

# Shenzhen Pagoda (2411 HK)

## Sowing the franchiser's seed

### ■ A national No.1 franchise-based OMO fruit retailer; initiate at Buy

Pagoda is China's largest fruit retailing company with over 5,600 stores nationwide. With over 20 year's industry experience, the company has improvised its proprietary business model by leveraging its competitive advantages such as upstream integration, product/ brand innovation, price segmentation, as well as its OMO (online-merge-offline) distribution. Pagoda's asset-light and thus scalable franchise-based network expansion enables it to swiftly out-race its competitors by store counts without hassle in green-field war chest. In response to the pandemic's disruption to its offline operation, Pagoda embraced channel migration (from purely brick-and-mortar) by launching its own WeChat APP, as well as collaborating with platforms such as Ele.me, etc. to solidify its community-based retail footprint. Pagoda is efficiency-driven. It has distinguished itself from peers by advancing its own IT solutions to standardize operation workflow and to enable price segmentation. All of these should commensurate well with the upcoming expansion of distribution business (2b) that represents yet another catalyst to growth. We think Pagoda has not only cemented an effective moat to shield against competition, but has also set stage to rejuvenate its post-pandemic growth within our forecast period. We initiate Pagoda at Buy.

### ■ Pagoda is both margin-enhancive and cash-generative

We project Pagoda to deliver an 11.6% 3-year revenue CAGR, outgrowing 7.8% of the industry, per Frost & Sullivan. In our view, an accelerating Excellent-grade sales mix, from 9.2% in 2019 to 19.6% in 2024E, drives the outperformance. Alternatively, we envisage the growth will be underpinned by a c.600 store addition per annum along with 3%/7%/9% same-store-sales growth. Both should aid GPM to expand from 11.9% in 2022E to 12.9% in 2024E.

Pagoda has RMB1.9bn cash on hands by June 2022. Relative to [Hongjiu](#), Pagoda enjoys a shorter cash conversion cycle and we forecast Pagoda to yield RMB316mn/419mn/531mn free cash flow at c.70% FCF conversion in 2022-24E. Given capex has already peaked-out, the ample cash stream, in our view, would be proportionally repatriated to shareholders by a 20% annual dividend payout.

### ■ Valuation – the stock is trading at 18.0x end-23E P/E

Our TP is based on 23.0x end-23E P/E which benchmarks to the average valuation of its domestic and global peers. In our view, our methodology is more appropriate to reflect 1) Pagoda's fair value given a short listing history since IPO in Jan 2023, and 2) the financial comparability of each peer group.

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	8,854	10,289	11,176	12,752	14,308
YoY growth (%)	(1.4)	16.2	8.6	14.1	12.2
Net income (RMB mn)	49	235	318	447	586
EPS (RMB)	0.2	0.2	0.2	0.3	0.4
YoY growth (%)	-	(5.8)	35.4	40.7	30.9
P/E (x)	n.a	n.a	25.3	18.0	13.6
P/B (x)	n.a	n.a	2.7	2.4	2.1
Div yield (%)	n.a	n.a	0.6	0.9	1.1
ROE (%)	2.0	8.9	10.9	13.6	15.5
Net gearing (%)	19.3	33.6	23.9	13.6	2.7

Source: Company data, Bloomberg, CMBIGM estimates

## BUY (Initiation)

Target Price	HK\$7.9
Up/Downside	29.5%
Current Price	HK\$6.1

### China Consumer - Food and Beverage

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#### Stock Data

Mkt Cap (HK\$ mn)	9,690
Avg 3 mths t/o (HK\$ mn)	n.a
52w High/Low (HK\$)	7.1/5.5
Total Issued Shares (mn)	1,183

Source: BBG

#### Shareholding Structure

Wang Yonghua	14.93%
CICC	13.26%
Hong Yuan Shang Go	10.97%

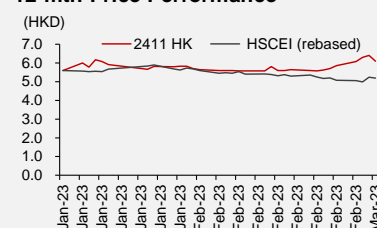
Source: BBG

#### Share Performance

	Absolute	Relative
1-mth	9.8%	17.5%
3-mth	n.a	n.a
6-mth	n.a	n.a

Source: BBG

#### 12-mth Price Performance



Source: BBG

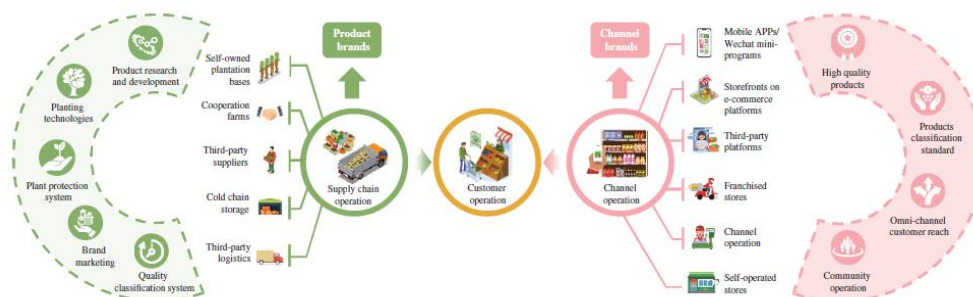
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## Investment summary

Pagoda is the largest nationwide fruit retailer with a vertically integrated upstream supply chain and downstream franchise-based OMO distribution network. With a history of over 20 years, the company has improvised its business model by leveraging its competitive advantages such as upstream integration, brand innovation, price segmentation, as well as its OMO distribution. Pagoda ranked first among all fruit retailers in China in terms of retail sales value. Pagoda also ranked first among all fruit specialty retail enterprises in China in terms of fruit retail sales value.

**Figure 1: An overview of Pagoda's business model**



Source: Company data, CMBIGM

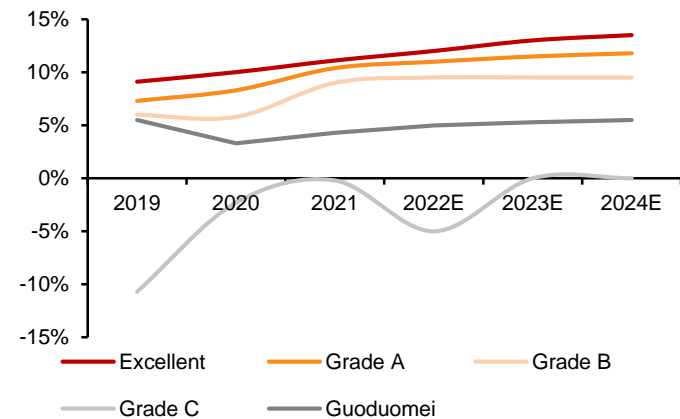
## The value chain cemented by Pagoda's agricultural technology, brand portfolio and IT solution

- Pagoda has successful agricultural technology empowerment along its supply chain, most notably Red Ballerina strawberries with its focus on strawberry cultivation, post-harvest and cold chain logistic technologies.
- Pagoda had introduced 31 self-owned product brands that are exclusively distributed by it in China under the Excellent and Grade A categories. Meanwhile, Pagoda registered 211 trademarks as brand names in China, such as "Daba" brand for musang king durian.
- Meanwhile, by leveraging its standardized fruit quality classification system, Pagoda is able to price differently based on different quality levels. Such a pricing strategy allows the company to maximize the value of each type of fruits and hence enables margins maximization.

## A best-of-class OMO distribution

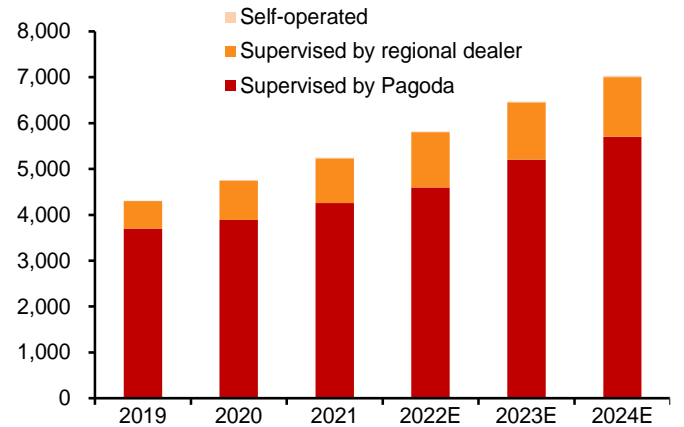
Pagoda has swiftly outraced its competitors through its franchise model and for now the company owns 5,600+ stores in China. Compounding with its wechat APP and own online platform, Pagoda has extended its distribution to online platforms and collaborates with food delivery partners to act as touchpoints serving all of its local community networks. Despite any upfront investment, the online business (or the Guoduomei brand) is expanding fast and we forecast the business to start break-even at gross level by 2023E.

Figure 2: Gross margins breakdown 2019-24E



Source: Company data, CMBIGM estimates

Figure 3: Number of stores by channel 2019-24E



Source: Company data, CMBIGM estimates

## Peers comparison

- **Vis-à-vis domestic peers.** Pagoda has a similar top line growth to the peer group but a lower GPM owing to a higher input cost contribution.
- **Vis-à-vis global peers.** Pagoda compares similarly to its global peers in terms of their gross and operating margins. Meanwhile, we project Pagoda to offer faster revenue growth thanks to its domestic leadership.

## Financial analysis

- We forecast that revenue will grow at 11.6% 3-year CAGR in 2021-24E, led by 1) an average of c600 new outlet openings per annum, 2) 3%/7%/9% same-store-sales growth between 2022-24E, and 3) a 35.7% 3-year revenue CAGR of Excellent-graded, thanks to greater brand acceptance and a strengthening demand on quality fruit products.
- We forecast that GPM will expand from 11.9% to 12.9% between 2022-24E, led by 1) an average 1pp increase in GPM for premium-branded SKUs, 2) a widening brand portfolio, and 3) break-even of online business in 2023E.
- Pagoda targets to control administration and R&D expense to grow approximately by 5% for 2023E and 2024E. Meanwhile, we forecast selling expense to grow proportionally at 16.7% and 14.7% for 2023E and 2024E, respectively. Overall, we expect opex ratio (to revenue) would remain stable and boost EBIT margins from 3.4% in 2022E to 4.2%/4.9% of 2023/24E.

## Valuation

Pagoda is trading at 18.0x 2023E P/E. Instead of historical valuation, our TP is based on 23.0x which benchmarks to the average valuation of its domestic and global peers. In our view, our methodology is more appropriate to reflect 1) Pagoda's fair value given a short listing history since Jan 2023, and 2) the financial comparability of each peer group.

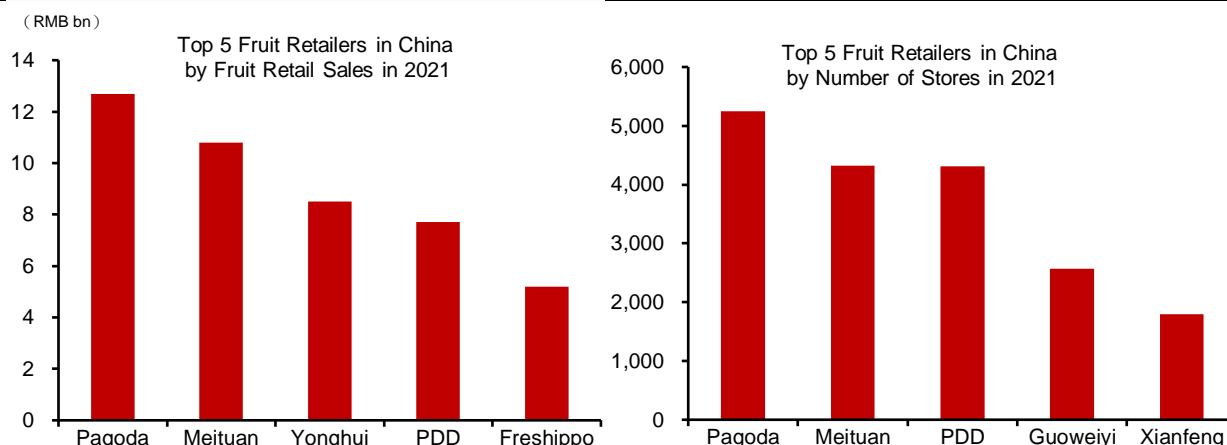
**Investment risks** - branding, extreme weather, competition, supply stability.

## Company Overview

### About Pagoda

Pagoda is the largest nationwide fruit retailer with a vertically integrated upstream supply chain and downstream franchise-based OMO distribution network. With a history of over 20 years, the company has accumulated industry-leading experience and has improvised its business model upon these core strengths, in addition to a proprietary fruit quality classification system, standardized management system across the entire industry value chain.

**Figure 4: Industry ranking of Pagoda**



Source: Company data, CMBIGM

The current Chairman Mr. Yu established Pagoda in 2001 in Shenzhen. The first offline store of Pagoda was opened in Shenzhen in 2002, and six years later Pagoda launched "Online Pagoda" to expand its online sales channel. The company was recognized as a China Well-known Trademark in 2016 and was awarded the National Leading Company of Agricultural Industrialization in 2021. In 2022, Pagoda was accredited with ISO22000:2018 certification and becomes a SGS-certified company for fruit trading, processing, packaging, storage, etc. Meanwhile, Pagoda acquired "Guo Duo Mei" trademark in 2017.

