

Hong Kong
ADD

Consensus ratings*: Buy 17 Hold 2 Sell 1

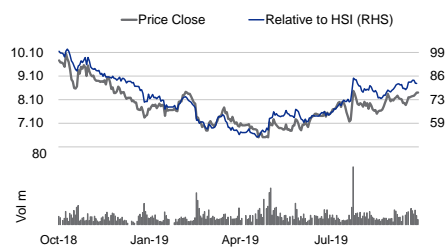
Current price:	HK\$8.40
Target price:	HK\$9.30
Previous target:	HK\$9.1
Up/downside:	10.7%
CGI / Consensus:	0.0%

Reuters:	6808.HK
Bloomberg:	6808 HK
Market cap:	US\$10,216m
	HK\$80,134m
Average daily turnover:	US\$9.94m
	HK\$77.49m
Current shares o/s:	9,540m
Free float:	23.0%

*Source: Bloomberg

Key changes in this note

- FY19F EPS no change.
- FY20F EPS increased by 1.9%.
- FY21F EPS increased by 3.7%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	0.6	11.3	-13.9
Relative (%)	3.6	18.4	-18.1

Major shareholders

	% held
A-RT Retail Holdings Limited	51.0
Alibaba Group	26.0

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Sun Art Retail Group

O2O business to bear fruit in FY20F

- After a recent company visit, we found that RT-Mart's SSSG turned positive yoy in 3Q19, supported by strong growth in its O2O business.
- Sun Art is considering raising shipping charges for its O2O business in FY20F and expects its O2O business to generate positive earnings.
- The redecoration of offline stores will also improve its SSSG in FY20F.
- We maintain our Add rating and raise our DCF-based TP to HK\$9.3.

RT-Mart's SSSG expected to turn to positive yoy in 3Q19

Supported by its O2O business, RT-Mart's SSSG turned to +0.2% yoy in 3Q19, from -0.6% yoy in 1H19. The number of orders per store for Taoxianda's business also improved to 730 orders in 3Q19 from 700 in June, and management expects it to improve to over 900 orders by end-FY19F. Overall SSSG for Sun Art remained slightly negative yoy in 3Q19, dragged down by the weak performance of Auchan. In Sep, Sun Art started to supply goods to Tmall through the B2B model, with positive NPM of 1–2%, which will drive up SSSG in 4Q19F and FY20F. Management expects orders through Tmall to reach 100 per store by end-FY19F and GMV to reach Rmb5bn in FY20F.

Transportation charges expected to rise for O2O business in FY20F

Excluding traffic volume acquisition costs, Taoxianda business should reach the breakeven point in FY19F. Currently, Taoxianda's ticket size is Rmb62 with 24% GPM. Now customers are exempt from paying shipping fees if the ticket size is above Rmb39 per order. Management is considering raising the shipping charges for its Taoxianda business in FY20F, and expects its O2O business to generate positive earnings. As Fig 2 shows, shipping charges could rise to Rmb 7.2, equivalent to 12% of the ticket size. We expect the shipping charge increase to lead to a drop in orders in the early stage, but as the customer base stabilizes and services improve, we believe orders will gradually return to normal. Management expects orders to return to 1,200–1,300 by end-FY20F.

Redecoration of offline stores expected to help improve SSSG

Sun Art started to upgrade its offline stores in 3Q19, and so far has completed the redecoration of two RT-Mart stores and one Auchan store. The upgraded stores delivered high single-digit positive SSSG in Sep. The company plans to start the upgrading process for 45 stores before the end of this year: i.e. 37 RT-Mart stores and 8 Auchan stores. We also expect the redecoration of offline stores to help improve Sun Art's SSSG in FY20F. Sun Art plans to open 10 new offline stores and 6 Hema stores in FY19F. Total capex guidance for FY19F is lowered to Rmb3.0bn–3.5bn.

Margins to improve gradually

Management said Sun Art also improved control of expenses in 3Q19. We expect net profit to grow by 6% and 5.5% yoy in 2H19F and FY19F, respectively. In FY20F, along with the SSSG increase and margin improvement in its O2O business, we forecast that Sun Art's OPM will improve by 0.6ppt yoy to 5.3%.

Maintain Add with a DCF-based TP of HK\$9.3

We reiterate our Add rating on Sun Art because of its improving SSSG and O2O business. We expect the O2O business to bear fruit in FY20F. We raise our FY20F and FY21F earnings forecasts by 1.9% and 3.7% to reflect better O2O margins. We raise our DCF-based TP from HK\$9.1 to HK\$9.3. Positive catalysts include: 1) stronger SSSG in 4Q19F, and 2) margin improvement. Negative catalysts include 1) weaker control of expenses, and 2) slower growth in its O2O business.

