

ZTO Express (ZTO US)

Price war to dent NT profitability; Share gain on track

SUMMARY. ZTO delivered strong 2Q19 results, as market share ratcheted up to 20% and adj. net profit beat consensus/ our est. by 8%/ 10%. However, its greater-than-expected ASP decline revealed the heated price war. We believe the heightened competition will continue in 2H19E, and the pitched battle will shadow the profitability outlook. We revised down adj. EPS in FY19/ 20E by 5%/ 3%, but maintain BUY with TP cut to US\$22.17 based on 25x FY19E P/E, to reflect its cemented leadership and visible share gain amid sector consolidation.

- **2Q19 beat amid fierce competition.** In 2Q19, ZTO's parcel volume increased to 3.1bn (+47% YoY), and the market share reached 19.9%. Revenue grew 29% YoY to RMB5.4bn, in line with consensus and our est., due to strong volume growth offset by unexpectedly dramatic ASP dive (-11% YoY). Adj. net profit came in at RMB1.4bn, 8%/ 10% above consensus/ our est., driven by unit cost decline of 8% YoY.
- **Margin under pressure as price war to culminate.** We deem that it's ASP dive leading to the operating profit miss on our est. by 10%, and it epitomized the heightened competition at current stage. Though momentum bifurcation between top players has seen stretched recently, we still maintain our cautious outlook toward the price war trend, especially considering STO's (002468 CH) most likely rise after Alibaba's takeover. Further, we think the ongoing pitched battle will hurt ZTO's profitability in 2H19E. As a result, we revised down our GP/ OP forecast by 9%/ 12% in FY19E.
- **Eyes on last-mile cost control.** ZTO used to build up edges in cost control over peers by self-operation, high-capacity truck replacement and sorting automation. Going forward, we believe cost control capability matters most in the ongoing rat race against the backdrop of ASP inevitable decline. On top of continued upgrade on sorting and transportation capacity, ZTO is also geared up to optimize last-mile cost through post functionality expansion and franchisees' income balancing. Mgmt believes the innovation and effort on last-mile process would bolster ZTO's further cost improvement.
- **Maintain BUY with TP trimmed.** Due to intensified competition and prudent margin outlook, we revised down our adj. net profit forecast in FY19/ 20E by 5%/ 3%. We reiterate BUY and slightly trim our TP from US\$23.64 to US\$22.17, based on 25x FY19E P/E. Key risks include 1) slower-than-expected e-commerce growth, and 2) greater-than-expected ASP decline.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	13,060	17,604	22,149	26,882	33,233
YoY growth (%)	33.4%	34.8%	25.8%	21.4%	23.6%
Adj. net income (RMB mn)	3,200	4,201	4,740	5,465	7,043
Adj. EPS (RMB)	4.46	5.59	6.03	6.95	8.96
YoY growth (%)	30.8%	25.2%	7.9%	15.3%	28.9%
P/E (x)	30.0	23.9	22.2	19.2	14.9
P/B (x)	4.5	2.9	2.8	2.5	2.2
Yield (%)	0.0	0.9	1.2	1.0	1.3
ROE (%)	15.3	15.8	12.4	13.8	15.8
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price **US\$22.17**
 (Previous TP **US\$23.64**)
 Up/Downside **+16.1%**
 Current Price **US\$19.10**

China Express Delivery Sector

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Stock Data

Mkt Cap (US\$ mn)	15,049
Avg 3 mths t/o (US\$ mn)	47.9
52w High/Low (US\$)	21.07/14.49
Total Issued Shares (mn)	582
Source: Bloomberg	

Shareholding Structure

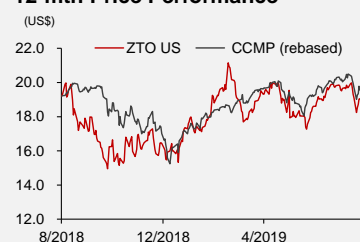
Lai Meisong	27.1%
Lai Jianfa	8.4%
Alibaba	7.3%
Source: Bloomberg	

