Gome Electrical Appliances

Rating **BUY**

Initiation: Traditional Retailer, but Not Traditional Story

Some investors have pessimistic outlook for traditional retailers facing threat of aggressive e-commerce retailers. However, we prefer to look at retailers from whether they have core strength to compete with its peers, rather than whether they are "E-commerce" or "Brick and Mock stores". We believe Gome has built up its good moat in home electronica appliance sector, and expect it to deliver strong growth from near term to long term. Initiate with BUY and PT of HK$1.83.

We believe Gome has built up its strength in electronica appliance retailing, as one of the most efficient channel between manufacture and consumers – the core competency of retailers in our view. This is helped by Gome's strength in 1) solid relationship with supplier with large sales scale; 2) lower logistic cost with sophisticated supply chain and 3) good knowledge of consumers demands in domestic market. We appreciate Gome's initiates to maintain growth among tough macro environment. We expect such initiates to enhance its core competency and drive earnings growth from near term to long term. **Key recent initiates include**:

1) **Store optimization to drive strong earnings growth in the near-term**. Gome has been streamlining its stores portfolio since 2012 by closing down unprofitable stores and open new stores in better locations. We expect the store optimization to drive 20bps YoY consolidated GP margin expansion and 5.5% SSSG in 2014.
2) **Online/offline integration to contribute good profit for e-commerce platform in the mid-term**. We are much more optimistic than the consensus view on Gome's e-commerce strategy. We expect its e-commerce platform to contribute meaningful profit in 2015, helped by the company's efforts in integrating online and offline in past 2 years.
3) **Enhanced merchandising skills to drive sustainable growth in the long-term**. With Gome's stronger merchandising skills in home electronica appliance, we expected Gome to improve its product mix, penetrate into other retail forms, and expand margins in the long-term. We expect 9.7% sales CAGR and 21.3% earnings CAGR in 2013-18.

Valuation is attractive: Gome is currently trading at 11.9x FY15 P/E, compared to its historical average at 14.0x P/E. The stock is trading at 0.26x FY15 P/S , which looks attractive compared Suning's 4.3x FY15 P/S and JD.com's 1.4x FY15 P/S. **We recommend BUY rating on the stock.** Potential price catalyst could be better than expected 1H14 results.

We derive our price target of HK$1.83 from our discounted cash flow model. We assume a discount rate of 11.5% and a terminal growth rate at 2.0%. Our target price implies a target P/E of 16.0x for FY15F.

Key risk: 1) 1. Significantly decline in property transactions; 2) irrational price competition from e-commerce retailers; and 3) management instability.

Valuation Statistics

YE 31 Dec	Turnover HK$ mn	Net profit HK$ mn	EPS YoY %	PER X	EV/EBITDA X	Yield %	ROE %	Net debt/equity (Net cash/equity) %
2012	51,097	(728)	(140)	(24.6)	(30.3)	0.0	(4.8)	(30)
2013	56,401	892	na	20.1	7.2	3.0	5.6	(39)
2014	63,131	1,258	41	14.3	5.6	1.4	7.6	(35)
2015	69,633	1,508	20	11.9	4.8	1.7	8.4	(39)
2016	77,343	1,802	19	10.0	4.3	2.0	9.3	(43)

Source: Company report, ICBCI estimates

31 July 2014

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Sector **China Consumer**

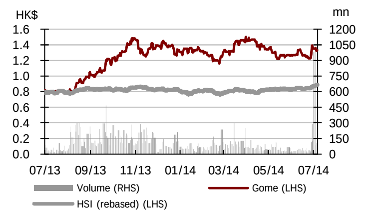
Key Data

Ticker	**493.HK**
Price (30 Jul)	**HK$1.33**
Target Price	**HK$1.83**
Upside	**37.6%**
52W High	HK$1.50
52W Low	HK$0.62
Mkt. Cap. (HK$mn)	23,790
Mkt. Cap. (US$mn)	3,069
Total Issued Share (mn)	16,875
Avg. 3mths t/o (HK$mn)	203

Shareholdings Structure

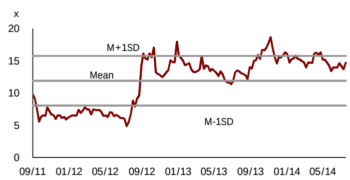
Shinning Crown	29.96%
Bain Capital	9.87%
Huang & Du	5.14%
Carmignac Gestion	5.03%
Free float	53.0%

Price performance



Performance %	1m	3m	6m
493.HK	4.7	(8.9)	0.0
HSI	6.6	11.7	12.2

Next year forward PER



Source: HKEx, Bloomberg, Company data

Financial Statements

Exhibit 1: Income Statement

YE 31 Dec (Rmb mn)	2013	2014E	2015E	2016E
Revenue	**56,401**	**63,131**	**69,633**	**77,343**
Cost of Goods Sold	(47,899)	(53,338)	(58,619)	(64,968)
Gross Profit	8,502	9,793	11,015	12,375
Other income from supplier	1,852	1,944	2,086	2,235
Consolidated Gross Profit	**10,354**	**11,737**	**13,101**	**14,610**
Selling expense	(7,163)	(7,770)	(8,667)	(9,698)
G&A	(1,579)	(1,705)	(1,880)	(2,011)
Other expenses	(597)	(821)	(850)	(1,005)
Operating Income	**1,015**	**1,441**	**1,704**	**1,896**
Net Interest Income	180	137	257	425
Non-operating income	-	-	-	-
Income Before Tax	1,195	1,578	1,960	2,321
Provision for Income Tax	(517)	(395)	(490)	(580)
Income Before Minority Interest	**677**	**1,184**	**1,470**	**1,741**
Minority Interest	215	74	38	61
Net Income	892	1,258	1,508	1,802

Source: Company report, ICBCI estimates

Exhibit 2: Balance Sheet

YE 31 Dec (Rmb mn)	2013	2014E	2015E	2016E
Current Assets				
Cash	9,016	9,370	10,652	12,359
Trade receivables	245	275	303	337
Prepayment and other receivable	2,333	2,882	3,004	3,153
Inventories	8,221	9,174	9,965	11,045
Other current asets	6,530	5,452	5,394	5,380
Total Current Assets	**26,345**	**27,152**	**29,318**	**32,274**
Non-current Assets				
PPE	4,095	5,100	5,504	5,493
Intangible Assets	7,434	7,411	7,387	7,364
Investment Properties	949	996	1,046	1,098
L-T Deposits and Prepayment	450	553	584	611
Deferred Tax Asset	51	53	56	59
Other investment	-	-	-	-
Total Non-current Assets	**12,978**	**14,113**	**14,578**	**14,624**
Total Assets	**39,324**	**41,265**	**43,896**	**46,898**
Current Liabilities				
Trade Payables/Bills Payables	18,077	19,735	19,520	19,471
Other Payabales	2,047	800	2,169	3,510
S-T loan	2,683	3,400	3,570	3,749
Tax Liabilities	563	619	681	749
Amoun Due to Related Parties	464	581	621	662
Total current liabilities	**23,834**	**25,135**	**26,560**	**28,139**
Non-current Liabilities				
Convertible bonds	-	-	-	-
Other Long Term Liabilities	172	181	190	199
Total non-current Liabilities	**172**	**181**	**190**	**199**
Total Liabilities	**24,007**	**25,316**	**26,750**	**28,339**
Minority Interest	**(610)**	**(684)**	**(722)**	**(782)**
Stockholders' Equity				
Common stock (includes par value, capital surplus, and treasury)	10,626	10,626	10,626	10,626
Retained earnings	4,859	5,866	7,072	8,513
Other common equity	441	141	169	202
Total Stockholders' Equity	**15,927**	**16,633**	**17,868**	**19,342**
Total Liabilities & Stockholders' Equity	**39,324**	**41,265**	**43,896**	**46,898**

Source: Company report, ICBCI estimates

Exhibit 3: Cash Flow

YE 31 Dec (Rmb mn)	2013	2014E	2015E	2016E
Operating Cash Flow				
Profit before tax	1,195	1,578	1,960	2,321
Add: D&A	576	603	706	776
Less: Finance income	(241)	(270)	(403)	(565)
Less: Working capital changes	555	(23)	282	62
Less: PRC income tax paid	(326)	(332)	(422)	(506)
Other changes	236	134	146	139
Subtotal	**1,995**	**1,689**	**2,270**	**2,229**
Investing Cash Flow				
Purchase of PPE	(436)	(1,585)	(1,087)	(741)
Proceeds from disposal of PP&E	108	-	-	-
Other investments	-	219	349	508
Subtotal	**(328)**	**(1,366)**	**(738)**	**(233)**
Financing Cash Flow				
Dividends	-	(552)	(274)	(327)
New loans	2,730	717	170	179
Repayment of bank loans	(2,408)	-	-	-
Other changes	(27)	(134)	(146)	(139)
Subtotal	**294**	**31**	**(250)**	**(288)**
Effect of FX rate changes, net	(13)	-	-	-
Cash & equivalent at year beginning	**7,067**	**9,016**	**9,370**	**10,652**
Net increase / (decrease) in cash & equivalent	1,948	354	1,282	1,707
Cash & equivalent at year end	**9,016**	**9,370**	**10,652**	**12,359**

