

Analyst: Kelvin Li

CHINA RAILWAY GROUP LIMITED (中國中鐵)

Sector	: Transportation	Chairman	: SHI Dahua
HKSE Code	: 0390		
Market Price	: HK\$7.66 (25/04/2008)		
HSI	: 25,516.78 (25/04/2008)		
H shares Issued	: 4,207.39 million		
H-share Mkt. Cap.	: HK\$32,228.6 million		
52 weeks Hi/ Lo	: HK\$11.94 / HK\$6.45		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

	FY2007	FY2006	<i>change</i>
	<u>RMB million</u>	<u>RMB million</u>	
• Turnover	173,751	153,568	+13.1%
• Gross profit	12,643	11,921	+6.1%
• Operating profit	4,150	4,045	+2.6%
• Attributable profit to shareholders	2,423	2,046	+18.4%
	<u>RMB</u>	<u>RMB</u>	
• EPS – basic	0.181	0.160	+13.1%
• DPS	-	N/A	N/A

- China Railway Group reported an 18.4% y-o-y increase in net profit to RMB2.42 billion for the year ended 31st Dec 2007, slightly above the management guidance of not less than RMB2.4 billion revealed during its IPO in Nov 2007. In fact, the Group's FY07 earnings growth was largely driven by non-core business items, including property development, sales of materials, gains from equity investments and write-back on provision for loans made in previous years.
- Turnover rose 13.1% y-o-y to RMB173.8 billion in FY07, mainly driven by the core infrastructure construction segment. Cost of sales, which mainly included raw material costs, subcontracting costs, equipment usage costs, staff-related expenses and depreciation & amortization expenses, jumped 13.7% y-o-y to RMB161.1 billion last year.
- China Railway did not provide the breakdown of its cost structure, only blaming rising raw materials and staff costs on depressing its operations. As a result, the Group's gross profit rose an unimpressive 6.1% y-o-y to RMB12.6 billion in FY07, while its gross profit margin dipped 0.5% point to 7.3% from 7.8% a year earlier.
- EPS for FY07 was RMB0.181, compared with a pre-listing EPS of RMB0.160 a year earlier. No final dividend was declared.
- As of 31st Dec 2007, the Group has total debts of RMB38.8 billion (31/12/2006: RMB34.2 billion). Following the A-share and the H-share offerings in 4Q2007, the Group's cash on hand surged to RMB56.7 billion as at the end of FY07 from RMB29.7 billion a year earlier. As a result, China Railway was in a strong net cash position of RMB18.0 billion at 2007 year end, compared with a net debt of RMB4.7 billion a year ago.

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Business highlights

- Breakdown of revenue by business segments:

	FY2007		FY2006		Change
	RMB million	%	RMB million	%	
Infrastructure construction	164,959	94.9%	140,399	91.4%	+17.5%
Survey, design & consulting services	3,394	2.0%	4,124	2.7%	-17.7%
Engineering equipment & component manufacturing	5,193	3.0%	4,095	2.7%	+26.8%
Property development	3,282	1.9%	1,879	1.2%	+74.7%
Other businesses	8,085	4.7%	6,278	4.1%	+28.8%
Inter-segment elimination	(11,162)	(6.4%)	(3,207)	(2.1%)	+248.1%
Total	173,751	100.0%	153,568	100.0%	+13.1%

- China Railway's core **Infrastructure construction** segment reported a 17.5% y-o-y rise in revenue to RMB101.7 billion. For FY07, revenue from railway construction totalled RMB77.5 billion, up 26.2% from FY06. Revenue from municipal works construction and highway construction totalled RMB46.6 billion and RMB40.9 billion, respectively, up 26.0% and down 2.7% y-o-y. Owing to rising raw material costs, the segment's gross profit grew only by 9.1% y-o-y to RMB9.5 billion. Profit from operations (segment results before unallocated corporate income & expenses) even experienced a 15.2% y-o-y drop in FY07, mainly due to higher selling & marketing and administrative expenses, while the segment's operating margin narrowed to 1.1% in FY07 from 1.6% a year earlier.
- Revenue from **survey, design & consulting services** amounted to RMB3.4 billion in FY07, down 17.7% y-o-y, as the Group disposed of The Third Railway Survey and Design Institute Group Corp in Dec 2006. According to China Railway's management, the segment's revenue would have grown by 6.7% y-o-y in FY07 if the impact of the disposal was excluded. Nonetheless, along with a 15.3% rise in cost of sales, the segment's gross profit fell by a sharp 26.0% y-o-y. Also due to higher selling & marketing and administrative expenses, the segment's operating profit tumbled 33.3% y-o-y in FY07, while its operating margin weakened by 1.6 percentage points to 6.9% in FY07.
- China Railway's **engineering equipment and component manufacturing** segment (design, manufacture and sale of turnouts, railway related equipment, bridge steel structures and engineering machinery) reported a 26.8% y-o-y rise in revenue to RMB5.2 billion in FY07. Owing to rising operating expenses on material costs, the segment's operating profit fell 62.2% y-o-y to RMB168 million, dragging down its operating margins to 3.2% from 10.9% a year earlier.
- Property development** contributed revenue of RMB3.3 billion in FY07, up 74.7% from a year earlier, which registered the strongest growth among various business segments of the Group. The segment's gross profit grew 46.0% y-o-y to RMB1.1 billion, but its operating profit increased only 17.8% to RMB502 million due to higher marketing expenses. As a result, the segment's operating margin dropped to 15.3% in FY07 from 22.7% a year earlier. As of the end of FY07, the Group had 59 development projects with a gross site area of 6.74 million square metres.

Outlook & Prospects

- Better profit margin seen in 2008** China Railway's profit margins in various business segments were under pressure in FY07, due to rising material costs and the time lag of better pricing of the new contracts. Management expects profit margins to improve in FY08 as higher project prices are to be realised this year, but the Group did not disclosed a definite target level for this year.
- Overseas expansion** China Railway revealed that overseas business accounted for less than 1% of its revenue in FY07. Nonetheless, expansion in the overseas market has been proceeding well, and management expects the segment would account for about 15% of its total revenue in 3 years' time.
- Patience needed** The FY07 results were a bit disappointing on weak cost control and profit margins. Management reveals that the Group would take 3 years' time to refine its corporate structure and enhance cost control to boost profitability and efficiency. Trading at around 30x FY08E P/E, valuation of China Railway looks demanding. Nonetheless, we would still recommend a "HOLD" on the counter given the booming railway infrastructure industry on the Mainland.

Recommendation: HOLD



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