

China Suntien Green Energy (956 HK)

 Target price: **HKD1.25** (from HKD1.20)

 Share price (4 Jan): **HKD1.03** | Up/downside: **+21.3%**

 5 4 3 2 **1**

Buy
 (from Outperform)

Upgrading: strong wind matters

- Slumping gas business should not be material as...
- ...wind capacity and utilisation hours continue to improve
- Upgrading to Buy (1); 0.4x PBR looks attractive for a wind IPP

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What's new: We think Suntien's recent 12% share-price correction due to concerns over the new wind farm tariff cut is overdone, while management recently guided for strong capacity and utilisation numbers in 2016.

What's the impact: New wind capacity of 700MW and 13% YoY utilisation-hour recovery in 2016. Suntien developed 700MW of wind farms in 2016 (the high end of its 500-700MW guidance). Given a 5-15% on-grid tariff cut for new capacity installed in 2019, management aims to develop 500-700MW of new capacity in 2017-18, to achieve 4GW of total wind farm capacity by 2018.

However, the outlook for Suntien's gas distribution business is weak, in our opinion. We expect Suntien's wholesales gas sales in 2016 (70% of Suntien's total gas sales) to fall by 4% YoY while the retail segment could fall by 15% YoY as Suntien faces more difficulty gaining new retail customers. In November 2016, it began supplying natural gas from Sinopec to glass manufacturers in Shahe City at a small CNY0.1/m³ unit dollar margin. We foresee a drop in the unit dollar margin and revise our 2016-18 assumptions from CNY0.29-0.30/m³ to CNY0.20-0.23/m³, similar to China gas peers.

However, we believe that growth in the wind segment could more than offset the decline in the gas segment, leading to 26% YoY growth in net profit in 2016 and a 16% CAGR for 2015-18. We expect the wind segment to contribute 94% of segment profit in 2018. On another positive note, Suntien was able to collect CNY120m from glass manufacturers in Shahe City and reduce bad debts from CNY1bn in 2015 to CNY660m in 2016, thus lowering impairment risk.

What we recommend: We raise 2016-18E earnings by 0-1% to factor in a 250-hour increase in utilisation in 2016 (from 188 hours), and 1.9GW of new wind farm capacity in 2016-18 (from 1.3GW). Notwithstanding the weak natural gas business, we believe Suntien is moving back to a growth trajectory, from a -13% CAGR in recurring net profit in 2012-15 to a 16% CAGR in 2015-18E. Hence, we consider it unjustified that Suntien's 0.4x 2017E PBR is in line with Datang Renewables' (1798 HK, HKD0.70, not rated), as the latter has a much lower ROE of 3-5% (Suntien's 6-7%). Hence, we upgrade Suntien to Buy (1) from Outperform (2) and raise our DCF-based (from SOTP) 12-month TP from HKD1.20 to HKD1.25. The key risk: slower-than-expected wind speeds in Hebei province.

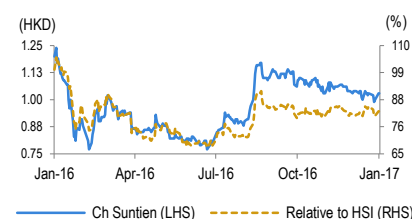
How we differ: Our 2016-17E earnings are 9-21% above consensus as we are more bullish on the performance of Suntien's wind IPP segment.

Forecast revisions (%)

Year to 31 Dec	16E	17E	18E
Revenue change	4.1	5.4	6.1
Net profit change	0.2	0.8	0.5
Core EPS (FD) change	0.2	0.8	0.5

Source: Daiwa forecasts

Share price performance



12-month range	0.77-1.24
Market cap (USDbn)	0.49
3m avg daily turnover (USDm)	0.35
Shares outstanding (m)	3,715
Major shareholder	Hebei Const & Inv (50.5%)

Financial summary (CNY)

Year to 31 Dec	16E	17E	18E
Revenue (m)	4,087	4,463	4,809
Operating profit (m)	1,209	1,398	1,542
Net profit (m)	449	497	566
Core EPS (fully-diluted)	0.121	0.134	0.152
EPS change (%)	26.0	10.7	13.9
Daiwa vs Cons. EPS (%)	20.8	8.7	(0.5)
PER (x)	7.6	6.9	6.1
Dividend yield (%)	2.4	3.3	3.8
DPS	0.022	0.031	0.035
PBR (x)	0.4	0.4	0.4
EV/EBITDA (x)	9.4	9.6	9.1
ROE (%)	5.9	6.2	6.7

Source: FactSet, Daiwa forecasts

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How do we justify our view?

