

China / Hong Kong Company Update

ENN Energy Holdings Ltd

Bloomberg: 2688 HK Equity | Reuters: 2688.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 Aug 2022

BUY

Last Traded Price (27 Jul 2022): HK\$126.80 (HSI : 20,670)
Price Target 12-mth: HK\$153 (20% upside) (Prev HK\$128)

Analyst

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What's New

- High visibility in decarbonisation roadmap for fast development in IE business
- Expect highest dollar margin of Rmb0.489/cm in FY22 among gas distributors under our coverage
- Expect decent gas volume growth of around 10% in FY22, despite COVID lockdown in 1H
- Maintain BUY with higher TP of HK\$153.00 for highest earnings growth and better ESG quality

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2021A	2022F	2023F	2024F
Turnover	93,113	108,823	122,062	141,272
EBITDA	13,107	13,880	15,890	18,594
Pre-tax Profit	11,393	11,425	13,158	15,552
Net Profit	7,755	7,548	8,629	10,249
Net Pft (Pre Ex) (core profit)	7,154	7,548	8,629	10,249
Net Profit Gth (Pre-ex) (%)	14.6	5.5	14.3	18.8
EPS (RMB)	6.88	6.68	7.64	9.07
EPS (HK\$)	7.99	7.76	8.87	10.53
Core EPS (RMB)	6.35	6.68	7.64	9.07
Core EPS (HK\$)	7.37	7.76	8.87	10.53
EPS Gth (%)	23.2	(3.0)	14.3	18.8
Core EPS Gth (%)	14.3	5.2	14.3	18.8
Diluted EPS (HK\$)	7.99	7.70	8.81	10.46
DPS (HK\$)	2.57	2.56	2.93	3.48
BV Per Share (HK\$)	36.77	44.53	50.32	57.34
PE (X)	15.9	16.3	14.3	12.0
CorePE (X)	17.2	16.3	14.3	12.0
P/Cash Flow (X)	11.8	10.6	9.3	8.2
P/Free CF (X)	43.8	33.9	23.4	17.3
EV/EBITDA (X)	10.8	10.1	8.9	7.5
Net Div Yield (%)	2.0	2.0	2.3	2.7
P/Book Value (X)	3.4	2.8	2.5	2.2
Net Debt/Equity (X)	0.3	0.2	0.1	0.1
ROAE(%)	23.4	19.1	18.7	19.6
Earnings Rev (%)		(4)	(3)	New
Consensus EPS (RMB)		6.97	7.81	8.76
Other Broker Recs:		B:16	S:2	H:4

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Highest growth to support further rerating

Investment Thesis

High visibility in decarbonisation pathway. ENN is the first gas distributor under our coverage to disclose a detailed decarbonisation roadmap with concrete targets and action plans. This gives better visibility in the development of integration energy (IE), where robust growth of >40% p.a. with a stable margin of 17% are expected in the coming few years. This is also key for ENN to transform into an integrated energy play.

Decent gas volume growth with minimum risk in energy affordability. We expect ENN to report gas volume growth of 6-7% and 10% in 1HFY22 and FY22 respectively, underpinned by its growing customer base and economic recovery. ENN also has a relatively low risk in energy affordability, and hence a less volatile dollar margin. We expect its dollar margin to be Rmb0.489/cm in FY22, the highest among the gas distributors under our coverage.

Technological innovation and digitalisation for better sustainable development. ENN has put focus on technological innovation and digitalisation, which is key for its green development and value creation. For instance, the application of Internet of Things will ensure operational safety and improve efficiency. Upgraded value-added services are offered on its smart city-smart home platform with higher turnover growth and a lucrative margin.

Valuation:

We have raised our TP to HK\$153.00 based on a higher 17x 12-month rolling PE or around 1.15x PEG. Such target PE is +1SD from its two-year historical valuation. We reckon such a premium is not aggressive and reflects its highest earnings growth and better ESG quality compared to its peers. ENN is our sector top pick.

Where we differ:

Our turnover estimates are 5% higher than the consensus as we are more optimistic about its revenue growth from gas sales.

