

**Nat Resources & Energy**  
**Gas Utilities**  
 Equity – China

## Overweight

Target price (HKD)	10.90
Share price (HKD)	7.24
Potential return (%)	50.6

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

Performance	1M	3M	12M
Absolute (%)	2.7	-10.5	-24.7
Relative <sup>A</sup> (%)	4.6	-14.9	-40.2

Index <sup>A</sup>	HSCEI
RIC	1083.HK
Bloomberg	1083 HK
Market cap (USDm)	2,453
Market cap (HKDm)	19,060
Enterprise value (HKDm)	17731
Free float (%)	26

17 March 2015

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# Towngas China (1083 HK)

OW: FY14 results first impression, slight miss

- ▶ **FY14 volume growth 10% (vs mid teens guidance) to 6.51bcm, 2H gas sales margin 6.3% vs 1H14/2H13: 9.0/7.1%**
- ▶ **Normalized net profit was HKD1,195m, +21% YoY, 4% below HSBCe, DPS HKD0.10 above HSBCe/Consensus of HKD0.09**
- ▶ **Reiterate OW, TP HKD10.90 unchanged**

**Investment thesis:** TCCL is smaller and less liquid than its peers but benefits directly from the quality of HKCG Group's management. It should benefit from the arrival of Russian gas through its exposure to the north-eastern provinces, particularly Liaoning.

**FY14 gas sales volume** was 6.51bcm (2H: 3.2bcm, +4.9% HoH), up 12% (vs guidance of 13-15%) yoy. Revenue and normalized net profit were HKD7,882m and HKD1,195 m, respectively, vs HSBCe HKD8,186m/HKD1,239m, a 4% miss vs our net profit estimates. This represents growth of 21% yoy. The DPS was HKD0.10 versus HKD0.08 in FY13, above with HSBCe/consensus forecasts of HKD0.09.

**Gas sales volume margin and customer mix:** 2H/FY14 Gas sales segment margin was 6.3/7.6% vs 1H14: 9.0% and 2H/FY13: 7.1/8.1%. Gas sales to C&I (commercial & industrial) segment accounts for 76.0% of total gas sales volume (vs FY13: 75.5%). We believe the drop in margin is mainly due to a larger gas sales revenue base (denominator) as a result of the citygate & end-user gas price hike in 2H14. **Connection fee:** TCCL connection fee revenue/profit increased by 18/10% to 6,205/471m. Connection fee segment margin was 43.8% for 2H14 (vs 1H14/FY13: 45.6/44.0%). Connection fee accounts for 21% (FY13: 21%) of segment profit.

**Results briefing** is to be held on 18 March 2015. We look for: a) guidance on FY15e volume growth, especially after citygate price hike (effective 1 Apr 2015); b) follow up on pass through of the previous citygate price hike effective 1 September 2014.

**Valuation and risks:** Our target price of HKD10.90 is based on the average of three methodologies: a 1x three-year forward PEG-based PE of HKD8.79 (15.6x FY15e PE and a 1.0x implied PEG), a ROE-implied PB of HKD10.24 (a ROE-implied PB of 1.80x, a FY14e BVPS of HKD5.69) and a DCF valuation of HKD13.64 (assumptions: WACC of 6.3%, risk-free rate of 3.5%, equity risk premium of 5.5% and beta of 0.60). We have a OW rating on the stock. **Downside risks:** 1) a decline in industrial volumes with slowing GDP; and 2) any future citygate price hikes not being passed through to customers.

**New projects during FY14:** TCCL added 9 projects during the year in Sichuan, Zhejiang, Jilin, Guizhou, Inner Mongolia, Jiangsu, Yunnan, Shandong and Heilongjiang. Total gas sales volume of these 9 projects is expected to reach 800mcm in 5 years. One more project was added in Anhui in early 2015 which the company believes gas sales volume could reach 280mcm in 5 years.

