

China / Hong Kong Company Guide

Xiabuxiabu Catering Mgmt

Version 1 | Bloomberg: 520 HK Equity | Reuters: 0520.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

16 Jul 2019

BUY (Initiating Coverage)

Last Traded Price (16 Jul 2019): HK\$11.30 (HSI : 28,620)

Price Target 12-mth: HK\$14.85 (31.4% upside)

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Price Relative



Forecasts and Valuation

FY Dec (RMB m)	2018A	2019F	2020F	2021F
Turnover	4,734	5,807	6,848	7,941
EBITDA	821	957	1,125	1,333
Pre-tax Profit	609	695	816	972
Net Profit	462	528	619	738
EPS (RMB)	0.43	0.50	0.58	0.69
EPS (HK\$)	0.49	0.57	0.66	0.79
EPS Gth (%)	10.1	14.2	17.2	19.2
Diluted EPS (HK\$)	0.49	0.57	0.66	0.79
DPS (HK\$)	0.19	0.23	0.27	0.32
BV Per Share (HK\$)	2.40	2.69	3.03	3.44
PE (X)	22.8	20.0	17.1	14.3
P/Cash Flow (X)	21.4	14.1	13.5	11.7
P/Free CF (X)	7680.5	42.0	37.2	26.2
EV/EBITDA (X)	11.2	9.6	8.1	6.8
Net Div Yield (%)	1.7	2.0	2.3	2.8
P/Book Value (X)	4.7	4.2	3.7	3.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	21.9	22.2	23.2	24.4

Earnings Rev (%):	New	New	New
Consensus EPS (RMB)	0.52	0.64	0.77
Other Broker Recs:	B: 17	S: 0	H: 2

Source: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Adaptable, feasible, expandable

- A leading hotspot chain in China with a dual-brand strategy of Xiabuxiabu and Coucou
- Expect steady improvement driven by store expansion and product mix enhancement
- Initiating coverage with Buy rating and HK\$14.85 TP

Dual-brand strategy to capture rising consumption demand. Xiabuxiabu Catering Mgmt (Xiabu) operates two brands targeted at fast-casual (Xiabuxiabu) and mid-to-premium markets (Coucou). Xiabu has been adaptive to changes undergone in the sector through store format remodelling, the adoption of digitalisation and delivery. With a total of 934 outlets in 108 cities as at Dec-18, we expect Xiabu to achieve earnings CAGR of 18% in FY19-21F on steady store expansion (+145 net new stores per annum), store upgrades, and cost efficiency.

Steady recovery post food safety scandal. With a scalable business model, Xiabu has recorded sales CAGR of 21% over the past 5 years. While 1H19 will unlikely to show strong numbers on mild decline in SSSG and table turnover, we expect Xiabu to mark steady improvement entering 2H on: (1) improvement in average selling prices supported by a reduction in discounting and product mix enhancement, (2) improvement from the food scandal impact since Sept'18, and lastly (3) stabilizing material cost trends. We believe the market has factored in a softer 1H19, as seen from >23% share price correction from peak YTD.

Coucou –potential aplenty. We expect Coucou's strong momentum to continue to bolster Xiabu's overall market share. Overall, we expect Coucou's sales contribution will expand from 12% in FY18 to 27% in FY21F with margin improvement supported by improving scale.

Valuation:

Our TP of HK\$14.85 is based on 22.5x FY20F PE, equivalent to its 2-year historical average, supported by 18% earnings CAGR in FY19-21F. The Company holds a net cash position of Rmb1,341m as of Dec'18.

Key Risks to Our View:

Food safety incidents, raw material cost volatility, competition, slowdown in macro-environment

At A Glance

Issued Capital (m shrs)	1,080
Mkt Cap (HK\$m/US\$m)	12,204 / 1,559
Major Shareholders (%)	
Ho (Kuang-Chi)	41.7
General Atlantic LLC	19.2
Snow Lake Capital (HK) Ltd.	5.4
Free Float (%)	33.7
3m Avg. Daily Val. (US\$m)	2.37
ICB Industry: Consumer Services / Travel & Leisure	
Bloomberg ESG disclosure score (2017)^	38.0
- Environmental / Social / Governance	34.9 / 26.3 / 57.1

^ refer to back page for more information



Live more, Bank less

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SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> • Xiabu is one of the largest fast casual hotpot cuisine brand in China with a total of 934 outlets as of Dec-18. The group adopts a dual-brand strategy to capture a wider customer base • Xiabu operates a scalable and directly operated model specialising in Taiwanese style hotpot cuisine. The group has made good effort in driving costs down through technology (manless cashiers, DIY condiment stations), resulting in a stable operating cost track record 	<ul style="list-style-type: none"> • Xiabu's table turnover ratio has been steadily declining despite effort made to upgrade its store formats (2.0, 2.0+), partly due to higher priced menu. In 1H19, we expect table turnover to continue to decline in NE China. On a positive note, we believe Coucou's expansion will continue to offset the moderating growth from maturing stores in the medium term
Opportunities	Threats
<ul style="list-style-type: none"> • The expanding catering industry in China should benefit the company. According to Frost & Sullivan, China's catering market is expected to grow at a CAGR of 10% in 2018-22F • Well-positioned to benefit from a shift in consumption trend towards eating out and food delivery • As of Dec-18, the group operates 48 Coucou outlets, which has garnered strong popularity. We expect the sales mix will gradually shift to Coucou in the long run 	<ul style="list-style-type: none"> • Slowdown in economic activities (e.g. trade war) will have a direct impact on frequency of eating out • Competitive landscape in the catering sector will remain difficult • Food safety concerns could be more difficult to contain as the group expands its scale. In 2H18, a customer found a rat in the broth ordered. SSSG in NE China recorded declines in subsequent months and saw a mild recovery m-o-m towards the peak season in Dec-18

Source: DBS HK

Xiabuxiabu Catering Mgmt

Company overview

Established in 1998 in Beijing and listed in Dec-14, Xiabu is the largest fast-casual hotpot chain operator in China with strong presence in over 108+ cities in >20 provinces and 3 centrally administered municipalities in Beijing, Tianjin and Shanghai. The group operates two brands - Xiabuxiabu (呷哺呷哺) and Coucou (凑凑) - targeting both fast-casual and mid-high end segments. As of Dec-18, Xiabu operates 886 Xiabuxiabu outlets (Dec'17: 738), and 48 Coucou outlets (Dec'17: 27).

Good reputation for its value for money menu sets. Xiabu is a pioneer and is one of the leading hotpot chains originally focused on the 'dining out alone concept', and hosted a cheaper price tag of Rmb40-50 per person. In recent years, China's food consumption trend has shifted rapidly towards group dining and delivery. To respond to the changes in consumption demand, Xiabuxiabu has been steadily upgrading its stores from 1.0 (bar settings) to 2.0 versions to cater to a more flexible dining experience (more group seating), and at the same time promoting a higher, but still considered a value for money dining option (c. Rmb50-80 per person) with an expanded menu choice (from 80 to 110). As at the end of FY18, Xiabuxiabu has upgraded c.60% of its store portfolio, with 50-60 stores upgraded annually.

