

# Zhongsheng (881 HK)

## Expect high growth in 2H20E

Zhongsheng announced its 1H20 results. 1H20 top-line increased by 1% YoY to RMB58.2bn, among which revenue from new car sales increased by 0.6% YoY to RMB49.8bn while revenue from after-sales and accessories increased by 6% YoY to RMB8.4bn. 1H20 bottom-line increased by 10% YoY to RMB2.3bn.

- 1H20 top-line missed CMBI estimate due to the slower-than-expected store expansion.** The number of stores only increased from 360 at the end of 2019 to 365 in 1H20 (newly added 3 luxury/2 mid-/high-end). In the meanwhile, sales volume per store fell 13% YoY to 540 units in 1H20 vehicles given the economy lockdown in 1Q20. As a result, new car sales volume decreased by 7.8% YoY to 197K units in 1H20.
- However, both aggregate unit price and GPM from new car sales improved in 1H20.** Given 1) mismatch between the supply side and the demand side in 1H20 and 2) the rising proportion of luxury brands sales volume (56% in 1H20 vs 47% in 1H19), the aggregate unit price increased by 9% YoY in 1H20. Moreover, GPM from new car sales increased by 0.3ppt to 3.0% in 1H20, which partially offset the top-line growth slowdown.
- 2Q20 performance has resumed to the high growth trajectory.** Both new car sales and after-sales service have rebounded strongly in 2Q20 (new car sales volume +7.4% in 2Q20 vs -25.7% in 1Q20/after-sales revenue +22.2% in 2Q20 vs -8.3% in 1Q20). The resilience of luxury brands (+23.7% in 2Q20) has contributed to the rapid recovery of the Company's new car sales. We expect the luxury brands will keep their growth momentum in 2H20E given 1) consumption upgrade and 2) the rising proportion of replacement purchase.
- 2H20E performance will be supported by excellent operation and recent M&A deals.** Inventory turnover days in 1H20 reduced to 29.7 days, reflecting its excellent operating efficiency. The Company disclosed that it acquired 3 stores at the beginning of 2020 with a total price of RMB1.5bn. We estimate that the P/E ratio was in the range of 3.5x to 4.0x, which is much lower than the Company's current P/E ratio of 20x. In Jul, the Company also announced the acquisition of 8 luxury brand 4S stores (6 Mercedes-Benz/2 JLR), which will further expand its luxury brand presence. A number of M&A expansion at low cost reflects the Company's strong bargaining power in deal negotiations. We believe the optimization in its geographic presence (East/South China, Tier-1/2 cities) and its product mix (BBA+Lexus+Toyota) will support the performance in 2H20E.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	107,736	124,043	140,133	156,802	170,756
YoY growth (%)	24.85%	15.14%	12.97%	11.90%	8.90%
Net income (RMB mn)	3,637	4,502	5,172	6,733	7,454
EPS (RMB)	1.60	1.98	2.28	2.96	3.28
YoY growth (%)	6%	24%	15%	30%	11%
Consensus EPS(RMB)	1.60	1.98	2.27	2.81	3.33
P/E (x)	28.64	23.15	20.15	15.48	13.98
P/B (x)	5.71	4.79	4.02	3.34	2.81
Yield (%)	0.7%	0.9%	1.0%	1.3%	1.4%
ROE (%)	21.3%	22.5%	21.7%	23.6%	21.8%
Net gearing (%)	99%	80%	76%	73%	70%

Source: Company data, Bloomberg, CMBIS estimates

**BUY (Maintain)**

**Target Price** HK\$64.3  
 (Previous TP) HK\$33.8  
**Up/Downside** +25.6%  
**Current Price** HK\$51.2

### China Auto Sector

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### Stock Data

Mkt Cap (HK\$ mn)	116,197
Avg 3 mths t/o (HK\$ mn)	220.62
52w High/Low (HK\$)	52.8/21.31
Total Issued Shares (mn)	2,272

