



Equity Research
Utilities/ China

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OP Express

Not Rated

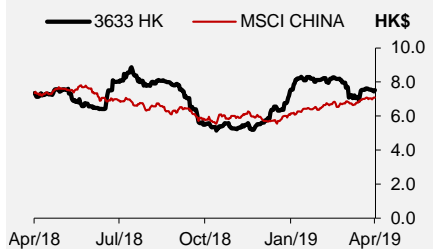
Close price: HK\$7.52

Key Data

HKEx code	3633 HK
12 Months High (HK\$)	9.22
12 Month Low (HK\$)	5.05
3M Avg Dail Vol. (mn)	1.78
Issue Share (mn)	2,537.21
Market Cap (HK\$m)	19,079.83
Fiscal Year	12/2018
Major shareholder (s)	China Gas (384.HK) (41.97%)

Source: Company data, Bloomberg, OP Research
Closing price are as of 18/04/2019

Price Chart



	1mth	3mth	6mth
Absolute %	-2.7	-0.5	35.5
Rel. MSCI CHINA %	-5.9	-15.4	13.1

Company Profile

Zhongyu Gas Holdings Ltd. operates, constructs and develops natural gas projects in China, which includes design and construction of natural gas pipeline network, sale and maintenance of natural gas and its appliances.

Zhongyu Gas (3633 HK)

Comeback with dollar margin improvement

Gas volume growth set at 30% in FY19E, highest among peers. We expect Zhongyu Gas to achieve 2.1bcm gas sales volume in 2019E driven by 26%/30% growth in residential/I&C sector respectively, coupled with 30% overall volume increase for FY18. 1Q19E has seen on-track recovery and we expect a sustainable upward trend to keep up in the rest of FY19E, supported by the company's stable urban projects expansion and continuous incremental gas demand from coal-to-gas projects.

Dollar margin is expected to lift on low base with pass-through to be completed by June. The company suffered from a greater-than-peers drop in dollar margin last year of -10% mainly due to slow pass-through that was restricted by varied timetables of local governments and pricing bureaus. We expect its dollar margin to recover significantly to RMB0.55 – RMB0.60 in FY19E from RMB0.47 in FY18, back to its listed peer's average level, as the pass-through is expected to be fully completed by this June.

FY18 forex loss arising from bank borrowings is expected to reverse to a gain in FY19E. The company reported a net FX loss of RMB321mn last year due to increased bank borrowings amid RMB depreciation. 65% of its debts are denominated in HKD/USD by end-FY18. We expect a reversal for FY19E of a not less than ~HKD200mn FX gain for the company. However, we haven't taken into account of the FX gain/loss in our fair value estimation given its non-core and one off nature.

Comeback with a decent earnings growth and as a potential beneficiary of Russian gas new supply. We estimate Zhongyu to achieve 32%/21% yoy revenue growth to HKD10.0bn/HKD12.1bn in FY19/20E. With improved profitability in gas sales and stable contribution from connection business, we estimate its adjusted net profit to reach HKD1,273mn/HKD1,507mn in FY19/20E. **We estimate the fair value of Zhongyu to be HK\$8.91 based on 15x FY20E PE.** The company is under-covered by sell side analysts despite being shortlisted on HK-SZ connect program, which we attribute to the lack of investor relationship activities in the past few years, a situation we believe to improve from FY19E onwards.

Risks: 1) Further slowdown in China's economy 2) Slower than expected pass-through of changes in city gate-price 3) RMB/USD depreciation.

