China/Hong Kong Industry Focus

Hotpot Sector

DBS Group Research . Equity 14 Sep 2021

Entering the peak season

- **Table turnover sees room to catch up with normal levels of 2019**
- **Rising vaccination rate and upcoming peak season could enable better same-store performance**
- **1H21 earnings miss already in the price, with more reasonable valuations. Reiterate BUY on Haidilao and upgrade XBXB to BUY rating**

Improving table turnover and overall operations. Table turnover remains impacted by COVID-19 resurgence in Mainland China and remains below 2019 levels. Rising vaccination rates plus the upcoming peak seasonality should beef up performance, where atypically 5/6 months in 2H account for bulk of the earnings. We expect XiabuXiabu (XBXB) and Haidilao to deliver store unit expansion of 3% and 17% in 2020-22E, to 1,271 units and 2,098 units, respectively.

Room for margin enhancement. Despite disappointing 1H21 results, the market has already revised down expectations significantly, especially on store counts and near-term operations. Cost management would be tightened further to carefully raise store productivity and overall profitability. We expect the operating margin for major players to expand by c.1-2ppt in 2021-2022E.

Latest disappointing results already in the price. With share prices retreating by 60-70% since the peak in Feb'21, we believe the current share price reflects opportunity for entrance in the hotpot segment, particularly amidst a peak seasonality in 2H21. Currently, valuation has become under-rated, with Haidilao now trading at 50x, which is more than 1SD below its average since listing and XBXB at 15x, equivalent to 1.5SD below its 4-year average. Our preference in the hotpot segment would be Haidilao. We also upgrade XBXB, as we expect the worst should be over with the removal of loss-making stores to raise the overall operating margin. Upgrade XBXB to BUY rating, with TP at HK$11.1, based on 21.9x or 1SD below its 4-year average.

HSI: 25,814

ANALYST
Alison FOK +852 36684170 alisonfok@dbs.com
Mavis HUI +852 36684188 mavis_hui@dbs.com
Alice HUI CFA +852 36684182 alicehuism@dbs.com

Recommendation & valuation

Company	Price Local$	Target Price Local$	Recom	Mkt Cap US$m	PE 21F x
Xiabuxiabu (520 HK)	7.71	11.10	BUY	1,098	21.3
Haidilao Int'l (6862 HK)	32.55	38.6	BUY	21,391	98.7

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

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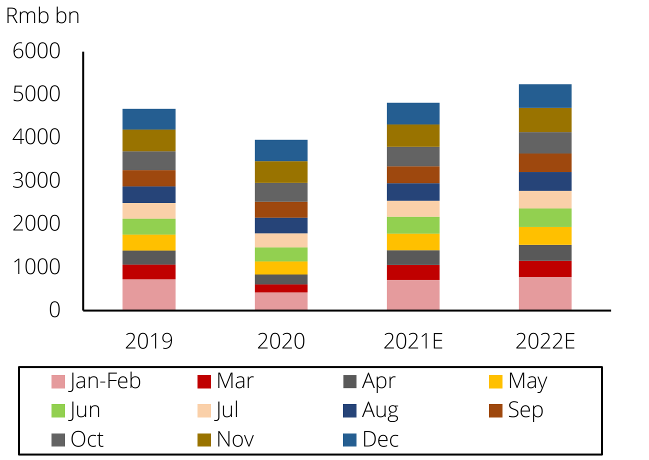
Live more, Bank less

On the mend

Decent sales rebound. China catering sales are estimated to be at Rmb4,812bn by end-FY21 (2020: Rmb3,953bn), based on our estimates. We forecast catering sales to record a 22% growth in 2021E and 9% in 2022E. Compared with 2019, we estimate sales to rise 3% y-o-y, based on our estimates. We assume sales growth to normalise to 6% y-o-y in 2H21, versus 1H21 of c.49% y-o-y.

Vaccination dosages high. As of 10-Sep, China vaccination dosages have reached 2.1bn doses (Source: NHC). Assuming 2 dosages for each citizen, we estimate c.1bn citizens have been vaccinated. This should encourage consumers to be more confident in dining out more frequently.

