

China Gas Holdings (384 HK)

Expect mild recovery ahead

CGH released pressured 1HFY23 results, but its FCF turned positive. Looking ahead in 2HFY23E, CGH's mgmt. were optimistic, considering: 1) higher gas demand during the heating season; 2) better epidemic control measures may stimulate economic recovery and boost gas demand recovery; 3) effective price-through measures enabled CGH to achieve full-year dollar margin target of RMB0.5cbm; 4) "Smart Living" maintains robust growth momentum. CGH is trading at undemanding valuation at around 7x FY23 forward PE. We believe gas sales growth may recover as the epidemic measures further relax, and the Smart Living will continue the robust growth momentum. Thus, **we assign TP of HK\$13.2 to CGH, based on 11x FY23E target PE (~close to avg. 5-year historical PE). We transfer coverage with BUY rating.**

- **1HFY23 results were under demand side disruption pressure; Free cash flow turned positive.** Due to the challenging operating environment by pandemic control and higher gas costs, CGH's core earnings dropped 22.2% YoY to HK\$3,289.9mn in 1HFY23; Yet, driven by resilient operating cash flow growth of 14.3% and better-controlled CAPEX and M&A investments, FCF turned positive to HK\$0.84bn (~ HK\$-3.1bn) in 1HFY23. For FY23E, we believe CGH can maintain positive free cash flow, supported by strong operating cash flow and optimized CAPEX control.
- **The outlook of gas sales and dollar margin are expected to follow economic recovery in FY23E.** In 1HFY23, given macro weakness and higher gas costs, total gas sales volume grew 7.4%YoY (~1HFY22 21.1% YoY) to 16.7bcm and residential gas sales grew 10% YoY (~16.8% YoY in 1HFY22). The dollar margin was in line and recorded RMB0.54cbm. Looking ahead in 2HFY23E, since better epidemic control measures may lead to economic recovery and stimulus gas demand, we expect CGH's city & township gas sales to grow by 10%YoY, following mgmt's guidance. Under the effective price-through measures, we estimated the dollar margin to achieve RMB0.5cbm in FY23E.
- **Slower but steady gas connection pace.** Given the downward pressure in the real estate industry and delayed connection engineering work under epidemic control. In 1HFY23, the newly-added township connection receded 3.3% YoY, with newly-added city residential connection declined 12.4% YoY. For FY23E, We expect CGH's full-year new residential connection will reach the mgmt's full-year guidance of around 2.66mn, and it may tend to level off in the following few years.
- **Smart Living maintained sound growth momentum; VAS developed steadily.** VAS's GP raised by 0.3% YoY to HK\$1.7bn in 1HFY23. In particular, 'Smart Living' recorded impressive results. Its GP boosted by 105% YoY to HK\$ 767mn, and its pre-tax profit increased by 106% YoY to HK\$586mn. In the near future, we believe 'Smart Living' will further unleash its value.
- **We assign TP of HK\$13.2 to CGH with BUY rating.** CGH is trading at around 7x FY23 forward PE. We believe the weak gas sales together with CGH's slower gas connection expectation have been largely price in. We assign TP of HK\$13.2, based on 11x FY23E target PE (~close to avg. 5-year historical PE) to factor in gas growth recovery due to relaxing epidemic control and solid growth momentum of "Smart Living". We transfer coverage with BUY rating.