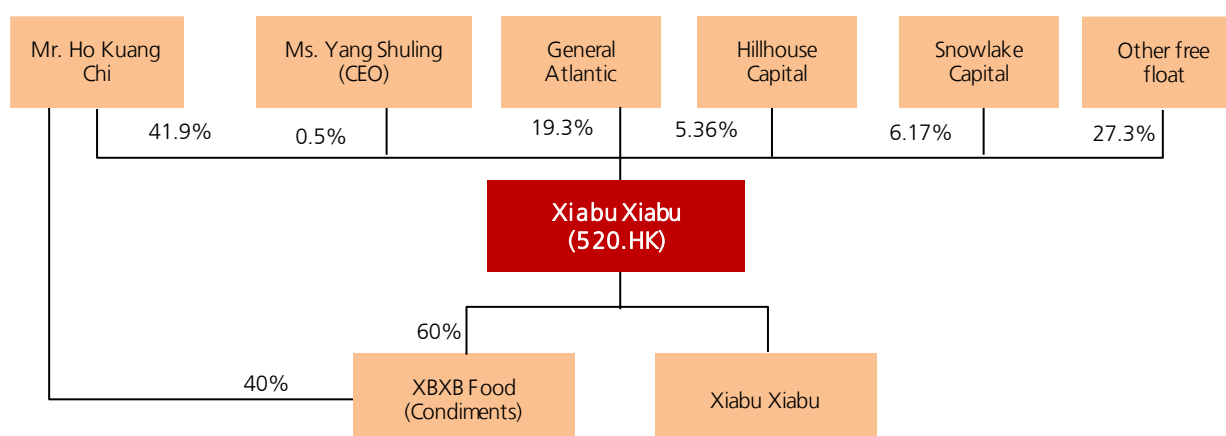
Coucou (凑凑) arrives. Within the hotpot category, the fastest growing segment has been the mid-high end category (Rmb100-200+ per person) spearheaded by popular brands such as Haidilao (海底捞), Liuyishou (刘一手), Tonglaishun (东来顺) and more. In late-2016, Xiabu launched a new mid-to-

high end dining brand, Coucou (凑凑), with average spending per person at Rmb100-150. Inspired by the founder's Taiwanese heritage, each store offers a handcrafted beverage tea bar supporting in-store dining as well as take-out orders. As of end-2018, there are 48 Coucou restaurants located in Beijing, Shanghai, Shenzhen, Hangzhou, Wuhan, Wuxi and Xi'an. Coucou continues to explore offering afternoon tea, and late-night snacks. Despite shorter history, Coucou is already profitable and recorded an operating profit of Rmb64.8m in FY18 or restaurant margin of 11%.

Delivery initiatives. In 2016, Xiabu launched hotpot delivery service, Xiabu Fresh, with an average order size of Rmb100-120 with soup bases and fresh ingredients available for delivery. As the time taken to prepare a hotpot meal may deter customers from ordering delivery, Xiabu introduced a new concept under "Xiazhuxiatang" (呷煮呷烫), which is provision of instant hotpot meals to complement its delivery service. The average order size per person for these takeaway meals is between Rmb30-50. Delivery accounted for roughly 6% of sales in FY18.

Shareholding structure. Key founder is Mr. Ho Kuang Chi with a 41.9% stake in Xiabu, and a 40% stake in its condiment segment. Both GAP and Hillhouse Funds were pre-IPO investors. General Atlantic (GAP) has since sold down its stake from 32.32% to 19.3%, while Hillhouse Fund's shareholding stood at 5.36%. Snowlake Capital recently raised their stake on 21/6 by 7.3m shares (average price HK\$9.8397) to 6.17%. Free float stood at 27.3%.

Shareholding structure (%)

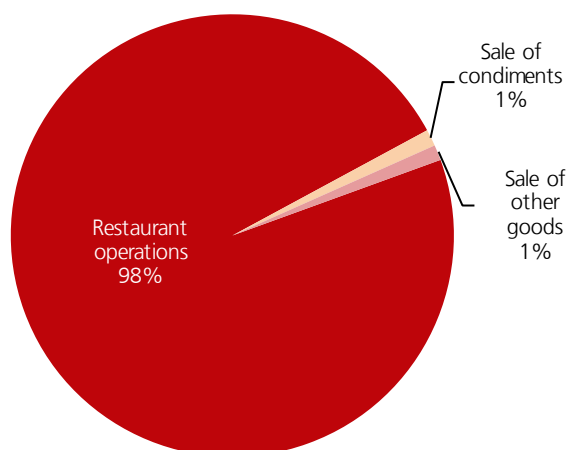


Source: Company, DBS HK

Xiabuxiabu Catering Mgmt

By revenue in FY18, restaurant operations accounted for 98% of sales, while sale of condiments and sale of other goods stood at 1% each.

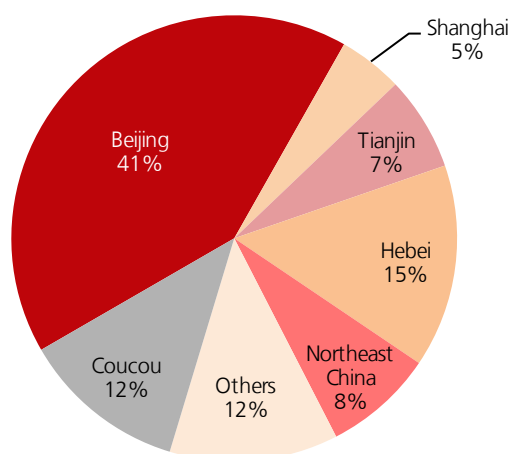
Revenue mix (%) – FY18



Source: Company data, DBS HK

Beijing as core market. Restaurant revenue can be further broken down into key regions including Beijing, Tianjin, Hebei, Northeast China, Shanghai and Others, which accounted for 41%, 7%, 14%, 8%, 5% and 12% of FY18 revenue. Separately, Coucou accounted for 12% of restaurant revenue.

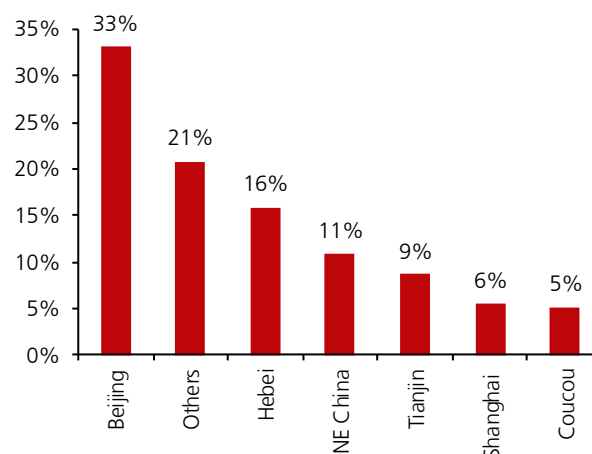
Restaurant sales mix by region (%) – FY18



Source: Company data, DBS HK

Xiabu has a wide presence with greater focus in Beijing and North/ Northeast China, which together account for >60% of store count. The group recorded net openings of 160/101/148 Xiabuxiabu and 2/19/27 Coucou outlets in FY16-18. While Beijing remains dominant, accounting for 47.2% of Xiabu sales and 61.5% of Xiabu's operating profit in FY18, the group aims to ramp up its exposure in East and South China in FY19F.

Store breakdown by key regions (%) – FY18



Source: Company data, DBS HK

60% of stores already upgraded to 2.0 model. As consumers demand more premium experiences, the group has been upgrading the Xiabuxiabu outlets to 2.0 and even 2.0+ formats where the layout is modern versus the earlier model (see pictures below). In terms of capex, it is roughly c.1-1.2m per store which takes 3 months to breakeven and 1-1.5 years for cash payback.

1.0>2.0 model transformation (Xiabuxiabu outlet)

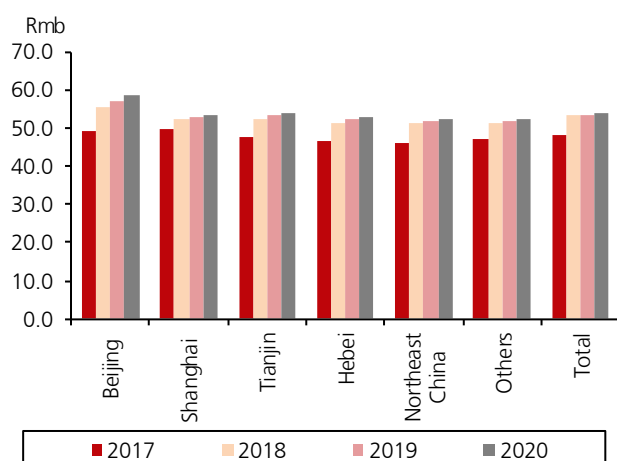


Source: Company data, DBS HK

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Average spending. With the newer store formats, the average ticket size has moved higher at Rmb50-80 (vs. 1.0 format at Rmb40-50). In FY18, the group achieved average spending of Rmb53.3 per customer (+10% y-o-y), with notable jumps in Beijing (+11.9% y-o-y) and Tianjin (+10.5%), supported by steady store upgrades to 2.0. The menu items were also refreshed with more variety and imported ingredients, set menus, utensils and increased services in conjunction with greater marketing efforts. Xiabuxiabu also aims to deliver an improved dining experience, and has also introduced Coucou's tea bar concept into some of its 2.0 models to further complement its menu offerings as well as also exploring afternoon tea sets.

