



Rating
Hold

Asia
China

Consumer
Retail / Wholesale Trade

Company
Gree

Reuters 000651.SZ Bloomberg 000651 CH Exchange SHZ Ticker 000651

Date
5 September 2018

Forecast Change

Price at 5 Sep 2018 (CNY)	37.61
Price target - 12mth (CNY)	34.50
52-week range (CNY)	57.40 - 36.70
Shenzhen Index	1,532

Why we believe cash dividend will continue to disappoint the market

Distributors' liquidity likely at critical level; cut DPS forecasts to below consensus

A common belief by investors is that Gree will eventually increase the cash dividend payout, to gradually distribute the significant net cash on its book (RMB13.5 per share as of 1H18). In this report, we argue that such is very unlikely in the next 3 years in our view, due to: (1) Gree's increased lending to distributors to maintain their liquidity and (2) Gree may hold significant interbank assets. We cut our cash DPS (dividend per share) forecasts in 2019/20 by 21%/24% to RMB 1.9/1.9 (23%/29% lower than Bloomberg Finance LP consensus).

Gree's surging financing to distributors hinting deteriorating liquidity in the channel, and poor revenue ahead

- In 1H18, Gree's "financing to distributors" reached a new high since 2014 (pre-inventory crisis):** we calculate Gree's financing to distributors (see the third bullet point for definition) has reached RMB45bn in 1H18, up 45% YoY. Based on a study on the 2015 inventory cycle, a sharp increase in financing to distributors tends to mean worsened distributor liquidity. As a result, distributor orders (sales) in the subsequent year tend to be poor (Figure 1 and 2).
- Outlook: we forecast Gree to increase its financing to distributors further,** and such may lead to accelerated cash out flow while curbing management's incentive to increase cash dividend payout.
- Financing to distributors: an indicator designed for AC (air conditioner) brands:** for most wholesale consumer companies, accounts receivable serves as the main funding source to distributors. However, the case of AC (Gree and Midea) is more complicated, due to: (1) AC brands collect cash from distributors before shipping products, thus holding a liability (advance from customers), instead of assets (accounts receivable), (2) Gree and Midea have accelerated their lending to distributors. **To cope with the increased complexity, we define an indicator "financing to distributors" (accounts receivable plus loan to distributors minus advance from customers).**

Close to 40% of Gree's cash on book is actually interbank

- Interbank asset has become a major component in Gree's cash, and increasing:** in 1H18, 37% of Gree's cash on book is interbank asset while 4% being deposit at PBOC. We expect interbank asset as a percentage

Valuation & Risks

John Chou
Research Analyst
+852-2203 6196

Anne Ling
Research Analyst
+852-2203 6177

Key changes

Sales (FYE)	180,963 to 178,845	↓	-1.2%
Op prof margin (FYE)	17.4 to 16.5	↓	-5.2%
Net profit (FYE)	28,185.7 to 28,777.9	↑	2.1%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-4.8	-22.5	-1.4
Shenzhen Index	-1.4	-17.6	-25.7

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	36.7
Net debt/equity (%)	-88.6
Book value/share (CNY)	15.13
Price/book (x)	2.5
Net interest cover (x)	-
Operating profit margin (%)	16.5

Source: Deutsche Bank

Deutsche Bank AG/Hong Kong

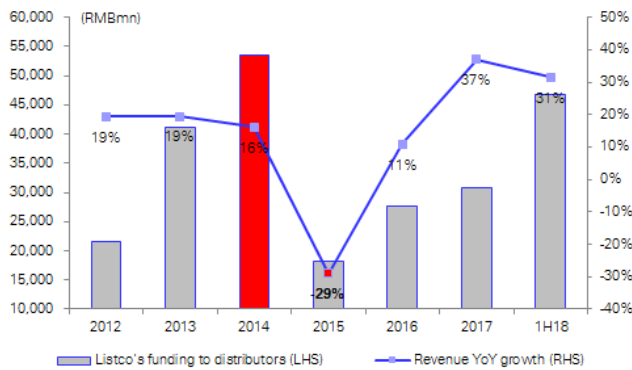
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of total cash to further increase (Figure 5). **We do not expect Gree to distribute its interbank to investors as Gree may need the interest revenue to propel earnings growth.** Historically, Gree has a tendency to increase interbank asset as market liquidity is tight (to enjoy the interest revenue) (Figure 3 & 4).

