

Gree [000651.CH]: Strong performance may not be sustainable

Gree reported a strong set of 3Q18 results, with revenue and EPS growing 38.2% and 38% YoY, respectively, led by strong results in air conditioning. While the results were solid, investor concern is focused on the sustainability of the strong performance, as rising channel inventory levels may account for a significant portion of the growth. In comparison, Gree's main competitors, Midea and Qingdao Haier, had reported deteriorating China AC sales in 3Q18. Excess inventory could weigh on 2019 sales and profitability, thus impeding share price performance. We reduce our target price from RMB43 to RMB40.

Investment Highlights

Strong 3Q18 growth, but concerns about channel inventory: Gree indicated that channel inventory is at least 15 million units, which we estimate accounts for ~5 months of annual production. This compares unfavourably with Midea, which holds 5 million units of channel inventory, or 2-2.5 months of annual production by our estimates. Unlike Midea, Gree does not warehouse inventory for its distributors, which provides the Company with less clarity over channel inventory levels.

Gree anticipates continued strength in 4Q18: Gree indicated that it expects 4Q18 growth to be roughly in line with that of Q3, but that the AC segment is difficult to predict. For 2019, Gree believes double-digit revenue growth should be achievable. We remain concerned that continued strong sales in a weak market may result in increased channel inventory levels, which may hamper growth in 2019.

Continued dividend uncertainty: Gree announced a proposed interim dividend of 3.6Bn, or RMB0.6 per share, indicating a ~30% payout ratio for 1H18. This was 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 intends to continue this payout ratio for 2H18 earnings. Nor has Gree provided further clarity on where it intends to invest its cash reserves.

Inexpensive valuation. In spite of a strong 9M18 top line, we remain cautious about Gree's future growth in light of increasing channel inventory, 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 raise our 2018 EPS estimates by 4.3% on the back of strong 3Q18, but cut our 2019 EPS estimates by 5%. Our 2018/2019 EPS estimates are 8%/14% below consensus. We value the Company at 9.5x 2019E PER, implying a 12-month target price of RMB40, or ~5% upside.

	2016	2017	2018E	2019E	2020E
Revenue (RMB Mn)	110,113	150,020	182,823	179,342	189,884
Growth (%)	9%	36%	22%	-2%	6%
Net Profit (RMB Mn)	15,464	22,402	25,777	25,605	27,123
Growth (%)	23%	45%	15%	-1%	6%
EPS (RMB)	2.57	3.72	4.28	4.26	4.51
PER (x)	14.8	10.2	8.9	8.9	8.4
PBR (x)	4.2	3.5	2.9	2.5	2.1

Sources: Company Annual Report, CGIS Research

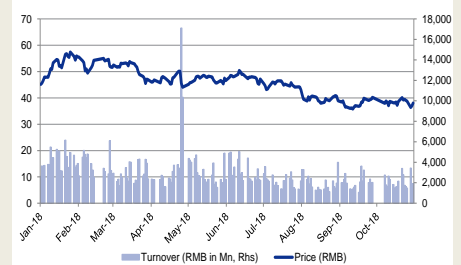
Home Appliances Sector

Hold

Close: RMB 38.06 (Oct. 31, 2018)

Target Price: RMB 40 (+5%)

Price Performance



Market Cap	US\$32,838m
Shares Outstanding	6,016m
Free Float	56%
52W High	RMB 58.70
52W Low	RMB 35.60
3M Avg Daily T/O:	US\$293m
Major Shareholders:	Gree Group. (18%)

Sources: Company, Bloomberg

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Results

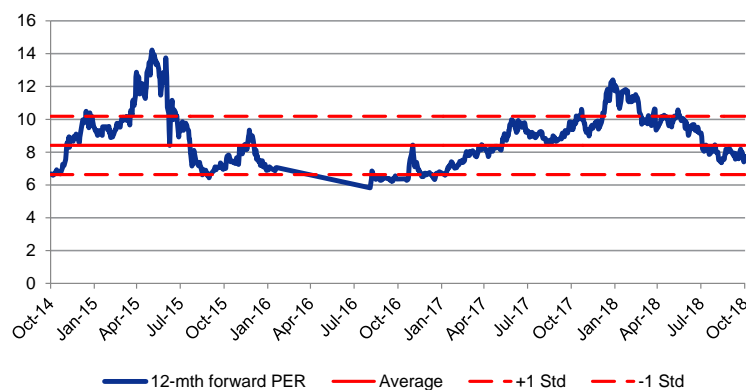
Gree released its 3Q18 results, which were in line with market expectations, following Gree's pre-announcement on October 9. Total revenue rose 38.2% YoY for the quarter, an acceleration over Gree's 31% growth in first half. Net profit to common grew 38.3% YoY for the quarter.

