

## **Corporate Snippet**

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## **Potential still intact**

## **China Utilities**

## Sino Gas (260 HK, HK\$0.54)

**Not Rated** 

**Interim results somewhat below expectations.** Sino Gas announced its interim results last week. Net profit was HK\$14.7m in 1H FY12/06 on a revenue of HK\$82.6m. While the results looked reasonably well on a YoY basis (i.e. from a very low base), it came in below our expectations on a sequential basis. As Sino Gas built up more CNG gas stations in 1H FY12/06, we had expected the company to show strong sequential earnings growth. However, net profit actually dropped 36% HoH in 1H FY12/06.

Sino Gas operated 3 CNG gas stations in the beginning of this year and built 21 CNG gas stations by the end of June. However, the company cited the sequential profit decline as (1) most of the new CNG stations built during the period were not in operation, and (2) lower contribution from one-off technical service (which contributed 64% revenue in 2H FY12/05). Meanwhile, the decline in gross margin in 1H FY12/06 was caused by lower contribution from the provision for technical services (which had a gross margin of over 90%). In 1H FY12/06, gas station operation contributed 51% of the revenue, followed by provision for technical services (33%), and trading of gas related products (15%).

Table 1: Interim results comparisons									
Year to Dec (HK\$m)	1H 06	1H 05	YoY (%)	2H 05	НоН (%)				
Revenue	82.6	41.2	101	78.2	5.6				
Gross profit	36.9	4.7	692	47.2	(21.8)				
Operating profit	16.3	(7.2)	NA	35.0	(53.4)				
Pre-tax profit	17.0	(176.9)	NA	39.1	(56.5)				
Net profit	14.7	(175.7)	NA	22.9	(36.0)				
Gross margin (%)	44.7	11.3		60.4					
Operating margin (%)	19.8	(17.4)		44.8					
Net margin (%)	17.7	(426.7)		29.3					

Source: Company data and SBI E2-Capital

**Down but not out.** Sino Gas targets to build up to 60 gas stations by the end of 2006. However, with only 21 CNG gas stations built as of the end of 1H FY12/06, the full-year target looks quite aggressive at this juncture. Nevertheless, the longer-term story is still intact for Sino Gas. As Sino Gas keeps on building more CNG stations, the company can sell more natural gas to public buses in various regions. Although 1H FY12/06 results were disappointing, we expect much better results in 2H FY12/06 and FY12/07. Assuming Sino Gas is able to achieve its target of building up to 60 stations by the end of the year with 70 gas stations running at full capacity in FY12/07, we expect natural gas sales will jump significantly to 378m m<sup>3</sup> in FY12/07 and contribute an expected net profit of HK\$141m.

As guarantor for Hongli. Few weeks ago, Sino Gas announced that its subsidiary, Beijing Sinogas, agreed to provide a guarantee to Hongli (a subsidiary of China National Petroleum Corporation) for a bank loan of RMB60m. The loan will be payable in a year time from the date Hongli receives the money. Including this agreement, Sino Gas has acted as a guarantor for a total of RMB100m loan for Hongli.

**Background of Hongli.** Hongli is principally engaged in the construction of petroleum natural gas pipes, investment and development in natural gas storage stations and other gas related business. Hongli has recorded an audited net asset value of RMB300m and RMB745m as at the end of 2004 and 2005 respectively. Hongli and its ultimate beneficial owner are independent of Sino Gas.

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Table 2: Earnings and sales assumptions							
Year to Dec	FY06F	FY07F					
CNG daughter stations planned to build (units)	60	129					
CNG daughter stations in full operation (units)	20	70					
Daily gas usage per station (m3)	15,000	15,000					
Annual gas consumption (m3)	108,000,000	378,000,000					
Average profit (RMB) per m3	0.5	0.5					
Total profit from natural gas station before minority interests (RMB)	54,000,000	189,000,000					
Attributable profit to Sino Gas (RMB)	37,674,000	140,814,000					

Source: SBI E2-Capital

Table 3: Progress of gas stations at the end of 1H FY12/06										
Location	Progress unitil June 2006			Target by year-end 2006				Effective		
	Mother CNG	Daughter CNG	Petrol	Mother CNG	Daughter CNG	Petro	Nature Nature	holdings		
Beijing		1			1		LPG	69%		
Shentong Qingdao		1			1		LPG	66%		
Jilin Changchun	1	17		1	18		LPG+CNG	35%		
Yinchuan	1	5		1	6		CNG	34%		
Henan Zhengzhou		10			10		CNG	41%		
Shentong Jinan	1	2		1	5		CNG	35%		
Guangzhou					2		LPG	62%		
Hefei		1			7		CNG	100%		
Nanjing					3		CNG	69%		
Xuzhou				1	7		CNG	85%		
Xuchang				2	7		CNG	80%		
Chengdu				1	3		CNG	85%		
Zhuhai				1	6		CNG	50%		
Shanghai					2		CNG	NA		
Zhangsu Wuxi			1			1	Petrol			
Accumulated										
LPG stations		16			18					
CNG stations	3	21		8	60					
Petrol stations			1			1				

Source: Company data and SBI E2-Capital

Why Sino Gas acts as guarantor? We believe the move was due to (1) this agreement would enable Sino Gas to further strengthen its relationship with CNPC, which controls the upstream gas supply, (2) given its strong asset value, Hongli's default risk is low, and (3) probably Beijing Sinogas is doing Hongli (which is a subsidiary of CNPC) a favor as Beijing Sinogas was once a subsidiary of CNPC.

**Share price weakness reflects market concerns.** While the arrangement may be a business decision, we believe this agreement will put Sino Gas in a higher financial risk situation, given that the company is still in its early growth stage. Market may also question the management's professionalism, especially Sino Gas is a new company with a limited track record.

**Healthy financials.** After a new share issue in July, we estimate that the company currently has a net cash of around HK\$60m. Capex amounted to HK\$33m in 1H FY12/06 and the company expects full year capex to top HK\$90m. With improving earnings in 2H FY12/06F, the company believes no more fund-raising is needed in 2H FY12/06. However, the company may increase its debt level, given the current net cash position. Since the company is still in a growth phase, it has no plan to pay dividend in the near term.