QKL Stores
Second Quarter 2010 Earnings Results
August 17, 2010

Operator: Good day, everyone and welcome to the QKL Stores Second Quarter 2010 Earnings conference call. Today's call is being recorded. At this time, I would like to turn the conference over to Mr. Bill Zima of ICR. Please go ahead, sir.

Bill Zima: Thank you, everyone and welcome to QKL Stores' Second Quarter 2010 conference call. On our call today is Mr. Zhuangyi Wang, Chairman and Chief Executive Officer; Mr. Alan Stewart, Chief Operating Officer; Miss Chrystal Chen, Chief Financial Officer; and Mike Li, Investor Relations Officer who will translate for Mr. Wang.

Before we begin, I would like to remind everyone that except for historical information, statements made during this conference call are forward-looking and made pursuant to the Safe Harbor provisions of the *Private Securities Litigation Reform Act* of 1995. Forward-looking statements involve known and unknown risks and uncertainties which may cause the Company's actual results in future periods to differ materially from forecasted or expected results. Those risks include, among other things, the competitive environment in the industry in general and in the Company's specific market areas, inflation, changes in the cost of goods and services, and economic conditions in general and in the Company's specific market area. Those and other risks are more fully described in the Company's filings with the SEC.

Mr. Wang and Mr. Stewart will discuss highlights of our business during the second quarter of 2010. Miss Chen will provide you with our financial highlights, followed by a question and answer session. With this said, I would now like to turn the call over to Mr. Wang. Please go ahead, sir.

Zhuangyi Wang: (Asian spoken).

Mike Li: The highlights of the second quarter (unintelligible) conference call.

Zhuangyi Wang: (Asian spoken).

Mike Li: (Inaudible) once again address quarter meaningful revenue.

Zhuangyi Wang: (Asian spoken).

Mike Li: A meaningful revenue same store sales and gross profit growth which increased 30%, 14% and 48% respective.

Zhuangyi Wang: (Asian spoken).

Mike Li: But we are active in our plan.

Zhuangyi Wang: (Asian spoken).

Mike Li: And we are confident that our growth initiatives in the second half of the year will position us for a very strong 2011.

Zhuangyi Wang: (Asian spoken).

Mike Li: Retail sales (unintelligible) from 8% of our revenue while revenue from our department store and (inaudible) brand from within our store location contributed the remaining one or 2%.

Zhuangyi Wang: (Asian spoken).

Mike Li: We opened two new stores in the first half of the year and now have a total of 37 stores, totaling 155,000 square meters.

Zhuangyi Wang: (Asian spoken).

Mike Li: The sales mix for our groceries, fresh food and non-food offerings continues to perform on par with our prior quarter.

Zhuangyi Wang: (Asian spoken).

Mike Li: In the quarter, sales mix generated 46.3% of the revenue, however, that was mostly 35.2% of the revenue and non-food items contributed 18.5% of the overall revenue during the second quarter.

Zhuangyi Wang: (Asian spoken).

Mike Li: Our new distribution center opened in late April which will allow us to accelerate opening of our store—opening new stores planned for this year and ultimately support our 200 store location.

Zhuangyi Wang: (Asian spoken).

Mike Li: Our state-of-the-art logistic (inaudible) system will improve our operating efficiency. Our (unintelligible) improve our profitability and continue to provide our customers with high quality product.

Zhuangyi Wang: (Asian spoken).

Mike Li: Our store expansion plan remains on track with the plan of opening up 20 new stores, opening 100,000 square meters this year.

Zhuangyi Wang: (Asian spoken).

Mike Li: We have a strong balance sheet to achieve our goal for this year and it is about rolling ahead (inaudible) 60 million, no debt and highly manageable inventory levels.

Zhuangyi Wang: (Asian spoken).

Mike Li: We have a highly motivated regional contract and operating division that can now accumulate our (unintelligible) diverse product offering and customer service from before.

Zhuangyi Wang: (Asian spoken).

