

ZhongSheng Group

Bloomberg: 881 HK EQUITY | Reuters: 0881.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

31 Aug 2022

BUY

Last Traded Price (31 Aug 2022): HK\$37.25 (HSI : 19,954)
Price Target 12-mth: HK\$60.00 (61% upside) (Prev HK\$78.00)

Analyst

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What's New

- 1H22 revenue and net earnings fell 1.5% and 7.3% y-o-y respectively, slightly below expectations
- Expansion into new energy segment to improve gross margins; securing contracts with NEV startups
- Opened 8 new centers for pre-owned vehicles in 1H22; pre-owned car sales benefited from favourable policies
- TP HK\$60 pegged to 13x FY22F PE; maintain BUY

Sales drivers in place

Investment Thesis

Recovering dealership outlook. Expansion of its dealership network and favourable government policies are expected to lift 2H revenue and profit margins. The focus on key premium brands especially Mercedes Benz (which accounted for 41% of 1H new car sales revenue) should drive profitability given the brand's strong new model cycle.

New cars sales volume projected to grow 8-11% in FY22/23.

Store expansions is expected to drive new car sales volume, especially with the normalization of supplies from auto OEMs. Hence, we estimate revenue FY21-23F CAGR of 15%. Zhongsheng has been expanding the sales network at a steady pace from 360 in FY19 to 417 in 1H22.

Stable financial position to support business growth. 1H22 operating net cash flow declined to Rmb3.6bn from Rmb6.4bn in 1H21, affected by the pandemic. We anticipate operating cashflow to improve on earnings recovery. Net gearing improved from 41% in Dec-21 to 33% in Jun-22.

Valuation:

We lower our TP to HK\$60, based on 13x FY22F PE (premised on 5-year historical mean). The volatile market has dragged the auto sector valuation and the stock is now trading at around 1SD below mean.

Where we differ:

Our FY23F net earnings are ahead of consensus as we believe Zhongsheng's huge sales network will see benefits from Mercedes Benz's new model cycle.

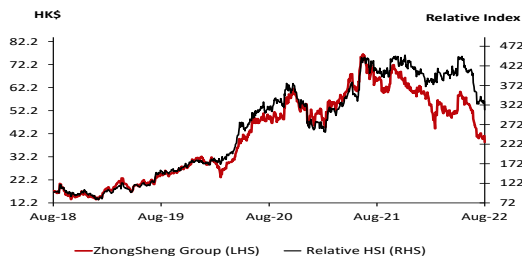
Key Risks to Our View:

Logistic bottlenecks and severe chip shortage could affect the availability of new car supplies, hence impacting sales.

At A Glance

Issued Capital (m shrs)	2,415
Mkt Cap (HKm/US\$m)	92,857 / 11,831
Major Shareholders (%)	
JSH Investment Holdings Ltd.	21.0
Vintage Star Ltd.	20.2
Mountain Bright Ltd.	20.2
Blue Natural Development Ltd.	7.8
Huang (Yi)	5.1
Free Float (%)	25.8
3m Avg. Daily Val. (US\$m)	26.41
GICS Industry: Consumer Discretionary / Retailing	

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	148,348	175,103	200,822	231,349
EBITDA	10,797	14,814	16,362	20,251
Pre-tax Profit	7,679	11,504	12,767	16,452
Net Profit	5,540	8,329	9,480	11,769
Net Pft (Pre-Ex) (core profit)	5,540	8,329	9,480	11,769
Net Profit Gth (Pre-ex) (%)	23.1	50.3	13.8	24.2
EPS (RMB)	2.44	3.56	3.93	4.88
EPS (HK\$)	2.77	4.04	4.46	5.54
EPS Gth (%)	23.0	46.0	10.5	24.1
Diluted EPS (HK\$)	2.77	4.04	4.46	5.54
DPS (HK\$)	0.55	0.81	0.89	1.11
BV Per Share (HK\$)	13.22	19.52	22.63	27.27
PE (X)	13.4	9.2	8.3	6.7
P/Cash Flow (X)	8.0	7.1	4.6	5.1
P/Free CF (X)	12.2	12.0	5.5	6.3
EV/EBITDA (X)	8.3	6.0	5.0	3.6
Net Div Yield (%)	1.5	2.2	2.4	3.0
P/Book Value (X)	2.8	1.9	1.6	1.4
Net Debt/Equity (X)	0.5	0.3	0.0	CASH
ROAE(%)	23.0	25.0	21.5	22.2
Earnings Rev (%)			(3)	(6)
Consensus EPS (RMB)			3.88	4.69
Other Broker Recs:		B:25	S:1	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters



