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Retail

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ACCUMULATE

Huiyin Household Appliance (01280.HK)

Good Growth from Low-tier Markets & Air-con Sales

(Rmb mn)	2008A	2009A	2010A	2011E	2012E
Turnover	988	1,248	1,784	2,518	3,502
(+/-)	97.5%	26.3%	43.0%	41.1%	39.1%
Gross Profit	121	206	320	457	636
(+/-)	42.7%	70.6%	55.5%	42.7%	39.1%
Net Profit	38	92	92	153	206
(+/-)	-12.1%	139.6%	0.2%	66.5%	35.0%
RecurrentNet Profit	38	97	117	153	206
(+/-)	-12.1%	155.1%	20.4%	30.1%	35.0%
Diluted Recurrent EPS(HK\$)	0.04	0.11	0.13	0.18	0.25
PE (x)	41.6	16.3	13.2	9.7	7.0
PB(x)	3.3	2.8	1.5	1.2	1.0
ROAE	8.3%	17.4%	11.4%	13.7%	15.9%
ROAA	5.2%	10.7%	6.5%	7.8%	9.1%

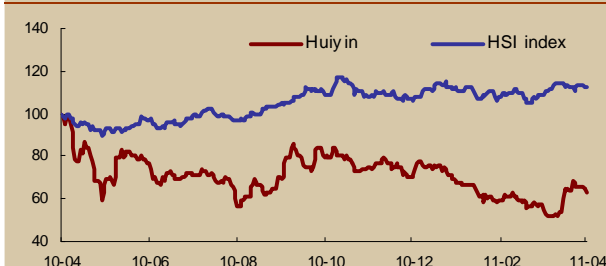
Share information

Share price	HK\$1.72
Target price	HK\$2.16
Market cap (mn)	1,803
52wk high/low	HK\$2.84/1.41
Issued shares (mn)	1,048
Free float (mn)	595
Major shareholders (%)	Mr.Cao (24.56%)

Recent price performance

	1W	1m	3m	YTD
Huiyin	-8.0	8.9	-7.5	-19.6
HSI index	0.3	3.2	0.5	3.7
Sector	-0.2	-1.1	9.5	0.5

52wk performance



Source: Bloomberg, company data, CICC Research

Investment Focus:

Huiyin is the largest home appliance distributor in Jiangsu and 2nd largest in Anhui. The company has 53 self-operated stores, 227 franchise stores and 135 service centers in tier 3~4 markets in Jiangsu and Anhui. Huiyin started as a bulk distributor for leading brands such as Gree and Midea, and now has expanded its brand coverage to more than 20 in distribution and 50 in retail. We believe Huiyin is a beneficiary of growth from both low-tier markets and air-conditioner sales.

Investment positives:

- **Focus on tier 3~4 markets**, where there is fast growth and competition is not yet intense. Suning and Gome mainly focus on tier 1~2 markets and Haier Goodaymart covers its own brand. The low-tier markets are still very fragmented, where local players with regional operational scale, location and logistics advantages, still have upside potential.
- **Gree and Midea's bulk distributor, benefited from air-conditioner sales growth.** Air-conditioner sales in China, accounted for 62% of Huiyin's revenue, and grew 37% in 2010, outperforming other categories, supported by penetration pickup and the upgrade of living conditions. Most manufactures such as Gree and Midea will continue to rely on regional distributors in low-tier markets.
- **2011 profit growth expected to be around 30%; 2012 no less than 35%.** Despite 43% growth of their top-line in 2010, net profit growth is flat due to store openings and one-off IPO expenses (recurrent earnings growth 20.4%). Huiyin's earnings growth is supported by new store turnaround, organic growth and surging demand from newly-entered regions.

Valuation and recommendation:

Trading at 9.7x 2011E P/E, Huiyin is at deep discount to peers (Haier13.1x and its distribution business around 18x, Gome 16.8x, Digital China 16.8x). Our target price HK\$2.16 implies 12x 2011E P/E (9x 2012E, 30%+ discount to peers) and has 26% upside.

Risks:

Thin liquidity, small-scale regional distributors, and capability for cross-region expansion not yet proven.

