

# United Energy Group (467 HK)

## A fast-growing medium-sized IOC

United Energy Group (short for "UEG") is a leading independent exploration and production company listed on the HKEX. The Company achieved proved and probable (2P) working interest of 1.07bn barrels of oil equivalent ("boe") by end-2020, successfully growing into a medium-sized independent oil & gas company. We think UEG offers a unique investment angle on oil and gas development in reputable emerging markets. **Initiate BUY with a TP of HK\$1.70.**

- A Fast-Growing Independent Oil & Gas Company.** UEG has business presence in emerging countries like Pakistan, Iraq and Egypt, and is dedicated to upstream oil and gas exploration and production. The Company located its headquarters in Hong Kong, regional center in Dubai, UAE, and also an operating center in Beijing. By end-2020, UEG had working interest 2P reserve of 1.07bn boe and a reserve-production ratio of 31.6. In 1H21, UEG achieved average working interest production of 91,435 boe per day ("boed").
- High-quality assets portfolio in emerging markets.** UEG had established high-quality assets portfolio in the past decade through a series of strategic assets acquisition. Among UEG's valuable assets portfolio, Block 9 in Iraq is the crown jewel of the Company. UEG made long term development for the field, and it will be a key earnings growth driver in the coming few years.
- Excellent operating efficiency leads the way to success.** We are quite impressed by UEG's earnings performance in the past nine years. We think outstanding cost control measures, high efficient resource development, and prudent financial planning are the key aspects leading to UEG's excellent operating efficiency. We believe those aspects will pave the way for UEG's long term success.
- Net profit to surge with 44.0% CAGR in 2020-23E.** UEG realized strong 1H21 earnings of HK\$959mn, exceeding that of FY20. On the back of production growth strategy in Block 9 and strict cost control measures, we expect 2021-23E net profit to be HK\$1,741/2,366/2,580mn respectively, reflecting a net profit CAGR of 44.0% in 2020-23E. **Based on 18.8x FY22 PER, we derive a TP of HK\$1.70, implying 58.5% upside. Initiate BUY.**
- Risk factors: 1) country risk; 2) unfavorable oil price movement.**

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (HK\$ mn)	7,104	6,204	7,731	9,067	9,472
YoY growth (%)	34.6	-12.7	24.6	17.3	4.5
Net income (HK\$ mn)	1,906	864	1,741	2,366	2,580
EPS (HK\$)	0.07	0.03	0.07	0.09	0.10
YoY growth (%)	16.5	-54.6	101.0	35.9	9.0
P/E (x)	14.9	32.8	16.3	12.0	11.0
P/B (x)	2.4	2.2	2.1	2.0	1.8
Yield (%)	3.70	2.19	3.70	5.00	5.45
ROE (%)	15.8	6.7	12.8	16.3	16.5
Net gearing (%)	12.2	20.0	19.8	12.3	2.1

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Initiation)

Target Price	HK\$1.70
Up/Downside	+58.5%
Current Price	HK\$1.07

### China Oil & Gas Sector

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### Stock Data

Mkt Cap (HK\$ mn)	28,130
Avg 3 mths t/o (HK\$ mn)	24.8
52w High/Low (HK\$)	1.67/ 0.98
Total Issued Shares (mn)	26,290
Source: Bloomberg	

### Shareholding Structure

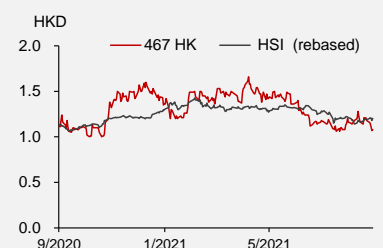
Zhang Hong Wei	66.44%
Free Float	33.56%
Source: HKEx	

### Share Performance

	Absolute	Relative
1-mth	-10.0%	-8.9%
3-mth	-20.6%	-12.6%
6-mth	-20.6%	-12.9%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

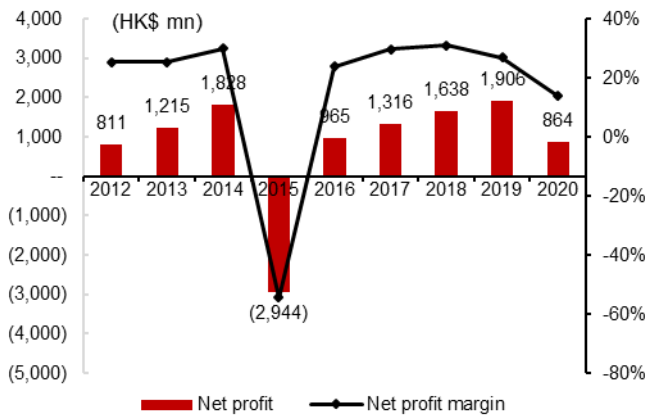
Auditor: RSM Hong Kong

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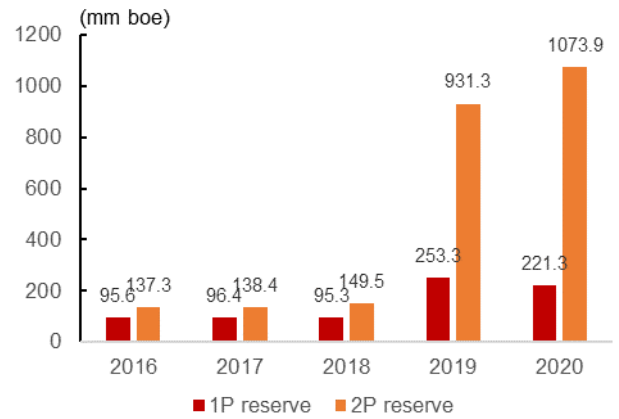
**Focus Charts**

**Figure 1: UEG delivered impressive earnings performance in 2012 - 2020**



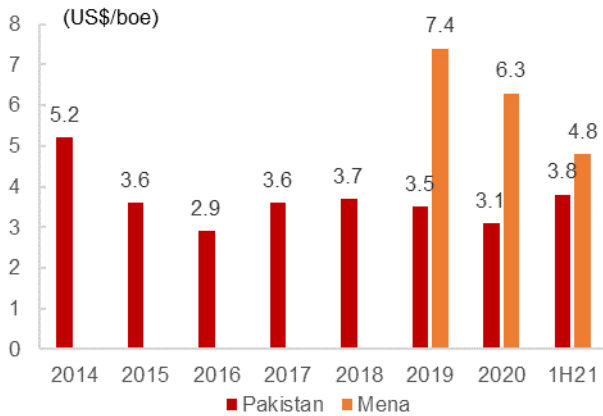
Source: Company data, CMBIS estimates

**Figure 2: UEG achieved 2P working interest through successful M&A in the emerging markets**



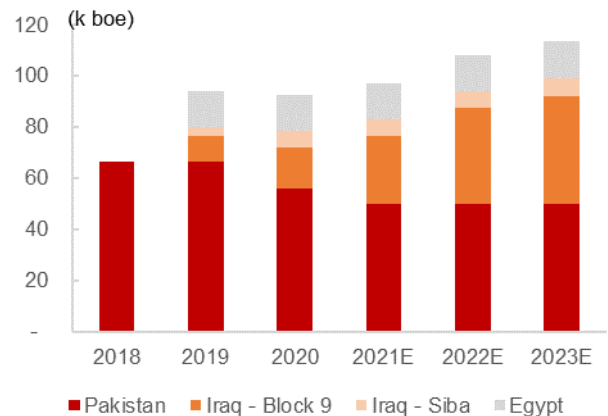
Source: Company data, CMBIS estimates

**Figure 3: Outstanding operating cost control is a key highlight of UEG: lifting costs lead ahead peers in the same regions**



