



Rating
Buy

Asia
China

Consumer
Retail / Wholesale Trade

Company
Gree

Reuters 000651.SZ Bloomberg 000651.CH Exchange SHZ Ticker 000651

Date
31 August 2017

Forecast Change

Price at 31 Aug 2017 (CNY)	38.65
Price target - 12mth (CNY)	44.40
52-week range (CNY)	41.53 - 19.49
Shenzhen Index	2,028

2Q17 beat but GPM pressure in 2H17; Buy given inexpensive valuation

Valuation remains inexpensive at 11/11x 17/18 PE and 5% yield

Gree's 2Q17 NP beat DB/market estimates by 35%/17% due to sales growth acceleration and operating leverage. We believe channel inventory remains at a healthy level at the beginning of the cold year (end of July). Thus, we raised our sales forecasts for 2017-2019 by 7-9%. Meanwhile, we lower our 2017 GPM forecast by 1.6ppt to reflect raw material price hike pressure in 2H17. Although 2018 will be a tough year given high base in 2017 due to property boom and restocking, we believe product upgrades and relatively inexpensive valuation with 5% yield warrants a Buy recommendation.

2H17 outlook – channel inventory remains healthy but more pressure on GPM

For 2H17, we expect Gree to report a 19% rise in sales with 10% increase in volume as we believe the current channel inventory level remains healthy (~21m units). Meanwhile, we expect GPM to decline 1.3ppt to 31.4% from 32.7% in 1H17 due to continuous raw material price increase. However, opex ratio might remain low as demand remains strong. We expect EBITM of 15% in 2H17 (15.5% in 1H17).

2Q17 NP beat due to sales growth acceleration and operating leverage

2Q17 saw NP up 68% on sales up by 60% vs 1Q sales/NP up by 19%/27%, mainly thanks to restocking cycle and strong demand from retail end. GPM shrank 8ppt to 30.2% affected by raw materials cost hike, while opex ratio contracted 12.6% to 14.1%. Thus, the company still enjoys an operating leverage with EBIT margin improving 7.6ppt to 16%.

Raising target price to RMB44.4 from RMB38.87; risks

We use DCF to value the company with a new target price of RMB44.4 (old RMB38.87), as we raise our FY17-FY19 NP forecast by 7-9%. Our target price implies 13x/12x FY17/18 PE, which is at a premium to its historical valuation point during de-stocking of channel inventory, and dividend yield at 4.6% for FY17E. Downside risks include competition, subsidy policy, and M&A.

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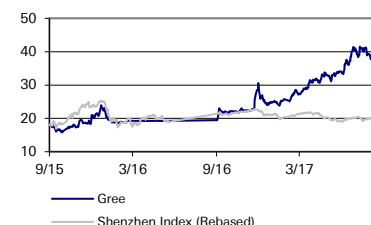
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Key changes

TP	38.87 to 44.40	↑	14.2%
Sales (FYE)	131,413 to 139,980	↑	6.5%
Op prof margin (FYE)	15.5 to 16.2	↑	4.4%
Net profit (FYE)	18,857.2 to 20,569.0	↑	9.1%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-1.5	13.4	101.1
Shenzhen Index	3.2	7.2	-4.6

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	99,812.6	108,682.7	139,979.7	155,684.2	171,216.9
EBITDA (CNYm)	14,315.1	15,515.4	24,349.0	25,866.2	28,495.9
Reported NPAT (CNYm)	12,532.4	15,421.0	20,569.0	22,163.2	24,638.1
Reported EPS FD(CNY)	2.08	2.56	3.42	3.68	4.10
DB EPS FD(CNY)	2.08	2.56	3.42	3.68	4.10
OLD DB EPS FD(CNY)	2.08	2.56	3.13	3.45	3.84
% Change	0.0%	0.0%	9.1%	6.9%	6.7%
DB EPS growth (%)	-11.5	23.0	33.4	7.8	11.2
PER (x)	10.3	8.3	11.3	10.5	9.4
EV/EBITDA (x)	2.7	2.3	4.6	3.7	2.6
DPS (net) (CNY)	1.50	1.50	2.05	2.21	2.46
Yield (net) (%)	7.0	7.1	5.3	5.7	6.4

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses



Model updated: 31 August 2017

Running the numbers

Asia
China
Retail / Wholesale Trade

Gree

Reuters: 000651.SZ Bloomberg: 000651.CH

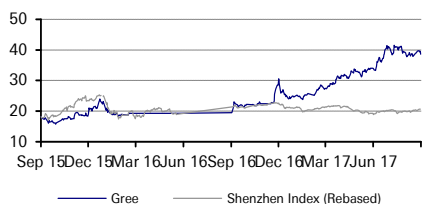
Buy

Price (31 Aug 17) CNY 38.65
Target Price CNY 44.40
52 Week range CNY 19.49 - 41.53
Market Cap (m) CNYm 232,508
USDm 35,321