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WHAT'S NEW

Further inroads into pre-owned vehicle market

Due to pandemic lockdown and supply chain disruption, Zhongsheng's total revenue was down by 1.5% y-o-y to Rmb86bn in 1H22. New car sales revenue dropped 5.2% y-o-y as new car sales volume fell 12.1% y-o-y to 242,280 units. Revenue from after-sales business and pre-owned car sales rose 13.4% and 25.5% y-o-y to Rmb13bn and Rmb4.4bn respectively. Gross profit for 1H22 was Rmb8.5bn, similar to 1H21, while gross margin saw a slight improvement of 0.1ppt to 9.8%. Net earnings in 1H22 declined by 7.3% y-o-y to Rmb3.4bn, slightly below expectations.

In the new car sales segment, luxury car sales volume declined 11.1% to 143,857 units. This segment has been a major contributor to revenue. Sales volume of Mercedes Benz increased by 16% y-o-y to 64,513 units and contributed 41% of new car sales revenue. As the brand moves into electrification, EV models EQ and EQE should have a greater presence. As of 30-Jun 22, 417 dealership stores were in operation, of which 63% were luxury brand stores. Zhongsheng has been expanding its premium brand network, and after the acquisition of the Mercedes Benz stores from Zung Fu, the company added some 10 new luxury stores in 1H, covering Mercedes Benz, Lexus and BMW.

After-sales business segment accounted for 71% of gross profit in 1H22, with gross margin of 47.1%, down 1.1ppts y-o-y. This is an important pillar for business and growth has been steady in the past 10 years. Revenue from this segment is expected to grow by 120% y-o-y in 2H22. Gross margin is also expected to increase in 2H22 as repair volume pick up post lockdown.

Commission income decreased 4.4% y-o-y to Rmb1.5bn in 1H22, primarily reflecting the drop in vehicle sales volume. Income from the segment is expected to increase in 2H22, as new car sales recover, during demand for new insurance plans and auto financing services. Financial services penetration rate increased 5.4ppts to 70.2%.

As for the pre-owned automobile segment, sale volume dropped by 1.7% y-o-y to 65,606 units. Gross profit margin declined by 2ppts y-o-y to 5.1%. With the new policies to remove all restrictions on secondhand vehicle trade,

starting from 3Q22, Zhongsheng has set up 8 Used-Car Centers (UCC) in 1H22 to create a more standardized sales channel for used cars. Higher profit margin is anticipated.

Due to rise of NEV startups and electrification of traditional brands, Zhongsheng commenced the delivery centers and superstores for Xpeng and a LEXUS electrification showroom was also set up in 1H. The company is in discussions with other NEV startups for future authorization, expanding the group's competitive landscape to both high-end vehicles and NEVs, which should improve overall gross margins on new car sales. NEV sales volume from traditional brands increased by 54% in 1H22.

Healthy financial position in 1H22. Operating cash flow was Rmb3.7bn in 1H22, while capex was Rmb897.9m. Net gearing ratio decreased from 41% in end-FY21 to 33% in 1H22. Inventory turnover increased 9.2 days to 30 days due to pandemic lockdown and logistics disruption which caused a temporary imbalance of vehicle supply and demand. Stable supply is expected in 2H22.

BUY rating maintained on better 2H outlook and attractive valuation. The recovery of the dealership business post lockdown is expected to support share price performance. We tweaked FY22/23F net earnings lower by 3/6% to factor in slightly weaker-than-expected earnings in 1H. However, the volatile stock market has dragged the auto sector valuation and the auto dealerships were also affected. Although we cut target PE to 13x FY22F, benchmarked to its 5-year historical average, we reiterate our BUY rating. The stock is currently trading around 1SD below mean.

