Thammasat University Student Research

Retailing Industry

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CPALL PUBLIC COMPANY LTD.

Date: Dec 23, 2011

Exchange rate

USD/THB: 31.31

Ticker: ● SET: CPALL **Recommendation: ●BUY**

Price: ● THB 51.25 (USD 1.64) **Price Target: ●THB 61.10 (USD 1.95)**

	2008	2009	2010	2011 F	2012 F	2013 F	2014 F	2015 F	2016 F
(In M THB.)									
Total Revenues	129,454	117,761	141,084	160,540	187,081	210,659	233,486	258,446	285,733
EBITDA	6,833	9,474	12,057	15,166	16,642	18,877	21,288	24,013	27,097
Net Income	3,301	4,992	6,663	7,824	9,065	10,359	11,764	13,376	15,228
(THB/Share)									
Earnings per Share	0.74	1.11	1.48	1.74	2.02	2.31	2.62	2.98	3.39
Dividend per Share	0.60	0.80	1.40	1.39	1.61	1.96	2.23	2.53	2.88
Book Value per Share	3.77	4.21	4.00	4.77	5.40	6.09	6.75	7.50	8.36
(Percentage)									
Return on Assets (%)	8.2%	11.2%	13.9%	16.0%	16.5%	17.1%	17.7%	18.4%	19.1%
Return on Equity (%)	19.5%	26.4%	37.1%	36.5%	37.4%	37.9%	38.8%	39.7%	40.6%

Source: Company data and team's estimates

Highlights

A defensive stock with an aggressive business attitude

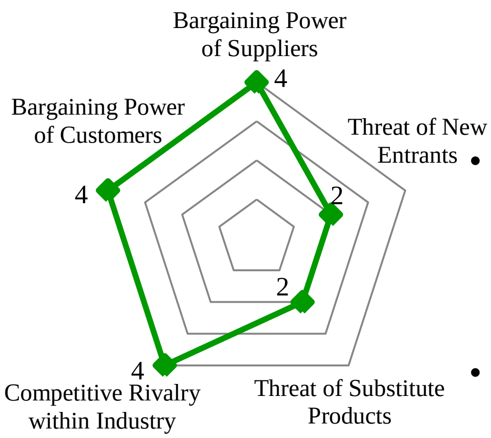
- **Fundamentals and valuation are indicative of a strong BUY:** With the target price at THB 61.10 at the end of 2012, there is a 21.9% upside gain[i], inclusive of dividend yield. CPALL's business is cash-based, enabling the company to maintain high liquidity. Coupled with its high bargaining power against suppliers, the company's balance sheet is free of interest-bearing debt, being financed largely by payables to suppliers.

- **Defensive Growth Stock with liquidity**: fundamentally, CPALL sells defensive products, being basic consumer goods and food items and is thus less vulnerable to economic volatility. This is evidenced by a relatively low correlation of 0.17 between CPALL's Average Store Sales Growth and the GDP growth, meaning that CPALL's revenues does not move in the same way as the economy. In addition, the CPALL stock itself is tolerant to economic downturn. In our view, a defensive play is attractive under current market uncertainty. Even more noteworthy is while the retail industry enjoys a 6.5% CAGR, CPALL's own staggering growth is expected to be 14.8%.

- **CPALL has a sustainable business model to support its rapid growth:** the Company's growth is supported by its franchising system, its strong balance sheet, its distribution centers nationwide, as well as its supportive subsidiaries and parent company, CP Group. The Five Forces model indicates that CPALL has an extremely favorable position in the retailing industry, especially in terms of high bargaining power over suppliers (Figure 1). This can be seen from the company's negative Cash Conversion Cycle, which implies that CPALL has effectively used suppliers to finance operations.

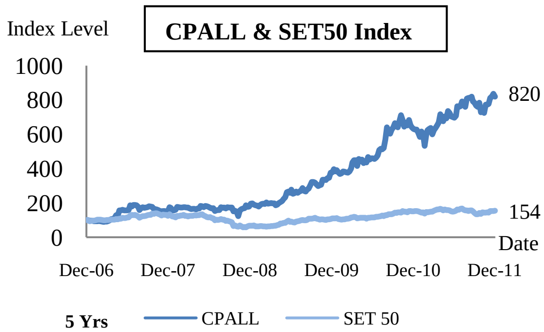
- **CPALL will maintain its dominance in the domestic market with no significant competitors on par:** CPALL's number of stores is far ahead of its competitors'. With the long history, the company has developed an expansive and highly efficient supply chain unmatched by other players. Given the company's financial capabilities and strengths in franchise, CPALL has possessed more strategic locations nationwide, preventing other players from being successful. When faced with new competition, CPALL opens new stores to encircle the competitors and drives them out. At the moment and in the near future, there are no potential sizable competitors that can threaten CPALL's leadership in convenience stores.

Figure 1: Five Forces Model



4 = Most favorable to CPALL
1 = Least favorable to CPALL

Source: Team's Analysis



Source: Bloomberg

Market Profile	
52 Week Price Range (THB/Share)	32.00 -53.50
Average Daily Volume (THB)	389M
Beta	0.80
Dividend Yield (Estimate)	2.96%
Share Outstanding (Shares)	4,493M
Free Float	43.9%
Market Capitalization (THB)	230,274M
Market Capitalization (USD)	7,355M
Institutional Holdings	63.7%
Insider Holdings	0.1%
Book Value per Share (THB)	4.46
Debt to Total Capital	60.0%
Return on Equity	42.1%

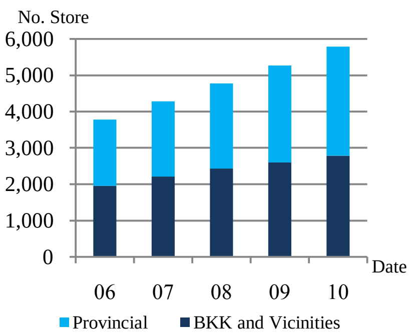
Source: Bloomberg

Figure 2: Type of store breakdown

Store Type	
Sub – Licensing	Exclusive rights for store expansion in the specified area
Type B	Management contract + Bonus
Type C	Profit sharing
Own Store	CPALL own operation
PTT Store	Contract to open 7-Eleven stores in PTT petrol service stations

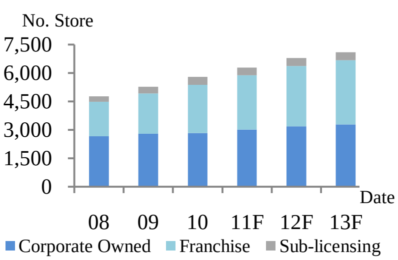
Source: Company website

Figure 3: Greater BKK vs. Provincial



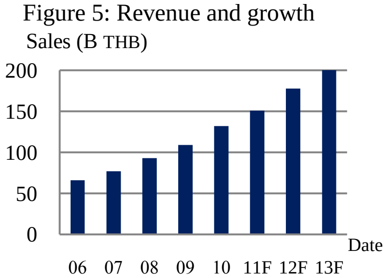
Source: Company release

Figure 4: Type of store breakdown



Source: Company release, team's estimates

Figure 5: Revenue and growth



Source: Company release, team's estimates

Business Description

One of the largest retail companies in Thailand, CP All Plc. was established in 1988. The company is a subsidiary of Charoen Pokphand Group, Thailand's giant and influential conglomerate dominating in the food, agribusiness, retailing, and telecommunications industries. The primary business of CP All Plc. involves the operation of convenience stores under "7-Eleven" trademark. The right to use this trademark in Thailand was exclusively granted to CPALL Plc. by 7-Eleven, Inc., USA. Today, this American-originated chain belongs to Seven & I Holdings Co., Ltd. in Japan (Appendix 7).

In Thailand, the store formats of 7-Eleven are divided into corporate stores, franchise stores, and sub-area license stores (Figure 2). The company has also established another type of outlet with a special contract with PTT, which is the largest oil and gas company in Thailand. PTT possesses the most extensive network of gas stations throughout the country. A contract with the company should thus tremendously benefit 7-Eleven.

The franchise model has proved to be strategically superior to the company's own stores as it fits well with the aggressive and rapid expansion of CPALL (Appendix 8). In addition, the franchise has allowed the company to save capital expenditure while simultaneously exposing to limited risk factors. To motivate franchisees, the return is rewarded upon performance. The franchise stores are further partitioned into two following types, with Type A having already been discontinued.

Type B. Regarding the initial investment in store setup, this is a relatively more expensive option for CPALL as franchisees pay less. However, all gross profits generated belong to the company, of which the obligation is to pay management fees and bonuses to the franchisees that have beat sales target.

Type C. This model involves less initial investment and yields a respectable return for the company. In this case, the franchisees are required to pay a large lump sum amount of right-to-manage fees, along with other fees. At the same time, CPALL enjoys a 46% share of the franchisee's gross profit. Like Type B, other administrative expenses incurred are borne by the franchisees.

Under the visionary management of CPALL, 7-Eleven has become the largest and most recognized convenience store chain in Thailand. The company's market capitalization of THB 230 billion also proves to be the largest among other convenience stores in Southeast Asia. The nationwide presence of more than 6,200 stores has allowed CPALL to serve approximately 7.1 million customers daily. Currently, almost half of the stores are located in Bangkok and Vicinities (Figure 3). The proportions of corporate stores, franchise stores, and sub-area license stores are 47.5%, 45.2% and 7.3% respectively (Figure 4). With the aggressive expansion, Thailand is now the third largest 7-Eleven hub in terms of the number of stores, only behind Japan and the U.S. In addition, 7-Eleven Thailand is growing at the most rapid rate among all. The compounded annual growth rate from 2006 to 2010 as regards number of stores and revenues from convenience stores are 11.2% and 18.9% respectively (Figure 5). The operational efficiency is also reflected through the consistent increase in margin.

Aiming to become "the convenience food store of Thais," CPALL has attempted to place heavier emphasis on food products, which generate a higher margin. At the same time, it is striving to expand its presence to reach more customers. In 2008, the company devised an objective to reach 7,000 branches within 2013 by opening 450 to 500 new stores annually. The expansion centers on provincial areas in which the penetration rate of 7-Eleven is still low while the mode of entry is largely franchising. The Bangkok-to-provincial store target mix of the new openings is 35 to 65. To support the future growth in rural areas, a new distribution center is also being constructed (Appendix 9-10).

In addition, there are several other strategic business units under CPALL. They serve to create synergies and ultimately bring about a sustainable growth platform for the convenience store operation. The major supporting businesses and brief descriptions are provided in Appendix 11.

Industry Overview and Competitive Positioning

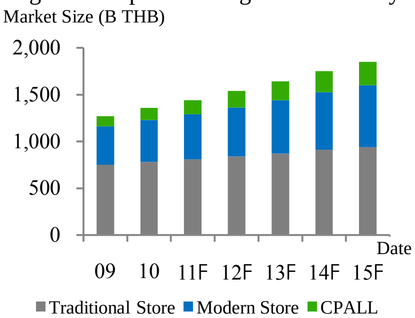
Macro Economic Analysis: Macro Conditions Point to Defensive Play.

The waning U.S. economy and the EU sovereign debt crisis post no direct impacts.
Unquestionably the Stock Exchange of Thailand will absorb some effects of the fragile economy in the U.S. and the European Union. The sideways-down market is to be expected. Consequently, there will be a demand for defensive stocks. Although the fundamentals of the Thai economy predominantly rely on export, Thailand will not likely take in the full impacts of the Western crisis. This can be explained by the fact that ASEAN has gradually increased its importance to Thai exports while trades with Western nations have reduced their

significance (Appendix 12). Furthermore, we are positive that the decline in the Western economies will not inflict a direct impact on Thailand's modern retails, let alone CPALL stock. Earnings of CPALL tend to remain healthy as the company's products are invulnerable to the economic cycle and are sold only to the domestic markets. Provided that CPALL is not only a defensive stock but also one that has grown consistently over the past, CPALL will remain impervious.

Infrastructure projects in Bangkok benefit retailing businesses.
The current expansion of mass transportation in Bangkok and Vicinities implies greater access to more residential locations[ii]. Urban sprawl as a result of mega projects and route extension of mass transits will enable CPALL to capture more strategic locations in new markets in Greater Bangkok. Since skytrain and subway metropolitanize the areas through which they pass and bring about greater business activities to the surrounding areas, the new routes present a lucrative opportunity in which dense customer traffic can be attained.

Figure 6: Rapid Growing Retail Industry



Source: McKinsey, Company, and Team's Estimates

Industry Analysis: Local Retail Industry Remains Sanguine.

Growth is expected to remain strong in Thailand's modern grocery[iii].
Despite the forecast that growth of the aggregate retail industry will slacken, the modern retails, which include hypermarkets and convenience stores, anticipate a high CAGR of roughly 10.1% from 2009 to 2015 according to McKinsey and Co.'s research (Figure 6). Traditional mom and pops, however, will suffer from stagnant growth. We expect CPALL will also enjoy such high growth through the company's aggressive expansion.

The Retail Sales Index suggests a strong and consistent growth pattern.
The historical Retail Sales Index from 2001 to 2010 shows a steadily rising trend with the CAGR of 10%. The Department Stores and Supermarkets category (Figure 7), including hypermarkets, department stores, and convenience stores, also enjoys the same rate of CAGR[iv]. In addition, this Index category has been growing every year regardless of the poor performance of the overall economy at certain times. This confirms that sales of the modern trade are independent of the economy.

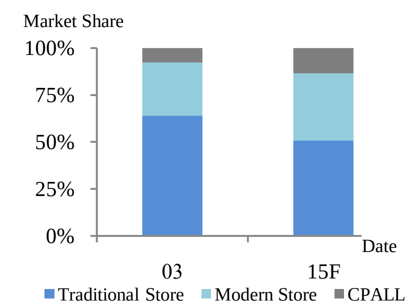
Figure 7: DSS Components

Cooperative Stores
Department Stores
Traditional Stores
Non – specialized Retails
Variety shops

Source: Bank of Thailand

The draft of the Retail and Wholesale Act may affect the expansion of modern trade stores.
In hopes of protecting traditional retail businesses from the rapid expansion of big store formats, the Thai Cabinet has proposed the amendment to the Retail and Wholesale Act. The amendment concerns more stringent zoning regulations that are applied to new openings of modern trade stores with an area greater than 100 square meters. The possible consequence is the slowdown of the large-format retail store expansion. 7-Eleven, however, is likely to stay aloft this Act since its outlets are of smaller sizes. The possible downside to CPALL is that other big players might focus more on the convenience store business model in order to circumvent the implications of this Act. As such, CPALL may eventually encounter a fiercer competition. Yet, we are confident that CPALL can fend off competitors.

