

# China Gas Holdings (384 HK)

## Entering golden era in Northeastern China

We attended China Gas Holdings (CGH)'s reverse roadshow in Harbin on 23-24 Sep. We were quite impressed by Heilongjiang government's determination in utilizing Russia gas. CGH is currently seizing ~70% cities' gas distribution concession rights in Heilongjiang. As Russian gas started to be supplied to China Northeastern areas from 1 Dec, we believe CGH's gas distribution business in Northeast China will enter golden era with rapid growth in the coming decade.

- **Russian gas is coming on 1 Dec.** The new pipeline supply comes with annual capacity of 38bcm, with target gas supply pace of 2/5bcm in 2019/20E, and will ramp up to 38bcm in 3-5 years, according to mgmt. Russian gas will fundamentally soothe the tightened gas supply in Northeast China, and unleash gas consumption growth potential in the area.
- **Heilongjiang will be the first to benefit.** As the first stop of Russian gas lands in China, Heilongjiang has made active plans to utilize new gas supply, including 1) accelerating provincial pipeline design and signing strategic framework agreement with Petro China (857 HK) to construct those pipelines which will be managed by the pending establishing National Pipeline Company; 2) kicking off coal-to-gas heating conversion; and 3) promoting distributed gas energy project. Russian gas supply to Jilin and Liaoning will come later in 2020/21 as domestic pipeline extends.
- **City-gate price would be better than expected.** Although not yet disclosed, CGH mgmt. and local officials expressed optimistic view on the city-gate price, suggesting a price range of around RMB1.6-1.8/cbm, which will be similar to existing gateway price of RMB1.64/cbm. Given that tightened supply has led to gas dollar margin as high as RMB1.5/cbm in Northeast China, mgmt. cares more about sufficient supply, and expects gas dollar margin to resume normal range (RMB0.6-0.7/cbm) with rapid gas sales volume growth.
- **Northeast China will support growth and valuation.** After 3 years' rapid growth driven by coal-to-gas projects, market has been questioning about CGH's future growth's sustainability. CGH's Northeast China development strategy will be a strong response to market concern. CGH is trading at 18.5x forward P/E, lower than its 5-yr average of 20.7x. As Russian gas delivers, we expect CGH's new growth in Northeast China will be verified, and we believe CGH's valuation will likely to aim higher. We see CGH's current valuation attractive.

### Earnings Summary

(YE 31 Mar)	FY15A	FY16A	FY17A	FY18A	FY19A
Revenue (HK\$ mn)	31,666	29,139	31,993	52,832	59,386
YoY growth (%)	21.76	-7.98	9.80	65.13	12.41
Net income (HK\$ mn)	3,371	2,273	4,148	6,095	8,224
EPS (HK\$)	0.67	0.46	0.85	1.23	1.66
YoY growth (%)	25.6	-31.9	84.5	45.1	34.9
P/E (x)	44.8	65.8	35.6	24.5	18.2
P/B (x)	8.2	8.2	7.2	5.2	4.4
Yield (%)	0.5	0.6	0.8	1.1	1.4
ROE (%)	18.3	12.6	20.4	21.4	24.5
Net gearing (%)	83.9	92.8	89.4	83.8	70.7

Source: Company data

NOT RATED

Current Price

HK\$30.15

### China Gas Sector

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### Stock Data

Mkt Cap (HK\$ mn)	157,340
Avg 3 mths t/o (HK\$ mn)	288.36
52w High/Low (HK\$)	33.30/19.70
Total Issued Shares (mn)	5,219

Source: Bloomberg

### Shareholding Structure

Beijing Enterprise	23.7%
Liu Ming Hui	20.9%
China Gas Group	14.5%
Free float	40.9%

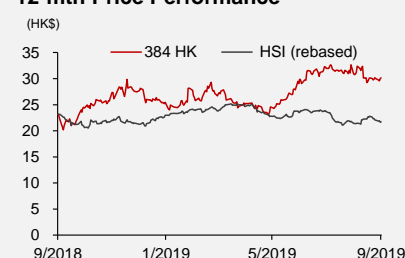
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	-8.0%	-7.1%
3-mth	3.4%	12.4%
6-mth	12.5%	23.7%
12-mth	30.7%	38.5%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte

■ **Gas boiler heating will be a priority.** Given that cold weather lasts for 6-7 months a year in Northeast China, CGH mgmt. set gas boiler heating a priority in its Northeast China development strategy, as a continuation of coal-to-gas conversion in North China. CGH's strategic focus is on citizen's rigid clean heating demand subject to less impacts from macro economy. Taking Harbin City as an example, converting the city's 24k tonnes coal-heating boiler to gas boiler will bring along 4bcm gas consumption demand from heating, which would be five times of Harbin's total gas consumption in 2018 (0.8bcm).