Share Performance

	Absolute	Relative
1-mth	-3.8%	2.3%
3-mth	1.5%	2.2%
6-mth	1.5%	-2.3%

Source: Bloomberg

12-mth Price Performance

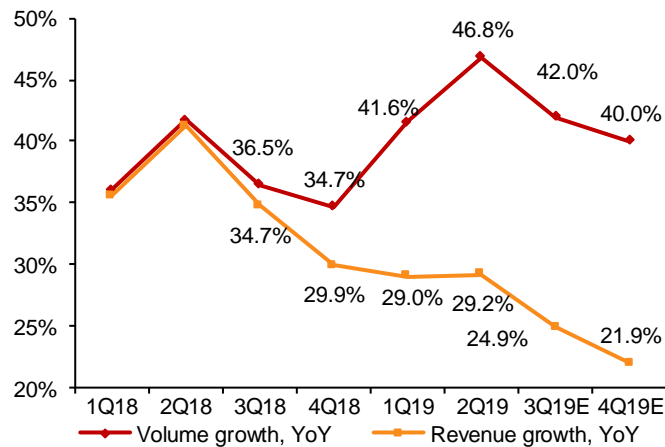


Source: Bloomberg

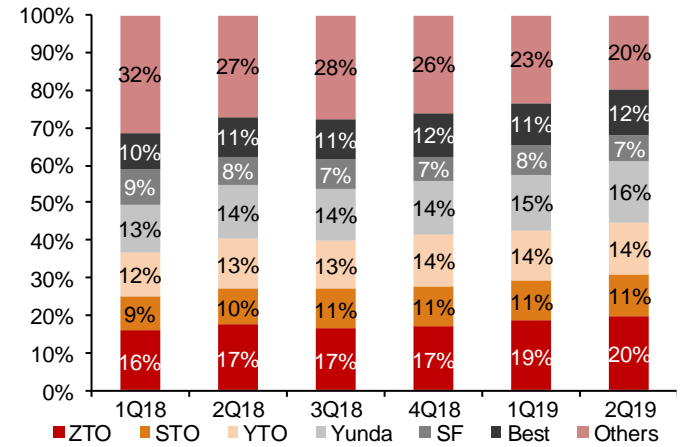
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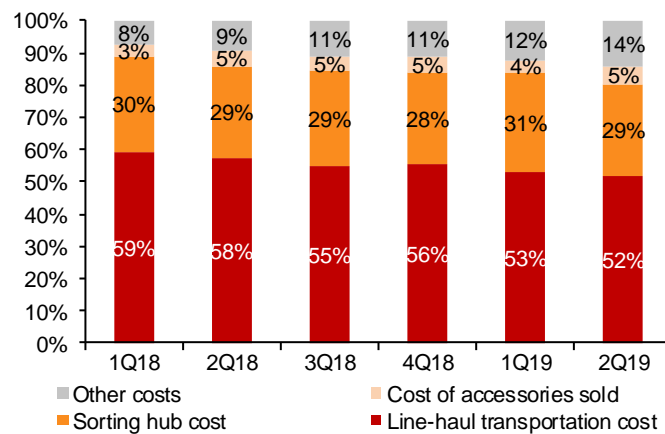
1. China Exp Delivery: YTO likely to fall behind "Tongda" peers – 19 July 2019
2. China Exp Delivery: Heated competition to stretch into 2020E – 5 July 2019

