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CUBEWEALTH

ZTO EXPRESS EQUITY REPORT

NOVEMBER 30TH, 2020

ZTO EXPRESS

BY THE NUMBERS

TICKER: ZTO
PRICE: \$28.24



ZTO Express Inc. provides express delivery and other value-added logistics services in the People's Republic of China.

The company offers delivery services for e-commerce and traditional merchants, and other express service users. As of Q3 2020, it operated a fleet of approximately 9,250 self-owned trucks.

The company was founded in 2002 and is headquartered in Shanghai, the People's Republic of China.

N/A

**DIVIDEND
YIELD**

+22.2%

**YTD
RETURN**

\$22B

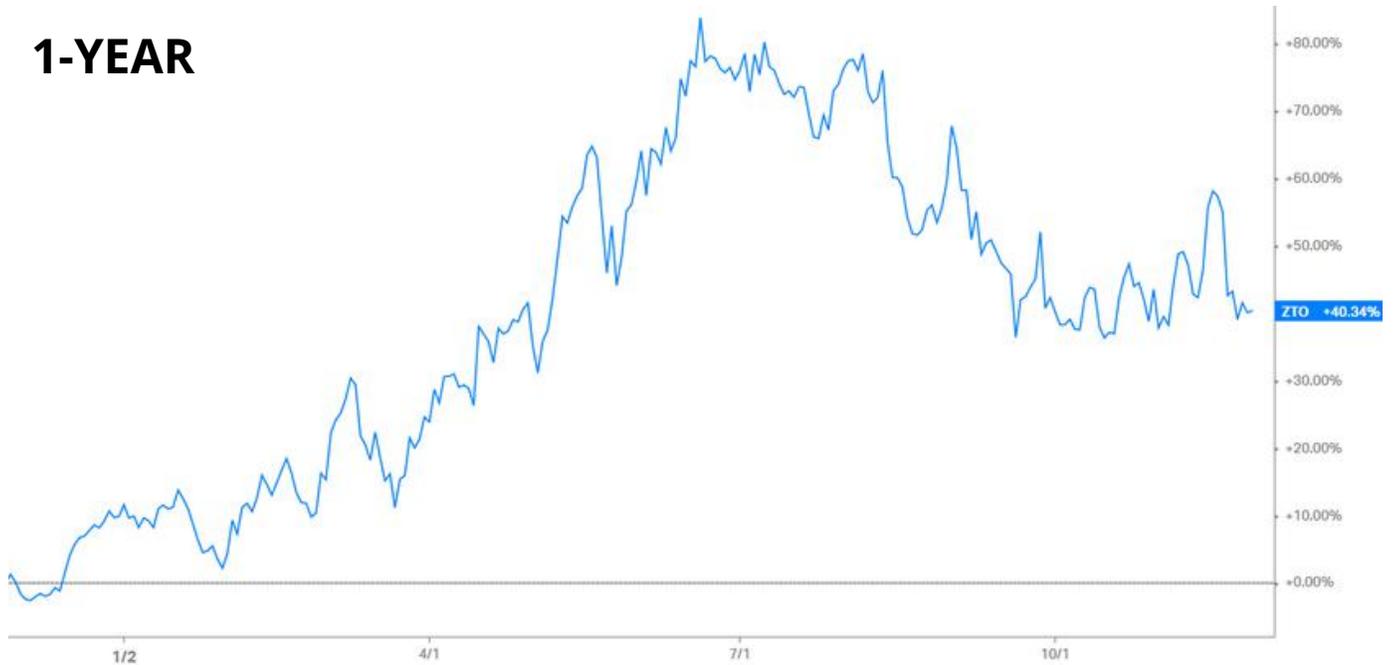
**MARKET
CAP**

ZTO

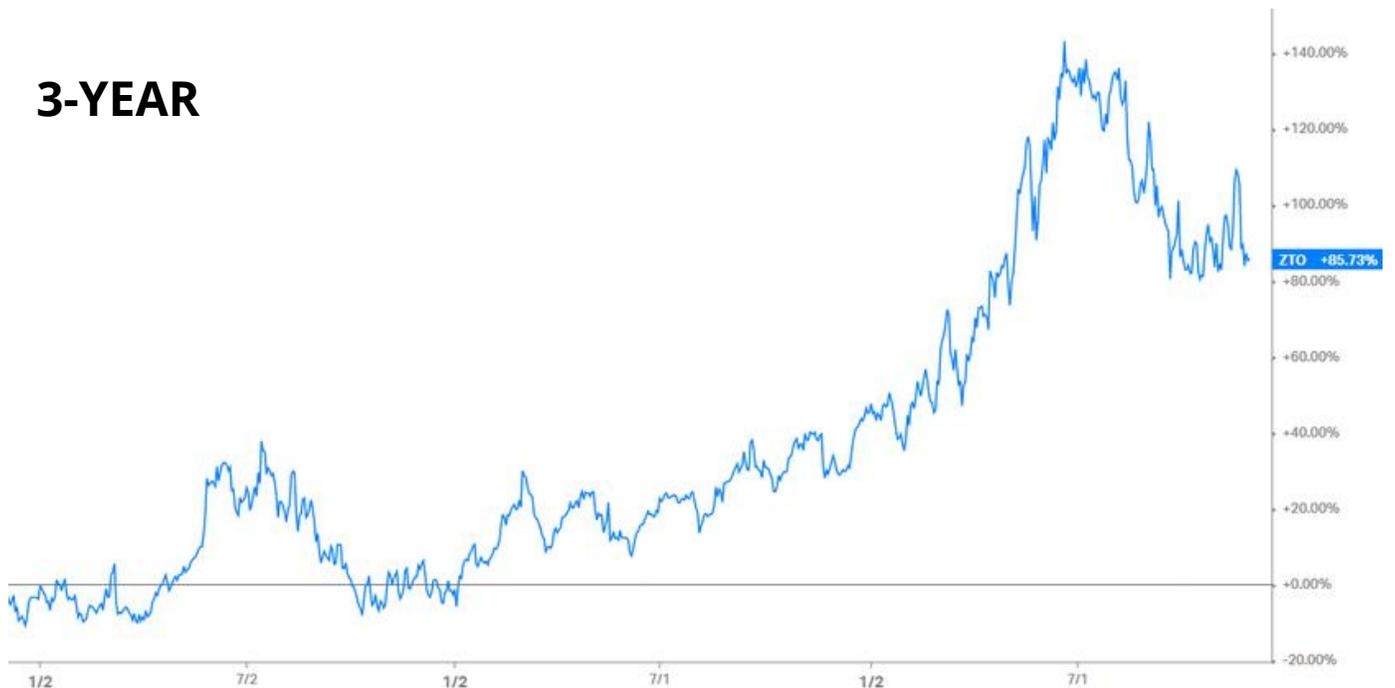


SHARE PRICE PERFORMANCE

1-YEAR



3-YEAR



ANALYSIS

China has three types of companies in its express delivery sector.

