

China
SELL

Consensus ratings*: Buy 18 Hold 5 Sell 2

Current price:	Rmb55.6
Target price:	Rmb44.0
Previous target:	Rmb40.0
Up/downside:	-21%

Reuters:	
Bloomberg:	000651 CH
Market cap:	US\$49,648m
	Rmb334,354m
Average daily turnover:	US\$440.1m
	Rmb2,957m
Current shares o/s:	6,016m
Free float:	50.0%

*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	17.7	36.6	26.1
Relative (%)	18.1	17.1	26.2

Major shareholders	% held
Zhuhai Gree Group	18.2
HKEX (Stock Connect)	11.6
Hebei Jinghai	8.9

Gree
Inventory Overhang Weighs on 1Q19 Results

- 1Q19 revenue slowed to 2.5% YoY vs. 32% growth in 4Q18. The slowdown was due to high channel inventory levels and seasonality.
- Investments in new ventures are beginning to impact Gree's OPEX line and may weigh on the Company's earnings growth.
- The payout ratio reduction indicates Gree is preserving cash, possibly for M&A.
- Its valuation remains at a historical high on expectations of a Zhuhai government sell-down, but visibility on the end buyer(s) remains unclear.
- Gree's high channel inventory, slower EPS growth and historically high valuation make us cautious on the stock. We roll forward our forecast to 2020 and update our TP from RMB40 to RMB44, downgrading to SELL on valuation grounds. We continue to value Gree at 9.5x 2020 PER.

2018 results in line, revenue growth stalls in 1Q19

While Gree's 2018 results were in line with street expectations, we think 1Q19 revenue growth was a surprise to the downside. Gree's revenue slowed to 2.5% YoY in 1Q19 vs. 32% growth in 4Q18. We think the slowdown was mostly on account of high channel inventory levels following channel stuffing during 2H18, though seasonality may have also played a role. CMM data (Figures 2-7) shows retail sales for air conditioning picking up in March, so we expect 2Q19 to show some improvement moving into the peak season. For 2019, Gree believes low double-digit growth is achievable. However, we think the high base in 2018 and high channel inventory levels are likely to continue weighing on Gree's sales, and think mid-single digit growth is more likely.

R&D and selling expenses to weigh on earnings growth

Gree is aware that its single market, single product focus limits the Company's growth potential. Therefore, the company is trying to diversify into new business areas in small appliances, smart equipment, and semi-conductors. Gree's R&D spending, for example, increased from 2.4% to 3.5% of sales between 2017 and 2018. As Gree continues to invest in new product lines, we think increased selling expense may also pressure the Company's bottom line. Selling expenses have fallen in recent years from ~15% of sales in 2015-16 to just 9.4% of sales in 2018. But with Gree investing in new product development and diversifying its revenue mix, we think increasing sales and R&D expenses may pressure its bottom line.

Payout ratio reduced to ~48%

Historically, Gree has maintained a ~70% payout ratio. This year's reduction to ~50% suggests the Company is withholding cash for M&A activity, despite cash reserves of ~RMB113Bn.

Stretched valuation

Gree has been re-rated in recent weeks on news that the Zhuhai government is looking to dispose of its 18% stake in the Company, which would lead to improved corporate decision making and better management incentives. However, visibility on the buyer(s) remains low, and we think that current valuation at ~12x rolling forward consensus is unlikely to continue (Figures 8-9). We remain cautious about Gree's future growth in light of high 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 2019-2020 EPS estimates by 3% and 4% on a slightly improving revenue outlook and roll forward our TP to 2020. We value the Company at 9.5x 2020E PER, implying a target price of RMB44, or ~21% downside. In the event of a home appliance stimulus roll-out in 2H19, we think Gree's shares are potentially worth RMB47 per share, or 15% downside.

