

## NewOcean Energy

### Refueling station set to contribute

to summarize...

- First issue with reference target price at HK\$2.02
- FY12/10A results lower than our preliminary forecast
- Expect acquisition of Guangzhou LPG refueling stations to contribute
- Base on our estimates, currently trading at 7.0x P/E for FY12/11F
- Potential upside on additional cities to adopt LPG vehicles

**2010 results summary.** NewOcean Energy sources liquefied petroleum gas (LPG) overseas and domestically to meet industrial and retail demand in China. Revenue increased 30.8% YoY to HK\$8,478m for FY12/10A on higher ASP and volume. While the company mainly earns stable dollar margin instead of percentage margin, gross profit was up 13.0% YoY to HK\$446.8m in line with sales volume growth of 15.0% YoY in the period. Net profit increased 21.4% YoY to HK\$136.6m, which was lower than our previous estimates of preliminary estimates at HK\$147.3m net profit at HK\$174.7m comprehensive net income made last year. Table 1 and Table 2 show annual results between 2007 and 2010 and 6-months results over the past 2 years.

**Table 1. Annual results between 2007 and 2010**

| HK\$ m                | FY12/07A | FY12/08A | FY12/09A | FY12/10A |
|-----------------------|----------|----------|----------|----------|
| Revenue               | 3,890    | 6,159    | 6,483    | 8,478    |
| Gross profit          | 171.0    | 227.4    | 395.3    | 446.8    |
| Profit for the period | 50.5     | 52.9     | 112.5    | 136.6    |

**Table 2. Six months results between 2009 and 2010**

| HK\$ m                | 1H FY12/09A | 2H FY12/09A | 1H FY12/10A | 2H FY12/10A |
|-----------------------|-------------|-------------|-------------|-------------|
| Revenue               | 3,147       | 3,336       | 3,796       | 4,682       |
| Gross profit          | 168.4       | 226.9       | 172.8       | 274.0       |
| Profit for the period | 40.7        | 71.7        | 63.5        | 73.1        |

Source: SBI E2-Capital

**Special items as a result of operational arrangement.** Normally the company pledges RMB saving and borrows US\$ for paying imports with derivatives to reduce exposure to exchange rate. In 2010, there was other gain including net gain in foreign exchange of HK\$115.3m, a derivative loss with respect to financial instrument of HK\$82.1m as well as interest expenses on bank trust of HK\$41.0m, making a net expense of HK\$7.7m. Due to anticipation of fast RMB appreciation and hikes in interest rates, the company entered into contracts to reduce the impact by 1) increase US\$ borrowing to replace RMB borrowing; 2) increase medium term fixed rate borrowing and reduce short term floating rate borrowings. Therefore, the special items have limited net effect and we believe this is under normal business operations rather than speculation.

**Growth driver beyond 2010.** On Oct last year, the company entered into an agreement to acquire 17 auto gas refueling stations in Guangzhou at a total consideration of HK\$583m. As we have previously discussed, the pricing is attractive at 4.9x upon it reaches net profit of HK\$120m with the new pricing mechanism in Guangzhou since 2009. Beyond 2011, synergy would be seen as company's supply to the 17 stations should be raised from 100,000 tonnes to 220,000 tonnes, in our view. Given good proximity, LPG and CNG are reasonable replacement of gasoline / diesel especially in coastal area and west China respectively. We believe there are potentially additional cities in Guangdong to adopt LPG vehicles to reduce carbon emission.

| Ticker                 | 0342 HK   |
|------------------------|-----------|
| Rating                 | Not Rated |
| Price (HK\$)           | 1.67      |
| Target Price (HK\$)    | n.a.      |
| 12m Price Range (HK\$) | 1.05-1.95 |
| Market cap. (US\$m)    | 279.6     |
| Daily t/o (US\$m)      | 0.7       |
| Free float (%)         | 52.5      |

