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CMB INTERNATIONAL

Fixed Income
Credit Commentary

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CMBI Credit Commentary

Zhongsheng: A shorter-dated consumption play

Initiate buy recommendations on ZHOSHK'25 (CB) and '26

We initiate the coverage on Zhongsheng and buy recommendations on ZHOSHK 0 05/21/25 (CB) and ZHOSHK 3 01/13/26. We consider Zhongsheng (rated Baa2/BBB/BBB by Moody's/S&P/Fitch) a solid IG credit with leading market position and adequate liquidity profile. Zhongsheng experienced lower car sales and weaker profit margin over the past 2 years. We take comfort that new car sales only accounted for 5.9% of its aggregate profit (gross profit+ commission income) in FY23 given the growing contribution from after-sale services and used car sales. We take additional comfort with its disciplined expansion strategies with track records of positive free cash flow generation, as well as Jardine Matheson (JMH, rated A1/A+ by Moody's/S&P)'s strategic ownership in Zhongsheng since 2014. At 110.8 and 95.0, ZHOSHK 0 05/21/25 (CB), to be redeemed at 117.49, and ZHOSHK 3 01/13/26 are trading YTM of 6.3%. We consider ZHOSHKs good shorter-dated carry plays.

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	110.8	142.7	6.3%
ZHOSHK 3 01/13/26	USD	450.0	3.0%	1/13/2026	95.0	142.4	6.3%

Source: Bloomberg

The largest automobile dealership by revenue in China

According to China Automobile Dealers Association (CADA), Zhongsheng has become the largest automobile dealership in China by revenue since 2022. See Table 2 below. It has established close relationships with luxury automakers such as Mercedes-Benz, Lexus and BMW and built an extensive store network with 420 stores across 25 provinces in China as of Dec'23. Zhongsheng ranks first, second and third by unit sales of Lexus, Mercedes and BMW in China, which accounted for 12%, 41% and 11% of its revenue from new car sales, respectively.

Table 2: Top 10 automobile dealerships in China

Rank	Group name	Revenue in FY23 (RMB mn)	Total Auto Sales Volume in FY23 (units) (incl. used cars)
1	Zhongsheng Group Holdings Ltd	179,290	665,679
2	China Grand Automotive Services Ltd	137,998	713,467
3	LSH Auto International Ltd	94,111	242,977
4	China Yongda Automobiles Services	83,051	286,957
5	HengXin Auto Group Co., Ltd	79,628	399,172
6	Anji Automoblie Co., Ltd	73,412	557,630
7	Wuchan Zhongda Group Co.,Ltd	52,747	302,704
8	Beijing Penglong Auto Co., Ltd.	51,002	102,569
9	Dah Chong Hong Holdings Ltd	45,032	157,287
10	Jiangsu Wanbang Golden Star Car Industry Investment Group Co., Ltd	43,857	106,819

Source: CADA

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Commission and after-sales services contributed 89% of aggregate profit

Chart 1: Breakdown of aggregate profit

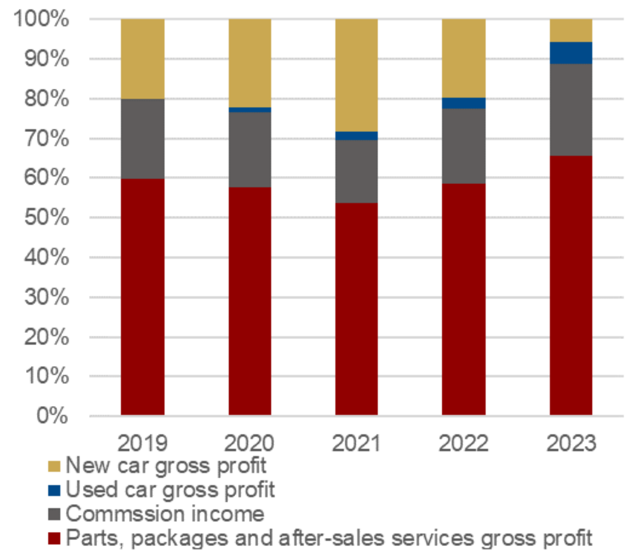
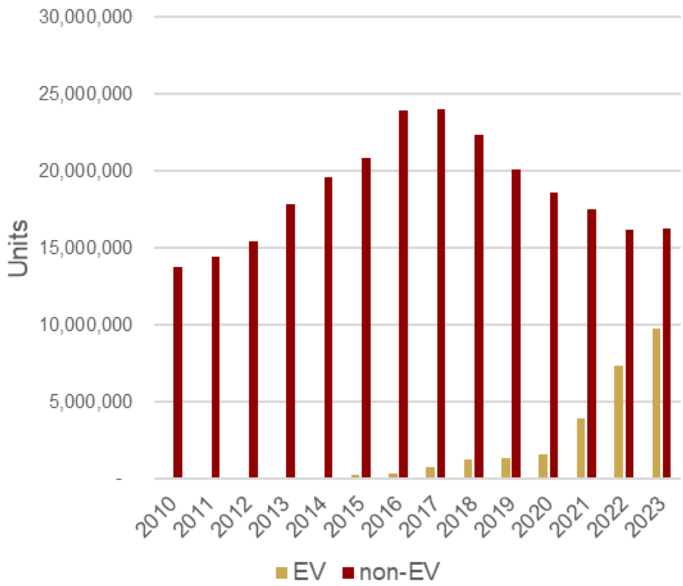


