Sinopec Kantons (934 HK)

8 October 2013

Embarking on a colossal transformation

Sinopec Kantons' (SK) recent acquisitions reaffirm its commitment to becoming a global logistics play on oil, petroleum and petrochemical transportation that will service a major portion of China's imported demand. We expect the company to capitalize on its large net cash position of around HK$2b to pursue further acquisitions in 2013 and 2014.

We forecast SK will achieve EPS CAGR growth of 42% in 2013-2015F (and at a 2014 P/E of 20x), underpinned by organic expansion, which is better than many listed infrastructure or logistics peers. On a DCF basis, we estimate SK's target price at HK$8.70 (before any new acquisitions), offering attractive potential upside of 27%.

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Sinopec Kantons (934 HK)

Embarking on a colossal transformation

- **The start of something big.** Sinopec Kantons (SK), a 60.3% owned subsidiary of Sinopec Corp, is being rapidly transformed into a world-class international oil, petroleum and petrochemical storage and logistics operator that will service a major portion of China's current energy import requirements. It has built a wide logistics network in China, Europe, the Middle East and Southeast Asia through acquisitions. As SK is at an early stage of a promising transformation, it deserves a valuation premium over its peers. We initiate with an Outperform rating on the shares.
- **EPS CAGR of 42% for 2013-2015F.** SK's rapid organic capacity expansion of its oil terminals and storage facilities, and construction of new LNG fleet capacity will underpin strong earnings growth in the next five years. This expansion coupled with high operating leverage and rapidly growing demand from China will boost earnings from HK$292m in 2012 to HK$1,066m in 2015F, a sharp rise of 53% pa.
- **More value creation in the making.** With current net cash of around HK$2b, SK has much room to gear up by making acquisitions of quality assets from Sinopec Group and by forming international alliances to expand its global logistics network in oil transportation. Infrastructure investments like oil and gas pipelines, terminals and storage facilities are possible targets. Given its record of purchasing assets at attractive prices (of over a 30% discount to our appraised values), SK's future acquisitions should boost its equity value and improve share price momentum.
- **Potential upside of 27%.** We estimate SK's target price at HK$8.70 based on sum-of-the-parts and DCF. The stock trades at 20x 2014 P/E, which does not fully reflect the future earnings prospects of its expanding capacity and potential value enhancement from asset acquisitions from Sinopec.
- **Risks** include delays in the timing of acquisitions or completion of capacity expansion, and overpayment for acquired assets.

Forecast and valuation

Year to 31 December	2011	2012	2013F	2014F	2015F
Revenue (HK$m)	19,685	22,042	23,876	23,973	23,592
Net profit (HK$m)	214	292	617	866	1,066
YoY (%)	9.0	36.6	111.6	40.3	23.1
Diluted EPS (HK$)	0.17	0.15	0.26	0.35	0.43
YoY (%)	(7.7)	(11.2)	69.7	32.6	23.1
P/E (x)	39.2	44.2	26.0	19.6	15.9
P/B (x)	2.5	2.2	1.8	1.6	1.5
DPS (HK$)	0.035	0.035	0.035	0.035	0.035
Yield (%)	0.5	0.5	0.5	0.5	0.5
ROE (%)	8.0	6.3	7.6	8.6	9.7

Source: Company data, CCBIS estimates

Company Rating: Outperform
(initiation)

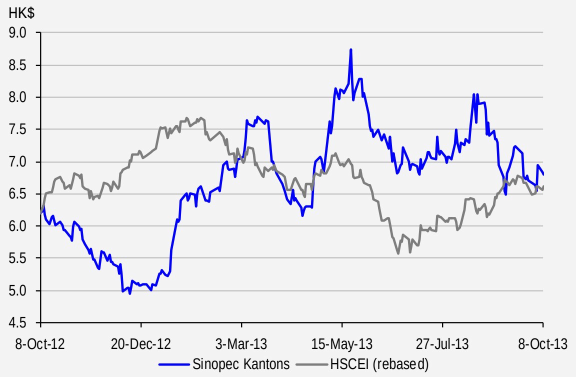
Price: HK$6.84
Target: HK$8.70
(initiation)

Trading data

52-week range	HK$4.88 – HK$8.95
Market capitalization (m)	HK$17,005/US$2,193
Shares outstanding (m)	2,486.2
Free float (%)	32.8
3 month average daily T/O (m share)	4.6
3 month average daily T/O (US$m)	4.3
Expected return (%) – 1 year	27.7

Price as at close on 8 October 2013

Stock price vs. HSCEI



Source: Bloomberg

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Sinopec Kantons – financial summary

Income statement

FYE 31 December (HK$m)	FY11	FY12	FY13F	FY14F	FY15F
Revenues	19,685	22,042	23,876	23,973	23,592
Trading of crude oil	18,792	20,936	22,928	22,928	22,928
China terminal and storage	612	621	560	657	664
Vessel charter services	281	485	388	388	0
Operating expenses	(19,229)	(21,665)	(23,601)	(23,570)	(23,108)
EBITDA	455	376	275	403	484
Depreciation and amortization	(171)	(170)	(194)	(184)	(184)
EBIT	284	207	81	219	300
Interest income	7	54	59	59	58
Finance expenses	(4)	(2)	0	0	0
Share of profit/(loss) of a JV	0	152	551	707	853
Profit before tax	281	357	691	985	1,210
Income tax	(67)	(66)	(74)	(118)	(144)
NCI	0	0	0	0	0
Net profit	214	292	617	866	1,066
Dividend	57	73	87	87	87

Balance sheet

FYE 31 December (HK$m)	FY11	FY12	FY13F	FY14F	FY15F
Inventories	42	48	63	63	63
Trade and notes receivable	1,083	629	850	854	840
Restricted bank deposits	5	5	5	5	5
Cash and cash equivalents	772	2,405	2,117	1,836	1,484
Total current assets	1,901	3,087	3,035	2,758	2,392
Property, plant and equipment	1,783	1,855	1,836	2,452	3,068
Lease prepayments	32	16	16	16	16
Intangible assets	79	75	70	66	62
Investment in associates	419	527	2,105	2,405	2,539
Investment in JCEs	0	2,305	3,910	4,054	4,653
Total non-current assets	2,314	4,778	7,937	8,993	10,338
Total assets	4,215	7,865	10,972	11,750	12,729
Short-term borrowings	267	0	0	0	0
Trade payables	1,113	1,345	1,257	1,256	1,256
Long-term borrowings	0	0	0	0	0
Other liabilities	9	13	13	13	13
Total liabilities	1,389	1,357	1,270	1,269	1,269
Share capital and reserves	104	207	249	249	249
Retained earnings	2,722	6,301	9,453	10,233	11,212
Shareholders' equity	2,826	6,508	9,702	10,481	11,461
Minority interest	0	0	0	0	0
Total equity	2,826	6,508	9,702	10,481	11,461
Total liabilities and equity	4,215	7,865	10,972	11,750	12,729

Cashflow statements

FYE 31 December (HK$m)	FY11	FY12	FY13F	FY14F	FY15F
Profit before tax	281	357	691	985	1,210
Depreciation and amortization	167	165	190	180	180
Share of profit/loss of JCEs/ associates	0	(152)	(551)	(707)	(853)
Other adjustments	(92)	(116)	(128)	(173)	(198)
Change in working capital	(352)	47	(323)	(5)	14
Operating cashflow	4	302	(122)	281	353
Capex	(72)	(1,850)	(3,236)	(1,118)	(1,382)
Dividends from investment in JCEs/associate	0	0	435	585	706
Other investment activities	7	54	59	59	58
Investment cashflow	(65)	(1,796)	(2,742)	(474)	(618)
Equity issues	0	3,463	2,649	0	0
Change in bank borrowing	111	(267)	0	0	0
Dividend paid	(36)	(73)	(73)	(87)	(87)
Other financing activities	(4)	(2)	0	0	0
Financing cashflow	71	3,122	2,576	(87)	(87)
Change in cash	11	1,628	(288)	(281)	(352)
Effect of FX changes	36	5	0	0	0
Cash at beginning of year	725	772	2,405	2,117	1,836
Cash at end of year	772	2,405	2,117	1,836	1,484

Source: Historical data from the company, forecasts by CCBIS

Key ratios

(%)	FY11	FY12	FY13F	FY14F	FY15F
Growth					
Revenue	18.6	12.0	8.3	0.4	(1.6)
EBIT	6.0	(27.2)	(60.8)	170.3	36.8
Net profit	12.2	56.8	78.6	40.3	23.1
Profitability					
EBITDA margin	2.3	1.7	1.2	1.7	2.1
EBIT margin	1.4	0.9	0.3	0.9	1.3
Net margin	1.1	1.3	2.6	3.6	4.5
Efficiency (days)					
Inventory turnover days	0.4	0.8	0.8	0.8	0.8
Trade receivables days	11.8	14.2	15.0	15.0	15.0
Trade payable days	(12.0)	(21.4)	(20.0)	(20.0)	(20.0)
Return and gearing					
Return on average assets	6.3	5.7	6.6	7.6	8.7
Return on average equity	8.2	7.4	7.6	8.6	9.7
Net debt (cash)/equity	(17.9)	(37.0)	(21.8)	(17.5)	(13.0)
Current ratio (x)	1.4	2.3	2.4	2.2	1.9
Quick ratio (x)	1.3	2.3	2.4	2.1	1.9

Executive summary

Sinopec Kantons' (SK) principal activities are crude oil trading, the operation of crude oil terminals and logistics services. The company is backed by Sinopec Corporation, one of the three-largest integrated oil services companies in China, which not only controls 60.33% of SK but is also SK's key customer. Sinopec Corporation has been injecting assets into SK since 2011. We initiate coverage with an Outperform rating on the stock based on the following factors.

Transforming into a specialized logistics play

A unique play on China's rising demand for energy

SK provides unique exposure to investment in China's crude oil terminals and logistics activities in major global oil trading and distributing centers. As a listed specialized subsidiary of Sinopec Group, SK enjoys good service demand from Sinopec, which accounts for a major portion of China's imported crude oil (65% in 2012). China's growing demand for energy and petrochemicals and its expanding investment in overseas energy projects will be potent drivers of future revenue growth at SK.

High entry barriers limit competitive threat

Benefits from high entry barriers…

The establishment of capital intensive oil terminals or storage facilities is tightly regulated by the Chinese authorities as well as governments overseas. This regulatory hurdle serves as an imposing entry barrier that reduces the threat of excess competition and earnings uncertainty. SK will benefit from steadily growing demand for energy in China as the domestic economy improves. In our view, SK's lower earnings risk and good growth prospects justify a premium rating over its peers.

High operating leverage, but low financial risk

SK's logistics business has high operating leverage with low variable costs, enabling it to enjoy improving margins and ROE as throughput volume for the oil terminals steadily increases in step with the expanding oil refining output of SK's customers. SK, after its rights issue and share placement in 2012 and 2013 currently has net cash of close to HK$2b. This puts it in position to take advantage of lucrative business opportunities should they arise. In our view, SK has considerable headroom to gear up and increase return on equity while boosting equity value.

New earnings drivers

…and high growth momentum

Since 2011, SK has acquired nine projects in China, the Middle East, Europe and Indonesia, some of which are undertaking further capacity expansion. Completion of this new capacity in 2013-2016F will significantly enhance SK's earnings growth momentum. From 2015F, its new business in LNG vessel operations will become another earnings driver. In addition to organic growth, SK's cash-rich position enables it to acquire more assets like oil pipelines with which to expand its earnings base.

