

China Railway Group Limited-A [601390.CH]

Initiate coverage: Dual engine to support earnings growth

With business diversification and a recovery in the mining business, CRG-A's earnings in 2017 exceeded market expectations. Including its one-off asset impairment loss of >RMB6bn, its net profit in 2017 still rose 29.4% YoY. The strong growth momentum continued in Q1 2018, with net profit rising 21.9% YoY. We think central SOE construction companies should be able to secure steady earnings growth from PPP investment and overseas expansion support by the central government. CRG-A outperformed CRCC-A and CCC-A CYTD, as it delivered the highest earnings growth in 2017 and Q1 2018. We initiate coverage on CRG-A with a BUY rating and target price (TP) of RMB9.10. We expect its earnings to grow at a CAGR of 14% in 2017-2019E. Its plan for a debt-to-equity swap means CRG has a strong incentive to boost its earnings in 2018, especially after it made a substantial one-off asset impairment in 2017. Our TP is based on our H-share valuation and A/H premium (discount) assumption (Fig 5).

Investment Highlights

- Earnings beat in 2018 and 1Q18:** CRG-A reported revenue growth of 8.8% YoY in 2017 and 10.1% YoY in 1Q18, led by increasing exposure to PPP investment and overseas expansion. Earnings rose even more with margin expansion, led by an improving revenue mix, effective cost control and the recovering mining business. The Company reported its gross profit margin expanded from 7.9% in 2016 to 9.1% in 2017. After some one-off asset impairment, the Company reported its net profit margin expanded by 0.3ppt YoY in 2017. The margin expansion continued in Q1 2018, thanks to its fast-growing municipal construction business and overseas expansion.
- Steady earnings growth expected to continue from rising PPP investment and overseas expansion:** We were concerned that the slowdown of its traditional railway business would constrain its earnings growth in 2018. But CRG-A achieved faster growth than we expected due to increasing exposure to PPP investment. We remain confident that CRG-A will continue to be one of the key beneficiaries of rising PPP investment. The government review of PPP projects turned out to be less negative than the market expected. With the addition of some new projects, total investment in all approved PPP projects by the end of April suggested a net increase in total project value compared to that at the end of December 2017. This should help restore market confidence in the construction sector. With the improving quality in PPP projects database, CRG-A is able to pick even higher-quality PPP projects to secure healthier growth for the Company.
- Debt-to-equity swap plan to fund future PPP investment:** CRG-A's leverage is not that excessive compared to that of CCC, but its net gearing is higher than that of CRCC. The Company announced on 6 May that it is planning a debt-to-equity swap with the subject assets being the equity rights of certain subsidiaries of the Company to be acquired by investors in the debt-to-equity swap. As it may constitute a material asset restructuring, trading of its A-shares was halted from 7 May. This should help CRG-A reduce its leverage, providing more room for it to raise debt for future PPP investment.
- BUY with a TP of Rmb9.40:** We set our TP to RMB9.10. Our CRG-A share TP is based on our CRG-H share valuation and the historical CRG A/H premium (discount) (Fig 5).

Y/E Dec 31	2015	2016	2017	2018E	2019E
Turnover (RMB m)	599,942	632,856	688,773	760,789	848,774
Recurring net profit (RMB m)	11,675	11,808	15,280	17,665	19,911
Net margin (%)	1.9%	1.9%	2.2%	2.3%	2.3%
Recurring EPS (RMB)	0.53	0.52	0.67	0.77	0.87
% change	10.0%	-2.5%	29.4%	15.6%	12.7%
PER(x)	14.1	14.5	11.2	9.7	8.6
PBR(x)	1.3	1.2	1.1	1.0	0.9
EV/EBITDA(x)	9.3	7.5	7.3	6.0	5.5

Sources: Company data, CGIS Research

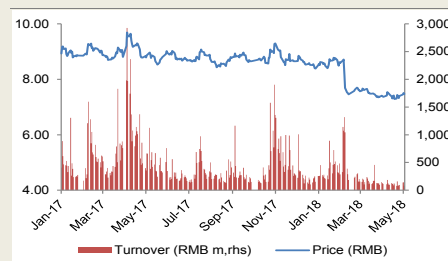
China construction sector

BUY

Close: Rmb7.47 (May 11, 2018)