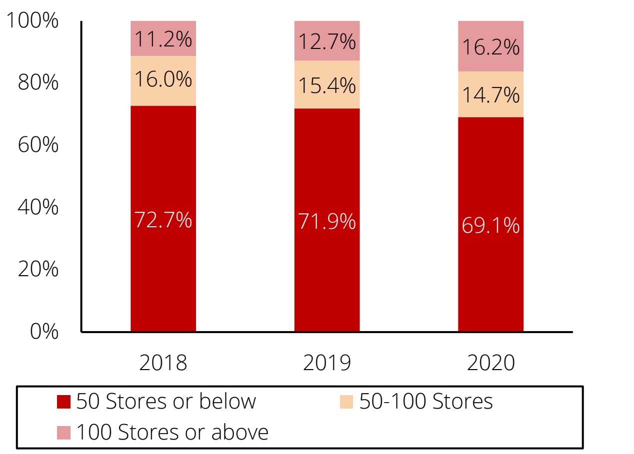
China catering sales



Source: CEIC, DBS HK estimates

Market consolidation amidst hotpot stores most apparent. In 2020, due to the impact of COVID-19 pandemic, the number of hotpot outlets have taken a hit. Overall hotpot chained store numbers increased at a rapid rate, arising from a market share of 15.1% to 18.3%, which is higher than the industry restaurant chained market share of c.15%.

Hotpot chained store breakdown (%) (2018-20)

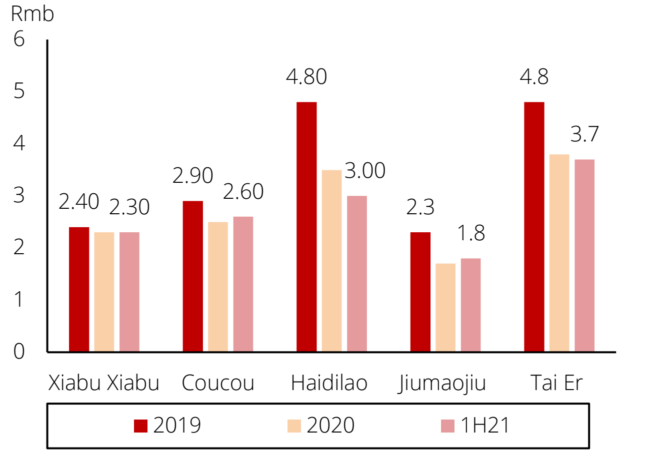


Source: Meituan, China Catering Big Data Report 2021, DBS HK

Table turnover remains soft versus 2019 level. Despite strong control of the pandemic situation, hotpot table turnover remains lower compared with 2019 levels. Both Haidilao and Xiabu Xiabu reported softer dine-in volume versus 2019 due to regional outbreaks, which has caused a sustained increase in consumer preference towards delivery and takeaways.

Because of the nature of offerings, hotpot delivery sales are low versus the sector penetration rate at c.20%. XBXB delivery sales accounted for 6% of 1H21 sales, while Haidilao accounted for 2% of 1H21 sales.

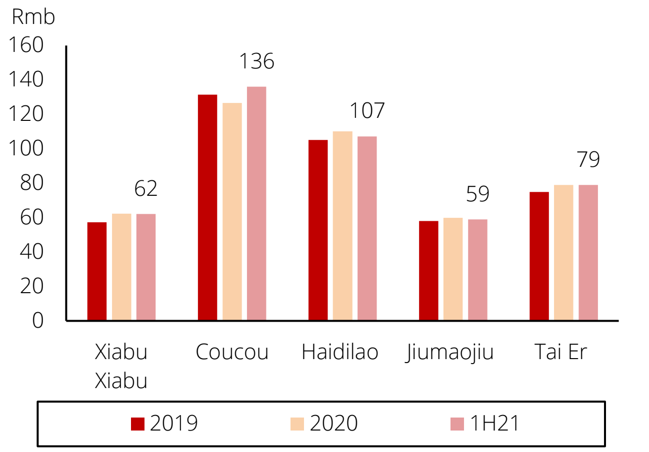
Table turnover rate



Source: Company data, DBS HK

Average spending largely on a decline. While pricing was mildly adjusted for some SKUs due to cost pressures, average spending stood flat/or on a decline in 1H21, due to increased promotions to drive sales back into restaurants.

