

Sun Art Retail Group

Bloomberg: 6808 HK Equity | Reuters: 6808.HK

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DBS Group Research . Equity

11 Jan 2024

HOLD

Last Traded Price (10 Jan 2024): HK\$1.21 (HSI : 16,097)
 Price Target 12-mth: HK\$1.17 (3% downside) (Prev HK\$1.71)

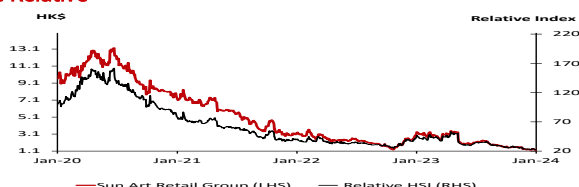
Analyst

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What's New

- 3Q FY24 sales weaker than expected
- Product differentiation to beef up margin recovery as well as the long-term success of M-Club membership stores
- Lifted FY24 losses to RMB265m and cut FY25F earnings by 31% given near-term sales pressure and the impact of store closures; maintain HOLD with revised TP of HK\$1.17

Price Relative



Forecasts and Valuation

FY Mar (RMBm)	2023A	2024F	2025F	2026F
Turnover	83.662	74.877	74.503	77.111
EBITDA	5.183	3.866	4.406	5.138
Pre-tax Profit	722	(156)	555	1,349
Net Profit	109	(265)	374	949
Net Pft (Pre Ex) (core profit)	493	15	524	949
Net Profit Gth (Pre-ex) (%)	(30.5)	(97.1)	3,513.0	81.0
EPS (RMB)	0.01	(0.03)	0.04	0.10
EPS (HK\$)	0.01	(0.03)	0.04	0.11
Core EPS (RMB)	0.05	0.00	0.05	0.10
Core EPS (HK\$)	0.06	0.00	0.06	0.11
EPS Gth (%)	N/A	N/A	N/A	153.6
Core EPS Gth (%)	(30.5)	(97.1)	3,513.0	81.0
Diluted EPS (HK\$)	0.01	(0.03)	0.04	0.11
DPS (HK\$)	0.04	0.00	0.02	0.05
BV Per Share (HK\$)	2.69	2.56	2.54	2.57
PE (X)	97.1	nm	28.3	11.2
CorePE (X)	21.5	729.7	20.2	11.2
P/Cash Flow (X)	2.5	2.3	3.2	2.4
P/Free CF (X)	3.7	4.3	8.8	4.5
EV/EBITDA (X)	nm	nm	nm	nm
Net Div Yield (%)	3.6	0.0	1.8	4.5
P/Book Value (X)	0.5	0.5	0.5	0.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	0.5	(1.2)	1.7	4.3
Earnings Rev (%)		nm	(31)	New
Consensus EPS (RMB)		0.01	0.05	0.10
Other Broker Recs:		B: 8	S: 1	H: 8

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

Taking longer to recover

Investment Thesis

Omni-channel strategy. Being the largest hypermarket operator in China, Sun Art continues to remodel its hypermarket stores into offline experience centres and online sales fulfilment centres. Riding on its network of 485 hypermarkets and 19 superstores, Sun Art will further expand the scale of its membership model "M Club", from currently two stores to a total of 15 stores in FY26.

Sales under pressure in the near-term. Same-store sales were below expectations in 3Q FY24, with December seeing 8% decline y-o-y, mainly affected by the lower ticket size and ongoing market competition. We expect Sun Art to record 11% top line contraction in FY24, followed by a low-single digit CAGR towards FY26, aided by faster expansion in M-Club and RT-Super.

Differentiation is the key. Differentiated goods (including house brands and exclusive offers) that have 10-15% higher gross margins will continue to be the key focus of Sun Art. We believe this could potentially support a c.0.5ppt expansion in Sun Art's GP margin each year over the medium-term.