Target Price: Rmb9.10 (+21.8%)

Price Performance



Market Cap	US\$25,339m
Shares Outstanding	22,844m
Auditor	Deloitte
Free Float	45.6%
52W range	HK\$7.20-9.34
3M average daily T/O	US\$18m
Major Shareholding	CRECG (54.4%)

Sources: Company data, Bloomberg

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Key financials

CRG (601390 CH)

P&L statement

(RMB m, except for per share amount)

FY ended 31 Dec	2H15	1H16	2H16	1H17	2H17
Sales Revenue	335,424	268,447	364,409	298,553	390,220
COGS	-308,269	-246,479	-336,588	-271,106	-354,938
Gross profit	27,155	21,968	27,821	27,447	35,282
Selling and distribution costs	-1,371	-1,141	-1,419	-1,301	-1,551
Administrative expenses	-16,295	-11,907	-16,190	-13,240	-17,982
Other gains and losses	1,944	371	2,114	-1,318	-5,343
Total EBIT	11,433	9,291	12,326	11,588	10,406
Depreciation & Amortisation	4,312	3,920	4,841	4,529	4,529
EBITDA	15,745	13,211	17,167	16,117	14,935
Net finance costs	-1,266	-1,606	-1,971	-1,056	-1,642
Profits from associates and JCEs	185	119	613	312	1,220
Pre-Tax Profit	10,352	7,804	10,968	10,844	9,984
Tax Expense	-2,971	-2,410	-3,659	-3,295	-3,329
Net Profit After Tax	7,381	5,394	7,309	7,549	6,655
Minority Interest	73	69	-263	158	1,705
Perpetual notes	-356	-347	-354	-625	-162
Reported Earnings (attributable)	7,098	5,116	6,692	7,082	8,198
Adjusted Earnings	7,098	5,116	6,692	7,082	8,198
EPS (rep)	0.31	0.22	0.29	0.31	0.36
EPS (adj)	0.31	0.22	0.29	0.31	0.36
DPS	0.09	0.00	0.09	0.00	0.11
% YoY growth					
Revenue	3.9%	1.5%	8.6%	11.2%	7.1%
Gross profit	-4.4%	2.0%	2.5%	24.9%	26.8%
EBIT	-4.1%	9.2%	7.8%	24.7%	-15.6%
Net profit	14.5%	11.8%	-5.7%	38.4%	22.5%
Margins and ratios					
Gross profit margin	8.1%	8.2%	7.6%	9.2%	9.0%
EBITDA Margin	4.7%	4.9%	4.7%	5.4%	3.8%
EBIT Margin	3.4%	3.5%	3.4%	3.9%	2.7%
Net Profit Margin	2.1%	1.9%	1.8%	2.4%	2.1%

P&L	2015	2016	2017	2018E	2019E
Sales Revenue	599,942	632,856	688,773	760,789	848,774
COGS	-551,256	-583,067	-626,044	-689,834	-770,077
Gross profit	48,686	49,789	62,729	70,954	78,697
Selling and distribution costs	-2,342	-2,560	-2,852	-2,282	-2,546
Administrative expenses	-27,790	-28,097	-31,222	-33,566	-37,448
Other gains and losses	1,387	2,485	-6,661	-6,000	-6,000
Total EBIT	19,941	21,617	21,994	29,106	32,703
Depreciation & Amortisation	7,813	8,761	9,057	10,070	10,597
EBITDA	27,754	30,378	31,051	39,176	43,300
Net finance costs	-3,172	-3,577	-2,698	-3,139	-3,457
Profits from associates and JCEs	248	732	1,532	1,609	1,689
Pre-Tax Profit	17,017	18,772	20,828	27,576	30,935
Tax Expense	-5,231	-6,069	-6,624	-8,770	-9,838
Net Profit After Tax	11,786	12,703	14,204	18,806	21,096
Minority Interest	472	-194	1,863	-353	-398
Perpetual notes	-583	-701	-787	-787	-787
Reported Earnings (attributable)	11,675	11,808	15,280	17,665	19,911
Adjusted Earnings	11,675	11,808	15,280	17,665	19,911
EPS (rep)	0.53	0.52	0.67	0.77	0.87
EPS (adj)	0.53	0.52	0.67	0.77	0.87
DPS	0.09	0.09	0.11	0.13	0.15
% YoY growth					
Revenue	1.7%	5.5%	8.8%	10.5%	11.6%
Gross profit	0.4%	2.3%	26.0%	13.1%	10.9%
EBIT	-1.5%	8.4%	1.7%	32.3%	12.4%
Net profit	13.8%	1.1%	29.4%	15.6%	12.7%
Margins and ratios					
Gross profit margin	8.1%	7.9%	9.1%	9.3%	9.3%
EBITDA Margin	4.6%	4.8%	4.5%	5.1%	5.1%
EBIT Margin	3.3%	3.4%	3.2%	3.8%	3.9%
Net Profit Margin	1.9%	1.9%	2.2%	2.3%	2.3%

