

China Longyuan (916 HK)

1H20 results in line; await subsidies funding resolve plan

CLY's 1H20 results were in line with our estimates. Net profit was resilient despite impacts from COVID-19. We did some estimates for potential impacts on subsidy collection rate for CLY (page 4-6). We think special green bond is feasible. Once the plan comes true, it will save CLY interest costs and boost free cash flow. Our earnings forecasts remain largely unchanged, but we factored in some expectation for accelerating subsidy collection. **We raised CLY's TP by 34.0% to HK\$7.38 per share.**

- **1H20 earnings in line.** CLY's revenue increased 1.3% YoY to RMB14.2bn, matching with power generation growth. Revenue from wind power was up 6.9% while coal-fired power revenue declined 11.3% due to drag of COVID-19 on power generation, which declined 13.4%. Operating expenses declined 0.9% YoY, supported by lower fuel costs and coal sales costs, but a boost from repair and maintenance. Financial costs declined 2.3% YoY to RMB1.73bn despite the fact that CLY's borrowings increased RMB5.5bn to RMB83.4bn (+7.1% YoY). Effective tax rate was 17.8% in 1H20, 1.3ppt higher than our estimates. Net profit (deducted perp. interests) was RMB3,210mn, up 4.0% YoY and in line with our estimates.
- **Subsidy receivables climbed high to RMB22.8bn.** The account had increased RMB5.8bn during 1H20, while CLY received only RMB532mn during the period. For FY20, mgmt. expects to collect only RMB3.5bn based on MoF's subsidy distribution budget, implying the receivables figure will be significantly higher (likely another RMB2bn) if nothing changes. We think the subsidy receivables issue has become a problem that is not negligible, and market has placed key fundamental focus on solving the issue.
- **Raising capacity/CAPEX target.** Mgmt. raised FY20 capacity addition target from 2.15GW to 2.3GW on smooth construction progress, CAPEX budget also increased from RMB19.3bn to RMB21.1bn accordingly. Other than that, CLY also accelerated development pace for Solar projects through winning 460MW solar farm projects through tariff bidding. CLY guided 2GW capacity addition in FY21.
- **Raise TP by 34% to HK\$7.38.** We roll over DCF valuation to FY21E with a base TP of HK\$6.00. We also factored in another HK\$1.38 per share for an expectation that CLY will collect RMB10bn from outstanding subsidy receivables. Our TP is raised by 34% to HK\$7.38, reflecting FY20/21E 11.0/9.1x PER and 1.03/0.94x PBR. **Maintain BUY.**

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	26,388	27,541	28,526	31,424	34,239
YoY growth (%)	7.3	4.4	3.6	10.2	9.0
Net income (RMB mn)	3,924	4,325	4,832	5,831	6,831
EPS (RMB)	0.49	0.54	0.60	0.73	0.85
EPS CHG (%)	6.39	10.22	11.7	20.7	17.1
Consensus EPS(RMB)	N/A	N/A	0.58	0.65	0.72
P/E (x)	10.05	9.12	8.16	6.76	5.8
P/B (x)	0.9	0.82	0.76	0.69	0.63
Yield (%)	2.0	2.2	2.5	3.0	3.5
ROE (%)	8.9	9.0	9.3	10.3	10.9
Net gearing (%)	163	156	167	163	144

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$7.38
(Previous TP	HK\$5.51)
Up/Downside	+33.2%
Current Price	HK\$5.54

China Wind Sector

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Stock Data

Mkt Cap (HK\$ mn)	44,522
Avg 3 mths t/o (HK\$ mn)	66.81
52w High/Low (HK\$)	5.07/3.30
Total Issued Shares (mn)	8,036
Source: Bloomberg	

Shareholding Structure – H share

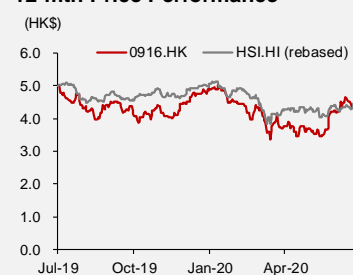
Wellington Mgmt Group	13.0%
BlackRock Inc.	7.0%
Free float	80.0%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	12.8%	7.0%
3-mth	25.7%	15.3%
6-mth	-2.0%	5.4%
12-mth	-5.6%	2.4%

Source: Bloomberg

12-mth Price Performance



Source: Wind

Auditor: Ernst & Young

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Other highlights in 1H20 results

Repairs and maintenance expenses surged 33.6% YoY. Mgmt. explained the increment was mainly due to 1) increasing operating capacity; 2) more capacity went out of warranty coverage period; and 3) CLY spent additional effort in repairs and maintenance during 1H20. By 1H20, CLY had 66% of wind turbines went out of warranty period. For full year trend, mgmt. expected unit repair and maintenance expenses to remain relatively stable.