Mike Li: We believe our store build out and overall (inaudible) planned for this year, establishing QKL Stores as a market leader in north China and positioning us extremely well for successful 2011.

Zhuangyi Wang: (Asian spoken).

Mike Li: I thank you all for your support. At this time I would like to turn the call over to our Chief Operating Officer, Mr. Alan Stewart and Miss Chrystal Chen, our Chief Financial Officer, who will discuss the Company's second quarter financial highlights, as well as our strategic initiatives with you, further.

Alan Stewart: Thank you, John. Thank you, everyone for joining our call today. Overall, our sales performance in the second quarter continued our long term trend of strong quarterly sales growth. We believe such trends are sustainable as we enjoy continued quarterly same-store sales growth and bring new stores online. Our overall execution related to operating existing stores, as well as bringing new stores online is improving rapidly and positioning us for a greater top and bottom line growth ahead.

In the second quarter of 2010 we remodeled two new stores and closed one store. It's worthwhile mentioning that the new stores and remodels that we're bringing online are generally larger than our earlier stores. These new additions to our store mix are resulting in stronger top line sales and faster pay offs than we've achieved from average stores in the past. Our execution has improved as well, largely due to the opening of our 19,600 square meter distribution center which opened in late April. Nearly 60% of the grocery and non-food merchandise of our stores now passes through our warehouse which allows us to reduce in-store stock and maximize savings. We are generally comfortable with gross margin trends and believe our performance can trend higher in future quarters.

The opening of our new distribution center will facilitate our future gross margin expansion because it will help us do the following. First, number one is to expand the direct purchases from manufacturers for grocery and non-food products which eliminates costs associated with distributors. Two, second, expand the hard fruit and vegetable purchases from farmers, as well as purchases in large quantities. And third, grow our private label business. This segment represented approximately 5.5% of revenue and we have over 600 products. We plan to have over 700 private label products in our stores by the year end. We believe we can drive our gross margin higher in the near term range, 15% range (inaudible) and ongoing quarterly basis starting in the third quarter.

Our operating expenses generally align with where we expect them to be, given expect them to be given our store expansion efforts in the coming months. We're taking on some additional expenses related to our construction, real estate, and regional buying teams, as well as new employee recruiting and training programs. It is critical to ensuring that we have the right infrastructure in place to efficiently manage our growth ahead. We now have six regional purchasing offices. All of the 18 stores we plan to open in the second half will benefit from the efforts of these offices.

Through the second quarter this year, we have added a total of 37 stores totaling 165,000 gross square meters. We currently have signed contracts to open 20 stores, over half of which are already under construction. It typically takes 13 weeks to open a new store, including two weeks of design, eight weeks to construct, and three weeks to stock it. We remain comfortable with our goal of opening 20 new stores in 2010.

At year end we expect to have an aggregate of 55 stores totaling 260,000 square meters. And of the stores which will be open—and of the stores which will be open this year, the majority are expected to be hypermarkets. As we look out to next year we will have almost double the square meter compared to 2009. As future stores come online in the back half, particularly in the fourth quarter, we expect to see significant revenue increases when compared to the prior year's period.

We are certainly encouraged by our progress and our team efforts and look forward to updating you on our developments in the weeks and months ahead. At this time, I will turn over the call to Chrystal who will review our financial results for the second quarter. Chrystal?

Chrystal Chen: Thank you, Alan. The income statement (inaudible) in the second quarter of 2010 increased 29.5% to $66 million from $51 million in the second quarter of 2009. Our revenue performance market growth (inaudible) existing as well as our ongoing operation of new stores. The 31 comparable stores which are stores that have been open for at least one year generated sales of $58 million in the second quarter of 2010, an increase of $7 million or 14% compared with $51 million in the second quarter of 2009.