Financial Summary

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue (Rmbm)	102,320	99,359	93,637	91,901	92,854
Operating EBITDA (Rmbm)	7,358	6,901	7,101	7,712	8,326
Net Profit (Rmbm)	2,793	2,588	2,731	3,006	3,315
Core EPS (Rmb)	0.29	0.27	0.29	0.32	0.35
Core EPS Growth	8.6%	(7.3%)	5.5%	10.0%	10.3%
FD Core P/E (x)	25.86	27.91	26.44	24.03	21.79
DPS (Rmb)	0.13	0.12	0.11	0.13	0.14
Dividend Yield	1.71%	1.58%	1.51%	1.66%	1.84%
EV/EBITDA (x)	8.58	8.72	8.46	7.68	6.83
P/FCFE (x)	15.39	16.84	49.18	31.61	18.11
Net Gearing	(44.0%)	(53.7%)	(51.3%)	(51.4%)	(56.1%)
P/BV (x)	3.24	3.05	2.85	2.66	2.48
ROE	12.7%	11.3%	11.2%	11.5%	11.8%
% Change In Core EPS Estimates				1.00	1.01
CGI/consensus EPS (x)					1.02

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

O2O business to bear fruit in FY20F

Figure 1: Earnings forecasts revisions

	FY19F			FY20F			FY21F		
	Old	New	% change	Old	New	% change	Old	New	% change
Revenue (Rmb m)	93,637	93,637	0.0%	91,901	91,901	0.0%	92,854	92,854	0.0%
Gross margin (%)	26.8%	26.8%	0.00 ppts	26.9%	26.9%	0.00 ppts	26.9%	26.9%	0.00 ppts
Combined gross margin (%)	28.5%	28.5%	0.00 ppts	28.7%	28.7%	0.00 ppts	28.9%	28.9%	0.00 ppts
Operating margin (%)	4.7%	4.7%	0.00 ppts	5.2%	5.3%	0.10 ppts	5.6%	5.8%	0.20 ppts
Net profit (Rmb m)	2,731	2,731	0.0%	2,948	3,006	1.9%	3,198	3,315	3.7%
Core net profit (Rmb m)	2,731	2,731	0.0%	2,948	3,006	1.9%	3,198	3,315	3.7%
EPS (Rmb)	0.29	0.29	0.0%	0.31	0.32	1.9%	0.34	0.35	3.7%

SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 2: Taoxianda operating profit breakdown

Rmb	
Ticket size	62.0
GPM	24%
Gross profit	14.9
Deliver fee	-7.3
Goods pick up fee	-2.7
Alibaba platform charge	-2.2
Depreciation	-0.6
Rental	-0.6
Utilities	-0.4
Others	-0.7
Operating profit	0.4

SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 3: DCF Valuation

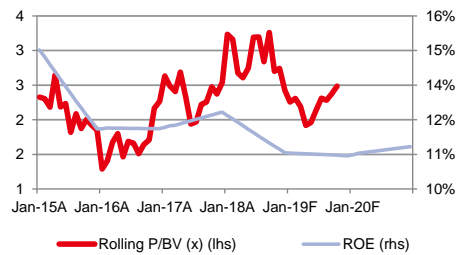
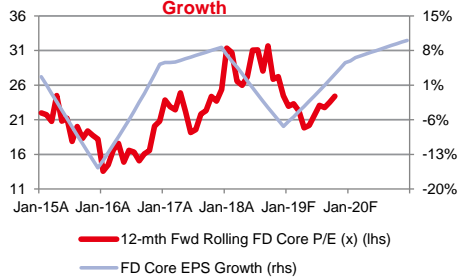
DCF valuation (Rmb m)	FY18	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F
EBIT	4,196.0	4,423.8	4,866.6	5,366.0	5,929.4	6,526.9	7,156.8	7,817.1	8,505.3	9,217.9	9,951.0	10,700.3	11,460.6	12,226.3
Taxes	-1,360.0	-1,431.9	-1,575.8	-1,738.1	-1,920.6	-2,114.1	-2,318.2	-2,532.0	-2,754.9	-2,985.8	-3,223.2	-3,465.9	-3,712.2	-3,960.2
NOPAT	2,836.0	2,991.9	3,290.8	3,627.9	4,008.8	4,412.7	4,838.6	5,285.1	5,750.3	6,232.1	6,727.8	7,234.4	7,748.4	8,266.1
NOPAT growth		5.5%	10.0%	10.2%	10.5%	10.1%	9.7%	9.2%	8.8%	8.4%	8.0%	7.5%	7.1%	6.7%
D&A	3,178.0	3,145.6	3,338.7	3,518.9	3,624.5	3,733.2	3,845.2	3,960.5	4,079.4	4,201.7	4,327.8	4,457.6	4,591.4	4,729.1
Funds from operation	6,014.0	6,137.5	6,629.5	7,146.8	7,633.3	8,145.9	8,683.8	9,245.6	9,829.7	10,433.8	11,055.6	11,692.0	12,339.8	12,995.2
Change in net working Capital	827.0	-1,320.7	-1,226.5	-239.8	-247.0	-254.4	-262.1	-269.9	-278.0	-286.4	-295.0	-303.8	-312.9	-322.3
Cash flow from operation	6,841.0	4,816.9	5,403.0	6,907.0	7,386.3	7,891.5	8,421.7	8,975.7	9,551.6	10,147.5	10,760.6	11,388.2	12,026.8	12,672.9
Capex	-2,679.0	-3,340.0	-3,110.0	-2,910.0	-2,997.3	-3,087.2	-3,179.8	-3,275.2	-3,373.5	-3,474.7	-3,578.9	-3,686.3	-3,796.9	-3,910.8
Free cash flow from operation	4,162.0	1,476.9	2,293.0	3,997.0	4,389.0	4,804.3	5,241.9	5,700.5	6,178.2	6,672.8	7,181.7	7,701.9	8,229.9	8,762.1
FCF growth		-64.5%	55.3%	74.3%	9.8%	9.5%	9.1%	8.7%	8.4%	8.0%	7.6%	7.2%	6.9%	6.5%
Terminal free cash flow														
Total discounted free cash flow														
Present value of terminal free cash flow														
Total present value of forecasted free cash flc	67,373.6													
Less: Minorities		1,678.7												
Less: Net Debt		-13,845.2												
Equity Value	79,540.0													
No. Shares (millions)		9,539.7												
Per Share Equity Value (Rmb)	8.34													
Exchange rate		1.11												
Target price (HK\$)	9.30													

SOURCES: CGIS RESEARCH, COMPANY REPORTS

Figure 4: WACC assumptions

	(%)
Cost of equity	9.6%
Risk free	4.0%
Market risk premium	7.6%
Beta	0.74
Cost of debt	6.5%
Kd (after tax)	4.6%
Target Debt / (Debt + Equity)	0.0%
Target Equity / (Debt + Equity)	100.0%
WACC	9.6%

SOURCES: CGIS RESEARCH, COMPANY REPORTS

BY THE NUMBERS
P/BV vs ROE

12-mth Fwd FD Core P/E vs FD Core EPS Growth

Profit & Loss

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Net Revenues	102,320	99,359	93,637	91,901	92,854
Gross Profit	24,674	25,119	25,077	24,704	25,007
Operating EBITDA	7,358	6,901	7,101	7,712	8,326
Depreciation And Amortisation	(3,263)	(3,178)	(3,155)	(3,348)	(3,529)
Operating EBIT	4,095	3,723	3,946	4,363	4,797
Financial Income/(Expense)	374	455	460	486	551
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Non-Operating Income/(Expense)	0	0	0	0	0
Profit Before Tax (pre-EI)	4,469	4,178	4,406	4,849	5,348
Exceptional Items					
Pre-tax Profit	4,469	4,178	4,406	4,849	5,348
Taxation	(1,449)	(1,360)	(1,432)	(1,576)	(1,738)
Exceptional Income - post-tax					
Profit After Tax	3,020	2,818	2,974	3,273	3,610
Minority Interests	(227)	(230)	(243)	(267)	(295)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	2,793	2,588	2,731	3,006	3,315
Recurring Net Profit	2,793	2,588	2,731	3,006	3,315
Fully Diluted Recurring Net Profit	2,793	2,588	2,731	3,006	3,315