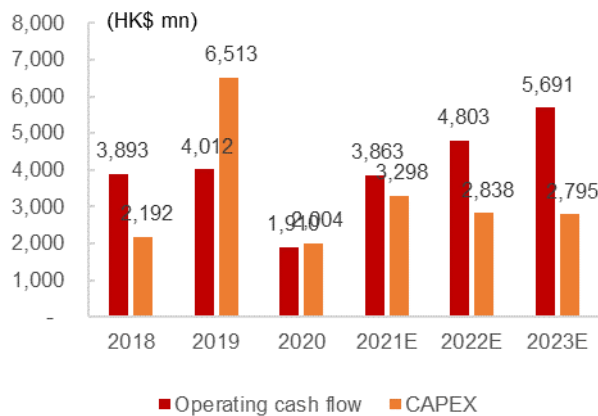
Source: Company data, CMBIS estimates

**Figure 4: Block 9 in Iraq is the crown jewel of UEG and will be the key growth driver in the coming few years**



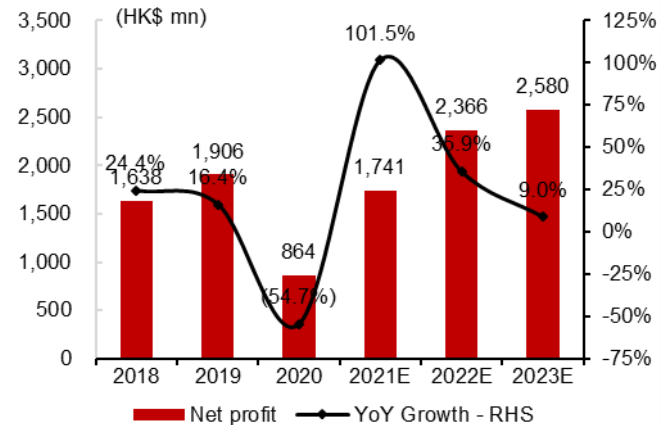
Source: Company data, CMBIS estimates

**Figure 5: UEG adopts prudent financial management and efficient development strategy**



Source: Company data, CMBIS estimates

**Figure 6: We estimate net profit to surge with 44% CAGR in 2020-23E**



Source: Company data, CMBIS estimates

## A Fast Growing Independent Oil & Gas Company

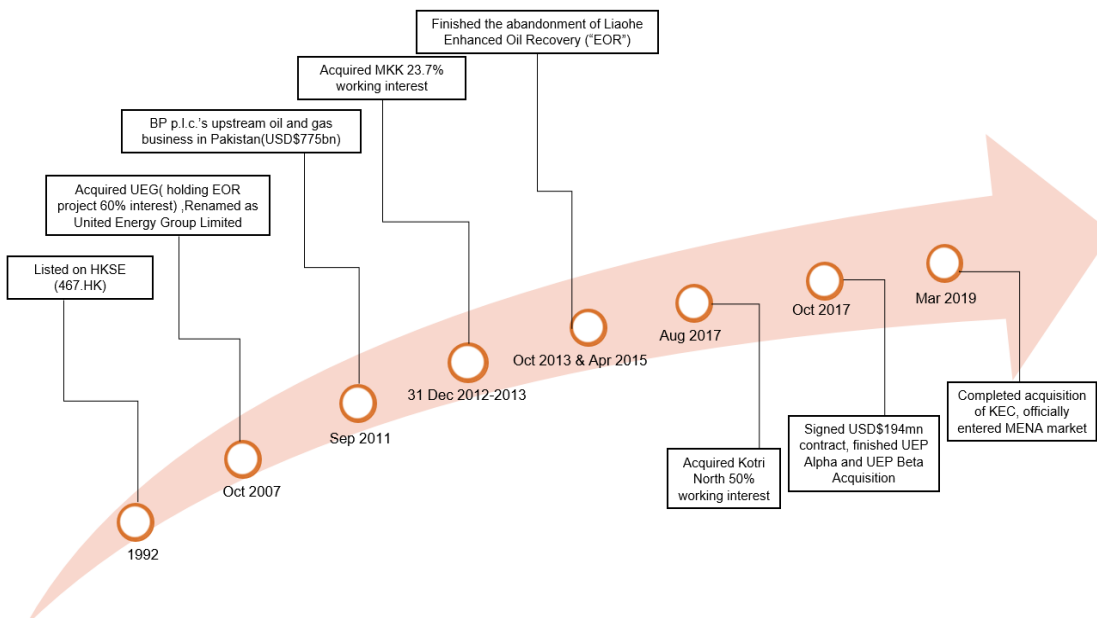
United Energy Group (short for “UEG”) is a leading independent exploration and production company listed on the HKEX. The Company has established itself as a reputable international oil and gas company, with business presence in emerging countries like Pakistan, Iraq and Egypt. UEG is dedicated to upstream oil and gas exploration and production. The Company located its headquarter in Hong Kong and regional center in Dubai, UAE, and an operating center in Beijing, China. By end-2020, UEG had working interest proved and probable (2P) reserve of 1.07bn boe and a reserve-production ratio of 31.6. In 1H21, UEG achieved average working interest production of 91,435 boe per day.

### Strategic acquisition led the way in business expansion

UEG acquired 60% interest of Liaohe Enhanced Oil Recovery (EOR) project in Bohai Bay Basin, China to enter the E&P business in Oct 2007. Since then, UEG has achieved rapid business expansions through a series of acquisitions and investments in Pakistan and in the Middle East and North Africa (MENA) region. Several key milestones of UEG include

- 1) UEG acquired BP’s upstream oil and gas business in Pakistan at a cash consideration of approximately US\$775mn in Sep 2011 to kick start its international expansion pace;
- 2) In 2012-2013, UEG further acquired another 23.7% working interest of MKK block in Pakistan;
- 3) In 2016, UEG disposed the Liaohe EOR project in China;
- 4) In 2019, UEG completed acquisition of KEC, officially entering MENA market and successfully enlarged and diversified assets portfolios with high quality oil field such as Block 9 and Siba in Iraq.

**Figure 7: UEG’s development and milestones**

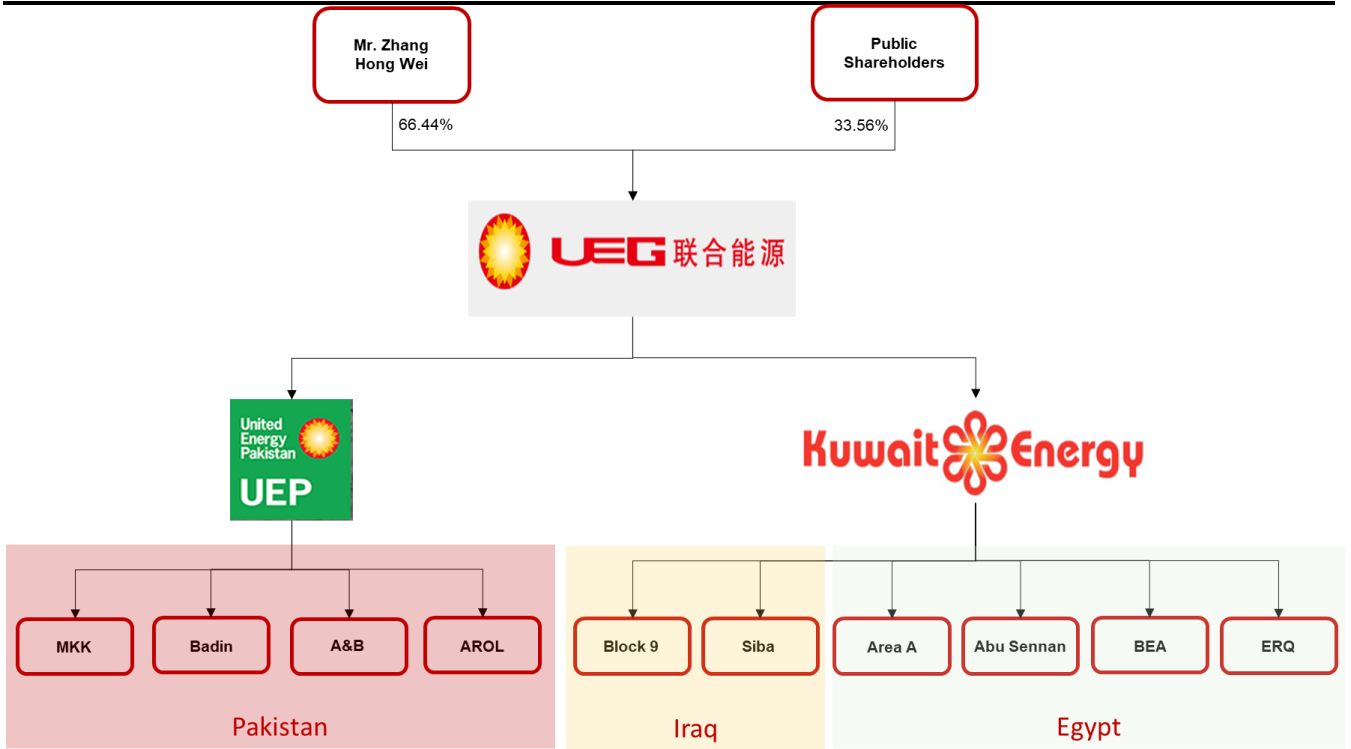


Source: Company data, CMBIS

## Shareholding and Company structure

Mr. Zhang Hong Wei, Chairman of the Board and Executive Director of UEG owns 66.45% shares of the Company, and public shareholders control the remaining 33.56% shares. UEG's operations are mainly conducted through two major platforms, namely 1) United Energy Pakistan, which is responsible for business operations for four oil and gas blocks in Pakistan; and 2) Kuwait Energy, which runs assets portfolios in Iraq and Egypt.

**Figure 8: UEG's shareholding and company structure**



Source: Company data, HKEX, CMBIS

## Experienced management team

UEG appointed management team with decades of oil & gas overseas project experience in the emerging markets. Key members include

- Mr. Song Yu, CEO, former Sinopec employee who has more than 20 years of industry experience and is good at M&A, oil and gas trading, and corporate management;
- Mr. Lin Yang, CFO, former CNOOC employee who has more than 22 years of industry experience and is strong at financial management and corporate financing; and
- Mr. Zhang Weihua, Chief Legal Counsel and Vice President, who is famous for oil & gas related legal matters in Asia Pacific.

The Company also retained regional heads and local staffs from acquired projects, including Mr. Mausuf Ahmad, VP of the Company and Regional Head of Pakistan; and Mr. Kamel Al Sawi, Regional Head of Egypt. We think high retention rate of the local team helps UEG better integrate into the local environment and achieve smooth consolidation for efficiency enhancement measures.

**Figure 9: UEG's senior management and local management team**

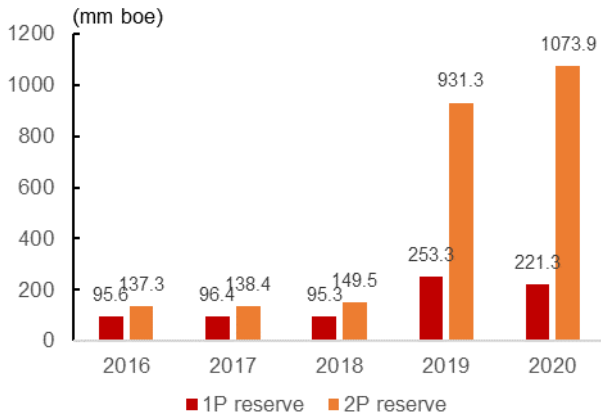
UEG's Management Team	Regional Management Team
<p><b>Mr. Song Yu,(宋宇), Executive Director-UEG &amp; CEO- Block 9</b></p> <ul style="list-style-type: none"> <li>Former Sinopec employee</li> <li>Joined UEG for 12 years</li> <li>He used to work in different subsidiaries of Sinopec Group during the period from Jul 2004 to Oct 2009.</li> <li>20+ years of experience in the oil &amp; gas industry</li> <li>Specialized in corporate M&amp;A, management of oil trade business</li> </ul>	<p><b>Mr. Mausuf Ahmad, Vice President -UEG &amp; CEO-Pakistan Asset</b></p> <ul style="list-style-type: none"> <li>Former BP employee</li> <li>Appointed as Regional President of Pakistan since 2019.</li> <li>He used to work for BP's MENA management team</li> <li>27+ years of regional management experience</li> <li>39+ years of experience in the oil &amp; gas industry</li> </ul>
<p><b>Mr. Lin Yang,(林杨), CFO-UEG</b></p> <ul style="list-style-type: none"> <li>Former CNOOC employee</li> <li>Joined UEG for 12 years, responsible for business planning and financial work.</li> <li>He used to work in CNOOC (China National Offshore Oil Corporation) during the period from 1999 to 2009.</li> <li>22+ years of experience in the oil &amp; gas industry .</li> <li>Specialized in corporate financing and accounting</li> </ul>	<p><b>Mr. Chang Guang Fa,(常广发), CEO-Siba &amp; Vice President – Blog 9</b></p> <ul style="list-style-type: none"> <li>Former PetroChina employee</li> <li>30+ years of experience in the oil &amp; gas industry .</li> <li>19+ years of international experience in the oil &amp; gas industry .</li> <li>He used to work as Vice President in CNPC Canada during the period from 1989 to 2018.</li> </ul>
<p><b>Mr. Zhang Wei Hua,(张伟华), Vice President &amp; General Counsel</b></p> <ul style="list-style-type: none"> <li>Former CNOOC employee</li> <li>Joined UEG for 5 years, responsible for global legal affairs</li> <li>He used to work in CNOOC (China National Offshore Oil Corporation) during the period from 2005 to 2016.</li> <li>17+ years of experience in the oil &amp; gas industry .</li> <li>Recognized by Legal500 as one of ASIA PACIFIC TOP CORPORATE COUNSELS</li> </ul>	<p><b>Mr. Kamel Al Sawi, Vice President –Egypt Asset</b></p> <ul style="list-style-type: none"> <li>Joined Kuwait Energy for 10 years</li> <li>17+ years of experience in the oil &amp; gas industry .</li> <li>He used to work for Halliburton, Qarun Petroleum, Apache, Petronas and Oil Search,etc</li> </ul>

