

CNOOC Ltd

Bloomberg: 883 HK EQUITY | Reuters: 0883.HK

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DBS Group Research . Equity

12 Jan 2022

BUY

Last Traded Price (11 Jan 2022): HK\$8.57 (HSI : 23,739)
Price Target 12-mth: HK\$15.00 (75% upside)

Analyst

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What's New

- FY21E production grew 8%, beating earlier growth guidance of 4%; guides for 6-7% pa growth through 2024
- Positive surprises – special dividend for FY21; committed to at least HK\$0.70/share or 40% payout ratio in the next 3 years; initiating share buyback
- Upcoming A-share listing lends further support to share price
- Reiterate BUY; TP HK\$15.00; lucrative dividend yield of 10%

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021F	2022F	2023F
Turnover	155,372	252,406	275,725	318,449
EBITDA	91,930	167,317	179,704	197,501
Pre-tax Profit	34,907	103,339	111,809	126,581
Net Profit	24,956	73,889	79,926	90,485
Net Pft (Pre Ex) (core profit)	24,956	73,889	79,926	90,485
Net Profit Gth (Pre-ex) (%)	(59.1)	196.1	8.2	13.2
EPS (RMB)	0.56	1.65	1.79	2.03
EPS (HK\$)	0.68	2.02	2.19	2.48
EPS Gth (%)	(59.1)	196.1	8.2	13.2
Diluted EPS (HK\$)	0.68	2.02	2.19	2.48
DPS (HK\$)	0.49	0.87	0.88	0.99
BV Per Share (HK\$)	11.88	13.09	14.40	15.89
PE (X)	12.5	4.2	3.9	3.5
CorePE (X)	12.5	4.2	3.9	3.5
P/Cash Flow (X)	3.8	2.8	2.2	2.1
P/Free CF (X)	110.3	13.2	7.0	5.5
EV/EBITDA (X)	4.2	2.3	2.1	1.7
Net Div Yield (%)	5.7	10.1	10.2	11.6
P/Book Value (X)	0.7	0.7	0.6	0.5
Net Debt/Equity (X)	0.2	0.2	0.1	0.0
ROAE (%)	5.7	16.2	15.9	16.4
Earnings Rev (%):		18	21	New
Consensus EPS (RMB)		1.62	1.76	1.78
Other Broker Recs:		B:24	S:0	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

2022 Strategy: Positive Catalysts in Play

Investment Thesis

Deep value gem; lucrative dividend yield of 10%. The stock is deeply undervalued, trading at 0.6x FY21 PB and 4x FY22 PE. While the stock has bounced off its low of ~HK\$6.50, it remains a far cry from pre-COVID high of HK\$13-14 despite oil prices recovering to higher levels of US\$70-80/bbl; we believe is attributable largely to US sanctions.

Solid oil price proxy. As a pure upstream company, CNOOC is our preferred proxy to ride on the oil price rebound, given its world-class execution and cost-control capabilities, supported by its firm output compound annual growth rate (CAGR) of 6% from 2021 to 2024. In 2021, CNOOC outperformed expectations, again, with output growing 8% y-o-y (vs 4% guidance).

Positive catalysts in place – dividend surprise, share buyback exercise, and A-share listing. CNOOC's earnings is expected to triple in 2021 and grow by a further 8-13% in FY22-23. Besides promising earnings and cashflow, investors should also be cheered by the positive surprises from its 2022 Strategy Preview – special dividend to be declared for FY21, commitment to pay >40% dividend or absolute dividend of >HK\$0.70 (implied >8% dividend yield) in the next 3 years as well as launch of share buyback exercise. Upcoming A-share listing, probably in Mar/Apr 2022, is another imminent rerating catalyst.

Valuation:

We value CNOOC based on discounted cash flow (DCF) with 10% weighted average cost of capital (WACC), 0% terminal growth, and long-term oil price assumption of US\$65/bbl.

Where we differ:

We remain hopeful on CNOOC's reserve growth, to which there could be a potential understatement of its proven reserve life by ~40% under US SEC reporting standards versus Society of Petroleum Engineers' (SPE) reporting.

Key Risks to Our View:

Oil price volatility, which is dependent on output by OPEC and US as well as near-term demand recovery.