Figure 1: Gree 9M18 Results Overview

RMB Mn	9M17	9M18	%YoY	3Q17	3Q18	%YoY
Revenue	112,027	150,050	33.9%	42,006	58,045	38.2%
COGS	(76,090)	(103,861)	36.5%	(29,001)	(40,202)	38.6%
Gross Profit	35,937	46,189	28.5%	13,005	17,844	37.2%
GPM	32.1%	30.8%	-1.3%	31.0%	30.7%	-0.2%
SG&A	(17,591)	(21,929)	24.7%	(5,532)	(8,515)	53.9%
Operating Profit	18,346	24,260	32.2%	7,473	9,329	24.8%
OP Margin	16.4%	16.2%	-0.2%	17.8%	16.1%	-1.7%
Financing Costs	277	696	151.4%	85	381	347.6%
Other G/L	(304)	207	-167.9%	(455)	149	-132.7%
PBT	18,318	25,163	37.4%	7,103	9,859	38.8%
Tax	(2,730)	(3,922)	43.7%	(1,046)	(1,503)	43.7%
Effective tax rate	15%	16%	0.7%	15%	15%	0.5%
Net Profit	15,588	21,241	36.3%	6,058	8,356	37.9%
NPM	13.9%	14.2%	0.2%	14.4%	14.4%	0.0%
Minority Interest	(72)	(123)	69.5%	(21)	(43)	102.7%
Profit to Common	15,461	21,118	36.6%	6,008	8,312	38.3%
EPS (Diluted)	2.57	3.51	36.6%	1.00	1.38	38.0%

Source: Company Reports, CGIS Research

Figure 2: Gree Consensus PE band



Source: Bloomberg, CGIS Research

FINANCIAL MODEL

Figure 3: Simplified Consolidated Statement of Profit and Loss

Dec. Year End (RMB Min)	2016	2017	2018E	2019E	2020E
Sales Revenue	110,113	150,020	182,823	179,342	189,884
COGS	(72,886)	(99,563)	(123,985)	(121,073)	(128,516)
Gross profit	37,227	50,457	58,838	58,268	61,367
Sale tax	(1,430)	(1,513)	(1,670)	(1,792)	(1,898)
Selling and distribution costs	(16,477)	(16,660)	(20,287)	(19,728)	(20,899)
General and administrative expenses	(5,486)	(6,071)	(7,296)	(7,994)	(8,468)
Others	(94)	(196)	(130)	(200)	(200)
Total EBIT	13,740	26,016	29,455	28,555	29,902
Depreciation & Amortisation	1,764	2,296	2,362	2,754	3,146
EBITDA	15,504	28,312	31,816	31,308	33,048
Interest expense	(311)	(819)	(1,026)	(751)	(476)
Interest income	1,484	2,205	2,291	2,471	2,643
Exchange gains/ losses	3,702	(1,603)	(238)	0	0
Others	(43)	819	(4)	0	0
Pre-Tax Profit	18,573	26,617	30,478	30,275	32,069
Tax Expense	(3,007)	(4,109)	(4,572)	(4,541)	(4,810)
Net Profit After Tax	15,566	22,509	25,907	25,733	27,259
Minority Interest	103	107	130	129	136
Earnings to Equity Owners	15,464	22,402	25,777	25,605	27,123
EPS (Basic)	2.57	3.72	4.28	4.26	4.51
EPS (Diluted)	2.57	3.72	4.28	4.26	4.51
DPS	1.80	0.00	4.00	2.13	2.25
% YoY growth					
Revenue	9.5%	36.2%	21.9%	-1.9%	5.9%
Gross profit	7.8%	35.5%	16.6%	-1.0%	5.3%
EBIT	9.2%	89.3%	13.2%	-3.1%	4.7%
Net profit	23.4%	44.9%	15.1%	-0.7%	5.9%
Margins and ratios					
Gross profit margin	33.8%	33.6%	32.2%	32.5%	32.3%
EBITDA Margin	14.1%	18.9%	17.4%	17.5%	17.4%
EBIT Margin	12.5%	17.3%	16.1%	15.9%	15.7%
Net Profit Margin	14.0%	14.9%	14.1%	14.3%	14.3%

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	108,502	115,975	123,218
Trade and other receivables	34,078	40,213	45,816	44,487	46,976
Inventories	9,025	16,568	17,220	15,470	16,422
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	185,598	189,992	200,675
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	231,670	238,310	250,847
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	11,710	11,435	12,138
Accounts payable	29,541	34,553	39,606	38,676	41,054
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	149,487	143,282	141,362
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	150,129	143,924	142,005
Shareholders Fund	53,972	65,595	80,171	92,888	107,208
Minority Interest	980	1,240	1,369	1,498	1,634
Total S/H Equity	54,952	66,835	81,541	94,386	108,842
Total Liab & S/H Fund	182,374	214,968	231,670	238,310	250,847

Sources: Company Annual Report, CGIS Research

Figure 5: Simplified Consolidated Statement of Cash Flows

Dec. Year End (RMB Mln)	2016	2017	2018E	2019E	2020E
Net Income	15,566	22,509	25,907	25,733	27,259
Depreciation & Amortization	1,764	2,296	2,362	2,754	3,146
Change in Working Capital	(906)	(6,883)	741	1,874	(360)
Other Non Cash Adjustments	(1,565)	(1,564)	0	0	0
Operating Cash Flow	14,860	16,359	29,009	30,362	30,045
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)	(12,889)	(12,802)
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)	(17,889)	(17,802)
Total Cash Flow	(10,138)	(48,164)	7,808	7,473	7,242
Cash Flow Ex. Fixed Deposit Investment	7,776	3,247	7,808	7,473	7,242

Sources: Company Annual Report, CGIS Research

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