

# Sun Art Retail (6808 HK)

## Initiatives to accelerate sales growth

12MFY20 net profit rose 1% to RMB2,872mn, 12%/9% below our estimates/consensus, due to lower-than-expected revenue and GPM. The Company will invest in community group purchase, superstores and mini-stores, both offline and online traffic to accelerate sales growth. We believe the community group purchase sector's heavy subsidy model is unsustainable. Industry landscape could be less competitive in FY22E. Maintain Buy but cut TP from HK\$15.60 to HK\$8.70, based on 27.7x FY21E P/E, at history average since Alibaba invested in the Company in Nov 2017.

- Accelerate community group purchase expansion...** The Company has two ways to grow group purchase business. **(1) Cooperate with Cainiao:** The Company has a profit-sharing mechanism with Cainiao. Through more than 100 stores located in 36 cities, cooperative active pick-up stations reached around 8,000. Number of Cainiao pick-up stations is expected to double to 200,000 in 2021E. This should provide the Company with large room to expand. **(2) Self-operated:** Feiniu group purchase started in more than 220 stores (out of 484 hypermarkets) in 125 cities.
- ... but in a controllable way.** The Company will not follow some peers' heavy subsidy strategy (even at negative GPM) to grow its group purchase business because this model is unsustainable. Instead, it will leverage on its supply chain and store network, and deeply cooperate with Alibaba, like Cainiao's network. The Company targets to reach RMB3bn sales in 2021E and limits its loss within 10ppt.
- Multi store format.** The Company plans to add 30-50 superstores and 200-300 mini-stores in 2021E. Superstores will be located to young consumers in second and third-tier cities. Mini-stores (>70% revenue from fresh food and dairy products) will satisfy consumers' demand for daily meals. Fresh food is the key category to introduce store traffic.
- Store remodeling.** It will expand lettable area and increase catering, entertainment and service tenant mix to attract store traffic and increase rental income. It also will reduce non-food operating area of under-performing store in each city in exchange for warehouse area to support online and group purchase businesses.
- Revised up earnings.** We cut FY21-22E NP estimates by 35-36% to factor in lower revenue and GPM assumptions as well as start-up losses of group purchase, superstores and mini-stores. We forecast FY21E net profit to fall 13% in FY21E and then rebound 11% in FY22E on anticipation of less competitive landscape. **Catalysts:** Revenue and margins beat; **Risk:** Keen competition in community group purchase.

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	95,357	95,486	102,243	112,347	124,710
YoY growth (%)	(4)	0	7	10	11
Net profit (RMB mn)	2,834	2,872	2,488	2,763	3,152
EPS (RMB)	0.297	0.301	0.261	0.290	0.330
YoY growth (%)	14	1	(13)	11	14
Consensus EPS (RMB)	NA	NA	0.356	0.382	0.470
P/E (x)	22.6	22.5	24.2	21.8	19.1
P/B (x)	2.7	2.5	2.3	2.1	2.0
Yield (%)	2.1	2.1	1.9	2.2	2.5
ROAE (%)	12.3	12.1	9.5	10.1	10.8

Source: Company data, Bloomberg, CMBIS estimates

**BUY (maintain)**

Target Price **HK\$8.70**  
 (Previous TP **HK\$15.60**)  
 Up/Downside **+14%**  
 Current Price **HK\$7.60**

### China Supermarket Sector

**Albert Yip**  
 (852) 3900 0838  
 albertyip@cmbi.com.hk

### Stock Data

Mkt Cap (HK\$ mn)	72,502
Avg 3 mths t/o (HK\$ mn)	168.87
52w High/Low (HK\$)	13.40/ 6.93
Total Issued Shares (mn)	9,539.7

Source: Bloomberg

### Shareholding Structure

Alibaba	83.37%
---------	--------

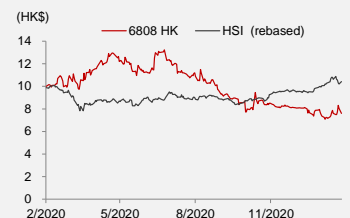
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	2.2%	-1.6%
3-mth	-3.9%	-18.1%
6-mth	-25.2%	-34.9%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: KPMG**

### Related Reports

- "Sun Art Retail – Kick off multi-format expansion" – 14 Aug 2020
- "China Supermarket – Digitalization and consolidation to accelerate" – 22 Jun 2020

## 12M20 results highlights

Revenue growth was flat at RMB98.5bn, 5%/3% below our/consensus estimates. The growth was driven by 80%+ growth of B2C on 60%+ growth of daily order per store but partly offset by 14% drop of rental income, weaker-than-expected B2B sales and offline sales. Though 2H20 SSS fell 4% (vs 5.7% in 1H20), store traffic reversed decline trend in 4Q20.

