

China Resources Gas Group
(1193 HK)

Hold

Target price (HKD)	22.00
Share price (HKD)	21.80
Upside/Downside (%)	0.9

Dec	2014 a	2015 e	2016 e
HSBC EPS	1.14	1.26	1.37
HSBC PE	19.1	17.3	15.9
Performance	1M	3M	12M
Absolute (%)	14.4	11.8	-12.4
Relative ^A (%)	16.8	8.0	-28.0

28 March 2015

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with the disclosures and
the analyst certifications in
the Disclosure appendix,
and with the Disclaimer,
which forms part of it

Hold: FY14e results in line, just 10% volume growth

- **FY14 attributable profit came in at HKD2,482m, in line with our forecast**
- **Gas sales volume up 10% to 13.32bcm. Excluding impact of loss of a major customer in Chongqing, growth was 15.6%**
- **Reiterate Hold rating with a fair value TP of HKD22.0 (was HKD22.1) after earnings revisions**

FY14 results were largely in line. FY14e revenue came in at HKD28,717m, a little behind our HKD31,315m estimate, while FY14e net attributable profit came in at HKD2,482m, more or less in line with our HKD2,457m estimate. Revenue and net attributable profit in 2H represented 45% and 50%, respectively, of their full-year totals vs our estimates of 59% and 49%. FY14e gas sales volume was 13.32bcm, up 10% YoY (1H14: 6.82bcm; 2H13: 5.84bcm; FY13: 12.1bcm). Excluding the loss of a large customer at its Chongqing project, gas sales volume grew by 15.6% YoY.

Management guidance: **a)** maintain FY15e gas sales volume guidance: 16bcm; **b)** no. of connection should be flat vs FY14 (c2.3m); **c)** HKD2-3bn capex for M&A, and HKD3-4bn capex for maintenance; **d)** no fixed target on CNG/LNG stations new-build but 300 stations achievable by end-FY15; and **e)** gross margin to improve from FY14

Earnings revisions. We have revised our FY15/16/17e earnings slightly, adjusting our dollar margin forecasts for gas sales down for the residential segment and up for the C&I segment. We have also raised our depreciation forecasts to reflect the actual FY14 numbers. Our EPS estimates are 5%, 12%, and 9% below consensus for FY15e, FY16e, and FY17e, respectively.

We reiterate our Hold rating with a revised fair value TP of HKD22.0 (was HKD22.10) based on the straight average of our PE, PB, and DCF valuations. The PE valuation of HKD15.14 (was HKD15.92) is based on a 12.0x (was 13.0x) 2015e PE (based on 1x 2015e-17e PEG). The PB valuation of HKD26.14 (was HKD26.11) is based on an ROE-implied PB of 3.1x (was 3.1x) with a 16.41% ROE and 1% growth rate. The DCF valuation is HKD24.8 (was HKD24.3) on a 5.7% WACC, 3.5% risk-free rate, 5.5% equity risk premium, and 0.49 beta. **Upside risks:** availability of gas allows higher growth, improved utilisation of existing gas pipelines, strong volume growth, and an increase in the share of C&I customers. **Downside risks:** a fall in industrial volumes with slowing GDP and any future citygate price hikes not being passed through to customers.

Index ^A	HSCEI
Index level	11,969
RIC	1193.HK
Bloomberg	1193 HK

Source: HSBC

Enterprise value (HKDm)	44,301
Free float (%)	32
Market cap (USDm)	6,252
Market cap (HKDm)	48,483

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (HKDm)				
Revenue	28,717	37,823	42,504	49,395
EBITDA	4,469	4,812	5,232	5,908
Depreciation & amortisation	-949	-977	-1,091	-1,153
Operating profit/EBIT	3,521	3,835	4,141	4,755
Net interest	378	494	598	718
PBT	4,760	5,257	5,713	6,496
HSBC PBT	4,760	5,257	5,713	6,496
Taxation	-1,409	-1,556	-1,691	-1,923
Net profit	2,482	2,741	2,979	3,387
HSBC net profit	2,482	2,741	2,979	3,387

Cash flow summary (HKDm)

Cash flow from operations	4,812	2,097	5,414	6,542
Capex	922	-3,630	-1,429	-1,364
Cash flow from investment	1,103	-2,847	-546	-364
Dividends	-543	-543	-812	-882
Change in net debt	932	-3,406	-3,599	-4,835
FCF equity	5,427	-1,758	3,829	5,107

