

March 23, 2015

China Petroleum & Chemical Corp.

After Weak 4Q14-1Q15, Recovery to Start from 2Q15e: OW

Industry View

Attractive

Stock Rating

Overweight

Sinopec is our top pick among large-caps in 2015. Downstream earnings recovery and ongoing marketing reform remain near-term catalysts while we are also encouraged by the long-term strategy shift from 'Petroleum+Chemical' to 'Energy+New Material'.

Opinion on shares – Positive: We believe the weak results in 4Q14-1Q15 have created a good opportunity to accumulate the stock, given 1) Sinopec's earnings should be the most resilient among Big 3 as refinery, chemical and marketing earnings soon return to normal level after one-off inventory adjustment in 4Q14-1Q15; 2) marketing reform will continue and could introduce positive earnings contribution as well as potential re-rating; 3) stronger gas output growth (>20% in 2015e) and yield optimization in refinery suggest management is maximizing return without heavy spending. Combined with a visible capex cut by ~12% in 2015, such strategy is a long-term positive for shareholder value, we believe. For details, please refer to [China Oil & Gas: Asia Insight: 2015: A Year of Downstream? Sinopec Our Favored Pick](#)

Opinion on results – In line: Reported net profit of Rmb46 bn was in line with our estimate, but 21% lower than consensus.

- **E&P:** Realized oil price fell from US\$97/bbl in 4Q13 to US\$74/bbl in 4Q14, leading to 34% E&P EBIT drop to Rmb5.3 bn. Excluding tax, we estimate the all-in cost at ~US\$62/boe in 2014.
- **Refinery** posted record loss of Rmb13.1 bn in 4Q14, mainly due to inventory loss. As the normal quarterly EBIT can at least exceed Rmb2 bn, we estimate an inventory loss of >Rmb15 bn in 4Q14.
- **Marketing:** Also due to inventory loss, marketing EBIT fell 63% YoY to Rmb3 bn in 4Q14 vs. Rmb8.1 bn.
- **Chemical** is the only division with positive EBIT, up 44% to Rmb1.3 bn.

Opinion on outlook – Positive: The company issued profit warning stating that it is likely to barely break even in 1Q15, vs. 1Q14 net profit of Rmb14 bn. However, we expect Sinopec to achieve gradual earnings recovery as inventory loss in refinery and marketing will disappear if crude oil price stays at current level. A potential crude oil price recovery could boost E&P earnings and lead to margin expansion in refinery, chemical and marketing segments. Sinopec's plan to cut 2015 capex to Rmb136 bn implies a more disciplined expansion strategy and could also benefit shareholders.

MORGAN STANLEY ASIA LIMITED+

Andy Meng, CFA

Andy.Meng@morganstanley.com

+852 2239-7689

Daisy Li

Daisy.Li@morganstanley.com

+852 2239-7822

China Petroleum & Chemical Corp. (0386.HK , 386 HK)

China Oil & Gas / China

Stock Rating**Industry View**

Shr price, close (Mar 20, 2015)

52-Week Range

Sh out, dil, curr (mn)

Mkt cap, curr (mn)

EV, curr (mn)

Avg daily trading value (mn)

Overweight**Attractive**

HK\$6.20

HK\$8.23-5.90

26,131

Rmb711,143

Rmb810,858

HK\$734.53

Fiscal Year Ending	12/13	12/14e	12/15e	12/16e
ModelWare EPS (Rmb)	0.57	0.39	0.26	0.39
Prior ModelWare EPS (Rmb)	-	-	-	-
Consensus EPS (Rmb)§	0.59	0.48	0.34	0.47
Revenue, net (Rmb mn)	2,880,311	2,984,905	2,973,042	3,286,330
EBITDA (Rmb mn)	178,050	158,610	154,614	180,843
ModelWare net inc (Rmb mn)	66,132	46,018	30,456	45,401
P/E	8.7	12.7	19.0	12.7
P/BV	1.0	1.0	0.8	0.8
RNOA (%)	12.5	8.4	6.7	8.6
ROE (%)	12.9	8.1	5.1	6.6
Div yld (%)	4.8	3.3	2.2	3.3

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework
 § = Consensus data is provided by Thomson Reuters Estimates
 e = Morgan Stanley Research estimates

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2014 & 4Q14 Results Analysis

