

JPM-pp1

Asia Pacific Equity Research

26 March 2015

PetroChina - H (857 HK)

Neutral

Price: HK\$8.84

25 Feb 2015

Price Target: HK\$8.20

PT End Date: 31 Dec 2015

Cost cutting challenges; FY15 capex down only 9%

We expect PetroChina's 4Q14 results to be taken slightly negatively by the market with earnings c15% below consensus with all segments excluding Refining/Chems and E&P lower than expectations. The ability for the company to significantly reduce costs is likely to be a focus for the market. Key points:

- **Upstream beats on better realizations and volumes:** E&P operating profit beat our estimates largely on better than expected realizations and volumes. FY14 lifting costs were up c3% y/y.
- **Poor refining profitability and chemicals within stop loss target:** Refining and chemicals were in line with our estimates. Refining was loss making in 4Q14 at cRmb9.7bn, a result of lower product prices and likely the impact of inventory losses. Chemicals lost cRmb5.1bn in 4Q14, on a full year basis the chemicals division lost Rmb16.5bn within the company's Rmb20bn loss target.
- **Marketing worse than expected:** Marketing operating profit was loss making in 4Q14 (Rmb5.1bn) on the back of weak diesel sales and likely inventory losses.
- **Natural gas segment misses; no update on divestment:** Natural gas/pipeline significantly missed our expectations which may imply that the company was unable to push previous gas price hikes to customers in the quarter. The company recorded less losses on imported gas (down c16% y/y).
- **Capex cut 9% in 2015:** Capex at cRmb292bn in FY14, only just within guidance at Rmb296bn. FY15 capex target is Rmb266bn (JPMe at Rmb270bn).
- **Dividend slight miss; payout maintained:** PetroChina has proposed an interim dividend at Rmb0.096/share (FY14 payout still c45%), lower than our forecast of Rmb0.12 and consensus at Rmb0.11.

Table 1: PetroChina's 4Q14 earnings summary

RMB m	4Q13A	3Q14A	4Q14A	4Q14E	Change y/y	Change q/q	vs. JPMe
Operating Profit:							
Exploration and production	42,688	43,716	40,943	29,574	(4%)	(6%)	38%
Refining and chemicals	(4,388)	(5,320)	(14,805)	(14,986)	237%	178%	(1%)
Marketing	857	2,421	(5,146)	888	NM	NM	NM
Natural gas and pipeline	11,390	5,151	3,892	12,825	(66%)	(24%)	(70%)
Corporate and Other	227	(3,513)	(586)	(1,649)	(358%)	(83%)	(64%)
Total Operating Profit	50,774	42,455	24,298	26,652	(52%)	(43%)	(9%)
Net financing	(1,467)	(1,875)	(3,836)	(3,036)			
Pretax Profit	49,307	40,580	20,462	23,615	(59%)	(50%)	(13%)
Taxation	(13,333)	(8,611)	(7,458)	(6,107)			
Tax Rate %	27%	21%	36%	26%			
Minorities	(2,409)	(4,046)	(1,879)	(4,523)			
Adjusted net income	33,565	27,923	11,125	12,985	(67%)	(60%)	(14%)
Adjusted EPS, RMB	0.18	0.15	0.06	0.07	(67%)	(59%)	(14%)
Exceptional Items	-	-	-	-			
Reported net income	33,565	27,923	11,125	12,985	(67%)	(60%)	(14%)
Reported EPS, RMB	0.18	0.15	0.06	0.07	(67%)	(59%)	(14%)

Source: Company data, J.P. Morgan estimates. % change is relative to 4Q14A. Our forecasts exclude any gains from the company's asset divestments

Table 2: PetroChina 4Q14 operating data

	4Q13	3Q14	4Q14	Change y/y	Change q/q
E&P					
Crude oil output (mm bbl)	235	234	246	4%	4%
Marketable natural gas output (bcf)	754	698	835	7%	15%
Oil and natural gas equivalent output (mm boe)	361	351	385	5%	8%
Refining					
Processed crude oil (mm bbl)	258	246	264	3%	8%
Gasoline, kerosene and diesel output (000' tons)	23,524	22,014	24,663	2%	9%

