



Rating  
**Hold**

Asia  
China

Utilities  
Utilities

Company  
**CR Gas**

|                     |                      |                 |                |
|---------------------|----------------------|-----------------|----------------|
| Reuters<br>1193.HK  | Bloomberg<br>1193 HK | Exchange<br>HKG | Ticker<br>1193 |
| ADR Ticker<br>CGASY | ISIN<br>US16951X1028 |                 |                |

Date  
27 March 2015

Forecast Change

|                            |               |
|----------------------------|---------------|
| Price at 26 Mar 2015 (HKD) | 21.80         |
| Price target - 12mth (HKD) | 18.80         |
| 52-week range (HKD)        | 26.75 - 17.94 |
| HANG SENG INDEX            | 24,528        |

|                     |                      |
|---------------------|----------------------|
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## In-line results; risk/reward unattractive; maintaining Hold

### Organic growth to remain anemic; Hold

CR Gas's FY14 net profit was up 15% yoy and in line with our estimates. Management maintained the 16bcm gas sales target in 2015 (+20% yoy) thanks to acquisition as organic growth guided remains anemic at 10%. Despite the slight cut in blended gas tariff, we believe the impact of the sharp oil price decline, weak industrial activities and residential property new starts slowdown will weigh on volume/connection in 2015; while margin upside is limited, if any. The stock looks fairly valued at 17.5x 15E P/E, Hold.

### FY14 net profit +15% yoy, in line; GPM deteriorated by 3.8ppt

Reported net profit was up 15% to HKD2,482m, or 2-4% below our estimate/consensus. The net profit growth was mainly driven by: 1) 13.9% yoy growth in attributable gas sales volume (organic growth is 10.8% if stripping out acquisitions); and 2) a higher-than-expected connection fee income growth of 21.7% yoy. Nevertheless, gross margin deteriorated by 3.8ppt on delayed pass-through. CR Gas declared HKD0.25/share dividend, with payout ratio unchanged at c.22%.

### 2015 guidance: 20% yoy gas sales volume growth

CR Gas maintained its guidance of 16bcm gas sales volume (+20% yoy) in 2015, with 10% growth from organic and 10% growth from M&A. M&A will see acceleration in 2015 and capex planned is nearly HKD3bn (vs. HKD1.97bn in 2014). Following the February 2015 tariff adjustment, management expects the gas sales margin would edge up on delayed pass-through – limited upside in our view as the competitiveness of gas vs. alternative fuels is still weakened given the sharp oil price decline.

### Earnings revision; DCF-based target price of HKD18.8 (from HKD17.4); risks

We lift our 2015/16E earnings by 5.0%/6.4% to factor in the contribution from new acquisition and slightly higher connection. Our target price is DCF-based using a WACC of 8.5% and a terminal growth rate of 2%. Key upside/downside risks include higher/lower-than-expected natural gas sales/margin/connection fee income and acquisitions.

### Forecasts And Ratios

| Year End Dec 31      | 2013A  | 2014A  | 2015E  | 2016E  | 2017E  |
|----------------------|--------|--------|--------|--------|--------|
| Sales (HKDm)         | 22,288 | 28,717 | 32,644 | 36,425 | 40,250 |
| EBITDA (HKDm)        | 3,578  | 4,387  | 4,660  | 5,009  | 5,335  |
| Reported NPAT (HKDm) | 2,161  | 2,482  | 2,774  | 3,139  | 3,380  |
| DB EPS FD (HKD)      | 0.977  | 1.140  | 1.247  | 1.412  | 1.520  |
| DB EPS growth (%)    | 21.4   | 16.7   | 9.4    | 13.2   | 7.7    |
| PER (x)              | 20.4   | 20.7   | 17.5   | 15.4   | 14.3   |
| Price/BV (x)         | 4.2    | 2.8    | 2.7    | 2.3    | 2.1    |
| EV/EBITDA (x)        | 8.8    | 12.8   | 12.3   | 11.4   | 10.5   |
| DPS (net) (HKD)      | 0.220  | 0.250  | 0.312  | 0.353  | 0.380  |
| Yield (net) (%)      | 1.1    | 1.1    | 1.4    | 1.6    | 1.7    |
| ROE (%)              | 16.7   | 16.4   | 16.2   | 16.1   | 15.3   |

Source: Deutsche Bank estimates, company data

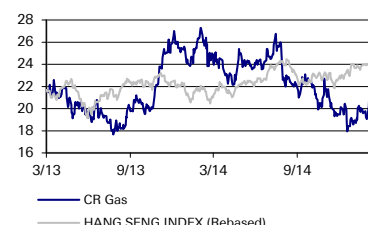
<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

### Key changes

|                      |                    |   |      |
|----------------------|--------------------|---|------|
| Price target         | 17.40 to 18.80     | ↑ | 8.0% |
| Sales (FYE)          | 30,995 to 32,644   | ↑ | 5.3% |
| Op prof margin (FYE) | 10.6 to 11.0       | ↑ | 4.0% |
| Net profit (FYE)     | 2,641.7 to 2,774.4 | ↑ | 5.0% |

Source: Deutsche Bank

### Price/price relative



| Performance (%) | 1m   | 3m   | 12m   |
|-----------------|------|------|-------|
| Absolute        | 14.4 | 11.8 | -12.4 |
| HANG SENG INDEX | -1.5 | 5.0  | 12.1  |

Source: Deutsche Bank

Deutsche Bank AG/Hong Kong

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Model updated: 26 March 2015

