



FOCUS ON CHINA
**2015 MARKET OVERVIEW:
IMPACTS AND OPPORTUNITIES
OF CAR PURCHASE
RESTRICTIONS**

Analysis completed: March 2016

INTRODUCTION

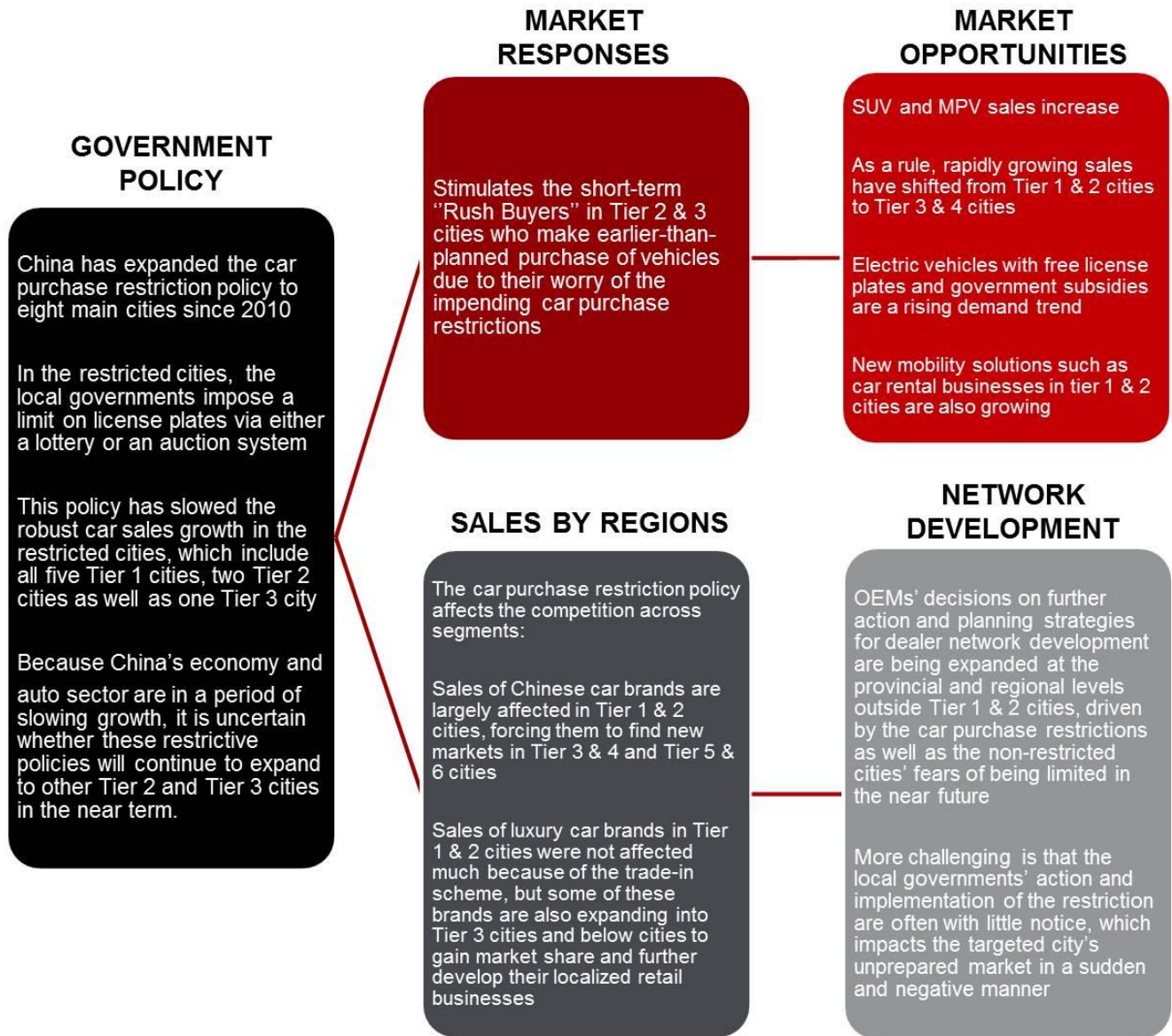
Recent national and international headlines have focused on China's economic slowdown and one of its key components – the automotive industry. China's economic growth is generally estimated to slow to 6.3% in 2016 and 6.0% in 2017, continuing the downward trend from the 6.9% growth seen in 2015 and the 7.3% seen in 2014. According to the International Monetary Fund (IMF), this gradual slowdown is the result of a shift in economic activity away from investment and manufacturing towards services.

Although growth is predicted to be at its lowest point since the global financial crisis, many maintain an optimistic outlook about the Chinese economy. James P. Gorman, chairman and CEO of leading global investment bank Morgan Stanley, believes that "A growth rate of 6% to 7% is very attractive and everywhere else in the world would love that kind of speed." (Xinhua, the official press agency of China on May 29, 2015)

China is still the world's largest passenger car sales market, with 18.9 million new vehicles registered in 2015 representing an 11% year-on-year (YoY) increase, but its new car sales are not growing as fast as in the past few years since YoY growth spiked at 45% in 2009.

While there are many factors influencing the slowing growth of the auto market, including changes in purchasing power, the effect of 'cars on call', improved public transport, and others, this report will focus on the effects that government Car Purchase Restrictions are having on this deceleration.