Figure 1: Revenue growth subdued by volume incentives

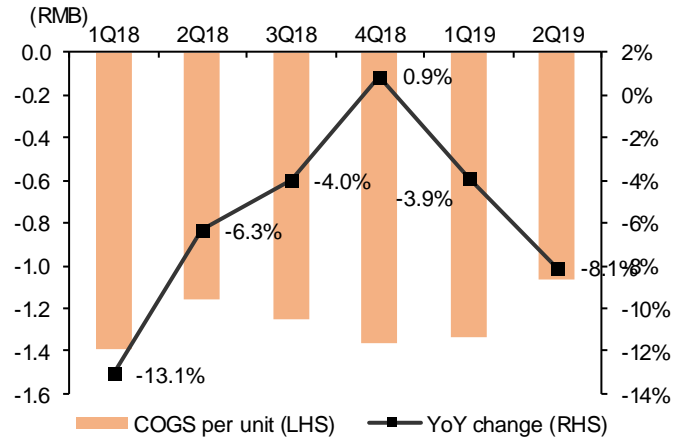
Source: Company data, CMBIS estimates

Figure 2: Market shares compression between major players

Source: Company data, State Post Bureau, CMBIS

Figure 3: Unit cost structure excluding COE

Source: Company data, CMBIS estimates

Figure 4: Continued unit cost reduction

Source: Company data, CMBIS

Figure 5: 2Q19 results overview

RMB mn, Dec-YE	2Q18	3Q18	4Q18	1Q19	2Q19	QoQ	YoY	Cons.	Diff %	CMBI	Diff %
Revenue	4,198	4,235	5,628	4,574	5,424	18.6%	29.2%	5,498	-1%	5,653	-4%
Operating Profit	1,845	1,269	1,501	880	1,660	88.6%	10.1%	1,537	8%	1,847	-10%
Adjusted EBITDA	1,520	1,473	1,766	1,441	1,963	36.2%	29.1%	1,768	11%	1,922	2%
Adj. Net profit	1,096	1,058	1,290	966	1,376	42.4%	25.6%	1,279	8%	1,253	10%
Adjusted EPS (RMB)	1.52	1.34	1.64	1.23	1.74	41.6%	14.7%	1.62	7%	1.59	9%
Margin (%)											
Gross Margin	34.7%	31.3%	27.5%	27.5%	32.6%			32.8%	-0.2ppt	34.7%	-2.1ppt
Operating Margin	28.3%	25.8%	24.0%	16.6%	27.5%			28.0%	-0.4ppt	30.2%	-2.7ppt
Adj. Net Margin	26.1%	25.0%	22.9%	21.1%	25.4%			23.3%	2.1ppt	22.2%	3.2ppt
Growth (%)											
Revenue (YoY)	41.3%	34.7%	29.9%	29.0%	29.2%						
Revenue (QoQ)	18.4%	0.9%	32.9%	-18.7%	18.6%						
Operating Profit	93.6%	32.2%	21.9%	22.0%	-10.1%						
Adj. Net Profit	50.0%	44.9%	1.9%	27.6%	25.6%						

Source: Company data, Bloomberg, CMBIS estimates

Our FY19-21E EPS are 2-8% below consensus

Considering accelerated ASP downward trend, we revised down FY19-21E EPS by 2-5% to reflect margin pressure amid the continued price war. Our FY19-21E EPS are slightly below consensus, due to our more cautious profitability outlook.

Figure 6: CMBI Earnings forecast

(RMB mn)	1Q19	2Q19	3Q19E	4Q19E	FY19E	FY20E	FY21E
Revenue	4,574	5,424	5,289	6,863	22,149	26,882	33,233
Gross profit	1,260	1,769	1,539	1,677	6,244	7,396	9,718
Operating profit	760	1,493	1,301	1,368	4,922	6,186	8,223
Adj. net profit	966	1,376	1,179	1,219	4,740	5,465	7,043
Adj. EPS (RMB)	1.23	1.74	1.50	1.55	6.03	6.95	8.96
Gross margin	27.5%	32.6%	29.1%	24.4%	28.2%	27.5%	29.2%
Operating margin	16.6%	27.5%	24.6%	19.9%	22.2%	23.0%	24.7%
Net margin	21.1%	25.4%	22.3%	17.8%	21.4%	20.3%	21.2%