Buy
(from Outperform)

Growth outlook



Valuation



Earnings revisions

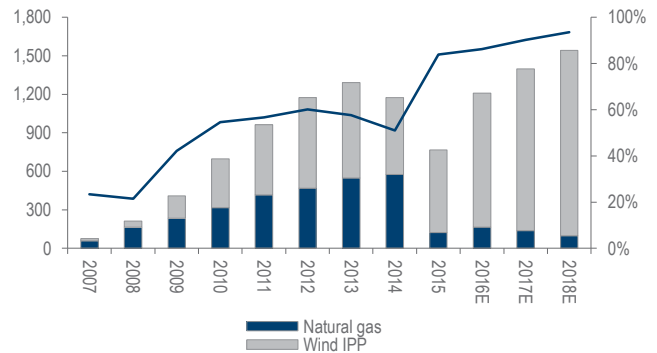


Growth outlook



We forecast Suntien's recurring attributable net profit to grow by 26% YoY in 2016 and at a 16% CAGR for 2015-18. We remain cautious on the earnings outlook for Suntien's natural gas business given continued weak industrial demand in Hebei. We are more positive on Suntien's wind IPP segment, which we expect to remain the company's earnings growth driver, driven by capacity expansion (24% CAGR in 2015-18E, previous: 17%) and utilisation improvement (3.6% CAGR in 2015-18E, previous: 3.4%); we expect the wind IPP to contribute 94% of segment profit in 2018.

Suntien: segment profit forecasts (CNYm)



Source: Company, Daiwa

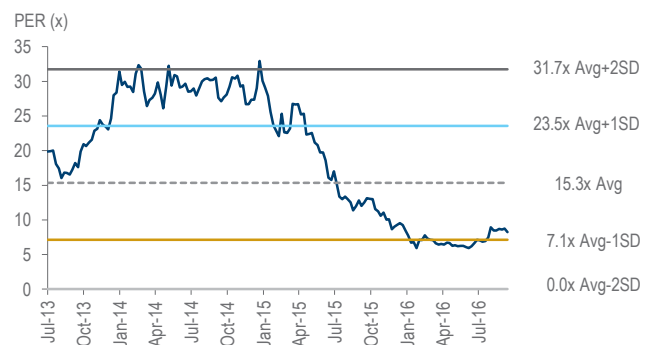
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Valuation



Suntien's stock price has corrected by 12% since end-September when the National Development and Reform Commission (NDRC) proposed a further on-grid tariff cut for newly installed wind farms in 2018-19. The stock is trading at 6.9x 2017E PER and 0.4x 2017E PBR – its lowest levels in 3 years. Our new TP of HKD1.25 implies 8x 2017E PER and a 0.5x 2017E PBR. We believe the market has priced in Suntien's weak natural gas business but has yet to fully reflect robust growth in the wind IPP segment in 2016, which we expect to more than cover the decline in its gas business. Thus, given that our forecast ROE of 6-7% for Suntien is some 1-3pp higher than for Datang Renewables, we see its valuation, currently in line with that of Datang Renewables, as appealing.

Suntien: 1-year forward PER



Source: Bloomberg, Daiwa

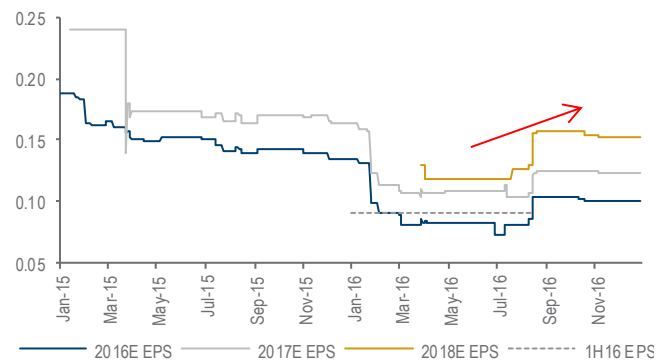
Earnings revisions



The Bloomberg-consensus EPS forecasts for 2016-18 have rebounded since the company reported strong 1H16 results.

