

Binhai Investment

Oligopoly in Tianjin Binhai New Area

to summarize...

- State-owned TEDAI became controlling shareholder of the listco since 2009
- Engages in Tianjin Binhai New Area gas business under umbrella of TEDAI
- Connection fee and gas sales supported HK\$99m adjusted net profit FY03/11A
- Announced 3Q results of 43% & 258% YoY increase in revenue and net profit
- 25.8x pre- and 50.2x post-dilution adjusted P/E for the year end of Mar 2011

Turned into an Oligopoly natural gas supplier in 2009. In 2009, as part of the restructuring proposal, TEDA Investment (TEDAI) made a mandatory cash offer at HK\$0.08 per share. Upon completion, TEDAI itself held 3,004m common shares. In addition to common shares, TEDAI and syndicated banks also hold HK\$170m convertible preference shares with exercise price at HK\$0.03 as well as 8.6m redeemable preference shares. As such, upon conversion of convertible preference shares, TEDAI in effect has 74.4% equity interest in the listco. Table 1 shows shareholding of BHI by end of Jan 2012. In fact, in Feb 2011, Mr Zhang Bing Jun, currently the Party Secretary, Chairman of Tianjin TEDAI, was appointed as Chairman and Executive Director of BHI. We see strong tie between BHI and TEDAI as in shareholding as well as management.

Table 1. Shareholding structure of BHI

Shareholder	Prior to derivatives conversion	Upon full conversion
TEDAI	50.1%	74.4%
Shum Ka Sang	12.8%	6.6%
Public	37.1%	19.0%
Total	100%	100%

Source: HKEx

Strategic development of Tianjin Binhai New Area by TEDAI. TEDAI was established in 1984. It is a state-owned enterprise with 27 years of experience developing Tianjin Economic Development Area. TEDAI orchestrates establishment of Tianjin Economic Development Area with business segment including real estate, public utilities, manufacturing and finance. In the field of public utilities, TEDAI has undertaken the supply of water, electricity, gas and heat. TEDAI also constructs and operates infrastructure such as mass transit and urban greening. TEDAI is the strategic planner in Tianjin and it currently focuses on Binhai New Area.

The role of BHI in Tianjin under the umbrella of TEDAI. Following overall development plan of TEDAI for Tianjin New Area, BHI engaged in construction of pipeline networks and provided connection services and piped natural gas mainly in the area. Tianjin area contributed 70%+ of total gas sales. Table 2 shows certain key operating statistics of BHI by end of Mar 2011.

Table 2. BHI operating statistics

	FY03/09A	FY03/10A	FY03/11A
Length of pipelines network	750km	818 km	930 km
Number of residential users	342k	398k	476k
Gas sales total	74.7 m m ³	152.6 m m ³	214.4 m m ³
Sales to residential clients	21.2 m m ³	27.8 m m ³	34.5 m m ³
Sales to industrial clients	53.5 m m ³	124.8 m m ³	182.9 m m ³

Source: SBI E2-Capital

Ticker	8035 HK
Rating	Not Rated
Price (HK\$)	0.42
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	0.18 - 0.57
Market cap. (US\$m)	324.8
Daily t/o (US\$m)	0.13
Free float (%)	28.8

Financial summary

Year to Dec	08A	09A	10A
Turnover (HK\$m)	621	795	1,231
Net Profit (HK\$m)	(40)	230	71
EPS (HK\$)	(0.02)	0.02	0.01
P/E (x) pre-CPS	(22.1)	19.1	70.0
P/B (x) pre-CPS	(2.8)	6.9	5.2
EV/EBITDA (x)	91.8	31.5	22.5
Yield (%)	0	0	0
ROE (%)	5%	63%	15%
ROCE (%)	n.a.	9%	11%
N. Gear. (%)	n.a.	Net cash	Net cash

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (HK\$)	-	-	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(6.3)	10.6	(11.9)
Actual price changes (%)	2.4	20.0	(19.2)



Source: Bloomberg

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Gas supply and distribution pipelines network. BHI signed contracts with PetroChina (0857 HK) to receive natural gas from national pipe as illustrated in blue in illustrate 1 below with up to 1,000m³ supply available. From its primary pipelines network in red, which is currently 70%+ fully completed, gas is transferred to Tianjin Binhai New Area at the bottom-right corner with BHI infrastructure. For the financial year ended Mar 2011, 214.4m m³ gas was transferred and sold. Recently BHI proposed to acquire the second pipelines network, which is illustrated in yellow with supply up to 600m³ a year. While as a good city planning, it is not preferable to rely on one single gas supplying company such as BHI, it is expected that BHI should be one of the very few participants in the area.

Illustration 1. Gas supply and main distribution network running within Tianjin



Source: SBI E2-Capital

Revenue mix shifting towards gas sales beyond 2011. Over the past 3 years, while connection services made up 55%-70% gross profit though piped gas sales made up the largest part of its revenue. Nevertheless, the management indicates that connection fee for industrial customers are actually low compared to residential users. In line with development of the area, it is expected to see increasing number of industrial customers, which actually consumed a larger volume. As such, the management expects to gradually raise gas sales to 60% in shorter-term and 70% in medium-term. Table 3 shows revenue and gross profit mix of BHI.

