

## EARNINGS REVIEW

## China Harmony Auto Holding Ltd (3836.HK)

Neutral

Equity Research

## Above expectations due to other income; aftersales progressing

## What surprised us

Harmony reported 1H14 net profit at Rmb275mn (+10% yoy, +79% hoh), +13% vs GHe. The earnings beat was mainly due to: 1) higher other interest income of Rmb29.8mn coming from its loans to third parties; 2) better expense control (SG&A was 5.8% of revenue vs. 6.5% in 2H13 and GHe's 6.2%); and 3) higher non-operating income; offset by; 4) lower GPM of luxury and super luxury new car sales at 6.7% vs. 8.2% in 2H13 and GHe's 7.0%, due to Harmony's expansion into geographic areas where competition is more intense. The company's new comprehensive aftersales business expanded to 21 outlets as of end-June 2014, achieving 1H14 revenue of Rmb106mn (19% of total aftersales business). In addition, Harmony is cooperating with BMW/Tesla in sales and/or aftersales business of new energy vehicle. Hence, we expect that its new business will grow rapidly in the next 2 years.

## What to do with the stock

We increase our 2014-16E EPS by 6%/4%/3% to reflect higher other income but lower new car sales GPM. Accordingly, we increase our 12-m Director's Cut based TP by 5% to HK\$5.61, implying 7.7% upside. We maintain our Neutral rating. The stock is currently trading at 8.0X 2014E P/E and 6.4X 2014E EV/EBITDA vs. China dealer sector average of 8.6X/6.8X. Risks: higher/lower vol/pricing/GPM of luxury new car sales; quicker/slower growth of new after-service business.

## Harmony 1H14 earnings review

(Rmb mn)	1H2014	GH 1H2014E	Var%	1H2013	YoY%	2H2013	HoH%
Revenue	5,004	5,217	-4%	3,659	37%	4,673	7%
Gross profit	594	630	-6%	500	19%	572	4%
EBIT	363	385	-6%	331	10%	292	24%
Pretax profit	360	331	9%	344	5%	218	65%
<b>Reported net profit</b>	<b>275</b>	<b>243</b>	<b>13%</b>	<b>251</b>	<b>10%</b>	<b>153</b>	<b>79%</b>
<b>Reported EPS (Rmb)</b>	<b>0.25</b>	<b>0.22</b>	<b>13%</b>	<b>0.23</b>	<b>10%</b>	<b>0.14</b>	<b>79%</b>
(%)							
Gross margin	12%	12%	-0.2%	14%	-1.8%	12%	-0.4%
EBIT margin	7%	7%	-0.1%	9%	-1.8%	6%	1.0%
Pretax profit margin	7%	6%	0.8%	9%	-2.2%	5%	2.5%
Net profit margin	5%	5%	0.8%	7%	-1.4%	3%	2.2%

Source: Company data, Gao Hua Securities Research.

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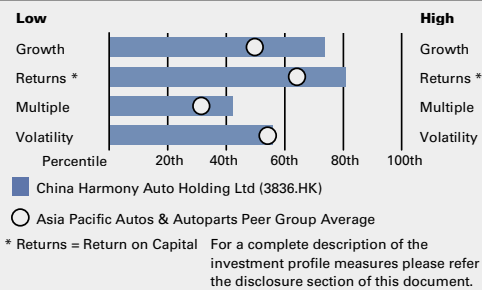
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## Coverage View: Neutral

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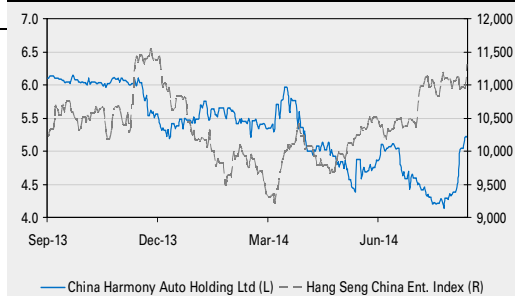
## Investment Profile



Key data	Current
Price (HK\$)	5.21
12 month price target (HK\$)	5.61
Market cap (HK\$ mn / US\$ mn)	7,815.0 / 1,008.4
Foreign ownership (%)	--

	12/13	12/14E	12/15E	12/16E
<b>EPS (Rmb) New</b>	<b>0.42</b>	<b>0.51</b>	<b>0.72</b>	<b>0.84</b>
EPS revision (%)	0.0	6.4	4.4	2.7
EPS growth (%)	(3.2)	21.3	39.9	16.6
<b>EPS (dil) (Rmb) New</b>	<b>0.37</b>	<b>0.51</b>	<b>0.72</b>	<b>0.84</b>
P/E (X)	10.8	8.0	5.7	4.9
P/B (X)	2.3	1.7	1.3	1.1
EV/EBITDA (X)	7.4	6.4	5.2	4.2
Dividend yield (%)	1.5	1.5	2.1	2.4
ROE (%)	28.8	22.8	25.7	24.1
CROCI (%)	33.9	24.7	19.5	19.7

## Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	13.3	(4.9)	(14.6)
Rel. to Hang Seng China Ent. Index	3.8	(18.0)	(22.6)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/03/2014 close.