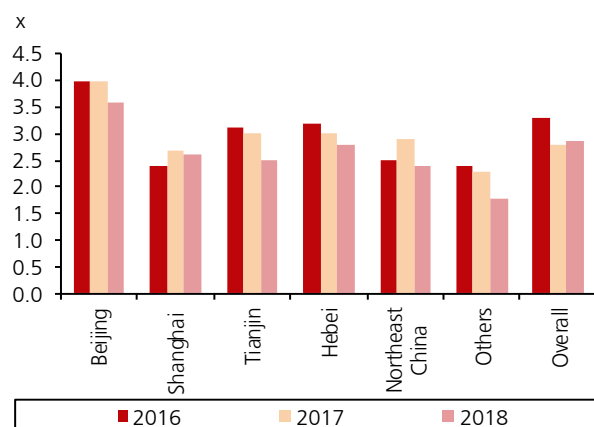
Average spending per person (Rmb)



Source: Company data, DBS HK

Table turnover ratio. Despite a new menu and more offerings, table turnover rate dropped to 2.8x (FY17: 3.3x) in FY18, with declines recorded across all regions. Part of the reason could be the rise of food delivery services, higher base effect and the rat scandal that had an impact on 2H18 sales.

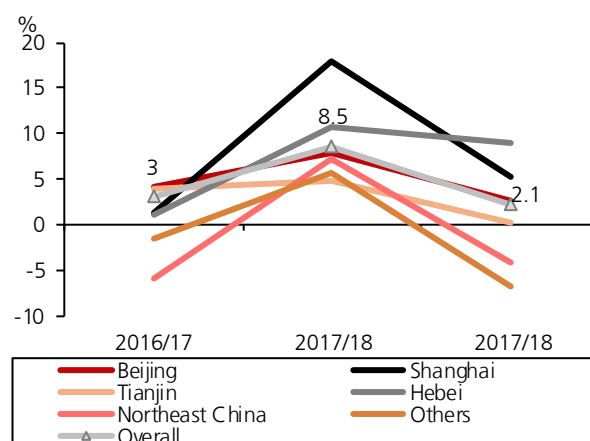
Table turnover ratio (x)



Source: Company data, DBS HK

Same-store-sales growth. In 2018, overall same store sales growth (SSSG) slowed to 2.1% post store expansion and improvements made in 2017. North/ Northeast China's SSSG deteriorated in 2H18 due to the rat incident. There was mild improvement in Jan-Mar q-o-q (negative y-o-y), but this trend reversed to a mild decline in April-June.

SSSG (%) by region



Source: Company data

Xiabuxiabu Catering Mgmt

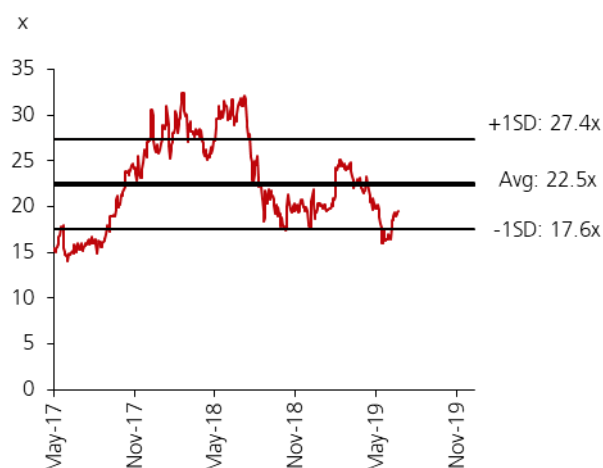
Valuation and recommendation

Due to trade war tensions and rising commodity prices, Xiabu's share price saw a sharp decline YTD to trade at 21x/18x/15x FY19-21F PE vs. its 2-year historical average of 22.5x. Xiabu is currently trading at a wider discount of c.63% to Haidilao's 48.6x FY20F PE, vs. an average of 40% discount since Haidilao's IPO in Sept'18.

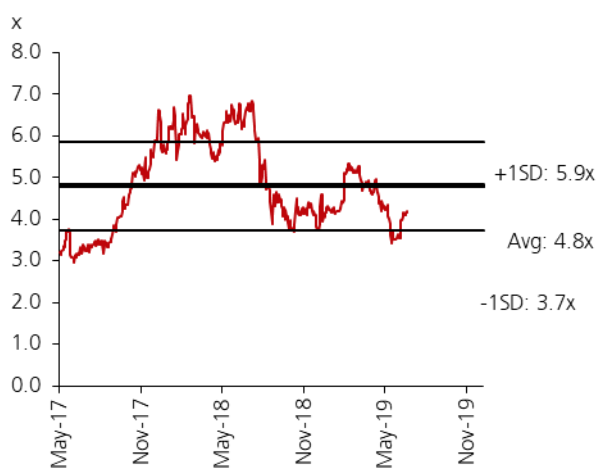
We initiate coverage on Xiabu with a BUY call, with a target price of HK\$14.85, based 22.5x FY20F PE, pegged to its 2-year average PE. This is on the back of earnings CAGR of 18% in FY19-21F.

Steady growth trajectory ahead despite some volatility. Xiabu is a leading hotpot chain in China with a total of 934 outlets in China as of Dec-18. With a dual-brand strategy, the group is able to target a wider customer base (fast-casual and mid-to-high end). We expect Xiabu to maintain a steady topline growth outlook, supported by (i) industry growth, with China catering sector expanding by c.9-10% p.a. in the past 5 years, and (ii) new stores. We expect the group to open 120 Xiabuxiabu outlets (FY18: +168) and 25 Coucou outlets (FY18: +27) in FY19. We expect the group to exceed its initial target of operating over 1,000 outlets by 2020F.

