Huiyin Household (匯銀家電)

ORIENTAL PATRON

BUY **Target Price: HK$2.30 (+27%)** **Price:** HK$1.81 **HKEx Code:** 1280 Tue, 17 May 2011

A niche leader with hyper growth ahead

Equity Research

Retail China

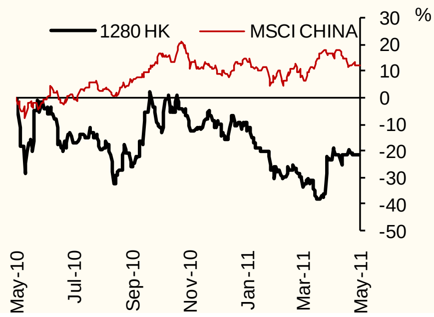
Initial Coverage

Key Data

Close price	(HK$)	1.81
12 Months High	(HK$)	2.48
12 Month Low	(HK$)	1.41
3M Avg Dail Vol.	(mn)	6.39
Issue Share	(mn)	1,048.34
Market Cap	(HK$mn)	1,897.50
Fiscal Year		12/2010
Major shareholder	(s)	Cao Kuanping (24.2%)

Source: Company data, Bloomberg, OP Research
Closing price are as of 16/5/2011
All figures are subject to rounding

Price Chart



OP vs Consensus

	BLOOMBERG		OP	
	FY11E	FY12E	FY11E	FY12E
Turnover	2,462	3,308	2,580	3,762
Net profit	143	191	150	221
Gross margin	17.10	17.40	17.56	18.17
Net margin	5.94	5.67	5.83	5.89
EPS (Rmb)	0.14	0.19	0.14	0.21

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Key points:

- **A hyper growth stage ahead:** we think the China's Tier 3&4 cities and rural home appliance market, especially air-con, is entering a hyper growth stage, on the back of 1) low penetration ratio, 2) rapid urbanization, 3) preferable policies, and 4)social housing and defensive Tier 3&4 property market. Huiyin's business is highly tilted to this segment and will benefit the most from the hyper growth.
- **An evolving niche leader despite strong rivalry:** we believe Huiyin will evolve into a niche leader in China's rural home appliance market, despite the existence of Suning and Gome. Our conviction builds on 1) the differentiated tier3&4 focus of Huiyin, 2) the limited market power of Suning and Gome in tier3&4, 3) Huiyin's differentiated business model that combines wholesale and retail, and 4) Huiyin's strategy to ally small players with e-commerce platform.
- **Turning point in FY11:** We think Huiyin is approaching a turning point in FY11, as new stores mature and SG&A ratio stabilizes, after SG&A expenses hike and disappointing flat earnings growth in FY10. Profit growth will catch up with revenue growth since FY11, and net profit margin will improve from 5.1% in FY10 to 6.1% in FY13. As Huiyin continuously expand its retail network, revenue and net profit will grow at CAGRs of 42% and 51%, respectively, from FY11 to FY13.
- **Recommend Buy with TP HK$2.30:** Huiyin is trading at 10.5x FY11E PE, in a 40%-45% discount to peers such as GOME, Suning and Haier Elec. We believe with 48% net profit CAGR in FY11-13, Huiyin deserves a higher valuation. We initiate coverage on Huiyin with a BUY rating. Our TP HK$2.30 is based on 12x FY11E PE and implies 27% upside.
- **Key risks:** Policy exit, slower than expected store expansion, lower than expected performance of new stores, on-line retailers gaining market share.

Exhibit 1: Investment Summary

Year to Dec (RMB mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Revenue	1,247.8	1,784.5	2,580.0	3,762.4	5,108.0
Growth (%)	*26.3*	*43.0*	*44.6*	*45.8*	*35.8*
Net Income	91.5	91.7	150.4	221.5	313.8
Growth (%)	*139.4*	*0.3*	*64.0*	*47.2*	*41.7*
Gross margin (%)	16.5	18.0	17.6	18.2	18.4
Profit margin (%)	7.3	5.1	5.8	5.9	6.1
ROE (%)	16.0	8.7	12.5	15.5	18.7
ROA (%)	9.7	4.9	5.7	6.6	7.0
EPS (Diluted) (RMB cents)	N/A	9	14	21	30
P/E (x)	N/A	17.2	10.5	7.1	5.0
P/B (x)	N/A	1.3	1.3	1.1	0.9

Source: Bloomberg, OP Research

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Investment Summary

Huiyin Household Appliances("Huiyin") is a regional home appliance retailer and distributor in Jiangsu and Anhui. In FY10, 43% of its revenue was from retail business, while the rest was from bulk distribution to franchisees under Huiyin brand and third parties. Jiangsu province was its home base, which generates 93% of its sales. It has formed a strategy to expand its retail network in Tier 3&4 cities and rural area in Jiangsu province and Anhui province and has doubled its retail stores from 26 to 53 in FY10.

We are optimistic about Huiyin's long term growth given 1)the strong home appliance demand in Tier 3&4 cities and rural market and 2)Huiyin's unique business model that is suitable for that niche market.

We think the China's Tier 3&4 cities and rural home appliance market, especially air-con, is entering a hyper growth stage, on the back of four drivers:

1. Low penetration ratio: The penetration ratios of major home appliances in rural area are significantly lower than in urban area. The gap is especially wide for air-conditioners, Every 100 rural households only own 12 air-conditioners, compared with 107 owned by urban households.

2. Rapid urbanization: The urbanization of China has accelerated in the past decade. We believe urbanization will boost home appliance consumption in Tier 3&4 cities and rural area.

3. Preferable policies: multiple policies have been launched to promote the consumption of home appliance. And we believe policy exit in the future won't impose significant negative impact on home appliance demand in Tier3&4 cities and rural area.

4. Social housing and defensive Tier 3&4 property market: the Tier 3&4 property market will be affected much less by tightening policies. Social housing will generate real home appliance demand as it is mostly occupied by end users rather than purchased by investors.

We believe Huiyin will be a niche leader, despite strong rivalry of Suning and Gome, for four reasons:

1. Differentiated tier3&4 focus of Huiyin: Almost 100% of Huiyin's retail stores and franchisees are in Tier 3&4 cities and rural area. Gome has no exposure to Tier3&4 cities and rural area, while only ~7.5% of total store GFA of Suning's stores is in Tier 3&4 cities.

2. Limited market power of Suning and Gome: Tier3&4 cities and rural market is highly fragmented, where Gome and Suning have less than 5% market share. Manufacturers rely on local dealers to distribute.

3. Huiyin's differentiated business model that combines dealership and retail: Huiyin has track record and existing dealership relation with various home appliance manufacturers. It can obtain new dealership to consolidate local market and develop retail business, while Gome and Suning can't change their role to involve in distribution business.

4. Huiyin's strategy to ally small players with e-commerce platform: fragmented Tier3&4 cities and rural market requires decentralized logistic network. Huiyin tackles the

problem with an innovative solution: establishing an alliance of small-mid regional home appliance distributors and sharing logistic network with an e-commerce platform.

We think Huiyin is approaching a turning point in FY11, as new stores mature and SG&A ratio stabilizes. We estimate revenue and net profit to grow at CAGRs of 42% and 51%, respectively, from FY11 to FY13.

1. Outstanding sales growth ytd: Huiyin has reported "5.1" holiday retail sales up 112% yoy and same store sales growth 35.9%, mainly due to its rapid store expansion in 2H10 and successful promotion during the holidays. We expect the strong growth momentum to continue in the rest of FY11.

2. Revenue growth driven by retail network expansion. We expect the growth of Huiyin retail revenue and total revenue to be continuously driven by the expansion of retail network. We estimate total revenue and retail revenue to grow at CAGR 42% and 60%, respectively from FY11 to FY13.

3. Uptrend of sales per sqm since FY12: the percentage of new stores will drop from 50% in FY10 to ~20% in FY13. A relatively lower percentage of new stores will be positive for improving sales per sqm.

4. Operating expenses ratio to stabilize after hike in FY10: As some one-off costs, will be gone, we estimate Huiyin's SG&A expense ratio to drop from 10.85% in FY10 to 10% in FY11 and maintain at such level in FY 12 and FY13.

5. Net margin improvement and net profit CAGR 51%: we estimate that Huiyin's net margin will improve from 5.1% in FY10 to 6.1% in FY13.We estimate that net profit will grow at CAGR 51% from FY11 to FY13.

We recommend Buy with target price of HK$2.3, at 13.4x FY11E PE, implying 27% upside. Our target price HK$2.3 is based on 13.4x FY11E PE and 0.24x PEG, 15% and 60% discount to peers' average. We believe the discount is enough to compensate for Huiyin's small size and risks.

Key risks include policy exit, slower than expected store expansion, lower than expected performance of new stores, on-line retailers gaining market share.

Hyper growth ahead

We think China's Tier 3&4 cities and rural home appliance market, especially for air-con, is entering a hyper growth stage, driven by 1) currently low penetration ratio, 2) rapid urbanization, 3) preferable policies, and 4) social housing. Huiyin is well positioned to benefit the most from this growth trend for its regional exposure and air-con focus.

