

28 Dec 2021 03:36:08 ET | 34 pages

Harmony Auto (3836.HK)

Initiate at Buy: Unique Ultra-luxury/ Luxury Brand Mix, 21-23E NP CAGR at 11%; TP of HK\$8.8

CITI'S TAKE

We initiate at Buy and with a TP of HK\$8.8 on Harmony, a luxury auto dealership group with a focus in central China. The company has a unique ultra-luxury brand mix that includes Rolls-Royce, Bentley, Ferrari, Lamborghini and Maserati. We forecast a 10.7% NP CAGR in 21-23E.

Unique mix of ultra-luxury brands — With around 20-30% of its stores focused on ultra-luxury brands in the recent 3 years and decent exposure in top-tier cities (46% of current dealer stores are in 1st-tier and new 1st-tier cities as end of 1H21), we expect relatively high ASP and margins for Harmony in both new car sales and after-sales services. Also, Harmony's new car sales should be supported by strong product cycles for key brands BMW/Lexus (over 80% of new car sales volume in 1H21).

Positive outlook for after-sales business — We see strong earnings growth for after-sales services on a relatively young blended store age (over 50% of stores had opened in last 5 years as end-1H21) and the contribution from ultra-luxury brands.

Asset-light business model in NEV — Aligning with the auto sector's electrification trend, Harmony has a strategic investment in Dangdang, an asset-light franchise focused on NEV after-sales services. (Dangdang's store capex is only 10-15% that of traditional 4S stores.) We expect Dangdang to start to post positive FCF in 2023E.

Valuation — Our SoTP-derived TP for Harmony of HK\$8.8 is based on: 1) 15.5x 22E P/E (sector average) for new car sales to factor in a decent earnings outlook given the strong product cycle of the key brands (BMW/Lexus) as well as the company's unique ultra-luxury brand portfolio; and 2) 24x 22E P/E (sector average) for the after-sales segment on the contribution from ultra-luxury brands and steady SSSG as the blended store age gradually matures. Our valuation implies 16.3x blended 22E P/E, 1.3x 21-23E PEG (lower than Yongda's 1.5x) and 1.6x 22E P/B.

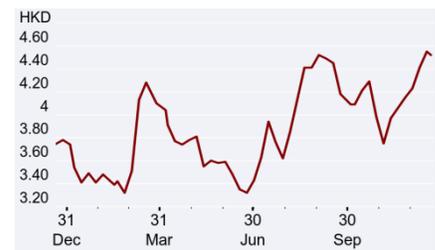
Downside risks — Key downside risks include 1) a weak macro which dampens overall purchasing power in China; 2) in a worst-case scenario, a full write-off of Byton (Baiteng) might incur a one-off cost of Rmb1.2bn for FY21, which could lead to FY21E NP loss (though such a one-off would not impact our earnings forecasts for FY22 and beyond); 3) a slower-than-expected network expansion pace; and 4) intensified competition could weigh on profitability, especially for new car sales.

Buy

Price (24 Dec 21 16:10)	HK\$4.58
Target price	HK\$8.80
Expected share price return	92.1%
Expected dividend yield	1.5%
Expected total return	93.7%
Market Cap	HK\$7,189M US\$922M

Price Performance

(RIC: 3836.HK, BB: 3836 HK)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RmbM)	(Rmb)	(%)	(x)	(x)	(%)	(%)
2019A	513	0.339	-23.4	10.9	0.8	7.3	1.9
2020A	411	0.266	-21.5	13.9	0.8	5.6	1.8
2021E	751	0.486	82.8	7.6	0.7	9.7	3.4
2022E	832	0.539	10.8	6.9	0.7	10.0	3.9
2023E	920	0.596	10.6	6.2	0.6	10.2	4.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and Research Analyst Affiliations.

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3836.HK: Fiscal year end 31-Dec						Price: HK\$4.52; TP: HK\$8.80; Market Cap: HK\$7,095m; Recomm: Buy					
Profit & Loss (Rmbm)	2019	2020	2021E	2022E	2023E	Valuation ratios	2019	2020	2021E	2022E	2023E
Sales revenue	12,622	14,747	18,074	21,830	24,245	PE (x)	10.9	13.9	7.6	6.9	6.2
Cost of sales	-11,535	-13,448	-16,341	-19,807	-21,930	PB (x)	0.8	0.8	0.7	0.7	0.6
Gross profit	1,087	1,299	1,732	2,023	2,315	EV/EBITDA (x)	3.8	4.6	3.1	3.0	2.7
Gross Margin (%)	8.6	8.8	9.6	9.3	9.5	FCF yield (%)	-3.4	10.7	5.2	3.2	5.4
EBITDA (Adj)	961	939	1,349	1,384	1,521	Dividend yield (%)	1.9	1.8	3.4	3.9	4.4
EBITDA Margin (Adj) (%)	7.6	6.4	7.5	6.3	6.3	Payout ratio (%)	20	26	26	27	27
Depreciation	-154	-183	-198	-222	-251	ROE (%)	7.3	5.6	9.7	10.0	10.2
Amortisation	-4	-5	0	0	0	Cashflow (Rmbm)	2019	2020	2021E	2022E	2023E
EBIT (Adj)	272	411	697	665	754	EBITDA	961	939	1,349	1,384	1,521
EBIT Margin (Adj) (%)	2.2	2.8	3.9	3.0	3.1	Working capital	-603	-92	-108	-216	-134
Net interest	-110	-134	-134	-134	-134	Other	-122	-47	-400	-331	-350
Associates	-20	1	0	0	0	Operating cashflow	236	800	841	837	1,037
Non-Op/Except/Other Adj	531	340	454	497	516	Capex	-426	-192	-542	-655	-727
Pre-tax profit	673	617	1,016	1,028	1,136	Net acq/disposals	193	18	0	0	0
Tax	-147	-195	-254	-185	-204	Other	-40	-57	0	0	0
Extraord./Min.Int./Pref.div.	-13	-11	-11	-11	-11	Investing cashflow	-273	-230	-542	-655	-727
Reported net profit	513	411	751	832	920	Dividends paid	-159	-104	-196	-222	-250
Net Margin (%)	4.1	2.8	4.2	3.8	3.8	Financing cashflow	-26	-208	-196	-222	-250
Core NPAT	513	411	751	832	920	Net change in cash	214	342	102	-39	60
Per share data	2019	2020	2021E	2022E	2023E	Free cashflow to s/holders	-190	608	299	182	309
Reported EPS (Rmb)	0.339	0.266	0.486	0.539	0.596						
Core EPS (Rmb)	0.339	0.266	0.486	0.539	0.596						
DPS (Rmb)	0.069	0.068	0.127	0.144	0.162						
CFPS (Rmb)	0.156	0.518	0.545	0.542	0.672						
FCFPS (Rmb)	-0.126	0.394	0.193	0.118	0.200						
BVPS (Rmb)	4.803	4.872	5.210	5.605	6.039						
Wtd avg ord shares (m)	1,514	1,537	1,539	1,539	1,539						
Wtd avg diluted shares (m)	1,514	1,543	1,544	1,544	1,544						
Growth rates	2019	2020	2021E	2022E	2023E						
Sales revenue (%)	18.6	16.8	22.6	20.8	11.1						
EBIT (Adj) (%)	421.1	50.7	69.7	-4.5	13.3						
Core NPAT (%)	-24.9	-20.0	82.8	10.8	10.6						
Core EPS (%)	-23.4	-21.5	82.8	10.8	10.6						
Balance Sheet (Rmbm)	2019	2020	2021E	2022E	2023E						
Cash & cash equiv.	1,543	1,955	2,058	2,018	2,078						
Accounts receivables	135	155	155	155	155						
Inventory	1,262	1,094	994	1,201	1,333						
Net fixed & other tangibles	3,396	3,740	4,052	4,485	4,962						
Goodwill & intangibles	156	279	279	279	279						
Financial & other assets	4,931	5,129	4,923	5,230	5,423						
Total assets	11,423	12,352	12,461	13,369	14,231						
Accounts payable	116	264	264	264	264						
Short-term debt	2,494	2,604	2,604	2,604	2,604						
Long-term debt	0	0	0	0	0						
Provisions & other liab	1,490	1,936	1,491	1,788	1,980						
Total liabilities	4,099	4,805	4,359	4,657	4,849						
Shareholders' equity	7,270	7,488	8,043	8,653	9,323						
Minority interests	53	59	59	59	59						
Total equity	7,323	7,547	8,102	8,712	9,382						
Net debt (Adj)	951	649	547	586	526						
Net debt to equity (Adj) (%)	13.0	8.6	6.7	6.7	5.6						

For definitions of the items in this table, please click [here](#).

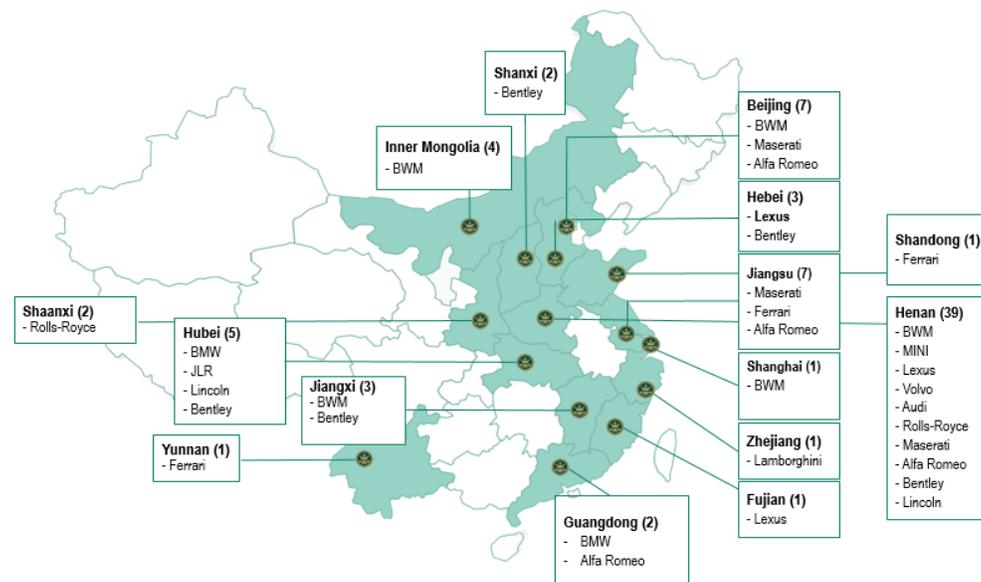
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Harmony Auto: Riding on Ultra-luxury and Luxury Franchise/ After-sales Services/ NEV

Harmony Auto is a leading automotive dealer group in China, representing 14 luxury and ultra-luxury brands in 39 cities across the country. The company deeply engages with auto franchises on new car sales, after services, and financial leasing.

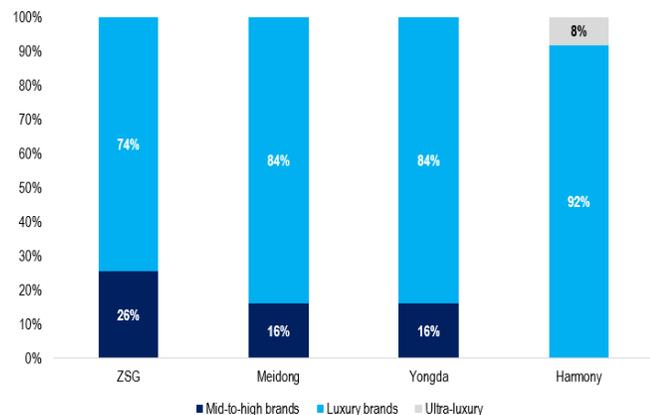
Figure 1. Harmony: Distribution Network



Source: Company Reports

Notably, Harmony offers a unique investment exposure to the growth potential of luxury car brands that are not offered by the brand-mix of its peers. Harmony works with 9 luxury brands including BMW, MINI, Audi, Volvo, Land Rover, Lexus, Jaguar, Lincoln, Alfa Romeo and 5 ultra-luxury brands (Rolls-Royce, Bentley, Ferrari, Lamborghini, and Maserati). As of June 30, 2021, the company had a total of 79 authorized dealership outlets in 39 cities across 15 provinces. As of end of FY20, ultra-luxury new car sales accounted for 8% of Harmony's total new car sales revenue.

