QKL Stores
Third Quarter 2010 Earnings Conference Call
November 16, 2010

Operator: Good day and welcome to the QKL Stores Third Quarter 2010 Earnings Conference Call. Today's conference is being recorded.

At this time, I will turn the conference over to Mr. Bill Zima, ICR. Please go ahead, sir.

Bill Zima: Thank you everyone and welcome to QKL Stores Third Quarter 2010 Conference Call. On our call today is Mr. Zhuangyi Wang, Chairman and Chief Executive Officer; Mr. Alan Stewart, Chief Operating Officer; Mr. Jerry Chan, Chief Financial Officer; and Mr. 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 forecasts of their 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 the Company's business during the third quarter and Mr. Chen will provide an update on the Company's 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: (Chinese spoken)

Mike Li: Thank you, Bill.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Good day, everyone.

Zhuangyi Wang: (Chinese spoken)

Mike Li: I'd like to thank everyone for taking the time to join us for today's conference call.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Well our third quarter results were not as strong as we would have liked, we believe that many of the initiatives taken place at our company are positioning QKL Stores for much stronger performance ahead.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Retail sales in the third quarter generated 98.7% of our revenue while revenue from our department store and tenants' rent from within our store locations contributed the remaining 1.3%.

Zhuangyi Wang: (Chinese spoken)

Mike Li: We opened four stores through the first nine months of this year and closed the third quarter with a total of 38 stores totaling 189,000 square meters.

Zhuangyi Wang: (Chinese spoken)

Mike Li: The sales mix for our grocery, fresh food and household items continue to perform on par with prior quarters.

Zhuangyi Wang: (Chinese spoken)

Mike Li: In the third quarter, fresh fruit generated 44.6% of the revenue followed by grocery at 36.0% of revenue and non-food items which contributed 19.4% of the overall revenue during the third quarter.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Our store opening plan is now accelerating, particularly as we move into the fourth quarter. This would not have been possible had it not been for the opening of our distribution center earlier this year.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Our new DC has a state-of-the-art logistics management system which will improve our operating efficiency, further enabling us to improve our profitability and continue to provide our customers with high quality products.

Zhuangyi Wang: (Chinese spoken)

Mike Li: As we enter the new year, we will have a significantly higher square meter total compared to 2009.

Zhuangyi Wang: (Chinese spoken)

Mike Li: As our new stores come on line and continue to do so in the coming months, we expect to see significant revenues and profit increases.

Zhuangyi Wang: (Chinese spoken)

Mike Li: With the high capable management team, strong balance sheet with no debt and profitable enterprises with strong growth forecast, we remain quite excited about the future prospects of our company.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Our unique and innovative retail store concept operates in a region not accustomed to a diverse product offering and strong customer service.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Our accomplishments through the first nine months of this year further established the QKL stores as the market leader in the northeast of China and position us extremely well for a successful 2011.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Thank you very much.

Zhuangyi Wang: (Chinese spoken)

Mike Li: At this time, I would like to turn the call over to our Chief Operating Officer, Mr. Alan Stewart, and Mr. Jerry Chan, our Chief Financial Officer, who will discuss the Company's third quarter financial highlights, as well as our strategic initiatives (inaudible).

Alan Stewart: Thank you, John. Thank you everyone for joining our call today. Overall, our financial performance in the third quarter was not as strong as we would like but we remain well on course for a better top and bottom line growth going forward.

I want to address a few points related to our results in this quarter. SG&A expanded more rapidly than we originally forecast primarily due to increased salaries, bonus payments for our employees. We made adjustments to our overall operating expenses as it relates to staff costs and store-related expenses in the fourth quarter and we will lower the labor but the seven new stores will contribute to a higher SG&A.

We closed two stores due to the expiration of lease contracts in the second and third quarter respectively due to the expiration of the contract.