Source: Company data, CGIS Research

Revenue breakdown (Rmb m)	2015	2016	2017	2018E	2019E
Construction	544,207	559,223	611,095	672,205	752,869
Design	10,711	12,312	13,761	15,825	18,199
Machinery	15,782	17,063	18,521	20,373	22,410
Real estate	29,260	32,976	30,951	34,046	35,748
Other business	40,044	42,671	53,074	58,381	64,220
Elimination	-40,062	-31,389	-38,629	-40,042	-44,672
Total	599,942	632,856	688,773	760,789	848,774

% of total					
Construction	91%	88%	89%	88%	89%
Design	2%	2%	2%	2%	2%
Machinery	3%	3%	3%	3%	3%
Real estate	5%	5%	4%	4%	4%
Other business	7%	7%	8%	8%	8%
Elimination	-7%	-5%	-6%	-5%	-5%
Total	100%	100%	100%	100%	100%

% YoY chg					
Construction	5.1%	2.8%	9.3%	10.0%	12.0%
Design	4.3%	14.9%	11.8%	15.0%	15.0%
Machinery	8.7%	8.1%	8.5%	10.0%	10.0%
Real estate	0.0%	12.7%	-6.1%	10.0%	5.0%
Other business	-27.1%	6.6%	24.4%	10.0%	10.0%
Elimination	8.7%	-21.6%	23.1%	3.7%	11.6%
Total	1.7%	5.5%	8.8%	10.5%	11.6%

Source: Company data, CGIS Research

Key financials

CRG (601390 CH)

Balance sheet, cash flow statements and key ratios

(RMB m, except for per share amount)

Balance sheet	2015	2016	2017	2018E	2019E
Cash	93,304	114,830	116,688	138,957	157,599
Restricted cash	7,414	9,254	13,704	13,704	13,704
Trade and other receivables	206,253	234,229	264,402	292,047	325,822
Inventories	124,379	113,014	128,005	141,306	157,671
Amounts due from contract customers	122,379	111,791	114,459	126,426	141,048
Available-for-sale financial assets	3,886	1,210	1,272	1,272	1,272
Held-for-trading financial assets	144	123	2,963	2,963	2,963
Other receivables	6,620	9,650	16,990	18,766	20,937
Tax recoverable	1,030	807	1,602	1,602	1,602
Lease prepayments	192	239	237	284	329
Total current assets	565,601	595,147	660,322	737,328	822,948
Long-term equity investment	7,889	11,482	21,002	29,611	38,300
Investment properties	3,722	4,547	4,787	4,616	4,452
PPE, net	53,045	56,207	60,695	64,954	68,173
Other intangible assets	37,547	36,821	35,995	36,239	36,477
Mining assets	5,454	4,664	4,142	4,015	3,896
Goodwill	829	829	829	829	829
Lease prepayments	9,290	11,986	11,952	14,318	16,616
Deferred tax assets	4,367	5,258	5,731	5,731	5,731
Trade receivables	7,137	5,209	15,755	17,402	19,415
Available-for-sale financial assets	8,351	12,896	13,418	13,418	13,418
Other loans and receivables	8,813	6,976	7,777	8,590	9,584
Other non-current assets	1,460	2,323	1,517	1,517	1,517
Total non-current assets	147,904	159,198	183,600	201,240	218,406
Total assets	713,505	754,345	843,922	938,568	1,041,354
Trade and bill payable	365,245	407,418	471,896	519,980	580,465
Short term Debt	84,209	80,017	88,483	103,521	115,264
Amounts due to contract customers	14,857	12,952	14,964	16,529	18,440
Obligations under finance leases	1,346	451	349	349	349
Tax payable	4,065	5,129	5,572	5,572	5,572
Defined benefit obligations	494	466	395	395	395
Held-for-sales financial liabilities	185	157	57	57	57
Provision	46	13	0	0	0
Total current liabilities	470,447	506,603	581,716	646,402	720,541
Long Term Debt	96,213	92,308	85,451	99,974	111,314
Deferred tax liabilities	920	782	1,006	1,006	1,006
Provision	248	335	637	637	637
Long-term payables	631	686	498	498	498
Defined benefit obligations	3,779	3,453	3,161	3,161	3,161
Deferred income	1,537	1,140	1,841	1,841	1,841
Obligations under finance leases	492	42	54	54	54
Total non-current liabilities	103,820	98,746	92,648	107,171	118,511
Total liabilities	574,267	605,349	674,364	753,573	839,053
Shareholders Fund	118,300	128,131	143,179	157,476	173,597
Perpetual notes	12,123	12,038	12,038	12,825	13,612
Minority Interest	8,815	8,827	14,341	14,694	15,093
Total S/H Equity	139,238	148,996	169,558	184,995	202,302
Total Liab & S/H Fund	713,505	754,345	843,922	938,568	1,041,354