Driver 1: Low rural penetration ratio to catch up

Large urban/rural gap. Due to lower income and less modernized living condition and life style, the home appliance market of China's rural area historically lagged far behind that of urban area. The penetration ratios of major home appliances in rural area, besides color TV, are 45% to 89% lower than in urban area. The gap is especially wide for air-conditioners. Every 100 rural households only own 12 air-conditioners, compared with 107 owned by urban households. Though the penetration ratios for color TV are similar, rural area has much lower LCD penetration, in our view.

Jiangsu is above national average, but rural/urban gap is also large. For Jiangsu, Huiyin's current major market, though the penetration ratios are higher than national average due to affluence of the region, the rural and urban gap is large as the country's, implying plenty growth potential, especially for air-conditioners.

Anhui is in line with national average, obvious growth potential. For Anhui province, Huiyin's regional expansion focus, penetration ratios are in line with or lower than national average, implying plenty room for growth for every category.

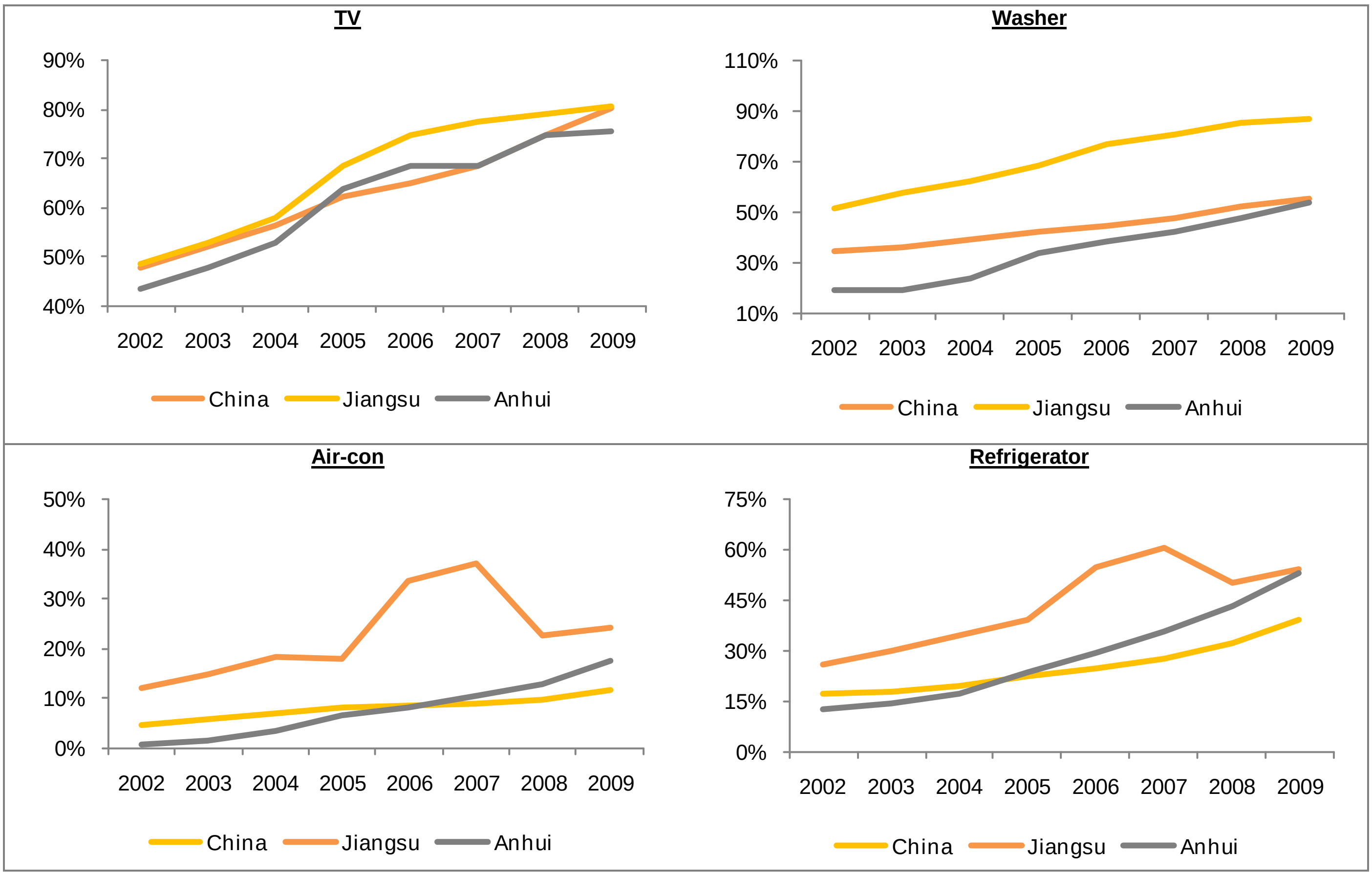
Exhibit 2: Urban/rural home appliance penetration as of 2009, defined as units of home appliance owned by 100 households

	China			Jiangsu			Anhui		
	Urban	Rural	Rural/Urban	Urban	Rural	Rural/Urban	Urban	Rural	Rural/Urban
Air-con	107	12	11%	164	40	24%	110	19	17%
Refrigerator	95	37	39%	98	53	54%	97	51	53%
Washer	96	53	55%	102	88	87%	97	52	54%
Color TV	136	109	80%	167	135	81%	140	106	76%

Source: Wind, OP Research

Penetration ratios catching up in rural area. We have seen fast catch-up of penetration ratio in three major home appliance categories, i.e. color TV, washer, and refrigerator, in rural area in the past 10 years. As penetration approaching or exceeding 100%, urban market growth slows down and is mainly driven by replacement demand. However, rural market is far from maturity and the penetration ratio keeps catching up with urban levels. We believe there will be a similar catch-up of penetration ratio for air-conditioners in the next few years, resulting in strong demand for air-conditioners in rural area.

Exhibit 3: Narrowing gap of home appliance penetration, shown by rurual as % of urban

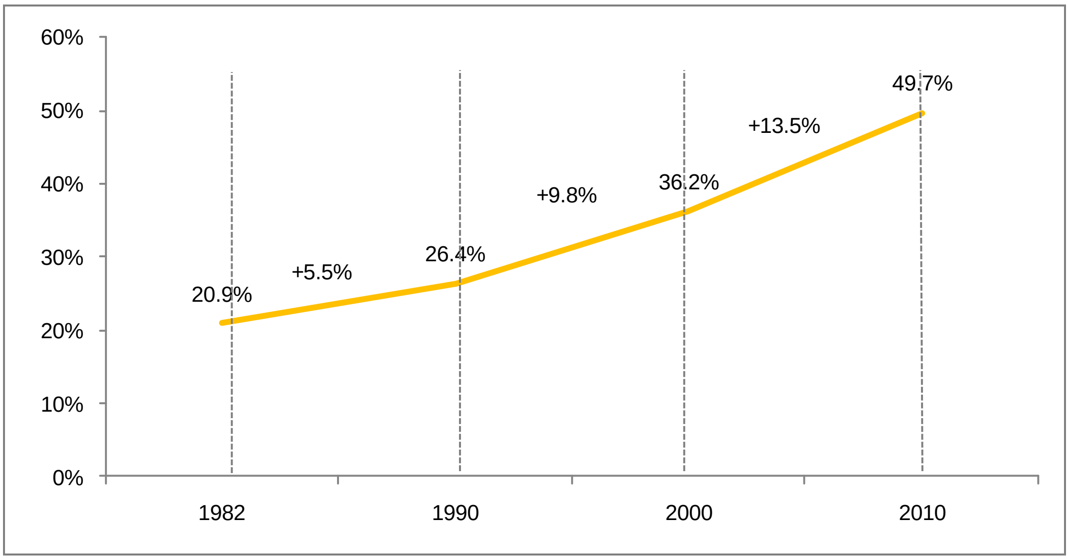


Source: Wind, OP Research

Driver 2: Rapid urbanization

Urbanization in the past decade accelerated. Underestimated by authority. According to the latest national population census results, China's urbanization ratio, increased 14ppt, from 36% in 2000(the last census) to 50% in 2010, much higher than the 10ppt and 5ppt in 90s' and 80s', respectively. The official estimate of urbanization ratio in 2009 was only 46.6%, which means the urbanization speed was underestimated at 1.15% per year from 2001 to 2009(the period between two latest censuses) by authority. Actually the speed was 1.35% per year, or 17% faster than official estimate.

