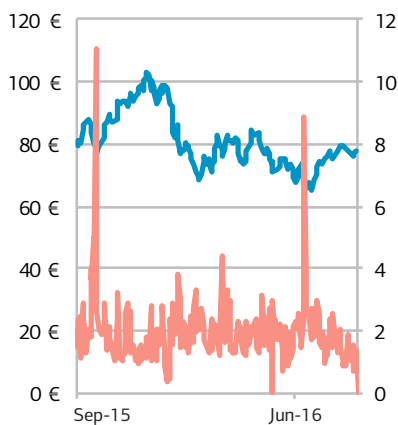


September 6, 2016
Company update

BMW (BMW GR)

Price	EUR 78.1
Rating	SELL
Price Target	EUR 71.4
Market Cap	3.5 bln
EPS 2016E	EUR 9.0
Forward P/E	7.93x

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



Source: Bloomberg June 5, 2015

Bayerische Motoren Werke AG (BMW GR) New Models Save China—For Now

▶ New Store Inventories Bloat Revenue Growth

BMW China reported 8.5% revenue growth and 7.4% growth in unit volumes in H1, but the numbers were bloated by inventories for 100 new stores. We estimate that sales to end users declined by more than 2%.

▶ Brilliance Reported Slower Growth

The popular Series 2 saved BMW's JV-model sales from negative growth in the first half, but the 1.7% growth number reported by BMW's joint venture partner, Brilliance, is more reliable, we think, than the 8% sales growth for JV models that BMW reported.

▶ China Sales Likely to Decline

Given the inventory effect, we expect China sales to decline by 2% for the full year 2016. Pricing pressure in China remains a headwind to BMW. More discounts are expected and ASPs are falling. The China region contributes over 30% of BMW's net profits.

▶ Margins Improved in H1 2016

BMW's new models are driving up sales elsewhere in the world. Although worldwide revenue growth slowed to 2.3% YoY, the group managed to improve its margins in H1 2016 by cutting costs.

▶ Increased Price Target

Because of stronger-than-expected sales in other regions and improved margins, we increase our target price from EUR 58.4 to EUR 71.4, based on an estimated 2016 EPS of EUR 9.0 and a forward P/E of 7.9x.

Responsible for this report:

Qin Shengxian qin@jcapitalresearch.com **Anne Stevenson-Yang** anne@jcapitalresearch.com +852 2534 7405

Despite slowing revenue growth, BMW improved margins.

A Fleeting Bright Spot

■ Qin Shengxian

BMW's revenue in the first half decelerated dramatically, but margins widened by 90 bps in the automotive division. In the report, the China region, growing at 8.5%, buoyed results, but we think that is artificial and fleeting: the growth came from joint venture models whose sales BMW reported growing at 8% while their manufacturer, Brilliance, reported only a 1.7% increase. Most of the BMW dealers are independently owned.

In H1 2016, revenue increased 2.3% YoY for the group, vs. 17.6% YoY in H1 2015, and 2.8% YoY for the automotive division vs. 15.6% YoY in H1 2015. China reported 6% sales growth in imported cars and 8% in JV models, for overall revenue growth of 8.5%. Despite slowing revenue growth, BMW managed to improve margins in H1, which we believe is mainly because of cost reductions.

Table 1. Margins

Margins	Group			Automotive		
	H1 2014	H1 2015	H1 2016	H1 2014	H1 2015	H1 2016
Gross Margin	21.8%	20.0%	20.8%	19.6%	17.4%	18.2%
EBIT Margin	0.0%	11.3%	11.3%	0.0%	8.9%	9.5%
Net Profit Margin	8.5%	7.3%	7.8%	7.4%	5.7%	6.6%