Source: Company data, CMBIS estimates

Figure 7: Earnings forecast change

(RMB mn)	New			Old			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	22,149	26,882	33,233	22,422	27,001	33,425	-1.2%	-0.4%	-0.6%
Gross profit	6,244	7,396	9,718	6,880	7,687	9,833	-9.3%	-3.8%	-1.2%
Operating profit	4,922	6,186	8,223	5,577	6,472	8,329	-11.8%	-4.4%	-1.3%
Adj. net profit	4,740	5,465	7,043	4,986	5,659	7,203	-4.9%	-3.4%	-2.2%
Adj. EPS (RMB)	6.03	6.95	8.96	6.34	7.20	9.16	-4.9%	-3.4%	-2.2%
Gross margin	28.2%	27.5%	29.2%	30.7%	28.5%	29.4%	-2.5ppt	-1.0ppt	-0.2ppt
Operating margin	22.2%	23.0%	24.7%	24.9%	24.0%	24.9%	-2.7ppt	-1.0ppt	-0.2ppt
Net margin	21.4%	20.3%	21.2%	22.2%	21.0%	21.5%	-0.8ppt	-0.6ppt	-0.4ppt

Source: Company data, Bloomberg, CMBIS estimates

Figure 8: CMBI Est. VS Consensus

(RMB mn)	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	22,149	26,882	33,233	22,549	27,820	33,696	-1.8%	-3.4%	-1.4%
Gross profit	6,244	7,396	9,718	6,699	8,037	10,055	-6.8%	-8.0%	-3.4%
Operating profit	4,922	6,186	8,223	5,465	6,708	8,350	-9.9%	-7.8%	-1.5%
Adj. net profit	4,740	5,465	7,043	4,974	5,929	7,198	-4.7%	-7.8%	-2.2%
Adj. EPS (RMB)	6.03	6.95	8.96	6.35	7.54	9.13	-5.0%	-7.8%	-1.9%
Gross margin	28.2%	27.5%	29.2%	29.7%	28.9%	29.8%	-1.5ppt	-1.4ppt	-0.6ppt
Operating margin	22.2%	23.0%	24.7%	24.2%	24.1%	24.8%	-2.0ppt	-1.1ppt	0.0ppt
Net margin	21.4%	20.3%	21.2%	22.1%	21.3%	21.4%	-0.7ppt	-1.0ppt	-0.2ppt

Source: Company data, Bloomberg, CMBIS estimates

Valuation

Reiterate BUY with TP of US\$22.17 (16% upside)

Our new 12-month TP of US\$22.17 is based on unchanged 25x FY19E P/E. We estimate 12% EPS FY18-20E CAGR, due to 1) 24% revenue CAGR and 2) downbeat margins during ongoing intensified competition. However, we maintain BUY to reflect its cemented leadership and continued share gain amid sector consolidation.

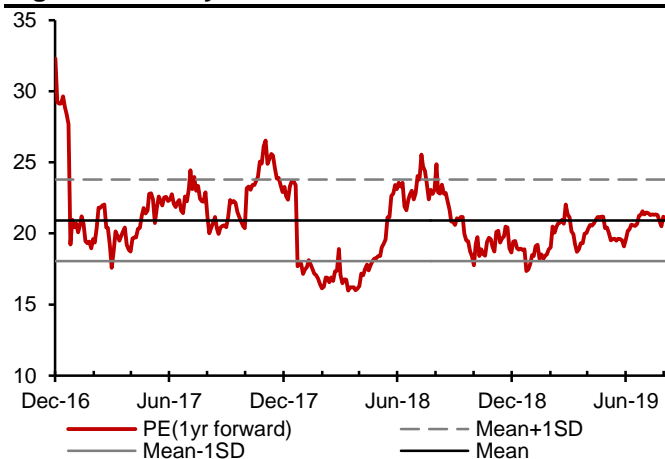
Key risks include 1) slower-than-expected e-commerce growth, and 2) greater-than-expected ASP decline.