Exhibit 4: % of urban population in past national census

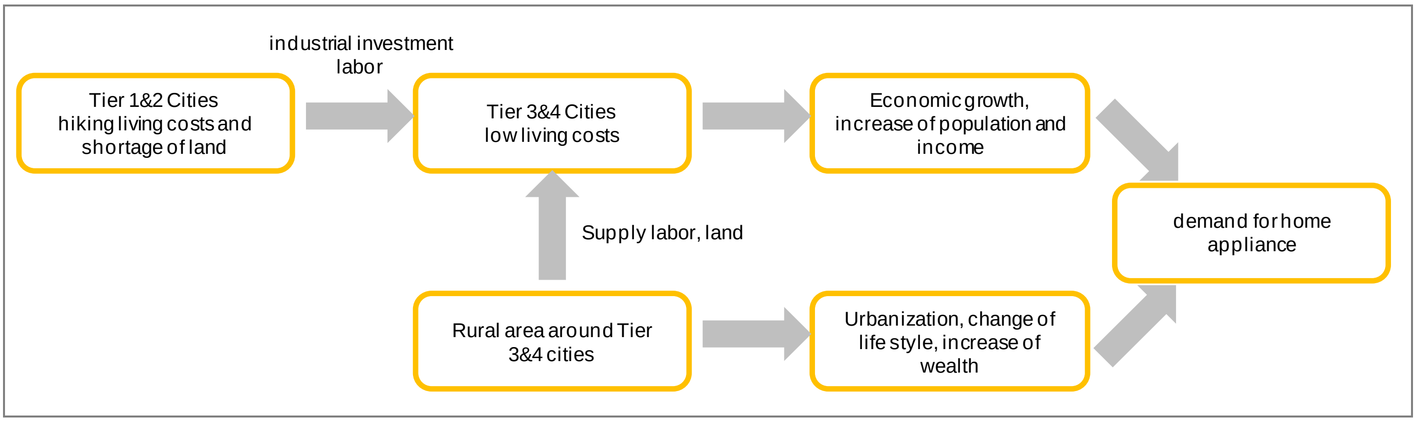


Source: Wind, OP Research

Urbanization to benefit Tier 3&4 cities and rural area more than Tier 1&2 cities in the future. Given the hiking living costs and land costs of Tier 1&2 cities in China, they are becoming less attractive to labor immigration and industrial investment. We think the flow of industrial investment and labor will shift its direction from Tier 1&2 cities to Tier 3&4 cities, where the costs are much lower.

Urbanization to boost home appliance consumption in Tier 3&4 cities and rural area. The urbanization happens in two ways: 1) Industrial investments attract labor from adjacent rural area to Tier 3&4 cities, and 2) Tier 3&4 cities expand to adjacent rural areas to accommodate the industrial land need and labor immigration. This two ways of urbanization will together boost home appliance consumption in Tier 3&4 cities and adjacent rural areas, as 1) the incremental consumption by immigrant labor as well as original residents in Tier3&4 cities who benefit from the industrial investment and economy growth, 2) the living condition and life style of rural area adjacent to Tier 3&4 convert to urban level. Air-con will be the direct beneficiary, as we have stated that air-con sees the largest urban/rural gap in major home appliance categories.

Exhibit 5: Urbanization to boost home appliance consumption in Tier 3&4 cities and rural area



Source: OP Research

Driver 3: Preferable policies

Policies promoting home appliance consumption. As part of the strategy to change the nation's economy growth driver to domestic consumption, Chinese government has launched three policies to promote home appliance consumption, i.e. Home appliance to rural area (“家电下乡”）, Swap old for new (“以旧换新”) & Energy saving subsidy(“节能惠民”).

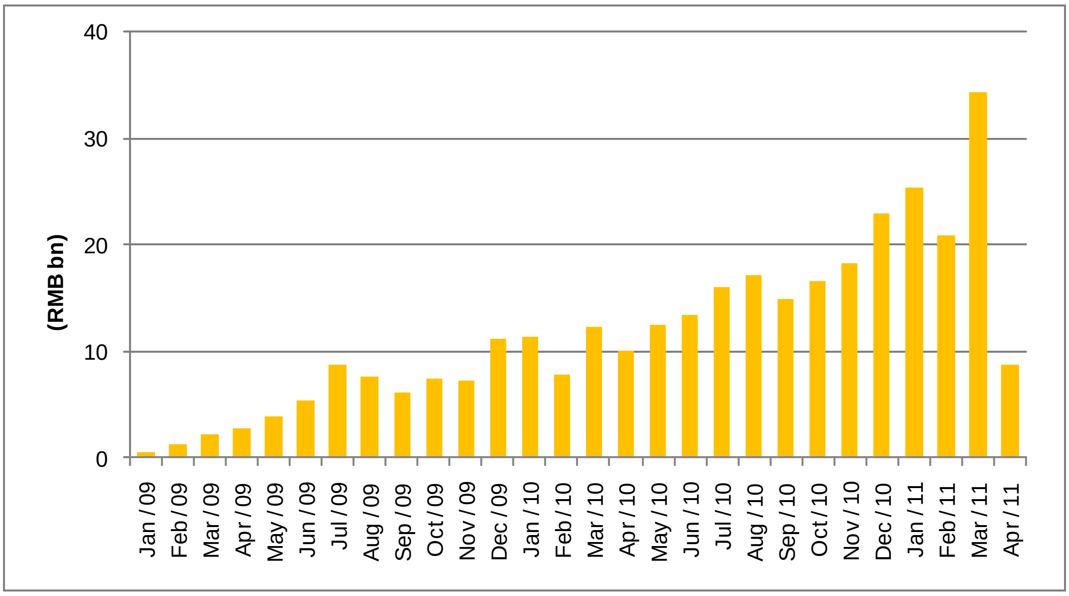
Exhibit 6: Policies at a glance

Policies	Coverage area	Expiry		Product	Subsidy	2010 sales	yoy %
Home appliance to rural area “家电下乡”	Whole country	Shandong, Henan, Sichuan, Qingdao	Nov 31, 2011	15 products: TV, Aircon, Fridge, Washer, Cell phone, PC, Microwave Oven, etc.	13%	RMB173.6bn	105%
		Inner Mongolia, Liaoning, Heilongjiang, Anhui, Hubei, Hunan, Guangxi, Chongqing, Shaanxi	Nov 31, 2012				
		Other area in China	Jan 31, 2013				
以旧换新	Whole country		Dec 31, 2011	5 products: TV, Aircon, Fridge, Washer, PC	10%	RMB107bn	660%
节能惠民	Whole country		May 31, 2011	Aircon, light, subject to certain energy efficiency standard	150-250 per set for aircon	-	-

Source: OP Research

Home appliance to rural area (“家电下乡”) policy boosted rural consumption. With a generous subsidy of 13% of sales price and country-wide implementation, the policy effectively stimulated the rural consumption of home appliance. Sales in 2010 reached RMB173bn, +170% yoy. Anhui and Jiangsu ranked 3rd and 5th in all provinces. Sales in Anhui increased 280% and reached RMB14.3bn, while sales in Jiangsu increased 240% and reached RMB11.7bn in 2010. Momentum remains strong as sales value increased 128% yoy in Jan to March 2011. Though sales in April slide 12% yoy, we think it is due to using of new labels since April 1, a measure taken by government to better regulate the distributors and won’t change the growth trend and policy direction in the long term.

Exhibit 7: Sales of “Home appliance to rural area”



Source: Wind, OP Research

Rural air-con sales skyrocketing, reaching 40% of country’s sales. Notably, air-con sales under “家电下乡” increased 398% yoy to RMB3.68 in March 2011, with its weight in domestic air-con sales reaching ~40%, if we assume RMB1500 ASP. We think it proves our view that rural consumption of air-con is entering a hyper growth stage, given the low penetration rate and urbanization trend.

Swap old for new (“以旧换新”) strong driver in cities. The policy was launched in Aug 2009 to promote home appliance consumption in cities and recorded RMB107bn sales in 2010. Sales of the program till Apr 21 2011 were up 99% yoy. Jiangsu recorded RMB25bn sales in 2010, the highest among all provinces in the country, while Anhui recorded sales of RMB1.6bn.

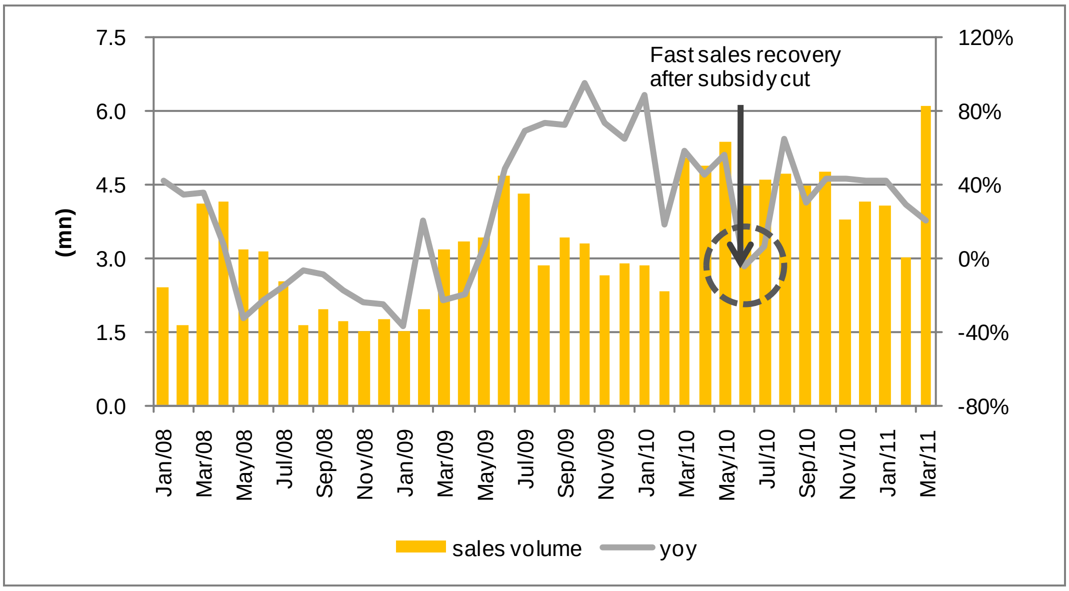
Energy saving subsidy (“节能惠民”) policy exit won’t seriously impact air-con sales. The energy saving subsidy will exit by end of May 2011. We think the impact of policy exit will be limited as 1) the subsidy has been cut by more than 50% since June 2010, but the sales volume only dropped in June and resume strong growth in 2H10 and 1Q11, and 2) the current subsidy doesn’t cover inverter air-con, while inverter air-con sales were growing much faster than regular air-con and already represents 40% of total air-con sales volume. The growth of inverter air-con will more than compensate potential impact of subsidy exit.