Source: Company data, CMBIS

## High-quality assets portfolio in the emerging markets

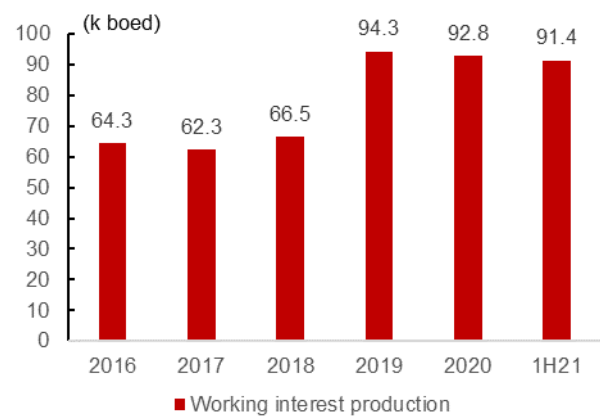
UEG had established high-quality assets portfolio in the past decade through a series of strategic assets acquisition. The Company achieved 2P working interest of 1.07bn boe by end-2020, and extended 2P reserve-production ratio from 6.1 in 2018 to 30.8 in 2020, successfully growing into a medium-sized independent oil & gas company.

**Figure 10: UEG's 2P reserve exceeded 1bn boe in 2020**



Source: Company data, CMBIS

**Figure 11: UEG net working interest production**



Source: Company data, CMBIS

## Pakistan assets to contribute stable cash flow

The Company kicked off its global energy market expansion through the acquisition of BP's oil and gas assets at a consideration of US\$775mn in Pakistan. Back then, BP decided to divest non-core business due to the impacts of oil spill in the Gulf of Mexico. Following the BP asset acquisition, UEG continued to acquire further working interest and new blocks with E&P potentials. Successful project acquisition and operation had sustained UEG's development in 2011-2019 and contributed considerable earnings and cash flow following global oil and gas prices movement.

UEG has equity interests in four blocks in Pakistan, namely the Badin Block, the MKK Block, the UEP A&B Block, and the Gambat South Block. UEG is the operator of three of the major blocks (except Gambat South Block). The Pakistan assets portfolio mainly produces natural gas and has an overall oil & liquid ratio of ~24%. Gas output mainly comes from the Badin and MKK blocks, with an average production of 700mcf and is sold through the state-owned SSGCL transmission pipeline. Oil and liquid output is sold through tanker truck to local refineries.

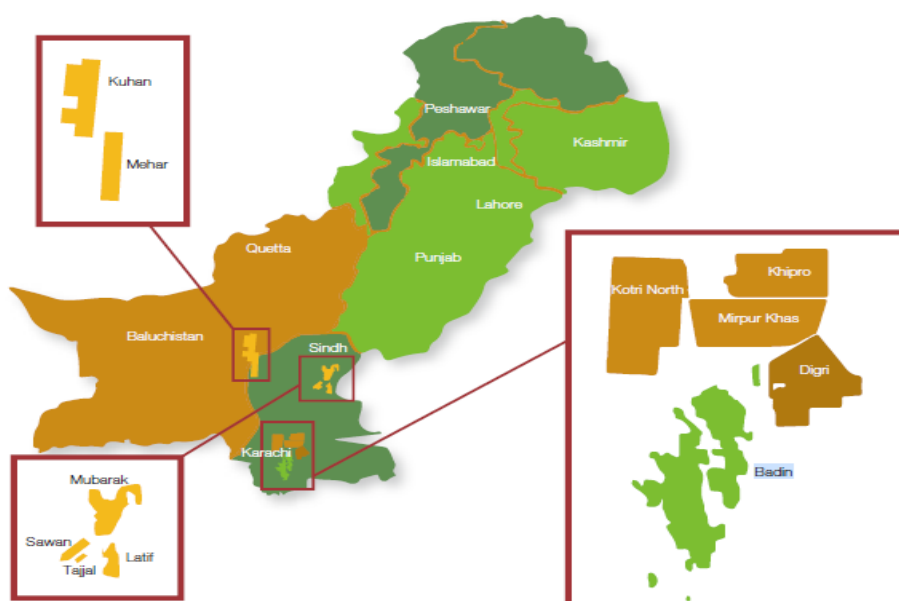
By end-2020, UEG had 2P working interest reserve of 116mm boe, with a reserve-production ratio of 5.7. In 1H21, UEG Pakistan achieved average working interest production of 47,279 boed, down 20.1% YoY. According to UEG, the Company's operating strategy in the Pakistan region is to maintain stable working interest output. We expect the Company to maintain appropriate CAPEX in the region to sustain reserve replacement rate at ~1.



**Figure 12: UEG's operational summary in Pakistan region**

Pakistan Assets	2019	2020	1H21
<b>Operation</b>			
Gross production(boed)	71,781	79,549	68,304
Average Daily Working Interest Production (boed)	66,560	55,929	47,729
Oil & Liquids Ratio	15.7%	12.7%	13.0%
<b>Reserve</b>			
Net Entitlement 1P Reserve at the year end (mmboe)	83.6	69.4	NA
Working Interest 2P Reserve at the year end (mmboe)	130.9	115.7	NA
<b>Exploration &amp; Development Activity</b>			
Rig workovers	10	6	NA
Exploration wells	17	8	NA
Development wells	21	5	NA

Source: Company data, CMBIS

**Figure 13: Pakistan asset allocation**

Source: Company data, CMBIS

## MENA: Iraq assets to be a key growth engine

Supported by stable operation and strong cash flow generated from Pakistan assets, UEG was able to accumulate experience and financial resources for next phase expansion. The Company acquired Kuwait Energy PLC (KEC) at consideration of US\$650.8mn in 2019, marking a significant step to become a medium-sized international independent oil and gas company, and expanded upstream businesses in the Middle East and North Africa region (MENA).

KEC assets package is composed of several key oil and gas fields, including exploration and development licenses in 1) Block 9, aka. Faihaa oil field and Siba gas field in Iraq; and



2) four major oil fields in Egypt (see Fig. 15). After the acquisition, UEG enriched its oil and gas reserves and carried out some fast track projects to ramp up KEC operations. MENA region brought significant contribution to UEG's 2P reserve (800.4mm boe) in 2019, and we saw good momentum to continue as MENA region's 2P reserve enlarged to 958.2mm boe in 2020. In terms of working interest production, UEG intends to maintain stable output level in Egypt assets, and to boost production growth in Iraq. In 1H21, Block 9 achieved working interest production of 24,369 boed, up 67.3% YoY.

**Figure 14: UEG's operational summary in MENA region**

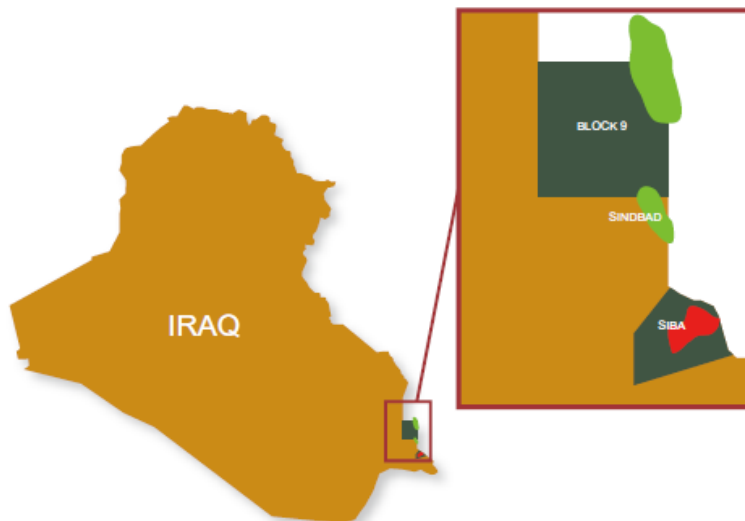
<b>MENA Assets</b>	<b>2019</b>	<b>2020</b>	<b>1H21</b>
<b>Operation</b>			
<b>Gross production(boed)</b>	<b>48,485</b>	<b>71,781</b>	<b>84,273</b>
Iraq-Block 9	16,364	26,849	40,615
Iraq-Siba	11,725	21,859	19,867
Egypt Assets	20,396	23,073	23,791
<b>Average Daily Working Interest Production (boed)</b>	<b>27,782</b>	<b>36,857</b>	<b>43,706</b>
Iraq-Block 9	9,818	16,110	24,369
Iraq-Siba	3,518	6,558	5,960
Egypt Assets	14,446	14,190	13,377
<b>Oil &amp; Liquids Ratio</b>	<b>94.5%</b>	<b>93.3%</b>	<b>NA</b>
Iraq-Block 9	100.0%	100.0%	100.0%
Iraq-Siba	63.8%	67.6%	67.0%
Egypt	NA	97.5%	96.0%
<b>Reserve</b>			
Net Entitlement 1P Reserve at the year end (mmboe)	169.7	151.9	NA
Egypt Assets	5.5	5.2	NA
Iraq Assets	164.2	146.7	NA
Working Interest 2P Reserve at the year end (mmboe)	800.4	958.2	NA
Egypt Assets	26.2	23.3	NA
Iraq Assets	774.2	934.9	NA
<b>Exploration &amp; Development Activity</b>			
Rig workovers	9	8	NA
Exploration wells	2	3	NA
Development wells	11	6	NA