Chart 2: Passenger car sales in China



Source: Company filings, CADA

Zhongsheng's operating performance over the past 2 years was adversely affected by the weaker economy and competition from EVs in China. The proportion of EV sales for luxury brands such as Mercedes Benz and BMW are notably lower than the nationwide EV share of new car sales of 35% in FY23. Hence, Zhongsheng's gross profit from new car sales dropped 83% to RMB1.1bn over the 2 years to FY23. Nonetheless, the growing contribution from parts, packages and after-sales services, used car sales and commission income helped narrow the aggregate profit decline to 19% over the same period. In FY23, the more stable income from parts, packages and after-sales services and commission income accounted for 66% and 23% of Zhongsheng's aggregate profit, respectively. Zhongsheng guided that unit sales of new car and used car would be flat and grow 30%, respectively while ASP could be moderately lower in FY24. Going forward, we expect that the growing contribution from more stable income sources will support steady profit growth and improve its profit margin over the coming 2-3 years. In FY23, the gross margin of parts, packages and after-sales services was 46.9% compared with that of new car sales of 0.8%.

Jardine Group is a long-term strategic shareholder

In Jan'14, Zhongsheng introduced Jardine Group as a strategic investor through shares and CB placements totaled HKD5.6bn (cUSD710mn) for 11.11% stakes in Zhongsheng before CB conversion. Subsequent to the equity-funded acquisition of Zung Fu China from Jardine Group in Oct'21, the latter's ownership in Zhongsheng further increased to 20.94%. Currently, Jardine Group owns 21.2% stakes in Zhongsheng and has assigned 2 non-executive directors into the 12-member board of Zhongsheng. The long-term strategic relationship with Jardine Group, in our view, has enhanced Zhongsheng's strategic developments and corporate governance.

Reliance on ST debts but adequate liquidity profile

Chart 3: Proportion of ST debts/Total debts

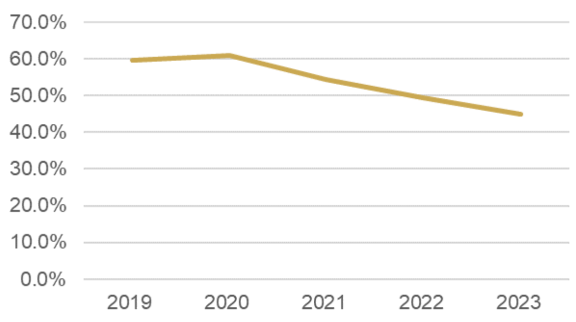
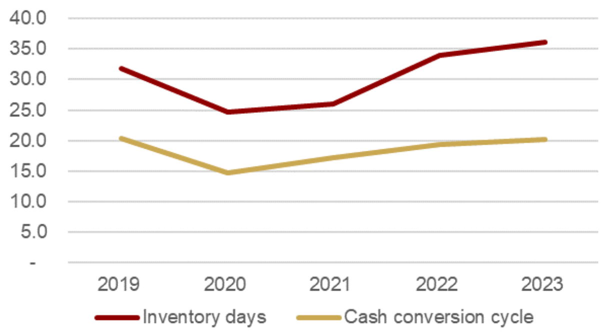


Chart 4: Cash conversion cycle and inventory days



Source: Company filings, CMBI

Zhengsheng relies heavily on ST debts and bills to fund the working capital and buy inventories. Nonetheless, we take comfort with its short inventory days of around 1 month and short cash conversion cycle of around 20 days. The issuance of offshore bonds of USD450mn in Jan'21 helped reduce its reliance on ST debts. We take additional comfort that its cash on hand and other ST deposits are adequate to cover ST debts. Zhongsheng will have offshore syndicated loans of USD350mn due Apr'25 and o/s CBs of HKD3.1bn (cUSD400mn) maturing in May'25. In May'24, Zhongsheng submitted the application to issue panda bonds totaled RMB5bn pending for NAFMII's approval. We see a good chance that Zhongsheng will successfully access funding channels such as CB, bond and syndicated loan markets for refinancing given its solid credit profile and track records of cash flow generations.

