Corporate Snippet

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Bright prospect ahead — China Utilities

China Oil and Gas Group (603 HK, HK$0.99) — Not Rated

Turnaround. China Oil and Gas Group returned to profitability with net earnings of HK$57.3m between August 2005 and December 2006, against a loss of HK$139.8m between August 2004 and July 2005. Until FY06/05A, the group's fiscal year end date was 31 July but from FY12/06A it is 31 December. EPS for the period was HK$0.0305 compared with a loss per share of HK$0.093 in August 2004 - July 2005.

Solid revenue growth. In the 17 months to 31 December 2006, the group's turnover reached HK$369.9m. On a year-on-year basis, turnover increased about 25.0% while administrative costs and operating expenses declined 26.0% to HK$38.1m. However, they are expected to increase in FY12/07 as projects acquired between 4Q FY12/06A and 1Q FY12/07F are launched.

Robust growth. The group's 50:50 JV with China Petroleum Pipeline Bureau (CCP), China City Natural Gas (CCNG), remains the sole contributor to the group, with revenue of HK$739.8m in the period under review. On an annualized basis, CCNG's turnover increased 25.0%; thanks to a 20.0% rise in total gas sales to 480.0m cubic meters and 22.0% increase in the number of connected users. We estimate that most of CCNG's revenue came from the group's city pipeline project and CNG station project in Xinling, Qinghai.

Liling - meaningful contribution. We expect strong earnings growth for CCNG's Liling city pipeline. The group has been offering special discounts to industrial users in Liling, but they are expected to end in FY12/07F. This will boost the gross profit per cubic meter four fold to RMB0.40. Besides, should CCNG acquire a majority stake in the local transmission station, its gross profit per cubic meter of gas will increase further. CCNG also plans to increase its gas supply in the city from about 45.0m cubic meters per annum to 150.0m.

CNG stations - another catalyst. The group has secured permits to operate compressed natural gas (CNG) refill stations in Binzhou and Qingyun in Shangdong province; Nanjing Jiangsu province; and Maanshan, Anhui province. It will operate its own CNG station network and enjoy all the earnings. We estimate that CNG stations are even more profitable than city pipeline projects. For example, gross profit per cubic meter of CNG is estimated at RMB1.90, compared with Xinling project's estimated blended margin per cubic meter. We expect the group's eight CNG stations in Nanjing and Maanshan to commence operations by FY12/08F and the company may acquire more such projects in the near future.

Acquisitions. As of 31 December 2006, the group was in a net debt position of HK$112.6m. It has completed three acquisitions:

1) November 2006 – acquisition of operating rights of refill stations in Binzhou and Qingyun, Shangdong, for HK$48.0m in cash and 175.0m shares at HK$0.06 each.

2) February 2007 – acquisition of 80.0% in operating rights of refill stations in Nanjing, Jiangsu, for HK$133.0m, including HK$62.0m in cash and the remainder in two-year bonds worth HK$66.0m convertible into 275.0m shares at HK$0.24 each.

3) March 2007 – acquisition of operating rights of refill stations in Maanshan, Anhui, for HK$196.4m, including HK$10.4m in cash, two-year bonds worth HK$90.0m to the vendor, convertible into 375.0m shares at HK$0.24 each and 400.0m new shares to the vendor at HK$0.24 each.

Disclosure of interest: SBI E2-Capital Securities Ltd. acted as the Placing Agent for China Oil And Gas Group on December 2006.