

UEG (467 HK)

On track volume growth along with good cost control

UEG's net profit in 1H22 grew 58% YoY to HK\$1.51bn, through decent volume growth and better-than-expected unit lifting cost. UEG plans to maintain the presence in Pakistan, despite a change in regime, as UEG is a major taxpayer in the country and the Company is confident that the risk is manageable. While we trim our 2022E earnings forecast by 4% due to the impairment made in 1H22, we revise up our forecast in 2023E/24E by 16%/10% after modelling higher oil & gas price forecast as well as lower lifting cost assumptions. We expect UEG to achieve accelerated oil & gas production growth in 2022E-24E (from 6% to 13%), driven by fast-growing output in Iraq's Block 9. On the back of strong operating cash flow (HK\$3.1bn in 1H22), we forecast dividend yield to reach 8% in 2022E. We roll over our valuation base to 2023E with a new TP of HK\$1.77 (based on unchanged target P/E of 10x). Maintain **BUY**.

- **1H22 net income grew 58% YoY to HK\$1.51bn.** Oil and gas sales value grew 80% YoY to US\$1.3bn, driven by: (1) 65% YoY increase in realized oil & gas price (Crude: US\$104.2/bbl; Gas: US\$29.4/boe), and (2) 9% YoY increase in sales volume. Stripping out the government royalty, windfall levy and government take, net revenue in 1H22 grew 59% YoY to HK\$5.5bn. UEG recognized HK\$350mn impairment loss on trade receivables and HK\$722mn exploration expenses, which were mainly in Pakistan based on our understanding. UEG also recognized HK\$120mn investment loss in JV in 1H22. That said, UEG still managed to report 58% YoY increase in net profit.
- **Average daily working interest production +9.5% to 100k barrels of oil equivalent per day (boed).** Iraq Block 9, the fast-growing asset, achieved working interest production growth of 33% YoY to 32.4k boed in 1H22. We expect this asset to deliver output growth of 30% p.a. in 2022E-23E, a key growth driver of UEG.
- **Good operating cost control.** On the cost side, operating expense dropped 4.7% YoY to US\$4.1/boe, driven by a 14.6% decline in unit cost in the Middle East & North Africa (MENA), which more than offset the 8% YoY increase in Pakistan. Such cost reduction is better than our expectation. This, together with a higher realized price, boosted the gross margin by 14.9ppt YoY to 58.4% in 1H22.
- **Risk factors:** (1) unexpected decline in crude & gas price; (2) political risk in Pakistan.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (HKD mn)	6,204	7,437	11,158	12,064	13,451
YoY growth (%)	-12.7	19.9	50.0	8.1	11.5
Net income (HKD mn)	864	2,001	3,510	4,653	4,944
EPS (HKD)	0.03	0.08	0.13	0.18	0.19
YoY growth (%)	-54.6	131.6	75.5	32.6	6.3
Consensus EPS (HKD)	NA	NA	NA	NA	NA
P/E (x)	26.7	11.5	6.6	5.0	4.7
P/B (x)	1.8	1.6	1.5	1.3	1.1
Yield (%)	2.68	4.55	7.98	10.57	11.23
ROE (%)	6.7	14.1	22.1	25.7	24.1
Net gearing (%)	20.0	19.7	18.9	15.8	9.3

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$1.77
(Previous TP	HK\$1.40)
Up/Downside	101%
Current Price	HK\$0.88

China Oil & Gas

Wayne Fung, CFA

(852) 3900 0826

waynefung@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	23,135
Avg 3 mths t/o (HK\$ mn)	29.65
52w High/Low (HK\$)	1.32/0.44
Total Issued Shares (mn)	26,290

Source: Bloomberg

Shareholding Structure

Zhang Hong Wei	66.44%
Free Float	33.56%

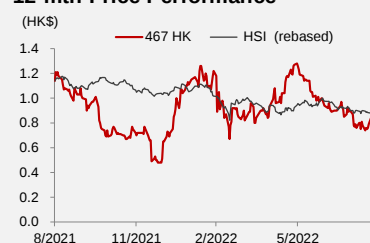
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-1.1%	1.1%
3-mth	-29.9%	-28.1%
6-mth	-24.6%	-15.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: RSM Hong Kong

Related Report:

