

## Sinopec Yizheng - H [1033.HK]

### Lower guidance suggests further earnings risk; Recent share price rebound unjustified; Reiterate SELL

Management tone remains conservative towards the operating outlook this year during the analyst meeting. We maintain our cautious stance on Sinopec Yizheng (Sinopec Oilfield Service Corporation [SSC] after restructuring) as a decline in work volume this year suggests that it's getting more challenging to achieve cost reduction. We lower our 2015E/2016E earnings estimates by 23%/9%. Given SSC's high earnings sensitivity amid the current unfavourable industry cycle, we switch our valuation methodology from PER (6.7x 2015E) to PBR (0.85x 2015E; in line with peers). Reiterate **SELL** with new TP of HK\$2.07 (previously: HK\$1.97). We believe recent rally of the share price, due to the strong performance of Yizheng-A share, is unjustified.

- 2014 earnings in line but helped by government subsidies.** Sinopec Yizheng reported RMB2,417m net profit in 2014, in line with SSC's profit forecast and our estimates. However, it was mainly helped by a 21% YoY increase in other income (RMB551m), of which 79% came from government grant (RMB437m, +9% YoY). Core operation was weak with revenue declined 12% YoY to RMB79bn, or 3% (or RMB2.7bn) below expectation.
- Lower guidance on work volume targets this year.** Sinopec [0386 HK; Not rated]'s E&P capex dropped 24% YoY in 2014, or 9% below its original target. In 2015E, Sinopec expects a 15% YoY capex reduction. As a result of the capex cut, SSC guided down the work volume for all the key segments this year by 25%-30% YoY (figure 1). This could mean a bigger decline in revenue as the contracts pricing will likely to be under pressure as well.
- Potential slowdown on drilling work in Fuling shale gas project.** Revenue from Fuling project reached ~RMB8bn in 2014, which accounted for 10% of SSC's total revenue. According to Sinopec, total investment for the project will be ~RMB21bn, of which RMB12bn was invested in 2014 and the balance of RMB9bn will be invested this year. The number of drill wells is expected to be 117 in Fuling this year, less than SSC's planned wells of 135. Given that SSC had completed 110 wells last year, new drill wells suggest limited growth this year.
- Upside risks:** (1) Sharp rebound of oil and gas price; (2) stronger than expected order flow; (3) better than expected cost reduction and efficiency improvement.

Key Financials (RMB m)	2013	2014	2015E	2016E
Revenue	89,729	78,993	61,942	63,762
Change (YoY)	-	-12.0%	-21.6%	2.9%
EBIT	2,744	3,729	3,662	4,062
Change (YoY)	-	35.9%	-1.8%	10.9%
Core net profit	1,465	2,417	2,310	2,848
Change (YoY)	-	65.0%	-4.4%	23.3%
Core EPS (HK\$)	-	0.238	0.206	0.250
Change (YoY)	-	-	-13.4%	21.3%
ROE	-	10%	10%	10%
Net debt/equity	49%	61%	19%	Net cash
PER (core earnings) (x)	-	12.5	14.5	11.9
Dividend yield	-	0.0%	0.0%	0.0%
PBR (x)	-	1.6	1.3	1.1
EV/EBITDA (x)	-	5.6	5.5	5.2

Sources: Company, CGIHK Research estimates

### Oilfield Services Sector

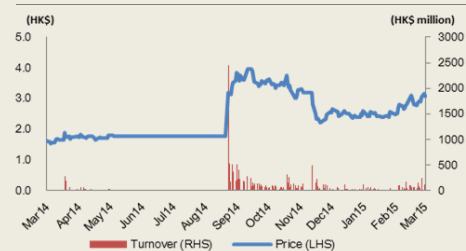
# SELL

(Unchanged)

**Close: HK\$2.98** (Mar 25, 2015)

**Target Price: HK\$2.07 (-31%)**

#### Share Price Performance



Market Cap	US\$5,403m
Shares Outstanding	14,143m
Auditor	Grant Thornton
Free Float	34%
52W range	HK\$1.51-4.11
3M average daily T/O	US\$12.7m
Major Shareholding	Sinopec Group (65.2%)

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**Figure 1: SSC's plans on business volume**

