



Investment theme

We initiate coverage on **Best Mart 360 (2360.HK)**, one of the market leaders in the fast expanding HK leisure food retail market which listed on the main board of HKEx in January 2019, with a Buy rating and target price of HK\$5.26 per share.

As the market leader with strong brand, unique market position and extensive sales network spanning across Hong Kong, Kowloon and New Territories Best Mart 360 is well positioned to benefit from the fast-expanding leisure food market in Hong Kong. To capitalize the expanding market, the group would add 84.7% more stores through FY19F-FY22F.

In our view, the group' would yield stable and valid return to investors, as each of its store generates stable cash flow; and consumption of leisure food is less likely affected by the economic cycle and sentiment over the economy given demand for food item is usually inelastic and ticket size for leisure food item is usually insignificantly small for average consumer.

Market leader. Founded in 2013 and listed on main board of HKEx in January 2019, Best Mart 360 was the second largest leisure food retailers in Hong Kong, with 85 shops as of the end of July 2018 and sales revenue exceeded HK\$1.0b, accounting for 21.6% of sales of leisure food retailing business in Hong Kong.

Competitive edges. Best Mart 360's competitive advantages, including extensive sales network and strategic stores locations, vast supplier base and multi-channel of procurement, comprehensive products portfolio, renowned household brand and precise inventory management system make it stay ahead in the expanding leisure food retail market which threshold is high in our view.

Expanding market. Sales revenue of leisure foods products in Hong Kong is projected to increase at four-year CAGR of 3.2% from HK\$11.8b in 2018 to HK\$13.3b in 2022; while sales revenue of leisure food retailers is projected to increase at four-year CAGR of 5.7% from HK\$5.2b in 2018 to HK\$6.5b in 2022, by Frost & Sullivan. As market leader, Best Mart 360 is well posted to benefit from the expanding leisure food retail market.

Increase in stores number. To boost sales revenue and expand market share, management of the group plan to open 72 more stores by the end of FY22F, bringing its total number of stores to 157.

Strong organic growth. Excluding listing expenses of HK\$24.3m, Best Mart 360's net profit for FY19F is projected to increase by 28.2% YoY to HK\$74.6m. Otherwise, including the listing expenses, the group's FY19F net profit is projected to ease slightly by 6.2% YoY to HK\$50.3m. The group's net profit CAGR for FY19F to FY22F is projected to be 38.8%.

Cash rich. Following the issuance of new shares and listing on main board of HKEx in January 2019, the group raised HK\$237.0m. We reckon as of the end of March 2019, the group would be in net cash position of HK\$215.1m, sufficient for its expansion plan. Since almost all of the group's transactions with customers are cash-based or equivalent, it does not have receivables. On the other hand, its suppliers in general provide about 8 days of credit to it. Thus, we expect the group would be cash rich going forward.

General Information

Best Mart 360	
Stock code	2360
# of shares issued (million)	1,000.0
Price (March 26th 2019) (HK\$)	3.08
Mkt cap (HK\$ million)	3,080.0
12-months target price (HK\$)	5.26
Recommendation	Buy

Sources: Best Mart 360, GRCS

Key financial data and ratios

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
Revenue (HK\$ million)	472.8	690.0	1075.9	1190.8	1433.7	1831.1	2129.2
Operating profit (HK\$ million)	16.8	33.1	68.8	61.8	109.4	146.6	160.8
Net profit (HK\$ million)	12.5	25.1	53.6	50.3	91.5	122.5	134.4
Equity (HK\$ million)	14.4	39.6	93.2	365.5	458.6	585.6	726.0
ROA (%)	11.0	14.0	24.8	11.8	17.7	18.7	16.7
ROE (%)	86.2	63.5	57.5	13.8	20.0	20.9	18.5
PE (X)	247.4	122.5	57.5	61.2	33.7	25.1	22.9
P/BV (X)	213.3	77.8	33.1	8.4	6.7	5.3	4.2

Sources: Best Mart 360, GRCS

Shareholder structure

	# of shares held (million)	% of shareholding
Long Ease	750	75
Public	250	25

Sources: Best Mart 360

Financial Analysis

Profit and loss projection

- Change in number of stores is directly correlated with the group's sales revenue growth, as we have seen the group managed to grow its sales revenue at CAGR of 50.8% between FY16A and FY18A by increasing its number of stores at CAGR of 47.9%. Growth in in SSS (same-store sales) as results of efficient management also provided boost to revenue.

