

# China Home Appliance Sector

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DBS Group Research . Equity

10 Aug 2022

## Concerns on inflation overblown

- **Leading players should sustain a positive growth despite high cost pressure in 2Q22. Latest downtrend of raw material prices could also benefit gross margins by 2H22**
- **Other performance drivers include improving consumer sentiment and new policy incentives**
- **Our top pick is [Haier Smart Home](#), given strong contribution of premium products and higher exposure in the categories that are less dependent on the Chinese real estate market**

**2Q22 should be the trough in 2022.** Affected by snap COVID lockdowns and logistics disruptions, we expect the home appliance sector to report soft 2Q22 performance. Yet, we do see multiple catalysts ahead for a better 2H22. These could include noticeable sequential rebound in consumer sentiment and home appliance retail sales (+43% m-o-m in Jun 2022) across China, a sustained premiumisation trend, moderating cost pressure, and positive local government policies to steer growth ahead. Recent progress of the Chinese home market could also alleviate concerns on payables from property developers, especially given the small exposure and the change of latest payments to cash on delivery.

**Margins to rebound ahead.** The cost of major raw materials posted a double-digit y-o-y decline during recent months. Coupled with earlier increases in average selling prices, home appliance plays are well-poised to log better gross margins by 3Q - 4Q22. Overall, we project leading home appliance operators could post at least 3-5ppt faster y-o-y earnings growth during 2H22.

**Policy incentives also drive sales.** China's consumption subsidies should accelerate sales and drive new demand, especially for the segments with lower penetration (e.g., air conditioners, small appliances). Recent government efforts to revive the property market could also support potential return of new home appliance demand into 2023. We stay positive on the outlook and reiterate BUY calls on both Haier and Midea. Our top pick is Haier, in view of its success in premium products, lower reliance on the property market, and a smaller base for air conditioner sales that could see sound medium-term prospects from lower household penetration and the global warming trend.

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### Recommendation & valuation

Company Name	Currency	Price		Target Price	Recom	Mkt Cap
			\$	\$		US\$m
<a href="#">Haier Smart Home 'H' (6690 HK)</a>	HKD	23.10	39.58	BUY	29,742	
<a href="#">Haier Smart Home 'A' (600690 CH)</a>	CNY	22.80	32.98	BUY	29,742	
<a href="#">Midea Group 'A' (000333 CH)</a>	CNY	51.83	93.94	BUY	53,713	

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK")



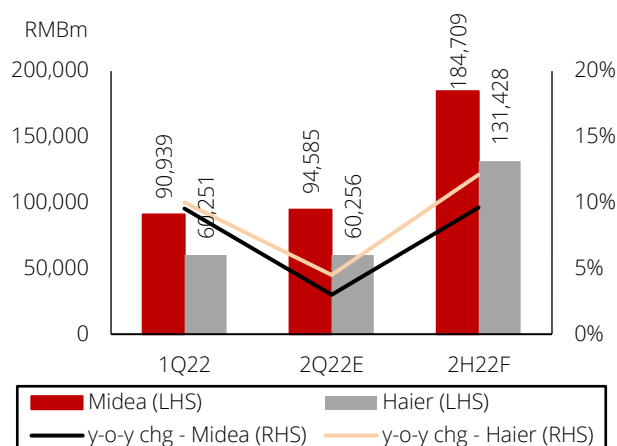
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## China Home Appliance Sector

## 2Q22 results preview

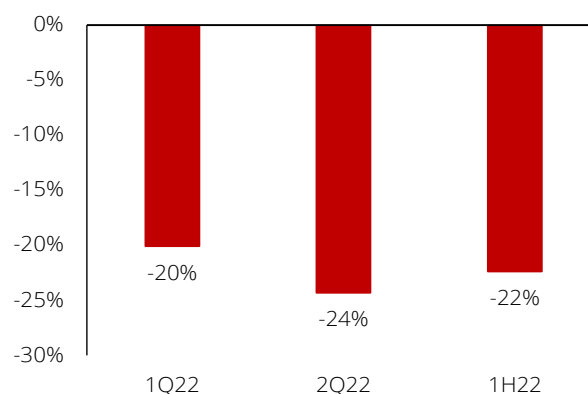
Leading plays still growing in spite of COVID-19 resurgence. Various cities in China experienced offline store closures as well as online delivery & home installation delays, as a result of the snap COVID-19 lockdowns and related logistics shutdowns. Coupled with a weaker global macroeconomic environment and consumer sentiment, the home appliance market in China recorded a poorer overall performance in 2Q22. However, Haier and Midea, the top players in the industry, are still expected to outperform and register a mid-single-digit y-o-y sales growth in 2Q22, with their results to be released on Aug 30 and Aug 31, respectively.