Earnings Summary

(YE 31 Mar)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (HK\$ mn)	69,975	88,225	101,124	112,014	123,820
YoY growth (%)	17.5	26.1	14.6	10.8	10.5
Net profit (HK\$ mn)	10,478.7	7,662.0	6,917.8	7,783.3	8,520.8
YoY growth (%)	14.0	(26.9)	(9.7)	12.5	9.5
EPS (Reported) (HK\$)	2.01	1.42	1.20	1.32	1.45
YoY growth (%)	14.1	(29.5)	(15.4)	10.2	9.5
Consensus EPS (HK\$ cents)	NA	NA	1.35	1.48	1.63
P/E (x)	13.2	14.5	7.33	6.54	6.8
P/B (x)	2.7	1.8	0.8	0.8	0.7
ROE (%)	19.8	11.6	9.3	9.7	9.7

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$13.2
Up/Downside	36%
Current Price	HK\$9.73

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Stock Data

Mkt Cap (HK\$ mn)	59,234.0
Avg 3 mths t/o (HK\$ mn)	9.1
52w High/Low (HK\$)	16.40/6.96
Total Issued Shares (mn)	100.0

Source: FactSet

Shareholding Structure

Beijing Enterprise	23.4%
China Gas Group	10.5%

Source: HKEx

Share Performance

	Absolute	Relative
1-mth	26.2%	4.5%
3-mth	-7.6%	-8.9%
6-mth	-17.4%	-10.8%

Source: FactSet

12-mth Price Performance



Source: FactSet

VAS business highlights

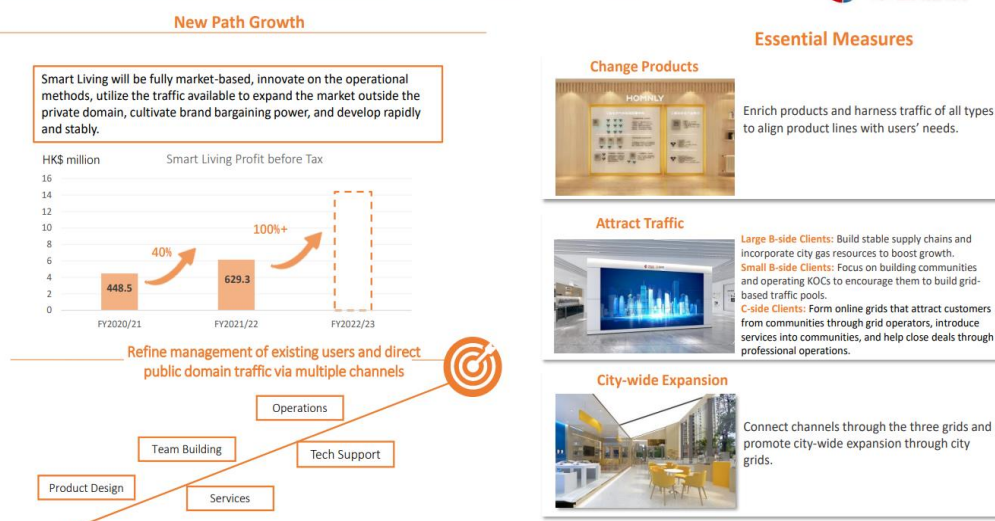
Furthermore, previously CGH announced its 'Smart Living' plan to complete the spin-off and IPO to further release its intrinsic value in the following two years. Smart Living operates an e-commerce platform to provide a one-stop smart living service to hundreds of millions of families.

For intra-domain operation, Smart Living launched the 3x3x3 GaaS (Grid as a Service) business model, combining offline services with online technologies and merging direct sales with fission marketing to offer a holistic household product portfolio. Meanwhile, it created an eco-platform to connect users, sales channels, technologies and data through smart households, IoT, and other scenarios where applicable in city buildings and industrial parks.

For extra market expansion, Smart Living aims to become a VAS operator and service provider for the gas sector in the short term. Up to date, it has signed deals with 42 main clients, generating RMB77.3mn revenue. For the mid-to-long period, Smart Living plans to extend its clients from local gas companies to other prominent clients in the utility sector, targeting to become an advanced VAS service provider for the utility sector.