Financial and Operational Summary

Exhibit 1: Sinopec: 4Q14 & 2014 Financial Results Review

Unit: Rmb bn	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	YoY	QoQ	2013	2014	YoY
Turnover													
E&P	56	53	54	56	54	54	55	48	-13%	-13%	219	211	-4%
Refining	333	309	329	335	321	329	331	288	-14%	-13%	1,305	1,268	-3%
Marketing & distribution	358	369	381	384	350	371	390	352	-8%	-10%	1,492	1,464	-2%
Chemicals	105	103	108	114	103	107	111	98	-14%	-11%	430	419	-3%
Corp & others	349	333	336	341	303	342	331	332	-3%	0%	1,358	1,309	-4%
Inter seg elimination	(515)	(458)	(494)	(506)	(498)	(497)	(469)	(424)	-16%	-10%	(1,972)	(1,889)	-4%
Other operating revenues	9	10	11	17	9	9	11	16	-6%	47%	47	44	-6%
Gross Revenue	696	720	725	740	641	715	759	710	-4%	-6%	2,880	2,826	-2%
Cost of goods													
Materials costs	(569)	(602)	(592)	(609)	(517)	(583)	(632)	(603)	-1%	-5%	(2,372)	(2,334)	-2%
SG&A	(16)	(16)	(18)	(20)	(16)	(18)	(16)	(18)	-10%	11%	(70)	(68)	-2%
DD&A	(19)	(20)	(20)	(22)	(21)	(22)	(23)	(24)	9%	8%	(81)	(90)	11%
Exploration expense	(4)	(4)	(2)	(3)	(3)	(3)	(3)	(3)	-17%	-2%	(13)	(11)	-13%
Staff expense	(12)	(13)	(14)	(17)	(13)	(14)	(14)	(17)	0%	24%	(55)	(57)	3%
Taxes other than income tax	(48)	(46)	(48)	(48)	(46)	(48)	(48)	(49)	2%	2%	(191)	(191)	0%
Other opex, net	(0)	0	0	(2)	0	(1)	0	1	-132%	298%	(2)	(0)	-92%
Total Cost	(668)	(701)	(693)	(722)	(616)	(688)	(735)	(713)	-1%	-3%	(2,784)	(2,752)	-1%
Operating profit	27.6	19.2	31.5	18.5	24.8	27.5	24.1	(2.9)	-116%	-112%	97	73	-24%
E&P	16.2	14.7	15.8	8.0	13.2	15.1	13.5	5.3	-34%	-61%	55	47	-14%
Refining	2.2	(2.0)	6.4	1.9	3.7	6.0	1.3	(13.1)	-772%	-1069%	9	(2)	-123%
Marketing & distribution	9.1	7.7	10.2	8.1	8.8	10.0	7.6	3.0	-63%	-61%	35	29	-16%
Chemicals	0.2	(0.6)	0.4	0.9	(1.3)	(2.6)	0.5	1.3	44%	195%	1	(2)	-351%
Corp & others	(0.2)	(0.7)	(1.2)	(0.5)	0.4	(1.0)	1.2	0.5	-199%	-55%	(3)	1	-143%
Interest expense	(3)	(3)	(2)	(3)	(3)	(3)	(3)	(2)	-17%	-7%	(11)	(11)	6%
Interest income	0	0	0	1	0	0	0	1	-9%	51%	2	2	13%
FX gain/(loss)	(0)	1	(0)	2	(2)	0	0	1	-46%	212%	3	(0)	-106%
Investment income	0	0	0	0	0	0	2	(0)	-138%	-101%	0	3	1599%
Associate	1	0	1	1	1	1	2	0	-98%	-99%	2	4	54%
Exception	(2)	2	1	0	(2)	(1)	0	(2)	-613%	-5888%	2	(5)	-327%
Pretax profit	24	21	31	19	20	26	26	(6)	-133%	-124%	95	66	-31%
Tax expense	(6)	(6)	(7)	(5)	(5)	(7)	(6)	0	-101%	-101%	(25)	(18)	-29%
Minority interest	(1)	(1)	(1)	(1)	(1)	(0)	(1)	1	-235%	-186%	(4)	(1)	-65%
Net profit	17	14	22	14	14	18	19	(5)	-139%	-128%	66	46	-30%
Financial Ratio									Bps Change	YoY	QoQ		Bps Chg
OP Margin	4%	3%	4%	2%	4%	4%	3%	0%	-290	-358	3%	3%	-76
E&P	29%	28%	29%	15%	24%	28%	25%	11%	-345	-1,351	25%	22%	-267
Refining	1%	-1%	2%	1%	1%	2%	0%	-5%	-512	-495	1%	0%	-81
Marketing & distribution	3%	2%	3%	2%	3%	3%	2%	1%	-126	-111	2%	2%	-34
Chemicals	0%	-1%	0%	1%	-1%	-2%	0%	1%	55	95	0%	-1%	-72
Material cost % of Revenue	82%	84%	82%	82%	81%	82%	83%	85%	261	161	82%	83%	26
SG&A % of Revenue	2%	2%	2%	3%	3%	2%	2%	3%	-17	41	2%	2%	-1
DD&A % of Revenue	3%	3%	3%	3%	3%	3%	3%	3%	42	45	3%	3%	37
Exploration expense % of Revenue	0.5%	0.6%	0.2%	0.4%	0.5%	0.4%	0.4%	0.4%	-6	2	0.4%	0.4%	-5
Effective Income Tax Rate	26%	30%	24%	24%	24%	28%	22%	1%	-2,298	-2,104	26%	27%	77
Net Margin	2%	2%	3%	2%	2%	3%	3%	-1%	-262	-329	2%	2%	-65

