

Morgan Stanley Asia Limited+

Wee-Kiat Tan

Weekiat.Tan@morganstanley.com
+852 2848 7488

Sara Chan

Sara.Chan@morganstanley.com

August 30, 2012

Stock Rating
Overweight

Industry View
In-Line

SPT Energy Group Inc

Strong momentum

What's Changed

Price Target **HK\$1.65 to HK\$2.20**

We are impressed by the good progress SPT is making in expanding its range of high-end services and moving into new markets. On the back of higher forecasts and rolling into 2013, we have raised its target price to HK\$2.20 based on a PER 7.5x implying 38% upside. Maintain OW.

Improving earnings profile: SPT delivered a strong set of 1H12 results. Even more encouraging is the progress SPT made in moving up the chain and offering a wider range of higher value services. These include the drilling of non-conventional gas wells, and introducing a turnkey service in the Tarim basin (complicated geological conditions). Building in the additional revenue streams from such services, we have raised our forecasts by 5-8% over the next three years. Rolling over into 2013, we set SPT's target price at HK\$2.20 based on a 2013-PER of 7.5x. Maintain OW.

Valuation is starting to catch up with peers': We expect SPT to deliver a 30% earnings CAGR over 2011-14e, driven by the rising need for enhanced oil recovery services in China and Kazakhstan, plus improving margins as SPT increases the proportion of parts manufactured in-house. Over the last few months, SPT's valuations have been catching up with its closest peer comparison Anton Oilfield Services Group. In our view, re-rating will continue as SPT delivers margin improvement and strong earnings momentum.

1H12 results suggest earnings momentum intact: SPT reported a 1H12 net profit of Rmb66mn, up 39% YoY and slightly ahead of our expectation. The key driver to this strong growth was the Well-services division where revenue grew 140% YoY. Operating margins improved by about 100bps given the expanded scale of its operations. In fact, 1H12 included some ramp up cost which we expect to moderate in 2H12.

Key Ratios and Statistics

Reuters: 1251.HK Bloomberg: 1251 HK

China Oil & Gas

Price target	HK\$2.20
Up/downside to price target (%)	41
Shr price, close (Aug 29, 2012)	HK\$1.56
52-Week Range	HK\$1.71-1.08
Sh out, dil, curr (mn)	1,335
Mkt cap, curr (mn)	US\$268.5
EV, curr (mn)	US\$260.6
Avg daily trading value (mn)	US\$0.7

Fiscal Year ending	12/11	12/12e	12/13e	12/14e
Revenue, net (Rmb mn)	1,321	1,957	2,327	2,901
EBITDA (Rmb mn)	319	453	559	699
ModelWare net inc (Rmb mn)	182	256	313	400
ModelWare EPS (Rmb)	0.14	0.19	0.23	0.30
Prior ModelWare EPS (Rmb)	-	0.18	0.22	0.28
Consensus EPS (Rmb)\$	0.13	0.17	0.22	0.28
P/E	7.7	6.7	5.5	4.3
EV/EBITDA	4.2	4.1	3.4	2.6
P/BV	1.6	1.5	1.2	0.9
ROE (%)	30.2	29.4	27.8	27.8
Div yld (%)	0.0	0.0	0.0	0.0

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

\$ = Consensus data is provided by Thomson Reuters Estimates.

e = Morgan Stanley Research estimates

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SPT Energy: Financial Summary