Average spending on slight decline



Source: Company data, DBS HK

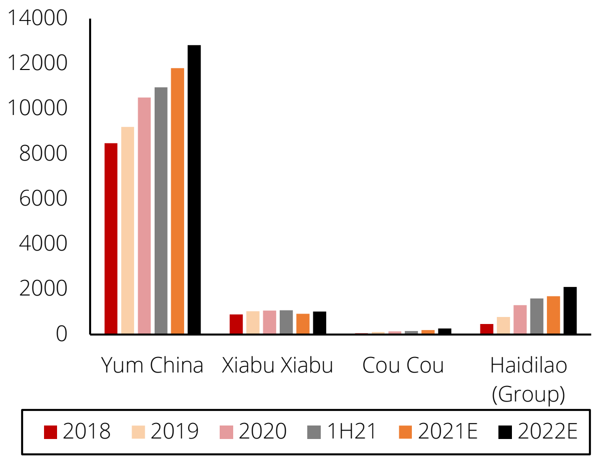
Store expansion plan revised. With weaker-than-expected table turnovers recorded, store expansion plans have largely been revised.

XBXB. For XBXB, the company aims to slow down the pace of store expansion through the closure of c.200 loss-making XBXB units in 2021F in regions including Beijing, Hebei, Henan, Shanghai etc (1H21: +40), with adjustment in store design. Menu SKU will be further revised to promote more valued products. Besides this, the group will have a new brand development for a more premium XBXB brand priced at ~-c. Rmb90 versus existing XBXB stores average spending at Rmb50-60.

For its premium brand, Coucou, the group has revised its store expansion target to c.50 stores (vs. 70-90) in 2021F, of which 9 stores have been opened in 1H21. Targeted locations include Yangtze River Delta, Pearl River Delta, and Southeast Asia. We now forecast the Group's store CAGR of 3% to 1,271 by end-FY22E (XBXB: -2%; Coucou: +36%)

Haidilao. Haidilao reported a longer-than-expected period to reach break-even for its new stores, while overseas operations remained impacted by the COVID-19 pandemic. As of Jun-21, the group had 1,491 restaurants in China and 106 restaurants in Hong Kong, Macau, Taiwan, and overseas countries. As such, we expect the company to open up to 300-400 stores in 2021E versus the initial street estimate of 400-500 outlets. We now forecast the group's store CAGR of 17% to 2,098 by end-FY22E.

