

China Gas Holdings (384 HK)

COVID-19 to have impacts on FY20 results

We had a recent update with CGH. Mgmt. disclosed 1Q20 gas sales suffered more severe impacts than previously estimated, with a range of around 10-15%, and FY20 gas sales growth would be dragged to single digit, as a result. Other than that, gas connection, LPG business and value added services were all subject to slight impacts from COVID-19 outbreak. We trim FY20-22E earnings projection by 5.6%/3.9%/4.2% to reflect COVID-19's impact and more conservative expansion outlook. Our TP is also revised down by 12.2% to HK\$33.37.

- **1Q20 gas sales volume to decline 10-15%.** Mgmt. disclosed 2M20 gas volume declined 13% YoY as a results of COVID-19 lockdown in most of China, and expected gas volume in Mar to decline within a range about 10-15%. CGH observed gas volume picking up from late Mar, and in early Apr, mgmt. disclosed gas demand had resume to normal with slight growth. Based on mgmt. update, we trim CGH's FY20E gas sales growth from 13.5% to 6.3% to reflect impacts from COVID-19.
- **Slight drag for residential connection.** The Company halted gas construction connection for about four weeks due to virus control measures in China, which had block CGH from fulfilling its 5.5mn residential connection target. Mgmt. expected the final outcome would not deviate too much from the original target, implying only slight impacts. We trim down FY20E connection outlook by 3.2% from 5.57mn household to 5.39mn household as a result.
- **Other businesses also suffer mild impacts.** As customer contacts were largely blocked during 1Q20, value added services would suffer mild impacts, leading to slower-than-previous-expected revenue and gross profit growth. For LPG distribution, fortunately, CGH was managed to avoid inventory loss from oil price tumble, as the Company adopted sales strategies to mitigate pricing risks, but which also decrease the segment's profit contribution.
- **Investor block trade creates a good entry point.** CGH's key strategic investor, SK E&S chose to cash out its investment through block trade for its 10.25% shareholdings. We think SK E&S' decision was made based on its own financial pressures, and it creates a good entry point for investing CGH.
- **Long term outlook remains intact, maintain BUY.** Though we have several downward revisions for CGH's operating assumptions, we think the Company's long term outlook remains intact. Our FY20-22E EPS estimates is revised down by only 5.6%/3.9%/4.2% to reflects updates and more conservative assumptions. Our SOTP TP is cut by 12.2% to HK\$33.37. Maintain BUY.

Earnings Summary

(YE 31 Mar)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (HK\$ mn)	52,832	59,386	62,782	73,904	87,475
YoY growth (%)	65.1	12.4	5.7	17.7	18.4
Net income (HK\$ mn)	6,095	8,224	9,209	10,908	12,694
EPS (HK\$)	1.23	1.63	1.76	2.09	2.43
YoY growth (%)	45.2	32.7	8.4	18.5	16.4
Consensus EPS (HK\$)	n/a	n/a	1.84	2.18	2.47
P/E (x)	19.0	14.3	13.2	11.1	9.6
P/B (x)	4.1	3.4	2.9	2.4	2.0
Yield (%)	1.5	1.9	2.2	2.6	3.0
ROE (%)	21.4	24.1	21.9	21.7	21.2
Net gearing (%)	83.8	69.1	74.7	69.3	61.7

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$33.37**
 (Previous TP **HK\$38.0**)
 Up/Downside **+43.5%**
 Current Price **HK\$23.25**

China Gas Distributor

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Stock Data

Mkt Cap (HK\$ mn)	121,332
Avg 3 mths t/o (HK\$ mn)	209.95
52w High/Low (HK\$)	34.95/22.30
Total Issued Shares (mn)	5,219

Source: Bloomberg

Shareholding Structure

Beijing Enterprise	23.7%
Liu Minghui	20.9%
Chiu Tat Jung	18.8%
Free float	36.6%

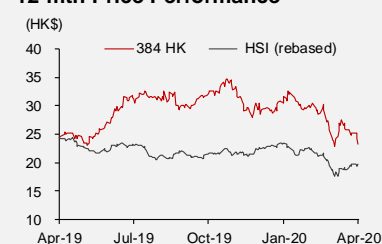
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	0.6%	-3.3%
3-mth	-20.5%	-4.3%
6-mth	-23.9%	-15.5%
12-mth	4.9%	19.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte

Related Reports

1. China Gas Holdings (384 HK , initiation) – Gas sales to slow, but earnings remain resilient” – 13 Feb 2020
2. China Gas Distributors – Scenario analysis on COVID-19's impact – 12 Feb 2020
3. China Gas Holdings (384 HK , initiation) – Leaping with “Beautiful China” – 12 Dec 2019

Figure 1: Earnings revision

	Old			New			Change(%)		
	FY20	FY21	FY22	FY20	FY21	FY22	FY20	FY21	FY22
Total gas sales volume (mcbm)	27,988	35,264	43,839	26,205	33,198	41,299	-6.4%	-5.9%	-5.8%
Retail gas sales volume (mcbm)	17,841	22,834	28,922	17,024	21,952	27,803	-4.6%	-3.9%	-3.9%
Residential connection (CTG incl. mm HH)	5.57	5.47	5.22	5.39	5.38	5.12	-3.2%	-1.7%	-2.1%
Revenue (HK\$, mn)	66,912	79,687	93,736	62,782	73,904	87,475	-6.2%	-7.3%	-6.7%
Net Income (HK\$,mn)	9,758	11,351	13,248	9,209	10,908	12,694	-5.6%	-3.9%	-4.2%
EPS (HK\$)	1.87	2.18	2.54	1.76	2.09	2.43	-5.6%	-3.9%	-4.2%

Source: CMBIS estimates

Figure 2: Our SOTP valuation

SOTP valuation (HK\$)	
Organic gas distribution	27.48
NE business value@20% discount	5.89
Our target price for CGH	33.37
Implied PER multiples (x)	
FY20E	18.9
FY21E	16.0

Source: CMBIS estimates

Figure 3: Our DCF valuation for core gas distribution business (excl. NE business)

DCF Valuation	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Key operating forecasts										
Annual gas sales volume	33,198	41,299	49,462	54,408	59,849	65,833	72,417	79,659	87,624	96,387
YoY change (%)	26.7%	24.4%	19.8%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Annual residential connection	5.4	5.1	4.9	4.2	3.6	3.1	2.8	2.5	2.3	2.1
YoY change (%)	-0.4%	-2.5%	-4.7%	-14.8%	-13.6%	-12.5%	-11.4%	-10.4%	-9.6%	-8.8%
City residential (mm HH)	2.68	2.62	2.49	2.37	2.25	2.14	2.03	1.93	1.83	1.74
Rural coal to gas conversion	2.70	2.50	2.40	1.80	1.35	1.01	0.76	0.57	0.43	0.32
Accumulated residential customer	40.5	45.6	50.5	54.6	58.2	61.4	64.2	66.7	68.9	71.0
Financial forecasts										
Turnover (HK\$ mn)	73,904	87,475	101,547	115,853	129,857	142,956	154,518	163,924	170,625	173,509
Turnover growth (%)	17.7%	18.4%	16.1%	14.1%	12.1%	10.1%	8.1%	6.1%	4.1%	1.7%
EBIT (HK\$ mn)	16,659	19,162	21,947	24,344	26,508	28,324	29,688	30,511	30,735	30,213
EBIT margin	22.5%	21.9%	21.6%	21.0%	20.4%	19.8%	19.2%	18.6%	18.0%	17.4%
Tax rate	21.0%	20.5%	20.8%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%
Depreciation - HK\$ mn	2,021	2,330	2,637	2,893	3,113	3,284	3,395	3,278	3,413	3,470
CAPEX (HK\$ mn)	(14,112)	(13,296)	(13,647)	(13,443)	(13,241)	(13,042)	(12,847)	(12,654)	(12,464)	(12,277)
Invest in working capital	150	(871)	789	(2,861)	(2,801)	(2,620)	(2,312)	(1,881)	(1,340)	(577)
Free cash flow	1,222	3,397	7,165	5,578	7,747	9,714	11,392	12,542	13,581	14,182
Discount factors										
Years	1	2	3	4	5	6	7	8	9	10
Discount factor	0.93	0.86	0.80	0.74	0.69	0.64	0.60	0.55	0.51	0.48
Discount free cash flow	1,135	2,929	5,738	4,148	5,350	6,230	6,785	6,937	6,976	6,765
Terminal value	268,706									
Terminal perpetual growth	2%									
Terminal EV/EBITDA	7.98									