1. State-owned enterprises (SOE) express mail service (EMS) under China Postal Express & Logistics
2. Private companies (e.g., SF holding (SF), ZTO Express (ZTO), YTO Express (YTO), STO Express (STO), BEST, and Yunda)
3. Foreign firms (UPS, FedEx, and DHL)

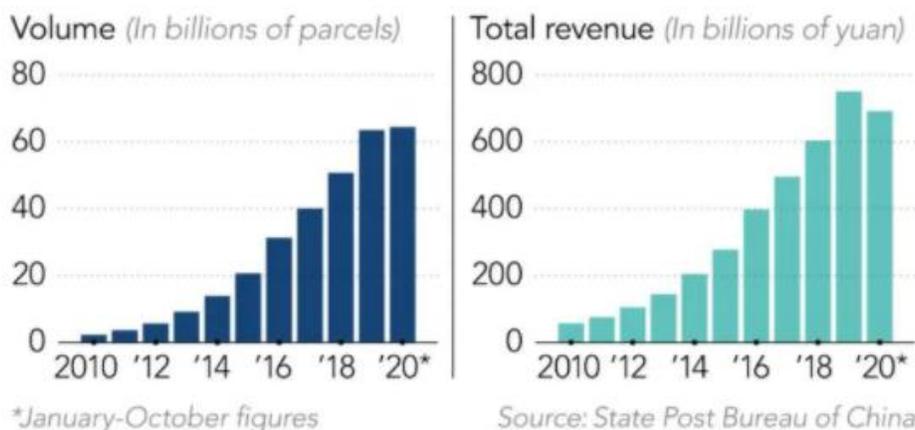
EMS and SF are centrally controlled and their headquarters are in charge of operations and managing branches.

On the other hand, ZTO, YTO, STO, BEST and Yunda operate under a franchise model that makes the franchisees responsible for parcel collection and last-mile delivery, while headquarters manages transportation and sorting.

Demand for courier services has boomed in China this year with a boost from the coronavirus pandemic but this has only heightened a brutal fight for market share. The number of parcels delivered in the country during the first 10 months of the year was 64.38 billion units, an increase of 29.6% from the same period a year earlier, and already exceeding the full-year level of 2019, even after a decade of double-digit growth.

The expansion in volume, however, has not necessarily translated into an increase in revenue. Overall revenue from parcel deliveries for the 10-month period increased 16.5% from a year earlier to 690.98 billion yuan (\$105 billion), still short of the level for all of 2019.

Growth in China's express delivery market



The main culprit: a price war brought on by harsh competition, which has had a bigger impact on some players more than others.

A mixed quarter for Chinese courier companies

	Q3 revenue (In billions of yuan)	Year-on-year percentage change	Q3 net profit (In millions of yuan)	2020 share price change (In percent)
SF Holding	38.46	34.0	1,836.36	113
YTO Express Group	8.83	15.3	415.07	5
Yunda Holding	8.76	0.8	339.01	-29
BEST	8.74	0.6	-3.48	-52
Deppon Logistics	7.33	11.9	141.81	24
ZTO Express	6.63	26.1	1.20	27
STO Express	5.45	-5.7	-65.47	-34

Stock price change as of Nov. 23

Source: Company filings

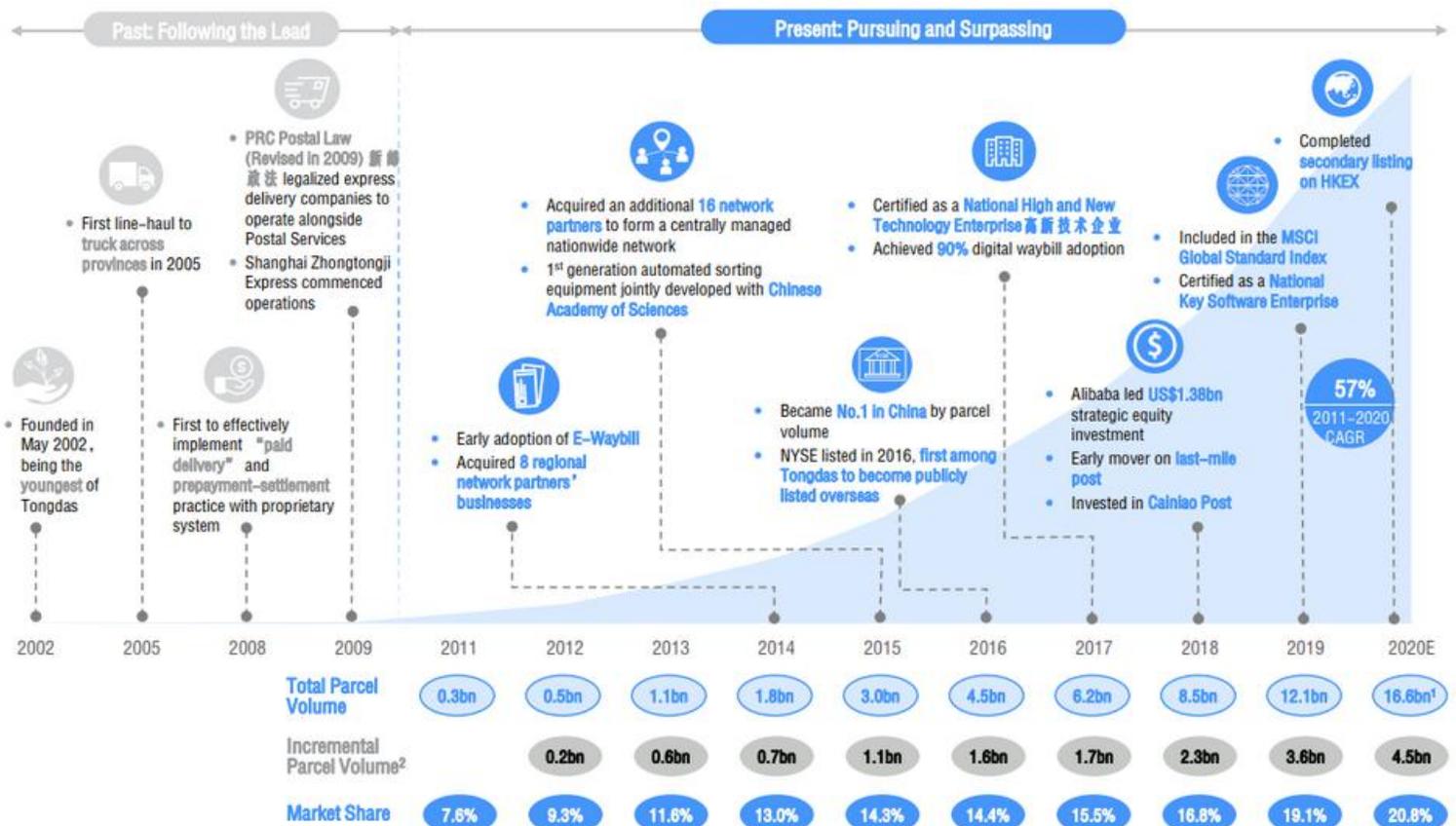
Thomas Chong, an analyst at Jefferies Hong Kong, wrote in a note that "it is becoming more and more difficult for smaller logistics service players to compete with leading giants due to lack of scale and infrastructure, as well as working capital." His two major picks are ZTO Express and SF Holding.