Store expansion target

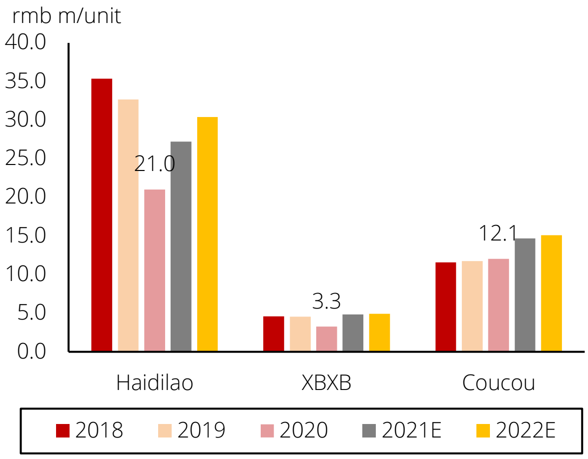


Source: Company data, DBS HK estimate

Operating margin

Source: Company data, DBS HK estimate

Sales per unit to reflect gradual recovery



Source: Company data, DBS HK estimate

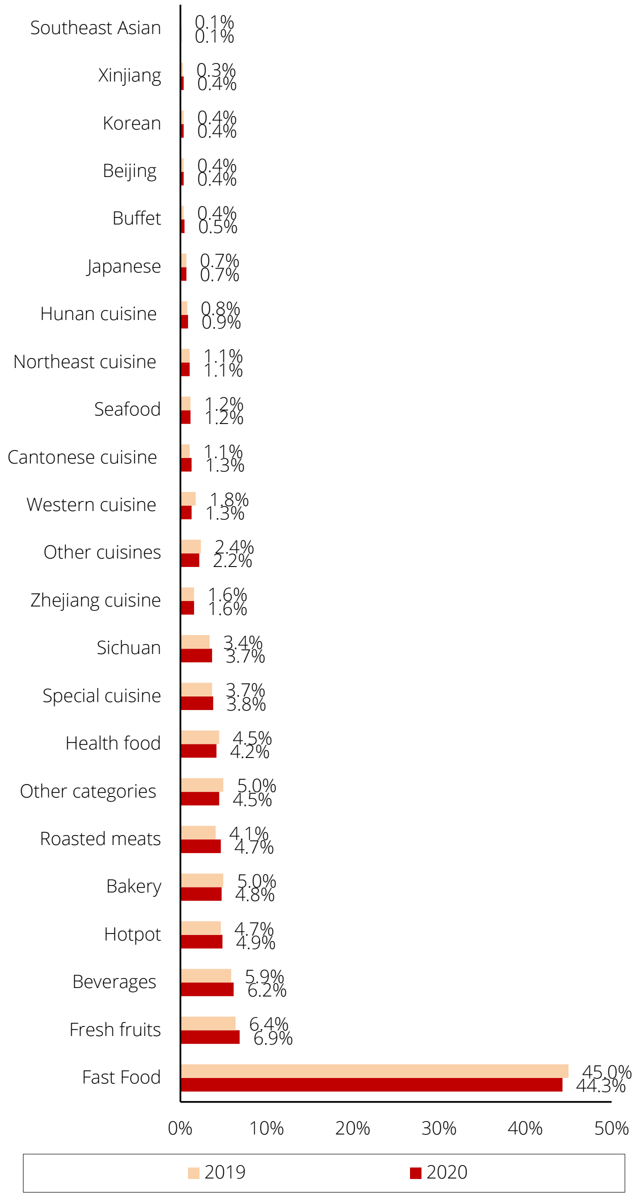
Margin uplift to continue into 2H22. Amidst sales recovery, we forecast XBXB and Haidilao's operating margins to record 0-2ppt expansions in 2H21, with the full-year operating margins at 8% and 6%% respectively.

Steady recovery on a month-on-month basis. With share prices retreating by 60-70% since their respective peaks in 2021, we believe the current share price reflects opportunity for entrance in the hotpot segment, particularly amidst a peak seasonality in 2H21. While July-August should record weaker sales due to regional fluctuation of the pandemic, we have seen better numbers incoming from restaurants. For example, Jiumaojiu's operations reached close to 80% of 2019 level, while Tai-Er reached close to c.90% in August. We expect the group's strategies to be to (1) slow down store openings, (2) raise existing and new store productivity, (3) increase incentive to improve profitability, which should enable the hotpot players to continue recording a gradual improvement in the operating margin on an h-o-h basis.

We reiterate our BUY call on Haidilao as the Group readjusts on store expansion pace and looks to raise store productivity. Our TP basis is changed to 62.3x FY22 PE, equivalent to 1SD below its trading average (Previously 1.2x 2019-22E PEG). We also upgrade our call for XBXB to BUY. We now forecast XBXB to sustain 48% growth in FY22E, while Haidilao should sustain 96% growth in FY22E, supported by store expansion, and improvement in productivity in new stores.

Fast food remains dominant in offline channel. By store breakdown, fast food is the dominant cuisine type with an over 44% market share. The next largest market shares by store count are fresh fruit (6.9%) and beverages (6.2%).

China: Store breakdown by cuisine (%) (2020)

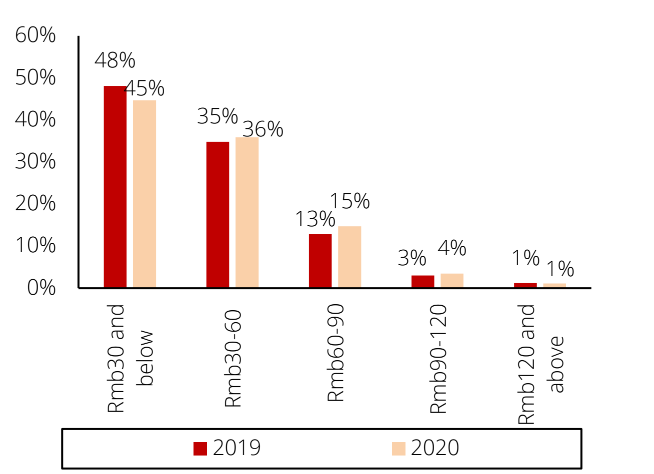


Source: Meituan, China Catering Big Data Report 2021, DBS HK

Industry pricing mainly below Rmb60

Offline hotpot cuisine pricing remained below Rmb60. Over 80% of hotpot outlets' average spending is ranged below Rmb60. In 2020, Rmb60-90 recorded a 2ppt expansion in share to 15% of total stores. This displays consumer willingness to spend more for better quality items.