Cash Flow

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
EBITDA	7,358	6,901	7,101	7,712	8,326
Cash Flow from Inv. & Assoc.					
Change In Working Capital	1,172	827	(1,321)	(1,227)	(240)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	(71)	(18)	0	0	0
Net Interest (Paid)/Received	(18)	(18)	(18)	(18)	(18)
Tax Paid	(1,469)	(1,293)	(1,432)	(1,576)	(1,738)
Cashflow From Operations	6,972	6,399	4,331	4,891	6,330
Capex	(2,509)	(2,679)	(3,340)	(3,110)	(2,910)
Disposals Of FAs/subsidiaries	2	14	0	0	0
Acq. Of Subsidiaries/investments	(43)	(35)	0	0	0
Other Investing Cashflow	295	591	478	504	569
Cash Flow From Investing	(2,255)	(2,109)	(2,862)	(2,607)	(2,341)
Debt Raised/(repaid)	(23)	(2)	0	0	0
Proceeds From Issue Of Shares	0	0	0	0	0
Shares Repurchased					
Dividends Paid	(2,084)	(1,238)	(1,092)	(1,202)	(1,326)
Preferred Dividends					
Other Financing Cashflow	(366)	39	(18)	(18)	(18)
Cash Flow From Financing	(2,473)	(1,201)	(1,110)	(1,220)	(1,344)
Total Cash Generated	2,244	3,089	358	1,064	2,645
Free Cashflow To Equity	4,694	4,288	1,469	2,285	3,989
Free Cashflow To Firm	4,735	4,308	1,487	2,303	4,007

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS... cont'd
Balance Sheet

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Cash And Equivalents	10,362	13,469	13,845	14,928	17,590
Total Debtors	3,326	3,061	2,908	2,763	2,624
Inventories	14,201	14,468	13,562	12,740	12,584
Total Other Current Assets	133	15	15	15	15
Total Current Assets	28,022	31,013	30,330	30,445	32,814
Fixed Assets	30,818	29,947	30,141	29,913	29,304
Total Investments	0	0	0	0	0
Intangible Assets	177	138	128	118	109
Total Other Non-Current Assets	695	640	640	640	640
Total Non-current Assets	31,690	30,725	30,910	30,671	30,052
Short-term Debt	2	1	1	1	1
Current Portion of Long-Term Debt					
Total Creditors	19,468	18,588	17,450	16,293	15,986
Other Current Liabilities	16,543	17,832	16,590	15,553	15,327
Total Current Liabilities	36,013	36,421	34,041	31,847	31,314
Total Long-term Debt	1	0	0	0	0
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	174	257	257	257	257
Total Non-current Liabilities	175	257	257	257	257
Total Provisions	0	0	0	0	0
Total Liabilities	36,188	36,678	34,298	32,104	31,571
Shareholders' Equity	22,315	23,665	25,304	27,108	29,097
Minority Interests	1,234	1,436	1,679	1,946	2,240
Total Equity	23,549	25,101	26,983	29,053	31,337

Key Ratios

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue Growth	1.87%	(2.89%)	(5.76%)	(1.85%)	1.04%
Operating EBITDA Growth	7.46%	(6.21%)	2.90%	8.59%	7.96%
Operating EBITDA Margin	7.19%	6.95%	7.58%	8.39%	8.97%
Net Cash Per Share (Rmb)	1.09	1.41	1.45	1.56	1.84
BVPS (Rmb)	2.34	2.48	2.65	2.84	3.05
Gross Interest Cover	227.5	206.8	219.2	242.4	266.5
Effective Tax Rate	32.4%	32.6%	32.5%	32.5%	32.5%
Net Dividend Payout Ratio	29.1%	28.9%	26.2%	26.2%	26.2%
Accounts Receivables Days	12.27	11.73	11.63	11.29	10.59
Inventory Days	69.60	70.48	74.61	71.63	68.12
Accounts Payables Days	94.69	93.55	95.93	91.89	86.83
ROIC (%)	18.7%	18.8%	22.5%	22.1%	22.6%
ROCE (%)	19.3%	17.2%	17.0%	17.4%	17.8%
Return On Average Assets	7.02%	6.37%	6.66%	7.39%	8.03%

Key Drivers

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
ASP (% chg, main prod./serv.)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (% , main prod./serv.)	N/A	N/A	N/A	N/A	N/A
No. of POS (main prod/serv)	461	484	503	523	543
SSS grth (% , main prod/serv)	-4.0%	-7.4%	-10.3%	-6.0%	-3.0%
ASP (% chg, 2ndary prod./serv.)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (% ,2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
No. of POS (2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
SSS grth (% , 2ndary prrod/serv)	N/A	N/A	N/A	N/A	N/A

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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We are transferring the rating mechanism from "BUY, SELL, HOLD" to "ADD, REDUCE, HOLD". Please refer to the definitions below.

Explanation on Equity Ratings (Existing mechanism (will be replaced by new mechanism by 01/09/19))

BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

Explanation on Equity Ratings (New mechanism)

ADD : The stock's total return is expected to exceed 10% over the next 12 months.

REDUCE : The stock's total return is expected to fall below 0% or more over the next 12 months.

HOLD : The stock's total return is expected to be between 0% and positive 10% over the next 12 months.

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