

**ENN Energy**

2688 HK

Target (HKD): 48.50 → 48.50

Upside: 13.5%

19 Apr price (HKD): 42.75

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

# A week in the US

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- We organised an NDR trip with ENN in the US
- FAQs by investors covered: gas price reform, 1Q13 gas demand and prospects of LNG
- Our investment thesis is intact; reiterate Buy

■ **What's new**

Investors' common concerns were addressed during our roadshow with ENN Energy (ENN) in the US in the week of 15-19 April.

■ **What's the impact**

**Gas price reform:** Gas price reform was a common concern among investors. ENN's management believes that higher import prices will push China to move the reform beyond Guangdong and Guangxi (piloted in late 2011), but the timing remains highly uncertain. ENN sees a low probability of a full-scale reform taking place during 2013 as: 1) China's economic recovery seems slower than expected, which does not bode well for a large increase in energy input costs, and 2) the government has been promoting clean energy including natural gas to tackle the serious environmental issues, so raising gas prices aggressively could reduce the competitiveness with other fuels. Our base case assumes a 20% increase in overall gas prices across the country in

2013, and if ENN is correct about the later-than-expected timing, it could improve market sentiment towards the city gas sector amid fewer worries about a margin squeeze. However, we reiterate our view that ENN should maintain its dollar margin given its large exposure to commercial and industrial customers (73% of its sales volume for 2013E on our forecast) with proven pass-through ability. Also, ENN said that it has 26 city projects locked in with automatic pass-through agreements for all customers.

**1Q13 gas demand:** Investors also asked about the impact of weaker-than-expected GDP and industrial output in 1Q13. While the official natural gas consumption for the country in March has not been released (up 14.7% YoY for the first two months), ENN said its gas sales remained robust during 1Q13 and maintains its guidance of 25% YoY growth in natural gas sales volume and 20% YoY in core earnings for 2013.

**LNG stations:** Investors were interested in how long ENN's organic business growth could last with liquefied natural gas (LNG) refuelling stations growing exponentially. ENN plans to add up to 500 LNG refuelling stations (of which 86 were in operation at end-2012) by 2015. Management expects a meaningful profit contribution from LNG stations to start in 2015. Compared with compressed natural gas (CNG) stations, LNG has a slightly longer payback period (3-5 years), but more volume density and profit per station. Average capex per LNG station is about CNY5-8m. Besides LNG, ENN will focus considerably on opportunities with industrial parks to boost its sustainable customer base.

■ **What we recommend**

Our positive investment thesis on ENN remains intact after the trip and despite its strong YTD share price performance (ENN has outperformed the HSCEI Index by 34%). Our DCF-based six-month target price remains at HKD48.50. The key risk to our call would be lower-than-expected gas sales volume.

■ **How we differ**

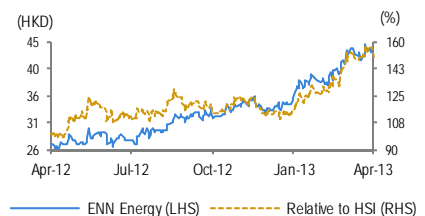
Our 2013-15 net profit forecasts are 8-10% higher than the Bloomberg consensus, due mostly to our more bullish view on gas volume.

**Forecast revisions (%)**

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

**Share price performance**



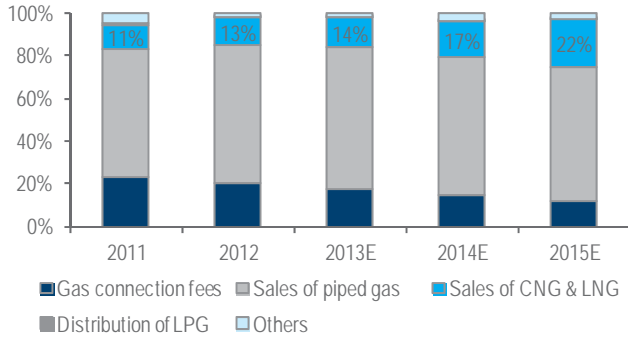
12-month range	26.40-44.60
Market cap (USDbn)	5.87
3m avg daily turnover (USDm)	13.82
Shares outstanding (m)	1,066
Major shareholder	ENN Group (31.2%)