Figure 8: CPALL Gains Market Share from Traditional Stores

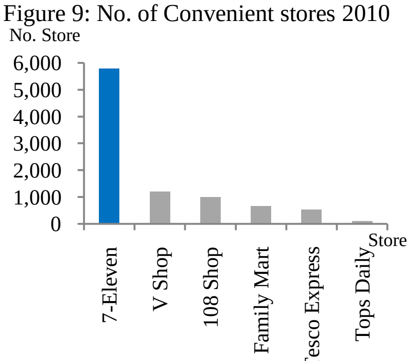


Source: McKinsey, Company, and Team's Estimates

The downturn of traditional grocers signals opportunities for modern groceries.
The number of mom-and-pop stores and street vendors has nosedived during the past decade. Despite representing the majority of the retail market, the presence of these traditional retailers has declined sharply. Their market share decreased from 60% in 2001 to 50% in 2005[v] (Figure 8). It was estimated that there were over 300,000 traditional retailers nationwide in 2001. In 2007, the number decreased by half to roughly 170,000[vi], which represented a 9.0% compounded annual decline rate. The decline has subsisted until today. We consider this a plus for modern trade retailers as the decrease in the traditional stores is offset by the increase in the modern retailers. Therefore, CPALL has more opportunities to gain new market share.

Convenience store has become part of the Megatrend.
As Thailand has become more and more economically developed, the city lifestyles emerge. Urbanization and increased wealth of the rural population have led to changes in purchasing behaviors and consumption habits. Consumers begin to value convenience and shopping time minimization. Ready-to-eat and prepared food is also gaining immense popularity as "two-thirds of grocers' sales during traffic times are for on the go/immediate consumption items.[vii]" The modern trade industry, especially convenience stores, will profit enormously from this universal trend in the next 10 to 20 years. This is particularly compatible with CPALL's business model, in which it plans to further emphasize on food products to account for up to 75% of the total product mix.

Figure 9: No. of Convenient stores 2010



Source: Each company's website

Competition Analysis:

7-Eleven has no clear peer comparison. Its market share in terms of the number of stores of 52.8%[viii] far exceeds that of competitors in the convenience store format (Figure 9). It has secured strategic locations which serves as the entry and success barrier to the business, allowing it to alienate the competitors from being a threat in the near future. Although the Retail and Wholesale Act may also drive competitors like Tesco Lotus and Big C to open more smaller formats known as Tesco Lotus Express and Mini Big C, these stores do not operate under a franchising system and therefore will not be able to expand as fast as CPALL.

On the other hand, operators such as Family Mart, 108 Shop and V Shop do franchising. Despite the fact, they all try to avoid 7-Eleven by being located in areas with few to no 7-Eleven outlets. Other competitors include gas station convenience stores and traditional mom-and-pop stores which still constitutes a high percentage of retail trade in Thailand. Refer to Appendix 13 for the comparison table between CPALL and Convenience Store competitors.

Tesco Lotus

The discount store giant has started to penetrate the convenient store market with its Tesco Lotus Express. It has expanded to 541 stores so far, with most of the locations in Bangkok and major cities. Tesco Lotus Express stores are larger in size than 7-Eleven stores, at 150-360 m^2 when compared to 7-Eleven's less than 100 m^2. Thus, Tesco Lotus Express can offer a greater variety of products, causing the product mix to differ from that of 7-Eleven. With its established distribution system and financial strength, Tesco could be a bigger threat in the future. However, CPALL uses the encircling strategy to counter Tesco Lotus Express by asking franchisees to open new stores to surround the competitor, thereby effectively driving them out.

Big C

Big C has recently begun opening smaller-sized convenience store formats by means of own expansion with 44 Mini BigC stores so far[ix]. Its primary focus is on Greater Bangkok. Mini BigC stores are 80-100m^2 in size, making it more comparable with 7-Eleven. The product mix is somewhat more diverse.

Family Mart[x]

Siam Family Mart Co., Ltd. is the most direct competitor of 7-Eleven with similar growth strategies and targets. It leverages the Japanese Family Mart franchise system and closely coordinates with Siam DCM Co., Ltd. a distribution and wholesaling company. Despite its 20 years' presence in Thailand, Family Mart is still a much smaller player with merely 661 stores. With plans to expand in urban areas and tourist destinations, it would be vying for the most attractive locations similar to 7-Eleven. Nevertheless, Family Mart has not been expanding much during the past decade.

V Shop

There are 1,200 V Shops nationwide, over 70%[xi] of which are located outside Bangkok. Its strategy is to avoid 7-Eleven. Thus, as 7-Eleven plans to focus more on non-Bangkok areas in the future, V Shop could be viewed as a potential direct competitor.

108 Shop

108 Shop is a convenience store chain and is one of the two-hundred subsidiaries of Saha Pathanapibul Group, one of the largest Thai manufacturers and distributors of consumer goods with modern logistics, 108 Shop possesses over 700 stores[xii] in grassroots communities, with the objective for traditional store operators to become its franchisees in order to be more competitive. It is starting to franchise in India and Myanmar.

Gas Station Stores

There are over 1,205 convenience store branches under different brands at different gas stations. In comparison, 7-Eleven has an exclusive agreement, enabling it to operate at 902 PTT nationwide[xiii].

Traditional Stores

There still exist hundreds of thousands traditional stores in the country. They are of smaller sizes and mostly located in rural areas. Nonetheless, they are obsolete in their inventory management and store offering format and, therefore, cannot compete with modern convenient stores which enjoy superior supply chain management and economies of scale.

Investment Summary

A Defensive stock with an aggressive business attitude

Fundamentals and valuation are indicative of a strong BUY.

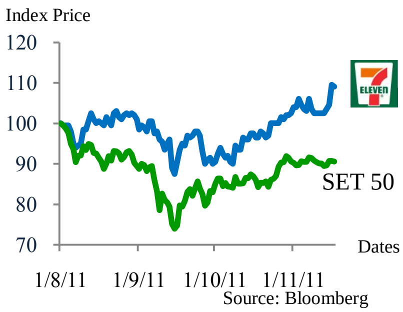
The analysis on the ground basis of the company, along with the estimated valuation of several methods, confirms the attractiveness of CPALL stock. The target price of THB 61.10 at the end of 2012 projects an impressive 21.9% absolute upside (Figure 10). Such a remarkable figure of the target price is entirely legitimate as it is derived from a holistic perspective, being justified by the ranges of values yielded by many pertinent valuation methods that are widely used in this industry. Endowed with CPALL are also the strong business fundamentals and attainable growth opportunities. Over the years, CPALL's strong balance sheet and outstanding operating performance have translated into the company's winning stock. The company has invariably maintained high liquidity with its cash-based and interest-bearing debt free balance sheet. Capitalizing on its unparalleled bargaining power, CPALL has also managed to be financed chiefly by suppliers.

Figure 10: Absolute Return

	THB
Target price	61.10
Dividend (2011)	1.39
Current Price	51.25
Upside	21.9%

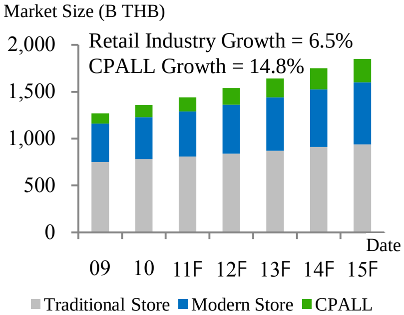
Source: Team's Estimate

Figure 11: Peak of Euro Crisis



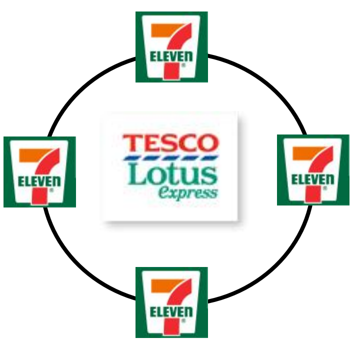
Source: Bloomberg

Figure 12: Rapid Growing Retail



Source: McKinsey, Company, and Team's Estimates

Figure 13: Encircle Strategy



Source: Management and Team's Analysis

Figure 14: Regional Peer Sharpe Ratio

Company	Sharpe Ratio
CPALL	2.52
President Chain Corp	1.39
Convenience Retail Asia	0.79
Seven & I	-0.23
Family Mart	-0.31
Philippine Seven	1.38

Source: Bloomberg

Defensive Growth Stock with liquidity: fundamentally, CPALL sells defensive products being basic consumer goods and food items and is thus less vulnerable to global economic volatility. In our view, a defensive play is attractive under current market uncertainty. The correlation between the Average Store Sales Growth and the GDP Growth is very low at only 0.17, meaning that CPALL's revenue does not move in the same way as the economy, further exhibiting its defensive nature. The stock itself is also more tolerant to economic downturn; for example, during the peak of the Euro Debt Crisis, CPALL only fell by 10% while the SET50 declined by 25% (Figure 11). Unlike any other defensive stocks, CPALL has enjoyed spectacular growth. While the retail industry is expected to grow at 6.5% CAGR from 2009 to 2015[xiv], the company's own growth is forecasted to more than double that of the industry, at 14.8% (Figure 12).

CPALL has a sustainable business model to support its rapid growth: the Company's growth is supported by its franchising system, its strong balance sheet, its distribution centers nationwide, and its supportive subsidiaries and parent company, CP Group. The Five Forces model indicates that CPALL has an extremely favorable position in the retailing industry, especially since it has high bargaining power over its suppliers, as seen from the negative cash conversion cycle, effectively using suppliers to finance its operations. Keeping costs low is another unique capability of 7-Eleven as it has economies of scale and significant negotiating power. CPALL's established relationship with, and its extensive support for, franchisees are of extraordinary strength. Franchising allows for CPALL to expand with lower investment as the franchisees already incurs most of the initial investment. CPALL can therefore enjoy greater return on investment (ROI). The current franchising compensation system enables CPALL to push costs to the franchisees as the profit sharing structure is calculated as a percentage of gross profit before deducting costs such as labor, utilities, leasing fees, shrinkage and costs of carrying perishable goods, for example (Appendix 14).

CPALL will maintain its dominance in the Thai market with no significant competitors on par.
In Southeast Asia, let alone Thailand, CPALL is the largest corporation in the convenience store industry in terms of market capitalization and number of stores. Having dominated the Thai market for over two decades, the company has developed a matchless supply chain and has possessed thousands of strategic locations nationwide. As having prime locations is a key success factor in this business, it serves as an entry and success barrier to competitors; it drives 7-Eleven further ahead of its competitors. When faced with new competition, CPALL opens new stores to encircle the competitors and drives them out (Figure 13). As a consequence, we see no potential competitors that will come close to emulating CPALL's success at the moment and in the near future.

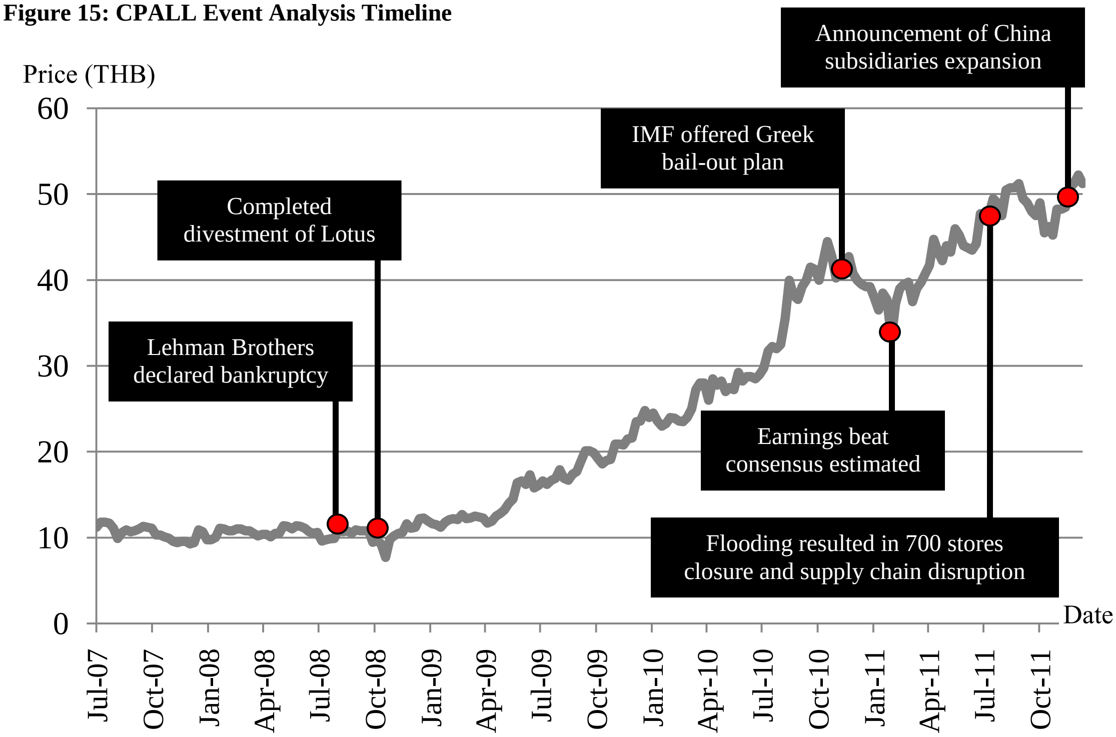
CPALL's Reward to Risk beats regional peers'
Comparing the Sharpe Ratios of CPALL and of other convenience chain operators in the region, namely President Chain Store Corp. Taiwan (Bloomberg ticker: 2912 TT Equity), Convenience Retail Asia Ltd. Hong Kong (Bloomberg ticker: 831 HK Equity), Seven & I Holdings Co. Ltd. Japan (Bloomberg ticker: 3382 JP Equity), Family Mart Co Ltd. Japan (Bloomberg ticker: 8028 JP Equity), Philippine Seven Corp(Bloomberg ticker: SEVN PM Equity), CPALL outperforms, giving higher reward per unit of risk. This also holds true when CPALL's Sharpe Ratio is compared to other domestic defensive stocks'. Refer to Figure 14.