Balance sheet summary (HKDm)

Intangible fixed assets	1,833	1,521	1,486	1,452
Tangible fixed assets	21,512	19,380	19,754	20,000
Current assets	20,464	24,382	27,947	34,711
Cash & others	9,708	12,826	16,538	21,449
Total assets	57,517	59,365	63,663	71,050
Operating liabilities	20,802	19,725	20,699	24,318
Gross debt	14,929	14,641	14,754	14,830
Net debt	5,222	1,815	-1,784	-6,619
Shareholders funds	16,065	18,319	20,697	23,431
Invested capital	13,298	12,732	11,951	10,396

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	28.8	31.7	12.4	16.2
EBITDA	24.5	7.7	8.7	12.9
Operating profit	16.7	8.9	8.0	14.8
PBT	24.9	10.4	8.7	13.7
HSBC EPS	14.7	10.4	8.7	13.7

Ratios (%)

Revenue/IC (x)	2.4	2.9	3.4	4.4
ROIC	20.5	20.7	23.6	30.0
ROE	16.4	15.9	15.3	15.4
ROA	6.9	6.9	7.1	7.3
EBITDA margin	15.6	12.7	12.3	12.0
Operating profit margin	12.3	10.1	9.7	9.6
EBITDA/net interest (x)				
Net debt/equity	24.8	7.5	-6.5	-21.3
Net debt/EBITDA (x)	1.2	0.4	-0.3	-1.1
CF from operations/net debt	92.1	115.5		

Per share data (HKD)

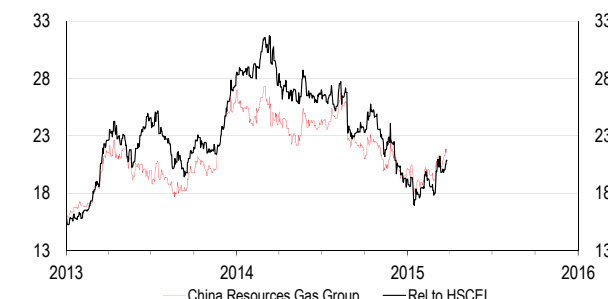
EPS reported (fully diluted)	1.14	1.26	1.37	1.56
HSBC EPS (fully diluted)	1.14	1.26	1.37	1.56
DPS	0.25	0.28	0.30	0.34
Book value	7.39	8.43	9.53	10.78

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	1.6	1.2	1.0	0.7
EV/EBITDA	10.5	9.2	7.9	6.2
EV/IC	3.5	3.5	3.4	3.5
PE*	19.1	17.3	15.9	14.0
P/Book value	2.9	2.6	2.3	2.0
FCF yield (%)	13.0	-4.1	8.9	11.7
Dividend yield (%)	1.1	1.3	1.4	1.6

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

Price relative



Source: HSBC

Note: price at close of 26 Mar 2015

FY14 results summary

- ▶ FY14 attributable profit came in at HKD2,482m, in line with our forecast
- ▶ Gas sales volume up 10% to 13.32bcm. Excluding impact of loss of a major customer in Chongqing, growth was 15.6%
- ▶ Overall gross margin dropped by 3.8ppt to 30.4% due to a lower margin for C&I/residential gas sales and a lower percentage contribution from connection fees

FY14/2H14 results summary

- ▶ **FY14 results were largely in line.** FY14e revenue came in at HKD28,717m vs our HKD31,315m estimate, and FY14e net attributable profit came in at HKD2,482m vs our HKD2,457m estimate. Revenue and net attributable profit in 2H represented 45% and 50%, respectively, of their full-year total vs our estimates of 59% and 49%. Total FY14 dividend was HKD0.25 vs HKD0.22 in FY13.
- ▶ FY14e gas sales volume was 13.32bcm, up 10% YoY (1H14: 6.82bcm; 2H13: 5.84bcm; FY13: 12.1bcm). Excluding the loss of a large customer at the Chongqing project, gas sales volume grew 15.6% YoY.
- ▶ **Gas sales volume at the Chongqing project (22.5%-owned associate) declined due to the cessation of supply to a large state-owned fertiliser plant which used c400mcm of gas annually as feedstock. Excluding the impact of the loss of this large customer in Chongqing, gross sale volume would have increased by 15.6% YoY.**
- ▶ **Connection fee income increased by 22% YoY** from HKD5,124m in 2013 to HKD6,236m in 2014 due to: a) an 18% increase in the daily installed capacity for commercial & industrial (C&I) customers from 40.31mcm to 47.43mcm; and b) a 13% increase in the number of connected households from 18.41m to 20.74m
- ▶ **The overall gross margin fell by 3.8ppt to 30.4% (1H14: 31.2%, FY13: 34.2%),** the decrease was due to:
 - a) **Gross margin of gas sales reduced from 25.8% in FY14 to 22.2%.** The lower overall gas sales margin was mainly due to **a)** slight dollar margin erosion in the industrial segment during the 2013/14 citygate price hikes and **b)** increase in gas sales mix to residential segment (FY14: 26% vs FY13: 25%). The gas sales dollar margin was RMB0.67/cm vs 1H14: RMB0.69/cm and FY13: RMB0.71/cm. In particular, the dollar margin per cm for the C&I segment was