Income Statement

Y/E Dec Rmb million	2010	2011	2012E	2013E	2014E
Revenue	1,050.4	1,321.3	1,956.6	2,326.5	2,900.8
Drilling	343.8	450.8	627.0	811.8	1,064.4
Well completion	323.8	354.9	637.8	811.8	889.8
Oil reservoir	382.8	515.6	691.8	702.9	946.7
Other gains/(losses)	4.2	(7.8)	(2.0)	(2.0)	(2.0)
Operating costs	(873.7)	(1,037.9)	(1,563.2)	(1,856.8)	(2,308.2)
Material costs	(264.9)	(363.4)	(537.5)	(630.0)	(770.0)
Employee benefit exp	(209.0)	(253.0)	(361.6)	(414.4)	(519.2)
Operating lease exp	(36.4)	(48.1)	(74.9)	(99.5)	(127.8)
Transportation costs	(51.2)	(66.3)	(88.8)	(108.1)	(129.3)
D&A	(31.5)	(43.6)	(61.2)	(91.2)	(108.7)
Technical service exp	(139.4)	(93.0)	(186.9)	(236.9)	(282.9)
Impairment loss on inv	0.0	(9.3)	(5.0)	0.0	0.0
Others	(141.3)	(161.3)	(247.4)	(276.6)	(370.2)
EBITDA	212.5	319.2	452.6	558.9	699.4
Operating profit	180.9	275.6	391.4	467.7	590.6
Finance income	0.3	0.5	0.5	5.0	5.0
Finance costs	(5.7)	(14.5)	(21.5)	(21.5)	(21.5)
Finance income/(cost)	(5.4)	(14.0)	(21.0)	(16.5)	(16.5)
Profit before tax	175.6	261.7	370.4	451.2	574.1
Income tax expense	(56.1)	(75.1)	(107.4)	(130.9)	(166.5)
Minority Interest	(0.1)	(4.8)	(7.4)	(7.4)	(7.4)
Net profit	119.4	181.8	255.6	313.0	400.2
Y/E Dec	2010	2011E	2012E	2013E	2013E
YoY % Growth					
Revenue (%)	15%	26%	48%	19%	25%
Drilling (%)	11%	31%	39%	29%	31%
Well completion (%)	21%	10%	80%	27%	10%
Oil reservoir (%)	15%	35%	34%	2%	35%
EBITDA (%)	18%	50%	42%	23%	25%
EBIT (%)	18%	52%	42%	20%	26%
Net Income (%)	41%	52%	41%	22%	28%
EBITDA Margin (%)	20%	24%	23%	24%	24%
EBIT Margin (%)	17%	21%	20%	20%	20%
Net Margin (%)	11%	14%	13%	13%	14%

E = Morgan Stanley Research estimates
Source: Company Data, Morgan Stanley Research

