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China E-commerce

Feeding China online

Online groceries are the next battleground and on track to become the second-biggest online retail category in China by 2022e

We believe it's also the best way for China's tech giants to capture new users but so far there's no business model that makes the economics work

We take a close look at Alibaba, JD and Meituan who are leading the pack; Pinduoduo and Dada are emerging players



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Fresh food, fresh opportunity

As Internet user growth slows (904m Internet users in China as of March 2020, up 6% from June 2019 and down from the 11% CAGR in 2008 to 2018), the major players are looking hard for the next leg of growth. They've already established themselves as leaders in online retail, advertising, travel and plenty of other areas. But the next big opportunity might not be an obvious one: fresh food + groceries. According to iResearch, online fresh food is valued at RMB280bn in 2019 (3% of online retail of physical goods GMV) and expected to grow more than double to reach RMB690bn (5% of online retail of physical goods GMV) in 2022e.

The reasons are fairly simple. The lockdowns caused by COVID-19 have sharply accelerated demand. It's still one of the least penetrated online areas in China at 3%, especially when compared to more developed markets like the UK at 7%. And what's especially attractive for China's large online players is that this is the one of best channels to acquire new users, especially those aged over 30. They typically become frequent buyers, using apps to buy fresh food twice or three times a week, and can also be cross-sold a wide variety of other products.

The main drawback is the inherently low profit margins. Delivering fresh food requires highly efficient delivery networks, sophisticated warehouses and cold-chain technology. All that costs money. We find some operators barely break even. This report looks this and also examines:

- **Monetization models:** direct sales, commissions or service fees
- **Delivery models:** **1)** delivery to your door from warehouses or physical stores, **2)** pickup at physical stores after an order online, or **3)** community group purchases where orders can be collected at a pickup point for bulk discounts.
- **Unit economics:** given the razor thin margins, we prefer platforms that have a technology advantage, a large user base, and fully fledged logistics infrastructure.

We also show why we see rural growth being the next growth area, what the rest of Asia is doing in this space, and take a close look at China's big three Internet platforms:

Alibaba (BABA US, USD275.29, Buy) has three advantages: **1)** multiple monetization models ranging from operating Freshippo, its mobile supermarket app, through to receiving commissions from transactions at Ele.me, its online food delivery service platform; **2)** users who buy online fresh food/grocery through Freshippo can then be cross-sold Alibaba's core retail marketplace which has higher margins; and **3)** can cross-sell online fresh food to existing customers on its online payment platform Alipay as well as local service platforms like Ele.me and Koubei. This will also help optimize its marketing spending and generate more targeted recommendations.

JD (JD US, USD75.00, Buy): Is uniquely positioned with its direct sales model and its supermarket business, China's largest by revenue in both online and offline, and of which was JD's single-largest category in 2Q. JD also leverages its strong supply chain capability with a self-operated nationwide logistics infrastructure made up of 176,000 delivery and warehouse personnel (as of 2019), along with 750+ warehouses in 2Q.

Meituan (3690 HK, HKD250.00, Buy): Most active in exploring various different formats like selling fresh food on its popular food delivery app and recently expanding into community group purchases. Revenue from its Meituan Grocery business climbed 4x in 2Q versus same period a year ago.

Competitive landscape at a glance

Exhibit 1: Alibaba has different formats and partners to target different types of shoppers and demographics

	Alibaba's ecosystem							
	Freshippo (盒马鲜生)	Freshippo Grocery (盒马菜市)	Freshippo Mini (盒马 Mini)	Freshippo F2 (盒马 F2)	Freshippo Pick'n Go (盒小马)	Freshippo Mall (盒马里)	RT-Mart Fresh (大润发优鲜)	Taoxianda (淘鲜达)
Launch time	Jan-16	Mar-19	Jun-19	Dec-17	Jul-19	Nov-19	Dec-17	Mar-18
Number of cities	21	3	2	1	1	1	200+	278
Number of stores	214 stores	5 stores	9 stores	1 store	7 stores	1 store	481 hypermarket complexes	800+ digitalized retail stores
Delivery area	3km	No	1.5km	No	No	3km	5km for all stores; 5-25km for 180 stores	5km
Delivery time target	30mins	N/A	30mins	N/A	N/A	30mins	60mins (5km), half-day (5-25km)	60mins (3km), 90mins (3-5km)
SKU	6,000-8,000	N/A	2,000 to 4,000	N/A	20-40	100,000	20,000	13,000-15,000
Per order value (RMB)	75 (online), 113 (offline) (Jul-18)	N/A	N/A	N/A	N/A	N/A	64	N/A
Online order %	>60% (Jun-20 Q)	N/A	50%+	N/A	N/A	N/A	15% in 2019	N/A
Sales productivity vs. traditional stores	5x more (Jul-18)	N/A	6x more (Jun-20)	N/A	N/A	N/A	N/A	N/A
Scale	daily avg. sales per mature store: RMB800,000 (Jul-18)	N/A	daily avg. sales per store with at least 3-mo operations: RMB200,000 (Jun-20)	N/A	N/A	N/A	Average Daily Order per Store: 1,000	N/A
Private label	10% of GMV (Aug-19)	N/A	N/A	N/A	N/A	N/A	N/A	N/A
% of Fresh Food SKU	15%	N/A	70%	N/A	N/A	N/A	N/A	N/A
AAC* (m)	Cross-sell to Alibaba's China retail marketplace's 742m							
MAU in Aug 2020 (m) - Per QuestMobile	15.3**	N/A	N/A	N/A	N/A	N/A	1.9**	N/A**
Differentiation	<ul style="list-style-type: none"> ◆ Mature stores (over 1.5 years operations) performance proven to be profitable ◆ More localized SKU offerings ◆ Better ROI than standard Freshippo store ◆ Position as convenience store ◆ Target quick meals ◆ Target integrated family needs and wide range of services ◆ Strong offline presence and operation know-know ◆ Technological, payment and delivery support from Alibaba's ecosystem ◆ Empower new retail partners with digitisation ◆ Digitalized 15% of Sun Art's sales in June-Q (up from 10% in Mar-Q) 							
Areas of improvement	Cross-sell with large e-commerce and local services user base; technological, logistics, inventory sourcing and payment support from Alibaba's ecosystem							
Revenue contribution	20% of Alibaba's total revenue (Jun-20 Q, from New Retail and direct sale businesses, including Tmall Supermarket, Freshippo, direct import and Intime)						15% of Sun Art's total revenue empowered by Alibaba (Jun-20 Q)	

Source: Questmobile, Ebrun, Wingshang, Sohu news, Sina news, company data, HSBC estimates

*Note: AAC stands for Annual Active Consumers

**Note: Freshippo and Taoxianda can also be accessed within Taobao app, RT-Mart Fresh can also be accessed on Weixin mini program.

Exhibit 2: Meituan (Meituan Grocery, Instashopping, Selected), JD (7FRESH, JD Jaojia), Tencent's investees (Missfresh) + Yonghui are key players in online fresh food...

	DingDong Grocery (叮咚买菜)	Tencent's investees Missfresh (每日优鲜)	Meituan Meituan Grocery (美团买菜)	Meituan Instashopping (美团闪购)	Meituan Selected (美团优选)	YH life (永辉生活)	Yonghui Super Species (永辉 超级物种)	Yonghui Mini (永辉 mini)	Dada JD Daojia (京东到家)	JD.com 7Fresh (京东七鲜)	JD.com 7Fresh Life (七鲜生活)	PDD Duoduo Maicai (多多买菜)
Launch time	May-17	Mar-16	Jan-19	Jul-18	Jul-20	Nov-15	Jan-17	Jan-19	Apr-15	Dec-17	Dec-19	Aug-20
Number of cities	6	278	4	2,800 cities/counties	8 cities as of 25 Sep 2020	156	10+	50	700+	7	1	2
Number of stores and warehouses	550 warehouses	1,000+ warehouses	c.165 warehouses + 30 self-pickup locations	N/A	N/A	46 warehouses + 177 stores	54 stores	500+ stores	89,000+ stores on JDDJ platform	22 stores	3	N/A
Delivery area	1km	3km	3km	N/A	N/A	3km	3km	3km	3km	3km	1.5km	N/A
Delivery time target	29mins	30mins	30mins	30mins	self pick up next day	30mins	N/A	N/A	60mins	30mins	N/A	self pick up next day
SKU	1,800	3,000-3,500 Target: 3,500-4,000 by 2021e	2,000	N/A	N/A	N/A	6,000-10,000	2,500-4,000	N/A	5,000-8,000	Huilongguan store: 3,000 Songjiazhuang store: 2,100	N/A
Per order value (RMB)	65 (end-2019)	85-90 before COVID-19 120 during COVID-19	N/A	Higher than Meituan's food delivery	N/A	N/A	N/A	N/A	117 (1Q20)	100 (Jul-18)	N/A	N/A
Online order %	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	100%	40% (May-19)	N/A	N/A
Sales productivity vs. traditional stores	N/A	3-5x more (Dec-2019)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3x more (May- 19)	N/A	N/A
Scale	Daily orders (Dec-19): 500k+; GMV: RMB5bn (2019)	Peak daily order per warehouse: 3,000 (Nov-19) Total monthly orders: 6m by Sep-19	N/A	2m daily orders (Aug-20)	N/A	Daily orders per warehouse: 2,000 (Nov-19)	N/A	Monthly sales T12M GMV of per store: RMB16bn as RMB1.4m (in 1H19)	N/A	N/A	N/A	N/A
Private label	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	60% of fresh food SKU	N/A	N/A
% of fresh food SKU	N/A	N/A	N/A	N/A	N/A	50%	N/A	60%	N/A	70%	70+%	N/A
AAC* (m)	N/A	N/A	457m annual transacting users for Meituan overall; 360m in food delivery			N/A	N/A	N/A	32m	417m (JD)		683m (PDD)
MAU in Aug 2020 (m) - Per QuestMobile	16**	8.8**	1.8**	N/A**	N/A**	3.1**	N/A	N/A	10**	0.2**	N/A	N/A**

Source: Company data, Questmobile, HSBC

*Note: AAC stands for Annual Active Consumers

**Note: DingDong Grocery, Missfresh, Meituan Grocery, Meituan Selected, YH life, JD Daojia, 7Fresh and Duoduo Maicai can also be accessed on Weixin mini program; Meituan Grocery, Meituan Instashopping and Meituan Selected can also be accessed within Meituan app, JD Daojia and 7Fresh can also be accessed within JD app, Duoduo Maicai can also be accessed within PDD app and PDD mini program..

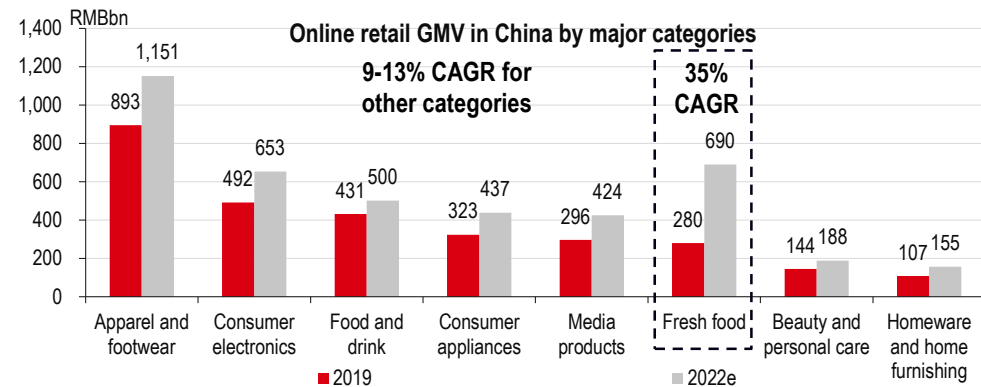
Exhibit 3: ...and they differentiate themselves by a number of ways

	DingDong Grocery (叮咚买菜)	Tencent's investees Missfresh (每日优鲜)	Meituan Grocery 1P (美团买菜)	Meituan Instashopping 3P (美团闪购)	Meituan Selected Group Buy (美团优选)	YH life (永辉生活)	Yonghui Super Species (永辉超级物种)	Yonghui Mini (永辉 mini)	Dada JD Daojia (京东到家)	JD.com 7Fresh (京东七鲜)	7Fresh Life (七鲜生活)	PDD Duoduo Maicai (多多买菜)
Differentiation	<ul style="list-style-type: none">◆ Stronger coverage in Eastern China◆ Front warehouses can cover more smaller communities that large stores cannot cover	<ul style="list-style-type: none">◆ Early starter in the front warehouse model◆ More warehouses than peers◆ Front warehouses can cover more communities that large stores cannot cover	<ul style="list-style-type: none">◆ Strong offline operation knowhow supports its execution◆ Front warehouses can cover more communities that large stores cannot cover	Relative to its other two models: 1) higher margins with minimal inventory risks, 2) more SKUs, 3) more cities are covered	<ul style="list-style-type: none">◆ Strong offline operation knowhow supports its execution◆ Tencent's support enables the use of the Weixin ecosystem to promote products and facilitate ordering	<ul style="list-style-type: none">◆ Strong offline presence and operation know-how◆ Strong supply chain capability with high-margin private label product sales reaching RMB2bn in 2019◆ Cooperation with major Internet players including Tencent and JD			<ul style="list-style-type: none">◆ Cooperation with JD Retail, leading supermarket chains (incl. Walmart and CR Vanguard) and brand owners◆ Strong delivery network on Dada Now (with 634k+ annual active riders as of 1Q20)◆ Wide city coverage: last-mile/intra-city delivery covering 2400+/1000+ cities	<ul style="list-style-type: none">◆ Cross sell to JD's e-commerce user base (417m as of 2Q)◆ Strong supply chain capability with extensive years of experiences in direct sales, and expertise in procurement to select the best available SKUs vs marketplace model◆ Self-operated nationwide logistics infrastructure that can improve order economics by leveraging its 176,000 delivery and warehouse staff and 750+ warehouses	<ul style="list-style-type: none">◆ Strategic investments in the agricultural value chain◆ High user engagement as reflected in highest DAU/MAU ratio◆ PDD started as group purchase, social commerce on Weixin	
Areas of improvement	Yet to turn profitable at overall level	Yet to turn profitable at the overall level	1P direct sales model; lots of operating leverage required to breakeven, but better assurance of product quality and customer services	3P marketplace model; high platform and reputational risk with product quality and authenticity of third-party merchants	Late starter compared to industry peers	<ul style="list-style-type: none">◆ Lack of user traffic◆ Digitalization and technology capability			<ul style="list-style-type: none">◆ Lack of traffic vs peers who can cross sell and leverage their large user base	<ul style="list-style-type: none">◆ Lower sales productivity vs peers' offline stores (7Fresh is 3x more efficient than traditional stores vs Freshippo which is 5x more efficient than traditional stores)◆ Fewer offline stores	<ul style="list-style-type: none">◆ Late starter vs peers;◆ Lack of supply chain capability and logistics infrastructure	
Revenue contribution	N/A	N/A	Online grocery: 4.6% contribution in Meituan's total revenue (Jun-20 Q, HSBCe)			"To-home" business: c.10% of total revenue (1H20)			JDDJ: 37% of Dada's total revenue (Jun-20 Q)	Supermarket (FMCG+fresh food): 20% of JD's total revenue (2019) and is the single largest category		N/A