## Running the numbers

Asia

China

Utilities

## CR Gas

Reuters: 1193.HK

Bloomberg: 1193 HK

## Hold

Price (26 Mar 15) HKD 21.80

Target Price HKD 18.80

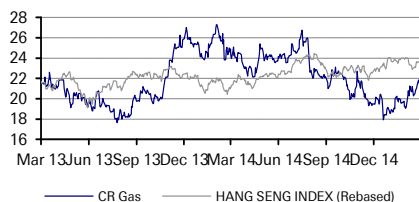
52 Week range HKD 17.94 - 26.75

Market Cap (m) HKDm 48,483  
USDm 6,252

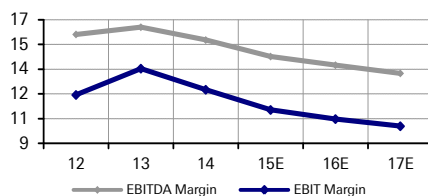
## Company Profile

China Resources Gas Group Limited (CR Gas) is principally engaged in the construction of city gas networks and provision of piped natural gas to households, commercial and industrial (C&I) users in the PRC. China Resources National Corp. is the controlling shareholder of the company holding c.68.5% stake.

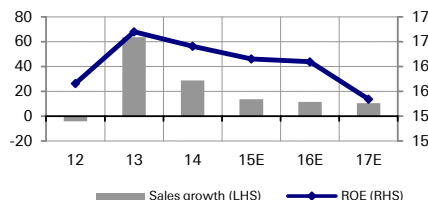
## Price Performance



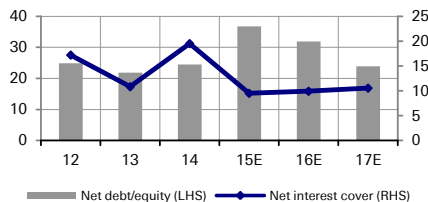
## Margin Trends



## Growth &amp; Profitability



## Solvency



Fiscal year end 31-Dec

## Financial Summary

|                             | 2012   | 2013   | 2014   | 2015E  | 2016E  | 2017E  |
|-----------------------------|--------|--------|--------|--------|--------|--------|
| DB EPS (HKD)                | 0.80   | 0.98   | 1.14   | 1.25   | 1.41   | 1.52   |
| Reported EPS (HKD)          | 0.82   | 1.00   | 1.14   | 1.25   | 1.41   | 1.52   |
| DPS (HKD)                   | 0.16   | 0.22   | 0.25   | 0.31   | 0.35   | 0.38   |
| BVPS (HKD)                  | 5.3    | 6.4    | 7.2    | 8.2    | 9.3    | 10.5   |
| Weighted average shares (m) | 2,016  | 2,171  | 2,173  | 2,224  | 2,224  | 2,224  |
| Average market cap (HKDm)   | 29,189 | 43,306 | 51,155 | 48,483 | 48,483 | 48,483 |
| Enterprise value (HKDm)     | 20,540 | 31,403 | 56,212 | 57,263 | 57,158 | 55,825 |

## Valuation Metrics

|                    |      |      |      |      |      |      |
|--------------------|------|------|------|------|------|------|
| P/E (DB) (x)       | 18.0 | 20.4 | 20.7 | 17.5 | 15.4 | 14.3 |
| P/E (Reported) (x) | 17.7 | 20.0 | 20.6 | 17.5 | 15.4 | 14.3 |
| P/BV (x)           | 3.04 | 4.23 | 2.79 | 2.65 | 2.34 | 2.08 |
| FCF Yield (%)      | nm   | 5.3  | 0.6  | nm   | 0.8  | 3.4  |
| Dividend Yield (%) | 1.1  | 1.1  | 1.1  | 1.4  | 1.6  | 1.7  |
| EV/Sales (x)       | 1.5  | 1.4  | 2.0  | 1.8  | 1.6  | 1.4  |
| EV/EBITDA (x)      | 9.7  | 8.8  | 12.8 | 12.3 | 11.4 | 10.5 |
| EV/EBIT (x)        | 12.6 | 10.4 | 16.0 | 15.9 | 15.0 | 13.8 |

## Income Statement (HKDm)

|                                     |        |        |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|--------|--------|
| Sales revenue                       | 13,622 | 22,288 | 28,717 | 32,644 | 36,425 | 40,250 |
| Gross profit                        | 4,739  | 8,153  | 9,553  | 10,267 | 11,057 | 11,854 |
| EBITDA                              | 2,127  | 3,578  | 4,387  | 4,660  | 5,009  | 5,335  |
| Depreciation                        | 486    | 531    | 837    | 1,028  | 1,162  | 1,262  |
| Amortisation                        | 14     | 30     | 29     | 29     | 29     | 29     |
| EBIT                                | 1,627  | 3,018  | 3,521  | 3,602  | 3,818  | 4,044  |
| Net interest income/(expense)       | -95    | -279   | -180   | -379   | -385   | -383   |
| Associates/affiliates               | 977    | 798    | 861    | 1,201  | 1,553  | 1,714  |
| Exceptionals/extraordinaries        | 32     | 55     | 7      | 0      | 0      | 0      |
| Other pre-tax income/(expense)      | 28     | 218    | 552    | 552    | 552    | 552    |
| Profit before tax                   | 2,569  | 3,811  | 4,760  | 4,975  | 5,538  | 5,926  |
| Income tax expense                  | 540    | 987    | 1,409  | 1,229  | 1,299  | 1,363  |
| Minorities                          | 384    | 663    | 869    | 972    | 1,100  | 1,184  |
| Other post-tax income/(expense)     | 0      | 0      | 0      | 0      | 0      | 0      |
| Net profit                          | 1,646  | 2,161  | 2,482  | 2,774  | 3,139  | 3,380  |
| DB adjustments (including dilution) | -23    | -40    | -5     | 0      | 0      | 0      |
| DB Net profit                       | 1,623  | 2,121  | 2,477  | 2,774  | 3,139  | 3,380  |