Coal-fired power operating profit declined 24.6% YoY. The profit drop was mainly due to a 13.4% YoY decline of coal-fired power generation during 1H20. Though the overall impacts were somewhat offset by lower coal fuel costs (-6.9% YoY), the segment still suffered from declining operating leverage. Power generation of the segment didn't follow recovery trend in Jul, with monthly coal-fired power generation declined 25.4% YoY. We revise FY20 utilization hours from 4,700 hours to 4,500 hours, and trim FY21-22E utilization hours outlook to more conservative level at 5,000 hours.

Trim FY20-22E earnings by 2.0-2.3%. We trim CLY's EPS outlook by 2.0-2.3% to RMB0.60/0.73/0.85, based on 1H20 operating updates and more conservative assumptions on coal-fired power segment.

Figure 1: 1H20 results summary

(Rmb, mn)	1Q19	2Q19	1H19	1Q20	2Q20	1H20A	1H20A YoY	1H20E	Diff%
Revenue	7,092	6,946	14,038	7,184	7,034	14,218	1.3%	14,137	0.6%
Wind	4,938	4,977	9,915	5,530	5,072	10,602	6.9%	10,575	0.2%
Coal power	1,916	1,837	3,753	1,582	1,748	3,330	-11.3%	3,318	0.4%
Others	236	119	354	72	102	174	-51.0%	244	-28.8%
Concession	2	14	16	0	113	113	604.7%	0	n/a
Other net income	226	229	456	203	220	423	-7.1%	442	-4.3%
Operating expenses	(4,237)	(4,140)	(8,377)	(3,989)	(4,314)	(8,303)	-0.9%	(8,322)	-0.2%
Depreciation and amortization			(3,754)			(3,862)	2.9%		
Coal consumption			(1,072)			(862)	-19.7%		
Coal sales costs			(1,740)			(1,554)	-10.7%		
Services concession construction costs			(16)			(113)	604.7%		
Personnel costs			(854)			(900)	5.4%		
Material costs			(82)			(83)	0.9%		
Repairs and maintenance			(267)			(357)	33.6%		
Administratation expenses			(179)			(198)	10.8%		
Other operating expenses			(411)			(374)	-9.0%		
Operating profit	3,081	3,035	6,116	3,081	3,257	6,338	3.6%	6,258	1.3%
Operating profit margin	43.4%	43.7%	43.6%	43.4%	46.3%	44.6%	1.0 ppt	44.3%	0.3 ppt
Net finance expenses	(731)	(1,042)	(1,773)	(774)	(958)	(1,732)	-2.3%	(1,662)	4.2%
Share profit	82	(41)	41	15	(26)	(11)	-127.1%	22	-151.4%
Profit before tax	2,432	1,952	4,384	2,638	1,956	4,594	4.8%	4,617	-0.5%
Income tax	(343)	(410)	(753)	(427)	(391)	(818)	8.7%	(762)	7.3%
Effective tax rate	14.1%	21.0%	17.2%	16.2%	20.0%	17.8%	0.6 ppt	16.5%	1.3 ppt
Profit for the period	2,089	1,542	3,632	2,211	1,565	3,776	4.0%	3,855	-2.0%
Less: Minority interest	213	210	424	221	225	445	5.1%	422	5.5%
Perpetual interest distribution*	61	61	121	61	61	121	0.0%	121	0.0%
Net profit*	1,815	1,272	3,087	1,930	1,280	3,210	4.0%	3,312	-3.1%

