

NewOcean Energy Holdings Ltd.

Growing from market consolidation

to summarize...

- NOE is the biggest LPG importer and exporter in China.
- NOE is growing from market consolidation benefiting from its efficient operation Chain and management
- Gross profit increased 105.3% YoY due to the lower international LPG price for 1H FY12/09A.
- Leveraging the facility in Zhuhai to develop the higher margin LPG business in HK and Macau. And it is expected to bring significant profit contribution.
- Expanding Zhuhai Terminal to have throughput capability of 1.6m tons a year, which is expected to complete at the end of 2010.
- The capex for 2010 would be around HK\$157.0m, which could be funded by NOE's own funds.
- NoE would still keep its electronic business as a profit contributor, however, it is possible to be disposed in the future.
- The counter is currently trading at 60.8% discount with 9.1x FY12/10F P/E based on our back of pad estimate.

Company Background. NewOcean Energy (NOE) is mainly engaged in sale and distribution Liquefied Petroleum Gas (LPG) to south China, Hong Kong, Macau, Vietnam and Thailand. NOE starts its LPG business in by acquiring a Daqing based LPG sales and distribution company in 2000. NOE is now the biggest LPG importer and exporter in P.R.C.. Its Zhuhai terminals could accomplish a throughput volume of more than 1m tons annually. In 2008, it imported 25.2% of China's total import volume and export 38.2% of China's total export volume.

LPG is a cleaning alternative fuel. LPG is obtained as a by product when refining crude oil or natural gas and is primarily composed of propane and butane with smaller amounts of propylene and butylenes. LPG has the advantage of: 1) more environmental friendly. When LPG is burnt it produces the cleanest emissions of all oil-based products, with a low carbon dioxide output. LPG emitting 19% less CO2 per kWh than oil, 30% less than coal and more than 50% less than coal-generated electricity distributed via the grid. 2) being stored easily as a liquid as it has property of turning from gas to liquid at atmospheric temperature if moderately compressed. It is 250 times denser as a liquid and hence a lot can be stored in a relatively small container. This characteristic of LPG makes it more flexible in usage than Liquefied Natural Gas (LNG). LPG could also be turned back into gas simply by relieving the pressure. 3) wide varieties of use. LPG could be used for home heating, refrigeration, air-conditioning, automobile, the industrial manufacture of paper, textiles, glass and heavy ceramics and etc.

NOE's operation model for LPG business. For LPG resources, NOE imports from leading international LPG suppliers including Geogas, Statoil, Total, Glencore, Vitol, Naftomar and Perdec. In 2008, NOE imported 662,000 tons of LPG, accounting for 83.3% of NOE's total sales volume and 25.2% of China's total import volume. The remaining LPG was purchased domestically with Sinopec Maoming branch, Sinopec Guangzhou branch, Sinopec Hunan Changling, Sinopec Hubei Jingmen branch and etc. NOE then sale and distribute LPG domestically and overseas:

- overseas wholesale. NOE export 260,000 tons of LPG to Hongkong, Macau, Vietnam, Thailand and Taiwan, which accounted for about 32.7% of NOE's total sales volume and 38.2% of China's total export volume in 2008. The selling price is normally linked with the international LPG price.
- domestic wholesale. The sales are mainly for Guangdong Province. The key

Ticker	342 HK
Rating	Not Rated
Price (HK\$)	0.93
Target Price (HK\$)	N.A.
12m Price Range (HK\$)	0.21-1.19
Market cap. (US\$m)	157.5
Daily t/o (US\$m)	1.6
Free float (%)	53.7

Financial summary

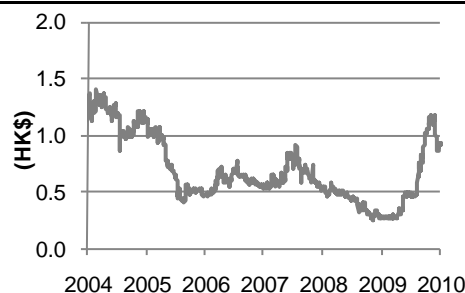
Year to Dec	06A	07A	08A
Turnover (HK\$m)	2,384.8	3,890.2	6,158.6
Net Profit (HK\$m)	38.4	50.5	52.9
EPS (HK\$)	0.040	0.052	0.055
P/E (x)	23.3	17.8	16.9
P/B (x)	2.01	1.75	1.25
EV/EBITDA (x)	13.7	11.1	7.5
Yield (%)	0.6	0.5	0.6
ROE (%)	9.2	10.5	8.6
ROCE (%)	8.5	3.0	3.2
N. Gear. (%)	35.5	78.1	75.7

