

EMER International: Bright prospects

Andes Cheng
(852) 2533 37721
andescheng@sbie2capital.com

Recommendation: Not Rated

China Energy Logistics

Price	HK\$3.00	Yield (12/06A)	na
12 mth range	HK\$0.37-3.50	ROE (12/06A)	28.6%
Market cap.	US\$113.4m	Net gearing (12/06A)	Net cash
No. shares o/s	322.6m	Net cash/sh. (12/06A)	HK\$0.02
Daily t/o, 3 mth	US\$0.1m	BV/sh. (12/06A)	HK\$0.56
Free float %	26.3%	Consensus EPS	
Major shareholder	Global Energy Investors/management – 46.7%	- 12/07F	HK\$0.174
Ticker	8149.HK/ 8149 HK	- 12/08F	HK\$0.260

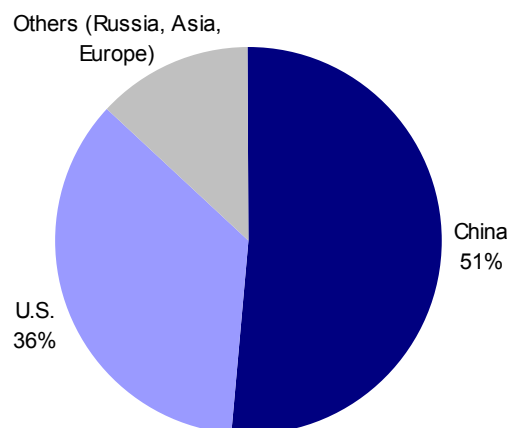
Key points:

- To secure big orders for rig control systems from one of China's major oil conglomerates.
- Mud pump sales to exceed 100 units in FY12/07F from 4 units in FY12/06A.
- Secured orders for four sets of jacking control systems.
- Yantai Raffles Shipyard took 13.3% in the group from a major shareholder in May.
- Plans to offer turnkey solutions.
- Appealing valuation at P/E of 11.5x for FY12/08F.

Corporate profile. Founded in 1995 and listed on the Growth Enterprise Market (“GEM”) of HKEX in November 2005, EMER International is engaged in the design, manufacture and sales of rig control systems and expendable parts of mud pumps, as well as mud pumps and jacking control systems. It also provides professional marketing and consultancy services to international oilfield equipment manufacturers, design houses and engineering companies. It launched its mud pump products in 2006 and will roll out its jacking control system this year.

Broad customer base. Its customers include local (CNPC and Sinopec subsidiaries) and foreign oil and gas drilling companies, drilling machinery manufacturers, and distributors. As of end-FY12/06A, the company had more than 100 customers and its business scope is expected to expand this year to offshore drilling equipment and offshore rig control systems.

Chart 1: Turnover by geographic location



Source: The company

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Rising sales in the US. The group set up a wholly-owned subsidiary, TSC (USA), in Houston, Texas, in 2002 as its sales and distribution office. Since the US oilfield equipment market is relatively closed and oil and gas drilling companies source materials only from familiar suppliers or distributors, TSC (USA) sells its products to distributors rather than to end-users. Under its distribution agreements, distributors are responsible for the promotion and sales and stock keeping of products in specific regions. To expand its US sales, the group plans to acquire a distributor there.

Foray into the Middle East. In 2005, the group entered into a five-year agreement with China Petroleum Technology & Development Corporation (CPTDC), a wholly-owned subsidiary of the CNPC group, making CPTDC its sole distribution agent for mud pump accessories in more than 13 countries in the Middle East.

Certified products. HHCT, one of the group's rig control system production bases, was awarded ISO 9001:2000 in 2003 by CEPREI Certification Co. Ltd. (廣州賽寶認證中心服務有限公司). The group's drilling rig expandable parts manufacturing arm, TSC (Qingdao), was awarded ISO 9001:2000 accreditation and API Spec Q1 registration in 2004. The American Petroleum Institute (API) granted it the right to use the API Monogram on its pump products. The API quality programs are well recognized in the oil and gas industry worldwide.

