

Event-driven idea

CRCCE a potential candidate of privatization?

The proposed spin-off of **China Railway Construction Heavy Industry Corporation ("CRCHI")** in the Science and Technology Innovation Board by **CRCC (1186 HK / 601186 CH, NR)** implies that CRCHI will become the flagship of CRCC's heavy machinery listing platform. **We believe this will increase the chance of a privatization of CRCC High-Tech Equipment ("CRCCE") (1786 HK, NR)**, another subsidiary of CRCC, as (1) there is less incentive for CRCC to maintain a similar listing platform; and most importantly, (2) CRCCE is trading at only ~0.3x P/B (based on the book value at Jun 2019), meaning that the fund raising capability is effectively disabled (no fund raising is allowed at below 1x book value for SOE).

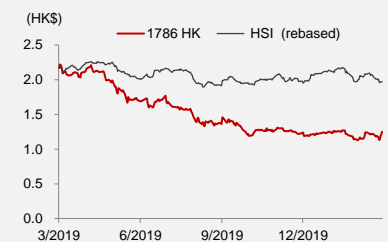
- **Background of CRCHI.** CRCHI is currently a wholly-owned subsidiary of CRCC and mainly engaged in the design, R&D and the manufacturing of tunnel boring machine, special equipment, railway track equipment and agricultural machine ([company website](#)). According to CRCC, CRCHI achieved net profit of RMB963mn / RMB1,308mn / RMB1,644mn / RMB923mn in 2016 / 2017 / 2018 / 9M19.
- **Proposed spin-off of CRCHI.** In Dec 2019, CRCC announced its proposal to spin-off of CRCHI in the Science and Technology Innovation Board. Last month, CRCC obtained the approval from HKEx for the spin-off proposal. While the spin-off plan is still subject to the approval by the general meeting of CRCC, CSRC and SSE, we do not expect any regulatory obstacles.
- **CRCCE will become less important as a fund-raising platform.** CRCC currently has 65% equity interest in **CRCCE (1786 HK, NR)**. CRCCE is engaged in the manufacturing of railway track maintenance machinery and the offering of overhaul services. CRCCE was spun off by CRCC in 2015 and has been listed in HKEx since then. The IPO of HK\$5.25 per share is significantly higher than the latest closing price of HK\$1.27. Given that CRCCE is trading at deep discount to book value (~0.3x), the fund raising capability is effectively disabled. The importance of CRCCE will be further reduced upon the proposed listing of CRCHI, in our view.
- **CRCCE's recent change in the use of IPO proceed implies a shift from M&A expansion to organic growth.** CRCCE raised capital of RMB2.27bn in the IPO in 2015. 20% of the net proceed (or RMB450mn) was budgeted for M&A at the first place and RMB120mn were actually spent after IPO. In Dec 2019, however, CRCCE revised the use of proceed by reallocating the remaining budget of RMB330mn from M&A to working capital to support its existing projects. The shift suggests that it will become less likely for CRCCE to pursue M&A in the foreseeable future and thereby reducing its upcoming capital needed.
- **Net cash = 90% of the market cap.** In 1H19, CRCCE generated net profit of RMB94.3mn, up ~15% YoY. As at Jun 2019, CRCCE had net cash of RMB1.57bn with no interest-bearing debts, which accounted for ~90% of the current market cap (HK\$1.93bn). We believe such valuation is attractive from the perspective of a controlling shareholder, as the market price does not reflect the value of the existing business.

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CRCCE 12-mth Price Performance



Source: Bloomberg

Figure 1: CRCHI versus CRCCE

Company	Ticker	Key business focus		2016	2017	2018
CRCHI	-	Machinery for the construction of new railways	Net profit (RMB mn)	963	1,308	1,644
			Change (YoY)	-	35.8%	25.7%
CRCCE	1786 HK	Railway track maintenance machinery	Net profit (RMB mn)	467	55	156
			Change (YoY)	2.4%	-88.2%	183.8%

Source: Company data, CMBIS

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