Exhibit 1: OP estimates on FY19/20E financial results

(HKD mn)	FY17	FY18	FY19E	FY20E
Revenue				
Sales of gas	3,399	4,871	6,973	8,784
Gas pipeline construction	1,235	2,251	2,402	2,432
CNG/LNG vehicle filling stations	329	342	342	342
Sales of stoves and other services	78	155	310	542
Sales of LPG	7	7	7	7
Total	5,048	7,627	10,034	12,108
yoy		51.1%	31.6%	20.7%
Gross profit	1,289	2,222	2,837	3,159
GPM (%)	25.5%	29.1%	28.3%	26.1%
PBT	849	1,121	2,211	2,261
Net profit	558	621	1,473	1,507
Adjusted net profit	443	1,001	1,273	1,507
yoy		126.0%	27.2%	18.3%

Source: OP Research estimates

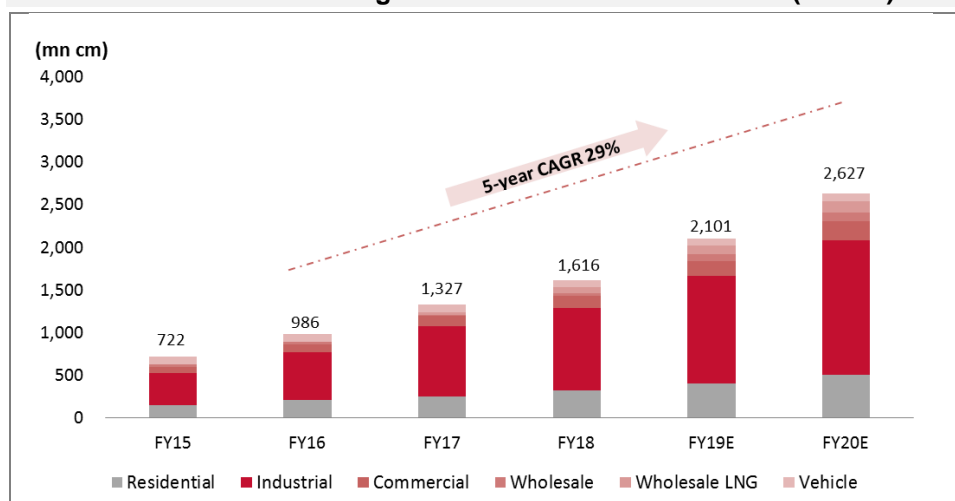
Gas volume growth set at 30% for 2019E

We expect a reacceleration in gas sales volume growth to 30% yoy in FY19E compared with a hiccup in FY18 (up only 22% yoy) when industrial demand growth plummeted to 17% from 50% in 2017. Amid the recovering business sentiment as China's PMI returns to above 50 (Mar. 2019), Zhongyu's gas demand recovers in all sectors as observed so far this year.

We believe the upward trend in its gas demand is well supported by stable projects acquisition. Zhongyu added 32 projects in the past 5 years to a current scale of 61 projects, enabling its number of residential /industrial /commercial clients to achieve FY13-18 CAGR of 28%/33%/30% respectively (including rural projects). The company budgets for RMB400-500mn for FY19E acquisition and has already signed a SPA in January of RMB462mn for Mengzhou and Wen County (nearby Jiaozuo, its second largest project in terms of residential users).

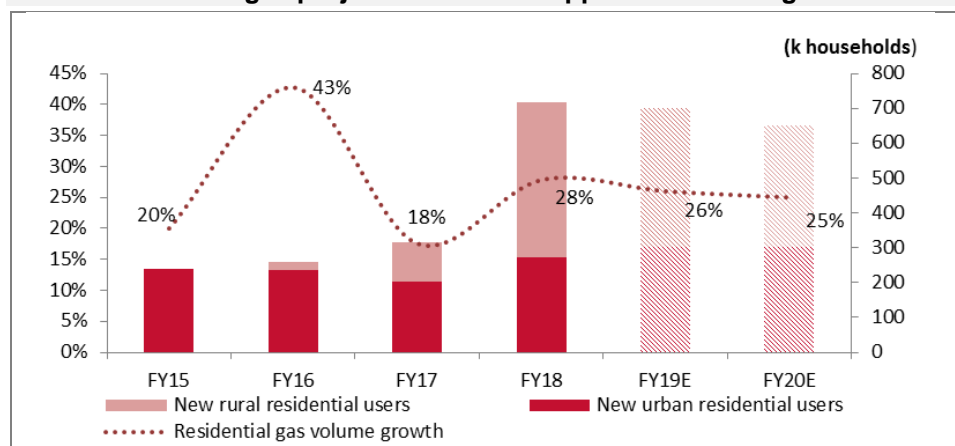
Incremental demand from coal-to-gas projects will continue to drive the growth as we expect the rural users to make up 27% of its residential clients in FY19E, up from 20% in FY18.

