

# China / Hong Kong Company Update

## China Gas Holdings

Bloomberg: 384 HK Equity | Reuters: 0384.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

27 Jun 2022

### BUY

Last Traded Price (24 Jun 2022): HK\$11.68 (HSI : 21,719)  
Price Target 12-mth: HK\$14.20 (22% upside) (Prev HK\$21.30)

#### Analyst

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#### What's New

- FY3/22 adjusted earnings declined 22%, below our and market expectations due to pressure on dollar margin
- Expect gas volume to grow by around 11% with dollar margin at Rmb0.48/cm in FY3/23
- Expect cash flow improvements to be a share price catalyst
- Trading at a low valuation of 8x FY3/23 PE, we maintain our BUY rating; TP cut to HK\$14.20

### Trough valuation

#### Investment Thesis

Trading at -2SD of its 5-year historical mean PE. China Gas Holdings' (CGH) share price has corrected by over 50% in the past one year, and is now trading at -2SD of its 5-year historical mean PE. We reckon this low valuation has already factored in most negatives and the challenging business environment. Improvement in cashflow and recovery in gas volume growth are share price catalysts.

**Dollar margin hinges on gas supply for residential users.** We estimate CGH to register around 11% gas volume growth in FY3/23, underpinned by 6% growth in customer base and ramp up in gas usage in rural coal-to-gas users. Ensuring gas supply for residential users in FY3/23 will reduce procurement of higher priced LNG, helping dollar margin to recover. Nevertheless, we have conservatively assumed dollar margin to decline by Rmb0.02/cm to Rmb0.48/cm in FY3/23.

**Improving cashflow is positive to share price.** We expect CGH's free cashflow to turn marginally positive in FY3/23, on the back of 1) further reduction in account receivables for rural coal-to-gas operations on declining number of new connections, and 2) stable capex.

#### Valuation:

We have cut our FY3/23 and FY3/24 earnings estimates by 18-23% to factor in the lower dollar margin. After the revision, adjusted earnings growth is expected to be 4-8% in those years. Our target price (TP) is lowered to HK\$14.20, based on 9.0x 12-month rolling PE or -1.5SD of its 5-year historical average PE and implies 1.2x PEG. We reckon the discount from historical average valuation has reflected the current challenging outlook. We reiterate our BUY call given its low valuation.

#### Where we differ:

We are more optimistic on the turnover growth in piped gas and VAS and our turnover estimates are 10% above market consensus.

#### Key Risks to Our View:

Slowdown in subsidy collection and China's economic growth. Dollar margin pressure due to high LNG prices.

#### At A Glance

Issued Capital (m shrs)	5,536
Mkt Cap (HKm/US\$m)	64,660 / 8,238
Major Shareholders (%)	
Beijing Enterprises Holdings Ltd	23.4
China Gas Group Ltd.	10.5
Liu (Ming Hui)	7.5
Fortune Oil Ltd	6.0
Capital Research Global Investors	5.0
Free Float (%)	47.7
3m Avg. Daily Val. (US\$m)	16.09
GICS Industry: Utilities / Gas Utilities	

#### Price Relative



#### Forecasts and Valuation

FY Mar (HK\$m)	2021A	2022A	2023F	2024F
Turnover	69,975	88,225	107,229	126,061
EBITDA	17,487	15,227	16,349	17,692
Pre-tax Profit	14,090	10,787	11,739	12,406
Net Profit	10,479	7,662	8,381	8,889
Net Pft (Pre Ex) (core profit)	10,318	8,052	8,381	8,889
Net Profit Gth (Pre-ex) (%)	8.8	(22.0)	4.1	6.1
EPS (HK\$)	2.01	1.39	1.51	1.61
EPS Gth (%)	10.4	(30.6)	8.6	6.1
Core EPS Gth (%)	5.3	(26.0)	3.4	6.1
Diluted EPS (HK\$)	2.01	1.39	1.51	1.61
DPS (HK\$)	0.55	0.55	0.55	0.55
BV Per Share (HK\$)	9.96	11.48	12.55	13.60
PE (X)	5.8	8.4	7.7	7.3
CorePE (X)	5.9	8.0	7.7	7.3
P/Cash Flow (X)	7.4	6.5	6.2	5.1
P/Free CF (X)	nm	nm	148.2	25.1
EV/EBITDA (X)	6.3	7.8	7.6	7.2
Net Div Yield (%)	4.7	4.7	4.7	4.7
P/Book Value (X)	1.2	1.0	0.9	0.9
Net Debt/Equity (X)	0.7	0.6	0.6	0.6
ROAE(%)	22.9	13.3	12.6	12.3
Earnings Rev (%)			(18)	(23)
Consensus EPS (HK\$)			1.72	1.91
Other Broker Recs:		B:14	S:2	H:6