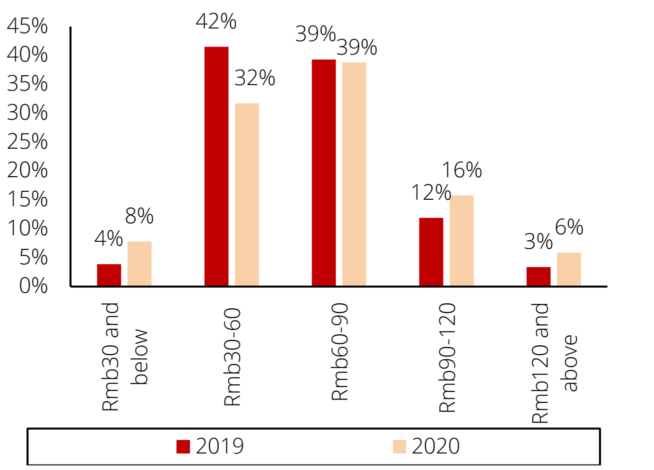
Offline: Hotpot cuisine store by pricing (2019-20)



Source: Meituan, China Catering Big Data Report 2021, DBS HK

Delivery order pricing on the rise. Delivery orders' pricing range largely fall between the Rmb30-60 and Rmb60-90 categories, accounting for 71% of total orders. Rmb90-120 and Rmb120 or above orders rose by 3.9ppt and 2.5ppt respectively to 17.2% and 10.9%.

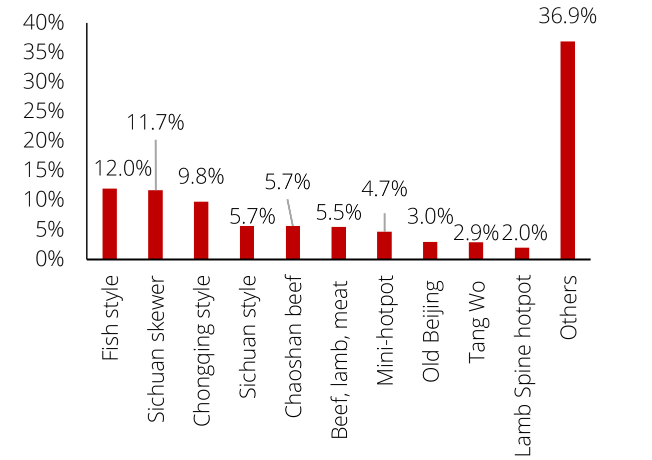
Online: Hotpot cuisine delivery orders by pricing (2019-20)



Source: Meituan, China Catering Big Data Report 2021, DBS HK

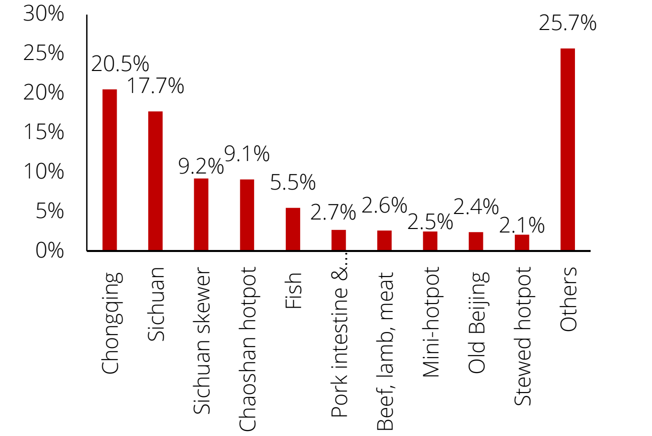
Hotpot cuisine outlets preference led by fish-hotpot. By sub-segment, fish hotpot account for the largest proportion of hotpot stores at 12.0%, followed by Sichuan skewer hotpot (11.7%) and Chongqing hotpot（9.8%）.

