

Corporate Flash

China Creative Home Group Ltd. 1678 HK

Opportunities hide behind the coming winter

- *In 1H FY12/14, the company recorded revenue of RMB531.1m, a 7.5% YoY increase and profit attributable to shareholders of RMB131.0m, a 1.2% YoY increase.*
- *Improvement in revenue mix has been witnessed in 1H FY12/14 result.*
- *Expansion in production capacity of fireplaces can provide a solid foundation to its sales in future, which we believe will translate into higher profit in following years.*
- *We expect the demand for electric fireplaces will accelerate in the second half of this year, due to seasonality factors.*

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Stock Data (1678 HK)

Rating	Not Rated
Price (HK\$)	1.53
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.4-1.93
Market cap. (HK\$m)	2,754.0
Daily t/o (HK\$m)	7.2
Free float (%)	21.4

Source: Bloomberg

Improvement in revenue mix has been witnessed in 1H FY12/14 result. Last month, China Creative announced its interim results for 1H FY12/14. For the period, the company recorded revenue of RMB531.1m, a 7.5% YoY increase. Profit attributable to shareholders was RMB131.0m, a 1.2% YoY increase. The revenue coming from electric fireplaces increased from RMB255.4m in 1H FY12/13 to RMB292.2m in 1H FY12/14, with its proportion to total revenue increased from 51.7% in 1H FY12/13 to 55.0% in 1H FY12/14. Since the sale of electric fireplaces command a much higher GPM than home décor, we believe the improvement in revenue mix is a piece of positive evidence to the GPM in 2H FY12/14.

Capacity expansion will boost its profit by providing a solid foundation to its sales in future. Among the 403,204 fireplaces sold in FY12/13, approximately 84.6% were self-produced while the majority of the remainder were purchased from 3rd party suppliers. We believe the future expansion in fireplace production capacity can translate into higher revenue and profit given its capacity expansion plan. In fact, the expansion work on the company's production facilities is already in progress, including Luojiang production facilities, the 2nd and 3rd phase of the new Anhui production facilities. The company expects that, upon the completion of the abovementioned expansion projects, total fireplace capacity will increase from 277,500 units per year in 2013 to 627,500 units in 2015.

Demand for electric fireplaces will accelerate in the 2nd half of this year. With the coming winter starting from October this year, we expect the sale of electric fireplaces in the 2H FY12/14 will accelerate compared with the sales in 1H FY12/14. As shown from its historical data, China Creative usually sells more electric fireplaces in the second half of a year. Assuming the trend continues, we expect the sales units of electric fireplaces in 2H FY12/14 will exceed 200,000 units, which is more than 35.4% than the 1H FY12/14.

Figure 1. Financials and valuation

	FY12/11	FY12/12	FY12/13
Total revenue (RMB m)	804.1	969.0	1,195.5
Revenue growth (YoY)	-	20.5%	23.4%
PBT (RMB m)	253.2	331.2	388.6
PBT growth (YoY)	-	30.8%	17.3%
Net profit (RMB m)	218.3	261.6	304.9
Net profit growth (YoY)	-	19.8%	16.6%
EPS (RMB)	-	-	0.21
DPS (RMB)	-	-	0.08
P/E (x)	-	-	5.76
Dividend yield	-	-	5.2%

Source: Company data

Company Background

China Creative Home Group (“China Creative”) was listed in HKEx in Dec 2013 and is principally engaged in the design, development, manufacture and sale of electric fireplaces and home décor products in China, where its products are sold under the brand of Allen (亞倫). The company also sells a portion its products in the overseas markets, including U.S., Germany, Canada, France, Australia, Taiwan and Japan (See Figure 2). The company commenced the sale of electric fireplaces under its brand in 2008, since then the revenue derived from the business segment has been growing at faster rate than that of the home decor product segment.