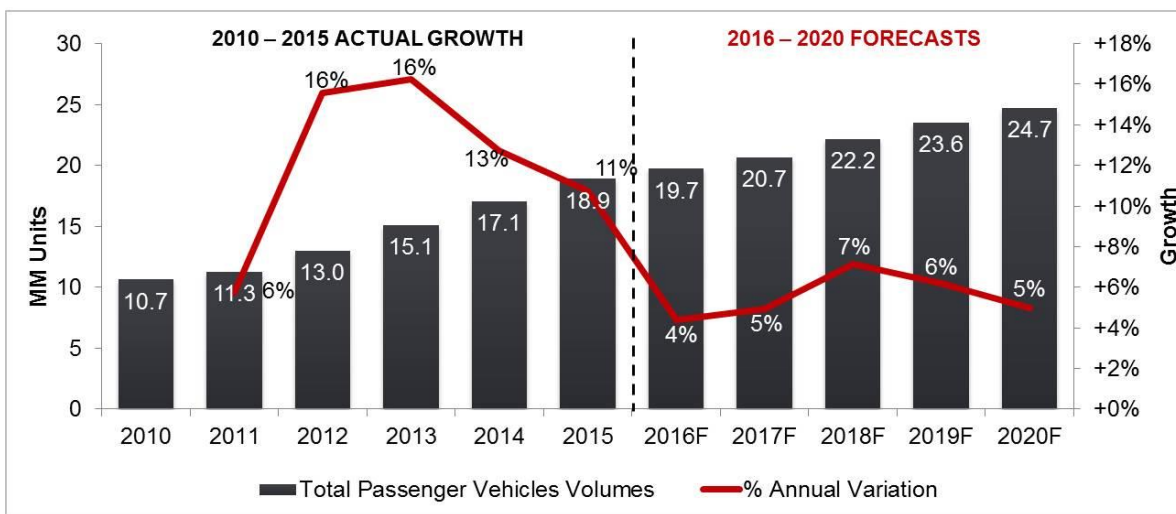
KEY FINDINGS



* Notes: For the city tiering classification, please refer to the notes on the map on page 13

OUTLOOK

China's new passenger car market closed 2015 with confidence recovering after seven months of lower-than-expected sales since February. China's total new passenger car registration volume for 2015 grew 11% YoY to 18.9 million. However this figure represents a further decline in growth with the YoY increase dropping from 13% in 2014 and from 16% in 2013. The 2016 full year projection for the car market is 19.7 million units, according to LMC Automotive and this would represent a YoY growth of only 4% over 2015.



Source: JATO Dynamics and LMC Automotive

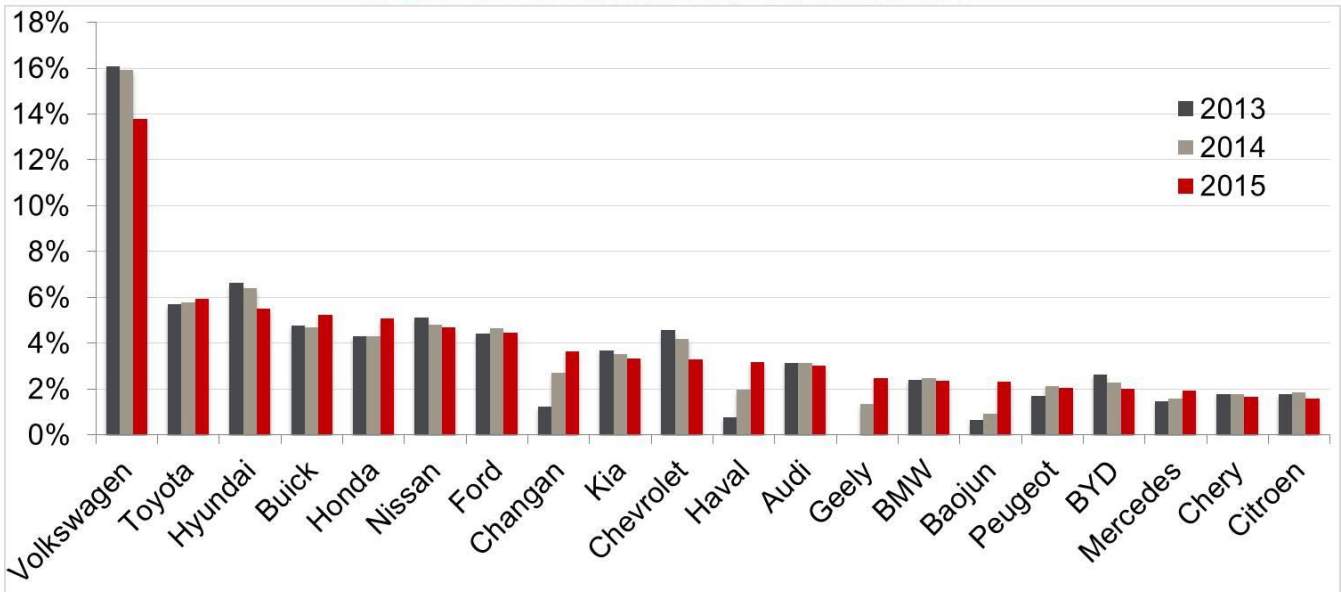


The largest contribution to overall market growth came from locally-produced SUVs, sales of which rose by an impressive 62% YoY to 5.7 million. The market performance clearly shows that Chinese brands such as Changan, Haval (Great Wall's own brand), Geely, and Baojun (SAIC-GM-Wuling) are rising significantly with strong growth, taking shares away from non-domestic brands that have been responsible for the vast majority of car sales for a long time. More specifically, the market share gain was driven by the more affordable SUVs.

The Chinese brands have new SUVs that cost less than \$24,000 on average (non-domestic branded SUVs cost more than \$45,000 on average) but still offer both a competitive exterior and interior design as well as desirable equipment features. Meanwhile non-domestic brands focus more on medium-to-high-end SUVs which are in less demand. New model activity was largely behind this success amongst the Chinese brands, as most of the new models launched to the market were well received by consumers. However, domestic manufacturers face competition from almost all non-domestic rivals as they too are catching up by introducing new models in the low-to-medium end of the booming SUV market.



CHINA NEW CAR MARKET MARKET SHARE TOP 20 BRANDS



Source: JATO Dynamics Limited



Among the international brands, Volkswagen sales slowed last year, resulting in negative YoY growth of -4% in 2015. Their sales of 2.6 million units represented a market share loss of 2 percentage points. However, it remains the number one brand in China, measured by total volume sold. Audi is also losing Chinese market share, in particular to Mercedes.

