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Jefferies

EQUITY RESEARCH CHINA

Integrated Oil

Cash Dry, But There's No Stopping the Supermajor; Initiate Sinopec Group Cos

Key Takeaway

Sinopec Group is largely responsible for increasing crude imports into China, and it has been tasked to acquire assets overseas. Both need continuous investments. Hence it needs to raise capital via listed subsidiaries. Supply-side reform and structural changes in refined oil market should create event-driven openings for watchful investors. We extend our coverage to encompass all the Sinopec subsidiaries. Initiate on Kantons (Buy), Sinopec Engineering (Hold).

We are not making stock calls based on an oil price rebound scenario. Instead, we want to see which companies would thrive in the doldrums.

BUY: Sinopec Shanghai Petchem H, Sinopec Corp H, Sinopec Kantons; **HOLD**: Sinopec Engineering, Sinopec Oilfield Service H, Sinopec Corp A; **UNDERPERFORM:** Sinopec Shanghai Petchem A, Sinopec Oilfield Service A.

Persistently low crude prices compel China to speed up long overdue reform. We expect the following themes in the 13th FYP (2016-2020):

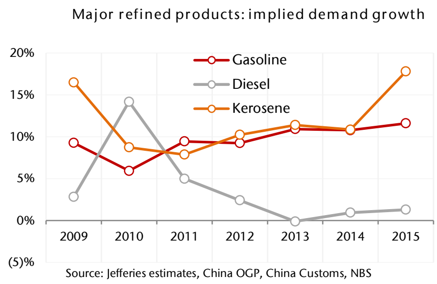
#1: China would be better off increasing crude import, and allowing oil majors to cut back on uneconomical production. For strategic reasons, China needs to build more oil storage and crude terminals, both domestically and overseas. To relieve the problem of diesel overcapacity, policy makers have begun to loosen refined oil exports. They are also re-engineering product yield at the state refiners' level, to adjust to the demand shift from industrial fuels to transportation fuels.

#2: Sinopec Group needs to deleverage for supply side reform, and to bring its gearing level closer to global supermajors' (currently close to 50% vs peers' 15-30%). We believe Sinopec Group will use its subsidiaries, particularly Sinopec Corp and Sinopec Kantons, as fund raising platforms. The typical scenarios might include asset sales, asset injections from parent group to subsidiaries to bolster share price, and placement.

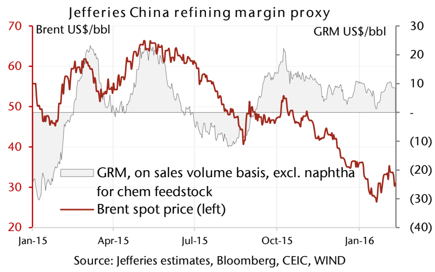
Most positive segment: We believe refining and chemical segment is the most actionable space. For refining segment, we assume that crude prices would not fall massively from current level (~US$30/bbl), and that further losses due to inventory cost/selling price mismatch would be limited. For chemical segment, supply/demand balance drives margins. Hence, performance of each product varies. But the low crude prices should alleviate cost pressure, leaving room for producers to make profit. Buy Sinopec Shanghai PetChem H.

Most negative segment: Low crude prices hurt E&P and oilfield services. Nonetheless, valuations look cheap. There are no visible catalysts, but the sector could potentially rerate on a sustainable oil price recovery.

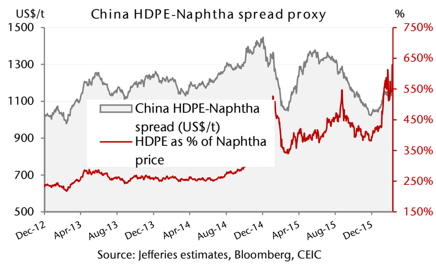
Structural play: 10 years on, China will likely be more dependent on crude import than it is today. China must continue to invest in oil logistics. We recommend investors buy Sinopec Kantons, which owns half of China's crude terminals, and is still growing. Fundamentals aside, we think that **event-driven risks** will catalyze share price.



Source: Jefferies estimates, China OGP, China Customs, NBS



Source: Jefferies estimates, Bloomberg, CEIC, WIND



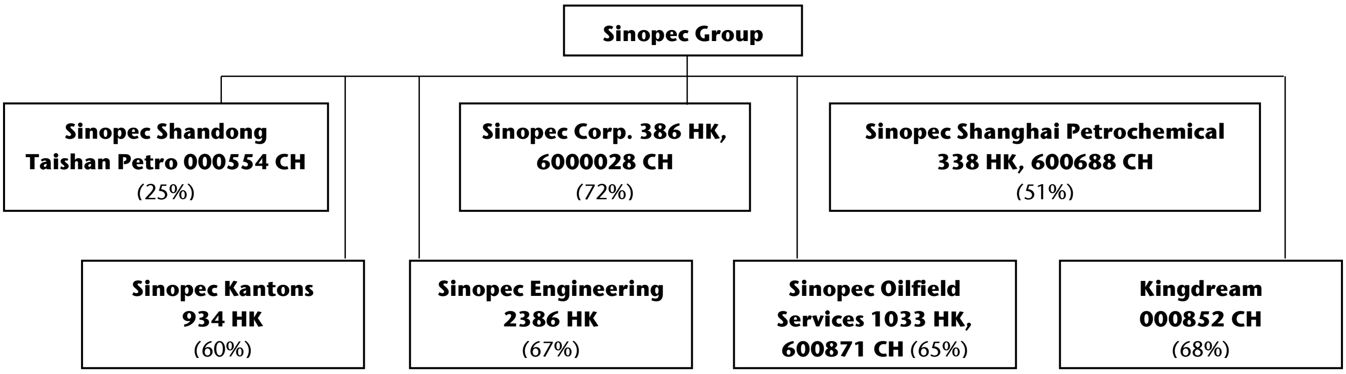
Source: Jefferies estimates, Bloomberg, CEIC

Elaine Lai *
Equity Analyst
+852 3743 8020 elai@jefferies.com
Laban Yu *
Equity Analyst
+852 3743 8047 lyu@jefferies.com
* Jefferies Hong Kong Limited

Company Name	Ticker	Mkt. Cap (MM)	Rating	Price	Price Target	Cons. Next FY	Current EPS Estimates 2015	2016	2017	Previous Est. 2016	2017
China Petroleum & Chem-A	600028 CH	$82,620.8	HOLD	Rmb4.41	Rmb4.80▼	RMB0.29	RMB0.22	RMB0.01	RMB0.25	RMB0.01	RMB0.25
China Petroleum & Chem-H	386 HK	$66,986.1	BUY	HK$4.27	HK$5.10▼	RMB0.29	RMB0.10	RMB0.04	RMB0.14	RMB0.01	RMB0.25
Sinopec Engineering	2386 HK	HK$28,782.0	HOLD	HK$6.50	HK$6.90	RMB0.76	RMB0.73	RMB0.58	RMB0.64	--	--
Sinopec Kantons	934 HK	HK$9,049.0	BUY	HK$3.64	HK$4.75	HK$0.51	HK$0.26	HK$0.40	HK$0.43	--	--
Sinopec Oilfield Service-H	1033 HK	HK$24,475.0	HOLD	HK$1.62	HK$1.50▼	RMB0.03	RMB0.00	RMB(0.07)	RMB0.03	RMB0.08	RMB0.21
Sinopec Oilfield Service-A	600871 CH	Rmb26,360.0	UNPF	Rmb6.59	Rmb1.36▼	RMB0.03	RMB0.00	RMB(0.07)	RMB0.03	RMB0.08	RMB0.21
Sinopec Shanghai Pchem-A	600688 CH	Rmb61,236.0	UNPF ▼	Rmb5.67	Rmb4.10▼	RMB0.30	RMB0.27	RMB0.32	RMB0.22	--	--
Sinopec Shanghai Pchem-H	338 HK	HK$32,832.0	BUY	HK$3.04	HK$4.20▲	RMB0.30	RMB0.27	RMB0.32	RMB0.22	--	--

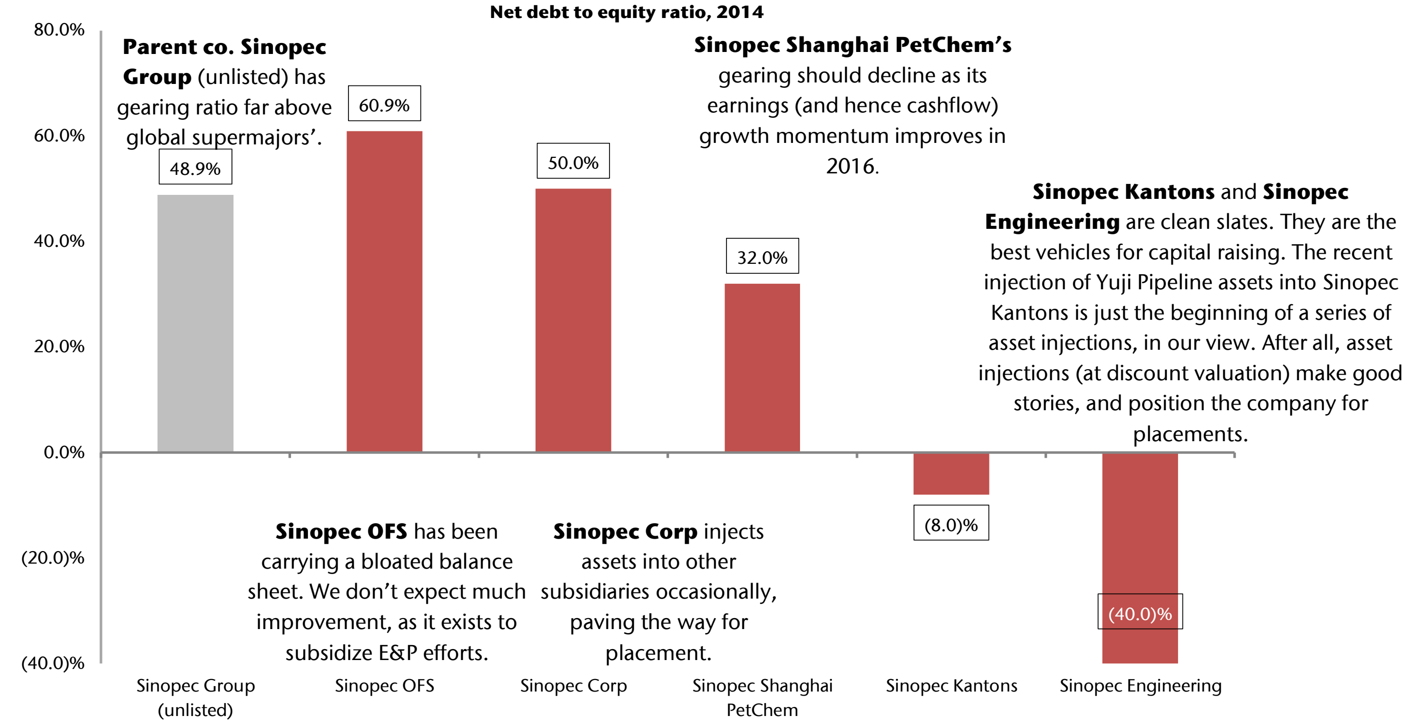
Key Charts & Tables

Chart 1: Sinopec Group's equity stake in its listed subsidiaries



Source: Jefferies, company data

Chart 2: Sinopec Group has a high gearing level ...



Source: Jefferies, company data

Table 1: ... as a result of aggressive M&A overseas in the past

Date	Buyer	Seller	Asset	Location	Deal type (% interest)	Deal size (US$B)
April, 2014	Sinopec Group	Lukoil	Kazakhstan assets	Kazakhstan	Acquisition (50%)	1.20
Aug, 2013	Sinopec Group	Apache	Egypt oil and gas fields	Egypt	Acquisition (33%)	3.10
Feb, 2013	Sinopec Group	Chesapeake Energy	Mississippi	US, MS	Acquisition (50%)	1.02
July, 2012	Sinopec Group	Talisman	North Sea production	North Sea	Acquisition (49%)	1.50
April, 2012	Sinopec Group	Devon	Five shale oil & gas blocks	US	Acquisition (33%)	2.44
Nov, 2011	Sinopec Group	Galp Energia	Galp Brazil Services	Brazil	Acquisition (30%)	3.54
Oct, 2011	Sinopec Group	Daylight Energy	Alberta shale gas and oil	Canada	Corporate take-over (100%)	2.10
Dec, 2010	Sinopec Group	Occidental Petroleum	Argentine concessions	Argentina	Acquisition (100%)	2.45
Oct, 2010	Sinopec Group	Repsol	Offshore development blocks	Brazil	JV buy-in (40%)	7.10
Apr, 2010	Sinopec Group	ConocoPhillips	Producing oil sands	Canada	Acquisition (9.03%)	4.65
Jun, 2009	Sinopec Group	Addax Petroleum	E&P corporate	W Africa, Iraq	Corporate take-over (100%)	7.30
					Sinopec Group total	**36.40**

Source: Jefferies, company data

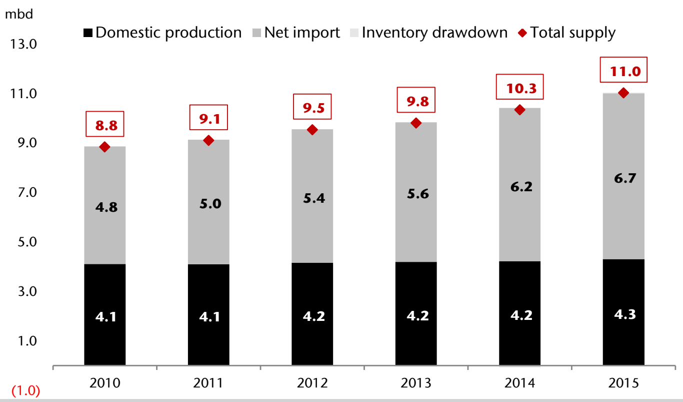
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 3: Sinopec Group's listed subsidiaries span across every part of the supply chain. Any of them can be used as a fund raising platform.

Subsidiary	Business	OP breakdown, 2013*
Sinopec Corp.	Integrated E&P, refining and chemical company, with dominant market share in both refining and production of basic chemicals.	E&P 57%, Refining 9%, Marketing 36%, Chemicals 1%
Sinopec Shanghai PetChem	Sinopec Shanghai Petrochemical was founded in 1972, and subsequently became a Sinopec Group subsidiary in 1993. Over the years, Sinopec Shanghai transformed from synthetic fiber producer to an integrated producer of a wide range of refined oil and petrochemical products. Its H shares were listed in 1993.	Petrolume products 99%, Intermediate petrochemicals 49%, Trading of petrochemical 5%, Others 10%, Synthetic fibers (loss), Resins & plastics (loss)
Sinopec Kantons	Sinopec Kantons is among the earliest batch of subsidiaries to be listed (1999). Sinopec Kantons is China's largest oil storage and terminal company, which owns over half of the country's crude terminals, and also the Fujairah Terminal in UAE, the VESTA Terminals in Europe, and the Batam Project in Indonesia. In 1H15, it terminated its loss-making crude trading business, and began to consolidate earnings from Yuji Pipelines (asset injection from parent co) in 2016.	Crude oil jetty 100%, Vessel charter services (loss), Trading of crude oil (loss, discontinued since 1H15). Pipeline business will be a major earnings driver from 2016.
Sinopec Engineering	China's leading oil and gas E&C company, and is among the largest by revenue among global peers. SEG's history dates back to the 1950s, and was restructured in 2012 to prepare for IPO on the HKEx in 2013.	EPC contracting 57%, E&C and licensing 32%, Construction 11%, Equipment manufacturing (loss), Unallocated 1%
Sinopec Oilfield Services	China Oilfield Services is China's largest offshore oil and gas services company. Its expertise has been in shallow/mid water drilling. In addition, the company has a well-services, marine support/transport and geophysical segment.	Other income 50%, Drilling engineering 25%, Logging & mud logging 11%, Special downhole operations 8%, Engineering construction 5%, Geophysics (loss)

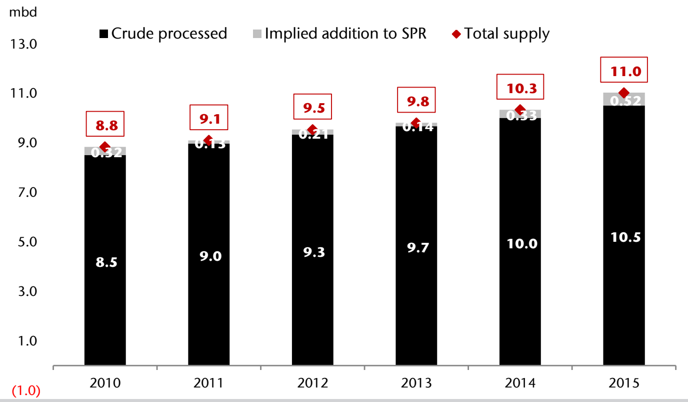
Source: Jefferies estimates, company data.
***We use 2013 data, as oil prices are stable in 2013. The underlying earnings contribution of each segment is thus representative of what drives company value in a stable oil price environment.**

Chart 4: China's domestic crude production can't keep up with demand. One solution is to increase import.



Source: Jefferies, company data

Chart 5: Building up of strategic reserves also adds to crude demand.



Source: Jefferies, company data

Chart 6: Hence, investments into oil logistics and storage will continue.

Announcement date	Project	Status	Loading and unloading Million ton/yr	Bbl/d
Jan-23, 2015	Shandong Rizhao Fengshan Port crude terminal phase 2	In progress	17.5	352,397
Jan-12, 2015	Shandong Yantai West Port crude terminal	In progress	14.7	296,014
Dec, 2013	Ningbo Zhoushan Laotangshan Port crude terminal phase 2	In progress	18.0	362,466
Nov, 2013	Qingdao Dongjiakou Port crude terminal	Completed	18.8	378,575
		Combined capacity	69.0	1,389,452

Source: Jefferies, NDRC

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

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Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Executive Summary

Sinopec Group (unlisted) is largely responsible for increasing crude imports into China, and it has been tasked to acquire assets overseas. Both these tasks require continuous investments. Hence it needs to raise capital via listed subsidiaries. Supply side reform and structural changes in the refined oil market will create event-driven opportunities for the watchful investors.

To understand China's energy policy, we extend our coverage to encompass all the Sinopec subsidiaries. We are not making stock calls based on a crude price rebound scenario. Instead, we want to see which companies would thrive in the doldrums.

Our ratings for Sinopec's subsidiaries:
BUY: Sinopec Shanghai Petchem H, Sinopec Corp H, Sinopec Kantons
HOLD: Sinopec Engineering, Sinopec Oilfield Service H, Sinopec Corp A
UNDERPERFORM: Sinopec Shanghai Petchem A, Sinopec Oilfield Service A

Persistently low crude prices have compelled China to speed up long overdue reforms. We expect the following themes in the 13th Five Year Plan (2016-2020):

#1: China would be better off increasing crude import, and allowing oil majors to cut back on uneconomical production. For strategic reasons, China needs to build more oil storage and crude terminals, both domestically and overseas. To relieve the problem of diesel overcapacity, policy makers have begun to loosen refined oil exports. They are also re-engineering product yield at the state refiners' level, to adjust to the demand shift from industrial fuels to transportation fuels.

#2: Sinopec Group needs to deleverage for supply side reform, and to bring its gearing level closer to global supermajors' (currently close to 50% vs peers' 15-30%). We believe that Sinopec Group will use its subsidiaries, particularly Sinopec Corp and Sinopec Kantons, as fund raising platforms. The typical scenarios might include asset sales, asset injections from parent group to subsidiaries to bolster share price, and placement.

Sector preference

Most positive: Refining and chemical segment is the most actionable space. Our view of the refining segment's outperformance is based on the assumption that crude prices would not fall massively from current level (~US$30/bbl), and that further losses due to inventory cost/selling price mismatch would be limited. For chemical segment, supply/demand balance drives margins. Hence, performance of each product varies. But the low crude prices should alleviate cost pressure, leaving room for producers to make profit. Buy Sinopec Shanghai PetChem H.

Most negative: Low crude prices hurt E&P and oilfield services. Nonetheless, valuations look cheap. There are no visible catalysts, but the sector could potentially rerate on a sustainable oil price recovery.

Structural play: 10 years on, China will likely be more dependent on crude imports than it is today. China must continue to invest in oil logistics. We recommend investors buy Sinopec Kantons, which owns half of China's crude terminals, and is still growing. Fundamentals aside, we think that **event-driven risks** will catalyse share price.

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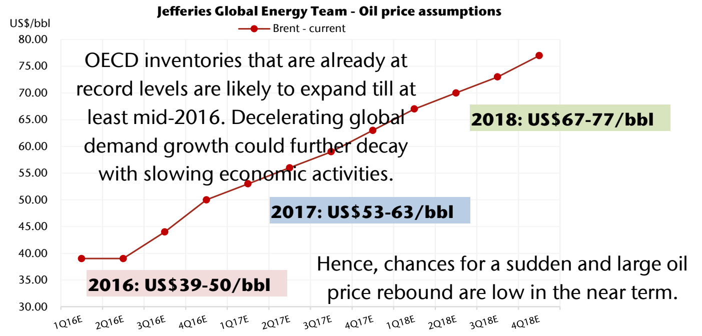
Chart 7: Jefferies Brent price forecast



Source: Jefferies estimates

Chart 8: Sinopec Corp: US$105/bbl Brent yields 5% ROC

Brent oil price (US$/bbl)	**104.93**
Basis differential	12.50
Realized boe price	**92.43**
Less: Windfall tax	7.60
Less: 5% ad valorem resource tax	4.62
Less: Cash operating costs	25.00
Less: SG&A	3.25
Cash Operating Margin	**51.96**
Less 10% time value of money haircut (30%)	15.59
Discounted cash operating margin	**36.37**
Less: Estimated China oil F&D	33.00
Less: Costs to develop 9% PUD's (15% TVM haircut)	1.64
Return on capital	**1.73**
% Return on capital	5%

Source: Jefferies, company data

Chart 9: CNOOC: US$89/bbl Brent yields 5% ROC

Brent oil price (US$/bbl)	**89.33**
Basis differential	2.00
Realized boe price	**87.33**
Less: Windfall tax	5.81
Less: 5% ad valorem resource tax	4.37
Less: Cash operating costs	17.50
Less: SG&A	3.00
Cash Operating Margin	**56.65**
Less present value discount factor (30%)	16.99
Discounted cash operating margin	**39.65**
Less: Estimated China oil F&D	23.00
Less: Costs to develop PUD's (59%)	14.76
Return on capital	**1.89**
% Return on capital	5%

Source: Jefferies estimates

Chart 10: PetroChina: US$76/bbl Brent yields 5% ROC

Brent oil price (US$/bbl)	**76.37**
Basis differential	7.00
Realized boe price	**69.37**
Less: Windfall tax	0.87
Less: 5% ad valorem resource tax	3.47
Less: Cash operating costs	23.00
Less: SG&A	2.20
Cash Operating Margin	**39.83**
Less 10% time value of money haircut (30%)	11.95
Discounted cash operating margin	**27.88**
Less: Estimated China oil F&D	24.00
Less: Costs to develop 33% PUD's (15% TVM haircut)	2.55
Return on capital	**1.33**
% Return on capital	5%

Source: Jefferies estimates

Stock picks

On a 2-3 year basis, we prefer E&P companies at historical low valuation. On a 12-18 months basis, we prefer refining and chemical companies as they have better earnings visibility than upstream.

Chart 11: Summary of stock recommendations

Company	Rating	Price target		Views
Sinopec Kantons 934.HK	Buy	HKD	4.75	For energy security, China will either import more crude, or acquire overseas assets. Hence, infrastructure building in the oil storage and logistics sector will not stop, in our view. Sinopec Kantons already has a monopolistic position. It handled 59% of China's crude import volume in 1H15, and is still growing. Aside from sound fundamentals, we expect further asset injections from parent co. to provide catalysts for the share price.
Sinopec Engineering 2386.HK	Hold	HKD	6.90	China built 66% of the world's new refining capacity in the last decade. Some chemical products (e.g. PTA) and plastics (e.g. PVC, synthetic fiber polymer) are in overcapacity mode. Since supply side reform is a key focus under the 13th Five Year Plan, we expect a sharp slowdown in refining and naphtha-based chemical projects. Many coal-chemical projects are economically unjustified at the low crude prices. Hence, we expect Sinopec Engineering to enter a lower stage of growth. Although we like its strong balance sheet and steady free cash flow, we assign a HOLD rating to the stock due to lack of catalysts.
Sinopec Corp.				
H share, 386.HK	Buy	HKD	5.10	We expect E&P losses to compel Sinopec Corp. to cut consolidated capex in 2016 by 20-25% from 2014 level. That should lead to improved cash flow. Among the three majors, Sinopec Corp. has the most cost-competitive refining and chemical segment to offset upstream losses. Policy actions (price reform, curbing illegal sales of unqualified fuels, loosening of import/export control) will create opportunities for the watchful investors.
A share, 600028.CH	Hold	RMB	4.80	
Sinopec Shanghai PetChem				
H share, 338.HK	Buy	HKD	4.20	Sinopec Shanghai Petrochemical (SSP) is mispriced, in our view. The stock has been flying under investors' radar, perhaps because of modelling complexity, and mixed results in the past. We think that 2016 is a year when the stars align. In a (prolonged) low oil price world, integrated refining and chemical producers will shine.
A share 600688.CH	Underperform	RMB	4.10	
Sinopec Oilfield Service				
H share, 1033.HK	Hold	HKD	1.50	SSC guided that FY15 would be slightly profitable. We expect losses to return in FY16, driven by lower revenue and limited room for further cost cutting. Most of SSC's revenue comes from Sinopec. We expect E&P losses to compel Sinopec to cut group capex to 20-25% below 2014's level. If we are right, that would be bad news for SSC.
A share, 600871.CH	Underperform	RMB	1.36	

Source: Jefferies estimates

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Valuation, liquidity and risks

Chart 12: Valuation

	Analyst	Ticker	MC (US$m)	Rec.		Price	TP	Upside/ (downside)	EV/EBITDA FY1	EV/EBITDA FY2	EV/EBITDA FY3	P/B (x) FY1	P/B (x) FY2	P/B (x) FY3	ROE FY1	ROE FY2	ROE FY3	Div yield FY1	Div yield FY2
Sinopec H	Elaine L.	386 HK	78,325	B	HKD	4.12	5.10	24%	5.9	6.6	5.8	0.6	0.6	0.6	2%	1%	3%	1.4%	0.6%
Sinopec A	Elaine L.	600028 CH	78,326	H	RMB	4.34	4.80	11%	6.4	7.2	6.3	0.8	0.8	0.8	2%	1%	3%	1.2%	0.5%
Sinopec Oilfield Service H	Elaine L.	1033 HK	12,226	H	HKD	1.54	1.50	(3)%	4.2	6.1	3.8	1.2	1.2	1.2	1%	(6)%	3%	0.0%	0.0%
Sinopec Oilfield Service A	Elaine L.	600871 CH	12,226	U	RMB	6.32	1.36	(78)%	18.4	24.5	16.9	4.8	5.1	4.9	1%	(6)%	3%	0.0%	0.0%
Sinopec Shanghai Petrochemical H	Elaine L.	338 HK	7,704	B	HKD	2.92	4.20	44%	4.8	3.4	3.8	1.4	1.2	1.1	15%	16%	10%	2.8%	3.6%
Sinopec Shanghai Petrochemical A	Elaine L.	600688 CH	7,704	U	RMB	5.48	4.10	(25)%	10.3	7.9	9.5	3.0	2.6	2.5	15%	16%	10%	1.3%	1.6%
Sinopec Engineering	Elaine L.	2386 HK	3,783	H	HKD	6.44	6.90	7%	2.8	2.8	2.0	1.0	0.9	0.9	13%	10%	10%	5.4%	4.2%
Sinopec Kantons	Elaine L.	934 HK	1,210	B	HKD	3.55	4.75	34%	23.8	12.7	11.2	0.8	0.8	0.7	6%	8%	8%	1.3%	2.0%
Supermajors																			
Sinopec H	Elaine L.	386 HK	78,325	B	HKD	4.12	5.10	24%	5.9	6.6	5.8	0.6	0.6	0.6	2%	1%	3%	1%	1%
Sinopec A	Elaine L.	600028 CH	78,326	H	RMB	4.34	4.80	11%	6.4	7.2	6.3	0.8	0.8	0.8	2%	1%	3%	1%	0%
ExxonMobil	Jason G.	XOM US	337,323	H	USD	81.03	82.00	1%	10.0	7.5	7.6	2.0	2.0	1.9	6%	10%	11%	4%	4%
PetroChina H	Laban Y.	857 HK	194,246	B	HKD	4.50	7.25	61%	7.0	7.4	6.0	0.6	0.6	0.6	3%	2%	4%	4%	4%
Chevron	Jason G.	CVX US	160,782	B	USD	85.43	110.00	29%	7.3	5.1	4.5	1.1	1.1	1.1	2%	5%	7%	5%	5%
Shell	Jason G.	RDSA LN	177,064	B	GBP	1525.5	2040	34%	5.8	4.6	3.8	0.8	0.8	0.7	4%	7%	9%	8%	8%
Total	Marc K.	FP FP	105,914	B	EUR	38.00	43.00	13%	6.3	4.9	4.4	1.1	1.0	1.0	7%	10%	11%	6%	6%
BP	Jason G.	BP/ LN	88,837	H	GBP	333	340	2%	5.2	4.1	3.9	0.9	0.9	1.0	3%	8%	10%	9%	9%
ConocoPhilips	Jason G.	COP US	40,620	H	USD	32.90	37.00	12%	9.1	5.5	5.3	1.0	1.1	1.1	(7)%	(1)%	3%	3%	3%
Integrated refining & chem.																			
Sinopec H	Elaine L.	386 HK	78,325	B	HKD	4.12	5.10	24%	5.9	6.6	5.8	0.6	0.6	0.6	2%	1%	3%	1%	1%
Sinopec A	Elaine L.	600028 CH	78,326	H	RMB	4.34	4.80	11%	6.4	7.2	6.3	0.8	0.8	0.8	2%	1%	3%	1%	0%
Sinopec Shanghai Petrochemical H	Elaine L.	338 HK	7,704	B	HKD	2.92	4.20	44%	4.8	3.4	3.8	1.4	1.2	1.1	15%	16%	10%	3%	4%
Sinopec Shanghai Petrochemical A	Elaine L.	600688 CH	7,704	U	RMB	5.48	4.10	(25)%	10.3	7.9	9.5	3.0	2.6	2.5	15%	16%	10%	1%	2%
Reliance Industries	Arya S.	RIL IN	45,012	B	INR	906.55	1130	25%	9.1	7.9	6.8	1.2	1.1	1.0	11%	11%	12%	1%	1%
Formosa PetChem	Kerry W.	6505 TT	23,275	H	TWD	79.50	87.00	9%	12.3	13.0	16.0	2.8	2.7	2.8	15%	14%	9%	1%	1%
Indian Oil	Arya S.	IOCL IN	13,848	B	INR	364.55	580	59%	6.6	5.9	5.3	1.2	1.1	1.0	16%	16%	15%	1%	1%
SK Innovation	YB K.	096770 KS	10,208	B	KRW	131000	150000	15%	6.0	5.9	6.4	0.7	0.7	0.6	8%	8%	7%	4%	4%
Bharat Petroleum	Arya S.	BPCL IN	8,275	B	INR	772.80	1090	41%	6.4	5.9	5.3	2.1	1.8	1.6	25%	23%	21%	0%	0%
S-Oil	YB K.	010950 KS	6,986	B	KRW	74300	110000	48%	7.4	7.0	7.0	1.4	1.3	1.2	15%	14%	13%	1%	1%
TonenGeneral	Thanh P.	5012 JT	4,812	B	JPY	965	2000	107%	8.7	8.8	-	1.3	1.2	-	13%	13%	-	4%	4%
Thai Oil	-	TOP TB	3,377	-	THB	58.00	-	-	5.4	5.4	5.5	1.2	1.1	1.0	15%	14%	13%	5%	5%
Oil logistics																			
Sinopec Kantons	Elaine L.	934 HK	1,210	B	HKD	3.55	4.75	34%	23.8	12.7	11.2	0.8	0.8	0.7	6%	8%	8%	1%	2%
Brightoil	-	933 HK	2,766	-	HKD	1.99	-	-	8.4	5.8	5.3	1.8	1.4	1.3	15%	21%	15%	-	-
E&C																			
Sinopec Engineering	Elaine L.	2386 HK	3,783	H	HKD	6.44	6.90	7%	2.8	2.8	2.0	1.0	0.9	0.9	13%	10%	10%	5%	4%
Hyundai E&C	KS L.	000720 KS	3,446	B	KRW	36850	45000	22%	4.7	4.4	4.6	0.7	0.6	0.6	9%	9%	8%	1%	1%
Daewoo E&C	KS L.	047040 KS	1,863	B	KRW	5420	8700	61%	8.3	7.4	6.0	0.8	0.7	0.6	8%	9%	11%	-	-
Chiyoda	Thanh P.	6366 JP	1,855	B	JPY	775	1000	29%	3.0	2.3	2.2	1.0	0.9	0.9	6%	8%	8%	2%	2%
Samsung Eng	KS L.	028050 KS	1,778	H	KRW	10900	10000	(8)%	-	20.3	16.4	-	2.2	1.9	(339)%	18%	8%	-	-
GS E&C	KS L.	006360 KS	1,463	B	KRW	24700	37000	50%	9.0	7.1	5.5	0.5	0.5	0.4	5%	7%	9%	-	-
Oilfield services & equipments																			
Sinopec Oilfield Service H	Elaine L.	1033 HK	12,226	H	HKD	1.54	1.50	(3)%	4.2	6.1	3.8	1.2	1.2	1.2	1%	(6)%	3%	0%	0%
Sinopec Oilfield Service A	Elaine L.	600871 CH	12,226	U	RMB	6.32	1.36	(78)%	18.4	24.5	16.9	4.8	5.1	4.9	1%	(6)%	3%	0%	0%
COSL (H)	Elaine L.	2883 HK	7,235	B	HKD	5.11	10.75	110%	11.2	11.1	9.8	0.5	0.5	0.5	4%	3%	4%	11%	11%
Hilong	Elaine L.	1623 HK	211	B	HKD	0.94	2.00	113%	5.5	5.2	4.8	0.4	0.4	0.4	9%	9%	10%	5%	5%
Anton Oil	Elaine L.	3337 HK	205	H	HKD	0.66	1.00	52%	10.3	6.9	6.2	0.7	0.7	0.7	(4)%	1%	5%	-	-
SPT	Elaine L.	1251 HK	110	H	HKD	0.49	0.75	55%	-	15.5	3.7	0.5	0.5	0.5	(18)%	(5)%	2%	-	-

Source: Jefferies estimates, company data. *B = Buy, H = Hold, U = Underperform. Note: Taiwan, Korea, Thailand stocks are covered by our co-branded partners

Chart 13: Liquidity and performance

Company	Ticker	MC (US$m)	3M avg. daily value traded (US$m)	Absolute performance 6 month	Absolute performance 12 month	Absolute performance 18 month	Relative performance 6 month	Relative performance 12 month	Relative performance 18 month
Sinopec H	386 HK	76,588	60.3	(29.0)%	(33.0)%	(45.9)%	(7.0)%	(9.7)%	(26.3)%
Sinopec A	600028 CH	76,587	120.2	(28.5)%	(25.7)%	(17.6)%	2.6%	(13.8)%	(33.6)%
Sinopec Oilfield Service H	1033 HK	11,993	1.8	(49.7)%	(36.1)%	(13.0)%	(34.1)%	(13.9)%	18.5%
Sinopec Oilfield Service A	600871 CH	11,993	38.9	(39.3)%	2.1%	nmf	(12.9)%	18.4%	nmf
Sinopec Engineering	2386 HK	3,662	2.6	(10.9)%	10.7%	(28.7)%	16.6%	49.1%	(2.9)%
Sinopec Shanghai Petrochemical H	338 HK	7,400	8.1	(13.9)%	24.8%	16.8%	12.8%	68.1%	59.1%
Sinopec Shanghai Petrochemical A	600688 CH	7,400	47.2	(40.8)%	32.7%	66.6%	(15.1)%	53.8%	34.2%
Sinopec Kantons	934 HK	1,133	1.1	(20.2)%	(39.3)%	(42.4)%	4.5%	(18.2)%	(21.5)%

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Source: Jefferies, Bloomberg. *Hang Seng Index is used as the benchmark index for Hong Kong listed shares. Shanghai Composite Index is used as the benchmark index for China listed shares.