Rig control systems in demand. In FY12/06A, the group delivered 37 sets of rig control systems against 13 in FY12/05A. The surge was a result of rig-packaging customers' asking to delay the delivery of the system because their production capacity was fully utilized. Sales are driven by the strong demand from domestic and international drilling rigs and the company's aggressive marketing campaign for SCR/VFD electrical rig control systems. We expect the growth momentum to stay strong on robust market demand and a big order expected from one of China's major oil conglomerates, which invited bids for 20 sets of rig control systems. The company is expected to win six of the contracts. The division's blended margin is estimated at 30.0% in FY12/07F.

Since capacities of rig packagers are fully occupied in 2005, some of them postponed the reception of shipment to next year. Thus, some of the rig control systems delivered in FY12/06A were actually ordered in 2005.

Sales of mud pump to surge. In FY12/06A, the group rolled out its TSC-branded mud pump series and sold four units. It currently offers three mud pump models - Workforce 360, Workforce 660 and Workforce 1200. Its TSC brand is well recognized in the US, as the company has been making and selling mud pump components (liners, pistons and piston rods) and providing mud pump expendable parts there since 2002. Its mud pump sales are expected to surge to at least 100 units this year, while its maximum capacity at TSC Offshore (Qingdao) stands at 120 units per annum. The division's blended margin is estimated at 25.0%. The Workforce 1200, suitable for offshore oil well drilling, is in strong demand given the rising number of offshore drilling rigs globally.

Jacking control system - a new revenue source. The group formed a 15:85 JV, Zhengzhou Fuge Overseas Project Equipment Co Ltd (鄭州富格海洋工程裝備有限公司) with the Zhengzhou Machinery Institute. The JV manufactures jacking units for jacking systems, which are used to lift and lower the hull of a jack-up. Each system requires 54 jacking units and a control system. The group will source the jacking units from the JV, combine them with its own jacking control systems and sell as sets, within the next two years. The company has already secured orders for four sets and is obligated to deliver three jacking control systems to overseas customers this year. Its jacking control system design is certified by the American Bureau of Shipping (ABS). The division's gross profit margin is estimated at 25.0%.

Team up with the strongest. Its major shareholder, Global Energy Investors LLC, sold 42.8m shares or 13.3% of the company's total issued share capital to Yantai Raffles Shipyard (YRS) at HK\$2.55 per share. YRS is 49.0% owned by Mr. Brian Chang. Another substantial shareholder with 6.4% in the group, Asian Infrastructure Limited (AFL), is 100.0% owned by Mr. Chang. Founded in 1994 and listed on Norway's Oslo OTC Stock Exchange in May 2006, Yantai Raffles Shipyard is a leading global offshore and marine fabrication specialist headquartered in Singapore. It specializes in jack-up drilling rigs, semi-submersible drilling rigs, FPSOs, FSOs, platform supply vessels, pipelay vessels, luxury yachts and other units. Its 72-hectare shipyard is equipped with state-of-the-art building facilities, including the world largest gantry crane with a lifting capacity of 20,000 tones. The crane can lift the entire deck box of a semi-submersible rig onto its columns/pontoons in one operation, allowing simultaneous construction of hull and deck boxes, which reduces construction time by half and cuts costs. The group has been the sole China representative of the world's leading designer of jack-ups, floating production systems and semi-submersibles, Friede & Goldman (F&G) since 1995.

Go offshore. The group plans to provide turnkey solutions for offshore drilling, including jacking systems (jacking control systems and jacking units inclusive) for jack up, rig control systems, drilling equipment and modules. Modules are a significant component of offshore drilling rigs providing facilities for daily life requirements of operators. It will team up with one of the world's top offshore rig design houses and a major shipyard to develop the turnkey solution business. Under the blueprint, the rig designer will provide the design of offshore rigs to the shipyard, which will then build the hull and outsource the equipment for turnkey solutions to the group.