**Financial summary (CNY)**

Year to 31 Dec	13E	14E	15E
Revenue (m)	22,371	28,568	34,193
Operating profit (m)	3,540	4,326	4,995
Net profit (m)	2,008	2,452	2,908
Core EPS (fully-diluted)	1.884	2.299	2.728
EPS change (%)	36.5	22.1	18.6
Daiwa vs Cons. EPS (%)	7.8	9.9	10.1
PER (x)	18.1	14.8	12.5
Dividend yield (%)	1.4	1.7	2.4
DPS	0.471	0.575	0.818
PBR (x)	3.6	3.0	2.6
EV/EBITDA (x)	9.8	8.0	6.6
ROE (%)	21.4	22.1	22.3

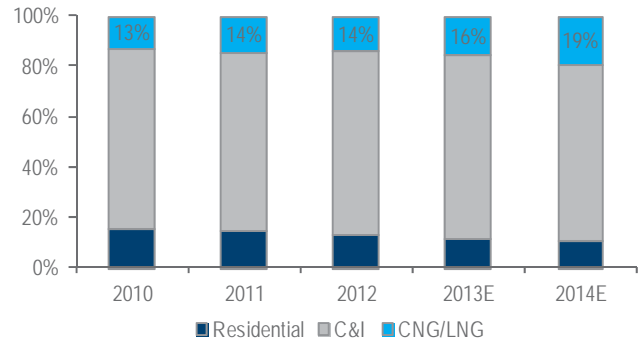
Source: FactSet, Daiwa forecasts

■ **ENN: revenue mix (CNYm)**



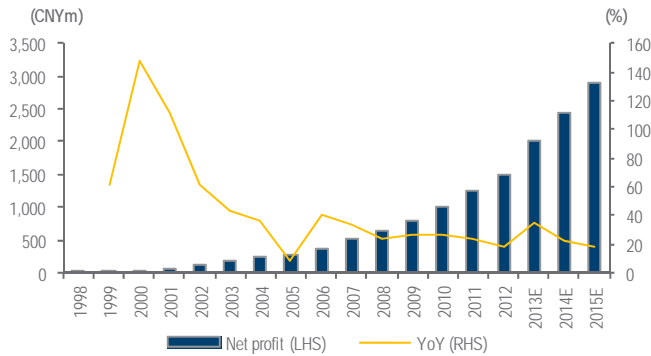
Source: Company, Daiwa forecasts

■ **ENN: gas sales volume mix (cubic metres)**



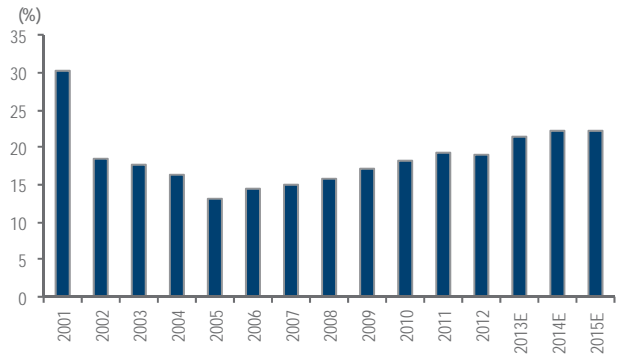
Source: Company, Daiwa forecasts

■ **ENN: long-term net profit trend**



Source: Company, Daiwa forecasts

■ **ENN: long-term ROE trend**



Source: Company, Daiwa forecasts

■ **ENN: 12-month forward PER history**



Source: Bloomberg, Daiwa forecasts

■ **China City Gas Sector: 12-month forward PER history**



Source: Bloomberg, Daiwa forecasts

## Financial summary

### ■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Gas sales volume (m cm)	2,889	2,940	4,149	5,373	6,460	8,269	10,481	12,909
Gas ASP - retail (Rmb/cm)	2.5	2.5	2.6	2.7	2.8	3.0	3.3	3.3
Gas ASP - CNG (Rmb/cm)	2.3	2.5	2.7	2.9	2.2	3.0	3.3	3.4
Gas purchase cost (Rmb/cm)	1.7	1.7	1.8	1.9	2.0	2.2	2.4	2.4
Revenue contribution – connection fee (%)	29.3	30.4	27.2	22.7	20.2	17.0	14.6	11.7
Gas penetration rate for residential households (%)	27.0	32.4	36.0	38.1	44.2	50.0	57.3	64.5

### ■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales of piped gas	3,095	4,078	6,633	9,152	11,547	14,827	18,410	21,487
Gas connection	2,422	2,554	3,049	3,415	3,633	3,807	4,178	4,015