Xiabu PE band



Xiabu PB band



Source: Company data, DBS HK

Peer valuation

Company Name	Code	Price Local\$	Mkt Cap US\$m	Fiscal Yr	EPS growth		PE	PE	PEG	Yield	P/Bk	P/Bk	ROE	Performance
					19F %	20F %	19F x	20F x	20F x	20F %	19F x	20F x	19F %	YTD %
Leading Greater China Restaurants and Food Ingredients														
Cafe De Coral Hdg.*#	341 HK	26.3	1,968	Mar	4.4	7.9	24.8	22.9	2.9	3.9	4.3	4.2	17.9	38.6
Gourmet Master	2723 TT	180	1,043	Dec	(2.7)	28.6	20.0	15.5	0.5	3.2	2.8	2.6	15.1	(12.6)
Haidilao International Holding	6862 HK	32.85	22,246	Dec	46.1	39.8	57.5	41.1	1.0	0.5	14.2	11.0	26.6	91.4
Xiabuxiabu Cater.Man. (China) Hdg	520 HK	11.3	1,559	Dec	14.2	17.2	20.0	17.1	1.0	2.3	4.2	3.7	22.2	(8.6)
Yihai Intl.Hldg.	1579 HK	44.5	5,953	Dec	26.6	33.3	55.6	41.7	1.3	0.6	15.0	11.4	30.5	132.5
Yum China Holdings	YUMC US	44.18	16,711	Dec	1.5	11.8	25.6	22.9	1.9	1.2	5.2	4.6	21.8	31.8
Average					15.0	23.1	33.9	26.9	1.4	2.0	7.6	6.2	22.4	45.5
Other H-shares Restaurants and Food Ingredients														
Ajisen(China)Holdings	538 HK	3.23	450	Dec	(57.4)	(5.6)	13.2	14.0	(2.5)	3.9	0.9	0.9	6.5	47.5
Fairwood Holdings#	52 HK	25.9	428	Mar	5.6	3.2	17.5	17.0	5.3	5.0	4.1	3.9	24.0	(1.3)
Hop Hing Group Holdings	47 HK	0.13	167	Dec	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	18.6	(16.1)
Tang Palace (China) Holdings	1181 HK	1.3	178	Dec	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	13.0
Tao Heung Holdings	573 HK	1.51	196	Dec	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	15.3
Tsui Wah Holdings#	1314 HK	0.63	114	Mar	n.a.	40.0	12.6	9.0	0.2	9.5	n.a.	n.a.	5.1	(13.7)
Average					(25.9)	12.5	14.4	13.3	1.0	6.1	2.5	2.4	13.6	7.4
International Restaurants and Food Ingredients														
Chipotle Mexn.Grill	CMG US	759.87	21,059	Dec	115.0	28.6	58.1	45.2	1.6	0.0	13.0	11.4	20.6	76.0
Darden Restaurants#	DRI US	125.42	15,424	May	n.a.	7.2	19.6	18.3	2.5	3.1	5.6	5.1	32.1	25.6
Domino'S Pizza	DPZ US	269.92	11,096	Dec	12.7	15.8	28.7	24.7	1.6	1.1	n.a.	n.a.	(10.3)	8.8
Dunkin Brands Group	DNKN US	80.79	6,677	Dec	10.8	7.9	27.0	25.0	3.2	2.0	n.a.	n.a.	(39.4)	26.0
Jollibee Foods	JFC PM	284.6	6,103	Dec	0.4	15.1	37.0	32.1	2.1	1.1	5.7	5.1	16.7	(2.5)
Mcdonalds	MCD US	214.21	163,561	Dec	5.1	8.6	26.7	24.6	2.9	2.3	n.a.	n.a.	(82.6)	20.6
Restaurant Brands Intl.	QSR US	94.26	34,223	Dec	8.7	10.6	26.8	24.2	2.3	3.0	8.2	7.4	46.4	32.2
Shake Shack 'A'	SHAK US	75.01	2,787	Dec	11.7	26.7	129.1	101.9	3.8	0.0	10.1	8.7	8.2	65.1
Starbucks	SBUX US	90.16	109,202	Sep	23.6	11.1	32.4	29.2	2.6	1.8	n.a.	n.a.	(65.9)	40.0
Wendy'S Class A	WEN US	19.23	4,437	Dec	(66.7)	21.6	30.6	25.1	1.2	2.3	8.3	10.1	24.3	23.2
Yum! Brands	YUM US	111.93	34,248	Dec	(14.8)	10.9	29.3	26.4	2.4	1.6	n.a.	n.a.	(14.8)	21.8
Average					10.6	14.9	40.5	34.2	2.4	1.7	8.5	8.0	(5.9)	30.6

FY20: FY21; FY21: FY22

Source: Thomson Reuters, *DBS HK

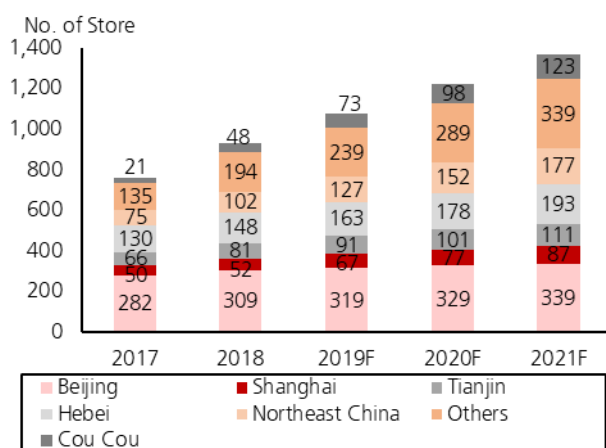
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Earnings drivers

Store expansion. In FY19-21F, we forecast Xiabu to open 120 net new outlets per annum, representing an increase of 16%/13%/12% with a stronger focus on East China, and less attention in South China. We expect the group to have more than 1,000 outlets by FY20F.

Beyond key market expansion. The Company has successfully developed regions beyond its core towards Hebei and Tianjin to offer higher than group operating margins at 23.3%/ 18.8% vs. Beijing at 26.6% in FY18. Shanghai remains a laggard with its 3-year operating margin average at 10% due to lack of scale, and higher degree of competition. Hence, Xiabu aims to raise the region's profitability.

Outlets by region

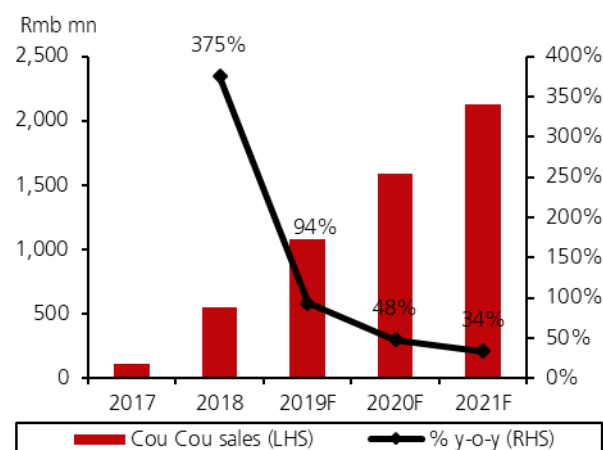


Source: Company data

Developing a rising brand. Coucou (凑凑) was first introduced in Beijing in late-2016 as a mid-to-high end hotpot dining experience with a larger store size of 600-800 sqm and average spending per customer at Rmb100-150 and. Taking advantage of its successful debut and overwhelming popularity, the group rapidly expanded across tier 1 cities such as Beijing, Shanghai, Hangzhou and Shenzhen at the initial stage with outlets subsequently added in Jiangsu, Hubei, Shaanxi, and Zhejiang.

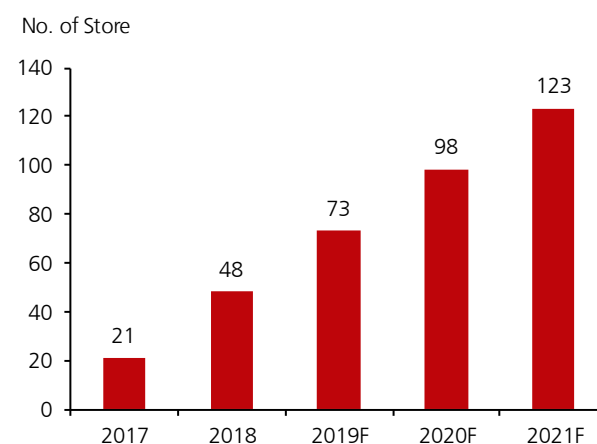
Coucou's sales grew by 375% y-o-y to Rmb556m (forming 12% of sales), driven by store expansion (+27 outlets). Coucou turned an operating profit of Rmb65m in FY18, and accounted for 11% of group operating profit. We forecast Coucou to deliver sales CAGR of 44% in FY19-21F, on the back of 52%/34%/26% expansion in number of outlets over the same period.

Coucou's sales growth (%)



Source: Company data, DBS

Number of Coucou outlets

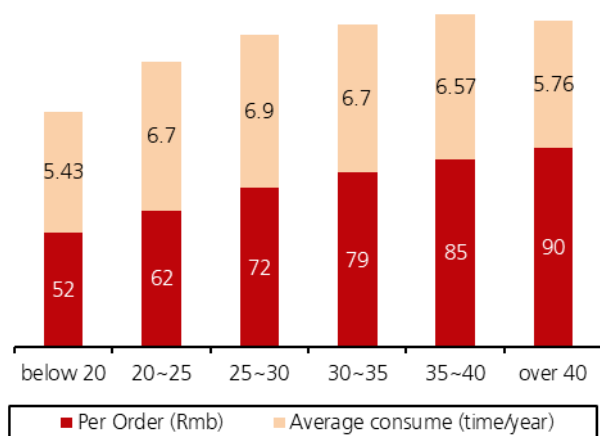


Source: Company data

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Delivery services is a plus. With a decline in table turnover count, the group developed Xiabu Fresh in 2016 to capture the fast-growing demand for home delivery services. According to Meituan Research, price points are typically higher online and are within the group's price point.