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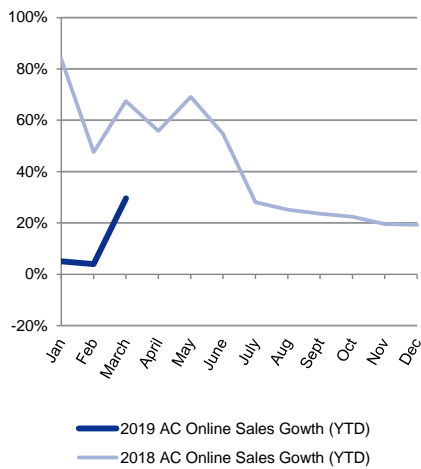
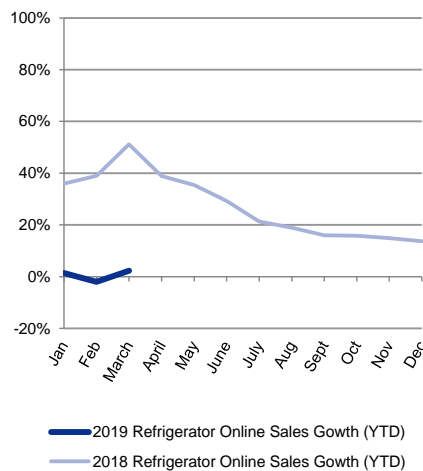
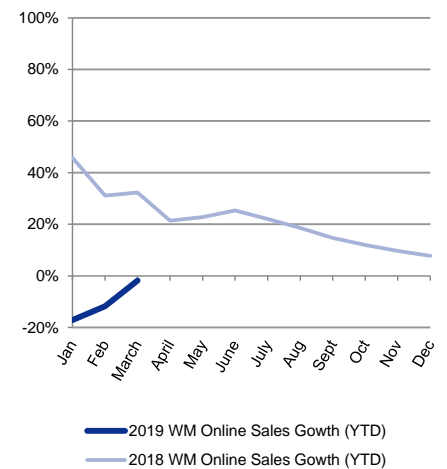
Financial Summary	2016	2017	2018	2019E	2020E
Revenue (Rmbm)	110,113	150,020	200,024	210,267	224,261
Net Profit (Rmbm)	15,464	22,400	26,203	26,311	28,092
Diluted EPS (Rmb)	2.57	3.72	4.36	4.37	4.67
Diluted EPS Growth		44.9%	17.0%	0.4%	6.8%
PER (x)	21.6	14.9	12.8	12.7	11.9
PBR (x)	6.2	5.1	3.7	3.2	2.8
DPS (Rmb)	1.80	0.00	2.10	2.19	2.33
Dividend Yield	3.2%	0.0%	3.8%	3.9%	4.2%
EV/EBITDA (x)	16.1	9.0	7.8	8.0	7.6
ROE	29%	34%	29%	25%	23%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Figure 1: Gree 2018 and 1Q19 results summary

(RMB M)	2018	2017	%YoY	1Q19	1Q18	%YoY
Revenue	200,024	150,020	33.3%	41,006	40,025	2.5%
COGS	(138,234)	(99,563)	38.8%	(28,144)	(27,354)	2.9%
Gross Profit	61,790	50,457	22.5%	12,862	12,672	1.5%
GPM	30.9%	33.6%	-2.7%	31.4%	31.7%	-0.3%
SG&A	(32,042)	(24,441)	31.1%	(6,629)	(6,551)	1.2%
Operating Profit	29,748	26,015	14.3%	6,233	6,120	1.8%
OP Margin	14.9%	17.3%	-2.5%	15.2%	15.3%	-0.1%
Financing Costs	1,088	(217)	-600.5%	23	112	-79.4%
Other G/L	438	818	-46.5%	356	156	128.1%
PBT	31,274	26,616	17.5%	6,612	6,388	3.5%
Tax	(4,894)	(4,108)	19.1%	(914)	(781)	17.0%
Effective tax rate	-16%	-15%	-0.2%	-14%	-12%	-1.6%
Net Profit	26,379	22,508	17.2%	5,698	5,607	1.6%
NPM	13.2%	15.0%	-1.8%	13.9%	14.0%	-0.1%
Minority Interest	176	107	64.7%	26	25	3.5%
Profit to Common	26,203	22,400	17.0%	5,672	5,582	1.6%
EPS (Diluted)	4.36	3.72	17.0%	0.94	0.93	1.4%

SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 2: 2019 vs 2018 AC online sales growth (YTD)

Figure 3: 2019 vs 2018 Refrigerator online sales growth (YTD)

Figure 4: 2019 vs 2018 WM online sales growth (YTD)


SOURCES: CHINA MARKET MONITOR, CGIS RESEARCH

Figure 5: 2019 vs 2018 AC offline sales growth (YTD)

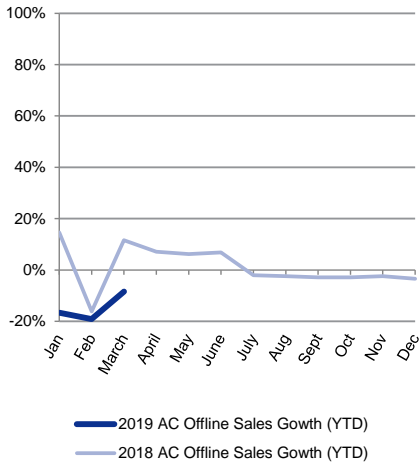


Figure 6: 2019 vs 2018 Refrigerator offline sales growth (YTD)

