

Company update

China Railway Group

Research Team
China | Industrials

Rating BUY (as at 23 November 2022)
 Last Close HKD 4.01
 Fair Value HKD 6.40

Valuation system with Chinese characteristics?

- **Outperformance vs market YTD; one of the leaders of the pack**
- **Infrastructure sector and other SOEs rallied after CSRC Chairman's remarks on exploring a valuation system for undervalued SOEs**
- **One of few in the sector not on US Entity List**

Investment thesis

Given slower economic growth as China rebalances its economy, infrastructure investments are often adopted as a counter-cyclical policy. We also see renewed focus on a highway-to-railway shift for cargo transportation as China seeks to lower logistics costs and accelerate its de-carbonisation push. CRG is a key beneficiary as one of the leading infrastructure constructors, though timing of new contracts approval could be volatile. While China's Belt and Road initiative could be a medium-term driver, domestic contracts remain the key driver, accounting >90% of total.

Investment summary

- **Outperformed market year to date (YTD) and leader of the pack** –YTD the total return of China Railway Group-H (CRG) is up 2%, outperforming the Hang Seng Index which is down 25% over the same period, based on 22 November 2022 closing prices. This is also stronger than the performance of peers such as China Communications Construction (CCCC), 1800 HK China Railway Construction (CRCC), 1186 HK and China State Construction International (CSCI), 3311 HK which are down about 9-10% YTD. We think this may be due to CRG's efforts to improve margins, the group's highest 9M22 order growth among Chinese infrastructure construction companies, and also less limitations on stock trading as CRG is not on the US Entity List, while CCCC and CRCC are. For CSCI, the rangebound trading is not surprising considering the stock's significant outperformance in 2021.

Security information

Ticker	0390.HK
Market Cap (HKD b)	139.5
Daily turnover (HKD m)	19.0
Free Float	53%
Shares Outstanding (m)	24,742
Top Shareholder	BlackRock Instit Trust N.A. 3.8%

Price performance chart



Financial summary

CNY b	FY21	FY22E	FY23E
Revenue	1,073	1,170	1,261
Operating income	48.0	52.9	56.1
PATMI	27.6	30.0	33.5
Adj EPS (CNY)	1.02	1.12	1.26
DPS (CNY)	0.18	0.19	0.20

Key ratios

	FY21	FY22E	FY23E
Operating margin (%)	4.5	4.5	4.4
Net profit margin (%)	2.6	2.6	2.7
Current debt over total (%)	36.0	33.0	30.0

Source: Refinitiv, Company, Internal estimates

- **Establishment of a valuation system with Chinese characteristics?** – The Chinese infrastructure construction sector, along with other state-owned enterprises (SOEs), also rallied on 22 November 2022 as Mr Yi Huiman of China Securities Regulatory Commission (CSRC) highlighted at the 2022 Financial Street Forum Annual Meeting that “it is necessary to explore the establishment of a valuation system with Chinese characteristics to promote better market resource allocation”. A number of stocks in the infrastructure sector, despite outperforming the broader market in 2021 and so far this year, are still trading at low valuations around 0.2-0.6x price-to-book (P/B) and 2-5x price-to-earnings (P/E). Like other SOEs, the low valuations are due to various reasons and we will be monitoring if more will be done to close the valuation gap. Meanwhile, we maintain our fair value estimate of HKD6.40 on CRG.

ESG updates

- **ESG rating downgraded in Jul 2021** – CRG used to have the highest ESG rating among the four Chinese infrastructure contractors under coverage, but this changed when its rating was downgraded in Jul 2021. The company had an independent majority board, but with the recent board reshuffle (Jun 2021), the leadership is no longer independent and comprises of three executives, including the CEO. This may limit independent management oversight. There are also recurring related-party transactions (RPTs) with its controlling owner, China Railway Engineering Corporation, although its fully independent audit committee may help mitigate potential governance risks associated with RPTs for all investors. Under the “Environment” segment, there is no evidence of targets to increase investments in clean tech.

