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February 10, 2014

Stock Rating
Overweight

Industry View
Cautious

China Petroleum & Chemical Corp.

Sharp Drop in Marketing Margin in 2015 Not Realistic, Raise 2013-14e EPS, OW

What's Changed	
Price Target	**HK$7.96 to HK$8.03**
2013e and 2014e EPS	**Up 4% and 3%**

We think it is unrealistic for Sinopec's marketing margin to decline sharply in 2015. We believe China will apply a market mechanism to deregulate the downstream; as a result, the integrated distribution channel is critical and penetration by new competitors will take a long time.

Sinopec's marketing margin unlikely to face sharp decline in 2015: Our analysis on pages 4-5 suggests that 1) Sinopec's refinery margin recovery reflects its OP strength and earlier facility upgrade; and 2) Sinopec and PetroChina still dominate the oil distribution landscape, and that is unlikely to change materially in 2014/15. In addition, we believe China will make oil quality upgrade its top priority and avoid a major reshuffle in the distribution network. Our channel check also suggests limited change in private refiner's yield even with the grant of a new crude oil import quota.

Asset sale unlikely to harm shareholder value: As for the potential injection of pipeline assets into Sinopec Kantons, we believe management is likely to apply a win-win strategy (i.e., Sinopec Kantons would not gain at the cost of Sinopec's loss).

QoQ earnings drop fully in line with our/market expectation: Lower crude oil prices in 4Q13 vs. 3Q13 will lead to lower E&P EBIT and lower refinery margin, which we believe is well understood by the market. We raise our earnings estimates by 4% in 2013 and 3% in 2014 to reflect 1) upbeat 3Q results; 2) better than expected E&P and refinery performance in 2013.

Key Ratios and Statistics

Reuters: 0386.HK Bloomberg: 386 HK
China Oil & Gas

Price target	HK$8.03
Up/downside to price target (%)	38
Shr price, close (Feb 7, 2014)	HK$5.84
52-Week Range	HK$7.20-5.02
Sh out, dil, curr (mn)	116,565
Mkt cap, curr (mn)	Rmb531,986
EV, curr (mn)	Rmb601,458
Avg daily trading value (mn)	Rmb526

Fiscal Year ending	12/12	12/13e	12/14e	12/15e
ModelWare EPS (Rmb)#	0.74	0.57	0.58	0.65
Prior ModelWare EPS (Rmb)	-	0.55	0.56	0.64
Consensus EPS (Rmb)§	0.70	0.60	0.66	0.69
Revenue, net (Rmb mn)	2,786,045	2,906,716	3,085,718	3,299,280
EBITDA (Rmb mn)	169,118	173,583	188,215	211,448
ModelWare net inc (Rmb mn)	63,879	66,919	67,597	75,400
P/E	7.4	8.6	7.9	7.1
P/BV	0.9	1.0	0.9	0.8
RNOA (%)	13.6	13.1	12.4	12.5
ROE (%)	13.5	13.1	12.2	12.6
Div yld (%)	5.5	4.2	4.6	5.1
Leverage (EOP) (%)	48.0	52.4	56.3	57.6

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
= Our pension accounting has changed in ModelWare, which will affect ModelWare EPS figures for some stocks under coverage. Visit www.ms.com/mw.pdf for details
§ = Consensus data is provided by Thomson Reuters Estimates.
e = Morgan Stanley Research estimates

Financial Summary

Profit and Loss Statement	2012	2013E	2014E	2015E
Gross revenue	2,786	2,907	3,086	3,299
Cost of goods sold	2,687	2,806	2,980	3,179
EBIT	**99**	**101**	**106**	**120**
- E&P	70	60	56	59
- Refinery	(11)	7	14	22
- Marketing	43	36	38	41
- Chemical	1	(0)	1	1
Net interest expense	10	9	12	14
Other operating income	0	1	1	1
Other non-operating income	2	2	2	1
Pretax profit	**91**	**94**	**97**	**108**
Tax expense	24	25	26	29
Minority interest	3	2	3	3
Net profit	**64**	**67**	**68**	**75**
EBITDA	**169**	**174**	**188**	**211**
Reported EPS (Rmb)	**0.74**	**0.57**	**0.58**	**0.65**

Balance Sheet	2012	2013E	2014E	2015E
Net fixed assets	758	884	987	1,083
Long-term investments	52	55	55	55
Other non-current assets	92	85	78	80
Total Non-Current Assets	**902**	**1,024**	**1,121**	**1,218**
Cash & other liquid assets	10	14	16	17
Non-cash assets	355	365	387	423
Total Current Assets	**365**	**379**	**403**	**440**
Current borrowings	116	137	157	173
Other current liabilities	397	437	464	510
Total Current Liabilities	**513**	**574**	**621**	**683**
Net Assets	**753**	**829**	**903**	**975**
Long-term debt	162	191	220	242
Other long-term liabilities	43	46	47	48
Shareholders equity (Incl. minority)	**548**	**592**	**636**	**685**
Capital Employed	**753**	**829**	**903**	**975**

Cash Flow Statement	2012	2013E	2014E	2015E
Gross Cash Flow	178	181	197	220
Capex	(157)	(188)	(200)	(202)
Working capital adj	(36)	(7)	(28)	(22)
Free Cash Flow	**(15)**	**(13)**	**(31)**	**(3)**
Sale of fixed assets/invmts	2	0	0	0
Share issues	0	23	0	0
Purchase of invmts/subsids/intang.	(10)	(3)	0	0
Share repurchases	0	0	0	0
Dividends paid	(25)	(26)	(24)	(24)
Net borrowings/repayment	(38)	22	55	27
Others	73	1	1	1
Increase/(decrease in cash)	**(14)**	**4**	**2**	**1**
Beginning cash	25	10	14	16
Ending cash	**10**	**14**	**16**	**17**

