

## Anton Oilfield Services Group

No equity raise...yet; more cost-cutting; limited guidance; moving out of China

We had expected a disappointing update from Anton Oil, and the company's FY14 briefing did not surprise us. The company ruled out raising equity (at least this year), and there was limited FY15 guidance, except guiding to better revenue than last year and suggesting that cost-cutting initiatives would see Anton Oil profitable this year.

- **Limited guidance:** FY15 revenue guidance is for "not...lower than 2014," but management is confident that Anton Oil will be profitable. Backlog is mostly overseas markets (1Q15 backlog released in April).
- **Funding a focus:** Funding is management's priority this year: short-term debt and working capital. The company is also "working very hard" to manage receivables (cRmb400m in cash received in Jan/Feb). The company has changed its internal incentive scheme (e.g., it gives employees penalties if they miss targets and bonuses if they exceed), and the target is to maintain positive CFO each month. Mr. Luo stated that there are "no plans for [an] equity raise...this year."
- **More cost control:** Anton Oil aims to change its whole cost structure and reduce fixed costs. It is cutting the workforce and making structural changes by allocating staff better across business lines (e.g., workovers and waste management). However, the company still expects to grow its staff in some areas (e.g., production services) from 200 to 1,000 employees by year-end 2015, based on current backlog. The Tianjin manufacturing site is complete, so the company is able lower materials costs through in-house manufacturing of fracturing equipment/tools, etc.
- **New opportunity in South America:** Anton Oil is expecting higher growth in the overseas market relative to the domestic market, as producers are cutting capex less. The company is exploring business in LatAm, although the market is very challenging, but the strategy is to develop business with IOCs. In Iraq, the company has two CPF 1& 2 contracts (2+1yr) and recently won a maintenance contract for a power plant. Contract sizes are c\$15-20m.
- **We update FY15E/17E earnings by an average of c1% p.a., maintain our Dec-15 PT of HK\$0.60 and remain Underweight.**

## Underweight

3337.HK, 3337 HK

Price: HK\$1.34

Price Target: HK\$0.60

### China

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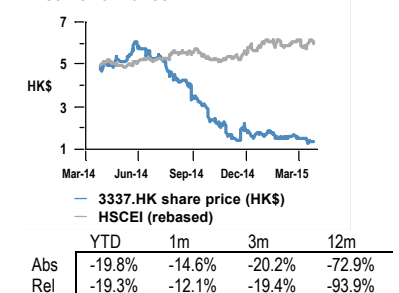
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### Price Performance



See our Credit/Corporate Research colleagues Daniel Fan and Soo Chong Lim's downgrade of Anton '18s and issuer rating to UW, [here](#).

### Anton Oilfield Services Group (Reuters: 3337.HK, Bloomberg: 3337 HK)

Rmb in mn, year-end Dec	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue (Rmb mn)	2,005	2,534	2,071	2,005	2,466	2,946
Net Profit (Rmb mn)	303	383	(198)	11	49	110
EPS (Rmb)	0.14	0.18	(0.09)	0.01	0.02	0.05
DPS (Rmb)	0.05	0.06	0.00	0.00	0.00	0.00
Revenue growth (%)	59.2%	26.4%	(18.2%)	(3.2%)	23.0%	19.5%
EPS growth (%)	288.1%	24.4%	(150.7%)	(105.8%)	332.0%	122.4%
ROCE	15.4%	13.2%	1.0%	3.1%	3.8%	5.0%
ROE	16.6%	18.0%	(9.1%)	0.6%	2.4%	5.0%
P/E (x)	7.5	6.0	NM	206.3	47.8	21.5
P/BV (x)	1.1	1.0	1.1	1.1	1.1	1.0
EV/EBITDA (x)	4.9	4.2	16.6	9.5	7.5	6.6
Dividend Yield	4.3%	5.2%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Shares O/S (mn)	2,212
Market Cap (Rmb mn)	2,375
Market Cap (\$ mn)	382
Price (HK\$)	1.34
Date Of Price	26 Mar 15
Free Float(%)	43.0%
3M - Avg daily vol (mn)	16.67
3M - Avg daily val (HK\$ mn)	26.42
3M - Avg daily val (\$ mn)	3.4
HSCEI	1,1919.69
Exchange Rate	7.75
Price Target End Date	31-Dec-15

See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.

