

EMERGING MARKET CONSUMER GROWTH IN AUTOMOBILES: DONGFENG MOTOR GROUP

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As I highlighted in two previous [blog posts](#), automobile ownership in emerging market countries is expected to see major increases, as more people enter the middle class and see their disposable income rise. I previously profiled Great Wall Motors (GWM), the leading SUV brand in China. I want to profile another major auto company in China—Dongfeng Motor Group—that has the same long-term potential but has not experienced the same strong short-term gains as GWM. I'll explore the cause of this short-term differential but also discuss why I believe Dongfeng is well positioned to benefit from the longer-term trends at work. **Dongfeng Motor Group Company** Dongfeng Motor Group is engaged primarily in the manufacture and sale of commercial vehicles, passenger vehicles, auto engines and parts, financing and other automotive-related businesses. Through its subsidiaries and joint ventures the group manufactured 39 series of passenger vehicles and 41 series of commercial vehicles, with annual production capacities of 2,200,000 units and 810,000 units, respectively¹. The chart below lists the sales and after-sales services network of Dongfeng Motor Group's 12 different brands.

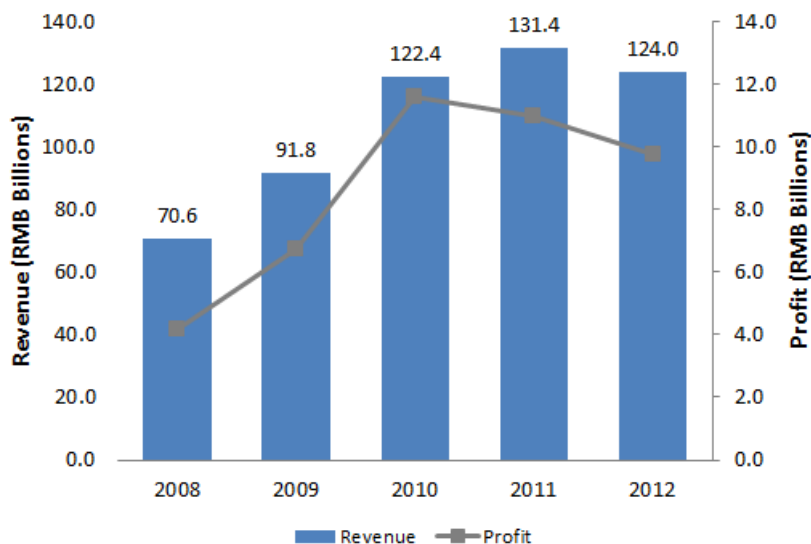
Brand Names	Number of Sales Outlets	Number of After-Sales Service Outlets
Commercial Vehicles		
Dongfeng (heavy and medium truck)	663	2,397
Chenglong (heavy and medium truck)	320	700
Dongfeng (light truck, mini truck, pickup)	2,342	2,589
Dongfeng Nissan Diesel	48	93
Passenger Vehicles		
Dongfeng Citroen	404	556
Dongfeng Peugeot	324	324
Dongfeng Nissan	1,039	856
Venucia	405	260
Dongfeng Future	350	573
Dongfeng Honda	354	354
Zhengzhou Nissan	919	442
Dongfeng Fengshen	202	202
Total	7,370	9,346

Source: Dongfeng Motor Group 2012 Annual Report

Recent Sales and Profitability

• **Market Share:** In the first half of 2013, Dongfeng Motor Group accounted for 11.2% of sales among the domestic automobile manufacturers in China.² • **Dongfeng Motor Group Sales:** In the first half of 2013 sales were approximately 1.2 million units, or 2.9% growth over the same period last year. This growth lagged the 12.3% growth of the broader industry, which sold 10.8 million vehicles.³ Dongfeng attributes its slower growth rate to the following factors: • **General Business Slowdown:** “The commercial vehicle market was affected by the prolonged economic downturn and Dongfeng was no

exception as its commercial vehicles were mainly used for logistics.”⁴ • **Japan Political Tensions Flare Up and Hurt Japanese Co-Branded Sales:** “Sales of Dongfeng Nissan and Dongfeng Honda fell below the sales targets as sales in Japanese-brand passenger vehicles significantly decreased as a whole since mid-September.”⁵ Despite these short-term factors weighing on growth, over the past five years Dongfeng has seen dramatic increases in both sales and profitability. **Figure 1: Dongfeng Motor Group Profitability (RMB Billions)**