Ratio Analysis	2012	2013E	2014E	2015E
Growth (%)				
Revenue	11%	4%	6%	7%
EBIT	-7%	2%	5%	13%
EBITDA	0%	3%	8%	12%
Pretax Profit	-13%	4%	2%	12%
Net Profit	-13%	5%	1%	12%
Margins (%)				
EBITDA margin	6%	6%	6%	6%
EBIT margin	4%	3%	3%	4%
Net profit margin	2%	2%	2%	2%
Return (%)				
ROE	13%	13%	12%	12%
ROA	5%	5%	4%	5%
Gearing (%)				
Net Debt/Equity	52%	57%	60%	62%
Long-term Debt/Equity	40%	43%	45%	45%
Total Debt/Equity	1.4	1.5	1.5	1.5
Net Interest Coverage	8.8	9.5	7.9	8.0

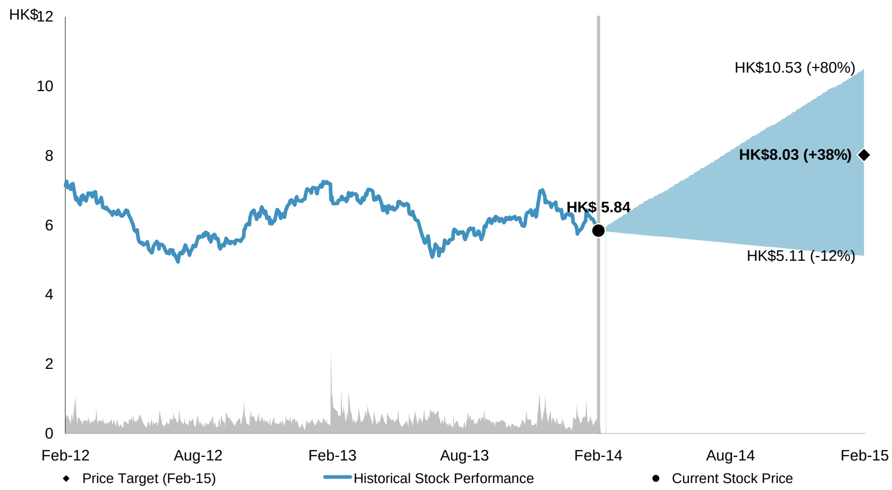
Operational Analysis	2012	2013E	2014E	2015E
Oil production growth	2%	2%	1%	1%
Gas production growth	16%	9%	4%	4%
Total production growth	5%	4%	2%	2%
Real. oil price (US$/bbl)	104	96	92	90
Real. gas price (US$/mcf)	5.8	7.1	8.3	9.5
E&P OP Change	5%	-1%	-2%	-4%
Refinery throughput growth	2%	5%	5%	5%
Refining EBIT (US$/bbl)	(0.8)	0.7	1.4	2.0
Marketing volume growth	5%	3%	5%	5%
Marketing margin (Rmb/ton)	268	220	220	225
Chemical production growth				
- Ethylene	-4%	4%	5%	5%
- Synthetic resins	-2%	8%	4%	10%
- Synthetic rubbers	-5%	5%	5%	5%
- Monomers and polymers	-5%	6%	5%	5%
- Synthetic fibers	-4%	5%	5%	5%
Chemical margin (Rmb/ton)	34	(10)	20	25

Valuation	2012	2013E	2014E	2015E
P/E	7.3	8.7	8.0	7.1
P/BV	0.9	1.1	0.9	0.8
EV/EBITDA	5.5	5.4	5.0	4.6
Dividend yield	5.6%	4.1%	4.5%	5.0%
FCF Yield	-2.4%	-2.3%	-5.7%	-0.6%

Note: Valuation may differ from ModelWare calculation due to exchange rate and definition differences. Year end as of Dec 31, Unit in Rmb bn, E = Morgan Stanley Research estimates, Source: Company data, Morgan Stanley Research

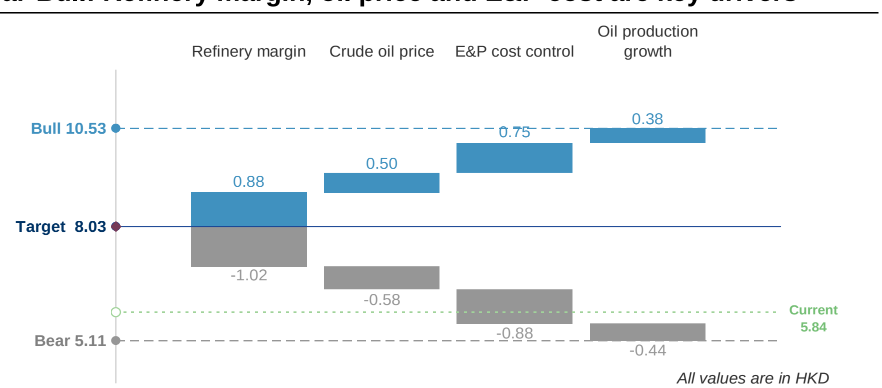
Risk-Reward Snapshot: Sinopec (0386.HK, HK$5.84, OW, PT HK$8.03)

Sustainable marketing margin and potential win-win asset sales, OW



Price target HK$8.03		Derived from our base case SOTP valuation.
Bull case HK$10.53	Implies 13.2x bull case 2014e EPS	**Higher oil prices favor E&P earnings, not much downside to refinery improvement:** In a scenario of higher crude oil prices with Brent at ~US$110/bbl, the E&P division is likely to achieve better earnings while the refinery EBIT margin could continue to improve as illustrated in our base case.
Base case HK$8.03	Implies 10.9x base case 2014e EPS	**Refinery margin recovery from oil product quality upgrade + marketing margin does not decline significantly:** We expect refinery margin to show improvement and turnaround, marketing EBIT to remain reasonable with slight improvement and chemical EBIT has slight recovery in 2014-2015.
Bear case HK$5.11	Implies 8.2x bear case 2014e EPS	**Hard landing for China's economy, significant correction in oil prices, no downstream recovery for five years:** With lower crude oil prices, E&P profitability faces downside pressure while recovery in the refinery margin is also weaker than expected.

