

Leading brand in secondary market

Note Rated

Key points:

- Defensive thanks to its focus on secondary cities.
- Expects to open 16 new stores by end-2009.
- Net margin widened in 1H FY12/08A to 4.3%.
- Same-store-sales growth in November recovered to a normal high single-digit level.
- Undemanding valuation compared to other players.

Focus on secondary cities. Times is a hypermarket chain in eastern China, ranked 31st among the country's top 100 retail chain enterprises by the Ministry of Commerce and the China Chain Store & Franchise Association in 2007. The company concentrates on secondary cities (e.g. small town with population over 200,000), which differentiates it from other listed supermarket operators, which focus on prime cities. As consumption in secondary cities seems less affected by the economic slowdown, we reckon Times is more defensive than its peers.

Table 1: Strengths and weaknesses

Strengths

- Consumption in secondary cities is more stable than in prime cities during economic downturns.
- According to the management, Times is usually the first hypermarket brand in a city and as such enjoys huge advantages in terms of location choices, market acceptance and local relationships.
- Competition in secondary cities is mainly between modern supermarkets, traditional shops and wet markets. Less head-to-head competition helps the company's margins.
- Buoyed by rising local incomes, supermarket spending is rising and secondary cities offer better upside potential in the long term.

Weaknesses

As the first mover in a small city, the company faces more operating uncertainties.

- Logistic and management challenges related to maintaining stores in many cities. The company outsources logistic to suppliers and other third-parties. A distribution centre is under plan.
- The expansion of secondary cities will eventually attract other supermarket operators, increasing competition.

Source: SBI E2-Capital

Cross-region expansion. At end-June, the company had 62 stores, including 45 hypermarkets (682,310sqm or 82.7% of total GFA) and 17 supermarkets (42,629sqm), in 48 cities in Jiangsu (35 hypermarkets and 15 supermarkets), Zhejiang (4 hypermarkets and 1 supermarkets), Shandong (3 hypermarkets and 2 supermarkets), Anhui (1 supermarket) and Shanghai (1 hypermarket). Although Jiangsu is still the focus in the short term, the

China Consumer

Tue, 16 Dec 2008

Norman Zhang

(852) 2533 3715

normanzhang@sbie2capital.com

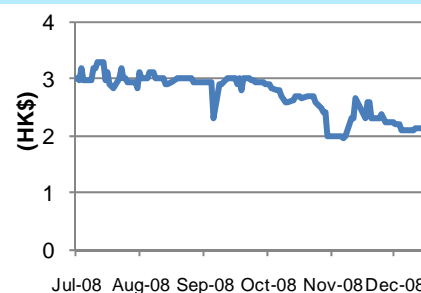
Stock data

Price	HK\$2.11
12 mth range	HK\$1.18-3.95
Market cap.	US\$236.6m
No. shares o/s	874.0m
Daily t/o, 3 mth	<US\$0.1m
Free float %	27.6%
Major shareholder	Fang brothers- 72.3%
Ticker	1832.HK/1832 HK

Financial summary

Year to Dec	07A
Yield (%)	1.6
ROE (%)	77.6
Net gearing (%)	399.7
Net debt/sh. (RMB)	0.499
BV/sh. (RMB)	0.20
Consensus EPS (RMB)	
- 12/08F	0.175
- 12/09F	0.220

Price Chart



SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

Analyst certification: the views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

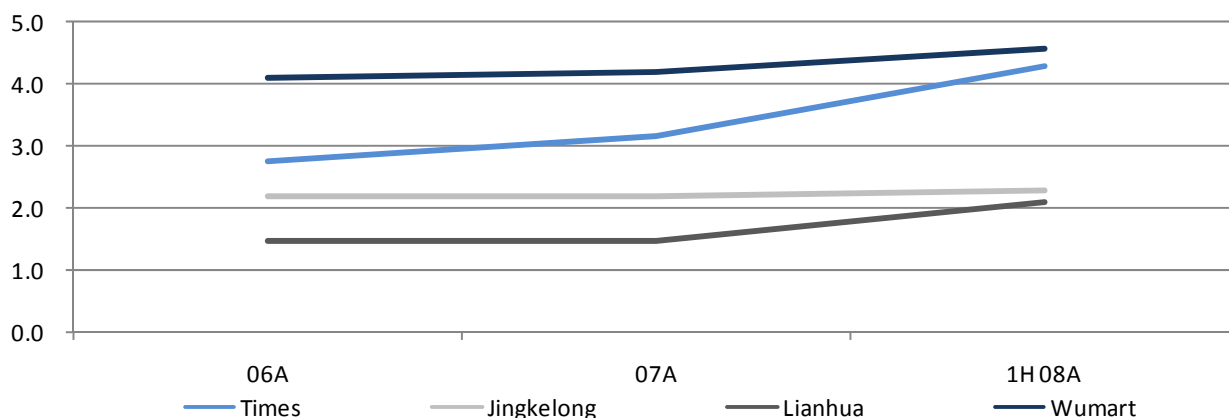
Disclaimer: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

company intends to strengthen its presence in Shandong and Anhui. Because of the severe geographic segmentation of China's retail market due to cultural, consumption and social differences, we are cautious about the short-term outlook of the cross-region expansion, though we agree that it is a promising long-term trend.

