



## Company Report: HK and China Gas (00003 HK)

公司报告: 中华煤气 (00003 HK)

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# 2017 Interim Results In Line, Maintain "Buy"

2017年中期业绩符合市场预期, 维持“买入”评级

- **The 2017 interim results of the Company were generally in line with market consensus and our expectations.** Total revenue of the Company increased 8.96% yoy to HK\$ 15.43 billion, net profit attributable to shareholders increased 3.26% yoy to HK\$ 4.47 billion.
- **Maintain operating profit assumptions unchanged, contributed by Hong Kong gas business.** The gas business of the Company in Hong Kong was rather stable and the sale of gas and cooking sets in Hong Kong in the first half of 2017 was generally in line with our estimation.
- **Revise up natural gas sales assumptions.** National policies on environmental protection, accelerated execution on “coal-to-gas” projects for local governments and sufficient gas supply all combined to stimulate gas consumption.
- **Revise down gas dollar margin assumptions slightly due to more competition in the industrial sector and customer group mix change.** We expect the gas dollar margin of the Company to remain at a steady level in 2017-2019 under new pricing mechanisms.
- **Maintain the TP at HK\$ 17.97 and maintain “Buy”.**
- 公司 2017 年中期业绩基本符合市场一致预期和我们的估计。公司收入同比增加 8.96% 至港币 154.3 亿元, 股东净利同比增长 3.26% 至港币 44.7 亿元。
- 维持香港燃气业务贡献运营利润假设不变。公司在香港的燃气业务十分稳定, 2017 年上半年香港天然气和炉具的销量基本符合我们的估计。
- 上调公司天然气销量假设。国家层面的环保政策, 地方政府加快执行“煤改气”以及充足的供应都有利于促进天然气的消费。
- 由于工业领域更激烈的竞争和客户群体结构的变化, 下调公司销气价差假设。我们预计在新的价格机制下公司 2017-2019 年的销气价差将保持在一个稳定的水平。
- 维持目标价在 17.97 港元, 维持“买入”评级。

Rating:

**Buy**

Maintained

评级:

买入 (维持)

6-18m TP 目标价:

**HK\$17.97**

Revised from 原目标价:

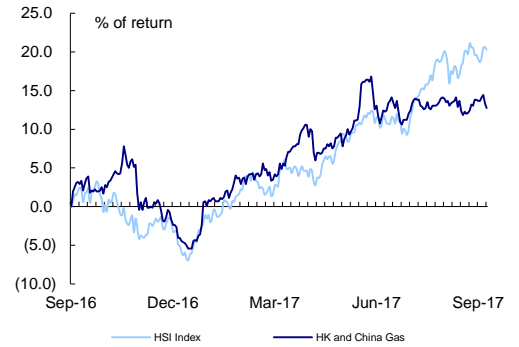
HK\$17.97

Share price 股价:

HK\$14.740

### Stock performance

股价表现



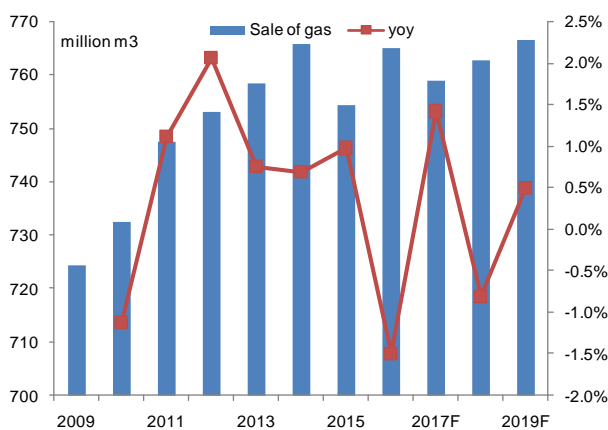
Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	(0.5)	1.0	12.8
Rel. % to HS Index 相对恒指变动 %	(2.9)	(6.8)	(7.5)
Avg. share price(HK\$) 平均股价 (港元)	14.8	14.8	13.9

Source: Bloomberg, Guotai Junan International.

