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2018 年 2 月 12 日

买入

首次覆盖

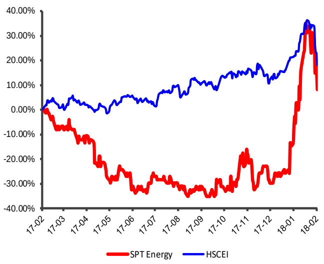
复苏起点

SPT Energy Group (1251 HK)

Market Data: 9 February 2018

Closing Price (HK$)	0.80
Price Target (HK$)	1.24
HSCEI	11,902
HSCCI	4,322
52-week High/Low (HK$)	1.05/0.48
Market Cap (RMB Mn)	1065
Market Cap (HK$ Mn)	1320
Shares Outstanding (Mn)	1535
Exchange Rate (RMB-HK$)	1.24

Price Performance Chart:



Source: Bloomberg

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财务摘要与估值

	2015	2016	2017E	2018E	2019E
Revenue (Rmbm)	1,060	818	1,028	1,318	1,713
YOY (%)	-51.12	-22.84	25.62	28.26	29.96
Net income (Rmbm)	-412	-292	2	79	166
YOY (%)	-	-	-	3,435.8	110.8
EPS (Rmb)	-0.27	-0.19	0.00	0.05	0.11
Diluted EPS (Rmb)	-0.27	-0.19	0.00	0.05	0.11
ROE (%)	-35.48	-31.08	0.24	7.69	13.95
Debt/asset (%)	46.93	50.86	48.86	45.32	44.93
Dividend Yield (%)	-	-	-	-	-
P/E (x)	-	-	443.86	12.55	5.96
P/B (x)	0.88	1.08	1.08	0.99	0.85
EV/EBITDA (x)	-	-	12.04	6.78	4.46

华油能源集团是一家中国民营的综合油田服务企业，提供一系列油气开发方案与技术，服务领域涵盖钻井、完井和油藏检测与和维护等板块。16 年华油能源 43%的收入来自海外，其中来自哈萨克斯坦的收入占总收入的 23%。受油价强势复苏、公司成本控制不断强化与中国上游油气改革逐步深化等利好因素推动，华油未来增长潜力巨大，我们对公司未来发展保持乐观。我们预测公司 2017/2018/2019 年的摊铺每股收益为人民币 0.00 元/0.05 元/0.11 元（同比增长 120%）。基于公司目前股价对应我们最新的目标价港币 1.24 元有 55%的上涨空间，我们首次覆盖给予买入评级。

油价强劲复苏 进入 18 年之后布伦特原油远期价格稳定站上 60 元美金/桶，并持续朝 70 元美金/桶靠近。我们认为不断下降的美国原油库存、强于预期的美国经济增长、美国页岩油产量瓶颈与 OPEC 减产导致的全球供给收紧是当前油价反弹的主要驱动力。根据路透社在 18 年 1 月对超过 1000 名油气行业专家进行的市场调查，布伦特原油价格在 18 年预计稳定在 65 元美金/桶。在此油价水平下，我们预计全球上游油公司资本开支在 18 年同比增加 11%，拉动华油的 Ebitda 率由 17 年的 14.8%提升至 18 年的 24.2%。

油气市场化改革 中国发展与改革委员会于 2014 年提出能源体制改革。在油气领域，通过向国际与民营公司开放上游勘探开发与下游分销市场，逐渐实现行业市场化。15-16 年油价低迷期间，受中国反腐败运动叠加影响，中国大型国有油公司内部运营受到负面冲击，上游资本开支大幅萎缩；随着油价复苏和反腐带来的负面冲击逐渐被消化，我们预计上游资本开支将重拾增势，在 17 年与 18 年分别同比增长 17%与 19%。我们认为中国政府基于环保考虑对提高天然气在一次能源消费中占比的努力（计划从 15 年的 5%提升至 2019 年的 15%）将驱动长期上游资本开支的增长。基于市场逐渐开放与资本开支长期增长的判断，我们预计中国民营油服企业在国内市场的占比将从 10%提升至 20%，民营市场规模相应将从 2016 年的 160 亿人民币提升至 2019 年 530 亿人民币。基于此，我们预计华油的国内收入将从 2016 年的 4.63 亿人民币增加至 2019 年的 9.70 亿人民币。

首次覆盖给予买入 受油价强势复苏、公司成本控制不断强化与中国上游油气改革逐步深化等利好因素推动，华油未来增长潜力巨大。我们预测公司 2017/2018/2019 年的摊铺每股收益为人民币 0.00 元/ 0.05 元/ 0.11 元（同比增长

120%)。基于公司目前股价对应我们最新的目标价港币 1.24 元有 55%的上涨空间，我们首次覆盖给予买入评级。

SPT Energy Group is a Chinese private oil & gas services company, with a comprehensive portfolio of products and services, ranging from drilling and well completion to reservoir monitoring and maintenance services. In 2016, SPT generated 43% of its revenue overseas, with Kazakhstan accounting for 23% of total revenue. We are positive on the firm's growth outlook on the back of recovering oil prices, increasing cost control efforts, and the gradual liberalisation of China's upstream oil & gas services sector. We forecast diluted EPS of Rmb0.00 in 17E (vs –Rmb0.19 in 16A), Rmb0.05 in 18E, and Rmb0.11 in 19E (+120% YoY). We derive a target price of HK$1.24, representing 20.1x 18E PE. With 55% upside, we initiate coverage of the company with a BUY rating.

Strong oil price recovery. Brent futures have remained above US$60/bbl since the beginning of the year, steadily approaching US$70/bbl. We believe the current price rebound is mainly driven by falling US crude oil inventories, stronger-than-expected US economic growth, and the US shale oil production bottleneck, amid continued tight crude oil supply by member countries of the Organization of the Petroleum Exporting Countries (OPEC). According to a survey conducted by Reuters in January 2018, based on responses from over 1,000 oil & gas professionals, Brent prices are expected to average US$65/bbl in 2018F. Under this scenario, we expect global upstream oil & gas Capex to grow 11% YoY in 2018E, leading SPT's Ebitda margin to increase from 14.8% in 17E to 24.2% in 18E.

Market liberalisation. China's National Development and Reform Commission (NDRC) released an oil & gas reform programme in 2014 to liberalise the domestic oil & gas sector gradually by opening upstream and downstream markets to international players and privately owned firms, such as SPT. We expect China's upstream oil & gas Capex to grow 17% YoY in 17E and 19% YoY in 18E, following a steep Capex contraction in 2015-16 amid China's anti-corruption campaign, which led to a period of relative stagnation among large oil & gas state-owned enterprises (SOEs). Moreover, we see the government's efforts to raise the proportion of natural gas in the country's primary energy consumption, from 5% in 2015 to 15% in 2030, as a long-term Capex growth driver. As a result, we forecast private companies to occupy a larger share of the domestic market, from 10% in 16A to 20% in 20E, while projecting China's upstream oil & gas services market to expand from Rmb16bn in 2016 to Rmb53bn in 2019E (48.7% Cagr). As such, we expect SPT's revenue in China to grow from Rmb463m in 2016 to Rmb970m in 2019E (28.0% Cagr).

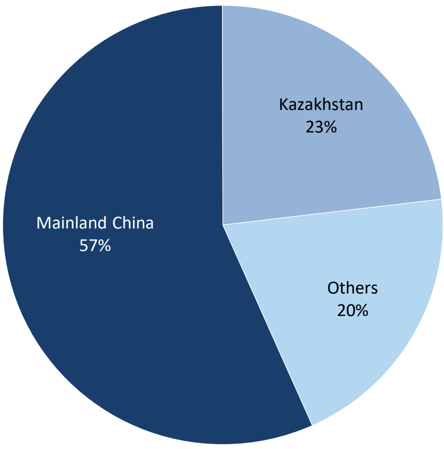
Initiate with a BUY. Given the firm's strong growth potential, underpinned by recovering oil prices, increasing cost control efforts, and the gradual liberalisation of China's upstream oil & gas services sector, we forecast net profit of Rmb2.2m in 17E, Rmb78.9m in 18E, and Rmb166.3m in 19E, translating into diluted EPS of Rmb0.00 in 17E (vs –Rmb0.19 in 16A), Rmb0.05 in 18E, and Rmb0.11 in 19E (+120% YoY). We derive a target price of HK$1.24, representing 20.1x 18E PE. With 55% upside, we initiate coverage of the stock with a BUY rating.

SPT Energy at a glance

SPT Energy Group is a Chinese private oil & gas services company. Over the past decade, the firm has developed a comprehensive portfolio of products and services in the oil & gas sector, ranging from integrated project design and field operation to drilling, well completion, and production equipment manufacturing. In 2016, reservoir services accounted for 64% of its revenue, while drilling services represented 21% and well completion services 14%. SPT has increased its global footprint to diversify country risks and improve its growth potential. In 2016, 43% of the firm's revenue were generated overseas, Kazakhstan alone accounting for 23% of total revenue. The company's revenue amounted to Rmb818m in 2016 (-22.8% YoY), amid the global oil & gas market downturn.

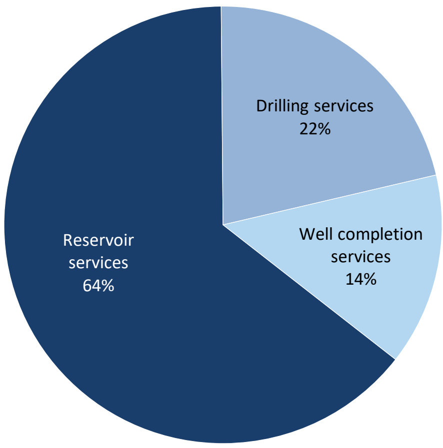
In terms of competitive advantages, SPT is one of the only two Chinese non-state-owned upstream players that provide a comprehensive range of oilfield services, allowing the firm to bid for turnkey contracts, which usually enjoy higher margin than individual contracts. We note CEO Wang Guoqiang and executive director Wu Dongfang own a combined 42.2% stake in the company. US$15m worth of convertible bonds were issued in 2012 with a conversion price of HK$1.69, accounting for 13.6% of the market capitalisation on 19 January 2018.