Figure 1: Smart Living's market expansion plans

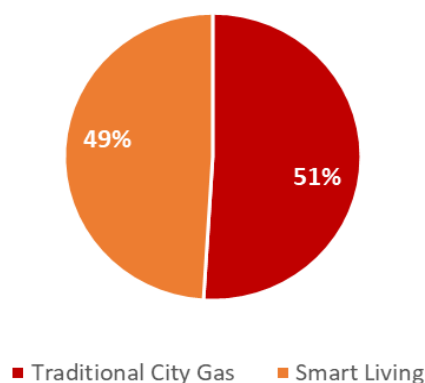
Smart Living: New Sustainable Development Path



Source: Company data, CMBIGM estimates

In 1HFY23, Smart Living's pre-tax profit accounted for around 51% of CGH's total VAS pre-tax profit. CGH also guided the pre-tax profit of Smart Living to double in FY23E. We believe Smart Living will maintain robust growth momentum in the future, and the spin-off will further unleash brand value. In addition, VAS still has significant growth potential with an increasingly higher penetration rate.

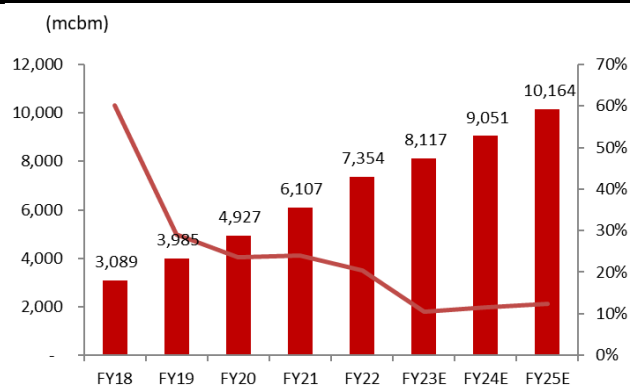
Figure 2: Composition of VAS's pre-tax profit



Source: Company data, CMBIGM estimates

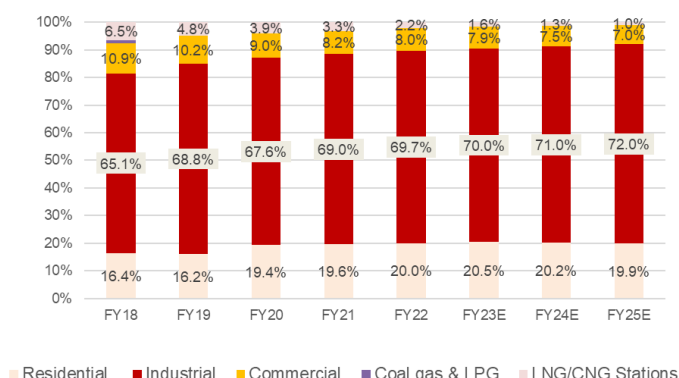
Focus charts

Figure 3: Residential gas sales (FY18-25E)



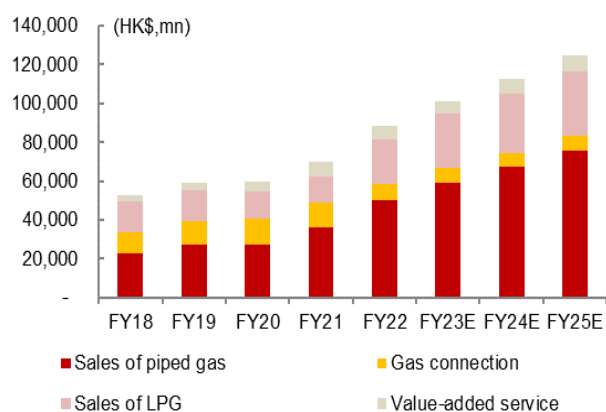
Source: Company data, CMBIGM estimates

Figure 4: CGH's gas sales volume mix (FY18-25E)