"7-Eleven" brand distinguishes CPALL from competitors.
One of the very reasons of CPALL's success lies within the brand equity of 7-Eleven. This highly exposed trademark has blended with the Thai society for more than two decades. 7-Eleven conveys 24-7 convenience and reliability. People have stronger bonds with, and trust in, 7-Eleven. This is what other competitors have never been able to achieve. We are certain the company will continue to successfully leverage "7-Eleven" brand value to attract prospective franchisees as well as customers.

The domestic macrostructure accommodates CPALL's growth strategy.
Our analysis supports that there is enough room for growth both inside and outside Bangkok. Taken the number of population, the population density, and the GRP[xv] per capita into consideration, 7-Eleven can still expand profitably beyond its target of 7,000 outlets. Our estimate on the feasible number of stores within 2013 actually amounts to 8,630 branches[xvi]. Please see Appendix 15 for further clarifications.

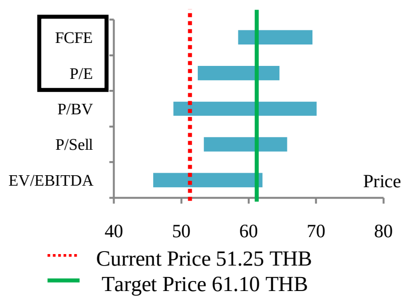
CPALL corporate governance is highly rated.
CPALL conducts its business under high ethical standards and transparency. The number of independent board members at CPALL exceeds the minimum requirement of the SEC, implying stringent supervision from unassociated parties and ensuring that minority's interests are protected. Please find more information regarding the CPALL's corporate governance in Appendix 16.

Figure 15: CPALL Event Analysis Timeline



Source: Bloomberg and Company's Website.

Figure 16: Football Field



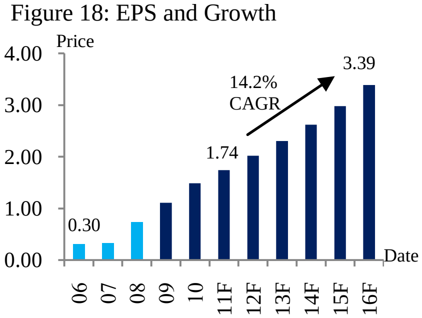
Source: Team's Estimates

Figure 17: FCFE components

	THB
Cash per Share	5.32
5 - Yr Projected CF	8.97
Terminal Value	49.10
FCFE	63.39

Source: Team's Estimates

Figure 18: EPS and Growth



Source: Company and Team's Estimates

Before the divestiture of Lotus China, CPALL's domestic operating profits were dragged down by 30% by the Chinese operations. After the divestiture, CPALL's share price skyrocketed as it was clear to the investors that positive structural changes have been implemented.

Valuation

Valuation of CPALL stems from two main models – FCFE and PER

We evaluated CPALL using Discounted Cash Flow and Multiples Analysis. We are convinced that the most appropriate techniques for CPALL are the Free Cash Flow to Equity (FCFE) and the Price/Earnings Ratio (PER). The former incorporates the long-term growth opportunity of this debt-free company, while the latter reflects the market valuation (Figure 16).

Discounted Cash Flow Model: Free Cash Flow to Equity (FCFE)

This method is suitable for CPALL as the company has no debt and it takes in consideration the time value of money. CPALL has high growth prospects and FCFE appropriately reflects the free cash flow value of the company and accounts for future growth as well as a long-term perspective. The base price from this model is THB 63.39.

Three Main Components of FCFE: Cash, Five-Year Projected Cash Flows and Terminal Value

CPALL's cash per share is THB 5.32 while the 5-year projected cash flows per share is valued to be at THB 8.97. The discounted terminal value component is THB 49.10 per share (Figure 17).

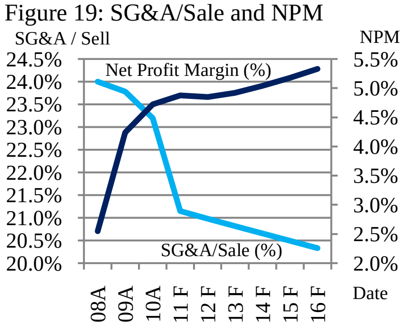
Five-Year Projected Cash Flow Assumptions

EPS growth is forecasted to be 14.2% as a result of increasing sales, rising margins, and the decline in SG&A to sales (Figure 18).

Sales forecast

The five-year projected cash flows are derived from increasing sales, from both aggressive store expansion and an increase in same store sales. Store expansion up to 2013 comes from management's concrete plan of reaching an implementable 7,000 branches from the current 6,206. There are abundant untapped opportunities in provincial areas while demand in Greater Bangkok is still unsaturated. New strategic locations for CPALL to exploit will arise with the expansion of mass transit systems in Greater Bangkok areas. Growth is expected to continue, albeit more slowly from 2013-2016. In contrast, service income is expected to decline due to increasing competition in payment services such as Internet banking and payment via ATM offered by the banking sectors. These services will rival 7-Eleven's Counter Service directly. Nevertheless, the risk is minimal since service income and other income account for only 4% of the total gross profit. As a result, sales are expected to grow at the rate of 12.5% CAGR over the next five years.

Figure 19: SG&A/Sale and NPM



Source: Company and Team's Estimates

Strong and increasing margins

Gross profit exhibits a steady and stable strong fundamental. As the company gradually increases its food composition in its product mix, from 73.5% to 75% in five years, its margin improves. Also as CPALL introduces its own house-brand products like its Le Pain baked goods it has the ability to improve margins further. Combined, the net margins will from 4.8% to 5.3% over the next five years. Such 0.5% increase is substantial in the retailing industry.

SG&A Growth Slower than Sales Growth

SG&A to sales is expected to decline (Figure 19). This is because headquarter administrative expenses will remain virtually unchanged, while sales increases. Moreover, since franchising will be the main mode of expansion in the future, CPALL will be able to push most SG&A expenses to franchisees. The current franchising compensation system enables CPALL to push costs to the franchisees as the profit sharing structure is calculated as a percentage of gross profit before deducting costs such as labor, utilities, leasing fees, shrinkage and costs of carrying perishable goods, for example.

Terminal Value Component Assumptions

The perpetual growth of 7.6% is the combination of the perpetual store expansion of 0.9% and the growth of Average Store Sales of 6.7%. The rate of the perpetual store expansion was calculated to be half of Thailand's annual urbanization rate of 1.8% as CPALL captures 50% of the modern convenience store market share. As regards the Average Store Sales growth, we ran the regression between Average Store Sales growth and Department Store and Supermarket Index growth (an index which includes convenience stores). Please see Appendix 17 for the regression equation and analysis. It should be noted that the first fifteen years of the perpetual growth period is the most important to the Terminal Value, and within that timeframe, we are certain that CPALL is able to attain the 7.6% perpetual growth rate.

Figure 20: Cost of Equity Composition

Cost of Equity	
10-Yr Risk Free Rate	3.24%
Expected Market Return	15.00%
Estimate MRP	11.76%
Beta	0.65
Beta (Adj.)	0.80
Equity Risk Premium	9.43%
Cost of Equity	12.67%

Source: Bloomberg and Team's Estimates

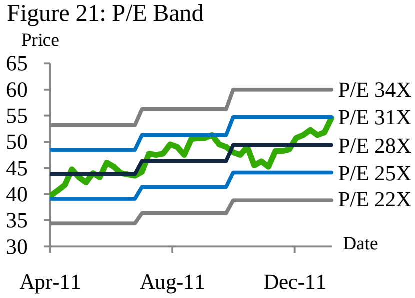
CAPEX

Whether the company is expanding by building its own-stores or through franchising, the CAPEX required is predicted to be the same at around THB 3.5 Million. Company own-stores usually rent the space from CPLAND, another company under the CP Group. The other capital expenditure includes store renovation, which is expected to increase every year from the rise in the number of total stores. In addition, one Regional Distribution Center can support 1,000 stores and requires an investment of THB 500 Million while the fast pace of information technology requires for a constant improvement. All of the above factors explain why we allocated an increasing CAPEX every year.

Cost of Equity

The Cost of Equity was calculated by the CAPM model, using the 10-year government bond risk-free rate of 3.24%, the expected market return of 15% and the adjusted beta of 0.8 to reflect the Cost of Equity of 12.67%. The raw data was extracted from Bloomberg (Figure 20).

Figure 21: P/E Band



Source: Bloomberg

Multiple Valuations: Price to Earnings Ratio (PER)

From a short-term point of view, the PER accounts for the market valuation during macroeconomic uncertainty. The P/E Band was employed to get the price range. Over the past year, CPALL was traded between 25 to 31 times (Figure 21). Therefore, we used the average PER band value of 28 to calculate the eventual price. With this method, we arrived at the final price of CPALL at THB 56.85.

Lowest PEG among the regional peers

Since there are no close peers for CPALL in Thailand, regional peers in the convenient store industry were chosen for better comparison. PEG ratio of CPALL is 1.1x which is the lowest among the regional peers. This implies that the price to earnings ratio of CPALL is not high when considering the growth prospects of CPALL. Please see Appendix 18-20 for further information.

Figure 22: Target Price

	Weight	Price (THB)	W x P (THB)
FCFE	65%	63.39	41.20
PER	35%	56.85	19.90
Target price			61.10

Source: Team's Estimates

Weighting of the models

Under the current bearish economic outlook, the valuation based on the fundamentals tends to be more useful and more relevant than the one based on the market sentiment. Therefore, FCFE is preferred to PER, and more weight is assigned to it – in this case 65%. The remaining 35% is then assigned to PER. The shareholding structure of CPALL serves as a proxy for the allocated weights to these two models. 65% of CPALL shareholders are institutions and the parent company whereas the remaining 35% is free float. The FCFE is more widely used by institutional shareholders who are long-term oriented. On the contrary, the PER better mirrors minor shareholders (Figure 22).

Conclusion
By combining both valuation methods to account for the company's intrinsic value and the market sentiment, as well as factoring in the growth potential, the fair price for CPALL is THB 61.10. Compared to the current price of THB 51.25, there is a clear opportunity to buy CPALL, with a potential absolute upside gain of 21.9% by the end of 2012.

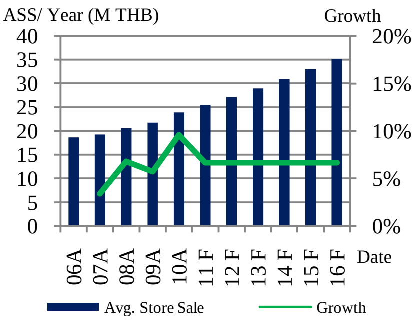
Risks to Price Target
The FCFE model relies mostly on the Terminal Value, which is determined largely by the assumed perpetual growth rate. The target price may be altered substantially should there be any changes to the Terminal Value, which represents a large lump sum amount of the discounted cash. Please see the Monte Carlo Simulation in the Risks Section for a more detailed analysis on the sensitivity of the perpetual growth rate. In addition to the risks of the perpetual growth rate, the risks of multiples entail subjectivity of the multiples themselves, being susceptible to the market conditions.

Financial Analysis

Strong earnings growth allows expansion by internally generated funds.

Earnings:

Figure 23: Average Store Sale & Growth



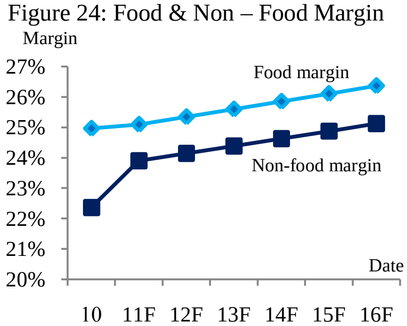
Source: Company and Team's Estimates

CPALL enjoys impressive earnings every year and its EPS will remain strong and steady, projecting a 12-15% growth.

Continual rise in Average Store Sales
Average Store Sales are shown to have consistently risen regardless of economic conditions (Figure 23). The average Store Sales are less volatile than the Department Store and Supermarket Index which includes convenience stores. This further emphasizes the company's quality of earnings.

Aggressive store expansion
The management's proposed expansion to 7,000 stores in 2013 from the current 6,206 will boost sales further as there exist many lucrative untapped opportunities outside Greater Bangkok. The Bangkok to provincial store target opening is 35 to 65, indicating that even Greater Bangkok itself is yet to be saturated in the short run. In addition, as mass transit systems expand in Bangkok, new strategic locations will arise for CPALL to capitalize upon. By using the franchise model as the main means of expansion, CPALL can also expand without incurring much investment as most of the capital expenditure will be paid by the franchisees.

Figure 24: Food & Non – Food Margin



Source: Company and Team's Estimates

Gross margins will improve
With more emphasis on food and house brand product additions, gross margins will improve (Figure 24). Focusing more on food products will not only help better CPALL's margins but it will also allow the company to differentiate itself from competitors through being a "convenience food store". On top of that, SG&A will grow more slowly than sales because of superior product procurement and economies of scale. Most of SG&A are fixed and will not rise, especially since franchising will be the main mode of expansion in the future. With franchising, the proportion of SG&A that will rise will only be associated to quality control and supervision, both of which are immaterial.

High quality of earnings from consistent growth and repeat sales while being less risky
Consumer goods and food products allow for faster repetition of sales when compared to durable items such as cars. Also, since the management aims to exert more emphasis on franchising, CPALL is able to push costs such as utilities, leasing fee, labor, shrinkage and all costs of carrying perishable goods to franchisees.

