

JPM-pp1

Asia Pacific Equity Research

27 March 2015

CNOOC (883 HK)

Underweight

Price: HK\$10.90

25 Feb 2015

Price Target: HK\$9.00

PT End Date: 31 Dec 2015

Good beat and dividend; limited impairment

CNOOC's 2H14 were above market expectations driven by higher volumes and better realizations. The company has impaired assets in the North America and the UK North Sea and the final dividend was HK\$0.32/sh. Key points:

- **Bottom line beats; dividend better than expected:** CNOOC's 2H14 net income at Rmb26.6bn, 53% above our forecast and 40% above consensus (Bloomberg), was driven by stronger than expected 4Q14 volumes and higher than expected realized crude prices. The company has proposed a 2H14 final dividend of HK\$0.32/sh (vs. our forecast of HK\$0.09/sh and consensus at HK\$0.14/sh). The Company had impaired Rmb4.12bn (US\$670.5mn) in 2014 for assets in North America and UK North Sea.
- **Opex/bl flat y/y , but all-in-costs down 6% y/y; no guidance for FY15:** Opex per bbl costs were only down <1% y/y and all-in-costs were down 6% y/y on the back of lower taxes and cost control. Absolute exploration costs were down c32% y/y.
- **RRR>100%; FY15 targets reiterated:** CNOOC reiterated its production guidance at 475-495mboe in FY15 and 6-10% pa 2011-15 with organic capex at US\$11.2-12.8bn. RRR was 112%.

Table 1: CNOOC's 2H14 earnings forecast

	2H13	1H14	2H14	2H14	y/y	h/h	vs. JPMe
Oil & gas sales*	115,646	117,095	101,115	104,430	(13%)	(14%)	(3%)
Operating expenses	(16,954)	(14,685)	(16,495)	(20,279)	(3%)	12%	(19%)
Production taxes	(8,451)	(7,793)	(4,049)	(7,714)	(52%)	(48%)	(48%)
Exploration costs	(12,760)	(4,742)	(6,783)	(14,684)	(47%)	43%	(54%)
DD&A	(30,016)	(27,966)	(30,320)	(26,717)	1%	8%	13%
Special Oil Levy	(11,550)	(11,971)	(7,101)	(5,729)	(39%)	(41%)	24%
SG&A & others	(434)	(4,713)	(677)	(2,599)	56%	(86%)	(74%)
Total operating profit	35,481	45,225	35,690	26,709	1%	(21%)	34%
Net financing charge & other income#	(2,397)	3,422	(1,824)	(2,542)			
Pretax Profit	33,084	48,647	33,866	24,167	2%	(30%)	40%
Taxation	(11,006)	(15,054)	(7,260)	(6,790)			
Tax rate, %	33%	31%	21%	28%			
Net income	22,078	33,593	26,606	17,377	21%	(21%)	53%
EPS, RMB	0.49	0.75	0.59	0.39	21%	(21%)	53%
DPS, HK\$	0.32	0.25	0.32	0.09	0%	28%	247%

Source: Company data, J.P. Morgan estimates. % change is relative to 1H14. *Excludes 'Marketing' revenue.

Table 2: CNOOC's 2H14 production statistics

	4Q13	3Q14	4Q14	q/q	y/y
Revenue	60,379	53,568	47,547	(11%)	(21%)
Oil (mn boe)					
Bohai Bay	36.0	36.8	41	10%	13%
W South China Sea	7.6	6.8	8	12%	0%
E South China Sea	12.7	11.7	14	19%	9%
East China Sea	0.2	0.1	0.3	200%	76%
Overseas	31.9	27.2	33	20%	3%
Total Oil (mn boe)	88	83	95	15%	7%
Gas (bcf)					
Bohai Bay	13	13	12	(5%)	(8%)
W South China Sea	30	31	30	(5%)	1%
E South China Sea	15	11	17	58%	14%
East China Sea	3	2	5	109%	55%
Overseas	65	61	70	14%	7%
Total Gas (bcf)	126	118	134	13%	6%
Total (mn boe)	110	103	118	14%	7%

Source: Company reports.