This is a strong point we want to emphasize. China's express delivery market is booming but with a lucrative market comes increased competition and right now we are starting to see who is executing at the highest level and who isn't.

We believe ZTO is, and it shows.

As you saw in the graph above, ZTO is experiencing the second fastest growth out of all of the couriers listed at 26.1% Y/Y.

If we look at the diagram below, ZTO has grown market share from 7.6% in 2011 to 20.8% today. We also see some major milestones achieved, primarily the the fact that they became the number #1 courier in China by parcel volume in 2016 and also saw Alibaba make a \$1.4B investment in them in 2018.

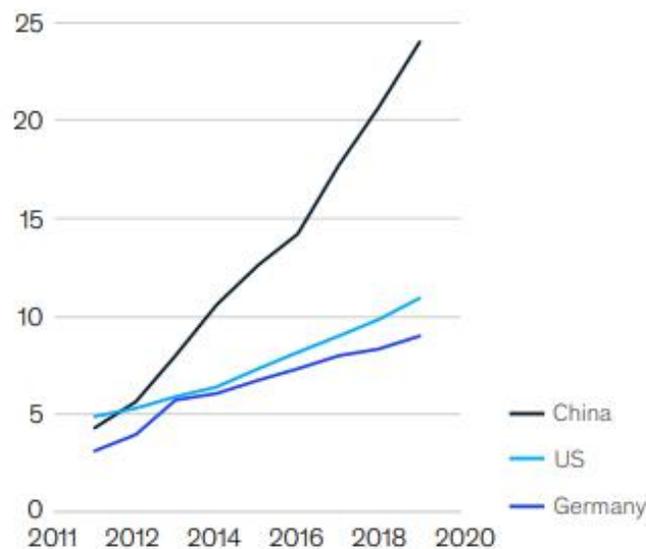


There is a huge tailwind right now in the market that was only further boosted by the COVID19 pandemic.

From January to October, national online retail sales reached 9,127.5B yuan (US\$1,385.7B), an increase of 10.9% Y/Y. The online retail sales of physical goods reached 7,561.9B yuan, an increase of 16.0%, accounting for 24.2% of the total retail sales of social consumer goods; among the online retail sales of physical goods, the sales of food, clothing, and consumer goods increased by 34.3%, 5.6%, and 17.4%, respectively.

China has long been a global leader in the digital economy

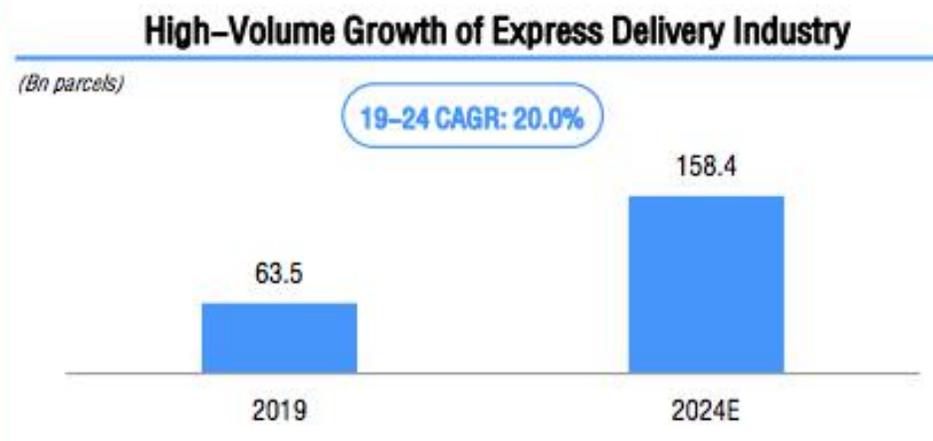
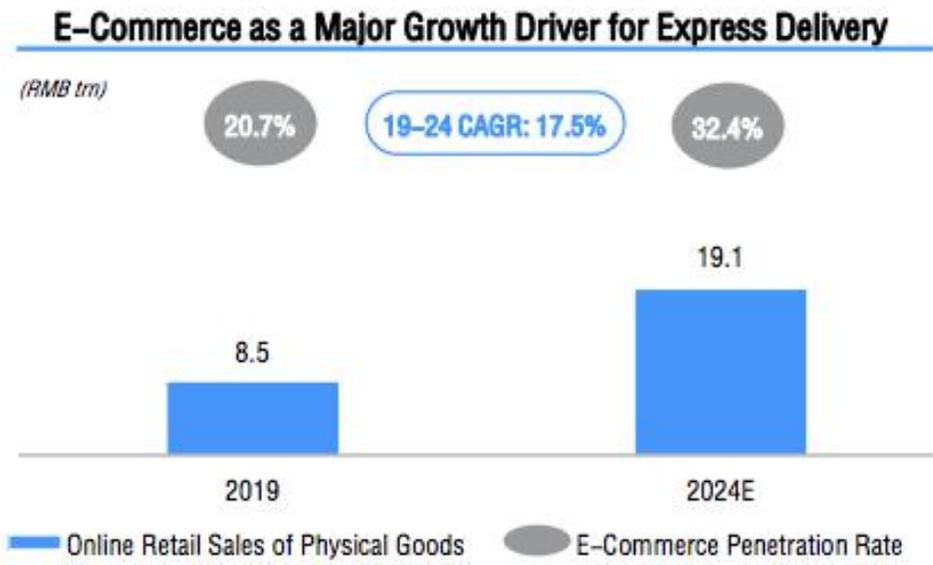
E-commerce as share of total retail value, %



Source: iResearch and MOFCOM for China; eMarketer for other countries; IITEN

China's digital ecosystem is arguably the most sophisticated in the world with more than 940 million internet users and a quarter of the world's startups valued in excess of a billion dollars. Mobile payment penetration is triple that of the United States, while e-commerce accounted for 24% of total retail sales in 2019, compared with 9% in Germany, and 11% in the US. Indeed, China is the world's largest e-commerce market, accounting for about 45% of global retail e-commerce transaction value in 2018.

Analysts believe the market for express delivery will grow at a 17.5% CAGR through 2024 to 19.1T RMB, or roughly \$2.9T USD as e-commerce penetration makes up about 1/3 of all purchases across an expected 158.4B parcel deliveries.



Furthermore, we found a mobile survey done by McKinsey of Chinese consumers conducted before, during, and after the peak of the epidemic in China. It found that about 55% of consumers are likely to continue buying more groceries online after the peak of the crisis. It also found that 74% of Chinese citizens increased their online grocery visit frequency during the pandemic, and 15% reported that they will increase visits after its peak has passed. While this is simply about groceries, we believe this trend will also hold true for other types of goods consumers purchase.