At A Glance

Issued Capital (m shrs)	44,647
Mkt Cap (HK\$m/US\$m)	382,625 / 49,082
Major Shareholders (%)	
China National Offshore Oil Corp	65.0
Free Float (%)	35.0
3m Avg. Daily Val. (US\$m)	64.81
GICS Industry: Energy / Oil, Gas & Consumable Fuels	



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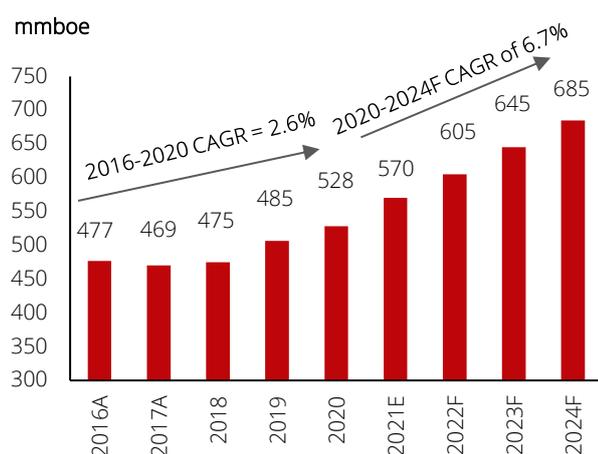
2022 STRATEGY PREVIEW

Dividend surprises!

Favourable production outlook backed by new projects.

CNOOC produced c. 570 mmboe in FY21E, exceeding guidance of c. 545 – 555 mmboe announced in its 2021 Strategy Preview by 4%. Management guided average production targets of 605 / 645 / 685 mmboe in FY22/23/24 (versus previous target of 595 / 645 mmboe). This translates into output compound annual growth rate (CAGR) of 6.3% during 2021-2024.

3-year Production Target



Source: Company, DBS Bank

Higher oil prices drive earnings upgrade. We are raising our FY21/22F earnings by 18-21% to Rmb74 bn and Rmb80bn respectively (implying +196% and +8% y-o-y growth), factoring in higher oil price assumption of US\$71 / 75 per bbl. We expect earnings to grow 13% in FY23 on the back of US\$80/bbl oil price. There is room for further upgrades if oil prices continue to stay above US\$80/bbl in these two years.

In 1H21, CNOOC reported net profit of Rmb33bn on the back of ~US\$62/bbl realised oil price. We expect the company to report ~Rmb40bn profit in 2H21E in view of the sequentially stronger oil price of ~US\$10/bbl on average.

Moderate capex guidance. CNOOC spent ~RMB90bn capex in FY21F, which is in line with the lower end of its FY21F guidance of RMB90-100bn. Management has guided similar capex spending of Rmb90-100bn for FY22. Domestic capex as a proportion of total capex is projected

to make up 73% in FY22F, similar to the last two years. Recent exploration efforts have generated positive returns; Reserves Replacement Ratio (RRR) is expected to stay above 100% at ~130%.

Dividend surprise and share buyback. CNOOC guided that it would pay special dividend for FY21 in conjunction with company's 20th anniversary of listing, though details to be announced during full year results. CNOOC paid HK\$0.30 interim dividend for 1H21, we expect final dividend of HK\$0.49 and a special dividend of HK0.06, bringing full year dividend to HK\$0.85, or c.10% yield

In addition, CNOOC commits to pay out at least 40% of profits as dividend and absolute dividend to be not less than HK\$0.70 (c. 8% yield) for the next 3-years. Assuming 40% payout, we project DPS to be HK\$0.86-0.97 in FY22-23, implying 10-11% dividend yield. We believe the dividend payout is sustainable as projected OCF of >Rmb130bn is sufficient to fund capex and dividends.

During the Strategy Preview briefing, management stressed that the company is undervalued, and has thus proposed to activate its buyback mandate for 2022.

Upcoming A-Share listing is another potential catalyst.

CNOOC's share price has underperformed oil prices and peers. Negative news on its US sanctions back in January 2021 had resulted in a plunge in its share price, which we believe is unjustifiable given that CNOOC's fundamentals and operations remained firm. We anticipate the upcoming A-Share listing to aid in the upward rerating of CNOOC's valuation, which could take place around Mar-Apr 2022, taking cue from recent A-share dual-listings of other SOEs.