Source: Company report, ICBCI estimates

Exhibit 4: Ratio Analysis

YE 31 Dec	2013	2014E	2015E	2016E
YoY Growth				
Sales	10.4%	11.9%	10.3%	11.1%
EBIT	-216.2%	42.1%	18.2%	11.3%
Net income	-222.5%	40.9%	19.9%	19.4%
Margins				
Gross margin	18.4%	18.6%	18.8%	18.9%
SG&A/Sales	15.5%	15.0%	15.1%	15.1%
EBIT margin	1.8%	2.3%	2.4%	2.5%
EBITDA margin	2.8%	3.2%	3.5%	3.5%
Net margin	1.6%	2.0%	2.2%	2.3%
Return				
ROA	2.3%	3.0%	3.4%	3.8%
ROE	5.6%	7.6%	8.4%	9.3%
Gearing				
Total liabilities/equity	151%	152%	150%	147%
Net debt/equity (Net cash/equity)	-39%	-35%	-39%	-43%
Asset/equity	247%	248%	246%	242%
Valuation (x)				
P/E	20.1	14.3	11.9	10.0
P/BV	1.1	1.1	1.1	0.9
EV/EBITDA	7.2	5.6	4.8	4.3
Dividend yield (%)	3.0%	1.4%	1.7%	2.0%
Efficiency				
Asset turnover (x)	1.4	1.5	1.6	1.6
Inventory days	61.0	59.5	59.6	59.0
Receivable days	1.6	1.6	1.6	1.6
Payable days	151.9	139.1	131.5	125.5
Others				
Effective tax rate	43%	25%	25%	25%
Payout ratio	60%	20%	20%	20%

Source: Company report, ICBCI estimates

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What We Different from Market

Market generally shares a pessimistic outlook for traditional retailers, while at the same time is extremely passionate for e-commerce names. Some investors insist e-commerce names should enjoy a premium valuation, while traditional retailer should subject to a valuation discount, regardless of profitability or company competency.

However, we prefer to look at retailers from their core competency, instead of from whether they are labeled with “E-commerce” or “Brick and Mock”. Based on our analysis in retailers’ core competency, we try to determine whether they have long-term growth potential. We believe the core competition factor for online retailer is NOT different from offline retailers – to become the most efficient channel between manufactures and consumers. Therefore, we like companies that have such competency, no matter whether it is doing business online or offline.

We believe Gome have the core strength to stand out in home electronic appliance retailing. Through passing two years’ various restructure, Gome has built up its good moat in home electronica appliance sector and become one of the most efficient channel between manufacturer and retailer. Specifically, we think Gome has strength in 1) lower procurement cost with large scale of sales; 2) lower logistic cost with sophisticated supply chain and 3) better understanding of consumer demands with 20+ years in domestic market.

In this report, we analyzed Gome’s growth potential in the horizon of near-term, mid-term and long-term. We expect 9.7% sales and 21.3% earnings CAGR in 2013-18E. This is helped by its store optimization, integration between online and offline channel, and product mix upgrades.

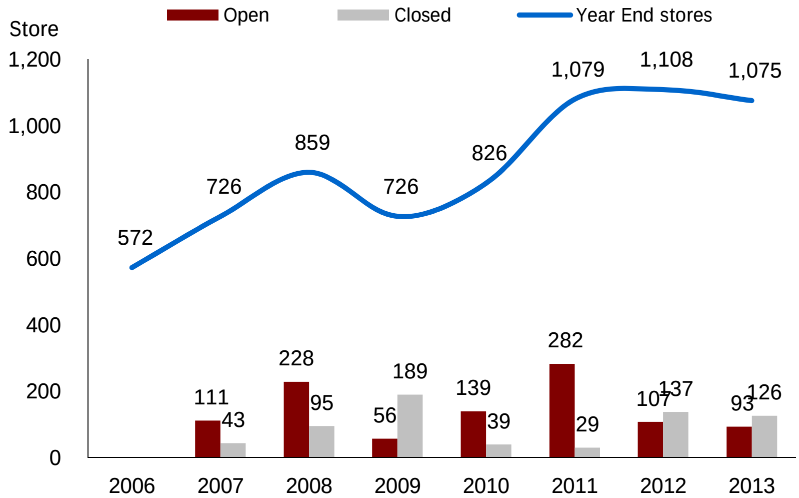
We derive our price target of HK$1.83 from our discounted cash flow (DCF) model. We use DCF model because it incorporates our view of the company’s long-term sustainable growth and the potential earnings risks. We forecast sales CAGR at 9.7% and earnings CAGR at 21.3% during FY13-18. We assume a discount rate of 11.5% and a terminal growth rate at 2.0%. Our target price implies a target P/E of 16.0x for FY15F. **Initiate with BUY**.

Near-term: Stores Optimization to Drive Earnings

Summary: Gome has been streamlining its stores portfolio since 2012. Key actions include closing down unprofitable stores, reduce low-productive store area, and open new stores in better locations**.** We expect the store optimization to drive good margin expansion and earnings growth in 2014.

Pressured by weak industry demand, the portion of unprofitable stores increased significantly in 1H12. As a result, Gome began to optimize its stores by closing down unprofitable stores and reduce unprofitable area since 2H12. **Between 2012 to 2013, the company closed down 263 stores, representing 24% of total stores as of Jan-2012 (Exhibit 5)**. This is the first time in history that the company has two consecutive years of store numbers net decline.

Exhibit 5: Gome closed down 263 stores in 2012-13



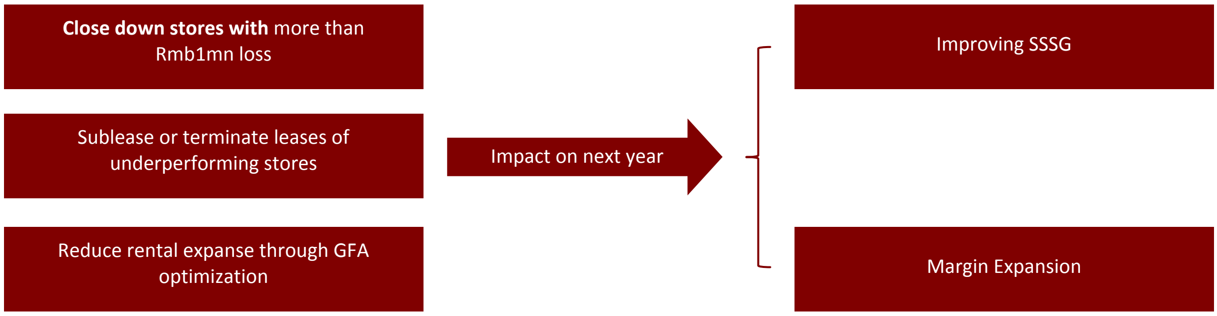
Source: Company, ICBCI Research

We believe store optimization is a good move to improve store productivity in the tough environment. The stores closed down were mainly unprofitable stores or redundant stores (which are closed to other Gome stores). In addition, the company opened 200 stores in better locations. Through this, the company could reduce its total labor and rental cost, while the demand of closed stores could be mostly transferred to other existing or new stores.

We expect positive financial impact to continue in 2014. The benefit from store optimization (Exhibit 6) often emerges on next year after such action was taken, because stores that were retained are more profitable stores, and comparing base become much easier in the next year. The financial benefits come in the form of better SSSG and improving margins.

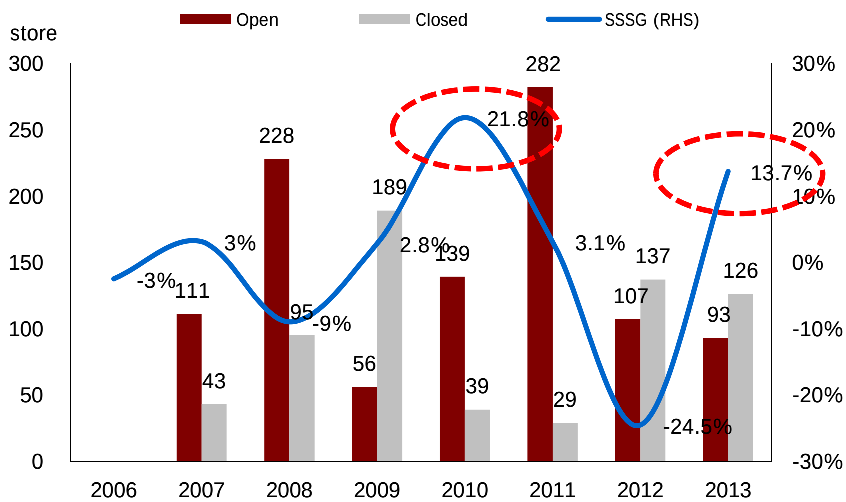
For example, following store optimization in 2009, Gome achieve a SSSG at 21.8% and expand consolidated GP margin by 90bps to 18.0% in 2010. Further, following store optimization in 2012, Gome achieve a SSSG at 13.7% and expand GP margin by 190bps to 18.4% in 2013 (Exhibit 7 & Exhibit 8).

Exhibit 6: Store optimization improves SSSG and expands margin in the next year



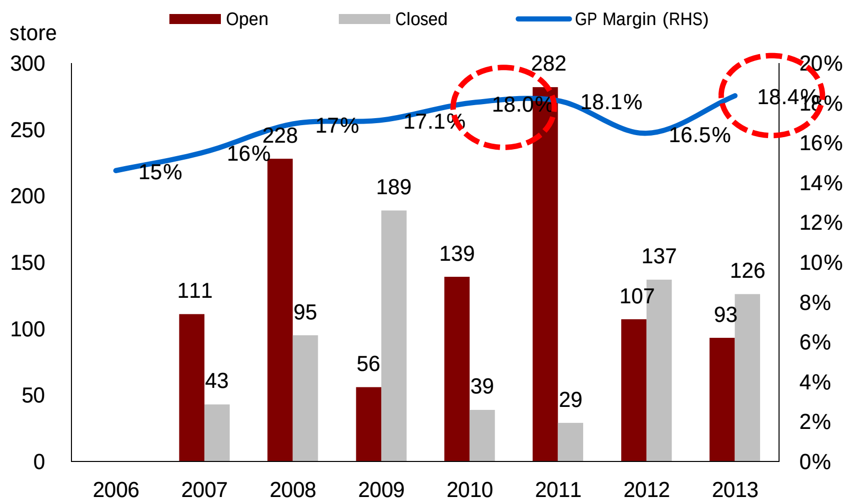
Source: Company report, ICBC Research.

