

Gree [000651.CH]: Potential slowdown in 2H18

Gree reported a strong set of interim results, with revenue and EPS growing by 31.4% and 34.2% respectively, led by strong results in air conditioning. At present, investor concern is focused on deteriorating China AC sales growth in July / August. We believe top line concerns are likely to pressure the stock into 2H18, and we trim our 2018 / 2019 EPS estimates by 5.7% / 11.4% and reduce our target price from RMB 48 to RMB 42.6 to account for softening top line growth.

Investment Highlights

Strong 1H18 growth, but weaker margins: Gree's AC segment, which comprised ~80% of total sales, grew 38.8% YoY. Gree indicated that sales growth was faster in Tier 3/4 cities for the period. In spite of strong top line growth, gross margins in the AC segment contracted 410bps on account of increased raw materials prices and low utilization at a new Changsha factory. Gree negated the impact of gross margin compression and by cutting selling expense by 350bps to 8.7%, a historical low, which may prove unsustainable in our view.

AC growth decelerating in 2H18: Midea, Gree, and Qingdao Haier all experienced negative growth in AC sales in July due to high base effect and weather. We understand Gree experienced single digit negative volume/sales growth in July due to high base and weather effect. In August, negative growth has moderated to approximately flat growth YoY. This trend is consistent with our channel checks and reporting from other home appliance manufacturers.

Dividend disappoints: Gree announced a proposed interim dividend of RMB3.6bn, indicating ~30% payout ratio for 1H18. This is less than our and market expectations of ~50% payout, and below Gree's historical payout ratio of ~60-70%. Gree has not provided clear guidance on whether it still intends to pay a delayed dividend on 2017's earnings. Gree has also not provided further clarity on where it intends to invest its cash reserves.

Inventory levels under control: Gree's factory and channel inventory remain seasonally low, according to the Company. Similarly, channel inventory levels of industry competitors also remain well controlled.

Inexpensive valuation. In spite of a strong 2018H1 top line, we remain cautious about Gree's 2018H2 in light of low visibility on AC sales, the lack of new discernible long-term growth drivers, and an inconsistent corporate strategy. Gree derives ~88% of its revenue from China, making its earnings almost wholly reliant on the domestic China market. On this basis, we believe Gree warrants a discount relative to its peers Haier and Midea. We cut our 2018/2019 EPS estimates by 5.7%/11.4% and value the Company at 9.5x PER, implying a 12-month target price of RMB42.6, or ~9% upside.

	2016	2017	2018E	2019E	2020E
Revenue (RMB Mn)	110,113	150,020	175,946	187,611	198,567
Growth (%)	9%	36%	17%	7%	6%
Net Profit (RMB Mn)	15,464	22,402	24,707	26,948	28,553
Growth (%)	23%	45%	10%	9%	6%
EPS (RMB)	2.57	3.72	4.11	4.48	4.75
PER (x)	15.2	10.5	9.5	8.7	8.2
PBR (x)	4.3	3.6	3.0	2.5	2.2

Sources: Company Annual Report, CGIS Research

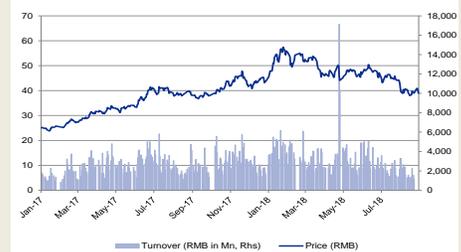
Home Appliances Sector

Hold

Close: RMB 38.95 (Aug. 31, 2018)

Target Price: RMB 42.6 (+9%)

Price Performance



Market Cap	US\$34,204m
Shares Outstanding	6,016m
Free Float	56%
52W High	RMB 58.70
52W Low	RMB 36.42
3M Avg Daily T/O:	US\$39m
Major Shareholders:	Gree Group. (18%)

Sources: Company, Bloomberg

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Figure 1: Gree 1H18 Results Summary