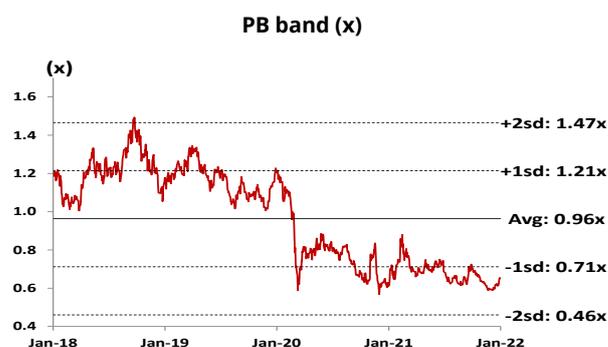
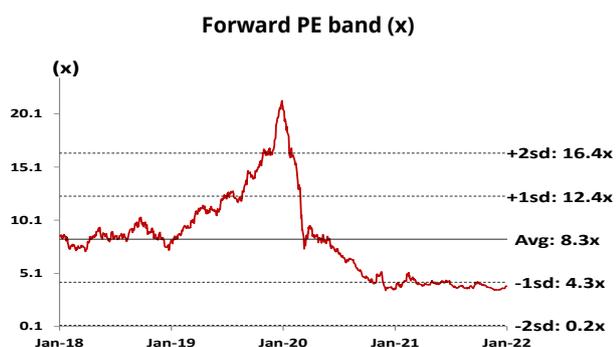
Reiterate BUY and TP of HK\$15.00. CNOOC remains our top pick in the O&G sector. CNOOC is currently trading at -1 SD below mean at 0.7x PB and 4x PE, which we believe presents an attractive entry point for investors in view of the positive catalysts in place: (1) favourable production outlook in 2022 backed by healthy realised oil prices, (2) special dividend for FY21 and lucrative dividend yield of 10-11% in the next 3-years; (3) A-Share listing. Share buyback exercise would also lend support to CNOOC's share price.

CNOOC Ltd

Company Background

CNOOC is engaged in the exploration and production of crude oil and natural gas, primarily within offshore China, with exclusive rights to engage in oil and gas exploration in offshore China. It has also increased its overseas output levels significantly via inorganic growth over the last 6-7 years.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021F	2022F	2023F
Realized oil price (US\$/bbl)	63.3	41.0	66.5	69.8	75.1
Realized gas price (US\$/mcf)	6.3	6.2	6.4	6.3	6.3
Oil production (mmbbls)	410.5	419.1	456.0	471.9	503.1
Gas production (bcf)	561.3	632.2	661.2	772.0	823.0

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenue	233,199	155,372	252,406	275,725	318,449
Cost of Goods Sold	(135,960)	(106,296)	(130,342)	(143,224)	(169,414)
Gross Profit	97,239	49,076	122,063	132,501	149,035
Other Opg (Exp)/Inc	(13,044)	(12,687)	(17,164)	(18,749)	(21,655)
Operating Profit	84,195	36,389	104,900	113,751	127,381
Other Non Opg (Exp)/Inc	5,250	3,867	2,700	2,700	2,700
Associates & JV Inc	1,002	(632)	(203)	(103)	(3)
Net Interest (Exp)/Inc	(4,798)	(4,717)	(4,057)	(4,539)	(3,496)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	85,649	34,907	103,339	111,809	126,581
Tax	(24,604)	(9,951)	(29,459)	(31,874)	(36,085)
Minority Interest	0	0	9	(10)	(11)
Preference Dividend	0	0	0	0	0
Net Profit	61,045	24,956	73,889	79,926	90,485
Net Profit before Except.	61,045	24,956	73,889	79,926	90,485
EBITDA	148,146	91,930	167,317	179,704	197,501
Growth					
Revenue Gth (%)	2.7	(33.4)	62.5	9.2	15.5
EBITDA Gth (%)	13.9	(37.9)	82.0	7.4	9.9
Opg Profit Gth (%)	4.9	(56.8)	188.3	8.4	12.0
Net Profit Gth (%)	15.9	(59.1)	196.1	8.2	13.2
Margins & Ratio					
Gross Margins (%)	41.7	31.6	48.4	48.1	46.8
Opg Profit Margin (%)	36.1	23.4	41.6	41.3	40.0
Net Profit Margin (%)	26.2	16.1	29.3	29.0	28.4
ROAE (%)	14.1	5.7	16.2	15.9	16.4
ROA (%)	8.5	3.4	10.0	10.3	11.1
ROCE (%)	8.7	3.0	10.3	10.4	11.4
Div Payout Ratio (%)	47.5	71.6	42.9	40.0	40.0
Net Interest Cover (x)	17.5	7.7	25.9	25.1	36.4

Source: Company, DBS HK

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Interim Income Statement (RMB m)

FY Dec	1H2019	2H2019	1H2020	2H2020	1H2021
Revenue	108,880	124,319	74,560	80,812	110,233
Cost of Goods Sold	(59,976)	(75,984)	(53,027)	(53,269)	(58,174)
Gross Profit	48,904	48,335	21,533	27,543	52,059
Other Oper. (Exp)/Inc	(5,594)	(7,450)	(5,954)	(6,733)	(6,610)
Operating Profit	43,310	40,885	15,579	20,810	45,449
Other Non Opg (Exp)/Inc	2,389	2,861	1,761	2,106	1,351
Associates & JV Inc	477	525	(22)	(610)	469
Net Interest (Exp)/Inc	(2,134)	(2,664)	(2,372)	(2,345)	(2,296)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	44,042	41,607	14,946	19,961	44,973
Tax	(13,789)	(10,815)	(4,563)	(5,388)	(11,647)
Minority Interest	0	0	0	0	0
Net Profit	30,253	30,792	10,383	14,573	33,326
Net profit bef Except.	30,253	30,792	10,383	14,573	33,326
Growth					
Revenue Gth (%)	3.1	2.5	(31.5)	(35.0)	47.8
Opg Profit Gth (%)	5.0	4.8	(64.0)	(49.1)	191.7
Net Profit Gth (%)	18.7	13.2	(65.7)	(52.7)	221.0
Margins					
Gross Margins (%)	44.9	38.9	28.9	34.1	47.2
Opg Profit Margins (%)	39.8	32.9	20.9	25.8	41.2
Net Profit Margins (%)	27.8	24.8	13.9	18.0	30.2