Good track record of acquiring assets at low prices

The following table shows the consideration SK paid and the valuation of the assets it acquired over past two years. Projects operated or acquired by SK have been reporting solid profit margins and ROE, and have contributed good cashflows to the group. On a both a P/E and P/B basis, the offer prices were attractive.

Acquisitions made by SK at low prices

Terminals	Year of acquisition	Consideration (HK$m)	Acquired stake (%)	Net profit as of acquisition (HK$m)	Implied P/E (x)	Book value as of acquisition (HK$m)	Implied P/B (x)	Appraised value* (HK$m)	ROE (%) during acquisition year
Zhanjiang	2011	400	50	224	3.6	912	0.9	2,784	24.6
Ningbo	2012	213	50	108	3.9	388	1.1	1,174	27.8
Qingdao	2012	719	50	308	4.7	1,180	1.2	2,479	26.1
Tianjin	2012	429	50	43	20.1	683	1.3	643	6.3
Rizhao	2012	525	50	(41)	N/A	940	1.1	1,681	(4.3)
Caofeidian	2012	335	90	52	7.2	365	1	1,503	14.2
PT West Point	2012	3,840	95	N/A	N/A	N/A	N/A	2,422	N/A
Vesta	2013	1,302	50	155	16.8	1,395	1.9	1,312	11.1
Fujairah	2013	195	50	N/A	N/A	N/A	N/A	345	N/A

** appraised values by end 2013 based on DCF estimation*

Source: CCBIS estimates

More acquisitions on the agenda

Expanding asset base

Sinopec is engaged in a number of cyclical businesses, including oil refining and chemical production, which explains its low P/E valuation most of the time. However, its oil and gas terminals, pipelines and storage business enjoy high earnings stability and steady growth, and should trade on higher valuation multiples than those of Sinopec Corporation. We believe it makes sense for Sinopec to spin off these stable businesses into another vehicle to help fund the group's future expansion both in China and overseas. Furthermore, the listed logistics network (with a diversified shareholder base) could help service more independent customers.

As Sinopec is the ultimate controlling shareholder of SK, we anticipate Sinopec will inject more assets – possibly oil and gas pipelines and terminals – into SK at attractive prices in order to strengthen SK's international competitiveness in energy storage and logistics.

Risks

1. **Delays in the completion of new projects.** Major projects like the Fujairah Project in the Middle East and the PT West Point Project in Indonesia, are scheduled to be completed by end-2014F and mid-2016F, respectively. If there are any delays in these projects, SK's earnings and value will be affected.

2. **Delay in acquisitions of new assets from Sinopec**. The market expects SK's acquisitions to be realized in 2013-2014F. Any delay could disappoint the market and precipitate a fall in the share price.

3. **Unattractive prices for acquisitions of new assets.** If the offer prices for SK's acquisitions are higher than expected (i.e. over 2.5x book value), it could disappoint the market and put downward pressure on the share price.

4. **Fall in demand due to economic cycles.** SK's various business activities, notably crude oil trading and oil transportation, could be affected by the economic downturn, which might lower both oil prices and demand.

Valuation

We apply a sum-of-the-parts (SOTP) method to estimate SK's fair value based on its existing businesses together with a discounted cashflow method (DCF) to appraise the company's existing projects. In our conservative projections, we have not incorporated any value enhancement associated with potential acquisitions. We estimate the 12-month target price for SK at HK$8.70, equivalent to 25x 2014F P/E. The stock is trading at a 30% discount to the target price.

SOTP valuation

Target price = HK$8.70/share

Based on a combined SOTP and DCF methodology, we estimate SK's fair value to be HK$8.72 per share (or 25x 2014 P/E), based on a weighted average cost of capital of 9.0% and a long-term growth rate of 1.0% along with a low debt-to-equity capital structure of 5.0%. Due to the stable nature of SK's future cashflows, the share has a low beta value, we estimate at 0.8 (similar to the utility of infrastructure companies). Underpinned by the potential for value accretive acquisitions, we expect SK's share price to trade towards the fair value, and we therefore set a 12-month target price of HK$8.70 for SK.

Should the company be able to finance future growth with more debt to lower its weighted average cost of capital, the company's fair value should improve accordingly.

Valuation of Sinopec Kantons

	Value (HK$m)	Value per share (HK$)
China's terminals and storage facilities	14,681	5.9
Huade	4,417	1.8
Zhanjiang	2,784	1.1
Ningbo	1,174	0.5
Qingdao	2,479	1.0
Tianjin	643	0.3
Rizhao	1,681	0.7
Tangshan Caofeidian	1,503	0.6
Overseas terminal and storage facilities	4,079	1.6
PT West Point Project, Indonesia	2,422	1.0
Fujairah Project, Middle East	345	0.1
Vesta Project, Europe	1,312	0.5
LNG vessels	797	0.3
East China LNG Shipping	55	0.0
China Energy Shipping	742	0.3
Net cash (end-2013)	2,117	0.9
Total	21,674	8.72

Source: CCBIS estimates

WACC estimation for SK

Risk-free rate	4.5%
Equity-risk premium	6.0%
Beta	0.8
Cost of equity	9.3%
Cost of debt, pre-tax	5.0%
Tax rate	25.0%
Cost of debt, post-tax	3.8%
Gearing	5.0%
Weighted average cost of capital (WACC)	9.0%
Terminal growth rate	1.0%
Number of shares	2,486.2

Source: CCBIS estimates

Sensitivity analysis

More leverage to lower discount rate

The estimated value of SK's share is sensitive to the discount rates based on DCF valuation. We estimate that for a 1% decline in WACC, the DCF value will rise 19%. With a low gearing, there is much room for SK to increase leverage especially given its steadily growing earnings streams) through additional borrowing to reduce the WACC, and thus enhance its ROE and value. If the gearing is increased from 5% to 25%, SK can reduce the WACC by 12% from 9% to 7.9%.

DCF and earnings sensitivity analysis

Variable	Changes	Change on DCF value
WACC	down 1 ppt (from 9% to 8%)	HK$10.34/share (up from HK$8.72/share)

Source: CCBIS estimates

Though SK derives a high proportion of revenues from oil trading, this is sensitive to EBIT margin change. However, it only earns a narrow spread over the oil trading revenues. The spread on the oil trading revenues is narrow and is not expected to significantly change, and thus has little impact on earnings.

Peer comparison

Stronger EPS growth momentum than peers

Chinese port companies listed on the Hong Kong Exchange are currently trading on 7.8-16.0x 2014F P/E while A-share listed port companies are trading on 17-23x 2014F P/E. International port operators are trading at similar valuation levels to A-share listed peers of 19.3-26.9x 2014F P/E yet at a premium to Hong Kong-listed peers due to their more diverse revenue distribution and stronger earnings growth. We believe SK deserves a premium to other Hong Kong-listed companies due to (1) its superior earnings growth of over 50% p.a. for SK versus 9-15% for China port operators in 2013-2014F, (2) robust demand for imported oil and gas, and (3) the possibility of value-enhancing acquisitions.

Global oil storage and terminal operators are trading at 13.9-18.4x 2014F P/E or at an average of 15.8x forward P/E. Our one-year target price for SK of HK$8.70 translates to 25x 2014F P/E, which we think is reasonable given its strong EPS growth in 2013-2015F and further earnings upside from potential acquisitions that are not incorporated into our financial model.

From a P/B perspective, international ports and storage players (1.5-5.6x 2014F P/B) normally trade at a premium to Chinese ports (0.6-2.4x 2014F P/B) due to their mature business model. Our one-year target price of HK$8.70 is equivalent to 2.1x 2014F P/B, which we believe is conservative compared with SK's international peers.

Valuation comparison : China and international ports and storage operators

	Stock	Market cap	EPS growth (%)		P/E (x)		P/B (x)		ROE (%)		Dividend yield (%)
Company	code	(US$m)	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F	FY13F
China port operators											
Sinopec Kantons	934 HK	2,193	69.7	32.6	26.0	19.6	1.8	1.6	7.6	8.6	0.5
China Merchants Holdings	144 HK	9,518	6.6	12.2	18.0	16.0	1.5	1.4	8.7	9.2	2.5
Tianjin Port Development	3382 HK	993	11.3	9.4	9.8	8.9	0.6	0.6	7.5	8.0	4.0
Dalian Port	2880 HK	1,684	15.0	12.4	8.7	7.8	0.4	0.4	5.3	5.4	4.3
Shenzhen Chiwan Wharf	200022 CH	1,413	9.8	4.8	18.0	17.2	2.3	2.1	12.5	12.5	3.4
Shanghai International Port	600018 CH	21,571	8.1	8.9	24.6	22.6	2.6	2.4	10.7	10.7	2.3
Average			20.1	13.4	17.5	15.3	1.5	1.4	6.4	6.7	4.1
International ports											
DP World	DPW DU	13,156	(23.2)	13.7	22.9	20.1	1.6	1.5	7.0	7.4	1.5
Port of Tauranga	POT NZ	1,539	(29.2)	(1.5)	23.3	23.7	2.4	2.3	10.3	9.8	3.2
Hamburger Hafen	HHFA GR	1,866	(20.2)	18.5	22.8	19.3	2.3	2.2	11.4	13.0	3.1
International Container Terminal	ICT PM	4,738	N/A	21.1	32.6	26.9	4.9	4.3	15.5	16.5	0.6
Average			(24.2)	13.0	25.4	22.5	2.8	2.6	11.0	11.7	2.1
International storage operator											
VOPAK	VPK NA	7,301	(0.2)	11.6	16.7	15.0	2.7	2.4	16.7	16.7	2.2
Oiltanking Partners	OILT US	2,133	55.0	22.5	22.5	18.4	6.6	5.6	30.2	30.2	3.2
Buckeye Technologies	BKI US	1,464	3.8	15.0	16.0	13.9	2.1	N/A	N/A	N/A	1.0
Average			19.5	16.4	18.4	15.8	3.8	4.0	23.4	23.4	2.1

** Price as at close on 8 October 2013*

Source: Bloomberg, CCBIS

Potential acquisitions to further enhance NAV

Impressive value creating asset acquisitions

Good track record of making asset acquisitions at low prices

SK is a listed subsidiary specializing in oil storage and logistics within the Sinopec Group. SK has established a record of asset acquisition at attractive prices over past seven years. Since its first acquisition of 30% interest in Huade in 2006, the company has completed another nine acquisitions since 2011.

Sinopec's Chairman, Mr. Fu Chengyu, was a well-known advocate of market liberalization and internationalization**,** back in 2002-2011 when he was in charge of CNOOC. He is now a major supporter of SK plans to achieve growth through M&A. Since 2011, interests in six Chinese oil terminals have been injected from Sinopec, while three overseas oil storage projects were acquired in three major oil distributing regions.

We see a high possibility for more asset acquisitions from Sinopec in the coming months (mostly likely in 2013-2014F) since SK just made a placement in 2Q13 and now has net cash nearing HK$2b.

