

COMPANY RESULTS

ENN Energy Holdings (2688 HK)

1H23: In Line; Gas Consumption Growth At Stake Amid Wavering Recovery

ENN reported 1H23 core profit of Rmb3,914m, down 5% yoy, representing 47% of our 2023 earnings forecast. Dollar margin has ticked up to Rmb0.52 per cbm. The 6.9% yoy decline in retail gas sales volume was dragged by industrial users with consumption slumping 11.7% yoy. New connections' gross margins grew to 53.3% without COVID-19 restrictions. ENN revised down retail gas sales volume and core profit guidance to not more than -5% yoy. Maintain BUY. Target price: HK\$102.00.

1H23 RESULTS

Year to 31 Dec (Rmbm)	1H22	1H23	yoy chg
Revenue	58,332	54,111	(7.2)
Cost of sales	(51,438)	(46,954)	(8.7)
Gross profit	6,894	7,157	3.8
SG&A	(2,476)	(2,608)	5.3
Net finance cost	(320)	(340)	6.3
PBT	4,803	5,055	5.2
Tax	(1,302)	(1,271)	(2.4)
Minority interest	(397)	(451)	13.6
Net Profit	3,104	3,333	7.4
Core Profit	4,118	3,914	(5.0)
EPS (Rmb)	2.75	2.95	7.3
DPS (HK\$)	0.64	0.64	-
Gross margin (%)	11.8	13.2	1.4
Net profit margin (%)	5.3	6.2	0.8

Source: ENN Energy Holdings, UOB Kay Hian

RESULTS

- In line.** ENN Energy Holdings (ENN) reported 1H23 core earnings of Rmb3,914m, down 5% yoy, representing 47% of our 2023 earnings forecast, in line with our expectation. The company announced interim dividend of 64 HK cents per share, flat yoy.
- Consolidated gross margin expanded 1.4ppt to 13.2%.** Gross margin of the retail gas sales segment remained flattish at 10.0% (1H22: 10.4%), but the greater contribution from high-margin segments, particularly the value added business, has lifted consolidated gross margin to 13.2% (1H22: 11.8%). Gross margin for new user connections was up 4.9ppt yoy to 53.3% due to cost savings in the absence of COVID-19 restrictions.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net turnover	93,113	110,051	103,501	117,329	127,298
EBITDA	11,643	13,279	13,360	15,465	17,157
Operating profit	10,286	11,268	11,051	12,803	14,076
Net profit (rep./act.)	7,755	5,865	7,684	8,877	9,877
Net profit (adj.)	7,755	5,865	7,684	8,877	9,877
EPS (Rmb)	6.9	5.2	6.8	7.9	8.7
PE (x)	10.6	14.0	10.7	9.3	8.3
P/B (x)	2.3	2.1	1.9	1.7	1.5
EV/EBITDA (x)	9.1	8.0	8.0	6.9	6.2
Dividend yield (%)	3.0	3.6	3.5	4.0	4.5
Net margin (%)	8.3	5.3	7.4	7.6	7.8
Net debt/(cash) to equity (%)	31.3	30.1	38.1	33.6	31.2
Interest cover (x)	20.2	19.8	25.6	24.9	31.9
ROE (%)	23.4	15.7	18.6	19.3	19.2
Consensus net profit	-	-	8,467	9,500	10,655
UOBKH/Consensus (x)	-	-	0.91	0.93	0.93

Source: ENN Energy Holdings, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$78.40
Target Price	HK\$102.00
Upside	+30.1%
(Previous TP)	HK\$128.00)

COMPANY DESCRIPTION

ENN is one of the largest gas distributors in China with 187 city gas projects as of 2018. It strategically taps into the LNG import market to avoid purchasing high-cost gas from three oil majors.

STOCK DATA

GICS sector	Utilities
Bloomberg ticker:	2688 HK
Shares issued (m):	1,131.2
Market cap (HK\$m):	88,687.6
Market cap (US\$m):	11,310.5
3-mth avg daily t'over (US\$m):	24.6

Price Performance (%)

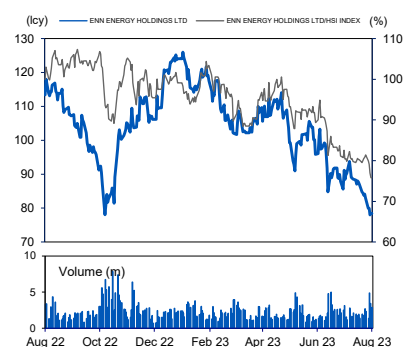
52-week high/low HK\$126.00/HK\$78.00

1mth	3mth	6mth	1yr	YTD
(8.4)	(24.5)	(33.3)	(28.6)	(28.5)