Valuations (HK\$ mn)		WACC Calculations	
Terminal value	268,706	Cost of debt	4.2%
Terminal perpetual growth	2.0%	Tax rate	22.0%
Terminal EV/EBITDA	7.98	After tax cost of debt	3.3%
Total discount FCF	52,993	Cost of equity	14.3%
Discount terminal value	128,168	Adjusted beta	0.85
Firm value	181,162	Market risk premium	14.7%
Discount FCF(% of total)	70.7%	Risk free rate	1.8%
Terminal value (% of total)	29.3%	% of debt financing	60.0%
Add: Cash & cash equivalent	10,377	WACC	7.7%
Less: Debt	41,839		
Non-controlling interest	6,313		
Equity Value - (HK\$, mn)	143,388		
Number of shares	5,219		
Share fair value (HK\$)	27.48		
2020E PER	15.57		
2021E PER	13.15		

Source: CMBIS estimates

Figure 4: Our DCF valuation for CGH's NE business

(YE Mar 31)	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
DCF Valuation										
Net profit from NE projects - (RMB mn)	947	1367	1751	1965	2050	2159	2274	2395	2550	2737
FX rate HKD/RMB	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90
Net profit from NE projects - (HK\$ mn)	1052	1519	1945	2184	2278	2399	2527	2662	2833	3041
Free cash flow projection	236	1,154	1,603	1,920	2,076	2,205	2,356	2,512	2,680	2,888
YoY Growth %	-222.5%	388.9%	38.9%	19.8%	8.1%	6.2%	6.9%	6.6%	6.7%	7.8%
Discount year	1	2	3	4	5	6	7	8	9	10
Discount factor	0.93	0.86	0.80	0.74	0.69	0.64	0.60	0.55	0.51	0.48
Discounted cash flow (HK\$,mn)	219	995	1,284	1,428	1,434	1,414	1,403	1,389	1,377	1,377
Discounted Terminal value (HK\$, mn)	26,097									
Terminal growth	2.0%									
Terminal EV/EBITDA	6.19									
Total discounted value (HK\$, mn)	38,417									
Share number (mn)	5,219									
NE Business value (HK\$/share)	7.36									
NE Business value @20% discount (HK\$/share)	5.89									

Source: CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	52,832	59,386	62,782	73,904	87,475
Costs of sales	(41,161)	(45,327)	(46,468)	(54,738)	(65,375)
Gross profit	11,671	14,059	16,315	19,166	22,100
Other income	564	786	719	762	851
Other gains and losses	165	295	50	50	50
Selling and distribution	(1,616)	(1,820)	(1,924)	(2,228)	(2,593)
Administrative expenses	(1,988)	(2,442)	(2,582)	(3,002)	(3,510)
Profit from associates	497	520	517	618	727
Profit from JVs	758	1,132	1,283	1,494	1,737
Share-based payments	(644)	(63)	(200)	(200)	(200)
EBIT	9,408	12,467	14,178	16,659	19,162
Finance costs	(808)	(1,284)	(1,467)	(1,577)	(1,719)
Pre-tax profit	8,600	11,183	12,711	15,082	17,443
Income tax	(1,931)	(2,198)	(2,651)	(3,165)	(3,576)
Less: Minority interests	(574)	(760)	(851)	(1,008)	(1,173)
Net profit	6,095	8,224	9,209	10,908	12,694

