

# Zhongsheng (881 HK)

## Foster the pre-owned vehicle sales business

**Zhongsheng announced its FY2020 results.** Top-line was RMB148.3bn, up 20% YoY. Revenue from new car sales was RMB125.5bn, up 18%YoY, while the revenue from after-sales service was RMB20.2bn, up 14% YoY. Pre-owned auto sales business was included in the top-line for the first time, contributing RMB2.6bn. In 2020, bottom-line increased 23%YoY to RMB5.5bn (vs CMBI estimate of RMB5.2bn). The Company announced a dividend of RMB0.49 per share, representing a dividend ratio of 20%.

- **Continuous optimization of geographic layout and brand mix.** The number of stores reached 373 (218 luxury +155 mid-/high-end) at end of 2020, a net increase of 13 compared with the end of 2019. The Company has enhanced its presence in the existing brand + region (76% of its stores are located in the provincial capital and tier-1/2 cities, and 56% in East and South China), further strengthening its brands and regional advantages. Among its main brands, Benz +10 / Lexus +1 / BMW +6 / Toyota +4 stores. At the same time, the Company closed 4 stores to optimize the store structure.
- **Maintain excellent operation efficiency.** The share of new car revenue from luxury brands increased to 74.4% in 2020 from 71% in 2019. Benefiting from inventory management and optimization of supply/demand relationship, GPM of the new car increased to 3.0% in 2020 from 2.7% in 2019. Scale effects continue to play a role in expense ratio improvement. S&D expense ratio decreased by 0.12ppt to 3.86%. Admin expense ratio decreased by 0.05ppt to 1.51%. Through tax optimization, the effective tax rate was reduced by 1.3ppt to 27.3%. Inventory turnover days decreased to 23.3 days in 2020 from 30.4 days in 2019. Given supportive monetary policy after COVID-19, the financial penetration rate increased by 8.1ppt to 60.8%. Operating cash flow reached RMB9.3bn. We believe that the continuous improvement of operational efficiency reflects the superior management capabilities of the Company.
- **We raised our 2021E earnings forecast by 1% to RMB6.8bn to reflect 1) strong growth in luxury vehicles and 2) expansion in pre-owned car sales.** We expect earnings growth to achieve 22% in 2021E. We believe the Company will leverage its brand strength and customer base to accelerate its pre-owned car business. We raise our TP to HK\$73.1 (based on 22.0x 2021E P/E) with 34.3% upside from HK\$64.3 (based on the initial 22.0x 2020E/2021E average P/E). Reiterates BUY.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	107,736	124,043	148,348	176,693	200,710
YoY growth (%)	24.85%	15.14%	19.59%	19.11%	13.59%
Net income (RMB mn)	3,637	4,502	5,540	6,778	7,941
EPS (RMB)	1.60	1.98	2.44	2.98	3.49
YoY growth (%)	6%	24%	23%	22%	17%
Consensus EPS(RMB)	1.60	1.98	2.27	3.01	3.68
P/E (x)	30.48	24.65	20.04	16.38	13.98
P/B (x)	6.08	5.10	4.19	3.52	2.93
Yield (%)	0.7%	0.8%	1.0%	1.2%	1.4%
ROE (%)	21.3%	22.5%	23.0%	23.4%	22.9%
Net gearing (%)	99%	80%	54%	49%	45%

Source: Company data, Bloomberg, CMBIS estimates

**BUY (Maintain)**

**Target Price** HK\$73.1  
**(Previous TP)** HK\$64.3  
**Up/Downside** +34.3%  
**Current Price** HK\$54.5

### China Auto Sector

**Jack Bai**  
 (852) 3900 0835  
 jackbai@cmbi.com.hk

### Stock Data

Mkt Cap (HK\$ mn)	124,306
Avg 3 mths t/o (HK\$ mn)	341.58
52w High/Low (HK\$)	62.9/24.92
Total Issued Shares (mn)	2,283

Source: Bloomberg

### Shareholding Structure

HUANG Yi/Li Guoqiang	57.53%
Jardine Matheson Holdings Limited	19.98%
JPMorgan Chase & Co.	7.96%