Our revised 2016-17 EPS forecasts are 9-21% higher than those of the market, which we believe has yet to fully factor in expected strong performance by its wind IPP segment in 2016-17. Hence, we expect the consensus 2017E EPS to be revised up when the company reports 2016 results in March.

Suntien: Bloomberg-consensus EPS forecasts (CNY)



Source: Bloomberg, Daiwa

Financial summary

Key assumptions

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Natural gas sales volume (mn m3)	1,213	1,246	1,484	1,523	1,127	1,060	1,039	1,053
Wholesales gas proportion (%)	61	56	51	55	70	71	71	72
Gas ASP, excl tax (CNY/m3)	1.93	1.97	2.16	2.44	2.32	1.90	1.89	1.87
Gas cost, excl tax (CNY/m3)	1.57	1.50	1.68	2.00	1.89	1.67	1.67	1.68
Consolidated installed wind power capacity (MW)	1,201	1,346	1,445	1,697	2,094	2,794	3,294	3,994
Wind utilisation (hours)	2,048	2,290	2,312	1,996	1,887	2,137	2,124	2,101

Profit and loss (CNYm)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Natural gas	2,405	2,569	3,327	3,903	2,792	2,198	2,130	2,120
Wind power	765	1,133	1,333	1,246	1,427	1,888	2,333	2,689
Other Revenue	0	0	0	0	6	0	(0)	0
Total Revenue	3,170	3,702	4,661	5,149	4,224	4,087	4,463	4,809
Other income	135	78	31	56	77	80	71	65
COGS	(2,257)	(2,464)	(3,202)	(3,854)	(3,103)	(2,747)	(2,886)	(3,051)
SG&A	(153)	(195)	(240)	(256)	(273)	(212)	(250)	(281)
Other op.expenses	(22)	(54)	(34)	(4)	(216)	0	0	0
Operating profit	873	1,067	1,216	1,093	710	1,209	1,398	1,542
Net-interest inc./(exp.)	(245)	(354)	(424)	(487)	(572)	(643)	(781)	(864)
Assoc/forex/extraord./others	73	90	40	69	63	56	70	101
Pre-tax profit	701	803	832	675	200	622	686	779
Tax	(82)	(7)	(158)	(176)	(11)	(82)	(86)	(92)
Min. int./pref. div./others	(170)	(246)	(215)	(163)	(21)	(91)	(103)	(122)
Net profit (reported)	449	550	460	335	168	449	497	566
Net profit (adjusted)	449	550	460	363	356	449	497	566
EPS (reported)(CNY)	0.139	0.170	0.142	0.091	0.045	0.121	0.134	0.152
EPS (adjusted)(CNY)	0.139	0.170	0.142	0.099	0.096	0.121	0.134	0.152
EPS (adjusted fully-diluted)(CNY)	0.139	0.170	0.142	0.099	0.096	0.121	0.134	0.152
DPS (CNY)	0.058	0.020	0.053	0.031	0.015	0.022	0.031	0.035
EBIT	873	1,067	1,216	1,121	898	1,209	1,398	1,542
EBITDA	1,243	1,535	1,767	1,718	1,591	2,065	2,456	2,796

Cash flow (CNYm)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Profit before tax	701	803	832	675	200	622	686	779
Depreciation and amortisation	370	468	550	598	694	856	1,058	1,254
Tax paid	(82)	(7)	(158)	(176)	(117)	(82)	(86)	(92)
Change in working capital	(331)	(618)	205	(197)	386	(248)	(177)	(133)
Other operational CF items	209	584	167	(13)	176	587	712	763
Cash flow from operations	866	1,230	1,597	885	1,339	1,735	2,193	2,571
Capex	(3,172)	(1,413)	(1,536)	(2,446)	(5,687)	(4,050)	(5,550)	(3,300)
Net (acquisitions)/disposals	(2)	(1)	(2)	(3)	0	0	0	0
Other investing CF items	(703)	86	268	116	458	47	47	47
Cash flow from investing	(3,877)	(1,329)	(1,270)	(2,333)	(5,228)	(4,003)	(5,503)	(3,253)
Change in debt	1,645	694	1,398	2,067	4,797	1,800	3,400	1,200
Net share issues/(repurchases)	0	0	0	1,256	0	0	0	0
Dividends paid	(146)	(272)	(94)	(248)	(101)	(148)	(209)	(238)
Other financing CF items	(232)	(427)	(576)	(465)	(645)	(250)	(631)	(686)
Cash flow from financing	1,267	(5)	728	2,610	4,051	1,402	2,561	276
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(1,743)	(104)	1,055	1,162	162	(866)	(750)	(406)
Free cash flow	(2,306)	(183)	61	(1,561)	(4,348)	(2,315)	(3,357)	(729)

Source: FactSet, Daiwa forecasts

Financial summary continued ...

