

ENN Energy (2688 HK)

Emerging from the downturn

ENN Energy delivered FY22 results with core profit rising by 11.3% YoY. Despite a 0.8% YoY decline in gross profit and 24.4% YoY drop in attributable net profit due to economic downturn, exchange fluctuation, and higher gas cost, ENN's integrated-energy business and VAS business maintain robust growth. We believe ENN's results will improve in 2023 considering that: 1) gas sales growth is expected to rebound to low double digit; 2) dollar margin may improve based on lower gas cost and more effective price-through measures; 3) wholesales gas net profit may further rise; 4) ENN's IE maintains a robust growth momentum; 5) the Company accelerates product promotion of value-added business which shows great growth potential. ENN is trading at around FY23E 12x PE, which is close to -1SD of its 5-year avg. PE. The valuation is still attractive. **We raised our SOTP-based TP to HK\$135.9 and maintain BUY rating.**

- **FY22 results achieved core net profit growth by 11.3% YoY during economic downstream and Covid-19 epidemic; expect a further improvement in 2023.** In 2022, ENN Energy recorded revenue of RMB110.051bn, increased by 18.2 %YoY. Its core profit went up by 11.3% YoY to RMB7.96bn. However, its gross margin decreased by 0.8ppt to 14.3%, dragged by the high gas costs that have not been fully passed to the customers. Besides, ENN Energy's attributable net profit declined by 24.4% YoY, due to economic downturn and exchange fluctuation. We believe the overall performance of ENN Energy will improve with the recovery of gas sales, better dollar margin, and sound IE segment's growth.
- **The growth of retail gas sales missed mgmt.'s guidance, but wholesales gas achieved impressive net profit.** Affected by weak C&I gas sales and climbing gas cost, ENN's totals gas sales went up by only 1.2% YoY. Its retailed gas sales increased by 2.7% YoY, which was lower than mgmt's guidance of 4-5% YoY. In particular, C&I's gas sales volume increased by 2.4%YoY, accounting for around 78.5% of retail gas sales volume. However, the wholesales gas net profit achieved great growth, partially hedging the drop of the retail gas sales. Besides, ENN's dollar margin dropped to RMB0.48cbm as the result of higher gas cost in 2022. In 2023, we believe the growth of C&I gas sales volume will rise to low-double digit, and the dollar margin will improve to RMB0.54cbm.
- **ENN Energy's IE segment was gaining momentum.** In 2022, the revenue of ENN's IE business surged by 40.3% YoY to RMB10.95bn, which was slightly below the increase of 50% YoY guided by its management. However, its gross profit advanced by 14% YoY to RMB1.56bn. Up to 2022, ENN had 210 integrated projects put into operation, and 60 IE projects were newly added. ENN generated the sales of 22,239mn kWh of integrated energy, up by 16.6%YoY. We expect ENN to have 54 projects under construction, and its gain of the comprehensive energy business is expected to increase by 30% in 2023, maintaining a stable and rapid development.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	93,113	110,051	120,109	131,224	146,504
YoY growth (%)	30.0	18.2	9.1	9.3	11.6
Net profit (RMB mn)	7,755.0	5,865.0	9,920.7	10,622.7	10,405.9
YoY growth (%)	23.5	(24.4)	69.2	7.1	(2.0)
EPS (Reported) (RMB)	6.88	5.20	8.67	9.21	9.01
YoY growth (%)	23.2	(24.4)	66.7	6.2	(2.2)
P/E (x)	16.6	18.7	12.9	11.7	10.5
P/B (x)	3.6	2.8	2.8	2.5	2.1
ROE (%)	23.4	15.7	23.1	21.0	18.0

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$135.90

(Previous TP) HK\$132.00)

Up/Downside 34%

Current Price HK\$101.70

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Stock Data

Mkt Cap (HK\$ mn)	115,032.0
Avg 3 mths t/o (HK\$ mn)	115.9
52w High/Low (HK\$)	132.70/78.05
Total Issued Shares (mn)	100.0

Source: FactSet

Shareholding Structure

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

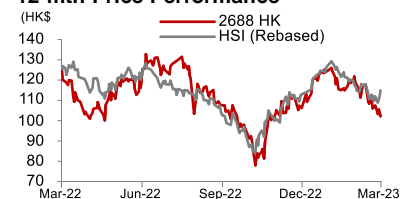
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-13.2%	-12.8%
3-mth	-4.0%	-5.5%
6-mth	-4.9%	-14.3%

