

Haier Elec (1169.HK)

High-end Products Strategy with Rural Logistics Coverage

Hong Kong | Appliances | Company report

We had a conference call with Haier Elec's management to conduct research on the company on 7 Feb 2017.

Investment Summary

- The company implements high-end products strategy. The proportion of high-end products will grow. The ASP of washing machine and water heater may rise. The company is making the transition from price-driven to value-driven.
- The company will develop the logistics business in Tier 3 and Tier 4 districts and villages in the future. Speed and village permeability are two important factors.
- The cash efficiency will be improved in the future. The company will also increase shareholder returns. The company is expected to increase repurchase and dividend payout ratio in the future.
- The development of smart appliances. The company will build the platform for smart appliances because the platform has highest value and can bind the users, merchants and all partners.

Company Business

The Group is principally engaged in the research, development, manufacture and sale of washing machines and water heaters in the PRC under the brand name of "Haier". In addition to manufacturing and sales of home appliances under the brand name of Haier, the Group is engaged in the integrated channel services business under the brand name of Goodaymart for home appliances and other household products of diversified brands. The integrated channel services business include distribution business, logistics business, after-sale service business and e-commerce business.

The company announced the quarterly results ended 30 Sep 2017. The Q1-Q3 revenue decreased by 3.5% YoY to RMB45.85 billion, and profit attributable to owners of the company increased slightly by 1.0% YoY to RMB 1.85 billion.

The Market Share of Washing Machine and Water Heater Ranked First

According to the market research report for 1H2016 released by CMM, the market share of Haier's washing machines continued to rank first in China; in terms of sales value, Haier held a market share of 26.9%, representing a YoY increase of 0.6%; and the market share in terms of sales volume was 26.5%, representing a YoY increase of 0.7%.

According to the market research report released by CMM, in 1H2016, the Group's water heaters continued to rank first in China in terms of sales volume, with the market share reaching 18.2%, increased by 1.0% YoY.

21 February 2017

Accumulate

CMP: HKD 14.40

(Closing price as at 17 Feb 2017)

TARGET: HKD 15.93 (+10.63%)

COMPANY DATA

O/S SHARES (MN) :	2792.1
MARKET CAP (HKDMN) :	40,206
52 - WK HI/LO (HKD):	15.18/10.80

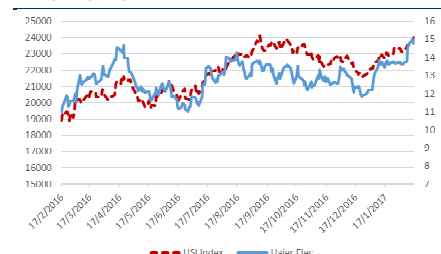
SHARE HOLDING PATTERN, %

Haier Corp	56.17
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PRICE PERFORMANCE, %

	1M	3M	1Y
Haier Elec	+5.42	+12.85	+30.91
HSI	+5.22	+7.95	+27.00

PRICE VS. HSI



Source: Bloomberg, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY14	FY15	FY16E	FY17E
Sales	67,134	62,826	62,700	68,030
Net Profit	2,447	2,703	2,696	2,855
EPS, CNY	0.92	0.98	0.97	1.02
PER, x	18.1	13.2	13.2	12.5
BVPS, CNY	4.28	5.31	6.28	7.26
P/BV, x	3.5	2.5	2.0	1.8
ROE, %	25.5	20.5	16.6	15.1

Source: Company reports, Phillip Securities Est.