Exhibit 2: Gas sales volume grows at 29% CAGR 2015-2020E (mn cm)



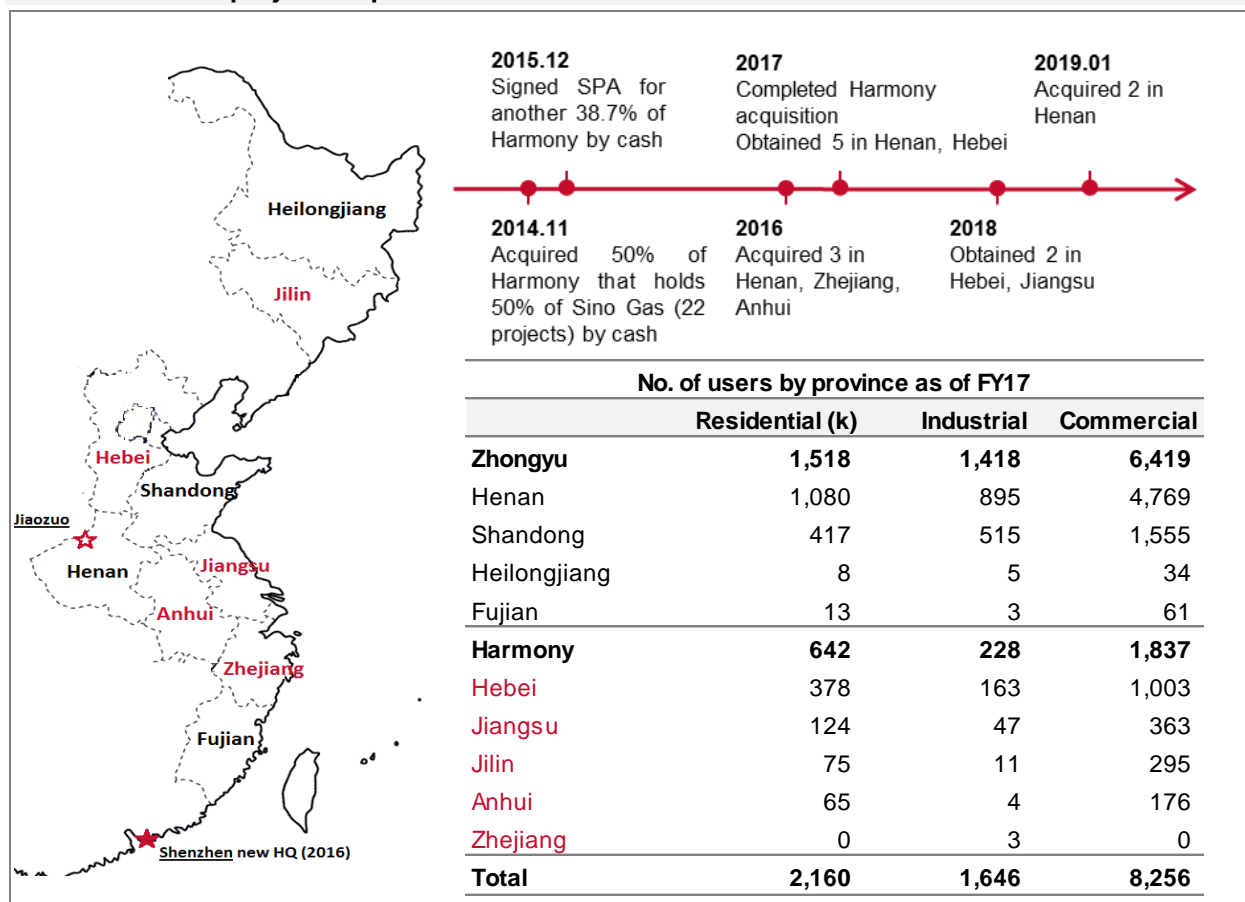
Source: Company, OP Research

Exhibit 3: Coal-to-gas projects to further support residential gas demand



Source: Company, OP Research

Exhibit 4: Stable projects expansion



Source: Company, OP Research

Comeback with dollar margin lift to industry average level

Zhongyu experienced a slash in dollar margin in FY18 from RMB0.52 to RMB0.47 mainly due to varied pass-through timetables of local governments. Industry peers generally suffered from -3% to -9% dollar margin shrinkage during the time.

We estimate Zhongyu's dollar margin to recover from RMB0.47 in FY18 to between RMB0.55-0.60 this year as we expect a full pass-through of aligned CIP (City Gate Price) by June, bringing back gas sales GPM to its normal level and gas sales GP contribution to 30% from merely 18% in FY18.