Fig 1: Revenue breakdown by geographical area in 2016



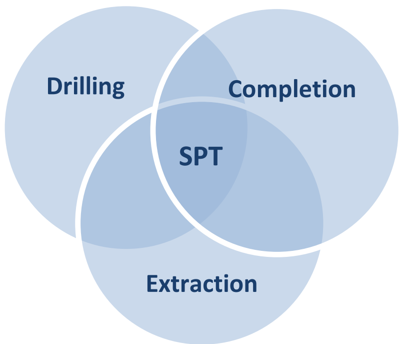
Source: Company data, SWS Research

Fig 2: Revenue breakdown by business segment in 2016



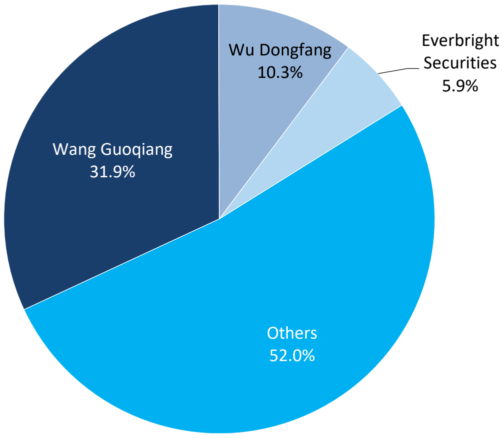
Source: Company data, SWS Research

Fig 3: SPT's comprehensive service offerings



Source: SWS Research

Fig 4: Ownership structure



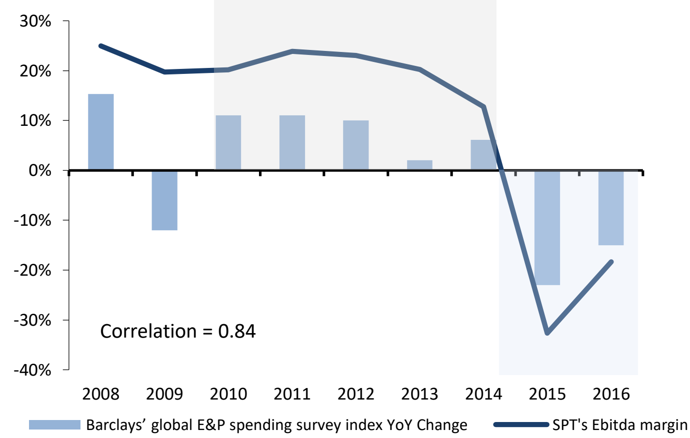
Source: Company data, SWS Research

Oil price support

The majority of SPT's clients are national oil companies (NOCs), which usually subcontract exploration and production (E&P), including prospecting for onshore and offshore oil & gas reserves, drilling wells to exploit new oil & gas fields, and performing routine well maintenance, to oilfield services providers, such as SPT. Oil companies' E&P efforts are reflected in their annual Capex. As such, changes in Capex have a significant impact on the demand for upstream oil & gas services, and thus on the profitability of oil & gas services companies. As shown in figure 5, the correlation between oil companies' Capex YoY changes and SPT's Ebitda margin in 2008-16 reaches 0.84 (R^2: 0.70).

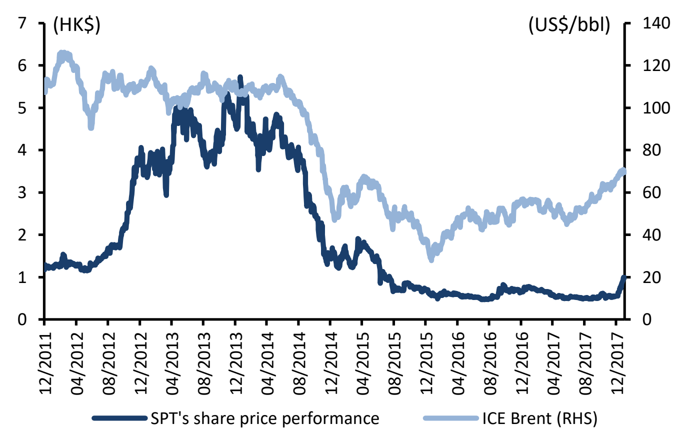
Oil price is one of the main triggers of Capex changes. We note global Capex expanded continuously as oil prices stayed above US$100/bbl in 2011-2013, while declining sharply when oil prices tumbled in 2014-2015. The share price performance of upstream oil & gas firms is directly affected by Capex changes, and therefore oil prices. As shown in figure 6, SPT's share price soared in 2011-13, when oil prices were at record-high levels, and plummeted in 2014 as oil prices collapsed.

Fig 5: Global E&P Capex growth and SPT's Ebitda margin



Source: Barclays, Wind, SWS Research

Fig 6: SPT's share price performance and ICE Brent crude oil price



Source: Wind, SWS Research

Fig 7: The impact of oil price recovery on oilfield service firms

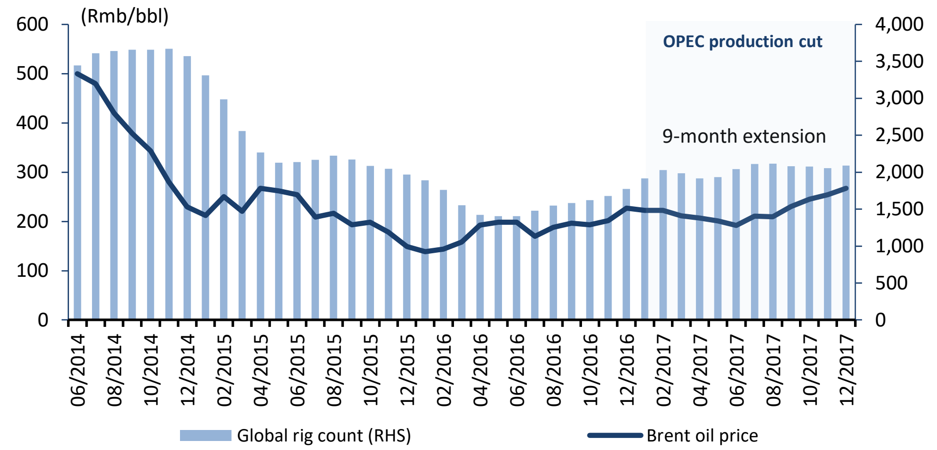
Source: SWS Research

In the following sections, we discuss in more details how the recent increase in oil prices has led to an expansion in oil companies' Capex and, as a result, improved upstream oilfield services firms' fundamentals.

Strong oil price recovery

Oil price recovery accelerated in late-2017 after the Organization of the Petroleum Exporting Countries (OPEC) extended its production cut pact. After declining for two years, Brent futures arrived at US$60/bbl in end-October 2017, catching the uptrend of global rotary rig count. Due to stronger-than-expected global oil demand growth and decreasing global oil supply, Brent futures have remained strong above US$60/bbl since the beginning of the year, steadily approaching US$70/bbl, amid falling US crude oil inventories and growing tensions in Iran.

Fig 8: Recovery in Brent oil price and worldwide rig account

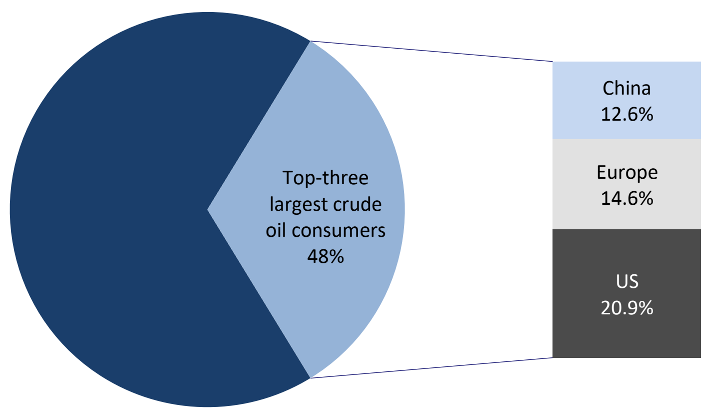


Source: Baker & Hughes, Wind, SWS Research

Growing oil demand

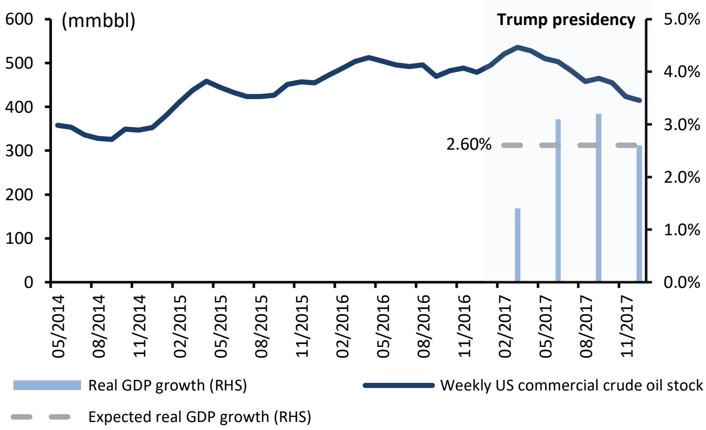
We see growing global oil demand as the primary short-term factor supporting the current oil price recovery, as upstream producers cannot increase supply as quickly as demand grows. US is one of the main consumers of crude oil and related products, exerting significant influence on global oil demand. As shown in figure 9, US accounted for 20.9% of the world's total crude oil consumption in 2016, vs 14.6% for Europe and 12.6% for China. According to monthly reports by the International Energy Agency (IEA), global oil demand grew 1.9% YoY in 2017, representing 2.1mmbpd, mainly supported by US and China. US' increasing oil demand is backed by stronger-than-expected economic growth. After a weak first quarter in 2017, US beat GDP growth consensus in the following two quarters, while being in line with market consensus in 4Q17, resulting in a gradual decrease in the country's commercial crude oil inventories amid tight global oil supply, thus driving up US oil demand.