CUBE'S TOP PROS FOR ZTO



GROWING MARKET
SHARE

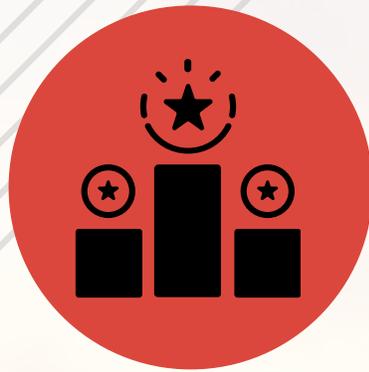


BOOMING MARKET
WITH STRONG
TAILWINDS



SCALING WHILE
INVESTING IN
TECH

CUBE'S TOP CONS FOR ZTO



FIERCE
COMPETITION



PRICING
PRESSURE



ASSET HEAVY
BUSINESS

FINANCIAL STATEMENTS

BALANCE SHEET

	As of		
	December 31,		Sept 30, 2020
	2019	RMB	
	RMB	RMB	US\$
	(In thousands)		
ASSETS			
Current assets:			
Cash and cash equivalents	5,270,204	16,408,906	2,416,771
Restricted cash	7,210	8,070	1,189
Accounts receivable, net	675,567	606,462	89,322
Financing receivables, net	511,124	1,046,286	154,101
Short-term investment	11,113,217	4,804,528	707,630
Inventories	43,845	49,929	7,354
Advances to suppliers	438,272	711,853	104,845
Prepayments and other current assets	1,964,506	2,224,856	327,688
Amounts due from related parties	74,312	63,620	9,370
Total current assets	20,098,257	25,924,510	3,818,270
Investments in equity investee	3,109,494	3,271,512	481,856
Property and equipment, net	12,470,632	16,477,106	2,426,815
Land use rights, net	2,508,860	4,105,231	604,635
Intangible assets, net	48,029	43,381	6,389
Operating lease right-of-use assets	901,956	844,208	124,338
Goodwill	4,241,541	4,241,541	624,711
Deferred tax assets	403,587	701,942	103,385
Long-term investment	946,180	1,472,960	216,944
Long-term financing receivables, net	549,775	1,355,041	199,576
Other non-current assets	612,191	465,375	68,542
TOTAL ASSETS	45,890,502	58,902,907	8,575,461

FINANCIAL STATEMENTS

BALANCE SHEET

LIABILITIES AND EQUITY

Current liabilities

Short-term bank borrowing	-	2,084,430	307,003
Accounts payable	1,475,258	1,468,675	216,312
Notes payable	-	720,420	106,106
Advances from customers	1,210,887	1,137,709	167,566
Income tax payable	80,272	39,269	5,784
Amounts due to related parties	38,943	21,082	3,105
Operating lease liabilities	298,728	267,348	39,376
Acquisition consideration payable	22,942	22,942	3,379
Dividends payable	1,629	12,304	1,812
Other current liabilities	3,552,288	4,083,074	601,372

Total current liabilities

6,680,947 **9,857,253** **1,451,815**

Non-current operating lease liabilities

504,442 459,518 67,680

Deferred tax liabilities

207,896 214,382 31,575

Other non-current liabilities

93,820 - -

TOTAL LIABILITIES

7,487,105 **10,531,153** **1,551,070**

Shareholders' equity

Ordinary shares (US\$0.0001 par value; 10,000,000,000 shares authorized, 803,551,115 shares issued and 781,947,464 shares outstanding as of December 31, 2019; 848,551,115 shares issued and 828,894,733 shares outstanding as of September 30, 2020)

517 548 81

Additional paid-in capital

22,336,594 29,357,326 4,323,867

Treasury shares, at cost

(1,436,767) (1,350,529) (198,911)

Retained earnings

16,726,540 19,750,612 2,908,951

Accumulated other comprehensive income

675,720 502,207 73,967

ZTO Express (Cayman) Inc. shareholders' equity

38,302,604 **48,260,164** **7,107,955**

Noncontrolling interests

100,793 111,590 16,435

Total Equity

38,403,397 **48,371,754** **7,124,390**

TOTAL LIABILITIES AND EQUITY

45,890,502 **58,902,907** **8,675,460**

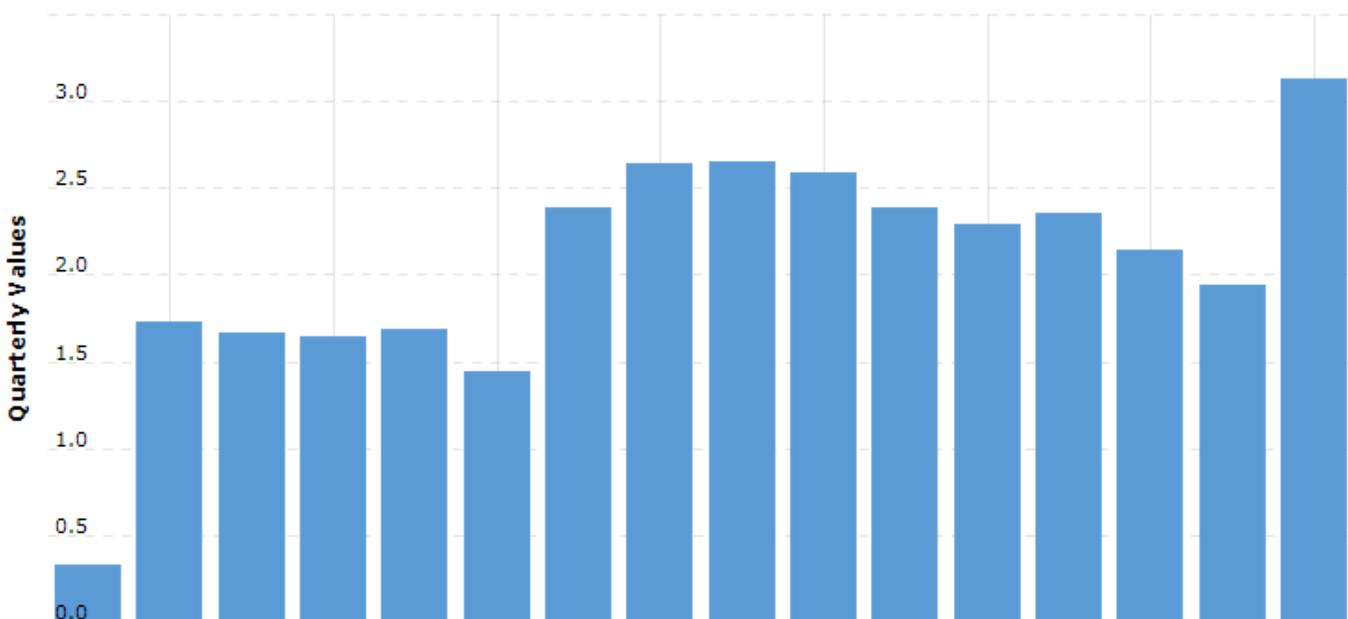
ZTO's balance sheet is in pristine shape especially given their cash flow generation as we will discuss in a few pages. The company currently has \$2.4B of cash on hand which on its own is roughly \$1B more than all of their current liabilities. On top of this, they have another \$707M in short-term investments.