Downside risks to our sector view

Refining

1) Continuous decline in crude prices. Refiners will suffer losses as they digest high cost inventory and mark down selling prices. NDRC's new pricing mechanism will not shield refiners from P&L losses. As a reminder, NDRC would not adjust refined oil prices if crude stays below US$40/bbl. Theoretically, this would lead to supernormal profit for refiners. However, there is no clarity on the booking of such profit. We believe that refiners will not be allowed to book the supernormal profit on P&L. Rather, they will be asked to keep the supernormal profit in a special reserve, for future capital expenditure.

We think that refiners have been hurt by falling crude in 4Q15, and the impact extended to 1Q16. For refining margins to normalize, crude prices must stabilize first.

2) Oversupply of refined products. Longer term, refining margins are driven by supply/demand balance.

Chemicals

1) Sudden spike in crude prices. Input costs drive selling prices. Chemical producers either pass through costs, or they are forced to bear some of the cost increase due to weak market conditions.

Oil logistics

1) China oil demand growth decelerates. This would have a direct negative impact on crude import volume.

2) Tariff cut on gas pipelines.

Engineering and construction

1) Sustainable recovery in crude prices. This would justify coal-to-chemical projects that have been put on hold, which in turn lead to upside for E&C companies.

2) More activities from teapot refiners. State refiners have almost completed their refining upgrade work. Now it is the teapot refiners that are lagging behind. If these teapot refiners can obtain financing to upgrade their facilities, E&C companies would benefit.

E&P

1) Sustainable recovery in crude prices. Our bearish view on E&P earnings is based on our house view that crude prices would stay below US$85/bbl from now till 2018. Should crude prices rebound faster and sooner, E&P economics improvement will exceed our expectation.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

If We had a Crystal Ball...

10 years on, China's import dependency is likely to be higher than today's

China's domestic crude production is not enough to meet demand. For energy security, China has been acquiring resources overseas for future development, and increasing crude imports. Both strategies point to increasing need for oil storage and logistics.

Net crude import to refining throughput ratio has climbed to 59% by 2015.

China used to be a net exporter of crude. The inflection point came in the early 90s when demand outstripped domestic production capacity. By 2015, net crude import averaged 6.7mbbl/d. The ratio of net import to refining throughput (proxy for apparent consumption) has climbed to 59%, and will continue to rise.

Compelled by economic and political reasons

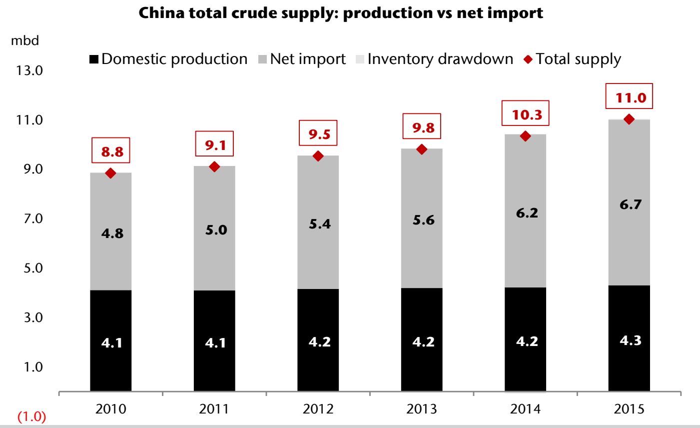
Crude demand is driven by consumption, and addition to SPR.

There are two drivers for crude demand: refined products consumption, and addition to strategic petroleum reserves (SPR).

China's economic growth will inevitably decelerate in the 13th FYP, given the high base and transition from an investment-led model to a consumption-led model. Structural adjustments/short term pains are overdue, and in fact, necessary for long-term stability. We expect oil demand (refining throughput plus net import plus inventory drawdown) to slowly emerge from the soft patch in the 12th FYP, driven by accelerating growth in consumption fuel (gasoline, kerosene).

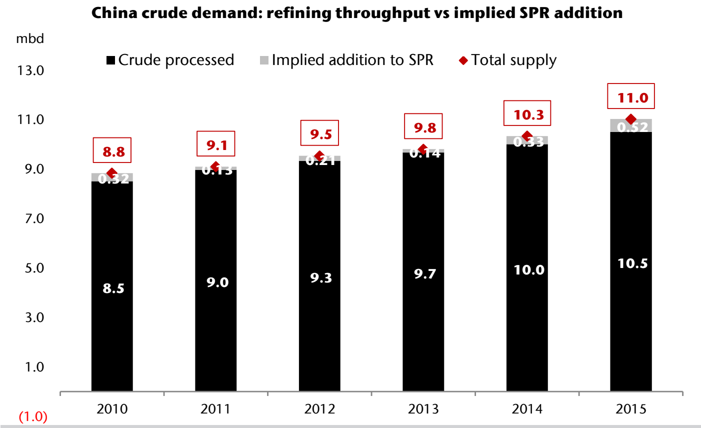
Aside from consumption, China will continue to import crude to fill its strategic petroleum reserves (SPR). We expect China to take advantage of the low crude prices and accelerate SPR build-up, subject to storage capacity (undisclosed by the government).

Chart 14: China's domestic crude production can't keep up with demand. Its dependence on import is increasing.



Source: Jefferies, Bloomberg

Chart 15: Crude demand is driven by refined products consumption, and addition to strategic petroleum reserves



Source: Jefferies, Bloomberg

Infrastructure projects have slowed down in most industries, but not for oil storage and logistics

NDRC-approved crude terminal projects in the last 3 years alone would add 1.4mbbl/d of loading and unloading capacity (~13% of 2015's 10.5mbbl/d refining throughput volume, a proxy to apparent consumption).

Aside from more crude import, rising refined oil export (mostly diesel) is an emerging trend. Since July 2015, China began to grant crude import quota to non-state owned refineries. It seems that regulators are providing policy support for refiners to expand overseas, in an attempt to resolve the overcapacity problem in China. Although the export volume is small for now, rising export is an emerging trend. The magnitude will depend on whether China raises the crude import quota.

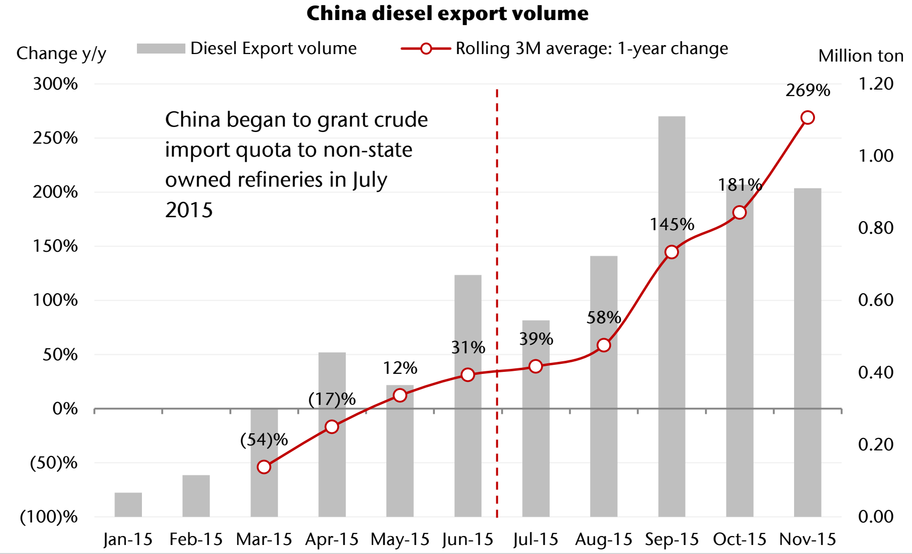
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 16: NDRC approved crude terminals projects 2013-2015

Announcement date	Project	Status	Loading and unloading Million ton/yr	Loading and unloading Bbl/d
Jan-23, 2015	Shandong Rizhao Fengshan Port crude terminal phase 2	In progress	17.5	352,397
Jan-12, 2015	Shandong Yantai West Port crude terminal	In progress	14.7	296,014
Dec, 2013	Ningbo Zhoushan Laotangshan Port crude terminal phase 2	In progress	18.0	362,466
Nov, 2013	Qingdao Dongjiakou Port crude terminal	Completed	18.8	378,575
		Combined capacity	69.0	1,389,452

Source: Jefferies estimates, NDRC

Chart 17: Rising diesel export volume is an emerging trend



Source: Jefferies estimates, CEIC

Oil logistics is a long-term theme

Sinopec Kantons is the de facto play on structural growth. It handled 59% of China's crude import volume last year, and is still growing. Fundamentals aside, we believe further asset injections from the parent co. will be catalysts for share price. In this report, we detail Sinopec Group and Sinopec Corp's capital raising history, and how we think they are positioning subsidiaries for placements.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

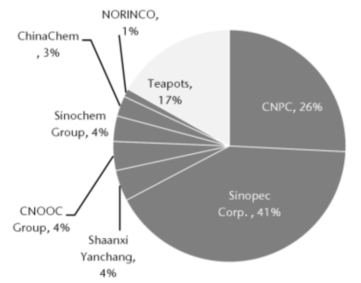
Enjoy the Honeymoon While It Lasts...

Tactical play on the refining and chemical space

China's refining sector is oligopolistic.

China's refining sector is oligopolistic. SOEs control 83% of capacity. There are emerging threats like diesel oversupply, illegal sale of unqualified fuels due to poor law outlook. However, in the near-term, refiners certainly have greater earnings visibility than E&Ps.

Chart 18: Breakdown of China's refining capacity



Source: Jefferies estimates, company data, BP

Our view of the refining sector's relative outperformance over crude is based on the assumption that crude prices will not fall massively from the current level. Year to date, crude prices have been range-bound around US$30/bbl. If crude prices do not fall sharply from current level, then refiners will not suffer losses due to inventory cost/selling prices mismatch. If crude prices were to rise gradually, then refiners would make above average margins in the short term

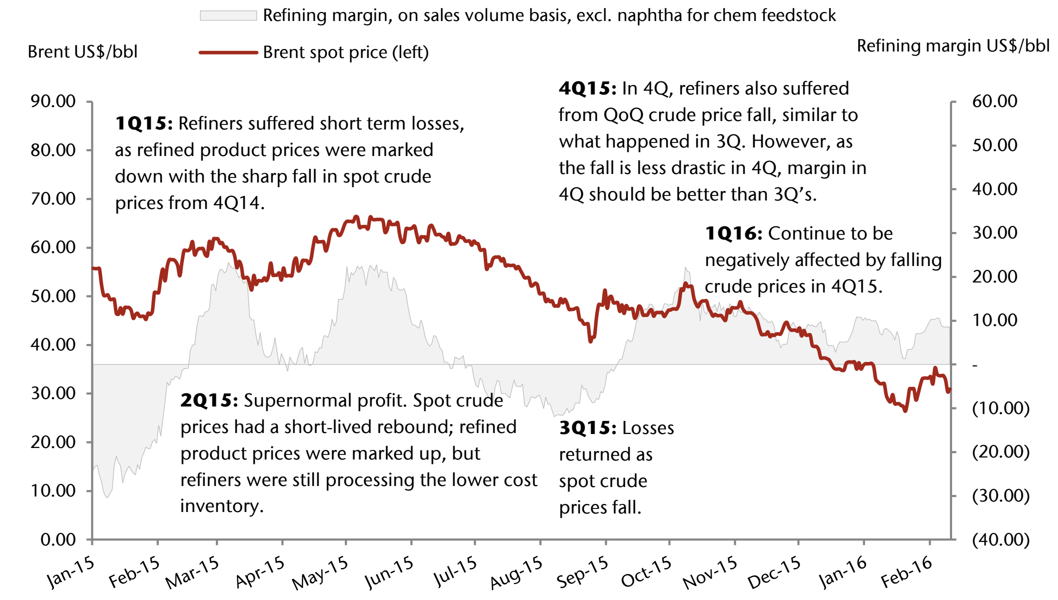
For the chemical sector, input cost drives selling prices; supply/demand balance drives margins. Producers either pass through the costs, or they are forced to bear some of the cost increase if market conditions are weak. Chinese chemical companies produce mostly commodity-grade chemical products, hence they have low pricing power. From January to mid-February 2016, the supply/demand balance of each chemical product have varied. But the low oil prices should alleviate cost pressure, leaving room for producers to make profit.

In summary, the refining and chemical sector is the most actionable space. Investors can express their convictions on crude price trend via **Sinopec Corp.** and **Sinopec Shanghai Petrochemicals.** Between these two stocks, we prefer **Sinopec Shanghai Petrochemicals** as it is unencumbered by E&P and marketing segments.

How volatility in crude prices impacts short term refining margins

In a **stable** crude price environment, refiners should make a rather stable (and thin) margin. Refiners make short term supernormal profit (or losses) only when crude prices move **drastically** due to mismatch in inventory costs and product prices (~1.5 months). A crude price increase is good for refiners, and vice versa.

Chart 22: China refining margin proxy



Trends in 2016:

In 1Q16, Chinese refiners are hurt by falling crude prices in 4Q15. For refining margins to normalize, crude prices needs to stabilize.

Source: Jefferies estimates, company data. *To compose the refining margin proxy, we benchmarked the product yield against that of Sinopec Shanghai Petrochemicals. Consumption tax on naphtha is excluded assuming the proxy is for an integrated refining and chemical company. Assumed inventory lag time of 1.5 months, and daily changes in product prices are benchmarked against observable market prices. Refiners' margins would deviate from the proxy above due to differences in product mix and sourcing costs.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Refining outlook

Emerging from demand soft patch

Back in 2012, we predicted that China oil demand would go through a temporary soft patch, as China moves from an investment-led to consumption-led economy. The weak diesel demand in 2013-2015 validated our thesis.

In our base case, we project implied oil demand growth of 6% in 2016, and 8% in 2017. We expect China to emerge from the demand soft patch in the last three years, driven by accelerating demand in gasoline, kerosene, and fuel oil, offsetting decline in diesel. **The key risk** to our base case is a faster deceleration of diesel demand, which would drag down the overall growth.

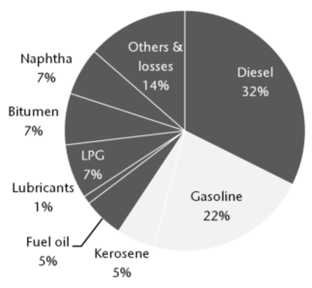
On the supply side, teapot refiners' threat to state refiners is contained

Since July 2015, China began to allow qualified teapot refiners to import crude directly. This led to rising output from teapot refiners. We think that the competition from teapot refiners is contained.

First, teapot refiners (both qualified and unqualified) make up only 17% of China's capacity. They are only running at 30-35% utilization. Second, we believe zombie refiners will exit the industry eventually. Among the survivors, many don't have capital to upgrade their equipment to match the higher National Standard requirements, and cannot build new plants.

The main reason for policy makers to give crude import rights to qualified teapot refiners is tax collection – policy makers need to win the support of local governments (who often have interest in the local refiners). Policy makers would not stop teapot refiners from exporting their products if they can't find a market locally, but certainly would not encourage new refinery construction.

Chart 23: Breakdown of China's refined products implied demand volume



Source: Jefferies estimates, China OGP, China Customs, NBS

Chart 24: Historical and projected refined products demand

(Tonnes/day)

Year	Throughput		Net imp GDK, fuel oil, base oil, naphtha, lube	Net imp LPG, bitumen, coke, paraffin, other	Apparent Consumption		Inventory drawdown	Implied demand		
		YoY				YoY			YoY	Δ mmbbl/d
2009	1,022,512	9.6%	31,207	24,053	1,077,772	7.1%	-7,316	1,070,456	8.1%	0.59
2010	1,159,055	13.4%	22,376	25,288	1,206,719	12.0%	3,947	1,211,760	13.2%	1.04
2011	1,221,532	5.4%	37,736	26,599	1,285,867	6.6%	-548	1,285,319	6.1%	0.54
2012	1,270,317	4.0%	38,550	31,897	1,337,026	4.0%	-1,749	1,339,014	4.2%	0.39
2013	1,316,195	3.6%	18,518	48,609	1,383,321	3.5%	671	1,383,993	3.4%	0.33
2014	1,362,398	3.5%	-472	40,586	1,402,513	1.4%	738	1,403,251	1.4%	0.14
2015	1,430,247	5.0%	-18,949	55,523	1,466,821	4.6%	-4,325	1,462,496	4.2%	0.44
2016	1,538,492	7.6%	-49,432	65,000	1,554,060	5.9%	0	1,554,060	6.3%	0.67
2017	1,661,271	8.0%	-49,432	65,000	1,676,839	7.9%	0	1,676,839	7.9%	0.90

Source: Jefferies estimates, China OGP, China Customs, NBS

Chart 25: Historical and projected diesel demand (32% of total in 2015)

(Tonnes/day)

Year	Production	YoY	Net Imports	Apparent Consumption	YoY	Inventory drawdown	Implied Consumption	YoY
		YoY			YoY			YoY
2009	386,025	6.1%	-7,316	378,709	(0.2)%	NA	378,709	2.8%
2010	434,488	12.6%	-7,874	426,614	12.6%	5,808	432,422	14.2%
2011	456,310	5.0%	-179	456,131	6.9%	-2,106	454,024	5.0%
2012	465,904	2.1%	-2,500	463,404	1.6%	1,560	464,965	2.4%
2013	472,019	1.3%	-6,890	465,129	0.4%	-701	464,428	(0.1)%
2014	478,809	1.4%	-9,667	469,142	0.9%	-361	468,782	0.9%
2015	492,245	2.8%	-18,454	473,791	1.0%	-1,555	472,237	0.7%
2016	499,876	1.6%	-30,000	469,876	(0.8)%	0	469,876	(0.5)%
2017	504,574	0.9%	-30,000	474,574	1.0%	0	474,574	1.0%

Source: Jefferies estimates, China OGP, China Customs, NBS

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 26: Historical and projected gasoline demand (22% of total in 2015)

(Tonnes/day)

Year	Production	YoY	MoM	Net Imports	Apparent Consumption	YoY	MoM	Inventory drawdown	Implied Consumption	YoY
		YoY				YoY				YoY
2009	197,184	13.7%		-13,421	183,762	6.1%		NA	183,762	9.3%
2010	209,584	6.3%		-14,166	195,417	6.3%		-767	194,650	5.9%
2011	221,392	5.6%		-11,033	207,915	6.4%		2,685	213,044	9.4%
2012	243,770	10.1%		-7,971	235,800	13.4%		-3,070	232,730	9.2%
2013	269,071	10.4%		-12,842	256,230	8.7%		1,902	258,132	10.9%
2014	298,627	11.0%		-13,562	285,066	11.3%		887	285,953	10.8%
2015	331,969	11.2%		-15,695	316,274	10.9%		-1,885	314,389	9.9%
2016	372,260	12.1%		-17,000	355,260	12.3%		0	355,260	13.0%
2017	432,654	16.2%		-17,000	415,654	17.0%		0	415,654	17.0%

Source: Jefferies estimates, China OGP, China Customs, NBS

Chart 27: Historical and projected kerosene demand (5% of total in 2015)

(Tonnes/day)

Year	Production	YoY	MoM	Net Imports	Apparent Consumption	YoY	MoM	Inventory drawdown	Kerosene	YoY
		YoY				YoY				YoY
2009	40,515	27.3%		-501	40,014	16.5%		NA	40,014	16.5%
2010	46,742	15.4%		-3,232	43,511	8.7%		NA	43,511	8.7%
2011	51,119	9.4%		-4,186	46,934	7.9%		275	47,209	7.9%
2012	58,254	14.0%		-5,973	52,281	11.4%		-240	52,041	10.2%
2013	63,148	8.4%		-6,877	56,271	7.6%		-503	57,975	11.4%
2014	82,126	30.1%		-18,072	64,054	13.8%		212	64,266	10.9%
2015	100,238	22.1%		-24,377	75,862	18.4%		-886	74,976	16.7%
2016	119,971	19.7%		-30,000	89,971	18.6%		0	89,971	20.0%
2017	141,564	18.0%		-30,000	111,564	24.0%		0	111,564	24.0%

Source: Jefferies estimates, China OGP, China Customs, NBS

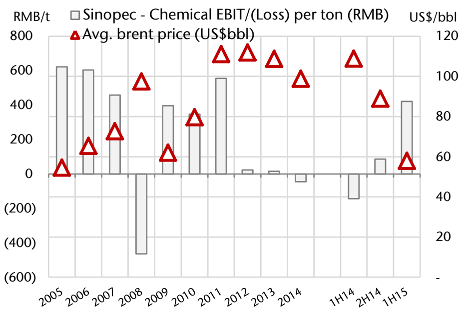
Chemical outlook

Low crude prices to alleviate cost pressure

Supply/demand balance drives margins. Hence, performance of each product varies. But the record low crude prices should alleviate cost pressure, leaving room for producers to make profit.

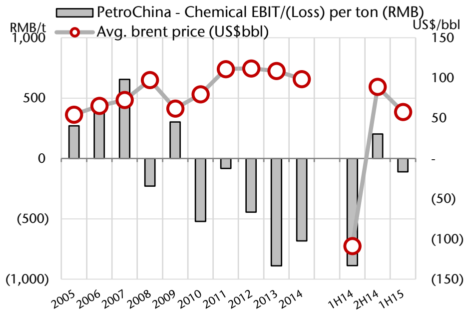
We observe that for Sinopec Corp, Sinopec Shanghai Petrochemicals, and PetroChina, their chemical segments are typically profitable when crude prices are below US$60/bbl.

Chart 28: Sinopec Corp's chemical unit makes profits when Brent is below US$90/bbl



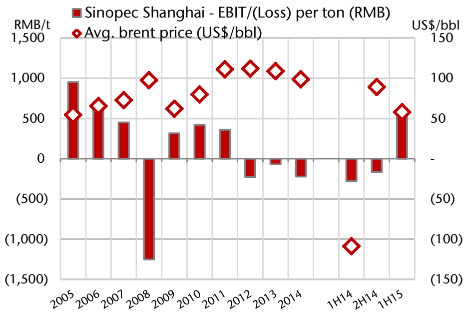
Source: Jefferies estimates, company data

Chart 29: PetroChina's chemical unit makes profits when Brent is below US$70/bbl



Source: Jefferies estimates

Chart 30: Sinopec Shanghai's chemical unit makes profits when Brent is below US$60/bbl



Source: Jefferies, company data

We composed our China HDPE-Naphtha spread index as a proxy for chemical margin. Similar to refined products, supply/demand determines the margin trend. However, in the

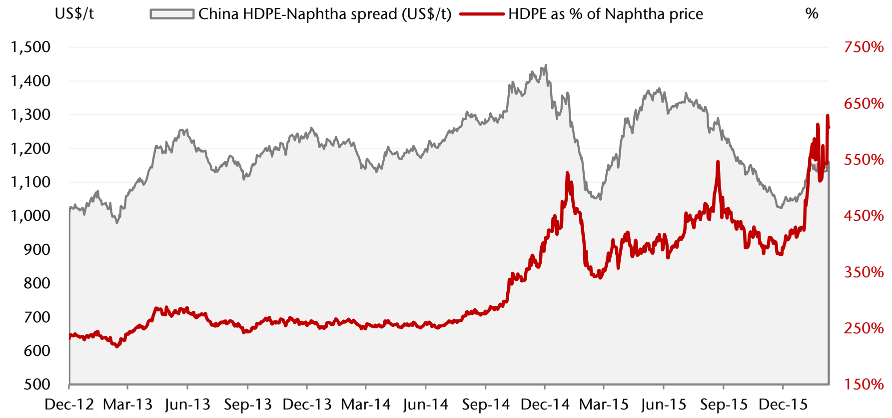
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

short term, sharp swings in crude prices (hence naphtha prices) skew the chemical margins.

In the short term, crude prices fall → refining margins fall.

For chemical products, the reverse is true. Crude prices fall → chemical margins rise.

Chart 31: China HDPE – Naphtha spread

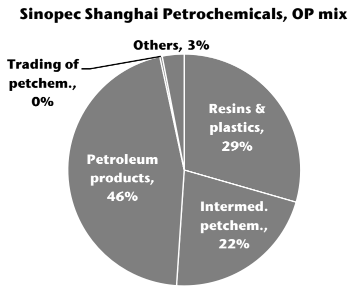


Source: Jefferies estimates, Bloomberg, CEIC

For chemical exposure, prefer Sinopec Shanghai Petrochemical > Sinopec Corp. > PetroChina

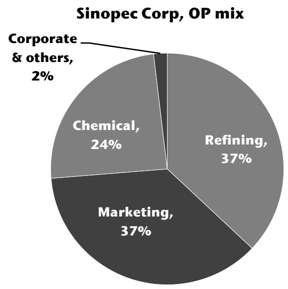
As discussed earlier, state refiners control most of China's refining capacity, hence the supply of naphtha (i.e. chemical feedstock). In contrast, the chemical market is fragmented, and is open to foreign competition. Integrated producers are better able to control costs. The three listed integrated producers in China are Sinopec Shanghai Petrochemical, Sinopec Corp and PetroChina, with different degrees of business exposure. We use 1H15 as the period of comparison. The larger the chemical exposure, the better able is the firm to make profit in the low crude price "window period".

Chart 32: Sinopec Shanghai PetChem: 51% of OP comes from chemicals



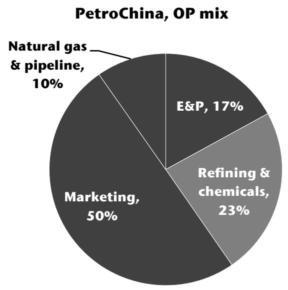
Source: Jefferies, company data

Chart 33: Sinopec Corp: 24% of OP comes from chemicals



Source: Jefferies, company data

Chart 34: PetroChina: 23% of OP comes from refining and chemicals combined



Source: Jefferies, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Kantons

Beginning of serial asset injections?

Key takeaway

For energy security, China will need to import more crude, and acquire overseas assets for future development. Hence, investment in oil storage and logistics will not stop, in our view. Sinopec Kantons already has a dominant position. It handled 59% of China's crude import volume in 1H15, and is still growing. Aside from sound fundamentals, we expect further asset injections from parent co. to provide catalysts for share price.

Initiating coverage at Buy, price target HK$4.75.

We detail parent co.'s asset injection history and possible future actions in this report.

#1: Asset injections at valuation discount make good stories. Parent co. Sinopec Group is constrained by a stretched balance sheet. We believe that Sinopec Group will inject more assets into Sinopec Kantons with the ultimate goal of fund raising. In the Hong Kong equity market, the chain of events often starts with asset injection, followed by share price rally, then placement. In this report, we detail the parent's asset injection history, and possible future actions.

Yuji Pipeline injection is an example of asset injection at discount valuation.

#2: Same script, different cast. Yuji Pipeline injection is an example of point #1. Yuji reminds us of the PetroChina-Kunlun Energy asset injection in 2008 (detail inside). Just that Sinopec Kantons' share price did not rally on deal closure, as low oil prices depress the valuation of the whole oil and gas sector. Otherwise, parent co. might have cashed out on a placement.

Deepwater crude terminal service is an industry with high entry barriers (government license, high initial capex, limited availability of sites).

#3: Event-driven risks aside, fundamentals are sound. Investment is slowing down in most industries, but not for oil storage and logistics. NDRC-approved crude terminal projects in the last 3 years alone would add 1.4mbbl/d of loading and unloading capacity (~13% of 2015's 10.5mbbl/d refining throughput volume, a proxy to apparent consumption). Rising crude import is inevitable, in our view, despite China's desire for self-sufficiency. Also, rising diesel export is an emerging trend as Chinese refiners grapple with overcapacity issue. Sinopec Kantons owns more than half of China's deepwater crude terminals, in an industry with high entry barriers (government license, high initial capex, limited availability of sites). If we are right on the structural trend, then Sinopec Kantons would be a beneficiary.

Pipelines are yield products.

#4: Pipelines are high-quality assets, but mispriced in the HK equity market. Yuji Pipeline would be fully consolidated from 1 Jan 2016. Pipelines have some of the highest quality earnings of all businesses. Tariffs, volumes and operating costs are usually stable. Maintenance capex is minimal. In the U.S., pipelines are perceived as yield products. But in the China market, a lack of comparables might have led to under-appreciation of this asset class.