**Figure 5: Milestone of Pagoda**

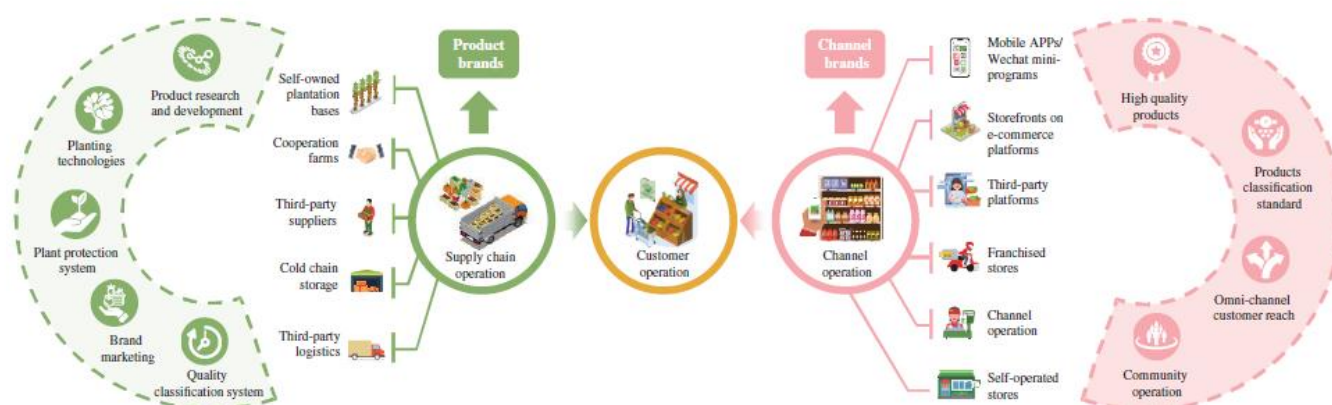
Year	Key business milestones of Pagoda
2001	·The Company was established in Shenzhen, China
2002	·First "Pagoda" store was opened in Shenzhen, China
2008	·The Company launched "Online Pagoda", further expanding online sales channels
2009	·The Company launched "Instant Refund" service standards
2013	·The Company established and launched the flavor-oriented fruit quality classification system, which is a first of its kind in China
2016	·The Company launched its mobile app "Pagoda", initiating a new fruit e-commerce business model ·"Pagoda" was recognized as a China Well-Known Trademark by National General Administration for Industry and Commerce
2017	·The Company launched an online procurement platform, a transaction platform aimed for specializing for suppliers of the fruit industry ·The Company acquired "Guo Duo Mei" trademark, achieving multichannel brands operation
2019	·The Company launched Pagoda quality fresh food strategy, announcing its entry into the fresh market, to expand its business to fresh retail
2020	·The Company launched "Panda.F" as the brand name for the Company's other fresh groceries
2021	·The company was awarded the National Leading Company of Agricultural Industrialization jointly by The Ministry of Agriculture and Rural Affairs, NDRC, MOF, MOFCOM, PBOC, State Taxation Administration, CSRC and All China Federation of Supply and Marketing Cooperatives
2022	·The Company was accredited with internationally recognized ISO 22000:2018 certification and became a SGS-certified company for fruit trading, preliminary processing, packaging, storage, etc., which demonstrates the Company's dedication to food safety

Source: Company data, CMBIGM

## Business model

Pagoda primarily sells fruits, and fruit-based products such as dried fruits and juice. Currently, Pagoda distributes over 60 types of fruits under 31 brands through its 5,613 offline store network located in over 140 cities in 22 provinces and municipalities across China. To cope with the rising online demand, Pagoda is gradually migrating its online business from third-party platforms to its own mobile APPs, WeChat Mini-program. Meanwhile, the company also collaborates with third-party food delivery platforms, such as Meituan, Koubei and Ele.me, which provide instant delivery fleets to fulfill the online orders. According to Frost & Sullivan, by end-2021, Pagoda ranked first among all retailers that sell fruits in China in terms of fruit retail sales value, accounting for 1.0% of total market share where the top five participants accounted for an aggregate of 3.6% market share in total.

**Figure 6: An overview of Pagoda's business model**



Source: Company data, CMBIGM

## Pagoda's mission statements

- **Pagoda's mission:** to offer delicious fruits and enjoyable lifestyle to people.
- **Pagoda's vision:** to be the world's largest fruit company.
- **Pagoda's value proposition:** to be the iconic brand with high value-for-money to consumers and create business value for various business partners.
  1. **Franchisee:** Pagoda provides globally sourced high-quality fruits SKUs with various business back-end support including store location guidelines, staff training, operation guidance, IT support, etc.
  2. **Suppliers:** Pagoda promotes modern planting concepts to plantation bases and farmers with advanced planting and post-harvest technology solutions. Pagoda also assists farmers in branding, marketing, and promotion and further empowerment to increase farm yields.
  3. **Other partners:** Pagoda closely connects with research institutions and college departments specializing in agricultural technologies.



## Seasoned management team

**Figure 7: Pagoda's management team profile**

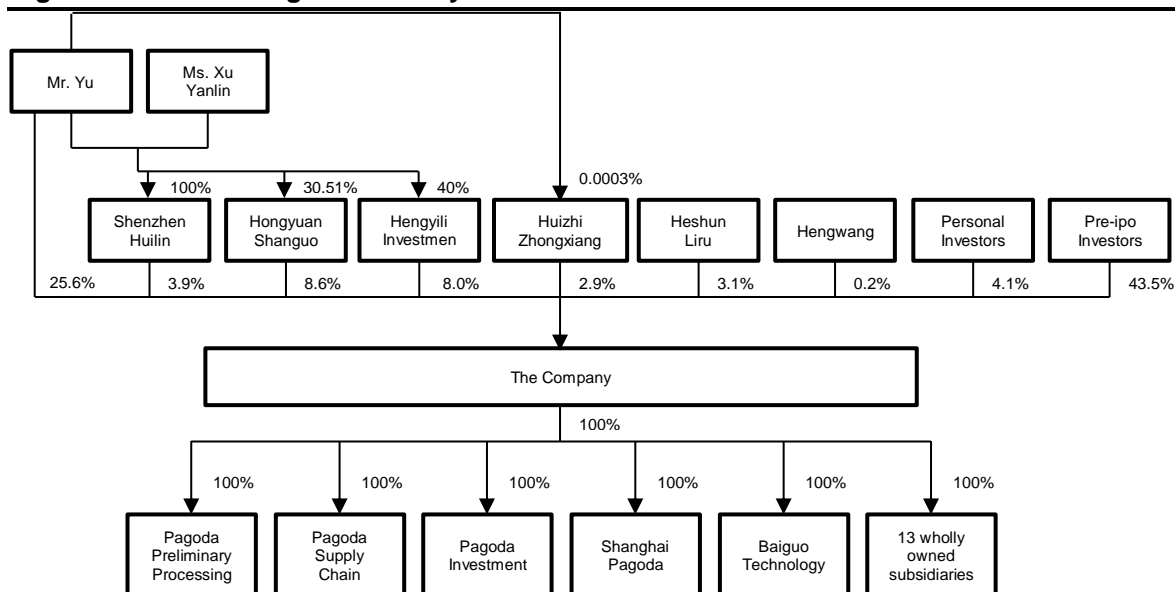
Name	Age	Joined the group since	Date of appointment	Position	Responsibility & Description
<b>Mr. Yu Huiyong</b> (余惠勇)	54 years old	Dec-01	Dec-01	Executive Director and chairman of the Board	Overseeing the implementation of resolutions of shareholders' meetings and formulating the overall strategies of the Company. Mr. Yu has been an executive Director and chairman of the Board since the establishment of the Company. He is also one of the founders of the Company. He has about 30 years of experience in fresh food industry. He was a manager at the distribution center of Shenzhen Aldi Green Food Center Co., Ltd, a company principally engaged in the retail of green food from 1995-2001.
<b>Ms. Xu Yanlin</b> (徐麗林)	53 years old	Aug-02	May-19	Executive Director	Overseeing the overall business operation of the Company. Ms Xu joined the Company in Aug 2002 as a clerk of the administration department and was promoted to be the general manager of the Company in Jan 2009. She has also been a member of the 6th Chinese People's Political Consultative Conference National Committee of Yantian District, Shenzhen since Oct 2021.
<b>Mr. Tian Xiqu</b> (田錫秋)	48 years old	Dec-01	Aug-15	Executive Director and vice-chairman of the Board	Assisting in formulating the overall development strategies of the Company. He served as a Director of the Company from Dec 2001 to Jul 2008, and re-joined the Company in Aug 2015 as a Director. He was re-designated as an executive Director and vice-chairman in Mar 2020. In addition, he has been a director of Wangpin Pagoda Industrial Development (Shenzhen) Co., Ltd. since Aug 2005. Prior to re-joining the Company, he operated his own fruits business from Jul 2008 to Aug 2015.
<b>Mr. Jiao Yue</b> (焦岳)	36 years old	Jul-16	May-19	Executive Director	Overseeing the day-to-day business operation of the Company. Since Apr 2019, he has been the general manager of Pagoda Xinxiang, where he is responsible for overseeing the overall business operation. He also held management positions. From May 2015 to Sep 2016, he was the chief executive officer of Juxian (Beijing) Technology Co., Ltd., where he was responsible for overseeing the overall business operation. From 2011 to 2015, he was the vice president of Youmeng Tongxin (Beijing) Technology Co., Ltd.
<b>Mr. Zhu Qidong</b> (朱啟東)	47 years old	Mar-02	May-19	Executive Director	Overseeing the procurement, wholesale and sales of the Company. He has also been an executive director of certain subsidiaries of the Company, and the chairman of the board of Pagoda Seeds and Jinnong Supply Chain since Jul 2020 and May 2021 respectively. Outside of the Company, he has been a director of Hainan Shengjie Agricultural Development Co., Ltd and Shanghai Niuguo Agricultural Technology Co., Ltd since Oct 2019 and Apr 2017 respectively. Hainan Shengjie focused on growing business of melons and Shanghai Niuguo focused on avocado ripening and sales. Pagoda owns 30% and 33.33% stake on the companies respectively.
<b>Mr. Pan Pan</b> (潘攀)	43 years old	Jul-15	Aug-15	Non-executive Director	Providing strategic advice and making recommendation of the operation and management of the Company. He is also the managing director of Tiantu Centre. Since Jun 2021, he has been a non-executive director of Nayuki Holdings Limited (SEHK: 2150). Since Jun 2016, he has been serving as a non-executive director of Zhou Hei Ya International Holdings Company Limited (SEHK: 1458). He represents investment entities directly and indirectly controlled by Tiantu Capital, which is entitled to appoint a board director due to its investment in such companies.
<b>Mr. Hu Qihao</b> (胡祺昊)	44 years old	May-19	May-19	Non-executive Director	Providing strategic advice and making recommendation of the operation and management of the Company. He is currently holding directorship in various companies, including being an executive director and general manager of Changsha Youhuo Shengya Education Consulting Co., Ltd. since Sep 2010, a managing director of CICC Qianhai Development (Shenzhen) Fund Management Co., Ltd since Oct 2014. He also served as a supervisor in Gangxiaoxian Catering Management (Nanjing) Co., Ltd from Mar 2021 to Jul 2021.
<b>Dr. Jiang Yanbo</b> (蔣岩波)	56 years old	Mar-20	Mar-20	Independent Non-executive Director	Providing independent advice on the operation and management of the Company. He has also been a non-executive director of Mubang High-tech Co., Ltd. (SHSE: 603398) since Nov 2021. He has been an independent non-executive director in Shenzhen Minkave Technology Co., Ltd (SZSE: 300506) since Sep 2021, BYD Company Limited (SZSE: 002594, SEHK: 1211) since Sep 2020, Guangdong Dowstone Technology Co., Ltd (SZSE: 300409) since Apr 2017.
<b>Mr. Ma Ruiguang</b> (馬瑞光)	49 years old	Mar-20	Mar-20	Independent Non-executive Director	Providing independent advice on the operation and management of the Company. In addition to directorship held in the Company, he has been serving as the chairman of Shenzhen Yima Brand Chain Education Group Limited since Apr 2019, Shenzhen Yima Technology Co., Ltd. since Sep 2009, Shenzhen Yima Management Consulting Co., Ltd. since Jul 2004, where he is principally responsible for overseeing the overall operation of these companies. He also worked as supervisor or senior management in various entities.
<b>Dr. Wu Zhanchi</b> (吳戰鵬)	47 years old	Mar-20	Mar-20	Independent Non-executive Director	Providing independent advice on the operation and management of the Company. He has been serving as an independent director in Guangdong Electric Power Development Co., Ltd. (SZSE: 000539, 200539), Guangzhou Jointas Chemical Co., Ltd. (SZSE: 002909) since May 2021, Cosonic Intelligent Technologies (SZSE: 300793) since Sep 2016. He has been a professor of Jinan University since Jul 2006.
<b>Mr. Cheung yee Tak Jonathan</b> (張以德)	34 years old	Jan-22	Jan-22	Independent Non-executive Director	Providing independent advice on the operation and management of the Company. He has over ten years of experience in the finance industry. He has been an assistant vice president at DBS Asia Capital Limited since Mar 2021. He is also a representative of DBS Asia Capital Limited for its Type 1, 4, 6 regulated activities under the SFO. He has been an independent non-executive director of Keen Ocean International Holding Limited (SEHK: 8070) since Oct 2019.
<b>Ms. Zhu Fang</b> (朱舫)	66 years old	Dec-20	Dec-20	Independent Non-executive Director	Providing independent advice on the operation and management of the Company. She has rich industry in the media industry. She has been the chief advisor and vice-chairman of the supervisory committee of China Chain Store & Franchise Association since Mar 2011. She worked at China Business Herald from Jan 1985 to Feb 2011 where she was primarily responsible for news reports.

Source: Company data, CMBIGM

## Shareholding and organisational structure

By Jun 2022, Pagoda's shareholding structure was as follows and remained unchanged prior to the completion of listing.

**Figure 8: Shareholding structure by Jun 2022**



Source: Company data, CMBIGM

## The value chain cemented by Pagoda's agricultural technology, brand portfolio and proprietary IT solution

### Advanced agricultural technology to enhance quality and yield rate

Pagoda has successful agricultural technology empowerment along its supply chain, most notably Red Ballerina strawberries with its focus on strawberry cultivation, post-harvest and cold chain logistic technologies. For instance, Paogda has provided comprehensive technical support to farmers for growing excellent grade strawberry. This medication includes both soil improvement and the R&D into fertilizers. On the other hand, Pagoda also 1) implemented advanced plant protection solutions to control pesticide residues and 2) provided post-harvest technical specifications to control the picking standards and post-harvest freshness of its branded strawberries.

**Figure 9: Red Ballerina Strawberry Plantation**

Focus on exploring strawberry cultivation, nutritional management, post-harvest and cold chain logistics technologies and empowering suppliers

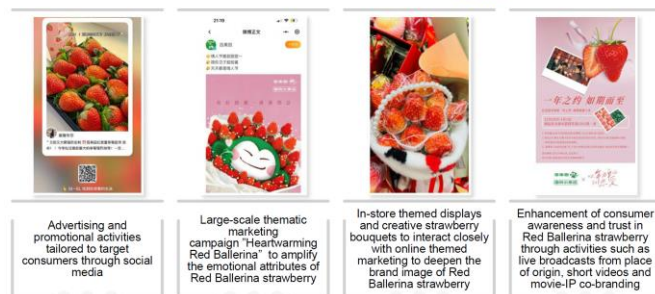


Source: Company data, CMBIGM

**Figure 10: Red Ballerina Strawberry Marketing**

Leverage existing channels to enter market and establish market awareness rapidly

Red Ballerina on Valentine's Day promotion video gained **5MM+** hits on major domestic media platforms with WeChat topic viewership of **17MM+**



Source: Company data, CMBIGM

### Successful branding strategy to create brand premium

Pagoda has adopted a branding strategy to exert control over upstream supply chain and to reserve high-quality product brands. Through organic development and close partnership with the relevant suppliers, the company had successfully introduced to the market 31 self-owned product brands that are exclusively distributed by the company in China under the Excellent and Grade A categories. These 31 product brands cover 20 fruit types, including apple, strawberry, durian, grape, mellow, prune and others. Meanwhile, Pagoda had registered 211 trademarks as brand names for its fruit products in China, such as "Red Ballerina" brand for strawberry (紅芭蕾), and "Daba" brand for musang king durian (大芭貓山王). Pagoda is also currently in the process of registering 33 additional brand names. Pagoda only applies such proprietary brand names to its premium quality products, which differentiates itself from other competitors in the market.

