

Zhongsheng (881 HK)

More certainty and profitably ahead

Zhongsheng announced its FY19 results, beating market expectations. Revenue achieved RMB124.0bn (vs CMBI estimate of RMB124.4bn/ vs consensus estimate of RMB124.9bn), an increase of 15% YoY. NP was RMB4.5bn (vs CMBI estimate RMB4.5bn / vs consensus estimate of RMB4.3bn), an increase of 24%. EPS has increased by 24% to RMB1.98.

- Strong brand mix and geographical layout will foster future growth.** In 2020, Mercedes-Benz will launch a new model GLB / new E-class model (Facelift version) while Lexus will launch a new RX model (Deluxe version) / new model LM. In 2019, 75% of the Company's stores are located in Tier 1/2 while 55% of its stores are located in eastern and southern China. Among them, Guangdong is the single largest province that Zhongsheng has the presence in. We believe the Company's business will benefit from economic growth in the relevant wealthy regions.
- Bottom-line performance certainty gradually increases as the business tiles to after-sales and value-added service.** The proportion of income from after-sales/accessories and value-added services increased to 80% in 2019 from 77% in 2018. In Apr 2019, the Company launched new services (双包无忧) to improve customer stickiness in the after-sales market. In the value-added service field, the financial penetration rate increased by 3.4ppt in 2019. Furthermore, the used car transaction volume in 2019 increased by 30% with the New/Used ratio reached 15.3%. We believe the performance certainty will be further enhanced in 2020E as the Company's bottom-line contribution tilts more to after-sales and value-added service.
- The proportion of luxury brands increased in the new car sales and after-sales market.** In 2019, luxury brands accounted for more than 50% of the sales volume and accounted for 71% of new car sales revenue. Moreover, the revenue from luxury brands accounted for 53% of revenue from after-sales service, for the first time exceeded 50%. We believe that, with the gradual increase in the proportion of luxury brands in the two major business segments, the comprehensive GPM will steadily increase.
- Zhongsheng has a potential expansion time window through M&A will in 2020E.** The Company's Capex in 2019 was RMB1,743mn, the lowest since 2014. At the same time, the Company improved its financial position in 2019 making its D/E ratio dropped from 70% to 62%. In 2019, OCF reached RMB7.8bn while CFF outflow was RMB4.7bn. We observed recent news from CADA that COVID-19 has caused 21 luxury brand dealers to exit the market. We believe that Zhongsheng is expected to take advantage of its scale advantages and excellent financial conditions to achieve external growth in 2020E.

BUY (Maintain)

Target Price	HK\$33.8
(Previous TP)	HK\$33.8)
Up/Downside	+37.5%
Current Price	HK\$24.6

China Auto Sector

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Stock Data

Mkt Cap (HK\$ mn)	55,884
Avg 3 mths t/o (HK\$ mn)	75.16
52w High/Low (HK\$)	33.50/ 16.48
Total Issued Shares (mn)	2,272

Source: Bloomberg

Shareholding Structure

HUANG Yi/LI Guoqiang	57.76%
JPMorgan Chase & Co.	9.20%

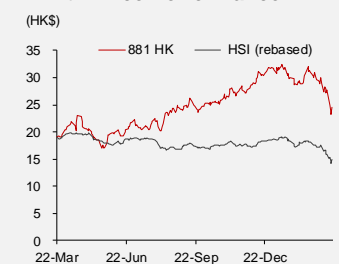
Source: HKEX

Share Performance

	Absolute	Relative
1-mth	-20.0%	-2.9%
3-mth	-19.2%	-1.4%
6-mth	-0.6%	12.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Reports

