

31 October 2018

Construction & Engineering | Engineering & Construction

China Railway

Buy (Maintained)

Stable 3Q18 Results; BUY

Target Price: HKD7.68
 Price: HKD6.73
 Market Cap: USD16,806m
 Bloomberg Ticker: 390 HK

Maintain BUY and HKD7.68 TP, with 14% upside plus 3% 2019F yield. On 30 Oct, China Railway announced its 3Q results, which met our expectations. The company delivered 3Q18 revenue of CNY180.2bn (+4.8% YoY) and 3Q18 net profit of CNY3.49bn (+4.9% YoY). 9M18 revenue and earnings came in at CNY497.406bn (+5.5% YoY) and CNY13bn (+18.25 YoY).

China Railway announced its 3Q results on 30 Oct. 3Q18 revenue and earnings growth were stable and largely in line with our expectations. As the quarter was a transition period in terms of policy changes, we view the 4.8% and 4.9% revenue and earnings growth in 3Q18 as fairly good. In 4Q18, we expect to see better revenue growth, as well as cash flow possibly turning positive.

Cash flow may always be a concern for China Railway, considering the funding structure of public-private partnership (PPP) projects. However, management sees positive signs of cash flows turning positive in 4Q. This is after taking into consideration the following factors – payback usually occurs in 4Q, land investments in 4Q are to be reduced, and China Railway is actively looking at fundraising options eg asset-backed securities. During 9M18, the negative operating cash flow was due to increases in land acquisition expenses and slow payback from a project owner.

Financial improvement may benefit cash flows. As at end-3Q18, China Railway's debt-to-asset ratio decreased to 78.65% (end-2017: 79.89%), in line with the company's target. This was driven by a debt-to-equity swap exercise in June. With better financials, China Railway should save on financial expenses, which in turn could lead to better net margins going forward.

Look forward to policy execution on liquidity improvements. With the Government's positive policies in July, there was a direct impact on the firm's 3Q revenue and earnings. According to management, there are no obvious signs of improved contracts or faster payback from its clients yet. However, we believe there will be improvements in 4Q18, as the increase in infrastructure investments should benefit the railway and urban rail segments first – these are key areas for China Railway. Maintain BUY and HKD7.68 TP.

Figure 1: China Railway's 3Q18 and 9M18 results

Year to Dec (CNYm)	3Q18	3Q17	YoY	9M18	9M17	YoY
Operating revenue	180,198	171,985	4.8%	497,406	471,696	5.5%
Cost of sales	-161,946	-156,254	3.6%	-445,036	-427,379	4.1%
Gross profit	18,252	15,731	16.0%	52,370	44,317	18.2%
Opex	-10,868	-9,522	14.1%	-28,341	-25,155	12.7%
Operating profit	7,384	6,209	18.9%	24,029	19,163	25.4%
Other non-operating income/expense	-1,060	-382	177.3%	-2,680	-1,374	95.0%
Finance cost	-1,283	-1,065	20.5%	-3,889	-2,509	55.0%
Profit before tax	5,041	4,761	5.9%	17,461	15,279	14.3%
Tax expense	-1,254	-1,230	2.0%	-4,261	-4,198	1.5%
Profit	3,787	3,532	7.2%	13,199	11,081	19.1%
Profit to shareholders	3,492	3,328	4.9%	13,045	11,036	18.2%
Minority interest	294	203	44.6%	154	46	238.1%
EPS (CNY)	0.17	0.15	15.3%	0.56	0.48	16.3%
Gross margin	10.1%	9.1%	1.0%	10.5%	9.4%	-1.1%
OPM	4.1%	3.6%	0.5%	4.8%	4.1%	-0.8%
Tax rate	25%	26%	-0.9%	24%	27%	3.1%
Net margin	1.9%	1.9%	0.0%	2.6%	2.3%	-0.3%

Source: Company data, RHB

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	632,856	688,773	761,492	869,572	1,033,272
Reported net profit (CNYm)	12,509	16,067	18,320	21,481	25,101
Recurring net profit (CNYm)	12,509	16,067	18,320	21,481	25,101
Recurring net profit growth (%)	7.1	28.4	14.0	17.3	16.9
Recurring EPS (CNY)	0.55	0.70	0.80	0.94	1.10
DPS (CNY)	0.09	0.11	0.12	0.14	0.16
Recurring P/E (x)	8.91	6.94	6.08	5.19	4.44
P/B (x)	0.87	0.78	0.70	0.63	0.56
P/CF (x)	2.05	4.02	2.05	2.81	2.30
Dividend Yield (%)	1.8	2.3	2.4	2.8	3.3
EV/EBITDA (x)	4.92	3.48	3.03	2.27	1.47
Return on average equity (%)	10.2	11.8	12.1	12.8	13.4
Net debt to equity (%)	38.6	33.8	19.2	14.8	7.8
Our vs consensus EPS (adjusted) (%)			11.4	16.1	18.1

Source: Company data, RHB

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