

GREE ELECTRIC [000651.CH]

Gree is benefitting from recent strong domestic demand for air conditioning, and we expect the Company to report a strong performance for 2018H1. Recent RMB weakness also benefits Gree. We remain cautious on Gree, however, due to low visibility on AC sales in 2018H2, its single-product, single-market focus, the lack of new discernible earnings drivers, and an inconsistent growth strategy.

Investment Highlights

Anticipating strong 2018H1 performance. Due to hot weather, lean inventory levels, and a resilient property market, all AC manufacturers in China are seeing strong sales growth. Gree is guiding revenue of RMB 200bn in 2018 versus consensus estimates of ~RMB 177bn. We expect Gree to achieve sales of ~RMB95bn in 2018H1, or 34% YoY growth.

Trade war concerns overblown. We estimate that 20% of Gree's exports, or ~RMB3bn in 2017, were exported to the United States. This is equivalent to ~2% of Gree's total sales in 2017.

USD holdings to result in currency gains. As of Dec. 2017, Gree held ~US\$6.5bn in cash, against ~US\$1.5bn in debt. We estimate that 5% RMB depreciation since Dec. 2017 will result in a translation gain of ~RMB1.8bn before tax, or a 6% increase in Gree's 2018E PBT. However, this is a one-off gain which should not result in a re-rating of the stock.

Gree's exports will benefit from USD strength. While the 2018H1 results should have been negatively affected by the relatively strong RMB in most of 2018H1, recent RMB exchange rate fluctuations should have an impact in 2018H2. We estimate that 5% RMB depreciation will increase Gree's 2018H2 PBT by ~RMB200m, or ~0.7% of 2018E's PBT. The impact should be greater in 2019.

Fair Valuation. Gree is on track for solid revenue growth in 2018H1, and its low valuation, coupled with an interim dividend announcement, may result in near-term outperformance. Although the Company may benefit from RMB weakness, the impact is not sufficiently large to justify a re-rating. In spite of a strong 2018H1 top line, we remain cautious about 2018H2 in light of low visibility on AC sales, the lack of new discernible long-term growth drivers, and an inconsistent corporate strategy. We believe Gree warrants a discount relative to its peers Haier and Midea and value the Company at 9.5x 2019 earnings, implying a 12-month target price of RMB48, or ~8.5% upside.

	2016	2017	2018E	2019E	2020E
Revenue (RMB Mn)	110,113	150,020	178,252	203,787	223,364
Growth (%)	9%	36%	19%	14%	10%
Net Profit (RMB Mn)	15,464	22,402	26,212	30,409	33,601
Growth (%)	23%	45%	17%	16%	10%
EPS (RMB)	2.57	3.72	4.36	5.05	5.59
PER (x)	16.8	11.6	9.9	8.5	7.7
PBR (x)	4.8	4.0	3.2	2.7	2.2

Sources: Company Annual Report, CGIS Research

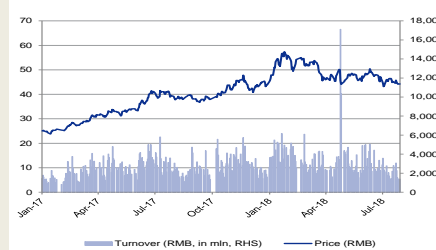
Home Appliances Sector

HOLD

Close: RMB 44.22 (July 30, 2018)

Target Price: RMB 48 (+8.5%)

Price Performance



Market Cap	US\$39Bn
Shares Outstanding	6,016m
Free Float	56%
52W High	RMB 58.7
52W Low	RMB 36.4
3M Avg Daily T/O:	US\$ 430m
Major Shareholders:	Gree Group (18.2%)

Sources: Company, Bloomberg

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Impact of Gree's USD Holdings

As of Dec. 2017, Gree held ~US\$46.5bn in cash against ~US\$1.5bn in debt. The net USD position was reported as the equivalent of RMB35.4bn. Changes in the USD/RMB exchange rate will create translation gains/losses that will accrue to net profit. We estimate that 5% RMB depreciation since Dec. 2017 will result in a translation gain of ~RMB1.8bn before tax, or a 6% increase in Gree's 2018E PBT (Figure 1).