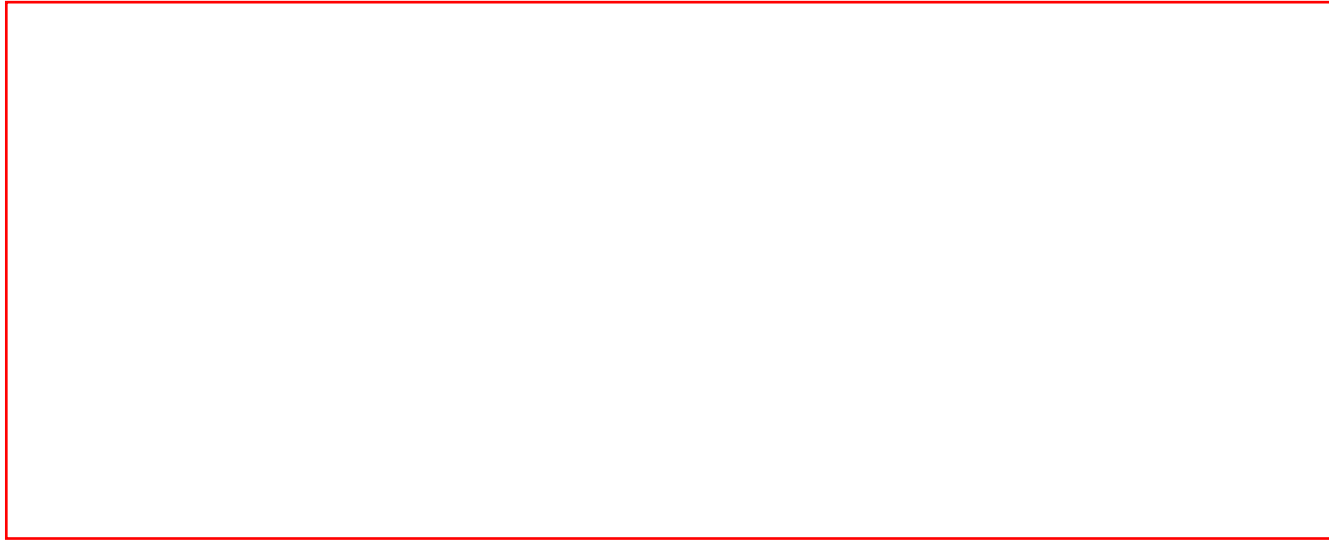
Table 3: CNOOC guidance summary

	Actual/previous 2014 guidance	New 2015 targets*
Upstream	432m boe (incl Nexen)	475-495m boe FY15 (incl-Nexen);

	Production growth at 6-10% pa 2011-15	Production growth at 6-10% pa 2011-15 (incl Nexen) FY15 guidance implies production growth at 7.5-8.5% pa 2011-15 (incl Nexen)
Drilling	RRR>100%	RRR>100%
Capex	185 exploration wells	c162 exploration wells
	Group capex at US\$17-19.5bn	Group capex at US\$11.2-12.8bn
	Organic capex at US\$14-16bn (Nexen US\$3.2-3.8bn)	(Nexen not disclosed)
	Development US\$11.2-12.9bn – 65%	Development US\$7.5-8.6bn – 67%
	Exploration US\$3.2-3.7bn – 19%	Exploration US\$2.3-2.7bn – 21%
	Production US\$2.5-2.8bn – 14%	Production US\$1.1-1.3bn – 10%

Source: Company reports. 2014 guidance based on US\$102/bl Brent forecast, 2015 Brent budget assumption not disclosed.