Source: Bloomberg

### Shareholding Structure

HUANG Yi/LI Guoqiang	57.76%
JPMorgan Chase & Co.	9.20%
Pandanus Associates Inc.	5.16%

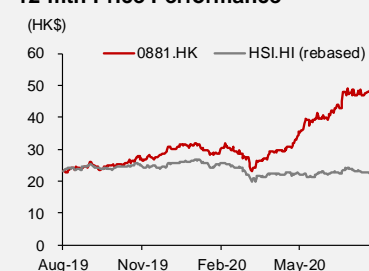
Source: HKEX

### Share Performance

	Absolute	Relative
1-mth	7.5%	11.1%
3-mth	50.2%	48.4%
6-mth	78.4%	97.7%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: Ernst & Young**

### Related Reports

- "Zhongsheng (881 HK) – More certainty and profitably ahead" – 23 Mar 2020
- "Zhongsheng (881 HK) – Sector leader with a great tracking record" – 11 Dec 2019

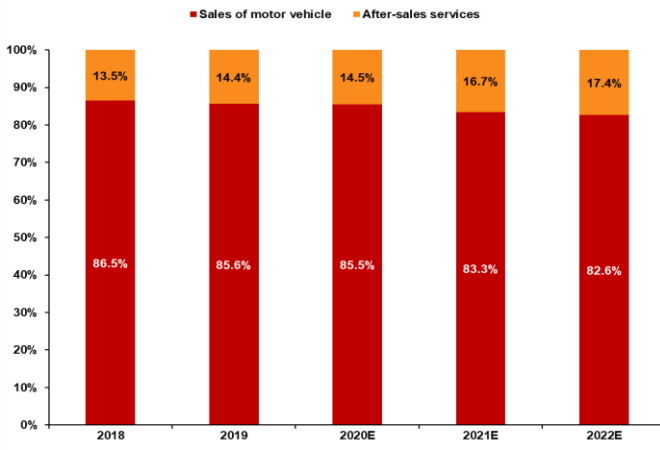
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- **Value-added service will continue to surprise the market.** Benefiting from 1) the VAT collection rate drop of used-car drop from 2% to 0.5% and 2) internal business focus, the Company's used-car transaction (+33.9%YoY in 1H20) outperformed the overall market (-19.6%YoY in 1H20) significantly. Zhongsheng has also put a great effort into developing close relationships with financial institutions for boosting its financial commission income. As a result, its financial penetration rate increased to 59% in 1H20 from 50% in 1H19. The aggregate value-added service revenue increased by 8% YoY to RMB1.3bn. We expect the Company will maintain its high growth in value-added service revenue thanks to both favorable policies (related used-car policies/expansionary monetary policies) and its internal strategy.
- **We slightly adjust down our bottom-line forecast by 6% in 2020E at RMB5.2bn to reflect its steady expansion.** Given 1) the growth potential brought about by recent M&A deal; 2) the high growth momentum of luxury brands market; 3) the growth in value-added services supported by favorable policies and its internal strategy; 4) resumption of car repair business as the economy normalized, we believe that Zhongsheng will deliver high growth in 2H20E. Based on our 2020E forecast, the implied bottom-line growth rate for Zhongsheng will be 19%YoY in 2H20E.
- **The Company's PER increased to around 20x from 12x at the beginning of 2020.** We believe the rerating of valuation multiple was reasonable as the market shifts its preference to companies with steady growth/steady cash flow (such as the property management sector) in the recent volatile market. Therefore, we raise our TP to HK\$64.3 (based on new 22.0x average 2020E/21E P/E) with an upside of 25.6% from initial TP HK\$33.8 (based on initial 12.5x 2020E P/E). Reiterate BUY.

