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S&P Global

China Ratings

Surveillance Credit Rating Report:

Midea Group Co. Ltd.

Issuer Credit Rating*: AAA_{spc}; Outlook: Stable

July 29, 2022

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The rating presented in this report is effective from the rating date, until and unless we make any further updates.

Tear Sheet

Company Name	Rating Type	Current Rating	Rating Date	Outlook/CreditWatch
Midea Group Co. Ltd.	Issuer Credit Rating	AAA_{spc}	July 29, 2022	Stable

Industry Classification: Consumer durables.

Company Profile: Midea Group Co., Ltd. ("Midea Group" or "company") is the largest home appliance manufacturer in China. It has a leading share in the markets for residential air conditioning units, washing machines, refrigerators and small home appliances. Main business lines are heating, ventilation and air conditioning (HVAC), consumer appliances, robotics, automation systems and other manufactured products. With particular strengths in air conditioning, its HVAC and consumer appliances businesses are the main sources of revenue and profit, accounting for more than 90% of total gross profit. Robotics, automation systems and other manufactured products contribute less than 10% of gross profit. Its products are sold to major global markets, with a balanced domestic-overseas income structure. In 2021, overseas revenue accounted for about 40%.

Economy and Industry Trends: Amid the real estate downturn, sporadic COVID outbreaks and low consumer confidence, we expect significant pressure on demand in China's consumer durables sector in 2022. White goods sales growth may decline or even turn negative from 2021, and product price increases may struggle to mitigate against dwindling sales. As economic stimulus measures overseas are withdrawn and supply chains gradually recover, international demand for appliances is also under pressure, with 2021's high export growth unlikely to be repeated. Upstream raw material prices and transportation costs should stay high, but players' ongoing product price hikes and price corrections for key materials such as copper and aluminum should ease pressure on profit margins. Top players have strong scale advantages, boosting their bargaining power in the supply chain. Furthermore, they have good operating efficiency and cost control ability, giving them more resilience through the cycle. COVID has seen top players consolidate their supply chain and distribution channel advantages, with market concentration further improving.

Credit Highlights

Business Risk Profile: The company's "excellent" business risk profile reflects its excellent brand awareness, outstanding supply-chain integration and strong domestic distribution channels. It has a diverse product mix and brand layout, strong operating efficiency and cost control ability, elevating its competitive strengths above most of its peers. These strengths have seen Midea Group long maintain a leading market share in the domestic home appliances market. Its global operations also allow it to mitigate against fluctuating domestic demand. However, its overseas business is still predominantly original equipment manufacturing (OEM) and it has room for improvement in terms of pushing its brand retail. We expect rising raw material prices to lead to some minor profit erosion. Rising cost pressure can be somewhat relieved through raising product prices and tighter cost control.

Financial Risk Profile: The company's "minimal" financial risk profile reflects its prudent financial policy, strong operating cash flow, abundant cash and low leverage level. While downward industry pressure may weigh on revenue growth compared to 2021, we expect operating cash flow and cash reserves to fully meet capital expenditure and M&A demands over the next 1-2 years. Leverage (measured by debt/EBITDA) should remain very low.

Key Metrics:

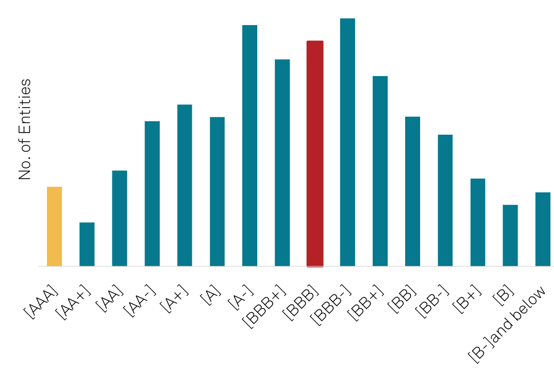
	2021A	2022E	2023F
EBITDA margin (%)	9.6	9.0-10.0	9.0-10.0
Debt/EBITDA (x)	0.8	0.5-1.5	0.5-1.5
EBITDA interest coverage (x)	24.2	20.0-26.0	20.0-26.0

Note: Above data adjusted by S&P Global (China) Ratings. A--Actual. E--Estimate. F--Forecast.