Exhibit 7: SSSG improved on the next year of store optimization



Source: Company report, ICBC Research.

Exhibit 8: Margin improved on the next year of store optimization

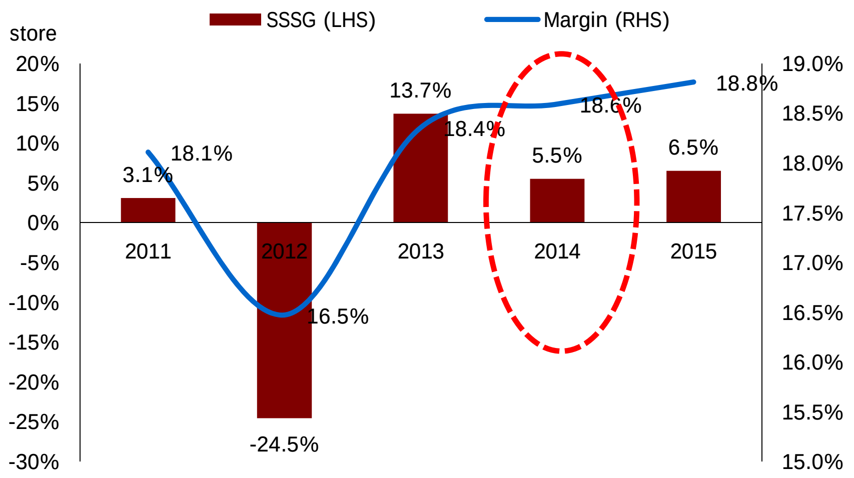


Source: Company report, ICBC Research.

We forecast financial in 2014 continues to benefit from store optimization

As Gome continued to conduct store optimization program in 2013, we expect positive financial impact continues into 2014. Furthermore, store number will return to growing track in 2014, which should drive more growth on top of SSSG. We forecast 5.5% SSSG, 50 net increase in store number and consolidated GP margin to expand by 200bps in 2014 (Exhibit 9).

Exhibit 9: 2014 SSSG and Margin expectation



Source: Company report, ICBC Research.

Mid -term: E-commerce platform to contribute good profit

Summary: Some investors argue that Gome has been left behind among e-commerce competitions. With much less traffic for Gome compared to other player such as JD.com and suning.com, Gome's e-commerce platform is not likely to thrive in future. **However, we are much more optimistic than consensus. We expect its e-commerce platform to contribute meaningful profit in 2015**, helped by the company's efforts in integrating online and offline in recent years.

Core competition strength of E-commerce is indifferent from offline stores

Market has generally regarded "scale" to be the core competency of e-commerce retailer, and think the retailers could easily achieve breakeven once they reached certain scale. Therefore, some investors regard Gomer's e-commerce is not likely to thrive with current's small scale.

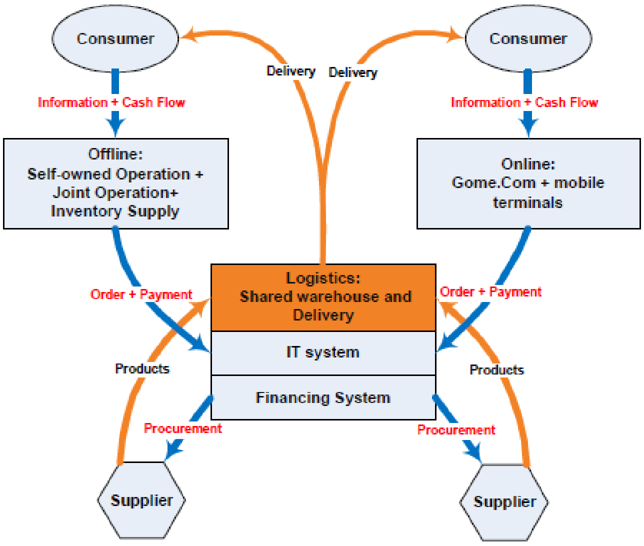
Different from market, we believe scale is not the core competency for e-commerce retailers, because scale can be easily achieved with investment such as sponsor search and price competition. What is worse, some e-commerce retailers (such as JD.com) are still struggling below water even when they achieve very large scales. Such reality has called market's belief in scale into questions. **Instead, we believe the core competition of e-commerce is not different from offline retailers – to become the most efficient channel between manufacturer and retailers**.

Therefore, retailers should reduce every unnecessary cost in the channel while bring highest satisfaction for consumers. Specifically for online retailers, they should 1) reduce procuring cost through increasing scale, 2) reduce logistic cost through high efficient delivery channel and 3) select the right products for consumers through understanding of consumers demands. Gome's stores have accumulated such strength in 20+ years of operation. Through integrated with offline stores, Gome's e-commerce platform is building up these core competency, in our view.

Gome is integrating its online platform with offline stores

Gome has been integrating the operation of online platform with offline stores since 2012 (Exhibit 10). This include 1) integration of supply chain – e-commerce platform can share the same supply channel of offline stores; 2) integration of logistic – e-commerce platform can share the same B2C logistic with offline stores; 3) integration of after-sales service – the e-commerce consumers could enjoy same after sales service as offline stores' consumers.

Exhibit 10: Gome is integrating its online and offline operation.



Source: Company report, ICBCI Research.

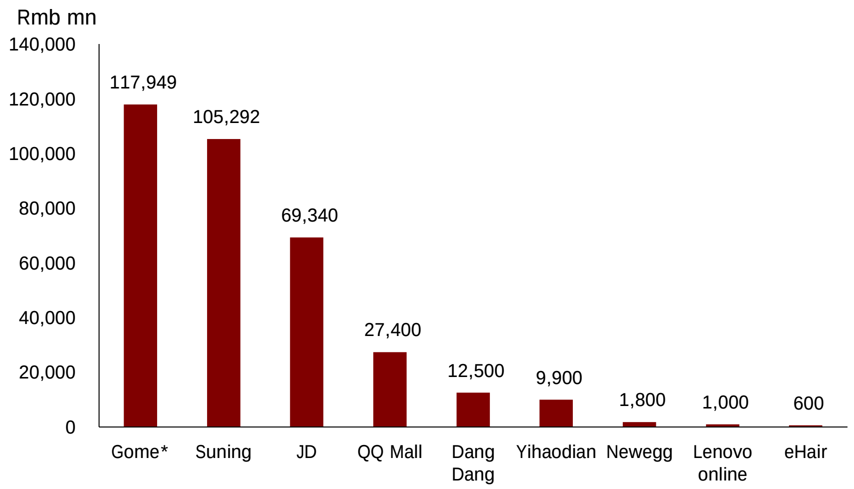
We expect the whole integration to be completed in 2015. Gome has completed integration of store network procurement and logistics in 2013, and target to complete the integration of after-sales and membership in 2014-15. We expect all the integration structure could be built up in early 2015.

We expect Gome's E-commerce platform to scale up post integration

We expect Gome's E-commerce platform to scale up in 2015, as Gome's e-commerce platform will be more efficient than most peers post integration, including in procurement cost and delivery cost, and has a higher consumer satisfaction. We expect www.gome.com.cn to grow up to be one of the best online home electronica appliance retailers in China.

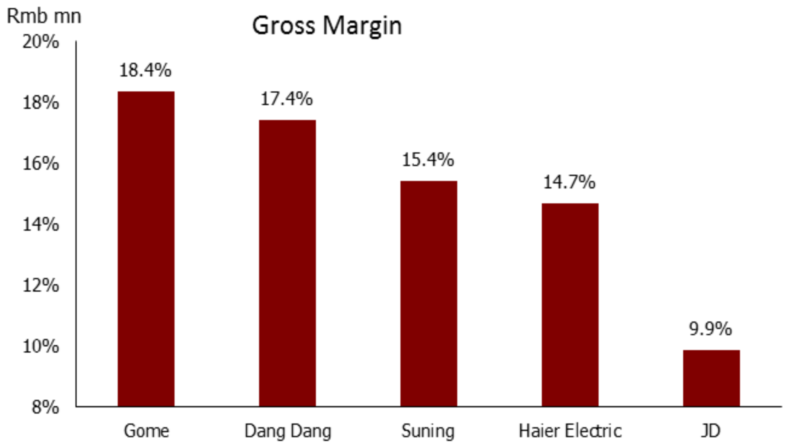
Firstly, Gome's E-commerce platform has cost advantage on products procurement. After integrating with offline stores, its online platform is able to procure merchandise together with offline stores. Gome group (including unlisted stores) have a total sales of Rmb118bn in 2013, compared to Rmb105bn for Suning and Rmb69.3bn for JD.com (Exhibit 11). The large scale procurement offers Gome a stronger bargaining power over suppliers, contributing a higher gross margins, in our view. Among major home appliance electrical retailers, Gome has higher consolidated gross margins at 18.4%, compared to 15.4% for Suning and 9.9% for JD.com in 2013 (Exhibit 12).

Exhibit 11: Gome has largest sales scale among major home appliance sellers



Gome includes sales from both listed and unlisted stores. Source: iResearch, company report, ICBCI Research.

