China Retail

Convenience Stores
The beauty of small format retailers

December 2015
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Executive summary

• Convenience stores (CVS) is the fastest-growing retail format among all other retail formats in China, but the development of CVS in China is still unbalanced.

• The development of CVS along coastal areas is more mature and concentrated than in inland areas.

• Most leading players in China’s CVS sector are regionally based. Currently, there is no national leader.

Trends

1. Implementing O2O initiatives
   • Providing pick-up services in-store
   • Establishing cross-border e-commerce platform
   • Accepting mobile payment
   • Selling via social networks

2. Offering more fresh food products

3. Private label is the key differentiator

4. Providing tailored services for local communities

5. Retailers of other formats to tap the CVS sector
Overview

- The emergence of small format shops, convenience stores (CVS) and community stores has gained popularity over the years. As smaller-scale retailers, convenience stores have the advantage of closer access to customers, while offering quicker services.
Overview

• CVS is the fastest-growing retail format among all other retail formats in China.
  – According to Kantar Retail, sales revenue of CVS in 2014 reached 40.8 billion yuan, more than
double the sales in 2009.
  – The number of stores reached 26,345*, doubling the store number in 2008.
  – CVS is expected to continue its growth momentum, as smaller retail format is gaining popularity in
China’s retail market recently.

Exhibit 1 | Sales revenue of CVSs, 2008 – 2014 (estimates),
million yuan

Exhibit 2 | Store counts of convenience stores, 2008 – 2014 (estimates)

* Excluding forecourt retailers such as Easy Joy and uSmile
Overview (Cont’d)

- Labour cost has increased rapidly over recent years, accounting for more than 60% of the total operating costs
  - CVS operators spent the most on wages. According to a survey by China Chain Store and Franchise Association (CCFA) and Deloitte*, labour expenditures accounted for 60.0% of total costs of surveyed enterprises in 2014, down from 61.2% in 2013. Rental contributed the largest increase at 15.9% yoy, compared to 7.6% yoy increase in labour costs and 6.7% yoy increase in utilities in 2014 (see Exhibit 3).
  - As shown in Exhibit 4, total number of staff decreased by 2.2% yoy in 2014, while labour cost increased by 7.6% yoy, indicating that the increase in wages was still significant in 2014.

Exhibit 3 | Cost structure for CVS in China, 2013 – 2014

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rentals</td>
<td>167M</td>
<td>194M</td>
</tr>
<tr>
<td>Labour costs</td>
<td>370M</td>
<td>398M</td>
</tr>
<tr>
<td>Utility fees</td>
<td>67M</td>
<td>71M</td>
</tr>
</tbody>
</table>

Exhibit 4 | Major KPI for CVS, 2013 – 2014

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>Yoy change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue (billion yuan)</td>
<td>4.5</td>
<td>4.7</td>
<td>4.4%</td>
</tr>
<tr>
<td>Store number</td>
<td>1,490</td>
<td>1,580</td>
<td>6.0%</td>
</tr>
<tr>
<td>Operating area (sqm)</td>
<td>417,000</td>
<td>429,000</td>
<td>2.9%</td>
</tr>
<tr>
<td>Number of staff</td>
<td>7,220</td>
<td>7,060</td>
<td>-2.2%</td>
</tr>
</tbody>
</table>


* The survey by the China Chain Store and Franchise Association covered 41 major CVS chains.
Competitive landscape

• The development of CVS in China is still unbalanced.
  – Guangdong and Shanghai have the highest store concentration, each with more than 5,000 stores.
  – Generally speaking, the development of CVS along coastal areas is more mature and concentrated than in inland areas. At the same time, the development of CVS in the Southern region is more mature than in the Northern region.

Exhibit 5 | Store count by provinces for CVS in China, February 2015

Source: Kantar Retail
Competitive landscape (Cont’d)

- CCFA released the “Convenience Store Service Index 2015” in May 2015. The index is a ranking of service level of CVS in different provinces. It is compiled based on store density, store growth rate, convenience, and supportive policies in the city.
  - Shenzhen and Guangzhou ranked the first, followed by Nanning, Dalian, Shijiazhuang, and Shenyang. This shows that the service of CVS in Shenzhen and Guangzhou is relatively more mature than in other cities.

