CICC 中金公司

Equity Research

December 13, 2017

CICC SH-HK Stock Connect

Zhou Hei Ya International Holdings

Focus on potential demand and attempts at extending brand

Initial Coverage

Investment positives

We initiate coverage with a BUY rating and a target price of HK$9.72 based on 23.4x 2018e P/E—lower than the average for Hong Kong staples and global peers using chain store business models. Given the long-term growth visibility, the current 16.5x 2018e P/E presents a good buying opportunity, in our view.

Why a BUY rating?

Abundant demand potential. We expect potential demand for existing products at 4.3x of 2017e sales in self-operated stores (Rmb2.78bn). Assuming the company meets all potential demand in 10 years, we expect the sales CAGR of self-operated stores to reach 15.6% over 2017–2027 in our base case.

Margin correction does not reflect weakening consumption. The margin correction is more a result of the company's attempts to expand membership, foster robust growth of online demand and a mismatch between the growth pattern of rental cost and average sales per store. Excluding member discounts, ASP and gross margin should remain stable. We also expect the ratios of online expenses and rentals to sales to fall after peaking in 2020 and 2022.

Watch moves to extend brand and improve margin prospects. New product development and moves to extend derivative products may accelerate, increasing sales per store and improving margin. Our sensitivity analysis shows that each 5% increase in the sales of self-operated stores will lift EBIT margin to about 1%.

How do we differ from the market? Our quantitative study suggests significant potential demand for existing products. We also see potentially higher value and believe the self-operated store platform is a realistic approach. We expect profit margins to turn around.

Potential catalysts: Fast growth in store numbers & sales; re-launch of crayfish product in January and refocus on vacuum-packed products; development of derivative products in 2018.

Financials and valuation

Our EPS forecast is Rmb0.32 for 2017 and Rmb1.33 for 2027, a CAGR of 15.4%. Under a base-case scenario, net margin will rebound after bottoming out (19.5%) in 2021. Potential long-term growth justifies a DCF pricing model, in our view, yielding an end-2018 TP of HK$9.72.

Risks

Poor performance of new products may fail to reverse margin decline; pace of new store opening and SSSG miss expectations.

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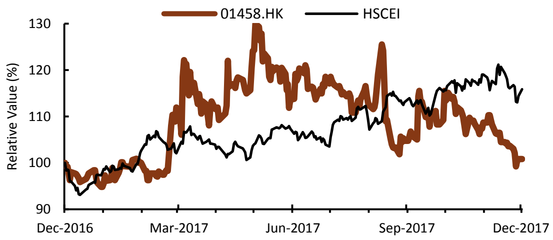
Initiate with BUY

Ticker	01458.HK
CICC investment rating	* BUY
Last close	HK$7.08
CICC target	HK$9.72
52wk price range	HK$9.80–6.38
Market cap (bn)	HK$17
Daily value (mn)	HK$21.46
Shares outstanding (mn)	2,383
Free float (%)	100
Daily volume (mn sh)	2.97
Business sector	Food & Beverages



(Rmb mn)	2015A	2016A	2017E	2018E
Revenue	2,432	2,816	3,343	3,882
(+/-)	34.4%	15.8%	18.7%	16.1%
Net profit	553	716	758	847
(+/-)	34.5%	29.5%	5.9%	11.8%
EPS	0.23	0.30	0.32	0.36
BPS	0.16	1.51	1.74	2.00
DPS	0.00	0.11	0.10	0.11
CPS	0.26	0.32	0.47	0.36
P/E	25.6	21.1	19.1	16.5
P/B	36.7	4.2	3.5	2.9
EV/EBITDA	17.8	12.5	10.8	9.1
Dividend yield	0.0%	1.4%	1.6%	1.8%
ROAA	51.5%	28.3%	17.2%	16.8%
ROAE	84.6%	36.0%	19.6%	19.0%

Source: Wind Info, Bloomberg, company data, CICC Research

Financial summary

Financial statement (Rmb mn)	2015A	2016A	2017E	2018E
Income statement				
Revenue	2,432	2,816	3,343	3,882
COGS	-1,059	-1,061	-1,309	-1,512
Selling expenses	-528	-701	-926	-1,127
Administrative expenses	-125	-142	-168	-185
Other ops income (expense)	0	0	0	0
Operating profit	748	963	1,010	1,130
Finance costs	0	0	0	0
Other income (expense)	0	0	0	0
Profit before income tax	748	963	1,010	1,130
Income tax	-195	-248	-253	-282
Minority interest	0	0	0	0
Net profit	553	716	758	847
EBITDA	788	1,011	1,084	1,248
Recurrent net income	0	0	0	0
Balance sheet				
Cash and bank balances	82	2,461	2,693	2,673
Trade and bill receivables	84	794	521	605
Inventories	134	206	210	242
Other current assets	106	18	18	18
Total current assets	407	3,479	3,442	3,539
Fixed assets and CIP	395	460	891	1,282
Intangible assets and others	154	168	365	559
Total non-current assets	549	628	1,256	1,841
Total assets	956	4,107	4,698	5,380
Short-term borrowings	0	0	0	0
Trade and bill payables	269	371	419	480
Other current liabilities	279	118	118	118
Total current liabilities	548	489	537	598
Long-term borrowings	0	0	0	0
Total non-current liabilities	23	22	22	22
Total liabilities	571	511	559	621
Share capital	0	0	0	0
Retained profit	385	3,596	4,139	4,759
Equity	385	3,596	4,139	4,759
Total liabilities & equity	956	4,107	4,698	5,380
Cash flow statement				
Pretax profit	748	963	1,010	1,130
Depreciation & amortization	40	47	74	119
Change in working capital	26	-45	317	-55
Others	-190	-208	-292	-323
Cash flow from operations	624	757	1,109	870
Capital expenditure	-163	-96	-702	-703
Others	-120	-2,843	40	41
Cash flow from investing	-283	-2,939	-662	-662
Equity financing	147	0	0	0
Bank borrowings	0	0	0	0
Others	-476	2,254	-215	-227
Cash flow from financing	-329	2,254	-215	-227
Foreign exchange gain (loss)	6	46	0	0
Net changes in cash	12	73	232	-20

Financial ratios	2015A	2016A	2017E	2018E
Growth ability				
Revenue	34.4%	15.8%	18.7%	16.1%
Operating profit	35.9%	28.8%	4.9%	11.8%
EBITDA	34.5%	28.2%	7.3%	15.2%
Net profit	34.5%	29.5%	5.9%	11.8%
Profitability				
Gross margin	56.4%	62.3%	60.8%	61.0%
Operating margin	30.8%	34.2%	30.2%	29.1%
EBITDA margin	32.4%	35.9%	32.4%	32.2%
Net margin	22.7%	25.4%	22.7%	21.8%
Liquidity				
Current ratio	0.74	7.11	6.41	5.91
Quick ratio	0.50	6.69	6.02	5.51
Cash ratio	0.15	5.03	5.01	4.47
Liabilities / assets	59.7%	12.5%	11.9%	11.5%
Net debt / equity	net cash	net cash	net cash	net cash
Return				
RoA	51.5%	28.3%	17.2%	16.8%
RoE	84.6%	36.0%	19.6%	19.0%
Per-share data				
EPS (Rmb)	0.23	0.30	0.32	0.36
BPS (Rmb)	0.16	1.51	1.74	2.00
DPS (Rmb)	0.00	0.11	0.10	0.11
Cash flow per share (Rmb)	0.26	0.32	0.47	0.36
Valuation				
P/E	25.6	21.1	19.1	16.5
P/B	36.7	4.2	3.5	2.9
EV/EBITDA	17.8	12.5	10.8	9.1
Dividend yield	0.0%	1.4%	1.6%	1.8%

Source: Company data, CICC Research

Company description

ZHOU HEI YA International Holding Co. Ltd., founded in Wuhan, Hubei Province, is the leading brand and retailer of casual braised food in China. The company is specialized in the production, marketing and retailing of packaged casual braised food, in particular, braised ducks and duck parts. ZHOU HEI YA has hundreds of self-operated retail stores throughout China, such as Beijing, Shanghai, Tianjin, Chongqing and Wuhan etc. The company has two production bases in Wuhan and Shanghai to support the expanding retail network and the growing online channel. The company is planning to build new capacities in central China and southern China.

Contents

Opening stores, expanding market and consumer base 5
Business model focus on products and marketing, low barriers with first-mover advantages 5
Increase platform value by brand extension 10
Speeding up new product development 10
Optimizing internal efficiency 11
Building product barriers 13
Building marketing barriers 13
Developing derivative products 14
Considering mergers and acquisitions 15
Case study: the increase of brand value for chain stores 16
Starbucks: Expansion of products and channels to improve SSSG and margins 16
Haidilao Hotpot Restaurant: Promoting brand value by expanding products and channels 18
Expecting margin to turn around in 2021 and an earnings CAGR of 15.4% over 2017–2027 20
Sales forecasts 20
Forecasts of costs, expenses and margins 21
Forecast on the possibility of new products changing SSSG and margin curve 22
Other forecasts 23
BUY rating with an end-2018 TP of HK$9.72 26
DCF model for pricing reflects long-term growth potentials 26
Valuation comparisons with peers 26
Appendix.. 29
Company profile 29
Industry overview 30
Operating data 31

Figures

Figure 1: Comparison of three business models 5
Figure 2: Demand forecast model and results display 7
Figure 3: Sales revenue and margin simulation curve (only duck products considered) 9
Figure 4: Product expansion route 11
Figure 5: Cost and expense breakdown and trend of expense ratio 12
Figure 6: Some Zhou Hei Ya promotional gifts 15
Figure 7: Efforts of Starbucks branding extension and performance 18
Figure 8: Haidilao Hotpot Restaurant branding extension and performance 19
Figure 9: Financial assumptions and earnings forecasts 24
Figure 10: EBIT margin curve simulation 25
Figure 11: DCF model 26
Figure 12: Valuation table of HK staples 27
Figure 13: Valuation table of comparable global chain brands 27
Figure 14: P/E and P/B bands 28
Figure 15: Company history and milestones 29
Figure 16: Company's current shareholding structure 29
Figure 17: Company's current product mix 29
Figure 18: Market size and growth of casual braised food 30
Figure 19: Market concentration and main competitors 30
Figure 20: Comparisons with direct compatible products 30
Figure 21: Distribution of self-operated stores at end-1H17 and the store development (2013–2017) 31
Figure 22: COGS breakdown and supply chain summary 31

Opening stores, expanding market and consumer base

For duck products, which have a shelf life of just 5–7 days, opening self-operated stores is still the most rewarding growth model. Our quantitative studies suggest huge potential demand that could support market expansion through opening self-operated stores, although a number of reasons may drag current margins to a more sustainable level. We view opening self-operated stores as a means to growth at reasonable cost. The margin curve may be subject to short-term downward pressure, but the reward will be valuable expansion of the market and consumer base. This will yield more brand extensional efforts on the growing platform of self-operated stores for the company, reversing the declining margins and creating greater opportunities for future growth.

Business model focus on products and marketing, low barriers with first-mover advantages

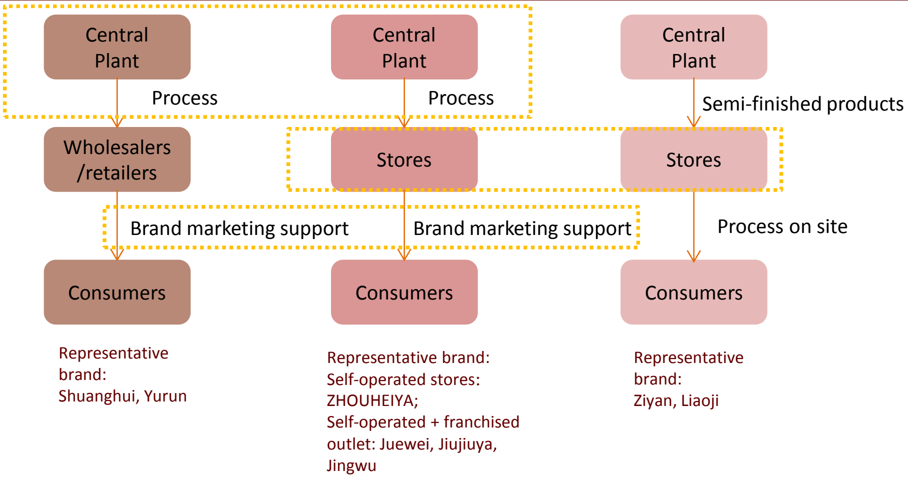
According to Zhou Hei Ya's current business model, the firm produces products with shorter shelf lives in central plants and distributes them mainly through a network of self-operated stores that have a clear consumer positioning as well as support from brand-based marketing activities.