## Cash Flow (HKDm)

|                                      |        |        |        |        |        |        |
|--------------------------------------|--------|--------|--------|--------|--------|--------|
| Cash flow from operations            | 2,271  | 5,405  | 5,709  | 3,927  | 4,373  | 4,634  |
| Net Capex                            | -4,189 | -3,105 | -5,414 | -5,750 | -4,000 | -3,000 |
| Free cash flow                       | -1,919 | 2,300  | 295    | -1,823 | 373    | 1,634  |
| Equity raised/(bought back)          | 2,699  | 0      | 0      | 0      | 0      | 0      |
| Dividends paid                       | -425   | -744   | -489   | -556   | -694   | -785   |
| Net inc/(dec) in borrowings          | 5,031  | 2,158  | 3,360  | 2,813  | 0      | 0      |
| Other investing/financing cash flows | -31    | -4,670 | -3,043 | 928    | 390    | 450    |
| Net cash flow                        | 5,355  | -955   | 123    | 1,362  | 70     | 1,299  |
| Change in working capital            | 528    | 2,720  | 2,468  | 324    | 497    | 493    |

## Balance Sheet (HKDm)

|                              |        |        |        |        |        |        |
|------------------------------|--------|--------|--------|--------|--------|--------|
| Cash and other liquid assets | 10,608 | 9,803  | 9,773  | 11,135 | 11,205 | 12,504 |
| Tangible fixed assets        | 13,010 | 18,528 | 21,512 | 27,826 | 30,665 | 32,403 |
| Goodwill/intangible assets   | 691    | 1,168  | 1,833  | 1,986  | 2,140  | 2,294  |
| Associates/investments       | 7,913  | 10,842 | 11,648 | 12,450 | 13,430 | 14,511 |
| Other assets                 | 5,461  | 10,140 | 12,751 | 14,218 | 14,966 | 15,722 |
| Total assets                 | 37,683 | 50,482 | 57,517 | 67,616 | 72,407 | 77,434 |
| Interest bearing debt        | 14,258 | 13,874 | 14,929 | 20,047 | 20,047 | 20,047 |
| Other liabilities            | 8,739  | 17,992 | 21,557 | 23,347 | 24,593 | 25,842 |
| Total liabilities            | 22,997 | 31,866 | 36,486 | 43,394 | 44,640 | 45,889 |
| Shareholders' equity         | 11,699 | 14,183 | 16,065 | 18,284 | 20,729 | 23,324 |
| Minorities                   | 2,987  | 4,433  | 4,966  | 5,938  | 7,038  | 8,221  |
| Total shareholders' equity   | 14,686 | 18,616 | 21,031 | 24,222 | 27,767 | 31,546 |
| Net debt                     | 3,650  | 4,071  | 5,155  | 8,912  | 8,842  | 7,543  |

## Key Company Metrics

|                        |      |      |      |      |      |      |
|------------------------|------|------|------|------|------|------|
| Sales growth (%)       | -4.1 | 63.6 | 28.8 | 13.7 | 11.6 | 10.5 |
| DB EPS growth (%)      | 38.2 | 21.4 | 16.7 | 9.4  | 13.2 | 7.7  |
| EBITDA Margin (%)      | 15.6 | 16.1 | 15.3 | 14.3 | 13.8 | 13.3 |
| EBIT Margin (%)        | 11.9 | 13.5 | 12.3 | 11.0 | 10.5 | 10.0 |
| Payout ratio (%)       | 19.6 | 22.1 | 21.9 | 25.0 | 25.0 | 25.0 |
| ROE (%)                | 15.7 | 16.7 | 16.4 | 16.2 | 16.1 | 15.3 |
| Capex/sales (%)        | 30.8 | 13.9 | 18.9 | 17.6 | 11.0 | 7.5  |
| Capex/depreciation (x) | 8.4  | 5.5  | 6.3  | 5.4  | 3.4  | 2.3  |
| Net debt/equity (%)    | 24.9 | 21.9 | 24.5 | 36.8 | 31.8 | 23.9 |
| Net interest cover (x) | 17.2 | 10.8 | 19.5 | 9.5  | 9.9  | 10.6 |

Source: Company data, Deutsche Bank estimates

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## 2014 results review

CR Gas announced FY14 results on 26 March after market close.

- Reported net profit was up 15% to HKD2,482m, which is 2-4% below our estimate/consensus. The net profit growth was mainly driven by: 1) 13.9% yoy growth in attributable gas sales volume (organic volume growth is 10.8% if stripping out acquisitions); and 2) 21.7% yoy growth in connection fee income.
- By segment, gas sales and connection fee accounted for 78% and 22% of total revenue, respectively. While on the operating profit level, the split is 48% (gas sales) and 52% (connection).
- CR Gas declared HKD0.25/share dividend, with the payout ratio remaining unchanged at c.22%.