In addition, the company takes proactive actions to keep/lower gas procurement costs. It plans for higher portion of direct supply contracts with the upstream to replace middle dealers. It also seeks to further diversify gas sources in addition to its originally-self-owned coal-bed methane source in Henan. We believe it is likely for Zhongyu to co-invest in LNG terminals in Shandong and Zhoushan that are nearby its current projects.

Exhibit 5: Historical dollar margin comparison with peers

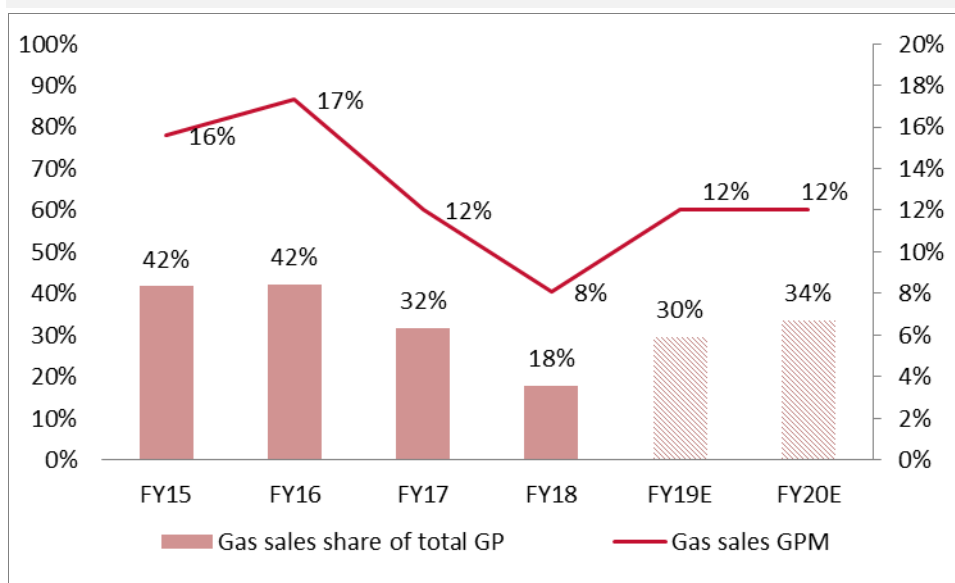
RMB		Dollar margin (ex-tax)			Unit cost (ex-tax)	
Ticker	Name	FY17	FY18	FY19E	FY17	FY18
3633.HK	Zhongyu Gas	0.52	0.47	0.55-0.60	2.11	2.46
1600.HK	Tianlun Gas	0.55	0.56	~0.56	1.76	0.00
0384.HK	China Gas*	0.68	0.62		0.00	1.88
1193.HK	CR Gas	0.58	0.60		2.04	2.08
2688.HK	ENN**	0.63	0.61		2.00	2.18

