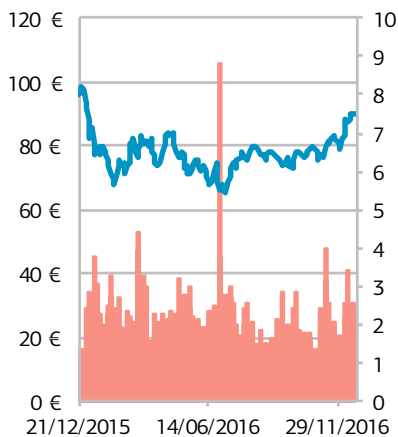


December 22, 2016
Closing Coverage

BMW (BMW GR)

Price	EUR 89.56
Rating	SELL
Price Target	EUR 86.1
Market Cap	EUR 58.2 bln
EPS 2017E	9.59
Forward P/E	8.98x

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



Source: Bloomberg

Bayerische Motoren Werke AG (BMW GR) Just Short of Target

► Solid Performance

Thanks to a better market environment, BMW's sales performed better than we expected, with YTD November sales up 11.2% YoY. Selling prices are also stabilizing at a lower level YoY.

► New Stores

Instead of pushing inventory onto dealers, BMW opened 69 new stores this year, bringing the dealer to 584.

► Closing Coverage

BMW is vulnerable to macro risks in China in 2017. But continued strong sales in other regions and better-than-expected performance in Mainland China prompt us to raise our target price from EUR 70.5 to EUR 86.1 based on an estimated 2017 EPS of EUR 9.59 and a forward P/E of 8.98. Given the small gap between our price target and the current market price, we are closing coverage.

Responsible for this report:

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China continued to gain importance for BMW.

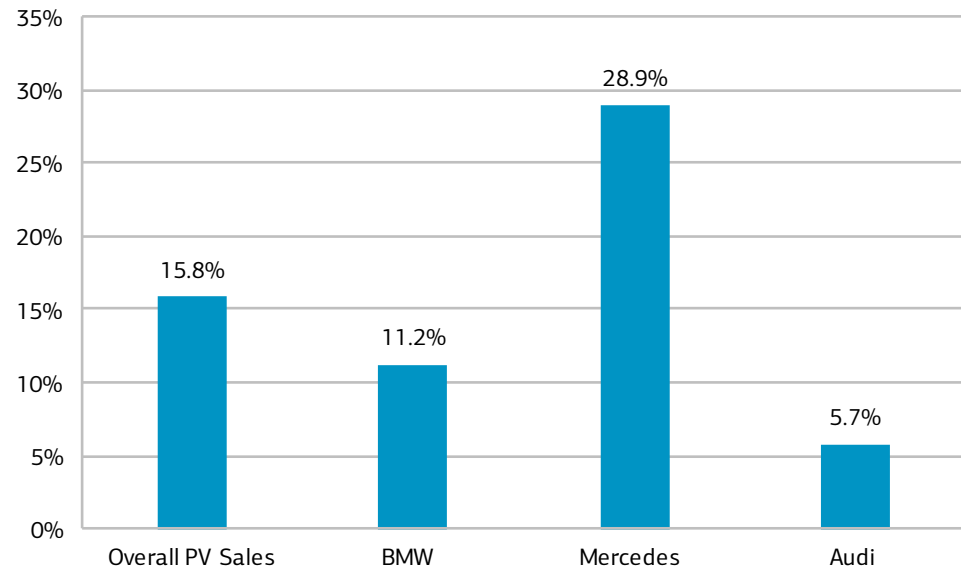
Surprising China Performance

■ Qin Shengxian

BMW China reported continued double-digit sales in November. YTD November sales volume reached 472,705 units, up 11.2% over the first 11 months of 2015. Based on data from the China Passenger Car Association (CPCA), joint-venture model sales rose 8% YoY January through November, and imported vehicle sales increased 16.4% YoY, to 189,142 units, according to our calculations.

China continued to gain the importance for BMW, accounting for 26% of total sales as of November. Compared with Mercedes and the overall market, BMW has underperformed somewhat.