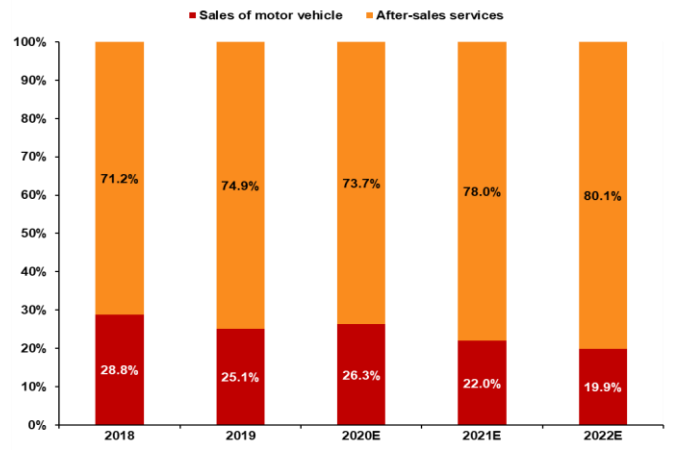
**Focus Charts**

**Figure 1: Revenue composition**



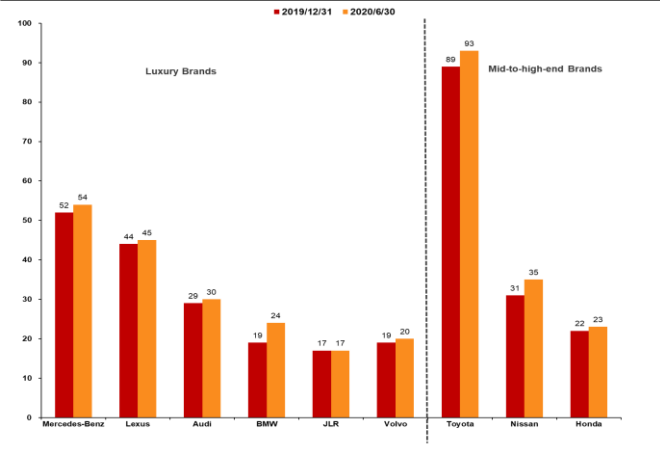
Source: Company data, CMBIS estimates

**Figure 2: GP composition**



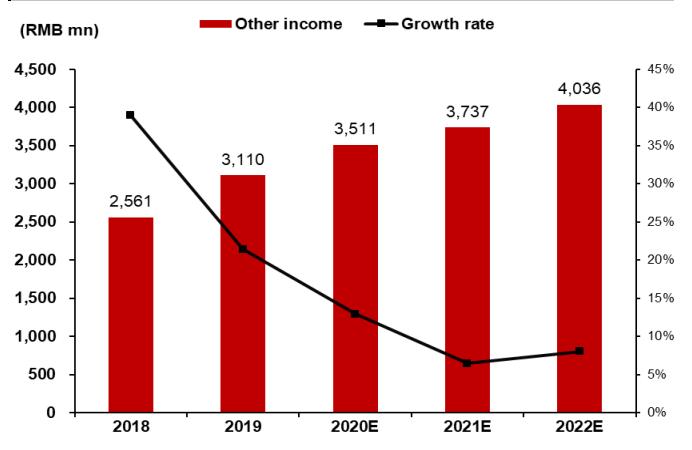
Source: Company data, CMBIS estimates

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



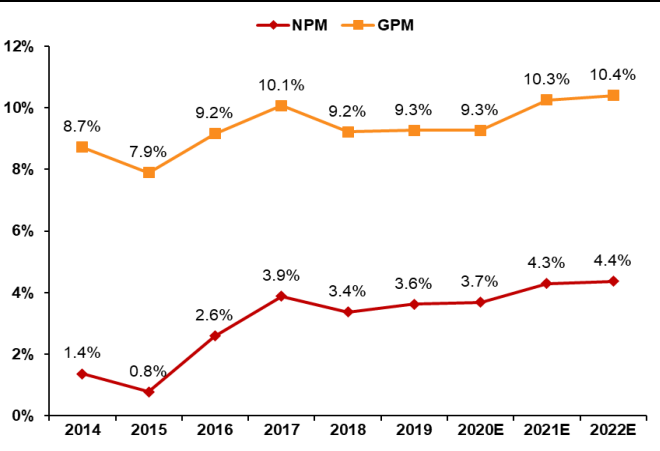
Source: Company data, CMBIS

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



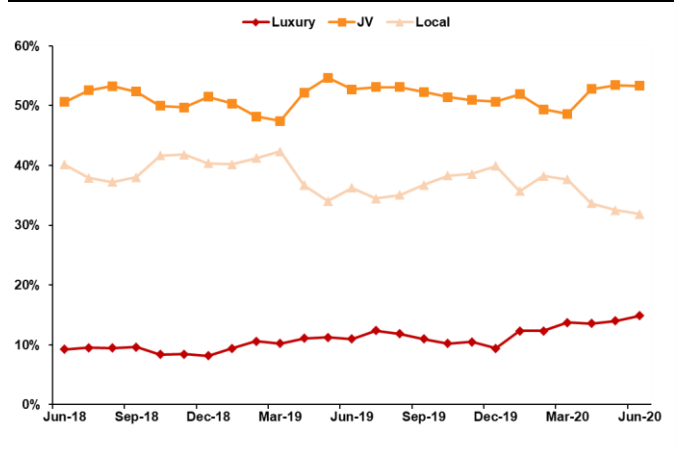
Source: Company data, CMBIS estimates

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



Source: Company data, CMBIS estimates

**Figure 6: Luxury brands keep expanding in 2020**



Source: CPCA, CMBIS

## Earnings Revision

Figure 7: Earnings revision

(RMB mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	140,133	156,802	141,004	155,896	-1%	1%
Gross profit	12,983	16,072	14,040	15,886	-8%	1%
Net profit	5,172	6,733	5,516	6,258	-6%	8%
EPS (RMB)	2.28	2.96	2.43	2.75	-6%	8%
Gross margin	9.26%	10.25%	9.96%	10.19%	-0.7 ppt	0.1 ppt