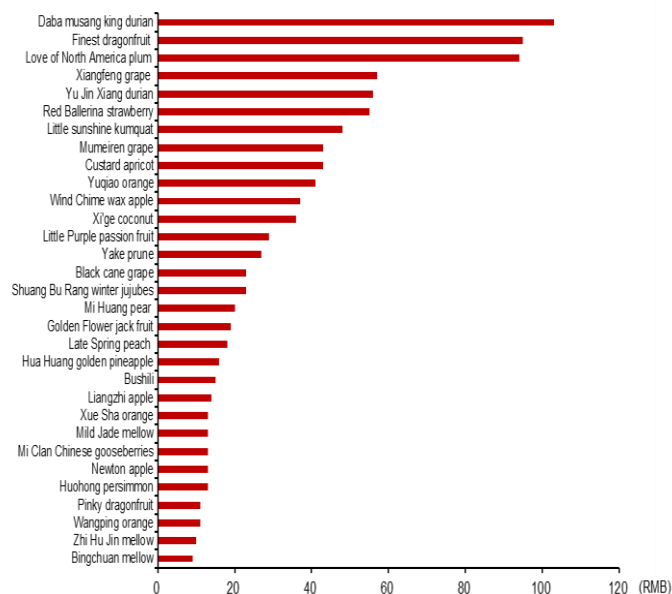


Figure 11: Snapshots of Pagoda's brand portfolio



Source: Company data, CMBIGM

Figure 12: List of brands and ASP



Source: Company data, CMBIGM

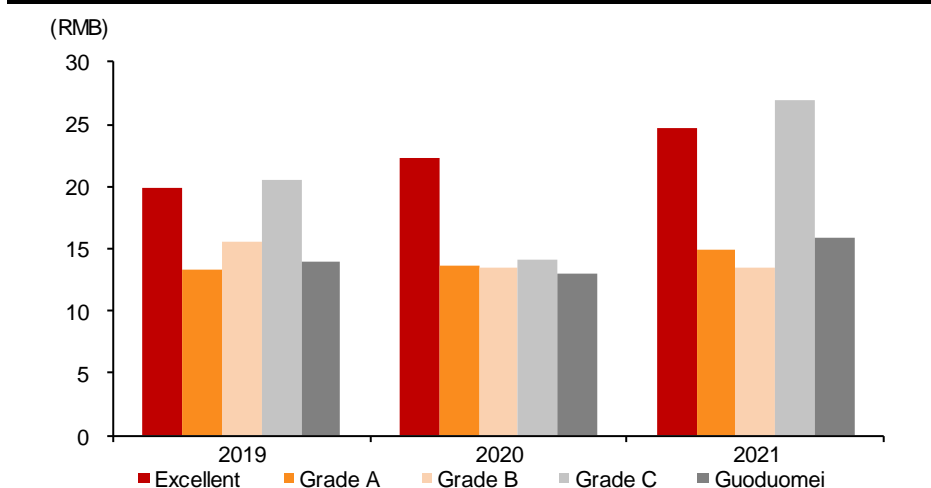
Figure 13: Brands under the trademark Panda.F



Source: Company data, CMBIGM

## Proprietary IT solutions to enable price mark-ups

Pagoda takes into account a number of factors to set prices to consumers, including costs relating to procurement and warehousing, market demands and the prices set by major competitors. Leveraging its standardized fruit quality classification system, Pagoda is able to price differently based on different quality levels of fruits. Such a pricing strategy allows the company to maximize the value of each type of fruits, achieve good value-for-money, and cater to the needs of consumers with different purchasing power. For instance, Excellent-grade commands an ASP of about RMB19.9 to RMB24.6 per kg between 2019-2021, while that for Grade A ranges from RMB13.3 to RMB14.9 per kg over the same period.

**Figure 14: ASP across various grades of fresh fruits 2019-21**

Source: Company data, CMBIGM

Pagoda has developed a proprietary 4-Grade Fruit Quality System in all stores under Pagoda brand: Excellent, Grade A, B and C. They are classified using parameters including sweetness and sourness, freshness, crispness, softness, flavor, safety, size, color, and absence of defects.

- **Excellent:** Fruits are exclusively provided by Pagoda with highest quality standards and are highly differentiated with other fruits available in the market in terms of all or part of the parameters listed above.
- **Grade A:** Fruits with certain differentiation with other fruits available in the market and are of higher quality, much better than average market products.
- **Grade B:** Fruits with generally similar quality to those in the market.
- **Grade C:** Edible fruits with poorer quality than those in the market.

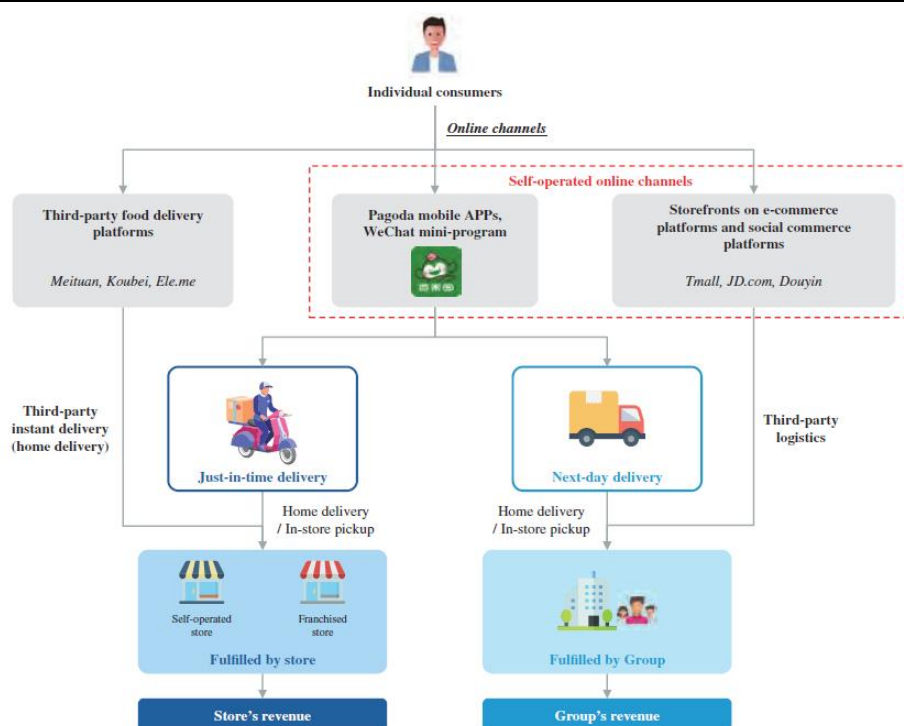
For other fresh groceries, such as vegetables and fresh meat, Pagoda generally prices the products based on their quality levels. With respect to other fresh groceries that are standard items, such as prepacked grains and oils, and dairy products, Pagoda typically sets the retail prices by adopting a cost-plus approach.

## A best-of-class OMO distribution

Pagoda's distribution model can be divided into 3 major building blocks.

1. **The store-as-warehouse features.** The extensive community-based network of small-scale stores that are close to consumers is able to satisfy the personalized consumption needs of community residents. In-store product displays and face-to-face selling have significant added-value. On the other hand, the store-as-warehouse model is able to enhance logistical efficiency and reduce logistic costs, thus, achieving high turnover and low loss rate.
2. **The OMO (online merge offline) strategy**
  - **Online.** By leveraging the store-as-warehouse features as offline touchpoints to consumers, Pagoda also established multiple self-operated online channels, comprising Pagoda mobile APPs, Pagoda WeChat mini-program, stores on mainstream e-commerce platforms such as Tmall and JD.com, as well as storefronts on popular social commerce platforms, such as Douyin. On the other hand, since purchasing of such other fresh groceries is more likely to be a decision of planned buying, Pagoda adopts the online pre-order model which is fulfilled by next-day delivery, and consumers may opt to pick up at a designated retail store or request for home delivery.

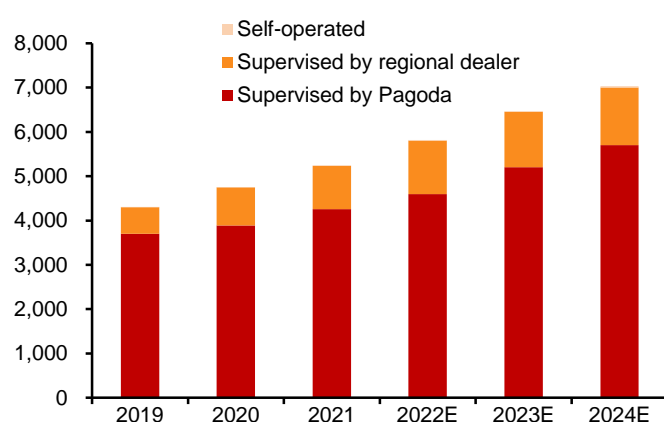
**Figure 15: Major building blocks of Pagoda's online channel**



Source: Company data, CMBIGM

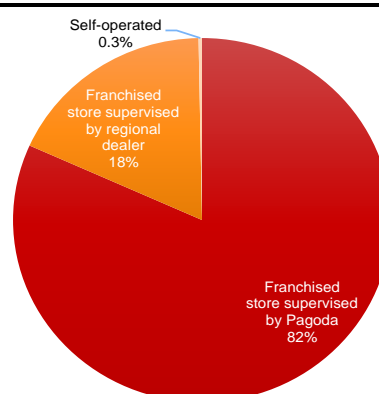
- **Offline.** Pagoda established an extensive nationwide offline retail store network, comprising self-operated stores, franchised stores operated by franchisees and supervised by Pagoda, and franchised stores operated by franchisees and supervised by regional dealers in designated regions. Within designated regions where Pagoda engages regional dealers, there were no cannibalization from franchised stores supervised by Pagoda nor its self-operated stores. By June 2022, Pagoda operated 5,451 stores located in over 140 cities covering 22 provinces and municipalities across China. Among these, 5,435 were franchised stores with the remaining 16 self-operated stores. Among all franchised stores, 4,454 were franchised stores supervised by Pagoda itself while 981 were franchised stores supervised by regional dealers.

Figure 16: Pagoda offline store by type 2019-24E



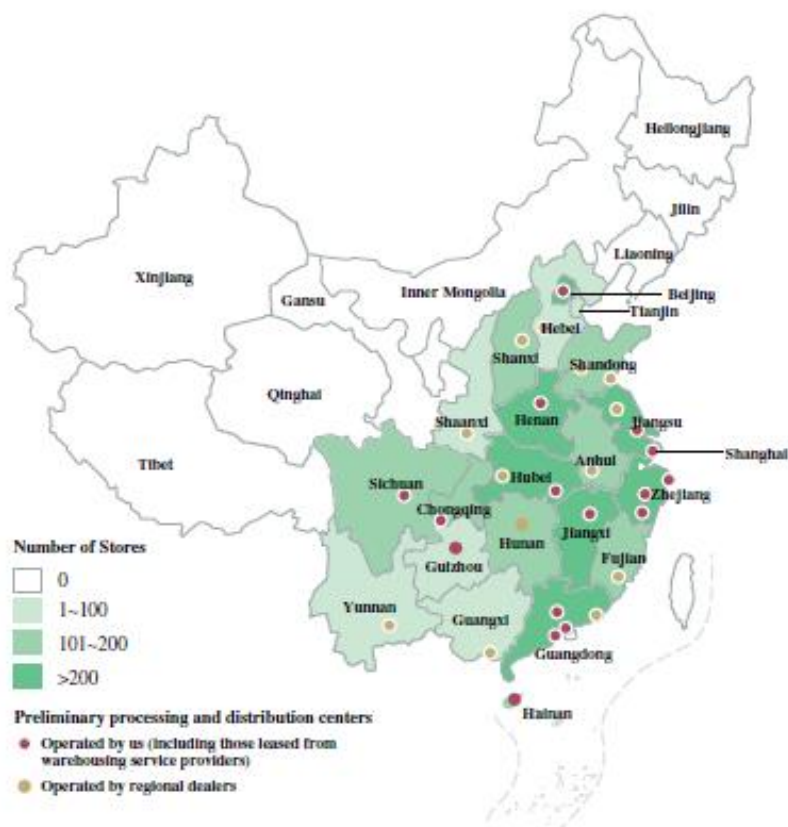
Source: Company data, CMBIGM

Figure 17: Offline store structure 1H22



Source: Company data, CMBIGM

**Figure 18: Overview of Pagoda retail network with 33.2% of total locating in tier 1 cities**



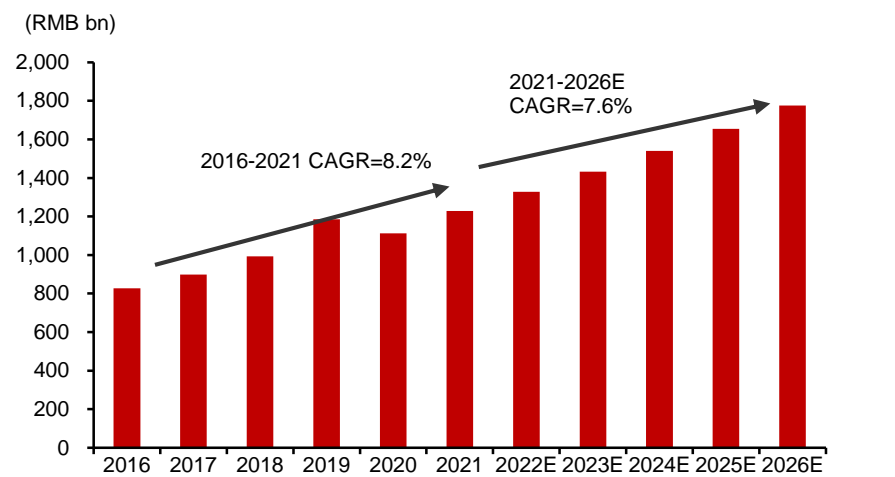
Source: Company data, CMBIGM

- 3. The franchising model.** Pagoda leverages the franchising model to expand its retail network, and such franchisees are either recruited by Pagoda, or referred by regional dealers. Pagoda systematically selects its franchisees based on a number of criteria, including, among others, their local relationships and experience, store locations, operational and marketing capabilities, financial condition, risk management capabilities, legal compliance status, reputation, as well as their understanding of the company, brand, culture and business model. In terms of incentives, the sales proceeds of the franchised stores, after deducting the monthly royalty fee and procurement costs (from Pagoda) shall belong to the franchisees. As such, the store performance is highly related to the economic returns of the franchisees. To start-up a franchise store, franchise will have to pay an upfront RMB20,000-30,000 subject to any concession arrangements. A monthly royalty fee that equals to a certain percentage of gross profits of that month shall also be paid to Pagoda.