Bear-Bull: Refinery margin, oil price and E&P cost are key drivers



Source: Thomson Reuters, Morgan Stanley Research estimates

Why Overweight?

- High downstream exposure makes Sinopec a potential outperformer with outlook for lower crude oil prices.
- With earlier refinery facility upgrade, we expect Sinopec's refinery margin to recover in 2014-15;
- Marketing margin is not likely to drop significantly, as the integrated distribution channel is still dominated by Sinopec and PetroChina;
- We believe the valuation is attractive: 0.9x 2014e P/B vs. 12% ROE,.

Key Value Drivers

- Refinery margin
- Crude oil price
- E&P cost control
- E&P production growth

Potential Catalysts

- Improvement of refinery margin thanks to accelerated oil price reform;
- Stronger-than-expected economic growth and demand in China;
- Accelerated oil product quality upgrade
- Increase in E&P production
- Recovery of chemical margins
- Higher crude oil prices;
- Better-than-expected E&P cost control;
- Breakthrough in shale gas.

Key Downside Risks

- Growth shock in China;
- Significant correction in crude oil prices;
- Lower refinery margin due to delayed oil price reform; and
- Production cost overrun in the E&P segment.

We Reiterate Our OW Rating on Sinopec

We believe market concern regarding a significant correction in marketing margin in 2015 is overdone: Our analysis of this debate suggests that the industry landscape is unlikely to change materially unless private or foreign enterprises can build an integrated channel from refinery to wholesale and then to retail distribution.

We raise our earnings estimates by 4% in 2013 and 3% in 2014: This is in light of upbeat 1Q-3Q13 results and only a slight decline in crude oil prices in 4Q13 vs. 3Q13,

Consequently, we raise our price target to HK$8.03: That implies 1.2x 2014e P/B, vs. the current 0.9x.

Debate on Marketing Margin in 2015

Market view: to be halved in 2015 as China's oil distribution market will be deregulated. Though Sinopec's refinery margin should improve in 2014-15, the government is likely to take back marketing margin as a balance.

Our view: We completely disagree. We think it is unrealistic for Sinopec's marketing margin decline to decline significantly in 2015, for three reasons:

1) China's oil product distribution network is still dominated by Sinopec and PetroChina;

2) Sinopec's refinery margin recovery is a reflection of OP strength & earlier facility upgrade;

3) Oil product quality upgrade is China's top priority, a rush deregulation would be a negative here.

We also disagree that the government will reduce Sinopec's marketing profitability to offset the company's refinery margin recovery in 2014-15. The policy will be applied for the whole nation; a cross-check on PetroChina's refinery and marketing margin trend suggests that such an offset would not work.

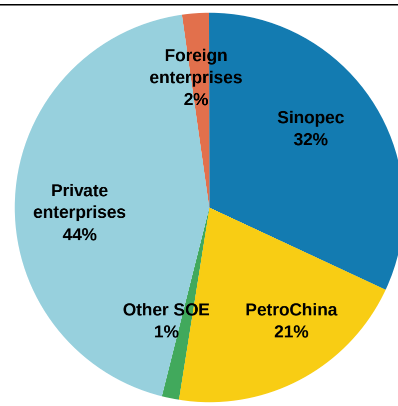
1) Sinopec and PetroChina still dominate China's oil product distribution network
We think the gradual deregulation is unlikely to change the landscape of oil product distribution in China within a short period of time. Based on data in Exhibits 1-2, Sinopec and PetroChina control 53% of the gas stations in China, but those two companies are distributing ~75% of oil products in China, implying:

a) Sinopec and PetroChina's gas stations are in premium locations and generate much higher sales volume than private-owned stations.

b) Gas stations alone are not the key competitive edge in the distribution business. The integrated channel – from refinery to wholesale and then to retail – is the core strength.

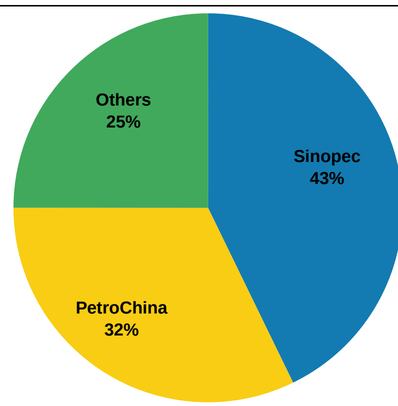
c) The mumber of gas stations controlled by private enterprises is not small, however, it hasn't been a key driver of marketing margin from 2006 to 2012. Instead, overall economic conditions are still the key driver of marketing margin.

Exhibit 1
China – Oil Product Distribution – Market Share by Number of Service Stations



Note: Data as of end of 2012. Source: Ministry of Commerce, Sinopec, PetroChina, Morgan Stanley Research

Exhibit 2
China – Oil Product Distribution – Market Share by Sales Volume



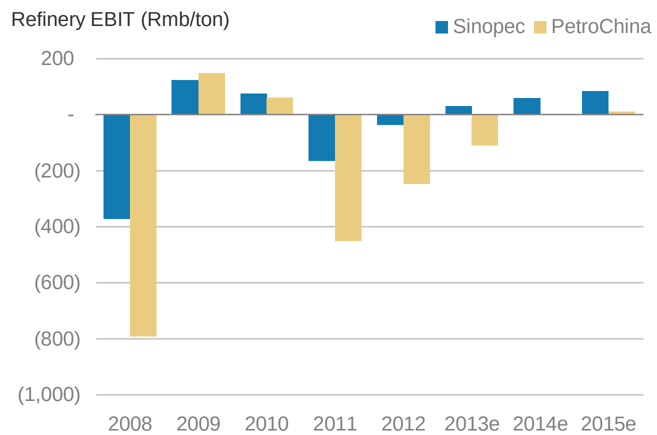
Note: Data as of end of 2012. Source: Ministry of Commerce, Sinopec, PetroChina, Morgan Stanley Research

2) Refinery margin recovery is a reflection of Sinopec's OP strength and earlier facility upgrade

Sinopec's refinery margin recovery does not reflect the government's aggressive price increases during the oil product quality upgrade. Instead, it mainly stems from earlier facility upgrade, which led to a higher cost basis in 2012-13. In addition, the recovery in refinery margin reflects e strength of Sinopec's refinery operation in China, rather than unfair policy support for the company. Our comparison of refinery margin between Sinopec and PetroChina in Exhibit 3 suggests that Sinopec has consistently outperformed PetroChina in the past five years.