Potential catalysts

- Faster new order growth should economic growth slow
- Government decides to increase fiscal stimulus via more infrastructure projects
- Unlocking value of existing infrastructure assets

Investment risks

- Margin pressure from higher raw material costs; working capital stress from contract payments delay
- Overseas projects are mainly in developing countries with higher political and economic uncertainty

Valuation analysis

	Price/Earnings		Price/Book		EV/EBITDA		Dividend Yield (%)		ROE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
CHINA RAILWAY GROUP LTD (0390.HK)	3.1	2.7	0.3	0.3	7.9	7.2	5.7	6.2	10.5	10.7
CHINA RAILWAY CONSTRUCTION CORP LTD (1186.HI)	2.0	1.8	0.2	0.2	7.2	6.5	6.7	7.4	9.6	9.9
CHINA COMMUNICATIONS CONSTRUCTION CO LTD	2.9	2.6	0.2	0.2	12.5	11.4	6.7	7.4	6.7	7.0
CHINA STATE CONSTRUCTION INTERNATIONAL HOLL	5.4	4.7	0.7	0.6	7.3	6.5	5.6	6.4	13.0	13.5

Source: Refinitiv

Price/Earnings chart



Source: Refinitiv

Price/Book chart



Source: Refinitiv

Company overview (as of 1 June 2021)

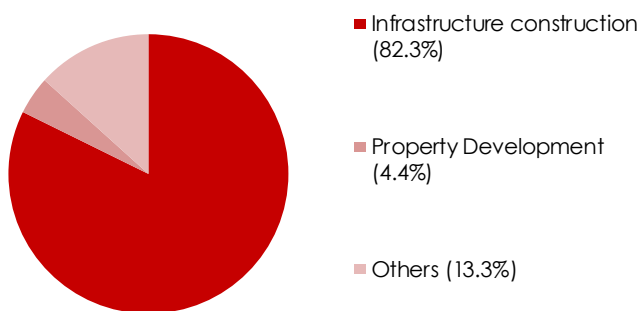
Company description

China Railway Group is a leading state-owned enterprise and one of China's fully-integrated construction groups. Key focus is in railway infrastructure, with operations spanning construction, survey/design, engineering equipment manufacturing. CRG also has peripheral exposure to property development, materials trading and mining. It is estimated that the group holds >45% market share in the domestic railway infrastructure market, >50% share in urban transit infrastructure and around 12% in highway infrastructure.

Infrastructure projects are often used as a counter-cyclical tool in China and new orders growth tend to be stronger when economic growth is weakening. Public-private partnership projects may be undertaken, with private participation from social capital and State-Owned Enterprises to alleviate the funding pressure on local governments. Operating cash flow seasonally tends to be weaker in first two quarters before picking up in third and fourth quarters on backend loaded payment from customers.

FY21 Revenue breakdown

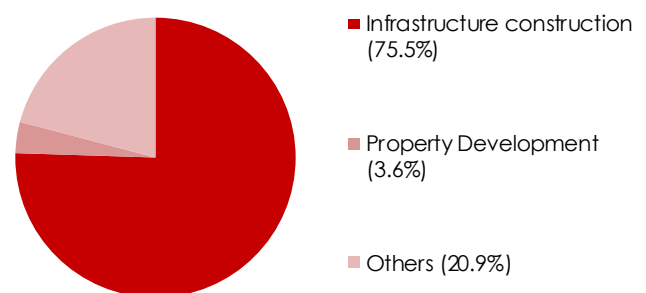
By segment



Source: Company, Internal estimates

FY21 Pre-tax profit breakdown

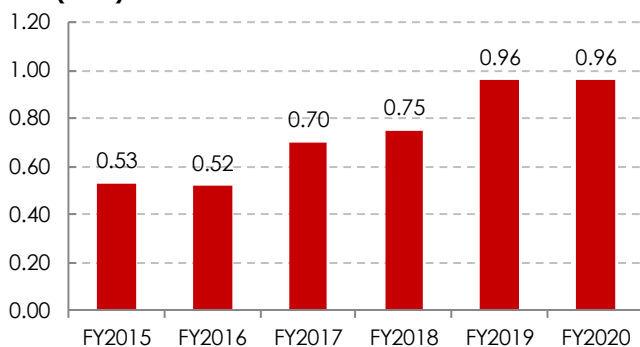
By geography



Source: Company, Internal estimates

Earnings per share

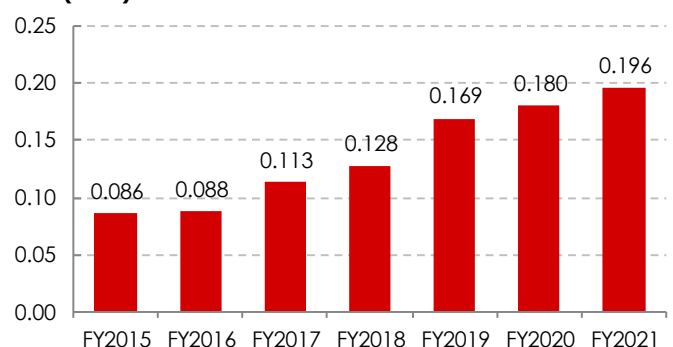
EPS (CNY)