GPM fell 1.5ppt to 25.5%, 0.5ppt below our/consensus estimates, due to 14% drop of rental income, higher sales mix of low-margin fresh products and 1-2 ppt drop of B2C GPM. The decline of B2C GPM was because of increased spending for traffic.

Other income jumped 56%, led by RMB180mn investment gain on financial assets and 107% growth of government grants.

Operating costs dropped 2% mainly on reduction and exemption of social welfare payments.

Administrative expenses declined 12% primarily due to savings from integration of two banners.

**Figure 1: FY20 second interim results review**

Y/E Dec (RMB m)	12M20	12M19	YoY (%)	Remarks
<b>Revenue</b>	<b>95,486</b>	<b>95,357</b>	<b>0%</b>	<b>1.0% SSSG (vs 2H20 -4%), rental income fell 14%</b>
Cost of sales	(71,143)	(69,626)	2%	
Gross profit	24,343	25,731	-5%	
Other income	1,604	1,027	56%	Led by government grant and gain on financial assets
Operating costs	(19,118)	(19,523)	-2%	Reduction and exemption of social welfare payments
Administrative expenses	(2,480)	(2,807)	-12%	Savings from integration of two banners
EBIT	4,349	4,428	-2%	
Finance income	315	462	-32%	
Finance costs	(547)	(623)	-12%	
Share of profit from JV/associate	(3)	(15)	-80%	
Profit before tax	4,114	4,252	-3%	
Tax expense	(1,068)	(1,207)	-12%	
Profit after tax	3,046	3,045	0%	
Non-controlling interests	(174)	(211)	-18%	
Net profit	2,872	2,834	1%	
EPS (RMB)	0.30	0.30	1%	
<b>Margin &amp; Ratio (%)</b>				
Gross margin	25.5	27.0	(1.5)	Due to less rental income, higher sales of FMCG and channel mix
EBIT margin	4.6	4.6	(0.1)	
SG&A expenses ratio	22.6	23.4	(0.8)	
Staff expenses ratio	10.7	11.2	(0.5)	Savings from integration of two banners
Net margin	3.0	3.0	0.0	
Effective tax rate	26.0	28.4	(2.4)	
	<b>12M20</b>	<b>12M19</b>	<b>change</b>	
Inventory days	84	84	0	
Net cash (RMB mn)	18,451	13,986	32%	

Source: Company data, CMBIS

Figure 2: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	102,243	112,347	124,710	107,504	116,198	NA	-5%	-3%	NA
Gross Profit	25,590	27,748	30,515	28,946	31,464	NA	-12%	-12%	NA
Operating Profit	3,782	4,096	4,557	5,821	6,571	NA	-35%	-38%	NA
Net profit	2,487	2,759	3,148	3,818	4,310	NA	-35%	-36%	NA
Gross Margin	25.0%	24.7%	24.5%	26.9%	27.1%	NA	-1.9ppt	-2.4ppt	NA
Operating Margin	3.7%	3.6%	3.7%	5.4%	5.7%	NA	-1.7ppt	-2.1ppt	NA
Net Margin	2.4%	2.5%	2.5%	3.6%	3.7%	NA	-1.2ppt	-1.2ppt	NA

