

China Harmony Auto

Boosting after sales service the next growth driver

Results Review

1H14 results slightly beat expectation

Revenue grew 36.8% YoY to Rmb5bn, net profit rose 10.2% YoY to Rmb276mn, slightly beat our forecast by 7%.

GPM of new car sales was -2.7ppt YoY to 6.7% in 1H14 due to intensified competition and declining prices in luxury auto markets outside Henan.

After-sales revenue boosted by comprehensive after-sales outlets but lowered GPM. After sales revenue grew 79.7% YoY to Rmb565mn in 1H14, 18.8% of which came from comprehensive after sales outlets. But GPM dropped 4.8ppt to 44%, due to 20~30% lower ASP at comprehensive outlets.

Inventory turnover days remained high at 57 days due to the increase in new 4S shops since 4Q13.

Trends to watch

Comprehensive after-sales outlets to benefit from anti-trust campaign. We believe the major goal of the anti-trust campaign is to cut the high price of auto parts and weaken OEM's strong dominant position in the industry chain. The campaign will have positive impacts on the business model of comprehensive after-sales outlets due to more diversified sources for parts and cheaper prices.

After-sales service continues to weigh more in earnings. 11 comprehensive after-sales service outlets were opened in 1H14, and we estimate another 30~40 will be opened in 2014~15. Total after sales services accounted for 45.4% of total GP in 1H14 (+11.7ppt HoH), and we believe that, driven by comprehensive services, after sales service will grow 83% and 45% in 2014~15, with its contribution to total gross profit rising by 4.7ppt to 50.1% in 2015.

Earnings revisions

We raise 2014/15 earnings forecasts by 10%/8% based on 1H14 results and more positive forecast on after sales business expansion.

Valuation and recommendation

We have a positive view on Harmony's fast expansion in after-sales services. **We keep TP of HK\$7.1, implying 7.8x 2014eP/E. Maintain BUY.**

Wei FENG

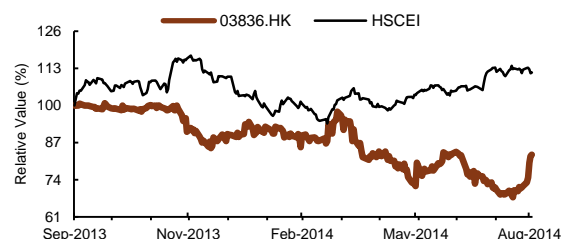
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Maintain BUY

Ticker	03836.HK
Last close	HK\$5.05
CICC target	HK\$7.10
52wk price range	HK\$6.50-4.03
Market cap (bn)	HK\$6
Daily value (mn)	HK\$1.90
Shares outstanding (mn)	1,094
Free float (%)	35
Daily volume (mn sh)	0.43
Business sector	Auto & Parts



(Rmb mn)	2012A	2013A	2014E	2015E
Revenue	5,657	8,333	11,112	13,012
(+/-)	86.6%	47.3%	33.4%	17.1%
Net profit	351	404	561	685
(+/-)	59.2%	15.1%	38.9%	22.2%
EPS	0.32	0.37	0.51	0.63
BPS	0.54	2.03	2.48	3.03
DPS	0.00	0.06	0.08	0.10
CPS	0.08	0.24	0.39	0.73
P/E	12.7	10.7	7.8	6.2
P/B	7.5	1.9	1.6	1.3
EV/EBITDA	8.3	5.0	3.6	2.7
Dividend yield	0.0%	1.6%	2.1%	2.6%
ROAA	12.6%	7.2%	6.7%	6.7%
ROAE	48.7%	28.7%	22.7%	22.7%

