



Rating  
**Buy**

Asia  
China

Consumer  
Retail / Wholesale Trade

Company  
**Yonghui Superstores**

Reuters 601933.SS    Bloomberg 601933 CG    Exchange SHH    Ticker 601933

Date  
3 January 2018

## Company Update

Price at 2 Jan 2018 (CNY)	10.09
Price target - 12mth (CNY)	10.50
52-week range (CNY)	10.95 - 4.93
Shanghai Composite	3,308

# Poised to be the new retail pioneer; Buy

### A series of new retail initiatives roll out

Yonghui rolled out a series of initiatives internally and externally over the past two months. We regard these moves as farsighted preparation for the new era of the retail market. We also believe that its solid offline merchandising capabilities employed by new technology and new business models will potentially create new growth drivers for Yonghui. We lift our target price by 4% to RMB10.5 after factoring in the Hongqi stake that it acquired in December.

### Seeking online strategic partner and soliciting offline resources

Yonghui announced Tencent's investment in December. This surprised the market along with Tencent's partnership with Vipshop. We believe Tencent is an ideal partner for Yonghui as Yonghui should have more flexibility and independence, given that Tencent is not a retailer by nature. Yonghui should benefit from its online traffic and increase its online capability.

More recently, it teamed up with Hongqi chain, a regional offline chain, by taking a 21% stake in the company. In addition, YH, Hongqi and CMIG Futurelife (a property management company in West China) signed a strategic agreement to tap into a community retail network. We believe this regional corporation should boost its growth in the Southwest market where it has a solid track record.

### Valuation and risks

We factor this deal into our model and derive a new RMB10.5 target price (vs. RMB10.14). Our primary valuation methodology is DCF, employing 9.5% COE, 1.0 beta and a 1.5% TGR, which is in line with the 1-2.5% range we apply to the consumer sector. Downside risks: 1) failure to achieve its three-year plan; 2) M&A capability (having control as the second-largest shareholder); 3) challenges in the multichannel strategy.

### Valuation & Risks

Anne Ling

Research Analyst  
+852-2203 6177

Louise Li

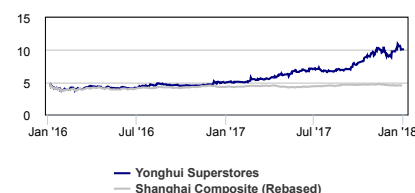
Research Associate  
+852-2203 6152

### Key changes

TP	10.14 to 10.50	↑	3.6%
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Source: Deutsche Bank

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	12.4	26.1	105.5
Shanghai Composite	-0.3	-1.2	6.6

Source: Deutsche Bank

### Key indicators (FY1)

ROE (%)	9.3
Net debt/equity (%)	-56.8
Book value/share (CNY)	2.10
Price/book (x)	4.8
Net interest cover (x)	-
Operating profit margin (%)	3.2

Source: Deutsche Bank

### Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	41,938.3	49,012.7	58,192.9	70,104.9	81,887.1
Reported NPAT (CNYm)	605.3	1,242.0	1,827.2	2,645.5	3,418.3
DB EPS FD(CNY)	0.08	0.14	0.19	0.28	0.36
OLD DB EPS FD(CNY)	0.08	0.14	0.19	0.28	0.36
% Change	0.0%	0.0%	0.0%	0.3%	0.4%

Source: Deutsche Bank estimates, company data

Deutsche Bank AG/Hong Kong

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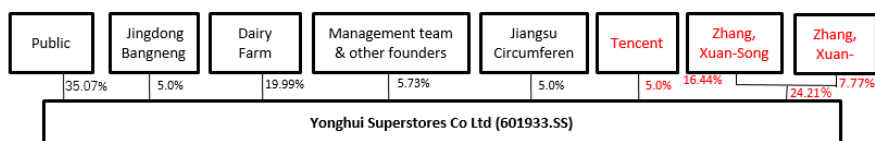
# Company update

## Seeking online strategic alliance – Tencent to take 5% of Yonghui

Yonghui announced on 15 December that Zhang Xuansong and Zhang Xuanning will sell 231m and 248m of yonghui shares to Tencent (0700.HK), respectively, (5% shares in total) at RMB8.81/share, which is 10% lower than the closing price before suspension. This implies a 32/25X P/E for 2018/2019. Tencent has no plans to further increase stake of Yonghui in the following 12 months, according to the announcement. Separately, Tencent's 15% investment into Yonghui Yunchuang is still under discussion, and details will be announced later.