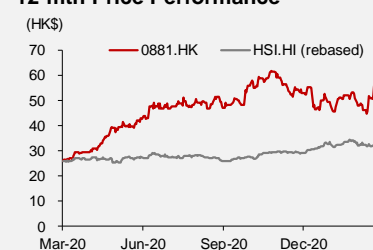
Source: HKEX

### Share Performance

	Absolute	Relative
1-mth	10.9%	19.5%
3-mth	2.5%	-3.0%
6-mth	15.5%	-3.8%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: Ernst & Young**

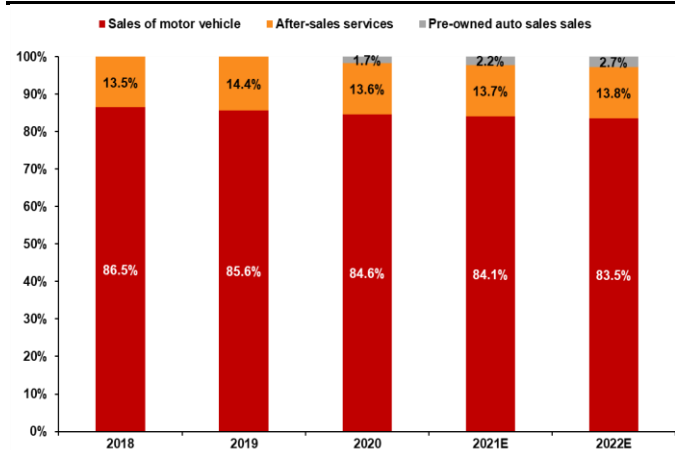
### Related Reports

1. "Zhongsheng (881 HK) – Expect high growth in 2H20E" – 12 Aug 2020
2. "Zhongsheng (881 HK) – More certainty and profitably ahead" – 23 Mar 2020
3. "Zhongsheng (881 HK) – Sector leader with a great tracking record" – 11 Dec 2019

- **Pre-owned automobile sales under distribution model contribute to revenue mix for the first time in 2020.** In 2020, the Company's trading volume of pre-owned cars was 1.07mn, up 50% YoY (66,399 units in 2H20, +61.9%YoY). Pre-owned car sales volume under distribution models accounted for more than 20% of the Company's total pre-owned car transaction volume, recorded to the revenue of RMB2.57mn for the first time. GPM of pre-owned car sales business is 7.6%, higher than that of new car sales. With the continued optimization of the pre-owned car policy and the improvement of the replacement penetration rate, we believe that the overall pre-owned car market in China will start to grow rapidly. Zhongsheng is expected to leverage its customer base of luxury brands to foster its pre-owned car business growth at a rapid speed. The Company will develop the pre-owned car business in the luxury brand and retail channel. Relevant after-sales service and financial service can be captured after a sizeable pre-owned car customer base was accumulated.
- **The advantages as the leading player are gradually confirmed.** The Company has been rated as investment grade rating (BBB -, baa3, BBB -) by major international credit rating agencies Standard & Poor's, Moody's, and Fitch. In May 2020, the Company successfully issued a new 5-year zero-coupon convertible bond of US \$588 million. In Jan 2021, a \$450 million five-year bond with a 3% coupon was offered to market. In 2020, the Company had an effective interest rate of 3.95%. We believe Zhongsheng will turn its cost advantage of financing into strong operational efficiency and high profitability. The Company will use its more than 5mn of customer base to rapidly expand its pre-owned vehicle business.