Source: Company data, CMBIS

**Figure 15: UEG's operational summary in MENA region**

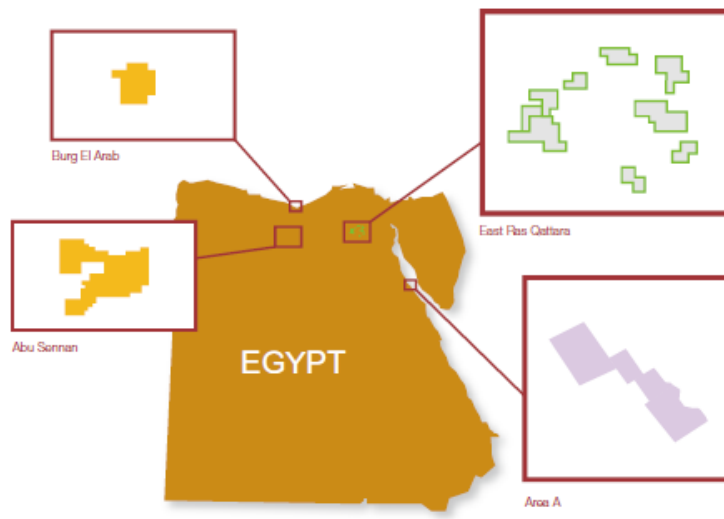
Area	Asset	Operator	Revenue Interest	Cost Interest	Licenses Expired Date	FY2020 Interest 2P Reserved (mnboe)
Iraq	Block 9	KEC	60%	60%	2039	9.14
Iraq	Siba	KEC	30%	40%	2032	0.21
Egypt	Abu Sennan	KEC	25%	53%	2032-2039	0.04
Egypt	Burg El Arab("BEA")	KEC	100%	100%	20201	0.05
Egypt	Area A	KEC	70%	70%	2019-2023	0.08
Egypt	East Ras Qattara	ENAP Sipetrol	49.50%	49.50%	2028-2030	0.07
<b>Total</b>						<b>9.58</b>

Source: Company data, CMBIS

**Figure 16: Iraq asset allocation**

Source: Company data, CMBIS

**Figure 17: Egypt asset allocation**



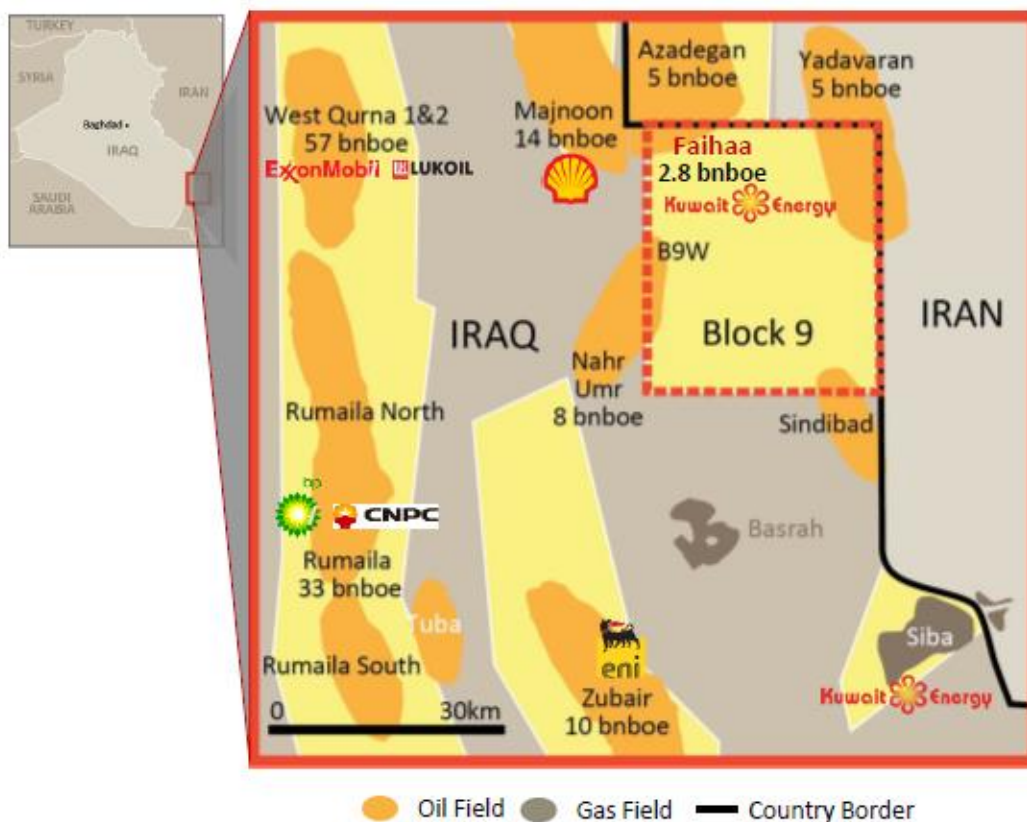
Source: Company data, CMBIS

## Block 9: The Crown Jewel of UEG

Block 9, aka. the Faihaa oil field, is located in southern Iraq, 25 kilometres north of Basra, covering 865 square kilometres on the border with Iran. It is an extension of Iran's giant Yadavaran field. Block 9 was discovered by a consortium led by KEC in Sep 2014. KEC had exploration well tested oil in both the Mishrif and Yamama formations and hooked up to a temporary processing facility and brought on stream in 2015. Block 9 has an oil and liquids ratio of 100%.

Block 9 is a major discovery in Iraq, having great geology and proven basin, recording stable oil regime in Southern Iraq with IOCs having uninterrupted production. The oil field has long been seen as Iraq's next sizeable producer. Nevertheless, former operator KEC was never able to capitalize on this, largely due to financial difficulties while Iraq's political instability has not helped either.

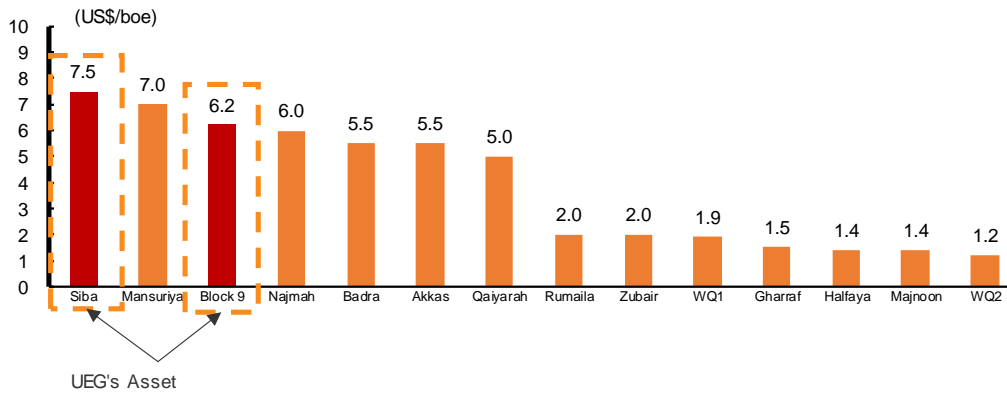
**Figure 18: Block 9 is located in southern Iraq, on the border area with Iran**



Source: Company data, CMBIS

After KEC acquisition, UEG is the operator and holds 60% participating interest in the Exploration Development and Production Service Contract (EDPSC or the "Service Contract") of Block 9. Under EDPSC of Block 9, UEG receives US\$6.2/boe remuneration of oil and liquids output, and the Company recovers development costs through payment-in-kind for oil from the Iraq government. Compared with other oil fields, the remuneration standard is high as Iraq government is willing to provide incentive to accelerate Block 9's development. Under the EDPSC, we think UEG's earnings performance will be significantly less sensitive tie to oil price, and more directly linked with production output.

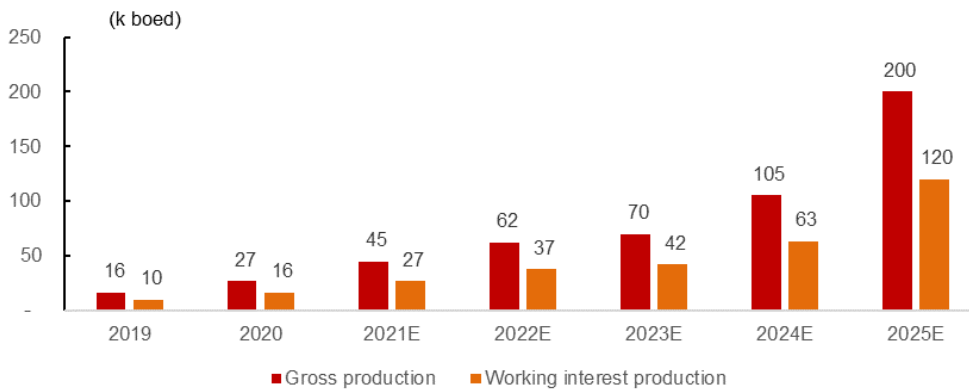
**Figure 19: Remuneration fee: Iraqi provides high incentives to boost Block 9 and Siba output**



Source: Company data, CMBIS

Block 9 has a long-term production capability of 300k boed. UEG had submitted field development plan to the Iraqi Government and working to increase production. Gross production output of Block 9 had exhibited rapid growth from 16,334 boed in 2019 to 26,849 in 2020, and further increased to 40,615 boed during 1H21. Looking ahead, based on UEG's capacity ramp up plan and ground processing facility expansion, we expect Block 9 gross output to be boosted to above 60,000 boed in 2022E, 100,000 boed in 2024E and 200,000 boed in 2025E. Block 9 will be the crown jewel of UEG and become the key growth driver in the coming years.

