

TRADING IDEA

BEIJING ENTERPRISES [0392.HK; HK\$41.25; NOT RATED] - DEEPLY UNDERVALUED BASED ON SOTP VALUATION

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Summary. The share price of Beijing Enterprises rebounded in the past few days, and we believe the rebound will continue, as the latest stub value of the Company implies its non-listed gas business is trading at an unrealistically low level of 0.95x PER. In particular, we believe some investors still treat the stock as a proxy of BE Water (0371.HK) and miss the fact that China Gas (0384.HK) accounted for more than half of the value of Beijing Enterprises' listed assets. If we conservatively assume the stub value can trade at 5x PER, we see potential share price upside of 25%.

Value of the listed assets. Currently the major listed assets of Beijing Enterprises include China Gas (384.HK; 24.91% stake), BE Water (0371.HK; 42.42%), Yanjing Brewery (000729.CH; 45.79%), BE Environment (0154.HK; 50.4%) and Biosino (8247.HK; 18.84%). Based on the closing price yesterday (May 17), the total value of the listed assets is about HK\$69.7bn (Figure 1). The latest market cap of Beijing Enterprises, however, is only HK\$52bn.

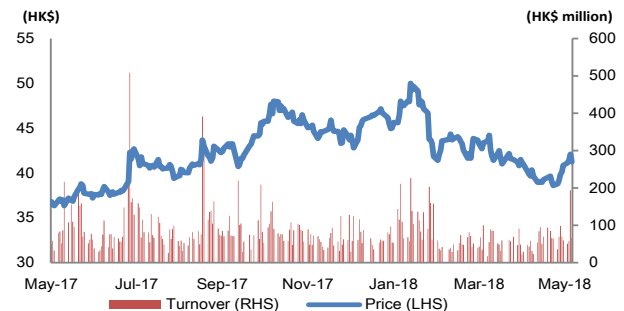
Wrongly treated as a proxy of BE Water. Figure 2 shows the share price movement of Beijing Enterprises and BE Water in the past two years. It's not difficult to see they move in the same direction in general. BE Water's share placement early this year and its weaker-than-expected 2017 results led to a de-rating of the Company, which also affected the share price performance of Beijing Enterprises.

Missing the fact that China Gas accounted >50% of the value of the listed assets. Figure 3 shows the substantial re-rating of China Gas since 2H17. As a result, China Gas now represents 52.8% of the value of Beijing Enterprises' listed assets. Therefore, Beijing Enterprises should be treated as a proxy of China Gas, not BE Water.

Mispricing has led to an unreasonably low stub value. Since the share price of Beijing Enterprises failed to follow the strong share price performance of China Gas, its stub value (market cap of Beijing Enterprises minus the value of its listed assets (including a 30% holding discount)) dropped to HK\$3.2bn. This suggests the stub value is trading at only 0.95x 2017 PER for the non-listed assets (mainly gas business), based on our estimates.

Full-year contribution from VCNG and the organic growth of Beijing Gas should largely offset the earnings decline of the pipeline business. PetroChina Beijing Pipeline Company contributed HK\$2.28bn of net profit to Beijing Enterprises in 2017. Due to the adjustment in the transmission tariff in September 2017, we may see a one-off decline of nearly 40% in net profit from the pipeline company in 2018 to about HK\$1.4bn. However, we expect the earnings gap to be largely filled by (i) the full-year contribution from VCNG, the oil production associate in Russia; the increase in oil prices should also help; VCNG contributed HK\$421m in net profit in 2H17; and (ii)

BEIJING ENTERPRISES



HK\$	2016	2017	2018E	2019E
Revenue (m)	55,959	57,508	62,681	65,733
COGS (m)	(46,523)	(48,145)	(52,607)	(55,290)
Gross profit (m)	9,436	9,363	10,073	10,442
Gross margin (%)	16.9	16.3	16.1	15.9
EBIT (m)	3,862	3,517	3,942	3,999
Net profit (m)	6,236	6,880	7,236	7,992
Net margin (%)	11.1	12.0	11.5	12.2
EPS	4.92	5.45	5.72	6.32
ROE (%)	10.80	11.02	10.29	10.47
Dividend yield (%)	2.30	2.84	2.90	3.05
PER (x)	8.4	7.6	7.2	6.5
PBR (x)	0.91	0.77	0.72	0.66

Source: Bloomberg, Company Data

organic growth from Beijing Gas, driven by the coal-to-gas conversion project. Therefore, we don't expect to see a sharp decline in earnings contribution from the non-listed gas business.