Source: Company data, CMBIS estimates

Note: Perpetual interest distribution and net profit is estimated by CMBIS

Figure 2: 1H20 operating performance summary

	1Q19	2Q19	1H19	1Q20	2Q20	1H20A	1H YoY
Total power generation (GWh)	13,558	12,732	26,291	13,693	13,233	26,925	2.4%
<i>Run Rate %</i>	26.7%	25.1%	51.8%	25.8%	25.0%	50.8%	n/a
Wind power generation (GWh)	10,856	10,590	21,445	11,662	11,111	22,772	6.2%
<i>Run Rate %</i>	26.7%	26.0%	52.6%	26.5%	25.2%	51.7%	n/a
Coal-fired power (GWh)	2,566	2,014	4,580	1,950	2,015	3,965	-13.4%
<i>Run Rate %</i>	26.9%	21.1%	48.1%	23.1%	23.9%	47.0%	n/a
Other power (GWh)	136	129	266	81	107	188	-29.4%
<i>Run Rate %</i>	28.8%	27.3%	56.1%	16.8%	22.3%	39.1%	n/a

Source: Company data, CMBIS estimates

Figure 3: Earnings revision

	Old			New			Change(%)		
	2020	2021	2022	2020	2021	2022	2020	2021	2022
Revenue (RMB mn)	28,531	31,668	34,545	28,526	31,424	34,239	0.0%	-0.8%	-0.9%
Net Income (RMB mn)	4,931	5,960	6,994	4,832	5,831	6,831	-2.0%	-2.2%	-2.3%
EPS (RMB)	0.614	0.742	0.87	0.601	0.726	0.85	-2.0%	-2.2%	-2.3%

	Our est. vs consensus		
Consensus earnings (RMB mn)	4,762	5,317	5,890
Consensus EPS (RMB mn)	0.582	0.648	0.723

Source: Company data, CMBIS estimates

Estimating impacts of the potential special purpose green bond

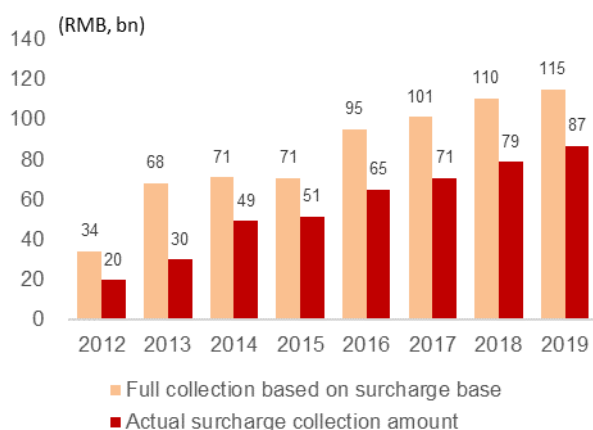
We think market sentiment on wind operators and CLY was ignited, after rumors were well spread around the market that MoF was planning to solve the long lasted renewables subsidy shortfall issue through issuing special purpose green bond. On 10 Aug, financial media Shanghai Securities News (上海證券報) reported ([link](#)) that MoF was preparing to issue a first batch of RMB140bn by end-2020, and State Grid and China Southern Power Grid were largely selected as the bond issuing bodies. CLY mgmt. didn't address much on this during analyst briefing. At current stage, we don't have enough information to assess the possibility and the timing for the special purpose bond, but we think it is worth it to do some calculation for the potential plans' meaning and impact to CLY, as it seems likely to bring re-rating opportunity to the Company.

Special purpose green bond: buying time to solve the subsidy shortfall issue

The renewable subsidy shortfall was accumulated quickly due to a mismatch between total subsidy demand and subsidy surcharge collected. Based on our conservative estimates, by 2020, the accumulated shortfall will expand to more than RMB244bn, and enlarge with more than RMB60bn per annum. If nothing is done, we estimate the shortfall will grow to ~RMB740bn by 2032E, until those heavily subsidized renewables capacity retire from operation. In medium term (3-5 years), given sluggish economy environment, we think it would be difficult for Chinese government to increase the RE surcharge to narrow the gap between subsidy demand and supply. The potential special purpose green bond, in our view, would likely help government to bridge through the period.

