

3 October 2014

Car Inc (699.HK)

Fast-growing leader of the car rental service of China

HONG KONG | TRANSPORTATION | COMPANY INITIATION

Rating: **Accumulate**

- As the biggest car rental company in China at present, China Auto Rental Inc (CAR) was established in 2007 and it provides short-term rental, long-term rental and finance leasing service for customers, and the supporting services of nationwide roadside assistance and return at different locations, etc.
- As of June, 2014, the total fleet scale of CAR amounted to 52,498 vehicles, which is not only the biggest in China but also exceeds the total of the fleet scales of car rental companies ranking from the second to the tenth, and is more than 4 times of the fleet scale of the second biggest car rental company. What's more, the number of car rental outlets established by the company is about 3 times of the rivals'.
- The revenue of CAR mainly comes from car rental business and sales of used cars, among which the revenue from car rental accounts for 70% to 90% of the total. It takes 31.2% shares of the short rental market. Among the company's 52.5 thousand vehicles, 35,602 vehicles are used for short-term rental.
- With the rapid growth of the industry, the company's total number of customers has increased from about 450,000 at the end of 2011 to 1.962 million by the end of June, 2014, with a growth of about four times. The company has set 717 direct-sale car rental outlets in 70 major cities in China. Along with the growing recognition of the brand image of its leader role, the average daily car rent and the utilization rates of the cars has increased gradually.

How we view this

China's car rental industry has been in a high speed development period in recent years. We believe, at least there are six reasons to support that China's car rental industry is still in the early stage of development. With this ipo, it will increase its advantage in its cost of fund and with 65% of the proceeds being used for procurement for new fleet (equal to its current size), the company's follow-up development will undoubtedly be further ahead.

Investment Action

Our 12-m-target price is HK\$13.2, equivalent to 51/22/11xP/E in 2014/2015/2016 respectively. We recommend Accumulate rating.

Key Financial Summary

FYE Dec	12/12	12/13	12/14F	12/15F	12/16F
Revenue (RMB mn)	1,609	2,703	4,624	7,539	11,620
Net Profit, adj. (RMB mn)	-132	-223	477	1,119	2,276
EPS, adj. (RMB)	NA	NA	0.20	0.47	0.97
P/E (X),adj.	NA	NA	46.2	19.6	9.6
BVPS (RMB)	NA	NA	1.22	1.47	1.91
P/B (X)	NA	NA	7.7	6.3	4.9
DPS (RMB)	NA	NA	0.05	0.12	0.24
Div. Yield (%)	NA	NA	0.5%	1.3%	2.6%

Source: Bloomberg, PSR est.

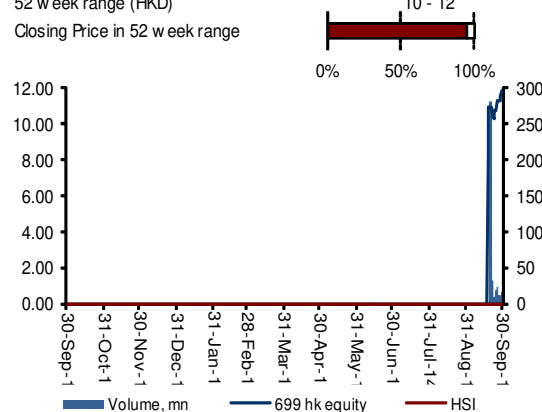
*All multiples & yields based on current market price

Target Price (HKD)	13.20
Forecast Dividend (HKD)	0.06
Closing Price (HKD)	11.90
Potential Return	11.5%

Company Description

The Group is principally engaged in the car rental business. The Group is the largest car rental company in China, offering comprehensive car rental services including short-term rentals, long-term rentals and leasing.

