

China Harmony New Energy Auto (3836.HK)

Starting a new phase of profit expansion; Buy

BUY

3836.HK | 12m Price Target: **HK\$5.90** | Price: **HK\$3.31** | Upside: **78.2%**

We expect Harmony to enter a phase of profit accelerations in 2H20E and 2021E. We currently model earnings to inflect from -25% yoy / -18% yoy in 2019 / 1H20 to +46% yoy / +22% yoy in 2H20 and 2021E. Harmony's concentrated revenue exposure to BMW sales in Henan is becoming a significant profit driver for 2H20. We estimate BMW and Lexus are the company's top two selling brands, with 46% / 30% gross profit contributions in 1H20. By geography, we estimate the company derived 55% of its gross profit from the province of Henan in 1H20. These brand and location exposures have been experiencing demand acceleration in recent months. In July / August, Chinese retail volume expanded +27% / +42% yoy for BMW and +25% / +28% yoy for Lexus (data source: China auto market). Premium car sales volume in Henan grew >30% yoy in both July and August, with BMW leading the volume expansion with +36% / +51% yoy sales in the two months.

At the interim results briefing on August 25, Harmony management reported -18% yoy net profits in 1H, but reiterated positive net profit growth for the full-year 2020E. The guidance would imply substantial profit acceleration in the forward months, for which we see high visibility on the back of market strength and network expansions. As of June the company is operating 75 dealership stores in 36 cities for 14 luxury and ultra-luxury brands, with 4 stores added via acquisitions in 1H (1 Ferrari, 1 Bentley, and 2 BMW). Management guides to add 8 more stores by year-end (manufacturer authorizations already received across BMW, Lexus, Ferrari, Bentley brands in target cities).

The share price is -16% year-to-date, underperforming premium peers (Zhongsheng/Meidong/Yongda +56%/+177%/+27%) due to the challenged 1H, but we believe the potential turnaround could provide attractive return opportunities for investors. The stock

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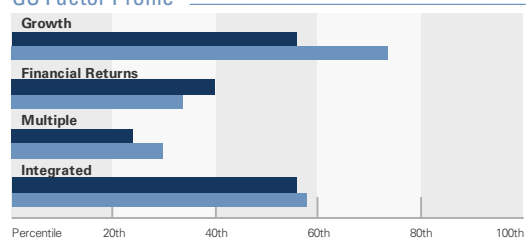
Market cap: HK\$5.2bn / \$673.0mn
Enterprise value: HK\$6.9bn / \$895.9mn
3m ADTV: HK\$8.2mn / \$1.1mn
China
China Autos
M&A Rank: 3
Leases incl. in net debt & EV?: No

GS Forecast

	12/19	12/20E	12/21E	12/22E
Revenue (Rmb mn)	12,621.8	13,355.7	14,929.9	16,589.9
EBITDA (Rmb mn)	961.4	983.9	1,150.9	1,318.1
EPS (Rmb)	0.34	0.36	0.44	0.51
P/E (X)	7.3	8.1	6.6	5.7
P/B (X)	0.5	0.6	0.6	0.5
Dividend yield (%)	2.8	2.5	3.1	3.6
N debt/EBITDA (ex lease,X)	1.2	1.5	1.3	1.2
CROCI (%)	17.1	13.0	14.1	14.6
FCF yield (%)	(5.0)	(4.8)	1.3	2.6

	12/19	6/20	12/20E	--
EPS (Rmb)	0.15	0.15	0.21	-

GS Factor Profile



3836.HK relative to Asia ex. Japan Coverage
3836.HK relative to China Autos

Source: Company data, Goldman Sachs Research estimates.
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Buy