Maintain HOLD, HK\$1.17 TP (vs. HK\$1.71 previously). We have revised up our FY24F loss projection to RMB265m and cut FY25F earnings by 31% given the near-term sales pressure and store closure impact. Our TP of HK\$1.17 continues to peg to 26x FY25F PE, in line with its pre-pandemic average. Maintain HOLD.

Key Risks

Food safety issues, catastrophic events, better-than-expected sales growth, etc.

At A Glance

Issued Capital (m shrs)	9,540
Mkt Cap (HKm/US\$m)	11,543 / 1,476
Major Shareholders (%)	
A-RT Retail Holdings Ltd.	46.3
Alibaba Group Holding Ltd.	27.3
New Retail Strategic Opportunities Fund, L.P.	5.0
Free Float (%)	21.3
3m Avg. Daily Val. (US\$m)	0.73
GICS Industry: Consumer Staples / Food & Staples Retailing	

Sun Art Retail Group

WHAT'S NEW

Lingering sales pressure. Sales continued to stay under pressure in December 2023 along with the shift in consumption patterns, while overall consumer sentiment remained lukewarm. Sun Art's comparable sales dropped 8% y-o-y on a relatively high base in December, with lower ticket sizes offsetting the growth in customer traffic. This resulted in a 6% decline in comparable sales during 9M FY24. We expect sales pressure to continue in the near term, due to intensifying competition (e.g., from global warehouse clubs) as well as macro uncertainties. Considering impacts from the closure of certain loss-making stores and the reduction of supply chain business with Alibaba, we expect Sun Art's top line to see a 11% decline in FY24, and show a slight improvement in FY25/26, driven by sequentially faster expansion of RT-Super and M-Club membership stores.

Membership stores in the pipeline. To address market competition, Sun Art's initiatives in its M-Club model could potentially support the company's margin recovery over the longer term. The target is to roll out an additional 13 M-Club stores by FY26 (currently two stores in Changzhou and Yangzhou). The company also aims to achieve a gross margin of >10% in M-Club in three years, while it may take longer to achieve 2% net profit margin. Product differentiation is the key to successful membership retention, and Sun Art plans to achieve a 25-30% (currently 10-15%) differentiation rate in the long term, benchmarking to global warehouse clubs. The differentiated products would include Sun Art's house brands and exclusive products from suppliers. Compared to global warehouse clubs that currently have good presence in China, we believe there should still be room for improvements for Sun Art (e.g., overseas supply chain) while this model could take time to realize benefits.

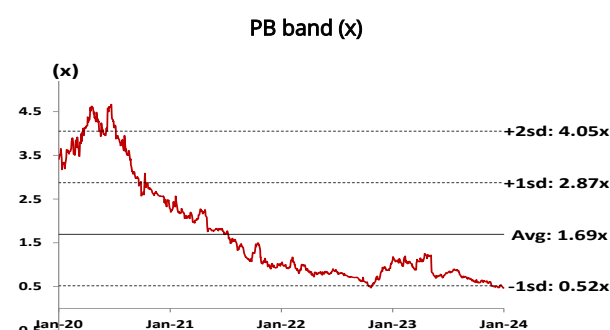
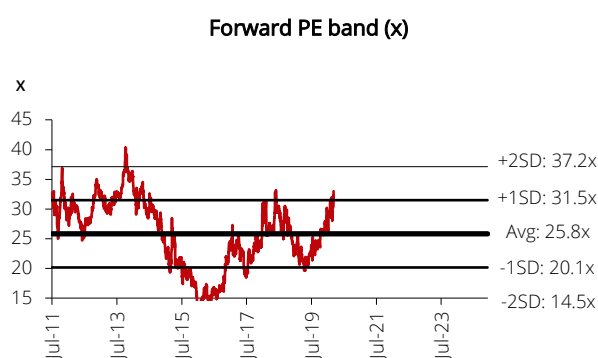
Efficiency improvement. In view of the near-term sales pressure, apart from store closures, Sun Art is also making progress on hypermarket remodeling, including streamlining of SKUs and lowering staff costs. For example, total SKUs per hypermarket is controlled at c.20,000 now (1H FY24: c.25,000), with a target to reach c.15,000 going forward. Meanwhile, Sun Art is also focusing on more stringent supplier selection to facilitate the above strategies. Coupled with 14 well-established fresh processing centres, Sun Art should be able to see gradual recovery in net profit margins, and is aiming for 1-1.5% by FY26.

