

## 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 2H24. 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 shored 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.

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## Weak new car sales mitigated by growing contribution from other segments

**Table 2: Zhongsheng's operating profiles**

RMB mn	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
<b>Gross profit</b>	<b>11,488.0</b>	<b>13,482.0</b>	<b>18,469.0</b>	<b>16,032.0</b>	<b>13,764.3</b>	<b>10,671.9</b>	<b>6,969.8</b>	<b>6,794.5</b>	<b>4,926.2</b>	<b>5,745.7</b>
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
<b>Aggregate profit</b>	<b>14,373.2</b>	<b>16,631.6</b>	<b>21,997.0</b>	<b>19,796.3</b>	<b>17,896.4</b>	<b>14,871.7</b>	<b>8,961.8</b>	<b>8,934.6</b>	<b>6,867.8</b>	<b>8,003.9</b>
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 (RMB mn)	6,101.2	8,210.4	10,950.0	11,679.0	15,612.0	18,687.5
Other ST deposits (RMB mn)	1,605.0	1,606.2	1,031.0	1,958.9	3,989.5	4,316.6
ST debts (RMB mn)	17,326.3	17,257.8	15,615.4	15,162.7	16,483.0	17,654.4
LT debts (RMB mn)	11,783.3	11,025.6	13,114.8	15,475.4	20,273.5	19,804.8
Total debts (RMB mn)	29,109.6	28,283.3	28,730.2	30,638.2	36,756.5	37,459.1
Net debts (RMB mn)	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.

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