#### Financial summary

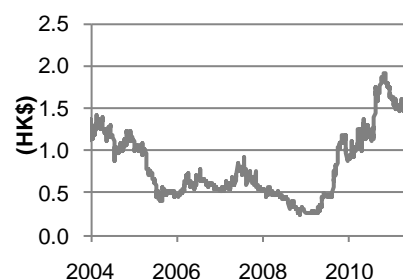
| Year to Dec       | 08A   | 09A   | 10A   |
|-------------------|-------|-------|-------|
| Turnover (RMBm)   | 6,159 | 6,483 | 8,478 |
| Net Profit (RMBm) | 52.9  | 112.5 | 137   |
| EPS (RMB)         | 0.085 | 0.115 | 0.114 |
| P/E (x)           | 19.7  | 14.4  | 14.6  |
| P/B (x)           | 2.5   | 2.0   | 1.4   |
| EV/EBITDA (x)     | 10.7  | 9.7   | 11.9  |
| Yield (%)         | 0.18  | 0.60  | 0.60  |
| ROE (%)           | 8.0   | 12.3  | 11.0  |
| ROCE (%)          | 14.7  | 14.3  | 8.4   |
| N. Gear. (%)      | 66.9  | 47.6  | 80.3  |

Source: SBI E2-Capital

|                          | 11F   | 12F   | 13F |
|--------------------------|-------|-------|-----|
| Consensus EPS (RMB)      | 0.225 | 0.260 | -   |
| Previous earnings (RMBm) | -     | -     | -   |
| Previous EPS (RMB)       | -     | -     | -   |

#### Price performance

| Year to Dec              | 1m   | 3m   | 12m  |
|--------------------------|------|------|------|
| Relative to HSI (%)      | 16.6 | 9.3  | 13.5 |
| Actual price changes (%) | 11.3 | 12.1 | 29.5 |



Source: Bloomberg

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**Business history and pricing mechanism.** The principal business of the company is sales and distribution of LPG and sales of electronics products. The company initially involved the retail sales of bottled LPG to domestic users of China. It subsequently expanded to the import, re-export, wholesale and retail of LPG business after its acquisition of the NewOcean Sea Terminal in Zhuhai in 2004, which has a berth that can handle large LGP ships up to 50,000 tonnes capacity. As a LPG importer, exporter and wholesaler, the NewOcean Sea Terminal has ranked number 1 in China since 2008 in terms of through-put volume. Normally the company buys LPG at a reference price linked to Argus Far East Index of the current month and sells on dollar-plus-cost basis to customers. Once the actual figure of the particular month is finalized, the company would settle the difference with suppliers and customers, which essentially eliminate price risk. Table 3 shows our estimation of gross profit for different sales channels. For instance, sales through refueling stations essentially capture dollar profit of sales to refueling stations plus sales at refueling stations.

**Table 3. Pricing mechanism - our estimates on per ton gross profit**

| US\$ per tonne                                       | FY12/09A | FY12/10A | FY12/11F | FY12/12F |
|--|----------|----------|----------|----------|
| Re-export sales                                      | 10.0     | 10.0     | 10.0     | 10.0     |
| Domestic sales of imports to industrial and retail   | 62.5     | 57.5     | 60.0     | 60.0     |
| Domestic sales of imports through refueling stations | 0.0      | 0.0      | 0.0      | 140.0    |
| Domestic sales of local purchases                    | 57.5     | 55.0     | 57.5     | 57.5     |

Source: SBI E2-Capital

**Expect increasing sales due to acquisition.** While the acquisition is to be completed, we conservatively assume the refueling stations not to contribute profit directly in 2011. Instead, in 2011, we assume the 17 refueling stations would source 220,000 tonnes LPG supply from the company instead of 100,000 tonnes in the past. Besides, the company would receive HK\$120m interest in 2011 on loan before the acquisition complete. While for 2012, we expect the acquisition would be completed and 250,000 tonnes sales would be classified as "domestic sales of imports through refueling stations". That said, there would be a reduction in "domestic sales of imports to industrial and retail" and increase in "domestic sales of imports through refueling stations" in 2012. Table 4 shows sales volume assumptions for 2011 and 2012. Table 5 shows our gross profit estimates for 2011 and 2012 based on forecast on volume and ASP. Note that, however, though gross profit increment in 2012 is apparently much higher than in 2011, there is HK\$120m interest income arise from the loan attached to the acquisition for 2011.

