

ENN Energy (2688 HK)

1H23 results miss amid weak economic recovery and gas cost fluctuation

ENN recorded 1H23 core profit of RMB3,914mn, down 5% YoY, lower than our expectation. Thanks to the weak economy recovery in 1H23, city gas sales volume declined by 6.9% YoY to 12.2bcm, slower than mgmt. guidance and our estimate, but gas dollar margin experienced slight improvement to RMB0.52/cbm. IE segment revenue missed and was up by 30% (vs prev. guidance of +40%YoY). Looking ahead, gas demand still takes time to recover and we adjust our full year gas sales growth forecast from 10.0% to 2.5%, and expect gas dollar margin to remain stable in 2H23E. We cut our SOTP TP by 10% to RMB123.6 on lower Integrated Energy's and gas sales expectation. **Maintain BUY.**

- 1H23 core profit dragged by 5% YoY, missed consensus and our estimates.** ENN's revenue declined by 7.2%YoY to RMB54.1bn as retailed gas sales revenue dragged by 3.6%YoY and wholesales gas sales decreased by 28.6%YoY. However, ENN's GP grew by 3.8%YoY with GPM climbing 1.4ppt to 13.2% as improved dollar margin. Major expenses were largely in line. And ENN recorded positive free cash flow of RMB0.412bn during 1H23. In addition, its attributed NP was RMB3.33bn, up 7.3% YoY. Stripping out non-recurring items, core profit decreased by 5%YoY to RMB3,914mn. ENN declared interim dividend of HK\$ 0.64/share (flat as 1H22), and maintained full year dividend payout guidance at 35%.
- Weak industrial and wholesale gas sales.** City gas sales volume squeezed by 6.9% YoY to 12.2bcm in 1H23. In particular, industrial gas sales dropped seriously by 11.7% YoY thanks to 1) lower gas sales to partial power plants clients; 2) the halt of M&A in 2022; and 3) weak economic recovery. Furthermore, ENN's commercial gas sales and residential gas sales slightly missed and lifted by 5.3%/5.1%YoY. Despite the improvement of 1H23 gas dollar margin to RMB0.52/cbm, its city gas sales GP slipped by 7.5%YoY due to higher gas procurement prices and safety cost. For wholesale gas, its revenue and GP declined by 28.6% YoY and 19.4% YoY due to lower demand for LNG flexible deployment, yet ENN believes its wholesale gas profit still can reach RMB1.5bn in FY23E. Looking ahead, we lower ENN's full year gas growth target from 10% to 2.5% YoY, adjust retail gas sales growth to 5.8% YoY, and expect gas dollar margin to stabilize at RMB0.51/cbm.
- Connection's steady slowdown continues while VAS results are inline.** Due to slowdown of property development, residential connection slowed down and achieved a modest rise of 1.9% YoY to 0.998mn households in 1H23, but it tended to be stable. VAS revenue lifted significantly by 45.8% YoY to RMB1,699mn. We maintained our estimates of residential connection of 2.0mn and VAS revenue surge by 40% for 2023.
- IE's revenue growth slower-than-expected, but is expected to accelerate in 2H23.** Because of unfavorable economic recovery in 1H23, IE business's projects in operation slightly missed and its revenue was boosted by 30%YoY (~mgmt. guided at +40%YoY). Yet, the energy sale volume grew 75% YoY and contributed a robust surge on gross profit/revenue by 30.8% YoY /30.3% YoY. Consequently, we adjusted our full-year IE revenue growth forecast from 45% to 40%YoY.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	93,113	110,051	108,556	119,935	136,911
YoY growth (%)	30.0	18.2	(1.4)	10.5	14.2
Net profit (RMB mn)	7,755.0	5,865.0	7,811.4	9,125.3	9,880.8
YoY growth (%)	23.5	(24.4)	33.2	16.8	8.3
EPS (Reported) (RMB)	6.88	5.20	7.25	8.54	9.33
YoY growth (%)	23.2	(24.4)	39.5	17.7	9.3
P/E (x)	16.6	18.7	10.0	8.5	7.8
P/B (x)	3.6	2.8	1.8	1.6	1.4
ROE (%)	23.4	15.7	18.7	19.2	18.4

