

Company Report

ENN ENERGY (2688 HK)

1Q18 operation on track

■ City gas sales vol. was up >20% YoY and gas dollar margin rebounded to RMB0.62/cu m in 1Q18

■ Targets to add 60 integrated energy projects and generate a revenue of RMB2bn in 2018

■ Maintain BUY and raise DCF-based TP to HK\$88.0

Solid operational performance in 1Q18

ENN Energy's city gas sales vol. was up >20% YoY in 1Q18, in line with mgmt.'s full year sales vol. guidance. Gas dollar margin rebounded from RMB0.6/cu m in 2H17 to RMB0.62/cu m as the pass-through rate of winter gas cost hike raised from 50% at the end of 2017 to 70-80% in 1Q18. Mgmt. reiterates a stable dollar margin of RMB0.63/cu m in 2018 thanks to 1) the cost saving of RMB0.1-0.29/cu m based on oil price of US\$65-70/barrel (vs Zhejiang city-gate gas price of RMB2.19/cu m) from its LNG import, with import vol. target of 700mn cu m and 1.5bn cu m in 2018 and 2019, respectively; and 2) relieving gas supply shortage problem in winter season due to ramping up capacities of 5 new LNG terminals in 2017-18, resumption of gas supply from Middle Asia and accelerating construction of storage facilities.

Integrated energy business expansion on track

Mgmt. targets to add 60 integrated energy projects with a capex of RMB1.2bn in 2018. Together with its existing 31 projects, mgmt. guides the energy sales (incl. electricity, steam and hot water) will reach 6bnkwh and generate a revenue of RMB2bn in 2018 (vs RMB294mn in 2017) assuming an ASP of RMB0.4/kwh. Leveraging on its >90k C&I customers base, mgmt. projects the energy sales vol. and revenue will quintuple to 30bnkwh and RMB10bn, respectively, by 2020E. The gross margin is expected to improve to 10-15% once projects mature in 2-3 years.

Maintain BUY and lift DCF-based TP to HK\$88.0

Although we have factored in higher revenue assumption of integrated energy business, given its low margin during the early development stage, we only revised up our 2018-20E earnings by 0.7-2.1%. In addition, with more positive assumptions on the integrated energy business in the mid-long term and terminal growth rate, we raised our DCF-based TP to HK\$88.0. The shares are trading at 2019E P/E of 14.0x, close to its 5-year historical P/E average of 13.9x. Valuation looks justified supported by the positive outlook. We reiterate our BUY rating.

Financials

Year ended 31 Dec (RMB mn)	2016	2017	2018E	2019E	2020E
Revenue	34,103	48,269	61,307	75,887	91,063
Gross profit	7,350	8,339	9,844	11,249	12,851
Reported net profit	2,151	2,802	4,296	4,936	5,666
Recurring net profit	3,212	3,697	4,296	4,936	5,666
Recurring EPS	2.76	3.41	3.96	4.56	5.23
Core P/E (x)	23.1	18.7	16.1	14.0	12.2
P/B (x)	4.6	4.1	3.5	3.0	2.6
Dividend yield (%)	1.2	1.4	1.8	2.3	2.9
ROE (%)	15.1	17.6	23.3	22.8	22.5
Net debt / equity (%)	52.0	48.7	45.5	40.8	35.4

Sources: Company data, CMS (HK) estimates

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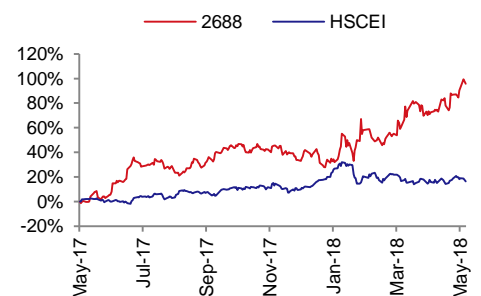
WHAT'S NEW

TP & estimate changes

BUY

Previous Rating	BUY
Price (2018/05/23)	HK\$78.9
12-month Target Price (Potential up/downside)	HK\$88.0 (+11.5%)
Previous Target Price	HK\$71.6