Average delivery order pricing



Source: Meituan Research

Since consumers are now getting accustomed to getting meals quickly through food delivery services, the group has introduced the XiaZhuXiaTang concept which offers instant hotpot meals to reduce the meal preparation time with ASP ranging between Rmb30-50 per person. The target market is high traffic locations such as high-speed rail stations and airports.

Delivery sales amounted to 6% of FY18 sales, and less than c.3% of operating profit. We expect the contribution will rise as consumption demand is shifting in favour of the delivery market. Delivery coverage increased from 4 major cities in 2017 to over 75 in the tier1/2 cities. To date, deliveries are conducted by 3rd party providers.

Xiabu currently relies on major delivery platforms (ele.me, Meituan), and c.15-20% of the margin is paid to them as commission. The delivery margin is higher than stores' operating margin due to higher average pricing of menu items. We project delivery sales to expand at a CAGR of 25% in FY19-21F.

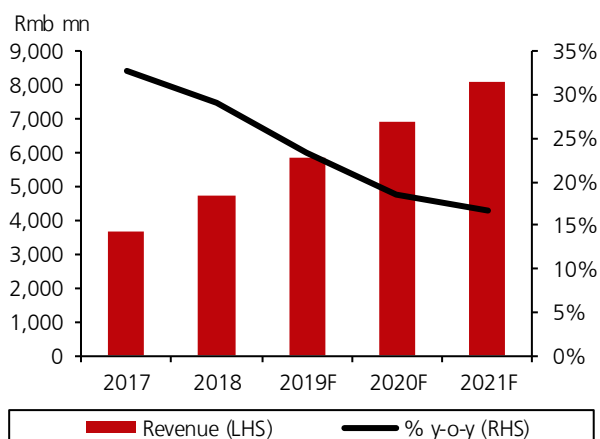
Financial summary and forecast

We forecast a **net profit CAGR of 18% in FY19-21F**, driven by revenue CAGR of 17% over the same period. This is supported by:

- (1) Steady new store openings from Xiabuxiabu (+120 p.a.) and Coucou (+20 p.a.) in 2019-21F;
- (2) Mild recovery in same-store-sales growth starting 2H19– with store and menu upgrades and expansion in delivery offerings.

In FY18, the group's revenue grew by 29.2% y-o-y to Rmb4,734m led by store network expansion (+148), and nationwide same-store sales growth of 2.3%. Coucou's revenue surged by 374.9% y-o-y to Rmb555.6m and accounted for 11.7% of overall sales, driven by aggressive store expansion (+27) in tier 1 cities.

Revenue growth and forecast

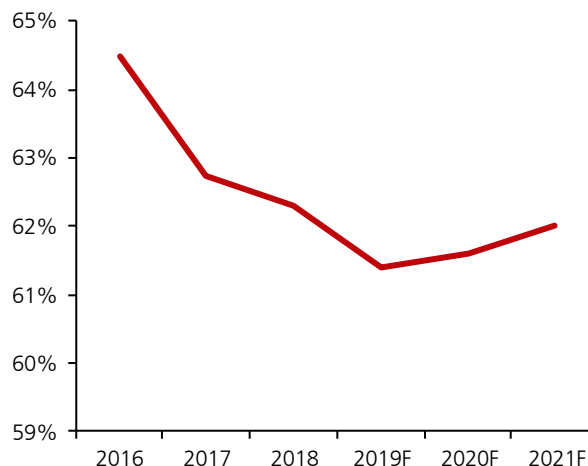


Source: Company data

Cost of raw materials and consumables grew by 30.7% y-o-y to Rmb1,784.5m with cost-to-sales ratio largely stable at 37.7% (FY17: 37.3%). The increase was due to expansion in store network, while lamb prices headed higher due to an increase in market demand. Raw material costs primarily consist of lamb, beef, vegetables, soup-bases, and condiments.

With higher raw material costs (lamb and beef) driven up by 13%/9% YTD (Source: MOC), we expect Xiabu to face greater raw material cost pressure in 2H19. The group is looking at alternative overseas food procurement sources. With the higher costs, we expect cost-to-sales ratio to expand by 0.9ppt to 38.6% in FY19F, thereafter recover by 0.2ppt in FY20F. We estimate every 5% increase in meat prices will result in 1.7% impact in net profit.

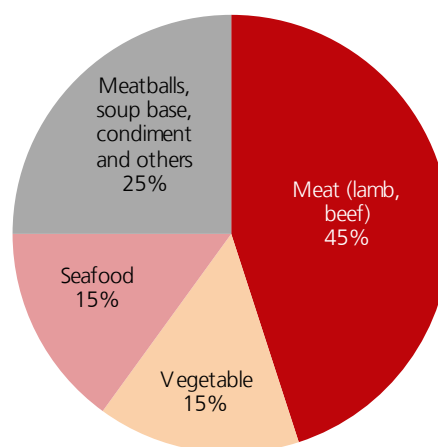
Gross margin trend (%)



Source: Company data, DBS estimates

More on raw material and consumable costs. Compared with Haidilao, Xiabu has a smaller menu. Key raw material costs include pork, beef, lamb, vegetables, soup-bases, and condiments, of which 60% is locally procured and 40% is imported, and purchased in Rmb. Each contract is typically secured by volume and prices are determined by market pricing. The group has 6 logistic centres which serve as storage and quality control for vegetables for both brands. Meat (lamb, beef, pork) is sourced locally.

Raw material cost breakdown (%)

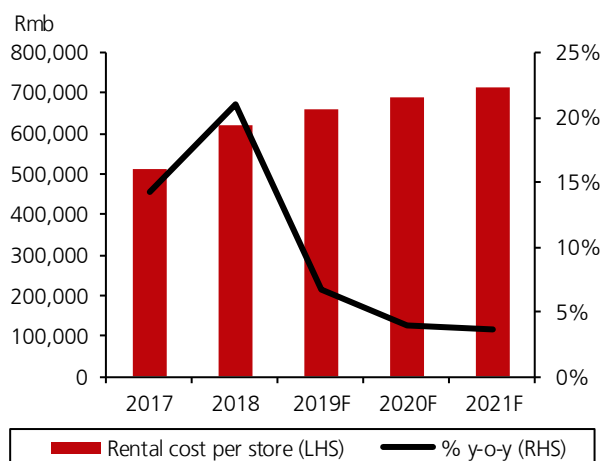


Source: DBS estimate

Xiabuxiabu Catering Mgmt

Rental cost. Xiabu's rental cost-to-sales has averaged 12.4% in the past three years, lower than most of its peers. Majority of Xiabu's rental agreements are under fixed rent. As consumption spending shifts towards modern malls, Xiabu has reduced the size of their outlets to raise productivity. On the other hand, Coucou's store size is larger on average, and has better turnover rates.

Rental cost

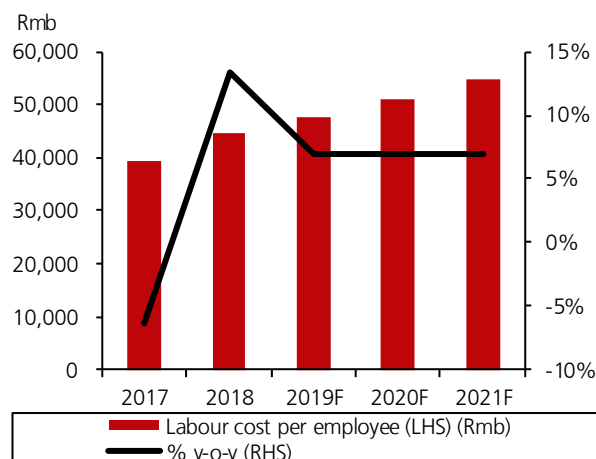


Source: Company data

Labour cost. Staff costs surged by 40.1% to Rmb1,167.9m (24.7% of sales) due to a rise in the number of employees by 5,019 to 26,219 as of Dec-18. This is also due to an increase in per capita wages as a result of an increase in minimum wages and social insurance in China.

