

Shengli Oil & Gas Pipe

Cyclical play in 2013-14

to summarize...

- Share price was up by 7% after the result announcement on Monday Morning.
- Shengli record an overall growth in turnover and sales volume increased by 45% and 26% YoY
- Overall average gross profit per ton for SSAW dropped by 17% YoY to RMB231, along with increased portion of lower margin regional projects. Gross profit margin compressed by 1.9pp YoY to 48%.
- Positive outlook on the overall domestic welded steel pipe industry, we expect possible rebound of company performance in FY13F.

Result update. Shengli Oil & Gas Pipe (Shengli) released its annual result for 1H FY12/11A on Monday morning after the profit warning on 22 June 2012. Turnover increased by 45% YoY to RMB617.4m, while net profit increased by 2% YoY to RMB12.5m, of which included fair value gains of derivative financial instrument of RMB18m as compared to previous period gain of RMB1.3m. The adjusted loss before tax for 1H FY12/12A was RMB2.0m as compared to previous profit before tax of RMB16.9m. Excluding the fair value gain and interest income, the core adjusted net loss increased by 4.2x YoY to RMB29.8m. Impacted by increase in sales portion to regional projects and unfavorable operating environment during 2H 11A, the ASP of the company's products were continues under pressure, SSAW's gross profit per tonne dropped by 17% YoY to RMB231, while gross profit margin dropped by 1.9pp YoY to 4.8%. The pre-adjusted net profit margin dropped by 0.85pp YoY to 2.0%.

In terms of operational result, total sales volume of SSAW increased by 26% YoY to 82,132 tonnes, of which 46.9% were for national projects and 53.1% were orders from regional pipeline projects. Pursuant to the management, the current undelivered orders are roughly 100,000 tonnes for 2H FY12/12F, which consists of the July contract announcement of 96,517 tonnes new order from China-Asia Natural Gas pipeline project with total contract price of RMB723.5m, (implied ASP of RMB7,496/t). The project is estimated to deliver in the 3Q FY12/12F.

Preliminary estimation for 2H FY12/12F result. As a result of the new order for the China-Asia Natural Gas pipeline project, the base case for the turnover will be the contract value of the project, which is RMB723.5m representing 117% of 1H FY12/12A result, 170% of 1H FY12/11A result and 52% of 2H FY12/11A, and adding up the 1H 12/12A result, total turnover represents 74% of previous annual turnover. Assume company produced similar amount of regional project as the 1H period of 43,600tonnes at average profit of RMB200/t, while the national project gives a higher margin at RMB700/t, the implied total gross profit for 2H would be RMB76.3m as compared to RMB29.5m for 1H and RMB114m for 2H FY12/11A. We believe this is an conservative preview for the Shengli, as we expect the orders book will continue to improve as the commencement of major national pipeline projects from Sinopec (386 HK) and PetroChina (857 HK).

Company overview. Shengli is the one of four authorized SSAW pipe producer in national pipe projects in China. Their current production capacity of 1,150k tonnes denoted roughly 33% of market share. Domestic demand for SSAW steel pipe products are mainly driven by the development pipeline network, while the development of domestic network is highly replied on the central government policy and guidance which directly affects the overall capital expenditure of the industry. Being the pure domestic player, Shengli's performance is highly correlated to the national pipeline development. As the commencement of the next national capital expenditure up-cycle coming ahead, we are bullish the welded pipe sector, while we believe Shengli has the ability to catch the rapid growth and rebound of the industry for the next three years.

Ticker	1080 HK
Rating	Not Rated
Price (HK\$)	0.6
Target Price (HK\$)	-
12m Price Range (HK\$)	0.5-1.2
Market cap. (US\$m)	190.8
Daily t/o (US\$m)	0.2
Free float (%)	48.2