Source: Company Data, Morgan Stanley Research. Note: Base on IFRS

Exhibit 2: Sinopec: 4Q14 & 2014 Segment Financial and Operational Review

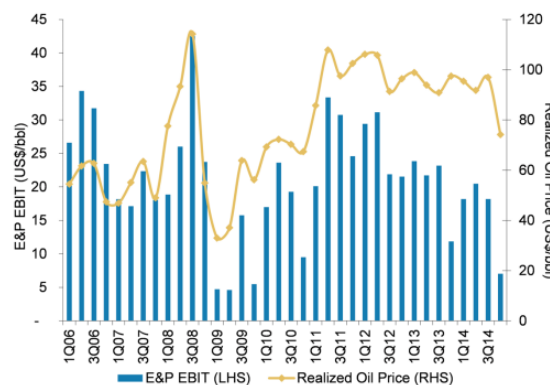
	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	YoY	QoQ	2013	2014	YoY
1. E&P Segment													
Oil production (mmbbl)	82	83	84	83	89	89	91	92	11%	1%	333	361	8%
- China	76	77	79	79	77	78	78	78	0%	0%	311	311	0%
- Overseas	6	6	6	4	13	11	13	14	225%	7%	22	50	130%
Gas (bcf)	163	161	162	174	177	177	176	186	7%	5%	660	716	9%
Total production (mm boe)	109	110	111	112	119	118	120	123	10%	2%	443	480	8%
Realised oil price (US\$/bbl)	98.8	93.8	90.8	97.4	95.4	91.8	96.9	74.1	-24%	-24%	96.2	89.7	-7%
Gas price (US\$/kcf)	5.9	6.1	6.5	6.6	7.0	6.9	7.3	8.3	26%	13%	6.3	7.4	18%
E&P EBIT (US\$/bbl)	23.8	21.7	23.2	11.8	18.2	20.5	18.2	7.0	-41%	-61%	20.1	15.9	-21%
2. Refining Segment													
Refinery Throughput (mt)	59	57	59	58	57	59	60	60	3%	-1%	232	235	1%
Oil products output (mt)	35	34	35	35	35	37	37	37	6%	0%	140	146	4%
- Gasoline	11	11	11	12	12	13	13	13	13%	-1%	46	51	12%
- Diesel	20	19	20	19	18	18	19	19	-2%	0%	77	74	-4%
- Kerosene	4	4	4	5	5	5	5	5	17%	0%	17	21	19%
Refining EBIT (US\$/bbl)	0.8	(0.8)	2.5	0.8	1.5	2.3	0.5	(4.9)	-744%	-1079%	0.8	(0.2)	-122.3%
3. Marketing Segment													
Total Marketing Volume (mt)	42	46	47	45	42	46	50	51	13%	2%	180	189	5%
Domestic Marketing Volume (mt)	39	42	43	42	39	42	45	45	8%	2%	165	171	3%
- Retail	27	29	29	29	27	29	30	31	8%	4%	114	118	4%
- Wholesale & Distribution	12	13	13	13	11	13	15	14	6%	-4%	52	53	3%
Marketing EBIT (US\$/ton)	34.8	27.3	35.7	29.4	34.3	34.7	24.9	9.6	-67%	-61%	31.8	25.3	-20%
4. Chemical Segment													
Chemical production (mt)	8.7	8.6	9.0	9.1	8.9	8.4	9.3	9.4	4%	1%	35.3	36.0	2%
- Ethylene	2.4	2.4	2.6	2.6	2.6	2.5	2.8	2.8	10%	2%	10.0	10.7	7%
- Synthetic resins	3.4	3.3	3.5	3.5	3.5	3.4	3.8	3.9	11%	3%	13.7	14.6	7%
- Synthetic rubbers	0.2	0.2	0.3	0.2	0.3	0.2	0.2	0.2	-13%	-12%	1.0	0.9	-2%
- Monomers and polymers	2.3	2.3	2.3	2.4	2.2	1.9	2.1	2.1	-10%	-1%	9.2	8.4	-9%
- Synthetic fibers	0.4	0.3	0.4	0.3	0.3	0.3	0.3	0.3	-4%	-3%	1.4	1.3	-6%
Chemical EBIT (US\$/ton)	3.0	(10.9)	6.4	16.8	(24.8)	(50.1)	7.9	23.1	37%	192%	4.0	(9.8)	-346%