## Quarterly performance estimations - sales



Source: Company data, DBS HK

## China retail sales of white goods (%y-o-y)

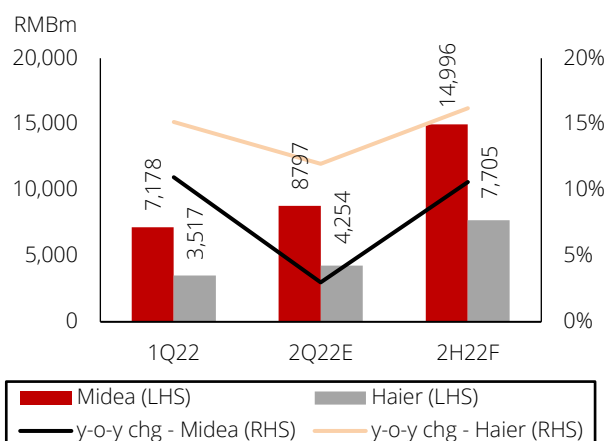


Source: CMM

**Product replacement still the key.** Product renewals and upgrades should continue to stand as powerful drivers to sustain growth for key brands in the industry. On the back of higher raw material costs, competent home appliance players are able to accelerate their product-mix upgrades and raise average selling prices (ASP) to safeguard their profitability. As such, we believe both Haier and Midea should be able to maintain their gross margins in 2022 to a good extent despite higher cost pressure. As we also expect some operating leverage benefits, we estimate Haier and Midea to post around 10% and a mid-single-digit y-o-y earnings growth in 2Q22, respectively, despite tough operating conditions.

## China Home Appliance Sector

## Quarterly performance estimates – net profit

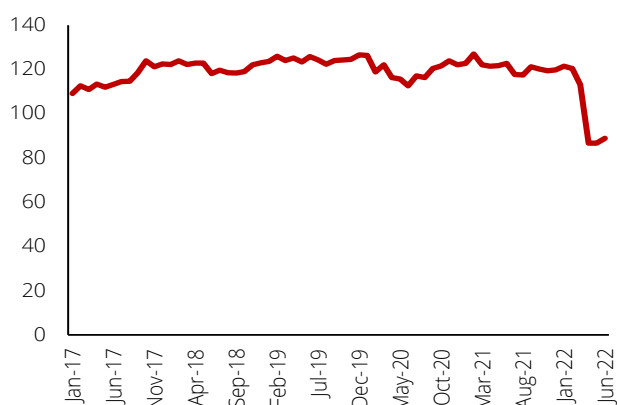


Source: Company data, DBS HK

## Outlook remains encouraging

**Sequential improvement.** China's consumer confidence index reached a 5-year low in May 2022, as severe COVID-19 lockdown measures in selected cities spurred concerns of lockdown fears across multiple regions of the country. As the situation gradually loosens up, the index rebounded by Jun 2022, and is expected to post a mild upward trend into 2H22. Total retail sales of consumer goods in China also rebounded by 3.1% y-o-y to RMB3,874bn in Jun 2022 (May 2022: -6.7% y-o-y), or up 15.5% m-o-m in Jun 2022, which also indicated a firm recovery in China consumption.