RMB Mn	1H17	1H18	%YoY
Revenue	70,021	92,004	31.4%
COGS	(47,089)	(63,659)	35.2%
Gross Profit	22,932	28,344	23.6%
GPM	32.8%	30.8%	
SG&A	(12,087)	(13,415)	11.0%
Operating Profit	10,844	14,930	37.7%
OP Margin	15.5%	16.2%	
Financing Costs	192	315	
Other G/L	98	(142)	
PBT	11,134	15,103	35.6%
Tax	(1,684)	(2,419)	
Effective tax rate	-15%	-16%	
Net Profit	9,450	12,684	34.2%
NPM	13.5%	13.8%	
Minority Interest	(51)	(79)	
Profit to Common	9,399	12,605	34.1%
EPS (Diluted)	1.57	2.13	35.5%

Sources: Company Reports, CGIS Research

Figure 3: Midea Segmentation Snapshot

Revenue by Product (RMB Mn)	1H17	1H18	% YoY
Consumer Appliances	51,827	55,279	6.7%
Air Conditioning	50,023	63,874	27.7%
Robotics	13,606	12,502	-8.1%
Other	9,507	12,081	27.1%
Revenue	124,964	143,736	15.0%

Gross Profit by Product (RMB Mn)	1H17	1H18	% YoY
Consumer Appliances	14,138	15,236	7.8%
Air Conditioning	14,613	19,325	32.2%
Robotics	2,000	3,055	52.7%
Other	1,161	2,239	92.9%
Gross Profit	31,913	39,854	24.9%

Gross Margin by Product (%)	1H17	1H18
Consumer Appliances	27.3%	27.6%
Air Conditioning	29.2%	30.3%
Robotics	14.7%	24.4%
Other	12.2%	18.5%
Company	25.5%	27.7%

Sources: Company Reports, CGIS Research

Figure 2: Gree Segmentation Snapshot

Revenue by Product (RMB MN)	1H17	1H18	%YoY
AC	54,637	75,820	38.8%
Small Appliances	1,005	1,565	55.7%
Smart Equipment	962	356	-63.0%
Compressors, motors, capacitors	2,684	1,007	-62.5%
Recycling & Other	10,732	13,255	23.5%
Revenue	70,021	92,004	31.4%

Gross Profit by Product (RMB MN)	1H17	1H18	%YoY
AC	21,011	26,057	24.0%
Small Appliances	195	267	36.5%
Smart Equipment	46	42	-9.7%
Compressors, motors, Capacitors	199	99	-50.2%
Recycling & Other	1,481	1,880	27.0%
Gross Profit	22,932	28,344	23.6%

Gross Margin by Product (%)	1H17	1H18
AC	38.5%	34.4%
Small Appliances	19.4%	17.0%
Smart Equipment	4.8%	11.7%
Compressors, motors, Capacitors	7.4%	9.9%
Recycling & Other	13.8%	14.2%
Company	32.8%	30.8%

Sources: Company Reports, CGIS Research

Figure 4: QD Haier Segmentation Snapshot

Revenue by Product (RMB MN)	1H17	1H18	%YoY
AC	16,327	19,194	17.6%
Refrigerator	22,743	25,443	11.9%
Kitchen appliances	13,162	10,473	-20.4%
Water heater	n.a.	3,872	n.a.
Washing machine	13,845	16,282	17.6%
Equipment	1,486	1,248	-16.0%
Channel services	9,680	11,820	22.1%
Revenue	77,243	88,332	14.4%

Gross Profit by Product (RMB MN)	1H17	1H18	%YoY
AC	5,202	5,831	12.1%
Refrigerator	7,324	7,882	7.6%
Kitchen appliances	4,895	3,637	-25.7%
Water heater	n.a.	1,680	n.a.
Washing machine	4,783	5,413	13.2%
Equipment	231	159	-31.1%
Channel services	717	958	33.6%
Gross Profit	23,152	25,559	10.4%

Gross Margin by Product (%)	1H17	1H18
AC	31.9%	30.4%
Refrigerator	32.2%	31.0%
Kitchen appliances	37.2%	34.7%
Water heater	n.a.	43.4%
Washing machine	34.5%	33.2%
Equipment	15.5%	12.7%
Channel services	7.4%	8.1%
Company	30.0%	28.9%