Gasoline (000' tons)	7,751	6,979	8,147	(5%)	5%
Kerosene (000' tons)	1,079	1,160	1,143	(9%)	(15%)
Diesel (000' tons)	14,694	13,875	15,373	7%	14%
Marketing (000' tons)					
Total sales volume of gasoline, kerosene and diesel	39,711	42,345	43,305	6%	3%
Gasoline	12,360	15,779	17,173	17%	15%
Kerosene	3,413	3,953	3,806	17%	22%
Diesel	23,938	22,613	22,326	(3%)	(6%)
Chemicals (000' tons)					
Ethylene	1,062	1,293	1,288	50%	6%
Synthetic resin	1,729	2,001	2,066	38%	(1%)
Synthetic fiber raw materials and polymer	283	320	350	34%	1%
Synthetic rubber	158	201	190	41%	11%
Urea	822	618	520	(27%)	(33%)

Source: Company reports. . % change is relative to 4Q14.

Investment Thesis

PetroChina is the largest oil company in China and one of the largest globally. It is integrated with E&P, R&C, marketing and pipelines (NGP). In 2012, crude production was 2.5 mn BOPD and natural gas 1.16 mn BOEPD, refining throughput was 2.8 mn BOPD, olefin production 7.7 mn tonnes and it operated over 40,000 km of pipelines (crude, products and natural gas). PetroChina has SEC proven reserves of 22.2bn BOE (47% natural gas, 67% of crude is developed). Major profit drivers are crude prices and refining margins in China. Our Neutral view of PetroChina-H is based on:

- **Shift in energy portfolio to be rewarded** – We expect investor focus to be on the company’s ability to strategically shift its energy portfolio away from low- return assets via asset divestments. We think visibility on asset divestments will lead to relative outperformance relative to local peers.
- **Natural gas to benefit from hikes and reforms** – We see good natural gas profitability from further price hikes and Chinese natural gas demand at low double-digit growth, which partly offsets a higher import burden. Clarity over natural gas reform progress should also be a catalyst for the shares.
- **Headwinds from global oil market; downstream drag on earnings** – With crude oil markets pressured, we believe that the upstream focused PetroChina will be in a period of lackluster returns; additionally, the downstream segment looks to be a continued burden (1Q15 theoretical China GRMs beginning in negative territory; chemicals look on track to continue to be a loss-making business).

Valuation

Our Dec-15 PT of HK\$8.20 is based on a sum-of-the-parts methodology, whereby we calculate a DCF-based value (WACC 10.5%, terminal g 2%) for each business segment, namely upstream, refining, chemicals and marketing added to give our total NAV. Debt and financial liabilities are deducted at book value.

Risks to Rating and Price Target

Upside and downside risks to our rating and price target include a sharp fall in oil prices, recent natural gas price hikes not being passed through to customers and no further rises, a higher import burden and weak chemicals profitability from lower demand and margins.

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
23-Mar-07	OW	8.66	7.40
30-Mar-07	UW	9.27	7.40
01-Aug-07	UW	11.66	8.30
23-Oct-07	UW	19.44	10.20
11-Jan-08	UW	13.68	12.00
19-Mar-08	N	9.60	10.50
19-Apr-08	N	9.82	8.75
06-May-08	UW	12.12	8.75
27-Oct-08	OW	4.25	8.75
08-Jan-09	OW	7.45	8.00
23-Apr-09	UW	6.79	6.00
18-Aug-09	UW	8.50	7.40
17-May-10	UW	8.76	7.60
06-Apr-11	UW	12.22	9.00
08-Nov-11	UW	10.08	8.50
13-May-12	UW	10.44	8.75
31-Oct-12	UW	10.80	8.25
08-May-13	NR	9.97	--
02-Jul-13	OW	8.25	11.00
03-Mar-14	OW	8.18	11.25
11-Jul-14	OW	9.80	11.80
28-Aug-14	OW	10.96	12.50
09-Nov-14	OW	9.18	11.50
18-Jan-15	N	8.72	8.20

<http://gfd-app.emea.jpmchase.net:6080/server/console/chart?shareClassId=502088&shareClassServerId=4&chartDesignation=1&actionType=C>

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