## Industry Analysis

With the growing consumption expenditure per capita and the upgrade of spending, consumers' demand for high-quality fruits has been increasing. According to Frost and Sullivan, China's fruit retail market will grow at a 7.6% CAGR between 2021-2026. The improvement of health awareness and a higher willingness and the efficiency of distribution explained the trend.

**Figure 19: Retail sales value of fruit retail market in China**



Source: Frost and Sullivan, CMBIGM

## Key drivers

### ■ Food upgrade

1. According to Frost & Sullivan, per capita consumption of fruits increased at a 3.7% CAGR from 2016 to 2021, and a projected CAGR of 2.8% until 2026. Compared with developed countries, the per capita consumption of fruit in the US/Japan was 2.1/1.4 times of China. There is a great potential for growth of China's fruits market. Moreover, China's economic growth has led to a continuous increase in disposable income per capita, customers are paying more attention to food safety and sources, and are willing to pay a premium for high-quality fruits.
2. In Aug 2019, the National Health Council issued the "Healthy China Action (2019-2030)", encouraging residents to improve their diet structure, and emphasizes the importance of promoting a healthy diet. The continuous improvement of health awareness is mainly represented by vegetarian and organic food as healthy diets.
3. Since younger generation gradually realizes the significance of healthy diet, they consume fruits as the main dietary substitute in their daily leisure, which has further promoted the expansion of the consumption scenarios and the consumption and market growth of fruits.



## ■ Supply chain especially cold-chain logistics upgrade

1. The lag of logistics technology in the past has caused a considerable loss of fresh food. The expansion of logistics coverage, and rapid developments in cold chain logistics technologies have enabled upgrades of professional transportation vehicles and warehouses, increasing transportation speed, and effectively reducing the loss.
2. Expansion of logistics coverage, including more constant temperature warehouses, professional transportation vehicles and labor force, is able to speed up transportation and reduce damage costs. With continuous applications of the IoTs, block chain, radio-frequency identification, and other technologies in cold chain logistics, real-time monitoring means will be gradually commercialized in the logistics phases, effectively guarantee quality control and reduce loss of fruit products.
3. The development of supply chain and the promotion of cold chain warehousing and logistics technologies have successfully guaranteed the quality of the fresh food products, further driving rapid development of fresh food industry. These core strengths, in addition to a comprehensive fruit quality classification system for fruit products, standardized management system across the entire industry value chain that is proprietary to Pagoda.

- **Policy support.** China launched a series of policies to support the development of the fruit industry in recent years, covering planting, logistics, sales and other aspects. Such policies emphasize the importance of agricultural quality and safety to the lifestyle of citizens, encourage transformation and upgrade of agricultural products, logistics and warehousing, and new retail of agricultural products.

**Figure 20: Relevant policies and supported projects by the central government**

Policies	Year of issuance	Issuing authorities	Objectives of policies
Development Plan for Cold Chain Logistics of "14th Five-Year"...	2021	State Council of the PRC	Building a national backbone network of cold chain logistics with internal and external connections, improving the large scale development and network operation of cold chain logistics, improving the utilization efficiency of cold chain facilities in production areas and post-production commercialization of agricultural products, and giving full play to the important role of cold chain logistics in promoting consumption and improving social and people's livelihood
The Rural Development Plan of Digital Agriculture (2019-2025)...	2020	Ministry of Agriculture and Rural Affairs, the Office of the Central Cyberspace Affairs Commission	Promoting the development of digital agriculture and rural construction by establishing a basic data collection system. Speeding up the digital transformation of production and operation, promoting digital transformation of management services, and implementing the construction of the National Agricultural and Rural Big Data Center
Main Points of Planting in 2019...	2019	Ministry of Agriculture	Adhering to "integration, improvement, promotion and unsealing" to deepen supply-side structural reform of agriculture, stabilize grain production, ensure supply of major agricultural products, optimize the planting structure, accelerate the promotion of green development, and comprehensively promote the development of high-quality planting industry
Opinions on Accelerating the Development of Cold Chain Logistics to Ensure Food Safety and Promote Consumption Upgrade...	2017	State Council of the PRC	Establishing a modern cold chain logistics system with strict standards and better traceability covering the entire value chain. Improving cold chain logistics infrastructure network and cold chain logistics information level, improving cold chain circulation rate, refrigerated transportation rate of fresh agricultural products and perishable food, and reducing decay rate of fresh products
Opinions of General Office of the State Council on Promoting Innovation and Transformation of Physical Retail...	2016	State Council of the PRC	Proposing 16 specific measures to promote transformation, upgrade and development vitality of physical retailers. Measures such as promoting online and offline integration, innovating operation mechanism, simplifying administration and decentralization, promoting fair competition and reducing tax burden of enterprises have become important guarantees to support the development of new retail industry.
Guiding Opinions of the State Council on Vigorously Advancing the "Internet Plus" Action...	2015	State Council of the PRC	Emphasis is placed on improving the rural e-commerce distribution service network and solving the key problems such as standardization of agricultural products, standardization of logistics, cold chain warehousing construction, etc.

Source: Company data, CMBIGM

## Barriers to entry

- **A fragmented market.** Fruit retailing industry is highly fragmented with fierce competition among existing market participants. The top five participants only accounted for 3.6% market share in aggregate.

**Figure 21: Top five retail enterprises in China in terms of fruit retail sales value**

Rank	Company	Retail sales value of fruits (RMB bn)	Market share	Number of stores
1	Pagoda	12.7	1.0%	5,249
2	Company A	10.8	0.9%	4,320
3	Company B	8.5	0.7%	1,065
4	Company C	7.7	0.6%	4,313
5	Company D	5.2	0.4%	302

Source: Company data, CMBIGM  
 Note: data is updated until Jun 2022

**Figure 22: Top five fruit specialty retail enterprises in China in terms of fruit retail sales value**

Rank	Company	Retail sales value of fruits (RMB bn)	Market share	Number of stores
1	Pagoda	12.7	1.0%	5,249
2	Company E	4.5	0.4%	1,800
3	Company F	2.7	0.2%	817
4	Company G	1.3	0.1%	2,570
5	Company H	0.9	0.1%	246

Source: Company data, CMBIGM  
 Note: data is updated until Jun 2022

- **System standardization.** Standardization of agricultural products is different from other commodities, and fruit products are not easy to be quantified by standards. There is no recognized industry standard for fruits in China. Fruit retailers have to invest time and money to establish their own standard and quality control systems for the entire retailing process.
- **Logistics and warehousing.** It is difficult to build and manage cold chain logistics and “last kilometer” distribution system. Fruit products need a well-designed cold-chain logistics system as they are particularly vulnerable to high temperature and careless unloading during transportation, which may lead to deterioration or damage. Moreover, the cold chain logistics system is an obstacle for new entrances, as the threshold of new retail of fresh food is even higher than traditional retail.
- **Quality control.** High-quality fruit producers and brand suppliers are scarce in China, so retailers need strong control ability. At present, large-scale retailers in China mainly cooperate with producers through direct sourcing, intervene in the upstream supply chain, provide planting technical guidance, formulae relevant fruit standards to improve the quality and stability of fruits while reducing the circulation phases. Retailers may also have long-term cooperation with domestic and overseas large brand suppliers to guarantee fruit quality.

- **Digitalization.** Advanced ERP system is required for daily operation, which is the basic technical obstacle for new retail operators of fruit groceries. Offline and online sales and data are converging into a new retail model, and “middle-end” management is becoming increasingly important. In terms of product operation, using big data and AI technology to manage marketing activities requires a skilled and experienced team. A strong membership system may manage a large customer base and maintain high customer loyalty. The data collected by retailers in the membership system may better understand customers’ needs. Fruit retailers need to distinguish, recognize and grasp the needs of consumers to bring user retention.
- **Upfront capital investment.** Building its own operation system requires a large amount of capital as support. High rotten rate of fruits in the process of transportation and warehousing has put great pressure on the early profits of fruit retailers, which requires sufficient funds for support.

## Upcoming trends

- **Agricultural modernization.** The planting process often lacked support of modern agriculture in the past, with low mechanized production capability and highly dispersed planting. With the development of modern planting technology, the mechanization level in planting of fruit groceries has been greatly improved. It reduces costs, improves quality and production volume to meet the increasing customers' demand in large-scale cultivation of fruits.

For warehousing and logistics, by virtue of advanced cold-chain logistics and supply-chain management capabilities, enterprises may simplify and shorten the circulation process, improve efficiency and reduce costs. For sales channels, fruit specialty retailers, modern retailers and e-commerce operators rely on the optimization of connection from cultivation to sales and trend of direct sourcing to further improve overall supply chain efficiency to increase corporate profitability and quality control level.

- **Emergence of new retail.** Traditional markets have been replaced by modern retail and fresh specialty retail due to large-scale urban transformation. At the same time, diversified sales channels have emerged and entered to the market, in particular, omni-channel new retail which offers diversified consumption scenarios, leveraging modern technologies, data and customer engagement techniques. Consumers have been gradually shifting from traditional markets to new retail operators.

New retail models, such as e-commerce and omni-channel retail, have been emerging. New retail models leverage technologies to grasp consumers' purchasing habits and provide more convenient shopping experience, leading to a continuous increase in market share. Offline fruit specialty chain retail is able to offer convenient shopping experience and drive high repeat purchase rate. Meanwhile, fruit new retailer operators take advantage of the integration of cultivation and sales end to shorten logistics duration, and reduce losses, further contributing to growth of the industry. In addition, the outbreak of COVID-19 in the beginning of 2020 accelerated the acceptance level and frequency of online consumption, which leads to a continuous increase in business opportunities through online expansion.

- **Becoming more tech-savvy.** Through integration of 5G, AI, big data and other technologies, fresh and fruit retailers can control the quality and freshness of fruits, reducing losses and costs. Efficient delivery goods will be carried out through the IoTs and real-time data sharing to ensure freshness and quality of fruits. They may also use it to formulate a membership system.
- **A widening product offerings.** Consumers' demand increase promotes diversified offering and branding of fruit categories. As disposable income per capita increases and consumers are more concerned about consumption experience, consumers will select retailers which provide more fruits.

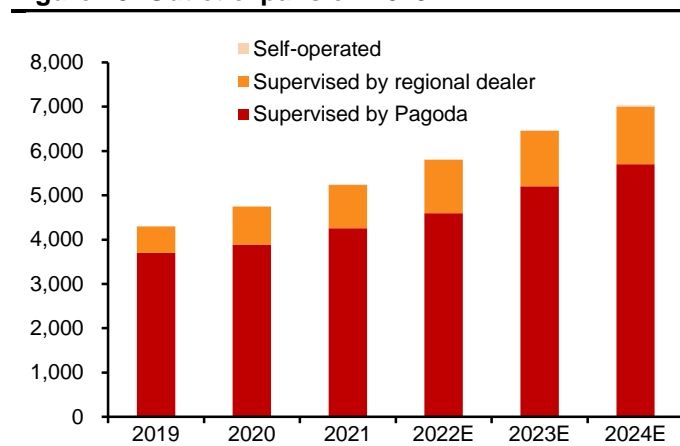
At present, China's fruit industry is in the period of industrial transformation in which products are mostly standardized. However, a few enterprises are simultaneously deploying channel brands and product category brands. Strong planting and processing technology, mechanized-oriented unified processing, as well as the emphasis on quality control ensure and accelerate this trend. A strong fruit brand will change the traditional idea that customers may only evaluate fruits in accordance with the place of production and freshness, in order to increase customer stickiness and maintain a long-term relationship with loyal customers.

## Financial analysis

We forecast revenue to grow at 11.6% CAGR in 2021-24E, led by

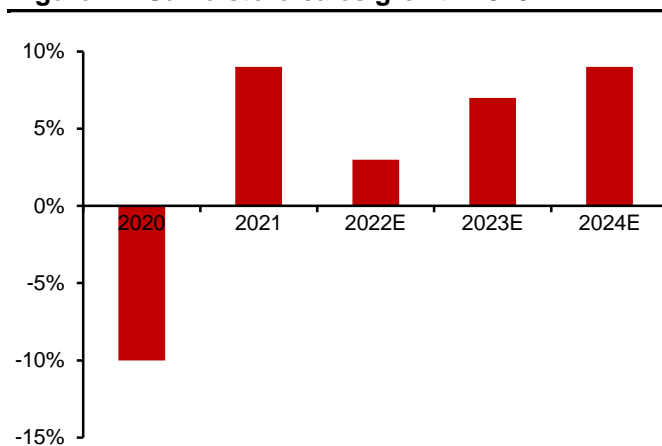
- 1. An average of c600 new outlet openings per annum.** We estimate the total number of new store openings will jump from 5,249 in 2021, to 5,816 in 2022, 6,470 in 2023 and 7,030 in 2024. We expect most of the new franchise stores will be supervised by Pagoda itself, and this would lead the number from 4,254 in 2021, to 4,600 in 2022, 5,200 in 2023 and 5,700 in 2024. Meanwhile, we expect the number of franchise store supervised by regional dealer to be largely stable and increase by 50 stores during 2022-24.
- 2. 3%/7%/9% same-store-sales growth between 2022-24E.** Given most of the new stores opened in the past two years have been managed by Pagoda itself, we forecast efficiency will start to improve and enhance same-store-sales growth from 3% in 2022E to 7% in 2023E and 9% in 2024E.
- 3. A 35.7% 3-year revenue CAGR of Excellent-graded,** thanks to greater brand acceptance and a strengthening demand on quality fruit products.

