

Best Mart 360(2360.HK)

Date: 3 July, 2019



GREAT ROC

CAPITAL SECURITIES LIMITED

鴻騰資本證券有限公司

A wholly-owned subsidiary of UNF (Investing) Limited (HKEX stock code 1468)

英商匯豐有限公司之全資附屬公司 (香港交易所上市編號1468)

Best Mart 360	
# of shares issued (million)	1,000.0
Price (July 2nd 2019) (HK\$)	2.30
Mkt cap (HK\$ million)	2,300.0
12-months target price (HK\$)	5.26
Recommendation	Buy

Sources: Best Mart 360, GRCS

Beat expectations

- Best Mart 360's revenue and headline net earnings for FY19A came in above our projections by 8.2% and 18.7%, respectively. DPS for FY19A would be HK\$6.0 cents, representing a payout ratio of 100.5%.
- Revenue and net earnings CAGR between FY19A and FY22F are projected to be 18.2% and 31.0% on its store expansion plan and market share gain. Catalysts and drivers to its earnings and developments including expansion into Great Bay Area, established channels to Tencent's Wechat and Wechat Pay and other technological initiatives such as self-help store and mobile app, as well as enlarging private label product category.
- As the leading leisure food and fast-moving consumer goods retailer in HK, the group is least to be affected by challenging operating environment.
- Buy rating reiterated with DCF-based target price at HK\$5.26, implying 128.7% upsides. The recent sell-off of the counter due to some investors unloaded their holdings amid sluggish market sentiment presents a buy-on-weakness opportunity.

Key financial data and ratios

	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Revenue (HK\$ million)	472.8	690.0	1,075.9	1,288.5	1,433.7	1,831.1	2,129.2
Operating profit (HK\$ million)	16.8	33.1	68.8	78.8	109.4	146.6	160.8
Net profit (HK\$ million)	12.5	25.1	53.6	59.7	91.5	122.5	134.4
Equity (HK\$ million)	14.4	39.6	93.2	369.6	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	16.2	20.0	20.9	18.5
PE (X)	184.7	91.5	42.9	38.5	25.1	18.8	17.1
P/BV (X)	159.3	58.1	24.7	6.2	5.0	3.9	3.2

Sources: Best Mart 360, GRCS



Shareholder structure

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

Sources: Best Mart 360

Outdid our expectation

- Best Mart 360 registered a 11.4% YoY growth in net profit to HK\$59.7m on 19.8% YoY increase in revenue to HK\$1.3b. Excluding IPO related expenses of about HK\$18.3m incurred for FY19A (HK\$4.6m for FY18A), the leisure food retailer's earnings for FY19A came in at HK\$78.0m, representing a growth of about 34.0% YoY. The group's results for FY19A beat our projections:

Actual vs forecasts

		FY18A	FY19A	FY19E
Revenue	(HK\$m)	1,075.9	1,288.5	1,190.8
Gross profit	(HK\$m)	342.3	434.4	380.2
Operating profit	(HK\$m)	68.8	78.8	61.8
Net profit	(HK\$m)	53.6	59.7	50.3
Total assets	(HK\$m)	215.9	507.7	427.5
Equity	(HK\$m)	93.2	369.6	365.5
GPM	(%)	31.8	33.7	31.9
OPM	(%)	6.4	6.1	5.2
NPM	(%)	5.0	4.6	4.2
ROE	(%)	57.5	16.2	13.8
ROA	(%)	24.8	11.8	11.8

Sources: Best Mart 360, Great Roc Capital Securities

- At this juncture, we reiterate our FY20F-FY22F revenue and net profit projections as well as our DCF based target price at HK\$5.26. 3-year revenue and net earnings CAGR between FY19A and FY22F are projected to be 18.2% and 31.0%, respectively.



Profuse payout

- The Board of Directors recommended the distribution of final dividends of HK\$60.0m or HK\$6.0 cents per share, representing a payout ratio of 100.5% or core earnings (ex-IPO expenses) payout ratio of 77.0%. At the closing price on July 2nd 2019 of HK\$2.30, prospected FY19A dividend yield is 2.6%.

