China Meidong Auto (1268 HK)

Best positioned amid industry consolidation

Initiate with BUY. We initiate coverage of China Meidong Auto with a BUY rating and a target price of HK$ 48.00, based on 20x FY23E P/E. Despite possible shrinking dealership market size, we believe such business is still justified. We are of the view that Meidong is best positioned to outrun its peers amid more challenging industry landscape with its superb operational efficiency. The company culture, as a fundamental differentiator, is almost impossible to mimic.

- **Industry margin dent has been priced in.** The overall outlook for dealership of Porsche, BMW and Lexus in 2022 still looks positive, based on our channel checks. As investors have lowered new-car gross margin estimates for dealers in 2022, we are of the view that margins for dealers may exceed expectation, since supply chain challenges are still lingering, which supports dealers' new-car margins.
- **Meidong's management execution potential could still be undervalued.** After its unique high inventory turnover approach, Meidong now has showcased its capabilities in M&As. We expect the acquired Porsche stores from StarChase (14x FY21E P/E) to contribute about RMB 350mn during 2Q-4Q22 and we project Meidong to double net margin of these stores in FY23 versus that in FY21. We believe Meidong's customer return ratio (CRR) program is a replica of inventory turnover and its positive impact on long-term profit growth could be larger than what investors currently expect.
- **FY21E earnings preview.** We project Meidong's FY21E net profit to rise 58% YoY to RMB 1.18bn, slightly lower than consensus, largely due to chip shortage. We forecast its net profit to surge 65% YoY to RMB 1.95bn in FY22E, aided by the StarChase acquisition.
- **Valuation/Key risks.** Our target price is based on 20x our FY23E P/E, as we believe FY23E could better reflect the contribution from the StarChase acquisition. Our valuation is in line with forward 12-month P/E in the past 12 months. We believe that Meidong's higher-than-peer valuation is still justified given its higher earnings growth. Key risks to our rating and target price include lower sales and/or margins, slower store expansion than our expectation, as well as a sector de-rating.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	16,210	20,207	23,944	35,367	44,984
YoY growth (%)	45.2	30.7	36.0	57.0	25.6
Net income (RMB mn)	551	751	1,183	1,949	2,525
EPS (RMB)	0.47	0.61	0.94	1.53	1.95
YoY growth (%)	51.8	36.3	57.6	64.7	29.6
P/E (x)	64.4	46.5	29.5	18.9	14.6
P/B (x)	20.8	11.2	8.8	6.2	4.7
Yield (%)	5.3	2.1	1.2	3.0	3.8
ROE (%)	35.6	30.4	32.8	39.2	36.8
Net gearing (%)	Net cash	Net cash	Net cash	14.5	Net cash

Source: Company data, Bloomberg, CMBIGM estimates. Note: Market data as of 4 Mar 2022.

BUY (Initiation)

Target Price	**HK$ 48.00**
Up/Downside	**+39.7%**
Current Price	**HK$ 34.35**

China Auto Sector

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Stock Data

Mkt Cap (HK$ mn)	43,637
Avg 3 mths t/o (HK$ mn)	112
52w High/Low (HK$)	48.40/28.20
Total Issued Shares (mn)	1,270

Source: Bloomberg

Shareholding Structure

Apex Sail Limited	55.3%
Others	44.7%

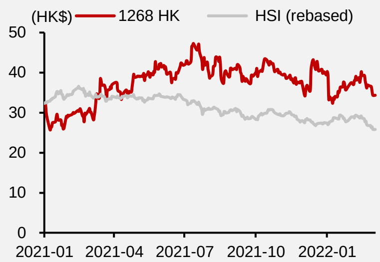
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-8.4%	2.5%
3-mth	-2.6%	6.1%
6-mth	-16.1%	0.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

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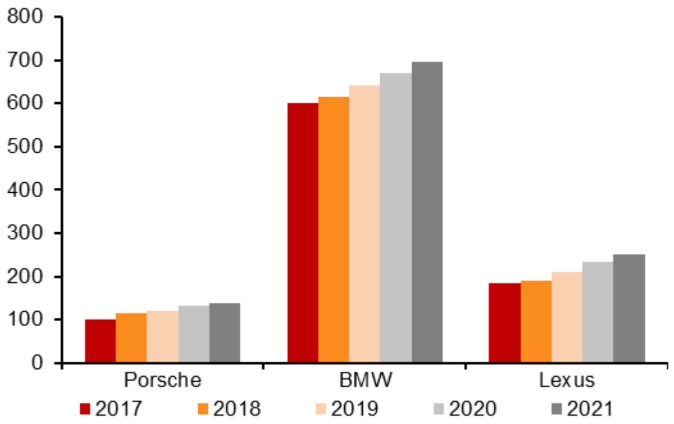
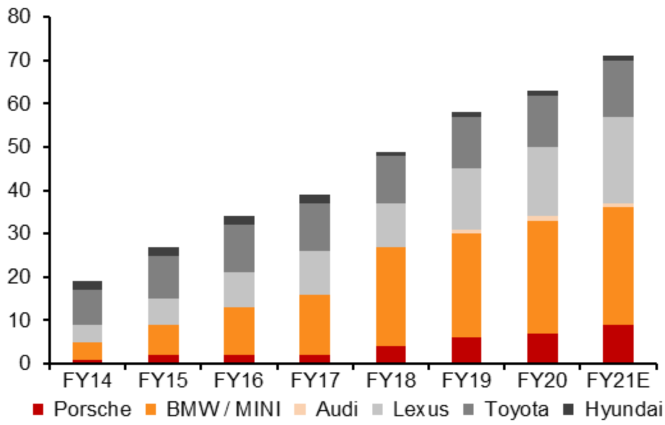
Figure 1: Number of authorized stores for Porsche, BMW and Lexus in China



