

## Hilong Holding [1623.HK]

### 2014 results above estimates but a low quality beat; Rising receivables a concern

Hilong's 2014 net profit came in at RMB398m. Excluding an one-off tax refund of RMB38.4m in 1H14 and adding back non-cash expenses on CB, options and swap for both 2013 and 2014, recurring net profit in 2014 was RMB375m (-12% YoY), or 13% above our estimates as Hilong capitalized RMB24m of interest expenses (21% of total). The results imply a recurring net profit decline of 6% YoY in 2H14, versus a drop of 21% in 1H14. Hilong declared dividend of HK\$0.05 per share, implying payout ratio of ~17% (down from 29-30% over the past three years). We are concerned about the 31% increase in the trade receivables (versus a 5% revenue growth), with past due jumped 43% YoY. On the positive side, we are encouraged by the strong sales in overseas market and resilient oilfield services segment. Our earnings estimates, TP and rating are under review.

- Solid oil equipment manufacturing and services segment helped by higher drill pipe sales in overseas.** Drill pipe sales volume in 2014 reached 39,498t (+14% YoY), beating our estimate by 3.5%. Sales volume in 2H14 increased by 28% YoY to 21,377t (above company target of 20,000t), mainly driven by the strong growth of international sales (mainly in American market) in 2H14 (+113% YoY), more than offset a 17% decline in domestic market. ASP slightly dropped 1.4% YoY (-3.4% HoH) in 2H14 with full year ASP stayed flat YoY. OCTG coating services revenue moderately increased by 8.6% YoY in 2H14, due to the weakness in domestic market that dragged its growth. EBIT of the segment as a whole dropped 10% YoY in 2H14 due to margin pressure.
- Oilfield services segment still on a good growth trajectory.** This is the best performing segment with revenue increased by 23% YoY in 2H14, accelerated from 13% in 1H14. Segment EBIT increased by 17% YoY in 2H14. Growth was driven by new drill rigs commencement with high day rates and the increase in revenue from OCTG trading business.
- Rising receivable days a concern.** Trade receivables increased by 31% YoY to RMB1,535m as of end-2014, implying 192 days of receivables versus 165 days as of end-2013. Most importantly, RMB522m (34% of the trade receivables) were past due but not impaired. In particular, 39% of the RMB522m have not paid for more than one year. We are increasingly concerned about this issue.
- Analyst meeting at 10:00 a.m. (HK time) today.** Venue: Ballroom C, Level 5, Island Shangri-La Hotel, Pacific Place, Supreme Court Road, Hong Kong.
- Upside risks:** (1) Oil price recovery; (2) Drilling demand recovery; (3) More new order intakes. **Downside risks:** (1) Further capex cut by oil companies; (2) Potential suspension on drill rigs operation by customers; (3) Margin squeeze; (4) Rising receivables.

### Oilfield Services Sector

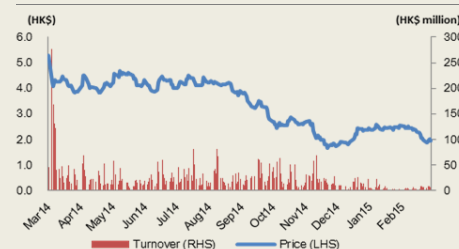
# HOLD

(Under review)

**Close: HK\$1.95 (Mar 20, 2015)**

**Target Price: HK\$2.52 (Under review)**

#### Share Price Performance



Market Cap	US\$424m
Shares Outstanding	1,695m
Auditor	PWC
Free Float	34%
52W range	HK\$1.61-5.62
3M average daily T/O	US\$0.8m
Major Shareholding	ZHANG Jun (Chairman and CEO)
	(60%)

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**Figure 1: Hilong results highlights**