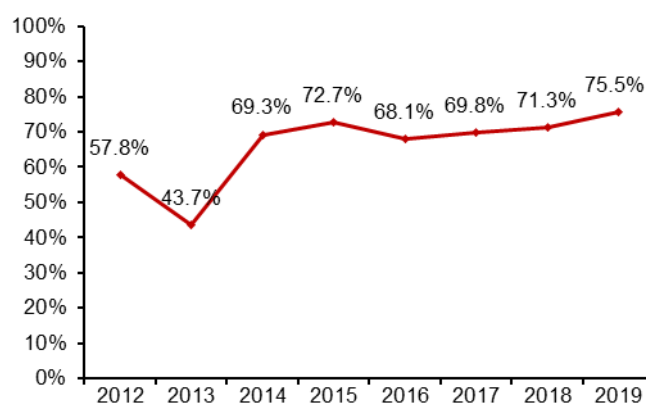
We think RMB140bn green bond issuance in 2020E would likely be the first batch for additional supply. We expect there will be more green bond issuance in the following years to narrow the subsidy shortfall. According to our calculation, we expect 1) RMB100bn additional funding supply in 2021-23E and 2) raising RE surcharge from per KWh RMB1.9 cents to RMB2.5 cents would largely solve the problem and flatten the shortfall curve.

Figure 4: Subsidy surcharges were not collected in full during the past few years range in RMB70-80bn



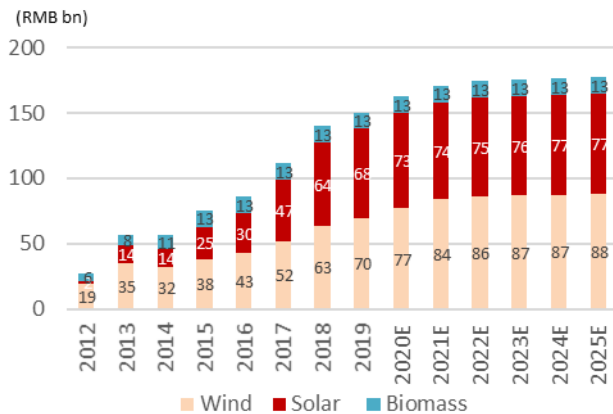
Source: MoF, CMBIS

Figure 5: We estimate subsidy demand is largely capped from 2022E



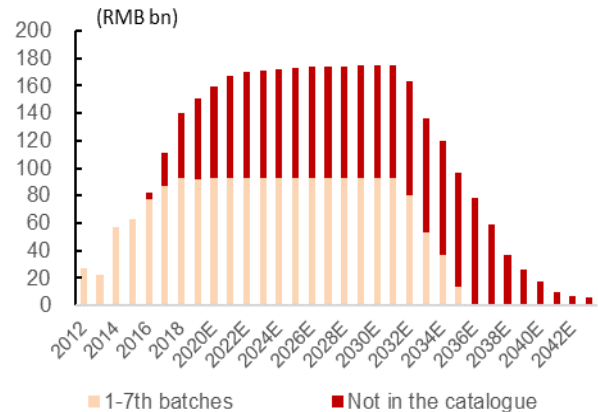
Source: CMBIS estimates

Figure 6: We expect subsidy demand is largely capped in 2022E



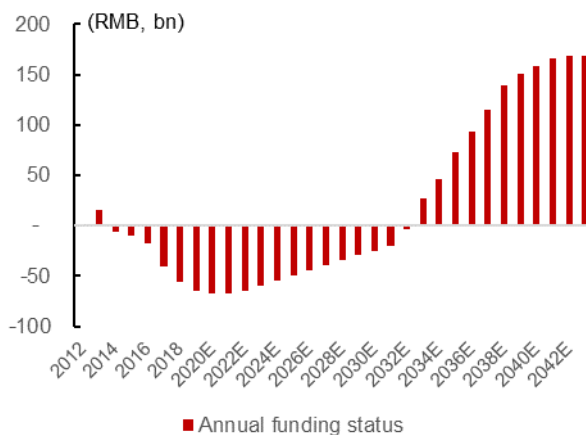
Source: CMBIS estimates

Figure 7: Subsidy demand will decrease as those subsidised capacity retire from 2032E