Sinopec Kantons' record of successful acquisitions

Asset acquired	Location	Year of acquisition	Consideration (HK$m)	Stake (%)	Trailing P/E (x)	Trailing P/B (x)	DCF value (HK$m)
Huade Terminal	Guangdong, China	2006	571	30	12.9	1.2	4,417
Zhanjiang Terminal	Guangdong, China	2011	400	50	3.6	0.9	2,784
Ningbo Terminal	Zhejiang, China	2012	213	50	3.9	1.1	1,174
Qingdao Terminal	Shandong, China	2012	719	50	4.7	1.2	2,479
Tianjin Terminal	Tianjin, China	2012	429	50	20.1	1.3	643
Rizhao Terminal	Shandong, China	2012	525	50	N/A	1.1	1,681
Caofeidian Terminal	Hebei, China	2012	335	90	7.2	1	1,503
PT West Point	Batam, Indonesia	2012	3.84	95	N/A	N/A	2,422
Vesta*	Europe	2013	1,302	50	144.1	1.9	1,312
Fujairah Storage	Fujairah, UAE	2013	195	50	N/A	N/A	345

** Vesta includes a one-off expense of EUR13.5m due to the change of depreciation policy. If excluded, the implied PE would be around 17x*

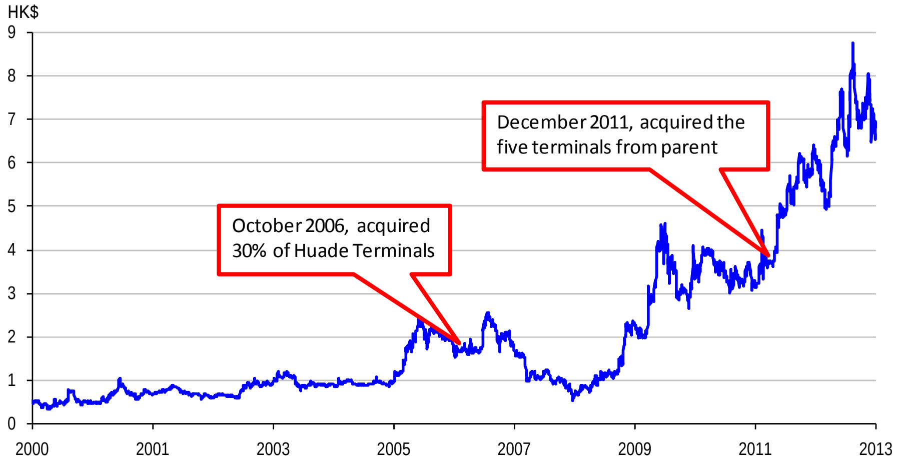
Source: Company data, CCBIS

Value accretive acquisitions boost stock price performance

Stock price reacted positively to acquisitions in the past

Historical price movements indicate SK's price performance could be significantly influenced by expectations and announcements of acquisitions. The company's share price quadrupled after the completion of the acquisition of the remaining 30% equity stake in Huade in December 2006 and a series of acquisitions made in 2011-2013.

Share prices reacted positively to acquisitions



Source: Yahoo Finance, CCBIS

The values of past acquisitions, especially of Chinese terminals, were attractively priced in the 0.9-1.3x trailing P/B range, which were generally at large discounts to our appraised values.

Potential acquisitions on the agenda

In 1H13, SK had HK$1.9b in cash on hand and no debt after raising HK$2.68b in a share placement in May 2013. The size of a possible asset acquisition could be up to HK$4.3b, assuming the company can lift its gearing ratio of 25% through further debt financing.

SK still has room to issue more shares, perhaps over 400m, and yet allow the parent (Sinopec Corporation) to maintain a controlling stake of over 50% (Sinopec's interest in SK is now 60.3%). This alternative may allow SK to raise equity funds of over HK$2.5b.

Potential acquisitions of pipelines, oil terminals or other assets are expected within 2013/2014

From the perspective of business synergy, the types of assets most likely to be acquired by SK include Sinopec's oil pipelines connecting its current oil terminals, Sinopec's LNG terminals under construction and related gas pipelines, and other crude oil terminals owned by Sinopec or other parties:

1. **Oil pipelines under Sinopec** are the most likely acquisition targets in view of their synergizing effect with current oil terminals and their attractive returns. There are over 35 oil pipelines with a total length exceeding 6,000km (according to the 2011 Sinopec Yearbook) that are managed by SPSTC. In our view, the oil pipelines that Sinopec will most likely inject into SK in 2013/14 are the Caofeidian-Tianjin Line, the Zhanjiang-Beihai Line and the Tanggu-Yanshan Line.

2. LNG terminals, in our view, are another candidate likely to be injected into SK in 2014-2015F. The first LNG vessel (under SK) and the first LNG terminals (under Sinopec) will be ready for delivery in 2015F and work together to ship LNG for Sinopec's two LNG projects. In total, Sinopec has three LNG terminals under construction (Qingdao, Guangxi and Tianjin) for a total capacity of 9.0mt pa. Furthermore, LNG terminals have both decent returns (about 12% IRR in the case of acquisitions made by Kunlun Energy (135 HK, Outperform)) and a reasonable acquisition size of HK$1b or more. Sinopec also has three main gas pipelines in operation. Of these, the Shandong gas pipelines are possible acquisition targets taking into account of their connections to the Qingdao LNG terminal.

Some oil pipeline projects owned by Sinopec

Source: Company website, CCBIS

Some gas pipeline projects owned by Sinopec

Source: Company website, CCBIS

Business activities of Sinopec Kantons

SK, listed on the Hong Kong Stock Exchange in 1999, is engaged in

1. Crude oil trading

2. Crude oil terminal services in China and overseas (crude oil transportation via pipelines, loading, unloading and storage)

3. Vessel chartering services for crude oil transportation and floating oil storage

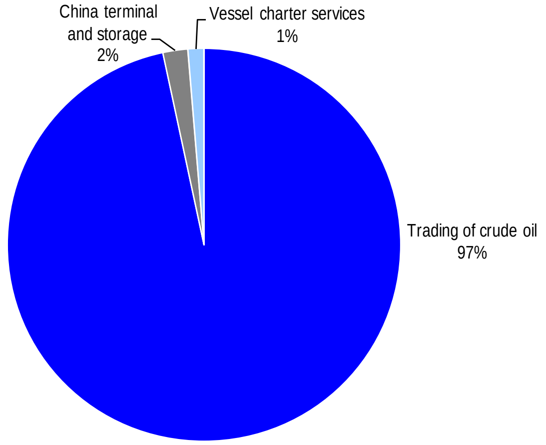
The company is 60.33% owned by Sinopec Group via UNIPEC (refer to appendix III for the detailed shareholder structure of SK group). UNIPEC, one of the largest oil trading companies in the world, is principally engaged in the import of crude oil, the import and export of oil products and oil processing for Sinopec Group, and in the international oil trading business.

Crude oil trading

The low-margin crude oil trading business (below 1.0% EBIT margin since 2008) accounted for the bulk of SK's revenue in 1H13 (96.6%) but had a negative contribution to operating profit.

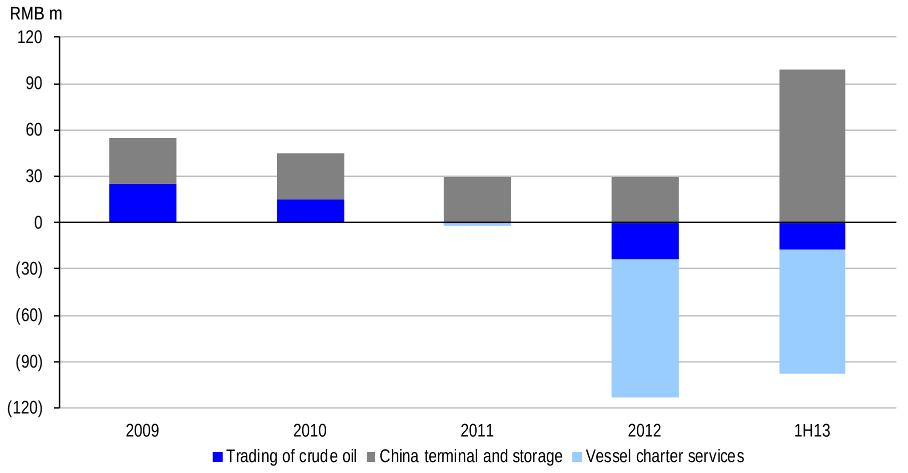
Crude oil trading contributed 97% revenue but little to profit

SK's revenue breakdown in 1H13



Source: CCBIS

SK's operating profit breakdown, 2009 – 1H13

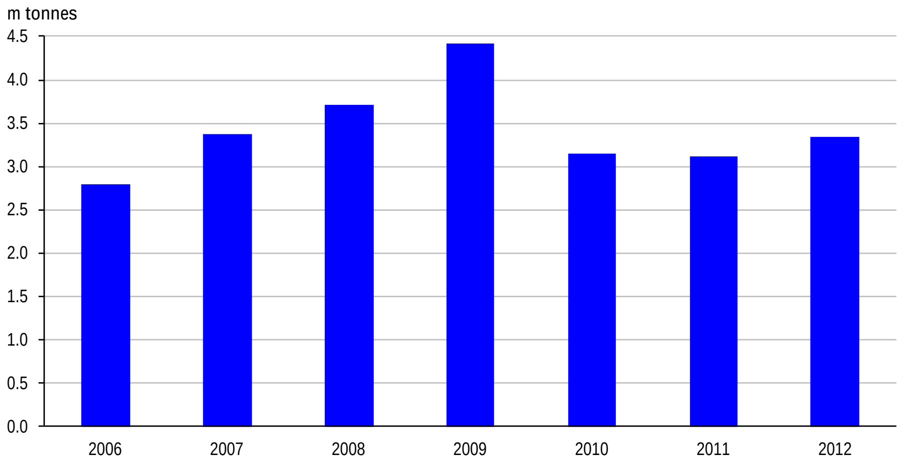


Source: CCBIS

Crude oil trading business is expected to contribute a tiny profit

SK buys imported crude oil and then sells it to enterprises within Sinopec Group for a thin commission that varies with China's import demand for crude oil. In 1H13, SK recorded losses due to the booking of one-off expenses related to the acquisition of the Vesta project. In 2014F and 2015F, we expect a small contribution from the crude oil trading activity of HK$1.1m and HK$1.1m respectively.

Volume of crude oil traded by SK



Source: CCBIS

Crude oil terminals

SK's objective is to become a world-class international oil and petrochemical storage and logistics company. This accounts for its aggressive acquisition strategy over the past two years.

Since 2011, SK acquired nine assets for a total cost of HK$7,958m. Among these nine assets were six crude oil terminals in China and three oil storage projects overseas. SK has also established two joint ventures with China Shipping Development to operate LNG vessels. The new businesses enable SK to diversify geographically and expand its current crude oil handling capacity to supplement that of its subsidiary, Huade.

Rapid transformation through oil terminal acquisitions

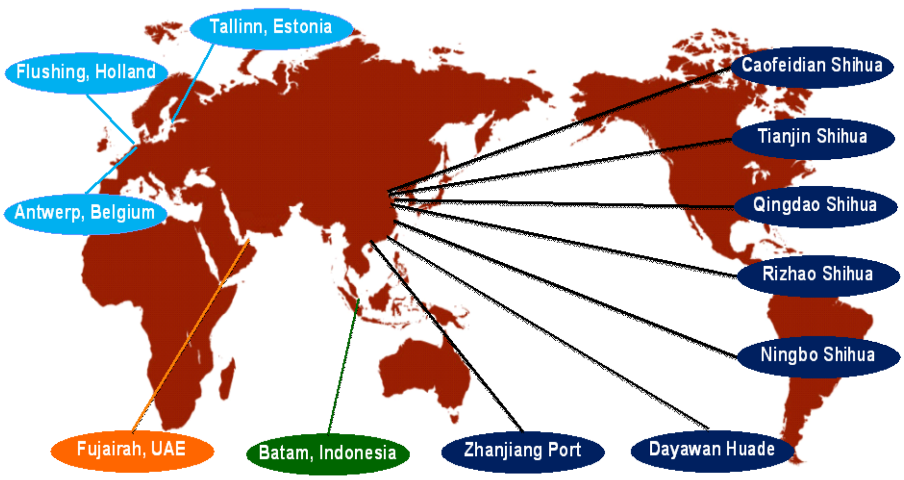
The assets SK has acquired have helped it to establish a global network of oil terminals and expand its scale of business. SK now owns seven VLCC ports in China, enabling it to efficiently handle large volume of imported crude oil from overseas.