<table>
<thead>
<tr>
<th>City</th>
<th>Index</th>
<th>City</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shenzhen</td>
<td>90.0</td>
<td>Wuhan</td>
<td>77.0</td>
</tr>
<tr>
<td>Guangzhou</td>
<td>90.0</td>
<td>Xiamen</td>
<td>74.0</td>
</tr>
<tr>
<td>Nanning</td>
<td>88.0</td>
<td>Changsha</td>
<td>73.0</td>
</tr>
<tr>
<td>Dalian</td>
<td>84.0</td>
<td>Kunming</td>
<td>72.0</td>
</tr>
<tr>
<td>Shijiazhuang</td>
<td>84.0</td>
<td>Qingdao</td>
<td>72.0</td>
</tr>
<tr>
<td>Shenyang</td>
<td>84.0</td>
<td>Hangzhou</td>
<td>70.0</td>
</tr>
<tr>
<td>Hohhot</td>
<td>82.0</td>
<td>Xi'an</td>
<td>68.0</td>
</tr>
<tr>
<td>Nanjing</td>
<td>82.0</td>
<td>Chongqing</td>
<td>68.0</td>
</tr>
<tr>
<td>Taiyuan</td>
<td>81.0</td>
<td>Urumqi</td>
<td>67.0</td>
</tr>
<tr>
<td>Beijing</td>
<td>78.7</td>
<td>Harbin</td>
<td>64.0</td>
</tr>
<tr>
<td>Shanghai</td>
<td>78.7</td>
<td>Yinchuan</td>
<td>64.0</td>
</tr>
<tr>
<td>Wenzhou</td>
<td>78.0</td>
<td>Tianjin</td>
<td>63.0</td>
</tr>
<tr>
<td>Dongguan</td>
<td>77.3</td>
<td>Fuzhou</td>
<td>60.0</td>
</tr>
<tr>
<td>Chengdu</td>
<td>77.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: China Chain Store and Franchise Association
Leading players

- Most leading players in China’s CVS sector are regionally based. Currently, there is no national leader.
  - Meiyijia is the market leader in terms of store count, with 6,390 stores in Guangdong*; followed by Tianfu, Gongxiao and Jialian, Sun-high, and Quik.

Exhibit 7 | Top convenience store operators by number of stores, 2014

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Enterprise</th>
<th>Convenience store brand</th>
<th>Country of origin</th>
<th>Store location</th>
<th>No. of stores in 2014</th>
<th>Yoy growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sinopec Group</td>
<td>Easy Joy</td>
<td>China (Beijing)</td>
<td>National</td>
<td>23,730</td>
<td>1.8%</td>
</tr>
<tr>
<td>2</td>
<td>PetroChina Co. Ltd.</td>
<td>uSmile</td>
<td>China (Beijing)</td>
<td>National</td>
<td>15,000</td>
<td>7.1%</td>
</tr>
<tr>
<td>3</td>
<td>Dongguan Sugar &amp; Liquor Group Meiyijia Convenience Store Co., Ltd.</td>
<td>Meiyijia</td>
<td>China (Guangdong)</td>
<td>Guangdong</td>
<td>6,390</td>
<td>14.5%</td>
</tr>
<tr>
<td>4</td>
<td>Guangdong Tianfu Chain Business Co., Ltd.</td>
<td>Tianfu</td>
<td>China (Guangdong)</td>
<td>Guangdong</td>
<td>2,568</td>
<td>11.7%</td>
</tr>
<tr>
<td>5</td>
<td>Zhejiang Gongxiao Supermarket Ltd.</td>
<td>Gongxiao; Jialian</td>
<td>China (Zhejiang)</td>
<td>Zhejiang</td>
<td>2,125</td>
<td>0.1%</td>
</tr>
<tr>
<td>6</td>
<td>Guangdong Sun-high Convenience Stores Co., Ltd.</td>
<td>Sun-high</td>
<td>China (Guangdong)</td>
<td>Guangdong</td>
<td>2,070</td>
<td>21.6%</td>
</tr>
<tr>
<td>7</td>
<td>Shanghai Lianhua Quik Convenience Stores Co., Ltd.</td>
<td>Quik</td>
<td>China (Shanghai)</td>
<td>Shanghai, Liaoning, Zhejiang, Beijing, Jiangsu</td>
<td>1,719</td>
<td>-9.8%</td>
</tr>
<tr>
<td>8</td>
<td>Nonggongshang Group</td>
<td>Kedi; Alldays</td>
<td>China (Shanghai)</td>
<td>Shanghai, Suzhou, Wuxi, Hangzhou</td>
<td>1,658**</td>
<td>-2.5%</td>
</tr>
<tr>
<td>9</td>
<td>Chengdu Hongqi Chain Co., Ltd.</td>
<td>Hongqi</td>
<td>China (Chengdu)</td>
<td>Sichuan</td>
<td>1,577</td>
<td>8.0%</td>
</tr>
<tr>
<td>10</td>
<td>C&amp;U Group</td>
<td>Shizu; Zhishang</td>
<td>China (Zhejiang)</td>
<td>Zhejiang</td>
<td>1,557</td>
<td>4.4%</td>
</tr>
<tr>
<td>11</td>
<td>Suguo Supermarket Co., Ltd.</td>
<td>Suguo</td>
<td>China (Nanjing)</td>
<td>Nanjing, Hefei, Anhui, Jiangsu</td>
<td>1,342</td>
<td>12.7%</td>
</tr>
<tr>
<td>12</td>
<td>Shanxi Taiyuan Tangjiu Supermarket Co., Ltd.</td>
<td>Tangjiu</td>
<td>China (Shanxi)</td>
<td>Shanxi</td>
<td>1,340</td>
<td>7.2%</td>
</tr>
</tbody>
</table>