Exhibit 12: Gome has highest gross margin compared to its peers



Gome includes sales from both listed and unlisted stores. Source: iResearch, company report, ICBCI Research.

Secondly, Gome's E-commerce platform is more efficient in order fulfillment. Different from other hypermarket or department stores, Gome has good experiences in delivering large items products (like TV, air conditioners). After integration of online and offline operation, Gome Group's 1,588 stores (including stores in the group but not in the lisco) could become a solid support for order fulfillment, and therefore make e-commerce platform to be more efficient. For example, Gome's delivery cost/sales is at 0.7% in 2013, which is also much lower than that of Suning's at 1.1% according to company reports. Furthermore, Gome's store fulfillment cost (rental and delivery)/ sales is 6.0% in 2013, actually even slightly lower than JD.com's at 6.1%.

Exhibit 13: Gome's ecommerce platform could leverage its offline stores' logistic advantages

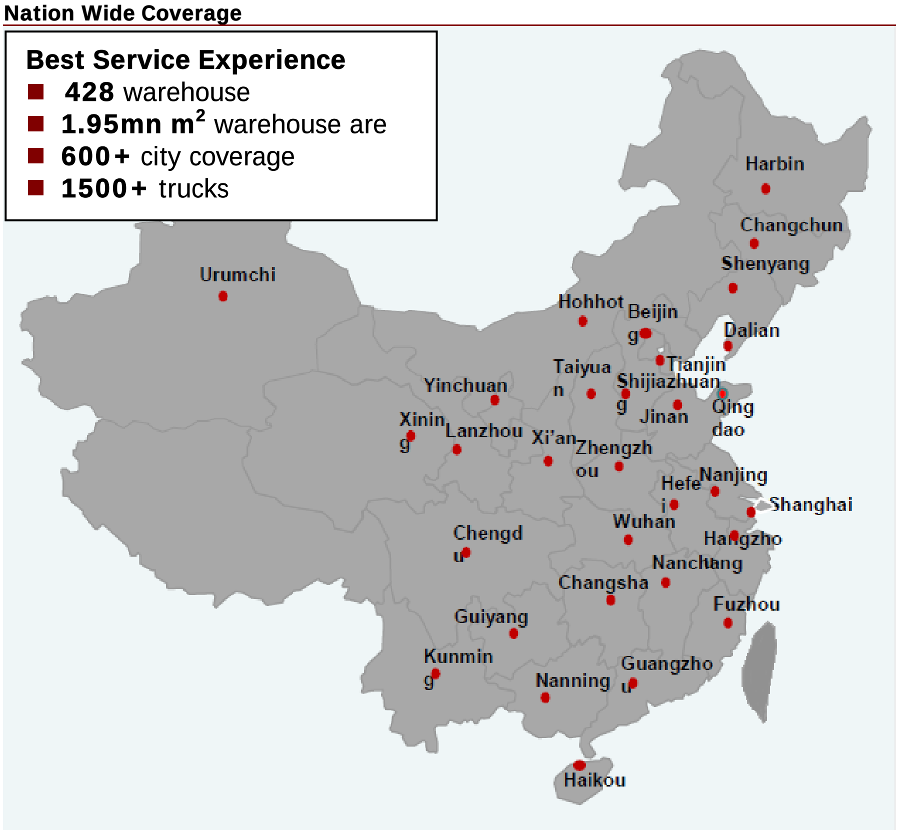
Source: Company report, ICBCI Research.

Thirdly, Gome's E-commerce platform could provide better consumer services. Different from other pure E-commerce players, consumers could visit Gome's offline stores, then put orders from online platform, and enjoy the same after-sales service as offline shoppers (Exhibit 13). We believe this will help Gome to gain online traffic and market share among the tough competition.

In this regards, we estimate a sales CAGR of 45% for Gome's online platform in 2013-15E, helped by its integration between online and offline stores. Further, we expect the E-commerce to achieve breakeven in 2015 and forecast net profit to be Rmb298mn in 2017, accounting for 14.5% of company's total profit.

Exhibit 14: Gome has vast scale of store network.

Nation Wide Coverage



Source: Company report, ICBCI Research

Long-term: Leading Merchandising Skills to Drive Sustainable Earnings Growth

Conclusion: Some investors think Gome's business as traditional retailer is of sunset industry. However, we believe its long term growth remain intact. With its leading merchandising skills, Gome is able to improve its product mix and penetrate into other retail format. We expect 9.7% 5 year sales CAGR and 21.3% earnings CAGR in 2013-18.

The Moat of Home Electrical Retailing

Merchandising skill for retailers refers to knowledge on "how to become the most efficient channel between manufactures and consumers", which is the core competency for retailers. **We believe Gome has leading merchandising skills**. This is supported by its solid relationship with suppliers (large-scale procurement), sophisticated supply chain (as illustrated in previous section), and understandings of consumer demands (>20 years store operation).

We believe Gome's leading merchandising skill is the foundation for its initiates in past two years, including store optimization and online/offline integration. This has formed a deep moat for Gome in home appliance electronica retailing sector. **We expect Gome's leading merchandising skills to be foundation of future initiates, driving sustainable earnings growth in the long term.** Particularly, we forecast Gome to move up its product mix and penetrate into other retail formats in next three years.

Mix-upgrade to drive Gome's margin improvement

Gome categorize its products into Regular Products (which also sells in other retailers) and Differentiated Products (which only sales in Gome). Regular products have an average margin of 15-17%, while GP margin of some Differentiated Products could be as high as 23-27% (Exhibit 15). Gome's Differentiated Products covers more than 100 brands, 2000 SKUs, and accounted for 30% of total sales in 2013.

Gome targeted to improve the portion of Differentiated Products in total sales to 50% in 2017. We expect its strength in merchandising skills to contribute to this target. On the one hand, Gome has good relationship with suppliers, therefore it has enough bargaining power to procure exclusively differentiated products; on the other hand, Gome has good understanding in consumer's preference, and therefore have low risk in missing sales targets for certain category.

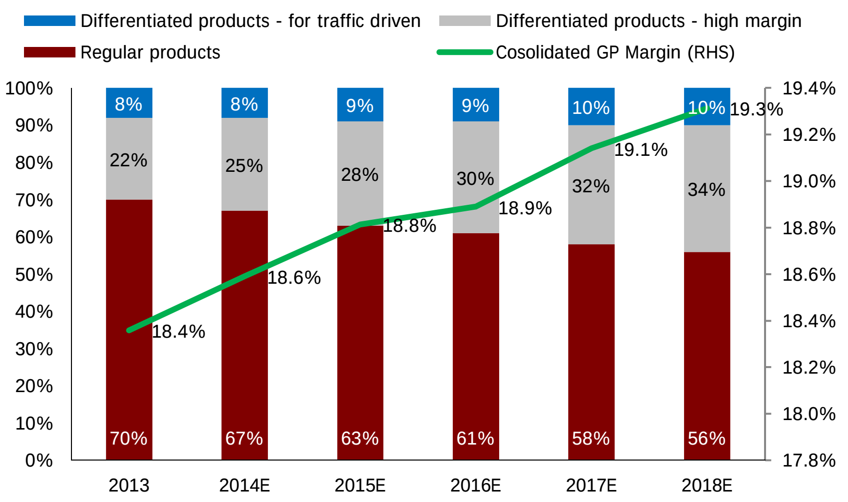
Exhibit 15: The three category of regular products

2013	GP Margin	Sales portion
Regular products	16.8%	70.0%
Differentiated products - high margin	26.0%	22.0%
Differentiated products - for traffic driven	10.0%	8.0%

Source: company report, ICBCI Research.

The Differentiated Products included high margin products and low margin products (for the purpose of driving traffic). We expect the high margin portion to increase from 22% in 2013 to 34% in 2018. In this regard, we forecast the GP margin to expand 90bps from 18.4% in 2013 to 19.3% in 2018 (Exhibit 16).

Exhibit 16: Mix upgrade to drive margin expansion



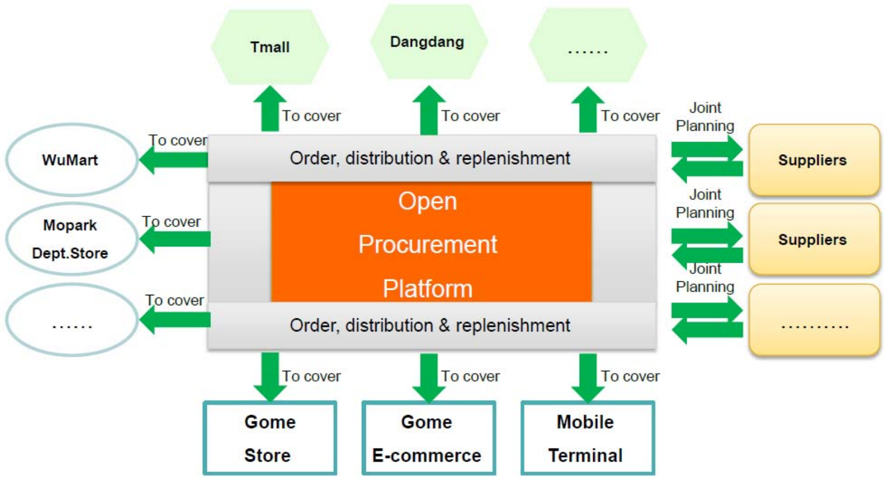
Source: company report, ICBCI Research. E=ICBCI Research estimates

Expanding to home electrical sector of other retailers

Since 2013, Gome began to penetrate into retailing formats (Exhibit 17). It has signed strategic contracts with some large hypermarkets and department operators, such as Wumart, Zhejiang Lianhua, and Mopark. According to cooperation contracts, Gome will directly operate the electrical sector for hypermarkets/department stores, and pay concession fee to the store owners.

