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PETROCHINA COMPANY LIMITED (中國石油天然氣)

Sector	: Energy & Petroleum	Chairman	: JIANG Jiemin
HKSE Code	: 0857		
Market Price	: HK\$9.84 (19/03/2008)		
HSI	: 21,866.94 (19/03/2008)		
H Shares Issued	: 21,098.9 million		
H-share Market Cap.	: HK\$207,613.1 million		
52-week Hi / Lo	: HK\$20.25 / HK\$8.51		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

	FY2007 RMB million	FY2006 RMB million	Change
• Turnover	835,037	688,978	+21.2%
• Operating profit	199,855	197,976	+0.9%
• Profit attributable to shareholders	145,625	142,224	+2.4%
• EPS – Basic	RMB0.810000	RMB0.790000	+2.0%
• Interim DPS	RMB0.205690	RMB0.202806	+1.4%
• Final DPS	RMB0.156859	RMB0.154699	+1.4%
• Total DPS	RMB0.362549	RMB0.357505	+1.4%

- PetroChina reported a tepid 2.4% y-o-y rise in net profit to RMB145.6 billion for the year ended 31st December 2007, weaker than consensus forecast of RMB156.14 billion, as loss in the refining & market segment and special levy on crude oil output weighed on the Group's bottom line.
- PetroChina produced 838.8 million barrels of crude oil in FY07, up 1.0% y-o-y. For FY07, PetroChina's oil output comprises 788.8 million barrels (94%) of domestically produced crude oil and 50.0 million barrels (6%) from overseas production, up 1.0% and 1.2% y-o-y, respectively. Meanwhile, output of PetroChina's marketable natural gas totalled 1,627.0 billion cubic feet (bcf), up 18.6% y-o-y, of which 97% was produced domestically and 3% from overseas.
- Overall, PetroChina's output of crude oil and natural gas amounted to 1,110.0 million barrels of oil equivalent (BOE), up 4.8% y-o-y. International crude oil prices had kept setting record highs since the end of last year, which helped lift the Group's average realized crude oil price to US\$65.27 per barrel in FY07 from US\$59.81 a barrel a year earlier.
- Driven by a higher refining and marketing volume, PetroChina's turnover grew a robust 21.2% y-o-y to RMB835.0 billion in FY07. However, owing to a jump in external purchases, non-income tax (a special levy on oil exploration imposed since 2006), rising labour costs and increased safety expenses, operating expenses jumped 29.4% y-o-y to RMB635.2 billion. As a result, operating profit of the Group rose a sluggish 0.9% y-o-y, while operating margin slipped to 23.9% in FY07 from 28.7% in FY06, down 4.8 percentage points.
- EPS for last year was RMB0.81 (FY06: RMB0.79). A final dividend of RMB0.156859 (FY06: RMB0.154699) per share was proposed. Along with the interim dividend, the full-year dividend payout ratio stood at 45%, flat from a year earlier.

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- Gearing ratio (debt to capitalization ratio) of the Group was 8.3%, down from 10.4% as of 31/12/2006. Total debt of PetroChina amounted to RMB70.6 billion, down slightly from 71.4 billion as of 31/12/2006. Following the A-share issue in October 2007, PetroChina's cash on hands surged to RMB83.5 billion (31/12/2006: RMB51.6 billion), which helped turn the Group into a net cash position of RMB12.9 billion, versus a net debt of RMB19.8 billion as of 31/12/2006.
- PetroChina completed the domestic A-share issue in October last year by issuing 4 billion A shares at RMB16.7 per share, raising a net proceeds of RMB66.2 billion.

Business highlights

- Breakdown of operating profit by business segments

	FY2007		FY2006		Change
	(RMB million)	%	(RMB million)	%	
Exploration and Production	206,587	103.4%	219,860	111.1%	-6.0%
Refining and Marketing	(20,680)	(10.3%)	(29,164)	(14.7%)	-29.1%
Chemicals and Marketing	7,831	3.9%	5,058	2.6%	+54.8%
Natural Gas and Pipeline	12,495	6.3%	8,986	4.5%	+39.0%
Other	(6,378)	(3.2%)	(6,764)	(3.4%)	-5.7%
Total	199,855	100.0%	197,976	100.0%	+0.9%