Rating Snapshot:

Issuer Credit Rating:	AAA_{spc}/Stable
Business Risk Profile:	1/Excellent
Industry Risk:	3/Intermediate
Competitive Position:	1/Excellent
Financial Risk Profile:	1/Minimal
Anchor:	aaa
Adjustments	
Diversification:	Neutral (no impact)
Capital Structure:	Neutral (no impact)
Financial Policy:	Neutral (no impact)
Liquidity:	Exceptional (no impact)
Management & Governance:	Neutral (no impact)
Comparable Ratings Analysis:	Neutral (no impact)
Stand-alone Credit Profile:	aaa_{spc}
External Influence:	0

Position of Midea Group's Credit Quality Among Indicative Credit Quality of 1,700 Chinese Companies



Note: The red bar represents the median indicative credit quality of top 1,700 entities, and the yellow bar represents the position of Midea Group.

Peer Comparison (2020-2021 two-year average, RMB, millions)	Midea Group	Haier	Gree Electric	Hisense Home Appliances
Revenue	312,727	218,640	178,034	57,978
EBITDA	31,482	17,729	27,132	3,616
EBITDA margin (%)	10.1	8.1	15.3	6.5
Debt/EBITDA (x)	0.8	2.1	0.1	1.3
EBITDA interest coverage (x)	23.6	15.6	19.4	30.9

Note: Above data adjusted by S&P Global (China) Ratings. Haier -- Haier Smart Home Co., Ltd., Gree Electric -- Gree Electric Appliances, Inc. of Zhuhai, Hisense Home Appliances -- Hisense Home Appliances Group Co., Ltd. Source: Wind, S&P Global (China) Ratings.

Assumptions and Forecasts

Assumptions

- We expect revenue growth of 0-5% in 2022, based on factors including the downturn in China's real estate sector, sporadic COVID outbreaks and falling overseas demand. 2023 revenue growth is expected to pick up to 3-7% as consumption stimulus measures gradually come into effect.
- Raw material costs should remain high, however profitability should stay stable thanks to increased product prices, RMB depreciation, improved product structures and cost controls. 2022-2023 EBITDA margin should stay at 9.0-10.0%.
- R&D expenditure as a proportion of revenue is expected to remain between 3.3-3.5% over 2022 and 2023.
- 2022 capital expenditure is expected to be 6-8 billion RMB, M&A is expected to be 3-5 billion RMB. In 2023, capex and M&A activity are set to remain stable.
- Over 2022 and 2023, its dividend payout ratio is expected to be 40-45%. Share buybacks are set to be around 2.5-5 billion RMB over the same period.

Outlook

The rating outlook for Midea Group is stable. We expect Midea Group to continue maintaining its leading market share in China's home appliances market over the next 24 months, considering its excellent brand awareness, rich and diversified product mix and proprietary brands, strong distribution channels, leading operating efficiency and cost control ability. The company has a prudent financial policy with leverage long maintained at a very low level. Despite industry challenges such as slowing revenue growth and high raw material prices, we expect the company to maintain strong operating cash flow and sufficient cash reserves. Debt is set to remain stable, with the company maintaining its "minimal" financial risk profile.

Downside scenario: In the following circumstances, we may consider downgrading the company's issuer credit rating: 1. The company's financial risk increases, with leverage (measured by debt/EBITDA) reaching and maintaining a level significantly higher than 1.5 times. Such a scenario could, for example, be caused by large-scale capital expenditure or M&A, leading to a substantial increase in debt; or its EBITDA margin contracting far beyond our expectations; 2. The company's competitive position in China's home appliances market weakens. For example, its share of the markets for white goods and small household appliances enters a long-term significant decline, or operating efficiency and cost advantages weaken significantly.

Upside scenario: N/A.