The company has in total \$8.6B in total assets against \$1.5B in total liabilities as ZTO does not have any significant debt on its books.

Accounts receivables are in check, as are inventories. Intangible assets do not make up a lot of their assets which is good as many companies try to inflate their balance sheet with this alongside goodwill.

Put simply, their cash and property & equipment (over 9,250 trucks owned plus warehouses, etc) make up half of their assets at \$4.8B.

Cash & Cash Equivalents (\$B)



FINANCIAL STATEMENTS

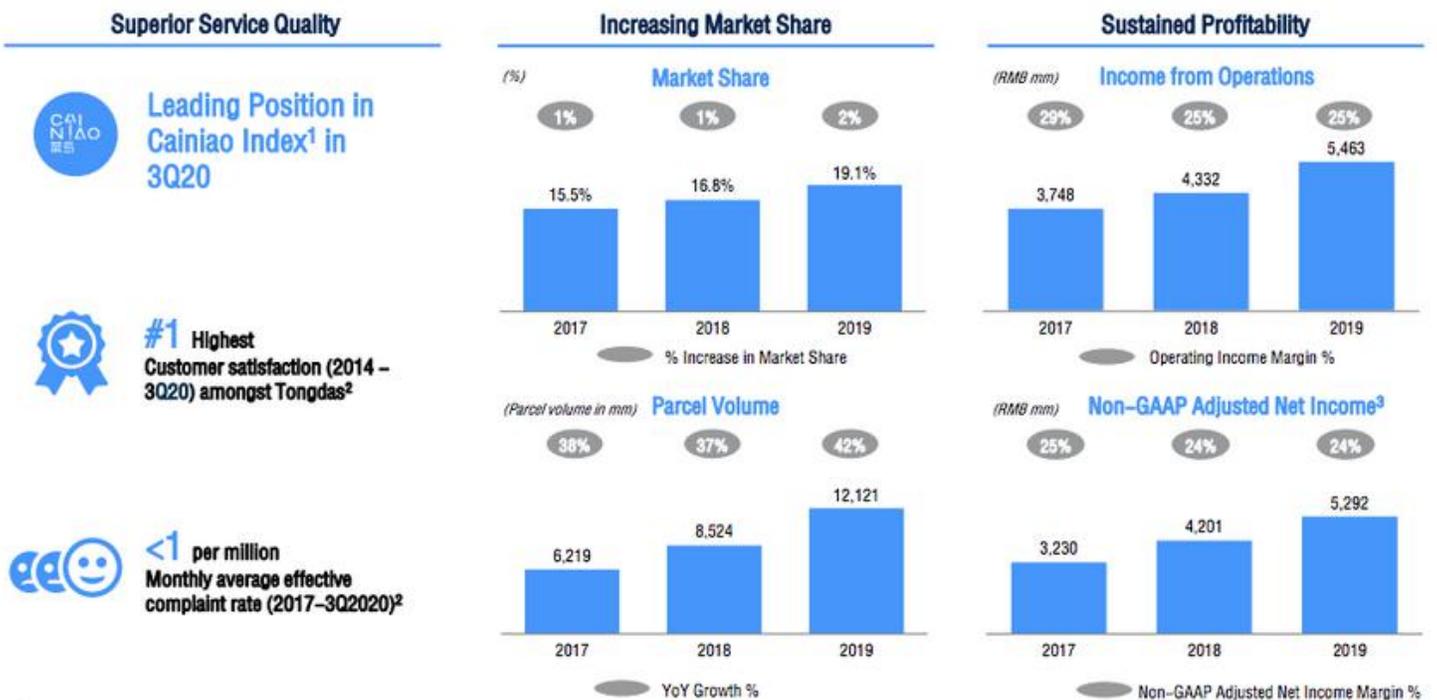
INCOME STATEMENT

	Three Months Ended Sept 30,			Nine Months Ended Sept 30.		
	2019	2020		2019	2020	
	RMB	RMB	US\$	RMB	RMB	US\$
	(in thousands, except for share and per share data)					
Revenues	5,265,760	6,638,836	977,795	15,263,430	16,957,146	2,497,518
Cost of revenues	(3,668,821)	(5,247,884)	(772,930)	(10,638,332)	(12,978,371)	(1,911,507)
Gross profit	1,596,939	1,390,952	204,865	4,625,098	3,978,775	586,011
Operating income (expenses):						
Selling, general and administrative	(290,893)	(373,668)	(55,035)	(1,154,021)	(1,246,140)	(183,537)
Other operating income, net	94,469	151,836	22,363	182,102	455,106	67,030
Total operating expenses	(196,424)	(221,832)	(32,672)	(971,919)	(791,034)	(116,507)
Income from operations	1,400,515	1,169,120	172,193	3,653,179	3,187,741	469,504
Other income (expenses):						
Interest income	146,372	96,654	14,236	437,313	337,138	49,655
Interest expense	-	(13,707)	(2,019)	-	(23,132)	(3,407)
Loss on disposal of equity investees and subsidiary	-	-	-	(529)	-	-
Foreign currency exchange gain/(loss), before tax	28,511	(64,354)	(9,478)	24,850	(45,307)	(6,673)
Income before income tax, and share of loss in equity method investments	1,575,398	1,187,713	174,932	4,114,813	3,456,440	509,079
Income tax expense	(266,297)	27,845	4,101	(746,958)	(400,228)	(58,947)
Share of loss in equity method investments	(1,420)	(5,268)	(776)	(13,433)	(21,378)	(3,149)
Net income	1,307,681	1,210,290	178,257	3,354,422	3,034,834	446,983
Net loss (income) attributable to noncontrolling interests	(153)	(9,271)	(1,365)	(6,700)	(10,762)	(1,585)
Net income attributable to ZTO Express (Cayman) Inc.	1,307,528	1,201,019	176,892	3,347,722	3,024,072	445,398
Net income attributable to ordinary shareholders						
Basic	1.67	1.53	0.23	4.27	3.86	0.57
Diluted	1.67	1.53	0.23	4.26	3.86	0.57

In the most recent quarter,

- Revenues were US\$977.8M, an increase of 26.1% Y/Y
- Gross profit was \$204.9M, a decrease of 12.9% Y/Y
- Net income was \$178.3M, a decrease of 7.4% Y/Y
- Adjusted EBITDA was \$246.8M, a decrease of 11.2% Y/Y
- Adjusted net income was \$178.3M, a decrease of 8.2% Y/Y
- Basic and diluted earnings per share was \$0.23, a decrease of 8.4% Y/Y

This was a great quarter in our eyes despite a weaker bottom line. If we look below, ZTO is consistently driving operating income margins in the mid 20% range, has grown market share at least 1% every year and added another 170 bps in 2020. The company is also seeing accelerated growth in parcel volume with 38% in 2017, 37% in 2018, 42% in 2019, and is guiding for 33.7-40.3% growth in 2020.