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# China Harmony Auto Holding Ltd: Summary Financials

Profit model (Rmb mn)	12/13	12/14E	12/15E	12/16E	Balance sheet (Rmb mn)	12/13	12/14E	12/15E	12/16E
<b>Total revenue</b>	<b>8,332.7</b>	<b>10,713.8</b>	<b>13,574.4</b>	<b>15,801.4</b>	Cash & equivalents	1,964.4	1,741.0	1,059.2	1,237.9
Cost of goods sold	(7,260.5)	(9,409.6)	(11,815.6)	(13,736.8)	Accounts receivable	116.8	109.4	177.2	156.4
SG&A	(544.0)	(642.8)	(800.9)	(932.3)	Inventory	1,526.8	1,630.6	2,398.9	2,361.1
R&D	--	--	--	--	Other current assets	2,133.2	2,387.6	3,058.4	3,153.8
Other operating profit/(expense)	169.4	249.9	357.4	455.5	<b>Total current assets</b>	<b>5,741.1</b>	<b>5,868.6</b>	<b>6,693.6</b>	<b>6,909.1</b>
<b>EBITDA</b>	<b>697.7</b>	<b>911.3</b>	<b>1,315.3</b>	<b>1,587.8</b>	Net PP&E	1,722.1	2,250.0	2,716.2	3,127.0
Depreciation & amortization	(75.1)	(94.2)	(129.8)	(149.3)	Net intangibles	4.4	3.9	3.5	3.1
<b>EBIT</b>	<b>622.6</b>	<b>817.1</b>	<b>1,185.5</b>	<b>1,438.5</b>	Total investments	6.5	6.5	6.5	6.5
Interest income	38.4	49.1	43.5	26.5	Other long-term assets	134.9	337.2	674.4	910.4
Interest expense	(194.8)	(215.3)	(221.9)	(232.4)	<b>Total assets</b>	<b>7,609.0</b>	<b>8,466.3</b>	<b>10,094.3</b>	<b>10,956.1</b>
Income/(loss) from uncons. subs.	0.5	0.0	0.0	0.0	Accounts payable	1,363.9	1,309.3	1,691.3	1,646.7
Others	95.4	100.0	50.0	0.0	Short-term debt	2,672.0	2,972.0	3,272.0	3,272.0
<b>Pretax profits</b>	<b>562.0</b>	<b>751.0</b>	<b>1,057.1</b>	<b>1,232.5</b>	Other current liabilities	1,275.5	1,385.1	1,632.8	1,724.6
Income tax	(154.8)	(184.0)	(264.3)	(308.1)	<b>Total current liabilities</b>	<b>5,311.4</b>	<b>5,666.5</b>	<b>6,596.2</b>	<b>6,643.4</b>
Minorities	(3.0)	(3.9)	(4.9)	(5.7)	Long-term debt	48.2	48.2	48.2	48.2
<b>Net income pre-preferred dividends</b>	<b>404.1</b>	<b>563.1</b>	<b>787.9</b>	<b>918.7</b>	Other long-term liabilities	12.3	15.0	15.0	15.5
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	60.5	63.2	63.2	63.7
<b>Net income (pre-exceptionals)</b>	<b>404.1</b>	<b>563.1</b>	<b>787.9</b>	<b>918.7</b>	<b>Total liabilities</b>	<b>5,371.9</b>	<b>5,729.7</b>	<b>6,659.4</b>	<b>6,707.1</b>
Post-tax exceptionals	0.0	0.0	0.0	0.0	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net income</b>	<b>404.1</b>	<b>563.1</b>	<b>787.9</b>	<b>918.7</b>	<b>Total common equity</b>	<b>2,220.8</b>	<b>2,716.4</b>	<b>3,409.8</b>	<b>4,218.2</b>
EPS (basic, pre-exception) (Rmb)	0.42	0.51	0.72	0.84	Minority interest	16.3	20.1	25.0	30.8
EPS (basic, post-exception) (Rmb)	0.42	0.51	0.72	0.84	<b>Total liabilities &amp; equity</b>	<b>7,609.0</b>	<b>8,466.3</b>	<b>10,094.3</b>	<b>10,956.1</b>
EPS (diluted, post-exception) (Rmb)	0.37	0.51	0.72	0.84	<b>BVPS (Rmb)</b>	<b>2.03</b>	<b>2.48</b>	<b>3.12</b>	<b>3.85</b>
DPS (Rmb)	0.07	0.06	0.09	0.10	<b>Ratios</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>
Dividend payout ratio (%)	16.6	12.0	12.0	12.0	CROCI (%)	33.9	24.7	19.5	19.7
Free cash flow yield (%)	(9.3)	(10.0)	(20.1)	6.0	ROE (%)	28.8	22.8	25.7	24.1
<b>Growth &amp; margins (%)</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	ROA (%)	6.7	7.0	8.5	8.7
Sales growth	47.3	28.6	26.7	16.4	ROACE (%)	19.6	19.8	19.1	17.9
EBITDA growth	51.9	30.6	44.3	20.7	Inventory days	56.2	61.2	62.2	63.2
EBIT growth	47.8	31.3	45.1	21.3	Receivables days	3.9	3.9	3.9	3.9
Net income growth	15.2	39.3	39.9	16.6	Payable days	54.8	51.8	46.3	44.3
EPS growth	(3.2)	21.3	39.9	16.6	Net debt/equity (%)	33.8	46.7	65.8	49.0
Gross margin	12.9	12.2	13.0	13.1	Interest cover - EBIT (X)	4.0	4.9	6.6	7.0
EBITDA margin	8.4	8.5	9.7	10.0	<b>Valuation</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>
EBIT margin	7.5	7.6	8.7	9.1	P/E (analyst) (X)	10.8	8.0	5.7	4.9
<b>Cash flow statement (Rmb mn)</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	P/B (X)	2.3	1.7	1.3	1.1
Net income pre-preferred dividends	404.1	563.1	787.9	918.7	EV/EBITDA (X)	7.4	6.4	5.2	4.2
D&A add-back	75.1	94.2	129.8	149.3	EV/GCI (X)	2.2	1.7	1.3	1.1
Minorities interests add-back	3.0	3.9	4.9	5.7	Dividend yield (%)	1.5	1.5	2.1	2.4
Net (inc)/dec working capital	(328.2)	(151.0)	(454.1)	14.0					
Other operating cash flow	106.5	(344.7)	(787.2)	(254.7)					
<b>Cash flow from operations</b>	<b>260.6</b>	<b>165.5</b>	<b>(318.7)</b>	<b>833.0</b>					
Capital expenditures	(668.3)	(621.6)	(595.5)	(559.7)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	36.4	0.0	0.0	0.0					
Others	(1,044.1)	0.0	0.0	0.0					
<b>Cash flow from investments</b>	<b>(1,676.0)</b>	<b>(621.6)</b>	<b>(595.5)</b>	<b>(559.7)</b>					
Dividends paid (common & pref)	0.0	(67.3)	(67.6)	(94.6)					
Inc/(dec) in debt	1,833.0	300.0	300.0	0.0					
Common stock issuance (repurchase)	1,202.8	0.0	0.0	0.0					
Other financing cash flows	1.3	0.0	0.0	0.0					
<b>Cash flow from financing</b>	<b>3,037.1</b>	<b>232.7</b>	<b>232.4</b>	<b>(94.6)</b>					
<b>Total cash flow</b>	<b>1,621.7</b>	<b>(223.4)</b>	<b>(681.8)</b>	<b>178.7</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