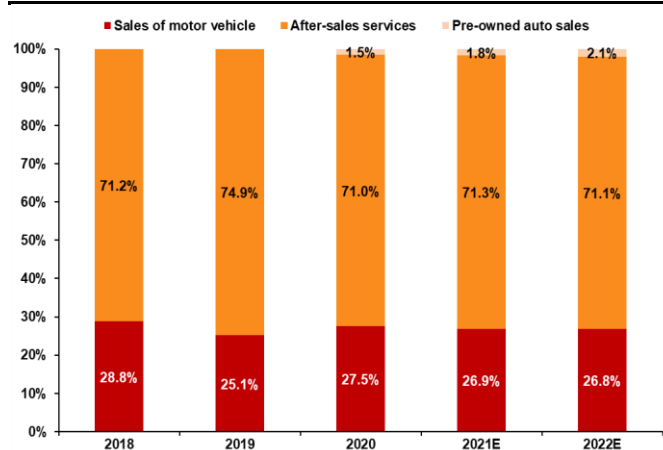
## Focus Charts

**Figure 1: Revenue composition**



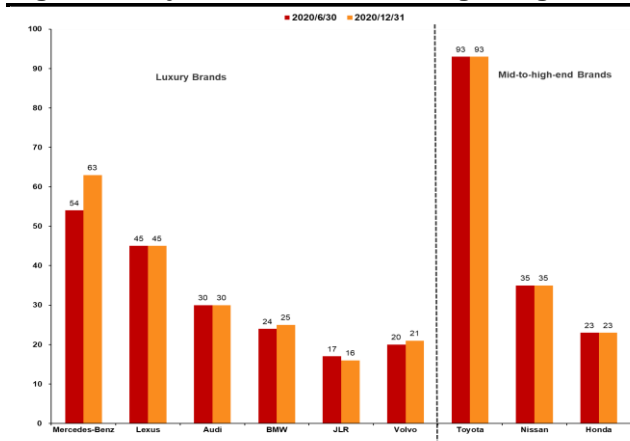
Source: Company data, CMBIS estimates

**Figure 2: GP composition**



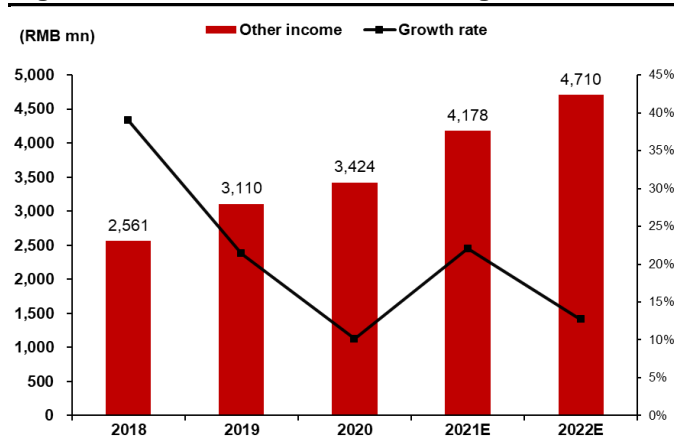
Source: Company data, CMBIS estimates

**Figure 3: Major brands mix of Zhongsheng**



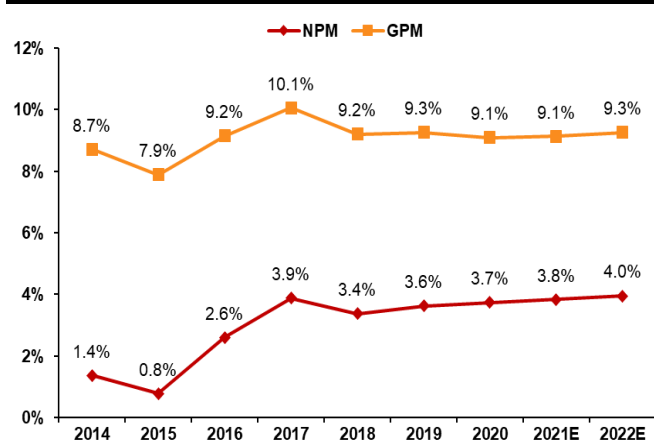
Source: Company data, CMBIS

**Figure 4: Other income continues to grow**



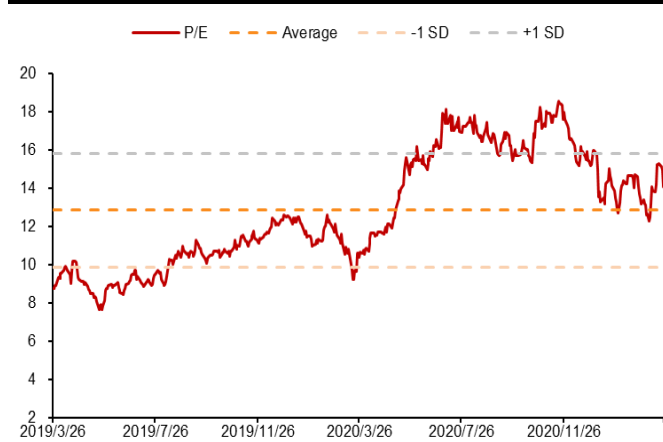
Source: Company data, CMBIS estimates

**Figure 5: Profitability is expected to improve further**



Source: Company data, CMBIS estimates

**Figure 6: PE Band**



Source: Bloomberg, CMBIS

## Earnings Revision

Figure 7: Earnings revision

(RMB mn)	New		Old		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	176,693	200,710	156,802	170,756	13%	18%
Gross profit	16,130	18,591	16,072	17,753	0%	5%
Net profit	6,778	7,941	6,733	7,454	1%	7%
EPS (RMB)	2.98	3.49	2.96	3.28	1%	7%
Gross margin	9.13%	9.26%	10.25%	10.40%	-1.1 ppt	-1.1 ppt
Net Margin	3.84%	3.96%	4.29%	4.37%	-0.5 ppt	-0.4 ppt

Source: CMBIS estimates

Figure 8: CMBIS estimates vs consensus

(RMB mn)	New		Consensus		Diff (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	176,693	200,710	173,700	203,635	2%	-1%
Gross profit	16,130	18,591	16,598	19,942	-3%	-7%
Net profit	6,778	7,941	7,021	8,730	-3%	-9%
EPS (RMB)	2.98	3.49	3.01	3.68	-1%	-5%
Gross margin	9.13%	9.26%	9.56%	9.79%	-0.4 ppt	-0.5 ppt
Net Margin	3.84%	3.96%	4.04%	4.29%	-0.2 ppt	-0.3 ppt

Source: Bloomberg, CMBIS estimates