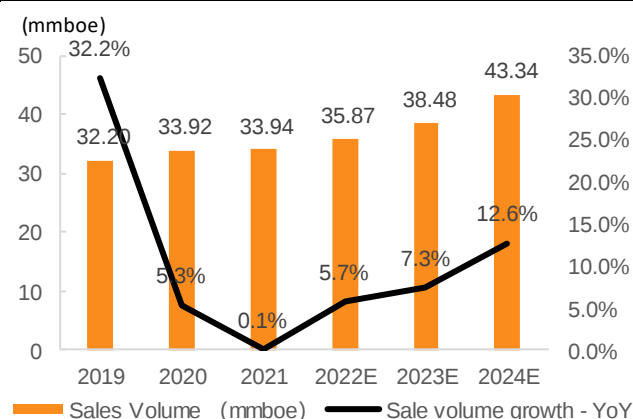
UEG (467 HK) Acceleration of volume growth + Higher price in 2022E – 13 Apr 2022

UEG (467 HK) a fast-growing medium-sized IOC—14 Sep 2021

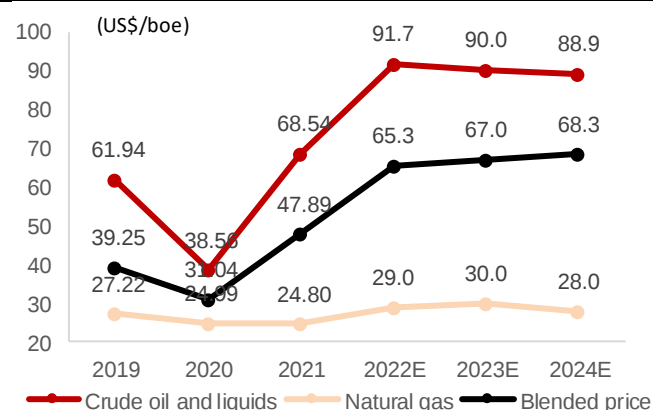
Figure 1: Change in key assumptions

	New			Old			Change		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Daily output (000 boed)									
Pakistan	47	46	46	46	46	46	2.2%	0.0%	0.0%
Iraq - Block 9	34	44	60	34	44	60	0.0%	0.0%	0.0%
Iraq - Siba	6	5	5	6	5	5	0.0%	0.0%	0.0%
Egypt	12	11	10	12	11	10	0.0%	0.0%	0.0%
Total	99	106	121	98	106	121	1.0%	0.0%	0.0%
Realized price									
Crude (US\$/bbl)	92	90	89	89	89	89	3.4%	1.4%	-0.1%
Natural gas (US\$/boe)	29	30	28	26	27	27	11.5%	11.1%	3.7%
Lifting cost (US\$/boe)	4.3	4.6	4.8	4.6	4.9	5.3	-8.0%	-6.0%	-8.4%
(HK\$ mn)									
Revenue	11,158	12,064	13,451	10,212	11,360	13,077	9.3%	6.2%	2.9%
Gross profit	6,730	7,049	7,517	5,514	6,031	6,740	22.1%	16.9%	11.5%
Gross margin	60.3%	58.4%	55.9%	54.0%	53.1%	51.5%	11.7%	10.1%	8.4%
Operating profit	2,459	4,868	5,113	3,883	4,240	4,704	-36.7%	14.8%	8.7%
Net profit	3,510	4,653	4,944	3,660	4,018	4,501	-4.1%	15.8%	9.8%