Valuation offers substantial upside even with 20% haircut.

Valuation: The current share price implies 0.7-0.8x P/B on 8% ROE, based on strong earnings accretion from Yuji Pipeline, and a growing crude terminal business. We believe Sinopec Kantons is being punished together with the oil sector, even though its earnings trajectory has the least correlation to oil prices. We understand that investors might prefer large caps in this tough environment. Hence, we apply a 15% small cap discount to our SOTP valuation, and arrive at our HK$4.75 price target (implied 0.9-1x P/B).

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Beginning of serial asset injections?

Implications from Yuji Pipeline

At the end of 2015, Sinopec Kantons received the Yuji Pipeline assets from Sinopec Corp. (a listed subsidiary of parent co. Sinopec Group) at discount valuation (Rmb2.6bn, ~9.5x 2014 PE). That was purportedly for bringing "long-term strategic advantage to SInopec Kantons".

The ambition of parent co.

Sinopec Group (unlisted) has a stretched balance sheet. Yet as China's Supermajor, it has to carry on capital intensive activities.

The raison d'etre of parent Sinopec Group (unlisted) is to ensure China's energy security. This involves overseas acquisitions, and infrastructure building. Yet, it is constrained by a stretched balance sheet. Hence, it needs to position its listed subsidiaries for capital raising (possibly via placement). Sinopec Kantons is one such vehicle.

Table 2: Details on the transfer of Yuji Pipeline to Sinopec Kantons

Yuji Pipeline - The Natural Gas Transmission Services Framework Master Agreement	
Asset transfer price to Sinopec Kantons	Rmb2.6bn
Expiry	31 Dec 2017.
Transmission fee	Unaffected by oil price collapse in mid-2014.
	Transmission fee is determined according to the fixed price prescribed by NDRC, upon the commencement of the pipeline's operation in 2010.
Designed capacity	Current: 3 bcm/yr.
	After upgrading: 5bcm/yr (original deadline was end of 2015; delayed. Capex of Rmb380m)
Annual caps & payment terms	2015: Not exceeding Rmb1343m
	2016: Not exceeding Rmb1478m
	2017: Not exceeding Rmb1550m
Customers	Prior to 2014, customers were independent city gas operators. From 2014 onwards, Sinopec Natural Gas Branch Co. became the sole customer.
Pipeline location	Starting from Yulin in Shaanxi Province, passing through Shaanxi, Shanxi, Henan, ending at Qihe in Shandong Province. Total length 944.93km.

Source: Jefferies, company data

Take the cue from PetroChina

We see parallels between the PetroChina-Kunlun Energy relationship and the Sinopec Corp-Sinopec Kantons relationship.

We see parallels between the PetroChina-Kunlun relationship and the Sinopec Corp-Sinopec Kantons relationship.

PetroChina and CNPC began injecting gas distribution businesses at discount valuation into CNPC Hong Kong (later renamed "Kunlun Energy") in 2008. Asset injections more than tripled CNPC Hong Kong's share price, positioning the company to issue 450m shares (10% dilution) in November 2009. Proceeds from the HK$3.7bn share placement were used to buy two LNG terminals in 2010.

At the end of 2010, the now renamed Kunlun Energy announced that it was acquiring 60% share of the Shaanxi-Beijing pipeline from PetroChina in an all-share deal valued at Rmb19bn. In a nutshell, Kunlun Energy would issue 2.194bn shares (22% share base expansion) to PetroChina in exchange for 60% of Shaanxi-Beijing pipeline.

Asset injections make good stories. However, timing matters.

In the Hong Kong equity market, the usual chain of events starts with asset injection, then earnings growth and share price appreciation, followed by placement.

Yuji Pipeline injection is earnings accretive. Yuji made Rmb249m net profit in 11M14 (or Rmb272m annualized), equivalent to 39% of Sinopec Kantons' 2014 net profit.

Unfortunately, the oil price collapse depressed the valuation of the whole oil and gas sector.

Usually, positive news drives up share price. Unfortunately, the oil price collapse depressed the oil sector's valuation. When Sinopec Kantons announced the asset transfer on 30 Dec 2014, Brent price was at US$53/bbl. One year later when Sinopec Kantons completed the deal on 31 Dec 2015, Brent had fallen to US$33/bbl.

The last placement happened in May 2013, when Sinopec Group reduced its stake from 72% to 60%.

Had the oil price collapse not happened, the asset injection might have led to a more sustainable share price rally, and Sinopec Group could have cashed out on a placement. (Note that the last placement happened in May 2013, when Sinopec Group reduced its stake from 72% to 60%).

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

More asset sales from Sinopec Corp. and Sinopec Group?

Sinopec Corp. has completed 3 major LNG projects in recent years. Sinopec Group holds the Sichuan-Eastern Pipeline. All these assets are relevant to Sinopec Kantons' business model. It makes sense to inject these assets into Sinopec Kantons.

To recall, Sinopec Corp. issued a Rmb23bn A-share convertible bond in Feb 2011, which has been fully redeemed in Feb 2015. Proceeds from the CB was used to fund multiple projects, including Yuji Pipeline. Eventually, Yuji Pipeline was sold to Sinopec Kantons.

It would make sense for Sinopec Corp. and Sinopec to inject relevant assets into Sinopec Kantons... for the purpose of unlocking market value, and eventually, capital raising.

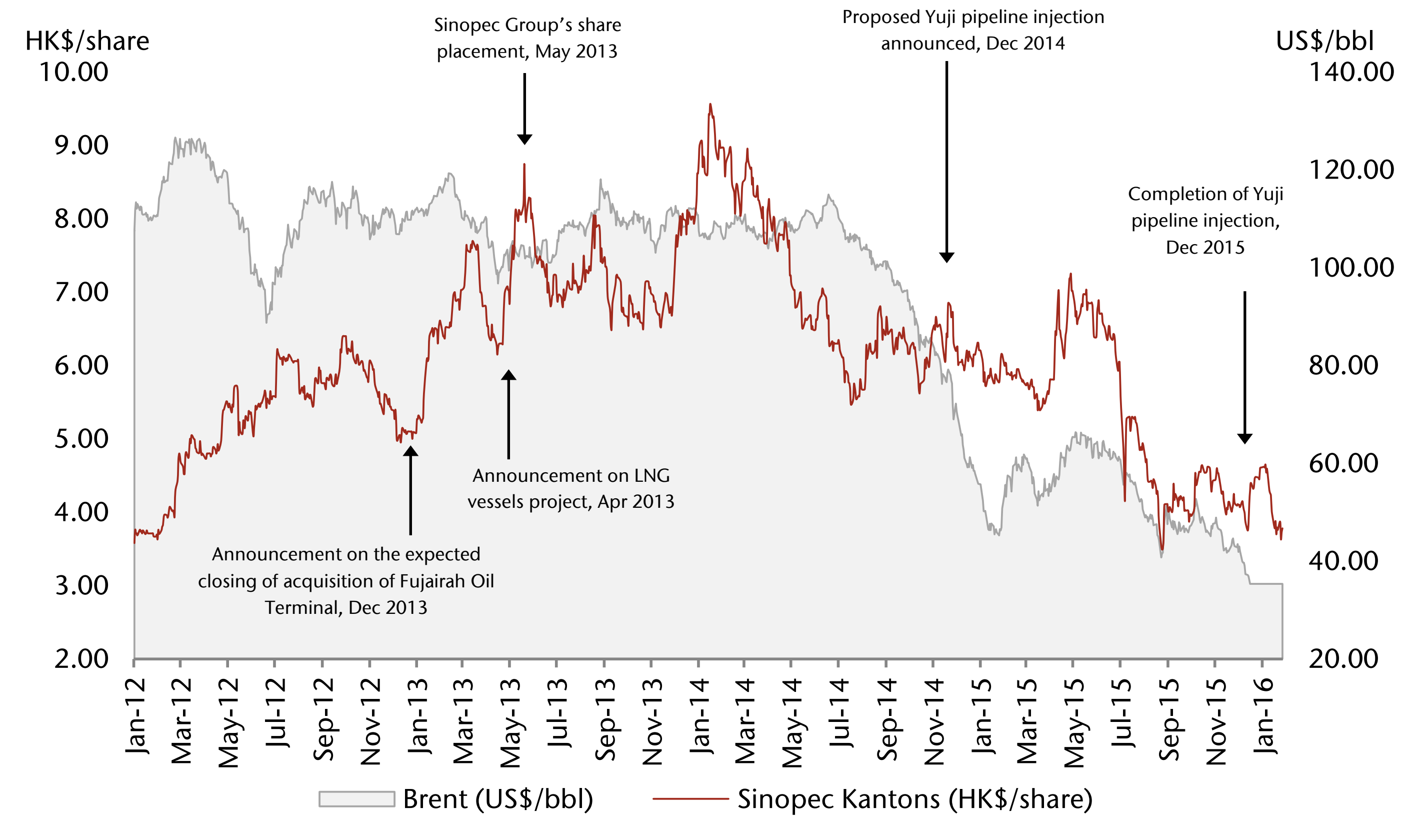
Sinopec Corp. has completed 3 major LNG projects in recent years. They are located in Shandong, Guangxi and Tianjin, with a combined loading and unloading capacity of 9m ton/year, and auxiliary gas pipelines.

Sinopec Group holds the Sichuan-Eastern Pipeline, which transmitted 2.3x as much gas as Yuji pipeline in 2014.

Announcements of further asset injections may drive up Sinopec Kantons' share price.

We expect any announcements on asset sale from Sinopec Corp. and Sinopec Group to Sinopec Kantons at discount valuation (just like the case of Yuji Pipeline) to drive up Sinopec Kantons' share price. The asset sale could potentially be followed by placement of Sinopec Kantons shares.

Chart 35: Sinopec Kantons' share price history



Source: Jefferies, HKEx, Bloomberg

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Placement risks aside, fundamentals are sound

#1: Crude terminal business: Monopolistic market, high margin

The crude oil terminal business is a monopolistic market.

Crude oil terminals are planned and controlled by the government. Non-state owned companies can hardly break into this industry, given the limited availability of suitable sites, and high capex requirement.

Sinopec Kantons handled 59% of China's crude import volume in 1H15.

Sinopec Kantons dominates the crude oil terminal market. In 1H15, its 7 oil jetties handled throughput volume of 96m ton, 59% of China's total import volume. Crude terminals and vessel charter services are the major revenue and earnings contributor to Sinopec Kantons (100% in 2015, est. ~50% in 2016).

Crude oil terminals tend to have low operating costs and high margins.

Crude terminals tend to have low operating costs and high margins. For example, the EBITDA margins for Qingdao Shihua, Tianjin Shihua and Ningbo Shihua (3 of the 5 jointly controlled oil jetties of Sinopec Kantons) can be as high as 88%. Contracts tend to be long-term.

Table 3: Sinopec Kantons' major acquisitions in the last 5 years

Assets and costs	Purpose
5 Oil jetties	
Seller: Sinopec Corp.	**Location**
Kantons' ownership: 50%	Ningbo, Qingdao, Tianjin, Rizhao, Tangshan
Cost: Rmb1.8bn, funded by rights issues	**Business rationale**
Implied valuation: 7.5x PE on annualized 2011 NP	Post-acquisition, Sinopec Kantons became the largest crude oil terminal company in China, with jointly-controlled interest in each of the country's top three coastal ports for crude. Annual designed capacity raised to 225m ton of crude (~4.53mbbl/d).
	Revenue stream
	Crude oil terminals tend to have low operating costs and high margins. EBITDA margins for Qingdao Shihua, Tianjin Shihua and Ningbo Shihua (3 of the 5 jointly controlled oil jetties of Sinopec Kantons) can be as high as 88%. Contracts tend to be long-term.
Vesta Terminals	
Seller: MEAM	**Business rationale**
Kantons' ownership: 50%	Bulk liquid storage terminals with 1.6m cm of storage capacity
Cost: EUR 129m	Self-supporting business in the Amsterdam-Rotterdam-Antwerp and Baltic regions.
Implied valuation: 14.9x PE on EUR 8.636m 2010 NP	The assets allow Sinopec Kantons to gain experience in operating European bulk liquid storage business, and to participate in Platts' transactions of refined oil trading.
	Revenue stream
	Storage revenues from guaranteed take-or-pay fees for dedicated capacity rentals.
	Service revenue from activities like tank-to-tank transfers (pump-overs), heating, nitrogen use and admin services.
	Throughput revenues where customer throughput volumes exceed contractually agreed volumes.
PT. West Point Terminal	
Seller: PBS, MCT	**Business rationale**
Kantons' ownership: 95%	The project is located along the Straits of Malacca, adjacent to Singapore, a global refined oil trading centre.
Cost: HK$3.2bn, funded by cash and loans	2.6bn cm crude oil and petroleum storage and oil blending complex, supporting quay and port facilities.
Implied valuation: 1.3x of 2012 net asset value. The business made operating losses then.	
Fujairah Oil Terminal	
JV partner: Concord Energy	**Business rationale**
Kantons' ownership: 50%	Port of Fujairah is one of the largest bunkering ports globally. Oil storage project of 1.2bn cm capacity.
Cost: US$51bn, valuation undisclosed	

Source: Jefferies, Company data

#2: Pipelines are one of the highest quality assets in the oil and gas industry

Pipelines are much like buildings – once they are built, they stay built. Maintenance capex is minimal.

Yuji Pipeline's P&L would be fully consolidated into Sinopec Kantons' P&L on 1 Jan 2016.

Pipelines have some of the highest quality earnings of all businesses. Tariffs, volumes and operating costs are usually stable. Maintenance capex is minimal; pipelines are much like buildings – once they are built, they stay built.

Pipeline earnings should receive yield product like multiples.

Pipeline earnings should receive yield product like multiples. In the US, midstream pipelines are incorporated into MLPs (Master and Limited Partnership) expressly because of their steady earnings and low capex requirement. MLPs are like REITs (Real Estate Investment Trusts), allowing shareholders to avoid corporate taxes if they pay out a large percentage of earnings as dividends.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial outlook

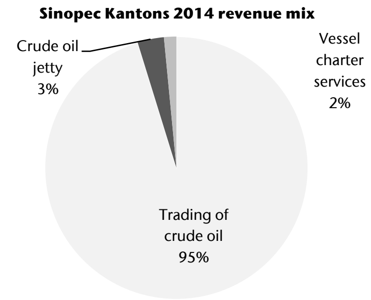
Reported revenue will be lower than 2014 level. But margins and earnings will improve.

In the past, crude trading was the bulk of Sinopec Kantons' group revenue. In 1H15, Sinopec Kantons terminated this business. We assume that going forward, the company will either cease this business, or maintain a minimal level of engagement. Hence, pipelines (new), and oil jetty and vessel chartering services (legacy) will form the major revenue base.

A more optimal business mix

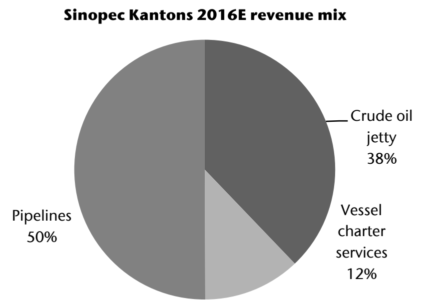
As a result, reported revenue will be lower than 2014 level. But margins and earnings will improve as the crude trading segment discontinues.

Chart 36: In the past, crude trading was the bulk of revenue, which has been loss making



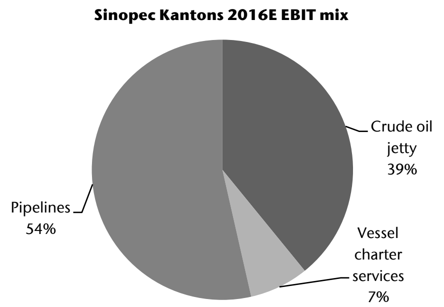
Source: Jefferies, company data

Chart 37: Going forward, it will be logistics and pipelines



Source: Jefferies estimates, company data

Chart 38: The new business mix is margin accretive



Source: Jefferies estimates

Near term, gas market outlook is weak. Nonetheless Yuji asset injection is a net positive to Sinopec Kantons' P&L.

Yuji Pipeline's P&L will be fully consolidated into Sinopec Kantons from 1 Jan 2016. Near term, gas market outlook is weak, both in volume and price. We expect revenue to stay far below the company guidance and annual cap in the contract in 2016-2017. Nonetheless, the addition of a pipeline asset is still a net positive. Historically Yuji made >40% operating margin. The chances of Yuji ever becoming loss-making are low.

Table 4: Yuji Pipeline P&L

(RMB m)	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast
Company guidance					1,221	1,339	1,410	
Annual cap					1,343	1,478	1,550	
.. Sales volume, billion cm (reported by Sinopec Grp)			3.12	3.69	3.43	3.43	3.53	3.64
1-year change				18%	(7)%	0%	3%	3%
.. Realized price, RMB per cm (implied)			0.40	0.31	0.28	0.27	0.28	0.29
1-year change				(23)%	(10)%	(5)%	5%	5%
Revenue (reported by Kantons)	870	980	1,255	1,143	957	909	983	1,063
1-year change		13%	28%	(9)%	(16)%	(5)%	8%	8%
Cost of services	(435)	(498)	(746)	(637)	(536)	(508)	(549)	(592)
Gross profit	435	481	508	506	421	401	434	471
Other income	-	-	6	62	-	-	-	-
Admin. & others	(13)	(28)	(24)	(32)	(27)	(25)	(26)	(27)
Operating profit	422	453	491	535	394	376	409	444
Cost of services as % of revenue	50.0%	50.9%	59.5%	55.8%	56.0%	55.9%	55.8%	55.7%
Admin & others as % of revenue	1.5%	2.9%	1.9%	2.8%	2.8%	2.7%	2.6%	2.5%
Gross margin	50.0%	49.1%	40.5%	44.2%	44.0%	44.1%	44.2%	44.3%
Operating margin	48.5%	46.3%	39.1%	46.8%	41.2%	41.4%	41.6%	41.8%

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Balance sheet & cashflows

Sinopec Kantons was in a net cash position before the Yuji acquisition. We expect it to turn into net debt post acquisition, at a manageable net debt to equity ratio of below 30%.

In future, debt-funded acquisition is possible. In fact, we believe that the cash generative pipeline business will give management more comfort in taking on new debts. After all, Sinopec Kantons has the most flexible balance sheet compared to the other Sinopec listed subsidiaries.

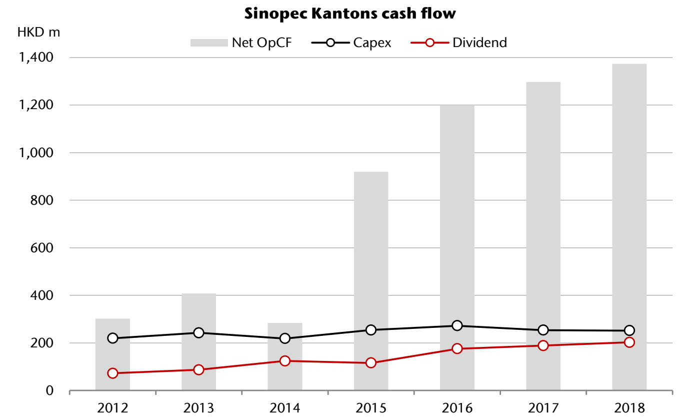
Dividend payout ratio has been 18% in the last few years. Assuming more acquisitions/capex requirements, we don't expect dividend payout ratio to increase.

Table 5: ROE, ROIC, ROA estimates

Balance sheet ratios (Dec-YE)	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Asset Turnover (sales/assets)	2.8	2.1	1.7	0.1	0.1	0.1	0.1
Leverage Ratio (assets/equity)	1.2	1.1	1.1	1.4	1.4	1.4	1.4
Net Profit Margin	1%	2%	4%	77%	55%	54%	54%
ROE	4%	5%	7%	6%	8%	8%	8%
Core operating profit, excl. other gains (HKD m)	164	23	158	276	683	736	796
Effective tax rate	18%	26%	11%	25%	25%	25%	25%
NOPAT (HKD m)	134	17	141	207	512	552	597
Debt, incl. payables (HKD m)	1,345	1,223	1,171	4,264	4,423	4,446	4,470
Equity (HKD m)	6,508	9,856	10,277	10,807	11,681	12,568	13,518
Invested capital (HKD m)	7,853	11,080	11,448	15,072	16,105	17,014	17,988
Average invested capital (HKD m)		9,466	11,264	13,260	15,588	16,559	17,501
ROIC		**0%**	**1%**	**2%**	**3%**	**3%**	**3%**
ROA	**4%**	**4%**	**6%**	**4%**	**6%**	**6%**	**6%**
Net debt to equity ratio; or Net cash (NC)	(37)%	(16)%	(8)%	35%	26%	17%	9%

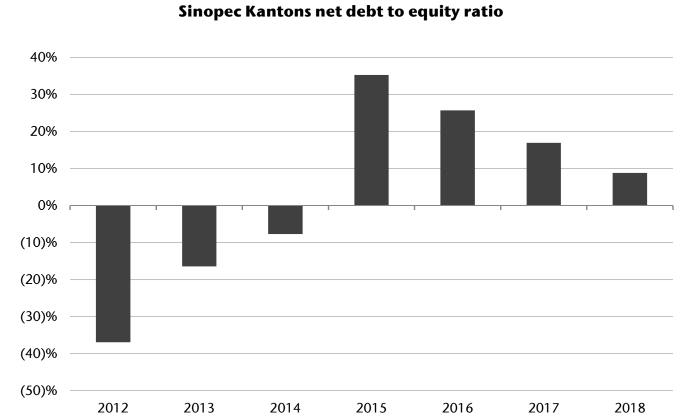
Source: Jefferies estimates, company data

Chart 39: Cash flow



Source: Jefferies estimates, company data

Chart 40: Gearing



Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Valuation and risks

Pipeline business is a cash cow. Crude oil jetty business is a near-monopoly at least in China

Sinopec Kantons has the highest earnings quality businesses not only among Sinopec subsidiaries, but also in the China oil sector. Pipeline business is a cash cow (>40% operating margin) with minimal maintenance capex requirement. The crude oil jetty business is a near-monopoly at least in China, and generates at least 35-40% operating margin. Vessel charter services makes losses historically, but it is only a small part of the group.

Initiate with a Buy rating, PT HK$4.75

Current share price implies 0.7-0.8x P/B, on strong earnings accretion from Yuji Pipeline, and a growing crude terminal business. We believe that Sinopec Kantons is being punished together with the rest of the oil sector, even though its earning trajectory has the least correlation to oil price. We understand that investors might prefer large cap in this tough environment. Hence, we apply a 15% small cap discount to our SOTP valuation, and arrive at HK$4.75 price target (implied 0.9-1x P/B).

We have applied a 20% haircut to factor in placement risk and small cap discount.

Downside risks: We have repeatedly emphasized in this report that Sinopec Kantons is used as a capital raising vehicle by the ultimate parent co. Sinopec Group. Asset injections often make good stories. In the Hong Kong equity market, the chain of events often starts with asset injections, followed by share price appreciation and then a share placement.

Another risk is pipeline tariff cut.

Upside risks: Stronger than expected throughput volume at the crude oil jetties will lead to earnings upside.

Chart 41: Implied valuation multiples on current price and target price

Current share price (HKD)	3.55			
Target price (HKD)	4.75			
	2015 F'cast	**2016** F'cast	**2017** F'cast	**2018** F'cast
Operating data				
Asset turnover (sales/assets)	0.1	0.1	0.1	0.1
Leverage ratio (assets/equity)	1.4	1.4	1.4	1.3
Net margin	77%	55%	54%	54%
ROE	6%	8%	8%	8%
ROA	4%	6%	6%	6%
Implied multiple on current share price				
P/BV	0.82	0.76	0.70	0.65
ROE	6%	8%	8%	8%
EV/EBITDA	23.79	12.73	11.18	9.68
Dividend yield	1.3%	2.0%	2.1%	2.3%
FCF yield	(26.9)%	10.5%	11.8%	12.7%
Implied multiple on price target				
P/BV	1.09	1.01	0.94	0.87
ROE	6%	8%	8%	8%
EV/EBITDA	29.30	15.88	14.16	12.49
Dividend yield	1.0%	1.5%	1.6%	1.7%
FCF yield	(20.1)%	7.8%	8.8%	9.5%

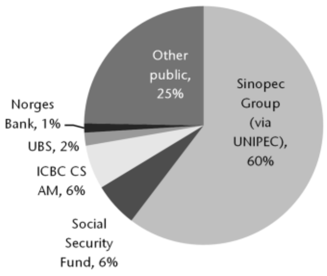
Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Management bios

All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Chart 42: Sinopec Kantons shareholding structure



Source: Jefferies, company data

Table 6: Management bio

Senior management	Position	Background
Mr CHEN Bo, 53	Chairman, since May 2014	Mr. Chen has extensive working experience in international crude oil and natural gas trading and transportation as well as international storage logistics, and has maintained good relationships with the world's major oil producers, large oil companies and large trading companies, and enjoys a good reputation and credit in the industry.
Mr XIANG XI Wen, 50	Deputy Chairman, since Dec 2015	Prior to joining Sinopec Kantons, Mr. Xiang served in senior management positions in Henan Petroleum Exploration Administration of China Petrochemical Corporation, Henan Oilfield Company, and Sinopec Corp.
Mr DAI Liqi, 48	Executive Director, since Dec 2015	Prior to joining Sinopec Kantons, Mr. Dai served in various engineering related positions in Sinopec Corp.
Mr LI Jian Xin, 47	Executive Director, since Dec 2015	Prior to joining Sinopec Kantons, Mr Li served in senior management positions in Sinopec Guangdong Oil, Sinopec Shenzhen Oil, Sinopec Guizhou Oil, and Sinopec (Hong Kong) Limited.
Mr WANG Guotao, 50	Executive Director, since Dec 2015	Since September 2014, Mr Wang has been the Deputy General Manager and the Standing Committee Member of the Communist Party Committee of Pipeline Storage & Transportation Company. Currently, Pipeline Storage & Transportation Company is a wholly-owned subsidiary of Sinopec Corp.
Mr LI Wen Ping, 52	Secretary of the Board, since March 2008	Mr. Li holds an MBA and has the professional qualification of senior economist. Prior to joining Sinopec Kantons, Mr Li served in senior management positions in Sinopec Yangzi Petrochemical Company.
Mr CHEN Hong, 43	Chief Financial Officer, since March 2012	Mr Chen worked with the finance department of Sinopec International Co. Ltd, Sinopec International Products Trading Co, Sinopec (Singapore) Company, UNIPEC (Singapore) Company and other units successively. He was deputy chief of finance department of UNIPEC from December 2008 to March 2012.

Source: Jefferies, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 43: Sum of the parts valuation

Sum-of-the-parts valuation		
Pipeline	**12-month weighted**	
Net profit (HKD m)	288	Yuji Pipeline's P&L would be fully consolidated into Sinopec Kantons' P&L on 1 Jan 2016. Pipelines have some of the highest quality earnings of all businesses. Tariffs, volumes and operating costs are usually stable. Maintenance capex is minimal; pipelines are much like buildings – once they are built, they stay built. Pipeline earnings should receive yield product like multiples. In the US, midstream pipelines are incorporated into MLPs (Master and Limited Partnership) expressly because of their steady earnings and low capex requirement. Our base case assumes 0%/3% volume growth in 2016/2017. We also conservatively modelled in a slight cut in tariff, although the tariff has been locked in the contract.
x Target PE multiple	20	
Market cap (HKD m)	5,767	
÷ Shares outstanding	2,486	
Per share value (HKD)	2.32	
Crude oil jetty		
Net profit (HKD m)	210	Crude oil terminals are planned and controlled by the government. Non-state owned companies can hardly break into this industry, given the limited availability of terminal sites and high initial capex. Sinopec Kantons owns over 50% of deepwater crude terminals in China. In 1H15, its 7 oil jetties handled throughput volume of 96m tons, 59% of China's total import volume. Crude terminals tend to have low operating costs and high margins. For example, the EBITDA margins for Qingdao Shihua, Tianjin Shihua and Ningbo Shihua (3 of the 5 jointly controlled oil jetties of Sinopec Kantons) can be as high as 88%. We benchmarked the PE multiple to global peers' mid range.
x Target PE multiple	10	
Market cap (HKD m)	2,099	
÷ Shares outstanding	2,486	
Per share value (HKD)	0.84	
Associates		
Net profit (HKD m)	239	Petrochemical terminals. Assigned the same multiple as the core business.
x Sinopec Kantons' share	50%	
x Target PE multiple	10	
Market cap (HKD m)	1,195	
÷ Shares outstanding	2,486	
Per share value (HKD)	0.48	
Vessel charter services		
Net profit (HKD m)	39	To a certain extent, business volume for the vessel charter services business is assured given the Sinopec Group's demand. However, this segment is is subject to much greater competition than the crude terminal business. Hence, a lower multiple is assigned.
x Target PE multiple	5	
Market cap (HKD m)	195	
÷ Shares outstanding	2,486	
Per share value (HKD)	0.08	
Jointly controlled companies		
Net profit (HKD m)	922	Sinopec Kantons' share price actually rallied through most of 2015 after the asset injection proposal of Yuji pipeline was released. However, share price crashed after the completion announcement was made in Dec 2015. Even though the asset is earnings accretive, and will generate steady cash flow going forward, shareholders took profit. We believe that two things are negatively affecting investor sentiment. First is the low crude price which led to de-rating of all oil-related stocks, even though Sinopec Kantons' earnings are not correlated to crude price. Second, small caps are punished the most in the oil space. Hence, we assigned a small cap discount to Sinopec Kantons.
Sinopec Kantons' share	500	
x Target PE multiple	10	
Market cap (HKD m)	5,000	
÷ Shares outstanding	2,486	
Per share value (HKD)	2.01	
Sub-total	5.73	
Valuation discount (small cap, placement risk	15%	
Price target (rounded to HKD 0.25/sha	**4.75**	
Current price	3.55	
Target upside/(downside)	34%	

Source: Jefferies estimates

Financial summary

Table 7:P&L statement

P&L (HKD m, Dec-YE)	2012	2013	2014	2015	2016	2017	2018
By business segments	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Trading of crude oil	20,936	22,436	18,307	-	-	-	-
1-year change		7%	(18)%	(100)%	0%	0%	0%
Crude oil jetty	621	580	624	643	688	736	787
1-year change		(7)%	8%	3%	7%	7%	7%
Vessel charter services	485	340	293	205	219	234	251
1-year change		(30)%	(14)%	(30)%	7%	7%	7%
Pipelines					909	983	1063
1-year change						8%	8%
Revenue	**22,042**	**23,356**	**19,224**	**847**	**1,816**	**1,953**	**2,101**
Operating profit	**207**	**97**	**184**	**302**	**709**	**762**	**822**
Margins	1%	0%	1%	36%	39%	39%	39%
Finance income/(costs) - net	(2)	(1)	7	1	2	3	2
Share of result of associated companies	92	109	104	111	118	125	133
Share of result of joint ventures	60	457	490	459	491	526	562
Profit before tax	357	662	784	873	1,320	1,416	1,519
Income tax exp.	(66)	(171)	(84)	(218)	(330)	(354)	(380)
Effective tax rate	18%	26%	11%	25%	25%	25%	25%
Profit for the period	**292**	**491**	**700**	**655**	**990**	**1,062**	**1,139**
1-year change		68%	42%	(6)%	51%	7%	7%
.. To shareholders	292	491	700	655	990	1,063	1,140
.. Non-controlling interest	-	0	(0)	(0)	(0)	(0)	(0)
Net margin	1%	2%	4%	77%	55%	54%	54%
Basic EPS (HKD/share)	0.15	0.21	0.28	0.26	0.40	0.43	0.46
.. Regular dividend payout ratio	25%	18%	18%	18%	18%	18%	18%
.. Total regular dividend (HKD/share)	0.04	0.04	0.05	0.05	0.07	0.08	0.08

Source: Jefferies estimates, company data

Table 8: Balance sheet

Balance sheet (HKD m, Dec-YE)	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Inventories	48	47	15	27	58	62	67
Trade and other receivables	629	730	1,193	139	298	321	345
Cash & cash equivalents	2,405	1,622	796	83	893	1,760	2,692
Others	5	-	-	-	-	-	-
Total current assets	**3,087**	**2,400**	**2,004**	**249**	**1249**	**2143**	**3104**
Trade and other payables	1,345	1,223	1,171	139	298	321	345
Income tax payables	10	13	6	21	21	21	21
Total current liabilities	**1,355**	**1,237**	**1,177**	**161**	**320**	**343**	**367**
P,P&E	1,855	1,958	1,999	7,610	7,643	7,659	7,672
Prepaid land lease	75	724	713	749	749	749	749
Others	2,848	6,108	6,841	6,588	6,588	6,588	6,588
Total non-current assets	**4,778**	**8,791**	**9,553**	**14,947**	**14,981**	**14,996**	**15,010**
Long-term debt				4,125	4,125	4,125	4,125
Deferred tax liabilities	2	98	103	103	103	103	103
Total non-current liabilities	**2**	**98**	**103**	**4,228**	**4,228**	**4,228**	**4,228**
Share capital	207	249	249	249	249	249	249
Reserves	6,301	9,598	9,990	10,520	11,394	12,280	13,231
Equity to shareholders	6,508	9,847	10,239	10,769	11,642	12,529	13,479
Non-controlling interest	-	10	39	39	39	39	39
Total equity	**6,508**	**9,856**	**10,277**	**10,807**	**11,681**	**12,568**	**13,518**

Source: Jefferies estimates, company data

Table 9: Cashflow statement

Cashflow statement (HKD m, Dec-YE)	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Net cash from operating activities	302	408	284	920	1,198	1,297	1,373
Net cash used in investing activities	(1,796)	(3,787)	(1,028)	(5,633)	(272)	(254)	(252)
Net cash from /(used in) financing activities	3,122	2,567	(83)	4,001	(116)	(176)	(189)
Net income/(decrease) in cash & cash equivalents	1,628	(811)	(827)	(712)	809	867	932
Cash - beginning	772	2,405	1,622	796	83	893	1,760
Exchange losses on cash & cash equivalents	5	29	(0)	-	-	-	-
Cash - ending	2,405	1,622	796	83	893	1,760	2,692

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Engineering (SEG)

Beginning of a structural adjustment period

Key takeaway

China has built 66% of the world's new refining capacity in the last decade. Some chemical products (e.g. PTA) and plastics (e.g. PVC, synthetic fiber polymer) are in overcapacity mode. Since supply side reform is a key focus under the 13th Five Year Plan, we expect a sharp slowdown in refining and naphtha-based chemical projects. At the record low crude prices, many coal-chemical projects are economically unjustified. Hence, we expect SEG to enter a lower stage of growth. Although we like its strong balance sheet and steady free cash flow, we initiate with a HOLD rating due to lack of catalysts.