Fig 9: Global demand breakdown in 2016



Source: OPEC, SWS Research

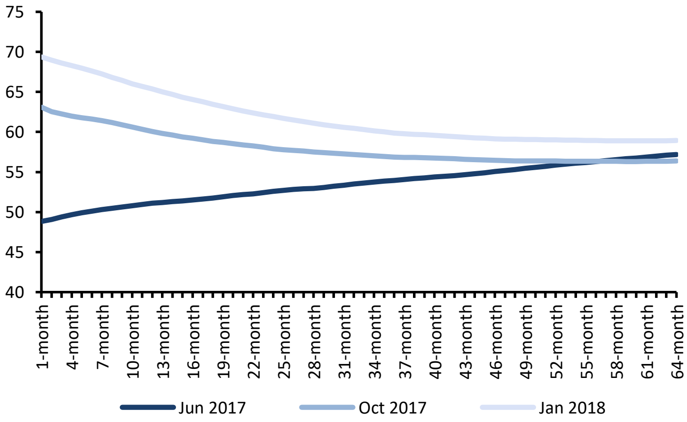
Fig 10: US GDP growth and crude oil inventories



Source: EIA, SWS Research

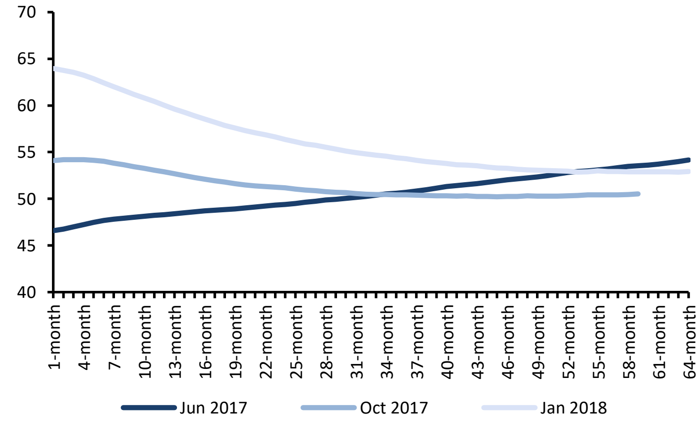
Looking at the forward curve of ICE Brent and WTI crude oil futures contracts, we highlight a change in shape from contango, where longer-dated futures are traded at a higher price than shorter-dated contracts, in June 2017 to backwardation, where longer-dated futures are exchanged at a lower price than shorter-dated contracts, in January 2018. We attribute this change to the oil spot price rally of 2H17 and the growing immediate demand for crude oil, which is consistent with our previous observation.

Fig 11: ICE Brent forward curve



Source: Bloomberg, SWS Research

Fig 12: WTI forward curve

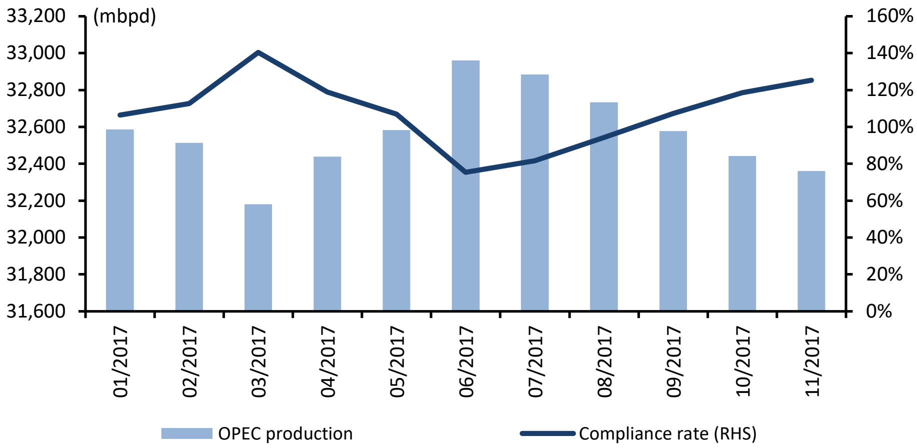


Source: Bloomberg, SWS Research

Tight oil supply

Crude oil is divided into conventional crude oil and unconventional crude oil, depending on the extraction technique used. OPEC countries, which mostly produce conventional crude oil, account for 40.5% of the global oil supply. To support oil prices, which OPEC economies heavily rely on, 11 of the 13 active OPEC members signed a production cut pact in October 2016, and agreed to extend the pact to mid-2018 in June 2017 and to end-2018 in November 2017. After the first extension was signed in June 2017, driven by Saudi Arabia's (31% of total OPEC production) pursuit of high IPO valuation for its NOC Aramco and other OPEC countries' resolve to stabilise their economies, the compliance rate towards the 1.2mmbpd production cut target increased from 75% in June 2017 to 125% in November 2017, while crude oil production declined from 32,961mbpd to 32,361mbpd. As Aramco will not get listed before late-2018 and it will take time for oil-dependent economies to recover, we expect OPEC's crude oil supply to remain tight in the long term, thus supporting continued oil price recovery.

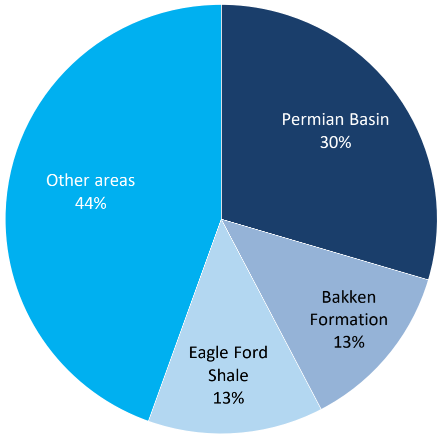
Fig 13: OPEC production and compliance rate



Source: OPEC, SWS Research

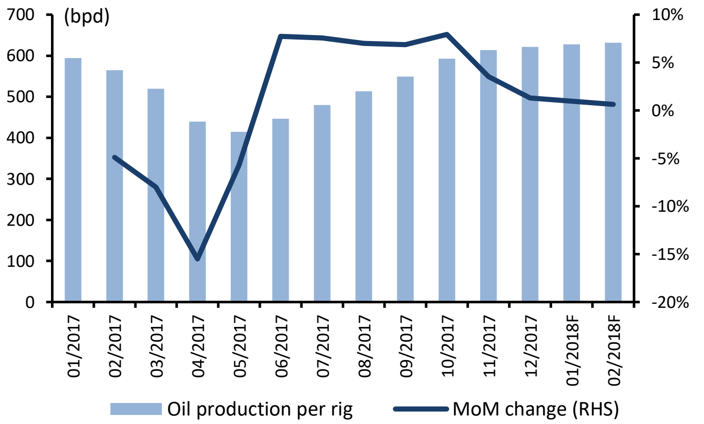
Looking at unconventional oil, we note shale oil represented 48.3% of US total domestic oil production in 2016, the US being one of the main producers of unconventional oil. We note many investors believe the growth in US shale oil production will compensate the decrease in OPEC production to a large extent, curbing the oil price recovery. However, we think it will not be the case as shale well productivity reaches a bottleneck. In the Permian Basin, which accounts for 30% of US total crude oil production and is the country's largest shale oil production region, oil production growth per rig gradually decreased to zero between October 2017 and December 2017, while rig count increased from 380 to 398. We see the 40%-plus natural decline rate of existing wells as the primary cause of the supply bottleneck. In the absence of technological change and improving productivity, increasing rig counts is the only way to drive up production or even maintain the current production level. As such, we expect production costs per barrel to climb, dissuading shale oil producers from increasing their supply, unless oil prices keep up with the growth in production costs.

Fig 14: Crude oil production breakdown



Source: EIA, SWS Research

Fig 15: Oil production per rig at Permian Basin (US)

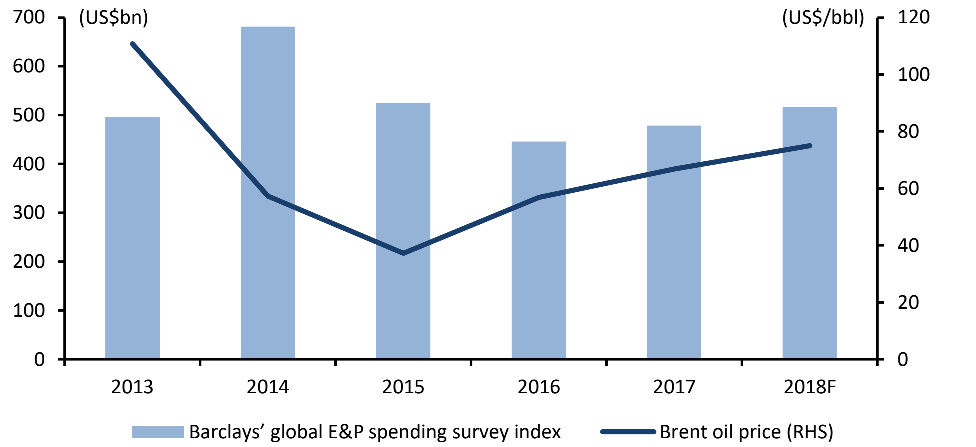


Source: EIA, SWS Research

Global Capex recovery

Global oil companies' Capex has entered an uptrend following the strong oil price recovery experienced since 2016. Barclays' global E&P spending survey index climbed 7% YoY in 2017, increasing for the first time since the 2014 oil price collapse, while Barclays forecasts global Capex to grow 8% YoY in 2018F.

