

# China Longyuan (916 HK)

## NDR takeaways - increasing odds for capital market action

We hosted a post-results NDR call with CLY. Investors were curious about 1) CLY's potential capital market actions in view of current extremely low valuation; 2) CLY's CAPEX plan and possibility to reach positive free cash flow from 2021 onwards; and 3) CLY's offshore wind farm development. Mgmt. said the Company will leave any possible capital market option on the table, and CHN Energy, CLY's parent corporation will be the entities holding decision power. Following Huaneng Renewables and CGN New Energy's privatization path, we think CLY's odd is increasing for a potential capital market action. **Maintain BUY with TP unchanged at HK\$4.73.**

- **Actively evaluating any possible capital market action.** Mgmt. expressed CLY itself does not hold decision power for potential capital market action in view of current low valuation, and it would be up to CHN Energy's discretion. According to CLY, CHN Energy has been evaluating possible option not limited to share buyback and privatization. Mgmt. also revealed that CLY was ranking the third subsidiary in terms of revenue and profit contribution within CHN Energy Group, and should be deserved some priority as leading renewable development platform. CHN Energy Group has healthy balance sheet with no deleverage pressures, implying CLY will have strong financial supports for capital actions from Parent Corporation.
- **Offshore wind will be a focus from 2020.** CLY held 2GW offshore project pipeline in Zhejiang, Fujian and Guangdong by end-2019. Mgmt. intended to accelerate offshore wind development, and planned to add 400/600MW in 2020/21 for securing tariff subsidies (RMB0.85/kWh). For the remaining 1GW offshore project, it will subject to local tariff subsidies from Guangdong Province yet to be decided. CAPEX budget will remain high in FY21, as offshore projects require RMB1.7-1.8/watt CAPEX, implying relatively low possibility for free cash flow to turn positive in FY20/21E
- **Subsidy shortfall solution is still uncertain.** Mgmt. looked forward to a comprehensive solution for solving subsidy shortfall by 2020 before entering grid-parity, but admitted that COVID-19 could bring disruption to government's plan. Combating COVID-19 and its associated economic impacts is now a top priority of China, and apparently government will have very limited effort to consider the subsidy delay issue.

### Earnings Summary

| (YE 31 Dec)         | FY18A  | FY19A  | FY20E  | FY21E  | FY22E  |
|---------------------|--------|--------|--------|--------|--------|
| Revenue (RMB mn)    | 26,388 | 27,541 | 28,684 | 31,668 | 34,545 |
| YoY growth (%)      | 7.3    | 4.4    | 4.2    | 10.4   | 9.1    |
| Net income (RMB mn) | 3,924  | 4,325  | 4,690  | 5,463  | 6,411  |
| EPS (RMB)           | 0.49   | 0.54   | 0.58   | 0.68   | 0.80   |
| EPS CHG (%)         | 6.39   | 10.22  | 8.44   | 16.48  | 17.4   |
| Consensus EPS(RMB)  | N/A    | 0.52   | 0.59   | 0.66   | 0.71   |
| P/E (x)             | 7.16   | 7.16   | 5.99   | 5.15   | 4.4    |
| P/B (x)             | 0.6    | 0.6    | 0.54   | 0.50   | 0.46   |
| Yield (%)           | 2.80   | 2.80   | 3.30   | 3.90   | 4.6    |
| ROE (%)             | 8.87   | 8.87   | 9.06   | 9.71   | 10.4   |
| Net gearing (%)     | 163    | 163    | 166    | 169    | 151.0  |

Source: Company data, Bloomberg, CMBIS estimates

## BUY (Maintain)

|               |           |
|---------------|-----------|
| Target Price  | HK\$4.73  |
| (Previous TP  | HK\$4.73) |
| Up/Downside   | +21.2%    |
| Current Price | HK\$3.90  |

### China Wind Sector

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### Stock Data

|                          |           |
|--------------------------|-----------|
| Mkt Cap (HK\$ mn)        | 31,342    |
| Avg 3 mths t/o (HK\$ mn) | 49.20     |
| 52w High/Low (HK\$)      | 5.42/3.46 |
| Total Issued Shares (mn) | 8,036     |

Source: Bloomberg

### Shareholding Structure

|                       |       |
|-----------------------|-------|
| CHN Energy            | 58.4% |
| Wellington Mgmt Group | 5.4%  |
| Free float            | 36.2% |