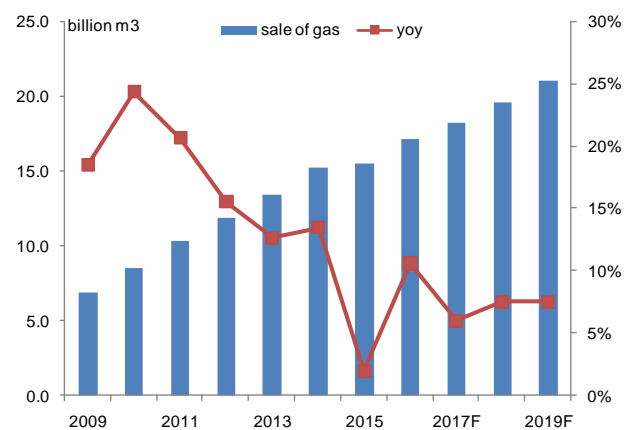
Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
12/31	(HK\$ m)	(HK\$ m)	(HK\$)	(Δ %)	(x)	(HK\$)	(x)	(HK\$)	(%)	(%)
2015A	29,591	7,302	0.574	(15.1)	25.7	4.155	3.5	0.318	2.2	13.8
2016A	28,557	7,341	0.577	0.5	25.5	4.241	3.5	0.350	2.4	13.6
2017F	31,661	7,672	0.603	4.5	24.4	4.494	3.3	0.350	2.4	13.4
2018F	33,789	8,217	0.646	7.1	22.8	4.790	3.1	0.350	2.4	13.5
2019F	36,116	8,849	0.696	7.7	21.2	5.136	2.9	0.350	2.4	13.5
Shares in issue (m) 总股数 (m)				12,717.0	Major shareholder 大股东				Lee Shau Kee	41.5%
Market cap. (HK\$ m) 市值 (HK\$ m)				187,448.6	Free float (%) 自由流通比率 (%)					58.5
3 month average vol. 3 个月平均成交股数 ('000)				10,071.9	FY17 Net gearing (%) FY17 净负债/股东资金 (%)					38.3
52 Weeks high/low (HK\$) 52 周高/低				15.273 / 12.273	FY17 Est. NAV (HK\$) FY17 每股估值 (港元)					21.3

Source: the Company, Guotai Junan International.

The 2017 interim results of the Company were generally in line with market consensus and our expectations. Total revenue of the Company increased 8.96% yoy to HK\$ 15.43 billion, net profit attributable to shareholders increased 3.26% yoy to HK\$ 4.47 billion. Total sale of gas in Hong Kong increased by 0.8% yoy, but the sale of cooking sets decreased slightly. Total sale of gas in mainland China increased by 13% yoy to 9.72 billion m<sup>3</sup> and total customers increased by about 10% to 24.15 million. Gas distribution and related businesses, including sale of gas, connection services, sale of gas appliances and maintenance services, are the core business areas of the Company. In the first half of 2017, these businesses contributed 90.0% of total revenue of the Company and 91.5% of EBITDA. Hong Kong gas business is the cornerstone of the Company and contributed 47.5% of total EBITDA in 1H2017. In the first half of 2017, gas distribution business and water business in mainland China contributed 44.0% of total EBITDA. The Company also benefited greatly from its associates and joint ventures, which are mainly engaged in gas distribution business and property development. The associates and joint ventures which engage in gas distribution business in mainland China contributed HK\$ 1.29 billion of profit in the first half of 2017; the associates and joint ventures engaged in property business contributed HK\$ 0.86 billion of profit in the first half of 2017.

**Figure-1: Sale of Piped Gas in Hong Kong**


Source: the Company, Guotai Junan International.

**Figure-2: Sale of Gas of in Mainland China**


Source: the Company, Guotai Junan International.

**Maintain operating profit assumptions contributed by Hong Kong gas business unchanged.** Gas distribution business of the Company in Hong Kong generally remained steady over the past several years. Total number of customers of the Company in Hong Kong increased steadily over the past 8 years and reached 1.87 million in 1H2017, but the growth rate has always been rather small. Total sale of piped gas increased 0.8% yoy to 15.9 billion MJ in 1H2017, which was generally in line with our estimation. Hong Kong's gas distribution market is a highly mature and stable market, mainly consisting of residential and commercial customers, making it normal to have a stable customer group and stable gas consumption. Total sale of cooking sets of the Company in Hong Kong was also rather stable. The sale of cooking sets is mainly from renewal demand of its customers, and the Company holds great competitive advantages comparing to other home appliance brands. With a stable customer group and a stable renewal rate, the sale of cooking sets of the Company in Hong Kong has also enjoyed stable demand. Although the Hong Kong gas distribution market is not expected to record significant growth in the future, it is expected to continue to offer stable operating profit to the Company. The sale of gas and cooking sets in Hong Kong in the first half of 2017 was generally in line with our estimation, so we maintain operating profit assumptions contributed by Hong Kong gas business unchanged.