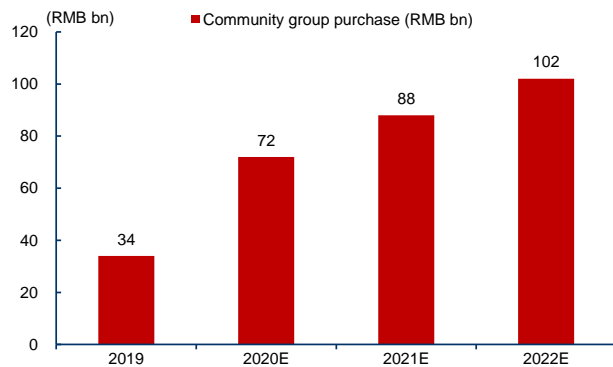
Source: CMBIS estimates

Figure 3: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	102,243	112,347	124,710	102,849	108,506	131,717	-1%	4%	-5%
Gross Profit	25,590	27,748	30,515	27,358	28,971	35,959	-6%	-4%	-15%
Operating Profit	3,782	4,096	4,557	5,099	5,561	NA	-26%	-26%	NA
Net profit	2,487	2,759	3,148	3,390	3,649	4,480	-27%	-24%	-30%
Gross Margin	25.0%	24.7%	24.5%	26.6%	26.7%	27.3%	-1.6ppt	-2.0ppt	-2.8ppt
Operating Margin	3.7%	3.6%	3.7%	5.0%	5.1%	NA	-1.3ppt	-1.5ppt	NA
Net Margin	2.4%	2.5%	2.5%	3.3%	3.4%	3.4%	-0.9ppt	-0.9ppt	-0.9ppt

Source: Bloomberg estimates, CMBIS estimates

Figure 4: Community group purchase is forecast to grow at 44% CAGR in FY19-22E



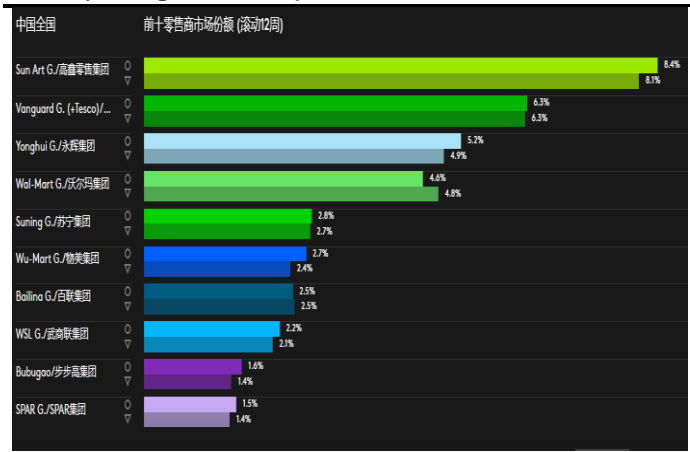
Source: iimedia research

Figure 5: Peers valuation table

Supermarkets	Stock code	Price	Mkt cap (LC mn)	Y/E	P/E (x)			EPS growth (%)			Revenue growth (%)		
					FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3
Sun Art Retail	6808 HK	7.60	72,502	Dec-19	22.5	24.2	21.8	1	(13)	11	0	7	10
Yonghui	601933 CH	6.87	65,377	Dec-19	27.7	22.5	17.9	49	23	25	17	17	16
Suning	002024 CH	6.61	61,539	Dec-19	59.5	38.2	23.4	(90)	56	63	1	19	15
Jiajiayue	603708 CH	20.34	12,375	Dec-19	22.7	18.9	16.2	19	20	16	26	13	11
Chengdu Hongqi	002697 CH	5.90	8,024	Dec-19	14.2	12.0	10.3	9	19	16	11	9	9
Zhongbai	000759 CH	5.72	3,895	Dec-19	40.9	29.3	15.1	815	39	95	(8)	6	5
Better Life	002251 CH	7.73	6,678	Dec-19	28.6	22.2	18.0	35	29	24	10	13	14
<b>A-share average</b>					<b>32.3</b>	<b>23.8</b>	<b>16.8</b>	<b>140</b>	<b>31</b>	<b>40</b>	<b>10</b>	<b>13</b>	<b>12</b>

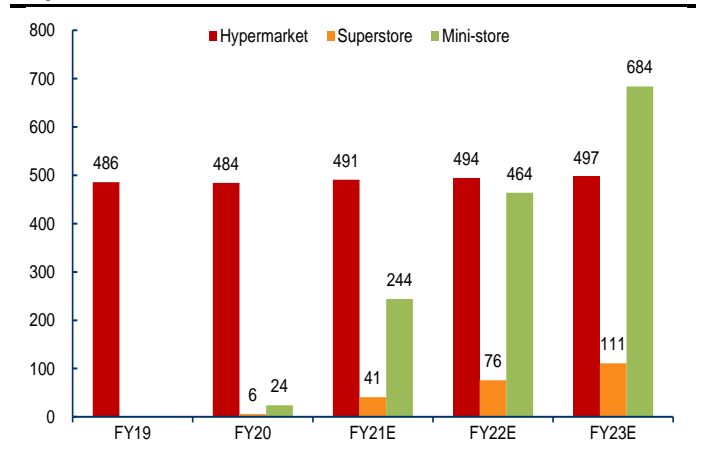
Source: Bloomberg estimates, CMBIS estimates