Source: Company, OP Research

* Unit cost is calculated as avg. weighted on gross volume

** Unit cost is calculated assuming 12.0% and 10.3% VAT for FY17 and FY 18

Exhibit 6: Gas sales GPM and share of total GP 2015-2020E



Source: Company, OP Research

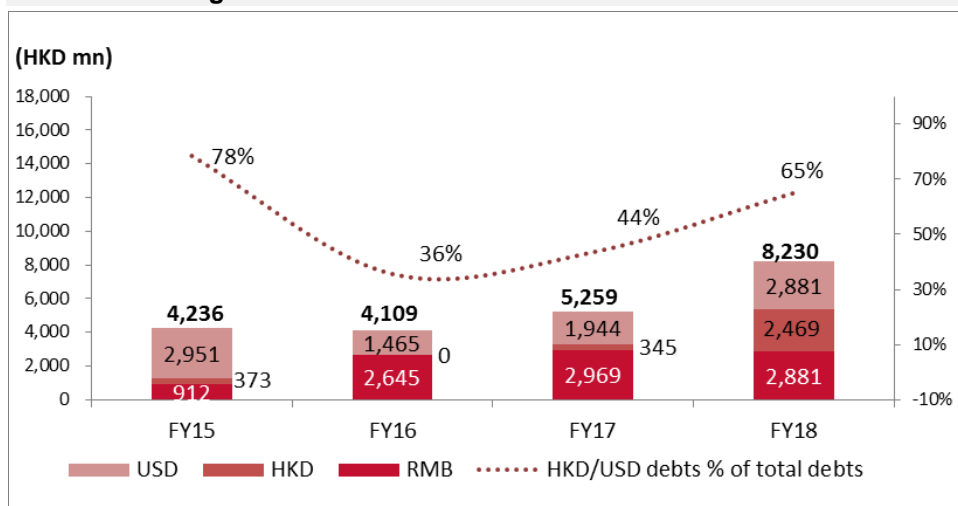
FX loss is likely reverse to gain this year

Zhongyu incurred net Forex loss of HK\$321mn in FY18 as it increased its borrowings by 57% with a high proportion of foreign debts, amid the unexpected sharp RMB depreciation (-7% Jun to Dec). HKD-denominated debts increased six fold and USD-denominated debts grew by 48%, leaving a considerable currency exposure of HKD5.8bn, or 65% of total borrowings by end-FY18.

We expect negative impact from Forex to diminish as a favorable trend in RMB/USD exchange rate witnessed so far would give the company a good buffer of est. RMB200mn Forex gain in FY19E. Given the FX gain/loss is one-off and non-cash item, we have not taken into account of such item in our fair value estimate.

Currently, there is no research coverage/rating on the company on Bloomberg despite it being shortlisted on HK-SZ connect program which we attribute to the lack of investor relationship activities in the past few years. However, we see the situation to improve from FY19E onwards.