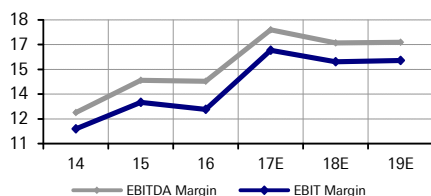
Company Profile

Gree is mainly engaged in the manufacture and distribution of household air conditioners and central air conditioners.

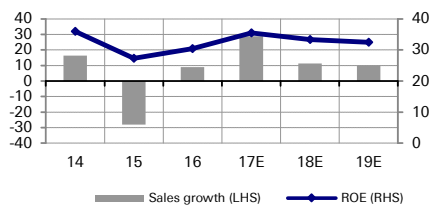
Price Performance



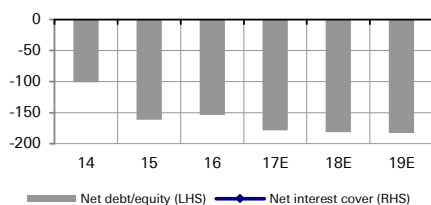
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	2.35	2.08	2.56	3.42	3.68	4.10
Reported EPS (CNY)	2.35	2.08	2.56	3.42	3.68	4.10
DPS (CNY)	1.50	1.50	1.50	2.05	2.21	2.46
BVPS (CNY)	14.7	7.9	9.0	10.3	11.8	13.4
Weighted average shares (m)	6,016	6,016	6,016	6,016	6,016	6,016
Average market cap (CNYm)	83,062	128,915	127,585	232,508	232,508	232,508
Enterprise value (CNYm)	28,595	38,315	36,239	112,780	94,460	75,270

Valuation Metrics

P/E (DB) (x)	5.9	10.3	8.3	11.3	10.5	9.4
P/E (Reported) (x)	5.9	10.3	8.3	11.3	10.5	9.4
P/BV (x)	1.20	2.83	2.75	3.74	3.28	2.88
FCF Yield (%)	20.2	34.2	11.6	17.6	13.7	14.7
Dividend Yield (%)	10.9	7.0	7.1	5.3	5.7	6.4
EV/Sales (x)	0.2	0.4	0.3	0.8	0.6	0.4
EV/EBITDA (x)	1.7	2.7	2.3	4.6	3.7	2.6
EV/EBIT (x)	1.8	3.0	2.6	5.0	3.9	2.8

Income Statement (CNYm)

Sales revenue	138,643	99,813	108,683	139,980	155,684	171,217
Gross profit	50,609	33,861	36,591	45,078	50,406	55,581
EBITDA	17,171	14,315	15,515	24,349	25,866	28,496
Depreciation	1,357	1,338	1,838	1,729	1,795	1,875
Amortisation	0	0	0	0	0	0
EBIT	15,814	12,977	13,678	22,620	24,071	26,620
Net interest income/(expense)	942	1,929	4,846	2,092	2,556	2,981
Associates/affiliates	-4	3	8	6	6	6
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	16,752	14,909	18,531	24,718	26,633	29,607
Income tax expense	2,499	2,286	3,007	4,010	4,321	4,804
Minorities	98	91	104	138	149	166
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	14,155	12,532	15,421	20,569	22,163	24,638
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	14,155	12,532	15,421	20,569	22,163	24,638

Cash Flow (CNYm)

Cash flow from operations	18,556	46,954	18,070	43,235	34,408	37,042
Net Capex	-1,777	-2,885	-3,277	-2,380	-2,647	-2,911
Free cash flow	16,779	44,070	14,793	40,856	31,762	34,132
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-4,676	-9,525	-9,180	-12,341	-13,298	-14,783
Net inc/(dec) in borrowings	2,417	1,526	792	0	0	11,363
Other investing/financing cash flows	1,483	-1,796	389	0	0	0
Net cash flow	16,004	34,274	6,793	28,514	18,464	30,712
Change in working capital	6,559	32,374	-85	19,921	9,996	9,887

Balance Sheet (CNYm)