Assumptions for sales forecasts

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
# of stores at FY end	32	52	70	87	115	143	157
Average number of stores	28	42	61	79	101	129	150
Average sales/store (HK\$m)	16.9	16.5	17.7	15.2	14.2	14.2	14.2

Sources: Best Mart 360, GRCS

Same store sales growth

	FY16A	FY17A	FY18A
SSS growth (%)	1.3%	8.8%	14.4%

Sources: Best Mart 360

- We project the group's sales revenue to increase by 10.7% YoY to HK\$1,190.8m, on 24.3% YoY increase in number of stores to 87 at the end of March 2019.
- FY19F-FY22F sales revenue CAGR is projected to be 21.4%, on presumed average number of stores CAGR at 23.8%.
- The group's gross profit is the difference between sales revenue and cost of inventories. GPM for FY19F is projected to be 31.9%, in line with GPM for FY18A. Given the group's broad suppliers base, multi-sourcing channels and bargaining power over its suppliers on scale of its network and bulk purchasing, we expect the group will continue to be able to procure merchandises at competitive costs. Thus, we project the group's GPM would be remain stable at 31.6% throughout FY22F.
- We estimate that listing expenses of HK\$24.3m would boost the administrative expenses by 66.9%, and dwindle operating profit and net profit for FY19F by 10.2% YoY and 6.2% YoY, respectively, to HK\$61.8m and HK\$50.3m. Stripping off the listing expenses, our FY19F net profit projection would be HK\$70.6m, representing a YoY growth of 31.7% over the corresponding period last year.
- Net profit CAGR for FY19F-FY22F is projected to be 38.8%.

Cash flow projection

- Its FCF increased from -HK\$8.5m for FY16A to HK\$63.9m for FY18A, due to the increase in number of shops, and improvement in GPM as well as OPM which were attributable to enhancement of economic of scale on expansion in stores network and better operating efficiency.
- FY19F FCF is expected to drop by 44.3% given the 10.8% drop in EBITDA due to the incurrence of listing expenses, and 93.2% and 21.8%, respectively increase in capex and inventory for the opening of 17 new stores during the period.
- FCF is projected to increase at three-year CAGR 44.5% FY19F-FY22F, on expansion in store network and enhancement in OPM due to better operating efficiency.

Financial position, net asset value and capital expenditures

- Since almost all of its transactions with customers are settled on cash-based or equivalent, it does not have receivables. On the other hand, its suppliers in general provide about 8 days of credit to it. Thus, the group is expected to be cash rich going forward.
- Investment for opening a new store is modeled at HK\$2.2m. 18.6% of the investment is for renovation and furnishing and treated as capital expenditure. 14.0% and 67.4% of the investment are for security deposits and advance rental payment for lease of premises and stocking, respectively and treated as expenses.
- As of the end of July 2018, the group was in net debt position of HK\$52.1m. The group raised about HK\$237.0m in January 2019 from its new shares offering, and is expected to turn into net cash position at HK\$215.1m by the end of March 2019.
- Following its IPO in January, the group's pro forma adjusted combined net tangible assets to equity owner was HK\$318.6m, or HK\$0.32 per share.

Valuation

		FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F
EBITDA	(HK\$m)	75.1	126.0	162.5	177.9	186.2	187.3	188.5	189.7	190.9	192.1	193.3	194.5	195.6
Change in working capi	(HK\$m)	(14.0)	(59.4)	(16.0)	(60.7)	(63.5)	(63.9)	(64.3)	(64.7)	(65.1)	(65.5)	(66.0)	(66.4)	(66.8)
Capex	(HK\$m)	(25.5)	(16.9)	(11.2)	(9.8)	(10.3)	(10.3)	(10.4)	(10.5)	(10.5)	(10.6)	(10.6)	(10.7)	(10.8)
FCF	(HK\$m)	35.6	49.7	135.3	107.4	112.4	113.1	113.8	114.5	115.2	116.0	116.7	117.4	118.1
Discount factor		1.0	1.1	1.2	1.3	1.4	1.5	1.7	1.8	2.0	2.2	2.4	2.6	2.8
PV of FCF	(HK\$m)	35.6	45.5	113.7	82.8	79.5	73.3	67.7	62.4	57.6	53.1	49.0	45.2	41.7
Terminal value														
Terminal growth rate		8.0%												
FCF in FY31F (HK\$m)	(HK\$m)	118.1												
Terminal value (HK\$m)	(HK\$m)	12,084.3												
PV of TV. (HK\$m)	(HK\$m)	4,270.2												
PV of FCF (HK\$m)	(HK\$m)	771.7												
PV of TV (HK\$m)	(HK\$m)	4,270.2												
Cash (HK\$m)	(HK\$m)	230.3												
Debt (HK\$m)	(HK\$m)	(15.2)												
Minority interest (HK\$m)	(HK\$m)	0.0												
Enterprise value (HK\$m)	(HK\$m)	5,257.0												
# of shares	(m)	1,000.0												
EV/share	(HK\$)	5.26												

