

China / Hong Kong Company Update

Sun Art Retail Group

Bloomberg: 6808 HK Equity | Reuters: 6808.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

29 Mar 2022

HOLD (Downgrade from BUY)

Last Traded Price (28 Mar 2022): HK\$3.06 (HSI : 21,928)

Price Target 12-mth: HK\$3.23 (6% upside)

Analyst

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What's New

- Expect sales recovery in Mar 2022 with higher demand for food & groceries
- Increasing contributions from self-operated APP should beef up profit margin of online division. Yet, offline shoppers' traffic stay low and needs further refinement
- Share price ramped up c.15% since mid-Mar 2022 and is approaching our target. Downgrade to HOLD with unchanged TP of HK\$3.23.

Better outlook

Investment Thesis

Sales recovery ahead. With a higher demand for foodstuff under more stringent COVID measures and the potential increase in food CPI, Sun Art could sustain a better sales recovery from Mar 2022 onwards. While competition from e-grocery and community group buying (CGB) platforms continues, we currently expect 8%/5% sales growth for FY23/FY24.

Online channels remain crucial. Riding on its strong position in B2C online platforms, and the increasing contribution from its self-operated APP that enjoys a higher net margin of c.3% (vs. 2% for its overall online division), Sun Art should continue with its commitment in online operations to score a mid to high single-digit online sales growth for FY23 to support overall margin recovery.

Room for efficiency improvement. While net margin for the group may remain below 1% in FY22, its expansion in fresh processing centres and more stringent costs control for its hypermarket operations could help Sun Art to achieve a more normalised net margin of 2%+ over the medium-term.

Valuation:

Our TP remains unchanged at HK\$3.23, which is pegged to a 26x FY23 PE.

Where we differ:

We are more prudent than the consensus for FY22, as the overall retail industry in China remains volatile in the near term amid geopolitical uncertainties, rising inflation, and increasing impacts from COVID-19 resurgence. Nevertheless, Sun Art may still achieve a relatively faster recovery than its peers as the CGB segment continues to consolidate.

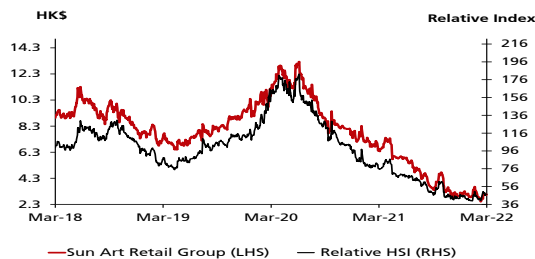
Key Risks to Our View:

Food safety issues; catastrophic events; etc.

At A Glance

| | |
|--|----------------|
| Issued Capital (m shrs) | 9,540 |
| Mkt Cap (HK\$/US\$m) | 29,383 / 3,756 |
| Major Shareholders (%) | |
| Alibaba Group Holding Ltd. | 78.7 |
| Free Float (%) | 21.3 |
| 3m Avg. Daily Val. (US\$m) | 4.42 |
| GICS Industry: Consumer Staples / Food & Staples Retailing | |

