

MIDEA GROUP [000333.CH]: Monitor arbitrage opportunity

We believe Midea's chances of a successful privatisation of Little Swan have increased since it updated its offer terms on Nov 21. Midea will exchange 1.1158 and 0.9056 new shares for each Little Swan A and B share, respectively, after an RMB4.0 dividend by Little Swan. This implies that the offer price for Little Swan A is RMB48.25, a ~3% premium to yesterday's close. While Little Swan's privatisation may result in a small EPS dilution, this will be offset by the long-term benefits stemming from a more efficient corporate structure. We maintain our Buy recommendation on Midea and suggest investors monitor the arbitrage opportunity. Meanwhile, the new offer structure suggests that each Little Swan-B share is worth about HK\$45, or a ~9% premium to yesterday's close of HK\$41.43.

Investment Highlights

Approval process continues: According to the Nov. 21 announcement, Little Swan and Midea have approval from their respective boards for the transaction. On Dec. 21, Little Swan and Midea will each hold a shareholders meeting to vote on the transaction. If successful, both companies will need further approval from the CSRC before the deal can be closed, though this last step is widely understood to be a formality. Ultimately, if the deal is successful, the transaction is expected to close after the Spring Festival.

Updated terms introduce a cash component: Midea originally proposed that it acquire the remaining 47% of Little Swan by offering 1.211 new shares for each Little Swan A share, and 1.0007 new shares for each Little Swan B share. This has effectively been revised to 1.1158 and 0.9056 shares for Little Swan A and B shares, respectively, with Little Swan issuing a special dividend of RMB 4.0 per share if the transaction is successful.

Midea to benefit in the long run: The deal itself may result in ~2% EPS dilution in 2019 (a ~5% increase in the number of shares offset by a ~3% increase in net profit). In the longer term, Midea will see efficiency gains as a result of fewer related-party transactions, reduced resource duplication, and less internal competition between the group's Little Swan, Midea and COLMO washing machine brands. We believe a common sales channel and strong branding will make Midea washing machines more competitive.

New offer sweetens the deal for Little Swan shareholders: This new offer structure implies that each Little Swan-A share is worth RMB48.25, or a ~3% premium to yesterday's close of RMB46.83. We believe investors should monitor this pricing difference to capture arbitrage opportunities. Meanwhile, the new offer structure suggests that each Little Swan-B share is worth about HK\$45, or a ~9% premium to yesterday's close of HK\$41.43.

	2016	2017	2018E	2019E	2020E
Revenue (RMB Mn)	159,842	241,919	263,065	266,368	280,540
Growth (%)		51%	9%	1%	5%
Net Profit (RMB Mn)	14,684	17,284	21,294	21,394	23,516
Growth (%)		18%	23%	0%	10%
EPS (RMB)	2.28	2.63	3.19	3.21	3.53
Growth (%)		16%	21%	0%	10%
PER (x)	17.4	15.1	12.4	12.4	11.3
PBR (x)	4.2	3.5	3.0	2.7	2.3

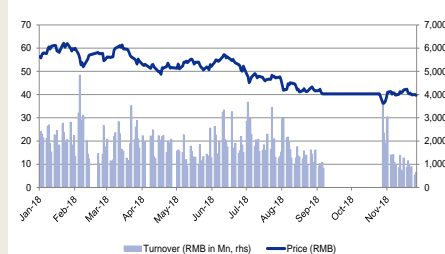
Home Appliances Sector

Buy

Close: RMB 39.66 (Nov. 27 2018)

Target Price: RMB 42 (+5.9%)

Price Performance



Market Cap	US\$37,824m
Shares Outstanding	6,627m
Free Float	41%
52W High	RMB 62.69
52W Low	RMB 34.10
3M Avg Daily T/O:	US\$186m
Major Shareholders:	Midea Hld. (33.3%)

Sources: Company, Bloomberg

Jeff Dorr – Analyst

(852) 3698 6323
jeffreydorr@chinastock.com.hk

An Zhang – Analyst

(852) 3698 6293
zhangnan@chinastock.com.hk

Johnson Cheung – Research Director

(852) 3698 6275
johnsoncheung@chinastock.com.hk

Disclaimer

This research report is not directed at, or intended for distribution to or used by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject China Galaxy International Securities (Hong Kong) Co., Limited ("Galaxy International Securities") and/or its group companies to any registration or licensing requirement within such jurisdiction.

This report (including any information attached) is issued by Galaxy International Securities, one of the subsidiaries of the China Galaxy International Financial Holdings Limited, to the institutional clients from the information sources believed to be reliable, but no representation or warranty (expressly or implied) is made as to their accuracy, correctness and/or completeness.

This report shall not be construed as an offer, invitation or solicitation to buy or sell any securities of the company(ies) referred to herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The recipient of this report should understand and comprehend the investment objectives and its related risks, and where necessary consult their own independent financial advisers prior to any investment decision.

Where any part of the information, opinions or estimates contained herein reflects the personal views and opinions of the analyst who prepared this report, such views and opinions may not correspond to the published views or investment decisions of China Galaxy International Financial Holdings Limited and any of its subsidiaries ("China Galaxy International"), directors, officers, agents and employees ("the Relevant Parties").

All opinions and estimates reflect the judgment of the analyst on the date of this report and are subject to change without notice. China Galaxy International and/or the Relevant Parties hereby disclaim any of their liabilities arising from the inaccuracy, incorrectness and incompleteness of this report and its attachment/s and/or any action or omission made in reliance thereof. Accordingly, this report must be read in conjunction with this disclaimer.

Disclosure of Interests

China Galaxy Securities Co., Ltd. (6881.HK; 601881.CH) is the direct and/or indirect holding company of the group of companies under China Galaxy International.

China Galaxy International may have financial interests in relation to the subjected company(ies) the securities in respect of which are reviewed in this report, and such interests aggregate to an amount may equal to or more than 1 % of the subjected company(ies)' market capitalization.

One or more directors, officers and/or employees of China Galaxy International may be a director or officer of the securities of the company(ies) mentioned in this report.

China Galaxy International and the Relevant Parties may, to the extent permitted by law, from time to time participate or invest in financing transactions with the securities of the company(ies) mentioned in this report, perform services for or solicit business from such company(ies), and/or have a position or holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto.

China Galaxy International may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the last 12 months, significant advice or investment services in relation to the investment concerned or a related investment or investment banking services to the company(ies) mentioned in this report.

Furthermore, China Galaxy International may have received compensation for investment banking services from the company(ies) mentioned in this report within the preceding 12 months and may currently seeking investment banking mandate from the subject company(ies).

Analyst Certification

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

Explanation on Equity Ratings

BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

Copyright Reserved

No part of this material may be reproduced or redistributed without the prior written consent of China Galaxy International Securities (Hong Kong) Co., Limited.

China Galaxy International Securities (Hong Kong) Co. Limited, CE No.AXM459

20/F, Wing On Centre, 111 Connaught Road Central, Sheung Wan, Hong Kong. General line: 3698-6888.