

Sun Art Retail (6808 HK)

Kick off multi-format expansion

1H20 NP +17% and 3% above consensus. Sun Art will accelerate its expansion by opening multi-format stores. Through in-depth cooperation with Alibaba, the Company will explore community group purchase with Cainiao. We raised FY20-22E NP estimates by 1-4% and lifted TP from HK\$15.32 to HK\$15.60, still at 35x FY21E P/E, at the high-end of forward P/E band. Maintain Buy.

■ **1H20 results above.** NP +17% to RMB2,062mn, representing 64% of FY20 NP (62-63% during past three years) and 3% above consensus. Revenue increased 5% to RMB53.2bn, and outperformed China's retail sales (11% drop) and sales of 50 key retailers. The revenue growth was led by 5.7% SSSG arising from strong B2C growth and 16.2% food CPI, but partly offset by 19% drop of rental income due to waiver of rental to certain tenants. Now more than 97% tenants resumed operations. GPM narrowed 1.5ppt to 24.6% because of rental income decline (1ppt) and increase of low-margin fresh food sales mix (0.5ppt). SG&A expenses ratio reduced 1.7ppt to 20.0% driven by decrease in social welfare costs and savings from integration between two banners.

■ **Strong B2C growth.** Due to COVID-19 and changing consumers' behavior, daily orders per store increased from 640 in 2019 to >750 in 1Q20 and >950 in 2Q20. Management expects DOPS to reach 1,200 at end of 2020. Ticket size jumped to >RMB85 in 1Q20 (vs RMB64 in FY19) because consumers reduced shopping frequencies amid pandemic. 2Q20 ticket size fell to >RMB68. Management expects RMB65-67 is normal level.

■ **Kick off multi-format expansion.** The Company plans to develop multi-format by opening supermarkets (3,000 – 5,000 sq m) and mini-marts (200-500 sq m) to gain market share. Compared to hypermarkets, such stores are located in community, which better serve consumers' convenient shopping needs. The Company plans to open 2-3/30-50 supermarkets/mini-marts in 2H20E and 30-50/200 supermarkets/mini-marts in FY21E. The three supermarkets opened in 1H20 were profitable in the first month.

■ **Other growth initiatives.** (1) **Community group purchase:** The Company leverages the warehouse function of its nationwide hypermarket network to provide a new shopping way. More than 3,000 Cainiao pick-up stations (out of 50,000 stations) and more than 5,000 directly developed outlets have rolled out this service. (2) **Tmall supermarket inventory sharing:** Now all stores provide 1-hour-delivery service and 180 stores provide half-day-delivery service. The project is still at pilot stage. (3) **Store remodeling:** The Company keeps its plan to renovate 50 stores in FY20E (vs 5 in 1H20).

■ **Revised up earnings.** We lifted FY20-22E NP estimates by 1-4% to factor in stronger expansion plan. **Catalysts:** Revenue and margins beat; **Risk:** keen competition.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	99,359	95,357	100,955	107,504	116,198
YoY growth (%)	(3)	(4)	6	6	8
Net profit (RMB mn)	2,478	2,834	3,269	3,818	4,310
YoY growth (%)	(11)	14	15	17	13
EPS (RMB)	0.260	0.297	0.343	0.400	0.452
YoY growth (%)	(11)	14	15	17	13
Consensus EPS (RMB)	na	na	0.329	0.375	0.411
P/E (x)	38.2	34.1	30.1	25.8	22.8
P/B (x)	4.2	4.0	3.8	3.5	3.2
Yield (%)	1.2	1.4	1.6	1.8	2.1

Source: Company data, Bloomberg, CMBIS estimates

BUY (maintain)

Target Price **HK\$15.60**
 (Previous TP **HK\$15.32**)
 Up/Downside **+33%**
 Current Price **HK\$11.50**

China Supermarket Sector

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Stock Data

Mkt Cap (HK\$ mn)	109,707
Avg 3 mths t/o (HK\$ mn)	175.40
52w High/Low (HK\$)	13.40/ 7.40
Total Issued Shares (mn)	9,539.7

Source: Bloomberg

Shareholding Structure

Auchan Holding	51.00%
Alibaba	26.02%

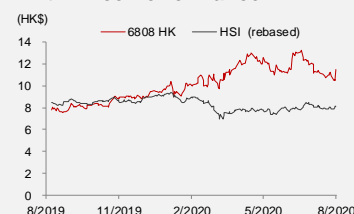
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-11.5%	-9.8%
3-mth	-12.5%	-16.0%
6-mth	4.2%	14.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

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Figure 1: 1H20 results review