Source: Company data, CMBIGM

Figure 2: Meidong's store number growth during FY14–21 by brand



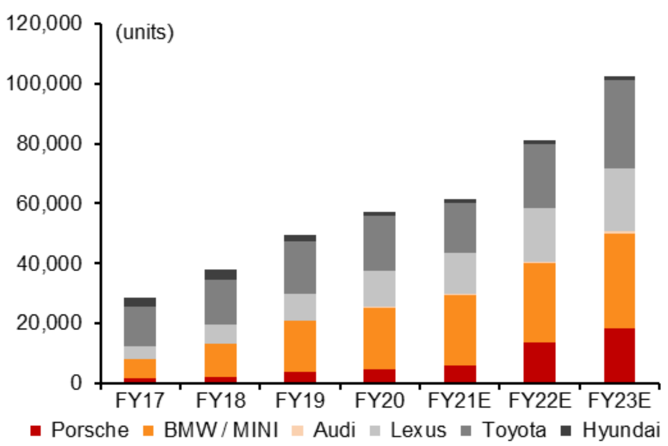
Source: Company data, CMBIGM estimates

Figure 3: Details about acquired Porsche stores (StarChase)

City	4S store	Showroom	Service center	Store age (years)	Number of 4S stores (incl. showroom) in the city	Owners of other stores
Chongqing	1	1		5.5 / 2.3	4	Chongqing General Trading (Group)
Nanjing	1	1		14.2 / 8.8	3	Jebsen
Qingdao	1	1	1	12.4 / 11.4	2	N/A
Tianjin	1		1	5.5	2	Betterlife
Weifang	1			7.8	1	N/A
Zhengzhou	1		1	13.5	2	Henan Dong An Group
Xinxiang		1		4.1	1	N/A
Jinan	1			9.5	2	Meidong
Total	**7**	**4**	**3**			

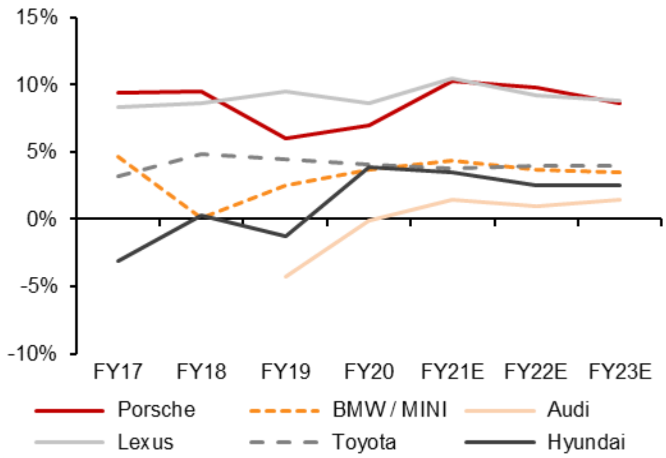
Source: Company data, CMBIGM

Figure 4: Meidong's new-car sales volume forecast by brand



Source: Company data, CMBIGM estimates

Figure 5: Meidong's new-car gross margin forecast by brand



Source: Company data, CMBIGM estimates

Industry Overview

2022 outlook for each brand

We have conducted channel checks for Porsche, BMW and Lexus. The overall outlook for these three brands in 2022, in our view, is still quite positive.

- **Porsche: We expect higher sales volume and slightly lower GPM in 2022**

Porsche targets a sales-volume growth of 20% YoY to about 115,000 units in China in 2022, should the supply chain be sufficient. Despite its aggressive sales target, the majority of the sales growth should come from new 4S stores, given there were a number of large stores opened in 2021 (in Shenzhen, Chengdu, Nanjing and Guangzhou). Therefore, we believe Meidong's new Porsche store in Guangzhou, along with the store acquisitions from StarChase, would be the key contributor to Meidong's revenue and profit growth. The sales target that Porsche sets for Meidong in 2022 is still lower than what Meidong is able to sell, based on the estimates from Meidong's director for the Porsche brand.

Despite the new-generation *Macan*'s launch, we are of the view that it would not be a key driver for Porsche's sales in 2022. Instead, the *Panamera* has become more and more important for Porsche and could account for 20% of Porsche's total sales in China in 2022.

After a strong gross-margin year in 2021 amid supply constraints, we expect Porsche's new-car gross margin to narrow slightly in 2022. We still project strong gross margin in 1H22 given Porsche's accelerating deliveries may only start in 2Q22. It also appears to us that shipments to dealers for most luxury brands could still be volatile in 2022 given the lingering chip shortage, which would be a double-edged sword to dealers. **Dealers' reaction to market changes and execution would be crucial again in 2022, in our view**.

Porsche may slow down sales of the *Taycan* battery-electric vehicle (BEV) in 2022, after selling more than 7,000 units in 2021, which could lift its gross margins at dealers. Porsche also plans to roll out the BEV version of the redesigned *Macan* in 4Q22 or early 2023.

- **BMW: We expect lower but reasonable GPM in 2022 despite the *X5* localization**

BMW targets 10% YoY growth for its retail sales volume in China in 2022, although the supply chain visibility is still quite low. Despite BMW's better supply chain management than its peers last year, our channel checks show that the supply visibility is probably less than two months now.

BMW dealers probably experienced the best half-year in 2H21 since 2007, which has made BMW cut 1 ppt from its rebates to dealers since 1Q22. In our view, **it is reasonable to assume BMW's new-car gross margin to narrow by 1 ppt in 1H22 versus 2H21.**

The locally-produced *X5* will arrive at dealers' showroom in April 2022. BMW dealers expect the retail price of the locally-produced *X5* to be cut slightly compared with the current imported version, with its long wheelbase and probably more functionalities. We are positive about the demand for the new *X5* and therefore, project similar new-car gross profit from the *X5* with slightly narrowed gross margin but higher sales volume in 2022.