Initiating coverage at Hold, price target HK$6.90.

Sinopec Group is known for its leading R&D capability among China's oil majors. Under its wing, SEG (67% owned by Sinopec Group) has developed full EPC capability. With its strong balance sheet, and limited competition from Chinese peers, it should continue to win projects domestically. Eventually, we expect it to venture out with Chinese companies overseas, albeit at a lower margin.

Overcapacity in refining and naphtha-based chemical sector points to fewer new projects going forward.

But the 13th FYP will be a lower growth period for SEG as there will be fewer green field projects. **1) Refining:** "Supply side reform" aims to rationalize excess capacity. Average utilization rate of refineries is at 80%. Diesel is oversupplied. Gasoline capacity is optimal. Hence the large refiners don't need to build new capacity. They could re-engineer processes to achieve moderate output increase if necessary. **2) Petrochemical:** this sector will offer better opportunities than refining sector, but mostly in the area of ethylene, PX and specialty chemical projects. **3) New coal chemical**: This is once a priority under the last FYP. However, development is likely to be stalled for as long as crude prices stay in the doldrums.

Capacity expansion in China's commodity space is planned capitalism.

Capacity expansion in China is planned capitalism. About 40% of SEG's revenue is from Sinopec Group; the rest mainly from Shenhua and CNOOC; all these are SOEs. With the current overcapacity in refining and chemicals sector, and low crude prices, new projects are not justified. Hence, we assume 20% decline in new contract values in 2016, and slight decline to no growth in 2017.

Valuation looks cheap. But within a 12 month horizon, there are no positive catalysts to drive share price.

What are investors paying for? On our 2016 forecast, the stock is trading on 4% dividend yield, 9x P/B, against a deteriorating ROE from low teens in the last few years to 10%. Free cash flow yield, however, is strong at 15%. SEG makes a good long term holding for dividend investors. But within a 12-month horizon, there are no positive catalysts.

If our view on the weak project outlook is correct, then SEG will need to trim its cost base if it wants to drive headline earnings (and hopefully share price). This is easier said than done for SOEs that operate with social obligations.

We will turn more constructive if crude prices rebound substantially, which would revive investments on coal chemicals. Otherwise, project visibility will improve soonest in 2017, as most SOE directed plans would be finalized only from the 2nd year of FYP onwards.

For now, we think that the stock is fairly valued. Initiate with a Hold rating.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Capacity rationalization, fewer greenfield projects

Rationalization of capacity is a key focus under the 13th FYP.

One needs to take a breather after a long sprint. The same can be said of infrastructure investment. China built 66% of the world's new refining capacity in the last decade. Some chemicals are beginning to show signs of oversupply. Supply side reform, which focuses on rationalizing capacity, is a key focus under the 13th FYP.

More equipment upgrade, less pollution

Refiners could achieve moderate capacity increase by reengineering processes, without building new plants.

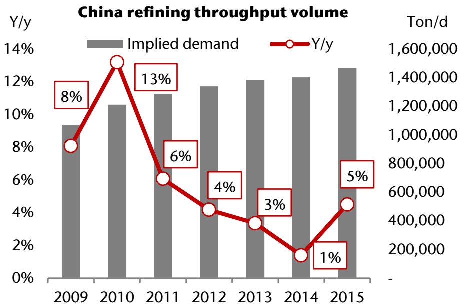
Pollution control is becoming an increasingly focus of policy makers. Hence, refiners are required to phase out fuels below National Standard IV and V by 1 Jan 2017. In fact, over the last two years, most of the refining projects were on equipment upgrade and process reengineering. Refiners could achieve moderate capacity increase without building new plants.

Table 10: Utilization rates of refineries have been falling, mainly due to diesel's weakening demand & capacity overbuild

Utilization rate	CNPC	Sinopec Corp.	Shaanxi Yanchang	CNOOC Group	Sinochem Group	ChinaChem	NORINCO	Teapots	National avg.
Source	CNPC	Implied from data	National avg.	National avg.	National avg.	National avg.	National avg.	Implied	BP
2010	91%	86%	82%	82%	82%	82%	82%	20%	82%
2011	92%	88%	80%	80%	80%	80%	80%	17%	80%
2012	90%	85%	77%	77%	77%	77%	77%	20%	77%
2013	87%	82%	73%	73%	73%	73%	73%	24%	73%
2014	83%	80%	71%	71%	71%	71%	71%	29%	71%

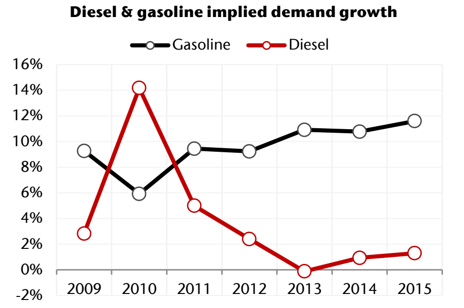
Source: Jefferies estimates, BP Statistical Review, CNPC, Sinopec Corp., Shaanxi Yanchang, CNOOC Group, ChinaChem, NORINCO

Chart 44: Implied demand growth of refining throughput volume is trending to a normalized range of low to mid single digit



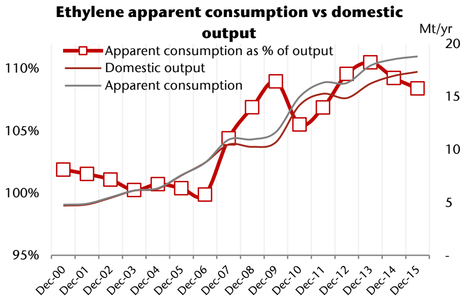
Source: Jefferies, CEIC, WIND, Bloomberg

Chart 45: Gasoline demand is strong (22% of throughput), but not enough to offset structural weakness of diesel demand (32% of throughput)



Source: Jefferies, CEIC, WIND, Bloomberg

Chart 46: Ethylene is one of the few basic chemicals where China still needs to add capacity. Domestic output only meets 92% of consumption needs.



Source: Jefferies, CEIC, WIND, Bloomberg

Table 11: Net import as % of apparent consumption. PVC, synthetic fiber polymer and PTA are in over-capacity. Except for PE, ethylene, benzene and PX, import dependency is falling among most other major chemical products.

	Synthetic resin	PP	PE	PVC	PS	ABS	Synthetic Fiber Monomer	Synthetic Fiber Polymer	Ethylene	Benzene	PX	PTA
2011	36%	27%	42%	6%	25%	55%	46%	(1)%	6%	1%	28%	8%
2012	35%	25%	42%	5%	24%	61%	40%	(3)%	9%	6%	24%	(21)%
2013	32%	22%	42%	2%	21%	58%	34%	(6)%	10%	11%	33%	(14)%
2014	28%	20%	46%	(2)%	20%	40%	30%	(7)%	8%	7%	34%	(60)%
2015	29%	18%	45%	1%	21%	43%	33%	(4)%	9%	14%	34%	(60)%

Source: Jefferies

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial outlook

Greenfield projects are the key drivers to revenue growth. Typically, 10-30% of contract value is received upfront as a deposit, depending on project type. The rest of the payment is collected on a percentage of completion basis, over 3-4 years. Hence, an earnings beat or miss is not the key concern of SEG investors. It is new contract announcements/policy directives that affect market expectations for the stock.

Large scale refining contracts are few under the new FYP

Typically, 10-30% of contract value is received upfront as a deposit, depending on project type. The rest of the payment is collected on a percentage of completion basis, over 3-4 years.

Backlog value is well known. As of 9M15, SEG management's estimated backlog value stood at Rmb106bn. Assuming no change in contract terms, and no project delay, that amount reflects 2.3 years of revenue, based on 2014's run-rate.

But investors are paying for the prospect of new contract win. The key question is how much SEG would make from new contracts in the 13th FYP (2016-2020). The outlook for oil refining and new coal chemical project wins is deteriorating. We modelled in 20% fall in new contract values in 2016, and no growth in 2017 and 2018. As a result, our **projected revenue decline** turns out to be -18% in 2016, and -4% in 2017.

Table 12: We expect new contract wins in 2016-2018 to be lower than 2014

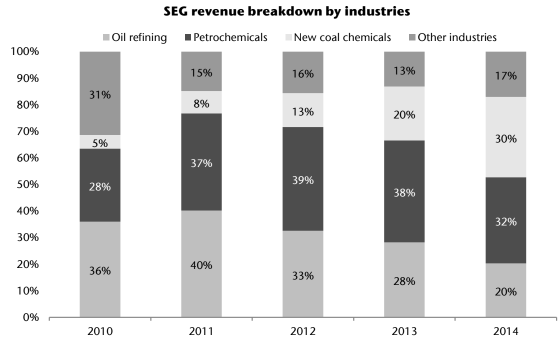
(RMB m)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
	Actual	Actual	Actual	Actual	Actual	F'cast	F'cast	F'cast	F'cast
Value of backlog			76,050	92,568	103,922	96,909	83,527	78,875	77,055
Oil refining				6,970	17,894	3,455	2,764	2,764	2,903
1-year change					157%	(81)%	(20)%	0%	5%
Petrochemicals				23,648	12,336	10,488	9,439	9,439	9,911
1-year change					(48)%	(15)%	(10)%	0%	5%
New coal chemicals				34,828	23,041	9,182	7,805	8,195	8,605
1-year change					(34)%	(60)%	(15)%	5%	5%
Other industries				5,143	7,429	32,578	19,547	20,524	21,550
1-year change					44%	339%	(40)%	5%	5%
Value of new contracts entered	41,210	50,300	40,140	70,589	60,700	55,702	39,555	40,923	42,969
1-year change					(14)%	(8)%	(29)%	3%	5%
Assume 20% deposit						11,140	7,911	8,185	8,594
Discount the balance by 5%						42,333	30,061	31,101	32,656
Upfront deposit						11,140	7,911	8,185	8,594
Revenue from work completed						32,303	27,842	26,292	25,685
Revenue projection						**43,444**	**35,753**	**34,476**	**34,279**
Reported revenue	**29,897**	**30,601**	**38,526**	**43,572**	**49,346**				

Source: Jefferies estimates, company data

Assumptions: 1) Upfront payment of 20%; 2) balance is paid out over 3 years; 3) 5% discount on balance to account for the risk of project delay, change of project terms.

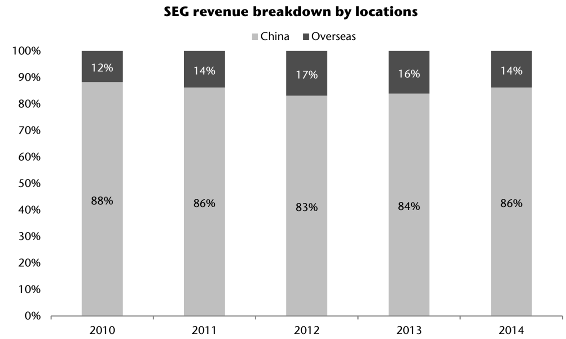
Notes: Value of backlog is company's total estimated contract value of work outstanding, net of estimated VAT, assuming performance in accordance with the terms.

Chart 47: New coal chemical industry has become a larger revenue contributor than oil refining. We expect headwinds for this industry.



Source: Jefferies, company data

Chart 48: Overseas expansion is inevitable, but competition will be more intense. Profitability will be lower as well.



Source: Jefferies, company data

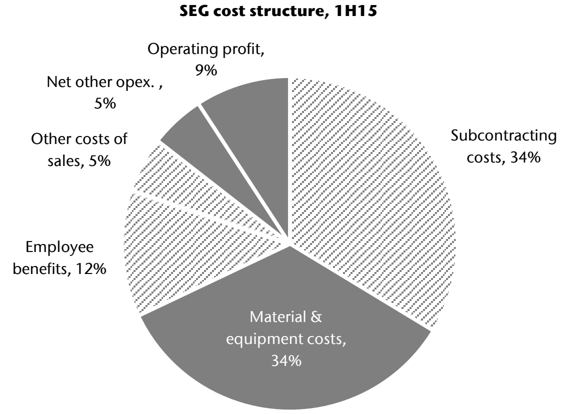
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Earnings depend on magnitude of cost cutting

If our view on a weak project outlook is correct, SEG will need to trim its cost base if it wants to drive headline earnings (and hopefully share price). This is easier said than done for SOEs that operate with social obligations.

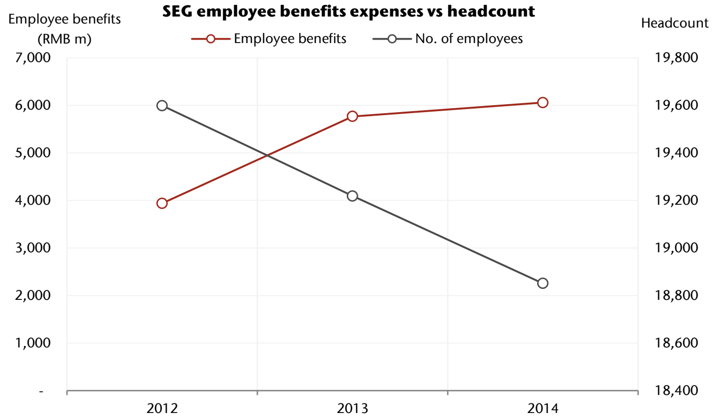
It is atypical for SOEs to slash headcount. Salary cut is a more common practice during tough times. Hence we have modelled in only 2% reduction in workforce every year till 2018. But we are assuming 5-10% cut in average compensation.

Chart 49: Subcontracting, employee benefits and others are 51% of revenue. We think these are the areas where cost cutting is possible.



Source: Jefferies estimates, company data

Chart 50: Headcount has declined 2% p.a. in the last 3 years. But employee expenses were up. There is room for cost reduction.



Source: Jefferies estimates, company data

Table 13: Margins

	2010 Actual	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast
Margins									
Gross margin	15%	17%	14%	15%	13%	15%	14%	15%	17%
Operating margin	11%	12%	10%	10%	8%	9%	8%	10%	11%
Pre-tax profit margin	12%	14%	11%	11%	9%	10%	9%	11%	12%
Net margin	10%	11%	9%	8%	7%	7%	7%	8%	9%

Source: Jefferies estimates, company data

Table 14: 1-year % change in major P&L items

	2010 Actual	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast
1-year change									
Revenue		2%	26%	13%	13%	(12)%	(18)%	(4)%	(1)%
Operating profit		12%	3%	15%	(8)%	(6)%	(22)%	12%	14%
Profit before taxation		15%	0%	12%	(4)%	(7)%	(19)%	12%	12%
Profit for the year		17%	(2)%	10%	(5)%	(7)%	(22)%	12%	12%

Source: Jefferies estimates, company data

SEG has sufficient cash to maintain dividend payout. Net cash is 40-50% of market cap. Even if SEG makes lower profit in the next 2-3 years, it can maintain 40% payout ratio.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Balance sheet & cash flows

Mid-ranking ROE among global peers

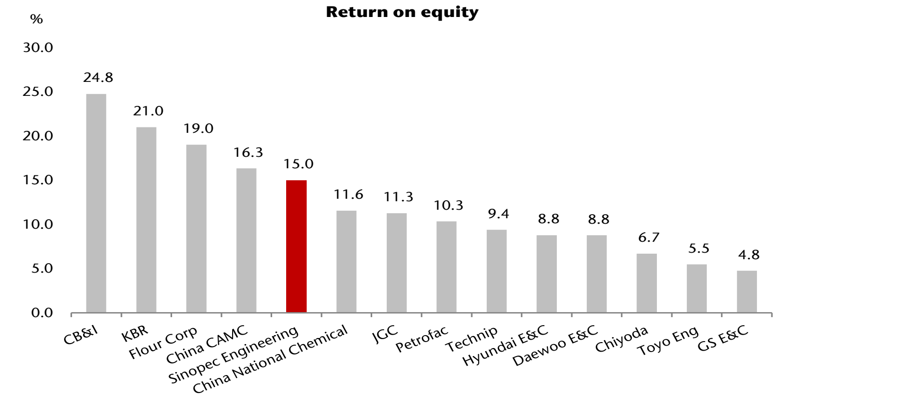
Net cash is 40-50% of market capitalization.

Most global E&C companies are in net cash position. SEG is no exception. SEG is the company with the strongest balance sheet among Sinopec Group subsidiaries.

The risk going forward is weaker revenue growth, which would lead to lower asset turnover, driving ROE lower.

Chart 51: Among global E&C peers, Sinopec is ranked in middle in ROE terms

Sinopec Engineering is ranked in the middle of the pack in terms of return on equity.



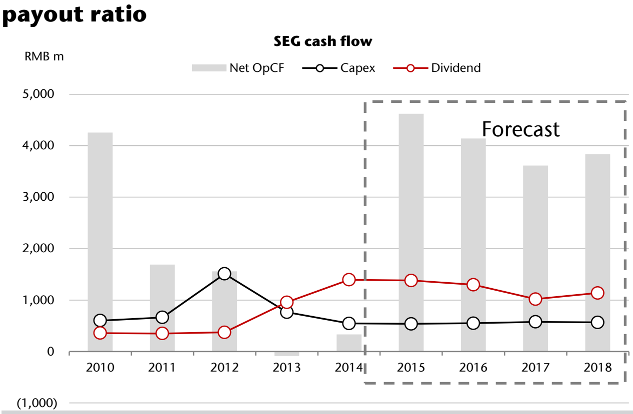
Source: Bloomberg

Table 15: ROE, ROIC and ROA estimates

Balance sheet ratios	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Asset Turnover (sales/assets)	0.8	0.7	1.0	0.9	0.9	0.8	0.7	0.7	0.6
Leverage Ratio (assets/equity)	4.0	16.2	5.2	2.3	2.3	2.1	1.9	1.9	1.8
Net Profit Margin	10%	11%	9%	8%	7%	7%	7%	8%	9%
ROE	**32%**	**123%**	**47%**	**17%**	**15%**	**13%**	**10%**	**10%**	**11%**
Core operating profit (excl. other gains)	3,232	3,641	3,788	4,331	3,848	3,683	2,879	3,241	3,731
Effective tax rate	21%	20%	22%	23%	23%	23%	25%	25%	25%
NOPAT	2540	2896	2956	3334	2951	2836	2159	2431	2798
Debt (incl. payables)	22,006	36,477	26,567	23,459	26,129	23,940	21,088	20,614	20,541
Equity	9,041	2,733	7,081	20,980	22,873	24,737	25,986	27,812	29,866
Invested capital	31,047	39,210	33,648	44,440	49,002	48,677	47,074	48,427	50,407
Average invested capital		35,129	36,429	39,044	46,721	48,840	47,876	47,750	49,417
ROIC		**8%**	**8%**	**9%**	**6%**	**6%**	**5%**	**5%**	**6%**
ROA	**8%**	**8%**	**9%**	**8%**	**7%**	**6%**	**5%**	**6%**	**6%**
Net debt to equity ratio; or Net cash (NC)	NC	NC	NC	NC	NC	NC	NC	NC	NC

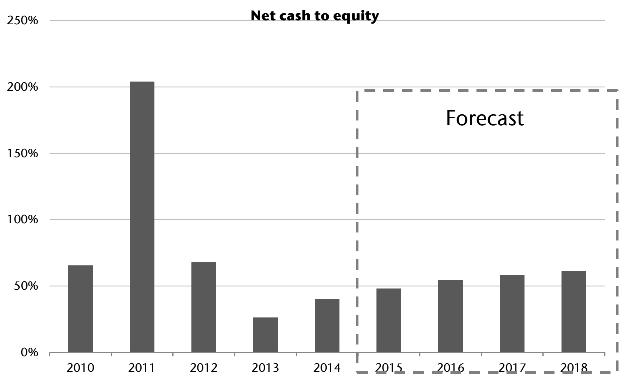
Source: Jefferies estimates, company data

Chart 52: SEG has sufficient cash to maintain 40% dividend payout ratio



Source: Jefferies estimates, company data

Chart 53: We expect SEG to remain in net cash position



Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Valuation and risks

Cheap on multiple metrics, but lacking catalysts

Stock looks cheap on multiple valuation metrics. But near term catalysts are lacking.

On our 2016 forecast, the stock is trading at 4% dividend yield, 9x P/B, against a deteriorating ROE from low teens in the last few years to 10%. Free cash flow yield, however, is strong at 15%. SEG may have longer term value for dividend investors, but on a 12-month horizon, there are no positive catalysts to drive share price.

SEG may need to slash costs to drive earnings, but that is easier said than done.

If our view on weak project outlook is correct, SEG will need to trim its cost base if it wants to drive headline earnings (and hopefully share price). This is easier said than done for SOEs that operate with social obligations.

Ultimately, investment decisions are closely linked to oil price recovery.

We will turn more constructive if crude prices rebound substantially, which would revive the investments on new coal chemicals. Otherwise, project visibility will become clearer soonest in 2017, as most SOE directed new projects would be finalized only after the 2nd year of FYP.

For now, we think that the stock is fairly valued. Initiate with a Hold rating.

Chart 54: Valuation

Latest exchange rate (HKD per 1 RMB)	1.18
Current share price (HKD)	6.43
12-month weighted book per share (HKD)	5.97
FY1 Remaining no. of months	9
FY2 Remaining no. of months	3
Target 12-month P/B multiple (x)	1.2
Price target (HKD)	6.90
Target upside/(downside)	7%

	2015 F'cast	2016 F'cast	2017 F'cast	2018 F'cast
Operating data				
BPS (RMB/share)	5.59	5.87	6.28	6.74
DPS (RMB/share)	0.29	0.23	0.26	0.29
EBITDA (RMB m)	4,401	3,562	3,944	4,439
FCF per share (RMB)	0.92	0.81	0.69	0.74
Implied multiple on current share price				
P/BV	0.98	0.93	0.87	0.81
ROE	13%	10%	10%	11%
EV/EBITDA	2.8	2.8	2.0	1.3
Dividend yield	5.4%	4.2%	4.7%	5.3%
FCF yield	16.9%	14.8%	12.5%	13.5%
Implied multiple on current share price				
P/BV	1.05	1.00	0.93	0.87
ROE	13%	10%	10%	11%
EV/EBITDA	3.2	3.3	2.5	1.7
Dividend yield	5.0%	3.9%	4.4%	4.9%
FCF yield	15.7%	13.8%	11.7%	12.6%

Source: Jefferies estimates, company data

Upside risks: Crude prices rebound sharply to above US$70-80/bbl, which would justify the economics of coal to chemical projects. Massive cost cutting will also bolster margin, though we believe this is unlikely to happen.

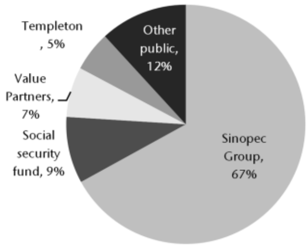
Downside risks: Lower than expected new contract wins.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Management bios

All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Chart 55: Sinopec Engineering shareholding structure



Source: Jefferies, Bloomberg

Table 16:Management bios

Senior personnel	Position	Background
Mr ZHANG Jianhua, 51	Chairman of SEG, since Jan 2015	Prior to joining SEG, Mr Zhang served in senior management positions in Sinopec Shanghai Gaoqiao Company and Sinopec Corp.
	Director & Senior VP of Sinopec Corp.	
Mr LU Dong, 51	Vice Chairman of SEG, since Jan 2015	Prior to joining SEG, Mr Lu served in senior management positions in Yangzi Petrochemical, Sinopec Corp, and Fujian Petrochemical Company.
Mr Yan Shaochun, 50	President & Executive Director of SEG, since April 2013	Prior to joining SEG, Mr Yan served in senior management positions in Luoyang Petrochemical Engineering Corporation, and Sinopec Guangzhou Engineering.
Mr JIA Yiqun, 52	Chief Financial Officer, since August 2012	Prior to joining SEG, Mr Jia held various positions in Sinopec Research Institute of Petroleum Engineering, China Petrochemical International Company, and Foreign Affairs Bureau of Sinopec Group.

Source: Jefferies, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial summary

Table 17:P&L statement

P&L (RMB m, Dec-YE)	2010	2011	2012	2013	2014	2015	2016	2017	2018
By clients	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Total revenue	**29,897**	**30,601**	**38,526**	**43,572**	**49,346**	**43,444**	**35,753**	**34,476**	**34,279**
% change YoY	NA	2%	26%	13%	13%	(12)%	(18)%	(4)%	(1)%
Gross profit	**4,539**	**5,074**	**5,528**	**6,406**	**6,291**	**6,303**	**4,871**	**5,259**	**5,794**
Operating profit	**3,338**	**3,725**	**3,832**	**4,413**	**4,039**	**3,792**	**2,972**	**3,340**	**3,822**
% change YoY	NA	12%	3%	15%	(8)%	(6)%	(22)%	12%	14%
Profit before taxation	**3,678**	**4,244**	**4,252**	**4,751**	**4,551**	**4,215**	**3,396**	**3,793**	**4,256**
Profit for the year	**2,890**	**3,375**	**3,317**	**3,657**	**3,490**	**3,246**	**2,547**	**2,845**	**3,192**
% change YoY	NA	17%	(2)%	10%	(5)%	(7)%	(22)%	12%	12%
Basic EPS (RMB/share)			1.07	0.93	0.79	0.73	0.58	0.64	0.72
Diluted EPS (RMB/share)			1.07	0.93	0.79	0.73	0.58	0.64	0.72
.. Regular dividend payout ratio				39%	40%	40%	40%	40%	40%
.. Total dividend per share (RMB)				0.46	0.31	0.29	0.23	0.26	0.29

Source: Jefferies estimates, company data

Table 18: Balance sheet

Balance sheet (RMB m, Dec-YE)	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Inventories	300	495	747	1,245	1,624	1,429	1,176	1,134	1,128
Notes & trade receivables	3,621	4,809	6,074	6,947	11,076	9,751	8,025	7,738	7,694
Prepayment & other receivables	3,619	4,466	4,659	4,608	5,368	4,726	3,889	3,751	3,729
Amounts due from customers for contract work	3,035	4,569	4,584	5,952	6,657	5,861	4,823	4,651	4,624
Loans due from ultimate holding co.	15,000	17,460	8,140	9,500	9,600	9,600	9,600	9,600	9,600
Restricted cash	54	37	24	19	26	26	26	26	26
Cash & cash equivalents	5,923	5,575	4,822	5,514	9,182	11,890	14,179	16,197	18,327
Others	311	0	-	5,413	500	500	500	500	500
Total current assets	**31,863**	**37,412**	**29,051**	**39,199**	**44,032**	**43,783**	**42,219**	**43,597**	**45,628**
Notes & trade payables	5,311	6,635	8,366	10,194	12,287	10,817	8,903	8,585	8,535
Other payables	9,743	23,224	11,802	8,361	7,827	7,827	7,827	7,827	7,827
Amounts due to customers for contract work	6,907	6,568	6,242	4,904	6,015	5,295	4,358	4,202	4,178
Loans due to fell subsidiaries	44	49	157	-	-	-	-	-	-
Others	1,169	1,413	195	162	219	219	219	219	219
Total current liabilities	**23,175**	**37,890**	**26,762**	**23,621**	**26,348**	**24,159**	**21,307**	**20,833**	**20,760**
P, P& E	2,708	3,463	3,834	4,049	4,090	4,020	3,980	3,955	3,904
Intangible assets	43	528	477	444	385	385	385	385	385
Others	1,575	3,002	3,768	3,673	3,578	3,578	3,578	3,578	3,578
Total non-current assets	**4,326**	**6,993**	**8,079**	**8,166**	**8,052**	**7,982**	**7,943**	**7,918**	**7,867**
Retirement and supplemental benefit obligations	3,600	3,374	2,878	2,397	2,530	2,530	2,530	2,530	2,530
Deferred income tax liabilities	45	47	369	330	302	302	302	302	302
Others	327	360	39	38	38	38	38	38	38
Total non-current liabilities	**3,973**	**3,781**	**3,286**	**2,764**	**2,864**	**2,870**	**2,870**	**2,870**	**2,870**
Share capital	400	400	3,100	4,428	4,428	4,428	4,428	4,428	4,428
Reserves	8,638	2,330	3,978	16,549	18,441	20,306	21,555	23,381	25,435
Shareholders' equity	**9,038**	**2,730**	**7,078**	**20,977**	**22,869**	**24,734**	**25,983**	**27,809**	**29,863**
Non-controlling interests	3	3	3	4	3	3	3	3	3
Total equity	**9,041**	**2,733**	**7,081**	**20,980**	**22,873**	**24,737**	**25,986**	**27,812**	**29,866**

Source: Jefferies estimates, company data

Table 19: Cash flow statement

Cashflow statement (RMB m, Dec-YE)	2010	2011	2012	2013	2014	2015	2016	2017	2018
Operating activities	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Operating cash flow		**(9,015)**	**13,300**	**5,553**	**3,636**	**3,854**	**3,137**	**3,448**	**3,809**
Net cash from operating activities	4,253	1,689	1,556	(86)	333	4,622	4,138	3,615	3,834
Net cash used in investing activities	(3,528)	(1,818)	(1,668)	(6,963)	4,725	(538)	(551)	(578)	(566)
Net cash from /(used in) financing activities	51	(184)	(644)	7,811	(1,397)	(1,376)	(1,298)	(1,019)	(1,138)
Net income/(decrease) in cash & cash equivalents	776	(313)	(756)	761	3,662	2,708	2,289	2,018	2,130
Cash - ending	5,923	5,575	4,822	5,514	9,182	11,890	14,179	16,197	18,327

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Corp.

An Interesting Hand of Cards

Key takeaway

We expect E&P losses to compel Sinopec Corp. to cut consolidated capex in 2016 by 20-25% from 2014 level. That should lead to improved cash flow. Among the three majors, Sinopec Corp. has the most competitive refining and chemical segment to offset upstream losses. Policy actions (price reform, curbing illegal sales of unqualified fuels, loosening of import/export control) will create opportunities for watchful investors.

Transfer coverage of Sinopec Corp. to Elaine Lai. BUY H share, PT HK$5.10; Hold A share, PT Rmb4.80.

Long term, product mix change is the key to maintaining profitability.

