China Consumer Sector

Shenzhen Trip: sustained growth in Feb 2023

- **Maintained OUTPERFORM after our Shenzhen Consumer Tour.** We visited a number of companies (catering, hotel and sportswear brands) and experts (catering & shopping mall operators) during our trip to Shenzhen this week. This channel check has strengthened our OUTPERFORM view on the Consumer discretionary sector, backed by 3 trends:

  1) post CNY sales growth remained robust, if not stronger, as there were still some distortions by COVID-19 cases in Jan 2023 (2 operators mentioned better growth in Feb vs Jan 2023 and the others had seen similar growth),

  2) spending per customer is growing strong (evidenced by improved sportswear brand's retail discounts and increases in hotel brand's ADR), hence the GP margin could potentially be benefited too, and

  3) luxury, experience based and "value for money" segments are rebounding better (mass marketing catering, sportswear brands, and mid-high end hotel brand's SSSG is fast during Jan-Feb 2023).

- We also have an OUTPERFORM rating on 1) catering, 2) sportswear and apparel and 3) tourism (hotels), while we have a MARKET-PERFORM rating on home appliances. Our sector top picks are now XBXB (520 HK, BUY), YUMC (9987 HK, BUY), CDC (341 HK, BUY), Anta (2020 HK, BUY), Xtep (1368 HK, BUY), Bosideng (3998 HK, BUY), JNBY (3306 HK, BUY), Atour (ATAT US), Haier (6690 HK, BUY) and Gree (000651 CH, NR).

- **Shopping mall expert:** During CNY 2023, customer traffic in Northeastern and Northern China went up by ~20%, retail sales growth was at ~30%, while customer traffic in Eastern and Southern China increased by ~16% and retail sales growth was at ~ 19%. Recovery rate (vs 2019) was the best in Western and Southern China at ~88%. Post CNY retail sales growth is still strong, because there were still some COVID-19 infection cases during CNY. The expert expected recovery rate to surpass 100% in late 2Q23E or early 3Q23E and shared that their SSSG target for 2023 was ~15% for both luxury/ non-luxury segments.

  Sub segments like: 1) catering, esp. the celebrity brands (like Tai Er and Cou Cou), 2) experience and entertainments, such as movie or family and kids related), 3) luxury brands, like gold and jewelry, 4) sportswear (FILA and China Li Ning), esp. those have more outdoor, skiing, fitness, yoga products, 5) designer brands (e.g. I.T.) have done better. While sub-segments like: 1) menswear, 2) womenswear are still struggling.

- **Catering brand expert:** Brands like Haidilao had a table turnover of ~3.2x during CNY, while turnover was at ~2.9x in FY22 and ~3.0x in FY21, underperformed the industry with a roughly 70% recovery rate (vs 2019). The reasons behind their underperformance are manifold, including internal factors like : 1) brand aging (where the major customer group is now over 35 years old) and insufficient innovations (the brand values standardization more, while other brands prefer creativity), 2) the signature services level has been caught up by other brands. Also, external factor likes the change in consumer behavior due to a drop of interest in group gathering, has led to a fall in number of customers per table to just 2.2x (from ~3.5x before COVID-19). As a result, table turnover for some new restaurants is as low as 2.5x.

  The expert also believed brands like Song Hotpot and Banu Maodu Hotpot have already caught up and wining market shares recently, thanks to their much younger and fun vibe and similarly comprehensive service level.

OUTPERFORM (Maintain)

China Consumer Discretionary Sector

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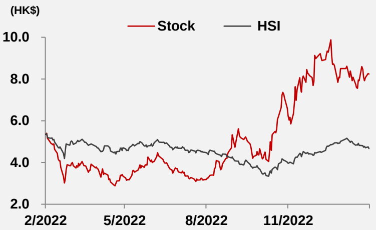
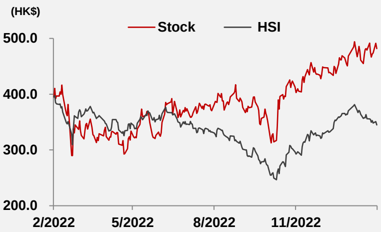
XBXB (520 HK) share price