Cash flow statement	2015	2016	2017	2018E	2019E
EBITDA	27,754	30,378	31,051	39,176	43,300
Net Interest Paid	-8,589	-6,932	-7,461	-3,139	-3,457
Tax Paid	-5,701	-5,763	-6,435	-8,770	-9,838
Change in Working Cap	5,835	27,212	-738	-7,502	-7,541
Others	2,669	2,668	9,300	0	0
Operating Cash Flow	21,968	47,563	25,717	19,764	22,464
Acquisitions	-11,245	-13,929	-28,168	-7,000	-7,000
Capex	-14,899	-14,802	-15,282	-16,688	-16,114
Asset Sales	7,903	11,676	16,392	0	0
Others	1,037	-1,921	-5,631	0	0
Investing Cashflow	-17,204	-18,976	-32,689	-23,688	-23,114
Dividend (ordinary)	-1,951	-2,674	-2,719	-3,368	-3,790
Equity Raised	20,837	0	0	0	0
Debt Movements	1,130	-4,497	2,646	29,561	23,083
Others	-351	-169	9,387	0	0
Financing Cashflow	19,665	-7,340	9,314	26,192	19,293
Exchange difference	196	279	-484	0	0
Net Chg in Cash/debt	24,625	21,526	1,858	22,269	18,642
FCF	4,764	28,587	-6,972	-3,924	-650
	2015	2016	2017	2018E	2019E
Valuation					
PE(x)	14.1	14.5	11.2	9.7	8.6
EPS growth (%)	10.0	-2.5	29.4	15.6	12.7
Yield(%)	1.2	1.2	1.5	1.8	2.0
PEG(%)	1.4	-5.8	0.4	0.6	0.7
EV/EBITDA(x)	9.3	7.5	7.3	6.0	5.5
PB(x)	1.3	1.2	1.1	1.0	0.9
Operational					
Revenue growth(%)	1.7	5.5	8.8	10.5	11.6
EBIT margin(%)	3.3	3.4	3.2	3.8	3.9
Net profit margin(%)	1.9	1.9	2.2	2.3	2.3
Days receivables	134	131	138	141	141
Days payables	239	242	256	262	261
Days inventories	25	18	17	17	17
Current ratio(x)	1.2	1.2	1.1	1.1	1.1
Quick ratio(x)	0.9	1.0	0.9	0.9	0.9
Asset/equity(x)	5.5	5.4	5.4	5.5	5.6
Net debt/equity(%)	62.6	38.6	33.8	34.9	34.1
EBITDA interest coverage(x)	4.5	5.3	6.5	7.2	6.9
ROE(%)	9.0	8.4	9.8	10.4	10.6

