



Rating
Buy

Asia
China

Consumer
Retail / Wholesale Trade

Company
Gome

Reuters 0493.HK	Bloomberg 493 HK	Exchange HKG	Ticker 0493
ADR Ticker GMELY	ISIN US3817351097		

Date
24 March 2015

Forecast Change

Price at 23 Mar 2015 (HKD)	1.06
Price target - 12mth (HKD)	1.69
52-week range (HKD)	1.50 - 1.01
HANG SENG INDEX	24,495

Anne Ling

Research Analyst
(+852) 2203 6177
anne.ling@db.com

Three-year plan confirmed, focus on offline channel; maintaining Buy

Maintaining Buy with new target price of HK\$1.69 (HK\$1.73)

Management believes the robust growth of e-commerce in China is over, and it will thus focus on a total retail strategy, offering a full house of sales channels to cater for differing consumer demand. For 2015, it expects 3% sssg with further penetration into low-tier cities. We cut our FY15/16 NP by 0.5%/2.2%. In our model, we expect core NP to grow 14%/16%/16% yoy in 2015/16/17. Given the potential upside to our target price, we maintain Buy.

Reiterating build of another Gome plan by 2017

Gome re-iterated its strategy of building another Gome, doubling sales revenue by 2017. It also upgraded its omni-channel strategy to a total retail strategy, aiming to offer consumers a seamless total retail experience in on/offline channels. For 2015, it guided for a 3% SSSg with RMB1bn capex. It plans to enter 100 new cities in the tier-two market with 80-100 new store openings each year for the next three years.

FY14 results in line with our and market forecasts

Net profit rose 43% yoy to RMB1,280m on the back of 7% growth in sales revenue to RMB60bn. This result is in line with our and market forecasts. SSSg was 4.8%, down from 6.0% in 9M14. For 4Q14, SSSg was 1% due to the renovation of flagship stores. Online GMV rose 84% yoy to RMB7.7bn with direct sales of RMB3.5-3.6bn. Online GP margin was 6% which was below our forecast, mainly on promotions. Gome declared a final dividend of HK\$1.8 per share, a 40% dividend payout ratio (30% in FY13 excluding special dividend).

Lowering target price from HK\$1.73 to HK\$1.69 on 14.7x FY16E PE; risks

We expect Gome's strong earnings growth to come from an improvement in supply chain management and optimization of its store network. We cut our FY15/16 NP by 0.5%/2.2% to reflect lower-than-expected online B2C sales and higher-than-expected online losses and introduce our 2017 forecast. Our DCF (9.5% COE, 2% TGR) yields HK\$1.69/share (from HK\$1.73), implying 14.7x 2016E PE. Downside risks: failure to improve store profitability and narrow losses at its online business, and historical corporate governance issues.

Key changes

Price target	1.73 to 1.69	↓	-2.3%
Sales (FYE)	64,790 to 65,040	↑	0.4%
Op prof margin (FYE)	2.4 to 2.2	↓	-8.6%
Net profit (FYE)	1,353.9 to 1,346.6	↓	-0.5%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	0.0	-0.9	-15.2
HANG SENG INDEX	-1.4	5.0	14.3

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (CNYm)	56,400.7	60,359.8	65,040.0	71,754.0	79,170.9
Reported NPAT (CNYm)	892.5	1,279.8	1,346.6	1,559.9	1,808.6
DB EPS FD(CNY)	0.05	0.07	0.08	0.09	0.11
OLD DB EPS FD(CNY)	0.05	0.07	0.08	0.09	-
% Change	0.0%	2.7%	-0.5%	-2.2%	-
DB EPS growth (%)	-	31.4	13.6	15.8	15.9
PER (x)	14.3	14.7	10.7	9.3	8.0
Yield (net) (%)	4.2	2.9	3.7	4.3	5.0

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

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Model updated: 23 March 2015

Running the numbers

Asia
China
Retail / Wholesale Trade

Gome

Reuters: 0493.HK Bloomberg: 493.HK

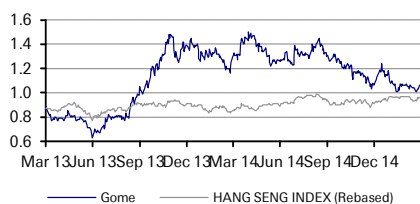
Buy

Price (23 Mar 15) HKD 1.06
Target Price HKD 1.69
52 Week range HKD 1.01 - 1.50
Market Cap (m) HKDm 17,977
USDm 2,318

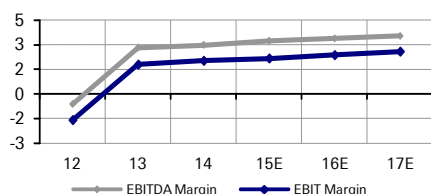
Company Profile

Gome Electrical Appliances Holdings Limited, through its subsidiaries, retails household appliances and consumer electronic products in China.