Source: Company Data, Morgan Stanley Research. Note: Base on IFRS

E&P

EBIT declined by 41% YoY to US\$7/bbl in 4Q14,
mainly due to sharp fall in crude oil price:

- **Oil production:** 92 mmbbl, up by 11% YoY, thanks to consolidation of overseas upstream assets acquired at the end of last year
- **Realized oil price:** US\$74.1/bbl, down 24% YoY, while Brent was down 30% YoY in 4Q14
- **Gas production:** 186 bcf, up 7% YoY
- **Realized gas price:** US\$8.3/kcf, up 26% YoY
- **E&P OP Margin:** up 345 bps YoY to 11%

Exhibit 3: E&P: 4Q14 EBIT at US\$7/bbl, down by 41% YoY

Source: Company Data, Morgan Stanley Research

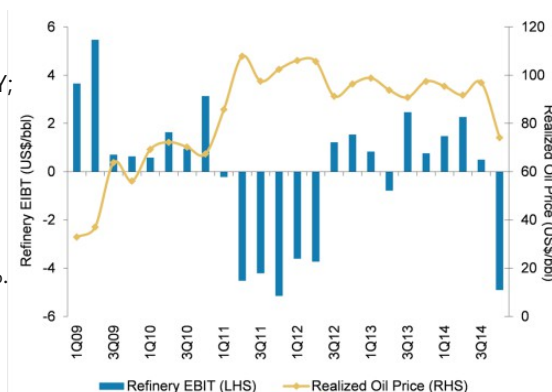
Refinery

EBIT loss at US\$4.9/bbl in 4Q14, which is the first time for refinery to incur quarterly loss since 2Q13,

The major reason is inventory loss amid the sharp fall in crude oil price.

- **Refinery throughput:** 60 mn tons, up by 3% YoY;
- **Oil products output (gasoline, diesel and kerosene):** 37 mn tons, up by 6% YoY; Gasoline accounts for 35% of the volume, up from 33% in 4Q13;
- **Refinery OP Margin** dropped by 512 bps to -5%.

Exhibit 4: Refinery: 4Q14 EBIT Loss Stood at US\$4.9/bbl



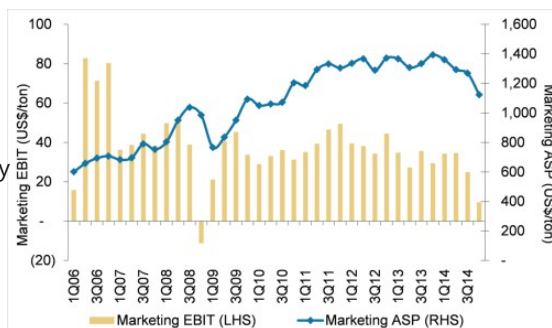
Source: Company Data, Morgan Stanley Research

Marketing

EBIT dropped by 67% to US\$9.6/ton in 4Q14, mostly due to inventory loss:

- **Total marketing volume** was 51mn tons, up by 13% YoY;
- **ASP:** down by 18% YoY and 12% QoQ to Rmb6,907/ton
- **Marketing OP margin** stood at 1%, decreased by 126bps YoY and 111bps QoQ.
- **Non-fuel sales** stood at Rmb17.1bn in 2014, up by 28% YoY, accounting for 5% of marketing segment revenue.

