

March 24, 2015

SPT Energy Group Inc

Most Solid Performer in Small-cap Oil Service Group, but Upside Capped by Industry Capex Cut & Less Outsourcing: EW

Industry View

Attractive

Stock Rating

Equal-weight

Despite more resilient earnings and solid balance sheet, SPT is unlikely to see its share price outperform in 2015 as capex cut and less outsourcing limit upside potential.

Opinion on shares - Neutral: With net profit of Rmb116 mn recorded in 2014 vs. industry peers Anton and Petro-Kong's loss making, SPT is an outperformer. Its balance sheet is also much stronger, with net cash position recorded in 1H14 and 2H14, while Anton and Petro-King's net debt/equity ratios were 59% and 25%, respectively, as of 1H14. However, without visible signs of a turnaround, we believe the capex cut and less outsourcing will continue to cap the stock performance. We maintain our EW rating.

Opinion on results - Neutral: With reported earnings having dropped by 61% in 2014 vs. the guidance for a 55-60% decline during the profit warning on Jan 19, we think SPT's lackluster 2014 results are fully in line with the market expectation. By segment,

- **Drilling:** Revenue declined by 14%, EBITDA by 38%, and EBITDA margin by 7.0 ppts YoY in 2014;
- **Well completion:** Revenue dropped by 13%, EBITDA by 36%, and EBITDA margin by 6.7 ppts YoY;
- **Reservoir management:** Revenue slightly up, by 1%, EBITDA down by 14%, and EBITDA margin down by 4.5 ppts.

Opinion on outlook - minor negative: We believe 2015 will be another tough year for oil service companies, as the material correction in the crude oil price will force oil majors to reduce their capex. CNOOC has already announced plans to reduce capex by 26-35% in 2015 while Sinopec targets to cut capex by 12% or even more. Although PetroChina hasn't announced a detailed capex plan, we expect the company to cut capex at a similar magnitude, which would have a negative impact on SPT's revenue, as >85% of it comes from PetroChina/CNPC. Besides this, the ongoing anti-corruption campaign is likely to further reduce the prospect of oil service outsourcing from CNPC to non-state-owned oil service companies.

MORGAN STANLEY ASIA LIMITED+

Andy Meng, CFA

Andy.Meng@morganstanley.com

+852 2239-7689

Daisy Li

Daisy.Li@morganstanley.com

+852 2239-7822

SPT Energy Group Inc (1251.HK , 1251 HK)

China Oil & Gas / China

Stock Rating**Industry View**

Shr price, close (Mar 23, 2015)

52-Week Range

Sh out, dil, curr (mn)

Mkt cap, curr (mn)

EV, curr (mn)

Avg daily trading value (mn)

Equal-weight**Attractive**

HK\$1.22

HK\$4.87-1.19

1,528

Rmb1,491

Rmb1,175

HK\$23.62

Fiscal Year Ending	12/13	12/14e	12/15e	12/16e
ModelWare EPS (Rmb)	0.20	0.08	0.06	0.08
Prior ModelWare EPS (Rmb)	-	-	-	-
Consensus EPS (Rmb)\$	0.21	0.12	0.12	0.17
Revenue, net (Rmb mn)	2,403	2,283	2,130	2,237
EBITDA (Rmb mn)	488	303	270	343
ModelWare net inc (Rmb mn)	300	128	85	124
P/E	18.3	13.7	17.5	12.0
P/BV	3.1	0.9	0.7	0.7
RNOA (%)	24.0	10.6	7.2	9.8
ROE (%)	19.0	7.2	4.4	5.9
Div yld (%)	1.1	1.8	1.4	2.1

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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Exhibit 1: SPT Energy: 2H14 and 2014 Financial Results Review