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Rating since Sep 2, 2019

Ratios & Valuation

	12/19	12/20E	12/21E	12/22E
P/E (X)	7.3	8.1	6.6	5.7
P/B (X)	0.5	0.6	0.6	0.5
FCF yield (%)	(5.0)	(4.8)	1.3	2.6
EV/EBITDAR (X)	5.1	6.2	5.4	4.7
EV/EBITDA (excl. leases) (X)	5.1	6.2	5.4	4.7
CROCI (%)	17.1	13.0	14.1	14.6
ROE (%)	7.3	7.6	8.7	9.4
Net debt/equity (%)	15.5	18.9	18.6	17.7
Net debt/equity (excl. leases) (%)	15.5	18.9	18.6	17.7
Interest cover (X)	7.3	8.2	9.8	11.3
Days inventory outst, sales	34.5	35.5	34.6	34.7
Receivable days	3.7	3.7	3.3	3.0
Days payable outstanding	4.0	3.5	3.1	2.8
DuPont ROE (%)	7.0	7.3	8.3	9.0
Turnover (X)	1.1	1.2	1.2	1.3
Leverage (X)	1.6	1.5	1.4	1.4
Gross cash invested (ex cash) (Rmb)	6,037.2	6,402.8	7,036.9	7,723.7
Average capital employed (Rmb)	8,182.9	8,849.0	9,559.8	10,220.3
BVPS (Rmb)	4.80	4.91	5.26	5.67

Growth & Margins (%)

	12/19	12/20E	12/21E	12/22E
Total revenue growth	18.6	5.8	11.8	11.1
EBITDA growth	(15.2)	2.3	17.0	14.5
EPS growth	(24.2)	6.2	22.3	16.7
DPS growth	(32.2)	6.2	22.3	16.7
EBIT margin	6.4	6.1	6.5	6.8
EBITDA margin	7.6	7.4	7.7	7.9
Net income margin	4.1	4.2	4.6	4.9

Price Performance



Income Statement (Rmb mn)

	12/19	12/20E	12/21E	12/22E
Total revenue	12,621.8	13,355.7	14,929.9	16,589.9
Cost of goods sold	(11,534.7)	(12,190.6)	(13,550.3)	(15,028.4)
SG&A	(814.6)	(845.4)	(923.4)	(1,008.5)
R&D	-	-	-	-
Other operating inc./(exp.)	530.6	499.9	520.0	573.8
EBITDA	961.4	983.9	1,150.9	1,318.1
Depreciation & amortization	(158.4)	(164.2)	(174.6)	(191.3)
EBIT	803.0	819.6	976.3	1,126.8
Net interest inc./(exp.)	(110.0)	(100.0)	(100.0)	(100.0)
Income/(loss) from associates	(20.1)	0.0	0.0	-
Pre-tax profit	672.9	719.6	876.3	1,026.8
Provision for taxes	(146.8)	(140.3)	(170.9)	(205.4)
Minority interest	(12.7)	(12.7)	(12.7)	(12.7)
Preferred dividends	-	-	-	-
Net inc. (pre-exceptionals)	513.3	566.6	692.7	808.7
Post-tax exceptionals	-	-	-	-
Net inc. (post-exceptionals)	513.3	566.6	692.7	808.7
EPS (basic, pre-exception) (Rmb)	0.34	0.36	0.44	0.51
EPS (diluted, pre-exception) (Rmb)	0.34	0.36	0.44	0.51
EPS (basic, post-exception) (Rmb)	0.34	0.36	0.44	0.51
EPS (diluted, post-exception) (Rmb)	0.34	0.36	0.44	0.51
DPS (Rmb)	0.07	0.07	0.09	0.10
Div. payout ratio (%)	20.3	20.3	20.3	20.3

Balance Sheet (Rmb mn)

	12/19	12/20E	12/21E	12/22E
Cash & cash equivalents	1,362.1	1,026.0	944.2	902.0
Accounts receivable	134.9	134.9	134.9	134.9
Inventory	1,261.9	1,335.2	1,492.6	1,658.6
Other current assets	2,789.3	2,963.8	3,278.7	3,610.7
Total current assets	5,548.1	5,460.0	5,850.3	6,306.1
Net PP&E	2,691.1	2,860.7	3,134.0	3,440.4
Net intangibles	156.5	156.5	156.5	156.5
Total investments	13.0	13.0	13.0	13.0
Other long-term assets	3,014.0	2,895.6	2,895.6	2,895.6
Total assets	11,422.6	11,385.8	12,049.4	12,811.6
Accounts payable	115.5	115.5	115.5	115.5
Short-term debt	2,493.7	2,493.7	2,493.7	2,493.7
Short-term lease liabilities	-	-	-	-
Other current liabilities	893.8	945.7	1,057.2	1,174.7
Total current liabilities	3,533.4	3,555.0	3,666.4	3,784.0
Long-term debt	-	-	-	-
Long-term lease liabilities	-	-	-	-
Other long-term liabilities	565.7	55.6	55.6	55.6
Total long-term liabilities	565.7	55.6	55.6	55.6
Total liabilities	4,099.1	3,610.6	3,722.1	3,839.6
Preferred shares	-	-	-	-
Total common equity	7,270.3	7,722.0	8,274.1	8,918.8
Minority interest	53.2	53.2	53.2	53.2
Total liabilities & equity	11,422.6	11,385.8	12,049.4	12,811.6
Net debt, adjusted	1,131.6	1,467.7	1,549.5	1,591.7