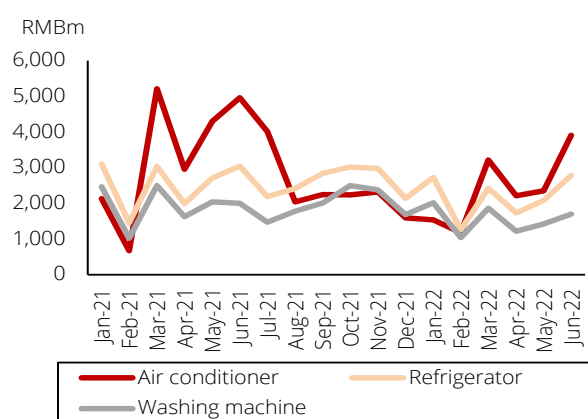
## Consumer Confidence Indicator



Source: CEIC

Specifically, the gradual relaxation of COVID-19 lockdowns in selected regions, demand backlog amid the Omicron outbreak in China since mid-Mar 2022, the "618" shopping festival in Jun 2022 with large-scale promotional activities and hottest products offered, as well as supportive government policies have all helped to re-energized domestic consumption. Overall retail sales of household electric & video appliances (for above designated sized enterprises) in China increased by 3.2% y-o-y in Jun 2022, versus -10.6% in May, -8.1% in Apr, and -4.3% in Mar this year, denoting a sound sequential improvement.

## China white goods performance: domestic market

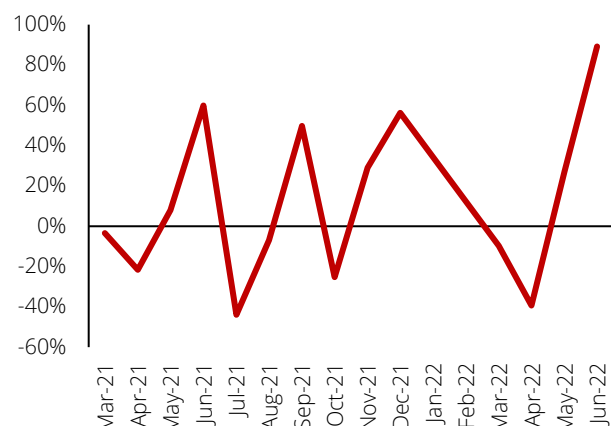


Source: CMM

According to leading home appliance operators, sales of white goods are currently dominated by replacement demand, contributing to c.80% of washing machine and refrigerator sales, and about 50% of air-conditioner sales, with new demand accounting for the rest across these key product categories.

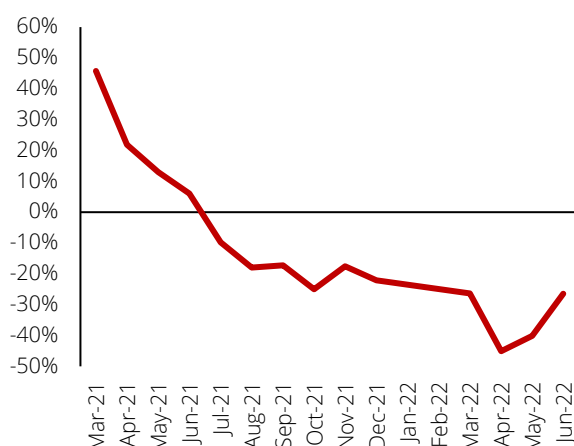
Having said that, given the strong m-o-m rebound in sales of existing residential & houses (in floor space terms) by Jun 2022, and a narrowing y-o-y decline in the pre-sale home market versus April and May 2022, we expect gradual home market improvement could also lay some support on new demand for home appliance products, especially into 2023. A more apparent trend could also re-emerge by 2H23-1H24, on the back of the 2-3 quarters of time lag between residential transactions and home appliance demand for the new homes.

