

EARNINGS REVIEW

Towngas China (1083.HK)

Sell

Equity Research

In line with expectations: Connection growth offsets slowing gas sales

What surprised us

Towngas reported 2014 results with core net profit up 22% to HK\$1,185mn excluding one-off forex and disposal gains/loss. Gas sales volumes growth slowed down to 10% yoy vs. 13% in 1H14, mainly due to slowing industrial demand growth (9% yoy vs. 12% in commercial and 14% for residential) and lack of gas supply in northeast regions. On the other hand, new user connections accelerated in 2H14 to 0.69mn vs. 0.28mn in 1H14, leading to 21% full year growth. Tax credits from projects in Sichuan lowered the overall tax expense in 2014.

What to do with the stock

We view gas sales and the dollar margin trend as the key focus for Towngas in China. For Jan 2015, its gas sales grew 10% yoy and the company targets double-digit growth for the full year. The company targets 15% of the incremental volume growth to be contributed by new project acquisitions. As far as the tariff pass through is concerned, 42 out of its 50 projects affected by the city gate price hikes in 2014 have completed pass through and Towngas has maintained its gross dollar margin in 2H14 at Rmb0.67/m³, the same rate as in 1H14. Towngas expects over 30% of its gas sales from incremental gas volume in 2015 and around Rmb0.1/m³ average procurement cost reduction post the city gate price hike in April 2015. However, we are concerned that Towngas's heavy reliance on organic-driven growth could lead to persistent gas sales growth pressure given the macro slowdown. We fine-tune our EPS by 1-2% for 2015-16, mainly to factor in the lower SG&A and tax expenses. We introduce 2017E EPS of HK\$0.57. Accordingly, we revise our 2015E EV/GCI vs. CROCI/WACC based 12m TP from HK\$5.7 to HK\$5.9 (1.16x val ratio unchanged). We reiterate our Sell rating, which is relative to our gas utility coverage. Risks: Value-accretive acquisitions and further gas price cuts.

Towngas 2014 results summary

Towngas China (HK\$m)	2H13	1H14	2H14	HoH%	YoY%	2013	2014	YoY%
Reported net profit	554	489	565	16%	2%	1,106	1,054	-5%
Core net profit	458	633	552	-13%	20%	971	1,185	22%

Source: Company data.

INVESTMENT LIST MEMBERSHIP

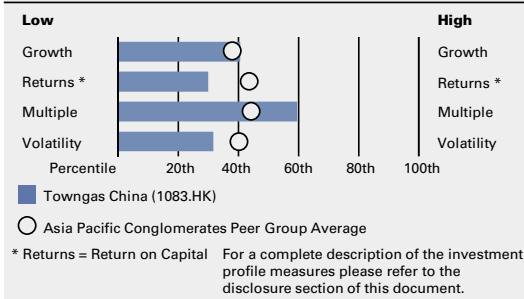
Asia Pacific Sell List

Coverage View: Neutral

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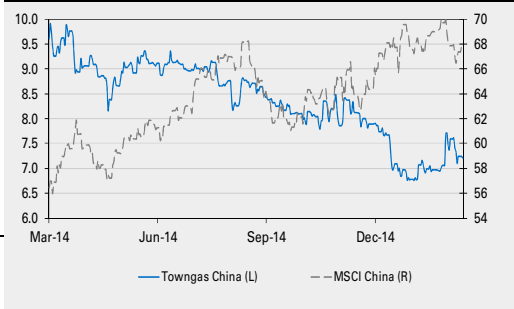
Investment Profile



Key data	Current
Price (HK\$)	7.21
12 month price target (HK\$)	5.90
Market cap (HK\$ mn / US\$ mn)	18,962.2 / 2,441.8
Foreign ownership (%)	--