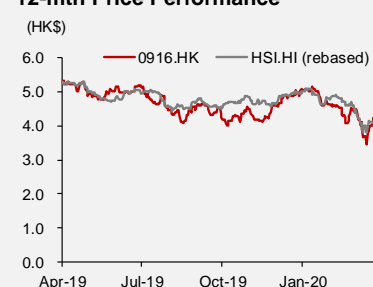
Source: HKEx

### Share Performance

|        | Absolute | Relative |
|--------|----------|----------|
| 1-mth  | -12.9%   | -5.0%    |
| 3-mth  | -22.0%   | -8.6%    |
| 6-mth  | -10.6%   | -3.4%    |
| 12-mth | -26.9%   | -8.3%    |

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: Ernst & Young

### Related Reports

1. "China Longyuan (916 HK) –Results slight beat; accelerate overseas expansion" – 31 Mar 2020
2. "China Longyuan (916 HK) –Flat FY19E earnings; longing for privatization" – 10 Mar 2020
3. "China Longyuan (916 HK) – Sluggish 3Q19 operating performance" – 21 Oct 2019

## Other topics covered

- **Non-compete issue with entities under CHN Energy.** CLY is aware the issue. Other than capacity operating under CLY, mgmt. disclosed there were another ~20GW wind farms operating under different entities in CHN Energy Group. Some of the projects were under GD Power Development (600795 CH), and the remaining majority were in non-listing platform. According to common practice, HKEx has relatively loose control on non-compete clause between subsidiaries and parent co., while CSRA had tight control on the matter. Therefore, according to mgmt., CLY is subjected to limited constrained if the Company choose not to privatize or returning to A-share market.
- **Prudent pace for overseas project development.** CLY has placed efforts for years in developing overseas renewable projects. The Company has higher project hurdle rate for overseas projects (i.e. 14% IRR for Canada and South Africa wind farm comparing with 12% IRR for domestic wind farm). The Company will have 77MW wind farm to commission in Ukraine in 2020.
- **Views about wind turbine.** Envision Energy, Goldwind (2208 HK / 002202 CH) and United Power are 3 major wind turbine suppliers to CLY. Mgmt. ranked both Envision and Goldwind top two brands ~~comparing~~ based on power generation capability, quality and services. Mgmt. saw limited supply risks from those suppliers, and expected future tender price to resume rational after installation rush in 2019-20.
- **Solar project development.** CLY was one of the earliest solar farm developers in China dated back to 2009. The Company ceased solar farm project development due to strategic adjustment to focus on wind farm development in 2015. In 2020, CLY will resume solar farm development, and will have 100MW solar farm capacity commission. Other than developing solar farms through internal resources, mgmt. also considers joint development with outside partners for solar farm projects. CLY expected to have more new solar farm project from 2021 onwards.
- **Engineering supports for offshore wind farm.** CLY has a JVs with ZPMC (600320 CH) offering offshore engineering services for wind farm development. The JV has jack up vessels to support offshore wind farm installation. Comparing with peers, mgmt. thought CLY was more conservative in both project development and offshore wind turbine selection. CLY preferred 4-6MW turbine with long track record rather than aggressively upgrading to 8-10MW in near term.

## Financial Summary

### Income statement

| YE 31 Dec (RMB mn)    | FY18A         | FY19A         | FY20E         | FY21E         | FY22E         |
|-----------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Revenue</b>        | <b>26,388</b> | <b>27,541</b> | <b>28,684</b> | <b>31,668</b> | <b>34,545</b> |
| Wind                  | 18,410        | 18,981        | 20,535        | 23,316        | 26,083        |
| Coal-fired            | 7,314         | 7,784         | 7,432         | 7,665         | 7,775         |
| Others                | 650           | 657           | 717           | 688           | 688           |
| Concession revenue    | 14            | 118           | -             | -             | -             |
| Cost of sales         | (13,927)      | (14,488)      | (14,960)      | (16,093)      | (17,267)      |
| <b>Gross profit</b>   | <b>12,461</b> | <b>13,053</b> | <b>13,724</b> | <b>15,576</b> | <b>17,278</b> |
| Other income, net     | 917           | 843           | 889           | 998           | 1,071         |
| Admin expense         | (588)         | (564)         | (588)         | (649)         | (708)         |
| Personnel costs       | (2,075)       | (2,352)       | (2,606)       | (2,843)       | (3,004)       |
| Other expenses        | (1,473)       | (1,034)       | (918)         | (1,013)       | (1,105)       |
| <b>EBIT</b>           | <b>9,242</b>  | <b>9,946</b>  | <b>10,501</b> | <b>12,068</b> | <b>13,532</b> |
| Finance costs, net    | (3,513)       | (3,486)       | (3,584)       | (4,142)       | (4,375)       |
| Associates & JVs      | 167           | (10)          | 43            | 44            | 44            |
| Exceptional           | -             | -             | -             | -             | -             |
| <b>Pre-tax profit</b> | <b>5,897</b>  | <b>6,450</b>  | <b>6,961</b>  | <b>7,970</b>  | <b>9,200</b>  |
| Income tax            | (976)         | (1,131)       | (1,261)       | (1,474)       | (1,756)       |
| Less:                 |               |               |               |               |               |
| Minority interests    | 755           | 753           | 768           | 791           | 791           |
| Perp. MTN             | 242           | 242           | 242           | 242           | 242           |
| <b>Net profit</b>     | <b>3,924</b>  | <b>4,325</b>  | <b>4,690</b>  | <b>5,463</b>  | <b>6,411</b>  |