Unlike the Porsche *Taycan*, the BMW *iX3* BEV has about RMB 30,000–40,000 gross loss per vehicle at dealers now, which may not change in 2022.

- **Lexus: Aggressive sales target reflects solid demand**

Lexus targets a sales-volume growth of 20% YoY to about 265,000 units in China in 2022, partially because of a sales decline in 2021 caused by chip shortage. Lexus has assigned more than 20,000 units to its new 4S stores in 2022, leaving each existing store with an even lower annual sales-volume target than that in 2020. Based on our channel checks, chip shortage continues to weigh on Lexus's production, as it lowered February order targets for its dealers.

The new-generation *NX* has been well received, based on our channel checks. As the 3rd largest sales-volume model at Lexus in China after the *ES* and *RX*, the *NX* sales volume has been stagnant since 2019 (about 37,000–40,000 units per year). Our concern is more about the supply side given the current large orders backlog. That also lifts dealers' new-car sales margin: Dealers now charge additional premium of about RMB25,000 for the new *NX* PHEV and RMB10,000 for its ICE version.

As noted on page 38 of our report titled '*Survival of the fittest: Pioneers in the NEV era*' on 13 January 2022, despite Toyota's announcement of a dramatic scale-up of its BEV plans, its electrification still looks slow in 2022. In 2021, non-plug-in hybrid vehicles (HEVs) accounted for 38% of Lexus' total retail sales volume in China and plug-in new-energy vehicles (NEVs) only accounted for 1%. Lexus only targets 40% market share for HEV, BEV and PHEV combined in 2022.

After an extraordinary year for Lexus dealers' new-car gross margin, it is reasonable to assume a slightly lower gross margin in 2022, should Lexus be able to deliver its sales target, in our view. Lexus dealers now also prefer higher sales volume to enlarge its after-sales client base.

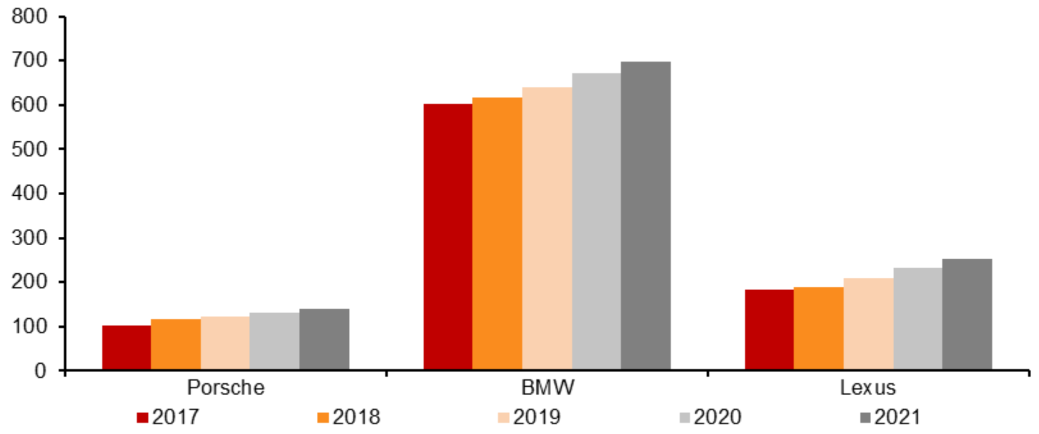
- **Toyota: Likely a strong year ahead**

FAW Toyota and GAC Toyota target sales volumes of 1.1mn and 1mn units in 2022, respectively, aided by a plethora of new models from their new plants. Based on our channel checks, new orders after Chinese New Year rose at a faster pace than last year. We are of the view that Toyota dealers' new-car gross margin should remain stable in 2022 with new models.

Dealership expansion slows but such business model still valid

Dealer network expansions for Porsche, BMW and Lexus have been stable for the past few years, as all three brands have been outperforming most of its peers. BMW, along with Mercedes-Benz and Audi, has about 700 4S stores, showrooms and service centers in China now, or about 1,000-1,200 units of annual sales volume per store on average nationwide. Lexus has maintained a growth of around 20 stores per year since 2019 to keep its average per-store annual sales volume of about 900-1,000 units. Porsche opened less than 10 stores each year in the past four years, with an average store sales volume of 670-720 units per year.

Figure 6: Number of authorized stores (incl. showrooms and service centers) for Porsche, BMW and Lexus in China



Source: Company data, CMBIGM

We expect China's overall authorized dealer network to expand at a slower pace than before, including brands like BMW, Toyota, Lexus and Porsche, for two reasons.

1) Auto sales growth in China has been slowing down, especially for internal-combustion engine (ICE) vehicles.

2) Automakers may attempt direct-sales model to sell at least part of their cars to customers, especially for NEVs.

We have not seen signals for direct-sales attempts from brands like BMW, Lexus and Toyota (Porsche has a few self-operating 4S stores for a long time in China), although we cannot rule out such possibilities. Despite that, we are still of the view that the auto dealer business will exist in the medium to long term for the following reasons.

1) The main purpose of direct-sales model is to react to customers' needs faster

In our view, the main purpose for automakers to adopt a direct-sales model is to know customers' needs faster and better, as software-defined vehicles make upgrades more flexible. However, it does not mean that automakers have to implement a 100% direct-sales model, especially in regions with lower investment return. Instead, automakers could open self-operating flagship stores in big cities that could serve as leading indicators for other lower-tier cities and meanwhile realign authorized dealers' KPI to enhance timely feedback and customer services. Xpeng (XPEV US, BUY) uses such hybrid sales channels.