	12/14	12/15E	12/16E	12/17E
EPS (HK\$) New	0.40	0.48	0.53	0.57
EPS revision (%)	(6.6)	1.9	1.2	--
EPS growth (%)	(5.3)	20.2	10.5	7.4
EPS (dil) (HK\$) New	0.40	0.48	0.53	0.57
P/E (X)	22.0	14.9	13.5	12.6
P/B (X)	1.8	1.3	1.2	1.2
EV/EBITDA (X)	20.4	15.2	13.8	12.6
Dividend yield (%)	1.1	1.7	1.8	2.0
ROE (%)	8.2	9.2	9.5	9.5
CROCI (%)	0.8	7.9	8.1	8.1

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(8.0)	(16.1)	(25.0)
Rel. to MSCI China	(15.2)	(20.3)	(37.5)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 3/17/2015 close.

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Towngas China: Summary Financials

Profit model (HK\$ mn)	12/14	12/15E	12/16E	12/17E	Balance sheet (HK\$ mn)	12/14	12/15E	12/16E	12/17E
Total revenue	7,881.8	8,447.8	9,490.5	10,331.5	Cash & equivalents	1,796.6	1,978.9	2,336.2	2,727.5
Cost of goods sold	(5,128.0)	(5,464.1)	(6,306.5)	(6,945.5)	Accounts receivable	1,788.1	1,916.5	2,153.0	2,343.8
SG&A	(788.0)	(811.0)	(873.1)	(929.8)	Inventory	566.0	603.0	696.0	766.5
R&D	0.0	0.0	0.0	0.0	Other current assets	225.4	225.4	225.4	225.4
Other operating profit/(expense)	(899.8)	(966.8)	(1,019.1)	(1,077.7)	Total current assets	4,376.0	4,723.8	5,410.6	6,063.2
EBITDA	1,480.8	1,703.9	1,857.6	2,018.1	Net PP&E	11,026.4	12,062.1	13,030.0	13,924.2
Depreciation & amortization	(414.8)	(497.9)	(565.9)	(639.5)	Net intangibles	6,498.9	6,465.2	6,431.5	6,397.8
EBIT	1,066.0	1,205.9	1,291.7	1,378.5	Total investments	4,943.3	5,665.9	6,446.5	7,279.6
Interest income	42.0	34.3	37.8	44.6	Other long-term assets	505.7	505.7	505.7	505.7
Interest expense	(216.0)	(228.8)	(231.7)	(231.7)	Total assets	27,350.2	29,422.8	31,824.3	34,170.5
Income/(loss) from uncons. subs.	624.8	722.6	780.6	833.1	Accounts payable	4,136.4	4,407.5	5,087.1	5,602.5
Others	144.9	60.0	60.0	60.0	Short-term debt	2,482.8	2,482.8	2,482.8	2,482.8
Pretax profits	1,531.1	1,794.1	1,938.3	2,084.5	Other current liabilities	770.2	823.0	856.1	881.9
Income tax	(350.1)	(375.0)	(370.5)	(400.4)	Total current liabilities	7,389.4	7,713.4	8,426.0	8,967.2
Minorities	(126.8)	(152.3)	(168.3)	(180.8)	Long-term debt	5,068.8	5,268.8	5,268.8	5,268.8
Net income pre-preferred dividends	1,054.2	1,266.7	1,399.5	1,503.2	Other long-term liabilities	447.6	949.8	1,488.3	2,059.7
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	5,516.4	6,218.6	6,757.1	7,328.5
Net income (pre-exceptionals)	1,184.8	1,266.7	1,399.5	1,503.2	Total liabilities	12,905.8	13,932.0	15,183.1	16,295.7
Post-tax exceptionals	(130.6)	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	1,054.2	1,266.7	1,399.5	1,503.2	Total common equity	13,254.0	14,205.5	15,256.8	16,386.0
EPS (basic, pre-exception) (HK\$)	0.45	0.48	0.53	0.57	Minority interest	1,190.5	1,285.3	1,384.5	1,488.8