Figure 9: Revenue breakdown

(RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Sales of motor vehicle</b>	<b>93,222</b>	<b>106,199</b>	<b>125,527</b>	<b>148,606</b>	<b>167,639</b>
...YoY	25%	14%	18%	18%	13%
Luxury and ultra-luxury brands	60,594	75,401	92,890	113,322	130,428
...YoY	25%	24%	23%	22%	15%
Mid- to high-end brands	32,628	30,798	32,637	35,284	37,212
...YoY	25%	-6%	6%	8%	5%
<b>After-sales services</b>	<b>14,514</b>	<b>17,843</b>	<b>20,245</b>	<b>24,223</b>	<b>27,660</b>
...YoY	25%	23%	13%	20%	14%
<b>Pre-owned auto sales</b>	<b>0</b>	<b>0</b>	<b>2,576</b>	<b>3,864</b>	<b>5,410</b>
...YoY				50%	40%
<b>Total</b>	<b>107,736</b>	<b>124,043</b>	<b>148,348</b>	<b>176,693</b>	<b>200,710</b>
...YoY	25%	15%	20%	19%	14%

Source: Company data, CMBIS estimates

Figure 10: P&L forecast

(RMB mn)	FY18	FY19	FY20A	FY21E	FY22E
<b>Revenue</b>	<b>107,736</b>	<b>124,043</b>	<b>148,348</b>	<b>176,693</b>	<b>200,710</b>
...YoY	24.85%	15.14%	19.59%	19.11%	13.59%
Cost of sales	(97,813)	(112,555)	(134,866)	(160,563)	(182,118)
<b>Gross profit</b>	<b>9,923</b>	<b>11,488</b>	<b>13,482</b>	<b>16,130</b>	<b>18,591</b>
GPM (%)	9.21%	9.26%	9.09%	9.13%	9.26%
...YoY	14.27%	15.77%	17.36%	19.64%	15.26%
Selling Exp	(4,311)	(4,939)	(5,730)	(6,803)	(7,707)
...% of rev	-4.00%	-3.98%	-3.86%	-3.85%	-3.84%
Admin Exp	(1,745)	(1,940)	(2,239)	(2,633)	(2,971)
...% of rev	-1.62%	-1.56%	-1.51%	-1.49%	-1.48%
<b>Net profit</b>	<b>3,637</b>	<b>4,502</b>	<b>5,540</b>	<b>6,778</b>	<b>7,941</b>
NPM (%)	3.38%	3.63%	3.73%	3.84%	3.96%
...YoY	8.57%	23.77%	23.06%	22.35%	17.17%