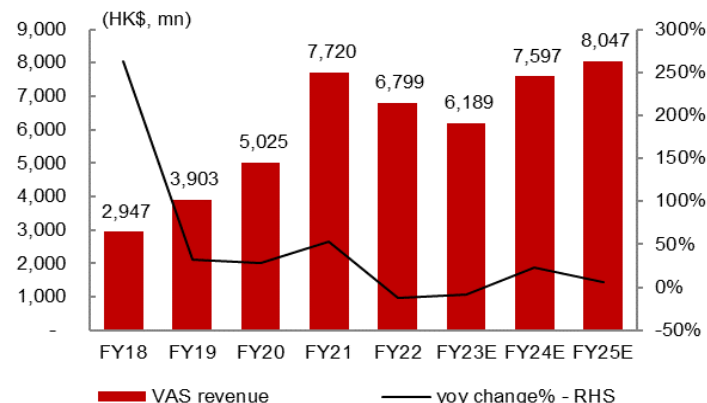
Source: Company data, CMBIGM estimates

Figure 5: CGH's revenue mix (FY18-25E)



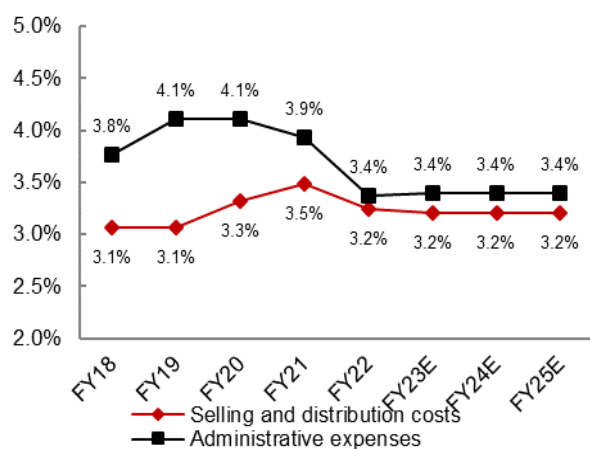
Source: Company data, CMBIGM estimates

Figure 6: CGH's VAS revenue (FY18-25E)