Source: FactSet

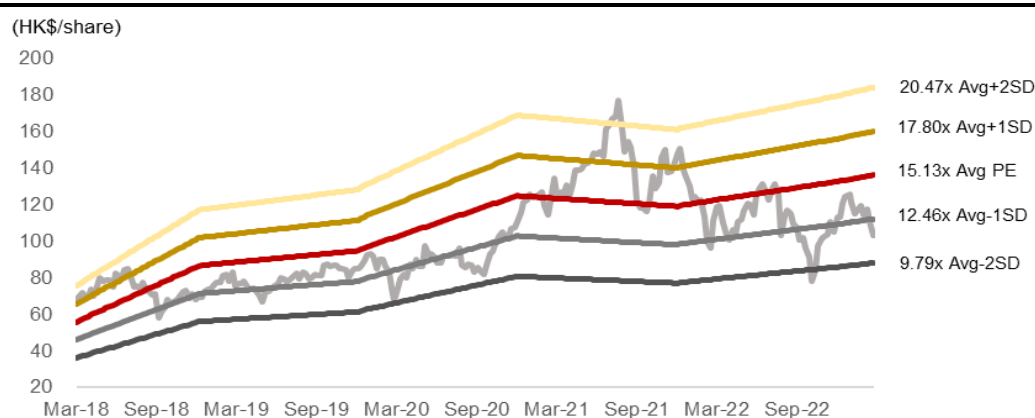
12-mth Price Performance



Source: FactSet

- **ENN Energy's value-added business showed great potential.** In 2022, VAS's revenue increased by 33% YoY to RMB3.11bn and gross profit went up by 20.6% YoY to RMB2,078mn. ENN actively accelerated product promotion and customer development. Its newly developed customers' penetration rate rose from 10.1% to 27.2% in 2022. In our view, value-added business still has excellent growth potential.
- **We raised our ENN's SOTP-based TP to HK\$135.9 and maintain BUY rating.** For FY23, we believe ENN's results will rebound, considering recovery of retail gas sales, better dollar margin, robust IE growth momentum and resilient value-added business. Thus, we raised our SOTP price to HK\$135.9, based on 1) retail gas sales growth recovery to 10% YoY; 2) dollar margin improvement to RMB0.54cbm; 3) IE's revenue rise by 40% YoY. The TP reflects 15x FY23E PE, close to ENN's 5-year avg. PE. ENN is now trading at FY23E 12x PE, around 1-SD of its 5-year avg. PE. The valuation is attractive. Maintain BUY rating.

Figure 1: PE band



Source: Company data, CMBIGM estimates

Figure 2: Comp 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	101.70	115032.00	7.68	8.50	9.43	10.8%	11.71	10.58	9.56	2.22	1.97	1.77
TIAN LUN GAS HOL	1600 HK	4.58	4625.92	0.73	0.87	na	na	5.48	4.61	na	0.60	0.55	na
CHINA GAS HOLDIN	384 HK	10.64	57885.17	1.27	1.44	1.60	12.4%	8.38	7.38	6.63	0.84	0.78	0.74
CHINA RES GAS	1193 HK	28.55	66065.07	3.02	3.33	3.57	8.8%	9.45	8.57	7.99	1.35	1.25	1.17
TOWNGAS SMART EN	1083 HK	3.35	10916.73	0.41	0.53	0.60	20.8%	8.11	6.37	5.56	0.50	0.48	0.46
KUNLUN ENERGY	135 HK	6.26	54204.10	0.77	0.79	0.84	4.8%	7.17	6.93	6.53	0.74	0.70	0.66
Average								8.4	7.4	7.3	1.0	1.0	1.0

Source: Company data, Bloomberg, CMBIGM estimates

Figure 3: Key data assumption

	2023E	2024E	2025E
Total gas sales volume (mcbm)	35,995	39,240	42,803
Retail gas sales volume (mcbm)	28,428	30,766	33,227
Residential connection (CTG incl. mm HH)	2.42	2.31	2.15
Revenue (HK\$, mn)	120,109	131,224	146,504
Net Income (HK\$,mn)	9,921	10,623	10,406
Core EPS (HK\$)	7.80	8.42	8.91