CHINA NEW CAR TOP 20 BRANDS REGISTRATIONS 2015 MARKET SHARE CHANGE

| Brand | Total Regs. (000) 2015 | Market Share Percentage Points Change | |
|------------|---------------------------|---------------------------------------|-----------|
| | | 2014-2015 | 2013-2015 |
| Volkswagen | 2,611.5 | -2.11 | -2.27 |
| Toyota | 1,127.8 | +0.17 | +0.26 |
| Hyundai | 1,043.8 | -0.88 | -1.12 |
| Buick | 990.6 | +0.53 | +0.44 |
| Honda | 962.2 | +0.77 | +0.75 |
| Nissan | 887.8 | -0.14 | -0.43 |
| Ford | 847.8 | -0.18 | -1.31 |
| Changan | 694.5 | +0.97 | +2.42 |
| Kia | 631.8 | -0.21 | -0.37 |
| Chevrolet | 624.7 | -0.91 | -1.31 |
| Haval | 606.0 | +1.22 | +2.44 |
| Audi | 577.6 | -0.12 | -0.08 |
| Geely | 474.6 | +1.14 | +2.51 |
| BMW | 446.3 | -0.11 | -0.07 |
| Baojun | 441.9 | +1.40 | +1.67 |
| Peugeot | 393.2 | -0.08 | +0.35 |
| BYD | 382.5 | -0.26 | -0.64 |
| Mercedes | 368.9 | +0.34 | +0.47 |
| Chery | 314.6 | -0.15 | -0.12 |
| Citroen | 300.9 | -0.28 | -0.20 |

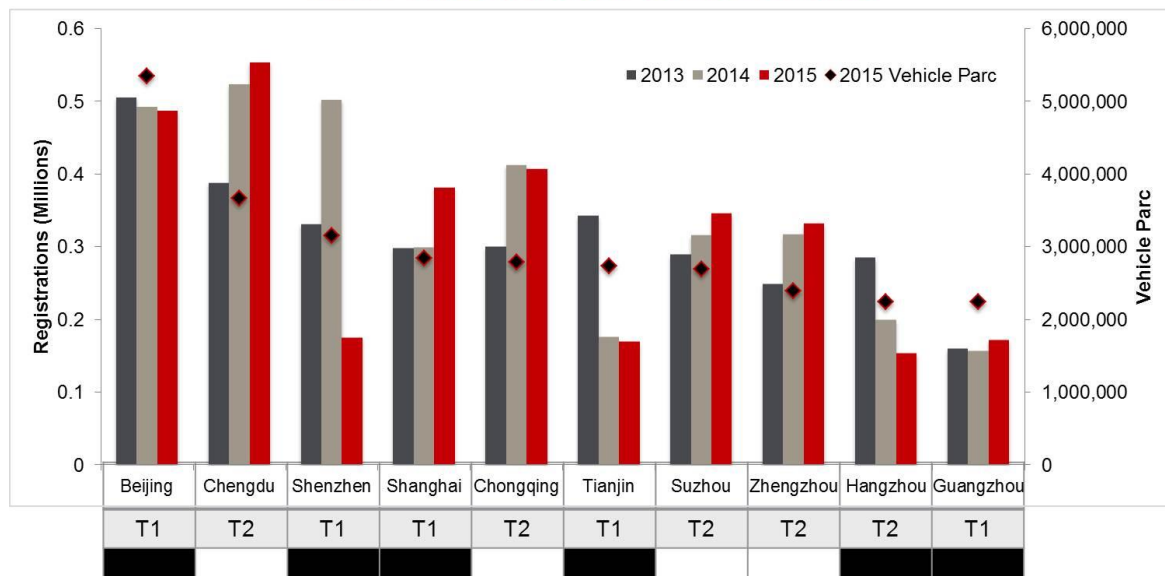
Source: JATO Dynamics Limited



THE IMPACT OF CAR PURCHASE RESTRICTIONS

Even though there are some signs of positive sales growth from automakers, the car purchase restriction policy is one of the key factors restraining China's car sales growth. A growing number of big cities in China, mainly Tier 1 and 2 cities, have enacted policies restricting the purchase of cars, aiming to reduce the growing problems of pollution and traffic congestion. Automakers and car buyers, however, are arguing that such restrictions are not an effective long term solution as the development of China's automotive industry will be negatively affected while the root causes of heavy pollution and traffic congestion will not be properly addressed. They add that improving the nation's infrastructure systems would be a more effective way to start. Moreover, the current slowdown we are seeing in China's new car market also raises doubts as to whether city-by-city limits on vehicle purchases should be extended or delayed as the government needs the automotive industry to stimulate and sustain China's economic growth.

CHINA NEW CAR MARKET GROWTH IN THE TOP 10 CITIES WITH THE LARGEST VEHICLE PARC



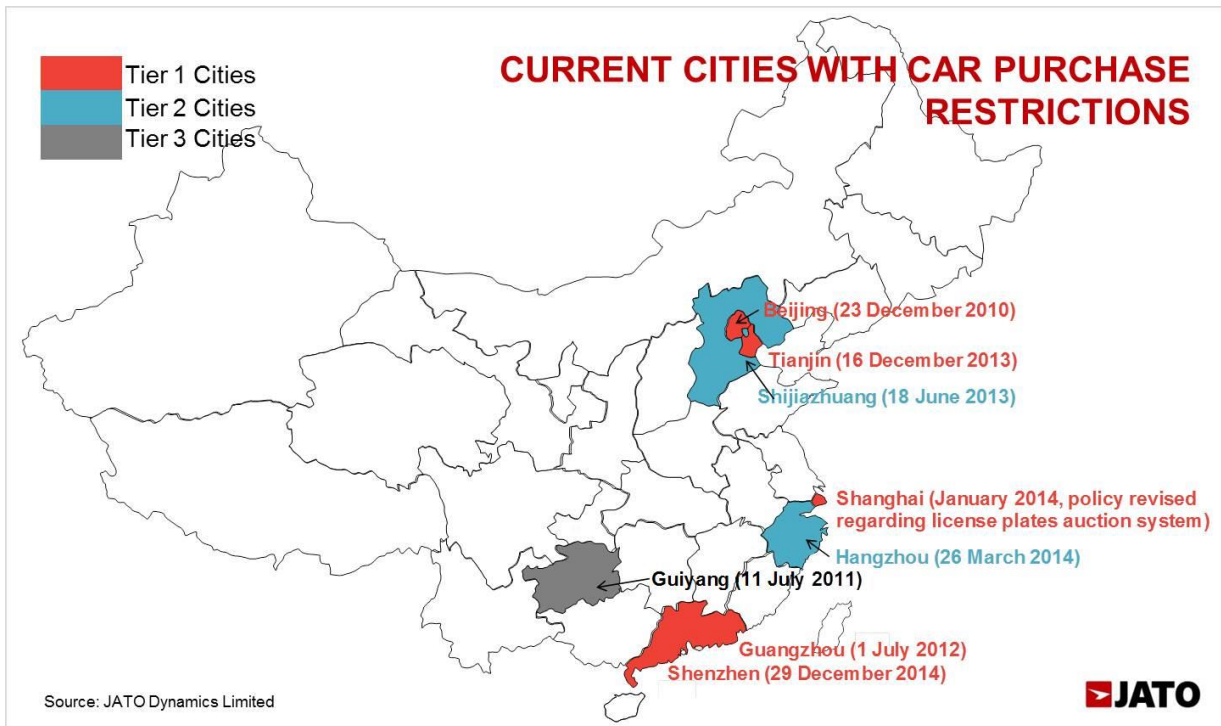
Notes: T1 – Tier 1 City
T2 – Tier 2 City
Car Purchase Restriction