Exhibit 7: Foreign debts increased in FY17 and FY18



Source: Company, OP Research

Appendix I – Historical financials

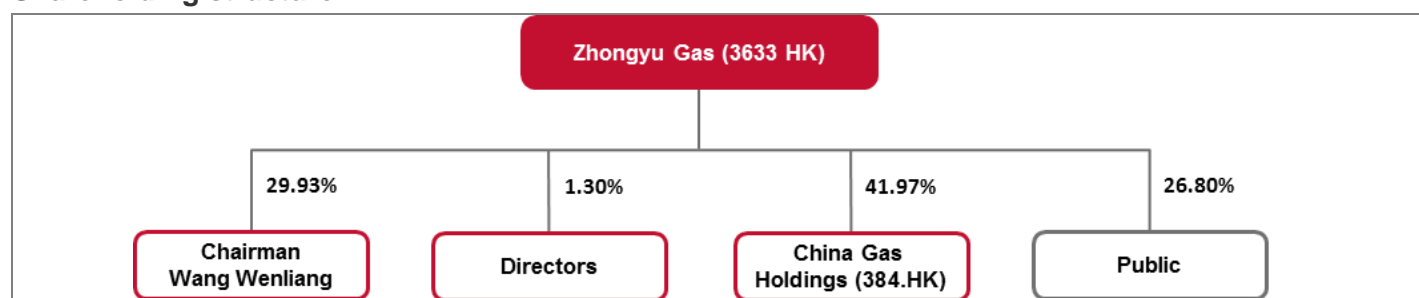
Historical financial summary

31-Dec (HKD mn)	FY 15	FY 16	FY 17	FY 18
Income Statement				
Revenue	3,277	3,723	5,048	7,627
YoY%	(0.04)	0.14	0.36	0.51
Gross profit	785	1,008	1,289	2,222
Gross margin	24%	27%	26%	29%
EBITDA	827	880	1,233	1,364
EBITDA margin	25%	24%	24%	18%
Net Income	93	206	558	621
YoY%	(0.71)	1.21	1.71	0.11
Net margin	3%	6%	11%	8%
EPS	0.04	0.08	0.22	0.24
DPS	0.00	0.00	0.05	0.07
Balance Sheet				
Inventories	104	106	210	326
Accounts receivables	319	411	672	1,669
Cash & cash equivalent	984	768	464	1,595
Other curr assets	527	369	665	911
Non-curr assets	6,776	7,970	9,790	11,779
Total assets	8,709	9,624	11,801	16,281
Accounts payables	858	899	1,201	1,722
Total debts	4,391	4,425	5,706	8,477
Other liabilities	1,188	1,495	1,171	1,577
Total liabilities	6,437	6,818	8,078	11,761
Shareholders' equity	2,007	2,553	3,174	3,939
ROE	5%	9%	19%	17%
Net debt-to-equity	150%	130%	141%	152%
Cash Flow Statement				
Operating cash flow	467	522	403	-
Investing cash flow	(700)	(527)	(743)	-
Free cash flow	(234)	(5)	(340)	-
Financing cash flow	393	(207)	11	-
Net change in cash flow	156	(216)	(304)	-

Source: Company, Bloomberg, OP Research

Appendix II – Shareholding and management

Shareholding structure



Source: Company, OP Research

Management profile

Name	Position	Responsibilities	Description
Mr. Wang Wenliang	Executive Director, Chairman	Overall business strategy and major business decisions	Over 20 years of experience in energy, aluminum, property industries. He was ED of China Gas (384 HK) for 6 months in 2013.
Mr. Lui Siu Keung	Executive Director, CEO	General management, financing, and IR activities	Associate member of HKICPA with over 20 years' experience in corporate finance, accounting and auditing.
Mr. Lu Zhaoheng	Executive Director,	Natural gas projects planning, designing and consultation	A leading member in the City Planning Design Institute of Henan Province, with 30 years of experience in natural gas.
Mr. Li Yan	Executive Director Exes. vice president	General management	Senior economist in China with over 30 years' experience in accounting, finance and economics.
Mr. Jia Kun	Executive Director Vice president	General management	Over 19 years' experience in legal and risk management, with another 8 years in judicial areas.