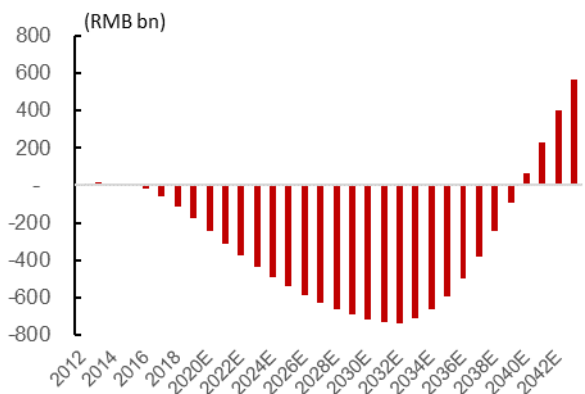
Source: NEA, CMBIS estimates

Figure 8: We estimate annual funding shortfall to peak out in 2021-22, and the shortfall will reverse in 2033 until first batch projects retire



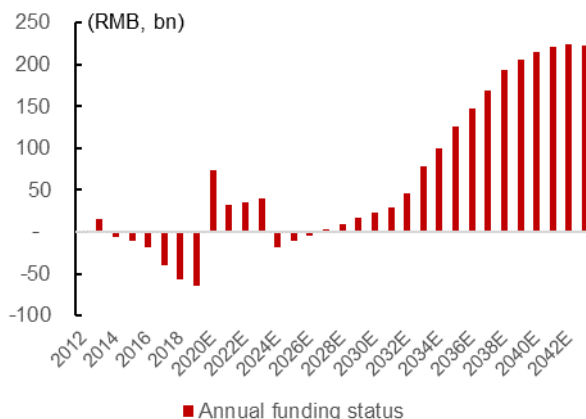
Source: MoF, CMBIS estimates

Figure 9: If nothing is changed, we estimate the shortfall will accumulated to above RMB738bn in 2032E



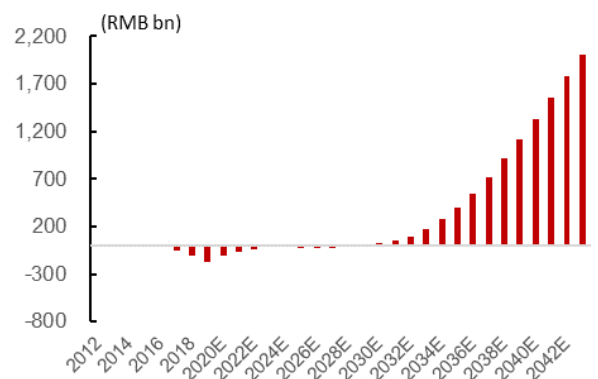
Source: NEA, CMBIS estimates

Figure 10: What will funding status would look like if 1) additional RMB140bn is added in 2020E, 2) RMB100bn is added in 2021-23E, and 3) raising surcharge to RMB2.5cent/KWh



Source: CMBIS estimates

Figure 11: Based on idea in Fig. 10, we expect the subsidy issue would be largely solved



Source: CMBIS estimates

Potential impacts to CLY

If no intervention, we estimate overall renewable operator's average subsidy receivable collection rate to be as low as 27.4% in 2020E. If the RMB140bn special green bond comes true, we expect the average collection rate will increase to 69.1%. We expect CLY to be more than RMB15bn based on our average collection calculation.

Earnings to be boosted from interest costs saving. Based on CLY's 1H20 financing cost at ~4%, we expect every RMB5bn receivable collected would help the Company reduce overall debt burden by RMB200mn per year.

Cash flow to be strengthened. Other than one-off collection from subsidy receivables, we expect subsidy distribution to resume normal, and that will likely contribute at least RMB5-7bn increment to CLY's operating cash flow. By then, we expect CLY will have strong financial support for raising dividend distribution (vs. current ~RMB1bn dividend distribution scale).

Valuation

We roll over DCF valuation to FY21E, our base value reflects nothing would be changed (no improvement in subsidy collection) is HK\$6.00 per share. We adopt rough estimates for simply adding subsidy collection amount of RMB5bn – 20bn in different scenarios in our DCF valuation to reflect potential valuation gain through accelerating subsidy collection. We think our estimates are conservative, as we do not factor in the potential gains from interest saving. Our base case with a subsidy collection amount of RMB10bn reflecting a per share value of HK\$1.38. We raise CLY's TP by 34.0% to HK\$7.38. Our TP reflects FY20/21E PER of 11.0/9.1x and PBR of 1.03x/0.94x, respectively. Maintain BUY.

