BEA securities

EAST ASIA SECURITIES COMPANY LIMITED
9/F, 10 Des Voeux Road Central, Hong Kong.
Dealing: 2308 8200 Research: 3608 8098 Facsimile: 3608 6113

**HONG KONG RESEARCH**

**Analyst: Kelvin Li**

**13th April, 2015**

# CHINA RAILWAY GROUP LIMITED (中國中鐵)

| | | |
|---|---|---|
| Sector | : | Capital goods |
| HKSE Code | : | 00390 |
| Market Price | : | HK$11.04 (13/04/2015) |
| HSI | : | 28,016.34 (13/04/2015) |
| H shares Issued | : | 4,207 million |
| H-share Mkt. Cap. | : | HK$46450 million |
| 52 weeks Hi/ Lo | : | HK$11.18 / HK$3.43 |

Chairman : LI Changjin

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

## Final Results Highlights

| | **FY2014** | **FY2013** | |
|---|---|---|---|
| | RMB million | RMB million | *change* |
| • Revenue | 590,166 | 540,394 | *+9.2%* |
| • Gross profit | 48,515 | 40,340 | *+20.3%* |
| • Operating profit | 20,249 | 18,478 | *+9.6%* |
| • **Attributable profit to shareholders** | **10,262** | **9,374** | ***+9.5%*** |
| | RMB | RMB | |
| • EPS – basic | 0.482 | 0.440 | *+9.5%* |
| • DPS – final | 0.078 | 0.066 | *+18.2%* |
| • DPS – total | 0.078 | 0.066 | *+18.2%* |

- China Railway Group (the 'Group') reported net profit of RMB10.3 billion for the year ended 31st December 2014, up by a stable 9.5% from a year earlier, supported by strong earnings in its core infrastructure construction segment. The bottom line was slightly below consensus forecast of RMB10.7 billion.

- Revenue grew 9.2% y-o-y to RMB590.2 billion in FY14, driven by steady growth in railway, highway and municipal related (mainly urban rail transit) construction on the Mainland. Cost of sales surged 8.3% y-o-y, largely in line with the Group's revenue growth. Overall, the Group's gross profit surged 20.3% y-o-y to RMB48.5 billion in FY14, while gross profit margin improved to 8.2% from 7.5% a year earlier.

- In FY14, the Group registered hefty impairment loss on trade and other receivables of RMB2.46 billion (mainly from other businesses like merchandise trading), compared with a loss of RMB588 million a year earlier. As a result, the Group's operating profit rose by an unexciting 9.6% y-o-y to RMB20.2 billion, while operating profit margin was flat at 3.4% (FY13: 3.4%).

- EPS for FY14 was RMB0.482 (FY13: RMB0.440). The Group proposed a final dividend of RMB0.078 per share, representing a full-year payout ratio of 16%, which was little changed from 15% a year earlier.

- As of 31st Dec 2014, the Group had total debts of RMB183.7 billion (31st Dec 2013: RMB187.2 billion). With cash on hand of RMB68.7 billion, the Group's net debt-to-shareholders' equity ratio eased to 120.4% by end of 2014 from 129.0% a year ago.

**Business highlights**

- Breakdown of revenue by business segments:

| | FY2014 | | FY2013 | | |
|---|---|---|---|---|---|
| | RMB million | % | RMB million | % | *Change* |
| Infrastructure construction | 518,022 | 87.8% | 456,272 | 84.4% | *+13.5%* |
| Survey, design & consulting services | 10,265 | 1.7% | 9,180 | 1.7% | *+11.8%* |
| Engineering equipment & component manufacturing | 14,519 | 2.5% | 13,711 | 2.5% | *+5.9%* |
| Property development | 29,255 | 5.0% | 27,566 | 5.1% | *+6.1%* |
| Other businesses | 54,963 | 9.3% | 68,958 | 12.8% | *-20.3%* |
| Inter-segment elimination | (36,858) | (6.2%) | (35,293) | (6.5%) | *+4.4%* |
| **Total** | **590,166** | **100.0%** | **540,394** | **100.0%** | ***+9.2%*** |