Solid financial position

- Its retail operation generated cash inflow of about HK\$37.1m for FY19A, compared to HK\$65.0m for FY18A. Since the group raised HK\$213.7m via its IPO in January 2019, it had about HK\$277.4m cash on its balance sheet, or HK\$203.6m net cash excluding bank loans of HK\$73.8m.

Moderated growth in revenue.

- The 19.8% increase in revenue for FY19A (55.9% for FY18A) was ascribed to the 6.8% YoY growth in same-store sales, and the net increase of 19 stores. Slower SSS growth for FY19A, compared to 8.8% recorded in FY18A, was attributable to adoption of less aggressive pricing strategy by management to balance out revenue growth and GPM, which enhanced by 1.9ppts to 33.7%, thanks to effective supply chain management. Slower revenue growth for FY19A was due to turnover at new stores which opened during the period were still ramping up by the end of the fiscal year.

OPM remain stable despite larger operation.

- OPM for FY19A was 6.1%, leveled with that for FY18A. Ex-IPO expenses OPM for FY19A was 7.5%, 0.7 ppts higher than that for FY18A. The OPM enhancement was mainly due to the 1.9 ppts increase in GPM and the growth in revenue and GP. Staffs costs for the period increased by 36.2% YoY to HK\$119.4m over the 29.5% YoY increase in headcounts to 728 staffs. Meanwhile, rental expenses for retail spaces increased 18.2% YoY to about HK\$133.0m, or 5.7% YoY to HK\$130.4 per sq.ft. Retail expenses accounted for about 10.3% of the group's revenue for the period.

SSS growth and number of stores for FY20F

- More new stores and positive SSS growth are the key growth drivers for the retailer's revenue and earnings for FY20F. We expect another 26 stores would be added into the group's retail network in FY20F, bringing its total number of stores to 115. Besides, since average investment payback period for the group's new store is about nine to ten months,



we expect that the 19 additional stores which were opened in last fiscal year would yield positive return to the group in FY20F. We also expect that the group's same store sales to continue to grow in FY20F, on management's proven track record of maintaining positive SSS growth rate three year in row. We left our FY20F GPM assumption at 31.6%, less than 33.7% for FY19A, as we think the group may adopt a slightly more aggressive pricing strategy to boost traffic at some of its newly opened stores. We maintain our FY20F OPM projection at 7.6% on stable rentals for retail space per sq.ft. due to suboptimal local economy and better operating efficiency following the upgrade of ERP system.

Number of stores

	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Number of stores	32	52	70	89	115	143	157

Sources: Best Mart 360, Great Roc Capital Securities

SSS growth

	FY17A	FY18A	FY19A
Number of same-store	18	26	45
Same-store sales (HK\$m)	271.5	435.7	802.3
SSS growth (%)	1.3	8.8	6.8

Sources: Best Mart 360

Initiatives to drive growth

- Management has been taking number of initiatives to strengthen the group's market position and brand, beckon new customers and expand into untapped market. Such initiatives include membership program, mobile application, private label products as well as setting up subsidiary in Macau. Further, through the set-up of the first self-checkout store in HK and launching two Wechat and Wechat Pay related mini applications, the group is set to explore the potentials of OTO retail model.

Expanding membership program

- Members of the group's membership scheme leaped 60.1% YoY from 792,000 as of the end of March 2018 to 1,268,000 as of the end of March 2019. Expansion in number of members of the group's membership program would definitely boost its revolving business. The group launched its owned mobile application in March 2019 that supports instant message function, allowing synchronized communication between the group and its



members. The instant messenger of the application enables the group to dispatch promotional offers, selective products promotion, information regarding store location and member privileges to its members and subscribers of the app from time to time. Further, the group's members are able to check their reward points records and redeem their reward points in the application. From March to June, 93,000 new members had been registered with the group via the application.

