

## July Sales of Air Conditioners Continued to Decline—NEUTRAL (Reiterated)

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### Company Report

Sep 10, 2008

#### Event:

According to the statistics of Zhonghuashangwuwang, China's total sales volume of air-conditioners in July were 4.802 million units, down 19.5% yoy; due to the negative factors such as "cool summer", year-on-year sales growth of China's air-conditioners in July saw the greatest setback from 2004 onward.

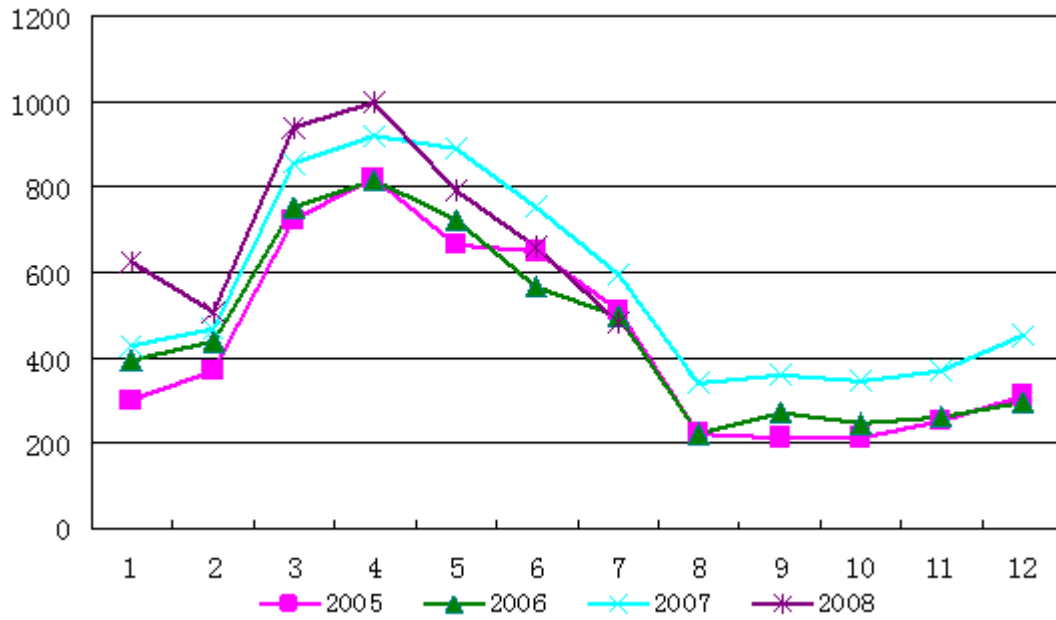
#### Comments:

- **Dependence of air-conditioners on the weather is unchanged.** The main distribution regions of air-conditioners include the middle and eastern part of Northern China, Southern China and Beijing where temperatures were 1-2°C lower, which was one of the main reasons for domestic substantial sales decline in July. Although sales difference of air-conditioners between off-seasons and busy-seasons has been weakened in recent years, the proportion of total domestic sales in off-seasons from annual September to the following March in total domestic sales rose from 28.9% in the cold year of 2001 to 53% in the cold year of 2008. However, for the year of 2008, domestic sales fell 32.7% in May, 21.7% in June and 11.8% in July. Judged from this, as long as obvious low temperatures appear in summer, air-conditioner sales will be seriously impacted and dependence of air-conditioners on weather is unchanged.
  - **The weak real estate market will affect the air-conditioner market in the second half of the year.** According to our calculations, sales areas of the real estate and the six-month lag of air-conditioner sales have the relevance of 52%. In the first 7 months of 2008, sales areas of commercial houses went down 10.8% yoy and the sluggish real estate market will directly affect the air-conditioner sales in the second half of the year; in addition, under the State macro-control, the wait-and-see buyers will increase and major cities such as Shanghai and Shenzhen will witness unchanged downturn of the real estate market in the short term, which will pose certain pressure on the sales prospect of air-conditioners in 2009.
  - **Strengthened global inflation, economic downturn and RMB appreciation impacted the exports of air-conditioners.** Affected by the rising energy and grain prices, global inflation was intensified, US CPI in July rose 5.6% over the same period of last year, the biggest increase in the recent 17 years; the EU considering inflation as No 1 enemy saw inflation rate of 4% in July; most of other countries suffered from new high inflation indexes in recent years. global inflation rate continued rising and the proportion of basic
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consumer goods such as energy and food in the residents' overall consumption increased, which will reduce the demand for consumer durables; due to revaluation of the yuan against the euro in July and economic weakness in Europe, China's exports of air-conditioners to Europe in July down 31% yoy, which acted as the main reason for China's export decline in July. Although China's capacity of air-conditioner accounted for 72 % of the world, since long-term trend of RMB revaluation has not changed, China's export competitiveness of the air-conditioners will be weakened. However, it is expected that the pace of the appreciation might slow down in the second half of year and short-term remission to the impact of RMB revaluation on air-conditioner exports will be available.

- **Concentration of the air-conditioner industry will further increase and recommendations go to the leading players in the industry.** Historical experience showed it was time for speeding up the integration of the industry when difficulties arose. Influenced by the sharp decline in sales, inventories in July rose by 8.4% yoy and sluggish sales appeared which will affect the normal production and operation of the SMEs with relatively weak capital links. China's top three air-conditioning sales in 2007 saw the market share go from 47.49% in 2006 to 50.13 in 2007; in the first half of 2008, market share of Gree, Midea and Haier in the air-conditioner industry came to 51.2%, a year-on-year increase of 4.3ppt. When the air-conditioner industry is facing all kinds of unfavorable factors, it is increasingly difficult for SMEs to survive; leading enterprises relying on their advantages in resource and technology and strong bargaining power with upstream and downstream manufacturers will further squeeze the living space for SMEs and industry concentration will be improved accordingly. In the context of the stock market downturn, investment value of the leading enterprises has appeared. Recommendations: Gree, Midea and Haier.

Figure: Monthly Sales Volume of China's Air Conditioners (Unit: 10,000)



Sources: Zhonghuashangwuwang and TX Investment Consulting

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4	Underweight	Relative performance over TX Free-float Index -5% ~ -15%
5	Sell	Relative performance over TX Free-float Index <-15%

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