We revised FY24 loss projection to RMB265m and cut FY25 earnings by 31%, considering the weaker-than-expected sales momentum as well as impact of store closures. Our new TP of HK\$1.17 is pegged to 26x FY25F PE (in line with its pre-pandemic average). We maintain HOLD as the M-Club initiatives could potentially offer long-term growth opportunities.

Company Background

Sun Art is a leading hypermarket operator in China. As of 31 Mar 2023, the company operated a total of 486 hypermarkets under "RT-Mart", 12 supermarkets under "RT-Super", and 84 "RT-Mini" stores, with total GFA of 13.8m sqm. As of 31 Mar 2023, 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.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Sun Art Retail Group

Segmental Breakdown (RMB m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Revenues (RMB m)					
Sales of goods	84,595	80,535	71,688	71,218	73,727
Rental income	3,539	3,127	3,190	3,285	3,384
Total	88,134	83,662	74,877	74,503	77,111

Source: Company, DBS HK

Income Statement (RMB m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Revenue	88,134	83,662	74,877	74,503	77,111
Cost of Goods Sold	(66,661)	(63,081)	(56,457)	(55,803)	(57,370)
Gross Profit	21,473	20,581	18,420	18,700	19,740
Other Opng (Exp)/Inc	(20,007)	(19,020)	(17,795)	(17,520)	(17,941)
Operating Profit	1,466	1,561	625	1,180	1,800
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	(1)	(1)	(1)	0	0
Net Interest (Exp)/Inc	(520)	(454)	(499)	(474)	(451)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(1,448)	(384)	(280)	(150)	0
Pre-tax Profit	(503)	722	(156)	555	1,349
Tax	(323)	(644)	(140)	(161)	(378)
Minority Interest	87	31	30	(20)	(22)
Preference Dividend	0	0	0	0	0
Net Profit	(739)	109	(265)	374	949
Net Profit before Except.	709	493	15	524	949
EBITDA	5,328	5,183	3,866	4,406	5,138
Growth					
Revenue Gth (%)	(5.3)	(5.1)	(10.5)	(0.5)	3.5
EBITDA Gth (%)	(30.9)	(2.7)	(25.4)	14.0	16.6
Opg Profit Gth (%)	(59.3)	6.5	(60.0)	89.0	52.5
Net Profit Gth (%)	N/A	N/A	N/A	N/A	153.6
Margins & Ratio					
Gross Margins (%)	24.4	24.6	24.6	25.1	25.6
Opg Profit Margin (%)	1.7	1.9	0.8	1.6	2.3
Net Profit Margin (%)	(0.8)	0.1	(0.4)	0.5	1.2
ROAE (%)	(2.9)	0.5	(1.2)	1.7	4.3
ROA (%)	(1.1)	0.2	(0.4)	0.6	1.4
ROCE (%)	4.4	0.5	2.1	2.9	4.6
Div Payout Ratio (%)	N/A	350.1	N/A	50.0	50.0
Net Interest Cover (x)	2.8	3.4	1.3	2.5	4.0