After the deal, Zhang Xuansong and Zhang Xuanning, the major shareholders of Yonghui, will reduce their stake from 29.21% to 24.21%. The shareholding structure change is displayed below:

Figure 1: New shareholding structure of Yonghui



Source: Deutsche Bank, company data. Changes after this deal are highlighted in red.

On the morning of 18 December, Tencent (0700.HK) and JD.com (JD.OQ) purchased 7% and 5.5% shares of VIP (VIPS.OQ), respectively, at USD13.08/ADS (55% higher than the closing price of VIPSHOP). We believe this deal further crystalized two main groups in new retail areas – i.e. Alibaba team (including Sun Art, Intime, Suning and others) and Tencent team (including JD.com, Vipshop, Yonghui and others).

We are not yet clear about the detailed strategy between Yonghui and Tencent. To recap, after JD.com partnered with Yonghui in August 2015, Yonghui has become one of the top 2 suppliers of Jingdong Daojia. **As of mid-2017, Wechat contributed 25-30% of incremental traffic to Jingdong.** Thus we are positive on the partnership between Tencent and Yonghui, and we believe Tencent could help Yonghui's online exposure by empowering technology.

We share management's view that Tencent is different from Alibaba by nature, as the latter is a retail company and its consolidation is mainly to create synergy within the retail space. Tencent is more like a social network that has a need to monetize its 900m Wechat traffic. Thus, the two have different criteria when they seek partnerships, particularly in the retail space. **Alibaba intends to seek a complementary partner and will subsequently seek more integration, while Tencent prefers to find independent players with less interference in retailers' operations in the future.**



## Soliciting offline resources – focusing on the southwest

### Acquiring Hongqi and strengthening the southwest market

On 25 December 2017 and 2 January 2018, Yonghui announced that it plans to acquire 163.2m and 122.4m shares (12%/9% of total shares) of Chengdu Hongqi Chain (Hongqi, 002697.SZ) at RMB 5.8/share from Cao Shiru and Cao Zengjun, respectively. This is 9% lower than Hongqi's last trading price before it was suspended on 15 December and implies 46x/41x of Hongqi's 2018/2019 P/E, according to market forecasts. The shares come from shareholders Cao Shiru and Cao Zengjun, who disposed 250m and 35m shares, respectively. After the two batches of disposals, their shareholding of Hongqi will be reduced from 42.5% and 6.2% to 24.1% and 3.6%, respectively.

The southwest is the No.2 largest market for Yonghui, with 103 stores in Chongqing by the end of 1H17. It only owns 42 stores in Sichuan, but they are mainly large 8,000-10,000 sqm stores. Super Species just entered into Chengdu in 4Q17. **We believe that the partnership with the local key player shows Yonghui's strong intention to strengthen the entire southwest market, and this move will likely help accelerate its development.** According to the announcement, Yonghui and Hongqi will mainly cooperate on operation structure, supply chain management, new business development, logistics systems, technology implementation, big data, and CSR, etc. We also believe that the partnership will potentially achieve stronger bargaining power in regards to sourcing, which will eventually translate to higher margins.