Sales from the opening of six new stores since January the first 2010 generated $8 million sales during the second quarter of 2010 compared to zero in the second quarter of 2009. Gross profit increased 27.8% year-over-year to 11.6 million compared to $9.1 million in the five year period. The increase in gross profit was primarily attributable to net sales increase in the second quarter of 2010 compared to the second quarter of 2009. Gross margin for the second quarter of 2010 was 17.5% compared to 17.8% for the second quarter of 2009.

Operating income decreased 7% to $2.7 million from $2.9 million in the second quarter of 2009.

Selling expenses increased 30.8% to $7 million or 10.8% of corporate revenue from $8.4 million or 10.7% of net sales in the prior year period, resulting from labor cost, (unintelligible) expenses related with the Company's increased store count over the past year.

General and administrative expenses increased 153% to $1.7 million, or 2.6% of net sales from $0.7 million, or 1.3% of net sales in the prior year period. This increase is primarily due to the higher debt cost, note appreciation and professional fee.

Income tax was $0.8 million for the second quarter of 2010 compared with $0.7 million for the second quarter of 2009.

(Inaudible) non-cash expenses relating to warrants and options our investor tax rate was 28% for the second quarter of 2010 compared with 22.7% in the prior year period, primarily due to higher taxable income resulting from non-deductible expenses relating to overseas expenditure and stock-based compensation expenses in the second quarter.

Net income for the second quarter of 2010 increased to $2 million or 0.05 per diluted share from the net loss 11.5 million, or $0.55 per diluted share in the second quarter of 2009. Excluding changes in the fair value of the warrants were 2010 and 2009 second quarter period adjusted net income for the second quarter of 2010 decreased 9.8% to $2.1 million or $0.05 per diluted share from 2.3 million or $0.08 per diluted share in the prior year period.

The number of shares used in communication of diluted EPS include 90.9% (inaudible) 9.9 million shares from 30 million shares.

The balance sheet and cash flow as of June 30, 2010 the Company has $59.4 million in (inaudible) restricted cash compared to $46.5 million as of March 31, 2010 and no debt or bank loan. Non-cash loss on operating activity was $5.3 million in the first half of 2010 compared to $7.2 million in the third half of 2009. The decrease in cash provided by operating activities was a result of a decrease in accounts payable, customer receipt, inventory and consumables. The decrease is largely applicable to the fact that we accelerated our repayment to suppliers for those (unintelligible) in order to maintain (inaudible) relationships with our suppliers.

Net cash used in investor activity was $8.2 million in the first half of 2010 compared to $3 million provided in the second half of 2009, reflecting the opening up three new stores compared to the prior year period. Moreover, we terminated a property value and selling agreement and approximately 11 million was revalued to us. The building was intended to accommodate future growth of the Company's administrative and operations (unintelligible) as it implements its marketing team which we have (inaudible). Non-cash used for financial activities during the first half 2010 and 2009.

In closing, we remain quite excited about the future (inaudible) of our company. We have a highly capable management team, a strong balance sheet and a profitable (inaudible) with strong top line revenue growth. We have a solid retail growth plan and (unintelligible) provide us with a strong foundation to leverage a growing market opportunity and enhance our future growth. We have the capability to establish QKL Stores as the leading international retailer in market retail channel.

This concludes our prepared remarks for today. We appreciate you listening to our call and look forward to providing you with updates to our business in the weeks and months ahead. After this we are now ready to take some questions.

Operator: Thank you. If you would like to ask a question at this time, press star, one. Please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, star, one if you would like to ask a question or make a comment.

We will first hear from Ping Luo of Global Hunter Securities.

Ping Luo: Thank you for taking my question. Your same store sales is—was 14% this quarter. Average was 9% in the first quarter. I would like to know what was the driver for a higher same store sales in this quarter and what's your expectation for the second half?

Alan Stewart: Ping, let me answer that. This is Alan.

Ping Luo: Hi Alan.

