

Guangshen Railway [525.HK]

Railway reform on track, Guangshen Railway is worth revisiting

Guangshen Railway (GSR) share price fell 14% CYTD, led by 1) the increasing market volatility since February and 2) the rail passenger tariff hike below market expectation. However, the share price has stabilized and rebounded gradually since late April after the release of Q1 2018 results. China Railway Corporation (CRC)'s freight business reform has drove GSR's earnings growth in Q1 2018. GSR reported its revenue rose 13.2% YoY and net profit grew 57.9% YoY in Q1 2018, well above market expectation. CRC has strong incentives to boost its profitability to reduce leverage and resolve funding issues through future asset securitization. Even the passenger tariff hike of regular trains may not happen that fast as market expect, CRC's market-oriented pricing strategy of its high-speed train services means GSR should also have the opportunity to raise passenger tariff of its intercity train services. We think the railway reform is in place to boost GSR's profitability and ROE. We raise our core earnings forecast for the Company in 2018-2019E by 10-32% to reflect GSR's strong Q1 2018 results. We now expect it will book the one-off disposal gain from the land asset sales in 2019E, which is to lift its 2019E earnings by >55%. We maintain our BUY rating on GSR and target price (TP) of HK\$6.25. Our TP is based on a SOTP valuation method, which implies a 1.2x 2018E PBR. The stock currently traded on only 0.9x 2018E PBR.

Investment Highlights

- Recap: Strong Q1 2018 results driven by railway business reform:** GSR reported its revenue rose 13.2% YoY in Q1 2018. With margin expansion, the net profit rose 57.9% YoY. The passenger traffic grew 2.5% YoY in Q1 2018. The strong revenue growth was mainly boosted by its freight transportation business, which growth was mainly helped by the rule change in freight transportation revenue booking between different railway bureaus. Under the new rule, GSR is allowed to book full revenue for freight transportation originated from its own train stations. Previously, GSR can only book revenue for freight transportation on rail section between its own train stations. The rule change could be seen as CRC's effort to enhance profitability of its listed business platforms to build investment cases for future asset securitization.
- Passenger rail tariff hike to further boost earnings:** Under the deleveraging environment, CRC's priority is to deepen its business reform to improve profitability, thereby to resolve funding issues. Other than expanding its higher-margin freight transportation business, CRC tries to improve profitability of its high-speed train services by means of increasing high-speed train operation density and raising passenger rail tariff. The passenger rail tariff hike of regular train services will likely take longer time than market expected. But the tariff hike of the high-speed train services on certain routes already took place last year. CYTD, CRC has adopted more market-oriented pricing strategy for its high-speed train services. Overall, we expect to see an upward trend for rail passenger tariff in the long term. In our model, we expect GSR's passenger yield increase of around 5% p.a. in 2018-2019E. Our earnings sensitivity analysis shows that every 5ppt increase in our passenger yield growth assumption boosts our core earnings forecast for the Company in 2018E by 6-12% (Fig 6).
- Land asset sales could be sustainable to release GSR's hidden asset value:** GSR's land sales in Guangzhou should provide it with a disposal gain of >Rmb1.3bn. GSR announced the payoff of this land sales will be Rmb1,305m. The book value of this parcel of land is only Rmb2.2m. GSR has ownership for 13m sqm of land it acquired from its parent company during its initial listing. The historical cost of these land is only Rmb130 per sqm. CRC has an incentive to redevelop its land resources, which helps it generate funds for railway development. We expect to see more similar deals in coming years to help release GSR's hidden asset value.
- Maintain BUY and TP of HK\$6.25:** We apply the SOTP valuation method to derive our valuation to better reflect the valuation accretion from its land asset development initiative (Fig 7).

Y/E Dec 31	2015	2016	2017	2018E	2019E
Turnover (RMB m)	15,725	17,281	18,331	20,395	22,075
Reported net profit (RMB m)	1,071	1,158	1,015	1,538	2,729
Net margin (%)	6.8	6.7	5.5	7.5	12.4
Reporting EPS (RMB)	0.15	0.16	0.14	0.22	0.39
% change	61.8%	8.2%	-12.3%	51.5%	77.5%
Recurring EPS (Rmb)	0.15	0.16	0.14	0.22	0.25
% change	61.8%	8.2%	-12.3%	51.5%	13.9%
PER(x)	24.3	22.5	25.7	16.9	14.9
PBR(x)	0.9	0.9	0.9	0.9	0.9
EV/EBITDA(x)	8.4	8.1	8.3	6.5	4.3