Source: Bloomberg, company data, CICC Research



Financial summary

Financial statement (Rmb mn)	2012A	2013A	2014E	2015E	Financial ratios	2012A	2013A	2014E	2015E
Income statement					Growth ability				
Revenue	5,657	8,333	11,112	13,012	Revenue	86.6%	47.3%	33.4%	17.1%
COGS	4,993	7,336	9,612	11,164	Operating profit	64.6%	27.9%	27.8%	26.5%
Selling expenses	237	426	556	651	EBITDA	67.6%	36.5%	31.5%	26.9%
Administrative expenses	72	118	144	169	Net profit	59.2%	15.1%	38.9%	22.2%
Other ops income (expense)	0	0	0	0	Profitability				
Operating profit	591	756	967	1,223	Gross margin	188.3%	188.0%	186.5%	185.8%
Finance costs	116	195	219	310	Operating margin	10.5%	9.1%	8.7%	9.4%
Other Income/ Expense (+/-)	0	0	0	0	EBITDA margin	11.1%	10.3%	10.2%	11.0%
Profit before income tax	475	562	748	914	Net margin	6.2%	4.8%	5.0%	5.3%
Income tax	125	155	187	228	Liquidity				
Net income	600	717	935	1,142	Current ratio	0.71	1.07	1.03	1.06
Minority interest	0	-3	0	0	Quick ratio	0.51	0.79	0.87	0.90
NAPT	351	404	561	685	Cash ratio	0.29	0.51	0.64	0.68
EBITDA	630	859	1,130	1,434	Liability / asset	102.1%	70.9%	70.6%	70.6%
Recurrent net income	351	404	561	685	Net debt / equity	131.6%	-1.0%	-12.1%	-11.7%
Balance sheet					Return				
Cash and bank balances	1,008	2,706	4,161	5,410	RoA	12.6%	7.2%	6.7%	6.7%
Trade and bill receivables	765	1,471	1,522	1,782	RoE	48.7%	28.7%	22.7%	22.7%
Inventories	711	1,527	1,064	1,236	Data per share				
Other current assets	0	0	0	0	EPS(Rmb)	0.32	0.37	0.51	0.63
Total current assets	2,483	5,704	6,747	8,428	BPS(Rmb)	0.54	2.03	2.48	3.03
Fixed assets and CIP	1,151	1,726	2,376	2,727	DPS(Rmb)	0.00	0.06	0.08	0.10
Intangible assets and others	62	141	141	141	CPS(Rmb)	0.08	0.24	0.39	0.73
Total non current assets	1,213	1,868	2,517	2,867	Valuation				
Total assets	3,696	7,572	9,264	11,296	P/E	12.7	10.7	7.8	6.2
ST borrowings	1,778	2,672	3,828	5,018	P/B	7.5	1.9	1.6	1.3
Trade and bill payables	818	1,364	1,522	1,782	EV/EBITDA	8.3	5.0	3.6	2.7
Other current liabilities	882	1,275	1,184	1,170	Dividend yield	0.0%	1.6%	2.1%	2.6%
Total current liabilities	3,478	5,311	6,534	7,970					
LT borrowings	5	12	5	5					
Total non current liabilities	295	61	5	5					
Total liabilities	3,773	5,372	6,539	7,975					
Share capital	0	0	0	0					
Retained profit	589	2,221	2,715	3,310					
Equity	589	2,221	2,715	3,310					
Total liabilities & equity	4,375	7,609	9,267	11,299					
Cash flow statement									
Pretax profit	475	562	748	914					
Depreciation & amortization	38	103	163	211					
Change in working capital	-375	-450	-188	-283					
Others	-47	46	-299	-41					
Cash flow from operating	91	260	424	801					
Capital expenditure	879	633	794	561					
Others	-2,081	-1,236	-1,588	-1,122					
Cash flow from investing	-1,202	-603	-794	-561					
Equity financing	0	1,224	0	0					
Lend from bank	1,208	360	1,400	1,190					
Others	66	520	-252	-399					
Cash flow from financing	1,274	2,104	1,148	791					
Foreign exchange gain (loss)	0	0	0	0					
Net changes in cash	163	1,761	779	1,030					

Source: Company data, CICC Research

Company description

Harmony Auto is the only car dealer in H-share market dedicated purely to luxury and ultra-luxury passenger vehicles, representing brands such as BMW, Lexus, MINI, Land Rover, Rolls Royce, and Aston Martin among others. Luxury car sales give the Company a high gross margin. Harmony now has a dominant position in Henan, and its dealership network covers a dozen 1st and 2nd tier cities such as Beijing, Guangzhou, Shanghai, Xiamen, and Wuhan. The Company strives to become the biggest dealership group specializing in this sector.



