

CNOOC

Impairment risks remain; M&A a focus; Dividend unlikely to be sustained

Despite CNOOC's strong results and surprisingly generous dividend, there was limited new information from the management update. There was more focus on cost management, although no specific FY15 target for opex reductions was provided. Impairment risk around the Nexen portfolio remains, in our view, and it is not clear CNOOC's long run oil price being employed. We are not clear on whether dividend is sustainable, although with management focused on M&A, we suspect not.

- **Limited impairment:** CNOOC did report small impairments (cUS\$671mn) in 2014 for assets in North America and the UK which largely relates to the Nexen business, but did not make any comments on whether a further assessment would be made at the interims.
- **No specific opex guidance:** There was no specific FY15 guidance on cost reductions, except outlining cost trends. Despite having suggested FY14 opex was down 10% y/y (see [note](#)), all-in-costs were down 6% y/y and it seems only SG&A can be significantly reduced – opex/DD&A may remain at FY14 levels considering activity this year, in our view.
- **M&A on the table:** Management indicated that the company is looking for acquisitions and would consider cash offers and asset/share swaps, although no details were disclosed of targets.
- **RRR>100%; FY15 targets reiterated:** Production guidance at 475-495mboe in FY15 and 6-10% pa 2011-15 with capex at US\$11.2-12.8bn was reiterated. There was no mention of oil price assumption for these targets, as has been the case in previous updates (presumably US\$70/bl similar to peers). RRR was 112% (reserve life 10.4yrs).
- **Raising FY15/17 EPS by c6% p.a.; PT to HK\$9.5, remain UW:** We have increased our FY15/17 EPS on average 6% p.a. to reflect 2H14 results and ytd. Brent prices; adjust Dec-15 PT to HK\$9.5 (from HK\$9).

CNOOC (Reuters: 0883.HK, Bloomberg: 883 HK)

Rmb in mn, year-end Dec	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue (Rmb mn)	247,627	285,857	274,634	180,120	210,115	235,502
Net Profit (Rmb mn)	63,691	56,461	60,199	21,638	29,258	41,492
EPS (Rmb)	1.43	1.26	1.35	0.48	0.65	0.93
DPS (Rmb)	0.38	0.40	0.45	0.16	0.22	0.31
Revenue Growth (%)	3%	15%	(4%)	(34%)	17%	12%
EPS Growth (%)	(9%)	(11%)	7%	(64%)	35%	42%
ROCE	18%	13%	12%	4%	5%	7%
ROE	22%	17%	16%	5%	7%	10%
P/E	5.9	6.7	6.2	17.4	12.9	9.1
P/BV	1.2	1.1	1.0	1.0	0.9	0.9
EV/EBITDA	2.4	3.0	3.0	5.3	4.3	3.6
Dividend Yield	4.5%	4.8%	5.4%	1.9%	2.6%	3.7%

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

Underweight

0883.HK, 883 HK

Price: HK\$10.50

▲ **Price Target: HK\$9.50**
Previous: HK\$9.00

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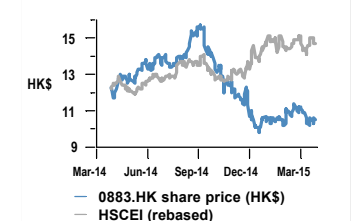
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J.P. Morgan Securities (Asia Pacific) Limited

Price Performance



Company Data	
Shares O/S (mn)	44,647
Market Cap (Rmb mn)	375,819
Market Cap (\$ mn)	60,463
Price (HK\$)	10.50
Date Of Price	27 Mar 15
Free Float(%)	-
3M - Avg daily vol (mn)	63.00
3M - Avg daily val (HK\$ mn)	671.60
3M - Avg daily val (\$ mn)	86.6
HSCEI	1,1898.09
Exchange Rate	7.75
Price Target End Date	31-Dec-15