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters



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## China Gas Holdings

### WHAT'S NEW

#### FY3/22 results below expectation due to pressure on dollar margin

China Gas Holdings (CGH) reported a 22% decline in adjusted net profit in FY3/22 (excluding one-off non-operational items) to HK\$8.05bn, below our and market expectations. The major discrepancy was lower-than-expected dollar margin of Rmb0.50/cm, compared with Rmb0.59/cm in FY3/21 and Rmb0.60/cm in 1HFY3/22. **Despite a drop in earnings, CGH maintained total dividend per share at the same level as last year at HK\$0.55.**

During FY3/22, CGH achieved gas volume growth of 17.2%, above its target of 15%. Gas volume growth of rural-coal-to-gas (RCG) operation jumped >77%. For FY3/23, **CGH has set a target to grow gas volume by 10-13% which we reckon is achievable** because 1) gas volume growth in April to June is expected to be 7%, above the overall China market, and the recovery from the trough of 5% in May is expected to continue; 2) CGH will add 2.6-2.9m new connections, growing the customer base by 6%. Although the number of new connections in RCG will continue to drop, ramp up in usage of the existing connections will contribute to higher gas volume growth.

**The higher-than-expected pressure in dollar margin was mainly due to insufficient gas supply for residential users.** The shortfall was filled by LNG, causing the gas procurement cost to be 50% higher than city-gate price for non-contracted volume. Although LNG price is expected to stay high amid the Ukraine crisis, we expect pressure on dollar margin to be less severe this year because central government has already put forward measures to ensure sufficient gas supply for winter this year. Inspection on gas consumption by residential users by three oil majors will complete in August. Negotiations on contracted gas volume can then be finalized. Apart from lowering intermediary transmission cost, implementation of winter prices for non-residential users for longer period will also help recover dollar margin. Management is optimistic of maintaining dollar margin at Rmb0.50/cm. **To be conservative, we have assumed dollar margin to decline by Rmb0.02/cm to Rmb0.48/cm, compared with our previous assumption of Rmb0.55/cm.**

The 13.2% higher gross profit from value-added services (VAS) with gross margin jumping 10.8ppts to 48.6% was a bright spot in the results, thanks to a change in product

mix. The share of VAS in gross profit also climbed 5.6ppts to 21%. Going forward, with the help of technology and Internet of Things, **CGH will enhance its product offerings to improve smart home experience for more customers.** We estimate VAS to register around 15% growth in gross margin, accounting for 22.8% of total gross margin in FY3/23.

Negative free cashflow during FY3/22 was a disappointment. This was caused by capex in a few one-off items, including Group office building and increase in investment in JV due to expansion of pipeline infrastructure to enhance connectivity. On a positive note, **operating cashflow improved 19%**, thanks to better working capital management. In particular, account receivables of RCG declined by at least HK\$1bn during the period. As new RCG connections is expected to drop to only 40,000 – 50,000 households from over 270,000 in FY3/22, we expect account receivables and contract assets will decline further in FY3/23. **With stable capex, we project free cashflow to turn marginally positive in FY3/23.**