Price Performance



Source: Bloomberg

%	1m	6m	12m
2688 HK	12.9	34.4	95.7
HSCEI	0.8	3.0	16.3

Sector: Oil and Gas

Hang Seng Index	30,666
HSCEI	12,091

Key Data

52-week range (HK\$)	39.9-81.5
Market cap (HK\$ mn)	86,775
Avg. daily volume (mn)	3.26
BVPS (HK\$) (2018E)	18.45

Shareholding Structure

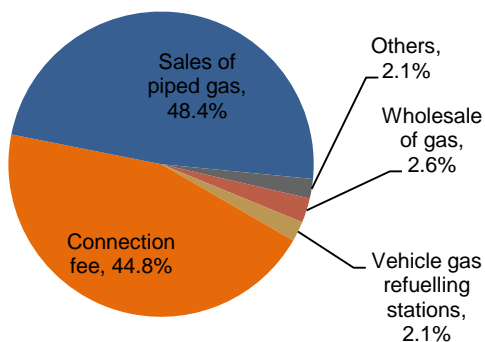
ENN Group Intl Investment	30.35%
Capital Group Companies Inc	11.97%
Commonwealth Bank of Australia	6.68%
Wellington Management Group	5.03%
No. of shares outstanding (mn)	1,085
Free float (mn)	755

Related Research

1. ENN ENERGY (2688 HK) - In line 2017 core profits 2018/03/23
2. Gas sector - 2017 results preview: Expecting solid earnings growth 2018/03/08
3. ENN ENERGY (2688 HK) - Supply is the golden key (BUY) 2018/02/09
4. Gas sector - Gas up China, BUY 2017/11/27

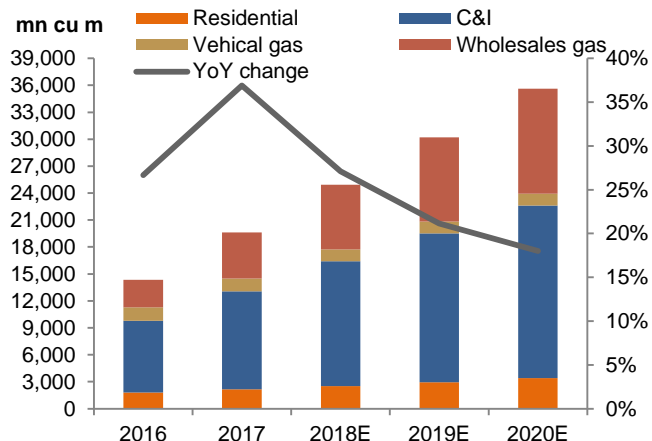
Focus charts

Figure 1: ENN Energy – 2017 Gross profit mix



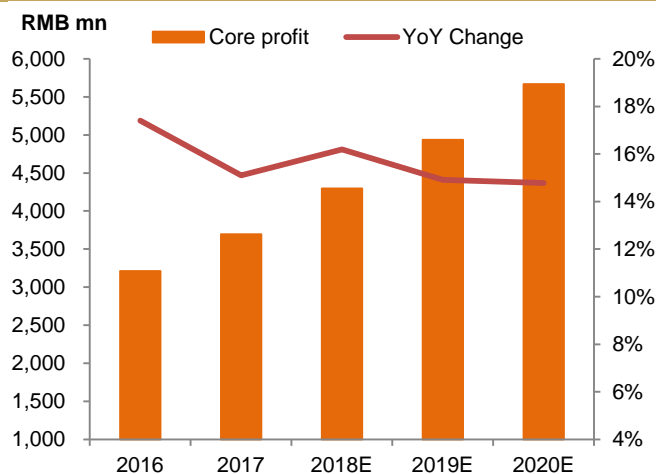
Sources: Company data, CMS (HK)