Source: China Chain Store and Franchise Association, modified by Fung Business Intelligence Centre

* Excluding the stores of forecourt retailers Easy Joy and uSmile
** Estimated value
Leading players (Cont’d)

- In general, foreign CVS chains are more active in expanding nationally, while domestic enterprises are mostly regionally focused.
  - Japanese CVS chain Lawson has presence in Shanghai, Hangzhou, Ningbo, Jiangyin, Wuxi, Zhenjiang, Beijing, Dalian and Chongqing;
  - Family Mart, another Japanese CVS chain, has stores in Shanghai, Guangzhou, Suzhou, Wuxi, Chengdu, Hangzhou, Beijing, Dongguan and Shenzhen.
  - By contrast, domestic players tend to focus their operations in areas near their places of origin. For instance, Tianfu operates mainly in Guangdong, Hongqi in Sichuan, and Suguo in Nanjing.
Leading players (Cont’d)

- Many retailers often adopt a multi-format strategy, hoping to leverage the sourcing capabilities of stores across different retail formats.

- According to a survey by Deloitte and CCFA, 60% of the surveyed sample* are multi-format operators.

**Better Life Group** operates supermarkets, department stores and electric appliance specialty stores, and recently it has rolled out its “Yunhou Wifi convenience stores” programme in June 2015. The Yunhou Wifi convenience stores, located in residential communities, not only sell goods, but also provide courier services, fresh breakfast, and offline payment services, etc.

**CR Vanguard** has been operating in multi-format for long, involving in hypermarket, supermarket, premium supermarket and convenience store operations. In September 2015, it added the "Tesco Express" brand to its portfolio, offering fresh food products to local communities.

* The survey by the Deloitte and China Chain Store and Franchise Association covered 206 major retail enterprises in China.
Implementing O2O initiatives

CVS is transforming to stay relevant in the “Internet Plus” era. Given the vast network of stores, CVS can better support O2O initiatives. Providing pick-up services in-store, establishing cross-border e-commerce platform, accepting mobile payment, selling via social networks are some of the examples. That said, many CVS chains are still testing the waters for O2O services.

However, retailers should beware that CVS’s core competence still lies in suitable product offerings at good quality and price. CVS needs to focus on choosing right product offerings, and providing good quality of goods and services.
Since 2013, major CVS chains including Family Mart, Dongguan Meiyijia, Taiyuan Tangjiu have teamed up with online retailers to provide pick-up services. CVS chains can benefit from the potential increase in customer flow, while online retailers can offer additional pick-up option for customers and enjoy lower logistics costs.

Source: Company websites
Convenience Retail Asia’s subsidiaries FingerShopping Limited and Circle K Convenience Store work together to tap the cross-border O2O market. FingerShopping.com, the e-commerce platform operated by FingerShopping Limited, has begun to roll out its cross-border e-commerce business in Circle K convenience stores in China. Currently, there are over 400 types of Japanese and Korean beauty products on FingerShopping.com. Users can make online purchases or scan codes in Circle K convenience stores to place orders. The products can be delivered to mainland users through direct shipping from Hong Kong, or picked up by the users in Hong Kong.

Source: Circle K China Sina Weibo
Japanese CVS chain Lawson Inc. has reached a cooperation agreement with Alipay. In August 2015, over 400 Lawson convenience stores in Jiangsu, Zhejiang and Shanghai started to accept Alipay.