We regard this is another good innovation to leverage its leading merchandising skill. As Gome has better bargaining power in products procurement (with large scale), is more efficient in logistic (with sophistical logistical facilities) and better understanding of consumer demands, it could be more efficient than hypermarket operator to run the electronic sector. Therefore good synergy could be expected in such cooperation.

Exhibit 17: Gome is penetrating into other retail formats



Source: company report, ICBCI Research.

We forecast the sales contribution from other retailers to increase from Rmb1.5bn in 2014E to Rmb9.1bn in 2018E, accounting for 10% of total revenue of the whole company in 2018. We expect the earnings contribution from other retailers to achieve 8% in 2018.

Investment Risks

We expect low risk for Gome's long-term growth, considering its solid strength in merchandising skills. The investment risks are mainly associated with completion and execution level in the near-term. Three major risks for our call as below:

1. **Significantly decline in property market**. Home electric appliance consumption is highly related with property markets, as consumer tend to buy new appliance while moving into new houses. The demand from new house installation could accounted for 50% of total electrical appliance consumption, according to our chat with store managers. If there is a significant decline in property transactions, there are risks that Gome could be impacted in the near-term.

2. **Price competition from e-commerce retailers**. Pure e-commerce retailers often have different business strategies compared to offline retailers. E-commerce retailers often focus on scale rather than profitability, while offline retailers will consider profitability before expanding store network to new regions. There are potential risks that e-commerce players launch another price competition to gain market share, which should pressure on offline retailers' sales growth.

3. **Management stability**. Gome has been criticized by capital market on its instable company strategy in passing few years. We think this is mainly due to its various management changes during the period. We appreciate the recent company strategy initiated by management in pass 2 years. However, if there is any change in top management, there is risk on whether such initiations could be well executed.

Valuation

We derive our price target of HK$1.83 from our discounted cash flow (DCF) model (Exhibit 18). We use DCF model because it incorporates our view of the company's long-term sustainable growth and the potential earnings risks. We forecast sales CAGR at 9.7% and earnings CAGR at 21.3% during FY13-18. We assume a discount rate of 11.5% and a terminal growth rate at 2.0%. Our target price implies a target P/E of 16.0x for FY15F.

Initiate the coverage with Buy. Gome is currently trading at 11.9x FY15 P/E. This is compared to its global peers at 13.4x P/E (Exhibit 19). Furthermore, Gome has a much higher net income CAGR at 21.3% during FY2013-FY2018, compared to 8.0% CAGR for global peers (Exhibit 20). We think Gome's valuation is quite attractive at current level.

Exhibit 18: DCF Valuation

GOME (Rmb mn)		2012	2013	2014E	2015E	2016E	2017E	2018E
Sales		**51,097**	**56,401**	**63,131**	**69,633**	**77,343**	**83,929**	**89,548**
YoY		*10.4%*	*11.9%*	*10.3%*	*11.1%*	*8.5%*	*6.7%*	*7.2%*
Net income		**(728)**	**892**	**1,258**	**1,508**	**1,802**	**2,056**	**2,342**
YoY		*-139.6%*	*-222.5%*	*40.9%*	*19.9%*	*19.4%*	*14.1%*	*13.9%*
Add: Depreciation & amortisation		494	576	603	706	776	835	893
Less: Finance income		(246)	(241)	(270)	(403)	(565)	(655)	(762)
Less: Working capital changes		555	(23)	282	62	67	(95)	(27)
Less: Capex		(812)	(436)	(1,585)	(1,087)	(741)	(788)	(709)
Free cash flow to equity		(737)	769	287	787	1,339	1,353	1,737
Discount rate	11.5%							
Terminal growth	2.0%							
Discount factor				0.978	0.877	0.786	0.705	0.632
PV				**280.7**	**689.8**	**1,053.2**	**954.0**	**1,098.9**
Discount rate			11.5%					
Terminal growth			2.0%					
PV of projecterd period			4,076					
Terminated value			21,788					
Total enterprise Value			**25,865**					
Add: Net debt			5,789					
Less: Minority interest			(790)					
Equity value			**30,863**					
Total shares outstanding			16,873					
Target price			**1.83**					

Source: company report, ICBCI Research. E=ICBCI Research estimates

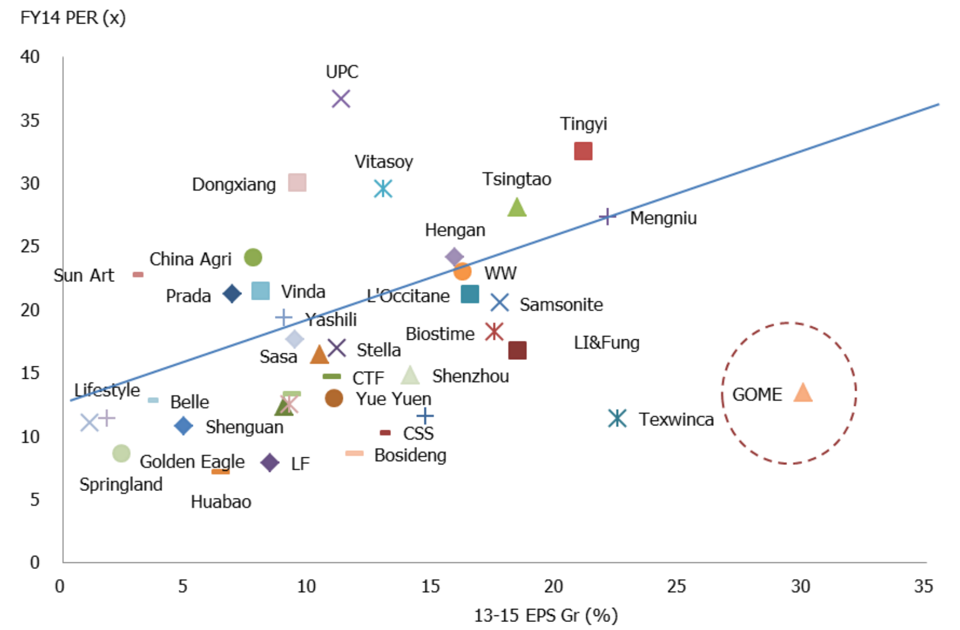
Peer valuation comparison

Exhibit 19: Peer comparison

Company	Ticker	30 Jul Price local cur	Year End	EPS chg (%) nxt 1 yr	EPS chg (%) nxt 2 yr	PER (x) nxt 1 yr	PER (x) nxt 2 yr	PBR (x) nxt 1 yr	PBR (x) nxt 2 yr	Dvd yield (%) nxt 1 yr	Dvd yield (%) nxt 2 yr	ROE (%) nxt 1 yr	ROE (%) nxt 2 yr
GOME ELECTRICAL APPLIANCES	493 HK	1.33	12/2013	40.9	19.9	14.3	11.9	1.1	1.0	1.4	1.7	7.6	8.4
SUNING COMMERCE GROUP CO -A	002024 CH	7.03	12/2013	na	na	na	na	1.8	1.8	0.6	0.7	(2.4)	(2.6)
BED BATH & BEYOND INC	BBBY US	63.03	02/2014	3.6	8.2	12.5	11.6	3.4	3.2	0.0	0.0	27.5	29.2
WILLIAMS-SONOMA INC	WSM US	67.98	01/2014	10.8	13.5	21.2	18.7	5.1	4.9	1.9	2.0	24.3	26.9
CBS CORP-CLASS B NON VOTING	CBS US	57.48	12/2013	9.3	18.0	17.0	14.4	3.9	3.7	0.9	1.0	21.7	26.8
DIXONS RETAIL PLC	DXNs LN	51.45	04/2014	na	15.2	15.6	13.5	8.6	5.4	0.0	0.0	88.2	42.4
YAMADA DENKI CO LTD	9831 JT	368.00	03/2014	40.4	12.7	13.0	11.5	0.6	0.6	1.8	2.0	4.6	5.2
BIC CAMERA INC	3048 JT	906.00	08/2013	257.4	(0.5)	17.9	17.9	1.9	1.8	1.1	1.1	11.7	10.6
JB HI-FI LTD	JBH AU	19.68	06/2013	7.3	7.3	15.6	14.5	6.7	5.7	4.0	4.3	47.3	42.6
LOTTE HIMART CO LTD	071840 KS	68,400.00	12/2013	(12.0)	13.3	14.7	13.0	0.9	0.9	0.4	0.4	7.2	8.1
Average				**44.7**	**11.9**	**15.8**	**14.1**	**3.4**	**2.9**	**1.2**	**1.3**	**23.7**	**19.8**
Median				**10.0**	**13.3**	**15.6**	**13.5**	**2.6**	**2.5**	**1.0**	**1.1**	**16.7**	**18.7**

*Source: Bloomberg, *ICBCI Research*

Exhibit 20: Gome – High growth with attractive valuation compared with China/HK consumer names



Source: Bloomberg, ICBCI Research

Company Profile

Main Business

GOME, founded in January 1st 1987, is China's largest home appliances and consumer electricals retail based on national chains. GOME has expanded its business footprint to Hong Kong since 2003 and listed in HK exchange in 2004. As at the end of 2012, with the inclusion of the 561 Non-listed GOME Group stores and 59 Dazhong Appliances stores managed by the Group, the total number of stores operating by the Group and the Non-Listed GOME Group would reach 1,669 and spanned 424 large- and medium-sized cities. GOME is now actively expanding the channels of its e-commerce platform. By sharing the procurement between its online and offline businesses, GOME enjoys economies of scale which enables it to improve its gross profit and score an advantage over other competing pure online platforms. With the sharing of logistics, after-sales and information platforms, the Group has achieved a low cost advantage under the integration of its online and offline businesses.