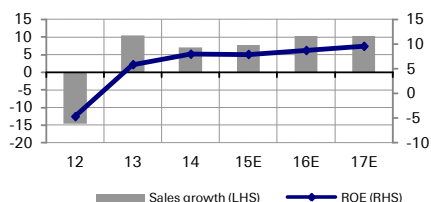
Price Performance



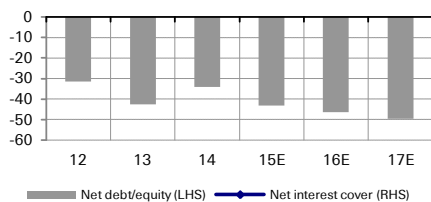
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2012	2013	2014	2015E	2016E	2017E
DB EPS (CNY)	-0.05	0.05	0.07	0.08	0.09	0.11
Reported EPS (CNY)	-0.04	0.05	0.08	0.08	0.09	0.11
DPS (CNY)	0.00	0.03	0.03	0.03	0.04	0.04
BVPS (CNY)	0.9	0.9	1.0	1.0	1.1	1.1
Weighted average shares (m)	16,875	16,829	16,924	16,959	16,959	16,959
Average market cap (CNYm)	17,057	12,719	17,358	14,397	14,397	14,397
Enterprise value (CNYm)	12,429	6,386	11,990	7,325	6,496	5,524

Valuation Metrics

P/E (DB) (x)	nm	14.3	14.7	10.7	9.3	8.0
P/E (Reported) (x)	nm	14.3	13.6	10.7	9.3	8.0
P/BV (x)	0.84	1.24	0.92	0.82	0.78	0.74
FCF Yield (%)	18.8	12.3	nm	15.2	9.8	11.4
Dividend Yield (%)	0.0	4.2	2.9	3.7	4.3	5.0
EV/Sales (x)	0.2	0.1	0.2	0.1	0.1	0.1
EV/EBITDA (x)	nm	4.0	6.6	3.5	2.7	2.0
EV/EBIT (x)	nm	6.3	9.8	5.2	3.8	2.7

Income Statement (CNYm)

Sales revenue	51,097	56,401	60,360	65,040	71,754	79,171
Gross profit	6,821	8,502	8,994	9,678	10,671	11,769
EBITDA	-318	1,591	1,803	2,105	2,425	2,797
Depreciation	494	576	579	692	720	746
Amortisation	0	0	0	0	0	0
EBIT	-812	1,015	1,224	1,413	1,705	2,050
Net interest income/(expense)	18	180	256	230	233	234
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	34	0	100	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	-759	1,195	1,580	1,643	1,937	2,284
Income tax expense	183	517	562	559	632	716
Minorities	-213	-215	-262	-262	-255	-240
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	-728	892	1,280	1,347	1,560	1,809
DB adjustments (including dilution)	-34	0	-100	3	3	3
DB Net profit	-763	892	1,180	1,350	1,563	1,812

Cash Flow (CNYm)

Cash flow from operations	4,010	2,000	-393	3,157	2,339	2,591
Net Capex	-812	-436	-626	-976	-933	-950
Free cash flow	3,199	1,564	-1,018	2,181	1,406	1,641
Equity raised/(bought back)	2	0	2	0	0	0
Dividends paid	0	-94	-718	-477	-577	-669
Net inc/(dec) in borrowings	328	244	743	0	0	0
Other investing/financing cash flows	-2,875	235	771	0	0	0
Net cash flow	654	1,948	-222	1,704	829	972
Change in working capital	4,657	555	-1,954	1,448	241	193

Balance Sheet (CNYm)

