Yonghui Superstores – the vanguard of China’s grocery market

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Teresa Lam, Christy Li
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Introduction

The “New Retail” concept is constantly reshaping China’s retail sector. In today’s consumer-driven arena, many traditional retailers are actively transforming to cater to the needs of modern consumers. Among them, Yonghui Superstores Co., Ltd. (Yonghui) understands the essence of transformation in the “New Retail” era and embraces change accordingly; it is certainly a pioneer of reform in China’s grocery sector.

Yonghui keeps on evolving its businesses – from operating only supermarkets targeting the mass market to launching premium supermarkets and rolling out new retail formats with O2O concepts at the core of its transformation. This article discusses Yonghui’s latest developments in the “New Retail” era, and also includes Fung Business Intelligence’s observations from our store visits.

Background

Founded in 2001, Yonghui is the fifth largest hypermarket chain operator in China in 2016 according to China Chain Store and Franchise Association. It ranked 140th in Fortune China’s list of Top 500 listed companies in China in 2016, the highest among other supermarket chains. Yonghui was listed on the Shanghai Stock Exchange in 2010. Headquartered in Fuzhou, the company operated a total of 549 stores cross the mainland China as of June 2017, covering 20 provinces including Fujian, Zhejiang, Guangdong, Chongqing, Guizhou, Sichuan, Beijing, Shanghai, Tianjin, Hebei, Shanxi, Anhui, Jiangxi, Jiangsu, Henan, Shaanxi, Heilongjiang, Jilin, Liaoning, and Yunnan. Yonghui’s sales revenue in 2016 reached 49.2 billion yuan, up 16.82% yoy. Gross profit margin rose form 19.83% in 2015 to 20.19% in 2016. Exhibits 1 and 2 show the store coverage and the store numbers of Yonghui.
Yonghui continues to pursue an aggressive expansion plan. It hopes to open 80 – 100 new stores each year going forward. It is also actively launching new format stores to adapt to the changing needs of consumers.
Yonghui’s major businesses

Yonghui operates four major businesses, including its main supermarket business, innovative retail formats under “New Retail” regime, B2B online platform focusing on fresh products, and supply chain finance business (Exhibit 3). In this article, we only focus on the retail business of Yonghui.

Exhibit 2: Business scope of Yonghui, as of 2017

Retail business

The supermarket segment is Yonghui’s core business. The company operates two supermarket brands, namely Yonghui Superstores (永辉超市) (so-called Red Label store, 红标店) and Bravo YH (so-called Green Label store, 绿标店). Yonghui is also actively exploring new formats as part of its O2O push under the “New Retail” regime. Launched in 2015, Yonghui Life (永辉生活) is an O2O initiative of Yonghui. It consists of smaller format convenience stores including YH Select (永辉优选) and Yonghui Membership Store (永辉会员店), and its Yonghui Life App. In 2017, Yonghui launched another new format named YH Super Species (超级物种), which focuses more on catering and experiential elements while offering fresh produce.
Yonghui Superstores (Red Label store)

Yonghui Superstores (Red Label store) is the flagship brand of Yonghui. As of June 2017, there were 357 Red Label stores in China. The Red Label stores can further be classified into three types of stores according to store size and location – community stores, supermarkets, and hypermarkets, all targeting the mass market. Since 2015, Yonghui has been working on transforming selected Red Label stores into Green Label stores according to store size and store location.

Bravo YH (Green Label store)

Bravo YH or Green Label store is generally smaller than the Red Label store with an operating area of around 12,000 sqm. It targets the mid to high-end income group and offers more premium products, thus its sales per sqm are 20-30% higher than the Red Label stores. According to Yonghui, revenue growth for Red Label stores is less than 2.5% yoy, but it can reach over 11% yoy for Green Label stores. Yonghui is reportedly increasing the proportion of its Bravo YH stores in its brand portfolio by either converting some of its Red Label stores into Green Label stores, or opening new stores. Indeed, Bravo YH has been growing at a fast pace since 2015, from 55 stores in December 2015 to 99 stores in December 2016 and further to 132 stores in June 2017. However, not every Red Label Store can be converted into Green Label store due to the store location and store size. Exhibit 4 shows the number of Red Label Stores and Green Label stores of Yonghui from 2011 to 2016.