CGH's target is not only boosting gas sales to heating companies, but also taking part in developing new heating customers through investing gas boiler facilities for new real estate projects. According to common practices in Northeast China, CGH will be eligible for 1) charging a one-off construction fee at per sqm based, and 2) charging for heating services provision in advance at per sqm based for each winter. Taking Harbin City as example, heating construction fee is RMB55/sqm, and heating service charge is RMB38.32/sqm. Mgmt. estimated there is at least 8mn sqm new heating connection potential in Harbin, and it is only one single city's potential. On the backdrop of increasing Russian gas supply, CGH expects heating coal-to-gas conversion pace in Northeast China will accelerate, and that will create tremendous room for the Company's business expansion.

**Figure 1: Harbin Heating Company's control room**



Source: Company data, CMBIS

**Figure 2: Harbin Heating Company made heavy investment in coal boilers to fulfil ultra-low emission standards**



Source: Company data, CMBIS

**Figure 3: Coal boiler heating with large coal storage yard is not suitable for city development**



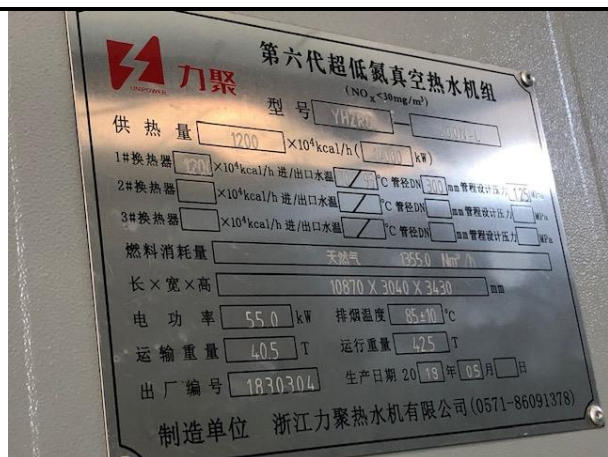
Source: Company data, CMBIS

**Figure 4: Coal storage yard now becomes issues to residents living nearby**



Source: Company data, CMBIS

**Figure 5: Gas boiler's name plate from Chalco's Northeast Aluminium Alloy subsidiary during our site visit**



Source: CMBIS

**Figure 6: Gas boiler offers compact, clear and labour saving solutions to winter heating demand**



Source: CMBIS

- **Ambitious gas sales growth target in coming years.** Based on conservative gas boiler heating penetration rate at only 20%, Heilongjiang Development and Reform Commission estimates gas consumption will reach 9bcm and CGH aims at 4.4bcm gas sales in 2025, representing CGH's market share of 48.9% in the province. In 2030, Heilongjiang DRC forecast gas consumption will reach 14.3bcm and CGH aims for 9bcm, which represents CGH's market share of 63.5%. The Company targets to reach a 2018-30E gas sales volume CAGR of 25.4%.

Aggregating three provinces' forecasts based on local DRC and CGH's estimate, gas sales volume is forecasted to reach 24.5bcm/38.6bcm in 2025/2030E, and CGH wishes to possess 9.1bcm/20.2bcm, respectively, representing target market share of 37.3% and 52.7%. Given CGH's broad project coverage in Northeast China, we expect CGH's target gas sales level to be feasible.

- **Risk factor:** 1) Russian gas supply delay; 2) NDRC sets substantially higher-than-expected city-gate price; 3) local government's policy change on heating coal-to-gas conversion.

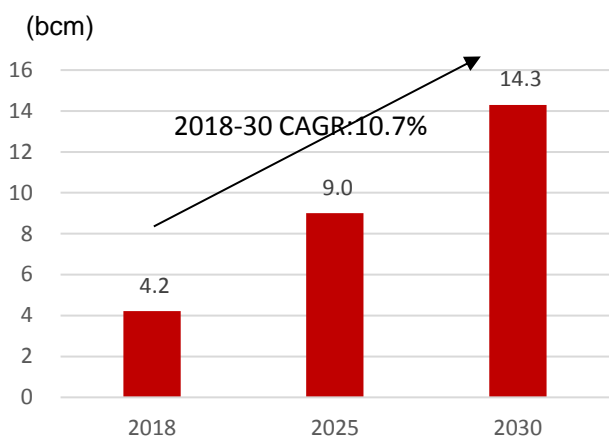
**Figure 7: Heilongjiang's gas consumption plan for 2025/2030, and CGH's gas sales target and market shares**

Gas usage type	2025			2030		
	Provincial	CGH	Target shares	Provincial	CGH	Target shares
City gas	33.0	15.1	45.8%	55.7	36.3	65.2%
Heating	20.3	13.3	65.5%	33.1	24.9	75.2%
Transportation	10.7	4.1	38.3%	24.2	14.6	60.3%
Chemical, power generation & distributed energy	26.0	11.5	44.2%	30.0	15.0	50.0%
<b>Total</b>	<b>90.0</b>	<b>44.0</b>	<b>48.9%</b>	<b>143.0</b>	<b>90.8</b>	<b>63.5%</b>