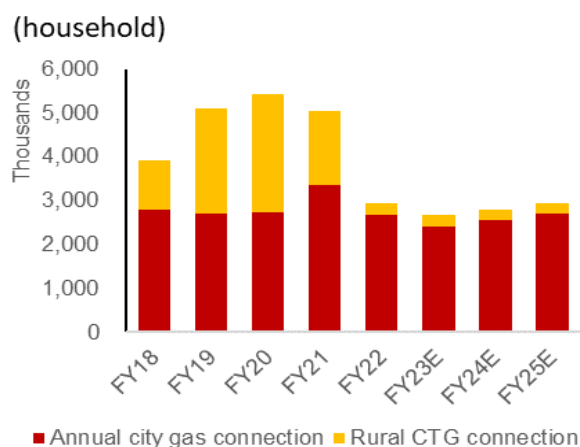
Source: Company data, CMBIGM estimates

Figure 7: CGH's S&A expenses as % to revenue



Source: Company data, CMBIGM estimates

Figure 8: Annual residential connection - City + rural



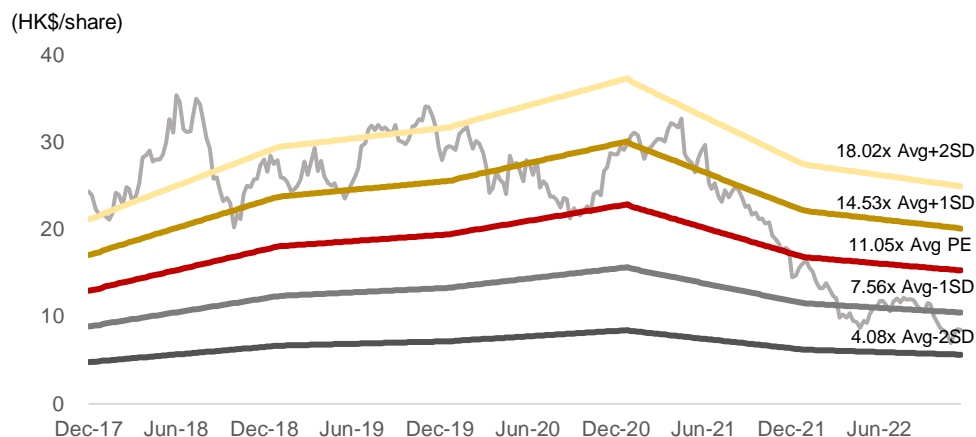
Source: Company data, CMBIGM estimates

Valuation method

- We update our operating assumptions according to CGH's guidance for FY23E as follows:
 1) residential gas sales growth of 10% YoY; 2) dollar margin targets to record RMB0.5cbm;
 3) newly-added residential connection of around 2.6mn households; 4) Smart Living's pre-tax profit double.

CGH is trading at around 7x FY23E PE now and the valuation is relatively attractive, we believe the slowdown of gas connection expectation and pressured gas sales are largely priced in. Moreover, we remain optimistic about CGH's robust VAS growth and gas sales growth recovery as epidemic control measures further relax. **To factor in all above factors, our TP was HK\$13.2/share, based on around 11x forward PE of FY23E (~close to around historical 5-year avg. PE. We transfer coverage with BUY rating.**

Figure 9: Forward PE band



Source: Company data, CMBIGM estimates

Figure 10: Peers table

Company	Ticker	Closing Price (HK\$)	Mkt cap (HK\$mn)	EPS			22-24E CAGR	PER			PBR		
				22A	23E	24E		FY22	FY23E	FY24E	FY22	FY23E	FY24E
CHINA GAS HOLDING	384 HK	9.73	52934.47	1.53	1.33	1.49	-19.9%	6.38	7.33	6.54	0.81	0.76	0.66
ENN ENERGY	2688 HK	107.20	121204.14	7.00	7.55	8.48	9.3%	13.78	12.78	11.37	2.66	2.34	1.91
TIAN LUN GAS HOL	1600 HK	3.69	3727.00	0.58	0.76	0.90	-14.6%	5.75	4.40	3.68	0.57	0.52	0.48
CHINA RES GAS	1193 HK	29.05	67222.07	2.74	2.98	3.35	4.6%	10.61	9.74	8.68	1.50	1.38	1.21
TOWNGAS SMART EN	1083 HK	3.85	12545.67	0.44	0.47	0.54	-9.9%	8.81	8.26	7.09	0.50	0.52	0.48
KUNLUN ENERGY	135 HK	5.76	49874.70	0.72	0.76	0.79	14.3%	7.23	6.83	6.60	0.74	0.70	0.61
Average								8.1	7.3	6.5	0.8	0.8	0.9

Source: Company data, CMBIGM estimates

Figure 11: Key operating data assumption and summary

HK\$ mn, YE Mar 31	FY21	FY22	FY23E	FY24E	FY25E
Revenue	69,975	88,225	101,124	112,014	123,820
Sales of piped gas	35,936	50,529	59,420	67,081	75,483
Reconciled gas connection	13,156	7,816	7,186	7,132	7,066
Sales of LPG	13,164	23,081	28,330	30,204	33,224
Value-added service	7,720	6,799	6,189	7,597	8,047
Others	-	-	-	-	-
Gross profit	18,102	15,739	15,544	17,347	18,443
Gross profit margin	25.9%	17.8%	15.4%	15.5%	14.9%
EBIT	15,509	12,244	11,380	12,764	13,081
EBIT margin	22.2%	13.9%	11.3%	11.4%	10.6%
Profit before taxation	14,090	10,787	9,605	10,949	11,228
Taxation	-2,418	-2,004	-1,729	-2,080	-2,021
effective tax rate	17.16%	18.58%	18.00%	19.00%	18.00%
Profit for the year	11,672	8,783	7,876	8,868	9,207
Less: Non-controlling interests	1,194	1,121	1,008	1,135	1,178
Net profit	10,479	7,662	6,868	7,733	8,028
yoy growth %	14.0%	-26.9%	-10.4%	12.6%	3.8%
net profit margin	15.0%	8.7%	6.8%	6.9%	6.5%
EPS(HK\$)	2.01	1.42	1.20	1.32	1.37
Operating performance					
City gas sales - mcbm					
Residential	6,107	7,354	8,117	9,022	10,068
Industrial	9,018	10,804	11,517	13,486	15,619
Commercial	2,549	2,948	3,124	3,339	3,534
Vehicle	1,024	812	650	586	528
Whole sale gas - mcbm	12,512	14,784	16,263	18,214	20,764
LPG sales - tonnes					
	4.25	4.59	4.36	4.79	5.27
Total residential connection					
City residential connection - k HH	5,038	2,941	2,658	2,619	2,581
Township residential connection - k HH	3,361	2,668	2,401	2,377	2,353
	1,678	273	257	242	227