EPS (basic, post-exception) (HK\$)	0.40	0.48	0.53	0.57	Total liabilities & equity	27,350.2	29,422.8	31,824.3	34,170.5
EPS (diluted, post-exception) (HK\$)	0.40	0.48	0.53	0.57	BVPS (HK\$)	5.04	5.40	5.80	6.23
DPS (HK\$)	0.10	0.12	0.13	0.14	Ratios	12/14	12/15E	12/16E	12/17E
Dividend payout ratio (%)	24.8	24.8	24.8	24.8	CROCI (%)	0.8	7.9	8.1	8.1
Free cash flow yield (%)	(6.9)	1.5	3.7	4.0	ROE (%)	8.2	9.2	9.5	9.5
Growth & margins (%)	12/14	12/15E	12/16E	12/17E	ROA (%)	4.0	4.5	4.6	4.6
Sales growth	17.4	7.2	12.3	8.9	ROACE (%)	7.6	7.6	8.0	8.2
EBITDA growth	16.8	15.1	9.0	8.6	Inventory days	41.1	39.0	37.6	38.4
EBIT growth	15.2	13.1	7.1	6.7	Receivables days	78.0	80.0	78.3	79.4
Net income growth	(4.7)	20.2	10.5	7.4	Payable days	295.0	285.4	274.8	280.9
EPS growth	(5.3)	20.2	10.5	7.4	Net debt/equity (%)	39.8	37.3	32.5	28.1
Gross margin	34.9	35.3	33.5	32.8	Interest cover - EBIT (X)	6.1	6.2	6.7	7.4
EBITDA margin	18.8	20.2	19.6	19.5	Valuation	12/14	12/15E	12/16E	12/17E
EBIT margin	13.5	14.3	13.6	13.3	P/E (analyst) (X)	22.0	14.9	13.5	12.6
Cash flow statement (HK\$ mn)	12/14	12/15E	12/16E	12/17E	P/B (X)	1.8	1.3	1.2	1.2
Net income pre-preferred dividends	1,054.2	1,266.7	1,399.5	1,503.2	EV/EBITDA (X)	20.4	15.2	13.8	12.6
D&A add-back	414.8	497.9	565.9	639.5	EV/GCI (X)	1.4	1.1	1.0	0.9
Minorities interests add-back	126.8	152.3	168.3	180.8	Dividend yield (%)	1.1	1.7	1.8	2.0
Net (inc)/dec working capital	(200.6)	105.6	350.0	254.1	Capital expenditures	(1,500.0)	(1,500.0)	(1,500.0)	(1,500.0)
Other operating cash flow	(1,569.2)	(220.4)	(242.1)	(261.7)	Acquisitions	0.0	0.0	0.0	0.0
Cash flow from operations	(174.0)	1,802.2	2,241.7	2,315.9	Divestitures	0.0	0.0	0.0	0.0
Capital expenditures	(1,500.0)	(1,500.0)	(1,500.0)	(1,500.0)	Others	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0	Cash flow from investments	(1,500.0)	(1,500.0)	(1,500.0)	(1,500.0)
Divestitures	0.0	0.0	0.0	0.0	Dividends paid (common & pref)	(208.4)	(262.3)	(315.2)	(348.2)
Others	0.0	0.0	0.0	0.0	Inc/(dec) in debt	651.2	200.0	0.0	0.0
Cash flow from investments	(1,500.0)	(1,500.0)	(1,500.0)	(1,500.0)	Common stock issuance (repurchase)	0.0	0.0	0.0	0.0
Dividends paid (common & pref)	(208.4)	(262.3)	(315.2)	(348.2)	Other financing cash flows	423.2	(57.6)	(69.2)	(76.4)
Inc/(dec) in debt	651.2	200.0	0.0	0.0	Cash flow from financing	866.0	(119.9)	(384.4)	(424.7)
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0	Total cash flow	(639.1)	182.4	357.3	391.3
Other financing cash flows	423.2	(57.6)	(69.2)	(76.4)					
Cash flow from financing	866.0	(119.9)	(384.4)	(424.7)					
Total cash flow	(639.1)	182.4	357.3	391.3					

Note: Last actual year may include reported and estimated data.
Source: Company data, Goldman Sachs Research estimates.