Sources: GRCS, Best Mart 360

At HK\$3.08, the counter is trading at FY20F PEG of 0.87x. Its valuation is not demanding in our view. Our DCF based target price at HK\$5.26 is based upon following assumption:

- FCF CAGR at 8.2% between FY20F and FY31F.
- Group's average number of operating stores per annum is assumed to increase at CAGR of 4.6% from 101 stores for FY20F to 165 stores for FY31F.
- Risk-free rate of 1.8%.
- Market risk premium of 9.8%.
- Beta of 1.0x.
- Stay at net cash position.
- Equity weighting 100.0%
- WACC at 9.1%.
- Terminal growth rate at 8.0%.

Income Statement FY ended 31 March

HK\$ Mil	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
Revenue	472.8	690.0	1075.9	1190.8	1433.7	1831.1	2129.2
COS	(334.4)	(473.7)	(733.6)	(810.6)	(980.3)	(1252.0)	(1455.8)
Gross Profit	138.4	216.3	342.3	380.2	453.4	579.1	673.4
Others	(0.2)	0.4	(0.2)	0.7	3.4	4.9	6.2
S&D exp.	(108.6)	(165.5)	(238.4)	(260.6)	(317.4)	(405.2)	(484.1)
Admin exp.	(12.8)	(18.0)	(35.0)	(58.4)	(30.0)	(32.3)	(34.7)
OP	16.8	33.1	68.8	61.8	109.4	146.6	160.8
Finance costs	(1.6)	(2.6)	(3.2)	(1.8)	0.0	0.0	0.0
Pretax Profit	15.2	30.4	65.6	60.1	109.4	146.6	160.8
Taxation	(2.8)	(5.3)	(12.0)	(9.7)	(17.9)	(24.0)	(26.4)
Net profit	12.5	25.1	53.6	50.3	91.5	122.5	134.4

Balance Sheet as at 31 March

HK\$ Mil	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
Fixed Asset	11.7	15.6	18.2	34.0	40.9	41.9	41.9
Others	13.7	20.6	22.2	22.1	9.2	9.2	5.0
Total NCA	25.4	36.2	40.4	56.1	50.1	51.1	46.9
Inventories	63.8	92.6	100.2	117.6	189.0	202.2	255.9
Receivables	0.6	1.2	4.2	1.8	1.6	1.9	2.5
Cash	8.8	24.2	37.8	230.3	254.7	376.8	470.7
Others	15.0	24.6	33.3	21.7	20.3	24.5	31.3
Total CA	88.2	142.8	175.5	371.4	465.6	605.5	760.3
Trade payables	19.7	23.9	43.9	41.1	48.6	60.9	70.5
Borrowings	44.1	87.9	52.4	15.2	0.0	0.0	0.0
Owners' loans	18.8	4.6	0.0	0.0	0.0	0.0	0.0
Tax payable	3.1	8.2	8.4	2.4	4.5	6.0	6.6
Total CL	85.6	124.5	104.7	58.7	53.0	66.9	77.1
Borrowings	0.0	0.0	15.2	0.0	0.0	0.0	0.0
Owners' loans	10.0	10.0	0.0	0.0	0.0	0.0	0.0
Others	3.6	4.9	2.9	3.2	4.1	4.1	4.1
Total NCL	13.6	14.9	18.1	3.2	4.1	4.1	4.1
Net Asset	14.4	39.6	93.2	365.5	458.6	585.6	726.0