Balance Sheet

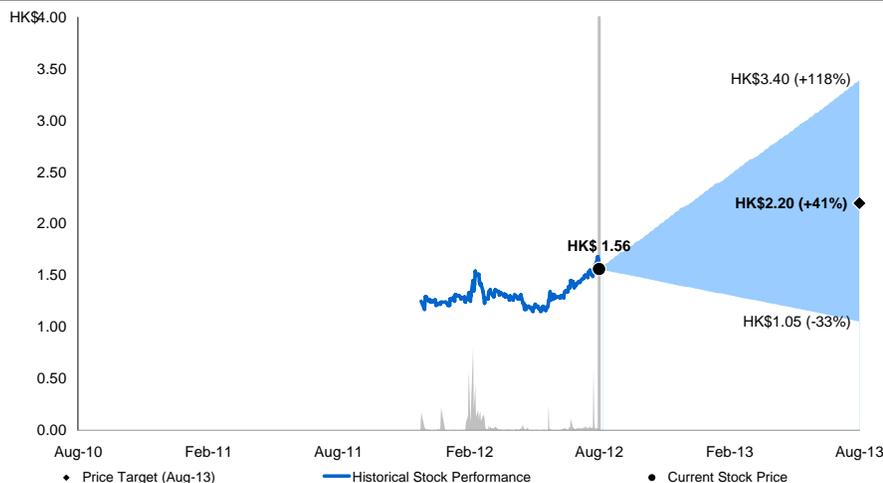
Y/E Dec Rmb million	2010	2011E	2012E	2013E	2013E
Non-current assets	236.2	284.4	460.7	669.5	735.7
PP&E	196.4	214.6	390.9	599.7	665.9
Intangible assets	0.8	0.2	0.2	0.2	0.2
Deferred income tax	31.8	42.1	42.1	42.1	42.1
Other receivable	7.2	27.5	27.5	27.5	27.5
Current assets	929.5	1,184.4	1,530.8	1,728.3	2,207.1
Inventories	211.1	245.1	369.2	438.5	545.1
Trade receivables	445.1	577.1	854.6	1,016.1	1,266.9
Other receivables	95.9	58.8	87.1	103.6	129.1
Restricted bank deposits	10.7	2.0	2.0	2.0	2.0
Cash	166.7	301.3	217.9	168.1	263.9
Total Assets	1,165.7	1,468.8	1,991.5	2,397.8	2,942.8
Non-Current liab	0.4	16.7	16.7	16.7	16.7
Deferred income tax liab	0.4	7.6	7.6	7.6	7.6
Current liabilities	563.3	548.3	817.4	912.8	1,059.6
Borrowings	160.0	210.1	310.1	310.1	310.1
Trade payables	269.2	199.9	301.1	357.7	444.6
Other payables	61.1	96.1	144.7	171.9	213.7
Income tax liabilities	73.0	41.5	61.5	73.1	91.1
Total liabilities	563.7	565.0	834.1	929.5	1,076.3
EQUITY					
Share capital	0.068	276.304	276.304	276.304	276.304
Other reserves	313.3	159.3	159.3	159.3	159.3
Fx difference	(15.2)	(33.6)	(33.6)	(33.6)	(33.6)
Retained earnings	303.8	468.2	723.8	1,036.8	1,437.0
Shareholders equity	602.0	870.3	1,125.9	1,438.8	1,839.1
Minority interests	(0.1)	33.5	31.5	29.5	27.5
Total equity and liabilities	1,165.7	1,468.8	1,991.5	2,397.8	2,942.9
ROE	20%	20%	22%	21%	21%
ROAE	23%	24%	25%	24%	24%
ROA	10%	12%	13%	13%	14%
Net Gearing	1%	10%	-8%	-10%	-2%

Cash Flow Statement

Y/E Dec Rmb million	2010	2011	2012E	2013E	2013E
Net Income	119.4	181.8	255.6	313.0	400.2
Add: Minority interest	(0.1)	(4.8)	(7.4)	(7.4)	(7.4)
Add: D&A	31.5	43.6	61.2	91.2	108.7
Change in NWC	(144.6)	(194.7)	(260.0)	(152.0)	(236.2)
Other CFO	61.7	35.9	0.0	0.0	0.0
Total CFO	67.9	61.8	49.4	244.8	265.4
Capex	92.1	90.0	200.0	300.0	175.0
Total CFI	(82.1)	(80.0)	(190.0)	(290.0)	(165.0)
Total CFF	82.8	190.7	100.6	0.6	0.6
Net Cash Flow	58.4	126.0	(40.0)	(44.6)	101.0

Risk-Reward Snapshot: SPT Energy (1251.HK, HK\$1.56, OW, PT HK\$2.20)

Risk-Reward View



Investment Thesis

We believe the SPT earnings growth potential is supported by:

- 1) Increased E&P capital spending in China, which should boost demand for SPT's services.
- 2) SPT's superior technological capability vs. state-owned providers', better positioning the company to benefit from China's rising capex and its growing focus on non-conventional energy sources.
- 3) The mounting trend among major Chinese oil producers to outsource service work to independent providers such as SPT.

Key Value Drivers

- E&P (exploration and production) capex.
- EBIT margin increases as the result of ASP increases.
- SPT's growing proportion of self-manufacturing.

Potential Catalysts

- Greater-than-expected E&P spending from higher-than-expected crude oil prices.
- Improved margins for all three divisions, thanks to growing demand for SPT's services.

Downside Risks

- Weaker-than-expected crude oil prices, slowing E&P operations.
- Increased competition in the services space.
- Execution risk in self-manufacturing of parts.
- Geopolitical risk.