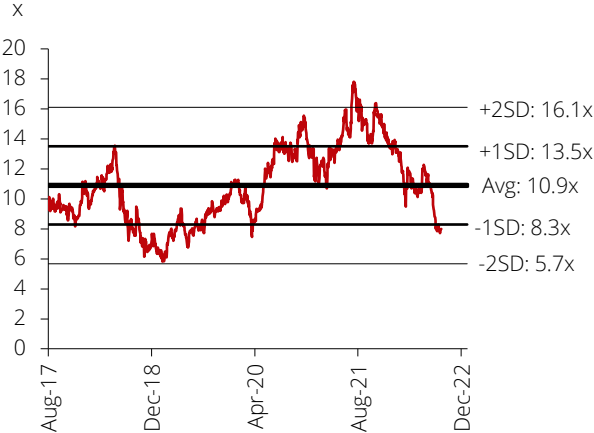
Company Background

Zhongsheng Group Holdings Ltd. (Zhongsheng) retails automobiles. The group operates 4S outlets and retails primarily luxury and mid-range to high-end automobile brands such as Audi, Lexus, Mercedes-Benz, BMW, Jaguar Land Rover, Volvo, Nissan, Toyota, and Honda.

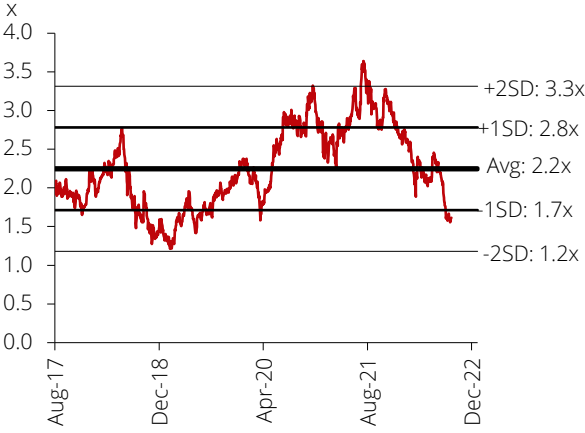
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Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Zhongsheng interim results performance

(RMBm)	1H21	2H21	1H22	1H22 vs 1H21	1H22 vs 2H21
Revenue	87,361	87,742	86,029	-1.5%	-2.0%
Cost of sales	(78,898)	(77,735)	(77,562)	-1.7%	-0.2%
Gross profit	8,463	10,007	8,467	0.0%	-15.4%
Other income	1,807	2,083	1,696	-6.1%	-18.6%
Selling and distribution costs	(3,442)	(3,729)	(3,721)	8.1%	-0.2%
Administrative expenses	(1,126)	(1,447)	(1,194)	6.1%	-17.5%
Operating profit	5,703	6,914	5,248	-8.0%	-24.1%
Finance costs	(596)	(524)	(560)	-6.1%	7.0%
Profit before tax	5,109	6,394	4,688	-8.3%	-26.7%
PATMI	3,696	4,633	3,425	-7.3%	-26.1%
EPS (RMB)	1.61	2.02	1.42	-11.8%	-29.7%
Margin Analysis (%)				<i>ppts chg.</i>	<i>ppts chg.</i>
Gross Profit Margin	9.7	11.4	9.8	0.2	-1.6
Operating Profit Margin	6.5	7.9	6.1	-0.4	-1.8
Net Profit Margin	4.2	5.3	4.0	-0.2	-1.3
Revenue breakdown					
New car sales	72,556	69,910	68,813	-5.2%	-1.6%
Mid-high end	16,398	17,509	15,621	-4.7%	-10.8%
Luxury	56,158	52,401	53,193	-5.3%	1.5%
After-sales services	11,302	13,202	12,820	13.4%	-2.9%
Gross Profit breakdown					
New car sales	2,763	3,434	2,201	-20.3%	-35.9%
After-sales services	5,451	6,332	6,043	10.9%	-4.6%
Pre-owned car sales	249	241	223	-10.4%	-7.5%
Total gross profit	8,463	10,007	8,467	0.0%	-15.4%
Gross margins (%)				<i>ppts chg.</i>	<i>ppts chg.</i>
New car sales	3.8	4.9	3.2	-0.6	-1.7
After-sales services	48.2	48.0	47.1	-1.1	-0.8
Pre-owned car sales	7.1	5.2	5.1	-2.0	-0.1
Total	9.7	11.4	9.8	0.2	-1.6
Sales Volume (units 000)					
Mid-high end	114	115	98	-13.4%	-14.6%
Luxury	162	137	144	-11.1%	4.7%
Total vehicles sold	276	253	242	-12.1%	-4.1%
Number of stores					
Mid-high end	157	158	156	-0.6%	-1.3%
Luxury	229	254	261	14.0%	2.8%
Total	386	412	417	8.0%	1.2%