**Figure 6: Sun Art gained market share in terms of retail sales (rolling 12 weeks)**



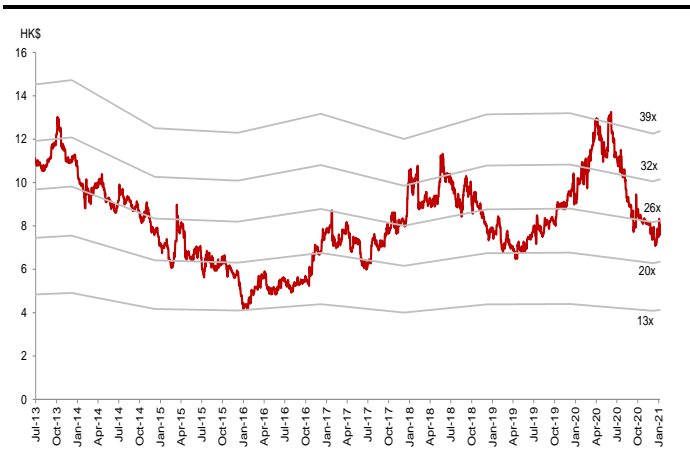
Source: Kantar (past 12 weeks ended 4 Dec 2020 vs 12 Jun 2020)

**Figure 7: Development into multi-format by opening superstores and mini-stores**



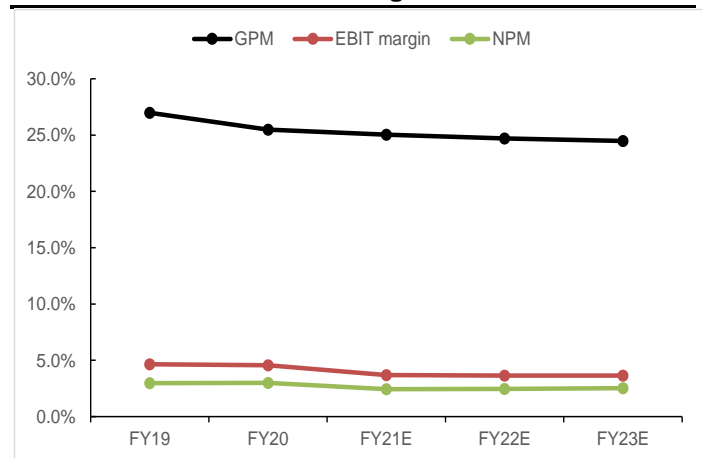
Source: Company data, CMBIS estimates

**Figure 8: P/E band chart**



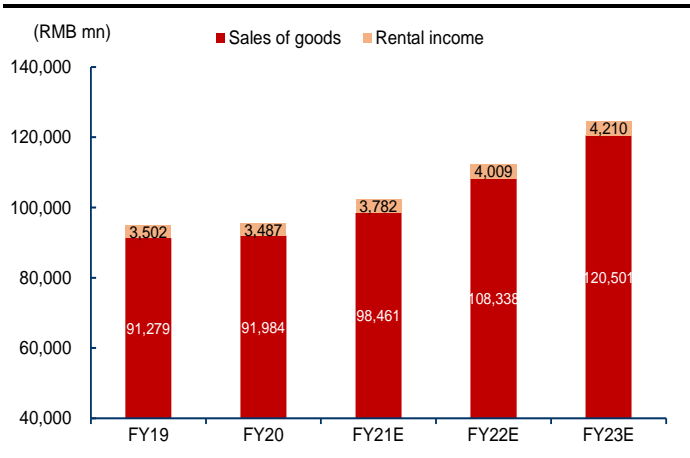
Source: Company data, CMBI estimates, Bloomberg