Results highlights (RMB m)	1H13	1H14	Chg (YoY)	2H13	2H14	Chg (YoY)	2013	2014	Chg (YoY)	Comments
<b>Oilfield equipment manufacturing and services</b>										
Revenue	575	589	2%	639	681	7%	1,214	1,270	5%	Drill pipe revenue +4.6% YoY.
Cost of sales	(300)	(350)	17%	(344)	(345)	0%	(644)	(696)	8%	OCTG coating services revenue +4.8% YoY.
Gross profit	276	239	-13%	295	336	14%	570	575	1%	
Gross margin	47.9%	40.6%		46.1%	49.3%		47.0%	45.3%		Gross margin improved in 2H14.
Operating expenses	(211)	(130)	-38%	(134)	(191)	42%	(345)	(321)	-7%	
Opex ratio	36.7%	22.0%		21.0%	28.1%		28.4%	25.3%		
EBIT	65	109	69%	160	144	-10%	225	254	13%	
EBIT margin	11.2%	18.6%		25.1%	21.2%		18.5%	20.0%		
<b>Line pipe technology and services</b>										
Revenue	173	120	-31%	192	152	-21%	365	272	-26%	Revenue decline was due to weakness line pipe
Cost of sales	(131)	(77)	-42%	(135)	(107)	-20%	(266)	(184)	-31%	coating segment despite strong growth of CRA lined
Gross profit	42	43	4%	58	44	-23%	99	88	-12%	pipe sales (accounted for 27% of the segment
Gross margin	24.1%	36.1%		29.9%	29.2%		27.1%	32.3%		revenue).
Operating expenses	(24)	(21)	-14%	(17)	(14)	-18%	(41)	(35)	-15%	
Opex ratio	14.1%	17.6%		8.7%	9.0%		11.3%	12.8%		
EBIT	17	22	29%	41	31	-25%	58	53	-9%	
EBIT margin	10.0%	18.5%		21.2%	20.2%		15.9%	19.5%		
<b>Oilfield services</b>										
Revenue	417	473	13%	456	560	23%	873	1,032	18%	
Cost of sales	(253)	(307)	21%	(301)	(368)	22%	(554)	(675)	22%	
Gross profit	164	166	1%	155	191	24%	318	357	12%	
Gross margin	39.3%	35.0%		33.9%	34.2%		36.5%	34.6%		
Operating expenses	(50)	(53)	5%	(47)	(62)	32%	(97)	(115)	18%	
Opex ratio	12.0%	11.2%		10.4%	11.2%		11.2%	11.2%		
EBIT	114	113	-1%	107	126	17%	221	239	8%	
EBIT margin	27.3%	23.9%		23.6%	22.5%		25.3%	23.1%		
<b>Offshore engineering services</b>										
Revenue	0	0	n/a	0	2	n/a	0	2	n/a	Contribution of pipe laying vessel will start contribution
Cost of sales	0	0	n/a	0	(1)	n/a	0	(1)	n/a	in 2015.
Gross profit	0	0	n/a	0	1	n/a	0	1	n/a	
Gross margin	0.0%	n/a		0.0%	70.6%		0.0%	70.6%		
Operating expenses	0	(6)	n/a	0	(5)	n/a	0	(11)	n/a	
Opex ratio	0.0%	n/a		0.0%	280.0%		0.0%	635.8%		
EBIT	0	(6)	n/a	0	(4)	n/a	0	(10)	n/a	
EBIT margin	0.0%	n/a		0.0%	-209.5%		0.0%	-565.3%		
<b>Total</b>										
Revenue	1,165	1,182	1%	1,287	1,394	8%	2,452	2,576	5%	
Cost of sales	(684)	(734)	7%	(780)	(822)	5%	(1,464)	(1,555)	6%	
Gross profit	481	448	-7%	507	573	13%	988	1,021	3%	Gross margin rebounded in 2H14.
Gross margin	41.3%	37.9%		39.4%	41.1%		40.3%	39.6%		
Operating expenses	(285)	(210)	-26%	(199)	(272)	37%	(484)	(482)		
EBIT	196	238	22%	309	297	-4%	504	536	6%	
D&A	63	83	32%	73	82	11%	136	164	21%	
EBITDA	259	321	24%	382	379	-1%	640	700	9%	
Finance income	5	1	n/a	4	12	218%	8	13	54%	
Finance costs	(34)	(51)	49%	(37)	(39)	6%	(71)	(90)	26%	RMB24m of interest payment was capitalized in 2014.
Profit/(loss) of associates/JCE	(5)	2	n/a	6	1	-89%	1	3	287%	
Pretax profit	161	191	19%	281	270	-4%	442	462	4%	
Income tax expenses	(43)	(2)	-95%	(29)	(45)	56%	(72)	(47)	-35%	Income tax decline was due to one-off tax refund of
After tax profit	118	189	60%	252	226	-11%	371	415	12%	RMB38m in 1H14.
Minority interests	(15)	(10)	-32%	(11)	(7)	-33%	(26)	(17)	-32%	
Net profit	103	179	73%	241	218	-9%	345	398	15%	
Recurring net profit	177	141	-21%	248	234	-6%	425	375	-12%	Recurring net profit is adjusted for the one-off tax effect.