Exhibit 8: Energy saving subsidy cut from June 2010

Old policy (June 1, 2009~May 31, 2010)			New policy (June 1, 2010~May 31, 2011)		
	Efficiency level 1	Efficiency level 2		Efficiency level 1	Efficiency level 2
Cooling capacity (W)	Subsidy per set (RMB)	Subsidy per set (RMB)	Cooling capacity(W)	Subsidy per set (RMB)	Subsidy per set (RMB)
≤2,800	500	300	≤4500	200	150
2,800-4,500	550	350	4,500-7,500	250	200
4,500-7,100	650	450			
7,100-1,4000	850	650			

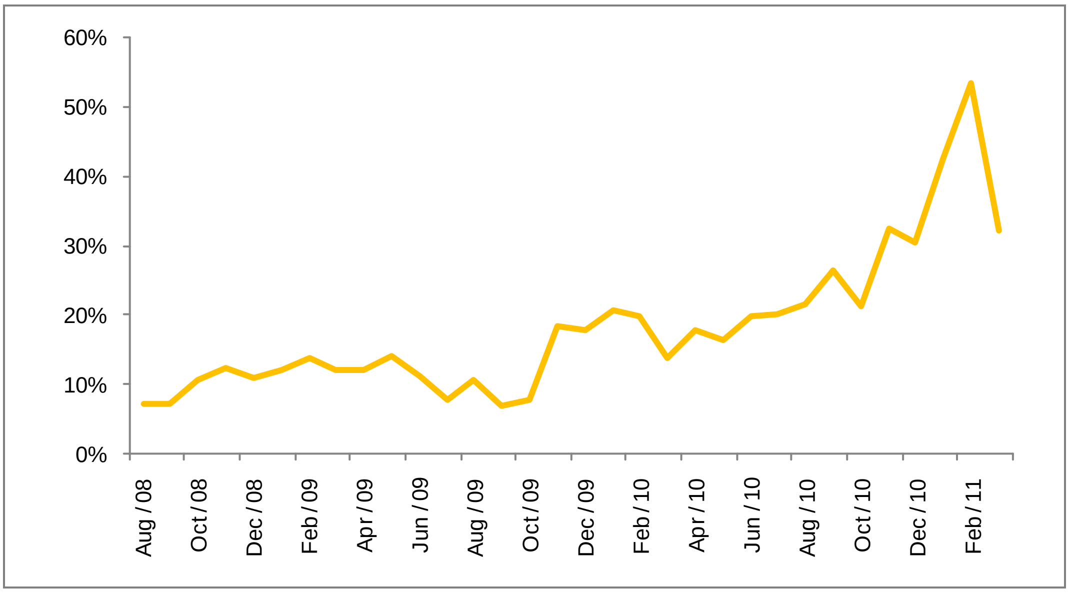
Source: OP Research

Exhibit 9: Domestic air-con sales yoy



Source: Wind, OP Research

Exhibit 10: Inverter air-con sales volume % of total air-con sales volume



Source: Wind, OP Research

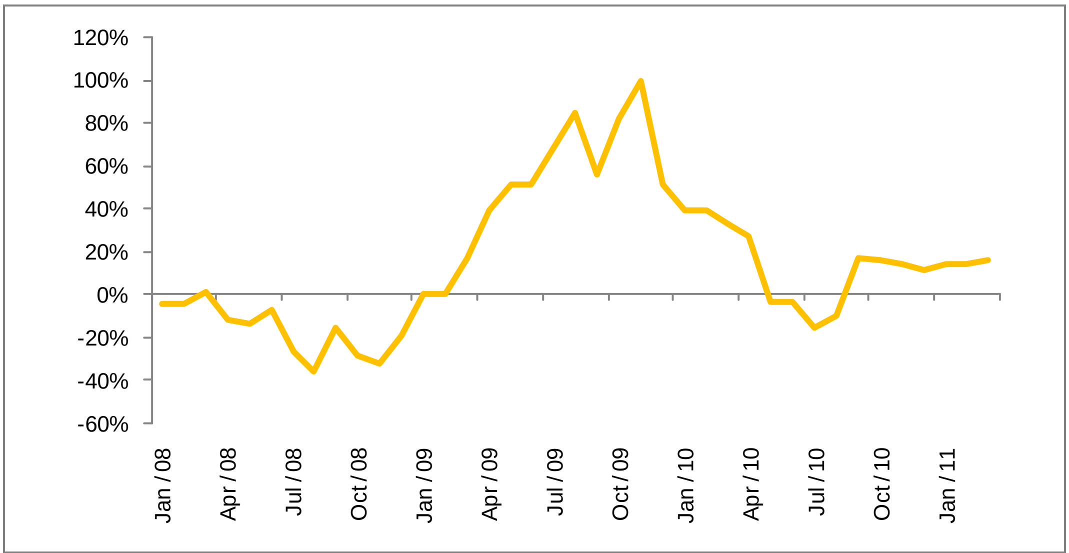
Driver 4: Social housing and defensive Tier 3&4 property market

Social housing construction at significant scale. Chinese government is committed to build 36mn units of social housing during its 12th 5 years plan. Its target for 2011, 10mn units, doubles 5.2mn units in 2010 and is around the same as units of commercial house sold in China in 2010.

More real demand for home appliance by social housing residents. Social housing are usually sold or leased to end users and thus represents more real demand for home appliance. To the contrast, commercial house can be bought by investors and left vacant for years. Thus, we believe decrease of home appliance demand by new commercial house buyers, due to recent property regulation, can be compensated by social housing sector, given its significant scale.

Defensive Tier 3&4 cities property market. Tier 3&4 cities property market is less affected by recent policy tightening. Most Tier 1&2 cities were forced to apply home purchase restriction policy, and saw ~30% volume drop yoy. Tier 3&4 cities usually don't have the pressure to apply such extreme measures. The country's residential GFA sold actually grew 15% yoy in 1Q, implying higher volume growth in Tier 3&4 cities, given the volume drop in Tier 1&2 cities. We think it is also another reason to believe home appliance market in Tier 3&4 cities will outperform.

Exhibit 11: China residential property monthly sales volume yoy growth



Source: Wind, OP Research

Huiyin has higher exposure to Tier 3&4 cities and rural market. Except for one small Gree brand store in Nanjing, which is considered as a Tier 2 city, all Huiyin's 52 retail stores are located in Tier 3&4 cities with 227 franchise stores covering adjacent rural area. In comparison, 63% of Gome's 826 outlets are located in Tier 1 cities, i.e. Beijing, Shanghai, Shenzhen, and Guangzhou. Gome has no exposure to Tier 3&4 cities and rural area. In 2010, Suning entered Tier 3&4 cities for the first time, opening 114 "county stores". However, 69% of Suning's stores are located in Tier1&2 cities by end of 2010.

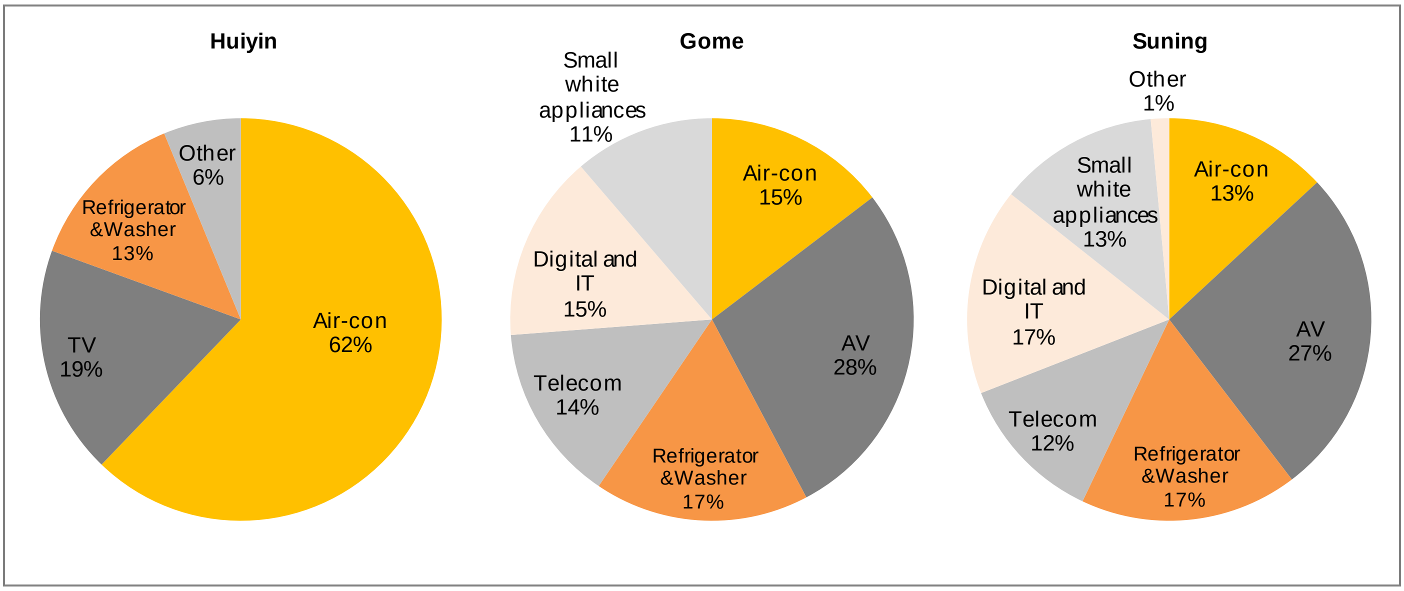
Exhibit 12: Huiyin's rural stores, compared with Gome and Suning