2) Easy-to-manage supply chain, low SKUs better fit direct-sales model

Investors see the similarity between smart phones and NEVs in terms of software importance, and therefore, infer that NEV makers could also adopt direct-sales business model. We acknowledge such analogy, but we are of the view that it could still be a bit different. As noted on page 39 of our report titled '*Survival of the fittest: Pioneers in the NEV era*' on 13 January 2022, if we had to quantify the importance of software for future cars, we would probably put 50:50 for the software/hardware ratio in terms of consumers' perceived value. Higher hardware ratio for cars than smart phones probably means higher stock-keeping units (SKUs) and higher inventory burden for automakers. Despite higher level of components integration for NEVs, the supply chain for cars is way more complex than smart phones. Volatile customer demand for cars by nature would create huge difficulty for automakers to manage their supply chain and therefore, dealers are the cushions for automakers during unexpected events. We are of the view that the current auto supply chain is not flexible enough for all automakers to face volatile demand.

On the other hand, we think that the market size for dealers would probably shrink amid the electrification. In this case, M&As become more important for dealers' growth. We are of the view that the dealership market size shrink would have little impact on Meidong given dealers' extremely fragmented landscape. There are about 40,000 authorized 4S stores and showrooms in China and about 4,000 for luxury brands. Meidong only had about 71 stores with six brands as of the end of 2021.

M&A becomes more crucial; we see more M&A opportunities ahead

Despite our views on the dealership business justification, we do think that the market size for dealers would probably shrink amid the electrification. In this case, we see two trends for dealership business ahead.

1) M&As become more important for dealers' growth. On the other hand, we also see more M&A opportunities amid stiffer competition, based on our channel checks. Dealers with higher valuations and higher operational efficiency would be more advantageous in acquiring other dealers.

2) Management execution would be even more important for dealers now than before in order to outrun peers amid a potentially shrinking and consolidating industry.

We are of the view that **Meidong would probably benefit the most among peers from the above two possible trends**.

Company Overview

We still see potential for management execution

We have been emphasizing the importance of management execution for dealers since 2018 when most investors still put brand mix and model cycle as key drivers for dealers. **We are of the view that even today, Meidong's management execution potential is still undervalued**, because such capabilities are difficult to quantify and predict. We are not going to spend a lot of time writing abstract concepts about management, but we will list what Meidong has done recently and what it is doing, as such data and facts are more or less self-explanatory, in our view. We believe the company is well positioned to outrun its peers amid more challenging environment with its superb operational efficiency.

Some investors are concerned whether Meidong's initiatives could be mimicked by other dealers as it looks like they are all selling same-brand cars. In our view, the fundamental differentiator is the company culture, which is difficult or even impossible to mimic. Consistency, focus and attention to details are key words that we perceive from many managers at Meidong after following the company for many years.

Acquisition of StarChase

The recent acquisition of StarChase with a consideration of RMB 3.7bn for Porsche stores (seven 4S stores, four showrooms and three service centers) underscores Meidong's M&A strategies: familiar brands, reasonable price (about 14x FY21E P/E) and efficiency gap. After the acquisition, Meidong would probably account for 15% of Porsche's total sales volume in China.

We are very positive about this long-awaited acquisition, and we expect Meidong to at least double the acquired stores' net margin within two years. **We project the Porsche stores from the StarChase acquisition to contribute about RMB 350mn in FY22, assuming the consolidation starts at the beginning of 2Q22.**

1) We estimate Meidong's Porsche net margin to more than double StarChase's
Net margins at StarChase were about 3.3% in 2020 and 4.2% in the first three quarters of 2021, respectively. We estimate that Porsche's net margin (excl. headquarters costs) at Meidong could be about 7-8% in FY20 and 8.5-9% in FY21. Given that the average store age of StarChase (nine years) is six years older than Meidong's Porsche stores' (three years), we believe Meidong could lift net margin of StarChase's stores to a similar level as its current Porsche stores'.

2) Turnaround should not take a long time
Based on our checks, the key reason for StarChase's relatively low margins could be wrong incentive schemes that demotivated staff and limited their creativity. Therefore, we believe it should not take much time for Meidong's management to enhance efficiency.

3) Competition in these cities is not intensified
Most acquired stores are either the only Porsche store(s) in corresponding cities (one in Weifang and two in Qingdao) or located in wealthy regions. After acquiring the StarChase Porsche store in Jinan, both Porsche stores in Jinan will be operated by Meidong. Meidong will also take up half of the Porsche stores in Chongqing, Tianjin and Zhengzhou. Two out of the total three Porsche stores in Nanjing will also be operated by Meidong. After analyzing Meidong's competitors in these cities, we are of the view that Meidong is probably better positioned in most cities, including Guangzhou where Meidong just opened a large new Porsche store in 2021.

4) Porsche is a defensive brand amid electrification

Despite the rising competition from NEV start-ups, we believe Porsche is more defensive than most luxury brands. We expect Porsche's new-car gross margin to remain high at least during 2022-23. Although we are not positive about traditional automakers' tech transformation, we believe Porsche is still better positioned than most brands given its established brand image and Volkswagen's (VOW GR, NR) rich resources.