Fig 16: Barclays' global E&P spending survey index



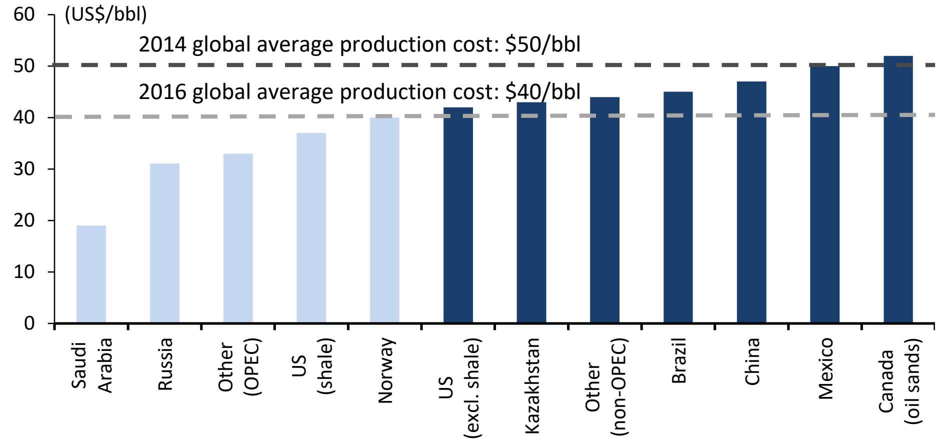
Source: Barclays, SWS Research

We highlight the current Capex recovery cycle is different from the previous one in several ways. Thanks to technological advances, the production cost of crude oil has decreased. More specifically, the average production cost per barrel declined from US$50/bbl in 2014 to US$40/bbl in 2016. This indicates that, on average, oil companies break even faster than before, which facilitates Capex recovery.

We estimate the global marginal cost of production to determine the price at which most oil companies would break even when producing an extra barrel of crude oil through Capex increase in the current oil upward cycle. We exclude the Middle East and Russia from our calculation as their Capex decisions are largely independent from oil price changes due to very low production costs (US$20-30/bbl). As such, we calculate a global supply-weighted average marginal cost of production of US$56/bbl.

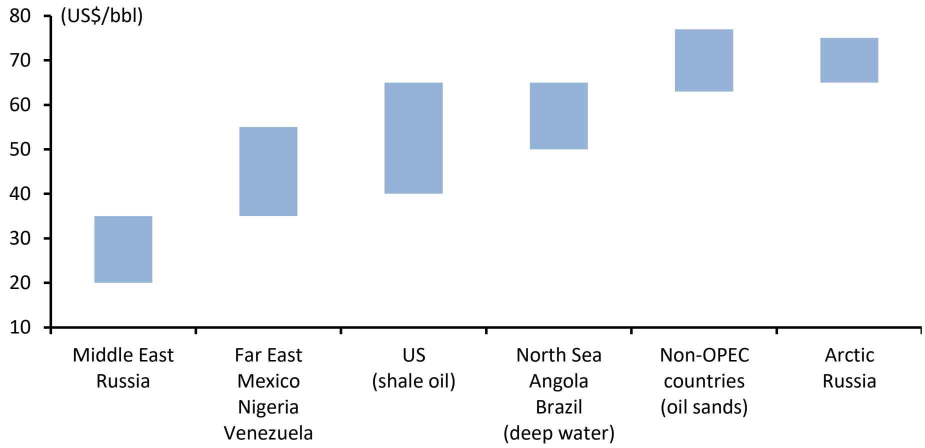
We note global Capex picked up in 2017, after two consecutive years of contraction, as Brent oil price exceeded the US$56/bbl threshold. Given the long-term market view of US$60/bbl, as shown by the ICE Brent forward curve (figure 11), we believe the Capex recovery will be sustainable. During the previous 2009-2010 oil price uptrend, Capex started to pick up in 2010, after Brent oil price increased from US$60/bbl to c.US$80/bbl in 2009. According to our estimations, the oil price threshold for Capex recovery at that time was c.US$70/bbl. During periods in which Brent oil price was within the US$70-80/bbl range, in 2007 and 2010-11, Barclays' global E&P spending survey index grew an average of 11% YoY, slightly higher than Barclays' 2018F forecast of 8% YoY. In the current cycle, we assume a similar level of growth in Capex, at c.10% YoY annually as long as oil prices remain above the current oil price threshold of US$56/bbl.

Fig 17: Average crude oil production cost per country in 2016



Source: Energy Aspects, SWS Research

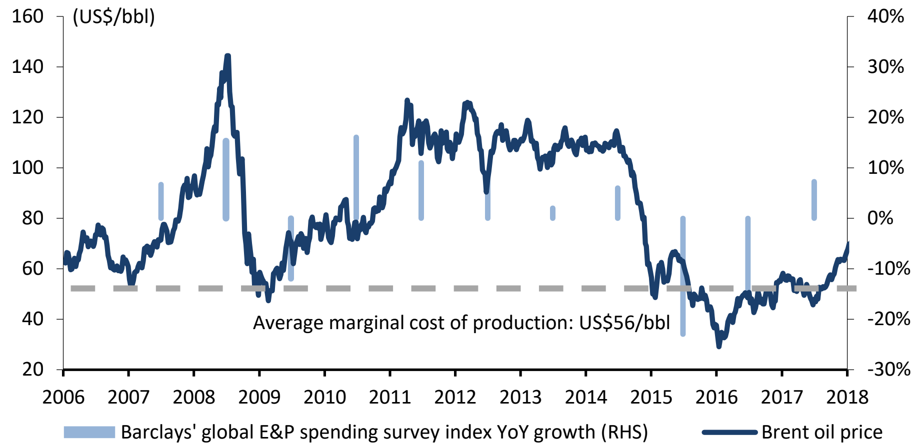
Fig 18: Crude oil production cost range by geographical area in 2016



Oil type	Conventional (less sulphide)	Conventional (more sulphide)	Unconventional (shale oil)	Unconventional (deep water)	Unconventional (oil sands)	Unconventional (mixed)
World supply (%)	49	28	5	13	5	-
Average cost (US$/bbl)	23	49	61	63	72	75

Source: EOG resources, PIRA, SWS Research

Fig 19: Brent oil price and global Capex growth



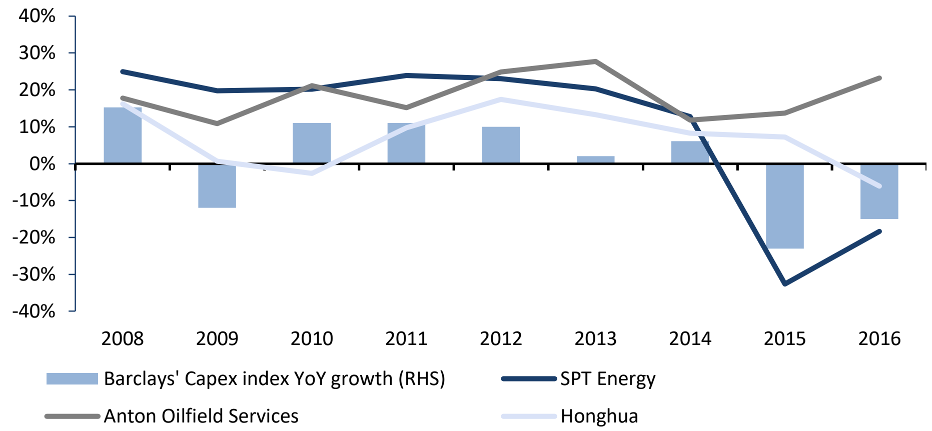
Source: Wind, Barclays, SWS Research

Improving fundamentals

Historically, Capex recovery leads to improving fundamentals, in particular profitability, for upstream oil & gas services companies. We note SPT's and Anton Oilfield Services Group's (3337:HK – N-R) Ebitda margin swiftly picked up as Capex recovered in 2010-14, supported by high oil prices. By contrast, oil & gas equipment manufacturer Honghua Group's (196:HK – Outperform) profitability only picked up in 2011. As one of the first destinations for upstream Capex during an upcycle tends to be oilfield services, and investment in new equipment typically occurs after idle capacity is fully utilised, services providers generally show a more rapid response to oil price recovery and Capex growth than equipment providers.

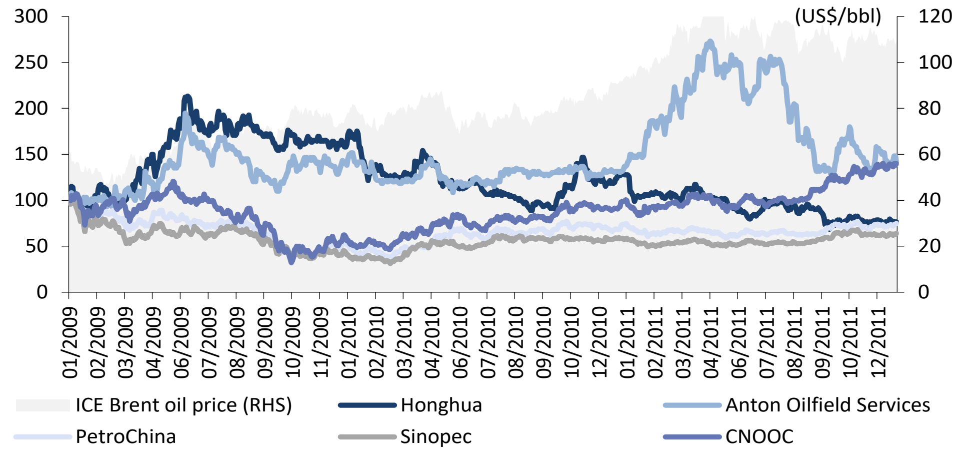
In terms of share price performance, we note upstream oil & gas services providers are more sensitive to oil price changes than upstream equipment manufacturers, like Honghua, and E&P companies, such as PetroChina (857:HK – N-R), China Petroleum & Chemical Corporation (Sinopec; 386:HK – N-R) and CNOOC (883:HK – N-R). Hence, during the 2009-11 oil price uptrend, oil & gas services firms experienced stronger share price performance, while during the 2014-15 oil price downtrend, they witnessed stronger share price corrections. Overall, oil & gas services companies tend to deliver more robust share price performance than equipment manufacturers and E&P companies when oil prices remain largely above the breakeven level.