Key Risks to Our View:

Slower economic recovery in China will drag gas volume growth. High volatility in LNG price will pressure dollar margin.

At A Glance

Issued Capital (m shrs)	1,130
Mkt Cap (HKm/US\$m)	143,352 / 18,265
Major Shareholders (%)	
ENN Natural Gas Co., Ltd.	32.7
Capital Research Global Investors	13.6
Free Float (%)	53.7
3m Avg. Daily Val. (US\$m)	31.3
GICS Industry: Utilities / Gas Utilities	



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WHAT'S NEW

Expect highest dollar margin among listed peers

Fine-tuning assumptions in view of COVID lockdown. ENN set FY22 targets of gas volume growth at 12%-15%, with a stable dollar margin of around Rmb0.50/cm. Its active M&A activities will help achieve its targets. Nevertheless, the 6.8% growth in gas volume achieved in 1Q2022 did not bode well. In addition, in 6M2022, China's natural gas consumption nudged down 0.1% y-o-y amid COVID lockdowns in various places. This has prompted us to trim our FY22 gas volume growth assumption by 3ppts to 9.9%. On a positive note, we have raised our dollar margin assumption by 2% to Rmb0.489/cm, as ENN is able to pass through costs to a higher percentage of users. We believe ENN has the highest dollar margin in FY22 among the gas distributors under our coverage.

Increasing profit from renewable energy in IE operation.

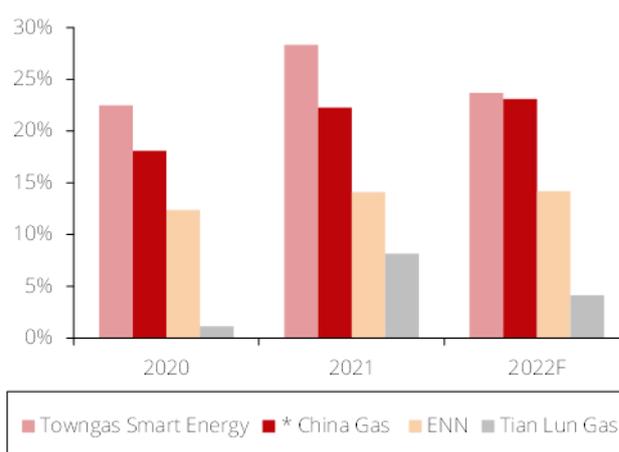
ENN is the first gas distributor under our coverage to disclose a detailed decarbonisation roadmap with concrete targets. As part of its decarbonisation actions to achieve carbon neutrality before 2050, ENN aims to increase the percentage of renewable energy-fuelled integrated energy (IE) projects from 20% in FY21 to 36% by 2030. Thus, ENN has the highest visibility in the decarbonisation pathway. We expect IE revenue to grow 47% in FY22 with a stable gross margin of 17%.

ESG performance continues to improve. We have identified safety expenses and affordability of energy as two material social risks for gas distributors. First, investment in operational safety increased 23% in FY21, with estimated safety expenses per residential household climbing over 16%. Gas pipelines >20 years old account for <3%. In addition, safety expenses accounted for around 15% of operating cash flow. We see minimum pressure on cash flow should safety expenses be required to increase. Second, affordability of energy often conflicts with gas distributors' profitability. To ensure sufficient gas supply for residential users, especially in winter when piped gas is inadequate, gas distributors have to procure LNG from the spot market at premium prices. But we reckon ENN faces the least risk in its dollar margin, as it has a better procurement strategy and exhibits good progress in its cost hike pass through.

Raise TP to HK\$153.00. We have only fine-tuned our FY22/23 earnings estimate. But we have raised our TP to HK\$153.00 based on a higher 17x 12-month rolling PE or

around 1.15x PEG. Such target PE is +1SD from its two-year historical valuation. We reckon such a premium is not aggressive and reflects its highest earnings growth and better ESG quality compared to its peers. Maintain BUY. ENN is our sector top pick.