Price Target HK\$2.20		We derive our HK\$2.20 price target using 7.5x our 2013 EPS.
Bull Case HK\$3.40	12x Bull Case 13e EPS	Global economy undergoes strong recovery, pushing up crude prices. Revenue growth 10% higher vs. base case. SPT consistently hits its targets. Strong expectations for future years causes stock to re-rate to trade at its peers' average P/E multiple of 12x.
Base Case HK\$2.50	8.6x Base Case 13x EPS	DCF based. China E&P expenditure leads to 29% higher revenue in 2012. Drilling and reservoir EBIT margin is relatively flat, and 20% of spare parts are self-manufactured within the well completion division as planned.
Bear Case HK\$1.05	8x Bear Case 13e EPS	Price of crude drops below US\$70/bbl, slowing revenue growth by 10% vs. base case in 2012, expectations of continued weakness in crude prices reduce revenue growth as well as margin in future years. Stock de-rates and is valued on a P/B basis

Investment Case

Summary & Conclusions

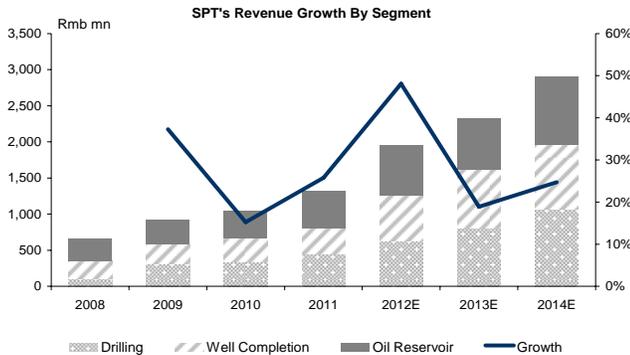
- 1H12 results were slightly ahead of expectation on the back of higher revenue. Margins were within expectations.
- We have raised our sales forecasts to take into account the additional revenue as SPT expands its range of services to include taking on turnkey projects and fracturing services to both conventional and non-conventional oil & gas fields. Accordingly, our earnings have been revised up by 5-8%.
- Rolling into 2013, we have set our target price for SPT at HK\$2.20 based on a 2013-PER of 7.5x (our target multiple is unchanged). This is a discount to the sector average of 10x to reflect its relative short trading history.
- At current levels, SPT is trading at a significant 43% discount to the industry's 2012 average PER. Against its closest comparable, Anton Oilfield Services Group, the gap is even larger, at a 57% discount. The discount to peers reflects the lack of track record, but we expect the gap to narrow as SPT begins to deliver on its target.

Exhibit 1 Changes to SPT forecasts and target price

Net profit (Rmb mn)	2012E	2013E	2014E	Target price (HK\$/share)
Previous	235.4	295.0	376.9	End-12: 1.65
New	255.6	313.0	400.2	End-13: 2.20
% change	8.6%	6.1%	6.2%	33%

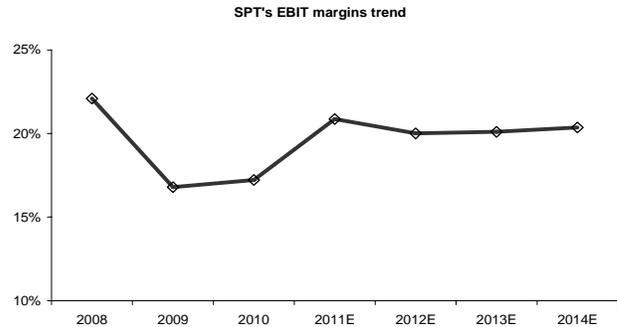
E = Morgan Stanley Research estimates Source: Company Data, Morgan Stanley Research

Exhibit 2 Revenue growth is expected to grow at over 20% driven by rising industry demand and SPT's expanding its range of services.