Figure 2: ENN Energy – Gas sales volume



Sources: Company data, CMS (HK) estimates

Figure 3: ENN Energy – Core profit forecasts



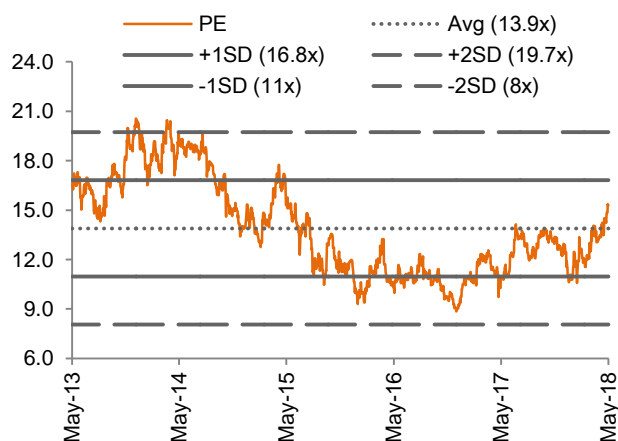
Sources: Company data, CMS (HK) estimates

Figure 4: CMS vs consensus estimates

	2018E	2019E	2020E	BUY	NEUTRAL	SELL
Dilutive core EPS (RMB)						
CMS	3.96	4.56	5.23	x		
% change	16.1%	14.9%	14.8%			
% difference to consensus	6.1%	4.3%	2.6%			
Consensus	3.74	4.37	5.10	22	2	2
% change	9.4%	16.9%	16.6%			

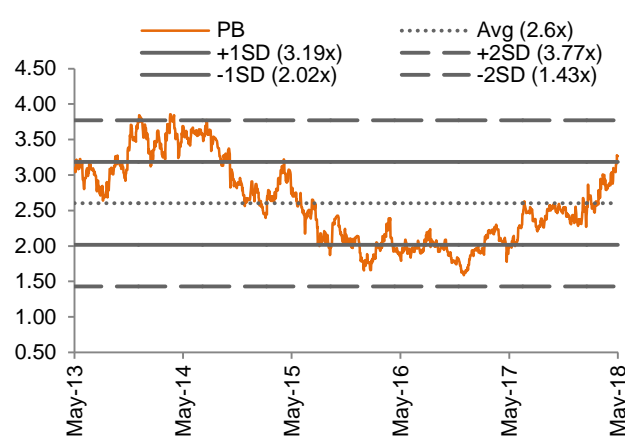
Sources: Bloomberg, CMS (HK) estimates

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)

Accelerating construction of gas storage facilities

On 26 Apr 2018, NDRC released the “Opinions of accelerating the construction of gas storage facilities and improving the market mechanism for ancillary services for gas storage and peak load regulation” to promote the construction of gas storage facilities across the country. It requires upstream gas suppliers and downstream city gas operators to own gas storage facilities equivalent to more than 10% of their annual contracted sales volume and 5% of their annual gas usage volume, respectively, by 2020. If city gas operators construct the gas storage facilities for their gas projects, the related capex and operating costs can be included into their gas distribution projects’ costs, implying that these gas storage facilities could be entitled to a maximum ROA of 7%. For the independent gas storage facilities operators, the service fee of gas storage and peak load regulation will be market-driven.

Currently, ENN Energy has a gas storage capacity of 91mn cu m, including 46mn cu m LNG tanks and 45mn cu m LNG trucks. To meet the government’s requirement, ENN Energy intends to rent its parent company’s gas storage facilities of Zhoushan LNG terminal (~100mn cu m capacity). In addition, the company will spend RMB300-600mn (~5-10% of capex) to build storage facilities in 2018. We expect the increasing gas storage capacities will help the company stabilize gas costs in winter season.

Maintain BUY and lift DCF-based TP to HK\$88.0

We revised up revenue assumption of integrated energy business by 91-186% in 2018-20E. However, given that the business is still in an early development stage, its gross margin is low at 6-9%. As a result, we only revised up our 2018-20E earnings by 1-2%. In addition, with more positive assumptions on the integrated energy business in the mid-long term and terminal growth rate (3.6% vs previous 3.2%), we raised our DCF-based TP to HK\$88.0. The shares are trading at 2019E P/E of 14.0x, close to its 5-year historical P/E average of 13.9x. Valuation looks justified underpinned by the positive outlook. We reiterate our BUY rating.