We summarize the yoy comparison in [Figure 1](#).

Figure 1: CR Gas's FY14 summary P&L

| P&L (HK\$ m)                            | 1H13         | 1H14          | 2H13          | 2H14          | FY13          | FY14          | FY14 yoy       |
|---|--------------|---------------|---------------|---------------|---------------|---------------|----------------|
|   | (restated)   |               | (restated)    |               |               |               |                |
| <b>Total turnover</b>                   | <b>9,786</b> | <b>12,846</b> | <b>12,502</b> | <b>15,871</b> | <b>22,288</b> | <b>28,717</b> | <b>28.8%</b>   |
| Connection fee                          | 1,747        | 2,212         | 3,376         | 4,024         | 5,124         | 6,236         | 21.7%          |
| Gas sales                               | 8,039        | 10,633        | 9,126         | 11,847        | 17,164        | 22,481        | 31.0%          |
| Cost of sales                           | (6,508)      | (8,832)       | (8,158)       | (11,169)      | (14,666)      | (20,001)      | 36.4%          |
| <b>Gross profit</b>                     | <b>3,278</b> | <b>4,014</b>  | <b>4,344</b>  | <b>4,702</b>  | <b>7,622</b>  | <b>8,716</b>  | <b>14.4%</b>   |
| Gross margin (%)                        | 33.5%        | 31.2%         | 34.7%         | 29.6%         | 34.2%         | 30.4%         | -3.8ppt        |
| Other income                            | 288          | 408           | 230           | 507           | 518           | 915           | 76.5%          |
| Admin. and selling expenses             | (1,872)      | (2,300)       | (2,733)       | (2,895)       | (4,604)       | (5,195)       | 12.8%          |
| <b>Profit from operations</b>           | <b>1,694</b> | <b>2,122</b>  | <b>1,842</b>  | <b>2,314</b>  | <b>3,536</b>  | <b>4,436</b>  | <b>25.4%</b>   |
| Operating margin (%)                    | 17.3%        | 16.5%         | 14.7%         | 14.6%         | 15.9%         | 15.4%         | -0.4ppt        |
| Finance costs                           | (297)        | (273)         | (227)         | (264)         | (524)         | (537)         | 2.6%           |
| Share of JCE                            | 412          | 329           | 286           | 426           | 698           | 756           | 8.2%           |
| Share of assoc.                         | 61           | 57            | 39            | 48            | 100           | 105           | 5.3%           |
| <b>Profit before tax</b>                | <b>1,871</b> | <b>2,235</b>  | <b>1,940</b>  | <b>2,524</b>  | <b>3,811</b>  | <b>4,760</b>  | <b>24.9%</b>   |
| PBT margin (%)                          | 19.1%        | 17.4%         | 15.5%         | 15.9%         | 17.1%         | 16.6%         | -0.5ppt        |
| Taxation                                | (393)        | (541)         | (594)         | (868)         | (987)         | (1,409)       | 42.7%          |
| Effective tax rate                      | 21.0%        | 24.2%         | 30.6%         | 34.4%         | 25.9%         | 29.6%         | 14.3%          |
| <b>Profit before MI</b>                 | <b>1,478</b> | <b>1,694</b>  | <b>1,346</b>  | <b>1,656</b>  | <b>2,824</b>  | <b>3,351</b>  | <b>18.7%</b>   |
| Minority interest                       | (411)        | (443)         | (251)         | (426)         | (663)         | (869)         | 31.1%          |
| <b>Net profit</b>                       | <b>1,067</b> | <b>1,251</b>  | <b>1,094</b>  | <b>1,231</b>  | <b>2,161</b>  | <b>2,482</b>  | <b>14.8%</b>   |
| Net margin (%)                          | 10.9%        | 9.7%          | 8.8%          | 7.8%          | 9.7%          | 8.6%          | -1.1ppt        |
| <b>Diluted EPS (HK\$/shr)</b>           | <b>0.491</b> | <b>0.576</b>  | <b>0.504</b>  | <b>0.566</b>  | <b>0.996</b>  | <b>1.142</b>  | <b>14.7%</b>   |
| <b>Recurring net profit</b>             | <b>1,074</b> | <b>1,250</b>  | <b>1,112</b>  | <b>1,365</b>  | <b>2,186</b>  | <b>2,615</b>  | <b>19.6%</b>   |
| <b>Recurring diluted EPS (HK\$/shr)</b> | <b>0.495</b> | <b>0.575</b>  | <b>0.512</b>  | <b>0.628</b>  | <b>1.007</b>  | <b>1.203</b>  | <b>19.5%</b>   |
| diluted weighted avg shrs (m)           | 2,170        | 2,173         | 2,171         | 2,173         | 2,171         | 2,173         | 0.1%           |
| <b>Dividend per share (HK\$)</b>        | <b>0.020</b> | <b>0.050</b>  | <b>0.2000</b> | <b>0.2000</b> | <b>0.2200</b> | <b>0.2500</b> | <b>13.6%</b>   |
| payout ratio                            |              |               |               |               | 22.1%         | 21.9%         | -0.9%          |
| <b>Net debt (cash) to total equity</b>  | <b>29%</b>   | <b>28%</b>    | <b>22%</b>    | <b>45%</b>    | <b>22%</b>    | <b>45%</b>    | <b>22.7ppt</b> |
| <b>Seg. profit from operations</b>      |              |               |               |               |               |               |                |
| Gas connection fee                      | 785          | 985           | 1,708         | 1,859         | 2,493         | 2,844         | 14.1%          |
| Sales of piped gas                      | 863          | 1,076         | 1,384         | 1,579         | 2,247         | 2,655         | 18.1%          |
| <b>Total</b>                            | <b>1,648</b> | <b>2,061</b>  | <b>3,091</b>  | <b>3,438</b>  | <b>4,740</b>  | <b>5,499</b>  | <b>16.0%</b>   |
| <b>Segmental operating margin</b>       |              |               |               |               |               |               |                |
| Gas connection fee                      | 44.9%        | 44.5%         | 50.6%         | 46.2%         | 48.6%         | 45.6%         | -3.0ppt        |
| Sales of piped gas                      | 10.7%        | 10.1%         | 15.2%         | 13.3%         | 13.1%         | 11.8%         | -1.3ppt        |
| <b>Total</b>                            | <b>16.8%</b> | <b>16.0%</b>  | <b>24.7%</b>  | <b>21.7%</b>  | <b>21.3%</b>  | <b>19.1%</b>  | <b>-2.1ppt</b> |