Braised snacks have two other business models on the market: 1) Shuanghui's, producing long/short shelf-life products in central plants but mainly distributing them through wholesalers and retailers with brand-based marketing support; and 2) the model of many chain store operating brands, including the renowned Liaoji Chicken.

Semi-processed products are cooked in stores shortly before being sold for instant consumption, but they have limited brand-based support. Although similar in certain respects, the three models are quite distinct, without direct competition. Zhou Hei Ya is more threatened by brands adopting the same business model, such as Juewei, Jingwu and Jiujiu Duck. The differences lie only in target consumer bases and the methods and efforts of marketing.

This business model obviously should focus on two KPIs: product and marketing. However, the products could be imitated, as we find no significant barriers. Moreover, theoretically, the marketing approach can be imitated. The only likely barrier arises from the business scale, which dictates the expenses available for marketing. With the limited protection of barriers in terms of products and marketing, perhaps the only way to further success is to be constantly creative (in both products and marketing approaches) to capture first-mover advantages.

Figure 1: Comparison of three business models



Source: CICC Research

Opening self-operated stores remains the best expansion approach

The 5–7 day shelf life restricts the dispersal of products through distributors. Even the directly selling chain KA, can only put products on the shelf following one or two transfers. It is virtually impossible for other stores to place one or two orders by telephone based on expected sales as the self-operated stores do, increasing the risk of product damage. E-commerce channels are subject to a similar restriction.

The O2O business model arranges for partners to collect supplies from the self-operated stores. The supply of products through nine storehouses nationwide for online 2C sales also limits the ordering scope and distribution radius (generally limited to 300km) due to the short shelf life. Thus, opening self-operated stores remains the best approach to grow at present, providing higher return compared with other distribution channels.

Great potential market demand, growth at reasonable cost

As of end-1H17, the company had opened 892 self-operated stores in 38 cities in China, including[1] four tier-1 cities, 11 new tier-1 cities and four tier-2 cities. The new stores will be further expanding to tier-3 and tier-4 cities after the completion of full-coverage of tier-1/-2 cities. Among the 892 stores, 303, 446 and 66 stores are located in 19 tier-1, new tier-1 and tier-2 cities.

According to the locations of existing self-operated stores, stores are mainly concentrated at traffic hubs (including airports, railway stations, urban metro stations, etc.) for the large traffic volume), central business districts (also for the advantage of a large traffic volume) and a few neighborhood and campus stores. Presently, 263 stores are located at traffic hubs.

We assume all cities of tiers 1 to 4 are potentially accessible to Zhou Hei Ya stores and the potential demand in these areas can be satisfied by opening self-operated stores. Meanwhile, we assume the urban population of tier-1 to tier-4 cities as the effective demand population and adopt the following model to estimate the potential demand that can be reached.

At present, China has 209 tier-1 to tier-4 cities with a total (urban) population of 589mn. We believe the potential demand of Zhou Hei Ya products is determined by, in the following order of significance: product preference, income per capita and consumption level, and the intensity of regional competition. Our study of the difference between mature self-operated stores in the CBDs of 38 cities convinces us that **product preference is the most significant contributor to the differences of potential demand in different regions.**

The differences in income per capita and consumption levels are partially offset by the company itself with graded pricing for different regions. There is also no evidence that sales per store are significantly lower in regions where more stores operate in direct competition with Zhou Hei Ya stores, which shows competing products do not highly overlap in taste and target customers to an extent that results in vicious competition.

Thus, we divide 209 accessible cities into four categories according to the degree of product preference. The first degree is strong preference, represented by Wuhan, with a population of 11 million; the second degree is mid-to-high preference, represented by the rest of Hubei (excluding Wuhan), Zhejiang and Hunan, including 30 cities with a population of 88 million; the third degree is light-to-mid preference, represented by Eastern and Southern China, including 111 cities with a population of 329 million; the fourth degree is mild preference, represented by Northwest, Southwest and Northeast China, including 674 cities with a population of 162 million.

[1] According to Yicai.com's classification, which groups China's 338 cities into five tiers: tier 1, new tier 1, and tiers 2–4

We choose Wuhan as a benchmark for our estimate and assume that stores and demand for Zhou Hei Ya products there is saturated. We estimate the total demand of the national market based on the total sales realized by Wuhan CBD stores in 2016 (instead of stores in traffic hubs, which we believe do not represent the local demand). We calculated the consumption per capita of the city, which we set as the target consumption that can be realized in cities of the first categories. Our estimate is that the potential demand for the products in cities of the first category total Rmb503mn.

The average annual sales realized per CBD store in 30 cities of the second category where Zhou Hei Ya stores operate was 44% lower than that in Wuhan. Thus, we assume that the maximum consumption per capita in such cities is 56% of cities in the first category due to a lower product preference. Following the same logic, we have worked out the maximum consumption per capita in cities of the third and fourth categories at 45% and 28% of Wuhan's and, accordingly, the potential demand in cities of the second through fourth categories is Rmb2.33bn, Rmb6.95bn and Rmb2.15bn, respectively. **We thus work out the total demand in cities of tier-1 through tier-4 to be Rmb11.93bn.**

Based on the foregoing estimates, **the expected 2017 sales of Zhou Hei Ya (Rmb3.34bn) imply only 28% coverage of total national demand, which can be at least trebled by opening stores. Even if the process of opening stores needs to be completed in ten years, the CAGR will reach 13.6%.** Thus, we are not worried about the market space or growth potential, but are more concerned with the cost to realize the potential.

Figure 2: Demand forecast model and results display

Province	Sales per store/Sales per store in areas of strong preference	Area	Degree of preference	No. of Accessible cities	Consumption per capita	Effective demand population (1,000)	Total demand (Rmb mn)	Note
Wuhan	100%	Central China	A	1	47	10,608	503	A/B/C/D represents areas of Heavy/Mid-high/light-to-mid/light popularity. This implies consumption per capita of Rmb 47/27/21/13, 100%/56%/45%/28% per capita in areas of strong preference
Hubei (excl. Wuhan)		Central China	B	9	27	23,254	618	
Zhejiang	56%	Eastern China	B	11	27	37,174	988	
Hunan		Central China	B	10	27	27,192	722	
Beijing		Northern China	C	1	21	21,730	459	
Jiangxi		Central China	C	8	21	16,511	349	
Shanghai	45%	Eastern China	C	1	21	24,200	511	
Jiangsu		Eastern China	C	13	21	53,193	1,123	
Guangdong		Southern China	C	20	21	64,739	1,367	
Henan		Central China	C	13	21	27,649	584	
Tianjin		Northern China	D	1	13	15,620	207	
Sichuan	28%	Southwest	D	11	13	26,215	348	
Chongqing		Southwest	D	1	13	18,898	251	
Un-covered area								
Anhui		Eastern China	C	12	21	19,696	416	Eastern China, Southern China and Northern China are classified as light-to-mid preference
Fujian		Eastern China	C	9	21	24,135	510	
Shandong		Eastern China	C	16	21	40,037	845	
Guangxi		Southern China	C	6	21	12,511	264	
Hainan		Southern China	C	2	21	1,680	35	
Hubei		Northern China	C	10	21	23,160	489	
Guizhou		Southwest	D	4	13	9,205	122	Southwest China is classifies as mild preference; no coverage in Northeast and Northwest China, but we classify these two areas as D to be conservative
Yunnan		Southwest	D	7	13	9,909	132	
Tibet		Southwest	D	0	13	-	-	
Shaanxi		Southnorth	D	5	13	13,385	178	
Gansu		Southnorth	D	1	13	1,672	22	
Qinghai		Southnorth	D	1	13	1,255	17	
Ningxia		Southnorth	D	1	13	1,254	17	
Xinjiang		Southnorth	D	1	13	1,517	20	
Shanxi		Northern China	D	5	13	10,673	142	
Inner Mongolia		Northern China	D	6	13	7,646	102	
Liaoning		Northern China	D	13	13	20,348	270	
Jilin		Northern China	D	5	13	9,906	132	
Heilongjiang		Northern China	D	5	13	14,378	191	
Sum				209		589,350	11,932	

Source: Company data, CICC Research

Given the existing duck products and the model of expansion through opening stores, the potential risks of cost growth exceeding revenue growth (i.e. margin decline) may come from:

- At present, 91% of the stores are located in tier-1, new tier-1 and tier-2 cities. In the future, there will be more blank spots and opportunities in tier-3 and tier-4 cities. The traffic volume and average spending per purchase order may be less than in tier-1 and tier-2 cities, but the difference in the costs for opening and operating stores may not be as big as that in the sales, which may lead to a lower margin.

- The number of transportation hubs (only airports and railway stations) in tier-1 and tier-2 cities totals 194, in 40 of which the company operates. There will be fewer transportation hubs available for opening stores in comparison with non-transportation hub stores. The average spending per purchase order at transportation hub stores may be more than double that at non-transportation hub stores, while the difference in cost is not that great. This means that there are not enough buses for Zhou Hei Ya to justify opening stores.

- The stores located early on in transportation hubs are mainly leased at rental rates lower than those in the pipeline. The third risk arises from the difference in and the bargain related to rentals. The same risk also threatens non–transportation hub stores.

- Central China is considered the area where Zhou Hei Ya products are best accepted, with a high density (the urban population a single store covers) of stores. In other regions, differences in product preference may prolong the period for stores to accumulate a mature traffic volume or even their ability to reach maturity, and average spending per purchase order in areas where the company's products are less preferred may be lower than in areas where products are more preferred. This risk arises from differences in product preference.

- At present, the costs of rental and fixed salaries for employees account for 55% and 19% of the operating costs for self-operated stores. There are rigid upward trends in both rental rates and fixed salaries. Despite the limited inter-year increases in both costs, the sales from mature stores may not be able to maintain equal growth, leading to a drop in operating margin.

- The company began to increase the number of members this year, intending to promote targeted marketing through the membership platform. Members are entitled to a price discount of 5% and other regular promotional benefits that have adverse impacts on margin during periods in which the number of members increases significantly. We estimate that this period will be four years long (2017–2020), and we expect membership consumption to account for as much as 25% of total sales in 2017.

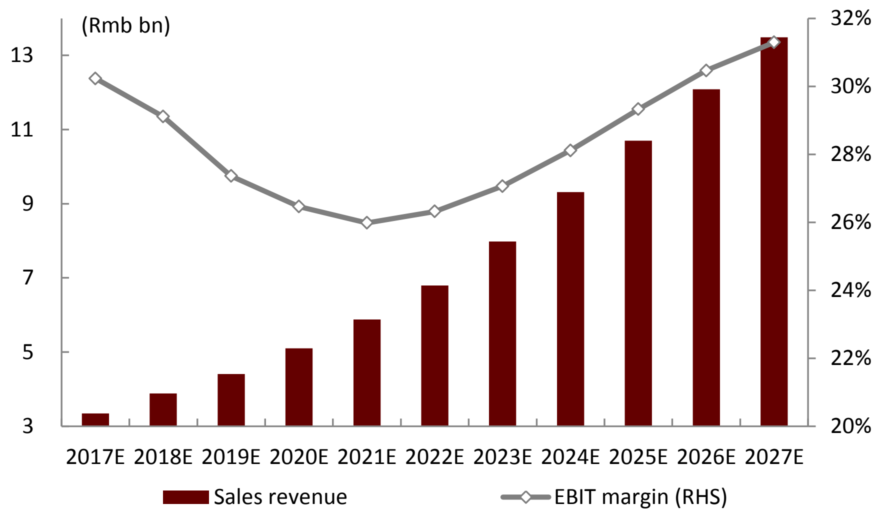
<u>Margin curve may have short-term downward pressure; more concerned with growth in market and consumer base</u>

We are unable to quantify the foregoing risks accurately, but we believe the margin will return to a sustainable level. This is why we define the increased opening of stores as "growth at a reasonable cost." Despite the costs, the company is willing to promote business growth to increase its market and consumer base quickly. Under the current self-operation model, opening stores is the only way to reach new markets and new consumers.

Recently, the company's share price has been hurt by market worries about the downward pressure on margin, but these worries neglect the potential benefits from the rapid increase in the market and consumer base. Even if newly opened stores fail to realize the average return rate of existing stores, they will make marginal contributions to earnings, since the company is unlikely to operate continuously losing stores (stores closed due to poor operation resulting from poor location account for 30–40% of stores closed in recent years). The company considers closing stores that fail to meet the standards of a mature store after operating for two years. This is a measure the company takes within the internal control system to prevent margin decline. Although the next move of brand extension is not considered, opening stores will sustain earnings growth. Since it will be facing downward pressure on margins, the company is likely to maintain good earnings growth as we forecast the potential sales growth will remain robust in the next ten years. The market may not be willing to give high valuations to the company due to declining margins, but we believe the share price can still rise with earnings and there is no need to be too worried.