Source: Company data, HSBC estimates

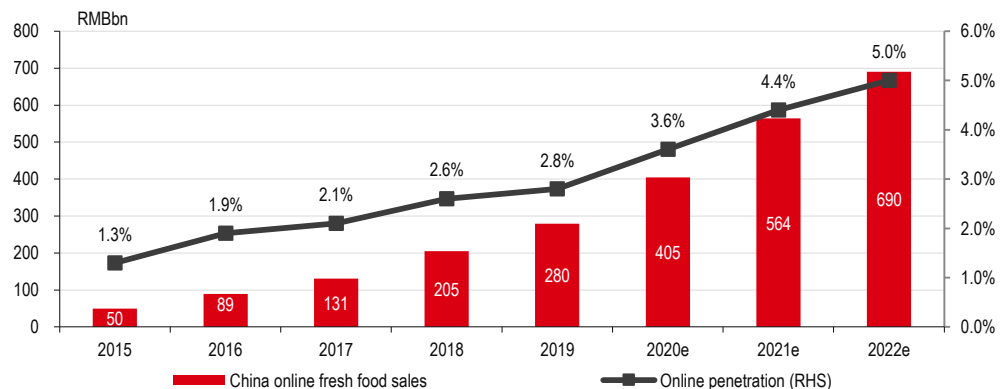
The story in seven key charts

Exhibit 4: China's fresh food e-commerce market has the fastest growth among major online categories and should become the No. 2 online retail category by 2022e



Source: Euromonitor, iResearch

Exhibit 5: China's fresh food e-commerce markets set to be worth RMB690bn by 2022e



Source: iResearch

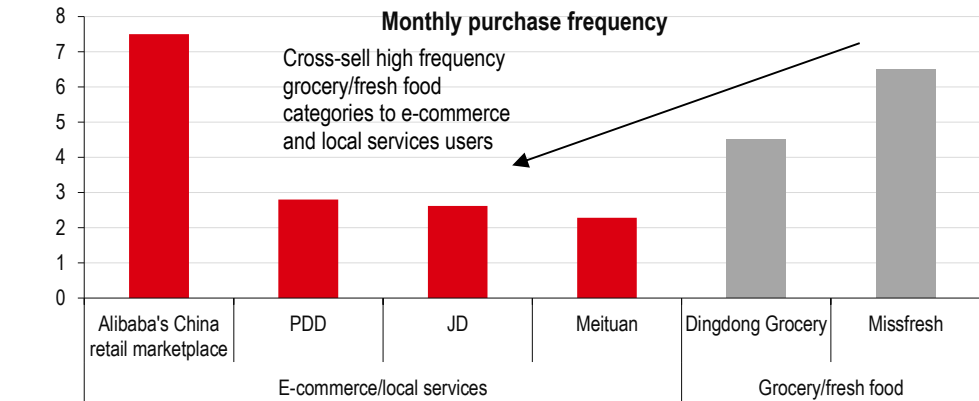
Exhibit 6: Online fresh food orders surged during Chinese New Year when COVID-19 was near its peak

	Name	Chinese name	Business model**	Y-o-y growth
Alibaba	Freshippo	盒马鲜生	To-store & to-home	Orders grew 220% y-o-y from the start of COVID-19, according to Ebrun on 16 Feb
	Ele.me	饿了么	Platform to-home	Online fresh food orders in Beijing grew nine times y-o-y during CNY, according to Ele.me on 5 February 2020
Tencent and JD*	WeChat mini program	微信小程序	N/A	The number of transactions for fresh food grew 149% y-o-y during 24-31 Jan
	JD Fresh	京东生鲜	Omni-channel	Online fresh food gross merchandise volume (GMV) grew 215% y-o-y from 24 Jan-2 Feb
	JD Daojia	京东到家	Platform to-home	GMV grew 470% y-o-y during CNY, as per the company on 2 Feb 2020
	Missfresh	每日优鲜	Front warehouse	Platform GMV grew 321% y-o-y during 24-28 Jan 2020
	YH Life	永辉生活	To-store & to-home	Orders at its "to home" business in Fuzhou rose 450% y-o-y with GMV up 600% y-o-y during 24-30 Jan 2020
Meituan	Meituan Grocery	美团买菜	Front warehouse	Daily orders in Beijing grew two to three times more than the pre-CNY period, according to BJnews on 2 Feb 2020
	Meituan	美团外卖	Platform to-home	N/A
Others	Pupu	朴朴超市	Front warehouse	N/A
	Dingdong Grocery	叮咚买菜	Front warehouse	Daily orders grew three to four times during CNY, according to 36kr on 20 Feb 2020

Source: Company news. * JD is 17.8% owned by Tencent as of May 2020. **We explain the different business models on p.9.

Online grocery/fresh food has huge growth potential as it rides on cross-selling by the major platforms

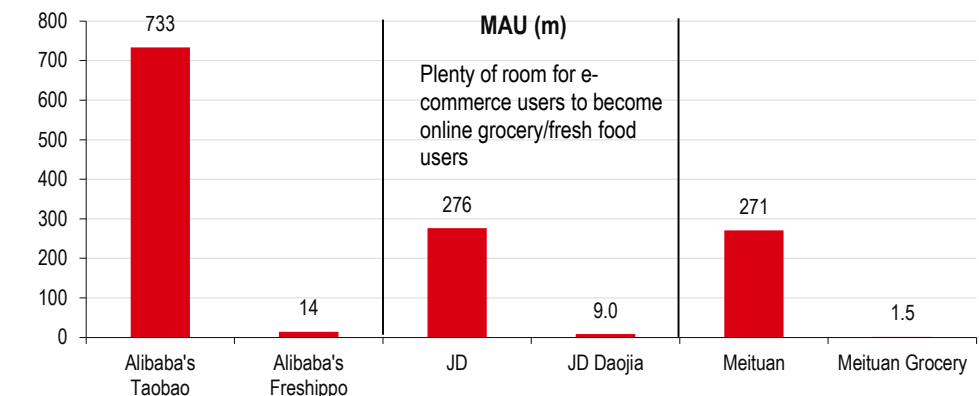
Exhibit 7: Grocery/fresh food platforms have a higher purchase frequency than e-commerce/local services platforms



Source: Company data, Ebrun, HSBC

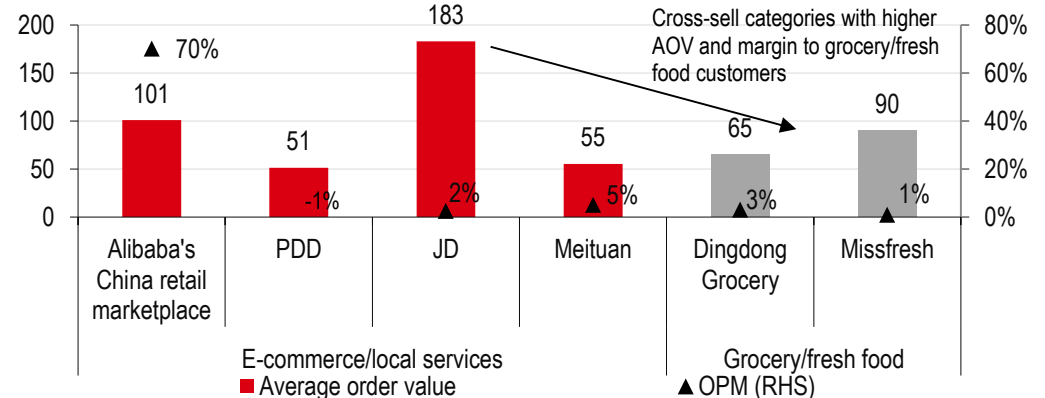
Note: For Alibaba, we used FY18 data for no. of orders and divide by 12; For JD, we used FY18 data for no. of orders per year and divide by 12; for others, we used FY19 data

Exhibit 8: Most e-commerce users are yet to order online groceries



Source: Questmobile. Data as of July 2020

Exhibit 9: E-commerce categories like apparel with high average order values (AOVs) and margins can be cross-sold to online grocery customers



Source: Company data, Ebrun, HSBC estimates

Note: For Alibaba: we used FY18 data for no. of orders and FY20 data for GMV to compute AOV and CY2019 data for adj. core of core commerce EBITA margin (excluding strategic investments); For JD: we used FY18 data for no. of orders and FY19 data for GMV per user to compute AOV and FY19 data for adj. OPM of JD retail. For others, it is based on FY19 data.

Exhibit 10: Comparison of Asian internet, e-commerce and online grocery metrics

Country	Population (m)	Internet usage		E-commerce				Grocery		% of consumers purchasing groceries online - 2020	Major online supermarkets/supermarkets with an online presence
		Internet users (m)	Internet users as a % of population	Online retail sales of goods (USDbn)	Online retail penetration in GMV (%)	E-commerce users (m)	E-commerce users as a % of population	Online grocery market size (USDbn)	Grocery online penetration in GMV (%)		
Mainland China	1,394	904	65%	1,223	21%	710	51%	40	2.8%	70%	Freshippo, Tmall Supermarket, Sun Art, Missfresh, Dingdong Grocery, 7Fresh, JD Daojia, Meituan Grocery
Korea	52	46	90%	117	29%	36	69%	15	7.4%	58%	Coupang, E-Mart
Southeast Asia	583	407	70%	38	7%	140-150	24%-27%	N/A	N/A	N/A	
Indonesia	271	171	63%	19	10%	35-40	13%-15%	N/A	N/A	45%	blibli.com, GrabMart, HappyFresh, sayurbox, TaniHub, Shopee, Lazada, GoFresh
Malaysia	32	26	82%	3	5%	11-15	34%-47%	N/A	N/A	N/A	Tesco Online, The Hive, Happy fresh, Jaya Grocer, GrocerExpress, BIGBox Asia, TM Farms, GrabMart, Lazada, Shopee
Philippines	108	79	73%	2	4%	40-45	37%-42%	N/A	N/A	N/A	LazMart, MetroMart, WalterMart, Landers, GrabMart, Shopee
Singapore	6	5	89%	2	9%	4	70%	N/A	N/A	N/A	Redmart (Lazada), Fairprice, GrabMart, Shopee
Thailand	70	57	82%	5	4%	15-20	21%-29%	N/A	1.5%*	44%	HappyFresh, honestbee, Delishop, Big C, Passion Delivery, Tesco Lotus, Tops, GrabMart, Lazada, Shopee
Vietnam	96	69	71%	3	2%	25-30	26%-31%	N/A	0%*	63%	Chopp, TELIO, Hellomam, Fruits Supermarket, Raucusach, GrabMart, Lazada, Shopee
India	1,366	560	41%	34	5%	N/A	N/A	N/A	4.1%*	64%	Big Basket, Amazon Pantry/Fresh, Milk Basket
Taiwan	24	22	93%	12	11%	N/A	N/A	N/A	N/A	N/A	Sinon, Momo, Shopee

Source: CNNIC, NBS, iResearch, Bain Company, KOSIS, United Nations, Euromonitor, Internetworldstats, HSBC

*Note: For Thailand, Vietnam, India, fresh food online penetration rate are in terms of retail volume according to Euromonitor.

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A competitive landscape

- ◆ As online grocery competition heats up, we examine the different business models followed by Alibaba, JD and Meituan...
- ◆ ...but given the complex dynamics, none have proven to be the best
- ◆ Rural areas are likely to be the next growth engine

Up until recently, ordering fresh food and groceries wasn't a priority for China's online giants. Margins were low, delivery is expensive and they had other priorities to focus on. But COVID-19 sharply accelerated demand for online groceries amid the lockdowns, and it's now become a new battleground. Like we highlighted in the introduction, we believe it's the best way for Internet giants to acquire new users who can then sell them other items in their vast ecosystems.

In this report, we take a close at the major players (Alibaba, JD and Meituan), how COVID-19 supercharged the industry, why rural areas are the next growth engine, how margins can be juiced, and finally what the rest of Asia is doing. But first we begin by looking at the different business models. So far none has proven to be the best and there's still plenty of pain points still to be solved – from how to control spoilage to how to keep users.

Exploring the most optimal
delivery method...

Competition is divided into three camps...

There are three major apps – Freshippo (Alibaba), Missfresh (invested in by Tencent) and Dingdong Grocery (independent) – with each illustrating three different models. Freshippo is the self-operator model where an Internet giant runs it and finds online grocery shopping attractive given the synergies with other parts of its empire. Plus Internet giants are very efficient in terms of logistics and delivery. Another model is like Missfresh where Tencent has invested in it and then lets it run the business with a fair amount of autonomy. A third example is Dingdong Grocery who does it all by themselves without backing from tech giants.

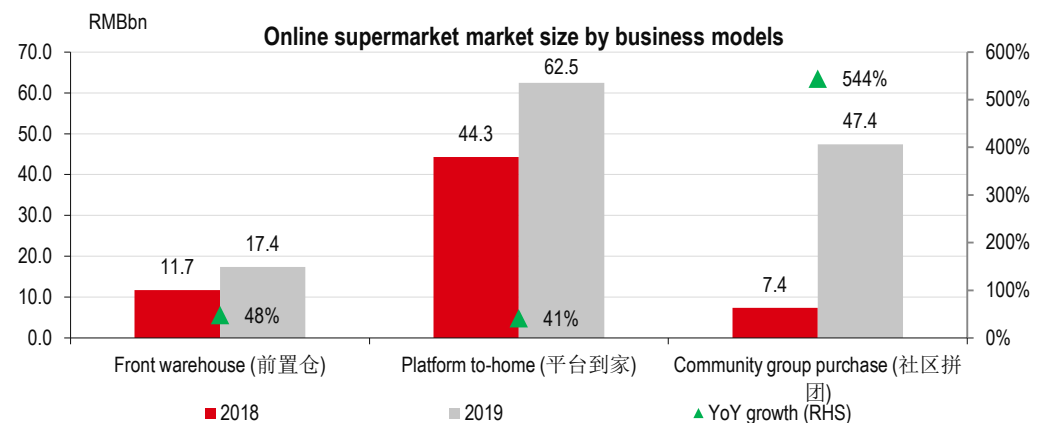
...while there are four delivery methods

- **Front warehouse** (前置仓) (RMB17bn GMV in 2019) – customers order online and the platform delivers products in under an hour to homes using their own small warehouses that are within a 1-3km radius of users. This is an asset heavy model and uses a direct sales model. **Examples:** Missfresh, Dingdong Grocery and Meituan Grocery.
- **Platform to-home** (平台到家) (RMB62bn GMV) – customers order online and the platform delivers products to homes within one-to-two hours using their partners' physical stores like supermarket, retailers and convenience stores. This is an asset-light model as it uses a marketplace platform. **Examples:** JD Daojia, Ele.me and Meituan.
- **Community group purchases** (社区拼团) (RMB47bn GMV) – local residents place orders in Weixin chat/social groups and can then collect their products at a pick-up point. **Examples:** Meituan Selected, PDD's Duoduo Maicai and Xingsheng Selected.

- **To-store & to-home (到店+到家)** – customers can either order online and have products delivered to their home or they can pick up at the store, or they can go to physical stores to buy it themselves. **Example:** Freshippo.

We believe users in top-tier cities prefer home delivery given its convenience and because they typically work long hours. Those in lower-tier cities generally prefer self-pickup given it is cheaper.

Exhibit 11: Community group purchases surged during 2019 given the lower user acquisition costs and minimal inventory risk leveraging on Weixin



Source: iResearch

Exhibit 12: A comparison of Meituan and PDD's recently launched community group purchase models for groceries

	Meituan Selected	Duoduo Maicai	
Online purchase time period: 00:00-23:00	美团优选 选购指南 在线下单 每天可购买商品时间: 00:00-23:00	多多买菜 选购指南 在线下单 每天23:00前下单, 商品次日送达	Online purchase time period: before 23:00
Next-day delivery to offline stores for self pick up	物流配送 每天物流会为您将自购的商品, 配送到您下单所选的团长门店	物流配送 每天16:00前物流会为您将自购的商品, 配送到您购买时选择的自提门店	Next-day delivery by 16:00
Self pick up time: after 16:00	门店自提 每天16点提货 (团长不同, 提货时间可能会有差异, 详见社群通知)	门店自提 每天16:00后可以提货 (不同的门店提货时间可能会有差异, 详见门店社群通知)	Self pick up time: after 16:00
After-sale service provided by community leader 团长	售后无忧 如果您购买的商品有任何问题, 请直接与团长联系, 团长将为您妥善处理	售后无忧 如果您购买的商品有任何问题, 请您直接与您提货的门店联系, 门店将为您处理, 让您售后无忧!	After-sale service provided by offline stores
After-sale service provided by platform	全国热线 若您找不到下单时所选的团长, 请致电美团优选平台热线, 电话: 4000919699		

Source: App screenshots, HSBC

Meituan

- ◆ **Meituan Instashopping (美团闪购):** This leverages Meituan's popular food delivery app by selling a wide range of other items on it, including fresh food and groceries. This covers a wide geography across China and is known as the "marketplace" model, where Meituan charges a commission rate to sellers and an on-demand delivery fee to consumers. Compared to Meituan Grocery, Meituan Instashopping might have better profitability as it does not bear inventory risk and has more SKUs with categories like flowers, medicines and charging cables. Meituan Instashopping had 2m daily orders in August and focuses on operating an online marketplace for small to medium enterprises (SMEs). Meituan's understanding of SME merchants in food delivery also creates synergies for this business. In

Meituan has developed diversified business models

the past few quarters, subsidies it provided have led to losses but without subsidies, it can break even. Going forward, as this model expands into more cities and the selection increases, losses should widen. But in the long term, this business should reach breakeven or even turn profitable.