Cash Flow:

CPALL is a cash cow, using internally-generated funds for expansion and capital investment. It has the ability to maintain superior credit terms; paying suppliers in 60 days and receiving cash at point of sales. Its inventory days is 21, resulting in an extremely favorable negative Cash Conversion Cycle position. CPALL is excellent in managing its inventory, utilizing the latest technology and continuously improving at every point of its supply chain. Although the company promises an approximate 50% dividend payout, the actual payout rate is always higher. The payout ratio is forecasted to be 80%.

Balance Sheet & Financing:

Ample cash position and debt-free balance sheet
CPALL has a very healthy balance sheet, free of interest-bearing debt. It uses internally-generated funds to expand its stores. Now that it relies more on franchising, investment burden on CPALL is made even lower as franchisees will incur most costs associated. Therefore, the company has financial flexibility and can make better use of internally-generated funds for any overseas expansion should the opportunity arise. In addition,

by having superior power over suppliers, as seen by the negative Cash Conversion Cycle, CPALL can use the suppliers' money to finance its operations.

Additional Upside Potentials

Government Policies
The current government proposed to raise the minimum wage to THB 300 – a 30% to 40% increase depending on the region. The raise will be gradually implemented, first starting in April 2012 in Bangkok and Municipalities, as well as in Phuket. The policy will take effect province by province. This is positive for CPALL as it boosts the purchasing power of Thais, leading to a faster rate of urbanization, which, in turn, will eventually enlarge potential market opportunities and average sales per store. Looking at the cost side, CPALL already pays its employees higher than THB 300 while franchisees take care of their own labor costs. Thus, the increase in minimum wage will not adversely affect CPALL. With regard to inflation concerns, CPALL has substantial bargaining power over its suppliers, thereby being able to maintain a sizable spread. To incentivize businesses, the Government would lower corporate tax from 30% to 23%; this too is favorable for CPALL. With our weighted FCFE and PER valuation, the target value of CPALL with the associated benefits will rise to 66.72 THB per share, leading to an absolute upside of 32.3%.

Overseas Expansion
China remains an attractive market to venture into. On November 3rd, 2011, CPALL announced the establishment of two indirect subsidiaries in China. These subsidiaries can serve as a platform of CPALL's future expansion. Moreover, the parent company of CPALL, CP Group, has a strong foothold in China, where it is known to the locals as "Chia Tai Group." Therefore, CP Group is in a good position to support CPALL should it wish to do further businesses in China. The opportunities do not merely exist in China. Recently, the management has expressed interest in expanding the convenience store business in neighboring countries[xvii]such as Laos, Cambodia, and Vietnam, in which there has been a rise in income per capita. Yet, there has not been a concrete plan announced up to the moment.

Sino-Thai Rail Project to Boost Urbanization
Under the Memorandum of Understanding, a joint venture between the Chinese and Thai Governments will create five high-speed rail lines which would span 3,133 kilometers from Thailand to China. Consequently, there will be a strong boost to the rate of urbanization along the rail lines and new strategic locations will arise for CPALL to open new stores.

Investment Risks

Operational Risks:

Disruption of supply chain
This arises from any incidents that may affect the supply chain of CPALL such as damages to distribution centers due to natural disasters like floods. The company has mitigated this risk by taking insurance against damages to the distribution centers and 7-Eleven outlets. After the great flood in late 2011, new stores were installed with special flood prevention systems. In addition, CPALL has established a main distribution center in each region all over the country, weeding out the risk of over dependence on a single distribution center.

IT and communication system failure
IT and communication system are crucial to the efficient operation at CPALL. It is critical that CPALL handle orders and calculate the optimal product selection mix accurately for each outlet so that products are distributed accordingly at minimum costs. Failure in the IT and internal communication infrastructure implies either a loss of sales (due to lack of inventory) or an inventory excess, or even both. CPALL mitigates such risks through yearly IT maintenance and updates.

Conflicts with franchisees
A large part of CPALL's revenues come from sales of franchisees who account for more than 45% of the total 7-Eleven stores. Franchisees will also serve a primary means of future expansion. Any conflict of interest with them will adversely affect CPALL's growth and profitability. The company alleviates this risk by offering franchisees fair rewards and relentless promotional and technological support. The problem of conflict with franchisees has been tackled well by CPALL as evidenced by the rate of closure of only 0.5% per year, which is much lower than the world average of 5% per year. The "7-Eleven" brand itself also represents a huge value to the franchisees. As well, CPALL usually offers the existing franchisees to open new store to capture the demand in the surrounding area and to prevent other players from taking the benefits.

Product selection risks
CPALL may tend to promote its own house brand items and CP products; this could create conflict between CPALL and suppliers. Nevertheless, CPALL has a very high bargaining power over its suppliers who will not risk the opportunity to sell their products through CPALL's 6,206 outlets by terminating the business relationships. However, any mistake in product selection may also result in CPALL's inability to best cater to the demand of consumers. To counter this risk, CPALL uses the superior IT system that enables the company to track changes in demand pattern.

Competition Risks:

Smaller sub-formats of hypermarket operators
From the competitive standpoint, these are the most prominent and most relevant competitors. These players are urged to tap into the convenience store format due to the tightening Retail and Wholesale Act. They also have a financial and distribution capacity to expand organically and are currently increasing the number of their mini stores. However, they do not capitalize on the use of franchise, which allows for rapid expansion. The risk is mitigated as CPALL has already owned most prime locations and through the company's Go Strategy[xviii], or in other words, the Encircling strategy.

7-Eleven store cannibalization
The "Encircling" strategy of CPALL may eventually backfire as 7-Eleven outlets that are situated adjacent to one another may create a cannibalization effect. This would lead to a reduction in same store sales. Feasibility studies are crucial to determining and identifying this risk from the onset. They include onsite observations by counting store traffic and Feng shui[xix] as well as stringent selection of franchisees.

Regulatory Risks:

Retail and Wholesale Act
The new modifications and the higher stringency of the Retail and Wholesale Act in the near future will alter the retailing competitive landscape. Hypermarket operators will place heavier emphasis on convenience store business to escape the impacts of the regulations. 7-Eleven itself will not be directly affected by the Act because of its small outlet size. However, the intensifying competition may change the value of CPALL due to pressure on competitive pricing and decrease in CPALL's monopolistic power in the convenience store industry. The company's counteraction plan is to distinguish itself through becoming a "convenience food store," which will allow it to earn higher margins.

Macro Risks:

These risks include inflation and economic volatility. However, such uncertainties will affect every player in the market. We are confident in CPALL's ability to weather the inflation risks through transferring higher costs of products to both suppliers and customers. It should be noted once again that CPALL's sales do not correlate with the GDP; therefore, CPALL's revenues do not move in the same way as the economy.

Please see Appendix 21 for more details on operational risk matrix and the probability of occurrence.

Valuation Risks:

Since the Terminal Value, which is determined largely by the perpetual growth rate, accounts for the major part of the DCF Model, we ran Monte Carlo Simulation to test the sensitivity of the perpetual growth rate. As seen from the Appendix 22, the probability that will trigger a change to our recommendation from buy to sell is minimal at 4%, and even if it does occur, the loss is very limited. On the other hand, the probability of a gain is as high as 75%. Thus, we conclude that CPALL is indeed a defensive growth stock.

Disclosures:

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Appendix:

Appendix 1: Income Statement

Income Statement (In M THB)	2006A	2007A	2008A	2009A	2010A	2011F	2012F	2013F	2014F	2015F	2016F
Total Revenues	104,873	115,358	129,454	117,761	141,084	160,540	187,081	210,659	233,486	258,446	285,733
Cost of Sales & Service	77,761	86,157	94,354	82,718	98,837	115,046	134,453	151,522	167,906	185,750	205,172
Gross Profit	**27,112**	**29,201**	**35,100**	**35,043**	**42,247**	**45,495**	**52,628**	**59,137**	**65,581**	**72,696**	**80,561**
SG&A expense	25,912	29,090	31,067	28,005	32,722	33,951	39,253	43,854	48,224	52,961	58,093
Others Expenses	1,292	9	9	248	367	356	412	471	535	609	693
EBIT	**- 92**	**101**	**4,024**	**6,790**	**9,157**	**11,188**	**12,962**	**14,812**	**16,821**	**19,127**	**21,775**
Interest Expenses	311	634	530	2	0	0	0	0	0	0	0
Earnings Before Taxes (EBT)	**-402**	**-533**	**3,495**	**6,787**	**9,157**	**11,188**	**12,962**	**14,812**	**16,821**	**19,127**	**21,775**
Tax Expenses	865	829	1,205	1,774	2,487	3,356	3,889	4,444	5,046	5,738	6,532
Net Income (NI)	-1,267	-1,362	2,290	5,013	6,670	7,832	9,074	10,368	11,775	13,389	15,242
Profit to Non-Controlling Interest	-2,599	-2,822	-1,012	21	6	7	9	10	11	13	14
Profit to Shareholder	**1,332**	**1,460**	**3,301**	**4,992**	**6,663**	**7,824**	**9,065**	**10,359**	**11,764**	**13,376**	**15,228**

Source: Team's Estimates and Company's Annual Report

Appendix 2: Balance Sheet

Balance Sheet (In M THB)	2006A	2007A	2008A	2009A	2010A	2011F	2012F	2013F	2014F	2015F	2016F
Assets											
Cash and Cash Equivalents	10,654	12,510	12,647	13,878	20,151	20,165	23,911	27,820	31,623	36,117	41,388
Receivable	970	886	545	439	474	541	633	715	795	882	977
Inventories	7,672	7,699	5,444	5,900	6,518	6,619	7,736	8,718	9,660	10,687	11,804
Others Current Assets	2,504	2,124	2,271	2,908	3,570	1,838	1,838	1,838	1,838	1,838	1,838
Current Assets	**21,801**	**23,219**	**20,907**	**23,125**	**30,713**	**29,163**	**34,118**	**39,091**	**43,916**	**49,524**	**56,008**
Long-Term Investments	-	-	4,726	5,871	691	1,750	1,750	1,750	1,750	1,750	1,750
Net PPE	17,867	18,899	12,660	13,826	14,825	16,106	17,147	18,086	18,913	19,615	20,183
Others Non-Current Assets	3,302	3,102	1,866	1,620	1,676	1,796	1,796	1,796	1,796	1,796	1,796
Total Assets	**42,970**	**45,220**	**40,159**	**44,441**	**47,904**	**48,814**	**54,810**	**60,723**	**66,375**	**72,685**	**79,736**
Liabilities and Shareholder Equity											
Short-Term Borrowing	6,752	7,859	168	10	0	0	0	0	0	0	0
Accounts and Notes Payable	21,558	24,888	17,733	19,189	21,613	18,912	22,102	24,908	27,601	30,534	33,727
Others Current Liabilities	5,335	5,006	3,774	4,371	5,757	5,365	5,365	5,365	5,365	5,365	5,365
Total Current Liabilities	**33,646**	**37,753**	**21,676**	**23,570**	**27,369**	**24,276**	**27,466**	**30,272**	**32,965**	**35,899**	**39,091**
Long-Term Liabilities	380	772	0	0	0	0	0	0	0	0	0
Others Non-Current Liabilities	909	1,064	1,583	1,935	2,577	3,098	3,098	3,098	3,098	3,098	3,098
Total Liabilities	**34,934**	**39,589**	**23,259**	**25,505**	**29,946**	**27,374**	**30,565**	**33,370**	**36,064**	**38,997**	**42,190**
Shareholders Equity &Paid-Up Capital	5,987	6,083	6,177	6,177	6,177	6,177	6,177	6,177	6,177	6,177	6,177
Retain Earning	2,658	3,005	4,859	7,156	12,160	15,491	18,297	21,404	24,362	27,739	31,598
Others Components of Equity	-609	-3,457	5,863	5,603	-379	-229	-229	-229	-229	-229	-229
Total Equity	**8,036**	**5,631**	**16,900**	**18,937**	**17,958**	**21,440**	**24,246**	**27,352**	**30,311**	**33,688**	**37,546**
Total Liabilities and Shareholder Equity	**42,970**	**45,220**	**40,159**	**44,441**	**47,904**	**48,814**	**54,810**	**60,723**	**66,375**	**72,685**	**79,736**

Source: Team's Estimates and Company's Annual Report

Appendix 3: Statement of Cash Flow

Statement of Cash Flow(In M THB)	2011F	2012F	2013F	2014F	2015F	2016F
Cash flow from operation						
Net Income	7,824	9,065	10,359	11,764	13,376	15,228
Depreciation and Amortization	2,694	2,494	2,752	3,021	3,301	3,593
Change in NOWC	-1,530	1,981	1,742	1,671	1,820	1,980
Change in non - current liabilities	521	0	0	0	0	0
Change in other component of equity	150	0	0	0	0	0
Total cash from operation	**9,660**	**13,541**	**14,853**	**16,456**	**18,497**	**20,801**
Cash flow from investing						
Net CAPEX	-3,975	-3,536	-3,691	-3,847	-4,004	-4,160
Short term investment	-2,265	0	0	0	0	0
Long term Investment	-1,059	0	0	0	0	0
Intangible and others asset	-120	0	0	0	0	0
Total cash from investing	**-7,420**	**-3,535**	**-3,692**	**-3,848**	**-4,004**	**-4,160**
Cash flow from financing						
Dividend paid	-4,493	-6,259	-7,252	-8,805	-9,999	-11,370
Total cash from financing	**-4,493**	**-6,259**	**-7,252**	**-8,805**	**-9,999**	**-11,370**
Net change in cash	-2,252	3,746	3,909	3,803	4,494	5,271
Beginning cash	15,716	13,464	17,210	21,119	24,922	29,416
Ending Cash	13,464	17,210	21,119	24,922	29,416	34,687