Source: Company data

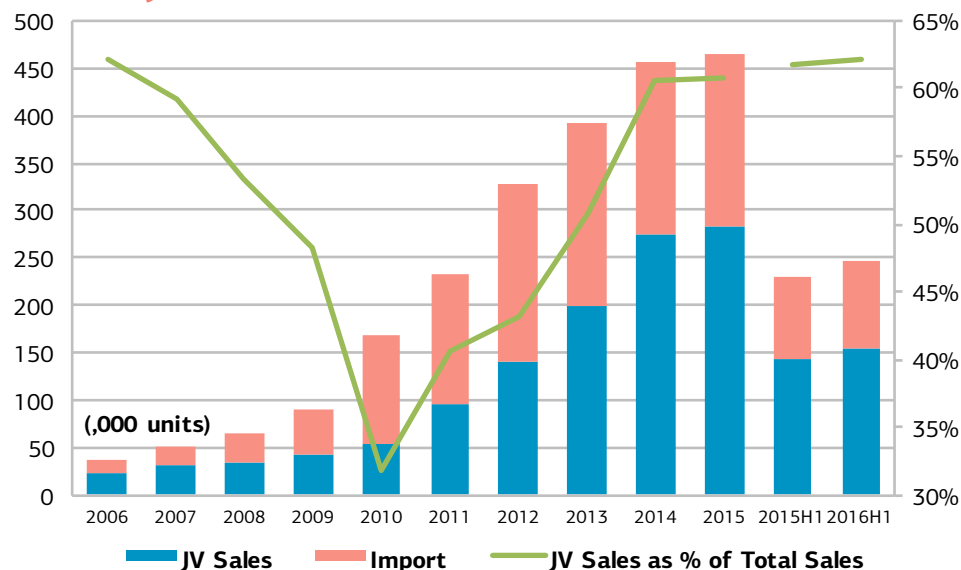
The Disparity in Local Models

Sales in the China region are a 62-38 mix of locally made JV cars and imports, with the imports growing 6% and locally made cars up 8% by BMW's count. But all the JV cars are manufactured by BMW Brilliance, and according to Brilliance, sales of JV models grew only 1.7% YoY in H1 2016. Excluding the new 2 Series, sales were down 2.2% YoY.

BMW Brilliance revenue fell 2.7% YoY and the net profit margin dropped to 8.5% from 8.9% in H1 2015. Profitability of the JV will likely continue to deteriorate in H2, since the competitive landscape is only becoming more intense.

September 6, 2016

Chart 1. JV Sales as % of Total Sales Volume



Source: Company data

Table 2. BMW Brilliance

(RMB 000s)	2014	2015	2016E
Manufacture and Sale of BMW Vehicles	94,545,204	92,179,364	87,957,726
YoY Change	29.2%	-2.5%	-4.6%
Share of Results	5,535,996	3,828,137	3,442,274
Margin	11.7%	8.3%	7.8%

Source: Company data, J Capital estimates

Growth Driven by Dealership Expansion

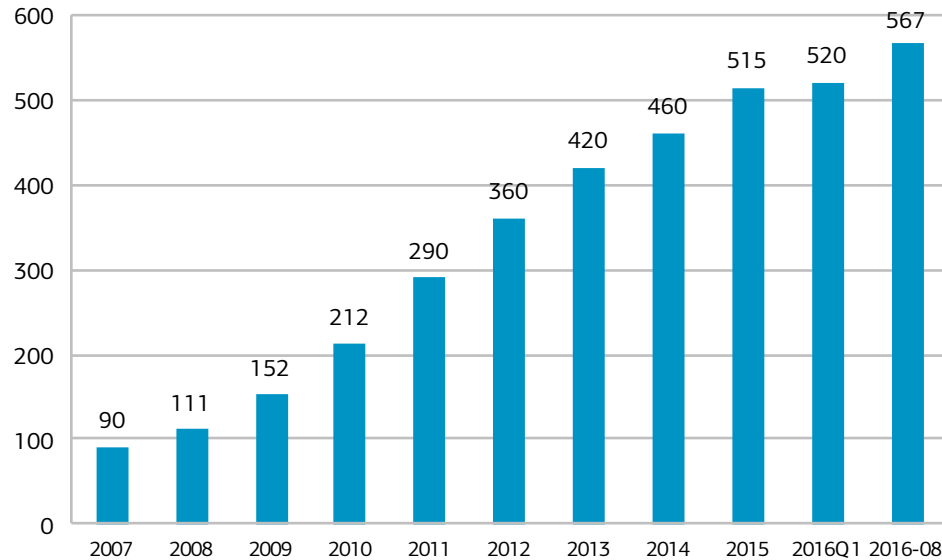
With less ability to push cars out to existing stores, the company seems to be packing inventory into new dealerships. The group has aggressively accelerated dealership expansion. BMW added 55 new dealers BMW 2015, mostly in H2, then the company opened 50 more in first 8 months of 2016. Consequently, in the year between H2 2015 and now, BMW reported better-than-expected sales performance. Each of the new dealers would have added a month's worth of inventory, and that, we think, is where BMW gets its growth.