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Key catalyst for the stock price:	Upside risks to our view:	Downside risks to our view:
1) 1Q15 backlog update 2) Iraq contract wins	1) Improved margins from integrated service strategy 2) Accelerated push by government into non-conventional gas 3) Improving cash conversion cycle unlocking value 4) Quicker expansion into international markets, such as Iraq and South America	1) Increased competition in the oilfield services sector from international and SOE entrants 2) Speed and direction of political reform limiting growth of private firms

Key financial metrics	FY14	FY15E	FY16E	FY17E
Revenues (LC)	2,071	2,005	2,466	2,946
Revenue growth (%)	(18%)	(3%)	23%	19%
EBITDA (LC)	710	416	557	666
EBITDA margin (%)	34%	21%	23%	23%
Tax rate (%)	(20%)	20%	20%	20%
Net profit (LC)	(198)	11	49	110
EPS (LC)	(0.090)	0.005	0.022	0.050
EPS growth (%)	(151%)	(106%)	332%	122%
DPS (LC)	-	-	-	-
Operating cash flow (LC mn)	(620)	874	241	337
Free cash flow (LC mn)	(431)	533	(86)	18
Interest cover (X)	0.2	1.0	1.3	1.7
Net margin (%)	(9%)	1%	2%	4%
Sales/assets (X)	0.3	0.3	0.4	0.4
Debt/equity (%)	125%	122%	131%	133%
Net debt/equity (%)	90%	71%	82%	86%
ROE (%)	(9%)	1%	2%	5%

Key model assumptions	FY14	FY15E	FY16E	FY17E
Down-hole EBITDA margins	38%	43%	45%	45%
Well completion EBITDA margins	30%	32%	33%	33%
Effective tax rate	(20%)	20%	20%	20%

Source: Bloomberg, Company and J.P. Morgan estimates.

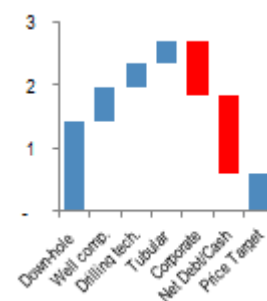
Sensitivity analysis	EBITDA		EPS	
	FY15E	FY16E	FY15E	FY16E
Sensitivity to				
1% chg in EBITDA margins	2%	2%	3%	3%
1% chg in tax rate	0%	0%	2%	2%

Source: Bloomberg, Company and J.P. Morgan estimates.

#### Valuation and price target basis

Our Dec-15 price target of HK\$0.60 is derived from a sum-of-the-parts methodology, with each of Anton's business segments valued using an EV/EBITDA multiple.

#### Price target breakdown



Source: Bloomberg, Company and J.P. Morgan estimates.

#### JPM vs. consensus, change in estimates

EPS (Rmb)	FY15E	FY16E
JPM old	0.006	0.020
JPM new	0.005	0.022
% chg	(13%)	12%
Consensus	0.009	0.056

Source: Bloomberg, Company and J.P. Morgan estimates.

#### China Oil & Gas/OFS coverage comparative metrics

Company name	Rating	PT (LC)	CMP (LC)	Pot. upside to PT (%)	Mkt cap (\$ B)	P/E (x)		P/B (x)		EV/EBITDA (x)		YTD perf (%)
						15Y	16Y	15Y	16Y	15Y	16Y	
PETROCHINA-H	N	8.20	8.35	(1.8)	335.2	21.2	12.2	1.0	1.0	9.3	7.8	(2.9)
SINOPEC CORP-H	N	5.70	6.05	(5.8)	119.0	21.2	14.1	0.9	0.9	8.0	7.2	(3.2)
CNOOC	UW	9.00	10.56	(14.8)	60.8	16.6	9.6	1.0	0.9	4.1	3.3	1.1
SPC-H	UW	1.50	2.68	(44.0)	7.7	14.7	13.0	1.3	1.2	14.6	11.5	18.1
CBC-H	OW	4.80	2.76	73.9	1.6	7.5	7.4	0.7	0.6	3.3	3.0	0.4
COSL-H	UW	10.60	12.32	(14.0)	13.8	8.8	8.2	1.0	0.9	10.2	9.6	(8.5)
ANTON OILFIELD	UW	0.60	1.34	(55.2)	0.4	200.1	46.3	1.1	1.0	9.5	7.0	(19.8)
SPT ENERGY	N	1.40	1.35	3.7	0.3	9.6	11.9	0.8	0.8	4.6	4.7	(5.6)
HILONG HOLDING	OW	2.90	1.96	48.0	0.4	7.2	5.7	0.8	0.7	5.8	4.7	8.3
HONGHUA	UW	0.60	0.91	(34.1)	0.4	11.4	8.4	0.5	0.4	8.4	7.7	(8.1)

Source: Bloomberg, Company and J.P. Morgan estimates. As of March 26, 2015.

