招銀国际 CMB INTERNATIONAL
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Yongda Automobiles (3669 HK)

After-sales as earnings driver amid low valuation

Initiate with BUY. We initiate coverage of Yongda with a BUY rating and a target price of HK$ 8.50, based on 7x FY23E P/E. Despite direct-sales attempts by some new-energy-vehicle (NEV) makers, we believe dealership business model is still justified. We believe the majority of short-term negatives has been priced in given its low valuation now. Some investors may underestimate the contribution of after-sales service recovery to Yongda's net profit growth this year.

- **Industry margin dent has been largely priced in.** Auto dealers' new-car sales business may face challenges amid price war in 1Q23, following phase-out of both NEV subsidy and purchase-tax benefit from this year. We expect sales volume and margins to recover from 2H23 after possible inventory reduction in 2Q23. Yongda's core brands, BMW and Porsche, could be better positioned than other traditional brands in the NEV world.
- **NEV brands and pre-owned vehicles may grow fast.** Yongda is a pioneer in partnering with NEV makers. We expect Yongda's new-car sales volume of NEV brands to surge over 90% YoY to 15,000 units (dealership model and agency model combined) in FY23E amid network expansion. We project Yongda's pre-owned vehicle sales volume to rise 10% YoY to 88,000 units in FY23E, amounting to more than 50% of its new-car sales volume.
- **After-sales services as a key earnings driver this year.** We project Yongda's after-sales service revenue to rise 15% YoY in FY23E and to account for 16.5% of its total revenue amid pent-up demand and commute resumption. That could lift Yongda's overall gross margin to 10.0% in FY23E from 8.9% in FY22E, based on our estimates. Accordingly, we forecast its net profit to rise 39% YoY to RMB 2.0bn in FY23E. We believe such profit and margin contribution from after-sales services could be underestimated by some investors.
- **Valuation/Key risks.** Our target price of HK$ 8.50 is based on 7x our FY23E P/E, the same as its average forward 12-month P/E in the past nine years. We think the valuation gap between Yongda and its peers could narrow, because the rising importance of after-sales services and Yongda's NEV exposure. We also project Yongda's dividend yield to exceed 8% this year. Key risks to our rating and target price include lower sales and/or margins, slower after-sales service recovery than our expectation, as well as a sector de-rating.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	68,201	77,917	72,950	70,598	69,260
YoY growth (%)	8.8	14.2	(6.4)	(3.2)	(1.9)
Net income (RMB mn)	1,625	2,480	1,443	2,005	2,327
EPS (RMB)	0.85	1.26	0.74	1.03	1.19
YoY growth (%)	10.3	52.6	(41.8)	38.9	16.1
P/E (x)	5.0	3.3	6.1	4.3	3.7
P/B (x)	0.7	0.6	0.6	0.5	0.5
Yield (%)	13.1	11.6	6.6	9.3	10.8
ROE (%)	15.0	19.4	10.3	13.4	14.1
Net gearing (%)	57	18	8.8	2.4	Net cash

Source: Company data, Bloomberg, CMBIGM estimates. Note: Market data as of 20 Mar 2023.

BUY (Initiation)

Target Price	**HK$ 8.50**
Up/Downside	**+68.0%**
Current Price	**HK$ 5.06**

China Auto Sector

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Stock Data

Mkt Cap (HK$ mn)	9,896
Avg 3 mths t/o (HK$ mn)	21
52w High/Low (HK$)	9.10/3.40
Total Issued Shares (mn)	1,956

Source: Bloomberg

Shareholding Structure

Mr. Cheung Tak On	29.8%
FIL Limited	8.1%
Others	62.2%

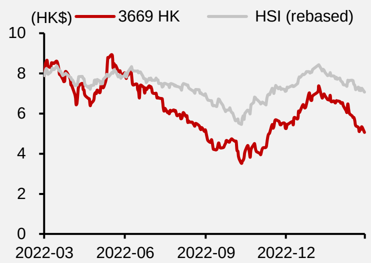
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-23.7%	-15.4%
3-mth	-4.0%	-3.5%
6-mth	1.2%	-1.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte

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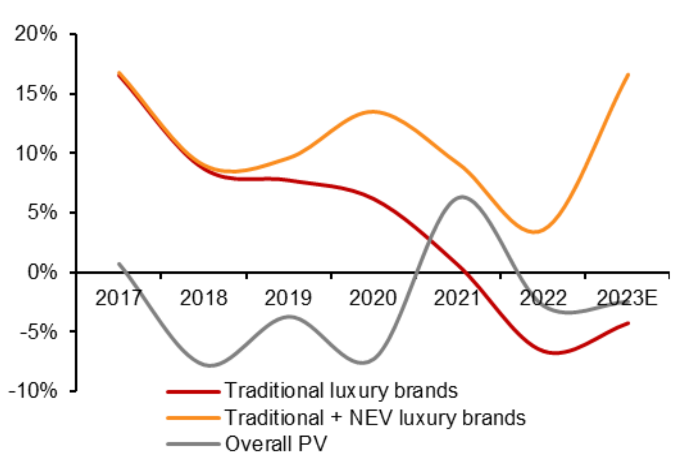
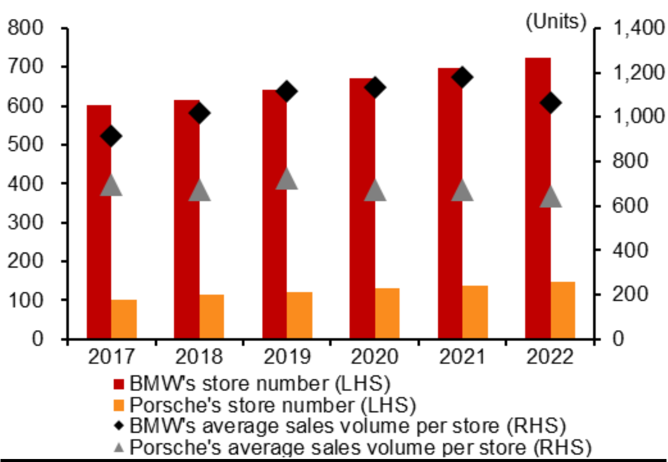


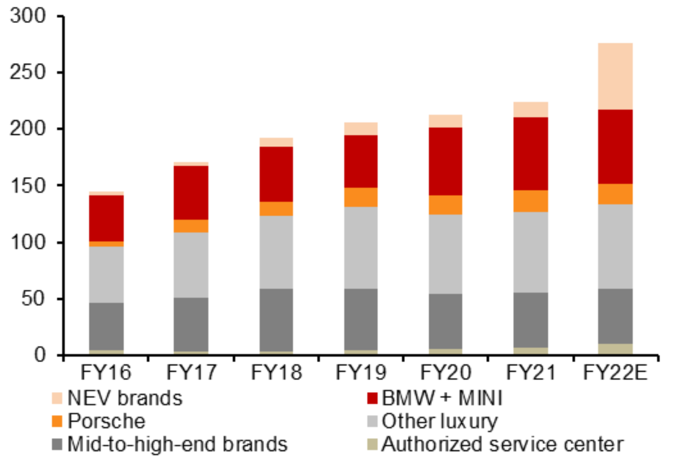
Source: CATARC, CMBIGM estimates

Figure 2: No. of authorized stores and avg. sales volume per store for Porsche and BMW in China



Source: Company data, CMBIGM

Figure 3: Yongda's authorized store number growth by brand



Source: Company data, CMBIGM estimates

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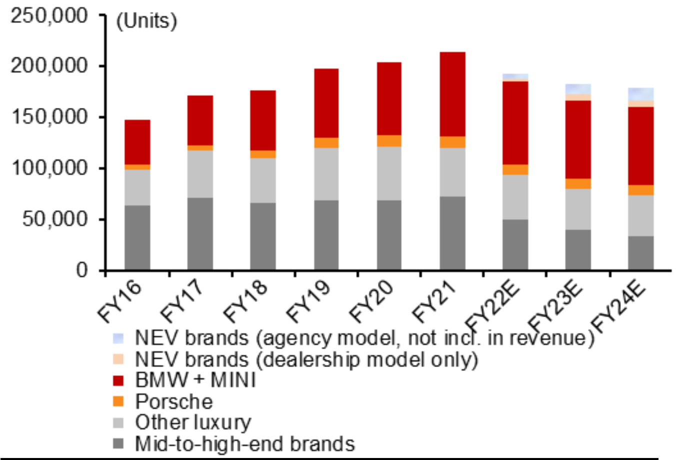
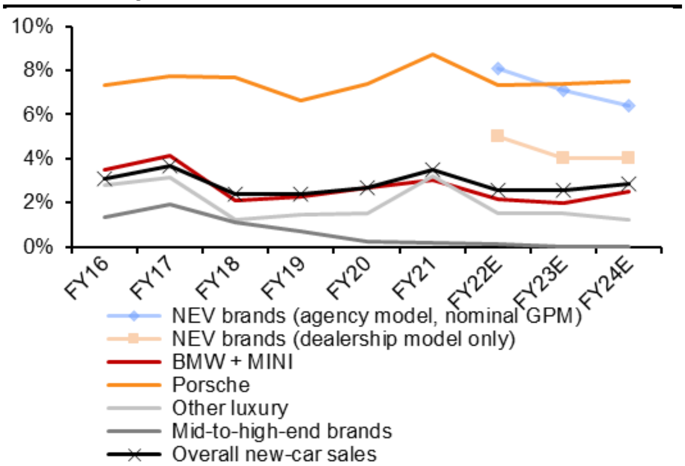


Source: Company data, CMBIGM estimates

Figure 5: Yongda's new-car sales gross margin forecast by brand



Source: Company data, CMBIGM estimates

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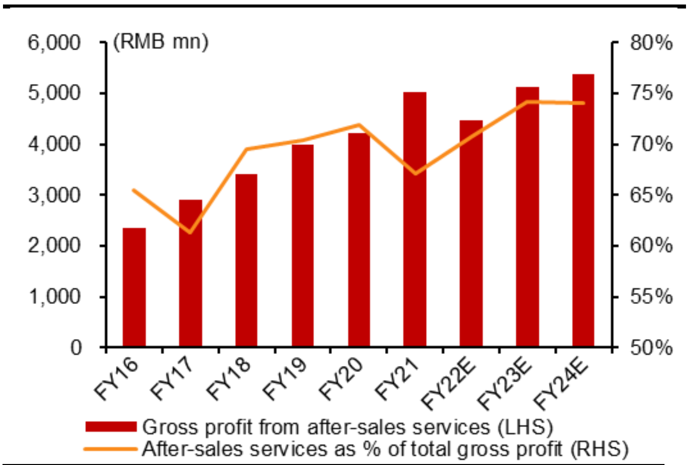


Source: Company data, CMBIGM estimates

Investment Thesis

Dealership will likely exist despite the adoption of direct sales by NEV start-ups

The main purpose for automakers to attempt direct sales is to know customers' needs faster and better, which does not mean a 100% direct-sales model, in our view, especially in regions with lower investment return. In addition, higher hardware ratio for cars than smart phones and volatile customer demand probably mean higher stock-keeping units (SKUs), which may lead to complex supply chain and higher inventory burden for automakers. Therefore, dealers are the cushions for automakers during unexpected events.