Our same store sales for the third quarter would have been 4.7 if we had excluded the two closed stores for computation. We believe our quarterly same store sales estimates will trend much higher moving forward. So what I'm saying is we have (inaudible) the 1% but in the 2009 as the business was put together, they left in the store 18 and 2 and that's partly my fault for not catching that. We very rarely have stores close and so it picked up the 2009 and there was no comparison for 2010 so it shows 1% when the real number was 4.7.

Through the first nine months of the year we operated 35 supermarkets, 3 department stores and 2 distribution centers, one for groceries and non-food merchandise and another for fresh food. Under our expansion plan we opened three supermarkets and one department store in the first nine months of 2010 and we have in the aggregate approximately 34,600 square meters of space. We closed two stores due the expiration of lease contracts in the second and third quarter respectively.

In the last quarter of 2010, we plan to open in the aggregate approximately 50,000 square meters of new retail space. We are also making improvements in our logistics and information system to support our supermarkets (inaudible) distribution center in Harbin that is approximately 19,600 square meters of space was put into operation in the second quarter of 2010. We closed one distribution center in Daqing City which had been servicing our stores with grocery and non-food merchandise over the last few years. Our new DC is critical to our store expansion and margin growth plan and we expect to see improved margin performance stemming from this new facility in the future. Right now we're running 65% of our grocery and non-food items through our warehouse. We expect this number to rise to 70% over the course of the next 6 to 12 months.

Thus far in the fourth quarter, we have opened four new stores and expect to open a total of seven stores in the fourth quarter. While our new store opening goals have fallen short in 2010, we expect to open an additional six new stores in January of 2011 as well as additional stores scheduled for opening in February and March. We expect to finance our new store expansion plan from funds generated from operations and proceeds from our last public offering. Each of new stores typically becomes profitable within three to six months time period.

As we analyze our store mix going forward, we expect that approximately 70% of the new stores that we open going forward will be hypermarkets which carry more volume and generate higher margin on average when compared to the other store concepts.

Expanding our operations represents a real opportunity to broaden our brand appeal and drive profits. We believe there are over 200 to 300 small and medium size cities in northeast China without modern supermarket chains. We have a fantastic opportunity to further penetrate these areas and believe the number of customers and supermarkets in these cities are likely to grow significantly over the next several years and will need to continue to experience urbanization and the middle class continues to grow.

In order to accelerate our growth and increase profitability, we remain focused on several important initiatives. These include the opening of new and larger stores in strategic locations, improving profitability by decreasing our product costs related to origin sourcing, further maximizing our distribution centers, expanding our private label sales, and improving our customer loyalty program. We made progress with many of the preceding initiatives in the third quarter. As an example, we added two new franchise label clothing lines in the quarter. Our private label sales business contributed approximately 5.5 total sales in the quarter. We believe our private labels sales will move higher going forward as we increase our number of private label skews.

As we look at our business over the course of the next year, we remain quite excited about our potential. Our operations team remains focused on a steady number of new store openings through March of next year. Our store growth plan would not be possible without our new warehouse. As we modify the acceleration of our store opening plan for the end of the first quarter of next year, we will look to maximize our warehouse efficiencies which can further improve our gross margin. This can be accomplished by an increase in the skews we carry in the warehouse. We currently have approximately 4,000 skews in the warehouse and intend to add another 2,000 skews, bringing the total to 6,000.

We intend to clearly analyze and strengthen our operations after the large number of stores we have opened in recent months and plan to open in the very near future. We want to ensure that every single one of our new stores are performing to the best of their abilities and that all points of execution are achieved as measured by private label performance. More product skews in our stores, a strong and growing customer reward program and keeping labor costs in line with our growth; such efforts can further strengthen our overall financial performance and market position in the region.

At this time, I will turn over the call to Jerry Chan, QKL Stores' new Chief Financial Officer, who will review our financial results for the third quarter.