Source: Company data, CGIS Research

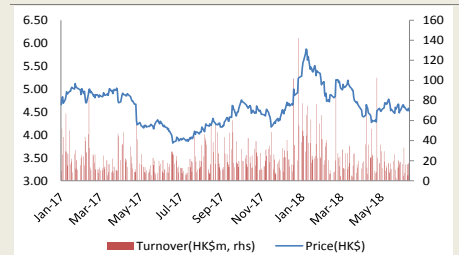
China Railway Sector

Buy

Close: HK\$4.52 (June 14, 2018)

Target Price: HK\$6.25 (+38.3%)

The Price Performance



Market Cap	US\$4,803m
Shares Outstanding	7,084m
Auditor	PWC
Free Float	62.9% (H-share)
52W range	HK\$3.72-5.89
3M average daily T/O	US\$3m
Major Shareholding	Guangzhou Railway (Group) Company (37.1%)

Sources: Company data, Bloomberg

Kelly Zou—Analyst

(852) 3698-6319

kellyzou@chinastock.com.hk

Wong Chi Man, CFA—Head of Research

(852) 3698-6317

cmwong@chinastock.com.hk

Key financials

Guangshen Railway (525 HK)												
P&L statement and key revenue segment forecast												
(RMB m, except for per share amount)												
FY ended 31 Dec	1H15	2H15	1H16	2H16	1H17	2H17	2015	2016	2017	2018E	2019E	
Sales Revenue	7,375	8,350	8,079	9,202	8,412	9,919	15,725	17,281	18,331	20,395	22,075	
Operating expense	-6,590	-7,567	-7,165	-8,473	-7,745	-9,188	-14,157	-15,638	-16,933	-18,301	-19,699	
Operating profit	785	784	914	729	667	731	1,569	1,643	1,399	2,094	2,376	
Other gains and losses	-152	-1	-26	-107	-6	-62	-153	-133	-67	-71	1,228	
Total EBIT	633	783	888	622	662	670	1,416	1,509	1,331	2,023	3,604	
Depreciation & Amortisation	721	691	715	804	880	783	1,412	1,519	1,662	1,747	1,729	
EBITDA	1,354	1,474	1,603	1,426	1,541	1,453	2,828	3,028	2,994	3,770	5,333	
Net finance costs	19	15	13	14	5	4	34	27	9	14	19	
Profits from associates and JCEs	1	1	6	1	7	0	2	7	7	7	8	
Pre-Tax Profit	653	799	907	637	673	674	1,452	1,544	1,347	2,044	3,631	
Tax Expense	-190	-198	-227	-163	-167	-169	-389	-390	-335	-509	-905	
Net Profit After Tax	463	600	680	474	506	506	1,063	1,154	1,012	1,535	2,726	
Minority Interest	2	6	2	2	2	1	8	5	4	4	4	
Reported Earnings (attributable)	465	606	682	476	509	507	1,071	1,158	1,015	1,538	2,729	
Adjusted Earnings	465	606	682	476	509	507	1,071	1,158	1,015	1,538	1,752	
EPS (rep)	0.07	0.09	0.10	0.07	0.07	0.07	0.15	0.16	0.14	0.22	0.39	
EPS (adj)	0.07	0.09	0.10	0.07	0.07	0.07	0.15	0.16	0.14	0.22	0.25	
DPS	0.00	0.08	0.00	0.08	0.00	0.08	0.08	0.08	0.08	0.12	0.22	
% YoY growth												
Revenue	2.9%	9.4%	9.5%	10.2%	4.1%	7.8%	6.2%	9.9%	6.1%	11.3%	8.2%	
EBIT	37.9%	64.8%	40.2%	-20.6%	-25.4%	7.7%	51.6%	6.6%	-11.8%	51.9%	13.8%	
Recurring net profit	41.4%	81.8%	46.7%	-21.4%	-25.4%	6.3%	61.8%	8.2%	-12.3%	51.5%	13.9%	
Margins and ratios												
EBITDA Margin	18.4%	17.6%	19.8%	15.5%	18.3%	14.6%	18.0%	17.5%	16.3%	18.5%	18.3%	
EBIT Margin	8.6%	9.4%	11.0%	6.8%	7.9%	6.8%	9.0%	8.7%	7.3%	9.9%	10.4%	
Recurring net profit margin	6.3%	7.3%	8.4%	5.2%	6.0%	5.1%	6.8%	6.7%	5.5%	7.5%	7.9%	

