

Bitauto Holdings (BITA US)

Buy: On the right path

- ▶ Bitauto unveiled targets on revenue and margin for its auto financing arm, and partnership with leading Internet firms
- ▶ With a bigger revenue contribution from the auto financing business, Bitauto's margin should gradually improve
- ▶ Maintain Buy with target price unchanged at USD35

A new era. Following two capital injections in the past three months, Bitauto gave more details regarding its auto eCommerce and financing businesses, as well as its partnership with leading Internet companies. More specifically, Bitauto will focus on Huimaiche, its C2B auto eCommerce platform, and Yixin Capital, its auto financing arm. It will gradually scale down the other eCommerce products including YiChe Mall and Auto Agent. The implication is Bitauto's headcount expansion will slow significantly in the future, which will support margin expansion. On Yixin Capital, Bitauto expects it to reach Rmb2bn in revenue in 2017 with a 20-30% margin, a similar level to Bitauto's media business. In other words, Yixin Capital could generate over Rmb400-600mn profit for Bitauto next year. The profitability of Yixin Capital is reflected in Bitauto's surge in tax expense in 2Q16.

Partnership with Internet giants. Tencent (700 HK, HKD184.50), JD.com (JD US, USD21.8, Buy), and Baidu (BIDU US, USD160.75, Buy) have each made two major investments in Bitauto and Yixin Capital in the past two months. Bitauto is looking to actively form partnerships with each of these Internet giants. For Tencent, Bitauto will have access to the former's advertising inventories, and connect to QQ Wallet, and hopefully Wechat Pay at a later stage. For Baidu, Bitauto will collaborate on online search, especially on auto financing and leasing key words. Bitauto will also connect to Baidu Wallet and Baidu Map in the future. For JD.com, Bitauto will continue to power the former's online auto mall. Already 10-15% of Bitauto's transaction volume comes from JD.com at this stage.

2Q results miss on earnings. Bitauto's 2Q revenue and 3Q revenue guidance were in line with our forecasts. Stripping out the other gains of Rmb36m, non-GAAP net income was 13% lower than expected due to lower gross margin and higher tax rate.

Maintain Buy with target price of USD35. Despite its earnings miss in 2Q, we think Bitauto's margin will start to recover in 4Q16 due to a higher revenue contribution from the profitable auto financing business and the improving profitability of Huimaiche. We maintain our Buy rating and unchanged target price of USD35. We use a 10-year DCF model to derive our target price of USD35 which implies 18x 2017e PER against an over 30% 3-year EPS CAGR. **Key downside risk:** slower-than-expected auto industry growth which weighs on Bitauto's media business.

EQUITIES INTERNET

China



MAINTAIN BUY

TARGET PRICE (USD)

35.00

PREVIOUS TARGET (USD)

35.00

SHARE PRICE (USD)

26.22

(as of 09 Aug 2016)

UPSIDE/DOWNSIDE

+33.5%

MARKET DATA

Market cap (USDm)	1,585	Free float	100%
Market cap (USDm)	1,585	BBG	BITA US
3m ADTV (USDm)	30.8	RIC	BITA.N

FINANCIALS AND RATIOS (CNY)

Year to	12/2015a	12/2016e	12/2017e	12/2018e
HSBC EPS	4.70	6.50	10.51	14.60
HSBC EPS (prev)	5.66	6.47	8.94	12.15
Change (%)	-17.0	0.5	17.6	20.2
Consensus EPS	5.14	7.67	12.63	16.79
PE (x)	37.1	26.9	16.6	12.0
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	-	7.8	3.6	1.5
ROE (%)	5.2	5.6	8.6	11.5

52-WEEK PRICE (USD)



Source: Thomson Reuters IBES, HSBC estimates

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Financials & valuation: Bitauto Holdings