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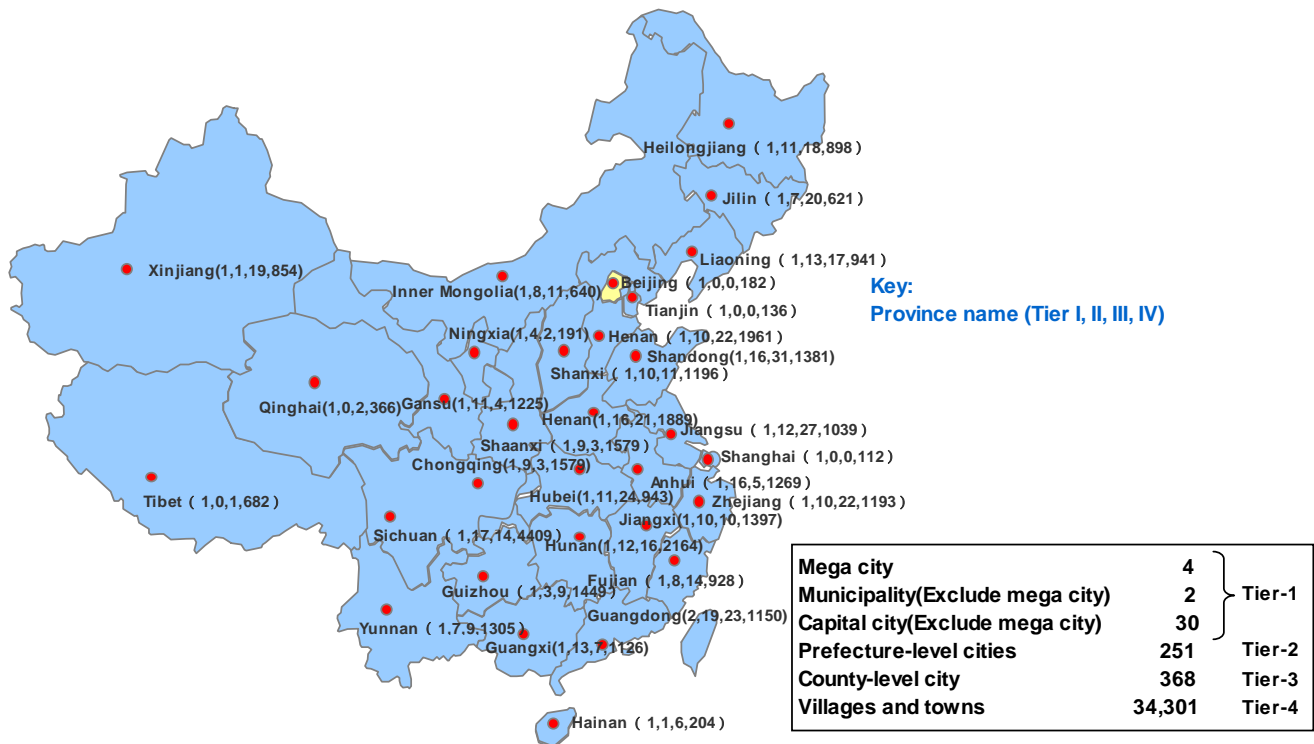
Fast-growing Tier 3~4 Markets and Air-conditioners

Home appliance market in China by tiers

Currently, there are 30 provincial capital cities (excluding tier 1 cities), 251 prefecture-level cities (excluding provincial capital cities), 368 county-level cities and 34,301 towns in China. The home appliance market is generally classified by market size as shown below:

- Tier 1: Mega cities, municipalities and provincial capitals;
- Tier 2: Prefecture-level cities, and regions of equivalent status;
- Tier 3: County-level cities;
- Tier 4: Villages and towns, rural areas

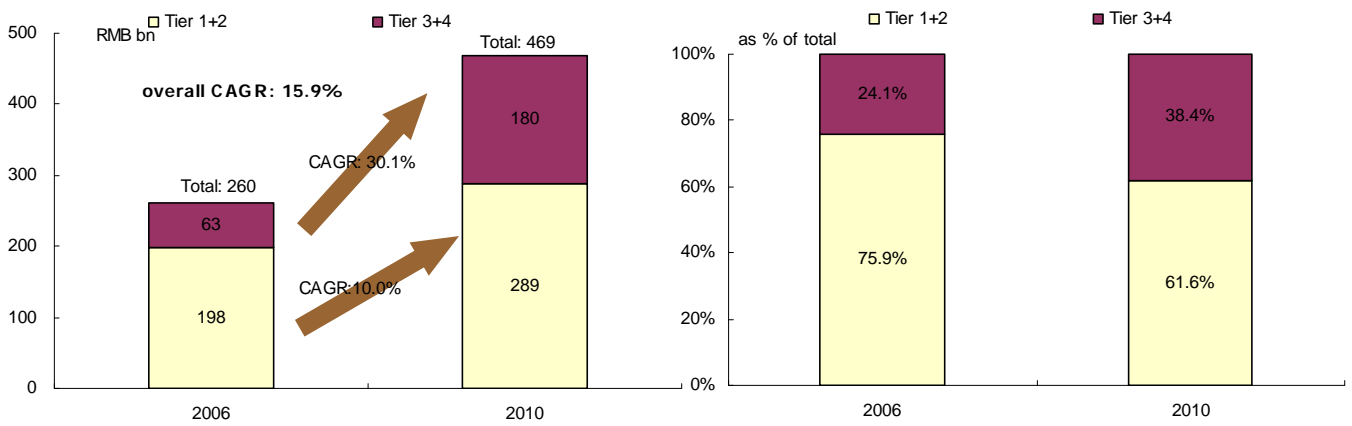
Figure 1: China market by tiers



Source: Company data, CICC Research

Demand for home appliances from lower-tier regions has outgrown that from larger cities. As shown in Figure 2, total demand for home appliances has been growing at a CAGR of 15.9% from 2006~2010, of which demand from tier 3 and 4 regions have been growing at a CAGR of 30.1%, and demand from tier 1 and 2 regions 10.0%. As a result, contribution from lower-tier regions has increased significantly, reaching 38.4% of the total in 2010.

Figure 2: Demand growth for home appliance in China by tiers



Source: CICC Research Estimates

Figure 3: Rural demand contribution (% of national sales)

Rural demand	Air-conditioners	Refrigerator	Washing machine	TV
2006	5.5%	20.2%	23.1%	34.4%
2007	11.0%	23.4%	19.3%	43.9%
2008	15.1%	35.1%	27.3%	54.1%
2009	19.1%	43.3%	31.9%	42.7%
2010	28.1%	47.5%	36.6%	40.9%

Source: Company data, CICC Research Note: % of total sales in TV sector contributed by the rural market declined in 2009 due to fast LCD TV sales growth in large cities.