Y/E Dec (RMB m)	1H20	1H19	YoY (%)	Remarks
Revenue	53,170	50,586	5%	5.7% SSSG led by B2C
Cost of sales	(40,116)	(37,398)	7%	
Gross profit	13,054	13,188	-1%	mainly due to 19% drop of rental income
Other income	674	560	20%	driven by gov't subsidies for employment stabilisation
Operating costs	(9,387)	(9,561)	-2%	reduction and exemption of social welfare
Administrative expenses	(1,225)	(1,410)	-13%	savings from integration of two banners
EBIT	3,116	2,777	12%	
Finance income	230	237	-3%	
Finance costs	(286)	(314)	-9%	
Share of profit from JV/associate	2	(9)	-122%	
Profit before tax	3,062	2,691	14%	
Tax expense	(871)	(792)	10%	
Profit after tax	2,191	1,899	15%	
Non-controlling interests	(129)	(133)	-3%	
Net profit	2,062	1,766	17%	
EPS (RMB)	0.22	0.19	17%	
Margin & Ratio (%)				
Gross margin	24.6	26.1	(1.5)	rental decline and sales mix contributed 1ppt and 0.5ppt decline
EBIT margin	5.9	5.5	0.4	
SG&A expenses ratio	20.0	21.7	(1.7)	
Staff expenses ratio	9.4	10.3	(0.9)	
Net margin	3.9	3.5	0.4	
Effective tax rate	28.4	29.4	(1.0)	utilization of previously unrecognized tax losses
	1H20	1H19	change	
Inventory days	59	54	5	
A/C payable days	76	84	(8)	
Net cash (RMB mn)	16,618	12,795	30%	

Source: Company data, CMBIS

Figure 2: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	100,955	107,504	116,198	101,499	106,091	111,815	-1%	1%	4%
Gross Profit	26,218	28,946	31,464	27,247	28,951	30,593	-4%	0%	3%
Operating Profit	5,003	5,821	6,571	4,982	5,722	6,304	0%	2%	4%
Net profit	3,269	3,818	4,310	3,239	3,746	4,139	1%	2%	4%
Gross Margin	26.0%	26.9%	27.1%	26.8%	27.3%	27.4%	-0.8ppt	-0.4ppt	-0.3ppt
Operating Margin	5.0%	5.4%	5.7%	4.9%	5.4%	5.6%	+0.1ppt	flat	+0.1ppt
Net Margin	3.2%	3.6%	3.7%	3.2%	3.5%	3.7%	flat	+0.1ppt	flat

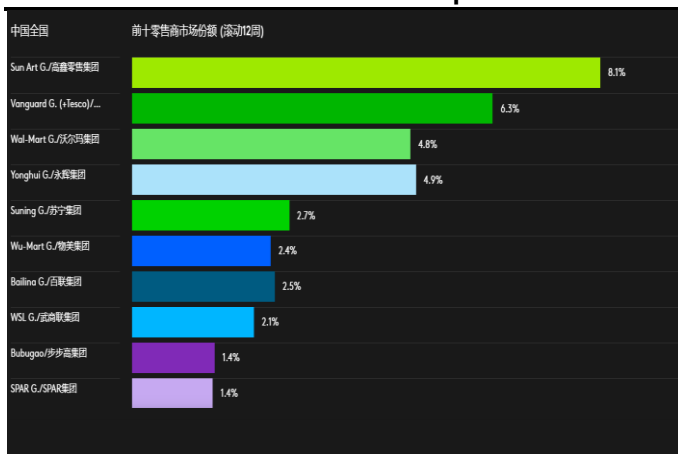
Source: CMBIS estimates

Figure 3: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	100,955	107,504	116,198	100,583	104,696	109,707	0%	3%	6%
Gross Profit	26,218	28,946	31,464	27,149	28,627	29,935	-3%	1%	5%
Operating Profit	5,003	5,821	6,571	4,966	5,547	5,681	1%	5%	16%
Net profit	3,269	3,818	4,310	3,174	3,585	3,884	3%	6%	11%
Gross Margin	26.0%	26.9%	27.1%	27.0%	27.3%	27.3%	-1.0ppt	-0.4ppt	-0.2ppt
Operating Margin	5.0%	5.4%	5.7%	4.9%	5.3%	5.2%	+0.1ppt	+0.1ppt	+0.5ppt
Net Margin	3.2%	3.6%	3.7%	3.2%	3.4%	3.5%	flat	+0.2ppt	+0.2ppt