Source: Company, DBS HK

Sun Art Retail Group

Balance Sheet (RMB m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Net Fixed Assets	30,331	28,425	27,951	27,440	26,774
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	1,678	2,612	2,855	3,122	3,416
Cash & ST Invt	19,912	21,543	22,312	22,177	22,978
Inventory	9,723	8,474	9,781	9,732	10,073
Debtors	4,102	3,064	2,671	2,658	2,751
Other Current Assets	0	0	0	0	0
Total Assets	65,746	64,118	65,570	65,129	65,991
ST Debt	0	673	673	673	673
Creditors	20,211	18,794	21,693	21,585	22,340
Other Current Liab	13,882	14,514	14,800	15,091	15,388
LT Debt	0	0	0	0	0
Other LT Liabilities	6,587	5,940	5,390	4,896	4,450
Shareholder's Equity	23,958	23,518	22,365	22,216	22,449
Minority Interests	1,108	679	649	669	691
Total Cap. & Liab.	65,746	64,118	65,570	65,129	65,991
Non-Cash Wkg. Capital	(20,268)	(21,770)	(24,041)	(24,286)	(24,905)
Net Cash/(Debt)	19,912	20,870	21,639	21,504	22,305
Debtors Turn (avg days)	15.3	15.6	14.0	13.1	12.8
Creditors Turn (avg days)	118.7	119.7	138.8	150.2	148.4
Inventory Turn (avg days)	57.3	55.9	62.6	67.7	66.9
Asset Turnover (x)	1.3	1.3	1.2	1.1	1.2
Current Ratio (x)	1.0	1.0	0.9	0.9	0.9
Quick Ratio (x)	0.7	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	216.0	326.9	310.5	295.0
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

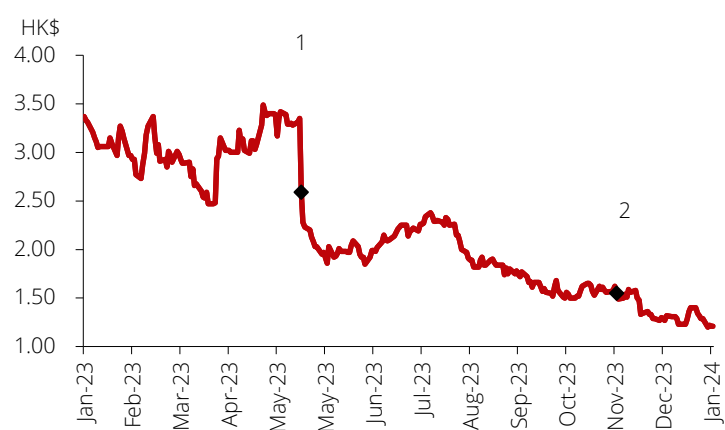
Cash Flow Statement (RMB m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Pre-Tax Profit	(503)	722	(156)	555	1,349
Dep. & Amort.	3,862	3,622	3,242	3,225	3,338
Tax Paid	(653)	(644)	(140)	(161)	(378)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(970)	870	1,985	(46)	322
Other Operating CF	1,841	(268)	(273)	(279)	(284)
Net Operating CF	3,577	4,302	4,658	3,295	4,347
Capital Exp.(net)	(1,979)	(1,454)	(2,200)	(2,090)	(1,986)
Other Invt.(net)	6,455	2,392	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(1,175)	(2,138)	336	336	336
Net Investing CF	3,301	(1,200)	(1,864)	(1,754)	(1,649)
Div Paid	(1,031)	(377)	(382)	0	(187)
Chg in Gross Debt	0	0	0	0	0
Capital Issues	0	0	0	0	0
Other Financing CF	(2,649)	(1,611)	(1,643)	(1,676)	(1,710)
Net Financing CF	(3,680)	(1,988)	(2,025)	(1,676)	(1,897)
Currency Adjustments	0	0	0	0	0
Chg in Cash	3,198	1,114	769	(135)	801
Opg CFPS (RMB)	0.48	0.36	0.28	0.35	0.42
Free CFPS (RMB)	0.17	0.30	0.26	0.13	0.25

Source: Company, DBS HK

Sun Art Retail Group

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	17-May-23	HK\$2.59	HK\$2.57	Hold
2:	16-Nov-23	HK\$1.58	HK\$1.71	Hold

Source: DBS HK

Analyst: Mavis Hui
Clement Xu

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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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Sources for all charts and tables are DBS HK unless otherwise specified.

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