	2013	2014	2015E
<b>Operating data</b>			
Drilling footages (km)	13,160	11,660	8,600
YoY change	-0.4%	-11.4%	-26.2%
2D seismic km	48,959	34,942	35,335
3D seismic km <sup>2</sup>	17,951	19,545	13,605
2D seismic YoY change	-	-28.6%	1.1%
3D seismic YoY change	-	8.9%	-30.4%
Logging (million meters)	445	388	241
Mud logging (million meters)	14	12.8	7.85
Logging YoY change	-	-12.9%	-37.9%
Mud logging YoY change	-	-8.6%	-38.7%
Special down-hole operations (wells)	7,736	7,345	4,980
YoY change	-	-5.1%	-32.2%
Engineering construction business (RMB bn)	24.5	20.6	16.9
YoY change	-	-15.9%	-18.0%

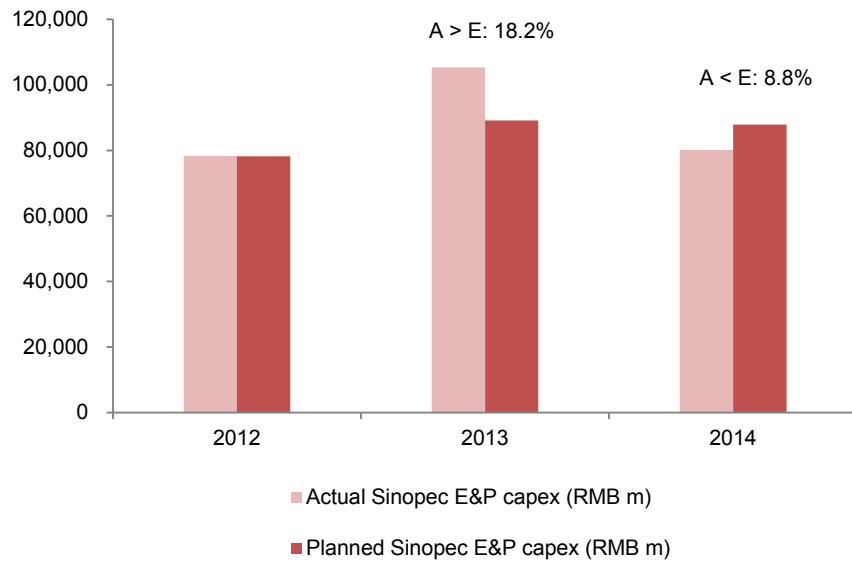
Sources: Company, CGIHK Research

**Figure 2: SSC's revenue breakdown**

	2013	2014	2015E	2016E
<b>Revenue breakdown by business segment</b>				
RMB m				
Drilling engineering	41,457	39,003	29,253	30,130
Logging and mud logging	5,120	4,177	2,924	3,012
Special down-hole operations	9,423	8,458	6,343	6,534
Geophysical	6,642	5,066	4,306	4,521
Engineering construction	24,484	19,876	16,894	17,232
Others services income	1,581	1,412	1,270	1,334
Other business income	1,022	1,002	952	999
<b>Total</b>	<b>89,729</b>	<b>78,993</b>	<b>61,942</b>	<b>63,762</b>
<b>Change YoY</b>				
Drilling engineering	-	-5.9%	-25.0%	3.0%
Logging and mud logging	-	-18.4%	-30.0%	3.0%
Special down-hole operations	-	-10.2%	-25.0%	3.0%
Geophysical	-	-23.7%	-15.0%	5.0%
Engineering construction	-	-18.8%	-15.0%	2.0%
Others services income	-	-10.7%	-10.0%	5.0%
Other business income	-	-2.0%	-5.0%	5.0%
<b>Total</b>	-	<b>-12.0%</b>	<b>-21.6%</b>	<b>2.9%</b>