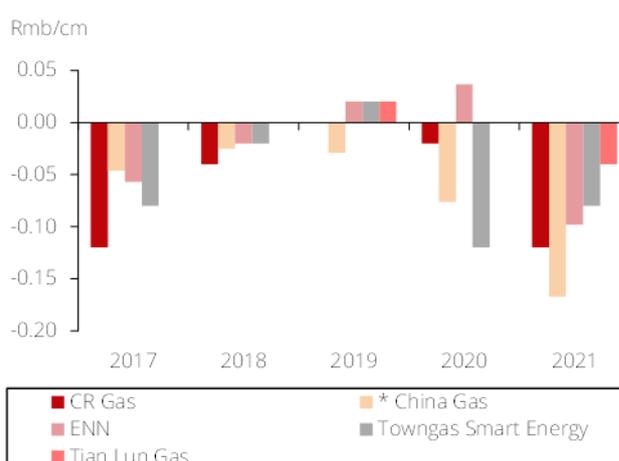
Safety expenses as a % of operating cash flow



Source: Companies, DBS HK

* 2020 = FY3/21, 2021 = FY3/22, 2022F = FY3/23F

Comparison of h-o-h change in dollar margin



Source: Companies, DBS HK

* 2017 = FY3/18, 2018 = FY3/19, 2019 = FY3/20, 2020 = FY3/21, 2021 = FY3/22

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Company Background

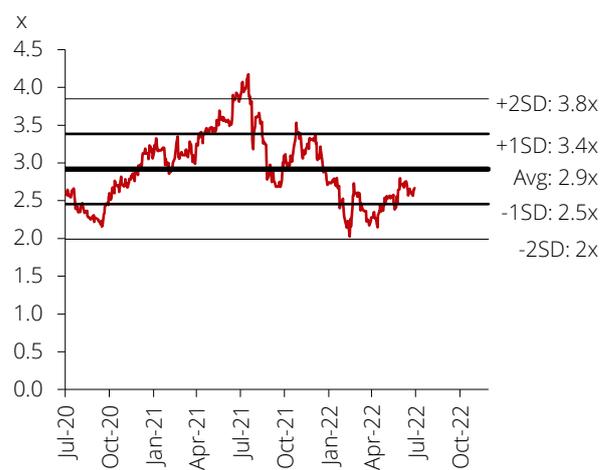
Established in 1993, ENN was one of the first privately owned gas distributors in China. The company is mainly involved in the distribution of natural gas through city gas operations, wholesale distribution, and compressed natural gas (CNG)/liquefied natural gas (LNG) refuelling stations. It is also involved in integrated energy supply (cooling, heating and steam, and electricity), gas appliances, and materials.

Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2020A	2021A	2022F	2023F	2024F
City gas sales volume growth (%)	10.2	15.1	9.9	13.0	13.1
New connection for residential users ('000)	2,293.0	2,622.0	2,400.0	2,160.0	2,246.4
Dollar margin (Rmb / 1000 m3)	600.0	510.0	489.4	481.1	472.8

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenues (RMB m)					
Sales of Piped Gas	40,510	49,247	57,563	61,126	69,038
Sales of integrated energy	5,042	7,805	11,473	16,063	22,488
Energy Trading	17,936	25,634	29,479	33,901	37,291
Connection Fee	6,444	8,086	7,147	6,707	6,994
VAS	1,685	2,341	3,160	4,266	5,461
Total	71,617	93,113	108,823	122,062	141,272

