

Luenmei (600167.SH)

Clean Heating Maintains High Prosperity, Accelerates Geo-replication

Hong Kong | Environmental Protection | Company report

10 January 2018

Summary of Investment

- Controlling shareholders increased their holdings to strengthen investment value of the Company;
- Clean heating maintains high prosperity;
- Endogenous + epitaxial growth can be expected;

Investment Rating

Recently stock price of the Company has been volatile, and the controlling shareholders increased their holdings to strengthen investment value of the Company and stable investment confidence. We expect the net profit of the Company in year 2017-2018 attributable to the parent company will be RMB893 million and RMB1142million, respectively, equivalent to EPS of RMB1.01/share, RMB1.30/share, respectively, and PE of 23.6, 18.4 times, respectively. For the first coverage, target price 30.55 and rating Buy are given. (Closing price as at 8 Jan 2018)

Historical P/E valuation



Source: Wind, Phillip Securities(HK)Research

Buy

CMP: RMB 23.90

(Closing price as at 8 Jan 2018)

TARGET: RMB 30.55 (27.8%)

COMPANY DATA

O/S SHARES (MN) :	880
MARKET CAP (RMB MN) :	21033
52 - WK HI/LO (RMB):	29.67/16.44

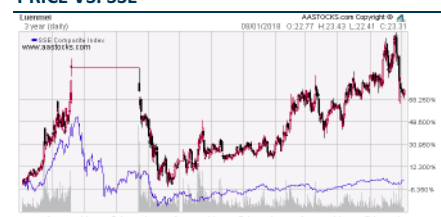
SHARE HOLDING PATTERN , %

Lianzhong new energy co. LTD	48.48
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PRICE PERFORMANCE , %

	1-Month	3-Month	1-Year
Luenmei	-15.67	-7.41	30.96
SSE	3.09	1.28	7.53

PRICE VS. SSE



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMBmn	FY15	FY16	FY17E	FY18E
Revenue	758	2044	2638	3320
Net Profit	177	699	893	1142
P/E,x	28.5	23.3	23.6	18.4
EPS, RMB	0.84	1.03	1.01	1.30
P/B, x	4.3	6.5	6.3	4.7
BVPS, RMB	5.5	3.7	3.8	5.1
ROE, %	15.2	28.2	26.5	25.3

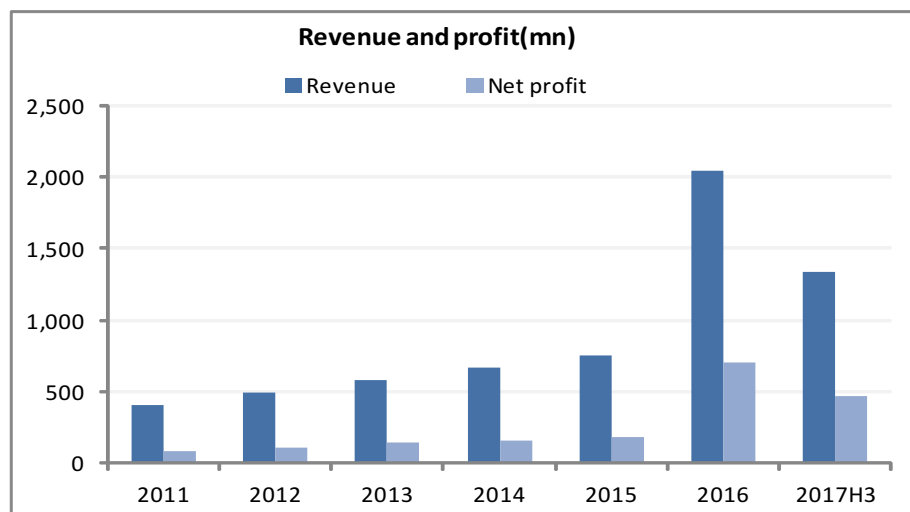
Source: Company reports, Phillip Securities Est.

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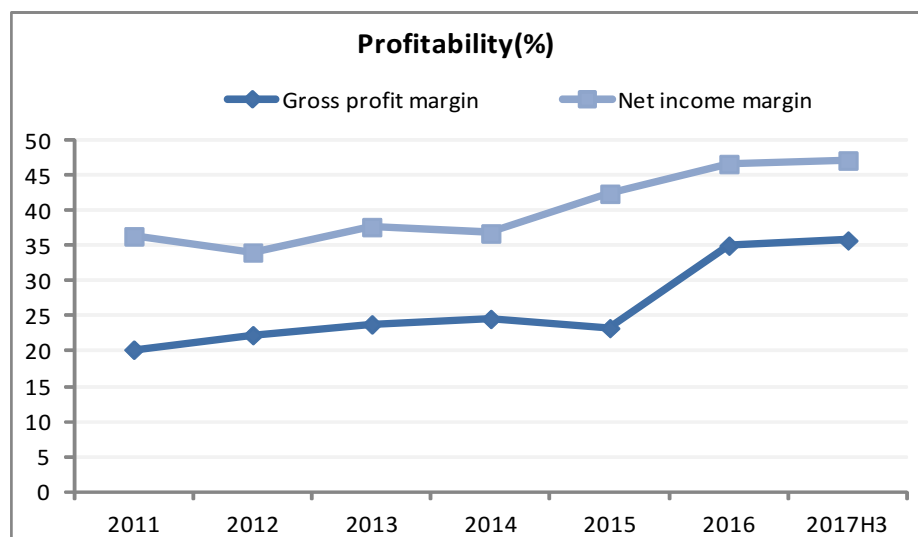
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Source: Wind, Phillip Securities(HK)Research

