

Nat Resources & Energy
Gas Utilities
Equity – China

Buy

Target price (HKD)	60.00
Share price (HKD)	47.35
Upside/Downside (%)	26.7

Performance	1M	3M	12M
Absolute (%)	15.1	8.4	-10.0
Relative ^A (%)	17.8	9.5	-24.3

Index^A HSCEI

RIC 2688.HK
 Bloomberg 2688 HK

Market cap (USDm) 6,612
 Market cap (HKDm) 51,283

Enterprise value (CNYm) 36957
 Free float (%) 69

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Enn Energy (2688 HK)

Buy: More wholesale, but company still expects 18% FY15e core earnings growth

- ▶ **FY15e volume growth guidance: 25%+/18% include/exclude wholesale gas, gas sales dollar margin not lower than FY14**
- ▶ **ENN US/Canada FY15e net loss no more than USD25m**
- ▶ **Reiterate Buy, TP cut to HKD60 (from HKD61) on earnings revision**

FY14 results update: 1) FY14 core earnings growth 20.69% YoY. 2) FY14 gas sales gross margin drop because: a) Sep 2014 gas price hike has caused revenue to be now in a higher base; b) Changsha project – decrease in transmission tariff in FY14 charged by ENN's subsidiary pipeline company to its jointly controlled entity (JCE) city gas distributor company, both 55% held by ENN. No overall impact to bottom line but gross margin decrease. 3) ENN US/Canada - FY14 loss: RMB290m (includes USD11m one-off expense on restructuring and CDB loan interest expense – loan already repaid). LNG sales volume has increased every Qtr (1H/2H14: 1,869/2,558 '000 DGE).

FY15 management guidance: 1) Volume growth guidance: 25%+ (includes wholesale gas); 18% (15-20% range) if exclude wholesale gas. 2) FY15 Core earnings growth (includes ENN US/Canada) 18%. 3) Capex: RMB3-3.5bn p.a for the next few years. 4) RMB1bn OCF for FY15. 5) No. of new connections: 1.4m. 6) Addition of C&I daily installed designed capacity: 8mcm. 7) To buy 6-8 mid-size projects. 8) To build 20/50 CNG/LNG stations in China and c3 LNG stations (movable stations). 9) ENN US/Canada not more than USD25m net loss. To achieve this, ENN will need to sell 6.6m DGE (FY14: 4.4m DGE). 10) LNG station utilization: 40-45% vs FY14: 35-40% (US stations: now low teens). 11) Dollar margin should not be lower than FY14 for FY15. 12) Gas costs will decrease RMB0.15/cm after 1 Apr 2015 Citygate price decrease.

Earnings revision. We increase FY15/16e by 1/5% and decrease FY17e EPS by 8% as we cut FY15-17e volume growth but this is offset by increased dollar margin estimates for C&I.

Valuation and risks. We lower our fair value target price to HKD60 (from HKD61) by equal-weighted average of: PE, PB, and DCF. Our PE-based valuation of HKD44.06 (was HKD57.75) uses a multiple of 14x (was 20.0x) 2015e EPS, based on 1x 2015e-17e PEG. Our PB valuation of HKD60.26 (was HKD54.54) is based on an ROE-implied 2015e PB of 3.7x (was 3.5x). Our DCF valuation of HKD74.67 (was HKD71.44) assumes a WACC of 6.5%, a risk-free rate of 3.5%, an equity risk premium of 5.5%, and a beta of 0.67. **We reiterate our Buy rating for the stock.**

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (CNYm)				
Revenue	29,087	39,955	48,958	57,281
EBITDA	4,381	5,039	5,921	6,320
Depreciation & amortisation	-729	-811	-880	-949
Operating profit/EBIT	3,652	4,228	5,041	5,371
Net interest	-159	-510	-299	-182
PBT	4,747	4,361	5,399	5,861
HSBC PBT	4,747	4,361	5,399	5,861
Taxation	-1,127	-1,035	-1,282	-1,392
Net profit	2,968	2,726	3,376	3,665
HSBC net profit	2,491	2,726	3,376	3,665

Cash flow summary (CNYm)

Cash flow from operations	5,609	10,121	6,256	6,764
Capex	-3,285	-2,186	-2,539	-2,142
Cash flow from investment	-3,682	-1,881	-2,128	-1,695
Dividends	-414	-715	-657	-813
Change in net debt	-1,624	-6,023	-2,601	-3,327
FCF equity	1,345	7,350	3,210	4,122

Balance sheet summary (CNYm)

Intangible fixed assets	1,993	1,870	1,794	1,717
Tangible fixed assets	19,441	21,614	23,349	24,618
Current assets	14,936	25,754	29,751	34,279
Cash & others	10,503	19,736	22,615	26,101
Total assets	43,035	56,315	62,436	68,634
Operating liabilities	13,615	21,233	23,759	26,319
Gross debt	14,500	17,710	17,988	18,147
Net debt	3,997	-2,026	-4,627	-7,953
Shareholders funds	12,098	14,109	16,828	19,680
Invested capital	12,252	8,269	8,520	8,195

