

# UEG (467 HK)

## On track volume growth along with good cost control

UEG's net profit in 1H22 grew 58% YoY to HK\$1.51bn, through decent volume growth and better-than-expected unit lifting cost. UEG plans to maintain the presence in Pakistan, despite a change in regime, as UEG is a major taxpayer in the country and the Company is confident that the risk is manageable. While we trim our 2022E earnings forecast by 4% due to the impairment made in 1H22, we revise up our forecast in 2023E/24E by 16%/10% after modelling higher oil & gas price forecast as well as lower lifting cost assumptions. We expect UEG to achieve accelerated oil & gas production growth in 2022E-24E (from 6% to 13%), driven by fast-growing output in Iraq's Block 9. On the back of strong operating cash flow (HK\$3.1bn in 1H22), we forecast dividend yield to reach 8% in 2022E. We roll over our valuation base to 2023E with a new TP of HK\$1.77 (based on unchanged target P/E of 10x). Maintain **BUY**.

- **1H22 net income grew 58% YoY to HK\$1.51bn.** Oil and gas sales value grew 80% YoY to US\$1.3bn, driven by: (1) 65% YoY increase in realized oil & gas price (Crude: US\$104.2/bbl; Gas: US\$29.4/boe), and (2) 9% YoY increase in sales volume. Stripping out the government royalty, windfall levy and government take, net revenue in 1H22 grew 59% YoY to HK\$5.5bn. UEG recognized HK\$350mn impairment loss on trade receivables and HK\$722mn exploration expenses, which were mainly in Pakistan based on our understanding. UEG also recognized HK\$120mn investment loss in JV in 1H22. That said, UEG still managed to report 58% YoY increase in net profit.
- **Average daily working interest production +9.5% to 100k barrels of oil equivalent per day (boed).** Iraq Block 9, the fast-growing asset, achieved working interest production growth of 33% YoY to 32.4k boed in 1H22. We expect this asset to deliver output growth of 30% p.a. in 2022E-23E, a key growth driver of UEG.
- **Good operating cost control.** On the cost side, operating expense dropped 4.7% YoY to US\$4.1/boe, driven by a 14.6% decline in unit cost in the Middle East & North Africa (MENA), which more than offset the 8% YoY increase in Pakistan. Such cost reduction is better than our expectation. This, together with a higher realized price, boosted the gross margin by 14.9ppt YoY to 58.4% in 1H22.
- **Risk factors:** (1) unexpected decline in crude & gas price; (2) political risk in Pakistan.

### Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (HKD mn)	6,204	7,437	11,158	12,064	13,451
YoY growth (%)	-12.7	19.9	50.0	8.1	11.5
Net income (HKD mn)	864	2,001	3,510	4,653	4,944
EPS (HKD)	0.03	0.08	0.13	0.18	0.19
YoY growth (%)	-54.6	131.6	75.5	32.6	6.3
Consensus EPS (HKD)	NA	NA	NA	NA	NA
P/E (x)	26.7	11.5	6.6	5.0	4.7
P/B (x)	1.8	1.6	1.5	1.3	1.1
Yield (%)	2.68	4.55	7.98	10.57	11.23
ROE (%)	6.7	14.1	22.1	25.7	24.1
Net gearing (%)	20.0	19.7	18.9	15.8	9.3

Source: Company data, Bloomberg, CMBIGM estimates

### BUY (Maintain)

Target Price	HK\$1.77
(Previous TP	HK\$1.40)
Up/Downside	101%
Current Price	HK\$0.88

### China Oil & Gas

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#### Stock Data

Mkt Cap (HK\$ mn)	23,135
Avg 3 mths t/o (HK\$ mn)	29.65
52w High/Low (HK\$)	1.32/0.44
Total Issued Shares (mn)	26,290