Revenue breakdown(Rmb m)	2015	2016	2017	2018E	2019E
<i>Intercity trains</i>	2,224	2,413	2,566	2,776	3,002
<i>Hong Kong through trains</i>	510	528	523	576	604
<i>Long-distance trains</i>	4,263	4,418	4,667	4,901	5,043
Passenger transportation	6,998	7,359	7,757	8,252	8,649
Freight transportation	1,761	1,718	1,894	2,737	3,222
Railway network usage	2,934	3,179	3,306	3,472	3,645
Railway operation service to new HSRs	2,941	3,915	4,338	4,846	5,416
Other business	1,092	1,110	1,037	1,088	1,143
Total revenue	15,725	17,281	18,331	20,395	22,075
% YoY					
<i>Intercity trains</i>	5.2%	8.5%	6.4%	8.2%	8.1%
<i>Hong Kong through trains</i>	-3.1%	3.5%	-0.9%	10.0%	5.0%
<i>Long-distance trains</i>	-1.9%	3.6%	5.7%	5.0%	2.9%
Passenger transportation	0.1%	5.2%	5.4%	6.4%	4.8%
Freight transportation	-0.1%	-2.5%	10.2%	44.5%	17.7%
Railway network usage	2.6%	8.4%	4.0%	5.0%	5.0%
Railway operation service to new HSRs	35.5%	33.1%	10.8%	11.7%	11.8%
Other business	7.3%	1.7%	-6.6%	5.0%	5.0%
Total revenue	6.2%	9.9%	6.1%	11.3%	8.2%
% of total					
<i>Intercity trains</i>	14%	14%	14%	14%	14%
<i>Hong Kong through trains</i>	3%	3%	3%	3%	3%
<i>Long-distance trains</i>	27%	26%	25%	24%	23%
Passenger transportation	44%	43%	42%	40%	39%
Freight transportation	11%	10%	10%	13%	15%
Railway network usage	19%	18%	18%	17%	17%
Railway operation service to new HSRs	19%	23%	24%	24%	25%
Other business	7%	6%	6%	5%	5%
Total revenue	100%	100%	100%	100%	100%