The direct sale model that has inventory risks and targets higher tier cities

- ◆ **Meituan Grocery (美团买菜):** Users can access this function via Meituan's main app or standalone app called "Meituan Maicai" or Meituan Grocery shopping, which started in cities like Beijing and Shenzhen, and expanded into Guangzhou in 2Q20. This is known as the "self-operated" front warehouse 前置仓 model, with offerings tilted towards fresh food. It focuses on higher-tier cities (Beijing, Shanghai, Guangzhou and Shenzhen) and targets less-price sensitive customers who value Meituan's brand endorsement, high quality products and quick delivery. It is incurring huge losses due to subsidies and expenses that have yet to create operating leverage. As the average order value (AOV) and repeat purchases improve, operating efficiency should rise. Compared to the other two models, it has the lowest margin as it bears inventory risk. Meituan is also focussing on increasing warehouse capacity and improving order densities.

The marketplace community purchase model that targets lower-tier cities

- ◆ **Meituan Selected (美团优选):** This brand just launched in Jinan (Shandong province) in July 2020 and leverages the community-group buying model by offering carefully-selected fresh produce and daily necessities at attractive prices for consumers in various local communities. Meituan chooses the group leaders for each community to promote discounted grocery products via Weixin chat groups. Group members can place orders via Meituan's Weixin mini programs and pick up the products at points near convenience stores the next day. While this model can operate in both higher and lower-tier cities, Meituan focuses on expanding in lower-tier cities as it suits the value proposition for users in these cities for inexpensive and popular products. A marketplace model like Meituan Instashopping and Selected could have higher margins than Meituan Grocery, which uses the direct sales model. Meituan Selected needs to operate small warehouses and delivery logistics (no last-mile delivery though). It has even less product selection than Meituan Grocery (as it focuses on inexpensive and popular items) and is also tilted to fresh food. The target demographics are those who do not order food delivery and instead cook from fresh at home with inexpensive ingredients. Currently Meituan is focusing on ramping up its scale, marketing and lowering the commissions to attract users. Hence in the near term, losses are likely to remain large. Some other industry players using this model are in breakeven mode currently. Meituan aims for breakeven in the long term and success also depends on the group leader who runs the business in each community (Meituan also has experience in this front).

Alibaba

Alibaba develops sub-formats under Freshippo and empowers its partners

Alibaba has established various sub-brands under its mobile-first supermarket brand Freshippo – like Freshippo Grocery and Freshippo Mall – which cover a wide range of consumers and types of online and offline shopping. It has also empowered its partners by leveraging Ele.me delivery services and Tmall Supermarket's inventory sharing.

- ◆ **Freshippo:** As one of the most popular fresh food e-commerce apps in China (14m MAU in July 2020, per Questmobile), the next focus is on developing new formats, in particular Freshippo Mini stores which are approximately 300-500 square meters, or about one-tenth of the size of a regular Freshippo store. We estimate 70% of its product types (aka SKUs) are fresh food. Freshippo Mini stories require smaller investments than standard-size Freshippo stores. Per Ebrun news on 21 March 2020, Freshippo targets to open 100 standard-sized stores, which have 5x better sales productivity than traditional supermarkets, and 100 Freshippo Mini stories in around a year's time. It is also converting 70+ existing Freshippo small stations into Freshippo Mini stores (not all will be in the same

locations), given that Freshippo Mini has 4x better sales productivity than fresh food grocery competitors. Some underperforming Freshippo small stations may be closed. We think the ongoing margin upside includes a higher GMV mix from private label products and better sales productivity. According to a Freshippo mini product manager, Freshippo Mini stores have shown strong momentum in core operating metrics including customer growth and retention amid the COVID-19 outbreak. In the quarter ending June, Freshippo's online GMV mix remained above 60% and mature stores (i.e. those in operation for more than 18 months) saw double-digit same-store-sales growth y-o-y.

Ele.me's riders also deliver groceries

- ◆ **Ele.me:** In Beijing, online food delivery service platform Ele.me saw online fresh food orders jump 9x during Chinese New Year y-o-y (per Sina news on 5 Feb 2020). Ele.me works with other fresh food suppliers and also directly sources from its own agricultural product suppliers. We think the mix of orders will diversify, including more non-meal orders like fresh food, groceries and medicine, which should boost unit economics and increase efficiencies.

Alibaba digitalizes retail partners and charges service fee

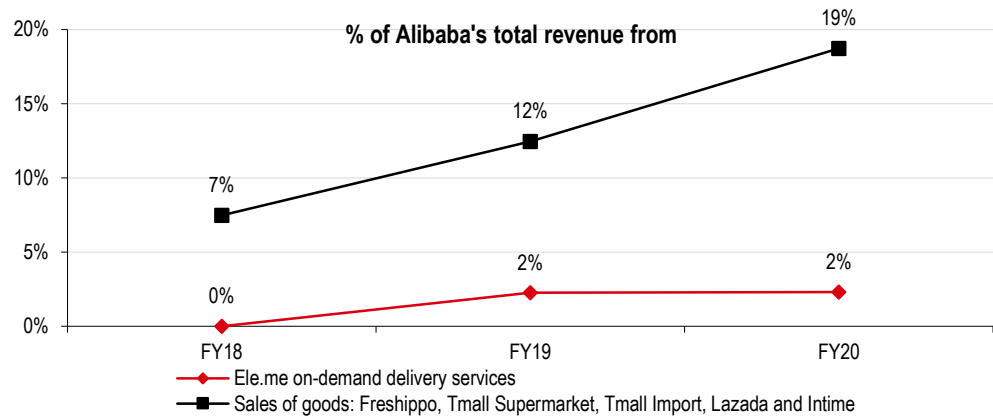
- ◆ **New retail partners:** Alibaba works with its hypermarket/supermarket partner Sun Art (6808 HK, HKD8.96, Buy) by facilitating: **1)** one-hour home delivery within a 5km radius via various apps like RT-Mart Fresh, Alibaba's Taoxianda and Tmall Supermarket, **2)** "Tmall Supermarket Inventory Sharing" which delivers Tmall Supermarket orders in under an hour if they are within a 5km radius, and half-day delivery within a 5-25km radius, **3)** community group purchases: one example is Sun Art collaborating with Cainiao's over 3,000 pick-up stations where customers can place an order and collect delivery the next day. In Alibaba parlance it has "enabled," or helped generate 15% of Sun Art's total revenue in 2Q20, up from 10% in FY20. We see Alibaba benefiting from the upside in revenue from new retail partners by acting as a traffic platform and enabler. We also expect the commission fee to be a major margin improvement driver for new retail going forward as we estimate the so-called 1P model – where Alibaba acts as a retailer – from Freshippo might have a similar margin profile to the business-to-customer or front warehouse model (i.e. single-digit margins) while commission fees should also be margin accretive. In contrast, we note competitors like Meituan Grocery, 7FRESH and others are mostly 1P models carrying inventory risks and losses.

Ecosystems generate cost synergies

- ◆ **Cross-selling and technology might drive a faster pace of profitability:** 75% of Alibaba's China retail marketplace annual active consumers (based on 674m, June quarter 2019 data) can be funnelled into local services businesses, in which its users also have increasing access to grocery/fresh food offerings and deliveries inside the Ele.me app. Also, Alipay will continue to deepen its relationship with Ele.me. As of the June 2020 quarter, Ele.me acquired 45% of new customers from Alipay, and over 60% of users came to the Alipay app looking for local services in the 12 months ended June 2020. We think cross-selling from Alibaba's ecosystem therefore can save acquisition and marketing costs incurred by Ele.me and Freshippo. In addition, technological support to enhance supply chain management, store location selection, and delivery efficiencies can support more efficient operations.

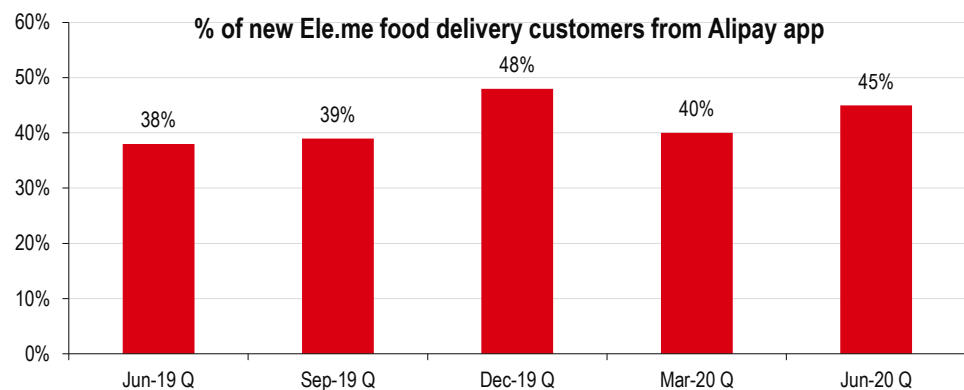
Alibaba ecosystem is seeing increasing contribution from online groceries

Exhibit 13: Sales of goods from platforms like Freshippo and Tmall Supermarket, along with Ele.me on-demand delivery, already contribute c20% to Alibaba's revenue



Source: Company data

Exhibit 14: Cross-selling from Alipay continues to support Ele.me's traffic



Source: Company data

Tencent/JD/Dada

For Tencent, it has made several investments:

1. Platform delivery company Dmall (多点)
2. Front warehouse company MissFresh
3. An 18% stake in JD, which is also the principal shareholder of Dada (JD owns a 48% stake) with its local on-demand retail platform JD Daojia (JDDJ).

Exhibit 15: PDD launched Duoduo Maicai on the front page of its app in September 2020

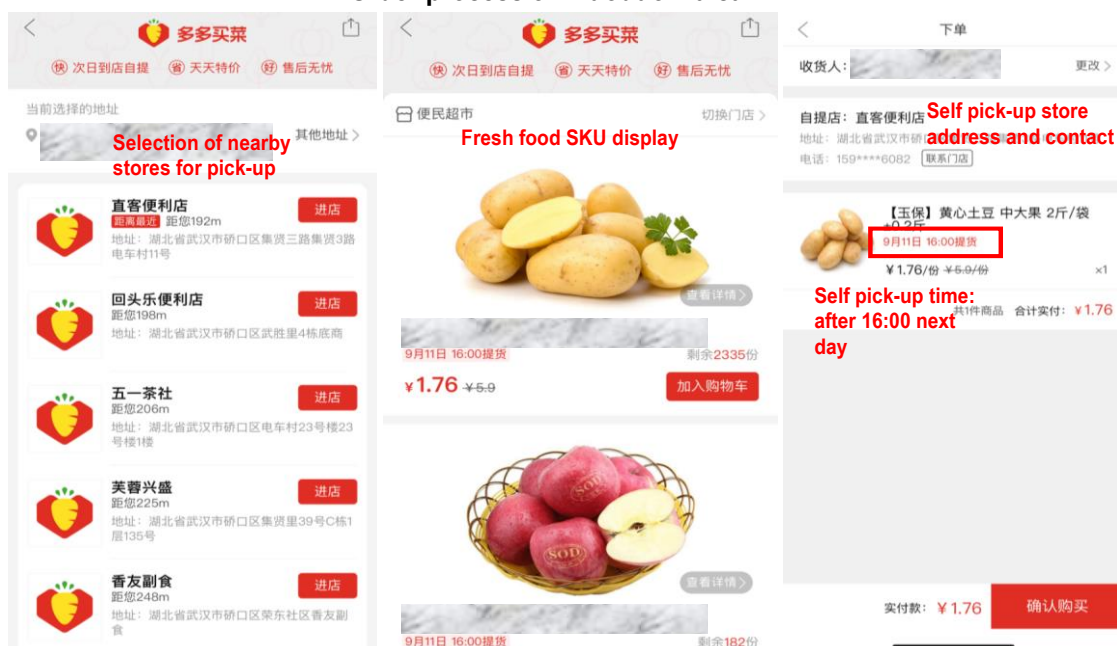
PDD app front page



Source: PDD screenshot, HSBC

Exhibit 16: PDD offers several nearby stores for users to pick up from with next-day delivery

Order process on Duoduo Maicai



Source: PDD screenshot, HSBC

Exhibit 17: Meituan has already launched its group purchase model “Meituan Selected” in eight cities with icons on the front page of its app

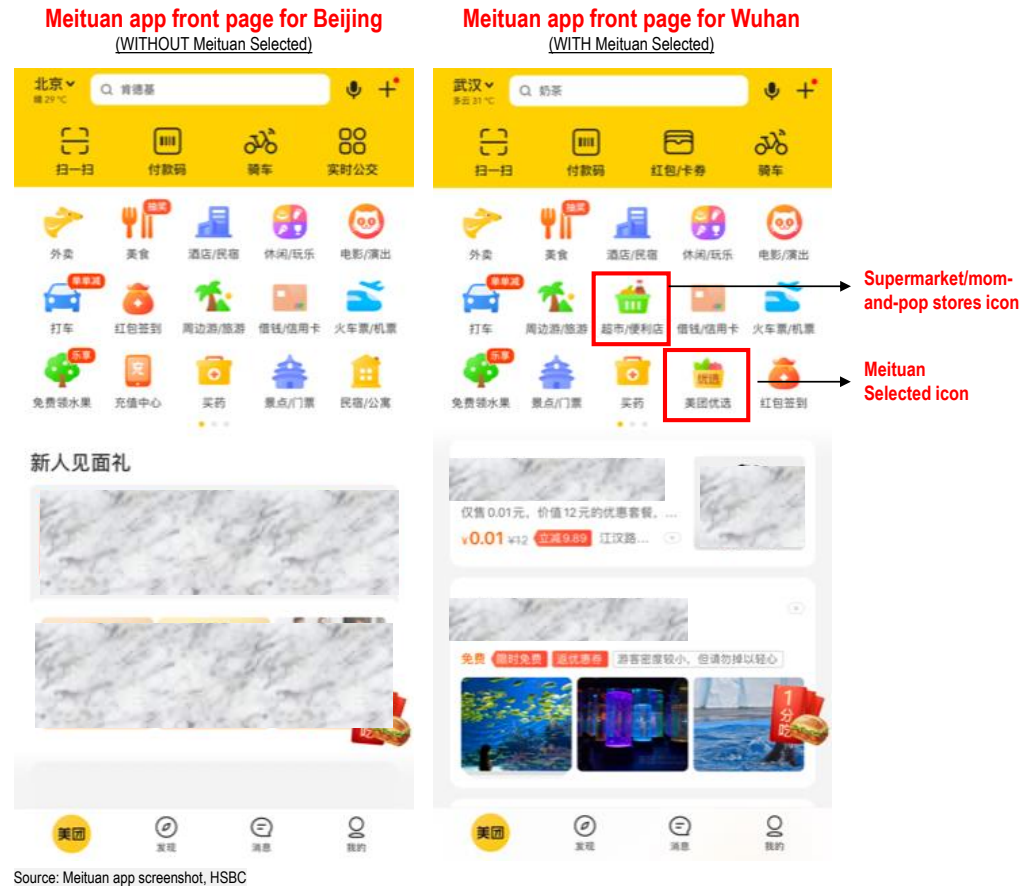
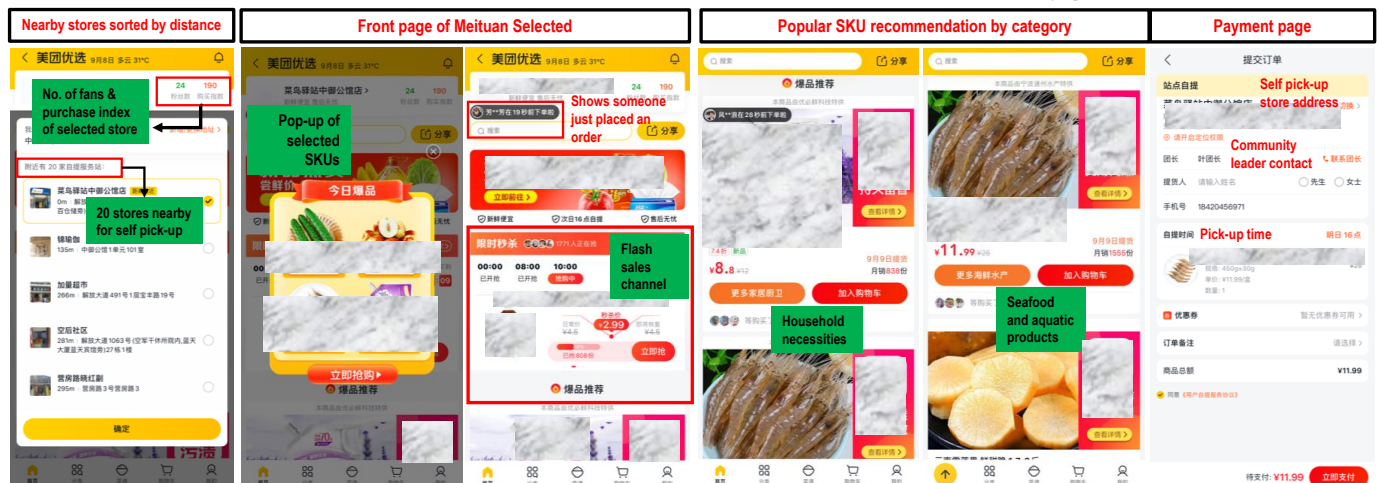