According to our forecasting model, the number of self-operated stores may reach 998 by end-2017 and 6,459 by end-2027, covering all 209 cities of tiers 1 through 4. The number of members may reach 6mn by the end of this year, with member consumption accounting for 25% of the total 2017 sales. The number and contribution to total sales will grow to 20mn and >50% in three years.

Figure 3: Sales revenue and margin simulation curve (only duck products considered)



Source: Company data, CICC Research

Increase platform value by brand extension

The nationwide network of self-operated stores and groups of loyal consumers (members) form a valuable market platform for the company. The adding of the platform value will generate greater revenue at minimal cost, effectively increasing revenue and improving margin and earnings growth prospects. The company is making efforts in this direction and we expect such efforts to be continued as it opens more stores.

Efforts to maximize the value of the platform are expected to be made in the following two directions: The first is to add sales per store without increasing operating cost (including efforts to minimize impacts of competition and improve sales); and the second is to reduce the operating cost at both the levels of stores and the headquarters. To achieve these two objectives, we expect the company will focus on the following measures:

Speeding up new product development

New product development will increase the fixed operating cost of a store by almost nil. The company's new product pipeline includes goose, pork, beef, crayfish and vegetable products. The beef and crayfish products were launched in May and June of 2017, although in a region-limited trial distribution mode for the first year.

If the strategy of turning duck products into snack foods is summarized as an attempt to extend the consumption environment beyond dining tables by using preservative packaging, we expect the company to take the following measures to expand its product varieties:

► **Efforts in extending more table foods to off-table consumption scenarios.** Snack foods are more for chewing than satiety. There are many choices in appetizers, finger foods and cold dishes in Chinese cuisine. The risk is that the taste may be compared with similar foods on the table (e.g. crayfish and beef products launched this year).

► **Efforts in improving freshness and taste of long shelf-life products.** The company may choose certain products and change the methods for preparing them, with the view of improving the freshness and taste. For example, dry squid slices can be replaced with braised squid.

► **Efforts in actively developing products with longer shelf life and expanding e-commerce and distribution.** The company may develop long-shelf-life braised snacks suitable to be distributed through e-commerce, distributors, or self-operated stores. The company may consider creating second-level brands to distinguish such snacks from current short-shelf-life products.

► **Efforts to develop meal series.** The company may leverage its braising technique to develop table series sub-brands such as ready-to-eat and ready-to-cook dishes, which can also be distributed through self-operated stores.

Figure 4: Product expansion route

Note: Asterisks indicate our estimates.
Source: Company data, CICC Research

Following the trial sales held from May to October this year, crayfish products have been improved in response to market feedback and will be re-launched before the coming Spring Festival. The improved products, although prepared with frozen supplies as raw material in the off-season (fresh crayfish are available only between May and September), are supposed to be better in terms of taste. The choice of the off-season to launch the products also shows the company's determination to distribute all year round. Unlike beef products, crayfish products will be distributed nationwide. At present, the first phase of the transformation project of the Wuhan plant has been completed, with 50mn MAP boxes and 50mn vacuum boxes reserved for crayfish products.

Optimizing internal efficiency

Store operating expenses mainly include rental fees, operating capex (including a one-time decoration cost amortized over three years), salaries and in-store public utility costs. These costs will account for 28.3%, 4.2%, 11.7% and 7.4% of average sales per store in 2018e, respectively. There is limited room for improvement at the level of the store as the rental terms are mostly fixed through negotiation with the owner and theoretically likely to be increased. The company may try to limit the risk of margin fluctuation by retaining a certain percentage of the sales for that end, but success does not completely depend on the company's efforts. The operating capex per store is Rmb120,000, to be amortized over three years. Salaries are not to be adjusted in order not to adversely affect the enthusiasm for work. The public utility cost, which depends on the length of store operation, will likely not be adjusted. We do not include in-store promotional expenses in our discussion at the store level as these are controlled by HQ.

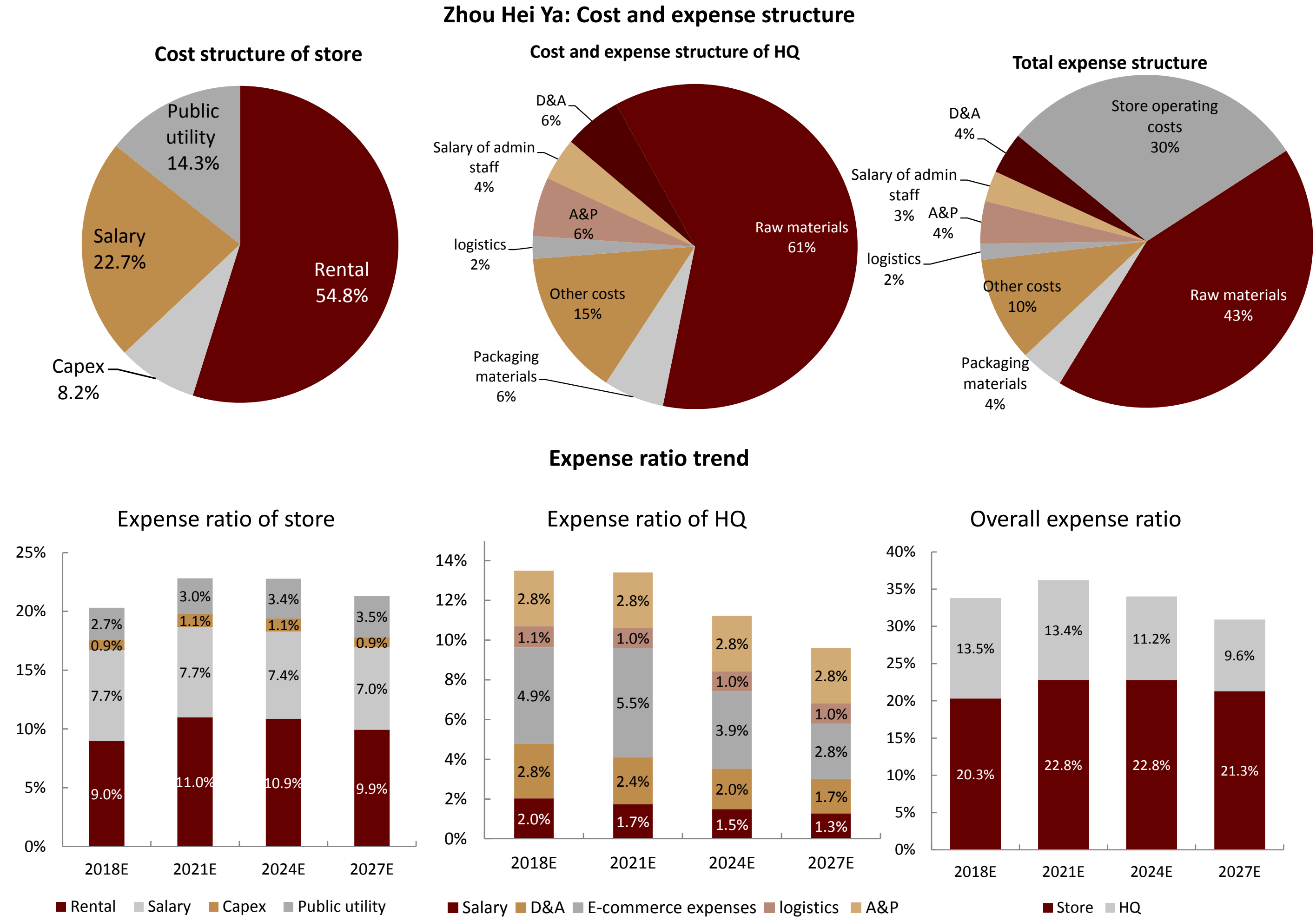
Optimizing efficiency largely up to headquarters. Internal efficiency may be improved from the perspectives of costs and expenses. To begin with costs, including those for raw materials and production, so far only the plants in Wuhan (Phase II) and Shanghai are in operation. Plants under construction include one each in Hebei (expected to be put into operation in 1H18), Dongguan (4Q18), Nantong (to replace the Shanghai plant in 1H19) and Chengdu (2H19). As the company's plants are running nearly at full capacity and it will take time for new facilities to be fully ramped up in the following two years, it is estimated that production expenses (9.2% of the total production cost in 2016) will rise in 2018 and 2019, but the impact will not last long and the plants will soon be running at full capacity with stores opened at an accelerating rate after 2019.

The other two major costs of production are raw materials and packaging materials, accounting for 75.9% and 7.3% of the company's total production costs last year. The company values the quality of raw materials and selects suppliers from regions producing the best. The cost efficiency related to raw materials can be improved at two levels: contacting more medium- and small suppliers in the selected regions to gain more say in the bargaining, and increasing the scope of regions from which alternative suppliers can be selected. The Company can increase its price bargaining power in packaging materials through increasing scale as sales grow over time.

Scale effects will also be realized with the depreciation of fixed assets, amortization of administration expenses, and salaries and benefits for the admin staff at headquarters, which will not increase at the same rate as sales. There is no fixed pattern of changes in A&P expenses disbursed by the headquarters, but we believe that the consecutive launch of new plants in North China, South China, East China and the Southwest will reduce the cost of transportation as the average delivery radius shortens. Last year, transportation expenses accounted for 1.1% of the company's sales revenue. The ratio is expected to fall below 1% after 2019.

Thus, excluding the fluctuation in the prices of raw materials and promotional expenses, costs and expenses (which accounted for 26.5% of total revenue last year) can be brought down by scale effects (e.g. production and labor expenses) or optimized (e.g. the transportation expenses).

Figure 5: Cost and expense breakdown and trend of expense ratio



Source: Company data, CICC Research

Building product barriers

Curb competition and increase sales. As product flavors cannot be patented, attempts to increase product barriers could be directed more toward innovation and patent protection over packaging techniques. This would require Zhou Hei Ya to invest more capital and R&D in packaging technology as the techniques for MAP packaging are freely accessible and imitation by competitors cannot be prevented. ,

At present, the company adopts mainly MAP technology for packaging its products, which, although quite mature, guarantees the freshness of products for only 5–7 days. This sets rigid limits on order satisfaction, coordination of production (in the case of short-shelf-life products produced on orders) and the management and control of inventories. The business efficiency is sacrificed to reduce the loss of products. For example, stores are unwilling to place larger orders, which in turn may lead to failures in satisfying demand. Transportation efficiency may also be subject to irregular orders over a short time limit. At present, the company is working with research institutions to develop new packaging technologies with the hope of prolonging shelf life and improving business efficiency. So far, there is no timetable for commercialization of the new technology.

The company launched vacuum packaging as early as 2009 and then independent vacuum packaging at the end of 2015. Processing with UHT guarantees a two-month shelf life, but until 2016, the sales revenue of vacuum-packed products accounted for less than 10% of the company's total, partly due to the limited production capacity of the company in 2015–2016 and the priority placed on the production of MAP products, but also partly due to the minor loss of taste in products packaged in vacuum packages at normal temperature. Nevertheless, we do not think no market exists for vacuum packaged products. Vacuum packaging can help the company develop new distribution channels (likely in the form of direct distribution chain stores), increase online business volume, reduce the e-commerce business platform cost and transportation cost and narrow the gap between the margins realized by online and offline businesses.

Building marketing barriers

Curb competition and increase turnover. As in the case of product barriers, marketing approaches can be improved in innovative ways but such improvement cannot prevent imitation. Innovation helps to build first-mover advantages as imitation takes time and more particularly, joint promotion (co-branding) makes imitation difficult as it take more time to build up cooperation and mutual recognition and brands with such relationships can complement one another's disadvantages. The differences between competitors in terms of funds available for marketing may also help build marketing barriers. In addition, the brand advantages built through continuous marketing and promotion efforts are conducive to obtaining good store resources and preferential conditions (in terms of store rent, online platform usage fee, etc.). Thus, marketing barriers are relatively more effective than product barriers.

Marketing may give new life to products. Zhou Hei Ya has been working in this direction. For example, based on online sales data, its duck products are targeted at young female consumers. The Company has proposed an entertainment-oriented promotional slogan to build an "eating for delight" brand image.

Compared with its direct competitors, Zhou Hei Ya started early with brand marketing and has been pursuing its strategy determinedly. The company makes limited investment in advertisements but the investment is well targeted on paper media closely related to the daily life of its target customers and online social media, outdoor advertisements (in vehicles, at transportation hubs and near stores) and product placements in TV dramas. Store decoration and in-store POPs can be effective advertising tools. The Company is not inferior to its peers in this aspect but there is still much room for improvement compared with other chain-store brands.

Promotional focus on targeted consumer groups. Themed promotional activities are also implemented in conjunction with relevant events, such as the Food Festival on May 17. The company has launched sports-related marketing activities and campus marketing in universities and colleges. It also implements general profit sharing activities. Examples include membership profit sharing activities (5% off for prepaid cardholders and 10% off for members on Tuesdays), irregular promotional activities and the issuance of large quantities of cash coupons, which has proven quite effective. The company has a budget for special activities for promoting new products. For example, in May when it introduced its crayfish products, the company invested Rmb20mn in new product marketing, online and offline discounts as well as related advertising expenses.

