



## Gree Electric Appliances Inc. (000651.SZ): Zhuhai Mingjun wins public auction bid to acquire 15% of Gree Electric shares

Post market close on December 2, Gree Electric announced that it has signed an agreement with Zhuhai Gree Group (ZGG), currently its largest shareholder, to transfer 15% of ZGG's Gree Electric shares to Zhuhai Mingjun (an entity jointly owned by Hillhouse Capital, its affiliated entities and Zhuhai Gezhen, an entity controlled by Gree Electric's current management team), closing out the public auction first announced in April. According to the press release, the transfer price per share is set at Rmb46.17, which brings the total consideration to Rmb41.66bn (based on 902,359,632 shares). The relevant parties in the transaction also reached an agreement on key terms such as maintaining Gree Electric's current management team and introducing a management incentive plan. Upon completion of the transfer, Zhuhai Mingjun will become the single largest shareholder of Gree Electric.

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**Pending approvals:** According to the announcement, the final transfer of shares is subject to approval from the Zhuhai State-owned Assets Supervision and Administration Commission (Zhuhai SASAC), Zhuhai Government, Shenzhen Stock Exchange and other relevant entities.

While we take no view on the completion of the announced share transfer, we see strategic scope for the proposed shareholding arrangement and management incentive plan helping to better align management's and investor interests. The announced stake transfer is in line with government initiatives to reduce state ownership in highly competitive industries. The settlement of Mixed Ownership Reform should also help clarify the company's ownership structure.

### Key terms of the transfer agreement

According to Gree Electric's press release:

- **Pricing and total consideration:** The transfer price per share has been set at Rmb46.17. Zhuhai Mingjun will pay Rmb41.66bn for c.902mn shares of Gree Electric (15% of total shares outstanding). According to the agreement, Zhuhai Mingjun will pay the total consideration in two installments within the next 10 days. Upon completion of payment, Gree Group will request that the Shenzhen Stock Exchange and other related entities such as the clearing house change the ownership of the shares. The Lockup Period for the transferred shares will be 36 months.

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- **Change in shareholder structure:** Upon completion of the share transfer, Zhuhai Mingjun will become the single largest shareholder of Gree Electric with a 15.00% stake. Hebei Jinghai Investment Guarantee Co., an entity jointly owned by some of Gree's largest distributors, will remain the second largest shareholder with its current 8.91% stake. Post completion of the transfer, Zhuhai Gree Group's stake will be reduced to 3.22%.
- **Other arrangement terms:** Zhuhai Gezhen (an entity jointly owned by members of Gree Electric's current management team), Zhuhai Mingjun, Zhuhai Xianying (Zhuhai Mingjun's General Partner (GP)), and Zhuhai Yuxiu (Zhuhai Xianying's GP) also reached an agreement on several key terms including introducing a management shareholding incentive plan.
- **Management shareholding in Zhuhai Mingjun and its GPs.** According to the press release, post completion of the transfer, management shareholding at Zhuhai Mingjun and its GPs will be as follows:
  - 11.10% shareholding in Zhuhai Mingjun (4.72% will be transferred by one of Mingjun's shareholders to Zhuhai Gezhen in the future). 7% of Zhuhai Mingjun's shares will be acquired through management investment in the entity.
  - 41% shareholding and its related economic interests in Zhuhai Xianying. Management stated that they will allocate 8% of their economic interests to members of management team and key employees as incentive in the future.
  - 41% shareholding in Zhuhai Yuxiu. With 41% shareholding, management could nominate 1 director out of the total 3 to Zhuhai Yuxiu's board. Other directors will be nominated by Zhuhai Hillhouse, HH Mansion and Pearl Brilliance.
- **Future management incentive plan.** According to the agreement, all relevant parties have agreed to help launch a share-based incentive plan (no greater than 4% of total shares of Gree Electric) for key management members and employees upon completion of the share transfer.

### TP and rating

We are Neutral-rated on Gree Electric. Our estimates and 12-month target price of Rmb55.0, which do not factor in the proposed stake transfer, are unchanged. Our TP is derived by applying an 12X exit P/E (15% discount to industry P/E) to our 2022E EPS, discounted back to 2019E using a COE of 9%.

Key downside risks: 1) property market slowdown affecting AC sales; 2) rising material costs affecting product margins; 3) high inventory levels negatively affecting ex-factory shipment; and 4) potential diversification strategy to drag on investor returns. Key upside risks: 1) better-than-expected AC demand; and 2) falling material costs affecting product margins.

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 2 Dec 2019 close.

# Disclosure Appendix

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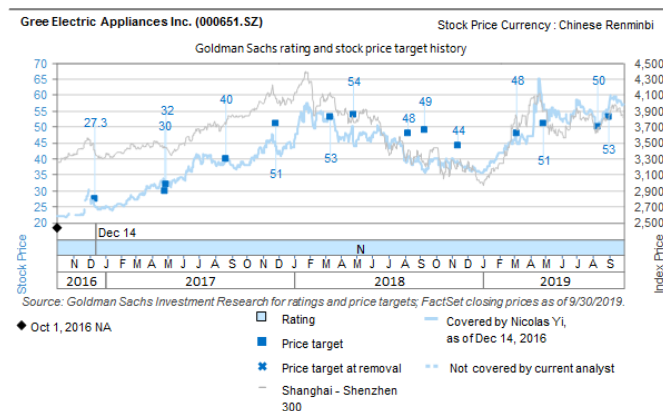
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