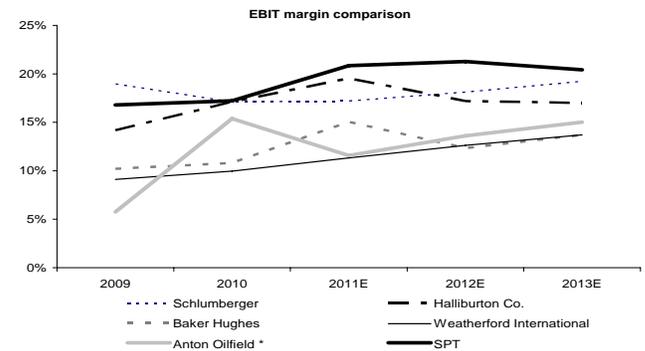
E = Morgan Stanley Research estimates Source: Company Data, Morgan Stanley Research

Exhibit 3 Despite rising cost pressure we expect SPT to hold its margin given efforts on cost control (increasing use of self-produced components)



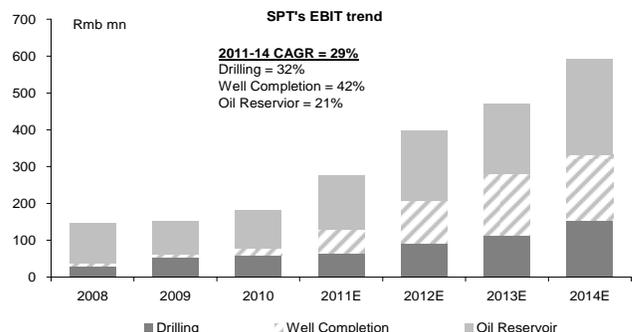
E = Morgan Stanley Research estimates Source: Company Data, Morgan Stanley Research

Exhibit 4 SPT margins are expected to be higher vs its peers'



E = Morgan Stanley Research estimates except * for consensus Source: Company Data, Thomson Reuters, Morgan Stanley Research

Exhibit 5 All three divisions are expected to show strong earnings growth ...

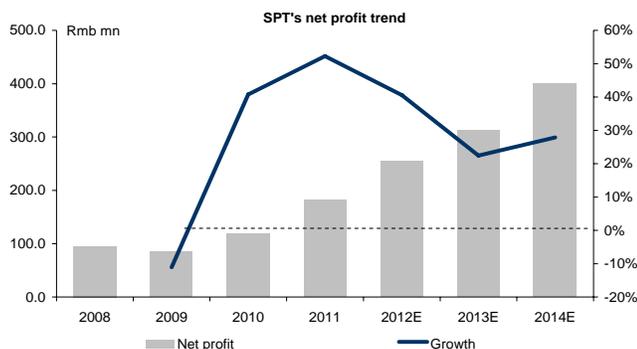


E = Morgan Stanley Research estimates Source: Company Data, Morgan Stanley Research

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Exhibit 6

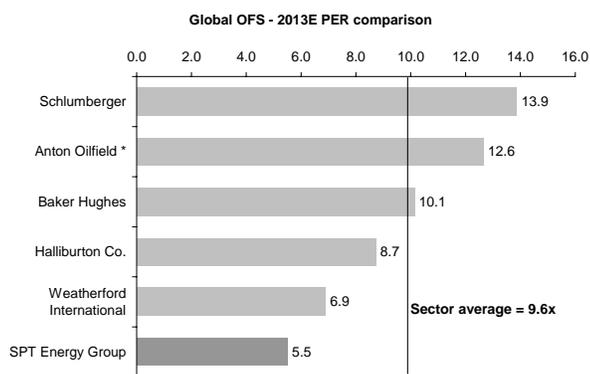
... and we expect this strong momentum to sustain for SPT over the next few years



E = Morgan Stanley Research estimates Source: Company Data, Morgan Stanley Research

Exhibit 7

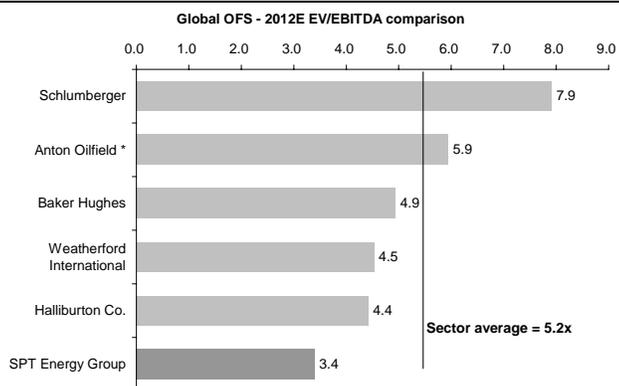
Against Anton Oilfield, SPT is trading at a significant discount on 2012/13-PER ...