RMB0.72/cm (FY13: RMB0.77) and for residential RMB0.17/cm (FY13: RMB0.25/cm).

Management explained that the drop in residential dollar margin was due to a change in the city mix. Indeed, in many of the new projects, the dollar margin of residential segment is lower than the overall average. Some are even loss-making in this segment. Typically projects in areas with higher gas price and relatively low gas supply will see lower residential margin. These areas include East/Northeast China and e.g. Changzhou.

- b) **Gross margin of connection fees decreased from 62.2% in FY14 to 59.8% due to changes in city mix** resulting in a reduction in average connection fee per household from RMB3,250 in 2013 to RMB3,160 in 2014.
- ▶ FY14 depreciation expenses came to HKD948m vs HKD572m in FY13, due to capex (operational capex was HKD3.9bn in FY13 and HKD3.4bn in FY14; M&A capex was HKD1.97bn in FY14) spent on project acquisition and construction of pipelines.
- ▶ **Individual projects:**
 - ▶ Tianjin project: During 2H14, the project more than passed through the new September 2014 citygate price increase, enabling it to offset dollar margin erosion resulting from the July 2013 price hike. For 2H14, the project recorded a net profit of cHKD3m vs a HKD92m loss in 1H14. The performance of the Tianjin project is expected to continue to improve in 2015.
 - ▶ Chongqing project: affected by the cessation of supply to the large fertilizer customers (400mcm gas usage pa). The FY14 profit contribution to CR Gas from Chongqing project was HKD83m vs HKD95m in FY13.
 - ▶ There are still c50-60 projects that are loss-making.

FY15e/Longer-term management guidance

FY15 guidance

- ▶ Maintain FY15e gas sales volume guidance: 16bcm; no separate guidance for Tianjin project yet as the new project general manager was just on board. CR Gas expects to be able to provide clearer guidance for FY15 gas sales volume for Tianjin project 1 month from now. CR Gas believes the 29 new projects obtained in FY14, plus the 24 projects that it has committed to invest in, will contribute to the c20% volume growth.
- ▶ The decline in gas sales volume (c400mcm pa) for Chongqing project due to cessation of supply to the large fertilizer customer is to be made up by supplying to Sinopec's industrial customer but CR Gas will only charge a RMB0.1/cm transmission fee.
- ▶ Qingdao project is expected to contribute to the volume growth for FY15e. FY14 gas sales volume was 380mcm. CR Gas expects FY15 gas sales volume to come to more than 400mcm. And by 2020, gas sales volume will double to c800mcm.
- ▶ Qinhuangdao project is likely to make a smaller contribution, as a JV is not expected to be set up until 2Q15. Gas sales volume from this project came to c225mcm in FY14.

- ▶ **No. of connection should be flat vs FY14 (c2.3m);**
- ▶ **Capex: HKD2-3bn for M&A and maintenance capex HKD3-4bn;**
- ▶ **No fixed target number on CNG/LNG stations new-build** but management believes can reach 300 stations by end FY15;
- ▶ **Expect gross margin to be better than in FY14.**
- ▶ **Gas cost should decrease by RMB0.11/cm after the decrease in citygate price effective 1 Apr 2015.**
- ▶ **Will look to invest in 10-20 projects in FY15**
- ▶ **If all residential projects adopts progressive gas tariff system, the dollar margin of residential segment is likely to increase by RMB0.05-0.08/cm**