Exhibit 4: Number of Red Label Stores and Green Label Stores of Yonghui, 2011 - 2016

Source: Annual reports of Yonghui, compiled by Fung Business Intelligence
Launched in 2015, Yonghui Life is the O2O initiative of Yonghui. It combines its offline and online operations – convenience stores under the brand name of “Yonghui Membership Store”, “YH Selects” and the Yonghui Life App. As of June 2017, there were 51 Yonghui Membership Stores and four YH Select stores across the country. Recently, some of the stores have been grouped under the convenience store brand “Yonghui Life”. With an operating area of around 100 sqm, each convenience store has approximately 800 SKUs of fresh food including fruits, vegetable, meat, and other daily necessities. Consumers can pay with Yonghui Life App, Yonghui’s WeChat Mini Program and other third party payment tools. Consumers can shop in-store and have their orders delivered to their home in 30 minutes within a distance of 3-km from the store.

Together with the offline stores, Yonghui Life also launched a new app to integrate its online and offline businesses. Selected Yonghui stores from all formats and brands in Fuzhou, Shanghai, Beijing, Nanjing, etc. are linked with the Yonghui Life App. Wide variety of fresh food, fruits, seafood, and meat are available for purchase on the App. Members can track their orders, read the feedback of others, scan the product barcodes, share products to WeChat. They can also earn discounts and download coupons. Members can enjoy home delivery services or pick up their orders in-store.
YH Super Species

YH Super Species is the latest smaller-sized supermarket format launched by Yonghui Superstores. The first store was launched in Fuzhou in January 2017. As of October 2017, there were 11 YH Super Species stores in China – five in Fuzhou, three in Shenzhen, one in Beijing, one in Xiamen, and one in Nanjing. YH Super Species is one of the pioneers in operating a new and innovative format which focuses on catering services and fresh food offerings. With an operating area of 500 - 800 sqm, each YH Super Species store sells mainly fresh products, including seafood, frozen food, fruits, meet and vegetables as well as selected dry food products. The stores feature a large catering area as well as various quick-service stalls selling different products, such as beef, lobster and seafood, fish and sushi, bread, etc. The food stalls are self-operated by Yonghui. They source fresh food directly from upstream suppliers. Customers can purchase fresh products from the food stalls and take them back home, or have them cooked by the chefs and consume in the catering area. Customers can pay with Yonghui shopping card, and third-party payment tools such as WeChat Pay, Alipay and Unionpay. Currently, cash is not accepted. Customers can also make purchases via the Yonghui Life App with wider product selections. Customers who live within 3-km distance from the store can receive the order in 30 minutes.

Previously, YH Super Store is operated as standalone store. Since July 2017, Yonghui has trialed the store-in-store concept by opening the first YH Super Species inside a Bravo YH store in Nanjing. It is believed that co-location of the two stores could drive foot traffic to both stores. Yonghui revealed that it plans to open 24 YH Super Species by the end of 2017.

Exhibit 5 shows the development timeline of the retail businesses of Yonghui as of October 2017

Exhibit 5: Development timeline of Yonghui, as of October 2017

Source: Yonghui website; designed by Fung Business Intelligence
Key highlights of Yonghui’s development and strategies

Yonghui’s ability to sell fresh products tops the industry

(1) High margin of fresh products

Yonghui’s increasing focus on fresh products is crucial to differentiating its merchandise offerings and strengthening customer stickiness. It has strong ability to directly source huge variety of fresh products for its stores. Fresh products account for around 45% of the total revenue of Yonghui, which is the highest among its major competitors. The gross profit margin for fresh products of Yonghui reached 12.81% in 2015, much higher than other supermarkets which also focus on fresh food – e.g. 9.5% for New Huadu and 11.54% for Sanjiang Shopping Club. The gross profit margin of Yonghui further increased to 13.35% in 2016.