"Zhongsheng (881 HK) – Sector leader with a great tracking record" – 11 Dec 2019

- **Given its potential M&A opportunities, we increased the Company's network expansion growth rate.** However, considering that COVID-19 will likely affect the supply of new cars, we lower our forecast for the growth rate of new car sales volume in 2020E from 10% to 7%. However, benefiting from the rise in the proportion of luxury brands and the low demand elasticity of luxury cars, we expect the Company's new car sales revenue to increase by 12% to RMB118.5mn in 2020E. In the meanwhile, benefit from the gradual maturity of 109 new stores opened in the past three years and the increase in the proportion of luxury cars. We believe that the Company's aftermarket will achieve a 26% growth to RMB22.5bn in 2020E.
- **We slightly adjust our bottom-line forecast in 2020E at RMB5.5bn.** In addition, we believe great governance and excellent operating capability was not affected by COVID-19 at all. Our TP is maintained at HK\$33.8 (based on initial 12.5x 2020E P/E) with an upside of 37.5%. Reiterate BUY.

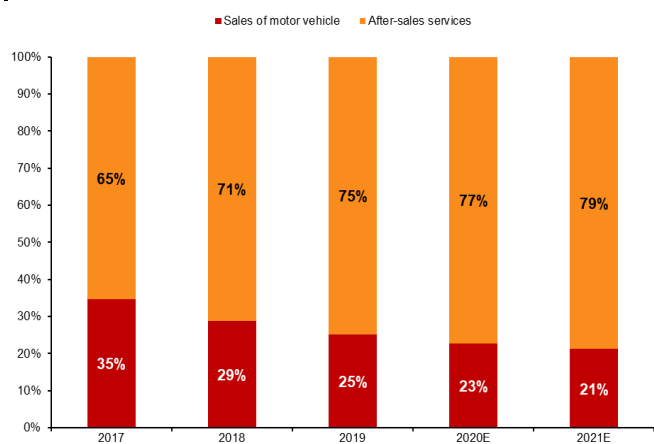
Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	107,736	124,043	141,004	155,896	171,440
YoY growth (%)	24.85%	15.14%	13.67%	10.56%	9.97%
Net income (RMB mn)	3,637	4,502	5,516	6,258	7,479
EPS (RMB)	1.60	1.98	2.43	2.75	3.29
YoY growth (%)	6%	24%	23%	13%	20%
P/E (x)	13.77	11.14	9.09	8.01	6.70
P/B (x)	2.75	2.30	1.99	1.69	1.43
Yield (%)	1.45%	1.81%	2.20%	2.49%	2.98%
ROE (%)	21.30%	22.51%	23.65%	22.80%	23.15%
Net gearing (%)	159%	149%	123%	113%	101%

