

China Harmony New Energy Auto (3836.HK)

Above-expectation 1H21 earnings; Buy

BUY

3836.HK | 12m Price Target: **HK\$7.70** | Price: **HK\$4.09** | Upside: **88.3%**

Harmony reported above-expectation 1H21 results: revenues of Rmb9.4bn, +63% yoy, +25% / +25% ahead of GSe / Bloomberg consensus. Net profits were Rmb391mn, +66% yoy, +39% / +41% ahead of GSe / Bloomberg consensus. The group has achieved record-high new car sales volume, new car sales margin, aftersales business and the fastest inventory turnover in history. The operational improvements, together with the Chinese passenger vehicle industry's accelerating premiumization, would create visible growth for the company in our view. Takeaways:

- New car sales:** The group recorded 22,447 units of new car sales in 1H21, +54% yoy, among which luxury vehicle increased +53% yoy to 21,972 units and ultra-luxury grew +127% yoy to 475 units. The group operates its core brands at a faster growth pace when compared with the brands' overall performance in China: BMW, which contributes to approx. 76% of the company's aggregate sales volume, has increased +51% yoy to 17,116 units, outpacing the brand's overall growth of 42% yoy in 1H21; Harmony operates Lexus, Volvo, Bentley and Rolls Royce with 1H21 yoy growth of +29% / +47% / +353% / +78%, all outpacing the corresponding brands' overall growth of +27% / +36% / +33% / +71% yoy. The group managed to enhance the profitability with new car sales margin growth of 0.5pp yoy to 4.2% in 1H21.
- Aftersales:** 1H21 aftersales service revenue was Rmb1.1bn, +53% yoy, contributing to 12% of total revenue. The segment reported gross margin at 44.6% in 1H21, +0.2pp yoy. According to management, the group totally serviced 209,114 units of vehicles for the aftersales business, +40% yoy.
- Network:** As of Jun 2021, the group managed 79 outlets in 15 provinces and 39 cities, with 4 new additions in 1H21: 2 Ferrari

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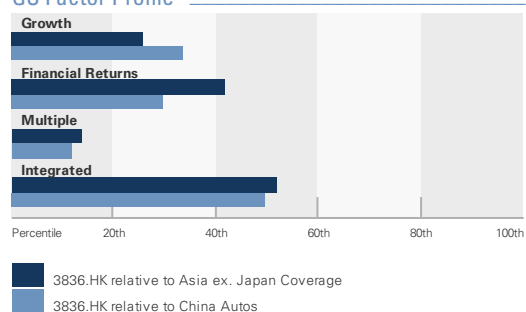
Key Data

Market cap: HK\$6.3bn / \$811.1mn
Enterprise value: HK\$7.3bn / \$939.4mn
3m ADTV: HK\$15.4mn / \$2.0mn
China
China Autos
M&A Rank: 3
Leases incl. in net debt & EV?: No

GS Forecast

	12/20	12/21E	12/22E	12/23E
Revenue (Rmb mn) New	14,746.9	17,688.1	18,868.7	19,834.0
Revenue (Rmb mn) Old	14,746.9	16,347.6	17,862.2	19,227.8
EBITDA (Rmb mn)	938.5	1,198.0	1,347.9	1,461.5
EPS (Rmb) New	0.27	0.45	0.52	0.56
EPS (Rmb) Old	0.27	0.40	0.47	0.53
P/E (X)	11.9	7.6	6.6	6.0
P/B (X)	0.7	0.7	0.6	0.6
Dividend yield (%)	2.1	3.4	3.9	4.2
CROCI (%)	16.9	16.5	18.6	19.2
	12/20	6/21	12/21E	--
EPS (Rmb)	0.11	0.25	0.20	-

GS Factor Profile



Source: Company data, Goldman Sachs Research estimates. See disclosures for details.