The China Passenger Car Association (CPCA) reports much lower sales volumes for BMWs in China than the company does. For H1, CPCA reported 1.8% volume growth for BMWs in China while BMW reported 8%.

Same-store inventory levels for BMW remain elevated year on year but are

improved sequentially. The new alliance of more than 200 BMW dealers is gaining bargaining power, and that seems to have driven the inventory into the new stores instead of the existing ones.

Chart 2. Number of BMW Stores in Mainland China



Source: Company data, J Capital Research

Guangdong as Litmus

Guangdong Province is the most important province in Mainland China for BMW sales and owns about 12% of BMW dealers in China. Based on online statistics from the site 16888, BMW registrations fell in the first quarter, while BMW reported growth over 10% in sales.

Table 3. Registrations in Guangdong vs. BMW-Reported Sales Volume Q1

YoY Change of Sales Volume	YoY Change of Q1 Registration Volume of Guangdong Province	YoY Change of Q1 Sales Volume from BMW
JV Sales	-5.35%	13.46%
Imports	-2.00%	5.39%
Total	-4.23%	10.45%

Source: Company data, CPCA, J Capital Research, [here](#)

In addition, BMW reported 8% more sales of JV models than Brilliance. Brilliance reported that sales volumes for locally made BMWs grew only 1.7% YoY in H1 2016, lower than the 8.0% YoY growth reported by BMW.

Table 4. JV Sales Volume

(units)	2012	2013	2014	2015	H1 2015	H1 2016
From BMW	141,165	198,542	275,891	282,000	142,285	153,701
YoY Change		40.6%	39.0%	2.2%		8.0%
From Brilliance	160,849	206,729	278,529	287,000	139,775	142,220
YoY Change		28.5%	34.7%	3.0%		1.7%
Industrial Data	148,757	207,327	278,195	287,000	139,746	142,193
YoY Change		39.4%	34.2%	3.2%		1.8%

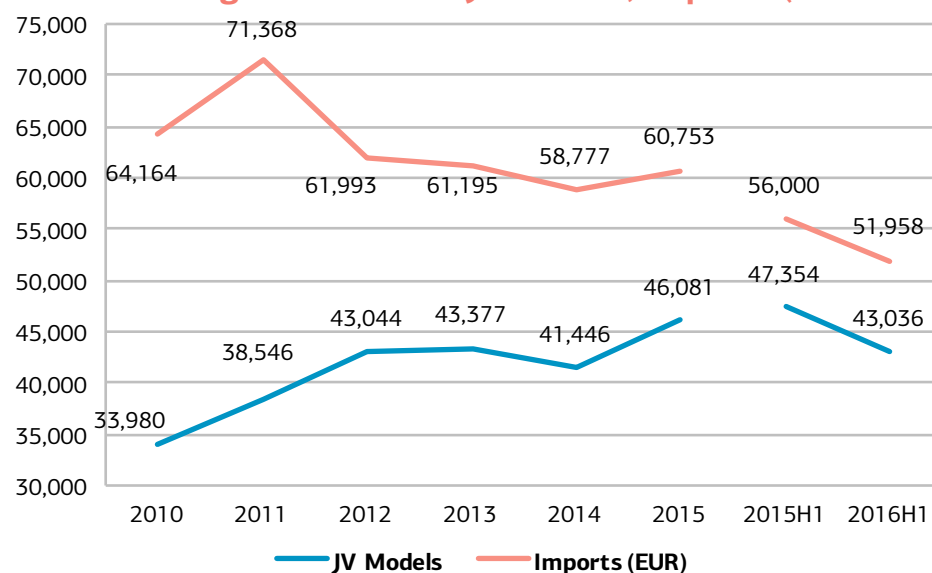
Source: Company data, CPCA

Dealers often overstate sales volume in order to be eligible for rebates at end of June, and we consider the manufacturer's numbers more reliable. That is why we think BMW has overstated sales volumes by 10%.

Pricing Pressure

Our calculation, based on company data, shows that BMW's ASP has continued a downward trend in H1 2016. The ASP of JV models and of imports fell 9.1% YoY and 7.2% YoY respectively, which indicates that more and more customers are choosing vehicles with lower selling prices. Also, currency fluctuation will have an impact on ASP. In 2015, the ASP of JV models was down 5.4% YoY in RMB but the ASP of imports climbed in 2015,

Chart 3. Falling ASP Trend of JV Models, Imports (EUR/unit)



Source: Company data, J Capital Research

September 6, 2016

Dealers often discount even newly released models.

thanks to more expensive cars such as the 7 Series. In the coming year, we do not expect new launches with high ASPs.