Cash Flow Statement FY ended 31 March

HK\$ Mil	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
EBT	15.2	30.4	65.6	60.1	109.4	146.6	160.8
Depreciation	4.1	6.7	9.7	9.5	10.0	10.2	9.8
Interest cost	1.6	2.6	3.2	0.9	(3.4)	(4.9)	(6.2)
Others	3.5	4.5	5.7	4.6	9.9	10.6	13.5
EBITDA	24.4	44.2	84.2	75.1	126.0	162.5	177.9
Change in WC	(25.1)	(43.3)	(7.0)	(14.0)	(59.4)	(16.0)	(60.7)
Tax Paid	0.0	(0.7)	(12.1)	(7.3)	(13.4)	(18.0)	(19.8)
Operating CF	<u>(0.7)</u>	<u>0.3</u>	<u>65.0</u>	<u>53.8</u>	<u>53.1</u>	<u>128.5</u>	<u>97.4</u>
Capex	(7.8)	(11.6)	(13.2)	(25.5)	(16.9)	(11.2)	(9.8)
Others	(0.0)	(5.3)	(5.1)	0.7	3.4	4.9	6.2
Investing CF	<u>(7.8)</u>	<u>(16.9)</u>	<u>(18.4)</u>	<u>(24.8)</u>	<u>(13.5)</u>	<u>(6.3)</u>	<u>(3.6)</u>
Free CF	<u>(8.5)</u>	<u>(10.7)</u>	<u>63.9</u>	<u>35.6</u>	<u>49.7</u>	<u>135.3</u>	<u>107.4</u>
Fund raised	0.0	0.0	0.0	236.6	0.0	0.0	0.0
Dividend paid	0.0	0.0	0.0	(20.0)	0.0	0.0	0.0
Change in loans	7.7	45.3	(12.9)	(52.4)	(15.2)	0.0	0.0
Others	(1.2)	(16.7)	(17.8)	(0.8)	0.0	0.0	0.0
Financing CF	<u>6.5</u>	<u>28.5</u>	<u>(30.7)</u>	<u>163.4</u>	<u>(15.2)</u>	<u>0.0</u>	<u>0.0</u>
Change in cash	(2.0)	11.9	15.9	192.4	24.4	122.2	93.8
Beginning cash	2.0	(0.1)	11.8	27.8	220.2	244.6	366.8

Financial Ratio

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
Inventory turnover days	57.6	60.3	48.0	49.0	57.1	57.0	57.4
Trade receivables days	0.3	0.5	0.9	0.9	0.4	0.4	0.4
Trade payables days	8.2	8.3	7.6	8.1	8.0	8.3	8.3
GPM(%)	29.3	31.3	31.8	31.9	31.6	31.6	31.6
OPM (%)	3.5	4.8	6.4	5.2	7.6	8.0	7.5
NPM (%)	2.6	3.6	5.0	4.2	6.4	6.7	6.3
ROE (%)	86.2	63.5	57.5	13.8	20.0	20.9	18.5
ROA (%)	11.0	14.0	24.8	11.8	17.7	18.7	16.7
Interest coverage (x)	10.6	12.5	21.2	34.6	0.0	0.0	0.0
Current ratio (x)	1.0	1.1	1.7	6.3	8.8	9.0	9.9
Quick ratio (x)	0.3	0.4	0.7	4.3	5.2	6.0	6.5
Gearing ratio (%)	504.4	258.7	72.5	4.2	0.0	0.0	0.0
Debt to equity ratio (%)	443.2	197.5	31.9	(58.8)	(55.5)	(64.4)	(64.8)

Competitive edges

Best Mart 360's competitive advantages among its competitors, including renowned household brand, extensive store network and strategic stores locations, developed supply chain and comprehensive product portfolio, efficient inventory management system, make it stay ahead in competition.

1. Renowned household brand built upon proactive marketing campaign

Offering the best all year around. Since its inception in 2013, Best Mart 360 has positioned itself as imported prepackaged leisure foods retailer offering comprehensive collection of distinctive products which are not generally available elsewhere in the Hong Kong. Best Mart 360 stands for offering best quality, best price, comfortable shopping environment and pleasurable shopping experience to customers all year around.

Proactive marketing campaign. Best Mart 360 established outstanding corporate image and gained brand awareness by engaging in various marketing campaign. To maintain its brand and publicity, the group has been proactively deploying commercials into various media such as television, printed media, as well as digital media. The group leverages on social media platforms as well as internet search engine such as Facebook, Youtube and Google to disseminate its latest promotions and products information. It often sponsors TV shows and premieres to enhance the awareness of its brand. All Best Mart 360's stores have identical layout, decoration and products displays, and use same promotional materials, which enhancing its corporate and brand image. The group plans to deploy HK\$31.3m more into its marketing campaign after its IPO in January 2019.

Membership program. Its website, <https://www.bestmart360.com/>, is not just only its billboard for marketing campaign and products display, but also its online membership services center. Since the commencement of Best Mart 360 membership program in 2015, the group has accumulated more than 1.0m members. Customer who spends HK\$200.0 or above in single transaction at any Best Mart 360 store is eligible to join the group's membership scheme. Member can enjoy incentives such as special discount on designated products and earning reward points for redemption. It has been proven that the group's membership scheme is an effective promotion channel that boost sales. It also fosters and enhances loyalty of targeted customer group (regular customer with average ticket size above HK\$200.0). Sales to members have been ramping up, from 17.3% of the total sales for FY16A to 40.3% of that for FY18A, indicating that members have become the most important group of customers of Best Mart 360 whom providing recurrent revenue to the group. Membership scheme is also the window for the group to collect data regarding consumer behavior and preference, which are critical inputs for formulation of sales and marketing strategies and procurement plans.