Chart 1. YTD November Sales Growth



Source: CAAM, Company data

In the first half of December, auto sales remained very strong. According to CPCA, average daily sales volume grew 30% YoY compared with 15% YoY during the same period in 2015.

Stabilizing Pricing Environment

Selling prices of BMW's models are stabilizing. Popular models other than the X1 are seeing fewer discounts, and dealers say that ASPs are flat or

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improved from September and October.

Table 1. Average Daily Retail Sales Volume in December by CPCA

(units)	2014	2015	2016
Cumulative Sales Dec 1-16	48,597	55,972	72,506
YoY Change		15%	30%
MoM Change			30%

Source: CPCA

Table 2. Discounting Trends for BMW's Key Models in Mainland China

Series	Official Selling Prices (RMB)	YTD Nov Sales Volume	Discounts at End of May 2016	Discounts at Early Feb 2016	Discounts at Aug 2016	Discounts at Mid Dec 2016
3 Series	296,800-607,800	88,585	10-26%	15-26%	18-26%	9-18%
5 Series	435,600-778,600	133,865	10-21%	17-25%	15-24%	13-20%
7 Series	933,500-2,703,500	NA	25-31%	0-34%	22-29%	12-24%
X1	259,000-436,000	48,318	15-32%	20-29%	7-11%	11-12%
X3	479,000-750,000	NA	8-10%	5-15%	12-15%	12-13%
X5	852,800-1,773,000	NA	13-15%	11-22%	10-16%	10-13%

Source: CPCA, Sina Miaoche, J Capital Research

BMW's 3 series, 5 series, and X5 in H2 all launched facelift models, which supported pricing. Typically, there is an immediate discount after the launch. This happened with the X5, for example.

Less Inventory Pressure

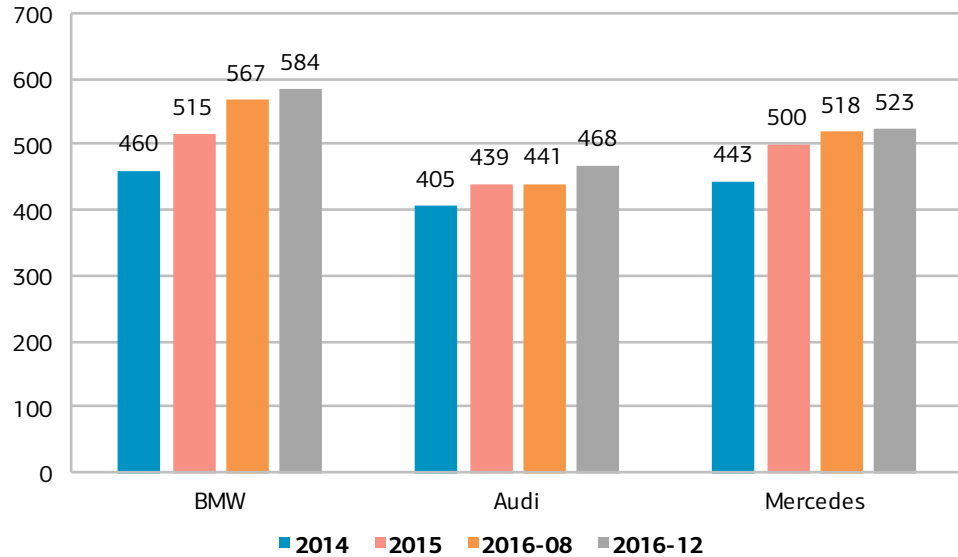
There are about six weeks of inventory on average at the dealers. Our checks with dealers show that inventory at unique store improved even at the year end, down from September and October and much lower than last year. According to them, BMW adjusted sales target in July for dealers, and did not add any inventory pressure to the dealers in Q4 this year.

Aggressive Dealership Expansion

BMW's 69 new dealerships in 2016 compare with 29 for Audi stores and

23 for Mercedes stores. BMW opened about 20 dealers in the second half alone.

Chart 2. No. of Dealership Networks of BMW, Audi and Mercedes in Mainland China



Source: Company data, J Capital Research

While BMW has the fastest growth rate of 4S store expansion, its YTD sales volume performed slower at 11.2% YoY and YTD sales volume at unique store was lowest among the top 3 luxury brands, indicating lower efficiency in selling new vehicles.