Cash and other liquid assets	54,546	88,820	95,613	124,127	142,591	161,940
Tangible fixed assets	17,948	18,588	21,636	22,286	23,138	24,173
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	9,946	13,397	8,155	8,161	8,167	8,173
Other assets	73,791	40,894	56,965	69,417	75,665	81,845
Total assets	156,231	161,698	182,370	223,992	249,561	276,131
Interest bearing debt	9,046	10,572	11,363	11,363	11,363	11,363
Other liabilities	102,054	102,560	116,083	149,339	165,894	182,443
Total liabilities	111,099	113,131	127,446	160,702	177,257	193,806
Shareholders' equity	44,153	47,521	53,864	62,092	70,957	80,812
Minorities	979	1,045	1,060	1,198	1,347	1,513
Total shareholders' equity	45,131	48,567	54,924	63,289	72,304	82,325
Net debt	-45,500	-78,248	-84,250	-112,764	-131,228	-150,577

Key Company Metrics

Sales growth (%)	16.4	-28.0	8.9	28.8	11.2	10.0
DB EPS growth (%)	30.2	-11.5	23.0	33.4	7.8	11.2
EBITDA Margin (%)	12.4	14.3	14.3	17.4	16.6	16.6
EBIT Margin (%)	11.4	13.0	12.6	16.2	15.5	15.5
Payout ratio (%)	63.7	72.0	58.5	60.0	60.0	60.0
ROE (%)	36.0	27.3	30.4	35.5	33.3	32.5
Capex/sales (%)	1.3	2.9	3.0	1.7	1.7	1.7
Capex/depreciation (x)	1.3	2.2	1.8	1.4	1.5	1.6
Net debt/equity (%)	-100.8	-161.1	-153.4	-178.2	-181.5	-182.9
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates

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Valuation and risks

Our primary valuation methodology is DCF. As most of Gree's business comes from China, we use a 9.5% China COE, provided by Deutsche Bank's Economics Team. We use a beta of 1 and a long-term growth rate of 2%, in line with our 2.0-2.5% sector assumption for other consumer stocks that we cover. This comes to a fair value estimate of RMB44.4/share, implying an FY17/18E PE of 13/12x. Downside risks include fierce competition, volatility in government subsidy policy, and M&A.

Figure 1: DB estimate vs. market consensus

RMBm	Current forecast			Previous forecast			Market forecast			% change vs. previous			% change vs. market		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Gross sales	141,394	157,257	172,946	131,413	144,733	159,427	131,940	144,553	158,437	8%	9%	8%	7%	9%	9%
EBIT	22,620	24,071	26,620	20,346	22,470	24,917	19,382	21,183	23,716	11%	7%	7%	17%	14%	12%
Net profit	20,569	22,163	24,638	18,857	20,733	23,088	18,969	21,197	23,299	9%	7%	7%	8%	5%	6%

Source: Deutsche Bank, Bloomberg Finance LP

1H/2Q17 results review

2Q17 NP beat DB/market estimates by 35%/17% thanks to better than expected topline growth and operating leverage

2Q17 NP was up 68% as sales rose 60%, both registering an acceleration in growth vs. 1Q. This is mainly thanks to restocking cycle and strong demand from retail end, together with an extraordinarily low base in 2Q16. Excluding connected transaction with Zhuhai Yinlong in 2Q, core sales grew 42%.

EBIT margin thus saw an improvement of 7.6ppt to 16%

During this quarter, GPM shrank 8ppt to 30.2%, while opex ratio contracted 12.6% to 14.1%. We believe this was due to a mixture of the following reasons:

- Raw material cost (e.g. copper (17% of total raw material) price climbed 4%/5%/4% for 4Q16/1Q17/2Q17) hike and less promotion expense required during a tight supply market,
- Recognition of some of the rebates which were booked in the previous years, given the air con retail market boom in 1H17.

1H17 NP rose by 48% on gross sales increase of 40%

Gree reported 48% NP growth to RMB9.4bn on gross sales up 40% to RMB70bn in 1H17. Sales beat market/DB estimates by 12%/11% and NP beat market/DB estimates by 9%/18%, mainly due to lower-than-expected opex ratio (5.5ppt lower than DB) despite a lower GPM (3.9ppt lower than DB) resulting from raw material cost hike, and overseas business saw GPM declining 8ppt.

EBIT margin has improved by 4ppt to 15.5%. Excluding connected transaction with Zhuhai Yinlong, core sales saw 27% growth. The company was also negatively affected by foreign exchange loss of RMB491m vs. an exchange gain of RMB2.3bn, due to RMB depreciation this year vs. the opposite trend last year.



Market share gain achieved

According to China IOL, Gree's sales volume (sell-in) jumped by 40% (vs. 33% in 1Q) with 68% growth from domestic market in 2Q (vs. 62% in 1Q). The high growth momentum has continued in July when Gree's sell-in volume moved up by 41% despite a high base last year.

