

## Technical Action

28 May 2008

### CNOOC (883.HK)

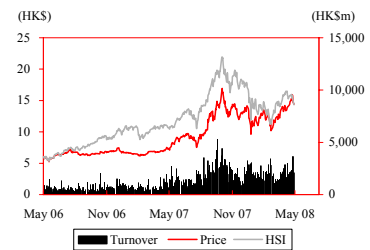
#### Time to Take Profit

- Based on our technical analysis, we recommend investors to take profit in CNOOC, following its strong rally over the past two months.
- CNOOC bottomed out in mid-March before surging due to skyrocketing oil prices.
- In such a strong rally, we keep a close eye on two technical indicators: the 10-day MA and the uptrend.
- On 23 May, CNOOC closed below its uptrend channel with a big black candle and on high trading volume, turning its technical chart weaker. The next day, the stock formed a large down-gap, finally confirming the end of the strong uptrend.
- From bottoming out at HK\$10.08 on 20 March to its high of HK\$16.30 on 22 May, CNOOC has surged 61.7% – we believe now is a good chance to take profit.
- Since peaking on 22 May, CNOOC seems to have formed a downtrend, though there have been some rebounds.
- We expect the next strong support levels to be its 50-day MA at around HK\$13.00 and its 250-day MA at HK\$12.37.

HSI **24,282**  
HSCEI **13,330**

Performance (%)	1m	3m	12m
HSI	(5.3)	(1.2)	18.4
HSCEI	(5.6)	(4.5)	26.0

CNOOC – Price vs. HSI, Share Data



Price – HK\$	14.96
HIS	24,282.04
52W high/low (HK\$)	17.6/6.96
Shares in issue – millions	44,668.05
Market cap – HK\$m	641,433.20
3M avg. turnover – HK\$m	1,965.99
Major shareholders – %	
CNOOC (BVI) Limited	64.97

Sources: Bloomberg and Sun Hung Kai Financial

Figure 1: Technical Chart



Sources: Bloomberg and Sun Hung Kai Financial

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## CNOOC (883.HK) – Company Background

CNOOC Ltd. explores, develops and produces crude oil and natural gas offshore of China. It is the listed company of the China National Offshore Oil Company, which holds a 66% interest. Via its parent, CNOOC has exclusive exploration and production rights within Chinese territorial waters. Furthermore CNOOC can negotiate for offshore PSCs in China with western oil companies and can take a 50% equity stake in any oil and gas production produced from any PSC agreement. The bulk of its operations are offshore China and it also has assets in Indonesia, Australia and Nigeria. CNOOC is the third largest oil-and-gas company in China, accounting for 8% of the nation's aggregate reserves and 9% of production in 2004.



### Fundamental View

Our oil analyst Michael Yuk has also published a report on CNOOC today, where he downgrades the stock from Buy to Neutral, keeping his target price at HK\$14.30. The stock has posted a sharp 47% rebound since reaching a low of HK\$10.18 on 20 March to currently trade at 15X FY08F and 13.2X FY09F earnings, in line with the E&P industry average. He does not see significant upside to the 27 May close of HK\$14.96, and notes that the stock has started to diverge from recent increases in crude prices, signaling that current price already reflects the rise in crude this year. He further expects downward pressure, such as higher costs from accelerated E&P, to cap further upside.

Overall, Michael sees the current stock price as reasonable and supported by E&P upside. However, the effect of higher crude prices has already been factored in and there is currently more downside pressure than upside potential, as the expected adjustment in the windfall levy will most likely not materialize this year.



Figure 2: Investment Highlights for CNOOC

(The points listed below are summaries and/or excerpts from various market views, and do not necessarily represent the opinions of Sun Hung Kai Financial. We do not make any representation or guarantee as to the accuracy of the information provided).