Source: Company data, CMBIS estimates

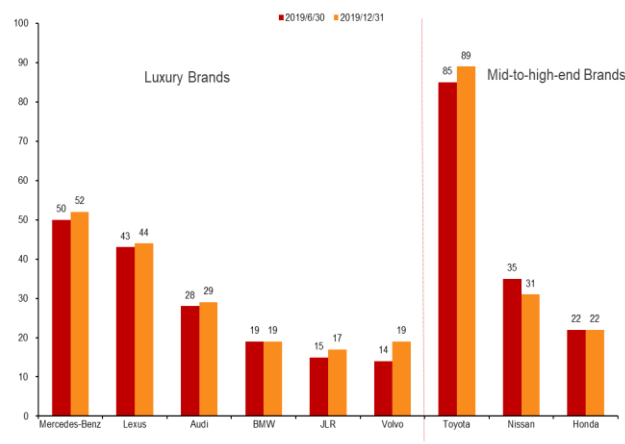
Focus Charts

Figure 1: GP composition



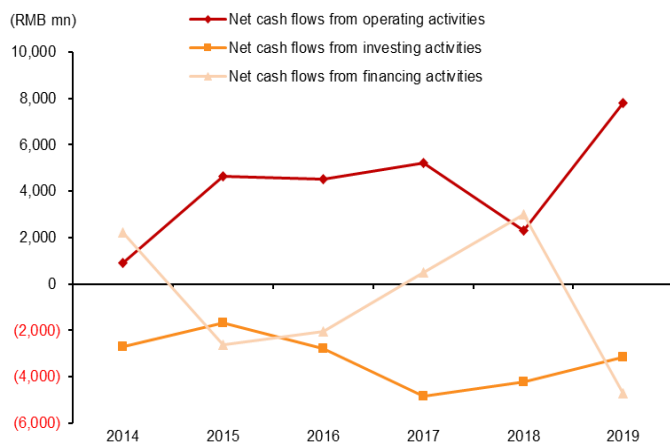
Source: Company data, CMBIS estimates

Figure 2: Major brands mix of Zhongsheng



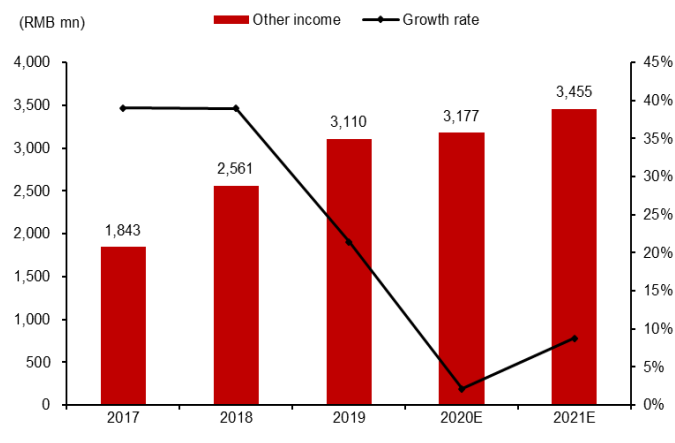
Source: Company data, CMBIS

Figure 3: Great CF management in 2019



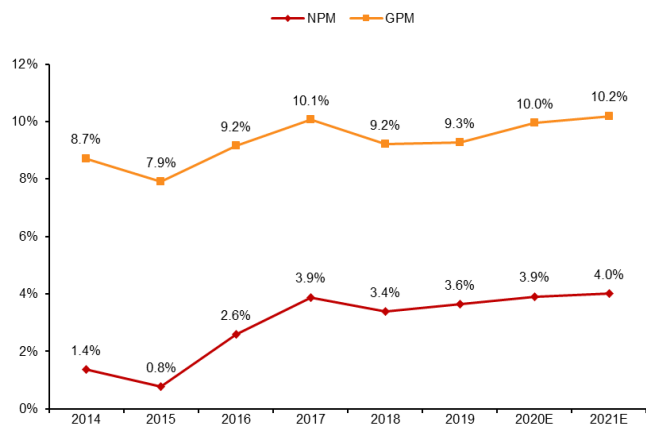
Source: Company data, CMBIS

Figure 4: Other income continues to grow



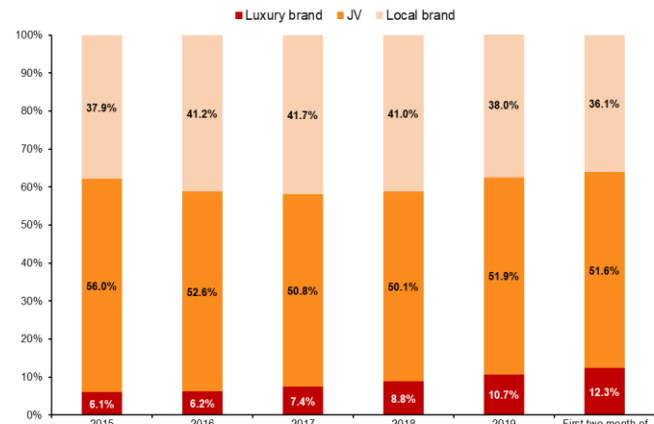
Source: Company data, CMBIS estimates

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: FY19 results review

RMB mn	FY18A	FY19A	YoY	CMBI		Consensus	
				FY19E	Diff (%)	FY19E	Diff (%)
Revenue	107,736	124,043	15%	124,427	0%	124,850	-1%
Gross profit	9,923	11,488	16%	11,650	-1%	11,465	0%
EBIT	6,432	7,717	20%	7,740	0%	7,473	3%
Net profit	3,637	4,502	24%	4,474	1%	4,342	4%
EPS (RMB)	1.60	1.98	24%	1.97	0%	1.88	5%
Gross margin	9.21%	9.26%	0.1 ppt	9.36%	-0.1 ppt	9.18%	0.1 ppt
EBIT margin	5.97%	6.22%	0.3 ppt	6.22%	0.0 ppt	5.99%	0.2 ppt
Net margin	3.38%	3.63%	0.3 ppt	3.60%	0.0 ppt	3.48%	0.2 ppt