Ratio, growth and per share analysis

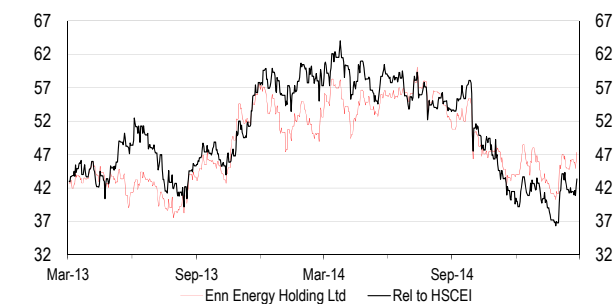
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	26.7	37.4	22.5	17.0
EBITDA	8.5	15.0	17.5	6.7
Operating profit	9.6	15.8	19.2	6.5
PBT	72.0	-8.1	23.8	8.6
HSBC EPS	19.6	9.4	23.8	8.6
Ratios (%)				
Revenue/IC (x)	2.4	3.9	5.8	6.9
ROIC	22.8	31.4	45.8	49.0
ROE	23.0	20.8	21.8	20.1
ROA	10.0	7.8	7.9	7.7
EBITDA margin	15.1	12.6	12.1	11.0
Operating profit margin	12.6	10.6	10.3	9.4
EBITDA/net interest (x)	27.6	9.9	19.8	34.8
Net debt/equity	27.5	-11.9	-22.8	-33.4
Net debt/EBITDA (x)	0.9	-0.4	-0.8	-1.3
CF from operations/net debt	140.3			
Per share data (CNY)				
EPS reported (fully diluted)	2.55	2.34	2.90	3.15
HSBC EPS (fully diluted)	2.14	2.34	2.90	3.15
DPS	0.66	0.61	0.75	0.81
Book value	11.17	13.03	15.54	18.17

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	1.5	0.9	0.7	0.5
EV/EBITDA	9.8	7.3	5.8	5.0
EV/IC	3.5	4.5	4.0	3.8
PE*	17.7	16.2	13.1	12.0
P/Book value	3.4	2.9	2.4	2.1
FCF yield (%)	3.4	18.9	8.2	10.5
Dividend yield (%)	1.7	1.6	2.0	2.1

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 27 Mar 2015

Earnings revision

RMBm	2015e	2016e	2017e
Revenues			
New	39,955	48,958	57,281
Old	41,841	52,896	58,044
% change	-5%	-7%	-1%
EPS / HSBC EPS (RMB)			
New	2.34	2.90	3.15
Old	2.31	2.77	3.41
% change	1%	5%	-8%

Source: HSBC estimates

We revise down FY15/16/17e earnings as we lower FY15e volume growth (18% ex wholesale gas), based on FY15e management guidance, this extends to the rest of the forecast period. At the same time we increase our C&I dollar margin. The impact of the latter outweighs that for lower volume growth for FY15-16e, leading to an increase in EPS; and it's the reverse for FY17, thus EPS decrease. Our FY15/16/17e is 1/7/13% above consensus. **Downside risks:** (1) a decline in industrial volumes with slowing GDP; (2) Any future Citygate price hikes not being passed through to customers.

Investment thesis. ENN Energy shares appear undervalued (below 3-year historical average PE of 22x) although we believe the company offers more robust EPS growth than its peers. Although China is expected to see a slowing economy and a low oil price environment, we continue to like ENN Energy, as we believe it can still deliver above-industry average volume growth in challenging times.

Valuation metrics

	New	Old
P/E valuation		
Target PEG	1.0x	1.0x
Average EPS growth	22.4%	19.7%
PEG based target PE	13.9x	19.6x
2015e EPS (RMB)	2.52	2.31
Value per share (RMB)	35.25	46.20
HKD/RMB exchange rate	1.25	1.25
Value per share (HKD)	44.06	57.75
P/B valuation		
Avg 3-yr RoE	20.81%	19.78%
CoE	5.66%	5.66%
RoE based target PB	3.7x	3.5x
FY15e BVPS (RMB)	13.03	12.47
Value per share (RMB)	48.21	43.63
HKD/RMB exchange rate	1.25	1.25
Value per share (HKD)	60.26	54.54
DCF valuation		
WACC	6.5%	6.5%
Risk free rate	3.5%	3.5%
Beta	0.67	0.67
	(HKD)	(HKD)
PEG based target PE	44.06	57.75
RoE based target PB	60.26	54.54
DCF Valuation	74.67	71.44
Equally weighted Target price (rounded)	60.00	61.00

Source: HSBC estimates

Disclosure appendix

Analyst Certification

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

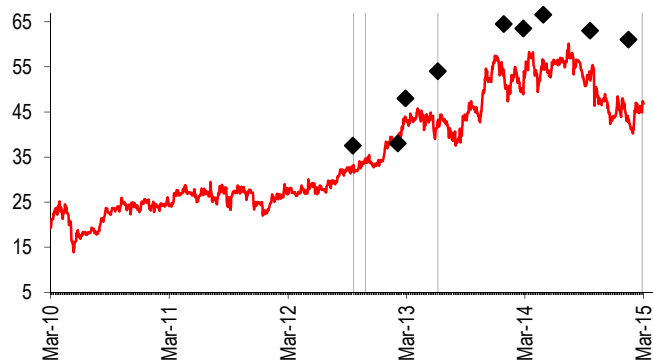
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Buy	41%	(30% of these provided with Investment Banking Services)
Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(21% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

Enn Energy Holding Ltd (2688.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	16 October 2012
Overweight	Neutral	22 November 2012
Neutral	Overweight	04 July 2013
Overweight	Buy	25 March 2015
Target Price	Value	Date
Price 1	37.50	16 October 2012
Price 2	38.00	03 March 2013
Price 3	48.00	27 March 2013
Price 4	54.00	04 July 2013
Price 5	64.50	24 January 2014
Price 6	63.50	25 March 2014
Price 7	66.50	25 May 2014
Price 8	63.00	16 October 2014
Price 9	61.00	12 February 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
ENN ENERGY HOLDINGS LTD	2688.HK	46.90	30-Mar-2015	1, 5, 6, 7

Source: HSBC

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