

Company Report

ENN ENERGY (2688 HK)

Supply is the golden key

- Gas sales growth remained strong (+30% YoY) in Jul-Nov17
- ENN Energy may source cheaper spot LNG price during winter season starting from 2H2018
- Reiterate BUY rating and TP at HK\$66.0

Rapid gas sales growth in Jul-Nov 2017

Following a 42% YoY gas sales volume growth in 1H17, the momentum remained robust in Jul-Nov 2017; city gas sales volume was up >25% YoY (C/I users: >30% YoY and residential users: >25% YoY) and wholesale gas volume also shot up by >50% YoY, mainly driven by strong demand for coal-to-gas conversion and continuous recovery in industrial activities. We believe management's 2017 gas sales volume growth guidance of >30% YoY (including wholesales gas) is achievable. With an expected national gas sales demand growth of 15% YoY in 2018, we estimate ENN Energy's gas sales growth will be around 20% YoY.

LNG supply in 2H18 helps mitigate the margin pressure in next winter season

During this winter season, the upstream players increased the non-residential city gate price by around 15% on average. So far, ENN Energy has obtained the cost pass-through for 70% of its affected projects. As a result, management expects the gas dollar margin to drop from RMB0.66/cu m in 1H17 to RMB0.60/cu m in 2H17 and then remain a stable margin of RMB0.63/cu m going forward thanks to its forthcoming long-term contracted LNG import (1.4mtpa) in 2H18. The contracted LNG price is about 8% below Zhejiang's city-gate price. Meanwhile, with a 50% spare capacity, the company may source more spot LNG during winter peak season, which can be potentially 64% lower than domestic LNG prices based on international and domestic prices in this winter (avg. Japan LNG import price: US\$8.0/mmbtu vs domestic LNG price: RMB6,778/ton during Nov 17-Jan 18). Cost advantage will help ENN Energy maintain its dollar margin and market share.

Reiterate BUY and TP at HK\$66.0

The counter is trading at 2018E PE of 12.5x on 18.9% FY17-19E EPS CAGR, the cheapest among peers. We reiterate our BUY rating and TP

Financials

Year ended 31 Dec (RMB mn)	2015	2016	2017E	2018E	2019E
Revenue	32,063	34,121	44,336	54,475	64,207
Gross profit	6,866	7,350	8,057	9,212	10,282
Reported net profit	2,036	2,151	3,061	4,278	4,897
Recurring net profit	2,736	3,212	3,719	4,278	4,897
Recurring EPS	2.53	2.76	3.20	3.95	4.52
Core P/E (x)	19.5	17.9	15.4	12.5	10.9
P/B (x)	4.0	3.6	3.1	2.6	2.3
Dividend Yield (%)	1.4	1.6	1.9	2.3	2.7
ROE (%)	15.9	15.1	19.1	23.0	22.3
Net debt / equity (%)	51.1	52.0	43.3	31.8	21.4

Sources: Company data, CMS (HK) estimates

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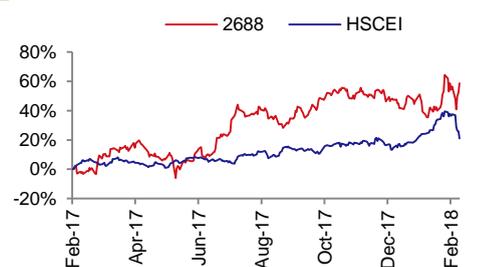
WHAT'S NEW

N/A

BUY

Previous	BUY
Price	HK\$60.40
12-month Target Price (Potential up/downside)	HK\$66.00 (+9%)
Previous TP	HK\$66.00

Price Performance



Source: Bloomberg

%	1m	6m	12m
2688 HK	17.1	12.9	55.3
HSCEI	(2.9)	8.6	18.1

Sector: Oil and Gas

Hang Seng Index	29,507
HSCEI	11,902

Key Data

52-week range (HK\$)	35.5-64.5
Market cap (HK\$ mn)	65,404
Avg. daily volume (mn)	3.52
BVPS (RMB) (2017E)	15.75