Discounts remain a headwind for the group. Since 2016, it has been common for dealers to offer discounts as soon as new models launch.

BMW has a fairly stable pricing environment in China. However, despite strong sales during the first seven months of 2016, we believe pricing pressure have grown stronger. Dealers told us that discounts are higher than before, and they expect pricing slippage in the second half. We estimate that discounts will be at least 3% deeper in the coming months.

Table 5. Discounts on Some of BMW's Models

Series	Official Selling Prices (RMB)	YTD July Sales Volume	YoY Change	Discounts at End of May	Discounts at Early Feb 2016	Discounts at Aug 2016	Discounts at Mid Aug 2016
3	296,800-607,800	56,181	3.3%	10-26%	15-26%	18-26%	19-26%
5	435,600-778,600	81,799	-3.7%	10-21%	17-25%	15-24%	18-24%
7	933,500-2,703,500	NA	NA	25-31%	0-34%	22-29%	21-29%
X1	259,000-436,000	23,506	4.7%	15-32%	20-29%	7-11%	11-12%
X3	479,000-750,000	NA	NA	8-10%	5-15%	12-15%	12-15%
X5	852,800-1,773,000	NA	NA	13-15%	11-22%	10-16%	9-15%

Source: Miaoche, J Capital Research, Company data, CPCA

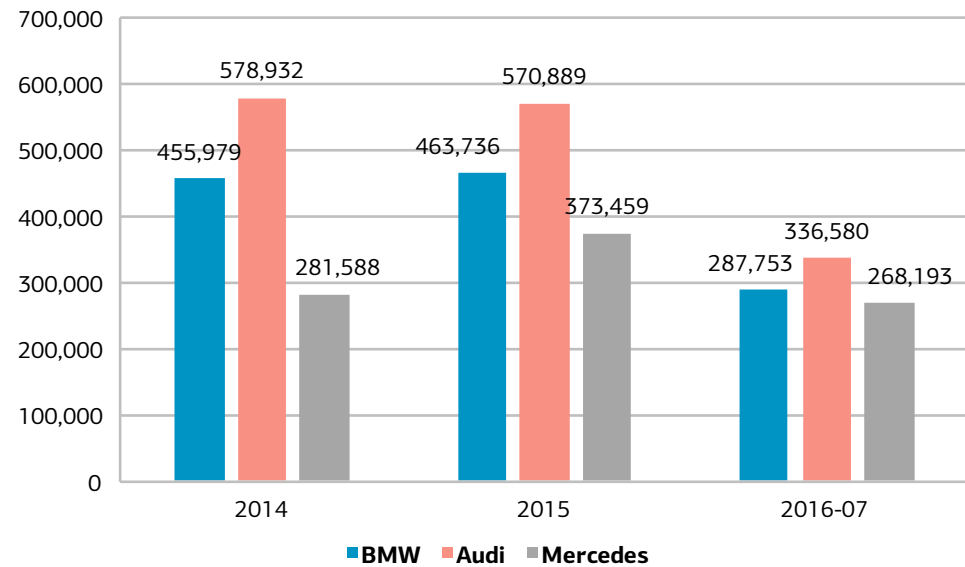
We have followed price discounts for BMW on an online platform since 2015, and discounts of some BMW models such as the 3 Series and X3 have become deeper in August.

Some models, including the 5 Series, 7 Series, and the X1, have improved pricing due to facelift models, but the effect is short-term. In early 2016, no discounts were being offered on the 7 Series, but now customers can get up to 23% off. When the X1 was first launched, its price was very high next to comparables like Audi's Q3 and the Mercedes GLA, so it did not take long for prices to fall in August, with discounts moving rapidly from 7-11% to at 11-12%.

