

# Harmony Auto (3836.HK)

## Negative have come to an end

China | Automobile retail | Company Initiation

12 July 2017

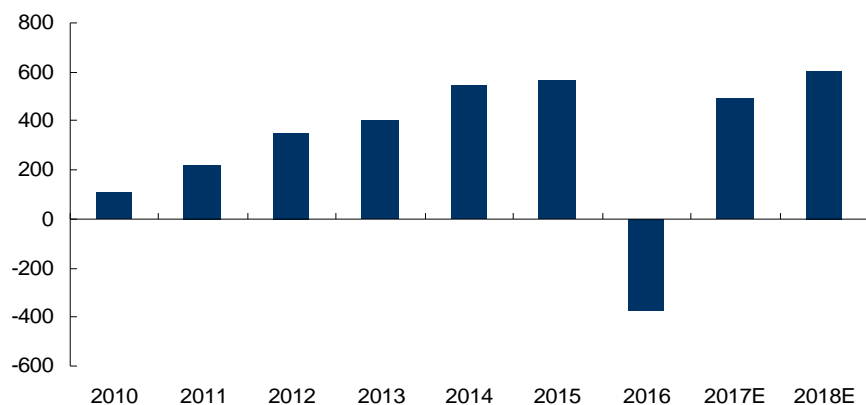
### Company Profile:

Harmony Auto, headquartered in Henan Province, engages mainly in 4S store business of luxury and ultra-luxury car brands. It has 11 luxury and ultra-luxury car brands, including 7 luxury car brands – BMW, Lexus, MINI, Jaguar, Land Rover, Volvo, Zinoro, and 4 ultra-luxury ones – Rolls Royce, Aston Martin, Ferrari, Maserati. At the end of 2016, the Company had 47 dealer outlets in total covering 21 cities in China, such as Beijing, Guangzhou, Shanghai, Xiamen, Wuhan, Shenyang, Tangshan, Zhengzhou, of which approximately 29 are in Henan Province. The Company was listed in HKEX in June, 2013. Its sales volume reached 24,620 in 2016 with a yoy increase of 6.2%, of which, 23,223 were luxurious cars, increased by 5% yoy, and 1,397 were super-luxurious cars, spiking by 32% yoy.

### Financial Analyst

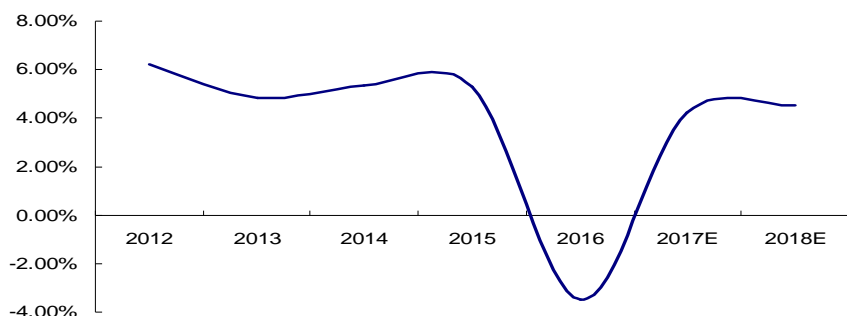
In 2016, the Company's revenue remained stable, with a yoy increase by 0.7% to RMB 10,700 million. Loss of profit attributable to shareholders was RMB 370 million, compared with that of the same period of former years, profit attributable to shareholders was RMB 560 million. EPS was RMB -0.24. The performance turned gains into losses, mainly because of: 1) the provisions of the expenses used for R&D and operations of new energy cars at the early stage and a lump-sum impairment of RMB 290 million, 2) and the great losses caused by the early input into independent after-sales repair business (more than RMB 200 million). 3) Moreover, sales promotion for speeding up capital turnover reduced the gross profit margin from 10.6% to 7.2%.

#### Net profit trend



Source: Company, Phillip Securities Hong Kong Research

#### Key margin trend



Source: Company, Phillip Securities Hong Kong Research

### Accumulate (Initiation)

CMP: HKD 3.78

(Closing price as at 10 July 2017)

TARGET: HKD 4.10 (+8.5%)

#### COMPANY DATA

O/S SHARES (MN) :	1570
MARKET CAP (CNY MN) :	5956
52 - WK HI/LO (CNY):	4.68/ 2.44

#### SHARE HOLDING PATTERN, %

Eagle Seeker Company Ltd.	43.79
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#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY15	FY16	FY17E	FY18E
Net Sales	10,620	10,696	11,727	13,412
Net Profit	563	-371	496	605
EPS, CNY	0.39	-0.24	0.32	0.39
P/E, x	8.1	(14.2)	10.3	8.6
BVPS, CNY	4.07	3.46	3.85	4.14
P/BV, x	0.8	1.0	0.9	0.8
DPS (CNY)	0.10	0.00	0.09	0.11
Div. Yield (%)	3.3%	0.0%	2.7%	3.3%

Source: Company reports, Phillip Securities Est.