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Exhibit 1: Towngas 2014 results summary

Towngas China (HK\$m)	2H13	1H14	2H14	HoH%	YoY%	2013	2014	YoY%	Comments
Turnover									
Sales of piped gas	2,871	3,030	3,176	5%	11%	5,265	6,205	18%	Driven by the 10% yoy growth of gas sales volume and higher gas prices
Gas connection	883	645	1,032	60%	17%	1,451	1,677	16%	Driven by the 20% yoy growth of new household connections by subsidiaries
Total revenue	3,754	3,674	4,208	15%	12%	6,716	7,882	17%	
EBIT									
Sales of piped gas	205	273	199	-27%	-3%	427	471	10%	
Gas connection	360	294	452	54%	26%	638	746	17%	
Unallocated corporate expenses	(75)	(70)	(81)	15%	8%	(140)	(151)	8%	
Total EBIT	490	496	570	15%	16%	925	1,066	15%	
Share of results of associates	173	183	164	-11%	-5%	336	347	3%	
Share of results of JCE	144	138	139	1%	-4%	265	278	5%	
Finance costs	(129)	(82)	(134)	63%	3%	(164)	(174)	6%	
Other gains, net	168	(42)	57	N/A	-66%	246	14	-94%	There was HK\$160mn FX gain in 2013
Profit before taxation	865	714	817	14%	-6%	1,609	1,531	-5%	
Taxation	(232)	(171)	(179)	4%	-23%	(383)	(350)	-8%	
Minority interest	(79)	(54)	(73)	36%	-7%	(120)	(127)	6%	
Net profit to shareholders	554	489	565	16%	2%	1,106	1,054	-5%	
Recurrent profit	458	633	552	-13%	20%	971	1,185	22%	Excluding HK\$141mn FX loss and other one-off gains/losses in 2014
Reported EPS (HK\$)	0.21	0.19	0.22	15%	1%	0.42	0.40	-5%	
DPS (HK\$)	0.08	N/A	0.10	N/A	25%	0.08	0.10	25%	
Key financial and operating data									
EBIT margin									
Sales of piped gas	7.1%	9.0%	6.3%	-2.7ppt	-0.9ppt	8.1%	7.6%	-0.5ppt	
Gas connection	40.8%	45.6%	43.8%	-1.8ppt	3.0ppt	44.0%	44.5%	0.5ppt	
Total	13.1%	13.5%	13.5%	0.0ppt	0.5ppt	13.8%	13.5%	-0.2ppt	Gas sales margin decrease was offset by higher contribution from connection business
New connections									
Residential households - subsidiaries	193,000	130,000	243,000	87%	26%	310,000	373,000	20%	
Residential households - overall	480,000	280,000	690,000	146%	44%	800,000	970,000	21%	
Unit of piped gas sold (mn m³)									
Total gas sold (mn m³)	3,017	3,295	3,216	-2%	7%	5,945	6,511	10%	Driven by the 10% growth of commercial and industrial gas sales volume

Source: Company data.

Disclosure Appendix

Reg AC

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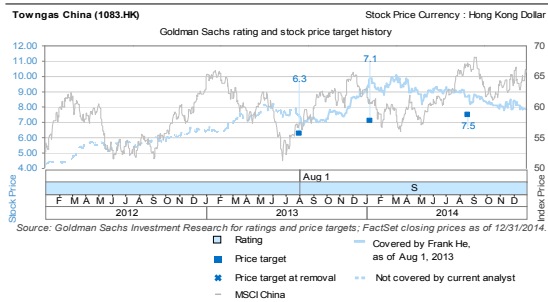
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