



Rating
Buy

Asia
China

Utilities
Utilities

Company
Towngas China

| | | | |
|---------|-----------|----------|--------|
| Reuters | Bloomberg | Exchange | Ticker |
| 1083.HK | 1083 HK | HSI | 1083 |

Date
16 August 2018

Results

| | |
|----------------------------|-------------|
| Price at 15 Aug 2018 (HKD) | 7.27 |
| Price target - 12mth (HKD) | 8.30 |
| 52-week range (HKD) | 8.04 - 5.09 |
| HANG SENG INDEX | 27,324 |

Volume/margin trends in line while connection slightly below DBe

Towngas 1H18 results confirm our expectations about the volume (strong momentum) and margins (yoy decline, hoh recover) and we believe similar trends should be seen in other companies, such as ENN and CR Gas which we expect to record higher earnings growth of 19%/23% respectively. Although the flattish new connection (on consolidated basis) is slightly below our forecast (+5% yoy), management expects an acceleration in the second half. In the next few years, Towngas should benefit from China's robust gas demand growth with stronger operating leverage. The company is trading at what we believe is an attractive valuation of 12x 2019 P/E. Maintain Buy.

1H18 recurring profit is slightly below DBe

Towngas reported net profit rose by 10% to HKD663mn in 1H18. After adjusting for HKD102mn in one-off items (mainly FV loss of financial assets and FX loss), recurring net profit was HKD765mn, up 10% yoy and 4% below DBe mainly on lower-than-expected new connections which is flattish yoy on a consolidated basis. Recurring profits in 1H18 account for 51% of our full year earnings forecast. On an EBIT level, gas sales segment profit grew strongly by 37% yoy driven by 18% volume growth and increasing operating leverage, partially offset by a Rm6cents/cm (or 9%) dollar margin yoy decline. Connection segment profit increased slightly by 5%, contributing 47% of total EBIT.

Volume growth on track with margin recovered hoh

The gas volume growth in 1H18 remains robust at 18%, similar to 2017. By segment, the volume growth is mainly driven by a 23% increase in industrial volume and 14% yoy growth in residential, followed by an 11% improvement in commercial. Subsidiary/Asso and JCE/Chengdu project (investments) recorded volume growth of 27%/18%/7% respectively.

Dollar margin dropped by Rmb6cents/cm yoy to Rmb0.61/cm (incl. VAT) but recovered by Rmb2cents/cm hoh, which is mainly because of the winter gas shortage impacts. Gas shortage was most severe in 4Q17 when the high procurement cost dragged down the gas sales margins significantly. Along with the ease of supply shortage, margin start to recover sequentially since 1Q18. We expect a similar trends for peers.

Valuation and risks

Valuation & Risks

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Price/price relative



| Performance (%) | 1m | 3m | 12m |
|-----------------|------|-------|------|
| Absolute | -8.0 | -1.8 | 39.3 |
| HANG SENG INDEX | -4.2 | -12.3 | 0.5 |

Source: Deutsche Bank

Key indicators (FY1)

| | |
|-----------------------------|------|
| ROE (%) | 9.1 |
| Net debt/equity (%) | 38.1 |
| Book value/share (HKD) | 6.11 |
| Price/book (x) | 1.2 |
| Net interest cover (x) | 5.7 |
| Operating profit margin (%) | 15.0 |

Source: Deutsche Bank



Our TP is based on DCF methodology with a WACC of 8.1% and 1% terminal growth rate (based on long-term economic growth). Key risks include lower-than-expected volume/new connection/margins, policy uncertainties on connection fee and distribution margins.