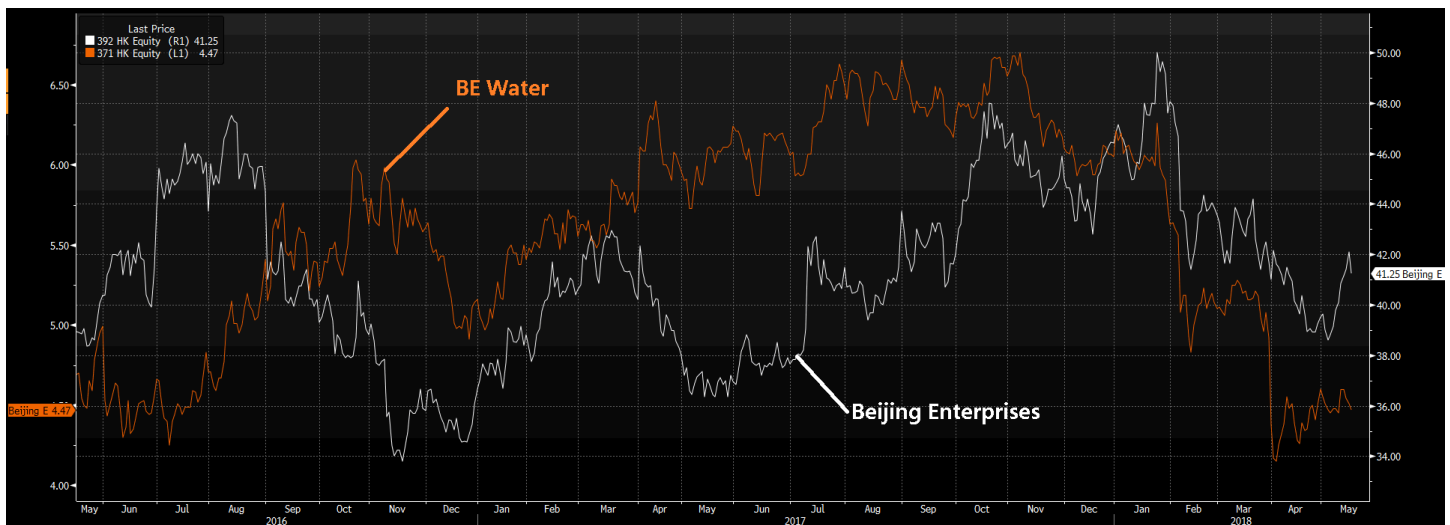
BE Water: Near the end of the de-rating. BE Water is currently trading at 9.3x 2018E PER, based on consensus. We believe this largely reflects the disappointing 2017 results. In addition, as we discussed in a research note dated May 14, the results of the PPP project review conducted by the authorities were better than expected, which should gradually remove concerns about the Company.

Further room for a rebound. The share price of Beijing Enterprises clearly outperformed BE Water in the past few days (Figure 2). We believe more and more investors found that the Company's stub value is trading at an extremely low valuation. If the stub value can trade at 5x PER, there is a potential share price upside of about 25%. This is not a demanding level, as it implies only 9x 2018E PER. This is still far below China Gas's 19.9x FY19E (March year-end) PER.