Appendix

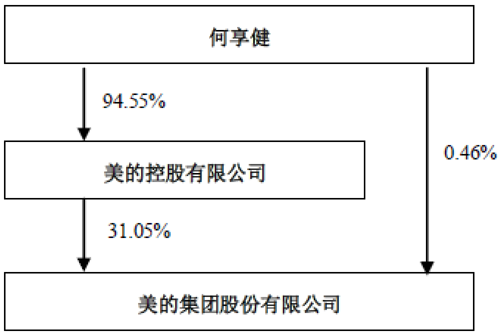
Appendix 1： Key Financial Data

Midea Group: Key Financial Data (RMB, millions)	2019	2020	2021	2022.1–3
Cash and cash equivalent	72,004	109,450	77,755	75,607
Fixed assets	21,665	22,239	22,853	22,910
Total assets	301,955	360,383	387,946	407,842
Short term borrowings	5,702	9,944	5,382	13,389
Notes payable and accounts payable	66,427	82,180	98,736	96,196
Non-current liabilities due within one year	1,460	6,310	28,948	26,999
Long term borrowings	41,298	42,827	19,734	19,531
Bonds payable	-	-	-	2,853
Total owner's equity	107,496	124,237	134,825	142,863
Total revenue	279,381	285,710	343,361	90,939
Operating costs	197,914	216,798	264,526	70,336
Selling expenses	34,611	23,563	28,647	7,600
Administrative expenses	9,531	9,264	10,266	2,381
Financial expenses	-2,232	-2,638	-4,386	-1,155
Investment income	164	2,362	2,366	261
Total profit	29,929	31,664	33,718	8,363
Net profit	25,277	27,507	29,015	7,229
Cash inflow from operating activities	252,123	252,985	330,416	82,313
Cash outflow from operating activities	213,533	223,428	295,324	74,334
Net cash flow from operating activities	38,590	29,557	35,092	7,979
Cash inflow from investment activities	89,005	147,013	127,801	22,674
Cash outflow from investment activities	112,112	182,323	114,202	34,210
Net cash flow from investing activities	-23,108	-35,311	13,600	-11,536
Cash inflow from financing activities	20,016	54,749	21,145	10,931
Cash outflow from financing activities	23,289	55,506	52,350	2,343
Net cash flow from financing activities	-3,274	-756	-31,205	8,587
Adjusted financial data and indicators				
Revenue	278,216	284,221	341,233	90,381
EBITDA	31,786	30,108	32,855	--
CFO	37,710	28,251	33,734	--
Capital expenditure	3,452	4,657	6,825	1,556
Interest expense	881	1,306	1,358	417
Debt	6,177	25,518	27,816	--
EBITDA margin (%)	11.4	10.6	9.6	--
Debt/EBITDA (x)	0.2	0.8	0.8	--
EBITDA interest coverage (x)	36.1	23.1	24.2	--

Notes: 1. The financial data in the above table are based on the 2019-2021 audit report PricewaterhouseCoopers Zhongtian Certified Public Accountants (special general partnership) and issued with standard unqualified opinion and the unaudited financial statements for the first quarter of 2022 disclosed by the company; 2. The adjusted financial data and indicators are the data adjusted by S&P Global (China) Ratings; and 3. "--" means that data are not available.

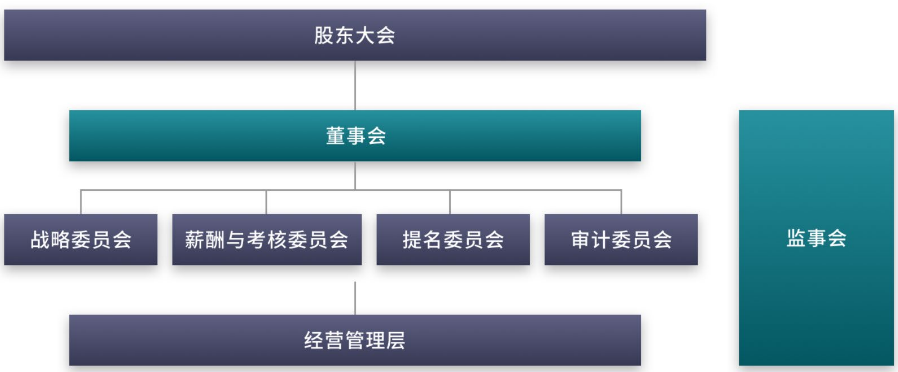
Source: Wind, S&P Global (China) Ratings.