Company History

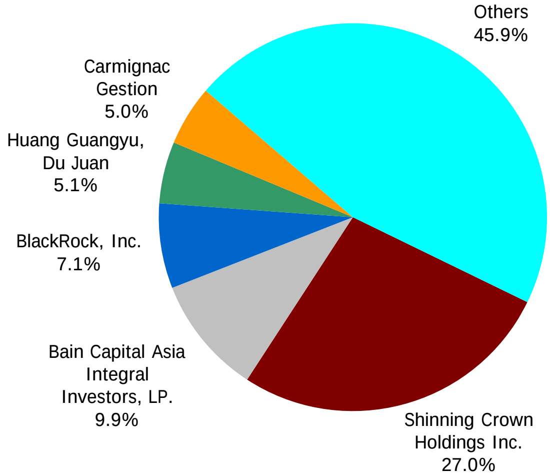
1987	GOME opened its first specialty retail store of electrical appliances in Beijing
1993	Adopted the brand name "GOME" and retail chain business model
1999	Commenced its nationwide retail coverage by establishing its first store outside Beijing in Tianjin
2003	GOME's first flagship shop outside Mainland China was opened in Hong Kong
2004	GOME began to build its digital store chain business model
2004	GOME was listed in Hong Kong exchange in August
2006	Announced the acquisition of the remaining 35% equity stake in GOME applicance
2006	Announced a HK%$5.2 billion merger with China Paradise
2007	GOME began to manage Beijing Dazhong Home Appliances Retail in December
2010	GOME invested in COO8 shopping website
2011	GOME online store (www.gome.com.cn) was launched in April and implemented e-business model
2012	"GOME online shopping mall" was renamed as "GOME-on-line", which was launched in December by integrating two e-commerce platforms, GOME online and COO8 website

Source: Company

Management Background

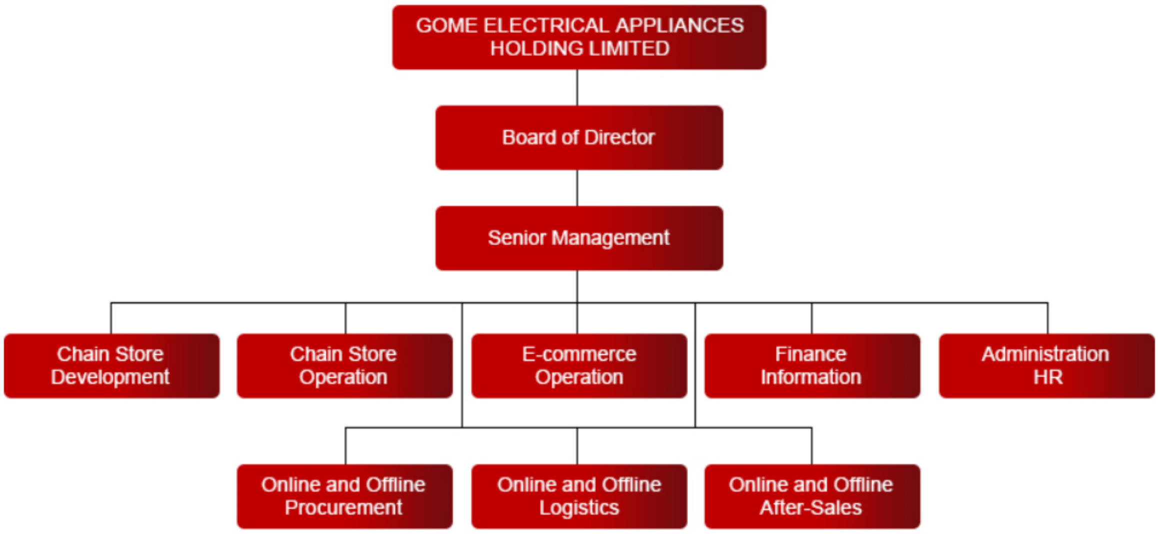
Mr. ZHANG Da Zhong(张大中) **Chairman and non-executive Director**	Mr. ZHANG Da Zhong, aged 64, has been the Chairman and non-executive Director of the Company since 10 March 2011. Mr. Zhang was the founder of Beijing Dazhong Electrical Appliances Co. Ltd. Mr. Zhang was a member of the standing committee for both the 9th and 10th Chinese People's Political Consultative Conference of Beijing and a member of the standing committee of the 13th Beijing People's Congress. Mr. Zhang is currently the deputy chairman of the Beijing Commerce Federation.
Mr. ZOU Xiao Chun (邹晓春) **Executive Director**	Mr. ZOU Xiao Chun, aged 43, has been an executive Director of the Company and the Vice President of the Group since December 2010 and has been recently re-designated as the Senior Vice President of the Group in March 2012 from the Vice President of the Group, mainly responsible for the Chinese legal and compliance matters and other deal-specific projects of the Group and is also a director of various subsidiaries of the Company. Mr. Zou graduated from the Department of Law of Nanchang University in June 1990.
Mr. WANG Jun Zhou (王俊洲) **President**	Mr. WANG Jun Zhou, aged 51, has been the President of the Group since 28 June 2010. He is also a director of various subsidiaries of the Company. Mr. Wang was the Executive Vice President of the Group during the period from November 2006 to June 2010 and an executive Director of the Company between December 2008 and June 2011. Mr. Wang is responsible for the overall management of daily operations, including the formulation of the Group's medium and long-term strategic plans and annual budgets as well as standardisation of various systems, processes and authorisations for the Group. Mr. Wang has over 10 years of experience in the sale and management of electrical appliances and joined the Group in 2001.
Mr. FANG Wei (方巍) **CFO**	Mr. FANG Wei, aged 41, has been re-designated as the Chief Financial Officer of the Group since September 2011. Before the re-designation, Mr. Fang had been the Acting Chief Financial Officer of the Group since November 2008. He is also a director of certain subsidiaries of the Company. Mr. Fang is responsible for the overall planning and implementation of the Group's internal budget as well as the accounting and auditing system. Mr. Fang also participates in major decision making in relation to the investment, financing and operations of the Group. Mr. Fang is a graduate of the accounting faculty of Central University of Finance and Economics and a holder of a Master degree in Management.

Shareholder Structure



Source: company report, ICBCI Research.

Exhibit 21: Corporate Structure

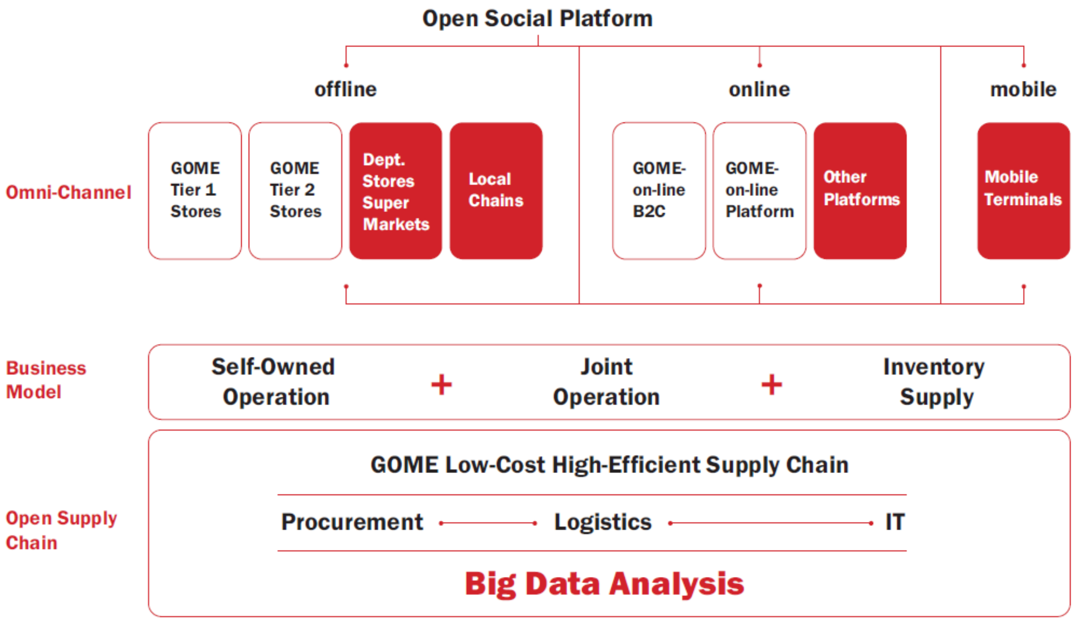


Source: company report, ICBCI Research.

Strategic layout：Omni-Channel Retailer

To upgrade the original supply chain platform, Gome operated an "Omni-Channel Retailer" strategy in 2014, forming a supply chain platform to the public for "online + offline + mobile terminals + other social channels" through joint operations and inventory supply (Exhibit 22). Gome enjoys its open supply chain platform, which includes an integrated procurement, regional based modern logistic and warehouse system, and an IT platform supported by big data analysis.