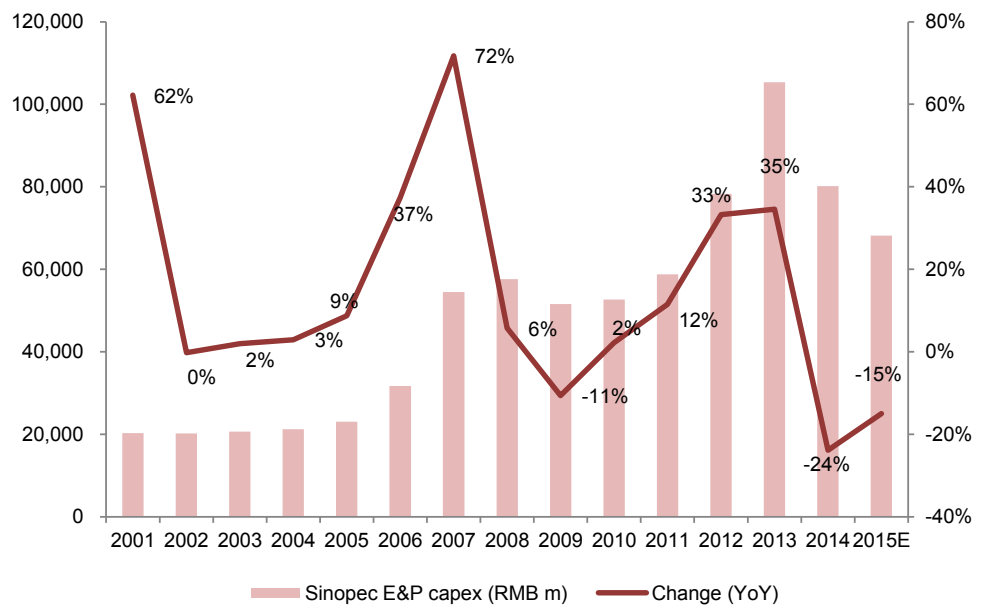
Sources: Company, CGIHK Research estimates

**Figure 3: Sinopec's E&P capex—actual versus planned**



Sources: Company, CGIHK Research

**Figure 4: Sinopec's E&P capex**



Sources: Company, CGIHK Research

Figure 4: Earnings projection

(RMBm)	2013	2014	2015E	2016E
<b>Income statement (Y/E Dec)</b>				
Revenue	89,729	78,993	61,942	63,762
Cost of sales	(82,397)	(70,675)	(54,819)	(56,111)
<b>Gross profit</b>	<b>7,332</b>	<b>8,318</b>	<b>7,123</b>	<b>7,651</b>
Selling expenses	(95)	(82)	(74)	(83)
General and administrative expenses	(4,493)	(4,507)	(3,387)	(3,507)
<b>EBIT</b>	<b>2,744</b>	<b>3,729</b>	<b>3,662</b>	<b>4,062</b>
D&A	4,084	4,374	4,510	4,690
<b>EBITDA</b>	<b>6,828</b>	<b>8,103</b>	<b>8,172</b>	<b>8,752</b>
Finance income/(expenses) - net	(823)	(770)	(728)	(766)
Investment income	2	2	0	0
Impairment losses on assets	(136)	(98)	(83)	0
Share of (loss)/profit from joint ventures	0	(4)	1	1
Other income	455	551	500	500
Other expenses	(62)	(90)	0	0
<b>Pretax profit</b>	<b>2,180</b>	<b>3,320</b>	<b>3,352</b>	<b>3,797</b>
Income tax expense	(687)	(901)	(1,042)	(949)
<b>After tax profit</b>	<b>1,493</b>	<b>2,419</b>	<b>2,310</b>	<b>2,848</b>
MI	(28)	(2)	0	0
<b>Net profit</b>	<b>1,465</b>	<b>2,417</b>	<b>2,310</b>	<b>2,848</b>
Retained profit	1,465	2,417	2,310	2,848
Dividend	0	0	0	0
<b>Core net profit</b>	<b>1,465</b>	<b>2,417</b>	<b>2,310</b>	<b>2,848</b>
<b>EPS (HK\$)</b>	-	0.238	0.206	0.250
<b>Core EPS (HK\$)</b>	-	0.238	0.206	0.250

(RMBm)	2013	2014	2015E	2016E
<b>Balance sheet (as of end-Dec)</b>				
<b>Current assets</b>				
Cash and equivalents	1,694	1,202	7,555	13,332
Notes receivable	2,744	220	220	220
Accounts receivables	25,682	28,065	14,361	29,311
Prepayments	784	675	675	675
Other receivables	3,046	2,427	2,427	2,427
Inventories	3,221	1,951	2,555	2,672
Others	10,682	9,994	9,994	9,994
Total current assets	47,853	44,533	37,787	58,631
<b>Non-current assets</b>				
Property, plant and equipment	38,730	31,080	31,084	29,408
Intangible assets	31	41	27	13
Investment in associates/JV/JCE	599	108	119	132
Others	5,523	5,533	5,533	5,533
Total non-current assets	44,884	36,763	36,764	35,087
<b>Total assets</b>	<b>92,737</b>	<b>81,296</b>	<b>74,551</b>	<b>93,717</b>
<b>Current liabilities</b>				
Short-term borrowings	16,218	12,016	12,316	12,716
Notes payable	1,142	856	856	856
Trade payables	30,605	30,057	15,000	31,119
Income tax payable	150	432	432	432
Deposits received and other payables	8,064	12,012	12,012	12,012
Others	5,131	6,564	6,564	6,564
Total current liabilities	61,309	61,938	47,180	63,700
<b>Non current liabilities</b>				
Long-term borrowings	580	568	318	118
Others	115	93	93	93
Total non-current liabilities	695	662	412	212
<b>Total liabilities</b>	<b>62,003</b>	<b>62,600</b>	<b>47,592</b>	<b>63,911</b>
<b>Equity</b>				
Equity attributable to owners of the parent	30,648	18,697	26,960	29,807
MI	85	(1)	(1)	(1)
Total Equity	30,733	18,696	26,959	29,806
<b>Total liabilities and equity</b>	<b>92,737</b>	<b>81,296</b>	<b>74,551</b>	<b>93,717</b>
<b>BVPS (RMB)</b>	-	1.46	1.94	2.11

