China Petroleum & Chemical Corp. (SNP)

Updated January 25th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$80	**5 Year CAGR Estimate:**	16.8%	**Volatility Percentile:**	61.4%
Fair Value Price:	$99	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	61.8%
% Fair Value:	81%	**5 Year Valuation Multiple Estimate:**	4.4%	**Growth Percentile:**	11.5%
Dividend Yield:	9.4%	**5 Year Price Target**	$114	**Valuation Percentile:**	76.3%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	92.2%

Overview & Current Events

China Petroleum is one of the largest integrated energy and chemical companies in China. It has a market cap of $97B and operates in four segments: exploration & production, refining, marketing and chemicals. In contrast to the well-known integrated oil majors, such as Exxon Mobil and Chevron, China Petroleum relies more heavily on the health of its domestic economy, as its refining and marketing segments play a much more vital role in its overall performance than they play in the performance of its peers.

In late October, China Petroleum reported (10/30/18) its financial results for the first nine months of fiscal 2018. In the first nine months of the year, its earnings-per-share jumped 56% thanks to strong improvement in the results of exploration & production and the refining segment. As the average realized oil price rose 38% over last year, the exploration & production segment narrowed its loss by 96%, from 26.523 billion RMB (about $4.0 billion) to 1.081 billion RMB ($164 million). The refining segment grew its operating income by 25% over last year while the marketing segment exhibited flat results due to intense competition.

While China Petroleum greatly increased its earnings in the first nine months of 2018, it is worth noting that its upstream segment still incurred losses, despite the strong rally of the oil price over prior year. This is a great divergence from all the oil majors, whose upstream segment became highly profitable last year. Even more surprising, China Petroleum prices its oil based on Brent, which trades at a wide premium to WTI. This means that the company's upstream performance is much worse than the upstream performance of U.S. oil majors, which sell a significant portion of their crude oil based on WTI. On the bright side, China Petroleum is less dependent on its upstream segment than its peers and greatly benefits from the strong growth of the Chinese economy, which posted 6.7% GDP growth last year.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$4.59	$10.58	$12.11	$12.57	$11.22	$8.66	$6.50	$4.32	$5.80	$6.35	***$9.50***	***$11.00***
DPS	$1.73	$2.64	$3.10	$4.64	$4.75	$3.88	$3.26	$2.41	$3.75	$7.41	***$7.56***	***$7.60***
Shares	114	114	114	117	118	122	117	121	121	121	***121***	***121***

China Petroleum has a volatile performance record. Its earnings are greatly affected by the underlying commodity prices and refining margins, which are beyond the control of the company. As a result, its earnings plunged during the downturn of the energy sector in 2014-2017, but they have begun to recover strongly thanks to the recovery of the oil price compared to three years ago. We expect the oil price to somewhat rise from its current level in the upcoming years. If this materializes, it will help China Petroleum grow its earnings. On the other hand, due to the dramatic swings of the oil price in recent years, we prefer to be somewhat conservative and thus forecast earnings-per-share around $11.00 by 2023, for a 3.0% annual earnings-per-share growth rate.

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Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.4	5.6	5.3	6.1	7.0	9.4	13.6	17.7	11.7	12.2	***8.4***	***10.4***
Avg. Yld.	2.5%	4.5%	4.8%	6.1%	6.0%	4.8%	3.7%	3.2%	5.5%	9.6%	***9.4%***	***6.7%***

China Petroleum is currently trading at a price-to-earnings ratio of 8.4, which is lower than its 10-year average of 10.4. As the stock is likely to revert to its average valuation level over the next five years, it is likely to enjoy a 4.4% annualized boost in its returns thanks to the expansion of its price-to-earnings ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Payout	37.7%	25.0%	25.6%	36.9%	42.3%	44.8%	50.2%	55.8%	64.7%	117%	***79.6%***	***69.1%***