Table 3. Growth Rate of 4S Stores VS YoY Change of YTD Sales Volume

	Growth of New 4S Stores	YoY Change of YTD Nov Sales Volume
BMW	13.4%	11.2%
Audi	6.6%	5.7%
Mercedes	4.6%	28.9%

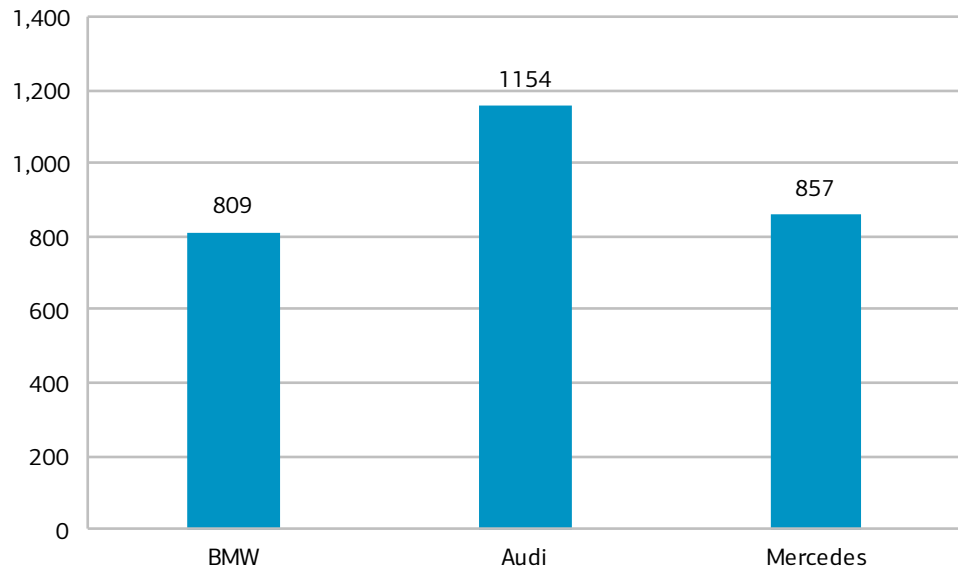
Source: Company data, J Capital Research

Tax Benefits Won't Change the 2017 Slowing

The tax cut incentive for small-engine cars has been extended into 2017. The Ministry of Finance announced that passenger vehicles with an engine size of 1.6L or below will be subject to a 7.5% purchase tax in 2017, up from the current 5% rate. The 10% purchase tax will be re-imposed in 2018. This is exactly what happened in 2009-2010. The 2009 50% tax cut boosted the market, and the 7.5% rate in 2010 slowed sales growth. We

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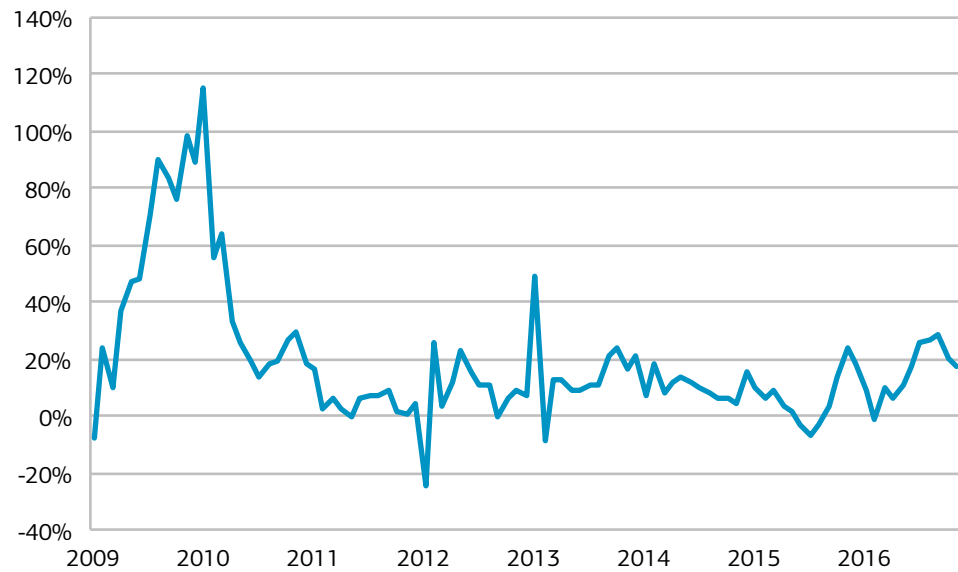
Chart 3. Average YTD November Sales Volume per 4S Store