The company has a staff of more than 20 in the Brand Center, headed by a director from the advertising industry. As most of its employees are under 30, the marketing design for the young consumer groups is quite effective, but room to improve remains. In particular, as flavor imitators have begun to crop up, it is urgent for the company to increase value added and build a sense of consumption superiority for the brand. Fortunately, compared with directly competing products, Zhou Hei Ya currently faces limited challenges in the field of marketing.

In our opinion, co-branding, among all marketing measures available, is difficult to imitate as it takes more time to build the cooperation and mutual recognition relationship and brands with such a relationship can complement one another's disadvantages. Zhou Hei Ya has cooperated with beer and Rio drink brands, effectively creating new consumption scenarios. The market influence of such cooperation also helps to promote the profile of Zhou Hei Ya brands to a satisfactory extent. Thus, we believe that co-branding will be one of the important marketing tools Zhou Hei Ya will continue to use.

Developing derivative products

The company has been developing promotional gifts to go with its products and we believe that such measures will be implemented in near future.

The derivative products can be developed and distributed generally in two directions:

1. **Launching tie-in products to increase consumption scenarios.** The company can develop and distribute other related categories (e.g. soft and alcoholic drinks) to go with its main products. The company may include such categories in its stores to increase the turnover in a variety of manners, e.g. co-branding, independent developing new brands or independent production or production by means of OEM. In fact, this is an approach widely adopted by chain-store brands. For example, cafés sell cakes and other beverages and most tea stores sell tea snacks and tea sets.

2. **Developing cross-category products under the same brand.** This is also a measure adopted by many fashionable brands to promote the brand. The company’s development of promotional gifts under the same brand (using the same logo) can be regarded as an early attempt in this direction. The development of such cross-category products of the same brand is often based on studies on the behavioral preferences of the target consumer groups (e.g. coffee ware for café frequenters and tableware for diners at chain food stores) and our brand culture. Zhou Hei Ya may begin with the promotional gifts and gradually develop derivative products of the same brand that can be separately sold.

Figure 6: Some Zhou Hei Ya promotional gifts

Source: CICC Research

Considering mergers and acquisitions

M&A are mainly for expanding the market and developing business. There is no conclusive information that the company will develop its business by means of M&A in the near future, but there is a possibility. Efforts in this direction are likely to be made in the following fields while other possibilities are open:

- **Category expansion:** Mergers with or acquisitions of other enterprises can reduce the pressure from the independent R&D, as the Company's knowhow centers on pickled food.

- **Food service allies:** Mergers with or acquisitions of food service companies can help promote new product innovation and channel expansion.

- **In-depth cooperation with online channels:** This will reduce operating costs and improve margins. For example, turnover realized through the cooperation with the O2O online platform accounts for 7.5% of the total turnover from the stores of the company. The problem with such platforms is the high cost.

Case study: the increase of brand value for chain stores

The core value of chain stores lies in the products and the store culture: The core value of the chain store business model lies in the attraction of the product and store culture (reflecting the product positioning and marketing capability) to the target consumers. The store is the most important for brand marketing and the core value of chain stores comes from the stores themselves.

Under economies of scale, the value of the brand spreads far beyond the stores. After chain stores develop to a certain scale, they have the financial capacity to support efforts to spread the brand image to other scenarios with which the target consumers are familiar. At this stage, the products and services provided by the chain store operators remain unchanged but the marketing measures and coverage of the marketing efforts are expanded, creating more carriers of the core values.

Expansion of the business models to increase brand value is the ultimate form of promoting the core value of the chain stores: Chain stores can promote the core value of the brand by expanding its business models, which may not be the approach all chain stores must follow to grow and development, but it is the ultimate approach to protect and promote the core value of chain stores.

Zhou Hei Ya currently adopts the chain store business model and the company is engaged in promotion of its brand image within and outside the stores. Its success in being listed should further promote the influence of its brand. The expansion of its business models is likely to effectively and efficiently protect and promote its core values. We present here the case of Starbucks and the Haidilao Hotpot Restaurants for a tentative exploration of such efforts and the impacts.

Starbucks: Expansion of products and channels to improve SSSG and margins

Starbucks has opened chain coffee stores under its name in 75 countries mainly by means of joint venture, license agreement and sole proprietorship. As of October 2017, Starbucks had 27,000 stores worldwide with sales revenue of US$22.4bn in FY17. In FY08, Starbucks saw a decline in SSSG for the first time in its history, setting it on the road to transformation, accelerating the implementation of its growth strategy for promoting SSSG and the overall margin by means of channel expansion and product diversification.

<u>Product diversification</u>

Expanding product portfolio and developing derivative products to boost sales per store. In addition to selling freshly roasted coffee and regularly launching new coffee products, Starbucks also strives to develop derivative products beyond freshly roasted coffee products to improve its product portfolio and increase same-store sales. In 2009, Starbucks introduced VIA, an instant product (“Just Add Water and Stir”); in 2011, it acquired Evolution Fresh and introduced bottled fruit juice products.

Also in 2011, it acquired Teavana, a local tea brand in USA and launched bottled tea and ready-to-drink tea drinks and a K-Cup Coffee capsule and a coffee machine product was launched in the same year. In 2012, Starbucks acquired La Boulange, a French franchise chain in the US, and launched breakfast and dinner products including organic breads and croissants; in 2012, Starbucks launched instant cold drinks and canned energy drinks under the name of Refreshers.

This year, Starbucks started supplying Affogato and Cold Brew Malt – two ice cream products. The firm has become a globally licensed retailer and investor in Princi, an Italian high-end bakery and pizza brand. Princi is providing selected Starbucks stores with exclusive food supplies. In addition, Starbucks stores also regularly launch local seasonal food series. For example, Starbucks stores in China launched seasonal rice-pudding in gift packages at Dragon Boat Festival and moon-cakes at Mid-Autumn Festival. Starbucks stores also sell derivative products, such as coffee machines, mugs and plush toys.

Same-store sales have been increasing steadily and food sales accounted for an increasing share of total sales over past years. After experiencing recessions in FY08 and FY09, Starbucks achieved positive results by actively expanding its product portfolio to boost the sales per store. Since 2010, the SSSG of Starbucks has remained stable. In the past 2 years, the average spending per purchase order attained a growth rate of 4%, suggesting the effective contribution of a diverse product portfolio to SSSG. The contribution of foodstuffs in Starbucks self-operated stores also increased from 15% in 2006 to 19% in 2016.

<u>Channel diversification</u>

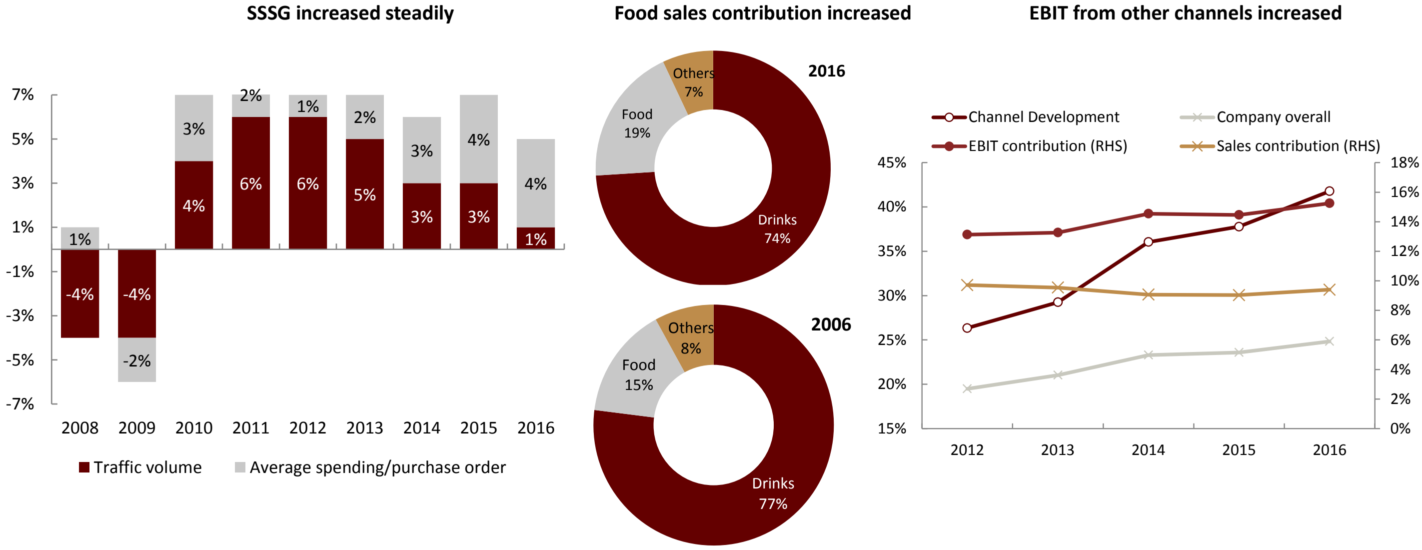
Developing products distributed through other retailing channels in addition to self-operated stores. Besides expanding the product portfolio sold in stores, Starbucks has also established a consumer product department responsible for building cooperative relationships with manufacturers and retailers beyond the scope of its self-operated stores and authorized franchisees and distributing products under its brand through grocery stores, warehousing clubs, franchise retailers, convenience stores, restaurants, etc. Products Starbucks currently sells through other channels include roasted coffee beans, ground coffee, bottled coffee drinks (Frappuccino, double concentrated American coffee, refreshing drinks, etc.) and other ready-to-drink drinks such as tea drinks, and K-cup capsules.

Other efforts Starbucks has made to develop other channels: In 1993, Starbucks signed an agreement with Barnes and Noble, USA, by which more than 400 chain bookstores provide only Starbucks coffee products. In 1995, Starbucks began to cooperate with Chapters chain bookstore, Canada. In 1996 Starbucks and Pepsi set up a joint venture named the North American Coffee Partnership (which now accounts for the largest share of the US ready-to-drink coffee market) to jointly develop and distribute bottled Starbucks coffee drinks and ice cream products in the United States. In 1998, Starbucks products began to be sold at retail outlets.

Finally, in 2011, Starbucks and Keurig Green Mountain reached agreement by which Starbucks used Keurig coffeemakers to manufacture and sell single-cup brewed coffee capsule products and sold Keurig coffeemakers in their stores. In 2015, Starbucks signed a cooperation agreement with Tingyi, by which Starbucks was responsible for product development and innovation while Tingyi manufactures and sells bottled Starbucks products in mainland China. In the same year, Starbucks partnered with Pepsi to launch its bottled coffee products in Latin America.

Contributions from other channels increased gradually, with a margin higher than the average of the company. Drawing on its strong brand power established by the coffee chain stores, Starbucks expanded its sales channels beyond the chain stores through packaged products, with the view of meeting the needs of more consumers. In FY16, turnover from other channels (channel development) accounted for 9.4% of the company’s total (7.4% in 2011), with an operating margin as high as 15.2%. The operating margin of other channels was 41.8% in FY16, much higher than the company's overall operating margin of 24.8% and the margin of the proprietary stores, making it the business segment of Starbucks with the highest margin.

Figure 7: Efforts of Starbucks branding extension and performance



Source: Company data, CICC Research

Haidilao Hotpot Restaurant: Promoting brand value by expanding products and channels

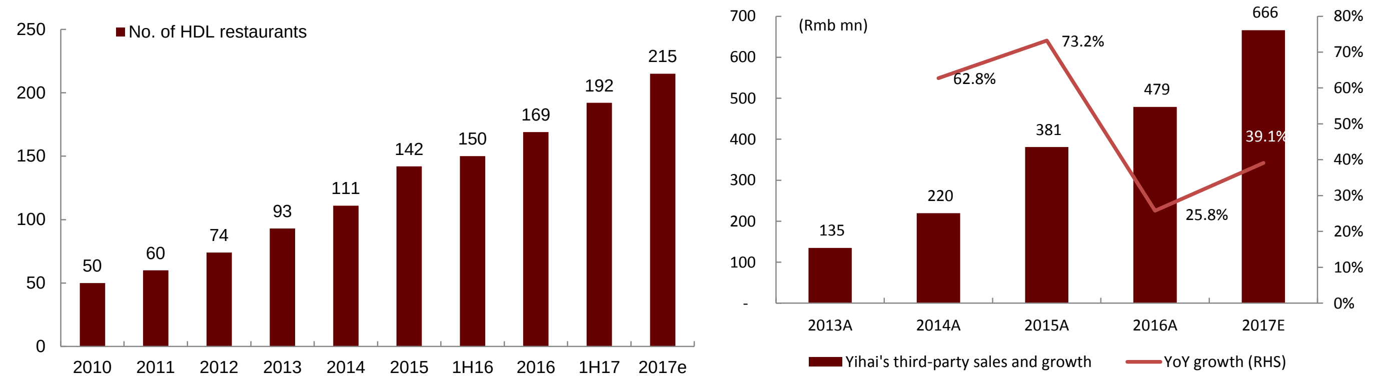
As of the end of 2016, there were 169 Haidilao Hotpot stores in China. The number of stores is increasing at an accelerating rate this year, estimated at 30% each year. In July 2016, just before the acceleration, Yihai International, a subsidiary of Haidilao Hotpot, a soup base condiment producer and supplier, was listed independently in Hong Kong.