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$123.60

(Previous TP) HK\$135.90

Up/Downside 57.7%

Current Price HK\$78.40

China Energy

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Stock Data

Mkt Cap (HK\$ mn)	88,687.6
Avg 3 mths t/o (HK\$ mn)	196.1
52w High/Low (HK\$)	126.00/78.00
Total Issued Shares (mn)	100.0

Source: FactSet

Shareholding Structure

Xinneng (Hong Kong) Energy	32.7%
Investment	
The Capital Group	14.0%

Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-8.4%	-6.1%
3-mth	-24.5%	-20.7%
6-mth	-33.3%	-26.7%

Source: FactSet

12-mth Price Performance



Source: FactSet

- **Cut TP to HK\$123.6 but maintain BUY considering its attractive valuation.** Based on revised mgmt. guidance, we trimmed our earnings estimates by 21.3%/ 14.1%/ 5% YoY in 2023E-25E. Thus, our SOTP target price is cut by around 10% to HK\$123.6 after adjusted FX rate to 0.89. Recently, ENN Energy is trading at near 10x PE, lower than its 3-year avg. PE of 14x. Though it takes time for a gas demand recovery, ENN's current valuation is attractive. **Maintain BUY.**

Figure 1: 1H23 revision table

	Old			New			Change(%)		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Total gas sales volume (mcbm)	35,995	39,240	42,803	33,417	35,823	39,078	-7.2%	-8.7%	-8.7%
Retail gas sales volume (mcbm)	28,428	30,766	33,227	27,337	29,439	32,055	-3.8%	-4.3%	-3.5%
Revenue (HK\$, mn)	120,109	131,224	146,504	108,556	119,935	136,911	-9.6%	-8.6%	-6.5%
Net Income (HK\$, mn)	9,921	10,623	10,406	7,811	9,125	9,881	-21.3%	-14.1%	-5.0%
EPS (HK\$)	8.67	9.21	9.01	7.25	8.54	9.33	-16.3%	-7.3%	3.6%

Source: Company data, CMBIGM estimates

Figure 2: Traditional business valuation

DCF Valuation	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
Key operating forecasts										
City gas sales volume (mcbm)	27,337	30,071	33,078	36,386	39,296	42,440	45,835	49,502	53,462	57,739
YoY change (%)	5.4%	10.0%	10.0%	10.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Wholesales gas volume (mcbm)	6,080	6,688	7,357	8,093	8,740	9,440	10,195	11,010	11,891	12,843
YoY change (%)	-10.0%	10.0%	10.0%	10.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Annual residential connection	2.0	1.9	1.8	1.7	1.7	1.6	1.5	1.5	1.4	1.4
YoY change (%)	-6.3%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%
Accumulated residential customer	29.9	31.8	33.6	35.3	36.9	38.5	40.1	41.5	42.9	44.3
Turnover (HK\$ mn)	108,556	119,935	136,911	152,182	166,418	178,990	189,290	196,775	201,015	201,727
Turnover growth (%)	-1.4%	10.5%	14.2%	11.2%	9.4%	7.6%	5.8%	4.0%	2.2%	0.4%
EBIT (HK\$ mn)	12,145	14,064	15,271	16,214	17,897	19,428	20,735	21,752	22,422	22,703
EBIT margin	11.2%	11.7%	11.2%	10.7%	10.8%	10.9%	11.0%	11.1%	11.2%	11.3%
Tax rate	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%
DD&A - HK\$ mn	2,886	3,174	3,459	3,845	4,205	4,523	4,783	4,972	5,079	5,097
CAPEX (HK\$ mn)	-13,207	-9,031	-9,035	-9,306	-9,585	-9,872	-10,169	-10,474	-10,788	-11,111
Invest in working capital	1,715	654	1,161	-1,527	-1,424	-1,257	-1,030	-749	-424	-71
Free cash flow	624	5,486	7,192	5,335	6,798	8,158	9,343	10,282	10,908	11,169
IE FCF	-989	-364	-140	28	553	1,168	1,890	2,633	3,914	4,549
Non IE FCF	1,613	5,850	7,332	5,307	6,246	6,990	7,453	7,648	6994.40	6619.77
Years	1	2	3	4	5	6	7	8	9	10
Discount factor	0.93	0.86	0.80	0.74	0.69	0.64	0.59	0.55	0.51	0.47
Discount free cash flow	1,497	5,036	5,857	3,933	4,295	4,460	4,413	4,201	3,565	3,131
Terminal value	113,685									
Terminal perpetual growth	2%									
Terminal EV/EBITDA(excl IE)	6.12									
Valuations (HK\$ mn)										
Terminal value				113,685						
Terminal perpetual growth				2%						
Terminal EV/EBITDA				6.12						
Total discount FCF				38,891						
Discount terminal value				53,764						
Firm value				92,656						
Discount FCF(% of total)				58.0%						
Terminal value (% of total)				42.0%						
Add: Cash & cash equivalent				3,684						
Less: Debt				19,129						
Non-controlling interest				6,876						
Equity Value - (RMB, mn)				70,335						
Number of shares				1,126						
Share fair value (RMB)				62.44						
Share fair value (HK\$)				70.16						
WACC Calculations										
Cost of debt								4.0%		
Tax rate								25.0%		
After tax cost of debt								3.0%		
Cost of equity								9.8%		
Adjusted beta								0.70		
Market risk premium								11.5%		
Risk free rate								1.8%		
% of debt financing								30.0%		
WACC								7.8%		