The strongest card: refining. Year to date, crude prices have been range-bound around US$30/bbl. Our view of the refining segment's outperformance is based on the assumption that crude prices will not fall massively from the current level, and that further losses due to inventory cost/selling price mismatch would be limited. Longer term, product mix change is the key to maintaining profitability. Currently, Sinopec Corp's diesel to gasoline production ratio is 1.3-1.4 to 1. As China moves to a more consumption-driven economy, diesel demand should weaken while gasoline demand strengthens. Sinopec Corp's refining upgrade projects in the last 2 years should bear fruit in 2016-2017 as the diesel/gasoline ratio is adjusted to 1:1.

In the chemical sector, only cost leaders will survive in the long term.

The nice card: chemical. China's chemical market is fragmented, with little product differentiation. In the long term, we believe only cost leaders will survive. We expect Sinopec Corp to consolidate the market, as it is able to control costs by self-producing feedstock (naphtha). Supply/demand balance drives margins. Hence, performance of each product varies. But the low oil prices should alleviate cost pressure, leaving room for producers to make a profit.

The wild card: E&P. In a low oil price world, E&P earnings visibility is nil. Yet, in the years past, E&P has been a key earnings contributor, till the oil price collapsed. The market may have been pricing in a distressed valuation for this segment. If that's the case, there is re-rating potential when oil prices recover.

We expect massive capex cut, and better cash flow.

We expect substantial capex cut. Parent co Sinopec Group owns 72% of Sinopec Corp; its major goal is to deleverage. In tough times, cash (in the form of dividend) is even more important to Sinopec Group. We expect annual capex in 2016 and 2017 to be 20-25% lower than 2014 level. After all, there is little justification to invest in declining domestic fields. Also, Sinopec Corp need not build any more large refineries to increase output at least in the next 2-3 years.

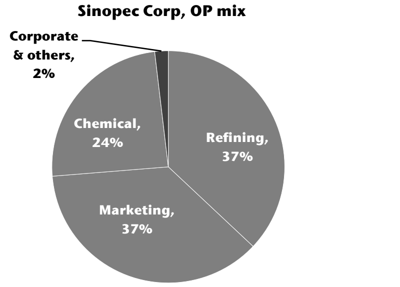
Valuation: The stock is trading on 6.4x EV/EBITDA on a 12-month weighted basis. Our target price is based on SOTP valuation. Key downside risks to our thesis are: 1) widening price discount in the marketing segment if the government does not stamp out the low quality substitution fuels; 2) parent co might inject uneconomical assets (overseas oil fields) into Sinopec Corp, adding to its financial burden.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial outlook

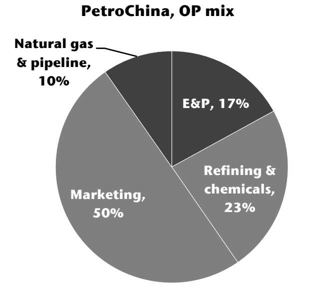
E&P economics is unfavourable in a low oil price world. Among the majors, only Sinopec Corp has a competitive refining & chemical business to profit from low crude prices.

Chart 56: Sinopec Corp: Downstream is 98% of OP



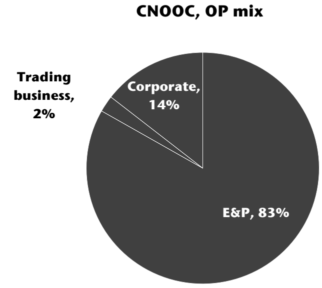
Source: Jefferies, company data

Chart 57: PetroChina: Downstream is 73% of OP



Source: Jefferies, company data

Chart 58: CNOOC: Zero exposure to downstream



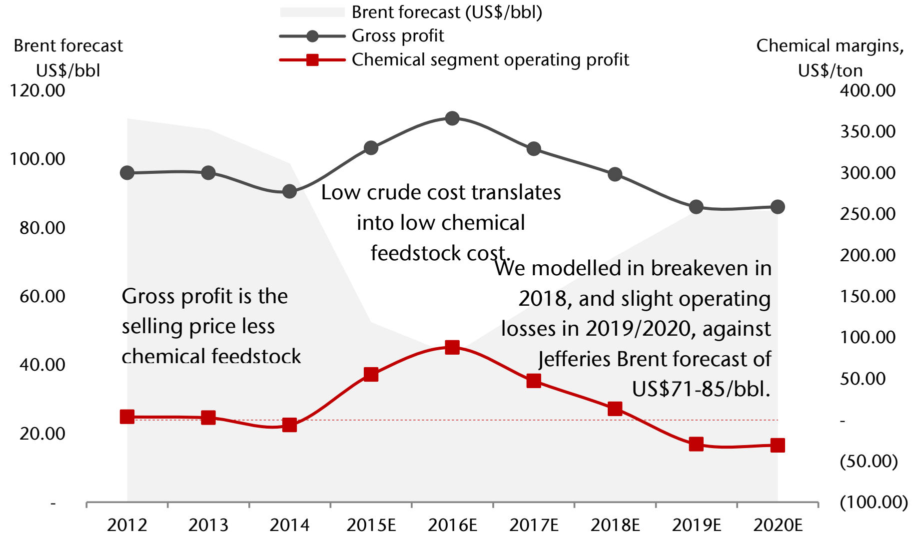
Source: Jefferies, company data

Chemical segment: Most Chinese chemical producers have low pricing power as they are focused on commodity grade products. Hence, business economics is all about input costs. An integrated producer like Sinopec Corp is able to control costs by producing its own chemical feedstock (naphtha). Historically, Sinopec Corp's chemical segment makes money when crude prices are below US$90/bbl, barring any wild swings in crude prices.

We observed that historically, Chinese chemical producers (incl. Sinopec Corp) struggle to break even when crude prices are near US$100/bbl.

Theoretically, the selling price should be feedstock cost plus a spread (gross profit). We assume that Sinopec Corp will try to charge a minimum spread (gross profit) to cover its operating expenses. However, Sinopec Corp may not be able to completely pass through feedstock cost increase in conditions such as weak demand/oversupply.

Chart 59: Sinopec Corp. chemical segment forecast



Source: Jefferies estimates, company data

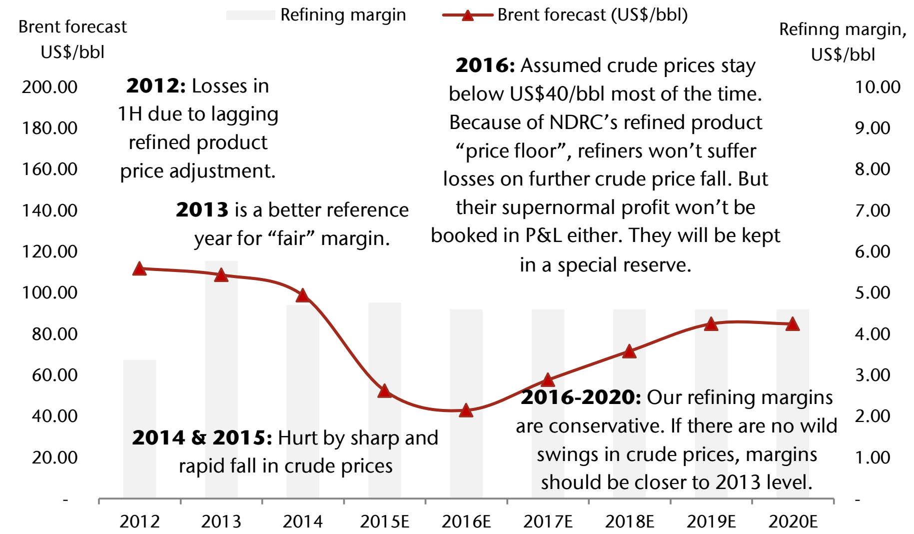
Refining segment: In the short term, refining margin is skewed by crude price volatilities, due to the mismatch between inventory lead time and product price adjustment. Year to date, crude prices have been range-bound around US$30/bbl. Our view of the refining segment's outperformance is based on the assumption that crude prices would not fall massively from current level (~US$30/bbl), and that further losses due to inventory cost/selling price mismatch would be limited. There are emerging risks to state refiners, such as 1) diesel oversupply, and 2) illegal sale of unqualified fuels (substitutes to National Standard 4/5 products) in markets where law enforcement is lax –

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

but we are not overly bearish on state refiners yet. Halting diesel capacity addition and curbing non-compliance is a key focus of “supply side reform”.

Over 80% of crude for Sinopec Corp’s refining throughput is imported. The lead time is 1.5-2 months. On the other hand, NDRC adjusts refined product prices to reflect changes in crude prices every 10 days. Hence, falling crude prices hurt Sinopec Corp’s refining margin, and vice versa.

Chart 60: Sinopec Corp. refining segment forecast



Source: Jefferies estimates, company data

Table 20: E&P segment – unit revenue and costs

	2012 Actual	2013 Actual	2014 Actual	2015 F'cast	2016 F'cast	2017 F'cast	2018 F'cast	2019 F'cast	2020 F'cast
Brent forecast (US$/bbl)	**111.96**	**108.80**	**98.83**	**52.52**	**43.00**	**57.75**	**71.75**	**85.00**	**85.00**
E&P segment (US$/boe)									
E&P revenue from sales of good	84.56	80.59	76.82	45.23	33.49	44.67	56.78	66.98	66.96
Other operating revenue	10.69	8.31	6.01	2.49	1.84	2.46	3.12	3.68	3.68
Production costs excl. taxes	(17.58)	(19.16)	(18.40)	(18.00)	(17.10)	(18.30)	(19.58)	(20.95)	(22.41)
Exploration expense	(5.75)	(4.62)	(3.99)	(4.00)	(4.00)	(3.60)	(3.60)	(3.60)	(3.60)
DD&A	(14.18)	(15.28)	(17.80)	(19.77)	(19.23)	(18.78)	(18.72)	(19.08)	(19.52)
Impairment	(0.37)	(0.93)	(0.89)	(1.10)	(1.10)	(1.10)	(1.10)	(1.10)	(1.10)
Special oil income levy	(10.86)	(9.38)	(8.07)	-	-	-	-	(2.83)	(2.83)
Resources tax	(2.82)	(2.69)	(2.64)	(1.55)	(1.15)	(1.53)	(1.95)	(2.30)	(2.30)
Other taxes	(1.06)	(2.54)	(3.77)	(2.22)	(1.64)	(2.19)	(2.78)	(3.28)	(3.28)
Non-production costs	(16.69)	(14.20)	(10.15)	(10.00)	(10.00)	(9.00)	(8.10)	(7.29)	(6.56)
Segment operating profit	25.95	20.12	17.12	(8.92)	(18.89)	(7.38)	4.07	10.22	9.03
F&D cost	(34.89)	(40.95)	(35.64)	(37.07)	(38.55)	(40.09)	(41.70)	(43.36)	(45.10)
Production costs	(17.58)	(19.16)	(18.40)	(18.00)	(17.10)	(18.30)	(19.58)	(20.95)	(22.41)
Proxy to all-in costs	(52.47)	(60.11)	(54.04)	(55.07)	(55.65)	(58.39)	(61.27)	(64.31)	(67.51)

Source: Jefferies estimates, company data

Table 21: Refining segment – unit revenue and costs

	2012 Actual	2013 Actual	2014 Actual	2015 F'cast	2016 F'cast	2017 F'cast	2018 F'cast	2019 F'cast	2020 F'cast
Refining segment (US$/bbl)									
Selling price	123.25	124.51	118.93	79.72	64.13	77.08	89.52	101.30	101.39
Refiner purchase price of crude	(110.98)	(107.43)	(103.67)	(52.52)	(38.50)	(51.98)	(64.58)	(76.50)	(76.50)
Consumption tax	(12.57)	(12.71)	(12.83)	(23.48)	(21.79)	(21.55)	(21.64)	(21.73)	(21.82)
Other feedstock rebate/(cost)	3.67	1.41	2.27	1.05	0.77	1.04	1.29	1.53	1.53
Refining margin	3.38	5.78	4.70	4.76	4.60	4.60	4.60	4.60	4.60

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Table 22: Chemical segment – unit revenue and costs

	2012	2013	2014	2015	2016	2017	2018	2019	2020
	Actual	Actual	Actual	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast
Chemical segment (US$/t)									
Selling price	1,248.70	1,282.73	1,191.03	895.49	789.72	852.87	917.30	967.45	967.65
Cost of feedstock	(948.36)	(805.92)	(751.13)	(456.50)	(383.71)	(481.96)	(575.04)	(663.16)	(663.50)
Gross profit	300.34	300.11	277.80	330.55	366.45	329.31	298.45	259.04	258.88
Depreciation	(27.43)	(32.08)	(34.46)	(34.01)	(31.01)	(30.56)	(30.11)	(29.67)	(29.23)
Impairment	-	-	(3.14)	(3.01)	(2.66)	(2.55)	(2.44)	(2.33)	(2.23)
Other costs	(292.71)	(339.99)	(317.64)	(310.79)	(288.79)	(290.40)	(292.07)	(293.82)	(295.63)
Chemical segment operating profit	3.64	2.59	(6.20)	55.02	87.94	47.47	13.59	(29.45)	(30.89)

Source: Jefferies estimates, company data

Table 23: Marketing segment – unit revenue and costs

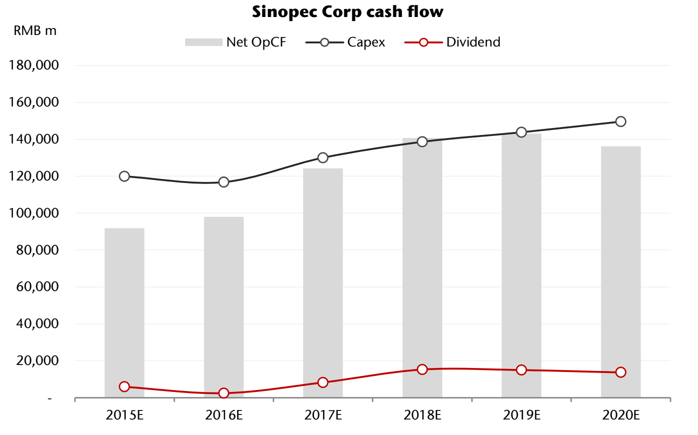
	2012	2013	2014	2015	2016	2017	2018	2019	2020
	Actual	Actual	Actual	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast
Marketing segment (US$/bbl)									
Selling price	155.63	154.76	150.46	109.68	90.78	105.74	120.34	134.25	134.72
Cost of purchase	(143.13)	(144.13)	(141.25)	(101.55)	(83.34)	(98.37)	(112.98)	(126.89)	(127.36)
Gross profit	12.50	10.63	9.21	8.13	7.43	7.36	7.36	7.36	7.36
As % of cost of purchase	0.09	0.07	0.07	0.08	0.09	0.07	0.07	0.06	0.06
Other taxes	(2.33)	(2.42)	(2.46)	(1.80)	(1.49)	(1.73)	(1.97)	(2.20)	(2.21)
Cash operating cost (reported)	(3.95)	(4.34)	(4.26)	(4.22)	(3.94)	(3.97)	(4.01)	(4.05)	(4.09)
Other rebate/(costs)	(1.67)	(0.11)	0.51	-	-	-	-	-	-
Other operating revenue	0.93	1.04	1.31	1.59	1.32	1.53	1.74	1.95	1.95
Depreciation	(0.94)	(1.15)	(1.28)	(1.19)	(1.07)	(1.04)	(1.01)	(0.99)	(0.96)
Impairment	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Segment operating profit	4.54	3.64	3.03	2.52	2.26	2.14	2.11	2.06	2.05

Source: Jefferies estimates, company data

Balance sheet & cash flow

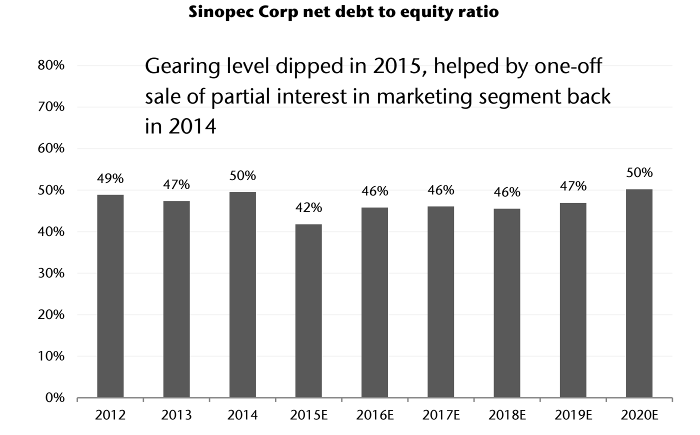
Sinopec Corp's net debt to equity ratio mirrors that of its parent Sinopec Group – it is consistently over 50%, far above global peers' high teens to low twenties. That was because Sinopec Group aggressively acquired overseas assets in the early 2000s. Gearing level is likely to remain elevated, though we expect Sinopec Group to do various fund raising activities via its listed subsidiaries.

Chart 61: Cash flow



Source: Jefferies estimates, company data

Chart 62: Gearing level



Source: Jefferies estimates, company data

We expect massive capex cut, and better cash flow.

We expect widening E&P losses, which should impel a massive capex cut, leading to improved cashflow. Parent co Sinopec Group owns 72% of Sinopec Corp; its major goal is to deleverage. In tough times, cash (in the form of dividend) is even more important to Sinopec Group. We expect annual capex in 2016 and 2017 to be 20-25% lower than 2014's level. After all, there is little justification to invest in declining domestic fields. Also,

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

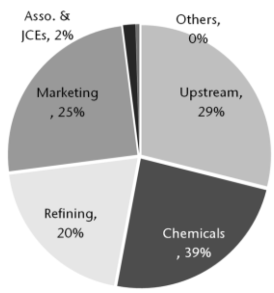
refining upgrade projects have been almost complete. Whether in China or global oil sector, strong FCF and stable dividend is a rarity. That adds to the appeal of Sinopec Corp, in our view.

Table 24: ROE, ROIC and ROA estimates

Balance sheet ratios (Dec-YE)	2012	2013	2014	2015	2016	2017	2018	2019	2020
	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Asset Turnover (sales/assets)	2.2	2.1	1.9	1.6	1.5	1.7	1.9	2.0	2.1
Leverage Ratio (assets/equity)	2.3	2.2	2.2	2.1	2.1	2.1	2.2	2.2	2.2
Net Profit Margin	2.4%	2.4%	1.7%	0.6%	0.2%	0.7%	1.1%	1.0%	0.9%
ROE	12%	11%	7%	2%	1%	3%	5%	4%	4%
Core operating profit, excl. other gains (RMB m)	46,195	49,721	29,214	(16,536)	(23,192)	(13,505)	(982)	(8,277)	(13,603)
Effective tax rate	26%	26%	27%	27%	27%	27%	27%	27%	27%
NOPAT (RMB m)	34,042	36,768	21,378	(12,071)	(16,930)	(9,859)	(717)	(6,042)	(9,930)
Debt (RMB m)	324,232	291,180	301,864	301,864	301,864	301,864	301,864	301,864	301,864
Equity (RMB m)	548,036	621,626	645,577	633,165	632,027	645,653	667,132	681,018	692,704
Invested capital (RMB m)	872,268	912,806	947,441	935,029	933,891	947,517	968,996	982,882	994,568
Average invested capital (RMB m)		892,537	930,124	941,235	934,460	940,704	958,257	975,939	988,725
ROIC		**4%**	**2%**	**(1)%**	**(2)%**	**(1)%**	**(0)%**	**(1)%**	**(1)%**
ROA	**5%**	**5%**	**3%**	**1%**	**0%**	**1%**	**2%**	**2%**	**2%**
Net debt to equity ratio	49%	47%	50%	42%	46%	46%	46%	47%	50%

Source: Jefferies estimates, company data

Chart 63: Breakdown of Sinopec Corp's target share price



Source: Jefferies estimates

Valuation and risks

Sinopec Corp.'s H share is trading on 6-7x EV/EBITDA, in-line with global peers that have de-rated. E&P, refining and chemicals segments make up 73% of our target price, and are the major earnings contributors. However, in a low oil price world, E&P is loss making. Should the oil price rebound, E&P earnings and operating cash flow will recover, boosting our valuation target.

We transfer coverage from Laban Yu to Elaine Lai, and reiterate our Buy recommendation on the H share, and Hold rating on A share. Price targets are based on sum of the parts valuation detailed below.

Key downside risks to our thesis are: 1) widening price discount in the marketing segment if the government does not stamp out low-quality substitution fuels; 2) parent co might inject uneconomical assets (overseas oil fields) to Sinopec Corp, adding to its financial burden.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 64: Sum of the parts valuation

	12m weighted	Key assumptions
Upstream		
DACF weighted 12 months (RMB m)	35,218	Our valuation is more weighted towards 2016, a year which many energy investors found to be a "lost year". Hence, instead of assigning a distressed multiple to an already depressed cashflow stream, we used a mid cycle multiple for global E&P companies.
x Target multiple	7.0	
Target EV (RMB m)	246,525	
Refining		
EBITDA weighted 12 months (RMB m)	21,344	China's refining market is oligopolistic, with state refiners controlling 87% of capacity. Hence, refining is supposed to be the most sustainable business under Sinopec Corp. Its multiple is benchmarked against regional peers.
x Target multiple	8.0	
Target EV (RMB m)	170,748	
Marketing		
EBITDA weighted 12 months (RMB m)	38,805	The fuel retailing market is more fragmented than the refining market. Margins are thin, and Sinopec Corp (like other SOEs) faces the threat of widening retail discount. Hence, a lower multiple than the refining segment is assigned.
x Target multiple	5.5	
Target EV (RMB m)	213,429	
Chemicals		
EBITDA weighted 12 months (RMB m)	45,488	The chemical segment's profitability is bumped up in a low oil price environment. In a high oil price environment, its contribution to company value will not be as high. We assigned a lower multiple relative to refining segment, while benchmarking against regional peers.
x Target multiple	4.5	
Target EV (RMB m)	204,694	
Associates & JCE's		
EBITDA weighted 12 months (RMB m)	2,632	Negligible contribution to valuation.
x Target multiple	5.0	
Target EV (RMB m)	13,159	
Other		
EBITDA weighted 12 months (RMB m)	794	Negligible contribution to valuation.
x Target multiple	5.0	
Target EV (RMB m)	3,970	
Target Enterprise Value	852,525	
- Net Debt	291,305	
- Minorities	52,536	
Target Market cap (RMB m)	508,684	
÷ Shares outstanding	117,242	
Sub-total	4.34	
A share premium 15%	0.43	
12-month Price target for A share (Rmb/share)	**4.80**	
Current share price	4.34	
Upside/(downside)	11%	
x Exchange rate (HKD/RMB)	1.18	
12-month Price target for H share (HK$/share)	**5.10**	
Current share price	4.12	
Upside/(downside)	24%	

Source: Jefferies estimates, company data

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Chart 65: Implied valuation multiples on current and target prices

H share target price	HKD	5.10				
A share target price	RMB	4.80				

	2015	2016	2017	2018	2019	2020
On H share:	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast
Operating data						
Net debt/equity, assume constant cash	41.8%	45.8%	46.1%	45.5%	46.9%	50.2%
Asset turnover (sales/assets)	1.60	1.50	1.70	1.87	2.03	2.06
Leverage ratio (assets/equity)	2.11	2.07	2.14	2.19	2.25	2.25
Net margin	0.6%	0.2%	0.7%	1.1%	1.0%	0.9%
ROE	1.9%	0.8%	2.6%	4.6%	4.4%	4.0%
ROA	0.9%	0.4%	1.2%	2.1%	2.0%	1.8%
Implied multiple on current share price, H share						
P/BV	0.64	0.65	0.63	0.61	0.60	0.59
ROE	1.9%	0.8%	2.6%	4.6%	4.4%	4.0%
EV/EBITDA	5.90	6.57	5.80	5.02	5.06	5.25
Dividend yield	1.4%	0.6%	2.0%	3.7%	3.7%	3.3%
FCF yield	(6.9)%	(4.6)%	(1.4)%	0.5%	(0.2)%	(3.3)%
Implied multiple on current share price, A share						
P/BV	0.80	0.80	0.79	0.76	0.74	0.73
ROE	1.9%	0.8%	2.6%	4.6%	4.4%	4.0%
EV/EBITDA	6.44	7.15	6.32	5.47	5.51	5.70
Dividend yield	1.2%	0.5%	1.6%	3.0%	2.9%	2.7%
FCF yield	(6.9)%	(4.6)%	(1.4)%	0.5%	(0.2)%	(3.3)%
Implied multiple on A share price target						
P/BV	0.89	0.89	0.87	0.84	0.82	0.81
ROE	1.9%	0.8%	2.6%	4.6%	4.4%	4.0%
EV/EBITDA	8.19	8.80	7.70	6.61	6.53	6.54
Dividend yield	1.0%	0.4%	1.5%	2.7%	2.7%	2.4%
FCF yield	(5.0)%	(3.4)%	(1.0)%	0.4%	(0.1)%	(2.4)%
Implied multiple on H share price target						
P/BV	0.80	0.80	0.79	0.76	0.74	0.73
ROE	1.9%	0.8%	2.6%	4.6%	4.4%	4.0%
EV/EBITDA	7.12	7.66	6.70	5.75	5.68	5.69
Dividend yield	1.2%	0.5%	1.6%	3.0%	2.9%	2.7%
FCF yield	(5.5)%	(3.7)%	(1.1)%	0.4%	(0.1)%	(2.6)%

Source: Jefferies estimates, Bloomberg

Management bios

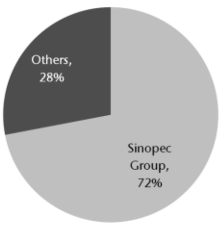
All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Table 25: Management bios

Senior management	Position	Background
Mr WANG Yupu, aged 60	Chairman	Mr Wang is an oil industry veteran and former Deputy Director of China Academy of Engineering. Mr Wang holds a PhD in Petroleum Engineering from the China University of Petroleum (Beijing).
Mr MA Yongsheng, aged 54	Senior Vice President	Mr. Ma is a professor level senior engineer with a Ph.D. degree and an academician of the Chinese Academy of Engineering. Prior to his current role, Mr Ma served in Sinopec Southern Exploration and Production Branch, and Sichuan-East China Gas Transmission Construction Project Headquarters.
Ms WEN Dongfen, aged 51	Chief Financial Officer	Ms. Wen is a professor level senior accountant with a university diploma. Ms. Wen Dongfen now serves as Director of Sinopec Shanghai Engineering Co. Ltd., Sinopec International Petroleum Exploration and Production Corporation and Sinopec Insurance Co., Ltd. She also serves as the Supervisor of Sinopec Oilfield Service Corporation, Vice Chairman of Sinopec Finance Company Limited and Director of Sunshine Insurance Group.

Source: Jefferies, company data

Chart 66: Sinopec Corp shareholding structure (H+A)



Source: Jefferies, Bloomberg

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial summary

Chart 67: P&L statement

	2012 Actual	2013 Actual	2014 Actual	2015 F'cast	2016 F'cast	2017 F'cast	2018 F'cast	2019 F'cast	2020 F'cast
Key items (RMB m)									
Sales of goods	2,733,618	2,833,247	2,781,641	2,093,917	1,932,664	2,296,354	2,677,256	3,053,967	3,148,020
Other operating revenues	52,427	47,064	44,273	39,347	36,788	42,625	48,865	54,824	56,490
Total operating revenues	2,786,045	2,880,311	2,825,914	2,133,265	1,969,451	2,338,978	2,726,121	3,108,792	3,204,511
Operating profit	98,622	96,785	73,487	22,811	13,595	29,119	47,883	46,548	42,888
Net income	66,796	70,289	47,933	11,778	4,867	16,552	30,645	30,041	27,461
1-year change									
Sales of goods		4%	(2)%	(25)%	(8)%	19%	17%	14%	3%
Other operating revenues		(10)%	(6)%	(11)%	(7)%	16%	15%	12%	3%
Total operating revenues		3%	(2)%	(25)%	(8)%	19%	17%	14%	3%
Operating profit		(2)%	(24)%	(69)%	(40)%	114%	64%	(3)%	(8)%
Net income		5%	(32)%	(75)%	(59)%	240%	85%	(2)%	(9)%
P&L (RMB m)									
E&P	70,054	54,793	47,057	(24,362)	(53,124)	(21,160)	12,022	30,900	27,931
Refining	(11,444)	8,599	(1,954)	1,210	4,522	4,585	4,233	3,867	4,042
Marketing	42,652	35,143	29,449	26,486	26,500	25,758	25,968	26,092	26,536
Chemicals	1,178	868	(2,181)	20,214	36,499	20,592	6,161	(13,960)	(15,306)
Corporate & others	(2,443)	(2,443)	(1,063)	(737)	(802)	(655)	(502)	(351)	(316)
Plug	(1,375)	(175)	2,179						
Operating profit	98,622	96,785	73,487	22,811	13,595	29,119	47,883	46,548	42,888
1-year change									
E&P			(14)%	(52)%	118%	151%	57%	157%	(10)%
Refining			(23)%	62%	274%	1%	(8)%	(9)%	5%
Marketing			(16)%	(10)%	0%	(3)%	1%	0%	2%
Chemicals			(251)%	927%	81%	(44)%	(70)%	(227)%	10%
Corporate & others			130%	44%	9%	22%	30%	43%	11%
Plug			1245%	(100)%					
Operating profit			(24)%	(69)%	(40)%	114%	64%	(3)%	(8)%
Mix									
E&P	71%	57%	64%	(107)%	(391)%	(73)%	25%	66%	65%
Refining	(12)%	9%	(3)%	5%	33%	16%	9%	8%	9%
Marketing	43%	36%	40%	116%	195%	88%	54%	56%	62%
Chemicals	1%	1%	(3)%	89%	268%	71%	13%	(30)%	(36)%
Corporate & others	(2)%	(3)%	(1)%	(3)%	(6)%	(2)%	(1)%	(1)%	(1)%
Plug	(1)%	(0)%	3%	0%	0%	0%	0%	0%	0%
Operating profit	100%	100%	100%	100%	100%	100%	100%	100%	100%
Interest expense	(11,217)	(10,602)	(11,218)	(11,218)	(11,218)	(11,218)	(11,218)	(11,218)	(11,218)
As % of debt	4.0%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
Interest income	1,254	1,568	1,779	1,779	1,779	1,779	1,779	1,779	1,779
Others	82	4,788	(4,790)	-	-	-	-	-	-
Net finance costs	(9,881)	(4,246)	(14,229)	(9,439)	(9,439)	(9,439)	(9,439)	(9,439)	(9,439)
Investment income, income from assoc./JCE	1,861	2,513	6,246	2,762	2,511	2,994	3,536	4,044	4,170
Pre-tax profit	90,642	95,052	65,504	16,135	6,667	22,675	41,979	41,152	37,618
Tax exp.	(23,846)	(24,763)	(17,571)	(4,356)	(1,800)	(6,122)	(11,334)	(11,111)	(10,157)
Net income	66,796	70,289	47,933	11,778	4,867	16,552	30,645	30,041	27,461
.. To shareholders	63,879	66,132	46,466	11,418	4,718	16,046	29,707	29,122	26,621
.. To non-controlling interests	2,917	4,157	1,467	360	149	507	938	919	840
Basic EPS (RMB/share)	0.57	0.57	0.40	0.10	0.04	0.14	0.25	0.25	0.23
Diluted EPS (RMB/share)	0.54	0.54	0.40	0.10	0.04	0.14	0.25	0.25	0.23
Effective tax rate	26.3%	26.1%	26.8%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%
Basic share count	112,854	116,103	116,822	116,822	116,822	116,822	116,822	116,822	116,822
Diluted share count	118,412	121,859	117,242	117,242	117,242	117,242	117,242	117,242	117,242
Total dividends	26,046	27,976	23,830	5,856	2,420	8,229	15,235	14,935	13,652
Dividend payout ratio	41%	42%	51%	51%	51%	51%	51%	51%	51%

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 68: Balance sheet statement

