

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

## Reduce

Target price (HKD)	7.20
Share price (HKD)	7.75
Upside/Downside (%)	-7.1

Performance	1M	3M	12M
Absolute (%)	-8.3	3.7	-39.8
Relative <sup>A</sup> (%)	-1.7	-4.4	-52.6

Index <sup>A</sup>	HSCEI
RIC	0135.HK
Bloomberg	135 HK
Market cap (USDm)	8,069
Market cap (HKDm)	62,561
Enterprise value (HKDm)	100650
Free float (%)	100

**22 June 2015**

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# Kunlun Energy (135 HK)

Reduce: Weak gas demand, ShaanJing IV timing and ramp-up cloud earnings outlook

- ▶ **According to NDRC, China's natural gas consumption declined by 5% y-o-y in May, following a 6% drop in April**
- ▶ **This implies downside risks to transmission volume of Kunlun's ShaanJing pipeline**
- ▶ **Reiterate Reduce with TP at HKD7.2**

**Event:** According to NDRC, in May 2015, China's natural gas consumption decline by 5% y-o-y to 13.5bcm, with production flat y-o-y at 10.3bcm and imports down by 9.4% to 4.4bcm. It is the second monthly demand decline in this year. In 5M15, total demand rose by a mere 2.1%, significantly lower than 2014's 6% and 2013's 13% (the NDRC data).

### Implications for Kunlun Energy:

**Downside risks to transmission volume:** Our model assumes Shanxi-Beijing(ShaanJing) pipeline volumes grow 9% y-o-y to 33bcm in 2015e. With national gas demand turning much weaker, volume may miss our forecast. The ShaanJing I-III pipeline system (35bcm capacity) is near full utilisation (87% in 2014 and 95% in 2015e). Thus, volume for I-III pipes is capped. Other key downside risks include: 1) sustainable level of transmission tariffs (possible cuts) and 2) ShaanJing IV (25bcm) commissioning timing (possible delays) and related utilization ramp-up. Kunlun's pipeline segment generates c70% of the operating profit and sum of the parts (SOTP) valuation; therefore, pipeline earnings uncertainty presents a downside share price risk.

**Gas sales volume growth is likely to remain subdued:** Kunlun's gas sales volume (incl. city gas projects, CNG and LNG stations) growth is mediocre at 10% in 2014. Compared to peers, Kunlun's volume growth momentum are weaker due to the less favourable geographic layout of its city gas projects and high exposure to LNG stations. Its LNG stations are still unprofitable even after a nationwide city-gate price cut in April 2015. We forecast its gas volume to grow by 10%/9%/9% in 2015/16/17e.

**Valuation and risks:** We maintain our Reduce rating with TP of HKD7.2. Our TP is derived from the SOTP of DCF (WACC of 10% based on a risk-free rate of 3.5%, market risk premium of 10%, beta of 1.0, cost of debt of 3.5% and a 25% debt weighing) for the E&P business (HKD0.4 per share) and 8-12x 2015e PE target multiples for the gas related segments: gas sales (8x), LNG processing (10x), LNG terminal (10x), and pipeline business (12x). We think the target multiples are reasonable after referencing the trading multiples of other Chinese gas utility companies. **Upside risks:** sharp rebound of oil prices, supportive policy towards natural gas vehicles and execution of asset injections.

## Financials & valuation

### Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
<b>Profit &amp; loss summary (HKDm)</b>				
Revenue	48,044	49,961	54,171	60,411
EBITDA	16,456	17,653	20,022	22,503
Depreciation & amortisation	-5,392	-6,261	-6,875	-7,399
Operating profit/EBIT	11,064	11,392	13,148	15,103
Net interest	-80	-569	-611	-531
PBT	11,956	11,267	13,065	15,047
HSBC PBT	11,956	11,267	13,065	15,047
Taxation	-3,080	-2,903	-3,366	-3,876
Net profit	5,610	5,179	5,991	7,064
HSBC net profit	5,610	5,179	5,991	7,064

### Cash flow summary (HKDm)

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Cash flow from operations	14,097	14,349	16,413	18,641
Capex	-10,160	-19,289	-14,127	-5,154
Cash flow from investment	-8,378	-18,279	-13,065	-4,328
Dividends	-3,275	-2,883	-2,728	-3,165
Change in net debt	-2,299	6,812	-620	-11,149
FCF equity	4,478	-4,830	2,528	13,845

### Balance sheet summary (HKDm)

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Intangible fixed assets	1,509	1,569	1,701	1,897
Tangible fixed assets	89,821	102,984	110,533	108,726
Current assets	19,615	18,049	19,448	31,750
Cash & others	10,729	8,809	9,429	20,577
Total assets	117,710	128,822	137,416	147,827
Operating liabilities	17,099	17,781	19,280	21,500
Gross debt	24,883	29,775	29,775	29,775
Net debt	14,154	20,966	20,346	9,198
Shareholders funds	52,888	56,453	60,954	66,295
Invested capital	83,117	96,013	102,974	100,296

### Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
<b>Y-o-y % change</b>				
Revenue	10.6	4.0	8.4	11.5
EBITDA	-3.6	7.3	13.4	12.4
Operating profit	-11.7	3.0	15.4	14.9
PBT	-16.7	-5.8	16.0	15.2
HSBC EPS	-18.1	-7.7	15.7	17.9

### Ratios (%)

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Revenue/IC (x)	0.6	0.6	0.5	0.6
ROIC	9.9	9.4	9.8	11.0
ROE	10.9	9.5	10.2	11.1
ROA	7.7	7.2	7.7	8.2
EBITDA margin	34.3	35.3	37.0	37.2
Operating profit margin	23.0	22.8	24.3	25.0
EBITDA/net interest (x)	205.4	31.0	32.8	42.4
Net debt/equity	19.0	26.3	23.4	9.7
Net debt/EBITDA (x)	0.9	1.2	1.0	0.4
CF from operations/net debt	99.6	68.4	80.7	202.7

### Per share data (HKD)

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EPS reported (fully diluted)	0.69	0.64	0.74	0.88
HSBC EPS (fully diluted)	0.69	0.64	0.74	0.88
DPS	0.20	0.18	0.21	0.25
Book value	6.55	7.00	7.55	8.21

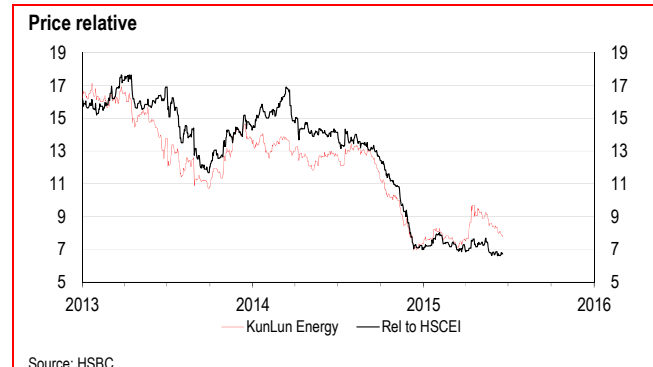
### Key forecast drivers

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Brent price (USD/bbl)	98.9	62.5	75.0	90.0
Gas sales price (Rmb/cm)	3.1	3.1	3.0	3.0
Transmission tariff (Rmb/cm)	0.3	0.3	0.3	0.3
Gas sales volume (mn cm)	6,845.3	7,524.6	8,204.0	8,905.8
Transmission volume (mn cm)	30,692.5	33,388.8	37,677.7	44,017.9
LNG terminal volume (mn cm)	5,181.0	5,741.1	7,701.5	8,121.6

### Valuation data

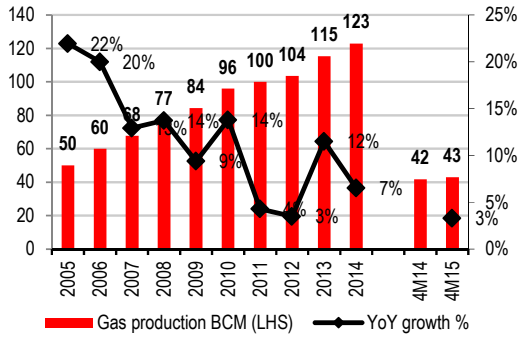
Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	1.9	2.0	1.9	1.6
EV/EBITDA	5.6	5.7	5.1	4.2
EV/IC	1.1	1.0	1.0	0.9
PE*	11.2	12.1	10.4	8.9
P/Book value	1.2	1.1	1.0	0.9
FCF yield (%)	5.8	-6.1	3.1	16.2
Dividend yield (%)	2.6	2.4	2.8	3.2

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



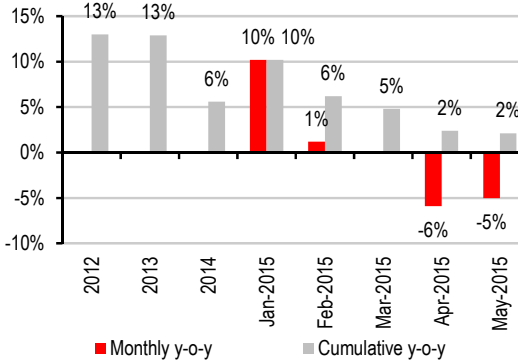
Note: price at close of 19 Jun 2015

**China's natural gas apparent consumption (bcm) and y-o-y growth (%), HSBC calculation, 2005-4M15**



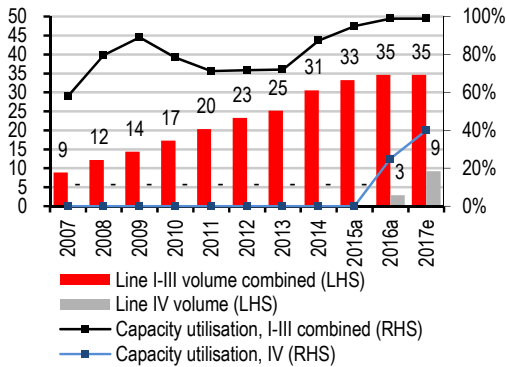
Source: National Bureau of Statistics (NBS) of China, Thomson Reuters, HSBC