Sources: Company Reports, CGIS Research

FINANCIAL MODEL

Figure 5: Simplified Consolidated Statement of Profit and Loss

Dec. Year End (RMB Mln)	2016	2017	2018E	2019E	2020E
Sales Revenue	110,113	150,020	175,946	187,611	198,567
COGS	(72,886)	(99,563)	(119,583)	(126,366)	(134,074)
Gross profit	37,227	50,457	56,362	61,245	64,493
Sale tax	(1,430)	(1,513)	(1,601)	(1,875)	(1,986)
Selling and distribution costs	(16,477)	(16,660)	(19,351)	(20,646)	(21,863)
General and administrative expenses	(5,486)	(6,071)	(7,090)	(8,366)	(8,859)
Others	(94)	(196)	(130)	(200)	(200)
Total EBIT	13,740	26,016	28,190	30,158	31,586
Depreciation & Amortisation	1,764	2,296	2,362	2,754	3,146
EBITDA	15,504	28,312	30,552	32,912	34,731
Interest expense	(311)	(819)	(1,026)	(751)	(476)
Interest income	1,484	2,205	2,291	2,456	2,651
Exchange gains/ losses	3,702	(1,603)	(238)	0	0
Others	(43)	819	(4)	0	0
Pre-Tax Profit	18,573	26,617	29,214	31,863	33,761
Tax Expense	(3,007)	(4,109)	(4,382)	(4,779)	(5,064)
Net Profit After Tax	15,566	22,509	24,832	27,084	28,697
Minority Interest	103	107	124	135	143
Earnings to Equity Owners	15,464	22,402	24,707	26,948	28,553
EPS (Basic)	2.57	3.72	4.11	4.48	4.75
EPS (Diluted)	2.57	3.72	4.11	4.48	4.75
DPS	1.80	0.00	3.92	2.24	2.37
% YoY growth					
Revenue	9.5%	36.2%	17.3%	6.6%	5.8%
Gross profit	7.8%	35.5%	11.7%	8.7%	5.3%
EBIT	9.2%	89.3%	8.4%	7.0%	4.7%
Net profit	23.4%	44.9%	10.3%	9.1%	6.0%
Margins and ratios					
Gross profit margin	33.8%	33.6%	32.0%	32.6%	32.5%
EBITDA Margin	14.1%	18.9%	17.4%	17.5%	17.5%
EBIT Margin	12.5%	17.3%	16.0%	16.1%	15.9%
Net Profit Margin	14.0%	14.9%	14.0%	14.4%	14.4%

Sources: Company Annual Report, CGIS Research

Figure 6: Simplified Consolidated Statement of Financial Position

Dec. Year End (RMB Min)	2016	2017	2018E	2019E	2020E
Cash & Equivalents	96,005	100,694	107,859	116,347	124,334
Trade and other receivables	34,078	40,213	44,174	46,439	49,026
Inventories	9,025	16,568	16,609	16,147	17,132
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	182,701	192,992	204,551
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	228,773	241,310	254,723
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	11,294	11,935	12,663
Accounts payable	29,541	34,553	38,200	40,367	42,829
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	147,665	145,472	143,663
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	148,308	146,115	144,305
Shareholders Fund	53,972	65,595	79,102	93,696	108,775
Minority Interest	980	1,240	1,364	1,499	1,643
Total S/H Equity	54,952	66,835	80,466	95,195	110,418
Total Liab & S/H Fund	182,374	214,968	228,773	241,310	254,723

Sources: Company Annual Report, CGIS Research

Figure 7: Simplified Consolidated Statement of Cash Flows

Dec. Year End (RMB Mln)	2016	2017	2018E	2019E	2020E
Net Income	15,566	22,509	24,832	27,084	28,697
Depreciation & Amortization	1,764	2,296	2,362	2,754	3,146
Change in Working Capital	(906)	(6,883)	1,173	1,004	(382)
Other Non Cash Adjustments	(1,565)	(1,564)	0	0	0
Operating Cash Flow	14,860	16,359	28,367	30,841	31,461
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)	(12,354)	(13,474)
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)	(17,354)	(18,474)
Total Cash Flow	(10,138)	(48,164)	7,166	8,487	7,987
Cash Flow Ex. Fixed Deposit Investment	7,776	3,247	7,166	8,487	7,987

Sources: Company Annual Report, CGIS Research

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