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Zhongsheng: Weaker 1H24 results but net debts reduction continues

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Maintain buy on ZHOSHKs

Zhongsheng (rated Baa2/BBB/BBB by Moody's/S&P/Fitch) reported weaker than expected 1H24 results due mainly to lower ASP in new car sales. That said, the impact was partly mitigated by the growing contributions from used car sales, as well as accessories and after-sales services. Zhongsheng continues to generate positive free cash flow to reduce net debts. Additionally, the funding exercises since Jul'24 have considerably shore up its liquidity and relieved its refinancing pressure over the coming 1-2 years. We consider Zhongsheng a solid IG. In our opinion, ZHOSHKs are good shorter-dated carry plays and candidates for early redemptions, especially the CBs. We maintain buy on ZHOSHKs.

Table 1: Summary of Zhongsheng's o/s bonds

Ticker	Ccy	O/S (mn)	Coupon	Maturity	Offer price	Z-spread	YTM (%)
ZHOSHK 0 05/21/25 CB	HKD	3,124.0	0.0%	5/21/2025	112.5	178.9	6.1%
ZHOSHK 3 01/13/26	USD	157.8	3.0%	1/13/2026	96.4	179.1	5.8%
ZHOSHK 5.98 01/30/28	USD	600.0	6.0%	1/30/2028	99.1	275.6	6.3%

Source: Bloomberg

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Weak new car sales mitigated by growing contribution from other segments

Table 2: Zhongsheng's operating profile

RMB bn	2021	2022	2023	1H23	2H23	1H24	1H24 vs. 1H23
New cars	6,197.0	3,940.0	1,058.0	865.6	192.4	(1,990.1)	-
Parts, packages and after-sales services	11,783.0	11,586.0	11,766.0	5,771.2	5,994.8	6,298.3	9.1%
Used cars	489.0	506.0	940.0	333.0	607.0	618.0	85.6%
Gross profit (RMB mn)	**18,469.0**	**16,032.0**	**13,764.0**	**6,969.8**	**6,794.2**	**4,926.2**	-29.3%
Commission income (under other income and gain)	3,528.0	3,764.3	4,132.1	1,992.0	2,140.1	1,941.6	-2.5%
Aggregate profit	**21,997.0**	**19,796.3**	**17,896.1**	**8,961.8**	**8,934.3**	**6,867.8**	-23.4%
New car sales % aggregate profit	28.2%	19.9%	5.9%	9.7%	2.2%	-29.0%	

Source: Company filings.

Zhongsheng's weaker 1H24 results reflected the demand and supply imbalance of luxury cars and the pricing pressure under the backdrop of weak economy. In 1H24, the gross profit of new car sales turned to -cRMB2.0bn from RMB855.6mn in 1H23 and RMB192.4mn in 2H23, reflecting the deteriorating operating environment. That said, we take comfort with the growing contribution from other segments. Indeed, new car sales accounted for a declining portion of Zhongsheng's aggregate profit, partly due to the weak new car sales and partly due to its maturing business model with growing income from sales of accessories, maintenance services and cross-sales revenue. Zhongsheng has been optimizing its store network with the focus on expansion of collision centers to create more "recurring" revenue and cross-selling opportunities, as well as exiting stores on brands with lagging sales such as Nissan. In Jul'24, BMW amended its sales target in China to rebalance prices and demand. This should help alleviate the pricing pressure on new car sales. Zhongsheng maintains its guidance on the growth of used car sales (by unit) at 30% and contribution of after-sales services at 10% p.a.

Net debt reduction trend to continue….

	2019	2020	2021	2022	2023	1H23	1H24
FCF (RMB mn)	3,478	5,100	240	3,341	3,527	2,952	2,476
Inventory days	30.8	23.3	21.6	27.0	31.2	33.6	36.2
Cash conversion cycle (days)	20.4	14.6	17.1	19.3	20.1	20.7	20.8
Cash	6,101.2	8,210.4	10,950.0	11,679.0	15,612.0	16,352.6	17,146.4
Other ST deposits	1,605.0	1,606.2	1,031.0	1,958.9	3,989.5	2,396.7	4,056.3
ST debts	17,326.3	17,257.8	15,615.4	15,162.7	16,483.0	18,291.6	17,164.6
LT debts	11,783.3	11,025.6	13,114.8	15,475.4	20,273.5	15,804.6	16,882.2
Total debts	29,109.6	28,283.3	28,730.2	30,638.2	36,756.5	34,096.2	34,046.8
Net debts	21,403.4	18,466.8	16,749.2	17,000.2	17,155.0	15,347.0	12,844.1
Debt/EBITDA	3.1x	2.6x	1.9x	2.4x	3.5x	2.9x	3.8x
Net debt/EBITDA	2.3x	1.7x	1.1x	1.3x	1.6x	1.3x	1.4x
EBITDA/int	6.5x	8.2x	12.6x	10.0x	6.6x	7.7x	5.3x
Net debt/equity	96.5%	68.7%	41.1%	38.6%	37.3%	34.9%	28.1%

Source: Company filings.

Zhongsheng continues to generate positive free flow with net debt reduction despite the weaker 1H24 results. We expect Zhongsheng to continue to be disciplined in expansion, taking cues from the equity-funded acquisitions of Zung Fu China in 2021, such that net debt reduction will continue. We expect its key coverage ratios such as Debt/EBITDA and EBITDA/int to improve to 2.5x, 1.5x and 7.5x over the coming 2-3 years.

…. refinancing risk considerably lowered after the recent funding exercises

In Jul'24, Zhongsheng completed the tender offer for ZHOSHK 3 01/13/26 and the larger than expected concurrent issue of ZHOSHK 5.98 01/30/28. We estimate that the remaining proceeds from the USD600mn issue of ZHOSHK 5.98 01/30/28 to be cUSD307mn after settlement of the tender offer. On 31 Jul'24, it signed new offshore syndicated loans of USD350mn for the refinancing of existing loans due Apr'25. Zhongsheng plans to draw down the loans in Oct'24. We understand the new 3-yr bullet loans will bear a lower credit spread than that of the existing loans although higher SOFR will lead to a higher all-in funding cost. Additionally, Zhongsheng issued Panda bonds of RMB1bn at a coupon rate of 3.5% on 1 Aug'24. The company obtained the approval from NAFMII for issuance of Panda bonds up to RMB5bn on 19 Jul'24. These funding exercises have considerably lengthened its debt maturity and largely addressed its refinancing requirements in the coming 1-2 years. These also offer Zhongsheng the war-chest for further early redemptions of its CB due May'24 and ZHOSHK 3 01/13/26.

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