Source: Company

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Mid-high end vol sales (unit)	227,685	225,192	228,849	242,580	266,838
Luxury vol sales (unit)	228,020	275,417	299,305	326,243	365,392

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (RMB m)					
New car sales	106,199	125,527	142,466	158,899	180,363
After-sales business	17,843	20,245	24,505	30,631	36,757
Pre-owned car business	N/A	2,576	8,133	11,292	14,228
Total	124,043	148,348	175,103	200,822	231,349
Gross Profit (RMB m)					
New car sales	2,888	3,710	6,197	5,653	7,525
After-sales business	8,600	9,575	11,783	14,488	17,460
Pre-owned car business	N/A	197	489	678	1,067
Total	11,488	13,482	18,470	20,818	26,052
Gross Profit Margins (%)					
New car sales	2.7	3.0	4.4	3.6	4.2
After-sales business	48.2	47.3	48.1	47.3	47.5
Pre-owned car business	N/A	7.6	6.0	6.0	7.5
Total	9.3	9.1	10.5	10.4	11.3

Source: Company, DBS HK

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Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	124,043	148,348	175,103	200,822	231,349
Cost of Goods Sold	(112,555)	(134,866)	(156,634)	(180,003)	(205,297)
Gross Profit	11,488	13,482	18,470	20,818	26,052
Other Opng (Exp)/Inc	(6,879)	(7,969)	(9,743)	(10,844)	(12,840)
Operating Profit	4,609	5,513	8,727	9,974	13,212
Other Non Opng (Exp)/Inc	3,050	3,343	3,707	3,889	4,266
Associates & JV Inc	(1)	2	6	7	8
Net Interest (Exp)/Inc	(1,331)	(1,179)	(937)	(1,103)	(1,034)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	6,327	7,679	11,504	12,767	16,452
Tax	(1,807)	(2,098)	(3,096)	(3,192)	(4,442)
Minority Interest	(18)	(41)	(78)	(96)	(240)
Preference Dividend	0	0	0	0	0
Net Profit	4,502	5,540	8,329	9,480	11,769
Net Profit before Except.	4,502	5,540	8,329	9,480	11,769
EBITDA	9,396	10,797	14,814	16,362	20,251
Growth					
Revenue Gth (%)	15.1	19.6	18.0	14.7	15.2
EBITDA Gth (%)	24.5	14.9	37.2	10.4	23.8
Opg Profit Gth (%)	19.2	19.6	58.3	14.3	32.5
Net Profit Gth (%)	23.8	23.1	50.3	13.8	24.2
Margins & Ratio					
Gross Margins (%)	9.3	9.1	10.5	10.4	11.3
Opg Profit Margin (%)	3.7	3.7	5.0	5.0	5.7
Net Profit Margin (%)	3.6	3.7	4.8	4.7	5.1
ROAE (%)	22.5	23.0	25.0	21.5	22.2
ROA (%)	7.5	8.4	10.8	10.6	12.0
ROCE (%)	6.5	7.3	9.9	10.0	11.9
Div Payout Ratio (%)	20.0	20.0	20.0	20.0	20.0
Net Interest Cover (x)	3.5	4.7	9.3	9.0	12.8

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	1H2020	2H2020	1H2021	2H2021	1H2022
Revenue	58,203	90,145	87,361	87,742	86,029
Cost of Goods Sold	(52,793)	(82,073)	(78,898)	(77,735)	(77,562)
Gross Profit	5,410	8,072	8,463	10,007	8,467
Other Oper. (Exp)/Inc	(3,082)	(4,887)	(4,567)	(5,176)	(4,915)
Operating Profit	2,328	3,185	3,896	4,831	3,552
Other Non Opng (Exp)/Inc	1,449	1,894	1,727	1,981	1,578
Associates & JV Inc	1	1	3	4	0
Net Interest (Exp)/Inc	(586)	(593)	(516)	(421)	(442)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	3,192	4,486	5,109	6,394	4,688
Tax	(883)	(1,215)	(1,377)	(1,719)	(1,252)
Minority Interest	(17)	(24)	(36)	(42)	(11)
Net Profit	2,292	3,248	3,696	4,633	3,425
Net profit bef Except.	2,292	3,248	3,696	4,633	3,425
Growth					
Revenue Gth (%)	1.4	35.3	50.1	(2.7)	(1.5)
Opg Profit Gth (%)	5.6	32.5	67.3	51.7	(8.8)
Net Profit Gth (%)	10.1	34.3	61.3	42.6	(7.3)
Margins					
Gross Margins (%)	9.3	9.0	9.7	11.4	9.8
Opg Profit Margins (%)	4.0	3.5	4.5	5.5	4.1
Net Profit Margins (%)	3.9	3.6	4.2	5.3	4.0