Net Margin	3.69%	4.29%	3.91%	4.01%	-0.2 ppt	0.3 ppt

Source: CMBIS estimates

Figure 8: CMBIS estimates vs consensus

(RMB mn)	New		Consensus		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	140,133	156,802	135,710	154,750	3%	1%
Gross profit	12,983	16,072	13,173	15,657	-1%	3%
Net profit	5,172	6,733	5,296	6,612	-2%	2%
EPS (RMB)	2.28	2.96	2.27	2.81	1%	5%
Gross margin	9.26%	10.25%	9.71%	10.12%	-0.4 ppt	0.1 ppt
Net Margin	3.69%	4.29%	3.90%	4.27%	-0.2 ppt	0.0 ppt

Source: Bloomberg, CMBIS estimates

Figure 9: Revenue breakdown

(RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Sales of motor vehicle	93,222	106,199	119,771	130,669	141,120
...YoY	25%	14%	13%	9%	8%
Luxury and ultra-luxury brands	60,594	75,401	89,093	100,007	109,057
...YoY	25%	24%	18%	12%	9%
Mid- to high-end brands	32,628	30,798	30,679	30,661	32,063
...YoY	25%	-6%	0%	0%	5%
After-sales services	14,514	17,843	20,361	26,134	29,635
...YoY	25%	23%	14%	28%	13%
<b>Total</b>	<b>107,736</b>	<b>124,043</b>	<b>140,133</b>	<b>156,802</b>	<b>170,756</b>
...YoY	25%	15%	13%	12%	9%