Figure 1: Translation Impact of Gree's USD Holdings

Dec. '18 RMB/USD	Change from '17 (%)	USD Net Cash Exposure (RMB Mn)	Translation Impact (RMB Mn)	2018 PBT (RMB Mn)	2018 PBT Impact (%)
7.2	10%	38,910	3,537	34,530	11%
6.9	5%	37,141	1,769	32,762	6%
6.5	0%	35,372	0	30,993	0%
6.2	-5%	33,604	(1,769)	29,224	-6%
5.9	-10%	31,835	(3,537)	27,456	-11%

Source: Company Reports, CGIS Research

Note: Ignores hedging effects

Exports to Benefit from RMB Depreciation

In 2017, Gree booked RMB18.4bn out of RMB150bn in sales to international markets. We understand that Gree currently operates one manufacturing plant outside of China. On this basis, we estimate the majority of Gree's total international sales are exports originating from mainland China. Theoretically, the appreciation of the USD for exports may result in higher revenues while overall RMB-based costs remain stable.

The benefits accruing to Gree from export revenue will be adjusted since (i) only ~20% of Gree's exports are to the U.S. market. So while the majority of Gree's exports are priced in USD, local currency depreciation in end markets may limit Gree's ability to hold fixed prices in USD, and (ii) currency fluctuation in the past two months will mainly affect sales in 2018H2 and 2019.

We sought to ascertain Gree's higher profitability from RMB depreciation. Based on our estimates, we see RMB depreciation of 5% from Dec. 2017 levels benefiting Gree's PBT by ~RMB 200m in 2018H2, or ~0.7% of 2018E's PBT. The impact on 2019 will be greater due to the full-year impact.

Figure 2: Incremental Impact on Exports

		A	B	C	D	A/C	B/D
Dec. '18 RMB/USD	Change from Dec. '17 (%)	2018H2 Impact (RMB Mn)	2019 Impact (RMB Mn)	2018 PBT (RMB Mn)	2019 PBT (RMB Mn)	2018 PBT Impact (%)	2019 PBT Impact (%)
7.2	10%	424	970	31,417	36,926	1.4%	2.7%
6.9	5%	212	485	31,205	36,441	0.7%	1.3%
6.5	0%	0	0	30,993	35,956	0%	0%
6.2	-5%	(212)	(485)	30,781	35,471	-0.7%	-1.3%
5.9	-10%	(424)	(970)	30,569	34,986	-1.4%	-2.7%

Source: Company Reports, CGIS Research

Note: Ignores hedging effects

FINANCIAL MODEL

Figure 3: Simplified Consolidated Statement of Profit and Loss

Dec. Year End (RMB Mln)	2016	2017	2018E	2019E	2020E
Sales Revenue	110,113	150,020	178,252	203,787	223,364
COGS	(72,886)	(99,563)	(119,521)	(136,428)	(149,592)
Gross profit	37,227	50,457	58,731	67,359	73,772
Sale tax	(1,430)	(1,513)	(1,798)	(2,055)	(2,253)
Selling and distribution costs	(16,477)	(16,660)	(19,796)	(22,631)	(24,805)
General and administrative expenses	(5,486)	(6,071)	(7,214)	(8,247)	(9,039)
Others	(94)	(196)	(196)	(197)	(197)
Total EBIT	13,740	26,016	29,727	34,229	37,478
Depreciation & Amortisation	1,764	2,296	2,362	2,754	3,146
EBITDA	15,504	28,312	32,089	36,982	40,623
Interest expense	(311)	(819)	(1,026)	(751)	(476)
Interest income	1,484	2,205	2,291	2,478	2,727
Exchange gains/ losses	3,702	(1,603)	0	0	0
Others	(43)	819	0	0	0
Pre-Tax Profit	18,573	26,617	30,993	35,956	39,729
Tax Expense	(3,007)	(4,109)	(4,649)	(5,393)	(5,959)
Net Profit After Tax	15,566	22,509	26,344	30,562	33,770
Minority Interest	103	107	132	153	169
Earnings to Equity Owners	15,464	22,402	26,212	30,409	33,601
EPS (Basic)	2.57	3.72	4.36	5.05	5.59
EPS (Diluted)	2.57	3.72	4.36	5.05	5.59
DPS	1.80	0.00	4.04	2.53	2.79
% YoY growth					
Revenue	9.5%	36.2%	18.8%	14.3%	9.6%
Gross profit	7.8%	35.5%	16.4%	14.7%	9.5%
EBIT	9.2%	89.3%	14.3%	15.1%	9.5%
Net profit	23.4%	44.9%	17.0%	16.0%	10.5%
Margins and ratios					
Gross profit margin	33.8%	33.6%	32.9%	33.1%	33.0%
EBITDA Margin	14.1%	18.9%	18.0%	18.1%	18.2%
EBIT Margin	12.5%	17.3%	16.7%	16.8%	16.8%
Net Profit Margin	14.0%	14.9%	14.7%	14.9%	15.0%