Fig 20: Ebitda margin of China's upstream oil & gas services companies



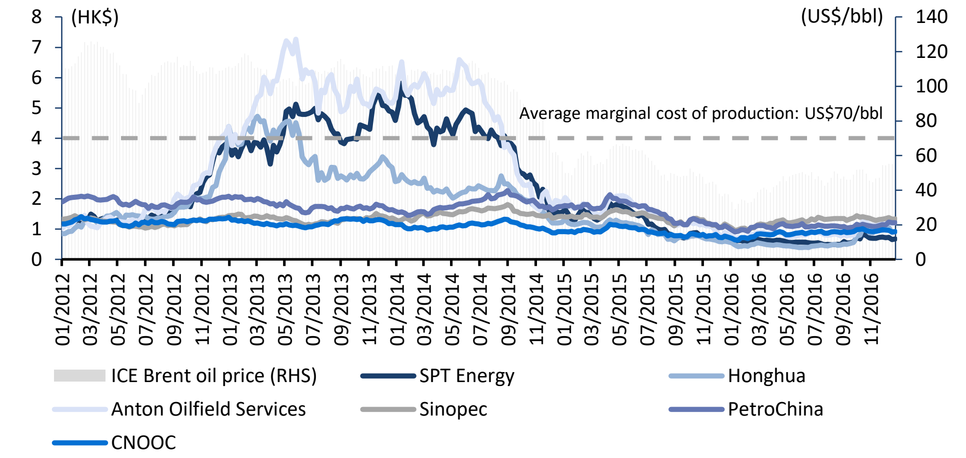
Source: Wind, SWS Research

Fig 21: Share price performance of upstream oil & gas companies (base 100), 2009-11



Source: Bloomberg, SWS Research

Fig 22: Share price performance of upstream oil & gas companies, 2012-16



Source: Bloomberg, SWS Research

Asset-light strategy

SPT increased its Capex from Rmb89m in 2011 to Rmb211.9m in 2014, representing a 33.5% Cagr, amid high oil prices. However, the 2014 oil price collapse took a heavy toll on SPT, as the company subsequently recorded large deprecations on idle equipment, thus impacting its financials. Depreciation accounted for 14% of the firm's total revenue in 2016 (vs only 4% in 2014). In addition, impairment losses represented 5-10% of total revenue in 2016-17, weighing on the company's overall profitability. As a result, Ebitda margin slumped from 12.7% in 2014 to -18.8% in 2016.

In response to the 2014 oil price fall and its consequences on the company's financials, management decided to develop an asset-light strategy, and streamline operations to improve asset efficiency. As a result, total asset turnover increased from 0.15 in June 2015 to 0.24 in June 2017, while fixed-asset turnover rose from 0.82 to 1.2 over the same period. Assuming the same profit margin and financial leverage as during the previous oil price uptrend, an improvement in asset turnover will push up the firm's profitability. As such, we expect SPT's share price to gain momentum as the company continues to roll out its asset-light strategy.

Scenario analysis

We have analysed the impact of oil prices on SPT's fundamentals under three scenarios.

Bull case: Stronger-than-expected US and China's economic growth would boost the demand for crude oil, driving up short-term oil prices above US$70/bbl. The market would adjust its long-term oil price forecast accordingly, beating Reuters' survey forecast of US$65/bbl. Given soaring oil prices, we believe global Capex would increase at the same average growth rate as when oil prices exceeded US$70/bbl during the previous upward cycle (c.+15% YoY), benefiting upstream oil & gas services companies, such as SPT. Under this scenario, we expect the company to experience double-digit revenue growth and substantial improvement in profitability. We believe the 15% YoY growth in oil companies' Capex would trigger an upward Capex investment upcycle for upstream services firms. However, surging oil prices would ease concerns about increasing production costs, leading US shale oil supply to grow substantially, thus weighing on the sustainability of oil price hikes. If oil prices unexpectedly decrease due to the sudden increase in long-term supply, large depreciations will negatively affect the company's profitability, as in the precious cycle. Although SPT's asset-light strategy would give the company further flexibility, oil price volatility would make steady revenue growth unsustainable.

Base case: We expect crude oil supply and demand to maintain the price of oil between the Capex recovery threshold of US$56/bbl and Reuters' survey forecast of US$65/bbl. Under this scenario, OPEC countries would maintain tight supply due to economic concerns. Shale oil supply would not rise substantially given increasing production costs, thus supporting the long-term stability of oil prices. As technology advances decrease average production costs, global Capex would increase steadily, at a rate of 8-10% YoY. Upstream services providers would benefit the most from this situation as they would receive steady order flows from oil companies, given solid Capex growth, thus making revenue growth sustainable. Moreover, a stable oil price outlook would encourage oil & gas services providers to increase Capex in the long run, providing further upside potential.

Bear case: Due to an unexpected shock to the global economy, demand would weaken and crude oil inventories pile up. Under this scenario, the OPEC could decide to cancel the production cut pact, increasing global oil supply. The combination of weakened demand and growing supply would drive oil prices below the Capex recovery threshold of US$56/bbl. As a result, global Capex would contract, catching upstream services companies off guard, and thus leading SPT's profitability to tumble.

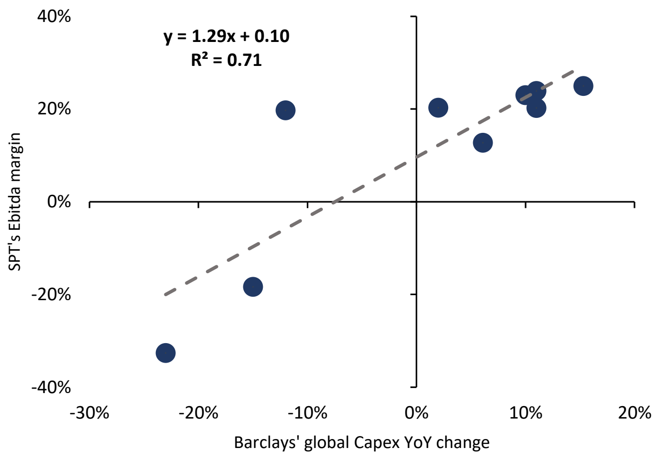
We conducted a sensitivity analysis to assess the impact of oil prices on global Capex growth and SPT's Ebitda margin, by considering the three scenarios described previously. We also ran a simple regression between SPT's Ebitda margin and global Capex growth. Under our bull scenario, SPT's profitability would significantly improve, reaching record-high levels, while under our base case scenario, SPT's profitability would recover to its historical average.

Fig 23: Sensitivity analysis

2018E	Brent oil price (US$/bbl)	Global Capex growth (YoY)	Ebitda margin
Bull case	> 65	> 15%	> 29.4%
Base case	56-65	8-11%	20.3-24.2%
Bear case	< 56	< 0%	< 10%

Source: SWS Research

Fig 24: Regression between SPT's Ebitda margin and global Capex growth



Source: Barclays, SWS Research

To this day, we have not seen any sign of large economic slowdown or sudden increase in supply. Therefore, we believe the base case and bull case scenarios are more likely than the bear case scenario. We see US shale oil as the most imminent threat to the current uptrend. We expect global Capex to grow moderately in 2018-19E, with a positive impact on SPT's fundamentals.

China market

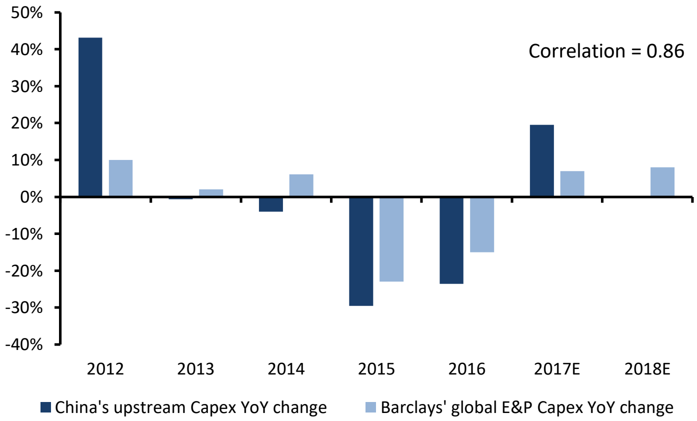
Although SPT has significantly increased its exposure to global markets, the China market cannot be ignored as a large portion of SPT's revenue still come from the domestic oil & gas market. In contrast to global markets, China's market is dominated by state-owned enterprises (SOEs), while the government largely influences NOCs' strategies.

Capex recovery

PetroChina, Sinopec, and CNOOC are China's three largest NOCs, accounting for 95%-plus of the country's upstream Capex. We used their E&P expenditure as a proxy for China's upstream Capex. As shown in figure 23, although China's Capex growth is significantly correlated (0.86) with global Capex growth, represented by Barclays' global E&P spending survey index, China's Capex decreased more during the 2015-2016 oil price downturn. We attribute this to China's anti-corruption campaign, targeting high-level government officials and SOE senior executives, in 2014-2016, which led to a period of relative stagnation in large SOEs, such as PetroChina, Sinopec, and CNOOC.

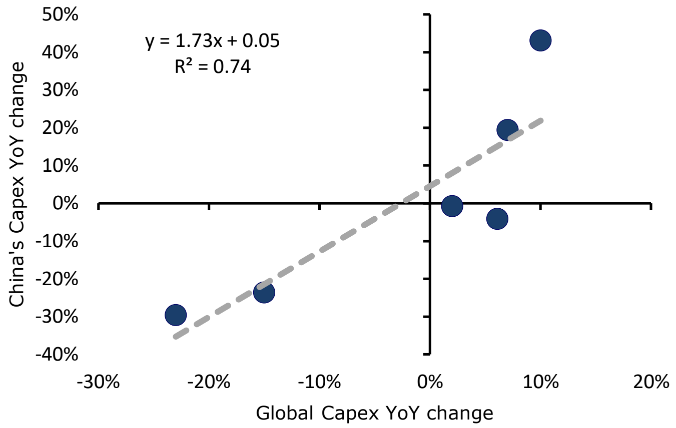
We ran a simple regression between China's upstream Capex YoY change and Barclays' global E&P Capex YoY change, as shown in figure 24. By extrapolating Barclays' 7% global Capex YoY growth forecast in 2017F and 8% YoY growth forecast in 2018F, we forecast 17% YoY growth for China's Capex in 2017E and 19% YoY growth in 2018E, which is in line with our expectation of stronger Capex expansion in China to offset the larger decrease in 2015-16. Moreover, we see China's ambitious unconventional gas production plan, aiming to raise the percentage of natural gas in primary energy consumption from 5% in 2017 to 10% in 2020 and 15% in 2030, as a long-term Capex growth driver.