Source: Company data, CMBIGM estimates

Figure 4: DCF Valuation for IE Segment

DCF Valuation for IE Segment	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E
ENNs IE sales (bn KWh)	32.25	43.53	54.42	62.58	71.97	82.76	93.52	102.87	111.10	119.99
Implied market share	1.06%	1.42%	1.78%	1.95%	2.14%	2.34%	2.52%	2.64%	2.71%	2.79%
ENNs IE revenue (RMB mn)	12,361	16,477	20,447	23,424	26,847	30,785	34,709	38,119	41,121	44,363
Gross profit (RMB mn)	1,977.8	2,859.8	3,589.6	4,159.1	4,820.6	5,589.1	6,371.0	7,073.3	7,712.5	8,409.2
Gross profit margin (%)	16.0%	17.4%	17.6%	17.8%	18.0%	18.2%	18.4%	18.6%	18.8%	19.0%
EBIT (RMB mn)	1,349	2,057	2,638	3,119	3,686	4,355	5,054	5,709	6,329	7,012
EBIT Margin	10.9%	12.5%	12.9%	13.3%	13.7%	14.1%	14.6%	15.0%	15.4%	15.8%
Tax rate(%)	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Depreciation (RMB mn)	613	817	1,014	1,162	1,332	1,527	1,722	1,891	2,040	2,200
Change in working capital	-226	-659	-635	-476	-548	-630	-628	-546	-480	-519
CAPEX (RMB mn)	-2,400	-2,000	-2,500	-3,000	-3,000	-3,000	-3,000	-3,000	-2,400	-2,400
Free cash flow	-1,001	-298	-143	25	549	1,163	1,884	2,626	3,906	4,541
Discount year	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
Discounted free cash flow (RMB mn)	-928	-257	-114	18	377	742	1,115	1,443	1,991	2,147
Terminal value (RMB mn)	97,930									
Terminal EV/EBITDA (x)	10.63									
Discounted Terminal value (RMB mn)	46,313									
Terminal perpetual growth	3.00%									

Source: Company data, CMBIGM estimates

Figure 5: IE valuation

Valuations (RMB mn)	
Discounted Terminal Value	46,313
Terminal perpetual growth(%)	3%
Terminal EV/EBITDA	10.6
Total discount FCF	7,463
Pan Energy Value	53,777
Discount FCF(% of total)	13.9%
Terminal value (% of total)	86.1%
IE value per share (RMB)	47.48
IE value per share (HK\$)	57.20

Source: Company data, CMBIGM estimates

Figure 6: Traditional business valuation

DCF Valuation	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
Key operating forecasts										
City gas sales volume (mcbm)	28,428	31,271	34,398	37,838	40,865	44,134	47,664	51,478	55,596	60,044
YoY change (%)	9.6%	10.0%	10.0%	10.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Wholesales gas volume (mcbm)	7,567	8,323	9,156	10,071	10,877	11,747	12,687	13,702	14,798	15,982
YoY change (%)	12.0%	10.0%	10.0%	10.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Annual residential connection	2.4	2.3	2.2	2.1	2.1	2.0	1.9	1.8	1.7	1.7
YoY change (%)	15.8%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%
Accumulated residential customer	30.8	33.2	35.4	37.5	39.6	41.5	43.4	45.2	47.0	48.7
Turnover (HK\$ mn)	120,109	131,224	146,504	160,632	173,713	185,254	194,783	201,880	206,208	207,535
Turnover growth (%)	9.1%	9.3%	11.6%	9.6%	8.1%	6.6%	5.1%	3.6%	2.1%	0.6%
EBIT (HK\$ mn)	14,920	15,961	15,804	16,525	18,044	19,428	20,623	21,576	22,245	22,595
EBIT margin	12.4%	12.2%	10.8%	10.3%	10.4%	10.5%	10.6%	10.7%	10.8%	10.9%
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	3,793	4,102	4,374	4,599	4,767	4,869	4,901
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	3,661	347	297	-1,130	-1,047	-923	-762	-568	-346	-106
Free cash flow	4,679	6,621	6,733	5,916	7,184	8,344	9,342	10,123	10,641	10,855
IE FCF	-1,001	-298	-143	25	549	1,163	1,884	2,626	3,906	4,541
Non IE FCF	5,680	6,919	6,875	5,891	6,636	7,181	7,458	7,497	6735.13	6314.78
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	5,270	5,957	5,492	4,366	4,563	4,582	4,415	4,118	3,433	2,986
Terminal value	117,835									
Terminal perpetual growth	2%									
Terminal EV/EBITDA(excl IE)	6.44									
Valuations (HK\$ mn)			WACC Calculations							
Terminal value		117,835	Cost of debt		4.0%					
Terminal perpetual growth		2%	Tax rate		25.0%					
Terminal EV/EBITDA		6.44	After tax cost of debt		3.0%					
Total discount FCF		39,914	Cost of equity		9.8%					
Discount terminal value		55,727	Adjusted beta		0.70					
Firm value		95,641	Market risk premium		11.5%					
Discount FCF(% of total)		58.3%	Risk free rate		1.8%					
Terminal value (% of total)		41.7%	% of debt financing		30.0%					
Add: Cash & cash equivalent		5,470	WACC		7.8%					
Less: Debt		19,129								
Non-controlling interest		6,876								
Equity Value - (RMB, mn)		75,106								
Number of shares		1,126								
Share fair value (RMB)		66.67								
Share fair value (HK\$)		75.99								
2022E PER		12.82								
2023E PER		7.61								