To reflect the variance in the results, we have lowered our FY3/23 and FY3/24 earnings estimates by 18-23%. After revision, adjusted earnings growth is expected to be 4-8%. **Our target price (TP) is lowered to HK\$14.20**, based on 9.0x 12-month rolling PE or -1.5SD of its 5-year historical average PE. It is also equivalent to 1.2x PEG. We reckon the discount from historical average has reflected the current challenging outlook. **We reiterate our BUY call on cheap valuation.**

#### Company Background

China Gas Holdings (CGH) is mainly involved in the construction and operations of city gas pipelines, as well as the sale of natural gas and liquefied petroleum gas (LPG) in China. The company also invests in gas terminals, storage, transportation, logistics systems and vehicle refilling stations. CGH was listed on the Hong Kong Stock Exchange in 2001.

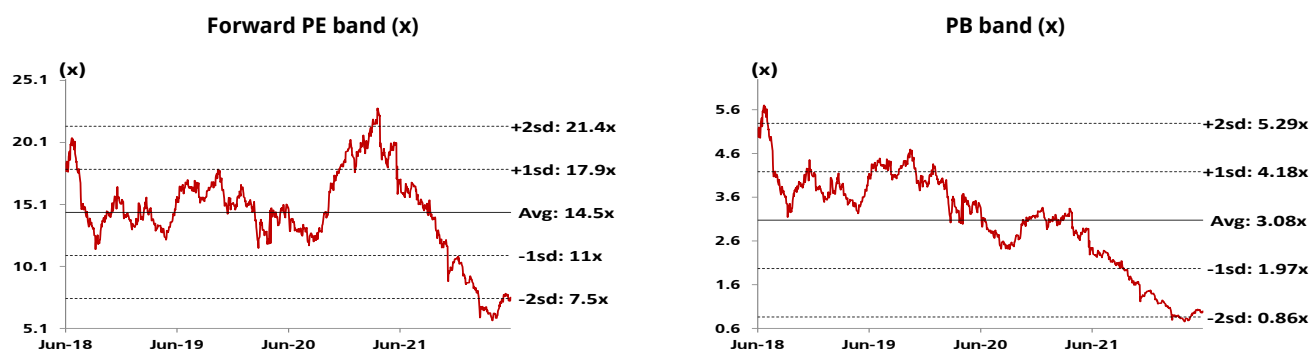
## China Gas Holdings

### Income Statement (HK\$ m)

FY Mar	2021A	2022A	% chg	voY
Revenue	69,975	88,225		26.1
Cost of Goods Sold	(51,873)	(72,486)		39.7
<b>Gross Profit</b>	<b>18,102</b>	<b>15,739</b>		<b>(13.1)</b>
Other Opng (Exp)/Inc	(5,286)	(5,919)		12.0
<b>Operating Profit</b>	<b>12,817</b>	<b>9,821</b>		<b>(23.4)</b>
Other Non Opng (Exp)/Inc	923	1,378		49.3
Associates & JV Inc	1,608	1,435		(10.7)
Net Interest (Exp)/Inc	(1,419)	(1,457)		(2.7)
Exceptional Gain/(Loss)	161	(390)		nm
<b>Pre-tax Profit</b>	<b>14,090</b>	<b>10,787</b>		<b>(23.4)</b>
Tax	(2,418)	(2,004)		(17.1)
Minority Interest	(1,194)	(1,121)		6.1
<b>Net Profit</b>	<b>10,479</b>	<b>7,662</b>		<b>(26.9)</b>
Net Profit before Except.	10,318	8,052		(22.0)
EBITDA	17,487	15,227		(12.9)
<b>Margins &amp; Ratio</b>				
Gross Margins (%)	25.9	17.8		
Opg Profit Margin (%)	18.3	11.1		
Net Profit Margin (%)	15.0	8.7		

Source: Company, DBS HK

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## China Gas Holdings

### Key Assumptions

FY Mar	2020A	2021A	2022A	2023F	2024F
City and township gas sales volume growth (%)	6.0	19.6	17.2	11.6	13.6
New connection for residential users (city) ('000)	2,731.7	3,360.8	2,668.1	2,500.0	2,500.0
New connection for residential users (rural) ('000)	2,695.7	1,687.5	273.4	50.0	50.0
Dollar margin (Rmb / 1000 m <sup>3</sup> )	605.0	590.0	500.0	480.4	482.8