Fig 25: China's Capex growth vs global Capex growth



Source: Company data, SWS Research

Fig 26: Regression between China's Capex growth and global Capex growth

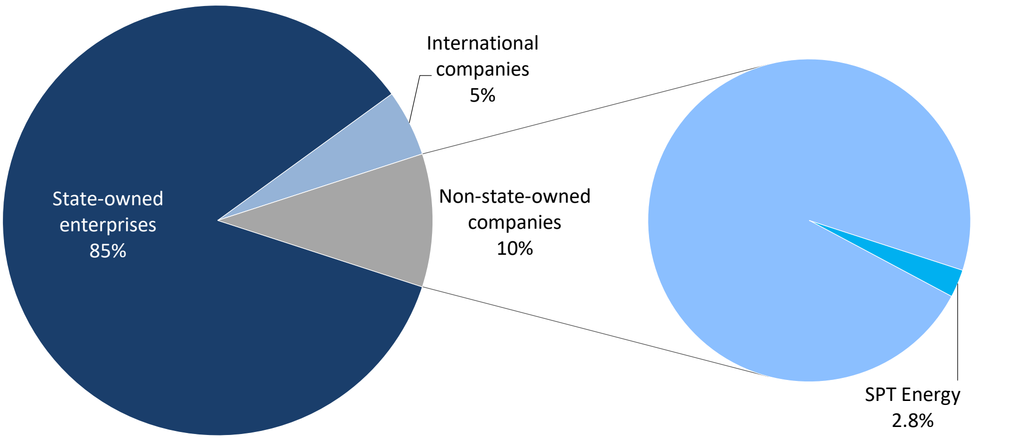


Source: Barclays, SWS Research

Market share

According to a study from Peking University, SOEs account for 85% of China's upstream oil & gas services market, private companies occupying a 10% market share and international players representing the remaining 5%. We estimate SPT's market share within the non-state-owned segment at 2.8%, and therefore estimate its share in the overall China market at 0.28%.

Fig 27: China's upstream oil & gas services market breakdown



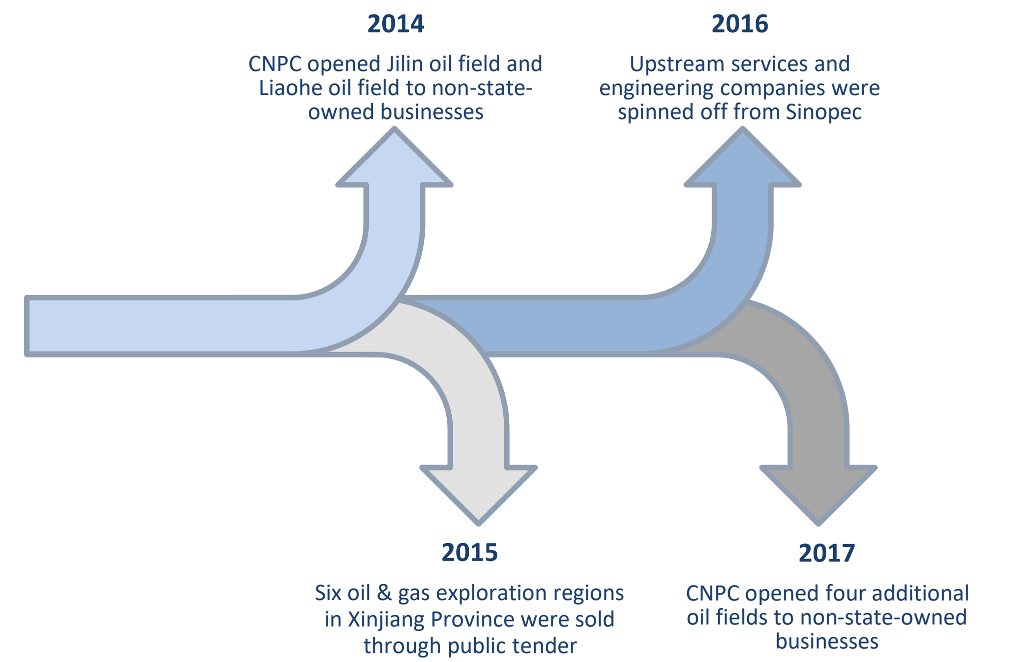
Source: Peking University Research Center, SWS Research

Opening up

China's National Development and Reform Commission (NDRC) released an oil & gas reform programme in 2014 to break the state-owned monopoly and bring healthy competition by opening upstream and downstream markets to international players and privately owned firms.

In mainland China, oil fields are all operated as branches of state-owned oil companies, such as China National Petroleum Corporation (CNPC). After Liaohe and Jilin oil fields were given full economic autonomy in 2014, Xinjiang, Dagang, Huabei, and Tuha oil fields were required to be responsible for their own financial situation, operating under their own accounting books, in December 2017. The six oil fields, which account for c.20% of China's crude oil production, are experiencing rising cost pressure. As a result, oil field management are encouraged to work with private services providers, which tend to offer more competitive prices, thus stimulating growth of the private sector.

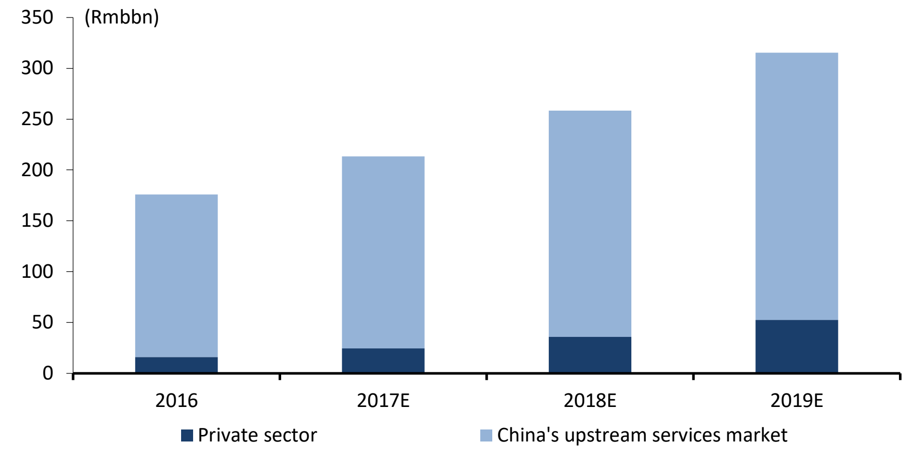
Fig 28: Gradual liberalisation of China's upstream oil & gas market



Source: SWS Research

Based on our previous regression analysis, we forecast China's upstream oil & gas Capex to grow 18% YoY on average over the next three years. Moreover, we expect SPT to maintain its current market share, on the back of solid long-term relationships with oil companies, and the private oil & gas services sector to expand 3.5 times over the same period, reaching Rmb53bn in three years (ie, 20% of the overall upstream market). As such, SPT's domestic revenue may potentially grow up to 230% over the next three years.

Fig 29: Estimated market size of China's private upstream services sector

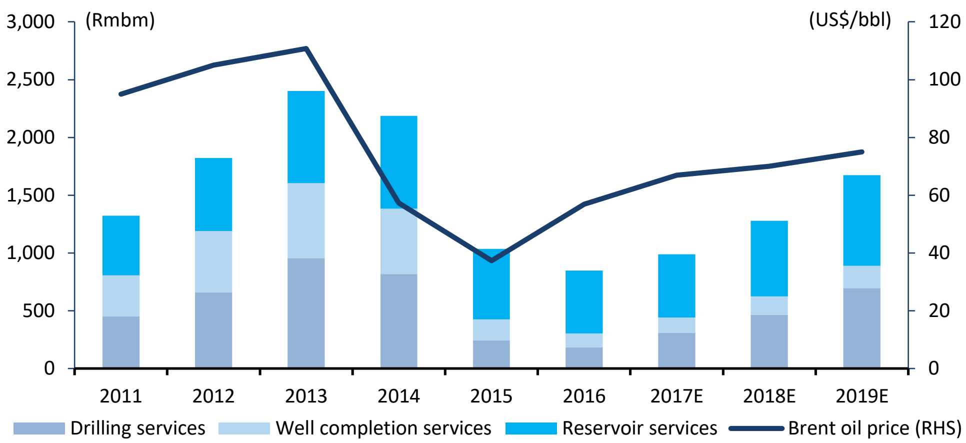


Source: SWS Research

Financial analysis

Given the oil price recovery and gradual liberalisation of the upstream oil & gas services sector, we anticipate positive and sustainable revenue growth in 2017-19E. As rig utilisation increased from 50% in early 2017 to 90% in late 2017, amid rising oil prices, we expect SPT's drilling services revenue to reach Rmb309.6m in 17E (+70% YoY), Rmb464.4m in 18E (+50% YoY), and Rmb696.5m in 19E (+50% YoY). Meanwhile, we forecast the firm's well completion revenue to arrive at Rmb132.7m in 17E (+10% YoY), Rmb159.2m in 18E (+20% YoY), and Rmb191.1m in 19E (+20% YoY), and its reservoir services revenue to reach Rmb545.4m in 17E (flat YoY), Rmb654.5m in 18E (+20% YoY), and Rmb785.4m in 19E (+20% YoY). As such, we expect total revenue to grow 25.6% YoY to Rmb1.0bn in 17E, 28.3% YoY to Rmb1.3bn in 18E, and 30.0% YoY to Rmb1.7bn in 19E.