Financial summary

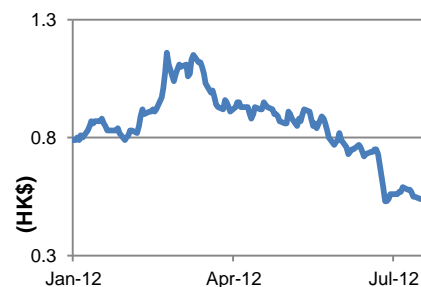
Year to Dec	09A	10A	11A
Turnover (RMBm)	2,999.1	1,126.9	1,821.8
Net Profit (RMBm)	335.9	89.2	93.8
EPS (RMB)	31.01	3.59	3.77
P/E (x)	3.6	13.8	13.0
P/B (x)	0.7	0.6	0.6
EV/EBITDA (x)	1.3	26.3	12.2
Yield (%)	-	-	-
ROE (%)	21	5	4
ROCE (%)	5	0	3
N. Gear. (%)	N.Cash	N.Cash	14

Source: SBI E2-Capital

	12F	13F	14F
Consensus EPS (RMB)	0.0	0.1	-
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	10.6	(36.5)	(39.7)
Actual price changes (%)	13.2	(32.6)	(37.5)



Source: Bloomberg

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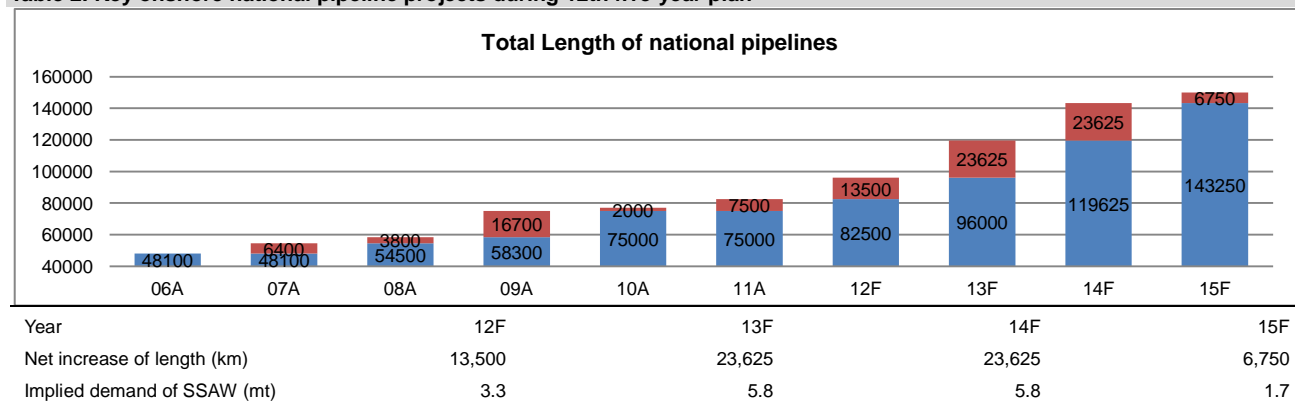
Our view and valuation. As the commencement of few national pipe projects in near term, we believe Shengli has the potential to catch the next industry growth, because of being one of the four approved suppliers of SSAW pipe in China, while SSAW dominates 70% of national steel pipes use. Company current P/E, trailing P/E and consensus 12F P/E, and 13F P/E are trading at 15.9x, 15.8x, 20.5x, and 8.9x respectively. Table below illustrates key result comparison between Shengli (1080 HK) and Chu Kong (1938 HK) for 1H FY12/12A.

Table 1. Key financial and operational performance comparison

RMBm	Chu Kong (1938 HK)			Shengli		
	1H FY12/12A	YoY	HoH	1H FY12/12A	YoY	HoH
Turnover	2,057.52	26%	18%	617.4	45%	-56%
Gross Profit	354.98	32%	48%	29.5	4%	-47%
Net Profit	170.34	50%	45%	12.5	2%	-85%
Gross Margin	17.3%	0.73pp	3.46pp	4.8%	-1.90pp	-3.47pp
Net Margin	8.3%	1.35pp	1.54pp	2.0%	-0.85pp	-3.81pp
Adjustments for Non operating result:						
Interest Income	3.2	-21%		27.9	23%	13%
Fair value gain on financial Instrument				18.0	12.9x	-13%
Government subsidy	51.2	11.8x				
Adjusted core net profit/loss before tax	153.8	17%		-29.8	4.3x	n.a.
Gross profit/ ton (RMB)	1,474			231	-17.3%	
Sales Volume	230,000 (LSAW)			82,000 (SSAW)	26%	
Market Capital (HK\$m)	2,320.0			1,488.3		
	11A	12m Trailing	12F	11A	12m Trailing	12F
P/E ratio	7.4x	5.9x	6.1x	15.9x	15.8x	20.5x