Alan Stewart: The—a couple things we did. We went a little more aggressive probably than we needed to but we brought two commodities, eggs and rice to a penny under cost as a lost liter to drive the transactions into the store. We just felt that it was important to keep and maintain the sales and it has been very fruitful and we've decided that, you know, not to increase the gross profit as we are catching up just a little bit as a result of going into the warehouse in April. So we just reinvested it back into the company and we're aggressive, I guess you would say, to maintain the cuts and get transactions in.

Ping Luo: Would we expect the same kind of same store sales in the third quarter and fourth quarter?

Alan Stewart: Well, I can tell you that so far in July and August it's been around the same.

Ping Luo: Okay, thank you.

Alan Stewart: Okay, same store in the numbers.

Ping Luo: Okay, thank you. Your cash increased by about 14 million this quarter (inaudible) end of last quarter. Your operating cash flow was just 3.7 million. Is the rest coming from this 11 million refund from the building? I just want to clarify that. I just wanted to know what contributed to the cash increase.

Alan Stewart: Chrystal, do you want to answer that?

Chrystal Chen: I cannot actually hear the question.

Alan Stewart: Yes, I think basically they—the bulk of the cash came from the refund of the warehouse (inaudible).

Ping Luo: Got it. Now you have close to 60 million in cash. How much will be spent on building the 18 stores in the second half? How much will be working for working capital?

Alan Stewart: Yes, let me just comment, Ping. The store is about between 1 million and 1.6 million to build a store, so the hypermarket is costing about 1.6 million and the smaller stores are costing a little over a million. We also have to prepay rent in many cases. In most cases it is a full year's rent going forward. So, take 18 stores and extrapolate it out. We do not have any cost of inventory because we turn the inventory prior to having to pay for it.

Ping Luo: Okay.

Alan Stewart: The operating cost very little promotional material is done at the opening of a store, but the rest of it you know, you have to take care of it. So, I'm going to say it's somewhere between 30-35 million probably.

Ping Luo: Is that for a new store opening? How much working capital you need ongoing, you know, you need to support existing stores and new store opening?

Alan Stewart: Okay, I think that Chrystal might have a comment on that but let me tell you that to feel comfortable, you know, in a downturn situation or anything else, because we have a lot of inventory sitting out there but we haven't paid for it. Let's say that the inventory, you know, you have to start paying for part of that because of a downturn in sales or something else. So you have to keep a comfortable cushion for the company. Chrystal, do you have any recommendations which you could tell Ping Luo that you should keep as a reserve?

Mike Li: Chrystal?

Alan Stewart: Chrystal?

Chrystal Chen: It's not clear on my side but I cannot really hear what you are talking.

Alan Stewart: Okay. Ping Luo, I think that probably, you know, we'll get your number.

Ping Luo: Sure, sure. Lastly, you know, we can talk off the line. In terms of the hypermarket and supermarket, the same store sales, would we expect the same data for same store sales for a hypermarket and your supermarket?

Alan Stewart: I have to tell you that we only have supermarkets currently. So, it's a little early but I would tell you that in my past history, a hypermarket performs much better than the small store. The reason for that is that at a large promotion like Chinese New Year's February 3rd this next year, the customer will flock to the hypermarket and they will bypass the small, regional supermarket. And so they gravitate towards the larger store that can accommodate the kinds of goods that they need for that theme or event.

Ping Luo: Got it. So, then for the 18 stores in the second half, you are constructing, can you remind us how many of them are supermarket, how many of them are the hypermarket?

Alan Stewart: Okay, there's nine hyper, six superstores.

Ping Luo: Got it. All right, thank you. I'll be back to the queue. Thank you.

Operator: Once again, star, one if you would like to ask a question or make a comment, star, one at this time. We'll pause for a moment. And we'll hear from Dan Wimsatt of AAD Capital.

Dan Wimsatt: Good afternoon and thanks for taking the time for this call. I have four very brief, unrelated questions. Question one, please is talk about private label mix in the quarter and how is that looking going forward?