Figure 23: Outlet expansion 2019-24E



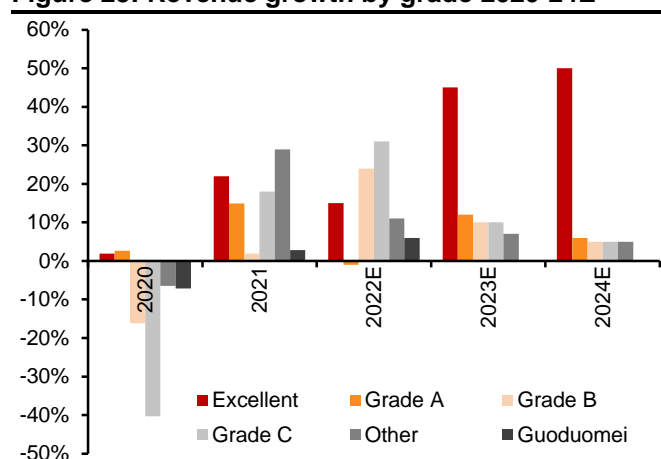
Source: Company data, CMBIGM estimates

Figure 24: Same-store-sales growth 2020-24E



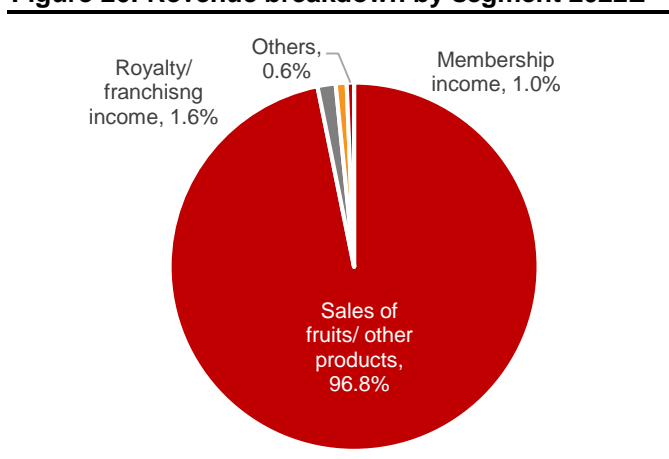
Source: CMBIGM estimates

Figure 25: Revenue growth by grade 2020-24E



Source: Company data, CMBIGM estimates

Figure 26: Revenue breakdown by segment 2022E



Source: Company data, CMBIGM estimates



Figure 27: Revenue breakdown by channel and our key revenue assumptions

	2019	2020	2021	2022E	2023E	2024E
<b>Total Revenue (Rmb mn)</b>	<b>8,976.133</b>	<b>8,853.693</b>	<b>10,289.375</b>	<b>11,176.468</b>	<b>12,751.593</b>	<b>14,307.881</b>
Sales of fruits/ other products	8,749.826	8,636.814	9,991.758	10,820.459	12,334.069	13,825.400
Franchise store	7,700.174	7,309.099	8,127.061	8,817.861	10,025.908	11,178.888
Self-operated stores	36.587	39.210	48.296	59.827	73.481	90.177
Regional dealers (wholesales)	455.887	493.562	968.022	1,064.824	1,192.603	1,311.863
Direct sales (to B)	524.289	515.526	522.750	601.163	751.453	939.316
Online	32.889	279.417	325.629	276.785	290.624	305.155
Royalty/ franchising income	171.549	131.364	160.288	177.621	197.527	214.371
Membership income	46.062	54.454	77.670	106.796	123.350	142.469
Others	8.696	31.061	59.659	71.591	96.648	125.642
<b>Total Revenue y-y</b>		<b>-1.4%</b>	<b>16.2%</b>	<b>8.6%</b>	<b>14.1%</b>	<b>12.2%</b>
Sales of fruits/ other products		-1.3%	15.7%	8.3%	14.0%	12.1%
Franchise store		-5.1%	11.2%	8.5%	13.7%	11.5%
Self-operated stores		7.2%	23.2%	23.9%	22.8%	22.7%
Regional dealers		8.3%	96.1%	10.0%	12.0%	10.0%
Direct sales		-1.7%	1.4%	15.0%	25.0%	25.0%
Online		749.6%	16.5%	-15.0%	5.0%	5.0%
Royalty/ franchising income		-23.4%	22.0%	10.8%	11.2%	8.5%
Membership income		18.2%	42.6%	37.5%	15.5%	15.5%
Others		257.2%	92.1%	20.0%	35.0%	30.0%
<b>Total Revenue contribution</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Sales of fruits/ other products	97.5%	97.6%	97.1%	96.8%	96.7%	96.6%
Franchise store	85.8%	82.6%	79.0%	78.9%	78.6%	78.1%
Self-operated stores	0.4%	0.4%	0.5%	0.5%	0.6%	0.6%
Regional dealers	5.1%	5.6%	9.4%	9.5%	9.4%	9.2%
Direct sales	5.8%	5.8%	5.1%	5.4%	5.9%	6.6%
Online	0.4%	3.2%	3.2%	2.5%	2.3%	2.1%
Royalty/ franchising income	1.9%	1.5%	1.6%	1.6%	1.5%	1.5%
Membership income	0.5%	0.6%	0.8%	1.0%	1.0%	1.0%
Others	0.1%	0.4%	0.6%	0.6%	0.8%	0.9%

Source: Company data, CMBIGM estimates

Figure 28: Revenue from sales of fruits and our key revenue assumptions

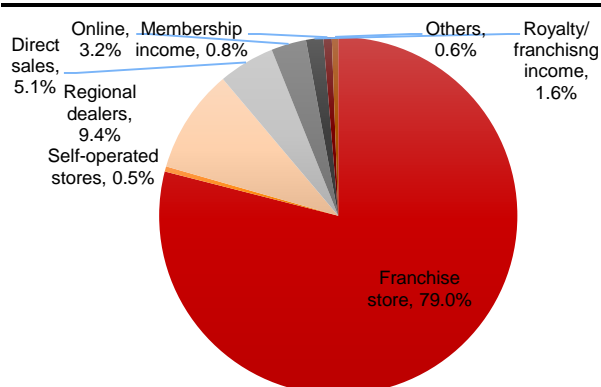
	2019	2020	2021	2022E	2023E	2024E
<b>Revenue from sales of fruits</b>	<b>7,736.761</b>	<b>7,348.309</b>	<b>8,175.357</b>	<b>8,877.688</b>	<b>10,099.389</b>	<b>11,269.065</b>
Excellent	711.522	725.258	884.704	1,017.410	1,475.244	2,212.866
Grade A	3,321.719	3,408.741	3,916.111	3,876.950	4,342.184	4,602.715
Grade B	2,493.582	2,090.679	2,130.082	2,641.302	2,905.432	3,050.703
Grade C	5.975	3.565	4.206	5.510	6.061	6.364
Other	362.373	338.897	436.954	485.019	518.970	544.919
Guoduomei	841.590	781.169	803.300	851.498	851.498	851.498
<b>Total Revenue y-y</b>		<b>-5.0%</b>	<b>11.3%</b>	<b>8.6%</b>	<b>13.8%</b>	<b>11.6%</b>
Excellent		1.9%	22.0%	15.0%	45.0%	50.0%
Grade A		2.6%	14.9%	-1.0%	12.0%	6.0%
Grade B		-16.2%	1.9%	24.0%	10.0%	5.0%
Grade C		-40.3%	18.0%	31.0%	10.0%	5.0%
Other		-6.5%	28.9%	11.0%	7.0%	5.0%
Guoduomei		-7.2%	2.8%	6.0%	0.0%	0.0%
<b>Total Revenue contribution</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Excellent		9.9%	10.8%	11.5%	14.6%	19.6%
Grade A		46.4%	47.9%	43.7%	43.0%	40.8%
Grade B		28.5%	26.1%	29.8%	28.8%	27.1%
Grade C		0.0%	0.1%	0.1%	0.1%	0.1%
Other		4.6%	5.3%	5.5%	5.1%	4.8%
Guoduomei		10.6%	9.8%	9.6%	8.4%	7.6%

Source: Company data, CMBIGM estimates

## Franchise store contributes the largest channel share

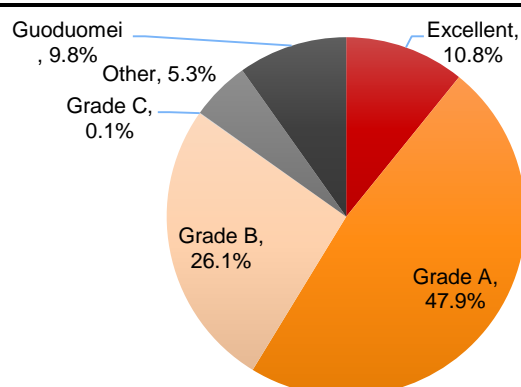
- **By distribution channel.** Sales of fruit from franchise store revenue represented the largest contribution of 79% to 2021 total revenue, followed by 9.4% from regional dealers and 5.1% from Pagoda's direct sales.
- **By product grading.** Grade A represented the largest contribution of 47.9% to 2021 revenue from sales of fruits and other products at retail stores. This is followed by 26.1% from Grade B and 10.8% from Excellent grade. Guoduomei contributed 9.8% to the total over the same period.
- **By tier of cities.** Tier-1 cities represented the highest 37.1% of 2021 revenue, followed by 22.0% and 21.8% of tier-2 and tier-3 cities. Other sales channel contributed the remaining 19.1% of the total.

**Figure 29: Revenue mix by channel 2021**



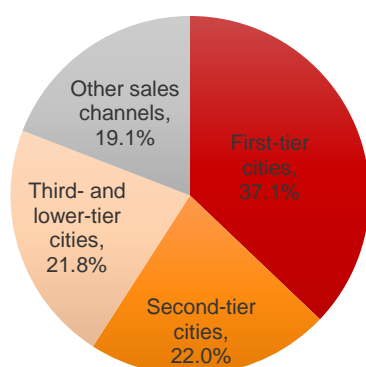
Source: Company data, CMBIGM

**Figure 30: Revenue mix by grading 2021**



Source: Company data, CMBIGM

**Figure 31: Revenue mix by tier of cities 2021**



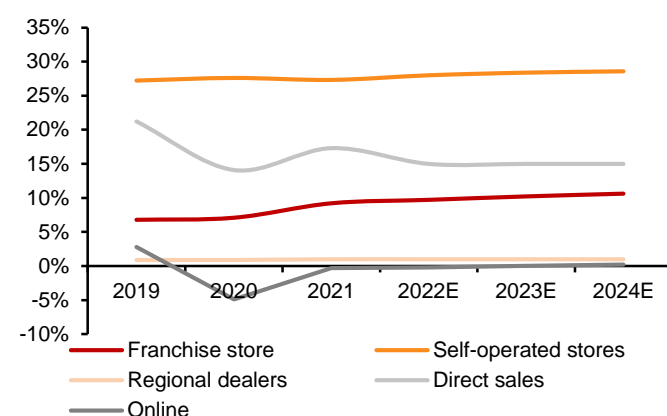
Source: Company data, CMBIGM

## GPM expansion underpinned by mix upgrade and brand additions

We forecast that GPM will expand from 11.9% to 12.9% between 2022-24E, led by

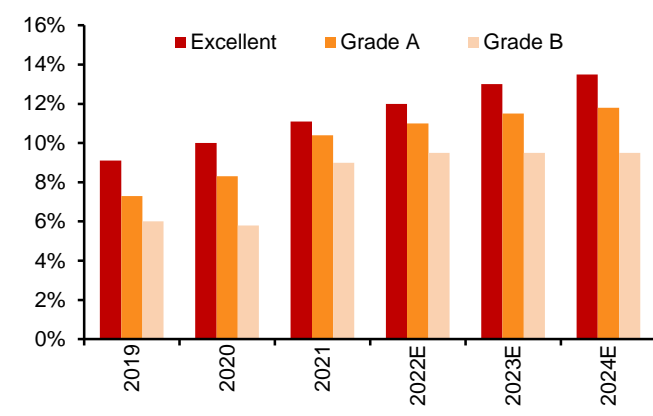
- 1. An average 1pp increase in GPM for premium-branded SKUs.** We base our forecast on a gradual improving sales mix of which Excellent-grade SKU will take a larger sales proportion, from 11.5% in 2021 to 14.6% in 2023E and 19.6% in 2024E.
- 2. A widening brand portfolio.** Excelled-grade fruits are mainly sold through brands, and Pagoda has been aggressively developed different brands to exert control over upstream supply chain and solidify consumer perception. For instance, the company launched 31 self-owned brands to cover 20 fruit types, which are exclusively distributed by the company in China as of October 2022. Branded fruit SKU enables Pagoda to charge a premium to non-branded fruit SKUs.
- 3. Potential break-even of online business in 2023E.** We expect the gross profit margin on online channels will improve from increasing economies of scale of online business, as Pagoda continues to optimize online product offerings, especially the products under the Panda.F brand, and to foster a broader and more engaging consumer base.

Figure 32: GPM breakdown by channel 2019-24E



Source: Company data, CMBIGM estimates

Figure 33: GPM breakdown by grade 2019-24E

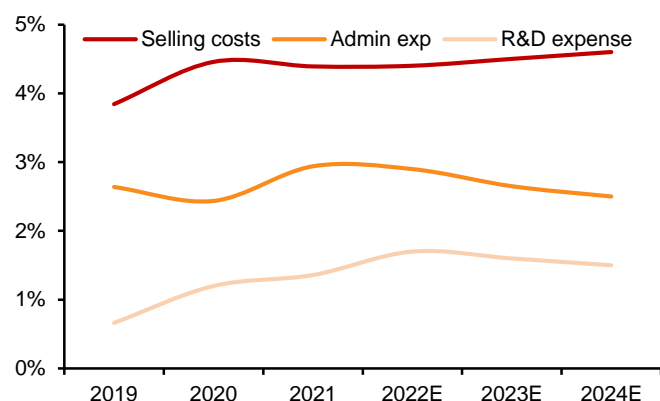


Source: Company data, CMBIGM estimates

## Stringent cost control will drive EBIT margins to expand

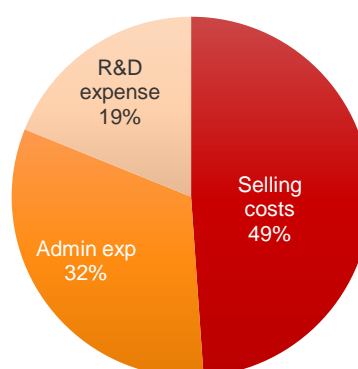
Pagoda is cost-cautious and targets to control administration and R&D expense to grow approximately by 5% for 2023E and 2024E. Meanwhile, selling expense is directly proportionate to revenue growth and we forecast the item to grow similarly to revenue at 16.7% and 14.7% for 2023E and 2024E, respectively. Overall, we expect opex ratio (to revenue) would remain stable and boost EBIT margins from 3.4% in 2022E (which include a one-off listing expense of RMB14.5mn) to 4.2%/ 4.9% for 2023/24E, respectively.