Source: Company data, CMBIGM estimates

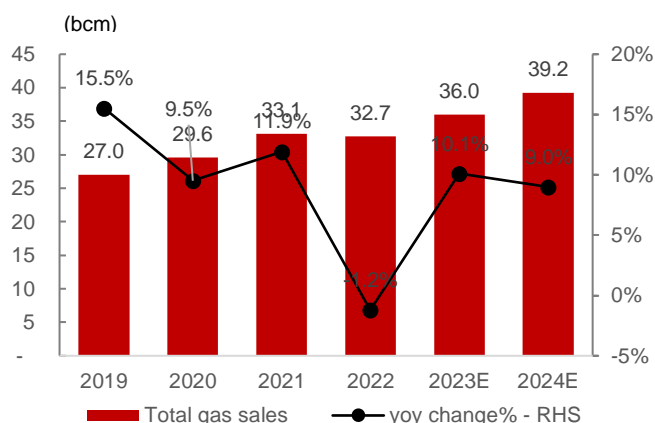
Figure 7: IE valuation

SOTP Valuation	
Traditional business value - RMB	66.67
IE value - RMB	47.48
ENN's Total value	114.15
FX rate HK/RMB	0.84
Target price- HK\$	135.90

Source: Company data, CMBIGM estimates

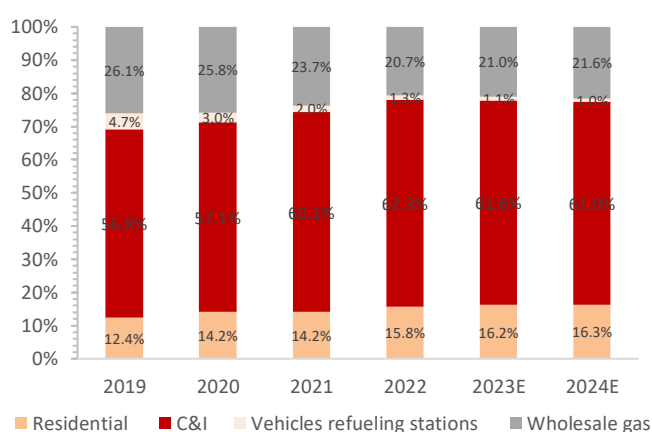
Focus Charts

Figure 8: ENN's total gas sales



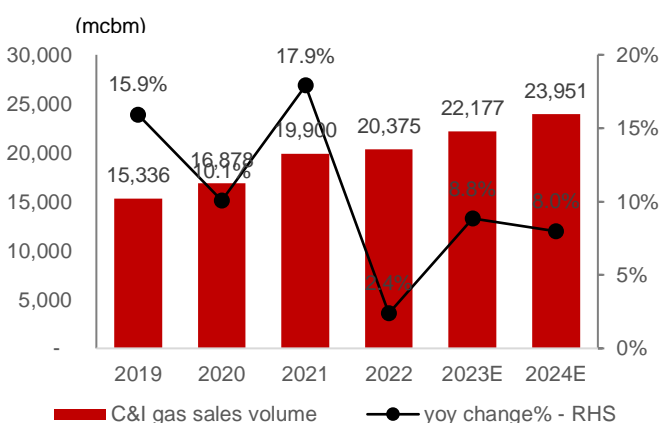
Source: Company data, CMBIGM estimates

Figure 9: ENN's gas sales mix



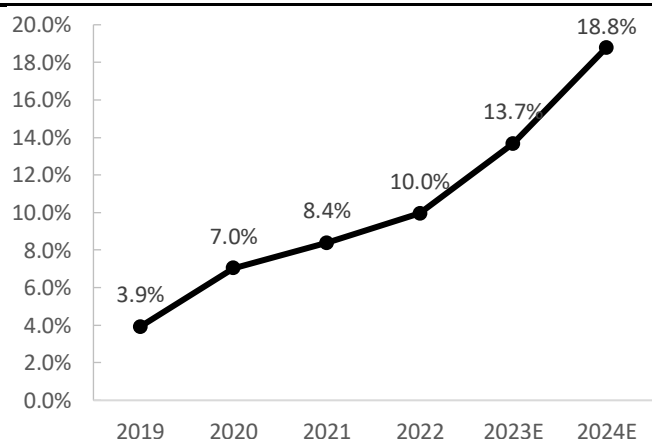
Source: Company data, CMBIGM estimates

Figure 10: ENN's C&I gas sales volume



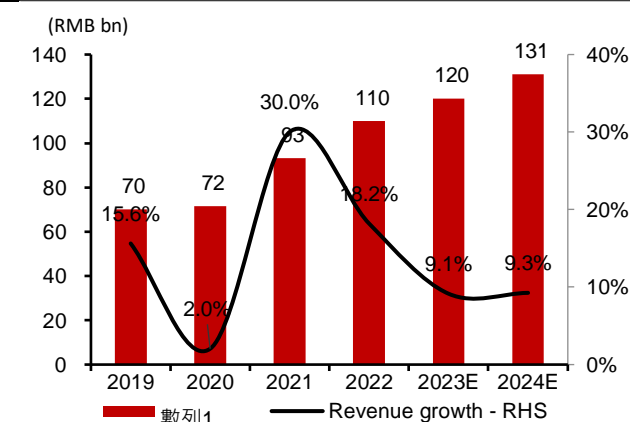
Source: Company data, CMBIGM estimates

Figure 11: ENN's IE segment in revenue mix



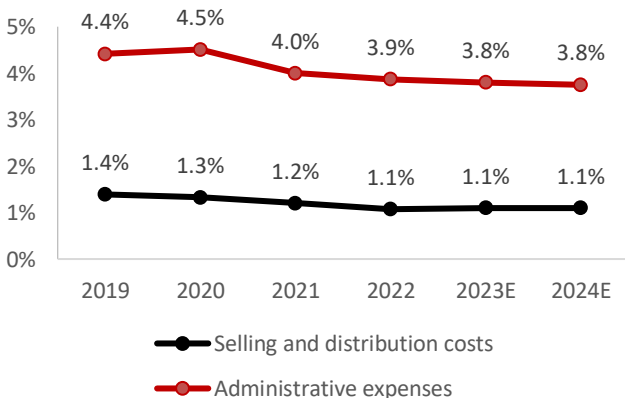
Source: Company data, CMBIGM estimates

Figure 12: ENN's total revenue growth



Source: Company data, CMBIGM estimates

Figure 13: ENN's selling and admin expenses



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	120,109	131,224	146,504
