

1H15 results held up well

Quick Note

1H in line; prefer names with stronger developed market exposure

- We expect Fuyao's share price to stabilise from here, on its in-line 16% y-y 1H15 net earnings growth (Fig 1), subsequent to a 26% sell-off since June this year. Although this set of results only implied 2Q15 net profits of CNY623mn (+8.4% y-y), we believe that high single-digit growth in 2Q15 was within investors' expectations, considering the challenging environment in the China auto industry since April.
- What was surprising, however, was a gross margin expansion of 0.5pp y-y to 41.8%, which was consistent with our positive investment thesis since initiation ([Initiate at Buy](#)). The improvement, in our view, was attributable not only to effective cost control, but also a stronger pursuit of driving pleasure which led to rising glass content per vehicle as well as growing replacement demand in auto glass as China's auto penetration grows.
- 1H15 net profit of CNY1.215bn has essentially achieved half of our full-year forecast (and 47% of the consensus estimate). Hence, we keep our FY15F estimate (CNY2.537bn) intact, while consensus should also be stable.
- Looking into 2H, we believe the impact of normalising auto sales in China should continue to flow through to upstream suppliers. While we believe Fuyao could mitigate part of the negatives through its market leadership and continuous new product launches, amidst the current industry cycle, we prefer auto-part players with more meaningful developed market exposure such as Nexteer (1316 HK, Buy) and Johnson Electric (179 HK, Buy), where overseas revenues contributed around 70% of the total.

Key 1H15 results takeaways

- Net income came in at CNY1,215mn, up 16% y-y, mainly thanks to 0.5pp gross margin expansion and slightly offset by a 12.7% y-y increase in SG&A expenses (including engineering expense).
- Revenue was CNY6,591mn, up 6.6% y-y, and completed 46.1% of Fuyao's FY15 target. Of note, both domestic and overseas revenue growth was stable at 6.3% and 5.7% y-y, respectively.
- The increase in selling expenses was mainly due to an increase in variable expenses such as packaging and transportation, while that for administration and engineering was owing to both an increase in R&D and start-up costs for the US automotive glass and float glass projects.
- No interim dividend was declared (same as last year).

Global Markets Research

24 August 2015

Rating Remains	Buy
Target price Remains	HKD 23.50
Closing price 21 August 2015	HKD 14.84

Research analysts

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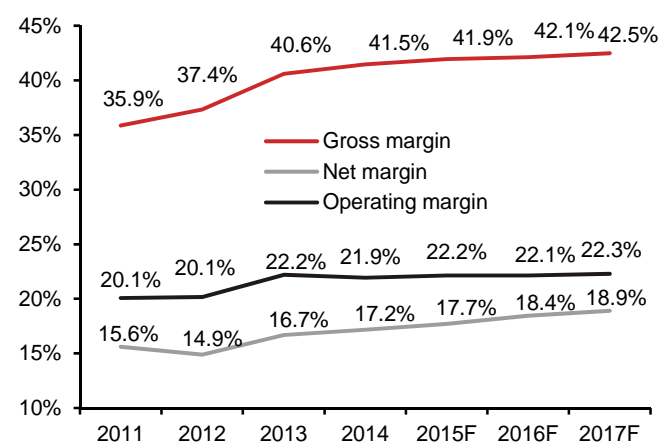
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Fig. 1: Fuyao: 1H15 results summary