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Source: Company data, CMBIGM estimates

Figure 3: IE valuation**SOTP Valuation**

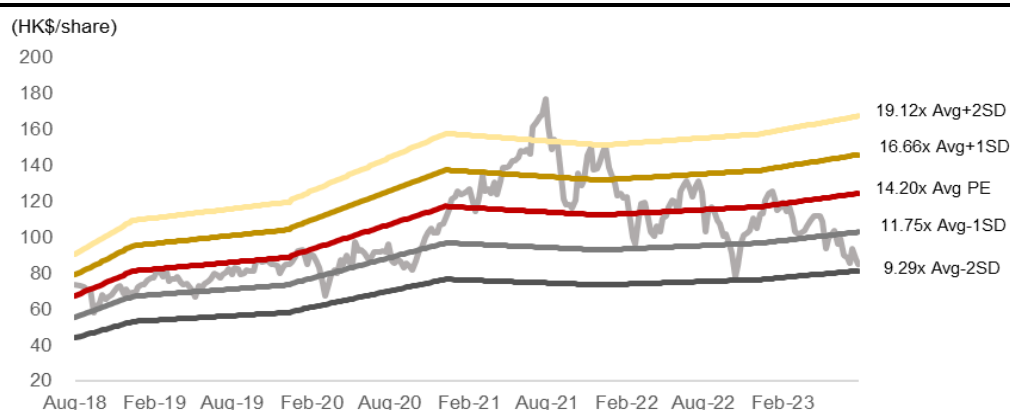
Traditional business value - RMB	62.44
IE value - RMB	47.53
ENN's Total value	109.97
FX rate HK/RMB	0.89
Target price- HK\$	123.60