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenue	71,617	93,113	108,823	122,062	141,272
Cost of Goods Sold	(59,285)	(79,057)	(93,585)	(104,846)	(121,134)
Gross Profit	12,332	14,056	15,237	17,217	20,139
Other Opg (Exp)/Inc	(3,019)	(3,988)	(4,033)	(4,448)	(5,150)
Operating Profit	9,313	10,068	11,204	12,769	14,988
Other Non Opg (Exp)/Inc	36	601	0	0	0
Associates & JV Inc	782	699	804	924	1,063
Net Interest (Exp)/Inc	(609)	(576)	(583)	(535)	(499)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	36	601	0	0	0
Pre-tax Profit	9,558	11,393	11,425	13,158	15,552
Tax	(2,227)	(2,398)	(2,514)	(2,961)	(3,499)
Minority Interest	(1,053)	(1,240)	(1,364)	(1,569)	(1,804)
Preference Dividend	0	0	0	0	0
Net Profit	6,278	7,755	7,548	8,629	10,249
Net Profit before Except.	6,242	7,154	7,548	8,629	10,249
EBITDA	11,721	13,107	13,880	15,890	18,594
Growth					
Revenue Gth (%)	2.0	30.0	16.9	12.2	15.7
EBITDA Gth (%)	8.3	11.8	5.9	14.5	17.0
Opg Profit Gth (%)	17.7	8.1	11.3	14.0	17.4
Net Profit Gth (%)	10.7	23.5	(2.7)	14.3	18.8
Margins & Ratio					
Gross Margins (%)	17.2	15.1	14.0	14.1	14.3
Opg Profit Margin (%)	13.0	10.8	10.3	10.5	10.6
Net Profit Margin (%)	8.8	8.3	6.9	7.1	7.3
ROAE (%)	22.3	23.4	19.1	18.7	19.6
ROA (%)	7.3	8.2	7.1	7.4	8.2
ROCE (%)	11.8	11.9	11.8	12.3	13.4
Div Payout Ratio (%)	36.7	32.2	33.0	33.0	33.0
Net Interest Cover (x)	15.3	17.5	19.2	23.9	30.0

Source: Company, DBS HK

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Interim Income Statement (RMB m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	34,839	31,543	40,074	41,232	51,881
Cost of Goods Sold	(29,172)	(25,941)	(33,344)	(34,190)	(44,867)
Gross Profit	5,667	5,602	6,730	7,042	7,014
Other Oper. (Exp)/Inc	(1,682)	(1,221)	(1,767)	(1,504)	(1,883)
Operating Profit	3,985	4,381	4,963	5,538	5,131
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	441	432	350	467	232
Net Interest (Exp)/Inc	(352)	(320)	(289)	(304)	(272)
Exceptional Gain/(Loss)	(236)	(419)	460	80	521
Pre-tax Profit	3,838	4,074	5,484	5,781	5,612
Tax	(922)	(909)	(1,318)	(1,351)	(1,047)
Minority Interest	(608)	(472)	(581)	(665)	(575)
Net Profit	2,308	2,693	3,585	3,765	3,990
Net profit bef Except.	2,544	3,112	3,125	3,685	3,469

Growth

Revenue Gth (%)	2.0	(10.8)	15.0	30.7	29.5
Opg Profit Gth (%)	21.1	1.5	24.5	26.4	3.4
Net Profit Gth (%)	122.8	(19.9)	55.3	39.8	11.3

Margins

Gross Margins (%)	16.3	17.8	16.8	17.1	13.5
Opg Profit Margins (%)	11.4	13.9	12.4	13.4	9.9
Net Profit Margins (%)	6.6	8.5	8.9	9.1	7.7