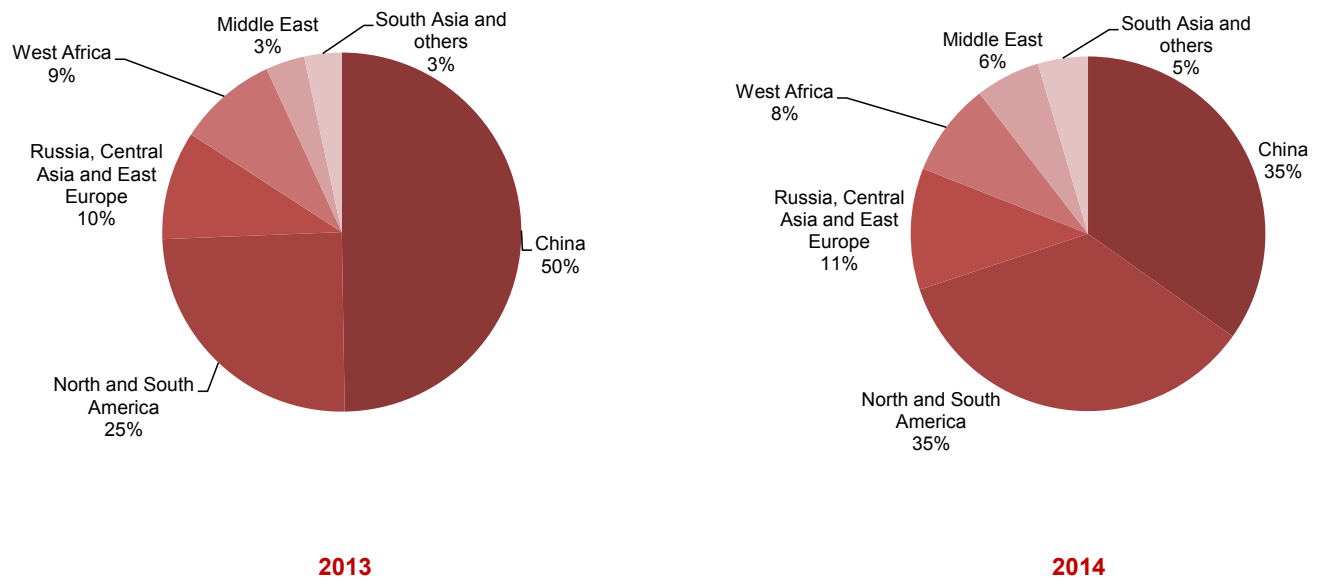
Sources: Company, CGIHK Research estimates

Figure 2: Hilong drill pipe segment highlights

Revenue (RMB m)	2007	2008	2009	2010	2011	2012	2013	2014
<b>Drill pipes and related products</b>								
<b>Drill pipes</b>								
<b>Breakdown by region</b>								
<b>China</b>								
Sales volume (t)	15,839	21,900	11,314	14,469	14,549	22,194	20,997	15,397
Change YoY	-	38.3%	-48.3%	27.9%	0.6%	52.5%	-5.4%	-26.7%
ASP (RMB/t)	30,941	25,493	26,357	24,961	28,357	24,954	23,280	22,427
Change YoY	-	-17.6%	3.4%	-5.3%	13.6%	-12.0%	-6.7%	-3.7%
<b>Revenue (RMB m)</b>	<b>490</b>	<b>558</b>	<b>298</b>	<b>361</b>	<b>413</b>	<b>554</b>	<b>489</b>	<b>345</b>
Change YoY	-	13.9%	-46.6%	21.1%	14.2%	34.2%	-11.7%	-29.4%
<b>Overseas</b>								
Sales volume (t)	4,419	17,120	3,961	10,550	13,059	15,213	13,665	24,101
Change YoY	-	287.4%	-76.9%	166.3%	23.8%	16.5%	-10.2%	76.4%
ASP (RMB/t)	35,931	37,830	29,395	25,842	25,267	24,541	23,401	23,745
Change YoY	-	5.3%	-22.3%	-12.1%	-2.2%	-2.9%	-4.6%	1.5%
<b>Revenue (RMB m)</b>	<b>159</b>	<b>648</b>	<b>116</b>	<b>273</b>	<b>330</b>	<b>373</b>	<b>320</b>	<b>572</b>
Change YoY	-	307.9%	-82.0%	134.2%	21.0%	13.1%	-14.3%	79.0%
<b>Drill pipe total</b>								
<b>Sales volume (t)</b>	<b>20,258</b>	<b>39,020</b>	<b>15,275</b>	<b>25,019</b>	<b>27,608</b>	<b>37,407</b>	<b>34,662</b>	<b>39,498</b>
Change YoY	-	92.6%	-60.9%	63.8%	10.3%	35.5%	-7.3%	14.0%
ASP (RMB/t)	32,030	30,906	27,145	25,333	26,895	24,786	23,328	23,231
Change YoY	-	-3.5%	-12.2%	-6.7%	6.2%	-7.8%	-5.9%	-0.4%
<b>Drill pipe revenue (RMB m)</b>	<b>649</b>	<b>1,206</b>	<b>415</b>	<b>634</b>	<b>743</b>	<b>927</b>	<b>809</b>	<b>918</b>
Change YoY	-	85.9%	-65.6%	52.9%	17.2%	24.9%	-12.8%	13.5%
Drill pipe components	0	0	0	21	94	27	83	30
Hardbanding	0	14	14	25	16	12	13	16
Equipment	13	18	34	1	11	16	1	0
Others	8	24	56	32	41	29	45	30
<b>Total</b>	<b>670</b>	<b>1,261</b>	<b>519</b>	<b>713</b>	<b>904</b>	<b>1,011</b>	<b>951</b>	<b>994</b>
Change YoY	-	88.2%	-58.9%	37.5%	26.7%	11.9%	-6.0%	4.6%

Sources: Company, CGIHK Research

**Figure 3: Hilong revenue breakdown by regions**



Sources: Company, CGIHK Research

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HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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