Buy

Financial statements

Year to	12/2015a	12/2016e	12/2017e	12/2018e
Profit & loss summary (CNYm)				
Revenue	4,012	5,713	7,028	8,727
EBITDA	-4	547	905	1,270
Depreciation & amortisation	-570	-674	-738	-770
Operating profit/EBIT	-574	-127	167	500
Net interest	17	4	36	41
PBT	-446	-139	203	541
HSBC PBT	-326	-25	343	715
Taxation	-65	-88	-143	-199
Net profit	-511	-227	59	342
HSBC net profit	273	502	812	1,129
Cash flow summary (CNYm)				
Cash flow from operations	-2,442	743	1,157	1,587
Capex	-232	-189	-189	-189
Cash flow from investment	-3,508	-189	-189	-189
Dividends	0	0	0	0
Change in net debt	-1,758	-2,484	-968	-1,398
FCF equity	-2,898	409	764	1,145
Balance sheet summary (CNYm)				
Intangible fixed assets	2,913	2,300	1,688	1,075
Tangible fixed assets	849	1,064	1,240	1,426
Current assets	7,534	10,577	11,836	13,595
Cash & others	3,041	5,525	6,493	7,890
Total assets	12,069	14,713	15,535	16,868
Operating liabilities	2,347	3,155	3,777	4,593
Gross debt	0	0	0	0
Net debt	-3,041	-5,525	-6,493	-7,890
Shareholders' funds	8,492	9,354	9,554	10,070
Invested capital	5,908	5,261	4,493	3,612

Ratio, growth and per share analysis

Year to	12/2015a	12/2016e	12/2017e	12/2018e
Y-o-y % change				
Revenue	63.1	42.4	23.0	24.2
EBITDA	-100.7		65.4	40.3
Operating profit	-206.7			199.7
PBT	-176.1			166.7
HSBC EPS	-59.0	38.3	61.7	38.9
Ratios (%)				
Revenue/IC (x)	1.2	1.0	1.4	2.2
ROIC	-2.0	14.2	4.7	17.3
ROE	5.2	5.6	8.6	11.5
ROA	-6.4	-1.5	0.4	2.1
EBITDA margin	-0.1	9.6	12.9	14.6
Operating profit margin	-14.3	-2.2	2.4	5.7
EBITDA/net interest (x)	0.3			
Net debt/equity	-35.3	-58.3	-67.1	-77.4
Net debt/EBITDA (x)	721.3	-10.1	-7.2	-6.2
CF from operations/net debt				
Per share data (CNY)				
EPS Rep (diluted)	-8.78	-2.94	0.77	4.42
HSBC EPS (diluted)	4.70	6.50	10.51	14.60
DPS	0.00	0.00	0.00	0.00
Book value	146.05	137.33	140.27	147.85

Valuation data

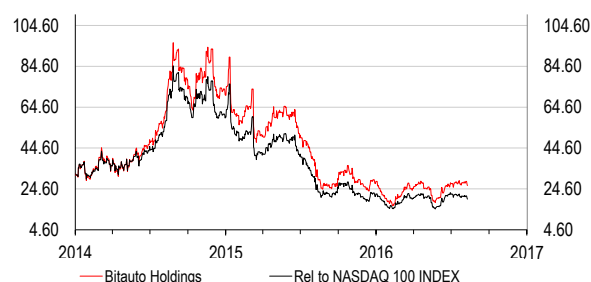
Year to	12/2015a	12/2016e	12/2017e	12/2018e
EV/sales	1.7	0.7	0.5	0.2
EV/EBITDA		7.8	3.6	1.5
EV/IC	1.1	0.8	0.7	0.5
PE*	37.1	26.9	16.6	12.0
PB	1.2	1.3	1.2	1.2
FCF yield (%)	-29.6	4.2	7.8	11.7
Dividend yield (%)	0.0	0.0	0.0	0.0

* Based on HSBC EPS (diluted)

Issuer information

Share price (USD)	26.22	Free float	100%
Target price (USD)	35.00	Sector	Internet
Reuters (Equity)	BITA.N	Country	China
Bloomberg (Equity)	BITA US	Analyst	Terry Chen
Market cap (USDm)	1,585	Contact	+852 2996 6635