See page 8 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p>Key catalysts for the stock price: 1) 1Q Operational Data (April 2015)</p>	<p>Upside risks to our view: Upside risk to our view includes increased oil and gas pricing in China, higher production volumes, and lower than expected capital expenditure spending</p>	<p>Downside risks to our view: Key downside risks are a collapse in the oil price, lack of nat gas price hikes and weakening downstream demand.</p>
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Key financial metrics	FY14	FY15E	FY16E	FY17E
Revenues (LC)	274,634	180,120	210,115	235,502
Revenue growth (%)	(4%)	(34%)	17%	12%
EBITDA (LC)	139,201	81,780	95,975	113,314
EBITDA margin (%)	51%	45%	46%	48%
Tax rate (%)	27%	30%	30%	30%
Net profit (LC)	60,199	21,638	29,258	41,492
EPS (LC)	1.348	0.484	0.655	0.929
EPS growth (%)	7%	(64%)	35%	42%
DPS (LC)	0.451	0.162	0.219	0.311
Operating cash flow (LC mn)	110,508	65,436	95,786	91,974
Free cash flow (LC mn)	6,108	(1,484)	34,487	33,048
Interest cover (X)	37.6	18.6	21.9	27.6
Net margin (%)	22%	11%	13%	17%
Sales/assets (X)	0.4	0.3	0.3	0.3
Debt/equity (%)	36%	41%	39%	38%
Net debt/equity (%)	10%	15%	9%	9%
ROE (%)	16%	5%	7%	10%

Key model assumptions	FY14	FY15E	FY16E	FY17E
Oil Price Assumption	99	53	57	65
Total Oil and Gas Production (000 boe/d)	1,177	1,307	1,394	1,402

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

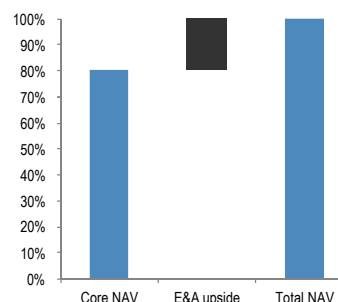
Sensitivity analysis	EBITDA		EPS	
Sensitivity to	FY15E	FY16E	FY15E	FY16E
Impact of each +US\$5/bbl	7%	7%	7%	7%

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

Valuation and price target basis

Our Dec 2015 PT of HK\$9.5 is calculated using a risk based methodology to arrive at a net asset value. We group CNOOC's assets into 2 categories - core NAV (producing and under-development assets) and risked upside which is generated by the exploration and assessment assets on a risked basis.

Price Target Breakdown - NAV Breakdown



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

JPM vs. consensus, change in estimates

EPS	FY15E	FY16E
JPMe old	0.430	0.710
JPMe new	0.484	0.655
% chg	13%	(8%)
Consensus	0.511	0.876

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

Asia Oil & Gas coverage comparative metrics

Company name	JPM Rating	JPM PT (LC)	CMP LC	Upside to PT (%)	Market Cap (\$bn)	P/E(x)		P/B(x)		EV/EBITDA(x)		YTD Perf (%)
						15Y	16Y	15Y	16Y	15Y	16Y	
PETROCHINA-H	N	8.20	8.34	(1.7)	327.5	20.3	15.5	1.0	1.0	10.5	8.7	(3.0)
SINOPEC CORP-H	N	5.70	6.03	(5.5)	117.8	21.0	13.8	0.9	0.8	8.3	7.1	(3.5)
CNOOC	UW	9.50	10.50	(9.5)	60.5	17.4	12.9	1.0	0.9	5.3	4.3	0.6
SINOPEC SHANG-H	UW	1.50	2.62	(42.7)	7.6	30.0	17.5	1.2	1.1	14.3	13.7	15.4
CHINA OILFIELD-H	UW	10.60	12.18	(13.0)	13.4	12.5	11.8	1.0	0.9	11.4	10.7	(9.5)
INPEX CORP	OW	1,560	1,361	14.7	16.7	22.9	18.6	0.7	0.7	5.2	4.0	1.1
OIL & NATURAL GA	UW	300	305	(1.6)	41.7	12.4	9.7	1.4	1.2	5.9	4.8	(11.4)
CAIRN INDIA	N	235	215	9.1	6.5	5.4	10.7	0.6	0.6	2.5	4.2	(9.8)
PTT PCL	N	330	325	1.5	28.5	11.7	10.7	1.2	1.1	6.0	5.9	0.3
PTT EXPL & PROD	UW	95	110	(13.2)	13.3	17.3	17.2	1.0	1.0	3.8	4.0	(2.2)

Source: Bloomberg, J.P. Morgan estimates.

Key points

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.