Based on statistics from China Market Monitor, Gree gained 4.8ppt/2.1ppt market share in terms of sales volume and sales value to 34.6%/38.7% in 1H17. ASP also increased 4.9% to RMB4192. This is in line with Gree's strategy focus to gain market share which was mentioned during 2016 annual results conference.

By product segment, Gree also focused on centralized air conditioner market, which has a higher industry growth with 25% growth in 1H17. Gree maintained its leading position in the segment since 2012.

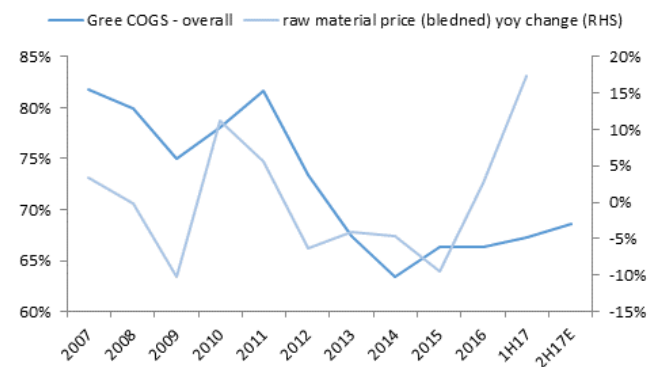
Its prepaid rebates balance increased 3% to RMB60bn in 1H17. Cash flow from operation has declined 68% to RMB3.6bn largely due to inventories being increased 134% for the upcoming peak season.

2H17 outlook

For 2H17, we expect Gree to report a 19% rise in sales with 10% increase in volume as we believe the extremely hot summer helped to digest channel inventories and the inventory level has been reduced from around 31m units as of March 2017 to 21m units as of July 2017, according to China IOL. Compared with 1H17, slower growth in 2H17 is expected due to high base in 2016, as 2017's growth driver includes retail end demand (property market boom and trading up for better models) and restocking by distributors.

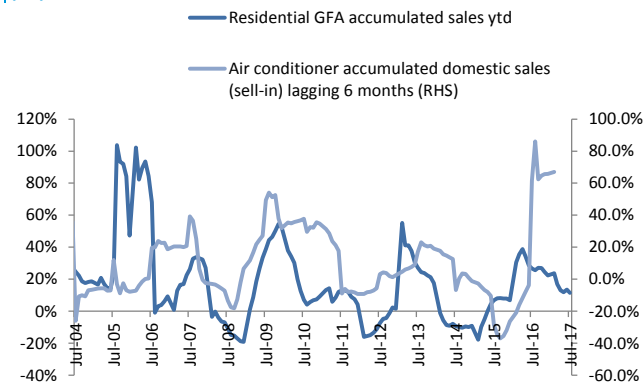
GPM might be under pressure (we expect a decline of 1.3ppt to 31.4% from 32.7% in 1H17) due to rise in raw material price. However, opex ratio might remain low as demand remains strong. We expect EBITM of 15% in 2H17 (15.5% in 1H17) assuming the GPM pressure in 2H17 will be more than 1H17.

Figure 2: Major raw material cost yoy % vs. Gree's COGS ratio



Source: Deutsche Bank, Bloomberg Finance LP. Note: blended raw materials assuming 17% are copper, 5% of steel, 5% aluminium and 73% of others

Figure 3: Residential GFA (accumulated) ytd vs. air conditioner accumulated domestic sell-in sales volume yoy %



Source: Deutsche Bank, China IOL, NBS



Figure 4: Quarterly results highlights

YE 31Dec, RMBm	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17E	4Q17E
Gross sales	25,010	33,920	41,089	39,986	25,094	26,517	32,065	16,889	25,098	24,993	33,679	26,342	30,035	39,985	40,549	30,823
yoy growth	12%	9%	17%	27%	0%	-22%	-22%	-58%	0%	-6%	5%	54%	19%	60%	20%	20%
Full year contribution	18%	24%	29%	29%	25%	26%	32%	17%	23%	23%	31%	24%	21%	28%	29%	22%
Gross profit	8,881	11,060	16,143	15,189	8,287	6,868	12,643	6,097	8,604	9,797	10,984	7,749	10,549	12,361	15,409	7,033
GP margin	35.5%	32.6%	39.3%	38.0%	33.0%	25.9%	39.4%	36.1%	34.3%	39.2%	32.6%	29.4%	35.1%	30.9%	38.0%	22.8%
EBIT	2,485	3,834	4,729	4,766	3,139	3,447	3,974	2,417	2,713	2,064	5,210	3,694	4,675	6,317	6,990	4,637
yoy growth	66%	12%	13%	31%	26%	-10%	-16%	-49%	-14%	-40%	31%	53%	72%	206%	34%	26%
EBIT margin	9.9%	11.3%	11.5%	11.9%	12.5%	13.0%	12.4%	14.3%	10.8%	8.3%	15.5%	14.0%	15.0%	15.9%	16.8%	11.9%
Net profit	2,255	3,463	4,109	4,328	2,775	2,945	4,232	2,580	3,160	3,243	4,827	4,192	4,015	5,438	6,519	4,598
Full year contribution	16%	24%	29%	31%	22%	24%	34%	21%	20%	21%	31%	27%	20%	26%	32%	22%