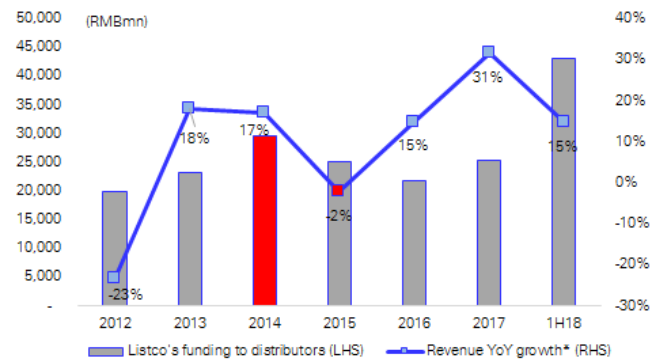
- **Gree's interest yield on interbank asset has been much higher than the big banks:** interestingly, Gree generated a 4.2% annualized rate on its interbank asset during 1H18, much higher than China's biggest commercial banks (Figure 7). We note that Gree's asset yield from interbank has been consistently higher than the big banks, by a significant spread of 100bps (2014 to 1H18 average).
- **How does Gree generate such a high yield on interbank asset?** we estimate that, in addition to participate in the ordinary interbank market, Gree may have been lending to smaller banks and/or trust companies that can "channel" the fund to specific third parties, including Gree's distributors.

Figure 1: Gree: revenue declined sharply in 2015 after financing to distributors surged in 2014. In 1H18, financing to distributors crept up again.



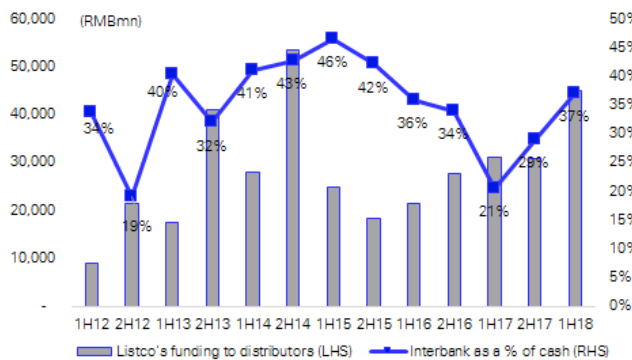
Source: Deutsche Bank estimates, company data

Figure 2: Midea: very similar trend.



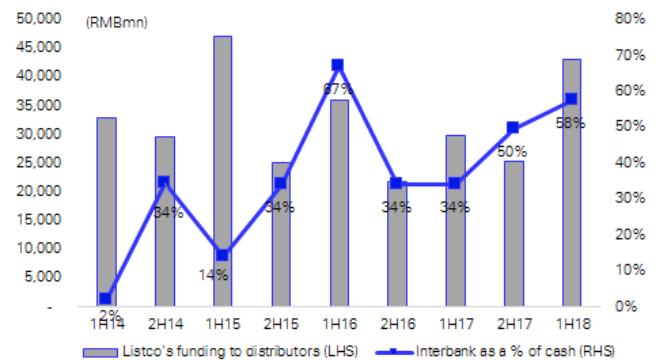
Source: Deutsche Bank estimates, company data * Note: ex-KUKA

Figure 3: Gree tends to hold more interbank asset when market liquidity is tight. This is often the time that Gree needs to increase its financing to distributors



Source: Deutsche Bank estimates, company data

Figure 4: Midea: same as Gree



Source: Deutsche Bank estimates, company data

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Figure 5: We forecast Gree's interbank to take an increasing portion in total cash

(RMBbn)	2011	2012	2013	2014	2015	2016	2017	1H18	2018E	2019E
Deposit to PBOC	1	1	3	5	4	3	3	4	4	5
Interbank	4	5	12	23	37	32	29	38	40	44
Cash (can be distributed to investors)	11	22	23	26	48	61	68	60	55	54
Cash on book	16	29	39	55	89	96	100	102	100	103
Mix %										
Deposit to PBOC	8%	5%	8%	9%	4%	3%	3%	4%	4%	5%
Interbank	26%	19%	32%	43%	42%	34%	29%	37%	41%	43%
Cash (can be distributed to investors)	66%	76%	60%	48%	54%	63%	68%	59%	55%	52%

Source: Deutsche Bank estimates, company data

Figure 7: Why Gree's interbank asset yield is been so much higher than the big banks?