**Figure 20: UEG Block 9's gross production data and our long-term projection**

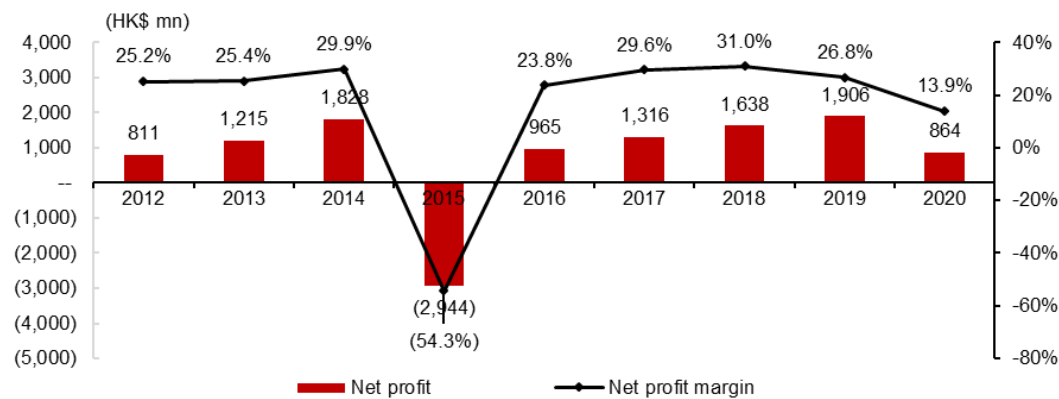


Source: Company data, CMBIS estimates

## Excellent operating efficiency leads the way to success

We are quite impressed by UEG's earnings performance in the past nine years since the Company acquired Pakistan assets and had full year financial consolidation of the asset package from 2012. The Company exhibited stable net profit margin trend in 2012-2020, except for 2015, when UEG decided to divest Liaohe EOR project and realized non-cash loss of HK\$4.4bn. We think outstanding cost control measures, high efficient resource development, and prudent financial planning are the key aspects leading to UEG's excellent operating efficiency. We believe those aspects pave the way for UEG's long term success.

**Figure 21: Impressive earnings performance in 2012-2020**



Source: Company data, CMBIS

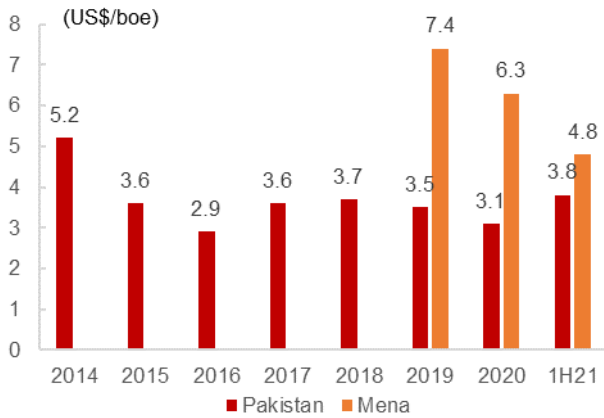
Note: UEG recognized HK\$3.86bn from impairment loss of intangible assets and HK\$693mn loss from impairment of PPE in associated with Liaohe EOR project disposal and non-producing wells in Pakistan.

### Outstanding cost control

UEG realized substantial cost reduction after Pakistan and KEC asset acquisition. In terms of lifting cost, Pakistan region follows a declining trend, while MENA assets realized significant costs reduction. Management disclosed that 1) streamline operation; 2) localized staffs; 3) China oil field services and supply chain supports; and 4) advance monitoring system and active cost management are the core elements for cost control.

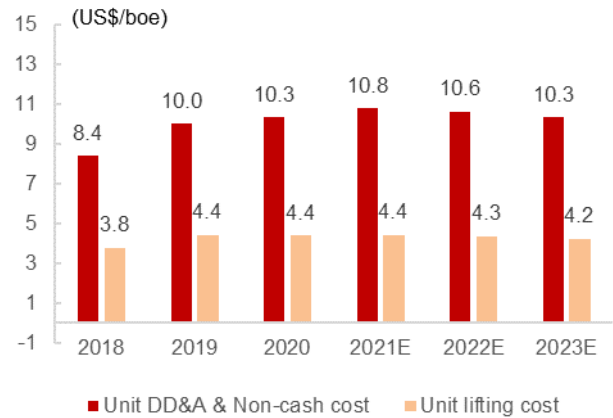
In 1H21, UEG's average lifting cost at working increased slightly by 7.5% YoY due to less output realized in Pakistan region, while MENA region realized another 27.3% YoY lifting cost decline to US\$4.8 per boe. We think those cost metrics lead ahead peers in the same regions, which sustain UEG's overall profitability. Looking ahead, we expect lifting costs in Pakistan region to stay largely stable, and MENA area to continue lifting costs reduction trend as oil and gas output to be boosted in the coming few years.

**Figure 22: Working interest lifting costs in Pakistan and MENA showed declining trend**



Source: Company data, CMBIS

**Figure 23: Overall unit lifting cost vs. DD&A and non-cash items**



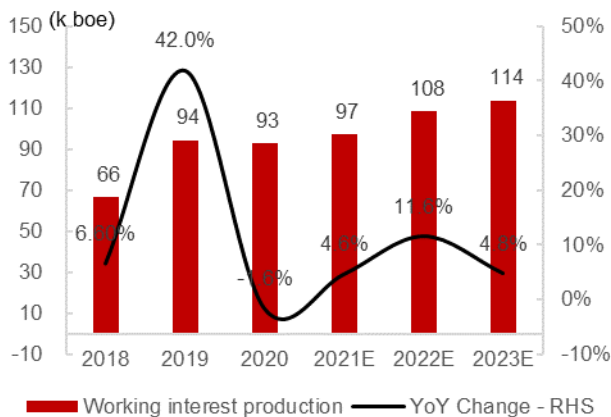
Source: CMBIS estimates based on COGS components divided by sales volume (in boe)

**High efficient development strategy**

UEG had proven successful development strategy in Pakistan. As oil and gas developers in China had accumulated abundant experiences in dealing with complex geological conditions, we believe UEG’s Chinese expert team had provided effective development strategy with advanced engineering solutions. Local team in the fields also exhibited high execution power. The Company maintained stable average working interest output at above 60,000 boe per day in Pakistan with relatively low investment intensity, which helped UEG generate sufficient cash flow to fund KEC acquisition and dividend distributions to shareholders.

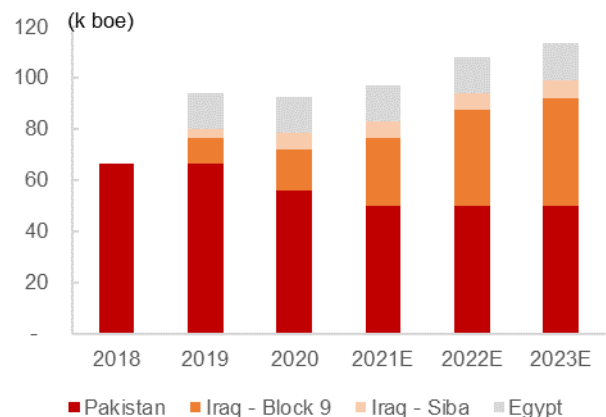
Going forward, UEG will place strategic focus on boosting output in Block 9 in Iraq, and maintaining stable output level in other regions. We expect UEG to replicate its successful experience from Pakistan to Iraq, meeting its production target and generating earnings growth.

**Figure 24: Working interest production**



Source: Company data, CMBIS estimates

**Figure 25: We expect Block 9 production will be a key output growth driver based on UEG’s efficient development strategy**



Source: CMBIS estimates based on COGS components divided by sales volume (in boe)

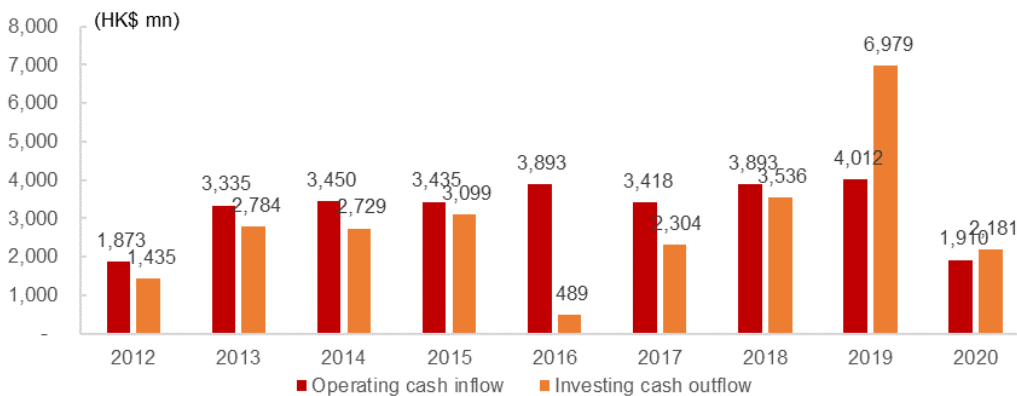


## Prudent financial management

UEG adopts robust financial management principle, in our view. The Company generated HK\$1.8bn operating cash flow in 2012, and maintained the figure above HK\$3bn in 2013-2020. In regard to investment cash outflow, UEG kept restrained mindset, and controlled CAPEX level below operating cash inflow in 2012-2018, reflecting sustainable free cash generation. Supported by increasing cash balance, UEG was able to pay down all borrowings in 2017 (mainly came with Pakistan assets acquisition), which prepared the Company for coming acquisition opportunities. UEG acquired KEC assets in 2019 at consideration of US\$650.8mn. The acquisition boosted UEG's net entitlement 2P reserve by six folds to 931.3mm boe, and marked a solid step for the Company to become a sizable medium independent energy company.

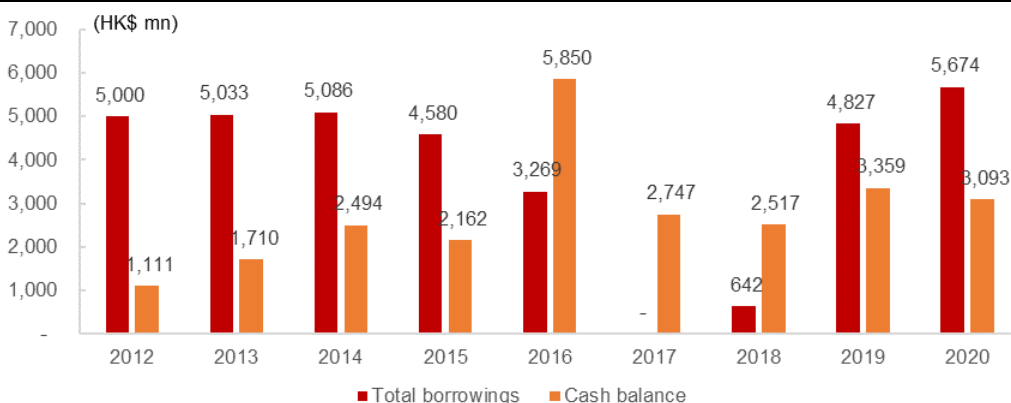
Looking ahead, we expect UEG to maintain its prudent financial management style. Supported by increasing oil and gas output as well as the rebound of oil and gas prices, we expect UEG to have ample room to increase investments for lifting Block 9's production. The Company guided overall CAPEX target to US\$390-420mn in 2021E, implying a significant jump than that of 2020, but still well below our operating cash flow projection. In view of Block 9 development goal, we expect UEG to maintain considerable investment intensity in 2022-23E.