Source: Team's Estimates

Appendix 4: Key Financial Ratio

Key Financial Ratio	2008	2009	2010	2011 F	2012 F	2013 F	2014 F	2015 F	2016 F
Liquidity Ratio									
Current Ratio (x)	1.0	1.0	1.1	1.2	1.2	1.3	1.3	1.4	1.4
Quick Ratio (x)	0.6	0.6	0.8	0.9	0.9	0.9	1.0	1.0	1.1
Cash Ratio (x)	0.6	0.6	0.7	0.8	0.9	0.9	1.0	1.0	1.1
Efficiency Ratio									
Total Asset Turnover (x)	3.2	2.7	3.0	3.3	3.4	3.5	3.5	3.6	3.6
Fixed Asset Turnover (x)	10.2	8.7	9.7	10.1	11.1	11.8	12.5	13.3	14.2
Acc Receivable Turnover (x)	222.2	249.4	278.8	279.7	280.6	281.1	281.6	282.0	282.3
Collection Period (days)	1.6	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Inventory Turnover (x)	17.1	13.8	15.0	17.2	17.2	17.2	17.3	17.3	17.3
Days in Inventory (days)	21.3	26.4	24.4	21.2	21.2	21.18	21.16	21.14	21.1
Payables Turnover (x)	5.3	4.3	4.5	6.0	6.0	6.0	6.0	6.0	6.1
Payables Period (days)	69.4	85.8	80.9	60.7	60.6	60.5	60.5	60.4	60.5
Operating Cycle (days)	22.9	27.9	25.7	22.5	22.5	22.5	22.5	22.4	22.4
Cash Cycle (days)	-46.4	-58.0	-55.2	-38.1	-38.1	-38.0	-38.0	-38.0	-38.0
Profitability Ratio									
Gross Profit Margin (%)	4.0%	26.4%	26.8%	25.4%	25.5%	25.7%	25.9%	26.1%	26.3%
EBIT Margin (%)	3.1%	5.8%	6.5%	7.0%	6.9%	7.0%	7.2%	7.4%	7.6%
EBITDA Margin (%)	5.3%	8.0%	8.6%	9.5%	8.9%	9.0%	9.1%	9.3%	9.5%
Net Profit Margin (%)	2.6%	4.2%	4.7%	4.8%	4.9%	4.9%	5.0%	5.2%	5.3%
ROA (%)	8.2%	11.2%	13.9%	16.0%	16.5%	17.1%	17.7%	18.4%	19.1%
ROE (%)	19.5%	26.4%	37.1%	36.5%	37.4%	37.9%	38.8%	39.7%	40.6%
SG&A/Sale	24.0%	23.8%	23.2%	21.1%	21.0%	20.8%	20.7%	20.5%	20.3%
Solvency Ratio									
Debt Ratio (%)	57.9%	57.4%	62.5%	56.1%	55.8%	55.0%	54.3%	53.7%	52.9%
Debt to Equity Ratio (x)	1.38	1.35	1.67	1.28	1.26	1.22	1.19	1.16	1.12
Equity Multiple (x)	2.38	2.35	2.67	2.28	2.26	2.22	2.19	2.16	2.12
Long Term Debt Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Interest Coverage Ratio (x)	7.59	2,744.37	81,761.04	0.00	0.00	0.00	0.00	0.00	0.00

Source: Team's Estimates and Company's Annual Report

Appendix 5: Income Statement (Common-Size)

Income Statement (Common-Size)	2006A	2007A	2008A	2009A	2010A	2011F	2012F	2013F	2014F	2015F	2016F
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Sales & Service	74.6%	74.7%	72.9%	70.2%	70.1%	71.7%	71.9%	71.9%	71.9%	71.9%	71.8%
Gross Profit	**25.9%**	**25.3%**	**27.1%**	**29.8%**	**29.9%**	**28.3%**	**28.1%**	**28.1%**	**28.1%**	**28.1%**	**28.2%**
SG&A expense	24.7%	25.2%	24.0%	23.8%	23.2%	21.2%	21.0%	20.8%	20.7%	20.5%	20.3%
Others Expenses	1.2%	0.0%	0.0%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
EBIT	**-0.1%**	**0.1%**	**3.1%**	**5.8%**	**6.5%**	**7.0%**	**6.9%**	**7.0%**	**7.2%**	**7.4%**	**7.6%**
Interest Expenses	0.3%	0.6%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Earnings Before Taxes (EBT)	**-0.4%**	**-0.5%**	**2.7%**	**5.8%**	**6.5%**	**7.0%**	**6.9%**	**7.0%**	**7.2%**	**7.4%**	**7.6%**
Tax Expenses	0.8%	0.7%	0.9%	1.5%	1.8%	2.1%	2.1%	2.1%	2.2%	2.2%	2.3%
Net Income (NI)	-1.2%	-1.2%	1.8%	4.3%	4.7%	4.9%	4.9%	4.9%	5.0%	5.2%	5.3%
Profit to Non-Controlling Interest	-2.5%	-2.5%	-0.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Profit to Shareholder	**1.3%**	**1.3%**	**2.6%**	**4.2%**	**4.7%**	**4.9%**	**4.9%**	**4.9%**	**5.0%**	**5.2%**	**5.3%**

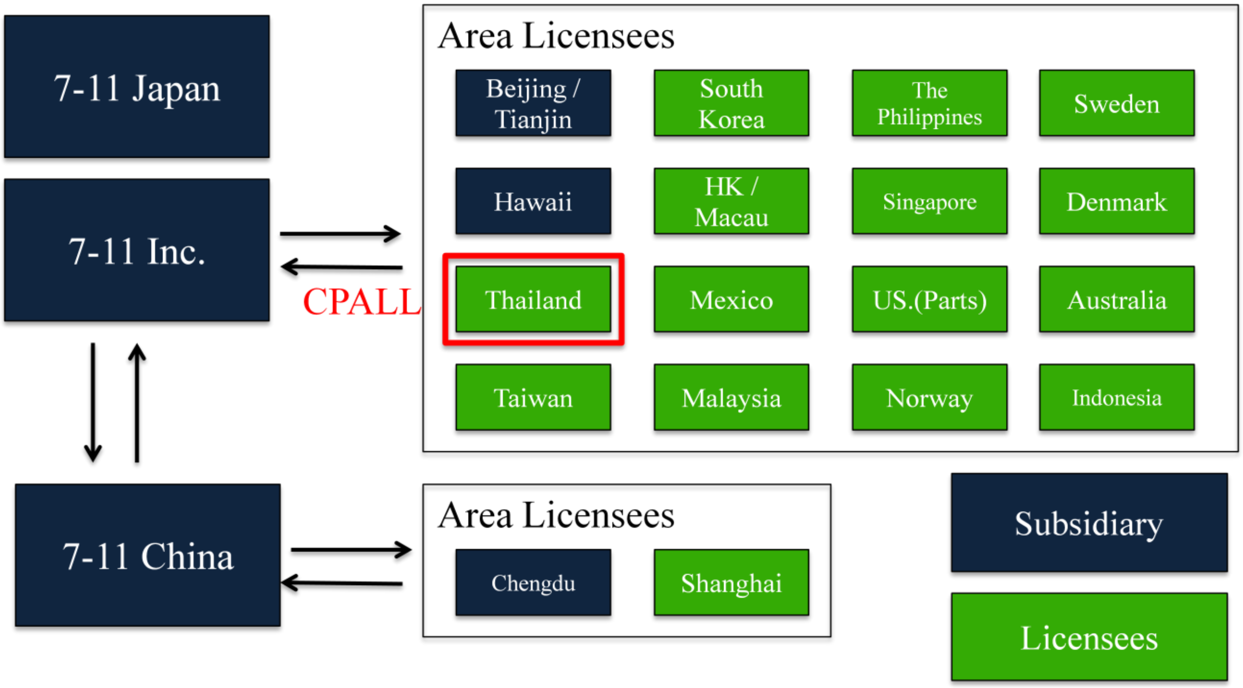
Source: Team's Estimates and Company's Annual Report

Appendix 6: Balance sheet (Common-Size)

Balance Sheet (Common-Size).	2008A	2009A	2010A	2011F	2012F	2013F	2014F	2015F	2016F
Assets									
Cash and Cash Equivalents	31.5%	31.2%	42.1%	41.3%	43.6%	45.8%	47.6%	49.7%	51.9%
Receivable	1.4%	1.0%	1.0%	1.1%	1.2%	1.2%	1.2%	1.2%	1.2%
Inventories	13.6%	13.3%	13.6%	13.6%	14.1%	14.4%	14.6%	14.7%	14.8%
Others Current Assets	5.7%	6.5%	7.5%	3.8%	3.4%	3.0%	2.8%	2.5%	2.3%
Current Assets	**52.1%**	**52.0%**	**64.1%**	**59.7%**	**62.3%**	**64.4%**	**66.2%**	**68.1%**	**70.2%**
Long-Term Investments	11.8%	13.2%	1.4%	3.6%	3.2%	2.9%	2.6%	2.4%	2.2%
Net PPE	31.5%	31.1%	31.0%	33.0%	31.3%	29.8%	28.5%	27.0%	25.3%
Others Non-Current Assets	4.7%	3.6%	3.5%	3.7%	3.3%	3.0%	2.7%	2.5%	2.3%
Total Assets	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Liabilities and Shareholder Equity									
Short-Term Borrowing	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Accounts and Notes Payable	44.2%	43.2%	45.1%	38.7%	40.3%	41.0%	41.6%	42.0%	42.3%
Others Current Liabilities	9.4%	9.8%	12.0%	11.0%	9.8%	8.8%	8.1%	7.4%	6.7%
Total Current Liabilities	**54.0%**	**53.0%**	**57.1%**	**49.7%**	**50.1%**	**49.9%**	**49.7%**	**49.4%**	**49.0%**
Long-Term Liabilities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Others Non-Current Liabilities	3.9%	4.4%	5.4%	6.4%	5.7%	5.1%	4.7%	4.3%	3.9%
Total Liabilities	**57.9%**	**57.4%**	**62.5%**	**56.01%**	**55.8%**	**55.0%**	**54.3%**	**53.7%**	**52.9%**
Shareholders' Equity and Paid-Up Share Capital	15.4%	13.9%	12.9%	12.7%	11.3%	10.2%	9.3%	8.5%	7.8%
Retain Earning	12.1%	16.1%	25.4%	31.7%	33.4%	35.3%	36.7%	38.2%	39.6%
Others Components of Equity and Minority Interests	14.6%	12.6%	-0.8%	-0.5%	-0.4%	-0.4%	-0.4%	-0.3%	-0.3%
Total Equity	**42.1%**	**42.6%**	**37.5%**	**43.9%**	**44.2%**	**45.0%**	**45.7%**	**46.4%**	**47.1%**
Total Liabilities and Shareholder Equity	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Team’s Estimates and Company’s Annual Report

Appendix 7: 7-Eleven Global Licensing Scheme



Source: 7-Eleven Japan's Annual Report

Appendix 8: World Profit Sharing Schemes

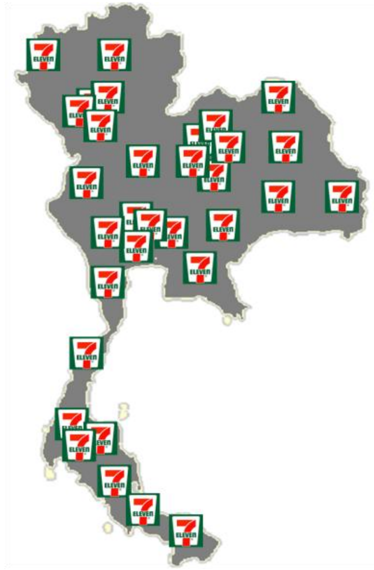
Can Command Highest Profit Share

	Thailand	US	Japan	Taiwan
Profit Sharing of Gross Profit	46%	Progressive 5-30%	43-45%	38%
Utilities	Franchisee	Franchisee	80% by 7-11	50% by 7-11
Start-up Costs	Med	High	Low	Low-Med
Initial investment(USD)	88,000	442,900	34,000	80,000

No additional costs such as payroll and utilities
Store expansion financed by Franchisee

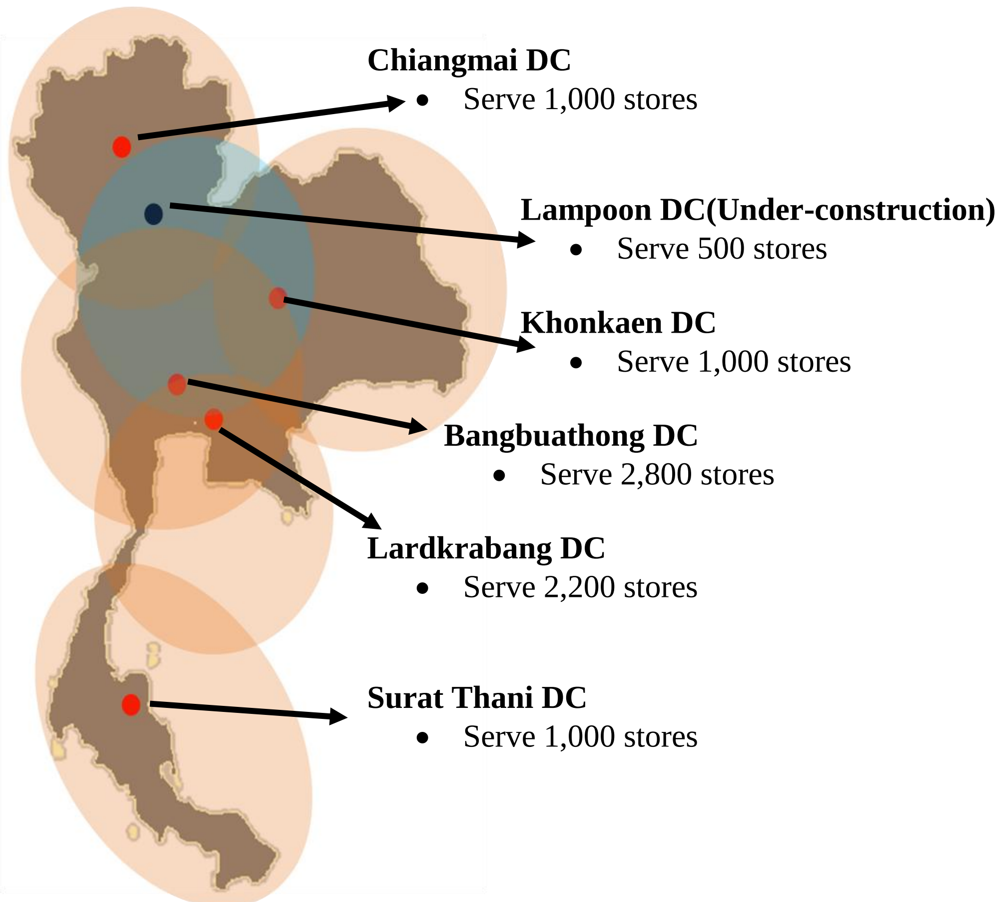
Source: Team's Estimates and 7 Eleven US, Japan, Taiwan Websites

