

# 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

#### Related Report:

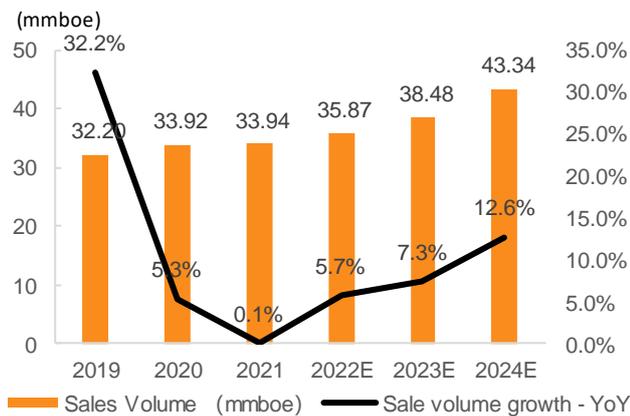
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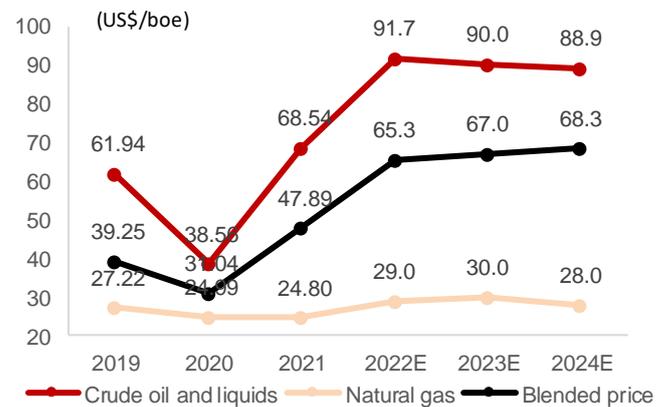
**Figure 1: Change in key assumptions**

|                                | 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> |

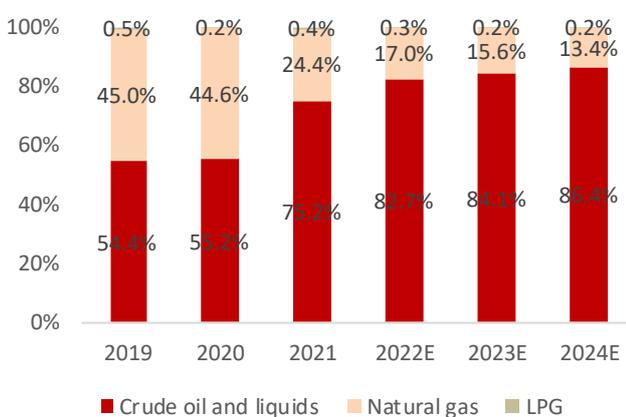
Source: Company data, CMBIGM estimates

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

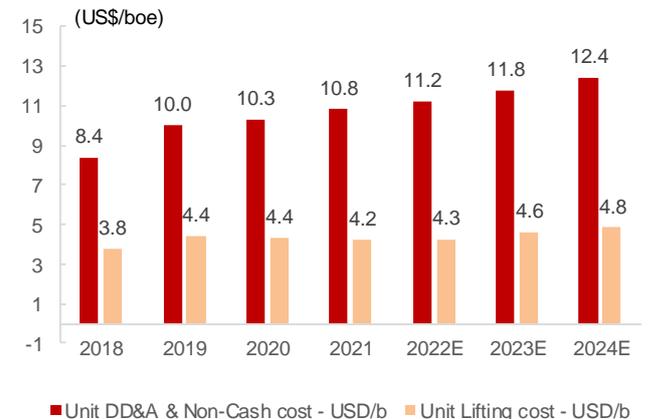
Source: Company data, CMBIGM estimates

**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**

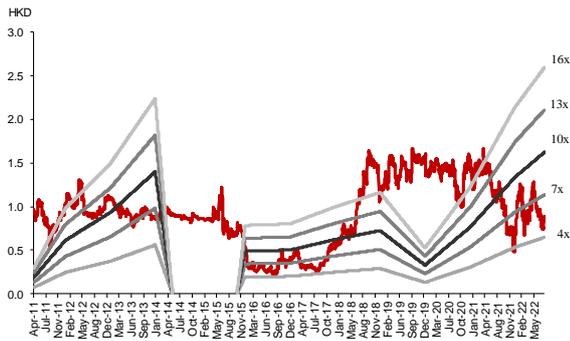
Source: Company data, CMBIGM estimates

## 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 (Pakistan) | <b>4.18</b> | <b>3,308</b>              | <b>3,409</b> | <b>3,510</b> | <b>3,611</b> | <b>3,713</b> |
|                         | 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 (Mena) | <b>4.11</b> | <b>3,308</b>              | <b>3,409</b> | <b>3,510</b> | <b>3,611</b> | <b>3,713</b> |
|                     | 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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