**Consolidated Income Statement**

HKDm	1H13	2H13	2H/FY13	FY13	1H14	2H14	HSBC 2H14e	2H14 Actual vs HSBCe	2H/FY14	FY14	HSBC FY14e	FY14 Actual vs HSBCe
<b>Turnover</b>	<b>2,962</b>	<b>3,754</b>	<b>56%</b>	<b>6,716</b>	<b>3,674</b>	<b>4,208</b>	<b>4,511</b>	<b>-7%</b>	<b>53%</b>	<b>7,882</b>	<b>8,186</b>	<b>-4%</b>
yoy growth	22%	37%		30%	24%	12%	20%			17%	22%	
<b>Operating profit</b>	<b>435</b>	<b>490</b>	<b>53%</b>	<b>925</b>	<b>496</b>	<b>570</b>	<b>547</b>	<b>4%</b>	<b>53%</b>	<b>1,066</b>	<b>1,043</b>	<b>2%</b>
Margin	14.7%	13.1%		13.8%	13.5%	13.5%	12.1%			13.5%	12.7%	
yoy growth	27%	22%		24%	14%	16%	12%			15%	13%	
Other gains, net	78	168	68%	246	(42)	57	145	-61%	397%	14	102	-86%
Share of results of associates	163	173	51%	336	183	164	247	-34%	47%	347	430	-19%
Share of results of jointly controlled entities	121	144	54%	265	138	139	174	-20%	50%	278	313	-11%
Finance costs	(73)	(91)	56%	(164)	(82)	(92)	(91)	0%	53%	(174)	(174)	0%
<b>Profit before taxation</b>	<b>725</b>	<b>884</b>	<b>55%</b>	<b>1,609</b>	<b>693</b>	<b>838</b>	<b>1,022</b>	<b>-18%</b>	<b>55%</b>	<b>1,531</b>	<b>1,715</b>	<b>-11%</b>
Margin	24.5%	23.6%		24.0%	18.9%	19.9%	22.7%			19.4%	21.0%	
yoy growth	39%	23%		30%	-4%	-5%	16%			-5%	7%	
Taxation	(150)	(232)	61%	(383)	(171)	(179)	(167)	7%	51%	(350)	(339)	3%
<b>Profit for the year</b>	<b>574</b>	<b>652</b>	<b>53%</b>	<b>1,226</b>	<b>522</b>	<b>659</b>	<b>855</b>	<b>-23%</b>	<b>56%</b>	<b>1,181</b>	<b>1,377</b>	<b>-14%</b>
Margin	19.4%	17.4%		18.3%	14.2%	15.7%	19.0%			15.0%	16.8%	
yoy growth	43%	22%		31%	-9%	1%	31%			-4%	12%	
Non-controlling interests	(41)	(79)	66%	(120)	(54)	(73)	(84)	-13%	58%	(127)	(138)	-8%
<b>Profit attributable to shareholders of the Company</b>	<b>533</b>	<b>574</b>	<b>52%</b>	<b>1,106</b>	<b>468</b>	<b>586</b>	<b>771</b>	<b>-24%</b>	<b>56%</b>	<b>1,054</b>	<b>1,239</b>	<b>-15%</b>
Margin	18.0%	15.3%		16.5%	12.7%	13.9%	17.1%			13.4%	15.1%	
yoy growth	49%	19%		32%	-12%	2%	34%			-5%	12%	
<b>Normalized attributable net profit</b>	<b>486</b>	<b>497</b>	<b>51%</b>	<b>984</b>	<b>612</b>	<b>583</b>	<b>627</b>	<b>-7%</b>	<b>49%</b>	<b>1,195</b>	<b>1,239</b>	<b>-4%</b>
Margin	16.4%	13.3%		14.6%	16.7%	13.9%	13.9%			15.2%	15.1%	
yoy growth	31%	15%		23%	26%	17%	26%			21%	26%	
<b>Earnings per share (HKD cents)</b>												
— Basic	20.51	21.95	52%	42.46	17.90	22.29	29.52	-24%	55%	40.19	47.42	-15%
— Diluted	20.45	21.89	52%	42.34	17.85	22.23	29.44	-24%	55%	40.08	47.29	-15%
					-13%							
<b>Segment Information</b>												
Sales and distribution of piped gas and related products	2,394	2,871	55%	5,265	3,030	3,176	3,966	-20%	51%	6,205	6,996	-11%
Gas connection	568	883	61%	1,451	645	1,032	545	89%	62%	1,677	1,190	41%
<b>Total</b>	<b>2,962</b>	<b>3,754</b>	<b>56%</b>	<b>6,716</b>	<b>3,674</b>	<b>4,208</b>	<b>4,511</b>	<b>-7%</b>	<b>53%</b>	<b>7,882</b>	<b>8,186</b>	<b>-4%</b>

Source: Company data, HSBC estimates

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for HK-traded stocks of 8.5%. Our target price implies a potential return of 51%, which is above the Neutral band. Therefore, we maintain our Overweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

# Disclosure appendix

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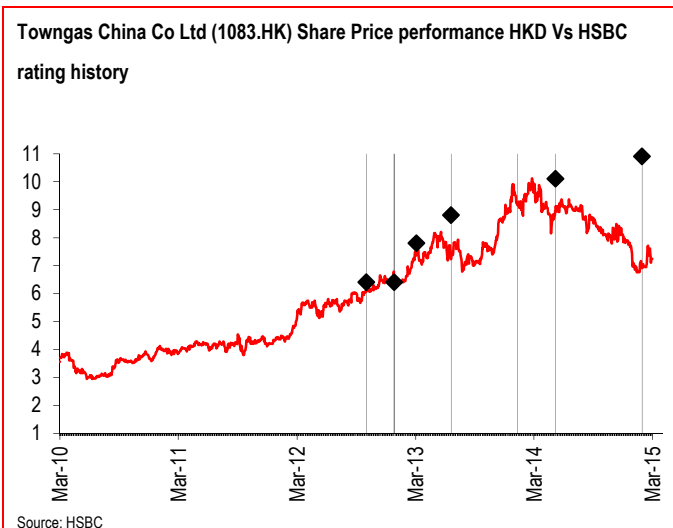
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## Share price and rating changes for long-term investment opportunities



### Recommendation & price target history

From	To	Date
N/A	Neutral	16 October 2012
Neutral	Restricted	09 January 2013
Restricted	Neutral	10 January 2013
Neutral	Overweight	04 July 2013
Overweight	Underweight	24 January 2014
Underweight	Neutral	22 May 2014
Neutral	Overweight	12 February 2015
Target Price	Value	Date
Price 1	6.40	16 October 2012
Price 2	Restricted	09 January 2013
Price 3	6.40	10 January 2013
Price 4	7.80	19 March 2013
Price 5	8.80	04 July 2013
Price 6	10.10	22 May 2014
Price 7	10.90	12 February 2015

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
TOWNGAS CHINA CO LTD	1083.HK	7.24	16-Mar-2015	4, 6

Source: HSBC

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