Cash and other liquid assets	7,067	9,016	8,794	10,498	11,328	12,300
Tangible fixed assets	5,298	5,044	5,018	5,302	5,515	5,719
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	7,598	7,569	7,628	7,628	7,628	7,628
Other assets	17,750	17,695	22,636	22,385	24,010	25,805
Total assets	37,713	39,324	44,077	45,813	48,481	51,452
Interest bearing debt	2,439	2,683	3,426	3,426	3,426	3,426
Other liabilities	20,604	21,765	24,851	26,042	28,028	30,154
Total liabilities	23,043	24,448	28,277	29,468	31,454	33,580
Shareholders' equity	15,064	15,486	16,671	17,479	18,415	19,500
Minorities	-395	-610	-871	-1,133	-1,389	-1,628
Total shareholders' equity	14,670	14,876	15,800	16,346	17,026	17,872
Net debt	-4,628	-6,333	-5,368	-7,072	-7,902	-8,874

Key Company Metrics

Sales growth (%)	-14.6	10.4	7.0	7.8	10.3	10.3
DB EPS growth (%)	na	na	31.4	13.6	15.8	15.9
EBITDA Margin (%)	-0.6	2.8	3.0	3.2	3.4	3.5
EBIT Margin (%)	-1.6	1.8	2.0	2.2	2.4	2.6
Payout ratio (%)	nm	59.8	39.9	40.0	40.0	40.0
ROE (%)	-4.7	5.8	8.0	7.9	8.7	9.6
Capex/sales (%)	1.6	0.8	1.0	1.5	1.3	1.2
Capex/depreciation (x)	1.6	0.8	1.1	1.4	1.3	1.3
Net debt/equity (%)	-31.5	-42.6	-34.0	-43.3	-46.4	-49.7
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates



Company update

Valuation

Lowering target price from HK\$1.73 to HK\$1.69 on 14.7x FY16 PE

We lower our FY15/16 forecast by 0.5%/2.2% and introduce our 2017 forecast. We use Deutsche Bank's China COE of 9.5% with a risk-free rate of 3.9%, an equity risk premium of 5.6% and a beta of 1.3. The terminal growth rate (TGR) is 2.0%, in line with our 2.0-2.5% sector assumption for other consumer stocks that we cover. Our DCF valuation yields HK\$1.69/share, implying 14.7x 2016E PE. Our forecasts are 4.4%/4.2% lower than market forecasts for 2015/16. For reference, Suning (002024.SZ, CNY12.97, NR) recorded a core net loss of RMB1.2bn in 2014 (excluding the gain of RMB2bn from the disposal of self-owned stores), and is expected to post a net loss of RMB370m for FY15, according to Bloomberg Finance LP.

Maintaining Buy

We expect Gome's NP growth to start to normalize after two years of strong recovery with the implementation of O2O business strategy and investment in its SAP system. That said, after JD's (JD.O, USD26.32, Hold) listing in May 2014, we believe the market has become more rational. Offline CE retailers also participate in the online market. Given the potential upside based on our target price, we maintain Buy.

Downside risks: 1) a failure to improve store profitability and narrow losses in its online business; 2) a failure to seek approval for the acquisition of Dazhong and the business of its parent company from MOFCOM; 3) further changes in management; 4) a sudden tightening in credit from banks and/or suppliers; 5) the history of corporate governance issues; and 6) the government's curbs on the property market.

Figure 1: Key changes

	Current forecast		Previous forecast		Market forecast		% change vs. previous forecast		Diff from market forecast	
	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
RMBm										
Sales	65,040	71,754	64,790	71,541	65,981	72,143	0%	0%	-1%	-1%
EBIT	1,413	1,705	1,541	1,802	1,552	1,903	-8%	-5%	-9%	-10%
Net profit	1,347	1,560	1,354	1,594	1,408	1,629	-1%	-2%	-4%	-4%

Source: Deutsche Bank estimates, Bloomberg Finance LP, company data

Outlook FY15

Reiterating build of another Gome plan

Gome reiterated its strategy of building another Gome by 2017, doubling sales revenue and maintaining GP margin (17.5-18.5%) and opex ratio. For 2015, it guided for a 3% SSSg, RMB1bn capex for logistics and IT investment. Management believes the robust growth of the e-commerce business in China has finished, and there will be a new normalized growth for the 1P (B2C) business. In addition, e-commerce could not fully replace physical stores as they offer different products and services.



Upgrade to total retail strategy from omni-channel strategy

During the conference call for the FY14 results, management released a new strategy, i.e., a total retail strategy. This is an upgrade of its omni-channel strategy, aiming to offer consumers a seamless total retail experience in on/offline channels. Consumers can move freely between any of the shopping access points including the online, offline, mobile terminal, micro shop and joint operation stores. Gome targets to build a total retail community covering 130m members, 120,000 suppliers, 10,000 merchants and 100,000 employees (including non-listed).

