

JV with a local leader – a solid step

Equity Research

Retail/ China

Company Visit Note

Key Data

Close price	(HK\$)	1.92
12 Months High	(HK\$)	3.08
12 Month Low	(HK\$)	1.56
3M Avg Dail Vol.	(mn)	4.20
Issue Share	(mn)	1,048.34
Market Cap	(HK\$m)	2,012.82
Free Float %		51.31
Net cash/share	(HK\$)	0.40
Net debt/ equity	(%)	net cash
Fiscal Year		12/2009

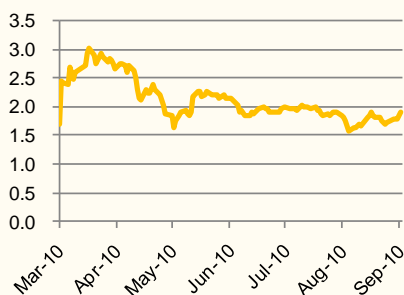
Major shareholder (s) Kuan Ping Cao (24.21%)

Source: Company data, Bloomberg, OP Research

Closing price are as of 24/9/2010

All figures are subject to rounding

Price Chart



Key points:

Huiyin Appliances ("Huiyin") announced a JV agreement with a home appliance retailer in Huainan, Anhui province. We view it as a solid step taken by Huiyin to execute its strategy to scale up its retail business and improve the business mix.

- ❖ **Buying a local major player:** the retailer is a leading player in Huainan city of Anhui province, commanding No. 1 market share with its 5 outlets. Through the JV agreement, Huiyin essentially acquired 65% equity of the retailer at 10x forward P/E.
- ❖ **Increase the retail business size by 20%:** Huiyin plans to open at least 20 outlets this year and increase the number from 26 to 46, or by 77%. It already achieved 13 after this acquisition. The acquisition will increase Huiyin's current retail business revenue by 20% and will help optimize the business mix which is now dependent on bulk distribution business.
- ❖ **Further expansion ahead in Anhui region:** Huiyin plans to use the JV as a platform and leverage the strong local partner to set up more outlets in adjacent area. A regional logistics center is also under planning.
- ❖ **Strategic focus on retail business:** Huiyin will focus on scaling up its retail business by more M&A and organic growth. It will not seek to get more bulk distribution business in new area it enters. However, it will try to make centralized purchase arrangement, which will increase its bargaining power without deteriorate its working capital condition.

Company Background

Huiyin Household Appliances Holdings Co Ltd. operates a chain of retail appliance and electronics stores and is a wholesale distributor. The Company's business focuses on retail, bulk distribution (including sales to its franchisees) and after-sales service.

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Exhibit 1: Investment Summary

Year Ended Dec (RMBmn)	FY07A	FY08A	FY09A	1H09	1H10
Revenue (mn)	500.5	988.2	1247.8	549.3	785.8
Growth (%)		97.4	26.3		43.1
Net Income (mn)	43.4	38.2	91.5	34.7	36.3
Growth (%)		-12.0	139.5		4.6
Gross margin (%)	16.9	12.2	16.5	15.9	17.7
Profit margin (%)	8.7	3.9	2.1	6.3	4.6
ROE (%)	9.8	8.3	17.3		
ROA (%)	6.3	5.2	10.7		
EPS (basic)	2.17	1.91	4.57		
P/E (x) –on expanded no. of shares			18.0		

Source: Bloomberg, OP Research

Buying a local major player

Huiyin announced on Sep 20 that Yangzhou Huiyin, a wholly owned subsidiary of the Company, entered into the Co-Operation Agreement with Xingfushu, a home appliance retailer in Huainan of Anhui province, and Xingfushu's current owner. A JV (Huiyin 65%, current owner 35%) is formed to take over the operation of Xingfushu.

Xingfushu is a leading retailer in its home court. It has 5 outlets and commands No. 1 market share in Huainan city of Anhui Province. Suning has only 1 outlet in the city, while Gome has none.

Huiyin is essentially acquiring the equity at 10x forward P/E. The net profit in FY09 was 7.4mn. A conditional bonus of RMB12mn will also be paid if the net profit for the third year exceeds RMB13mn and the aggregate net profit of the first three years exceeds RMB30mn.

Increase the retail business size by 20%

Huiyin plans to open at least 20 outlets this year and increase the number of outlets from 26 to 46, or by 77%. It already opened 8 before this acquisition. Now it achieved 13, or 65% of its yearly target. We believe the addition of 5 mature outlets is a sensible move to enter a new market while minimizing the risks involved in expansion.

We estimate that this acquisition will increase Huiyin's current retail business revenue by 20%. We estimate that the revenue of Xingfushu is around RMB150mn per year. Huiyin's retail revenue in 1H10 was RMB339mn.

We believe the increase of retail revenue size will help optimize the business mix, which is now dependent on bulk distribution business.

Exhibit 2: Huiyin's self-operated outlets

Jiangsu Province	
Yangzhou	14
Taizhou	6
Suzhou	1
Nanjing	1
Zhenjiang	2
Yancheng	1
Huaian	3
Anhui Province	
Chuzhou	3
Xuancheng	3
Huainan	
	5
Total	39

Source: Company, OP Research

Further expansion ahead in the region

Huiyin plans to use the JV as a platform and Huainan as a stronghold to further expand to northern Anhui Province. Huainan is at a strategic location. It is adjacent to Hefei, the provincial capital. It is like a gateway Hefei to all the five Tier 3-4 cities in northern Anhui province. A regional logistics center is under planning.

We expect Huiyin to leverage its JV partner's strong local knowledge and leading market share to further expand in Anhui province.

Exhibit 3: Huiyin's presence in Anhui Province



Source: Company, OP Research

Strategic focus on retail business

Huiyin will focus on scaling up its retail business by more M&A and organic growth and put less emphasis on bulk distribution business.

In the past, Huiyin relied on its bulk distribution business to gain size and thus earn bargaining power against upstream suppliers. In this way, its retail business can compete with its larger peers, i.e. Suning and Gome, on price and secure a similar margin. But it also pay the cost of higher working capital and slower turnover.

Now Huiyin is focusing on sizing up its retail business to gain bargaining power and get less dependent on bulk distribution, which will lead to a healthier business model and sustainable growth.

Thus, Huiyin will not seek to get more bulk distribution business in new area it enters. Instead, it will try to make centralized purchase arrangement, which will increase its bargaining power without deteriorate its working capital condition.

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