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pre-tax profit	8,600	11,183	12,711	15,082	17,443
Depreciation and	1,174	1,326	1,714	2,021	2,330
Change in working capital	(2,261)	7,038	(4,207)	150	(871)
Taxation	(1,580)	(1,874)	(2,693)	(2,924)	(3,381)
Others	512	(7,556)	(796)	(966)	(1,088)
Net cash from operating	6,446	10,117	6,728	13,363	14,433
Capex & investments	(13,175)	(11,816)	(11,628)	(14,112)	(13,296)
Others	6,007	784	-	-	-
Net cash from investing	(7,168)	(11,032)	(11,628)	(14,112)	(13,296)
Equity raised	0	3,785	426	504	587
Change of Debts	8,754	5,526	3,940	3,940	3,940
Dividend paid	(1,606)	(2,172)	(2,829)	(3,225)	(3,797)
Others	(3,240)	(804)	-	-	-
Net cash from financing	3,908	6,335	1,536	1,219	729
Net change in cash	3,186	5,419	(3,364)	470	1,867
Cash at the beginning of the	4,725	8,246	13,239	9,875	10,346
Exchange difference	336	(427)	-	-	-
Cash at the end of the year	8,246	13,239	9,875	10,346	12,212
Cash at balance sheet	8,246	13,239	9,875	10,346	12,212

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	57,181	68,277	78,442	90,537	101,511
Investment properties	273	556	561	566	571
PPE	34,088	42,965	51,102	58,921	66,413
Prepaid lease payments	1,997	2,148	2,525	2,855	3,153
Investment in associates	5,925	5,746	5,746	8,081	9,408
Investment in joint	6,424	8,022	9,335	10,859	12,626
Others non-current assets	8,474	8,840	9,172	9,255	9,341
Current assets	24,877	41,603	42,393	46,983	52,108
Inventories	3,069	3,412	3,641	4,275	5,053
Amount due from	3,167	-	-	-	-
Contract assets	-	7,185	9,811	11,276	11,588
Trade receivables	9,019	10,061	11,087	13,051	15,162
Bank balances and cash	8,246	13,239	9,875	10,346	12,212
Other current assets	1,376	7,706	7,978	8,036	8,093
Current liabilities	27,102	46,644	46,311	51,418	54,478
Trade and other payables	14,045	23,699	22,304	24,632	24,843
Amount due to customers	943	-	-	-	-
Contract liabilities	-	5,168	5,952	6,923	8,012
Taxation	944	1,245	1,193	1,424	1,609
Bank and other borrowings	11,079	16,408	16,736	18,312	19,888
Other current liabilities	91	125	126	126	127
Non-current liabilities	22,226	22,453	26,085	28,469	30,853
Borrowings	21,293	21,491	25,103	27,467	29,831
Deferred income tax	933	962	982	1,002	1,022
Total net assets	32,730	40,782	48,439	57,634	68,290
Minority Interest	4,274	5,461	6,313	7,321	8,494
Shareholders' equity	28,456	35,321	42,126	50,313	59,796

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Sales of piped gas	42.8	45.6	47.9	51.9	55.3
Gas connection	21.4	21.0	21.9	18.5	14.8
Sales of LPG	30.2	26.8	21.4	19.1	17.4
Value-added service	5.6	6.6	8.7	9.4	10.1
Others	-	-	-	1.2	2.3
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Operating margin	17.8	21.0	22.6	22.5	21.9
Pre-tax margin	16.3	18.8	20.2	20.4	19.9
Net margin	11.5	13.8	14.7	14.8	14.5
Effective tax rate	22.5	19.7	20.9	21.0	20.5
Balance sheet ratios					
Current ratio (x)	0.92	0.89	0.92	0.91	0.96
Quick ratio (x)	11.6	9.7	9.7	10.6	11.1
Cash ratio (x)	0.3	0.3	0.2	0.2	0.2
Inventory turnover days	16.4	19.9	20.5	19.5	19.5
Receivable turnover days	52.1	58.6	61.5	59.6	58.9
Payable turnover days	105	152	181	156	138
Total debt / equity ratio (%)	98.9	92.9	86.4	79.4	72.8
Net debt / equity ratio (%)	83.8	69.1	74.7	69.3	61.7
Returns (%)					
ROE	21.4	24.1	21.9	21.7	21.2
ROA	7.4	7.5	7.6	7.9	8.3
Per share					
EPS (HK\$)	1.23	1.63	1.76	2.09	2.43
DPS (HK\$)	0.35	0.44	0.50	0.60	0.69
BVPS (HK\$)	5.7	6.77	8.07	9.64	11.46

Source: Company data, CMBIS estimates

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