**Figure 26: UEG's Operating cash inflow vs. Investing cash outflow in 2012 - 2020**



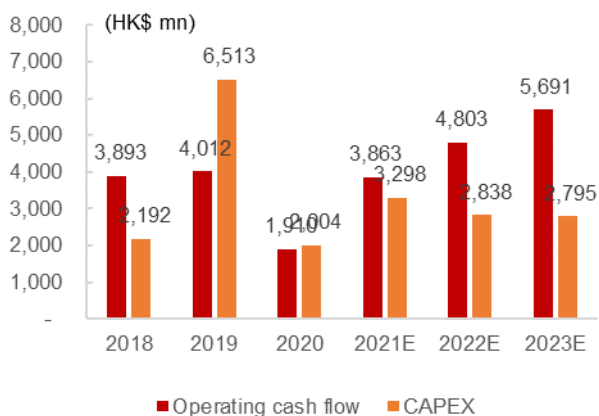
Source: Company data, CMBIS estimates

**Figure 27: UEG's total borrowings vs. cash position in 2012 - 2020**



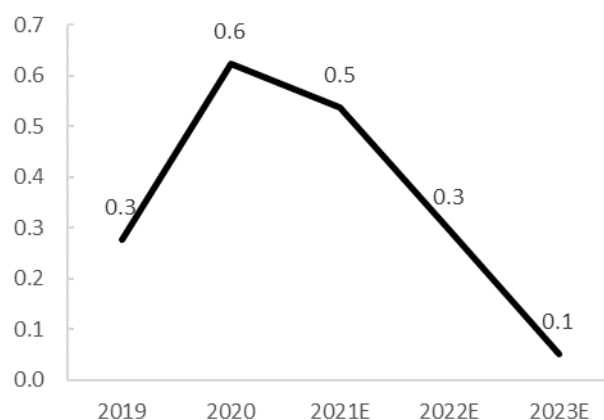
Source: Company data, CMBIS estimates

**Figure 28: Operating cash flow and CAPEX projection**



Source: Company data, CMBIS estimates

**Figure 29: UEG's net debt to EBITDA ratio**



Source: Company data, CMBIS estimates  
Note: UEG was in net cash position in 2018

## ESG development

UEG established its ESG management system. The Company publishes ESG reports following HKEX's guidance. We think UEG is facing long-term environmental exposures for tightening greenhouse gas emission and hazardous waste generated intensity control. We believe the Company is well aware of the issue, and taking initiative to control it by measuring those emissions accurately and setting emission control targets.

UEG had well elaborated processes and systems to ensure a healthy and safe working environment throughout the lifecycle of its operations. The Company has inherited an international health, safety and environmental management system. It is committed to conduct its business activities in a safe and efficient manner, and care for everyone involved or impacted by its activities.

For energy transformation, UEG invested in its first wind farm in Pakistan, called UEP Wind Power. UEP Wind Power is a 99MW power project located in Jhampir, Sindh and is among the top 14 priority projects in China Pakistan Economic Corridor (CPEC). The project was commissioned in time (July 2017) and supplies renewable electricity to the national grid. The Company has started installation of solar power facility in Iraq Block 9 to support power generation to life support camps.

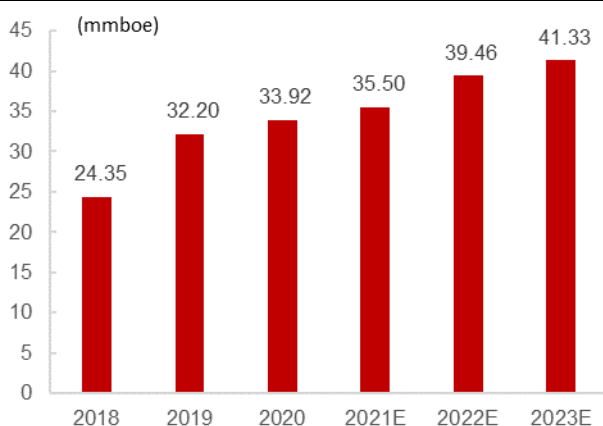
We believe UEG has done well for integrating into the local community. UEG has diversified workforce and has high employment rate for local staff. The Company was also actively helping to raise the level of local culture and education, offer free education to thousands of children, and repair buildings and provide facilities and books for several schools. UEG also committed to enhancing local health care through funding the construction of several medical centers and provided many medical institutions and communities with a lot of medical equipment, ambulances, epidemic prevention supplies, and medicines so that patients can be examined and treated in a timely manner.

## Financials

### Revenue to increase with 15.1% CARG in 2020-23E

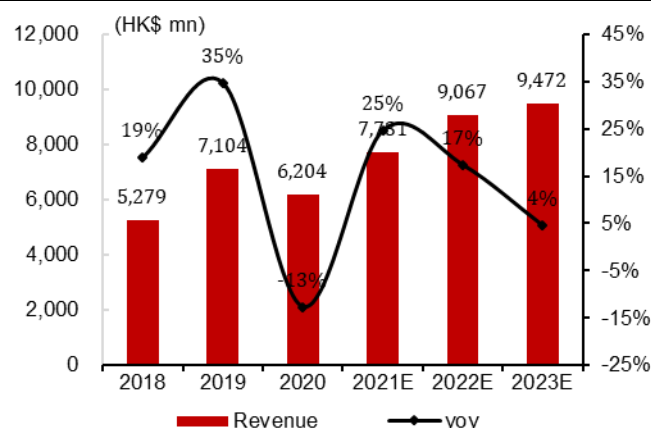
Natural gas sales used to be a key contributor to UEG back in 2018. After the KEC acquisition, crude oil and liquids sales accounted for the majority of revenue contribution from 2019, and we expect the trend to continue as UEG determined to accelerate Block 9's development pace. We estimate total oil and gas sales volume to increase by 6.8% CAGR from 33.92mm boe in 2020 to 41.33mm boe in 2023E. Since oil and liquids has significantly higher price in terms of boe, we estimate revenue to increase at faster pace than volume growth at 15.1% CAGR in 2020-23E.

Figure 30: Sales volume



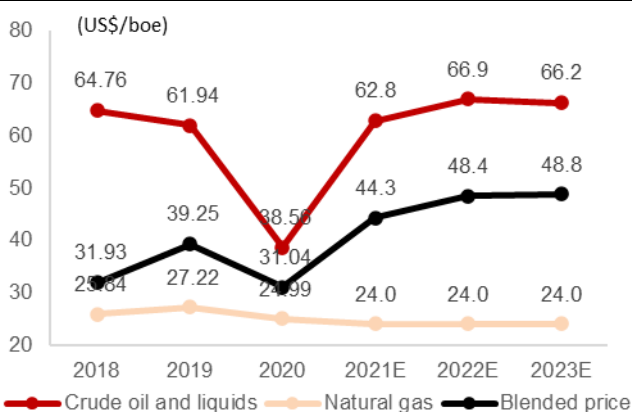
Source: Company data, CMBIS estimates

Figure 31: Revenue projection



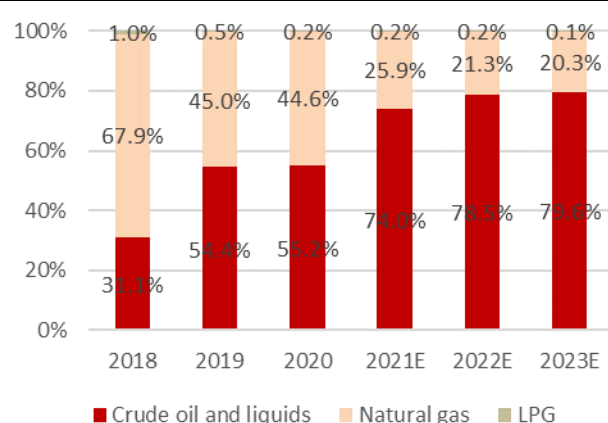
Source: Company data, CMBIS estimates

Figure 32: Realized price assumptions



Source: Company data, CMBIS estimates

Figure 33: Revenue mix



Source: Company data, CMBIS estimates

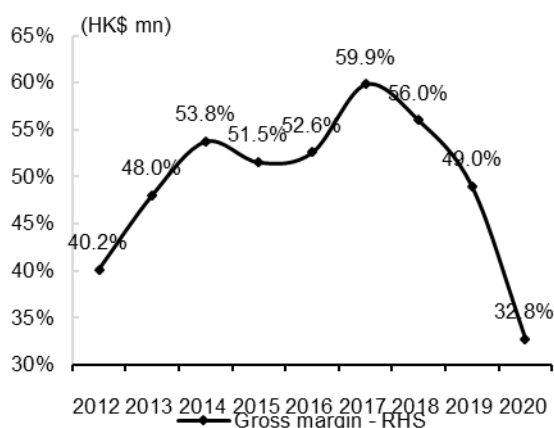
Note: Revenue mix estimate before government royalty, windfall levy and government take (at working interest production)

### Gross profit to expand at much faster pace

UEG had realized gross profit margin in the range of 40.2-59.9% in 2012-2019 on the back of excellent operating efficiency and cost control. In 2020, Gross profit margin was squeezed to 32.8% due to oil and gas prices tumble caused by impacts of the pandemic. UEG's gross profit margin rebounded strongly to 43.5% in 1H21, and we expect the good momentum to continue in 2H21E. We expect UEG's gross profit margin to improve gradually as overall output increases, which will lead to much faster gross profit CARG in

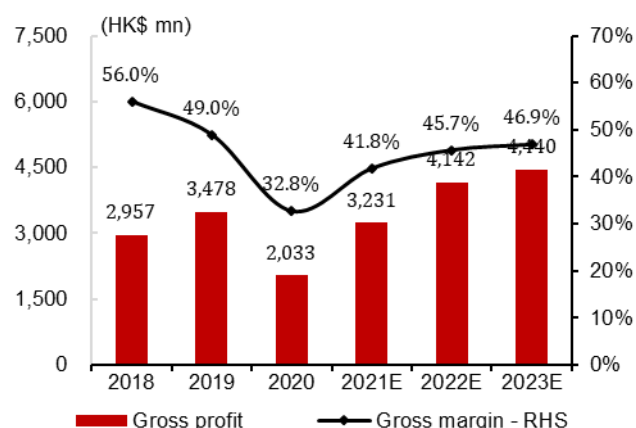
2020-23E at 31.8%. We project UEG's gross profit to increase to HK\$3.38/4.33/4.66bn respectively in 2021-23E.