Exhibit 18: Meituan Selected offers popular products with deep discounts and uses a community group purchase model

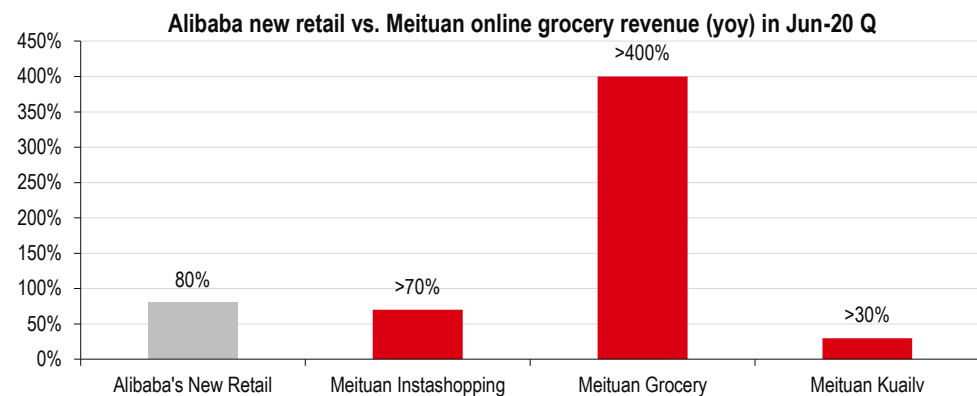


Fresh food e-commerce penetration was expedited by COVID-19

Robust industry growth

We expect fresh food e-commerce to see rapid growth this year with online penetration reaching 4%, up from 3% in 2019 per iResearch (Exhibit 5), still much lower than the online retail penetration rate of 25% YTD as of August, per NBS. COVID-19 has already expedited online order growth. Exhibit 6 suggests triple-digit growth in order volumes of online fresh food during Chinese New Year.

Exhibit 19: Alibaba and Meituan's fresh food related businesses saw rapid growth in 2Q



Source: Company data

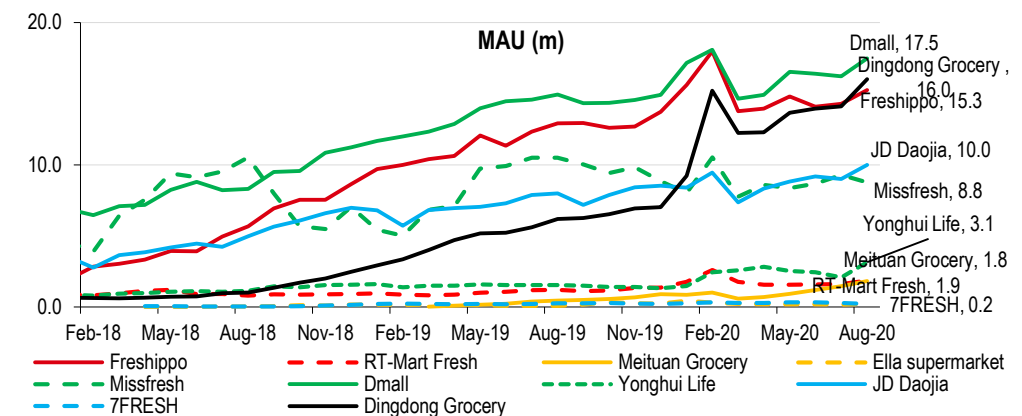
A surge in online fresh food orders

More users, particularly older ones, and more engagement

- ◆ **Users peaked in Feb, but are still largely higher y-o-y:** The fresh food e-commerce industry and the major apps (e.g. Freshippo, Dingdong Grocery and Missfresh) recorded strong growth in monthly average users (MAU) and daily average users (DAU) y-o-y during the pandemic period. Although numbers have since fallen, they are still higher than last year. For example, in August 2020, Meituan Grocery's MAU grew 294% y-o-y while the MAUs of Dingdong Grocery and Freshippo grew 159% and 18% respectively, according to Questmobile.

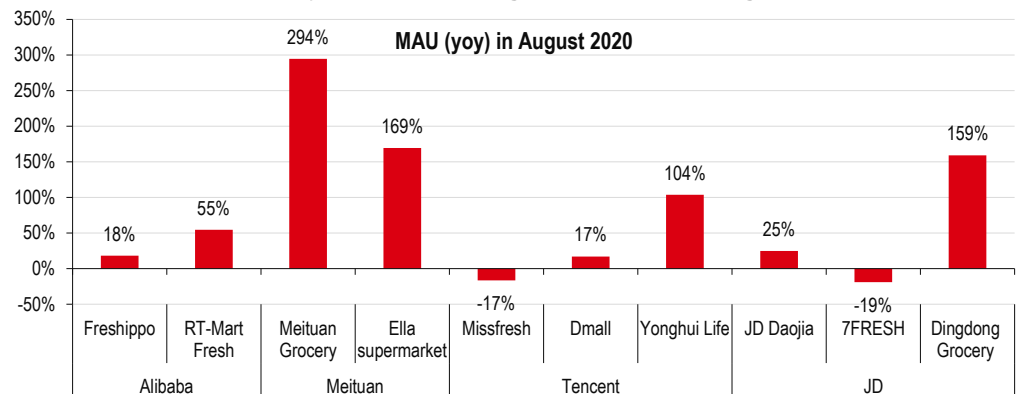
Meituan Grocery and Dingdong Grocery saw triple digit growth in MAU y-o-y

Exhibit 20: Freshippo is one of the top three fresh food e-commerce apps in terms of MAU



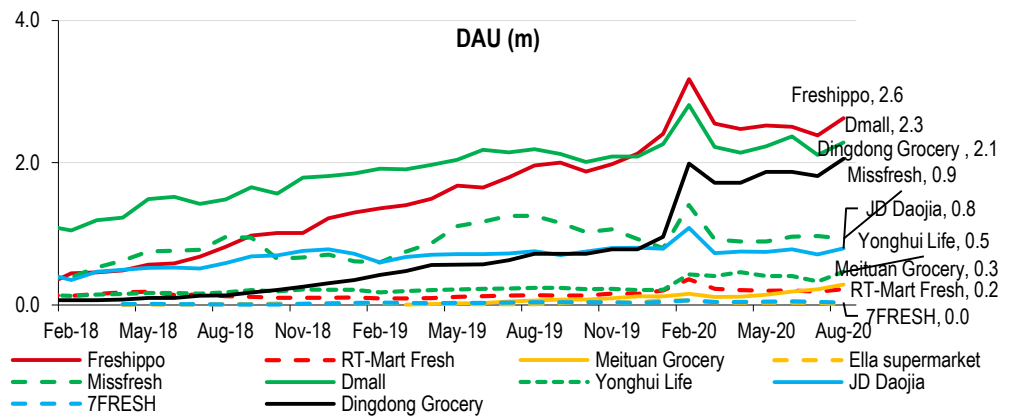
Source: Questmobile

Exhibit 21: Meituan Grocery saw the fastest growth in MAU in August 2020



Source: Questmobile

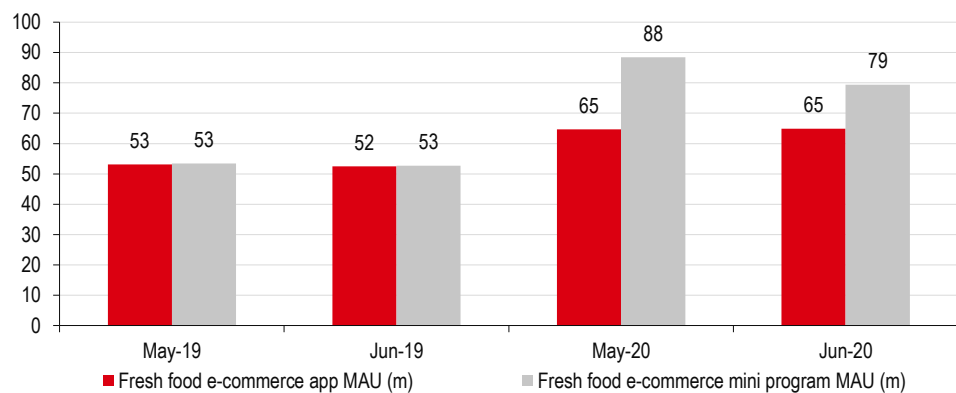
Exhibit 22: Freshippo is the top fresh food e-commerce app in terms of DAU



Source: Questmobile

The pandemic enlarged the user base for fresh food e-commerce platforms

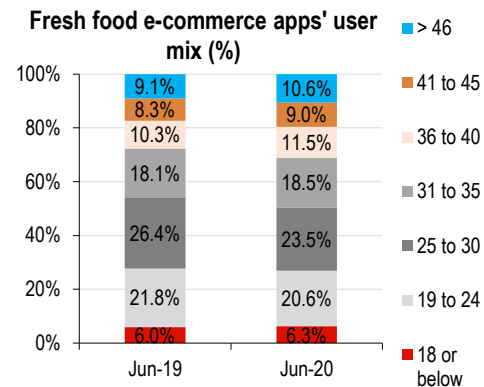
Exhibit 23: Fresh food e-commerce industry traffic grew over 20%/50% for mobile apps/mini programs from May 2019 to June 2020



Source: Questmobile

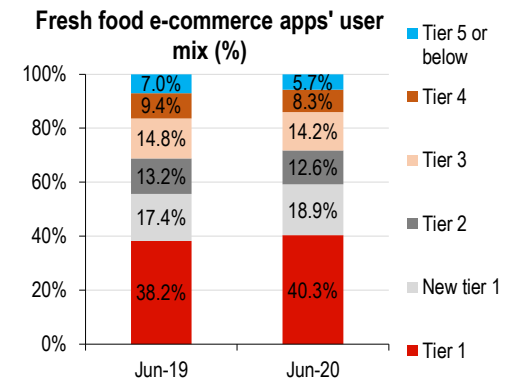
- ◆ **Older users and higher-tier city users:** The percentage of users aged 31 or above grew from 45.8% in Jun 2019 to 49.6% in Jun 2020. The percentage of users from Tier 1 and 2 cities rose from 68.8% to 71.8% during the same period.

Exhibit 24: More users aged 31 or above...



Source: Questmobile

Exhibit 25: ...and more users from Tier 1 and 2 cities

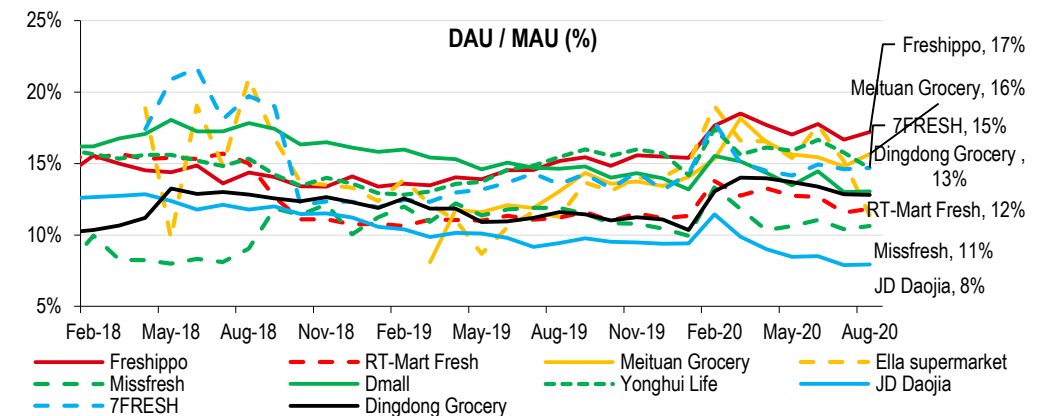


Source: Questmobile

Freshippo, Meituan Grocery and Dingdong Grocery have the best user engagement and retention metrics

- ◆ **User engagement and retention improving:** The DAUs and MAUs also improved across apps with Freshippo still the leader. In terms of usage frequency (the daily usage per user), Dingdong Grocery, Meituan Grocery and JD Daojia are the top three apps. For user retention rate, Meituan Grocery improved significantly (up 9ppts to 37% y-o-y in August 2020) while Freshippo and Dingdong Grocery also saw improvement to 33% and 39%, respectively.

Exhibit 26: DAU / MAU improved y-o-y in August 2020...



Source: Questmobile, HSBC

Exhibit 27: ...and so did usage frequency...