Source: Company data, CMBIS estimates

Figure 10: P&L forecast

(RMB mn)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	107,736	124,043	140,133	156,802	170,756
...YoY	24.85%	15.14%	12.97%	11.90%	8.90%
Cost of sales	(97,813)	(112,555)	(127,149)	(140,730)	(153,003)
<b>Gross profit</b>	<b>9,923</b>	<b>11,488</b>	<b>12,983</b>	<b>16,072</b>	<b>17,753</b>
GPM (%)	9.21%	9.26%	9.26%	10.25%	10.40%
...YoY	14.27%	15.77%	13.02%	23.79%	10.46%
Selling Exp	(4,311)	(4,939)	(5,570)	(6,225)	(6,782)
...% of rev	-4.00%	-3.98%	-3.97%	-3.97%	-3.97%
Admin Exp	(1,745)	(1,940)	(2,186)	(2,452)	(2,673)
...% of rev	-1.62%	-1.56%	-1.56%	-1.56%	-1.57%
<b>Net profit</b>	<b>3,637</b>	<b>4,502</b>	<b>5,172</b>	<b>6,733</b>	<b>7,454</b>
NPM (%)	3.38%	3.63%	3.69%	4.29%	4.37%
...YoY	8.57%	23.77%	14.89%	30.17%	10.71%

Source: Company data, CMBIS estimates

## Financial Summary

Income statement						Cash flow					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>107,736</b>	<b>124,043</b>	<b>140,133</b>	<b>156,802</b>	<b>170,756</b>	<b>Net income</b>	<b>3,637</b>	<b>4,502</b>	<b>5,172</b>	<b>6,733</b>	<b>7,454</b>
Sales of motor vehicle	93,222	106,199	119,771	130,669	141,120	D&A	790	860	960	1,136	1,353
After-sales services	14,514	17,843	20,361	26,134	29,635	Change in working	3,483	539	1,809	4,394	4,361
Cost of sales	(97,813)	(112,555)	(127,149)	(140,730)	(153,003)	Others	(5,592)	1,899	(1,078)	(5,206)	(4,789)
<b>Gross profit</b>	<b>9,923</b>	<b>11,488</b>	<b>12,983</b>	<b>16,072</b>	<b>17,753</b>	<b>Net cash from operating</b>	<b>2,318</b>	<b>7,800</b>	<b>6,863</b>	<b>7,057</b>	<b>8,378</b>
S&D expenses	(4,311)	(4,939)	(5,570)	(6,225)	(6,782)	Capex & investments	(3,760)	(2,902)	(3,562)	(5,902)	(7,069)
Admin expenses	(1,745)	(1,940)	(2,186)	(2,452)	(2,673)	Associated companies	-	(3)	3	3	-
Credit/asset impairment	0	0	0	0	0	Others	(473)	(234)	-	-	-
Other income	2,561	3,110	3,511	3,737	4,036	<b>Net cash from investing</b>	<b>(4,233)</b>	<b>(3,139)</b>	<b>(3,559)</b>	<b>(5,899)</b>	<b>(7,069)</b>
Other expenses	0	0	0	0	0	Equity raised	-	-	-	-	-
Finance expenses	(1,231)	(1,391)	(1,475)	(1,677)	(1,867)	Change of Debts	3,323	(1,395)	(797)	1,928	1,209
PL from JVs	3	(1)	(0)	0	0	Dividend paid	(667)	(727)	(900)	(1,034)	(1,346)
PL from Associates	0	0	0	0	0	Others	347	(2,589)	-	-	-
<b>Profit before income tax</b>	<b>5,201</b>	<b>6,327</b>	<b>7,263</b>	<b>9,454</b>	<b>10,466</b>	<b>Net cash from financing</b>	<b>3,003</b>	<b>(4,712)</b>	<b>(1,698)</b>	<b>894</b>	<b>(137)</b>
Income tax expense	(1,505)	(1,807)	(2,070)	(2,694)	(2,983)	<b>Net change in cash</b>	<b>1,088</b>	<b>(51)</b>	<b>1,606</b>	<b>2,053</b>	<b>1,172</b>
<b>Profit for the year</b>	<b>3,695</b>	<b>4,520</b>	<b>5,193</b>	<b>6,760</b>	<b>7,483</b>	Cash at the beginning	6,789	7,887	7,706	7,706	9,312
Less: MI	58	18	21	27	30	Exchange difference	10	(130)	-	-	-
Net Profit	3,637	4,502	5,172	6,733	7,454	<b>Cash at the end</b>	<b>7,887</b>	<b>7,706</b>	<b>9,312</b>	<b>9,759</b>	<b>10,484</b>
						Less: pledged cash	1,744	1,605	1,605	1,605	1,605