Jerry Chan: Thank you, Alan. First of all, net sales in the third quarter increased by $8.3 million or 14.7% to $64.9 million for the three months ended September 30, 2010 from $56.6 million for the three months ended in the same period of 2009. Our revenue performance will affect the growth in existing stores as well as our ongoing expansion of new stores.

The 30 (sp?) comparable stores which are stores that have been open for at least one year generated sales of approximately $57.1 million in the third quarter of 2010, an increase of 1% compared with $56.1 million in the third quarter of 2009.

New store sales increase reflects (inaudible) opening of eight new stores since July 1st, 2009. These eight stores generate approximately $7.8 million sales in the third quarter of 2010 compared to 42,000 for the one new store open in the third quarter of 2009.

The number of stores, including supermarkets, hypermarkets and the department stores, at the end of the third quarter were 38 compared to 33 in the prior year period.

Gross profit increased 15.9% year-over-year to $11.3 million compared to $9.7 million in the prior year period. The increase in gross profit was primarily attributable to the increase in net sales over the prior year period. Gross margin for the third quarter of 2010 was 17.4% compared to 17.2% for the third quarter of 2009.

Our third quarter operating income decreased to $1.4 million or 2.1% of sales from $3.1 million or 5.4% in the third quarter of 2009.

Selling expense increased by 2.2% to $7.8 million or 12.1% of total revenue in the third quarter from $5.6 million or 9.9% of total revenue in the prior year period due to an increase in labor costs, depreciation, rent expense, utilities and other operating costs primarily (unintelligible) due to an increase in store count.

General and administrative expense increased to $2.1 million or 3.3% of net sales from $1.1 million or 1.9% of net sales in the prior year period. This increase was mainly due to the strengthening of our work force by hiring new employees, training and providing higher compensation to our managerial staff.

Excluding non-cash expenses related to warrants and options, our effective tax rate was 27.8% for the third quarter of 2010 compared with 26.7% for the third quarter of 2009. This increase was primarily due to higher non-deductible expenses related to overseas expenditures in the three months ended September 30, 2010 compared to the same period in 2009.

Third quarter net income was approximately $1.0 million compared with a net loss of $29.3 million for the three months ended September 30, 2009. Including changes in fair value of warrants, adjusted net income for the three months ended September 30, 2010, was $1 million or $0.03 per diluted share compared to $2.3 million or $0.11 per diluted share in the prior year period. The number of shares used in the computation of diluted EPS increased 84.5% to 38.5 million shares from 20.9 million shares in the third quarter of 2009.

As of September 30, 2010, the Company had $48.4 million in unrestricted cash compared to $26.7 million as of September 30, 2009 and no debt or bank loans.

The total inventory position at the end of the third quarter was $23.5 million compared to $24.7 million at the end of December 2009.

In the last quarter of 2010, we plan to open seven stores… seven new locations comprised of hypermarkets, supermarkets and department stores having in the aggregate of approximately 350,000 square meters of space. We expect to finance this expansion plan from funds generated from our operations and proceeds from our fourth quarter 2009 public offering.

Our long-term target is to open more than 200 stores over the next four to five years, including hypermarkets, supermarkets and department stores.

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. Operator, we are now ready to take some questions.

Operator: Thank you, sir. The question and answer session will be conducted electronically. If you would like to ask a question, please do so by pressing the star key, followed by the digit one, on your touch-tone telephone. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment.

Once again, that is star, one, to ask a question. We'll pause for just a moment.

We'll take our first question from Howard Zo (sp?) with Roth Capital Partners.

Howard Zo: Hello. Good evening, everyone.

(Chinese spoken)

Zhuangyi Wang: (Chinese spoken)

Howard Zo: (Chinese spoken) My first question is on same store gross. It only grow 1% year-over-year or 4.7% according to Alan's correction so could you provide some color on what caused the much slower same store gross and what happened.