Table 3. BHI revenue and gross profit mix

HK\$m	FY03/09A	FY03/10A	FY03/11A	3Q FY03/12A
Revenue	622	795	1,231	1,168
Piped gas sales	245	390	575	629
Connection services	169	174	221	168
On site and bottled gas sales	208	231	435	371
Gross profit	94	127	167	146
Piped gas sales	25	51	68	47
Connection services	67	74	97	100
On site and bottled gas sales	(2)	(2)	(2)	(1)
Gross margin	15.1%	16.0%	13.6%	12.5%
Piped gas sales	10.2%	13.1%	11.8%	7.4%
Connection services	39.6%	42.5%	43.9%	59.2%
On site and bottled gas sales	-1.0%	-0.9%	-0.5%	-0.3%

Source: SBI E2-Capital

Expecting continual sales volume growth especially with acquisition of second pipelines network. As revenue mix shifts towards piped gas sales, there is potentially decrease in connection fee income in short-term up to 10% to 20%. Nevertheless, it is expected that strong growth in gas sales and gas gross profit could well compensate decline in connection fee. In line with development of Tianjin Binhai New Area, BHI expects to see excellent growth in the next 5 years, up from 214m m³ for the year ended Mar 2011 to 1,200m m³ by the year ended Mar 2016. Table 4 shows the sales target of BHI. Noted that initially the company leased the second pipelines network from TEDAI at a cost of RMB0.1 per m³ upon completion; BHI recently proposed to acquire the second pipelines network at RMB279m based on revenue projection, which represents a slight premium over construction cost of RMB218m.

Table 4. Medium-term target gas sales

m m ³	FY03/09A	FY03/10A	FY03/11A	FY03/12F	FY03/16F
Natural gas sales (total)	74.7	152.6	214.4	400.0+	1,200.0+
Primary pipelines network	74.7	116.6	148.4	300.0+	900.0+
Second pipelines network	0.0	36.0	66.0	100.0+	300.0+

Source: SBI E2-Capital

Current financial information. Table 5 and Table 6 show balance sheet and profit loss items since FY03/09A. FY03/10A and FY03/11A, there were one-off items “net gains from interest waived” and “share-based payments” respectively. As such, we adjust the two one-off items for illustration purpose. Between FY03/09A and FY03/11A, adjusted annual shareholders’ profit was -HK\$40m, HK\$21m and HK\$98m, representing improvements in core natural gas business since its resumption in 2009.

Table 5. Balance sheet summary

HK\$m	FY03/09A	FY03/10A	FY03/11A	1H FY03/12A
<u>Non-current assets</u>				
Property, plant and equipment	205	238	645	906
Land use rights	37	35	42	42
Other non-current assets	0	0	20	17
<u>Current assets</u>				
Trade and other receivables	102	113	226	272
Inventories	28	30	38	47
Cash and cash equivalents	63	387	431	265
Other current assets	135	31	51	60
<u>Non-current liabilities</u>				
Long-term payables	0	34	18	0
Borrowings	0	15	10	5
<u>Current liabilities</u>				
Trade and bills payables	697	357	594	694
Borrowings	705	5	298	318
Other current liabilities	56	46	41	40
<u>Equity</u>				
Total equity	(887)	376	493	551

Table 6. Profit and loss summary and adjustments

HK\$m	FY03/09A	FY03/10A	FY03/11A	3Q FY03/12A
Revenue	621	795	1,231	1,168
Cost of goods sold	(527)	(668)	(1,064)	(1,022)
Gross profit	94	127	167	146
Operating expenses	(119)	(72)	(47)	(60)
Share-based payments (adj. item)	0	0	(26)	0
Net gains from interest waived (adj. item)	0	209	0	0
Profit before tax	(24)	263	94	86
Income tax expenses	(15)	(32)	(21)	(20)
Total profit	(39)	232	73	66
Net profit	(40)	230	71	64
Adjusted net profit	(40)	21	98	64
Adjusted P/E pre-dilution	n.a.	118.5	25.8	n.a.
Adjusted P/E post-dilution	n.a.	230.6	50.2	n.a.

Source: BHI, SBI-E2 Capital

Valuation. According to Bloomberg, on 12-month trailing P/E measurement, BHI is currently trading at 21.3x, representing considerable premium over its peers at various stages. We believe the difference arises from the fact that BHI is expected to grow substantially in short-to-medium term for its very interest in Tianjin area. While there is no consensus forecast for BHI, the average expected growth rates of ENN Energy (2688 HK), China Resources Gas (1193 HK), China Gas (0384) and China Oil and Gas (0603 HK) are 10% and 25% for FY12/11F and FY12/12F respectively.

Table 7. Peers comparison

Company	Ticker	Fiscal Year End	Mkt Cap (US\$m)	P/E (x) 12-M trailing	1-year fwd	2-year fwd	P/B (x)	ROE (%)
BINHAI INVESTMENT	8035 HK Equity	03/2011	324.8	21.3	n.a.	n.a.	n.a.	n.a.
TIANJIN TIANLI-H	1265 HK Equity	12/2010	227.8	12.9	n.a.	n.a.	n.a.	11.3
			average:	17.1	n.a.	n.a.		
ENN ENERGY	2688 HK Equity	12/2010	3,481.9	19.4	17.1	14.1	3.4	18.1
CHINA RES GAS	1193 HK Equity	12/2010	3,002.1	19.2	19.0	15.5	3.3	9.7
CHINA GAS	384 HK Equity	03/2011	2,092.6	17.5	17.9	15.0	1.8	8.1
CHINA OIL AND GAS	603 HK Equity	12/2010	460.5	19.5	n.a.	n.a.	1.4	11.0
			average:	18.9	17.1	13.8		

Source: Bloomberg

Risk factors. 1) There are substantial in-the-money convertible securities in circulation that may potentially dilute existing shareholders and may pressure on valuation; 2) By the end of Sep 2011, the company has high level of current liabilities at HK\$1,053m compared to HK\$265m cash and HK\$272m receivables which represents demand for short-term liquidity; 3) Shift of income mix from connection fee towards gas sales potentially poses pressure on both revenue and profit margin; 4) While Tianjin presents substantial business opportunities in short to medium term, the success of BHI may be heavily depended on Tianjin alone.

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