Source: Bloomberg

#### Shareholding Structure

Zhang Hong Wei	66.44%
Free Float	33.56%

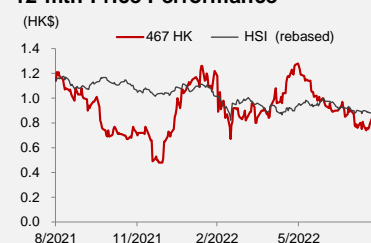
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-1.1%	1.1%
3-mth	-29.9%	-28.1%
6-mth	-24.6%	-15.1%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: RSM Hong Kong

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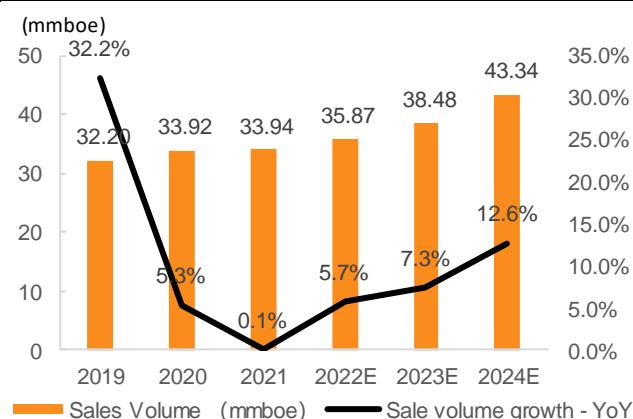
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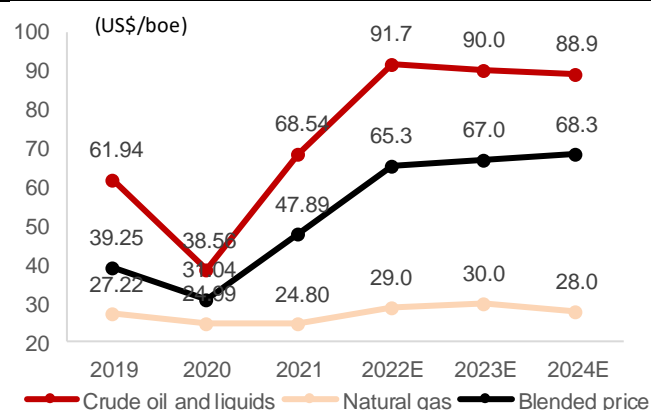
**Figure 1: Change in key assumptions**

	New			Old			Change		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
<b>Daily output (000 boed)</b>									
Pakistan	47	46	46	46	46	46	2.2%	0.0%	0.0%
Iraq - Block 9	34	44	60	34	44	60	0.0%	0.0%	0.0%
Iraq - Siba	6	5	5	6	5	5	0.0%	0.0%	0.0%
Egypt	12	11	10	12	11	10	0.0%	0.0%	0.0%
<b>Total</b>	<b>99</b>	<b>106</b>	<b>121</b>	<b>98</b>	<b>106</b>	<b>121</b>	<b>1.0%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>Realized price</b>									
Crude (US\$/bbl)	92	90	89	89	89	89	3.4%	1.4%	-0.1%
Natural gas (US\$/boe)	29	30	28	26	27	27	11.5%	11.1%	3.7%
Lifting cost (US\$/boe)	4.3	4.6	4.8	4.6	4.9	5.3	-8.0%	-6.0%	-8.4%
<b>(HK\$ mn)</b>									
Revenue	11,158	12,064	13,451	10,212	11,360	13,077	9.3%	6.2%	2.9%
Gross profit	6,730	7,049	7,517	5,514	6,031	6,740	22.1%	16.9%	11.5%
Gross margin	60.3%	58.4%	55.9%	54.0%	53.1%	51.5%	11.7%	10.1%	8.4%
Operating profit	2,459	4,868	5,113	3,883	4,240	4,704	-36.7%	14.8%	8.7%
<b>Net profit</b>	<b>3,510</b>	<b>4,653</b>	<b>4,944</b>	<b>3,660</b>	<b>4,018</b>	<b>4,501</b>	<b>-4.1%</b>	<b>15.8%</b>	<b>9.8%</b>