Figure 7: Details about acquired Porsche stores from StarChase

City	4S store	Showroom	Service center	Store age (years)	Number of 4S stores (incl. showroom) in the city	Owners of other stores
Chongqing	1	1		5.5 / 2.3	4	Chongqing General Trading (Group)
Nanjing	1	1		14.2 / 8.8	3	Jebsen
Qingdao	1	1	1	12.4 / 11.4	2	N/A
Tianjin	1		1	5.5	2	Betterlife
Weifang	1			7.8	1	N/A
Zhengzhou	1		1	13.5	2	Henan Dong An Group
Xinxiang		1		4.1	1	N/A
Jinan	1			9.5	2	Meidong
Total	**7**	**4**	**3**			

Source: Company data, CMBIGM

CRR: A replica of inventory turnover

In 2021, we noted that Meidong's customer return ratio (CRR) program could be a replica of inventory turnover, which could lift Meidong's margins in the long term. Both initiatives seem counter-intuitive: Selling cars as quickly as possible could sacrifice margins and making customers happy about after-sales services could mean lower fees charged. It turns out that lowered inventories have lifted Meidong's margins based on its earnings in the recent years. We are of the view that the payback period for CRR could be longer than that for inventory turnover because CRR is to enhance customer stickiness and increase income from an extended life cycle of a vehicle for dealership. Although it is difficult for us to quantify the long-term benefit from CRR with the current limited information, we believe Meidong's superb operational efficiency could help it succeed in the CRR program.

Although we may not see any financial impact in FY21E from CRR, we still see some positive signals based on our checks with BMW, Porsche and Lexus directors at Meidong. We list a few points below for reference.

1) All three brands saw significantly lower complaint ratios to OEMs.

2) Lexus' customer retention ratio has increased 4 ppts from CRR.

3) The CRR program could help retain female drivers.

4) The CRR program could also facilitate new-car sales. More than 10% of new-car sales in the Foshan Porsche store are from referrals of existing clients.

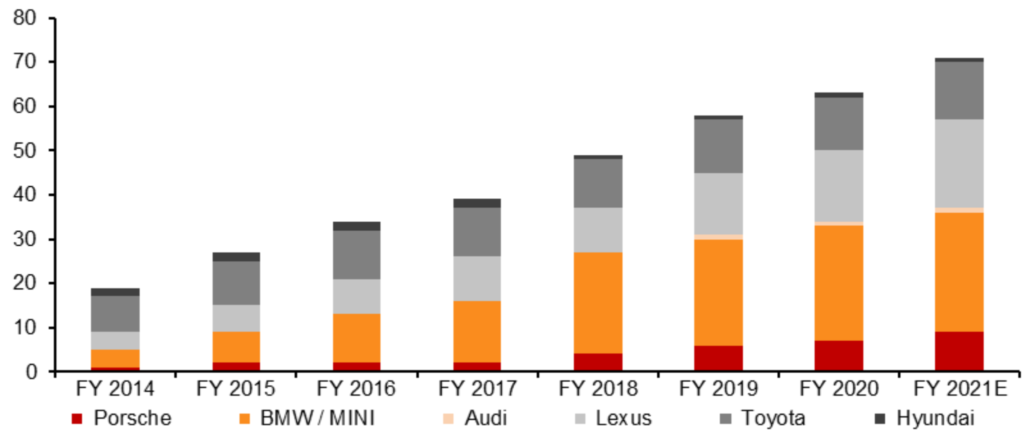
5) BMW acknowledges Meidong's initiatives and has sought reference from Meidong and created a similar position to enhance its customer service.

Store, sales and margin outlook

- **Stores: Brand mix, age profile, 'single city single store'**

There were about 71 stores at Meidong as of 31 Dec 2021, including 27 BMW stores, 20 Lexus stores and 9 Porsche stores. The organic store growth has been slowing down slightly since COVID-19 whereas growth from M&As is accelerating. As noted in the previous paragraph, we expect China's overall authorized dealer network to expand at a slower pace than before but with more M&A opportunities. That makes our forecasts for Meidong's store growth even more difficult. Nevertheless, we project Meidong's store number to rise to 87 and 100 at the end of FY22 and FY23, respectively, based on our best guess.

Figure 8: Meidong's store number growth by brand during FY14–21E



Source: Company data, CMBIGM

Although we are not a big fan of 'single city single store', we list Meidong's stores by city tier below. We are of the view that so-called 'single city single store' approach in lower-tier cities has both its advantage and disadvantage: higher bargaining power but lower number of vehicles for after-sales services. What Meidong has been after is higher investment return. Meidong's culture and IT system have helped it manage such stores in lower-tier cities better than its peers.

Figure 9: Meidong's store by brand, by city tier as of 31 Dec 2021

City tier	Porsche	BMW/MINI	Lexus	Audi	Toyota	Hyundai	Total
Tier 1	1	4	1	0	1	0	**7**
Tier 2	5	2	9	0	7	1	**24**
Tier 3	2	8	7	0	2	0	**19**
Tier 4 and below	1	13	3	1	3	0	**21**
Total	**9**	**27**	**20**	**1**	**13**	**1**	**71**

Source: Company data, CMBIGM estimates

After consolidating the acquired Porsche stores from 2Q22, the number of stores in tier-2 cities will rise further. The number of 'single city single store' is also set to increase as we mentioned earlier that Meidong will be the only Porsche dealer in the cities including Jinan, Qingdao and Weifang.

Based on the data we have compiled, 'single city single store' accounts for about half of Meidong's total stores, including those acquired Porsche stores from StarChase. Note that our data may be different from the company's disclosure because we count these stores as 'single city single store' if there is more than one store in the city and all these stores are operated by Meidong, e.g. two Porsche stores in Jinan and two Lexus stores in Zhuhai.