Source: Lawson Shanghai Sina Weibo
In April 2014, Quik started to sell their merchandise via social networks by allowing their franchisees to open micro-stores on WeChat. Quik also offer home delivery services to consumers making orders on WeChat from the stores nearby.

Source: Company website
Trends
Offering more fresh food products

Some community CVS stores are putting more focus on fresh foods such as vegetables, fruits etc. Selling fresh foods may be a new growth point for CVS, but additional investments in cold chain logistics and storages are needed.

An increasing number of CVS chains are offering fresh food products to attract footfall. Since the profit margin of fresh food produce is low, the proportion of these products sold at CVS is usually small.
Trends
Offering more fresh food products (Cont’d)

CP Fresh Mart enters the China market

- Since April 2015, the CP Group, a Thailand-based conglomerate, has opened several “CP Fresh Mart” in Shanghai, Chengdu, Wuhan, Zhengzhou, Beijing.
- The stores focus on selling fresh foods such as eggs, meat, and frozen seafood.
- Light meals are also offered and customers can also eat in-store.
- CP Group plans to open 50 “CP Fresh Mart” in Beijing in 2016.

Source: CP Group, Chaoshi Weekly
Trends
Offering more fresh food products (Cont’d)

Tesco Express focuses on fresh food products

In CR Vanguard's Tesco Express, around 30% of the operation area is for selling fresh food products.

Source: CR Vanguard official website
Trends
Offering more fresh food products (Cont’d)

**Easy Joy sells fruits in selected stores**

Easy Joy Convenience Store has started selling fruits in selected stores in Beijing since July 2015.

*Source: Sinopec website*
Trends
Private label is the key differentiator

Many CVS operators are developing their own private labels or importing unique goods to differentiate themselves with competitors. According to CCFA, 60% of CVS operators have launched their own private labels, but the share of private labels in the total sales is low at around 5%.

Share of private labels in the total sales is low

Quik’s private label products accounted for only around 3.5% of the total sales.

Source: Company website
CVS is the most relevant format serving local communities. Instead of offering standardized products and services, CVS can better understand its target customers and provide tailor-made services for them. Specifically, CVS can provide goods and services suitable for the elderly, families, or university students in nearby areas.

**Family Mart in Beijing offers delivery services and partners with catering services companies**

- Family Mart in Beijing offers delivery service for selected commercial districts and buildings.
- It also partners with third-party catering services companies such as Baidu Takeaway, Meituan Takeaway, Ele.me to provide take-away services.

*Source: Company websites*
Trends
Retailers of other formats to tap the CVS sector

Eyeing the success of small format shops, some traditional retailers have branched out into smaller-scale stores. By adopting a multi-format strategy, they hope to expand their business scope and create multiple income streams.

Compared with large-scale stores, smaller outlets provide a quicker and more convenient shopping experience for customers. Many retailers opened community stores recently to serve residents in neighbourhoods. Many retailers, especially the supermarket and hypermarket players, are actively entering the CVS format leveraging their sourcing ability and supplier network.
Carrefour steps into the CVS sector

• Carrefour opened its first convenience store "Easy Carrefour" in China in November 2014. This is a unique format only for the China market.
• "Easy Carrefour" is a community store with store size around 400 sqm, selling approximately 4,000 SKUs.
• As of September 2015, there are three "Easy Carrefour" stores in Shanghai.

Source: Fung Business Intelligence Centre
Conclusions

• FBIC believes that the CVS sector will continue its high growth momentum in the coming two to three years, given its eagerness to roll out various O2O initiatives and its willingness to innovate and change according to the needs of the market.

• Meanwhile, CVS chains with precise and unique positioning, particularly those targeting local communities, have been growing rapidly, offering convenient lifestyle to the surrounding neighbourhoods.

• Some CVS operators reflected that there is insufficient government support for the sector in some cities, which make them difficult to launch new services.

• In addition, high labour turnover and high training costs remain a significant challenge for CVS players.

“While facing governments restrictions for launching catering services in CVS in some cities, some domestic CVS chains also encounter operational problems along their own supply chain when launching catering services. Moreover, even within the same city, policies for different enterprises may vary.

According to a survey by CCFA, among the 27 surveyed cities, only two cities reflected that they had received high level of support from the local governments. “

-- Pei Liang, CCFA Secretary General
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