Joint marketing. Further, Best Mart 360 often team up with other institutions from various sectors such as credit card issuing institutions, amusement parks, shopping malls, film production companies...etc to launch joint promotion campaigns, creating synergy among itself and its partners in promotion of their respective products/services/brands. In a typical joint marketing campaigns, partner institutions purchase cash coupons from Best Mart 360 as gift or incentives to their customers; or Best Mart 360 gives out incentives such as entrances tickets provided by partner institutions. Occasionally, the group place partners' promotional materials in its stores or post those on its website or related social media platforms.

Awards and certification. Best Mart 360 has been certificated or acknowledged by a number of organizations and won numerous honors and awards upon its outstanding services and products qualities, which enhanced its brand and corporate image:

- Member of the "No Fakes Pledge" Scheme since September 2014, certificated by The

- Intellectual Property Department of the Government of the HKSAR.
- Octopus Partner Awards 2014 – Second Runner-up for “Usage Award for New Retail Merchants”
- Certification Mark upon “Retail Shops” Category under the “Quality Tourism Services Scheme” certificated by Hong Kong Tourism Board since July 2015.
- Member of the Quality Tourism Services Association since July 2015.
- Consumer’s Most Favorable Hong Kong Brands of Year 2015 –Golden Award given by China Enterprise Reputation & Credibility Association (Overseas).
- Best Loved Brands Awards 2015 given by RoadShow.
- Merit Award for “MTR Shops Voting Campaign 2017– Light Refreshment” given by MTRC.
- Octopus Partner Awards 2017– Champion for “Usage Growth Award for Retail Acquirer Merchant” given by Octopus.

2. Extensive store network

Extensive store network. As of the end of July 2018, Best Mart 360 had 85 retail shops stretching through Hong Kong, consisting of 15 retail stores stationed in Hong Kong Island, 33 retail stores in Kowloon and 37 stores in New Territories. Amongst all of its stores, 31 of them were stationed at street-level, 48 were in shopping arcades of neighborhood or residential districts and 6 were stationed at various transportation hubs where tourists gather, including train station, ferry terminal, mass transit railway station, airport and border shopping district.

Precise premise selection system. By studying demographic information such as population and its density and age group distribution of concerned districts where the group intend to station, directors and leasing team of Best Mart 360 are able to estimate customer flow, purchasing power and spending preferences of customers there, and project sales of the planned new store. Store site would then be selected upon criterions that may affect sales performance. Factors which determine investment return such as capex for the store and rental rate...etc would be elevated prior the group commit lease with term of two years or longer with landlord. Store would be opened only if investment and rate of return are justified by gauged monthly sales. Empirically, prime location for stores which target tourists are noticeable sites at street-level in popular urban area or in shopping malls with high pedestrian flow, while typical “good” neighborhood store should be stationed at expedient spot in communities with high population density, and able to cover at least 20,000 regular customers.

Test market with lower rental cost and risk. Occasionally, the group leases vacant sites as temporary shop premise in districts where retail rental market is underperformed at below market rate and lease terms of less than six months from landlords. By renting site with below average rental and shorter lease term, the group can exploit market potential of concerned district with lower risk exposure and costs. Further, the premises of lower rental would balance out the group’s over rental expenses for its store network.

Speedy startup. Typical saleable floor area of Best Mart 360’s store is about 46.9 sq.m. to 285.3 sq.m.. As soon as management identified a suitable premise for new store, they negotiate and enter into leasing contract with the landlord to secure the premise. The site then would be renovated and furnished into the group’s unified layout. Typically, it takes about 3.5 to 4.5 weeks for the group to open a store from scratch. Should the store does not perform as expected, initiatives would be taken promptly to improve sales of the store. The group also has options to shut down or relocate the underperforming store upon expiration of the respective lease.

Expansion in stores network. It is expected that Best Mart 360’s number of stores would increase by 2 to 87 by the end of March 2019. 13,21 and 38 new stores are planned to be opened in Hong Kong, Kowloon and New Territories respectively, bringing its total number of shops to 157 by the end of FY22F. Capex for expansion in sales network is budgeted at HK\$154.8m, or about HK\$2.2m per store.