Other Revenue	2,749	1,782	1,534	2,501	2,847	3,738	5,979	8,691
<b>Total Revenue</b>	<b>8,266</b>	<b>8,413</b>	<b>11,215</b>	<b>15,068</b>	<b>18,027</b>	<b>22,371</b>	<b>28,568</b>	<b>34,193</b>
Other income	184	84	162	96	20	66	66	66
COGS	(6,019)	(5,873)	(8,203)	(11,166)	(13,183)	(16,850)	(22,074)	(26,887)
SG&A	(847)	(625)	(929)	(1,242)	(1,443)	(1,440)	(1,558)	(1,666)
Other op. expenses	(313)	(391)	(453)	(421)	(528)	(608)	(676)	(711)
<b>Operating profit</b>	<b>1,270</b>	<b>1,608</b>	<b>1,792</b>	<b>2,335</b>	<b>2,893</b>	<b>3,540</b>	<b>4,326</b>	<b>4,995</b>
Net-interest inc./(exp.)	(351)	(308)	(284)	(389)	(470)	(291)	(270)	(173)
Assoc/forex/extraord./others	211	83	303	381	429	451	461	536
<b>Pre-tax profit</b>	<b>1,131</b>	<b>1,383</b>	<b>1,811</b>	<b>2,327</b>	<b>2,852</b>	<b>3,700</b>	<b>4,516</b>	<b>5,358</b>
Tax	(260)	(304)	(410)	(660)	(859)	(999)	(1,219)	(1,447)
Min. int./pref. div./others	(240)	(276)	(388)	(414)	(511)	(692)	(845)	(1,003)
<b>Net profit (reported)</b>	<b>631</b>	<b>803</b>	<b>1,013</b>	<b>1,253</b>	<b>1,482</b>	<b>2,008</b>	<b>2,452</b>	<b>2,908</b>
<b>Net profit (adjusted)</b>	<b>631</b>	<b>803</b>	<b>1,013</b>	<b>1,253</b>	<b>1,482</b>	<b>2,008</b>	<b>2,452</b>	<b>2,908</b>
EPS (reported)(CNY)	0.625	0.775	0.965	1.190	1.390	1.884	2.299	2.728
EPS (adjusted)(CNY)	0.625	0.775	0.965	1.190	1.390	1.884	2.299	2.728
EPS (adjusted fully-diluted)(CNY)	0.614	0.772	0.954	1.180	1.380	1.884	2.299	2.728
DPS (CNY)	0.154	0.192	0.286	0.303	0.345	0.471	0.575	0.818
EBIT	1,270	1,608	1,792	2,335	2,893	3,540	4,326	4,995
EBITDA	1,583	1,999	2,245	2,756	3,422	4,148	5,002	5,706