Major Shareholders

	%
ENN Group	33.3
-	-
-	-
FY23 NAV/Share (Rmb)	38.44
FY23 Net Debt/Share (Rmb)	14.64

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **Retail gas sales volume fell 6.9% yoy, dragged by weak industrial demand.** ENN's retail gas sales volume was down 6.9% yoy to 12,162m cbm in 1H23, dragging down segment revenue by 3.6% yoy to Rmb29,217m. Gas sales to industrial/commercial/residential users saw changes of -11.7%/+5.3%/+5.1% yoy to 7,979m/1,096m/2,911m cbm in 1H23.
- **Resources reallocation and lingering property overhang.** The key reason for the decline in retail gas sales volume in 1H23 was due to a 66%/14% yoy drop in gas supply to power plants and industries dependable on the property sector. The company intentionally redirected its gas resources away from the low margin power plant users which have not been the company's targeted group of users as a city gas distributor. Gas sales to emerging industries like solar glass and intelligent equipment manufacturing was up 17% yoy in 1H23.
- **Dollar margin recovered to Rmb0.52 per cbm.** Dollar margin recovery remained intact in 1H23, up from 1H22/2022's Rmb0.50/Rmb0.48 per cbm to Rmb0.52 per cbm. ASP for residential users ticked up to Rmb3.25 per cbm from 1H22/2022's Rmb3.23/Rmb3.24 per cbm, thanks to the acceleration in implementation of new cost-pass through the pricing mechanism for residential users in multiple provinces. As of 1H23, 34% of the company's overall residential gas consumption volume has completed ASP revision in 1H23.
- **Subpar new installations amid challenging macro environment.** New installation for residential customers was up 1.9% yoy to 998,000 households, whereas new installed daily capacity for commercial & industrial (C&I) users was down 11.8% yoy to 8.359m cbm. The company is on track to hit the annual new installation target for residential users of 1.8m-2.0m households, but still lagging behind the target of 20m cbm for new daily capacity for C&I users. However, it still maintains the new installation target for the year.
- **Downward revision of gas sales guidance.** ENN has revised down its retail gas sales volume guidance for 2023 to not lower than -5% yoy from previously guided +10% yoy. With that, core profit yoy growth was also guided at not lower than -5% yoy, down from the initially guided over 10% yoy growth. Dollar margin for the retail gas segment has been revised up to Rmb0.51 per cbm from previously guided Rmb0.50 per cbm. Management maintained its guidance of Rmb1.5b LNG trading gain for this year.

EARNINGS REVISION/RISK

- We cut our earnings forecast for 2023/24/25 by 8%/7%/7% to factor in weaker-than-expected retail gas sales volume growth.

VALUATION/RECOMMENDATION

- **We maintain BUY with a lower target price of HK\$102.00.** Slowdown of industrial activities remains as the biggest concern for 2H23. However, we believe the slowdown in retail gas sales could be largely offset by the high-pace growth of the value added business and integrated energy segments, and the only gap left unfilled would be the decline in LNG trading gain. Besides, the company has also announced the successful extension of gas distribution rights in Changsha by another 10 years with no gas distribution rights expiring in the next five years.
- We believe the company's dollar margin will continue to recover with more supportive policies from the authorities in ensuring reasonable margin for city gas distributors. This is to ensure an uninterrupted gas supply during the winter season and higher safety standards being adopted by city gas distributors after a series of gas explosions incidents. Also, with more cities adopting the new pricing mechanism and revising residential gas prices, the guidance of Rmb0.51 per cbm dollar margin for 2023 could be slightly conservative in our view.

SHARE PRICE CATALYST

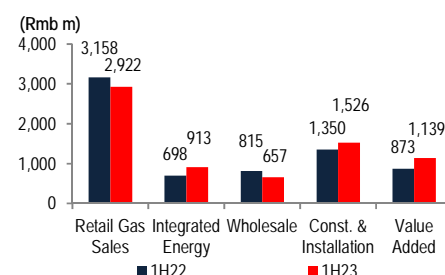
- Stronger-than-expected gas consumption recovery.