Figure 2. Peer Comparison: Brand-mix (as of end-1H21)



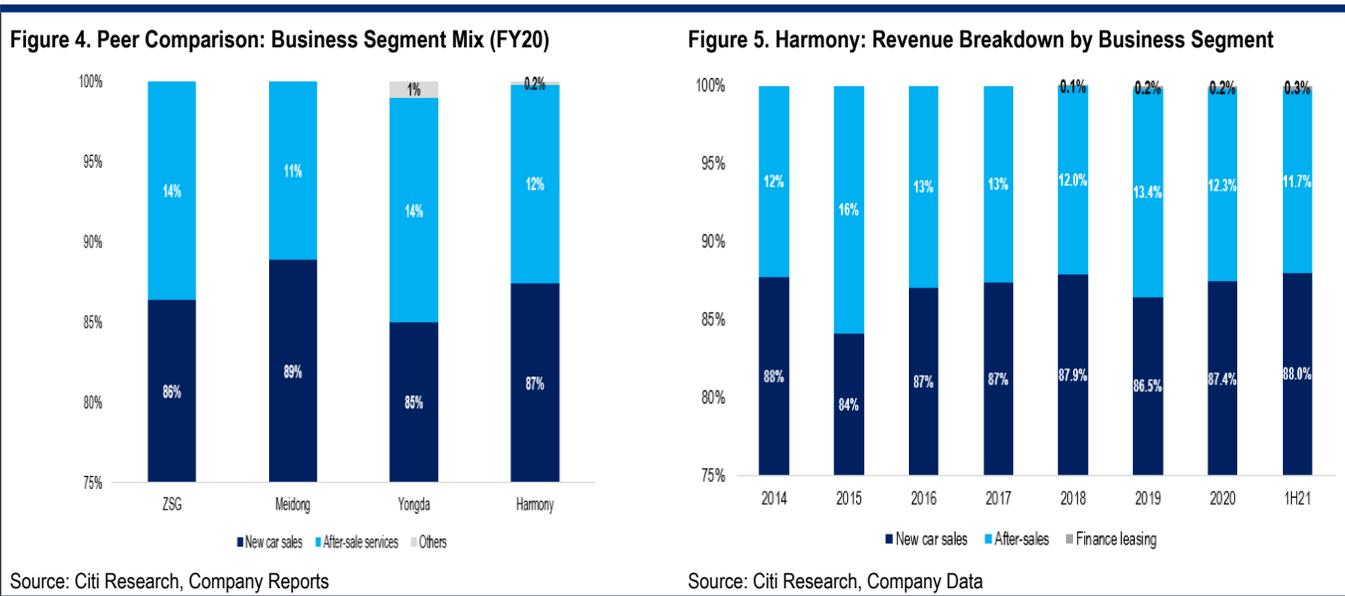
Source: Citi Research, Company Reports

Figure 3. Harmony: Brand Mix

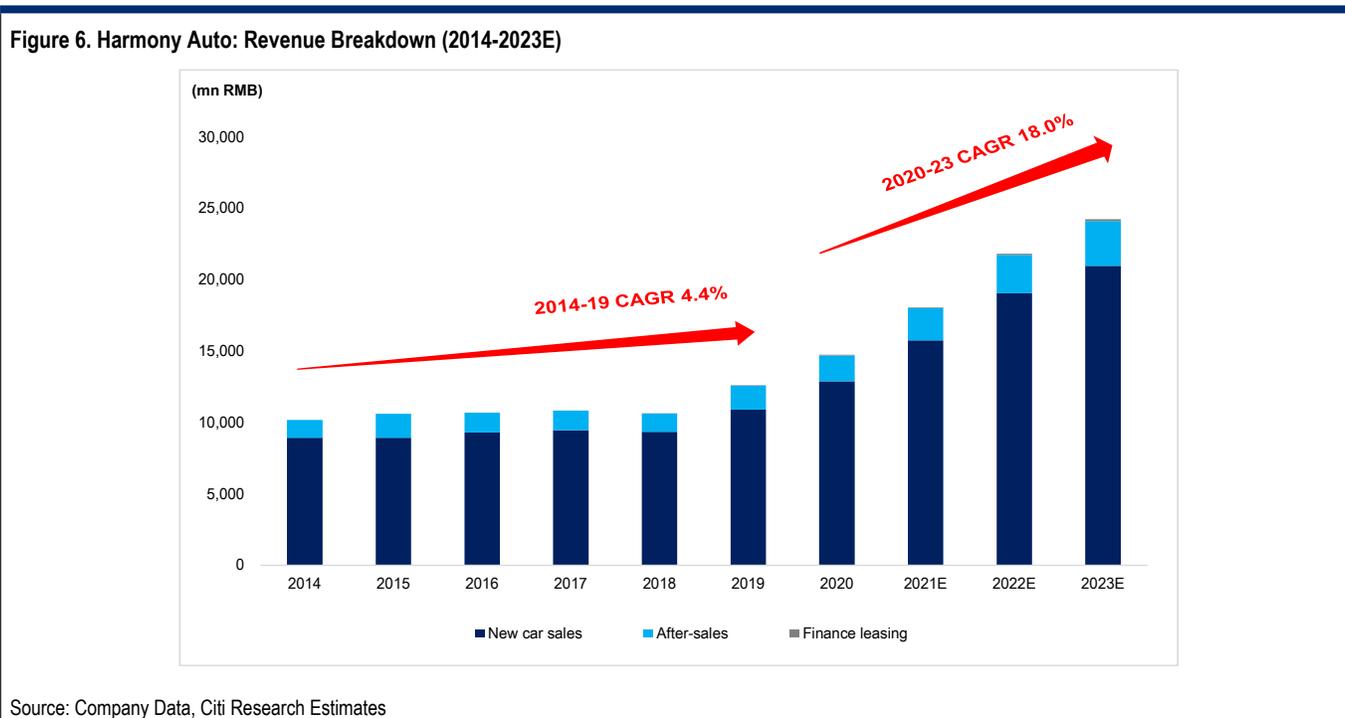


Source: Citi Research, Company Reports

Currently, Harmony has three key business segments: 1) new car sales, 2) after-sales services, 3) finance leasing, with each representing 88.0%/11.7%/0.3% of total revenue in 1H21, respectively. Harmony enjoys a revenue split (87%/12% in FY20) for new car sales and after-sales services that is similar to those of its peers (ZSG/Meidong/Yongda).

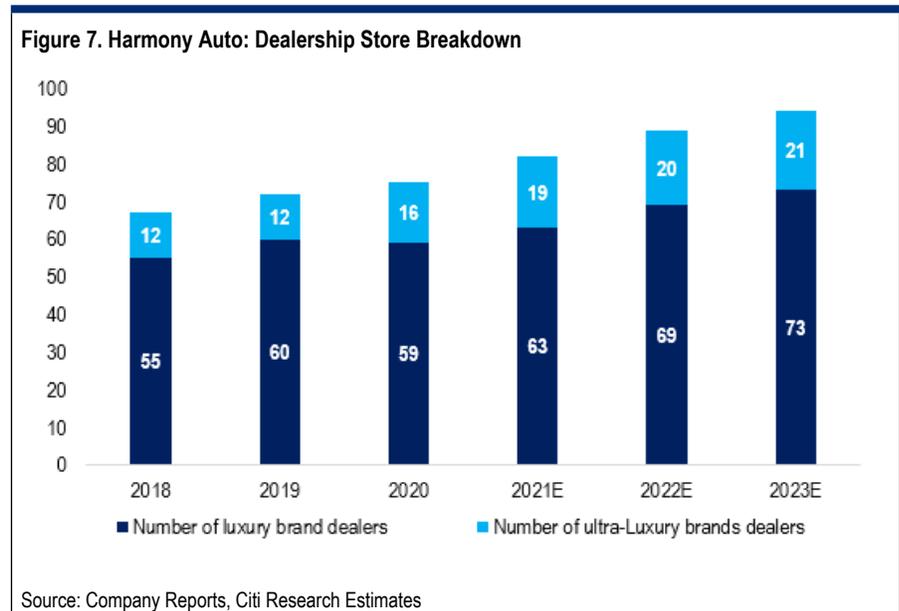


Harmony posted 2014-2019 revenue CAGR at 4.4%. We estimate Harmony's 2020-2023E revenue CAGR to be 18.0%, supported by 1) its unique ultra-luxury/luxury brand-mix and exposure to top-tier cities; 2) a strong demand outlook for after-sales services; 3) robust new car sales along with strong key brand performance; and 4) its asset-light NEV business model and other business segments.



Unique Ultra-luxury/Luxury Brand-mix and Exposure to Top-tier Cities

We believe the success of Harmony’s strategy lies in its unique brand-mix of ultra-luxury/luxury dealerships and decent geographical exposure. As of end of Jun-21, Harmony’s ultra-luxury brand stores accounted for 29% of its total dealer stores, a gradual increase from 18% in 2018 and 21% in 2020. Going forward, we expect the company to maintain a stable store count for ultra-luxury brands, while being more aggressive in expanding key luxury brand stores. Thus, we expect the proportion of ultra-luxury stores to stabilize at around 22% of the total store count in 2022-23E.



Since 2015, the contribution to new car sales revenue from ultra-luxury brands has gradually declined from 12% to 8% in 2020 on stronger growth by luxury brands. During 2018-20, ultra-luxury brand and luxury brand new car sales revenues grew at respective CAGRs of 6.6% and 18.5%, with total new car sales revenue CAGR at 17.4% over the period.

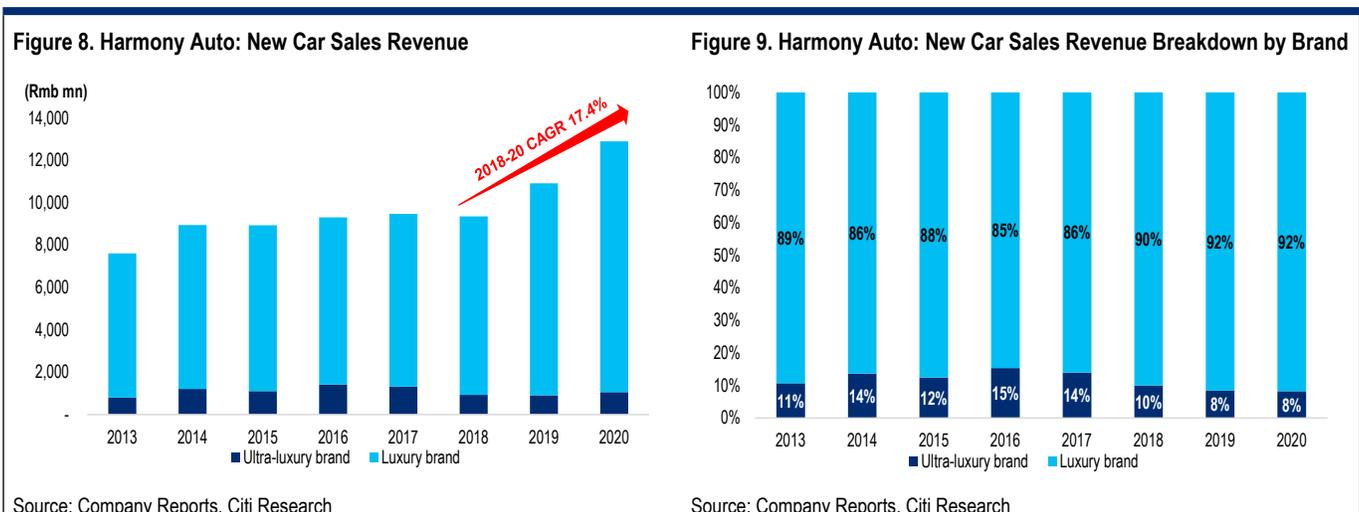
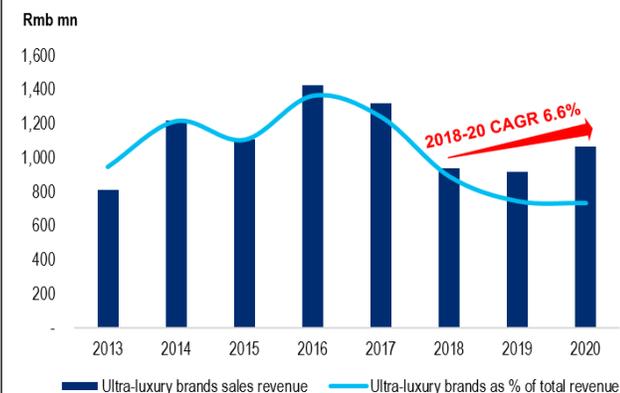
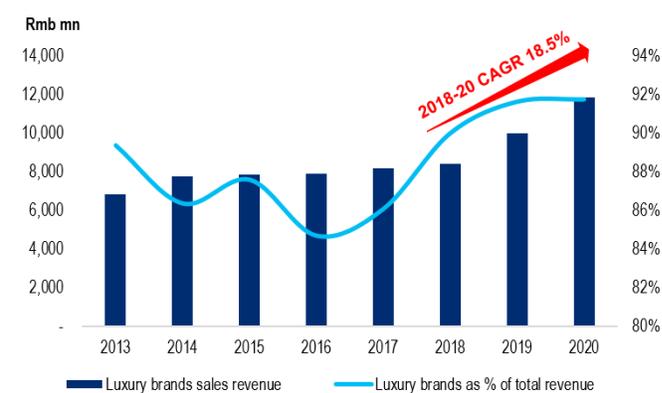