### Cash flow summary

| YE 31 Dec (RMB mn)           | FY18A          | FY19A           | FY20E           | FY21E           | FY22E           |
|------------------------------|----------------|-----------------|-----------------|-----------------|-----------------|
| <b>Net income</b>            | <b>3,924</b>   | <b>4,325</b>    | <b>4,690</b>    | <b>5,463</b>    | <b>6,411</b>    |
| DD&A                         | 7,316          | 7,786           | 8,501           | 9,403           | 10,400          |
| WC change                    | (2,405)        | (1,865)         | (6,148)         | (5,759)         | (2,902)         |
| Others                       | 5,420          | 2,269           | 341             | 53              | 83              |
| <b>Operating CF</b>          | <b>14,255</b>  | <b>12,515</b>   | <b>7,384</b>    | <b>9,160</b>    | <b>13,992</b>   |
| Capex                        | (7,248)        | (9,799)         | (17,289)        | (17,500)        | (10,753)        |
| Associates inv.              | (78)           | 221             | (43)            | (44)            | (44)            |
| Other                        | (1,308)        | (1,196)         | (61)            | (83)            | (81)            |
| <b>Investment CF</b>         | <b>(8,633)</b> | <b>(10,774)</b> | <b>(17,393)</b> | <b>(17,627)</b> | <b>(10,878)</b> |
| Equity raised                | -              | -               | -               | -               | -               |
| Change of Debts              | (2,459)        | 3,286           | 10,967          | 9,417           | (1,132)         |
| Dividend paid                | (738)          | (785)           | (865)           | (938)           | (1,093)         |
| Others                       | (4,605)        | (4,201)         | 150             | 150             | 150             |
| <b>Financing CF</b>          | <b>(7,802)</b> | <b>(1,700)</b>  | <b>10,252</b>   | <b>8,629</b>    | <b>(2,074)</b>  |
| <b>Net change in cash</b>    | <b>(2,179)</b> | <b>41</b>       | <b>244</b>      | <b>161</b>      | <b>1,040</b>    |
| Cash at beginning            | 5,071          | 2,861           | 2,908           | 3,152           | 3,313           |
| Exchange difference          | (31)           | 7               | -               | -               | -               |
| <b>Cash at the end</b>       | <b>2,861</b>   | <b>2,908</b>    | <b>3,152</b>    | <b>3,313</b>    | <b>4,353</b>    |
| Pledged cash                 | 253            | 523             | 320             | 354             | 350             |
| Time deposit                 | -              | -               | -               | -               | -               |
| <b>Cash at balance sheet</b> | <b>3,114</b>   | <b>3,432</b>    | <b>3,472</b>    | <b>3,668</b>    | <b>4,704</b>    |

