

Analyst: Louis Chan

## **GEM-board Listing - Research**

山東墨龍石油機械股份有限公司

**Shandong Molong Petroleum Machinery Company Limited [Stock Code: 8261]**

**Sponsor** : Deloitte & Touche Corporate Finance Ltd  
**Global Bookrunner** : Guotai Junan Securities (Hong Kong) Limited  
**Joint-Lead Managers** : Guotai Junan Securities (Hong Kong) Limited CM-CCS Securities Limited

**Sector:** Industrials – machineries

**Business:** Design, manufacture and sale of petroleum-extraction machineries and related accessories

<p><b>Total share offer:</b> <u>138,276,000</u> H shares (25.6% of the enlarged share capital)</p> <p><b>Public offer:</b> 13,828,000 new shares (10%)  <b>Placement:</b> 124,448,000 shares (90%)  - 121,170,000 new shares  - 3,278,000 sale shares</p> <p><b>Greenshoe:</b> 20,740,000 shares</p>	<p><b><u>Business of Shandong Molong</u></b></p>
<p><b>Price:</b> HK\$0.56-HK\$0.76 per H share  <b>H-share mkt cap.:</b> HK\$77.4 mln-HK\$105.1 mln</p> <p><b>Historical 2003 P/E:</b> 5.5x-7.5x  <b>Adjusted net tangible asset per share:</b> HK\$0.30-HK\$0.35</p> <p><b>Staffing:</b> 1,105</p>	<p>The Company is principally engaged in the design, manufacture and sale of petroleum-extraction machineries and related accessories. Its products can be grouped into 5 main categories, namely oil-well pipes, oil-well sucker rods, oil-well pumps, oil-well pumping machines and other petroleum-extraction machinery accessories. The Company's products are largely for sale to domestic oil fields within the PRC and are partly for export to North America.</p>
<p><b>Public offer opens:</b> 30<sup>th</sup> March 2004  <b>Public offer closes:</b> 2<sup>nd</sup> April 2004</p> <p><b>Receiving bank:</b> Standard Chartered Bank  <b>Share registrar:</b> Tricor Investor Services Limited</p> <p><b>Listing date:</b> 15<sup>th</sup> April 2004</p>	<p>The Company has been awarded several ISO quality certificates and has also been granted API's certificates regarding its licensed right to use the API Monogram on certain of the Company's principal products.</p> <p>The Company's main customers are oil fields in the PRC including Daqing Oil Field, Shengli Oil Field, Xinjiang Oil Field, Zhongyuan Oil Field and Liaohe Oil Field, all of them being subsidiaries or branch oil fields of PetroChina (stock code: 0857) and Sinopec (stock code: 0386).</p>

### **Major Shareholders after Listing**

(Assuming the over-allotment option is not exercised)

ZHANG Enrong (aged 64) – the chairman and a co-founder of the Company	51.76%
An executive director and 3 other staff at senior-management level	9.65%
LIN Fulong (aged 51) – an executive director and a co-founder of the Company	6.34%
ZHANG Yunsan (aged 42) – a co-founder of the Company and the son of the chairman	5.67%
Shengli Oil Field Kaiyuan Oil Exploration Company Ltd	0.97%
	<u>74.39%</u>

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**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$70.95 million

(Assuming that the over-allotment option is not exercised and an issue price of HK\$0.66 per share, being the midpoint of the proposed price range of HK\$0.56-HK\$0.76 per share)

	HK\$ million
To carry out R&D works	6.40
To expand the Company's production capacity	37.30
To improve and develop the Company's products	23.30
To carry out sales and marketing works	1.95
To expand the Company's work force	1.50
To obtain new certification and renew existing licences	0.50

**Financial Highlights**

	Year ended 31 <sup>st</sup> December		
	2003 RMB'000	2002 RMB'000	2001 RMB'000
Turnover			
Sale of petroleum machineries	<u>302,274</u>	<u>197,776</u>	<u>154,308</u>
Operating profit	64,085	28,777	14,029
Net profit	<u>43,977</u>	<u>19,098</u>	<u>11,528</u>
Dividends	-	22,275	-
EPS	<u>RMB0.1090</u>	<u>RMB0.0472</u>	<u>RMB0.0285</u>

**Strengths**

- ✓ The Company's gross profit margin was kept fairly steady at above 20% for each of the 3 years ended 31<sup>st</sup> December 2003. Meanwhile, its operating margin (2001: 9.1%; 2002: 14.6%; 2003: 21.2%) and net profit margin (2001: 7.5%; 2002: 9.7%; 2003: 14.6%) even managed to pick up markedly over the years.
- ✓ Industry revenues are dependent on the exploration and production capex of oil and gas producers. In fact, there has been a strong recovery of oil prices in the previous year or so while producers' earnings were at high levels in 2003. According to their respective capex plans, the mainland oil majors all propose to overhaul their spending this year, with a bulk of that in exploration and production.
- ✓ The counter is being offered at a 2003 historical P/E range of 5.5x-7.5x, which is not demanding for an industry that is not associated with rigorous competition (major competitors are mainly from the US and their products are unable to match the Company's in terms of product range and prices). Besides, the Company looks set to enjoy a prosperous year ahead with major oil producers increasing their spending in upstream machineries.

**Weaknesses**

- × As part of its overall strategy of expansion, the Company intends to invest approximately HK\$58.8 million in the production of special seamless oil-well pipes and super-strength oil-well sucker rods. In fact, these businesses are new to the Company and require different technologies, the use of different raw materials and production facilities. The move will surely alter the risk profile of the Company's operations. Furthermore, the Company's current management does not seem to possess the necessary expertise in this area and we therefore reckon it may face certain difficulties in launching the new products.
- × A significant portion of the Company's revenues are derived from a limited number of customers. For each of the 3 years ended 31<sup>st</sup> December 2003, the Company's sales to its largest customers, PetroChina, accounted for approximately 67.3%, 71.0% and 68.7% respectively of total turnover. Should any of those customers cancel or reduce their orders, there would be an adverse effect on the Company's profitability.

**Recommendation: Trading Buy**