Chengdu Hongqi Chain is the dominant supermarket chain in the Sichuan market, with **strong logistics capacity**. It owns three logistics centers in Sichuan, which enabled the company to increase its sourcing scale and strengthen its bargaining power. It operated 2,700 stores by 1H17, most of which were 300-500 sqm supermarkets, which is a complementary format for Yonghui in this market. **According to market forecasts for Hongqi's earnings and based on equity methodology, we estimate that Hongqi will contribute 1.3%/1.2% to Yonghui's NP (DBe) in 2018/2019. We factor this deal into our model and derive a new target price of RMB10.5 (vs. RMB10.14).**



Figure 2: Hongqi's results highlights

RMBm	2016	2017E	2018E	2019E
Revenue	6,322	7,195	8,052	8,915
Gross profit	1,676	1,963	2,216	2,474
EBIT	146	171	189	228
Net income	144	151	171	200
<b>yoy%</b>				
Revenue		13.8%	11.9%	10.7%
Gross profit		17.1%	12.9%	11.6%
EBIT		17.4%	10.5%	20.6%
Net income		4.6%	13.0%	17.0%
<b>as % of sales</b>				
Gross Margin %	26.5%	27.3%	27.5%	27.7%
EBIT margin %	2.3%	2.4%	2.3%	2.6%
Net profit margin %	2.3%	2.1%	2.1%	2.2%

Source: Bloomberg Finance LP

### New retail into community

Yonghui also reached a strategic partnership agreement with Hongqi and CMIG Futurelife on community retail and service. CMIG Futurelife is engaged in property management, community service and consumer finance. It provided community service and property management services to 18m residents living in different communities in 126 cities. The details of the partnership include the following:

- Yonghui and Hongqi can expand into a community retail network by leveraging CMIG Futurelife managed residential community resources. They can jointly roll out various retail formats, **such as unmanned retail, unmanned shelves, and community based consumption/retail format**. The **consumer database captured in its property management system** can also help Yonghui and Hongqi to accurately penetrate its target customers.
- Creating **"CVS + elderly service + consumer loan" services** by targeting elderly consumers offering convenience in retail and financial resources. This should also help Yonghui regarding its private label products dedicated to elderly residents.
- Establishing a leading **cold chain logistic system** by leveraging CMIG Futurelife's residential community space and facilities. This should further **direct Yonghui/Hongqi's online traffic to offline with "zero-distance" to customers**.

### Others

The company also announced a 2017 restricted share reward scheme on 1 December.

- Total restricted shares involved:** 167m restricted shares of Yonghui, accounting for 1.74% of total shares.
- Subscription price:** RMB4.58/share, which is 50% off of its share price before this announcement.



- **Target participant:** 339 of mid- to high-level management, excluding the major shareholder of the company.
- **Source of the shares:** the company will repurchase the needed shares from the public market using the company's cash on hand.
- **Evaluation by management:** Yonghui's sales grow by no less than 20% yoy, and core NP (excluding 37 innovative subsidies, included in Yonghui Yunchuang and Yonghui Yunshang segments) grows by no less than 25% yoy for 2018/2019/2020 for each.
- **Estimated impact on P&L:** the share-based compensation impact will be around RMB496m/191m/76m for the years 2018/2019/2020.

However, management is concerned that it will not be able to buy enough shares in the market. Thus, the major shareholder might dispose no more than 170m in the next 12 months, should the company fail to amply sufficient shares.

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## 2018 outlook

In a group investor meeting hosted on 20 December 2017, management commented that the "partnership program" (i.e., creating entrepreneurial spirit by having a small sales team taking care of its own P&L) has been the driver for operating efficiency in 2016/2017. Improvement in technology will likely be the next efficiency gain driver for 2018. For instance, the number of back-end employees has been well controlled due to technology empowerment.

Management guided to **achieve 3%/3.5% NPM for 2017E/2018E** vs. our forecasts of 3.1%/3.8%. **Looking ahead, management believes that 4-6% NPM is achievable in the long term.**

Regarding the store opening plan, it believes that 150 new openings for 2018 is achievable. Its strategy is to open small stores in large cities and to open large stores in small cities. It will focus more on lower-tier city penetration.

Management is positive on the operating outlook of Super Species, and will position it as a high-end imported product platform. It plans to launch a membership system and to tap into all major cities' prime locations.