OPERATIONAL DATA

Sales Volume	1H22	1H23	yoy chg
Retail Gas Sales Volume (m cbm)	13,065	12,162	(6.9)
Wholesale of Gas Volume (m cbm)	3,770	3,665	(2.8)
Sales of Integrated Energy (m kWh)	10,801	15,664	45.0
New Natural Gas Customers	1H22	1H23	yoy chg
Residential Customers ('000 households)	979	998	1.9
C/I Customers (sites)	9,138	8,233	(9.9)
Installed designed daily capacity (C/I) ('000 cbm)	9,479	8,359	(11.8)
Accumulated Number of Customers	1H22	1H23	yoy chg
Residential Customers ('000 households)	26,814	28,919	7.9
C/I Customers (Sites)	211,597	232,695	10.0
Installed designed daily capacity (C/I) ('000 cbm)	172,301	191,685	11.3
Number of domestic city-gas projects	254	254	-
Piped Gas Penetration Rate	62.7%	65.1%	2.4

Source: ENN Energy Holdings, UOB Kay Hian

SEGMENTAL GROSS PROFIT



Source: ENN Energy Holdings, UOB Kay Hian

SEGMENTAL GROSS MARGINS

Segment	1H22	1H23	yoy chg
Retail gas sales	10.4%	10.0%	-0.4 ppt
Integrated energy	13.0%	13.1%	+0.1 ppt
Wholesale	4.4%	4.9%	+0.6 ppt
Construction and installation	48.4%	53.3%	+4.9 ppt
Value added business	74.9%	67.0%	-7.9 ppt
Overall	11.8%	13.2%	+1.4 ppt

Source: ENN Energy Holdings, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Net turnover	110,051	103,501	117,329	127,298
EBITDA	13,279	13,360	15,465	17,157
Deprec. & amort.	2,011	2,309	2,662	3,081
EBIT	11,268	11,051	12,803	14,076
Total other non-operating income	(1,569)	0	0	0
Associate contributions	25	665	749	852
Net interest income/(expense)	(672)	(522)	(620)	(538)
Pre-tax profit	9,052	11,195	12,933	14,390
Tax	(2,388)	(2,463)	(2,845)	(3,166)
Minorities	(799)	(1,048)	(1,210)	(1,347)
Net profit	5,865	7,684	8,877	9,877
Net profit (adj.)	5,865	7,684	8,877	9,877

BALANCE SHEET

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Fixed assets	50,380	60,140	67,185	75,422
Other LT assets	24,838	24,843	25,434	26,132
Cash/ST investment	8,056	5,893	7,126	5,188
Other current assets	19,077	18,057	20,210	21,762
Total assets	102,351	108,933	119,954	128,503
ST debt	6,341	7,019	7,317	6,419
Other current liabilities	29,741	27,883	31,275	33,764
LT debt	13,451	15,432	16,115	15,696
Other LT liabilities	7,263	7,565	7,882	8,215
Shareholders' equity	39,034	43,466	48,586	54,284
Minority interest	6,521	7,569	8,779	10,126
Total liabilities & equity	102,351	108,933	119,954	128,503

CASH FLOW

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Operating	10,102	9,712	13,447	14,404
Pre-tax profit	9,052	11,195	12,933	14,390
Tax	(2,388)	(2,463)	(2,845)	(3,166)
Deprec. & amort.	1,801	2,020	2,280	2,587
Associates	(25)	(665)	(749)	(852)
Working capital changes	(1,021)	(1,006)	1,096	788
Other operating cashflows	2,683	630	734	658
Investing	(6,679)	(8,587)	(8,642)	(10,094)
Capex (growth)	(7,521)	(9,000)	(9,000)	(10,500)
Investments	(37)	(37)	(37)	(37)
Proceeds from sale of assets	0	0	0	0
Others	879	450	395	443
Financing	(4,052)	(3,288)	(3,573)	(6,248)
Dividend payments	(3,282)	(3,252)	(3,757)	(4,180)
Issue of shares	0	0	0	0
Proceeds from borrowings	11,752	9,000	8,000	6,000
Loan repayment	(11,850)	(6,341)	(7,019)	(7,317)
Others/interest paid	(672)	(2,695)	(797)	(752)
Net cash inflow (outflow)	(628)	(2,163)	1,233	(1,938)
Beginning cash & cash equivalent	8,684	8,056	5,893	7,126
Changes due to forex impact	0	0	0	0
Ending cash & cash equivalent	8,056	5,893	7,126	5,188

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	12.1	12.9	13.2	13.5
Pre-tax margin	8.2	10.8	11.0	11.3
Net margin	5.3	7.4	7.6	7.8
ROA	5.8	7.3	7.8	8.0
ROE	15.7	18.6	19.3	19.2
Growth				
Turnover	18.2	(6.0)	13.4	8.5
EBITDA	14.1	0.6	15.8	10.9
Pre-tax profit	(20.5)	23.7	15.5	11.3
Net profit	(24.4)	31.0	15.5	11.3
Net profit (adj.)	(24.4)	31.0	15.5	11.3
EPS	(24.3)	31.0	15.5	11.3
Leverage				
Debt to total capital	30.3	30.6	29.0	25.6
Debt to equity	50.7	51.7	48.2	40.7
Net debt/(cash) to equity	30.1	38.1	33.6	31.2
Interest cover (x)	19.8	25.6	24.9	31.9

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