广发证券(香港)经纪有限公司
GF SECURITIES (HONG KONG) BROKERAGE LIMITED

Petro-king (2178 HK)

Underperform (downgraded)

Target price: HK$0.93

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Cashflow remains a concern; downgrade to Underperform

Net loss for 2014 on receivables impairment Petro-king recorded a net loss of HK$418m in 2014, vs our estimate/consensus of a net loss of HK$32m/HK$26m. The discrepancy was mainly due to the HK$280m provision for the impairment of trade receivables due to slow payments from PDVSA. Revenue dropped 34% YoY to HK$705m during the year, dragged down by the decline in production enhancement services in China as well as the substantial drop in revenue from South America on PDVSA's slow payments.

Uncertainty remains in repayments from PDVSA in 2015 We were not surprised to see Petro-king adopt "big bath" accounting in 2014 for the impairment of receivables from PDVSA as its ability to repay is directly linked to the crude oil price. Management indicated that they used Venezuelan bolivar CDSs as a reference point to arrive at a 60% impairment for receivables from PDVSA. Repayment of receivables is still slow. Regarding the screen pipes that are yet to be delivered to PDVSA, management reiterated that they will not deliver until further repayment is received.

Better order flow expected in 2015 In order to spur a recovery in profitability, management aims to reduce opex, including cutting employee benefits by 25% and conducting a further headcount reduction. Overall, management is upbeat on the outlook for 2015. YTD, contracts on hand (excluding those from South America) have reached HK$500m, according to management. Contracts from Iraq amount to ~HK$300m, with the rest primarily from Central Asia. EBIT margin should have stabilized thanks to the persistent increase in client recognition of Petro-king's self-manufactured tools.

Conservative cashflow outlook We are still concerned about how Petro-king will improve cashflow in 2015 after seeing both inventory and receivable turnover days skyrocket to >400 days in 2014. Management indicated that 20% of receivables have been collected in 1Q15. However, we still have some reservations on this issue and expect both inventory and receivables turnover days to remain above 300 days in 2015. Nevertheless, following the further repayment of bank loans and the ~HK$300m raised from its CB issuance and rights issue, net gearing has been lowered further to 21% so far in 2015 (from 28% in 2014).

Downgrade to Underperform We slash our 2015/16 earnings forecasts further, from HK$36m/89m to HK$-56m/-19m given a more conservative outlook for cost reduction and revenue growth. We maintain our valuation benchmark of 0.6x forward P/B to reflect a discount for weak cashflow. We cut our target price from HK$1.10 to HK$0.93, and downgrade the stock to Underperform.

Stock performance

Source: Bloomberg

Key data

Mar 30 close (HK$)	1.12
Shares in issue (m)	1,235
Major shareholder	Wang Jinlong (28%)
Market cap (HK$ bn)	1.4
3M avg. vol. (m)	2.1
52W high/low (HK$)	3.11 / 1.00

Source: Bloomberg

Stock valuation

	Turnover (HK$ m)	Net profit (HK$ m)	EPS (HK$)	EPS YoY (%)	P/E	BPS (HK$)	P/B	ROE (%)
2013	1,063	197	0.184	17	6.1	2.1	0.55	9.0
2014	706	-423	-0.392	NM	NM	1.6	0.69	-24.2
2015E	844	-56	-0.045	-87	NM	1.5	0.73	-2.9
2016E	1,026	-19	-0.015	-66	NM	1.5	0.73	-1.0
2017E	1,237	48	0.039	NM	28.8	1.6	0.71	2.5

Sources: Company data, GF Securities (HK)
Note: Calculated based on fully diluted shares after completion of right issues

Rating definitions

Benchmark: Hong Kong Hang Seng Index
Time horizon: 12 months

Company ratings	
Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%
Sector ratings	
Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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