Source: JATO Dynamics Limited
Top 10 Cities by Vehicle Parc 2015, Traffic Control Dept.
The Ministry of Public Security (MPS) of China



By the end of 2014, eight cities - Beijing, Shanghai, Guangzhou, Guiyang, Tianjin, Shijiazhuang, Hangzhou and Shenzhen - had introduced limits on buying cars. They also took steps to limit driving in some places through measures such as increasing parking fees by the hour and banning cars registered outside the city from being driven inside on the busiest roads on work days. Over half of these cities are in the top ten in China by total number of vehicles. All the top ten cities reached 2 million vehicles or above in 2015.

The impact of these policies can be seen in restricted cities like Shenzhen (-65%) and Hangzhou (-23%) which have seen large decreases in new car registrations.

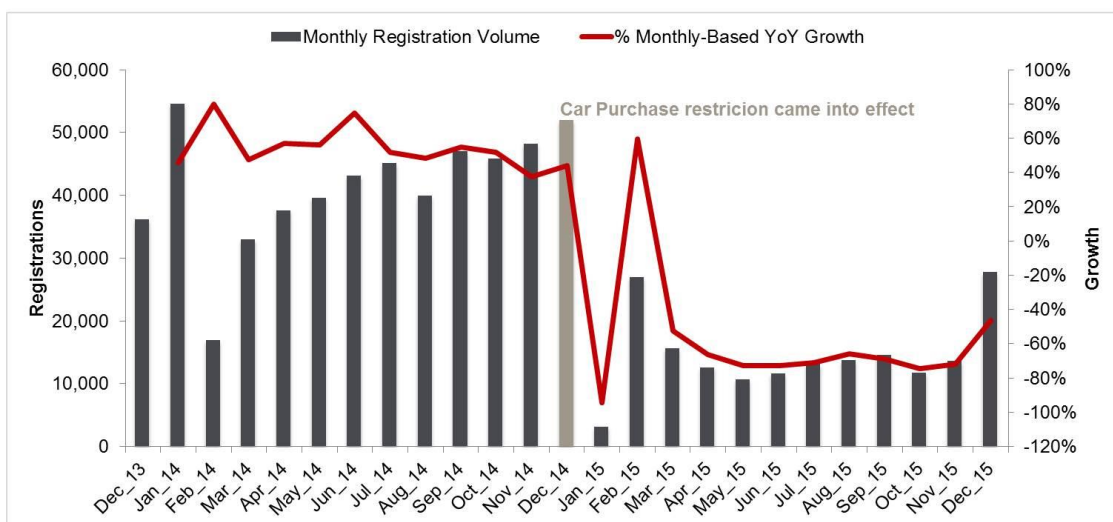


IMPACT ON SHENZHEN CAR MARKET

The car purchase restriction policy in Shenzhen came into force on December 29, 2014, and will be in effect for at least five years. January is normally one of the peak vehicle sales months as it is just before Chinese New Year. However, the policy made a huge impact on the registration volume for January 2015, which dropped to 3,137 units, a 94% plunge compared to January 2014's registration volume of 54,597 units.

The registration volume recovery in February 2015 was mainly due to the processing of registration applications and/or the delivery of the new cars that were purchased or ordered in November/December before the restriction policy came into effect. In particular, the Toyota Corolla and the Nissan Sylphy, the top two best-selling models with over 1,500 units registered per month, helped push up the February registration volume. However, in February both of these volumes were half of what they were in December 2014. Monthly sales volumes have dropped severely since March 2015, down 65% on average compared to the same period in 2014.

SHENZHEN (TIER 1 CITY) NEW CAR REGISTRATIONS VOLUME



Source: JATO Dynamics Limited

JATO

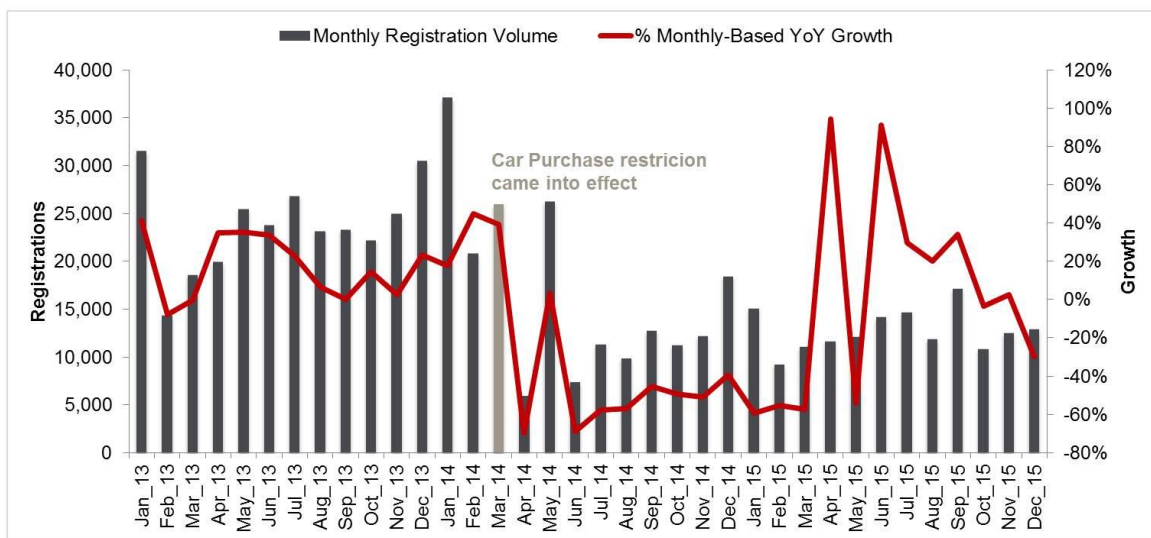
IMPACT ON HANGZHOU CAR MARKET

As a major Tier 2 city, with a vehicle population of 2.3 million, the regular strong growth of new car sales in Hangzhou has slowed dramatically since the car purchase restriction policy came into force on March 26, 2014.