Appendix 2： Ownership Structure of the Rated Entity (as of end of 2021)



Source: Company annual report.

Appendix 3： Organizational Structure of the Rated Entity (as of end of 2021)



Source: Company's official website.

Appendix 4： Key Terms

Key Terms
EBITDA (reported) = Revenue - COGS- SG&A - R&D + D&A(reported) - Taxes and Surcharges - other operating expenses(income)
EBITDA = EBITDA (reported) + OLA rent - Capitalized development cost + Capitalized interest in COGS + Dividend received from equity investments + other adjustments
D&A = D&A(reported)+ OLA depreciation + other adjustments
EBIT = EBITDA (reported) + OLA rent - Capitalized development cost + Capitalized interest in COGS - D&A + non-operating income(expense) + other adjustments
Interest expense = interest expense(reported) + Capitalized interest + OLA interest expense + Hybrid dividend accrual + other adjustments
Cash interest paid = Cash Interest expense + Hybrid dividend cash payment + other adjustments
FFO = EBITDA - Interest expense + interest and dividend income - Current tax + other adjustments
CFO = CFO (reported) + OLA depreciation - Capitalized development cost - Hybrid dividend cash payment - Cash interest expense + Dividends received + other adjustments
Capital expenditure = Capital expenditure(reported)- Capitalized development cost + other adjustments
FOCF = CFO - Capital expenditure
Dividends = Cash dividends + Dividends to minority interest - Hybrid dividend cash payments
DCF = FOCF - Dividends
Short-term debt = Shot-term loan + Financial liabilities held for trading + (Account payable - margin for payables) + Current portion of non-current liabilities (interest-bearing) + Interest payable + Other interest-bearing short-term debt
Long-term debt = Long-term loan + Bond + Financial lease payable+ Lease obligation + Provisions - guarantees & litigations + other interest-bearing long-term debt
Debt = Short-term debt + Long-term debt + OLA debt - Surplus cash + Asset retirement obligation debt adjustment + Hybrid securities + External guarantees & litigations + other adjustments

Capital = Total Equity - Hybrid securities + Debt + Deferred taxes + other adjustment
EBITDA interest coverage = EBITDA/Interest expense
FFO interest coverage = (FFO + Interest expense)/ Cash interest paid
EBITDA (reported) = Revenue - COGS- SG&A - R&D + D&A(reported) - Taxes and Surcharges - other operating expenses(income)
EBITDA = EBITDA (reported) + OLA rent - Capitalized development cost + Capitalized interest in COGS + Dividend received from equity investments + other adjustments

Appendix 5： Ratings Definitions

Category	Definition
AAA_{spc}	The repayment ability is extremely strong, generally not impacted by any adverse economic environment, and the default risk is extremely low.
AA_{spc}	The repayment ability is very strong, not considerably impacted by any adverse economic environment, and the default risk is very low.
A_{spc}	The repayment ability is comparatively strong, comparatively vulnerable to the impact of adverse economic environment, and the default risk is comparatively low.
BBB_{spc}	The repayment ability is average, comparatively impacted by adverse economic environment, and the default risk is average.
BB_{spc}	The repayment ability is comparatively weak, materially impacted by adverse economic environment, and the default risk is comparatively high.
B_{spc}	The repayment ability relies comparatively on fair economic environment and the default risk is very high.
CCC_{spc}	The repayment ability relies extremely on fair economic environment and the default risk is extremely high.
CC_{spc}	Lower protection in situation of bankruptcy or reorganization and the repayment of debt may not be generally guaranteed.
C_{spc}	Unable to repay the debt.

Note: except for AAA_{spc} rating, CCC_{spc} and all ratings below may be added a "+" or "-" sign for minor adjustment to indicate a slightly higher or lower rating.

Appendix 6： Surveillance Plan

S&P Ratings (China) Co., Ltd. shall monitor the credit quality of the rated issuer and issues on a periodic and an ongoing basis. If any material credit events are likely to change the credit quality of the issuer and issues, we will conduct ad-hoc surveillance, and determine whether the outstanding ratings need to be adjusted.