Figure 1: Interim financial data

(Rmb mn)	Interim data								Annual data					
	1H11	2H11	2011	1H12	2H12	1H13	2H13	1H14	HoH	YoY	2011	2012	2013	YoY
Revenue	1,418	1,614	3,032	2,952	2,705	3,659	4,673	5,004	7.1%	36.8%	3,032	5,657	8,333	86.6%
Cost of sales	(1,233)	(1,382)	(2,614)	(2,611)	(2,383)	(3,192)	(4,144)	(4,457)	7.5%	39.6%	(2,614)	(4,993)	(7,336)	91.0%
Gross profit	185	232	418	341	322	468	529	548	3.5%	17.1%	418	663	997	58.9%
Other income and gains	25	54	79	76	161	168	135	196	45.8%	16.6%	79	237	303	199.9%
Selling and distribution costs	(45)	(62)	(107)	(109)	(128)	(165)	(262)	(237)	-9.4%	44.0%	(107)	(237)	(426)	122.1%
Administrative expenses	(12)	(18)	(30)	(27)	(44)	(45)	(72)	(51)	-30.0%	12.3%	(30)	(72)	(118)	136.1%
Profit From Operating Activities	154	205	359	281	311	426	330	456	38.2%	7.0%	359	591	756	64.6%
Finance costs	(23)	(39)	(62)	(60)	(57)	(82)	(113)	(98)	-12.7%	19.7%	(62)	(116)	(195)	88.1%
Share of Jointly-controlled entities	-	-	-	-	0	0	0	2	3218.1%	1492.7%	-	0	0	n.m.
Profit Before Tax	131	167	297	221	254	344	217	360	65.7%	4.6%	297	475	562	59.8%
Tax	(34)	(43)	(77)	(57)	(68)	(95)	(60)	(84)	39.4%	-11.7%	(77)	(125)	(155)	61.7%
Minority interests	-	0	0	(0)	0	(1)	(2)	2	n.m.	n.m.	0	0	(3)	543.8%
Net income	97	124	220	165	186	251	159	276	73.8%	10.2%	220	351	410	59.1%
EPS			0.25	0.21	0.19	0.30	0.17	0.26	54.3%	-13.3%	0.25	0.40	0.47	59.1%
Financial ratio														
GP margin	13.1%	14.4%	13.8%	11.6%	11.9%	12.8%	11.3%	10.9%	-0.4%	-1.8%	13.8%	11.7%	12.0%	13.8%
Selling cost / Revenue	3.2%	3.8%	3.5%	3.7%	4.7%	4.5%	5.6%	4.7%	-0.9%	0.2%	3.5%	4.2%	5.1%	3.5%
Administrative expenses / Revenue	0.8%	1.1%	1.0%	0.9%	1.6%	1.2%	1.5%	1.0%	-0.5%	-0.2%	1.0%	1.3%	1.4%	1.0%
Finance expenses / Revenue	1.6%	2.4%	2.0%	2.0%	2.1%	2.2%	2.4%	2.0%	-0.4%	-0.3%	2.0%	2.1%	2.3%	2.0%
Effective tax rate	26.0%	25.8%	25.9%	25.7%	26.7%	27.5%	27.6%	23.2%	-4.4%	-4.3%	25.9%	26.2%	27.6%	25.9%
Net margin	6.8%	7.7%	7.3%	5.6%	6.9%	6.9%	3.4%	5.5%	2.1%	-1.3%	7.3%	6.2%	4.9%	7.3%