Research Analyst

Ocean Pan

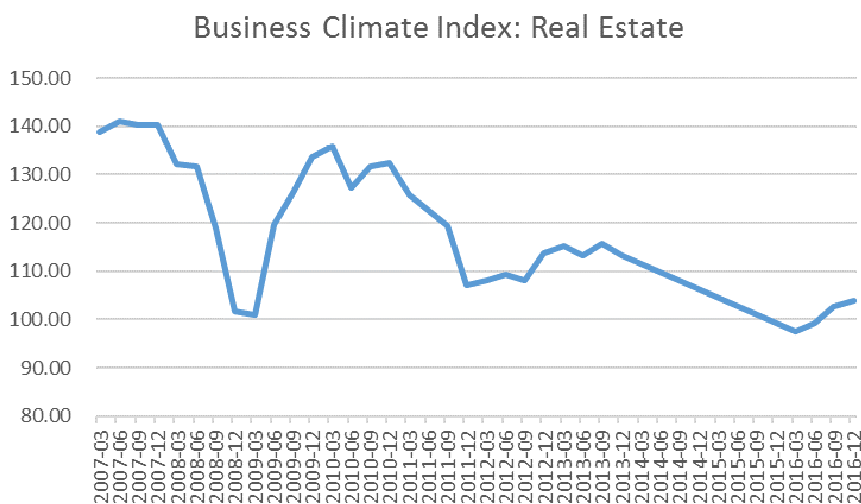
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According to Euromonitor, Haier accounted for 9.8% of the global large-scale home appliances market in terms of retail volume in 2015, topping the world for the seventh consecutive year.

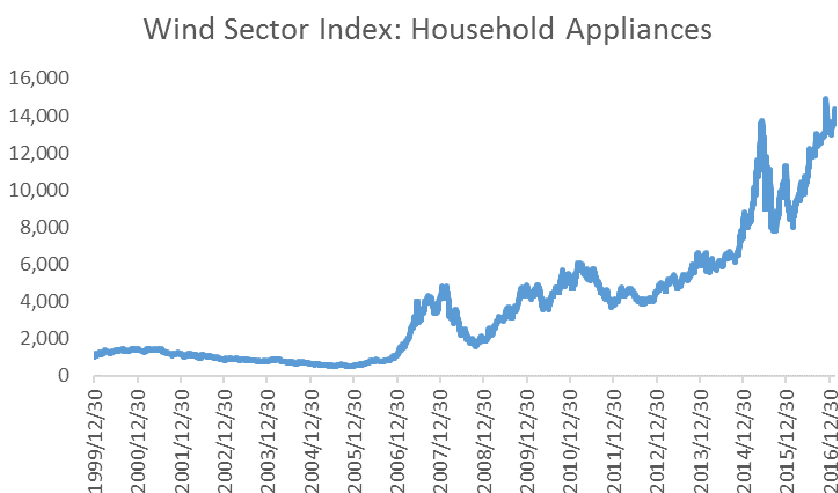
Industry Overview

The business climate index of real estate industry began to rebound from the beginning of 2016.



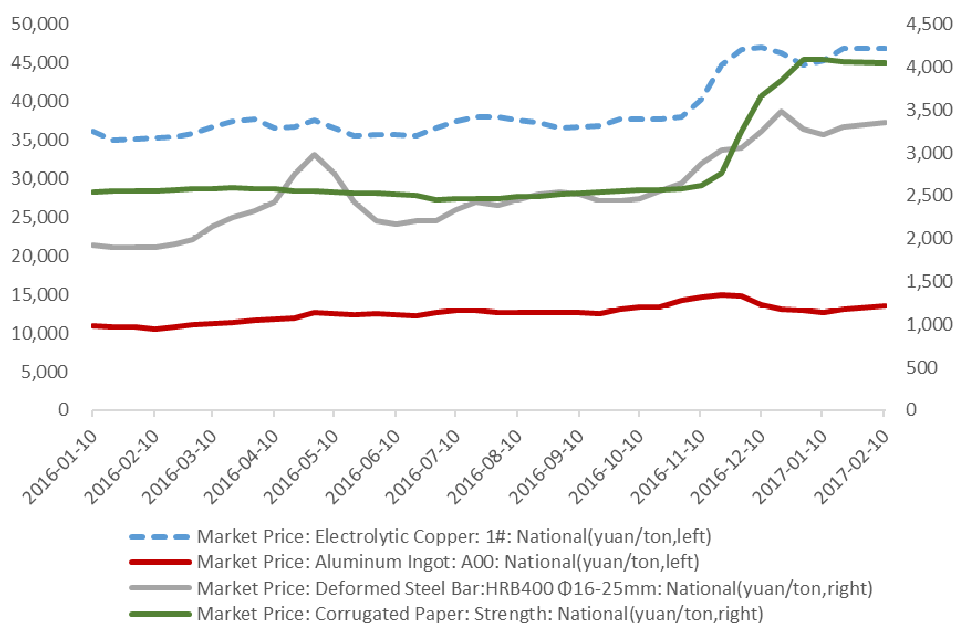
Source: Wind, Phillip Securities (HK) Research

The following graph shows the wind household appliances sector index. The index continued to rise from the beginning of 2016.