Price Relative



Forecasts and Valuation

| FY Mar (RMBm) | 2021A | 2022F | 2023F | 2024F |
|-----------------------------|--------|--------|--------|---------|
| Turnover | 92,679 | 88,548 | 95,278 | 100,042 |
| EBITDA | 7,934 | 5,544 | 6,606 | 7,216 |
| Pre-tax Profit | 3,201 | 622 | 1,407 | 1,790 |
| Net Profit | 2,145 | 429 | 971 | 1,235 |
| Net Profit Gth (Pre-ex) (%) | (25.3) | (80.0) | 126.0 | 27.3 |
| EPS (RMB) | 0.22 | 0.05 | 0.10 | 0.13 |
| EPS (HK\$) | 0.28 | 0.06 | 0.13 | 0.16 |
| EPS Gth (%) | (25.3) | (80.0) | 126.0 | 27.3 |
| Diluted EPS (HK\$) | 0.28 | 0.06 | 0.13 | 0.16 |
| DPS (HK\$) | 0.14 | 0.03 | 0.06 | 0.08 |
| BV Per Share (HK\$) | 3.38 | 3.43 | 3.31 | 3.19 |
| PE (X) | 10.8 | 54.0 | 23.9 | 18.8 |
| P/Cash Flow (X) | 2.9 | 3.7 | 3.6 | 3.4 |
| P/Free CF (X) | 4.1 | 7.0 | 6.3 | 5.6 |
| EV/EBITDA (X) | 0.4 | 0.4 | 0.1 | 0.0 |
| Net Div Yield (%) | 4.5 | 0.9 | 2.1 | 2.7 |
| P/Book Value (X) | 0.9 | 0.9 | 0.9 | 0.9 |
| Net Debt/Equity (X) | CASH | CASH | CASH | CASH |
| ROAE (%) | 8.3 | 1.6 | 3.7 | 4.9 |
| Earnings Rev (%) | | Nil | Nil | Nil |
| Consensus EPS (RMB) | | 0.10 | 0.16 | 0.18 |
| Other Broker Recs: | | B:8 | S:1 | H:7 |

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters



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Sun Art Retail Group**WHAT'S NEW**

Sales to recover gradually. The latest resurgence of COVID-19 cases across various cities in China has led to tightened social distancing measures and lockdowns. So far, a total of nearly 30 stores of Sun Art have experienced temporary suspension of business due to confirmed cases, close contacts, or lockdowns since Feb 2022. While Sun Art should benefit from the increasing demand for food & groceries as a result of COVID-19 resurgence, the company is seeing a flattish, or slight y-o-y increase in its sales performance for Mar 2022. Such a trend suggests potential turnaround following its consecutive sales decline for over a year when selected CGB operators intensified price competition in the industry. We currently believe that Sun Art will attain 8%/5% sales growth in FY23/FY24, to be supported by ongoing consolidation of the CGB sector as well as the potential rebound of food CPI. Nevertheless, strong competition from e-grocery plays and slower offline shoppers' traffic may linger in the near-term.

Potentials for efficiency improvement. With customer traffic declining in certain RT-Mart stores (hypermarkets), Sun Art is looking to terminate selected store operations, or relocate them to districts with higher residential occupancy to improve overall store profitability. The company is also seeking the chance to turn some fixed rents into variable rentals through re-negotiation with landlords, as well as better managing its staff costs to further mitigate the impact from slower shoppers' traffic and lockdowns. Its standardised fresh processing centre model may also improve operating efficiency and help to expand profit margins ahead. For example, RT-Mini has lifted its gross margin by c.5ppt given its higher proportion of fresh food sales that are supported by its fresh processing centres. Sun Art also aims to further expand its footprint across the country, with 10+ processing centres in the pipeline for FY23.

Online channels to support performance. Sun Art's ongoing efforts in online channels has paid off, seeing c.40% y-o-y sales growth from its self-operated platform RT-Mart Youxian (大润发优鲜) so far in 4Q FY22 to account for c.30% of total online revenue (FY21: 21%). Besides, sales through third-party platforms have remained stable.

The increasing contribution from RT-Mart Youxian should also help Sun Art secure higher profitability given its estimated net margin of 2.9% (vs. 2% for overall online business) and an average ticket size of RMB85 (vs. RMB75 for overall online division). In view of the near-term pressure in offline customers' traffic, Sun Art's newly launched membership programme may further help to integrate both its online and offline channels to improve customer loyalty. We also believe Sun Art continues to target at c.40% revenue contribution from its online business in the longer run.