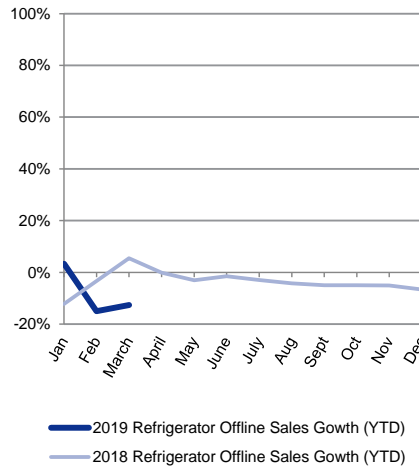
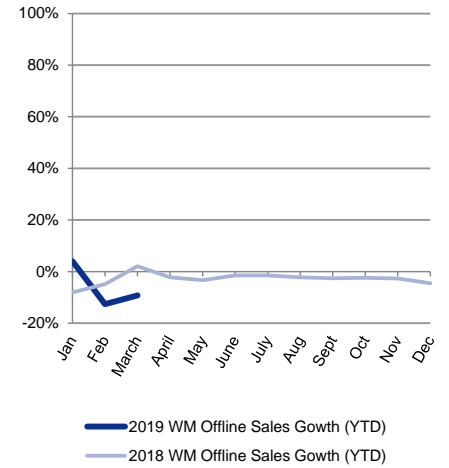
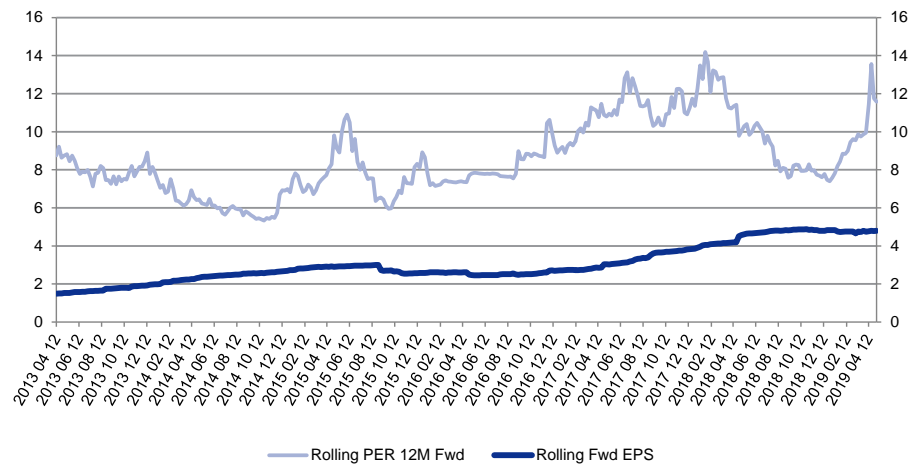


Figure 7: 2019 vs 2018 WM offline sales growth (YTD)