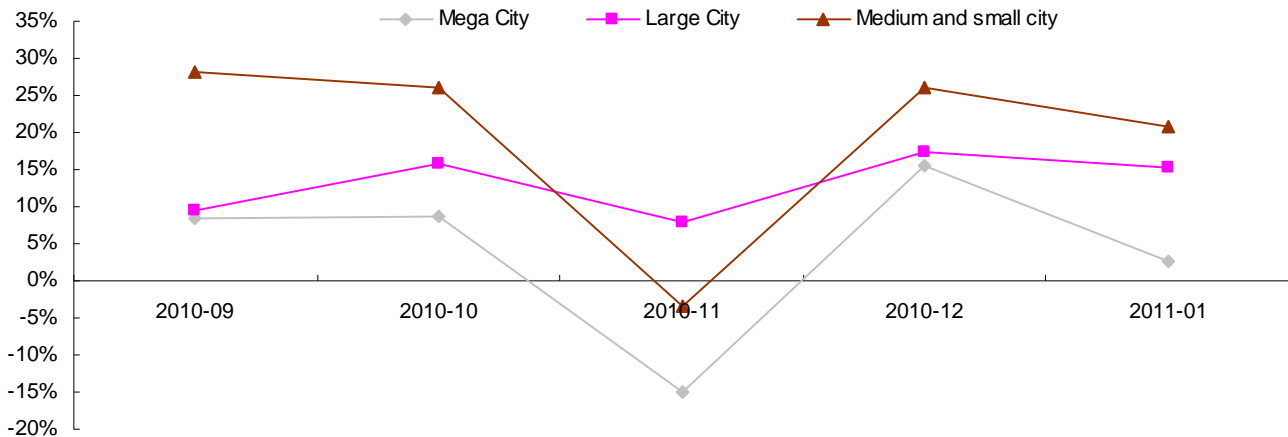
Smaller cities enjoy faster demand growth

We see demand for home appliances in China's rural regions and county-level cities picking up much faster than that from mega cities and provincial capitals. This is well supported by the following reasons:

- Starting from a lower penetration rate;
- Continuous increase in personal disposable income;
- Strong government support and subsidies

According to CMM, retail sales of air-conditioners in large, medium and small cities have grown faster than those in mega cities. As such distribution and retail networks in China's tier 3 cities are increasingly important.

4: Smaller cities show faster demand growth: air-conditioners

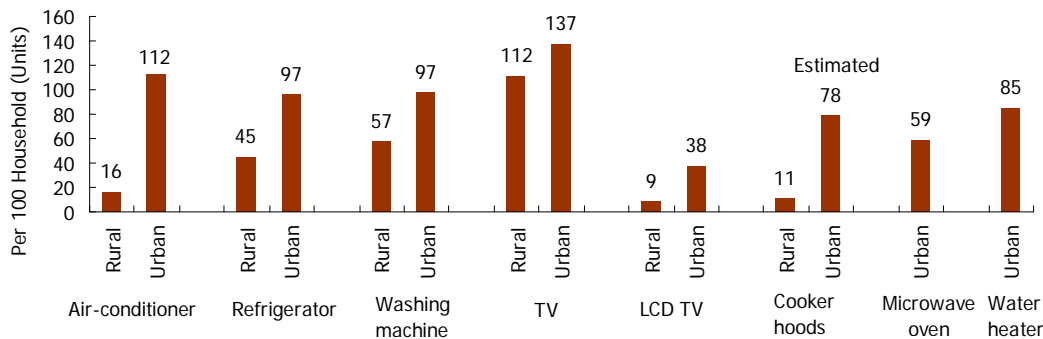


Source: CMM, CICC Research

Increased contribution from rural market

Home appliance penetration in rural regions lags far behind that in urban regions. According to CEIC, the possession rate of air-conditioners per 100 households is only 16 in rural regions versus 112 in urban regions. This gap also exists in other categories including refrigerators, washing machines, LCD TVs, etc. Growth potential is expected, given such a gap, as well as other pre-requisites including an increase in disposable income, government subsidies.

Figure 5: Home appliance possession per 100 households

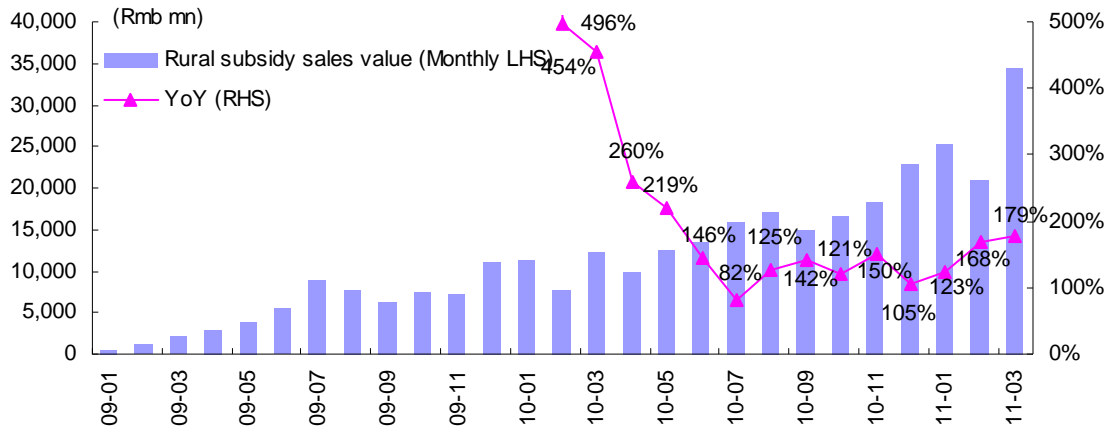


Source: CEIC, CICC Research

In 2011, we expect rural sales as a percentage of total sales to exceed 28% for air-conditioners, 47% for refrigerators, 37% for washing machines and 41% for TVs, assuming a rural population of 700mn in 180mn rural households. The figures could be higher depending on the results of the sixth national census to be released in July~August 2011.