Cost of goods sold	(59,285)	(79,057)	(94,295)	(101,493)	(111,246)	(126,106)
Gross profit	12,332	14,056	15,756	18,616	19,978	20,397
Operating expenses	(4,181)	(4,847)	(5,441)	(5,885)	(6,364)	(7,032)
Selling expense	(951)	(1,122)	(1,180)	(1,321)	(1,443)	(1,612)
Admin expense	(3,230)	(3,725)	(4,261)	(4,564)	(4,921)	(5,421)
Operating profit	16,513	18,903	21,197	24,501	26,343	27,429
Other income	952	1,077	953	1,243	1,281	1,335
Other gains/(losses)	282	984	(1,569)	107	190	190
Share of (losses)/profits of associates/JV	782	699	25	839	876	914
EBITDA	12,248	14,228	12,319	17,807	19,135	19,263
Depreciation	2,081	2,259	2,595	2,886	3,174	3,459
EBIT	10,167	11,969	9,724	14,920	15,961	15,804
Interest income	(609)	(576)	(672)	(700)	(700)	(700)
Pre-tax profit	9,558	11,393	9,052	14,220	15,261	15,104
Income tax	(2,227)	(2,398)	(2,388)	(3,413)	(3,663)	(3,625)
After tax profit	7,331	8,995	6,664	10,808	11,598	11,479
Minority interest	1,053	1,240	799	887	976	1,073
Discontinued operations	6,278	7,755	5,865	9,921	10,623	10,406
Net profit	6,278	7,755	5,865	9,921	10,623	10,406