Appendix 9: Store Location- Concentrated in Greater Bangkok and major cities in each region



Source: Team's Estimates and Company's Annual Report

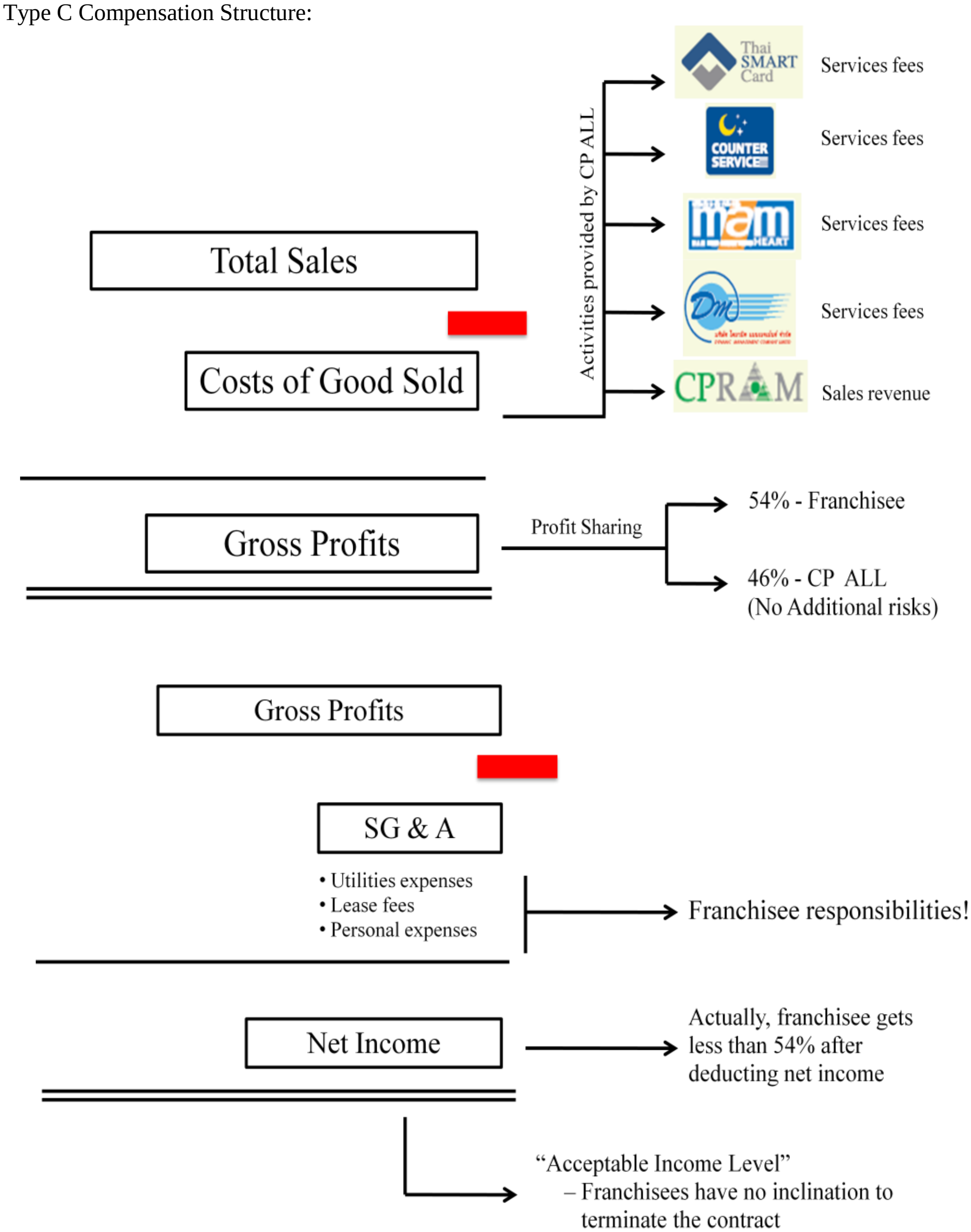
Appendix 10: Distribution Centers' Locations



Source: Team's Estimates and Company's Annual Report

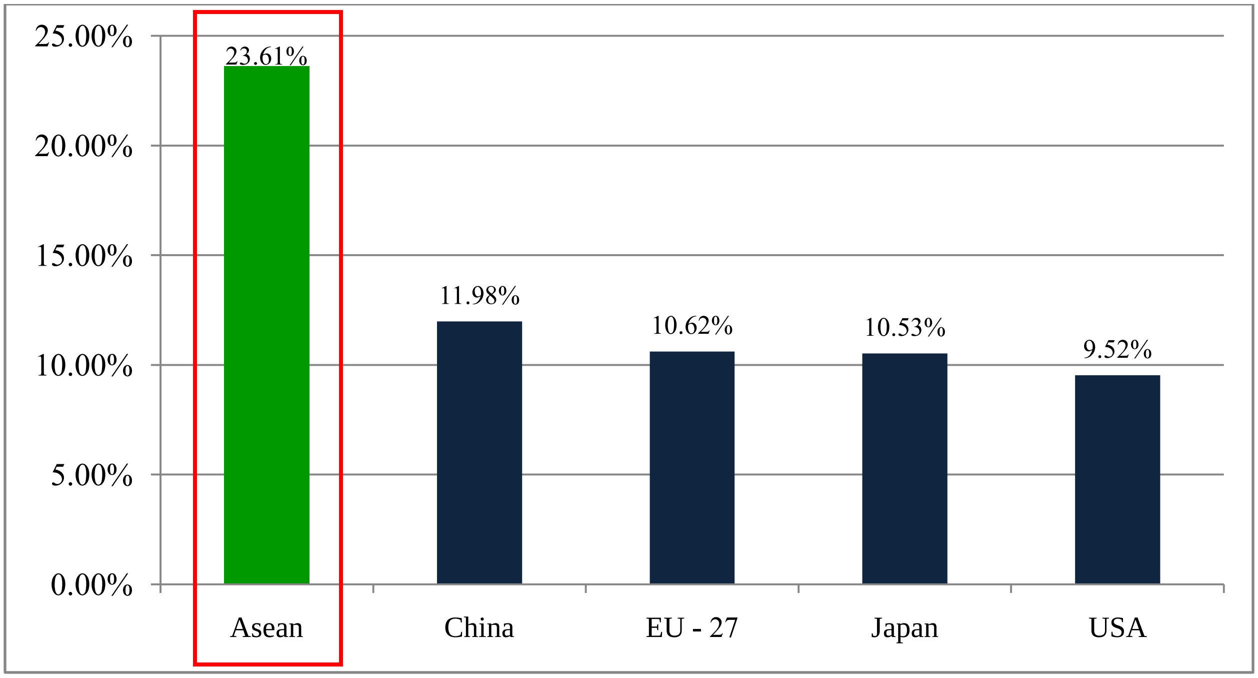
Appendix 11: Business Structure and Franchise Compensation Structure

Franchise Store Type C Compensation Structure:



Source: Company's Annual Report and Team's Analysis

Appendix 12: Thailand Export Partners in 2010



Source: Department of Trade Negotiation

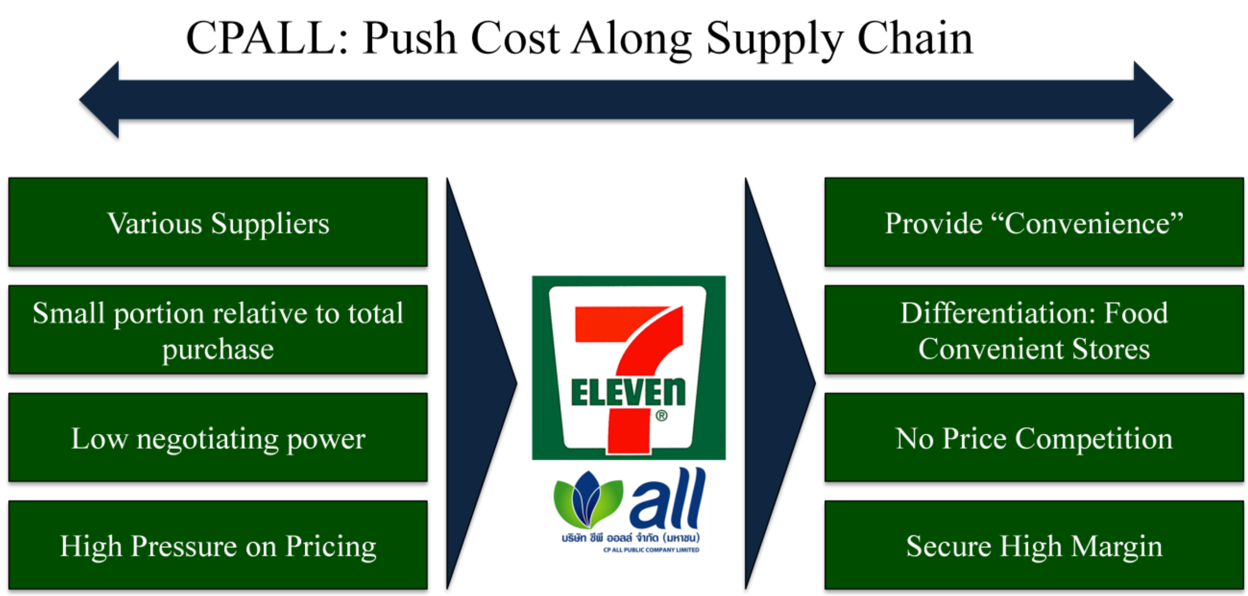
Appendix 13: CPALL's Competition Matrix

Comparison Table between CPALL and Competitors

Dimension	7 ELEVEN	TESCO Lotus express	mini Big C	FamilyMart	V SHOP	108 SHOP
Number of Stores	6,206	541	44	661	1,200	700
Franchising System	High	--	--	Med	Low	Low
Distribution Channel	High	High	Med	Low	Low	Med
Bangkok Stores	High	Med	Low	Med	Low	Low
Provincial Stores	High	Low	--	Low	Med	Med
Brand Equity	High	High	High	Med	--	--
Financial Resources	High	High	High	Med	Low	Med

Source: Team's Estimates and Companies' Releases

Appendix 14: CPALL has the ability to push cost along supply chain



Source: Team's Analysis

Appendix 15: Two Quantifying Methods of Store Growth Potential Calculation

First Method

What? The first method attempts to find out whether or not our team's assumption of CPALL having 7,990 outlets by the end of Year 2016 is possible.

Note that in our FCFE valuation model, we assume that CPALL can open 500 new stores in 2012 and 300 additional stores in each year afterward up until 2016. Therefore, by the end of 2016, there will have been roughly 7,990 7-Eleven outlets nationwide. The calculation is shown below:

- *The number of 7-Eleven stores by the end of Year 2010 was 5,790.*
- *According to the management, CPALL is to open additional 500 stores during 2011. So by the end of 2011, there will be 5,790 + 500 = 6,290 Seven-Eleven outlets.*
- *In 2012, we assume that CPALL can open another 500 new outlets. So, at the end of the year, there will be a total of 6,290 + 500 = 6,790 stores.*
- *We assume further that from 2013 – 2016, there will be 300 new stores opened annually. All together, there will be 300 x 4 = 1,200 new stores. Therefore, by the end of 2016, there will be a total of 6,790 + 1,200 = 7,990 7-Eleven outlets nationwide.*

Answer: Our analysis has indicated that the domestic market offers enough room for CPALL to expand its branches to the target of 7,990 by the Year 2016. In fact, our calculation suggests that the feasible number of 7-Eleven outlets in 2016 can be as high as 8,038 stores. This number is derived from the amalgamation of factors considered to be relevant criteria for the convenience store expansion. These criteria are elaborated below.

In this case, we assume that "Bangkok and Vicinities" itself is not yet saturated. From 2013 to 2016, it presents a roughly 5% growth opportunity (1.67% per year) due to route extensions of mass transportation and urban sprawl. Refer to Cell C2 of Table 1 below, by 2013, there is expected to be 3,243 stores located in Bangkok and Vicinities. Therefore, based on our assumption, by the end of 2016, there will have been a total of 3,243 x 1.05 = 3,405 Seven-Eleven outlets in Bangkok and Vicinities as evidenced in Cell J7 in Table 2.

Having established Bangkok as a benchmark, we then quantify and interpolate the potential in other provincial regions, namely North, Northeast, South, Central, West, and East. The main factors brought into the equation include:

- The number of population
  - This represents how large the market in a particular region is. With more population, there is likely to be a high number of potential customers for 7-Eleven.
- Population density
  - The number of population itself is not completely meaningful as it cannot incorporate the dispersion of people residing in the particular regions. If people are scattered, for example, it will be more difficult for the company to achieve strategic locations where there is dense customer traffic.
- Gross Regional Product per Capita (GRP per cap)
  - This factor takes into consideration the purchasing power of people in different regions. Population alone does not suffice to identify whether the region is conducive to operating the convenience store business. Rather, people must also have sufficient income to be able to afford 7-Eleven's products. In this case, the higher the GRP per capita, the more favorable it is for CPALL.

Refer to Table 2 and its explanation for the detailed calculation of potential number of 7-Eleven stores by the end of 2016.

Please note that Tables 1 serves as a complementary to Table 2.