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Buy

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Rating since Sep 2, 2019

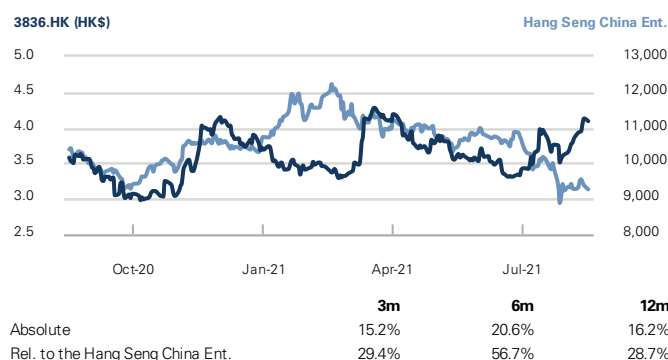
Ratios & Valuation

	12/20	12/21E	12/22E	12/23E
P/E (X)	11.9	7.6	6.6	6.0
P/B (X)	0.7	0.7	0.6	0.6
FCF yield (%)	12.2	5.6	9.5	9.7
EV/EBITDAR (X)	6.2	5.1	4.3	3.8
EV/EBITDA (excl. leases) (X)	6.2	5.1	4.3	3.8
CROCI (%)	16.9	16.5	18.6	19.2
ROE (%)	5.6	8.9	9.6	9.7
Net debt/equity (%)	11.8	9.6	5.5	2.0
Net debt/equity (excl. leases) (%)	11.8	9.6	5.5	2.0
Interest cover (X)	5.6	8.3	9.3	10.1
Days inventory outst, sales	29.1	21.3	19.4	19.6
Receivable days	3.6	3.2	3.0	2.9
Days payable outstanding	5.2	6.0	5.6	5.4
DuPont ROE (%)	5.4	8.6	9.2	9.3
Turnover (X)	1.2	1.4	1.4	1.4
Leverage (X)	1.6	1.5	1.5	1.5
Gross cash invested (ex cash) (Rmb)	6,136.4	5,825.5	6,118.6	6,472.1
Average capital employed (Rmb)	8,446.4	8,635.6	8,980.2	9,303.5
BVPS (Rmb)	4.87	5.18	5.57	5.98

Growth & Margins (%)

	12/20	12/21E	12/22E	12/23E
Total revenue growth	16.8	19.9	6.7	5.1
EBITDA growth	(2.4)	27.6	12.5	8.4
EPS growth	(21.2)	68.2	14.7	9.1
DPS growth	(0.8)	68.4	14.7	9.1
EBIT margin	5.1	5.7	6.0	6.1
EBITDA margin	6.4	6.8	7.1	7.4
Net income margin	2.8	3.9	4.2	4.4

Price Performance



Source: FactSet. Price as of 16 Aug 2021 close.

Income Statement (Rmb mn)

	12/20	12/21E	12/22E	12/23E
Total revenue	14,746.9	17,688.1	18,868.7	19,834.0
Cost of goods sold	(13,448.1)	(16,142.0)	(17,188.7)	(18,036.0)
SG&A	(888.3)	(952.4)	(1,013.5)	(1,077.7)
R&D	-	-	-	-
Other operating inc./(exp.)	339.5	406.0	460.6	496.8
EBITDA	938.5	1,198.0	1,347.9	1,461.5
Depreciation & amortization	(188.5)	(198.3)	(220.9)	(244.4)
EBIT	750.0	999.7	1,127.0	1,217.2
Net interest inc./(exp.)	(134.1)	(120.6)	(120.6)	(120.6)
Income/(loss) from associates	1.3	0.0	-	-
Pre-tax profit	617.3	879.1	1,006.3	1,096.5
Provision for taxes	(195.2)	(175.8)	(201.3)	(219.3)
Minority interest	(11.4)	(11.4)	(11.4)	(11.4)
Preferred dividends	-	-	-	-
Net inc. (pre-exceptionals)	410.7	691.8	793.6	865.8
Post-tax exceptionals	-	-	-	-
Net inc. (post-exceptionals)	410.7	691.8	793.6	865.8
EPS (basic, pre-exception) (Rmb)	0.27	0.45	0.52	0.56
EPS (diluted, pre-exception) (Rmb)	0.27	0.45	0.51	0.56
EPS (basic, post-exception) (Rmb)	0.27	0.45	0.52	0.56
EPS (diluted, post-exception) (Rmb)	0.27	0.45	0.51	0.56
DPS (Rmb)	0.07	0.11	0.13	0.14
Div. payout ratio (%)	25.5	25.6	25.6	25.6

Balance Sheet (Rmb mn)