Oil terminals acquired by Sinopec Kantons

	Year of acquisition	No. of berths	Largest vessel to dock (k tonnes)	Annual designed capacity (m tonnes)	Equity stake (%)
Zhanjiang	2011	12	300	55	50
Ningbo	2012	3	300	35	50
Qingdao	2012	4	300	45	50
Tianjin	2012	1	300	20	50
Rizhao	2012	1	300	20	50
Caofeidian	2012	1	300	20	90
West Point	2012	9	300		95
Vesta	2013	13	300		50
Fujairah	2013	N/A	300		50

Source: Company data, CCBIS

Sinopec Kantons' global oil terminal network



Source: Company, CCBIS

Selective oil terminals/storage facilities held by SK

Huade (100% owned)

Huade operates terminals, storage facilities and pipelines

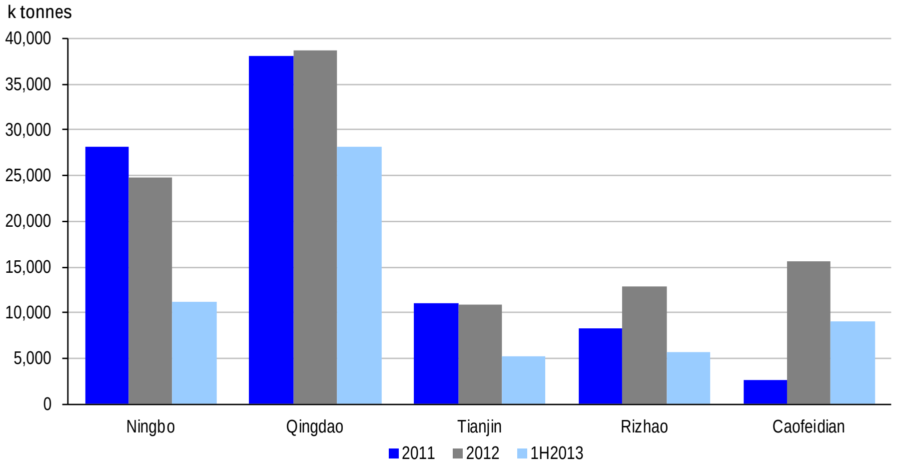
Huade is responsible for the operation of the Huizhou Crude Oil Jetty, which is engaged in crude oil unloading, storage and transmission activities. The jetty complex, located at Mabianzhou Island in Huizhou Guangdong, provides oil tanker handling, storage and pipeline transmission facilities. It has two berths and can dock 250k tonnage tankers. The storage oil tanks have a total capacity of 800k m^3 connected to Sinopec Guangzhou Branch.

Zhan Jiang Port Petrochemical Jetty Co (50% owned)

The Zhan Jiang Port is one of the 25 main ports of China connecting southwest and southern China to other regions. SK holds a 50% stake in Zhan Jiang Port Petrochemical Jetty, which provides logistics services including storage, logistics, jetty and distribution of oil and petrochemical products. It owns 12 berths, and is able to dock 300k tonnage ships. Annual throughput capacity is 55m tonnes.

In addition, the project owns 59 storage tanks (including 52 oil tanks and 3 gas tanks), with a total storage capacity of over half a million cubic meters. It serves refineries at Maoming, Zhan Jiang, Bei Hai and southwest China.

Crude oil throughput volumes of the five newly acquired terminals in China



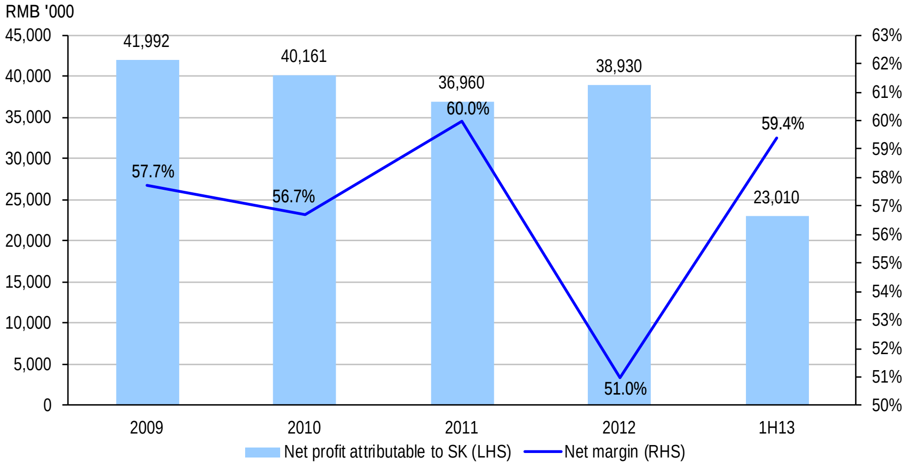
Source: Company data, CCBIS

Ningbo Shihua (50% owned)

Important supplier to southeastern refineries

Ningbo Shihua provides port facilities to vessels such as the loading and unloading of goods. The company operates three berths, and is capable of accommodating 450k tonne vessels. The total design throughput capacity is 35m tonnes of crude oil. Through the oil pipes on the working platform of the berth, crude oil is transferred to oil refining enterprises, other branches of Sinopec Group or its clients including refineries in Jinling, Yanzi, Zhenhai, Jinshan, Gaoqiao, Jiu Jiang and Wuhan.

Ningbo Shihua's net profit contribution to SK and net margins



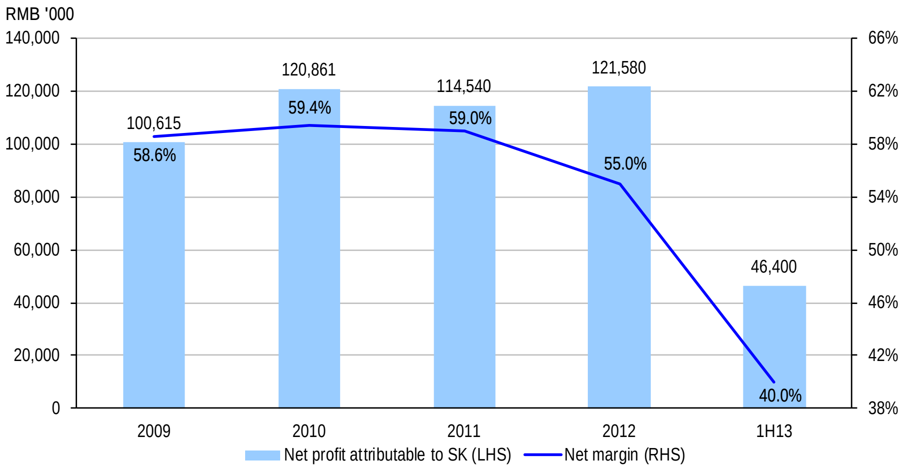
Source: Company data, CCBIS

Qingdao Shihua (50% owned)

Enjoys stable contributions

Qingdao Shihua's activities include operation of oil terminals, and the loading and unloading of crude oil and refined oil. It operates three terminals capable of docking 300k tonnes vessels with a total throughput capacity of 450k tonnes. The terminals are connected by pipelines to other oil refining enterprises of the Sinopec group, including refineries at Qingdao, Qilu and Jinan, etc.

Qingdao Shihua's net profit contribution to SK and margins



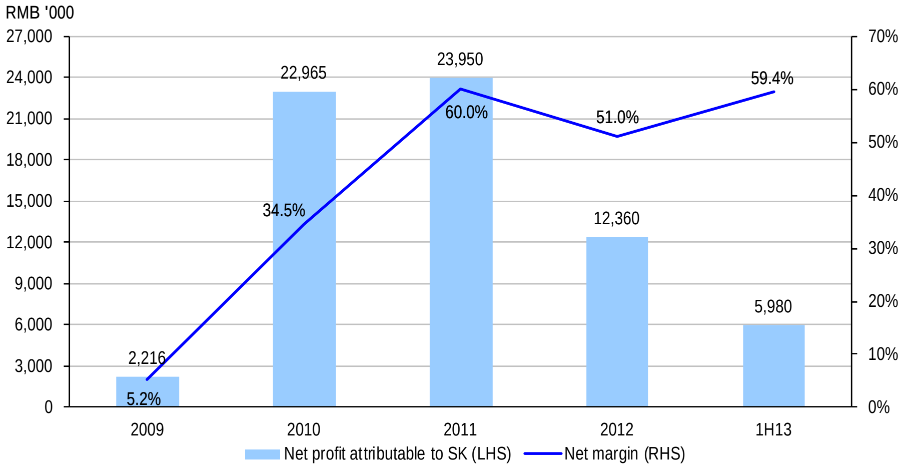
Source: Company data, CCBIS

Tianjin Port Shihua (50% owned)

The joint venture operates one crude oil terminal capable of docking 300k tonne vessels with total annual capacity of 20m tonnes of crude oil. It serves refineries at Tianjin, Yanshan, Shijiazhuang, Cangzhou and northern China.

Tianjin Port's net margin has been picking up since 2009

Tianjin Port Shihua's net profit contribution to SK and margins



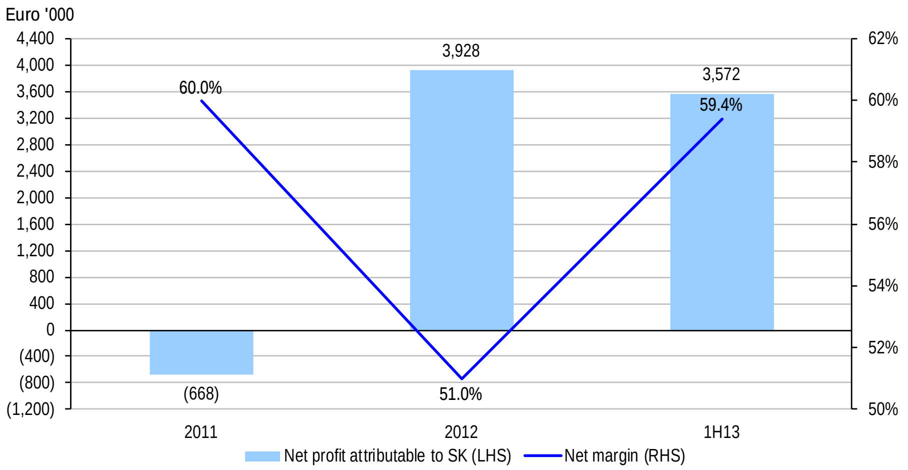
Source: CCBIS

Rizhao Shihua (50% owned)

Rizhao Shihua operates a 300k tonnes crude oil terminal at Rizhao Port Lanshan North Port Area. It has a design capacity of 20m tonnes of crude oil. The company serves refineries at Jiu Jiang, Jingmen, Luoyang and Wuhan.