	Suning	Gome	Huiyin
Tier 1	525	522	0
Tier 2	379	304	1
Tier 3&4	407	0	52
Rural	0	0	227

Source: Company, OP Research

More revenue contribution from air-con sales for Huiyin. 62% of Huiyin's revenue in FY10 was from air-con sales. The ratios for Gome and Suning were 15% and 13%, respectively. The difference is mainly attributable to Huiyin's bulk distribution business. Though the revenue mix is not directly comparable, we believe Huiyin will benefit more from the growth of air-con consumption, especially in Tier 3&4 cities and rural market. Gome and Suning also purchase air-con from Huiyin in some areas.

Exhibit 13: Huiyin's product weight, compared with Gome and Suning.



Source: Company, OP Research

An evolving niche leader despite strong rivalry

We believe Huiyin will evolve into a niche leader in China's Tier 3&4 cities and rural home appliance market, despite the existence of Suning and Gome. Our conviction builds on 1) differentiated tier3&4 focus of Huiyin, 2) Huiyin's sales model, 3)The limited market power of Gome and Suning in Tier3&4 cities, 4) Huiyin's differentiated business model that combines wholesale and retail, and 5) Huiyin's strategy to ally regional players with e-commerce platform to share logistics.

Differentiated regional exposure of Huiyin. Almost 100% of Huiyin's retail stores, retail GFA, and franchise stores are in Tier 3&4 cities and ajacent rural area. Gome has no exposure to Tier3&4 cities and rural area. 63% and 37% of Gome's outlets are located in Tier 1 & Tier 2 cities, respectively. 31% of Suning's outlets are located in Tier3&4 cities by end of 2010. Given the smaller size of Suning's outlets in Tier 3&4 market (1000-1500 sqm, compared to 4000 sqm of regular shops), the GFA of Suning's stores in Tier 3&4 cities was ~7.5% of total store GFA.

Suning and Gome to focus on competition in Tier 2 cities (provincial capitals and core prefecture-cities in affluent provinces). According to industry anecdote, Gome and Suning aggregately take ~80% market share in the four Tier 1 cities, while duopoly's share is lower than ~10% in Tier 2 cities. Gome has no intention to enter Tier 3&4 market in the near term. It will open 480 new stores in 2011, mostly in Tier 2 cities, compared with 139 new stores in FY10. Suning currently plans to open 362 new stores, 40% in Tier 3&4 cities. Although Suning has done well in penetrating Tier 3&4 market in FY10 by opening 114 county stores, we think Gome's aggressiveness in Tier 2 cities will force Suning to refocus on competition in Tier 2 cities to defend market share.

Exhibit 14: New store plan, gome no intention in Tier 3&4

	Suning	Gome	Huiyin
Tier 1&2	217	480	0
Tier 3&4	145	0	25
Total	362	480	25

Source: Company, OP Research

Huiyin's sales model more suitable for Tier 3&4 cities. Gome and Suning are more tilted to a mega-store model, which is basically commercial property operation, with the following attributes: 1) large stores in downtown area, usually 4k to 10k sqm, 2) carrying huge amount of SKUs, usually 20k~100k, 3) using intensive advertising, 4) sales work mainly conducted by suppliers' sales personnel, usually 80% of total sales staff. Apparently, this model relies on high traffic and turnover, which is not possible for Tier 3&4 cities and rural area. Huiyin, in comparison, has a sales model suitable for Tier3&4 cities: 1) operate smaller stores (usually 1000~1500 sqm), 2) carry ~15k SKUs, and 3) rely heavily on service and inter personal relation to generate sales, 4) develop franchise network to cover adjacent rural area.

The limited market power of Gome and Suning in Tier3&4 cities and rural area. The market of Tier3&4 cities and rural area are highly fragmented, where Gome and Suning have less than 5% market share, compared with more than 80% in Tier 1 cities. Manufacturers rely less on Gome and Suning and more on regional distributors in Tier3&4 cities and rural area. Regional distributors distribute to retailers, including Gome and Suning. Huiyin, as a retailer, is not at a disadvantageous competitive position in such an environment.

Huiyin's differentiated business model that combines wholesale and retail benefits its future expansion in Tier3&4 cities and rural market. As we discussed above, fragmented distribution system is a barrier for Suning and Gome to expand in Tier3&4 cities and rural market. Huiyin has track record and existing dealership relation with various home appliance manufacturers. It can obtain new dealership to consolidate local market and develop retail business. Gome and Suning can't change their role to involve in distribution business.

Huiyin's strategy to ally regional players to share logistic network with e-commerce platform. Another barrier for Gome and Suning to expand to the fragmented Tier3&4 cities and rural market is to build a decentralized logistic network. Now their logistics networks only cover Tier 1 and some Tier 2 cities, with large and centralized storages. Huiyin tackle the problem with an innovative solution: establishing an alliance of small-mid regional home appliance distributors and sharing logistic network with an e-commerce platform. In July 2010, Chinese Consumer Electronics Channel Association (CCECA) was established to improve cooperation of regional home appliance distributors. Mr. Cao, Chairman of Huiyin, is the first chairman of the association. In April 2011, Huiyin has established a JV with a home appliance retailer in Zhejiang to develop the e-commerce platform and share each other's logistic network mainly in Zhejiang, Jiangsu, and Anhui. We expect the JV to recruit other regional players and evolve into a widely spread logistic network in Tier 3&4 cities and rural area in the long run.

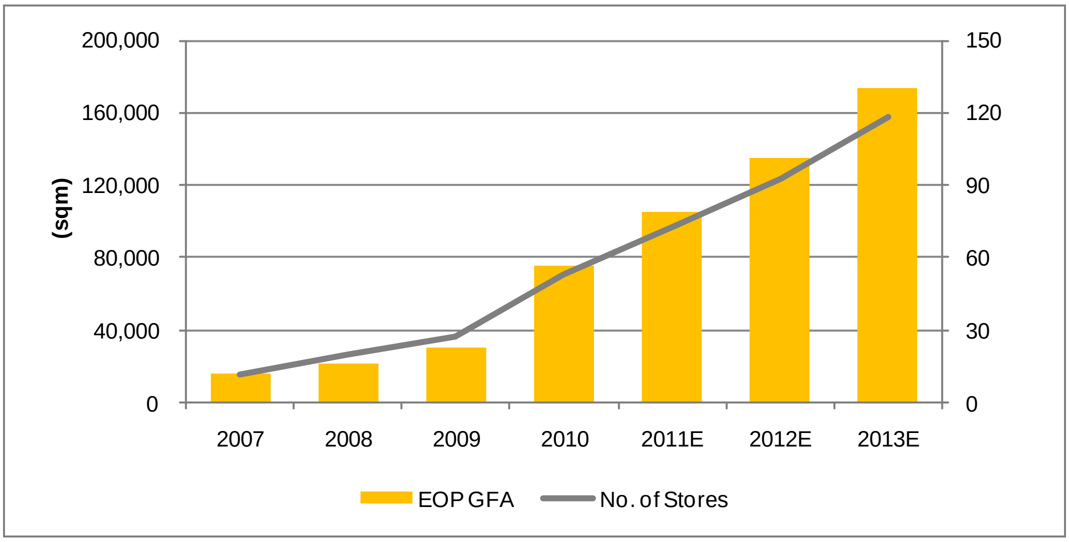
Turning point in FY11

We think Huiyin is approaching a turning point in FY11, as new stores mature and SG&A ratio stabilizes, after SG&A expenses hike and flat earning growth despite 43% revenue growth in FY10. Profit growth will catch up with revenue growth since FY11, and net profit margin will improve from 5.1% in FY10 to 6.1% in FY13. As Huiyin continuously expand its retail network, revenue and net profit will grow at CAGRs of 42% and 51%, respectively, from FY11 to FY13.

Outstanding sales growth ytd. Huiyin has reported "5.1" holiday retail sales up 112% yoy and same store sales growth 35.9%, outperforming Suning and Gome's 20%~30% sales growth and 10%~15% same store growth. We think the outperformance of Huiyin is mainly due to its rapid expansion in 2H10 and successful promotion during the "5.1" holidays. We estimate that its same store sales growth ytd was ~15% and total retail sales growth ytd was ~70% ytd. We expect the strong growth momentum to continue in the rest of FY11.