Source: Company data, CMBIGM estimates

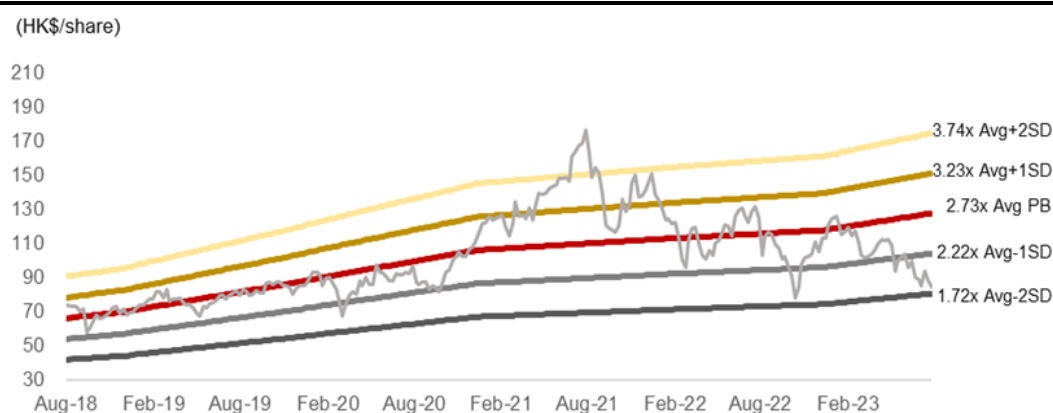
Figure 4: Peers table

Company	Ticker	Closing Price (HK\$)	Mkt cap (HK\$mn)	EPS			23-25E CAGR	PER			PBR		
				23E	24E	25E		23E	24E	25E	23E	24E	25E
ENN ENERGY	2688 HK	78.40	88687.60	7.62	8.39	9.34	10.7%	9.56	8.68	7.79	1.84	1.62	1.44
TIAN LUN GAS HOL	1600 HK	4.28	4202.47	0.71	0.82	1.03	20.7%	5.62	4.83	3.86	0.73	0.56	0.47
CHINA GAS HOLDIN	384 HK	8.17	44447.54	1.14	1.08	1.21	3.2%	7.17	7.60	6.74	0.66	0.71	0.69
CHINA RES GAS	1193 HK	22.75	52643.79	2.56	2.84	3.17	11.3%	8.88	8.02	7.17	1.21	1.10	1.02
TOWNGAS SMART EN	1083 HK	3.12	10466.04	0.43	0.45	0.51	9.1%	7.32	7.00	6.15	0.47	0.45	0.43
KUNLUN ENERGY	135 HK	5.65	48922.23	0.75	0.80	0.86	6.8%	6.98	6.57	6.13	0.71	0.66	0.62
Average								7.6	7.1	6.3	0.9	0.8	0.8

Source: Company data, CMBIGM estimates

Figure 5: PE band

Source: Company data, CMBIGM estimates

Figure 6: PB band

Source: Company data, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	71,617	93,113	110,051	108,556	119,935	136,911
Cost of goods sold	(59,285)	(79,057)	(94,295)	(92,734)	(100,962)	(115,077)
Gross profit	12,332	14,056	15,756	15,822	18,973	21,834
Operating expenses	(4,181)	(4,847)	(5,441)	(5,319)	(6,476)	(8,078)
Selling expense	(951)	(1,122)	(1,180)	(1,194)	(1,439)	(1,780)
Admin expense	(3,230)	(3,725)	(4,261)	(4,125)	(5,037)	(6,298)
Operating profit	16,513	18,903	21,197	21,142	25,449	29,911
Other income	952	1,077	953	1,203	1,242	1,302
Other gains/(losses)	282	984	(1,569)	(400)	(550)	(700)
Share of (losses)/profits of associates/JV	782	699	25	839	876	914
EBITDA	12,248	14,228	12,319	15,031	17,238	18,731
Depreciation	2,081	2,259	2,595	2,886	3,174	3,459
EBIT	10,167	11,969	9,724	12,145	14,064	15,271
Interest income	(609)	(576)	(672)	(700)	(750)	(800)
Pre-tax profit	9,558	11,393	9,052	11,445	13,314	14,471
Income tax	(2,227)	(2,398)	(2,388)	(2,747)	(3,195)	(3,473)
After tax profit	7,331	8,995	6,664	8,698	10,119	10,998
Minority interest	1,053	1,240	799	887	993	1,117
Discontinued operations	6,278	7,755	5,865	7,811	9,125	9,881
Net profit	6,278	7,755	5,865	7,811	9,125	9,881