Source: Wind, Phillip Securities (HK) Research

The prices for reference



Source: Wind, Phillip Securities (HK) Research

The prices of raw materials such as steel and copper have risen since the end of last year. The requirements for environmental protection purpose for the packaging industry made the prices of packaging materials rise a lot. In addition, from September 2016 China began to raise the prices of highway transportation nationwide. The household appliances industry began to raise prices since last December.

Driven by the consumption upgrade and the rising raw material prices, small businesses which don't have the cost advantages and face operational difficulties are expected to be eliminated. The industry threshold will be higher. Large enterprises with quality advantages and cost advantages have stronger resistance abilities.

The Company Implements High-end Products Strategy

Facing the rise of upstream raw material prices, the company has the pressure to raise the product prices. The company hopes more and more consumers will know its products and the proportion of high-end products will grow. The ASP of washing machine and water heater are expected to rise.

The company's products have high-end technology, and the brand premium is not yet fully reflected. The company won't enter the price war which can occupy the market share but are not sustainable. The company is making the transition from price-driven to value-driven.

The Distribution Business Accounts for Large Percentage of Total Revenue

The distribution business accounts for large percentage of total revenue. Thanks to the structure adjustment, the NPM of distribution business is expected to rise.

The “home appliances going to the countryside” plan made the appliances consumption ahead of schedule. The washing machine and water heater sales grew fast then, but the 10-year cycle is almost over. And the air conditioner industry’s inventory clean-up is over, the industry is expected to return to high-growth path.

Expanding the Logistics Network

In order to further develop the rural life service industry and increase the consumption of rural services, China’s Ministry of Commerce published “the guidance of developing rural life service industry and increasing rural service consumption”. It plans that until 2020 a number of exemplary counties, townships and villages which will develop rural life service industry should be constructed to form a rural life service system where urban and rural areas are coordinated and is high in quality, convenient, green and affordable. The system should continuously meet the diversified and high in quality consumer demand of the rural areas. The guidance also called for accelerating the cultivation of rural e-business services.

In Dec 2013, the Goodaymart logistics business under Haier Elec was invested by Alibaba Group, involving HK\$2.8 billion. After the exercise of the exchange right, Alibaba Group indirectly holds an aggregate of 34% of the equity interest of Goodaymart Logistics.

The company will develop the logistics business in Tier 3 and Tier 4 districts and villages in the future. It’s in line with Alibaba’s rural Taobao strategy. Now in the area of large-scale item logistics, Goodaymart has established logistics distribution stations in over 2800 districts and counties. Haier will expand its logistics network and deliver the goods directly to the villages. Speed and village permeability are two important factors.

All of the franchise shops are managed using internet and all the data can be checked in JSH and the company can distribute and response timely using the network data.

Cash Efficiency will Improve in the Future

Cash efficiency will improve in the future. In 2016 the company mainly invested in the fix income products, but in 2017 the company will lower the proportion of fix income investment and increase strategic investment. In 2016 the company focused on building interconnected factories and additional logistics warehouses, in 2017 the CAPEX/cash ratio may be increased to around 15%. The company will also increase shareholder returns and is expected to increase repurchase and dividend payout ratio in the future.

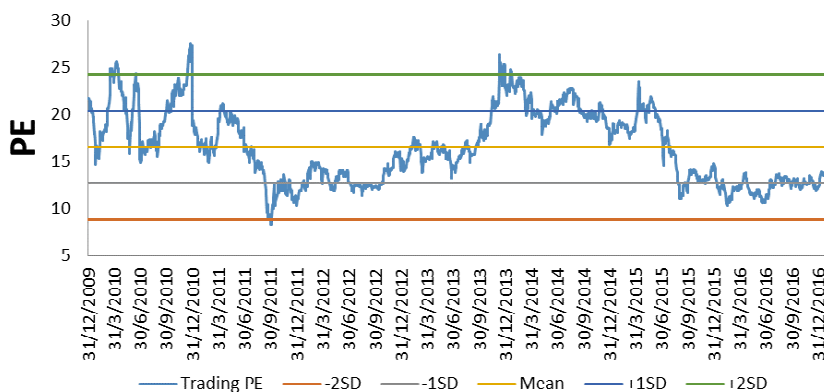
The Development of Smart Appliances

Almost all the home appliances of the company are intelligentized now. The company will build the platform for smart appliances because the platform has highest value and can bind the users, merchants and all partners. It can become the entrance of the data and the entrance of user interaction. Data will be fed back to the designers, then they will improve product designs and improve the service quality to increase customer viscosity and become good service driven.

