

China Gas

Solid growth momentum

Investment Focus

Action

Raise target price by 27% to HK\$14, implying 12x 2018e P/E and 13% share price upside. **Maintain HOLD.**

Reasoning

Significant exposure to China's most polluted regions. We estimate ~50% of China Gas' total gas sales volume came from the country's top 15 smog-hit provinces. We assume favorable gas policies and local coal-to-gas switch programs should generate a faster CAGR at 17% for its sales volume (including wholesale) over FY17~FY19.

Prices were hiked in winter, but likely to be cut in spring. Margin squeeze was inevitable last winter, but we believe a recovery is likely in 2H17. We assume China Gas' unit margin to drop from HK\$0.65 to HK\$0.62 over FY17~FY19.

Overly concerned with regulatory risks. ~20% of China Gas' revenue and ~50% of its EBIT come from connection fees. We recognize the risk that local governments may adjust connection fees and pipeline tariffs, but expect little impact in 2017 and only a limited impact over the longer term. We believe that gas infrastructure development should be ahead of profit redistribution on government agendas.

Gas sourcing overly concentrated. We estimate that previously, ~80% of the company's gas was from PetroChina, while LNG's role in gas sourcing was insignificant. We believe the company would be wise to diversify its sourcing channels and take advantage of intensified price competition among upstream suppliers.

Earnings forecast and valuation

Raise FY17/18 EPS forecasts by 2%/6% to HK\$0.85/1.02, and introduce FY19e at HK\$1.13.

Risks

Weaker gas demand; cancellation of connection fees; big tariff/price cuts; loss of industrial customers; and low return M&A

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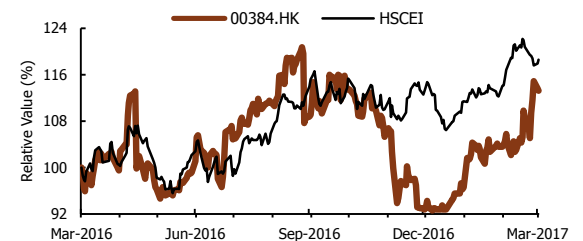
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Maintain HOLD

Ticker	00384.HK
CICC investment rating	HOLD
Last close	HK\$12.42
CICC target	HK\$14.00
52wk price range	HK\$13.38~9.87
Market cap (bn)	HK\$62
Daily value (mn)	HK\$64.30
Shares outstanding (mn)	4,986
Free float (%)	100
Daily volume (mn sh)	5.42
Business sector	Oil & Gas



(HK\$ mn)	2015A	2016A	2017E	2018E
Revenue	31,666	29,139	30,327	37,395
(+/-)	21.8%	-8.0%	4.1%	23.3%
Net profit	3,371	2,273	4,182	4,993
(+/-)	30.9%	-32.6%	84.0%	19.4%
EPS	0.65	0.46	0.85	1.02
BPS	3.57	3.60	4.29	5.13
DPS	0.16	0.19	0.24	0.31
CPS	0.90	1.18	1.17	1.35
P/E	19.0	27.1	14.6	12.2
P/B	3.5	3.5	2.9	2.4
EV/EBITDA	15.3	16.6	12.0	9.9
Dividend yield	1.3%	1.6%	1.9%	2.4%
ROAA	7.0%	4.4%	7.4%	7.8%
ROAE	19.7%	12.5%	21.5%	21.6%