Major drivers for its total retail platform.

- **Mobile micro shop.** It encourages each of its staff to build one micro shop. It has 100,000 members of staff thus it aims to build 100,000 micro shops by 2015. It aims to double the number of registered members (fan base) to 250m by 2017 from 130m in 2014. It expects to create a superb consumer experience and promote product information and interactive sharing through social media, creating a fans' economy.
- **Smart stores.** It has renovated 100 flagship stores in 2014, equipping them with WIFI coverage, multiple payment methods, and open display facilities. It aims to increase footfall at the smart stores by 20% yoy in 2015.
- **Tier-two market.** It plans to enter 100 new cities in the tier-two market in three years. It will add 80-100 new stores each year for the next three years.
- **Gome online.** It plans to accelerate the integration of the on/offline supply chain, develop 1P home appliances business and 3P non-appliances categories. Online GMV is set to grow at a CAGR of 100%+ in the next three years. The number of mobile users should increase at a CAGR of 100%+ for the next three years.

FY14 review

Results in line with our and market forecasts

Gome announced FY14 results on 23 March at noon. Net profit rose 43% yoy to RMB1,280m on the back of 7% growth in sales revenue to RMB60bn. This result is in line with our and market forecast. It declared a final dividend of HK\$1.8 per share, a 40% dividend payout ratio (30% in FY13 excluding special dividend).

Results met profit alert

Net profit has met its preliminary review in its profit alert announced on 22 January. To recap, it expected net profit to increase by about 40% yoy (43% in actuality), with a net margin in exceeds of 2% (2.1% in actuality).

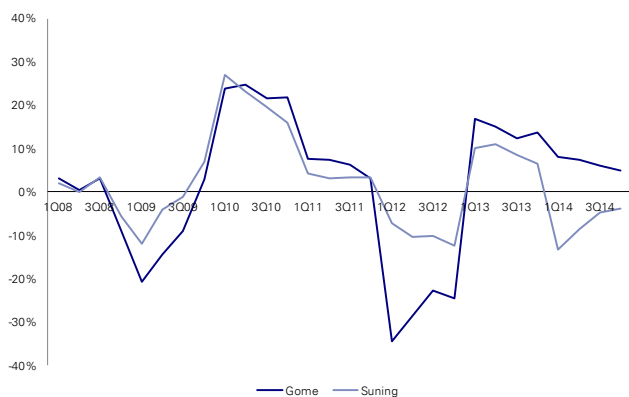
Key highlights

- **Online** GMV rose 84% yoy to RMB7.7bn. direct sales were RMB3.5-3.6bn. The online loss for the list-co was RMB350. The online GP margin was 6%.
- **SSSg** was 4.8%, down from 6.0% in 9M14. It was 3.8%/9.3% in the first/second tier market. For 4Q14, it was c.1% due to the renovation of flagship stores.



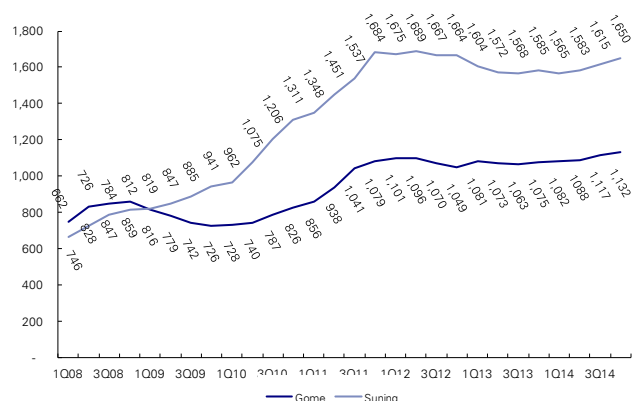
- **Joint operation store** sales rose 67% qoq to RMB309m. It had 154 the joint operation stores as of end-2014.
- **Store network:** it opened 145 stores including 78 stores (46 in FY13) in the second-tier market. It has net added 57 stores, bringing the total number of stores to 1,132 as of end-FY14.
- **Core total GP margin** was flat at 18.32% in FY14, excluding the one-off compensation (RMB100m) received from the controlling shareholder. The differentiated products proportion increased to 33% of total sales from 30% in FY13.
- **Opex** ratio decreased by 0.3 ppts to 16.3%, mainly due to tightening control over rental expenses and staff costs. In 4Q14, it was 16.8% (16.1% in 9M14) mainly due to the expenditure on store renovations.
- **EBIT** increased by 21% yoy to RMB1.2bn. The EBIT margin improved 0.2 ppts to 2.0%.
- **Inventory** turnover increased by seven days to 68 days, which is within the historical range of 30-70 days.
- **ETR** for the offline business was consistently at 23-24% during 2013-2014.
- **Capex** increased 45% yoy to RMB630m. Capex was mainly for opening new stores, remodeling stores and purchasing hardware equipment relating to the ERP project.
- **Share repurchase.** It repurchased 74.5m shares during April-May 2014 at a consideration of HK\$102m. The repurchased shares have been cancelled.
- **Operating cash flow** was RMB861m, a decrease from RMB2.1bn in 2013, mainly due to the increase in advances to suppliers to secure more quality products as at the end of 2014.