Strong financial performance. The group's net profit surged 76.4% YoY to RMB34.1m in FY12/06A against a 95.1% increase in revenue to RMB216.4m. Its blended margin widened to 44.8% from 42.3%, thanks to its higher sales of high-margin rig control systems and client base expansion. The group distributed bonus shares to shareholders (one bonus share for five existing shares) in FY12/06A. In 1Q FY12/07F, it returned to the black with net profit of RMB8.0m, against a loss of RMB4.1m in the year-earlier period, while its turnover surged 180.0% YoY to RMB57.5m. Driven by the strong growth for new and replacement machinery, its mud pump and rig control system sales surged 22.0x YoY and as of end-FY12/06A, the company has net cash of RMB4.5m.

Undemanding valuation. Market consensus forecasts put the company's net profit at RMB57.0m in FY12/07F and RMB85.0m in FY12/08F. Trading at a P/E of 17.2x for FY12/07F and 11.5x for FY12/08F, its valuation is not demanding, compared with peer's average one-year forward P/E of 21.4x and two-year forward P/E of 17.1x.

Table 1: Peer comparison

Company name	Ticker	Year end	Currency	Market cap (US\$m)	P/E (x)		EV/EBITDA	
					1-yr forward	2-yr forward	1-yr forward	2-yr forward
Technics Oil & Gas	TGH SP	Jun	SGD	82	9.7	8.2	5.8	4.7
ASL Marine Holdings	ASL SP	Sep	SGD	249	12.2	10.5	3.8	3.3
Pan-United Marine	PANU SP	Dec	SGD	419	14.1	12.0	3.3	5.5
Cosco Corp Singapore	COS SP	Dec	SGD	4,273	21.5	16.7	12.4	9.1
Ausgroup	AUSG SP	Jun	SGD	489	40.4	29.7	2.1	1.5
KS Energy Services	KST SP	Dec	SGD	524	15.1	12.4	11.1	8.6
Labroy Marine	LBRY SP	Dec	SGD	1,332	18.4	14.2	10.0	8.0
SembCorp Marine	SMM SP	Dec	SGD	4,336	21.2	17.1	12.8	10.5
Jutal Offshore Oil Services	3303 HK	Dec	HKD	177.9	29.7	25.7	6.6	5.3
Shandong Molong	568 HK	Dec	HKD	746.4	28.4	25.1	7.7	6.8
Anhui Tianda Oil Pipe	8241 HK	Dec	HKD	493.1	17.3	14.4	4.8	4.1
Average					21.4	17.1	10.8	8.5