Source: Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Revenue</b>	<b>107,736</b>	<b>124,043</b>	<b>148,348</b>	<b>176,693</b>	<b>200,710</b>
Sales of motor vehicle	93,222	106,199	125,527	148,606	167,639
After-sales services	14,514	17,843	20,245	24,223	27,660
Pre-owned auto sales	0	0	2,576	3,864	5,410
Cost of sales	(97,813)	(112,555)	(134,866)	(160,563)	(182,118)
<b>Gross profit</b>	<b>9,923</b>	<b>11,488</b>	<b>13,482</b>	<b>16,130</b>	<b>18,591</b>
S&D expenses	(4,311)	(4,939)	(5,730)	(6,803)	(7,707)
Admin expenses	(1,745)	(1,940)	(2,239)	(2,633)	(2,971)
Credit/asset impairment	0	0	0	0	0
Other income	2,561	3,110	3,424	4,178	4,710
Other expenses	0	0	0	0	0
Finance expenses	(1,231)	(1,391)	(1,260)	(1,512)	(1,671)
PL from JVs	3	(1)	4	0	0
PL from Associates	0	0	(2)	0	0
<b>Profit before income tax</b>	<b>5,200</b>	<b>6,327</b>	<b>7,679</b>	<b>9,360</b>	<b>10,952</b>
Income tax expense	(1,505)	(1,807)	(2,098)	(2,555)	(2,979)
<b>Profit for the year</b>	<b>3,695</b>	<b>4,520</b>	<b>5,581</b>	<b>6,805</b>	<b>7,973</b>
<b>Less: MI</b>	<b>58</b>	<b>18</b>	<b>41</b>	<b>27</b>	<b>32</b>
<b>Net Profit</b>	<b>3,637</b>	<b>4,502</b>	<b>5,540</b>	<b>6,778</b>	<b>7,941</b>

### Cash flow

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Net income</b>	<b>3,637</b>	<b>4,502</b>	<b>5,540</b>	<b>6,778</b>	<b>7,941</b>
D&A	790	860	960	1,074	1,225
Change in working	3,483	539	(414)	2,430	5,151
Others	(5,592)	1,899	3,239	(3,810)	(6,192)
<b>Operating Cash Flow</b>	<b>2,318</b>	<b>7,800</b>	<b>9,324</b>	<b>6,471</b>	<b>8,125</b>
Capex & investments	(3,760)	(2,902)	(3,562)	(4,249)	(5,313)
Associated companies	-	(3)	2	3	1
Others	(473)	(234)	-	-	-
<b>Investing Cash Flow</b>	<b>(4,233)</b>	<b>(3,139)</b>	<b>(3,234)</b>	<b>(4,246)</b>	<b>(5,311)</b>
Equity raised	-	-	-	-	-
Change of Debts	3,323	(1,395)	(1,642)	4,214	3,133
Dividend paid	(667)	(727)	(900)	(1,107)	(1,355)
Others	347	(2,589)	-	-	-
<b>Financing Cash Flow</b>	<b>3,003</b>	<b>(4,712)</b>	<b>(3,964)</b>	<b>3,107</b>	<b>1,778</b>
<b>Net change in cash</b>	<b>1,088</b>	<b>(51)</b>	<b>2,127</b>	<b>5,331</b>	<b>4,592</b>
Cash at the beginning	6,789	7,887	7,706	7,706	9,817
Exchange difference	10	(130)	(16)	-	-
<b>Cash at the end</b>	<b>7,887</b>	<b>7,706</b>	<b>9,817</b>	<b>13,038</b>	<b>14,408</b>
Less: pledged cash	1,744	1,605	1,606	1,606	1,606