Exhibit 3

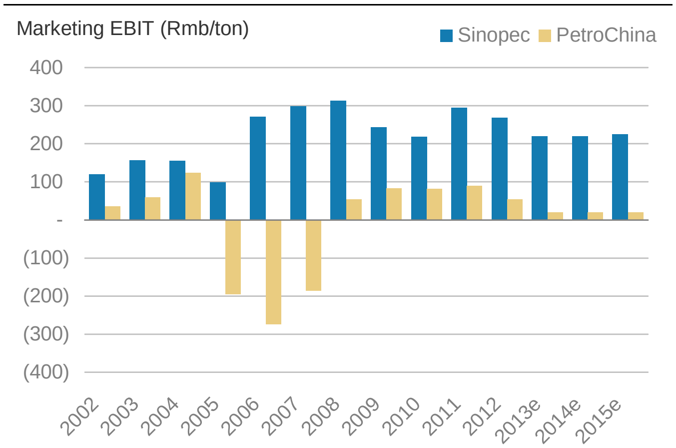
Sinopec vs. PetroChina Refinery Margin, 2008-2015e



e = Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Exhibit 4

Sinopec & PetroChina Marketing EBIT, 2009 – 2015e



Note: Data for PetroChina in 2002 – 2007 includes marketing EBIT and refinery EBIT. As PetroChina does not report total sales volume of all oil product, data for PetroChina is a self-produced EBIT based on refinery throughput. e = Morgan Stanley Research estimates. Source: Company Data, Morgan Stanley Research

3) Taking marketing margin back sounds logical for Sinopec, but not for PetroChina

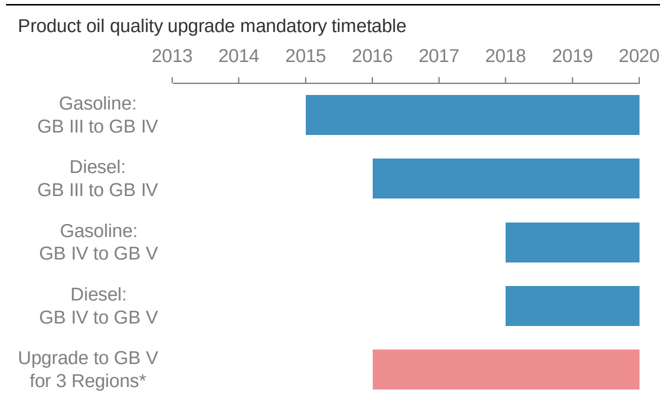
What's more, though it sounds logical for the government to take the marketing margin back while awarding higher refinery margin to Sinopec, it doesn't make sense if we take a look from PetroChina's perspective. Owing to later capacity upgrade to GB-IV standard, PetroChina is unlikely to record significant refinery profits in 2014 and 2015 (Exhibit 3). Meanwhile, if Sinopec's market margin is halved because of deregulation in China, PetroChina's marketing margin would also face significant downside (exhibit 4). This supports our view that the government is unlikely to take back market margin on Sinopec to balance the refinery gain – the same practice would have negative impact only on PetroChina.

4) Oil product quality upgrade top priority, a rush deregulation would be negative for the upgrade

We believe the government will make environmental protection and oil product quality upgrade a top priority in 2014-15. As a result, it is more likely to apply a gradual approach on the deregulation. Any rush deregulation measures in refinery and distribution would be likely to destabilize the market and delay the progress of upgrading.

Exhibit 5

China – Oil Product Quality Upgrade Timetable



Note: Unless specified, the timetable is applicable nationwide. * The three regions include Beijing-Tianjin-Hebei region, the Yangtze Delta region and the Pearl River Delta region. Source: State Council, Morgan Stanley Research

Asset sale unlikely to harm shareholder value

On December 30, 2013, Sinopec Kantons (0934.HK, Not Covered) announced that Sinopec was considering a potential asset injection: the Yulin – Jinan Natural Gas Transmission Pipeline, ~940 kilometers long, passing through four provinces (Shaanxi, Shanxi, Henan, and Shandong).

We believe Sinopec is unlikely to harm shareholder value during the potential asset sale. State-owned companies need to conduct asset valuations before any transfer and report to SASAC regarding its reasonableness.

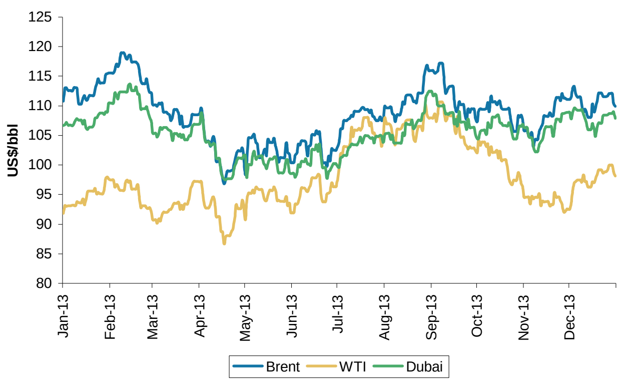
In addition, we think the management will follow a ‘win-win’ strategy in the potential transaction because Sinopec Kantons is a connected party. A scenario where Sinopec Kantons would gain at the cost of Sinopec’s loss would not reflect well on the company. Considering the flagship status, we think Sinopec will apply a fair approach toward the potential transaction.

