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Buy

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Company
**Zhengtong Auto
Services Alert**

Reuters 1728.HK Bloomberg 1728 HK Exchange HKG Ticker 1728

Date
31 March 2015

Results

| | |
|----------------------------|-------------|
| Price at 30 Mar 2015 (HKD) | 3.75 |
| Price target - 12mth (HKD) | 5.30 |
| 52-week range (HKD) | 4.81 - 3.32 |
| HANG SENG INDEX | 24,486 |

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FY14 net profit missed on new car profitability

4% YoY FY14 earnings decline on weaker new car revenue and margin

Zhengtong's FY14 net profit declined by 4.0% YoY to RMB803.8m, 16% below our expectation and 15% below Bloomberg consensus. Total revenue grew 3.6% YoY to RMB30.9bn, largely in line with our expectation, on 9.8% new car sales volume growth and 14.3% YoY growth in after-sales revenue. New car revenue of RMB27.1bn was 5% below our expectation, while after-sales services recorded RMB3.2bn in revenue, in-line with our expectation.

Zhengtong's blended gross profit margin remained stable in FY14 at 8.8% on 50bps decrease in new car margin (lower ASP due to competition in luxury and ultra-luxury auto market in China) and offset by 2.1ppt increase in after-sales margin (improved operating efficiency and service quality). After-sales contributed 55% of total gross profit in FY14, as compared to 49% in FY13. However, after accounting for 1) 34.8% YoY growth in other income mainly driven by commission income, 2) 24.2% higher SG&A cost and 3) 2.3% YoY decline in finance cost, Zhengtong's net profit margin deteriorated by 21bps YoY to 2.6% in FY14.

Earnings forecast under review; analyst briefing on 31 March

Given the weaker-than-expected FY14 results, our FY15-16E earnings estimates appear to be optimistic. Zhengtong will host an analyst briefing on 31 March and we will seek more colors in the FY14 results and FY15E outlook.

Figure 1: Zhengtong – FY14 results summary

| RMBm | FY14 | FY13 | YoY | 2H14 | 1H14 | HoH |
|-----------------------------|-----------------|-----------------|--------------|-----------------|-----------------|---------------|
| Total revenue | 30,910.1 | 29,840.3 | 3.6% | 15,300.8 | 15,609.3 | -2.0% |
| New car sales revenue | 27,130.1 | 26,594.6 | 2.0% | 13,352.1 | 13,778.0 | -3.1% |
| After-sales revenue | 3,179.7 | 2,782.8 | 14.3% | 1,637.7 | 1,542.0 | 6.2% |
| Logistics and lubricant oil | 600.3 | 462.8 | 29.7% | 311.0 | 289.3 | 7.5% |
| Gross profit | 2,725.6 | 2,588.4 | 5.3% | 1,258.9 | 1,466.7 | -14.2% |
| Gross profit margin | 8.8% | 8.7% | | 8.2% | 9.4% | |
| Other income | 491.9 | 364.9 | 34.8% | 239.8 | 252.1 | -4.9% |
| SG&A (excl. Dep and Amort) | (1,588.3) | (1,279.2) | 24.2% | (810.7) | (777.6) | 4.3% |
| EBIT | 1,629.1 | 1,674.0 | -2.7% | 687.9 | 941.2 | -26.9% |
| EBIT margin | 5.3% | 5.6% | | 4.5% | 6.0% | |
| Net finance cost | (478.1) | (489.3) | -2.3% | (252.1) | (226.0) | 11.5% |
| Net profit | 803.8 | 837.4 | -4.0% | 304.5 | 499.3 | -39.0% |
| Net profit margin | 2.6% | 2.8% | | 2.0% | 3.2% | |

Source: Company data

Stock data

| | |
|-------------------------------|---------------------|
| Market cap (HKDm) | 8,287 |
| Market cap (USDm) | 1,069 |
| Shares outstanding (m) | 2,210.0 |
| Major shareholders | Joy Capital (62.1%) |
| Free float (%) | 38 |
| Avg daily value traded (USDm) | 1.3 |

Source: Deutsche Bank

Key data

| FYE 12/31 | 2013A | 2014E | 2015E |
|-------------------|--------|--------|---------|
| Sales (CNYm) | 29,840 | 32,478 | 36,436 |
| Net Profit (CNYm) | 837.4 | 958.6 | 1,173.4 |
| DB EPS (CNY) | 0.38 | 0.43 | 0.53 |
| PER (x) | 10.7 | 6.9 | 5.7 |
| Yield (net) (%) | 1.9 | 2.9 | 3.5 |

Source: Deutsche Bank

Zhengtong - gross profit breakdown

| | FY12 | FY13 | FY14 |
|---------------|-------|-------|-------|
| New car sales | 54.5% | 48.8% | 41.8% |
| After-sales | 42.6% | 48.7% | 55.3% |
| Others | 2.9% | 2.5% | 2.9% |

Source: Company data

Deutsche Bank AG/Hong Kong

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