Source: Deutsche Bank, company data



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## Outlook and key takeaways after the results briefing

### Natural gas sales volume: +20% yoy in 2015E

CR Gas achieved total gas sales volume of 13,323mcm in FY14 from 12,091mcm in FY13, or up 10.2% yoy (8.0% yoy organic growth, excluding acquisition). Looking into 2015, management maintained its guidance of 16bcm gas sales volume (+20% yoy), with 10% growth from organic and 10% growth from M&A. Two new projects are highlighted as key growth drivers, namely Qingdao and Qinhuangdao.

- **Qingdao:** CR Gas announced on 9 March that it will invest Rmb612.5m to set up a JV with Qingdao Energy group with 49%:51% stake split. The project achieved 380mcm of gas sales in 2014 and management expects the contribution will increase to 400mcm and 800mcm by 2015 and 2020, respectively.
- **Qinhuangdao:** CR Gas signed a framework agreement with local government on 8 March to form a 49%:51% JV in 2015. Qinhuangdao has an annual gas consumption of 225mcm.

Management has not provided an updated forecast for Tianjin's gas sales volume this time. As a recap, CR Gas cut its 2015 gas sales volume target to 16bcm (from 20bcm) during 1H14 results briefing mainly due to 1) Tianjin gas project: management lowered gas sales volume target to 2.1bcm in 2015E (vs. 5.1bcm as forecast in the feasibility study report, as heating and gas-fired co-generation usage is unlikely to pick up as previously forecast); 2) Chongqing gas project: the gas sales volume guidance was lowered to 2.4bcm in 2015E (vs. 3.4bcm as previously forecast).

In 1-2M15, CR Gas achieved 13% yoy growth in gas sales volume (excl. Chongqing and Tianjin).

### Gas sales margin might edge up in 2015

The gross margin for gas sales was down 3.6ppt yoy to 22.2%, for which management attributes 1) lower C&I margin (down 5.2ppt to 23%) due to delayed pass through and 2) increase in the low-margin residential volume. For the September 2014 gas tariff hike, pass through of most projects was delayed by two months. We show the yoy margin comparison in Figure 2.

Following the February 2015 gas tariff adjustment (effective from 1 April), CR Gas noted the average purchasing cost will see a Rmb0.11/cm decrease. With some delayed pass through, the company believes the overall gas sales margin will likely see slight improvement in 2015E. However, in our view, the upside is limited, if any, as the competitiveness of gas vs. alternative fuels is still weakened given the sharp oil price decline.



Figure 2: CR Gas' FY13 summary operating statistics

| Key operating data                     | FY13         | FY14         | yoy     | Deutsche Bank comment   |
|--|--------------|--------------|---------|---|
| No. of projects                        | 176          | 205          | 16%     |   |
| Total gas sales vol. (mil. cm)         | 12,091       | 13,323       | 10.2%   | Organic growth: 10.2%; M&A growth: 2.2%; 15.6% if excl. Chongqing |
| Residential                            | 3,023        | 3,467        | 14.7%   |   |
| C&I                                    | 7,567        | 8,235        | 8.8%    | C&I growth was lowest among difference users                      |
| Gas station                            | 1,397        | 1,617        | 15.7%   |   |
| Bottled gas                            | 104          | 4            | -96.2%  |   |
| Consol. gas sales vol. (mil. cm)       | 5,404        | 6,405        | 18.5%   | Organic growth: 13.6%; M&A growth: 4.9%                           |
| Attrib. gas sales vol. (mil. cm)       | 6,542        | 7,449        | 13.9%   | Organic growth: 10.8%; M&A growth: 3.1%; 16.7% if excl. Chongqing |
| Connected households (mil.)            | 18.41        | 20.74        | 12.6%   |   |
| C&I daily installed capacity (mil. cm) | 40.3         | 47.4         | 17.7%   |   |
| No. of gas refueling stations          | 192          | 279          | 45.3%   |   |
| CNG                                    | 156          | 194          | 24.4%   |   |
| LNG                                    | 27           | 55           | 103.7%  |   |
| L-CNG                                  | 9            | 30           | 233.3%  |   |
| <b>Avg. tariff (Rmb/cm)</b>            | <b>2.75</b>  | <b>2.91</b>  | 5.8%    |   |
| Residential                            | 2.17         | 2.03         | -6.5%   |   |
| C&I                                    | 2.74         | 2.99         | 9.1%    |   |
| Gas station                            | 3.55         | 3.62         | 2.0%    |   |
| <b>Avg gas sale margin (Rmb/cm)</b>    | <b>0.71</b>  | <b>0.67</b>  | -5.6%   | Due to 1) lower margin of C&I; 2) mix change                      |
| Residential                            | 0.25         | 0.17         | -32.0%  |   |
| C&I                                    | 0.77         | 0.72         | -6.5%   | Mainly on delayed pass-through                                    |
| Gas station                            | 1.09         | 1.07         | -1.8%   | Highest margin among all users                                    |
| <b>Avg gas margin (%)</b>              | <b>25.8%</b> | <b>22.2%</b> | -3.6ppt | Margin compression recorded in all user types                     |
| Residential                            | 11.5%        | 7.8%         | -3.7ppt |   |
| C&I                                    | 28.2%        | 23.0%        | -5.2ppt |   |
| Gas station                            | 30.6%        | 29.5%        | -1.1ppt |   |
| Avg. residential connection fee (Rmb)  | 3,250        | 3,160        | -2.8%   | Due to mix change   |
| Connection gross margin (%)            | 62.2%        | 59.8%        | -2.4ppt |   |