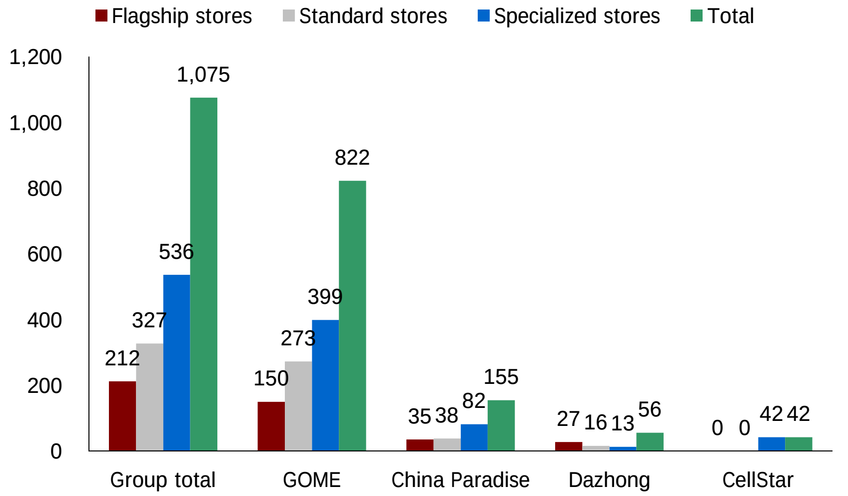
Exhibit 22: Omni-Channel Retailer strategy



Source: company report, ICBCI Research.

Store Network

Exhibit 23: Store Network by Brand (year ended 31 December 2013)



Source: company report, ICBCI Research.

Exhibit 24: Store Network by Region (year ended 31 December 2013)

	Flagship stores	Standard stores	Specialized stores	Total
Beijing	47	33	20	100
Shanghai	25	18	26	69
Tianjin	13	17	10	40
Chengdu	10	28	22	60
Chongqing	10	19	16	45
Xian	14	15	58	87
Shenyang	8	11	10	29
Qingdao	6	12	16	34
Jinan	6	6	15	27
Shenzhen	16	24	34	74
Dongguan	–	11	12	23
Guangzhou	15	26	57	98
Foshan	2	13	19	34
Wuhan	7	17	25	49
Kunming	4	4	20	28
Fuzhou	5	12	25	42
Xiamen	2	12	22	36
Henan	5	13	24	42
Nanjing	1	10	24	35
Wuxi	3	2	9	14
Changzhou	2	6	7	15
Suzhou	4	5	13	22
Hefei	2	5	12	19
Xuzhou	1	1	14	16
Tangshan	1	1	5	7
Lanzhou	3	4	12	19
Wenzhou	–	2	9	11
Total	**212**	**327**	**536**	**1075**

Source: company report, ICBCI Research.

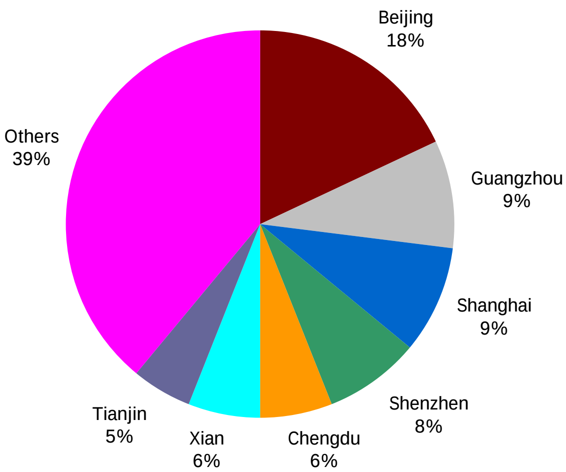
Exhibit 25: Company-managed retail network in Mainland China

As at 31 December 2013

Source: company report, ICBCI Research.

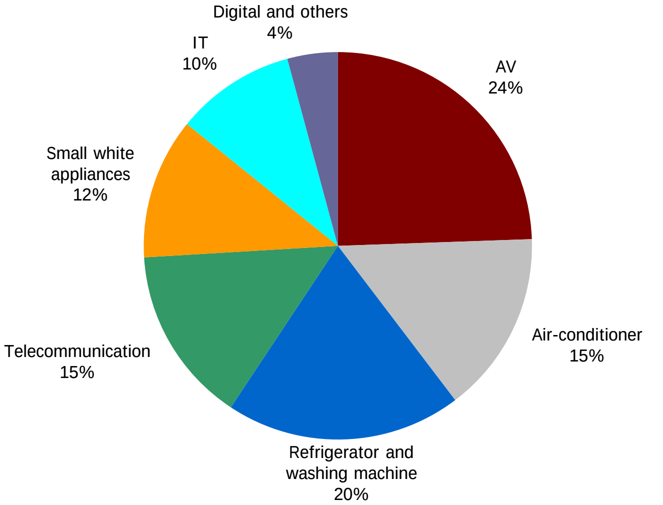
Revenue & Gross Profit Breakdown

Exhibit 26: Revenue Breakdown by Region (2013)



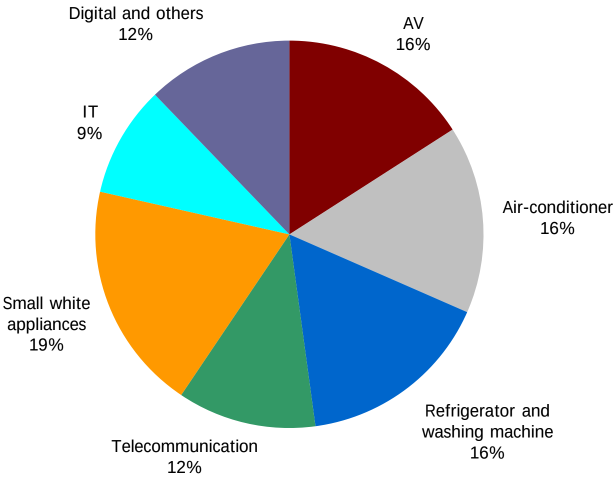
Source: company report, ICBCI Research.

Exhibit 27: Revenue Breakdown by Product Category (2013)



Source: company report, ICBCI Research.

Exhibit 28: Gross Profit Breakdown by Product Category (2013)



Source: company report, ICBCI Research.

Financial Statements

Exhibit 29: Income Statement

YE 31 Dec (Rmb mn)	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E
Revenue	**45,889**	**42,668**	**50,910**	**59,821**	**51,097**	**56,401**	**63,131**	**69,633**	**77,343**	**83,929**	**89,548**
Cost of Goods Sold	(41,381)	(38,408)	(44,991)	(52,264)	(44,276)	(47,899)	(53,338)	(58,619)	(64,968)	(70,244)	(74,773)
Gross Profit	4,508	4,260	5,919	7,557	6,821	8,502	9,793	11,015	12,375	13,685	14,775
Other income from supplier	3,266	3,050	3,239	3,276	1,597	1,852	1,944	2,086	2,235	2,380	2,519
Consolidated Gross Profit	**7,774**	**7,310**	**9,158**	**10,833**	**8,417**	**10,354**	**11,737**	**13,101**	**14,610**	**16,065**	**17,294**
Selling expense	(4,487)	(4,352)	(5,114)	(6,904)	(7,358)	(7,163)	(7,770)	(8,667)	(9,698)	(10,575)	(11,417)
G&A	(828)	(845)	(1,165)	(1,219)	(1,482)	(1,579)	(1,705)	(1,880)	(2,011)	(2,098)	(2,149)
Other expenses	(314)	(327)	(315)	(372)	(450)	(597)	(821)	(850)	(1,005)	(1,133)	(1,182)
Operating Income	**2,145**	**1,786**	**2,563**	**2,339**	**(873)**	**1,015**	**1,441**	**1,704**	**1,896**	**2,258**	**2,546**
Net Interest Income	229	(8)	(103)	159	18	180	137	257	425	517	617
Non-operating income	(840)	55	49	(23)	95	-	-	-	-	-	-
Income Before Tax	1,534	1,833	2,510	2,475	(759)	1,195	1,578	1,960	2,321	2,775	3,163
Provision for Income Tax	(435)	(406)	(548)	(673)	(183)	(517)	(395)	(490)	(580)	(694)	(791)
Income Before Minority Interest	**1,099**	**1,426**	**1,962**	**1,801**	**(942)**	**677**	**1,184**	**1,470**	**1,741**	**2,081**	**2,372**
Minority Interest	(51)	(17)	-	39	213	215	74	38	61	(26)	(30)
Net Income	1,048	1,409	1,962	1,840	(728)	892	1,258	1,508	1,802	2,056	2,342
EPS	**0.082**	**0.103**	**0.127**	**0.109**	**-0.043**	**0.053**	**0.075**	**0.089**	**0.107**	**0.122**	**0.139**
EBIT	**2,145**	**1,786**	**2,563**	**2,339**	**(873)**	**1,015**	**1,441**	**1,704**	**1,896**	**2,258**	**2,546**
EBITDA	**2,451**	**2,140**	**2,905**	**2,746**	**(379)**	**1,591**	**2,045**	**2,410**	**2,672**	**3,093**	**3,439**