Given the scalability of the hotpot concept and lower requirements for skilled labour, Xiabu has been able to keep labour cost stable through the use of permanent and part-time staff to manage cost more efficiently. Xiabu is improving labour efficiency through technology, such as manless cashiers and self-service condiment bars and more efficient use of part-time labour force. We currently assume 7% increase in wages y-o-y.

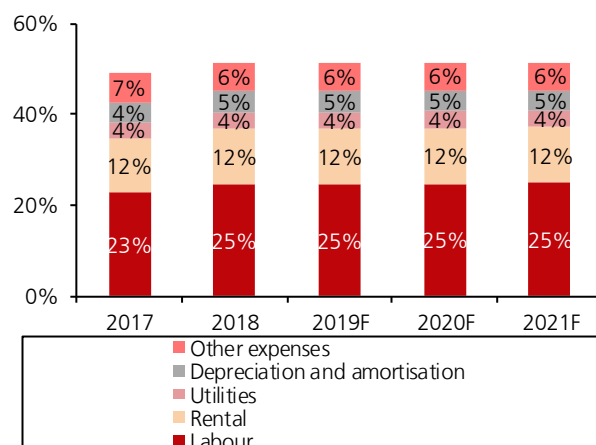
Labour cost per employee



Source: Company data

Other expenses rose by 20.9% to Rmb288.8m in FY18, with cost-to-sales declining by 0.4ppt to 6.1% of sales. The increase in quantum was primarily due to an increase in advertising expenses, logistic fees and delivery expenses due to expansion of Xiabu Fresh.

Operating cost trend (%)

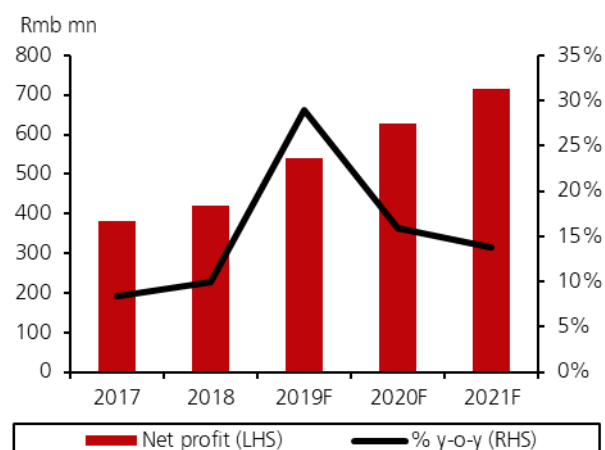


Source: Company data

Xiabuxiabu Catering Mgmt

Net profit. While operating costs as a percentage of sales rose by 2.7ppts in FY18, the group has secured higher interest investment products which has helped to cushion net margins by roughly c.1ppt. We expect higher food costs to be offset by less discounts, improved labour efficiency. Overall, we expect Xiabu's net profit to grow by 14% y-o-y to Rmb528m in FY19F.

Net profit growth and projection (% y-o-y)



Source: Company data, DBS HK

Key assumptions

Store maturity profile	2016	2017	2018	2019	2020	2021
1st year						
Beijing	0	0	27	10	10	10
Shanghai	0	0	2	15	10	10
Tianjin	0	6	15	10	10	10
Hebei	111	19	18	15	15	15
Northeast China	49	26	27	25	25	25
Others	0	57	59	45	50	50
	160	101	148	120	120	120
2nd year						
Beijing	52	48	9	27	10	10
Shanghai	2	10	1	2	15	10
Tianjin	17	10	6	15	10	10
Hebei	0	28	8	18	15	15
Northeast China	0	18	3	27	25	25
Others	36	17	19	59	45	50
	107	131	46	148	120	120
3rd year						
Beijing	233	238	273	282	309	319
Shanghai	52	43	49	50	52	67
Tianjin	43	50	60	66	81	91
Hebei	74	83	122	130	148	163
Northeast China	23	31	72	75	102	127
Others	42	61	116	135	194	239
	467	506	692	738	886	1,006

Source: DBS HK estimates

Management structure

Key personnel are stated as below

Management structure

Management	Title	Age	Description
Mr. HO Kuang-Chi (賀光啓)	Chairman of the Board and executive Director	54	Mr. Ho is the founder of the Group and was appointed as the Group's Director on 14th of May 2008, and is responsible for formulating the overall development strategies and business plans of the Group. Mr. Ho established the first Xiabu restaurant in Beijing in 1999.
Ms. YANG Shuling (楊淑玲)	Chief Executive Officer, and executive Director	56	Ms. Yang is the Group's chief executive officer and executive Director. Ms. Yang joined the Group in 1998 as an accountant, and subsequently served as the finance manager, deputy general manager, executive vice president, and president with over 19 years of experience.
Ms. Chen Su-Yin (陳素英)	Non-Executive Director	54	Ms. Chen, the wife of Chairman, is responsible for the business development of the Group. Ms. Chen has provided guidance on the range and variety of foods offered.
Mr. Zhang Chi (張弛)	Non-Executive Director	42	Mr. Zhang is primarily responsible in providing strategic advice and guidance on the business development of the Group. Mr. Zhang heads the General Atlantic business in China. Prior to that, Mr. Zhang was a Global Partner and Managing Director at the Carlyle Group, where he focused on investment opportunities in Asia from 2006 to 2016.
Ms. Chang Le (常樂)	Non-Executive Director	35	Ms. Chang Le was appointed as an alternate Director to Mr. Zhang Chi with effect from Aug'17. Ms. Chang joined General Atlantic, and is currently a Principal of General Atlantic.
Ms. Zhao Yi (趙怡)	Chief Financial Officer	48	Ms. Zhao is the Chief Financial Officer responsible for the audit, accounting, financial management and IT related matters of the Group. Ms. Zhao previously worked in multinational companies such as The East Asiatic Company, PepsiCo Food, Unilever Service, Sony Ericsson Group and McDonald's.

Source: Company, DBS HK

Appendix: Coucou

Coucou’s bestselling dishes



Coucou’s bestselling dishes



Coucou’s bestselling dishes



Xiabuxiabu’s set menu



Source: Company data, DBS HK

Xiabuxiabu Catering Mgmt

CRITICAL FACTORS TO WATCH

Earnings drivers

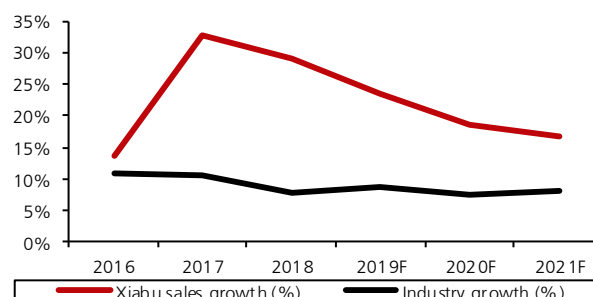
Expanding geographic footprint with a dual-brand strategy. As one of the leading hotpot chains in China, Xiabu has a total of 886 Xiabuxiabu and 48 Coucou outlets in 108 cities as of Dec-18. We expect the group to sustain steady topline growth, supported by (i) industry growth, with China's catering sector growing by c.9-10% p.a. in the past 5 years, and (ii) steady store opening plans. We expect the company will open 120 Xiabuxiabu outlets (FY18: +168) and 25 Coucou outlets (FY18: +27) in FY19F. We expect the group to beat its initial target of operating over 1,000 outlets by 2020F by a year.