Figure 9: Peers comparison

Company	Ticker	Mkt cap (USD mn)	Curr.	Price	ROE		PE		PB		EV/EBITDA		FY18-20E
					19E	20E	19E	20E	19E	20E	19E	20E	EPS CAGR
China express delivery													
ZTO	ZTO US	15,049	USD	19.10	12.4	13.8	22.2	19.2	2.8	2.5	13.0	10.5	12%
SF	002352 CH	23,143	CNY	36.91	12.5	13.6	32.1	26.7	4.0	3.6	16.6	12.9	29%
YTO	600233 CH	4,484	CNY	11.13	16.8	16.7	14.3	12.4	2.4	2.1	8.6	7.6	15%
STO	002468 CH	4,831	CNY	22.22	21.5	21.5	16.4	13.8	3.4	2.8	9.5	7.8	10%
Yunda	002120 CH	11,056	CNY	34.96	20.4	20.5	26.2	21.4	5.7	4.8	15.1	12.0	14%
Deppon	603056 CH	1,668	CNY	12.23	17.2	18.3	14.6	11.5	2.5	2.1	5.8	4.7	21%
Average					16.8	17.4	21.0	17.5	3.5	3.0	11.5	9.2	16%
Overseas express delivery													
FedEx	FDX US	39,866	USD	152.82	19.7	19.7	10.0	10.4	2.0	2.0	6.5	6.5	3%
UPS	UPS US	97,806	USD	113.9	121	85.9	15.2	14.1	14.8	9.9	11.3	10.5	6%
Yamato	9064 JP	7,089	JPY	1,832	6.4	6.7	20.0	18.3	1.3	1.2	6.1	5.6	59%
DHL	DPW GR	39,060	EUR	28.51	18.9	19.4	13.5	11.6	2.4	2.2	6.6	6.0	16%
Average					41.4	32.9	14.7	13.6	5.1	3.8	7.6	7.1	21%
Total Average					37.4	37.6	18.5	11.7	3.7	7.2	9.7	5.3	18%

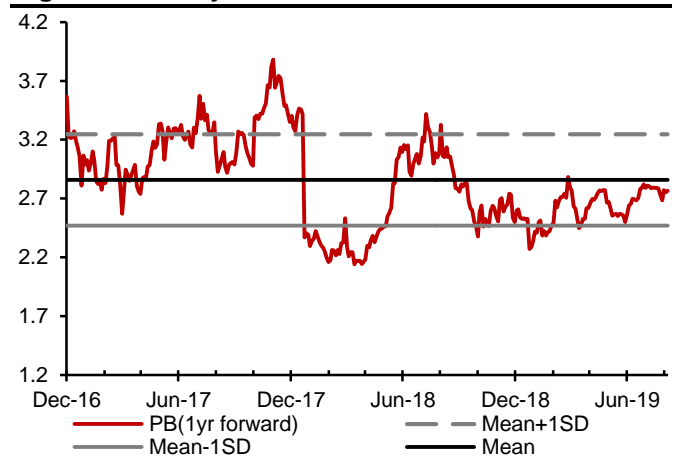
Source: Company data, Bloomberg, CMBIS estimates

Figure 10: One-year forward P/E



Source: Bloomberg, CMBIS

Figure 11: One-year forward P/B



Source: Bloomberg, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	13,060	17,604	22,149	26,882	33,233
Express delivery	12,174	15,400	19,601	24,046	30,026
Freight forwarding	270	1,279	1,357	1,384	1,412
Sales of accessories	592	813	1,109	1,344	1,662
Others	25	113	82	108	133
COGS	(8,714)	(12,240)	(15,905)	(19,486)	(23,514)
Gross profit	4,346	5,365	6,244	7,396	9,718
Selling, general and	(781)	(1,211)	(1,410)	(1,210)	(1,495)
Other operating income	183	178	88	-	-
Operating profit	3,748	4,332	4,922	6,186	8,223
Other income	73	1,004	495	473	464
Profit before tax	3,821	5,336	5,417	6,659	8,687
Income tax	(646)	(929)	(970)	(1,188)	(1,637)
Non-operating income	57	985	495	473	464
Profit for the year	3,159	4,388	4,447	5,471	7,050
Non-controlling interest	1	(5)	(4)	(5)	(7)
Net profit attr. to ZTO	3,160	4,383	4,438	5,465	7,043
Preferred share changes	-	-	-	-	-
Net profit	3,160	4,383	4,438	5,465	7,043
Adj. net profit	3,200	4,201	4,740	5,465	7,043