Table 1: The Expected Number of Stores by 2013

		A	B	C	D
		Number of Stores (Q3Y2011)	**Concentration of New Stores**	**Number of Stores (2013 Target)**	**Difference**
1	**Number of stores**	6,206	100%	7,000	794
2	**BKK and Vicinities**	2,965	35%	3,243	278
3	**Provincial**	3,241	65%	3,757	516

Sources: Company's release and team's estimates

By 2013, the management of CPALL expects to have 7,000 outlets nationwide (Cell C1). With this, we can find the difference between the current number of stores and the number of stores in 2013, which is found to be 7,000 – 6,206 = 794 stores (Cell C1). Since we know that the management plans to place 35% of the new stores in Bangkok and Vicinities, we can calculate how many more 7-Eleven stores there will be in Bangkok and Vicinities, which are 35% x 794 = 278 stores (Cell D2). Likewise, since 65% of the new stores will be in provincial areas, there will be 65% x 794 = 516 new stores outside Bangkok and Vicinities (Cell D3). Thus, Cells C2 and C3 can then be calculated by A2 + D2 and A3 + D3 respectively.

Table 2: The Calculation of Potential Number of 7-Eleven Stores by the End of 2016

		A	B	C	D	E	F	G	H	I	J
				= A/B		= C/C7	= D/D7	= A/A7	= E*G		= (I*J7)/ I7
	Region	**Population**	**Area Size (km^2)**	**Population Density**	**GRP per Capita (THB)**	**Score of Population Density**	**Score of GRP per Capita**	**Other Pop/ BKK Pop**	**Score of Pop Dense * Other Pop/ BKK Pop**	**Weighted Average**	**Potential Number of Stores**
1	**North**	12,176,037	93,690	129.96	79,158	10.49	21.91	1.05	11.04	15.39	524
2	**Northeast**	22,878,473	168,854	135.49	49,092	10.93	13.59	1.98	21.63	18.42	627
3	**South**	9,377,986	70,715	132.62	104,738	10.70	28.99	0.81	8.68	16.81	572
4	**Central**	3,044,409	82,465	36.92	264,285	2.98	73.16	0.26	0.78	29.73	1,012
5	**West**	3,686,075	53,679	68.67	114,951	5.54	31.82	0.32	1.77	13.79	469
6	**East**	4,587,428	34,380	133.43	355,435	10.77	98.39	0.40	4.27	41.92	1,427
7	**BKK & Vicinities**	11,562,216	9,330	1239.22	361,243	100.00	100.00	1.00	100.00	100.00	3,405
8	**Total**	67,312,624							**Total Provincial Stores**		**4,633**
9									**Total Domestic Stores**		**8,038**

Sources: Bank of Thailand, Office of the National Economics and Social Development Board, and National Statistics Office

As mentioned, we assume that there still remains a 5% upside in Bangkok and Vicinities from Years 2013 to 2016. So, the optimal number of outlets in Bangkok and Vicinities by 2016 will be 3,243 x 1.05 = **3,405 stores** (Cell J7). We then used this number as a benchmark in the interpolation, benchmarking it against the number of population, GRP per capita, as well as population density.

The logic of calculation is illustrated on the main table above, column by column. Please be reminded once again that we use Bangkok and Vicinities as a benchmark. Therefore, when we calculate the Score of Population Density and Score of GRP per Capita, for instance, we use Bangkok and Vicinities as a denominator and assign it the full score of 100.

Population Density = Population/ Area Size

Since Population Density and GRP per Capita have different denominations, they cannot be used in conjunction in order to calculate the Potential Number of Stores in different regions. The Population Density is in terms of number of people per km^2 while the GRP per Capita is in terms of THB per person. To get rid of such denomination discrepancies, we assign each variable a score, with the full score being 100 as mentioned earlier.

Score of Population Density = (Population Density in each region/ Population Density in Bangkok and Vicinities) x 100

Score of GRP per Capita = (GRP per capita of each region/ GRP per capita of Bangkok and Vicinities) x 100

Once we have arrived at the Score of Population Density and the Score of GRP per Capita in each region, we still have to take into consideration the actual amount of population in the region. This is because neither the Population nor the Population Density alone is comprehensive enough to indicate whether the area is attractive to 7-Eleven. Rather, the combination of both variables will be a superior indicator. For example, the area that is densely populated but hosts only a handful of people will not be as attractive as one that is densely populated and also hosts millions of people. Therefore, we arrive at the Column H on Table 1, using Bangkok and Vicinities as a benchmark once again:

Score of Pop Dense x Other Pop/BKK Pop = Score of Population Density x (Population in each region/ BKK Population)

Having already taken into account a holistic view of factors, we then assign the weights to the population variable and the purchasing power variable. In this case, we assign 60% and 40% to Column H (population variable) and to Column F (purchasing power variable) respectively. We believe that for 7-Eleven, the population itself is more significant than the purchasing power of the people because 7-Eleven sells basic consumer goods and food products, all of which are necessities in everyday life anyway. Besides, the products sold at 7-Eleven are affordable by most people. The formula of the Weighted Average (Column I) then follows:

Weighted Average = [Weight of Population Variable x *Score of Pop Dense * Other Pop* in each region/ *BKK Pop*] + [Weight of Purchasing Power Variable x *Score of GRP per Capita*]

The final Column J of "***Potential Number of Stores***" is subsequently derived from the ***Weighted Average*** **of each region multiplied by 3,405 then divided by the benchmarked weighted average of Bangkok and Vicinities** (which equals 100).

The final conclusion can now be drawn. Referring to Cell J9 Table 2, the total number of 7-Eleven stores by the end of Year 2016 can be as high as 8,038 stores. This confirms that our assumption of 7,990 stores is realistic and achievable. It should also be noted that this number of 8,038 stores is even derived from a very conservative method. The data used, such as the number of population and the GRP per Capita, is based on the Year 2010. In the Year 2016, these pieces of data are likely to be even more favorable for 7-Eleven. GRP per capita and the number of population, especially in provincial areas, will undoubtedly increase, thus bigger room for CPALL to expand its number of stores.

Second Method

We also used an alternative method to analyze whether the store expansion target is actually possible and to further confirm our findings from the First Method above.

The Second Method relies on the rate of urbanization and the number of urbanized people inside and outside Bangkok. According to the CIA World Factbook, the urbanization rate in Thailand stands at 1.8% per year. In addition, as of 2011, approximately 34% of the total population is considered urbanized.

Given that the total Thai population is 67,312,624, there are 22,886,292 urbanized Thais (= 34% x 67,312,624). To simplify the calculation, we use 23,000,000 instead. The research also implies that currently there are roughly 9,000,000 urbanized people living in Bangkok and Vicinities. Therefore, we get the number of urbanized people living outside Bangkok and Vicinities to be 14,000,000 (= 23,000,000 – 9,000,000).

As we know that the annual rate of urbanization is 1.8%, we can approximate the number of urbanized Thais by the end of 2016 by multiplying to current number of urbanized population with 1.08 to the power of 5. For example, 9,000,000 x 1.08^5 is 9,839,690 and so forth. The result is shown on the table below.

	Stores (3Q11)	**Urbanized Population (2011)**	**Urbanized Population (2016)**	**Stores (2016)**	**Urbanized Population per Store**
Bangkok and Vicinities	2,965	9,000,000	9,839,690	3,405	2,890
Provincial	3,241	14,000,000	15,306,184	4,638	3,300
Total	6,206	23,000,000	25,145,873	**8,043**	

Sources: National Statistics Office and CIA World Factbook

As we initially assume that there will be a total of 3,405 stores in Bangkok and Vicinities in 2016, we can then calculate the number of urbanized population per store. The number turns out to be 2,890 urbanized people per store (= 9,839,690/ 3,405).

Because 7-Eleven in Bangkok and Vicinities is more mature than in Provincial areas, it makes perfect sense to say that its number of urbanized people per store must be less than that of 7-Eleven in the Provincials. Therefore, we devise another assumption that there will be 3,300 urbanized people per store in the Provincials. With this, we can calculate the number of 7-Eleven stores in the Provincials by the end of the Year 2016 to be 4,638 outlets (= 15,306,184/ 3,300).

Having identified all the variables, we then arrive at the conclusion that the total feasible number of 7-Eleven branches nationwide by the end of 2016 is 8,043 outlets (= 3,405 + 4,638). This number once again exceeds our assumption of 7,990 outlets.

Conclusion

With both methods of our analysis above, it can be concluded that our assumption regarding 7-Eleven's number of stores in 2016 is indeed realistic and can be achieved by CPALL. For that reason, it would also be fair to say that our FCFE Valuation Model is valid and logical.

Appendix 16: Corporate Governance and Corporate Social Responsibility

Corporate Governance and Corporate Social Responsibility

Corporate Governance Rating of CPALL (we estimated rating for CPALL regarding TRIS Rating and OECD Principles of Corporate Governance)

Thai Rating and Information Services (TRIS Rating) Corporation Limited

Criteria
Shareholder's rights (20%)
Director's structure and responsibility (40%)
Disclosure standard of key information and transparency (25%)
Corporate culture and good governance (15%)
Total (100%)

Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance – Thai Institute of Directors (IOD)

Criteria
Shareholder's rights (20%)
Equitable treatment of shareholders (20%)
Role of stakeholders (20%)
Disclosure and transparency (20%)
Board responsibilities (20%)
Total (100%)

Score Range	Description
Less than 50	N/A
50 -59	Pass
60-69	Satisfactory
70-79	Good
80-89	**Very Good**
90-100	Excellent

Note: CPALL was classified as "Very good" corporate governance by Thai Institute of Directors in 2010

- CPALL management set a target that is realistic and achievable. For instance, the management planned to expand new 7-Eleven 450-500 stores every year and they always meet the targets.

Source- Team's estimates, Thai Rating and Information Services (TRIS Rating) and OECD Principles of Corporate Governance

Appendix 17: Regression between Average Store Sales and Department Stores and Supermarket Index

Regression

$$Y = a + bX_1$$

$$Y = a + bX_1 + cX_2$$

$$ASS = a + b(DSS)$$

$$ASS = a + b(GDP) + c(CPI)$$

Relationship between ASS and DSS are much more significant than other economic indicators

		Correlation	Adjusted R^2	Intercept Coefficient	t Stat	Variable Coefficient	t Stat
ASS	DSS	0. 73	0. 53	0. 0087	1. 59	0. 4332	4. 29
ASS	CPI	0. 18	0. 03	0. 0163	1. 94	-0.0949	-0.20
	GDP					0. 2984	0. 69

How Net Sales was forecasted:

DSS CQGR	1.73%
Intercept	0.88%
DSS Coefficient	0. 433
ASS Quarterly Growth	1.63%
ASS Annually Growth	6.67%

ASS Quarterly Growth

0.88% +0.433(1.73) = 1.63%

ASS Yearly Growth

$[(1+1.63\%)^4 -1]= 6.67\%$

Net Sales = ASS x (Average No. of Stores)

Source: Team's Analysis, Bank of Thailand and Company release

Appendix 18: Regional peer comparison

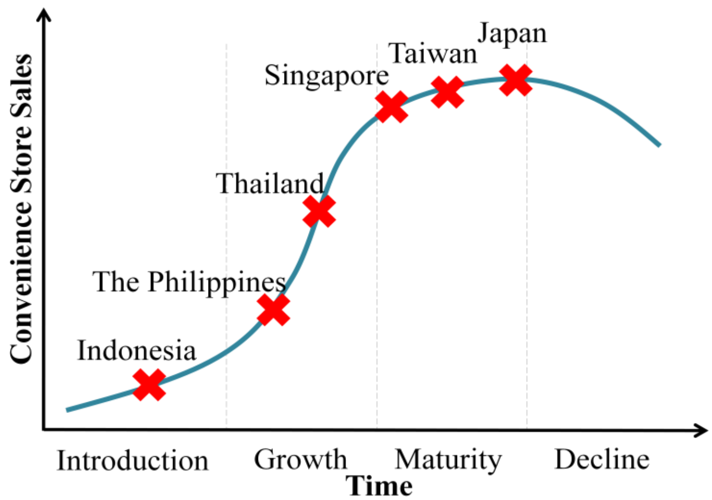
Company	Country	Chain	CS Revenue (B THB)	PEG (x)	EPS Growth (%)	ROE (%)
CPALL	**Thailand**	**7 - Eleven**	**139**	**1.1**	**28.8**	**36.5%**
Circle K Sunkus	Japan	Circle K	69	5.9	2.9	5.3%
President Chain	Taiwan	7 - Eleven	106	2.3	12.0	29.3%
Taiwan Family Mart	Taiwan	Family Mart	44	2.5	10.6	23.2%
Dairy Farm International	Singapore	7 - Eleven	45	1.8	16.5	65.4%
Philippine Seven	Philippine	7 - Eleven	6	2.6	12.9	26.6%
PT Modern International	Indonesia	7 - Eleven	N.A. (Has only 44 branches)	1.3	32.7	12.0%

Note:

- CS stands for Convenient Store
- Dairy Farm International has a very ROE of 65.4% due to its highly leveraged position.
- While PT Modern International has a higher growth rate because it is only in the introduction stage and its success is not yet guaranteed.