Private label products

- Best Mart 360 has launched seven private label products since 2017, including wet tissues, chestnuts, canned abalone, dried fruits, aloe gel and pork jerky. Since the group owns the brands and has absolute control over pricing, quality and brand image of its private label products, it could adapt most suitable marketing strategy to promote its owned branded products via its extensive retail network and effective marketing platform. Besides, offering unique private label products at its stores is another way to differentiate itself among its competitors.

Expanding into GBA

- In June 2019, the group announced that it has established a wholly-owned subsidiary in Macau. Such move could be viewed as the first step the group took to expand into Macau and GBA. Its strong brand as well as its channels to Wechat and Wechat Pay would facilitate its expansion into other untapped markets in Guangdong-HK-Macau Greater Bay Area.

First online offline integration attempt

- In June, 2019, the group opened the first self-checkout smart store in HK at New Mandarin Plaza, TST. The store is authorized and acknowledged by Tenpay Payment Technology Co. Ltd., subsidiary of Tencent (700 HK), to harness Wechat Pay and related technologies in store. Alongside the opening of smart store, the group launched a self-checkout Wechat mini application, "Best Mart Scan & Go". The scene at the self-checkout smart store would resemble as following steps:



Sources: Best Mart 360

- 1.) Shopper uses her smart phone with "Best Mart Scan & Go" mini application operating to scan the RFID or QR code on the merchandises she intends to purchase.



Sources: Best Mart 360

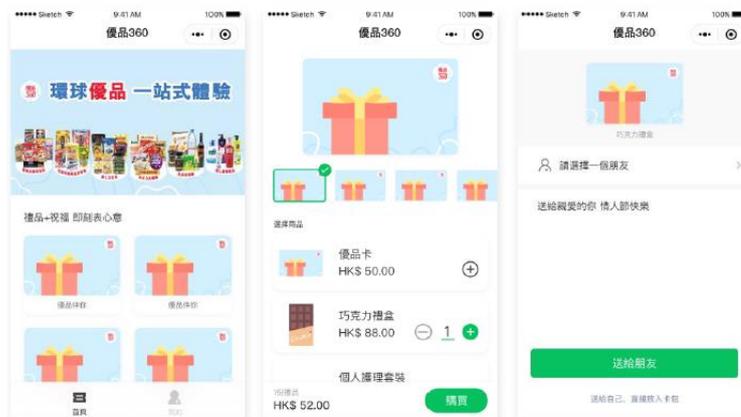
- 2.) The scanned items would be moved into the shopping cart in the mini application. The cart could be filled with 20 items at most each time.
- 3.) The amount for the baskets would be calculated and shopper could settle the bill with her Wechat Pay account in the mini application.
- 4.) Shop staff check the items in shopper's basket before she leaves the store.
- 5.) Currently, "Best Mart Scan & Go" supports both Wechat Pay HK and Wechat Pay in Mainland China.



- The implementation of the application is expected to reduce customers' queueing time substantially thus increase traffic, and allow more transactions to be generated. Less in-person services required by customers could contain operating costs.

E-gift card

- Alongside "Best Mart Scan & Go" and Best Mart 360 mobile application, another Wechat Mmni application, "Best Mart Card", has been launched. "Best Mart Card" is an e-gift card related application allowing users to purchase virtual gift card, which is valid in a year with different denomination and redeemable at all Best Mart 360 stores from the retailer online. User could send the virtual gift card with customized greetings to friends online. Further, "Best Mart Card" features another social function resemble to the Wechat's "Drawing of lucky money in red pocket"; it enables user to share drawing page among selected members, and the e-gift card could be drawn among members. E-gift card is sales in advances that will bring in revenue and cash inflow to the group. It is also a marketing tool that helps beckon new customers to its stores; and a mean to retain or even strengthen connection with existing customers.



Sources: Best Mart 360

- Potentials of the group's "New Retailing" initiatives, including Big Data collection and analysis, social media exposures, precise marketing, expansion and upgrading of its membership program, ameliorative customers' experience and costs containment are yet to be fully explored.
- Immediate upsides of the retailer's channel to Wechat and Wechat Pay would be access to an enormous market especially in Mainland China. Wechat Pay covers 50 countries including Mainland China, 800m users and 16 currencies.



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