(2) Strong sourcing team

Yonghui has a strong sourcing team of more than 2,500 buyers to procure products domestically and overseas. Yonghui directly sources from farms, allowing the retailer to get unique and good quality products at cheaper costs. Thus, Yonghui’s fresh produce sourcing costs can be much lower than its peers.

(3) Well-developed logistics infrastructures

As of December 2015, Yonghui has 12 distribution centers in China in Fujian, Chongqing, Anhui, Sichuan, Beijing, Henan, Hebei, Dongguan, Hangzhou, Shenyang, Jiangsu and Shanghai to ensure the freshness of its products. The company revealed in its 2016 Annual Report that it plans to build more facilities for cold-chain logistics in the coming years.

Private label development is set to accelerate

Yonghui has a division to develop private label products. Although private labels currently comprise only 2% of Yonghui’s sales, Yonghui will continue to scale up its sales of private labels, targeting to have more than 5% of the total sales coming from the sales of private labels in 2017.
Collaborations with other companies to strengthen sourcing capability, private label and O2O development

(1) Dairy Farm

In August 2014, Dairy Farm International and Yonghui Superstore signed an acquisition agreement. Dairy Farm International acquired a 19.99% stake in Yonghui Superstore for US$909 million. The transaction was approved in March 2015. Dairy Farm further acquired shares in Yonghui Superstores for about US$190 million in August 2015 to maintain its shareholding at 19.99%, after JD.com bought back 10% share in August 2015. The two companies collaborate on procurement, private label products, fresh food processing and store development.

(2) JD.com

In August 2015, JD.com acquired 10% of the share capital of Yonghui Superstores market for approximately 4.3 billion yuan when the two sides signed a strategic cooperation framework agreement. They will explore joint procurement, integrated supply chain management capabilities, O2O businesses, and retail financial services. The collaboration allows Yonghui to join hands with JD Daojia, JD.com's O2O platform which connects nearby supermarkets with consumers, to deliver fresh produce directly to users at home; while JD.com can strengthen its fresh produce business.

(3) Daymon Worldwide

In January 2017, Yonghui Superstores teamed up with Bain Capital Private Equity to buy U.S. retail services group Daymon Worldwide Inc. for US$413 million. Yonghui invested US$165 million for a 40% stake in Daymon, while Bain Capital bought 60%. Daymon's expertise ranges from private brand development to strategy and branding, sourcing and logistics, retail merchandising services and to consumer experience marketing. By acquiring Daymon, Yonghui can further accelerate the process of private label development. It can also strengthen Yonghui's global supply chain capability from a long-term perspective.

(4) Zhongbai Holdings

In October 2014, Yonghui and Zhongbai Holdings signed a strategic cooperation framework agreement to jointly develop their core businesses and work together in areas such as resource management, network and information systems, and logistics. In April 2017, the two companies were in talks to set up a JV with registered capital of 100 million yuan. In July 2017, Zhongbai Holdings announced that Chongqing Yonghui, a subsidiary of Yonghui Superstore, further purchased shares of the company. Yonghui Superstore and its subsidiaries including Chongqing Yonghui and Yonghui Logistics, together hold 25% of the equity interest of Zhongbai. Representative of Yonghui can sit on Zhongbai's board of directors. Zhongbai is a leading player in Hubei's retail market. Having more control in Zhongbai, Yonghui can have more influence in Zhongbai's strategic decisions which can benefit the cooperation of Zhongbai and Yonghui.
Members are the key to Yonghui’s success

Yonghui is actively expanding its membership base and luring its members as they account for around 40% of the total sales of Yonghui. As of December 2016, there were 17 million members, of which 72.5% were offline members, 10.9% were App members, 8.6% were web members, and 8% were WeChat members. Yonghui offers discounts and coupons exclusive to its members. Different promotions are offered to members in different channels. In the “New Retail” regime, many retailers are combining online and offline membership bases. Yonghui, however, did not mention if it would merge the membership in different channels in the near future though.