### Balance sheet

| YE 31 Dec (RMB mn)             | FY18A          | FY19A          | FY20E          | FY21E          | FY22E          |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>Non-current assets</b>      | <b>128,718</b> | <b>133,773</b> | <b>142,585</b> | <b>150,627</b> | <b>150,923</b> |
| Fixed asset                    | 110,00         | 114,60         | 123,52         | 131,91         | 132,57         |
| Prepaid lease payments         | 2,152          | -              | -              | -              | -              |
| Interest in JVs                | 4,549          | 4,328          | 4,371          | 4,415          | 4,459          |
| Others                         | 12,016         | 14,838         | 14,690         | 14,294         | 13,888         |
| <b>Current assets</b>          | <b>17,786</b>  | <b>23,029</b>  | <b>27,479</b>  | <b>31,450</b>  | <b>34,381</b>  |
| Cash                           | 3,114          | 3,432          | 3,472          | 3,668          | 4,704          |
| Account receivable             | 10,542         | 16,365         | 20,098         | 23,767         | 25,577         |
| Prepayments                    | 2,819          | 1,963          | 2,495          | 2,567          | 2,648          |
| Others                         | 1,312          | 1,269          | 1,415          | 1,449          | 1,452          |
| <b>Current liabilities</b>     | <b>39,780</b>  | <b>43,538</b>  | <b>48,384</b>  | <b>50,197</b>  | <b>48,757</b>  |
| 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         | 35,562         | 39,365         | 38,943         |
| Others                         | 264            | 230            | 312            | 314            | 301            |
| <b>Non-current liabilities</b> | <b>50,158</b>  | <b>52,610</b>  | <b>57,050</b>  | <b>62,575</b>  | <b>61,774</b>  |
| Borrowings                     | 46,645         | 48,881         | 53,343         | 59,047         | 58,415         |
| Obligation under financial     | 361            | -              | -              | -              | -              |
| Others non-current assets      | 3,152          | 3,728          | 3,706          | 3,528          | 3,359          |
| <b>Minority Interest</b>       | <b>7,329</b>   | <b>7,732</b>   | <b>7,882</b>   | <b>8,032</b>   | <b>8,182</b>   |
| <b>Perpetual MTN</b>           | <b>4,991</b>   | <b>4,991</b>   | <b>4,991</b>   | <b>4,991</b>   | <b>4,991</b>   |
| <b>Shareholders' equity</b>    | <b>44,245</b>  | <b>47,932</b>  | <b>51,757</b>  | <b>56,282</b>  | <b>61,600</b>  |
| <b>Total Equity</b>            | <b>56,566</b>  | <b>60,655</b>  | <b>64,630</b>  | <b>69,305</b>  | <b>74,773</b>  |

### Key ratios

| YE 31 Dec                           | FY17A        | FY18A        | FY19E        | FY20E        | FY21E        |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Sales mix (%)</b>                |              |              |              |              |              |
| Wind                                | 69.8         | 68.9         | 71.6         | 73.6         | 75.5         |
| Coal-fired                          | 27.7         | 28.3         | 25.9         | 24.2         | 22.5         |
| Others                              | 2.5          | 2.4          | 2.5          | 2.2          | 2.0          |
| Concession revenue                  | 0.1          | 0.4          | -            | -            | -            |
| <b>Total</b>                        | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> |
| <b>Profit &amp; loss ratios (%)</b> |              |              |              |              |              |
| Operating margin                    | 35.0         | 36.1         | 36.6         | 38.1         | 39.2         |
| Pre-tax margin                      | 22.3         | 23.4         | 24.3         | 25.2         | 26.6         |
| Net margin                          | 14.9         | 15.7         | 16.4         | 17.3         | 18.6         |
| Effective tax rate                  | 16.5         | 17.5         | 18.1         | 18.5         | 19.1         |
| <b>Balance sheet ratios</b>         |              |              |              |              |              |
| Current ratio (x)                   | 0.45         | 0.53         | 0.57         | 0.63         | 0.71         |
| Quick ratio (x)                     | 0.43         | 0.51         | 0.55         | 0.61         | 0.68         |
| Cash ratio (x)                      | 0.07         | 0.07         | 0.07         | 0.07         | 0.09         |
| Inventory turnover days             | 12.5         | 11.1         | 11.4         | 11.3         | 10.6         |
| Debtors turnover days               | 122.4        | 178.3        | 232.0        | 252.8        | 260.7        |
| Creditor turnover days              | 51.8         | 68.9         | 66.6         | 46.5         | 43.3         |
| Total debt / equity ratio (%)       | 169.5        | 162.4        | 171.8        | 174.9        | 158.0        |
| Net debt / equity ratio (%)         | 163.0        | 156.3        | 165.7        | 169.0        | 151.0        |
| <b>Returns (%)</b>                  |              |              |              |              |              |
| ROE                                 | 8.9          | 9.0          | 9.1          | 9.7          | 10.4         |
| ROA                                 | 2.7          | 2.8          | 2.8          | 3.0          | 3.5          |
| <b>Per share</b>                    |              |              |              |              |              |
| EPS (RMB)                           | 0.49         | 0.54         | 0.58         | 0.68         | 0.80         |
| DPS (RMB)                           | 0.10         | 0.11         | 0.12         | 0.14         | 0.16         |
| BVPS (RMB)                          | 5.51         | 5.96         | 6.44         | 7.00         | 7.67         |

Source: Company data, CMBIS estimates

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|                       |   |
|-----------------------|---|
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