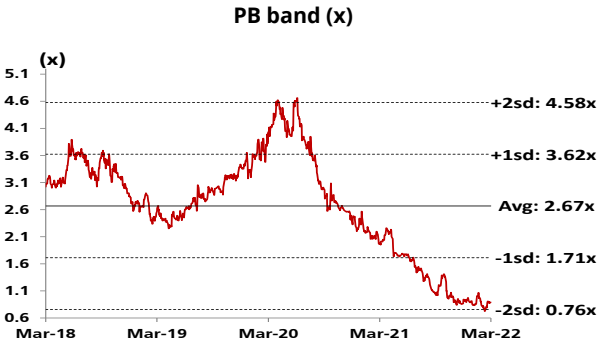
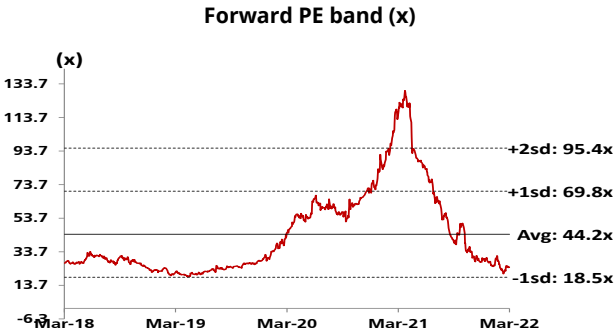
Multi-store formats. While Sun Art has slowed its hypermarket openings, the company may continue to remodeling about 30-40 hypermarkets each year during FY23/FY24, including an improvement in their "gallery shopping space" in order to attract more offline customers ahead. Such renovations may also support rental income growth going forward as vacancy rate could be lowered to <2%. Meanwhile, Sun Art also continues to expand its smaller store formats, with 10+ RT-Super and 100+ RT-Mini stores on the way for FY23. In particular, its RT-Mini stores may serve as delivery & pick-up points for Sun Art's online business and support O2O sales expansion in the long-term. With some of the stores already making a profit, we believe Sun Art could continue to narrow the overall losses from RT-Mini division.

Company Background

Sun Art is a leading hypermarket operator in China. As of 30 Sep 2021, the company operated a total of 491 hypermarkets under the banners of "RT-Mart" and "Auchan", six supermarkets under "RT-Super", and 68 "RT-Mini" stores, with total GFA of 13.6m sqm. As of 31 Sep 2021, Taobao China directly or indirectly held 78.7% of the issued share capital in Sun Art, and, therefore, is the ultimate controlling shareholder of the company.

Sun Art Retail Group

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Sun Art Retail Group

Segmental Breakdown (RMB m)

| FY Mar | 2020A | 2021A | 2022F | 2023F | 2024F |
|-------------------------|---------------|---------------|---------------|---------------|----------------|
| Revenues (RMB m) | | | | | |
| Sales of goods | 91,984 | 88,474 | 84,133 | 90,553 | 94,987 |
| Rental income | 3,502 | 4,205 | 4,415 | 4,724 | 5,055 |
| Total | 95,486 | 92,679 | 88,548 | 95,278 | 100,042 |

Source: Company, DBS HK

Income Statement (RMB m)