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Non-current assets</b>	<b>26,706</b>	<b>31,383</b>	<b>34,650</b>	<b>34,799</b>	<b>38,612</b>
Fixed asset	11,507	12,362	14,373	13,813	14,966
Intangible assets	6,331	6,218	6,620	7,512	8,643
Interest in JV/associate	45	47	49	43	42
Other non-current assets	8,823	12,756	13,607	13,431	14,960
<b>Current assets</b>	<b>30,462</b>	<b>31,642</b>	<b>33,851</b>	<b>44,536</b>	<b>51,760</b>
Cash	7,887	7,706	9,817	13,038	14,408
Account receivable	1,342	1,463	1,430	1,784	2,276
Inventory	10,980	9,828	9,090	11,894	13,797
Other current assets	10,253	12,644	13,515	17,821	21,279
<b>Current liabilities</b>	<b>26,599</b>	<b>27,147</b>	<b>28,474</b>	<b>32,158</b>	<b>35,958</b>
Borrowings	17,071	17,326	17,258	20,408	23,182
Account payables	4,815	4,875	4,980	5,352	5,691
Other payables	3,243	3,469	4,462	4,225	4,553
Tax payables	1,470	1,476	1,774	2,172	2,532
<b>Non-current liabilities</b>	<b>11,532</b>	<b>13,701</b>	<b>13,145</b>	<b>15,156</b>	<b>16,023</b>
Borrowings	5,575	3,924	2,351	3,415	3,774
Convertible bond	4,048	4,294	4,827	4,827	4,827
Deferred income tax	1,909	1,918	2,120	3,066	3,575
Others	-	3,565	3,847	3,847	3,847
<b>Shareholders' equity</b>	<b>18,240</b>	<b>21,759</b>	<b>26,463</b>	<b>31,548</b>	<b>37,823</b>
<b>Minority Interest</b>	<b>797</b>	<b>418</b>	<b>419</b>	<b>473</b>	<b>567</b>
<b>Total net assets</b>	<b>19,037</b>	<b>22,177</b>	<b>26,882</b>	<b>32,021</b>	<b>38,391</b>

### Key ratios

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Sales mix (%)</b>					
Sales of motor vehicle	87%	86%	85%	84%	84%
After-sales services	13%	14%	14%	14%	14%
Pre-owned auto sales	0%	0%	2%	2%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>P&amp;L ratios (%)</b>					
Gross profit margin	9%	9%	9%	9%	9%
Pre-tax margin	5%	5%	5%	5%	5%
Net margin	3%	4%	4%	4%	4%
Effective tax rate	29%	29%	27%	27%	27%
<b>Balance sheet ratios</b>					
Current ratio (x)	1.15	1.17	1.19	1.38	1.44
Quick ratio (x)	0.35	0.37	0.40	0.47	0.47
Cash ratio (x)	0.30	0.32	0.35	0.41	0.40
Inventory days	41	32	25	27	28
AR days	18	16	13	12	11
AP days	5	4	4	4	5
Total debt / total equity	200%	184%	155%	148%	135%
Net debt / equity ratio	99%	80%	54%	49%	45%
<b>Returns (%)</b>					
ROE	21%	23%	23%	23%	23%
ROA	12%	13%	14%	15%	15%
<b>Per share</b>					
EPS (RMB)	1.60	1.98	2.44	2.98	3.49
DPS (RMB)	0.32	0.40	0.49	0.60	0.70
BVPS (RMB)	8.04	9.58	11.64	13.88	16.64

Source: Company data, CMBIS estimates

# Disclosures & Disclaimers

## Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

## CMBIS Ratings

<b>BUY</b>	: Stock with potential return of over 15% over next 12 months
<b>HOLD</b>	: Stock with potential return of +15% to -10% over next 12 months
<b>SELL</b>	: Stock with potential loss of over 10% over next 12 months
<b>NOT RATED</b>	: Stock is not rated by CMBIS

<b>OUTPERFORM</b>	: Industry expected to outperform the relevant broad market benchmark over next 12 months
<b>MARKET-PERFORM</b>	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
<b>UNDERPERFORM</b>	: Industry expected to underperform the relevant broad market benchmark over next 12 months

## CMB International Securities Limited

**Address:** 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

**CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)**

## Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

CMBIS is not a registered broker-dealer in the United States. As a result, CMBIS is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.