Source: company data

	09F	10F	11F
Consensus EPS (HK\$)	0.095	0.125	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-7.1	-14.6	+140.5
Actual price changes (%)	-6.1	-11.4	+272.0



Source: Bloomberg

Research Team

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wholesale clients include Lianxin (the auto-gas operator in Guangzhou), Guangzhou SHV, Zhuhai Gas, Puning Zhonghong and etc. The selling price is normally linked with domestic LPG price.

- retail business. NewOcean development, 75%-owned subsidiary, owns all subsidiary involving in retail business. The company currently owns 250 retail sales points in Guangdong province and Guangxi province.

Development history of NOE's LPG business. The company started its LPG operation by acquiring Well Jade, a LPG operation company based in Daqing in 2000. Afterwards, NOE has aggressively expanded its LPG business by acquisition and self development. In FY12/03A, the sale of LPG was HK\$428.7m with sales volume of 130,000 tonnes. In 2004, the acquisition of Zhuhai terminal strongly improved NOE's LPG distribution handling capability. The sales of LPG increased 56.5% CAGR to HK\$5,702.3 with sales volume up 32.2% CAGR to 795,000 from 2004 to 2008.

Table 1. M&A record

Acquisition	Date	Acquired %	Description	Amt (HK\$m)	Remark
Well Jade	Nov-00	70%	Wholesale and retail of LPG in P.R.C.	50.0	Sale and distribution LPG in P.R.C, owns 55% of Daqing Longyou
Environmental energy	Oct-01	100%	Sales and distribution of LPG in GX	10.0	Operate LPG business in Guangxi Province
Bai Fu Yang	Dec-02	100%	LPG bottled cylinders business	24.5	Owns 30 sales points in Guangdong province
Zhuhai LPG company	Mar-04	100%	Manufacture, process and sales of LGP	140.0	Owns Zhuhai sea terminal
Yong Long Gas	Jan-05	80%	LPG bottled cylinders business	31.7	Owns 20 sales points in Guangdong province
Shenzhen Baorun	Dec-05	80%	Sales and distribution LPG	21.2	Access to distribution network in Shenzhen
Menghua LPG	Jan-07	51%	Wholesale and retail of LPG in GD	15.4	39 LPG tankers and deliver trucks
Sanyang LPG	Jun-08	100%	Wholesale and retail of LPG in GD	31.4	Access to the distribution network in Maoming

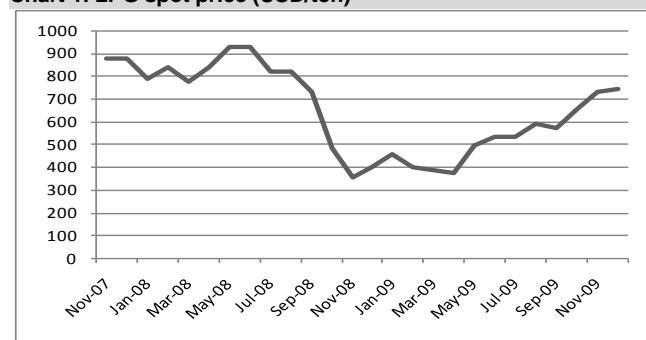
Source: Company data

Current LPG Market outlook. Domestic LPG distribution is a slim margin business because: 1) increasing domestic refiners. 2) the government price control; 3) the low entry barrier lead to vicious price competition. China Gas (384 HK) sold 435,900 tons in 1H FY03/10A but still report an operating loss of 2.4m. Towngas (1083 HK) announced to dispose its LPG distribution business in China in April 2009. BP China also sold its Ningbo BP LPG business in August 2009 and has potential to further sell its other LPG business.