Alan Stewart: It's 5.5% right now and I'm very bullish on private label. A lot of Chinese retailers have not had very much success with the private label. Unlike the United States, we went in with products that were consumable, primarily toilet tissue, cleaning supplies, soap, some you know, shampoos and things like that. Success rate has been very, very good and, I mean, the packaging is as good as you'd get in the United States. I have recommended and I think that they are pretty much staying on course not to put product inside a can and expect a customer to buy it. If we're going to pack peaches, they're in a glass 2.5 jar. If we have juice, it is in a clear, actually we've got some blueberry that just came out in two sizes and it's lots and lots of shelf. So I think you have to be very careful what you put in and we have about seven people, Mike.

Mike Li: Yes seven, seven/eight.

Alan Stewart: Seven or eight people and they are sourcing products all over China, all the way to the south and they've been so far very successful. I'm not saying it's 100%. We will probably, out of the first 600 we'll go through 100 trials on product that didn't—I'm not worried about that. We buy a little enough operating margin.

Dan Wimsatt: John, where's that number, back of the envelope, by the end of next year? What would you hope that private label mix gets to and what does that mean for margins?

Alan Stewart: Well when I would say 5.5, you have to understand that that is grocery and non-food. It's closer to nine or 10 if you look at just grocery and non-food because 50% of our fresh, I mean, 50% of our business is in fresh.

Dan Wimsatt: Right.

Alan Stewart: The—we're already starting things like in the United States you would put many of your fresh products, you'd put your bakery under private label and flour and jelly. You'd have roasted chicken. In—just exactly like the United States we have flavors and we're putting them in a private label bag. So, you know, I think we will get (inaudible)% as we up to the fresh and we add additional products to grocery and non-food. (Unintelligible) even though it doesn't sound like five or 600 items, we do have a good facility we can balance. So when we produce the product we have to ship it 100% to the existing stores. So, our slower selling and other store sold out so be it. Now we have a facility that we can bring it in and move it to the stores as needed. So I think in total sales you could be up at 15% in the next couple years but you're also adding some fresh mix.

Dan Wimsatt: Great. Second question because it relates somewhat, membership card and royalty program, talk about where you are on that and the expectations.

Alan Stewart: You know, a year ago we were about 25% penetration. We changed the card and we put out a card that also has a debit strip on the backside, so they can load money into it. That has gone to over 60% within seven months. We're trying to get 55% penetration. The price program in the store, and I talked about eggs and rice earlier at a penny under cost, only buy one kilo of rice at the lower price. The rest has to be purchased at the normal retail price. The customer, we have a rebate that we give on some other things that primarily they're interested in buying, the add items. They don't know how many of the 150 items are two price but we have many two priced programs on the shelf. So they assume that all 150 they can't buy without, you know, a membership card.

Dan Wimsatt: What is 60% in absolute, just in raw numbers, how many people are signed up?

Alan Stewart: Oh, 600-800?

Male Speaker: I think it's 670 net, about 30,000 on average every store. I go with a million before the end of the year I think because you're adding stores. You add 18 stores and 30.

Dan Wimsatt: And do you have any data on frequency or higher (unintelligible)?

Alan Stewart: We have a full CRM, so I can tell you if we lose a customer, who's our top 10%. We (unintelligible). We know what zip they're coming out of. We also, if we see that we are not getting customers from an area then we send a bus in that area. We have buses in many of our stores, so we can contact (inaudible) into an area that we are not penetration. And we have each of the stores the information have a CRM person who monitors their own store, and in addition we can monitor here. I wanted to know, for example, how many customers are just buying eggs in my store. Out of 120,000 or 30,000 every day, only 1,600 are buying eggs, only eggs, coming in and cherry picking (inaudible). And I can tell you how many are buying, you know, two items or three items or four items. So we've got as good of data as you'd see anywhere in the US.

Dan Wimsatt: Great. Question three, you talked early in the call about the new warehouse, I think that's just over 200,000 square feet. Any sense for what you're able to buy with that, what that will do to margins, again, looking out four or five or six quarters? What do you see?