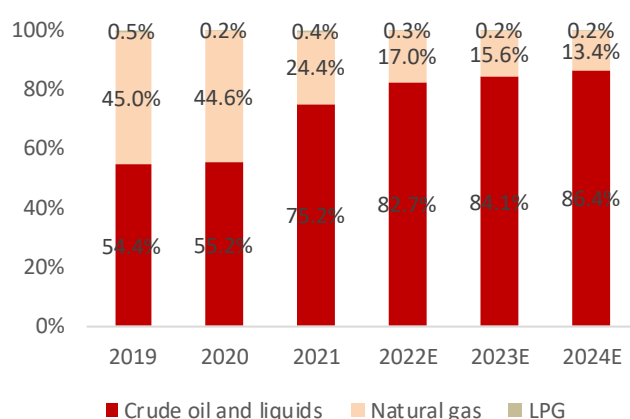
Source: Company data, CMBIGM estimates

Figure 2: UEG's oil & gas sales volume

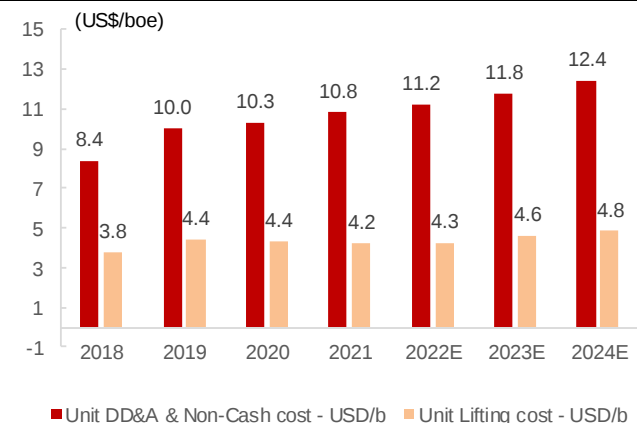
Source: Company data, CMBIGM estimates

Figure 3: UEG's realised oil and gas price

Source: Company data, CMBIGM estimates

Figure 4: Revenue mix

Source: Company data, CMBIGM estimates

Figure 5: UEG's unit operating cost

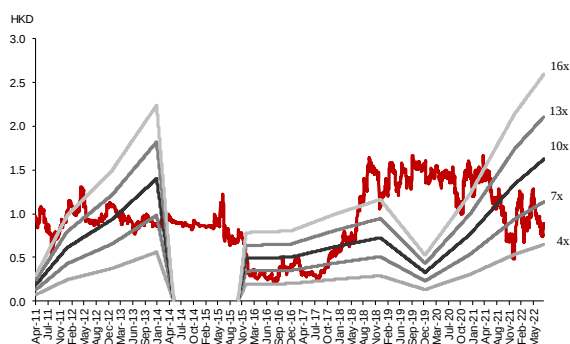
Source: Company data, CMBIGM estimates

Valuation

UEG is trading at 6.6x 2022E P/E, close to 1x SD below UEG's historical average of 15x (since 2011). We raise our TP from HK\$1.40 to HK\$1.77, based on 10x 2023E P/E which is equivalent to ~30% discount to the historical average.

We estimate every 5% increase in Brent oil price will result in 3% increase in net profit on an annualized basis.

Figure 6: 12M forward P/E band



Source: Company data, Bloomberg, CMBIGM estimates

Figure 7: Brent crude oil price



Source: Bloomberg, CMBIGM

Figure 8: UEG's earnings sensitivity to crude price and lifting cost (Pakistan)

		Realised price (US\$/boe)				
		90	95	100	105	110
	4.59	3,261	3,362	3,463	3,564	3,666
	4.38	3,284	3,385	3,487	3,588	3,689
Lifting cost	4.18	3,308	3,409	3,510	3,611	3,713
(Pakistan)	3.97	3,331	3,432	3,534	3,635	3,736
	3.76	3,355	3,456	3,557	3,658	3,760

Source: CMBIGM estimates

Figure 9: UEG's earnings sensitivity to crude price and lifting cost (MENA)

		Realised price (US\$/boe)				
		90	95	100	105	110
	4.52	3,255	3,356	3,457	3,559	3,660
	4.31	3,281	3,383	3,484	3,585	3,686
Lifting cost	4.11	3,308	3,409	3,510	3,611	3,713
(Mena)	3.90	3,334	3,435	3,537	3,638	3,739
	3.70	3,360	3,462	3,563	3,664	3,765

Source: CMBIGM estimates

Note: Mena = Middle East & North Africa

Financial Summary

Income statement

YE 31 Dec (HK\$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	6,204	7,437	11,158	12,064	13,451
Cost of revenue	(4,171)	(4,080)	(4,428)	(5,015)	(5,934)
Gross profit	2,033	3,357	6,730	7,049	7,517
Operating expenses	(724)	(599)	(2,135)	(1,090)	(1,202)
Investment & other income	75	112	123	145	161
Other gains and losses	79	26	(11)	--	--
Impairment losses for trade	(3)	57	(502)	(60)	(54)
Exploration expenses	(340)	(164)	(1,004)	(362)	(404)
Administrative expenses	(440)	(574)	(658)	(724)	(807)
Other operating	(96)	(55)	(82)	(89)	(99)
Operating profit	584	2,160	2,459	4,868	5,113
Finance Cost	(313)	(267)	(366)	(381)	(396)
Share of losses of associates	31	(59)	(60)	(52)	(47)
Profit before tax	1,027	2,433	4,169	5,526	5,872
Income tax expense	(163)	(432)	(659)	(873)	(928)
MI	0	(0)	(0)	(0)	(0)
Net profit	864	2,001	3,510	4,653	4,944