Raw Beta (Past 2yrs weekly data) #N/A N/A
Market Cap. (HKD bn) 28,054
Enterprise Value (HKD mn) 25,382
52 week range (HKD) 10 - 12
Closing Price in 52 week range



Major Shareholders

1. Grand Union	29.20%
2. Amber Gem	18.30%
3. Hertz	16.20%
4. Haode Group	12.50%

Valuation Method

PE

Analyst

Zhang Jing
zhangjing@phillip.com.cn
+86 63512937

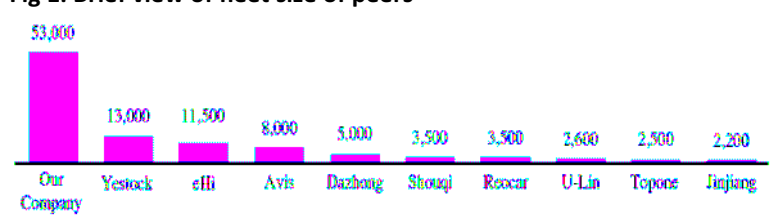
Company Profile

China Auto Rental Inc (CAR), headquartered in Beijing, was established in 2007 and was formerly known as the United Automobile Association, an O2O company for car service founded by Lu Zhengyao. As the biggest car rental company in China at present, it provides short-term rental, long-term rental and finance leasing service for customers, and the supporting services of nationwide roadside assistance and return at different locations, etc. The major shareholders of the company are Legend Capital under Legend Holdings, accounting for 29.2%, Warburg Pincus 18.3% and the global car rental giant Hertz 16.2%.

The dominant leader of domestic car rental industry

According to the data from Roland Berger, the company is the dominant leader in the market in terms of the scale of fleet, revenue, network coverage and brand reputation, etc. As of June, 2014, the total fleet scale of CAR amounted to 52,498 vehicles (excluding franchises), which is not only the biggest in China but also exceeds the total of the fleet scales of car rental companies ranking from the second to the tenth, and is more than 4 times of the fleet scale of the second biggest car rental company. What's more, the number of car rental outlets established by the company is about 3 times of the rivals'.

Fig 1. Brief view of fleet size of peers



Source: Company, PSR

The revenue of CAR mainly comes from car rental business and sales of used cars, among which the revenue from car rental accounts for 70% to 90% of the total. In 2011, 2012, 2013 and the first half of 2014, the percentage of car rental in the total revenue is respectively 94.7%, 96.9%, 81.7% and 74.2%. At present, the company mainly focuses on short-term rental market; it takes 31.2% shares of the short rental market, while eHi Car Services and Topone 1 Car Rental take respectively 8.1% and 1.9%. Among the company's 52.5 thousand vehicles, 35,602 vehicles are used for short-term rental, 5,946 for long-term rental, 4,475 for financial leasing, and there are 6,500 vehicles which are retired for sale and halted due to violation of rules.

The company's fleet is composed of 29 brands and 122 types of vehicles, with a net book value of 4 billion yuan (the average purchase price of short-term rental vehicles is 98 thousand yuan, and that of long-term rental vehicles is 160 thousand yuan) which can provide diversified vehicle choices and 7*24 hours service for customers.

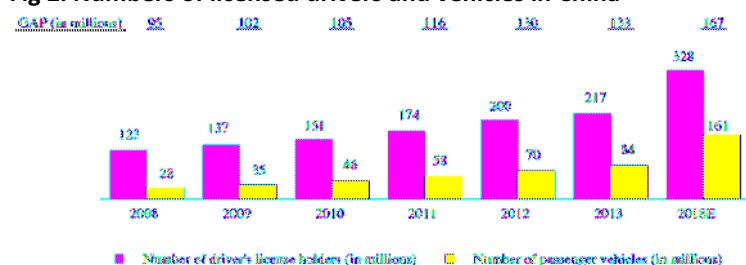
Leading the high speed development of the industry and benefiting from the strengthened concentration of market

China's car rental industry has been in a high speed development period in recent years. According to the data from Roland Berger, the total scale of China's car rental market increased from 9 billion yuan in 2008 to 34 billion yuan in 2013, with a compound annual growth rate up to 30%. The fleet scale of China's car rental market rapidly increased from 48 thousand vehicles in 2005 to 369 thousand in 2013, with a compound annual growth rate reaching 29%.

We believe, at least there are following several reasons to support that China's car rental industry is still in the early stage of development:

1) The scale of annually increasing driving license holders in China indicates the rigid demand for car use, now the number of driving license holders in China has already exceeded 260 million, but the holding volume of private cars is only about 120 million. Roland Berger predicts that there will be nearly 1 billion people to own driving licenses in the next 10 to 15 years in China.

Fig 2. Numbers of licensed drivers and vehicles in China



Source: Company, PSR

2) Expressways and other facilities are constantly improved, and tourism and commercial needs are released continuously. The number of self-driving travelers has increased from 128 million in 2008 to about 467 million in 2013. It is predicted that it will further rise to 970 million in 2018.