**Figure 34: Opex trend and % to revenue 2019-24E**



Source: Company data, CMBIGM estimates

**Figure 35: Opex breakdown 2022E**

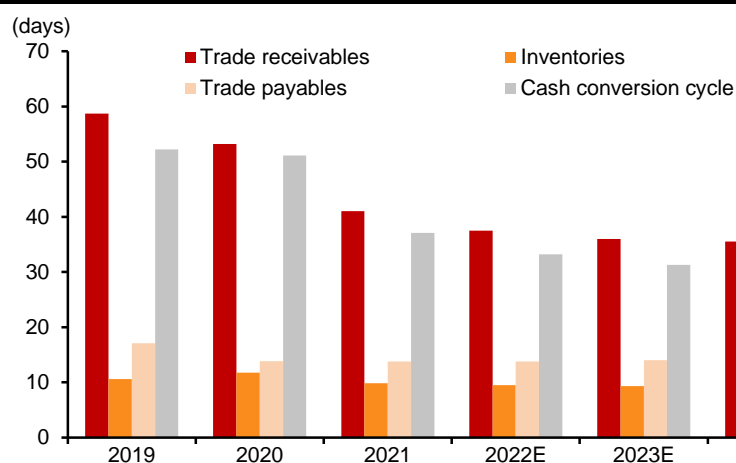


Source: Company data, CMBIGM estimates

## Working capital, CAPEX, dividend

- **A steady operating cash inflow.** We forecast Pagoda to generate RMB371mn, 474mn and 586mn of OCF during 2022-24E, and this is much underpinned by solid working capital management with a gradually decreasing trade receivable days. Meanwhile, we expect Pagoda to pay off its payable at a similar pace. To ensure sufficient inventory when sales growth accelerates, we assert stable inventory days throughout 2022-24E. After all, this results in a shorter cash conversion cycle from 37.1 days in 2022E to 30.3 days in 2024E.

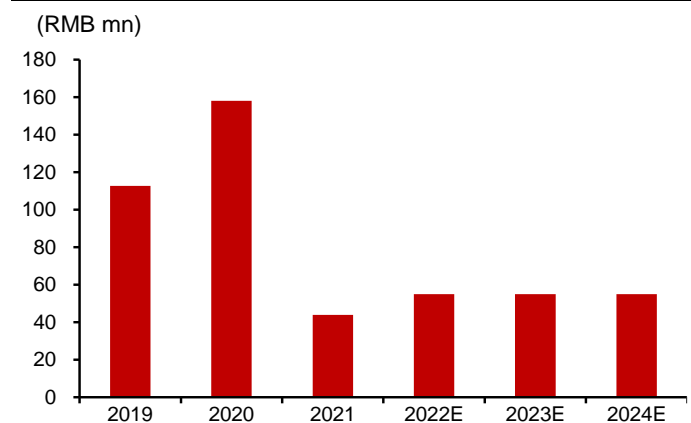
**Figure 36: Working capital days analysis and cash conversion cycle**



Source: Company data, CMBIGM estimates

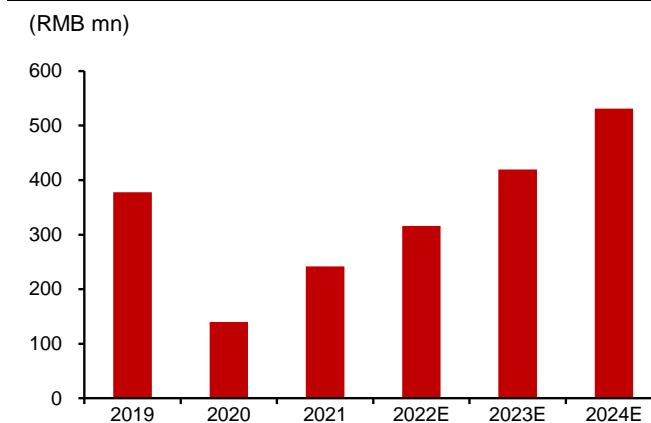
- **A disciplined capex plan.** Pagoda's capex cycle has peaked-out in 2020 with RMB158mn being spent on warehouse construction and equipment additions. For 2022-24E, we think Pagoda will uphold RMB55mn capex mainly for maintenance purpose.

Figure 37: Capex to flatten out since 2022E...



Source: Company data, CMBIGM estimates

Figure 38: ...which leads to an improving FCF



Source: Company data, CMBIGM estimates

- **Dividend policy.** We estimate Pagoda will commence its dividend payment upon the first year of listing to align shareholder interest with management's. We forecast dividend payout ratio to initially set at 20% and would adjust from time to time in view of business situation and thus operation cash generation.

## Peers comparison

### Vis-à-vis Hongjiu Fruits (6689 HK, Buy)

We consider Hongjiu Fruits the closest comparable peers to Pagoda.

#### ■ Similarities

1. Both of them has operated in the domestic fresh fruit distribution business for over 20 years of history;
2. Both of them engage in the fruit wholesales business;
3. Both of them develop their own brands;
4. Both of them source from both local and overseas markets;
5. Both of their businesses were once hit by the pandemic but are set to recover in the next three years.

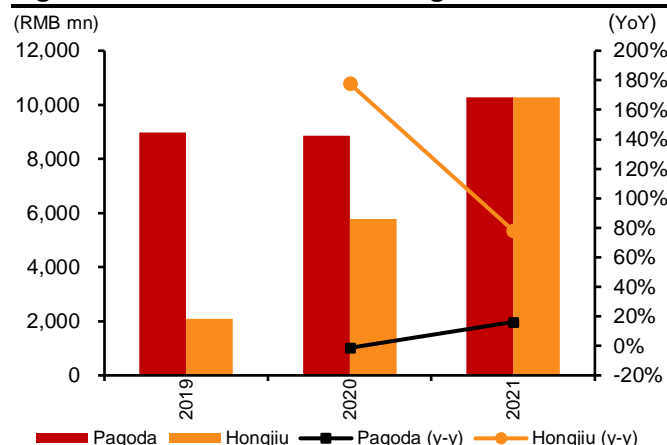
#### ■ Difference

1. Pagoda develops its own agricultural expertise and is able to manage its fruits quality;
2. Hongjiu does not principally engage in the fruit retailing business, but Pagoda does;
3. Hongjiu does not own a franchise-based national distribution network as Pagoda does;
4. Pagoda's retail business also enables it to derive other sources of revenue such as membership income and franchise royalties;

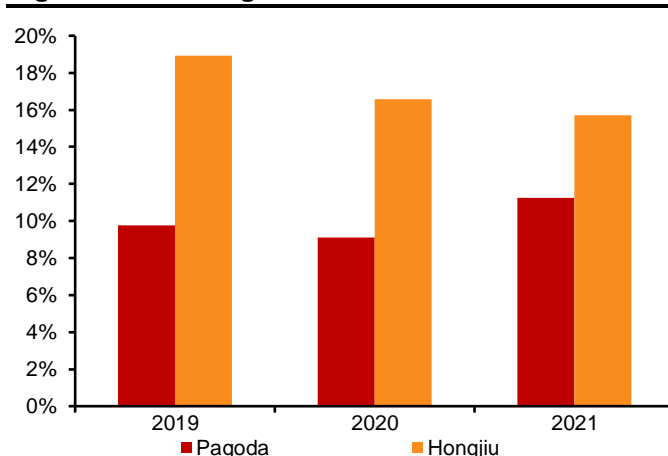
#### ■ These similarities and differences have manifested into the following financial attributes:

1. Both of them would enjoy the ongoing fresh fruits demand recovery, especially the structural wallet share gains on high-quality fruits;
2. Brand initiations will not only help them to gain market share from non-branded competitors, but also empower them to be more efficient in price segmentation execution;
3. Pagoda delivers slower retail top line growth but with a better diversity of revenue sources from membership income, royalty fees and distribution of other fruit-related SKUs;
4. Retail margins are thinner, yet the business enjoys a shorter receivable cycle and, more importantly, a more sustainable positive free cash flow;
5. Pagoda is more cash-generative, and that provides better visibility of dividend distribution.

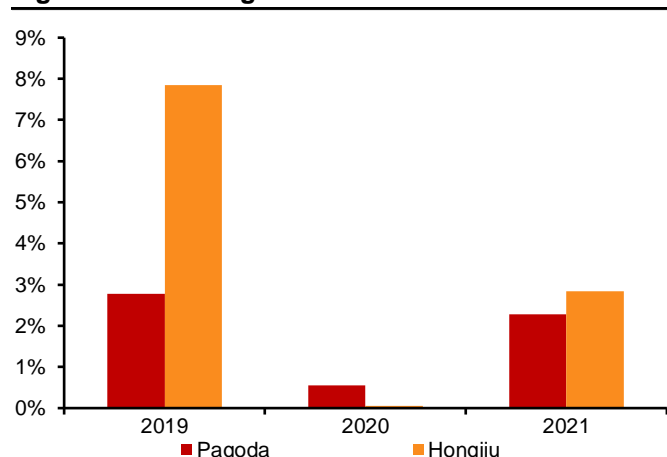


**Figure 39: Revenue and revenue growth 2019-21**

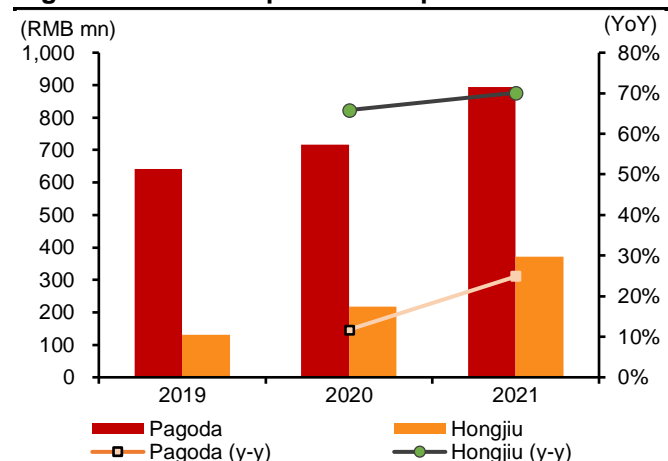
Source: Company data, CMBIGM

**Figure 40: GP margin 2019-21**

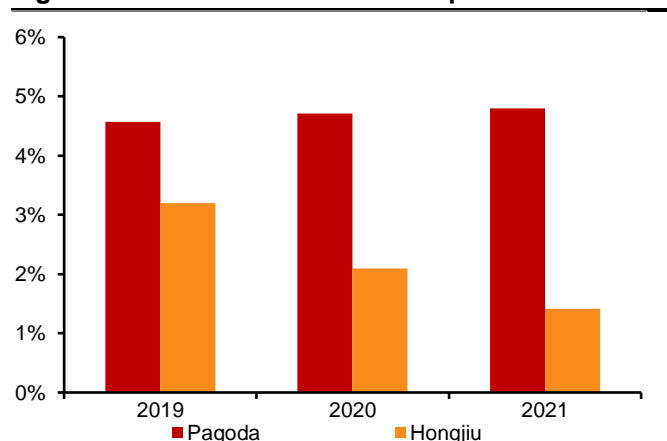
Source: Company data, CMBIGM

**Figure 41: NP margin 2019-21**

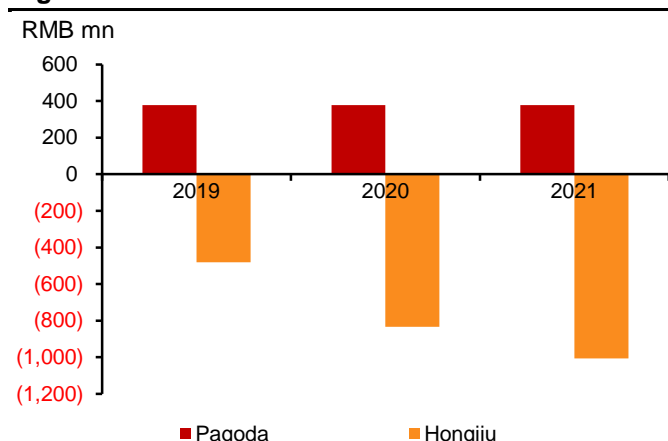
Source: Company data, CMBIGM

**Figure 42: SG&A expenses comparison 2019-21**

Source: Company data, CMBIGM

**Figure 43: PPE to total assets comparison 2019-21**

Source: Company data, CMBIGM

**Figure 44: Free cash flow 2019-21**

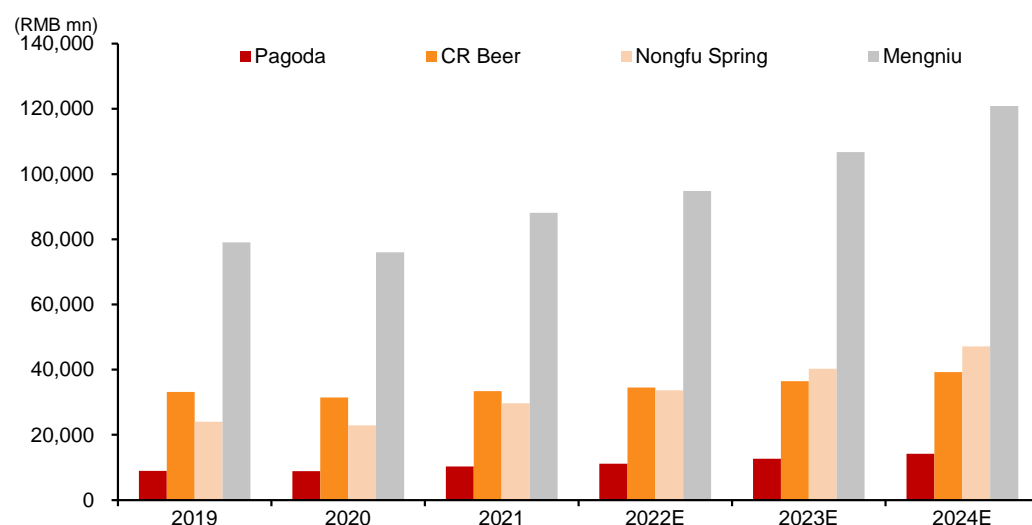
Source: Company data, CMBIGM

## Vis-à-vis China F&B H-share peers

We compare Pagoda with other H-share F&B peers CR Beers (291 HK, BUY), Mengniu (2319 HK, BUY) and Nongfu Spring (9633 HK, BUY) to better understand the business dynamics of different sub-segments.