Source: Company data, Bloomberg, CMBIS estimates

Figure 8: Earnings revision

(RMB mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	141,004	155,896	139,425	155,130	1%	0%
Gross profit	14,040	15,886	13,529	15,605	4%	2%
EBIT	9,405	10,705	9,360	11,208	0%	-4%
Net profit	5,516	6,258	5,512	6,695	0%	-7%
EPS (RMB)	2.43	2.75	2.43	2.95	0%	-7%
Gross margin	9.96%	10.19%	9.70%	10.06%	0.3 ppt	0.1 ppt
EBIT margin	6.67%	6.87%	6.71%	7.22%	0.0 ppt	0.4 ppt
Net Margin	3.91%	4.01%	3.95%	4.32%	0.0 ppt	-0.3 ppt

Source: CMBIS estimates

Figure 9: CMBIS estimates vs consensus

(RMB mn)	New		Consensus		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	141,004	155,896	140,104	156,479	1%	0%
Gross profit	14,040	15,886	13,463	15,429	4%	3%
EBIT	9,405	10,705	8,537	9,901	10%	8%
Net profit	5,516	6,258	5,155	6,162	7%	2%
EPS (HK\$)	2.43	2.75	2.24	2.66	8%	3%
Gross margin	9.96%	10.19%	9.61%	9.86%	0.3 ppt	0.3 ppt
EBIT margin	6.67%	6.87%	6.09%	6.33%	0.6 ppt	0.5 ppt
Net Margin	3.91%	4.01%	3.68%	3.94%	0.2 ppt	0.1 ppt

Source: Bloomberg, CMBIS estimates

Figure 10: Revenue breakdown

(RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Sales of motor vehicle	93,222	106,199	118,490	129,914	141,686
...YoY	25%	14%	12%	10%	9%
Luxury and ultra-luxury brands	60,594	75,401	85,901	95,533	105,516
...YoY	25%	24%	14%	11%	10%
Mid- to high-end brands	32,628	30,798	32,589	34,381	36,170
...YoY	25%	-6%	6%	5%	5%
After-sales services	14,514	17,843	22,513	25,983	29,754
...YoY	25%	23%	26%	15%	15%
Total	107,736	124,043	141,004	155,896	171,440
...YoY	25%	15%	14%	11%	10%

Source: Company data, CMBIS estimates

Figure 11: P&L forecast

HK\$ mn	FY18	FY19	FY20E	FY21E	FY22E
Revenue	107,736	124,043	141,004	155,896	171,440
...YoY	24.85%	15.14%	13.67%	10.56%	9.97%
Cost of sales	-97,813	-112,555	-126,963	-140,010	-153,578
Gross profit	9,923	11,488	14,040	15,886	17,862
GPM (%)	9.21%	9.26%	9.96%	10.19%	10.42%
...YoY	14.27%	15.77%	22.22%	13.15%	12.44%
Selling Exp	-4,311	-4,939	-5,604	-6,189	-6,809
...% of rev	-4.00%	-3.98%	-3.97%	-3.97%	-3.97%
Admin Exp	-1,745	-1,940	-2,212	-2,450	-2,698
...% of rev	-1.62%	-1.56%	-1.57%	-1.57%	-1.57%
Operating profit	6,432	7,717	9,405	10,705	12,462
OPM (%)	5.97%	6.22%	6.67%	6.87%	7.27%
...YoY	9.20%	19.98%	21.87%	13.83%	16.41%
Net profit	3,637	4,502	5,516	6,258	7,479
NPM (%)	3.38%	3.63%	3.91%	4.01%	4.36%
...YoY	8.57%	23.77%	22.52%	13.46%	19.52%

Source: Company data, CMBIS estimates

Valuation

Maintain BUY and TP at HK\$33.8

We slightly adjust our bottom-line forecast in 2020E at RMB5.5bn. In addition, we believe great governance and excellent operating capability was not affected by COVID-19 at all. Our TP is maintained at HK\$33.8 (based on initial 12.5x 2020E P/E) with an upside potential of 37.5%. Reiterate BUY.