(Rmb mn)	1H13	2H13	1H14	2H14	YoY	HoH	2013	2014	YoY
Revenue	870	1,533	1,057	1,130	-26%	7%	2,403	2,187	-9%
Other losses, net	(0)	13	(17)	(1)	-111%	-91%	13	(18)	-242%
Operating Costs	(736)	(1,265)	(913)	(1,051)	-17%	15%	(2,001)	(1,985)	-2%
Material costs	(182)	(357)	(307)	(258)	-28%	-16%	(540)	(565)	5%
Employee benefit expenses	(236)	(308)	(305)	(312)	1%	2%	(544)	(617)	13%
Operating lease expenses	(31)	(142)	(42)	(92)	-35%	116%	(173)	(134)	-22%
Transportation costs	(24)	(54)	(29)	(47)	-13%	61%	(78)	(76)	-2%
D&A	(35)	(36)	(42)	(41)	13%	-2%	(71)	(83)	17%
Technical service expenses	(129)	(193)	(89)	(172)	-11%	94%	(323)	(261)	-19%
Impairment loss of assets	(8)	(18)	(5)	11	-161%	-328%	(26)	6	-123%
Others, net	(90)	(157)	(95)	(140)	-11%	48%	(248)	(235)	-5%
Operating profit	134	280	127	77	-72%	-39%	414	204	-51%
Finance costs, net	(10)	(15)	(22)	(22)	49%	0%	(25)	(44)	78%
Finance income	5	2	2	1	-26%	-12%	7	3	-58%
Finance costs	(15)	(16)	(23)	(23)	41%	-1%	(31)	(47)	49%
Profit before income tax	124	265	105	55	-79%	-47%	389	160	-59%
Income tax expense	(25)	(56)	(25)	(21)	-62%	-14%	(81)	(46)	-43%
Profit for the period	99	210	80	34	-84%	-58%	308	114	-63%
Minority interest	1	7	(1)	(1)	-112%	-28%	8	(2)	-124%
Net Income	98	203	81	35	-83%	-57%	300	116	-61%
Reported EBITDA	243	416	281	191	-54%	-32%	659	472	-28%
Segment Performance	1H13	2H13	1H14	2H14	YoY	HoH	2013	2014	YoY
Drilling									
Revenue	341	613	403	414	-32%	3%	954	817	-14%
EBITDA	89	158	101	54	-66%	-47%	247	155	-38%
Well Completion									
Revenue	269	380	344	222	-42%	-35%	650	566	-13%
EBITDA	73	93	89	18	-81%	-80%	166	107	-36%
Reservoir									
Revenue	260	539	310	494	-8%	60%	799	804	1%
EBITDA	81	164	91	120	-27%	32%	245	210	-14%
Financial Ratio	1H13	2H13	1H14	2H14	ppts chg	ppts chg	2013	2014	ppts chg
EBITDA Margin	28%	27%	27%	17%	-10.2	-9.7	27%	22%	-5.8
Drilling	26%	26%	25%	13%	-12.8	-12.0	26%	19%	-7.0
Well Completion	27%	25%	26%	8%	-16.6	-18.0	26%	19%	-6.7
Reservoir	31%	30%	29%	24%	-6.2	-5.1	31%	26%	-4.5
OP Margin	15%	18%	12%	7%	-11.4	-5.2	17%	9%	-7.9
Material costs % of rev	21%	23%	29%	23%	-0.5	-6.2	22%	26%	3.3
Employee benefit exp % of rev	27%	20%	29%	28%	7.5	-1.2	23%	28%	5.6
Transportation costs % of rev	3%	4%	3%	4%	0.6	1.4	3%	3%	0.2
Technical service exp % of rev	15%	13%	8%	15%	2.6	6.9	13%	12%	-1.5
Effective tax rate	20%	21%	24%	39%	17.5	14.9	21%	29%	7.9
Net Profit Margin	11%	13%	8%	3%	-10.2	-4.6	13%	5%	-7.2

Due to weak oil market and depreciation of KZT

Hired more employees in 2H13-1H14 for business expansion.

Net impact of KZT devaluation is Rmb21.5mn, breakdown is as follows:
 *Losses recognized in other losses, net: Rmb19.8mn
 *Losses recognized in financial cost, net: Rmb7.1mn
 *Deduct: income tax impact: Rmb5.4mn.

Partly for capex related exploration & development; Partly for opex related existing wells & workover

Mostly for capex related exploration & development.

Mainly for production; Major clients did not reduce output.

Intensified competition in OFS market

Increase in non-deductible expenses, e.g. withholding tax

Source: Company data, Morgan Stanley Research

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(as of February 28, 2015)

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	COUNT	% OF TOTAL	COUNT	% OF TOTAL	% OF RATING IBC CATEGORY
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Equal-weight/Hold	1459	44%	370	47%	25%
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TOTAL	3,330		789		