Interbank yield, annualized	1H14	2H14	1H15	2H15	1H16	2H16	1H17	2H17	1H18
CCB	4.7%	4.6%	4.0%	3.8%	2.8%	2.7%	2.5%	2.8%	3.5%
ICBC	3.1%	3.4%	2.8%	2.3%	2.2%	2.3%	3.2%	3.5%	3.7%
ABC	5.3%	4.5%	4.3%	3.5%	3.2%	2.9%	3.3%	3.4%	3.4%
CCB+ICBC+ABC	4.3%	4.2%	3.7%	3.2%	2.7%	2.6%	3.0%	3.2%	3.5%
Gree	5.9%	5.1%	5.1%	4.3%	3.5%	4.0%	4.6%	3.8%	4.2%
Gree over three banks (bps)	151	98	138	110	79	136	156	56	74

Source: Deutsche Bank estimates, company data

Forecasts and ratios

Year End Dec 31	2016A	2017A	2018E	2019E	2020E
Sales (CNYm)	108,302.6	148,286.5	178,844.9	160,317.6	170,072.0
DB EPS FD(CNY)	2.41	3.70	4.79	3.74	3.70
OLD DB EPS FD(CNY)	2.41	3.70	4.75	3.40	3.49
% Change	0.0%	0.0%	0.8%	10.0%	5.8%
DB EPS growth (%)	8.1	53.4	29.4	-21.9	-1.2
PER (x)	8.8	9.7	7.9	10.1	10.2
DPS (net) (CNY)	1.80	0.00	1.91	1.89	1.87
Yield (net) (%)	8.5	0.0	5.1	5.0	5.0

Source: Deutsche Bank estimates, company data

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Revisions, valuation and risks

We take this opportunity to update 2Q18 financials (which was in-line with DBE) and increase Gree's interest revenue significantly to model accelerating financing to distributors. Based on the above analysis we cut our forecasted 2019/20 DPS. Despite of increased earnings forecasts, DBE remains significantly lower than consensus.

Figure 9: Earnings revision

Revision analysis	2018E			2019E			2020E		
	New	Old	diff.	New	Old	diff.	New	Old	diff.
Revenue	178,845	180,963	-1%	160,318	161,825	-1%	170,072	165,922	3%
Gross Profit	58,133	59,027	-2%	51,587	51,301	1%	55,117	52,517	5%
DB Op.Income	29,517	29,892	-1%	20,295	19,715	3%	20,221	20,131	0%
Recur. Net Income	28,795	28,566	1%	22,502	20,450	10%	22,238	21,021	6%
Recur. EPS (RMB)	4.79	4.75	1%	3.74	3.40	10%	3.70	3.49	6%
Gross Margin (%)	32.5%	32.6%	-0.1%	32.2%	31.7%	0.5%	32.4%	31.7%	0.8%
Op. Margin (%)	16.5%	16.5%	0.0%	12.7%	12.2%	0.5%	11.9%	12.1%	-0.2%
Recur. Net Margin (%)	16.1%	15.8%	0.3%	14.0%	12.6%	1.4%	13.1%	12.7%	0.4%
DPS	1.91	1.87	2%	1.89	2.38	-21%	1.87	2.45	-24%

Source: Deutsche Bank estimates, company data

Figure 11: DBE vs. Bloomberg Finance LP consensus

	2018E			2019E			2020E		
	DBe	Consensus	diff.	DBe	Consensus	diff.	DBe	Consensus	diff.
Revenue	178,845	179,935	-1%	160,318	203,917	-21%	170,072	241,088	-29%
Gross Profit	58,133	59,125	-2%	51,587	67,526	-24%	55,117	80,529	-32%
Op.Income	31,985	32,446	-1%	24,304	36,968	-34%	24,482	41,590	-41%
Net Income	28,778	27,339	5%	22,756	30,470	-25%	22,492	34,843	-35%
EPS (RMB)	4.78	4.55	5%	3.78	5.06	-25%	3.74	5.79	-35%
Gross Margin (%)	32.5%	32.9%	-0.4%	32.2%	33.1%	-0.9%	32.4%	33.0%	-0.6%
Op. Margin (%)	17.9%	18.0%	-0.1%	15.2%	18.1%	-3.0%	14.4%	17.3%	-2.9%
Net Margin (%)	16.1%	15.2%	0.9%	14.2%	14.9%	-0.7%	13.2%	14.5%	-1.2%
DPS	1.91	2.56	-25%	1.89	2.45	-23%	1.87	2.62	-29%

Source: Deutsche Bank estimates, company data

We maintain our target price as increased earnings offset by deteriorated working capital conditions. 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 1%, in line with our 1-2% sector assumption for other consumer stocks that we cover.