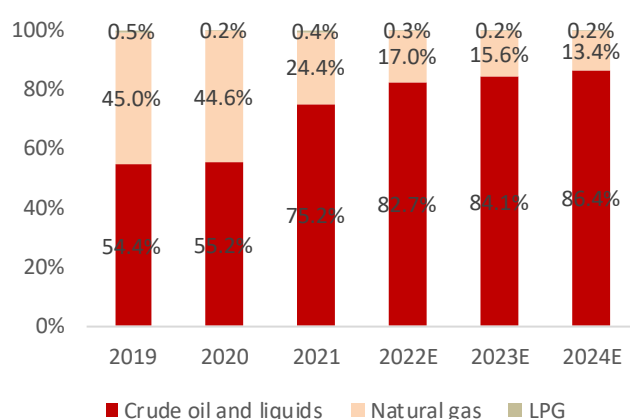
Source: Company data, CMBIGM estimates

**Figure 2: UEG's oil & gas sales volume**

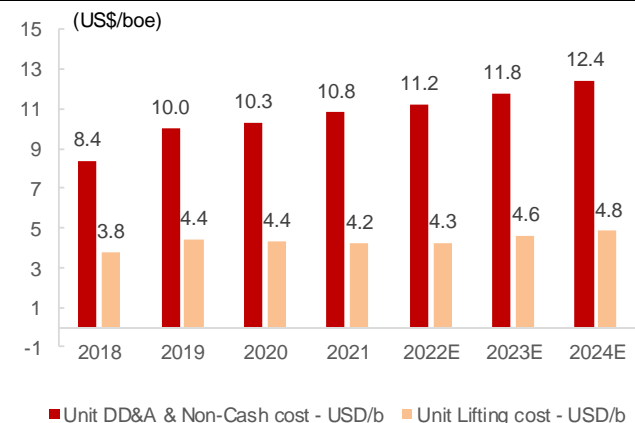
Source: Company data, CMBIGM estimates

**Figure 3: UEG's realised oil and gas price**

Source: Company data, CMBIGM estimates

**Figure 4: Revenue mix**

Source: Company data, CMBIGM estimates

**Figure 5: UEG's unit operating cost**

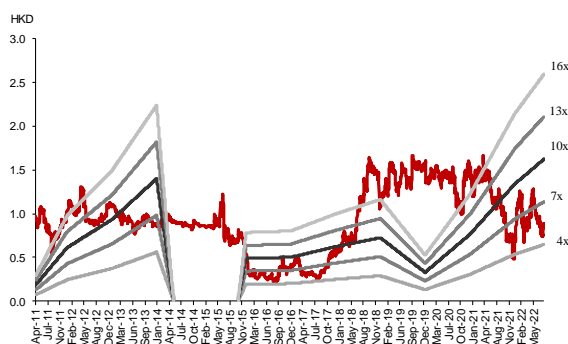
Source: Company data, CMBIGM estimates

## Valuation

UEG is trading at 6.6x 2022E P/E, close to 1x SD below UEG's historical average of 15x (since 2011). We raise our TP from HK\$1.40 to HK\$1.77, based on 10x 2023E P/E which is equivalent to ~30% discount to the historical average.

We estimate every 5% increase in Brent oil price will result in 3% increase in net profit on an annualized basis.