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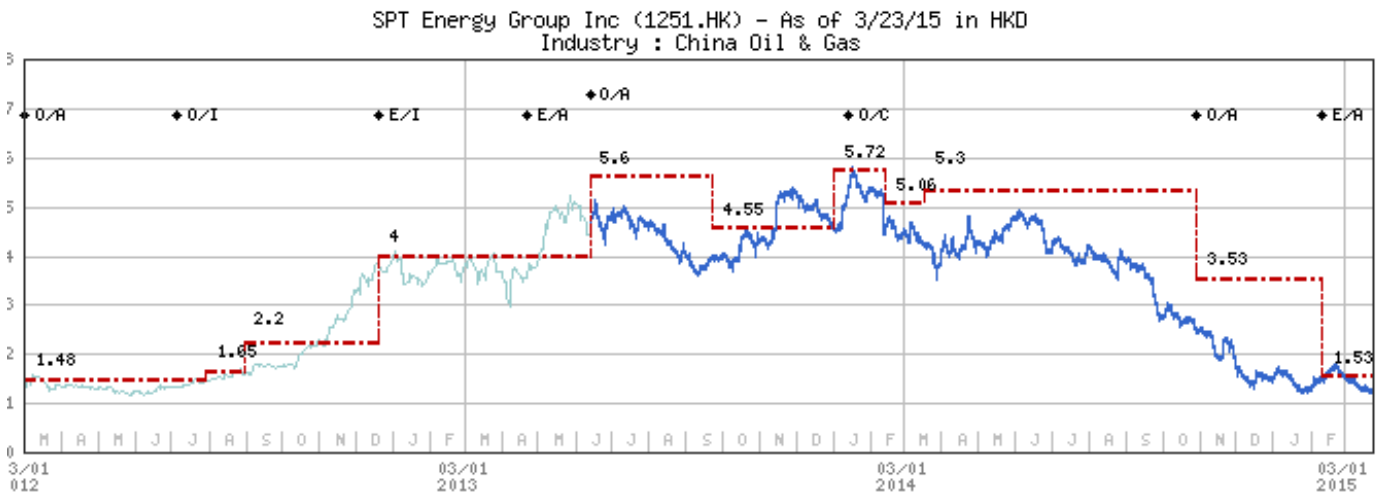
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Stock Rating History: 3/1/12 : O/A; 7/6/12 : O/I; 12/20/12 : E/I; 4/22/13 : E/A; 6/13/13 : O/A; 1/13/14 : O/C; 10/29/14 : O/A; 2/11/15 : E/A

Price Target History: 1/30/12 : 1.48; 7/30/12 : 1.65; 8/30/12 : 2.2; 12/20/12 : 4; 6/13/13 : 5.6; 9/23/13 : 4.55; 1/1/14 : 5.72; 2/13/14 : 5.06; 3/18/14 : 5.3; 10/29/14 : 3.53; 2/11/15 : 1.53

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
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INDUSTRY COVERAGE: China Oil & Gas

COMPANY (TICKER)	RATING (AS OF)	PRICE* (03/23/2015)
Meng CFA, Andy		
China BlueChemical (3983.HK)	O (02/11/2015)	HK\$2.83
China Oilfield Services Ltd. (601808.SS)	U (12/11/2014)	Rmb20.50
China Oilfield Services Ltd. (2883.HK)	O (01/13/2012)	HK\$11.84
China Petroleum & Chemical Corp. (0386.HK)	O (10/29/2014)	HK\$6.07
China Petroleum & Chemical Corp. (600028.SS)	E (02/11/2015)	Rmb6.44
CNOOC (0883.HK)	O (07/14/2009)	HK\$10.42
Hainan Rubber (601118.SS)	U (10/16/2014)	Rmb9.69
Hilong Holding Limited (1623.HK)	O (06/13/2013)	HK\$1.95
Honghua Group Ltd. (0196.HK)	U (03/18/2014)	HK\$0.89
Inner Mongolia Junzheng (601216.SS)	U (12/11/2014)	Rmb21.17
Offshore Oil Engineering (600583.SS)	U (12/11/2014)	Rmb10.56
PetroChina (601857.SS)	U (02/11/2015)	Rmb11.80
PetroChina (0857.HK)	E (02/11/2015)	HK\$8.30
Qinghai Salt Lake (000792.SZ)	U (10/16/2014)	Rmb28.17
Sinofert Holdings (0297.HK)	O (10/16/2014)	HK\$1.64
Sinopec Kantons (0934.HK)	O (03/18/2014)	HK\$5.45
Sinopec Shanghai Petrochemical Co Ltd (0338.HK)	O (02/11/2015)	HK\$2.58
SPT Energy Group Inc (1251.HK)	E (02/11/2015)	HK\$1.22
Tianhe Chemicals (1619.HK)	O (07/24/2014)	HK\$1.16

Stock Ratings are subject to change. Please see latest research for each company.

* Historical prices are not split adjusted.