## FY15E/17E EPS cut by c1%; maintain Dec-15 PT of HK\$0.60

We have adjusted our FY15/17 EPS forecasts by an average of c1% p.a. to reflect 2H14 results (see [here](#) for details). We maintain our Dec-15 PT for Anton Oil of HK\$0.60, based on our sum-of-the-parts methodology, with each of Anton Oil's business segments valued using an EV/EBITDA multiple.

**Table 1: Anton Oil EPS estimate revisions**

<b>Rmb</b>	<b>New</b>	<b>Old</b>	<b>Consensus</b>	<b>Change</b>	<b>Vs. consensus</b>
15Y	0.01	0.01	0.01	(13%)	(42%)
16Y	0.02	0.02	0.06	12%	(60%)
17Y	0.05	0.05	0.09	(2%)	(41%)

Source: J.P. Morgan estimates, Bloomberg. % change is reference to new estimates.

## Investment Thesis, Valuation and Risks

### Anton Oilfield Services Group *(Underweight; Price Target: HK\$0.60)*

#### Investment Thesis

Anton Oil is one of China's integrated oil services companies, with Schlumberger as its strategic shareholder (c20% interest). The company comprises four segments: down-hole operations, well completion, drilling technology and tubular services. These businesses have patented technologies, and Anton Oil's proprietary products of downhole tools, chemicals and service equipment, combined with job design, allow it to provide "a one-stop service" for the oil and gas industry. Our negative view on the firm is based on:

- **Limited domestic order visibility...** The company has limited order visibility for the medium term, with several quarters of less-than-impressive backlog growth; while new service lines may improve results, it is hard to forecast their contributions.
- **...in light of growing threat from SOEs.** With SOE OFS competitors (e.g., SOSC, CNPC Drilling) looking to improve their own efficiencies and product offerings, we believe private service providers will see more pressure in securing contracts.
- **Ballooning cost base.** With major investments into equipment and personnel in FY14, we believe the company's cost base has inflated and that margins will remain depressed in FY15/16.

#### Valuation

Our Dec-15 PT of HK\$0.60 is based on a sum-of-the-parts methodology and derived by assigning an EV/EBITDA multiple to each of the four business segments. Our valuation breakdown is as follows:

Segment	EBITDA (Rmb M)	EV/EBITDA (x)	EV (Rmb M)
Down-hole operation cluster	363	6.5	2,360
Well completion cluster	134	6.5	872
Drilling technology cluster	125	5.0	625
Tubular services	75	7.5	561
Corporate Expenses	(281)	5.0	(1,404)
Total	416		3,014
Net (debt)/cash			(2,025)
Equity value			989
NOSH			2,198
Fair value (Rmb)			0.4
<b>Price target (HK\$)</b>			<b>0.6</b>

Source: J.P. Morgan estimates.

#### Risks to Rating and Price Target

The main upside risks to our rating, price target and earnings estimates are higher-than-expected tenders and new contracts from a pickup in activity and government policy; and higher margins due improved efficiencies and the leverage of the expanded equipment/personnel base.