Cash Flow (Rmb mn)

	12/19	12/20E	12/21E	12/22E
Net income	513.3	566.6	692.7	808.7
D&A add-back	158.4	164.2	174.6	191.3
Minority interest add-back	-	-	-	-
Net (inc)/dec working capital	(608.1)	(618.0)	(360.7)	(380.4)
Other operating cash flow	172.3	0.0	0.0	-
Cash flow from operations	235.9	112.8	506.5	619.6
Capital expenditures	(426.0)	(333.9)	(447.9)	(497.7)
Acquisitions	-	-	-	-
Divestitures	106.2	-	-	-
Others	47.3	0.0	0.0	-
Cash flow from investing	(272.5)	(333.9)	(447.9)	(497.7)
Repayment of lease liabilities	-	-	-	-
Dividends paid (common & pref)	(156.1)	(114.9)	(140.5)	(164.1)
Inc/(dec) in debt	356.1	-	-	-
Other financing cash flows	50.4	0.0	0.0	0.0
Cash flow from financing	250.4	(114.9)	(140.5)	(164.1)
Total cash flow	213.8	(336.0)	(81.9)	(42.2)
Free cash flow	(190.1)	(221.1)	58.7	121.9

Source: Company data, Goldman Sachs Research estimates.

currently trades at 7x 2021E P/E, compared to Zhongsheng/Meidong/Yongda at 14x/28x/8x. Harmony's average market cap per dealership store is at US\$9mn, a considerable discount to Zhongsheng/Meidong/Yongda at US\$39mn/69mn/10mn despite a robust balance sheet (gearing ratio at an industry-low 36.5% in 1H20 / -3.4pp yoy).

Exhibit 1: Valuation comps on luxury dealerships

	Market Cap (US\$mn)	P/E			EV/EBITDA			Number of stores (by 1H20)	Market cap per store (US\$mn)
		2019	2020E	2021E	2019	2020E	2021E		
0881.HK Zhongsheng	14,211	22.3X	18.4X	14.1X	12.5X	11.4X	9.1X	365	39
1268.HK Meidong	4,115	52.6X	41.6X	27.8X	27.6X	23.2X	16.3X	60	69
3669.HK Yongda	2,114	10.1X	9.7X	7.7X	7.3X	7.1X	6.0X	207	10
3836.HK Harmony	673	8.9X	8.4X	6.8X	5.9X	6.2X	5.4X	75	9

Source: Company data, Thomson Reuters

Reiterate Buy rating. Our 12-month target price of HK\$5.90 is based on 15x 2020E P/E, implying 78% upside. Risks: Lower car volumes on macro/trade headwinds, policy overhang, and price competition among luxury.

Disclosure Appendix

Reg AC

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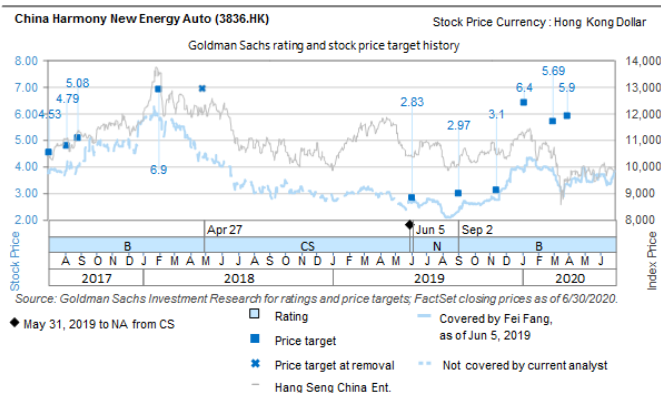
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