More and more NEV makers have been relying on dealers to adopt so-called agency model. Yongda is one of the pioneers to work with NEV start-ups and attempt agency model. Agency model requires lower initial investments for dealers, which could mean shorter payback period. More importantly, operational risks are lower for dealers as they do not need to take inventories compared with the dealership model, and automakers are likely to offer generous incentives to dealers at the beginning under the agency model. On the other hand, we estimate the overall after-sales service revenue in the NEV world to decline by about 20%, with a slightly lower gross margin.

After-sales service as an earnings driver this year for Yongda

Although vehicle consumption upgrade has never halted in China in our opinion, retail sales volume of traditional luxury brands may continue to underperform the overall passenger-vehicle (PV) market this year, given a lack of competitive NEV models. Yongda, as a leading luxury-brand auto dealer, could post new-car sales volume YoY decline for traditional brands in FY23E. On the other hand, we project Yongda's new-car sales volume of NEV brands to surge over 90% YoY to about 15,000 units in FY23E, driven by its network expansion last year. Despite low base for new-car gross margin in FY22E, we still expect a similar level for FY23E amid price war. We also forecast Yongda's pre-owned vehicle sales volume to rise 10% YoY to about 88,000 units in FY23E.

We believe Yongda's after-sales services could be its earnings driver in FY23E after the significant dent by lockdowns last year. We forecast Yongda's after-sales service revenue to rise 15% YoY in FY23E, driven by 11% increase in number of after-sales services and slightly higher average selling price (ASP) from better product mix. We project Yongda's after-sales services to account for 16.5% of its total revenue in FY23E, the highest in history. Therefore, we project Yongda's overall gross margin to widen from 8.9% in FY22E to 10.0% in FY23E, aided by high-margin after-sales services.

Earnings forecast and valuation

We project Yongda's total revenue to drop 3% YoY to RMB 70.6bn in FY23E and 2% YoY RMB 69.3bn in FY24E, largely due to sales slowdown in traditional luxury brands in China. We expect Yongda' net profit to rise 39% YoY and 16% YoY to RMB 2.0bn and RMB 2.3bn, respectively, during FY23-24E. We believe some investors may underestimate Yongda's earnings improvement driven by after-sales service rebound this year.

We initiate our coverage with a BUY rating and our target price of HK$8.50 is based on 7x FY23E P/E, the same as its average forward 12-month P/E in the past nine years. The company is likely to further improve the dividend payout ratio to about 40% this year in our view, implying a dividend yield of above 8% in FY23E, which should be a good support to the company's share price, in our view.

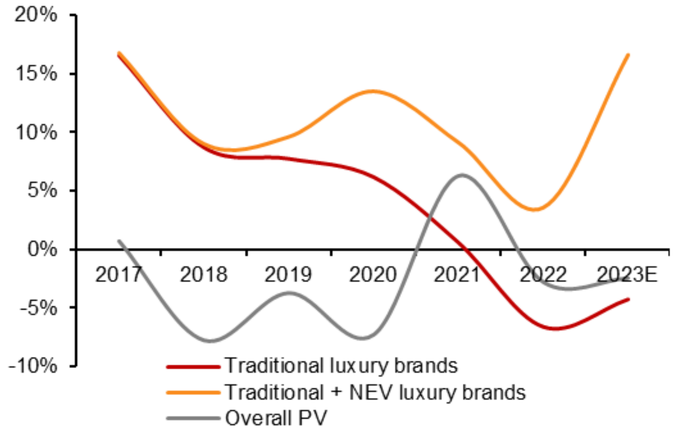
Industry Overview

Overall luxury car: Traditional luxury down, premium NEV up

We divide luxury-auto segment into two categories to better reflect the industry landscape changes: traditional luxury and NEV luxury, as premium NEV models have already contributed a significant portion to high-end vehicle sales. Our defined NEV luxury brands include Tesla, NIO, Lixiang, Xpeng, Zeekr, Aito, Denza, HiPhi, Great Wall's SL, JIDU, BYD's Yangwang, Avatar, Voyah, IM and Polestar.

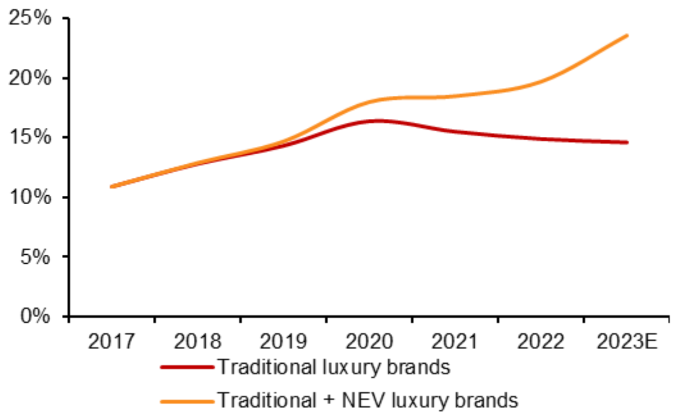
After four-year outperformance during 2017-20, retail sales volume of traditional luxury brands underperformed the overall PV market in 2021-22. However, the figures below clearly show that vehicle consumption upgrade has never halted in China, as the overall luxury segment, including premium NEV brands, has been consistently outperforming the overall PV market.

Figure 7: Retail sales YoY growth for traditional luxury brands, overall luxury brands and overall PV



Source: CATARC, CMBIGM estimates

Figure 8: Market shares for overall luxury brands and traditional luxury brands in China



Source: CATARC, CMBIGM estimates

We expect such trend to continue in 2023. We project traditional luxury brands to drop 4% YoY in 2023, slightly weaker than the overall PV market's 2% YoY decline. We expect the overall luxury auto retail sales volume to rise 17% YoY in 2023. That means we expect the overall luxury brands (including NEV luxury) to account for 23.5% of China's total retail sales volume in 2023, whereas traditional luxury brands' market share may drop to about 14.6%. In other words, retail sales volume of NEV luxury brands could account for almost 40% of total luxury brands in 2023, based on our estimates.

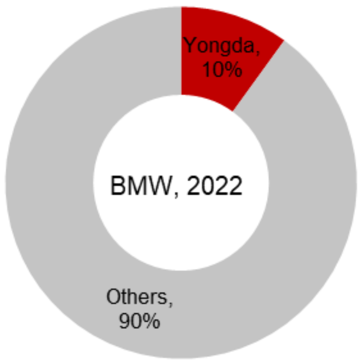
Traditional luxury brands have been lagging in the rollouts of competitive NEV models in the past few years, which should be one of the key reasons for their underperformance in China, in our view. We believe some traditional luxury brands still have opportunities to catch up, as their better brand image gives them a longer transition time toward electrification than mass-market brands.

As Hong Kong-listed auto dealers mainly sell traditional luxury-brand vehicles, sales underperformance of traditional luxury brands has trimmed dealers' valuation in the past two years. As we project such sales underperformance to continue in 2023, new-car gross margins and after-sales service would be more critical to dealers' earnings outlook. Most dealers achieved all-time high net margins in 2021 amid new-car sales declines due to chip shortage.

BMW: No need to read too much into its aggressive sales target

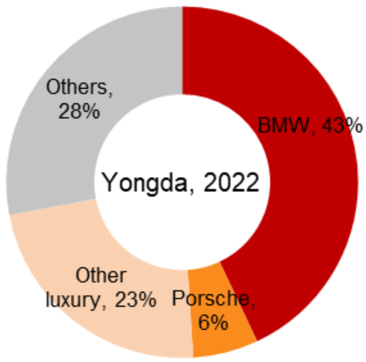
Yongda is one of BMW's largest dealers in China, with over 40% of its total new-car sales volume coming from BMW in 2022 on our estimates. Yongda opened its first BMW 4S store in 2005 in Shanghai and now operates about 56 BMW 4S stores and showrooms nationwide. Yongda accounted for about 10% of BMW's total retail sales volume in China in 2022.

Figure 9: Yongda's contribution to BMW's China retail sales volume



Source: Company data, CATARC, CMBIGM estimates

Figure 10: BMW accounts for about 43% of Yongda's new-car sales volume

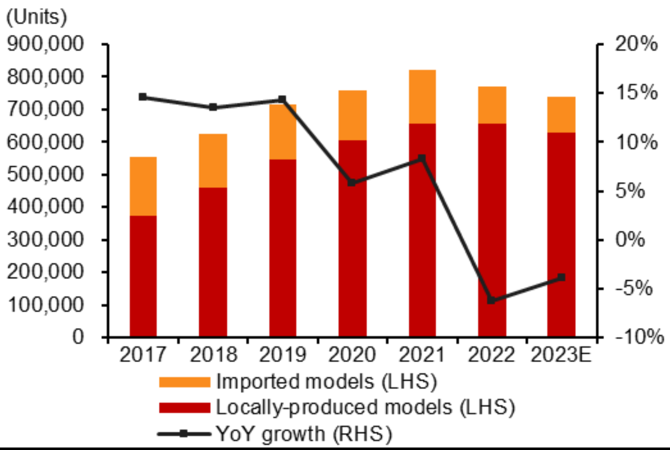


Source: Company data, CMBIGM estimates

BMW targets a sales-volume growth of over 15% YoY to about 900,000 units in China in 2023, which is quite aggressive in our view. BMW may aim to take over the luxury-car sales volume crown from Mercedes-Benz in China this year, as it only fell short by less than 4,000 units in 2022. On the other hand, BMW announced MSRP (manufacturer's suggested retail price) increase of about RMB 2,000-20,000 for most models in China from Feb 2023, due to raw-material price hike amid high inflation in the Eurozone.