Yihai International, while producing condiments for Haidilao Hotpot restaurants, also distributes soup base condiment products, dipping sauces and other Chinese compound condiment products under the name Haidilao for other restaurants. Yihai International actively distributes its products through modern channels, traditional wholesale channels, overseas exports, e-commerce and restaurants.

In 2016, its turnover from third party channels totaled Rmb479mn and its turnover from third-party channels realized a CAGR as high as 52.5%. In 2H17, Haidilao Hotpot Restaurant and Yihai International set up a joint venture to produce and sell convenience hotpot products using the name Haidilao Hotpot, with the view of marketing and distributing the products through online, offline and other retail channels.

Haidilao Hotpot Restaurant and condiment products jointly penetrated the market and increased the brand exposure through different distribution channels and expansion models, demonstrating the effectiveness of combined practices to increase the brand value and overall profit by means of expanding the products and distribution channels under the chain store business model.

Figure 8: Haidilao Hotpot Restaurant branding extension and performance



Source: Company data, CICC Research

Expecting margin to turn around in 2021 and an earnings CAGR of 15.4% over 2017–2027

Sales forecasts

Store openings

Our potential demand model shows that Zhou Hei Ya's existing products can hit a sales target of Rmb11.8bn over 10 years of opening new stores, and we expect a sales CAGR of 15.6% over 2017–2027.

New stores will roll out across the targeted regions following the order of product preference and city tiers. The progress of new capacity release will also be considered. Thus, we expect number of stores opened each year to increase gradually over the next 10 years starting in regions of high product preference then moving toward to those with low product acceptance.

The sales growth of each year may be close, as stores in regions of high product preference can realize higher sales. We expect 226, 250 and 340 new stores to open each year over 2018–2020; 440, 540 and 690 new stores each year over 2021–2023; and 700–800 each year over 2024–2027, totaling 6,459 at end- 2027. We expect the number of self-operated stores to grow at a CAGR of 20.5% over 2017-2027.

Sales of self-operated stores

We expect that the average sales at self-operated stores to decline 3.8% p.a. over 2017–2025, reflecting the gradual opening of stores in regions with lower product preference. Meanwhile, we assume that the sales of existing stores in mature regions to remain stable and will not grow.

We assume that 2017–2020 will be the period when the greatest number of membership cards is issued, with around 4–5mn members being recruited each year and the sales realized from member contribution will increase from 25% in 2017 to 50% in 2020.

Over 2020–2027, the membership expansion will continue, but the member contribution should remain stable at 50%. As the members are entitled to a regular discount of 5% and a discount of 10% once a week, membership will have adverse impact on the ASP (excl. price increase). The impact in 2017 is already reflected and could be significant over 2017–2020; however, it should decline following that period.

Online and distributors channel

We estimated the sales revenue that the company can realize by selling its existing products through self-operated stores over 2017–2027. We believe that the higher ASP of products purchased online (vs. off-line self-operated stores) reflects potential demand. Thus, with new stores opening in a greater number of cities, we expect the growth of online sales to continue to decline.

We estimate that the growth in online sales (50% now) will decline 10ppt each year from over 2017–2021, suggesting that sales at self-operated stores will exceed online sales in 2020. The negative impact of the low operating margin of online business (dragged by the high expenses ratio of platform and transportation expenses, despite gross margin being almost equal with self-operated stores) will decline over the years, in our view.

A small portion of sales revenue is realized through distributors, but we did not price in the sales growth of this channel into our forecasts, as we have no evidence that the company plans to develop this channel in the near future.

Forecasts of costs, expenses and margins

Costs

While raw material costs fluctuate cyclically, our model assumes that the raw material costs will remain stable over 2017–2027, as we cannot predict the pattern of the fluctuation. Accordingly, we also assume that the company's ASP will remain stable (excl. the possibility of member recruitment causing a drop in ASP). Raw materials (incl. packaging materials) account for 83% of the firm's total costs.

Meanwhile, thanks to its business model whereby production is determined by expected sales, we expect the firm's capacity utilization rate to remain high and we do not expect labor, energy or storage costs to exceed sales growth. Thus, the only risk threat to future gross margin, in our view, arises from the ASP discount due to member recruitment.

We expect the growth of the headquarters expenses and online sales expenses to drag down operating margin for the company, as well as the likely slip in gross margin. As the company has no debt or interest expenses and its tax rate remains stable, we believe that net margin will keep pace with operating margin.

Expenses

The cost structure of the store is mainly fixed costs: rental, base salary for salespersons, decoration fees and utilities account for 96% of the total. Among such fixed costs, rental and salary are likely to rise each year (we estimate 3%/year in our model).

Thus, if the firm cannot realize an equivalent sales growth, the operating margin will be adversely impacted. At the same time, the increase in the number of stores in markets of mild preference will lead to a decline in sales per store. If the rents and salaries do not decline at the same pace as sales per store, the operating margin will also be hurt.

HQ expenses (mostly transportation and A&P expenses) are largely linked to sales revenue, while fixed expenses (G&A expenses increase rapidly in the early years following the company's founding but remain stable afterwards and use expenses linked to the online business and D&A) account only for 1/3 of the total. The fixed costs of the headquarters and the stores account for 85% of the total, if the sales per store do not grow at the same rate, the operating margin will be hurt. If the sales at mature stores do not grow, the operating margin realized from sales of existing products will continue to fall at a slight rate with more and more stores opened in higher-end markets due to the rental. This tendency was seen in the company's 1H17 results. However, after the focus of store openings shifted to lower-tier cities, we expect the lower rents to support a rebound in margin, and we forecast the margin turning point will be in 2021.

Margin

Based on our model, which anticipates no new products, over 2017–2025, the number of new stores, sales revenue, gross profit, operating profit and net profit will grow 20.5%, 15%, 15%, 15.4 and 15.4% each year. Gross margin will remain stable while operating margin and net margin will first decline and then increase, while t operating and net profit will remain flat and generally in line with the sales growth. However, the growth of both revenue and earnings will be lower than the growth in the number of stores.

We expect operating and net margin to edge downward continuously over 2017–2021 due to two factors. First, new stores will be opening in in tier-1/-2 cities, which have higher rental costs and not all such cities are very receptive to the company's products. Thus, the sales per store decline from the current peak will be larger than the decline in rental, leading to the rental/sales rising continuously until 2021 and then declining.

Over 2017–2020, we expect the sales growth of online channels to reach 20–50%, and the higher online channel expenses may cause the expense-to-sales ratio increase until 2021 and then decline.

Thus, we expect operating and net margin to edge downward over 2017–2021, and recover over 2022–2027. We expect operating and net margin in 2021 at 26% and 19.5%, but during the period of their decline, the operating and net profit should maintain growth.

Forecast on the possibility of new products changing SSSG and margin curve

We are convinced that crayfish products and vacuum packaged products will be re-launched in 2018, with both designed to be distributed nationwide and generating a gross margin similar to the existing MAP products. If both products are distributed through self-operated stores and online channels, they will benefit sales per store, as well as the operating margin realized in stores and online, as they can dilute the platform using expenses.

Our base case is that the crayfish and the vacuum packaged product re-launched in 2018 will increase the total sales of the company Rmb100mn and Rmb50mn and that the two will increase the store sales by 5% in 2018. We further assume that the company will continue launching new products (incl. derivative products). Moreover, the gross margin realized by selling new and derivative products will not be less than that of existing products, but it will be subject to the same membership discounts. The continual launch of new products will increase sales per store, slightly narrowing the fall in operating and net margin.

In such a scenario, our base case is that the new products will increase SSS 5% in 2018 and grow at 10% in the following years. This should offset the expected growth of 3% in the fixed expenses at the headquarters and at stores that account for 85% of total fixed expenses, narrowing the operating and net margin declines. We expect operating profit and net profit to realize a CAGR of 15.4% over 2017–2027. Our sensitivity analysis shows that every 5% store sales contribution of new products with the same gross margin with the old products results in a 1% increase in operating margin

Our bear case is that new products fail to meet expectations and with only the existing duck products, the CAGR of operating and net profit will grow by only 14.7% over 2017–2027. The margin inflection point may also be in 2021, implying the bottoms of operating margin and net margin of 25% and 18.7%.

Our bull case is that new products are successful and perform better than expected, suggesting that the CAGR of operating and net profit of the company reaches 16.7%. The margin inflection point may also be in 2021, implying the bottoms of operating margin and net margin of 27.1% and 20.3%.

Other forecasts

Capacity and capital expenditures

The transformation of Phase I of the plant in Wuhan should realize an annual vacuum packaging capacity of 20,000 tons—half for crayfish products and the rest for duck products—and 10,000 tons of MAP packaging capacity p.a., all reserved for crayfish products.

Phase II of the plant in Wuhan has a realized capacity of 32,000 tons p.a., which can be raised to 44,000 tons. An annual capacity of 20,000 tons per plant is designed for the plants in the eastern (Nantong), northern China (Hebei), southern (Dongguan) and southwestern (Chengdu) part of China, with a capital expenditure of Rmb100mn per 10,000 tons of the capacity.

We expect Rmb1.6bn to be invested over 2017–2019 to build the aforementioned capacities. After the completion, the annual production capacity should rise to 152,000 tons, 4x the estimated sales (38,000 tons) in 2017, and meeting the estimated triple or higher growth potential for the demand for duck products and production of new products.

Thus, we expect the capex of the company to decline significantly from an annual expenditure of Rmb600mn over 2017–2019 (including expenses to maintain the existing production capacity). We expect the annual capex to maintain at a level of Rmb300mn each year over 2020–2027.

Other assumptions

We expect the exchange rate and income tax rate to remain unchanged, and thus the dividend payout ratio to remain unchanged at 30%—at least during the capacity expansion over 2017 to 2019. We expect the dividend payout to rise 60% from 2020, thanks to lower capex.

Exclusions from model include new channel expansion opportunities brought about by new categories of products – e.g., channels for products with long shelf lives to be disseminated by distributors and table food products to be distributed by catering channels – and M&A.

Figure 9: Financial assumptions and earnings forecasts

Operating data& income statement

Rmb mn	2016A	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
No. of self-operated stores	778	998	1,224	1,474	1,814	2,254	2,794	3,484	4,209	4,934	5,664	6,459
Net increase	137	220	226	250	340	440	540	690	725	725	730	795
Sales breakdown												
Self-operated retail stores	2,421	2,779	3,142	3,501	4,051	4,742	5,611	6,756	8,055	9,422	10,797	12,197
-Duck products	2,421	2,779	2,992	3,336	3,869	4,542	5,391	6,514	7,789	9,129	10,475	11,843
-Value-added products			150	165	182	200	220	242	266	292	322	354
Online channels	264	396	554	720	864	951	998	1,038	1,070	1,091	1,102	1,102
Distributors	121	158	175	175	175	175	175	175	175	175	175	175
Others	11	11	11	11	11	11	11	11	11	11	11	11
Overall sales	**2,816**	**3,343**	**3,882**	**4,407**	**5,101**	**5,878**	**6,795**	**7,980**	**9,310**	**10,698**	**12,084**	**13,484**
Cost of goods sold	1,061	1,309	1,512	1,729	1,999	2,303	2,657	3,114	3,625	4,159	4,691	5,230
Gross profit	1,755	2,033	2,369	2,678	3,102	3,575	4,138	4,866	5,685	6,539	7,392	8,254
S&D expenses	701	926	1,127	1,345	1,608	1,888	2,171	2,502	2,839	3,152	3,447	3,760
G&A expenses	142	168	185	200	220	241	265	296	328	358	384	408
Operating profit	**963**	**1,010**	**1,130**	**1,206**	**1,350**	**1,527**	**1,788**	**2,159**	**2,617**	**3,137**	**3,681**	**4,220**
Profit before taxation	963	1,010	1,130	1,206	1,350	1,527	1,788	2,159	2,617	3,137	3,681	4,220
Taxation	248	253	282	301	337	382	447	540	654	784	920	1,055
Net profit	**716**	**758**	**847**	**904**	**1,012**	**1,145**	**1,341**	**1,620**	**1,963**	**2,353**	**2,761**	**3,165**
Dividend	215	227	254	271	607	687	805	972	1,178	1,412	1,657	1,899
Margin												
Gross margin	62.3%	60.8%	61.0%	60.8%	60.8%	60.8%	60.9%	61.0%	61.1%	61.1%	61.2%	61.2%
S&D costs/sales	24.9%	27.7%	29.0%	30.5%	31.5%	32.1%	31.9%	31.4%	30.5%	29.5%	28.5%	27.9%
G&A costs/sales	5.0%	5.0%	4.8%	4.5%	4.3%	4.1%	3.9%	3.7%	3.5%	3.3%	3.2%	3.0%
EBIT margin	34.2%	30.2%	29.1%	27.4%	26.5%	26.0%	26.3%	27.1%	28.1%	29.3%	30.5%	31.3%
Effective tax rate	25.7%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Net margin	**25.4%**	**22.7%**	**21.8%**	**20.5%**	**19.8%**	**19.5%**	**19.7%**	**20.3%**	**21.1%**	**22.0%**	**22.8%**	**23.5%**