Source: Bloomberg, SBI E2-Capital

P & L (HK\$m)	04A	05A	06A	Cash Flow (HK\$m)	04A	05A	06A
Year to Dec				Year to Dec			
Turnover	105.8	110.9	216.4	EBIT	28.5	21.2	38.7
% chg	145.0	4.9	95.1	Depre./amort.	0.8	1.2	2.7
Gross profit	39.2	46.9	97.1	Net int. paid	(0.1)	(0.8)	(0.4)
				Tax paid	-	(0.7)	(1.5)
EBITDA	29.3	22.5	41.4	Dividends received	-	-	-
Depre./amort.	(0.8)	(1.2)	(2.7)	Gross cashflow	29.2	21.0	39.6
EBIT	28.5	21.2	38.7	Chgs. in working cap.	(33.6)	(19.7)	(39.6)
Net int. income/(exp.)	(0.1)	(0.9)	(1.2)	Operating cashflow	(4.4)	1.3	(0.0)
Exceptionals	-	-	-	Capex	(7.2)	(13.8)	(15.7)
Associates	-	-	(0.0)	Free cashflow	(11.6)	(12.5)	(15.7)
Jointly-controlled entit.	-	-	-	Dividends paid	-	-	-
Pre-tax profit	28.4	20.4	37.5	Net distribution to MI	-	-	-
Tax	0.7	(1.0)	(3.4)	Investments	-	-	-
Minority interests	-	-	-	Disposals	-	-	-
Net profit	29.1	19.4	34.1	New shares	7.5	33.5	0.3
% chg	625.7	(33.4)	76.4	Others	2.3	1.5	(3.3)
Dividends	-	-	-	Net cashflow	(1.8)	22.4	(18.7)
Retained earnings	29.1	19.4	34.1	Net (debt)/cash - Beg.	2.6	0.9	23.3
				Net (debt)/cash - End.	0.9	23.3	4.5
EPS (HK\$) - Basic	0.161	0.105	0.142	Interim Results (HK\$m)	05A	06A	
EPS (HK\$) - F.D.	0.150	0.100	0.137	Six months to Jun			
DPS (HK\$)	-	-	-	Turnover	54.2	95.9	
No. sh.s o/s (m) - W.A.	180.0	185.0	240.1	% chg		77.2	
No. sh.s o/s (m) - Y.E.	200.0	240.0	241.0	Profit from operations	11.3	15.3	
No. sh.s o/s (m) - F.D.	193.5	193.5	249.3	Interest expenses	(0.4)	(0.4)	
				Associates	-	-	
Margins (%)				Jointly-controlled entit.	-	-	
Gross	37.1	42.3	44.8	Pre-tax profit	10.9	14.9	
EBITDA	27.7	20.3	19.1	Tax	(2.4)	0.8	
EBIT	27.0	19.2	17.9	Minority interests	-	-	
Pre-tax	26.9	18.4	17.3	Net profit	8.6	15.7	
Net	27.5	17.5	15.8	% chg		83.8	
				EPS (HK\$) - Basic	0.047	0.065	
				DPS (HK\$)	-	-	
Balance Sheet (HK\$m)	04A	05A	06A	Shareholding Structure			
Year to Dec					Shares o/s (m)	%	
Fixed assets	6.4	13.4	26.5	GEI and management	150.6	46.7	
Intangible assets	0.7	0.6	0.5	Zhang Hongru and Osbeck Inv	23.7	7.3	
Other LT assets	5.1	11.9	13.7	YRSI	42.8	13.3	
Cash	5.5	31.3	23.4	Brian Chang	20.6	6.4	
Accounts receivable	38.3	45.5	63.3	Keywise	29.2	9.0	
Other receivables	4.9	6.8	25.2	Other public shareholders	55.9	17.3	
Inventories	11.5	23.8	57.8	Total	322.6	322.6	
Due from related co.s	0.8	1.9	1.8				
Other current assets	2.0	5.3	1.6				
Total assets	75.3	140.3	213.7				
Accounts payable	(9.8)	(14.6)	(23.7)	Background			
Other payable	(2.2)	(8.9)	(23.7)	Founded in 1995 and was listed on the Growth Enterprise Market ("GEM") of			
Tax payable	(1.6)	(4.4)	(4.2)	HKEX on November 2005, Emer International is engaged in design,			
Due to related co.s	(8.6)	(0.5)	(0.0)	manufacture and sales of rig control systems and expendable parts of mud			
ST debts	(4.6)	(7.9)	(18.8)	pumps.			
Other current liab.	-	(1.5)	(6.3)				
LT debts	(0.0)	(0.1)	-	Key Ratios	04A	05A	06A
Other LT liabilities	(0.0)	(0.0)	(0.3)	Net gearing (%)	Cash	Cash	Cash
Total liabilities	(26.8)	(38.0)	(77.0)	Net ROE (%)	60.0	25.7	28.6
				EBIT ROCE (%)	53.8	26.0	29.2
Share capital	0.2	25.0	25.1	Dividend payout (%)	-	-	-
Reserves	48.3	77.3	111.6	Effective tax rate (%)	(2.3)	5.0	9.0
Shareholders' funds	48.4	102.3	136.7	Net interest coverage (x)	226.5	24.2	31.7
Minority interest	-	-	-	A/R turnover (days)	132.2	137.9	91.7
Total	48.4	102.3	136.7	A/P turnover (days)	33.7	40.1	32.3
Capital employed	53.1	110.3	155.5	Stock turnover (days)	63.3	100.7	124.6
Net (debt)/cash	0.9	23.3	4.5				