

JPM-pp1

Asia Pacific Equity Research

27 March 2015

China Resources Gas Group Limited (1193 HK)

Overweight

Price: HK\$21.80

26 Mar 2015

Price Target: HK\$25.50

PT End Date: 31 Dec 2015

FY14 results in-line; M&A revival the positive surprise

- **FY14 results in line:** CR Gas announced FY14 results overnight. Net profits of HK\$2.48B represented a +15% Y/Y growth, largely in line with consensus. The profit growth was mainly driven by (1) gas sales volume growth (attributable growth of 14% Y/Y), and (2) connection fees (segment profit up 14% Y/Y).
- **Positive developments in Tianjin:** Management highlighted that (1) a healthy relationship has been restored with the JV partner (TJ Gas) and a new business plan will be rolled out very soon, (2) the gas tariff hike in Sep 2014 (which more than offset the Jul 2013 gas cost hike) has led to a significant profit turnaround from HK\$45MM loss in 1H2014 to a HK\$1.4MM profit in 2H2014 (4Q2014: >HK\$30MM), and (3) Binhai region (now under TJ Tianlian, 1265 HK, NR) will ultimately be injected into the CR Gas JV.
- **M&A coming back:** In addition to the new Qingdao concession (announced in mid-March), management also signed a framework agreement for a new gas JV in Qinghuangdao (the only city gas project with > 200MM m³ annual gas consumption available for acquisition over the past 3 years). Management sees the two acquisitions as a major milestone to signal the company's revival in the M&A market. Management targeted Rmb3B in M&A capex this year (2014: Rmb1.6B), of which ~50% will be allocated to the Qingdao / Qinghuangdao projects. With a <35% net gearing, management were comfortable with the capex plan.
- **Gas prices:** Management expected a further gas cost cut under the current gas pricing formula, but did not provide any guidance on the exact timing. Also, management expected a slight margin improvement Y/Y on piped gas sales to non-residential users by delaying the corresponding end user tariff cut following the gas cost cut (effective Apr 2014).
- **Gas volume growth:** Total gross gas sales volume picked up slightly in 2H14 to 11% from 9% in 1H14. Management expected a >10% Y/Y volume growth this year, consistent with piped gas sales volume growth in Jan-Feb 2015 (+13% Y/Y, excluding Chongqing) and attributable volume growth (+14% Y/Y) last year, but lower than original target of +20% Y/Y to reach the 160B m³ mark. Most gas sales foregone from the SOE fertilizer in Chongqing last year (400MM m³ annual consumption) have been replaced by new transmission volume demand from Sinopec's industrial customer at Rmb0.1/m³ transmission fee.
- **Operating CF** declined by 2% Y/Y last year despite the solid profit growth, mainly due to weaker working capital, according to management.
- **An impairment provision of Rmb125MM** was made last year, mainly due to porcelain producers in the Jingde project.
- **Future upstream competition:** Management sees limited risk from potential competition arising from direct gas supplies to major industrial users by oil majors under the gas pricing policies announced in Mar this year.
- **Maintain OW:** We believe the market will take the FY14 results / management 2015 outlook as positive, particularly on (1) the expected profit turnaround in TJ, (2) signs of potential demand revival and, most importantly, (3) M&A revival.

Investment Thesis

China Resources Gas Group Limited is the city gas distribution arm of the China Resources Group, engaging in piped natural or petroleum gas distribution and operating CNG (compressed natural gas) filling stations in the PRC. Its piped natural gas operations are strategically located in areas of China with rich reserves of natural gas and areas which are economically more developed and densely populated. It operates >170 city gas projects as at the end of 2013, one of the highest amongst listed peers.

Valuation

Our Dec-15 PT of HK\$25.50 is based on DCF with a 10.0% WACC and a 2% terminal growth.

Risks to Rating and Price Target

Downside risks to our Overweight rating and PT include (1) higher-than-expected valuations paid for new city gas projects, (2) delays in new project acquisitions and (3) lower-than-expected gas cost pass through in the event of upstream natural gas cost hikes.

China city gas

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Table 1: Summary of FY14 results

HK\$MM	1H12 (restated)	1H13 (restated)	1H14	Y/Y	2H12	2H13	2H14	Y/Y	2012 (restated)	2013	2014	Y/Y
Turnover	5,572	9,786	12,846	31	8,050	12,502	15,871	27	13,622	22,288	28,717	29
Gas sales	4,744	8,039	10,633	32	5,982	9,126	11,847	30	10,725	17,164	22,481	31
Gas connection	828	1,747	2,212	27	2,068	3,376	4,024	19	2,896	5,124	6,236	22
Cost of sales	(3,817)	(6,508)	(8,832)	36	(5,552)	(8,158)	(11,169)	37	(9,369)	(14,666)	(20,001)	36
Gross profit	1,755	3,278	4,014	22	2,498	4,344	4,702	8	4,253	7,622	8,716	14
Gross margin (%)	31	33	31	(2)	31	35	30	(5)	31	34	30	(4)
Operating profit	1,293	2,167	2,508	16	1,591	2,167	2,789	29	2,884	4,334	5,297	22
Gas sales	553	863	1,076	25	706	1,384	1,579	14	1,259	2,247	2,655	18
Gas connection	342	785	985	26	1,004	1,708	1,859	9	1,346	2,493	2,844	14
Others (including asso/JV pickup)	398	519	447	(14)	(119)	(924)	(649)	(30)	278	(405)	(202)	(50)
Operating profit margin (%)	23	22	20	(3)	20	17	18	0	21	19	18	(1)
Finance costs	(105)	(297)	(273)	(8)	(210)	(227)	(264)	16	(315)	(524)	(537)	3
Profit before tax	1,188	1,871	2,235	19	1,381	1,940	2,524	30	2,569	3,811	4,760	25

Tax	(239)	(393)	(541)	38	(300)	(594)	(868)	46	(540)	(987)	(1,409)	43
MI	(186)	(411)	(443)	8	(197)	(251)	(426)	69	(384)	(663)	(869)	31
Net profit	762	1,067	1,251	17	883	1,094	1,231	12	1,646	2,161	2,482	15
Net profit margin (%)	14	11	10	(1)	11	9	8	(1)	12	10	9	(1)
EPS (HK\$)	0.38	0.49	0.58	18.37	0.44	0.51	0.56	10	0.82	1.00	1.14	14
Net Gearing (%)	(20)	39	37	(2)	10	30	33	2	10	30	33	2
Margin analysis (%)												
Operating profit margin (%)	23.2	22.1	19.5	(2.6)	19.8	17.3	17.6	0.2	21.2	19.4	18.4	(1.0)
Gas sales	11.7	10.7	10.1	(0.6)	11.8	15.2	13.3	(1.8)	11.7	13.1	11.8	(1.3)
Gas connection	41.3	44.9	44.5	(0.4)	48.5	50.6	46.2	(4.4)	46.5	48.6	45.6	(3.0)
Gas sales volume (MM m³)	4,248	6,251	6,816	9	5,020	5,840	6,507	11	9,268	12,091	13,323	10

Source: Company data, J.P. Morgan calculations

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
01-Mar-12	OW	12.04	15.00

14-Mar-12	OW	13.48	17.10
14-Mar-13	OW	18.50	20.50
31-May-13	NR	20.30	--
26-Aug-13	N	17.98	20.50
14-Mar-14	N	25.40	21.70
22-Jul-14	OW	24.35	30.00
11-Feb-15	OW	19.90	25.50

<http://gps-app.amer.jpmchase.net:6080/server/console/chart/?shareClassId=504805&shareClassServerId=4&chartDesignation=1&actionType=C>

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