17 new stores planned. According to the company, new stores take up to two years to break even. Sites for 17 new hypermarkets (10 in Jiangsu, 3 in Shandong and 4 in Anhui) have been confirmed. Six will open in 2H FY12/08F and 10 in 2009. Typically, Times signs 20-year leases with fixed rent for the first three years and a 1.0% increase each year thereafter. However, China's rapid development, especially in the property market, has made finding suitable leasing projects more difficult. Hence the company is considering purchasing properties. Four of its 10 new stores in 2008 are based in self-owned properties (around RMB400m for 91,000sqm). In 2009, the company will acquire three more (in Nantong, Xinghua and Jiangyin with GFA of around 30,000sqm each) at around RMB450m. Although, self-owning is a useful supplement to leasing, we are concerned about the risks such as: 1) large capex which may weaken the company's cash flow; 2) advance payment for new premises to small developers, whose financials may be less stable.

Attractive net margin. Gross margins vary across the industry due to different business models. The net margin is more comparable and ranges from 1.0% to 5.0%. Times' net margin was 2.7% in FY12/06A and 3.1% in FY12/07A, after excluding RMB21.6m one-off expenses in 1H FY12/07A related to its Hong Kong listing. The net margin in 1H FY12/08A widened 0.4pcp to 4.3% due to a YoY decline in staff costs, from 5.6% of total turnover to 5.1%. The management explained that to minimize the negative impact of increased staff wage due to implementation of the new labor law, the company reduced its per store headcount (average 187 at end-Dec 2007, 169 at end-Jun 2008) and improved the staff cost / sales ratio. Nevertheless, we do not expect this trend to extend into 2H FY12/08 and a sustainable net margin level might be 3.0 – 4.0%.

Chart 1: Net margin comparison (%)



Source: Companies data

Mild recovery in November. Turnover increased 25.7% in 1H FY12/08A, backed by sales network expansion (4 new hypermarkets with an additional GFA of 58,551sqm) and same-store-sales (SSS) growth (11.6%). Thanks to the enlarged net margin, net profit rose 106.9% to RMB89.3m. SSS growth moderated in 3Q and slowed to a low single-digit in October. In November, it has recovered to a high single-digit, which is within the normal seasonal pattern (higher growth in 1H due to the impact of the Chinese New Year).

Table 2: SSS growth in 2008

Company name	Ticker	1H	3Q	Oct	Nov
Times	1832 HK	11.6%	moderated from 1H	slowed further to low single-digit	recovered to high single-digit
Jingkelong	814 HK	9.5%	9.3%	n.a.	n.a.
Lianhua	980 HK	13.0%	low single-digit	n.a.	n.a.
Wumart	8277 HK	13.9%	7.9%	similar to 3Q figure	n.a.

Source: Compiled by SBI E2-Capital

History and corporate governance. Times was established by Fang brothers in 1992 in Nantong. The company opened its first hypermarket in Changchou in 2000. In 2006, the owners planned to sell 50.0% of the company to **Wumart (8277 HK, HK\$5.90)** for HK\$1,141.8m but cancelled the deal in 2007 due to uncertainties associated with Wumart's internal problems (Wumart's ex-chairman, Mr. Zhang, was investigated by the Chinese government). The company listed in Hong Kong in Jul 2007 through a global offering of 210.6m new shares at HK\$4.18 each. Substantial shareholders include Fang brothers (72.3%), the

Commonwealth Bank of Australia (6.2%) and Newton Investment (6.1%).

Valuation. The counter is trading at 12.3x P/E historically or 10.6x one year forward based on market consensus estimates, which are both at the lower-end in the sector.

Table 3: Valuation comparison

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
Times	1832 HK	12/2007	236.6	12.3	10.6	8.5	14.0
Jingkelong	814 HK	12/2007	140.7	7.4	6.1	5.1	11.2
Lianhua	980 HK	12/2007	702.2	13.7	13.6	12.0	12.5
Wumart	8277 HK	12/2007	923.7	n.a.	15.3	13.6	15.0