Figure 10: Meidong's 'single city single store' by brand, including acquired Porsche stores

Brand	'Single city single store' number	City of 'single city single store'
Porsche	9	Shantou, Jieyang, Ganzhou, Jinan, Qingdao, Weifang, Xinxiang
BMW	18	Yangjiang，Jingdezhen，Xinyu，Guang'an，Huanggang，Zhuzhou，Hengyang，Changde，Yueyang，Liuyang，Yongzhou，Chengde，Huaibei，Suuzhou，Chuzhou，Tongling，Chizhou，Huangshan
Lexus	10	Zhuhai，Yangjiang，Qingyuan，Shaoguan，Zhuzhou，Hengyang，Langfang，Lanzhou，Longyan
Audi	1	Heyuan
Toyota	4	Bazhou，Yiyang，Xinyu，Jiujiang

Source: Company data, CMBIGM

As M&As play a more important role in Meidong's store growth, we expect Meidong's average store age to rise faster than before. We estimate Meidong's average store age to be around 5.6 years at the end of FY21 and close to 7 years at the end of FY22E after adding the acquired Porsche stores.

Figure 11: Store age distribution at Meidong

Year End	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Average store age	4.2	4.0	4.1	4.4	4.4	4.6	5.2	5.8
Store age breakdown								
Less than 1 year	16%	22%	21%	13%	12%	16%	8%	7%
1 - 3 years	16%	22%	26%	33%	35%	21%	24%	21%
3 - 5 years	26%	15%	12%	15%	20%	31%	27%	17%
5 years and above	42%	41%	41%	38%	33%	33%	41%	55%

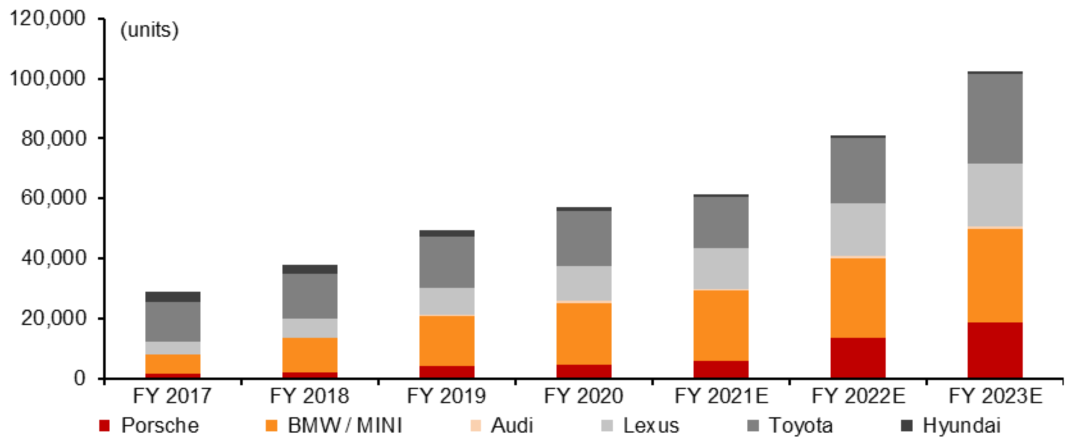
Source: Company data, CMBIGM estimates

Higher store age usually means more vehicles and higher margins for after-sales services. Everything else being equal, we calculate that a dealer's overall before-tax margin is to widen by about 0.4 ppt when revenue contribution from after-sales services increases by 1 ppt. After-sales services could account for about 20% of total revenue for a mature 4S store, whereas after-sales services only took up 11% of Meidong's total revenue in FY20 when the average store age was about 5 years.

■ New-car sales: Porsche plays a key role in revenue and margins

We project Meidong's new-car sales volume to rise 7% YoY in FY21E amid chip shortage, 32% YoY in FY22E driven by Porsche and 26% YoY with supply chain recovery. Accordingly, we expect new-car revenue to rise 19% YoY, 48% YoY and 27% YoY during FY21-23E, respectively, as higher portion of Porsche sales also lifts average selling price (ASP).

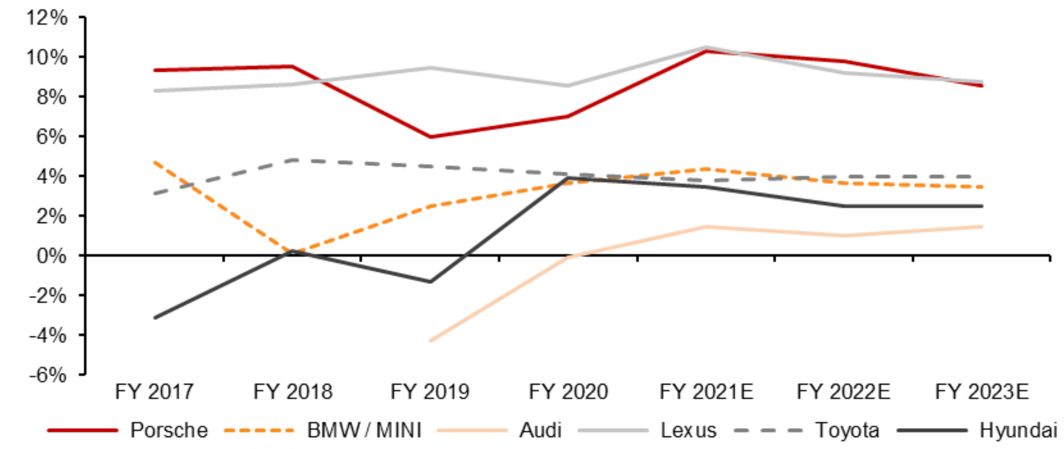
Figure 12: Meidong's new-car sales volume forecast by brand



Source: Company data, CMBIGM estimates

The overall new-car gross margin at Meidong has been rising since FY18, aided by BMW and Lexus. We expect new-car gross margin to widen to all-time high of 7.2% in FY21E amid chip shortage. Although we forecast new-car gross margins for Porsche, BMW and Lexus to narrow slightly in FY22E, we still project a similar overall new-car gross margin at Meidong in FY22E as FY21E, because of higher sales-volume contribution from Porsche.