Rizhao Port began to contribute to net profit in 2012

Rizhao Shihua's net profit contribution to SK and margins

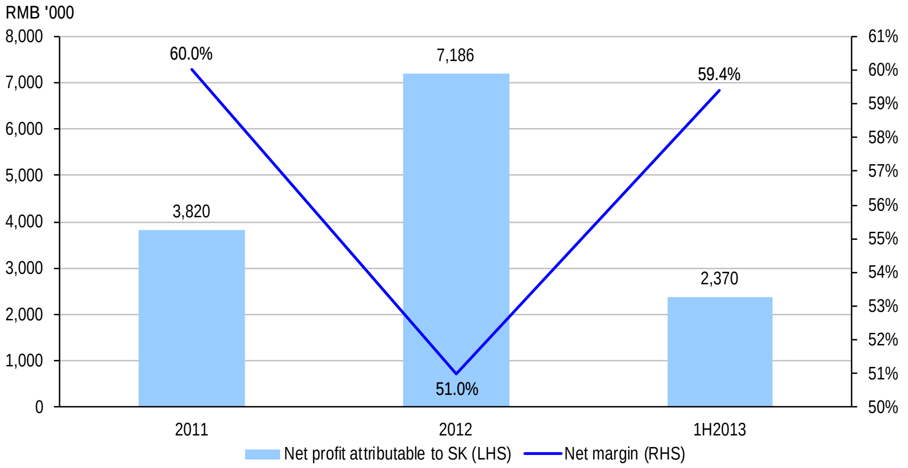


Source: Company data, CCBIS

Tangshan Caofeidan Shihua (90% owned)

The joint venture has been operating a 300k tonne crude oil terminal since April 2011. The terminal has a design capacity of 20m tonnes of crude oil. The company serves refineries at Tianjin, Yanshan, Shijiazhuang, Cangzhou and northern China.

Tangshan Caofeidan Shihua's net profit contribution to SK and margins



Source: Company data, CCBIS

Overseas oil storage and logistics business

PT West Point project to commence operations in mid-2016F

SK has expanded to Southeast Asia, the Middle East and Europe through a series of acquisitions made over the past two years. We believe these strategic acquisitions could create synergies for Sinopec Group.

PT West Point Project, Indonesia (95% owned)

SK is constructing an oil storage terminal in Batam Island of Indonesia with a storage capacity of 2.6m m^3, through a 95%-held subsidiary named PT West Point Terminal. The project enjoys attractive government policies as it is located in the Batam free trade zone. It is also close to the Strait of Malacca and a global oil trading center in Singapore.

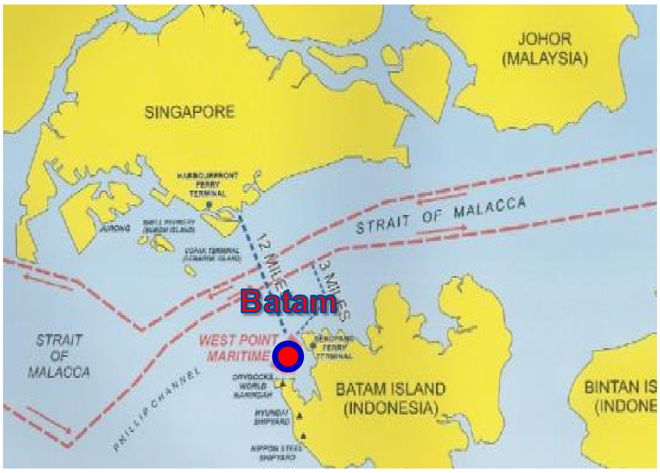
The total project capital expenditure is estimated to be US$841m, of which 70% is financed by bank loans and the rest of the 30% financed by equity. We expect the project to commence operation in mid-2016F.

Details of Batam Project

Name	PT West Terminal
Location	Batam Island, Indonesia
Site areas (Hectares)	75
Storage capacity (mcm)	2.616
Number of berth	9 (1 for VLCC)
Max berth capacity (kt)	300
Expected throughput per year (mcm)	50.56
Products stored	Crude oil, petroleum products, jet fuel, etc.
Project capex	US$841m/HK$6,547m
Sinopec Kantons' capex	US$240m/HK$1,866m

Source: Company, CCBIS

Location of Batam Island



Source: Company, CCBIS

Batam project layout

Source: Company, CCBIS

Fujairah project, Middle East (50% owned)

SK owns 50% interest in the Fujairah Project, which is strategically positioned in the Fujairah Port of the UAE in the Middle East. The port is located on the east side of the Strait of Hormuz, which enjoys a safe and stable environment with no record of pirate activity. Total capital expenditure size is US$360m, and the project is financed 80% through bank loans and 20% from equity. The project is currently under construction and expected to commence operations by end-2014F.

Fujairah Project to commence operations by end-2014F

Besides its excellent location, we like the utilization rate of the Fujairah Project's storage facilities due to the construction of Yanbu Aramco Sinopec Refining (YASREF), a joint venture of Sinopec (37.5% stake), with a production capacity of 400k barrel per day. The YASREF will begin production in 2H14F and will be a major customer of Fujairah storage facilities once operations commence.

Details of Fujairah Project

Name	Fujairah Project
Location	Fujairah Port, UAE
Site areas (hectares)	30
Storage capacity (mcm)	1.155 (580kcm for crude oil/fuel. 265kcm for gasoline, 250kcm for gas oil. 60kcm for jet fuel)
Products stored	Crude oil, petroleum products, jet fuel, etc.
Project capex	US$360m/HK$2,791m
Sinopec Kantons' capex	US$54m/HK$419m

Source: Company, CCBIS

Location of Fujairah port

Source: Company, CCBIS

Fujairah terminal layout

Source: Company, CCBIS

Vesta Project, Europe (50% owned)

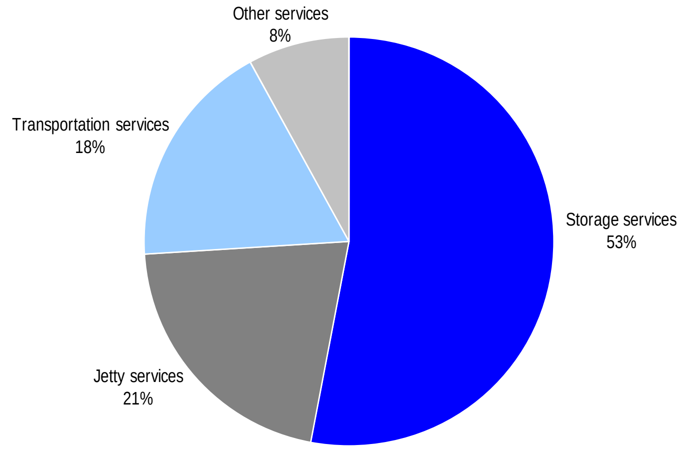
SK completed acquisition of a 50% equity stake in Vesta Project on 2 April 2013 for a consideration of HK$1,302m. The deal expands SK's footprint in a core oil trading area of Europe. Prior to the acquisition, Vesta was wholly owned by Mercuria Energy Group, one of the world's largest independent energy trading companies.

Vesta project provides stable cashflow and an immediate contribution to earnings

The Vesta Project has three major oil storage terminals, namely the Antwerp Terminal in Belgium, the Flushing Terminal in the Netherlands and the Tallinn Terminal in Estonia. Located in prime locations in the Baltic and ARA ("Amsterdam-Rotterdam-Antwerp", the world's second-largest petrochemical cluster after the Houston Ship Channel), all three terminals have well-established water and inland transportation networks to major refineries in Europe.

The oil storage business is the major revenue contributor to Vesta Project (53% of 2010 total revenue), while its jetty services and transportation services contributed 21% and 18% to its revenue in 2010, respectively. The current business model provides stable cashflow to shareholders and is able to immediately contribute earnings to SK.

Revenue breakdown of Vesta (2010)



Source: Company data, CCBIS

Operation details of Vesta Terminals

City location of terminals	Antwerp	Flushing	Tallinn	Total
Country	Belgium	Netherland	Estonia	
Storage capacity (kcm)	827	391	406	1,624
Heated shell capacity (kcm)	202	34	316	552
Number of tanks	65	33	35	133
Number of berth	5	3	5	13
Max berth capacity (kt)	160	50	N/A	
Max water draft of terminal (m)	15	12	17	
Products stored	Petroleum products	Petroleum products	Petroleum products and crude oil	
Investment/consideration	HK$1,302.1m for 50% equity			
JV partner	Mercuria Energy Group			

Source: Company data, CCBIS

Vesta Terminal Flushing in Netherland

Source: Company, CCBIS

Vesta Terminal Tallinn in Estonia

Source: Company, CCBIS

Vessel charter business and LNG vessel projects

SK chartered three VLCC vessels back in 2011 from international ship owners under 3+2 contracts (3 years plus 2 years optional) while leasing to charterers on the spot market. Due to the continuous decline in oil tanker spot rates over the past two years, the vessel charter business recorded a net loss of HK$89m and HK$60m in 2012 and 1H13. We forecast the company will terminate its vessel charter business in 2015F after the expiry of its current charter contracts, though SK may choose to extend the contract by two years for one of the charters at a lower rate.

Looking beyond 2014F, SK's recently constructed LNG vessels will be the major contributor to its future logistics business. In 2010, the company formed two joint ventures with China Shipping LNG Investment Company to build a total of 10 vessels for Sinopec Group.

A new contributor from 2015F

We expect the first vessel to be delivered in 2015F and all 10 vessels to commence operations by early 2018F. Given Sinopec Group is the only customer, we believe vessel demand is well protected at the different stages of SK's business cycle. We estimate total capital expenditure of the two projects will amount to US$2.6b and IRR will be over 8%.

Operation details of the two LNG vessel projects

	East China LNG Shipping Investment	China Energy Shipping Investment
Stake (%)	30	49
No of vessels	2	8
Capacity (m tonnes)	2.0	7.6
Partners	ExxonMobil	Origin, Conoco Philips
Expected clients	Sinopec PNG (Papua New Guinea) LNG	Sinopec AP (Australia Pacific) LNG
Contracted years	20	20
Project capex	US$528m/HK$4,092m	US$2.1b/HK$16.2b
Sinopec Kantons' capex	US$9.5m/HK$163.7m	US$73.7m/HK$1,268.7m
Estimated IRR	8.4%	8.4%

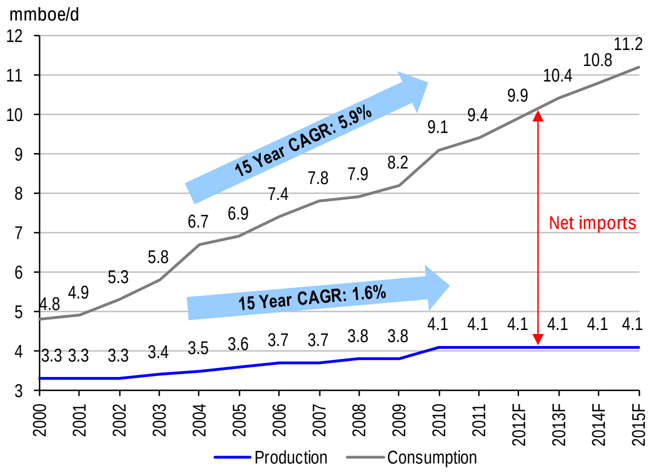
Source: Company data, CCBIS

Prospect: Best positioned for China's growing demand for oil and LNG

China secures energy supplies through more imports and overseas acquisitions

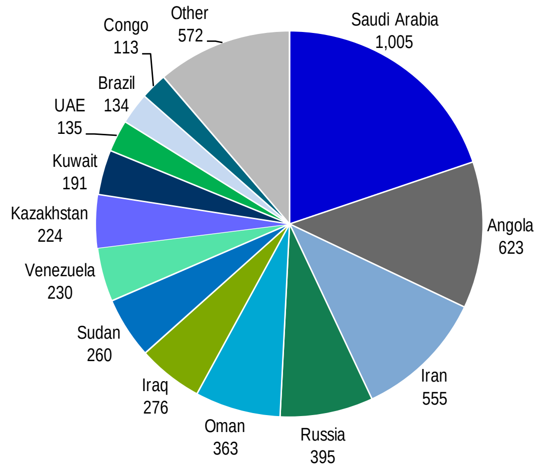
In 2009, China became the second-largest net oil importer in the world behind the United States, with net total crude imports reaching 5.4m bbl/day and oil product imports reaching 1.2m bbl/day in 2012 (accounting for 56.6% of China total crude consumption, 14% of world total crude imports and 10.4% of oil product imports).