The Competitive Outlook

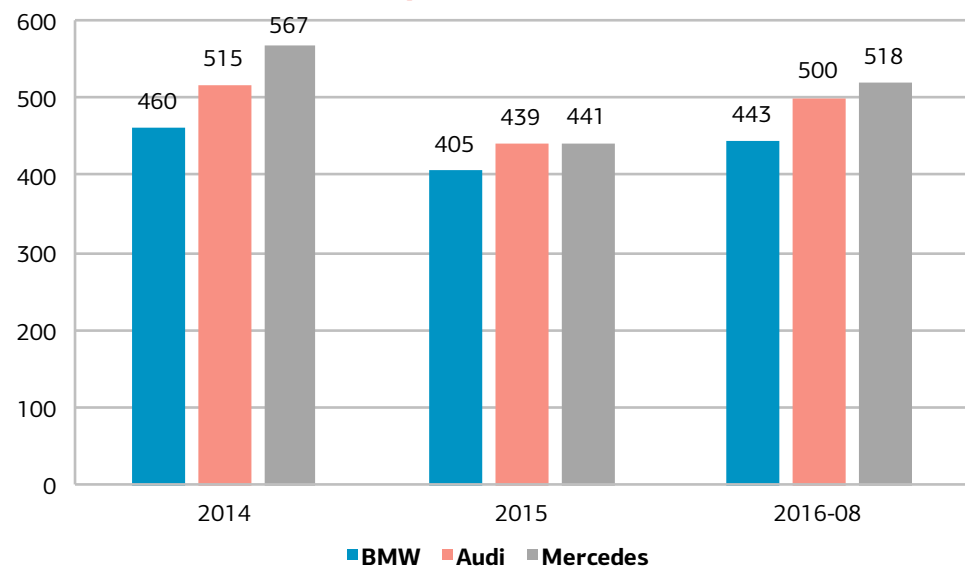
Audi and Mercedes showed unit growth YTD August of 14% and 17% respectively, even while adding many fewer stores: four for Audi and 18 for Mercedes in the first eight months. Of the three German premium brands, Audi still sells the most vehicles in China and has fewer dealerships with

Chart 4. Sales Volume (Units)



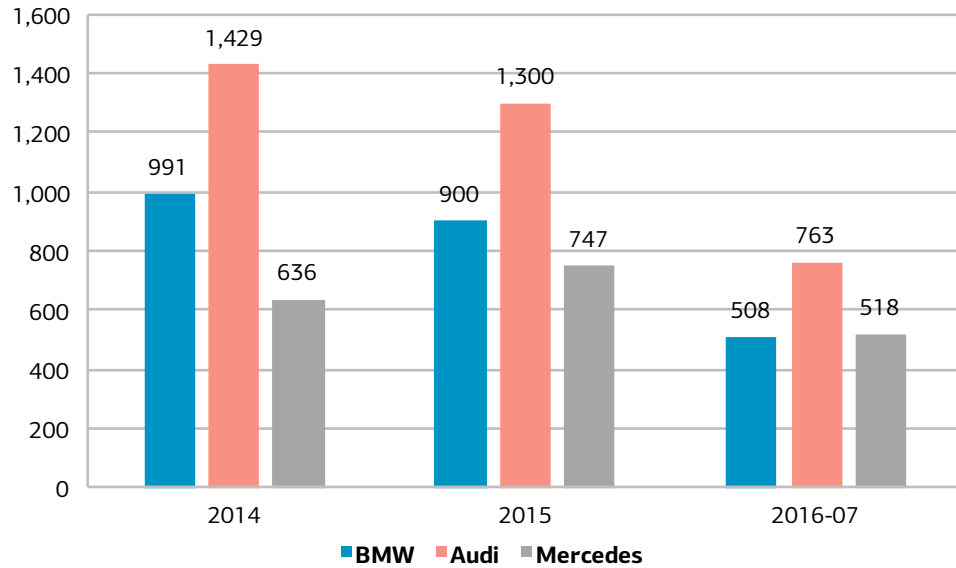
Source: Company data,

Chart 5. No. of Dealerships, Three German Premium Brands



Source: Company data, J Capital Research

Chart 6. Cars Sold per Store (Units)



Source: Company data, J Capital Research

highest throughput for new vehicles. By 2015, BMW was ahead of Mercedes in terms of cars sold per store, but it was surpassed by Mercedes in 2016.

Table 6. German Premium SUV Models

Brand	SUV Model	Official Price ('000s/per unit)	Engine Size	YTD July 2016 Sales Volume (Units)	YoY Change	Average Discount (%)
BMW	X1	286.0-439.0	1.5T, 2.0T	23,506	4.7%	11-12%
Audi	Q3	234.2-344.9	1.4T, 2.0T	48,642	36.1%	14-16%
Mercedes-Benz	GLA	269.8-398.0	1.6T, 2.0T	39,943	222.0%	9-13%

Source: Company data, Miaoche.com, J Capital Research

Mercedes is gaining on BMW: Mercedes’s YTD sales volume of 268,193 units is only 6.8% lower than BMW’s 287,753. BMW has been late to unveil its new 5 Series, while Mercedes’s new E class, with the same price range as that of BMW’s 5 Series, came to market in late August. It did not take very long for Mercedes’ GLA and C-class to beat BMW’s X1 and 3 Series. We believe the Mercedes’s E-class is a strong competitor to BMW’s 5-series.