Rural subsidy has been a strong catalyst for home appliance sales in rural regions over the past two years. In March 2011, China's rural home appliance sales volume rose by 135% YoY to 14.715mn units and revenue increased 179% to Rmb34.48bn. Sales volume totaled 36.26mn units and revenue was Rmb85.78bn in 1Q11. As of March 2011, China's accumulated rural home appliance sales volume and revenue were 150mn units and Rmb327.35bn respectively, while the accumulated government subsidy was Rmb37.56bn. Ranking by product categories, air-conditioners became the new growth driver in March, with sales revenue rising by 398% YoY to Rmb3.68bn. Looking at sales revenue by regions, Henan, Shandong and Hebei are the top three, where sales revenue totaled Rmb11.59bn, accounting for more than 1/3 of China's overall sales revenue.

6: Rural subsidy sales value and YoY growth

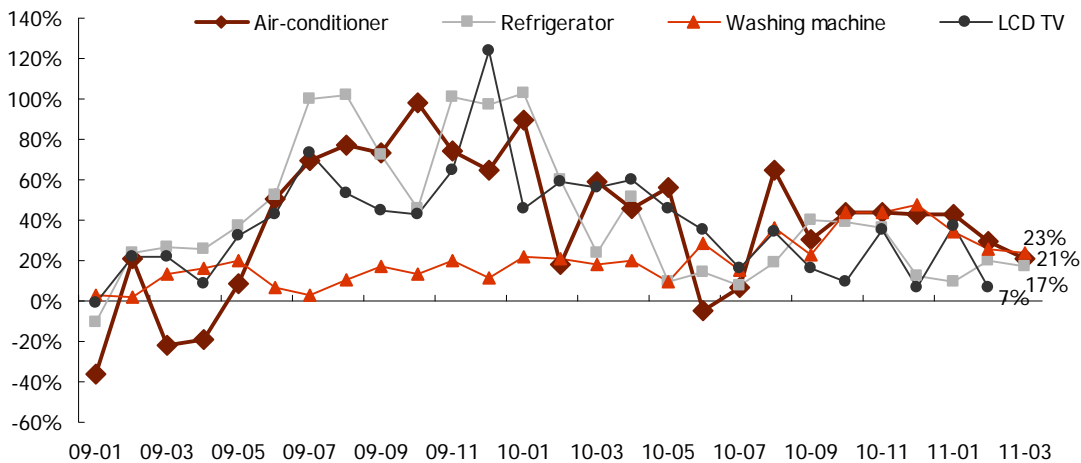


Source: Company data, CICC Research

Air-conditioners outperform other categories by sales growth

Domestic sales volume of air-conditioners recorded 37% YoY growth in 2010, higher than the growth level in refrigerators (31%), LCD TVs (30%) and washing machines (28%). High growth has reached 29% in 1Q2011, supported by the low penetration rate of air-conditioners in rural areas and strong replacement demand. We forecast that domestic sales of air-conditioners will continue to outperform other categories, reaching 16% for FY2011, versus 8% for refrigerators, and 15% for washing machines.

Figure 7: Air-conditioners' sales growth is much faster than other categories



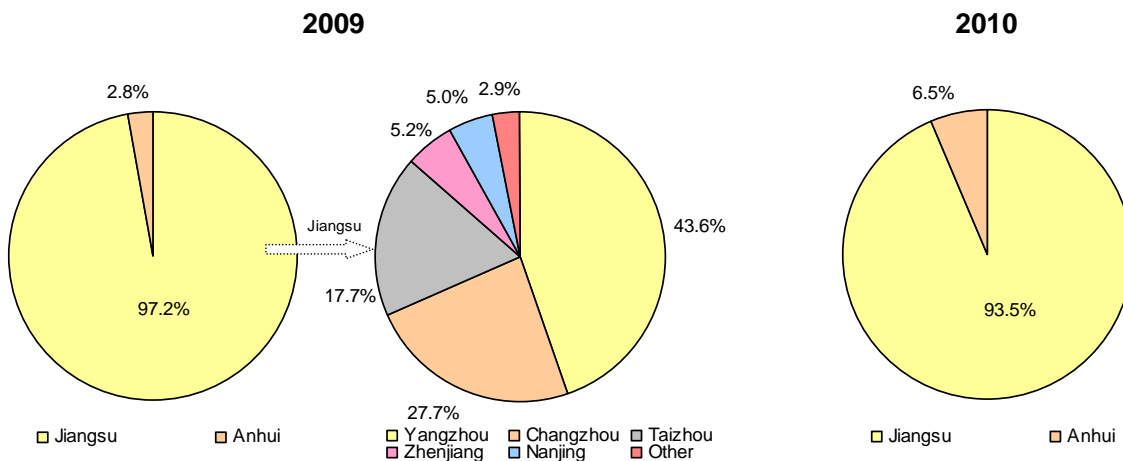
Source: ChinaIOL, CICC Research

Huiyin: Beneficiary of Tier 3~4 Markets Boom

Distribution business: Diversified brand portfolio and regional economies of scale

Huiyin Household Appliance is the largest home appliance distributor in Jiangsu province. It started as a bulk distributor for Gree and Midea (as well as other brands such as Daikin and Sharp), and positioned itself in tier 3~4 markets in Jiangsu and Anhui provinces.