Cash flow summary

YE 31 Dec (HK\$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Profit after tax	864	2,001	3,510	4,653	4,944
D&A	2,835	2,972	3,137	3,669	4,211
Change in working capital	(2,572)	(1,032)	(1,630)	(365)	(271)
Others	783	340	109	7	7
Operating cash flow	1,910	4,281	5,127	7,963	8,891
CAPEX	(2,004)	(2,528)	(6,058)	(5,753)	(5,864)
Others	(177)	34	60	52	47
Investing cash flow	(2,181)	(2,494)	(5,998)	(5,701)	(5,817)
Changes in borrowings	(477)	(1,03)	1,83	188	188
Dividends paid	(619)	(1,049)	(1,840)	(2,439)	(2,592)
Others	1,002	630	925	378	545
Financing cash flow	(94)	(1,452)	920	(1,874)	(1,859)
Net change in cash	(365)	335	49	388	1,215
Cash at the beginning	3,35	3,09	3,17	3,21	3,60
FX change, net	99	(258)	--	--	--
Cash at the end	3,093	3,171	3,219	3,607	4,822

Balance sheet

YE 31 Dec (HK\$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	7,280	7,669	10,240	11,217	13,051
Bank and cash balances	3,093	3,171	3,219	3,607	4,822
Trade receivables	3,762	4,145	6,360	6,877	7,398
Inventories	331	287	558	603	673
Other current assets	94	66	103	130	158
Non-current assets	17,661	17,364	20,153	22,195	23,815
PPE	10,847	10,835	13,638	16,026	17,987
Right-of-use assets	585	530	535	539	544
Intangible assets	5,701	5,340	5,452	5,144	4,832
Other non-current assets	528	659	528	485	452
Total assets	24,941	25,032	30,394	33,412	36,866
Current liabilities	5,341	5,093	5,570	5,836	6,216
Borrowings (current)	1,370	1,761	1,556	1,619	1,681
Trade and bills payables	3,653	2,818	3,479	3,639	3,891
Lease liabilities (current)	107	108	192	208	232
Other current liabilities	212	407	342	370	412
Non-current liabilities	6,684	5,699	8,907	9,438	10,153
Borrowings	3,866	2,833	4,668	4,856	5,043
Deferred tax liabilities	1,955	1,979	3,347	3,619	4,035
Others	863	886	891	963	1,074
Total equity	12,916	14,240	15,917	18,138	20,497
Shareholders' equity	12,907	14,234	15,911	18,132	20,491
Non-controlling interests	9	6	6	6	6

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Net revenue growth (%)	-13%	20%	50%	8%	11%
P&L ratios (%)					
Operating margin	21.1	37.1	41.2	49.4	46.9
Pre-tax margin	16.5	32.7	37.4	45.8	43.7
Net margin	13.9	26.9	31.5	38.6	36.8
Effective tax rate	15.8	15.8	15.8	15.8	15.8
Balance sheet ratios					
Current ratio (x)	1.4	1.5	1.8	1.9	2.1
Quick ratio (x)	1.3	1.4	1.7	1.8	2.0
Payable turnover days	320	320	320	320	319.6
Total debt / total equity ratio (%)	104	88	101	93	88.1
Total Liabilities to Assets (%)	48.2	43.1	47.6	45.7	44.4
Net Debt / EBITDA	0.6	0.5	0.4	0.3	0.2
Returns (%)					
ROA	3.5	8.0	11.5	13.9	13.4
ROE	6.7	14.1	22.1	25.7	24.1
Per share					
EPS (RMB)	0.03	0.08	0.13	0.18	0.19
DPS (RMB)	0.02	0.04	0.07	0.09	0.10
BVPS (RMB)	0.49	0.54	0.61	0.69	0.78

Source: Company data, CMBIGM estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM

OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.