Shareholding Structure

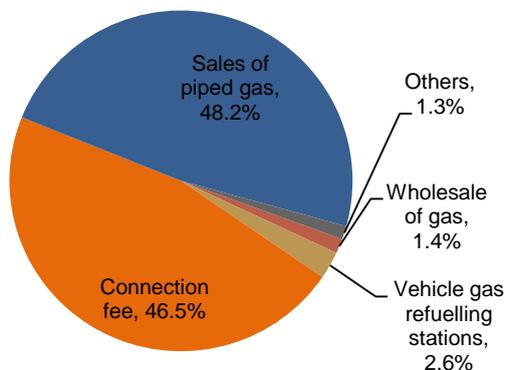
ENN Group Intl Investment	30.41%
Capital Group Companies Inc	11.99%
Commonwealth Bank of Australia	6.98%
JPMorgan Chase & Co	5.89%
No. of shares outstanding (mn)	1,083
Free float (mn)	753

Related Research

1. Gas sector – Gas up China, BUY (OVERWEIGHT) 27/11/2017

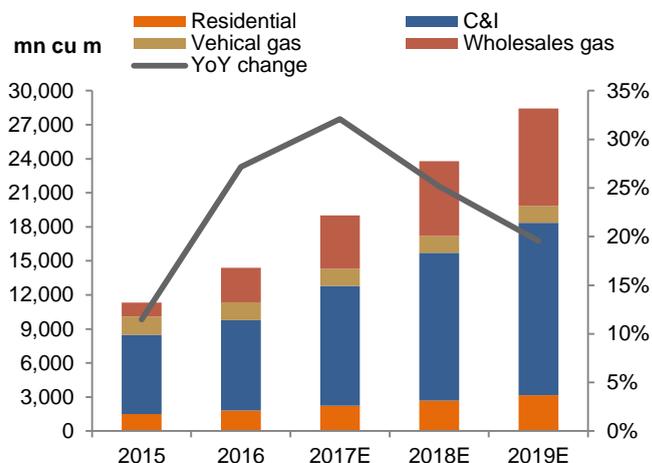
Focus charts

Figure 1: ENN Energy – 1H17 gross profit mix



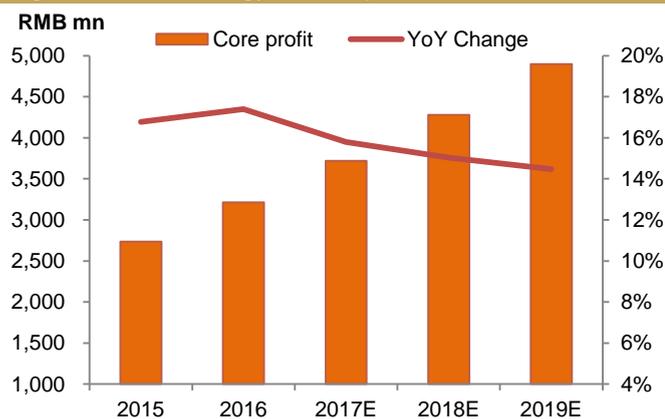
Sources: Company data, CMS (HK)

Figure 2: ENN Energy – Gas sales volume



Sources: Company data, CMS (HK) estimates

Figure 3: ENN Energy – Core profit forecasts



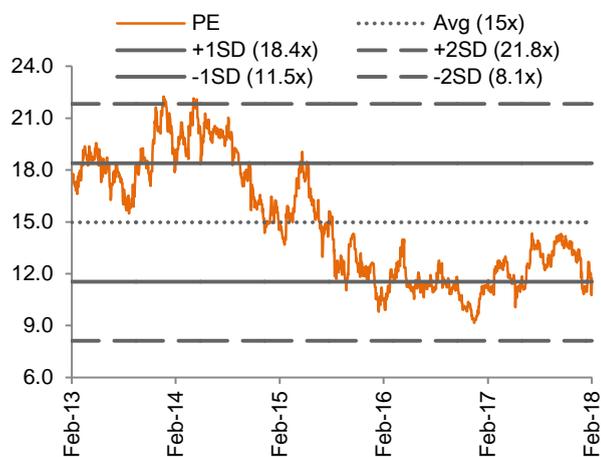
Sources: Company data, CMS (HK) estimates

Figure 4: ENN Energy – Earnings sensitivity

2018Earnings impact	
Pipeline construction	
+/-5% change in no. of new connection	+/-2.2%
+/-5% change in the connection fee	+/-3.6%
Piped gas retails	
+/-5% change in the gas sales volume	+/-4.1%
+/-5% change in the price	+/-19.0%
+/-100bp change in interest rate	+/-0.5%