Source: Bloomberg

Year to Dec	Times 1832 HK			Wumart 8277 HK			Jingkelong 814 HK			Lianhua 980 HK		
	06A	1H07A	1H08A	06A	1H07A	1H08A	06A	1H07A	1H08A	06A	1H07A	1H08A
Number of stores	52	58	62	504	504	552	222	222	222	3,716	3,649	3,848
Department store												
Hypermarket	32	41	45							104	103	121
Supermarket				92	86	83				1,652	1,660	1,768
Mini-marts and convenient store	20	7	17	420	418	268				1,960	1,886	1,959
GFA (sqm)	550,812	666,388	585,105	384,363	411,388	724,939	187,562	185,128	185,128			
Department store							27,800	27,300	27,300			
Hypermarket	550,812	623,370	548,025	682,310	682,310	682,310	53,138	60,138	60,138			
Supermarket							95,820	95,586	95,586			
Mini-marts and convenient store	50,580	623,370	47,080	42,629	42,629	42,629	10,804	11,304	11,304			
Average GFA per store (sqm)	10,593	11,489	10,820	11,693	2,078	1,971	1,954	1,971	1,971			
Department store							27,800	27,300	27,300			
Hypermarket	7,213	15,203	15,223	15,152			8,856	8,591	8,591			
Supermarket							2,337	2,283	2,283			
Mini-marts and convenient store	2,529	36,685	2,478	2,508			225	231	231			
Daily turnover per store (RMB)	149,032.9	159,752.2	136,915.6	185,075.7	28,158.5	43,637.5	76,730.8	88,544.1	88,544.1	2,123.1	13,313.5	15,333.5
Department store							0.0	59,587.9	59,587.9			
Hypermarket	206,387.0	199,231.5	219,659.3	225,597.1			325,158.4	390,565.9	390,565.9	126,059.0	243,025.1	280,747.7
Supermarket							117,851.5	124,389.1	124,389.1	5,472.1	10,383.5	10,861.2
Mini-marts and convenient store	57,260.3	64,544.7	36,937.1	67,226.9			12,152.1	15,264.9	15,264.9	1,054.0	2,221.0	2,167.0
Daily turnover per sqm (RMB)	14.1	13.9	15.4	15.8	24.5	31.6	39.3	44.9	44.9	6.4	3.0	3.6
Department store							0.0	2.1	2.1			
Hypermarket	12.0	13.1	14.4	15.1			36.7	45.5	45.5			
Supermarket							50.4	54.5	54.5			
Mini-marts and convenient store	22.6	1.8	27.0	26.8			54.0	66.2	66.2			
Turnover (RMBm)	2,828.6	3,382.0	1,631.6	2,086.4	5,158.7	7,118.5	2,297.3	2,688.5	2,688.5	6.4	3.0	3.6
Department store							0.0	0.0	0.0			
Hypermarket	2,410.6	2,981.5	1,431.3	1,880.4			701.0	712.1	712.1	4,861.1	9,846.2	6,143.4
Supermarket							1,413.1	1,763.6	1,763.6	3,263.4	6,560.5	3,716.8
Mini-marts and convenient store	418.0	400.5	230.3	208.0			177.2	212.9	212.5	739.7	1,524.0	758.6
Gross margin (%)	16.3	16.4	16.8	16.8	6.7	7.6	14.5	15.5	15.0	2.1	13.0	12.7
Operating margin (%)	4.8	5.4	5.1	6.1	6.4	6.1	5.1	5.0	7.2	1.4	2.3	2.5
Net margin (%)	2.7	3.1	3.9	4.3	4.1	4.2	2.2	2.2	3.0	1.5	1.5	1.6

Source: Companies data, SBI E2-Capital

Table 5: P&L

Year to Dec (RMBm)	04A	05A	06A	07A	1H 06A	1H 07A	1H 08A
Revenue	1,982.6	2,353.6	2,828.6	3,382.0	1,394.7	1,661.6	2,088.4
Cost of sales	(1,671.4)	(1,980.0)	(2,367.2)	(2,826.1)	(1,162.4)	(1,381.8)	(1,737.4)
Gross profit	311.2	373.6	461.4	555.9	232.3	279.9	351.0
Other income	119.0	188.7	233.4	293.8	102.5	140.4	151.2
Selling and distribution costs	(302.4)	(395.2)	(483.3)	(582.1)	(228.4)	(274.0)	(327.1)
Administrative expenses	(47.7)	(65.6)	(75.5)	(83.4)	(37.7)	(39.7)	(47.2)
Other expenses				(21.6)		(21.6)	
Profit from operation	80.1	101.4	136.0	162.5	68.6	85.0	127.8
Finance costs	(9.0)	(13.2)	(17.3)	(15.7)	(8.3)	(12.0)	(0.9)
Profit before taxation	71.1	88.2	118.7	146.8	60.4	73.0	127.0
Income tax	(24.9)	(32.3)	(41.2)	(62.2)	(19.5)	(29.8)	(37.7)
Profit for the period	46.2	56.0	77.5	84.7	40.9	43.2	89.3
Attributable to:							
Equity holders of the Company	46.1	56.1	77.6	84.7	40.9	43.2	89.3
Minority interests	0.2	(0.2)	(0.0)		(0.0)		
EPS - Basic (RMB)	0.073	0.089	0.123	0.114	0.065	0.068	0.073
Proposed DPS (RMB)				0.030			

Source: Company data