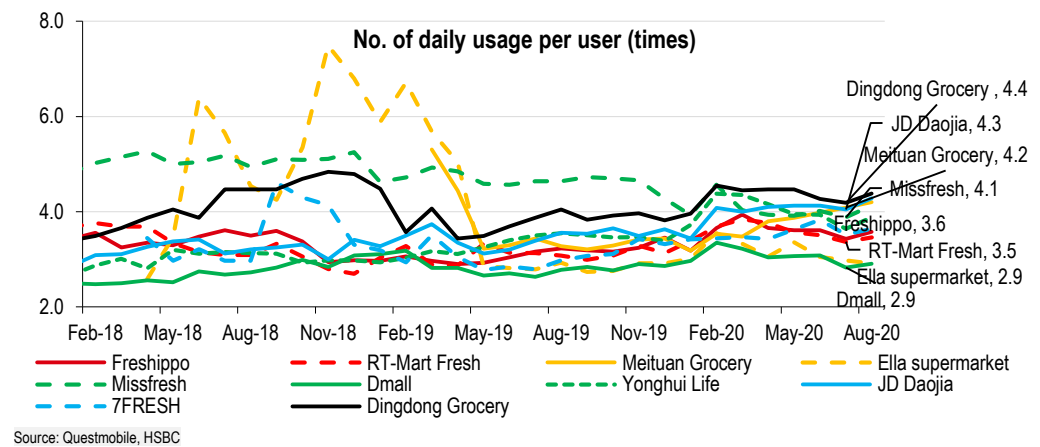
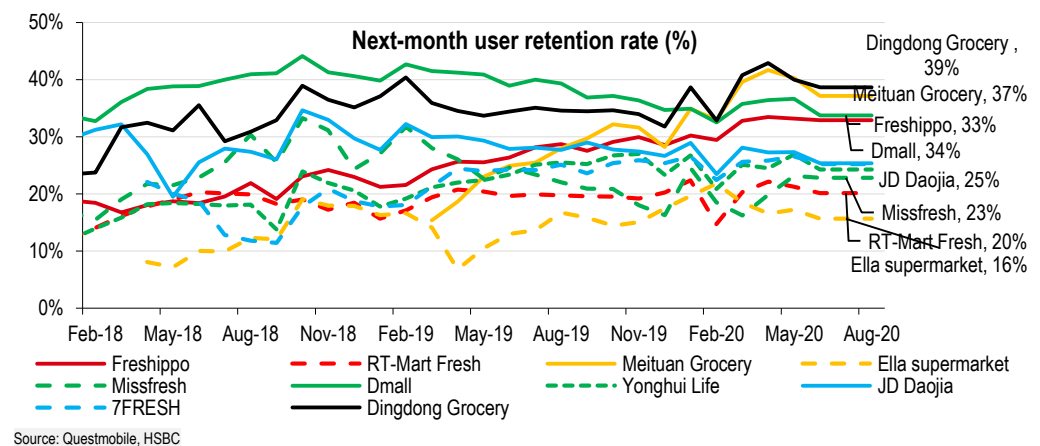


Exhibit 28: ...and retention rates



Triple-digit growth in sales volumes

Online penetration of fresh food should rise to 5% in 2022e from 3% in 2019

Other than the increasing number of users, we believe higher purchasing frequency is another driver for rising online grocery orders. The percentage of users buying online groceries two to three times a week rose after the pandemic. This should lead to faster online penetration of fresh food as this is one of the most under-penetrated segments among all the e-commerce categories (only 3% per iResearch vs China's online retail penetration of 21% in FY19 per NBS). Online penetration of fresh food should reach 5% by 2022e, according to iResearch.

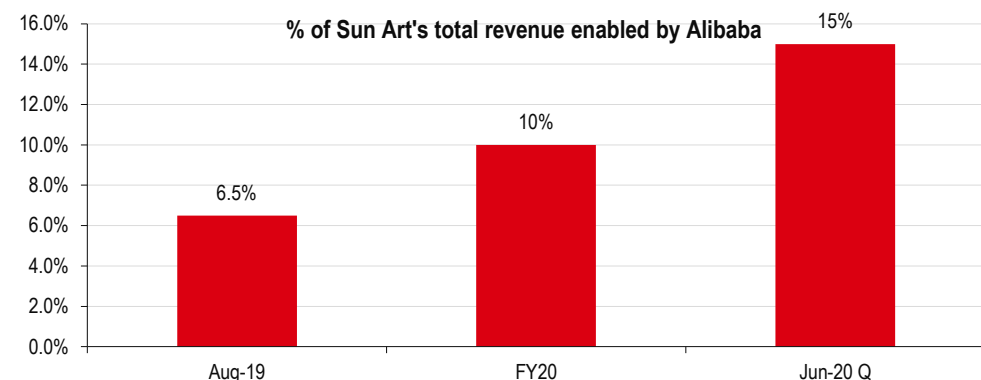
Offline supermarkets and hypermarkets have been shifting more businesses online to maintain revenue momentum. According to 36kr on 20 February 2020, as per Shen Huafeng, general manager of Fresh China (“生鲜传奇”), an independent online fresh food company, online orders grew from 2% of total orders pre-COVID-19 to 15% after. The combination of online and offline channels for fresh food sales is a long-term trend, with online orders accounting for 15-20% at a normal level.

Exhibit 29: Orders for online fresh food deliveries surged during the 2020 Chinese New Year period

	Name	Chinese name	Business model	Y-o-y growth
Alibaba	Freshippo	盒马鲜生	To-store & to-home	Orders grew 220% y-o-y from the start of the COVID-19, according to Ebrun on 16 Feb
	Ele.me	饿了么	Platform to-home	Online fresh food orders in Beijing grew nine times y-o-y during CNY, according to Ele.me on 5 February 2020
Tencent and JD*	WeChat mini program	微信小程序	N/A	The number of transactions for fresh food grew 149% y-o-y during 24-31 Jan 2020
	JD Fresh	京东生鲜	Omni-channel	Online fresh food GMV grew 215% y-o-y during 24 Jan-2 Feb 2020
	JD Daojia	京东到家	Platform to-home	GMV grew 470% y-o-y during CNY, as per the company on 2 Feb 2020
	Missfresh	每日优鲜	Front warehouse	Platform GMV grew 321% y-o-y during 24-28 Jan 2020
	YH Life	永辉生活	To-store & to-home	Orders the "to home" business in Fuzhou rose 450% y-o-y with GMV up 600% y-o-y during 24-30 Jan 2020
Meituan	Meituan Grocery	美团买菜	Front warehouse	Daily orders in Beijing grew two to three times more than the pre-CNY period according to BJnews on 2 Feb 2020
	Meituan	美团外卖	Platform to-home	N/A
Others	Pupu	朴朴超市	Front warehouse	N/A
	Dingdong Grocery 叮咚买菜	叮咚买菜	Front warehouse	Daily orders grew three to four times during CNY, according to 36kr on 20 Feb 2020

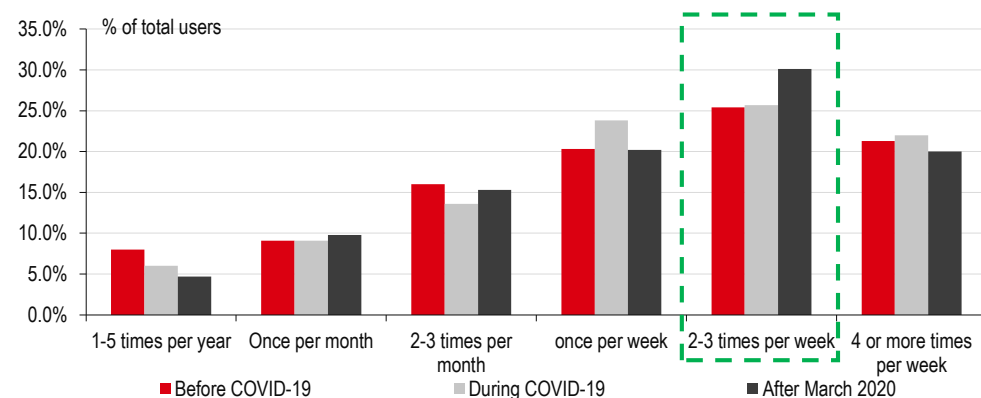
Source: Company news. * JD is 17.8% owned by Tencent as of May 2020

Exhibit 30: Alibaba's support to digitalize Sun Art continues to contribute to its revenue



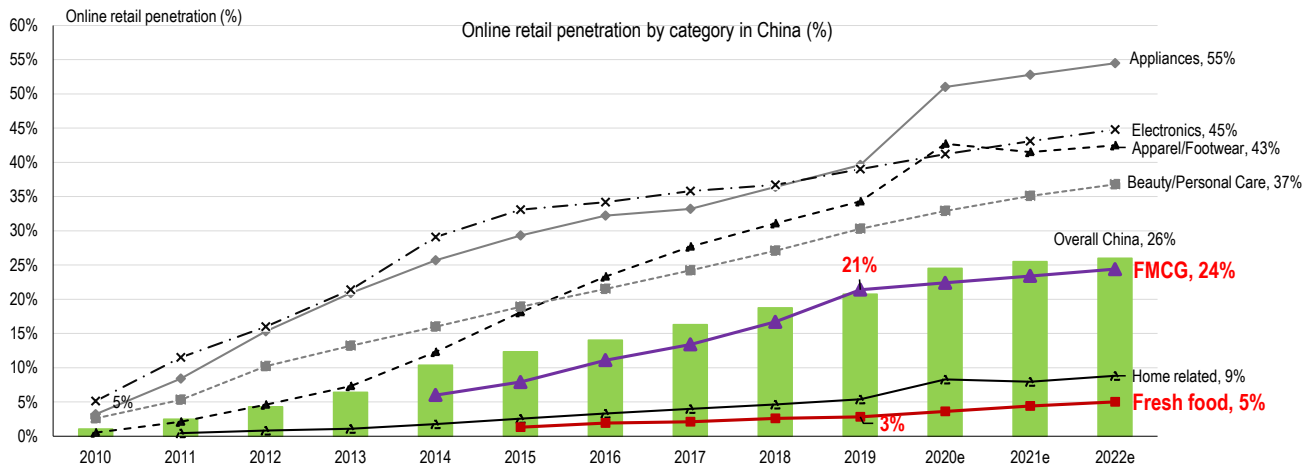
Source: Company data

Exhibit 31: Buyers have increasingly bought fresh food online via apps after March 2020



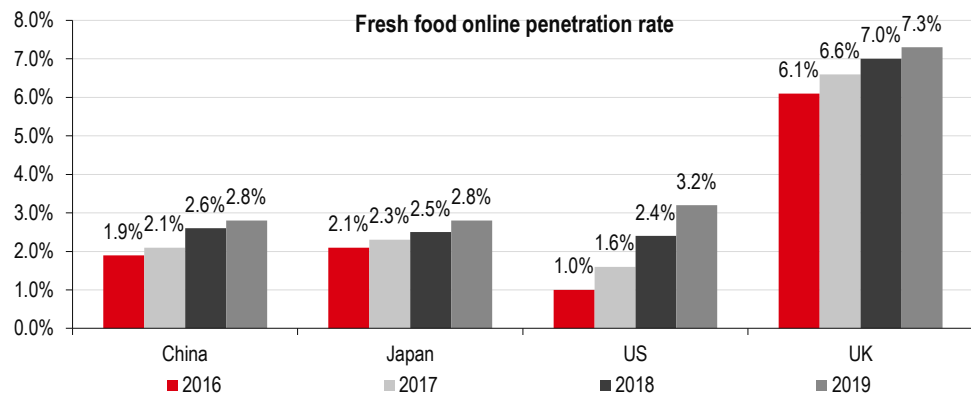
Source: iResearch

Exhibit 32: Fresh food is underpenetrated at just 3%; iResearch expects it to rise to 5% by 2022e



Source: Euromonitor, NBS, iResearch, Bain Company, HSBC estimates; Note: We use NBS data for overall China online penetration, iResearch for 2015-22e fresh food online penetration, Bain company for 2014-19 FMCG online penetration and HSBC estimates for FMCG 2020-22e online penetration, use Euromonitor for online penetration of other categories

Exhibit 33: We expect China's fresh food online penetration to reach similar levels as the UK



Source: Euromonitor, iResearch
Note: For Japan, US and UK, it is in terms of fresh food order volume

Rural areas are the next growth engine

Rising agricultural sales supported by supply chain investments of key players and government policies

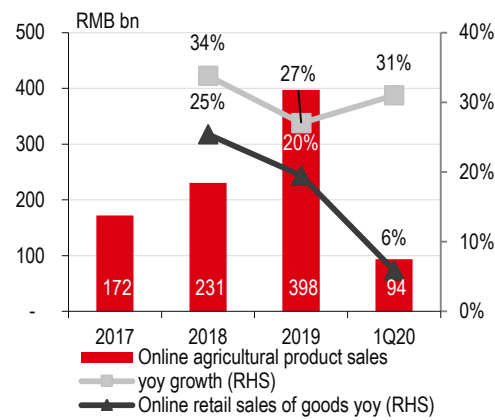
Rural areas have regained the spotlight since the COVID-19 outbreak given the lack of fresh food supplies there and strengthened policy support for e-commerce in these parts. We have seen major e-commerce players launch specific campaigns to help sell agricultural products and meet surging demand for groceries in cities (Exhibit). But the Chinese government in February emphasized the development of the digital economy in rural areas by increasing e-commerce penetration and logistics infrastructure construction. According to the Ministry of Commerce, China's agricultural product online sales GMV grew 27% in 2019 to RMB398bn, with major e-commerce players sourcing products directly from rural areas and counties, driven by rising demand and supply chain investments. We expect rural areas to be the next growth driver for e-commerce players. Pinduoduo (PDD) has a market share of 34% in 2019 (up from 28% in 2018) while Alibaba leads with a 50% market share.

Exhibit 34: Major e-commerce players are penetrating into rural areas amid COVID-19

	Alibaba	JD.com	PDD
Launch date	12-Feb	10-Feb	10-Feb
Measures	Launched a poverty relief program to help rural areas with a RMB1bn fund	Launched a program for agricultural products by providing subsidies for supply chains, logistics and marketing	Launched a section on its app for agricultural products, with a RMB500m specialized fund and a delivery subsidy of RMB2-3 per order

Source: Company news

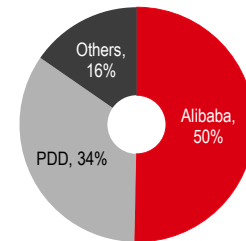
Exhibit 35: Online sales of agricultural products grew 31% YoY in 1Q20, accelerated by COVID-19



Source: MOFCOM, Company data

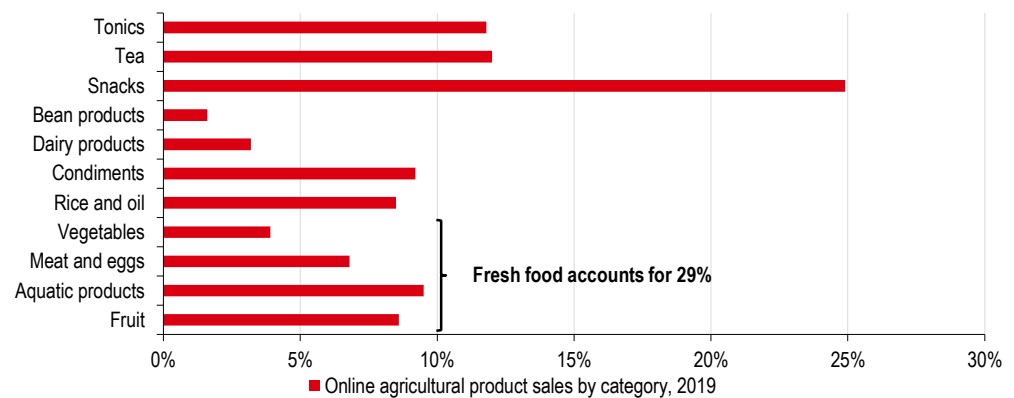
Exhibit 36: Alibaba leads with a 50% market share in online agricultural product sales

Market share in online agricultural product sales, 2019



Source: Ministry of Agriculture and Rural Affairs, Company data, HSBC

Exhibit 37: Fresh food only accounts for 29% of online agricultural product sales in 2019



Source: iResearch

Low profits keep small players out

- ◆ Online grocery shopping is a low-margin business, although COVID-19 provided a temporary boost
- ◆ We see further market consolidation with the top players leveraging their advantage in logistics, delivery and various retail models...
- ◆ ...and see private label products driving up long-term margins

Small profits

Online fresh food sales is a low-margin business, especially when compared to high-profit discretionary consumer goods like apparel and cosmetics. Much of this is because fresh food requires higher levels of delivery efficiency, sophisticated warehouses and cold-chain technology. Plus there's intense competition like we detailed in the previous chapter.