Source: Company data, CGIS Research

Figure 4: Earnings estimates: CGIS new vs. consensus estimates (RMB m, except for EPS)

2018E	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS	760,789	29,106	39,176	17,665	0.77	0.77
Consensus	747,648	29,472	38,667	17,801	0.78	0.78
Diff%						
CGIS vs. consensus	1.8%	-1.2%	1.3%	-0.8%	-0.5%	-0.7%
2019E	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS	848,774	32,703	43,300	19,911	0.87	0.87
Consensus	813,880	32,353	42,692	20,057	0.88	0.88
Diff%						
CGIS vs. consensus	4.3%	1.1%	1.4%	-0.7%	-0.4%	-0.8%

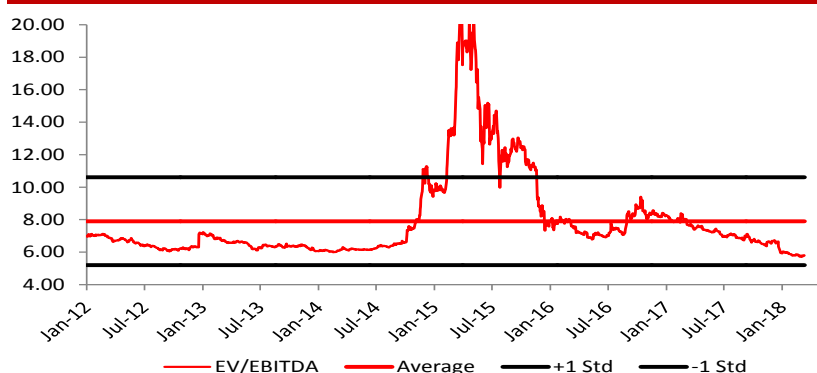
Source: Bloomberg, CGIS Research

Figure 5: Target price EV/EBITDA multiple calculation

Assumption	
2018E EBITDA (Rmb m)	39,176
Target EV/EBITDA multiple	5.4x
EV (Rmb m)	211,550
Net debt (Rmb m)	64,538
Target fair value (Rmb m)	147,012
FX	0.81
No of shares (mn)	22,844
Target price (HK\$/share)	7.90
H/A discount	-30.0%
A-share target share price (Rmb)	9.10
% upside to current price	21.8%

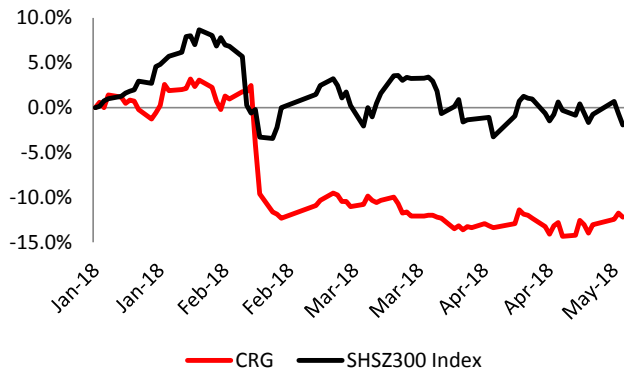
Source: CGIS Research

Figure 6: CRG-A 12-mth forward EV/EBITDA band



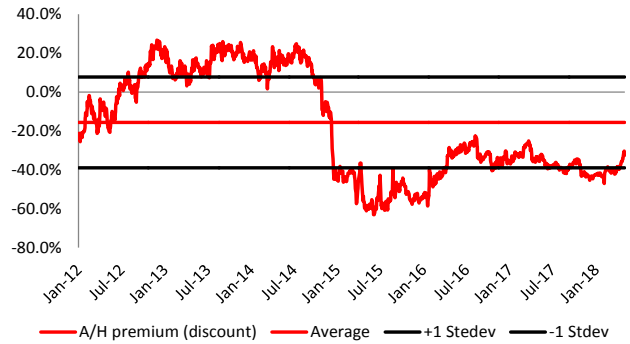
Source: Bloomberg, Company data, CGIS Research

Figure 7: CRG-A share performance CYTD



Source: Bloomberg, CGIS Research

Figure 8: CRG A/H premium (discount) band



Source: Bloomberg, CGIS Research

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- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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