Balance sheet (CNYm)

As at 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Cash & short-term investment	920	758	1,670	3,198	3,139	2,161	1,411	1,005
Inventory	25	30	43	43	48	43	42	44
Accounts receivable	396	843	846	1,402	1,241	1,309	1,405	1,588
Other current assets	622	601	565	689	804	509	524	568
Total current assets	1,962	2,231	3,123	5,331	5,232	4,023	3,382	3,204
Fixed assets	7,713	8,602	10,180	11,731	14,971	18,277	22,875	25,022
Goodwill & intangibles	2,458	2,357	2,256	2,198	2,101	1,996	1,897	1,803
Other non-current assets	1,925	2,072	1,855	2,350	4,620	4,656	4,648	4,641
Total assets	14,059	15,263	17,414	21,610	26,924	28,951	32,802	34,670
Short-term debt	636	971	1,359	1,730	2,440	2,440	2,440	2,440
Accounts payable	125	197	224	437	553	481	463	488
Other current liabilities	1,062	928	1,162	1,364	1,561	1,381	1,331	1,402
Total current liabilities	1,824	2,096	2,744	3,531	4,555	4,302	4,234	4,330
Long-term debt	6,114	6,529	7,545	9,296	13,386	15,186	18,586	19,786
Other non-current liabilities	26	15	19	21	82	78	78	78
Total liabilities	7,964	8,640	10,307	12,848	18,023	19,566	22,898	24,194
Share capital	3,238	3,238	3,238	3,715	3,715	3,715	3,715	3,715
Reserves/R.E./others	1,967	2,329	2,727	3,644	3,698	4,091	4,507	4,958
Shareholders' equity	5,206	5,568	5,966	7,360	7,413	7,806	8,222	8,673
Minority interests	889	1,055	1,141	1,403	1,487	1,578	1,682	1,803
Total equity & liabilities	14,059	15,263	17,414	21,610	26,924	28,951	32,802	34,670
EV	9,769	10,816	11,433	11,739	16,532	19,370	23,623	25,351
Net debt/(cash)	5,831	6,742	7,234	7,828	12,687	15,465	19,615	21,221
BVPS (CNY)	1.608	1.719	1.842	2.001	1.995	2.101	2.213	2.334

Key ratios (%)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Sales (YoY)	41.4	16.8	25.9	10.5	(18.0)	(3.3)	9.2	7.8
EBITDA (YoY)	47.3	23.5	15.1	(2.8)	(7.4)	29.7	19.0	13.8
Operating profit (YoY)	43.8	22.2	14.0	(7.9)	(19.9)	34.7	15.6	10.3
Net profit (YoY)	60.8	22.5	(16.4)	(21.0)	(1.8)	26.0	10.7	13.9
Core EPS (fully-diluted) (YoY)	12.0	22.5	(16.4)	(30.5)	(2.8)	26.0	10.7	13.9
Gross-profit margin	28.8	33.5	31.3	25.2	26.5	32.8	35.3	36.6
EBITDA margin	39.2	41.5	37.9	33.4	37.7	50.5	55.0	58.1
Operating-profit margin	27.5	28.8	26.1	21.8	21.3	29.6	31.3	32.1
Net profit margin	14.2	14.8	9.9	7.1	8.4	11.0	11.1	11.8
ROAE	9.0	10.2	8.0	5.4	4.8	5.9	6.2	6.7
ROAA	3.5	3.7	2.8	1.9	1.5	1.6	1.6	1.7
ROCE	7.5	7.9	8.1	6.3	4.0	4.7	4.8	4.8
ROIC	7.7	8.4	7.1	5.2	3.5	4.5	4.5	4.4
Net debt to equity	112.0	121.1	121.3	106.4	171.1	198.1	238.6	244.7
Effective tax rate	11.7	0.9	18.9	26.1	5.7	13.2	12.5	11.8
Accounts receivable (days)	33.7	61.1	66.1	79.6	114.2	113.9	111.0	113.6
Current ratio (x)	1.1	1.1	1.1	1.5	1.1	0.9	0.8	0.7
Net interest cover (x)	3.6	3.0	2.9	2.3	1.6	1.9	1.8	1.8
Net dividend payout	41.8	11.8	37.2	34.4	33.1	18.1	23.1	23.1
Free cash flow yield	n.a.	n.a.	1.8	n.a.	n.a.	n.a.	n.a.	n.a.