Mike Li: (Chinese spoken)

Zhuangyi Wang: (Chinese spoken)

Mike Li: I think, Alan…

Alan Stewart: Yes. Howard, statistically I think we lost a little focus. We clearly were watching all of the new stores opening up. Most of our merchandising team was out in the field getting set up. As you know, we opened stores in the far end of the region down in Jian (sp?) and Leoni (sp?) so they've been concentrating on that. We backed off a little bit of our advertising and some of our loss leaders to assure that the gross would hold. As you know, when you open up new stores, we always put some higher promotions in the new stores and that creates a little pressure on the gross profit. We didn't want to drop that gross more than what we had anticipated in the 17.5 range so when we do that, obviously the sales backed off a little more than I thought they would because we were trying for at least the 10%.

Howard Zo: Okay, so if that's the case, what kind of actions is Management going to take to bring the same store gross back on-track for the next several quarters and how would the outlook be like?

Alan Stewart: We're (inaudible) that we will bring those back closer to the 10% range and right now we're tracking at those numbers so I don't that that will be a problem. We brought a little bit back on some of the loss leaders but again we're still watching that gross weekly because we still have a few more stores to open and, as you know, we've opened already four this quarter.

Howard Zo: Okay. So what would your expectation on the same store gross? Could you provide some kind of guidance for the next several quarters?

Alan Stewart: For the fourth quarter, somewhere between 6 and 10%.

Howard Zo: You mean for the first quarter of next year?

Alan Stewart: Oh, for the first quarter of next year, I don't have that number yet. We expect it to go back because right now I think we're going to be opening somewhere in the neighborhood of six stores in January or early February and so, again, the pressure will be a little bit less than what we've been opening in the fourth quarter… third and fourth quarter.

Howard Zo: Okay. Okay. So you said 6 to 10% for the fourth quarter of this year, right? Same store gross. That's your expectation.

Alan Stewart: Uh-huh.

Howard Zo: Okay. And then secondly, you talk about open the seven stores in the fourth quarter; you've already opened three, so how confident are you on the remaining four and how many do you expect to open in total next year? Not just the first quarter, in total for next year.

Alan Stewart: Let me correct one thing in the press release. It said that we'd opened three. We've actually opened four. We opened the fourth one, Xiantu (sp?) on the 15th. The release was written a day before and they didn't include Xiantu. So there's four opened already and we'll open three more, Oo-ling (sp?), Manchuli (sp?) and either Deway (sp?) or Sipping (ph?) because they're right on the border of the year, and so I'm very optimistic that we will get our seven stores this quarter.

Howard Zo: Okay. What about next year?

Alan Stewart: The first couple of months we're probably going to be opening between six and eight. These were already in the pipeline and so these… we're pretty well assured they're already under construction or just about ready to start under construction. On the inside.

Howard Zo: Okay. What about the remaining three quarters next year? Do you expect to open any new stores?

Alan Stewart: (Unintelligible) some new stores but we're in the process of signing some leases.

Howard Zo: Okay. Okay. And just lastly, could you talk about… I mean, given your store expansion plan, okay? And what is your overall expectation on the revenue growth for next year? And also could you comment on the gross margin trend? Now it's kind of flat on the sequential basis at 17.4% and we actually expect some improvement in the gross margin given your distribution center is now up and running so could you provide some insight on these two questions?

Alan Stewart: (Unintelligible - talkover) we're expecting at least a couple of percent higher. Again, you have to look at the mix of what has gone on this last quarter and this next quarter because you're (inaudible) at this point, 10 stores or almost 10 stores that we've opened, there will be nine stores at least that as you open up a store, you're going to get a (unintelligible – talkover) at the beginning. You have to mix that with what is coming from the existing stores and so we are seeing increases in the gross profit as a result of our buying through the warehouse but that's being mixed with the stores that are also opening and putting pressure on the gross profit. I mean if we backed off on the new stores, immediately you'd see higher gross profit but that's an investment to get those stores up and going.

Operator: Thank you. And ladies and gentlemen, as a reminder, that is star, one, if you'd like to ask a question.