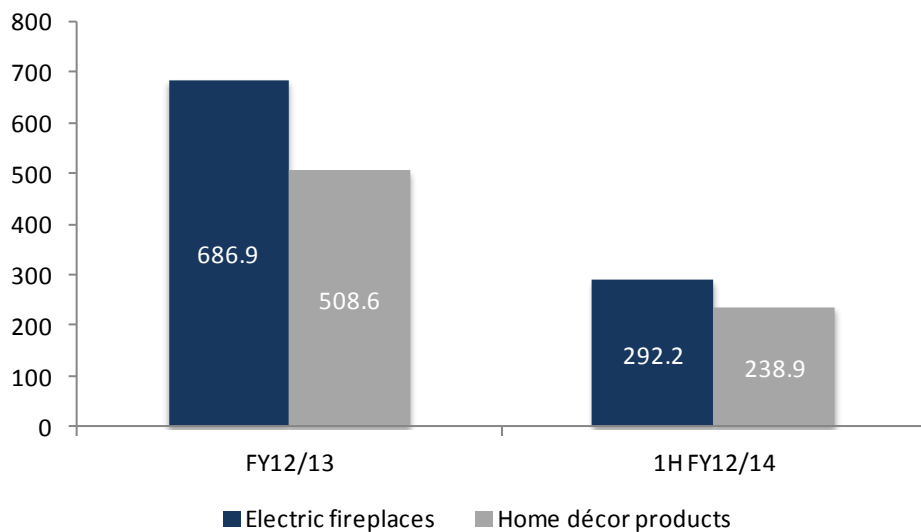
Figure 2. Revenue breakdown by regions in FY12/13 and 1H FY12/14



Source: Company data

Last month, China Creative announced its interim results for 1H FY12/14. For the period, the company recorded revenue of RMB531.1m, a 7.5% YoY increase. Profit attributable to shareholders amounted to RMB131.0m, a 1.2% YoY increase. The board of the company did not recommend any interim dividend for 1H FY12/14. The sale of electric fireplaces reminded to be the major revenue contributor of the company, which accounted for 57.5% and 55.0% of its total revenue in FY12/13 and 1H FY12/14 (See Figure 3).

Figure 3. Revenue breakdown by segments in FY12/13 and 1H FY12/14 (RMB m)



Source: Company data

Our views

Improvement in revenue mix has been witnessed in 1H FY12/14 result. In 1H FY12/13, the electric fireplaces sector accounted for 51.7% of its total revenue, and the proportion increased to 55.0% in 1H FY12/14. We believe this is a good sign as historically electric fireplaces sector commanded a much higher GPM compared with home décor sector (See Figure 4).

Figure 4. Historical GPM recorded by electric fireplace sector and décor sector

	FY12/10	FY12/11	FY12/12	FY12/13	1H FY12/14
Electric fireplaces sector	48.9%	45.8%	49.2%	50.7%	47.5%
Home décor sector	40.8%	39.2%	40.1%	40.1%	34.8%
Blended	42.9%	41.2%	44.2%	44.3%	41.7%

Source: Company data

Capacity expansion will boost profit by providing a solid foundation to its sales in future. Among the 403,204 fireplaces sold in FY12/13, 84.6% were self-produced and the majority of the remainder were purchased from 3rd party suppliers. We believe the future expansion in fireplace production capacity can translate into higher revenue and profit given its capacity expansion plan.

In fact, China Creative will continue to expand its production facilities in the following years. For example, the expansion work on the company's Luojiang production facilities is in progress, and will increase its production capacity of electric fireplaces by around 50,000 units each year upon its completion by the end of 2014. Together with the first phase of the new Anhui production facilities with the capacity of approximately 100,000 units, its production capacity in FY12/14 will reach to around 427,500 units. Moreover, the second phase of the new Anhui production facilities with an annual production capacity of approximately 100,000 units of electric fireplaces will commence in 4Q 2014 and will be completed by 1H 2015. The construction of the third phase of the new Anhui production facilities with an annual production capacity of 100,000 units of electric fireplaces will commence in the first half of 2015 and will be completed by the end of 2015. Upon completion of all the projects mentioned above, the fireplaces capacity will increase from 277,500 units per year in 2013 to 627,500 units per year in 2015 (See Figure 5). As such, we think the actual sales units will grow accordingly.