Figure 10. New Car Sales Revenue: Ultra-luxury Brands



Source: Company Data, Citi Research

Figure 11. New Car Sales Revenue: Luxury Brands



Source: Company Data, Citi Research

Besides the contribution from ultra-luxury brands, we believe Harmony's new car sales revenue growth benefits from the company's comprehensive geographical exposure. As of end of Jun-21, Harmony had 79 dealer stores across China, spanning 1st- to 5th-tier cities, with around 46% of the stores in 1st-tier and new 1st-tier cities.

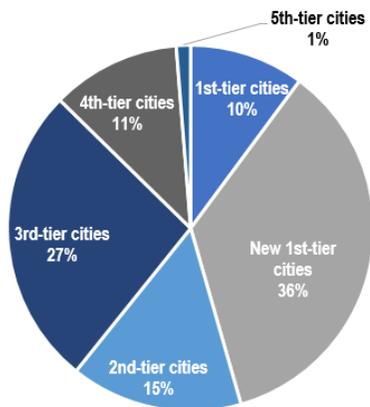
Figure 12. Dealer Store Breakdown: Peer Comparisons

	ZSG	Yongda	Meidong	Harmony
Bentley				6
Ferrari/Masarati				11
Aston Martin		1		
Porsche		20	7	
Mercedes-Benz	63	3		
Lexus	45	4	16	8
Audi	30	9	1	
BMW (incl. Mini)	25	76	26	34
Volvo	21	15		
JLR	16			
Toyota	93		12	
Nissan	35			
Honda	23			
Hyundai			1	
Sum	373	213	63	79

Source: Citi Research, Company Data

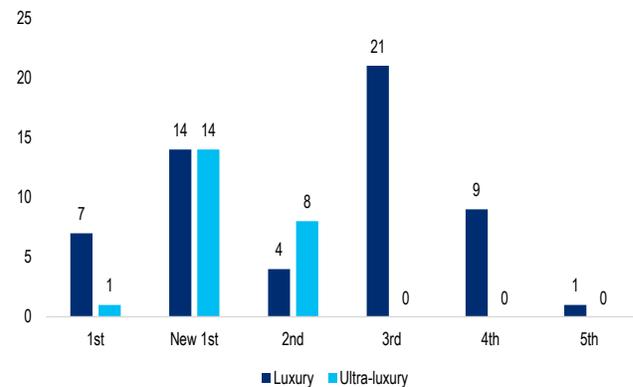
Harmony has a clear distribution strategy for its luxury and ultra-luxury brands. As of end of Jun-21, Harmony's ultra-luxury auto dealer stores had strong geographical exposure to top-tier cities in China, with 4%/61%/35% of its ultra-luxury brand outlets located in either 1st/new 1st/2nd-tier cities. For luxury brands, 13%/ 25%/ 7%/ 38%/16%/1% of the company's outlets were located in 1st/new 1st/2nd/3rd/4th/5th-tier cities, respectively.

Figure 13. Geographical Distribution of Dealer Stores (as of end-1H21)



*New 1st-tier cities include Chengdu, Hangzhou, Chongqing, Suzhou, Nanjing, etc.
Source: Company Data, Citi Research

Figure 14. Geographical Distribution of Ultra-luxury/Luxury Dealer Stores (as of end-1H21)



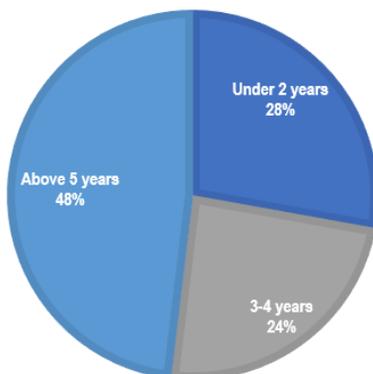
Source: Company Data, Citi Research

In addition, we expect Harmony to continue to grow sales in its home province of Henan, where the company has 39 out of its 79 dealer stores (or 49.4%). With a relatively low penetration rate for luxury brand cars, the Henan market should have strong growth potential. In terms of a near-term catalyst, the regional market is still witnessing growing demand in vehicle replacement (for [c. 400k unit vehicles](#)).

Strong Earnings Outlook for After-sales Services

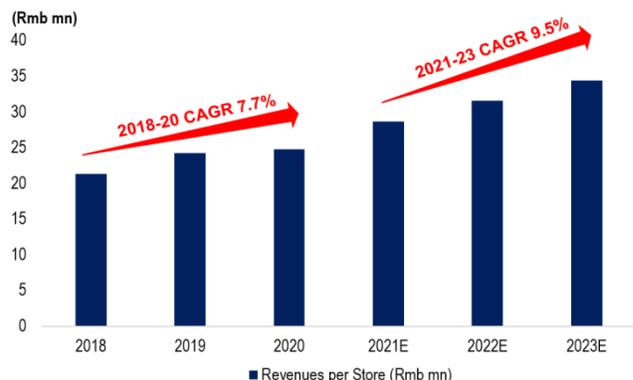
Harmony's stores are comparatively new with an average age of around 5 years, according to management, implying a growing customer base for the after-sales services segment. As of end of Jun-21, 48%/24%/28% of the company's dealer stores were 5+ years/3-4 years/under 2 years. On that, Harmony's after-sales revenue per store posted a 2018-20 CAGR of 7.7%, and we expect growth to maintain at a steady pace (2021-23E CAGR of 9.5%).

Figure 15. Harmony: Age of 4S Stores



Source: Company Reports, Citi Research

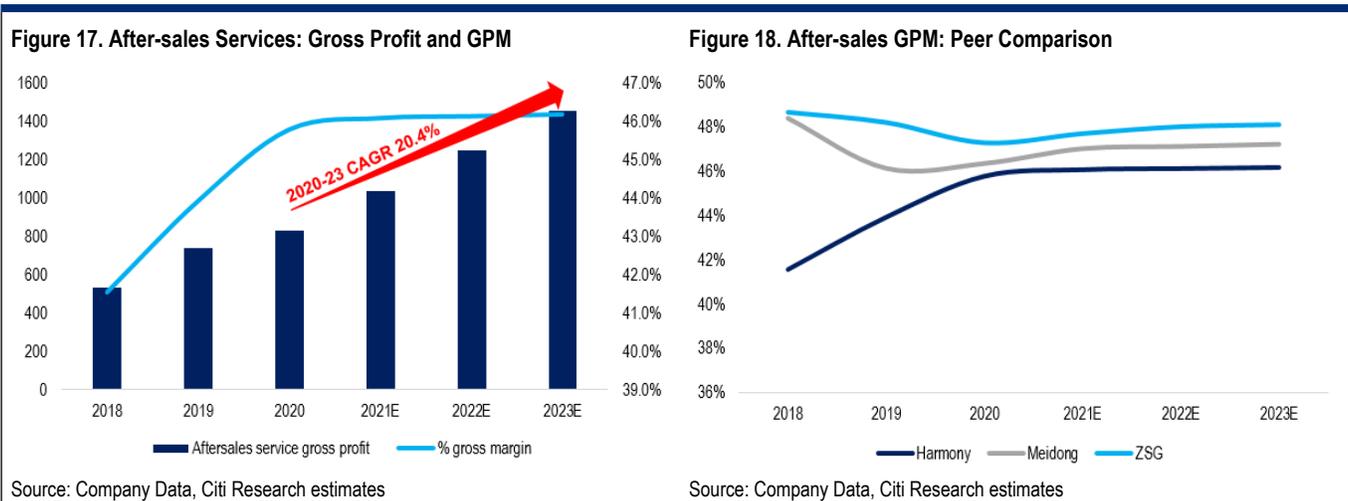
Figure 16. Harmony: After-sales Services Revenue per Store



Source: Company Reports, Citi Research Estimates

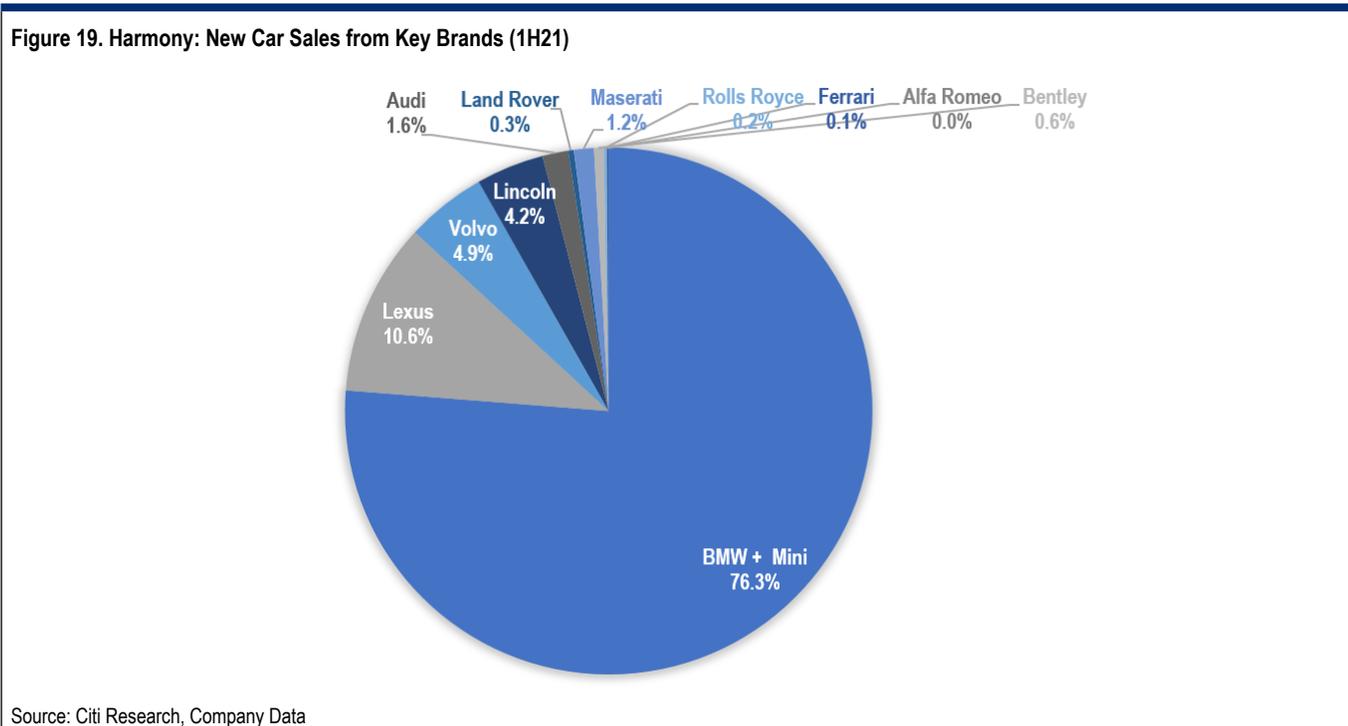
Thanks to the unique edge from its brand-mix, Harmony's after-sales services segment has been growing strongly, contributing c.12% of total revenue in 1H21. Despite the fast expansion of distribution and the after-sales services network, Harmony has continued to improve its client retention ratio, achieving a half-year increase of 9.51% in 1H21. With the client retention ratio expected to be stable at

c.70% going forward, we expect the after-sales revenue contribution to hike to 14% in 2023E, with an after-sales revenue CAGR of 20.1% for 2020-23E.