China's crude oil production and consumption



Source: BP Statistical Review, CCBIS

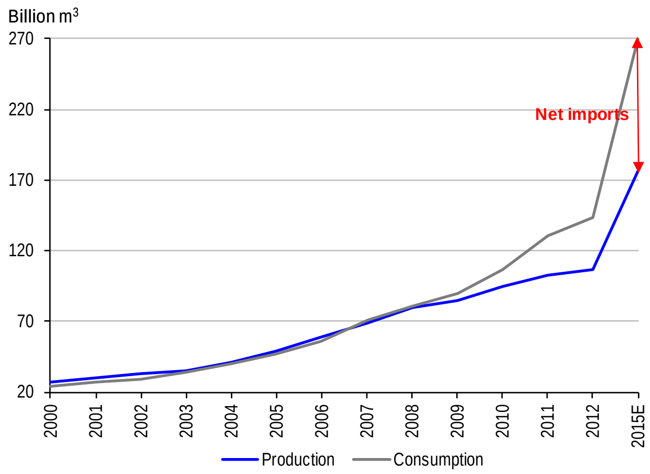
China's crude oil imports by source (2011) ('000 barrels/day)



Source: EIA, CCBIS

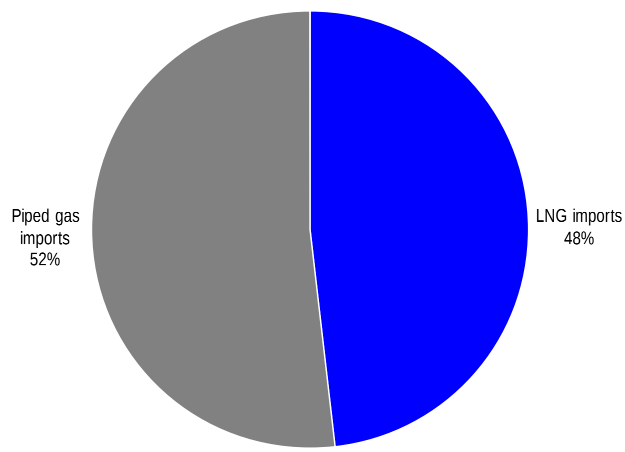
China also became a natural gas importer for the first time in 2007. Imports have increased dramatically in the past few years alongside China's thirst for natural gas and rapidly developing infrastructure, with total natural gas net imports reaching 42.5b m^3 in 2012, accounting for 28.9% of China total gas consumption.

China's gas production and consumption



Source: BP Statistical Review, CCBIS

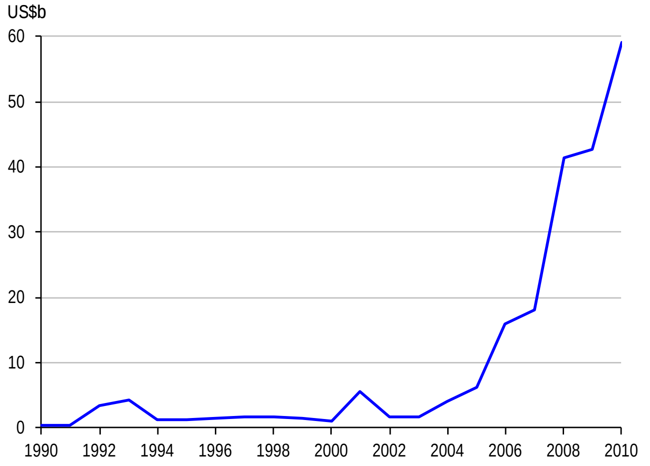
China's gas imports by source (2012)



Source: EIA, CCBIS

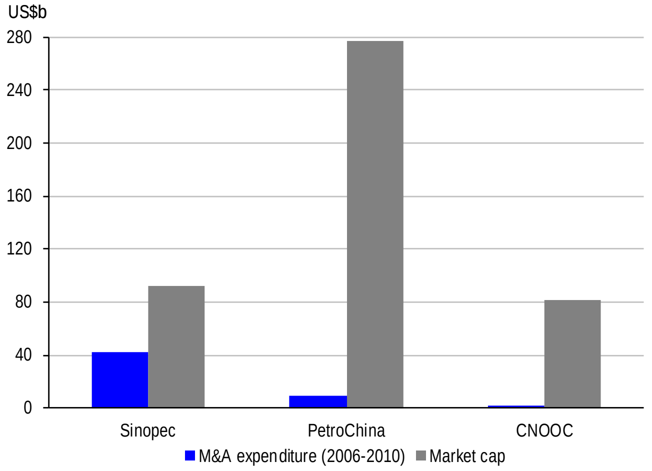
In addition to imports, major Chinese oil companies have been topping up their domestic production with rapid overseas acquisitions in past few years. There was a surge of overseas M&A spending beginning in 2004-2005F, with the Big-three Chinese national oil companies (NOC) spending US$34.0b in 2012, accounting for 13.6% of the world's total M&A spending on oil and gas.

Total Chinese outbound investments



Source: MOFCOM, CCBIS

M&A spending by the three main Chinese NOCs



Source: Company data, CCBIS

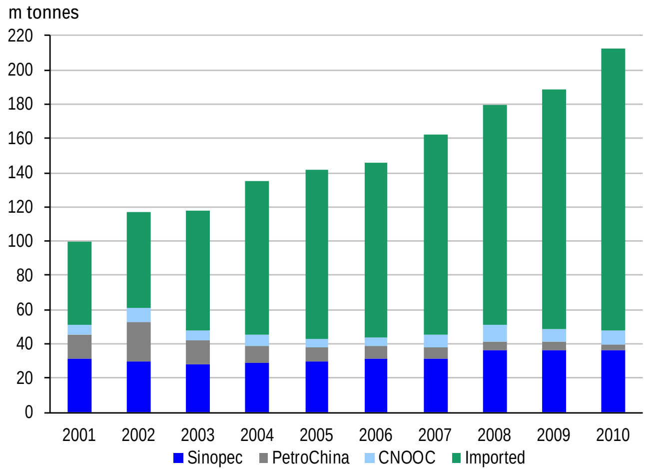
Sinopec the leader in oil imports while aggressively acquiring LNG imports

Sinopec is demanding more imports of oil and LNG. This represents an opportunity for SK

PetroChina, as the direct subsidiary of the Ministry of Petroleum, claimed most of its upstream and a substantial amount of its downstream assets. In contrast, Sinopec was established as a downstream specialist. While Sinopec's domestic oil production has remained generally flat for many years (crude oil production CAGR for 2000-2010 of about 2.2%), its oil refining capacity has been growing steadily (fuel production CAGR for 2000-2010 of about 9.3%). Sinopec has a long-term strategy centered on ensuring uninterrupted access to reserves for its downstream business, achieved by both maintaining a strong position in China oil imports and being aggressive in overseas acquisitions.

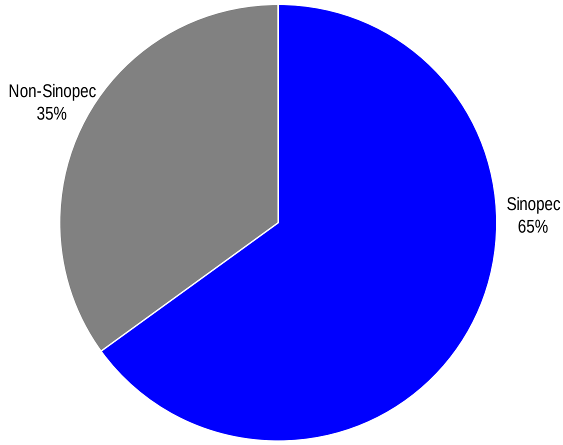
In China, oil imports are highly regulated and monopolized by the NOCs, the main players being CNPC, Sinopec, CNOOC, ChemChina and Zhuhai Zhenrong. Among these, Sinopec is the major oil importer, accounting for about 65% of the market in 2012.

Sinopec's crude oil sources



Source: EIA, CCBIS

China's oil imports by importing sources (2012)



Source: CEIC

Of the Chinese NOCs, Sinopec has been the most aggressive in overseas acquisitions

Sinopec has been the most aggressive in overseas acquisitions among the Chinese NOCs. Led by its former Chairman Chen Tonghai, who worked for Zhenhai Petroleum and Petrochemical Plant, the company began a series of upstream acquisitions in 2004 to ensure sufficient reserves for its downstream business.

The following table shows Sinopec's major acquisitions, some of which are located in Europe, some in the Middle East and some in Southeast Asia (close to the new strategic acquisitions of overseas oil terminals made by SK).

Selected acquisitions made by Sinopec Corporation

Date	Event/deal	Regions	Asset type	Size
October 2004	Agreement with Iranian government on Yadavaran oilfield	Middle East	Oil	US$2b
June 2006	Acquisition of Udmurtneft	Russia	Oil	US$3.5b
March 2008	Acquisition of 60% of AED Oil's Puffin and Talbot	Australia	Oil	US$599m
September 2008	Acquisition of Tanganyika Oil	Canada	Oil	US$1.9b
June 2009	Acquisition of Addax	Middle East	Oil	US$7.22b
October 2010	Acquisition of 40% of Repsol Brazil	Latin America	Oil	US$7.1b
December 2010	Acquisition of 18% of Chevron's deepwater project in Indonesia	Indonesia	Oil	US$0.9b
October 2011	Acquisition of 100% of Daylight in Canada	Canada	Oil	US$2.2b
April 2012	Acquisition of 30% of Galp Brazil & Galp Nertheland	Latin & Euro	Oil	US$5.18b
July 2012	Acquisition of 49% of Talisman Energy Inc.(UK)	Euro	Oil	US$1.5b

Source: CCBIS

LNG import is another important business within natural gas imports in China. In 2012, LNG imports accounted for 48.2% of China's total gas imports. By the end of 2012, there were a total of six LNG terminals under operation in China. CNOOC owns four out of the six and its LNG processing capacity accounts for about 75% of the market.

Sinopec endeavors to diversify its upstream gas sources by investing heavily on LNG. In December 2009, Sinopec secured a 20-year LNG supply contract with ExxonMobil's LNG projects in Papua New Guinea to procure 2mtpa starting end of 2014. In February 2011, Sinopec formed a JV (APLNG) with ConocoPhilips and Origin to develop LNG projects in Australia. Together with its upstream development, Sinopec is entitled to buy 7.5mtpa of LNG from 2015.

In addition, Sinopec has three LNG terminals under construction. The first, Qingdao LNG terminal, will begin commercial operations in mid-2014F, and the other two will commence operations in 2015F. The three LNG terminals will have a processing capacity of 9.0m tonnes per year in total beginning in 2015F. This is almost equivalent to the 9.6m tonnes of LNG imports from the two long-term contracts.

