

7th largest oil well pipe maker in China

China Oil Services

Anhui Tianda Oil Pipe (8241 HK, HK\$3.62)

Not Rated

Background. Listed on GEM board in Dec 2006, Anhui Tianda Oil Pipe was the seventh largest oil well pipe manufacturer in China with more than 13 years of operating history. The group's product portfolio consists of two main categories: the specialized seamless pipes for the oil and natural gas industry and other specialized seamless pipes include vessel pipes and boiler pipes.

Valuation and earnings forecast. The group posted a 3.0% YoY drop in net profit to RMB71.9m for FY12/05A, as it incurred tax expenses of RMB24.4m, against a tax credit of RMB49.5m reported in FY12/04A. Meanwhile, its pre-tax profit surged 291.3% YoY to RMB96.3m. For 1H FY12/06A, the group's pre-tax profit and net profit leaped 153.4% YoY and 162.5% YoY to RMB81.1m and RMB53.4m, respectively. Its output in FY12/06F is expected to be 210,000 tons, representing an annualized growth rate of 63.4%. Net profit for FY12/06F is projected to be HK\$109.4m, or HK\$0.216 per share. As at the closing price of HK\$3.62, the counter is trading at a P/E of 16.8x for FY12/06F, compared with the sector average P/E of 14.4x and 12.0x for FY12/06F and FY12/07F, respectively.

Table 1: Peer group comparisons

Company name	Ticker	Year End	Currency	Price	Market cap (US\$m)	P/E (x) FY06F	P/E (x) FY07F	P/E (x) FY08F
Lone Star Technologies	LSS US	Dec	USD	50.8	1,573	13.9	11.4	9.2
Grant Prideco	GRP US	Dec	USD	42.7	5,464	13.0	11.0	9.5
Hydriil	HYDL US	Dec	USD	73.3	1,635	19.9	16.4	12.7
Vallourec	VK FP	Dec	EUR	219.5	15,391	12.4	10.5	10.0
Tenaris SA	TEN IM	Dec	EUR	19.3	30,202	15.4	12.7	11.6
Shandong Molong	8261 HK	Dec	HKD	2.7	228	15.2	9.9	8.7
<i>Average</i>						<i>14.4</i>	<i>12.0</i>	<i>10.9</i>

Source: Bloomberg

Shareholders structure. Collectively, Tianda Holdings and Tianda Investment has 67.0% interest in the group (issued share capital of 507.6m shares). Baring Asset Management, Atlantis Investment Management Credit Agricole Asset Management and Northern Trust Fiduciary Services have 4.2%, 3.2%, 2.2% and 3.9% interest in the group respectively.

Driver 1: Capacity expansion. Designated production capacity at the group's two manufacturing plants is 300,000 t.p.a, currently. Approximately 83% and 17% of the capacity were devoted to the production of oil well pipes and other specialized seamless pipes in FY12/05A. An additional 50,000 t.p.a of capacity is expected to be added on its existing capacity, through technological upgrades and production optimization at its current production lines.

Driver 2: New products. The group plans to develop a 300,000 t.p.a. capacity to produce high grade oil well pipes. Its existing oil well pipes are catered for oil well with a depth of approximately 3,000 meters or less. Compared with the group's existing products, high grade oil well pipes are more heat-resistant and anti-corrosive. It can be applied to the offshore wells, deep wells and arctic wells. The proposed project has been classified as a part of the 861 Action Plan of Anhui Province. Nevertheless, the application for the proposed project is pending for approval from the authorities. Sales of high grade pipes can potentially be a new source of revenue to the group. Besides, demand for high grade pipe is expected to increase robustly going forward, since the mining companies will increase exploration in offshore and Western China, as resources lay in Eastern China have been depleting. Last but not least, high grade pipes is expected to command a gross profit margin higher than that of

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the group's existing oil well pipes, given its sophistication.

Driver 3: Margin enhancement. HK\$101.0m, or approximately 21.8% of the net proceeds raised from the group's IPO in December is earmarked for the installation of threading and heat processing line with production capacity of 100,000 t.p.a. The new line is expected to be on line by 1H FY12/07F. Currently, the group sells semi-finished products to its client (oilfield engineering companies at most cases), and the users must modify the pipes to cater for the requirements of different wells. When the new processing line commences operation, the group can offer customized finished products to its customers according to their unique specifications. This should lead to margin enhancement.

Driver 4: Favorable operating environment. The group stands to benefit from the increase in number of oil exploration and production (E&P) projects and rise in capex on oil E&P in China, as its casing pipes and oil transfer pipes products are the essential parts of the oil well structure. PetroChina's (857 HK, NR) and CNOOC's (883 HK, NR) E&P capex increased at a 4-year CAGR of 19.2% and 31.6%, between 2001 and 2005, respectively. It is expected that PetroChina and CNOOC will increase their E&P capex going forward on strong demand for oil in China, robust financial position and relative high crude prices.

Supportive policies. The government has promulgated a series of policies that are supportive to the pipe manufacturing industry in China and favorable to the group. The production of oil well pipes and boiler pipes is regarded as an encouraged segment in steel industry in China by National Development and Reform Commission (NDRC). The State Council of PRC intends to increase its support to the research and development of enterprises in mid-west. Furthermore, the group's high value added oil well pipes and petrochemical pipes expansion project has also been designated as part of the 861 Action Plan promoted and supported by the Anhui Provincial Government.

One of the largest oil well pipes manufacturers in China. With the top ten players occupied 99.6% of the market, the oil well pipes production industry in China is concentrated. With the market share of 3.8% in terms of output, the group was ranked seventh among oil pipe manufacturers in China in 2005, according to China Iron and Steel Association. Unlike its state-owned counterparts who offer a wide range of products, the group has been focusing on the production and development of specialized seamless pipes for over 13 years.

Certificated products' quality. The group was awarded the Product Inspection Waiver in December 2005, making it a preferred supplier of many large petrochemical companies in China. The group has been granted the API certification by American Petroleum Institute as well. Besides, the group's production plants have been recognized by national shipping registers such as China Classification Society in China, Det Norske Veritas in Norway, Lloyd's Register in the U.K., Germanischer Noske Veritas in Germany, etc..