

CMBI Credit Commentary

Zhongsheng: Weaker FY24 results but signs of stabilizing in 2H24

Buy on ZHOSHKs, prefer ZHOSHK 5.98 01/30/28

Zhongsheng (rated Baa2/BBB/BBB by Moody's/S&P/Fitch) reported weaker FY24 results due mainly to negative gross margin of new car sales. The results should not be a surprise given the weak 1H24 results. Indeed, we note the negative gross margin of new car sales narrowed in 2HFY24. Additionally, the impact of weak new car sales was partly mitigated by the growing contributions from used car sales, as well as accessories and after-sales services which contributed an average of c90% of Zhongsheng's aggregate profit over the past 5 years. Furthermore, 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 ZHOSHKs good shorter-dated carry plays and maintain buy on ZHOSHKs. Out of the outstanding ZHOSHKs, we prefer ZHOSHK 5.98 01/30/28 for better trading liquidity.

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

Ticker	ISIN	Ccy	Size (mn)	O/S (mn)	Coupon	Maturity	Offer px	Z-spread	YTM (%)
ZHOSHK 0									
05/21/25 CB	XS2171663227	HKD	4,560.0	3,124.0	0.0%	5/21/2025	116.7	83.8	4.8%
ZHOSHK 3									
01/13/26	XS2278364075	USD	450.0	157.8	3.0%	1/13/2026	97.9	165.3	5.7%
ZHOSHK									
5.98 01/30/28	XS2867272630	USD	600.0	600.0	6.0%	1/30/2028	99.7	244.4	6.1%

Source: Bloomberg.

Glenn Ko, CFA 高志和
 (852) 3657 6235
 glennko@cmbi.com.hk

Cyrena Ng, CPA 吳蒨瑩
 (852) 3900 0801
 cyrenang@cmbi.com.hk

Jerry Wang 王世超
 (852) 3761 8919
 jerrywang@cmbi.com.hk

CMBI Fixed Income
 fis@cmbi.com.hk

Weak new car sales mitigated by growing contribution from other segments

Table 2: Zhongsheng's operating profiles

RMB bn	2019	2020	2021	2022	2023	2024	1H23	2H23	1H24	2H24
New cars	2,888.0	3,710.0	6,197.0	3,940.0	1,058.0	(3,208.4)	865.6	192.4	(1,990.1)	(1,218.3)
Parts, packages and after-sales services	8,600.0	9,575.0	11,783.0	11,586.0	11,766.3	12,650.5	5,771.2	5,995.1	6,298.3	6,352.2
Used cars	0.0	197.0	489.0	506.0	940.0	1,229.8	333.0	607.0	618.0	611.8
Gross profit (RMB mn)	11,488.0	13,482.0	18,469.0	16,032.0	13,764.3	10,671.9	6,969.8	6,794.5	4,926.2	5,745.7
Commission income (under other income and gain)	2,885.2	3,149.6	3,528.0	3,764.3	4,132.1	4,199.8	1,992.0	2,140.1	1,941.6	2,258.2
Aggregate profit	14,373.2	16,631.6	21,997.0	19,796.3	17,896.4	14,871.7	8,961.8	8,934.6	6,867.8	8,003.9
New car sales % aggregate profit	20.1%	22.3%	28.2%	19.9%	5.9%	-21.6%	9.7%	2.2%	-29.0%	-15.2%
Absorption ratio	104.0%	103.8%	108.5%	100.7%	100.9%	111.4%	108.5%	94.5%	118.2%	105.4%

Source: Company filings.

Zhongsheng's weaker FY24 results reflected the demand and supply imbalance of luxury cars and the pricing pressure under the backdrop of weaker economy. In FY24, Zhongsheng recorded a negative gross profit of RMB3.2bn from new car sales from a positive gross margin of RMB1.1bn in FY23. As we discussed in our daily on 11 Mar'24 regarding the FY24 results on Jardine Matheson, Zhongsheng's FY24 results should not be a surprise and indeed, on the bright side, we see some improvements in 2H24 results, especially the improving margin of new car sales. The negative gross margin of new car sales narrowed to 1.9% in 2H24 from 3.3% in 1H24. While the company remains cautious on new car sales, we take comfort that luxurious brands amended their sales targets in China to rebalance prices and demand, and the ramping up of the sales of AITO with positive gross margin. We expect the margin pressure on new car sales to alleviate. We take additional comfort with the growing contribution from other segments. Since FY21, new car sales accounted for a declining portion of Zhongsheng's aggregate profit, reflecting the weak new car sales and 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. Its absorption ratio had therefore improved to 111.4% in FY24 from 108.5% in FY21.

Credit profile remain solid for IG ratings

Table 3: Zhongsheng's financials

	2019	2020	2021	2022	2023	2024
Inventory days	30.8	23.3	21.6	27.0	31.2	35.1
Cash conversion cycle (days)	20.4	14.6	17.1	19.3	20.1	23.7
Cash	6,101.2	8,210.4	10,950.0	11,679.0	15,612.0	18,687.5
Other ST deposits	1,605.0	1,606.2	1,031.0	1,958.9	3,989.5	4,316.6
ST debts	17,326.3	17,257.8	15,615.4	15,162.7	16,483.0	17,654.4
LT debts	11,783.3	11,025.6	13,114.8	15,475.4	20,273.5	19,804.8
Total debts	29,109.6	28,283.3	28,730.2	30,638.2	36,756.5	37,459.1
Net debts	21,403.4	18,466.8	16,749.2	17,000.2	17,155.0	14,455.0
Debt/EBITDA	3.1x	2.6x	1.9x	2.4x	3.5x	4.4x
Net debt/EBITDA	2.3x	1.7x	1.1x	1.3x	1.6x	1.7x
EBITDA/int	6.5x	8.2x	12.6x	10.0x	6.6x	5.4x
Net debt/equity	96.5%	68.7%	41.1%	38.6%	37.3%	30.8%

Source: Company filings.

Zhongsheng continued to generate positive free flow with net debt reduction despite the weaker FY24 results. We expect Zhongsheng to continue to focus on optimizing its store network and to remain disciplined in expansion, such that net debt reduction will continue. Its key coverage ratios are better our original projections, we expect its key coverage ratios such as debt/EBITDA and net debt/EBITDA to improve to below 2.5x and 1.5x while EBIT/int to improve to above 7.0x, respectively, over the coming 2-3 years.

Refinancing pressure and liquidity profile considerably improved 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. On 31 Jul'24, it signed new offshore syndicated loans of USD350mn for the refinancing of existing loans due Apr'25. 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. We expect Zhongsheng to comfortably repay or refinance its CB due May'24 given its sufficient liquidity and good access to various funding channels.

CMB International Global Markets Limited

Fixed Income Department

Tel: 852 3657 6235/ 852 3900 0801

fis@cmbi.com.hk

CMB International Global Markets Limited ("CMBGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Author Certification

The author 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 author 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 author in this report.

Besides, the author confirms that neither the author 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.

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. CMBIGM 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. CMBIGM 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 CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM and/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 CMBIGM 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. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM 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. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM 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 CMBIGM 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 CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM 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 CMBIGM.

Additional information on recommended securities is available upon request.

Disclaimer:

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 CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM 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.