Alan Stewart: I think you're probably, I would tell you that the goods that are coming from the warehouse are anywhere between 3.5 and 10% less cost of goods. Now, there's basic goods we put in the warehouse. We have about 2,700, 2,000 basic goods. We have (inaudible) 6,000. So we're doing it slowly. We have about (inaudible) that we're buying from and then we have (inaudible). So the (inaudible) also asking if they can go through the warehouse and minimally we charge them 3.5 to 5% to redeliver that product to the stores, costing us 1.76 to deliver to the stores. So, you know, (inaudible) 5% is only costing 1.7. So, we expect it will be somewhere in the two to 3%. How quickly we want to pass that price on to the customer or how much we want to hold is a marketing decision that we will make on a quarterly basis. We may pass part of that on to the customer or hold some. We may try to put over to the bottom line. Again, everybody's been watching the market and if we feel that the market's going to go soft, we will beef it up and pass it on to the customer.

Dan Wimsatt: Great. Last question, investor relations strategy. You just gave a great call. We don't see you a lot in the States. Any expectations? Are you going to be doing any road shows or coming over to the States? I understand you're not going to be at the last conference next month now.

Alan Stewart: We just can't make it. Let me let Mike answer that. Mike was my translator. We had a choice of going out and finding a professional IR person and trying to teach him the business and in doing the minus 40 degree weather in Daqing for six months of the year, or picking somebody local and teach him the IR. We have taught Mike and he has done a superb job so you can let Mike talk for himself but I will let him speak to the road show (inaudible).

Mike Li: First of all, we should be there (inaudible). It's a great conference. I know that maybe 400, 500 national will be there. But our take is we were have an appointment with some banker trying to get a non deal road show in the September/October period. So, the timing is conflict, that's why we dropped the conference in Hawaii and the conference in the Europe.

Dan Wimsatt: Got it.

Alan Stewart: The reason I asked for Mike's third quarter earnings report to road show.

Dan Wimsatt: Okay, I'll pass the line. Thank you for answering those questions.

Alan Stewart: Sure.

Mike Li: Thank you.

Operator: Peter Siris of Huamei.

Peter Siris: (Asian spoken).

Mike Li: Hello Peter.

Peter Siris: Hello Michael, Alan, Chrystal, ni hao. The first, just a comment on the—Alan's last comment. I'm thinking picking Mike for IR is a very smart decision, so I applaud that. I wanted to follow up on something Dan was asking about. I'm just trying to understand the business model here. The warehouse has just recently been opened. So, as you were saying Alan, either you have these savings or some of the savings you'll take advantage of with, you know, your ability to put lower prices in. So one way or another you'll either have higher sales or higher margins from the warehouse, is that reasonable?

Alan Stewart: That's exactly true.

Peter Siris: Okay, so there's no way to figure out what the model is. You've basically got 3% or 2.5% either in better margins or your lower margins on selected products and drive sales. So either comp store sales will be higher or margins will be higher, right?

Alan Stewart: Correct.

Peter Siris: And what percentage of products are going to go through the warehouse?

Alan Stewart: Right now we're running 57% of the grocery and non-food is going through the warehouse, of which 2,700 or (inaudible) and 10,000 are (inaudible). But we will (inaudible) in the next six months to (inaudible) another 3,000.

Peter Siris: So would you say whereas you know in the next nine months something like 70% of the items will have that cost savings opportunity, right.

Alan Stewart: That's correct.

Peter Siris: Okay. Now, just to—private label is what percent now?

Alan Stewart: Five point five.

Peter Siris: And you expect it to go to where?

Alan Stewart: Probably if you add the fresh, again, I'm using that 5.5, Peter is of groceries and non-food, not the total.

Peter Siris: Right.

Alan Stewart: So it's really almost double, okay. And so I'm using, let's say 9%. I don't know the number exactly but let's say it's 9%, I can probably move it to 15 if I were to take most of my bakery, most of my flour, some of my jelly, chicken, et cetera and with that private label I can move to 15% (inaudible).