Admittedly, this all changed during COVID with gross margins rising to 30+%. That was all thanks to higher online prices, which climbed to about 20-30% higher than some physical supermarkets, given the increased demand especially from well-educated users who were less sensitive to prices as they valued not having to leave their house for food shopping.

Still, margins are likely to return to being thin when demand falls back post COVID-19. Our industry analysis show that in normal times margins are low even before overhead and administrative costs (see Exhibit below). There are a few forces that can improve these unit economics, including **1)** supply chain consolidation leaving larger companies with stronger bargaining power, and **2)** higher conversion rates (some players reach as high as 30%) on better targeting and marketing tools to enhance user stickiness and purchasing frequency.

Our analysis indicates that margins are still thin despite improving profitability

Exhibit 38: Industry average unit economics show thin margins even before admin costs

	RMB/order	Remark
Average Order Value (AOV)	50	AOV is RMB50-55 on average
Gross profit margin	18	GPM is 30-36% on average
Warehouse cost	(4)	7-8% on average; 12% for big warehouses
Delivery cost	(8)	RMB5-8 per order
Sales & marketing costs	(3)	5-6%
Net profit before overhead and other admin costs	3	Net profit margins at 6%

Source: HSBC estimates

Even during the demand surge amid COVID-19, players tended not to charge a delivery fee. Instead, they choose to gain market share with lower prices, which is what we've seen post COVID-19 too.

As large players have single-digit margins, we expect smaller players suffering from delivery disruptions due to a lack of financing might be forced out of the market. Hence, we prefer companies with sufficient cash flow, technology advantages, larger customer bases, and full-fledged logistics infrastructure.

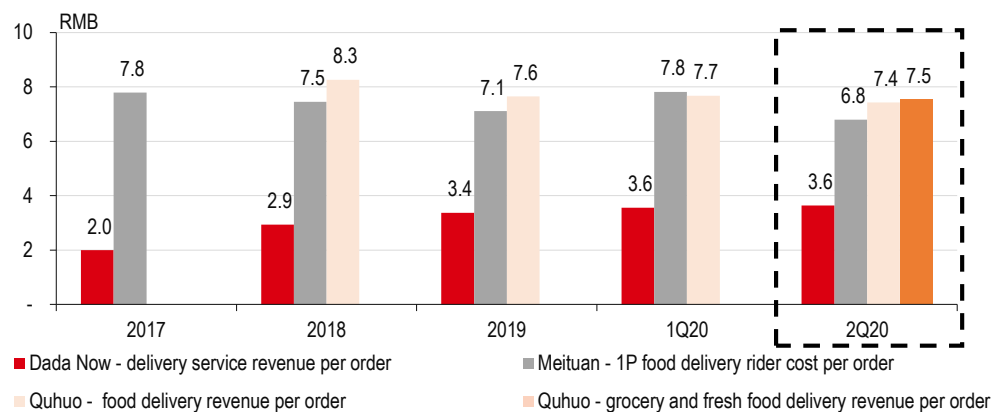
Exhibit 39: Gross margins for fresh food are relatively low, ranging from 5-25%

	Vegetables			Fruits	Meat and eggs	Cooked food and bakery	Aquatic products	
Frequency of needs	High			High	Mid	Mid	Mid	
No. of online purchase per week	2.08			1.77	1.58	1.39	1.38	
Gross margin	15%			20%	5-15%	25%	20%	
Damage rate	3-4%			4-5%	1.5-4%	4-5%	3%	
Examples	Spinach	Tomato	Orange	Watermelon	Eggs	Pork	Ham, bread	Shrimps
Wholesale price (RMB/kg)	1-4	2-5.6	2.6-9	2-4.2	RMB0.65-2 each	20-40	N/A	36-60
Retail price on e-commerce platforms (RMB/kg)	4.8-14	6.6-13.8	11-23	6.4-16.6	RMB0.6-2 each	21.8-52	N/A	46-60
% mark up	250-380%	146-230%	155-230%	220-330%	0-20%	9-30%	N/A	27.8-66.7%

Source: iResearch

Grocery and fresh food have higher requirements in terms of delivery times than food delivery and supermarket categories (incl. FMCG), hence higher delivery costs

Exhibit 40: A cross-check among platforms suggests delivery costs ranging from RMB3-8 per order



Source: Company data; Note: Acknowledge that there are differences between delivery service revenue/cost definitions of various companies

In 1H20, Sun Art's businesses from online sales accounted for 20% of revenue, up from 8% in 2018. Growth from online therefore has become a key profit driver as well as a revenue driver for Sun Art. In 1H20, its revenue grew by 5% y-o-y and its net profit was up by 16.8%.

Exhibit 41: Sun Art's B2C business had a net margin of 2% in 2019 by leveraging Alibaba's new retail technology and logistics systems

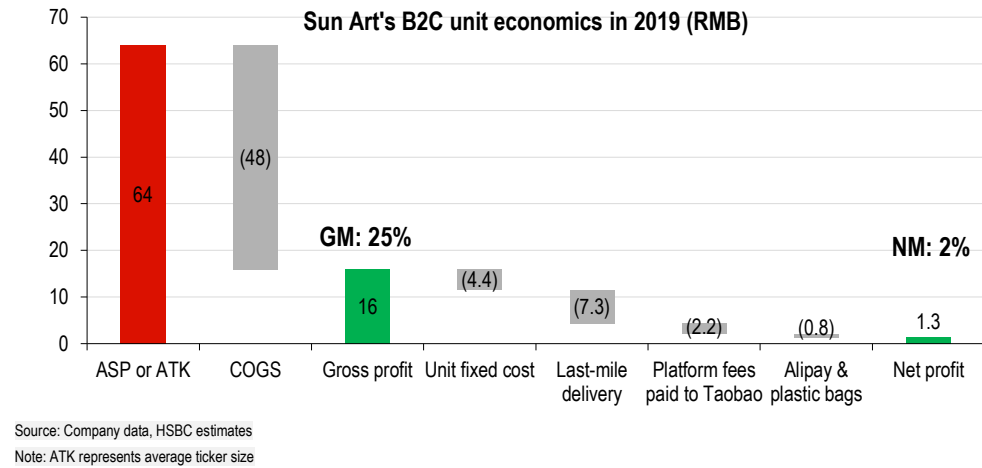


Exhibit 42: Sun Art's B2C daily order volume

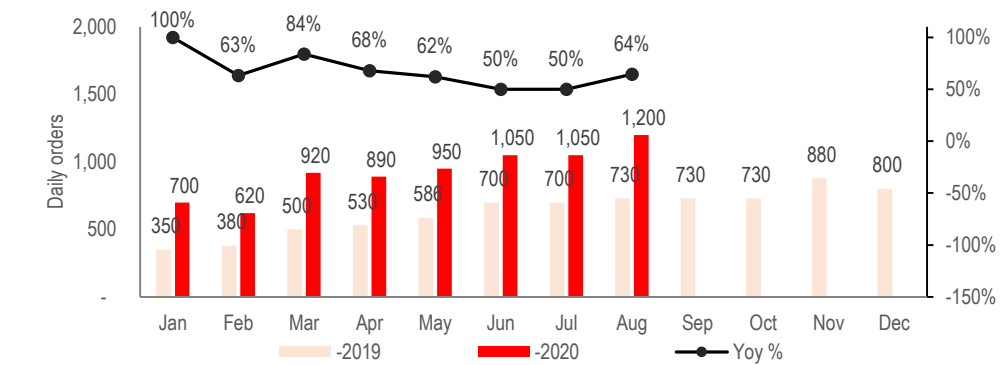
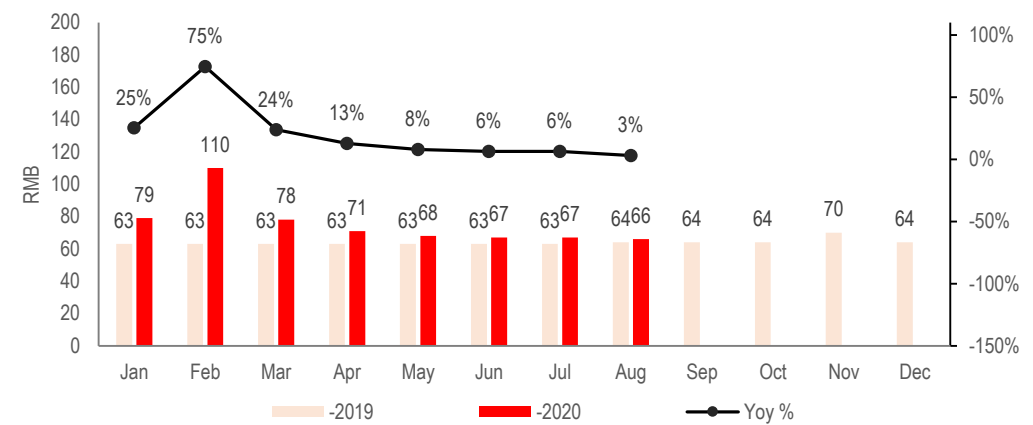
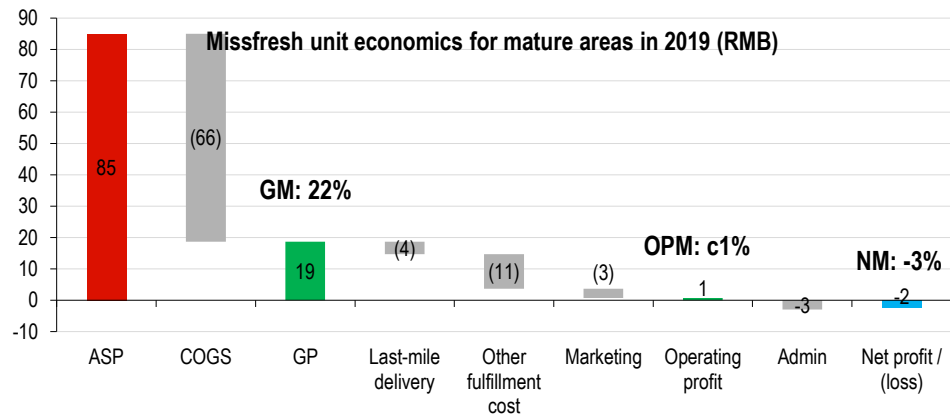


Exhibit 43: Sun Art's B2C average ticker size (RMB)



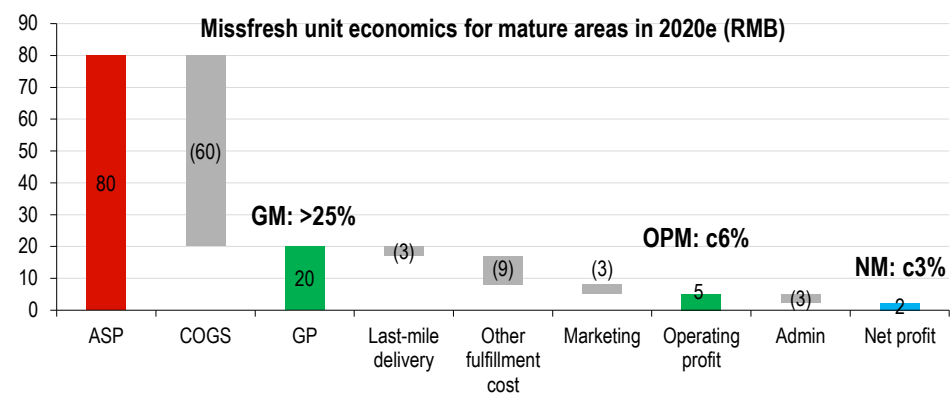
The unit economics of different companies suggest thin margins

Exhibit 44: Missfresh is also just breaking even at the operating level currently...



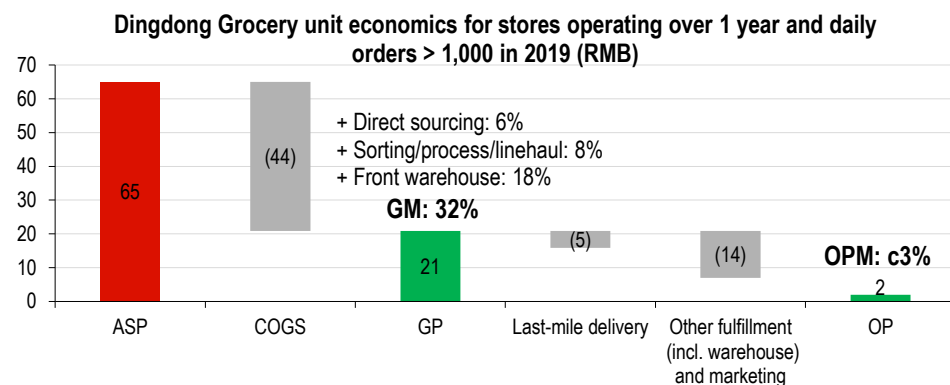
Source: Ebrun

Exhibit 45: ...and most likely has very thin net margins in 2020e (c3%)



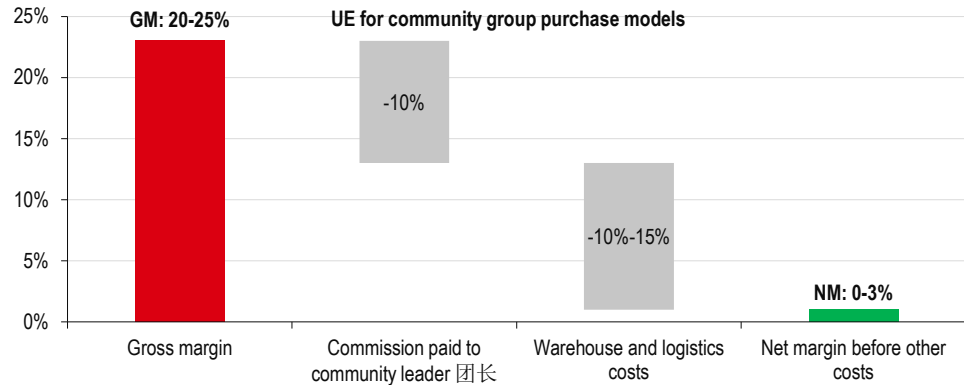
Source: Ebrun

Exhibit 46: Dingdong Grocery also has c3% for operating margins for mature stores



Source: Ebrun

Exhibit 47: Community group purchases have lower logistics and delivery costs, but commission fees to community leaders are high at c.10%, leading to thin margins



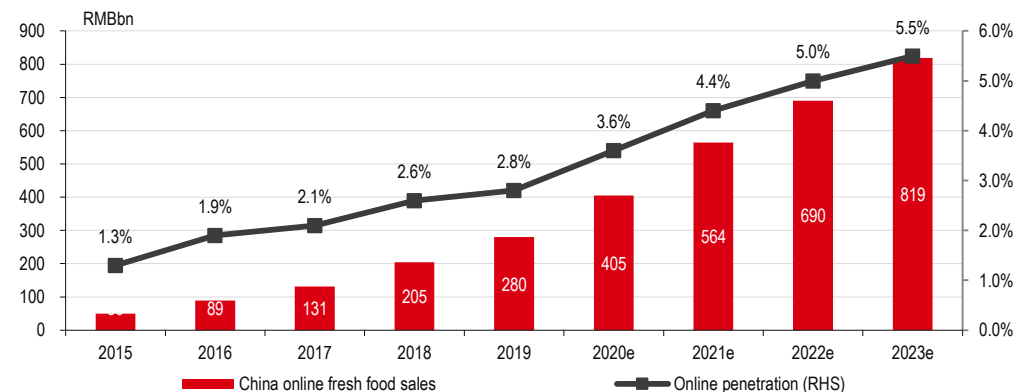
Source: iResearch

Market share consolidation

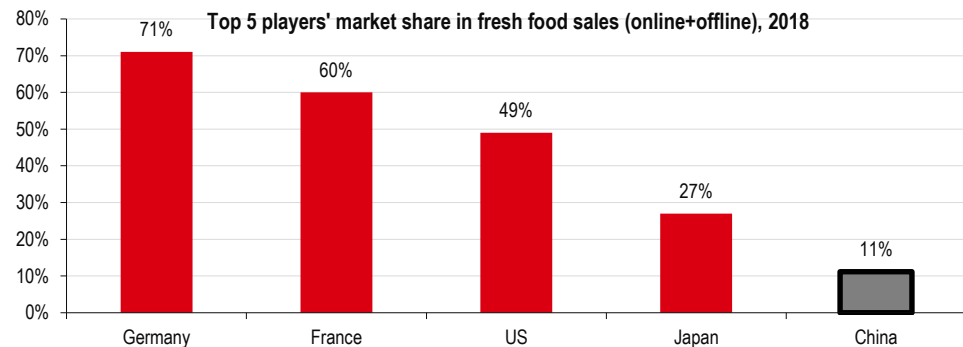
Market share in online fresh food market is more concentrated than offline

In 2019, China's online fresh food sales reached RMB280bn, with several e-commerce players entering into this area by launching self-operated online stores or cooperating with large supermarkets and hypermarkets. Despite the rising penetration, China still lags compared to developed countries. Both the online and offline fresh food market is more fragmented with the top five companies' total market share at only 11% in 2018, vs other developed countries of 27-71%. The top players have more competitive advantages in terms of logistics, supply chains and larger customer bases; hence, the online market is more consolidated with the top players' market share at 57% in 2019, according to iResearch. We expect COVID-19 to further accelerate market consolidation in China's online fresh food market with the top players leveraging their advantages in logistics infrastructure, delivery network, and omni-channel new retail models.