Figure 7: Key assumptions, earnings, target price revision

		Old	New	% chg
Key assumptions				
Sales of integrated energy business (RMB mn)	2018E	617	1,176	90.5%
	2019E	1,235	3,528	185.7%
	2020E	2,346	6,350	170.7%
P&L				
Revenue (RMB mn)	2018E	60,749	61,307	0.9%
	2019E	73,593	75,887	3.1%
	2020E	87,059	91,063	4.6%
Operating profits (RMB mn)	2018E	7,071	7,084	0.2%
	2019E	8,061	8,147	1.1%
	2020E	9,069	9,319	2.8%
Core profits (RMB mn)	2018E	4,266	4,296	0.7%
	2019E	4,908	4,936	0.6%
	2020E	5,551	5,666	2.1%
DCF - assumptions				
Terminal growth rate		3.2%	3.6%	0.4pts
DCF target price (HK\$)		71.60	88.00	22.9%

Sources: CMS (HK) estimates

Catalysts and key risks

The near term catalysts and upside risks to our forecast are: 1) stronger gas demand; 2) more cost saving from LNG import resulting in less-than-expected gas dollar margin squeeze; and 3) faster-than-expected development of integrated energy business.

The key downside risks to our target price include: 1) slowdown in gas demand; 2) delays in the commissioning of greenfield projects; and 3) an inability to pass through the increased costs to end users during the winter season.

Financial Summary

Balance Sheet

Year ended 31 Dec (RMB mn)	2016	2017E	2018E	2019E	2020E
Fixed assets	22,297	25,490	30,277	34,946	39,542
Associates & JCE	5,054	5,434	5,879	6,396	6,965
Goodwill & intangibles	1,675	1,873	1,770	1,667	1,564
Deferred tax assets	745	941	941	941	941
Others	7,770	7,851	7,796	7,790	7,806
Non-current assets	37,541	41,589	46,663	51,740	56,819
Inventories	515	744	959	1,204	1,457
Trade & bills receivables	1,510	2,450	3,173	4,004	4,895
Prepayments, deposits & others	2,945	3,801	4,889	6,128	7,444
Cash	7,515	8,213	5,218	4,820	4,859
Others	1,355	2,418	2,377	2,361	2,330
Current assets	13,840	17,626	16,615	18,516	20,986
Total assets	51,381	59,215	63,279	70,256	77,804
Trade & bills payables	2,237	3,182	4,050	5,022	5,998
Accruals & other payables	6,086	8,035	10,058	12,298	14,722
Bank loans	3,944	1,737	3,274	3,274	3,274
Bonds, CB & debentures	700	6,631	2,500	0	0
Others	5,374	6,020	5,848	5,704	5,567
Current liabilities	18,341	25,605	25,730	26,298	29,560
Tax payable	732	982	982	982	982
Bank loans	197	523	986	986	986
Bonds, CB & debentures	11,950	9,176	9,174	11,674	11,674
Others	3,039	3,694	3,839	4,067	4,295
Non-current liabilities	15,186	13,393	13,999	16,727	16,955
Total liabilities	33,527	38,998	39,729	43,025	46,515
Total net assets	17,854	20,217	23,550	27,231	31,290
Share capital	112	112	112	112	112
Reserves	14,854	16,840	19,874	23,212	26,874
Shareholder's equity	14,966	16,952	19,986	23,324	26,986
Minority interests	2,888	3,265	3,564	3,907	4,304
Total Equity	17,854	20,217	23,550	27,231	31,290
Total debts	16,791	18,067	15,934	15,934	15,934
Net cash/(debts)	(9,276)	(9,854)	(10,716)	(11,114)	(11,075)
BVPS (RMB)	13.83	15.67	18.45	21.53	24.91