QoQ Earnings Drop in 4Q13 Fully In Line with Market Expectation

We believe the market is well aware of a QoQ earnings drop in 4Q13. Lower crude oil prices in 4Q13 vs. 3Q13 will lead to lower E&P EBIT and lower refinery margin.

Exhibit 6

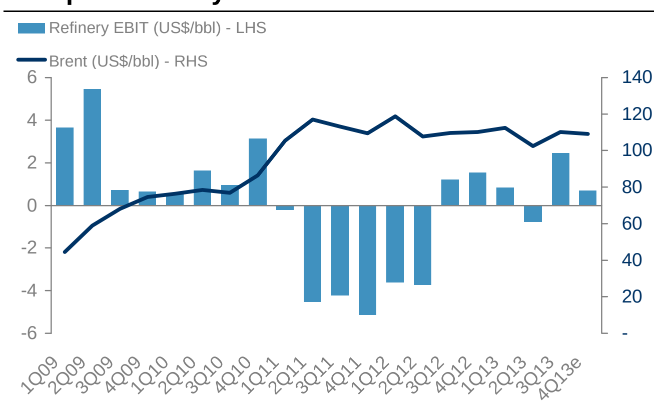
Sinopec E&P EBIT to Decline in 4Q13 on Lower Crude Oil Price



e = Morgan Stanley Research estimate, Source: Bloomberg EIA, Morgan Stanley Research

Exhibit 7

Sinopec Refinery EBIT vs. Brent Crude



e = Morgan Stanley Research estimate, Source: Company Data, EIA, Morgan Stanley Research

Llower crude oil prices will naturally lead to lower E&P EBIT, which is well expected by the market. As for refinery margin, we think it is still likely to remain positive despite the slight decline in crude oil prices. The company recorded refinery EBIT of Rmb6.4 bn in 3Q13, which is mainly thanks to the high crude oil price sin that quarter. For the same reason, we think it would be no surprise to see refinery margin decline in 4Q13.

3Q13 Results Upbeat, Raise 2013-14 Earnings Estimates

We raise our earnings estimates by 4% in 2013 and 3% in 2014. The 2013 increase reflects upbeat 3Q13 results. EBIT in both the E&P and refinery segments was better than we expected, and we thus raise our full-year estimates accordingly.

Exhibit 8

Sinopec 1Q-3Q13 Results

Unit: Rmb bn	1Q11	2Q11	3Q13	YoY	QoQ	1Q-3Q13	YoY
Turnover							
E&P	48	58	54	1%	2%	164	-3.9%
Refining	278	315	329	11%	7%	970	4.0%
Marketing & distribution	309	343	381	2%	3%	1,108	2.7%
Chemicals	101	105	108	12%	5%	316	7.6%
Corp & others	278	295	336	19%	1%	1,017	8.6%
Inter seg elimination	*(433)*	*(479)*	*(494)*	*12%*	*8%*	*(1,466)*	3.2%
Other operating revenues	8	9	11	-11%	12%	31	-7.9%
Gross Revenue	**589**	**644**	**725**	**7%**	**1%**	**2,140**	**5.7%**
Operating profit	**30.7**	**27.7**	**31.5**	**12%**	**65%**	**78.3**	**14.7%**
E&P	13.1	21.5	15.8	7%	7%	46.7	-15.4%
Refining	(0.6)	(11.6)	6.4	113%	n.m.	6.7	n.a.
Marketing & distribution	9.2	10.4	10.2	2%	32%	27.0	-10.5%
Chemicals	9.3	7.0	0.4	-64%	n.m.	(0.1)	n.a.
Corp & others	(0.3)	0.3	(1.2)	112%	72%	(2.1)	n.a.
Interest expense	(2.4)	(2.2)	(2.4)	-21%	-3%	(7.7)	-15.5%
Interest income	0.3	0.3	0.4	-26%	31%	1.0	-9.7%
FX gain/(loss)	0.3	0.3	(0.1)	-34%	n.m.	1.2	n.a.
Investment income	0.0	0.1	0.0	-50%	52%	0.1	-35.4%
Associate	1.5	1.3	0.6	206%	64%	1.5	183.8%
Exception	(0.1)	0.3	0.8	20%	-67%	1.6	33.3%
Pretax profit	**30.2**	**27.8**	**30.8**	**17%**	**46%**	**75.9**	**22.9%**
Tax expense	(7.8)	(6.1)	(7.5)	1%	16%	(20.2)	18.6%
Minority interest	(1.8)	(1.2)	(1.3)	105%	15%	(3.4)	77.4%
Net profit	**20.6**	**20.5**	**22.0**	**20%**	**62%**	**52.3**	**22.1%**
				Bps Change			**Bps Chg**
Financial Ratio	**1Q11**	**2Q11**	**3Q13**	**YoY**	**QoQ**	**1Q-3Q13**	**YoY**
OP Margin	**5.2%**	**4.3%**	**4.4%**	**19**	**169**	**3.7%**	**29**
E&P	27.4%	37.1%	29.1%	156	148	28.5%	-391
Refining	-0.2%	-3.7%	2.0%	94	260	0.7%	235
Marketing & distribution	3.0%	3.0%	2.7%	1	58	2.4%	-36
Chemicals	9.2%	6.7%	0.3%	-67	88	0.0%	8
SG&A % of Revenue	2.3%	1.9%	2.4%	0	23	2.3%	9
Staff expense % of Revenue	1.5%	1.9%	1.9%	35	14	1.8%	10
Effective Income Tax Rate	25.8%	21.8%	24.3%	-377	-612	26.6%	-96
Net Margin	**3.5%**	**3.2%**	**3.0%**	**33**	**115**	**2.4%**	**33**

Source: Company Data, Morgan Stanley Research

For 2014 earnings, we raise our E&P and chemical EBIT forecasts because 1) a better-than-expected E&P EBIT in 2013 introduced a lower cost basis for 2014 and 2) stabilization of the chemical business in 4Q13 implies potential breakeven in 2014.