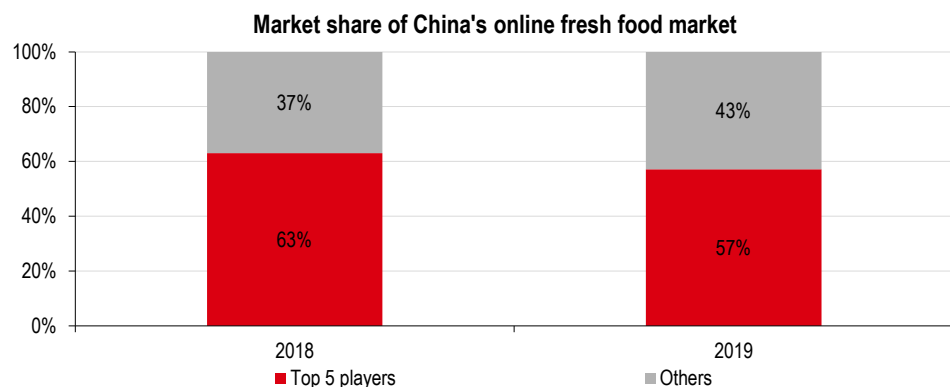
Exhibit 48: Online fresh food sales reached RMB280bn in 2019



Source: iResearch

Exhibit 49: China's fresh food market is more fragmented given numerous offline stores


Source: MOFCOM

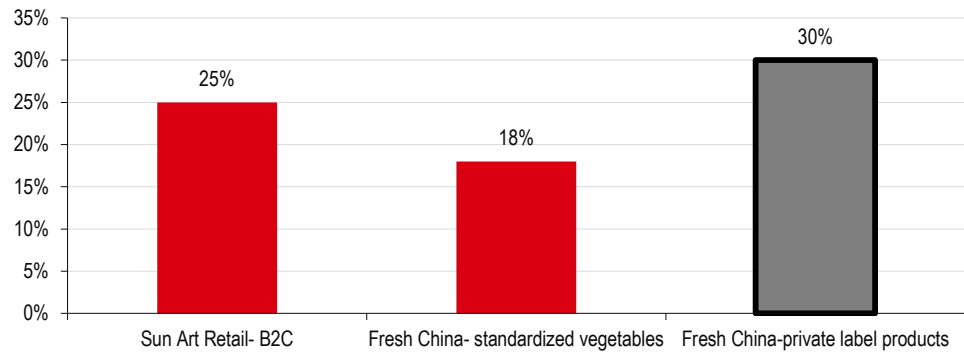
Exhibit 50: Online fresh food market is more consolidated given top players' huge advantages in logistics and supply chain


Source: iResearch

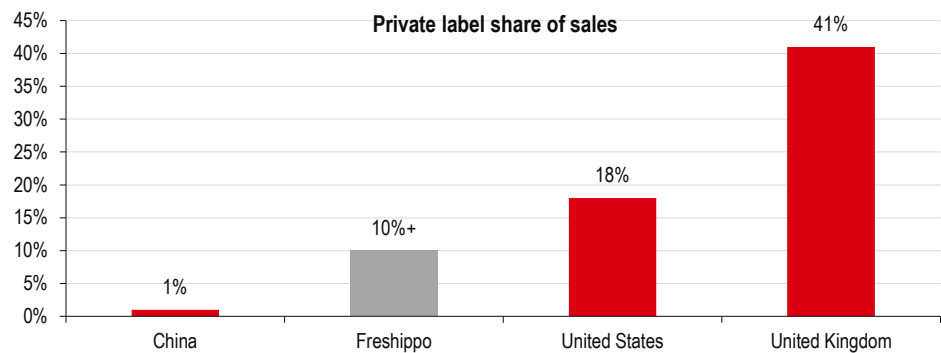
China's private label product sales only account for 1% of total sales, vs 18% in US

Private label products to drive long-term margin profile

As shown in Exhibit 3 above, cooked food and the bakery segment have the highest gross margins of 25% vs other fresh products. According to Fresh China, per 36kr on 20 February 2020, their private label products can achieve a gross margin of 30% in 2019, 12% higher than their standardized vegetable products. We expect companies to continue to invest in private labels, mostly bakery and cooked foods, to lift prices, improve margins and gain consumer mind share through more diversified product offerings. According to Nielsen, China's private label products only accounted for 1% of total sales vs 18% in United States and 41% in United Kingdom, which suggests huge potential for private label products to grow.

Exhibit 51: Private label products have the highest gross margin reaching 30%


Source: Company news, HSBC

Exhibit 52: Private label products only accounted for 1% of sales in China, much lower than other developed countries


Source: Nielsen, Alibaba's investor day 2019 presentation

Note: For Freshippo's private label share of sales, it is in the month of Aug 2019; Freshippo private label products include products under Freshippo owned brands and products from partners that are solely developed for and sold at Freshippo

A look across the region

- ◆ Singapore is leading in Southeast Asia given its strong infrastructure; online groceries not a priority for Shopee
- ◆ In India, online groceries make up just 1% of the market but growth has surged this year; Dmart, Reliance pursuing their own initiatives
- ◆ Korea's major grocery players are increasingly moving online; SSG.COM's freshness guarantee is popular

Southeast Asia

Southeast Asia saw a surge in online grocery shopping during COVID-19

In Southeast Asia, online grocery market is significantly underpenetrated due to a lack of infrastructure investment in logistics and warehousing. The leading e-commerce company, Shopee, has a limited presence in groceries, focusing primarily on non-perishable product categories like packaged food and beverages. In our view, Shopee (Shopee's parent company is Sea Ltd [SE US, USD147.88, Buy]) strategically doesn't want to focus on groceries currently as there's a significantly low penetration in other product categories where it benefits from triple-digit growth and there's a higher take-rate. We believe Shopee will focus on grocery category in its next phase – once growth tapers off in other product categories.

Online grocery penetration varies across the region – it is higher in countries with better infrastructure like Singapore which can deliver 'perishable' items in a timely manner. The leading online grocery company in the city is 'Redmart' which was acquired by Lazada in November 2016. Due to COVID-19, there has been strong user growth in the online grocery category and many companies have expanded their online presence or entered into online grocery. For example, Singapore grocer FairPrice doubled down on its online grocery presence leveraging its offline store inventory. Ride-hailing app Grab also expanded into online grocery during COVID-19 by launching GrabMart, an on-demand grocery and essential delivery service to connect offline retailers to consumers.

India

In India's overall grocery market, online grocery remains less than 1% and is still in a very nascent stage. But, similar to other markets in Asia, growth has accelerated this year amid COVID-19 given the convenience it offers and risk aversion by consumers.

Up to now, many online retailers have struggled to make a profit though players like Grofers, Big Basket and even the large online market places such as Amazon and Flipkart are all trying to make it work. The key challenge is the high fulfilment costs and low transaction sizes. Value retailers such as Dmart and Reliance Group (not listed) offer offline prices even better than

those online (while still making attractive and industry-leading profits) and online players bleed matching those prices.

Still, large modern trade players like Dmart and Reliance are pursuing their own online initiatives to complement their offline stores. Dmart plans to offer more online convenience and already offers the Dmart Ready platform in Mumbai. Reliance, the largest grocery retailer in India, has more aggressive plans. It launched its grocery e-commerce initiative 3-4 months ago in 200 cities. As a part of its strategy it intends to tie up with mom-and-pop stores to supply groceries to consumers. It is currently testing this in three micro markets. The key strength for Reliance is its presence in Tier II and Tier III cities which we believe will allow it to exploit online retail. In the current format, Jio Mart (a joint venture between Reliance Retail and Jio Platforms) is also a differentiator by offering a 5% discount and allowing customers to order without a minimum ticket size or delivery charge.

Korea

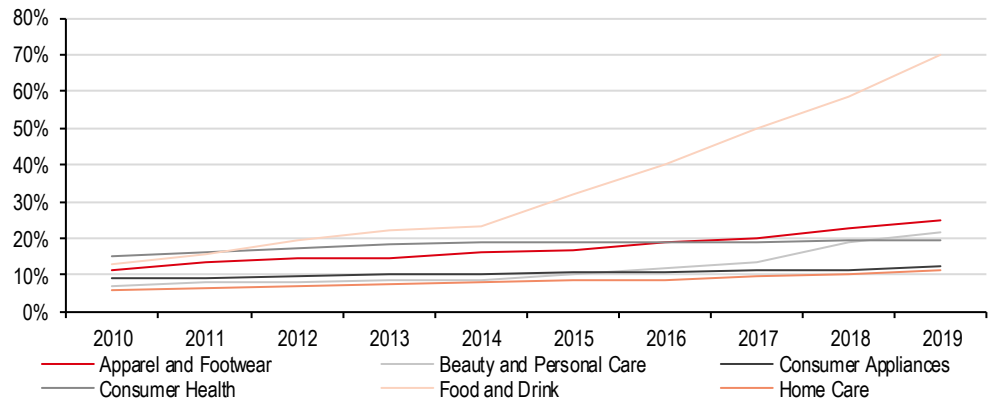
Korea's major grocery players – including hypermarkets, supermarkets and even convenience stores – are increasingly moving online by developing their own websites such as SSG.COM, an integrated online shopping platform run by the supermarket chain E-Mart (139480 KS, KRW141,000, Buy). They are also entering partnerships with delivery platforms. For example convenience store chain CU's delivery service with delivery company Yogiyo. In addition, online shopping mall players such as eBay and Coupang are also expanding their range of items to include fresh food – which isn't commonly sold by online shopping malls – and investing in private label items.

Like anywhere, delivery is also key to attracting more consumers. Since guaranteed overnight delivery by Market Kurly, a Korea startup, became very popular in the market with fresh and chilled food delivered in packaging that maintains temperature and quality for seven hours, many other retailers have started to introduce fast and convenient delivery processes. Coupang started a subscription-based delivery model, named Rocket Wow, where all items can be delivered the next day regardless of the minimum price when consumers pay less than USD3 per month. As delivery is key in the e-commerce industry, more players are expected to invest heavily in logistics.

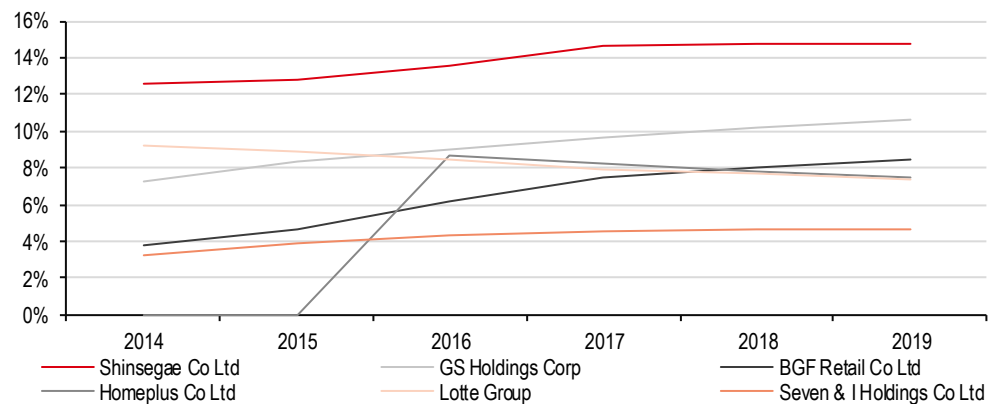
SSG.COM conducts a service which guarantees freshness of food products. If a fruit or vegetable appears not to be fresh, customers can exchange them or receive a refund via online payment. A delivery service will visit again to collect a returned item, so they can leave it in front of their door. Customers attach great credibility to the "freshness guarantee", hence, they are more willing to try online grocery shopping. This was considered a good idea to attract consumers who believe food should be chosen by themselves by visually inspecting its freshness.

We believe the trend of shopping grocery online will continue, if not accelerate, especially in light of COVID-19. Food accounts for more than 50% of convenience stores' sales, over 60% for hypermarkets and over 80% of SSM's revenue, which is significantly high when compared with online sales contribution of food (source: MOTIE).

In terms of growth rates, online sales increased by 17.5% y-o-y in 1H20 and growth from the food category was the highest with over 50% y-o-y growth. As such, online grocery retailing continues to grow, and we expect SSG.COM to gain market share. SSG.COM recorded over 40% GMV sales in 1H20 which was an acceleration from its 20% growth in 2019. Shinsegae Group (004170 KS, KRW207,500, Buy), where E-Mart is part of the group, saw its store-based grocery market share rank the highest with 14.8% in 2019, whereas its online market share is a mere 2.5%.

Exhibit 53: Online penetration rate of the Korea consumer market, by product category


Source: Euromonitor

Exhibit 54: The market share trend of grocery retailers


Source: Euromonitor

Valuation and risks

		Valuation	Risks
Alibaba BABA US	Current price:	We value Alibaba using a DCF-based valuation for which we assume a WACC of 9.2% based on a risk-free rate of 2.5%, cost of debt of 4.1%, equity risk premium of 5% and beta of 1.51 (all unchanged). We also assume a terminal growth rate of 4% (unchanged). We rate Alibaba Buy given its ecosystem synergies, leadership in ecommerce in China and its more profitable revenue growth than peers.	Downside risks: Margin pressure and competition; slower-than-expected pace of content monetisation; regulatory risks; higher-than-expected costs to integrate new retail initiatives; an economic slowdown; slower-than-expected global expansion; and geopolitical risks.
	Target price:		
Buy	Up/downside:	We calculate a fair value target price of HKD313 for the local shares (9988 HK, HKD267.00), based on our 2020 year-end USD/HKD exchange rate assumption of 7.80 and an ADS-to-Hong Kong-listed-share conversion rate of 1 to 8.	
Tencent 700 HK	Current price:	We value Tencent using a DCF-based valuation for which we assume a WACC of 8.5%, which is based on a risk-free rate of 2.5%, equity risk premium of 5%, beta of 1.65 and tax rate of 15%. We assume debt/debt and equity at 27% and a terminal growth rate of 3% (unchanged).	Downside risks: Inability to get monetisation approval for games; regulatory headwinds on games and internet finance; a deeper macro slowdown that could affect advertisers' budgets; inappropriate advertising and video content; and changes in user preferences in terms of entertainment formats or communication.
	Target price:		
Buy	Up/downside:	We rate the stock Buy as we believe its diversification allows better resilience than peers with a good mix of cyclical and counter-cyclical traits.	
Meituan 3690 HK	Current price:	We value Meituan Dianping using a DCF-based valuation for which we assume a WACC of 9.1% based on a cost of equity of 11%, risk-free rate of 2.5%, China market equity premium of 5% and an estimated beta of 1.6, based on its close comparables in China e-commerce and leading transaction platforms. We also assume a terminal growth rate of 3% (all unchanged).	Downside risks: Intensified competition; limited room to lift the monetisation rate; aggressive investments; and a consumption slowdown.
	Target price:		
Buy	Up/downside:	We reiterate our Buy rating on Meituan because it is a top transaction platform in mainland China with a stickier user base, it is the profitable market leader in food delivery, and it has a comprehensive portfolio of products to cross sell to users via its apps.	
JD.com JD US	Current price:	We value JD using a DCF-based valuation for which we assume a WACC of 10.9% based on a risk-free rate of 2.5%, cost of debt of 7.9%, equity risk premium of 5% and beta of 1.7 (all unchanged). We also assume a terminal growth rate of 3% (unchanged). We maintain our Buy rating given the company's full-fledged logistics infrastructure, margin expansion and higher earnings growth potential vs peers.	Downside risks: Intensified competition, unexpected additional government regulations, failure to manage inventory effectively, operational disruptions in its logistics system, and failure to recoup returns from logistics and technology investments.
	Target price:		
Buy	Up/downside:	We calculate a fair value target price of HKD390 for the local shares (9618 HK, HKD292.4) based on the 2020e year-end USD/HKD exchange rate of 7.80 and an ADS-to-Hong Kong-listed-share conversion rate of 1 to 2.	