Figure 12: Peers valuation

Company	Ticker	Rating	Market Cap (LC mn)	Price (LC)	TP (LC)	Up/Down -side	P/E (x)		P/B (x)		ROE (%)	
							FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
HK-listed												
Zhongsheng	881 HK	Buy	52,703	24.60	33.84	38%	9.1	8.0	2.0	1.7	23.7	22.8
China Meidong	1268 HK	Buy	9,282	8.39	11.33	35%	12.6	10.0	3.7	2.9	33.6	32.5
Yongda	3669 HK	Hold	9,361	5.32	6.59	24%	4.6	4.0	0.7	0.6	17.5	17.2
Zhengtong	1728 HK	NR	3,286	1.30	NA	NA	3.2	2.9	0.3	0.2	8.1	8.6
Grand Baoxin	1293 HK	NR	2,525	0.95	NA	NA	4.0	3.4	0.3	0.3	8.4	9.0
China Harmony	3836 HK	NR	4,818	2.94	NA	NA	9.3	8.2	0.7	0.6	7.7	7.9
Average							7.1	6.1	1.3	1.1	16.5	16.3
China-listed												
Sinomach	600335 CH	NR	7,430	5.10	NA	NA	NA	10.4	0.6	0.6	7.3	8.0
China Grand	600297 CH	NR	31,735	3.89	NA	NA	10.5	8.9	0.8	0.7	7.8	8.2
Average							10.5	9.7	0.7	0.7	7.6	8.1
Overseas-listed												
Auto Nation	AN US	NR	2,018	22.55	NA	NA	4.6	4.6	0.6	0.5	12.0	10.8
Carmax	KMX US	NR	7,878	48.22	NA	NA	9.4	8.9	2.1	1.8	24.8	24.6
Penske	PAG US	NR	1,767	21.72	NA	NA	3.8	3.7	0.6	0.5	14.4	14.6
Lithia	LAD US	NR	1,480	63.38	NA	NA	5.2	4.7	0.9	0.8	17.2	17.6
Average							5.7	5.5	1.0	0.9	17.1	16.9

Source: Bloomberg, CMBIS estimates

Financial Summary

Income statement

YE Dec 31 (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	107,736	124,043	141,004	155,896	171,440
Sales of motor vehicle	93,222	106,199	118,490	129,914	141,686
After-sales services	14,514	17,843	22,513	25,983	29,754
Cost of sales	(97,813)	(112,555)	(126,963)	(140,010)	(153,578)
Gross profit	9,923	11,488	14,040	15,886	17,862
Selling & distribution expenses	(4,311)	(4,939)	(5,604)	(6,189)	(6,809)
Administrative expenses	(1,745)	(1,940)	(2,212)	(2,450)	(2,698)
Net impairment losses on financial assets	0	0	0	0	0
Other income	2,561	3,110	3,177	3,455	4,102
Other expenses	0	0	0	0	0
Finance expenses	(1,231)	(1,391)	(1,652)	(1,909)	(1,948)
PL from JV and Associate	3	(1)	4	4	4
Profit before income tax	5,201	6,327	7,753	8,796	10,513
Income tax expense	(1,505)	(1,807)	(2,210)	(2,507)	(2,996)
Profit for the year	3,695	4,520	5,543	6,289	7,517
Less: MI	58	18	28	31	38
Net Profit	3,637	4,502	5,516	6,258	7,479