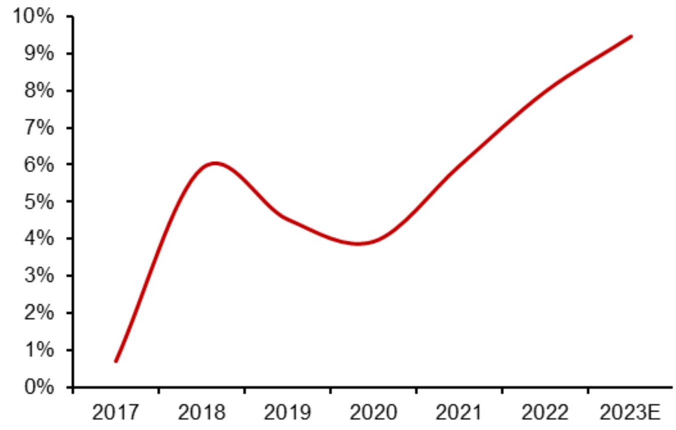
We are of the view that investors do not need to read too much into such aggressive sales target. BMW has been more responsive to market changes than before, after its oversupply during 2014-15 and 2H18, which resulted in quite significant subsidies to dealers afterwards. BMW initially targeted 10% YoY sales-volume growth in China in 2022 but ended up with 7% YoY decline. BMW dealers' inventory levels were one of the lowest among all the brands last year. We think similar trend could happen to BMW this year.

Figure 11: BMW's retail sales volume in China



Source: CATARC, CMBIGM estimates

Figure 12: NEV market share at BMW in China



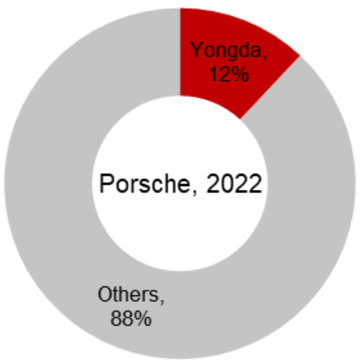
Source: CATARC, CMBIGM estimates

We project BMW's retail sales volume to decline 4% YoY to about 740,000 units in 2023 amid the aging *3-Series* and *5-Series*. We expect BMW to retain the NEV sales crown among the German "Big Three" in 2023 aided by the *i3* and *iX3* BEVs, as we project NEVs to account for almost 10% of BMW's total sales volume in 2023. We also expect BMW dealers' new-car gross margin to improve from 2Q23, which could be a positive catalyst for Yongda's share price.

Porsche: New-car gross margin to rebound amid conservative sales target

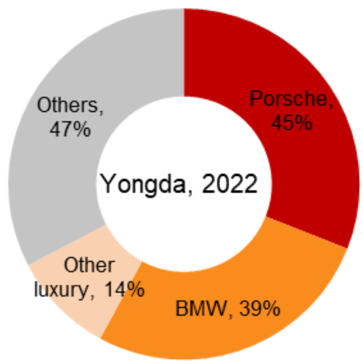
Yongda is also one of Porsche's largest dealers in China, accounting for about 12% of Porsche's total new-sales volume in China in 2022. Yongda opened its first Porsche 4S store in Hainan Province in 2011 and now has 19 Porsche 4S stores and showrooms nationwide. Porsche probably accounted for about 6% of Yongda's total new-car sales volume, but 45% of Yongda's total new-car gross profit in 2022, based on our estimates.

Figure 13: Yongda's contribution to Porsche's China retail sales volume



Source: Company data, CATARC, CMBIGM estimates

Figure 14: Porsche accounts for about 45% of Yongda's new-car gross profit

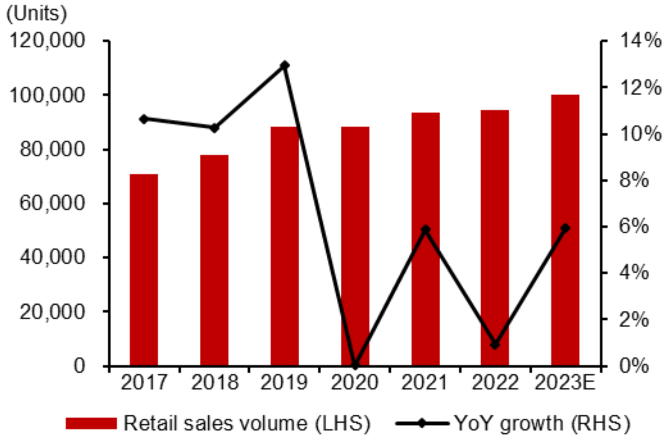


Source: Company data, CMBIGM estimates

Porsche targets retail sales volume of 90,000 units in 2023, implying a YoY decline of 5%, which is conservative and probably reflects Porsche's determination to maintain its more luxurious brand image after experiencing unusually high discounts in 2H22. We are of the view that Porsche may be best positioned among traditional luxury brands when facing competition from NEVs, thanks to its more luxurious brand image and better received *Taycan BEV* than those BEVs at Mercedes-Benz and BMW.

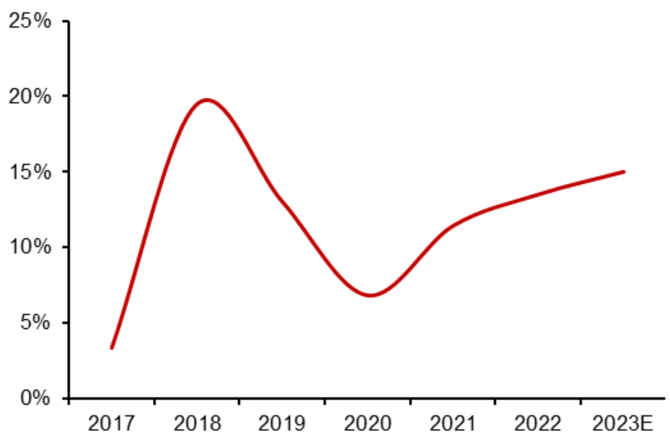
We project Porsche's retail sales volume to grow 6% YoY to about 100,000 units in 2023, partly aided by upcoming new *Macan BEV* and new stores opened in 2022. Unlike BMW and Mercedes-Benz, Porsche's BEV models are profitable for dealers.

Figure 15: Porsche's retail sales volume in China



Source: CATARC, CMBIGM estimates

Figure 16: NEV market share at Porsche in China



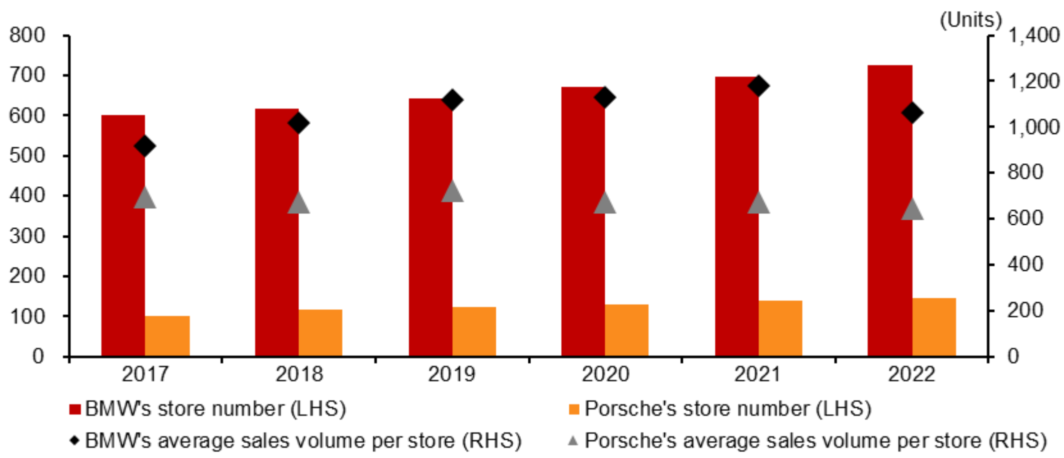
Source: CATARC, CMBIGM estimates

Will dealership business model disappear amid slower expansion?

Dealer network expansions for traditional luxury brands have been stable during the past few years, except for Audi, as it set up a new joint venture (SAIC Audi). The store number growth rate is less than 5% for major luxury brands in China per annum. The majority of new stores are located in lower-tier cities.

BMW has about 730 4S stores, showrooms and service centers in China now, or about 1,000-1,200 units of annual sales volume per store on average nationwide. Porsche now has about 150 4S stores, showrooms and service centers in China, with an average store sales volume of 650-720 units per year.

Figure 17: Number of authorized stores (incl. showrooms and service centers) and average sales volume per store for Porsche and BMW in China



Source: Company data, CMBIGM

We expect China's overall authorized dealer network to expand at a slower pace than before, including brands like BMW and Porsche, for two reasons.

1) Auto sales growth in China has been slowing down, especially for internal-combustion engine (ICE) vehicles.

2) Automakers may attempt direct-sales model to sell at least part of their cars to customers, especially for NEVs.

Auto dealer business will exist in the medium to long term

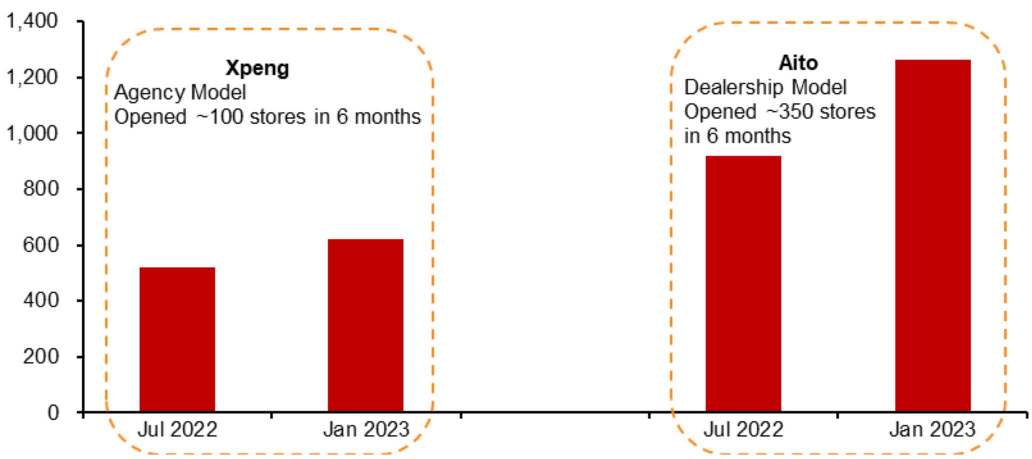
We have not seen signals for direct-sales attempts from brands like BMW and Audi (Porsche has a few self-operating 4S stores for a long time in China), although we cannot rule out such possibilities. Despite that, we are still of the view that the auto dealer business will exist in the medium to long term for the following reasons.