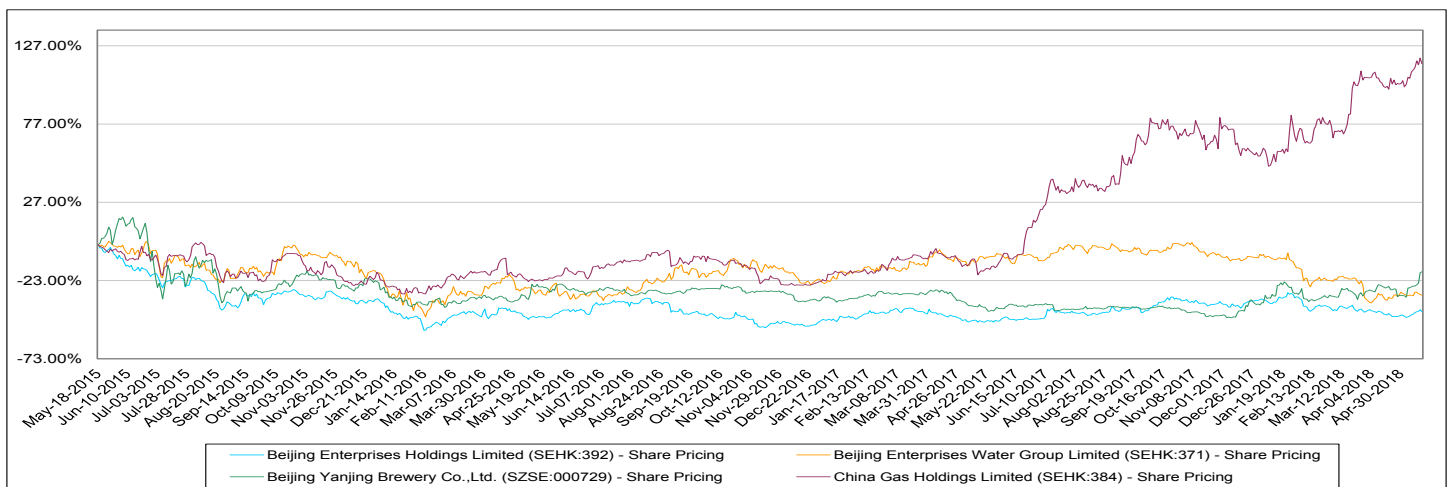
Figure 1: Beijing Enterprises' major listed assets

Company name	Ticker	Stake	Attributable market cap (HK\$m)
China Gas	384 HK Equity	24.91%	36,820
BE Water	371 HK Equity	42.42%	17,847
Yanjing Brewery	000729 CH Equity	45.79%	14,371
BE Environment	154 HK Equity	50.40%	650
Biosino	8247 HK Equity	18.84%	58
Total			69,747
Applying 30% holding company discount			48,823
Market cap of Beijing Enterprises			52,060
Stub value			3,237

Sources: Bloomberg, CGIS Research

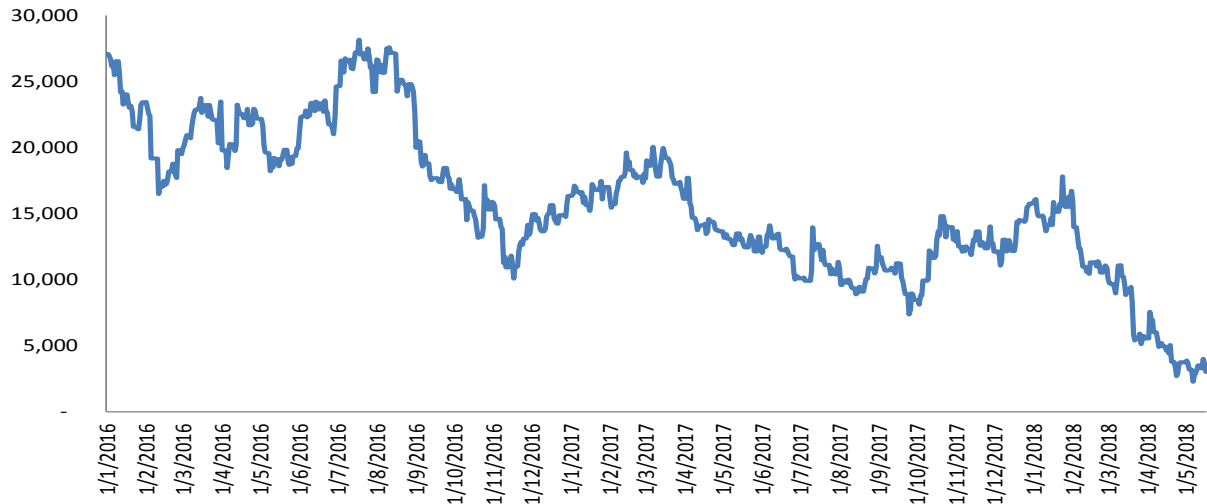
Figure 2: Share price movement of Beijing Enterprises and BE Water


Sources: Bloomberg, CGIS Research

Figure 3: Relative performance of Beijing Enterprises' listed assets


Sources: Capital IQ, CGIS Research

Figure 4: Stub value of Beijing Enterprises (HK\$m)



Stub value = market cap of Beijing Enterprises - value of its listed assets (including 30% holding company discount)

Sources: Bloomberg, CGIS Research

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- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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