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	23,568	27,558	27,133	27,783	32,337	37,278
Cash & equivalents	8,630	8,684	8,056	5,470	8,170	10,591
Restricted cash	116	363	458	230	240	249
Account receivables	9,053	10,568	10,675	12,927	14,125	15,772
Inventories	1,285	1,508	1,708	2,162	2,362	2,637
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	4,921	5,377	6,003
Contract assets	732	775	638	585	576	538
Non-current assets	66,475	72,430	75,218	86,194	92,361	98,318
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	2,282	2,493	2,784
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	113,977	124,698	135,596
Current liabilities	33,233	41,579	36,082	43,277	45,898	49,039
Short-term borrowings	4,590	6,150	6,341	7,561	7,893	8,225
Account payables	8,302	10,172	8,066	13,518	14,772	16,491
Tax payable	971	909	1,517	1,287	1,468	1,604
Other current liabilities	5,039	9,365	4,657	4,739	5,131	5,593
Lease liabilities	89	75	91	91	91	91
Contract liabilities	14,242	14,908	15,410	16,082	16,544	17,035
Non-current liabilities	20,638	16,259	20,714	19,531	20,554	21,747
Long-term borrowings	3,212	2,993	2,825	2,988	3,073	3,165
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	3,603	3,937	4,395
Other non-current liabilities	14,864	10,481	14,915	12,941	13,544	14,187
Total liabilities	53,871	57,838	56,796	62,808	66,453	70,786
Share capital	117	117	117	118	118	118
Other reserves	30,444	35,660	38,917	46,696	54,087	60,998
Total shareholders equity	30,561	35,777	39,034	46,814	54,205	61,116
Minority interest	5,611	6,373	6,521	6,876	7,266	7,695
Total equity and liabilities	90,043	99,988	102,351	116,498	127,923	139,597

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	9,558	11,393	9,052	14,220	15,261	15,104
Depreciation & amortization	2,081	2,259	2,595	2,886	3,174	3,459
Tax paid	(1,554)	(2,079)	(1,936)	(3,739)	(3,359)	(3,321)
Change in working capital	(208)	187	(1,539)	3,661	347	297
Others	(181)	(3)	(1,285)	(1,455)	(1,572)	(1,729)
Net cash from operations	9,696	11,756	6,888	15,574	13,852	13,811
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)	(2,842)	(3,066)
Net cash from financing	(2,673)	1,822	(7,843)	(957)	(2,012)	(2,236)
Net change in cash						
Cash at the beginning of the year	7,373	7,598	13,433	4,159	5,470	8,170
Others	(7,148)	(1,763)	(22,707)	(2,849)	(2,770)	(5,750)
Cash at the end of the year	225	5,835	(9,274)	1,311	2,700	2,421
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	2.0%	30.0%	18.2%	9.1%	9.3%	11.6%
Gross profit	9.5%	14.0%	12.1%	18.2%	7.3%	2.1%
Operating profit	7.6%	14.5%	12.1%	15.6%	7.5%	4.1%
EBITDA	7.9%	16.2%	(13.4%)	44.5%	7.5%	0.7%
EBIT	6.3%	17.7%	(18.8%)	53.4%	7.0%	(1.0%)
Net profit	10.7%	23.5%	(24.4%)	69.2%	7.1%	(2.0%)
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	17.2%	15.1%	14.3%	15.5%	15.2%	13.9%
Operating margin	23.1%	20.3%	19.3%	20.4%	20.1%	18.7%
EBITDA margin	17.1%	15.3%	11.2%	14.8%	14.6%	13.1%
Return on equity (ROE)	22.3%	23.4%	15.7%	23.1%	21.0%	18.0%
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	0.8
Receivable turnover days	10.6	10.9	11.2	12.1	12.7	na
Inventory turnover days	10.6	10.9	11.2	12.1	12.7	na
Payable turnover days	68.6	72.0	63.4	67.3	79.2	na
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	14.4	16.6	18.7	12.9	11.7	10.5
P/B	3.0	3.6	2.8	2.8	2.5	2.1

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

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