1) Reacting to customers' needs faster does not need 100% direct-sales model

In our view, the main purpose for automakers to adopt a direct-sales model is to know customers' needs faster and better, as software-defined vehicles make upgrades more flexible. However, it does not mean that automakers have to implement a 100% direct-sales model, especially in regions with lower investment return. Instead, automakers could open self-operating flagship stores in big cities that could serve as leading indicators for other lower-tier cities and meanwhile realign authorized dealers' KPI to enhance timely feedback and customer services.

More and more NEV makers, including Xpeng, SAIC's IM, Smart and Dongfeng's Voyah, have been relying on dealers to adopt so-called agency model. In this model, customers are required to place orders online through mobile APP, while dealers do not take inventory but help deliver vehicles and service customers. In this case, automakers can still closely monitor demand dynamics and react quickly to customers' needs, by leveraging dealers' capital and resources.

Figure 18: Fast store expansion of Xpeng and Aito in China



Source: Company data, CMBIGM

2) High SKUs and complex supply chain may challenge direct-sales model

Investors see the similarity between smart phones and NEVs in terms of software importance, and therefore, infer that NEV makers could also adopt direct-sales business model. We acknowledge such analogy, but we are of the view that it could still be a bit different. As noted in our previous reports, if we had to quantify the importance of software for future cars, we would probably put 50:50 for the software/hardware ratio in terms of consumers' perceived value. Higher hardware ratio for cars than smart phones probably means higher stock-keeping units (SKUs) and higher inventory burden for automakers. Despite higher level of components integration for NEVs, the supply chain for cars is way more complex than smart phones. Volatile customer demand for cars by nature would create huge difficulty for automakers to manage their supply chain and therefore, dealers are the cushions for automakers during unexpected events.

Agency model: Shorter payback period and lower operational risk for dealers

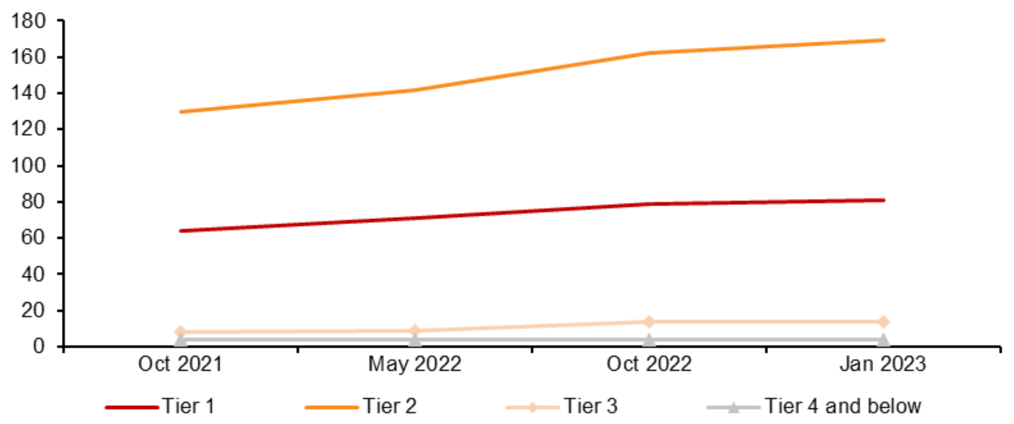
Agency model appears to gain popularity nowadays among incumbent automakers' NEV brands, such as Smart, SAIC's IM and Dongfeng's Voyah, as it satisfies traditional automakers' attempts to know customers' needs with much lower investments than direct-sales model. Much lower investments than direct-sales model also means a faster sales network expansion when automakers set up a new sales network for a new brand. Dealers are willing to take this option as long as automakers offer a reasonable incentive scheme for selling new cars. Agency model requires lower initial investments for dealers, which could mean shorter payback period. More importantly, operational risks are lower for dealers as they do not need to take inventories compared with the dealership model.

Yongda is one of the pioneers to work with NEV start-ups and attempt agency model with some automakers. It appears to us that automakers are likely to offer generous incentives to dealers at the beginning under the agency model especially when new-car sales and after-sales services are usually separated in the NEV sales business model. Possible abnormal profits from agency model would be gone when the NEV brands get mature. In fact, we are of the view that agency model could either convert into pure direct-sales model or go back to dealership model in the long term. Therefore, payback period could be crucial for dealers.

Will the likes of Tesla leverage dealers in lower-tier cities?

This year could be interesting for dealers, as NEV start-ups may experience production overcapacity for the first time in history. The possible inventory burden could make NEV makers rethink about dealers. As noted in our previous report, Tesla needs to expand its sales network in lower-tier cities in China, in a bid to maintain its high capacity utilization rate. Although Tesla has never utilized dealers for its sales network, we cannot rule out such possibilities. It could be a huge positive catalyst for Chinese dealers' share price, if any leading NEV makers adopt agency or dealership model.

Figure 19: Tesla's showroom expansion in different city tiers



Source: Company data, CMBIGM

Will NEV's after-sales service be less profitable than ICE vehicle's for dealers?
Investors have been questioning the profit dent on NEVs' after-sales services for dealers. We are of the view that it is not a crucial issue as long as dealers still exist in the NEV world, because the nature of opportunity cost requires a reasonable investment return for dealers, whether it is from new-car sales or after-sales services. Profits of traditional dealership model mainly come from after-sales services. In other words, dealers are willing to sell a new car at a loss if they can generate enough profits later from after-sales services. If profits from after-sales services are lower in the NEV world, automakers may have to lift profits of new-car sales for dealers in order to offer dealers a reasonable profit level.

Nevertheless, we try our best to estimate the potential profit dent for after-sales services in the NEV world, based on the limited data we have compiled. We estimate that powertrain, warranty and paint and body account for 40%, 15% and 45% of an ICE vehicle's after-sales service revenue. We expect the frequency for the paint and body shop to be largely unchanged in the NEV world and the dollar amount for such services to rise slightly given more integrated manufacturing technologies and more electronic components. We expect powertrain related service revenue to fall about 70% in the NEV world. Therefore, we estimate the overall after-sales service revenue in the NEV world to decline about 20%. We also project gross profit from after-sales services to fall about 22% in the NEV world, assuming a slightly lower gross margin.

Figure 20: Our estimates on the profitability of NEVs' after-sales service

	ICE vehicles				NEVs			
	Est. revenue mix	Est. revenue	Est. GPM	Est. gross profit	Est. revenue mix	Est. revenue	Est. GPM	Est. gross profit
Powertrain related	40%	40	60%	24	15%	12	55%	7
Warranty	15%	15	20%	3	20%	16	30%	5
Paint and body	45%	45	40%	18	65%	52	45%	23
Total	**100%**	**100**	**45%**	**45**	**100%**	**80**	**44%**	**35**

Source: Company data, CMBIGM estimates

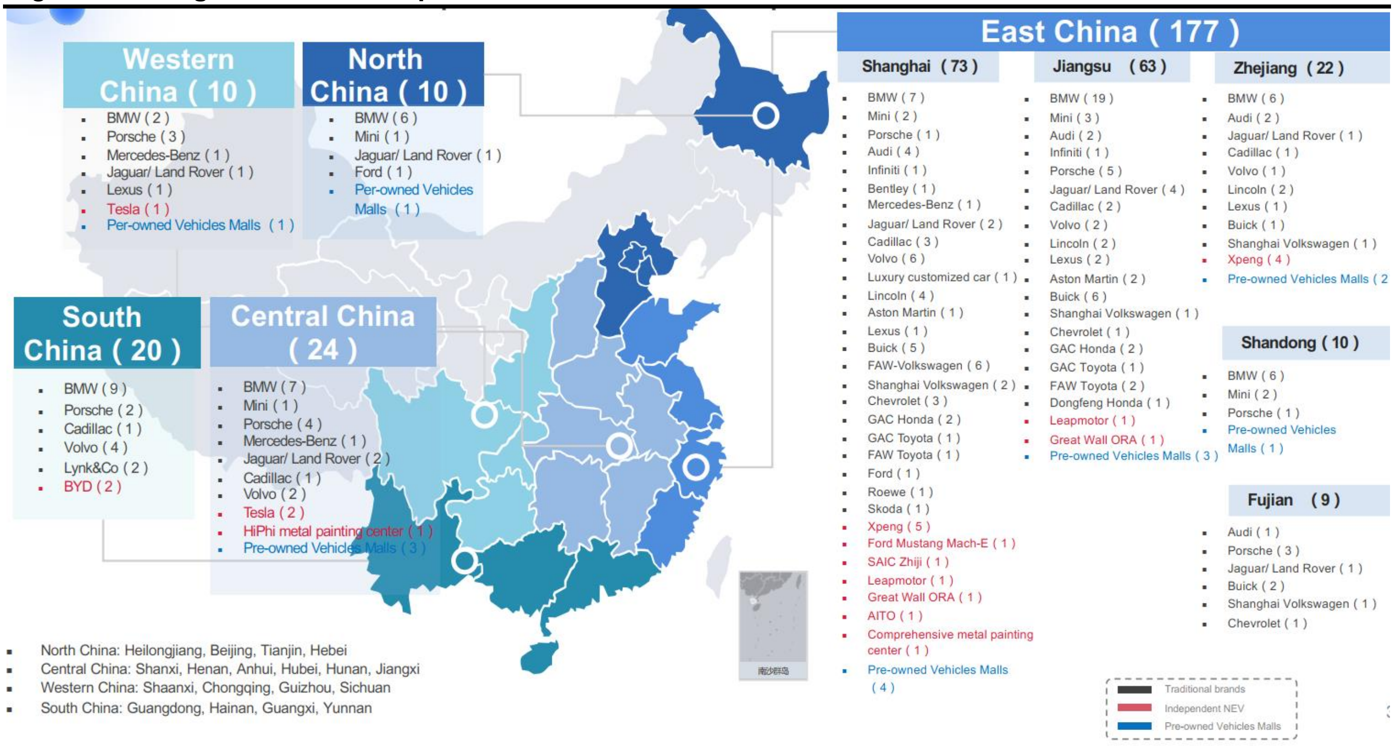
Company Overview

Luxury-brand auto dealer, complex ownership of subsidiaries

Yongda is one of the largest auto dealers in China, mainly focusing on luxury brands, especially BMW and Porsche. The company was listed on the Hong Kong stock market in Jul 2012. Yongda's history can be traced back to 1991, when its founder, Mr. Cheung Tak On, started his hardware electromechanical business in Shanghai. Mr. Cheung Tak On now holds 29.6% of Yongda's stake.