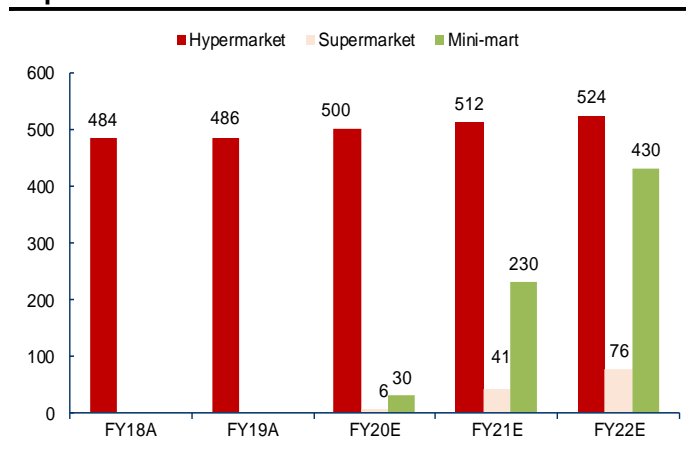
Source: Bloomberg estimates, CMBIS estimates

Figure 4: Sun Art ranked No.1 out of top 10 retail chains in terms of retail sales over past 12 weeks



Source: Kantar (past 12 weeks ended 12 Jun 2020)

Figure 5: Development into multi-format by opening supermarkets and mini-marts



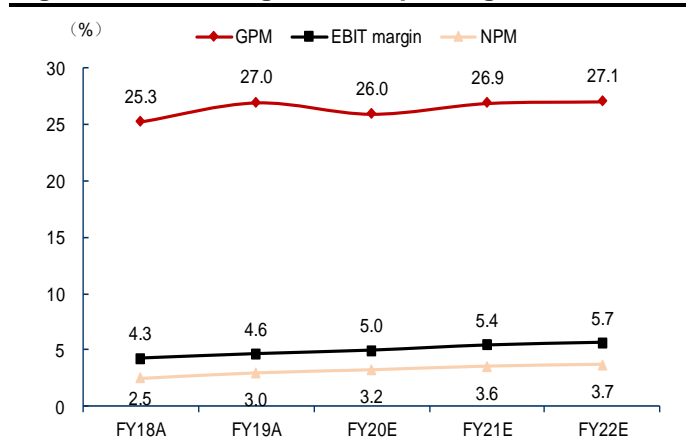
Source: Company, CMBIS estimates

Figure 6: P/E band chart



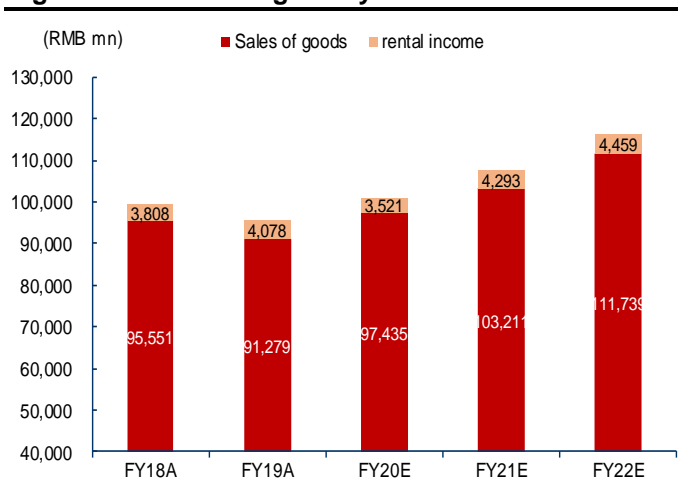
Source: Company data, CMBI estimates, Bloomberg