3) Restricted by the urban traffic jam, more and more cities begin to implement the policy of limited license plate, which has restricted the development of private cars and given birth to needs for using cars of numerous drivers without a license plate.

4) Full implementation of bus reform has eliminated a majority of 2 million buses, of which a considerable part need the car rental market to replace. Therefore, it has also brought huge business opportunities to the car rental market.

5) At present, China's car rental market is quite scattered. Its future potential is equal to 14% of the market share of China's top five companies, and the total market share of the leading companies in the American, Germany, and Brazilian market has generally exceeded 50%, with the highest reaching 95%.

6) Currently, China's car rental market permeability (ratio of rental car quantity to the total number of car) is still very low. It was only 0.4% in 2012, which was far lower than 2.5% of Japan, 1.6% of America, 1.4% of Korea, and 1.3% of Brazil.

With the rapid growth of the industry, the company's total number of customers has increased from about 450,000 at the end of 2011 to 1.962 million by the end of June, 2014, with a growth of about four times.

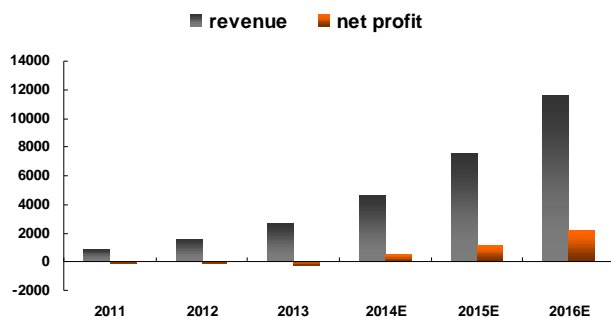
The company has set 717 direct-sale car rental outlets in 70 major cities in China, with the nearly 5,000 employees in total. It has also developed 202 joining service outlets in 162 small-scale cities, which has further expanded the network coverage.

The company has established an efficient technology platform as well to collect data of transaction, income, customer, fleet, and financial management in public and utilize the platform to analyze different data. The short-term rental market that the company focuses on currently is relatively scattered. Therefore, the predicted service needs are driven mainly by the increase of individuals' and institutional clients' needs for leisure and business travel and general car using needs of drivers without a license plate.

Financial analyze & Outlook

According to the prospectus, the revenue as well as the core profit of CAR has kept a strong growing trend nowadays. The adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) of 2011, 2012, and 2013 were 265 million yuan, 728 million yuan and 1.061 billion yuan respectively. And the EBIT margins were 34.2%, 46.7% and 48.1% respectively. The gradual increase of EBITDA margin has showed the results of the scale economy as well as effective operation of the company. Up to June 30, 2014, the adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) of CAR has reached 796.3 million yuan. The operation revenue of the first half year has reached 1.862 billion yuan. While these figures of 2013H were 463.8 million yuan and 1.15 billion yuan respectively. The year-on-year growing rates are as high as 71.3% and 61.9% respectively..

Fig 3. Brief view of Revenue and Net profit trends

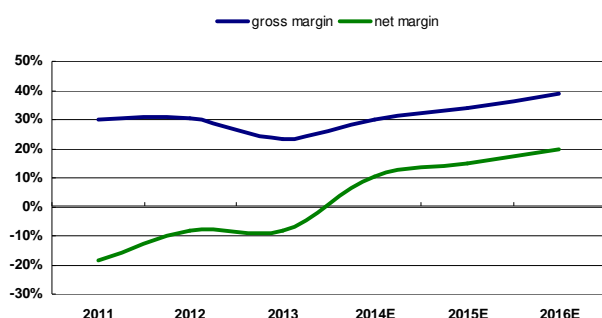


Source: Company, PSR

Along with the growing recognition of the brand image of its leader role, the average daily car rent of the company has also increased gradually, from the 197 Yuan of 2011 to 212 Yuan of 2012, then to 246 Yuan of 2013, and further come to 277 Yuan at the end of June 2014. The utilization rates of the cars of these years are 56.7%, 59%, 57.9% and 61.7% accordingly.