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	23,568	27,558	27,133	23,952	28,073	34,523
Cash & equivalents	8,630	8,684	8,056	3,684	5,906	9,499
Restricted cash	116	363	458	230	240	249
Account receivables	9,053	10,568	10,675	11,682	12,908	14,738
Inventories	1,285	1,508	1,708	1,954	2,159	2,464
Prepayment	0	0	0	0	0	0
Financial assets at FVTPL	406	1,737	1,488	1,488	1,488	1,488
Other current assets	3,346	3,923	4,110	4,448	4,914	5,610
Contract assets	732	775	638	466	458	474
Non-current assets	66,475	72,430	75,218	85,975	92,146	98,136
PP&E	41,861	46,793	50,380	59,188	64,214	68,905
Right-of-use assets	2,129	2,119	2,323	2,305	2,387	2,463
Deferred income tax	1,370	1,212	1,557	2,063	2,279	2,601
Investment in JVs & assos	7,760	8,718	8,477	10,285	11,168	12,116
Intangibles	4,446	4,311	4,549	3,973	3,785	3,585
Goodwill	2,511	2,520	2,520	2,760	2,880	3,000
Financial assets at FVTPL	5,052	5,352	4,327	4,327	4,327	4,327
Other non-current assets	1,346	1,405	1,085	1,075	1,106	1,138
Total assets	90,043	99,988	102,351	109,927	120,219	132,659
Current liabilities	33,233	41,579	36,082	39,619	42,538	46,738
Short-term borrowings	4,590	6,150	6,341	7,561	7,893	8,225
Account payables	8,302	10,172	8,066	12,218	13,501	15,411
Tax payable	971	909	1,517	1,163	1,342	1,499
Other current liabilities	5,039	9,365	4,657	4,375	4,772	5,290
Lease liabilities	89	75	91	91	91	91
Contract liabilities	14,242	14,908	15,410	14,212	14,939	16,223
Non-current liabilities	20,638	16,259	20,714	18,728	19,810	21,217
Long-term borrowings	3,212	2,993	2,825	2,640	2,775	3,014
Convertible bonds	0	0	0	0	0	0
Obligations under finance leases	0	0	0	0	0	0
Deferred income	2,562	2,785	2,974	3,257	3,598	4,107
Other non-current liabilities	14,864	10,481	14,915	12,831	13,437	14,096
Total liabilities	53,871	57,838	56,796	58,346	62,348	67,955
Share capital	117	117	117	118	118	118
Other reserves	30,444	35,660	38,917	44,587	50,480	56,866
Total shareholders equity	30,561	35,777	39,034	44,705	50,598	56,984
Minority interest	5,611	6,373	6,521	6,876	7,273	7,720
Total equity and liabilities	90,043	99,988	102,351	109,927	120,219	132,659

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	9,558	11,393	9,052	11,445	13,314	14,471
Depreciation & amortization	2,081	2,259	2,595	2,886	3,174	3,459
Tax paid	(1,554)	(2,079)	(1,936)	(3,324)	(2,891)	(3,129)
Change in working capital	(208)	187	(1,539)	1,715	654	1,161
Others	(181)	(3)	(1,285)	1,065	(885)	(998)
Net cash from operations	9,696	11,756	6,888	13,788	13,366	14,965
Investing						
Capital expenditure	(3,906)	(4,932)	(3,587)	(8,808)	(5,026)	(4,691)
Others	(2,892)	(2,812)	(4,732)	(4,498)	(4,114)	(4,463)
Net cash from investing	(6,798)	(7,744)	(8,319)	(13,306)	(9,140)	(9,154)
Financing						
Dividend paid	(1,688)	(2,290)	(2,004)	(2,178)	(3,268)	(3,531)
Net borrowings	388	3,599	(5,383)	830	830	830
Others	(3,061)	(1,777)	(2,460)	(1,787)	(2,835)	(3,048)
Net cash from financing	(2,673)	1,822	(7,843)	(957)	(2,005)	(2,218)
Net change in cash						
Cash at the beginning of the year	7,373	7,598	13,433	4,159	3,684	5,906
Others	(7,148)	(1,763)	(22,707)	(4,634)	(1,462)	(2,313)
Cash at the end of the year	225	5,835	(9,274)	(475)	2,222	3,593
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	2.0%	30.0%	18.2%	(1.4%)	10.5%	14.2%
Gross profit	9.5%	14.0%	12.1%	0.4%	19.9%	15.1%
Operating profit	7.6%	14.5%	12.1%	(0.3%)	20.4%	17.5%
EBITDA	7.9%	16.2%	(13.4%)	22.0%	14.7%	8.7%
EBIT	6.3%	17.7%	(18.8%)	24.9%	15.8%	8.6%
Net profit	10.7%	23.5%	(24.4%)	33.2%	16.8%	8.3%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	17.2%	15.1%	14.3%	14.6%	15.8%	15.9%
Operating margin	23.1%	20.3%	19.3%	19.5%	21.2%	21.8%
EBITDA margin	17.1%	15.3%	11.2%	13.8%	14.4%	13.7%
Return on equity (ROE)	22.3%	23.4%	15.7%	18.7%	19.2%	18.4%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Current ratio (x)	0.7	0.7	0.8	0.6	0.7	0.7
Receivable turnover days	10.6	10.9	11.2	11.4	11.5	na
Inventory turnover days	10.6	10.9	11.2	11.4	11.5	na
Payable turnover days	68.6	72.0	63.4	63.2	72.0	na
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	14.4	16.6	18.7	10.0	8.5	7.8
P/B	3.0	3.6	2.8	1.8	1.6	1.4

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
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