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Net Fixed Assets	440,554	446,668	483,122	504,766	517,584
Invt in Associates & JVs	45,490	42,366	42,063	41,860	41,757
Other LT Assets	65,742	68,850	63,191	61,792	60,400
Cash & ST Invt	50,534	65,831	55,717	68,591	91,995
Inventory	6,314	5,644	7,414	8,876	9,945
Debtors	24,794	18,982	27,765	35,844	47,767
Other Current Assets	124,303	72,934	72,934	72,934	72,934
Total Assets	757,731	721,275	752,206	794,663	842,382
ST Debt	12,590	11,217	12,590	12,590	12,590
Creditors	40,146	41,203	27,999	30,189	34,521
Other Current Liab	38,513	22,432	22,432	22,432	22,432
LT Debt	136,152	125,013	121,464	111,620	98,494
Other LT Liabilities	82,104	87,480	89,563	91,709	93,919
Shareholder's Equity	448,187	433,708	477,945	525,900	580,190
Minority Interests	39	222	213	223	234
Total Cap. & Liab.	757,731	721,275	752,206	794,663	842,382
Non-Cash Wkg. Capital	76,752	33,925	57,682	65,033	73,693
Net Cash/(Debt)	(98,208)	(70,399)	(78,337)	(55,619)	(19,090)
Debtors Turn (avg days)	36.6	51.4	33.8	42.1	47.9
Creditors Turn (avg days)	171.3	275.0	179.3	133.0	115.8
Inventory Turn (avg days)	28.4	40.4	33.8	37.2	33.7
Asset Turnover (x)	0.3	0.2	0.3	0.4	0.4
Current Ratio (x)	2.3	2.2	2.6	2.9	3.2
Quick Ratio (x)	0.8	1.1	1.3	1.6	2.0
Net Debt/Equity (X)	0.2	0.2	0.2	0.1	0.0
Net Debt/Equity ex MI (X)	0.2	0.2	0.2	0.1	0.0
Capex to Debt (%)	53.5	58.4	67.1	76.5	85.5
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Pre-Tax Profit	85,649	34,907	103,339	111,809	126,581
Dep. & Amort.	57,699	52,306	59,920	63,355	67,424
Tax Paid	(24,604)	(9,951)	(29,459)	(31,874)	(36,085)
Assoc. & JV Inc/(loss)	(1,002)	632	203	103	3
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	15,630	(11,472)	(23,757)	(7,351)	(8,660)
Other Operating CF	(9,851)	15,916	3,441	3,985	3,007
Net Operating CF	123,521	82,338	113,687	140,028	152,270
Capital Exp.(net)	(79,600)	(79,500)	(90,000)	(95,000)	(95,000)
Other Invt.(net)	11,900	53,958	0	0	0
Invt in Assoc. & JV	(7,707)	0	0	0	0
Div from Assoc & JV	100	100	100	100	100
Other Investing CF	7,850	(25,408)	13,675	15,772	20,908
Net Investing CF	(67,457)	(50,850)	(76,225)	(79,128)	(73,992)
Div Paid	(28,973)	(17,859)	(31,700)	(31,970)	(36,194)
Chg in Gross Debt	4,037	(4,844)	(9,844)	(9,844)	(13,125)
Capital Issues	0	0	0	0	0
Other Financing CF	(12,755)	(15,995)	(6,032)	(6,210)	(5,554)
Net Financing CF	(37,691)	(38,698)	(47,576)	(48,025)	(54,874)
Currency Adjustments	311	(2,450)	0	0	0
Chg in Cash	18,684	(9,660)	(10,114)	12,874	23,404
Opg CFPS (RMB)	2.42	2.10	3.08	3.30	3.60
Free CFPS (RMB)	0.98	0.06	0.53	1.01	1.28

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	26-Mar-21	HK\$8.08	HK\$15.00	Buy
2:	20-Aug-21	HK\$8.11	HK\$15.00	Buy

Source: DBS HK

Analyst: Pei Hwa HO

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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