| FY Mar | 2020A | 2021A | 2022F | 2023F | 2024F |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 95,486 | 92,679 | 88,548 | 95,278 | 100,042 |
| Cost of Goods Sold | (71,143) | (67,443) | (65,703) | (70,506) | (73,831) |
| Gross Profit | 24,343 | 25,236 | 22,845 | 24,772 | 26,211 |
| Other Opng (Exp)/Inc | (19,679) | (21,406) | (21,729) | (22,882) | (23,947) |
| Operating Profit | 4,664 | 3,830 | 1,116 | 1,890 | 2,264 |
| Other Non Opng (Exp)/Inc | 0 | 0 | 0 | 0 | 0 |
| Associates & JV Inc | (3) | (16) | (2) | (1) | (1) |
| Net Interest (Exp)/Inc | (547) | (613) | (492) | (482) | (473) |
| Dividend Income | 0 | 0 | 0 | 0 | 0 |
| Exceptional Gain/(Loss) | 0 | 0 | 0 | 0 | 0 |
| Pre-tax Profit | 4,114 | 3,201 | 622 | 1,407 | 1,790 |
| Tax | (1,068) | (908) | (162) | (366) | (465) |
| Minority Interest | (174) | (148) | (31) | (70) | (90) |
| Preference Dividend | 0 | 0 | 0 | 0 | 0 |
| Net Profit | 2,872 | 2,145 | 429 | 971 | 1,235 |
| Net Profit before Except. | 2,872 | 2,145 | 429 | 971 | 1,235 |
| EBITDA | 8,768 | 7,934 | 5,544 | 6,606 | 7,216 |
| Growth | | | | | |
| Revenue Gth (%) | 0.1 | (2.9) | (4.5) | 7.6 | 5.0 |
| EBITDA Gth (%) | (5.7) | (9.5) | (30.1) | 19.2 | 9.2 |
| Opg Profit Gth (%) | (4.6) | (17.9) | (70.9) | 69.3 | 19.8 |
| Net Profit Gth (%) | 1.3 | (25.3) | (80.0) | 126.0 | 27.3 |
| Margins & Ratio | | | | | |
| Gross Margins (%) | 25.5 | 27.2 | 25.8 | 26.0 | 26.2 |
| Opg Profit Margin (%) | 4.9 | 4.1 | 1.3 | 2.0 | 2.3 |
| Net Profit Margin (%) | 3.0 | 2.3 | 0.5 | 1.0 | 1.2 |
| ROAE (%) | 11.6 | 8.3 | 1.6 | 3.7 | 4.9 |
| ROA (%) | 4.1 | 3.1 | 0.6 | 1.3 | 1.7 |
| ROCE (%) | 10.2 | 7.9 | 2.3 | 4.0 | 4.9 |
| Div Payout Ratio (%) | 0.0 | 48.9 | 50.0 | 50.0 | 50.0 |
| Net Interest Cover (x) | 8.5 | 6.2 | 2.3 | 3.9 | 4.8 |

Source: Company, DBS HK

Sun Art Retail Group

Balance Sheet (RMB m)

| FY Mar | 2020A | 2021A | 2022F | 2023F | 2024F |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Fixed Assets | 33,054 | 33,388 | 31,627 | 29,760 | 27,516 |
| Invts in Associates & JVs | 0 | 0 | 0 | 0 | 0 |
| Other LT Assets | 1,309 | 1,297 | 1,309 | 1,309 | 1,309 |
| Cash & ST Invts | 18,501 | 21,285 | 22,574 | 24,314 | 26,391 |
| Inventory | 14,928 | 9,990 | 13,343 | 14,357 | 15,075 |
| Debtors | 2,835 | 3,267 | 3,639 | 3,916 | 4,111 |
| Other Current Assets | 0 | 0 | 0 | 0 | 0 |
| Total Assets | 70,627 | 69,227 | 72,492 | 73,656 | 74,402 |
| ST Debt | 0 | 0 | 0 | 0 | 0 |
| Creditors | 23,819 | 20,644 | 24,260 | 26,103 | 27,409 |
| Other Current Liab | 12,534 | 13,472 | 12,777 | 13,024 | 13,276 |
| LT Debt | 0 | 0 | 0 | 0 | 0 |
| Other LT Liabilities | 7,116 | 7,257 | 7,116 | 7,116 | 7,116 |
| Shareholder's Equity | 25,487 | 26,223 | 26,637 | 25,640 | 24,739 |
| Minority Interests | 1,671 | 1,631 | 1,702 | 1,772 | 1,862 |
| Total Cap. & Liab. | 70,627 | 69,227 | 72,492 | 73,656 | 74,402 |
| Non-Cash Wkg. Capital | (18,590) | (20,859) | (20,054) | (20,855) | (21,499) |
| Net Cash/(Debt) | 18,501 | 21,285 | 22,574 | 24,314 | 26,391 |
| Debtors Turn (avg days) | 11.1 | 12.0 | 14.2 | 14.5 | 14.6 |
| Creditors Turn (avg days) | 135.2 | 128.1 | 133.7 | 139.7 | 141.8 |
| Inventory Turn (avg days) | 88.9 | 71.8 | 69.5 | 76.8 | 78.0 |
| Asset Turnover (x) | 1.3 | 1.3 | 1.2 | 1.3 | 1.4 |
| Current Ratio (x) | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 |
| Quick Ratio (x) | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 |
| Net Debt/Equity (X) | CASH | CASH | CASH | CASH | CASH |
| Net Debt/Equity ex MI (X) | CASH | CASH | CASH | CASH | CASH |
| Capex to Debt (%) | N/A | N/A | N/A | N/A | N/A |
| Z-Score (X) | NA | NA | NA | NA | NA |