Source: Company data, J Capital Research

expect that many consumers rushed to purchase in December, ahead of the hike, and we reiterate our growth rate estimate for the overall PV market at 2% in 2017.

Chart 4. Monthly Sales Volume Growth

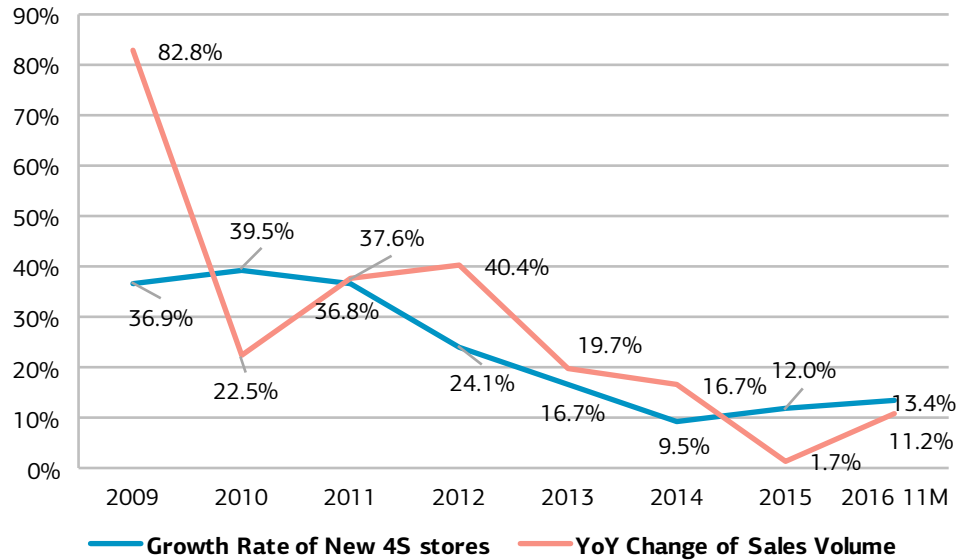


Source: CAAM

BMW also saw very strong sales in 2009, up 82.8% YoY. In addition to the market environment, the introduction of the 5 series JV model and dealership expansion in 2009 promoted sales volume. In 2010, the auto market

cooled down, and BMW's sales slowed to 22.5% YoY even with 39.5% more new dealers opening.

Chart 5. Sales Volume and Growth Rate of New 4S Stores



Source: Company data, J Capital Research

Although we think BMW will be less impacted by the tax change than automakers deriving more sales from small vehicles, that segment of BMW sales is growing. Currently, vehicles with small engines contribute only about 13% of BMW's total sales in mainland China, but the volume of small engine vehicle sales rose by 561% YoY in the first eight months of 2016, according to Chinese [news sources](#). In 2017, BMW plans to introduce the 1 series model, adding more small-engine vehicles to its portfolio.

Table 4. YTD Aug 2016 Sales Volume of Vehicles <=1.6L of BMW, Audi and Mercedes

Brand	Sales Volume of Vehicles <=1.6L	as % of Total Sales Volume	YoY Change
Audi	89,998	25%	0%
BMW	25,457	13%	561%
Mercedes	53,787	27%	104%

Source: Toutiao.com

To promote sales, OEMs can subsidize the purchase tax for their customers. For example, after the announcement of new tax cut rate, Mercedes has announced 50% and 25% subsidies for the A-class and B-class models respectively, so their customers will continue to pay the same level of tax.

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Luxury cars rise and fall with the macro economy.