Key financials

Guangshen Railway (525 HK)											
Balance sheet, cash flow statements and ratios											
(RMB m, except for per share amount)											
Balance sheet	2015	2016	2017	2018E	2019E	Cash flow statement	2015	2016	2017	2018E	2019E
Cash	2,327	1,468	1,269	1,718	3,001	EBITDA	2,828	3,028	2,994	3,770	5,333
Trade and bill receivables	2,886	3,364	4,142	4,176	4,520	Net Interest Paid	34	27	9	14	19
Inventories	307	333	331	358	386	Tax Paid	-389	-390	-335	-509	-905
Prepayments	143	330	314	359	388	Change in Working Cap	-606	-1,009	-421	42	-8
Total current assets	5,663	5,495	6,056	6,611	8,295	Others	396	-14	390	0	-1,303
Long-term equity investment	169	168	175	182	189	Operating Cash Flow	2,263	1,643	2,637	3,316	3,137
PPE, net	24,643	25,068	25,048	25,256	25,491	Acquisitions	-61	0	0	0	0
Other intangible assets	949	1,625	1,980	2,325	2,659	Capex	-1,292	-1,974	-2,273	-2,300	-2,300
Goodwill	281	281	281	281	281	Asset Sales	8	18	1	0	1,305
Long-term receivables	31	31	31	31	31	Others	-7	18	6	0	0
Deferred tax assets	93	80	37	37	37	Investing Cashflow	-1,352	-1,938	-2,266	-2,300	-995
Other	115	122	384	384	384	Dividend (ordinary)	-354	-567	-569	-567	-858
Total non-current assets	26,281	27,375	27,936	28,497	29,073	Equity Raised	0	0	0	0	0
Total assets	31,943	32,870	33,992	35,107	37,368	Debt Movements	0	0	0	0	0
Trade and bill payable	1,105	1,144	1,325	1,334	1,436	Others	-1	0	0	0	0
Short term Debt	0	0	0	0	0	Financing Cashflow	-355	-567	-569	-567	-858
Other payables and accruals	2,890	3,384	3,678	3,816	4,108	Exchange difference	0	0	0	0	0
Dividend payable	14	16	13	305	969	Net Chg in Cash/debt	556	-861	-199	449	1,283
Tax payable	314	122	149	149	149	FCF	910	-294	370	1,016	2,141
Total current liabilities	4,324	4,665	5,165	5,604	6,663						
Long Term Debt	0	0	0	0	0						
Deferred tax liabilities	71	69	66	66	66	Valuation					
Other non-current liabilities	104	107	106	106	106	PE(x)	24.3	22.5	25.7	16.9	14.9
Total non-current liabilities	175	176	172	172	172	EPS growth (%)	61.8	8.2	-12.3	51.5	13.9
Total liabilities	4,499	4,840	5,337	5,776	6,835	Yield(%)	2.2	2.2	2.2	3.3	5.8
Shareholders Fund	27,462	28,054	28,685	29,364	30,570	PEG(%)	0.4	2.8	-2.1	0.3	1.1
Minority Interest	-18	-24	-28	-31	-35	EV/EBITDA(x)	8.4	8.1	8.3	6.5	4.3
Total S/H Equity	27,444	28,030	28,657	29,333	30,536	PB(x)	0.9	0.9	0.9	0.9	0.9
Total Liab & S/H Fund	31,943	32,870	33,994	35,110	37,370	Operational					
						Revenue growth(%)	6.2	9.9	6.1	11.3	8.2
						EBIT margin(%)	9.0	8.7	7.3	9.9	10.4
						Net profit margin(%)	6.8	6.7	5.5	7.5	7.9
						Days receivables	53	64	71	81	80
						Days payables	82	97	99	103	101
						Days inventories	11	8	8	7	7
						Current ratio(x)	1.3	1.2	1.2	1.2	1.2
						Quick ratio(x)	1.2	1.1	1.1	1.1	1.2
						Asset/equity(x)	1.2	1.2	1.2	1.2	1.2
						Net debt/equity(%)	-8.5	-5.2	-4.4	-5.9	-9.8
						EBITDA interest coverage(x)	15.7	657.2	na	na	na
						ROE(%)	3.9	4.1	3.5	5.2	8.9

Source: Company data, CGIS Research

Figure 4: Guangshen Railway 1Q18 results

Rmb m	1Q18	1Q17	% YoY
Revenue	4,877	4,309	13.2%
COGS	-4,238	-3,877	9.3%
GP	639	432	47.7%
GPM	13.1%	10.0%	3.1%
SG&A	-52	-61	-13.7%
OP	586	372	57.7%
OPM	12.0%	8.6%	3.4%
Financing cost	3	3	-24.7%
Profit contribution from associates	2	2	-24.7%
Other gains and losses	0	-2	-103.6%
PBT	591	376	57.2%
Tax	-146	-95	54.8%
effective tax rate	24.8%	25.1%	-0.4%
PAT	445	281	58.0%
NPM	9.1%	6.5%	2.6%
Minority interest	1	1	31.1%
Profit to common shareholder	446	283	57.9%

Source: Company data, CGIS Research

Figure 5: Earnings estimates: CGIS new vs. old and consensus estimates

2017 (Rmb m, Rmb)	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS	17,980	1,413	3,107	1,090	0.15	0.15
Result	18,331	1,331	2,994	1,015	0.14	0.14
Consensus	18,198	1,391	3,118	1,012	0.15	0.14
Diff%						
Result vs. consensus	0.7%	-4.3%	-4.0%	0.4%	-1.8%	0.2%
Result vs. CGIS	2.0%	-5.8%	-3.7%	-6.9%	-6.9%	-6.9%
2018E (Rmb m, Rmb)	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS old	19,659	2,298	4,051	1,167	0.16	0.25
CGIS new	20,395	2,023	3,770	1,538	0.22	0.22
Consensus	19,482	1,969	3,699	1,573	0.23	0.25
Diff%						
CGIS new vs. consensus	4.7%	2.7%	1.9%	-2.2%	-4.8%	-11.4%
CGIS new vs. old	3.7%	-12.0%	-6.9%	31.7%	31.7%	-11.9%
2019E (Rmb m, Rmb)	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS old	21,378	2,064	3,797	1,585	0.22	0.22
CGIS new	22,075	3,604	5,333	1,752	0.25	0.39
Consensus	20,694	2,199	3,932	1,665	0.24	0.23
Diff%						
CGIS new vs. consensus	6.7%	63.9%	35.6%	5.2%	2.7%	66.1%
CGIS new vs. old	3.3%	74.6%	40.5%	10.6%	10.6%	72.2%