Due to the feature of the industry, the company needs a lot of money to purchase vehicles for its development. And this leads to a large amount of financial fees and depreciation cost. While the proportion of these two has surpassed ten percent and thirty percent of the whole rental income of the company thus become the main factor for net profit loss of the previous three years. We think that as the revenue per car and the total revenue of the company is increasing, the scale effect is increasingly emerging, and the scale effect of procurement leads to a continuous improvement in its bargaining ability, the depreciation cost will account for in the revenue will continuously decrease. However, CAR is the only domestic car rental enterprise that is able to leverage bank fund in a large scale and to solve the problem of car procurement with debt financing. It has already attracted many capitals before listing. With this listing, it will increase its advantage in its cost of fund again, and the company's follow-up development will undoubtedly be further ahead.

Fig 4. Brief view of margin trends



Source: Company, PSR

Fig 5. Peer's comparison

Name	Ticker	Mkt Cap (USD)	BEst P/B	BEst P/B: 2FY	BEst P/E:1 FY	BEst P/E:2 FY	BEst EV/BEst EBITDA	P/B	ROA LF	ROE
LOCALIZA	RENT3 BZ	3025	4.2	3.6	18.1	16.9	8.8	4.8	8.8	26.7
SIXT SE	SIX2 GR	1426	1.7	1.5	11.8	10.5	5.0	1.9	3.8	16.7
HERTZ	HTZ US	11676	3.5	2.9	18.5	13.7	13.9	4.2	1.5	13.4
AVIS	CAR US	6138	7.3	5.9	19.8	15.5	22.2	9.2	0.6	18.3
CAR INC	699 HK	3517	N/A	N/A	N/A	N/A	N/A	N/A	-4.0	-505.0

Source: Bloomberg, PSR

Income Statement	FY1 2011	FY1 2012	FY1 2013
Revenues	819.208	1609.022	2702.715
- Cost of Revenue	575.148	1116.026	2073.791
Gross Profit	244.06	492.996	628.924
- Selling, General & Admin Expense	256.056	352.008	538.955
Operating Income	-11.868	142.561	91.803
- Interest Expense	140.406	269.488	333.876
- Foreign Exchange Losses (Gains)	0	7.071	-22.711
- Net Non-Operating Losses (Gains)	-1.687	-1.644	-3.421
Pretax Income	-150.587	-132.354	-215.941
- Income Tax Expense	0.638	-0.051	7.424
Income Before XO Items	-151.225	-132.303	-223.365
Net Income	-151.225	-132.303	-223.365
Balance Sheet			
Assets			
+ Cash & Near Cash Items	628.483	910.372	840.005
+ Short-Term Investments	0.148	0	0
+ Accounts & Notes Receivable	34.454	88.414	208.426
+ Inventories	10.996	39.4	330.304
+ Other Current Assets	395.001	230.481	386.533
Total Current Assets	1069.082	1268.667	1765.268
+ Long-Term Investments	24.972	31.095	70.507
+ Gross Fixed Assets	80.779	111.564	151.891
- Accumulated Depreciation	13.24	32.545	55.589
+ Net Fixed Assets	67.539	79.019	96.302
+ Other Long-Term Assets	2606.28	3679.514	4234.994
Total Long-Term Assets	2698.791	3789.628	4401.803
Total Assets	3767.873	5058.295	6167.071
Liabilities & Shareholders' Equity			
+ Accounts Payable	5.939	13.892	13.802
+ Short-Term Borrowings	1553.273	3125.608	2247.576
+ Other Short-Term Liabilities	1259.933	1379.186	2229.566
Total Current Liabilities	2819.145	4518.686	4490.944
+ Long-Term Borrowings	784.413	498.145	1563.299
+ Other Long-Term Liabilities	16.489	25.941	39.89
Total Long-Term Liabilities	800.902	524.086	1603.189
Total Liabilities	3620.047	5042.772	6094.133
+ Total Preferred Equity	0	0	0
+ Minority Interest	0	0	0
+ Share Capital & APIC	-		
+ Retained Earnings & Other Equity	147.826	15.523	72.938
Total Shareholders' Equity	147.826	15.523	72.938
Total Liabilities & Equity	3767.873	5058.295	6167.071
Cash Flow			
Cash From Operating Activities	-1575.244	-1179.089	-916.852
Cash From Investing Activities	102.588	94.098	22.29
Cash from Financing Activities	2028.839	1358.118	826.025