Figure 5. Capacity of electric fireplaces and the historical utilization rate

	FY12/11	FY12/12	FY12/13	FY12/14E	FY12/15E
Designed production capacity (units)	268,950	277,500	277,500	427,500	627,500
Actual production (units)	123,888	208,843	270,944	-	-
Actual sales units	122,641	234,657	403,204	-	-
Utilization rate	46.1%	75.3%	97.6%	-	-

Source: Company data

We think its GPM in 2H FY12/14 may be stabilized given its future business strategy. Before its electric fireplaces capacity expanding plan, the company always selects the potential transactions with higher GPM given its limited capacity and the growing demand. That said, after its electric fireplaces capacity expansion plan being kicked off, China Creative would expand its sales in future, in which the GPM will be similar to the current one. The GPM for its overseas business will also be kept with the same level. As such, we think the company will have a more stable GPM after completing its capacity expansion plan. At that time, the revenue as well as profit will grow accordingly.

Demand for electric fireplaces will accelerate in the 2nd half of this year. With the coming winter starting from October this year, we expect the sale of electric fireplaces in the 2H FY12/14 will accelerate compared with the sales in 1H FY12/14. As shown from its historical data (See Figure 6), China Creative usually sells more electric fireplaces in the second half of a year. Assuming the trend continues, we expect the sales units of electric fireplaces in 2H FY12/14 will exceed 200,000 units, which is more than 35.4% than the 1H FY12/14.

Figure 6. Actually sales units of electric fireplaces in recent years

1H FY12/12	2H FY12/12	1H FY12/13	2H FY12/13	1H FY12/14	2H FY12/14
93,669	140,988	142,990	260,214	147,660	-

Source: Company data

In addition, we think the company will sell more products in overseas market given the recovering economy in U.S. and its overseas sales will account more in its total revenue in 2H FY12/14. Thus both domestic demand and overseas demand will accelerate in the coming winter. Moreover, China Creative is also expanding its research and development segment. Currently the company is working with University of Shanghai for Science and Technology to further develop innovative multifunctional electric fireplaces with air purification and cooling functions. We view the new product will contribute to the company's revenue in long run as environmental protection is gaining increasing importance in China and consumers are increasingly having an environmental perspective and health conscious approach in their purchasing habits. As such, we think China Creative will continue to focus on the R&D of the environmental friendly products in the following days thus more related products can be developed.

Valuation. At the trading price of HKD1.53 per share, China Creative is trading at a historical P/E of 6.4x for FY12/13. As for the company's HK-listed peers, there are several companies that are engaged in furniture industry in China, including Nature Home Holdings Ltd (2083 HK), Dongpeng Holdings Ltd. (3386 HK), Royale Furniture Holdings Ltd. (1198 HK), etc.. On average, these companies are trading at a trailing P/E of 10.7x for FY12/13 and a prospective P/E of 9.3x for FY12/14.