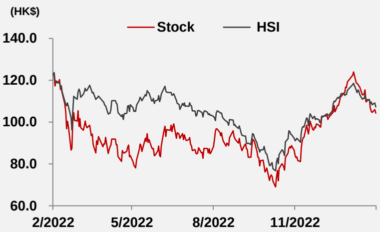
Source: Bloomberg, CMBIGM estimates

Yum China (9987 HK) share price



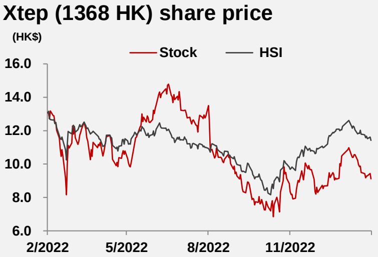
Source: Bloomberg, CMBIGM estimates

Anta (2020 HK) share price



Source: Bloomberg, CMBIGM estimates

Xtep (1368 HK) share price



Source: Bloomberg, CMBIGM estimates

The expert would not be surprised to see Haidilao to re-open more stores in FY23E-25E, as the breakeven table turnover become much lower (now at 3x, vs 4x in the past) and these new stores should mostly (~80%) be in the tier 2 and tier 3 cities.

- **Atour (ATAT US, NR):** Group level RevPAR in Jan 2023 had already surpassed the level in 2019, outperforming the industry. The growth rate of RevPAR had even speeded up in Feb 2023. Therefore the low season in during Feb is rather hot in 2023.

  For the specific hotel we visited, OCC reached 95%+ in Jan 2023, and demand in Feb 2023 actually exceeded management's expectation. Therefore the ADR has been raised a few times YTD and reached ~RMB 800. Note that hikes in ADR is a more important driver than OCC improvement. Management believed such an encouraging performance was driven by: 1) ATOUR's superior brand equity and price to quality ratio and 2) piled up demand for exhibitions and business travels in the past three years.

  No changes in the RevPAR recovery rate (vs 2019) of ~103%, as well as the expansion target of 280 hotels net add in FY23E and 2,000 hotels in total by FY25E, but sentiment of the investors had improved meaningfully.

- **XBXB (520 HK, BUY):** CNY YoY SSSG was excellent for XBXB at 24%, while it was just fair for Cou Cou at 0%. But the management is still optimistic about the outlook, given the recent reforms and low base ahead in FY23E.

  Management also sees meaningful room in margin improvements. For examples, GP margin in FY23E can return to the level in FY19, thanks to the greater use of in-house meat processing factory. Rental expenses (as % of sales) for XBXB and Cou Cou can hopefully improve to 11-12%/ 10% and 9-10%/ 8% in FY23E/ 24E, driven by increased bargaining power after the merge of various middle to back office functions between these two brands. There is certainty pressure on staff costs after the re-opening and the up-coming min wages increases. However, aided by improvement in store productivity and efficiency, staff costs (as % of sales) for XBXB and Cou Cou may be refined to 20% and 25% by FY24E. Moreover, after the use of in-house restaurant interior design teams and the location decoration teams, capex per store per sq m for XBXB and Cou Cou could be reduced from RMB 10,000 and RMB 8,000 to RMB7,000 and RMB 4,500 respectively. Hence the mid-term restaurant OP margin for XBXB and Cou Cou could be ~20% and 16%.

  The group expects to have 120/ 70/ 20 gross new stores for XBXB/ Cou Cou/ Shao Hot in FY23E. In fact, there are already 34/ 4/ 0 stores opened just in Jan 2023.

- **Xtep (1368 HK, BUY):** Retail sales growth in Jan-Feb 2023 was at around 20-30% in the Shenzhen flagship store, note that the momentum remained strong even after the CNY. More importantly, we believe the cut in retail discount was well supported by the much healthier inventory level at ~2.5 months (vs 3.0 months in 2022).

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