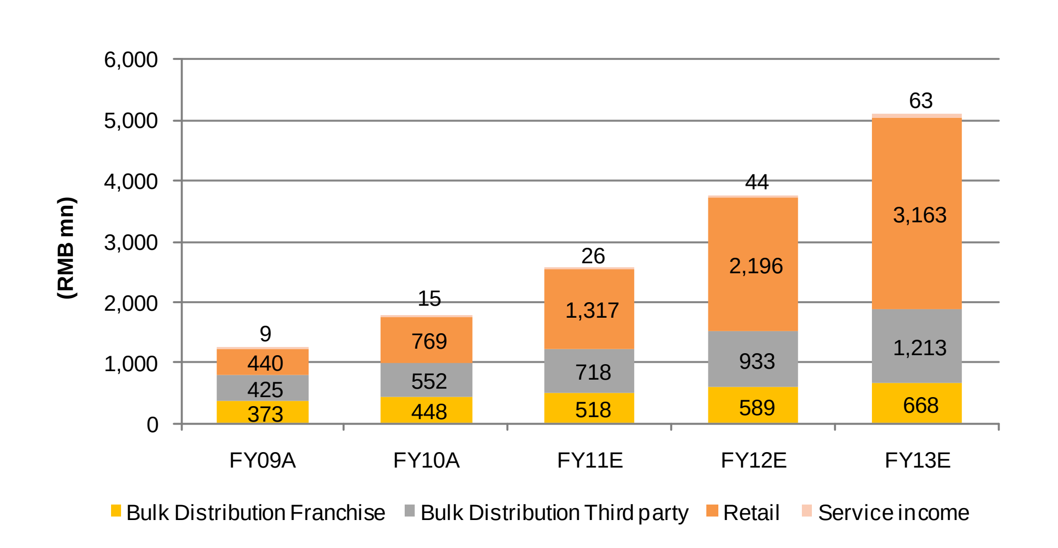
Revenue growth driven by retail network expansion. We expect the growth of Huiyin retail revenue and total revenue to be continuously driven by the expansion of retail network. We estimate total revenue and retail revenue to grow at CAGR 42% and 60%, respectively from FY11 to FY13. We made our projection based on the following assumptions: 1) a stable speed of new store expansion, i.e. 20-30 per year, with an average GFA of 1500 sqm, 2) 18 months maturity cycle for new stores, and 3) SSSG 10% in FY11 and 5% in FY12~13, 4) bulk distribution business to third parties to grow 30% per year, 5) no. of franchise stores to maintain at current level and single store sales to grow at 9%.

Exhibit 15: No of stores & GFA end of period



Source: Company, OP Research

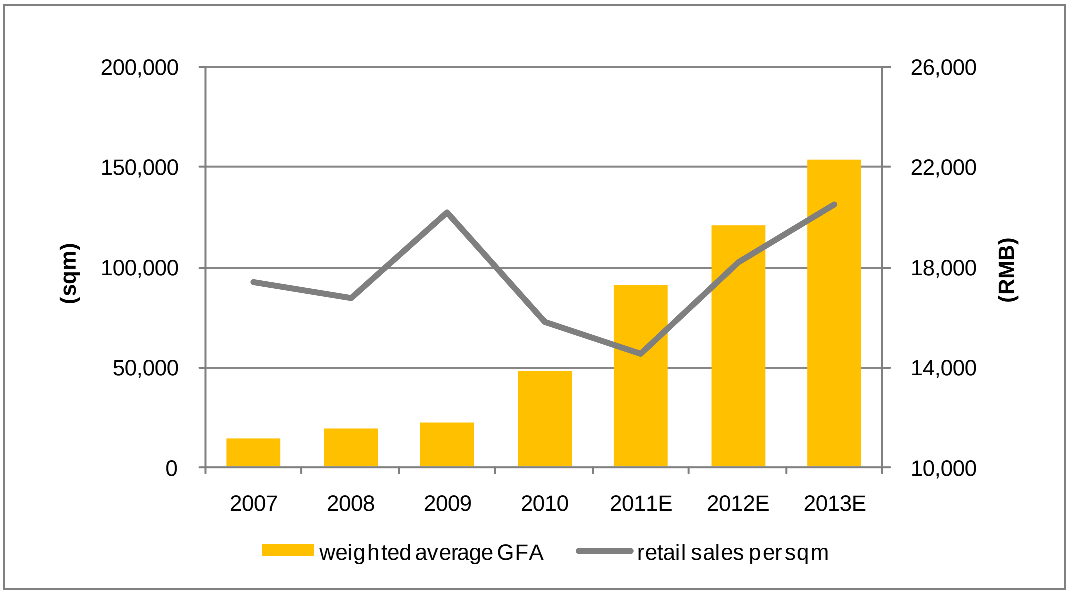
Exhibit 16: Revenue growth driven by retail expansion



Source: Company, OP Research

Uptrend of sales per sqm since FY12 as new stores mature and percentage of new store drops. We estimate that the sales per sqm will maintain an uptrend from FY12 and return to FY09 peak in FY13. Huiyin plans to keep a fast pace of retail store expansion and open 20~30 stores each year. As the base become larger, the percentage of new stores will drop from 50% in FY10 to ~30% in FY11 and further drop to ~20% in FY13. A relatively lower percentage of new stores will be positive for improving sales per sqm, as new stores usually take 1-2 years to ramp up sales and will see higher sales growth in 2nd year of operation.

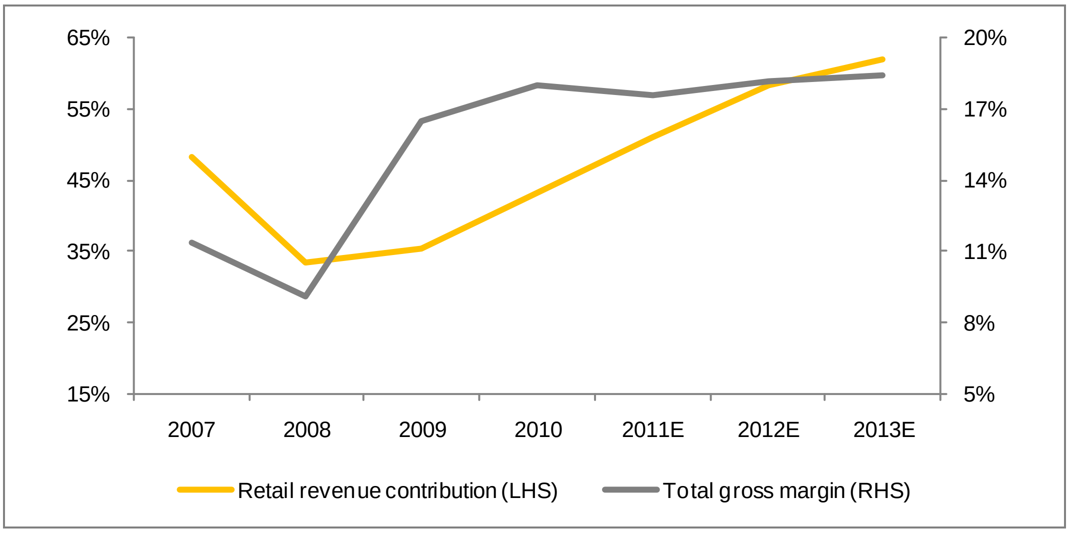
Exhibit 17: Weighted average GFA & retail sales per sqm



Source: Company, OP Research

Gross margin expansion driven by increasing contribution of retail business. As Huiyin keeps expanding its retail network, contribution of higher gross margin retail business will increase from 43% in FY10 to 62% in FY13. As a result, the overall gross margin will expand from 17.6% in FY11 to 18.4% in FY13. The slight drop of gross margin in FY11 is mainly due to increasing sales from Anhui province which offsets increasing retail contribution.

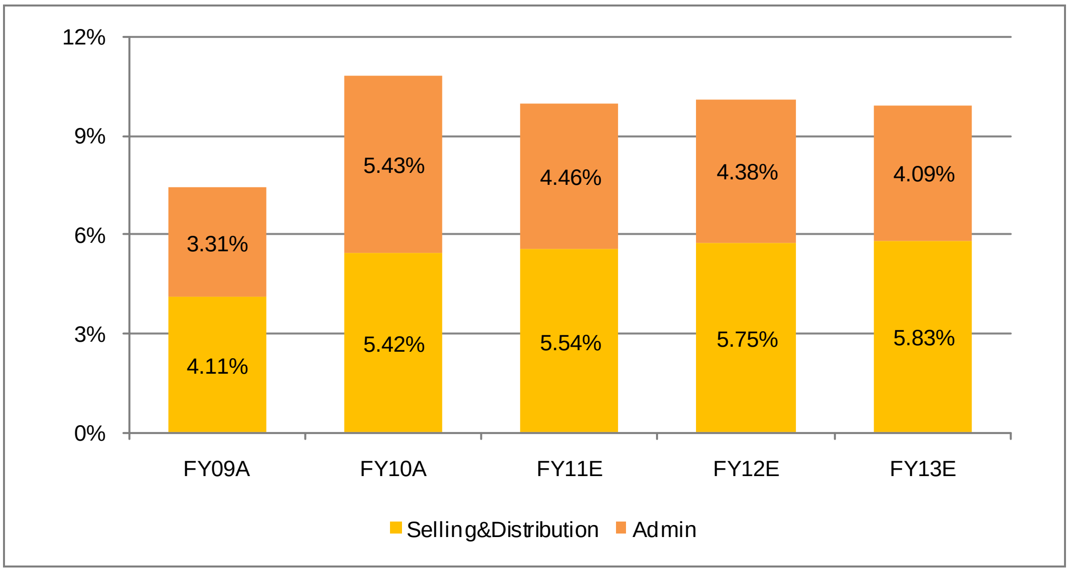
Exhibit 18: Retail business contribution & total gross margin



Source: Company, OP Research

Operating expenses ratio to stabilize after hike in FY10. As some one-off costs, such as IPO related costs, will be gone, we believe Huiyin will see stabilized operating expenses ratio, after an SG&A ratio hike from 7.42% to 10.85% in FY10. SG&A expense ratio will drop to 10% in FY11 and maintain at such level in FY 12 and FY13, as we estimate. That said, we estimate selling and distribution ratio will increase gradually in line with the increasing weight of retail business, which requires higher advertising, employee salary, and rental spending than bulk distribution.