Source: Company, Internal estimates

Dividends per share

DPS (CNY)



Source: Company, Internal estimates

Company financials

Income Statement

In Millions of CNY except Per Share	FY2017	FY2018	FY2019	FY2020	FY2021
12 Months Ending	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Revenue	688,773.0	740,383.0	850,843.0	974,732.0	1,073,272.0
- Cost of Revenue	626,044.0	668,725.0	770,979.0	884,380.0	969,886.0
Gross Profit	62,729.0	71,658.0	79,864.0	90,352.0	103,386.0
+ Other Operating Income	--	--	--	--	--
- Operating Expenses	40,735.0	42,945.0	45,763.0	54,503.0	65,541.0
Operating Income or Losses	21,994.0	28,713.0	34,101.0	35,849.0	37,845.0
- Interest Expense	4,655.0	5,521.0	5,255.0	6,448.0	7,219.0
- Foreign Exchange Losses (Gains)	--	--	--	--	--
- Net Non-Operating Losses (Gains)	-3,489.0	-1,753.0	-4,341.0	-6,211.0	-9,010.0
Pretax Income	20,828.0	24,945.0	33,187.0	35,612.0	39,636.0
- Income Tax Expense (Benefit)	6,624.0	7,509.0	7,808.0	8,362.0	9,166.0
Income Before XO Items	14,204.0	17,436.0	25,379.0	27,250.0	30,470.0
- Extraordinary Loss Net of Tax	--	--	--	--	--
- Minority/Non Controlling Interests (Credits)	-1,863.0	238.0	1,701.0	2,062.0	2,852.0
Net Income/Net Profit (Losses)	16,067.0	17,198.0	23,678.0	25,188.0	27,618.0
Net Inc Avail to Common Shareholders	15,280.0	16,409.0	23,678.0	23,668.0	25,469.0
Abnormal Losses (Gains)	--	--	--	--	--
Tax Effect on Abnormal Items	--	--	--	--	--
Normalized Income	14,268.1	22,219.8	23,258.4	27,256.9	30,616.8
Basic Earnings per Share	0.7	0.7	1.0	1.0	1.0
Basic Weighted Avg Shares	22,844.0	22,844.0	23,276.0	24,571.0	24,571.0
Diluted EPS Before Abnormal Items	0.7	0.7	1.0	1.0	1.0
Diluted EPS Before XO Items	0.7	0.7	1.0	1.0	1.0
Diluted EPS	0.7	0.7	1.0	1.0	1.0
Diluted Weighted Avg Shares	22,844.0	22,844.0	23,276.0	24,571.0	24,571.0

Profitability Ratios

	FY2017	FY2018	FY2019	FY2020	FY2021
12 Months Ending	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Returns					
Return on Common Equity	10.35	9.46	11.47	9.93	9.61
Return on Assets	1.78	1.95	2.54	2.42	2.38
Return on Capital	9.15	8.05	6.83	5.84	4.93
Return on Invested Capital	21.05	17.90	15.67	11.61	8.79
Margins					
Operating Margin	3.19	3.88	4.01	3.68	3.53
Incremental Operating Margin	0.93	1.21	1.03	0.92	0.96
Pretax Margin	3.02	3.37	3.90	3.65	3.69
Income before XO Margin	2.33	2.32	2.78	2.58	2.57
Net Income Margin	2.22	2.22	2.78	2.43	2.37
Net Income to Common Margin	2.22	2.22	2.78	2.43	2.37
Additional					
Effective Tax Rate	31.80	30.10	23.53	23.48	23.13
Dividend Payout Ratio	17.08	17.81	16.24	18.94	18.91
Sustainable Growth Rate	10.33	9.45	11.45	9.92	9.59

Credit Ratios

	FY2017	FY2018	FY2019	FY2020	FY2021
12 Months Ending	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Total Debt/EBIT	7.84	5.56	6.90	6.55	7.37
Net Debt/EBIT	2.40	1.72	2.36	2.36	3.50
EBIT to Interest Expense	4.78	6.23	6.45	5.97	5.89
Long-Term Debt/Total Assets	10.13	9.44	11.40	14.02	14.65
Net Debt/Equity	0.44	0.47	0.47	0.58	0.84

Source: Refinitiv

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