Source: Wind, Bloomberg, company data, CICC Research



Financial summary

Financial statement (HKD mn)	2015A	2016A	2017E	2018E	Financial ratios	2015A	2016A	2017E	2018E
Income statement					Growth ability				
Revenue	31,666	29,139	30,327	37,395	Revenue	21.8%	-8.0%	4.1%	23.3%
COGS	-25,210	-22,105	-22,743	-28,556	Operating profit	24.3%	-11.0%	42.0%	17.2%
Selling expenses	-1,150	-1,088	-1,041	-1,197	EBITDA	24.3%	-8.9%	37.5%	16.6%
Administrative expenses	-1,436	-1,561	-1,516	-1,683	Net profit	30.9%	-32.6%	84.0%	19.4%
Other ops income (expense)	51	-959	0	0	Profitability				
Operating profit	4,597	4,092	5,813	6,812	Gross margin	20.4%	24.1%	25.0%	23.6%
Finance costs	-554	-758	-639	-639	Operating margin	14.5%	14.0%	19.2%	18.2%
Other income (expense)	0	0	0	0	EBITDA margin	17.1%	16.9%	22.3%	21.1%
Profit before income tax	4,810	3,718	5,940	7,093	Net margin	10.6%	7.8%	13.8%	13.4%
Income tax	-940	-984	-1,188	-1,419	Liquidity				
Minority interest	-499	-460	-570	-681	Current ratio	1.11	0.69	0.77	0.93
Net profit	3,371	2,273	4,182	4,993	Quick ratio	1.01	0.63	0.71	0.87
EBITDA	5,409	4,925	6,770	7,897	Cash ratio	0.45	0.28	0.34	0.47
Recurrent net income	3,371	2,273	4,182	4,993	Liabilities / assets	57.7%	60.8%	58.7%	56.3%
Balance sheet					Net debt / equity	72.3%	80.3%	67.9%	44.3%
Cash and bank balances	5,228	5,497	6,531	10,254	Return				
Trade and bill receivables	5,328	5,094	5,302	6,537	RoA	7.0%	4.4%	7.4%	7.8%
Inventories	1,199	1,213	1,034	1,298	RoE	19.7%	12.5%	21.5%	21.6%
Other current assets	1,213	1,843	1,913	2,333	Per-share data				
Total current assets	12,968	13,647	14,779	20,423	EPS (HKD)	0.65	0.46	0.85	1.02
Fixed assets and CIP	21,116	22,850	27,307	28,800	BPS (HKD)	3.57	3.60	4.29	5.13
Intangible assets and others	16,541	17,037	17,845	18,458	DPS (HKD)	0.16	0.19	0.24	0.31
Total non-current assets	37,656	39,886	45,152	47,258	Cash flow per share (HKD)	0.90	1.18	1.17	1.35
Total assets	50,624	53,533	59,931	67,680	Valuation				
Short-term borrowings	3,919	10,324	8,324	8,324	P/E	19.0	27.1	14.6	12.2
Trade and bill payables	6,924	8,549	9,888	12,416	P/B	3.5	3.5	2.9	2.4
Other current liabilities	794	929	1,046	1,284	EV/EBITDA	15.3	16.6	12.0	9.9
Total current liabilities	11,637	19,803	19,258	22,025	Dividend yield	1.3%	1.6%	1.9%	2.4%
Long-term borrowings	16,817	12,010	15,010	15,010					
Total non-current liabilities	17,552	12,766	15,922	16,099					
Total liabilities	29,189	32,569	35,181	38,124					
Share capital	50	49	49	49					
Retained profit	18,346	17,803	21,019	24,842					
Equity	18,396	17,853	21,069	25,194					
Total liabilities & equity	50,624	53,533	59,931	67,680					
Cash flow statement									
Pretax profit	4,810	3,718	5,940	7,093					
Depreciation & amortization	812	832	957	1,085					
Change in working capital	1,317	1,298	757	789					
Others	-2,286	14	-1,926	-2,355					
Cash flow from operations	4,653	5,862	5,728	6,612					
Capital expenditure	-3,042	-3,834	-3,500	-3,000					
Others	-2,128	-167	706	1,282					
Cash flow from investing	-5,170	-4,001	-2,794	-1,718					
Equity financing	0	0	0	0					
Bank borrowings	783	1,599	1,000	0					
Others	-1,491	-2,926	-966	-1,171					
Cash flow from financing	-708	-1,327	34	-1,171					
Foreign exchange gain (loss)	0	-265	0	0					
Net changes in cash	-1,225	268	2,968	3,723					

Source: Company data, CICC Research

Company description

China Gas is one of China's largest city gas distributors. It specializes in the investment, construction, and operation of city gas pipeline infrastructure; LPG storage and transportation; the marketing of various kinds of gas to residential, commercial, construction and industrial users; and the construction and operation of gas refueling stations for autos and vessels. The company currently has 305 city gas projects in 24 provinces/cities, it markets more than 9.8bn cubic meters of natural gas; has 12 long distance natural gas pipeline projects, 571 natural gas vehicle refueling stations and 98 LPG distribution projects.