Exhibit 19: SG&A ratio



Source: Company, OP Research

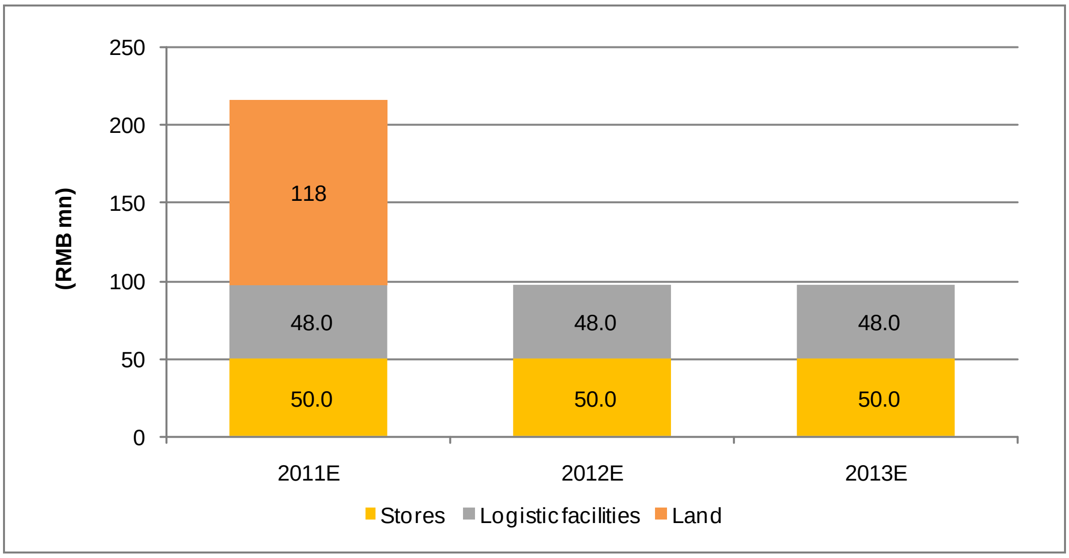
Exhibit 20: SG&A ratio hike in FY10

	2009	% of revenue	2010	% of revenue	% +/-
Revenue(RMB mn)	1,248	100%	1,784	100%	0.0%
Promotion and advertising expenses	15.2	1.2%	26.6	1.5%	0.3%
Operating leases	11.8	0.9%	19.5	1.1%	0.1%
Employee benefit expenses	4.4	0.3%	15.3	0.9%	0.5%
Depreciation costs	10.0	0.8%	11.6	0.7%	-0.1%
Transportation expenses	4.8	0.4%	8.7	0.5%	0.1%
Service charges	1.1	0.1%	5.2	0.3%	0.2%
Travelling expenses	1.2	0.1%	3.2	0.2%	0.1%
Utilities and telephone expenses	1.4	0.1%	1.4	0.1%	0.0%
Entertainment expenses	0.4	0.0%	-	0.0%	0.0%
Others	0.5	0.0%	5.2	0.3%	0.3%
Office expenses	0.5	0.0%	-	0.0%	0.0%
Total Selling & Distribution Exp	51.2	4.1%	96.8	5.4%	1.3%
Employee benefit expenses	12.8	1.0%	28.5	1.6%	0.6%
Option expenses	0.0	0.0%	15.8	0.9%	0.9%
Listing expenses	4.8	0.4%	7.5	0.4%	0.0%
Operating leases	3.6	0.3%	5.5	0.3%	0.0%
Utilities and telephone expenses	2.2	0.2%	5.0	0.3%	0.1%
Consulting expenses	0.4	0.0%	4.3	0.2%	0.2%
Travelling expenses	1.3	0.1%	4.1	0.2%	0.1%
Auditors' remuneration	0.3	0.0%	3.8	0.2%	0.2%
Amortisation	2.8	0.2%	2.2	0.1%	-0.1%
Write-off of prepayment	0.0	0.0%	0.0	0.0%	0.0%
Others	13.1	1.1%	20.1	1.1%	0.1%
Total Admin Exp	41.3	3.3%	96.9	5.4%	2.1%

Source: Company, OP Research

Capex to rise as retail network expands. Huiyin will invest RMB2mn for each new store's set up. It also plans to invest RMB48mn to set up logistic facilities to support the retail network expansion in FY11. We assume its Capex in logistic facilities to be proportional to new stores opened in the future. Another one-off Capex would be RMB118mn land premium payment in FY11. Due to the early stage of the land, we haven't included it in our P&L forecast but count its impact on balance sheet and cash flow.

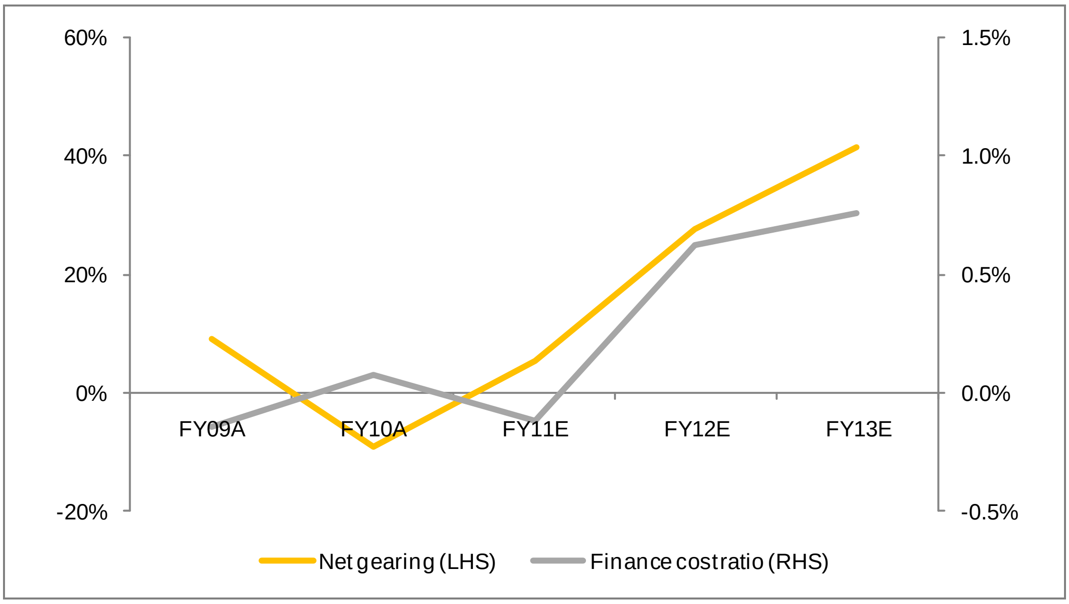
Exhibit 21: Capex estimate



Source: Company, OP Research

Interest expenses to increase from FY12 with rising gearing ratio. We forecast that Huiyin will utilize more debt financing to support its expansion, mainly for capex and working capital need. Huiyin plans to issue RMB400mn medium-term note in the PRC, which may materialize late FY11. Thus, the interest expense will increase from FY12.

Exhibit 22: Net gearing and financing cost



Source: Company, OP Research

Net margin improvement and net profit CAGR 51%. As a blended result of aforementioned developments, we estimate Huiyin's net margin will improve from 5.1% in FY10 to 6.1% in FY13.We estimate that net profit will grow at CAGR 51% from FY11 to FY13 with EPS being RMB0.16, RMB0.24, and RMB0.34. Our FY12 EPS estimate is 10% higher than consensus, as we have higher retail revenue growth estimate for FY12, which we believe will realize given the high growth potential of Huiyin's targeted Tier3&4 cities and rural home appliance market.