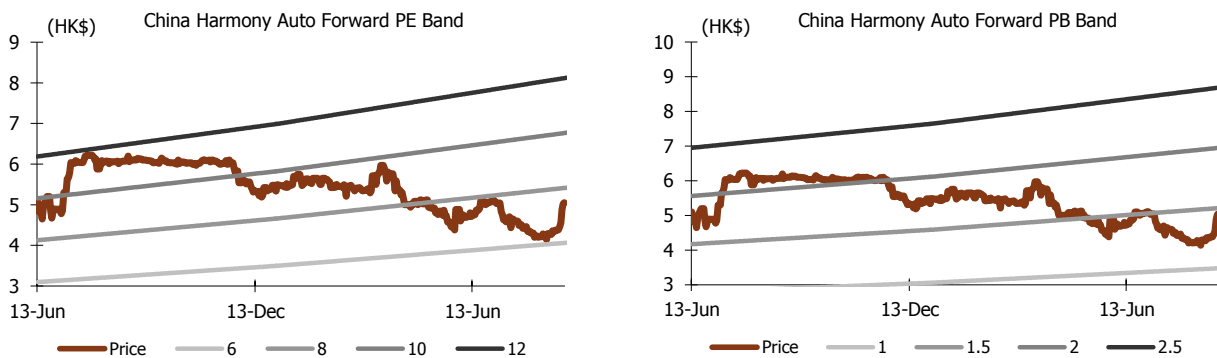
Source: Company data, CICC Research

Figure 2: Earnings forecast revisions

RMB mn	2013	2014E			2015E		
	Actual	Before	After	Change	Before	After	Change
Revenue	8,333	10,333	11,112	7.5%	12,296	13,012	5.8%
COGS	7,336	8,938	9,612	7.5%	10,550	11,164	5.8%
Gross profit	997	1,395	1,500	7.5%	1,746	1,848	5.8%
Other income	303	155	167	7.5%	184	195	5.8%
Selling expenses	426	517	556	7.5%	615	651	5.8%
G&A	118	134	144	7.5%	160	169	5.8%
Financial expenses	195	219	219	0.0%	310	310	0.0%
PBT	562	680	748	10.0%	846	914	8.0%
Income tax	155	170	187	10.0%	212	228	8.0%
Minority interests	(3)	0	0	10.0%	0	0	8.0%
Net income	404	510	561	10.0%	635	685	8.0%
EPS (Rmb)	0.37	0.47	0.51	10.0%	0.58	0.63	8.0%