## Anton Oilfield Services Group: Summary of Financials

Income Statement						Cash flow statement					
Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E	Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E
Revenues	2,534	2,071	2,005	2,466	2,946	EBIT	572	38	186	232	321
% change Y/Y	26.4%	(18.2%)	(3.2%)	23.0%	19.5%	Depr. & amortization	138	222	230	325	346
EBITDA	710	260	416	557	666	Change in working capital	(133)	(667)	630	(137)	(121)
% change Y/Y	44.5%	(63.4%)	60.2%	33.9%	19.5%	Taxes	(87)	(31)	(4)	(13)	(28)
EBIT	572	38	186	232	321	Cash flow from operations	379	(620)	874	241	337
% change Y/Y	43.8%	(93.4%)	389.0%	24.9%	38.2%	Capex	(817)	(462)	(400)	(400)	(400)
EBIT Margin	22.6%	1.8%	9.3%	9.4%	10.9%	Disposal/(purchase)	-	-	-	-	-
Net Interest	(73)	(178)	(168)	(166)	(180)	Net Interest	(73)	(178)	(168)	(166)	(180)
Earnings before tax	490	(160)	18	66	141	Other	8	(114)	(86)	(106)	(127)
% change Y/Y	33.4%	(132.6%)	(111.3%)	263.0%	115.4%	Free cash flow	(378)	(868)	609	(26)	81
Tax	(87)	(31)	(4)	(13)	(28)	Equity raised/(repaid)	0	7	0	0	0
as % of EBT	17.7%	(19.6%)	20.0%	20.0%	20.0%	Debt raised/(repaid)	1,807	259	(48)	265	189
Net income (reported)	383	(198)	11	49	110	Other	1	54	0	0	0
% change Y/Y	26.4%	(151.8%)	(105.8%)	332.0%	122.4%	Dividends paid	(113)	(127)	0	0	0
Shares outstanding	2,151	2,198	2,198	2,198	2,198	Beginning cash	523	1,770	760	1,100	1,100
EPS (reported)	0.17	(0.09)	0.01	0.02	0.05	Ending cash	1,770	760	1,100	1,100	1,100
% change Y/Y	23.6%	(152.0%)	(105.8%)	332.0%	122.4%	DPS	0.06	0.00	0.00	0.00	0.00
Balance sheet						Ratio Analysis					
Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E	Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E
Cash and cash equivalents	1,770	760	1,100	1,100	1,100	EBITDA margin	28.0%	12.5%	20.8%	22.6%	22.6%
Accounts receivable	1,332	1,588	903	1,110	1,326	EBIT margin	22.6%	1.8%	9.3%	9.4%	10.9%
Inventories	541	710	490	585	699	Net margin	15.1%	(9.6%)	0.6%	2.0%	3.7%
Others	284	624	521	593	669	Sales per share growth	24.3%	(20.0%)	(3.2%)	23.0%	19.5%
Current assets	3,927	3,682	3,013	3,388	3,794	Sales growth	26.4%	(18.2%)	(3.2%)	23.0%	19.5%
LT investments	-	-	-	-	-	Net profit growth	26.4%	(151.8%)	(105.8%)	332.0%	122.4%
Net fixed assets	1,602	2,293	2,507	2,632	2,742	EPS growth	23.6%	(152.0%)	(105.8%)	332.0%	122.4%
Total Assets	5,968	6,491	6,078	6,634	7,221	Interest coverage (x)	9.8	1.5	2.5	3.3	3.7
Liabilities						Net debt to equity	25.6%	89.8%	71.3%	81.6%	85.7%
Short-term loans	396	694	1,246	1,511	1,701	Sales/assets	0.5	0.3	0.3	0.4	0.4
Payables	704	695	621	742	886	Assets/equity	2.2	2.9	3.0	3.0	3.2
Others	508	954	648	766	905	ROE	18.0%	(9.1%)	0.6%	2.4%	5.0%
Total current liabilities	1,608	2,342	2,515	3,019	3,492	ROCE	13.2%	1.0%	3.1%	3.8%	5.0%
Long-term debt	1,983	1,996	1,396	1,396	1,396						
Other liabilities	2	4	4	4	4						
Total Liabilities	3,593	4,342	3,915	4,419	4,892						
Shareholder's equity	2,283	2,054	2,068	2,121	2,234						
BVPS (Rmb)	1.10	0.98	0.98	1.01	1.06						

Source: Company reports and J.P. Morgan estimates.

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Anton Oilfield Services Group (3337.HK, 3337 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
12-Nov-13	OW	4.65	6.40
17-Jan-14	OW	6.06	7.00
19-Mar-14	OW	5.00	6.70
21-Jul-14	N	4.57	5.30
04-Aug-14	N	4.24	5.20
28-Aug-14	N	3.98	3.60
09-Nov-14	UW	1.54	1.30
15-Feb-15	UW	1.60	0.60

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Nov 12, 2013.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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IB clients*	56%	49%	33%
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IB clients*	75%	67%	52%

\*Percentage of investment banking clients in each rating category.

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