Like Shenzhen, there was an immediate impact. In April 2014, new car volumes fell from 26,000 units to 6,000 units in just one month, a 70% decrease compared to April 2013.

In May, the registration increase was only because the people who signed car purchase contracts and paid their deposit before March 26 were allowed to apply for a licence plate. To support the launch of the policy, Hangzhou's authorities stopped the services for car registration applications, transfers etc. from March 26 to April 25. Since June 2014, the policy has caused monthly new registration volumes to roughly half compared to the pre-restriction period.

HANGZHOU (TIER 2 CITY) NEW CAR REGISTRATIONS VOLUME



Source: JATO Dynamics Limited



STRONG RAPID GROWTH OCCURS IN NON-RESTRICTED REGIONS

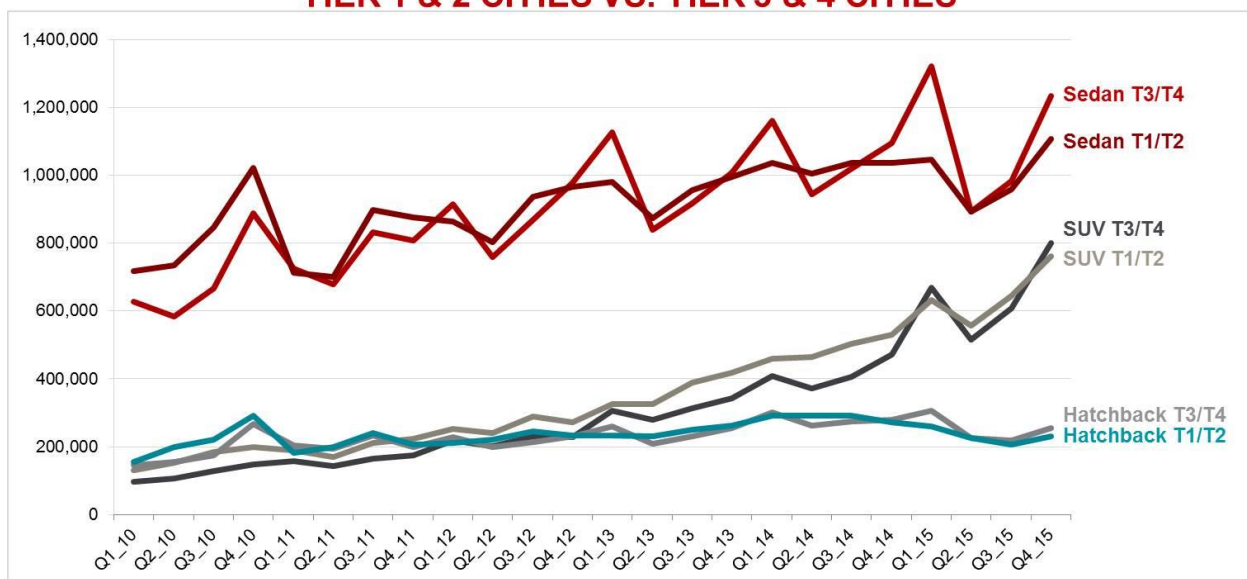
Restrictions have been introduced to two cities each year for the last two years (Shijiazhuang and Tianjin in 2013, Hangzhou and Shenzhen in 2014). This suggests that further provincial and smaller cities may encounter such policies in the near future. Such restrictions are altering the makeup of the regional markets as automakers expand their focus to include non-restricted Tier 2 cities.

Meanwhile, retail clients, especially first time buyers in non-restricted locations, have begun to respond by making their purchases earlier than originally planned due to the worry of the policy coming into effect in their area at short notice.

On-going trends:

- Overall, the quarterly registration volume of new cars with various body types shows an upward trend from 2010 to 2015. Some body types have seen slow growth (Hatchbacks) while other body types have rapid growth (SUVs and MPVs)
- Sales of Sedans have been slowing too, but there was a significant increase in the fourth quarter of 2015, driven by the Chinese government's temporary purchase tax cut from 10% to 5% for vehicles with engines of 1.6 litres and smaller. This policy began in October and runs until the end of 2016. Many automakers with their best-selling or majority volume models falling into this range have seen the desired benefits and strong sales growth in October compared to September as a result
- Tier 3 and 4 cities have begun to overtake Tier 1 and 2 cities as the fastest-growing sales regions in China. This is partly due to the impact of the car purchase restriction policy, and also because the gradually rising income level per capita makes more car ownership more affordable for a growing number of people across the country