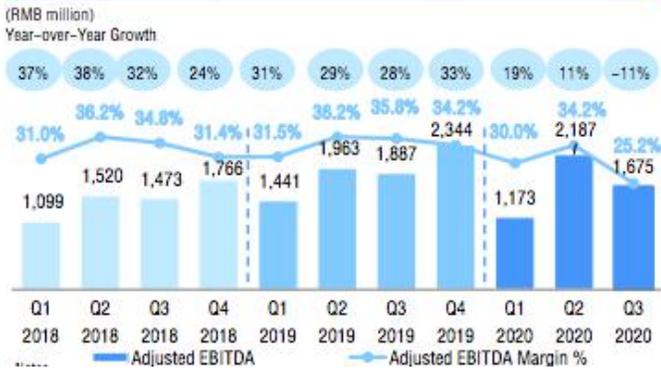
Income from Operations and Margin



Net Income and Margin



Adjusted EBITDA¹ and Margin



Adjusted Net Income² and Margin



The company's ability to drive down their cost per parcel is why they are witnessing much stronger margins than their peers and is also why ZTO is guiding 2020 adjusted net income to be in the range of RMB4.8 billion to RMB5.2 billion, a 1.7% to 9.3% decrease Y/Y - not bad in our view after a rough Q1 from the pandemic where adjusted net income fell 34.3% Y/Y.

Line-Haul Transportation

- Largest self-owned line-haul fleet of ~9,250 vehicles
- Systematic upgrade with high-capacity trailers
- Data-driven route planning and safety monitoring

- Patented curved trailer with higher load capacity and improved fuel economy
- RFID-equipped tires to allow real-time monitoring of operating conditions and schedule needed maintenance

DECREASING COST PER PARCEL

(RMB)

Year	Sorting Cost (RMB)	Transportation Cost (RMB)
2016	0.83	0.43
2017	0.77	0.39
2018	0.68	0.38
2019	0.62	0.34

— Sorting Cost — Transportation Cost

Sorting Technologies

- 300 automated sorting lines in service as of 3Q20
- Joint collaborations with Chinese Academy of Sciences to develop several generations of automated sorting technologies (e.g. cross-belt sorting equipment, line shaft diverter, dynamic weighting machines)

- Developed and continuously re-engineered sophisticated software to support high-speed sorting (e.g. data-enabled algorithm, real-time analytics and recalibration)

FINANCIAL STATEMENTS

CASH FLOW

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2020		2019	2020	
	RMB	RMB	US\$	RMB	RMB	US\$
	(in thousands)					
Net cash provided by operating activities	1,417,706	1,480,429	218,044	4,043,780	2,910,490	428,669
Net cash (used in) provided by/ investing activities	(4,015,458)	1,179,946	173,787	(1,621,341)	(632,608)	(93,173)
Net cash / provided by (used in) financing activities	511,528	8,602,624	1,267,030	(1,995,524)	8,965,576	1,320,487
Effect of exchange rate changes on cash, cash equivalents and restricted cash	33,113	(109,243)	(16,090)	9,683	(89,783)	(13,224)
Net (decrease) / increase in cash, cash equivalents and restricted cash	(2,053,111)	11,153,756	1,642,771	436,598	11,153,675	1,642,759
Cash, cash equivalents and restricted cash at beginning of period	7,112,663	5,277,333	777,267	4,622,954	5,277,414	777,279
Cash, cash equivalents and restricted cash at end of period	5,059,552	16,431,089	2,420,038	5,059,552	16,431,089	2,420,038

	As of		
	September 30, 2019	September 30, 2020	
	RMB	RMB	US\$
	(in thousands)		
Cash and cash equivalents	5,058,640	16,408,906	2,416,771
Restricted cash, current	912	8,070	1,189
Restricted cash, non-current	-	14,113	2,079
Total cash, cash equivalents and restricted cash	5,059,552	16,431,089	2,420,038

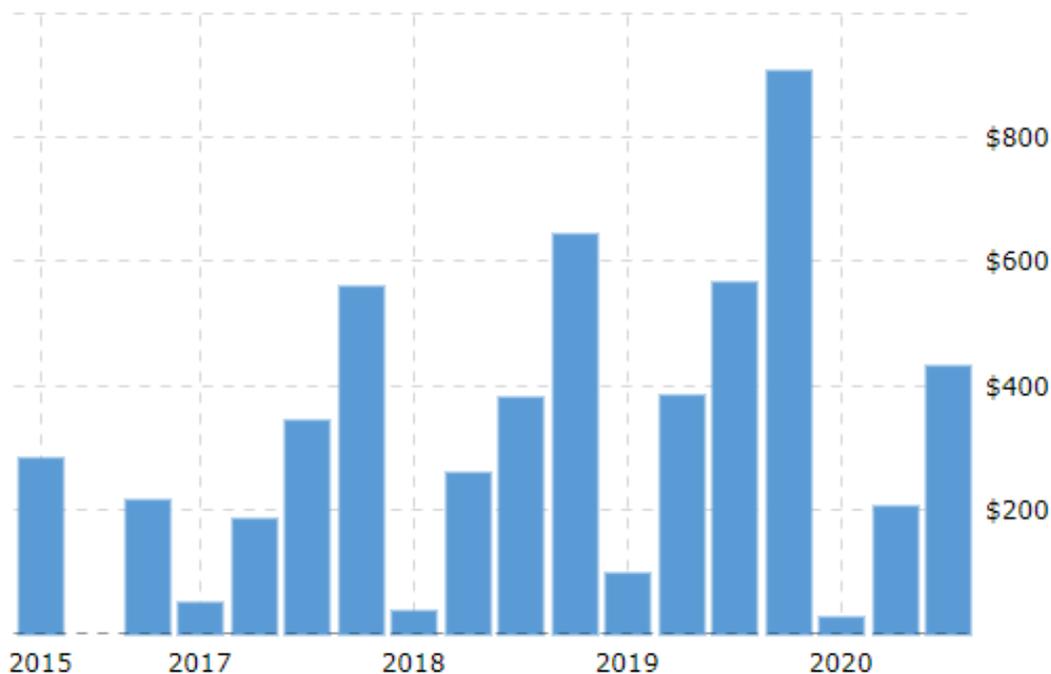
Net cash provided by operating activities in Q3 was RMB1,480.4 million (US\$218.0M), compared with RMB1,417.7 million in the same period of 2019 - in other words only a small gain Y/Y.

Year-to-date, ZTO has generated \$428M in operating free cash flow which is an impressive 17% operating cash flow margin. Put another way, for every \$1.00 in revenue ZTO brings in, \$0.17 is generated in operating free cash flow.