Growing quickly at the expenses of weak players. Thanks for the efficient operation chain and good management, NOE's LPG business has been always in the money. It always keeps a low inventory with inventory turnover day of only around 8 days. The company has been growing quickly by actively consolidating weak players and keeping self-expansion. It also successfully made the acquired company from making loss to making profit.

NOE's profit surged from low International LPG price. For 1H FY12/09A, the LPG wholesales business increased only 6.0% YoY to HK\$2,411.4m with the sales volume up 30.9% YoY to 397,000 tons because of 19.0% YoY ASP drop to HK\$6074.1 (US\$778.7) per ton. The LPG retail business decreased 30.4% YoY to HK\$359.4m with the sales volume up 10.8% YoY to 103,000 tons because of 37.4% YoY ASP drop to HK\$3489.7 (US\$447.4) per ton. The sales of electronic product increased 108.6% YoY to HK\$376.1m. However, the gross profit increased 105.3% YoY to HK\$168.4m because the gross margin widened 2.6 pcp YoY to 5.4% benefiting from the lower international LPG purchase price. The net profit increased 36.9% YoY to HK\$40.7m affecting by less exchange gains.

Chart 1. LPG spot price (USD/ton)



Source: Bloomberg

HK and Macau business will greatly improve the profitability.

According to our channel check, lately, the LPG retail price is HK\$17.38/kg in HK, HK\$11.48/kg in Macau, and HK\$6.61/kg in Zhuhai, Guangdong province. The high HK selling price is due to: 1) the high operation expenses in HK because current major players use the terminals in HK and do the LPG processing work in HK as well. 2) the higher affordability of HK residence. 3) less competitive market. Comparing to HK, Macau players are outsourcing the facility in Zhuhai, which lower the expenses and hence the selling price. NOE is now actively exploring its bottle LPG business in HK and Macau by taking its advantage in: 1) location advantage of zhuhai terminal as it is very close to HK and Macau; 2) the cheaper operation expenses comparing to the existing players; 3) bonded warehouse; 4) scalability; 5) operating facility in HK. According to our talk with the management, the sales in Macau would be expected to start from February 2010 with daily sales volume of 40 tons and in HK from May 2010 with daily sales volume of 30 tons. It is expected that the sales volume could reach 7,300 tons in HK and 13,383 in Macau in 2010. We estimate that the net profit contribution from HK and Macau market would be around HK\$20.9m for FY12/10F. Going forward, NOE will have a high growth in HK and Macau, we estimate that they could make net profit of HK\$43.0m for FY12/11F and 51.8m for FY12/12F by keeping 30.0% daily volume growth for FY12/11F and 20.0% for FY12/12F.

Table 2. Hong Kong and Macau profit projection

	10F		11F				12F			
	HK	Macau	HK	%	Macau	%	HK	%	Macau	%
Sales volume (Tons/year)	7,300	13,383	14,235	95.0	18,980	41.8	17,082	20.0	22,776	20.0
Gross profit per ton (HK\$)	3231.0	1217.5	3231.0		1217.5		3231.0		1217.5	
Total gross profit(HK\$m)	23.6	16.3	46.0	95.0	23.1	41.8	55.2	20.0	27.7	20.0
Operating expenses(HK\$m)	10.0	5.0	12.0	20.0	6.0	20.0	14.2	18.0	7.1	18.0
Operating profit(HK\$m)	13.6	11.3	34.0	150.2	17.1	51.5	41.0	20.7	20.6	20.7
Taxation(HK\$m)	2.2	1.8	5.4	150.2	2.7	51.5	6.6	20.7	3.3	20.7
Net profit(HK\$m)	11.4	9.5	28.6	150.2	14.4	51.5	34.5	20.7	17.3	20.7

Source: SBI E2 Capital

Expansion of Zhuhai Terminal. Zhuhai Terminal is now the biggest LPG importing terminal in China. NOE is building two more berths in its Zhuhai Terminal to increase its throughput capability from current 1m tons per year to 1.6m tons per year. The construction is expected to be completed by the end of 2010. By leveraging the scalability, the new berths are expected to help the company save US\$4 per ton in import and US\$2 per ton in export. If we assume that the import of the company could increase 20% annually to 953,000 tons and export could increase 15% annually to 343,850 tons in from 2008 to 2011, the new berths would expect to contribute HK\$36.6m for profit in 2011.