	2012 Actual	2013 Actual	2014 Actual	2015 F'cast	2016 F'cast	2017 F'cast	2018 F'cast	2019 F'cast	2020 F'cast
Non-current assets									
E&P	293,146	354,331	385,629	386,311	384,927	395,223	411,975	430,976	452,205
Refining	125,212	137,417	150,402	153,681	155,691	159,085	162,553	166,097	169,718
Chemicals	67,416	75,848	79,618	80,867	81,511	81,908	82,182	82,182	82,182
Marketing	93,472	111,831	126,340	142,578	158,817	175,055	191,293	207,532	223,770
Corporate & others	9,723	10,388	12,429	13,988	15,547	17,106	18,665	20,224	21,783
PP&E	588,969	689,815	754,418	777,425	796,492	828,378	866,668	907,010	949,657
Others	312,709	320,091	336,806	229,712	229,712	229,712	229,712	229,712	229,712
Total non-current assets	**901,678**	**1,009,906**	**1,091,224**	**1,007,137**	**1,026,204**	**1,058,090**	**1,096,380**	**1,136,722**	**1,179,369**
Current assets									
Cash and cash equivalents	10,456	15,046	9,355	64,501	39,808	31,673	25,468	9,497	(18,842)
Inventories	218,262	221,906	188,223	140,269	129,498	153,796	179,252	204,414	210,708
Receivables and prepayments	135,889	136,003	161,821	122,736	113,311	134,571	156,845	178,862	184,369
Others	408	55	745	745	745	745	745	745	745
Total current assets	**365,015**	**373,010**	**360,144**	**328,251**	**283,362**	**320,785**	**362,310**	**393,517**	**376,979**
Total assets	**1,266,693**	**1,382,916**	**1,451,368**	**1,335,389**	**1,309,567**	**1,378,875**	**1,458,690**	**1,530,239**	**1,556,348**
Long term debt	124,518	107,234	107,787	107,787	107,787	107,787	107,787	107,787	107,787
Loans from Sinopec Group companies	37,598	38,356	43,145	43,145	43,145	43,145	43,145	43,145	43,145
Others	43,168	43,878	50,602	50,602	50,602	50,602	50,602	50,602	50,602
Total non-current liabilities	**205,284**	**189,468**	**201,534**	**201,534**	**201,534**	**201,534**	**201,534**	**201,534**	**201,534**
Current liabilities									
Short-term debt	73,063	109,806	75,183	75,183	75,183	75,183	75,183	75,183	75,183
Loans from Sinopec Group companies	42,919	54,064	102,965	102,965	102,965	102,965	102,965	102,965	102,965
Accruals and payables	391,346	404,856	425,018	321,451	296,767	352,449	410,785	468,448	482,871
Others	6,045	3,096	1,091	1,091	1,091	1,091	1,091	1,091	1,091
Total current liabilities	**513,373**	**571,822**	**604,257**	**500,690**	**476,006**	**531,688**	**590,024**	**647,687**	**662,110**
Equity									
Share capital	86,820	116,565	118,280	118,280	118,280	118,280	118,280	118,280	118,280
Reserves	424,094	452,238	474,761	462,349	461,211	474,837	496,316	510,202	521,888
Shareholders' equity	**510,914**	**568,803**	**593,041**	**580,629**	**579,491**	**593,117**	**614,596**	**628,482**	**640,168**
Non-controlling interests	37,122	52,823	52,536	52,536	52,536	52,536	52,536	52,536	52,536
Total equity	**548,036**	**621,626**	**645,577**	**633,165**	**632,027**	**645,653**	**667,132**	**681,018**	**692,704**

Source: Jefferies estimates, company data

Chart 69: Cash flow statement

	2012 Actual	2013 Actual	2014 Actual	2015 F'cast	2016 F'cast	2017 F'cast	2018 F'cast	2019 F'cast	2020 F'cast
Operating activities									
EBIT				22,811	13,595	29,119	47,883	46,548	42,888
D&A				96,926	97,753	98,165	100,374	103,507	106,975
Interest income				1,779	1,779	1,779	1,779	1,779	1,779
Interest expense				(11,218)	(11,218)	(11,218)	(11,218)	(11,218)	(11,218)
Tax paid				(4,356)	(1,800)	(6,122)	(11,334)	(11,111)	(10,157)
Others				2,402	2,362	2,488	2,598	3,124	3,329
Operating cash flow				**108,344**	**102,472**	**114,211**	**130,081**	**132,629**	**133,596**
Changes in working capital:									
Inventories				47,954	10,771	(24,298)	(25,456)	(25,162)	(6,294)
Receivables and others				39,085	9,425	(21,260)	(22,274)	(22,017)	(5,507)
Payables and others				(103,567)	(24,684)	55,682	58,337	57,663	14,423
Net cash flow from operating				**91,815**	**97,984**	**124,335**	**140,688**	**143,113**	**136,218**
Investing activities									
Exploration and production	(78,272)	(105,311)	(80,196)	(54,670)	(52,700)	(64,186)	(72,083)	(76,677)	(81,566)
Refining	(32,161)	(26,064)	(27,957)	(19,673)	(18,761)	(20,364)	(20,808)	(21,262)	(21,725)
Marketing and distribution	(27,232)	(29,486)	(26,989)	(28,729)	(28,729)	(28,729)	(28,729)	(28,729)	(28,729)
Chemicals	(18,996)	(19,189)	(15,850)	(13,743)	(13,512)	(13,652)	(13,925)	(14,062)	(14,484)
Corporate and other	(2,061)	(5,076)	(3,648)	(3,118)	(3,118)	(3,118)	(3,118)	(3,118)	(3,118)
Capex	(158,722)	(185,126)	(154,640)	(119,933)	(116,821)	(130,050)	(138,664)	(143,848)	(149,622)
Acquisition									
Others									
Net cash flow from investing				**(119,933)**	**(116,821)**	**(130,050)**	**(138,664)**	**(143,848)**	**(149,622)**
Financing activities									
Issue of new shares									
Borrowings and bond				-	-	-	-	-	-
Dividends paid				(23,830)	(5,856)	(2,420)	(8,229)	(15,235)	(14,935)
Others				107,094					
Net cash flow from financing				**83,264**	**(5,856)**	**(2,420)**	**(8,229)**	**(15,235)**	**(14,935)**
Net increase in cash				55,146	(24,693)	(8,135)	(6,206)	(15,971)	(28,339)
Cash at beginning of the year				9,355	64,501	39,808	31,673	25,468	9,497
Exchange loss					0	0	0	0	0
Cash at end of the year			**9,355**	**64,501**	**39,808**	**31,673**	**25,468**	**9,497**	**(18,842)**

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Shanghai Petrochemical (SSP)

Oil Price Optionality

Key takeaway

SSP is mispriced, in our view. The stock has been flying under the investors' radar, perhaps because of modelling complexity, and mixed results in the past. We think that 2016 is a year when the stars align. In a (prolonged) low oil price world, integrated refining and chemical producers will shine.

Transfer coverage of Sinopec Shanghai Petrochemical to Elaine Lai. BUY H share, PT HK$4.20; Underperform A share, PT Rmb4.10.

Oil price optionality, strike at US$60: 1) For the chemical segment, input costs drive selling prices; supply/demand balance drive margins. Hence, the performance of each chemical product varies. But the low crude prices should alleviate cost pressure, leaving room for chemical producers to profit. We observe that historically, SSP usually stays profitable when crude prices are below US$60/bbl (Charts 23-25). **2)** For refining, volatilities in crude prices skew short term margins. Supply/demand balance drives long term margins. Our view of the refining segment's outperformance is based on the assumption that crude prices would not fall massively from the current level, and that further losses from the inventory cost/selling prices mismatch would be limited. **3)** Should crude rebound beyond US$40/bbl (NDRC lower limit), refining segment may be able to arbitrage on the short-term mismatch between inventory cost and product prices. Lead time for crude inventory is 1.5-2 months, while NDRC adjusts refined oil prices every 10 days to align with crude price changes. Hence, the refining segment will be processing cheap inventory when crude is on the way up.

We prefer SSP over Sinopec Corp, we prefer SSP, as it is unencumbered by upstream.

Integrated refining and chemical is the most actionable space in a low oil price world. Investors can get exposure through both Sinopec Corp and SSP, but we prefer SSP, as it is unencumbered by upstream. It does not face a pricing discount risk at the fuel retailing level like Sinopec Corp does, as it does not have a marketing segment. SSP runs about 7% of Sinopec Corp's refining capacity, and is exposed to the strongest end market, Eastern China. Hence, SSP usually makes a slightly higher refining margin than Sinopec Corp. and the national average.

Under the amended dividend policy, SSP's 3-year cumulative dividend must be at least 30% of cumulative profit.

Valuation/risks: Historically, SSP's earnings have been difficult to predict, due to the mixed performance of its various segments. The record low crude prices increase the potential for both refining and chemical to outperform. Hence, 2016 might be a rare window opportunity for investors to revisit SSP. Also, under the amended dividend policy, SSP's 3-year cumulative dividend must be at least 30% of cumulative profit. Hence, SSP would have to make up the dividend payment in good years. The H share is trading on 3.4x 2016 EV/EBITDA on our forecast. We think that the risk/reward looks attractive. Our PT is based on a 12-month weighted SOTP valuation. Downside risks to our thesis are 1) supply glut in chemical products. If that happens, then margin will narrow as producers may have to compete on prices; 2) influx of low quality fuel supply into the market. This is a smaller risk to Shanghai Petrochemical than to other state refiners, as fuel standard enforcement in Eastern China is the strictest in the country, and the region is already moving towards National Standard 6 (vs. Standard 4 and 5 in the rest of the country).

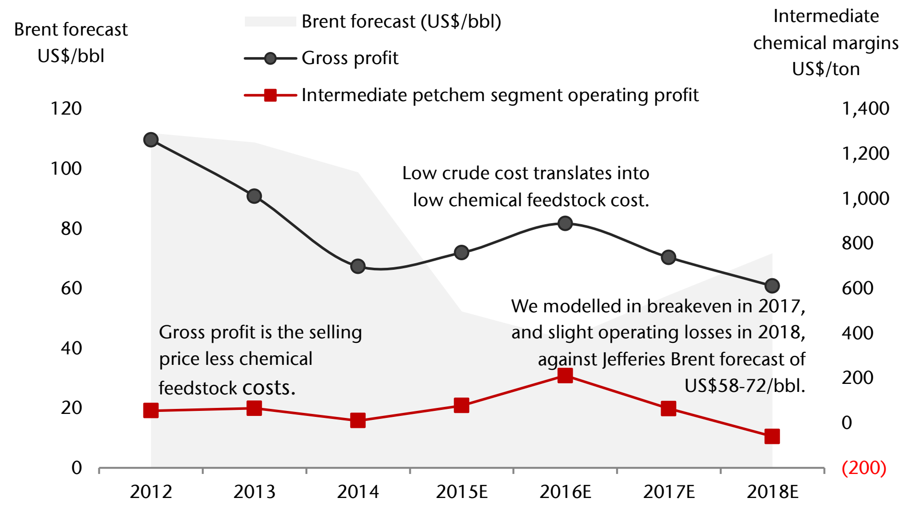
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial outlook

For the chemical segment, input costs drive selling prices; supply/demand balance drive margins. Hence, the performance of each chemical product varies. But the low crude prices should alleviate cost pressure, leaving room for chemical producers to profit. We observe that historically, SSP usually stays profitable when crude prices are below US$60/bbl.

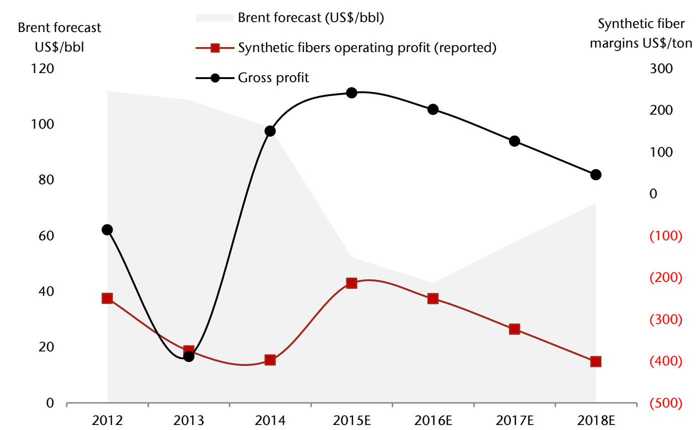
If crude falls from current level, chemical segment should still be in-the-money, assuming no sudden influx of domestic supply.

Chart 70: SSP intermediate chemical segment



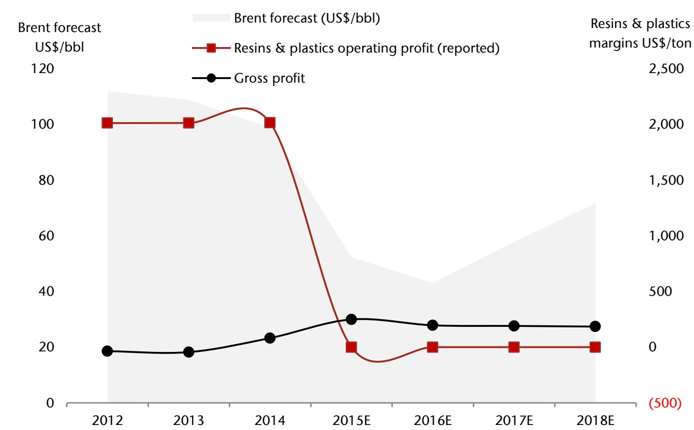
Source: Jefferies estimates, company data

Chart 71: SSP synthetic fibers segment forecast



Source: Jefferies estimates, company data

Chart 72: SSP resins & plastics segment forecast



Source: Jefferies estimates, company data

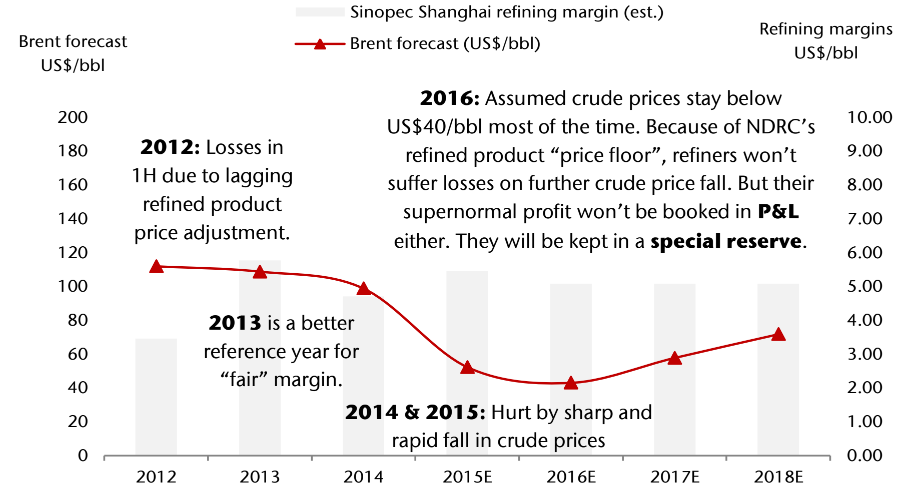
If crude rebounds past US$40/bbl (NDRC lower limit), the refining segment may be able to arbitrage on the short-term mismatch between inventory cost and product prices. Lead time for crude inventory is 1.5-2 months, while NDRC adjusts refined oil prices every 10 days to align with crude price changes. Hence, the refining segment will be processing cheap inventory when crude is on the way up.

Our view of refining segment's outperformance is based on the assumption that crude prices would not fall massively from the current level, and that further losses due to inventory cost/selling price mismatch would be limited. Long term, product mix change is the key to maintaining profitability.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

SSP does not disclose its refining margin (selling prices less cost of crude), so we have to estimate it by observing market prices and making assumptions on inventory lead time. A useful reference is Sinopec Corp. Typically Sinopec Corp discloses its refining margin (which is above national average). In a stable oil price environment, SSP should make a slightly higher refining margin than Sinopec Corp. However, simply glancing over the segment OP of the two companies leads to the conclusion that their refining margins do not correlate. Variances in product mix and inventory lead time would have skewed their refining segment results.

Chart 73: SSP refining margin forecast



Source: Jefferies estimates, company data

Chart 74: Refining segment – Unit profit and cost

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	F'cast	F'cast	F'cast
Brent forecast (US$/bbl)	**54.55**	**65.41**	**72.71**	**97.51**	**61.98**	**79.73**	**111.14**	**111.96**	**108.81**	**98.81**	**52.30**	**43.00**	**57.75**
Petroleum products segment (US$/bbl)													
Selling price	55.56	65.34	72.10	96.25	86.30	106.54	120.22	142.34	144.62	140.04	99.28	86.63	104.30
Refiner purchase price of crude	(53.21)	(64.84)	(69.56)	(103.83)	(60.25)	(78.89)	(106.20)	(112.67)	(106.61)	(101.98)	(52.30)	(43.00)	(57.75)
Consumption tax	(1.65)	(1.63)	(2.75)	(2.40)	(13.35)	(13.58)	(14.25)	(14.60)	(17.03)	(17.91)	(34.18)	(32.39)	(33.10)
Other feedstock rebate/(costs)	0.63	0.80	2.21	2.69	(6.29)	(7.99)	0.99	(11.56)	(14.97)	(15.26)	(7.85)	(6.45)	(8.66)
As % of crude purchase price	(0.0)%	(0.0)%	(0.1)%	(0.1)%	0.2%	0.2%	(0.0)%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%
Sinopec Shanghai refining margin (est.)	1.33	(0.33)	2.00	(7.29)	6.41	6.07	0.76	3.51	6.01	4.89	4.95	4.79	4.79
D&A	(1.04)	(1.26)	(1.09)	(1.07)	(1.19)	(1.00)	(0.89)	(2.10)	(2.12)	(2.23)	(2.05)	(1.78)	(1.68)
Impairment	-	-	-	-	-	-	-	(0.37)	-	(0.31)	-	-	-
Other costs	(3.33)	(4.52)	(3.19)	(11.37)	(2.41)	(1.73)	(1.14)	(3.90)	0.42	(2.42)	-	-	-
Segment operating profit	(1.26)	(5.24)	(1.99)	(12.44)	2.81	3.34	(1.27)	(2.86)	4.31	(0.06)	2.90	3.01	3.11

Source: Jefferies estimates, company data

Chart 75: Intermediate chemical segment – Unit profit and cost

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	F'cast	F'cast	F'cast
Brent forecast (US$/bbl)	**54.55**	**65.41**	**72.71**	**97.51**	**61.98**	**79.73**	**111.14**	**111.96**	**108.81**	**98.81**	**52.30**	**43.00**	**57.75**
Intermediate segment (US$/t)													
Total turnover	2,465	2,665	2,830	3,001	1,995	2,227	1,325	2,672	2,436	2,307	1,569	1,432	1,515
Cost of chemical feedstock	(1,400)	(1,589)	(1,292)	(1,716)	(889)	(887)	(1,166)	(1,392)	(1,383)	(1,582)	(785)	(625)	(810)
Gross profit	1,065	1,076	1,538	1,285	1,107	1,340	160	1,281	1,052	726	785	807	705
Depreciation	(72)	(83)	(65)	(60)	(55)	(36)	(40)	(45)	(49)	(51)	(46)	(39)	(35)
Impairment	-	-	-	-	-	(7)	(1)	(1)	(0)	(2)	-	-	-
Other costs	(874)	(908)	(1,386)	(1,230)	(1,033)	(1,274)	(40)	(1,179)	(935)	(661)	(648)	(599)	(599)
Intermediate petchem segment operating profit	118	85	87	(5)	18	23	79	55	68	11	91	169	70

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 76: Synthetic fiber segment – Unit profit and cost

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	F'cast	F'cast	F'cast
Brent forecast (US$/bbl)	**54.55**	**65.41**	**72.71**	**97.51**	**61.98**	**79.73**	**111.14**	**111.96**	**108.81**	**98.81**	**52.30**	**43.00**	**57.75**
Synthetic fiber segment (US$/t)													
Total turnover	1,641	1,768	1,940	1,897	1,707	2,283	2,589	2,093	2,116	2,083	1,662	1,578	1,676
Cost of feedstock (from intermediate segment)	(1,155)	(1,259)	(1,504)	(1,740)	(2,008)	(1,943)	(2,076)	(2,180)	(2,521)	(1,927)	(1,414)	(1,391)	(1,587)
Gross profit	486	509	436	157	(302)	340	513	(87)	(405)	156	248	187	89
D&A	(77)	(88)	(102)	(115)	(134)	(130)	(134)	(96)	(119)	(131)	(126)	(114)	(112)
Impairment	-	(19)	(81)	(228)	(45)	(53)	-	(22)	(17)	(21)	(20)	(18)	(18)
Other cash operating costs/rebate	(319)	(328)	(290)	(668)	487	94	(193)	(49)	151	(417)	(318)	(294)	(294)
Synthetic fibers operating profit (reported)	90	73	(37)	(854)	7	251	186	(254)	(391)	(413)	(216)	(239)	(335)

Source: Jefferies estimates, company data

Chart 77: Resin & plastics segment – Unit profit and cost

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	F'cast	F'cast	F'cast
Brent forecast (US$/bbl)	**54.55**	**65.41**	**72.71**	**97.51**	**61.98**	**79.73**	**111.14**	**111.96**	**108.81**	**98.81**	**52.30**	**43.00**	**57.75**
Resin & plastics segment (US$/t)													
Total turnover	1,139	1,283	1,366	1,469	1,183	1,384	1,614	1,496	1,585	1,584	1,353	1,266	1,412
Cost of feedstock (from intermediate segment)	(1,209)	(1,208)	(1,275)	(1,470)	(1,419)	(1,362)	(1,453)	(1,532)	(1,631)	(1,499)	(1,100)	(1,082)	(1,235)
Gross profit	(71)	75	91	(0)	(236)	22	161	(37)	(46)	85	254	184	177
D&A	(28)	(29)	(30)	(34)	(33)	(32)	(34)	(19)	(33)	(29)	(28)	(25)	(24)
Impairment	-	-	-	(2)	-	(2)	-	(2)	(0)	(0)	(0)	(0)	(0)
Other cash operating costs/rebate	220	48	(5)	(177)	350	102	(125)	(71)	(3)	(97)	(80)	(74)	(74)
Resins & plastics operating profit (reported)	121	94	56	(214)	80	90	1	(129)	(83)	(41)	146	86	79

Source: Jefferies estimates, company data

Balance sheet & cash flow

SSP's gearing level has fallen in recent years, thanks to lower capex. At the end of 2013, SSP amended its dividend policy. The new policy specifies that the cumulative dividend payout would be at least 30% of the cumulative distributable profit in the last 3 years. In 2014, no dividend was paid. 2015 is definitely a profitable year (according to profit alert announcement). Also, we expect 2016 to be another profitable year. Hence, dividend payout in 2015-2016 should make up for the zero payout in 2014.

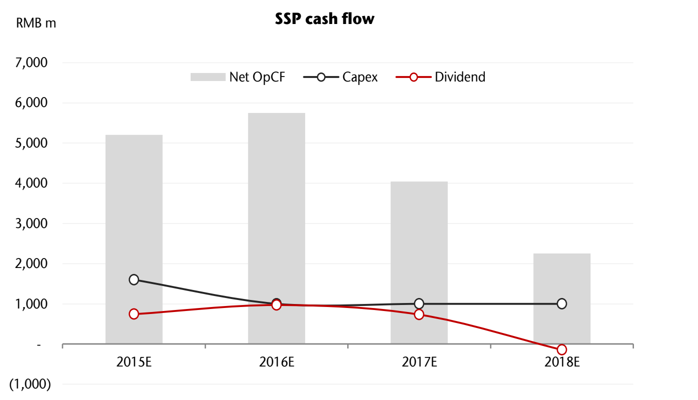
Chart 78: ROE, ROA, ROIC estimates

Balance sheet ratios (Dec-YE)	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**	**2018E**
	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Asset Turnover (sales/assets)	2.4	2.9	3.0	2.4	2.2	2.5	2.8
Leverage Ratio (assets/equity)	2.2	2.0	1.8	1.6	1.6	1.6	1.7
Net Profit Margin	(1.7)%	2.0%	(0.7)%	3.8%	4.4%	2.5%	0.6%
ROE	(9.2)%	11.5%	(4.0)%	14.9%	15.6%	9.9%	2.8%
Core operating profit, excl. other gains (RMB m)	(2,106)	1,519	(849)	3,664	4,937	3,405	1,128
Effective tax rate	25%	16%	24%	25%	25%	25%	25%
NOPAT (RMB m)	(1,572)	1,283	(645)	2,748	3,703	2,554	846
Debt (RMB m)	12,094	7,589	5,432	1,802	(2,231)	(4,936)	(6,003)
Equity (RMB m)	16,304	17,992	16,772	19,686	22,433	23,810	23,546
Invested capital (RMB m)	28,398	25,580	22,203	21,488	20,202	18,874	17,544
Average invested capital (RMB m)		26,989	23,892	21,845	20,845	19,538	18,209
ROIC		**5%**	**(3)%**	**13%**	**18%**	**13%**	**5%**
ROA	**5%**	**5%**	**3%**	**1%**	**0%**	**1%**	**1%**
Net debt to equity ratio	74%	42%	32%	9%	(10)%	(21)%	(25)%

Source: Jefferies estimates, company data

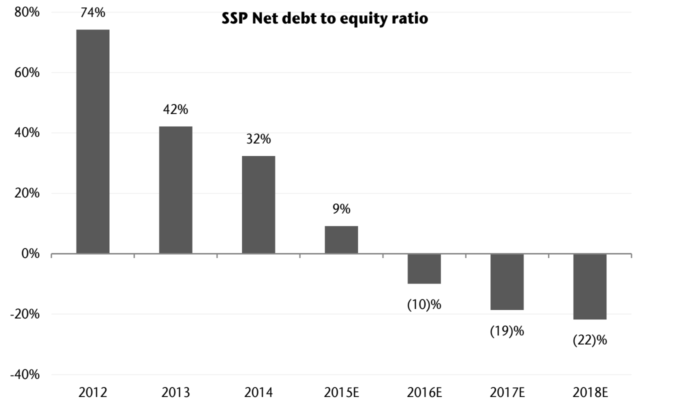
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 79: Cash flow



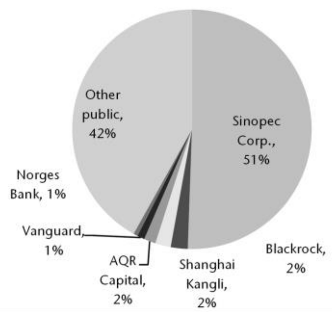
Source: Jefferies estimates, company data

Chart 80: Gearing



Source: Jefferies estimates, company data

Chart 81: Sinopec Shanghai Petrochemicals shareholding structure (H+A)



Source: Jefferies, Bloomberg

Management bios

All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Table 26: Management bios

Senior personnel	Position	Background
Mr WANG Zhiqing, 53	Chairman	Mr Wang commenced work in 1983 and has held various senior positions in Luoyang Petrochemical Complex, Sinopec Jiujiang Company, and Shanghai Secco Petrochemical Company.
Mr WU Haijun, 53	Vice Chairman	Mr Wu has held various positions in Shanghai Secco Petrochemical Company, and Sinopec Corp.
Mr GAO Jinping, 49	Vice Chairman	Mr Gao is the Secretary of the Communist Party Committee in SSP. He graduated from the Food Processing Faculty of Shanghai Aquatic Products University with a major in cooling and cold storage technology and obtained a bachelor's degree in engineering.
Mr YE Guohua, 47	Director, CFO	Mr Ye has held various senior positions in Shanghai Gaoqiao Petrochemical Corp prior to his current role in SSP.
Mr JIN Qiang, 50	Director, VP	Mr Ye has held various senior positions in Sinopec Zhenhai Refining and Chemical Company prior to his current role in SSP.
Mr GUO Xiaojun, 46	Director, VP	Mr Guo joined SSP in 1991 and has held various positions across different divisions. He graduated with a major in basic organic chemical engineering from the East China University of Science and Technology in 1991 and obtained Bachelor of Engineering, and obtained a master's degree majoring in chemical engineering from the East China University of Science and Technology in 2008.

Source: Jefferies, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Valuation and risks

SSP's H share is trading on 3.4x EV/EBITDA on 2016 earnings, a steep discount to regional refining and chemical companies' 6-7x. Our price targets are based on sum of the parts valuation. The reasoning for each segment is detailed below.