Robust New Car Sales Along With Strong Key Brand Performance

Harmony enjoys robust new car sales from strong performances from key brands: BMW/MINI and Lexus among luxury brands, and Maserati and Alfa Romeo among ultra-luxury brands. In terms of new car sales volumes, BMW+MINI accounted for 75%-82% of the total among luxury brands during 2018-1H21, while Maserati accounted for around 60% of the total among ultra-luxury brands. In 1H21, BMW and Lexus brands represented c.88.9% of total sales volumes.



■ **Near-term Growth Driver: New Product Pipelines**

In the near-term, we expect Harmony’s new car sales to be further boosted by the strong product pipelines of BWM and Lexus: 1) Brilliance BMW X5L forthcoming in 2Q22 is expected to shift supply volume to 100-120k units per year from the current imported volume of 30k units. The strong new product pipeline is expected to further boost Harmony’s new car sales outlook; 2) Lexus RZ, as the flagship BEV SUV model of Lexus, is expected to ride on the growth momentum for NEV sales.

Figure 20. Upcoming New Products: Lexus and BMW

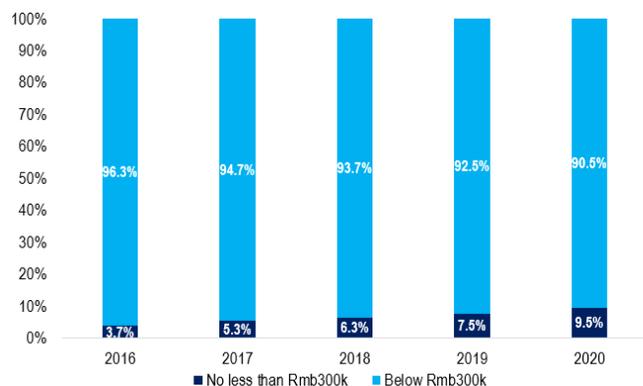
Model	Fuel Type	Size Category	Segment	Schedule
Lexus				
Lexus RZ	BEV	SUV	B	2022E
BMW				
M4 CSL	ICE	Sedan	C	2022E
X5L	ICE	SUV	D	2022E

Source: Company Data, Autohome, Citi Research

■ **Long-term Growth Driver: Riding on Demand for Luxury Cars**

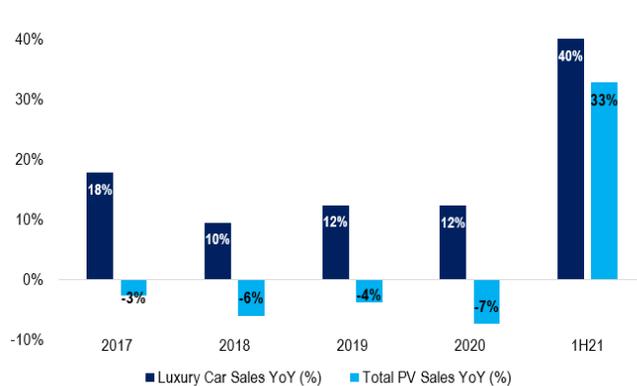
We believe the growth potential of Harmony will increase alongside rising demand for luxury cars, supported by ongoing household consumption upgrade in China’s auto market. Per [CAAM](#) (China Association of Automobile Manufacturers) statistics, the sales penetration of luxury vehicles (denoted as vehicle ASP higher than Rmb300k) increased to 9.5% in 2020, from 3.7% in 2016. According to [CBIRC](#) (China Banking and Insurance Regulatory Commission) statistics, the sales growth of luxury cars in 2017-2H21 YoY was higher (often significantly) than for the overall passenger vehicle (PV) market.

Figure 21. Household Consumption Upgrade in Chinese Auto Market



Source: CAAM, Citi Research

Figure 22. Luxury Car Sales YoY Higher than Overall PV Sales YoY

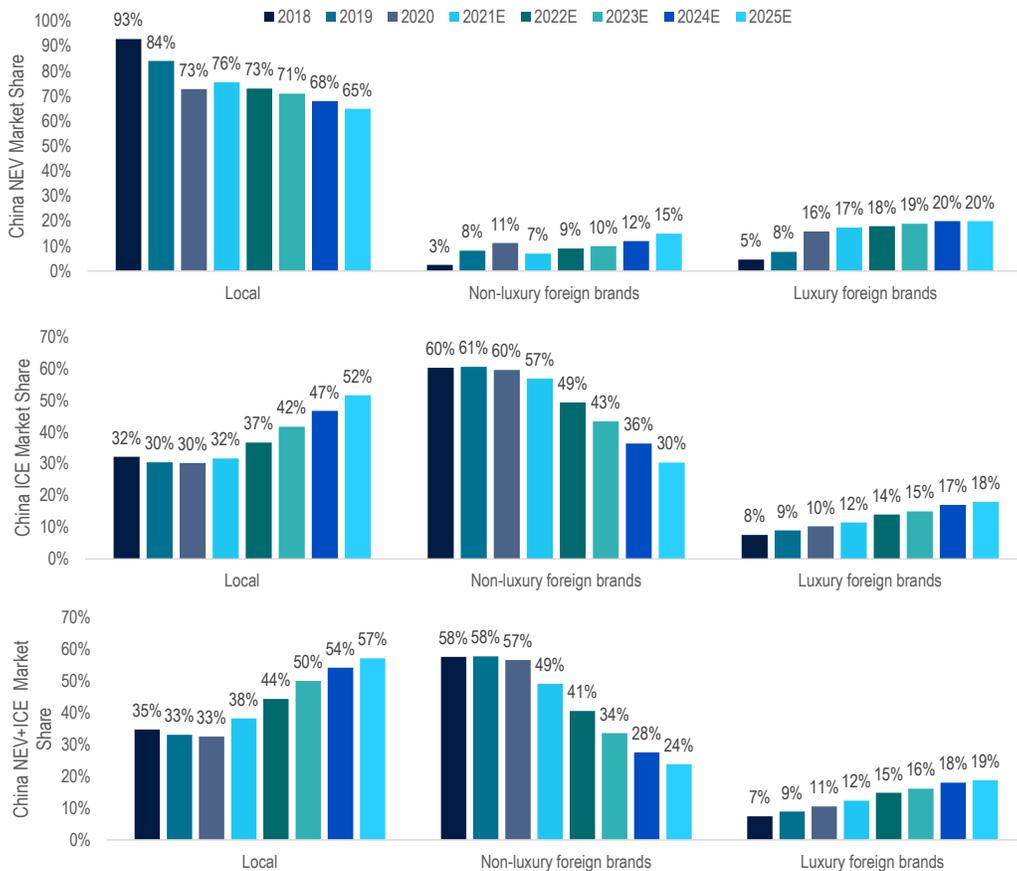


Source: Autohome, CBIRC, Citi Research

As analyzed in our sector report [Auto-Property-Chips 1.0](#), we expect some market share shift among local brands, non-luxury foreign brands and luxury foreign brands in 2022-25E. We expect the NEV market share of luxury foreign brands to grow to 20% by 2025E (from 16% in 2020) as their efforts to increase NEV product offerings will accelerate into 2022E when the pandemic should ease. Likewise, due to competitive ICE and hybrid products by local brands, we expect luxury foreign brands will also continue to see ICE market share gains, to 18% by 2025E (10% in 2020) on ongoing consumption upgrades and an increased retail presence in China.

As a result, luxury foreign brands would see their sector-level (ICE+NEV) market shares widening to 19% by 2025E (from 11% in 2020).

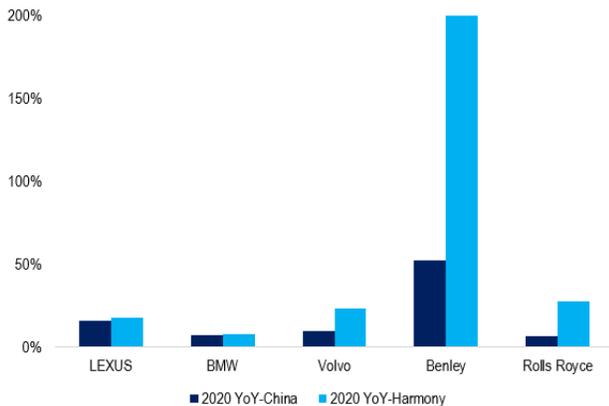
Figure 23. China: NEV-PV/ICE-PV/NEV+ICE-PV



Source: Citi Research, CPCA, Thinkercar

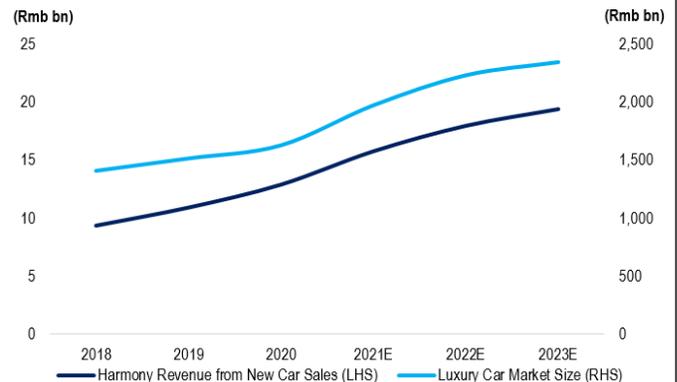
Riding on the fast-evolving demand for luxury car sales, Harmony outperformed the market with its collection of key brands. As shown in Figure 24, the company's brand-level YoY growth of new car sales volumes in 2020 was 2ppt/ 0.7ppt/ 13.7ppt/ 153.1ppt/ 21.2ppt higher than for the sector for Lexus/ BMW/ Volvo/ Bentley/ Rolls-Royce. Moving forward, we expect the company's revenue from new car sales will expand at a similar pace to growth in China's luxury vehicle sector, as shown in Figure 25.

Figure 24. Harmony: Brand Sales YoY Market Beat



Source: Company Reports, Citi Research

Figure 25. Harmony: Riding on Luxury Vehicle Sector Growth

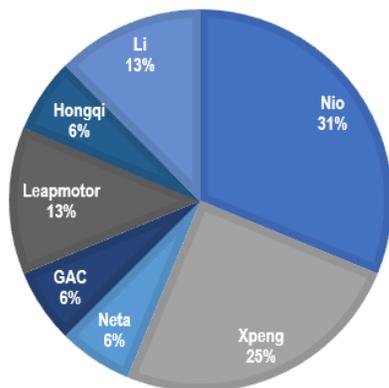


Source: LLResearch, Citi Research Estimates

Asset-light NEV Business Model and Other Business Segments

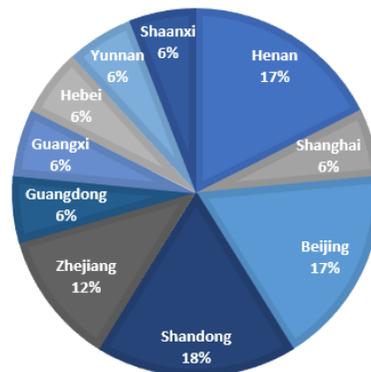
Riding along with the accelerated NEV penetration, Harmony's future growth potential is also supported by its strategic business investments in the NEV sector. As of end of Jun-21, the company held c.20% of Dangdang, an auto-related franchise specializing in NEV after-sales services. We expect Dangdang's FCF to turn positive from 2023E.

