

Equities

15 March 2011 | 9 pages

China Autos

Alert: Assessing the Potential Impact from Japan Earthquake

Potential Impact from Japan Earthquake – While it is too early to assess the actual impact from last week's Japan earthquake on China autos companies, we provide feedback from discussions with companies under our coverage which we believe could potentially be affected. In general the key risk to companies under our coverage is the supply of imported auto parts and/or raw materials from Japan. We believe any potential impact to China Autos companies should be limited if auto parts and/or raw materials production disruption in Japan is not protracted.

Dongfeng (489.HK, Buy, HK\$13.08) – Dongfeng Nissan and Dongfeng Honda are Dongfeng's key JV's that require auto parts imports from Japan. Dongfeng Nissan and Dongfeng Honda made up 39% and 13% of Dongfeng's 2010 unit sales respectively. Dongfeng Nissan and Dongfeng Honda's overall local content are about 80% and 85% respectively. Dongfeng indicates Dongfeng Honda has about four weeks of imported auto parts on hand. Dongfeng Nissan and Dongfeng Honda have no export exposure to Japan.

Qingling (1122.HK, Buy, HK\$2.03) – Qingling builds Isuzu trucks in China. Qingling sources auto parts from Isuzu in Japan and exports auto parts to Isuzu in Japan (Qingling is a net auto parts importer). Qingling's overall local content level is about 85%. Qingling indicates it has about three months of key imported auto parts on hand. Qingling's auto parts export to Isuzu in Japan is minimal and accounted for 1% of revenue in 1H10.

Xingda (1899.HK, Buy, HK\$7.33) – Xingda processes wire rods into tire cords and sawing wires. Xingda uses domestic and imported wire rods for tire cord production and imported wire rods for sawing wire production. Imported wire rods made up about 20% of wire rod tonnage consumed in 2010. Xingda's top three imported wire rods suppliers are Nippon Steel, POSCO and Kobe Steel. Xingda has about three months of imported wire rods on hand. In addition to its imported wire rods inventory, Xingda could also switch to POSCO and Corus in case of imported wire rods supply disruption from Japan. Xingda has no export exposure to Japan.

Insight from our Japan Autos team – For more insight please refer to report titled "Alert: Eastern Japan earthquake/autos industry - Bottlenecks in parts and power supplies" published on 14 March. Link to report: <https://ir.citi.com/uPPVIdiCiMoWgBjGn1MWLSIBUU7q%2FGyvB65grStZB1M%3D>

■ Industry Overview

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Dongfeng Motor

Valuation

Our HK\$20.75 target price for Dongfeng is based on a 11E P/E of 11.4x, which is a 50% premium to Dongfeng's historical average P/E of 7.6x and translates to a 11E P/B of 3.6x. We believe the valuation premium is justified given Dongfeng is expected to post near historical high profitability in 11E. We also believe Dongfeng deserves a premium valuation to peers given it is the only national autos industry consolidator listed in Hong Kong. We use P/E as our primary valuation tool for China autos stocks because some key autos stocks such as Dongfeng provide limited disclosure and do not consolidate their cash flows, making straightforward EV/EBITDA and DCF valuation comparisons difficult.

Risks

We rate Dongfeng as Medium Risk, as opposed to the High Risk rating based on our quantitative risk rating system, which tracks 260-day historical share price volatility. We ascribe a Medium Risk rating to Dongfeng because of: 1) Dongfeng's positioning as one of China's "Big Three" automakers and one of four national autos industry consolidators; 2) its operational relationships with leading global automakers Nissan, Honda and PSA Peugeot Citroen through its three JVs; and 3) its diversified product exposure to both the PV and CV markets. Downside risks that could impede the stock from reaching our target price are: 1) unit sales volume may be below our expectations if car sales growth is slower than expected; 2) unit sales volume may be below our expectation if new model launches are less successful than expected; and 3) profitability may be below our expectation if unit cost decline is lower than expected and/or product mix is worse than expected.

Qingling Motors

Valuation

Our HK\$2.75 target price for Qingling is based on a 11E P/E of 18.8x, which is set at a 30% discount to Qingling's average P/E since 2002 of 26.8x and which implies a 10E P/B of 0.84x. We believe the valuation is justified given Qingling's relatively low ROE. We use P/E as our primary valuation tool for China autos stocks because some key autos stocks, such as Dongfeng, provide limited disclosures and do not consolidate their cash flows, making straightforward EV/EBITDA and DCF valuation comparisons difficult.

Risks

We rate Qingling Medium Risk in line with the Medium Risk rating suggested by our quantitative risk rating system, which tracks 260-day historical share price volatility. We ascribe a Medium Risk rating to Qingling because of: 1) its strong operating cash flow that exceeds its investment and financing cashflow needs; 2) its solid balance sheet that has a growing net cash balance and 3) its partnership with Isuzu that provides internationally competitive truck model and technology. Downside risks to our target price are: 1) unit sales volume may be below our expectations if competition is stronger than expected; 2) profitability may be below our expectation if price cuts are deeper than expected; and 3) profitability may be below our

expectation if cost control is weaker than expected and JPY is stronger than expected.