### Floor space sold: Existing houses (%m-o-m)



Source: National Bureau of Statistics

### Floor space sold: Houses under construction or the pre-sale market (%y-o-y)



Source: National Bureau of Statistics

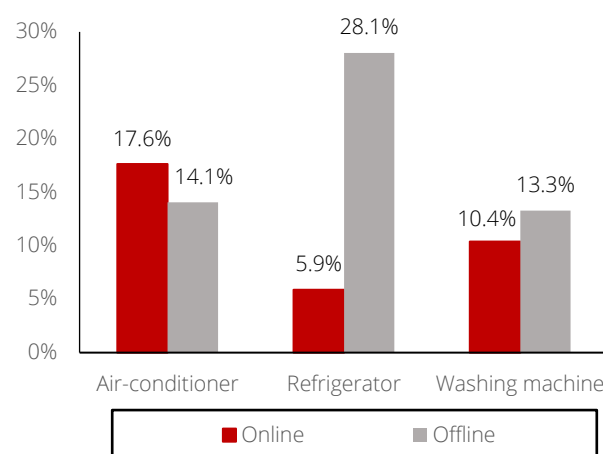
**Further premiumisation and ASP expansion.** Higher priced premium products normally rely more on their offline sales channels, amid a bigger consumer demand for better shopping experience & services. Despite COVID-19 lockdowns in selected cities of China, the high-end home appliance market still sustained a single-digit y-o-y growth in 1H22, likely attributable to the relatively lower impacts on the high-income group from COVID-19 resurgence and

slower economic growth. On the whole, retail sales of premium air conditioners (ASP >RMB8,000), washing machines (ASP >RMB10,000) and refrigerators (ASP >RMB10,000) accounted for 17.7%, 11.6% and 36.2% of total segmental sales, respectively, in 1H22. Casarte, the premium brand of Haier, is estimated to achieve c.15% growth in 1H22, while COLMO, the premium brand of Midea, is also expected to meet its full-year growth target. Increasing revenue contribution from premium products should also continue to support overall profitability of these players.

Over the last two years, the sharp increase in raw material prices since 2021 has further expanded room for product price increases. During Jan 2021 to Jun 2022, all three major white good categories, being the refrigerators, washing machines and air conditioners, had recorded double-digit ASP growth. In particular, refrigerators scored the most ASP increase, up 28.1% for the offline channels, as consumers are more willing to spend on them for stocking up fresh and frozen foods amid the COVID-19 resurgence, especially given the sudden lockdown and quarantine arrangements in certain regions of China during recent months.

While the pace of ASP expansion could curb slightly in 2H22 given moderating raw material prices, we believe the big premiumisation trend in China will sustain over the medium-term. Key home appliance operators could still secure a rising trend in their blended product ASP ahead.

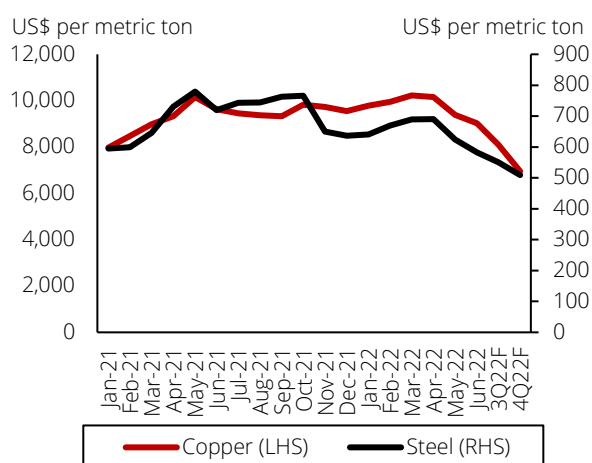
### ASP increases since 2021



Source: AVC, DBS HK

**Moderating raw material costs.** Both copper and aluminium prices dropped by over 20% y-o-y in Apr-Jul 2022. The price index of steel, non-ferrous metal, and plastics also fell by around 21%, 19%, and 11%, respectively during the same period. As home appliance manufacturers gradually use up the more expensive raw materials, we expect their earnings could resume a stronger trend by 2H22. The Euromonitor estimates on raw material prices also post a downward trend, which largely align with our house view. Such descending cost trends should bode well for a better earnings prospect in 2H22-2023.