For more details on our earnings estimate adjustments, please refer to Exhibit 9 on page 7.

Exhibit 9

Sinopec: 2013-2015 Earnings Estimate Revisions

	2013E			2014E			2015E		
Unit: Rmb bn	New	Old	Change	New	Old	Change	New	Old	Change
Gross revenue	**2,907**	**2,907**	**0%**	**3,086**	**3,086**	**0%**	**3,299**	**3,300**	**0%**
- E&P	79	79	0%	79	79	0%	78	78	0%
- Refining	197	197	0%	196	196	0%	198	199	0%
- Marketing	1,541	1,541	0%	1,664	1,664	0%	1,799	1,799	0%
- Chemicals	393	393	0%	419	419	0%	457	457	0%
- Corp/others	697	697	0%	727	727	0%	767	767	0%
Cost of goods	**(2,806)**	**(2,809)**	**0%**	**(2,980)**	**(2,982)**	**0%**	**(3,179)**	**(3,180)**	**0%**
Materials costs	(2,398)	(2,401)	0%	(2,548)	(2,550)	0%	(2,721)	(2,722)	0%
SG&A	(73)	(73)	0%	(77)	(77)	0%	(82)	(82)	0%
DD&A	(73)	(73)	0%	(82)	(82)	0%	(92)	(92)	0%
Exploration expense (inc. dry hole)	(14)	(14)	0%	(15)	(15)	0%	(15)	(15)	0%
Staff expense	(49)	(49)	0%	(52)	(52)	0%	(56)	(56)	0%
Taxes other than income tax	(182)	(182)	0%	(187)	(187)	0%	(194)	(194)	0%
Other opex	(17)	(17)	0%	(18)	(18)	0%	(19)	(19)	0%
EBITDA	**174**	**170**	**2%**	**188**	**186**	**1%**	**211**	**211**	**0%**
EBIT	**101**	**98**	**3%**	**106**	**104**	**2%**	**120**	**119**	**0%**
- E&P	60	59	3%	56	54	3%	59	57	3%
- Refining	7	7	8%	14	14	0%	22	23	-7%
- Marketing	36	36	0%	38	38	0%	41	41	0%
- Chemicals	(0)	(1)	-71%	1	0	100%	1	1	67%
- Corp/others	(2)	(2)	0%	(2)	(2)	0%	(2)	(2)	0%
Pretax profit	94	90	4%	97	94	3%	108	108	0%
Tax expense	(25)	(24)	4%	(26)	(25)	3%	(29)	(29)	0%
Minority interest	(2)	(2)	27%	(3)	(3)	3%	(3)	(4)	-5%
Net profit	**67**	**64**	**4%**	**68**	**66**	**3%**	**75**	**75**	**1%**

	2013E			2014E			2015E		
Operational Analysis	New Est	Org Est	% Diff/ bps	New Est	Org Est	% Diff/ bps	New Est	Org Est	% Diff/ bps
Exploration & Production (E&P)									
Brent Crude Oil (US$/bbl)	105	105	0%	100	100	0%	97	97	0%
Realised Gas Price (Rmb/cbm)	1.53	1.53	0%	1.73	1.73	0%	1.93	1.93	0%
Oil production Growth (%)	0%	0%	0	0%	0%	0	0%	0%	0
- Domestic	1.2%	1.2%	0	1.2%	1.2%	0	1.2%	1.2%	0
- Overseas	10.0%	10.0%	0	5.0%	5.0%	0	5.0%	5.0%	0
Gas Production Growth (%)	0%	0%	0	0%	0%	0	0%	0%	0
- Existing	2.0%	2.0%	0	2.0%	2.0%	0	2.0%	2.0%	0
- Puguang	15.0%	15.0%	0	5.0%	5.0%	0	5.0%	5.0%	0
Change of Production/Lifting Cost (%)	6.0%	9.0%	-300	1.0%	1.0%	0	1.0%	1.0%	0
Capex	183,000	183,000	0%	185,000	185,000	0%	187,000	187,000	0%
Refining	0%	0%	0	0%	0%	0	0%	0%	0
Growth of Crude Throughput (%)	5.0%	5.0%	0	5.0%	5.0%	0	5.0%	5.0%	0
Gross margin (US$/bbl)	21.7	21.6	0%	23.1	23.1	0%	24.6	24.7	-1%
Change of cash operating cost (%)	3.0%	3.0%	0	3.0%	3.0%	0	3.0%	3.0%	0
Marketing									
Growth of sales volume (%)	3.0%	3.0%	0	5.0%	5.0%	0	5.0%	5.0%	0
Marketing EBIT (Rmb/ton)	220.0	220.0	0%	220.0	220.0	0%	225.0	225.0	0%
Chemicals									
EBIT (Rmb/ton)	(10)	(35)	-71%	20	10	100%	25	15	67%
Change of Ethylene production (%)	4.0%	4.0%	0	5.0%	5.0%	0	5.0%	5.0%	0
Change of Synthetic resins production (%)	6.6%	6.6%	0	4.3%	4.3%	0	10.0%	10.0%	0
Change of Monomers and polymers for synthetic fibres	5.0%	5.0%	0	5.0%	5.0%	0	5.0%	5.0%	0

E= Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Price Target and Valuation

We set Sinopec's price target at HK$8.03, based on our sum-of-the-parts valuation outlined in Exhibit 10.

DCF Valuation

For the E&P division, we assume the following in our model: 1) EBIT CAGR at -5.6% in 2013-15; 2) EBIT CAGR of -4.7% in 2016-28; 3) a tax rate of 27.0% in 2013-28; and 4) capex CAGR of 0.8% 2013-2028. We continue to apply our WACC assumption of 7.9% for E&P division and derive an intrinsic value of HK$4.75 per share.