Figure 2: SSSg ytd comparison (Gome vs. Suning)



Source: Deutsche Bank, company data

Figure 3: Store number comparison (Gome vs. Suning)



Source: Deutsche Bank, company data
Note: Gome list-co only



Figure 4: Gome online/offline assumptions

YE 31 Dec RMBm	2015E			2016E			2017E		
	Total	Offline	Online	Total	Offline	Online	Total	Offline	Online
Sales	65,040	60,840	4,200	71,754	66,924	4,830	79,171	73,616	5,555
Consolidated gross profit	11,889	11,620	269	13,111	12,782	328	14,461	14,061	400
SG&A	(10,476)	(9,552)	(924)	(11,406)	(10,440)	(966)	(12,410)	(11,411)	(1,000)
EBIT	1,413	2,069	(655)	1,705	2,342	(638)	2,050	2,650	(600)
Common size									
Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
consolidated GP margin	18.3%	19.1%	6.4%	18.3%	19.1%	6.8%	18.3%	19.1%	7.2%
SG&A as a % of sales	-16.1%	-15.7%	-22.0%	-15.9%	-15.6%	-20.0%	-15.7%	-15.5%	-18.0%
EBIT margin	2.2%	3.4%	-15.6%	2.4%	3.5%	-13.2%	2.6%	3.6%	-10.8%

Source: Deutsche Bank estimates, company data



Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Gome	0493.HK	1.06 (HKD) 23 Mar 15	NA

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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Historical recommendations and target price: Gome (0493.HK)

(as of 3/23/2015)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

1. 26/03/2013:	Hold, Target Price Change HKD0.85	5. 18/11/2013:	Buy, Target Price Change HKD1.70
2. 03/06/2013:	Hold, Target Price Change HKD0.93	6. 23/03/2014:	Buy, Target Price Change HKD1.94
3. 09/09/2013:	Upgrade to Buy, Target Price Change HKD1.15	7. 25/08/2014:	Buy, Target Price Change HKD1.93
4. 21/10/2013:	Buy, Target Price Change HKD1.32	8. 04/02/2015:	Buy, Target Price Change HKD1.73



Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.

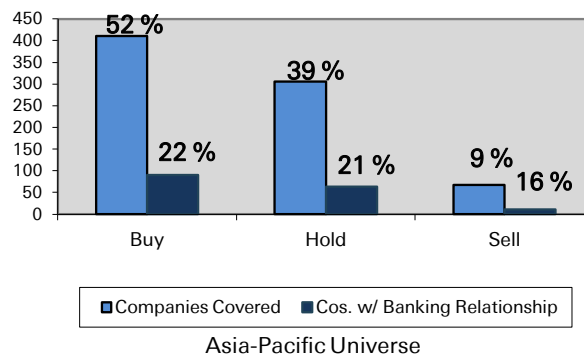
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Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships





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David Folkerts-Landau
Group Chief Economist
Member of the Group Executive Committee

Raj Hindocha
Global Chief Operating Officer
Research

Marcel Cassard
Global Head
FICC Research & Global Macro Economics

Richard Smith and Steve Pollard
Co-Global Heads
Equity Research

Michael Spencer
Regional Head
Asia Pacific Research

Ralf Hoffmann
Regional Head
Deutsche Bank Research, Germany

Andreas Neubauer
Regional Head
Equity Research, Germany

Steve Pollard
Regional Head
Americas Research

International locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500

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