For a company in this field with the pricing pressure they've experienced from high level competition, this is phenomenal. When we look at established companies like UPS and FedEx here in the States they are generating 15.9% and 10.4% year-to-date operating free cash flow margins, respectively.

ZTO - Cash Flow from Operating Activities

Quarterly TTM Values (Millions of US \$)





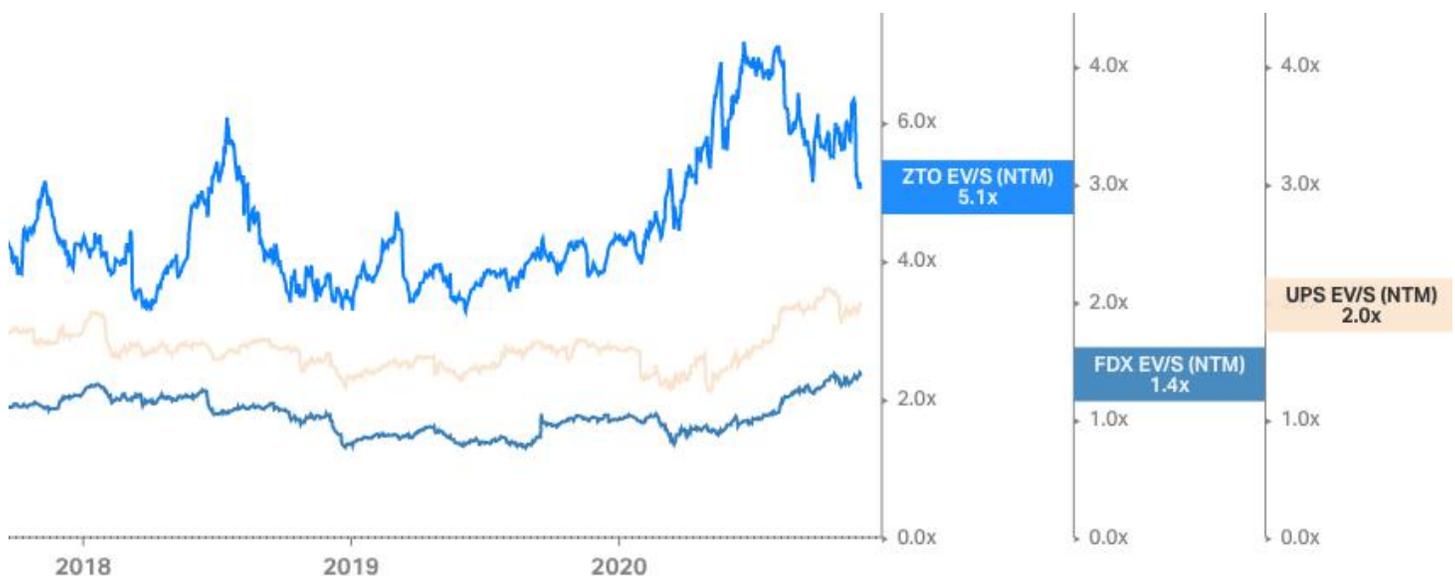
ZTO FUNDAMENTALS

We are going to compare ZTO to the only other public shipping companies on U.S. exchanges and that is FedEx (FDX) and UPS. It's not a perfect comparison but will help paint a better picture.

On a price to sales basis, ZTO is trading at much higher multiple simply because the company is growing at faster rates.

For example, in the last 10 years, UPS' best growth annually was 9.4% in 2010. FDX has been much more inconsistent with revenue growth but did witness 19.8% growth once in 2017. ZTO, on the other hand, has seen revenue grow 56% in 2015, 61% in 2016, 33.4% in 2017, 34.8% in 2018, and 25.6% in 2019.

Analysts expect ZTO to grow over 20% annually for the next 3 years.





ZTO FUNDAMENTALS

On an enterprise value to EBITDA (earnings before interest, taxes, depreciation, and amortization) basis, ZTO is valued a bit more expensive at 19.1x.

UPS and FDX trade at 14.5x and 11.7x, respectively. We believe given the market tailwinds in China and the growth rates ZTO is generating, this premium is more than fair.





ZTO FUNDAMENTALS

Ironically, on a price to earnings basis, ZTO actually trades at a cheaper valuation. Much of this can be attributed to China not staying in lockdown as long as the United States due to the COVID19 pandemic.

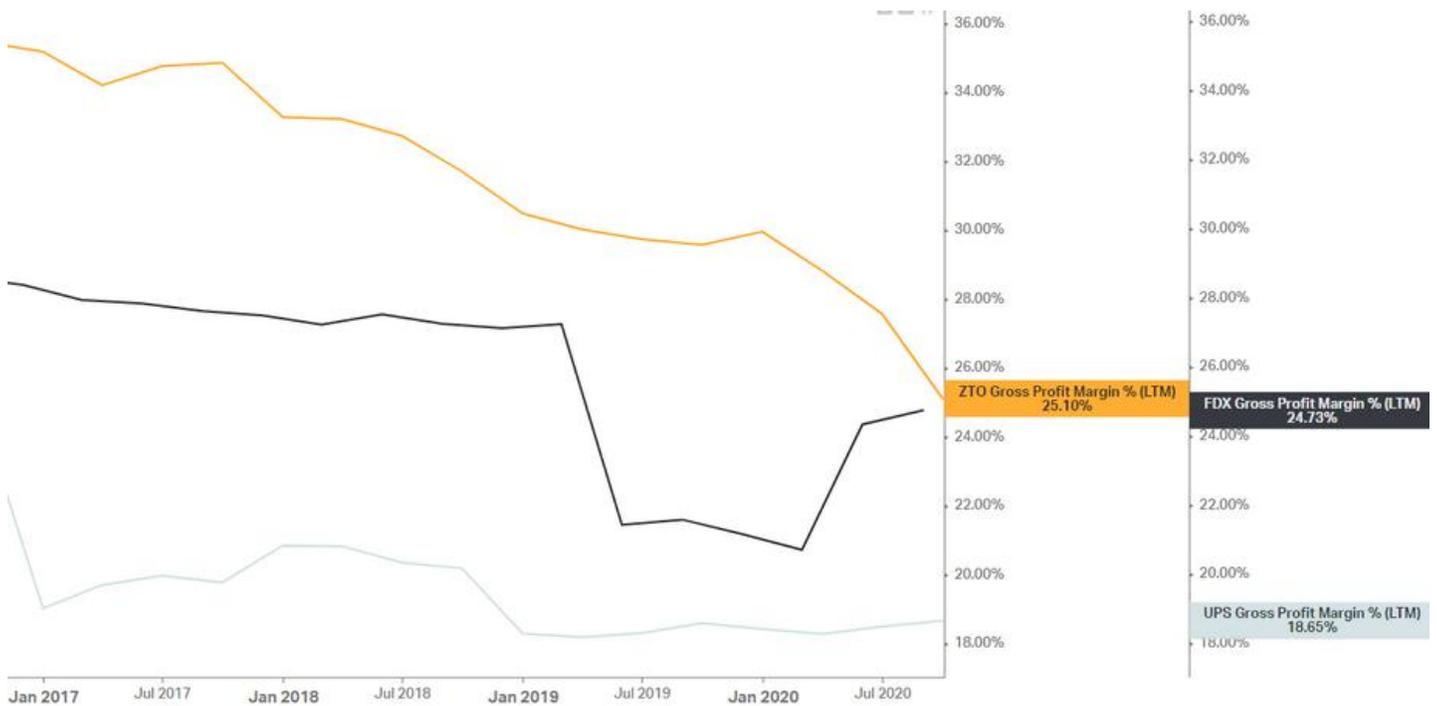
Looking out ahead for 2021, ZTO trades at 27.0x while UPS trades at 9.0x and FDX trades at 18.6x.