Figure 7: Profit margins are improving



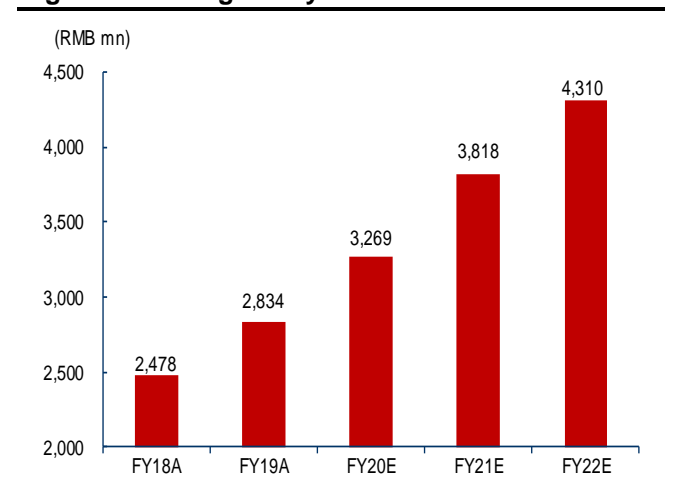
Source: Company data, CMBI estimates

Figure 8: Revenue to grow by 7% CAGR from FY19-22E



Source: Company data, CMBIS estimates

Figure 9: NP to grow by 15% CAGR from FY19-22E



Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	99,359	95,357	100,955	107,504	116,198
Sales of goods	95,551	91,279	97,435	103,211	111,739
Rental income	3,808	4,078	3,521	4,293	4,459
Cost of sales	(74,240)	(69,626)	(74,737)	(78,558)	(84,734)
Gross profit	25,119	25,731	26,218	28,946	31,464
Other income	1,270	1,027	1,241	1,089	1,145
Selling expenses	19,317	19,523	19,888	21,286	23,007
Administration expenses	2,847	2,807	2,568	2,928	3,030
EBIT	4,225	4,428	5,003	5,821	6,571
Finance income, net	(197)	(161)	(121)	(134)	(151)
JV & associates	(8)	(15)	(10)	(5)	0
Pre-tax profit	4,020	4,252	4,872	5,682	6,420
Income tax	(1,320)	(1,207)	(1,382)	(1,609)	(1,817)
Less: Minority interests	(222)	(211)	(222)	(255)	(293)
Net profit	2,478	2,834	3,269	3,818	4,310

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
EBIT	4,225	4,428	5,003	5,821	6,571
D&A	4,458	4,404	4,338	4,440	4,524
Change in working capital	631	(3,392)	887	1,029	1,371
Income tax paid	(1,293)	(1,359)	(1,382)	(1,609)	(1,817)
Others	132	524	(121)	(135)	(151)
Operating cash flow	8,153	4,605	8,726	9,546	10,499
Capex	(2,703)	(2,277)	(3,500)	(3,900)	(3,900)
Others	594	469	-	-	-
Investing cash flow	(2,109)	(1,808)	(3,500)	(3,900)	(3,900)
Net change in debt	(1,078)	(1,087)	(343)	(329)	(316)
Dividend paid	(1,238)	(1,153)	(1,319)	(1,521)	(1,776)
Others	(621)	(775)	-	-	-
Financing cash flow	(2,937)	(3,015)	(1,661)	(1,850)	(2,092)
Net change in cash	1,231	(608)	3,564	3,796	4,507
Cash at the beginning	3,129	4,370	13,251	16,815	20,611
Forex effect	10	36	-	-	-
Cash at the end	4,370	3,798	16,815	20,611	25,118

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	39,274	36,464	35,616	35,071	34,446
PPE	38,153	35,271	34,433	33,893	33,268
Goodwill and intangible assets	138	124	124	124	124
JV & associates	41	17	7	2	2
Others	942	1,052	1,052	1,052	1,052
Current assets	30,601	34,722	39,702	44,876	51,381
Cash	13,469	13,251	16,815	20,611	25,118
Inventory	14,468	17,724	18,919	20,041	21,697
Trade receivables	372	423	448	477	515
Prepayment	420	419	444	472	511
Others	1,872	2,905	3,076	3,275	3,540
Current liabilities	37,147	38,012	40,272	42,639	45,969
Borrowings	1,049	1,057	1,015	974	935
Trade payables	18,588	18,267	19,499	20,655	22,362
Other payables	7,854	7,560	8,004	8,523	9,212
Tax payables	549	459	459	459	459
Others	9,107	10,669	11,295	12,028	13,001
Non-current liabilities	9,079	7,816	7,516	7,227	6,950
Borrowings	8,822	7,511	7,211	6,922	6,645
Deferred tax	207	255	255	255	255
Others	50	50	50	50	50
Total net assets	23,649	25,358	27,530	30,081	32,908
Shareholders' equity	22,287	23,925	25,875	28,172	30,706
Non-controlling interests	1,362	1,433	1,655	1,909	2,202

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Sales of goods	96.2	95.7	96.5	96.0	96.2
Rental income	3.8	4.3	3.5	4.0	3.8
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross margin	25.3	27.0	26.0	26.9	27.1
EBIT margin	4.3	4.6	5.0	5.4	5.7
Pretax margin	4.0	4.5	4.8	5.3	5.5
Net margin	2.5	3.0	3.2	3.6	3.7
Effective tax rate	32.8	28.4	28.4	28.3	28.3
Balance sheet ratios					
Current ratio (x)	0.8	0.9	1.0	1.1	1.1
Quick ratio (x)	0.4	0.4	0.5	0.6	0.6
Cash ratio (x)	0.4	0.3	0.4	0.5	0.5
Inventory turnover days	52	61	65	65	65
A/C receivables days	1	2	2	2	2
A/C payables days	90	94	94	95	95
Net cash (RMB mn)	41.7	33.8	29.9	26.3	23.0
Returns (%)					
ROAE	11.1	12.3	13.1	14.1	14.6
ROAA	4.2	4.3	4.8	5.2	5.6
Per share					
EPS (RMB)	0.26	0.30	0.34	0.40	0.45
DPS (RMB)	0.12	0.14	0.16	0.19	0.21
BVPS (RMB)	2.34	2.51	2.71	2.95	3.22

Source: Company data, CMBIS estimates

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