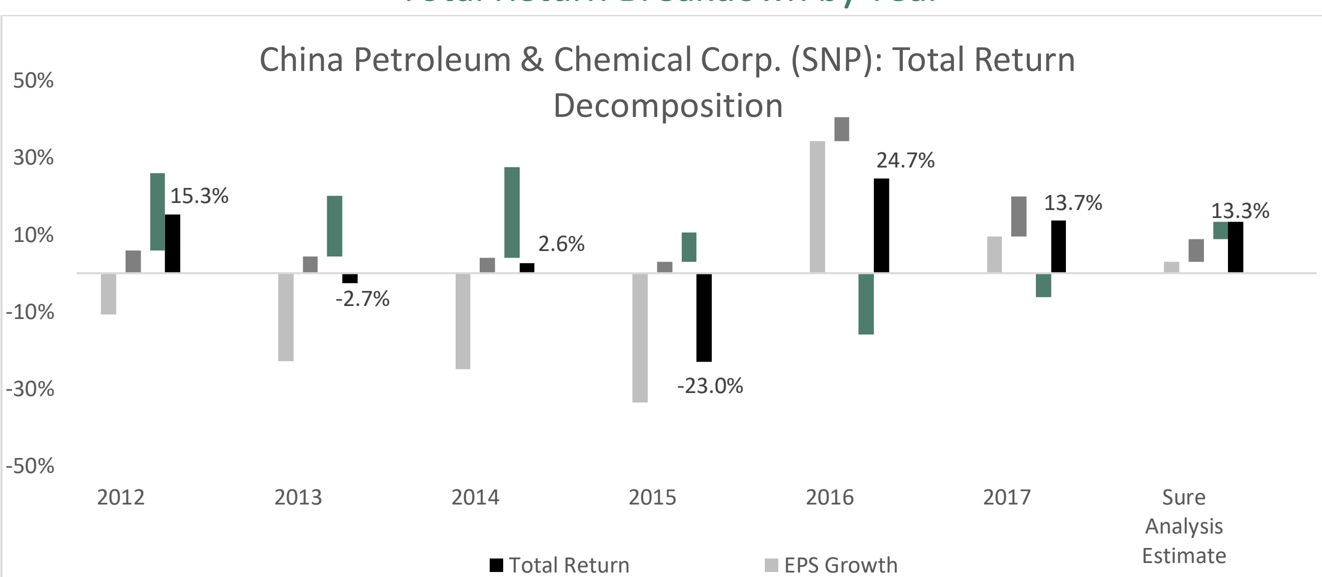
Like the well-known oil majors, China Petroleum is highly vulnerable to downtrends in the oil price. Due to the plunge of the oil price that began in mid-2014, the earnings-per-share of China Petroleum plunged 50%, from $8.66 in 2013 to $4.32 in 2015. On the other hand, China Petroleum benefits from a strong tailwind, namely the strong economic growth in China, which has grown its GDP at a higher than 6% rate every single year in the last decade.

China Petroleum has a reasonable amount of debt, with its net debt currently standing around 10 times its annual earnings and its interest expense consuming less than 10% of its operating income.

Final Thoughts & Recommendation

Since the price of oil began to plunge in early October, China Petroleum shares have lost 22%. As a result, it has become somewhat attractive and can offer a 13.3% average annual return over the next five years, in the absence of a renewed downtrend of the oil price. However, we prefer the well-known oil majors due to their more stable dividends and greater transparency. We need a greater margin of safety to recommend China Petroleum. We thus rate the stock as a hold at its current price.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue ($B)	208.18	197.18	282.03	387.27	440.95	468.34	458.83	321.54	290.04	349.85
Gross Profit	25038	53432	64281	73884	76737	82675	79842	83766	82797	87386
Gross Margin	12.0%	27.1%	22.8%	19.1%	17.4%	17.7%	17.4%	26.1%	28.5%	25.0%
SG&A Exp.	9056	10179	13279	16134	17875	20371	20457	20071	19264	20726
Operating Profit	6679	14368	17614	16678	15831	16348	12439	9840	11165	13677
Op. Margin	3.2%	7.3%	6.2%	4.3%	3.6%	3.5%	2.7%	3.1%	3.8%	3.9%
Net Profit	4497	9254	10582	11317	10110	10753	7568	5174	7010	7596
Net Margin	2.2%	4.7%	3.8%	2.9%	2.3%	2.3%	1.6%	1.6%	2.4%	2.2%
Free Cash Flow	-2379	8506	9429	2919	-520	1125	5671	11180	22392	18883
Income Tax	522	2872	3786	4037	3774	4026	2851	2007	3110	2413

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	114.36	131.51	150.14	180.84	201.54	228.19	233.98	222.94	215.77	244.38
Cash & Equivalents	1029	1286	2564	3894	1675	2483	1508	10618	17921	17342
Acc. Receivable	1907	3893	6497	9278	13040	11298	14643	8648	7241	10491
Inventories	14087	20749	23602	32140	34968	36617	30343	22429	22535	28596
Goodwill & Int.	2090	2060	1251	1297	1002	1032	1013	966	915	1322
Total Liab. ($B)	63.20	72.24	82.14	100.68	113.73	125.62	129.90	101.53	96.09	113.75
Accounts Payable	8287	14166	19981	27966	34546	33451	31979	20111	25096	30645
Long-Term Debt	34648	33371	31647	37103	44554	51064	53051	39310	27683	27536
Total Equity ($B)	48.12	55.48	63.26	74.63	81.85	93.86	95.60	104.16	102.37	111.22
D/E Ratio	0.72	0.60	0.50	0.50	0.54	0.54	0.55	0.38	0.27	0.25

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	4.2%	7.5%	7.5%	6.8%	5.3%	5.0%	3.3%	2.3%	3.2%	3.3%
Return on Equity	10.1%	17.9%	17.8%	16.4%	12.9%	12.2%	8.0%	5.2%	6.8%	7.1%
ROIC	5.7%	10.4%	11.0%	10.4%	8.1%	7.5%	4.9%	3.3%	4.6%	5.0%
Shares Out.	114	114	114	117	118	122	117	121	121	121
Revenue/Share	182.41	172.77	247.12	331.75	372.39	384.33	391.35	266.06	239.56	288.96
FCF/Share	-2.08	7.45	8.26	2.50	-0.44	0.92	4.84	9.25	18.50	15.60

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.