Source: Company data, CMBIS

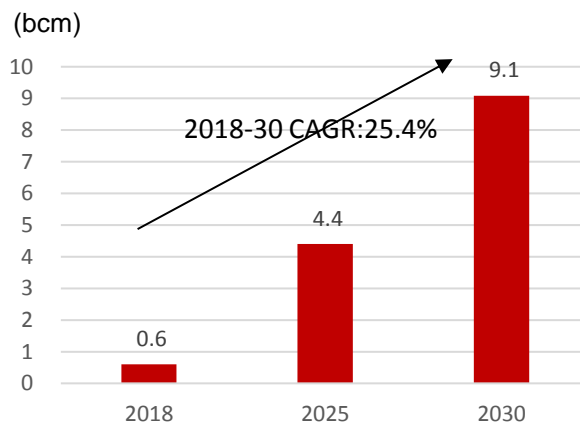


**Figure 8: Heilongjiang's 2018-30E gas consumption growth CAGR is estimated at 10.7% by local DRC**



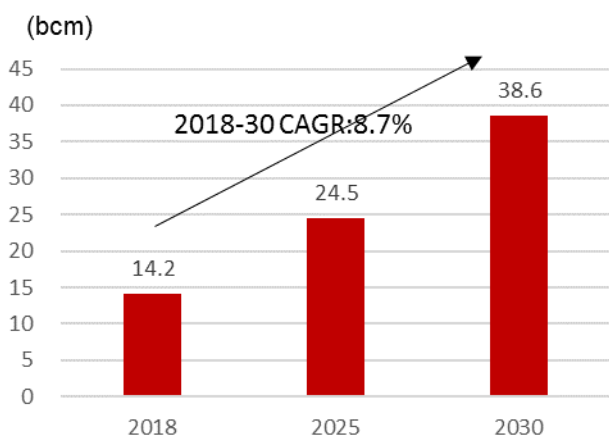
Source: Company data, CMBIS

**Figure 9: CGH and associates' 2018-30E target gas sales CAGR is 25.4%**



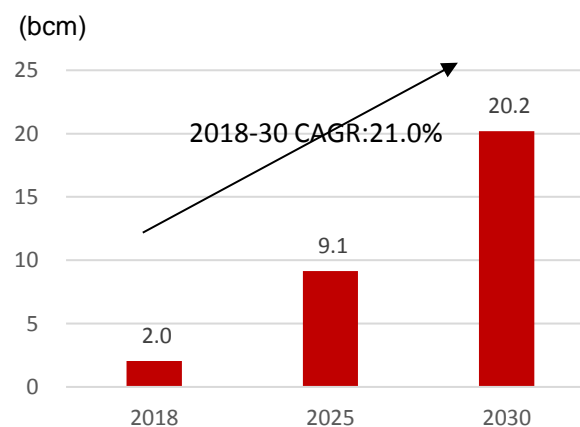
Source: Company data, CMBIS

**Figure 10: Aggregating three North-eastern provinces' gas consumption target, 2018-30E gas consumption CAGR would be 10.7%**



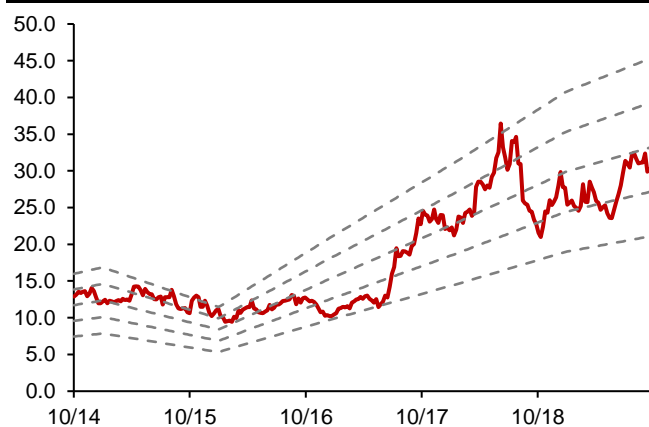
Source: Company data, CMBIS

**Figure 11: CGH aims at reaching faster 2018-30E CAGR at 21.0% for aggregating three North-eastern provinces' gas sales volume**



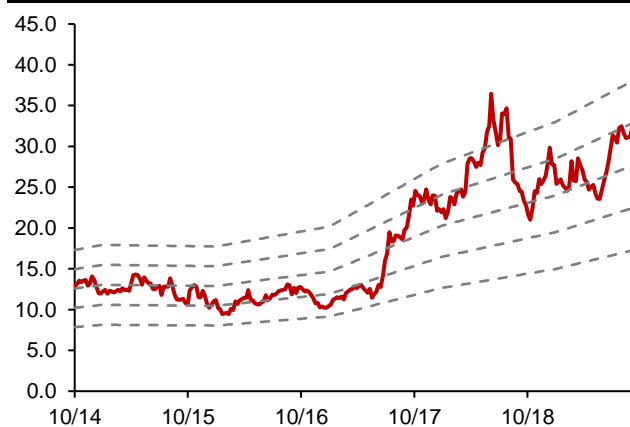
Source: Company data, CMBIS

**Figure 12: 12M forward P/E band**



Source: Bloomberg, CMBIS

**Figure 13: 12M forward P/B band**



Source: Bloomberg, CMBIS

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