Source: Company, OP Research

Exhibit 8: Peer Group Comparison

Company	Ticker	Price	Mkt cap3-mth avg t/o (US\$m)	PER	PER	PER	EPS FY1	EPS FY2	3-Yr EPS Cagr (%)	PEG (x)	Div yld (%)	Div yld (%)	P/B		EV/		EV/	Net gearing (%)	Gross margin (%)	Net margin (%)		ROE (%)	ROE (%)	Sh px 1-mth %	Sh px 3-mth %		
													Hist	P/B	Ebitda	Ebitda				Cur Yr	Hist					Hist	Hist
Zhongyu Gas Hold	3633 HK	7.52	2,432	1.8															125.1	27.9	11.1	18.9			(1.8)	(0.5)	
HSI		29,963.26			11.7	11.6	10.7	0.8	8.2	5.8	1.99	3.3	3.5	1.39	1.28							11.9	11.0	1.9	10.6		
HSCEI		11,768.63			9.7	9.0	8.3	8.0	8.3	8.1	1.11	3.5	3.8	1.20	1.07							12.4	11.9	0.8	10.6		
CSI300		4,072.08			15.5	12.9	11.5	19.7	12.4	14.8	0.9	2.0	2.4	2.0	1.7							12.6	13.1	5.7	28.5		
HK-listed peers																											
Adjusted sector avg*					19.8	12.8	11.1	33.3	12.1	19.5	0.7	1.6	2.3	3.1	2.7	11.9	9.5		40.2	23.1	9.3	16.9	18.9	(6.2)	6.0		
Tian Lun Gas	1600 HK	8.17	1,031	2.2	12.0	7.2	5.3	67.1	34.7	34.1	0.2	0.7	3.8	2.1	1.7	8.1	6.5		126.1	27.9	11.1	18.9	26.2 (13.8)	22.1			
China Gas Holdin	384 HK	24.70	15,980	36.2	20.1	15.9	13.7	26.5	16.1	20.3	0.8	1.4	1.9	4.2	3.6	17.2	12.8		73.6	22.1	11.5	25.9	24.3 (15.7)	(5.0)			
Hong Kg China Gs	3 HK	18.46	36,205	32.7	30.5	32.0	29.7	(4.6)	7.8	3.5	9.2	1.8	2.1	4.6	4.1	29.2	26.3		37.8	N/A	24.1	15.2	13.7	0.4	10.5		
Enn Energy	2688 HK	75.30	10,789	23.5	25.1	14.6	12.6	72.1	15.8	31.9	0.5	1.4	2.2	3.4	2.9	12.7	9.2		45.4	15.7	4.6	14.7	21.0 (9.7)	1.1			
Towngas China	1083 HK	6.05	2,167	1.2	13.8	10.9	10.0	26.7	9.0	15.0	0.7	2.5	3.0	1.0	1.0	12.0	10.3		44.2	N/A	10.4	7.6	8.9 (3.8)	(2.9)			
China Res Gas	1193 HK	35.70	10,121	14.6	17.5	15.6	14.0	12.3	11.7	12.1	1.3	1.5	2.4	3.3	2.8	9.5	8.6		0.0	26.6	8.7	19.3	19.5	5.2	10.0		
A-shares peers																											
Adjusted sector avg*					19.7	16.0	12.7	18.9	20.7	17.0	0.9	2.5	2.7	2.4	2.3	12.2	124.9		18.2	24.0	11.1	9.6	13.7	4.0	20.6		
Chongqing Gas-A	600917 CH	8.65	2,008	8.4	39.3	37.6	37.6	4.5	0.0	2.9	12.8	1.5	1.2	3.5	3.2	21.1	N/A		0.0	12.9	5.5	8.9	8.6	16.0	20.8		
Shaan Xi Natur-A	002267 CH	8.61	1,428	16.3	23.7	20.3	16.4	16.9	23.5	15.5	1.3	3.5	1.7	1.7	1.6	10.5	N/A		50.9	10.2	4.5	7.2	6.9 (2.6)	11.5			
Shenzhen Gas -A	601139 CH	6.24	2,678	11.0	20.0	17.9	14.6	11.4	22.7	16.8	1.1	1.8	1.9	2.0	1.9	12.8	10.7		33.8	20.3	8.1	10.8	11.2	0.6	13.7		
Bestsun Energy-A	600681 CH	13.50	2,077	18.1	13.8	11.6	9.7	19.1	19.8	16.6	0.7	3.3	5.5	3.1	2.3	10.7	239.0		6.4	31.3	21.3	24.0	23.6 (1.4)	10.0			
Xinjiang Xinta-A	603393 CH	42.24	1,008	14.6	20.2	14.2	10.3	42.4	37.6	33.1	0.4	2.4	3.1	3.0	2.6	15.9	N/A		0.0	42.8	20.6	15.9	18.3	1.3	37.1		
Jinhong Holdin-A	000669 CH	7.38	749	28.4	21.1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.2	N/A	11.4	N/A		141.0	26.5	6.4	5.2	N/A	10.1	30.6		