Sustainable same-store-sales growth. In FY18, group SSSG slowed to 2.1% (FY17: 9.3%), and this was across all regions including Beijing (2.7%), Shanghai (5.2%), Tianjin (0.3%), Hebei (9.0%), Northeast China (-4.1%), others (-6.9%), hurt by a slowdown in the economy in 2H18 as well as the rat incident. We expect SSSG to post an improvement in 2H19 supported by less discounting, an improvement in menu mix, emphasis on food quality safety, and rising delivery sales.

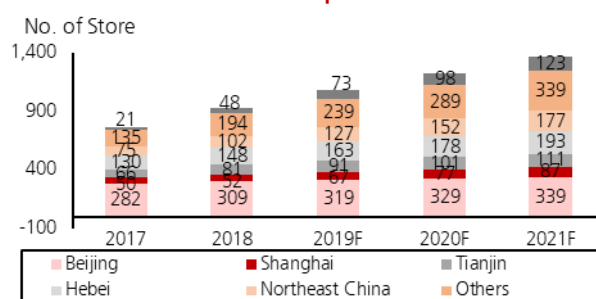
Higher commodity costs ahead. Xiabu is still at an expansionary phase with its new brand Coucou. Operating cost as a percentage of sales rose by 2.7ppts in FY18, still at a manageable level with peers. In FY19F, we expect COGS-to-sales ratio to expand by 0.9ppt due to higher lamb and pork prices in FY19F. The group also has other initiatives to maintain cost control. For example, the group is actively looking at overseas food procurement sources, and other means to increase efficiency (increase usage of central kitchen, increase technology support).

New initiatives bearing fruit. The delivery market is expected to grow strongly in the medium term with its food ingredient delivery (Xiabu Fresh) and instant hotpot businesses (XiaZhuXiaTang). The group has expanded its food delivery presence from 5 to 75 tier one and two cities (or c.400 outlets) in FY18, with revenue increasing by 203.3% y-o-y, and accounted for c.6% of FY18 sales. We forecast delivery sales will outgrow the industry (CAGR of 21.7% in FY18-22F) (Source: F&S). In addition, the group also operates a condiments business which is expected to contribute more meaningfully in the long run.

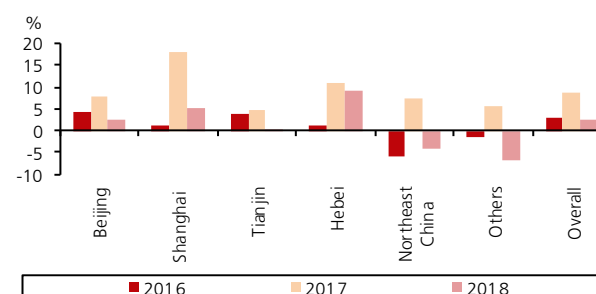
Industry growth vs. Xiabu sales growth (%)



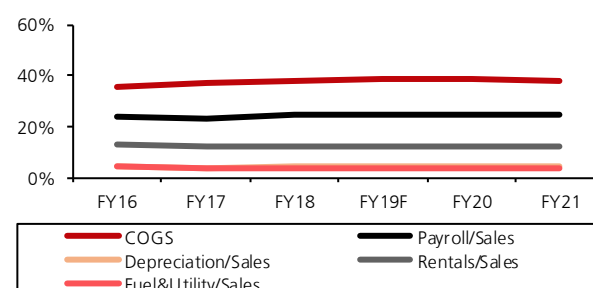
Store expansion



SSSG (%)



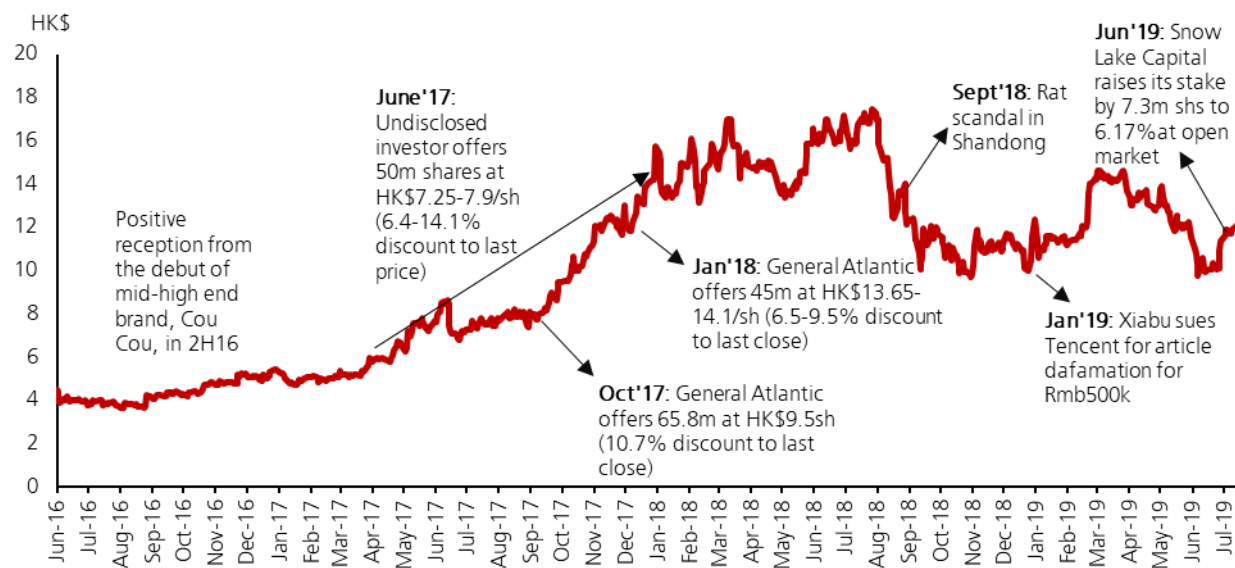
Cost trend



Source: Company, DBS HK

Appendix 1: A look at Company's listed history – what drives its share price?

Share price performance event chart



Source: Bloomberg finance LP, DBS HK

Xiabuxiabu Catering Mgmt

Balance Sheet:

Xiabu is in net-cash position of Rmb1,341m as of Dec-18 (Dec-17: Rmb1,453m). In Jan-Mar'19, the group has purchased financial assets at for Rmb1,070m consisting of short-term financial products issued by China Merchant Bank, and Fubon Bank. The financial products have terms ranging from 182-304 days, with expected return rates at between 4.22-4.45% per annum. We forecast capex to be unchanged at c.Rmb500m in FY19F, largely for new store openings and store upgrades and initial investment in condiment plant (FY18 capex: Rmb491.6m). We expect dividend payout to be unchanged at 38.2%.

Share Price Drivers:

Faster turnaround with new store openings for Xiabuxiabu and Coucou brands to drive stronger SSSG.

Better than expected cost management in light of steady store expansion and upgrades

Key Risks:

Food safety & reputation risk. Xiabu is subject to food safety and reputational risk. In Sept-18, a pregnant woman found a boiled rat in her broth when dining at a Xiabuxiabu outlet. A restaurant staff responded inappropriately which led to a temporary closure of the Shandong outlet. In response, Xiabu stated it has always placed great emphasis on food security and would make the necessary improvements. This incident had an impact on sales in the surrounding Northeast region in 2H18.

Raw material cost volatility. Raw material cost volatility has an impact on food cost.