Number of stores

FY16A	FY17A	FY18A	FY19F	FY20F	FY21F	FY22F
32	52	70	87	115	143	157

Sources: Best Mart 360, GRCS

3. Well-developed supply chain delivers comprehensive products

Multi-sourcing channels. Best Mart 360 distinguished itself among its competitors by being able to consistently introduce new products and new brands to its customers and offer wide selection of products at competitive price. Its objectives are accomplished upon its flexible and responsive parallel importation-based sourcing system and diversified suppliers base. Through referral from existing suppliers, attending international exhibitions, trade shows and business missions, market intelligence and daily search over the internet, the group's sourcing team identifies new products and new suppliers.

Parallel importation. Since its inception in 2013, Best Mart 360 has been sourcing prepackaged leisure foods and other grocery products from multiple channels including brand owners, manufacturers, distributors, trading companies around the world and importers of overseas products in Hong Kong. By parallel importation, the group can differentiate itself from other retailers by offering different products or the same products with different packages. Further, the group can response to customers' demand promptly, broaden its product mix, contain procurement costs and facilitates the introduction of new products from overseas into Hong Kong.

Comprehensive product portfolio. Best Mart 360 is offering variety of products covering collection of confectioneries, packaged bakery products and snacks, nuts and dried fruits, grains and miscellaneous food products, beverages and wine, personal care products and other products such as baby food and products, health food and supplements and miscellaneous household items. It is estimated that the group's products portfolio has more than 1,960 SKUs, including 454 SKUs of confectioneries, 138 SKUs of nuts and dried fruits, 648 SKUs of packaged bakery products and snacks, 198 SKUs of grains and miscellaneous food products, 284 SKUs of beverages and wine, 73 SKUs of personal care products and 165 SKUs of other products.

Private label. Best Mart 360 has been developing private label products since 2017, and has launched two own branded wet tissues and one chestnut product. Private label products are customized products produced for the group based upon selected specifications available from manufacturers, and exclusive available at Best Mart 360 stores. Since the group fully control pricing, quality and brand image of private label products, it always can formulate and adapt most suitable and effective marketing strategy to promote its owned branded products hence facilitating the sales of those. Offering unique private label products at its stores is another way to differentiate itself among its competitors.

4. Sophisticated and efficient inventory management system

Sophisticated inventory management system. Best Mart 360 has developed an efficient and sophisticated inventory management system by integrating WMS (warehouse management system) and POS (point of sales) systems and staffs at POS, logistics and warehouse management team together.

POS system supports the group's procurement and sales management, inventory management, supply chain management and membership management functions. Each SKU at any of the group's store is coded with unique barcode. When check-out item secured through barcode scanner, data and details of such items will be displayed on the screens at check-out counter and stored in POS system. Such data can be reviewed on real time basis, allowing user to track sales, inventories level and movement of each SKUs at retail stores online. POS system also records specific information regarding in-store inventory, such as product description, product mix and price.

Management formulate weekly sales forecast and stock replenishment plan based on weekly inventory data generated by POS, after taking into account of factors such as stock level, expected sales and lead times of each product, seasonal effects, promotion campaign, consumers' taste and market trend. Further, management pre-set inventory maintenance level of each SKU at each retail store, which is determined upon store size, turnover days of concerned SKU and lead time. Order would be placed automatically by the POS system should sales of concerned SKU reach the designated replenish level. Manager at each retail store is responsible to monitor the orders made by POS system and makes adjustment manually if needed. In order to keep stock at optimal level that tallies its ordinary course of business while lessen obsolete or expired inventory, management and front-line store keeper review and adjust inventory level periodically.

WMS system supports inventory management, stocking and logistics functions, and facilitates logistics between warehouse and POS. The system provides comprehensive information regarding inventories to users, such as stock description, stock mix, storage place at warehouse, location of warehouse, turnover of stocks, and expiration dates of each SKU. WMS system show where the SKUs which will be expired soon are stored in warehouse, so that staffs at warehouse can move such SKUs as soon as they can. At the beginning of every calendar month, in-house logistics team spots out stocks in warehouse which will expire within three months and report to purchasing team, so that the latter and operation team could move the stock beforehand. Besides, area managers and supervisors also report stock description and quantities in their retail stores to head office with expiry dates before the end of the next calendar month.

System would be upgraded. The group would acquire a new ERP system and integrate it with its existing IT platform. The upgraded system is expected to substantially enhance the efficiencies of various functions of the group's operations including enterprise resources and capital management, procurement planning, inventory management, supply chain planning, sales channel support, accounting and administration functions and CRM. HK\$23.5m has been budgeted for system upgraded.