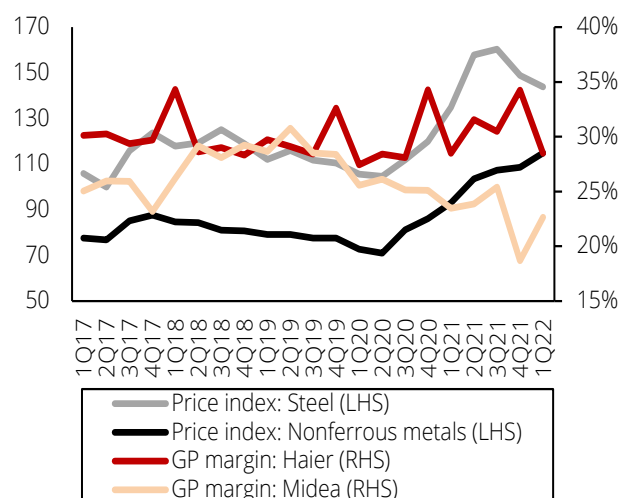
### Prices of copper and steel



Source: Euromonitor

Raw material prices directly affect the gross profit of home appliance plays. Any substantial fluctuations on such costs could result in volatile gross margin trends. However, the correlation between profit and raw material prices is expected to weaken along with improving production efficiency, rising ASP and product-mix upgrades.

### GP margin trend



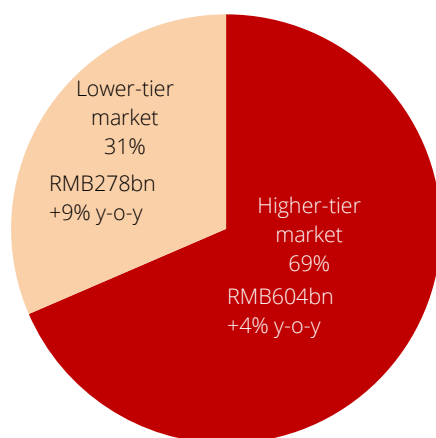
Source: Wind, DBS HK

**Policy incentives.** Since 2022, new incentives have been introduced across China to encourage local demand of home appliance products, mostly in the form of consumption vouchers and subsidies. Key focuses still rest on the old-for-new consumption and the purchase of energy-efficient products. Aside from traditional black and white goods, small appliance products are also included in this round of subsidies.

While the household penetration rate of large appliances in China has mostly reached a stable level, air conditioners should still see room to expand in household ownership, especially across the rural areas that merely reaches c.90 units per 100 household (vs. 320 units in Japan, c.290 in the US, and 289 in S. Korea). Besides, global warming could also boost air conditioner penetration rates to new highs in the medium-term. The average ownership of small appliances per family reaches 9.5 units in China, which is also less than one-third of the US market. Meanwhile, the lower-tier markets (tier-3 and below) cover >70% of China's total population, while their home appliance demand grows at a much faster rate than the higher-tier markets.

Overall, it is expected that the subsidies and supportive policies could drive more demand for the segments with lower penetration in China (e.g., air conditioners, small appliances), as well as for the lower-tier markets of China.

### Home appliance market size in 2021



Source: CCID(中国电子信息产业发展研究院), DBS HK

### Summary of subsidy policy

Location	Policy
Shenzhen	Eligible household appliances, such as TVs, air conditioners, refrigerators, washing machines, kitchen appliances and small appliances, are subsidized at 15% of the sales price, with the total subsidy not exceeding RMB2,000 per person.
Beijing	Consumers can obtain coupons via online platform (e.g. JD.com). Coupons are issued for six periods with a total of RMB900 per person. Appliances such as air purifiers, TVs, air conditioners, refrigerators, washing machines, microwave ovens, range hoods, projectors, etc., should reach Level 2 energy efficiency and above, and dishwashers and water purifiers should reach Level 2 water efficiency and above.
Shanxi	A total of RMB10m of subsidies for home appliance, including RMB8.3m of consumption vouchers and RMB1.7m of old-for-new subsidies.
Shandong	Issue RMB200m of consumption vouchers, and encourage home appliance old-for-new consumption. Add an extra RMB100 consumption voucher for consumers who purchase TVs, refrigerators, washing machines, and air-conditioners, with old-for-new method.
Guangxi	More than 10 million subsidies will be arranged to carry out a new round of home appliance old-for-new activities. Subsidies will be given at no more than 8% of the sales price of new appliances, with a maximum of RMB500 for each appliance.
Guizhou	An offset of around RMB100-RMB500 is available for old-for-new method, and additional consumption vouchers reductions of up to RMB5,000.
Shijiazhuang	A subsidy of RMB 300 for appliances selling at RMB3,000-RMB6,000 A subsidy of RMB 800 for appliances selling at RMB6,000-RMB10,000 A subsidy of RMB 1,000 for appliances selling >RMB10,000
Chongqing	Another 10% discount on the transaction price of old-for-new method, the maximum subsidy is RMB4,999.
Lianyungang	A 10% subsidy for one-time purchases of energy-efficient appliances with a single invoice price over RMB2,000.
Hefei	For home appliance selling >RMB3,000, a discount of RMB200 (quota: first 100,000 units).