We'll move on to Ping Luo with Global Hunter Securities.

Ping Luo: Thank you for taking my question. Hi, Alan.

Alan Stewart: Hi, Ping.

Mike Li: Hi, Ping.

Ping Luo: Yes, hi, Mike. (Chinese spoken)

Mike Li: (Chinese spoken)

Ping Luo: Yes. (Chinese spoken) Sorry, I should ask in English first. Basically following up on the gross margin question. You're gross margin is relatively flat on the last quarter, so you're basically saying that the benefit from the distribution center is basically kind of offset by the lower gross margin due to the new store openings. Is that the case?

Alan Stewart: That's correct.

Ping Luo: Okay. So the second question on the SG&A, certainly the SG&A, we had actually expected some heat on the bottom line due to the new store opening expenses but it looks like the heat is more than what we had expected. So what percentage of this… or roughly what percentage of SG&A operating expenses is due to the new store opening and what is from other… as you mentioned, it's salary, bonus and et cetera and other items?

Alan Stewart: Yes, there's really four or more components of that. One is labor. The Company did go through and raise some labor based on the market. We have corrected part of that. We should have gone out and let some of the people go before we gave the raises but we gave raises and then we had to reduce some of the staff so I think we're corrected that going into part of the fourth quarter. The compliance… as you're working with PWP to make sure that all the stocks compliance is done and there are some costs to that. Depreciation is a little bit higher and we stepped up a little bit on the depreciation numbers and then there's some options. As you know, we gave options a while back and so there's some cost to booking those options. Some of that will go forward. The labor will not. The labor we corrected but the rest of it will continue and there will be, as I said, for six months, there will be pressure as you backload the stores. In the third and fourth quarter, there will be some extra SG&A. We have new store expenses and at the same time I like to make sure that all the accruals are cleaned up at the end of the year so we will make sure that any expenses attributable to the stores opening is fully booked so we go in clean next year. But saying that, also, the stores for next year, we are already booking some labor for those stores at the same time. As we've said before, it takes 13 weeks to open a store. Part of that is the training that's required for those stores and then we put the store people into the stores early enough to stock it and get ready. So if you look at the first quarter of next year, we will have a few expenses already in the fourth quarter that we have to book.

Ping Luo: Thank you, Alan. In terms of new store opening, we had expected basically for the full year, close to 20 stores opened by year end. It looks right now we probably have… this year it would be 13, 14 stores from the numbers you have provided.

Mike Li: We will have 11, 11 stores opened by the year end and another open in January and another… a couple in February.

Ping, just the one point to talk about the gross profit, our gross profit is even right now… the DC actually was opened in late April. At that time, we already finalized the '09… the '10 contract with the supplier. So you're not going to get a lot of decrease from the cost of goods. But right now we are really renegotiating the New Year contract so we think our gross profit will increase but slowly in the next year.

Ping Luo: Got it. Thank you, Mike. So returning to the new store opening, it looks like it's a little bit postponed according to the schedule. So any recent events that lead to the new store opening postponed… some of them postponed to January?

Alan Stewart: Yes, I would tell you that the bulk of delays are a result of the landlords and in many of these second, third, fourth tier cities, the landlord is fairly new (unintelligible – talkover). He will build a strip mall or a department store, promises a lot and is not able to deliver. Most of the problems have been the result of problems for electricity, problems for heat and in (Inaudible) which was just opened, the 13 weeks that we normally take to open a store was probably prolonged another 60 days and that's a killer because of costs and you have all the people that you've trained and get ready and then you find that you don't have heat that the landlord has promised or he doesn't have electricity or he doesn't have enough power. So all of these… I think when we get promises and you know, we're not paying rent but there are up front costs, and most of that is labor and sending out the team to research all of the purchasing. So almost all of those could be laid to the landlord. I'm not trying to offset it from any issues that we have but our planning has been pretty good.