Sinopec LNG terminals

LNG terminal	Location	Capacity (mtpa)	Capacity (bcm pa)	Status	Commencement
Qingdao LNG	Qingdao, Shandong	3.0	4.0	Under construction	2014
Guangxi LNG	Beihai, Guangxi	3.0	4.0	Under construction	2015
Tianjin LNG	Tianjin	3.0	4.0	Under construction	2015

Source: CCBIS

Well-positioned for China's growing demand for oil and LNG

Before 2011, SK operated only one oil port (two berths with 30mtpa capacity in Huade Jetty) and served as an in-house agent Sinopec Guangzhou Petrochemical. With the recent acquisition of five ports from the parent (Ningbo, Tianjin, Qingdao, Rizhao and Caofeidian), SK now manages seven domestic oil ports with a total unloading capacity of 225mtpa among 24 berths. All of the newly acquired ports are joint ventures with Shihua Group, an entity ultimately controlled by the Port Authority.

SK is developing a global logistics infrastructure network to support China's growing demand for oil and LNG

After the acquisitions, SK became the largest independent crude oil terminal business operator in China, and holds a jointly-controlled interest in four of China's top five coastal crude oil ports by import volume (Ningbo, Qingdao, Tianjin and Zhanjiang). By the end of 2012, the total annual designed capacity of SK's oil terminals in China reached 225m tonnes. Meanwhile, SK imported a total of 137m tonnes crude oil in 2012, representing a 60.9% utilization rate. In 2012, SK accounted for 77.8% of Sinopec's oil imports and 51% of China's total oil imports.

As there are only a limited number of deep-water terminals in China, and with the increasing size of international oil carriers, it is important for the company to own deep-water terminals that can accommodate VLCC (very large crude carrier). SK now owns 9 out of the 20 berths in China that can accommodate VLCC as at 2011.

Sinopec Kanton's oil terminals in China

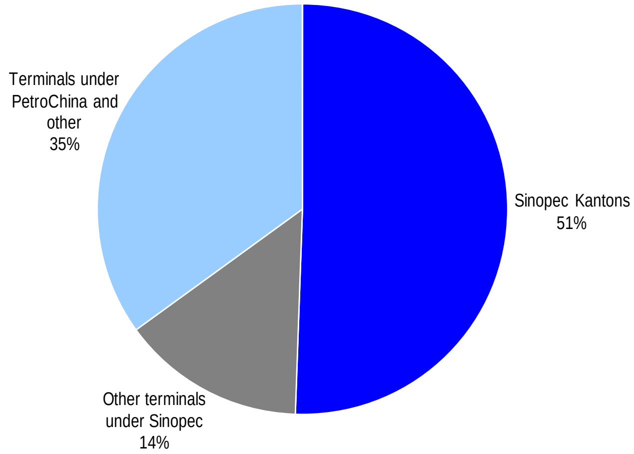
	Year of acquisition	Startup year	No. of berths	Largest vessel (k tonnes)	Annual designed capacity (m tonnes)	Stake (%)
Huade	2006	1997	2	250	30	100
Zhanjiang	2011	2000	12	300	55	50
Ningbo	2012	2002	3	300	35	50
Qingdao	2012	2006	4	300	45	50
Tianjin	2012	2009	1	300	20	50
Rizhao	2012	2011	1	300	20	50
Caofeidian	2012	2011	1	300	20	90
Total			24		225	

Source: Company data, CCBIS

China and SK's VLCC crude oil ports

Source: Company, CCBIS

Sinopec Kantons' share of China oil imports in 2012



Source: CCBIS

SK has not only built a leading position in coastal oil terminals in China, but has also developed a global network of oil jetties by acquiring terminal assets in three strategic locations in Europe, the Middle East and Indonesia.

Potential acquisitions in 2013-2014F

Mr. Fu Chengyu, who transferred to Sinopec Group as Chairman in mid-2011, will draw upon his expertise in capital markets to restructure Sinopec Group. We believe Mr. Fu will enhance the efficiency of the group, given his 30-years of experience with CNOOC, specializing in acquisitions, restructurings, spin-off listings and international market development.

It is likely that Sinopec Group will develop its business along similar lines to CNOOC, one with four highly profitable and independently-listed entities post restructuring while the parent company houses businesses with higher levels of risk or unprofitable operations.

We noted that Sinopec Group is accelerating the restructuring of its business operations. In mid-2012, Sinopec officially began to restructure its refining and petrochemical engineering business and in the process formed a company called Sinopec Engineering, which was listed on the Hong Kong Exchange in May 2013.

As a listed subsidiary of Sinopec Group specializing in crude oil trading, storage and transportation, SK has become the largest crude oil terminal business operator in China and one of the largest in Asia. SK already acquired equity interest in five crude oil terminal operators in China from Sinopec Group in 2012. In our view, the asset injection of Sinopec to its one and only red-chip-listed subsidiary is a vital step for Mr. Fu to optimize and to foster a new capital platform. The acquisition embodied Sinopec's determination to strengthen and expand SK.

SK has the capital resources to acquire assets costing HK$4.2b to HK$7.7b

In our view, SK will continue acquiring strategic asset from its parent and/or overseas to become one of the largest oil terminals and LNG shipping business players in Asia. Potential asset acquisitions may include crude oil terminals, LNG terminals, and oil/gas pipelines from Sinopec Group or overseas.

SK had HK$1.9b cash on hand with no debt in 1H13. In addition, SK still has the room to issue more shares to raise equity funds without affecting Sinopec's majority control. Sinopec's interest in SK is now 60%. If SK is to issue new shares to lower Sinopec's stake in to 51%, it would be able to issue 455m more shares. Assuming a placement price of HK$6 per share, SK can potentially raise HK$2.73b of equity funds, leading to a possible asset acquisition of around US$1b.

Sinopec Kantons' capital sources for potential acquisitions

HK$m	After placement in May 2013	Sinopec with additional equity issues*
Total equity	9,457	12,187
Gearing ratio to achieve for debt financing (%)	25	25
Potential debt added	2,364	3,047
Cash on hand	1,900	4,630*
Total equity and debt financing available	4,264	7,677

** Includes equity funds of HK$2.73b*

Source: CCBIS

Oil pipelines-the most likely target for acquisition

In our view, assets mostly likely to be injected into SK from its parent are oil pipes that could consolidate well with its seven coastal oil terminals in China.

First of all, the main crude oil terminals have been injected into SK (the seven oil terminals under SK accounted for about 78% of Sinopec's oil imports in 2012). Although there are other terminals under Sinopec, including Zhenhai, Zhoushan, Fujian and Hainan, we believe their profitability and returns may not be as high as SK's terminals due to their handing capacities.

Second, the five oil terminals recently injected into SK were originally managed by a subsidiary of Sinopec called Sinopec Pipeline Storage and Transportation Company (SPSTC). 37 oil pipelines with a total length of 6,132km are managed by SPSTC, according to the 2011 yearbook.

Acquisition target: pipelines

In our view, the Caofeidian-Tianjin Line, the Zhanjiang-Beihai Line and the Tanggu-Yanshan Line are most likely to be injected by Sinopec into Kantons in the coming 6-12 months, taking into account their attractive returns and acceptable sizes.

Some of Sinopec's main pipelines

	Pipelines	Length (km)	Capacity (mtpa)
Crude oil	Ningbo-Shanghai-Nanjing Line	680	40
	Rizhao-Yizheng	390	36
	Dongying-Huangdao Line	250	10
	Dongying-Huangdao Double Line	250	20
	Puyang-Linyi Line	242	3.5
	Cangzhou-Tianjin-Yanshan Line	230	6
	Tanggu-Yanshan Line	228	20
	Weifang-Jingmen Line	226	3.5
	Honghu-Jingmen Line	210	3.5
	Zhanjiang-Beihai Line	198	10
	Caofeidian-Tianjin Line	190	20
	Dongying-Linyi Line	189	10
	Linyi-Cangzhou Line	178	10
	Mabianzhou-Guangzhou Pet	174	12
	Dongying-Linyi Double Line	159	16
	Zhanjiang-Maoming Line	105	10
	Cangzhou-Hejian Line	87	8
	Tianjin-Cangzhou Line	82	4
Oil products	Southwest Oil Product Pipeline	1,691	6
	Shandong Anhui Oil Product Pipeline II	1,280	5.9
	Shandong Anhui Oil Product Pipeline I	769	5.25
	Hunan Oil Product Pipeline II	533	5.2
	Luoyang-Zhengzhou Line	425	3.9
	Southern Jiangxu Oil Product Pipeline	393	8
	Ningbo-Shaoxing-Jinhua-Quzhou Line	378	7.6
	Shijiazhuang-Taiyuang Line	316	4.3
	Hunan Oil Product Pipeline I	274	6
	Jiangxi Oil Product Pipeline	240	3.3
	Zhenhai-Xiaoshan-Hangzhou Line	199	3.1
	Zhumadian-Xinyang Line	172	2.25
	Jinshan-Jiaxing-Huzhou Line	152	2.6

Source: Sinopec, CCBIS

LNG terminals and gas pipelines

SK already formed two LNG shipping JVs with China Shipping to carry LNG from the Sinopec PNG project and Sinopec APLNG project. According to the contracts, the two projects will begin delivering LNG from 2015F.

SK plans to construct 8 LNG vessels under Sinopec APLNG and 2 LNG vessels under Sinopec PNG. The first LNG vessel for both projects is also expected to be delivered by 2015F.

Sinopec has three LNG terminals under construction in Qingdao, Guangxi and Tianjin. Together, these terminals have a total capacity of 9.0mtpa, which corresponds to the two LNG supply contracts of 9.2mtpa. The first LNG terminal in Qingdao is expected to be completed in mid-2014F, compatible with the delivery of LNG vessels under the two LNG projects.

We believe LNG terminals are another type of asset likely to be injected into SK within the next two years. First, Sinopec's LNG terminals and Sinopec Kantons' LNG vessels could be consolidated to deliver LNG for Sinopec's APLNG and PNG projects. Second, LNG terminals are assets that generate acceptable returns (judging by Kunlun Energy's Jiangsu and Dalian LNG terminals, the IRR is about 12%). Finally, the acquisition size of the LNG terminals is acceptable. An LNG terminal with 3.0mtpa capacity has an estimated acquisition cost of HK$1b (assuming 1.0x P/B and a 100% stake).

Gas pipelines, gas storage tanks and LNG terminals are other acquisition targets

Sinopec has three main gas pipelines in operation. These pipelines are also possible assets for injection into SK. Among the three main gas pipelines, Sichuan-Shanghai Line and Yulin-Jinan Line connect two major gas fields of Puguang/Yuanba (Sichuan) and Daniudi (Ordos), while the Shandong natural gas pipelines network could work with Sinopec Qingdao LNG terminal in the future. The Shandong natural gas pipelines network generates better returns taking into account its relatively short distance (1,317km in total for the seven-to-eight gas pipelines in the network) and high tariff (RMB0.27/cm) compared with the other two pipelines (RMB0.55/cm in tariff and 2,170km in length for Sichuan-Eastern Pipeline).