Peter Siris: The difference in the margins between private label and branded is what?

Alan Stewart: (Inaudible) about 20-25%.

Peter Siris: So basically, so again, there's a margin opportunity for improvement if I take the over a period of time that going up 10% and it's 25%, so that's the blended, that's another 2% plus margin improvement, or, either margin improvement or opportunity for lower prices driving sales.

Alan Stewart: You don't get quite that opportunity in the fresh because you're already getting 34% in flour and bakery, as you know but just and the non-food and the grocery.

Peter Siris: Okay, now I want to go on to the new stores. The hypermarkets that you're opening will have a—the percentage of non-food in the hypermarkets will be much higher. Does non-food have a higher margin than food?

Alan Stewart: That's correct.

Peter Siris: How much of a higher margin?

Alan Stewart: Over a—20—I'll just use 18-19. It might be another 5-6% higher. Textile might get 30-plus but electronics (unintelligible) considerably low. Let's say a 25-26 in that area.

Peter Siris: So, as we move forward, there—where would you expect, you know, sort of the margins on this business to end up in the next couple, two years or something?

Alan Stewart: I don't know, Peter, but I'm pretty assured that you're going to be up two to 3%.

Peter Siris: Okay. So what you're figuring is you can get two to 3% better margins and some of that and then with the extra savings from the private label and the warehouse you'll be able to lower some prices and drive sales, so you should be able to keep the same kind of sales going with higher margins.

Alan Stewart: Yes.

Peter Siris: Okay. I want to ask about the store openings, the elephant in the room. Is there a reason the store openings seem to be back loaded in the second half of the year? Is that mostly weather or what's the reason?

Alan Stewart: A (inaudible) flooded areas in the (inaudible) areas (inaudible), you know, area. Totally sensitive. (Unintelligible) been problems with fire marshal and marshal is the OSHA of the United States. So, they're the guys who control everything. Most of them have just done, they're back loaded because the landlord is not a professional landlord and they make lots of promises and they don't come true but we (inaudible). I personally visit every location and my construction team is out right now as we speak and there's a meeting next Tuesday to go through every store. If we're under construction by October 1st we'll have only took people. We've got them in training, so I'm very bullish that we will get those stores. We might miss one or two and that means it moves into January or February. But the buildings are (unintelligible). I don't worry about sitting in the cold weather and not having the ability to go inside. Only one store to my knowledge (inaudible) is. I was there two weeks ago and there was 98% (unintelligible). All the rest are buttoned up, no issues.

Peter Siris: And you're biggest selling season is going to be Chinese New Year, not Christmas, right.

Alan Stewart: That's correct. February 3rd is the (inaudible) and that's about three weeks prior. So (unintelligible) get stores open and (inaudible) with these stores.

Peter Siris: So you want to get them—you want to get as many open as you can before year end so at least you can get Chinese New Year in.

Alan Stewart: That's correct.

Peter Siris: Okay and last question, is it geographically, as in new areas you're moving to or looking at?

Alan Stewart: Because I told you about six regional offices until we have a cost. John's vision to go to the three regions included and plus we are a year ahead of each of those plans in that these plans are 2011 being in Liaoning, we are making it in 2010. So, when you go down to those areas you have to go out with people early. So in Shenyang, the capital of Liaoning, we already have seven people working on our merchandising. (Inaudible) we're still opening it. But when I open up the five stores it will be opening in that province this next year—this year but the last six months, we will be ready. (Unintelligible) in the past have gone into Nong'an and not even Jilin did not have a regional office. We operated out of it and we couldn't get the support from the suppliers because we didn't have a regional office in (inaudible). And so now we have all the offices covered and all we have to do is open up the stores in the center of this fringe of stores. We've got them all the way to the south part of Liaoning, all the way to the Russian border on the northeast to the Russian border on the northwest and truly is right on the Russian border and so now we're just filling in the middle. There is no cost to it. That's what we have won early. We decided that that was the right thing to do.