Long-term guidance

- ▶ The group has made or committed to make a total investment of RMB1,554m in 29 city gas distribution and related projects in China (2013: investment of RMB643m in 27 projects). The company's board has approved investment into 24 projects (proposed investment is RMB674.9m) as at end FY14. These projects are located in Fujian, Guangdong, Guangxi, Hebei, Heilongjiang, Henan, Hunan, Inner Mongolia, Jiangsu, etc. **These 53 projects are expected to deliver a combined gas sales volume of 1bcm by 2020.**
- ▶ Management **may consider increasing dividend payout after the company achieves positive total cash flow. The company believes it is possible that it will achieve positive total cash flow in FY15.**
- ▶ CR Gas believes there are 4 gas-fired power plants planned to be/have been constructed. **Potential volume contribution from gas-fired power plants: 3.88bcm. CR Gas is likely to charge transmissions fee (e.g. RMB0.1-0.2/cm) when supplying to these plants.**

Consolidated income statement

HKDm	1H13	2H13	2H/FY13	FY13	1H14	2H14	2H/FY14	FY14	HSBC FY14	Actual vs HSBCe
Revenue	9,786	12,502	56%	22,288	12,846	15,871	55%	28,717	31,315	-8%
Cost of sales	(6,508)	(8,158)	56%	(14,666)	(8,832)	(11,169)	56%	(20,001)	(23,238)	-14%
Gross Profit	3,278	4,344	57%	7,622	4,014	4,702	54%	8,716	8,077	8%
Gross Margin (%)	33%	35%		34%	31%	30%		30%	26%	
Revenue YoY change %	76%	55%		64%	31%	27%		29%	41%	
COGS YoY change %	71%	47%		57%	36%	37%		36%	58%	
Other income	288	230	44%	518	408	507	55%	915	517	77%
Selling and distribution expenses	(1,036)	(1,338)	56%	(2,373)	(1,332)	(1,407)	51%	(2,739)	(2,262)	21%
Administrative expenses	(836)	(1,395)	63%	(2,231)	(968)	(1,488)	61%	(2,456)	(2,342)	5%
Share of results of associates/JCEs	473	326	41%	798	386	475	55%	861	838	3%
Finance costs	(297)	(227)	43%	(524)	(273)	(264)	49%	(537)	(496)	8%
Profit before tax	1,871	1,940	51%	3,811	2,235	2,524	53%	4,760	4,333	10%
Taxation	(393)	(594)	60%	(987)	(541)	(868)	62%	(1,409)	(1,122)	26%
Net income	1,478	1,346	48%	2,824	1,694	1,656	49%	3,351	3,210	4%
Net Margin (%)	15%	11%		13%	13%	10%		12%	10%	
Profit attributable to:										
Owners of the Company	1,067	1,094	51%	2,161	1,251	1,231	50%	2,482	2,457	1%
Non-controlling interests	411	251	38%	663	443	426	49%	869	754	15%
Normalized attributable profit	1,074	1,087	50%	2,161	1,250	1,232	50%	2,482	2,457	1%
YoY / HoH growth	41.0%	21.2%		30.9%	16.3%	13.4%		14.8%	13.7%	
Earnings per share (HKD)	0.49	0.51	51%	1.00	0.58	0.56	49%	1.14	1.13	1%
YoY / HoH growth	28.9%	15.9%		22.0%	18.4%	9.8%		14.0%	13.2%	
Dividends per share (HKD cents)	2.00	20.00	91%	22.00	5.00	20.00	80%	25.00	24.90	0%
YoY / HoH growth		42.9%		37.5%	150.0%	0.0%		13.6%	13.2%	

Source: Company data, HSBC

Earnings revisions

- ▶ We have made adjustments of -1.3% to 3.0% in our FY15e, FY16e and FY17e EPS estimates
- ▶ We adjust our dollar margin estimates for residential/C&I gas sales based on actual FY14 numbers
- ▶ We also increase depreciation expense for the forecast period based on actual FY14 numbers

Earnings revision

We revised our FY15e, FY16e, and FY17e, as we decrease the residential gas sales dollar margin but increase our C&I gas sales dollar margin for the forecast period based on the actual numbers in FY14. We have also increased the depreciation expense based to reflect the actual magnitude of depreciation in FY14.

Our FY15e, FY16e and FY17e EPS estimates are 5%, 12%, and 9%, respectively, below consensus.