Offline: Hotpot store breakdown by sub-segment (%) (2020)



Source: Meituan, China Catering Big Data Report 2021, DBS HK

Online: Hotpot delivery order by sub-segment (%) (2020)

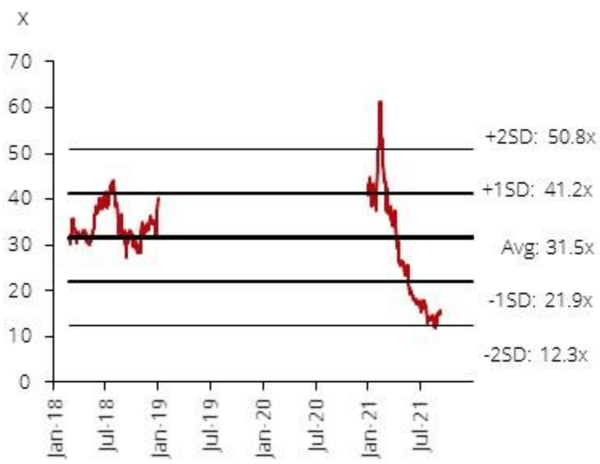


Source: Meituan, China Catering Big Data Report 2021, DBS HK

Haidilao PE Band

Source: Thomson Reuters, DBS HK

Xiabu Xiabu PE Band



Source: Thomson Reuters, DBS HK

Peers table

Company Name	Code	Price Local$	Mkt Cap US$m	Fiscal Yr	EPS growth 21F %	EPS growth 22F %	PE 21F x	PE 22F x	PEG 21F x	Yield 21F %	Yield 22F %	P/Bk 21F x	P/Bk 22F x	ROE 21F %	Performance YTD %
Leading Greater China Restaurants and Food Ingredient Plays															
Gourmet Master	2723 TT	138	900	Dec	24.8	9.5	19.6	17.9	2.1	3.0	3.5	2.1	2.0	11.1	(2.1)
Haidilao International*	6862 HK	32.55	21,391	Dec	340.8	95.6	98.7	50.5	1.0	0.6	0.0	12.1	10.7	12.8	(45.5)
Jiumaojiu Int'l	9922 HK	24.75	4,625	Dec	292.2	59.4	63.1	39.6	1.1	0.4	0.7	8.5	7.1	14.5	4.9
Xiabuxiabu *	520 HK	7.71	1,098	Dec	17258.1	48.0	21.3	14.4	0.4	1.9	2.8	2.8	2.5	13.4	(56.4)
Yihai Intl.Hldg.	1579 HK	43.7	5,882	Dec	16.7	24.1	36.8	29.7	1.5	0.7	0.9	8.6	6.9	25.8	(62.0)
YUM China*	9987 HK	480.2	25,986	Dec	12.0	10.0	30.3	27.5	3.0	0.8	0.8	3.8	3.5	13.4	8.0
YUM China*	YUMC US	61.94	26,070	Dec	12.0	10.0	30.4	27.6	3.0	0.8	0.8	3.8	3.5	13.4	8.5
Average					2565.2	36.6	42.9	29.6	1.7	1.2	1.3	6.0	5.2	14.9	(20.7)

 # FY21: FY22; FY22: FY23

*Source: Thomson Reuters, *DBS HK*

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

DBS Regional Research Offices

HONG KONG
DBS Bank (Hong Kong) Ltd
Contact: Carol Wu
13th Floor One Island East,
18 Westlands Road, Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

MALAYSIA
AllianceDBS Research Sdn Bhd
Contact: Wong Ming Tek (128540 U)
19th Floor, Menara Multi-Purpose, Capital Square,
8 Jalan Munshi Abdullah 50100, Kuala Lumpur, Malaysia.
Tel.: 603 2604 3333
Fax: 603 2604 3921
e-mail: general@alliancedbs.com
Co. Regn No. 198401015984 (128540-U)

SINGAPORE
DBS Bank Ltd
Contact: Janice Chua
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
e-mail: groupresearch@dbs.com
Company Regn. No. 196800306E

INDONESIA
PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: indonesiaresearch@dbs.com

THAILAND
DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
Tel. 66 2 857 7831
Fax: 66 2 658 1269
e-mail: research@th.dbs.com
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