Cashflow Statement

Year ended 31 Dec (RMB mn)	2016	2017E	2018E	2019E	2020E
Operating profit	4,644	5,327	6,425	7,484	8,653
Dep. & Amort.	969	1,016	1,213	1,451	1,646
Chg in working cap	751	767	737	769	832
Others	454	454	556	543	449
Tax paid	(1,452)	(1,471)	(1,868)	(2,142)	(2,480)
Net cash from operations	5,366	6,093	7,064	8,106	9,100
Capex	(3,049)	(4,527)	(6,000)	(6,120)	(6,242)
Others	(439)	236	858	863	897
Net cash from investments	(3,488)	(4,291)	(5,142)	(5,257)	(5,345)
Issue/ buyback of shares	(29)	0	0	0	0
Dividends paid	(705)	(775)	(975)	(1,262)	(1,598)
Net change in debt	452	1,567	(2,133)	0	0
Others	(1,454)	(1,500)	(1,568)	(1,745)	(1,876)
Net cash from financing	(1,736)	(708)	(4,676)	(3,006)	(3,475)
Net change in cash	142	1,094	(2,754)	(157)	281
Adjustments	18	(44)	0	0	0
Opening cash	7,355	7,163	7,972	4,977	4,579
Closing cash	7,515	8,213	5,218	4,820	4,859

Profit & Loss Statement

Year ended 31 Dec (RMB mn)	2016	2017E	2018E	2019E	2020E
Turnover	34,103	48,269	61,307	75,887	91,063
COGS	(26,753)	(39,930)	(51,463)	(64,637)	(78,212)
Gross profit	7,350	8,339	9,844	11,249	12,851
Selling & distribution	(534)	(635)	(721)	(806)	(911)
Admin	(2,172)	(2,377)	(2,698)	(2,958)	(3,287)
Other opex	0	0	0	0	0
Total opex	(2,706)	(3,012)	(3,419)	(3,765)	(4,198)
Operating profit	4,644	5,327	6,425	7,484	8,653
Other income / (exp)	(564)	(441)	659	663	666
Finance costs	(456)	(330)	(374)	(450)	(408)
JVs and associates' income	571	634	735	853	938
Pre-tax profit	4,195	5,190	7,446	8,550	9,849
Tax	(1,307)	(1,517)	(1,868)	(2,142)	(2,480)
Profit after tax	2,888	3,673	5,579	6,408	7,369
Minority interest	(737)	(871)	(1,283)	(1,471)	(1,704)
Net profit	2,151	2,802	4,296	4,936	5,666
Non-core items adj.	1,061	895	0	0	0
Core profit	3,212	3,697	4,296	4,936	5,666
EBITDA	5,613	6,343	7,638	8,935	10,299
Basic EPS (RMB)	1.99	2.59	3.96	4.56	5.23
Fully diluted EPS (RMB)	2.76	3.41	3.96	4.56	5.23
DPS (RMB)	0.74	0.90	1.16	1.48	1.85

Financial Ratios

	2016	2017E	2018E	2019E	2020E
YoY growth rate (%)					
Turnover	6.4	41.5	27.0	23.8	20.0
EBITDA	9.2	13.0	20.4	17.0	15.3
Operating profit	11.0	14.7	20.6	16.5	15.6
Core profit	17.4	15.1	16.2	14.9	14.8
Fully diluted core EPS	9.4	23.6	16.1	14.9	14.8
DPS	15.6	21.6	29.4	26.6	25.4
Margins (%)					
Gross margin	21.6	17.3	16.1	14.8	14.1
EBITDA margin	16.5	13.1	12.5	11.8	11.3
EBIT margin	13.6	11.0	10.5	9.9	9.5
Net margin (Core profit)	9.4	7.7	7.0	6.5	6.2
Effective tax rate (%)	36.1	33.3	27.8	27.8	27.8
Total opex as % of rev	7.9	6.2	5.6	5.0	4.6
Interest coverage (x)	10.2	16.1	17.2	16.6	21.2
Dividend payout (%)	24.1	26.4	29.4	32.4	35.4
Net debt/equity (%)	52.0	48.7	45.5	40.8	35.4
Net debt/total cap (%)	34.2	32.8	31.3	29.0	26.1
Current ratio (x)	0.8	0.7	0.6	0.7	0.7
Returns (%)					
Asset turnover (x)	0.7	0.9	1.0	1.1	1.2
Financial leverage (x)	3.5	3.5	3.3	3.1	2.9
EBIT margin (%)	13.6	11.0	10.5	9.9	9.5
Interest burden (x)	0.9	1.0	1.2	1.1	1.1
Tax burden (x)	0.5	0.5	0.6	0.6	0.6
ROE (%)	15.1	17.6	23.3	22.8	22.5
ROIC (%)	12.4	13.6	18.2	18.5	19.0

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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