Figure 7. Peer comparison

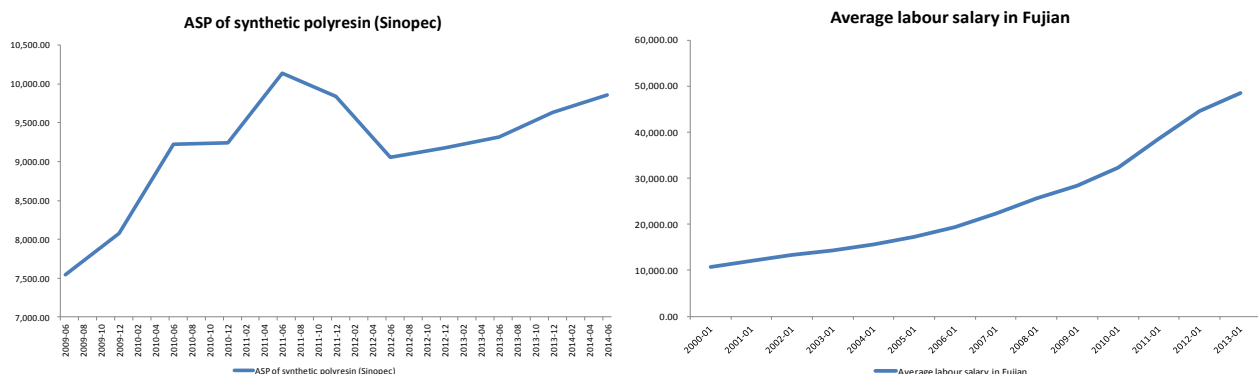
Company	Ticker	Mkt Cap (HKD m)	3M avg turnover (HKD m)	2013 P/E (x)	2014E P/E (x)	P/book (x)	ROIC (%)	ROE (%)	ROA (%)	Dvd Yield (%)
China Creative	1678 hk	2,754.0	7.2	6.4	6.4	1.3	-	-	-	2.5
Nature Home Holdings Ltd.	2083 hk	1,776.6	0.8	10.3	-	0.6	4.5	5.5	4.5	2.2
Dongpeng Holdings Ltd.	3386 hk	3,763.9	1.8	6.6	6.3	1.6	25.6	32.4	10.1	2.4
Royale Furniture Holdings Ltd.	1198 hk	418.0	0.3	-	-	0.3	-	(30.4)	(17.5)	0.0
Man Wah Holdings Ltd.	1999 hk	10,955.3	15.0	10.7	-	2.5	17.8	24.8	17.6	4.3
Samson Holdings Ltd.	531 hk	3,043.6	1.7	22.1	12.9	0.8	1.8	3.0	2.3	12.0
Bolina Holdings Ltd.	1190 hk	3,117.4	9.9	12.9	13.6	2.5	15.4	20.5	13.2	4.3
Merry Garden Holdings Ltd.	1237 hk	1,068.0	21.0	5.9	7.3	1.5	19.9	29.6	18.5	1.5
Average*		3,362.1	7.2	10.7	9.3	1.4	14.2	12.2	7.0	3.6

Source: Company data

*The average figure does not include China Creative

Risks. Gross profit margin of both sectors eroded due to the increased cost of raw material and labour costs. For example, the price of synthetic polyresin kept increasing while the average labour salary in Fujian also moved upward over the past few years (See Figure 8).

Figure 8. ASP of synthetic polyresin (Sinopec) and average labour salary in Fujian (RMB)



Source: Company data

*According to its prospectus in 2013, polyresin was its most significant raw material and accounted most in its cost on raw material

Another aspect that draws our attention is the pressure from the property market, the business of China Creative is highly related to the development of the real estate industry, the purchasing power of consumer and the acceptance of creative-styled furnishing, especially with the influence from the western culture. With the slowdown of the property market in China, demand for electric fireplaces has a downside risk in the future.

Figure 9. Per share items (RMB)

	FY12/11	FY12/12	FY12/13
EPS - basic and diluted	-	-	0.21
DPS	-	-	0.08
BVPS	-	-	1.07

Source: Company data

Figure 10. Ratio analysis

	FY12/11	FY12/12	FY12/13
Growth (YoY)			
Revenue	-	20.5%	23.4%
Net profit	-	19.8%	16.6%
Margins			
Net profit margin	27.1%	27.0%	25.5%
Other ratios			
Return on average assets	27.5%	27.2%	23.8%
Return on average equity	36.6%	37.3%	30.3%
Dividend payout ratio	-	-	38.1%
Valuation measures			
P/E (x)	-	-	5.76
P/B (x)	-	-	1.18
Dividend yield	-	-	0.05

Source: Company data

Figure 11. Income statement (RMB m)