Source: Company, DBS HK

Balance Sheet (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	41,861	46,793	52,921	58,724	64,181
Invt in Associates & JVs	7,760	8,718	9,522	10,446	11,509
Other LT Assets	16,854	16,919	17,419	17,919	18,419
Cash & ST Invt	8,630	8,684	10,149	8,943	10,350
Inventory	1,285	1,508	1,817	2,038	2,359
Debtors	9,785	11,343	13,936	14,891	17,157
Other Current Assets	3,868	6,023	6,377	6,676	7,109
Total Assets	90,043	99,988	112,142	119,636	131,085
ST Debt	6,970	11,850	9,850	6,850	6,350
Creditors	22,983	26,108	30,513	33,249	37,351
Other Current Liab	3,280	3,621	3,546	3,546	3,546
LT Debt	13,299	8,580	9,492	10,042	9,251
Other LT Liabilities	7,339	7,679	7,679	7,679	7,679
Shareholder's Equity	30,561	35,777	43,325	48,965	55,798
Minority Interests	5,611	6,373	7,737	9,306	11,109
Total Cap. & Liab.	90,043	99,988	112,142	119,636	131,085
Non-Cash Wkg. Capital	(11,325)	(10,855)	(11,928)	(13,190)	(14,272)
Net Cash/(Debt)	(11,639)	(11,746)	(9,193)	(7,949)	(5,251)
Debtors Turn (avg days)	46.0	41.4	42.4	43.1	41.4
Creditors Turn (avg days)	138.2	115.9	112.7	113.4	108.6
Inventory Turn (avg days)	7.8	6.6	6.6	6.9	6.8
Asset Turnover (x)	0.8	1.0	1.0	1.1	1.1
Current Ratio (x)	0.7	0.7	0.7	0.7	0.8
Quick Ratio (x)	0.6	0.5	0.5	0.5	0.6
Net Debt/Equity (X)	0.3	0.3	0.2	0.1	0.1
Net Debt/Equity ex MI (X)	0.4	0.3	0.2	0.2	0.1
Capex to Debt (%)	33.3	37.5	41.4	47.4	51.3
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

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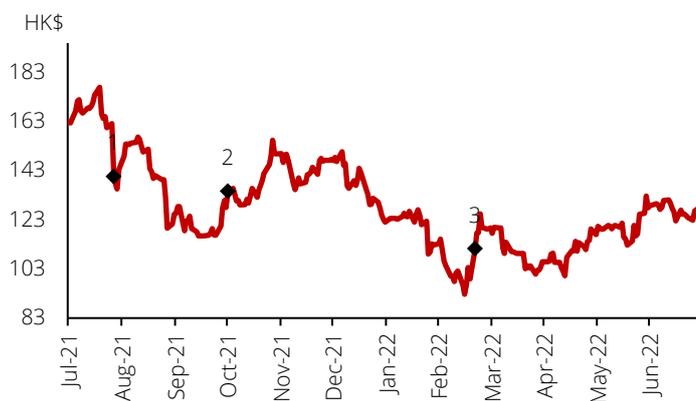
Cash Flow Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	9,558	11,393	11,425	13,158	15,552
Dep. & Amort.	1,590	1,739	1,872	2,197	2,543
Tax Paid	(1,601)	(1,841)	(2,514)	(2,961)	(3,499)
Assoc. & JV Inc/(loss)	(873)	(873)	(804)	(924)	(1,063)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	644	755	1,329	1,414	1,303
Other Operating CF	378	(707)	327	383	278
Net Operating CF	9,696	10,466	11,636	13,267	15,114
Capital Exp.(net)	(6,741)	(7,657)	(8,000)	(8,000)	(8,000)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	(307)	(338)	0	0	0
Div from Assoc & JV	558	613	0	0	0
Other Investing CF	(1,110)	(1,359)	(500)	(500)	(500)
Net Investing CF	(7,600)	(8,740)	(8,500)	(8,500)	(8,500)
Div Paid	(1,179)	(2,827)	0	(2,988)	(3,416)
Chg in Gross Debt	386	2,258	(1,088)	(2,450)	(1,291)
Capital Issues	0	0	0	0	0
Other Financing CF	(46)	(1,103)	(583)	(535)	(499)
Net Financing CF	(839)	(1,672)	(1,671)	(5,974)	(5,206)
Currency Adjustments	0	0	0	0	0
Chg in Cash	1,257	54	1,465	(1,206)	1,407
Opg CFPS (RMB)	8.06	8.62	9.12	10.49	12.22
Free CFPS (RMB)	2.63	2.49	3.22	4.66	6.30

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1	24-Aug-21	HK\$162.20	HK\$157.00	HOLD
2	29-Oct-21	HK\$128.00	HK\$138.00	HOLD
3	21-Mar-22	HK\$98.95	HK\$128.00	BUY

Source: DBS HK

Analyst: Patricia Yeung
Ilan Chui

ENN Energy Holdings Ltd

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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ENN Energy Holdings Ltd

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