Exhibit 5: Marketing: EBIT declined by 67% to US\$9.6/ton in 4Q14

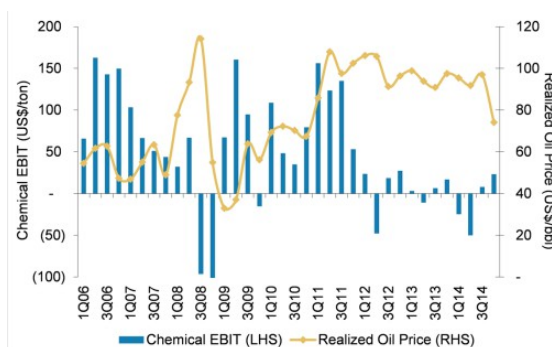


Source: Company Data, Morgan Stanley Research

Chemical

EBIT expanded to US\$23.1/ton in 4Q14, surging 37% YoY and 192% QoQ, mainly due to margin improvement, as chemical product prices are not falling as much as crude oil prices.

Exhibit 6: Chemicals: 4Q14 EBIT expanded to US\$23.1/ton

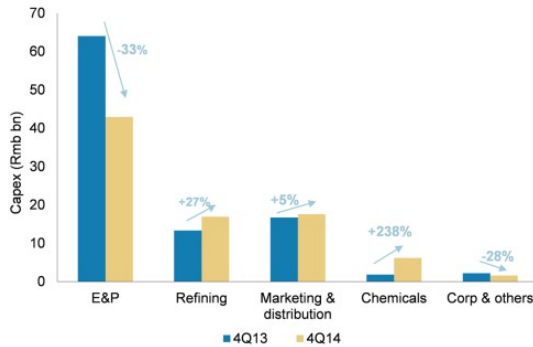


Source: Company Data, Morgan Stanley Research

Capex

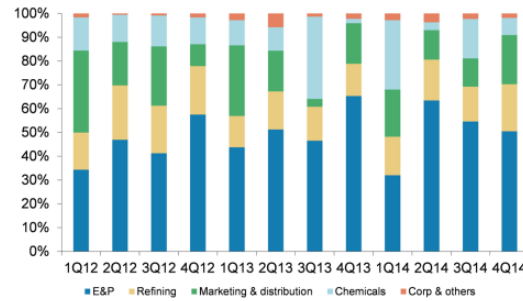
Declined by 13% YoY in 4Q14 to Rmb85bn. E&P capex declined while downstream capex increased.

Exhibit 7: Overall Capex Declined 13% YoY in 4Q14



Source: Company data, Morgan Stanley Research

Exhibit 8: Quarterly Segment Weight of Capex

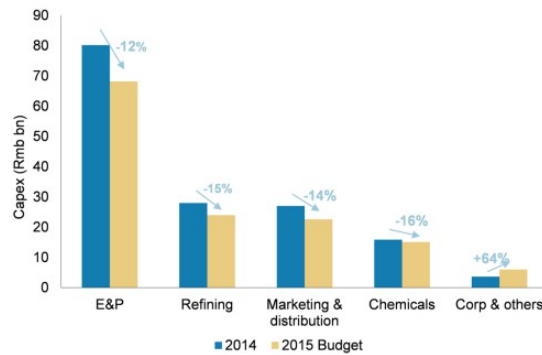


Source: Company data, Morgan Stanley Research

2015 Capex cut by 12%

Sinopec budgeted Rmb135.9 bn in capex for 2015, which represents a 12% YoY decline. Capex is cut for all major segments. Please refer to for detailed changes by segment.

Exhibit 9: Sinopec: 2015 Capex Budget vs. 2014



Source: Company data, Morgan Stanley Research

1Q15 Profit Warning

Together with 2014 annual results, Sinopec issued profit warning for 1Q15. According to the announcement, the company is likely to barely break even in 1Q15 due to low realized oil price for E&P and inventory loss for downstream.

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(as of February 28, 2015)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)		
	COUNT	% OF TOTAL	COUNT	% OF TOTAL	% OF RATING IBC CATEGORY
Overweight/Buy	1161	35%	321	41%	28%
Equal-weight/Hold	1459	44%	370	47%	25%
Not-Rated/Hold	101	3%	10	1%	10%
Underweight/Sell	609	18%	88	11%	14%
TOTAL	3,330		789		

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

Analyst Stock Ratings

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.

Equal-weight (E). The stock's total return is expected to be in line with 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.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to 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.