Capex Plan. The company plans to invest about HK\$157.0m for berths construction in Zhuhai Terminal, developing bottled LPG business in Hong Kong and Macau and M&A for the LPG business companies with potential of improving the margin level of NOE. Currently, the company has sufficient funding for its development. In August 2009, NOE sold 25% of one of its subsidiary NewOcean development, which mainly engaged in LPG retail business, for HK\$100.0 for supporting its development in HK and Macau. In December 2009, the company raised HK\$189.0m by issue new shares, which would be used for support the new development of the company.

Electronic business would be disposed in the future. NOE's electronic business is selling mobile phone and other electronic component in China and some other countries in Asia. NOE's electronic business accounted for 12.0% of its total revenue for 1H FY12/09A. The sales of electronic business increased 108.6% YoY to HK\$376.1m with operating profit contribution of HK\$26.9m. NOE will still keep the electronic business as a profit contributor for the company, however, there are also potential that the company will dispose this business in the future.

Corporate governance. MR. Shum Siu Hung, the chairman of the company, has over 20 years experience in international trading and investment in project in China. He is now holding 42.5% of the total share of the company. Mr. Shum Chun, Lawrence, the son of the chairman, is the executive director and managing director of the company holding 3.9% of the total share. He is now actively in charged the operation of the company.

Risks. 1) International LPG price increased substantially; 2) unfavorable government regulation and policy relating to operating LPG business in mainland China, Hong Kong, Macau and other Asia countries; 3) market competition.

Valuation. With a conservative view on domestic LPG margin for FY12/10F, our back of pad estimate comes out a total net profit of HK\$118.5m net profit for FY12/10F. The Hong Kong listed city gas operator is currently trading at average of 23.2x FY12/10F P/E based on market consensus. NOE is currently trading at 9.1x FY12/10F P/E based on our estimate, which is 60.8% discount to its peers. In our view, the higher valuation of its peers may be for their more diversified business in city gas operation and the better overall margin.

Table 3. Hong Kong listed Peers comparison

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
China Gas	384	1,842.9	4.28	120.2	28.7	20.5	3.9	3.3
Xinao Gas	2688	2,941.8	21.85	27.1	24.0	19.5	4.3	15.8
Towngas China	1083	1,001.2	3.49	29.7	27.1	21.0	1.1	3.4
China Resource Gas	1193	2,478.1	11.96	24.9	49.2	31.9	9.5	8.6
Average				50.5	32.3	23.2		

Source: Bloomberg

Table 4. P & L

Year to Dec (HK\$m)	06A	07A	08A	1H08A	1H09A
Turnover	2,384.8	3,890.2	6,158.6	2,972.1	3,147.0
Cost of sales	(2,261.6)	(3,719.2)	(5,931.2)	(2,890.1)	(2,978.6)
Gross profit	123.3	171.0	227.4	82.0	168.4
Othe operating income	35.3	90.3	163.7	133.5	18.5
Selling and distribution expenses	(28.4)	(58.1)	(99.1)	(42.1)	(31.7)
Administrative expenses	(44.2)	(74.2)	(85.6)	(85.2)	(42.2)
Other expenses	(10.0)	(23.3)	(6.5)	(11.0)	(13.6)
Profit from Operation	75.9	105.7	200.0	77.2	99.5
Finance costs	(37.3)	(53.7)	(145.5)	(45.7)	(32.6)
Share of results of a jointly controlled entity	(0.4)	0.6	(0.4)	(0.4)	(2.4)
Profit before taxation	38.2	52.6	54.1	31.2	64.5
Taxation	0.2	(2.1)	(1.2)	(1.4)	(23.8)
Net profit	38.4	50.5	52.9	29.7	40.7

Source: Company data

Disclosure of interests: SBI E2-Capital Securities Limited acted as sub-placing agent for NewOcean Energy (stock code: 342) in December 2009.

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