

## Utilizing cash

## China Energy Logistics

## EMER International (8149 HK, HK\$4.94)

## BUY (unchanged)

### Target price: HK\$7.06 (+42.9%)

**Acquisition bid.** EMER International has been in talks with the board of Global Marine Energy (GME) about a cash offer for GME at 13.0 pence (or about HK\$2.05) per share. EMER's proposal is not the only offer put forward to GME's shareholders and is considered as hostile takeover. GME will hold an EGM on October 24 to consider the proposals.

**Favored counter offer.** 4D Global Energy Advisors and Lime Rock Partners have since February 2007 been considering a reverse takeover of GME. Under the terms, GME would acquire the entire issued share capital of IDM (majority owned by Lime Rock Partners) for £52.5m, which would be satisfied by an issue of 525.0m new shares to the IDM shareholders at 10.0 pence each. To facilitate the transaction, Lime Rock Partners would provide a bridge loan of US\$14.0m to GME. The loan could be drawn down only if shareholders approve the transaction. GME would raise about £10.0m through equity financing to repay the loan and generate working capital. Should the share placement go ahead, existing shareholders' holding of the company's enlarged share capital will be 10.4%. Gatemore Investment, GM's largest shareholder with a 20.05% stake, indicated that it is in favor of the reverse takeover proposal.

**Loss maker.** Formed in 1988 and listed on AIM in 2001, GME provides offshore and onshore oil & gas lifting & handling equipment, specializing in engineering heavy handling and lifting solutions. For the fiscal year to March 2007, the company reported a net loss of £11.6m (FY03/06A: £2.2m profit) due to lack of profitable sales, low production and inefficient cost controls. Turnover was £13.2m (FY03/06A: £11.2m). As of end-FY03/07A, GME's deficit of shareholder equity was £3.4m (FY03/06A: positive £4.8m) and net debt £9.2m. The company has 65.2m shares outstanding.

**Background.** IDM specializes in the design and manufacture of drilling systems, particularly onshore drilling rigs, and power and control products for the oil and gas drilling industry. It has plants in Houston, Texas, and Stryi, Western Ukraine. Lime Rock Partners is a private equity fund providing capital to global energy companies in the exploration and production, energy service, and oil service technology sectors. 4D Global Energy Advisors is a Paris-based advisor to funds investing exclusively in mid-market companies along the hydrocarbons value chain.

**Cash.** As of the end of 1H FY12/07A, EMER was in a net cash position of RMB15.5m. It raised HK\$300.0m by placing 53.5m new shares at HK\$5.80 each at the end of July 2007. We estimate it now has net cash of HK\$315.5m. At end-September, the company said it would acquire 28.02% in GODLLC for HK\$56.8m, with HK\$28.4m satisfied in cash and the balance by 5.7m shares at HK\$4.98 each issued to the vendors. After the acquisition by the end of November, the company would still have HK\$287.1m in cash in hand, sufficient to acquire the entire share capital of GME, which would require a lump sum of HK\$133.7m. The group would also

**Table 1: Financial summary**

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Mar	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
05A	19.4	0.105	(36.4)	48.1	9.1	76.5	na	18.9	17.6	Cash
06A	34.1	0.142	35.2	33.9	8.8	43.3	na	28.6	22.0	Cash
07F	42.0	0.146	2.8	34.8	3.4	36.8	na	12.4	7.7	Cash
08F	100.6	0.264	81.2	19.2	2.7	15.7	na	16.6	15.0	Cash
09F	94.3	0.248	(6.2)	20.5	2.4	16.5	na	13.1	12.3	Cash

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have to provide a loan GME for its working capital. We estimate the loan at US\$14.0m, based on the loan size to be offered to GME by Lime Rock Partners. Thus, the total cash outlay for this transaction would be HK\$242.9m.

**Hidden value.** Through the acquisition of 28.02% stake in GODLLC, the group will own about 7.0% in Friede & Goldman, one of the world-renowned offshore rig designers, and gain access to its client base and expertise in offshore rig building. Acquiring GME would allow EMER to expand its product portfolio to offshore and onshore oil & gas lifting & handling equipment, gain new clients and extend its geographical coverage to Europe. At end-FY03/07A, the UK generated 38.5% of GME's sales, the US 55.8% and Asia 5.6%. The move would enhance EMER's turnkey solution services and make it a true one-stop shop for rig builders. Although GME is poorly managed, it has a strong order book, which stood at just over US\$150m in September 2007, with deliveries accelerating through the coming financial year. Should GME retain its listing status on AIM, EMER would have another fund raising platform in Europe. The fact that EMER is not the only company after GME implies that GME offers some embedded value to be uncovered.

**Risks associated with the cash offer.** Theoretically, acquiring a company with negative equity may erode existing shareholders' value. Initially, EMER had offered 10.0 pence per share for GME and later raised the amount to 13.0 pence. However, for a loss maker, it is hard to judge whether a bid is fair. Also, EMER may find it difficult to turn around GME because it has no exposure to the business GME is involved in. Not to mention cultural differences between the British and Chinese management teams. Since GME's major shareholder favors the reverse takeover proposal by 4D Global Energy Advisors and Lime Rock Partners, we believe there is a chance for EMER to fail in its bid.

**Valuation and recommendation.** Trading at an ex-cash P/E of 26.6x for FY12/07F and 14.7x for FY12/08F, the group's valuation is attractive, compared with its HK-listed peers average 1-year forward P/E of 30.2x and 2-year forward P/E of 23.7x. We are bullish on the sector as a whole, given the strong oil prices, vigorous demand for drilling equipment and increase in global E&P capital expenditure. We reiterate our STRONG BUY call on the group.

**Table 1: Peer group comparisons**

Company name	Ticker	Year end	Currency	Market cap (US\$m)	P/E (x)	
					1-yr forward	2-yr forward
CARBO Ceramics	CRR US	Dec	USD	1,155.4	20.7	15.8
National Oilwell Varco	NOV US	Dec	USD	24,880.1	19.4	16.1
Gulf Island Fabrication	GIFI US	Dec	USD	519.5	16.8	13.4
Dril-Quip	DRQ US	Dec	USD	2,050.2	20.6	16.8
NATCO Group	NTG US	Dec	USD	944.6	21.3	17.2
FMC Technologies	FTI US	Dec	USD	7,568.2	27.2	22.0
Dresser-Rand Group	DRC US	Dec	USD	3,325.5	28.2	17.6
Sondex PLC	SDX LN	Feb	GBP	128.3	22.0	18.1
R H Energy	RHE SP	Dec	SGD	279.2	37.2	23.9
Shandong Molong Petroleum Machinery	568 HK	Dec	HKD	861.1	36.8	29.4
Anhui Tianda Oil Pipe	8241 HK	Dec	HKD	373.3	17.1	13.3
Jutal Offshore Oil Services	3303 HK	Dec	HKD	212.0	26.8	18.5
<i>Average</i>					22.1	17.6

Source: Bloomberg

**Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the lead placing agent for EMER International on July 31 2007.**