Cash flow

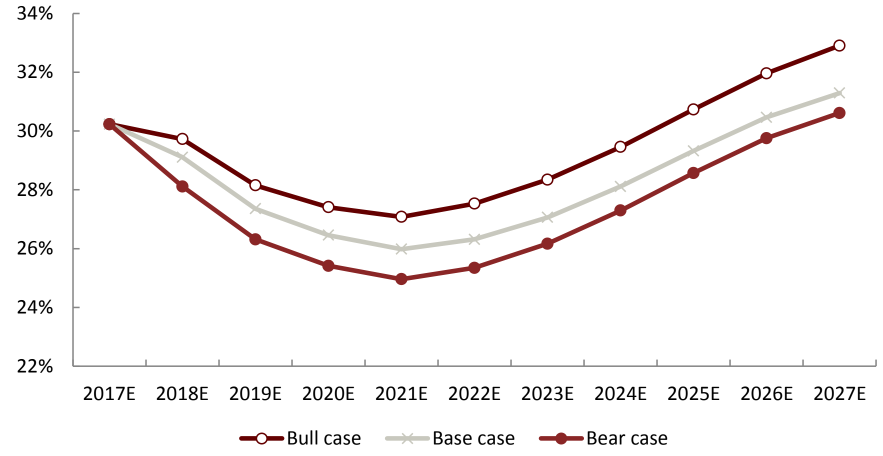
Rmb mn	2016A	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
Operating cashflow	757	1,109	870	978	1,106	1,239	1,456	1,724	2,059	2,461	2,874	3,297
Investment cashflow	-2,939	-662	-662	-662	-259	-254	-249	-243	-236	-226	-215	-201
Capex	-111	-702	-703	-703	-303	-303	-303	-303	-303	-303	-303	-303
Financing cashflow	2,254	-215	-227	-254	-271	-607	-687	-805	-972	-1,178	-1,412	-1,657
Net cash change	73	232	-20	62	576	378	519	675	852	1,056	1,248	1,440
Cash BB	82	201	432	413	475	1,051	1,429	1,948	2,623	3,475	4,532	5,780
Cash EB	**201**	**432**	**413**	**475**	**1,051**	**1,429**	**1,948**	**2,623**	**3,475**	**4,532**	**5,780**	**7,219**

Balance sheet

Rmb mn	2016A	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
Current assets												
Cash	2,461	2,693	2,673	2,735	3,311	3,690	4,209	4,884	5,736	6,792	8,040	9,480
A/R receivables	8	8	10	11	13	15	17	20	24	27	31	34
Inventories	206	210	242	277	320	369	426	499	581	667	752	838
Other receivables	786	513	596	676	782	902	1,042	1,224	1,428	1,641	1,854	2,069
Available-for-sale financial assets	10	10	10	10	10	10	10	10	10	10	10	10
	3,479	3,442	3,539	3,717	4,445	4,993	5,712	6,645	7,786	9,145	10,694	12,438
Non-current assets												
Prepayments	22	22	22	22	22	22	22	22	22	22	22	22
Fixed assets,net	460	891	1,282	1,632	1,749	1,843	1,912	1,956	1,976	1,972	1,944	1,891
Intangible assets and others	7	7	9	10	10	11	11	10	10	8	7	5
Prepaid land lease payments	65	261	454	642	629	615	601	588	574	561	547	534
Deferred tax assets	27	27	27	27	27	27	27	27	27	27	27	27
	628	1,256	1,841	2,380	2,485	2,565	2,620	2,651	2,657	2,638	2,595	2,526
Total assets	**4,107**	**4,698**	**5,380**	**6,098**	**6,930**	**7,558**	**8,332**	**9,296**	**10,443**	**11,783**	**13,289**	**14,965**
Current liabilities												
Payables to suppliers	82	81	94	107	124	143	165	193	225	258	291	325
Other payables	289	338	386	441	516	587	685	806	930	1,061	1,185	1,319
Taxation payable	117	117	117	117	117	117	117	117	117	117	117	117
	489	537	598	667	758	848	968	1,117	1,273	1,438	1,594	1,762
Non-current liabilities												
Government grants, non-current	18	18	18	18	18	18	18	18	18	18	18	18
Other payables and accruals	4	4	4	4	4	4	4	4	4	4	4	4
	22	22	22	22	22	22	22	22	22	22	22	22
Total liabilities	511	559	621	689	780	870	990	1,139	1,295	1,460	1,616	1,784
Shareholder's Equity	**3,596**	**4,139**	**4,759**	**5,409**	**6,150**	**6,688**	**7,342**	**8,157**	**9,148**	**10,323**	**11,672**	**13,180**

Source: company data, CICC Research

Figure 10: EBIT margin curve simulation



Source: company data, CICC Research

BUY rating with an end-2018 TP of HK$9.72

DCF model for pricing reflects long-term growth potential

Zhou Hei Ya's advantage is its significant potential demand. If the demand is fully explored, the firm should exceed the long-term DCF and earnings CAGR of its competitors. In addition, as we expect margins to begin picking up, we believe that the short-term static P/E ratio pricing model cannot fully reflect the company's future growth potential. Thus, we believe that a DCF model is the best way to value the company.

Based on our DCF model built on sophisticated earnings predictions for the next ten years, we derive an end-2018 TP of HK$9.72, or 23.4x 2018e P/E for the company.

Valuation comparison with peers

Zhou Hei Ya currently adopts a chain-store business model, but its future expansion may not be limited to this model, as the company could develop multi-channel, multi-brand businesses. Thus, we include both comparable companies operating under the chain-store business model and consumer staples companies listed on the Hong Kong Stock Exchange.

The comparison shows that under a chain-store business model, the P/E under the company's end-2018 TP is still 5.6% and 5.6% lower than the average of both HK staples and global peers. We thus believe our target share price is reasonable.

Figure 11: DCF model

Free cash flow forecast (Rmb mn)	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
Net revenue	3,882	4,407	5,101	5,878	6,795	7,980	9,310	10,698	12,084	13,484	13,754
YoY	*16.1%*	*13.5%*	*15.7%*	*15.2%*	*15.6%*	*17.4%*	*16.7%*	*14.9%*	*13.0%*	*11.6%*	*2.0%*
EBIT	1,130	1,206	1,350	1,527	1,788	2,159	2,617	3,137	3,681	4,220	4,304
YoY	*11.8%*	*6.7%*	*11.9%*	*13.2%*	*17.1%*	*20.8%*	*21.2%*	*19.9%*	*17.3%*	*14.6%*	*2.0%*
EBIT margin	*29.1%*	*27.4%*	*26.5%*	*26.0%*	*26.3%*	*27.1%*	*28.1%*	*29.3%*	*30.5%*	*31.3%*	*31.3%*
EBIT*(1 - t)	847	904	1,012	1,145	1,341	1,620	1,963	2,353	2,761	3,165	3,228
+ Depreciation and amortization	119	163	198	223	248	272	297	322	346	371	399
- Change in working capital	55	48	60	80	80	109	134	137	145	137	70
- Capex	-703	-703	-303	-303	-303	-303	-303	-303	-303	-303	-303
Free cash flows	**318**	**413**	**968**	**1,145**	**1,366**	**1,698**	**2,091**	**2,509**	**2,950**	**3,370**	**3,394**
YoY	*-269.7%*	*29.8%*	*134.2%*	*18.4%*	*19.2%*	*24.3%*	*23.1%*	*20.0%*	*17.6%*	*14.2%*	*0.7%*

DCF Analysis			
PV of FCF	9,176	Tax rate	25.0%
Terminal value	25,615	Debt ratio	0.0%
PV of terminal value	7,381	Beta	1.90
Enterprise value	16,557	Risk free rate	2.8%
Net cash/(debt), minority interests	2,681	Risk premium	5.5%
Equity value	19,238	Equity cost	13.3%
Equity value per share (HK$)	9.72	Debt cost	6.0%
		Debt cost (After tax)	4.5%
		WACC	13.3%
		Perpetual growth	0.0%

Source: Company data, CICC Research

Figure 12: Valuation of HK staples

Company	Ticker	Stock 2017/12/11	Target price	Market cap HKD mn	Rating	P/E (x) 2016A	2017E	2018E	P/B (x) 2016A	2017E	2018E	ROE (%) 2016A	2017E	2018E	Dividend Yield (%) 2016A	2017E	2018E	EV/EBITDA (x) 2016A	2017E	2018E
Food & Beverage																				
China Foods	0506.HK	3.82	6.21	10,685	BUY	21.4	26.6	21.1	2.0	1.8	1.7	9.2	6.9	8.1	0.6	0.0	0.0	11.9	9.7	7.6
WH Group	0288.HK	8.84	10.51	129,591	BUY	16.0	15.3	12.9	2.6	2.4	2.2	16.4	15.8	16.8	3.0	3.2	3.7	8.4	8.1	7.3
Tingyi	0322.HK	13.70	15.92	76,809	BUY	56.3	37.8	28.4	3.6	3.4	3.2	6.4	9.0	11.2	0.9	1.3	1.8	11.3	10.6	9.0
Dali	3799.HK	6.15	8.06	84,219	BUY	23.0	20.8	18.2	5.2	4.8	4.2	22.6	22.9	23.3	3.0	2.9	3.3	13.7	12.1	10.4
H&H International	1112.HK	49.85	33.70	31,751	HOLD	28.3	31.1	25.4	8.5	6.6	5.3	29.9	21.4	20.7	0.0	0.0	0.0	15.3	15.4	13.4
Yashili	1230.HK	1.51	1.47	7,166	HOLD	n.m	n.m	97.8	1.1	1.1	1.1	-5.6	-3.2	1.1	0.0	0.0	0.3	n.m	n.m	21.8
Mengniu	2319.HK	21.00	20.24	82,473	BUY	n.m	29.7	20.8	3.4	3.1	2.7	-3.6	10.4	13.2	0.5	0.8	1.1	65.0	15.4	13.3
Modern Dairy*	1117.HK	1.45	2.28	8,891	BUY	18.5	n.m	10.3	1.1	1.2	1.2	5.9	1.0	11.8	0.0	0.0	0.0	15.0	15.3	8.2
China Shengmu	1432.HK	1.26	1.39	8,007	HOLD	10.1	24.8	18.1	1.3	1.2	1.1	12.7	4.9	6.3	0.0	0.0	0.0	6.9	10.3	8.5
Tsingtao Brewery	0168.HK	33.05	26.93	44,650	HOLD	36.6	32.2	31.4	2.3	2.2	2.1	6.4	7.0	6.8	1.2	1.1	1.1	12.1	13.0	12.5
Want Want	0151.HK	5.96	7.34	74,387	BUY	18.1	20.1	17.9	5.3	4.7	4.1	29.1	23.2	22.7	1.7	1.8	2.0	10.9	11.3	10.0
CRB	0291.HK	24.75	22.29	80,293	BUY	109.3	34.8	30.5	3.9	3.6	3.2	3.6	10.2	10.6	0.4	0.6	0.7	19.6	16.4	14.7
UPC	0220.HK	6.13	5.94	26,478	HOLD	37.3	28.7	27.9	1.9	1.8	1.7	5.0	6.2	6.1	0.5	0.7	0.7	9.8	9.1	8.4
Yihai	1579.HK	6.60	5.74	6,910	BUY	31.7	24.2	18.9	4.7	3.7	3.0	14.7	15.5	15.9	0.7	0.8	1.1	21.5	13.1	9.5
ZHOUHEIYA	1458.HK	7.08	9.72	16,873	BUY	21.1	19.1	16.5	4.2	3.5	2.9	36.0	19.6	19.0	1.4	1.6	1.8	12.5	10.8	9.1
Average						**31.5**	**25.6**	**24.8**	**3.3**	**2.9**	**2.5**	**12.5**	**11.4**	**12.1**	**1.0**	**1.1**	**1.1**	**16.1**	**11.8**	**10.2**