CHINA NEW CAR REGISTRATIONS VOLUME TOP 3 BODY TYPES TIER 1 & 2 CITIES VS. TIER 3 & 4 CITIES

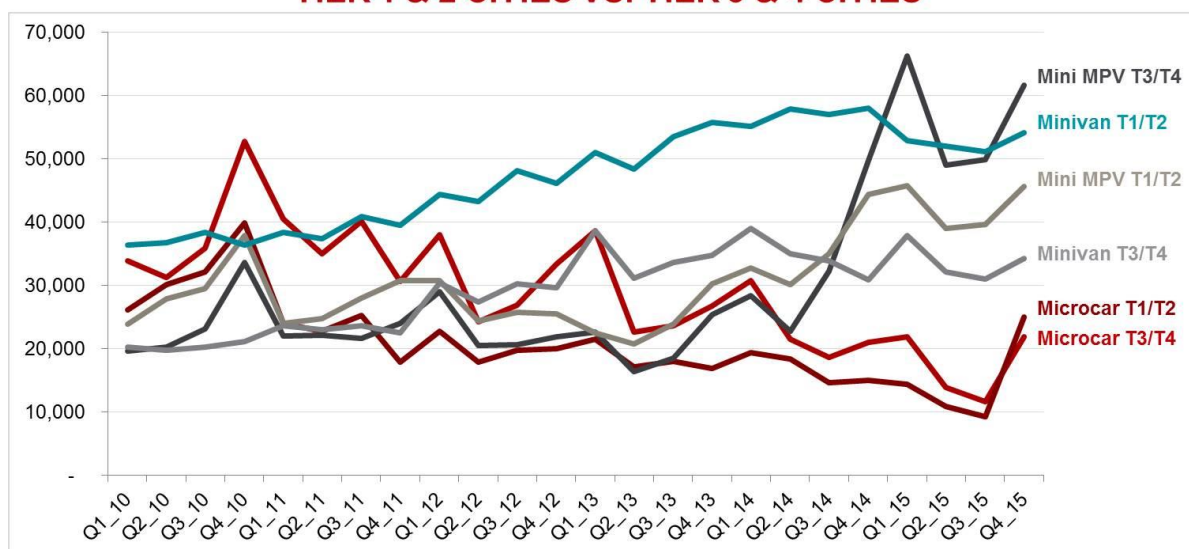


Source: JATO Dynamics Limited



- Specifically, the sales of Sedan cars and Mini MPVs in Tier 3 and 4 cities have surpassed those in Tier 1 and 2 cities since the fourth quarter of 2014. Among the Sedans, the Buick Excelle and the Chevrolet Sail, the joint venture models, had the top sales with 56,597 units and 31,706 units respectively in Q4 2014 in Tier 3 and 4 cities. In the Mini MPV group, the top performing Baojun 730 had 30,566 unit sales in Q4 2014 in Tier 3 and 4 cities
- The sales of SUVs and Hatchbacks in Tier 3 and 4 cities have exceeded those in Tier 1 and 2 cities since the first quarter of 2015. Chinese brand Great Wall Motor's Haval H6 topped the SUV segment with 51,413 units sold in Q1 2015 in Tier 3 and 4 cities and totalled at 371,926 units across China in 2015
- SUVs' sales in Tier 1-4 cities have surpassed the sales of Hatchbacks since the fourth quarter of 2011 when SUVs grew 7% higher than Hatchbacks. The key distinguishing features of Hatchback versus Sedan are the cargo space and access. The increasing gap between the sales of SUVs and Hatchbacks also indicates that some of those shopping for a Hatchback have shifted their preference to an SUV-sized car with more space and power than a Hatchback
- Sales of MPVs in China also presented rapid growth in 2015 through 2014. Baojun 730, the sub-brand of SAIC-GM-Wuling, is leading the Mini MPV sub-segment. Baojun 730 sales volume spiked at 36,000 units in January 2015, since its launch into the market in July 2014 with 365 unit sales. This explains the fast growing trend in Mini MPVs. Among the Mini MPV sales regions, sales in Tier 3 & 4 cities showed a sharp surge in Q1 2015. This was also due to Baojun 730's strong sales in the top selling Tier 3 & 4 cities such as Dongguan (Guangdong Province), Chongqing (municipality), Zhengzhou (Henan Province) and many other cities.

CHINA NEW CAR REGISTRATIONS VOLUME MPV, MINIVAN, MICROCAR TIER 1 & 2 CITIES VS. TIER 3 & 4 CITIES



Source: JATO Dynamics Limited



Note: definitions of Minivan and Mini MPV

Minivan: a vehicle for passenger transport available with three rows of seats, either as standard equipment or as an option. It usually features multi-purpose seating facilities, table, luxurious upholstery, etc. Normally 4 or 5 doors, often with sliding side doors. It must be at least 4.5m long.

Mini MPV: a vehicle for passenger transport which usually has a higher body over other body types in the same model range, to allow for increased headroom. The overall length is usually between 3,501mm and 4,500mm.

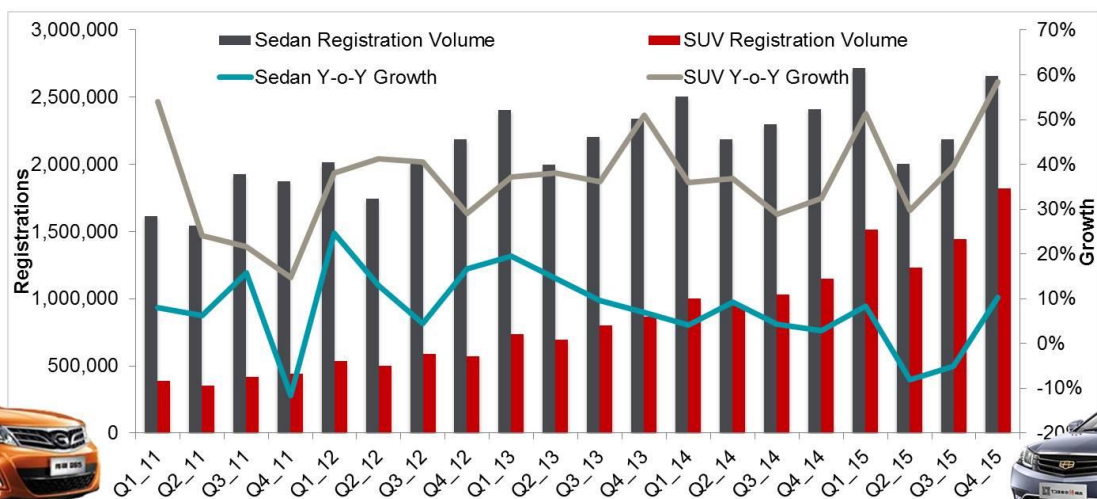
SUVS ARE SHIFTING THE MARKET

Between 2005 and 2015, SUVs have become the fastest-growing and an increasingly popular segment in China. SUV sales have increased year-on-year by 33% in 2014 to over 4 million units and 45% in 2015 to 6 million units.

In comparison, Sedan models, though still the largest segment in China, have seen sales slow substantially, with only a 5% year-on-year rise in 2014 to 9.4 million units and 2% in 2015 to 9.57 million units. They may not have even reached the volumes last year without the stimulus of the tax break for vehicles with engines up to 1.6 litres which came into effect in October 2015.

Even with a slowdown in growth of the overall market, 6 million SUVs were sold in China in 2015, accounting for 32% of the 19 million total passenger vehicles sold. That's why global and local auto players keep racing to introduce the new SUV models, ranging from compact SUVs to larger crossovers. At the Shanghai International Motor Show in April 2015, roughly 40% of the newly launched models were SUVs while around 20% were Sedans. New SUVs will be still a big focus this year, and will feature strongly at the Beijing International Motor Show in April.