Deepwater breakthrough at Lingshui 17-2: CNOOC is confident of the commercial potential of a prospective project at Lingshui 17-2; after studying the local market demand management looks to update on the potential scope of the project

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 FY15 guidance summary

	Actual 2014	New 2015 guidance*
Upstream	432m boe (incl Nexen) Production growth at 6-10% pa 2011-15	475-495m boe FY15 (incl-Nexen); 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 Group capex at US\$17-19.5bn Organic capex at US\$14-16bn (Nexen US\$3.2-3.8bn) Development US\$11.2-12.9bn – 65% Exploration US\$3.2-3.7bn – 19% Production US\$2.5-2.8bn – 14%	c162 exploration wells Group capex at US\$11.2-12.8bn (Nexen not disclosed) Development US\$7.5-8.6bn – 67% Exploration US\$2.3-2.7bn – 21% 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

Project	Location	Expected Startup	Peak Production (boe/d)	Working Interests
Jinzhou 9-3 oil field adjustment	Bohai	Commenced production	12,000	100%
Bozhong 28/34 oil fields adjustment	Bohai	First half	30,000	100%
Kenli 10-1 oil field	Bohai	First half	36,000	100%
Dongfang 1-1 gas field Phase I adjustment	Western South China Sea	Second half	9,000	100%
Weizhou 12-2 oil field joint development	Western South China Sea	Second half	16,000	100%
Weizhou 11-4N oil field Phase II	Western South China Sea	Second half	8,000	100%
Luda 10-1 oil field adjustment	Bohai	Second half	6,000	100%

Source: CNOOC

Raising FY15/17 EPS by average 6% pa; new Dec-15 PT of HK\$9.5

We have adjusted our FY15/17 EPS forecast up by an average of 6% to reflect 2H15 earnings and marking to market year to date Brent prices. We update our Dec-15 PT for CNOOC to HK\$9.5 from HK\$9.0, based on our risk based NAV approach to take into account better costs reductions offset by impairments of Canada/UK North Sea assets.

Table 4: CNOOC EPS revisions

	New	Old	Cons	Change (%)	Vs. cons (%)
15Y	0.48	0.43	0.51	13%	(5%)
16Y	0.65	0.71	0.88	(8%)	(25%)
17Y	0.93	0.83	1.17	12%	(21%)

Source: J.P. Morgan estimates, Company data. % change is reference to New estimates.

Investment Thesis, Valuation and Risks

CNOOC (*Underweight; Price Target: HK\$9.50*)

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 more 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\$9.50 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.

CNOOC: 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	285,857	274,634	180,120	210,115	235,502	EBIT	78,503	80,915	29,304	40,008	57,020
% change Y/Y	15%	(4%)	(34%)	17%	12%	Depr. & amortization	56,456	58,286	52,475	55,966	56,294
EBITDA	134,959	139,201	81,780	95,975	113,314	Change in working capital	6,540	4,303	(6,927)	12,473	(3,702)
% change Y/Y	12%	3%	(41%)	17%	18%	Taxes	(24,390)	(22,314)	(9,274)	(12,539)	(17,782)
EBIT	78,503	80,915	29,304	40,008	57,020	Cash flow from operations	110,891	110,508	65,436	95,786	91,974
% change Y/Y	(10%)	3%	(64%)	37%	43%	Capex	(185,305)	(107,100)	(70,000)	(64,365)	(61,805)
EBIT Margin	27%	29%	16%	19%	24%	Disposal/(purchase)	-	-	-	-	-
Net Interest	(2,365)	(3,701)	(4,400)	(4,380)	(4,112)	Net Interest	(2,365)	(3,701)	(4,400)	(4,380)	(4,112)
Earnings before tax	80,851	82,513	30,912	41,797	59,274	Other	72,885	6,310	0	0	0
% change Y/Y	(10%)	2%	(63%)	35%	42%	Free cash flow	(72,762)	6,108	(1,484)	34,487	33,048
Tax	(24,390)	(22,314)	(9,274)	(12,539)	(17,782)	Equity raised/(repaid)	0	0	0	0	0
as % of EBT	30%	27%	30%	30%	30%	Debt raised/(repaid)	81,056	35,000	20,000	0	(20,000)
Net income (reported)	56,461	60,199	21,638	29,258	41,492	Other	0	0	0	0	0
% change Y/Y	(11%)	7%	(64%)	35%	42%	Dividends paid	(17,443)	(19,017)	(13,708)	(8,525)	(11,851)
Shares outstanding	44,669	44,669	44,669	44,669	44,669	Beginning cash	55,024	14,318	14,918	16,647	39,542
EPS (reported)	1.26	1.35	0.48	0.65	0.93	Ending cash	14,484	14,918	16,647	39,542	37,861
% change Y/Y	(11%)	7%	(64%)	35%	42%	DPS	0.40	0.45	0.16	0.22	0.31
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	14,318	14,918	16,647	39,542	37,861	EBITDA margin	47%	51%	45%	46%	48%
Accounts receivable	34,136	29,441	19,309	22,524	25,246	EBIT margin	27%	29%	16%	19%	24%
Inventories	9,153	10,608	6,957	8,116	9,096	Net margin	19%	22%	11%	13%	17%
Others	11,624	8,876	8,876	8,876	8,876	Sales per share growth	15%	(4%)	(34%)	17%	12%
Current assets	146,552	140,708	128,654	155,923	157,944	Sales growth	15%	(4%)	(34%)	17%	12%
LT investments	10,892	9,437	10,139	11,002	12,062	Net profit growth	(11%)	7%	(64%)	35%	42%
Net fixed assets	436,102	479,713	491,879	500,278	505,789	EPS growth	(12%)	6%	(65%)	37%	43%
Total Assets	621,473	662,859	663,673	700,204	708,796	Interest coverage (x)	57.1	37.6	18.6	21.9	27.6
Liabilities						Net debt to equity	10%	10%	15%	9%	9%
Short-term loans	49,841	31,180	31,180	31,180	31,180	Sales/assets	0.5	0.4	0.3	0.3	0.3
Payables	48,558	52,192	35,305	49,043	49,043	Assets/equity	1.7	1.8	1.7	1.7	1.7
Others	30,549	20,126	16,303	19,413	19,413	ROE	17%	16%	5%	7%	10%
Total current liabilities	128,948	103,498	82,789	99,636	99,636	ROCE	13%	12%	4%	5%	7%
Long-term debt	82,011	105,383	125,383	125,383	125,383						
Other liabilities	68,894	74,368	74,368	74,368	74,368						
Total Liabilities	279,853	283,249	282,540	299,387	299,387						
Shareholder's equity	341,620	379,610	383,194	402,878	411,471						
BVPS (Rmb)	7.65	8.50	8.58	9.02	9.21						