Source: Bloomberg, Company data, CGIS Research

Figure 6: Earnings sensitivity analysis to changes in passenger yield growth assumption (Rmb m)

Inter-city train	2018E earnings	Change from base case	2017 earnings	% YoY chg
Passenger yield change	1,538		1,015	
20.0%	1,836	19.4%		80.8%
15.0%	1,737	12.9%		71.0%
10.0%	1,637	6.5%		61.3%
5.0%	1,538	0.0%		51.5%
0.0%	1,439	-6.5%		41.7%
-5.0%	1,340	-12.9%		31.9%
-10.0%	1,240	-19.4%		22.2%

HK-through train	2018E earnings	Change from base case	2017 earnings	% YoY chg
Passenger yield change	1,538		1,015	
15.0%	1,603	4.2%		57.9%
10.0%	1,581	2.8%		55.7%
5.0%	1,560	1.4%		53.6%
0.0%	1,538	0.0%		51.5%
-5.0%	1,516	-1.4%		49.4%
-10.0%	1,495	-2.8%		47.2%
-15.0%	1,473	-4.2%		45.1%

Long-distance train	2018E earnings	Change from base case	2017 earnings	% YoY chg
Passenger yield change	1,538		1,015	
20.0%	2,064	34.2%		103.2%
15.0%	1,888	22.8%		86.0%
10.0%	1,713	11.4%		68.7%
5.0%	1,538	0.0%		51.5%
0.0%	1,363	-11.4%		34.2%
-5.0%	1,188	-22.8%		17.0%
-10.0%	1,013	-34.2%		-0.3%

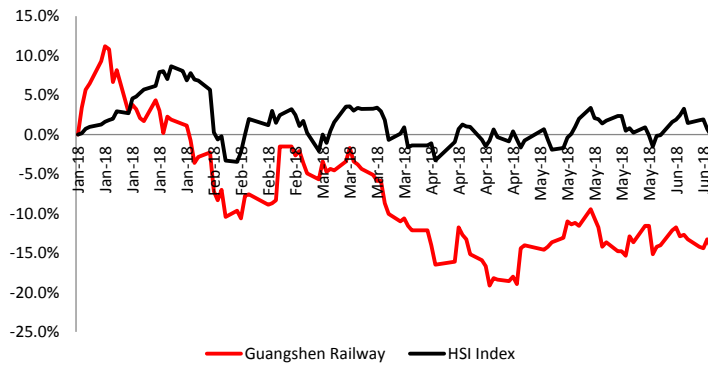
Source: Company data, CGIS Research

Figure 7: SOTP valuation for Guangshen Railway

Core railway business	
2018E core EPS (Rmb/share)	0.22
Target PER multiple	18x
FX(Rmb/HK\$)	0.82
Core railway business value per share (HK\$/share)	4.80
GSR's land bank	
GSR's land bank (m sqm)	13
Historical cost of the land bank (Rmb/sqm)	135
Market price of similar land sales deal in Guangzhou, Shenzhen and Dongguan (Rmb/sqm)	10,000
Total market value of GSR's land bank (Rmb m, before-tax)	130,000
% discount ratio in terms of land development progress	6%
Land bank mark-to-market value per share (HK\$/share)	1.24
Net cash value/share (HK\$/share)	0.22
Implied fair value for GSR (HK\$/share)	6.25
Implied 2018E PER multiple	23.5x
Implied 2018E PBR multiple	1.23x

