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Margin enhancement **China Energy Logistics**

Anhui Tianda (8241 HK, HK$5.21) HOLD (Downgraded from BUY)

Target price: HK$5.35 (+2.7%)

Results slightly lower than expected. FY12/06A earnings came in at RMB118.5m or RMB0.335 per share, representing an annualized growth rate of 64.9%, beating the prospectus forecast of RMB110.0m by 7.7%, but below our forecast of RMB126.9m. The company proposed a final dividend of RMB0.05 per share, representing a payout ratio of 21.4%. Turnover increased 39.6% YoY to RMB1,265.3m, lower than our projection of RMB1,389.9m.

Margin expansion. The gross profit margin widened from 15.9% in FY12/05A to 19.9% in FY12/06A, above our projection of 18.0%. The enhancement of the blended margin was mainly due to the company's economies of scale and higher utilization rate.

Tax rate to be reduced. The company's effective tax rate surged from 25.3% to 37.9%, against our projection of 26.0%, as its deferred income tax surged 100.3% and current income tax charge more than six-fold. Since the company will install domestically made machinery at its new production facilities under the "861 plan", it will be entitled to a tax credit after the launch. However, we do not know how much in tax credit the group can receive.

Upgrade the products. The company has been developing heat and thread processing lines for oil casing pipes, which are expected to commence operation by 1H FY12/07F and produce 100,000 t.p.a. threaded oil casing pipes. The pipes can be used directly without further modification, with their quality enhanced by heat processing and suitable for harsh geological conditions.

Cash rich. The Chinese government has approved the company's plan to proceed with its 300,000 t.p.a. high grade oil well casing pipes production facility under the "861 Plan". The environmental impact assessment is underway and the company is applying for other approvals pursuant to environmental regulations. The project's budgeted capex of RMB790.0m will come from internal funds, bank loans and equity. As of the end of FY12/06A, the group was in a net cash position of RMB331.4m.

Premium deserved. Trading at P/E of 11.7x for FY12/07F and 9.7x for FY12/08F, the company's valuation is roughly in-line with its peers. However, Chinese oil country tubular goods (OCTG) producers should trade at higher earnings multiples than global peers, in our view, because of the better industrial outlook. PetroChina announced it would increase its budgeted capex for FY12/07F by 24.9% to RMB185.7b. Since Anhui Tianda's share price has surpassed our target price of HK$5.35, we are downgrading it to HOLD from BUY and revising our earnings forecasts for FY12/07F and FY12/08F as well as composing estimates for FY12/09F. We are also reviewing our valuation methodology and will review our rating after necessary modifications to our earnings and valuation model.

Table 1: Financial summary

Year to Dec	Net profit RMBm	EPS RMB	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	74.1	0.926	-	5.6	3.3	90.5	0.2	58.6	12.6	(68.3)
05A	71.9	0.263	(71.6)	19.6	4.6	22.3	1.2	32.8	31.5	(44.4)
06F	118.5	0.335	27.3	15.4	3.2	12.2	1.1	20.6	28.2	Cash
07F	223.8	0.441	31.8	11.7	2.7	8.0	2.1	24.4	29.5	Cash
08F	268.2	0.528	19.9	9.7	2.3	6.9	2.5	24.8	31.1	Cash

Table 2: Peer group comparisons

Company name	Ticker	Year end	Currency	Market cap (US$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward	EV/EBITDA 1-yr forward	EV/EBITDA 2-yr forward
Lone Star Technologies	LSS US	Dec	USD	1,472	11.9	8.7	5.5	4.4
Grant Prideco	GRP US	Dec	USD	5,950	11.7	10.2	8.0	7.0
Hydril	HYDL US	Dec	USD	2,046	19.8	16.1	10.9	9.4
Vallourec	VK FP	Dec	EUR	11,795	8.7	8.2	4.8	4.5
Tenaris SA	TEN IM	Dec	EUR	25,389	11.2	7.0	7.3	7.4
Anhui Tianda Oil Pipe	8241 HK	Dec	HKD	338	11.7	9.8	8.0	6.8
Enric Energy Equipment	3899 HK	Dec	HKD	243	19.0	13.9	14.7	10.6
Average					***11.1***	***8.2***	***6.9***	***6.6***

Source: SBI E2-Capital, Bloomberg