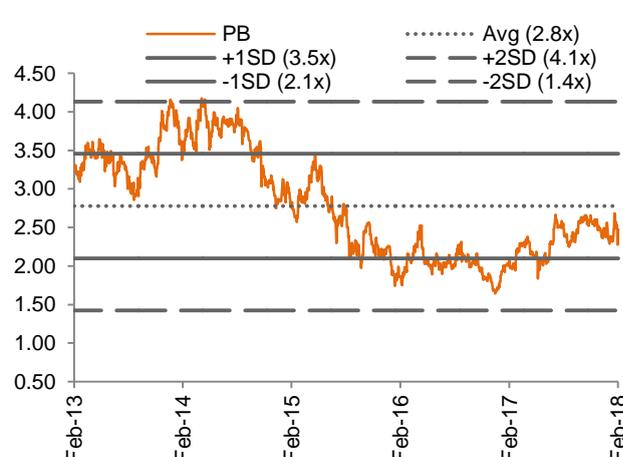
Sources: CMS (HK) estimates

Figure 5: ENN Energy – 12 month blended forward P/E



Sources: Bloomberg, CMS (HK)

Figure 6: ENN Energy – 12-month blended forward P/B



Sources: Bloomberg, CMS (HK)

Financial Summary

Balance Sheet

Year ended 31 Dec (RMB mn)	2015	2016	2017E	2018E	2019E
Fixed assets	21,121	22,297	24,808	27,287	29,682
Associates & JCE	4,834	5,054	5,493	6,001	6,590
Goodwill & intangibles	2,206	1,675	1,578	1,480	1,383
Deferred tax assets	582	745	745	745	745
Others	6,419	7,770	7,227	7,146	7,103
Non-current assets	35,162	37,541	39,851	42,659	45,502
Inventories	404	515	698	871	1,037
Trade & bills receivables	1,096	1,510	2,039	2,560	3,082
Prepayments, deposits & others	1,982	2,945	3,990	4,957	5,907
Cash	7,454	7,515	12,000	9,209	10,362
Others	921	1,355	1,362	1,367	1,374
Current assets	11,857	13,840	20,089	18,964	21,762
Total assets	47,019	51,381	59,940	61,624	67,264
Trade & bills payables	1,651	2,237	2,902	3,576	4,206
Accruals & other payables	5,482	6,086	7,405	8,967	10,441
Bank loans	2,600	3,944	3,944	3,944	3,944
Bonds, CB & debentures	4,054	700	3,515	2,500	0
Others	5,621	5,374	5,373	5,105	4,902
Current liabilities	19,408	18,341	23,139	24,092	23,493
Tax payable	706	732	732	732	732
Bank loans	836	197	197	197	197
Bonds, CB & debentures	8,190	11,950	13,115	10,117	12,171
Others	2,490	3,039	3,246	3,450	3,650
Non-current liabilities	11,516	15,186	16,558	13,764	16,018
Total liabilities	30,924	33,527	39,697	37,856	39,511
Total net assets	16,095	17,854	20,243	23,768	27,753
Share capital	113	112	112	112	112
Reserves	13,355	14,854	16,948	20,071	23,597
Shareholder's equity	13,468	14,966	17,060	20,183	23,709
Minority interests	2,627	2,888	3,183	3,585	4,043
Total equity	16,095	17,854	20,243	23,768	27,753
Total debts	15,680	16,791	20,771	16,758	16,312
Net cash/(debts)	(8,226)	(9,276)	(8,771)	(7,549)	(5,950)
BVPS (RMB)	12.44	13.83	15.75	18.63	21.88