We estimate the company now has about 276 authorized outlets, covering 24 provinces mainly in eastern and southern China. About 66% of stores are located in Shanghai, Jiangsu and Zhejiang province. The network covers 13 luxury brands, 10 mid-to-high-end brands and more than 10 NEV brands. About 70% of stores sells luxury-brand cars.

Figure 21: Yongda's network map as of Jun 2022



Source: Company data

Mergers and acquisitions (M&As) have contributed a lot to Yongda's development, as about 60 stores were acquired since 2013, based on the information we have compiled. We have listed some major M&A projects of Yongda in the table below. Yongda either targeted the brands it is familiar with, such as BMW and Porsche, to further strengthen its positions in these brands, or leveraged M&As to access new brands such as Mercedes-Benz, Tesla and Lexus.

Figure 22: Yongda's major M&As in history

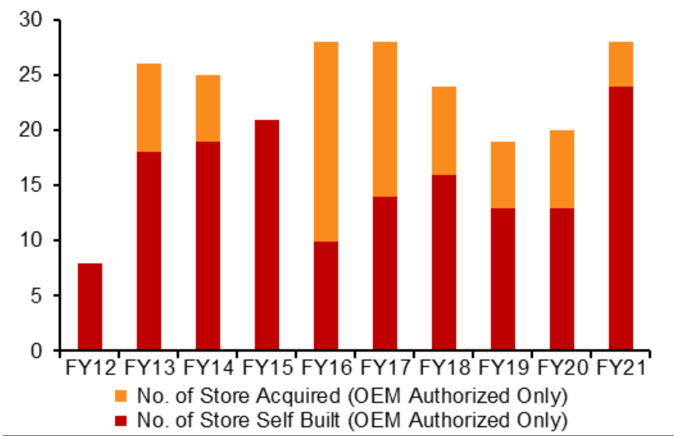
Year	Project	Brand	Number of stores	Location	Consideration (RMB mn)	Est. valuation (P/E)
2016	JS Baozun 18 stores	BMW	5	Jiangsu	764	6.4
		Cadillac	2	Jiangsu		
		Buick	5	Jiangsu		
		Chevrolet	4	Jiangsu		
		Roewe	1	Jiangsu		
		FAW-Toyota	1	Jiangsu		
2017	Baitai 4 stores	Porsche	3	Shaanxi, Fujian, Sichuan	103	4.5
		BMW	1	Shandong		
2019	Inchcape 4 stores	Porsche	1	Jiangxi	819	12.6
		Mercedes-Benz	1	Jiangxi		
		Lexus	1	Zhejiang		
		Tesla, after-sales	1	Jiangxi		
2020	Zhongzhiyuan 6 stores	BMW	6	Yunnan, Sichuan	682	3.9
2021	Oriental 4 stores	Lexus	2	Jiangsu	833	4.9
		BMW	2	Jiangsu		

Source: Company data, CMBIGM estimates

On the other hand, M&As could create challenges for managing different mindset and company culture, especially for those acquired stores that are not wholly-owned by Yongda. We estimate over 25% of Yongda's stores have minority interests. We also calculate that the profitability of those stores should be lower than Yongda's wholly-owned stores. We note that Yongda's SG&A ratio is higher than major peers', which may be partly explained by the complex equity structure of its subsidiaries.

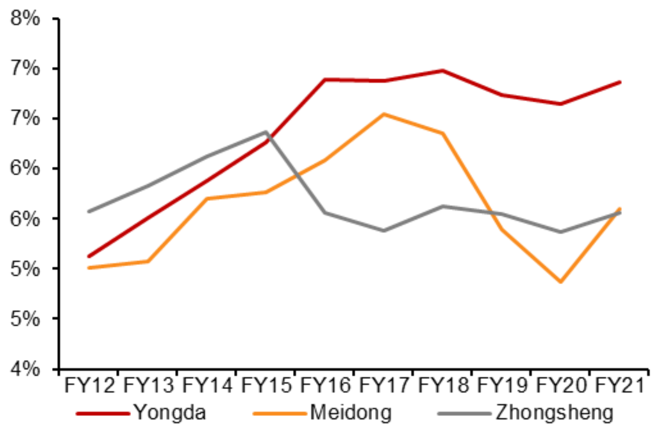
We expect Yongda's M&As to slow down in the next few years, given the company's low valuation now and its focus on NEV brands in a bid to hedge the possible risks in traditional automakers' electrification progress.

Figure 23: No. of store acquired or self-built by Yongda



Source: Company data, CMBIGM

Figure 24: SG&A ratio comparison of Yongda, Meidong and Zhongsheng



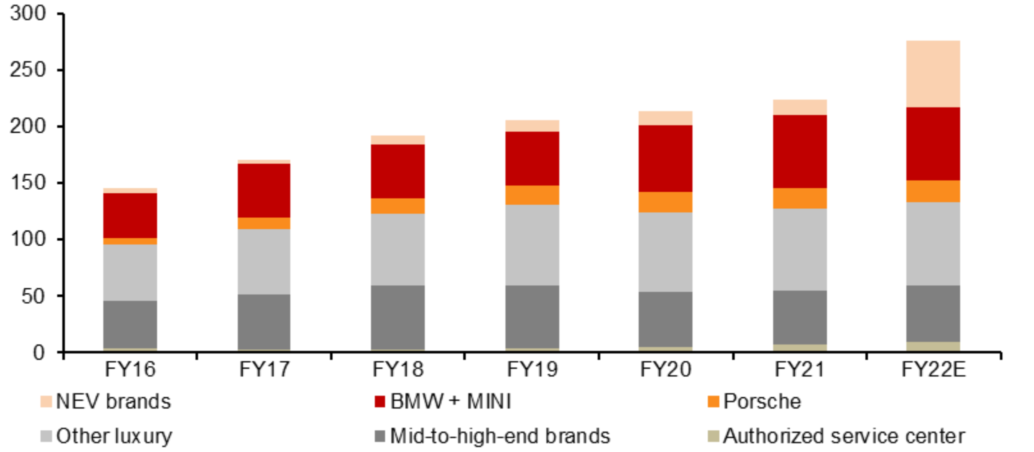
Source: Company data, CMBIGM

New-car sales: Luxury is the foundation, NEV could be a driver

Network: More NEV-brand stores; Shanghai, Jiangsu and Zhejiang as key regions
We estimate Yongda has about 276 authorized stores as of FY22 end, including 56 BMW stores (excl. service stores), 19 Porsche stores, five Lexus stores, three Mercedes-Benz stores, 75 other luxury-brand stores (incl. Audi, Jaguar Land Rover, Cadillac, Volvo, Lincoln, etc.), 49 mid-to-high-end stores and 59 NEV stores (excl. service stores).

Yongda is one of the pioneers to work with NEV start-ups and attempt agency model with some automakers, including Xpeng, SAIC's IM, Smart, Lotus, Mustang and Dongfeng's Voyah. The company added about 48 new NEV stores in 2022 and still has plenty in its pipeline. We believe NEV stores could be a main driver for Yongda's network expansion for the next 2-3 years. Meanwhile, we expect Yongda to close some stores of tier-2 luxury brands and mid-to-high-end brands in the following years, should their profitability plunge amid intensifying competition.

Figure 25: Yongda's authorized store number growth by brand



Source: Company data, CMBIGM estimates

Yongda's stores are mainly located in the eastern coastal region of China, as shown in the figure below. Shanghai, Jiangsu and Zhejiang accounted for 31%, 27% and 8% of Yongda's total stores as of FY21-end, respectively. That could explain why Yongda's operation was heavily disrupted during Shanghai's lockdown from late Mar to May 2022. On the other hand, that may imply potential sales and earnings YoY improvement at Yongda this year.

Figure 26: Yongda's store number growth by province

	FY16	FY17	FY18	FY19	FY20	FY21
Total	**147**	**173**	**194**	**206**	**213**	**224**
- Shanghai	48	50	52	52	59	69
- Jiangsu	45	47	56	60	58	60
- Zhejiang	19	21	22	24	18	19
- Guangdong	6	7	11	12	13	13
- Fujian	5	8	9	9	9	9
- Shandong	1	6	7	8	8	9
- Shanxi	5	5	6	6	6	6
- Sichuan	-	3	3	3	5	6
- Anhui	3	3	3	4	5	5
- Jiangxi	2	2	1	4	4	4
- Yunnan	-	-	-	-	4	4
- Heilongjiang	2	5	5	5	3	3
- Hebei	3	3	3	3	3	3
- Hunan	1	1	2	2	3	3
- Tianjin	2	2	2	2	2	2
- Hainan	2	2	2	2	2	2
- Beijing	1	1	1	2	2	1
- Henan	1	1	1	1	1	1
- Shaanxi	-	2	2	1	1	1
- Guizhou	1	1	1	1	1	1
- Chongqing	-	3	3	3	3	1
- Hubei	-	-	1	2	2	1
- Guangxi	-	-	-	-	1	1
- Jilin	-	-	1	-	-	-

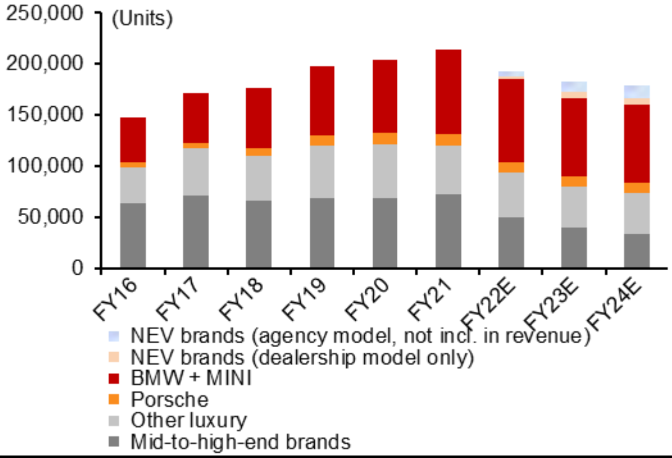
Source: Company data, CMBIGM

New-car sales: Sales volume may drop; gross margin largely stable

We project Yongda's new-car sales volume to drop 12% YoY to about 188,000 units in FY22E, excluding sales based on agency model. Note that revenue from the agency model is recognized as commission income under "other income". We estimate NEV sales volume under the agency model to be about 4,400 units in FY22E.