Sinopec– selected LNG terminals and gas pipelines

		Length (km)	Capacity	Capex(RMB m)	Startup
LNG terminals	Qingdao LNG		3.0mtpa	9,660	2014
	Guangxi LNG		3.0mtpa	14,056	2015
	Tianjin LNG		3.0mtpa		2015
Gas pipeline	Sichuan-to-East Line	2,170	12bcm/year		
	Yulin-Jinan Line	1,045	3bcm/year		
	Shandong gas Line	1,317	N/A		
Gas storage	Wen-96		588mcm		Operational
	Jintan		1,080		Under construction

Source: CCBIS

Other oil terminals and storage assets

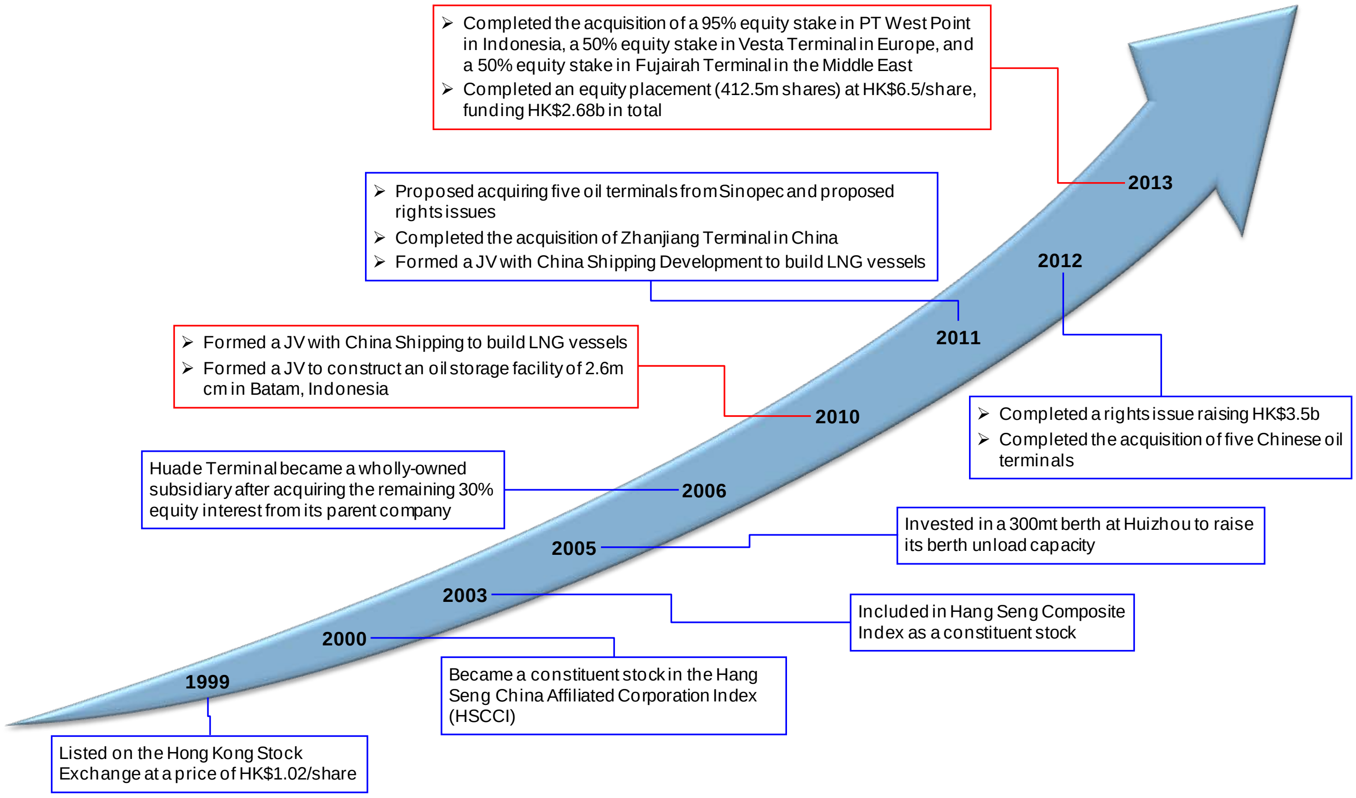
Sinopec has storage tanks with a total capacity of 23.6m cm under SPSTC, according to Sinopec Yearbook 2011. These are assets that can be injected to complement SK's existing storage facilities.

Appendix 1: Company milestones

SK is a subsidiary of Sinopec Group. It was established in March 1998 and listed on the Hong Kong stock exchange in June 1999. Since its listing, SK has engaged in oil trading and jetty services. In 2010, Sinopec Group repositioned SK as a specialized arm with the intension of transforming it into a world-class petrochemical storage and logistics company.

Since 2006, SK has been gradually acquiring Chinese terminals from its parent company. It now has seven, making it a leading player in the domestic oil terminal market. SK began to accelerate its overseas expansion in 2010, extending its footprint into Southeast Asia, the Middle East and Europe through M&A. SK has contracted eight-to-ten oil vessels to consolidate its status as a global oil logistic company.

Sinopec Kantons' development milestones



Source: Company

Appendix 2: Management profile

Mr. Dai Zhao Ming, age 47, Chairman of SK. Mr. Dai is a senior economist and holds a doctoral degree in economics. He joined Sinopec Guangzhou Petrochemical Complex in August 1990 and served as deputy section chief, section chief, deputy director of Planning Department, and deputy chief economist of Sinopec Guangzhou Petrochemical Complex successively. Since December 1996, Mr. Dai had served as general manager of Sinomart KTS Development Co. Ltd. and from March 1998, he served as managing director of Sinopec Kantons Holdings Limited. From March 2004, he served as Deputy General Manager of China International United Petroleum & Chemicals Co. Ltd. Since 2005, Mr. Dai has been General Manager and Executive Director of China International United Petroleum & Chemicals Co. Ltd. Mr. Dai has been the chairman of the company since October 2008.

Mr. Zhu Zeng Qing, age 57, Deputy Chairman of SK. Mr. Zhu is a senior accountant with a degree from Technical College of Zhejiang Jin Hua Supply and Sales School in July 1980. He was also a graduate of business management at University of Ningbo in July 2005. He was successively deputy head and then head of the finance division of Zhenhai Refining & Chemical Company from February 1991 to November 2000; deputy chief accountant and chief accountant of Zhenhai Refining & Chemical Company from December 2000 to November 2005; and deputy officer of the finance department of China Petroleum & Chemical Corporation since December 2005. Mr. Zhu has been the Deputy Chairman of SK since April 2007.

Mr. Zhu Jian Min, age 48, Executive Director of SK. Mr. Zhu is a senior engineer and holds a doctoral degree in industrial studies. He has extensive experience in corporate management. He graduated from China Textile University in July 1992. Mr. Zhu has been an Executive Director of the Company since March 2004.

Mr. Tan Ke Fei, age 45, Executive Director of SK. Mr. Tan holds a Bachelor's Degree in Arts and a Bachelor's Degree in Law. He is a practicing lawyer and possesses substantial legal and foreign trade management experience. Mr. Tan has been an Executive Director of SK since April 2007.

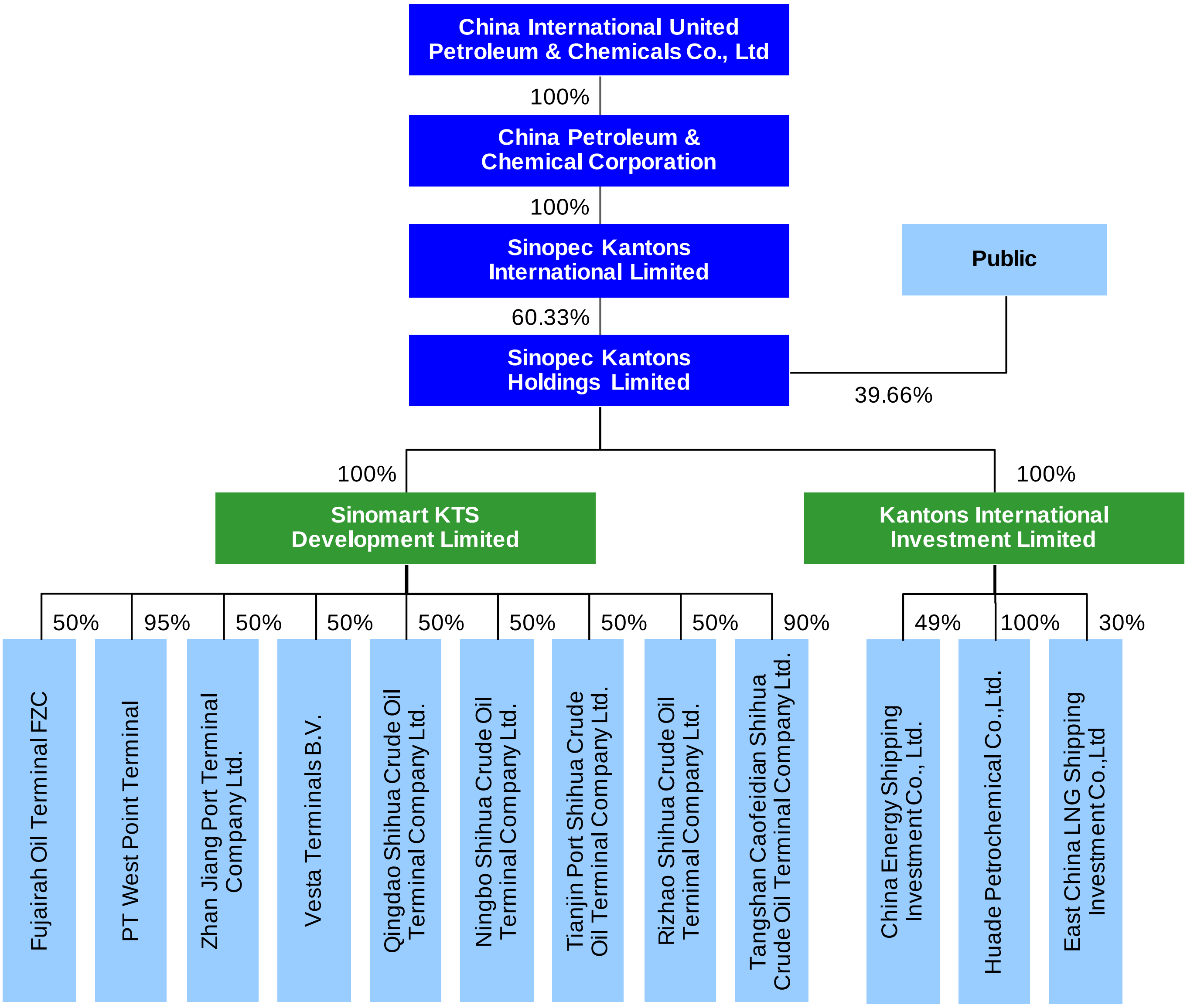
Mr. Zhou Feng, age 47, Executive Director of SK, Mr. Zhou has a Master's Degree in Business Administration and has a professional qualification as a senior accountant. He graduated from chemical engineering from Eastern China Polytechnic University in July 1987. Mr. Zhou has been an Executive Director of SK since April 2004.

Mr. Ye Zhi Jun, age 46, Managing Director of SK, Mr. Ye holds a Master's Degree in Business Administration and was an engineer. Mr. Ye has been a Managing Director of SK since January 2002.

Appendix 3: Shareholding structure

Sinopec Group, through its wholly-owned subsidiary UNIPEC (China International United Petroleum & Chemicals Company), holds a 60.3% stake in SK. The remaining shares are held by public investors, representing a free float of 39.66%.

Shareholding structure as at 1 October 2013



Source: Company, CCBIS

Rating definitions

Outperform (O) – expected return > 10% over the next twelve months

Neutral (N) – expected return between -10% and 10% over the next twelve months

Underperform (U) – expected return < -10% over the next twelve months

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