Model updated: 02 January 2018

Running the numbers

Asia  
China  
Retail / Wholesale Trade

Yonghui Superstores

Reuters: 601933.SS Bloomberg: 601933 CG

Buy

Price (2 Jan 18) CNY 10.09

Target Price CNY 10.50

52 Week range CNY 4.93 - 10.95

Market cap (m) CNYm 96,566  
USDm 14,828

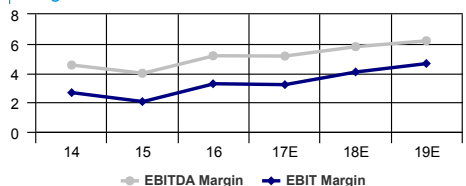
Company Profile

With its first store established in 1995, Yonghui Superstores (Yonghui) is principally engaged in the operation of chain supermarkets. The company sells fresh meat products, agricultural products, processed foods, daily necessities, clothing and imported goods, among other items.

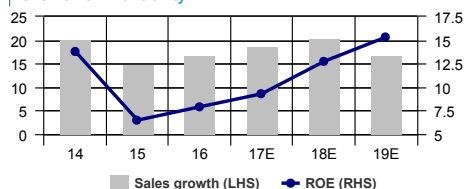
Price Performance



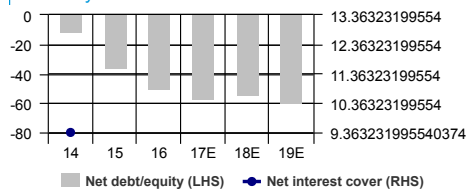
Margin Trends



Growth & Profitability



Solvency



Anne Ling

+852 2203 6177

anne.ling@db.com

Fiscal year end 31-Dec 2014 2015 2016 2017E 2018E 2019E

Financial Summary

DB EPS (CNY)	0.13	0.08	0.14	0.19	0.28	0.36
Reported EPS (CNY)	0.13	0.08	0.14	0.19	0.28	0.36
DPS (CNY)	0.08	0.08	0.13	0.10	0.14	0.18
BVPS (CNY)	2.0	3.0	2.0	2.1	2.2	2.4
Weighted average shares (m)	6,509	7,725	8,719	9,570	9,570	9,570
Average market cap (CNYm)	22,538	40,760	38,086	96,566	96,566	96,566
Enterprise value (CNYm)	21,830	36,385	28,547	85,159	85,004	82,882

Valuation Metrics

P/E (DB) (x)	26.5	67.3	30.7	52.8	36.5	28.2
P/E (Reported) (x)	26.5	67.3	30.7	52.8	36.5	28.2
P/BV (x)	2.14	1.65	2.45	4.80	4.51	4.17
FCF Yield (%)	2.6	0.5	1.8	2.7	3.2	4.0
Dividend Yield (%)	2.2	1.5	3.0	0.9	1.4	1.8
EV/Sales (x)	0.6	0.9	0.6	1.5	1.2	1.0
EV/EBITDA (x)	13.1	21.8	11.2	28.4	20.9	16.3
EV/EBIT (x)	22.4	42.2	17.8	45.6	29.8	21.8

Income Statement (CNYm)

Sales revenue	36,551	41,938	49,013	58,193	70,105	81,887
Gross profit	7,044	8,153	9,721	11,665	14,262	16,838
EBITDA	1,661	1,671	2,538	3,001	4,064	5,076
Depreciation	687	809	934	1,133	1,208	1,268
Amortisation	0	0	0	0	0	0
EBIT	975	862	1,604	1,868	2,856	3,808
Net interest income/(expense)	-104	25	74	267	283	320
Associates/affiliates	-5	-89	-121	40	112	127
Exceptionals/extraordinary	219	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	1,084	797	1,556	2,175	3,251	4,255
Income tax expense	232	197	343	435	683	936
Minorities	1	-5	-28	-87	-77	-100
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	852	605	1,242	1,827	2,646	3,418
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	852	605	1,242	1,827	2,646	3,418