**Figure 34: UEG's GPM trend in 2012-2020**



Source: Company data, CMBIS estimates

**Figure 35: Gross profit vs. Gross profit margin**



Source: Company data, CMBIS estimates

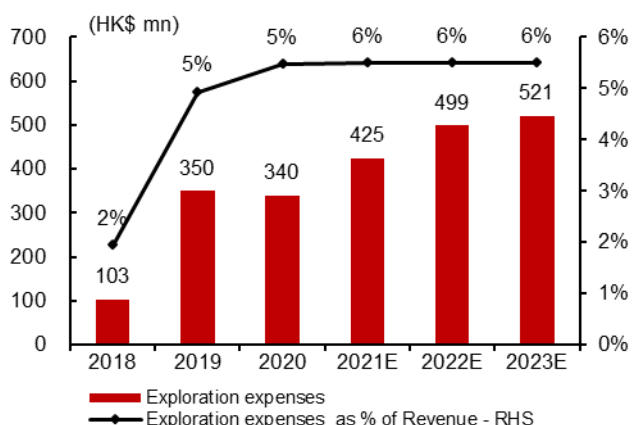
### Key OPEXs to be in well control

UEG has two major items in operating expenses, namely exploration expenses and administrative expenses.

Exploration expenses include performance of geological and geophysical studies, surface use rights & wells and the written off losses from non-performing wells. The expenses was a bit fluctuated based on the progress of exploration activities, and accounted for 2.0-5.5% of total revenue in 2018-20. We expect UEG to maintain steady pace in exploration expenses and project the expenses to revenue ratio to stay flat at 5.5% in 2021-23E.

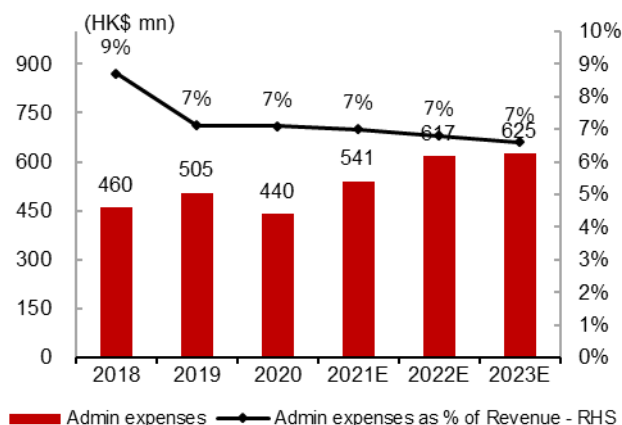
Administrative expenses accounted for 7.1-8.7% of total revenue in 2018-20. As the Company adopted strict control on administrative expenses, we expect the ratio to decline gradually with improving operating leverage and output growth in Block 9.

**Figure 36: Exploration expenses**



Source: Company data, CMBIS estimates

**Figure 37: Administrative expenses**



Source: Company data, CMBIS estimates

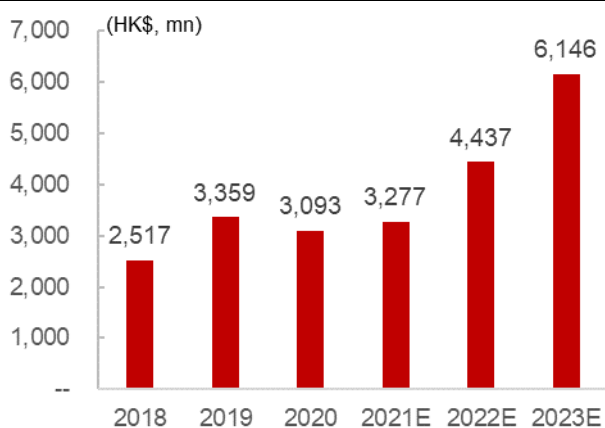
## Financial expenses to reduce on strong cash flow and profitability

UEG increased total borrowings (borrowings and leasing liabilities) to HK\$4.8bn in 2019 for the KEC acquisition. Total borrowings increased by HK\$847mn in 2020, as the Company invested in Block 9, spent some working capital to boost output and maintained dividend payout in a year with poor prosperity. In 2021E, on the back of oil and gas prices rebound and sales volume growth, we expect operating cash flow to boost to HK\$3.86bn, enough to cover UEG's US\$390-420mn CAPEX guidance. We think cash flow performance will strengthen in the coming few years, and that will leave room for the Company to reduce overall financial costs or to pay down borrowings' level.

## Net profit to surge with 44.0% CAGR in 2020-23E

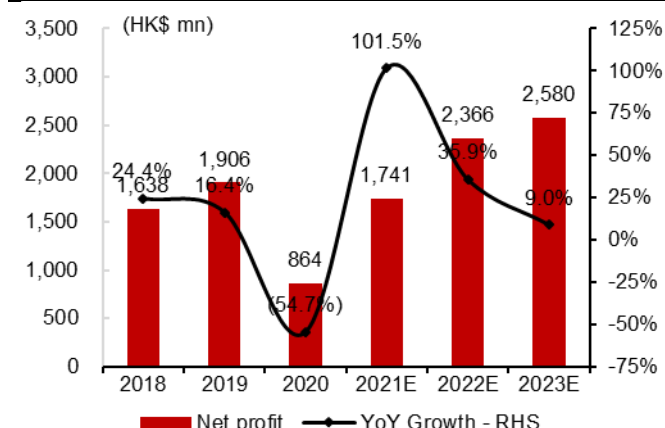
UEG's net profit experienced a sharp decline in 2020 due to extreme oil and gas prices movement under the impacts of the pandemic. The Company managed to sustain positive bottom line at HK\$864mn in 2020 on successful cost reduction measures. Following oil and gas prices rebound, UEG realized strong 1H21 earnings of HK\$959mn, exceeding that of FY20. We believe the good earnings momentum will continue in 2H21E and in 2022-23E on the back of UEG's production growth strategy in Block 9 and strict cost control measures. We expect 2021-23E net profit to be HK\$1,741/2,366/2,580mn respectively, reflecting a net profit CAGR of 44.0% in 2020-23E.

**Figure 38: Based on stable borrowings outlook, we expect UEG to generate sufficient cash to pay down debt and sustain increasing dividend distribution**



Source: Company data, CMBIS estimates

**Figure 39: Net profit to surge with 44% CAGR in 2020-23E**



Source: Company data, CMBIS estimates

## Valuation

### Initiate BUY with TP of HK\$1.70

UEG has no direct peers as it is an independent oil and gas company in the HKEX. The close comparable in HKEX are those National Oil Companies (NOC), oil field services and equipment suppliers. Extending the universe to the US market, some IOCs could be close fit, but those Company are mostly working in the developed markets (such as US and Canada), struggling with high development cost, and facing earnings squeeze.

We believe UEG stands out for 1) successful low costs development strategy; 2) prudent financial management; and 3) realizing earnings growth with high visibility. We think UEG offers a unique investment angle on oil and gas development in reputable emerging markets, through mature management and stable growth strategy.

**We use 18.8x FY22E PE multiple to derive a TP of HK\$1.70. The PE multiple is based on 5-year average PE of UEG. Our TP implies 58.5% upside. Initiate UEG with BUY recommendation.**