Source: Wind, CICC Research

Figure 3: P/B and P/E bands



Source: Wind, CICC Research



Figure 4: Comparable valuations

Company	Category	Price 8/30/2014	Market Cap US\$ mn	P/E				P/B				EV/EBITDA			
				11A	12A	13A	14E	11A	12A	13 A	14E	11A	12A	13 A	14E
China A-Share Listcos															
CICC Coverage															
Weichai Power A	CV	20.48	40,946	7.3	13.7	11.4	7.4	1.8	1.6	1.4	1.2	5.3	8.3	7.8	6.4
CNHTC Jinan Truck	CV	13.79	941	16.0	124.5	16.1	11.6	1.5	1.6	1.4	1.3	8.3	21.3	15.8	13.0
Yutong Bus	CV	18.38	3,801	10.5	8.4	12.9	10.1	3.9	1.8	2.7	2.7	13.3	10.2	8.7	5.9
Beqi Foton Motor	CV	5.44	2,488	10.0	11.3	21.0	13.3	1.7	1.0	1.0	1.0	10.4	77.0	12.3	8.3
Jiangling Motor	CV	30.19	4,242	13.9	17.2	15.1	12.6	3.6	3.2	2.9	2.6	8.0	9.4	7.9	6.5
Jianghuai Auto	CV/PV	12.83	2,683	26.8	33.4	16.0	11.2	2.9	2.8	2.4	2.1	15.6	17.4	10.3	7.4
Zhongding Sealing Parts	Parts	11.11	2,017	22.4	12.8	15.5	12.6	4.8	3.5	2.9	2.5	25.2	19.2	16.2	13.7
Huayu Automotive	Parts	11.60	4,878	10.0	9.7	8.6	6.5	1.8	1.6	1.4	1.2	5.1	4.5	4.2	3.8
Songz Automobile AC	Parts	14.29	943	19.2	30.5	25.1	17.9	2.4	2.4	2.3	2.2	16.8	23.1	17.8	12.5
Fuyao Glass	Parts	9.99	3,257	13.2	13.1	11.8	10.5	3.2	2.9	2.7	2.5	8.9	8.3	7.2	6.4
Zhejiang Yinlun	Parts	12.30	656	37.3	94.5	41.0	25.6	3.4	3.3	3.0	2.8	23.6	45.6	24.5	17.3
Weifu Hi-tech	Parts	26.96	4,477	43.2	43.2	24.7	18.3	5.2	3.1	2.8	2.5	16.1	22.4	18.6	15.0
Chang'an Auto A	PV	13.03	9,890	62.8	42.0	17.4	8.2	4.1	3.9	3.2	2.4	47.5	32.6	17.3	9.0
SAIC Motor	PV	16.93	30,385	9.2	9.0	6.7	6.0	1.8	1.5	1.2	1.1	4.4	5.0	4.6	4.5
Joyson Electronics	Parts	27.42	2,839	37.1	76.2	60.9	44.2	19.0	9.5	7.6	6.5	74.0	26.2	21.1	19.5
Consensus															
King Long Motor	CV	11.29	813	20.2	20.2	22.5	17.3	2.6	2.6	2.2	1.8	15.2	15.2	n.a.	n.a.
Dongfeng Automobile	CV	4.32	1,406	13.0	10.9	n.a.	n.a.	1.4	1.3	n.a.	n.a.	13.6	13.6	n.a.	n.a.
FAW Car	PV	10.97	2,906	6.7	6.7	15.7	12.6	1.6	1.6	2.1	1.8	6.5	6.5	n.a.	n.a.
FAW Xiali	PV	4.90	1,272	30.0	30.0	n.a.	n.a.	2.0	2.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Zhejiang Zhongda	Dealer	9.29	1,506	13.9	17.2	n.a.	14.8	2.2	1.9	n.a.	2.0	15.2	17.2	11.8	9.9
Wuhu Yaxia Automobile	Dealer	9.08	406	17.6	20.6	33.0	45.2	2.0	1.9	2.3	2.7	22.9	30.3	18.7	14.4