CNY mn	1H14	2H14	FY14	1H15	y-y
Revenue	6,181	6,747	12,928	6,591	6.6%
Cost of goods sold	(3,632)	(3,933)	(7,566)	(3,839)	5.7%
Gross profit	2,549	2,814	5,363	2,753	8.0%
Distribution and selling expense	(475)	(508)	(982)	(495)	4.2%
General and administrative expenses	(490)	(541)	(1,031)	(556)	13.6%
Engineering/development expense	(232)	(286)	(518)	(297)	28.2%
Other gains and losses, net	22	(19)	3	(23)	-202.4%
Operating income	1,375	1,459	2,834	1,382	0.5%
Finance income	4	10	14	10	149.4%
Finance expense	(107)	(134)	(241)	(95)	-11.6%
Share of loss of JV	15	16	31	21	40.2%
Pretax Income/Recurring Profit	1,287	1,352	2,638	1,318	2.4%
Income tax expense	(239)	(182)	(422)	(100)	-58.3%
Net income for the year	1,047	1,169	2,217	1,218	16.3%
Minority interest	0	2	2	(3)	n.m
Net Income for equity shareholders	1,048	1,172	2,219	1,215	16.0%
EPS (CNY) - basic and fully diluted	0.52	0.59	1.11	0.54	3.8%
Dividend per share (CNY)	-	0.75	0.75	-	n.a
<i>Gross margin</i>	<i>41.2%</i>	<i>41.7%</i>	<i>41.5%</i>	<i>41.8%</i>	<i>0.5 ppt</i>
<i>Operating margin</i>	<i>22.2%</i>	<i>21.6%</i>	<i>21.9%</i>	<i>21.0%</i>	<i>-1.3 ppt</i>
<i>Net margin</i>	<i>16.9%</i>	<i>17.4%</i>	<i>17.2%</i>	<i>18.4%</i>	<i>1.5 ppt</i>
<i>Selling exp as % of sales</i>	<i>7.7%</i>	<i>7.5%</i>	<i>7.6%</i>	<i>7.5%</i>	<i>-0.2 ppt</i>
<i>General exp as % of sales</i>	<i>7.9%</i>	<i>8.0%</i>	<i>8.0%</i>	<i>8.4%</i>	<i>0.5 ppt</i>
<i>SG and A exp as % of sales</i>	<i>15.6%</i>	<i>15.5%</i>	<i>15.6%</i>	<i>15.9%</i>	<i>0.3 ppt</i>
<i>Engineering exp as a % of sales</i>	<i>3.7%</i>	<i>4.2%</i>	<i>4.0%</i>	<i>4.5%</i>	<i>0.8 ppt</i>

