

Cheaper alternative to the Beijing retail market

China Retail

Beijing Jingkelong (8245 HK)

Not Rated

Company profile. Beijing Jingkelong (BJKL), the second largest retail chain store operator in Beijing, currently has 169 stores (68 directly owned and 101 with franchise arrangement) mainly located in Chaoyang District, the main Central Business District. There are 4 hypermarkets, 29 supermarkets and 35 convenience stores under directly operated in addition to 5 supermarkets and 96 convenience stores operated under franchise arrangement,

Wholesale segment. Unlike the business model of other retailers, BJKL is also engaged in wholesale business with two distribution centers mainly for fresh and dry food. In 1H06, wholesale segment contributed around 48% of its total turnover. According to management, its major Beijing customers include Wumart Group, Lianhua, Carrefour, Wal-Mart and other leading chain operators.

Table 1: Gross profit breakdown

Year to Dec	2003	2004	2005
Hypermarkets (%)	23.0	21.0	18.5
Supermarkets (%)	46.0	41.6	35.6
Convenience stores (%)	6.8	5.0	4.8
Wholesale (%)	24.2	32.4	41.2
Total	100.0	100.0	100.0

Source: Company data

Wumart is c.3x larger. Closest peer is Wumart Group (8277 HK, HK\$23.80, Not Rated), which is mainly focused on the higher margin retail segment. Wumart's retail products have a higher gross margin of 14.5% in 1H06, compared with BJKL's 14.4%. BJKL's wholesale segment commanded a gross margin of around 9.8%. Generally speaking, Wumart's operation is 3 times larger than that of BJKL. Wumart is the largest Beijing chain store operator with an estimated market share of over 15% market share.

Table 2: Offer stats

Price range	HK\$3.9-4.5
No. of H shares offered	132m
Fund raised:	HK\$515m-594m
Offer PE (2005F F.D.)	19.6-22.6x
FY05 net profit/EPS	RMB75.1m/RMB30.5cents
1H06 net profit/EPS	RMB47.3m/RMB19.2 cents
Market cap	HK\$1.43b-1.65b
IPO open	12 Sep
IPO close	15 Sep
Listing	25 Sep

Source: Company data

Increasing retail contribution. According to management, BJKL will expand its distribution network to 225 stores by 2008 in the greater Beijing region, northern China and eastern China. Approximately RMB283.2m will be used for retail network expansion, RMB139.3m for expansion wholesale logistic system and the rest for general working capital.

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Table 3: Financials

Year to Dec (RMBm)	2003	2004	2005	1H06
Sales	2,894.1	3,568.9	4,121.7	2,161.1
Gross profit	349.4	404.0	500.0	263.1
Operating profit	82.2	146.7	164.6	101.1
Finance costs	(20.2)	(21.0)	(19.1)	(8.7)
Pre-tax profit	65.8	127.9	145.5	92.4
Net profit	38.2	*54.8	75.1	47.3
Gross margin (%)	12.1	11.3	12.1	12.2
Operating margin (%)	2.8	4.1	4.0	4.7
Pre-tax margin (%)	2.3	3.6	3.5	4.3
Net margin (%)	1.3	1.5	1.8	2.2
Net gearing (%)	109.5	101.5	128.6	122.9
Inventory turnover (days)	46	41	37	34
AP turnover (days)	68	66	64	60
AR turnover (days)	23	31	38	32

* Net profit in 2004 was adjusted to exclude a net one-off revaluation gain of RMB18.4m on Jinsong Supermarket.

Source: Company data

Table 4: Peer comparisons in 2005

Year to Dec	Beijing Jingkelong (8245 HK)	Wumart (8277 HK)	Lianhua (980 HK)
Turnover growth rate (YoY %)	15.5	50.9	32.3
Net profit growth rate (YoY %)	37.1	52.6	16.4
Gross margin (%)	12.1	16.1	12.2
EBIT margin (%)	3.8	5.6	2.1
Net margin (%)	1.8	4.2	1.7
ROE (%)	18.5	13.2	12.3
ROA (%)	3.8	11.6	4.8
Net gearing (%)	128.6	Cash	Cash

Source: Company data

Risks. 1) BJKL's net gearing ratio is higher than other retail chain operators. The current net gearing is estimated to be 122.9% and is expected to reduce to 60% - 70% after listing; 2) Government may require BJKL to surrender some retail outlets for state redevelopment. In 2003 - 2005, five stores were closed for urban redevelopment and the compensations received were sufficient to cover its losses; 3) Keen competition from both domestic and overseas operators; 4) Management came from a SOE background.

Valuation. Wumart is trading at 36.0x FY12/05 P/E and 29.7x FY12/06F P/E. Another listed peer Lianhua is trading at 21.4x FY12/05 P/E and 18.8x FY12/06F P/E. BJKL is expected to be priced at a discount to Wumart and is likely to trade close to Lianhua.

Table 5: Market share of chain store sales by major cities in China

	Total retail sales of consumer goods (RMBb)	Sales of chain stores operators (RMBb)	Sales of chain stores operators as a % of total retail sales (%)	No. of stores
Shanghai	245.5	92.6	38	10,220
Beijing	219.2	63.5	29	5,000
Tianjin	105.3	24.5	23	n.a.

Source: China Chain Store Almanac 2005