Figure 1: Earnings revisions

Earning revision (HK\$ mn)	FY17E			FY18E			FY19E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Revenue	30,842	30,327	-2%	34,952	37,395	7%	44,817	44,817	0%
Gross Profit	7,522	7,584	1%	8,269	8,839	7%	10,169	10,169	0%
Operating profit	5,707	5,813	2%	6,430	6,812	6%	7,495	7,495	0%
Profit before income tax	5,835	5,940	2%	6,711	7,093	6%	7,849	7,849	0%
Net profit attributable to shareholders	4,108	4,182	2%	4,724	4,993	6%	5,526	5,526	0%
EPS (HK\$)	0.84	0.85	2%	0.96	1.02	6%	1.13	1.13	0%

Source: Company data, CICC Research

Figure 2: Key assumptions

		FY17E	FY18E	FY19E
Gas volume	mmcm	11,259	13,068	15,401
Gas volume (excl. wholesales)		8,309	9,676	11,499
Residential		1,837	2,186	2,599
Industrial		3,642	4,298	5,243
Commercial		1,577	1,814	2,140
Vehicle		1,253	1,378	1,516
Wholesale		2,950	3,393	3,901
Growth		14%	16%	18%
Growth (excl. wholesales)		14%	16%	19%
Residential		19%	19%	19%
Industrial		15%	18%	22%
Commercial		10%	15%	18%
Vehicle		9%	10%	10%
Wholesale		15%	15%	15%
Dollar margin	Rmb/cm	0.65	0.63	0.62
Residential		0.22	0.22	0.22
Industrial		0.76	0.74	0.72
Commercial		0.70	0.70	0.70
Vehicle		0.88	0.88	0.88
New connection				
Residential	thsd household	2,426	2,714	2,876
Industrial	site	1,200	1,320	1,452
Commercial	site	26,000	31,200	37,440
Gas stations		20	30	30
Connection fee				
Residential	Rmb/household	2,530	2,520	2,500
Industrial	Rmb/site	281,453	267,380	254,011
Commercial	Rmb/site	35,932	34,135	32,428

Source: Company data, CICC Research



Figure 3: Our estimates of the gas purchase mix of major city gas distributors

Gas supplier	ENN	CR Gas	China Gas
Three majors	85%	95%	97%
PetroChina	68%	70%	80%
Sinopec	9%	15%	9%
CNOOC	9%	10%	8%
Others	15%	5%	3%

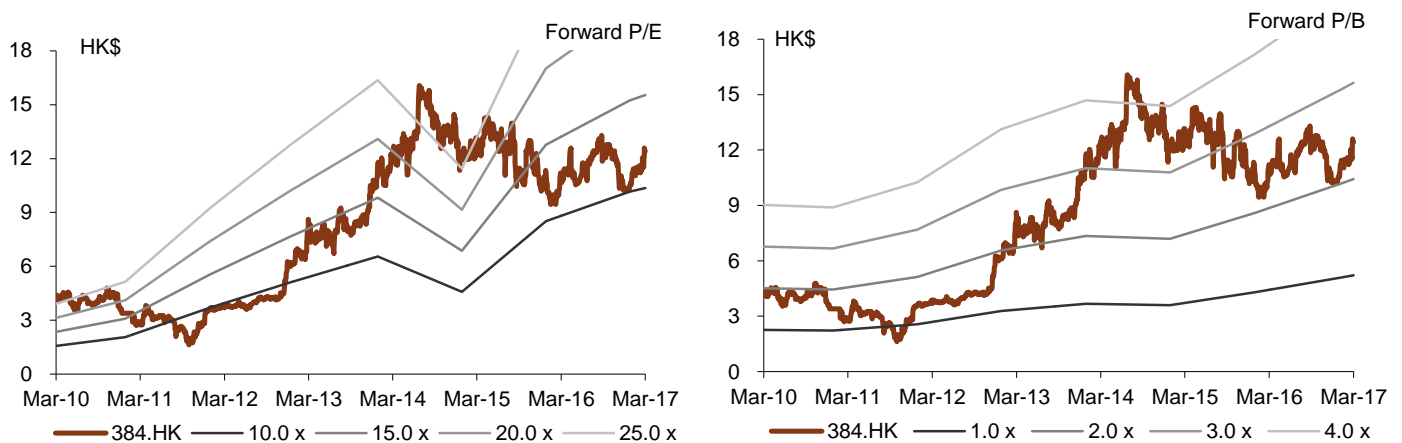
Source: Company data, CICC Research

Figure 4: Gas sales volume in China's 15 most severely polluted provinces

Location	No. of days AQI>100	Provincial FYP			Gas sale volume as % of total			
		2015	2020	CAGR	China Gas	ENN	CR Gas	Towngas
Henan	229	6.3	15	19%	21%	10%	9%	
Hebei	185	8.5	27	26%	5%	10%		
Beijing	179							
Hubei	176						4%	
Liaoning	158							
Sichuan	154						15%	30%
Tianjin	149						13%	
Xinjiang	147							
Heilongjiang	138				5%			3%
Shanxi	135	6.5	16	20%			2%	
Jiangsu	134				5.5%	11%	12%	1%
Jilin	128							9%
Anhui	127				8%	6%		5%
Shandong	124	8.0	25	26%	5%	12%	6%	23%
Zhejiang	123	7.8	16	15%		7%	2%	4%
Total					50%	56%	63%	75%
Surrounding Beijing-Tianjin-Hebei					31%	32%	30%	23%
*Other provinces								
Guangdong	53	14.5	28.0	14%		14%	2%	19%
Fujian	21	4.5	9.2	15%		10%	4%	