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	12,362	14,373	17,372	18,456	19,314
Invt in Associates & JVs	47	49	56	63	71
Other LT Assets	18,974	20,228	27,700	27,724	27,700
Cash & ST Invt	7,706	9,817	11,981	19,038	24,168
Inventory	9,828	9,090	11,192	8,069	8,439
Debtors	1,463	1,430	1,815	2,368	2,728
Other Current Assets	12,644	13,515	15,359	17,776	20,344
Total Assets	63,024	68,501	85,474	93,494	102,764
ST Debt	17,090	16,980	15,219	12,219	9,219
Creditors	4,875	4,980	5,460	8,069	9,206
Other Current Liab	5,182	6,514	7,701	8,203	9,222
LT Debt	8,218	7,178	8,866	8,866	8,866
Other LT Liabilities	5,483	5,967	7,521	7,521	7,521
Shareholder's Equity	21,759	26,463	40,244	48,058	57,931
Minority Interests	418	419	463	558	799
Total Cap. & Liab.	63,024	68,501	85,474	93,494	102,764
Non-Cash Wkg. Capital	13,878	12,540	15,204	11,941	13,083
Net Cash/(Debt)	(17,602)	(14,342)	(12,104)	(2,047)	6,083
Debtors Turn (avg days)	4.1	3.6	3.4	3.8	4.0
Creditors Turn (avg days)	16.0	13.5	12.4	13.9	15.6
Inventory Turn (avg days)	34.3	26.0	24.0	19.8	14.9
Asset Turnover (x)	2.1	2.3	2.3	2.2	2.4
Current Ratio (x)	1.2	1.2	1.4	1.7	2.0
Quick Ratio (x)	0.3	0.4	0.5	0.8	1.0
Net Debt/Equity (X)	0.8	0.5	0.3	0.0	CASH
Net Debt/Equity ex MI (X)	0.8	0.5	0.3	0.0	CASH
Capex to Debt (%)	10.5	13.4	18.7	14.2	16.6
Z-Score (X)	4.3	4.3	4.3	4.3	4.3

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	6,327	7,679	11,504	12,767	16,452
Dep. & Amort.	1,738	1,940	2,374	2,492	2,766
Tax Paid	(1,808)	(1,745)	(2,443)	(2,448)	(3,192)
Assoc. & JV Inc/(loss)	1	(2)	(6)	(7)	(8)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	204	322	(1,468)	3,419	(1,492)
Other Operating CF	1,337	1,131	912	1,103	1,034
Net Operating CF	7,799	9,324	10,872	17,326	15,560
Capital Exp.(net)	(2,668)	(3,232)	(4,507)	(3,000)	(3,000)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	(356)	(1,528)	(5,463)	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(115)	1,526	554	(1,317)	(1,284)
Net Investing CF	(3,139)	(3,234)	(9,417)	(4,317)	(4,284)
Div Paid	(1,182)	(991)	(1,215)	(1,666)	(1,896)
Chg in Gross Debt	(1,782)	(1,315)	1,068	(3,000)	(3,000)
Capital Issues	0	0	2,498	0	0
Other Financing CF	(1,748)	(1,658)	(1,050)	(1,287)	(1,250)
Net Financing CF	(4,711)	(3,964)	1,301	(5,952)	(6,146)
Currency Adjustments	10	(17)	(17)	0	0
Chg in Cash	(41)	2,109	2,740	7,057	5,130
Opg CFPS (RMB)	3.34	3.96	5.27	5.77	7.07
Free CFPS (RMB)	2.26	2.68	2.72	5.94	5.21

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	19-Jan-22	HK\$61.10	HK\$86.00	Buy
2:	18-Mar-22	HK\$51.65	HK\$78.00	Buy

Source: DBS HK

Analyst: Rachel Miu

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Dissemination Date: 31 Aug 2022 19:00:41 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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