BMW may have to match that offer when it launches the 1-series is on the market in February.

Challenges

BMW sales outperformed our expectations in 2016 thanks to a strong new product cycle around the world. The U.S. market (down 10.2% 1-11 YoY) was the exception. Its new model X1 is recording strong growth in Mainland China, up 30% YoY for the first 11 months.

However, luxury cars rise and fall based on the macro economy. We believe the risk of a debt crisis in China still exists and the property market will definitely cool down in 2017. The higher purchase tax will also affect sentiment.

In the past decade, the top three luxury brands have sold in total about 8.3 mln units. By end of 2017, there will be over 10 mln luxury autos in the market. To afford a luxury vehicle like BMW, a family needs to have an annual income of at least RMB 200,000, a level of income enjoyed by about 5% of the population or roughly 20.2 mln families. That means that nearly half the addressable population owns a luxury vehicle from one of the three top automakers. Yet other brands have a 25% share of luxury vehicle sales, and there are other brands competing for the category. All of this makes us skeptical about growth much beyond replacement demand.

Table 5. Estimated Ownership of Luxury Vehicles

(units)	Cumulative Sales from 2007 to Nov 2016	Estimated Sales Volume from 2007 to 2017e
BMW	2,785,789	3,312,854
Total Top Three	8,296,241	10,150,326
Top Ten Luxury Vehicles	11,061,655	13,533,768
Number of Families with Annual Income above RMB 200,000		22,500,000
Ownership of Luxury Vehicles		60.2%

Source: Company data, CAAM, J Capital Estimate

Mercedes is still taking share from BMW, which was late in launching its 5-series this year. Despite about 40% lower than the sales volume of BMW 5 series and Audi A6L, its monthly volume increased 53% YoY in November. In addition, the Mercedes E-class, which is regarded as the smaller S-class, is nearly one year ahead of the New 5-series. So when the New 5

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series is put into the market, E-class will offer larger discounts to compete with BMW.

Since we believe the current strong growth in Mainland China was mainly driven by dealership expansion in 2016, once the new openings stop or slow sharply in 2017, sales will also slow quickly. We estimate BMW sales volume will increase 1.7% YoY in 2017, with 1.5% YoY from JV models and 2.0% from imported models.

Table 6. China Sales Volume Estimate

EPS Estimate	2014	2015	2016e	2017e
Imported Vehicles (Units)	180,841	181,700	206,411	210,539
JV Vehicles (Units)	278,529	282,000	311,979	316,526
BMW China (Units)	459,370	463,700	518,390	527,065
ASP of Imported Vehicles (EUR)	58,777	60,753	57,715	51,958
ASP of JV Vehicles (EUR)	41,446	46,898	40,550	43,036
EPS (EUR)	8.83	9.70	10.06	9.59

Source: Company data, CPCA, J Capital Research

Valuation

Because of continued strong sales in other regions and better than expected performance in Mainland China, we increase our target price from EUR 70.5 to EUR 86.1, which is derived from an estimated 2017 EPS of EUR 9.59 and a forward P/E of 8.98, based on Bloomberg.

Table 7. Valuation

EPS 2017e	9.59
PE 2017e(x)	8.98
Target Price (EUR)	86.10
Current Share Price (EUR)	89.95
Difference	-4.3%

Source: J Capital Research

Risks

- ▶ The macro economy may recover faster than we expect.
- ▶ BMW's new models may buoy sales in mainland China.
- ▶ Better-than-expected performance in other countries.

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Appendix 1. Dealer Checks

Dealers	Region	Sales	Pricing	Inventory	Financing
Dealer A	Hebei	up following the market trend	down YoY but up from Sep and Oct	1.5	
Dealer B	Henan	Up 10% YoY, 5% from Sep and Oct	up 4% YoY and 2% from Sep and Oct	1	60%
Dealer C	Yunnan	down 25% YoY, 10% from Sep and Oct	Slightly down YoY, flat from Sep and Oct	1-1.5	most
Dealer D	Shaanxi	up 17%	down YoY, flat from Sep and Oct	2	>50%
Dealer E	Shandong	flat	down YoY	0.7	NA

Source: J Capital Research

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