Figure 8: Huiyin sales breakdown by geography



Source: Company data

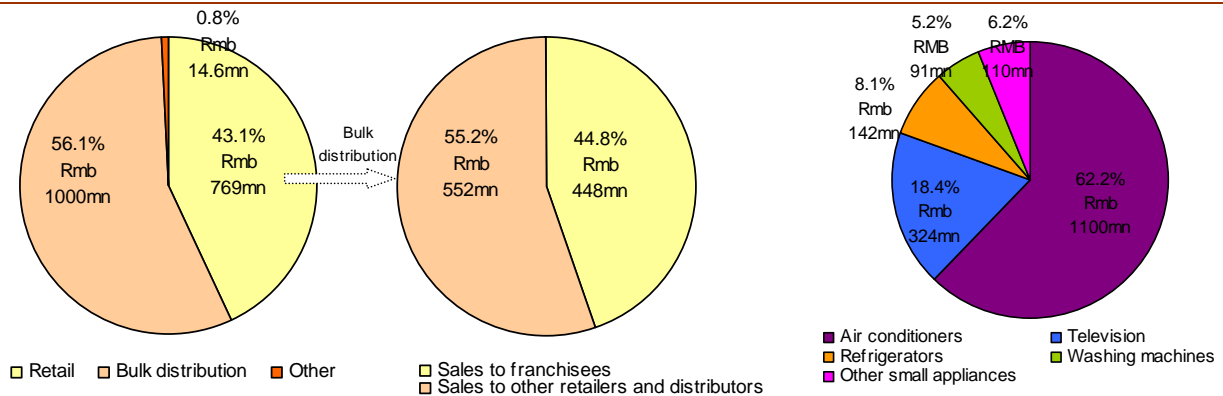
Currently, Huiyin enjoys exclusive distribution rights in certain regions for Gree and Midea:

- **Gree:** Yangzhou, Taizhou, Changzhou, and Kunshan in Jiangsu
- **Midea:** Yangzhou, Taizhou, Nanjing in Jiangsu, and Chuzhou in Anhui

In 2010, the revenue of bulk distribution business reached Rmb1000mn, 56.1% of total revenue. Contribution from air-conditioners sales reached 62.2%.

Huiyin currently distributes more than 20 brands, and its retail outlets cover more than 50 brands, including Gree, Midea, Sharp, Sony, Haier, Daikin and Siemens. Going forward, Huiyin plans to 1) further expand its brand coverage, 2) further explore and consolidate the fragmented Anhui market. We expect the company to quickly grow its distribution business in the coming years, supported by network penetration, strong demand in rural areas, as well as the Gree/Midea brand name.

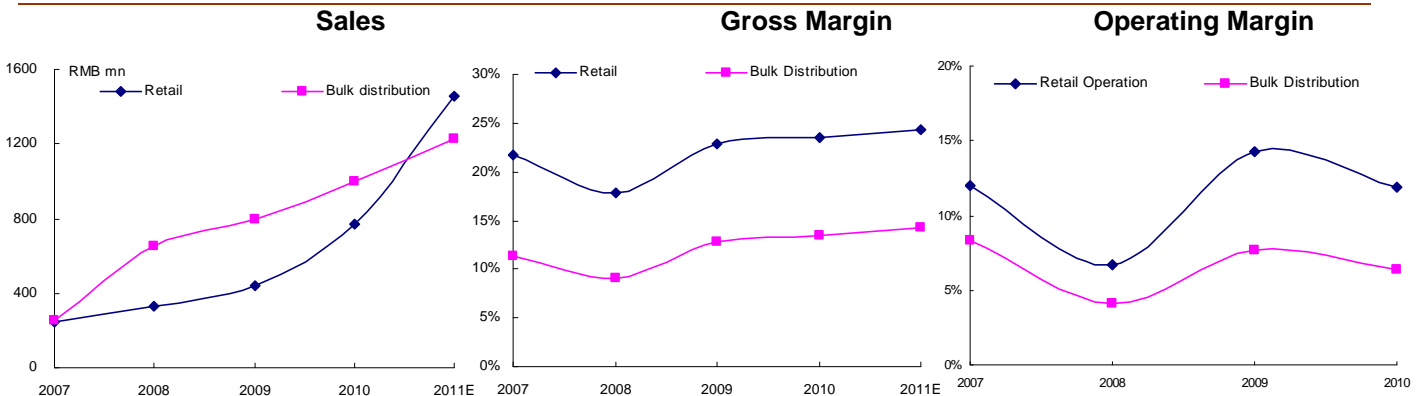
9: Company sales breakdown (2010)



Source: Company data, CICC Research

Benefits from economies of scale and gross margin will continue to increase in 2011.

Figure 10: Sales and margin breakdown



Source: Company data, CICC Research

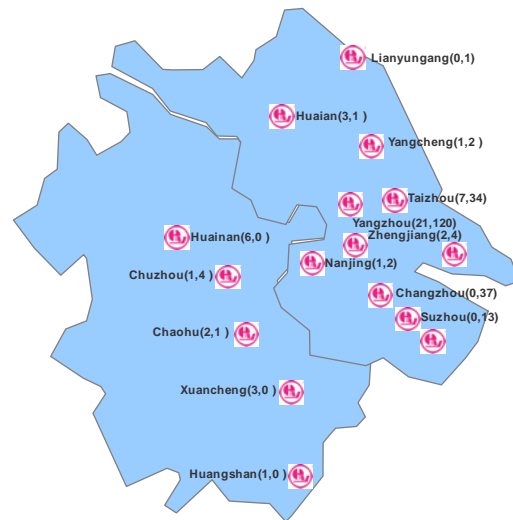
Retail business: Regional strategy

Since the opening of their first self-operated store in Yangzhou in 2003, Huiyin’s retail network has expanded rapidly. In 2010, Huiyin opened 26 stores and doubled its self-operated store number to 53 self-operated stores in 31 cities/districts in Jiangsu and Anhui.