Source: Company data, CICC Research

Figure 5: P/E and P/B band



Source: Company data, Bloomberg, CICC Research



Figure 6: Valuation of comparables

H share	Bloomberg Code	Price Curr.	Mkt. cap 7-Mar (US\$bn)	P/E (x)				P/B (x)				EV/EBITDA (X)				Div. Yield				ROE				
				15A	16E	17E	18E	15A	16E	17E	18E	15A	16E	17E	18E	15A	16E	17E	18E	15A	16E	17E	18E	
BEHL(*)	0392 HK	HKD	42.8	6.9	9.7	8.7	8.2	6.7	0.9	0.9	0.8	0.7	17.2	15.7	15.0	14.3	2.2%	2.5%	2.6%	3.2%	8.7%	9.8%	10.3%	10.0%
CR Gas (*)	1193 HK	HKD	26.0	7.4	20.4	15.8	13.9	12.0	3.4	2.9	2.5	2.1	11.4	10.0	8.7	7.6	1.1%	1.5%	1.8%	2.1%	17.2%	19.7%	19.2%	19.1%
ENN (*)	2688 HK	HKD	42.9	6.0	18.9	12.7	11.4	10.0	2.8	2.6	2.2	2.0	8.1	7.3	6.6	6.0	2.2%	2.4%	3.1%	3.5%	15.9%	21.8%	20.8%	20.9%
Towngas (*)	1083 HK	HKD	4.6	1.6	15.0	10.6	9.9	9.2	0.9	0.8	0.8	0.7	13.4	12.6	12.1	11.1	2.2%	2.8%	3.0%	3.1%	6.0%	8.2%	8.2%	8.1%
China Gas (*)	0384 HK	HKD	12.4	8.0	27.1	14.8	12.9	12.2	3.5	2.9	2.5	2.2	15.3	16.8	12.4	11.0	1.6%	1.9%	2.3%	2.5%	18.3%	12.7%	19.6%	19.2%
JCE (*)	0579 HK	HKD	2.4	2.1	7.1	6.9	6.0	6.1	0.9	0.8	0.8	0.7	6.1	6.0	5.4	5.3	3.4%	3.6%	4.2%	4.6%	11.9%	11.6%	12.0%	10.9%
China Oil & Gas	0603 HK	HKD	0.6	0.5	n.m	9.3	9.0	8.1	1.3	1.1	1.0	0.9	15.1	5.9	5.3	4.8	0.0%	0.8%	1.0%	1.1%	-5.8%	12.8%	13.4%	13.4%
HKCG	0003 HK	HKD	15.0	24.5	26.0	25.1	24.8	23.9	3.6	3.3	3.1	3.0	24.3	23.3	22.3	20.7	2.1%	2.4%	2.5%	2.7%	13.8%	13.3%	12.9%	12.7%
Suntien (*)	0956 HK	HKD	1.4	0.7	27.0	9.9	8.5	7.4	0.6	0.6	0.6	0.6	13.4	8.8	7.9	7.2	1.2%	3.3%	3.9%	4.5%	2.3%	6.4%	7.1%	8.0%
Bluesky Power	6828 HK	HKD	0.6	0.8	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	1.4%	0.2%	2.6%	3.3%
Suchuang Gas	1430 HK	HKD	2.3	0.3	10.2	n.m	n.m	n.m	1.7	n.m	n.m	n.m	7.3	n.m	n.m	n.m	1.7%	n.m	n.m	n.m	19.9%	15.8%	14.7%	n.m
Zhongyu Gas	3633 HK	HKD	6.3	0.8	16.9	17.9	15.3	13.3	2.3	1.9	1.6	1.4	12.5	10.6	8.5	6.9	0.0%	n.m	n.m	n.m	16.3%	17.2%	16.4%	15.7%
Tianlun Gas	1600 HK	HKD	0.7	0.2	27.1	n.m	n.m	n.m	0.6	n.m	n.m	n.m	12.6	n.m	n.m	n.m	0.0%	n.m	n.m	n.m	2.2%	6.3%	7.2%	8.7%
Tianjin Jinran	1265 HK	HKD	2.0	0.7	54.9	n.m	n.m	n.m	2.6	n.m	n.m	n.m	12.9	n.m	n.m	n.m	0.0%	n.m	n.m	n.m	4.7%	n.m	n.m	n.m