Figure 13: Meidong's new-car gross margin forecast by brand



Source: Company data, CMBIGM estimates

■ **After-sales service as a larger contributor to revenue and margins**

We expect after-sales services to account for about 12%, 13% and 14% of total revenue at Meidong during FY21-23E, respectively, amid higher average store age and positive impact from CRR. We also forecast after-sales gross margin to be about 45.1-46.5% during FY21-23E, as rising average store age also lifts after-sales gross margin.

Earnings Preview

2H21 earnings preview: Chip shortage limits top-line growth

We project Meidong's FY21E net profit to rise 58% YoY to RMB 1.18bn, based on our assumptions for new-car sales, after-sales services and margins listed in the previous paragraphs. We expect 2H21 revenue to only rise 3% YoY, the lowest growth since its IPO, capped by new-car deliveries with chip shortage. On the other hand, we estimate net margin in 2H21 to be around 5.3%, the highest since its IPO.

Earnings outlook: FY22-23E net profit 10-12% above consensus

We project Meidong's net profit to surge 65% YoY to RMB 1.95bn in FY22E, based on our assumptions listed above. We estimate that Meidong could lift net profit of the acquired Porsche stores from StarChase by more than 60% YoY in FY22E. Therefore, we expect these stores to contribute FY22E net profit by about RMB 350mn. We believe that it is possible for Meidong to double net profit of these stores in two years.

We believe consensus has not fully factored in the contribution from the StarChase acquisition. Our FY22-23E net profit is therefore 10-12% above consensus.

Figure 14: CMBI estimates vs consensus

	CMBI			Consensus			Diff (%)		
RMB mn	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	23,944	35,367	44,984	25,823	36,419	45,237	-7.3%	-2.9%	-0.6%
Gross Profit	2,769	4,347	5,459	2,759	3,930	4,952	0.3%	10.6%	10.3%
Operating Profit	1,765	2,962	3,794	1,711	2,539	3,275	3.1%	16.6%	15.9%
Net profit	1,183	1,949	2,525	1,221	1,734	2,301	-3.1%	12.4%	9.7%
Gross Margin	11.6%	12.3%	12.1%	10.7%	10.8%	10.9%	0.9 ppt	1.5 ppt	1.2 ppt
Operating Margin	7.4%	8.4%	8.4%	6.6%	7.0%	7.2%	0.7 ppt	1.4 ppt	1.2 ppt
Net Margin	4.9%	5.5%	5.6%	4.7%	4.8%	5.1%	0.2 ppt	0.7 ppt	0.5 ppt

Source: Bloomberg, CMBIGM estimates

Valuation

Initiate with BUY; TP of HK$ 48.00 (40% upside)

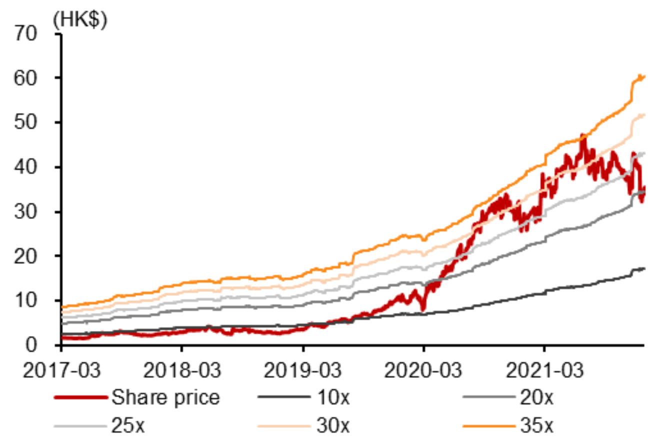
Our target price of HK$ 48.00 is based on 20x our FY23E P/E. We are of the view that the valuation based on FY23E earnings estimates is more appropriate than FY22E as FY23E could better reflect the contribution from the StarChase acquisition. Our target price is equivalent to 25x our FY22E P/E, which is in line with the average forward 12-month P/E of 27x during the past 12 months. In our view, Meidong's forward 12-month P/E falling from the all-time high of about 35x to an average of 27x within a year has already reflected investors' concerns about dealers' valuation amid electrification and margin dent from supply recovery. We believe that Meidong's higher-than-peer valuation is still justified given its higher earnings growth.

Figure 15: Peers' valuation

Company	Ticker	Rating	Mkt Cap (HK$ mn)	Price (LC)	TP (LC)	P/E (x) FY22E	P/E (x) FY23E	P/B (x) FY22E	P/B (x) FY23E	ROE (%) FY22E	ROE (%) FY23E
Meidong	1268 HK	BUY	45,098	34.35	48.00	18.9	14.6	6.2	4.7	39.2	36.8
Zhongsheng	881 HK	NR	149,733	51.75	N/A	12.4	10.1	2.4	2.0	25.1	25.6
Yongda	3669 HK	NR	19,617	8.52	N/A	5.7	5.0	0.9	0.8	19.6	19.9
Grand Automotive	600297 CH	NR	26,578	2.56	N/A	7.6	6.7	0.4	0.4	7.1	7.7
	Average					**11.1**	**9.1**	**2.5**	**2.0**	**22.7**	**22.5**

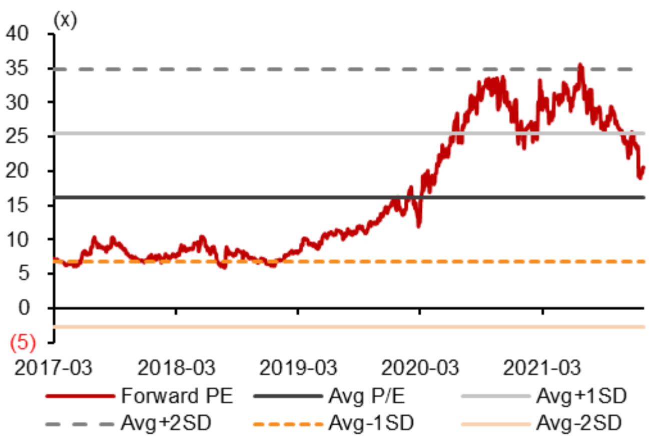
Source: Bloomberg, CMBIGM estimates. Note: Market data as of 4 Mar 2022.

