

China Longyuan (916 HK)

Absorption and merger to enhance leading position and release Company value

CLY released detail plan to merger Pingzhuang Energy (PZE, 000780 CH) and had a briefing thereafter. The Company planned to issue 342mn A-share to merge PZE aiming for back door listing, and to have assets swap for PZE's existing coal mining assets with CHN Energy's renewables assets at the same time. The merger plan is subject to various approvals from SASAC, CSRC and SGM for both shareholders. CLY mgmt. expects the transaction will be closed by Dec 2021. Post-merger, CLY will become an A+H dual listing platform with substantially enhanced financing capabilities. We think the merger will enhance CLY's leading position and release Company value. **We lift TP by 103% to HK\$15.00 to reflect earnings acceleration. Maintain BUY.**

- **Fair plan to both sides.** CLY offered to issue 342mn A-share at RMB11.42 in exchange for all shares of PZE. Exchange rate will be 1:0.3771, reflecting RMB3.80 for each PZE share and 10% premium of PZE's 20-day average closing price before trading halt. For CLY, the total consideration would be RMB3.9bn, non-cash, and reflects only 7.5% premium vs. PZE's book value by Sep 2020. Considering that PZE had made net loss for two consecutive years in 2018-19 and CLY is eager to obtain an onshore equity financing channel, we think the offer is fair to both sides with few shareholder objections.
- **High quality asset injection of 2.04GW.** The second and third arm of the transaction will be disposal of PZE's existing coal mining assets and swap for renewables assets from CHN Energy's other subsidiaries. Assets swap will be in cash basis, and CLY mgmt. had identified 2.04GW wind farm asset from 9 subsidiaries from CHN Energy. Mgmt. disclosed pending injection assets had net profit of ~RMB560mn in 9M20 with annualized ROE of 16.8%, significantly higher than CLY's ~9% ROE in recent years. Valuation for PZE's assets and 2.04GW wind farm has not been finalized yet. We expect valuation will not deviate much from 1.0x P/B for both asset types.
- **A-share platform to enhance leading position.** We are optimistic on the absorption and merger, as the transaction will open financing channel in A-share market, and more importantly will facilitate CHN Energy's future renewables assets injection. By end-2019, CHN Energy had 41.26/1.34GW wind/solar farm assets. Deducting CLY's ~20GW operating wind farms, 2GW from the transaction, and ~6GW from GD Power (600795 CH, NR), we expect CLY will have potential to acquire 13-15GW wind projects from CHN Energy.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
cRevenue (RMB mn)	26,388	27,541	28,431	31,806	35,118
YoY growth (%)	7.3	4.4	3.2	11.9	10.4
Net income (RMB mn)	3,924	4,325	4,710	5,882	6,685
EPS (RMB)	0.49	0.54	0.59	0.73	0.83
EPS CHG (%)	6.39	10.22	8.9	24.9	13.7
Consensus EPS(RMB)	N/A	N/A	0.60	0.68	0.77
P/E (x)	19.2	17.4	16.0	12.8	11.3
P/B (x)	1.7	1.57	1.45	1.33	1.21
Yield (%)	1.0	1.1	1.3	1.6	1.8
ROE (%)	8.9	9.0	9.1	10.4	10.7
Net gearing (%)	163	156	168	176	173

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$15.00**
 (Previous TP **HK\$7.38**)
 Up/Downside **+33.0%**
 Current Price **HK\$11.28**

China Wind Sector

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Stock Data

Mkt Cap (HK\$ mn)	90,650
Avg 3 mths t/o (HK\$ mn)	250.8
52w High/Low (HK\$)	12.22/3.30
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%

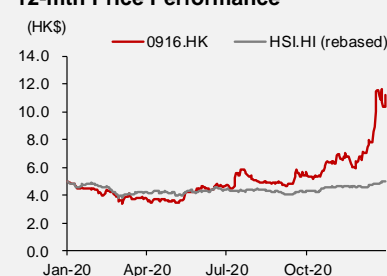
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	65.6%	52.1%
3-mth	105.5%	73.6%
6-mth	142.0%	110.4%
12-mth	128.9%	130.4%