Source: Company, DBS HK

### Segmental Breakdown (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
<b>Revenues (HK\$ m)</b>					
Piped gas	27,053	35,936	50,529	61,993	72,832
Gas connection	12,320	12,477	7,227	6,659	7,062
Engineering design and construction	1,367	678	589	412	371
LPG	13,774	13,164	23,081	30,005	36,006
VAS	5,025	7,720	6,799	8,159	9,790
<b>Total</b>	<b>59,540</b>	<b>69,975</b>	<b>88,225</b>	<b>107,229</b>	<b>126,061</b>

Source: Company, DBS HK

## China Gas Holdings

### Income Statement (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
Revenue	59,540	69,975	88,225	107,229	126,061
Cost of Goods Sold	(42,443)	(51,873)	(72,486)	(90,583)	(107,358)
<b>Gross Profit</b>	<b>17,097</b>	<b>18,102</b>	<b>15,739</b>	<b>16,646</b>	<b>18,703</b>
Other Opng (Exp)/Inc	(4,303)	(5,286)	(5,919)	(6,303)	(7,379)
<b>Operating Profit</b>	<b>12,794</b>	<b>12,817</b>	<b>9,821</b>	<b>10,343</b>	<b>11,325</b>
Other Non Opg (Exp)/Inc	640	923	1,378	1,172	1,054
Associates & JV Inc	976	1,608	1,435	1,768	1,945
Net Interest (Exp)/Inc	(1,388)	(1,419)	(1,457)	(1,544)	(1,918)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(297)	161	(390)	0	0
<b>Pre-tax Profit</b>	<b>12,725</b>	<b>14,090</b>	<b>10,787</b>	<b>11,739</b>	<b>12,406</b>
Tax	(2,464)	(2,418)	(2,004)	(2,181)	(2,305)
Minority Interest	(1,072)	(1,194)	(1,121)	(1,177)	(1,212)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>9,188</b>	<b>10,479</b>	<b>7,662</b>	<b>8,381</b>	<b>8,889</b>
Net Profit before Except.	9,485	10,318	8,052	8,381	8,889
EBITDA	16,016	17,487	15,227	16,349	17,692
<b>Growth</b>					
Revenue Gth (%)	0.3	17.5	26.1	21.5	17.6
EBITDA Gth (%)	16.7	9.2	(12.9)	7.4	8.2
Opg Profit Gth (%)	27.7	0.2	(23.4)	5.3	9.5
Net Profit Gth (%)	11.7	14.0	(26.9)	9.4	6.1
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	28.7	25.9	17.8	15.5	14.8
Opg Profit Margin (%)	21.5	18.3	11.1	9.6	9.0
Net Profit Margin (%)	15.4	15.0	8.7	7.8	7.1
ROAE (%)	23.2	22.9	13.3	12.6	12.3
ROA (%)	8.2	8.3	5.0	5.0	4.9
ROCE (%)	11.9	10.7	6.6	6.2	6.3
Div Payout Ratio (%)	28.4	27.4	39.7	36.3	34.3
Net Interest Cover (x)	9.2	9.0	6.7	6.7	5.9