Industry Overview

Factors which support the market to continue to expand

Expanding market. According to Frost & Sullivan, retail sales of leisure food of all sort of retailers in Hong Kong increased at four-year CAGR of 3.6% from HK\$10.0b in 2013 to HK\$11.5b in 2017, which retailers specializing on the sales of leisure food such as Best Mart 360 accounted for 43.4% of that. Meanwhile, sales revenue of leisure food retailers in Hong Kong increased at four-year CAGR of 6.4%, from HK\$3.9b in 2013 to HK\$5.0b in 2017, according to Frost & Sullivan, outpacing the leisure food sales CAGR. Total market size of leisure foods products in Hong Kong is projected to increase at four-year CAGR of 3.2% from HK\$11.8b in 2018 to HK\$13.3b in 2022; while sales revenue of leisure food retailers in Hong Kong is projected to increase at four-year CAGR of 5.7% from HK\$5.2b in 2018 to HK\$6.5b in 2022, by Frost & Sullivan. With competitive edges among its competitors, Best Mart 360 is set to benefit from the booming leisure food market which has been supported by the following factors:

Wide selection of products. As global market place and trading hub, Hong Kong has been offering rich diversification of leisure food products to cater to various demand and fast changing preference of consumer for years. Social medias and e-commerce platforms have been facilitating and accelerating introduction of new products into Hong Kong market by conveying information on trendy leisure food items oversea to consumers. By the same token, overseas producers and suppliers are capitalizing social medias and e-commerce platforms to promote their products abroad efficiently with less budget and effort. Hence more and more products would be introduced to the local market. With more products, retailers can diversify their risk of overstocking of a few SKUs. Further, retailers whom are able to offer rich variety of products to consumers could find opportunities in niche market by offering specific products catering to demand of non-mainstream customers.

Benefit from tourism boom. Number of inbound visitors to Hong Kong increased at CAGR of 3.7%, from 54.3m in 2013 to 65.1m in 2018. Meanwhile, visitors from Mainland China increased at CAGR of 4.6%, from 40.7m in 2013 to 51.0m in 2018, according to Hong Kong Tourism Board. Visitors and shoppers from Mainland China, which accounted for 78.3% of total inbound visitors in 2018, have strong confidence in consumers' interest protection systems in Hong Kong, believing all products, in particular F&B items sold in Hong Kong are genuine and authentic, safe and have been undergone stringent inspections and subject to severe labeling requirement. Influx of visitors from Southern China following the completion of major transportation infrastructures such as high-speed railway and HK-Zhuhai-Macau bridges, would boost sales of leisure food in Hong Kong.

Increase in population. Population in Hong Kong increased at five-year CAGR of 0.7% from about 7.2m in 2013 to more than 7.4m in 2018. Number of domestic households increased from about 2.5m in 2015 to approximately 2.6m at 4Q 2018, according to Census and Statistics Department. Consumptions of leisure food should grow alongside population.

Rising households' expenditures on snack. Median monthly domestic household income in Hong Kong increased at five-year CAGR of 4.3% from HK\$20,200.0 in 2013 to HK\$24,890.0 in 2016. Data provided by Census and Statistics Department reveals that average monthly households' expenditures on F&B items, including on leisure food, rose at five-year CAGR of 5.2% in 2010-2015, implying that growth in household expenditure on F&B is positively correlated with growth in household income. Frost & Sullivan projected that average monthly household expenditure on F&B would increase at seven-year CAGR of 3.7% between 2015 and 2022. In our view, F&B consumption, in particular leisure food consumption would be less affected by economic cycle and sentiment over economy, given demand for food is inelastic and ticket size for leisure food is usually insignificantly small for average consumer.

Competitive landscape

HK leisure food retail market. Best Mart 360 is indirectly competing with supermarket chain operators, convenience store chain operators and grocery chain operators and in direct competition with other chained leisure food retailers in Hong Kong. We estimate that there are more than 800 supermarkets and 1,200 convenience stores in Hong Kong. Nevertheless, leisure food chain operators differentiate themselves from supermarket by offering products which could not be found on the shelves of supermarkets.

Major supermarket operators in Hong Kong

Name	# of shops
ParknShop	over 290
Wellcome	278
AEON Stores	63
DCH Food Mart	51
Market Place by Jasons	43
U-Select	43
City'super	21
CR Vanguard Shop	13
YATA	11
Sogo	1
Oliver's The Delicatessen	1
Apita Uny PIAGO	3

Sources: Companies' websites, USDA Foreign Agricultural Service

Convenience store chains in Hong Kong

Name	# of outlets
7-Eleven	over 900
Circle K	337
Van Go	36

Sources: Companies' websites, USDA Foreign Agricultural Service

Leisure food retailers in HK. At the end of March 2018, there were seven chained leisure food retailers in Hong Kong. Each of them had at least 20 or more shops in Hong Kong. Aggregate revenue from the seven leisure food retailers made up about 87.6% of the total leisure food sales in Hong Kong as of the end of March 2018. With sales revenue exceeded HK\$1.0b for twelve-month period ended March 2018 and estimated market share of 21.6%, Best Mart 360 ranked the second place among the seven largest chained leisure food retailers in Hong Kong, just after CEC International (759 HK).