Source: Bloomberg

12-mth Price Performance



Source: Wind

Auditor: Ernst & Young

Related Reports

1. "China Longyuan (916 HK) – 9M20 results on track; seeing silver lining for accelerating subsidy collection" – 28 Oct 2020
2. "China Longyuan (916 HK) – 1H20 results in line; await subsidies funding resolve plan" – 13 Aug 2020

- **Lift capacity addition pace.** CHN Energy had raised renewables capacity addition outlook in 14th FYP period, and CLY will be the most important renewables energy platform to fulfill ~20GW capacity plan in the coming five years. We expect CLY will accelerate its capacity addition pace with average 2GW wind and 2GW solar projects for each year. We also expect CAPEX level to be boosted to above RMB20bn in view of accelerating expansion pace.
- **Subsidy collecting expectation still in play.** CLY's share price surged more than 45% YTD. We think strong performance not only reflects market optimism on the absorption and merger, but more importantly reflects market expectation for accelerating subsidy receivables collection. By end-2020, we expect CLY to accumulate more than RMB25bn tariff subsidy receivables. CLY collected RMB5bn subsidies during 2020, higher than mgmt. guidance of RMB3.5bn earlier in 2020. In 2021E, to promote renewables energy development, we expect MoF and NEA to roll out special measures such as subsidy-related green bond issuance to fix the enlarging subsidy shortfall. We expect potential measures to further boost CLY's valuation.
- **Raise TP by 103% to HK\$15.00; maintain BUY.** We had slight adjustment on 2020-22E EPS by -2.5%/0.9%/-2.1% based on operating updates and revised assumptions. Our DCF valuation is revised mainly on 1) terminal growth boosted from 2% to 3%; 2) updating HK\$/RMB FX assumption from 0.90 to 0.83; and 3) adding solar farm component in our valuation. In view of long approval time frame and potential transaction uncertainties, we did not factor in potential absorption and merger impact in our valuation model. Our TP is raised by 103% from HK\$7.38 to HK\$15.00, and our TP reflects FY21E 17.2x/1.8x PER/PBR. We think CLY's re-rating is not yet done, and we expect China's 14th FYP for renewables energy development and subsidy solution will be short-term catalyst to boost valuation upward. Maintain BUY recommendation.

Figure 1: CLY's power generation performance in 2020

	1Q19	2Q19	3Q19	4Q19	FY19	1Q20	2Q20	3Q20	4Q20	FY20	FY20 YoY
Total power generation (GWh)	13,558	12,732	10,307	11,569	50,736	13,693	13,233	11,008	15,133	53,066	4.6%
Run Rate %*	26.7%	25.1%	20.3%	22.8%	100.0%	25.8%	24.9%	20.7%	28.5%	100.0%	n/a
Wind power generation (GWh)	10,856	10,590	7,717	11,569	40,732	11,662	11,111	8,376	12,535	43,683	7.2%
Run Rate %*	26.7%	26.0%	18.9%	28.4%	100.0%	26.7%	25.4%	19.2%	28.7%	100.0%	n/a
Coal-fired power (GWh)	2,566	2,014	2,471	2,480	9,531	1,950	2,015	2,547	2,521	9,034	-5.2%
Run Rate %*	26.9%	21.1%	25.9%	26.0%	100.0%	21.6%	22.3%	28.2%	27.9%	100.0%	n/a
Other power (GWh)	136	129	119	89	473	81	107	85	77	349	-5.2%
Run Rate %*	28.8%	27.3%	25.1%	18.8%	100.0%	23.1%	30.7%	24.3%	22.0%	100.0%	n/a

Source: Company data, CMBIS

Figure 2: We made slight adjustments on 2020-22E earnings

	Old			New			Change(%)		
	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
Revenue (RMB mn)	28,526	31,424	34,239	28,431	31,806	35,118	-0.3%	1.2%	2.6%
Net Income (RMB mn)	4,832	5,831	6,831	4,710	5,882	6,685	-2.5%	0.9%	-2.1%
EPS (RMB)	0.601	0.726	0.85	0.586	0.732	0.83	-2.5%	0.9%	-2.1%