Average					21.3	15.2	18.4	13.3	1.9	1.8	1.6	1.4	12.7	11.5	10.3	9.3	1.3%	2.1%	2.5%	2.6%	9.3%	11.1%	11.7%	11.5%
A share																								
Shaanxi Nat.Gas	002267 CH	RMB	9.7	1.6	18.4	19.2	17.3	13.6	2.2	n.m	n.m	n.m	9.6	n.m	n.m	n.m	2.1%	n.m	n.m	n.m	12.4%	11.5%	11.3%	11.5%
Shenzhen Gas (*)	601139 CH	RMB	9.1	2.9	30.5	26.1	24.3	18.6	2.7	2.5	2.3	2.1	15.5	12.9	11.7	9.6	1.1%	1.4%	1.9%	2.5%	10.5%	11.7%	12.0%	12.8%
Chongqing Gas	600917 CH	RMB	13.1	2.6	44.2	50.3	42.2	35.4	4.9	5.1	4.8	4.6	30.3	30.0	27.7	25.8	1.1%	1.1%	1.4%	1.5%	11.1%	9.4%	10.3%	10.8%
Changchun Gas	600333 CH	RMB	8.6	0.6	n.m	61.6	41.1	30.8	2.4	n.m	n.m	n.m	46.7	n.m	n.m	n.m	0.6%	n.m	n.m	n.m	-18.8%	n.m	n.m	n.m
Shenergy	600642 CH	RMB	6.3	3.7	10.9	15.8	16.6	n.m	1.0	n.m	n.m	n.m	12.5	n.m	n.m	n.m	3.2%	n.m	n.m	n.m	9.1%	7.7%	8.0%	8.0%
Xin Gas	603393 CH	RMB	52.2	1.1	25.3	n.m	n.m	n.m	7.7	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	n.m	32.2%	n.m	n.m	n.m
Average					72.2	31.8	25.6	20.2	4.4	3.5	3.2	2.9	69.1	21.5	19.7	17.7	0.9%	1.2%	1.6%	1.9%	7.4%	15.5%	15.7%	16.8%
American																								
ONEOK	OKE US	USD	56.6	11.9	48.4	33.4	27.5	25.6	35.4	273.5	7.6	9.8	18.0	13.0	12.4	11.2	27.0%	4.3%	4.7%	5.2%	52.8%	118.2%	16.0%	19.5%
Atmos Energy	ATO US	USD	78.1	8.2	25.3	23.6	22.0	20.7	2.5	2.3	2.2	2.0	12.9	12.2	11.3	10.3	12.4%	2.2%	2.3%	2.5%	10.0%	10.3%	10.3%	10.3%
WGL Holdings	WGL US	USD	83.5	4.3	31.6	26.4	23.9	22.3	3.3	3.2	3.1	2.9	16.6	14.2	12.8	11.5	13.6%	2.3%	2.4%	2.6%	10.5%	12.0%	12.7%	12.2%
NiSource, Inc.	NI US	USD	23.6	7.6	26.2	21.9	20.3	19.3	2.0	1.9	1.8	1.7	11.7	10.7	10.0	9.4	22.1%	2.7%	2.9%	3.1%	5.7%	8.9%	9.0%	9.0%
TransCanada	TRP CT	CAD	61.6	39.7	n.m	22.5	21.7	20.0	3.1	2.4	2.3	2.2	66.2	15.7	13.9	12.5	16.6%	3.6%	4.0%	4.4%	-8.1%	11.8%	13.5%	11.6%
Enbridge	ENB CT	CAD	55.2	67.3	n.m	24.0	22.5	20.2	3.9	2.1	1.8	1.9	36.3	20.3	12.7	10.9	17.1%	3.8%	4.4%	4.8%	-0.3%	9.8%	13.2%	15.2%
Average					32.9	25.3	23.0	21.4	8.4	47.5	3.1	3.4	27.0	14.3	12.2	11.0	18.1%	3.2%	3.5%	3.8%	11.8%	28.5%	12.5%	12.9%

Source: Company data, Bloomberg, CICC Research; Note: Earnings forecasts are from CICC for companies with * and from market consensus for other companies.



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