E = Morgan Stanley Research estimates, except * for consensus Source: Thomson Reuters, company data, Morgan Stanley Research

Exhibit 8

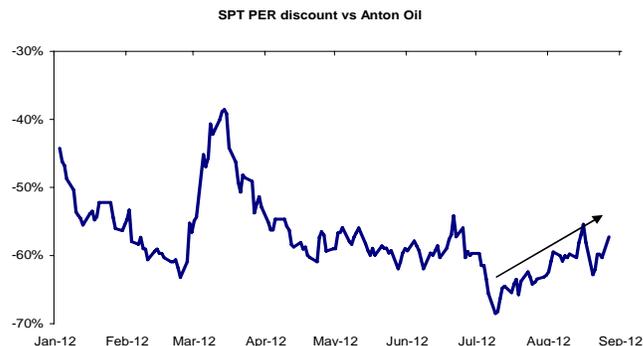
...as well as on EV/EBITDA



E = Morgan Stanley Research estimates except * for consensus Source: Thomson Reuters, company data, Morgan Stanley Research.

Exhibit 9

SPT's valuations discount to Anton Oil narrowed in the last few months. We expect this continue as SPT delivers on earnings and margin improvement



Source: Company Data, DataStream, Morgan Stanley Research

Exhibit 10

SPT Energy: Half-yearly financials

Y/E Dec Rmb million	1H11	2H11	1H12	YoY %	HoH %
Revenue	408.5	912.8	590.3	45%	-35%
Drilling	128.7	322.1	178.2	38%	-45%
Well completion	74.6	280.3	179.4	140%	-36%
Oil reservoir	205.2	310.4	232.7	13%	-25%
Other gains/(losses)	(5.0)	(2.8)	(0.4)	-91%	-85%
Operating costs	(335.0)	(702.9)	(485.8)	45%	-31%
Material costs	(98.9)	(264.5)	(130.1)	32%	-51%
Employee benefit exp	(91.8)	(161.2)	(153.2)	67%	-5%
Operating lease exp	(18.2)	(29.8)	(29.7)	63%	0%
Transportation costs	(24.5)	(41.8)	(33.3)	36%	-20%
D&A	(19.0)	(24.6)	(29.3)	54%	19%
Technical service exp	(32.6)	(60.4)	(43.7)	34%	-28%
Impairment loss on inv	(1.3)	(8.0)	(3.7)	184%	-54%
Others	(48.7)	(112.6)	(62.9)	29%	-44%
EBITDA	87.5	231.7	133.4	52%	-42%
Operating profit	68.6	207.1	104.1	52%	-50%
Finance income/(cost)	(3.5)	(10.5)	(7.5)	113%	-28%
Finance income	0.2	0.4	1.4	790%	252%
Finance costs	(3.7)	(10.9)	(8.9)	141%	-18%
Profit before tax	65.0	196.6	96.6	48%	-51%
Income tax expense	(18.7)	(56.4)	(29.2)	57%	-48%
Minority Interest	0.9	(5.7)	(1.5)	-271%	-73%
Net profit	47.2	134.6	65.8	39%	-51%
Net Margin	11.6%	14.7%	11.1%		
EBITDA Margin	21.4%	25.4%	22.6%		
EBIT Margin	16.8%	22.7%	17.6%		

E = Morgan Stanley Research estimates Source: Company Data, Morgan Stanley Research

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(as of July 31, 2012)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	Total IBC	% of Rating Category
Overweight/Buy	1133	38%	457	42%	40%
Equal-weight/Hold	1260	43%	489	45%	39%
Not-Rated/Hold	109	4%	32	3%	29%
Underweight/Sell	454	15%	114	10%	25%
Total	2,956		1092		