Peter Siris: So between the regional offices and the warehouses, you front-loaded costs and now going forward we should start to see some of the earnings benefits?

Alan Stewart: Yes.

Peter Siris: Great. Well, thank you all very much. (Asian spoken).

Male Speaker: (Asian spoken).

Operator: Next we'll hear from Howard Zhou of Roth Capital Partners.

Howard Zhou: Hi, good day everyone. Hello (Asian spoken). Well, good quarter. Most of my questions have been asked already. Just a quick follow up on the store openings trend. Out of the 18 stores you intend to open in the second half, how many do you expect for the third quarter and how many for the fourth quarter?

Alan Stewart: Three for the third quarter.

Howard Zhou: Three for the third quarter. Okay. All right, thank you.

Alan Stewart: Thanks Howard.

Mike Li: Thanks Howard.

Operator: Jin Liu, Huamei.

Jin Liu: Thank you. Thank you for taking my call. Hello everyone. (Asian spoken). My first question is about inventory and the inventory decreased to 19 million from 25 million from the end of 2009. And (inaudible) has been enrolled in the (inaudible). I'm just wondering why the inventory could decrease with the new DC?

Alan Stewart: The DC was started to fill in, in April. We were shipping a few items the latter part of April and really in May. We really haven't had any (inaudible). We made the decision to get out of the Daqing warehouse. It just closed the Daqing warehouse, really a week closed it. So, we have extra inventory, no question in the (inaudible) warehouse. In fact, we have (unintelligible) told everybody get your inventory out of the stores and back to the DC because now we have the ability to limit the amount that gets carried in the store. So as we have an overstock in the store it will go back (inaudible) carried in the warehouse then it will be sent back to the warehouse and we won't be buying anything. We will share it with the rest of the stores that need the product. So we went ahead and stocked the warehouse roughly fully but we have enough merchandise in there that if we didn't have any product in the store we could ship right away, so we wouldn't have any scratches. So you're going to have to give us at least a quarter and a half to get this inventory readjusted.

Jin Liu: Thank you. And the next question is about the CPI and the performance. And I would like to know what impact the high CPI will have on the gross margin (inaudible).

Mike Li: Yes, the CPI at stage one is like 3.3 increase, you know, (unintelligible) and I know that right now we (unintelligible) and rice price increase very high in (inaudible) this year but we don't really cost, you know, the high price to the customer directly. We really prefer to capture the market share right now as we are making a good (inaudible) expansion plan right now.

Alan Stewart: There's no question that when (inaudible) a great boon to a supermarket. We want those prices very close. In fact, I watch the egg price and the rice price every day and we're buying on a daily basis. We have not done any forward buying. I just don't believe that we have enough good people to know what the price is going to be out three months or longer and rather than use our cash we would rather buy local (inaudible).

Jin Liu: And my third question is about the (inaudible) and I know (unintelligible) new areas (unintelligible). And Mr. Wang, could you talk more about (inaudible) situation of those areas? (Asian spoken).

Zhuangyi Wang: (Asian spoken).

Mike Li: I will say the situation of the tier three and tier two cities in the (unintelligible).

Zhuangyi Wang: (Asian spoken).

Mike Li: And we're trying to (unintelligible).

Zhuangyi Wang: (Asian spoken).

Mike Li: There's no major difference between customers. Tier two/three cities, there's no outside international (inaudible).

Jin Liu: Okay, that's great. Thank you. That's all my questions.

Operator: And that does conclude the question and answer session for today. At this time I'd like to turn the conference back over to management for any additional or closing comments.

Alan Stewart: Let me just say that I really appreciate everybody's support and good questions. So, keeps us on our toes but I thank everybody for joining the call and hope to communicate more with you in the future.

Operator: That does conclude today's teleconference. Thank you all for your participation.