ZTO FUNDAMENTALS

We continue to come back to it. ZTO has very nice gross margins for their industry at 25.1%. This is actually slightly higher than FDX at 24.73% the last twelve months and higher than UPS at 18.65% the last twelve months. Keep in mind, FDX and UPS are driving revenues 20x that of ZTO so scale is on their side.





ZTO DCF MODEL

Attached in the email, as well as in the Vault, you will see the discounted cash flow model. Here are the following variables used:

- Discount Rate: 7.42% +/- 0.50%
 - Beta: 1.0
 - 30 YR Treasury (Risk Free Rate): 1.42%
 - Market Risk Premium: 6.00%
- Perpetual Growth Rate: 3.25% +/- 0.50% (tracking China long-term growth of GDP assuming it tapers to this range by 2030)
- CUBE expects continued 20%+ revenue growth up until 2024. We assume revenue will bounce back strong next year due to stronger 1H2021 comps from COVID19 impact
- Shares outstanding: 785M
- Free Cash Flow Margins: 13.5% with growth up to 15% in 2024+ due to economies of scale and better use of technology like that of drones in addition to conversion to electric vehicles.
- Current Price: \$28.24

Model predicts:

- **Base case: \$35.68 (+26%)**
- **Bull Case: \$45.94 (+63%)**
- **Weak Case: \$29.35 (+4%)**



ZTO

TECH ANALYSIS

ZTO ZTO Express (Cayman) Inc. NYSE

© StockCharts.com

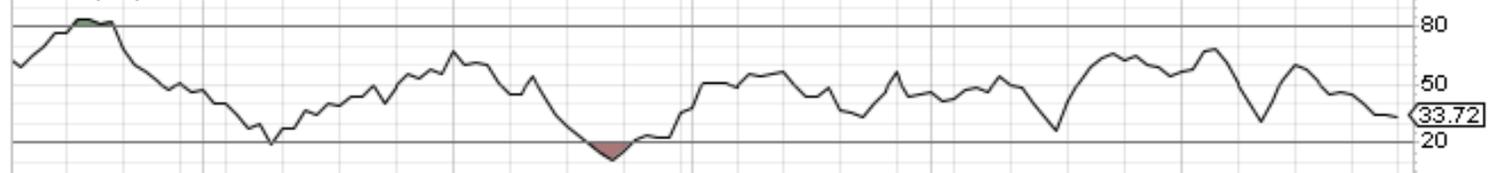
30-Nov-2020

Open 29.23 High 29.45 Low 27.93 Close 28.24 Volume 4.8M Chg -1.27 (-4.30%)

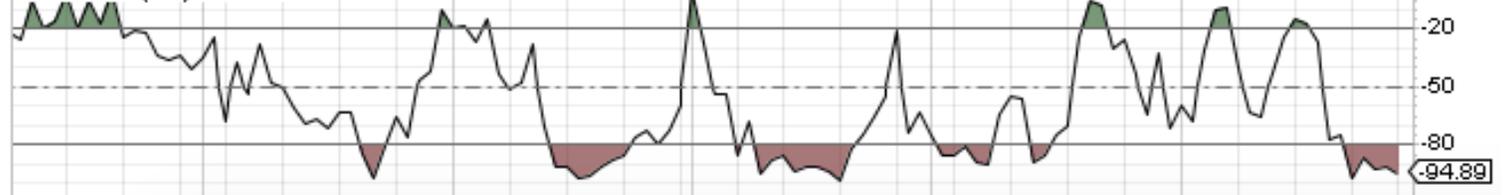
▲ RSI(14) 38.52



▲ MFI(14) 33.72



▲ Wm%R(14) -94.89



TECH ANALYSIS SUMMARY

Looking at the charts, ZTO is pointing towards more near-term downside.

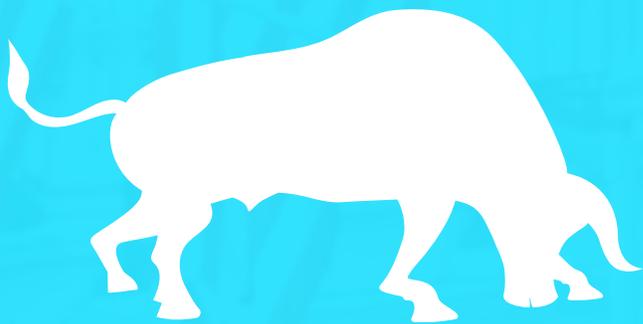
The stock was unable to stay above its support level at the fibonacci pivot point of \$29.42 after holding it for several days.

We expect shares to visit the S1 fibonacci level of \$27.63. In the case that it doesn't hold, we expect a move to the S2 of \$26.29.

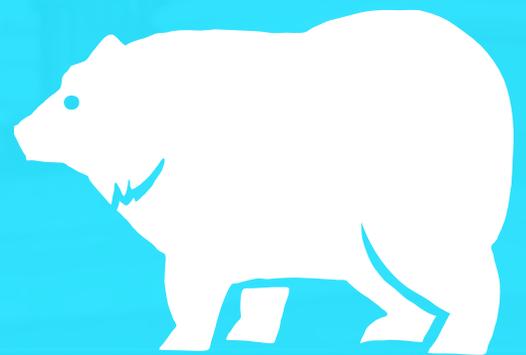
Given how oversold the stock is on the W%R and nearing oversold territory on RSI and MFI, we favor a bounce off of the \$27.63 level.



BULLISH OR BEARISH?



VS.



**MORE BULLISH
(POSITIVE)**

**MORE BEARISH
(NEGATIVE)**





ZTO CONCLUSION

Overall, CUBE finds ZTO to be a very attractive investment on this recent pullback from \$38. We like that they are growing market share at a considerable rate and now have nearly 21% of the express delivery business in China. We believe the company's balance sheet and margins also puts them in a unique position to outperform competitors.

Both from a technical and fundamental perspective, we believe there is great support in this mid-to-upper \$20 range and believe ZTO is a nice investment for those seeking exposure to the booming e-commerce market in China.

This is a company that is now on CUBE's watchlist and we may consider entering in the coming weeks.

DISCLAIMER

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