	12/20	12/21E	12/22E	12/23E
Cash & cash equivalents	1,714.3	1,832.6	2,129.7	2,419.9
Accounts receivable	155.4	155.4	155.4	155.4
Inventory	1,093.6	972.8	1,037.8	1,090.9
Other current assets	3,084.1	2,824.2	2,800.8	2,827.2
Total current assets	6,047.3	5,785.1	6,123.7	6,493.3
Net PP&E	2,914.1	3,246.5	3,591.7	3,942.4
Net intangibles	279.4	279.4	279.4	279.4
Total investments	14.3	14.3	14.3	14.3
Other long-term assets	3,097.2	3,065.4	3,065.4	3,065.4
Total assets	12,352.4	12,390.7	13,074.5	13,794.8
Accounts payable	264.4	264.4	264.4	264.4
Short-term debt	2,604.4	2,604.4	2,604.4	2,604.4
Short-term lease liabilities	-	-	-	-
Other current liabilities	1,140.0	1,402.7	1,496.3	1,572.9
Total current liabilities	4,092.7	4,271.5	4,365.2	4,441.7
Long-term debt	-	-	-	-
Long-term lease liabilities	-	-	-	-
Other long-term liabilities	712.2	57.3	57.3	57.3
Total long-term liabilities	712.2	57.3	57.3	57.3
Total liabilities	4,804.9	4,328.8	4,422.4	4,499.0
Preferred shares	-	-	-	-
Total common equity	7,488.0	8,002.5	8,592.6	9,236.4
Minority interest	59.4	59.4	59.4	59.4
Total liabilities & equity	12,352.4	12,390.7	13,074.5	13,794.8
Net debt, adjusted	890.1	771.8	474.7	184.5

Cash Flow (Rmb mn)

	12/20	12/21E	12/22E	12/23E
Net income	410.7	691.8	793.6	865.8
D&A add-back	188.5	198.3	220.9	244.4
Minority interest add-back	-	-	-	-
Net (inc)/dec working capital	(137.9)	(63.7)	52.1	(2.9)
Other operating cash flow	338.2	0.0	-	-
Cash flow from operations	799.5	826.4	1,066.6	1,107.3
Capital expenditures	(191.9)	(530.6)	(566.1)	(595.0)
Acquisitions	(179.8)	-	-	-
Divestitures	142.2	-	-	-
Others	(0.8)	0.0	-	-
Cash flow from investing	(230.3)	(530.6)	(566.1)	(595.0)
Repayment of lease liabilities	-	-	-	-
Dividends paid (common & pref)	(104.0)	(177.4)	(203.5)	(222.0)
Inc/(dec) in debt	110.7	-	-	-
Other financing cash flows	(233.7)	0.0	0.0	0.0
Cash flow from financing	(227.0)	(177.4)	(203.5)	(222.0)
Total cash flow	342.3	118.3	297.0	290.2
Free cash flow	607.6	295.7	500.5	512.2

Source: Company data, Goldman Sachs Research estimates.

located in Qingdao and Nanjing respectively, 1 Lexus in Cangzhou, and 1 Lamborghini in Wenzhou. The group has 4 additional authorizations in hand: 1 Ferrari, 1 Bentley, 1 Lamborghini and 1 Lexus. We expect the group to continue to focus on the luxury and ultra-luxury brands.

- **Inventory:** Inventory turnover improved: the group level inventory turnover days declined from 32 days in 2020 to 24 days in 1H21, with luxury brands falling from 30 days in 2020 to 23 days in 1H21, and ultra-luxury brands falling from 52 days to 34 days.
- **2H21 outlook:** Management reiterated the observation of strong demand on luxury / ultra-luxury vehicles, though citing the adverse impacts of rainstorm in Henan in July (39 out of the 79 outlets are located in Henan province) and the recurrence of covid cases in some regions. Management expect limited impacts over the semi-conductor shortage given their operating brands are generally assigned with production priority within OEM.

Valuation and risks

Buy. We increase 2021-23E net income by 7-13% to reflect the improving core business of new car sales and aftersales; we maintain our valuation method of 15x 2021E P/E unchanged. Correspondingly, our 12-month target price has increased from HK\$6.8 to HK\$7.7. Risks: Lower car volumes on macro/trade headwinds, policy overhang, and price competition among luxury.

Disclosure Appendix

Reg AC

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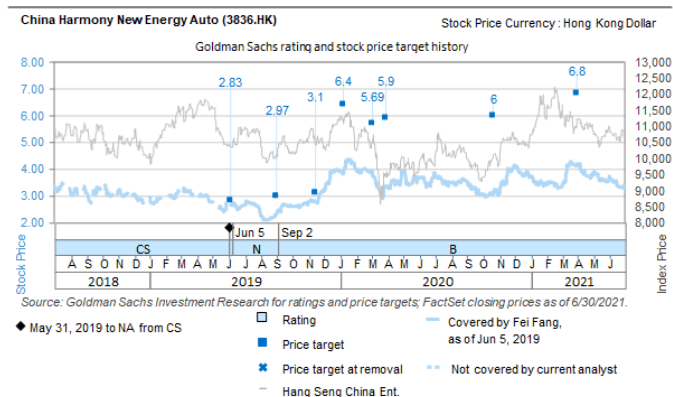
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