMW 3	2.9%	-0.3%
BMW 5	-2.1%	6.2%
BMW X1	-25.6%	-11.8%

Source: CPCA, Che Zhu Zhi Jia online (available in Chinese [here](#)), BMW Company reports

Pressure from Price Cuts

Despite strong sales at year-end of 2015, pricing pressure is becoming stronger and even new models have to offer discounts. For the 5-series, discounts are at 17-25% in early 2016, up from 10-21% at the end of May 2015. BMW is trying to maintain its pricing on the new 7-series model, but the strategy is not working given discounts up to 40% on other models.

Table 2. Discounts on BMW Models

Series	Official Selling Prices (RMB)	2015 Sales Volume in China*	YoY Change of 2015 Sales Volume	Discounts at End of May 2015	Discounts at Early Feb 2016
3 Series	296,800-607,800	106,659	4.9%	10-26%	15-26%
5 Series	435,600-778,600	158,134	2.0%	10-21%	17-25%
7 Series	933,500-2,703,500	12,985	-40.7%	25-31%	0-34%
X1	259,000-436,000	42,200	-14.3%	15-32%	20-29%
X3	479,000-750,000	28,752	-8.6%	8-10%	5-15%
X5	852,800-1,773,000	32,462	29.4%	13-15%	11-22%

Source: Miao Che (available in Chinese [here](#)), J Capital Research

End of the Cycle

BMW's most popular models are approaching the end of the product cycle. The company's new launch plans fail to impress. BMW is issuing its 2-series Active Tourer in Q1, the new X1 SUV in Q2, and a new 1-series sedan H2, but we don't expect significant improvement in BMW China sales until late 2017, when the new 5-series will be launched. Instead, we estimate there will be a 2.8% sales decline in 2016, as the most popular model, the 5-series, reaches the end of its lifecycle. In addition, Mercedes will launch its new E-class in late 2016 and take some market share.

In 2015, reported sales of the 2-series, introduced in late 2014, totaled 12,000 units but a lot of these seem to be sitting in channels. Guangdong Province reported registrations of only 637 units of the 2-series in the first

BMW's most popular models need renewing.

10 months of 2015 when normally that should have been at least 1,000 units. We estimate that total registration of 2-series cars reached fewer than 8,000 units in FY2015, or only two-thirds of reported imports. Current selling prices of 2-series range from RMB 279,900 to RMB 349,900, and the new JV 2-series will have the same prices. For imported 2-series, current discounts are at 20-24%. So the new JV 2-series will have to discount as well. As a result, we estimate average monthly sales of JV 2-series at 1,000 units starting from March and ~5,000 imported units per month.

The second generation of BMW-Brilliance's long-wheel X1 SUV model will come out in H2. With a 1.5L engine size and more space than the old model, sales may improve compared with the -11.5% YoY drop in 2015. However, Audi's new Q3 will also be released ahead of BMW's X1 and Mercedes' GLA is still new to the market, so there will be intense competition among compact SUVs in 2016.

Table 3. Current Compact SUV Models of ABB

Brand	SUV Model	Official Price ('000s/per unit)	Engine Size	2015 Sales Volume (unit)	YoY Change	Average Discount
BMW	X1	259.0-436.0	2.0T	41,200	-11.5%	19.0%
Audi	Q3	249.8-428.8	1.4T, 2.0T	68,519	-21.5%	15.0%
Mercedes-Benz	GLA	269.8-398.0	1.6T, 2.0T	42,662	NA	12.0%

Source: Company data, Autohome

11% Drop in Profits from a 10% RMB Depreciation

Other than sales performance, BMW is facing headwinds from RMB depreciation. We estimate that a 10% RMB depreciation against the Euro would mean an impact of 11% on the company's pre-tax income in 2016.

Table 4. Estimated Impact of RMB Depreciation on BMW's Pre-Tax Income

(in EUR mln)	2016e
Impact of RMB Depreciation	10%
Revenue from Mainland China	11,631
Decrease in Revenue	819
Decrease in Operating Costs	-9
Operating Profit from China	1,221
Operating Profit Excluding China	6,896
Impact on Shared Result	45
Shared Result from JV After RMB depreciation	419

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Total Impact Before Tax	864
As % of Pre-Tax Income	11%

Source: Company data, J Capital Research Estimate

Chart 5. EUR/CNY Exchange Rate



Source: Company data, J Capital Research

Valuation

We believe there will be no significant improvement in BMW sales in 2016 even with the help of new 2-series and X1 SUV model. Sales of JV models will grow 3.6% to 297,000 units, while imports will fall 17% YoY. Profit will drop further under price pressure, and a potential RMB depreciation against the Euro will further eat into profits from Mainland China.

Our target price of EUR 58.42 is derived from an estimated 2016 EPS of EUR 7.54, based on our base case assumption of a 10% depreciation against the Euro in 2015 and a forward P/E of 7.75, based on Bloomberg.

Table 5. Valuation

EPS 2016e	7.54
Forward PE (x)	7.75
Target Price (EUR)	58.42
Current Share Price (EUR)	71.29
Difference	-18.1%

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Table 6. EPS Estimate

	2014	2015e	2016e
Imported Vehicles (Units)	180,841	181,700	150,811
JV Vehicles (Units)	278,529	287,000	297,332
BMW China (Units)	459,370	463,736	448,143
ASP of Imported Vehicles (EUR)	58,532	54,142	50,082
ASP of JV Vehicles (EUR)	339,445	312,207	296,597
EPS (EUR)	8.83	8.03	7.54

Source: Company data, J Capital Research Estimate, Bloomberg

Risks

- ▶ BMW has fully hedged its position
- ▶ RMB appreciates after central bank intervention
- ▶ A strong improvement of BMW sales in Mainland China
- ▶ Better than expected performance in other countries

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