

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

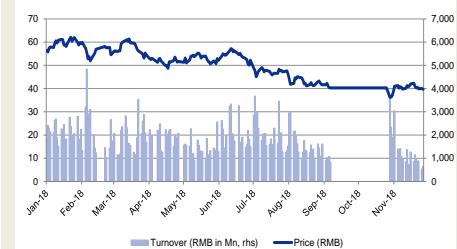
Home Appliances Sector

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
zhangan@chinastock.com.hk

Johnson Cheung – Research Director

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

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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

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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.