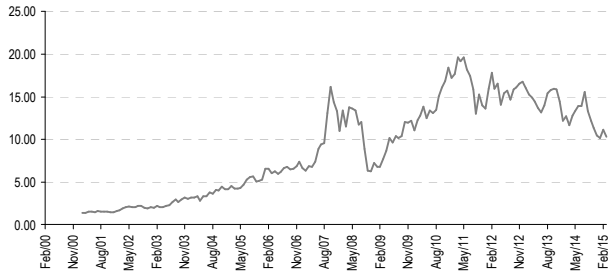
Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile
CNOOC Limited (CHINA / Energy)
 As Of: 27-Mar-2015

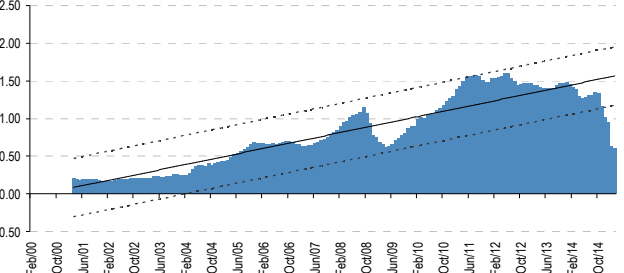
Global Equity Quantitative Analysis

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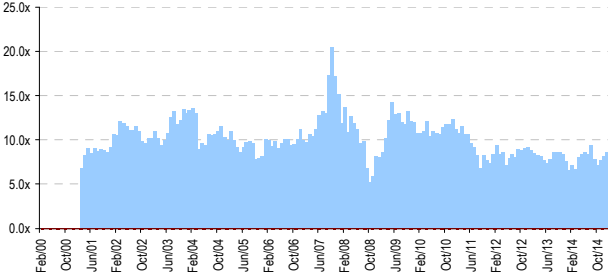
Local Share Price **Current: 10.34**