Source: Deutsche Bank, company announcement

The author of this report wishes to acknowledge the contribution made by Louise Li, employee of Evalueserve, a third-party provider to Deutsche Bank of offshore research support services.



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Gree	000651.SZ	38.65 (CNY) 31 Aug 17	14

Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>. Aside from within this report, important conflict disclosures can also be found at <https://gm.db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

Important Disclosures Required by U.S. Regulators

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14. Deutsche Bank and/or its affiliate(s) has received non-investment banking related compensation from this company within the past year.

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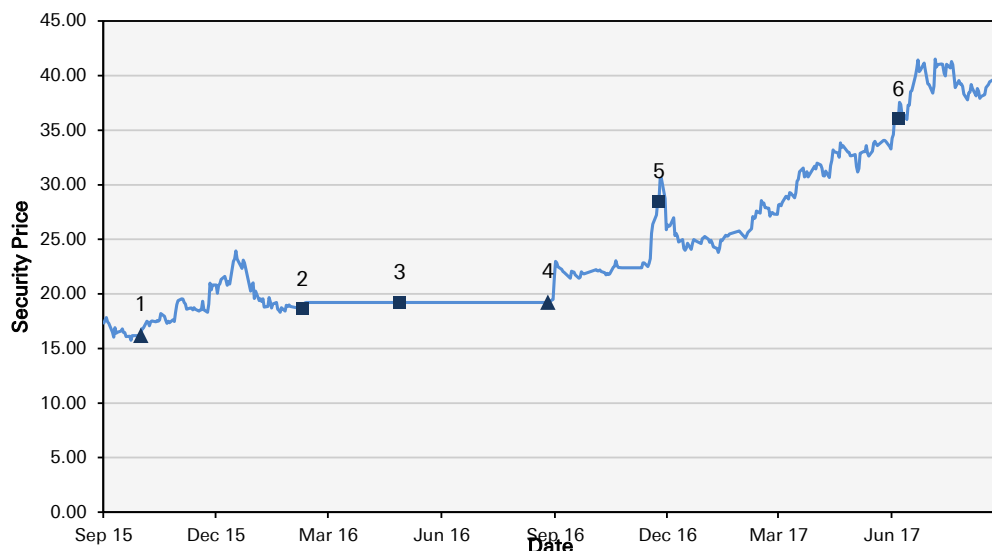
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Anne Ling



Historical recommendations and target price: Gree (000651.SZ)

(as of 8/31/2017)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

**Analyst is no longer at Deutsche Bank

1. 07/10/2015:	Upgrade to Hold, Target Price Change CNY17.27 Richard Rui-Huang**	4. 01/09/2016:	Upgrade to Buy, Target Price Change CNY24.91 Richard Rui-Huang**
2. 15/02/2016:	Hold, Target Price Change CNY16.29 Richard Rui-Huang**	5. 30/11/2016:	Buy, Target Price Change CNY28.48 Richard Rui-Huang**
3. 04/05/2016:	Hold, Target Price Change CNY18.10 Richard Rui-Huang**	6. 12/06/2017:	Buy, Target Price Change CNY38.87 Anne Ling

Equity rating key

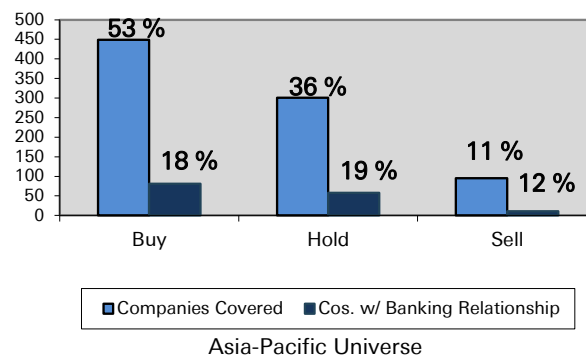
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships





Additional Information

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