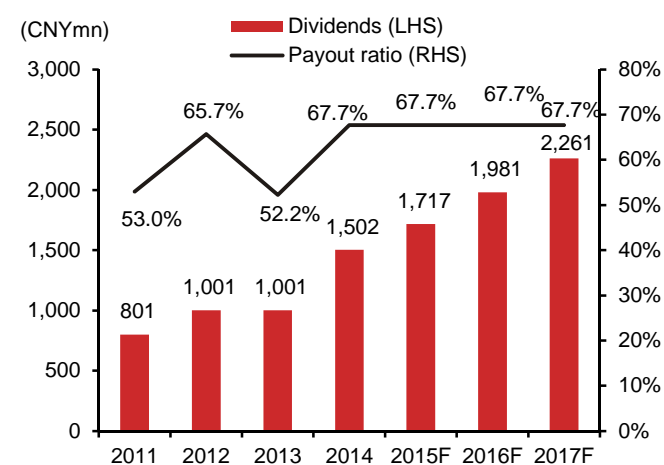
Source: Company data, Nomura research

Fig. 2: Fuyao: Margin trends

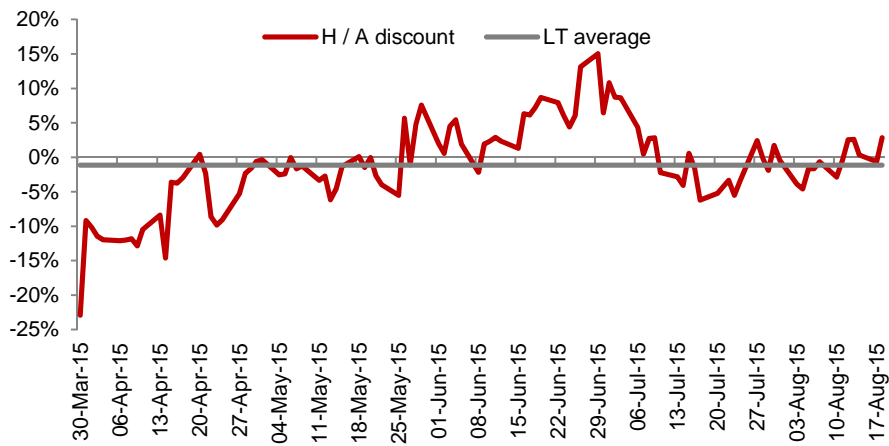


Source: Company data, Nomura estimates

Fig. 3: Fuyao: Dividend pay-outs



Source: Company data, Nomura estimates

Fig. 4: Fuyao: H-share to A-share discount

Source: Bloomberg, Nomura research

Appendix A-1

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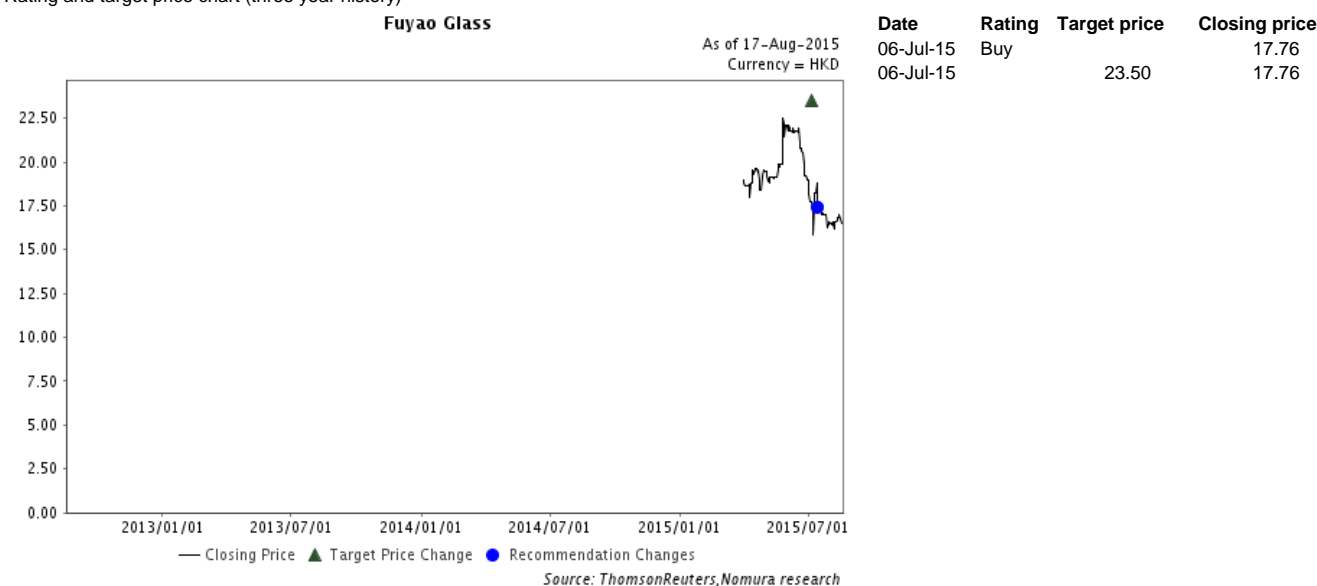
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Nexteer Automotive	1316 HK	HKD 6.39	21-Aug-2015	Buy	N/A	
Johnson Electric Holdings	179 HK	HKD 26.60	21-Aug-2015	Buy	N/A	
Fuyao Glass	3606 HK	HKD 14.84	21-Aug-2015	Buy	N/A	A11

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Fuyao Glass (3606 HK)