Figure 26. Dangdang: Store Breakdown by Brand (as of end-1H21)



Source: Company Data, Citi Research

Figure 27. Dangdang: Store Breakdown by Region (as of end-1H21)

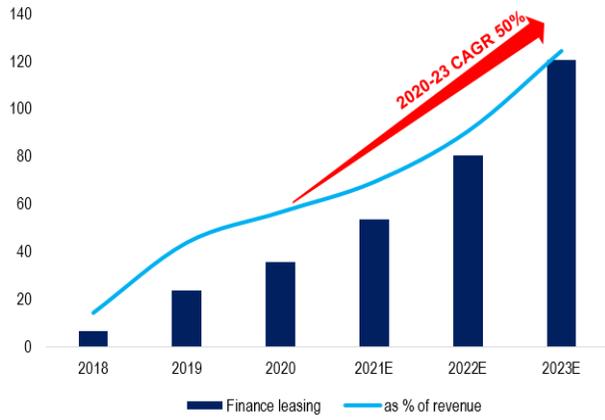


Source: Company Data, Citi Research

Dangdang is in partnership with the leading NEV manufacturers in China, including Nio/Xpeng/Li/Leapmotor/Neta, among many others. Thanks to the asset-light business model of NEV after-sales services stores (capex level at only 10-15% of traditional ICE 4S stores), Dangdang is fast expanding its service network across China.

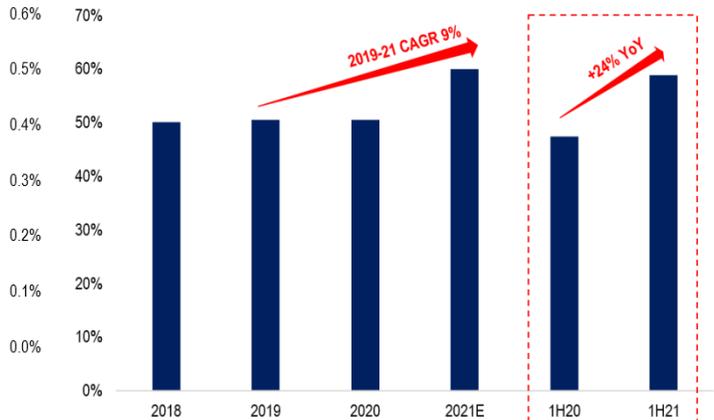
In other business segments, moving forward we also expect the company to benefit from the fast-growing segment of financial leasing. Per management guidance, growth for financial leasing services is expected to be in line with overall YoY growth in FY21, implying a 2020-23 revenue CAGR at 50% (per Figure 28). In addition, the penetration rate of auto finance in new car sales increased at a 9% CAGR in 2019-21E (+24% YoY in 1H21 vs 1H20).

Figure 28. Harmony: Revenue Contribution from Financial Leasing and Other Value-added Services



Source: Company Reports, Citi Research

Figure 29. Harmony: Auto Finance Penetration



Source: Company Reports, Citi Research

Key Financial Analysis

Rosy Performance Outlook: Net Profit on Uptrend

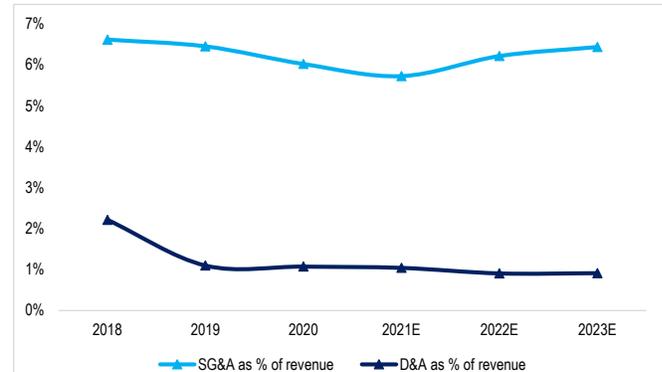
We expect Harmony's operating costs to grow at a steady marginal pace compared to revenue growth going forward. In a similar vein, we expect D&A expenses to be kept at a constant marginal level as per earlier years. For 2021E, we project Harmony's net profit at Rmb751mn, +83% YoY on the constrained performance in 2020 due to the Covid-19 pandemic, and NPM to improve to 4.2% from 2.8% in FY20. We expect the net profit growth to imply 31% 2020-23E CAGR on an enhanced performance outlook for revenue, GPM, and overall efficient control of operating costs.

Figure 30. EBIT and EBIT Margin



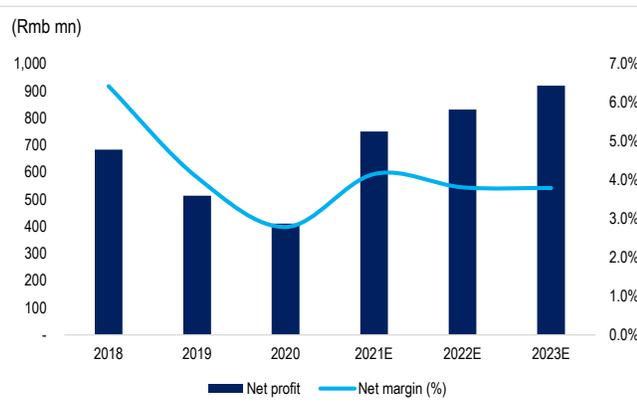
Source: Company Data, Citi Research Estimates

Figure 31. SG&A and D&A as % of Revenue



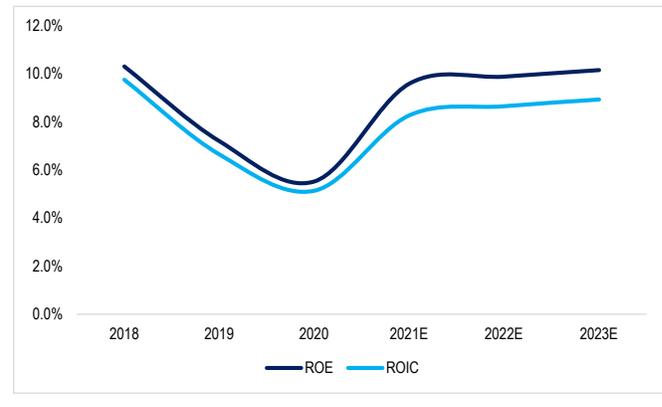
Source: Company Data, Citi Research Estimates

Figure 32. Net Profit and Net Margin



Source: Company Data, Citi Research Estimates

Figure 33. ROE and ROIC



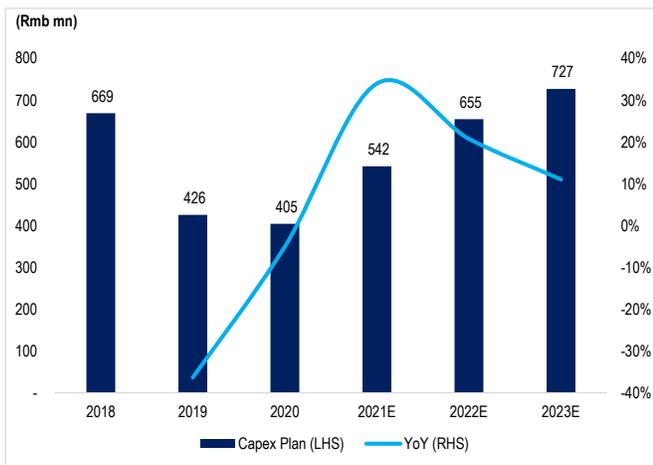
Source: Company Data, Citi Research Estimates

Expect Positive FCF going forward

Harmony incurred capex of Rmb404.6million in 2020 and Rmb170.1mn in 1H21, mainly used for the expenses and prepayments to purchase property, plant and equipment for setting up new outlets. As the overall distributional and after-sales services network will continue to expand, we estimate 34% YoY growth for capex in FY21 to Rmb542mn, to be followed by steady capex increases in FY22/FY23E. With our overall optimistic outlook for net profits and stable capex, we expect the company to have positive FCF of Rmb299mn in 2021E, and to maintain a healthy

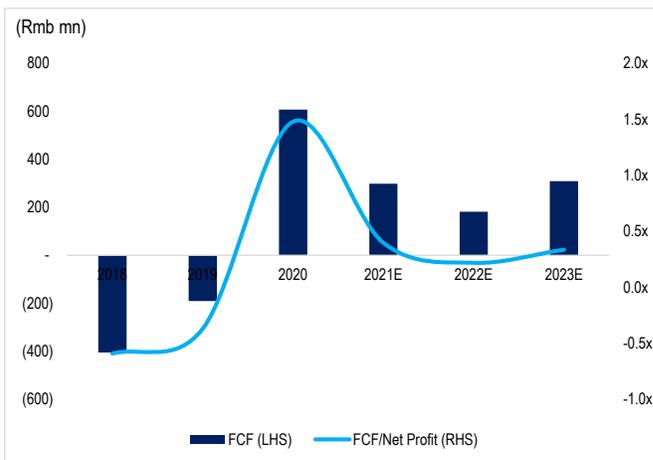
trend going forward. For business efficiency, we expect Harmony to have a stable level of inventory turnover at around 23 days for 2021E, with possible room to cut to 20-21 days in FY22/23E with the company's ongoing commitment to delicacy management on organizational and operational efficiency.

Figure 34. Capex Plan



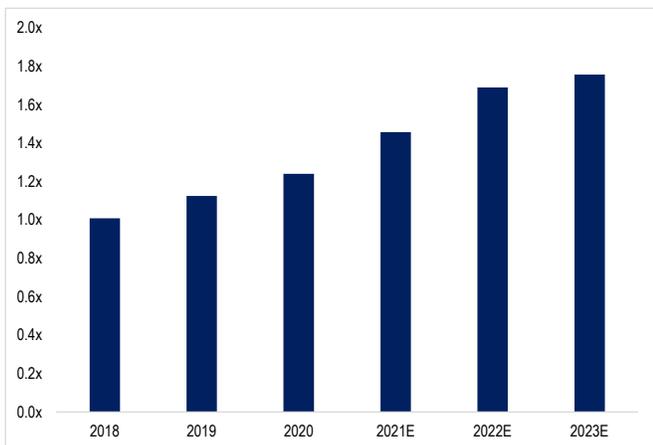
Source: Citi Research, Company Data

Figure 35. Free Cash Flows and FCF/Net Profit



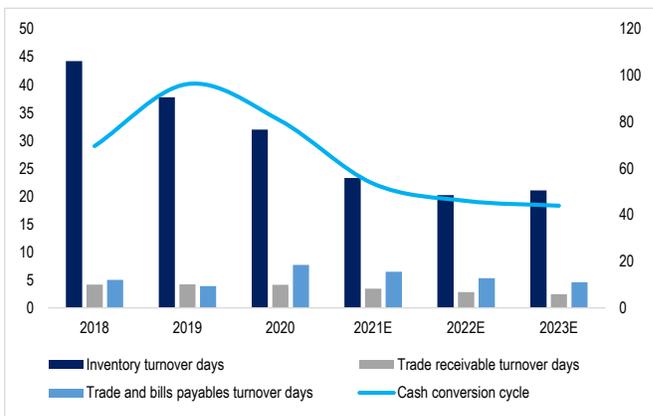
Source: Citi Research, Company Data

Figure 36. Asset Turnover



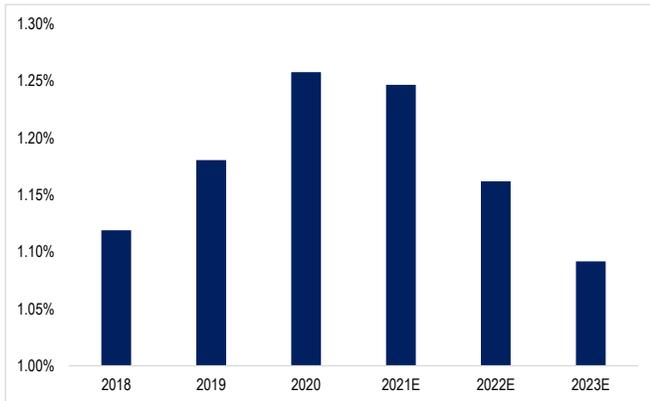
Source: Company Data, Citi Research Estimates