Forecasts and ratios

| Year End Dec 31 | 2016A | 2017A | 2018E | 2019E | 2020E |
|----------------------|-------|-------|--------|--------|--------|
| Sales (HKDm) | 7,181 | 8,760 | 10,229 | 11,834 | 13,329 |
| EBITDA (HKDm) | 1,514 | 1,830 | 2,058 | 2,373 | 2,624 |
| Reported NPAT (HKDm) | 974 | 1,365 | 1,496 | 1,719 | 2,026 |
| Reported EPS FD(HKD) | 0.363 | 0.499 | 0.540 | 0.621 | 0.732 |
| DB EPS FD (HKD) | 0.402 | 0.471 | 0.540 | 0.621 | 0.732 |
| DB EPS growth (%) | -11.5 | 17.1 | 14.8 | 14.9 | 17.9 |
| PER (x) | 10.5 | 10.9 | 13.5 | 11.7 | 9.9 |
| Price/BV (x) | 0.8 | 1.1 | 1.2 | 1.1 | 1.0 |
| EV/EBITDA (x) | 11.6 | 11.5 | 12.5 | 10.7 | 9.3 |
| DPS (net) (HKD) | 0.121 | 0.152 | 0.162 | 0.217 | 0.293 |
| Yield (net) (%) | 2.9 | 2.9 | 2.2 | 3.0 | 4.0 |
| ROE (%) | 7.2 | 9.3 | 9.1 | 9.8 | 10.7 |

Source: Deutsche Bank estimates, company data



Figure 1: Towngas China 1H18 results review

| P&L Summary (HKD mn) | 2016 | 2017 | 2017 yoy | 1H17 | 2H17 | 1H18 | 1H18 yoy |
|---|--------------|--------------|------------|--------------|--------------|--------------|------------|
| Revenue | 7,181 | 8,760 | 22% | 4,036 | 4,724 | 5,584 | 38% |
| Total operating expense | (6,158) | (7,470) | 21% | (3,375) | (4,095) | (4,789) | 42% |
| Operating profit | 1,023 | 1,289 | 26% | 661 | 628 | 796 | 20% |
| Other income | 65 | 257 | 297% | (4) | 262 | (28) | 558% |
| JCs and associates | 618 | 633 | 2% | 337 | 297 | 372 | 10% |
| Finance costs | (251) | (262) | 5% | (123) | (140) | (151) | 23% |
| Profit before tax | 1,455 | 1,918 | 32% | 871 | 1,047 | 989 | 14% |
| Tax | (362) | (405) | 12% | (198) | (208) | (242) | 22% |
| Minorities | (119) | (147) | 23% | (71) | (76) | (83) | 18% |
| Reported net profit | 974 | 1,365 | 40% | 602 | 763 | 663 | 10% |
| Recurring profit | 1,080 | 1,289 | 19% | 695 | 594 | 765 | 10% |
| Segment results (HKD mn) | 2016 | 2017 | 2017 yoy | 1H17 | 2H17 | 1H18 | 1H18 yoy |
| Gas sales | | | | | | | |
| Revenue | 5,518 | 6,996 | 27% | 3,272 | 3,723 | 4,728 | 44% |
| EBIT | 450 | 633 | 40% | 340 | 292 | 466 | 37% |
| Segmental margin (%) | 8.2% | 9.0% | 0.1ppt | 10% | 8% | 10% | -0.5ppt |
| Connection | | | | | | | |
| Revenue | 1,663 | 1,764 | 6% | 764 | 1,000 | 856 | 12% |
| EBIT | 722 | 807 | 12% | 387 | 420 | 405 | 5% |
| Segmental margin | 43% | 46% | 0.1ppt | 51% | 42% | 47% | -3.3ppt |
| Operational data | 2016 | 2017 | 2017 yoy | 1H17 | 2H17 | 1H18 | 1H18 yoy |
| Gas sales vol. (mn cm) | 7,120 | 8,417 | 18% | 4,186 | 4,231 | 4,949 | 18% |
| By customer type | | | | | | | |
| Residential | 1,922 | 2,104 | 9% | 1,129 | 975 | 1,307 | 14% |
| Commercial | 1,282 | 1,431 | 12% | 783 | 648 | 866 | 11% |
| Industrial | 3,916 | 4,882 | 25% | 2,273 | 2,609 | 2,776 | 23% |
| By ownership | | | | | | | |
| Subsidiaries | 1,890 | 2,365 | 25% | 1,157 | 1,208 | 1,472 | 27% |
| JCE/asso | 3,888 | 4,620 | 19% | 2,219 | 2,401 | 2,620 | 18% |
| Investment | 1,342 | 1,432 | 7% | 804 | 628 | 858 | 7% |
| New connection ('000) - Subsidiary | 400 | 400 | 0% | 190 | 210 | 190 | 0% |
| connection fee (Rmb) | 3,648 | 3,779 | 4% | 3,537 | 4,030 | 3,648 | 3% |