CHINA NEW CAR MARKET. SEDAN & SUV QUARTERLY EVOLUTION



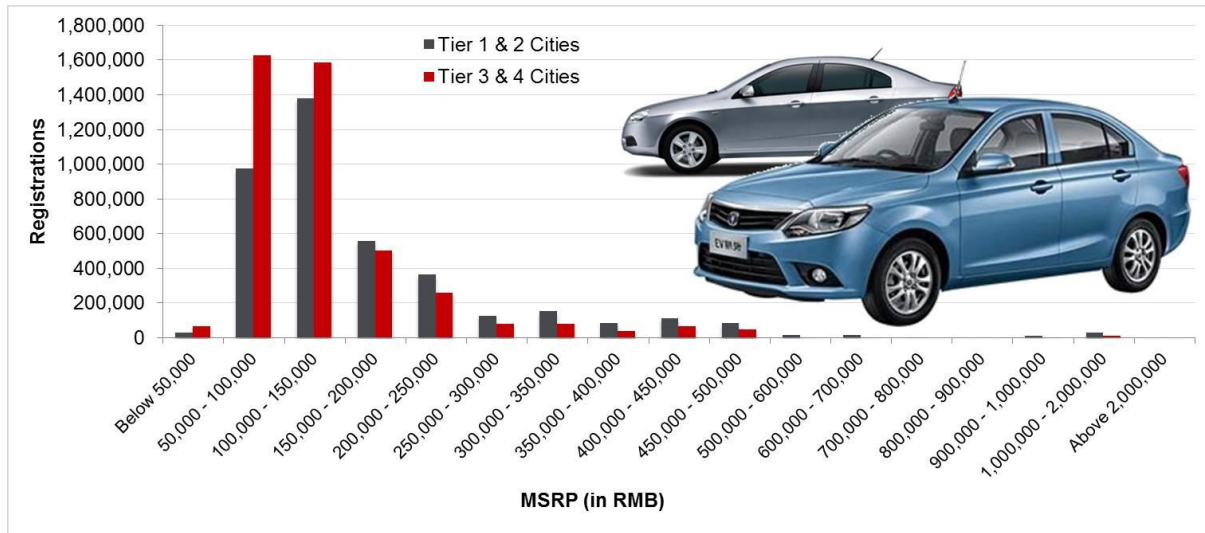
Source: JATO Dynamics Limited



FACTS ABOUT SEDANS AND SUVS

- People like the SUV's sporty body and styling, and its dynamic driving presence on the road. The body also gives the car a strong, durable and safe look
- Automakers work on everything from upgrading the exterior body style to the high quality interior features equipment to create a greater feeling of value-for-money and to stay competitive with other brands
- The most popular price ranges for Sedans are between 50,000 – 150,000 RMB (US\$7,727 – \$23,180) and 150,000 – 250,000 RMB (US\$23,180 – \$38,635). Demand for Sedans at the lower-end price range of 50,000 – 100,000 RMB from Tier 3 and 4 cities has grown at over 1.5 times the rate it has in Tier 1 and 2 cities

SEDAN REGISTRATIONS BY PRICE RANGE 2015

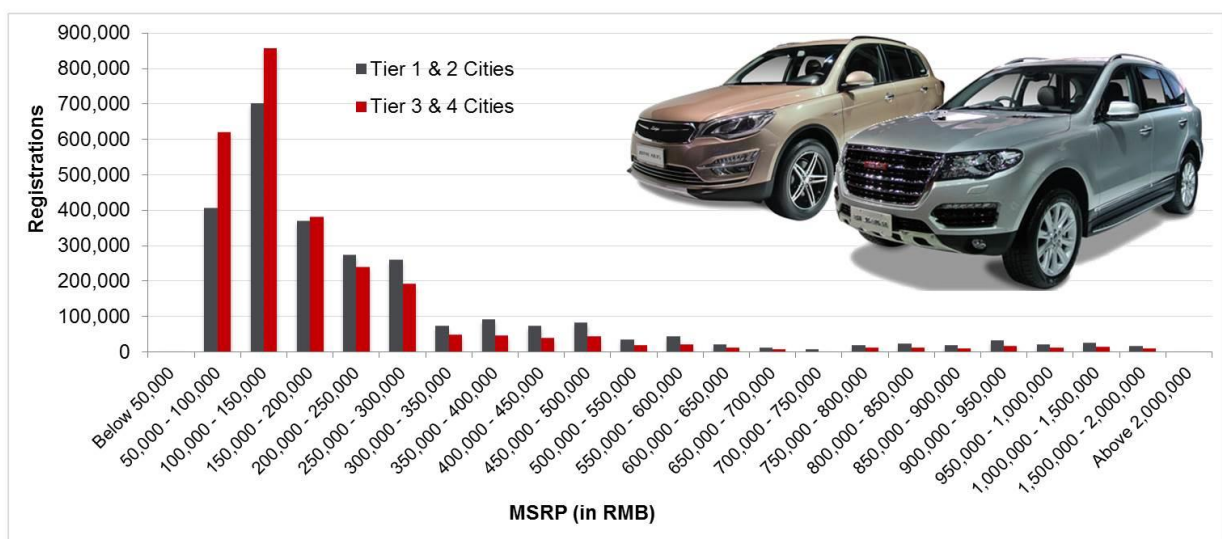


Source: JATO Dynamics Limited



- Moving to the medium-end price range of 250,000 – 300,000 RMB, SUV sales doubled that of Sedans, indicating that more buyers prefer the SUV's diverse capabilities as well as its more spacious interior over the Sedans available at the similar price level
- Demographic change is also likely to sustain further demand for SUVs. After three decades of strict population control under China's one-child policy, the Chinese government has started to gradually loosen the restriction since 2012 in an attempt to prevent the reduction in birth rate and overall population. Under this policy, 29 out of the 31 provinces in China each have approximately 11 million couples who are now allowed to have a second child
- Although there is a limited impact from a big rise in new babies in the medium term, in the long term, we will still be able to see a change in the size of Chinese families and family planning. This would mean that the average household size will increase. If we connect that to household car purchasing, a car that can comfortably hold all of the family members is important