Summary View

BMW sales worldwide have performed better than we expected thanks to new products in the first seven months of 2016. With the exception of the U.S. market, which declined 9.5% YoY, the company did extremely well, notably in Europe, where revenue rose 10.5%. BMW managed to improve its profitability by cutting costs.

Table 7. YoY Change of YTD Sales in July 2016 by Region

YoY Change	YTD Sales in July 2016	YoY Change	YTD Sales in July 2016
Europe	10.50%	Japan	8.20%
Germany	7.80%	South Korea	9.90%
UK	9.60%	Americas	-7.40%
France	13.00%	USA	-9.50%
Asia	7.40%	Canada	7.30%
China	8.50%	Mexico	9.10%

Source: Company data

In China, however, we believe a falling macro economy and the growing traffic problem will eventually impact purchasing. In addition, the growth driven by dealership expansion is not sustainable.

We suspect that about 10% of Chinese sales are overstated, and the growth driven by dealership expansion will gradually slow, leading us to estimate that H2 sales in Mainland China will drop by 2.5% YoY. That would bring full-year volume down 2% YoY. In H1 2017, the new 5 Series will not be available yet and the 50% tax cut will expire, so we are negative on auto sales. We estimate sales will decrease 3.2% YoY in H1 2017.

Valuation

Because of strong sales in other regions and improved margins, we increase our target price from EUR 58.4 to EUR 71.4, which is derived from an estimated 2016 EPS of EUR 9.0 and a forward P/E of 7.9.

Table 8. EPS Estimate

EPS Estimate	2014	2015	2016E	H1 2016	H1 2017E
Imported Vehicles	180,841	181,700	167,618	93,943	89,246
JV Vehicles	278,529	282,000	287,224	142,220	139,376

September 6, 2016

EPS Estimate	2014	2015	2016E	H1 2016	H1 2017E
BMW China (Units)	459,370	463,700	454,843	236,163	228,621
ASP of Imported Vehicles (EUR)	58,777	60,753	51,640	51,958	50,091
ASP of JV Vehicles (EUR)	41,446	46,898	39,952	43,036	37,047
EPS (EUR)	8.83	9.70	9.00	5.44	4.47

Source: Company data, J Capital Research Estimate, Bloomberg

Table 9. Valuation

EPS 2016e	9.00
PE (x)	7.93
Target Price (EUR)	71.40
Current Share Price (EUR)	78.11
Difference	-8.6%

Source: Company data, Bloomberg, J Capital Estimate

Risks

- ▶ BMW could again surprise to the upside with attractive new models, sustaining worldwide growth.
- ▶ A strong improvement in the macro economy could lead to better sell-through of the new BMW stores in Mainland China.

September 6, 2016

Disclaimer

This publication is prepared by J Capital Research Limited (“J Capital”), a Hong Kong registered company. J Capital is regulated as a company advising on securities by the Hong Kong Securities and Futures Commission (CE# AYS956) and is registered as an investment adviser with the U.S. SEC (CRD# 165324). This publication is distributed solely to authorized recipients and clients of J Capital for their general use in accordance with the terms and conditions of a Services Agreement and the J Capital Authorized User Content Agreement available [here](#). Unauthorized copying or distribution is prohibited. If you are reading this publication without having entered into a Services Agreement with J Capital, or having received written authorization to do so, you hereby agree to be bound by the J Capital Non-Authorized User Content Agreement that can be viewed [here](#). J Capital does not do business with companies covered in its publications, and nothing in this publication should be construed as a solicitation to buy or sell any security or product. In preparing this document, J Capital did not take into account the investment objectives, financial situation and particular needs of the reader. This publication is intended by J Capital only to be used by investment professionals. Before making an investment decision, the reader needs to consider, with or without the assistance of an adviser, whether the contents are appropriate in light of their particular investment needs, objectives and financial circumstances. J Capital accepts no liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this publication and/or further communication in relation to this document.