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Profit for the year	3,159	4,388	4,447	5,471	7,050
D&A	560	854	1,340	1,842	2,198
Change in working capital	(178)	(443)	379	27	238
Others	89	(394)	-	-	-
Operating cash flow	3,631	4,404	6,167	7,339	9,485
Capex	(2,827)	(3,981)	(6,800)	(7,000)	(5,000)
Others	(5,468)	(8,892)	-	-	-
Investing cash flow	(8,295)	(12,873)	(6,800)	(7,000)	(5,000)
Equity raised	-	8,892	-	-	-
Proceeds from borrowing	550	-	-	-	-
Dividend payout	-	(895)	(1,266)	(1,093)	(1,409)
Others	(1,612)	(955)	-	-	-
Financing cash flow	(1,062)	7,042	(1,266)	(1,093)	(1,409)
Exchange effect	(424)	276	-	-	-
Net change in cash	(5,725)	(1,426)	(1,899)	(754)	3,077
Cash at the beginning	11,923	5,774	4,623	2,724	1,970
Cash at the end	5,774	4,623	2,724	1,970	5,046
Restricted cash	349	0	0	0	0
Cash and cash equivalent	5,425	4,623	2,723	1,969	5,046

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	13,450	18,449	23,904	29,062	31,864
PP&E	6,473	9,036	13,544	18,088	20,486
Land use rights, net	1,603	1,969	2,924	3,545	3,955
Intangible assets, net	60	54	45	39	33
Goodwill	4,242	4,242	4,242	4,242	4,242
Other non-current assets	1,072	3,148	3,148	3,148	3,148
Current assets	12,378	21,234	19,510	19,047	22,448
Cash and cash equivalent	5,425	4,623	2,723	1,969	5,046
Restricted cash	349	0	0	0	0
Accounts receivable	288	597	664	806	997
Short-term investment	5,225	13,600	13,600	13,600	13,600
Other current assets	1,092	2,414	2,522	2,671	2,804
Current liabilities	4,146	5,141	5,696	6,014	6,575
Borrowings	250	0	0	0	0
Accounts payable	889	1,312	1,750	1,949	2,351
Other payables	352	427	427	427	427
Other current liabilities	2,655	3,403	3,520	3,638	3,797
Non-current liabilities	240	272	272	272	272
Deferred tax liabilities	157	158	158	158	158
Long-term debt	0	0	0	0	0
Others	83	114	114	114	114
Minority Interest	6	52	56	62	69
Common equity	21,435	34,217	37,389	41,761	47,395
Total equity	21,441	34,270	37,446	41,823	47,464

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Express delivery services	93.2	87.5	88.5	89.5	90.4
Freight forwarding services	2.1	7.3	6.1	5.1	4.2
Sales of accessories	4.5	4.6	5.0	5.0	5.0
Others	0.2	0.6	0.4	0.4	0.4
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross margin	33.3	30.5	28.2	27.5	29.2
Adj. EBITDA margin	34.1	33.3	31.8	31.6	32.8
Operating margin	28.7	24.6	22.2	23.0	24.7
Adj. net margin	24.5	23.9	21.4	20.3	21.2
Effective tax rate	16.9	17.4	17.9	17.8	18.8
Balance sheet ratios					
Current ratio (x)	3.0	4.1	3.4	3.2	3.4
Quick ratio (x)	3.0	4.1	3.4	3.2	3.4
AR turnover days	1.0	0.8	0.7	0.7	0.7
AP turnover days	31.9	32.8	35.1	34.6	33.4
Net gearing ratio(%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	15.3	15.8	12.4	13.8	15.8
ROA	12.8	13.4	10.7	11.9	13.8
Per share					
Adj. EPS (RMB)	4.46	5.59	6.03	6.95	8.96
DPS (RMB)	0.00	1.26	1.61	1.39	1.79
BVPS (RMB)	29.9	45.5	47.6	53.1	60.3

Source: Company data, CMBIS estimates

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