Figure 16: Meidong's forward 12-m P/E band



Source: Company data, Bloomberg, CMBIGM

Figure 17: Meidong's forward 12-m P/E range



Source: Company data, Bloomberg, CMBIGM

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	16,210	20,207	23,944	35,367	44,984
Cost of sales	(14,652)	(18,172)	(21,175)	(31,019)	(39,525)
Gross profit	**1,558**	**2,035**	**2,769**	**4,347**	**5,459**
Other income	154	96	259	324	447
Distribution expenses	(493)	(546)	(703)	(937)	(1,159)
Administrative expenses	(382)	(439)	(560)	(773)	(952)
Operating profit	**837**	**1,146**	**1,765**	**2,962**	**3,794**
Finance costs	(123)	(137)	(149)	(274)	(298)
Share of profits of assos	-	-	-	-	-
Share of profits of JVs	44	43	48	59	62
Profit before tax	**757**	**1,052**	**1,664**	**2,747**	**3,558**
Taxation	(200)	(282)	(441)	(728)	(943)
Minority interests	(7)	(20)	(40)	(70)	(90)
Net profit	**551**	**751**	**1,183**	**1,949**	**2,525**

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Profit before taxation	**757**	**1,052**	**1,664**	**2,747**	**3,558**
Depreciation/amortization	182	229	320	590	829
Change in working capital	77	35	113	(109)	393
Others	(86)	(125)	(415)	(561)	(779)
Net cash from operating	**931**	**1,191**	**1,682**	**2,668**	**4,000**
Capex	(429)	(336)	(681)	(635)	(641)
Others	145	190	(562)	(3,911)	(943)
Net cash from investing	**(283)**	**(145)**	**(1,243)**	**(4,546)**	**(1,584)**
Share issuance	9	1,16	21	669	36
Dividend paid	(175)	(420)	(478)	(715)	(1,241)
Others	(224)	(298)	(440)	1,986	(376)
Net cash from financing	**(390)**	**449**	**(897)**	**1,940**	**(1,580)**
Net change in cash	**257**	**1,494**	**(458)**	**62**	**836**
Cash at beginning of the year	867	1,12	2,53	2,08	2,14
Exchange difference	-	(80)	-	-	-
Cash at the end of the year	**1,124**	**2,538**	**2,080**	**2,142**	**2,977**

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Current assets	**3,785**	**5,110**	**4,892**	**6,276**	**7,825**
Cash and equivalents	1,124	2,538	2,080	2,142	2,977
Accounts receivables	1,159	1,518	1,706	2,519	3,081
Inventories	541	495	406	765	866
Other current assets	962	559	700	850	900
Non-current assets	**2,140**	**2,661**	**4,233**	**8,863**	**10,438**
PP&E	1,035	1,120	1,911	4,687	5,332
Intangibles	65	61	400	1,846	2,293
Interests in JVs and assos	55	56	61	67	73
Other non-current assets	984	1,423	1,861	2,263	2,740
Total assets	**5,925**	**7,770**	**9,125**	**15,13**	**18,26**
Current liabilities	**3,180**	**3,061**	**3,236**	**4,602**	**5,771**
Short-term debt	871	729	500	600	600
Accounts payable	2,132	2,082	2,437	3,654	4,765
Other current liabilities	177	250	299	347	406
Non-current liabilities	**975**	**1,365**	**1,760**	**4,410**	**4,550**
Long-term debt	240	222	212	2,428	2,038
Other non-current liabilities	735	1,143	1,548	1,982	2,512
Total liabilities	**4,156**	**4,426**	**4,996**	**9,012**	**10,321**
Share capital	91	99	100	103	104
Reserves	1,620	3,127	3,891	5,858	7,644
Minority interests	58	118	138	166	193
Shareholders' equity	**1,712**	**3,227**	**3,991**	**5,961**	**7,749**
Total equity and liabilities	**5,925**	**7,770**	**9,125**	**15,139**	**18,263**

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Sales of new vehicles	88.7	88.9	88.4	86.8	86.2
After-sales services	11.3	11.1	11.6	13.2	13.8
Growth (%)					
Revenue	46.5	24.7	18.5	47.7	27.2
Gross profit	45.2	30.7	36.0	57.0	25.6
Operating profit	59.8	36.9	54.0	67.8	28.1
Net profit	51.8	36.3	57.6	64.7	29.6
Profit & loss ratio (%)					
Gross margin	9.6	10.1	11.6	12.3	12.1
Operating margin	5.2	5.7	7.4	8.4	8.4
Net profit margin	3.4	3.7	4.9	5.5	5.6
Balance sheet ratio					
Net cash/total equity (x)	0.0	0.5	0.3	(0.1)	0.0
Current ratio (x)	1.2	1.7	1.5	1.4	1.4
Receivable turnover days	26.1	27.4	26.0	26.0	25.0
Inventory turnover days	13.5	9.9	7.0	9.0	8.0
Payable turnover days	53.1	41.8	42.0	43.0	44.0
Profitability (%)					
ROE	35.6	30.4	32.8	39.2	36.8
ROA	10.9	11.0	14.0	16.1	15.1
Per share data (RMB)					
EPS	0.47	0.61	0.94	1.53	1.95
DPS	0.26	0.39	0.38	0.84	1.07

Source: Company data, CMBIGM estimates

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