Source: Deutsche Bank, company data

### Stable connection outlook

In 2014, total connected household increased by 2.33m to 20.74m (vs. 1.70m added in 2013, or up 37% yoy). On a consolidated basis, 1.34m was added in 2014 (vs. 1.06m in 2013, or up 26% yoy). However, average residential connection fee slightly declined by 2.8% due to change in city mix. Despite an overall property new start slowdown, management still expects stable new household connections in 2015 considering its advantageous location mix (higher exposure to Tier 1-3 cities).

### Tianjin project back on track

Tianjin project recorded a HKD3m profit in 2H14, reversed from a HKD92m loss in 1H14 (attributable to CR Gas was HKD45m), as it managed to more-than-pass through the September 2014 tariff hike and made up for some margin erosion in 2013.

- To recap, the Tianjin gas project was supposed to pass through an Rmb0.65/cm higher cost to its non-residential users during the city-gate tariff increase in 2H13, but it eventually managed to pass through only Rmb0.4/cm in 2013 (i.e., Rmb0.25/cm unit margin squeeze).

Meanwhile, management advised that the previous divergence with Tianjin government has been largely solved, with the new General Manager nominated by CR Gas coming into office in March.

### 2015E capex: organic expansion - flat; M&A – accelerating

CR Gas spent HKD3.9bn of operating capex in 2014 and expects a similar amount in 2015. However, accelerations will be seen on the M&A front: compared with the HKD1.97bn M&A capex spent in 2014, management guided a HKD2-3bn budget in 2015 (likely on the high-end).



- In 2014, CR Gas added 29 city gas projects (Rmb1.55bn investment). It has another 24 projects approved by the board with proposed investments of Rmb675m.

#### Other key takeaways

- Dividend payout:** Management advised that dividend payout ratio is likely to be increased after positive FCF is achieved, which is likely in 2015 (still negative at -HKD191m in 2014)
- Residential tiered pricing:** Currently CR Gas has achieved residential tiered gas pricing for 21 projects. According to management, a Rmb0.11/cm dollar margin enhancement should be achieved for residential gas sales. However, considering the actual execution, it expects a blended margin increase of Rmb0.05-0.08/cm after a full roll-out by the end of this year.

## Earnings revision; valuation and risks

### Earnings revision

We lift our 2015/16E earnings by 5.0%/6.4% to factor in the contribution from new acquisition and slightly higher connection. Consequently, we increase our DCF-based target price to HKD18.8 (from HKD17.4). We also introduce our 2017 forecasts, while the Street forecast is currently not representative yet given the limited data points.

We show our earnings change and Deutsche Bank vs. consensus in [Figure 3](#) and [Figure 4](#).

Figure 3: Earnings estimate and target price changes

| 1193.HK                   | Current      | Before       | % change    |
|---------------------------|--------------|--------------|-------------|
| <b>Revenue (Rmb m)</b>    |              |              |             |
| 2015E                     | 32,644       | 30,995       | 5.3%        |
| 2016E                     | 36,425       | 34,308       | 6.2%        |
| 2017E                     | 40,250       | NA           | NA          |
| <b>EBITDA (Rmb m)</b>     |              |              |             |
| 2015E                     | 4,660        | 4,204        | 10.8%       |
| 2016E                     | 5,009        | 4,441        | 12.8%       |
| 2017E                     | 5,335        | NA           | NA          |
| <b>Net profit (Rmb m)</b> |              |              |             |
| 2015E                     | 2,774        | 2,642        | 5.0%        |
| 2016E                     | 3,139        | 2,952        | 6.4%        |
| 2017E                     | 3,380        | NA           | NA          |
| <b>Rating</b>             | <b>Hold</b>  | <b>Hold</b>  |             |
| <b>Target price (HKD)</b> | <b>18.80</b> | <b>17.40</b> | <b>8.0%</b> |