				Our est. vs consensus		
Consensus earnings (RMB mn)	4,853	5,503	6,357	-3.0%	6.9%	5.2%
Consensus EPS (RMB mn)	0.600	0.681	0.773	-2.3%	7.5%	7.6%

Source: Bloomberg, CMBIS estimates

Figure 3: Our DCF valuation for CLY

DCF Valuation (RMB, mn)	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Turnover	35,118	37,758	40,452	43,096	43,466	45,506	47,494	49,433	51,327
Turnover growth (%)	10%	8%	7%	7%	1%	5%	4%	4%	4%
EBIT	13,792	14,953	16,126	17,283	17,935	18,525	19,067	19,567	20,025
EBIT margin	39%	40%	40%	40%	41%	41%	40%	40%	39%
Tax rate (%)	19%	19%	19%	19%	20%	20%	21%	21%	22%
Depreciation	10,577	11,701	12,813	13,909	15,029	16,148	17,268	18,388	19,508
CAPEX	(22,069)	(21,668)	(21,449)	(21,061)	(20,714)	(20,373)	(20,038)	(19,709)	(19,386)
Change in working capital	(3,278)	(1,213)	(2,208)	(1,371)	(37)	(204)	(199)	(194)	(189)
Free cash flow	2,980	3,333	6,603	8,155	8,724	10,732	12,519	14,260	15,959

Years	1	2	3	4	5	6	7	8	9
Discount factor	0.92	0.85	0.79	0.73	0.67	0.62	0.57	0.53	0.49
Discount free cash flow	2,752	2,841	5,198	5,928	5,855	6,651	7,163	7,534	7,785
Terminal value	310,023								
Terminal perpetual growth	3%								
Terminal EV/EBITDA	7.84								

Valuations (RMB mn)					WACC Calculations	
Terminal value	310,023				Cost of debt	4.5%
Terminal perpetual growth	3.0%				Tax rate	20.0%
Terminal EV/EBITDA	7.84				After tax cost of debt	3.3%
Total discount FCF	51,707				Cost of equity	14.4%
Discount terminal value	151,240				Adjusted beta	0.96
Firm value	202,946				Market risk premium	14.0%
Discount FCF(% of total)	25.5%				Risk free rate	1.0%
Terminal value (% of total)	74.5%	Accelerate subsidy collection			% of debt financing	55.0%
Add: Cash & cash equivalent	2,511	5,000	10,000	20,000	WACC	8.3%
Less: Debt	102,379					
Non-controlling interest	8,032					
Perpetual MTN note	4,991					
Equity Value - RMB	90,055					
Share fair value (RMB)	11.21	0.62	1.24	2.49		
Exchange rate (HKD/RMB)	0.83					
Share fair value (HKD)	13.50	0.75	1.50	3.00		
TP (HK\$)	15.00	14.25	15.00	16.50		

Source: CMBIS estimates

* Our TP of HK\$15.00 embedded expectation of accelerating subsidy collection of RMB10bn in 2021E.

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	26,388	27,541	28,431	31,806	35,118
Wind	18,410	18,981	20,354	23,511	25,913
Coal-fired	7,314	7,784	7,443	7,526	7,591
Others	650	657	522	769	1,613
Concession revenue	14	118	113	-	-
Cost of sales	(13,927)	(14,488)	(14,865)	(15,897)	(17,408)
Gross profit	12,461	13,053	13,566	15,909	17,710
Other income, net	917	843	878	1,002	1,089
Admin expense	(588)	(564)	(582)	(652)	(719)
Personnel costs	(2,075)	(2,352)	(2,620)	(2,857)	(3,058)
Other expenses	(1,473)	(1,034)	(995)	(1,113)	(1,229)
EBIT	9,242	9,946	10,246	12,290	13,792
Finance costs, net	(3,513)	(3,486)	(3,240)	(3,827)	(4,304)
Associates & JVs	167	(10)	(22)	22	22
Exceptional	-	-	-	-	-
Pre-tax profit	5,897	6,450	6,985	8,484	9,509
Income tax	(976)	(1,131)	(1,265)	(1,569)	(1,792)
Less:					
Minority interests	755	753	768	791	791
Perp. MTN	242	242	242	242	242
Net profit	3,924	4,325	4,710	5,882	6,685