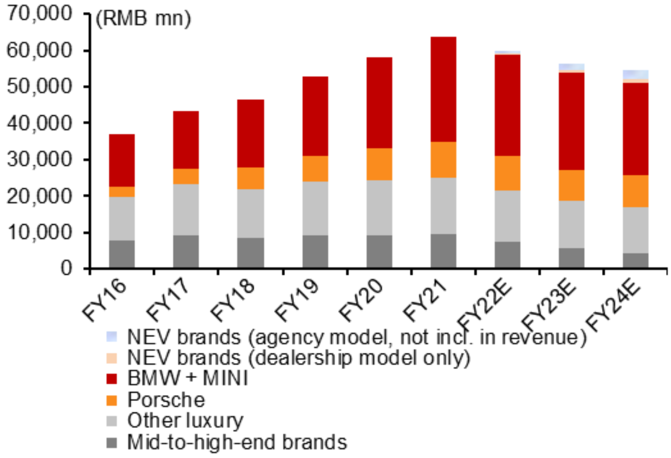
We forecast Yongda's new-car sales volume to drop 8% YoY to about 172,000 units in FY23E amid traditional luxury brands' lagging in NEV rollouts. We project new-car sales volume for traditional luxury brands at Yongda to fall 6% YoY to about 127,000 units in FY23E, accounting for 74% of its total new-car sales volume. We expect Yongda's total NEV-brand sales volume to rise over 90% YoY to about 15,000 units (over 60% under the agency model) in FY23E, driven by new stores opened in FY22. Accordingly, we project new-car sales revenue to drop 7%, 8% and 5% YoY during FY22-24E, respectively.

Figure 27: Yongda's new-car sales volume forecast by brand



Source: Company data, CMBIGM estimates

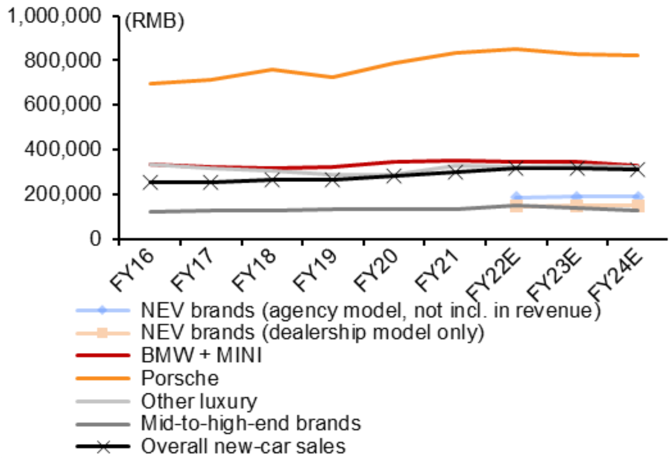
Figure 28: Yongda's new-car sales revenue forecast by brand



Source: Company data, CMBIGM estimates

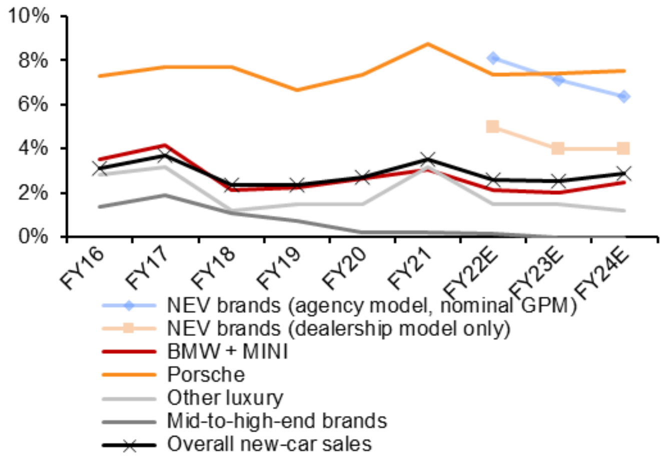
We estimate Yongda's new-car gross margin to be 2.6% in FY22E, down from 3.5% in FY21 which was benefited from supply constraints. We project BMW's new-car gross margin to fall from 2.2% in FY22E to 2.0% in FY23E, assuming that BMW increases rebates to dealers this year versus last year. We also expect Porsche's new-car gross margin to be around 7.4% in both FY22E and FY23E. We forecast NEV brands' new-car gross margin to drop from 5% in FY22E to 4% in FY23E amid intensifying NEV competition. Accordingly, we expect Yongda's new-car gross margin to be 2.5% in FY23E.

Figure 29: Yongda's new-car sales ASP forecast by brand



Source: Company data, CMBIGM estimates

Figure 30: Yongda's new-car sales gross margin forecast by brand



Source: Company data, CMBIGM estimates

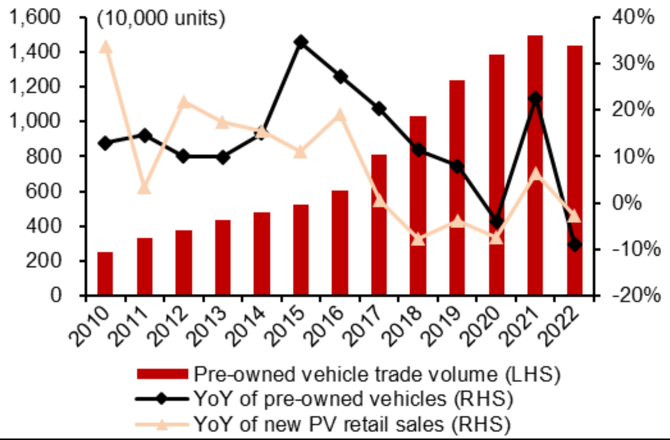
Pre-owned vehicles: Next profit driver for dealers?

Strong growth potential but still needs time to find an optimal model

Pre-owned vehicle sales volume has grown faster than new cars in China since 2015 except for 2022, partially due to widened discounts for new cars. Pre-owned vehicle market could still be challenging in 2023 amid new-car price war.

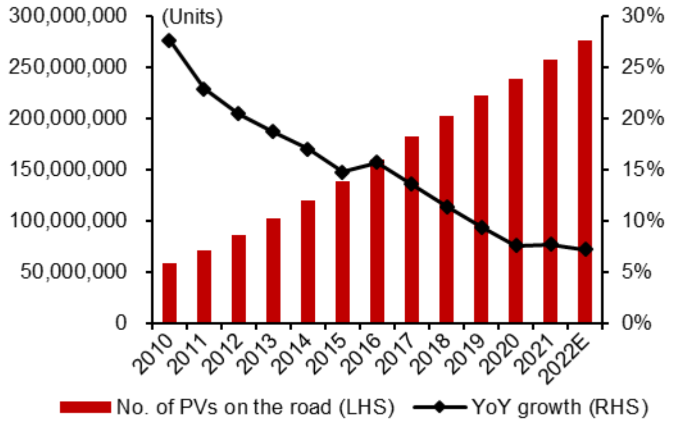
In our view, the biggest challenge for dealers is that pre-owned vehicle is not a properly regulated market yet with non-standardized products. It requires a much higher level of management and skillset for dealers when sourcing and selling pre-owned cars. It may also need further regulation from the government, in our view. Nevertheless, pre-owned vehicles could be another source of income for dealers, although it is not a good hedge for new-car profits. We expect dealers to play a more important role in pre-owned vehicle trading when the market matures, given its advantage in sourcing and after-sales services.

Figure 31: Pre-owned vehicle trade volume and YoY growth vs. new PV sales in China



Source: CADA, CATARC, CMBIGM

Figure 32: Number of passenger vehicles on the road and YoY growth in China



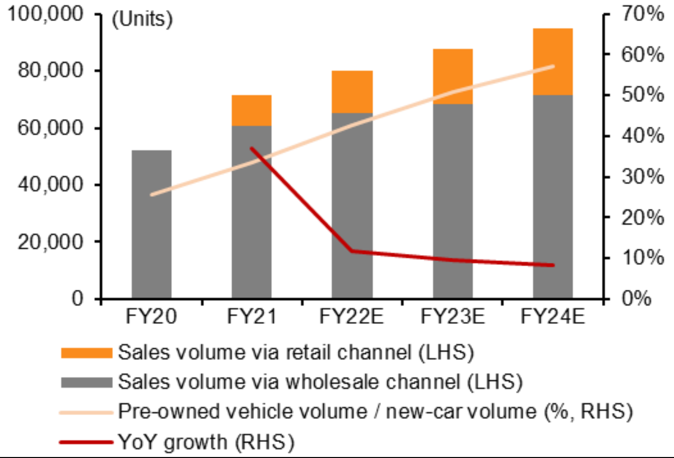
Source: NBS, CMBIGM estimates

Yongda is a pioneer in the pre-owned vehicle market

Yongda has been developing its pre-owned vehicle business for almost 10 years, which could give Yongda a first-mover advantage in this market. Prior to FY21, pre-owned vehicle business was booked under "after-sales services", as the majority of used cars were sold based on the wholesale model to generate commission income. In 2021, the Chinese government announced a value-added tax cut for selling used cars to 0.5% from 2% in a bid to facilitate used car sales. Dealers started to take more inventories of used cars and sell them based on the retail model. Such incomes are booked as the top line revenue. In FY22, about 20% of pre-owned cars sold were through retail model.