FAWAY	Parts	25.20	868	12.5	13.6	n.a.	11.1	2.1	1.8	n.a.	1.5	20.5	24.2	26.5	23.3
Aeolus Tyres	Parts	9.83	600	9.7	9.7	n.a.	n.a.	1.5	1.5	n.a.	n.a.	6.7	6.7	n.a.	n.a.
Guizhou Tyres	Parts	5.39	680	6.7	6.7	n.a.	n.a.	0.8	0.8	n.a.	n.a.	13.8	13.8	n.a.	n.a.
Qingdao Doublestar	Parts	5.02	429	12.9	12.9	n.a.	n.a.	1.5	1.5	n.a.	n.a.	7.8	7.8	n.a.	n.a.
Median	Median			13.9	15.4	16.0	12.6	2.1	1.9	2.3	2.1	13.6	17.2	15.7	9.4
HK Listcos															
CICC Estimation															
Weichai Power H	CV	31.40	8,129	8.7	16.3	13.6	11.2	2.1	2.0	1.7	1.5	6.5	11.0	8.4	7.1
Xinyi Glass Holding	Parts	4.89	2,483	14.4	15.8	9.4	7.9	1.3	1.3	1.1	1.0	12.2	12.7	8.0	9.5
Minth Group	Parts	16.50	2,336	17.6	16.5	14.4	12.2	2.3	2.1	1.9	1.7	13.1	13.1	10.3	8.2
Brilliance Auto	PV	14.36	9,345	30.9	24.3	16.7	10.2	8.1	5.6	4.3	3.0	25.5	22.0	15.6	9.7
Geely Auto	PV	2.97	3,385	12.2	9.3	7.3	8.9	2.1	1.4	1.1	1.0	5.3	4.5	3.6	4.1
Great Wall Motor	CV/PV	32.90	12,960	22.8	13.7	9.4	8.4	4.7	3.6	2.8	2.2	18.8	11.8	8.3	7.4
Dongfeng Motor	PV	14.36	16,020	9.2	10.6	9.7	9.7	2.1	1.8	1.5	1.4	5.9	n.m.	n.m.	72.8
Sinotruk	CV	4.07	1,455	8.7	79.4	35.3	21.2	0.5	0.5	0.5	0.5	3.8	6.2	5.2	4.5
Zhongsheng Holdings	Dealer	8.59	2,388	9.0	17.0	11.8	9.3	1.8	1.7	1.5	1.3	10.7	12.6	11.0	9.2
DCH Holdings	Dealer	4.81	1,141	1.6	1.6	0.9	0.9	1.3	1.3	0.7	0.7	6.8	6.9	7.9	6.8
Zhengtong Auto	Dealer	4.14	1,185	13.6	11.8	8.5	6.6	1.1	1.1	0.9	0.8	15.9	8.8	7.8	6.4
Consensus															
Qingling	CV	2.48	794	17.7	20.7	16.5	14.6	0.8	0.9	0.8	0.8	2.3	2.7	2.2	2.2
Baoxin Auto	Dealer	5.75	1,897	21.3	20.5	14.7	11.3	4.8	n.a.	3.1	2.6	21.7	18.0	10.9	8.9
Yonda Auto	Dealer	6.78	1,295	19.4	19.9	17.0	12.5	n.a.	n.a.	2.9	2.3	13.8	13.4	11.3	7.8
Median	Median			13.6	16.5	13.6	9.7	1.9	1.4	1.5	1.3	11.4	11.8	8.3	7.8
Europe & US Listcos															
Man AG	CV	90.01	17,440	55.6	73.2	n.m.	31.2	2.4	2.6	2.6	2.5	6.9	11.4	21.2	13.1
Volvo	CV	84.20	25,839	9.6	15.0	47.6	20.1	2.0	2.6	2.2	2.3	7.0	8.6	10.8	11.3
Paccar	CV	62.69	22,240	21.8	20.0	18.9	17.2	4.2	4.5	3.3	3.0	9.1	8.5	7.9	7.6
Daimler AG	CV/PV	62.21	87,732	11.7	10.3	9.7	10.4	1.7	2.1	1.6	1.4	11.7	11.8	11.7	9.3
FIAT	CV/PV	7.59	12,516	7.0	210.8	10.2	15.7	1.1	0.9	1.1	0.9	4.1	3.0	2.9	2.9
Renault	PV	60.20	23,467	7.8	9.2	28.0	8.9	0.7	1.1	0.8	0.7	10.0	11.9	13.0	9.6
