

Industrials
Road & Rail
Equity – China

Overweight

Target price (HKD)	4.50
Share price (HKD)	3.85
Potential return (%)	16.9

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	0.0	12.2	8.1
Relative ^A (%)	0.4	10.9	-11.0

Index^A HSCEI

RIC 0525.HK
 Bloomberg 525 HK

Market cap (USDm) 4,523
 Market cap (HKDm) 35,071

Enterprise value (CNYm) 30444
 Free float (%) 63

Note: (V) = volatile (please see disclosure appendix)

6 March 2015

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Guangshen Railway (525 HK)

OW: Beneficiary of railway reform

- ▶ **China Railway Corp (CRC) GM Mr Sheng indicated in the NPC that railway tariff reform is progressing**
- ▶ **CRC is considering diversified ownership reform as well as potential listings in the capital market**
- ▶ **Reiterate OW on Guangshen Railway; no change in earnings and TP of HKD4.5.**

Passenger tariff reform could be under way: According to Xinhua News, CRC General Manager Mr Sheng Guangzu mentioned at the National People's Congress (NPC) that the railway bureaus are now trialling various market-driven rail tariff pricing mechanisms. We think this is not only for rail freight but also for passenger tariffs. Mr Sheng indicated that high speed rail tariffs should move toward a mechanism of flexibility on tariffs depending on demand (i.e. peak and off-peak periods). We believe the long-awaited passenger rail tariff reform could be progressing and a flexible passenger rail tariff could be introduced, similar to the rail freight tariff. Passenger tariff reform could be a major catalyst for Guangshen Railway.

Potential listing of rail operators in capital market: Mr Sheng also stated that CRC would implement a mixed ownership structure in order to attract private investment and would consider a potential listing. We think individual rail projects or specific regions with good quality assets could become listed. The potential listing of Chinese rail operators would enhance CRC's financial situation and diversify the funding channel for future rail infrastructure investment. We expect government policy to be favourable for rail operators in the coming years, which could improve asset returns.

Positive policy development to offset near-term earnings weakness: Guangshen Railway will release its FY14 earnings on 25 March. We forecast FY14 net profit to decline 33% YoY to RMB857m. While the company's earnings performance has been soft due to value-added tax reform in 2014, we think the Chinese railway industry reform process should be picking up pace and enable the company to unlock value from its assets and generate higher returns.

Financials & valuation

Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (CNYm)				
Revenue	15,801	14,849	15,733	16,522
EBITDA	3,303	2,441	2,880	3,146
Depreciation & amortisation	-1,430	-1,430	-1,430	-1,427
Operating profit/EBIT	1,873	1,010	1,449	1,720
Net interest	-192	-192	-100	0
PBT	1,702	1,140	1,346	1,732
HSBC PBT	1,702	1,140	1,346	1,732
Taxation	-431	-285	-336	-433
Net profit	1,274	857	1,012	1,302
HSBC net profit	1,274	857	1,012	1,302

Cash flow summary (CNYm)

Cash flow from operations	2,784	2,789	2,369	2,694
Capex	-1,377	-1,414	-1,414	-1,344
Cash flow from investment	-1,573	-1,356	-1,414	-1,400
Dividends	-573	-386	-455	-586
Change in net debt	270	-860	-569	-839

Balance sheet summary (CNYm)

Intangible fixed assets	281	281	281	281
Tangible fixed assets	25,504	25,487	25,471	25,387
Current assets	7,088	7,341	8,093	9,094
Cash & others	413	-220	349	1,188
Total assets	33,232	33,469	34,205	35,121
Operating liabilities	2,946	4,393	4,505	4,577
Gross debt	3,493	2,000	2,000	2,000
Net debt	3,080	2,220	1,651	812
Shareholders' funds	26,651	26,934	27,560	28,407
Invested capital	29,513	28,936	28,991	28,996

Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
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Y-o-y % change

Revenue	4.7	-6.0	6.0	5.0
EBITDA	1.3	-26.1	18.0	9.3
Operating profit	0.6	-46.1	43.5	18.7
PBT	-3.2	-33.0	18.1	28.7
HSBC EPS	-3.4	-32.7	18.1	28.7

Ratios (%)