Figure 12: Our DCF valuation suggests TP of HK\$5.51 per share

DCF Valuation (RMB, mn)	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Turnover	34,239	36,210	33,915	33,260	32,601	31,939	31,276	30,616	29,958
Turnover growth (%)	9%	6%	-6%	-2%	-2%	-2%	-2%	-2%	-2%
EBIT	13,546	14,562	14,100	13,470	12,851	12,244	11,650	11,069	10,504
EBIT margin	40%	40%	42%	40%	39%	38%	37%	36%	35%
Tax rate (%)	19%	19%	20%	20%	21%	21%	22%	22%	23%
Depreciation	9,966	10,594	10,800	11,002	11,199	11,390	11,577	11,759	11,936
CAPEX	(11,146)	(11,014)	(10,805)	(10,600)	(10,400)	(10,203)	(10,010)	(9,821)	(9,637)
Change in working capital	(2,860)	(683)	(865)	(327)	(330)	(331)	(331)	(330)	(329)
Free cash flow	12,641	11,997	12,152	11,449	11,292	11,140	10,994	10,856	10,725
Years	1	2	3	4	5	6	7	8	9
Discount factor	0.92	0.85	0.78	0.72	0.66	0.61	0.56	0.52	0.47
Discount free cash flow	11,636	10,165	9,479	8,220	7,463	6,777	6,157	5,596	5,089
Terminal value	164,872								
Terminal perpetual growth	2%								
Terminal EV/EBITDA	7.35								

WACC Calculations

Cost of debt	4.5%
Tax rate	20.0%
After tax cost of debt	3.6%
Cost of equity	13.7%
Adjusted beta	0.97
Market risk premium	12.2%
Risk free rate	1.8%
% of debt financing	50.0%
WACC	8.6%

Valuations (RMB mn)		Worst	Base	Best
Terminal value	164,872			
Terminal perpetual growth	2.0%			
Terminal EV/EBITDA	7.35			
Total discount FCF	70,584			
Discount terminal value	78,238			
Firm value	148,822			
Discount FCF(% of total)	47.4%			
Terminal value (% of total)	52.6%	Accelerate subsidy collection		
Add: Cash & cash equivalent	4,943	5,000	10,000	20,000
Less: Debt	97,338			
Non-controlling interest	8,032			
Perpetual MTN note	4,991			
Equity Value - RMB	43,403			
Share fair value (RMB)	5.40	0.62	1.24	2.49
Exchange rate (HKD/RMB)	0.90			
Share fair value (HKD)	6.00	0.69	1.38	2.77
TP (HKD)	7.38			

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	26,388	27,541	28,526	31,424	34,239
Wind	18,410	18,981	20,535	23,248	25,954
Coal-fired	7,314	7,784	7,255	7,488	7,598
Others	650	657	624	688	688
Concession revenue	14	118	113	-	-
Cost of sales	(13,927)	(14,488)	(14,751)	(15,726)	(16,851)
Gross profit	12,461	13,053	13,775	15,697	17,388
Other income, net	917	843	881	990	1,061
Admin expense	(588)	(564)	(584)	(644)	(701)
Personnel costs	(2,075)	(2,352)	(2,606)	(2,843)	(3,004)
Other expenses	(1,473)	(1,034)	(998)	(1,100)	(1,198)
EBIT	9,242	9,946	10,466	12,101	13,546
Finance costs, net	(3,513)	(3,486)	(3,311)	(3,700)	(3,848)
Associates & JVs	167	(10)	(22)	22	22
Exceptional	-	-	-	-	-
Pre-tax profit	5,897	6,450	7,134	8,422	9,719
Income tax	(976)	(1,131)	(1,292)	(1,558)	(1,855)
Less:					
Minority interests	755	753	768	791	791
Perp. MTN	242	242	242	242	242
Net profit	3,924	4,325	4,832	5,831	6,831