SUV REGISTRATIONS BY PRICE RANGE 2015



Source: JATO Dynamics Limited



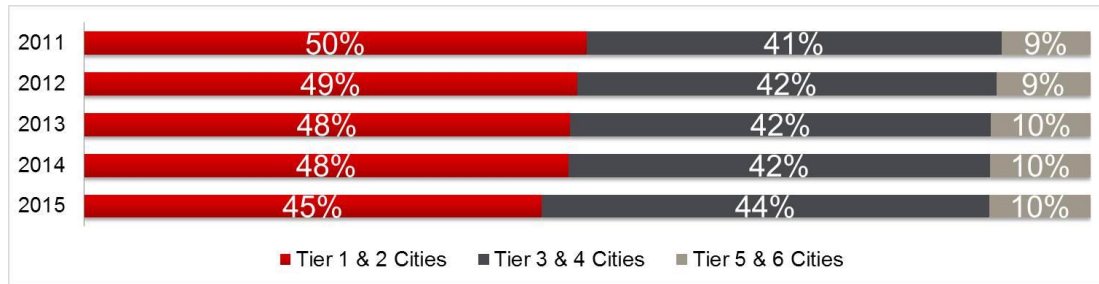
DISTRIBUTION OF THE MARKET BY CITIES



The distribution of all cars registered in China suggests that more than half of the new cars have been, and will continue to be, sold mainly in Tier 3 and 4 cities but also in Tier 5 and 6 cities as these expand. Looking at the above map, the pink Tier 3 cities and the green Tier 4 cities are expected to experience increased new car sales in the coming years.

Like the upward trend in total new car sales, the sales of non-domestic brands in China have also been growing more in Tier 3 cities and below, than in Tier 1 and 2 cities. However, the impact of car purchase restrictions has not been as negative on non-domestic and Joint-Venture brands as on Chinese brands.

NON-DOMESTIC CAR BRANDS REGISTRATIONS BY TIER CITIES

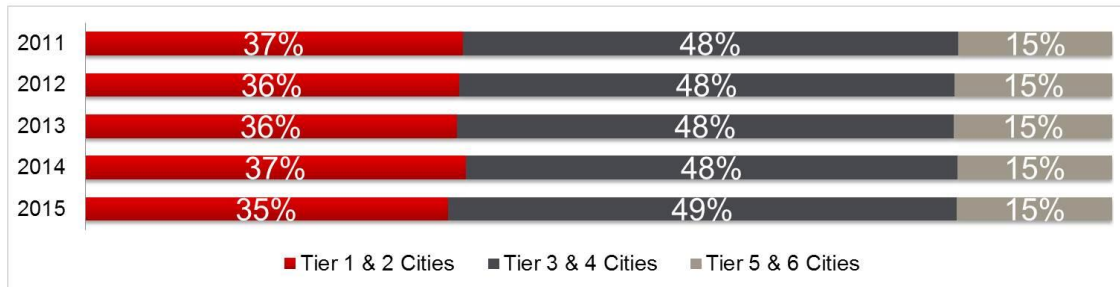


Source: JATO Dynamics Limited



How OEMs' develop their dealer networks is crucial to them remaining competitive and fighting for a bigger market share. Many automakers have also been expanding their sales regions in Tier 3 cities and below. For instance, among the non-domestic brands, Mercedes-Benz opened 97 new dealerships across China in 2014, 35% of which were based outside Tier 1 and 2 cities. Likewise, Audi added 70 new dealers in China with 45% established outside Tier 1 and 2 cities, as were 38% of the 47 new dealers for BMW. Among the Joint-Venture brands in 2014, Shanghai Volkswagen expanded significantly, opening 120 new dealers, 38% of which were established in Tier 3 cities and below. Likewise, 38% of the 77 new dealers for Beijing Hyundai, and 43% of the 47 new dealerships for FAW Toyota were also established outside Tier 1 and 2 cities (Source: *TIMER*, a partner of JATO China).

CHINESE CAR BRANDS REGISTRATIONS BY TIER CITIES

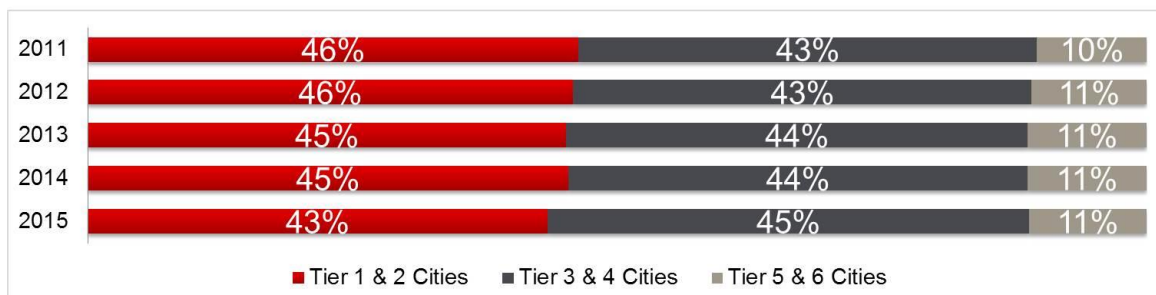


Source: JATO Dynamics Limited



Since consumer tastes, personal income levels and spending power vary from region to region and city to city, auto finance schemes in Tier 3, 4, 5 and 6 cities should be a focus of all automakers.

TOTAL CAR REGISTRATIONS BY TIER CITIES



Source: JATO Dynamics Limited



CONCLUSION

Continued growth in the Chinese car market demonstrates that it is still in reasonable shape. Annual volumes are forecast to keep growing and over the next few years it is expected to see sales increases that will ensure it remains the world's largest car market. Even at lower growth rates, China is still one of the world's most attractive growth markets due to the potential in its less developed cities and lower-populated areas that have not yet been on the radar of the industry. Tier 1 and 2 cities will slowly yield market share to the smaller and lesser known cities that will be the big drivers of growth in the coming years. Increasing proportions of the population of these cities are expected to enter the car market in the mid and long term, with big opportunities for both Chinese and non-domestic brands.

The big challenge for the world's largest car market is to maintain these positive trends whilst limiting pollution and congestion. Local authorities have put a number of plans in place to address these problems. Car purchase restrictions are one example, these have reduced sales in most cases. Other factors such as increased parking prices and limits on busy roads, for cars registered outside a city, during busy times have also had an impact.

The Chinese market is focused on finding ways to deal with social issues such as pollution and congestion whilst maintaining growth in the auto sector and in particular maintaining demand for sedans, hatchbacks and SUVs. The automotive sector is vital for creating jobs and generating developments in new technologies. The latest car purchase restrictions in the largest cities could easily become growth drivers for the small and midsize segments, with Chinese manufacturers benefitting as most of their sales are taking place in Tier 3, 4, 5 and 6 cities.



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