Valuation

Accumulate Rating is given with TP of HK\$15.93. We expect net profit change of -0.3%/5.9%, driven by -0.2%/8.5% revenue change. Our TP of HK\$15.93 represents 14.6/13.8x FY16E/FY17E P/E. (Closing price as at 17 February 2017)

Haier Elec Trading PE band



Source: Bloomberg, Phillip Securities (HK) Research

Peers Comparison

Company	Ticker	Market Cap(mn)	2017/2/17		P/E(x)		P/B(x)		D/E(%)	D/A(%)
			Price		FY16E	FY17E	FY16E	FY17E		
SKYWORTH DIGITAL HLDGS LTD	751 HK Equity	15,146	5.0	7.3	6.6	0.9	0.8	152.9	60.3	
TCL MULTIMEDIA TECHNOLOGY	1070 HK Equity	6,356	3.7	25.1	16.6	1.0	1.0	312.3	75.7	
HISENSE KELON ELECC HLD	921 HK Equity	15,997	9.1	10.4	8.0	2.2	1.7	263.7	72.5	
HAIER ELECTRONICS GROUP CO	1169 HK Equity	40,206	14.4	13.2	12.5	2.0	1.8	92.7	48.1	
Average					14.0	10.9	1.5	1.3		
A Share(RMB)										
HISENSE ELECTRIC CO LTD-A	600060 CH Equity	23,369	17.9	13.2	11.9	1.7	1.5	71.1	41.6	
SICHUAN CHANGHONG ELECTRIC-A	600839 CH Equity	20,450	4.4	30.6	32.8	1.6	1.5	212.4	68.0	
GREE ELECTRIC APPLIANCES I-A	000651 CH Equity	164,891	27.4	11.5	10.3	3.1	2.8	232.9	70.0	
MIDEA GROUP CO LTD-A	000333 CH Equity	207,204	32.3	14.0	12.0	3.5	2.9	129.9	56.5	
Average					17.3	16.8	2.5	2.2		

Source: Company reports, Bloomberg, Phillip Securities (HK) Research Estimates

Risk

Fluctuation in prices of raw materials, packaging materials and logistics;
The competition in the home appliances industry.

Financials

FYE	FY13	FY14	FY15	FY16E	FY17E
Valuation Ratios					
P/E	14.4	18.1	13.2	13.2	12.5
P/B	5.9	3.5	2.5	2.0	1.8
Per Share Data(RMB)					
EPS	0.80	0.92	0.98	0.97	1.02
Book Value Per Share	3.00	4.28	5.31	6.28	7.26
Dividend Per Share	0.08	0.09	0.10	0.13	0.15
Growth & Margins(%)					
Growth Rates					
Revenue	12.0%	7.8%	-6.4%	-0.2%	8.5%
Operating profit	13.9%	14.4%	-5.3%	8.2%	6.3%
Net Profit	20.2%	20.1%	10.5%	-0.3%	5.9%
Margins					
Gross profit margin	14.7%	14.7%	15.9%	16.6%	16.6%
Operating profit margin	4.2%	4.5%	4.5%	4.9%	4.8%
Net profit margin	3.3%	3.6%	4.3%	4.3%	4.2%
Key Ratios					
ROE(%)	30.7	25.5	20.5	16.6	15.1
ROA(%)	10.2	9.9	9.4	8.7	8.5
Income Statement(RMB mn)					
Revenue	62,263	67,134	62,826	62,700	68,030
Gross profit	9,138	9,842	9,993	10,377	11,259
Operating profit	2,624	3,002	2,843	3,076	3,271
EBT	2,638	3,166	3,344	3,326	3,521
Net Income	2,037	2,447	2,703	2,696	2,855

Source: Company, Bloomberg, Phillip Securities (HK) Research Estimates
 (Financial figures as at 17 Feb 2017)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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