China Oil & Gas

Solid FY12/07A results

STRONG BUY (unchanged)

China Utilities

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Solid FY12/07A results. China Oil & Gas's net profit reached HK$72.6m in FY12/07F on a turnover of HK$677.3m, pretty much in-line with our projection of HK$72.1m. Its turnover for 17 months to December was HK$369.9m and net profit HK$57.3m. Turnover and net profit increased about 51.0% YoY and 80.0% YoY, respectively.

HoH comparisons. Turnover for 2H FY12/07A surged 268.7% HoH to HK$532.8m and net profit rose 29.5% HoH to HK$41.0m. The substantial leap in turnover was due to an increase in the company's stake in China City Natural Gas (CCNG), its JV with China Pipeline Bureau, to 51.0% from 50.0% in Jul 2007, which allowed it to fully consolidate CCNG into its own accounts. The HoH bottom line growth in 2H FY12/07A lagged behind its top line growth implying some margin pressure in 2H 2007.

Margin squeeze. The group's blended margin for FY12/07A was 25.1%. Its gross margin in 1H was 35.8% and 2H 22.1%. The margin squeeze in 2H FY12/07A could be due to the full consolidation of CCNG's results. Still, the company is facing margin pressure together with other utilities in China. Xinao Gas (2688 HK, HK$13.52, NR) blended margin shrunk 4.4pcp to 30.4% in FY12/07A and 5.0pcp to 28.4% in 2H FY12/07A.

Debtors and creditors increase. The group's A/C receivable and A/C payable surged 109.5% YoY and 229.6% to HK$202.3m and HK$316.2m respectively. Its A/C receivable dropped 31.1% HoH to HK$82.5m in 2H. The substantial increase in receivables is due to the full consolidation of CCNG into the company's own accounts. Receivable turnover days in FY12/07A reached 109.0. As a utility, the company's receivable turnover days should not exceed 30, in our view. The group's payable surged 131.6% HoH to HK$220.8m. It had HK$254.9m of other payable and accruals outstanding at end FY12/07A. Details of the payable are yet to be revealed.

Administrative expenses up. Administrative expenses reached HK$64.0m in FY12/07A. During 17 months to Dec 2006, the group's administrative expenses reached HK$33.1m. They increased 46.0% YoY in FY12/07A due to higher due diligence and marketing expenses for new projects and new markets. Also, there were some start-up costs for new projects during the period. The group reported a financial cost of HK$19.8m for FY12/07A including HK$7.2m from the liabilities portion of the convertible notes in the principal amount of HK$156.0m issued during the period (actual coupon interest for the notes was HK$0.6m).

Gas sales increase. Gas sales generated almost all of FY12/07A

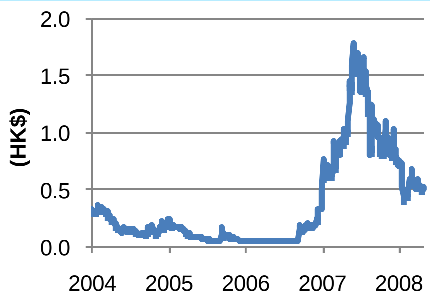
Stock data

Price	**HK$0.51**
Target price	HK$2.27 (+345.1%)
12 mth range	HK$0.37-1.89
Market cap.	US$254.4m
Daily t/o, 3 mth	US$0.75m
Free float %	69.0%
Ticker	0603.HK/603 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Net profit (HK$m)	57.3	72.6	156.9	236.7	3,602.9
Turnover (HK$m)	369.9	677.4	1,630.6	2,724.3	268.4
EPS (HK$)	0.030	0.0207	0.035	0.053	0.060
EPS Δ %	na	(31.0)	69.2	50.9	13.4
P/E (x)	16.7	24.6	14.6	9.7	8.5
P/B (x)	4.1	1.4	2.1	2.0	1.6
EV/EBITDA (x)	16.9	9.5	4.1	2.9	2.2
Yield (%)	na	na	na	na	na
ROE (%)	23.8	5.8	14.5	21.2	19.1
ROCE (%)	17.6	5.9	12.0	13.6	17.3
N. Gear. (%)	Cash	Cash	Cash	Cash	2.8

Price Chart



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revenue, rising 20.8% YoY to 580.0m m^3. Out of total revenue of HK$677.3m, HK$78.0m came from connection fees from the Nanchang city gas project and sales of CNG stations. We estimate that the group's flagship Xining project sold about 415.0m m^3 of gas in FY12/07A. Its Liling gas project sold about 100.0m m^3. Three CNG stations (in Qingyun Shandong province, Maanshan, Anhui province, and Nanjing, Jiangsu province) were launched in the period. The group's CNG stations sold about 65.0m m^3 of condensed natural gas in FY12/07A. We believe the mother station in Maanshan was the only contributing station.

Drivers for FY12/08F. 1) More connection fee income to be recognized from the Nanchang city gas project; 2) Full-year contribution from CNG stations in Qingyun and Nanjing; 3) Five new stations to come on stream; 4) Contribution from new LNG plant launched in 4Q 2007 facilitating supplying downstream and new projects such as Jiangxi, Nanchang and Pingxiang, and Jiangsu Rugao.

Net cash position. At end-FY12/07A, the group was in a gross and net cash position of HK$839.2m and HK$533.9m, respectively, with net cash per share at HK$0.15. Excluding the CB, its net cash on hand was HK$679.9m, or HK$0.19/share.

Reiterate STRONG BUY call. We maintain our earnings projection of HK$156.9m for FY12/08F and HK$236.7m for FY12/09F and reiterate our DCF-based target price at HK$2.27 and STRONG BUY call on the group. We will re-visit our estimates after meeting the company's management. Currently, the group is trading at FY12/08F P/E of 14.6x and FY12/09F P/E of 9.7x, compared with the sector's one-year forward P/E of 21.5x and two-year forward P/E of 16.4x.

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Placing Agent for China Oil And Gas Group in May 2007.