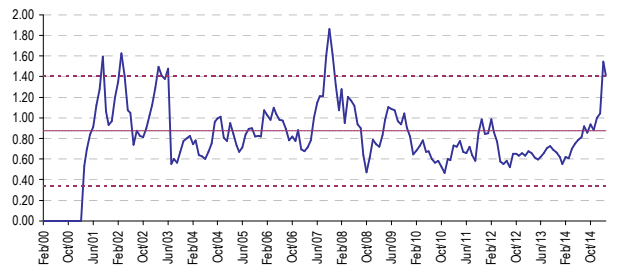
12 Mth Forward EPS **Current: 0.61**



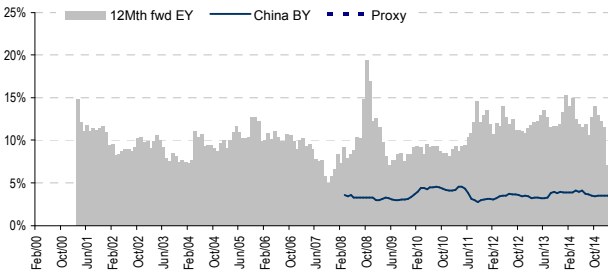
PE (1Yr Forward) **Current: 13.6x**



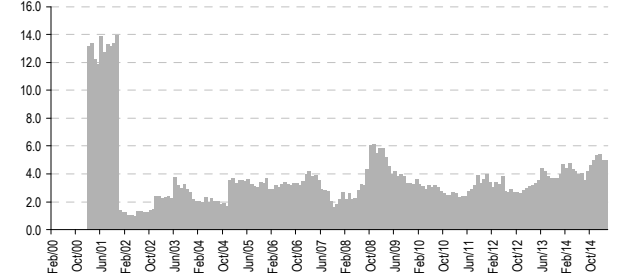
P/E Relative to China Index **Current: 1.41**



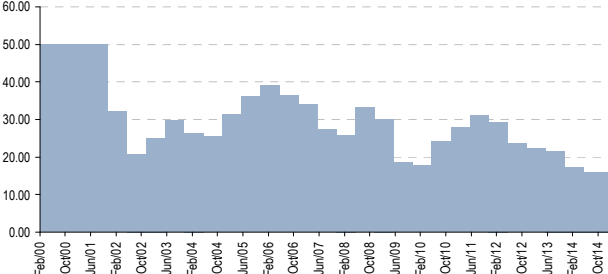
Earnings Yield (& Local Bond Yield) **Current: 7%**



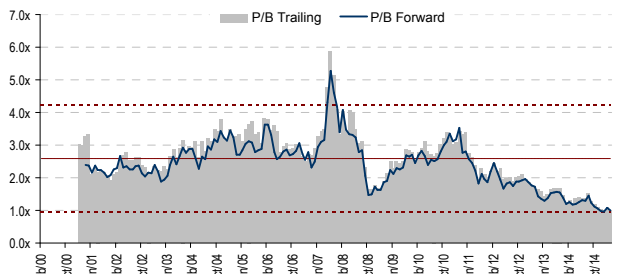
Dividend Yield (Trailing) **Current: 4.94**



ROE (Trailing) **Current: 15.99**



Price/Book (Value) **Current: 1.0x**



Summary

CNOOC Limited		TICKER 883 HK		As Of: 27-Mar-15							
CHINA				Local Price: 10.34							
Energy				EPS: 0.61							
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	13.59x				2.60	4.23	0.97	-1%	482%	162%	158%
P/BV (Trailing)	1.01	1.00	5.87	2.64	3.75	8.87	-1.37	-80%	183%	-35%	-24%
Dividend Yield (Trailing)	4.94x	0.98	13.97	3.24	29.56	48.82	10.29	0%	213%	75%	85%
ROE (Trailing)	15.99	15.99	50.00	27.92							

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

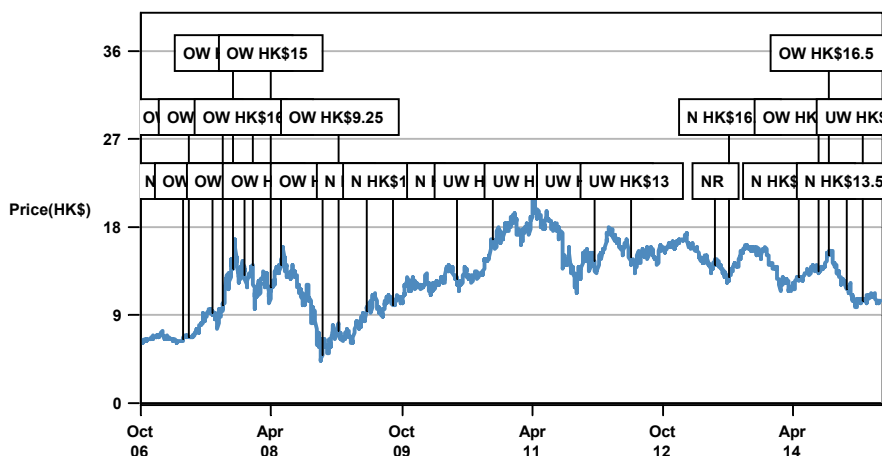
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CNOOC (0883.HK, 883 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Break in coverage May 06, 2013 - Jul 02, 2013.

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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