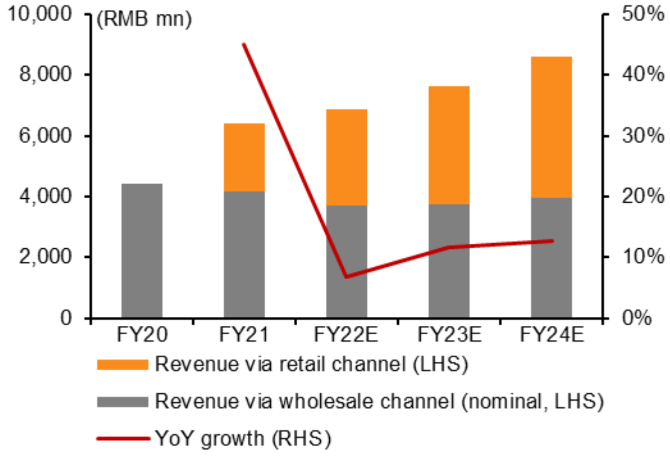
The company targets pre-owned vehicle sales volume of 100,000 units in FY23E, which, in our view, could be aggressive amid the current price war. We project Yongda's total pre-owned vehicle sales volume to rise 10% YoY to about 88,000 units with retail sales taking up 22% in FY23E. That means sales volume of pre-owned vehicles could be amounted to half of Yongda's new-car sales this year, based on our estimates. We also forecast Yongda's total pre-owned vehicle sales volume to rise 8% YoY to about 95,000 units in FY24E. Accordingly, we project Yongda's revenue from pre-owned vehicles (retail model only) to rise 40% / 24% / 20% YoY to about RMB 3.1bn / 3.9bn / 4.7bn during FY22-24E, respectively.

Figure 33: Yongda's pre-owned vehicle sales volume forecast



Source: Company data, CMBIGM estimates

Figure 34: Yongda's pre-owned vehicle revenue forecast

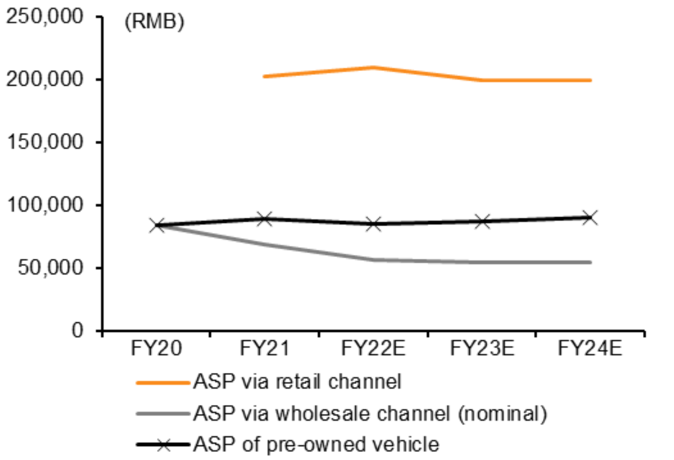


Source: Company data, CMBIGM estimates

We project gross margin for Yongda's pre-owned cars sold via retail channel to be 8.5% in FY22E with an ASP of around RMB 200,000. We expect such margin to narrow to 7.5-8.0% during FY23-24E amid intensifying competition.

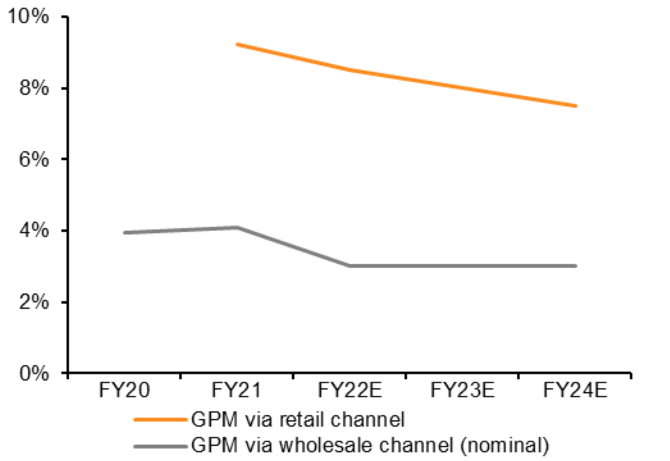
We project the commission income per vehicle for pre-owned cars sold via wholesale model to be stable during FY22-24E, around RMB 1,600-1,700. That implies a nominal gross margin of 3% given an ASP of RMB 55,000-65,000.

Figure 35: Yongda's pre-owned vehicle ASP forecast



Source: Company data, CMBIGM estimates

Figure 36: Yongda's pre-owned vehicle GPM forecast



Source: Company data, CMBIGM estimates

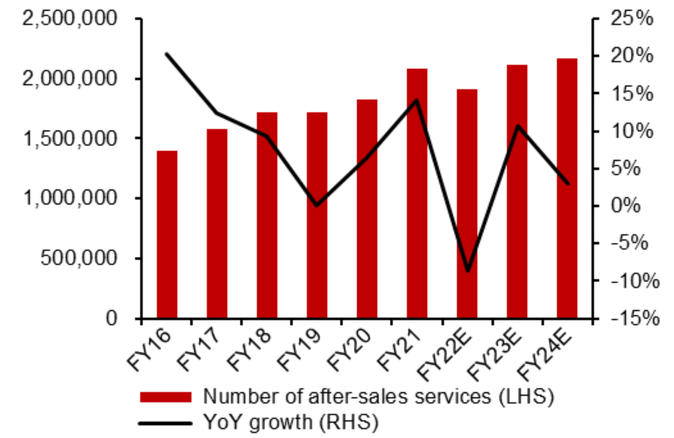
After-sales services: Earnings driver in FY23E

We believe Yongda's after-sales services could be its earnings driver in FY23E after the significant dent by lockdowns last year. We project Yongda's number of after-sales services to fall 9% YoY to about 1.9mn in FY22E although we estimate its retained customer number to rise 6% YoY to about 1.1mn at the end of 2022.

We forecast Yongda's after-sales service revenue to rise 15% YoY in FY23E, driven by 11% increase in number of after-sales services and slightly higher ASP from better product mix. We project Yongda's after-sales services to account for 16.5% of its total revenue in FY23E, the highest in history. We estimate Yongda's overall gross margin to rise about 0.5

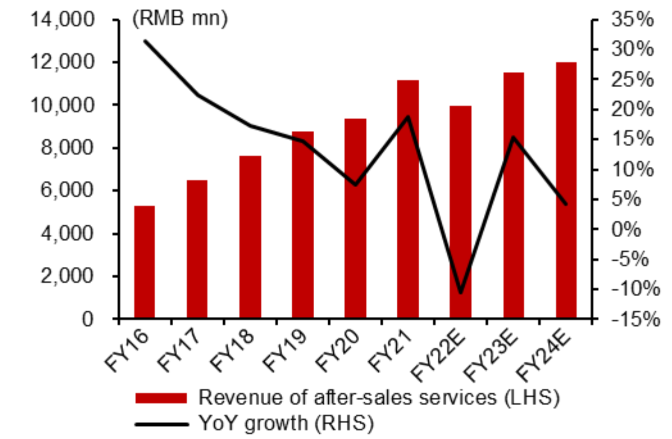
ppt if its after-sales services contribute 1 more ppt in total revenue, assuming everything else being equal. Therefore, we project Yongda's overall gross margin to widen from 8.9% in FY22E to 10.0% in FY23E, aided by high-margin after-sales services.

Figure 37: Yongda's number of after-sales services forecast



Source: Company data, CMBIGM estimates

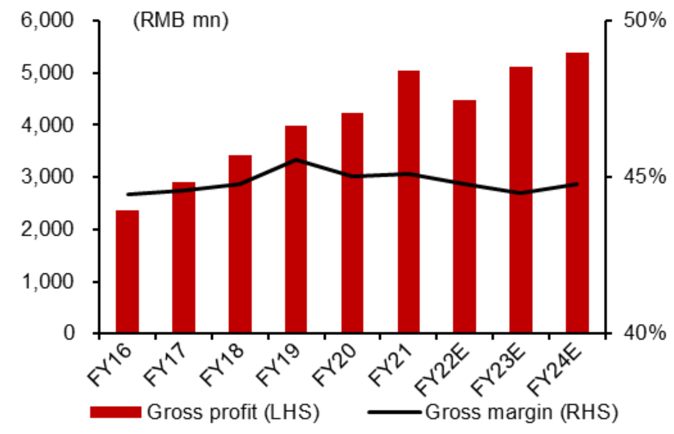
Figure 38: Yongda's after-sales service revenue forecast (ex. pre-owned vehicles)



Source: Company data, CMBIGM estimates

We expect Yongda's after-sales services to account for 17.5% of its total revenue in FY24E, which could further lift its overall gross margin to 10.7%. We also estimate Yongda's absorption ratio to exceed 100% in FY24E for the first time in its history. In other words, its gross profit from after-sales services would fully cover its SG&A expenses in FY24E on our estimates. We assume gross margin for Yongda's after-sales services to be largely stable at 44.5-44.8% during FY22-24E.

Figure 39: Our forecasts for Yongda's gross profit and gross margin from after-sales services



Source: Company data, CMBIGM estimates

Figure 40: Yongda's overall gross profit contributed from after-sales services

Source: Company data, CMBIGM estimates

Earnings Forecast

We expect net profit to rise almost 40% YoY in FY23E

According to Yongda's profit warning on 17 Jan 2023, its FY22E net profit may drop no more than 43% YoY to no less than RMB 1.4bn, as its operation was severely disrupted by several rounds of lockdowns especially in Shanghai in 2Q22 and the nationwide pandemic in Dec 2022.

We project Yongda's total revenue to drop 3% YoY and 2% YoY to RMB 70.6bn in FY23E and RMB 69.3bn in FY24E, respectively, mainly due to overall new-car sales slowdown from traditional luxury brands. Despite that, we expect Yongda's gross profit to rise 9% YoY in FY23E and 5% YoY in FY24E, driven by faster growth in after-sales services.

We believe Yongda's other income could be largely stable YoY during FY23-24E, as the improvement from NEV agency business may be offset by the decline from finance and insurance commissions amid falling new-car sales volume.

We expect Yongda's SG&A ratio during FY23-24E to be at similar levels as in FY22E, as its cost reduction efforts may be offset by lower top line revenue and rising competition. Accordingly, we expect Yongda' net profit to rise 39% YoY and 16% YoY to RMB 2.0bn and RMB 2.3bn, respectively, during FY23-24E. We believe some investors may underestimate Yongda's earnings improvement driven by after-sales service rebound this year.