**Table 4. Sales volume breakdown**

| US\$ per tonne                                       | FY12/09A  | FY12/10A  | FY12/11F  | FY12/12F  |
|--|-----------|-----------|-----------|-----------|
| Re-export sales                                      | 264,000   | 227,000   | 232,675   | 238,492   |
| Domestic sales of imports to industrial and retail   | 534,000   | 258,000   | 384,450   | 199,061   |
| Domestic sales of imports through refueling stations | 0         | 0         | 0         | 250,000   |
| Domestic sales of local purchases                    | 262,000   | 734,000   | 752,350   | 781,159   |
| Total  | 1,060,000 | 1,219,000 | 1,369,475 | 1,438,712 |

**Table 5. Gross profit breakdown**

| HK\$ m   | FY12/09A | FY12/10A | FY12/11F | FY12/12F |
|--|----------|----------|----------|----------|
| Re-export sales                                      | 20       | 18       | 18       | 18       |
| Domestic sales of imports to industrial and retail   | 259      | 115      | 179      | 93       |
| Domestic sales of imports through refueling stations | 0        | 0        | 0        | 271      |
| Domestic sales of local purchases                    | 117      | 314      | 335      | 348      |
| Total  | 396      | 446      | 532      | 730      |

Source: SBI E2-Capital

**Profit and loss forecasts.** Table 6 shows our preliminary forecast on profit and loss for 2011 and 2012. We expect net profit to increase 108% to HK\$285m for FY12/11F and then grow at a slower pace to HK\$302m for FY12/12F. This forecast assumes no additional Guangdong cities to adopt LPG vehicle in short-term.

**Table 6. Preliminary profit and loss forecast (Full-year)**

| HK\$ m                       | FY12/10A | FY12/11F | FY12/12F |
|------------------------------|----------|----------|----------|
| Revenue                      | 8,478    | 12,811   | 15,513   |
| Cost of sales                | (8,031)  | (12,293) | (14,782) |
| Gross profit                 | 447      | 517      | 730      |
| SG&A                         | (216)    | (237)    | (255)    |
| Other net gain / loss        | (8)      | 120      | 0        |
| EBIT                         | 224      | 415      | 476      |
| Finance Costs                | (68)     | (89)     | (104)    |
| Share of profit / loss of JV | 0.2      | 0        | 0        |
| EBT                          | 155      | 325      | 371      |
| Income tax expenses          | (18)     | (41)     | (46)     |
| Net profit                   | 137      | 285      | 325      |

Source: SBI E2-Capital

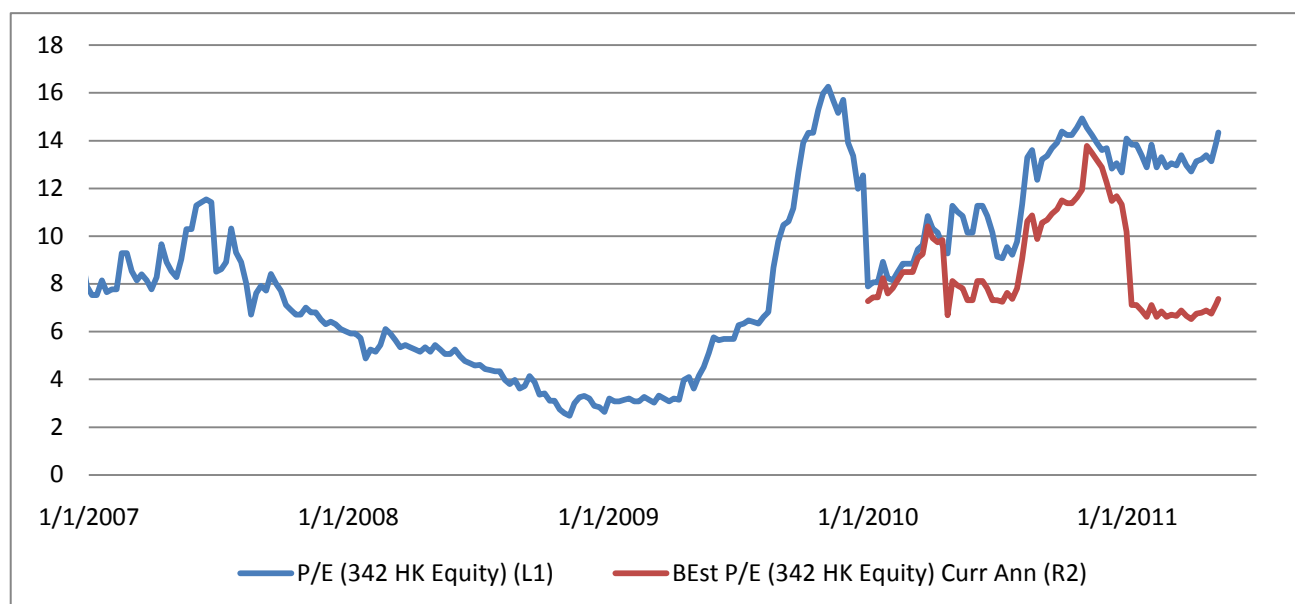
Table 7. Actual profit and loss (Half-year)