Figure 6: 12M forward P/E band



Source: Company data, Bloomberg, CMBIGM estimates

Figure 7: Brent crude oil price



Source: Bloomberg, CMBIGM

Figure 8: UEG's earnings sensitivity to crude price and lifting cost (Pakistan)

		Realised price (US\$/boe)				
		90	95	100	105	110
	4.59	3,261	3,362	<b>3,463</b>	3,564	3,666
	4.38	3,284	3,385	<b>3,487</b>	3,588	3,689
Lifting cost	<b>4.18</b>	<b>3,308</b>	<b>3,409</b>	<b>3,510</b>	<b>3,611</b>	<b>3,713</b>
(Pakistan)	3.97	3,331	3,432	<b>3,534</b>	3,635	3,736
	3.76	3,355	3,456	<b>3,557</b>	3,658	3,760

Source: CMBIGM estimates

Figure 9: UEG's earnings sensitivity to crude price and lifting cost (MENA)

		Realised price (US\$/boe)				
		90	95	100	105	110
	4.52	3,255	3,356	<b>3,457</b>	3,559	3,660
	4.31	3,281	3,383	<b>3,484</b>	3,585	3,686
Lifting cost	<b>4.11</b>	<b>3,308</b>	<b>3,409</b>	<b>3,510</b>	<b>3,611</b>	<b>3,713</b>
(Mena)	3.90	3,334	3,435	<b>3,537</b>	3,638	3,739
	3.70	3,360	3,462	<b>3,563</b>	3,664	3,765

Source: CMBIGM estimates

Note: Mena = Middle East & North Africa

## Financial Summary

### Income statement

YE 31 Dec (HK\$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>	<b>6,204</b>	<b>7,437</b>	<b>11,158</b>	<b>12,064</b>	<b>13,451</b>
Cost of revenue	(4,171)	(4,080)	(4,428)	(5,015)	(5,934)
<b>Gross profit</b>	<b>2,033</b>	<b>3,357</b>	<b>6,730</b>	<b>7,049</b>	<b>7,517</b>
<b>Operating expenses</b>	<b>(724)</b>	<b>(599)</b>	<b>(2,135)</b>	<b>(1,090)</b>	<b>(1,202)</b>
Investment & other income	75	112	123	145	161
Other gains and losses	79	26	(11)	--	--
Impairment losses for trade	(3)	57	(502)	(60)	(54)
Exploration expenses	(340)	(164)	(1,004)	(362)	(404)
Administrative expenses	(440)	(574)	(658)	(724)	(807)
Other operating	(96)	(55)	(82)	(89)	(99)
<b>Operating profit</b>	<b>584</b>	<b>2,160</b>	<b>2,459</b>	<b>4,868</b>	<b>5,113</b>
Finance Cost	(313)	(267)	(366)	(381)	(396)
Share of losses of associates	31	(59)	(60)	(52)	(47)
<b>Profit before tax</b>	<b>1,027</b>	<b>2,433</b>	<b>4,169</b>	<b>5,526</b>	<b>5,872</b>
Income tax expense	(163)	(432)	(659)	(873)	(928)
MI	0	(0)	(0)	(0)	(0)
<b>Net profit</b>	<b>864</b>	<b>2,001</b>	<b>3,510</b>	<b>4,653</b>	<b>4,944</b>

### Cash flow summary

YE 31 Dec (HK\$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Profit after tax</b>	<b>864</b>	<b>2,001</b>	<b>3,510</b>	<b>4,653</b>	<b>4,944</b>
D&A	2,835	2,972	3,137	3,669	4,211
Change in working capital	(2,572)	(1,032)	(1,630)	(365)	(271)
Others	783	340	109	7	7
<b>Operating cash flow</b>	<b>1,910</b>	<b>4,281</b>	<b>5,127</b>	<b>7,963</b>	<b>8,891</b>
CAPEX	(2,004)	(2,528)	(6,058)	(5,753)	(5,864)
Others	(177)	34	60	52	47
<b>Investing cash flow</b>	<b>(2,181)</b>	<b>(2,494)</b>	<b>(5,998)</b>	<b>(5,701)</b>	<b>(5,817)</b>
Changes in borrowings	(477)	(1,03)	1,83	188	188
Dividends paid	(619)	(1,049)	(1,840)	(2,439)	(2,592)
Others	1,002	630	925	378	545
<b>Financing cash flow</b>	<b>(94)</b>	<b>(1,452)</b>	<b>920</b>	<b>(1,874)</b>	<b>(1,859)</b>
Net change in cash	(365)	335	49	388	1,215
Cash at the beginning	3,35	3,09	3,17	3,21	3,60
FX change, net	99	(258)	--	--	--
<b>Cash at the end</b>	<b>3,093</b>	<b>3,171</b>	<b>3,219</b>	<b>3,607</b>	<b>4,822</b>