Figure 37. Cash Conversion Cycle



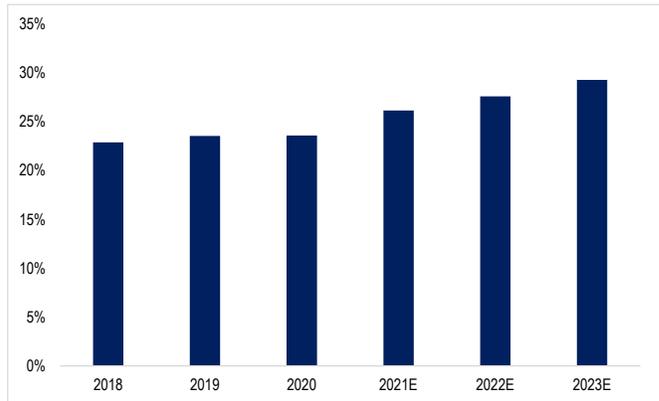
Source: Company Data, Citi Research Estimates

Figure 38. Trade Receivables as % of Total Assets



Source: Company Data, Citi Research Estimates

Figure 39. PPE as % of Total Assets



Source: Company Data, Citi Research Estimates

Valuation

Our target price for Harmony of HK\$8.8 is derived from a sum-of-the-parts valuation, which we believe better captures the fair value of the company's three main sources of income: 1) new car sales, 2) after-sales services, and 3) finance leasing and insurance commissions. We assign:

- 15.5x 2022E P/E (China auto sector average) to new car sales to factor in the decent earnings outlook on the strong model cycle of Harmony's key brands BMW/Lexus as well as the company's unique ultra-luxury brand portfolio;
- 24x 2022E P/E (China auto dealers' after-sales sector average) to the after-sales segment to reflect Harmony's better-than-peers' brand portfolio, as well as improving same-store sales growth as its blended store age gradually matures.
- 10x 2022E P/E (sector average for auto-finance business) to auto-finance and insurance commissions.

Our valuation implies 16.3x blended 2022E P/E, 1.3x 2022-24E PEG, 1.6x 2022E P/B and 10.4x 2022E EV/EBITDA.

Figure 40. Harmony: SoTP Valuation

	2020E EPS	2021E EPS	2022E EPS	2023E EPS	2024E EPS	NP CAGR	Target P/E	TP (HKD)
New Car Sales	0.09	0.19	0.20	0.22	0.24	9%	15.5x PE	2.55
Aftersales	0.17	0.29	0.33	0.37	0.44	15%	24.0x PE	6.24
Finance and insurance commission income	0.00	0.01	0.00	0.00	0.00	0%	10.0x PE	0.04
Total	0.27	0.49	0.54	0.60	0.69	13.0%	16.3x	8.80

Source: Citi Research

- **Cross-checking with Straight PER Valuation:** We cross-check our valuation using a straight PER target approach. Applying a target 2022E PER of 15x, using the company's 2yr historical average, yields a similar fair value of HK\$8.3.

Figure 41. Harmony: Straight PER Valuation

TP (HK\$) - P/E based	8.30
Target 22E P/E	15x
Current Px (HKD)	4.51
Upside	84%

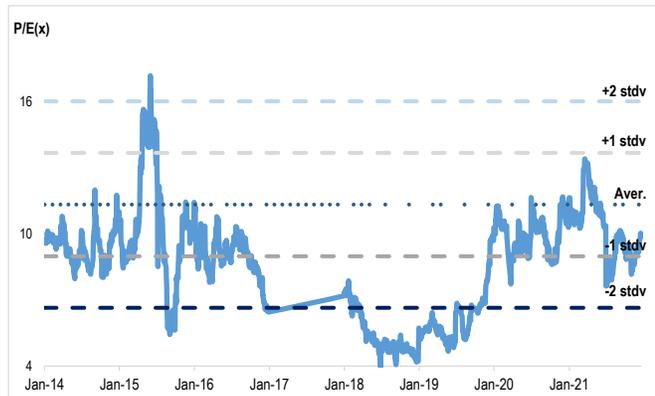
Current Px as of market close price at Dec 22nd Wednesday

Source: Citi Research

- **How our estimates compare against market consensus:** Our 21/22/23 EPS are +10%/+4%/+2% higher than those of consensus as we are relatively more optimistic in both of our new car sales and after-sales assumptions: 1) higher new car sales revenue growth, and 2) higher after-sales ASP growth as

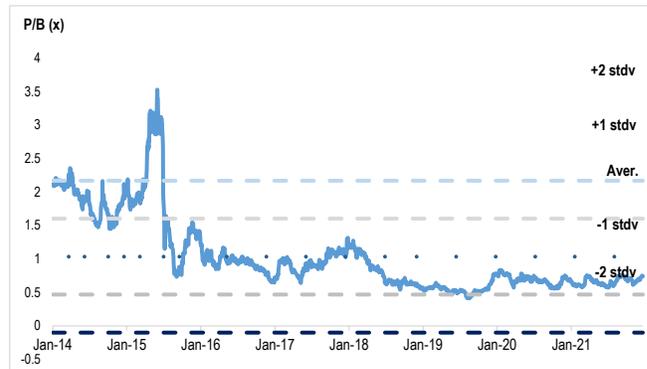
the average store age gradually increases. Our blended GPM assumptions are in-line with consensus at around 9.6%/9.3%/9.6% in 21/22/23E.

Figure 42. Harmony: P/E Band



Source: Citi Research Estimates, Bloomberg

Figure 43. Harmony: P/B Band



Source: Citi Research Estimates, Bloomberg

Risks

Key downside risks includes:

- 1) a weak macro which dampens overall purchasing power in China;
- 2) in a worst-case scenario, a full write-off of Byton (Baiteng) might incur a one-off cost of Rmb1.2bn for FY21, which could lead to FY21E NP loss (though such a one-off would not impact our earnings forecasts for FY22 and beyond). Harmony conducted a strategic investment in Byton (a Chinese NEV brand) starting from 2016, when Byton was named as "Future Mobility". However, Byton's operation was heavily impacted amid the bearish auto market in China during 2019 and the pandemic afterwards. In July 2020, Byton announced the suspension of business and production;
- 3) slower-than-expected retail network expansion;
- 4) intensified competition could weigh on profitability, especially for new car sales.

Sector Comps

Figure 44. Global Auto Dealers: Valuation Comps

Company	Ticker	Currency	Price	Mar Cap (mn) A+H	TP	ETR (%)	Rating	2021	2022	2023	2021	2022	2023	2020	2021	2022	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023	EPS
								P/E			Price/Sales			Price/Book			EV/Sales			EV/EBITDA			Dividend Yield (%)			21-23 CAGR			
								20E	21E	22E	20E	21E	22E	20E	21E	22E	20E	21E	22E	20E	21E	22E	20E	21E	22E	20E	21E	22E	
Harmony	3836.HK	HKD	3.78	769	8.80	133%	1	32.9	18.8	13.2	0.9	0.7	0.7	1.8	1.7	1.5	0.6	0.5	0.5	9.4	7.3	6.4	0.12	0.21	0.31				32.7%
China Auto Dealers																													
Meidong	1268.HK	HKD	29.50	4,735	51.00	73%	1	48.7	27.5	17.6	1.8	1.3	1.0	11.2	8.8	6.6	1.8	1.3	0.9	27.8	17.0	10.8	1.33	2.00	4.55				50.0%
ZTA	1728.HK	HKD	0.80	278	0.32	-60%	3	-0.2	-0.7	-1.1	0.1	0.1	0.1	0.5	1.4	-4.4	0.8	0.7	0.6	-1.6	-11.9	-107.1	-	-	-				-34.7%
ZSG	0681.HK	HKD	54.60	16,070	96.90	77%	1	20.0	13.8	10.8	0.7	0.5	0.5	3.9	3.1	2.3	0.8	0.6	0.5	12.2	8.4	7.0	0.98	1.22	1.57				25.5%
Yongda	3669.HK	HKD	12.92	3,287	27.50	113%	1	12.8	8.7	6.1	0.3	0.2	0.2	1.7	1.5	1.3	0.4	0.3	0.3	7.9	5.9	4.4	1.99	3.41	4.83				29.6%
Average								20.3	12.3	8.4	0.7	0.5	0.4	4.3	3.7	1.4	0.9	0.7	0.6	11.6	4.8	-21.2	1.07	1.66	2.74				17.6%
Global Auto Dealers																													
Auto Trader Group plc	AUTOA.L	GBP	5.88	7,671	7.30	24%	2	25.8	42.5	24.0	14.9	21.8	13.7	39.0	12.5	11.3	16.2	22.1	13.6	22.4	34.6	19.3	40.50	84.37	138.10				40.6%
Autonation Inc	AN.N	USD	67.98	5,973	n/a	n/a	n/a	9.1	6.6	6.5	0.3	0.3	0.2	1.6	3.2	2.4	0.4	0.4	0.4	8.3	5.0	5.3	-	-	-				39.0%
Carmax Inc	KMX.N	USD	93.18	15,192	n/a	n/a	n/a	18.1	19.4	19.1	0.8	0.8	0.7	4.1	-	6.0	0.9	0.8	0.8	21.0	0.8	0.8	-	-	-				11.4%
Asbury Auto	ABG.N	USD	139.79	2,696	n/a	n/a	n/a	9.1	6.3	5.7	0.3	0.2	0.2	2.4	1.9	1.5	0.6	0.5	0.3	10.7	6.3	4.6	-	-	-				28.4%
Lithia Motors	LAD.N	USD	288.45	7,651	345.00	20%	2	16.3	8.0	8.5	0.5	0.4	0.3	2.9	1.7	1.4	0.7	0.4	0.3	12.1	5.8	5.2	0.41	0.45	0.47				-2.8%
Group 1 Auto	GPI.N	USD	120.41	2,205	n/a	n/a	n/a	6.6	5.6	5.6	0.2	0.2	0.2	1.4	1.7	1.3	0.4	0.4	0.3	5.8	5.0	5.0	0.60	0.69	0.62				19.0%
Sonic Auto	SAH.N	USD	38.19	1,606	n/a	n/a	n/a	10.9	6.2	5.3	0.2	0.2	0.1	2.1	1.9	1.3	0.4	0.3	0.2	5.1	5.8	4.7	0.80	0.92	0.99				28.1%
Penske Auto	PAG.N	USD	58.13	4,670	n/a	n/a	n/a	8.8	6.9	7.5	0.2	0.2	0.2	1.4	2.0	1.7	0.4	0.5	0.4	5.0	5.7	6.2	2.00	1.75	1.63				21.0%
Average								13.1	12.7	10.3	2.2	3.0	2.0	6.9	3.5	3.4	2.5	3.2	2.1	11.3	8.6	6.4	5.54	11.02	17.73				23.1%

Price as of market close of Dec 23, 2021
Source: Bloomberg, dataCentral, Citi Research