| HK\$ m                       | 1H FY12/10A | 2H FY12/10A | 1H FY12/11F | 2H FY12/11F |
|------------------------------|-------------|-------------|-------------|-------------|
| Revenue                      | 3,147       | 3,336       | 3,796       | 4,682       |
| Cost of sales                | (2,979)     | (3,109)     | (3,623)     | (4,408)     |
| Gross profit                 | 168.4       | 226.9       | 172.8       | 274.0       |
| SG&A                         | (73.9)      | (104.5)     | (88.3)      | (127.3)     |
| Other net gain / loss        | (8.3)       | 5.3         | 28.8        | (36.5)      |
| EBIT                         | 86.2        | 127.8       | 113.3       | 110.2       |
| Finance Costs                | (19.3)      | (33.6)      | (43.2)      | (25.2)      |
| Share of profit / loss of JV | (2.4)       | (3.6)       | 0.2         | 0.1         |
| EBT                          | 64.5        | 90.6        | 70.3        | 85.1        |
| Income tax expenses          | (23.8)      | (18.9)      | (6.8)       | (11.2)      |
| Net profit                   | 40.7        | 71.7        | 63.5        | 73.1        |

Source: SBI E2-Capital

**Our view.** Stock price has retreated from HK\$1.95 since last Oct and currently trading at 14.5x historical P/E for FY12/10A. Based on our net profit estimations at HK\$285m and HK\$325m for FY12/11F and FY12/12F, the company is trading at 7.0x and 6.2x P/E respectively. The chart below shows historical P/E and forward P/E based on Bloomberg consensus. While the company is to issue TDR, we believe the company is still at good value compared to forward P/E range between 6.5x and 13.8x. We currently price the company at HK\$2.02 at a reference target of 8.5x and 7.4x P/E for FY12/11F and FY12/12F based on HK\$285m and HK\$325m net profit respectively.

Chart 1. Historical P/E and forward P/E based on Bloomberg consensus



Source: Bloomberg

Table 8. Hong Kong listed Peers comparison

| Company name      | Ticker  | Fiscal year | Mkt cap<br>(US\$m) | His P/E<br>(x) | 1-Yr P/E<br>(x) | 2-Yr P/E<br>(x) | PB<br>(x) | ROE<br>(%) |
|-------------------|---------|-------------|--------------------|----------------|-----------------|-----------------|-----------|------------|
| ENN ENERGY        | 2688 HK | 12/2010     | 3,756.3            | 24.2           | 19.3            | 16.2            | 4.1       | 18.2       |
| CHINA RES GAS     | 1193 HK | 12/2010     | 2,535.4            | 21.3           | 19.5            | 15.4            | 3.5       | 18.1       |
| CHINA GAS         | 384 HK  | 03/2010     | 1,758.8            | 19.7           | 18.7            | 13.9            | 2.3       | 23.8       |
| CHINA OIL AND GAS | 603 HK  | 12/2010     | 501.4              | 23.6           | 16.8            | 11.3            | 1.6       | 8.1        |
| NEOCEAN ENERGY    | 342 HK  | 12/2010     | 279.6              | 14.4           | 7.4             | 6.4             | 1.5       | 11.0       |
| Average:          |         |             |                    |                | 16.4            | 12.6            |           |            |

Source: Bloomberg

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Disclosure of interests: SBI E2-Capital Securities Limited, a parent company of SBI E2-Capital Financial Services Limited, acted as sub-placing agent for NewOcean Energy (stock code: 0342 HK) in November 2010.

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