Cash Flow Statement

Year ended 31 Dec (RMB mn)	2015	2016	2017E	2018E	2019E
Operating profit	4,183	4,644	5,377	6,384	7,304
Dep. & Amort.	956	969	1,089	1,222	1,323
Chg in working cap	481	751	(595)	(732)	(862)
Others	303	454	519	932	924
Tax paid	(1,207)	(1,452)	(1,548)	(1,770)	(2,020)
Net cash from operations	4,716	5,366	4,841	6,036	6,669
Capex	(2,514)	(3,049)	(3,600)	(3,700)	(3,719)
Others	(4,249)	(439)	1,738	1,823	1,891
Net cash from investments	(6,763)	(3,488)	(1,862)	(1,877)	(1,827)
Issue/ buyback of shares	(16)	(29)	0	0	0
Dividends paid	(709)	(705)	(802)	(967)	(1,155)
Net change in debt	597	452	3,980	(4,013)	(446)
Others	(890)	(1,454)	(1,320)	(1,618)	(1,736)
Net cash from financing	(1,018)	(1,736)	1,858	(6,598)	(3,337)
Net change in cash	(3,065)	142	4,837	(2,439)	1,505
Adjustments	16	18	0	0	0
Opening cash	10,503	7,355	7,163	11,648	8,857
Closing cash	7,454	7,515	12,000	9,209	10,362
FCF	2,202	2,317	1,241	2,336	2,950

Profit & Loss Statement

Year ended 31 Dec (RMB mn)	2015	2016	2017E	2018E	2019E
Turnover	32,063	34,121	44,336	54,475	64,207
COGS	(25,197)	(26,771)	(36,279)	(45,263)	(53,925)
Gross profit	6,866	7,350	8,057	9,212	10,282
Selling & distribution	(500)	(534)	(630)	(702)	(765)
Admin	(2,183)	(2,172)	(2,050)	(2,126)	(2,213)
Other opex	0	0	0	0	0
Total opex	(2,683)	(2,706)	(2,680)	(2,827)	(2,978)
Operating profit	4,183	4,644	5,377	6,384	7,304
Other income / (exp)	(446)	(536)	(52)	659	663
Finance costs	(405)	(484)	(453)	(487)	(486)
JVs and Associates' income	695	571	720	832	965
Pre-tax profit	4,027	4,195	5,592	7,389	8,446
Tax	(1,306)	(1,307)	(1,548)	(1,770)	(2,020)
Profit after tax	2,721	2,888	4,044	5,618	6,426
Minority Interest	(685)	(737)	(982)	(1,340)	(1,529)
Net profit	2,036	2,151	3,061	4,278	4,897
Non-core items adj.	700	1,061	658	0	0
Core profit	2,736	3,212	3,719	4,278	4,897
EBITDA	5,139	5,613	6,466	7,606	8,627
Basic EPS	1.88	1.99	2.83	3.95	4.52
Fully diluted EPS (RMB)	2.53	2.76	3.20	3.95	4.52
DPS (RMB)	0.64	0.74	0.89	1.07	1.27

Financial Ratios

	2015	2016	2017E	2018E	2019E
YoY growth rate (%)					
Turnover	10.2	6.4	29.9	22.9	17.9
EBITDA	17.1	9.2	15.2	17.6	13.4
Operating profit	14.5	11.0	15.8	18.7	14.4
Core profit	16.8	17.4	15.8	15.0	14.5
Fully diluted core EPS	25.4	9.4	15.7	23.5	14.5
DPS	(3.0)	15.6	20.6	19.5	18.7
Margins (%)					
Gross margin	21.4	21.5	18.2	16.9	16.0
EBITDA margin	16.0	16.5	14.6	14.0	13.4
EBIT margin	13.0	13.6	12.1	11.7	11.4
Net margin (Core profit)	8.5	9.4	8.4	7.9	7.6
Effective tax rate (%)	39.2	36.1	31.8	27.0	27.0
Total opex as % of rev	8.4	7.9	6.0	5.2	4.6
Interest coverage (x)	10.3	9.6	11.9	13.1	15.0
Dividend payout (%)	25.2	25.0	26.0	27.0	28.0
Net debt/equity (%)	51.1	52.0	43.3	31.8	21.4
Net debt/total cap (%)	33.8	34.2	30.2	24.1	17.7
Current ratio (x)	0.6	0.8	0.9	0.8	0.9
Returns (%)					
Asset turnover (x)	0.7	0.7	0.8	0.9	1.0
Financial leverage (x)	3.5	3.5	3.5	3.3	2.9
EBIT margin (%)	13.0	13.6	12.1	11.7	11.4
Interest burden (x)	1.0	0.9	1.0	1.2	1.2
Tax burden (x)	0.5	0.5	0.5	0.6	0.6
ROE (%)	15.9	15.1	19.1	23.0	22.3
ROIC (%)	13.9	12.4	15.5	19.8	20.9

Sources: Company data, CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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