### ■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	1,131	1,383	1,811	2,327	2,852	3,700	4,516	5,358
Depreciation and amortisation	313	391	453	421	528	608	676	711
Tax paid	(260)	(304)	(410)	(660)	(859)	(999)	(1,219)	(1,447)
Change in working capital	55	910	902	416	930	734	188	805
Other operational CF items	23	198	93	(242)	(602)	31	94	15
<b>Cash flow from operations</b>	<b>1,261</b>	<b>2,578</b>	<b>2,849</b>	<b>2,262</b>	<b>2,849</b>	<b>4,074</b>	<b>4,255</b>	<b>5,443</b>
Capex	(1,418)	(1,552)	(2,497)	(1,889)	(2,521)	(3,100)	(2,000)	(1,000)
Net (acquisitions)/disposals	(180)	(289)	(509)	(578)	(642)	0	0	0
Other investing CF items	111	(144)	16	(200)	(356)	0	0	0
<b>Cash flow from investing</b>	<b>(1,487)</b>	<b>(1,985)</b>	<b>(2,991)</b>	<b>(2,667)</b>	<b>(3,519)</b>	<b>(3,100)</b>	<b>(2,000)</b>	<b>(1,000)</b>
Change in debt	349	481	378	(723)	576	(2,072)	(164)	(1,172)
Net share issues/(repurchases)	0	237	0	83	496	0	0	0
Dividends paid	(158)	(200)	(304)	(322)	(371)	(502)	(613)	(873)
Other financing CF items	47	258	206	5,215	490	3,200	0	0
<b>Cash flow from financing</b>	<b>238</b>	<b>776</b>	<b>280</b>	<b>4,254</b>	<b>1,191</b>	<b>626</b>	<b>(777)</b>	<b>(2,044)</b>
Forex effect/others	0	0	0	0	0	0	0	0
<b>Change in cash</b>	<b>12</b>	<b>1,369</b>	<b>139</b>	<b>3,848</b>	<b>521</b>	<b>1,600</b>	<b>1,478</b>	<b>2,399</b>
Free cash flow	(157)	1,026	352	373	328	974	2,255	4,443

Source: FactSet, Daiwa forecasts

■ Balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	1,725	2,713	2,851	6,024	6,472	7,477	9,025	11,277
Inventory	254	286	249	272	311	398	521	634
Accounts receivable	1,431	1,208	1,356	1,837	2,062	2,559	3,268	3,911
Other current assets	943	547	623	811	842	885	1,805	2,030
<b>Total current assets</b>	<b>4,354</b>	<b>4,754</b>	<b>5,079</b>	<b>8,944</b>	<b>9,687</b>	<b>11,319</b>	<b>14,618</b>	<b>17,852</b>
Fixed assets	7,855	9,028	10,800	13,073	15,099	17,624	18,981	19,603
Goodwill & intangibles	634	622	894	1,247	1,434	1,181	1,147	1,114
Other non-current assets	1,731	2,231	2,867	3,624	4,673	4,673	4,673	4,673
<b>Total assets</b>	<b>14,574</b>	<b>16,635</b>	<b>19,640</b>	<b>26,888</b>	<b>30,893</b>	<b>34,797</b>	<b>39,419</b>	<b>43,242</b>
Short-term debt	1,869	1,484	2,379	3,213	3,945	1,208	1,208	1,208
Accounts payable	2,752	2,772	3,573	4,172	4,894	6,255	8,195	9,981
Other current liabilities	807	1,108	1,536	2,135	2,775	2,823	2,898	2,975
<b>Total current liabilities</b>	<b>5,428</b>	<b>5,364</b>	<b>7,488</b>	<b>9,520</b>	<b>11,614</b>	<b>10,286</b>	<b>12,300</b>	<b>14,164</b>
Long-term debt	3,534	4,400	3,884	7,459	7,297	11,162	10,998	9,826
Other non-current liabilities	171	444	728	1,069	1,312	480	569	661
<b>Total liabilities</b>	<b>9,133</b>	<b>10,208</b>	<b>12,100</b>	<b>18,048</b>	<b>20,223</b>	<b>21,928</b>	<b>23,867</b>	<b>24,651</b>
Share capital	106	110	110	110	113	113	113	113
Reserves/R.E./others	4,149	5,007	5,922	6,936	8,540	10,046	11,885	13,921
<b>Shareholders' equity</b>	<b>4,256</b>	<b>5,117</b>	<b>6,031</b>	<b>7,046</b>	<b>8,653</b>	<b>10,159</b>	<b>11,998</b>	<b>14,034</b>
Minority interests	1,186	1,310	1,508	1,794	2,017	2,709	3,555	4,558
<b>Total equity &amp; liabilities</b>	<b>14,574</b>	<b>16,635</b>	<b>19,640</b>	<b>26,888</b>	<b>30,893</b>	<b>34,797</b>	<b>39,419</b>	<b>43,242</b>
EV	40,083	39,412	39,341	40,285	39,988	40,803	39,936	37,515
<b>Net debt/(cash)</b>	<b>3,678</b>	<b>3,172</b>	<b>3,412</b>	<b>4,648</b>	<b>4,770</b>	<b>4,893</b>	<b>3,180</b>	<b>(243)</b>
<b>BVPS (CNY)</b>	<b>4.217</b>	<b>4.939</b>	<b>5.745</b>	<b>6.692</b>	<b>8.116</b>	<b>9.529</b>	<b>11.253</b>	<b>13.163</b>