Revenue/IC (x)	0.5	0.5	0.5	0.6
ROIC	4.9	2.6	3.8	4.5
ROE	4.8	3.2	3.7	4.6
ROA	4.3	3.0	3.2	3.7
EBITDA margin	20.9	16.4	18.3	19.0
Operating profit margin	11.9	6.8	9.2	10.4
EBITDA/net interest (x)	17.2	12.7	28.8	
Net debt/equity	11.5	8.2	6.0	2.9
Net debt/EBITDA (x)	0.9	0.9	0.6	0.3
CF from operations/net debt	90.4	125.6	143.6	331.8

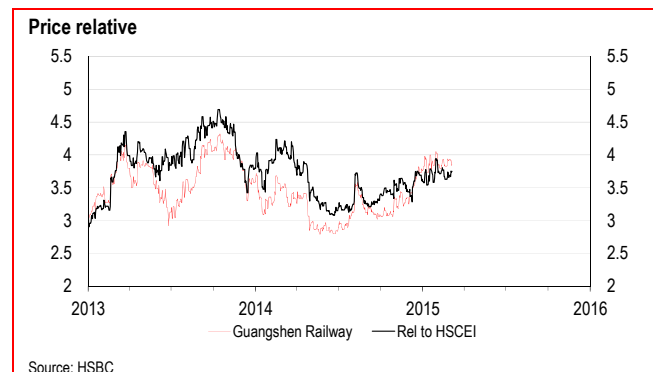
Per share data (CNY)

EPS reported (fully diluted)	0.18	0.12	0.14	0.18
HSBC EPS (fully diluted)	0.18	0.12	0.14	0.18
DPS	0.08	0.05	0.06	0.08
Book value	3.76	3.80	3.89	4.01

Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	2.0	2.1	1.9	1.8
EV/EBITDA	9.5	12.5	10.4	9.2
EV/IC	1.1	1.1	1.0	1.0
PE*	17.3	25.7	21.8	16.9
P/Book value	0.8	0.8	0.8	0.8
Dividend yield (%)	2.6	1.7	2.1	2.7

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 5 Mar 2015

Earnings sensitivity analysis

2015e earnings impact (%)

Passenger	
Guangshen railway volume +5%	2%
Long distance volume +5%	3%
Total passenger volume +5%	5%
Long distance revenue per passenger +5%	15%
Freight	
Freight volume +5%	1%
Freight tariff +5%	6%

Source: HSBC estimates

Valuation and risks

We value Guangshen Railway using a DCF approach with a WACC of 9.2%. Our key assumptions are: a risk-free rate of 3.5%, an equity risk premium of 6.5%, an equity beta of 0.925, a terminal growth rate of 4% and a target gearing ratio of 30%. Our target price is HKD4.50 and implies a 0.9x PB.

Key downside risks: China railway industry reform progress; cost inflation and potential investment risk if rail assets are acquired from Guangshen Railway's parent company.

Disclosure appendix

Analyst Certification

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Important disclosures

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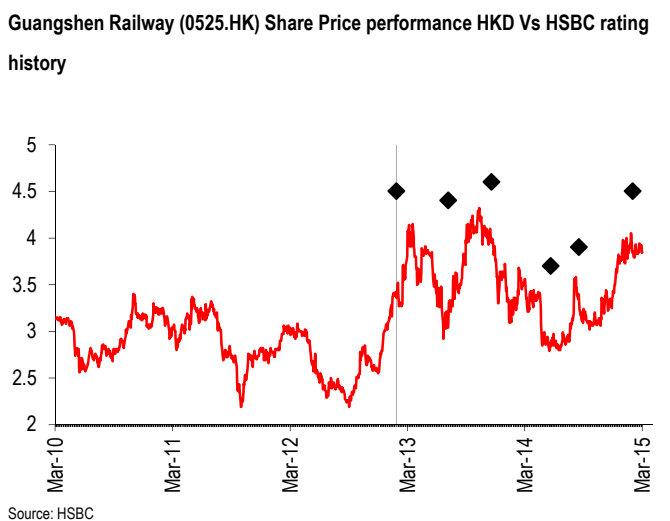
*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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Neutral (Hold)	39%	(28% of these provided with Investment Banking Services)
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Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
N/A	Overweight	31 January 2013
Target Price	Value	Date
Price 1	4.50	31 January 2013
Price 2	4.40	11 July 2013
Price 3	4.60	22 November 2013
Price 4	3.70	25 May 2014
Price 5	3.90	21 August 2014
Price 6	4.50	04 February 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
GUANGSHEN RAILWAY	0525.HK	3.85	05-Mar-2015	6

Source: HSBC

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