Source: Dongfeng Motor Group 2012 Annual Report

• **Double-Digit Growth** -

Over the past five calendar years, Dongfeng had average annual revenue growth of more than 11.9% and was able to grow profits by over 18.6%. It is important to note that profitability grew faster than revenue, usually a sign of higher margins and increased efficiency. • **Recent Sales Declines in Japanese Brands** - The dispute between China and Japan over the sovereignty of the Diaoyu Islands in September 2012 had an adverse impact on the sales of Japanese automobile brands in China, and Dongfeng Nissan and Dongfeng Honda were not spared. Although the sales of these brands will likely continue to suffer in the near future, eventually they will begin to normalize. I would also remind investors that Dongfeng is a diversified automobile company with over 12 different brands, as the above chart highlights, and is still in a position to benefit from the growth in incomes across China’s large population. **Outlook** “It is anticipated that the growth of production and sales volume of the Dongfeng Motor Group will continue to outpace the industry, which will further consolidate and enhance its market position in the automobile industry in the [People’s Republic of China].”⁶ The short-term growth concerns have certainly put pressure on Dongfeng Motor’s [price-to-earnings ratio](#). Dongfeng has underperformed the [MSCI China Index](#) in 2013 and is trading below both the Chinese market and the broader emerging market on a price-to-earnings basis. Yet Dongfeng’s positioning as a market share leader in many categories in China makes it a potentially attractive option for investors looking to capitalize on future growth in the Chinese auto market at what may be temporarily depressed prices.

Name	YTD Performance	P/E Ratio
Dongfeng Motor Group	-7.21%	8.0x
MSCI China Index	-0.25%	9.7x
MSCI Emerging Markets In	0.28%	12.2x

Sources: Bloomberg, WisdomTree, as of 10/28/13. Year-to-date performance (12/31/12–10/28/13). Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of indexes in the

chart, please go to [Glossary](#). **Conclusion** Regardless of the [WisdomTree Emerging Markets Consumer Growth Index’s](#) (WTEMCG) current positioning, the biggest ongoing benefit of the methodology, we believe, comes from the ongoing disciplined rebalancing

process. The fast growth rates of the auto market in emerging countries and the large numbers of possible purchases are two elements that have the potential to make investors forget some of the more basic elements of investing—such as [valuation](#). From a selection standpoint, for constituents to maintain inclusion, higher [earnings yields](#) will be favored over lower earnings yields. From a weighting standpoint, qualifying firms whose price levels rise but whose earnings stay stable or decline will tend to see reductions in weight. At each annual rebalance, depending on the market environment, the natural focus of the Index will continue to be on valuation. Dongfeng Motors provides another example of the [WTEMCG](#) methodology and investment theme: it is a company poised to benefit from China's long-term consumer growth potential. In this case, the stock is selling at below-market valuation multiples because of what looks like short-term factors due to political tensions with Japan. In my opinion, these political factors are likely to dissipate over time and Dongfeng could be well positioned to resume its long-term growth trajectory. ¹Source: Dongfeng Motor Group 2013 Interim Report. ²Source: Dongfeng Motor Group 2013 Interim Report. ³Source: Dongfeng Motor Group 2013 Interim Report. ⁴Source: Dongfeng Motor Group 2012 Annual Report. ⁵Source: Dongfeng Motor Group 2012 Annual Report. ⁶Source: Dongfeng Motor Group 2013 Interim Report. As of 10/31/2013, the weight of the Dongfeng Motor Group in the WisdomTree Emerging Markets Consumer Growth Index was 2.54%.

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DEFINITIONS

MSCI China Index: A free float-adjusted, market capitalization-weighted equity index designed to measure the performance of the Chinese equity market.

WisdomTree Emerging Markets Consumer Growth Index: A fundamentally weighted index designed to measure the performance of emerging market equities that have a potential heightened sensitivity to increased emerging market consumption. Weighting is by earnings.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Earnings yield: The earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company.