	
Key investment positives	Key investment negatives
<ul style="list-style-type: none"> <li>▪ CNOOC benefits from the national policy of expanding oil-and-gas exploration and production to meet increasing demand in China.</li> <li>▪ The company has made seven new discoveries:               <ol style="list-style-type: none"> <li>1. <b>Bohai Bay</b> (Bozhong 28-2 East, Bozhong 26-3, Jinzhou 25-1 and Kenli 20-1).</li> <li>2. <b>Western South China Sea</b> (Weizhou 11-7, Weizhou 11-8 and Weizhou 6-1 South).</li> </ol> </li> <li>▪ Company will enjoy a 15% preferential tax rate for 2007.</li> <li>▪ For every US\$1/bbl change in crude prices, earnings would move around 1.8%</li> <li>▪ The 2008 E&amp;P budget has been raised 43.7% to US\$5.24bn.               <ol style="list-style-type: none"> <li>1. US\$4.15bn for development</li> <li>2. US\$1.04bn for exploration.</li> <li>3. Overseas developments include OML-130, Nigeria, while domestic developments include PL19-3, Bohai Bay.</li> </ol> </li> <li>▪ FY08 oil-and-gas production should reach 195-199 mboe, up 15-17% based on a US\$70/bbl WTI price assumption.               <ol style="list-style-type: none"> <li>1. Strong growth is expected from the steady stream of new projects coming on line, e.g. China's Penglai and Wenchang offshore fields should add about 240 kb/d to production.</li> </ol> </li> <li>▪ 18% production growth expected for 2009, given full-year contributions from new overseas projects such as OML-130 (Nigeria) and Tangguh LNG. These projects are expected to deliver their first production in 4Q08.</li> <li>▪ 10 new projects are scheduled to come on stream in 2008 and 10-plus in subsequent years.</li> <li>▪ Replacement ratio expected to remain above 100%, are coming in at 186% for 2005 and 199% for 2006.</li> <li>▪ 11% production CAGR expected for 2006-10</li> </ul>	<ul style="list-style-type: none"> <li>▪ 1H07 oil price was US\$58.80/bbl, with a gas price of US\$3.17/kcuft, vs. US\$58.9/bbl and US\$3.05/kcuft in FY06.</li> <li>▪ Lower crude prices:               <ol style="list-style-type: none"> <li>1. 1H08 oil-price correction due to U.S. economic pressure; 2H08 outlook depends on demand.</li> <li>2. A non-OPEC supply surge from a slew of new projects.</li> <li>3. Higher OPEC production and draft on weak OECD demand suggests oil is likely to correct.</li> </ol> </li> <li>▪ Special oil gain levy (SOG levy) imposed by the MOF at 20-40% progressive rates for crude lifted in the PRC and priced over US\$40/bbl.</li> <li>▪ The 169-171 mBOE in FY07 was slightly lower than most expectations of 173 mBOE.</li> <li>▪ Shutting down Dongfang 1-1 in the South China Sea due to damage to undersea pipelines. Supply was restored at end-December 2007.</li> <li>▪ CNOOC estimates production costs to post a 10% CAGR over 2007-10 due to rising costs in construction material, drilling, equipment, engineering and labor.</li> </ul>

Source: Sun Hung Kai Financial

Figure 3: Upside/ negative Price Catalyst

 Upside price catalyst	 Negative price catalyst
<ul style="list-style-type: none"> <li>▪ Greater exploration success.</li> <li>▪ Higher-than-expected oil prices.</li> <li>▪ The central government allowing an adjustment in the Special Oil Gain Levy (windfall levy).</li> <li>▪ Asset injections by the parent company.</li> <li>▪ New gas-and-oil discoveries and acquisitions.</li> <li>▪ A-share listing.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Sharp crude-price drops due to global recession.</li> <li>▪ Possible overpriced M&amp;A activity and minority investor concerns about corporate-governance discipline</li> <li>▪ Disappointing new discoveries</li> <li>▪ Higher operational risk, capital risk, and cost creep affecting international operations.</li> <li>▪ Lower targeted production growth in 2007-10 and weather-related disruptions.</li> <li>▪ Regulatory changes enhancing the position of Chinese competitors offshore and/or raising taxes further</li> <li>▪ Earnings dilution if options on investments are executed in LNG purchases, related pipelines and LNG imports.</li> <li>▪ Possible inconsistent dividend payouts</li> <li>▪ Stronger RMB and cost inflation can lower reported earnings</li> <li>▪ Increase in capex from US\$3.60bn to US\$5.24bn may not be productive</li> </ul>

Source: Sun Hung Kai Financial

Figure 4: CNOOC - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY03-07 CAGR (%)
Revenue	55,222.1	69,455.7	88,947.3	90,723.8	113,404.8	120,209.1	22.0
Operating expenses	(32,860.1)	(33,247.1)	(45,640.2)	(49,757.9)	(62,372.6)	(66,115.0)	18.5
Operating profit	22,362.0	36,208.7	43,307.1	40,965.9	54,434.3	61,306.6	27.1
Finance expenses	(322.1)	(528.5)	(307.3)	(330.6)	(357.0)	(371.3)	6.0
PBT	23,163.0	36,476.4	44,123.3	43,310.6	53,300.3	56,257.8	27.9
Tax	(6,930.8)	(10,977.8)	(13,196.3)	(12,052.3)	(12,259.1)	(11,251.6)	27.0
Net profit	16,232.2	25,498.5	30,926.9	31,258.3	41,041.2	45,006.3	28.3
EPS –RMB fens	39.0	62.0	73.0	72.0	92.6	101.6	26.6