Source: Bloomberg, PSR

RMB: mil	FY1 2011	FY1 2012	FY1 2013
EBITDA	258.738	701.155	811.67
Gross Margin%	29.7922	30.6395	23.2701
Operating Margin%	-1.4487	8.8601	3.3967
Profit Margin%	-18.4599	-8.2226	-8.2645
Actual Sales Per Employee	242082.74	362392.342	542495.986
Total Debt to Total Assets	62.0426	71.6398	61.7939
Net Debt	1709.055	2713.381	2970.87
Net Debt to Equity	1156.1261	17479.7462	4073.1443
Tangible Common Equity Ratio	3.0669	-0.8696	-1.2966
Current Ratio	0.3792	0.2808	0.3931
Free Cash Flow	-1615.868	-1210.522	-949.023
Depreciation Expense	10.354	19.527	23.245

Source: Bloomberg, PSR

Income Statement	FS1 2013	FS2 2013	FS1 2014
Sales/Revenue/Turnover	1,150	1,553	1,862
Cost of Goods Sold	835	1,239	1,283
SG&A	174	365	190
Operating Income (Losses)	141	-49	392
Interest Expense	152	182	153
Net Non-Oper Losses(Gains)	-1	-2	-6
Income Tax Expenses (Credits)	1	6	10
Inc(Loss) bef Extraord Items	2	-225	218
Net Income/Net Profit (Losses)	2	-225	218
EBIT(Earn Bef Int & Tax)	141	-49	392
Pretax Income	3	-219	228
Balance Sheet	FS1 2013	FS2 2013	FS1 2014
Cash&Near Cash Items		840	1,011
Total Assets		6,167	6,987
Total Liabilities		6,094	4,847
Total Shareholders' Equity		73	2,140
Total Liabilities and Equity		6,167	6,987
Gross Margin	27.37	20.23	31.09
Operating Margin	12.28	-3.18	21.04
Profit Margin	0.14	-14.49	11.73

Source: Bloomberg, PSR

FYE DEC	FY11	FY12	FY13	FY14F	FY15F	FY16F
Valuation Ratios						
P/E (X), adj.	NA	NA	NA	46.2	19.6	9.6
P/B (X)	NA	NA	NA	7.7	6.3	4.9
Dividend Yield (%)	NA	NA	NA	0.5%	1.3%	2.6%
Dividend payout ratio (%)	NA	NA	NA	25.0%	25.0%	25.0%
Per share data (RMB)						
EPS, reported	NA	NA	NA	0.20	0.47	0.97
EPS, adj.	NA	NA	NA	0.20	0.47	0.97
DPS	NA	NA	NA	0.05	0.12	0.24
BVPS	NA	NA	NA	1.22	1.47	1.91
Growth & Margins (%)						
Growth						
Revenue	NA	96.4%	68.0%	71.1%	63.0%	54.1%
EBIT	NA	-1354.7%	-32.8%	760.5%	113.8%	90.9%
Net Income, adj.	NA	NA	NA	NA	134.8%	103.3%
Margins						
Gross margin	29.8%	30.6%	23.3%	30.0%	34.0%	39.0%
EBIT margin	-1.4%	9.1%	3.6%	18.2%	23.9%	29.6%
Net Profit Margin	NA	NA	NA	10.3%	14.8%	19.6%
Key Ratios						
ROE (%)	NA	-161.99%	-505.00%	32.3%	35.3%	57.1%
ROA (%)	NA	-3.00%	-3.98%	6.8%	13.0%	21.4%
Income Statement (RMB mn)						
Revenue	819	1609	2703	4624	7539	11620
- Cost of Revenue	575	1116	2074	-3237	-4976	-7088
Gross Profit	244	493	629	1387	2563	4532
Other income	2	-8	21	-11	10	9
Selling Expense	-107	-140	-153	-110	-151	-198
Admin Expense	-149	-207	-378	-435	-611	-895
Interest Expense	-141	-270	-335	-277	-430	-639
Operating Income	-12	146	98	843	1802	3440
EBT	-151	-132	-216	555	1382	2809
- Income Tax	-1	0	-7	-78	-263	-534
Net profit	-151	-132	-223	477	1119	2276
Total capital share	NA	NA	NA	2358	2358	2358

Source: PSR

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

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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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
Number 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Heng Feng Road,
Green Tech Tower Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 60911155
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005