Disciplined expansion with positive FCF generation

Table 3: Key financials

FY	2019	2020	2021	2022	2023
FCF (RMB mn)	3,478	5,100	240	3,341	3,526
Debt/EBITDA	3.1x	2.6x	1.9x	2.4x	3.5x
Net debt/EBITDA	2.3x	1.7x	1.1x	1.3x	1.6x
EBITDA/int	6.5x	8.2x	12.6x	10.0x	6.6x
Net debt/equity	96.5%	68.7%	41.1%	38.6%	37.3%

Sources: Company fillings, CMBI

We expect Zhongsheng's aggregate profit and profitability to improve gradually from the levels of FY23, supported by stabilizing new car sales and growing contribution from more stable income sources. Additionally, 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 it will continue to generate positive free cash flow. Additionally, Zhongsheng has been optimizing its store network with the focus on expansion of collision centers and stores in coastal areas where auto demand is more resilient while exiting stores on brands with lagging sales such as Nissan. 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.

Table 4: Zhongsheng's financial summary

RMB mn	2019	2020	2021	2022	2023
Revenue	124,042.5	148,348.1	175,103.1	179,857.0	179,290.1
Gross profit	11,487.6	13,481.7	18,469.6	16,031.6	13,764.3
EBITDA	9,456.7	10,876.3	14,991.0	13,020.1	10,557.7
Gross int	1,463.8	1,329.2	1,194.2	1,302.5	1,590.3
CFO	7,799	9,324	10,872	8,785	6,426
Capex & Investments	(4,113)	(4,949)	(10,623)	(5,262)	(2,709)
Disposals	914	1,633	1,023	1,423	1,757
Others	60	81	183	240	455
FCF	3,478	5,100	240	3,341	3,526
Cash	6,101.2	8,210.4	10,950.0	11,679.0	15,612.0
Other ST deposits	1,605.0	1,606.2	1,031.0	1,958.9	3,989.5
Debt	29,109.6	28,283.3	28,730.2	30,638.2	36,756.5
ST debts	17,326.3	17,257.8	15,615.4	15,162.7	16,483.0
LT debts	11,783.3	11,025.6	13,114.8	15,475.4	20,273.5
Net debts	21,403.4	18,466.8	16,749.2	17,000.2	17,155.0
Equity (incl NCI)	22,176.7	26,881.7	40,706.5	44,064.4	46,046.6
Total assets	63,024.3	68,501.0	85,474.0	91,829.4	103,268.5
Gross margin	9.3%	9.1%	10.5%	8.9%	7.7%
EBITDA margin	7.6%	7.3%	8.6%	7.2%	5.9%
Debt/EBITDA	3.1x	2.6x	1.9x	2.4x	3.5x
Net debt/EBITDA	2.3x	1.7x	1.1x	1.3x	1.6x
EBITDA/int	6.5x	8.2x	12.6x	10.0x	6.6x

Sources: Company fillings, CMBI

Table 5: Peer comparisons

FY23 (RMB mn)	Zhongsheng	China Grand Auto
Credit ratings	Baa2/BBB/BBB	WR/-/CCC-
New car sales (units)	501,570	595,659
Used car sales (units)	164,109	117,808
No. of 4S stores	420	735
Revenue	179,290.1	137,998.5
Gross profit	13,764.3	11,442.4
EBITDA	10,557.7	5,930.6
Gross int	1,590.3	2,922.7
Cash	15,612.0	11,235.0
Other ST deposits	3,989.5	-
Debt	36,756.5	60,630.4
ST debts	16,483.0	52,198.4
LT debts	20,273.5	8,432.0
Net debts	17,155.0	49,395.4
Equity (incl NCI)	46,046.6	42,401.4
Total assets	103,268.5	117,684.4
Gross margin	7.7%	8.3%
EBITDA margin	5.9%	4.3%
Debt/EBITDA	3.5x	10.2x
Net debt/EBITDA	1.6x	8.3x
EBITDA/int	6.6x	2.0x
Net debt/equity	37.3%	116.5%

Sources: Company fillings, CMBI

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