Exhibit 23: OP vs Consensus

	BLOOMBERG Cons		OP		
	FY11E	FY12E	FY11E	FY12E	Comment
Turnover	2,462	3,308	2,580	3,762	We have higher than consensus retail revenue growth estimate for FY12
Net profit	143	191	150	221	Due to our higher FY12 revenue estimate
Gross margin	17.10	17.40	17.56	18.17	
Net margin	5.94	5.67	5.83	5.89	
EPS	0.14	0.19	0.14	0.21	Due to our higher FY12 revenue estimate

Source: Bloomberg, OP Research

Valuation

Recommend Buy with target price of HK$2.3, at 13.4x FY11E PE, implying 27% upside. Huiyin is trading at 10.5x FY11E PE and 0.19x PEG, compared with peers' average 15.7x FY11E PE and 0.59x PEG. Our target price HK$2.3 is based on 13.4x FY11E PE and 0.24x PEG, 15% and 60% discount to peers' average. We believe the discount is enough to compensate for Huiyin's small size and risks. Our TP is HK$2.30 which implies 27% upside. **Recommend Buy.**

Exhibit 24: Peer valuation comparison

	Bloomberg code	Price (HKD)	Mkt Cap (HKD mn)	PER (x) FY10A	PER (x) FY11E	PER (x) FY12E	EPS CAGR FY10-FY12	PEG	P/B (x) FY10A	P/B (x) FY11E	P/B (x) FY12E
SUNING APPLIAN-A	002024 CH	15.50	108,469	23.7	17.1	13.9	0.31	0.56	5.0	4.1	3.3
GOME ELECTRICAL	493 HK	2.71	45,604	18.6	14.9	12.2	0.23	0.64	2.6	2.3	2.0
HAIER ELECTRONIC	1169 HK	9.85	22,760	18.3	15.0	11.6	0.26	0.59	7.3	4.9	3.3
Average				**20.2**	**15.7**	**12.6**	**0.27**	**0.59**	**5.0**	**3.8**	**2.9**
HUIYIN HOUSEHOLD	1280 HK	1.81	1,898	17.2	10.5	7.1	0.55	0.19	1.6	1.1	0.9

Source: Bloomberg, OP Research

Risks analysis

Policy exit to slow down home appliance consumption. The multiple stimulus policies for home appliance sector will expire gradually in the next 3 years. It is reasonable to worry the impact of policy exit. However, we believe several factors will help mitigate the impact on Tier3&4 cities and rural market. First, Tier 3&4 cities and rural market is becoming more important for home appliance manufacturers. To secure sales growth in the future, manufacturers will provide competitive product offering to offset the impact of policy exit. Second, Tier 3&4 rural market still has large growth potential given drivers other than policy stimulation.

Slower than expected store expansion. Huiyin plans to open 25~30 stores per year and focuses on the Tier3&4 cities of Jiangsu and Anhui. We believe there are three factors crucial to success of Huiyin’s store expansion: suitable store space, qualified management talent, and supply chain to cover new stores. If Huiyin fails to secure any of the three factors, its store expansion may fall behind schedule and thus may affect its revenue and profit growth. However, we believe Huiyin will face less competition from home appliance retailer peers and other retailers in such area for store space, talent, and suppliers, than in Tier 1&2 cities. Huiyin has also accumulated experience and local network in such area regarding store development during its past operation, which is a competitive edge for Huiyin. Thus, we believe Huiyin will be able to execute its expansion plan successfully.

Lower than expected performance of new stores. Due to lower income and lower population density, the sales of a typical home appliance store in Tier3&4 cities is lower than in Tier 1&2 cities. We believe some new stores may fall short of sales target, especially at early stage, though Huiyin has been highly selective in choosing store space. Thus, we have adopted a low per sqm sales assumption to accommodate such risks.

Suning and Gome entering Tier 3&4 cities and rural market. The two major players, especially Suning is expanding to lower tier market. However, as we have analyzed above, Huiyin has a regional focus and a business model different from Suning and Gome, which gives it competitive edge in Tier 3&4 and rural home appliance market. The market power of Suning and Gome in such market is much weaker than in Tier 1&2 cities. It is also difficult for Suning and Gome to change their current business model to accommodate the different business environment in lower tier market. Huiyin has plenty room to grow and good chance to be a leader.

On-line retailers taking market share from off-line retailers. 360Buy is targeting copying its success from 3C products to large home appliance. Suning and Gome also launched on-line stores. We agree the increasing market share of e-commerce will be a long-term trend, but the off-line retailer will still be the main stream in Tier 3&4 and rural area in the near future, given 1) the consumers’ low acceptance of internet and e-commerce, and 2) the fragmented market that are more challenging for on-line retailers’ logistics network to ensure in-time and safe delivery.

Financials

Exhibit 25: Income Statement

Year to Dec (RMB mn)	FY10A	FY11E	FY12E	FY13E
Revenue	**1,784**	**2,580**	**3,762**	**5,108**
Cost of sales	(1,464)	(2,127)	(3,079)	(4,166)
Gross Profit	**320**	**453**	**683**	**942**
Other revenue	15	22	32	43
S&D	(97)	(143)	(216)	(298)
Admin expenses	(97)	(115)	(165)	(209)
EBIT	**142**	**217**	**334**	**479**
Finance cost	(1)	3	(23)	(39)
Pretax Income	**140**	**220**	**310**	**440**
Income tax expense (credit)	46	66	84	119
Minority interests	2	4	5	7
Net Profit	**92**	**150**	**221**	**314**
EPS (Basic) (Cents)	9	14	21	30
EPS (Diluted) (Cents)	9	14	21	30

Source: Company and OP Research

Exhibit 26: Balance Sheet

Year to Dec (RMB mn)	FY10A	FY11E	FY12E	FY13E
Property, plant and equip. (Net)	141	224	300	368
Intangible assets	7	4	2	1
Others	88	204	200	196
Non-current assets	**235**	**432**	**503**	**566**
Others current asset	97	140	204	277
Deposits, prepayments and other rec'e	789	855	1,325	1,917
Deposits with banks	207	301	435	589
Account Receivable	70	158	199	275
Inventories	276	362	562	688
Cash & Equivalent	182	370	113	153
Current assets	**1,621**	**2,186**	**2,838**	**3,899**
Total assets	**1,857**	**2,618**	**3,340**	**4,465**
Others	201	220	294	424
Trade and other payables	527	765	1,108	1,499
ST borrowing	50	0	79	428
Current liab	**777**	**986**	**1,481**	**2,351**
Deferred tax liabilities	2	2	2	2
Other LT Liabilities	5	403	404	403
Non-current liabilities	**7**	**404**	**406**	**405**
Total liabilities	**785**	**1,390**	**1,886**	**2,756**
Share Capital	7	8	8	8
Reserves	794	803	817	837
Retained earnings	256	397	605	832
Total common equity	**1,057**	**1,208**	**1,430**	**1,677**
Minority interest	15	19	24	31
Total Liab & Equity	**1,857**	**2,618**	**3,340**	**4,465**

Source: Company and OP Research

Exhibit 27: Cash Flow

Year to Dec (RMB mn)	FY11E	FY12E	FY13E
Net Profit	150	221	314
Depreciation & Amortization	17	27	35
Finance cost	3	(23)	(39)
Net (inc)/dec working capital	(25)	(361)	(348)
Others	4	9	9
Operating Cash Flow	**149**	**(127)**	**(29)**
Net CAPEX	(98)	(98)	(98)
Change in LT Investment	-	-	-
Others	(210)	(135)	(154)
Investment Cash Flow	**(308)**	**(233)**	**(252)**
Proceeds from ST debt	(50)	79	349
Proceeds from loans	400	-	-
Dividend Paid	-	-	(66)
Inc (dec) of Share premium	-	-	-
Inc (dec) of Share Capital	1	-	-
Others	(3)	23	39
Financing Cash Flow	**348**	**102**	**322**
Change in cash & equivalent	189	(258)	40

Source: Company and OP Research

Exhibit 28: Financial Ratio

Year to Dec (RMB mn)	FY10A	FY11E	FY12E	FY13E
Growth (%)				
Revenue	43.0	44.6	45.8	35.8
Gross Profit	55.5	41.4	50.8	37.9
EBITDA	13.2	48.7	54.4	42.1
EBIT	13.4	52.9	54.0	43.3
Net Profit	0.3	64.0	47.3	41.7
Profitability (%)				
Gross margin	18.0	17.6	18.2	18.4
EBITDA margin	8.8	9.1	9.6	10.1
EBIT margin	7.9	8.4	8.9	9.4
Net Profit margin	5.1	5.8	5.9	6.1
ROE	8.7	12.4	15.5	18.7
ROIC	19.1	13.2	17.2	18.8
Liquidity				
Debt Ratio (%)	42.3	53.1	56.5	61.7
Interest bearing Debt Ratio (%)	2.7	15.3	14.3	18.5
Net Gearing (%)	-28.9	-19.7	-2.5	7.1
Current Ratio	2.1	2.2	1.9	1.7
Quick Ratio	1.7	1.8	1.5	1.4
Operating				
Inventory turnover days	55	55	55	55
A/R turnover days	17	103	77	77
A/P turnover days	90	111	111	114
Valuation Ratios				
P/E (x)	16.1	10.5	7.1	5.0
P/B (x)	1.3	1.3	1.1	0.9
EV/EBITDA (x)	9.9	9.9	6.6	5.3
Dividend yield (%)	0.0	0.0	3.5	5.0
Per Share Data (HK$)				
EPS	0.11	0.17	0.25	0.36
BVPS	1.38	1.38	1.63	1.91
DPS	-	-	0.06	0.09

Source: Company and OP Research

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