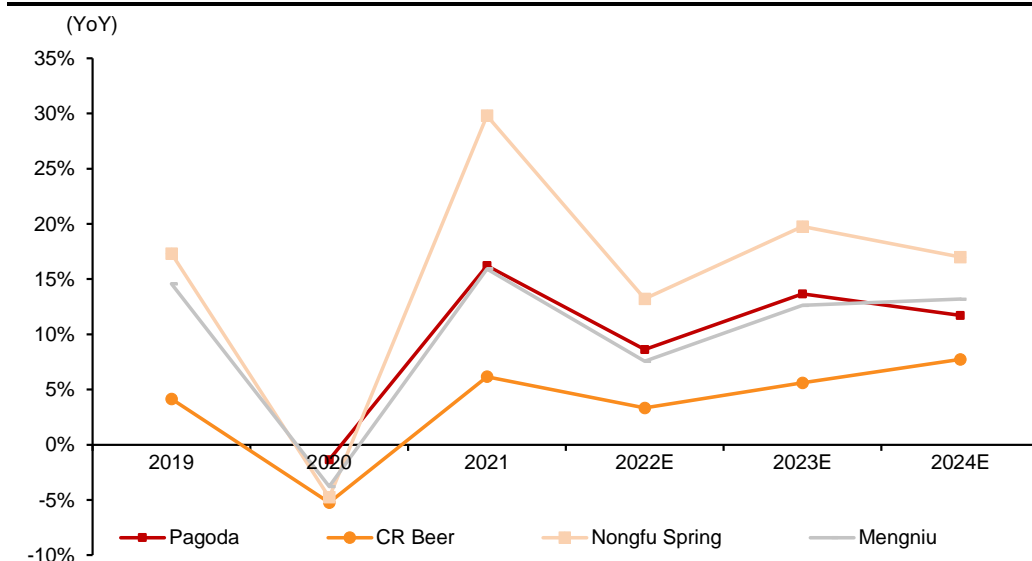
- **Revenue growth.** Among the four companies in our analysis, Pagoda offers similar revenue growth profile to the peer average. Except CR Beer that offers a mid-single digit 3-year CAGR between 2021-24E in our forecast, as China's beer market is already ex-growth, the other three companies, in our view, will deliver low-to-mid-teen increases driven by both market share gain and penetration improvement.

**Figure 45: Revenue comparison 2019-24E**



Source: Company data, CMBIGM estimates

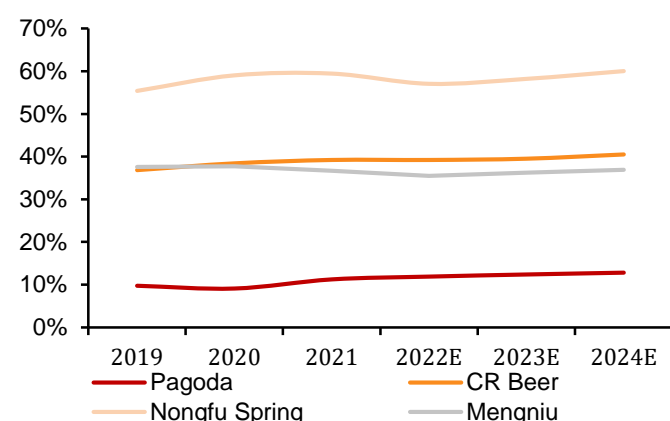
**Figure 46: Revenue growth comparison 2019-24E**



Source: Company data, CMBIGM estimates

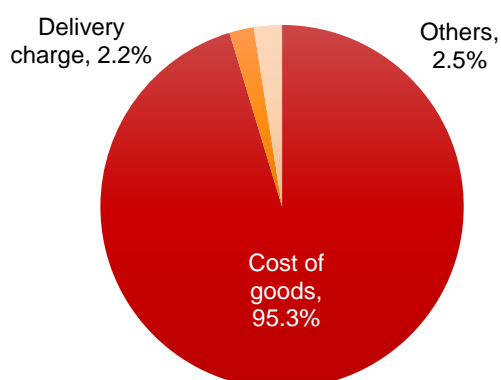
- **Gross margin.** Pagoda has the lowest gross margins among all at 11.2% in 2011, while those of CR Beer, Mengniu and Nongfu Spring were 39.2%, 36.7% and 59.5%, respectively. We attribute this to 1) a 90%+ fruit cost contribution to total COGS vs 50%-ish raw material cost contribution for the peer group; 2) a relatively thinner retail margins that compared to distributor margins for the brand owners and 3) a relatively less solid brand power that stems from more value-added to the production process and investment into advertising and promotions.

Figure 47: Gross margins comparison 2019-24E



Source: Company data, CMBIGM estimates

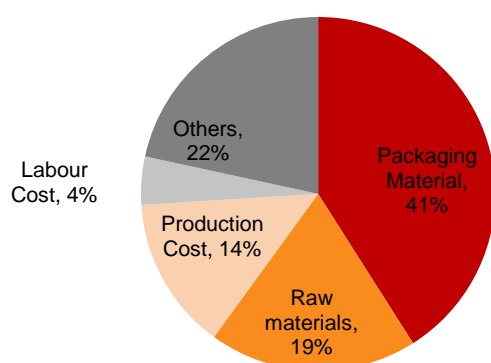
Figure 48: Pagoda COGS mix 2021



Source: Company data, CMBIGM

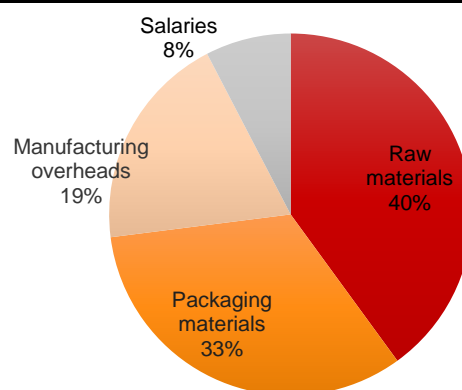
Despite these, Pagoda has muted packaging cost in its COGS mix and that should save the company from any packaging cost inflation which CR Beer (bottle and aluminium cost) and Nongfu (PET) have been facing.

Figure 49: CR Beer COGS mix 2021



Source: Company data, CMBIGM

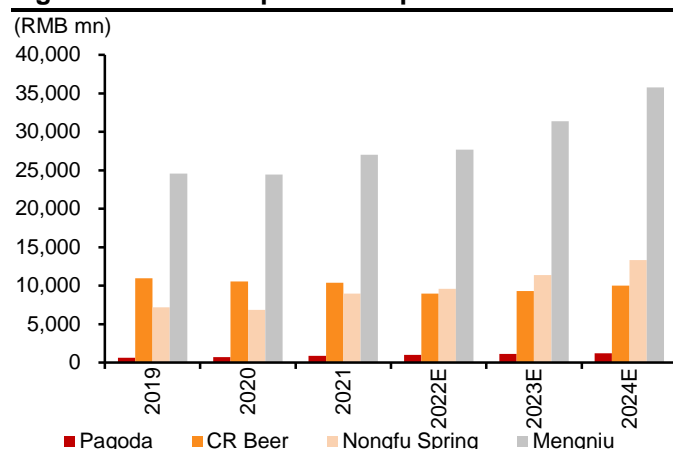
Figure 50: Nongfu Spring COGS mix 2021



Source: Company data, CMBIGM

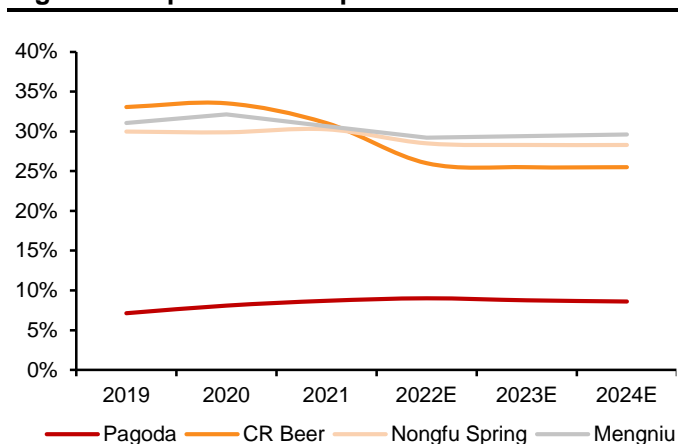
- **Opex.** Pagoda has a lower opex ratio than the peer group. We believe, as discussed, this is mainly due to a lower selling and promotion expense.

Figure 51: SG&amp;A expense comparison 2019-24E



Source: Company data, CMBIGM estimates

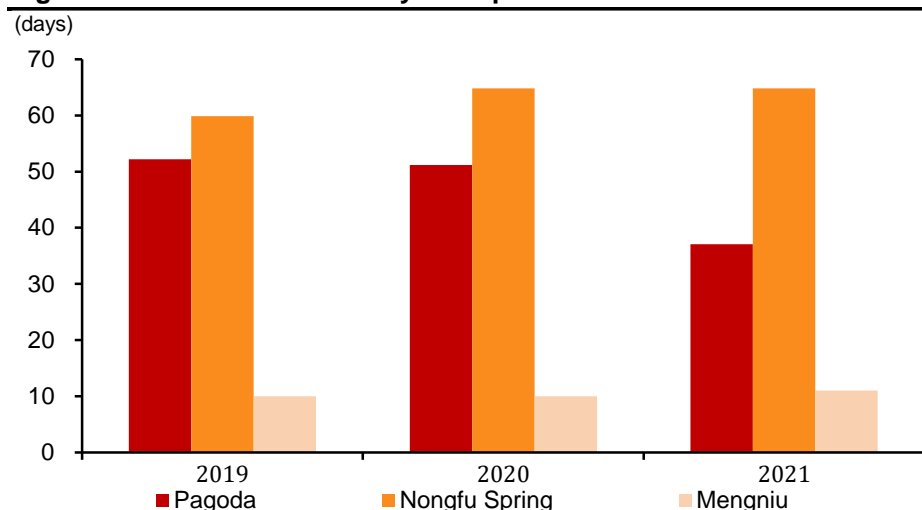
Figure 52: Opex ratio comparison 2019-24E



Source: Company data, CMBIGM estimates

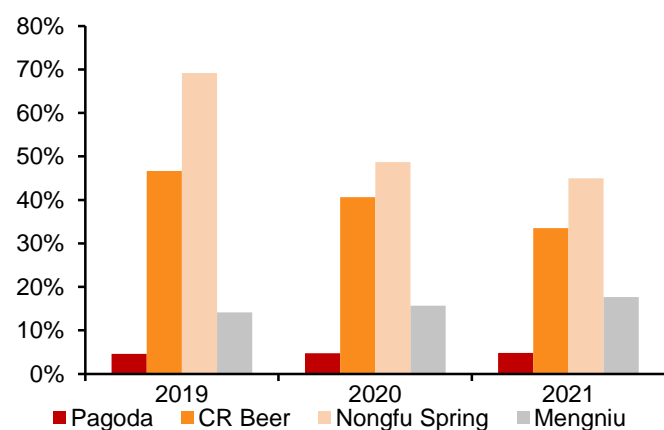
- **Cash conversion cycle.** Pagoda has a 37-day+ cash conversion cycle in 2021, higher than that of Mengniu but lower than that of Nongfu. In general, Pagoda's receivable day is in line with its payment terms with its franchisee and membership program. Meanwhile, Pagoda has the lowest inventory days among all.

Figure 53: Cash conversion days comparison 2019-2021

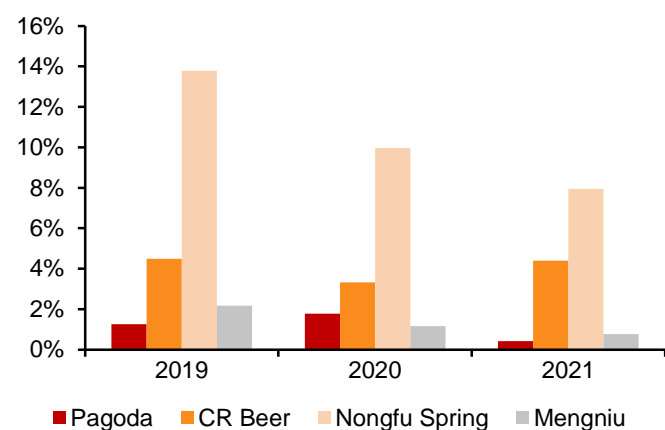


Source: Company data, CMBIGM

- **PPE and Capex.** Pagoda has the lowest PPE ratio to total assets among its peers, as the company 1) adopts an asset-light franchisee model, and 2) is relatively less automated and involved in value-adding along the production process. Separately, these also explain why Pagoda spends the least on capex among all.

**Figure 54: PPE to total assets 2019-21**

Source: Company data, CMBIGM

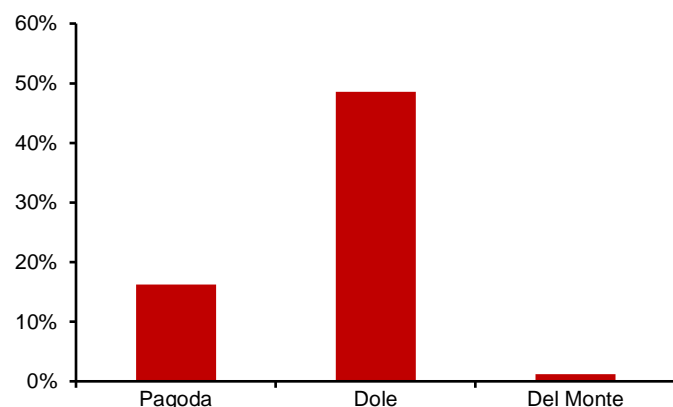
**Figure 55: Capex to revenue 2019-21**

Source: Company data, CMBIGM

## Vis-à-vis Global Fresh food peers

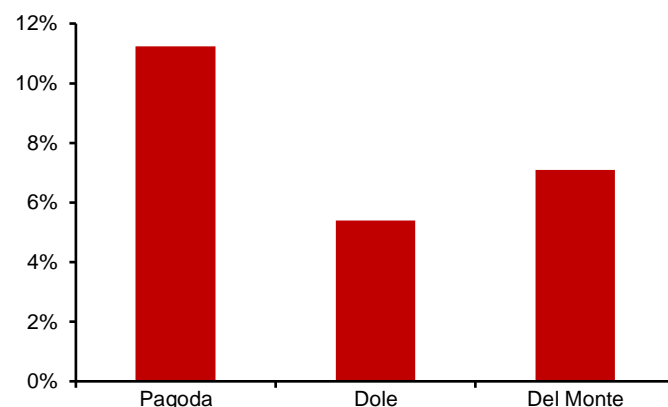
Despite being a single market distributor, Pagoda compares similarly to its global fresh food retail peers such as Del Monte (FDP US, NR) and Dole (DOLE US, NR) in terms of their gross and operating margins. Meanwhile, we project Pagoda to offer faster revenue growth thanks to its domestic leadership.