Source: Company data, CMBIGM estimates

Figure 12: CMBIGM estimates vs consensus

HKD mn, Mar-YE	CMBIGM			Consensus			Diff(%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue (HK\$, mn)	101,124	112,014	123,820	97,673	106,293	114,409	3.5%	5.4%	8.2%
Gross Profit	15,544	17,347	18,443	15,417	17,290	18,685	0.8%	0.3%	-1.3%
Net Income (HK\$,mn)	6,868	7,733	8,471	7,505	8,496	9,658	-8.5%	-9.0%	-12.3%
EPS (HK\$)	1.20	1.32	1.45	1.35	1.48	1.63	-11.2%	-10.7%	-11.3%
Gross Margin	15%	15%	15%	16%	16%	16%	-0.4%	-0.8%	-1.4%
Net Margin	7%	7%	7%	8%	8%	8%	-0.9%	-1.1%	-1.6%

Source: Company data, CMBIGM estimates

1HFY23 Results Highlight:

- Revenue rose 10.3% YoY to HK\$42.98bn
- Core profit declined by 22.2 YoY to HK\$3.29bn
- Retail gas sales volume raised 8.7% YoY, and residential gas sales volume ascended by 10% YoY
- 1.34mn residential connections were newly added, dragged by 12.4%YoY
- Gas dollar margin achieved RMB0.54/cbm
- Value-added services GP were up 0.3%YoY to HK\$1.6bn. Its pre-tax profit decreased 7.5% YoY to HK\$1.2bn, accounting for around 50% of total pre-tax profit.
- Interim dividend was HK\$10 cents

FY23E Key Guidance:

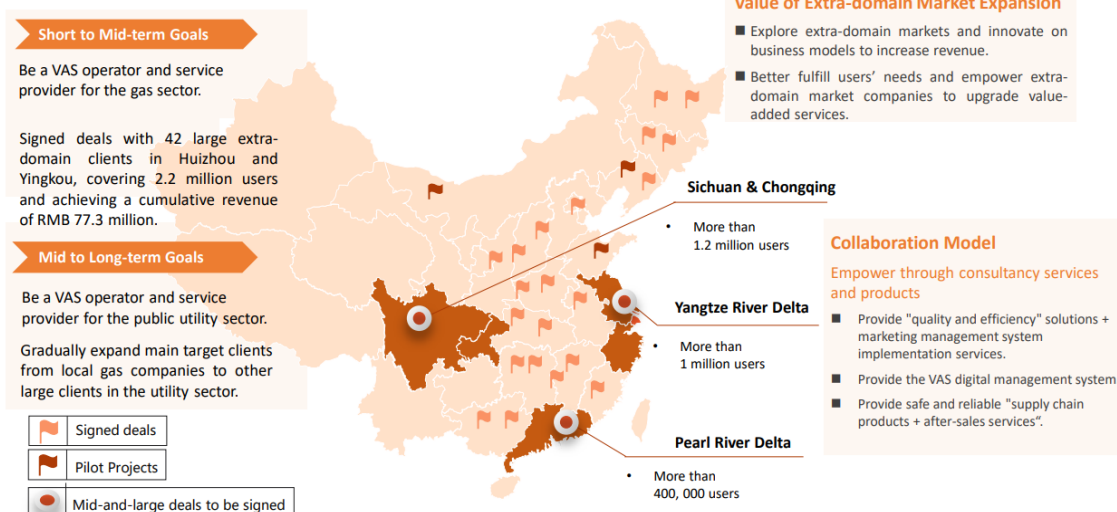
- Dollar margin came in at RMB0.5cbm
- City and township gas sales volume reported 10% YoY growth
- Newly-added residential connection targeted at 2.6-2.9mn households
- Smart Living's pre-tax profit rose 100% YoY