**Figure 9: Profit margins to drop in FY21E due to initiatives to accelerate sales growth**



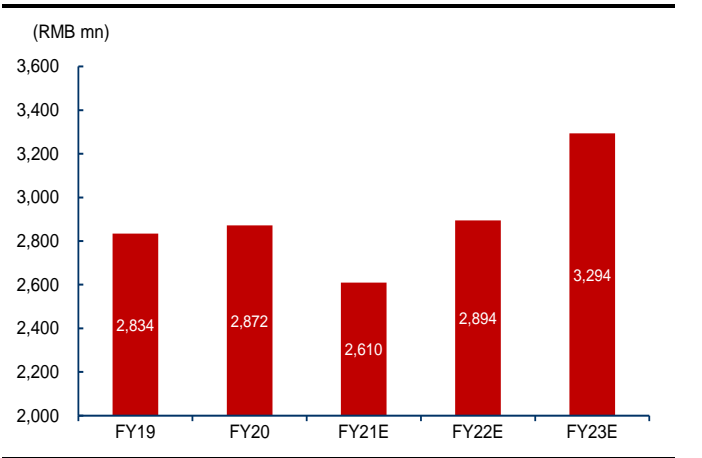
Source: Company data, CMBI estimates

**Figure 10: Revenue to grow by 10% CAGR from FY21-23E**



Source: Company data, CMBIS estimates

**Figure 11: NP to grow by 13% CAGR from FY21-23E**



Source: Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>95,357</b>	<b>95,486</b>	<b>102,243</b>	<b>112,347</b>	<b>124,710</b>
Sales of goods	91,279	91,984	98,461	108,338	120,501
Rental income	4,078	3,502	3,782	4,009	4,210
Cost of sales	(69,626)	(71,143)	(76,653)	(84,600)	(94,196)
Gross profit	25,731	24,343	25,590	27,748	30,515
Other income	1,027	1,604	1,796	1,886	1,983
Selling expenses	(19,523)	(19,118)	(21,062)	(22,919)	(25,192)
Administration expenses	(2,807)	(2,480)	(2,542)	(2,618)	(2,749)
EBIT	4,428	4,349	3,782	4,096	4,557
Finance income, net	(161)	(232)	(249)	(185)	(106)
JV & associates	(15)	(3)	(5)	0	0
Pre-tax profit	4,252	4,114	3,529	3,911	4,452
Income tax	(1,207)	(1,068)	(919)	(1,017)	(1,157)
Less: Minority interests	(211)	(174)	(122)	(132)	(142)
<b>Net profit</b>	<b>2,834</b>	<b>2,872</b>	<b>2,488</b>	<b>2,763</b>	<b>3,152</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>EBIT</b>	<b>4,252</b>	<b>4,447</b>	<b>3,529</b>	<b>3,911</b>	<b>4,452</b>
D&A	4,404	4,104	4,117	4,137	4,162
Change in working capital	(2,118)	1,267	658	874	1,021
Income tax paid	(1,359)	(1,068)	(919)	(1,017)	(1,157)
Others	(574)	(242)	197	26	(145)
<b>Operating cash flow</b>	<b>4,605</b>	<b>8,508</b>	<b>7,582</b>	<b>7,931</b>	<b>8,331</b>
Capex	(2,274)	(2,044)	(3,500)	(3,500)	(3,400)
Others	466	(9,634)	224	327	398
<b>Investing cash flow</b>	<b>(1,808)</b>	<b>(11,678)</b>	<b>(3,276)</b>	<b>(3,173)</b>	<b>(3,002)</b>
Dividend paid	(1,263)	(1,336)	(1,403)	(1,169)	(1,298)
Dividend paid	(623)	(547)	(523)	(512)	(504)
Others	(1,129)	(964)	(932)	(913)	(897)
<b>Financing cash flow</b>	<b>(3,015)</b>	<b>(2,847)</b>	<b>(2,858)</b>	<b>(2,595)</b>	<b>(2,700)</b>
<b>Net change in cash</b>	<b>(218)</b>	<b>(6,017)</b>	<b>1,447</b>	<b>2,164</b>	<b>2,630</b>
Cash at the beginning	13,469	13,251	7,531	8,978	11,142
Forex effect	0	0	0	0	0
<b>Cash at the end</b>	<b>13,251</b>	<b>7,234</b>	<b>8,978</b>	<b>11,142</b>	<b>13,772</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Non-current assets</b>	<b>36,464</b>	<b>34,363</b>	<b>34,466</b>	<b>34,529</b>	<b>34,567</b>
PPE & ROU assets	35,271	33,054	33,147	33,215	33,257
Goodwill and intangible assets	124	128	143	138	134
JV & associates	17	9	4	4	4
Others	1,052	1,172	1,172	1,172	1,172
<b>Current assets</b>	<b>34,722</b>	<b>36,264</b>	<b>39,068</b>	<b>43,200</b>	<b>48,210</b>
Cash	13,251	7,531	8,978	11,142	13,772
Inventory	17,724	14,928	16,084	17,752	19,765
Trade receivables	423	281	301	331	367
Prepayment	2,539	2,554	2,735	3,005	3,336
Others	785	10,970	10,970	10,970	10,970
<b>Current liabilities</b>	<b>38,012</b>	<b>36,353</b>	<b>38,298</b>	<b>41,087</b>	<b>44,439</b>
Trade payables	18,267	16,293	17,555	19,375	21,572
Other payables	18,229	18,547	19,300	20,321	21,525
Lease liabilities	1,057	1,107	1,037	985	936
Tax payables	459	406	406	406	406
<b>Non-current liabilities</b>	<b>7,816</b>	<b>7,116</b>	<b>6,784</b>	<b>6,464</b>	<b>6,164</b>
Lease liabilities	7,511	6,701	6,369	6,049	5,749
Other financial liabilities	50	50	50	50	50
Deferred tax	255	365	365	365	365
<b>Total net assets</b>	<b>25,358</b>	<b>27,158</b>	<b>28,453</b>	<b>30,177</b>	<b>32,173</b>
<b>Shareholders' equity</b>	<b>23,925</b>	<b>25,487</b>	<b>26,660</b>	<b>28,253</b>	<b>30,107</b>
<b>Non-controlling interests</b>	<b>1,433</b>	<b>1,671</b>	<b>1,793</b>	<b>1,924</b>	<b>2,066</b>

### Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Sales mix (%)</b>					
Sales of goods	95.7	96.3	96.3	96.4	96.6
Rental income	4.3	3.7	3.7	3.6	3.4
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>P&amp;L ratios (%)</b>					
Gross margin	27.0	25.5	25.0	24.7	24.5
EBIT margin	4.6	4.6	3.7	3.6	3.7
Net margin	3.0	3.0	2.4	2.5	2.5
Effective tax rate	28.4	26.0	26.0	26.0	26.0
Payout ratio	47.1	47.0	47.0	47.0	47.0
<b>Balance sheet ratios</b>					
Current ratio (x)	0.9	1.0	1.0	1.1	1.1
Quick ratio (x)	0.5	0.6	0.6	0.6	0.6
Inventory turnover days	84	84	74	73	73
A/C receivables days	2	1	1	1	1
A/C payables days	97	89	81	80	79
Net cash (RMB mn)	13,986	18,451	19,898	22,062	24,692
<b>Returns (%)</b>					
ROAE	12.3	12.1	9.5	10.1	10.8
ROAA	4.3	4.5	3.6	3.8	4.1
<b>Per share</b>					
EPS (RMB)	0.30	0.30	0.26	0.29	0.33
DPS (RMB)	0.14	0.14	0.12	0.14	0.16
BVPS (RMB)	2.51	2.67	2.79	2.96	3.16

Source: Company data, CMBIS estimates

# Disclosures & Disclaimers

## Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

## CMBIS Ratings

**BUY** : Stock with potential return of over 15% over next 12 months  
**HOLD** : Stock with potential return of +15% to -10% over next 12 months  
**SELL** : Stock with potential loss of over 10% over next 12 months  
**NOT RATED** : Stock is not rated by CMBIS

**OUTPERFORM** : Industry expected to outperform the relevant broad market benchmark over next 12 months  
**MARKET-PERFORM** : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months  
**UNDERPERFORM** : Industry expected to underperform the relevant broad market benchmark over next 12 months

## CMB International Securities Limited

**Address:** 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

**CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)**

## Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

For recipients of this document in the United States

CMBIS is not a registered broker-dealer in the United States. As a result, CMBIS is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.