Source: Company & ICBCI estimates

Exhibit 30: Balance Sheet

YE 31 Dec (Rmb mn)	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E
Current Assets											
Cash	3,051	6,029	6,232	6,414	7,067	9,016	9,370	10,652	12,359	14,382	16,631
Trade receivables	45	54	206	292	203	245	275	303	337	365	390
Prepayment and other receivable	1,384	1,702	2,446	3,789	2,843	2,333	2,882	3,004	3,153	3,233	3,257
Inventories	5,473	6,532	8,085	10,169	7,779	8,221	9,174	9,965	11,045	11,801	12,412
Other current asets	8,529	8,955	6,527	4,923	6,431	6,530	5,452	5,394	5,380	5,239	5,024
Total Current Assets	**18,483**	**23,273**	**23,496**	**25,586**	**24,324**	**26,345**	**27,152**	**29,318**	**32,274**	**35,020**	**37,714**
Non-current Assets											
PPE	3,720	3,392	3,556	3,932	4,379	4,095	5,100	5,504	5,493	5,469	5,308
Intangible Assets	3,497	4,140	4,131	7,497	7,474	7,434	7,411	7,387	7,364	7,341	7,317
Investment Properties	389	821	831	915	918	949	996	1,046	1,098	1,153	1,211
L-T Deposits and Prepayment	734	4,107	4,163	748	481	450	553	584	611	631	652
Deferred Tax Asset	18	31	40	67	137	51	53	56	59	61	65
Other investment	653	-	-	-	-	-	-	-	-	-	-
Total Non-current Assets	**9,012**	**12,490**	**12,721**	**13,159**	**13,389**	**12,978**	**14,113**	**14,578**	**14,624**	**14,655**	**14,553**
Total Assets	**27,495**	**35,763**	**36,217**	**38,745**	**37,713**	**39,324**	**41,265**	**43,896**	**46,898**	**49,675**	**52,267**
Current Liabilities											
Trade Payables/Bills Payables	12,918	15,815	16,900	18,331	18,017	18,077	19,735	19,520	19,471	18,947	18,152
Other Payabales	1,530	1,830	1,820	1,629	1,722	2,047	800	2,169	3,510	4,807	5,945
S-T loan	170	2,530	230	2,112	2,434	2,683	3,400	3,570	3,749	3,936	4,133
Tax Liabilities	529	507	509	552	460	563	619	681	749	824	906
Amoun Due to Related Parties	-	-	98	-	235	464	581	621	662	695	718
Total current liabilities	**15,147**	**20,682**	**19,557**	**22,623**	**22,868**	**23,834**	**25,135**	**26,560**	**28,139**	**29,208**	**29,854**
Non-current Liabilities											
Convertible bonds	3,570	3,175	1,814	-	5	-	-	-	-	-	-
Other Long Term Liabilities	78	103	111	157	171	172	181	190	199	209	220
Total non-current Liabilities	**3,648**	**3,278**	**1,925**	**157**	**176**	**172**	**181**	**190**	**199**	**209**	**220**
Total Liabilities	**18,795**	**23,961**	**21,482**	**22,780**	**23,043**	**24,007**	**25,316**	**26,750**	**28,339**	**29,417**	**30,074**
Minority Interest	**140**	**-**	**-**	**(30)**	**(395)**	**(610)**	**(684)**	**(722)**	**(782)**	**(757)**	**(727)**
Stockholders' Equity											
Common stock (includes par value, capital surplus, and treasury)	6,941	8,950	10,122	10,747	10,589	10,626	10,626	10,626	10,626	10,626	10,626
Retained earnings	1,619	2,852	4,031	5,249	4,476	4,859	5,866	7,072	8,513	10,158	12,032
Other common equity	-	-	582	-	-	441	141	169	202	230	262
Total Stockholders' Equity	**8,560**	**11,802**	**14,735**	**15,996**	**15,064**	**15,927**	**16,633**	**17,868**	**19,342**	**21,015**	**22,921**
Total Liabilities & Stockholders' Equity	**27,495**	**35,763**	**36,217**	**38,745**	**37,713**	**39,324**	**41,265**	**43,896**	**46,898**	**49,675**	**52,267**

Source: Company & ICBCI estimates

Exhibit 31: Cash Flow

YE 31 Dec (Rmb mn)	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E
Operating Cash Flow											
Profit before tax	1,534	1,833	2,510	2,475	(759)	1,195	1,578	1,960	2,321	2,775	3,163
Add: D&A	306	355	342	406	494	576	603	706	776	835	893
Less: Finance income	(441)	(341)	(339)	(400)	(246)	(241)	(270)	(403)	(565)	(655)	(762)
Less: Working capital changes	1,779	(2,437)	1,110	(1,040)	4,657	555	(23)	282	62	67	(95)
Less: PRC income tax paid	(263)	(440)	(553)	(787)	(347)	(326)	(332)	(422)	(506)	(612)	(701)
Other changes	946	349	451	(270)	341	236	134	146	139	138	145
Subtotal	**3,861**	**(682)**	**3,520**	**383**	**4,140**	**1,995**	**1,689**	**2,270**	**2,229**	**2,549**	**2,642**
Investing Cash Flow											
Purchase of PPE	(1,180)	(330)	(507)	(861)	(812)	(436)	(1,585)	(1,087)	(741)	(788)	(709)
Proceeds from disposal of PP&E	15	7	1	83	66	108	-	-	-	-	-
Other investments	(2,939)	537	307	42	(84)	-	219	349	508	596	700
Subtotal	**(4,104)**	**214**	**(200)**	**(736)**	**(829)**	**(328)**	**(1,366)**	**(738)**	**(233)**	**(192)**	**(9)**
Financing Cash Flow											
Dividends	(661)	-	-	-	-	-	(552)	(274)	(327)	(383)	(436)
Proceeds from issue of shares	-	1,361	-	-	-	-	-	-	-	-	-
Repurchase of shares	(2,068)	-	-	(15)	-	-	-	-	-	-	-
Changes in Convertible Bonds	-	2,127	(2,686)	-	(2,598)	-	-	-	-	-	-
New loans	100	860	100	-	2,434	2,730	717	170	179	187	197
Repayment of bank loans	(230)	(680)	(350)	(100)	-	(2,408)	-	-	-	-	-
Other changes	(16)	(200)	(166)	222	(2,503)	(27)	(134)	(146)	(139)	(138)	(145)
Subtotal	**(2,875)**	**3,467**	**(3,102)**	**107**	**(2,666)**	**294**	**31**	**(250)**	**(288)**	**(334)**	**(385)**
Effect of FX rate changes, net	(101)	(21)	(15)	(15)	10	(13)	-	-	-	-	-
Cash & equivalent at year beginning	**6,270**	**3,051**	**6,029**	**6,232**	**6,414**	**7,067**	**9,016**	**9,370**	**10,652**	**12,359**	**14,382**
Net increase / (decrease) in cash & equivalent	(3,219)	2,978	203	(261)	654	1,948	354	1,282	1,707	2,024	2,249
Cash & equivalent at year end	**3,051**	**6,029**	**6,232**	**5,971**	**7,067**	**9,016**	**9,370**	**10,652**	**12,359**	**14,382**	**16,631**

Source: Company & ICBCI estimates

Exhibit 32: Key Ratios

YE 31 Dec	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E
YoY Growth											
Sales	8.0%	-7.0%	19.3%	17.5%	-14.6%	10.4%	11.9%	10.3%	11.1%	8.5%	6.7%
EBIT	4.4%	-16.8%	43.5%	-8.7%	-137.3%	-216.2%	42.1%	18.2%	11.3%	19.1%	12.7%
Net income	-7.0%	34.5%	39.2%	-6.2%	-139.6%	-222.5%	40.9%	19.9%	19.4%	14.1%	13.9%
Margins											
Gross margin	16.9%	17.1%	18.0%	18.1%	16.5%	18.4%	18.6%	18.8%	18.9%	19.1%	19.3%
SG&A/Sales	11.6%	12.2%	12.3%	13.6%	17.3%	15.5%	15.0%	15.1%	15.1%	15.1%	15.2%
EBIT margin	4.7%	4.2%	5.0%	3.9%	-1.7%	1.8%	2.3%	2.4%	2.5%	2.7%	2.8%
EBITDA margin	5.3%	5.0%	5.7%	4.6%	-0.7%	2.8%	3.2%	3.5%	3.5%	3.7%	3.8%
Net margin	2.3%	3.3%	3.9%	3.1%	-1.4%	1.6%	2.0%	2.2%	2.3%	2.4%	2.6%
Return											
ROA	3.8%	3.9%	5.4%	4.7%	-1.9%	2.3%	3.0%	3.4%	3.8%	4.1%	4.5%
ROE	12.2%	11.9%	13.3%	11.5%	-4.8%	5.6%	7.6%	8.4%	9.3%	9.8%	10.2%
Gearing											
Total liabilities/equity	220%	203%	146%	142%	153%	151%	152%	150%	147%	140%	131%
Net debt/equity (Net cash/equity)	9%	-2%	-28%	-26%	-30%	-39%	-35%	-39%	-43%	-49%	-54%
Asset/equity	321%	303%	246%	242%	250%	247%	248%	246%	242%	236%	228%
Valuation (x)											
P/E	12.2	9.1	6.5	7.0	(17.6)	14.4	10.2	8.5	7.1	6.2	5.5
P/BV	1.5	1.1	0.9	0.8	0.9	0.8	0.8	0.7	0.7	0.6	0.6
EV/EBITDA	2.6	3.0	2.2	2.3	(16.7)	4.0	3.1	2.6	2.4	2.0	1.8
Dividend yield (%)	2.69%	0.00%	4.55%	2.95%	0.00%	4.18%	1.96%	2.35%	2.81%	3.21%	3.66%
Efficiency											
Asset turnover (x)	1.7	1.2	1.4	1.5	1.4	1.4	1.5	1.6	1.6	1.7	1.7
Inventory days	47.9	57.0	59.3	63.7	71.7	61.0	59.5	59.6	59.0	59.4	59.1
Receivable days	0.4	0.5	1.5	1.8	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Payable days	132.1	152.5	147.5	135.1	158.3	151.9	139.1	131.5	125.5	121.4	116.8
Others											
Effective tax rate	28%	22%	22%	27%	-24%	43%	25%	25%	25%	25%	25%
Payout ratio	33%	0%	30%	21%	0%	60%	20%	20%	20%	20%	20%

Source: Company & ICBCI estimates

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