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	43.6	1.8	33.3	34.4	19.6	24.1	27.7	19.7
EBITDA (YoY)	28.4	26.2	12.3	22.7	24.2	21.2	20.6	14.1
Operating profit (YoY)	28.4	26.6	11.5	30.3	23.9	22.3	22.2	15.5
Net profit (YoY)	24.3	27.3	26.2	23.7	18.3	35.5	22.1	18.6
Core EPS (fully-diluted) (YoY)	22.1	25.7	23.6	23.7	16.9	36.5	22.1	18.6
Gross-profit margin	27.2	30.2	26.9	25.9	26.9	24.7	22.7	21.4
EBITDA margin	19.2	23.8	20.0	18.3	19.0	18.5	17.5	16.7
Operating-profit margin	15.4	19.1	16.0	15.5	16.1	15.8	15.1	14.6
Net profit margin	7.6	9.5	9.0	8.3	8.2	9.0	8.6	8.5
ROAE	15.8	17.1	18.2	19.2	18.9	21.4	22.1	22.3
ROAA	4.7	5.1	5.6	5.4	5.1	6.1	6.6	7.0
ROCE	12.4	13.9	13.7	14.0	14.0	15.0	16.3	17.4
ROIC	11.4	13.4	13.5	13.7	14.0	15.6	17.3	19.7
Net debt to equity	86.4	62.0	56.6	66.0	55.1	48.2	26.5	net cash
Effective tax rate	23.0	22.0	22.6	28.4	30.1	27.0	27.0	27.0
Accounts receivable (days)	55.2	57.3	41.7	38.7	39.5	37.7	37.2	38.3
Current ratio (x)	0.8	0.9	0.7	0.9	0.8	1.1	1.2	1.3
Net interest cover (x)	3.6	5.2	6.3	6.0	6.2	12.2	16.0	28.9
Net dividend payout	24.6	24.8	29.7	25.5	24.8	25.0	25.0	30.0
Free cash flow yield	n.a.	2.8	1.0	1.0	0.9	2.7	6.2	12.2

Source: FactSet, Daiwa forecasts

■ Company profile

Founded in 1989, ENN Energy is engaged principally in the investing in, and the operation and management of, gas-pipeline infrastructure and the sale and the distribution of piped and bottled gas in more than 80 cities in the PRC.

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