

# Bitauto Holdings (BITA US)

**Buy: Momentum intact but margin recovery may slow**

## EQUITIES INTERNET

China

- Headcount expansion may slow margin recovery
- 4Q'16 results are better than consensus
- Maintain Buy, with lower target price of USD27 from USD35

**Headcount on the rise.** Bitauto's headcounts increased by 1,359 or 22% sequentially from 6,261 in 3Q'16 to 7,620 in 4Q'16 because it acquired Kankanche, which specializes in used car sales and financial services. For 2017, Bitauto plans to add 1,000 headcount to support the expansion of Yixin Capital, Bitauto's auto financing arm. With a larger offline sales and support team, Yixin Capital is targeting to double its service revenue in 2017. We estimate the headcount expansion will likely lead to Rmb375m incremental opex for Bitauto in 2017, which represents c5.4% of its revenue base, on our estimates. We believe it may take 2 years for Yixin Capital to reach the optimal geographical footprint, which means it may add another 1,000 headcount in 2018.

**Used auto remains the focus.** Bitauto expects its total paying transactions to increase from 447,000 in 2016 to at least 600,000 in 2017, mainly driven by the used auto business. According to management, Yixin Capital will account for two thirds of transaction volume in 2017, of which used autos will contribute 60% of Yixin Capital's transaction volume (up from 40% in 2016). Bitauto's transaction service revenue, excluding the GMV-based revenue, may double from RMB1bn in 2016 to over RMB2bn in 2017, according to management.

**Mixed 4Q'16 results.** Bitauto's total revenue increased 32% y-o-y to RMB1.75bn in 4Q, 4% above our expectation. But its advertising and subscription revenue only grew 2.2% y-o-y in 4Q, 2.3% below our expectation. Excluding other gains of RMB25m and investment loss of RMB21m, Bitauto's non-GAAP operating income and net income were 7% and 18%, respectively, below our forecasts in 4Q due to higher headcount-related expenses. But Bitauto's non-GAAP net income of RMB98m in 4Q was significantly higher than consensus of RMB38m. Bitauto's revenue guidance for 1Q'17 is RMB1.48b-1.53bn, in line with consensus of RMB1.5bn.

**Maintain Buy, with lower TP.** We continue to believe Bitauto will likely achieve over 50% y-o-y growth in its transaction revenue in 2017e-2018e given the synergies between its media and transaction businesses and the support from its strategic shareholders like JD.com (JD US, CP USD30.67, Buy), Tencent (700 HK, HKD206.40, Buy), and Baidu (BIDU US, USD175.33, Buy). However, we become more cautious on the potential margin improvement due to headcount expansion. We lower our non-GAAP operating margin forecast by 3.3%/5.5% in 2017e/2018e to factor in the incremental opex related to headcount. Our USD EPS estimates are adjusted downward by 23%/36% in 2017e/2018e accordingly. Our new DCF-based target price of USD27 implies 16x 2018e PE against 20% 3-year EPS CAGR. Maintain Buy rating.



**MAINTAIN BUY**

TARGET PRICE (USD)

**27.00**

PREVIOUS TARGET (USD)

**35.00**

SHARE PRICE (USD)

**19.53**

(as of 01 Mar 2017)

UPSIDE/DOWNSIDE

**+38.2%**

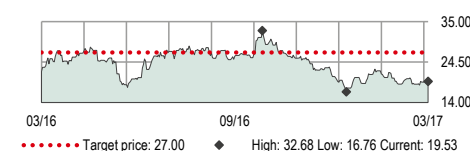
### MARKET DATA

Market cap (USDm)	1,381	Free float	100%
Market cap (USDm)	1,381	BBG	BITA US
3m ADTV (USDm)	24	RIC	BITA.N

### FINANCIALS AND RATIOS (CNY)

Year to	12/2016a	12/2017e	12/2018e	12/2019e
HSBC EPS	6.35	8.03	9.71	11.84
HSBC EPS (prev)	5.66	9.75	14.23	-
Change (%)	12.2	-17.6	-31.8	-
Consensus EPS	4.01	7.03	11.99	15.05
PE (x)	21.2	16.7	13.8	11.3
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	5.5	4.2	2.3	0.8
ROE (%)	4.9	6.0	7.3	8.8

### 52-WEEK PRICE (USD)



Source: Thomson Reuters IBES, HSBC estimates

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## Financials &amp; valuation: Bitauto Holdings

Buy

## Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
<b>Profit &amp; loss summary (CNYm)</b>				
Revenue	5,773	7,005	8,544	10,309
EBITDA	597	645	783	936
Depreciation & amortisation	-686	-750	-781	-797
Operating profit/EBIT	-89	-105	1	139
Net interest	-11	-5	-6	-5
PBT	-144	-130	-20	124
HSBC PBT	-67	30	166	340
Taxation	-148	-98	-119	-145
Net profit	-291	-228	-138	-21
HSBC net profit	439	556	672	819

## Cash flow summary (CNYm)

Cash flow from operations	690	811	1,106	1,366
Capex	-189	-189	-189	-189
Cash flow from investment	-189	-189	-189	-189
Dividends	0	0	0	0
Change in net debt	-2,399	-587	-872	-1,122
FCF equity	288	540	672	879

## Balance sheet summary (CNYm)

Intangible fixed assets	2,288	1,664	1,040	416
Tangible fixed assets	1,087	1,307	1,523	1,746
Current assets	10,388	11,237	12,412	13,830
Cash & others	5,440	6,027	6,899	8,021
Total assets	14,535	14,981	15,747	16,764
Operating liabilities	3,069	3,583	4,301	5,124
Gross debt	0	0	0	0
Net debt	-5,440	-6,027	-6,899	-8,021
Shareholders' funds	9,262	9,194	9,241	9,437
Invested capital	5,254	4,598	3,774	2,848

## Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
<b>Y-o-y % change</b>				
Revenue	35.7	21.3	22.0	20.7
EBITDA	452.1	8.0	21.4	19.6
Operating profit				10727.2
PBT				
HSBC EPS	0.5	26.5	20.8	22.0
<b>Ratios (%)</b>				
Revenue/IC (x)	1.0	1.4	2.0	3.1
ROIC	19.4	18.5	103.9	-3.9
ROE	4.9	6.0	7.3	8.8
ROA	-1.4	-0.9	1.8	-0.2
EBITDA margin	10.3	9.2	9.2	9.1
Operating profit margin	-1.5	-1.5	0.0	1.3
EBITDA/net interest (x)	56.8	121.5	126.3	183.8
Net debt/equity	-58.0	-64.7	-73.7	-83.9
Net debt/EBITDA (x)	-9.1	-9.4	-8.8	-8.6
CF from operations/net debt				
<b>Per share data (CNY)</b>				
EPS Rep (diluted)	-4.21	-3.30	-2.00	-0.30
HSBC EPS (diluted)	6.35	8.03	9.71	11.84
DPS	0.00	0.00	0.00	0.00
Book value	142.15	141.10	141.82	144.82

## Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	0.6	0.4	0.2	0.1
EV/EBITDA	5.5	4.2	2.3	0.8
EV/IC	0.6	0.6	0.5	0.2
PE*	21.2	16.7	13.8	11.3
PB	0.9	1.0	0.9	0.9
FCF yield (%)	3.3	6.2	7.7	10.1
Dividend yield (%)	0.0	0.0	0.0	0.0

\* Based on HSBC EPS (diluted)

## Issuer information

Share price (USD)	19.53	Free float	100%
Target price (USD)	27.00	Sector	Internet
Reuters (Equity)	BITA.N	Country	China
Bloomberg (Equity)	BITA US	Analyst	Terry Chen, CFA
Market cap (USDm)	1,381	Contact	+852 2996 6635

## Price relative



Source: HSBC

Note: Priced at close of 01 Mar 2017

**4Q'16 results**

(RMBm)	4Q16 results			Delta		1Q17e		
	Actual	HSBC	Consensus	vs. HSBC	vs Cons.	Guidance	HSBC	Consensus
Revenue	1,749	1,678	1,631	4%	7%	1,505	1,510	1,496
Advertising and subscription	933	955		-2%				
Transaction service	638	522		22%				
Digital marketing solutions	230	201		14%				
Gross profit	1,109	1,050		6%				
Non-GAAP operating profit	161	146		10%				
Non-GAAP net income	98	115	38	-14%	157%			

Source: Bitauto, HSBC estimates

**Summary of estimate changes**

(RMBm)	2017e	2018e	2019e
<b>Current</b>			
Total revenue	7,005	8,544	10,309
Non-GAAP operating margin	9.4%	9.3%	9.4%
Non-GAAP net margin	7.9%	7.9%	7.9%
EPS (USD)	1.2	1.4	1.7
<b>Previous</b>			
Total revenue	7,009	8,742	
Non-GAAP operating margin	12.7%	14.9%	
Non-GAAP net margin	10.8%	12.6%	
EPS (USD)	1.5	2.2	
<b>Delta</b>			
Total revenue	0%	-2%	
Non-GAAP operating margin (ppt)	(3.3)	(5.5)	
Non-GAAP net margin (ppt)	(2.8)	(4.7)	
EPS (USD)	-23%	-36%	

Source: Bitauto, HSBC estimates

**Valuation and risks**

We maintain our Buy rating on the stock but lower our target price from USD35 to USD27. 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, as an integrated online automotive platform, Bitauto has the opportunity to tap into after-sales services in the long term, which provides an option value for the stock.

We derive our target price using a 10-year DCF model. Our key assumptions are a WACC of 18.1% and a 2% terminal growth rate. Our WACC of 18.1% is calculated using a 2.5% 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 implies 16x 2017e PE against 20% 3-year EPS CAGR.

**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 the growth rate in sales volume 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 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, we think it is unlikely Bitauto would escape the 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 the long term. 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.

# Disclosure appendix

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Upside/Downside is the percentage difference between the target price and the share price.

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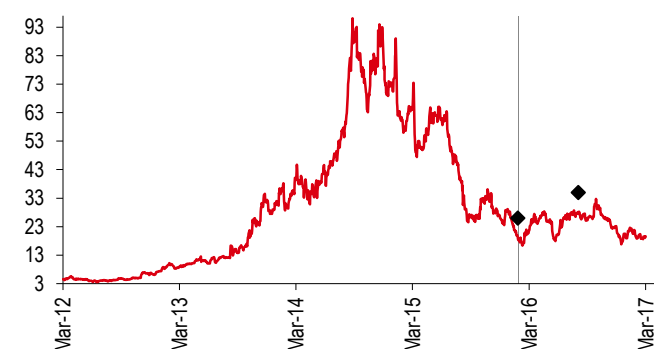
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**Share price and rating changes for long-term investment opportunities****Bitauto Holdings (BITA.N) share price performance USD****Vs HSBC rating history****Rating & target price history**

Source: HSBC

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

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Company	Ticker	Recent price	Price date	Disclosure
BITAUTO HOLDINGS	BITA.N	19.53	02 Mar 2017	6, 7

Source: HSBC

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