Among its 53 self-operated stores, 10 stores are located in prefecture-level cities, 4 are operated within Golden Eagle department stores, and the rest are in county-level cities and towns. Most of its 227 franchise stores are located in towns and villages. In addition, Huiyin has 135 service centers deployed in counties where Huiyin stores operate. These service centers are profitable instead of acting as cost centers only.

11: Fast expansion of self-operated stores and geographic coverage

	2009	2010	Change	Change%
Self-operated stores	27	53	+26	96%
Franchised stores	220	227	+7	3%
After-sale service centers	126	135	+9	7%



Source: Company data, CICC Research

Strong logistics capability

Distribution has long been an integral part of China’s home appliance market. Except for Haier, most brands such as Gree and Midea will continue to use regional distributors in low-tier markets. Distributors can help expedite cash inflow and improve logistics and after-sales services. In certain regions, both Gome and Suning need to procure from Huiyin.

Huiyin currently has 6 regional distribution centers, located in the Yangzhou, Taizhou, Yangcheng and Sunan regions in Jiangsu, and in Xuancheng and Huainan regions in Anhui, with lower-level centers phasing out. Such distribution capabilities will prepare the company for further development in the coming few years.

We believe Huiyin have distribution advantage in lower-tier regions:

Logistics in tier 1 cities does not work well in the fragmented rural market. Home appliance distribution in Jiangsu is fragmented. Such fragmentation has provided sufficient space for local distributors to thrive, where they control supply chains and distribution channels.

Huiyin’s outlet deployment has expedited delivery turnover for the most part. For example, delivery time for air conditioners has shortened to 3 days in franchise stores, and its service center can provide installation services for clients, for an additional charge.

Business alliance and online initiatives

In July 2010, Chinese Consumer Electronics Channel Association (CCECA) was established by the top regional home appliance retailers in China, including Huiyin. This association is the first of its kind in China, aiming to improve cooperation and coordination in procurement efforts totaling more than Rmb 100 billion. Huiyin Chairman, Mr. Cao is also the first chairman of the association, indicating Huiyin’s leadership in tier 3~4 markets.

Other than leading industry alliance efforts, Huiyin also formed strategic partnerships with Pengcheng Home Alliance and others to enter the B2C segment and establish an online platform for home appliance distribution and retail sales (similar to 360buy, Taobao, Suning, Egou, etc.).

Comparison with Goodaymart and National Retailers

The low-tier market is quite fragmented. Such fragmentation has provided sufficient space for local distributors to thrive. As such, we are not surprised to see Gree and Midea try to use local distributors. Local players have regional scale, location and logistics advantages, so also have upside potential. Suning and Gome together added 470 stores in 2010 (370 for Suning and 100 for GOME); however, as mentioned earlier there are around 38,000 counties, towns and villages in China (composite of tier 3~4 markets). We believe the tier 3~4 market in China is big enough for regional players such as Huiyin to grow.

Diversified brand portfolio, Felix business model, local customer access

There is no direct competition between Huiyin and Haier Goodaymart. Haier Goodaymart mainly focuses on its own brands. **Huiyin distributes products for more than 20 brands.** At the same time, Huiyin operates home appliance retail outlets for various brands, while Haier Goodaymart functions as a distributor for Haier products to Huiyin.

Figure 12: Goodaymart and Huiyin comparison

Rmb mn	Goodaymart	Huiyin
Revenue	27,722	1784
Business Model	Wholesale	Wholesale + Retail
Brands	Haier Brand >90%	distributes more than 20 brands, and its retail outlets cover more than 50 brands
Region	All across China	Jiangsu, Anhui provinces

Company data, CICC Research

69% of Suning stores located in tier 1~2 cities, and almost 100% of Gome stores in tier 1~2 cities. In contrast, 99% of Huiyin's stores operate in tier 3~4 regions.

Figure 13: Comparison of distribution tiers between Suning, Gome and Huiyin

	Suning		GOME		Huiyin	
	Store No.	% of Total NO.	Store No.	% of Total NO.	Store No.	% of Total NO.
Tier-1	525	40%	522	63%	0	0%
Tier-2	379	29%	304	37%	4	1%
Tier-3	303	23%	n.a.	n.a.	45	16%
Tier-4	104	8%	n.a.	n.a.	231	83%
Total	1311	100%	826	100%	280	100%

Source: Company data, CICC Research

As the first mover in low tier cities, Huiyin has better access to local customers and is more familiar with their preferences. By establishing an integrated model covering distribution, retail, franchise as well as after-sales service, Huiyin can maximize its foothold in the rural market.

Scale advantage in certain regions

Huiyin already has a strong foothold in its core low-tier markets in Jiangsu. We have conducted a store count for both Suning and Huiyin in major cities in Jiangsu, including Yangzhou, Taizhou, Changzhou and Wuxi, and found that Huiyin has many more stores in all four cities than Suning, indicating its strong local market position.