Sources: Bloomberg and Sun Hung Kai Financial

Figure 5: CNOOC – Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY03-07 CAGR (%)
Cash and securities	14,091.5	8,991.8	14,364.1	23,356.6	26,392.9	29,032.2	12.9
Accounts receivable	4,276.5	5,277.8	5,437.9	7,129.8	8,845.6	9,496.5	13.8
Inventory	1,147.3	1,199.6	1,691.5	2,345.9	2,513.6	2,765.0	21.0
Other current assets	15,777.4	28,952.2	26,398.7	22,899.8	25,088.2	27,830.6	24.5
Total current assets	35,292.7	44,421.4	47,892.1	55,732.1	62,840.3	69,124.3	17.5
Net fixed assets	57,182.0	66,625.2	103,406.4	118,880.2	136,712.2	154,484.8	28.9
Other long-term assets	1,327.1	3,718.5	3,969.5	5,181.0	0.0	0.0	46.7
Total assets	93,801.9	114,765.1	155,268.0	179,793.3	199,552.5	223,609.1	25.1
Short-term debt	24.4	825.7	17.8	0.0	0.0	0.0	N/A
Accounts payable	3,102.0	2,867.7	4,146.0	5,051.4	5,670.2	6,010.5	6.2
Other current liabilities	7,276.0	9,922.9	10,317.6	16,350.3	20,412.9	21,637.6	32.4
Total current liabilities	10,402.4	13,616.2	14,481.4	21,401.7	26,083.1	27,648.1	23.1
Long-term debt	17,178.8	16,556.2	20,324.0	11,046.0	11,178.5	11,335.0	5.2
Other long-term liabilities	9,778.0	10,989.6	12,648.8	13,030.9	17,312.6	18,865.6	11.5
Total liabilities	37,359.1	41,162.0	47,454.1	45,478.5	54,574.2	57,848.7	14.2
Shareholders equity	56,442.8	73,603.1	107,813.9	134,314.7	144,978.3	165,760.5	30.2
Minorities	0.0	0.0	41.9	0.0	0.0	0.0	N/A
Total equity and liabilities	93,801.9	114,765.1	155,268.0	179,793.2	199,552.5	223,609.1	25.1

Sources: Bloomberg and Sun Hung Kai Financial

Figure 6: CNOOC – Key Ratios

Year ended 31 Dec - %	FY04	FY05	FY06	FY07	FY08F	FY09F	FY03-07 CAGR (%)
<b>Growth ratios</b>							
Revenue growth	34.9	25.8	28.1	2.0	25.0	6.0	22.0
EBIT growth	42.6	61.9	19.6	(5.4)	32.9	12.6	27.1
Net-profit growth	40.7	57.1	21.3	1.1	31.3	9.7	28.3
EPS growth	39.3	59.0	17.7	(1.4)	28.7	9.7	26.6
<b>Profitability ratios</b>							
Operating margin	40.5	52.1	48.7	45.2	48.0	51.0	46.6
Net margin	29.4	36.7	34.8	34.5	36.2	37.4	33.8
ROAA	19.4	24.5	22.9	18.7	21.6	21.3	21.4
ROAE	31.5	39.2	34.1	25.8	29.4	29.0	32.6
<b>Other ratios</b>							
Capex/sales	33.7	25.2	49.7	29.6	27.5	27.2	34.5
Capex/depreciation	341.4	292.9	637.7	364.3	397.5	392.3	409.1
Net debt/equity (net cash)	(19.4)	(24.0)	(14.5)	(21.7)	(10.5)	(10.7)	(19.9)
Inventory/sales	2.1	1.7	1.9	2.6	2.2	2.3	2.1
Effective tax rate	29.9	30.1	29.9	27.8	23.0	20.0	29.4
<b>ROAA component analysis</b>							
Revenue/average assets	66.0	66.6	65.9	54.2	59.8	56.8	63.2
Operating expenses/average assets	(39.3)	(31.9)	(33.8)	(29.7)	(32.9)	(31.2)	(33.7)
Operating profit/average assets	26.7	34.7	32.1	24.5	28.7	29.0	29.5
Finance expenses/average assets	(0.4)	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)
PBT/average assets	27.7	35.0	32.7	25.9	28.1	26.6	30.3
Tax/average assets	(8.3)	(10.5)	(9.8)	(7.2)	(6.5)	(5.3)	(8.9)
Net profit/average assets	19.4	24.5	22.9	18.7	21.6	21.3	21.4
<b>ROAE component analysis</b>							
Revenue/average equity	107.0	106.8	98.1	74.9	81.2	77.4	96.7
Operating expenses/average equity	(63.7)	(51.1)	(50.3)	(41.1)	(44.7)	(42.6)	(51.6)
Operating profit/average equity	43.3	55.7	47.7	33.8	39.0	39.5	45.2
Finance expenses/average equity	(0.6)	(0.8)	(0.3)	(0.3)	(0.3)	(0.2)	(0.5)
PBT/average equity	44.9	56.1	48.6	35.8	38.2	36.2	46.4
Tax/average equity	(13.4)	(16.9)	(14.5)	(10.0)	(8.8)	(7.2)	(13.7)
Net profit/average equity	31.5	39.2	34.1	25.8	29.4	29.0	32.6

Sources: Bloomberg and Sun Hung Kai Financial

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