

No surprises

China Utilities

China Gas (384 HK, HK\$1.28)

Not Rated

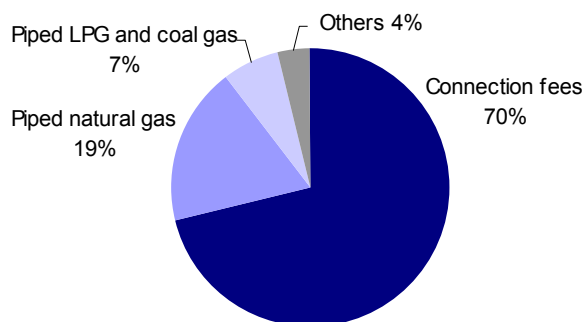
FY03/06 results covered by one-off income. Mainland piped-gas operator China Gas reported net profit of HK\$157m (up 62% YoY) in FY03/06 along with (1) higher revenue, and (2) one-off contributions from changes in fair value of derivative financial instruments (HK\$25.7m) as a result of new accounting standard, and (3) discounts on acquisition of subsidiaries (HK\$37.9m). Gross margin fell to 48.4% during the period (cf. 60.1% in FY03/05), which was attributable to the higher contribution of sales of natural gas, as it carries a lower gross margin of 15%. Sales of natural gas accounted for 43.3% of revenue in FY03/06, compared with 18.6% in a previous year. The company proposed to pay its first ever final dividend of HK\$1 cent per share (~ 20% payout), translating dividend yield of 0.78%. This represented one of the highest payout for this industry.

Table 1: Final results

(HK\$m)	FY03/06	FY03/05 (restated)	YoY (%)
Revenue	631	411	53%
Gross profit	305	247	23%
Operating profit	163	147	11%
Pre-tax profit	183	134	36%
Net profit	157	97	62%
Gross margin (%)	48.4	60.1	
Operating margin (%)	25.8	35.7	
Net margin (%)	24.9	23.5	

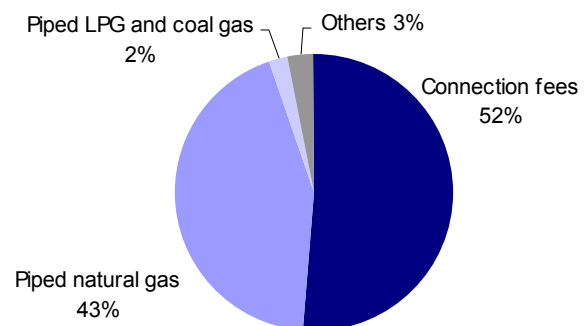
Source: Company data and SBI E2-Capital

Chart 1: Revenue breakdown in FY03/05



Source: Company data

Chart 2: Revenue breakdown in FY03/06



Source: Company data

Industrial users remain in focus. China Gas continues to focus on the industrial users, which accounted for 73% of its natural gas usage in FY03/06. At the end of March 2006, the company owned 72 industrial users (cf. 26 in the previous year). China Gas offers the lowest tariff to industrial users (compared with residential users, commercial users and gas stations) in order to attract more users to switch to natural gas. China Gas has started to provide natural gas to vehicle users during the year and has accumulated 6 gas stations by FY03/06. Sales of coal gas and LPG gas declined significantly to 4m m³ in FY03/06 (cf. 39.18m m³ in FY03/05), as many of its operating cities have switched to natural gas usage. Note that average tariff for resident users was lower in

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FY03/06, reflecting lower costs associated with pipeline natural gas (vs. higher costs of Compressed Natural Gas (CNG) used in the previous year). At the end of Mar 2006, urban population covered by China Gas amounted to 23m with a piped gas penetration rate of 11.2%.

Table 2: China Gas' sales volume of natural gas

(m m ³)	Mar-05	Mar-06
Residential	9.7	32.0
Industrial	24.7	126.0
Commercial	2.7	12.4
CNG stations	0.0	0.3
Others	0.0	1.6
Total natural gas consumption	37.1	172.3
Total LPG/coal gas consumption	39.2	4.1

Source: Company data and SBI E2-Capital

Table 3: China Gas' average tariff rate

RMB (excluding tax)	Mar-05	Mar-06
Residential	1.96	1.73
Industrial	1.61	1.57
Commercial	2.07	2.22
CNG stations	0.0	2.35
Other users	0.0	2.21

Source: Company data and SBI E2-Capital

Table 4: China Gas' total piped gas users

	Mar-05	Mar-06
Residential users	411,064	806,103
Industrial users	26	72
Commercial users	498	1,395
Number of CNG stations	0	6

Source: Company data and SBI E2-Capital

Source of fund secured. Net gearing ratio improved to 37.8% during the year (cf. 71.8% in FY03/05). In January 2006, China Development Bank (CDB) granted a facility of RMB20b to finance China Gas' future gas projects in China. China Gas will prefer to use debt financing in the future in order to avoid excessive share dilution. Capex is expected to be around HK\$1~1.2b in FY03/07 and HK\$1.2~1.5b in FY03/08. The company expects positive free operating cash flow in 2~3 years' time.

Aggressive goals in FY03/07. With its solid relationship with Sinopec (China) and Strait Finance, along with a secured funding from CDB, China Gas is in a good position to win more new projects in the future. The company targets to add 10 more projects in FY12/07 to its current 50, which is by far the most aggressive gas operator among its peers. The company expects connectible population to reach 35m from the current level of 23m. Management believes total gas consumption could reach 500m m³ (400m m³ for natural gas, and 100m for LPG and coal gas) in FY03/07, from 176m m³ in FY03/06, thanks to the organic growth from existing projects and newly acquired projects such as Dalian projects in Liaoning Province.

Expensive valuation. The stock trades at 19x consensus FY03/07F PE. We think its valuation is demanding compared to its peers such as Xiano Gas (18x), Panva Gas (10x) and Zhengzhou Gas (9.7x).

Table 5: Peer group comparisons

Gas consumption (FY05)	Zhengzhou Gas (8099 HK)	XinAo Gas (2688 HK)	China Gas* (384 HK)	Panva Gas (1083 HK)
Residential users (%)	34	42	19	
Commercial users (%)	31		7	
Industrials users (%)	19	44	73	
Vehicular users (%)	16	4	1	
Others (%)	0	10	0	
Total natural gas consumption (k m³)	261,890	471,539	172,320	80,000
Revenue breakdown by segment (FY05)				
Connection fees (%)	27	50	52	31
Sales of piped gas (%)	67	37	46	7
Sales of bottled LPG (%)	1	9	0	61
Sales of gas appliance (%)	1	4	0	1
Others (%)	4	0	2	0

* March year-end

Source: Company data and SBI E2-Capital