Figure 14: Suning and Huiyin's store locations in major cities in Jiangsu

Region	Huiyin			Suning
	Self-operated	Franchised	Total stores	
Yangzhou	21	120	141	8
Taizhou	7	34	41	8
Changzhou	0	37	37	8
Wuxi	0	13	13	9

Source: Company data, CICC Research

Surging Sales Growth, Earnings Growth Turnaround from 2011

- Industry growth is robust with new shopping areas and continued urbanization in rural areas. We are positive on Huiyin's long-term revenue growth and potential from tier 3~4 markets.
- Huiyin plans to open 20 to 30 new stores each year.
- Direct competition unlikely in the next five years. Huiyin will balance revenue growth and profitability.

Good momentum continued in 1Q2011

Distribution business:

We estimate that total sales growth is more than 50%, thanks to the fast growing sales growth of air conditioners (Gree, Midea, Daikin).

Retail business:

- Total sales growth is expected to be 40% with SSSG around 10%. SSSG could be lower than last year due to expansion (renovation) of the Shidai flagship store.
- Huiyin currently operates 63 stores, adding 10 more (4 from acquisition) to the 53 as of end-2010. We expect at least 25 stores will open in the coming months, which can drive fast earning growth for the retail business.

Gross margin is expected to be stable at 18% (the same as 2010); overall expenses are well controlled, although retail business expenses will grow faster due to new store openings.

Earnings projection

2010 net profit increased by 0.2% to Rmb92mn. If excluding Pre-IPO option expenses and professional fees for the listing of the company, net profit would be RMB117.3 million, an increase of 20.43% from Rmb97.4mn in 2009.

We expect Huiyin to deliver around 30% growth to the bottom line (recurrent net profit was around 153mn) in 2011, thanks to strong top-line growth and stable margins. EPS is around RMB0.15 (HK\$0.18) in 2011.

- Total revenue will continue to grow rapidly, driven by store openings and SSSG in the retail business, and organic growth and further geographic penetration in the bulk distribution business.
- Gross margin is expected to be flat as the company penetrates further into the Anhui market, which is not as rich as Jiangsu; however, margin pressure will be offset by economies of scale and consumption upgrade in Jiangsu.
- Financial expenses are expected to increase, as the company seeks loans to finance its fast expansion.
- Recurrent net margin (excluding one-off IPO expenses in 2010) is expected to decrease by a few percentage points, as expenses related to store openings will increase during Huiyin's fast expansion stage.

15: Key assumptions for earnings forecast

(Rmb mn)	2007	2008	2009A	2010A	2011E	2012E
Retail	242	330	440	769	1196	1806
+/-		37%	33%	75%	56%	51%
Store Units	12	20	27	53	78	103
+/-	3	8	7	26	25	25
New stores/ Old stores		67%	35%	96%	47%	32%
Sales Per Store	20	22	24	26	28	31
		8%	9%	9%	10%	10%
Bulk distribution	252	649	798	1,000	1,301	1,665
+/-		157.2%	23.0%	25.3%	30.0%	28.0%
Others	7	9	9	15	21	31
+/-		33.3%	5.2%	60.0%	45.0%	45.0%
Total Sales	500	988	1,248	1,784	2,518	3,502
+/-		97.5%	26.3%	43.0%	41.1%	39.1%
Market Growth	n.a.	n.a.	n.a.	30.0%	35.0%	35.0%

Source: Company data, CICC Research

Investment Recommendation

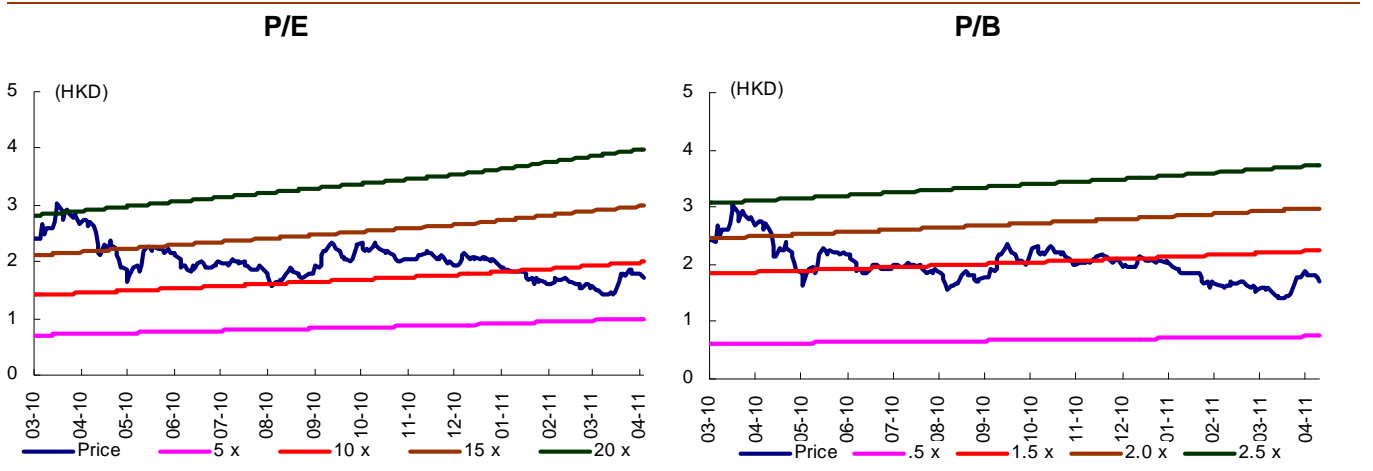
- ▶ **Comparable valuation indicates that the market generally gives home appliance distributors/retailers 16x-18x 2011E PE.** Huiyin currently trades at 9.7x 2011E P/E, at deep discount to comparable companies (Qingdao Haier 13.1x, Gome 16.8x, Digital China 16.8x). For example, **Haier's distribution business 2011E PE would be 18x** if we exclude its manufacturing business, which accounts for two thirds of its profit, and deserves around 10-12x PE only.
- ▶ A small cap regional retailer, Jingkelong, is also comparable. JKL is trading at 14.7x 2011E PE, 30% discount to larger player, Lianhua.
- ▶ **Revaluation is well deserved**, with strong fundamental industry support and earnings recovery. Investors can also benefit from the revenue growth of Gree and Midea via Huiyin.
- ▶ **Our target price of HK\$2.16 implies 12x 2011E P/E (9x 2012E PE, 30%+ discount to larger cap players) and has 26% upside.**
- ▶ Potential Risk: Thin liquidity, small-scale regional distributors, capability for cross-region expansion is not yet proven.