Source: Deutsche Bank estimates

Figure 4: Deutsche Bank vs. consensus forecast

| Company                   | Ticker  | Target price | Rating           |
|---------------------------|---------|--------------|------------------|
| CR Gas                    | 1193.HK | HKD18.80     | Hold             |
|                           | DB      | Consensus    | DB vs. Consensus |
| <b>Revenue (Rmb m)</b>    |         |              |                  |
| 2015                      | 32,644  | 32,336       | 1%               |
| 2016                      | 36,425  | 37,470       | -3%              |
| 2017                      | 40,250  | 40,889       | -2%              |
| <b>EBITDA (Rmb m)</b>     |         |              |                  |
| 2015                      | 4,660   | 5,437        | -14%             |
| 2016                      | 5,009   | 6,240        | -20%             |
| 2017                      | 5,335   | 7,517        | -29%             |
| <b>Net income (Rmb m)</b> |         |              |                  |
| 2015                      | 2,774   | 2,935        | -5%              |
| 2016                      | 3,139   | 3,438        | -9%              |
| 2017                      | 3,380   | 4,079        | -17%             |
| <b>Consensus Ratings</b>  |         |              |                  |
|                           | 16      | 6            | 5                |

Source: Deutsche Bank estimates, Bloomberg Finance LP

### Valuation

Our target price is based on DCF, assuming a WACC of 8.5% (a 3.9% risk-free rate, 1.0 beta, a 5.6% equity risk premium, 4.5% after-tax cost of debt and a 30% target debt to total capital ratio). We employ a 2% terminal growth rate (based on long-term economic growth) in cash flow to arrive at our terminal value.



### Key risks

Key upside/downside risks include margin expansion/compression in the downstream gas distribution business, higher-/lower-than-expected natural gas sales and connection fee income, better-/worse-than-expected operating leverage from increasing scale, acquisitions and higher-/lower-than-expected RMB appreciation.

We show the comparable trading analysis in Figure 5.

Figure 5: Sector valuation comps and share performance

| Share price as of |         | 3/25/2015 |        | Performance  |             |                 |          |          |      |      |      | Valuations |      |      |     | Returns & Gearing (%) |      |     |     |         |     |       |  |
|-------------------|---------|-----------|--------|--------------|-------------|-----------------|----------|----------|------|------|------|------------|------|------|-----|-----------------------|------|-----|-----|---------|-----|-------|--|
| Company           | Ticker  | Price     | Rating | Price target | % to target | Mkt. Cap. US\$m | Absolute | Relative | 14E  | 15E  | 16E  | EV/EBITDA  |      | P/BV |     | RoE                   |      | ROA |     | Gearing |     | Yield |  |
|                   |         |           |        |              |             |                 | 3m       | 3m       |      |      |      | 14E        | 15E  | 14E  | 15E | 14E                   | 15E  | 14E | 15E | 14E     | 15E |       |  |
| Towngas China     | 1083.HK | HKD6.99   | Hold   | HKD6.40      | (8%)        | 2,343           | (11%)    | (14%)    | 17.4 | 15.2 | 13.6 | 20.2       | 17.8 | 1.4  | 1.3 | 7.3                   | 8.7  | 3.6 | 4.3 | 34.0    | 1.3 |       |  |
| BJ Enterprises    | 0392.HK | HKD57.60  | Buy    | HKD71.40     | 24%         | 9,426           | (2%)     | (5%)     | 16.5 | 12.9 | 10.9 | 4.9        | 4.2  | 1.3  | 1.2 | 8.6                   | 9.5  | 4.3 | 4.8 | 23.1    | 2.0 |       |  |
| ENN Energy        | 2688.HK | HKD44.90  | Hold   | HKD39.70     | (12%)       | 6,430           | 2%       | (2%)     | 18.9 | 17.6 | 15.5 | 9.3        | 8.7  | 3.5  | 3.0 | 21.7                  | 19.7 | 6.0 | 5.8 | 50.8    | 1.1 |       |  |
| China Gas         | 0384.HK | HKD12.16  | Hold   | HKD11.50     | (5%)        | 7,924           | 2%       | (2%)     | 20.7 | 18.5 | 16.0 | 11.3       | 13.4 | 3.4  | 2.9 | 19.2                  | 18.0 | 6.9 | 6.9 | 61.5    | 1.3 |       |  |
| Kunlun Energy     | 0135.HK | HKD7.36   | Hold   | HKD7.80      | 6%          | 7,816           | 1%       | (3%)     | 11.5 | 13.4 | 10.5 | 6.0        | 6.3  | 1.1  | 1.1 | 10.1                  | 8.2  | 4.2 | 3.2 | 20.0    | 2.4 |       |  |
| CR Gas            | 1193.HK | HKD21.85  | Hold   | HKD18.80     | (14%)       | 6,252           | 12%      | 8%       | 19.1 | 17.5 | 15.4 | 13.3       | 13.6 | 3.0  | 2.7 | 16.4                  | 16.2 | 4.6 | 4.4 | 24.5    | 1.1 |       |  |
| Average           |         |           |        |              |             |                 | 0%       | (3%)     | 17.3 | 15.9 | 13.7 | 10.8       | 10.7 | 2.3  | 2.0 | 13.9                  | 13.4 | 4.9 | 4.9 | 35.7    | 1.6 |       |  |

All estimates are DB estimates and all stock data is from Datastream, Bloomberg Finance LP