* Outliners and "N/A" entries are in red and excl. from the calculation of averages

Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
18/04/2019	Li Ning	2331	Upbeat 1Q19E sales performance	HOLD	Dallas Cai/Megan Jin
15/04/2019	Anta Sports	2020	1Q19E retail performance in line	BUY	Dallas Cai/Megan Jin
10/04/2019	Q Tech	1478	March saw improving product mix	BUY	Yuji Fung/Dallas Cai
09/04/2019	Xtep Intl	1368	1Q19 operations on track	BUY	Dallas Cai/Megan Jin
09/04/2019	China Youzan	8083	Introducing Tencent as strategic investor	BUY	Yuji Fung/Dallas Cai
04/04/2019	Regal Intl Airport	357	FY18 results up to expectations	BUY	Yuji Fung/Dallas Cai
02/04/2019	Tianlun Gas	1600	FY18 results up to expectations	BUY	Yuji Fung/Dallas Cai
01/04/2019	Truly Int'l	732	FY18 earnings miss on GPM and loss from associate	BUY	Yuji Fung/Dallas Cai
28/03/2019	China Youzan	8083	FY18 saw narrower loss than expected	BUY	Yuji Fung/Dallas Cai
27/03/2019	Sinosoft Tech	1297	FY18 results in line	BUY	Yuji Fung/Dallas Cai
26/03/2019	Q Tech	1478	Downgrade to SELL as margin recovery was priced in	SELL	Yuji Fung/Dallas Cai
25/03/2019	Li Ning	2331	FY18 saw sustainable high-quality growth	HOLD	Dallas Cai/Megan Jin
22/03/2019	Chinasoft Intl	354	FY18 results up to expectations	BUY	Yuji Fung/Dallas Cai
21/03/2019	Sunny Optical	2382	Downgrade on fair value	HOLD	Yuji Fung/Dallas Cai
21/03/2019	Tongda	698	GPM likely bottom out	BUY	Yuji Fung/Dallas Cai
21/03/2019	Ju Teng Intl	3336	On secular trend of metal casing adoption	BUY	Yuji Fung/Dallas Cai
20/03/2019	CH Display OPT	334	FY18 revenue beat, earnings in line	BUY	Yuji Fung/Dallas Cai
20/03/2019	Ausnutria Dairy	1717	Margin expansion story continues	BUY	Dallas Cai
20/03/2019	TCL Electronics	1070	Promising FY19E ahead	BUY	Yuji Fung/Dallas Cai
18/03/2019	361 Degrees Intl	1361	Rebranding strategies to bear fruit in 2020E	BUY	Yuji Fung/Dallas Cai
15/03/2019	Kingdee Intl	268	FY18 results up to expectations	HOLD	Yuji Fung/Dallas Cai
13/03/2019	Xtep Intl	1368	Growth momentum likely keeps up in FY19E	BUY	Dallas Cai/Megan Jin
06/03/2019	Xtep Intl	1368	JV with Wolverine for multi-brand portfolio	BUY	Dallas Cai/Megan Jin
05/03/2019	CH Display OPT	334	Foldable smartphone play backed by CSOT	BUY	Yuji Fung/Dallas Cai
27/02/2019	Anta Sports	2020	FY18 revenue strong beat, profits in-line	BUY	Dallas Cai/Megan Jin
22/02/2019	Ausnutria Dairy	1717	FY18 profit surprise on margin expansion	BUY	Dallas Cai
20/02/2019	Q Tech	1478	Jan shipments growth was solid	BUY	Yuji Fung/Dallas Cai

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