Figure 41: CMBI estimates vs consensus

	CMBI			Consensus			Diff (%)		
RMB mn	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	72,950	70,598	69,260	72,934	82,317	88,984	0.0%	-14.2%	-22.2%
Gross Profit	6,474	7,029	7,416	6,964	7,988	8,737	-7.0%	-12.0%	-15.1%
Operating Profit	2,369	3,052	3,532	2,730	3,264	3,671	-13.2%	-6.5%	-3.8%
Net profit	1,443	2,005	2,327	1,674	2,108	2,417	-13.8%	-4.9%	-3.7%
Gross Margin	8.9%	10.0%	10.7%	9.5%	9.7%	9.8%	-0.7 ppt	0.3 ppt	0.9 ppt
Operating Margin	3.2%	4.3%	5.1%	3.7%	4.0%	4.1%	-0.5 ppt	0.4 ppt	1.0 ppt
Net Margin	2.0%	2.8%	3.4%	2.3%	2.6%	2.7%	-0.3 ppt	0.3 ppt	0.6 ppt

Source: Bloomberg, CMBIGM estimates

Valuation

Initiate with BUY; TP of HK$ 8.50 (over 65% upside)

Yongda's valuation multiple has been lower than its major peers, i.e. Meidong (1268 HK, BUY) and Zhongsheng (881 HK, NR), over the past few years, mainly due to its lower profitability, in our view. Yongda's earnings usually showed higher-than-peers volatility amid market changes. We believe Yongda's earnings rebound in FY23E could be larger than its peers given its more severe disruption in Shanghai last year and more resilient consumption recovery in high-tier cities.

Yongda has been a pioneer for many new businesses. Such initiatives have its benefits and costs, which should not be a valuation discount, in our view, especially amid the auto industry's revolutionary transformation. The key to Yongda's valuation lies in its management execution in improving its operational efficiency.

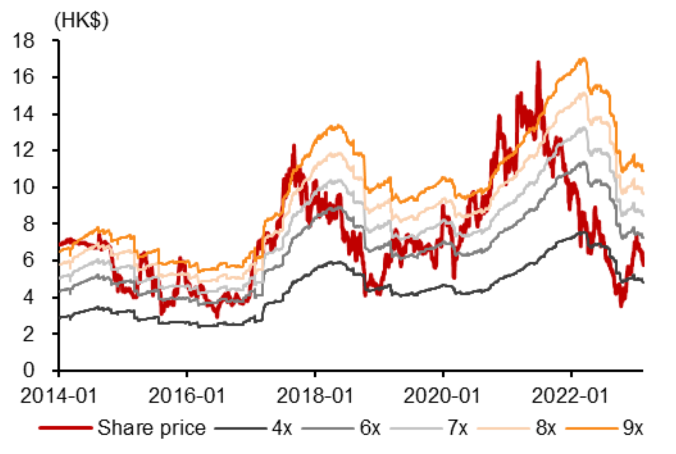
We initiate our coverage with a BUY rating and our target price of HK$8.50 is based on 7x FY23E P/E, the same as its average forward 12-month P/E in the past nine years. The company is likely to further improve the dividend payout ratio to about 40% this year, implying a dividend yield of 8% in FY23E, which should be a good support to the company's share price, in our view.

Figure 42: Peers' valuation

Company	Ticker	Rating	Mkt Cap (HK$ mn)	Price (HK$)	TP (HK$)	P/E (x) FY22E	P/E (x) FY23E	P/B (x) FY22E	P/B (x) FY23E	ROE (%) FY22E	ROE (%) FY23E
Yongda	3669 HK	BUY	9,896	5.06	8.50	6.0	4.3	0.6	0.6	10.3	13.4
Meidong	1268 HK	BUY	19,994	14.86	25.00	21.1	12.0	3.9	2.6	19.7	26.0
Zhongsheng	881 HK	NR	80,030	33.30	N/A	9.1	7.4	1.5	1.3	17.9	18.6
	Average					**12.1**	**7.9**	**2.0**	**1.5**	**16.0**	**19.3**

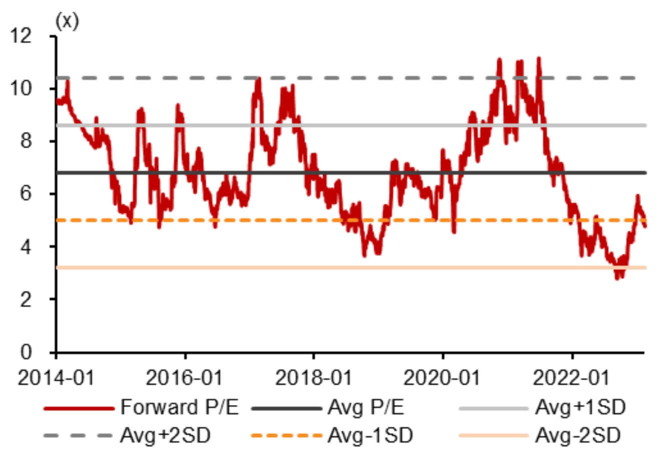
Source: Bloomberg, CMBIGM estimates. Note: Market data as of 20 Mar 2023.

Figure 43: Yongda's forward 12-m P/E band



Source: Company data, Bloomberg, CMBIGM

Figure 44: Yongda's forward 12-m P/E range



Source: Company data, Bloomberg, CMBIGM

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	68,201	77,917	72,950	70,598	69,260
Cost of sales	(62,070)	(70,164)	(66,475)	(63,569)	(61,843)
Gross profit	**6,131**	**7,753**	**6,474**	**7,029**	**7,416**
Other income	1,171	1,405	1,482	1,413	1,429
Distribution expenses	(2,990)	(3,534)	(3,760)	(3,606)	(3,612)
Administrative expenses	(1,543)	(1,814)	(1,827)	(1,784)	(1,702)
Operating profit	**2,769**	**3,809**	**2,369**	**3,052**	**3,532**
Finance costs	(676)	(506)	(442)	(370)	(401)
Share of profits of associate	48	71	70	77	81
Share of profits of JVs	(2)	1	1	2	2
Profit before tax	**2,140**	**3,375**	**1,998**	**2,761**	**3,214**
Taxation	(524)	(837)	(490)	(676)	(787)
Minority interests	(108)	(138)	(66)	(80)	(100)
Net profit	**1,625**	**2,480**	**1,443**	**2,005**	**2,327**

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Profit before taxation	**2,295**	**3,491**	**1,998**	**2,761**	**3,214**
Depreciation/amortization	1,094	1,154	1,223	1,292	1,329
Change in working capital	2,013	652	941	(850)	(1,085)
Others	327	(283)	(113)	(388)	(485)
Net cash from operating	**5,729**	**5,015**	**4,050**	**2,815**	**2,973**
Capex	(996)	(1,120)	(955)	(640)	(520)
Others	(672)	838	(54)	(13)	(114)
Net cash from investing	**(1,668)**	**(282)**	**(1,009)**	**(653)**	**(634)**
Share issuance	964	9	12	14	14
Dividend paid	(553)	(672)	(995)	(641)	(882)
Others	(3,602)	(4,899)	(1,890)	(45)	312
Net cash from financing	**(3,191)**	**(5,562)**	**(2,873)**	**(672)**	**(556)**
Net change in cash	**869**	**(830)**	**168**	**1,490**	**1,783**
Cash at beginning of the year	2,210	3,080	2,250	2,418	3,908
Cash at the end of the year	**3,080**	**2,250**	**2,418**	**3,908**	**5,692**

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	**20,205**	**16,617**	**15,142**	**17,085**	**19,750**
Cash and equivalents	3,080	2,250	2,418	3,908	5,692
Accounts receivables	7,511	9,127	7,994	7,737	7,590
Inventories	4,856	4,038	3,642	3,832	4,236
Other current assets	4,759	1,203	1,086	1,608	2,232
Non-current assets	**14,533**	**14,949**	**15,141**	**14,929**	**14,684**
PP&E	6,012	5,838	6,041	5,561	4,879
Intangibles	2,333	2,860	2,818	3,070	3,512
Interests in JVs and assos	595	714	773	840	911
Other non-current assets	5,592	5,537	5,509	5,457	5,382
Total assets	**34,73**	**31,56**	**30,28**	**32,01**	**34,43**
Current liabilities	**16,044**	**13,328**	**11,383**	**11,125**	**11,429**
Short-term borrowings	6,434	3,596	2,000	2,500	3,000
Accounts payable	5,807	5,569	5,464	5,225	5,083
Other current liabilities	3,803	4,163	3,920	3,400	3,346
Non-current liabilities	**6,338**	**3,950**	**4,102**	**4,615**	**5,120**
Long-term borrowings	3,221	911	1,351	1,791	2,231
Other non-current liabilities	3,118	3,039	2,751	2,823	2,889
Total liabilities	**22,382**	**17,278**	**15,486**	**15,739**	**16,549**
Share capital	16	16	16	16	16
Reserves	11,815	13,701	14,197	15,657	17,247
Minority interests	524	580	594	610	630
Shareholders' equity	**11,832**	**13,717**	**14,213**	**15,673**	**17,264**
Total equity and liabilities	**34,737**	**31,576**	**30,292**	**32,022**	**34,442**

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
Sales of passenger vehicles	84.7	84.5	85.5	82.9	81.9
After-sales services	14.0	14.8	13.9	16.5	17.5
Growth (%)					
Revenue	8.8	14.2	(6.4)	(3.2)	(1.9)
Gross profit	4.6	26.4	(16.5	8.6	5.5
Operating profit	(1.8)	37.5	(37.8	28.8	15.7
Net profit	10.3	52.6	(41.8	38.9	16.1
Profit & loss ratio (%)					
Gross margin	9.0	9.9	8.9	10.0	10.7
Operating margin	4.1	4.9	3.2	4.3	5.1
Net profit margin	2.4	3.2	2.0	2.8	3.4
Balance sheet ratio					
Net cash/total equity (x)	(0.6)	(0.2)	(0.1)	(0.0)	0.0
Current ratio (x)	1.3	1.2	1.3	1.5	1.7
Receivable turnover days	40.3	42.9	40.0	40.0	40.0
Inventory turnover days	28.6	21.1	20.0	22.0	25.0
Payable turnover days	34.2	29.0	30.0	30.0	30.0
Profitability (%)					
ROE	15.0	19.4	10.3	13.4	14.1
ROA	4.6	7.5	4.7	6.4	7.0
Per share data (RMB)					
EPS	0.85	1.26	0.74	1.03	1.19
DPS	0.56	0.48	0.29	0.41	0.48

Source: Company data, CMBIGM estimates

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