Figure 1: CNOOC projects in FY15



Source: CNOOC

Investment Thesis

CNOOC is the largest offshore oil company in China and purely focused on offshore upstream operations. CNOOC also has significant interests in Canada with its Nexen acquisition, as well as Nigeria, Australia, Argentina and Indonesia. Crude prices in China are internationally benchmarked, with windfall taxes applied. CNOOC sells gas into NDRC controlled markets at US\$4.00-6.00/mcf and guided to increase by an ~8% CAGR. CNOOC Ltd's parent, CNOOC, owns 66.4% of the shares, and also has a controlling shareholding in oil service, refining, petrochemicals, fertilizer, engineering and LNG facilities. Our negative view of the company is based on:

- **Returns challenged in a low-oil price environment, and ...** With our view of Brent trading at cUS\$49/bl in FY15, we see challenged returns for CNOOC in the near-term.
- **... growing risk of write-downs** – Additionally, we believe that CNOOC could be looking at write-downs of assets purchased in a high oil environment (e.g. Nexen); which could be an added negative to returns.

Valuation

Our Dec 2015 PT of HK\$9.00 is calculated using a risk-based methodology to arrive at a net asset value. We group CNOOC's assets into two categories – core NAV (producing and under-development assets) and risked upside, which is generated by the exploration and assessment assets on a risked basis. Core NAV represents c80% of CNOOC's value, with the remaining being E&A upside.

Risks to Rating and Price Target

The main downside risks to our rating and price target include a sharp fall in oil prices, recent natural gas price increases not being passed through to customers or no further increases, a higher import burden and rising domestic decline rates in areas such as Bohai Bay.

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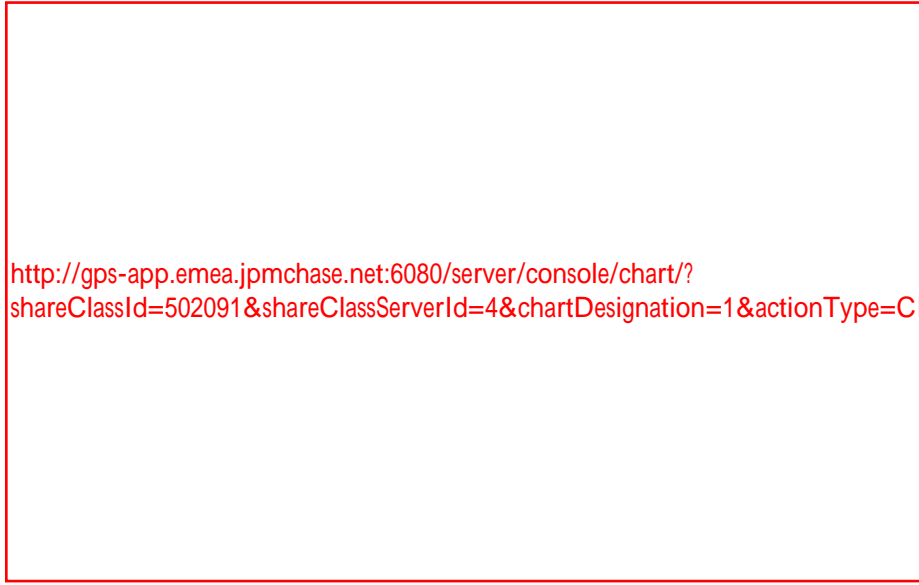
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Date	Rating	Share Price (HK\$)	Price Target (HK \$)
28-Mar-07	N	6.60	8.70
18-Apr-07	OW	6.86	8.70
02-Aug-07	OW	9.13	10.20
14-Sep-07	OW	10.14	12.25
22-Oct-07	OW	13.80	15.20
12-Dec-07	OW	13.20	15.50
11-Jan-08	OW	14.12	16.60
28-Mar-08	OW	11.88	15.00
13-May-08	OW	14.08	16.50
29-Oct-08	OW	5.01	10.00
08-Jan-09	OW	7.37	9.25
04-May-09	N	9.49	9.25
20-Aug-09	N	10.04	10.50
17-May-10	N	12.62	12.50
12-Oct-10	UW	16.80	12.50
06-Apr-11	UW	20.85	15.00
14-Dec-11	UW	14.64	12.50
13-May-12	UW	14.90	13.00
06-May-13	NR	14.18	--
02-Jul-13	N	12.94	16.50
22-Apr-14	N	12.94	15.25
11-Jul-14	OW	13.46	15.75
28-Aug-14	OW	15.14	16.50
09-Nov-14	N	11.78	13.50
18-Jan-15	UW	10.56	9.00

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