The fourth quarter heating season leads the growth of annual result

In the first three quarters of 2017, Luenmei Holding recorded a revenue of RMB1,338 million with an increase of 18.88% year on year, net profit attributable to parent company RMB467 million with an increase of 56.83% year on year, equivalent to EPS of RMB0.61, with an increase of 38.7% year on year. Among them, the Q1 / Q2 / Q3 revenue was RMB1,046 / 143 / 149 million, respectively, in line with expectations. The Company's revenue mainly came from heating, steam, power generation, engineering and network access. The heating season in the heating area is from November to March next year. Therefore, the fourth quarter and the first quarter will contribute most of the annual results.



Source: Wind, Phillip Securities(HK)Research

Profitability continued to improve

The period cost rate during the first three quarters of the year dropped significantly from 9.36% to 1.04% mainly due to a significant reversal of financial costs. After the issuance of new shares, the Company's financial position was improved. The Company no longer paid interest on loans while interest income increased significantly, with its financial expenses dropped from RMB21.7 million to -RMB73.63 million year on year. Gross profit rate improved by 4.11 percentage points to 47.11% year on year. Driven by higher gross profit rate and lower expense ratio during the

period, net profit ratio increased 8.62 percentage points to 35.77% year on year. The profitability continued to improve.

Geo-replication is accelerated

Clean heating is encouraged and promoted by related policies, and clean heating transformation maintains high prosperity. The cogeneration units and large-tonnage boilers of the Company can effectively save fuel and reduce pollution, and is expected to become the main method for urban centralized heating in the future. Currently the heating area and access area of the Company are growing steadily, with the access area reaching 61.6 million square meters and the heating area reaching 46 million square meters. Under the strategy of expanding in different areas, the heating area has a huge potential growth room in the future. During the period, the Company won the bid of the franchise leasing project of about 5.3 million square meters initiated by Shenyang City Huanggu District Heating Company, replicating and expanding existing businesses with the dual mode of “self-build” and “light assets” such as entrusted operation and management. On November 28, the Company also signed a cooperation framework agreement for Baotou City central heating project, geo-replication covering another city.

Adequate capital helped extend the expansion

In May 2017, the Company issued 200 million shares through private placement and raised a total of RMB3.87 billion for investment in areas such as heating capacity. By the end of the third quarter, the Company possessed a cash capital of RMB5,077 million, with ample book capital and low interest-bearing debts. The good financial position provides financial support for the Company to speed up the expansion in different places. In addition, on November 1, the Company became the second shareholder of Cinda Property and Casualty Insurance through a RMB650 million transferee. In addition to the main business of heating, the Company relies on the abundant capital advantage to implement a diversified layout in the property and casualty insurance industry to help with the assets and the financial structure improvement. The future development prospect is worth looking forward to.

Controlling shareholders increased their holdings to strengthen investment value of the Company

From the Company’s announcement, based on the confidence on the Company’s performance and innovative development, as well as the long-term recognition of the value of the Company, the second shareholder Luenmei Group increased its holdings by 586,500 shares on December 26 at the price of RMB14.169 million, accounting for 0.067% of the issued shares, with the average price of RMB24.16 / share. Luenmei Group undertakes to, within the next six months from December 26 onwards, continue to increase its holdings with the total price of RMB20-200 million, and ratio of holdings should be no more than 1% of the issued shares.

Risk Warnings

Business expansion below expectations;
Access area growth below expectations;
Increasing raw material prices leading to declining profits;

Financials

FYE	FY14	FY15	FY16	FY17E	FY18E
Valuation Ratios					
Price Earnings(P/E)	31.0	28.5	23.3	23.6	18.4
Price to Book(P/B)	5.1	4.3	6.5	6.2	4.7
Per share data(RMB)					
EPS,Adjusted	0.77	0.84	1.03	1.01	1.30
Book Value Per Share	4.69	5.52	3.65	3.83	5.13
Growth & Margins(%)					
Growth					
Revenue	13.7%	14.5%	169.8%	29.0%	25.9%
Operating income	19.2%	27.0%	244.0%	29.9%	28.5%
Net profit	17.4%	8.5%	295.8%	27.7%	27.9%
Margins					
Gross profit margin	30.8%	34.2%	39.6%	43.8%	44.7%
Operating profit margin	30.8%	34.1%	43.5%	43.8%	44.7%
Net income margin	24.6%	23.3%	34.2%	33.8%	34.4%
Key Ratios					
ROE(%)	16.5%	15.2%	28.2%	26.5%	25.3%
ROA(%)	5.8%	5.8%	14.4%	12.3%	12.4%
Income Statement(RMB million)					
Revenue	661	758	2,044	2,638	3,320
- Cost of Goods Sold	458	498	1,236	1,482	1,836
Gross Income	204	259	809	1,156	1,484
- Operating Expenses	0	1	-81	0	0
Operating Income	204	259	890	1,156	1,484
- Net Non-Operating Loss	(13)	25	(34)	(23)	(28)
Pretax Income	217	233	924	1,179	1,512
- Income Tax Expense	54	57	225	286	371
Net profit	163	177	699	893	1,142

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 8 Jan 2018)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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