Source: Company Data



Appendix 1

Important Disclosures

*Other information available upon request

| Disclosure checklist | | | |
|----------------------|---------|------------------------|------------|
| Company | Ticker | Recent price* | Disclosure |
| Towngas China | 1083.HK | 7.07 (HKD) 16 Aug 2018 | NA |

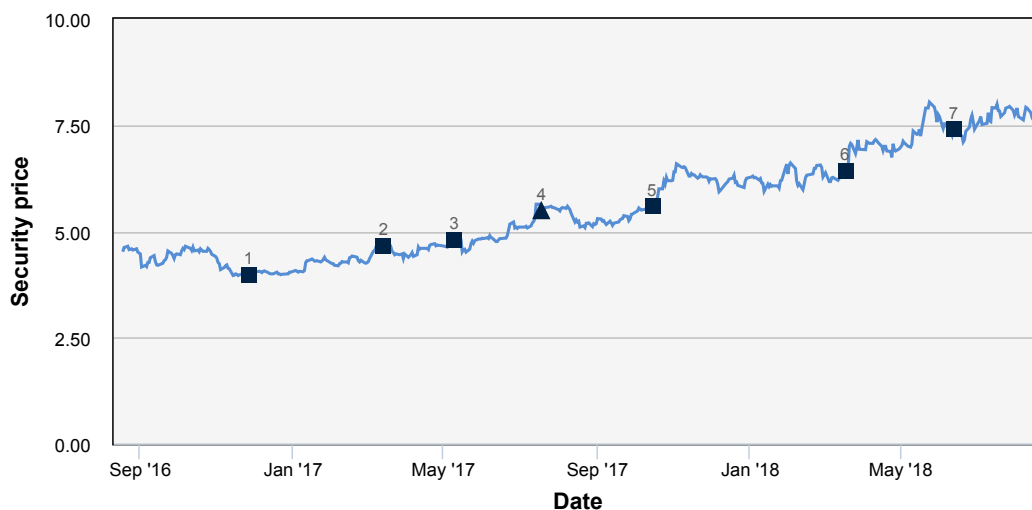
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Historical recommendations and target price. Towngas China (1083.HK)

(as of 08/15/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

| | | | | | | | |
|----|------------|---|-------------|----|------------|-----------------------------------|-------------|
| 1. | 11/27/2016 | Hold, Target Price Change HKD 4.10 | Hanyu Zhang | 5. | 10/16/2017 | Buy, Target Price Change HKD 6.60 | Hanyu Zhang |
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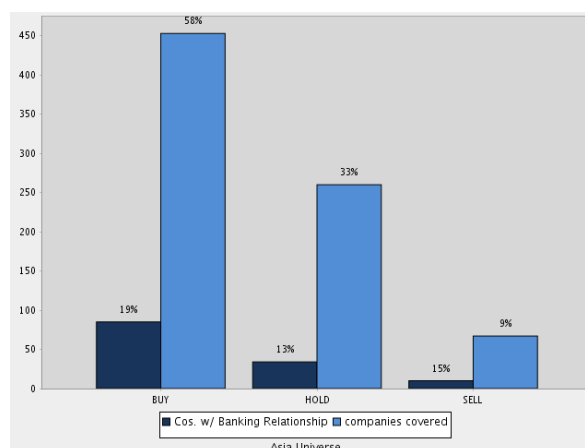
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