Downside risks include heavier than expected distributor channel inventory, more severe pressure on distributor margins and weaker execution on investments. Upside risks include special cash dividend, easing distributor pressure thanks to better liquidity and/or lower channel inventory, higher than expected sell-through thanks to stronger consumer and/or weather and accelerating margin expansion.

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Model updated: 05 September 2018

Running the numbers

Asia

China

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Reuters: 000651.SZ Bloomberg: 000651 CH

Hold

Price (5 Sep 18) CNY 37.61

Target Price CNY 34.50

52 Week range CNY 36.70 - 57.40

Market cap (m) CNYm 226,252
USDm 33,123

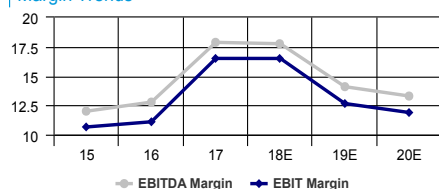
Company Profile

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

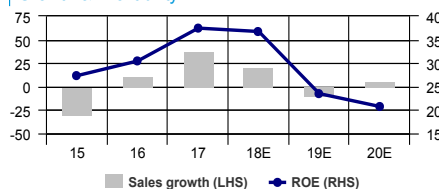
Price Performance



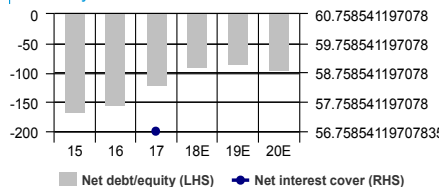
Margin Trends



Growth & Profitability



Solvency



John Chou

+852 2203 6196

john.chou@db.com

Fiscal year end 31-Dec

Financial Summary

	2015	2016	2017	2018E	2019E	2020E
DB EPS (CNY)	2.23	2.41	3.70	4.79	3.74	3.70
Reported EPS (CNY)	2.08	2.57	3.72	4.78	3.78	3.74
DPS (CNY)	1.50	1.80	0.00	1.91	1.89	1.87
BVPS (CNY)	7.9	9.0	10.9	15.1	17.1	19.0
Weighted average shares (m)	6,025	6,017	6,022	6,016	6,016	6,016
Average market cap (CNYm)	129,118	127,611	216,984	226,252	226,252	226,252
Enterprise value (CNYm)	48,722	43,583	136,682	143,604	139,149	116,499

Valuation Metrics

P/E (DB) (x)	9.6	8.8	9.7	7.9	10.1	10.2
P/E (Reported) (x)	10.3	8.3	9.7	7.9	9.9	10.1
P/BV (x)	2.83	2.74	4.01	2.49	2.20	1.98
FCF Yield (%)	32.1	9.1	6.4	5.3	3.9	10.1
Dividend Yield (%)	7.0	8.5	0.0	5.1	5.0	5.0
EV/Sales (x)	0.5	0.4	0.9	0.8	0.9	0.7
EV/EBITDA (x)	4.2	3.1	5.2	4.5	6.2	5.2
EV/EBIT (x)	4.7	3.6	5.6	4.9	6.9	5.8

Income Statement (CNYm)

Sales revenue	97,745	108,303	148,286	178,845	160,318	170,072
Gross profit	33,046	37,234	50,757	60,377	53,893	57,509
EBITDA	11,739	13,840	26,512	31,762	22,601	22,612
Depreciation	1,318	1,817	2,033	2,245	2,306	2,391
Amortisation	0	0	0	0	0	0
EBIT	10,421	12,023	24,479	29,517	20,295	20,221
Net interest income/(expense)	1,929	4,845	-431	1,338	2,555	2,754
Associates/affiliates	97	-2,221	397	950	973	997
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	2,463	3,926	2,173	2,355	3,218	2,760
Profit before tax	14,909	18,573	26,617	34,160	27,041	26,732
Income tax expense	2,286	3,007	4,109	5,273	4,174	4,126
Minorities	91	103	107	109	111	114
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	12,532	15,464	22,402	28,778	22,756	22,492
DB adjustments (including dilution)	904	-963	-133	17	-254	-254
DB Net profit	13,436	14,500	22,269	28,795	22,502	22,238

Cash Flow (CNYm)

Cash flow from operations	44,378	14,860	16,359	14,923	12,239	25,814
Net Capex	-2,883	-3,250	-2,421	-3,040	-3,367	-3,061
Free cash flow	41,495	11,610	13,937	11,882	8,873	22,753
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-9,525	-9,180	-11,121	-3,609	-11,378	-11,246
Net inc/(dec) in borrowings	585	1,328	8,601	-1,262	-1,000	-1,000
Other investing/financing cash flows	1,304	-9,802	-61,379	-339	-9,153	-9,435
Net cash flow	33,859	-6,044	-49,962	6,672	-12,658	1,072
Change in working capital	32,374	43	-5,718	-10,470	-3,850	9,928