Cash Flow (CNYm)

Cash flow from operations	1,775	1,521	2,108	4,042	4,677	5,468
Net Capex	-1,198	-1,313	-1,440	-1,455	-1,542	-1,638
Free cash flow	577	209	668	2,588	3,134	3,831
Equity raised/(bought back)	0	5,704	6,357	0	0	0
Dividends paid	-405	-513	-611	-914	-1,323	-1,709
Net inc/(dec) in borrowings	531	-1,444	0	0	0	0
Other investing/financing cash flows	-707	-1,733	-1,251	195	-1,656	0
Net cash flow	-4	2,223	5,163	1,869	155	2,122
Change in working capital	386	124	-242	1,066	764	756

Balance Sheet (CNYm)

Cash and other liquid assets	2,152	4,375	9,538	11,407	11,562	13,683
Tangible fixed assets	5,926	6,343	6,827	7,148	7,483	7,853
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	1,237	1,955	1,986	1,831	3,599	3,726
Other assets	6,164	7,631	11,088	11,849	13,456	15,045
Total assets	15,480	20,304	29,438	32,235	36,099	40,308
Interest bearing debt	1,444	0	0	0	0	0
Other liabilities	7,572	8,023	10,197	12,167	14,786	17,385
Total liabilities	9,016	8,023	10,197	12,167	14,786	17,385
Shareholders' equity	6,438	12,228	19,199	20,112	21,435	23,144
Minorities	26	54	43	-44	-121	-221
Total shareholders' equity	6,464	12,281	19,241	20,068	21,314	22,923
Net debt	-708	-4,375	-9,538	-11,407	-11,562	-13,683

Key Company Metrics

Sales growth (%)	20.2	14.7	16.9	18.7	20.5	16.8
DB EPS growth (%)	13.7	-40.1	81.8	34.0	44.8	29.2
EBITDA Margin (%)	4.5	4.0	5.2	5.2	5.8	6.2
EBIT Margin (%)	2.7	2.1	3.3	3.2	4.1	4.7
Payout ratio (%)	57.3	100.8	92.5	50.0	50.0	50.0
ROE (%)	13.8	6.5	7.9	9.3	12.7	15.3
Capex/sales (%)	3.3	3.1	2.9	2.5	2.2	2.0
Capex/depreciation (x)	1.7	1.6	1.5	1.3	1.3	1.3
Net debt/equity (%)	-11.0	-35.6	-49.6	-56.8	-54.2	-59.7
Net interest cover (x)	9.4	nm	nm	nm	nm	nm

Source: Company data, Deutsche Securities estimates



# Appendix 1

## Important Disclosures

\*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Yonghui Superstores	601933.SS	10.09 (CNY) 2 Jan 2018	NA

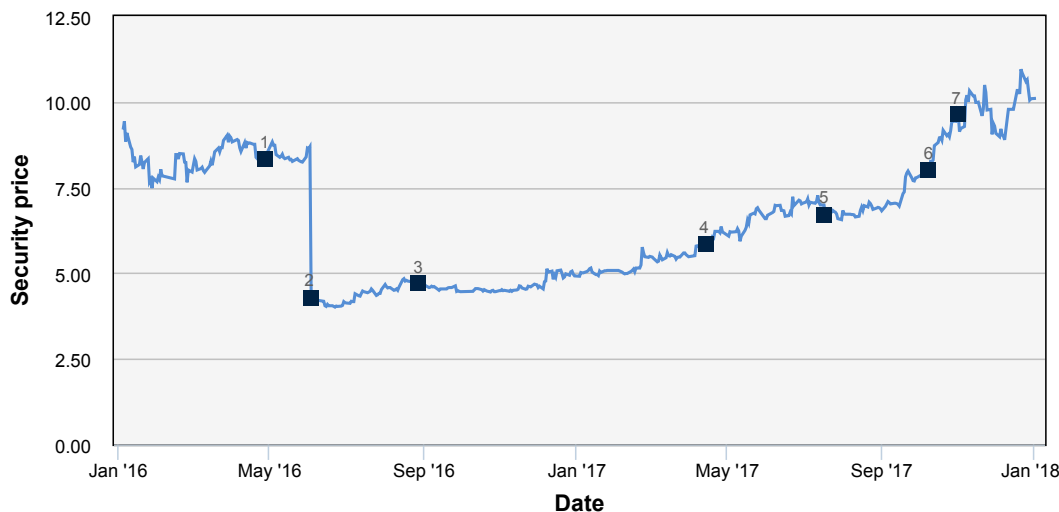
\*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>. Aside from within this report, important conflict disclosures can also be found at <https://gm.db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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## Historical recommendations and target price. Yonghui Superstores (601933.SS)