Figure 16: Comparable valuations

Sub-Industry Classification	Ticker	Company	Price	Mkt cap (mn)	Net Profit						EPS			P/E			10 End - 12 End Net Profit CAGR	PEG
					2010E	YoY	2011E	YoY	2012E	YoY	2010E	2011E	2012E	2010E	2011E	2012E		
Home appliances																		
	1169.HK	Haier Electric	9.72	23,058	964	114.9%	1,442	49.5%	1,824	26.5%	0.47	0.74	0.96	20.6	13.1	10.1	37.5%	0.3
	0861.HK	DIGITAL CHINA	14.98	16,346	824	37.1%	975	18.3%	1,187	21.7%	0.76	0.89	1.09	19.8	16.8	13.8	20.0%	0.8
	2347 .TT	Synnex	74.80	112,441	5500	13.9%	6912	25.7%	8,416	21.8%	3.66	4.60	5.60	20.4	16.3	13.4	23.7%	0.7
	0449.HK	Chigo	0.74	5,827	310	-1.6%	511	65.0%	598	16.9%	0.05	0.08	0.09	16.2	9.3	7.8	38.9%	0.2
	0921.HK	Hisense Kelon	4.46	6,038	681	298.7%	811	19.2%	951	17.3%	0.50	0.60	0.70	8.9	7.4	6.3	18.2%	0.4
	0921.HK	Hisense Kelon (Recurrent)	4.46	6,038	542	229.0%	677	25.0%	921	36.0%	0.40	0.50	0.68	11.2	8.9	6.6	30.4%	0.3
Retailer																		
	493.HK	GOME	2.77	46,598	1,962	40.7%	2,437	24.2%	2,965	21.7%	0.13	0.16	0.21	21.9	16.8	13.5	22.9%	0.7
	1280.HK	HUIYIN HOUSEHOLD	1.72	1,803	117	20.4%	153	30.1%	206	35.0%	0.13	0.18	0.25	13.2	9.7	7.0	32.5%	0.3
Regional small cap retailer																		
	814.HK	JKL	9.81	4,044	181	22.1%	226	25.0%	278	23.3%	0.51	0.67	0.84	19.3	14.7	11.6	24.2%	0.6

Source: Bloomberg, Company data, CICC Research

Figure 17: Historical P/E and P/B bands



Source: Bloomberg, Company data, CICC Research

Figure 18: Historical and forecasted financial data

(Rmb mn)	2007A	2008A	2009A	2010A	2011E	2012E
Turnover	500	988	1,248	1,784	2,518	3,502
Cost of Sales	-416	-867	-1,042	-1,464	-2,061	-2,866
Gross profit	85	121	206	320	457	636
Other Income	13	9	12	16	25	37
Distribution costs	-28	-42	-51	-97	-134	-190
Administrative expenses	-16	-39	-41	-97	-131	-186
Other Operation Expense	0	0	-0	-1	-2	-4
Operating profit	54	49	125	142	216	293
Finance Income	-1	6	2	-1	-12	-15
Profit before taxation	53	56	127	140	204	278
Taxation	-9	-17	-34	-46	-49	-69
Profit after taxation	43	39	93	94	155	208
Minority Interest	0	-0	-1	-2	-2	-2
Net profit	43	38	92	92	153	206
Cash Flow (Rmb mn)	2007A	2008A	2009A	2010A	2011E	2012E
Operating cashflow	-131	-46	-101	-143	-47	118
Investment cashflow	-50	30	-24	-30	-23	-23
Financing cashflow	294	-23	62	339	100	30
Balance Statement (Rmb mn)	2007A	2008A	2009A	2010A	2011E	2012E
Current Assets						
Cash	121	82	18	182	210	333
Pledged deposits	135	98	134	207	207	207
A/R receivables	242	299	456	956	1,116	1,393
Inventories	74	161	163	276	309	390
	572	640	771	1,621	1,842	2,323
Non-current Assets						
Fixed assets,net	69	73	117	141	111	52
Intangible assets and others	21	28	22	59	57	55
	123	128	174	235	204	142
Total Assets	695	768	946	1,857	2,046	2,465
Current Liabilities						
ST bankloans	21	0	70	50	150	180
Payables to suppliers	176	178	196	527	463	644
Other Payables	40	72	61	87	87	87
Taxation payable	9	17	4	80	80	80
	246	267	331	777	813	1,026
Non-current Liabilities						
LT bankloans/CB	0	0	0	0	0	0
	6	19	42	22	22	22
Total Liabilities	252	286	373	800	836	1,049
Total Equity	443	481	573	1,057	1,210	1,416

Source: Company data, CICC Research

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