Xingda International Holdings

Valuation

Our HK\$7.60 target price for Xingda is based on an 11E P/E of 9.8x, which represents a 30% premium to Xingda's average forward P/E since IPO of 7.5x. Our target price translates to 1.8x 11E P/B. We believe Xingda should be valued at a premium to its average historical forward P/E given better than expected profitability and tire cord demand. We use P/E as our primary valuation tool for the other China autos stocks in our universe given that a number of key autos stocks such as Dongfeng provide limited disclosure and do not consolidate their cash flows, making straight EV/EBITDA and DCF valuation comparisons difficult.

Risks

We rate Xingda as Medium Risk, as opposed to the High Risk rating based on our quantitative risk-rating system, which tracks the stock's 260-day historical share price volatility. We ascribe a Medium Risk rating to Xingda because of: 1) Xingda's position as one of China's top two tire cord makers and its combined 60% production share with Bekaert, 2) increasingly steady tire demand in China as replacement tires gain a larger share of tire demand due to a growing autos fleet and 3) tire cord industry's relatively high barriers to entry due to high capital intensity, high level of production expertise and long payback period due to long customer certification process. Downside risks that could prevent the stock from achieving our target price are: 1) gross margins could be lower than expected if wire rod prices increase greater than expected; 2) gross margins could be lower than expected if pricing is lower than expected due to less favorable tire cord supply and demand dynamics; 3) revenue could be lower than expected if sales tonnage is lower than expected due to weaker than expected China replacement and OEM tires demand; and 4) profit could be lower than expected if sawing wires demand, production and profitability are lower than expected.

Appendix A-1

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IMPORTANT DISCLOSURES

Dongfeng Motor (0489.HK)

Ratings and Target Price History Fundamental Research

Analyst: Gerwin Ho

Covered since August 4 2008

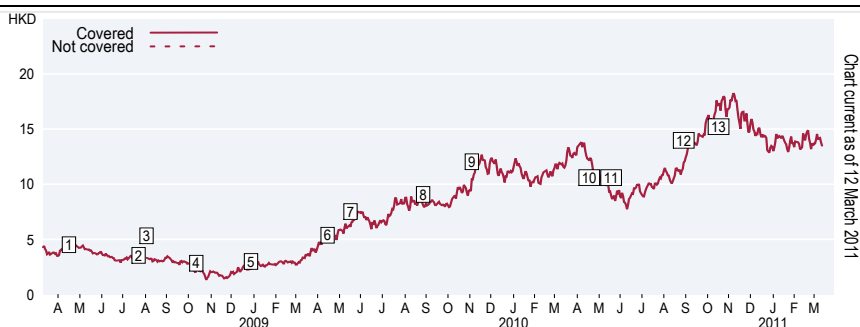


Chart current as of 12 March 2011

	Date	Rating	Target Price	Closing Price
1	16-Apr-08	*3M	*3.50	4.04
2	23-Jul-08	Coverage terminated		
3	4-Aug-08	*1M	*4.20	3.32
4	13-Oct-08	1M	*3.60	2.28
5	28-Dec-08	1M	*3.20	2.25

* Indicates change

	Date	Rating	Target Price	Closing Price
6	15-Apr-09	1M	*6.35	5.17
7	17-May-09	1M	*7.50	6.27
8	27-Aug-09	1M	*10.15	8.11
9	4-Nov-09	1M	*12.60	10.52
10	18-Apr-10	1M	*15.00	12.26

	Date	Rating	Target Price	Closing Price
11	19-May-10	1M	*10.70	8.97
12	29-Aug-10	1M	*13.65	11.38
13	18-Oct-10	1M	*20.75	17.20

Rating/target price changes above reflect Eastern Standard Time

Dongfeng Motor (0489.HK)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Gerwin Ho

Covered since August 4 2008

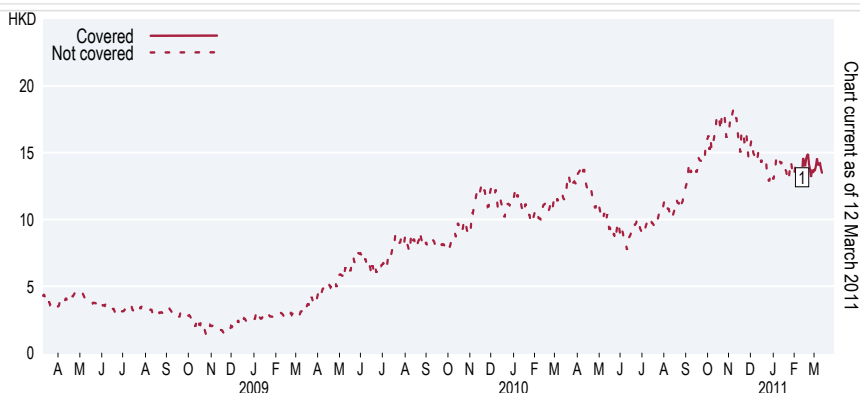


Chart current as of 12 March 2011

	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	13.36

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Qingling Motors (1122.HK)