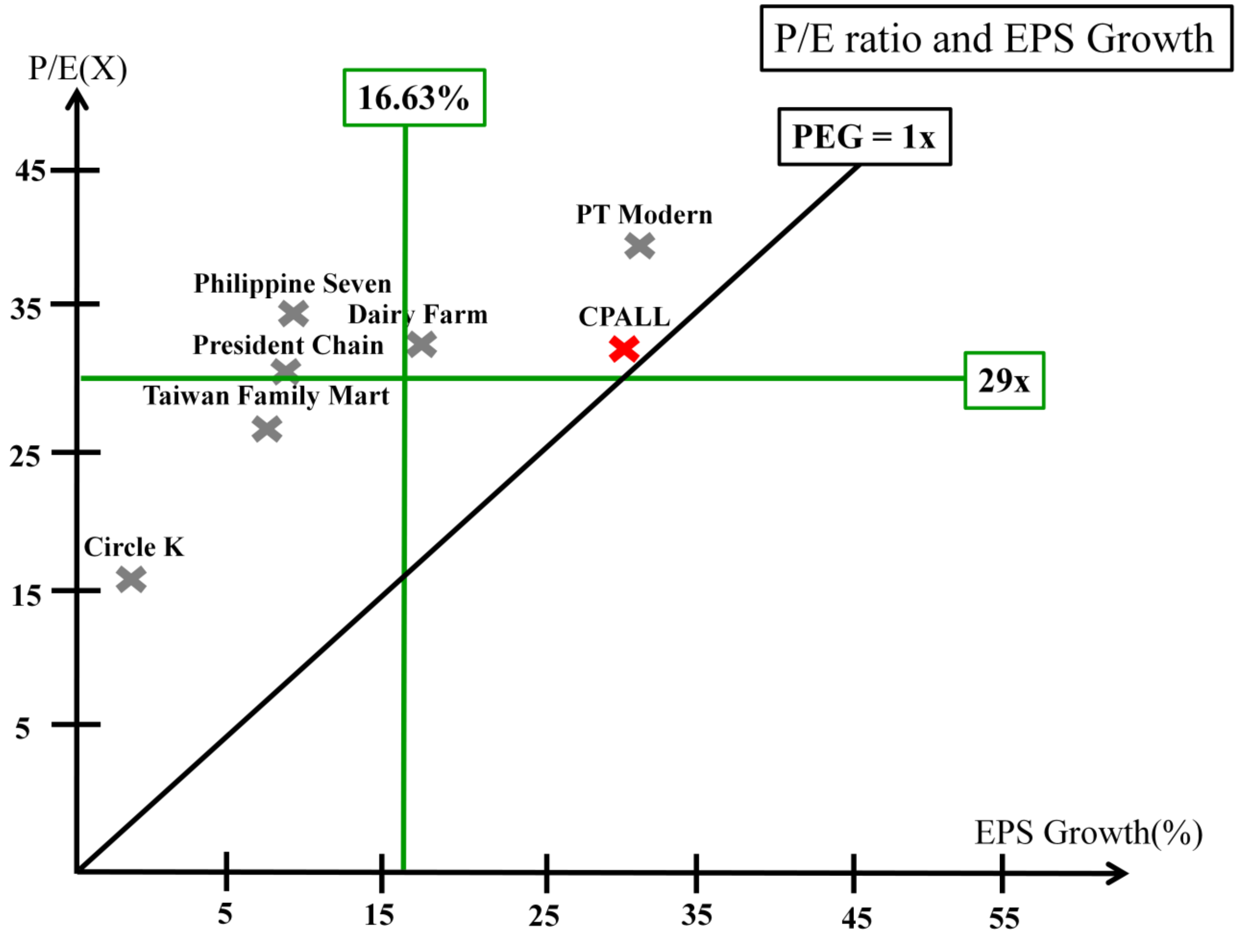
Source Bloomberg and Team's Analysis

Appendix 19: Regional Peers' Growth Stage Comparison



Source: Team's Analysis

Appendix 20: Price Earnings to Growth Analysis for Regional Peers



Note: CPALL has the lowest PEG amongst regional peers confirming that the stock is not expensive.

Source: Bloomberg and Team's Estimates

Appendix 21: Risk Matrix

Impact \ Probability	Low	Medium	High
Significant	• Supply chain disruption • Trademark termination	• Government policies • Conflicts with franchisees	
Moderate	• Failure in branch expansion	• IT Problems • Misunderstanding customer behavior and demography • Negative publicity	• Product selection
Minor		• Higher land/ rental fees	• Economic volatility

Source: Team's estimates and company's release

Potential Risks Pertaining to CPALL

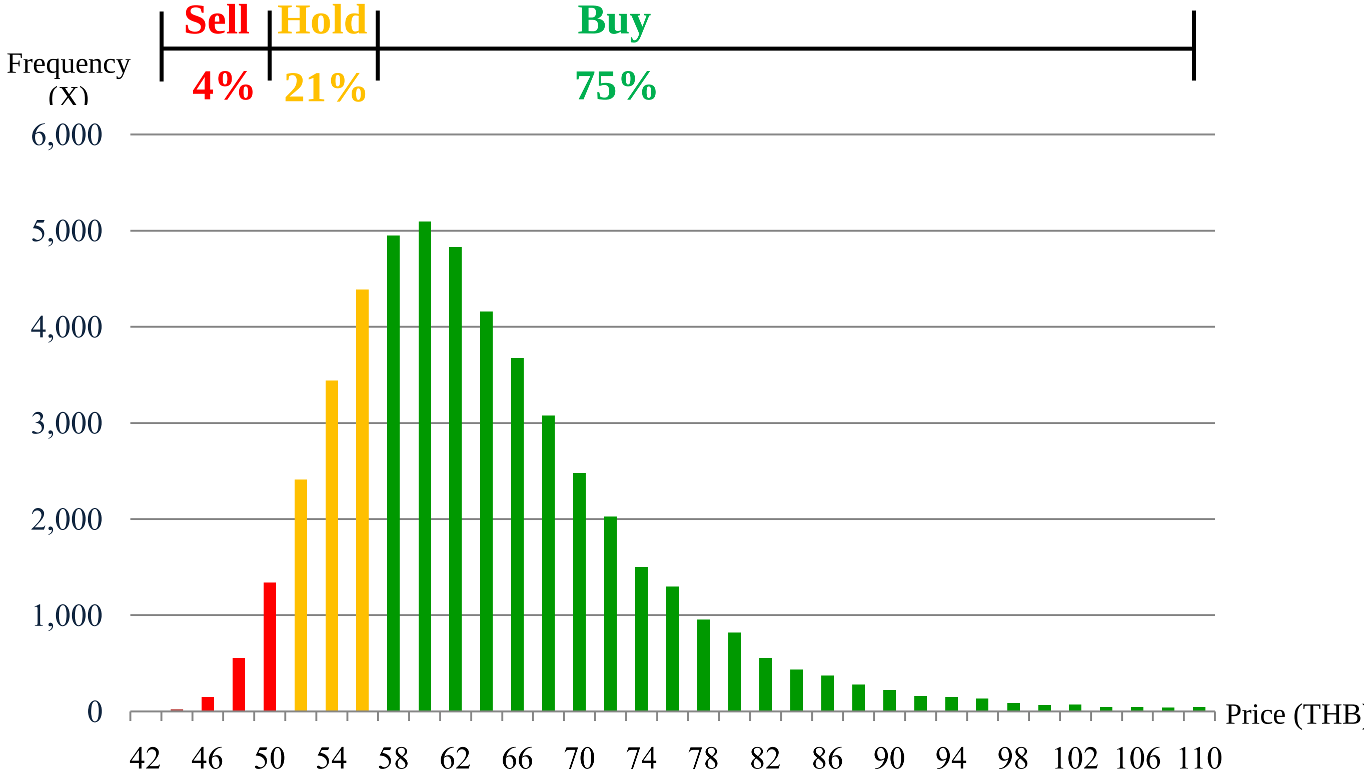
1. Risks from 7-Eleven trademark termination
    - If the Area License Agreement is terminated, which is unlikely, the company will lose the right to use 7-Eleven trademark. This will crucially affect CPALL. Moreover, if the relationship between the company and 7-Eleven, Inc. turns sour, the company may not obtain appropriate assistance from 7-Eleven, Inc.
    - **CPALL Mitigation Approach:** During the past 22 years, the company has never breached the agreements and has never had any conflicts with 7-Eleven Inc. Moreover, given CPALL's extensive network and expertise in the Thai market, the operation under "7-Eleven" brand is of mutual benefits.

2. Risks from laws and government regulations
    - The Retail and Wholesale Act may affect the expansion plan and impose some restrictions on expansion area. Besides, the Product Liability Act B.E. 2551 had an impact on the operating process of the company and its suppliers.
    - **CPALL Mitigation Approach:** The act basically controls the expansion plan of the large discount stores or big department stores. The size of each 7-Eleven outlet is small and thus is not directly affected.

3. Risk**s** from inability to expand branches as expected
    - Future natural disasters and political unrests in some area may affect the expansion plan of the company
    - **CPALL Mitigation Approach:** Company has a plan to expand in upcountry more than in Bangkok and vicinities which less affected by political unrest. Moreover, the company had already insured all of its stores in case of damages from natural disasters such as flooding.

4. Risks from higher land price and rental fees
    - Increases in land prices and rental fees in strategic area can affect CPALL costs and franchisees' profitability. This will also inevitably increase the probability of terminating the contract.
    - **CPALL Mitigation Approach:** Company tended to make longer-term contracts with franchisees to reduce the risk of premature contract terminations.
5. Risks from economic volatility
    - The European debt crisis and the declining U.S. economy will probably impact Thai Economy and the income of CPALL customers.
    - **CPALL Mitigation Approach:** Company focuses more on food products that are less sensitive to the economic volatility.
6. Disruption of supply chain
    - This arises from any incidents that may affect the supply chain of CPALL such as damages to distribution centers due to natural disasters like floods.
    - **CPALL Mitigation Approach:** The company has mitigated this risk by taking insurance against damages to the distribution centers and 7-Eleven outlets. After the great flood in late 2011, new stores were installed with special flood prevention systems. In addition, CPALL has established a main distribution center in each region all over the country, weeding out the risk of over dependence on a single distribution center.
7. IT and communication system failure
    - IT and communication system are crucial to the efficient operation at CPALL. It is critical that CPALL handle orders and calculate the optimal product selection mix accurately for each outlet so that products are distributed accordingly at minimum costs. Failure in the IT and internal communication infrastructure implies either a loss of sales (due to lack of inventory) or an inventory excess, or even both.
    - **CPALL Mitigation Approach:** CPALL mitigates such risks through yearly IT maintenance and updates.
8. Conflicts with franchisees
    - A large part of CPALL's revenues come from sales of franchisees who account for more than 45% of the total 7-Eleven stores. Franchisees will also serve a primary means of future expansion. Any conflict of interest with them will adversely affect CPALL's growth and profitability.
    - **CPALL Mitigation Approach:** The company alleviates this risk by offering franchisees fair rewards and relentless promotional and technological support. The problem of conflict with franchisees has been tackled well by CPALL as evidenced by the rate of closure of only 0.5% per year, which is much lower than the world average of 5% per year. The "7-Eleven" brand itself also represents a huge value to the franchisees. As well, CPALL usually offers the existing franchisees to open new store to capture the demand in the surrounding area and to prevent other players from taking the benefits. If the franchisees lack interest, CPALL will usually open the new stores by itself. In opening a new franchised store, CPALL relentless counts store traffic and does other due diligence and even Fengshui.
9. Product selection risks
    - CPALL may tend to promote its own house brand items and CP products; this could create conflict between CPALL and suppliers. Nevertheless, CPALL has a very high bargaining power over its suppliers who will not risk the opportunity to sell their products through CPALL's 6,206 outlets by terminating the business relationships. However, any mistake in product selection may also result in CPALL's inability to best cater to the demand of consumers.
    - **CPALL Mitigation Approach:** To counter this risk, CPALL uses the superior IT system that enables the company to track changes in demand pattern.
10. Negative Publicity
    - Being under CP Group, CPALL may sometimes be scrutinized that it acts in the interest of the CP Group but not the other shareholders.
    - **CPALL Mitigation Approach:** CPALL mitigates such risks by employing five independent directors out of the fifteen which is much higher than the Securities Exchange Commission's Requirement. Moreover, it sets clear and transparent Corporate Governance guidelines
11. Misunderstanding customer behavior and demography
    - The selection of products at different stores varies, depending on the specific demand in each location and at different timings. Shifting to food products may not be appropriate for all stores as it may result in CPALL's inability to best cater to the demand.
    - **CPALL Mitigation Approach:** To counter this risk, CPALL uses the superior IT system that enables the company to track changes in demand pattern. Branch managers are encouraged to use their own initiatives to order appropriate products for their respective branches.

Appendix 22: Monte Carlo Simulation using the Perpetual Growth Rate from the FCFE Model as the Sensitive Variable



Source: Team's Estimates

<u>Assumptions and analysis:</u>

We determined that the only sensitive factor that could change our target price would be the perpetual growth rate. This is because the terminal value constitutes the largest portion of our DCF model and is affected by the perpetual growth rate, g. We assumed that g is normally distributed using the standard deviation of 0.95% per year derived from the DSS Index.

We have considered other factors however, are convinced that they would not impact our eventual target price. For example, CPALL would be able to maintain its net profit margin due to its high negotiating power over its suppliers and customers. While the cost of equity which was used to discount the five-year projected cash flows would affect every stock in the market.

The Monte Carlo Simulation showed that there is only a 4% chance that would trigger a change in our recommendation from sell to buy and even so, the loss would be minimal. On the other hand, the possibility of a gain is as high as 75%.

Endnotes

[i] *Absolute upside includes capital gain and dividend yield*
[ii] *"Mass Rapid Transit Master Plan in Bangkok Metropolitan Region: M-MAP," http://www.otp.go.th*
[iii] *Thailand Modern Grocery at a Crossroads, McKinsey and Company, February 2010*
[iv] *Retail Sale Index, Bank of Thailand*
[v] *Thailand Modern Grocery at a Crossroads, McKinsey and Company, February 2010*
[vi] *http://thesis.swu.ac.th/swuthesis/Bus_Eng_Int_Com/Sopida_K.pdf*
[vii] *Thailand's Modern Grocery at a Crossroads, McKinsey & Company*
[viii] *Company's release and team's estimates*
[ix] *http://www.bigc.co.th*
[x] *Bangkokbiznews.com 11 April 2010*
[xi] *http://www.thaismefranchise.com/?p=14245*
[xii] *Thailand Retail, Food & Hospitality Services estimates*
[xiii] *CPALL management estimates*
[xiv] *Thailand Modern Grocery at a Crossroads, McKinsey and Company, February 2010*
[xv] *GRP refers to Gross Regional Product.*
[xvi] *Refer to Appendix15 for the method and assumptions of calculation.*
[xvii] *"Thai 7-Eleven operator mulls China stores," http://www.chinadaily.com.cn/bizchina/2011-04/06/content_12278858.htm: April 4, 2011*
[xviii] *"Go" refers to an ancient game in which the player attempts to surround his opponents' territories.*
[xix] *In Chinese beliefs, Feng shui is used to orient buildings and structure in an auspicious manner, which may include the reference to local surroundings.*