Balance Sheet (CNYm)

Cash and other liquid assets	88,820	95,754	99,610	99,668	103,011	124,548
Tangible fixed assets	18,588	21,636	21,591	21,494	21,638	21,296
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	95	355	1,193	2,110	2,111	2,111
Other assets	54,195	64,630	92,573	104,237	108,260	102,136
Total assets	161,698	182,374	214,968	227,509	235,019	250,091
Interest bearing debt	7,474	11,100	19,262	18,000	17,000	16,000
Other liabilities	105,658	116,322	128,871	117,339	114,341	119,049
Total liabilities	113,131	127,422	148,133	135,339	131,341	135,049
Shareholders' equity	47,517	53,972	65,595	91,039	102,659	114,137
Minorities	1,045	980	1,240	1,131	1,019	906
Total shareholders' equity	48,567	54,952	66,835	92,170	103,678	115,042
Net debt	-81,346	-84,654	-80,349	-81,668	-86,011	-108,548

Key Company Metrics

Sales growth (%)	-29.0	10.8	36.9	20.6	-10.4	6.1
DB EPS growth (%)	-14.4	8.1	53.4	29.4	-21.9	-1.2
EBITDA Margin (%)	12.0	12.8	17.9	17.8	14.1	13.3
EBIT Margin (%)	10.7	11.1	16.5	16.5	12.7	11.9
Payout ratio (%)	72.1	70.0	0.0	40.0	50.0	50.0
ROE (%)	27.3	30.5	37.5	36.7	23.5	20.7
Capex/sales (%)	3.0	3.0	1.6	1.7	2.1	1.8
Capex/depreciation (x)	2.2	1.8	1.2	1.4	1.5	1.3
Net debt/equity (%)	-167.5	-154.0	-120.2	-88.6	-83.0	-94.4
Net interest cover (x)	nm	nm	56.8	nm	nm	nm

Source: Company data, Deutsche Bank estimates

5 September 2018
 Retail / Wholesale Trade
 Gree



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Gree	000651.SZ	37.61 (CNY) 5 Sep 2018	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 <https://research.db.com/Research/Disclosures/CompanySearch>. Aside from within this report, important risk and conflict disclosures can also be found at <https://research.db.com/Research/Topics/Equities?topicId=RB0002>. Investors are strongly encouraged to review this information before investing.

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5 September 2018

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Gree



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

(as of 09/05/2018)



Current Recommendations

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

** Analyst is no longer at Deutsche Bank

1.	11/30/2016	Buy, Target Price Change CNY 28.48	Richard Rui-Huang**	5.	04/29/2018	Downgraded to Hold, Target Price Change CNY 45.00	John Chou
2.	06/12/2017	Buy, Target Price Change CNY 38.87	Anne Ling	6.	07/09/2018	Hold, Target Price Change CNY 40.00	John Chou
3.	08/31/2017	Buy, Target Price Change CNY 44.40	Anne Ling	7.	08/17/2018	Hold, Target Price Change CNY 34.50	John Chou
4.	11/13/2017	Buy, Target Price Change CNY 49.20	John Chou				

Equity Rating Key

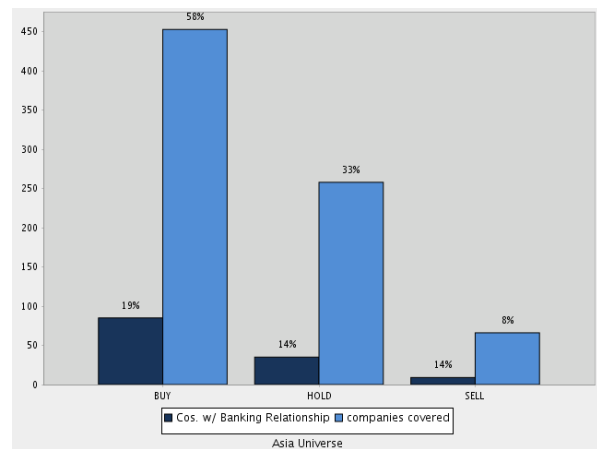
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

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



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Gree



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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Pam Finelli
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research
Global Head of Economics

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Kinner Lakhani
Head of EMEA
Equity Research

Dave Clark
Head of APAC
Equity Research

Andreas Neubauer
Head of Research - Germany

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International Production Locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500