Ping Luo: So basically as planned, the 20 stores will be ready before Chinese New Year, February 3rd next year.

Alan Stewart: Close.

Ping Luo: Okay.

Alan Stewart: Yes.

Ping Luo: Thank you, Alan. This quarter revenue slightly below last quarter and somewhat below the first quarter. What's the… can you tell us a little bit more, or again, on the seasonality of the retail business? The third quarter versus second quarter, and also we're looking to the fourth quarter and the first quarter ahead. Can you see what kind of… basically the outlook for the next two quarters?

Alan Stewart: Yes, the… as you're aware, Chinese New Year comes on the 3rd of February this year. So the first quarter is always a big quarter for the Company. As we go into the fourth quarter, Christmas is not a big thing but you get a little bit of hike from it and the weight all goes to the first quarter of next year.

Ping Luo: The third quarter is below the second quarter. Is there any seasonality there or is it because you have… was there… learned that you have done a big promotion in the second… in the third quarter which should drive down the (inaudible), et cetera? Is that a reason for lower third quarter versus the second quarter? Or is that mainly due to seasonality?

Alan Stewart: You have mid-autumn in the third quarter. You have National Day in the second quarter.

Mike Li: No, National Day is on (unintelligible). Fourth, yes.

I think we have the time do a lot of anniversary… store anniversaries second quarter so we actually make a lot of sales on second quarter but second quarter usually it's a low quarter in our history. That's why companies have the good forecast, good prospects about the third quarter. So they spend most of their… for the new stores in Ji Lin Province and (Inaudible) Province but the result is not like we had expected. But right now everything is on track. The Company will focus on the existing stores as well as the new stores.

Ping Luo: Okay. Thank you very much. That's all my questions. Thank you, Mike. Thank you, Alan, and (Chinese spoken). Thank you.

Mike Li: Thank you.

Zhuangyi Wang: (Chinese spoken)

Operator: Again, ladies and gentlemen, as a reminder, if you'd like to ask a question, that is star, one.

We'll move on to Michael Madden with Talon Asset Management.

Michael Madden: Hi, good evening. How are you guys?

Mike Li: Hi, Michael.

Michael Madden: Good. I was just wondering if you guys could characterize the competitive landscape, what the competitors are doing and, you know, just generally how you're positioned in your markets?

Alan Stewart: I think, Michael, as you're aware, there's not too much competition in the northern. We do watch all of the competition. We also have 17 IGA retailers and in fact 16 of them are in town looking at our stores because we're going through what we call 5-star customer (unintelligible – talkover). So we monitor all those and we think that we are in good shape as anyone else. We're just now coming into the cold season so that affects us a little bit but we don't think we're behind anyone and we're not concerned about the competition.

Michael Madden: Okay. And then most of the bigger box guys are still staying in the tier 1, tier 2 cities, right?

Alan Stewart: Right.

Michael Madden: Okay. And then just generally on finding new leases, are you guys seeing any rent inflation in the tier 3 and tier 4s or is it kind of staying flat-line?

Alan Stewart: I'm going to let John answer that because he's a little bit closer. You know, the rents are escalating a little bit but part of that is the cost of materials that's forcing the landlords (inaudible – talkover) a little bit.

Michael Madden: Okay.

Alan Stewart: Let me see if John has any comment.

Zhuangyi Wang: (Chinese spoken)

Mike Li: I will see the inflation as a (inaudible) of regional—especially supermarkets—business because when they increase the cost of the products we just pass the cost… the increase to the customer directly and we have the actual sale.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Most of the case we won't hurt a lot from the gross profit standpoint.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Here if you have inflation coming, the government or customers saw that in the media, they will start to storage some products, necessities like oil or rice or other basics.