(as of 01/02/2018)



### Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*\* Analyst is no longer at Deutsche Bank

1.	04/28/2016	Buy, Target Price Change CNY 11,60	Richard Rui-Huang**	5.	07/18/2017	Buy, Target Price Change CNY 8,20	Anne Ling
2.	06/03/2016	Buy, Target Price Change CNY 5,80	Richard Rui-Huang**	6.	10/09/2017	Buy, Target Price Change CNY 8,90	Anne Ling
3.	08/28/2016	Buy, Target Price Change CNY 5,70	Richard Rui-Huang**	7.	11/01/2017	Buy, Target Price Change CNY 10,14	Anne Ling
4.	04/14/2017	Buy, Target Price Change CNY 6,50	Mark Yuan				



### Equity Rating Key

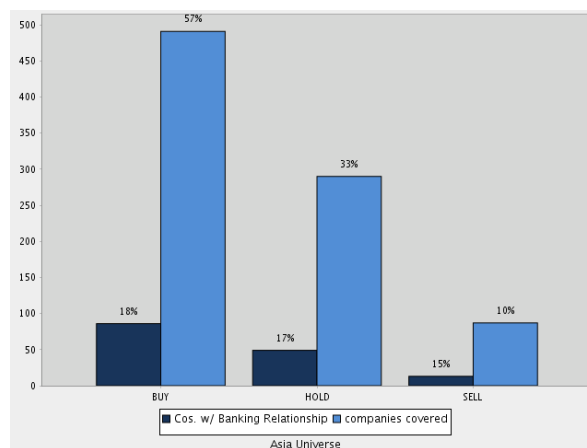
**Buy:** Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield ) , we recommend that investors buy the stock.

**Sell:** Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

**Hold:** We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

### Equity rating dispersion and banking relationships





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## David Folkerts-Landau

Group Chief Economist and Global Head of Research

Raj Hindocha  
Global Chief Operating Officer  
Research

Michael Spencer  
Head of APAC Research  
Global Head of Economics

Steve Pollard  
Head of Americas Research  
Global Head of Equity Research

Anthony Klarman  
Global Head of  
Debt Research

Paul Reynolds  
Head of EMEA  
Equity Research

Dave Clark  
Head of APAC  
Equity Research

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Equity Derivatives Research

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Spyros Mesomeris  
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#### Deutsche Bank AG

Deutsche Bank Place  
Level 16  
Corner of Hunter & Phillip Streets  
Sydney, NSW 2000  
Australia  
Tel: (61) 2 8258 1234

#### Deutsche Bank AG

Mainzer Landstrasse 11-17  
60329 Frankfurt am Main  
Germany  
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#### Deutsche Bank AG

Filiale Hongkong  
International Commerce Centre,  
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Hong Kong  
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#### Deutsche Securities Inc.

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
Japan  
Tel: (81) 3 5156 6770

#### Deutsche Bank AG London

1 Great Winchester Street  
London EC2N 2EQ  
United Kingdom  
Tel: (44) 20 7545 8000

#### Deutsche Bank Securities Inc.

60 Wall Street  
New York, NY 10005  
United States of America  
Tel: (1) 212 250 2500

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