Source: Company, DBS HK

Cash Flow Statement (RMB m)

| FY Mar | 2020A | 2021A | 2022F | 2023F | 2024F |
|-------------------------------|-----------------|----------------|----------------|----------------|----------------|
| Pre-Tax Profit | 4,114 | 3,201 | 622 | 1,407 | 1,790 |
| Dep. & Amort. | 4,104 | 4,104 | 4,427 | 4,716 | 4,952 |
| Tax Paid | (1,131) | (1,098) | (162) | (366) | (465) |
| Assoc. & JV Inc/(loss) | 0 | 0 | 0 | 0 | 0 |
| (Pft)/Loss on disposal of FAs | 0 | 0 | 0 | 0 | 0 |
| Chg in Wkg. Cap. | 918 | 1,553 | 1,222 | 553 | 392 |
| Other Operating CF | 199 | 203 | 203 | 207 | 211 |
| Net Operating CF | 8,204 | 7,963 | 6,313 | 6,517 | 6,879 |
| Capital Exp. (net) | (1,561) | (2,320) | (3,000) | (2,850) | (2,708) |
| Other Invts. (net) | (9,750) | (2,852) | 7,131 | 0 | 0 |
| Invts in Assoc. & JV | 0 | 0 | 0 | 0 | 0 |
| Div from Assoc & JV | 0 | 0 | 0 | 0 | 0 |
| Other Investing CF | 368 | 357 | 336 | 336 | 336 |
| Net Investing CF | (10,943) | (4,815) | 4,467 | (2,514) | (2,371) |
| Div Paid | (1,498) | (1,049) | (215) | (485) | (618) |
| Chg in Gross Debt | 0 | 0 | 0 | 0 | 0 |
| Capital Issues | 0 | 0 | 0 | 0 | 0 |
| Other Financing CF | (1,483) | (1,534) | (1,743) | (1,778) | (1,814) |
| Net Financing CF | (2,981) | (2,583) | (1,958) | (2,263) | (2,431) |
| Currency Adjustments | 0 | 0 | 0 | 0 | 0 |
| Chg in Cash | (5,720) | 565 | 8,822 | 1,740 | 2,077 |
| Opg CFPS (RMB) | 0.76 | 0.67 | 0.53 | 0.63 | 0.68 |
| Free CFPS (RMB) | 0.70 | 0.59 | 0.35 | 0.38 | 0.44 |

Source: Company, DBS HK

Sun Art Retail Group

Target Price & Ratings History



| S.No. | Date | Closing Price | 12-mth Target Price | Rating |
|-------|-----------|---------------|---------------------|--------|
| 1: | 27-May-21 | HK\$5.84 | HK\$8.42 | Buy |
| 2: | 3-Nov-21 | HK\$3.72 | HK\$3.81 | Hold |
| 3: | 9-Feb-22 | HK\$2.91 | HK\$3.06 | Hold |
| 4: | 14-Mar-22 | HK\$2.70 | HK\$3.23 | Buy |

Source: DBS HK

Analyst: Mavis Hui
Clement Xu

Sun Art Retail Group

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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