Michael Madden: Okay. Great. And then just one more question, you know you guys talked about the gross margin pick up from the distribution center as kind of being masked by the new store openings. When do we hit that inflection point where we really start to see—I mean it's probably Q2 next year, right? Just because you're going to be opening a few more this quarter and then in the beginning of the year certainly you should be opening, call it six to eight more stores to get to the original 20 target. But, you know, from Q2 going on, is that when we see the inflection point and gross margins really start to turn and maybe we see… I don't know what it is, 150 or 200 basis points on that line? Or is it later than that?

Alan Stewart: No, I think that you're probably correct. It shouldn't be any later than the second quarter, maybe even earlier.

Michael Madden: Okay. And then can you give us a sense on what you guys are planning in terms of store openings beyond first quarter? I mean is it… you know, the original plan for this last year was 20. Is it more than that?

Alan Stewart: He's asking John the plans for after the first and second quarter, plans for next year.

Mike Li: (Chinese spoken)

Zhuangyi Wang: (Chinese spoken)

Mike Li: John explained that the gross profit probably is going to increase slowly again in first quarter, start from first quarter because we are renegotiating the contract. When we opened the DC this year in April, you know, we already finalized all the contracts. John believes treat the supplier as his partner so he won't tear up all the contracts and redo again. So in the next year we will see the DC (inaudible).

Speaker: (Unintelligible – talkover)

Mike Li: (Chinese spoken)

Zhuangyi Wang: (Chinese spoken)

Mike Li: I'm very to explain that we fell short in this 20 store target for '10. A lot of stores (inaudible) to January and February but we will keep working on that and make sure that all the stores open before, you know, February, before the Chinese New Year. Beyond that, our third quarter… start from second quarter company… the current plan is the Company will open at least 10 stores by the year end.

Zhuangyi Wang: (Chinese spoken)

Mike Li: Additional 10.

Michael Madden: Okay.

Zhuangyi Wang: (Chinese spoken)

Mike Li: If you saw the earlier press release about the latest store we opened, it's all hypermarket, big store, and John believes if we finish this 20 stores… 20 new stores by the end of February, we might (unintelligible).

Zhuangyi Wang: (Chinese spoken)

Mike Li: Actually we have 12 stores under construction in the rough.

Michael Madden: Okay. And then just one last question, what had been the next hyper versus super previously? I know you guys said 70% are going to be hyper now in the press release which are… you know, the box is double the size so that's obviously meaningful but I was just wondering what had been the mix before, or the ideal mix?

Mike Li: Our current real estate strategy is still finding the supermarkets at 2,500 square meters as a supermarket and hypermarket probably double the size.

Michael Madden: Right but I was just wondering of your planned expansion before, what percentage were going to be supermarkets versus hypermarkets and now you had said that it's going to be 70% hypermarkets. So I was just wondering what had it been before. Just the percentage of total store openings going forward.

Mike Li: We planned to open 12 hypermarkets and 7 supermarkets and 1 department store in the earlier year but now we definitely open… we're going to open over 12 hypermarkets and I think the Company's strategy still will focus on the hypermarkets.

Michael Madden: Okay. Sounds good. Thank you, guys. I appreciate the color.

Mike Li: Thank you.

Operator: We have no further questions at this time. I'll now turn the conference back over to Management for any additional or closing remarks.

Mike Li: Thanks.

Alan Stewart: I'd just like to thank everybody for your support and as John has said, I will reiterate I feel worse than John about not accomplishing our 18, 19 stores but it's not weather at this point. Last year it was weather; this year it's our landlords and as much as we pick the landlords and tell them what to expect and tell them not to let us down, they still let us down. So, I feel like (unintelligible) but we are putting a lot of square meters (inaudible – talkover) and the bigger stores are clearly more profitable and coming on much quicker from the standpoint of the profit line. So, hang in there and '11 is going to be a great year for us.

Mike Li: Thanks to everyone. Thanks for taking the time.

Zhuangyi Wang: (Chinese spoken)

Operator: Ladies and gentlemen, that does conclude today's conference. We thank you for your participation.