(RMBm)	2013	2014	2015E	2016E
<b>Cash flow statement (Y/E Dec)</b>				
Pretax profit	2,180	3,320	3,352	3,797
Depreciation	4,071	4,361	4,496	4,676
Amortization	13	13	14	14
Share of results of associates/JCE	(0)	4	(1)	(1)
Finance income/(expenses) - net	765	544	728	766
Change in working capital	(4,121)	(1,001)	(1,959)	1,053
Interest paid	(765)	(544)	(728)	(766)
Income tax paid	(687)	(901)	(1,042)	(949)
Others	402	(660)	0	0
<b>Operating cash flow</b>	<b>1,858</b>	<b>5,136</b>	<b>4,861</b>	<b>8,589</b>
<b>Investing cash flow</b>				
Purchase/(disposal) of PP&E	(7,265)	(2,468)	(4,500)	(3,000)
Purchase of intangible assets	0	(23)	0	0
Acquisition of subsidiaries	(0)	(53)	0	0
Investment in associates/JCE	0	(97)	(10)	(12)
Dividend received from associates/JCE	0	0	0	0
Others	149	111	0	0
<b>Investing cash flow</b>	<b>(7,117)</b>	<b>(2,529)</b>	<b>(4,510)</b>	<b>(3,012)</b>
<b>Financing cash flow</b>				
Proceed from/(repayment of) borrowings	(2,415)	(2,384)	50	200
Proceed from equity	1,110	0	5,953	0
Proceed from CB	0	0	0	0
Dividend paid	0	0	0	0
Others	5,023	(81)	0	0
<b>Financing cash flow</b>	<b>3,718</b>	<b>(2,465)</b>	<b>6,003</b>	<b>200</b>
Net change in cash	(1,540)	142	6,353	5,777

	2013	2014	2015E	2016E
<b>Valuation</b>				
<b>PER (core net profit) (x)</b>	-	12.5x	14.5x	11.9x
Dividend yield	-	0.0%	0.0%	0.0%
PBR (x)	-	1.6x	1.3x	1.1x
<b>EV/EBITDA (x)</b>	-	5.6x	5.5x	5.2x
<b>Growth rate</b>				
Revenue	-	(12.0%)	(21.6%)	2.9%
EBIT	-	35.9%	(1.8%)	10.9%
EBITDA	-	18.7%	0.9%	7.1%
Recurring net profit	-	65.0%	(4.4%)	23.3%
Recurring EPS	-	-	(13.4%)	21.3%
<b>Operating ratios</b>				
Gross margin	8.2%	10.5%	11.5%	12.0%
EBIT margin	3.1%	4.7%	5.9%	6.4%
EBITDA margin	7.6%	10.3%	13.2%	13.7%
Recurring net margin	1.6%	3.1%	3.7%	4.5%
Asset Turnover	-	0.91	0.79	0.76
Adjusted ROE	-	9.8%	10.1%	10.0%
Adjusted ROA	-	2.8%	3.0%	3.4%
Interest coverage	8.3x	10.5x	11.2x	11.4x
Net debt / equity	49%	61%	19%	Net cash
Current Ratio	0.8	0.7	0.8	0.9
Quick Ratio	0.7	0.7	0.7	0.9
Days inventories	38	13	15	17
Days receivables	82	124	125	125
Days payables	115	157	150	150

Sources: Company, CGIHK Research estimates

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- BUY : share price will increase by >20% within 12 months in absolute terms
- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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