Partnership program to motivate store managers

Yonghui has rolled out a partnership program since 2014. Store managers act as partners and take initiatives to set the growth target and operational plans of individual stores. Store managers are motivated by the profit sharing scheme.
Store visit and observations from Fung Business Intelligence

YH Super Species

Fung Business Intelligence visited YH Super Species’ first store in Beijing in October 2017. The store is located in a community area in Lugu, an hour away from the city centre of Beijing. This is the first YH Super Species store in Beijing. We visited the store on a weekday morning; foot traffic was not very high at the time we visited, only some customers choosing seafood and walking around. Foot traffic was much higher in Bravo YH, the supermarket co-located with YH Super Species.
As observed, the store has an operating area of around 700 sqm and sells around 1,500 SKU, mainly fresh food in the food stalls and limited offerings of imported goods. There are seven sections in the store – namely lobster stall, salmon stall, Boxbeef (beef stall), Wheat Works (bakery stall), Cheers to Joy (wine stall), fruit section, and flower section. Limited SKU of imported products can also be found in YH Super Species. Most people gathered around the seafood sections during the time of our visit.
There is a spacious catering area in-store, locating near the food stalls. It can accommodate around 200 people.

The QR code of Yonghui Life app is displayed in-store for consumers to trial convenient online order and home-delivery. Product QR code is also printed on the product tag. Consumers can scan the QR code for product information or make purchase via the Yonghui Life App. Consumers who live within 3-km distance from the store can receive the order within 30 minutes.
Yonghui Life

Fung Business Intelligence visited Yonghui Life in Shanghai recently on a weekday afternoon. The store operates around the clock. With an operating area of around 100 sqm, the store sells mainly fresh products such as vegetables, fruits, meat, daily necessities and wine. This is a community store where most of the customers are residents living nearby or workers working in the vicinity. Quite a lot of people shopping around when we visited the store.

As observed, some products are packed with the unique packing of Yonghui Life – an orange banner on the package and with the QR code linking to its app. Product QR code is also printed on the product tag. During the time of our visit, Yonghui offered discounts for consumers who scanned the QR codes. Consumers could download the e-coupons via the app and presented to the staff at the checkout counter. It is believed that Yonghui can collect more consumer data via these kinds of O2O campaigns."
Comments from Fung Business Intelligence

Yonghui has always been innovative and constantly introducing new ideas and retail formats, from Red Label store to Green Label store, and further to Yonghui Life and YH Super Species. To stay relevant in the rapidly evolving retail market, Yonghui continues to closely follow the changing needs of consumers, and also the trend of consumption upgrade.

Despite being a forerunner to ride the “fresh supermarket” wave, Yonghui is facing fierce competition from other grocery retailers. Many of them are launching new retail formats to go “fresh” and “experiential”. Selected examples of “fresh supermarkets” in China include Hema Xiansheng, Sp@ce, Hai Wu Hui, Fresh Ideas, RISO, Benlai Experiential Store, and Jingxuan Future Store. Competition is getting intense in this new battleground. Please refer to our *“New Retail” in Action – Issue 6 Going “fresh” and “experiential”* for details.

Among which, Alibaba’s Hema Xiansheng is considered one of YH Super Species’s major competitors, as they both focus on catering service and fresh food in community areas. Exhibit 6 compares the two companies.

At the same time, Yonghui is also facing intensifying competition from online grocery retailers. Internet giants are expanding fast in the fresh food market. For instance, JD.com has set up its supermarket channel chaoshi.jd.com, and Tmall has launched its supermarket channel chaoshi.tmall.com. They roll out aggressive promotions from time to time, especially during online shopping festivals. Yonghui’s alliance with JD.com will be able to put itself into a better position to compete in the market. Meanwhile, Yonghui has been extending its offline network to online in recent years via Yonghui Life and YH Super Species. It also cooperates with JD Daojia to lure consumers to purchase on the app.