Ratings and Target Price History

Fundamental Research

Analyst: Gerwin Ho
Covered since October 21 2008



Date	Rating	Target Price	Closing Price
1 23-Apr-08	1M	*2.15	1.37
2 23-Jul-08	Coverage terminated		
3 21-Oct-08	*3M	*0.70	0.73

* Indicates change

Date	Rating	Target Price	Closing Price
4 19-Apr-09	3M	*1.11	1.21
5 24-Aug-09	*1M	*1.96	1.50
6 24-Mar-10	1M	*2.67	2.05

Date	Rating	Target Price	Closing Price
7 22-Aug-10	1M	*2.75	2.06

Rating/target price changes above reflect Eastern Standard Time

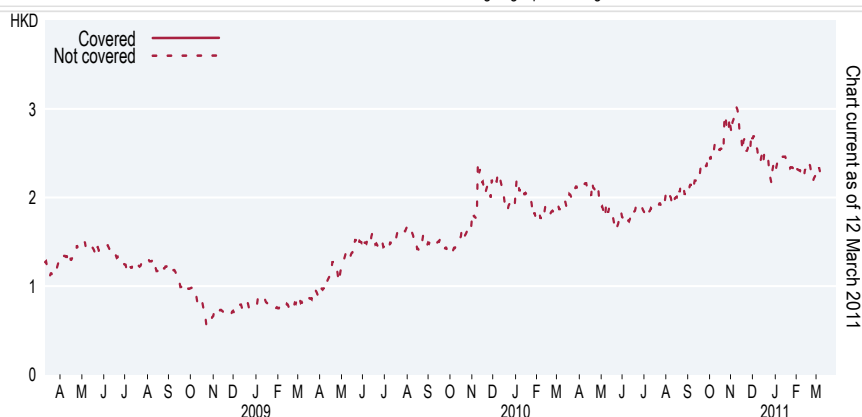
Qingling Motors (1122.HK)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Gerwin Ho
Covered since October 21 2008



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Xingda International Holdings (1899.HK)

Ratings and Target Price History

Fundamental Research

Analyst: Gerwin Ho
Covered since September 5 2008



Date	Rating	Target Price	Closing Price
1 9-Apr-08	1M	*2.68	1.61
2 29-May-08	1M	*3.25	1.69
3 23-Jul-08	Coverage terminated		

* Indicates change

Date	Rating	Target Price	Closing Price
4 5-Sep-08	1M	*2.10	1.59
5 24-Nov-08	1M	*1.10	0.75
6 13-Apr-09	1M	*1.68	1.28

Date	Rating	Target Price	Closing Price
7 6-Sep-09	1M	*3.45	2.72
8 11-Apr-10	1M	*6.25	4.98
9 2-Sep-10	1M	*7.60	5.95

Rating/target price changes above reflect Eastern Standard Time

Xingda International Holdings (1899.HK)

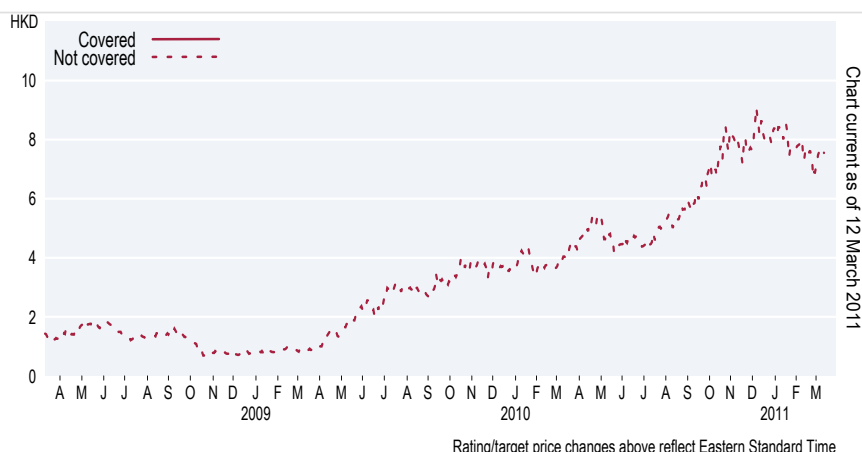
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Gerwin Ho

Covered since September 5 2008



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Data current as of 31 Dec 2010

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
52%	37%	11%	0%	100%	0%
45%	44%	40%	0%	44%	0%

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