### Balance sheet

YE 31 Dec (HK\$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Current assets</b>	<b>7,280</b>	<b>7,669</b>	<b>10,240</b>	<b>11,217</b>	<b>13,051</b>
Bank and cash balances	3,093	3,171	3,219	3,607	4,822
Trade receivables	3,762	4,145	6,360	6,877	7,398
Inventories	331	287	558	603	673
<b>Other current assets</b>	<b>94</b>	<b>66</b>	<b>103</b>	<b>130</b>	<b>158</b>
<b>Non-current assets</b>	<b>17,661</b>	<b>17,364</b>	<b>20,153</b>	<b>22,195</b>	<b>23,815</b>
PPE	10,847	10,835	13,638	16,026	17,987
Right-of-use assets	585	530	535	539	544
Intangible assets	5,701	5,340	5,452	5,144	4,832
Other non-current assets	528	659	528	485	452
<b>Total assets</b>	<b>24,941</b>	<b>25,032</b>	<b>30,394</b>	<b>33,412</b>	<b>36,866</b>
<b>Current liabilities</b>	<b>5,341</b>	<b>5,093</b>	<b>5,570</b>	<b>5,836</b>	<b>6,216</b>
Borrowings (current)	1,370	1,761	1,556	1,619	1,681
Trade and bills payables	3,653	2,818	3,479	3,639	3,891
Lease liabilities (current)	107	108	192	208	232
Other current liabilities	212	407	342	370	412
<b>Non-current liabilities</b>	<b>6,684</b>	<b>5,699</b>	<b>8,907</b>	<b>9,438</b>	<b>10,153</b>
Borrowings	3,866	2,833	4,668	4,856	5,043
Deferred tax liabilities	1,955	1,979	3,347	3,619	4,035
Others	863	886	891	963	1,074
<b>Total equity</b>	<b>12,916</b>	<b>14,240</b>	<b>15,917</b>	<b>18,138</b>	<b>20,497</b>
Shareholders' equity	12,907	14,234	15,911	18,132	20,491
Non-controlling interests	9	6	6	6	6

### Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Net revenue growth (%)</b>	-13%	20%	50%	8%	11%
<b>P&amp;L ratios (%)</b>					
Operating margin	21.1	37.1	41.2	49.4	46.9
Pre-tax margin	16.5	32.7	37.4	45.8	43.7
Net margin	13.9	26.9	31.5	38.6	36.8
Effective tax rate	15.8	15.8	15.8	15.8	15.8
<b>Balance sheet ratios</b>					
Current ratio (x)	1.4	1.5	1.8	1.9	2.1
Quick ratio (x)	1.3	1.4	1.7	1.8	2.0
Payable turnover days	320	320	320	320	319.6
Total debt / total equity ratio (%)	104	88	101	93	88.1
Total Liabilities to Assets (%)	48.2	43.1	47.6	45.7	44.4
Net Debt / EBITDA	0.6	0.5	0.4	0.3	0.2
<b>Returns (%)</b>					
ROA	3.5	8.0	11.5	13.9	13.4
ROE	6.7	14.1	22.1	25.7	24.1
<b>Per share</b>					
EPS (RMB)	0.03	0.08	0.13	0.18	0.19
DPS (RMB)	0.02	0.04	0.07	0.09	0.10
BVPS (RMB)	0.49	0.54	0.61	0.69	0.78

Source: Company data, CMBIGM estimates

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