Financials

Income Statement

Figure 45. Harmony: Income Statement

(mn RMB)	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Income Statement								
Revenue	10,640	12,622	14,747	18,074	21,830	24,245	26,372	28,546
YoY (%)	-1.8%	18.6%	16.8%	22.6%	20.8%	11.1%	8.8%	8.2%
Rev breakdown								
New car sales	9,354	10,912	12,893	15,767	19,050	20,976	22,587	24,162
After-sales	1,280	1,686	1,818	2,253	2,699	3,148	3,604	4,113
Finance leasing	7	24	36	54	80	121	181	271
Others								
Cost of sales	(9,883)	(11,535)	(13,448)	(16,341)	(19,807)	(21,930)	(23,774)	(25,640)
Gross profit	757	1,087	1,299	1,732	2,023	2,315	2,598	2,906
YoY (%)	-25.7%	43.7%	19.5%	33.4%	16.8%	14.4%	12.3%	11.9%
Gross margin (%)	7.1%	8.6%	8.8%	9.6%	9.3%	9.5%	9.9%	10.2%
Operating expense								
Selling & distribution expense	(549)	(633)	(690)	(807)	(1,049)	(1,206)	(1,327)	(1,526)
Administrative expense	(155)	(181)	(199)	(229)	(308)	(355)	(365)	(420)
Other expenses	-	-	-	-	-	-	-	-
Total operating expense	(704)	(815)	(888)	(1,035)	(1,357)	(1,561)	(1,692)	(1,946)
Other income and gains, net	942	531	340	454	497	516	659	682
EBIT	994	803	750	1,151	1,162	1,270	1,565	1,643
YoY (%)	-29.2%	-19.2%	-6.6%	53.4%	1.0%	9.2%	23.3%	4.9%
EBIT margin (%)	9.3%	6.4%	5.1%	6.4%	5.3%	5.2%	5.9%	5.8%
Core EBIT								
Core EBIT	52	272	411	697	665	754	906	960
YoY (%)	-37.3%	421.1%	50.7%	69.7%	-4.5%	13.3%	20.2%	6.0%
Core EBIT margin (%)	0.5%	2.2%	2.8%	3.9%	3.0%	3.1%	3.4%	3.4%
EBITDA								
EBITDA	1,133	961	939	1,349	1,384	1,521	1,565	1,711
YoY (%)	-30.9%	-15.2%	-2.4%	43.7%	2.6%	9.9%	2.9%	9.3%
EBITDA margin (%)	10.6%	7.6%	6.4%	7.5%	6.3%	6.3%	5.9%	6.0%
Financing costs	(68)	(110)	(134)	(134)	(134)	(134)	(134)	(134)
Share of profit of joint ventures	(109)	(20)	(0.82)	-	-	-	-	-
Share of profit of associates	0	0	2.15	-	-	-	-	-
Profit before taxation	817	673	617	1,016	1,028	1,136	1,431	1,508
Income tax	(127)	(147)	(195)	(254)	(185)	(204)	(358)	(272)
Non-controlling interests	(6)	(13)	(11)	(11)	(11)	(11)	(11)	(11)
Net profit	684	513	411	751	832	920	1,062	1,225
YoY (%)	-32.3%	-24.9%	-20.0%	82.8%	10.8%	10.6%	15.5%	15.4%
Net margin (%)	6.4%	4.1%	2.8%	4.2%	3.8%	3.8%	4.0%	4.3%

Source: Citi Research, Company Data

Balance Sheet

Figure 46. Harmony: Balance Sheet

(mn RMB)	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Balance Sheet								
Current assets								
Inventories	1,124	1,262	1,094	994	1,201	1,333	1,450	1,570
Trade receivables	123	135	155	155	155	155	155	155
Prepayment, other receivables and other assets	1,797	2,497	2,736	2,530	2,838	3,031	3,165	3,283
Amounts due from related parties	-	-	-	-	-	-	-	-
Structured deposits	-	-	-	-	-	-	-	-
Pledged and restricted bank deposits	75	68	85	85	85	85	85	85
Cash in transit	36	44	22	22	22	22	22	22
Cash and bank balances	1,148	1,362	1,714	1,817	1,777	1,837	2,021	2,310
Time deposits	-	-	-	-	-	-	-	-
Finance lease receivables	51	92	157	157	157	157	157	157
Available-for-sale investments	-	-	-	-	-	-	-	-
Financial assets at fair value through profit or loss	168	88	84	84	84	84	84	84
Cash and cash equivalents	1,366	1,543	1,955	2,058	2,018	2,078	2,262	2,551
Total current assets	4,522	5,548	6,047	5,844	6,319	6,704	7,139	7,666
Non-current assets								
Plant, property, equipments	2,523	2,691	2,914	3,258	3,691	4,168	4,675	5,213
Prepaid land lease payments / right-of-use assets	11	525	731	731	731	731	731	731
Intangible assets	105	99	138	138	138	138	138	138
Goodwill	58	58	142	142	142	142	142	142
Prepayments and other assets	1,603	789	777	777	777	777	777	777
Finance lease receivables	82	131	222	222	222	222	222	222
Investments in joint ventures	6	6	8	8	8	8	8	8
Investments in associates	686	7	7	7	7	7	7	7
Available-for-sale investments	-	-	-	-	-	-	-	-
Financial assets at fair value through profit and loss	1,377	1,390	1,273	1,273	1,273	1,273	1,273	1,273
Deferred tax	49	61	63	63	63	63	63	63
Others	-	118	32	-	-	-	-	-
Total non-current assets	6,500	5,874	6,305	6,617	7,050	7,527	8,034	8,573
Total assets	11,022	11,423	12,352	12,461	13,369	14,231	15,174	16,239
Current liabilities								
Bank loans and other borrowings	2,138	2,494	2,604	2,604	2,604	2,604	2,604	2,604
Trade & bill payables	136	116	264	264	264	264	264	264
Other payables and accruals	987	675	855	1,084	1,309	1,454	1,582	1,712
Income tax payable	786	218	285	349	422	468	509	551
Others	-	30	84	-	-	-	-	-
Total current liabilities	4,047	3,533	4,093	4,302	4,600	4,791	4,960	5,133
Non-current liabilities								
Bank loans and other borrowings	-	-	-	-	-	-	-	-
Deferred tax liabilities	53	56	57	57	57	57	57	57
Others	-	510	655	-	-	-	-	-
Total non-current liabilities	53	566	712	57	57	57	57	57
Total liabilities	4,101	4,099	4,805	4,359	4,657	4,849	5,017	5,190
Shareholders' equity								
Share capital	12	13	13	13	13	13	13	13
Reserve & Retained profits	6,866	7,258	7,476	8,030	8,640	9,310	10,084	10,977
Treasury shares	-	-	-	-	-	-	-	-
Equity attributable to shareholders	6,878	7,270	7,488	8,043	8,653	9,323	10,097	10,990
Minority interest	43	53	59	59	59	59	59	59
Total Shareholders' equity	6,921	7,323	7,547	8,102	8,712	9,382	10,156	11,049
Total liabilities & shareholders' equity	11,022	11,423	12,352	12,461	13,369	14,231	15,174	16,239

Source: Citi Research, Company Data

Statement of Cash Flows

Figure 47. Harmony: Statement of Cash Flows

(Rmb mn)	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Cash Flow Statement								
Operating activities								
Profit before tax	817	673	617	1,005	1,017	1,124	1,420	1,497
Share of profits and losses of joint ventures and associates	109	20	(1)	-	-	-	-	-
Depreciation of items of property, plant and equipment	134	154	183	198	222	251	284	318
Amortisation of prepaid land lease payments	0	-	-	-	-	-	-	-
Amortisation of intangible assets	5	4	5	-	-	-	-	-
Interest income	(102)	-	-	-	-	-	-	-
Loss on disposal of a subsidiary	-	-	-	-	-	-	-	-
Net loss on disposal of items of property, plant and equipment	17	14	11	-	-	-	-	-
Penalty income from cancellation of a potential acquisition contract	-	-	-	-	-	-	-	-
Gain on deemed disposal of subsidiaries	-	-	-	-	-	-	-	-
Gain on deemed partial disposal of an associate	-	-	-	-	-	-	-	-
Gain on transferring the investment in an associate to available-for-sale	-	-	-	-	-	-	-	-
Gain on disposal of shares in an associate	-	(32)	-	-	-	-	-	-
Loss on disposal of shares in a financial asset at fair value through profit or loss	236	-	-	-	-	-	-	-
Fair value gains, net:								
Fair value gain on a financial asset at fair value through profit or loss	(697)	(17)	120	-	-	-	-	-
Impairment/(reversal of impairment) of inventories	8	-	-	-	-	-	-	-
Impairment of property, plant and equipment	-	-	-	-	-	-	-	-
Equity-settled share award expense	-	-	-	-	-	-	-	-
Equity-settled share option expense	26	-	-	-	-	-	-	-
Finance costs	68	110	134	-	-	-	-	-
Decrease in pledged and restricted bank deposits	6	7	(16)	-	-	-	-	-
Decrease/(increase) in cash in transit	1	(8)	22	-	-	-	-	-
(Increase)/decrease in trade receivables	(17)	(12)	(20)	-	-	-	-	-
Increase in prepayments, other receivables and other assets	(280)	(53)	(452)	-	-	-	-	-
Decrease/(increase) in inventories	139	(137)	170	100	(207)	(133)	(117)	(120)
Increase in finance lease receivables	(111)	(91)	(155)	-	-	-	-	-
Decrease in trade and bills payables	(70)	(21)	140	206	(308)	(193)	(134)	(118)
Increase in other payables and accruals	68	(294)	174	(414)	298	192	169	172
Others	-	5	46	-	-	-	-	-
Operating cash flows	356	323	978	1,095	1,022	1,241	1,621	1,750
Income tax paid	(92)	(87)	(179)	(254)	(185)	(204)	(358)	(272)
Net Operating cash flows	264	236	800	841	837	1,037	1,263	1,478
Investing activities								
Interest received	30	41	66	-	-	-	-	-
Dividend received from an associate	-	-	-	-	-	-	-	-
Purchase of items of property, plant and equipment	(669)	(426)	(192)	(542)	(655)	(727)	(791)	(856)
Proceeds from disposal of items of property, plant and equipment	89	106	142	-	-	-	-	-
Purchase of intangible assets	(1)	-	-	-	-	-	-	-
Acquisition of a subsidiary	-	-	(180)	-	-	-	-	-
Disposal of a subsidiary	-	-	-	-	-	-	-	-
Deemed disposal of subsidiaries	-	-	-	-	-	-	-	-
Investments in joint ventures	-	-	-	-	-	-	-	-
Investments in associates	-	-	-	-	-	-	-	-
Proceeds from capital reduction in the investment in a joint venture	-	-	-	-	-	-	-	-
Proceeds from liquidation of an associate	-	192	-	-	-	-	-	-
Proceeds from disposal of financial assets at fair value through profit or loss	247	84	-	-	-	-	-	-
Purchases of financial assets at fair value through profit or loss/available-for-sale	(254)	-	-	-	-	-	-	-
Loans to a third party	(260)	(42)	260	-	-	-	-	-
Repayment of loans to third parties	-	-	-	-	-	-	-	-
Advance made to a related party	(108)	-	(315)	-	-	-	-	-
Collection of loans and receivables from third parties	200	-	-	-	-	-	-	-
Penalty income from cancellation of a potential acquisition contract	-	-	-	-	-	-	-	-
Proceeds from disposal of shares in an associate	-	-	-	-	-	-	-	-
(Increase)/decrease in time deposits	(95)	(230)	(10)	-	-	-	-	-
Decrease in structured deposits	-	-	-	-	-	-	-	-
Others	-	2	(2)	-	-	-	-	-
Net Investing cash flows	(821)	(273)	(230)	(542)	(655)	(727)	(791)	(856)
Financing activities								
Proceeds from exercise of share options	2	4	13	-	-	-	-	-
Share issue expenses/proceeds	-	134	-	-	-	-	-	-
Repurchase of shares	(40)	(167)	(25)	-	-	-	-	-
Proceeds from bank loans and other borrowings	11,610	11,922	11,783	-	-	-	-	-
Repayment of bank loans and other borrowings	(11,289)	(11,566)	(11,672)	-	-	-	-	-
Acquisition of non-controlling interests	(3)	-	(4)	-	-	-	-	-
Dividends paid	(161)	(156)	(104)	(196)	(222)	(250)	(288)	(333)
Dividends paid to a non-controlling shareholder	(4)	(2)	-	-	-	-	-	-
Capital contributions from non-controlling shareholders	-	-	-	-	-	-	-	-
Interest paid	(85)	-	(143)	-	-	-	-	-
Others	200	(194)	(57)	-	-	-	-	-
Net financing cash flows	231	(26)	(208)	(196)	(222)	(250)	(288)	(333)
Cash at beginning of year	1,475	1,148	1,362	1,704	1,807	1,767	1,827	2,011
Net increase in cash	(326)	(62)	361	102	(39)	60	184	289
FX Effect	(1)	276	(18)	-	-	-	-	-
Cash at the end of year	1,148	1,362	1,704	1,807	1,767	1,827	2,011	2,300

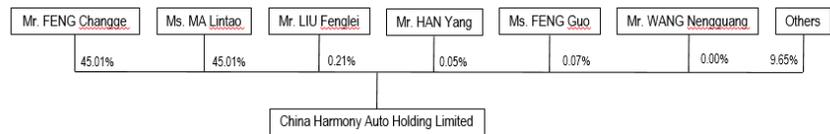
Source: Citi Research, Company Data

Company Background

Harmony Auto is a leading automotive services group in China, representing 14 luxury and ultra-luxury brands in 39 cities across the country. It serves 9 luxury brands such as BMW, MINI, Audi, Volvo, Land Rover, Lexus, Jaguar, Lincoln, Alfa Romeo and 5 super luxury brands such as Rolls-Royce, Bentley, Ferrari, Lamborghini, and Maserati.