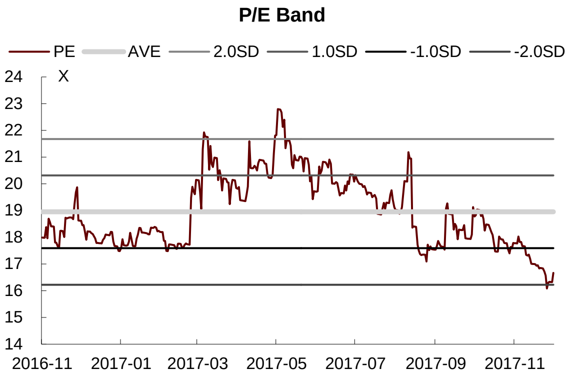
Source: Bloomberg, company data, CICC Research

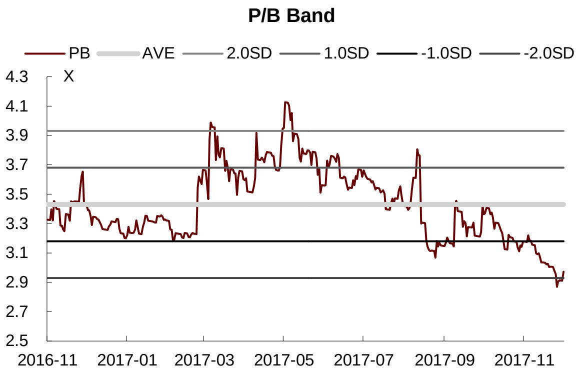
Figure 13: Valuation of comparable global chain brands

Company	Ticker	Market Cap (USD mn)	PE Ratio				PB Ratio			ROE (%)			Dividend Yield (%)			EV/EBITDA			EPS CAGR	PEG
2017/12/11			2016A	2017E	2018E	2019E	2016A	2017E	2018E	2016A	2017E	2018E	2016A	2017E	2018E	2016A	2017E	2018E	2017-19	2017-19
MCDONALD'S CORP	MCD US Equity	138,033	31.5	26.5	24.7	22.9	n.m	n.m	n.m	n.m	n.m	n.m	2.1	2.2	2.4	17.7	15.9	15.8	7.6%	3.5
INDUSTRIA DE DISENO TEXTIL	ITX SM Equity	114,573	30.7	28.6	25.8	23.3	8.4	7.0	6.3	27.2	24.5	24.6	1.6	2.4	2.7	18.0	16.7	15.1	11.0%	2.6
STARBUCKS CORP	SBUX US Equity	83,390	29.5	25.3	22.2	19.0	15.4	16.2	16.0	52.3	64.2	72.2	1.8	2.1	2.4	17.6	14.1	12.7	15.2%	1.7
TJX COMPANIES INC	TJX US Equity	46,715	21.0	18.8	17.6	15.8	10.1	10.0	9.6	47.8	53.1	54.8	1.4	1.6	1.9	10.2	9.6	9.2	9.1%	2.1
ADIDAS AG	ADS GR Equity	44,439	35.5	26.7	22.7	19.1	5.6	5.0	4.4	15.9	18.8	19.4	1.1	1.4	1.8	19.9	15.4	13.3	18.1%	1.5
HENNES & MAURITZ AB-B SHS	HMB SS Equity	38,487	17.5	18.6	17.0	15.8	6.0	5.3	5.0	34.2	28.6	29.5	4.9	4.9	4.9	10.2	10.4	9.4	8.5%	2.2
RESTAURANT BRANDS INTERN	QSR US Equity	28,309	41.0	30.5	22.8	20.4	6.7	9.7	7.5	16.4	31.7	32.9	1.0	1.3	1.6	21.5	18.9	17.1	22.4%	1.4
ROSS STORES INC	ROST US Equity	29,383	27.0	23.4	21.6	19.4	10.3	9.8	8.6	38.1	41.9	40.0	0.7	0.8	0.9	13.6	12.2	11.5	9.8%	2.4
YUM! BRANDS INC	YUM US Equity	28,078	20.3	29.6	26.2	22.5	n.m	n.m	n.m	n.m	n.m	n.m	4.3	1.4	1.6	19.1	18.1	18.0	14.7%	2.0
YUM CHINA HOLDINGS INC	YUMC US Equity	15,682	30.0	28.6	25.2	22.4	5.5	5.6	4.9	18.2	19.5	19.4	-	0.5	1.2	14.3	11.9	10.7	13.0%	2.2
ANTA SPORTS PRODUCTS LTD	2020 HK Equity	11,364	29.4	24.4	20.6	17.3	5.7	5.5	5.0	19.3	22.5	24.1	2.1	2.9	3.4	16.1	13.1	10.9	19.0%	1.3
GAP INC/THE	GPS US Equity	13,023	19.8	15.9	15.6	16.1	4.3	4.3	4.0	21.7	27.3	25.7	2.7	2.8	2.8	7.2	6.7	6.7	-0.7%	-23.0
WHITBREAD PLC	WTB LN Equity	9,636	17.0	15.3	14.4	13.3	2.7	2.5	2.3	15.8	16.5	15.7	2.4	2.5	2.7	10.5	9.5	8.8	7.3%	2.1
BURLINGTON STORES INC	BURL US Equity	7,705	36.9	26.1	23.0	20.2	n.m	n.m	n.m	n.m	n.m	n.m	-	-	-	15.5	13.0	11.7	13.7%	1.9
SAMSONITE INTERNATIONAL SA	1910 HK Equity	6,264	24.3	24.6	20.2	17.1	4.2	3.8	3.4	17.1	15.6	17.0	1.5	1.6	2.0	2.4	1.8	1.6	20.1%	1.2
YAMAZAKI BAKING CO LTD	2212 JP Equity	4,341	27.0	20.8	27.8	26.6	1.7	1.6	1.6	6.2	7.9	5.7	0.8	1.0	0.9	6.9	6.9	7.1	-11.5%	-1.8
URBAN OUTFITTERS INC	URBN US Equity	3,582	17.7	21.1	19.0	18.6	2.8	2.7	2.5	15.8	12.9	13.0	-	-	-	6.8	7.9	7.7	6.6%	3.2
AMERICAN EAGLE OUTFITTERS	AEO US Equity	3,055	14.7	14.9	14.1	14.8	2.6	2.6	2.2	17.8	17.4	15.8	2.9	2.9	2.7	5.7	5.7	5.5	0.5%	31.4
JUEWEI FOOD CO LTD-A	603517 CH Equit	2,421	36.9	33.1	28.1	23.7	9.6	6.2	5.3	26.0	18.8	18.9	n.m	1.3	1.5	25.0	31.8	26.8	18.1%	1.8
ZENSHO HOLDINGS CO LTD	7550 JP Equity	2,579	34.4	38.0	40.5	42.1	4.1	4.0	3.8	11.9	10.5	9.3	0.9	0.9	0.9	10.7	11.8	11.7	-5.0%	-7.6
CAFE DE CORAL HOLDINGS LTD	341 HK Equity	1,582	24.3	25.3	22.4	21.4	3.7	3.6	3.6	15.2	14.4	15.8	3.8	3.7	3.9	12.8	12.4	11.1	8.7%	2.9
XIABUXIABU CATERING MANAGEME	520 HK Equity	1,742	31.0	26.4	21.2	18.2	6.3	5.8	4.7	20.5	21.8	22.1	1.3	1.7	2.1	15.7	12.9	10.5	20.4%	1.3
ONWARD HOLDINGS CO LTD	8016 JP Equity	1,421	30.5	28.2	28.1	25.5	0.9	0.9	0.9	2.8	3.1	3.1	2.5	2.5	2.5	13.8	14.2	14.0	5.2%	5.4
DOUTOR NICHIRES HOLDINGS CO	3087 JP Equity	1,235	21.8	19.8	18.7	17.6	1.3	1.2	1.2	5.9	6.1	6.2	1.1	1.2	1.2	6.9	6.4	6.1	6.1%	3.2
ABERCROMBIE & FITCH CO-CL A	ANF US Equity	1,227	300.2	183.8	96.3	174.9	1.1	1.0	1.0	0.4	0.5	1.1	4.4	4.4	4.4	5.2	4.7	4.8	2.5%	72.9
YOSHINOYA HOLDINGS CO LTD	9861 JP Equity	1,103	99.2	56.5	56.7	48.6	2.2	2.2	2.1	2.2	3.8	3.7	1.0	1.0	1.0	17.1	13.2	12.8	7.8%	7.2
SHANGHAI LAIYIFEN CO LTD-A	603777 CH Equit	1,013	39.9	46.6	27.2	n.m	3.5	n.m	n.m	8.8	n.m	n.m	1.3	n.m	n.m	27.3	n.m	n.m	n.m	n.m
ESPRIT HOLDINGS LTD	330 HK Equity	991	135.3	43.7	21.7	17.3	0.7	0.7	0.7	0.5	1.5	3.0	-	1.4	2.7	5.7	3.7	2.8	59.0%	0.7
GIORDANO INTERNATIONAL LTD	709 HK Equity	823	14.8	13.0	11.9	11.2	2.3	2.4	2.4	15.3	18.3	19.9	6.7	7.7	8.4	7.3	6.8	6.4	7.6%	1.7
YONDOSHI HOLDINGS INC	8008 JP Equity	768	15.4	13.9	13.3	12.7	1.5	n.m	n.m	9.7	n.m	n.m	1.7	2.2	2.4	10.0	n.m	n.m	4.9%	2.8
GANSO CO LTD-A	603886 CH Equit	720	28.8	30.8	26.5	23.2	4.5	4.0	3.7	15.5	13.1	13.9	1.2	1.4	1.5	22.8	16.9	14.1	15.1%	2.0
FUJIYA CO LTD	2211 JP Equity	644	56.3	48.6	46.5	41.9	2.5	2.3	2.2	4.4	4.8	4.8	0.4	0.4	0.4	12.1	n.m	n.m	7.7%	6.3
AJISEN CHINA HOLDINGS LTD	538 HK Equity	505	5.0	16.9	15.5	12.9	1.0	1.0	0.9	20.0	5.7	6.1	3.9	4.2	4.3	2.0	4.7	4.4	14.7%	1.2
KAPPAHL AB	KAHL SS Equity	412	9.6	11.0	10.4	10.5	1.7	2.1	1.9	17.8	18.6	18.0	4.4	4.7	5.3	5.8	6.1	5.8	2.3%	4.8
BREADTALK GROUP LTD	BREAD SP Equity	325	38.3	28.9	21.1	19.0	3.3	3.1	2.9	8.6	10.7	13.8	1.6	3.2	2.6	5.7	5.6	5.5	23.2%	1.2
BAROQUE JAPAN LTD	3548 JP Equity	307	8.9	18.0	17.1	12.7	2.1	2.0	1.9	23.3	11.1	11.2	1.0	3.9	3.9	5.0	n.m	n.m	19.2%	0.9
TSUI WAH HOLDINGS LTD	1314 HK Equity	204	17.6	14.1	12.6	10.3	1.4	1.2	1.1	7.7	8.4	8.5	3.1	5.3	6.2	5.7	6.0	5.3	17.3%	0.8
Average			**38.3**	**30.2**	**24.8**	**24.7**	**4.3**	**4.2**	**3.9**	**17.1**	**17.9**	**18.4**	**2.0**	**2.3**	**2.5**	**12.2**	**11.1**	**10.2**	**0.1**	**4.1**
ZHOUHEIYA	1458 HK Equity	2,161	21.1	19.1	16.5	15.5	4.2	3.5	2.9	36.0	19.6	19.0	1.4	1.6	1.8	12.5	10.8	9.1	11.0%	1.7