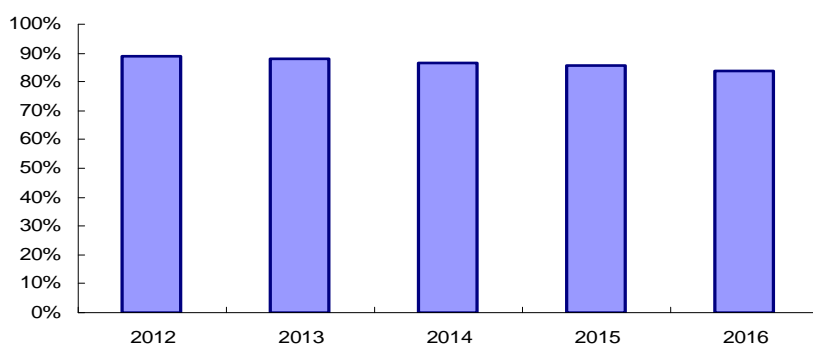
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In terms of different sectors, the sales revenue of new cars increased by 4.2% yoy to RMB 9,310 million, with its gross margin decreased from 4.1% to 2.2%; the revenue of after-sales service decreased by 18% to RMB 1,387 million yoy, with its gross margin reduced from 45% to 41%. Apart from increased sales promotion, Henan government has lift requirements for environmental protection, which has enormous influences on the Company's after-sales business, resulting in decreased revenue and gross margin. On the other hand, sales expenses and administrative expenses increased by 31% and 34%, respectively, because of the large quantity of early input into its independent after-sales business.

### Negative come to an end and the Company has re-focused on its main business

In order to turn the unfavorable tide, the Company has adjusted the business strategy. Recently, the Company has introduced the strategic investors, Leagur Automobile and AOTO Investment, to increase the capital and expand shares of its independent after-sales companies. After investment, the Company's shareholding will decrease from 100% to 49.28%. The independent after-sales companies will seek for A-share listing in the future, from which the Company is likely to improve its investment gain for higher valuation. As for the new energy car sector, the Company has reflected its radical measures in the past and shrunk the low-end electric vehicle business selectively with a lump-sum impairment provision of RMB 240 million. Its high-end new energy vehicle platform FMC, the Company holds 33% of the shares and will bear no burden for its performance in 2017.

#### Proportion of BMW sales in total new car sales



Source: Company, Phillip Securities Hong Kong Research

In 2017, the Company will re-concentrate on its main business and plan to open 15 new 4S stores. BMW is the largest brand in the Company, accounting for 83.6% of the sales volume, the highest among the listed companies. The Company's sales performance will benefit most from BMW's powerful cycle of new product development. It is expected that the Company's gross margin and profit level will be recovered greatly compared with those of 2016 on average.

### Investment Thesis

We expected diluted EPS of the Company will return to RMB 0.32 and 0.39 for 2017/2018. And we accordingly gave the target price to 4.1, respectively 11.2/9.3x P/E for 2017/2018. "Accumulate" rating. (Closing price as at 10 July 2017)

## Financials

FYE DEC	FY11	FY13	FY14	FY15	FY16	FY17F	FY18F
<b>Valuation Ratios</b>							
P/E (X), adj.	15.0	8.0	6.0	8.1	(14.2)	10.3	8.6
P/B (X)	2.4	1.5	1.2	0.8	1.0	0.9	0.8
Dividend Yield (%)	0.9%	2.3%	2.9%	3.3%	0.0%	2.7%	3.3%
Dividend payout ratio (%)	14.6%	18.8%	17.5%	26.7%	0.0%	27.9%	28.0%
<b>Per share data (RMB)</b>							
EPS, (Basic)	0.207	0.369	0.497	0.391	(0.236)	0.322	0.393
EPS, (Diluted)	0.192	0.369	0.497	0.391	(0.236)	0.322	0.393
DPS	0.028	0.070	0.087	0.104	0.000	0.090	0.110
BVPS	1.29	2.03	2.49	4.07	3.46	3.85	4.14
<b>Growth &amp; Margins (%)</b>							
<b>Growth</b>							
Revenue	4.3%	Na	22.4%	4.2%	0.7%	9.6%	14.4%
EBIT	11.6%	Na	22.1%	-0.3%	-84.8%	441.5%	21.1%
Net Income, adj.	12.8%	Na	34.7%	3.5%	-165.9%	-233.7%	22.0%
<b>Margins</b>							
Gross margin	18.2%	12.0%	10.7%	10.6%	7.2%	10.3%	10.5%
EBIT margin	11.4%	9.1%	9.1%	8.7%	1.3%	6.5%	6.8%
Net Profit Margin	7.4%	4.8%	5.3%	5.3%	-3.5%	4.2%	4.5%
<b>Key ratios (%)</b>							
ROE	17.5%	28.8%	22.0%	13.1%	-6.6%	8.7%	9.8%
ROA	5.6%	6.7%	6.9%	5.8%	-3.6%	5.1%	5.9%
<b>Income Statement (RMB mn)</b>							
Revenue	20,965	8,333	10,196	10,620	10,696	11,727	13,412
Gross profit	3,820	997	1,089	1,122	770	1,207	1,408
EBIT	2,394	756	923	920	140	758	918
Profit before tax	2,183	562	726	763	(321)	672	821
Tax	(467)	(155)	(181)	(195)	(47)	(172)	(210)
Profit for the period	1,716	407	545	568	(368)	500	611
Minority interests	(172)	3	1	5	3	4	6
Total capital share	7,450	1,094	1,094	1,440	1,570	1,540	1,540
Net profit	1,543	404	544	563	(371)	496	605

Source: PSR

(Financial figure as at 10 July 2017)

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Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm$ 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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