Priced at 23 Sep 2020
 Source: Bloomberg, HSBC estimates

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), or strategist(s) who is(are) primarily responsible for this report, including any analyst(s) whose name(s) appear(s) as author of an individual section or sections of the report and any analyst(s) named as the covering analyst(s) of a subsidiary company in a sum-of-the-parts valuation certifies(y) that the opinion(s) on the subject security(ies) or issuer(s), any views or forecasts expressed in the section(s) of which such individual(s) is(are) named as author(s), and any other views or forecasts expressed herein, including any views expressed on the back page of the research report, accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Binnie Wong, Karen Choi, Piyush Choudhary, CFA, Amit Sachdeva, Lina Yan, Ritchie Sun, Cleo Zhang and Puneet Gulati, CFA

Important disclosures

Equities: Stock ratings and basis for financial analysis

HSBC and its affiliates, including the issuer of this report ("HSBC") believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 25 September 2020, the distribution of all independent ratings published by HSBC is as follows:

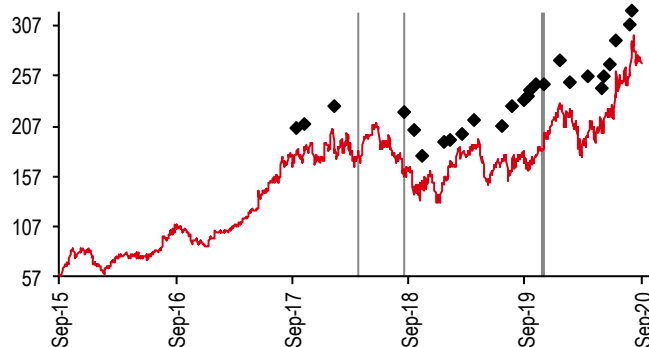
Buy	55%	(32% of these provided with Investment Banking Services)
Hold	36%	(32% of these provided with Investment Banking Services)
Sell	9%	(24% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see "Stock ratings and basis for financial analysis" above.

For the distribution of non-independent ratings published by HSBC, please see the disclosure page available at <http://www.hsbcnet.com/gbm/financial-regulation/investment-recommendations-disclosures>.

Share price and rating changes for long-term investment opportunities

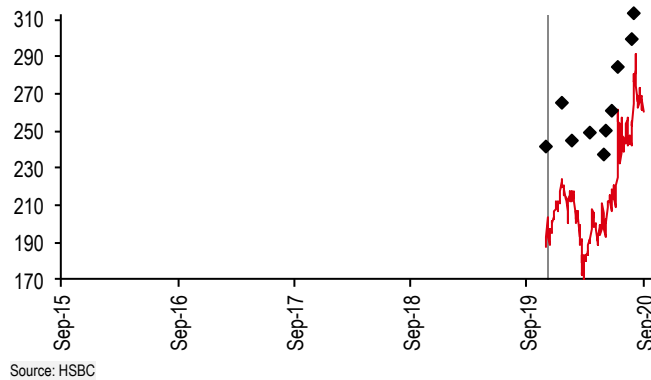
Alibaba Group (BABA.N) share price performance USD Vs HSBC rating history



Rating & target price history

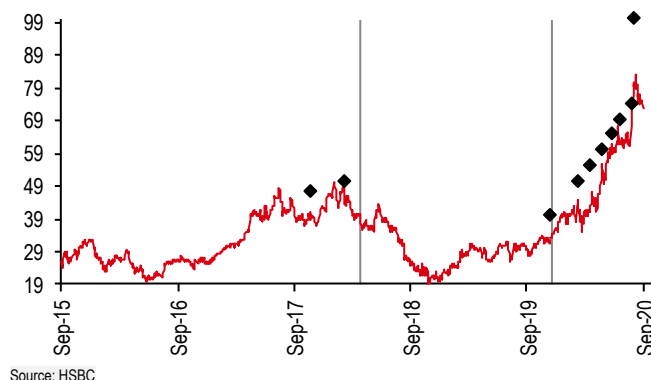
From	To	Date	Analyst
Buy	N/A	18 Apr 2018	
N/A	Buy	11 Sep 2018	Binnie Wong
Buy	Restricted	14 Nov 2019	
Restricted	Buy	21 Nov 2019	Binnie Wong
Target price	Value	Date	Analyst
Price 1	204.00	10 Oct 2017	Chi Tsang
Price 2	209.00	02 Nov 2017	Chi Tsang
Price 3	226.00	02 Feb 2018	Wayne Wang
Price 4	N/A	18 Apr 2018	
Price 5	220.00	11 Sep 2018	Binnie Wong
Price 6	203.00	10 Oct 2018	Binnie Wong
Price 7	177.00	04 Nov 2018	Binnie Wong
Price 8	190.00	14 Jan 2019	Binnie Wong
Price 9	192.00	31 Jan 2019	Binnie Wong
Price 10	199.00	14 Mar 2019	Binnie Wong
Price 11	213.00	17 Apr 2019	Binnie Wong
Price 12	206.00	15 Jul 2019	Binnie Wong
Price 13	226.00	16 Aug 2019	Binnie Wong
Price 14	233.00	24 Sep 2019	Binnie Wong
Price 15	236.00	08 Oct 2019	Binnie Wong
Price 16	242.00	11 Oct 2019	Binnie Wong
Price 17	247.00	01 Nov 2019	Binnie Wong
Price 18	Restricted	14 Nov 2019	
Price 19	247.00	21 Nov 2019	Binnie Wong
Price 20	272.00	13 Jan 2020	Binnie Wong
Price 21	250.00	13 Feb 2020	Binnie Wong
Price 22	255.00	13 Apr 2020	Binnie Wong
Price 23	243.00	24 May 2020	Binnie Wong
Price 24	256.00	01 Jun 2020	Binnie Wong
Price 25	268.00	19 Jun 2020	Binnie Wong
Price 26	292.00	09 Jul 2020	Binnie Wong
Price 27	307.00	20 Aug 2020	Binnie Wong
Price 28	321.00	27 Aug 2020	Binnie Wong

Source: HSBC

Alibaba Group (9988.HK) share price performance HKD Vs HSBC rating history

Rating & target price history

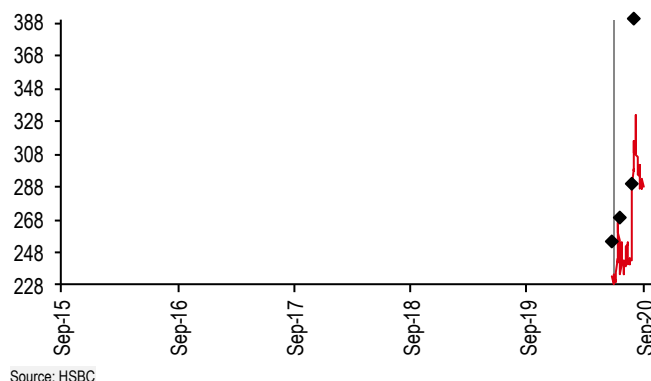
From	To	Date	Analyst
N/A	Buy	26 Nov 2019	Binnie Wong
Target price	Value	Date	Analyst
Price 1	241.00	26 Nov 2019	Binnie Wong
Price 2	265.00	13 Jan 2020	Binnie Wong
Price 3	244.00	13 Feb 2020	Binnie Wong
Price 4	249.00	13 Apr 2020	Binnie Wong
Price 5	237.00	24 May 2020	Binnie Wong
Price 6	250.00	01 Jun 2020	Binnie Wong
Price 7	261.00	19 Jun 2020	Binnie Wong
Price 8	284.00	09 Jul 2020	Binnie Wong
Price 9	299.00	20 Aug 2020	Binnie Wong
Price 10	313.00	27 Aug 2020	Binnie Wong

Source: HSBC

JD.com Inc (JD.OQ) share price performance USD Vs HSBC rating history

Rating & target price history

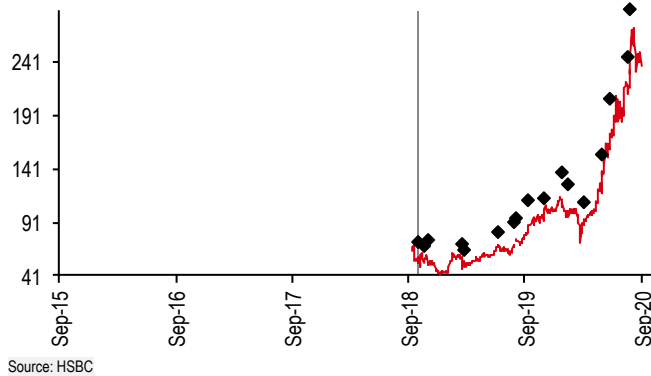
From	To	Date	Analyst
Buy	N/A	18 Apr 2018	
N/A	Buy	08 Dec 2019	Binnie Wong
Target price	Value	Date	Analyst
Price 1	47.00	13 Nov 2017	Chi Tsang
Price 2	50.00	02 Mar 2018	Wayne Wang
Price 3	N/A	18 Apr 2018	
Price 4	40.00	08 Dec 2019	Binnie Wong
Price 5	50.00	02 Mar 2020	Binnie Wong
Price 6	55.00	13 Apr 2020	Binnie Wong
Price 7	60.00	15 May 2020	Binnie Wong
Price 8	65.00	19 Jun 2020	Binnie Wong
Price 9	69.00	16 Jul 2020	Binnie Wong
Price 10	74.00	17 Aug 2020	Binnie Wong
Price 11	100.00	27 Aug 2020	Binnie Wong

Source: HSBC

JD.com Inc (9618.HK) share price performance HKD Vs HSBC rating history

Rating & target price history

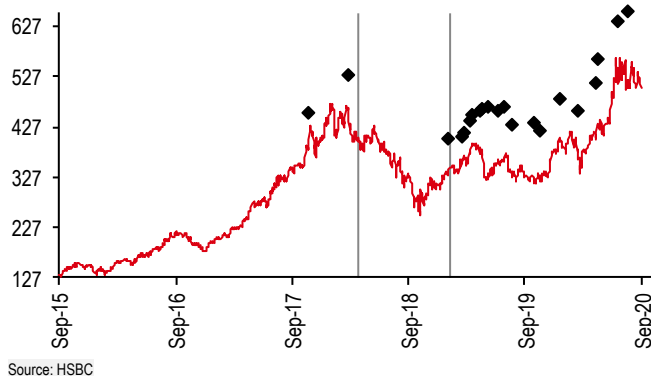
From	To	Date	Analyst
N/A	Buy	19 Jun 2020	Binnie Wong
Target price	Value	Date	Analyst
Price 1	254.00	19 Jun 2020	Binnie Wong
Price 2	269.00	16 Jul 2020	Binnie Wong
Price 3	289.00	17 Aug 2020	Binnie Wong
Price 4	390.00	27 Aug 2020	Binnie Wong

Source: HSBC

**Meituan Dianping (3690.HK) share price performance
 HKD Vs HSBC rating history**

Rating & target price history

From	To	Date	Analyst
N/A	Buy	24 Oct 2018	Binnie Wong
Target price	Value	Date	Analyst
Price 1	72.00	24 Oct 2018	Binnie Wong
Price 2	68.00	12 Nov 2018	Binnie Wong
Price 3	74.00	23 Nov 2018	Binnie Wong
Price 4	69.00	12 Mar 2019	Binnie Wong
Price 5	64.00	19 Mar 2019	Binnie Wong
Price 6	82.00	01 Jul 2019	Binnie Wong
Price 7	90.00	25 Aug 2019	Binnie Wong
Price 8	95.00	28 Aug 2019	Binnie Wong
Price 9	111.00	08 Oct 2019	Binnie Wong
Price 10	113.00	21 Nov 2019	Binnie Wong
Price 11	138.00	21 Jan 2020	Binnie Wong
Price 12	126.00	07 Feb 2020	Binnie Wong
Price 13	110.00	30 Mar 2020	Binnie Wong
Price 14	153.00	21 May 2020	Binnie Wong
Price 15	206.00	16 Jun 2020	Binnie Wong
Price 16	246.00	11 Aug 2020	Binnie Wong
Price 17	290.00	21 Aug 2020	Binnie Wong

Source: HSBC

**Tencent Holdings (0700.HK) share price performance
 HKD Vs HSBC rating history**

Rating & target price history

From	To	Date	Analyst
Buy	N/A	18 Apr 2018	
N/A	Buy	30 Jan 2019	Binnie Wong
Target price	Value	Date	Analyst
Price 1	454.00	15 Nov 2017	Chi Tsang
Price 2	527.00	21 Mar 2018	Wayne Wang
Price 3	N/A	18 Apr 2018	
Price 4	400.00	30 Jan 2019	Binnie Wong
Price 5	404.00	11 Mar 2019	Binnie Wong
Price 6	412.00	21 Mar 2019	Binnie Wong
Price 7	438.00	09 Apr 2019	Binnie Wong
Price 8	450.00	11 Apr 2019	Binnie Wong
Price 9	457.00	08 May 2019	Binnie Wong
Price 10	460.00	16 May 2019	Binnie Wong
Price 11	466.00	03 Jun 2019	Binnie Wong
Price 12	458.00	01 Jul 2019	Binnie Wong
Price 13	464.00	24 Jul 2019	Binnie Wong
Price 14	430.00	14 Aug 2019	Binnie Wong
Price 15	433.00	23 Oct 2019	Binnie Wong
Price 16	417.00	13 Nov 2019	Binnie Wong
Price 17	483.00	15 Jan 2020	Binnie Wong
Price 18	458.00	12 Mar 2020	Binnie Wong
Price 19	511.00	03 May 2020	Binnie Wong
Price 20	559.00	13 May 2020	Binnie Wong
Price 21	635.00	13 Jul 2020	Binnie Wong
Price 22	655.00	12 Aug 2020	Binnie Wong

Source: HSBC

To view a list of all the independent fundamental ratings disseminated by HSBC during the preceding 12-month period, please use the following links to access the disclosure page:

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HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price date	Disclosure
ALIBABA GROUP	BABA.N	269.73	24 Sep 2020	1, 4, 5, 6, 7, 11
JD.COM INC	JD.OQ	72.72	24 Sep 2020	1, 5, 6, 7, 11
MEITUAN DIANPING	3690.HK	238.60	24 Sep 2020	4, 7, 11
TENCENT HOLDINGS	0700.HK	505.00	24 Sep 2020	1, 2, 5, 6, 7, 11

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
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- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
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