Underweight (U). The stock's total return is expected to be below 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.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

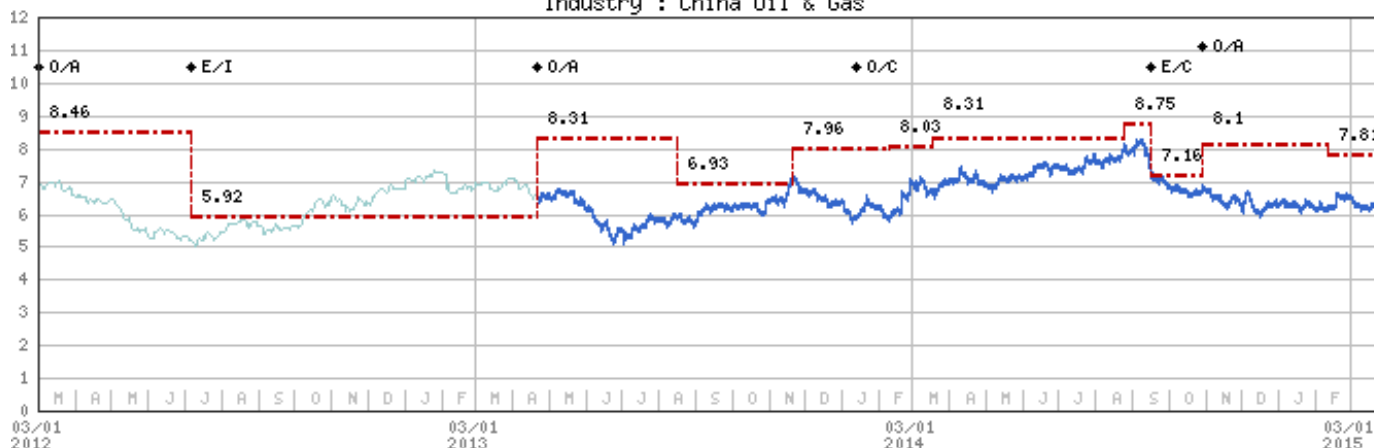
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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

China Petroleum & Chemical Corp. (0386.HK) - As of 3/22/15 in HKD
Industry : China Oil & Gas



Stock Rating History: 3/1/12 : O/A; 7/6/12 : E/I; 4/22/13 : O/A; 1/13/14 : O/C; 9/16/14 : E/C; 10/29/14 : O/A

Price Target History: 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; 2/10/14 : 8.03; 3/18/14 : 8.31; 8/25/14 : 8.75; 9/16/14 : 7.16; 10/29/14 : 8.1; 2/11/15 : 7.81

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)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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INDUSTRY COVERAGE: China Oil & Gas

COMPANY (TICKER)	RATING (AS OF)	PRICE* (03/20/2015)
Meng CFA, Andy		
China BlueChemical (3983.HK)	O (02/11/2015)	HK\$2.87
China Oilfield Services Ltd. (601808.SS)	U (12/11/2014)	Rmb20.30
China Oilfield Services Ltd. (2883.HK)	O (01/13/2012)	HK\$11.94
China Petroleum & Chemical Corp. (0386.HK)	O (10/29/2014)	HK\$6.20
China Petroleum & Chemical Corp. (600028.SS)	E (02/11/2015)	Rmb6.42
CNOOC (0883.HK)	O (07/14/2009)	HK\$10.54
Hainan Rubber (601118.SS)	U (10/16/2014)	Rmb9.39
Hilong Holding Limited (1623.HK)	O (06/13/2013)	HK\$1.95
Honghua Group Ltd. (0196.HK)	U (03/18/2014)	HK\$0.87
Inner Mongolia Junzheng (601216.SS)	U (12/11/2014)	Rmb20.53
Offshore Oil Engineering (600583.SS)	U (12/11/2014)	Rmb10.39
PetroChina (601857.SS)	U (02/11/2015)	Rmb11.68
PetroChina (0857.HK)	E (02/11/2015)	HK\$8.37
Qinghai Salt Lake (000792.SZ)	U (10/16/2014)	Rmb28.03
Sinofert Holdings (0297.HK)	O (10/16/2014)	HK\$1.66
Sinopec Kantons (0934.HK)	O (03/18/2014)	HK\$5.39
Sinopec Shanghai Petrochemical Co Ltd (0338.HK)	O (02/11/2015)	HK\$2.56
SPT Energy Group Inc (1251.HK)	E (02/11/2015)	HK\$1.25
Tianhe Chemicals (1619.HK)	O (07/24/2014)	HK\$1.15

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* Historical prices are not split adjusted.