Source: FactSet, Daiwa forecasts

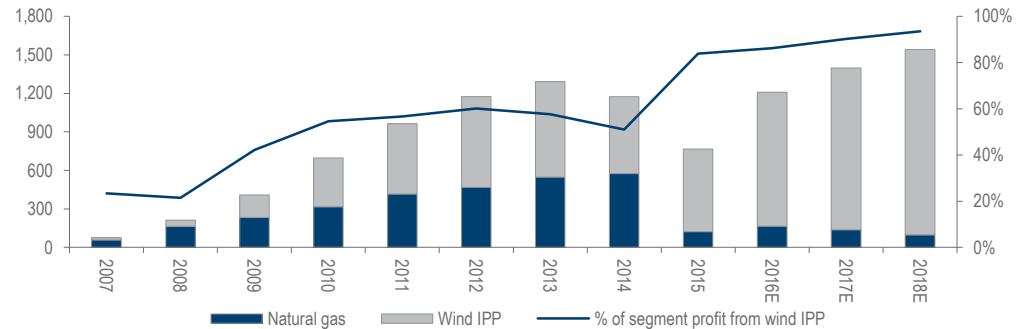
Company profile

China Suntien Green Energy is a clean-energy enterprise controlled by the Hebei Construction & Investment Group. Its main businesses include the investment, construction and operation of wind farms, as well as the transmission and distribution of natural gas and compressed natural gas (CNG).

Valuation and risks

We raise our 2016-18E earnings by 0-1% to factor in expectations of increases of 250 utilisation hours in 2016 (previous: 188 hours) and 1.9GW of new wind farm capacity in 2016-18 (previous: 1.3GW). We believe Suntien's wind IPP segment, which we expect to remain the company's growth driver, is likely to more than offset the decline in its natural gas distribution business, leading to 26% YoY growth in net profit in 2016, and a 16% CAGR in 2015-18E. We expect the wind IPP to contribute 94% of segment profit in 2018.

Suntien: recurring net profit forecast by segment (CNYm)



Source: Company, Daiwa

Given we expect the natural gas distribution segment to make limited earnings contributions for Suntien (6% of total segment profit in 2018, on our estimates), we change our valuation methodology from a SOTP-based model that values the wind IPP and gas distribution segments separately to a single DCF model. Using the assumptions detailed below, we derive our new DCF-based 12-month TP of HKD1.25, implying a 8x 2017E PER, slightly above -1SD of its historical PER.

Suntien is trading at the same 0.4x 2017E PBR as Datang Renewables, which we view as unjustified

For the same reasons, we compare the company with pure wind farm operators rather than gas distributors. Suntien is now trading at a 0.4x 2017E PBR, at a discount to the 1x 2017E PBR of leading wind IPPs such as China Longyuan (916HK, HKD6.12, Buy [1]). Its 2017E PBR is in line with that of Datang Renewables, which strikes us as unjustified given our forecast ROE of 6-7% for Suntien (includes slumping gas business whose ROE could be less than 1%) vs. 3-5% for Datang Renewables.

Suntien: DCF valuation

(HKDm)	
Terminal Value	
Terminal Growth Rate	0.0%
Terminal WACC	8.3%
Estimated Terminal Free Cash Flow	3,140
NPV of Terminal Value (as at 30 Jun 2026)	37,732
NPV of Terminal Value (as at 01 Jan 2017)	17,661
DCF Valuation	
NPV of Forecasts	6,084
NPV of Terminal Value	17,661
Add: Market value of stakes in Associates #1	0
Associate #2	
Associate #3	
Enterprise Value	23,745
Less: Net Debt	(19,615)
Equity Value	4,130
No. Shares (m)	3,715
Per Share Equity Value	HKD1.25

Source: Daiwa

Suntien: WACC calculation

Target gearing (debt/capital) (%)	60%
Beta	1.10
Market risk premium (%)	10.74%
Risk-free rate (%)	2.80%
Cost of debt (%)	5.50%
Cost of equity (%)	14.61%
WACC (%)	8.3%