Figure 13: Smart Living maintained robust growth

Smart Living Taking Off



Exploring extra-domain markets and creating modular growth models for gas value-added services (VAS).



Source: The Company, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar (HK\$ mn)						
Revenue	59,540	69,975	88,225	101,124	112,014	123,820
Cost of goods sold	(42,443)	(51,873)	(72,486)	(85,580)	(94,666)	(105,377)
Others	na	na	na	na	na	0
Gross profit	17,097	18,102	15,739	15,544	17,347	18,443
Operating expenses	(3,444)	(3,581)	(4,399)	(5,174)	(5,593)	(5,753)
Selling expense	(1,973)	(2,439)	(2,861)	(3,236)	(3,584)	(3,715)
Admin expense	(2,447)	(2,751)	(2,973)	(3,438)	(3,808)	(3,838)
Others	976	1,608	1,435	1,500	1,800	1,800
Operating profit	14,113	15,509	12,244	11,430	12,814	13,750
Other income	640	923	1,378	1,000	1,000	1,000
Other gains/(losses)	(180)	65	(474)	60	60	60
EBITDA	15,704	17,420	14,511	13,988	15,661	16,849
Depreciation	1,591	1,911	2,267	2,558	2,846	3,098
EBIT	14,113	15,509	12,244	11,430	12,814	13,750
Interest expense	(1,388)	(1,419)	(1,457)	(1,775)	(1,816)	(1,854)
Pre-tax profit	12,725	14,090	10,787	9,655	10,999	11,897
Income tax	(2,464)	(2,418)	(2,004)	(1,729)	(2,080)	(2,132)
After tax profit	10,261	11,672	8,783	7,926	8,918	9,764
Minority interest	1,072	1,194	1,121	1,008	1,135	1,243
Net profit	9,188	10,479	7,662	6,918	7,783	8,521
Core net profit	na	na	na	na	na	0
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar (HK\$ mn)						
Current assets	39,509	50,394	55,423	65,398	68,388	72,446
Cash & equivalents	7,119	8,294	10,011	14,852	14,309	15,970
Account receivables	468	504	542	504	504	504
Inventories	3,246	5,302	5,701	7,685	8,513	9,410
Prepayment	0	0	0	0	0	0
Other current assets	15,925	19,369	22,032	23,965	26,704	28,296
Contract assets	12,751	16,925	17,138	18,391	18,357	18,266
Non-current assets	72,558	90,326	107,723	111,069	120,276	129,519
PP&E	46,128	56,909	68,065	70,709	76,084	81,184
Deferred income tax	260	489	705	509	519	529
Investment in JVs & assos	7,815	9,052	12,223	10,711	12,125	13,667
Goodwill	3,042	3,298	3,473	3,598	3,698	3,798
Other non-current assets	112,067	140,721	163,146	176,467	188,664	201,966
Current liabilities	49,347	46,313	54,287	62,627	67,306	72,485
Short-term borrowings	24,121	17,272	22,143	23,417	23,908	24,399
Account payables	17,700	19,409	21,079	28,241	31,240	34,774
Tax payable	1,246	1,021	1,269	778	936	960
Other current liabilities	207	364	140	364	364	364
Lease liabilities	75	210	214	224	234	244
Contract liabilities	5,998	8,037	9,443	9,603	10,625	11,745
Non-current liabilities	16,936	34,543	36,790	36,928	37,700	38,471
Long-term borrowings	15,568	31,717	33,986	34,065	34,776	35,488
Other non-current liabilities	1,368	2,826	2,804	2,864	2,924	2,984
Total liabilities	66,283	80,857	91,077	99,555	105,006	110,956
Share capital	52	52	54	59	59	59
Other reserves	39,553	51,885	63,523	67,354	73,047	79,272
Total shareholders equity	45,783	59,864	72,069	76,912	83,740	91,208
Minority interest	6,178	7,927	8,491	9,499	10,635	11,878
Total equity and liabilities	112,067	140,721	163,146	176,467	188,746	202,165