Definitions: 1) Gearing is net debt / shareholders equity; 2) EV is after deducting estimated value of associates;

| Share price as of | 3/25/2015 |        | Share price performance |      |       |       |       |       |                 |      | Relative performance                      |       |       |       |       |            |                 |       | Share price statistics |       |        |        |             |  |                 |  |
|-------------------|-----------|--------|-------------------------|------|-------|-------|-------|-------|-----------------|------|---|-------|-------|-------|-------|------------|-----------------|-------|------------------------|-------|--------|--------|-------------|--|-----------------|--|
|                   |           |        | local currency          |      |       |       |       |       | Avg. daily vol. |      | local currency & local currency index**** |       |       |       |       |            | Avg. daily vol. |       | current / current/     |       |        |        |             |  | Avg. daily vol. |  |
| Company           | Price     | Rating | 1wk                     | 1m   | 3m    | 6m    | 12m   | 3yr   | US\$, 1m**      | 1wk  | 1m  | 3m    | 6m    | 12m   | 3yr   | US\$, 6m** | 52w H           | 52w L | 52W L                  | 52W L | 10yr H | 10yr L | US\$, 1yr** |  |                 |  |
| Towngas China     | HKD6.99   | Hold   | (3%)                    | 1%   | (11%) | (17%) | (26%) | 31%   | 4.0             | (2%) | 1%  | (14%) | (26%) | (40%) | 17%   | 3.8        | 10.06           | 6.70  | 0.69                   | 1.04  | 10.24  | 1.28   | 3.8         |  |                 |  |
| BJ Enterprises    | HKD57.60  | Buy    | 0%                      | 0%   | (2%)  | (14%) | (14%) | 23%   | 13.6            | 0%   | 1%  | (5%)  | (24%) | (31%) | 9%    | 12.2       | 76.45           | 56.65 | 0.75                   | 1.02  | 78.15  | 9.75   | 11.9        |  |                 |  |
| ENN Energy        | HKD44.90  | Hold   | (3%)                    | 12%  | 2%    | (15%) | (13%) | 63%   | 17.1            | (3%) | 12%                                       | (2%)  | (24%) | (29%) | 45%   | 20.9       | 61.90           | 40.05 | 0.73                   | 1.12  | 61.90  | 3.90   | 17.4        |  |                 |  |
| China Gas         | HKD12.16  | Hold   | (4%)                    | 1%   | 2%    | (10%) | 3%    | 219%  | 17.7            | (4%) | 2%  | (2%)  | (20%) | (17%) | 184%  | 15.6       | 16.22           | 10.70 | 0.75                   | 1.14  | 16.22  | 0.47   | 16.2        |  |                 |  |
| Kunlun Energy     | HKD7.36   | Hold   | (0%)                    | (4%) | 1%    | (38%) | (42%) | (47%) | 13.5            | (0%) | (3%)                                      | (3%)  | (45%) | (53%) | (53%) | 23.9       | 13.86           | 6.88  | 0.53                   | 1.07  | 17.32  | 1.11   | 22.5        |  |                 |  |
| CR Gas            | HKD21.85  | Hold   | 5%                      | 13%  | 12%   | (1%)  | (11%) | 55%   | 11.0            | 5%   | 14%                                       | 8%    | (12%) | (28%) | 38%   | 7.7        | 26.80           | 17.88 | 0.82                   | 1.22  | 27.80  | 1.70   | 8.0         |  |                 |  |
| Average           |           |        | (1%)                    | 4%   | 0%    | (16%) | (17%) | 57%   | 12.8            | (1%) | 5%  | (3%)  | (25%) | (33%) | 40%   | 14.0       | 34.22           | 23.14 | 0.71                   | 1.10  | 35.27  | 3.04   | 13.3        |  |                 |  |

\*\* in USD millions

\*\*\*\* Relative performance is against the HSCEI

Source: Deutsche Bank, Datastream





# Appendix 1

## Important Disclosures

Additional information available upon request

### Disclosure checklist

| Company | Ticker  | Recent price*         | Disclosure |
|---------|---------|-----------------------|------------|
| CR Gas  | 1193.HK | 21.80 (HKD) 26 Mar 15 | NA         |

\*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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### Historical recommendations and target price: CR Gas (1193.HK)

(as of 3/26/2015)



|                |   |                |                                    |
|----------------|---|----------------|------------------------------------|
| 1. 08/05/2013: | Sell, Target Price Change HKD14.50            | 5. 27/06/2014: | Hold, Target Price Change HKD23.50 |
| 2. 23/07/2013: | Sell, Target Price Change HKD15.00            | 6. 23/07/2014: | Hold, Target Price Change HKD23.10 |
| 3. 25/08/2013: | Upgrade to Hold, Target Price Change HKD16.10 | 7. 22/08/2014: | Hold, Target Price Change HKD23.20 |
| 4. 09/01/2014: | Hold, Target Price Change HKD22.20            | 8. 09/02/2015: | Hold, Target Price Change HKD17.40 |





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**Buy:** Based on a current 12-month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

**Sell:** Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

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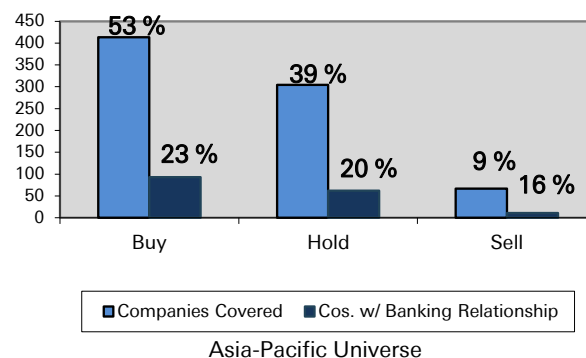
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## Equity rating dispersion and banking relationships





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