HKD 14.84 (21-Aug-2015) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



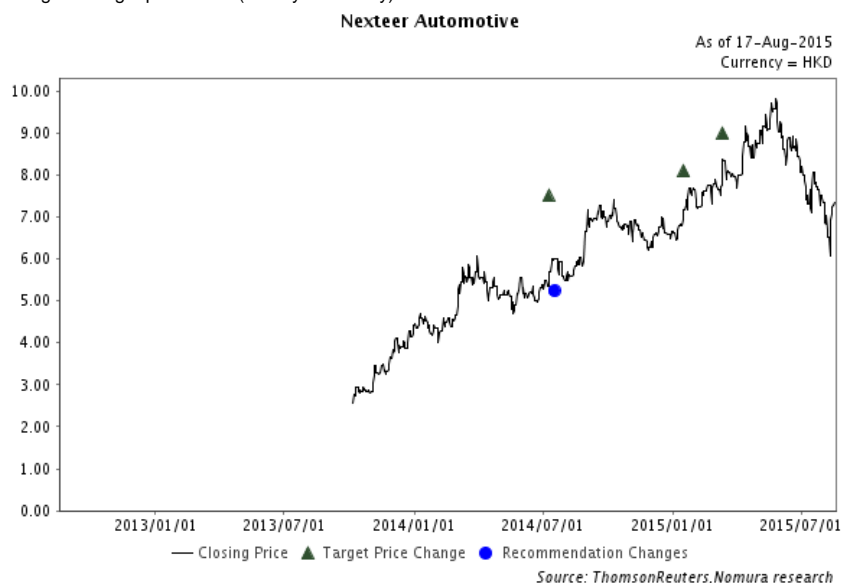
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of HKD23.5 is based on 16x FY16F P/E (EPS: CNY1.2) which represents a small premium to Fuyao's H share peer target average. The benchmark index for this stock is MSCI China.

Risks that may impede the achievement of the target price Key downside risks include pricing pressure from OEMs, rising raw material costs, potential loss of business on OEM product recalls.

Nexteer Automotive (1316 HK)**HKD 6.39 (21-Aug-2015)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
12-Mar-15		9.00	8.39
16-Jan-15		8.10	7.16
09-Jul-14	Buy		5.38
09-Jul-14		7.50	5.38

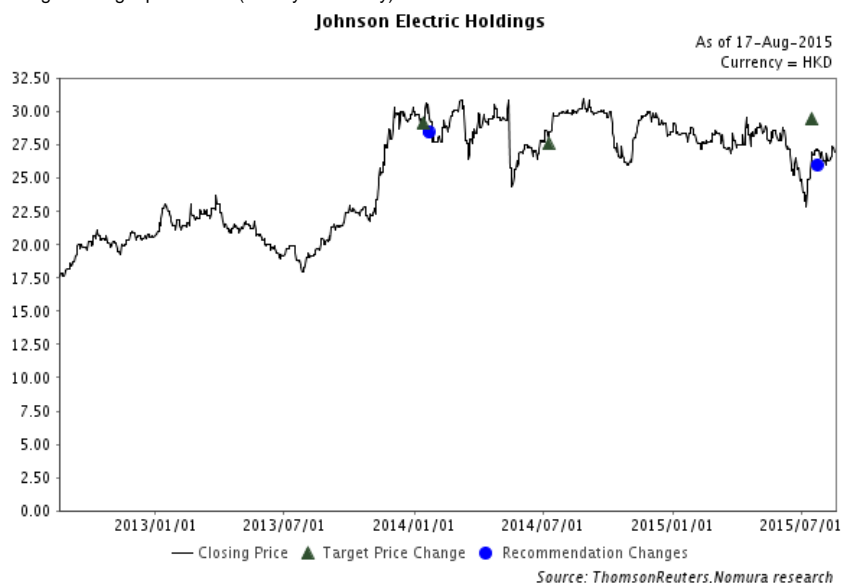
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of HKD9.0 is based on 13.5x (+1 SD above mean) FY15 EPS (USD0.08). The benchmark index is MSCI China.

Risks that may impede the achievement of the target price 1) potential liability claims on OEM recalls; 2) rising raw material costs; 3) slowdown in GM fleet sales; and 4) potential pricing pressure exerted by OEMs.

Johnson Electric Holdings (179 HK)**HKD 26.60 (21-Aug-2015)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
15-Jul-15	Buy		26.45
15-Jul-15		29.50	26.45
09-Jul-14		27.60	28.00
13-Jan-14	Neutral		28.92
13-Jan-14		29.20	28.92

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of HKD29.5 implies 14x FY17F P/E (EPS: USD0.28) and 1.5x P/B (BVPS: USD2.55) based on DCF (cashflows discounted back to FY15). The benchmark index for this stock is MSCI HK.

Risks that may impede the achievement of the target price 1) uncertainty over the sustainability of US/ EU economic recovery, and auto demand recovery, 2) pricing pressure from clients, 3) further euro depreciation and 4) rising commodity prices could exert pressure on gross margins.

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