Peugeot	PV	10.72	11,061	5.6	n.m.	n.m.	n.m.	0.2	0.3	0.6	0.8	7.0	12.2	12.7	9.2
BMW	PV	89.14	75,865	12.0	11.5	11.0	9.9	2.2	2.9	1.6	1.5	7.7	7.3	7.9	9.5
VW	PV	171.50	107,638	5.2	3.7	9.2	8.0	1.4	2.0	0.9	0.9	8.4	7.4	6.7	7.2
Ford	CV/PV	17.42	67,563	3.3	11.8	9.6	13.2	4.4	n.m.	2.6	2.3	4.2	5.0	4.8	5.9
GM	CV/PV	34.68	55,650	7.0	11.2	12.8	12.5	2.0	n.a.	1.4	1.4	2.7	6.9	2.8	3.5
Magna	Parts	113.36	24,259	26.6	18.4	16.5	13.1	3.2	3.5	2.6	2.6	11.7	9.8	7.7	7.1
Borgwarner	Parts	61.95	14,150	24.6	27.8	22.7	18.4	5.6	6.6	4.0	3.4	13.6	14.1	12.7	10.1
Autoliv	Parts	103.50	9,609	14.8	20.0	20.3	16.8	2.8	3.7	2.5	2.4	8.1	9.5	8.9	8.2
Elringklinger	Parts	25.77	2,152	17.2	19.1	15.5	14.9	2.8	4.9	2.4	2.2	8.8	9.3	8.3	8.0
Valeo	Parts	91.94	9,630	16.2	18.7	16.1	12.8	3.8	5.6	3.1	2.5	6.5	6.8	6.4	5.5
Median	Median			12.0	18.5	16.1	14.0	2.4	2.9	2.4	2.3	8.1	8.6	7.9	8.0
Japan Listcos															
Isuzu	CV	719	11,742	22.7	21.5	11.0	9.7	5.0	4.4	3.4	3.0	130.4	42.0	17.8	14.1
Hino Motors	CV	1,475	8,158	21.0	11.8	11.9	10.4	4.1	4.6	4.4	3.6	151.8	40.4	26.0	21.6
Nissan	PV	999	43,473	59.9	10.5	9.3	8.1	2.3	2.3	2.5	2.5	n.m.	180.5	87.2	129.6
Toyota	CV/PV	5,928	195,041	26.9	13.3	9.4	8.6	2.8	2.8	2.8	2.5	260.8	n.m.	n.m.	n.m.
Mazda	PV	2,454	14,170	131.9	8.8	8.0	8.1	1.6	1.8	2.9	2.9	8.5	8.5	8.5	8.5
Honda	PV	3,513	61,256	40.9	24.1	10.0	8.9	3.5	3.5	3.7	3.6	n.m.	617.8	118.0	n.m.
Suzuki	PV	3,381	18,260	52.1	28.2	14.7	13.8	2.8	2.7	2.7	2.5	18.5	18.5	17.5	17.6
Denso	Parts	4,513	38,406	24.8	16.4	13.0	11.7	2.4	2.4	2.3	2.0	60.6	19.9	23.9	22.3
Aisin Seiki	Parts	3,845	10,906	27.4	26.0	11.3	10.3	3.1	3.0	2.8	2.4	47.8	25.3	28.0	30.4
Toyota Boshoku	Parts	1,138	2,056	14.5	n.m.	14.3	12.5	1.7	1.6	1.4	1.3	21.8	9.5	11.2	13.3
Jtekt	Parts	1,654	5,448	51.0	71.7	13.0	11.8	2.0	2.0	1.9	1.9	27.5	37.6	24.5	29.6
Median	Median			27.4	19.0	11.3	10.3	2.8	2.7	2.8	2.5	47.8	31.4	24.2	21.6
Global Median				17.6	17.2	14.4	11.7	2.4	2.4	2.4	2.2	11.2	11.9	10.9	9.0
Global Median-CV				16.0	17.1	15.5	11.2	2.3	2.1	2.2	2.0	12.7	12.7	10.5	9.0
Global Median-PV				12.1	11.8	10.0	8.9	2.1	2.2	2.1	1.9	8.5	11.8	12.2	9.2
Global Median-Parts				17.6	18.7	16.0	12.6								

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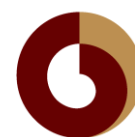
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