- The **exploration and production** segment reported an 11.1% rise in total turnover (including inter-segment sales) of RMB468.2 billion in FY07, driven by rising crude oil prices. Operating profit from the segment slipped 6.0% y-o-y to RMB206.6 billion, due to a 29.8% jump in operating expenses on a jump in the special levy on oil production. For FY07, the Group's lifting cost was US\$7.75 per barrel, up a sharp 15.0% from US\$6.74 per barrel a year earlier.
- The **refining and marketing** segment posted an operating loss of RMB20.7 billion in FY07 (FY06 loss: RMB29.2 billion), despite a 23.5% y-o-y rise in the segment's total turnover to RMB670.1 billion, owing to unparallel rise in refined product price in the Mainland when compared with crude oil prices. In fact, the Group continued its efforts in cost control last year, containing the cash processing cost at RMB155 per tonne in FY07, down from RMB169 per tonne in FY06, which also helped contain the rise in operating expense at 20.8% to RMB572.5 billion, compared with the segment's top line growth at 23.5%.
- PetroChina processed 823.6 million barrels of crude oil last year, up 4.9% y-o-y. Revenue from sales of diesel rose by 18.6% y-o-y to RMB253.8 billion in FY07 on a 5.8% increase in the average realized selling price and a 12.1% rise in sales volume. Revenue from sales of gasoline jumped 16.0% y-o-y to RMB139.6 billion, thanks to a 2.6% rise in average realised selling and a 13.0% rise in sales volume. Sales revenue of kerosene rose sharply by 91.6% y-o-y to RMB17.7 billion on a 84.1% jump in sales volume. In FY07, PetroChina expand further its retail network. It added 441 stations to its retail network to a total of 18,648 as of 31/12/2007, with most of the expansion actually completed during the first half. As a result, PetroChina's share of the retail market of refined oil products on the Mainland rose to 37.0% in FY07, up from a 34.7% share in FY06.
- The **chemicals and marketing** segment stole the spot line during FY07, with its operating profit up 54.8% y-o-y to RMB7.8 billion on a 24.1% rise in turnover and better cost efficiency.
- The **natural gas and pipeline** segment reported a robust 28.6% y-o-y rise in turnover to RMB50.1 billion, mainly driven by a surge in sales volume and higher gas transmission via the Group's gas pipelines. The segment's operating profit grew a solid 39.0% y-o-y to RMB12.5 billion, accounting for 6.3% (FY06: 4.5%) of the Group's total.

Outlook & Prospect

- **Battered in both fronts** Despite the remarkable earnings figure (being the most profitable company in the world), the FY07 results showed that PetroChina was battered in two fronts. On one hand, it had to pay the special levy on sales of domestic oil, which jumped 54% y-o-y in FY07 to RMB44.6 billion. On the other hand, it saw its refining business under serious operating pressure due to the pricing control on refined oil products in the Mainland. The Group management said it has already addressed the business difficulties arising from refined product price control to the government. Nonetheless, as Beijing continues its efforts to fight rising inflations in the Mainland, we expect liberalisation of pricing regime would proceed in only a slow and gradual manner.
- **Second West-East Gas Pipeline commenced construction** PetroChina revealed that the connection network of the first West-East Gas Pipeline connecting to four major natural gas processing areas (Tarim, Southwest, Changqing and Qinghai) was realized, with further upgrade work pending in the next couple of years. Meanwhile, the Second West-East Pipeline, the longest gas pipeline in the world linking Central Asia to Guangzhou in the Southern China and Shanghai in the East, has commenced construction. The 2nd Pipeline is expected to become operational by 2010.
- **Acquiring full control of the overseas JV from parent** Overseas operations accounted for about 6% of the Group's total crude oil output and 2.6% of natural gas production last year, which the Group management considered as "too small". In order to transform into a global oil and gas producer with significant business exposure in overseas market, the Group said it plans to buy out the remaining 50% stake in the joint venture, the unit holding the Group's overseas business, from its parent CNPC.
- **Setting a high 2008 output target** The Group has set the 2008 total oil and gas production target at 1.189 billion BOEs, up 7.1% from a year earlier, which would be faster than the growth of 4.8% in FY07. For crude oil, the FY08 output is seen at 871.6 million barrels, up 3.9% from a year earlier, while the output target of natural gas is set at 1,907 billion cubic feet, up 17.2% from FY07.
- **Fruitful result in oil and gas reserve exploration** The Group management revealed that, besides the sizable discoveries of Jidong Nanpu oil field in Bohai Bay and Longgang gas field in Sichuan, it has also made significant progress in reserve finding in Erdos, Songliao and Tarim basins. PetroChina is optimistic about outlook of its reserve exploration, claiming the Group has entered "a new growth period of oil and gas reserve". In FY07, the reserve replacement ratio (RRR) for oil was 1.104x and that of natural gas was 3.238x. In the next 5-8 years, the Group estimates that the oil and gas RRR could be maintained at higher than 1x and 3x, respectively.
- **Higher capex for the natural gas and pipeline segment** PetroChina has budgeted a capex of RMB207.9 billion in FY08, up 14.5% from FY07. 63.6% (FY07: 73.9%) of which would be allocated to exploration and production, while 18.1% (FY07: 6.1%) would be utilised in natural gas and pipeline projects.
- **Challenging outlook but largely factored in** PetroChina's FY07 results has worried investors about its refining segment, amid a rigid pricing regime in the Mainland. Nonetheless, we also saw the segment's operating loss narrowed in FY07 despite record oil prices, thanks to the Group's efforts in cost control and technology refinement. Trading at 10.6x FY08E P/E, valuation of PetroChina is not demanding and in line with global peers. Share price in the medium term should also be supported by an expected news flow of its update on oil and gas reserve discoveries. Accordingly, we recommend a "HOLD" on the counter.

Recommendation: HOLD



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