Sources: Company Annual Report, CGIS Research

Figure 4: Simplified Consolidated Statement of Financial Position

Dec. Year End (RMB Mln)	2016	2017	2018E	2019E	2020E
Cash & Equivalents	96,005	100,694	108,804	119,645	130,500
Trade and other receivables	34,078	40,213	44,725	50,258	54,881
Inventories	9,025	16,568	16,600	17,432	19,115
Prepayments	1,815	3,718	3,718	3,718	3,718
Other current assets	1,993	10,342	10,342	10,342	10,342
Total current assets	142,915	171,535	184,188	201,396	218,555
Loans and advances	4,737	6,673	6,673	6,673	6,673
PPE, net	18,263	18,488	20,709	22,548	24,004
Intangible assets	3,355	3,604	4,022	4,429	4,827
Deferred tax assets	9,668	10,838	10,838	10,838	10,838
Other non-current assets	3,436	3,829	3,829	3,829	3,829
Total non-current assets	39,459	43,433	46,072	48,318	50,172
Total assets	182,374	214,968	230,260	249,713	268,727
Short-term borrowings	10,701	18,646	13,646	8,646	3,646
Prepayments	10,022	14,143	14,143	14,143	14,143
Notes payable	9,127	9,767	11,288	12,885	14,128
Accounts payable	29,541	34,553	38,180	43,581	47,786
Tax payable	3,126	3,909	3,909	3,909	3,909
Other payables	4,601	5,561	5,561	5,561	5,561
Other current liabilities	59,733	60,912	60,912	60,912	60,912
Total current liabilities	126,852	147,491	147,639	149,637	150,085
Long-term borrowings	0	0	0	0	0
Other long term liabilities	570	642	642	642	642
Total non-current liabilities	570	642	642	642	642
Total liabilities	127,422	148,133	148,282	150,279	150,728
Shareholders Fund	53,972	65,595	80,606	97,910	116,306
Minority Interest	980	1,240	1,372	1,524	1,693
Total S/H Equity	54,952	66,835	81,978	99,434	117,999
Total Liab & S/H Fund	182,374	214,968	230,260	249,713	268,727

Sources: Company Annual Report, CGIS Research

Figure 5: Simplified Consolidated Statement of Cash Flows

Dec. Year End (RMB MIn)	2016	2017	2018E	2019E	2020E
Net Income	15,566	22,509	26,344	30,562	33,770
Depreciation & Amortization	1,764	2,296	2,362	2,754	3,146
Change in Working Capital	(906)	(6,883)	605	631	(856)
Other Non Cash Adjustments	(1,565)	(1,564)	0	0	0
Operating Cash Flow	14,860	16,359	29,311	33,947	36,059
Cash recovered from investment	3,441	4,003	0	0	0
Capex	(3,277)	(2,425)	(5,000)	(5,000)	(5,000)
Cash spent on investment *	(1,496)	(12,420)	0	0	0
Investments in Fixed Deposits**	(17,914)	(51,412)	0	0	0
Investing Cashflow	(19,247)	(62,253)	(5,000)	(5,000)	(5,000)
Dividend (ordinary)	(9,180)	(11,121)	(11,201)	(13,106)	(15,205)
Debt Movements	1,328	8,601	(5,000)	(5,000)	(5,000)
Others	2,100	251	0	0	0
Financing Cashflow	(5,752)	(2,269)	(16,201)	(18,106)	(20,205)
Total Cash Flow	(10,138)	(48,164)	8,110	10,841	10,855
Cash Flow Ex. Fixed Deposit Investment	7,776	3,247	8,110	10,841	10,855

Note: * Cash investment in WMPs, primarily booked in "Other Current Assets"

** Cash investment into fixed term deposits, which we regard as cash equivalents

Sources: Company Annual Report, CGIS Research

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