**Figure 56: Revenue growth comparison 2021**



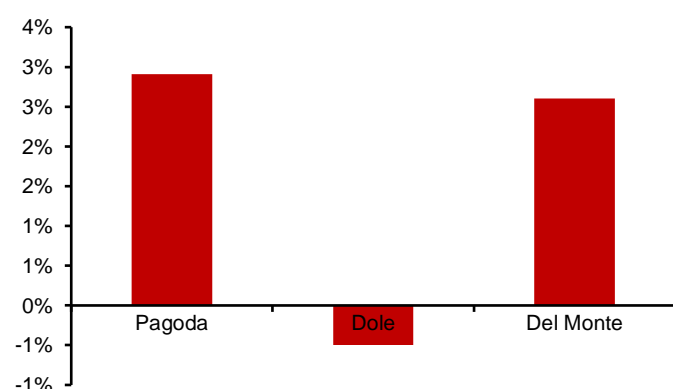
Source: Bloomberg, Company data, CMBIGM

**Figure 57: Gross margins comparison**



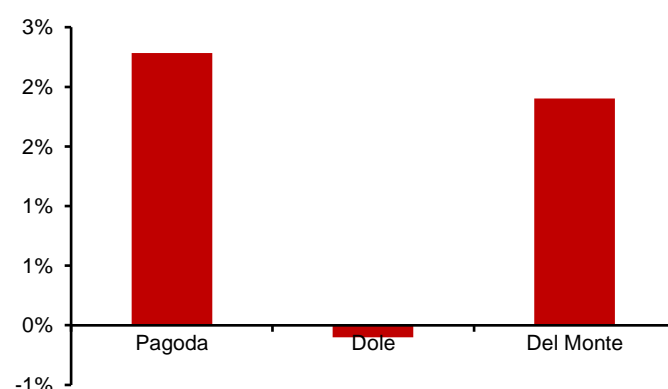
Source: Bloomberg, Company data, CMBIGM

**Figure 58: EBIT margin comparison**



Source: Bloomberg, Company data, CMBIGM

**Figure 59: Net margins comparison**



Source: Bloomberg, Company data, CMBIGM

**Figure 60: Global peers comparison at a glance**

US\$ mn	Hongjiu	Dole	Bid Corp	Del Monte	Mission Produce	Performance Food	Great Sun Food	Zespri
Ticker	6689.HK	DOLE.US	BID.SJ	FDP.US	AVO.US	PFGC.US	603336.SS	N/A
Sales	1,593	6,454	7,762	4,252	892	50,894	151	3,012
Sales YoY growth	78.1%	48.5%	28.2%	1.2%	3.4%	67.4%	1.1%	9.3%
GP margin	15.7%	5.4%	24.0%	7.1%	14.0%	10.3%	10.5%	N/A
EBIT margin	12.9%	-0.5%	4.2%	2.6%	6.8%	0.6%	6.5%	11.7%
Adjusted net margin	10.6%	-0.1%	2.7%	1.9%	5.0%	0.2%	4.6%	8.4%

Source: Bloomberg, Company data, CMBIGM



## Valuation

Pagoda is trading at 18.0x 2023E P/E. Instead of historical valuation, our TP is based on 23.0x end-23E P/E, which benchmarks to the average valuation of its domestic and global peer. In our view, our methodology is more appropriate to reflect 1) Pagoda's fair value given a short listing history since Jan 2023, and 2) the comparability of the financial profiles of each peer group.

**Figure 61: Valuation comps – China leading F&B and global fresh food peers**

			TP	Price	Mkt Cap	PER (x)		Div. yield (%)		ROE (%)	
Name	Ticker	Rating	(LC)	(LC)	USD Mn	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
China F&B peers											
CR Beer	291 HK	BUY	77.4	61.9	25,562	42.1	37.9	0.7	0.8	16.5	16.4
Tsingtao Beer	168 HK	BUY	89.9	81.2	18,382	28.6	25.7	1.3	1.4	13.7	14.0
Budweiser APAC	1876 HK	HOLD	27.2	24.7	41,588	39.7	33.2	0.0	0.0	9.0	10.0
Chongqing Beer	600132 CH	NR	n.a.	137.4	9,641	51.5	41.5	0.0	0.0	59.9	55.5
Mengniu	2319 HK	BUY	52.0	35.6	17,938	20.4	17.3	1.1	1.3	15.0	16.0
Yili	600887 CH	BUY	44.0	31.1	28,888	21.1	16.9	3.3	4.4	17.8	20.9
China Feihe	6186 HK	BUY	8.0	6.5	7,509	9.9	8.5	3.2	3.7	22.6	22.4
Nongfu Spring	9633 HK	BUY	57.6	44.4	63,541	53.6	44.6	4.1	4.9	33.2	32.4
Smooore	6969 HK	BUY	25.2	10.6	8,208	21.7	14.2	1.3	2.0	12.7	17.3
Hongjiu Fruits	6689 HK	BUY	44.0	28.8	5,144	7.8	5.5	-	-	25.2	26.2
Pagoda	2411 HK	BUY	7.9	6.1	1,234	25.3	18.0	0.6	0.9	10.6	13.3
WH Group	288 HK	NR	n.a.	4.8	7,878	6.0	5.9	0.1	0.1	14.9	13.6
Want Want	151 HK	NR	n.a.	5.1	7,751	12.6	13.9	0.1	0.1	27.3	22.6
Tingyi	322 HK	NR	n.a.	13.1	9,431	23.3	17.1	0.1	0.1	15.8	24.1
Uni-President	220 HK	NR	n.a.	7.3	3,995	22.1	17.2	0.0	0.1	9.2	11.9
Zhouheiya	1458 HK	NR	n.a.	4.1	1,257	165.3	26.9	0.0	0.0	3.1	7.4
Juewei	603517 CH	NR	n.a.	51.5	4,717	96.5	31.2	0.0	0.0	5.8	15.2
Haitian	603288 CH	NR	n.a.	81.6	54,818	55.1	46.7	0.0	0.0	24.9	25.2
Moutai	600519 CH	NR	n.a.	1828.0	332,912	36.8	31.3	0.0	0.0	28.9	28.9
Wuliangye	000858 CH	NR	n.a.	206.2	116,059	29.8	25.9	0.0	0.0	24.0	23.9
Laojiao	000568 CH	NR	n.a.	255.0	54,409	37.0	30.0	0.0	0.0	30.7	30.7
Shede	600702 CH	NR	n.a.	201.8	9,747	43.5	34.3	0.0	0.0	25.1	25.1
Mean						37.0	30.8	0.7	0.9	20.3	21.5
Median						29.2	25.8	0.1	0.1	17.1	21.7
Global Fresh Food peers											
Mission Produce	AVO US	NR	n.a.	11.5	811	25.2	16.9	n.a.	0.0	5.8	7.6
Dole	DOLE US	NR	n.a.	11.9	1,127	12.9	10.6	0.0	0.0	6.6	6.7
Del Monte	FDP US	NR	n.a.	31.7	1,516	21.7	14.1	n.a.	n.a.	n.a.	n.a.
Performnce Food	PFGC US	NR	n.a.	57.3	8,947	22.3	15.0	n.a.	n.a.	6.8	14.4
Bid Corp	BID SJ	NR	n.a.	39827	7,354	31.0	21.8	0.0	0.0	16.8	19.9
Mean						22.6	15.7	0.0	0.0	9.0	12.2
Median						22.3	15.0	0.0	0.0	6.7	11.0
Average of Global and China peers mean						29.8	23.0	0.4	0.5	14.6	16.8
Average of Global and China peers median						25.7	20.4	0.0	0.0	11.9	16.3

Source: Bloomberg, Company data, CMBIGM estimates

## Investment risks

- **Branding risk.** Pagoda's offline network consists primarily of franchised stores that are operated by third parties, either previous staff, regional dealers or other business partners. The result of the Group's operations is significantly subject to the performance of the franchised stores. Pagoda may not be able to control or effectively monitor the operations of these stores, resulting in the damage of the brands under the umbrella of Pagoda. Also, any failure to maintain food safety and consistent quality could have a material and adverse effect on its brands, business and financial performance.
- **Extreme weather risk.** Cultivation of fresh fruits is vulnerable to extreme weather conditions such as windstorms, hailstorms, drought, temperature extremes and typhoons, as well as natural disasters such as earthquakes, forest fires and floods. Unfavourable conditions can reduce both fruit yield and quality. In extreme cases, entire harvests may be lost in some geographic areas. These factors may create substantial volatility in the availability and price of certain fruits in a certain period.
- **The competition risk.** Fruit retailing is a highly fragmented industry with top 5 players commanding no more than 3.6% (Pagoda holds 1%), according to Frost & Sullivan. Any new entrants with enormous cash wallet to burn could intensify competition or disintegrate the competitive moat that Pagoda has cemented over the past 20 years.
- **The valuation risk.** Our valuation framework is based on global and China peer average valuation, underpinned by our growth assumptions that Pagoda will benefit from a more liberal domestic policy rhetoric towards social distancing. Should growth outlook significantly derail from our projections, we see risk in multiple compression away from the target we deploy in our framework.

## Financials

### Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>	<b>8,854</b>	<b>10,289</b>	<b>11,176</b>	<b>12,752</b>	<b>14,308</b>
Sales of fruits/ other	8,637	9,992	10,820	12,334	13,825
Others	217	298	356	418	482
<b>Gross profits</b>	<b>807</b>	<b>1,156</b>	<b>1,328</b>	<b>1,586</b>	<b>1,848</b>
Selling expense	(395)	(452)	(492)	(574)	(658)
Administration expenses	(216)	(303)	(324)	(338)	(358)
R&D expense	(106)	(140)	(190)	(204)	(215)
Other expense, net	57	37	63	72	80
<b>EBIT</b>	<b>148</b>	<b>300</b>	<b>385</b>	<b>541</b>	<b>698</b>
Finance costs, net	(40)	(54)	(47)	(39)	(32)
Non-operating	(36)	16	16	16	16
<b>Pre-tax profit</b>	<b>72</b>	<b>262</b>	<b>355</b>	<b>518</b>	<b>682</b>
Income tax	(26)	(36)	(49)	(74)	(100)
Less: Minority interests	3	9	12	3	3
<b>Net profit</b>	<b>49</b>	<b>235</b>	<b>318</b>	<b>447</b>	<b>586</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Profits before tax</b>	<b>72</b>	<b>262</b>	<b>355</b>	<b>518</b>	<b>682</b>
D&A	47	55	61	61	61
Change in working capital	197	104	(43)	(71)	(89)
Others	(18)	(134)	(2)	(34)	(67)
<b>Net cash fr. operating act.</b>	<b>298</b>	<b>286</b>	<b>371</b>	<b>475</b>	<b>586</b>
Capex & investments	(158)	(44)	(55)	(55)	(55)
Others	(220)	(534)	(50)	(50)	(50)
<b>Net cash fr. investing act.</b>	<b>(378)</b>	<b>(578)</b>	<b>(105)</b>	<b>(105)</b>	<b>(105)</b>
Change of Debts	308	523	(100)	(100)	(100)
Dividend paid	-	-	(32)	(77)	(103)
Others	(90)	(121)	(47)	(39)	(32)
<b>Net cash fr. financing act.</b>	<b>217</b>	<b>402</b>	<b>(179)</b>	<b>(216)</b>	<b>(235)</b>
<b>Net change in cash</b>	<b>137</b>	<b>110</b>	<b>87</b>	<b>154</b>	<b>246</b>
Cash at the beginning of the	317	455	565	652	805
<b>Cash at the end of the year</b>	<b>455</b>	<b>565</b>	<b>652</b>	<b>805</b>	<b>1,051</b>
Less: pledged cash	-	-	-	-	-

### Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Non-current assets</b>	<b>1,750</b>	<b>2,015</b>	<b>2,009</b>	<b>2,003</b>	<b>1,997</b>
PP&E/Fixed assets	247	308	317	324	330
Intangible assets	252	248	233	220	207
Right-of-use assets	295	610	610	610	610
Other non-current assets	955	849	849	849	849
<b>Current assets</b>	<b>3,495</b>	<b>4,409</b>	<b>4,622</b>	<b>4,964</b>	<b>5,416</b>
Cash	455	565	652	805	1,051
Account receivable	1,291	1,156	1,148	1,258	1,392
Inventory	259	247	256	285	307
Other current assets	1,490	2,442	2,566	2,616	2,666
<b>Current liabilities</b>	<b>2,321</b>	<b>3,057</b>	<b>2,984</b>	<b>2,940</b>	<b>2,896</b>
Accounts payable	305	345	372	428	485
Accruals and other	1,028	1,178	1,178	1,178	1,178
Borrowing	911	1,435	1,335	1,235	1,135
Other current liabilities	77	98	98	98	98
<b>Non-current liabilities</b>	<b>395</b>	<b>650</b>	<b>656</b>	<b>667</b>	<b>678</b>
Borrowings	18	17	17	17	17
Lease liabilities	261	519	519	519	519
Other non-current liabilities	116	114	120	131	142
<b>Total equity</b>	<b>2,529</b>	<b>2,717</b>	<b>2,991</b>	<b>3,360</b>	<b>3,838</b>
Share capital	1,500	1,500	1,500	1,500	1,500
Minority Interest	74	77	65	62	59
Reserves	955	1,140	1,426	1,797	2,280

### Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Sales mix (%)</b>					
Sales of fruits/ other products	97.6	97.1	96.8	96.7	96.6
Others	2.4	2.9	3.2	3.3	3.4
<b>P&amp;L ratios (%)</b>					
Gross margin	9.1	11.2	11.9	12.4	12.9
EBIT margin	1.7	2.9	3.4	4.2	4.9
Pre-tax margin	0.8	2.5	3.2	4.1	4.8
Net margin	0.6	2.3	2.8	3.5	4.1
Effective tax rate	36.3	13.8	13.8	14.2	14.6
<b>Balance sheet analysis</b>					
Current ratio (x)	0.1	0.1	0.1	0.2	0.2
Net trade receivable days	53.2	41.0	37.5	36.0	35.5
Inventory turnover days	11.8	9.9	9.5	9.3	9.0
Net trade payable days	13.8	13.8	13.8	14.0	14.2
Net debt to equity (%)	19.3	33.6	23.9	13.6	2.7
<b>Returns (%)</b>					
ROE	2.0	8.9	10.9	13.6	15.5
ROA	0.9	3.7	4.8	6.4	7.9
ROIC	1.0	4.3	5.7	8.0	10.1
<b>Per share</b>					
EPS (RMB)	0.2	0.2	0.2	0.3	0.4
DPS (RMB)	-	-	0.0	0.1	0.1
BVPS (RMB)	1.7	1.8	2.0	2.2	2.6

Source: Company data, CMBIGM estimates

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<b>BUY</b>	: Stock with potential return of over 15% over next 12 months
<b>HOLD</b>	: Stock with potential return of +15% to -10% over next 12 months
<b>SELL</b>	: Stock with potential loss of over 10% over next 12 months
<b>NOT RATED</b>	: Stock is not rated by CMBIGM
<b>OUTPERFORM</b>	: Industry expected to outperform the relevant broad market benchmark over next 12 months
<b>MARKET-PERFORM</b>	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
<b>UNDERPERFORM</b>	: Industry expected to underperform the relevant broad market benchmark over next 12 months

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