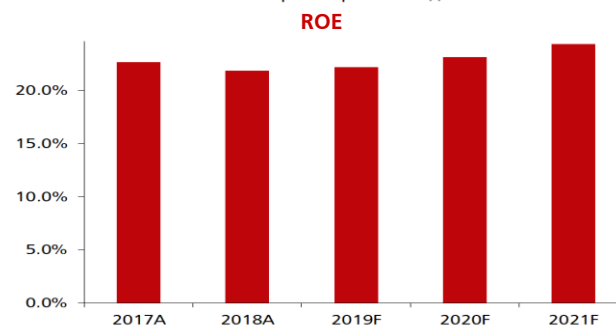
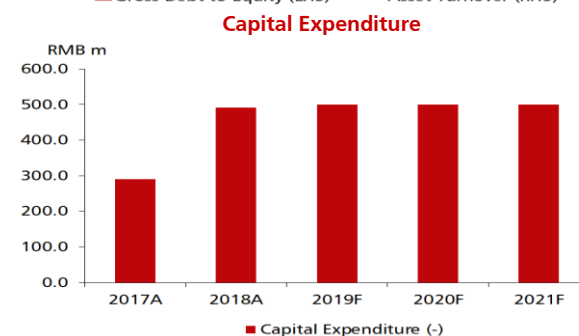
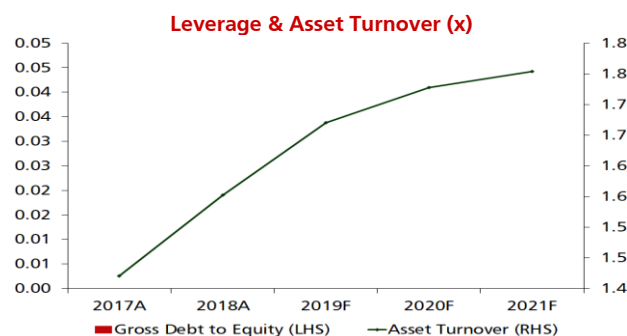
Coucou takes longer than expected to achieve sustainable profitability. Weaker than sales ramp-up and higher than expected expenses could lead to a dilution to group margins. In FY18, operating margin at the Coucou's restaurant level stood at 11.7% vs. Xiabuxiabu at 20.4%.

Environment, Social, Governance:

To conserve energy, the Company applied to install additional 1,200W induction cookers instead of 1,500W to reduce power consumption and GHG emission. This also helped to deliver ideal boiling time and cooking performance.

Company Background

Since its inception in 1998, Xiabuxiabu Catering Management (Xiabu) is a leading Taiwanese-style fast-casual hotpot chain restaurant in China with >900 stores nationwide under its mass-market brand "Xiabuxiabu" and premium brand "Coucou" (湊湊). The group operates under a wholly-owned operating model and serves as a fully-integrated supply chain. In response to rising delivery service demand, Xiabu has launched Xiabu Fresh (hot-pot delivery) and XiabuXiaTang (instant hotpot meal). The group also holds a 40/60 joint-venture with the founder to engage in food processing (condiments, soup-bases).



Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenues (RMB m)					
Beijing	1,815	1,925	2,036	2,153	2,275
Shanghai	212	216	320	348	400
Tianjin	270	317	380	422	464
Other	365	567	727	860	983
Cou Cou	1,002	1,708	2,345	3,065	3,820
Total	3,664	4,734	5,807	6,848	7,941

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenue	3,664	4,734	5,807	6,848	7,941
Cost of Goods Sold	(1,365)	(1,784)	(2,241)	(2,629)	(3,018)
Gross Profit	2,299	2,950	3,565	4,218	4,924
Other Opng (Exp)/Inc	(1,770)	(2,350)	(2,880)	(3,413)	(3,961)
Operating Profit	529	600	685	806	962
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	14	10	10	10	10
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	543	609	695	816	972
Tax	(123)	(147)	(168)	(197)	(235)
Minority Interest	0	1	1	1	1
Preference Dividend	0	0	0	0	0
Net Profit	420	462	528	619	738
EBITDA	680	821	957	1,125	1,333
Growth					
Revenue Gth (%)	32.8	29.2	22.7	17.9	16.0
EBITDA Gth (%)	19.5	20.7	16.6	17.6	18.5
Opg Profit Gth (%)	16.2	13.4	14.3	17.5	19.5
Net Profit Gth (%)	14.2	10.1	14.2	17.2	19.2
Margins & Ratio					
Gross Margins (%)	62.7	62.3	61.4	61.6	62.0
Opg Profit Margin (%)	14.4	12.7	11.8	11.8	12.1
Net Profit Margin (%)	11.5	9.8	9.1	9.0	9.3
ROAE (%)	22.7	21.9	22.2	23.2	24.4
ROA (%)	16.3	15.2	15.2	15.6	16.3
ROCE (%)	21.9	21.4	21.6	22.4	23.5
Div Payout Ratio (%)	39.7	38.2	40.0	40.0	40.0
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	2H2016	1H2017	2H2017	1H2018	2H2018
Revenue	1,496	1,576	2,088	2,129	2,605
Cost of Goods Sold	(510)	(558)	(808)	(792)	(993)
Gross Profit	985	1,018	1,281	1,337	1,612
Other Oper. (Exp)/Inc	(705)	(778)	(992)	(1,053)	(1,297)
Operating Profit	281	240	289	284	315
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	9	7	7	5	5
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	290	247	296	289	320
Tax	(61)	(59)	(64)	(80)	(68)
Minority Interest	0	0	0	0	1
Net Profit	229	188	232	209	253

Growth

Revenue Gth (%)	14.7	24.8	39.6	35.1	24.7
Opg Profit Gth (%)	69.0	37.7	2.8	18.3	9.3
Net Profit Gth (%)	56.8	35.0	1.5	11.2	9.1

Margins

Gross Margins (%)	65.9	64.6	61.3	62.8	61.9
Opg Profit Margins (%)	18.8	15.3	13.8	13.4	12.1
Net Profit Margins (%)	15.3	11.9	11.1	9.8	9.7

Source: Company, DBS HK

Balance Sheet (RMB m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Net Fixed Assets	599	911	1,261	1,611	1,961
Invts in Associates & JVs	0	0	0	0	0
Other LT Assets	266	303	303	303	303
Cash & ST Invts	1,453	1,341	1,392	1,440	1,561
Inventory	327	390	450	528	606
Debtors	168	308	292	344	399
Other Current Assets	33	0	0	0	0
Total Assets	2,846	3,253	3,699	4,227	4,831
ST Debt	0	0	0	0	0
Creditors	738	847	995	1,168	1,340
Other Current Liab	109	147	154	162	170
LT Debt	0	0	0	0	0
Other LT Liabilities	13	12	33	62	99
Shareholder's Equity	1,986	2,241	2,512	2,832	3,218
Minority Interests	0	6	5	4	3
Total Cap. & Liab.	2,846	3,253	3,699	4,227	4,831
Non-Cash Wkg. Capital	(319)	(296)	(408)	(457)	(505)
Net Cash/(Debt)	1,453	1,341	1,392	1,440	1,561
Debtors Turn (avg days)	13.2	18.3	18.3	18.3	18.3
Creditors Turn (avg days)	166.7	162.1	162.1	162.1	162.1
Inventory Turn (avg days)	60.3	73.3	73.3	73.3	73.3
Asset Turnover (x)	1.4	1.6	1.7	1.7	1.8
Current Ratio (x)	2.3	2.1	1.9	1.7	1.7
Quick Ratio (x)	1.9	1.7	1.5	1.3	1.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	N/A	N/A	N/A	N/A
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Profit	543	609	695	816	972
Dep. & Amort.	151	219	150	150	150
Tax Paid	(144)	(150)	(147)	(168)	(197)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(147)	(144)	104	42	39
Other Operating CF	95	130	51	47	42
Net Operating CF	395	493	751	784	904
Capital Exp.(net)	(290)	(492)	(500)	(500)	(500)
Other Invts.(net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	48	93	12	12	12
Net Investing CF	(243)	(399)	(488)	(488)	(488)
Div Paid	(167)	(177)	(211)	(248)	(295)
Chg in Gross Debt	0	0	0	0	0
Capital Issues	0	0	0	0	0
Other Financing CF	(12)	(30)	0	0	0
Net Financing CF	(179)	(206)	(211)	(248)	(295)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(26)	(112)	52	48	121
Opg CFPS (RMB)	0.51	0.60	0.61	0.70	0.81
Free CFPS (RMB)	0.10	0.00	0.24	0.27	0.38

Source: Company, DBS HK

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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Sources for all charts and tables are DBS HK unless otherwise specified.

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