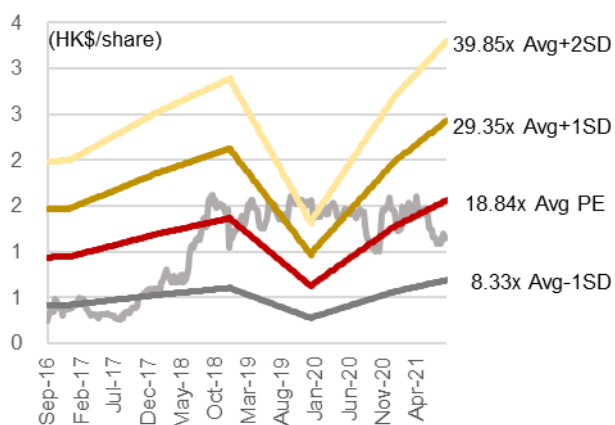
Figure 40: Peers' valuation

Company	Ticker	PX (Local currency)	Mkt cap (US\$m)	EPS					21-23E CAGR	PER			PBR		
				20A	21E	22E	23E	FY0		FY1	FY2	FY0	FY1	FY2	
CONOCOPHILLIPS	COP US	55.73	74,627	(2.51)	4.80	4.98	4.91	1.1%	38.0	11.6	11.2	1.69	1.63	1.55	
ENI SPA-ADR	E US	24.86	44,818	(0.42)	1.70	2.11	2.20	13.9%	N/A	12.4	10.0	1.20	0.97	0.95	
CAN NATURAL RES	CNQ US	33.44	39,670	(0.42)	4.99	5.08	4.36	-6.5%	N/A	8.5	8.4	N/A	1.38	1.36	
PIONEER NATURAL	PXD US	151.08	36,857	(1.21)	12.22	18.59	17.87	20.9%	27.5	12.4	8.1	1.63	1.49	1.33	
OCCIDENTAL PETE	OXY US	24.98	23,325	(17.06)	1.25	1.15	0.52	-35.2%	N/A	20.0	21.8	2.75	1.80	1.73	
DEVON ENERGY CO	DVN US	28.07	19,003	(7.12)	2.81	3.88	3.73	15.3%	21.3	10.0	7.2	2.26	3.04	1.94	
OMV AG-ADR	OMV KY US	56.17	18,383	4.59	7.03	6.64	N/A	20.3%	12.2	6.8	7.2	N/A	N/A	N/A	
CONTL RES INC/OK	CLR US	38.59	14,184	(1.65)	3.95	3.57	3.26	-9.1%	29.7	9.8	10.8	2.15	1.84	1.61	
APA CORP	APA US	18.69	7,065	(12.86)	3.23	2.90	2.41	-13.6%	13.0	5.8	6.5	N/A	N/A	9.56	
CHESAPEAKE ENERG	CHK US	59.54	5,852	(998.26)	7.38	6.53	7.32	-0.4%	26.4	8.1	9.1	1.71	N/A	N/A	
CALIFORNIA RESOU	CRC US	39.33	3,220	35.68	4.74	4.73	4.86	1.3%	62.1	8.3	8.3	3.67	N/A	N/A	
YPF SA-ADR	YPF US	5.15	2,026	(10.34)	(39.06)	106.94	86.53	-19.1%*	N/A	N/A	4.7	N/A	0.29	0.30	
<b>Oversea peers' average</b>									<b>27.5</b>	<b>10.2</b>	<b>9.7</b>	<b>2.2</b>	<b>1.8</b>	<b>2.6</b>	
PETROCHINA-H	857 HK	3.57	147,751	0.10	0.46	0.39	0.35	-11.9%	5.3	6.5	7.6	0.4	0.4	0.4	
SINOPEC CORP-H	386 HK	3.91	82,490	0.27	0.58	0.55	0.54	-3.6%	4.1	5.6	5.9	0.5	0.5	0.5	
CNOOC	883 HK	8.33	47,693	0.56	1.52	1.59	1.58	1.9%	6.4	4.5	4.3	0.7	0.7	0.6	
UNITED ENERGY GP	467 HK	1.06	3,616	0.03	0.07	0.09	0.10	21.7%	32.1	16.0	11.8	2.0	1.9	1.8	
SHANDONG XINCH-A	600777 CH	2.70	2,845	(0.39)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.5	N/A	N/A	
GEO-JADE PETRO-A	600759 CH	3.33	1,168	0.08	N/A	N/A	N/A	N/A	19.1	N/A	N/A	1.4	N/A	N/A	
ANTON OILFIELD	3337 HK	0.44	172	(0.03)	0.04	0.07	0.09	50.0%	N/A	9.1	5.6	0.4	0.4	0.4	
HILONG HOLDING	1623 HK	0.21	46	(0.18)	0.01	0.06	0.07	164.6%	N/A	17.4	2.9	0.1	0.1	0.1	
HONGHUA GROUP	196 HK	0.23	159	0.01	0.03	0.04	0.06	41.4%	N/A	6.4	4.8	0.2	N/A	N/A	
<b>China &amp; HK peers' average</b>									<b>13.4</b>	<b>9.4</b>	<b>6.1</b>	<b>0.8</b>	<b>0.7</b>	<b>0.6</b>	
<b>Average</b>									<b>22.9</b>	<b>10.0</b>	<b>8.2</b>	<b>1.4</b>	<b>1.2</b>	<b>1.6</b>	

Source: Bloomberg, CMBIS

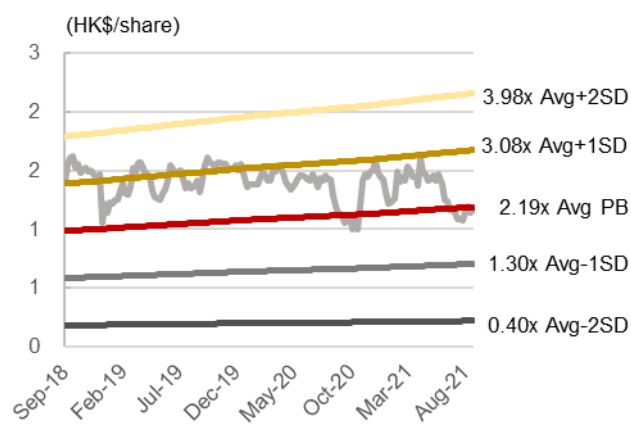


**Figure 41: 12M forward P/E band**



Source: Bloomberg, CMBIS

**Figure 42: 12M forward P/B band**



Source: Bloomberg, CMBIS

## Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (HK\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (HK\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>7,104</b>	<b>6,204</b>	<b>7,731</b>	<b>9,067</b>	<b>9,472</b>	<b>Profit after tax</b>	<b>1,906</b>	<b>864</b>	<b>1,741</b>	<b>2,366</b>	<b>2,580</b>
<b>Cost of Revenue</b>	(3,626)	(4,171)	(4,499)	(4,925)	(5,033)	D&A	2,568	2,835	2,771	3,032	3,290
<b>Gross profit</b>	<b>3,478</b>	<b>2,033</b>	<b>3,231</b>	<b>4,142</b>	<b>4,440</b>	Change in working capital	(781)	(1,990)	(656)	(603)	(186)
<b>Operating expenses</b>	<b>(745)</b>	<b>(724)</b>	<b>(974)</b>	<b>(1,129)</b>	<b>(1,160)</b>	Others	319	201	7	7	7
Investment and other income	146	75	77	91	95	<b>Operating cash flow</b>	<b>4,012</b>	<b>1,910</b>	<b>3,863</b>	<b>4,803</b>	<b>5,691</b>
Other gains and losses	328	79	4	5	5	CAPEX	(6,513)	(2,004)	(3,298)	(2,838)	(2,795)
Impairment loss for trade & other receivables	(68)	(3)	4	--	--	Others	(466)	(177)	(114)	(100)	(30)
Exploration expenses	(350)	(340)	(425)	(499)	(521)	<b>Investing cash flow</b>	<b>(6,979)</b>	<b>(2,181)</b>	<b>(3,413)</b>	<b>(2,938)</b>	<b>(2,825)</b>
Administrative expenses	(505)	(440)	(541)	(617)	(625)	Changes in borrowings	3,88	(477)	614	188	188
Other operating expenses	(295)	(96)	(93)	(109)	(114)	Dividends paid	(1,050)	(619)	(1,051)	(1,420)	(1,548)
<b>Operating profit</b>	<b>1,989</b>	<b>584</b>	<b>1,283</b>	<b>1,884</b>	<b>2,119</b>	Others	756	1,002	171	527	203
Finance Cost	(441)	(313)	(280)	(293)	(305)	<b>Financing cash flow</b>	<b>3,589</b>	<b>(94)</b>	<b>(266)</b>	<b>(705)</b>	<b>(1,157)</b>
Share of losses of associates	(34)	31	90	90	90	Net change in cash	622	(365)	184	1,160	1,708
<b>Profit before tax</b>	<b>2,258</b>	<b>1,027</b>	<b>2,068</b>	<b>2,811</b>	<b>3,064</b>	Cash at the beginning	2,51	3,35	3,09	3,27	4,43
Income tax expense	(352)	(163)	(327)	(444)	(484)	FX change, net	220	99	--	--	--
<b>Profit for the year from</b>	<b>1,906</b>	<b>864</b>	<b>1,741</b>	<b>2,366</b>	<b>2,580</b>	<b>Cash at the end</b>	<b>3,359</b>	<b>3,093</b>	<b>3,277</b>	<b>4,437</b>	<b>6,146</b>
<b>Net profit</b>	<b>1,906</b>	<b>864</b>	<b>1,741</b>	<b>2,366</b>	<b>2,580</b>						

Balance sheet						Key ratios					
YE 31 Dec (HK\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Current assets</b>	<b>7,211</b>	<b>7,280</b>	<b>8,424</b>	<b>10,300</b>	<b>12,005</b>	<b>Sales growth (%)</b>	35%	-13%	25%	17%	4%
Bank and cash balances	3,359	3,093	3,277	4,437	6,146	<b>P&amp;L ratios (%)</b>					
Trade receivables	3,369	3,762	4,638	5,259	5,210	Operating margin	38.5	21.1	29.2	33.2	34.6
Inventories	325	331	387	453	474	Pre-tax margin	31.8	16.5	26.7	31.0	32.4
Other current assets	158	94	122	150	176	Net margin	26.8	13.9	22.5	26.1	27.2
<b>Non-current assets</b>	<b>18,532</b>	<b>17,661</b>	<b>18,317</b>	<b>18,237</b>	<b>17,776</b>	Effective tax rate	15.6	15.8	15.8	15.8	15.8
PPE	11,678	10,847	11,262	11,375	11,192	<b>Balance sheet ratios</b>					
Right-of-use assets	124	585	585	585	585	Current ratio (x)	1.1	1.4	1.5	1.8	2.1
Intangible assets	6,099	5,701	5,814	5,506	5,193	Quick ratio (x)	1.0	1.3	1.4	1.7	2.0
Other non-current assets	631	528	657	771	805	Payable turnover days	606	320	320	320	320
<b>Total assets</b>	<b>25,743</b>	<b>24,941</b>	<b>26,742</b>	<b>28,536</b>	<b>29,781</b>	Total debt / total equity ratio (%)	117	104	107	107	101
<b>Current liabilities</b>	<b>6,630</b>	<b>5,341</b>	<b>5,713</b>	<b>5,859</b>	<b>5,723</b>	Total Liabilities to Assets (%)	53.2	48.2	49.1	49.0	47.6
Borrowings (current)	352	1,370	1,494	1,556	1,619	Net Debt / EBITDA	0.3	0.6	0.5	0.3	0.1
Due to a director	2	0	0	0	0	<b>Returns (%)</b>					
Trade and bills payables	6,024	3,653	3,850	3,869	3,652	ROA	7.4	3.5	6.5	8.3	8.7
Other current liabilities	251	319	369	433	453	ROE	15.8	6.7	12.8	16.3	16.5
<b>Non-current liabilities</b>	<b>7,059</b>	<b>6,684</b>	<b>7,417</b>	<b>8,112</b>	<b>8,454</b>	<b>Per share</b>					
Borrowings	4,344	3,866	4,481	4,668	4,856	EPS (HK\$)	0.07	0.03	0.07	0.09	0.10
Employee retirement benefits obligations	34	36	--	--	--	DPS (HK\$)	0.04	0.02	0.04	0.05	0.06
Trade and other payables	--	--	--	--	--	BVPS (HK\$)	0.46	0.49	0.52	0.55	0.59
<b>Total equity</b>	<b>12,054</b>	<b>12,916</b>	<b>13,612</b>	<b>14,565</b>	<b>15,604</b>						
Shareholders' equity	12,037	12,907	13,603	14,557	15,595						
Non-controlling interests	18	9	9	9	9						

Source: Company data, CMBIS estimates

# Disclosures & Disclaimers

## Analyst Certification

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