Earnings revisions summary

HKDm	2015e	2016e	2015e
Revenues			
New	37,823	42,504	49,395
Old	37,706	44,142	53,191
% change	0.3%	-3.7%	-7.1%
Operating Profit			
New	3,835	4,141	4,755
Old	3,822	4,149	4,931
% change	0.3%	-0.2%	-3.6%
HSBC EPS			
New	1.26	1.37	1.56
Old	1.22	1.34	1.58
% change	3.0%	2.1%	-1.3%
DPS			
New	0.28	0.30	0.34
Old	0.27	0.30	0.35
% change	2.6%	1.8%	-1.6%

Source: HSBC estimates

Valuation

Valuation metrics summary

	New	Old	Change
PE Valuation			
Target PEG	1.0x	1.0x	-
Justified PE based on PEG	12.0x	13.0x	-1.0x
EPS 2015e	1.26	1.22	3.0%
Value per share	15.14	15.92	-4.9%
ROE implied PB Valuation			
RoE	16.41%	16.19%	0.2%-pts
CoE	5.26%	5.26%	-
ROE implied justified PB	3.1x	3.1x	0.0x
BVPS 2015e	8.43	8.42	0.1%
Value per share	26.14	26.11	0.1%
DCF (HKD)	24.80	24.35	1.9%
Target Price (HKD)	22.00	22.10	-0.5%

Source: HSBC estimates

We reiterate our Hold rating with a revised fair value TP of HKD22.0 (was HKD22.10) based on the straight average of our PE, PB, and DCF valuations. The PE valuation of HKD15.14 (was HKD15.92) is based on a 12.0x (was 13.0x) 2015e PE (based on 1x 2015e-17e PEG). The PB valuation of HKD26.14 (was HKD26.11) is based on an ROE-implied PB of 3.1x (was 3.1x) with a 16.41% ROE and 1% growth rate. The DCF valuation is HKD24.8 (was HKD24.3) on a 5.7% WACC, 3.5% risk-free rate, 5.5% equity risk premium and 0.49 beta.

Upside risks: availability of gas allows higher growth, improved utilisation of existing gas pipelines, strong volume growth, and an increase in the share of C&I customers. **Downside risks:** a fall in industrial volumes with slowing GDP and any future citygate price hikes not being passed through to customers.

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Gloria Ho and Jenny Cosgrove

Important disclosures

Equities: Stock ratings and basis for financial analysis

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was 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 had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 27 March 2015, the distribution of all ratings published is as follows:

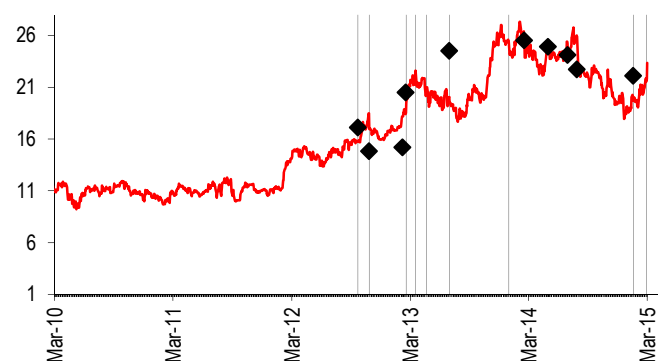
Buy	41%	(29% of these provided with Investment Banking Services)
Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

China Resources Gas Group (1193.HK) Share Price performance HKD Vs

HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Neutral	16 October 2012
Neutral	Underweight	20 November 2012
Underweight	Neutral	13 March 2013
Neutral	Underweight	12 April 2013
Underweight	Restricted	15 May 2013
Restricted	Overweight	25 July 2013
Overweight	Underweight	24 January 2014
Underweight	Neutral	12 February 2015
Neutral	Hold	25 March 2015
Target Price	Value	Date
Price 1	17.10	16 October 2012
Price 2	14.80	20 November 2012
Price 3	15.20	03 March 2013
Price 4	20.50	13 March 2013
Price 5	Restricted	15 May 2013
Price 6	24.50	25 July 2013
Price 7	25.50	13 March 2014
Price 8	24.90	25 May 2014
Price 9	24.10	24 July 2014
Price 10	22.70	22 August 2014
Price 11	22.10	12 February 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
CHINA RESOURCES GAS GROUP LTD	1193.HK	23.35	27-Mar-2015	6, 7

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 28 February 2015 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
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