

# J.P.Morgan

Asia Pacific Equity Research

22 March 2016

## SPT Energy Group Inc. (1251 HK)

**Underweight**

Price: HK\$0.63

22 Mar 2016

Price Target: HK\$0.30

PT End Date: 31 Dec 2016

Management sees CNPC 2016 capex cut at >20%;  
breaking even a challenging target

SPT held its management briefing today after reporting a 53% revenue decline and RMB412mn loss (versus RMB1bn revenue) in 2015. Key takeaways:

- **Sees CNPC 2016 capex cut at more than 20%.** SPT management expects CNPC's (including PetroChina) upstream capex cut to be more than 20% this year, both in domestic China and overseas markets, in line with our estimates (see [note](#)).
- **We consider management's target of breaking even in 2016 as very challenging.** Management targets to make SPT's business breakeven in 2016, by increasing cost-cutting efforts like further slashing headcounts. However, we think this goal would be very challenging to achieve given the estimated >20% capex cut at its largest client and CNPC's strategy of prioritizing insourcing instead of outsourcing in a weak market like now. There would be also difficulties in further cost reductions, in our view – as noted in the company's annual report, about 50% of SPT's expenses are fixed, and according to local regulations it would be difficult to drastically cut headcounts in the regions where it operates. Management guided they may be able to reduce the number of employees from 3,400 at end-2015 to c. 2,800 as a minimum in 2016 (c. 18%). Maintain UW.

Table 1: SPT's semiannual financials

RMB mn

Earnings	2H14	1H15	2H15A	y/y	h/h	2H15 JPMe
Revenue						
Drilling	400	111	133	(72%)	(72%)	114
Well completion	222	104	76	(70%)	(53%)	66
Reservoir	508	280	331	(64%)	(78%)	392
<b>Total Revenue</b>	<b>1,130</b>	<b>495</b>	<b>540</b>	<b>(53%)</b>	<b>(56%)</b>	<b>572</b>
Operating Cost	(923)	(718)	(791)			(788)
Other operating (expenses) / income	(129)	(3)	28			3
<b>Operating Income</b>	<b>77</b>	<b>(225)</b>	<b>(223)</b>	<b>(277%)</b>	<b>(392%)</b>	<b>(213)</b>
Finance Revenue / (Expense)	(22)	(21)	(17)			(39)
Other Non-operating income (loss)	-	-	-			-
<b>Pre-tax profit</b>	<b>55</b>	<b>(246)</b>	<b>(240)</b>	<b>(334%)</b>	<b>(546%)</b>	<b>(252)</b>
Taxes	(21)	35	-			
Tax Rate, %	39%	NM	NM			NM
Non-controlling interests	(1)	(12)	(19)			-
<b>Reported net income (ex-MI)</b>	<b>35</b>	<b>(199)</b>	<b>(213)</b>	<b>(345%)</b>	<b>(673%)</b>	<b>(252)</b>

Source: Company data; J.P. Morgan estimates

### Investment Thesis

SPT Energy Group is one of China's independent oilfield service providers, with customers in China and internationally, mainly in Turkmenistan and Kazakhstan. The firm has leverage to local SOEs (mainly PetroChina/CNPC), which is its

main client, and has a strategic alliance and JV with Halliburton. SPT provides integrated oilfield services ranging from reservoir research to drilling, well completion and well testing. SPT also manufactures and sells oilfield service-related products. Our negative view is based on:

- **Limited domestic order visibility...** The company has limited order visibility for the medium term; and there is a threat that it will be impacted by cuts at E&Ps in China and Central Asia. CNPC's deeper-than-expected capex reduction is a key risk, as it is SPT's major revenue contributor in both China and abroad.
- **...in light of the growing threat from SOEs** – With SOEs' OFS competitors (e.g., SSC, CNPC Oilfield Service) looking to improve their own efficiencies and product offerings, we believe private service providers will see more pressure in securing contracts.
- **High default risk:** Due to SPT's high concentration on PetroChina/CNPC and weak markets (China and Kazakhstan), it incurred largest losses among comparable peers, and we forecast negative EBITDA from 2015 onward.

### Valuation

Our Dec-16 PT of HK\$0.30 is derived from blended multiples, including P/B and EV/sales, as EBITDA is projected to be negative.

Multiple (x)	P/B 0.6x	EV/EBITDA 6.0x	EV/sales 1.6x
Derived EV (Rmb M)	2,260	N/A (negative EBITDA)	1,483
Weighted EV (Rmb M)	2,144		
Net debt (Rmb M)	1,691		
Equity Value (Rmb M)	453		
<b>Price target (HK\$)</b>	<b>0.3</b>		

Source: J.P. Morgan estimates.

### Risks to Rating and Price Target

Upside risks include rapid oil price increases, lower-than-expected capex reductions at E&P clients, higher margins due to improved efficiencies and a rapid rebound in global oil prices.

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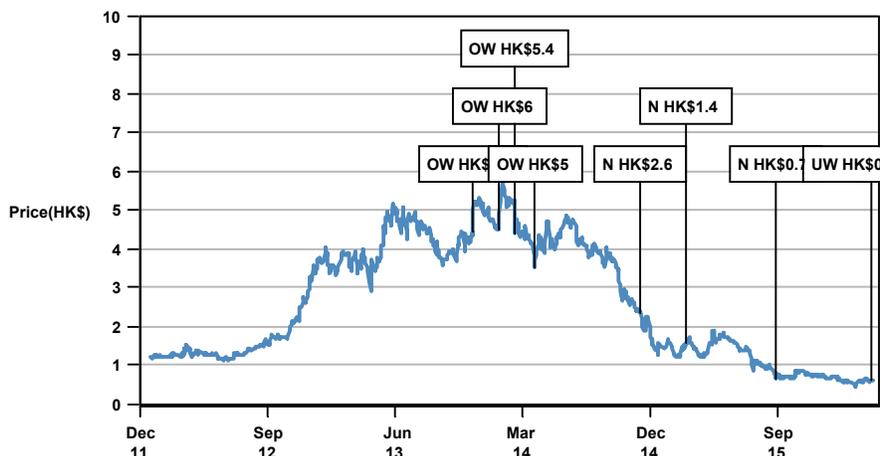
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SPT Energy Group Inc. (1251.HK, 1251 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
13-Nov-13	OW	4.44	5.60
08-Jan-14	OW	4.53	6.00
13-Feb-14	OW	4.43	5.40
27-Mar-14	OW	3.53	5.00
09-Nov-14	N	2.36	2.60
15-Feb-15	N	1.60	1.40
26-Aug-15	N	0.66	0.70
19-Mar-16	UW	0.61	0.30

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Nov 13, 2013.

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