Source: Shengli, CKPNG, SBI E2-Capital

National pipeline expansion hypothesis. Pursuant to the 12th five-year plan, it was set to increase the total length of PRC national pipeline by 95% to 150,000km. By end of 2011, the total national length was 82,500km representing a short of 67,500km. If we assume that 1km of steel pipeline requires 350/t of steel pipe while 70% of national pipeline is formed by SSAW steel pipe, total demand steel pipe of national pipe for the SSAW in 12th Five-year plan will be 5.9m tonnes. Meanwhile, we expect the development of regional and city gas pipeline network will increase correspondingly to cope with development of the national pipe network with some time lag. Table 2 illustrated our forecast changes of the total length of national pipeline during the 12th five-year plan.

Table 2. Key onshore national pipeline projects during 12th five-year plan

Source: Shengli, SBI E2-Capital

Table 4. Financial Result

RMBm	FY12/11A	1H FY12/11A	2H FY12/11A	1H FY12/11A
Turnover	1,821.84	617.43	1,396.11	425.72
COGS	(1,678.44)	(587.98)	(1,281.10)	(397.34)
Cross profit	143.40	29.46	115.01	28.39
Other income	96.25	58.04	61.82	34.43
S&D expenses	(42.15)	(9.59)	(34.06)	(8.09)
Admin expenses	(54.21)	(34.60)	(29.31)	(24.90)
Other expenses	(3.08)	(4.97)	2.80	(5.87)
Operating profit	140.22	38.34	116.25	23.96
Finance costs	(20.18)	(18.44)	(15.87)	(4.31)
Share of loss of a JV	(0.79)	(0.07)	(0.79)	
Share of loss of an associate	(3.75)	(3.81)	(2.30)	(1.45)
Net profit before tax	115.50	16.02	97.30	18.20
Tax expenses	(23.58)	(6.20)	(17.61)	(5.97)
Total profit	91.92	9.82	79.69	12.23
Net profit	93.78	12.52	81.55	12.23

Source: SBI E2-Capital

Table 5. Balance sheet items

RMBm	FY12/09A	FY12/10A	FY12/11A	1H FY12/12A
PPE	230.7	336.8	710.1	738.8
Prepaid land lease payments	17.1	49.5	60.7	91.8
Goodwill	2.5	2.5	9.9	9.9
Available for sale investment				15.0
Investment in a JV			17.2	17.1
Investment in an associate		247.0	243.3	239.4
Derivative financial instrument		53.0	75.0	93.0
Deferred tax assets			9.0	10.4
Other assets			1.3	39.7
Total non-current assets	250.3	688.8	1,126.6	1,255.2
Inventories	255.6	392.7	176.1	350.9
Trade and bills receivables	489.0	685.9	465.5	701.1
Prepayments, deposits and other receivables		113.3	211.0	184.1
Loan receivable		300.0	100.0	180.0
Available for sale investment		4.8		
Prepaid land lease payments	0.4	1.1	1.0	1.4
Pledged deposits		36.2	87.3	115.4
Cash and cash equivalents	1,168.3	381.8	357.0	376.7
Other current assets	4.4			
Total current assets	1,917.6	1,915.9	1,397.8	1,909.6
Trade payables	350.0	68.4	95.0	72.0
Other payables and accruals		47.8	135.9	133.7
Interest-bearing bank loans	87.1		631.8	730.5
Tax payable		8.3	15.8	7.5
Deferred income			0.3	0.9
Dividend payable				23.3
Total Current liabilities	437.1	124.5	878.8	967.8
Deferred income			12.0	10.3
Deferred tax liabilities	0.5	0.5	5.9	10.4
Total non-current liabilities	0.5	0.5	17.9	20.7
Issued capital	211.7	219.6	218.8	218.8
Reserves	1,518.8	1,742.1	1,809.2	1,802.3
MI			117.9	155.2
Total Equity	1,730.4	1,961.7	2,145.8	2,176.3

Source: SBI E2-Capital

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