	FY12/11	FY12/12	FY12/13
Revenue	804.1	969.0	1,195.5
Cost of sale	(472.8)	(540.8)	(666.1)
Gross profit	331.2	428.2	529.5
Other income	1.9	2.6	6.5
Selling and distribution costs	(48.7)	(53.5)	(59.9)
Administration expense	(29.5)	(43.0)	(83.0)
Employee benefits expenses	-	(7.0)	-
Operating profit	254.9	334.3	393.1
Finance cost	(1.7)	(3.0)	(4.5)
Profit before income tax	253.2	331.2	388.6
Income tax expense	(35.0)	(69.7)	(85.4)
Profit attributable to shareholders	218.3	261.6	303.2
Total comprehensive income attributable to shareholders	218.3	261.6	304.9

Source: Company data

Figure 12. Balance sheet (RMB m)

	FY12/11	FY12/12	FY12/13
Non-current assets			
PPE	297.2	294.3	199.9
Land use right	120.0	117.3	112.6
Investment property	-	-	112.6
Prepayment	-	-	24.8
Total non-current assets	417.1	411.6	449.9
Current assets			
Inventory	23.3	27.4	37.6
Trade receivables	203.7	289.0	336.0
Deposits, prepayments and other receivables	7.5	16.5	100.0
Amount due from a related company	-	-	-
Amount due from a controlling shareholders	57.5	-	-
Restricted bank deposits	7.3	75.9	2.4
Short-term bank deposits	35.6	-	-
Cash and cash equivalent	5.2	343.8	995.7
Total current assets	340.2	752.5	1,471.8
Non-current liability			
Deferred tax liability	4.7	5.4	7.1
Total non-current liabilities	4.7	5.4	7.1
Current liabilities			
Trade and other payables	97.8	265.6	206.1
Amounts due to related companies	0.0	-	-
Amount due to a controlling shareholder	0.0	4.2	-
Bank borrowings	50.0	61.0	59.0
Current income tax liabilities	7.4	23.5	29.7
Total current liabilities	155.3	354.2	294.8
Net assets	597.2	804.5	1,619.7
Equity			
Reserves	597.2	804.5	1,136.2
Share capital	-	-	0.1
Share premium	-	-	483.4
Total equity	597.2	804.5	1,619.7

Source: Company data

Figure 13. Cash flow statement (RMB m)

	FY12/11	FY12/12	FY12/13
Operating activities			
Cash generated from operations	196.9	351.0	281.0
Interest paid	(3.4)	(4.1)	(4.5)
Income tax paid	(45.4)	(52.9)	(78.0)
Net cash generated from operating activities	148.2	294.0	198.5
Investing activities			
Purchases of PPE	(20.7)	(11.6)	(8.0)
Prepayments for constructions	-	-	(6.3)
Prepayments for land use rights	(2.5)	-	(18.5)
Additions to land use rights	(3.6)	-	(20.3)
Interest received	1.3	2.4	3.0
Decrease in short-term bank deposits	(0.8)	35.6	-
Decrease in amount due to the controlling shareholder	-	-	(10.4)
Decrease in amount due from the controlling shareholder	(142.2)	7.2	-
Net cash used in investing activities	(168.3)	33.7	(60.5)
Financing activities			
Proceeds from issuance of shares for IPO	-	-	483.6
Proceeds from borrowings	50.0	64.0	69.0
Repayments of borrowings	(42.0)	(53.0)	(71.0)
Capital contribution from a controlling shareholder	-	-	118.6
Dividends paid	-	-	(85.5)
Net cash used in financing activities	8.0	11.0	514.7
Net increase/ (decrease) in cash and cash equivalent	(12.2)	338.6	652.6
Cash and cash equivalents at 1 January	18.7	5.2	343.8
Exchange losses on cash and cash equivalents	(1.2)	0.0	(0.7)
Cash and cash equivalents at 31 December	5.3	343.8	995.7

Source: Company data

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