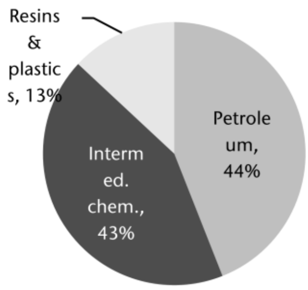
Chart 82: Sum of the parts valuation

Petroleum		**Assumptions**
EBITDA weighted 12 months (RMB m)	2,759	China's refining market is oligopolistic, with state refiners controlling 87% of capacity. Hence, refining is supposed to be the most sustainable business under SSP. Also, SSP typically makes slightly higher refining margins than parent co.
x Target multiple	5.0	Sinopec Corp., as it serves the strong Eastern China markets. However, due to its much smaller scale relative to parent co., we assigned a lower valuation multiple (vs. Sinopec Corp. refining segment's 8x)
Target EV (RMB m)	13,793	
Intermediate chemicals		
EBITDA weighted 12 months (RMB m)	2,989	Chemical segment's profitability is bumped up in a low oil price environment. In a high oil price environment, its
x Target multiple	4.5	contribution to company value will not be as high. We assigned a lower multiple relative to refining segment, while benchmarking against regional peers.
Target EV (RMB m)	13,452	
Synthetic fibers		
EBITDA weighted 12 months (RMB m)	(244)	Synthetic fibers segment has been generally oversupplied. We have modelled in continuous losses. Assigned a lower
x Target multiple	4.0	valuation multiple relative to intermediate chemicals segment.
Target EV (RMB m)	-	
Resins & plastics		
EBITDA weighted 12 months (RMB m)	1,024	A lower multiple is assigned to this segment relative to intermediate chemical segment.
x Target multiple	4.0	
Target EV (RMB m)	4,097	
Trading of petroleum		
EBIT weighted 12 months (RMB m)	77	Negligible contribution to valuation.
x Target multiple	2.0	
Target EV (RMB m)	155	
Others		
EBIT weighted 12 months (RMB m)	5	Negligible contribution to valuation.
x Target multiple	2.0	
Target EV (RMB m)	9	
Target Enterprise Value	31,506	
- Net Debt	(6,985)	
- Minorities	271	
Target Market cap (RMB m)	38,220	
÷ Shares outstanding	10,800	
Sub-total	3.54	
A share premium 15%	0.53	
12-month Price target for A share (Rmb/share)	**4.10**	
Current share price	5.48	
Upside/(downside)	(25.2)%	
x Exchange rate (HKD/RMB)	1.18	
12-month Price target for H share (HK$/share)	**4.20**	
Current share price	2.92	
Upside/(downside)	44%	

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 83: SSP target valuation breakdown



Source: Jefferies estimates

Chart 84: Implied valuation multiples on current and target prices

Current share price (H share)	HKD	2.92			
	RMB	2.47			
H share price target	HKD	4.20			
A share price target	RMB	4.10			
		2015	**2016**	**2017**	**2018**
		F'cast	F'cast	F'cast	F'cast
Implied multiple on current share price, H share					
P/BV		1.4	1.2	1.1	1.1
ROE		14.9%	15.6%	9.9%	2.8%
EV/EBITDA		4.8	3.4	3.8	6.1
Dividend yield		2.8%	3.6%	3.4%	0.2%
FCF yield		13.3%	17.7%	13.5%	7.1%
Implied multiple on A share price target					
P/BV		2.2	2.0	1.9	1.9
ROE		14.9%	15.6%	9.9%	2.8%
EV/EBITDA		6.1	5.0	6.4	10.6
Dividend yield		1.7%	2.2%	2.1%	0.1%
FCF yield		8.0%	10.7%	8.1%	4.3%
Implied multiple on H share price target					
P/BV		1.9	1.7	1.6	1.6
ROE		14.9%	15.6%	9.9%	2.8%
EV/EBITDA		5.3	4.4	5.5	9.2
Dividend yield		1.9%	2.5%	2.4%	0.2%
FCF yield		9.3%	12.4%	9.4%	5.0%

Source: Jefferies estimates, company data

Financial summary

Chart 85: P&L statement - key items

P&L statement (RMB m, Dec-YE, IFRS)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Net sales	45,190	49,918	54,255	59,330	47,345	72,096	89,510	87,217	105,507	92,725	77,130	78,988	93,456	107,881
Operating profit	2,528	553	893	(7,817)	2,023	2,967	1,060	(1,772)	2,192	(588)	3,664	4,937	3,405	1,128
Profit for the year	1,850	844	1,634	(6,238)	1,591	2,772	987	(1,505)	2,066	(676)	2,929	3,508	2,359	651
1 year change														
Net sales		10%	9%	9%	(20)%	52%	24%	(3)%	21%	(12)%	(17)%	2%	18%	15%
Operating profit		(78)%	61%	(876)%	26%	47%	(64)%	(167)%	124%	(27)%	623%	35%	(31)%	(67)%
Profit for the year		(54)%	94%	(382)%	26%	74%	(64)%	(153)%	137%	(33)%	433%	20%	(33)%	(72)%
OP margin	5.6%	1.1%	1.6%	(13.2)%	4.3%	4.1%	1.2%	(2.0)%	2.1%	(0.6)%	4.8%	6.2%	3.6%	1.0%
Net margin	4.1%	1.7%	3.0%	(10.5)%	3.4%	3.8%	1.1%	(1.7)%	2.0%	(0.7)%	3.8%	4.4%	2.5%	0.6%

Source: Jefferies estimates, company data

Chart 86: Balance sheet

Balance sheet (RMB m, Dec-YE, IFRS)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Inventories	4,115	4,163	5,198	4,492	6,884	5,352	5,582	8,938	9,039	5,931	4,860	4,977	5,889	6,798
Trade receivables	252	359	212	89	120	74	122	93	148	631	525	537	636	734
Bills receivable	731	1,212	1,757	533	573	1,993	2,988	2,047	2,689	1,366	1,136	1,163	1,376	1,589
Other receivables and prepayments	455	239	263	484	82	236	243	599	346	269	224	229	271	313
Others	607	695	613	285	1,276	776	639	1,053	2,131	1,035	1,035	1,035	1,035	1,035
Cash & cash equivalents	1,347	895	893	628	126	100	91	161	133	279	3,909	7,942	10,647	11,713
Total current assets	**7,508**	**7,563**	**8,937**	**6,511**	**9,061**	**8,532**	**9,666**	**12,891**	**14,486**	**9,510**	**11,689**	**15,884**	**19,854**	**22,182**
Borrowings	3,927	4,270	4,092	9,373	7,775	4,395	5,512	11,024	7,094	4,078	4,078	4,078	4,078	4,078
Trade payables & advance from customers	963	1,386	1,504	1,273	1,521	2,376	3,126	2,887	2,740	3,512	2,921	2,991	3,539	4,085
Bills payable	68	7	301	263	112	41	16	-	9	12	10	10	12	14
Other payables	680	733	1,442	679	1,400	1,943	1,352	1,603	1,507	1,831	1,523	1,560	1,846	2,131
Amounts due to related parties	468	600	905	1,753	3,488	1,801	2,243	3,411	6,664	3,042	2,531	2,592	3,066	3,539
Others	27	34	18	2	9	16	22	2	4	10	10	10	10	10
Total current liabilities	**6,133**	**7,030**	**8,262**	**13,343**	**14,305**	**10,573**	**12,272**	**18,927**	**18,017**	**12,485**	**11,073**	**11,241**	**12,551**	**13,857**
P,P&E	14,651	13,360	14,977	13,273	14,977	13,571	12,502	17,469	16,669	15,542	14,865	13,585	12,302	11,016
Lease prepayment and other assets	508	603	649	604	754	717	825	1,131	917	1,044	1,044	1,044	1,044	1,044
Others	4,144	5,880	5,290	7,145	5,116	5,749	7,726	4,971	4,564	4,810	4,810	4,810	4,810	4,810
Total non-current assets	**19,303**	**19,843**	**20,916**	**21,022**	**20,847**	**20,037**	**21,053**	**23,571**	**22,151**	**21,395**	**20,719**	**19,439**	**18,156**	**16,870**
Borrowings	1,477	1,064	639	429	304	175	160	1,231	628	1,633	1,633	1,633	1,633	1,633
Others	23	-	-	-	-	-	91	-	-	16	16	16	16	16
Non-current liabilities	**1,500**	**1,064**	**639**	**429**	**304**	**175**	**251**	**1,231**	**628**	**1,649**	**1,649**	**1,649**	**1,649**	**1,649**
Share capital	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200	10,800	10,800	10,800	10,800	10,800	10,800
Reserves	11,630	11,776	13,448	6,297	7,805	10,361	10,726	8,837	6,932	5,700	8,614	11,362	12,739	12,475
Shareholders' equity	**18,830**	**18,976**	**20,648**	**13,497**	**15,005**	**17,561**	**17,926**	**16,037**	**17,732**	**16,500**	**19,414**	**22,162**	**23,539**	**23,275**
Non-controlling interests	347	336	304	264	294	260	270	267	259	271	271	271	271	271
Total equity	**19,177**	**19,312**	**20,952**	**13,761**	**15,299**	**17,821**	**18,196**	**16,304**	**17,992**	**16,772**	**19,686**	**22,433**	**23,810**	**23,546**

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 87: Cash flow statement

Cashflow statement (RMB m, Dec-YE, IFRS)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Operating activities	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast
EBIT	2,528	553	893	(7,817)	2,023	2,967	1,060	(1,772)	2,192	(588)	3,664	4,937	3,405	1,128
D&A	1,706	1,840	1,704	1,635	1,652	1,658	1,629	1,903	2,539	2,273	2,277	2,280	2,283	2,286
Interest income	97	138	82	228	19	178	299	87	498	65	65	65	65	65
Interest expense	(276)	(303)	(260)	(558)	(341)	(274)	(215)	(370)	(377)	(424)	(424)	(424)	(424)	(424)
Tax paid	(366)	(53)	(468)	1,813	(511)	(736)	(310)	511	(379)	214	(976)	(1,169)	(786)	(217)
Others	256	(472)	(174)	(87)	1,747	(1,151)	904	323	1,403	(3,002)	557	54	59	68
Operating cash flow	**3,944**	**1,702**	**1,777**	**(4,787)**	**4,590**	**2,643**	**3,366**	**681**	**5,876**	**(1,461)**	**5,162**	**5,741**	**4,601**	**2,905**
Changes in working capital:														
Inventories		(48)	(1,035)	706	(2,392)	1,532	(230)	(3,356)	(101)	3,109	1,070	(117)	(912)	(909)
Receivables and others		(372)	(422)	1,126	331	(1,528)	(1,050)	613	(443)	917	381	(45)	(353)	(352)
Payables and others		414	1,122	(1,032)	818	1,328	134	(5)	(234)	1,098	(1,412)	168	1,310	1,306
Net cash from operating activities	3,944	1,697	1,442	(3,986)	3,347	3,974	2,220	(2,066)	5,099	3,662	5,201	5,747	4,646	2,950
Capex	(1,143)	(2,009)	(2,134)	(1,511)	(2,120)	(1,357)	(3,481)	(4,260)	(1,317)	(1,089)	(1,600)	(1,000)	(1,000)	(1,000)
% of revenue	3%	4%	4%	3%	4%	2%	4%	5%	1%	1%	2%	1%	1%	1%
Acquisition	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Others	(3,990)	(1,040)	181	4,790	(3,402)	(3,080)	(1,549)	2,264	(4,411)	(3,484)	-	-	-	-
Net cash used in investing activities	(1,189)	(1,353)	(511)	(707)	(2,175)	(463)	(2,810)	(4,062)	(629)	(910)	(1,600)	(1,000)	(1,000)	(1,000)
Issue of new shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Borrowings and bond	9,836	13,936	17,606	32,529	29,211	39,356	35,106	53,365	55,038	51,385	-	-	-	-
Repayments of borrowings	(11,394)	(15,910)	(16,167)	(27,378)	(31,850)	(42,631)	(32,791)	(46,780)	(59,156)	(53,444)	-	-	-	-
Dividends paid	(1,440)	(720)	(288)	(646)	(1)	(201)	(713)	(388)	(379)	(547)	-	(743)	(971)	(912)
Others	(96)	1,900	(2,081)	(76)	965	(60)	(1,020)	(0)	(0)	(0)	29	29	29	29
Net cash from /(used in) financing activities	(3,094)	(794)	(930)	4,429	(1,673)	(3,536)	582	6,198	(4,497)	(2,606)	29	(714)	(942)	(883)
Net income/(decrease) in cash & cash equivalents	(340)	(450)	1	(265)	(502)	(25)	(8)	70	(28)	146	3,630	4,033	2,705	1,067
Cash - beginning	1,691	1,347	895	893	628	126	100	91	161	133	279	3,909	7,942	10,647
Exchange losses on cash & cash equivalents	(3)	(2)	(2)	(1)	(0)	(0)	(0)	(0)	(0)	0	-	-	-	-
Cash - ending	1,347	895	893	628	126	100	91	161	133	279	3,909	7,942	10,647	11,713

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Oilfield Service (SSC)

What happened in 4Q15 will not repeat

Key takeaway

SSC guided that FY15 would be slightly profitable. We expect losses to return in FY16, driven by lower revenue and limited room for further cost cutting. Most of SSC's revenue comes from Sinopec. We expect E&P losses to compel Sinopec to cut group capex to 20-25% below 2014's level. If we are right, that would be bad news for SSC.

Reiterate Hold on H share, price target HK$1.50; Underperform on A share, price target Rmb1.36.

We think that cost reduction is the main reason for the loss reversal in 4Q15.

A curious case of loss reversal in 4Q15. SSC expected FY15 net profit of Rmb23m, a big reversal of the net loss of Rmb2.1bn posted in 9M15. The reasons were 1) more investments from Sinopec in 4Q; 2) higher proportion of payment settlements made in 4Q; 3) cost reduction. We think that #1 and #2 probably do not matter much. It is #3 that explains the loss reversal.

Let's find clues in the numbers. Revenue fell by over 40% y/y in 9M15. Suppose revenue actually increased slightly y/y in 4Q15. Even under such a rosy scenario, SSC would have relied on massive cost cutting to achieve the Rmb23m NP. How much more cost reduction can SSC do in 2016?

We expect E&P losses to compel Sinopec Corp. to cut group capex. That would be bad news for SSC.

Conclusion: losses might return in 2016. We expect E&P losses to compel Sinopec Corp. to cut group capex to 20-25% below 2014 level. Year to date, crude prices have been range-bound around US$30/bbl. E&P economics are unfavourable, particularly for Sinopec Corp. which has ageing domestic fields. If we are right on Sinopec Corp's capex cut, then SSC will suffer. After all, state-owned oilfield services companies are created to subsidize E&P companies, not the other way round.

Why we think Sinopec Corp. would cut capex. We think that capex cut is a rational move, a possible directive from the cash dry Sinopec Group, which owns both Sinopec Corp and SSC. Sinopec Group made aggressive overseas acquisitions in the 2000s and ended up with a bloated balance sheet. Net debt to equity ratio is now close to 50%, far above that of global supermajors. We think that the low oil price scenario hastens the need to deleverage. Subsidiaries are therefore used as cost cutting/fundraising vehicles.

Consistent with our Sinopec Corp capex forecast, we project a J-curve revenue and earnings trajectory for SSC.

Valuation/risks: Consistent with our Sinopec Corp capex forecast, we project a J-curve revenue and earnings trajectory for SSC - losses in 2016, small profit in 2017 and improved margin in 2018. We assigned a 5x EV/EBITDA multiple on 12-month weighted forecasted earnings (unchanged from previous methodology) to arrive at our target prices. We have applied a 15% premium on our A share target price. Yet we found that A share still trades on an unjustifiably large premium over H share. The restructured SSC has a short trading history and public financial disclosure. There is no "prior cycle" valuation that we can reference from. Our reason for applying a much lower target multiple on SSC (vs. 9x on COSL) is SSC's limited track record, much lower ROIC and Sinopec Corp's ageing fields. Risks to our thesis would be further massive cost cutting, faster than expected rebound in crude prices and increase in Sinopec Corp's capex in 2016.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Financial Outlook

The IFRS income statement (for H shares) differs slightly from the China ASBE income statement in terms of reporting format. For consistency purposes, we refer to the IFRS statement for financial projection and discussion. The most important things to note are 1) the revenue line excludes revenue from internal customers; 2) our estimated operating profits do not embed finance costs and one-off items like impairment expenses; 3) We project revenue to remain below the pre oil price collapse level over the next two years and recover gradually by the end of 2017, in-line with our domestic E&P capex projection for Sinopec.

Limited financial history on the restructured entity

The restructured Sinopec OFS offers only 2 full years of financial history. The short track record shows a thin net margin (on clean adjusted earnings) of 1.7-3.2%. Management pledged to cut cost by Rmb800m in 2015, and it has achieved 56% of that in 1H. We believe the cost cutting target is achievable. But a more important question is, whether any margin improvement is sustainable. The cost base might inflate quickly again when OFS activities pick up.

A-share disclosure provides insights into cost base

Despite the short financial history, Sinopec OFS provides investors with interesting insights into the cost structure of the major categories of oil services, as its A-share disclosure shows a breakdown of the cost of each segment. All the other listed OFS companies on HKEx report a consolidated cost base. Based on the A share disclosure, we know that the logging and geophysical services probably have the highest amount of fixed costs – as they have the highest percentage of costs allocated to employee costs. We do not think that employee costs are a variable expense item as it is not always practical to cut headcount massively in tough times.

Chart 88: DuPont analysis and other return metrics

	2013	2014	2015E	2016E	2017E	2018E
ND/E	49.1%	60.9%	12.0%	30.2%	12.9%	0.5%
Asset Turnover (sales/assets)	1.0	1.0	0.7	0.7	0.7	0.8
Leverage Ratio (assets/equity)	3.0	4.3	4.1	3.5	3.4	3.2
Clean adjusted net margin	1.7%	3.2%	0.2%	(2.4)%	1.1%	2.4%
ROE	5.1%	13.3%	0.6%	(5.7)%	2.7%	6.3%
ROA	1.7%	3.1%	0.1%	(1.7)%	0.8%	2.0%
ROIC	3.3%	8.0%	0.3%	(3.5)%	1.7%	4.3%

Source: Jefferies estimates, company data

Chart 89: Cash flow statement

Cashflow statement (RMB m, DEC-YE)	2013	2014	2015E	2016E	2017E	2018E
Profit/(loss) before income tax						
Continuing operations	2,180	3,320	27	(1,014)	646	1,639
Discontinued operations	(1,211)	(2,261)	-	-	-	-
	969	**1,059**	**27**	**(1,014)**	**646**	**1,639**
Adjustment for:						
Cashflow from operating activities before changes in working capital	**5,979**	**6,137**	**5,086**	**4,045**	**5,599**	**6,360**
Cashflow from operations	**1,858**	**5,136**	**11,452**	**(1,033)**	**5,237**	**5,083**
Income tax paid	(686)	(635)	(5)	-	(161)	(410)
Net cash generated from operating activities	1,172	4,501	11,448	(1,033)	5,075	4,673
Cashflow from investing activities						
Net cash used in investing activities	(7,117)	(2,529)	(1,602)	(1,370)	(1,373)	(1,735)
Net cash (used in)/generated from financing activities	3,718	(2,465)	(1,505)	(1,500)	(1,500)	(1,500)
Net decrease in cash and cash equivalents	(2,226)	(492)	8,341	(3,903)	2,202	1,438
Cash and cash equivalents at beginning of year	3,920	1,694	1,202	9,543	5,640	7,841
Cash and cash equivalents at ending of year	1,694	1,202	9,543	5,640	7,841	9,280

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 90: P&L statement

	2013	2014	2015E	2016E	2017E	2018E
Revenue (excl. internal customers)	**89,729**	**78,993**	**54,558**	**42,625**	**45,544**	**50,727**
Total operating exp.	(86,985)	(75,264)	(53,973)	(43,147)	(44,419)	(48,631)
Operating profit	**2,744**	**3,729**	**585**	**(521)**	**1,125**	**2,096**
Finance income/(exp.) - net	(823)	(770)	(670)	(663)	(661)	(659)
Impairment losses on assets	(136)	(98)	(101)	-	-	-
Investment income	2	2	-	-	-	-
Share of (loss)/profit from JV	0	(4)	(5)	-	-	-
Other income	455	551	218	171	182	203
Other exp.	(62)	(90)	-	-	-	-
Pre-tax profit	**2,180**	**3,320**	**27**	**(1,014)**	**646**	**1,639**
Income tax exp.	(687)	(901)	(5)	-	(161)	(410)
Profit for the period from continuing op.	**1,493**	**2,419**	**23**	**(1,014)**	**484**	**1,229**
... Non-controlling interests	(28)	(2)	(0)	-	-	-
... Owners of the company	1,465	2,417	23	(1,014)	484	1,229
Clean adjusted earnings	**1,558**	**2,488**	**106**	**(1,014)**	**484**	**1,229**
Basic EPS (RMB) to shareholders	0.10	0.16	0.00	(0.07)	0.03	0.09
Diluted EPS (RMB) to shareholders	0.10	0.16	0.00	(0.07)	0.03	0.09
Basic clean adjusted EPS (RMB) to shareholders	0.10	0.16	0.01	(0.07)	0.03	0.09
Diluted clean adjusted EPS (RMB) to shareholders	0.10	0.16	0.01	(0.07)	0.03	0.09
Revenue mix by segments						
Geophysics	7%	6%	7%	8%	7%	7%
Drilling engineering	46%	50%	51%	53%	55%	57%
Logging and mud logging	6%	5%	4%	4%	4%	4%
Special downhole operations	11%	11%	12%	10%	9%	9%
Engineering construction	27%	26%	23%	24%	22%	21%
Others	2%	2%	3%	3%	3%	3%
Margins						
Operating margin	3.1%	4.7%	1.1%	(1.2)%	2.5%	4.1%
Net margin	1.7%	3.1%	0.0%	(2.4)%	1.1%	2.4%
Clean adjusted net profit margin	1.7%	3.2%	0.2%	(2.4)%	1.1%	2.4%
Cost as % of revenue						
Staff costs	18.2%	20.9%	23.7%	26.0%	24.3%	24.0%
Retirement benefit plan contribution	1.7%	2.0%	-3.6%	0.0%	0.0%	1.2%
Cost of goods sold	28.7%	26.4%	30.0%	26.0%	25.0%	24.0%
D&A	4.0%	4.9%	8.1%	10.3%	9.4%	8.0%
Op. lease exp.	1.9%	2.3%	2.6%	2.4%	2.2%	2.0%
Rental income from P,P&E	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Research & development exp.	0.5%	0.6%	0.8%	0.5%	0.6%	0.6%
Auditors' remuneration	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Others	41.8%	38.0%	37.3%	36.0%	36.0%	36.0%
Total operating exp.	**96.9%**	**95.3%**	**98.9%**	**101.2%**	**97.5%**	**95.9%**
1-year change						
Revenue		(12.0)%	(30.9)%	(21.9)%	6.8%	11.4%
Operating profit		35.9%	(84.3)%	(89.2)%	215.8%	86.3%
Pre-tax profit		52.3%	(99.2)%	(3727.1)%	63.7%	153.8%
Reported net profit to shareholders		62.1%	(99.1)%	(4501.3)%	47.8%	153.8%
Clean adjusted profit to shareholders		59.7%	(95.7)%	(958.5)%	47.8%	153.8%

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 91: Balance sheet

Balance sheet (RMB m, DEC-YE)	2013	2014	2015E	2016E	2017E	2018E
Non-current assets						
P,P&E	38,730	31,080	28,319	25,330	22,450	20,164
Other non-current assets	4,922	5,285	5,285	5,285	5,285	5,285
Prepaid land leases	339	51	51	51	51	51
Intangible assets	31	41	41	41	41	41
Interests in JV	599	108	108	108	108	108
Interests in associates	0	0	0	0	0	0
AFS financial assets	41	40	40	40	40	40
Deferred income tax assets	220	157	157	157	157	157
Total non-current assets	**44,884**	**36,763**	**34,002**	**31,013**	**28,133**	**25,847**
Current assets						
Inventories	3,221	1,951	2,392	1,635	1,497	1,668
Notes and trade receivables	28,426	28,284	17,937	14,014	14,973	16,677
Prepayment and other receivables	3,830	3,102	5,082	3,503	3,119	2,780
Amounts due from customers for contract works	10,649	9,982	6,894	5,386	5,755	6,410
Restricted cash	34	12	12	12	12	12
Cash and cash equivalents	1,694	1,202	9,543	5,640	7,841	9,280
Total current assets	**47,853**	**44,533**	**41,859**	**30,190**	**33,198**	**36,826**
Total assets	**92,737**	**81,296**	**75,861**	**61,203**	**61,331**	**62,673**
Non-current liabilities						
Long-term borrowings	580	568	568	568	568	568
Deferred income	103	44	44	44	44	44
Special payables	7	3	3	3	3	3
Deferred income tax liabilities	5	47	47	47	47	47
Total non-current liabilities	**695**	**662**	**662**	**662**	**662**	**662**
Current liabilities						
Notes and trade payables	31,746	30,914	29,895	21,021	21,212	20,847
Deposits received and other payables	8,064	12,012	9,566	7,007	7,487	8,339
Amounts due to customers for contract works	5,131	6,564	5,381	3,971	3,743	4,169
Short term borrowings	16,218	12,016	11,216	10,416	9,616	8,816
Current income tax payable	150	432	432	432	432	432
Total current liabilities	**61,309**	**61,938**	**56,490**	**42,846**	**42,490**	**42,603**
Total liabilities	**62,003**	**62,600**	**57,152**	**43,508**	**43,152**	**43,264**
Equity						
Share capital	6,000	12,809	12,809	12,809	12,809	12,809
Reserves	24,648	5,888	5,910	4,896	5,381	6,610
Equity attributable to owners of the company	**30,648**	**18,697**	**18,720**	**17,705**	**18,190**	**19,419**
Non-controlling interests	85	(1)	(1)	(1)	(1)	(1)
Total equity	**30,733**	**18,696**	**18,719**	**17,704**	**18,189**	**19,418**

Source: Jefferies estimates, company data

Valuation/risks

Sinopec OFS has a very short share price history that investors can reference. Sinopec OFS was previously a petrochemical company called Sinopec Yizheng Chemical Fibre, until September 2014 when Sinopec Group (current parent) and Sinopec Corp. (former parent) restructured the company. Sinopec Yizheng sold its petrochemical assets to Sinopec Corp. At the same time, it received the oilfield services assets from Sinopec Group. Hence it was renamed "Sinopec OFS".

There are only 2 full years of financial disclosure for the oilfield services entity, and these disclosures reflect low margins and ROIC. The market seemed to expect Sinopec OFS to benefit somehow from the parent co.'s reform, hence the share price rallied even post the oil price collapse. Going forward, we expect the share price to react to headline news surrounding the "reform" theme. But we think that Sinopec OFS must show improved fundamentals to sustain a re-rating.

We think that applying EV/EBITDA multiple on the next 12 months' projected earnings to arrive at a target price is a more practical methodology than DCF. After all, both analysts and the capital market have much more visibility on the earnings stream over a 12-month horizon than that of the perpetuity required by the DCF model. Questions that investors

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

often ask about the OFS sector are, "how much of XYZ's contract value would be booked this year and next year", "what is the impairment risk and receivable risk", "what is the rig utilization trend", etc. Most of the topics are centered on near term outlook, and we believe that interpretations of these topics would impact investors' perception of fair value.

Chart 92: Target price

	12m weighted
EBITDA (RMB m)	4,260
x Target multiple	5
Target EV (RMB m)	21,299
- Net Debt (RMB m)	4,594
- Minorities (RMB m)	(1)
Market capitalization (RMB m)	16,707
÷ Shares outstanding	14,143
	1.18
Latest exchange rate (HKD per 1 RMB)	1.18
Target price, rounded to HK$0.25	**1.50**
Current price, H share (HK$)	**1.54**
Upside/(downside)	(2.6)%
15% premium on A share (RMB)	0.18
Target price, rounded to RMB$0.25	**1.36**
Current price, A share (RMB)	**6.32**
Upside/(downside)	(78.5)%

Consistent with our Sinopec Corp capex forecast, we project a J-curve revenue and earnings trajectory for SSC - losses in 2016, small profit in 2017 and improved margin in 2018. We assigned a 5x EV/EBITDA multiple on 12-month weighted forecasted earnings (unchanged from previous methodology) to arrive at our target prices. We have applied a 15% premium on our A share target price. Yet we found that A share still trades on an unjustifiably large premium over H share. The restructured SSC has a short trading history and public financial disclosure. There is no "prior cycle" valuation that we can reference from. Our reason for applying a much owner target multiple on SSC (vs. 9x on COSL) is SSC's limited track record, much lower ROIC and Sinopec Corp's ageing fields.

Source: Jefferies estimates, company data

Chart 93: Implied valuation multiples on current and target prices

Current share price (H share)	HKD	1.54		
Target price (H share)	HKD	1.50		
	2015	**2016**	**2017**	**2018**
	F'cast	F'cast	F'cast	F'cast
Implied multiple on current share price, H share				
P/BV	1.16	1.23	1.20	1.12
ROE	0.6%	(5.7)%	2.7%	6.3%
EV/EBITDA	4.15	6.14	3.84	3.01
Dividend yield	0.0%	0.0%	0.0%	0.0%
FCF yield	53.2%	(13.2)%	19.8%	15.7%
Implied multiple on H share price target				
P/BV	0.96	1.02	0.99	0.93
ROE	0.6%	(5.7)%	2.7%	6.3%
EV/EBITDA	4.15	6.14	3.84	3.01
Dividend yield	0.0%	0.0%	0.0%	0.0%
FCF yield	39.2%	(9.7)%	14.6%	11.6%

Source: Jefferies estimates, company data

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

U.S. – Surge in shale oil led to cheaper domestic crude, better refining margin, and higher volume of refined products exports. Also, since U.S. crude is generally lighter, it can be processed with lower-capex and less complex refining facilities. This spurred moderate capacity addition in the last few years.

Europe – Slowly consolidating. Capacity has fallen ~ 11% since 2006 peak level.

Middle East – Refining capacity addition continues despite falling utilization rate.

Asia Pacific – Diesel is over-supplied. International oil companies like BP and Shell have been consolidating/cancelling refining projects in Asia Pacific/Australia.

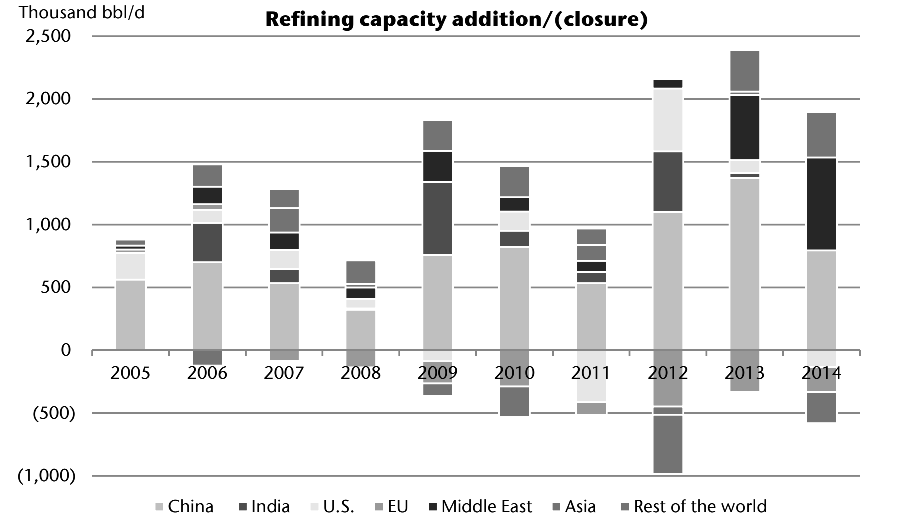
China – The industry is facing overcapacity, higher cost from adjusting product mix (to meet environmental standards, shift from diesel to gasoline), and more competition from teapot refiners.

Appendices

China refining industry overview

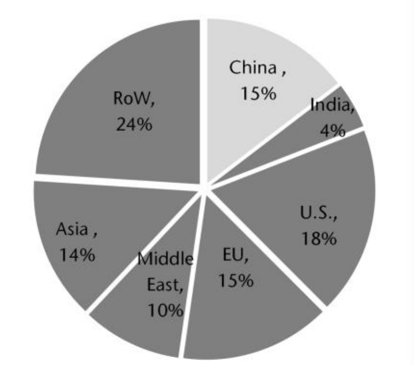
The global refining industry is in overcapacity in general. Utilization rates in major production hubs, except the U.S., have been falling.

Chart 94: Global refining capacity addition and closure



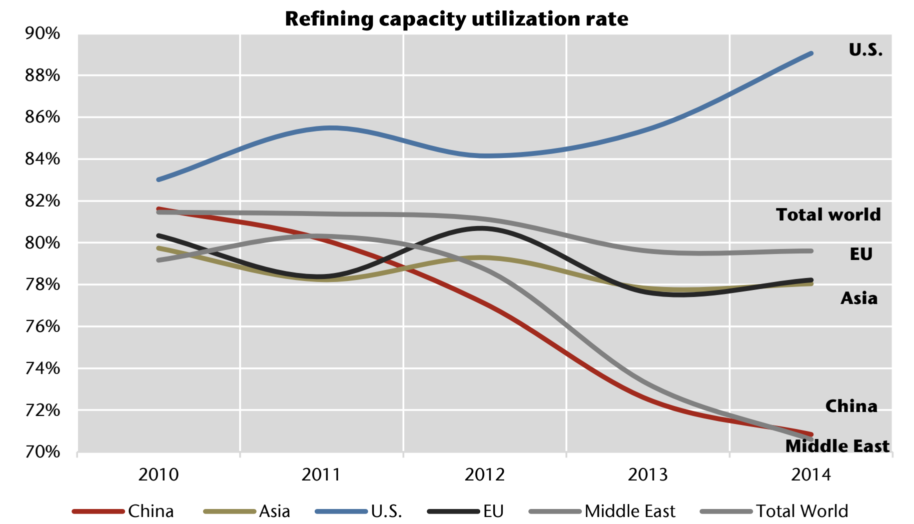
Source: BP Statistical Review, Jefferies

Chart 95: Global refining capacity by location



Source: BP Statistical Review, Jefferies

Chart 96: Refining utilization rates have been falling at major production hubs, except U.S.



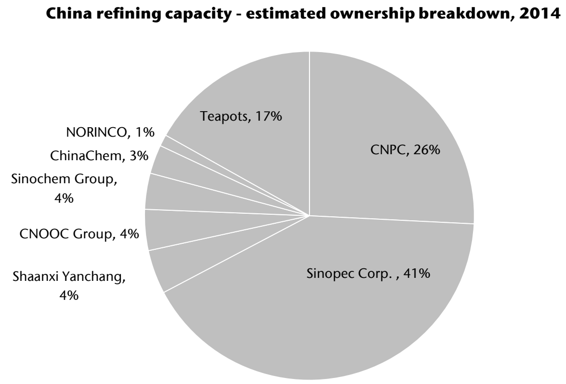
Source: BP Statistical Review, Jefferies

China refining industry is going through upgrade

China's refining capacity doubled in the last decade. The utilization rates of major refiners (Sinopec, CNPC, Yanchang, CNOOC) have been falling in the last 5 years to 70-80%. Teapot refiners, many of whom are loss making, are operating at ~20% utilization rates.