Peer comparison of Hong Kong retailers

Retailers	No. of stores in HK	Types	Place of sourcing	FY18 Retail Revenue (HK\$ mil)	FY18 Estimated Retail Revenue (HK\$ mil)	Same Store Sales Growth
CEC Int'l (759 Store)	220	Leisure food retail store	the PRC, Japan, Korea, Europe	1983.7	9.0	-
Best Mart 360	70	Leisure food retail store	Japan, U.S, Europe, South Asia Asia	1075.9	15.4	FY18:8.8%
PrizeMart	29	Leisure food retail store	U.S, Japan, the PRC, Vietman, Europe	360.2	12.4	-
Okashi Land	43	Leisure food retail store	the PRC, Japan	312.3	7.3	-
Company D	38	Leisure food retail store	the PRC, Japan, Korea	255.8	6.7	-
Company E	37	Leisure food retail store	the PRC, Japan, Korea	239.1	6.5	-
Company F	23	Leisure food retail store	U.S, Japan, Korea, Thailand	144.2	6.3	-
Aeon	63	General Merchandise store, supermarket	-	4376.9	69.5	-
IH Retail (JHC)	290	Household goods retail stores	-	1941.3	6.7	FY18:4.5%

Source: Media Reports, prospectus of Best Mart 360(2360.HK), annual reports of Aeon (984.HK) and IH retails (1373.HK), Great Roc Capital Securities

Entry barriers of the leisure food retailing business

Demanding investment threshold. Initial capital investment for setting up a new leisure food retail store is relatively high in Hong Kong. Major expenditures include advanced rental payment, security deposits and monthly rental for the lease of the premise, fixed asset investment such as decoration and renovation of the premise, stocking and salary and benefits for staffs. Sufficient funding is required for not just only opening a leisure food retail store but supporting the ongoing operation. According to Best Mart 360's track record and capex plan, average initial investment for new store would be about HK\$2.2m. In general, it takes a month for a new store to break even and nine to ten months to be profitable.

Rising costs. According to Best Mart 360's track record, on average, selling and distribution expenses accounted for 89.0% of the group's operating costs, and rental expenses and salary and wages for staffs accounted for 49.2% and 27.1%, respectively, of selling and distribution expenses. Rental and labor costs in Hong Kong have been on the uptrend.

According to Census and Statistics Department of HKSAR, nominal salary index for middle-level managerial and professional employees in import/export, wholesale and retail trades industries grew at ten-year CAGR of 2.8% between 2007 and 2017. In addition, median hourly wage of employees in Hong Kong retail industry increased at eight-year CAGR of 2.7% from HK\$39.9/hour for 2009 to HK\$49.3/hour for 2017.

According to Rating and Valuation Department of HKSAR, Average rent/m² for private retail properties in Hong Kong Island, Kowloon and New Territories increased from HK\$1,050.0/ m², HK\$1,200.0/ m² and HK\$909.0/ m² as of December 2008, respectively, to HK\$1,438.0/ m², HK\$1,339.0/ m² and HK\$1,337.0/ m² as of December 2018, representing a ten-year CAGR of 3.2%, 1.1% and 3.9%.

Hard to find right spot. It is very difficult to secure appropriate location for the premise of store in Hong Kong. Supplies of suitable sites for premise for leisure food retail store in popular districts with high pedestrian flow are scarce and rentals for such spots are usually unattainable for average operator.

Stable supply chain and economic of scale . Established relationships with suppliers and vast suppliers base are essential for leisure food retailer to secure sourcing. It takes time and effort to develop a stable supply chain from scratch. Further, chain operators like Best Mart 360 has competitive advantage among single store and smaller operators, as the former benefit from economic of scale such as discount offered by suppliers due to bulk purchasing, better logistic services or deployment of sophisticated IT system to support its inventory management.

Brand and market position. Unique brand image and distinctive market position help drawing in targeted customer group and fostering customer loyalty. Nevertheless, it takes times capital and endeavor to find out the right market position and build brand for new comer.

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** Great Roc Capital Securities Limited acted as the Joint Lead Manager in the share offer of Best Mart 360 Holdings Limited (02360.HK), both parties had investment banking business relationship in the past 12 months**

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