Fung Business Intelligence believes that Yonghui’s relentless efforts to scale up its stores network and enhance operational leverage, raise its O2O capacity to tap prosperous online grocery sector, and diversify its product sourcing, store positioning, brand names, store sizes to better adapt to regional customer demand will provide ample room for the company to seize more market shares ahead.
### Exhibit 6: Comparison of YH Super Species and Hema Xiansheng, as of October 2017

<table>
<thead>
<tr>
<th></th>
<th>YH Super Species</th>
<th>Hema Xiansheng</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Launched date of first store</strong></td>
<td>• 2017-01-01</td>
<td>• 2016-01-15</td>
</tr>
<tr>
<td><strong>Background</strong></td>
<td>• Leverage on other formats of Yonghui and have the support from JD.com</td>
<td>• Launched by Alibaba; a pioneering example of “New Retail”</td>
</tr>
<tr>
<td><strong>Number of stores as of October 2017</strong></td>
<td>• 11 (Fuzhou 5, Shenzhen 3, Beijing 1, Xiamen 1, Nanjing 1)</td>
<td>• 20 (Shanghai 13, Beijing 3, Ningbo 1, Hangzhou 1, Guiyang 1, Shenzhen 1)</td>
</tr>
<tr>
<td><strong>Store size</strong></td>
<td>• ~500-800 sqm</td>
<td>• ~4,000-10,000 sqm</td>
</tr>
<tr>
<td><strong>SKUs</strong></td>
<td>• ~1,500</td>
<td>• &gt;5,000</td>
</tr>
<tr>
<td><strong>Store formats</strong></td>
<td>• Independent store</td>
<td>• Standalone store</td>
</tr>
<tr>
<td></td>
<td>• Store inside Bravo YH</td>
<td></td>
</tr>
<tr>
<td><strong>Logistics/ last-mile delivery</strong></td>
<td>• Backed by the logistics team of Yonghui</td>
<td>• Focus on delivery efficiency, stores serve as warehouse for online orders, with automatic conveyor belt systems in-store</td>
</tr>
<tr>
<td></td>
<td>• 30 minutes within 3 km</td>
<td>• 30 minutes within 3 km</td>
</tr>
<tr>
<td><strong>Food stalls</strong></td>
<td>• Food stalls are operated independently; flexible to mix and match the food stalls according to consumer needs in different stores</td>
<td>• Some food stalls are self-operated and some are operated by third-parties</td>
</tr>
<tr>
<td></td>
<td>• Self-operated by Yonghui</td>
<td>• Larger area selling fresh products</td>
</tr>
<tr>
<td></td>
<td>• Smaller area selling fresh products</td>
<td></td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>• Alipay</td>
<td>• Alipay</td>
</tr>
<tr>
<td></td>
<td>• WeChat Pay</td>
<td>• Cash (for some stores)</td>
</tr>
<tr>
<td></td>
<td>• Yonghui’s shopping card</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Unionpay</td>
<td></td>
</tr>
<tr>
<td><strong>Development goals</strong></td>
<td>• Opens 80-100 new stores each year going forward</td>
<td>• 2,000 stores in 10 years</td>
</tr>
</tbody>
</table>

Source: Fung Business Intelligence
References

1 "Dairy Farm completes investment in Yonghui Superstores to acquire a 19.99% interest", 12 April 2015, Seeking Alpha. 
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Contacts

Asia Distribution and Retail

Teresa Lam
Vice President
E: teresalam@fung1937.com

Christy Li
Senior Research Manager
E: christyli@fung1937.com

Fung Business Intelligence
10/F LiFung Tower
888 Cheung Sha Wan Road
Kowloon, Hong Kong
T: (852) 2300 2470
F: (852) 2635 1598
E: fbicgroup@fung1937.com

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