**Revise up natural gas sales assumptions of the Company.** According to the National Development and Reform Commission (NDRC), natural gas consumption in mainland China accelerated in the first half year of 2017, increasing 15.2% yoy to 114.6 billion m<sup>3</sup>. National policies on environmental protection, accelerated execution on "coal-to-gas" projects for local governments and sufficient gas supply all combined to stimulate gas consumption. Environmental protection pressure will be the major driver for gas consumption in the coming years. In March 2017, the Ministry of Environmental Protection of the People's Republic of China (MEP), the National Development and Reform Commission (NDRC), the Ministry of Finance, and governments of six relevant provinces and municipalities, issued the 2017 Work Plan on "The Prevention and Control of Atmosphere Pollution in the Beijing, Tianjin and Hebei Areas and Surrounding Regions", clearly specifying the 2+26 key areas for implementing "coal-to-gas conversion". On the other hand, the need to adjust energy consumption structure will also drive natural gas consumption. NDRC and 13 central authorities jointly issued "The Opinions on Accelerating the Use of Natural Gas" in July 2017, which plans to develop natural gas into one of the major types of energy in China's modern clean energy system. We expect that such policies will strongly drive gas consumption in northern China. More "coal to gas" projects are on the way,

and “coal to gas” projects account for a significant part of newly installed capacity for industrial/commercial customers. The Company had a total of 131 city-gas projects across 23 provinces, municipalities and autonomous regions throughout mainland China and one of the largest customer groups among gas distribution companies. We expect the Company to benefit greatly from favorable policy environments. Total sale of natural gas increased by 13% yoy to 9.72 billion m<sup>3</sup> in the first half of 2017, which was higher than our previous estimation. Hence, we revise up natural gas sales assumptions of the Company.

**Revise down gas dollar margin assumptions of the Company.** After the gas price reform which took place in 2015, the price difference between “legacy” and “incremental” gas was removed. The price adjustments will not have a structural impact on the purchase costs of the Company and has made gas dollar margins of gas distribution companies much more stable. On the other hand, the implementation of a step pricing mechanism will help to raise the dollar margin of residential customers. Hence, we expect the gas dollar margin of the Company to remain at a stable level in 2017-2019. However, the Company had to offer preferential prices in some instances to secure large industrial customers. Additionally, in order to stimulate the use of gas, gas sold to “coal to gas” customers is usually lower in price. Hence, gas dollar margin of “coal to gas” customers is usually lower than that of normal industrial customers. Hence, we revise down gas dollar margin assumptions of the Company due to customer group mix change.

**Maintain connection service revenue assumptions unchanged.** The Company connected about 1.05 million new residential customers in the first half of 2017, which was generally in line with our estimation. Revenue contributed by connection business increased by 1.1% yoy to HKD\$ 1.28 billion. The Company is expected to continue to add more customers as current gas penetration rate remains low and more gas projects are acquired. The Company still holds great growth potential for industrial customers in its existing operation areas due to low penetration rates. We expect the Company to continue to develop more industrial customers at a fast speed. The connection service results of the Company were generally in line with our estimation, so we maintain connection service revenue assumptions unchanged.

**Maintain the TP at HK\$ 17.97, and maintain “Buy”.** The Hong Kong and China Gas Company is one of the largest gas distributors in mainland China and also operates gas distribution business in Hong Kong. We expect the golden age of natural gas to continue for four reasons: the need to adjust China’s energy consumption structure, relatively sufficient supply, complete gas transport system and relatively low prices. We expect gas consumption growth in China to maintain at double-digit levels in the next 5 years. Additionally, the price reform of natural gas is positive for long-term consumption growth of natural gas and the stabilization of profitability in mainland China’s gas distribution business. We expect the Company to continue to benefit from the growth of mainland China’s fast growing gas market. We expect total sale of piped natural gas of the Company to continue to maintain steady growth over the next few years. At the same time, the Company also enjoys the stable profitability in Hong Kong gas market. Although the growth speed of the Company is slower than other large gas distributors, the Company has much higher profitability and stable dividend ratio. We believe the Company justifies a higher PE valuation level. We revise up gas sales assumptions due to faster growth of natural gas consumption in mainland China, but revise down gas dollar margin slightly due to customer mix change. We also maintain operating profit contributed by Hong Kong assumptions unchanged. Hence, we revise up net profit assumption of the Company. Hence, we maintain our target price at HK\$ 17.97, which represents 30.0x FY17 PE and maintain “Buy”.

