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Not much surprise in the near term — China Utilities

Enric Energy (3899 HK, HK$4.95) HOLD (downgraded from BUY)

Target price: HK$5.25 (+6.1%)

Interim results were in line with expectations. Enric Energy reported a net profit of RMB41.9m (up 30% YoY and 15% HoH) on a revenue growth of 56% YoY to RMB327m. The interim results were in line with our expectations and achieved 46% of our original full-year forecast. The company managed to maintain its gross margin at 31% thanks to the change in product mix of the pressure vessels segment (i.e. increased shipments of CNG trailers and seamless pressure cylinders) and the increase of CNG product ASP to reflect higher material costs. The company booked an RMB5m expense for the main board listing in 2Q06. Effective tax rate of 8.2% in 1H FY12/06 was higher than the 4% in 1H FY12/05, as one of Enric's subsidiaries started to pay tax (e.g. only a 50% exemption). Management did not propose to pay any interim dividend in 1H FY12/06.

Table 1: Interim results comparisons

(RMBm)	1H FY12/06	1H FY12/05	*YoY (%)*	2H FY12/05	*HoH (%)*
Revenue	327	210	*55.8*	303	*7.7*
Gross profit	101	66	*53.4*	84	*20.4*
Operating profit	49	38	*31.0*	41	*21.7*
Pre-tax profit	46	34	*35.5*	37	*23.8*
Net profit	42	32	*29.7*	36	*15.2*
Gross margin (%)	*31.0*	*31.5*		*27.7*	
Operating margin (%)	*15.1*	*18.0*		*13.4*	
Net margin (%)	*12.8*	*15.4*		*12.0*	

Source: Company data and SBI E2-Capital

Financials remained at healthy levels. Enric energy reported a negative free operating cash flow (i.e. out flow of RMB17m) in 1H FY12/06 due to the relatively large amount of working capital tied in inventory. The company had a net cash position (close to RMB200m) as at the end of June 2006. AR, AP and inventory turnovers stayed similarly at 50 days, 83 days, and 115 days respectively during the period. We expect the high level of inventory was driven by the preparation of the stronger shipments season in 2H FY12/06. Enric spent around RMB30.5m in 1H FY12/06, and the company has maintained the full-year capex target of RMB80m for capacity expansion.

Ups and downs in 2H06. Pressure vessels accounted for 59% of revenue in 1H FY12/06 (cf. 51% in 2005), followed by integrated business solutions 23% (26% in 2005) and compressors 18% (23% in 2005). Shipments for compressors and pressure vessels were ahead of our forecasts in 1H FY12/06, while integrated business

Table 2: Financial summary

Year to Dec	Net profit RMBm	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	36.2	0.136	243.2	36.4	37.6	41.5	NA	77.1	27.1	188.3
05A	68.7	0.219	60.8	22.7	5.0	20.2	NA	29.9	20.9	Cash
06F	92.9	0.200	(8.7)	24.8	3.7	13.7	NA	19.4	17.8	Cash
07F	128.5	0.272	36.2	18.2	2.7	8.9	NA	19.8	20.5	Cash
08F	167.9	0.355	30.7	13.9	2.0	5.8	NA	19.1	20.7	Cash

solutions somewhat came behind our expectations. As a result, management now guides better shipments outlook for natural gas compressors and CNG trailers this year, and slower than expected ramp up for integrated business solutions. The company indicated that it took longer than expected for the gas distributors to apply for the operation certificates to run gas stations.

Table 3: Enric's shipment comparisons

(Units)	1H05	2H05	1H06	2005	2006F
Compressor	**114**	**106**	**134**	**220**	**260**
Gas compressor	46	50	70	96	140
Special-purpose compressor	68	56	64	124	120
Pressure vessel	**209**	**189**	**292**	**398**	**590**
CNG trailers	48	80	148	128	280
Seamless pressure cylinders (4 units per set)	39	35	46	74	100
LNG trailers	12	22	0	34	45
LNG storage tanks	20	25	10	45	40
LPG tank trucks	90	27	88	117	125
Integrated business solutions	**38**	**83**	**62**	**121**	**170**
Pressure-regulating stations	5	12	1	17	10
CNG hydraulic daughter refueling stations	17	19	25	36	60
CNG daughter refueling stations trailers	16	52	36	68	100

Source: Company data and SBI E2-Capital

Longer term story intact. Recent results by gas distributors in China (such as XinAo Gas and Hong Kong and China Gas) suggested that they have been aggressively expanding the gas station business in China and the move should continue to benefit Enric Energy for its integrated business solutions. As for the LNG products, the company continues to believe that meaningful benefit from the first LNG terminal in Guangdong (will be fully commercialized in Sept.) will be realized in 2H FY12/07 or early 2008. Overseas business in Brazil and Pakistan contributed around 4.2% of revenue in 1H FY12/06, compared with PetroChina, Sinopec and CNOOC together accounted for 40% of turnover. While the overseas business remains small for Enric, the company has been eyeing the US, SE Asia and EU markets.

New business in the making. Enric Energy targets to become a total energy provider by expanding its footing to other energy products such as nuclear storage equipment. Management believes that the technique is transferable between producing CNG equipment and nuclear storage equipment. While the company has been in talks with some local equipment companies for acquisition, management believes that any acquisition will only happen in 1H FY12/07 at the earliest. Meanwhile, Enric is expected to set up a subsidiary to focus on energy efficient equipment such as heat exchanger towards the end of the year. The heat exchanger market is estimated to be around RMB20b and Enric will target the high-end market.

Not much surprise in the near term. We have fine-tuned our earnings forecast by 1~2% in 2006 and 2007 to reflect different shipment assumptions. The stock currently trades at 24.8x FY12/06F P/E and 18.2x FY12/07F P/E. Our target price remains unchanged at HK$5.25 (derived from our sum-of-the parts valuation), which translates into 18.9x FY12/07F P/E, or an upside of just 6.1% from the current price level. Given that we do not expect any major surprise in 2H FY12/06, we have downgraded our rating to HOLD.

Table 4: Sum-of-the parts valuation

Product segments	EBIT contribution in 2007 (%)	Valuation method	Fair value (HK$m)	Fair value/share (HK$)
Compressors	12	10X 2007F PE	186	0.40
CNG equipment	30	15x 2007F PE	773	1.68
LNG equipment	11	13x 2007F PE	204	0.44
LPG equipment	1	10X 2007F PE	18	0.04
Gas station equipment	46	15x 2007F PE	846	1.84
Cash		2007 Year-end	385.4	0.84
Total	100		**2,411**	**5.25**

Source: SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as one of the underwriters for the Enric Energy Equipment IPO on Oct 2005.