- Breakdown of pre-tax profit by business segments:

| | FY2014 | | FY2013 | | |
|---|---|---|---|---|---|
| | RMB million | % | RMB million | % | *Change* |
| Infrastructure construction | 11,642 | 71.7% | 7,682 | 51.8% | *+51.5%* |
| Survey, design & consulting services | 1,018 | 6.3% | 945 | 6.4% | *+7.7%* |
| Engineering equipment & component manufacturing | 1,089 | 6.7% | 803 | 5.4% | *+35.6%* |
| Property development | 4,373 | 26.9% | 3,966 | 26.8% | *+10.3%* |
| Other businesses | (121) | (0.7%) | 2,057 | 13.9% | *-105.9%* |
| Inter-segment elimination and adjustments | (1,768) | (10.9%) | (634) | (4.3%) | *+178.9%* |
| **Total** | **16,233** | **100.0%** | **14,819** | **100.0%** | ***+9.5%*** |

- The **Infrastructure construction** segment was the Group's key growth driver in 2014 with revenue up by 13.5% y-o-y and pre-tax profit up sharply by 51.5%. The segment reported better pre-tax profit margin of 2.2% (FY13: 1.7%) on better margin of its urban rail transit (URT) BT projects as well as dropping raw material prices.

- The **survey, design & consulting services** segment reported a 7.7% increase in pre-tax profit, while its profit margin slipped to 9.9% from 10.3% a year earlier on lower margin from design jobs of comprehensive construction projects and increased outsourcing costs.

- The **engineering equipment and component manufacturing** segment (design, manufacture and sale of turnouts, railway related equipment, bridge steel structures and engineering machinery) registered strong pre-tax profit growth of 35.6% y-o-y and improved profit margin at 7.5% (FY13: 5.9%) on better profit mix and effective cost control.

- The Group's **property development** segment posted revenue growth of 6.1% and higher profit (+10.3% y-o-y), as it sold more high-end residential projects despite a cooling property market on the Mainland last year.

- **Other businesses** (including BOT project investments, mining operations, materials trading and financial trust operations) registered a loss of RMB121 million in FY14, compared with a pre-tax profit of RMB2.1 billion a year earlier, as the Group recorded impairment loss of RMB1.56 billion on trade and other receivables. The impairment loss may be related to the Group's merchandise trading operation following the Qingdao Port metal financing fraud case in 2H14.

**Outlook & Prospects**

- ***New contract value*** *signed in FY2014 &* ***backlog contract value*** *as of 31/12/2014:*

| *(RMB billion)* | New contracts | *y-o-y chg* | Backlog contracts | *y-o-y chg* |
|---|---|---|---|---|
| Infrastructure construction | 708.2 | *-3.2%* | 1,450.8 | *+4.7%* |
| *- railway* | *248.9* | *+14.7%* | N/A | |
| *- highway* | *94.7* | *-12.1%* | N/A | |
| *- municipal & others (including urban railway transit (URT))* | *364.6* | *-10.3%* | N/A | |
| Survey, design & consulting services | 13.4 | *-0.8%* | 21.7 | *+3.4%* |
| Engineering equipment & component manufacturing | 22.7 | *+22.2%* | 20.8 | *+7.2%* |
| Other businesses | 190.3 | *+14.4%* | 307.8 | *+6.5%* |
| **Total** | **934.6** | ***+0.5%*** | **1,801.0** | ***+5.0%*** |

The Group's new contract growth failed to impress, as it only inched up by 0.5% y-o-y to RMB934.6 billion in 2014, following a 3.2% drop in new infrastructure construction contracts. The Group secured less new highway contracts, as it focused on higher-margin projects like railway. It also signed up less new municipal & other contracts, as it has been engaged in a number of large-scaled URT projects in previous years. For 2015, the Group targeted to seal RMB750 billion new contracts, 10% higher than its 2014 target of RMB680 billion.

- ***No more good bargain*** Despite unimpressive earnings figures in its FY14 results, China Railway Group staged a strong rally since late March 2015, riding on the latest stock market bull run and investors' optimism over President Xi Jinping's 'One Belt One Road' (OBOR) initiatives. The Group plans to lift contribution from overseas projects to about 10% of its total revenue by 2020 (end of the $13^{th}$ Five-Year Plan) from the current level of less than 5%. Trading at 15.8x FY15E P/E, we no longer see good bargain at China Railway Group following recent rally. Nonetheless, we also see limited downside to the counter, amid hot money chasing after the OBOR trading proxies and speculative buying in deep A-H discount shares (the counter is trading at a discount of nearly 40% to its A-share counterparts). Accordingly, we keep a 'HOLD' rating on the counter.

## Recommendation: HOLD

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