

## Client Update

# China's e-commerce companies are eating the big grocers' lunch

November 2021

The country's biggest bricks-and-mortar grocery chains are fighting back against online competition.

The pandemic has accelerated certain long-term shifts in consumer behaviour, such as using more online orders for everything from clothing to food. The latest battleground appears to be groceries, but the disrupter emerged from a not-so-new technology – WeChat groups.

China's online e-commerce giants such as Meituan<sup>1</sup> and Pinduoduo are now taking market share from the traditional grocers via community group buying (CGB), which began only four years ago and went mainstream during Covid-19. In this form of e-commerce, leaders of WeChat groups – or other platforms which recently entered the market – collect orders and have the goods delivered the next day to pick-up spots in their members' communities. In between, the orders are aggregated by the platforms and transmitted to the upstream suppliers which deliver the goods.

This offers many long-term benefits for platform companies – a sticky user base, last-mile delivery for fresh groceries, and penetration into lower-tier cities. But the downside is the price competition that has heated up, causing margins to be minimal or even negative in many cases.

At first, three start-ups – Xingsheng Youxuan, Nice Tuan and Tongcheng – emerged as regional leaders. By the middle of 2020, this model gained wide adoption after meeting consumers' demand for fresh groceries during the lockdown. That's when Didi, Meituan and Pinduoduo entered the market with significant financial backing, making the landscape more challenging for all players.

We are also watching the traditional grocers, which are investing into technology and fighting back as the new underdogs. These include Yonghui and Sun Art, two of China's largest retail supermarket chains.

For **Yonghui**, new CEO Li Songfeng brings a technology background, having joined earlier this year as Chief Technology Officer after 10 years at JD. This shows the company's focus is on technology going forward, as it aims to increase digitalisation to a level close to e-commerce platforms. Besides digitalisation, management's main goal this year is to bring back lost traffic.

Management is also experimenting with warehouse membership stores, a concept similar to Sam's Club and Costco in the US. In Fuzhou where the company is headquartered, management converted 50 supermarkets into warehouse membership stores. As a result, Fuzhou's same-store sales accelerated but at the expense of margins.

What's encouraging is that the chairman bought significant shares in the open market recently, and has plans to buy more. The company has also been buying back and cancelling shares. In our view, this shows confidence in company's outlook, or at least alignment with shareholders.

In the case of **Sun Art**, management will continue to open new stores despite the challenging environment. Both mini stores and supermarkets are currently loss-making, while hypermarkets are facing a big profit decline.

Alibaba seems to have taken the driver's seat following its majority share purchase a year ago. Sun Art's digital transformation was given a boost from the resources and technology in Alibaba. For example, all of Sun Art's physical

<sup>1</sup> For illustrative purposes only. Reference to the names of each company mentioned in this communication is merely for explaining the investment strategy and First Sentier Investors does not necessarily maintain positions in such companies. Any fund or stock mentioned in this presentation does not constitute any offer or inducement to enter into any investment activity nor is it a recommendation to purchase or sell any security.

stores in China have been integrated into Alibaba's Taoxianda and Tmall Supermarket platforms, providing one-hour and half-day on-demand delivery.

New CEO Lin Xiaohai came onboard after being a Vice President at Alibaba. Out of the four non-independent directors, three are from Alibaba. While many grocers have received investments from the internet community (Tencent bought a 5% stake in Yonghui in 2017), Sun Art has embraced the motto, "If you can't beat 'em, join 'em."

### Keeping an eye on sector consolidation

The competitive environment remains tough for food retailers due to intense competition from CGB, and there are even signs of consolidation among CGB players. For example, Tongcheng Life filed for bankruptcy this year

and other companies are reducing their investments and laying off employees. However, internet giants such as Pinduoduo and Meituan continue to ramp up investments. Reported investments add up to RMB 100bn, which give these CGB platforms a big stomach for eating losses. As a result, price competition remains heated.

Despite gaining market share in online groceries, there have been numerous headwinds for the internet companies this year. There are also regulatory risks for the CGB model, from an anti-monopoly standpoint, so the tide is still shifting.

Looking ahead, Yonghui is still a highly competitive food retailer in China and has a big advantage in fresh food supply chain; however, we think it's too difficult to invest now with the disruption from CGB. Similarly with Sun Art, we prefer to stay on the sidelines but are keeping an eye on the sector.

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 October 2021 or otherwise noted.

#### **Important Information**

This material is solely for the attention of institutional, professional, qualified or sophisticated investors and distributors who qualify as qualified purchasers under the Investment Company Act of 1940 and as accredited investors under Rule 501 of SEC Regulation D under the US Securities Act of 1933 ("1933 Act"). It is not to be distributed to the general public, private customers or retail investors in any jurisdiction whatsoever.

This presentation is issued by First Sentier Investors (US) LLC ("FSI"), a member of Mitsubishi UFJ Financial Group, Inc., a global financial group. The information included within this presentation is furnished on a confidential basis and should not be copied, reproduced or redistributed without the prior written consent of FSI or any of its affiliates.

This document is not an offer for sale of funds to US persons (as such term is used in Regulation S promulgated under the 1933 Act). Fund-specific information has been provided to illustrate First Sentier Investors' expertise in the strategy. Differences between fund-specific constraints or fees and those of a similarly managed mandate would affect performance results. This material is provided for information purposes only and does not constitute a recommendation, a solicitation, an offer, an advice or an invitation to purchase or sell any fund and should in no case be interpreted as such.

Any investment with FSI should form part of a diversified portfolio and be considered a long term investment. Prospective investors should be aware that returns over the short term may not be indicative of potential long term returns. Investors should always seek independent financial advice before making any investment decision. The value of an investment and any income from it may go down as well as up. An investor may not get back the amount invested and past performance information is not a guide to future performance, which is not guaranteed.

Certain statements, estimates, and projections in this document may be forward-looking statements. These forward-looking statements are based upon First Sentier Investors' current assumptions and beliefs, in light of currently available information, but involve known and unknown risks and uncertainties. Actual actions or results may differ materially from those discussed. Actual returns can be affected by many factors, including, but not limited to, inaccurate assumptions, known or unknown risks and uncertainties and other factors that may cause actual results, performance, or achievements to be materially different. Readers are cautioned not to place undue reliance on these forward-looking statements. There is no certainty that current conditions will last, and First Sentier Investors undertakes no obligation to publicly update any forward-looking statement.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE PERFORMANCE.

Reference to the names of each company mentioned in this communication is merely for explaining the investment strategy, and should not be construed as investment advice or investment recommendation of those companies. Companies mentioned herein may or may not form part of the holdings of FSI.

For more information please visit [www.firstsentierinvestors.com](http://www.firstsentierinvestors.com). Telephone calls with FSI may be recorded.