**Table-1: Peers Comparison**

Company	Stock Code	Currency	Last price	PE (fiscal year)				PB (fiscal year)				ROE(%)
				16A	17F	18F	19F	16A	17F	18F	19F	17F
<b>Large Cap. Gas Distributors</b>												
Hong Kong & China Gas	3 HK	HKD	14.74	27.1	26.7	25.4	24.4	3.6	3.4	3.3	3.2	13.4
Kunlun Energy Co Ltd	135 HK	HKD	7.41	31.3	11.4	10.7	9.6	1.2	1.3	1.2	1.1	12.4
Beijing Enterprises Hldgs	392 HK	HKD	42.25	8.6	8.2	7.6	7.0	0.9	0.8	0.8	0.7	10.6
China Gas Holdings Ltd	384 HK	HKD	20.80	28.2	25.5	18.9	16.2	5.0	4.8	4.1	3.5	19.9
Enn Energy Holdings Ltd	2688 HK	HKD	52.65	16.7	13.7	12.2	10.7	3.2	2.7	2.2	2.0	20.9
China Resources Gas Group Lt	1193 HK	HKD	26.65	16.5	15.2	13.6	12.0	2.9	2.9	2.5	2.2	20.0
Towngas China Co Ltd	1083 HK	HKD	5.19	11.3	12.0	11.0	9.8	1.0	1.0	0.9	0.9	8.4
Simple Average				20.0	16.1	14.2	12.8	2.5	2.4	2.2	1.9	15.1
Weighted Average				21.1	16.1	13.4	11.8	2.9	2.8	2.4	2.1	16.9
<b>Small Cap. Gas Distributors</b>												
China Oil And Gas Group Ltd	603 HK	HKD	0.54	7.9	9.3	8.1	7.2	1.0	0.9	0.8	0.7	11.7
China Tian Lun Gas Holdings	1600 HK	HKD	5.93	15.0	12.5	11.0	9.7	1.8	1.6	1.4	1.2	14.8
Zhongyu Gas Holdings Ltd	3633 HK	HKD	3.03	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Binhai Investment Company Lt	2886 HK	HKD	1.87	12.5	7.8	6.9	6.2	n.a.	1.6	1.4	1.2	21.9
Tianjin Jinran Public Util-H	1265 HK	HKD	0.61	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	7.2
Chinese People Holdings Co	681 HK	HKD	0.09	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Simple Average				11.8	9.9	8.7	7.7	1.4	1.4	1.2	1.1	13.9
Weighted Average				13.2	9.2	8.1	7.2	1.8	1.6	1.4	1.2	17.7
<b>A Share Gas Distributors</b>												
Guanghui Energy Co Ltd-A	600256 CH	CNY	4.27	65.7	34.7	25.1	20.3	2.0	1.8	1.7	1.6	4.2
Shenergy Company Limited-A	600642 CH	CNY	6.09	15.2	16.0	15.2	n.a.	n.a.	n.a.	n.a.	n.a.	8.0
Shenzhen Gas Corp Ltd-A	601139 CH	CNY	8.81	22.1	20.3	17.8	16.1	2.4	2.3	2.1	1.9	11.3
Shaan Xi Provincial Natura-A	002267 CH	CNY	8.66	16.8	18.3	16.4	19.2	n.a.	1.7	1.6	1.5	7.5
Changchun Gas Co Ltd -A	600333 CH	CNY	7.25	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Sichuan Datong Gas Develop-A	000593 CH	CNY	10.97	n.a.	52.2	27.4	n.a.	3.4	3.2	2.9	n.a.	6.1
Simple Average				30.0	28.3	20.4	18.6	2.6	2.3	2.1	1.6	7.4
Weighted Average				18.4	20.4	17.3	17.4	2.5	2.2	2.0	1.7	9.0

Source: Bloomberg, Guotai Junan International.



### Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

### Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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