**China's natural gas apparent consumption monthly and cumulative y-o-y growth (%), NDRC reports, 2012-May 2015**



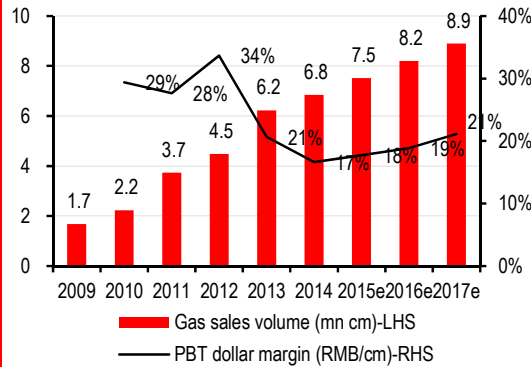
Source: NDRC

**ShaanJing pipeline transmission volume (bcm) and capacity utilisation (%), 2007-17e**



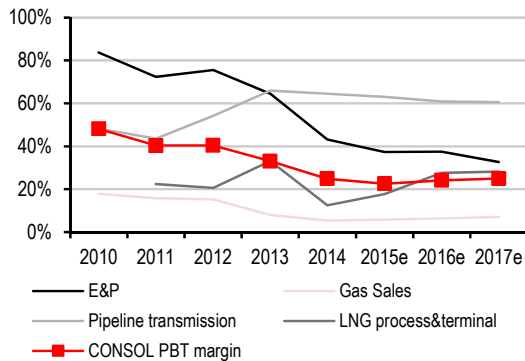
Source: Kunlun Energy, HSBC estimates

**Kunlun gas sales volume (bcm) and y-o-y growth (%), 2009-17e**



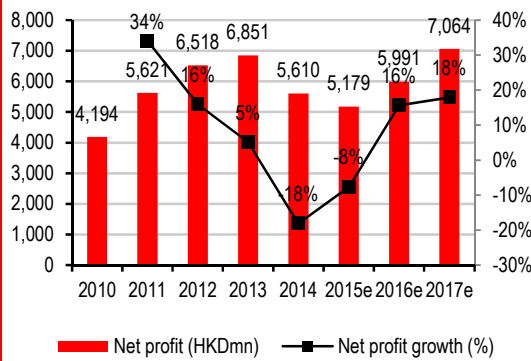
Source: Kunlun Energy, HSBC estimates

**Kunlun PBT margin by segment, %, 2010-17e**



Source: Kunlun Energy, HSBC estimates

**Kunlun net profit and growth rate, 2010-17e**



Source: Kunlun Energy, HSBC estimates

# Disclosure appendix

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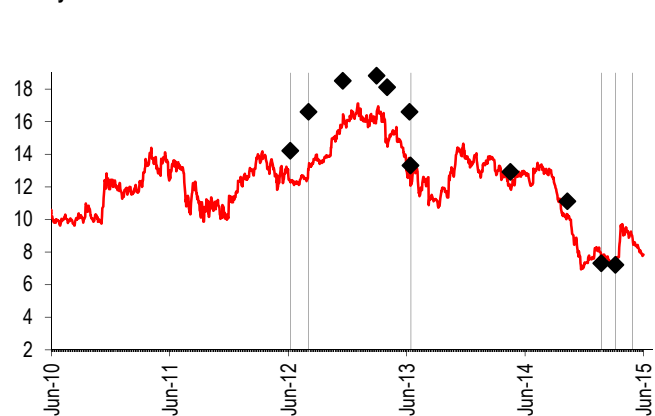
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<b>Hold</b>	43%	(28% of these provided with Investment Banking Services)
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## Share price and rating changes for long-term investment opportunities

KunLun Energy (0135.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

### Recommendation & price target history

From	To	Date
N/A	Neutral	28 June 2012
Neutral	Overweight	23 August 2012
Overweight	Neutral	04 July 2013
Neutral	Underweight	12 February 2015
Underweight	Hold	27 March 2015
Hold	Reduce	18 May 2015
Target Price	Value	Date
Price 1	14.20	28 June 2012
Price 2	16.60	23 August 2012
Price 3	18.50	06 December 2012
Price 4	18.80	21 March 2013
Price 5	18.10	23 April 2013
Price 6	16.60	01 July 2013
Price 7	13.30	04 July 2013
Price 8	12.90	08 May 2014
Price 9	11.10	30 October 2014
Price 10	7.30	12 February 2015
Price 11	7.20	27 March 2015

Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
KUNLUN ENERGY	0135.HK	7.83	22-Jun-2015	1, 2, 5, 6, 7, 11

Source: HSBC

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