Source: Daiwa

Suntien: DCF sensitivity

Discount Rate	NPV of FCF	Enterprise Value	Equity Value	Per share (HKD)
5.82%	7,845	39,360	19,744	5.95
6.32%	7,464	35,215	15,600	4.70
6.82%	7,098	31,694	12,079	3.64
7.32%	6,747	28,668	9,053	2.73
7.82%	6,409	26,043	6,428	1.94
8.32%	6,084	23,745	4,130	1.25
8.82%	5,772	21,719	2,104	0.63
9.32%	5,472	19,920	305	0.09
9.82%	5,184	18,315	-1,301	(0.39)
10.32%	4,906	16,873	-2,742	(0.83)
10.82%	4,639	15,573	-4,042	(1.22)

Source: Daiwa

Suntien: NPV of free cash flow

12 mths to 31 Dec, All figures in CNYm	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	
Valuation Date	1-Jan-17	2-Jul-17	30-Jun-18	30-Jun-19	30-Jun-20	30-Jun-21	30-Jun-22	30-Jun-23	30-Jun-24	30-Jun-25	30-Jun-26
Next Balance Date	31-Dec-17										
First Year Cash Flow Adjustment	1.00										
Free Cash Flow											
EBITDA	2,456	2,796	3,223	3,829	4,417	4,534	4,557	4,587	4,610	4,632	
Less: Other Non Cash	(99)	(112)	(130)	(143)	(198)	(258)	(278)	(279)	(279)	(279)	
Less: Cash Tax Payable on EBIT	(175)	(182)	(249)	(351)	(476)	(548)	(605)	(720)	(723)	(726)	
Plus: Decrease in Working Capital	(177)	(133)	(86)	(70)	(179)	(106)	(9)	10	11	12	
Less: Capital Expenditure	(5,550)	(3,300)	(3,300)	(3,300)	(500)	(500)	(500)	(500)	(500)	(500)	
Free Cash Flow	(3,545)	(930)	(541)	(35)	3,064	3,123	3,166	3,098	3,119	3,140	
Free Cash Flow for Valuation Purposes	(3,545)	(930)	(541)	(35)	3,064	3,123	3,166	3,098	3,119	3,140	
WACC	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	
NPV of Free Cash Flow	(3,407)	(826)	(444)	(27)	2,139	2,012	1,883	1,701	1,581	1,469	

Source: Daiwa

Suntien: peer comparison

Company name	BBG code	Rating	Share price	Target price	Upside Pot.	Mkt cap (USDm)	Turnover (USDm)	PER (x)		PBR (x)		ROE (%)		Net debt-to-equity (%)		EPS CAGR (%)
								2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	
Wind IPPs																
China Longyuan Power	916 HK	Buy	6.13	8.60	40%	6,269	9.7	11.3	9.3	1.1	1.0	10%	11%	197%	193%	23%
Huadian Fuxin	816 HK	Underperform	1.70	1.51	-11%	1,810	3.1	6.0	5.6	0.7	0.6	12%	12%	321%	326%	11%
China Suntien Green Energy	956 HK	Buy	1.03	1.25	21%	493	0.4	7.6	6.9	0.4	0.4	6%	6%	198%	239%	17%
CGN New Energy Holdings	1811 HK	Hold	1.12	1.20	7%	620	0.5	6.2	5.9	0.7	0.7	13%	12%	179%	146%	2%
Huaneng Renewables - H	958 HK	Outperform	2.58	2.95	14%	3,136	5.9	8.2	7.1	1.1	1.0	14%	14%	265%	268%	23%
China Dalang Renewables - H	1798 HK	NR	0.71	n.a.	n.a.	656	0.1	15.2	8.1	0.4	0.4	3%	5%	405%	433%	96%
Simple average							8.8	7.0	0.8	0.7	10%	11%	247%	247%	26%	
Weighted average							9.3	7.7	0.9	0.9	11%	12%	230%	225%	22%	

Source: Bloomberg, Daiwa

Risks

The main risk to our call on Suntien would be slower-than-expected wind speed, which would have a direct impact on the power generation of Suntien's wind farms. Besides, our earnings forecasts could be at risk if Suntien's expansion of wind power capacity were to be slower than its guidance suggests.

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