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	3,924	4,325	4,832	5,831	6,831
DD&A	7,316	7,786	8,421	9,251	10,163
WC change	(2,405)	(1,865)	(6,045)	(5,668)	(2,860)
Others	5,420	2,270	338	60	83
Operating CF	14,255	12,515	7,546	9,475	14,217
Capex	(7,248)	(9,799)	(18,493)	(14,124)	(10,753)
Associates inv.	(78)	221	22	(22)	(22)
Other	(1,308)	(1,196)	(61)	(83)	(81)
Investment CF	(8,633)	(10,774)	(18,533)	(14,229)	(10,856)
Equity raised	-	-	-	-	-
Change of Debts	(2,459)	3,286	11,751	7,560	(1,132)
Dividend paid	(738)	(785)	(865)	(966)	(1,166)
Others	(4,605)	(4,202)	150	150	150
Financing CF	(7,802)	(1,700)	11,036	6,744	(2,148)
Net change in cash	(2,179)	41	49	1,989	1,213
Cash at beginning	5,071	2,861	2,908	2,957	4,946
Exchange difference	(31)	(7)	-	-	-
Cash at the end	2,861	2,908	2,957	4,946	6,159
Pledged cash	253	523	323	350	347
Time deposit	-	-	-	-	-
Cash at balance sheet	3,114	3,432	3,280	5,297	6,506

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	128,718	133,773	143,805	148,600	149,111
Fixed asset	110,001	114,607	124,809	129,979	130,873
Prepaid lease payments	2,152	-	-	-	-
Interest in JVs	4,549	4,328	4,306	4,328	4,350
Others	12,016	11,683	11,493	11,113	10,727
Current assets	17,786	23,029	27,184	32,885	35,948
Cash	3,114	3,432	3,280	5,297	6,506
Account receivable	10,542	16,365	19,987	23,583	25,351
Prepayments	2,819	1,963	2,495	2,567	2,648
Others	1,312	1,269	1,422	1,438	1,443
Current liabilities	39,780	43,538	48,698	49,767	48,328
Trade and other payable	2,059	3,411	2,049	2,049	2,049
Other payables	9,122	10,840	10,465	8,480	7,474
Borrowings	28,336	28,965	35,876	38,935	38,514
Others	264	230	220	225	222
Non-current liabilities	50,158	52,610	57,520	61,931	61,130
Borrowings	46,645	48,881	53,813	58,403	57,771
Obligation under financial	361	-	-	-	-
Others non-current assets	3,152	2,984	3,052	2,952	2,852
Minority Interest	7,329	7,732	7,882	8,032	8,182
Perpetual MTN	4,991	4,991	4,991	4,991	4,991
Shareholders' equity	44,245	47,932	51,898	56,763	62,428
Total Equity	56,566	60,655	64,772	69,787	75,601

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Wind	69.8	68.9	72.0	74.0	75.8
Coal-fired	27.7	28.3	25.4	23.8	22.2
Others	2.5	2.4	2.2	2.2	2.0
Concession revenue	0.1	0.4	0.4	-	-
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratios (%)					
Operating margin	35.0	36.1	36.7	38.5	39.6
Pre-tax margin	22.3	23.4	25.0	26.8	28.4
Net margin	14.9	15.7	16.9	18.6	20.0
Effective tax rate	16.5	17.5	18.1	18.5	19.1
Balance sheet ratios					
Current ratio (x)	0.45	0.53	0.56	0.66	0.74
Quick ratio (x)	0.43	0.51	0.54	0.64	0.72
Cash ratio (x)	0.07	0.07	0.06	0.10	0.13
Inventory turnover days	12.5	11.1	11.5	11.4	10.6
Debtors turnover days	122.4	178.3	232.6	253.0	260.8
Creditor turnover days	51.8	68.9	67.5	47.6	44.4
Total debt / equity ratio (%)	169.5	162.4	172.8	171.5	154.2
Net debt / equity ratio (%)	163.0	156.3	167.1	162.8	144.4
Returns (%)					
ROE	8.9	9.0	9.3	10.3	10.9
ROA	2.7	2.8	2.8	3.2	3.7
Per share					
EPS (RMB)	0.49	0.54	0.60	0.73	0.85
DPS (RMB)	0.10	0.11	0.12	0.15	0.17
BVPS (RMB)	5.51	5.96	6.46	7.06	7.77

Source: Company data, CMBIS estimates

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