For the marketing business, our base case scenario assumes: 1) EBIT lower at Rmb220-225/ton in 2013-15; 2) EBIT margin recovers from 2016 and is stable at Rmb300/ton in 2018-28, and EBIT increases continuously following volume growth; 3) a tax rate of 27.0%; and 4) capex CAGR of 0.8% 2013-28. We continue to apply our WACC assumption of 7.9% for marketing division and derive an intrinsic value of HK$4.08 per share.

See Exhibits 11-14 for details of our divisional DCF valuations.

P/B valuation

For the refinery business, our base case scenario assumes a gradual improvement in EBIT of US$0.68/bbl in 2013 to US$2.01/bbl in 2015, after which volume will be the key earnings driver. Because this division is likely to see a sustainable turnaround, we apply a multiple of 0.75x 2012 P/B to value it.

For the chemical business, in our base case scenario we assume that it remains cyclical with a loss in 2013 and a very low margin afterwards. Therefore, we apply a multiple of 0.5x 2012 P/B to value the division.

These two segments are cyclical and in downturn, so we consider PB the most appropriate valuation method. We continue to use the most recent reported yearly book value for these businesses, owing to lack of detailed segment balance sheet reporting, which makes the most recent period more reliable than forecasts based on unspecific assumptions. We present DCF valuations for these operations as cross-checks.

Exhibit 10
Sinopec: SOTP Valuation

HKD bn	Valuation Methodology	Pct. of Total	NAV
E&P	DCF	42%	554
Refinery	0.75x 2012 P/B	18%	234
Marketing	DCF	36%	475
Chemical	0.5x 2012 P/B	5%	69
Total NAV			**1,332**
Shares outstanding (bn)			117
Per share value (HK$)			
E&P			4.75
Refinery			2.01
Marketing			4.08
Chemical			0.59
- 2013e net debt / share			3.40
Fair value (HK$/share)			**8.03**
Latest stock price			5.84
Upside / downside			**37%**

E = Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Exhibit 11

Sinopec: E&P Division DCF Valuation

		EXPLICIT FORECAST			BEYOND EXPLICIT FORECAST													TERMINAL
Sinopec - E&P		**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	
Unit: Rmb bn	**2012**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	
EBIT	70	60	56	59	63	58	56	51	50	45	45	40	36	43	39	35	31	
Growth of EBIT	-2%	-14%	-8%	6%	8%	-9%	-3%	-9%	-3%	-9%	-1%	-10%	-11%	20%	-9%	-10%	-11%	
+ Depreciation & Amortization	39	43	49	55	61	67	73	78	84	90	95	101	106	112	117	122	127	
- Tax	17	15	14	14	15	14	14	12	12	11	10	9	8	10	9	8	7	
- Change in working capital	(0)	1	0	0	2	0	0	0	0	1	0	(0)	0	0	0	0	0	
- Capex	89	93	94	95	96	97	97	97	97	97	97	97	97	98	99	100	101	
Free Cashflow (FCFF)	**4**	**(7)**	**(4)**	**4**	**11**	**13**	**18**	**20**	**25**	**27**	**32**	**35**	**36**	**46**	**47**	**49**	**50**	**792**
Present value		(7)	(4)	3	9	10	12	13	15	14	16	16	16	19	18	17	16	254
Sum of PV		**437**																
Total equity value		437																
Number of Shares (bn)		117																
Per share value (HKD)		**4.75**																

E = Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Exhibit 12

Sinopec: Refinery Division DCF Valuation

		EXPLICIT FORECAST			BEYOND EXPLICIT FORECAST													TERMINAL
Sinopec - Refinery		**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	
Unit: Rmb bn	**2012**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	
EBIT	(11)	7	14	22	14	10	11	10	9	10	10	11	12	13	10	11	12	
Growth of EBIT	-68%	-161%	103%	52%	-35%	-28%	4%	-7%	-8%	6%	7%	7%	7%	7%	-17%	9%	9%	
+ Depreciation & Amortization	12	13	15	17	19	21	23	24	26	28	30	32	34	35	37	39	41	
- Tax	(3)	2	4	5	3	2	3	2	2	2	2	3	3	3	2	3	3	
- Change in working capital	(0)	3	0	1	4	1	1	1	1	3	1	(1)	1	1	1	1	2	
- Capex	35	37	38	38	38	39	39	39	39	39	39	39	39	39	40	40	40	
Free Cashflow (FCFF)	**(32)**	**(21)**	**(12)**	**(5)**	**(13)**	**(11)**	**(9)**	**(8)**	**(6)**	**(6)**	**(2)**	**2**	**3**	**5**	**5**	**7**	**9**	**140**
Present value		(21)	(11)	(5)	(10)	(8)	(6)	(5)	(4)	(3)	(1)	1	1	2	2	2	3	45
Sum of PV		**(18)**																
Total equity value		(18)																
Number of Shares (bn)		117																
Per share value (HKD)		**(0.20)**																

E = Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Exhibit 13

Sinopec: Marketing Division DCF Valuation

		EXPLICIT FORECAST			BEYOND EXPLICIT FORECAST													TERMINAL
Sinopec - Marketing		**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	
Unit: Rmb bn	**2012**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	
EBIT	43	36	38	41	45	54	63	66	69	73	76	80	84	88	93	97	102	
Growth of EBIT	-5%	-16%	5%	7%	12%	18%	17%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	
+ Depreciation & Amortization	9	7	8	9	9	10	11	12	13	13	14	15	16	16	17	18	19	
- Tax	10	9	9	10	11	13	15	16	16	17	18	19	19	20	21	22	23	
- Change in working capital	(2)	21	3	7	39	7	8	8	9	30	13	(9)	14	8	17	20	24	
- Capex	27	28	28	29	29	29	29	29	29	29	29	29	29	30	30	30	31	
Free Cashflow (FCFF)	**16**	**(15)**	**5**	**4**	**(24)**	**14**	**21**	**24**	**27**	**9**	**30**	**56**	**37**	**46**	**42**	**43**	**43**	**687**
Present value		(15)	4	3	(19)	11	15	15	16	5	15	26	16	19	16	15	14	220
Sum of PV		**376**																
Total equity value		376																
Number of Shares (bn)		117																
Per share value (HKD)		**4.08**																

E = Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Exhibit 14

Sinopec: Chemical Division DCF Valuation

		EXPLICIT FORECAST			BEYOND EXPLICIT FORECAST													
Sinopec - Chemical		**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**TERMINAL**
Unit: Rmb bn	**2012**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	
EBIT	1	(0)	1	1	2	2	2	3	3	3	3	3	3	3	4	4	4	
Growth of EBIT	-96%	-131%	-309%	34%	110%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	
+ Depreciation & Amortization	9	8	9	10	10	11	12	13	13	14	15	16	17	17	18	19	20	
- Tax	0	(0)	0	0	1	1	1	1	1	1	1	1	1	1	1	1	1	
- Change in working capital	(1)	5	1	2	10	2	2	2	2	7	3	(2)	3	2	3	4	4	
- Capex	21	22	22	23	23	23	23	23	23	23	23	23	23	23	24	24	24	
Free Cashflow (FCFF)	**(11)**	**(20)**	**(14)**	**(14)**	**(21)**	**(12)**	**(11)**	**(10)**	**(10)**	**(13)**	**(9)**	**(3)**	**(7)**	**(5)**	**(6)**	**(6)**	**(6)**	**(90)**
Present value		(20)	(13)	(12)	(17)	(9)	(8)	(7)	(6)	(7)	(4)	(1)	(3)	(2)	(2)	(2)	(2)	(29)
Sum of PV		**(144)**																
Total equity value		(144)																
Number of Shares (bn)		117																
Per share value (HKD)		**(1.56)**																

E = Morgan Stanley Research estimates, Source: Company Data, Morgan Stanley Research

Company Description

China Petroleum & Chemical Corporation (Sinopec) is one of the largest integrated energy and chemical companies, with upstream, midstream and downstream operations in China. The principal operations of the company include: exploration and production, petroleum refining, production, storage and transportation of petroleum products, petrochemical products, synthetic fiber, fertilizer and other chemical products. The company is the largest refiner in China, with annual throughput of >220mn tons.

China Oil & Gas

Industry View: Cautious

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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Equal-weight/Hold	**1315**	**44%**	**392**	**48%**	**30%**
Not-Rated/Hold	**101**	**3%**	**26**	**3%**	**26%**
Underweight/Sell	**543**	**18%**	**96**	**12%**	**18%**
Total	**2,973**		**825**		

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
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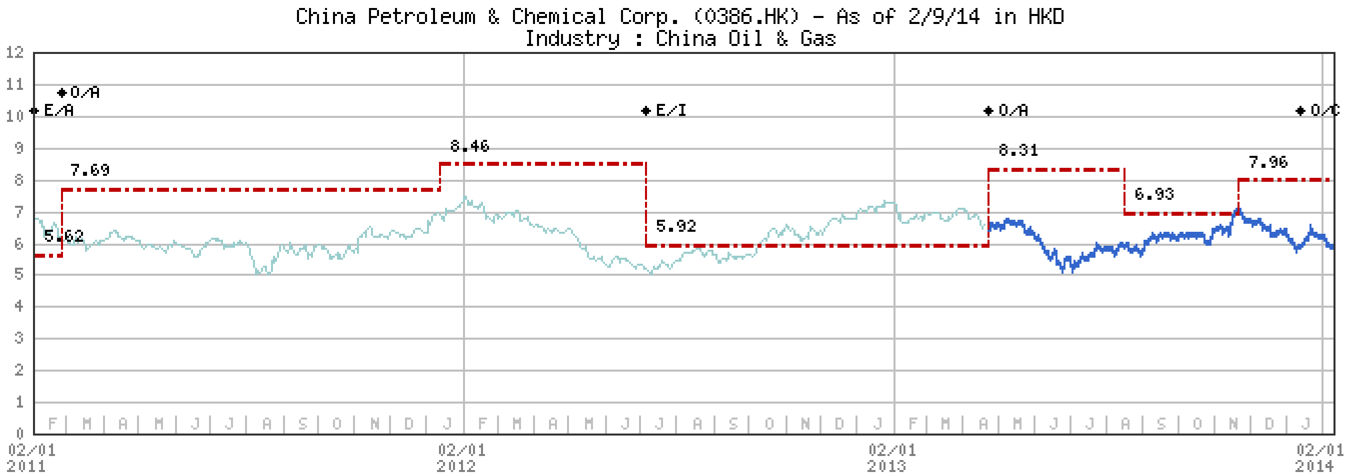
.

Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 2/1/11 : E/A; 2/24/11 : O/A; 7/6/12 : E/I; 4/22/13 : O/A; 1/13/14 : O/C

Price Target History: 8/23/10 : 5.62; 2/24/11 : 7.69; 1/13/12 : 8.46; 7/6/12 : 5.92; 4/22/13 : 8.31; 8/16/13 : 6.93; 11/21/13 : 7.96

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage:China Oil & Gas

Company (Ticker)	Rating (as of)	Price* (02/07/2014)
Andy Meng, CFA		
CNOOC (0883.HK)	O (07/14/2009)	HK$12.12
China Oilfield Services Ltd. (2883.HK)	O (01/13/2012)	HK$20.75
China Petroleum & Chemical Corp. (0386.HK)	O (04/22/2013)	HK$5.84
Hilong Holding Limited (1623.HK)	O (06/13/2013)	HK$5.66
Honghua Group Ltd. (0196.HK)	O (09/23/2013)	HK$2.15
PetroChina (0857.HK)	U (01/13/2014)	HK$7.55
SPT Energy Group Inc (1251.HK)	O (06/13/2013)	HK$5.19

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* Historical prices are not split adjusted.