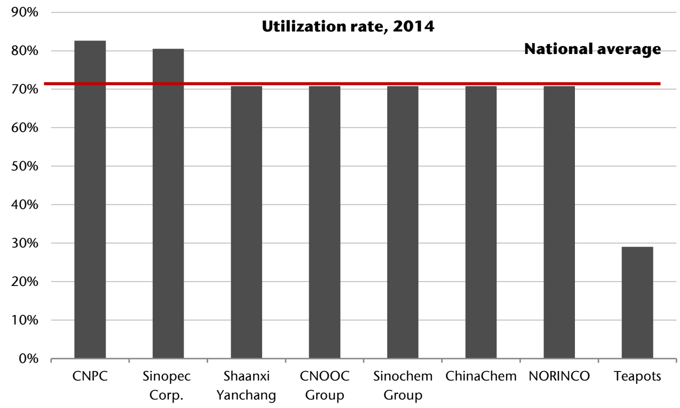
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Chart 97: CNP, Sinopec, CNOOC & Yanchang own 75% of China's refining capacity



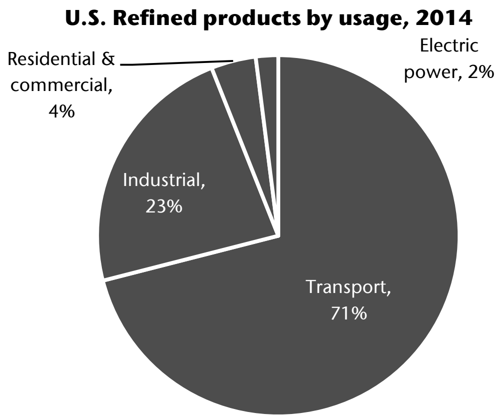
Source: CNOOC Group, CNPC, Sinopec Corp., Shaanxi Yanchang, Sinochem, ChinaChem, NORINCO, BP Statistical Review, Jefferies estimates

Chart 99: Refining capacity doubled in the last decade



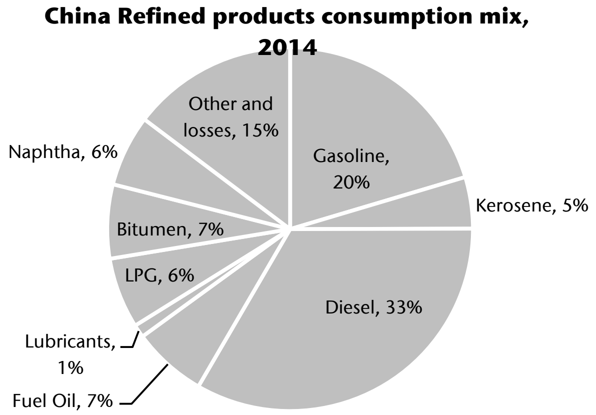
Source: CNOOC Group, CNPC, Sinopec Corp., Shaanxi Yanchang, Sinochem, ChinaChem, NORINCO, BP Statistical Review, Jefferies estimates

Chart 98: Transportation fuels form the bulk of U.S. oil demand



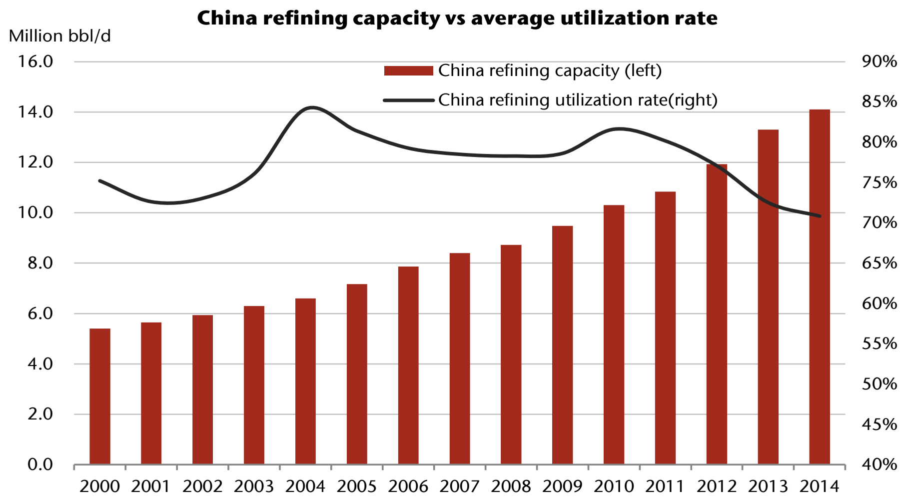
Source: EIA, Jefferies

Chart 100: Contrary to the U.S., industrial fuels form the bulk of China's oil demand



Source: China Customs, NBS, China OGP, Jefferies

Chart 101: Refining capacity doubled in the last decade. Average utilization rate has been falling in the last 5 years



Source: BP Statistical Review, Jefferies estimates

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Strength of consumer oil demand is not well understood

In the public domain, not much analysis has been done on structural change of oil usage. Headline news in the last two years was almost always about weak power demand and GDP growth.

Hence, we came up with our own estimate of implied oil demand. Every month, we collate data from China Customs, China OGP, and NBS, taking into account the effects of commercial inventory drawdown, import/export of even the marginal refined products. This is a more robust approach to estimate the implied oil demand, as opposed to simply downloading “apparent consumption” data from NBS.

- Our analysis shows that China’s transportation fuel demand is on steroids.
- Gasoline implied daily consumption was up ~9.9% in 2015. Likewise, kerosene implied demand was strong, up ~16.7% in 2015, accelerating from 10-11% CAGR (in 2012-2014). This is far from the grim picture that news headlines portray.

Various economic indicators show that consumer activity is strong: surging air travel and a growing passenger car installed base are two examples. Though these indicators are only representative of the middle to upper middle class consumers, the low car penetration rate in China means there is still a long runway for growth.

China’s refined products pricing reform

Up until March 2001, the NDRC pretty much set prices on refined products based on a cost plus model: indicative crude prices set by NDRC + transportation and miscellaneous costs.

Such a pricing mechanism was inefficient. In the ensuing decade, regulators took steps to move pricing towards a market-driven direction.

From March 2001, NDRC stopped publishing indicative prices of crude. From March 2013, price revision period is shortened from 22 days to 10 days. The 4% upward and downward fluctuation cap on benchmark crude oil prices has been abolished. Composition of domestic benchmark crude oil types are now reflective of the types traded in the overseas market.

Today, China’s refined product pricing mechanism is still regulated. But it is as close to market pricing as it can get.

Table 27: New pricing mechanism for refined products, announced on January 13, 2016

Pricing mechanism	
Crude above US$130/bbl	Retail ceiling prices of diesel and gasoline will be raised minimally, or not at all.
Crude at US$40-130/bbl	Retail ceiling prices of diesel and gasoline will be adjusted according to oil price changes.
Crude below US$40/bbl	Retail ceiling prices of diesel and gasoline will not be cut.
Policy rationale	Low oil prices lower China's cost of crude import in the short term, but cause domestic crude output to fall in the long term. That's because China's oil reserves are limited, and production cost is high (China's dependency ratio is already high at 60%).
	Persistently low oil prices are negative to the long term development of China's oil and gas industry, including that of alternative energy industry.
	The goal of a completely market-driven refined product pricing mechanism has not been achieved yet.
Next steps	LPG factory prices will be liberalized. Due to refining capacity addition, and more opportunities for imports, LPG supply is plentiful. The retail prices of LPG will be persistently below NDRC's ceiling prices.
	The communication on pricing adjustment will be simplified.
Implementation	Ensure supply stability. NDRC expects the producers to coordinate the crude inventory and refined products output, and maintain a reasonable inventory level.
	Pricing discipline. NDRC requires producers to strictly follow NDRC's pricing policy, and punish non-compliant behaviors.
	Strengthen market supervision.

Source: NDRC, Jefferies

Relaxation of crude import rights is a game-changer

In the past, crude import rights were almost exclusive to the state-owned refiners. Teapot refiners, mostly located in Shandong province, used to buy crude oil from SOEs, or import fuel oils from Russia and Venezuela, for processing into diesel and gasoline.

These fuel oils often contain higher sulphur content than crude oil, and are costlier to process. Higher input cost, lack of scale and inferior technology means that many of these teapot refiners are uncompetitive and loss making.

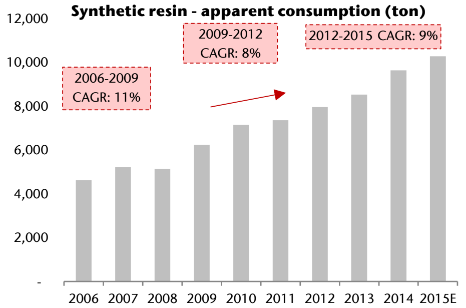
Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Starting in July 2015, Ministry of Commerce began to grant crude oil import quota to teapot refiners (capped at 37.6m ton/year, equivalent to 8% of China's refining throughput volume in 2014).

China petrochemical industry overview

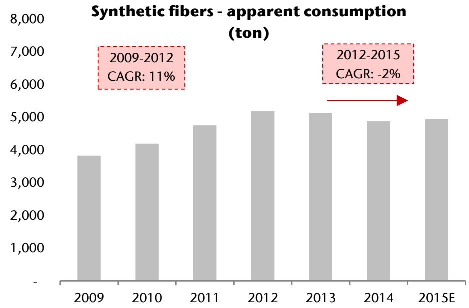
Domestically, the petrochemical industry is dominated by Sinopec and PetroChina, which presents a problem for petrochemical investors eager for China exposure. Sinopec's value is largely determined by its refiners, upstream assets and government policy. PetroChina's chemical segment is minuscule compared to its upstream enormity.

Chart 102: Synthetic resin – China imports 26% of apparent consumption



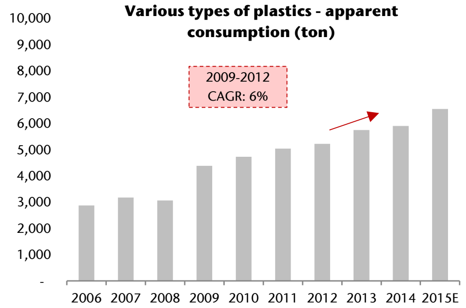
Source: Jefferies, company data

Chart 103: Synthetic fiber – China imports 20% of apparent consumption



Source: Jefferies, company data

Chart 104: Plastics – China imports 21% of apparent consumption



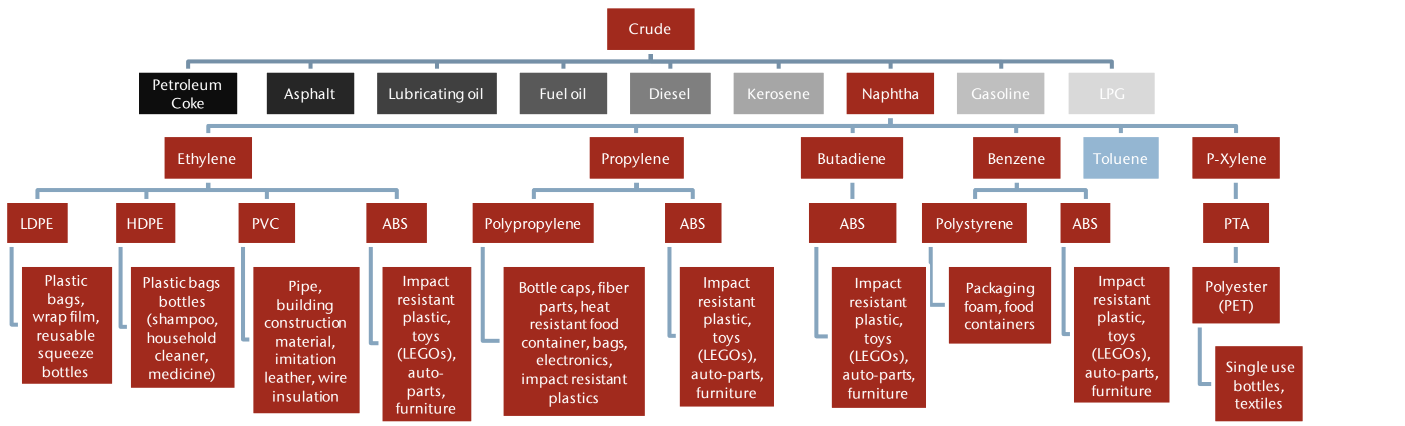
Source: Jefferies, company data

Petrochemical plants in the Middle East, and increasingly North America, have access to ample supplies of low cost natural gas whose ethane component can be a low cost petrochemical feedstock. China is a high cost producer. It does not have the natural gas advantage of North America and the Middle East, and it is an oil importer.

- **Middle East.** Because of extensive natural gas resources, the Middle East has been on a petrochemical construction binge, nearly quadrupling capacity in the past decade. The Middle East's proportion of global ethylene capacity increased from 7% in 2000 to ~18%.

- **North America.** The US had been experiencing a steady decline in petrochemical production for much of the past decade but is likely at an inflection point as surging natural gas production from shale developments collapsed the natural gas price. The first of a new wave of ethylene crackers is coming on stream this year.

Chart 105: Petrochemical chain



Source: Chemical Engineering Magazine, China Plastics, Sinopec

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Kantons (934 HK)

Buy; HK$4.75 Price Target

Scenarios

Target Investment Thesis

- The solution to China's rapidly ageing oilfields is either overseas asset acquisitions, or crude import. Both options point to rising demand for oil transportation and storage, a LT positive for Sinopec Kantons.
- Our price target of HK$4.75 is based on SOTP valuation, implying 0.9x P/B on 2017 estimate, against an 8% ROE.

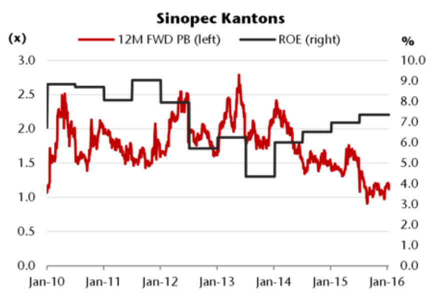
Upside Scenario

- Upside drivers include 1) data points that affirm gas demand recovery, 2) further asset injection from parent.
- Our bull case price target is HK$5.70.

Downside Scenario

- Downside drivers include 1) share placement, 2) disappointments in gas transmission volume and gas prices.
- Our bear base price target is HK$3.80.

Analysis



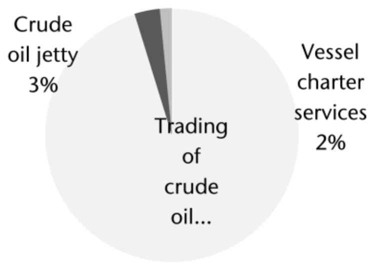
Long Term Financial Model Drivers

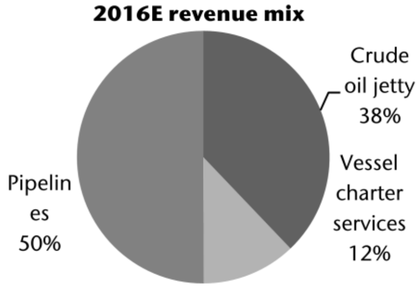
LT Earnings CAGR	**5.0%**
Organic Revenue Growth	**5.0%**
Acquisition Contribution	**0.0%**
Operating Margin Expansion	**0.0%**

Others

- The ultimate parent company, Sinopec Group, has a stretched balance sheet. We expect Sinopec Group to use its listed subsidiaries for capital raising, in order to bring its gearing level closer to global supermajors'.

Snapshot of sales and profit mix





Ticker	Rating		Price target
386 HK	Buy	HKD	5.10
600028 CH	Hold	RMB	4.80
1033 HK	Hold	HKD	1.50
600871 HK	Underperform	RMB	1.36
338 HK	Buy	HKD	4.20
600688 CH	Underperform	RMB	4.10
2386 HK	Hold	HKD	6.90
934 HK	Buy	HKD	4.75

Catalysts

We believe that earnings accretion from Yuji Pipelines (to be reported through 2016) will bolster investor interest. However, crude price rebound is the most important catalyst to revive fund flow into the oil and gas sector.

Company Description

Sinopec Kantons is China's largest oil storage and terminal company, which owns over half of the country's crude terminals, and also the Fujairah Terminal in UAE, the VESTA Terminals in Europe, and the Batam Project in Indonesia. In 1H15, it terminated its loss-making crude trading business, and began to consolidate earnings from Yuji Pipelines (asset injection from parent co) in 2016. Sinopec Kantons is among the earliest Sinopec subsidiaries to be listed (1999). All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Engineering (2386 HK)

Hold: HK$6.90 Price Target

Scenarios

Target Investment Thesis

- China built 66% of the world's new refining capacity in the last decade. Most chemicals oversupplied, except for ethylene and PX. We expect SEG to enter a lower stage of growth. We like SEG's strong balance sheet and industry leading position, but initiate with a Hold rating due to lack of near term catalysts.
- Our price target of HK$6.90 is based on 1.2x 12-month weighted P/B multiple.

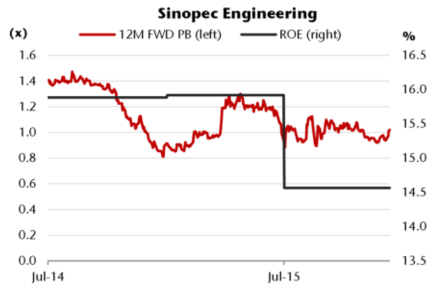
Upside Scenario

- Upside drivers are 1) faster than expected surge in crude prices, which would revive investments in chemical infrastructure projects; 2) increased capacity expansion from teapot refiners.
- Our bull case price target is HK$8.30.

Downside Scenario

- Downside drivers are 1) project delay, 2) change in contract terms.
- Our bear case price target is HK$5.50.

Analysis



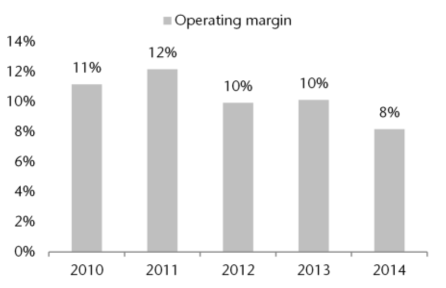
Long Term Financial Model Drivers

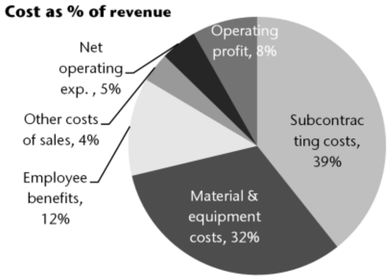
LT Earnings CAGR	5.0%
Organic Revenue Growth	5.0%
Acquisition Contribution	0.0%
Operating Margin Expansion	0.0%

Others

- The ultimate parent company, Sinopec Group, has a stretched balance sheet. We expect Sinopec Group to use its listed subsidiaries for capital raising, in order to bring its gearing level closer to global supermajors'.

Key metrics





Ticker	Rating		Price target
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338 HK	Buy	HKD	4.20
600688 CH	Underperform	RMB	4.10
2386 HK	Hold	HKD	6.90
934 HK	Buy	HKD	4.75

Catalysts

Policy announcements/clarifications regarding refining/chemical sector projects would affect market expectation on SEG's outlook.

Company Description

SEG is China's leading oil and gas E&C company, and is among the largest by revenue among global peers. SEG's history dates back to the 1950s, and was restructured in 2012 to prepare for IPO on the HKEx in 2013. Before IPO, 50% of SEG's revenue was from Sinopec Group. Post IPO, the percentage has been falling, and other corporations (mainly Shenhua and CNOOC) have been contributing more to SEG's revenue. China is still the core market (85% of revenue). Just like the Japanese and Korean E&Cs that have entered mature growth phase in their domestic markets and need to seek opportunities overseas, SEG would do the same. However, overseas competition is more intense, and profitability would be lower. All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Corp. (H share: 386 HK, Buy; A share: 600028 CH, Hold)

Price Target: H share HK$5.10; A share RMB 4.80

Scenarios

Target Investment Thesis

- Low prices hurt E&P segment. Hence, Sinopec Corp has to count on downstream to achieve profitability.
- Our target price is based on SOTP valuation. Target prices imply 7-8x EV/EBITDA on 2017 estimate. Price Target: H share HK$5.10; A share RMB 4.80

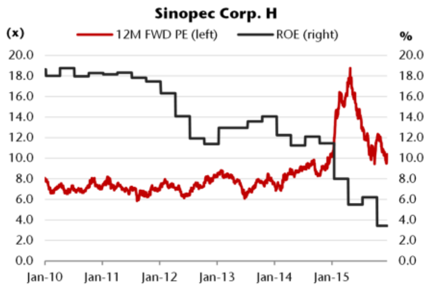
Upside Scenario

- Drivers for upside are: Recovery of crude prices, leading to better E&P economics, and short term arbitrage opportunities for refining segment.
- Our bull case target price is HK$6.10 for H share, and RMB 5.80 for A share.

Downside Scenario

- Drivers for downside are: injections of uneconomical assets from Sinopec Group, wider than expected E&P losses, refining losses due to sharp swings in crude prices.
- Our bear base target price is HK$4.10 for H share, and RMB 3.80 for A share.

Analysis



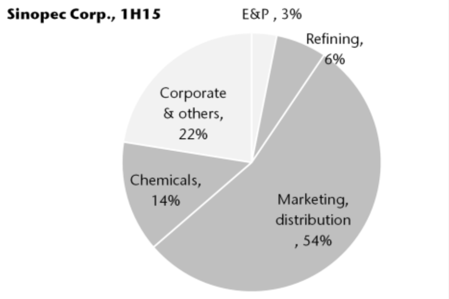
Long Term Financial Model Drivers

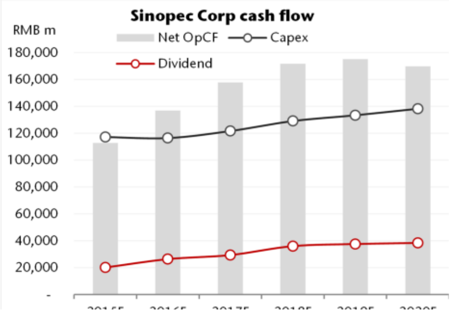
LT Earnings CAGR	**5.0%**
Organic Revenue Growth	**5.0%**
Acquisition Contribution	**0.0%**
Operating Margin Expansion	**0.0%**

Others

- The ultimate parent company, Sinopec Group, has a stretched balance sheet. We expect Sinopec Group to use its listed subsidiaries for capital raising, in order to bring its gearing level closer to global supermajors'.

Snapshot of key financials





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600688 CH	Underperform	RMB	4.10
2386 HK	Hold	HKD	6.90
934 HK	Buy	HKD	4.75

Catalysts

Supply/demand dynamics of refined products in China; strict policy implementation of National Standard 4/5 fuels.

Company Description

Sinopec Corp. is an integrated E&P, refining and chemical company, with dominant market share in both refining and production of basic chemicals. All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Shanghai Petrochemical (H: 338 HK; A: 600688 CH)

BUY H share, Price Target HK$4.20; UNPF A share, Price Target RMB 4.10

Scenarios

Target Investment Thesis

- The stock has been flying under the investors' radar, perhaps because of modelling complexity, and mixed results in the past. We think that 2016 is a year when the stars align. In a (prolonged) low oil price world, integrated refining and chemical producers will shine.
- Our target prices are based on SOTP valuation. Target prices imply 5-6x EV/EBITDA on 2017 estimate. Price Target: H share HK$4.20; A share RMB 4.10.

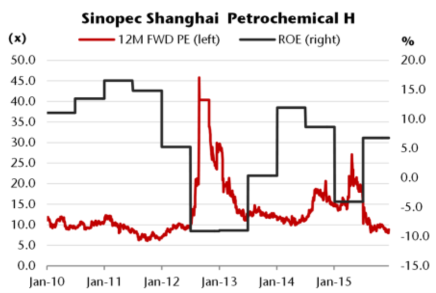
Upside Scenario

- Drivers for upside are: 1) steadily rising crude prices; 2) faster exit of marginal producers who fail to meet National Standard V will lead to market share gain opportunity.
- Our bull case target price is HK$5.00 for H share, and RMB 4.90 for A share.

Downside Scenario

- Drivers for downside are: 1) oversupply of refined products and chemical products, 2) refining losses due to sharp swings in crude prices.
- Our bear base target price is HK$3.40 for H share, and RMB 3.30 for A share.

Long Term Analysis



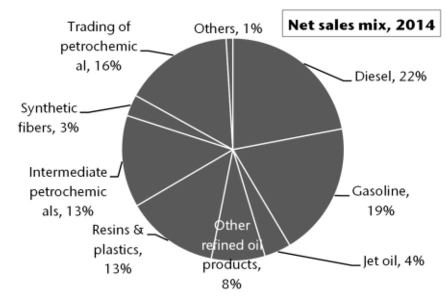
Long Term Financial Model Drivers

LT Earnings CAGR	**5.0%**
Organic Revenue Growth	**5.0%**
Acquisition Contribution	**0.0%**
Operating Margin Expansion	**0.0%**

Others

- The ultimate parent company, Sinopec Group, has a stretched balance sheet. We expect Sinopec Group to use its listed subsidiaries for capital raising, in order to bring is gearing level closer to global supermajors'.

Snapshot of sales and profit mix



Ticker	Rating		Price target
386 HK	Buy	HKD	5.10
600028 CH	Hold	RMB	4.80
1033 HK	Hold	HKD	1.50
600871 HK	Underperform	RMB	1.36
338 HK	Buy	HKD	4.20
600688 CH	Underperform	RMB	4.10
2386 HK	Hold	HKD	6.90
934 HK	Buy	HKD	4.75

Catalysts

- Regional supply/demand imbalance could skew Sinopec Shanghai Petrochemical's refining margins.
- Sudden spike in oil price means short term margin compression
- Imposition of consumption tax that may hurt demand of refined products
- Relaxation of import policy of refined products that would exacerbate oversupply situation in China

Company Description

Sinopec Shanghai Petrochemical was founded in 1972, and subsequently became a Sinopec Group subsidiary in 1993. Over the years, Sinopec Shanghai transformed from synthetic fiber producer to an integrated producer of a wide range of refined oil and petrochemical products. Its H shares were listed in 1993. In 2000, Sinopec Group transferred its interest in Sinopec Shanghai to Sinopec Corp. All the senior managers have risen through the ranks within the Sinopec Group system. Board members/senior managers can be reassigned to other Sinopec subsidiaries by the parent Sinopec Group. The current term for Directors, Executive Officers and members of the Supervisory Committee will end in June 2017.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Sinopec Oilfield Services (H: 1033 HK; A: 600871 CH)

Hold H share: HK$1.50 Price Target; Underperform A share: RMB 1.36 Price Target

Scenarios

Target Investment Thesis

- The restructured Sinopec OFS has only 2 full years of financial history that investors can reference from – and these disclosures reflect low margins and ROIC.
- We expect losses to return in 2016, although breakeven was achieved in 2015.
- Our target prices are based on 5x EV/EBITDA multiple on 12-month weighted EBITDA estimate. Target price of HK$1.50 for H share, RMB 1.36 for A share.

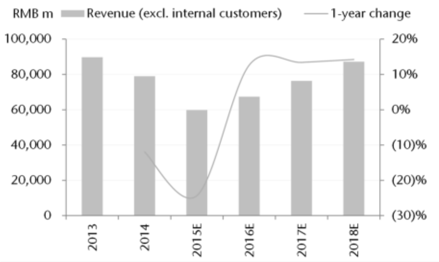
Upside Scenario

- Drivers for upside are 1) massive cost cutting in 2016, 2) smaller than expected E&P capex cut by customers.
- Our bull case target price is HK$1.80 for H share, and RMB 1.60 for A share.

Downside Scenario

- Drivers for downside are 1) impairment charges, 2) larger than expected capex cut, 3) sharp rebound in crude prices.
- Our bear base target price is HK$1.20 for H share, and RMB 1.10 for A share.

Long Term Analysis



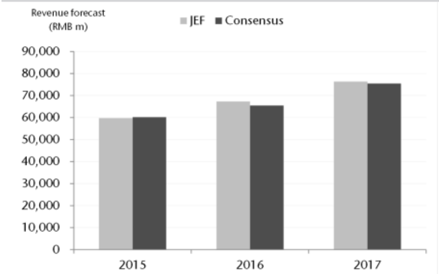
Long Term Financial Model Drivers

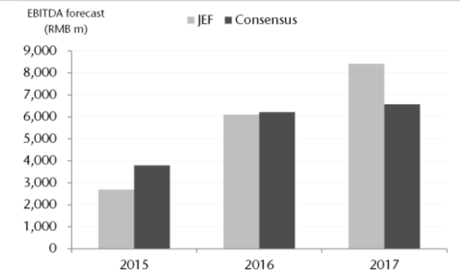
LT Earnings CAGR	**5.0%**
Organic Revenue Growth	**4.5%**
Acquisition Contribution	**0.0%**
Operating Margin Expansion	**0.5%**

Other Considerations

Cost cutting and efficiency gain is a key focus. Sell-side analysts have different expectations on the timing and effectiveness of the cost cutting program, hence their earnings forecast differ.

Peer Group





Ticker	Rating		Price target
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338 HK	Buy	HKD	4.20
600688 CH	Underperform	RMB	4.10
2386 HK	Hold	HKD	6.90
934 HK	Buy	HKD	4.75

Catalysts

- Signs of sustained rebound in oil prices; news headlines that point to possibility of supply tightening to accelerate market rebalancing; voluntary announcements by the listed companies on order book updates; announcements of capex guidance by PetroChina, CNOOC and Sinopec.

Company Description

Sinopec Oilfield Service is China's leading oilfield services company, majority owned by Sinopec.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

Company Description

China Petroleum and Chemical Corporation (Sinopec) refines, produces and trades petroleum and petrochemical products such as gasoline, diesel, jet fuel, kerosene, ethylene, synthetic fibers, synthetic rubber, synthetic resins, and chemical fertilizers.

China Petroleum and Chemical Corporation (Sinopec) refines, produces and trades petroleum and petrochemical products such as gasoline, diesel, jet fuel, kerosene, ethylene, synthetic fibers, synthetic rubber, synthetic resins, and chemical fertilizers.

Sinopec Kantons Holdings Limited trades crude oil, petroleum and petrochemical products. The company also operates a crude oil jetty and its ancillary facilities and petrol stations.

Sinopec Engineering provides petrochemical engineering and construction services.

Sinopec Shanghai Petrochemical Co., Ltd. processes crude oil into a broad range of synthetic fibers, resins and plastics, intermediate petrochemical products and petroleum products.

Sinopec Shanghai Petrochemical Company Limited processes crude oil into a broad range of synthetic fibers, resins and plastics, intermediate petrochemical products and petroleum products.

Sinopec Oilfield Service Corporation manufactures and distributes polyester chips, staple fiber, hollow fiber and polyester filament.

Sinopec Oilfield Services manufactures and distributes polyester chips, staple fiber, hollow fiber and polyester filament.

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Niki Kouzmanov holds a long equity position in BP plc.
Jefferies & Company, Inc. is acting as financial advisor to Chesapeake Energy Corp.
Jefferies is acting as sell-side advisor to Devon Energy in the proposed sale of non-core assets.

Company Specific Disclosures

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Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.
Hold - Describes securities that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.
Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.
The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below $10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below $10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below $10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.
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CS - Coverage Suspended. Jefferies has suspended coverage of this company.

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

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Other Companies Mentioned in This Report

- Anton Oilfield Services Group (3337 HK: HK$0.69, HOLD)
- Bharat Petroleum Corporation Limited (BPCL IN: INR779.75, BUY)
- BP plc (BP/ LN: p332.80, HOLD)
- Chesapeake Energy Corporation (CHK: $1.59, UNDERPERFORM)
- Chevron (CVX: $85.43, BUY)
- Chicago Bridge & Iron (CBI: $32.42, BUY)
- China Oilfield Services - H (2883 HK: HK$5.48, BUY)
- China Petroleum & Chemical - A (600028 CH: CNY4.41, HOLD)
- CHIYODA Corporation (6366 JP: ¥810, BUY)
- CNOOC Ltd. (883 HK: HK$7.96, BUY)
- ConocoPhillips Corporation (COP: $32.90, HOLD)
- Devon Energy Corp. (DVN: $21.69, BUY)
- ExxonMobil (XOM: $81.03, HOLD)
- Galp Energia (GALP PL: €10.42, BUY)
- Hilong Holdings Ltd. (1623 HK: HK$0.97, BUY)
- Indian Oil Corporation Limited (IOCL IN: INR388.60, BUY)
- Occidental Petroleum (OXY: $67.06, HOLD)
- Petrochina Co. Ltd - H (857 HK: HK$4.67, BUY)
- Reliance Industries (RIL IN: INR946.75, BUY)
- Repsol (REP SM: €8.97, HOLD)
- Royal Dutch Shell plc (RDSA LN: p1,542.00, BUY)
- Sinopec Oilfield Service Corporation - H (1033 HK: HK$1.62, HOLD)
- Sinopec Oilfield Services - A (600871 CH: CNY6.59, UNDERPERFORM)
- Sinopec Shanghai Petrochem - A (600688 CH: CNY5.67, UNDERPERFORM)
- Sinopec Shanghai Petrochem - H (338 HK: HK$3.04, BUY)
- SPT Energy Group Inc. (1251 HK: HK$0.53, HOLD)
- TonenGeneral Sekiyu K. K. (5012 JP: ¥977, BUY)
- Total SA (FP FP: €38.63, BUY)

Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

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Rating	Count	Percent	IB Serv./Past 12 Mos. Count	IB Serv./Past 12 Mos. Percent
BUY	1181	54.73%	335	28.37%
HOLD	819	37.95%	162	19.78%
UNDERPERFORM	158	7.32%	17	10.76%

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Elaine Lai, Equity Analyst, +852 3743 8020, elai@jefferies.com

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