Price relative



Source: HSBC

Note: Priced at close of 09 Aug 2016

Quarterly profit & loss

(Rmb 000)	1Q15	2Q15	1Q16	2Q16	3Q16e
Revenues	740,457	1,061,299	1,083,504	1,391,413	1,425,431
Advertising and subscription	607,115	771,100	714,500	890,300	938,912
Transaction service	29,136	183,800	201,400	308,300	360,000
Digital marketing solutions	104,175	106,400	167,604	192,800	126,519
Cost of revenues	(241,607)	(379,228)	(352,503)	(540,936)	(555,918)
Gross profit	498,851	682,071	731,000	850,477	869,513
Gross margin (%)	67.4%	64.3%	67.5%	61.1%	61.0%
Operating expenses	(512,689)	(730,494)	(808,640)	(850,851)	(905,149)
Income/(loss) from operations	(13,838)	(48,423)	(77,640)	(373)	(35,636)
Non-GAAP operating profit	34,122	128,281	99,477	169,394	145,995
Non-GAAP operating profit margin	4.6%	12.1%	9.2%	12.2%	10.2%
GAAP Net income	60,453	(55,179)	(108,209)	(47,504)	(46,801)
Non-GAAP net income	18,599	122,567	69,196	124,763	134,830
Non-GAAP net margin	2.5%	11.5%	6.4%	9.0%	9.5%
EPS - Basic (USD)	0.05	0.31	0.07	0.21	0.33

Source: Bitauto, HSBC estimates

Annual profit & loss

(Rmb 000)	2016e	2017e	2018e
Revenues	5,712,949	7,027,622	8,727,069
Advertising and subscription	3,587,063	3,978,793	4,404,267
Transaction service	1,400,000	1,960,000	2,744,000
Digital marketing solutions	725,886	1,088,829	1,578,802
Cost of revenues	(2,142,356)	(2,635,358)	(3,272,651)
Gross profit	3,570,593	4,392,264	5,454,418
Gross margin (%)	62.5%	62.5%	62.5%
Operating expenses	(3,697,876)	(4,225,358)	(4,954,248)
Income/(loss) from operations	(127,283)	166,906	500,170
Non-GAAP operating income/(loss)	599,467	919,949	1,287,202
Non-GAAP operating margin (%)	10.5%	13.1%	14.7%
GAAP Net income	(227,072)	59,445	341,735
Non-GAAP net income	502,464	812,488	1,128,767
YoY growth (%)	83.8%	61.7%	38.9%
Non-GAAP net margin (%)	8.8%	11.6%	12.9%
EPS (US\$)	1.1	1.8	2.4

Source: HSBC estimates

Estimate changes

(Rmb mn)	2016e	2017e	2018e
Current			
Total revenue	5,713	7,028	8,727
Non-GAAP operating margin	10.5%	13.1%	14.7%
Non-GAAP net margin	8.8%	11.6%	12.9%
EPS (USD)	1.1	1.8	2.4
Previous			
Total revenue	5,457	6,985	8,695
Non-GAAP operating margin	10.7%	11.1%	12.3%
Non-GAAP net margin	9.2%	9.9%	10.8%
EPS (USD)	1.1	1.5	2.0
Delta			
Total revenue	4.7%	0.6%	0.4%
Non-GAAP operating margin	-0.2%	1.9%	2.5%
Non-GAAP net margin	-0.4%	1.7%	2.1%
EPS (USD)	0.4%	17.6%	20.2%

Source: HSBC estimates

We raise our 2016 revenue forecast by 4.7% on the back of our higher ASP assumption for Bitauto's transaction service business. We increase the ASP assumption to Rmb4,000 from Rmb3,500 previously. Other assumptions remain unchanged. For 2017 and 2018, our revenue forecasts remain largely unchanged but we have factored in a larger contribution from Yixin Capital which has much higher margins of 20-30% according to management. Therefore, we

have adjusted up our margin assumptions accordingly. We expect Yixin Capital to generate around Rmb300m in after-tax profit for Bitauto in 2017, representing the majority of the profit increase for the company.

Valuation and risks

We maintain our Buy rating on the stock. Our investment thesis rests on two points: first, the transaction service business will likely become a new growth engine for Bitauto with improved profitability. Second, being an integrated online automotive platform, Bitauto has the opportunity to tap into auto financing and after-sales services, which provides an option value for the stock.