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	3,924	4,325	4,710	5,882	6,685
DD&A	7,316	7,786	8,411	9,414	10,747
WC change	(2,405)	(1,865)	(5,979)	(6,060)	(3,278)
Others	5,420	2,270	338	42	49
Operating CF	14,255	12,515	7,479	9,278	14,202
Capex	(7,248)	(9,799)	(18,563)	(21,291)	(21,075)
Associates inv.	(78)	221	22	(22)	(22)
Other	(1,308)	(1,196)	(61)	(83)	(81)
Investment CF	(8,633)	(10,774)	(18,603)	(21,396)	(21,178)
Equity raised	-	-	-	-	-
Change of Debts	(2,459)	3,286	11,796	12,556	8,263
Dividend paid	(738)	(785)	(865)	(942)	(1,176)
Others	(4,605)	(4,202)	150	150	150
Financing CF	(7,802)	(1,700)	11,081	11,764	7,237
Net change in cash	(2,179)	41	(43)	(355)	262
Cash at beginning	5,071	2,861	2,908	2,866	2,511
Exchange difference	(31)	(7)	-	-	-
Cash at the end	2,861	2,908	2,866	2,511	2,773
Pledged cash	253	523	323	369	399
Time deposit	-	-	-	-	-
Cash at balance sheet	3,114	3,432	3,189	2,880	3,171

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	128,718	133,773	143,886	155,686	165,935
Fixed asset	110,001	114,607	124,889	137,064	147,697
Prepaid lease payments	2,152	-	-	-	-
Interest in JVs	4,549	4,328	4,306	4,328	4,350
Others	12,016	14,838	14,690	14,294	13,888
Current assets	17,786	23,029	27,027	30,793	33,357
Cash	3,114	3,432	3,189	2,880	3,171
Account receivable	10,542	16,365	19,921	23,869	26,000
Prepayments	2,819	1,963	2,495	2,567	2,648
Others	1,312	1,269	1,423	1,477	1,537
Current liabilities	39,780	43,538	48,716	51,784	54,102
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	35,894	40,952	44,289
Others	264	230	312	314	301
Non-current liabilities	50,158	52,610	57,547	64,956	69,792
Borrowings	46,645	48,881	53,841	61,428	66,433
Obligation under financial	361	-	-	-	-
Others non-current assets	3,152	3,728	3,706	3,528	3,359
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	51,776	56,716	62,225
Total Equity	56,566	60,655	64,650	69,740	75,398

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Wind	69.8	68.9	71.6	73.9	73.8
Coal-fired	27.7	28.3	26.2	23.7	21.6
Others	2.5	2.4	1.8	2.4	4.6
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	36.0	38.6	39.3
Pre-tax margin	22.3	23.4	24.6	26.7	27.1
Net margin	14.9	15.7	16.6	18.5	19.0
Effective tax rate	16.5	17.5	18.1	18.5	18.8
Balance sheet ratios					
Current ratio (x)	0.45	0.53	0.55	0.59	0.62
Quick ratio (x)	0.43	0.51	0.53	0.57	0.60
Cash ratio (x)	0.07	0.07	0.06	0.05	0.05
Inventory turnover days	12.5	11.1	11.5	11.5	11.0
Debtors turnover days	122.4	178.3	232.9	251.3	259.2
Creditor turnover days	51.8	68.9	67.0	47.0	43.0
Total debt / equity ratio (%)	169.5	162.4	173.3	180.5	177.9
Net debt / equity ratio (%)	163.0	156.3	167.8	176.1	173.5
Returns (%)					
ROE	8.9	9.0	9.1	10.4	10.7
ROA	2.7	2.8	2.8	3.2	3.4
Per share					
EPS (RMB)	0.49	0.54	0.59	0.73	0.83
DPS (RMB)	0.10	0.11	0.12	0.15	0.17
BVPS (RMB)	5.51	5.96	6.44	7.06	7.74

Source: Company data, CMBIS estimates

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