Source: DBS HK

### China Home Appliance Sector

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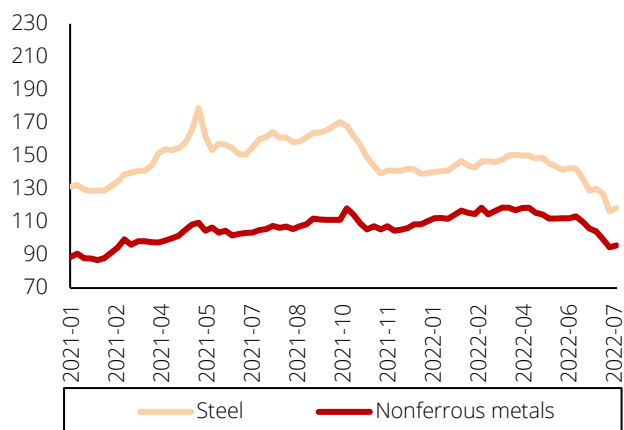
#### Undemanding valuation

Despite the weaker global economic performance and high inflation rates in the US and Europe this year, we stay hopeful for the China home appliance sector amid multiple catalysts ahead. These could include the sequential improvement in overall consumer sentiment as well as the gradual rebound in real estate demand since late-2Q22; sustained premiumisation trend to prompt ongoing product-mix improvements; noticeable declines in major raw material prices in recent months; and new government incentives to support consumption across the home appliance industry.

On the whole, our sector top pick is Haier Smart Home (6690.HK; 600690.CH), given its relatively higher revenue contribution from premium products; effective response to minimize cost pressures; as well as its slightly higher exposure to washing machines & refrigerators that are less dependent on new home demand. Besides, its lower base in the air conditioner category could also provide a better upside for the segment, especially given a lower penetration rate in China and the potential impacts from global warming.

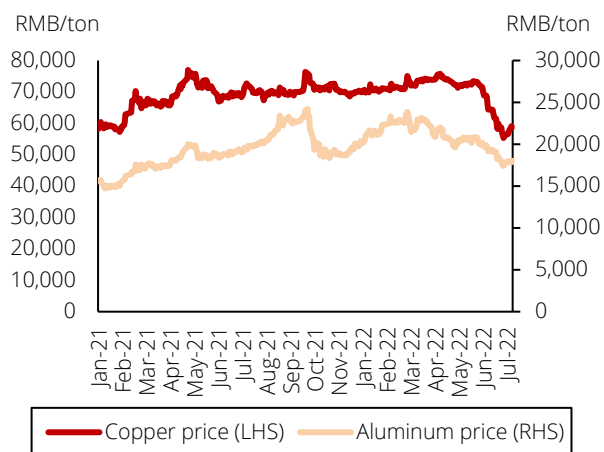
Appendix

China commodity price index



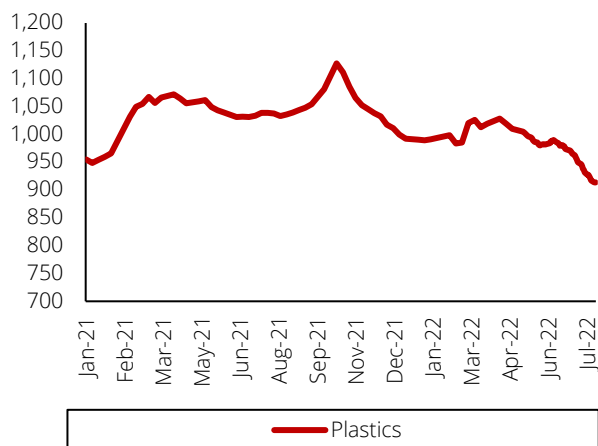
Source: Wind

Commodity prices: Copper and Aluminum



Source: Wind

China commodity price index: Plastics



Source: Wind



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**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

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\*Share price appreciation + dividends

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