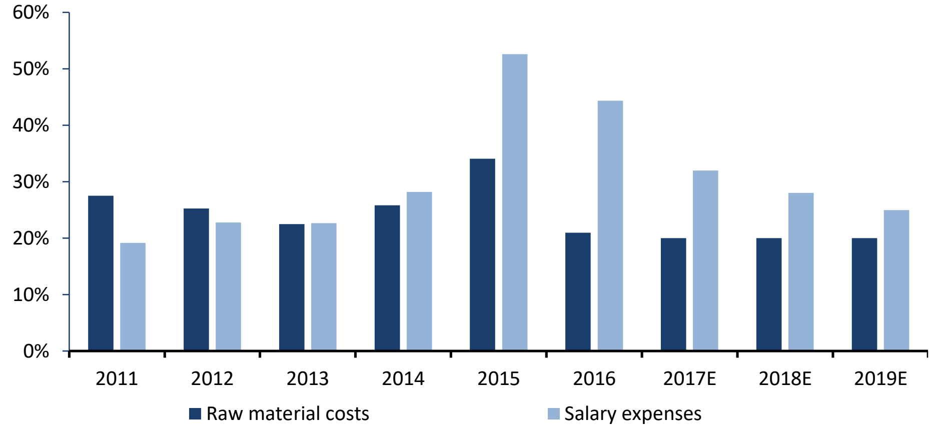
Fig 30: Revenue breakdown



Source: Company data, SWS Research

Raw material costs and salaries currently account for 60% of SPT's operating costs. In line with its asset-light strategy, the company has stepped up its cost control efforts, resulting in improved inventory and personnel management. According to the firm's annual report, the number of employees decreased from 4,084 in 2014 to 3,400 in 2015 (-16.7% YoY) and 3,013 in 2016 (-11.3% YoY). We forecast salaries to account for 32% of revenue in 17E, 28% in 18E, and 25% in 19E, following the firm's redundancy plan. Meanwhile, we expect raw material costs to stabilise at 20% of total revenue in 2017-19E.

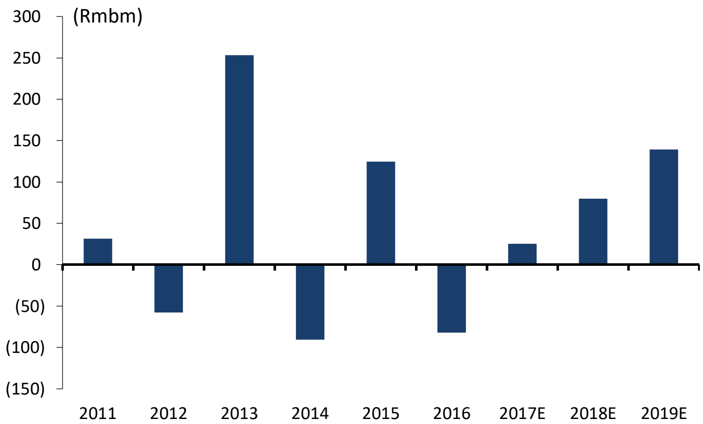
Fig 31: Raw material costs and salary expenses as a percentage of revenue



Source: Company data, SWS Research

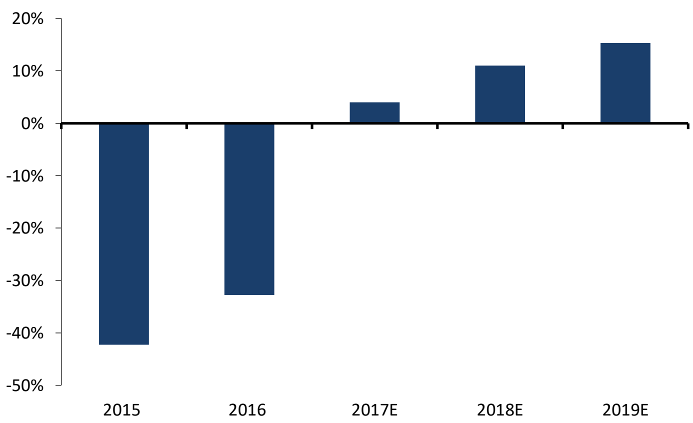
Given increasing revenue, on the back of recovering oil prices, and improved control of personnel expenses and raw material costs, we forecast net profit of Rmb2.2m in 17E (vs net loss of Rmb292.4m in 16A), Rmb78.9m in 18E (+3,436.0% YoY), and Rmb166.3m in 19E (+110.8% YoY). As such, we expect the company's Ebit margin to reach 4% in 17E, 11% in 18E, and 15% in 19E.

Fig 32: Net profit



Source: Company data, SWS Research

Fig 33: Ebit margin



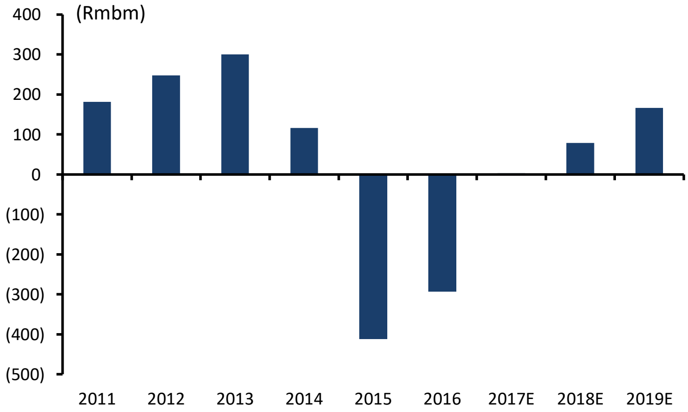
Source: Company data, SWS Research

We believe the firm's asset-light strategy will improve its operating cash flows. More specifically, we expect net cash flow from operating activities to reach –Rmb46.7m in 17E (vs –Rmb82.3m in 16A), Rmb108.2m in 18E, and Rmb182.4m in 19E (+68.6% YoY). Meanwhile, we forecast net cash flow from investing activities of –Rmb61.1m in 17E, –Rmb80m in 18E, and –Rmb80m in 19E, and net cash flow from financing activities of Rmb17.7m in 17E (+111.7% YoY), Rmb10.0m in 18E (-43.6% YoY), and Rmb40.0m in 19E (+300.0% YoY).

Under its asset-light strategy, we expect the firm to dispose of its idle assets. Therefore, we forecast its total asset turnover to increase from 0.52 in 17E to 0.74 in 19E, and its net asset turnover to rise from 1.01 to 1.34 over the same period. In addition, we expect its debt-to-asset ratio to decrease from 49% in 17E to 45% in 19E.

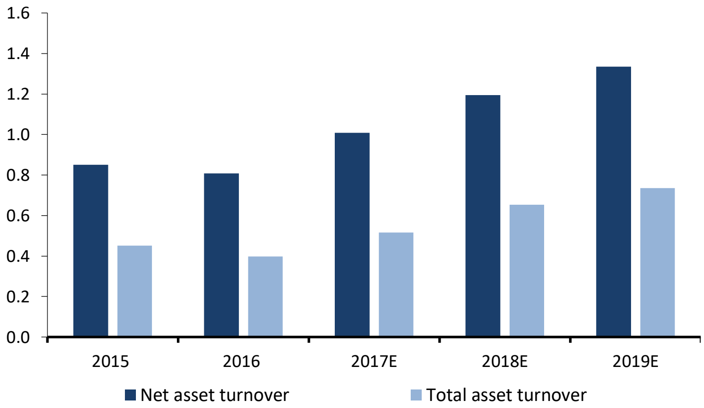
Given the company's strong growth potential, underpinned by recovering oil prices, increasing cost control efforts, and the gradual liberalisation of China's upstream oil & gas services sector, we forecast net profit of Rmb2.2m in 17E, Rmb78.9m in 18E, and Rmb166.3m in 19E, translating into diluted EPS of Rmb0.00 in 17E (vs –Rmb0.19 in 16A), Rmb0.05 in 18E, and Rmb0.11 in 19E (+120% YoY).

Fig 34: Operating cash flow



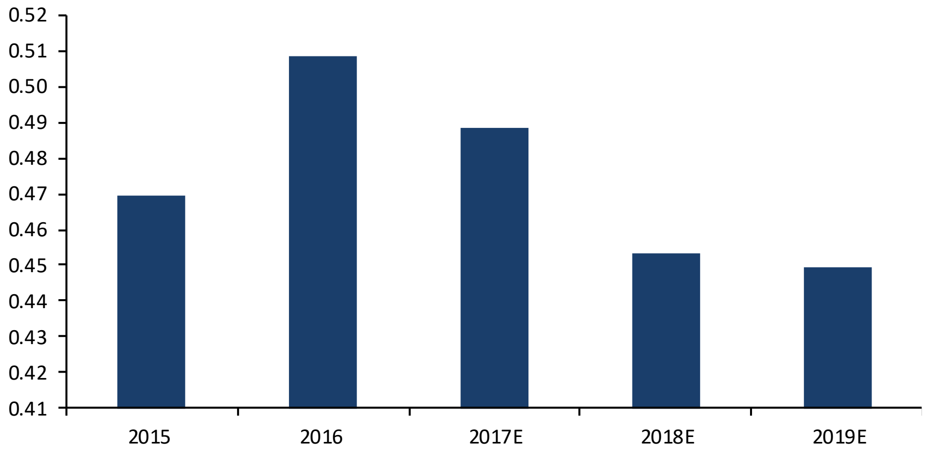
Source: Company data, SWS Research

Fig 35: Asset turnover ratios



Source: Company data, SWS Research

Fig 36: Debt-to-asset ratio



Source: Company data, SWS Research

Valuation

We use a three-stage discounted cash flow (DCF) valuation model to estimate our target price. Our model is based on a cost of equity of 11.98%, a pre-tax cost of debt of 4.3%, a long-term debt-to-equity ratio of 50%, and an effective tax rate of 20%. We estimate SPT's weighted average cost of capital (WACC) at 9.14%.

Fig 37: Key assumptions in our FCFF calculation

	Years	Revenue growth	Ebit margin
Stage 1 (explicit)	1 to 3	-	-
Stage 2 (semi-explicit)	4 to 13	10%	stable
Stage 3 (terminal value)	> 13	2%	4.0%

Source: SWS Research

We expect faster revenue growth than consensus, as lower production costs allow upstream Capex to recover at lower oil prices, compared with the previous upward cycle. Moreover, we are positive on SPT's asset-light strategy, leading to increased cost control and thus improved profitability.