Our target price is USD35. We derive our target price using a 10-year DCF model. The key assumptions of our DCF model are an 18.6% WACC and a 2% terminal growth rate. Our WACC of 18.6% is calculated using a 3% risk-free rate, a 2.6 equity beta from Bloomberg, a 6% equity risk premium and the assumption that Bitauto will remain debt-free in the long term. Our target price of USD35 per ADS implies an 18x 2017e PE against an over 30% 3-year EPS CAGR.

Note that the company has restated its 2015 historical numbers in accordance with the change to US GAAP accounting, and thus we adjust our 2015 numbers accordingly.

SOTP valuation for Bitauto

Bitauto's traditional business	2016e	2017e	2018e	2024e	2025e	2026e
Revenue (Rmb m)	5,713	7,028	8,727	12,809	15,217	17,684
EBITDA (Rmb m)	547	1,010	1,575	2,641	3,328	4,093
EBITDA margin (%)	9.6%	14.4%	18.1%	25.9%	27.2%	28.6%
FCF (Rmb m)	285	517	910	1,652	2,143	2,699
WACC (%)	18.6%					
Terminal growth rate (%)	2.0%					
Implied terminal EB/EBITDA (x)	4.2					
Enterprise value (Rmb bn)	14,765					
Net cash (Rmb bn)	3,895					
Equity value (Rmb bn)	18,660					
Equity value (Rmb per share)	241					
Equity value (USD per share)	35					

Source: HSBC estimates

Key downside risks

Macro

Bitauto's operational results are highly correlated to the automotive industry. Our base case is that the auto industry could sustain a growth rate in sales volumes of 5-10% in the coming years. If the growth rate turns out to be significantly lower than this range or even negative, automakers and dealers could cut their advertising budgets or shift their budgets from advertising to direct sales rebates to consumers. As a result, Bitauto's revenue growth could be significantly lower than our forecasts. As a pure online auto advertising platform, it is unlikely Bitauto would escape any drag from the real economy.

Investments in mobile and new business initiatives

Our base case is that Bitauto will control spending, especially on sales and marketing expenses, to adjust to slower revenue growth. The company will continue to spend on mobile, e-commerce, and used auto businesses, but we expect expenses to grow more slowly than revenue, and the margin to gradually improve in future years. If Bitauto puts market share ahead of profitability or makes strategic investments in new businesses at the expense of margin, its profitability could be much lower than our forecasts.

PE trend for Bitauto based on Bloomberg consensus

Source: Bloomberg

Actual results vs. HSBC and consensus

2Q16 results (Rmb mn)	Actual	HSBC	Consensus	Actual vs. HSBC	Actual vs. Consensus
Revenue	1,391	1,382	1,366	1%	2%
Non-GAAP net income	125	102	145	22%	-14%
Non-GAAP EPS (USD)	0.21	0.25	0.32	-17%	-35%

Source: Company data, Bloomberg, HSBC estimates

Disclosure appendix

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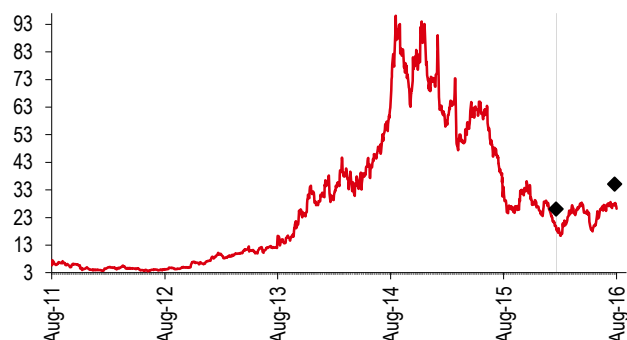
Share price and rating changes for long-term investment opportunities

Bitauto Holdings (BITA.N) share price performance USD
Vs HSBC rating history

Rating & target price history

From	To	Date	Analyst
N/A	Buy	27 Jan 2016	Terry Chen
Target price	Value	Date	Analyst
Price 1	26.00	27 Jan 2016	Terry Chen
Price 2	35.00	03 Aug 2016	Terry Chen

Source: HSBC



Source: HSBC

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Source: HSBC

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