Source: Bloomberg, company data, CICC Research

Figure 14: P/E and P/B bands



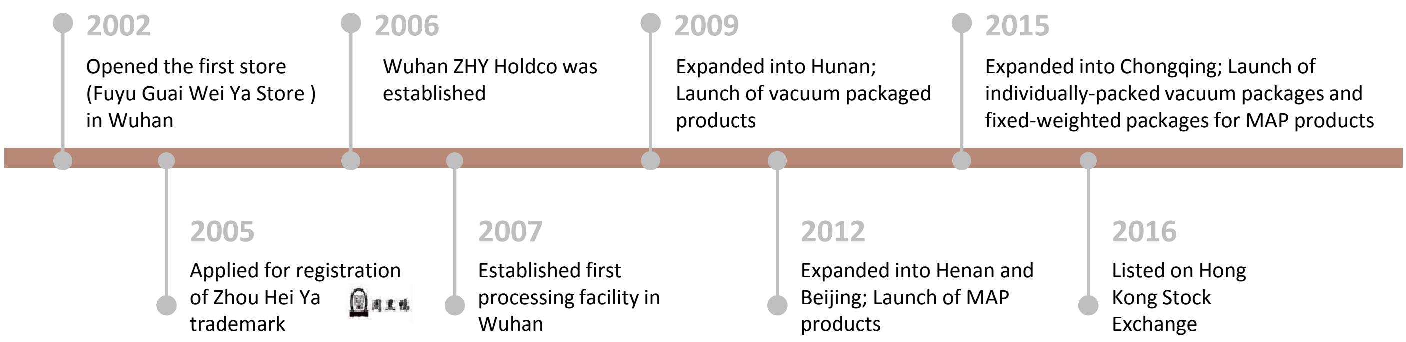


Source: Bloomberg, company data, CICC Research

Appendix

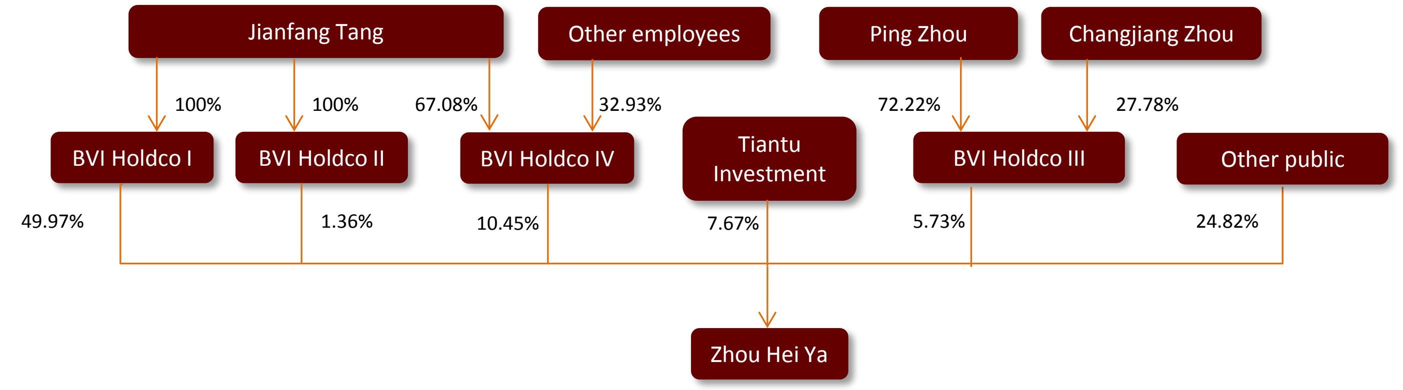
Company profile

Figure 15: Company history and milestones



Source: Company data, CICC Research

Figure 16: Company's current shareholding structure



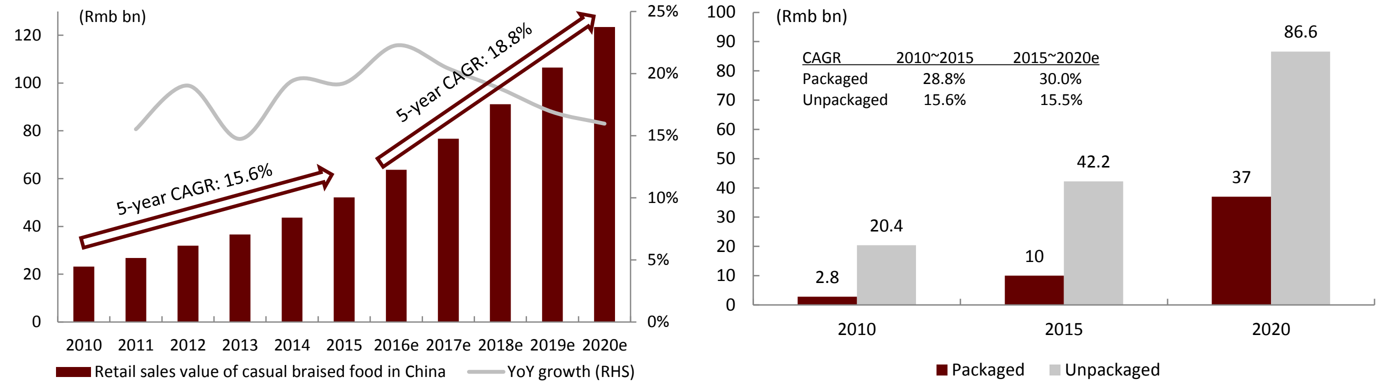
Source: Company data, CICC Research. Note: Jianfang Tang is Mr. Zhou Fuyu's wife; Ping Zhou is Mr Zhou's sister and Changjiang Zhou is Mr. Zhou's brother

Figure 17: Company's current product mix

Source: Company data, CICC Research

Industry overview

Figure 18: Market size and growth of casual braised food



Source: Frost& Sullivan, CICC Research

Figure 19: Market concentration and main competitors

	Market share	No. of stores	No. of self-operated stores	Business model	Products
Juewei	8.9%	7200	128	Short shelf life+Central plant	Braised duck, chicken, pork, beef and other meat products; braised vegetables, aquatic products, soy products, etc
Zhou Hei Ya	5.5%	734	716	Short shelf life+Central plant	Duck and duck by-products, braised vegetables, aquatic products, soy products, beef, crayfish
Ziyan	2.7%	1480	1405	Semi-finished goods processed in store	Accompaniments cold dishes, braised foods
HSH	2.6%	2560	180	Short shelf life+Central plant	Braised meat products (including ducks, chickens, geese, pork, beef, mutton and other aquatic products, vegetables, and soy products) and table vegetables
Liaoji	1.3%	480	340	Semi-finished goods processed in store	Accompaniments cold dishes, casual braised foods

Note: Market share data is based on 12-month sales value until June 2016; the numbers of stores and self-operated stores are based on 2016 data
Source: Frost& Sullivan, CICC Research;

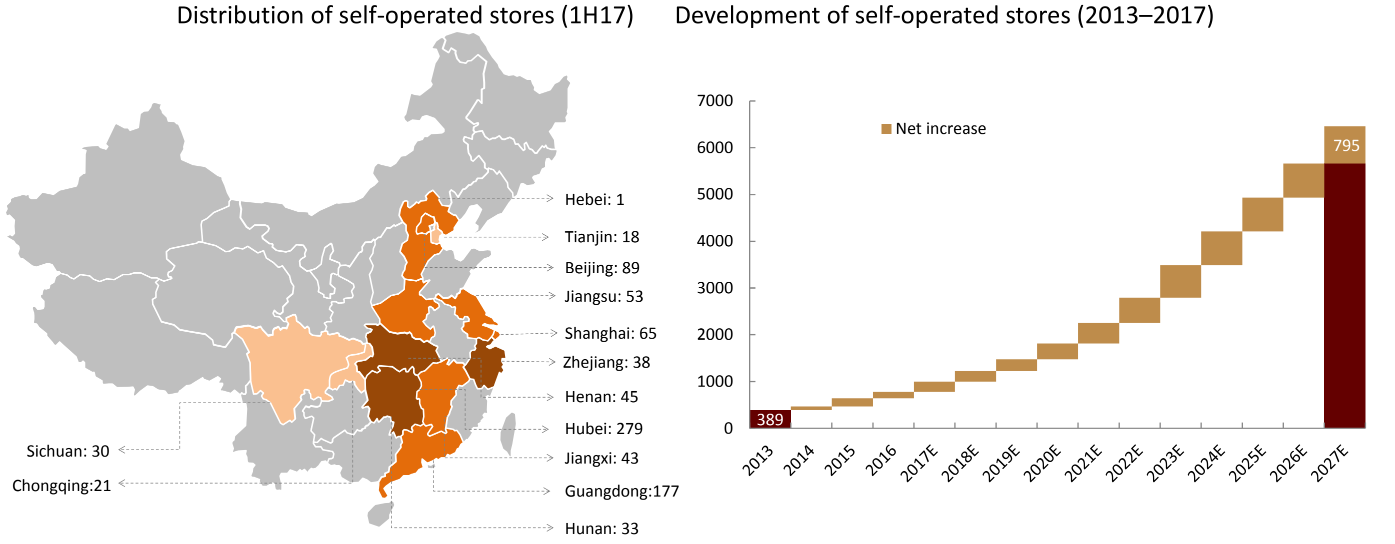
Figure 20: Comparisons with direct compatible products

Company	Brand	Products	Packaging	Pricing	Business model	2016 revenue (Rmb mn)
Zhou Hei Ya		Duck and duck by-products, braised vegetables, aquatic products, soy products, beef, crayfish	Short shelf life: MAP Long shelf life: vacuum packaging	MAP packaging: Duck neck Rmb35.9/320g; Vacuum packaging: Duck neck Rmb24.9/215g	Opening self-operated stores; by end-1H17, no. of stores: 892; Short shelf life+Central plant	2,816
Juewei		Braised duck, chicken, pork, beef and other meat products; braised vegetables, aquatic products, soy products, etc	Short shelf life: unpackaged, MAP Long shelf life: vacuum packaging	Unpackaged: Duck neck Rmb39.8/500g; MAP packaging: Duck neck Rmb23.8/200g; Vacuum packaging: Duck neck Rmb21.8/200g	Self-operated stores+franchised stores; by end-1H17, no. of stores: 8610; Short shelf life+Central plant	3,274
HSH		Braised meat products (including ducks, chickens, geese, pork, beef, mutton and aquatic products, vegetables, and soy products) and table vegetables	Short shelf life: unpackaged, MAP Long shelf life: vacuum packaging	Unpackaged: Duck neck Rmb24.8/500g; MAP packaging: Duck neck Rmb28.8/260g; Vacuum packaging: Duck neck Rmb29/250g	Self-operated stores+franchised stores; by end-1H17, no. of stores: 2560; Short shelf life+Central plant	1,218
Jingwu		The main products are duck products, while extending to pork, beef and vegetarian dishes	Short shelf life: unpackaged, MAP Long shelf life: vacuum packaging	Unpackaged: Duck neck Rmb35/500g; MAP packaging: Duck neck Rmb30/350g; Vacuum packaging: Duck neck 25.8/250g	Self-operated stores+franchised stores; ~2000 stores nationwide; Short shelf life+Central plant	~200-300mn
Jiujiuya		Braised meat products (including ducks, chickens, geese, pork, beef, mutton and aquatic products, vegetables, and soy products) and table vegetables	Short shelf life: unpackaged, MAP Long shelf life: vacuum packaging	Unpackaged: Duck neck Rmb33.8/500g; MAP packaging: Duck neck Rmb28/290g; Vacuum packaging: Duck neck Rmb39.9/420g	Self-operated stores+franchised stores; ~1000 stores nationwide; Short shelf life+Central plant	~400-500mn

Source: Frost& Sullivan, CICC Research

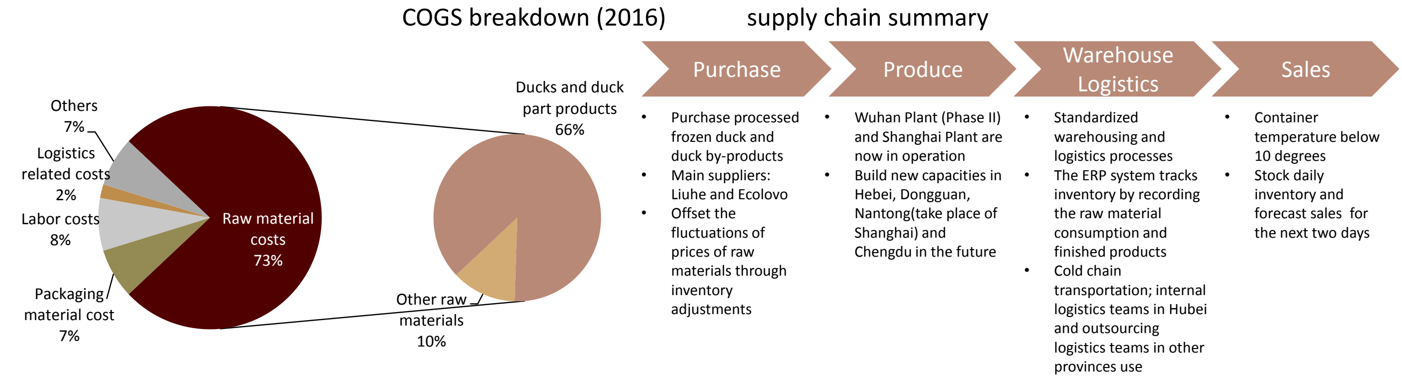
Operating data

Figure 21: Distribution of self-operated stores at end-1H17 and the store development (2013–2017)



Source: Frost& Sullivan, CICC Research

Figure 22: COGS breakdown and supply chain summary



Source: Frost& Sullivan, CICC Research

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