Source: Company, DBS HK

## China Gas Holdings

### Balance Sheet (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
Net Fixed Assets	46,128	56,909	68,065	75,175	81,984
Invt in Associates & JVs	14,878	17,817	22,886	24,654	26,599
Other LT Assets	11,585	15,600	16,773	16,596	16,419
Cash & ST Invt	7,119	8,294	10,011	10,723	10,085
Inventory	3,246	5,302	5,701	6,929	8,146
Debtors	22,644	31,480	33,386	34,246	36,746
Other Current Assets	6,500	5,319	6,326	6,387	6,447
<b>Total Assets</b>	<b>112,100</b>	<b>140,721</b>	<b>163,146</b>	<b>174,711</b>	<b>186,428</b>
ST Debt	24,121	17,272	22,143	20,143	19,143
Creditors	23,773	27,656	30,736	30,922	33,832
Other Current Liab	1,453	1,385	1,409	1,409	1,409
LT Debt	15,568	31,718	33,987	40,297	43,048
Other LT Liabilities	1,384	2,826	2,804	2,804	2,804
Shareholder's Equity	39,605	51,937	63,578	69,468	75,312
Minority Interests	6,195	7,927	8,491	9,668	10,880
<b>Total Cap. &amp; Liab.</b>	<b>112,100</b>	<b>140,721</b>	<b>163,146</b>	<b>174,711</b>	<b>186,428</b>
Non-Cash Wkg. Capital	7,164	13,059	13,268	15,231	16,099
Net Cash/(Debt)	(32,570)	(40,696)	(46,119)	(49,717)	(52,106)
Debtors Turn (avg days)	138.8	141.2	134.2	115.1	102.8
Creditors Turn (avg days)	212.5	188.7	152.5	128.6	113.6
Inventory Turn (avg days)	29.0	31.4	28.7	26.3	26.5
Asset Turnover (x)	0.5	0.6	0.6	0.6	0.7
Current Ratio (x)	0.8	1.1	1.0	1.1	1.1
Quick Ratio (x)	0.6	0.9	0.8	0.9	0.9
Net Debt/Equity (X)	0.7	0.7	0.6	0.6	0.6
Net Debt/Equity ex MI (X)	0.8	0.8	0.7	0.7	0.7
Capex to Debt (%)	17.1	14.9	17.9	16.5	16.1
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

### Cash Flow Statement (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
Pre-Tax Profit	12,725	14,090	10,787	11,739	12,406
Dep. & Amort.	1,606	2,139	2,593	3,066	3,368
Tax Paid	(2,184)	(2,868)	(2,581)	(2,181)	(2,305)
Assoc. & JV Inc/(loss)	(976)	(1,608)	(1,435)	(1,768)	(1,945)
(Pft)/ Loss on disposal of FAs	(106)	68	68	0	0
Chg in Wkg.Cap.	(6,220)	(4,676)	770	(1,948)	(853)
Other Operating CF	1,641	1,133	(326)	1,529	1,903
<b>Net Operating CF</b>	<b>6,486</b>	<b>8,279</b>	<b>9,876</b>	<b>10,436</b>	<b>12,574</b>
Capital Exp.(net)	(6,796)	(7,309)	(10,026)	(10,000)	(10,000)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	(1,370)	(290)	(2,053)	0	0
Div from Assoc & JV	172	307	261	0	0
Other Investing CF	(1,460)	(1,032)	(386)	0	0
<b>Net Investing CF</b>	<b>(9,455)</b>	<b>(8,325)</b>	<b>(12,205)</b>	<b>(10,000)</b>	<b>(10,000)</b>
Div Paid	(2,401)	(2,609)	(3,045)	(2,491)	(3,045)
Chg in Gross Debt	3,435	6,055	7,140	4,311	1,751
Capital Issues	0	(133)	(133)	0	0
Other Financing CF	(3,695)	(2,448)	83	(1,544)	(1,918)
<b>Net Financing CF</b>	<b>(2,661)</b>	<b>866</b>	<b>4,046</b>	<b>276</b>	<b>(3,212)</b>
Currency Adjustments	(490)	355	0	0	0
Chg in Cash	(6,120)	1,175	1,717	712	(638)
Opg CFPS (HK\$)	2.52	2.48	1.66	2.24	2.43
Free CFPS (HK\$)	(0.59)	(0.01)	(0.42)	0.08	0.46

Source: Company, DBS HK

## China Gas Holdings

### Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	29-Jun-21	HK\$25.30	HK\$34.40	Buy
2:	30-Nov-21	HK\$17.56	HK\$21.30	Buy

Source: DBS HK

Analyst: Patricia Yeung  
Ilan Chui

## China Gas Holdings

DBS HK recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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## China Gas Holdings

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