Shareholding Structure

Figure 48. Harmony: Shareholding Structure (as of end-1H21)



Source: Citi Research, Company Reports

Management

Figure 49. Harmony: Management Background

Management name	Position	Background
Mr. Feng Changge	Chairman	Mr. Feng is the chairman and one of the founders of Harmony group. He is also the co-founder of FMC smart electric vehicles. He is responsible for the strategic management of the group and formulating the overall goals and tasks. He graduated from Zhongnan University of Political Science and Law (now known as Zhongnan University of Economics and Law) in 1992 with a bachelor degree in economic law and in 2001 he completed his master degree in Law. After graduating in 1992, he served in Henan Higher People's Court. Mr. Feng quitted his job and ventured into automotive business in 2002. He has over 15 years of extensive experience in the Chinese automotive industry and has unique insights into the industry.
Mr. Liu Fenglei	CEO	Mr. Liu is the chief executive officer and one of the founders of the Group. He is responsible for the overall management and operation of the Group. He obtained a bachelor's degree in business English from Zhengzhou University in 1998. He joined Harmony Group in February 2003 as assistant to the chairman of Henan Zhongdebao Automobile Sales and Service Co., Ltd. Mr. Liu was assigned as the general manager of Zhengzhou Yuanda Lexus Sales and Service Co., Ltd. in August 2006, and was appointed as the vice president / director of network development of China Harmony New Energy Automobile Holdings Limited in April 2013. The board of directors believe that Mr. Liu has rich experience in automotive industry and made a major contribution to the development of the Group. Mr. Liu proved his ability with outstanding work and strong execution during his tenure. He was appointed as Executive Director and CEO of China Harmony New Energy Automobile Holdings Limited in October 2015.
Mr. Zhang Lei	CFO	Mr. Zhang is the Group's Chief Financial Officer and is responsible for the Group's financial planning, strategy and management. Mr. Zhang joined Henan Zhongdebao Automobile Sales and Service Co., Ltd. of Harmony Group in March 2005. He has served as an accounting supervisor and financial manager; and has been the chief accountant of the Group since May 2011. He has extensive experience in finance, auditing, taxation and capital management in the automotive industry, and Mr. Zhang holds the qualification of senior accountant. In August 2017, Mr. Zhang was appointed as the Chief Financial Officer of China Harmony New Energy Automobile Holdings Limited.
Ms. Ma Lintao	VP	Ms. Ma is the vice president of the Group and is responsible for the administration and public relations of the Group. Ms. Ma graduated from Henan University of Finance and Economics (now Henan University of Economics and Law) with a bachelor degree in national economic planning and statistics in June 1992. From July 1992 to November 2003, Ms. Ma worked at the Henan Branch of China Construction Bank. She served as the director of the Credit Approval Committee and the deputy governor of Futures in Zhengzhou branch. Ms. Ma joined the company in November 2003. In June 2006, he served as chairman and legal representative of Zhengzhou Yuanda Lexus Sales Service Co., Ltd. She participated in building the first Lexus 4S shop in Henan, and led the team to obtain Lexus China Distributor of the Year for five times. In April 2013, he was appointed as executive director and vice president of China Harmony New Energy Automobile Holdings Limited. Ms. Ma is responsible for the operation and management of the second division department of the automotive business. Her extensive enterprise operation management experience and good risk control capabilities have made significant contributions to the business development of Lexus and other brands in the second division department.
Ms. Feng Guo	VP	Ms. Feng is the vice president of the group and is responsible for the group's audit, internal control and financial management at the subsidiary level. Ms. Feng participated in BMW China's establishment of a Henan province partnership and the establishment of Zhongdebao. Ms. Feng is also responsible for the development of automobile brands such as BMW, Land Rover and Rolls-Royce. She has extensive experience in the operation, financial accounting, capital planning, and financial data analysis of luxury and ultra-luxury automobile brands in automobile dealership groups, and has solid networks and resources in commercial banking. Ms. Feng has excellent management, organizational coordination, and risk control capabilities. Ms. Feng graduated from Zhengzhou University with an undergraduate degree in law in 2007 and obtained a master degree in business administration from Zhongnan University of Economics and Law in 2009. Ms. Feng joined Henan Zhongdebao Automobile Sales Service Co., Ltd. in March 2004 as a financial manager and deputy general manager. In October 2010, she was appointed as the chief financial officer of China Harmony New Energy Automobile Holdings Co., Ltd., and in August 2017, she took the position of executive director and vice president of China Harmony New Energy Automobile Holdings Co., Ltd.

Source: Citi Research, Company Reports

History

- In 2001, Jinsha Lake International Golf Club was established.
- In 2005, it was authorized by the first BMW brand in Henan Province to establish Henan Zhongdebao.
- In 2007, Henan Harmony Real Estate Co., Ltd. was established.
- In 2008, Henan Harmony Industry Group Co., Ltd. was established.

- **In 2013**, China Harmony New Energy Auto Holding Limited was successfully listed on the stock market of Hong Kong (stock name: Harmony Automobile Co., Ltd., stock code: 03836. HK).
- **In 2015**, Tencent, Foxconn and China Harmony Auto Holding Ltd. signed the "Internet+ smart electric vehicle strategic cooperation framework agreement" by the three parties, marking the Harmony Group's formal entry into the new energy vehicle field.
- **In 2016**, Harmony Group, as a founding investor, registered and established a global intelligent joint electric vehicle company in Hong Kong, China, known as FMC (Future Mobility Corporation Ltd).
- **In 2019**, the group merged the "Harmony Auto Repair" and "Harmony Zhilian" established in 2017 and 2018, and renamed them "Dangdang New Energy Auto" (Dangdang Auto Repair).
- **From June to November 2019**, China Harmony Auto Holding Ltd. signed strategic cooperation agreements with ISUZU, Suning Auto, Everbright Bank, Zhongyuan Bank, etc.
- **In June 2019**, Harmony Group donated 200,000 RMB to "Community Governance and Development Charity Fund" of Ruyi Lake Office, Zhengdong New District, Zhengzhou city.
- **In November 2019**, China Harmony Auto Holding Ltd. reached a strategic cooperation with Mr. Lee Ka Kit, Chairman of Hong Kong Henderson Land Development.
- **In July 2021**, Harmony Group donated 11 million yuan for flood relief and post disaster reconstruction in Henan.

Headquarters

The company's principal place of business and headquarter in PRC is located in Zhengzhou, Henan Province.

Employees

As of December 31, 2020, the group had 4,206 employees (2019: 3,589), including 4,203 employees in Mainland China, 2 in Hong Kong and 1 in Macao. The group believes it provides competitive remuneration and benefits, adjusts salaries in accordance with the actual situation in each year, and regularly reviews its compensation and performance appraisal mechanism to reduce employee turnover.

Bull/Bear: Harmony Auto (3836.HK)

Bull/Bear: Harmony Auto (3836.HK)

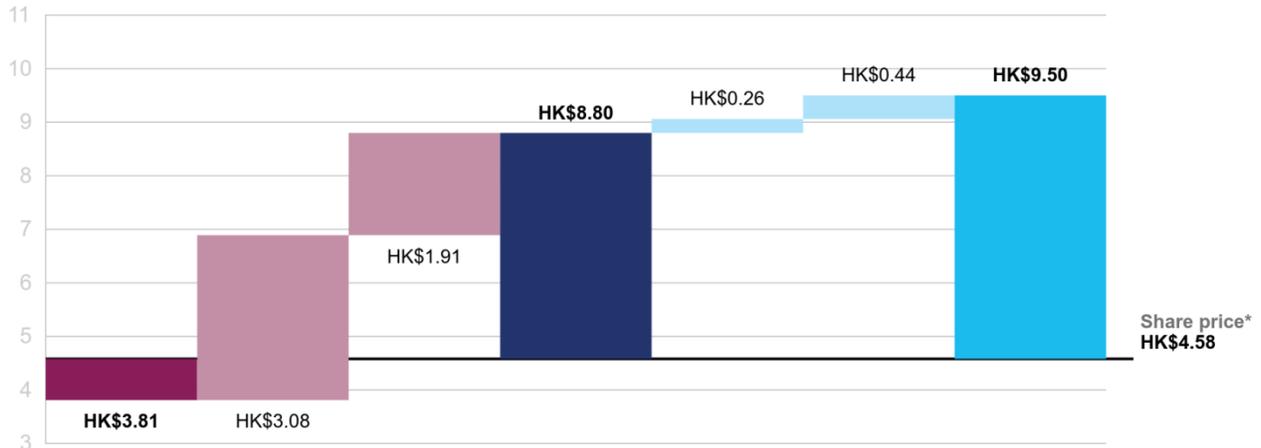


HK\$8.8 target price

92% expected share price return

Buy rating

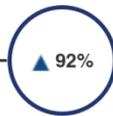
124pp Bull/Bear Spread



PV sales volume 25% below forecast in 22E
Aftersales GPM 8ppts lower than estimate in 22E



PV sales volume 3% above forecast in 22E
Aftersales service revenue to grow 5% above forecast in 22E



Share price*
HK\$4.58

Source: Citi Research

*Share price as of 24 Dec 2021 16:10



- PV sales volume 3% above forecast in 22E
- Aftersales service revenue to grow 5% above forecast in 22E

HK\$9.5



- New car sales volume at 39k with gross margin at 4.3% in 22E
- Aftersales service revenue +20% YoY with gross margin at 46.1% in 22E

HK\$8.8



- PV sales volume 25% below forecast in 22E
- Aftersales GPM 8ppts lower than estimate in 22E

HK\$3.81

Harmony Auto

Company description

Harmony Auto is a leading automotive dealer group in China, representing 14 luxury and ultra-luxury brands in 39 cities across the country. As of end of FY20, ultra-luxury new car sales accounted for 8% of Harmony's total new car sales revenue. The company's headquarters are in Zhengzhou, Henan Province.

Investment strategy

We have a Buy rating on Harmony based on our positive outlook for luxury/ultra-luxury brand car sales in China. We estimate Harmony's 2020-23E revenue CAGR to be 18.0%, supported by 1) its unique ultra-luxury/luxury brand-mix and exposure to top-tier cities; 2) a strong earnings outlook for after-sales services; 3) robust new car sales along with strong key brand performance; and 4) its asset-light NEV business model and other business segments.

Valuation

Our sum-of-the-parts target price for Harmony of HK\$8.8 is based on: 1) 15.5x 22E P/E (sector average) for new car sales to factor in a decent earnings outlook given the strong product cycle of the key brands (BMW/Lexus) as well as the company's unique ultra-luxury brand portfolio; and 2) 24x 22E P/E (sector average) for the after-sales segment on the contribution from ultra-luxury brands and steady SSSG as the blended store age gradually matures. Our valuation implies 16.3x blended 22E P/E, 1.3x 21-23E PEG and 1.6x 22E P/B.

Risks

Key downside risks that could mean the Harmony shares fail to achieve our target price include: 1) a weak macro which dampens overall purchasing power in China; 2) in a worst-case scenario, a full write-off of Byton (Baiteng) might incur a one-off cost of Rmb1.2bn for FY21, which could lead to FY21E NP loss (though such a one-off would not impact our earnings forecasts for FY22 and beyond); 3) slower-than-expected network expansion; and 4) intensified competition could weigh on profitability, especially for new car sales.

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Appendix A-1

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IMPORTANT DISCLOSURES

Harmony Auto (3836.HK)

Ratings and Target Price History
Fundamental Research



*Indicates Change

Rating/target price changes above reflect Eastern Time

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Data current as of 30 Sep 2021	12 Month Rating			Catalyst Watch		
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