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>26,706</b>	<b>31,383</b>	<b>32,880</b>	<b>37,483</b>	<b>42,776</b>	<b>Sales mix (%)</b>					
Fixed asset	11,507	12,362	13,066	14,989	17,187	Sales of motor vehicle	87%	86%	85%	83%	83%
Intangible assets	6,331	6,218	6,744	7,925	9,525	After-sales services	13%	14%	15%	17%	17%
Interest in JV/associate	45	47	43	43	42	<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
Other non-current assets	8,823	12,756	13,026	14,526	16,021	<b>P&amp;L ratios (%)</b>					
<b>Current assets</b>	<b>30,462</b>	<b>31,642</b>	<b>39,099</b>	<b>45,167</b>	<b>50,821</b>	Gross profit margin	9%	9%	9%	10%	10%
Cash	7,887	7,706	9,312	9,759	10,484	Pre-tax margin	5%	5%	5%	6%	6%
Account receivable	1,342	1,463	1,532	2,070	2,354	Net margin	3%	4%	4%	4%	4%
Inventory	10,980	9,828	10,961	12,237	13,909	Effective tax rate	29%	29%	29%	29%	29%
Other current assets	10,253	12,644	17,293	21,102	24,074	<b>Balance sheet ratios</b>					
<b>Current liabilities</b>	<b>26,599</b>	<b>27,147</b>	<b>31,832</b>	<b>35,428</b>	<b>38,666</b>	Current ratio (x)	1.15	1.17	1.23	1.27	1.31
Borrowings	17,071	17,326	21,454	24,021	26,638	Quick ratio (x)	0.35	0.37	0.37	0.36	0.36
Account payables	4,815	4,875	5,086	5,413	5,667	Cash ratio (x)	0.30	0.32	0.32	0.30	0.30
Other payables	3,243	3,469	3,532	3,704	3,826	Inventory days	41	32	31	32	33
Tax payables	1,470	1,476	1,759	2,290	2,535	AP days	18	16	15	14	14
<b>Non-current liabilities</b>	<b>11,532</b>	<b>13,701</b>	<b>13,840</b>	<b>15,536</b>	<b>17,270</b>	AR days	5	4	4	5	6
Borrowings	5,575	3,924	3,497	4,443	5,832	Total debt / total equity	200%	184%	174%	161%	149%
Provisions	-	-	-	-	-	Net debt / equity ratio	99%	80%	76%	73%	70%
Deferred income tax	1,909	1,918	2,484	3,233	3,580	<b>Returns (%)</b>					
Others	4,048	7,859	7,859	7,859	7,859	ROE	21%	23%	22%	24%	22%
<b>Shareholders' equity</b>	<b>18,240</b>	<b>21,759</b>	<b>25,918</b>	<b>31,218</b>	<b>37,105</b>	ROA	12%	13%	13%	14%	14%
Minority Interest	797	418	389	468	557	<b>Per share</b>					
<b>Total net assets</b>	<b>19,037</b>	<b>22,177</b>	<b>26,307</b>	<b>31,687</b>	<b>37,661</b>	EPS (RMB)	1.60	1.98	2.28	2.96	3.28
						DPS (RMB)	0.32	0.40	0.46	0.59	0.66
						BVPS (RMB)	8.04	9.58	11.41	13.74	16.33

Source: Company data, CMBIS estimates

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