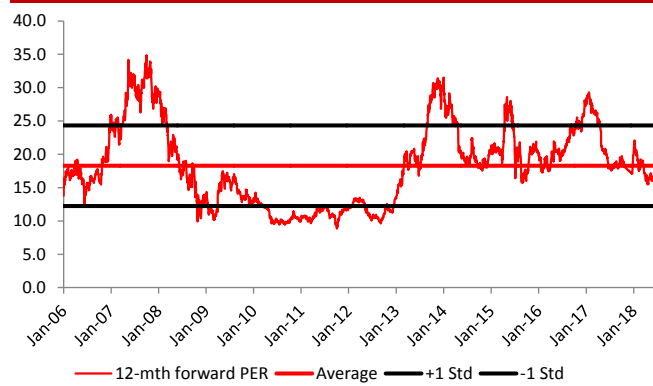
Source: Company data, CGIS Research

Figure 8: Guangshen Railway H-share CYTD performance



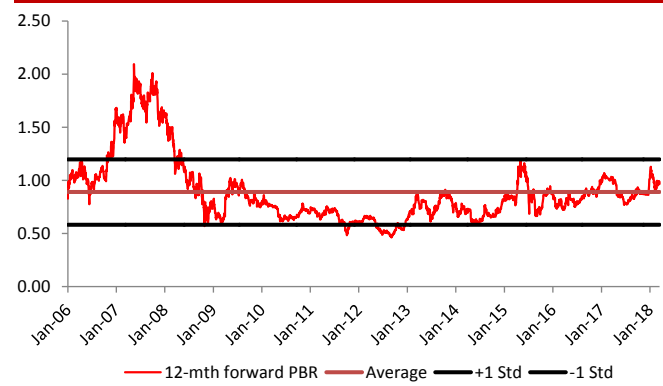
Source: Bloomberg, CGIS Research

Figure 9: Guangshen Railway 12-mth forward PER band



Source: Bloomberg, Company data, CGIS Research

Figure 10: Guangshen Railway 12-mth forward PBR band



Source: Bloomberg, Company data, CGIS Research

Disclaimer

This research report is not directed at, or intended for distribution to or used by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject China Galaxy International Securities (Hong Kong) Co., Limited ("Galaxy International Securities") and/or its group companies to any registration or licensing requirement within such jurisdiction.

This report (including any information attached) is issued by Galaxy International Securities, one of the subsidiaries of the China Galaxy International Financial Holdings Limited, to the institutional clients from the information sources believed to be reliable, but no representation or warranty (expressly or implied) is made as to their accuracy, correctness and/or completeness.

This report shall not be construed as an offer, invitation or solicitation to buy or sell any securities of the company(ies) referred to herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The recipient of this report should understand and comprehend the investment objectives and its related risks, and where necessary consult their own independent financial advisers prior to any investment decision.

Where any part of the information, opinions or estimates contained herein reflects the personal views and opinions of the analyst who prepared this report, such views and opinions may not correspond to the published views or investment decisions of China Galaxy International Financial Holdings Limited and any of its subsidiaries ("China Galaxy International"), directors, officers, agents and employees ("the Relevant Parties").

All opinions and estimates reflect the judgment of the analyst on the date of this report and are subject to change without notice. China Galaxy International and/or the Relevant Parties hereby disclaim any of their liabilities arising from the inaccuracy, incorrectness and incompleteness of this report and its attachment/s and/or any action or omission made in reliance thereof. Accordingly, this report must be read in conjunction with this disclaimer.

Disclosure of Interests

China Galaxy Securities Co., Ltd. (6881.HK; 601881.CH) is the direct and/or indirect holding company of the group of companies under China Galaxy International.

China Galaxy International may have financial interests in relation to the subjected company(ies) the securities in respect of which are reviewed in this report, and such interests aggregate to an amount may equal to or more than 1 % of the subjected company(ies)' market capitalization.

One or more directors, officers and/or employees of China Galaxy International may be a director or officer of the securities of the company(ies) mentioned in this report.

China Galaxy International and the Relevant Parties may, to the extent permitted by law, from time to time participate or invest in financing transactions with the securities of the company(ies) mentioned in this report, perform services for or solicit business from such company(ies), and/or have a position or holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto.

China Galaxy International may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the last 12 months, significant advice or investment services in relation to the investment concerned or a related investment or investment banking services to the company(ies) mentioned in this report.

Furthermore, China Galaxy International may have received compensation for investment banking services from the company(ies) mentioned in this report within the preceding 12 months and may currently seeking investment banking mandate from the subject company(ies).

Analyst Certification

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

Explanation on Equity Ratings

- BUY : share price will increase by >20% within 12 months in absolute terms
- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

Copyright Reserved

No part of this material may be reproduced or redistributed without the prior written consent of China Galaxy International Securities (Hong Kong) Co., Limited.

China Galaxy International Securities (Hong Kong) Co. Limited, CE No.AXM459

20/F, Wing On Centre, 111 Connaught Road Central, Sheung Wan, Hong Kong. General line: 3698-6888.