We see lower-than-expected oil prices as the main downside risk for SPT, while considering OPEC's production cut decisions and global economic growth as two important catalysts for the stock.

We derive a target price of HK$1.24, representing 20.1x 18E PE. With 55% upside, we initiate coverage of the stock with a BUY rating.

Fig 38: WACC calculation

Item	Estimation	Source / method used
Risk-free rate	3.80%	SWS Research
Equity risk premium	6.82%	SWS Research
Beta	1.2	Bloomberg
Cost of equity	11.98%	CAPM
Nominal cost of debt	4.30%	Historical average
Debt-to-equity ratio	50%	Long-term capital structure
Effective tax rate	20.00%	Long-term value combined with current tax rate
WACC	**9.14%**	

Source: SWS Research

Fig 39: DCF valuation

(Rmbm)	Value	Proportion
Stage 1 (fast growth)	117	6%
Stage 2 (stable growth)	553	27%
Stage 3 (terminal value)	1,095	54%
Core firm value	**1,765**	**88%**
Plus: Non-core long-term investment	0	0%
Bank balances and cash	246	12%
Held-for-trading investment	0	0%
Total firm value	**2,011**	**100%**
Minus: Interest bearing debt	382	19%
Minority interests	97	5%
Equity value	1,532	76%
Share capital (m)	1,535	
Equity value per share (Rmb)	1.00	
Equity value per share (HK$)	**1.24**	

Source: SWS Research

Appendix

Fig 40: Management team

Name	Position	Summary
Wang Guoqiang	CEO and chairman of the board	Wang Guoqiang has served as chief executive officer for about five years, and has been a director of the company since June 2008. Wang is also chairman of the board and nomination committee, and a member of the remuneration committee. He has worked in the oil & gas industry for more than 32 years, and is currently in charge of the overall operation and management of the group.
Wu Dongfang Ethan	Executive director	Wu Dongfang has worked in the oil & gas industry for more than 25 years, and has been a director of the company since June 2008. Wu is in charge of business development for the group.
Liu Ruoyan	Executive director and executive president	Liu Ruoyan has worked in the oil & gas industry for more than 43 years, and has been an executive director of since December 2011. Liu is in charge of marketing for the well drilling and workover business, and management of production and operation for the group.
Jin Shumao	Vice president	Jin Shumao resigned as an executive director on 21 March 2017. Jin has worked in the oil & gas industry for more than 44 years in China and abroad. Jin is responsible for the operation, integration, and development of all product and service lines worldwide.
Li Qiang	Executive director, vice president, and CFO	Li Qiang has been involved in corporate management for more than 19 years, and has been an executive director since March 2017. Li is primarily responsible for internal control, including planning and operations, capital operation, and information disclosure.
Lin Yang	Non-executive director	Lin Yang currently serves as an executive director at Forebright Capital Management Limited. He was appointed by China Outfitters Holdings Limited as a non-executive director.
Chen Chunhua	Independent non-executive director	Chen Chunhua has worked for South China University of Technology since July 1986, and now serves as a professor and tutor for doctoral students in the Business Administration School, with more than 30 years of experience in academic education and practice in corporate operations and business management. She is also a member of the audit committee of the group.
Zhang Yujuan	Independent non-executive director	Zhang Yujuan is the chairman of the remuneration committee and a member of the nomination committee. She successively served as general manager of Nanjing Pincheng Four Seasons Cultural and Creative Company, general manager of Chengdu Tianxinyang Gold Industry, and director of Hong Kong Tianxinyang.
Wu Kwok Keung Andrew	Independent non-executive director	Wu Kwok Keung is the chairman of the audit committee and a member of the remuneration committee and nomination committee. He worked for Ernst & Young for over 32 years before retiring.
Wan Kah Ming	Independent non-executive director	Wan Kah Ming has been involved in legal practice for more than 22 years, focusing on China inbound and outbound investment, finance, mergers and acquisitions, and restructuring. Wan is also a member of the audit committee.
Jiang Qingsong	CEO, vice president, and general manager of the Russian division	Jiang Qingsong has worked in the oil & gas industry for more than 20 years, and joined the group in March 2003. Jiang is primarily responsible for the business development and management of the overseas market (except North America).
Zhao Feng	Vice president and general manager of the North American division	Zhao Feng has worked in the oil & gas industry for about 30 years, and joined the group in January 1999. Zhao is primarily responsible for business development and management of the North American and Singaporean markets.
Li Zhiguo	COO and manager of the project expansion department	Li Zhiguo has worked in the oil & gas industry for more than 22 years, and joined the group in March 1996. Li is primarily responsible for market development in China.
Wan Wenjiang	Vice president and head of the engineering technology centre	Wan Wenjiang has worked in the oil & gas industry for more than 36 years, and joined the group in April 2004. Wan is mainly responsible for technology development and management.
Ma Hongguo	Vice president and general manager of eastern China	Ma Hongguo has worked in the oil & gas industry for more than 20 years, and joined the group in 2003. Ma is primarily in charge of operations and management for eastern China.

Source: SWS Research

Fig 41: Consolidated Income Statement

(Rmbm)	2015	2016	2017E	2018E	2019E
Revenues	1,060	818	1,028	1,318	1,713
Material Costs	(352)	(178)	(198)	(256)	(335)
Employee Benefit Exp	(544)	(376)	(316)	(358)	(418)
Rental Costs	(70)	(53)	(69)	(89)	(117)
Transportation Costs	(41)	(23)	(31)	(40)	(51)
D&A	(102)	(118)	(86)	(81)	(81)
Service Costs	(149)	(107)	(134)	(171)	(223)
Impairments	(47)	(83)	(30)	(20)	(20)
Others Operating Costs	(202)	(149)	(123)	(158)	(206)
Operating Profits	(448)	(268)	41	145	262
Finance Costs	(38)	(35)	(38)	(39)	(39)
PBT	(486)	(303)	3	106	223
Tax	43	(11)	(1)	(21)	(45)
PAT	(443)	(315)	2	85	179
Minority interest	(30)	(22)	0	6	13
Net profit	(412)	(292)	2	79	166
Basic EPS (HK$)	(0.31)	(0.22)	0.00	0.06	0.13

Source: SWS Research

Fig 42: Consolidated Balance Sheet

(Rmbm)	2015	2016	2017E	2018E	2019E
Current Assets	1,561	1,447	1,406	1,413	1,724
Cash and cash equivalents	345	246	159	197	340
Trade & notes receivables	632	564	642	775	856
Other receivables	172	249	257	165	171
Inventories	394	372	329	256	335
Other current assets	19	18	18	20	22
PP&E	535	393	364	361	359
Intangible assets	81	57	60	62	63
Other non-current assets	173	163	161	181	181
Total Assets	2,350	2,060	1,991	2,017	2,327
Current Liabilities	965	923	851	782	874
Borrowings	260	279	300	300	300
Trade and other payables	554	493	395	293	363
Other current liabilities	152	151	156	189	211
Long-term liabilities	138	125	122	132	172
Total Liabilities	1,103	1,048	973	914	1,046
Minority Interests	120	97	97	103	116
Shareholder Equity	1,127	915	921	1,000	1,166
Share Capital	1	1	1	1	1
Reserves	1,603	1,318	1,320	1,399	1,565
Forex Difference	(477)	(403)	(400)	(400)	(400)
Total Liabilities and equity	2,350	2,060	1,991	2,017	2,327

Source: SWS Research

Fig 43: Consolidated Cash Flow Statement					
(Rmbm)	**2015**	**2016**	**2017E**	**2018E**	**2019E**
Profit before taxation	(448)	(268)	41	145	262
Plus:Depr. and amortisation	102	118	86	81	81
Finance cost	(38)	(30)	(38)	(39)	(39)
Losses from investments	0	(5)	0	0	0
Change in working capital	492	(5)	(138)	(38)	(77)
Others	(101)	109	3	1	45
CF from operating activities	125	(82)	(47)	108	182
CAPEX	(249)	(29)	(60)	(80)	(80)
Other CF from investing activities	(1)	0	0	1	0
CF from investing activities	(256)	(28)	(61)	(80)	(80)
Equity financing	0	0	0	0	0
Net change in liabilities	(115)	8	18	10	40
Other CF from financing activities	0	0	0	0	0
CF from financing activities	(115)	8	18	10	40
Forex Difference	(3)	3	3	0	0
Net cash flow	(250)	(99)	(87)	38	142
FCFF	(59)	(196)	(71)	87	141
FCFE	(144)	(163)	(23)	128	213

Source: SWS Research

Fig 44: Key Financial Ratios					
	2015	**2016**	**2017E**	**2018E**	**2019E**
Ratios per share (Rmb)					
Earnings per share	(0.27)	(0.19)	0.00	0.05	0.11
Diluted EPS	(0.27)	(0.19)	0.00	0.05	0.11
Operating CF per share	0.08	(0.05)	(0.03)	0.07	0.12
Dividend per share	0.00	0.00	0.00	0.00	0.00
Net assets per share	0.73	0.60	0.60	0.65	0.76
Key Operating Ratios(%)					
ROIC	-34.72	-30.38	-2.50	4.42	10.31
ROE	-35.48	-31.08	0.24	7.69	13.95
EBITDA Margin	-32.66	-18.36	12.38	17.15	20.05
EBIT Margin	-42.27	-32.77	3.99	11.00	15.32
Growth rate of Revenue(YoY)	-51.12	-22.84	25.62	28.26	29.96
Growth rate of Profit(YoY)	-	-	-	3435.76	110.78
Debt-to-asset ratio	46.93	50.86	48.86	45.32	44.93
Turnover rate of net assets	0.85	0.81	1.01	1.20	1.34
Turnover rate of total assets	0.45	0.40	0.52	0.65	0.74
Effective tax rate (%)	8.93	-3.71	20.00	20.00	20.00
Dividend yield (%)	-	-	-	-	-

Source: SWS Research

Information Disclosure:

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