Cash flow

YE Dec 31 (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	3,637	4,502	5,516	6,258	7,479
D&A	790	-	894	1,028	1,206
Change in working capital	(6,947)	(6,674)	(2,253)	(4,995)	(5,606)
Others	4,838	9,972	8,105	5,100	9,622
Net cash from operating	2,318	7,800	12,262	7,391	12,702
Capex & investments	(3,760)	-	(5,288)	(6,018)	(6,633)
Associated companies	-	(3)	3	-	-
Others	(473)	(3,136)	-	-	-
Net cash from investing	(4,233)	(3,139)	(5,285)	(6,018)	(6,633)
Equity raised	-	-	-	-	-
Change of Debts	3,323	3,033	954	5,479	801
Dividend paid	(667)	(727)	(900)	(1,101)	(1,250)
Others	347	(7,018)	-	-	-
Net cash from financing	3,003	(4,712)	54	4,377	(449)
Net change in cash	1,088	(51)	7,030	5,750	5,620
Cash at the beginning	6,789	7,887	7,706	13,618	14,736
Exchange difference	10	(130)	-	-	-
Cash at the end	7,887	7,706	14,736	19,368	20,357
Less: pledged cash	1,744	1,605	1,605	1,605	1,605

Balance sheet

YE Dec 31 (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	26,706	31,383	30,320	34,495	39,017
Fixed asset	11,507	12,362	13,363	15,377	17,557
Intangible assets	6,331	6,218	6,752	8,192	9,690
Interest in JV/associate	45	47	48	49	50
Other non-current assets	8,823	12,756	10,157	10,877	11,720
Current assets	30,462	31,642	42,144	49,835	53,906
Cash	7,887	7,706	14,736	19,368	20,357
Account receivable	1,342	1,463	1,536	1,702	1,871
Inventory	10,980	9,828	11,429	12,875	14,319
Other current assets	10,253	12,644	14,442	15,889	17,360
Current liabilities	26,599	27,147	33,505	39,695	41,191
Borrowings	17,071	17,326	21,006	25,814	25,698
Account payables	4,815	4,875	5,672	6,310	6,971
Other payables	3,243	3,469	4,311	4,761	5,184
Tax payables	1,470	1,476	2,516	2,810	3,337
Non-current liabilities	11,532	13,701	13,066	14,113	15,706
Borrowings	5,575	3,924	5,627	6,298	7,215
Provisions	-	-	-	-	-
Deferred income tax	1,909	1,918	3,146	3,522	4,197
Others	4,048	7,859	4,294	4,294	4,294
Total net asset	19,037	22,177	25,892	30,522	36,027
Minority interest	797	418	663	862	1,058
Shareholders' equity	18,240	21,759	25,229	29,660	34,969

Key ratios

YE Dec 31	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Commercial services	87%	86%	84%	83%	83%
Financial services	13%	14%	16%	17%	17%
Total	100%	100%	100%	100%	100%
P&L ratios (%)					
Gross profit margin	9%	9%	10%	10%	10%
Pre-tax margin	5%	5%	5%	6%	6%
Net margin	3%	4%	4%	4%	4%
Effective tax rate	29%	29%	29%	29%	29%
Balance sheet ratios					
Current ratio (x)	1.15	1.17	1.26	1.26	1.31
Quick ratio (x)	0.35	0.37	0.52	0.56	0.56
Cash ratio (x)	0.30	0.32	0.47	0.51	0.52
Inventory days	41	32	33	34	34
Account payable days	18	16	16	16	17
Account receivable days ratio (%)	5	4	4	4	4
Total debt / total equity ratio (%)	200%	184%	180%	176%	158%
Net debt / equity ratio (%)	159%	149%	123%	113%	101%
Returns (%)					
ROE	21%	23%	24%	23%	23%
ROA	12%	13%	14%	14%	14%
Per share					
EPS (RMB)	1.60	1.98	2.43	2.75	3.29
DPS (RMB)	0.32	0.40	0.48	0.55	0.66
BVPS (RMB)	8.04	9.58	11.11	13.06	15.39

Source: Company data, CMBIS Estimate

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