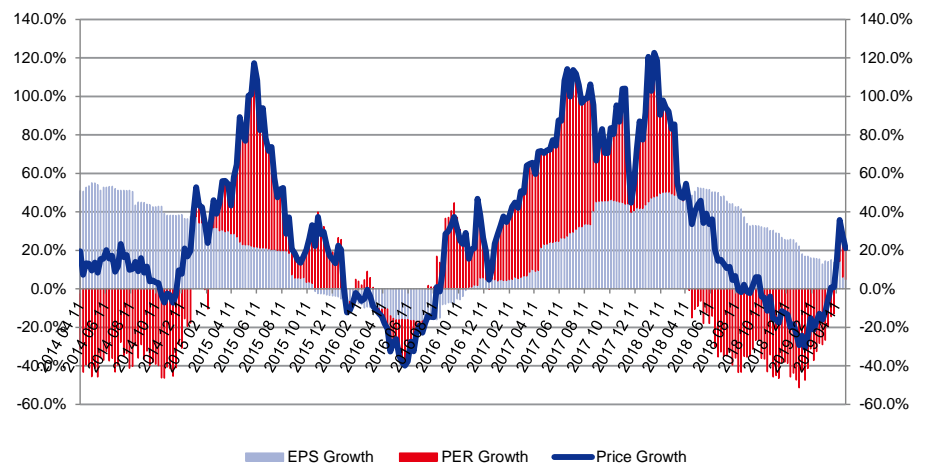
SOURCES: CHINA MARKET MONITOR, CGIS RESEARCH

Figure 8: 12M Forward PER and EPS Consensus for Gree



SOURCES: CGIS RESEARCH, BLOOMBERG

Figure 9: Components of Gree's Price Growth: EPS vs Multiple Expansion



SOURCES: CGIS RESEARCH, BLOOMBERG

BY THE NUMBERS

Profit & Loss					
(Rmbm)	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Total Net Revenues	110,113	150,020	178,252	203,787	223,364
Gross Profit	37,227	50,457	58,731	67,359	73,772
Operating EBITDA	13,740	26,016	29,727	34,229	37,478
Depreciation And Amortisation	44	(264)	0	0	0
Operating EBIT	13,784	25,752	29,727	34,229	37,478
Financial Income/(Expense)	1,143	1,173	1,266	1,727	2,251
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Non-Operating Income/(Expense)	3,646	(308)	0	0	0
Profit Before Tax (pre-EI)	18,529	26,881	30,993	35,956	39,729
Exceptional Items					
Pre-tax Profit	18,573	26,617	30,993	35,956	39,729
Taxation	(3,007)	(4,109)	(4,649)	(5,393)	(5,959)
Exceptional Income - post-tax					
Profit After Tax	15,566	22,509	26,344	30,562	33,770
Minority Interests	(103)	(107)	(132)	(153)	(169)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax	(92)	126	0	0	0
Net Profit	15,372	22,527	26,212	30,409	33,601
Recurring Net Profit	15,335	22,750	26,212	30,409	33,601
Fully Diluted Recurring Net Profit	15,335	22,750	26,212	30,409	33,601

Cash Flow					
(Rmbm)	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
EBITDA	13,740	26,016	29,727	34,229	37,478
Cash Flow from Inv. & Assoc.					
Change In Working Capital	(3,012)	(5,747)	605	631	(856)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	1,773	2,297	2,362	2,754	3,146
Other Operating Cashflow	532	(2,699)	0	0	0
Net Interest (Paid)/Received	(311)	(819)	(1,026)	(751)	(476)
Tax Paid					
Cashflow From Operations	12,723	19,047	31,669	36,863	39,292
Capex	(3,277)	(2,425)	(5,000)	(5,000)	(5,000)
Disposals Of FAs/subsidiaries	27	4	0	0	0
Acq. Of Subsidiaries/investments	(1,496)	(12,420)	0	0	0
Other Investing Cashflow	(14,500)	(47,412)	0	0	0
Cash Flow From Investing	(19,247)	(62,253)	(5,000)	(5,000)	(5,000)
Debt Raised/(repaid)	(11,054)	(13,009)	(5,000)	(5,000)	(5,000)
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(9,180)	(11,121)	(11,201)	(13,106)	(15,205)
Preferred Dividends					
Other Financing Cashflow	14,483	21,861	0	0	0
Cash Flow From Financing	(5,752)	(2,269)	(16,201)	(18,106)	(20,205)
Total Cash Generated	(12,275)	(45,476)	10,468	13,757	14,087

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS... cont'd

Balance Sheet					
(Rmbm)	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Total Cash And Equivalents	96,005	100,694	108,804	119,645	130,500
Total Debtors	32,788	38,071	42,582	48,116	52,739
Inventories	9,025	16,568	16,600	17,432	19,115
Total Other Current Assets	5,098	16,202	16,202	16,202	16,202
Total Current Assets	142,915	171,535	184,188	201,396	218,555
Fixed Assets	17,682	17,467	19,689	21,527	22,983
Total Investments	0	0	0	0	0
Intangible Assets	3,355	3,604	4,022	4,429	4,827
Total Other Non-Current Assets	18,422	22,362	22,362	22,362	22,362
Total Non-current Assets	39,459	43,433	46,072	48,318	50,172
Short-term Debt	10,701	18,646	13,646	8,646	3,646
Current Portion of Long-Term Debt	0	0	0	0	0
Total Creditors	56,418	67,932	73,081	80,079	85,527
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
Total Long-term Debt	0	0	0	0	0
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	290	239	239	239	239
Total Non-current Liabilities	290	239	239	239	239
Total Provisions	280	403	403	403	403
Total Liabilities	127,422	148,133	148,282	150,279	150,728
Shareholders' Equity	53,972	65,595	80,606	97,910	116,306
Minority Interests	980	1,240	1,372	1,524	1,693
Total Equity	54,952	66,835	81,978	99,434	117,999

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- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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