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar (HK\$ mn)						
Operating						
Profit before taxation	12,725	14,090	10,787	9,605	10,949	11,847
Depreciation & amortization	1,591	1,911	2,267	2,558	2,846	3,098
Change in working capital	(8,091)	(4,682)	1,682	1,836	1,510	3,376
Others	(4,833)	(6,457)	(872)	(2,760)	(5,415)	15,657
Net cash from operations	6,486	8,279	13,126	12,545	12,907	15,657
Investing						
Capital expenditure	(3,163)	(10,781)	(11,156)	(2,645)	(5,375)	(5,101)
Others	(3,776)	(7,219)	(9,512)	(2,875)	(6,669)	(7,231)
Net cash from investing	(6,939)	(18,000)	(20,668)	(5,520)	(12,043)	(12,331)
Financing						
Dividend paid	(2,934)	(3,203)	(3,643)	(3,539)	(2,608)	(2,868)
Net borrowings	1,790	9,300	7,140	1,353	1,203	1,203
Others	(1,103)	(146)	6,505	2	0	0
Net cash from financing	(2,246)	5,951	10,001	(2,184)	(1,406)	(1,665)
Net change in cash						
Cash at the beginning of the year	13,239	7,119	8,294	10,011	14,852	14,309
Exchange difference	(3,420)	4,945	0	0	0	0
Others	(2,700)	(3,770)	2,460	4,841	(542)	1,661
Cash at the end of the year	7,119	8,294	10,753	14,852	14,309	15,970
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
Revenue	0.3%	17.5%	26.1%	14.6%	10.8%	10.5%
Gross profit	21.6%	5.9%	(13.1%)	(1.2%)	11.6%	6.3%
Operating profit	12.6%	9.9%	(21.1%)	(6.6%)	12.1%	7.3%
EBITDA	13.3%	10.9%	(16.7%)	(3.6%)	12.0%	7.6%
EBIT	12.6%	9.9%	(21.1%)	(6.6%)	12.1%	7.3%
Net profit	10.9%	14.0%	(26.9%)	(9.7%)	12.5%	9.5%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
Gross profit margin	28.7%	25.9%	17.8%	15.4%	15.5%	14.9%
Operating margin	23.7%	22.2%	13.9%	11.3%	11.4%	11.1%
EBITDA margin	26.4%	24.9%	16.4%	13.8%	14.0%	13.6%
Return on equity (ROE)	21.2%	19.8%	11.6%	9.3%	9.7%	9.7%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
Current ratio (x)	0.8	1.1	1.0	1.0	1.0	1.0
Receivable turnover days	61.2	63.8	63.7	63.1	65.4	65.5
Inventory turnover days	20.4	22.3	22.8	24.2	26.4	26.4
Payable turnover days	178.0	130.6	101.9	105.2	114.7	114.3
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
P/E	16.7	13.2	14.5	8.2	7.4	6.8
P/B	3.9	2.7	1.8	0.8	0.8	0.7
Div yield (%)	1.7	2.1	2.7	3.5	3.8	4.2

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

Disclosures & Disclaimers

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