## Analyst Contributors

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**Exhibit 1: We revise our 2014-16E estimates**

(Rmb mn)	2014E			2015E			2016E		
	New	Old	Diff.	New	Old	Diff.	New	Old	Diff.
Revenue	10,714	11,342	-6%	13,574	13,638	0%	15,801	15,126	4%
Gross profit	1,304	1,369	-5%	1,759	1,749	1%	2,065	1,946	6%
EBIT	817	836	-2%	1,186	1,133	5%	1,438	1,325	9%
Pretax profit	751	721	4%	1,057	1,013	4%	1,233	1,199	3%
<b>Reported net profit</b>	<b>563</b>	<b>529</b>	<b>6%</b>	<b>788</b>	<b>755</b>	<b>4%</b>	<b>919</b>	<b>894</b>	<b>3%</b>
<b>Reported EPS (Rmb)</b>	<b>0.51</b>	<b>0.48</b>	<b>6%</b>	<b>0.72</b>	<b>0.69</b>	<b>4%</b>	<b>0.84</b>	<b>0.82</b>	<b>3%</b>

Source: Gao Hua Securities Research.

# Disclosure Appendix

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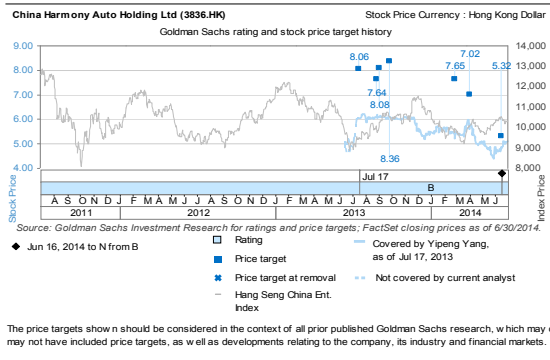
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## Price target and rating history chart(s)



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