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Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

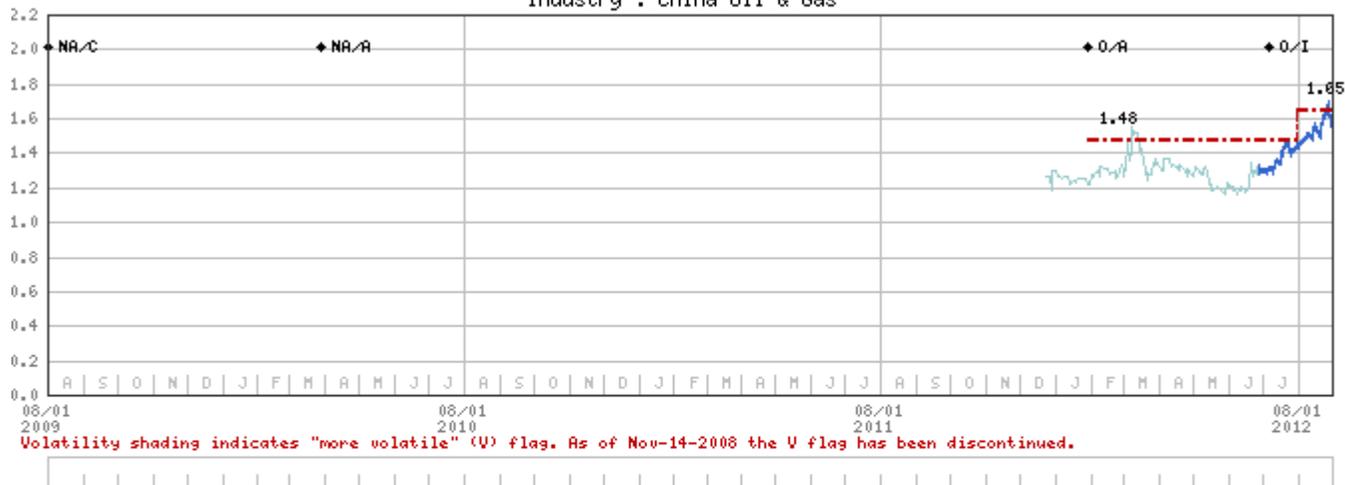
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock Price, Price Target and Rating History (See Rating Definitions)

SPT Energy Group Inc (1251.HK) - As of 8/29/12 in HKD
Industry : China Oil & Gas



Stock Rating History: 8/1/09 : NA/C; 3/29/10 : NA/A; 1/30/12 : O/A; 7/6/12 : O/I

Price Target History: 1/30/12 : 1.48; 7/30/12 : 1.65

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Ratings/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (U) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

August 30, 2012
SPT Energy Group Inc

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August 30, 2012
SPT Energy Group Inc

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The Americas

1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1) 212 761 4000

Europe

20 Bank Street, Canary Wharf
London E14 4AD
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan

4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0) 3 5424 5000

Asia/Pacific

1 Austin Road West
Kowloon
Hong Kong
Tel: +852 2848 5200

Industry Coverage:China Oil & Gas

Company (Ticker)	Rating (as of)	Price* (08/29/2012)
Sara Chan		
Honghua Group Ltd. (0196.HK)	O (12/13/2011)	HK\$1.21
Sunshine Oilsands Ltd. (2012.HK)	O (04/10/2012)	HK\$4.4
Wee-Kiat Tan		
CNOOC (0883.HK)	O (07/14/2009)	HK\$14.8
China Oilfield Services Ltd. (2883.HK)	O (01/13/2012)	HK\$12.68
China Petroleum & Chemical Corp. (0386.HK)	E (07/06/2012)	HK\$7.46
Hilong Holding Limited (1623.HK)	E (01/13/2012)	HK\$1.83
PetroChina (0857.HK)	U (07/06/2012)	HK\$9.45
SPT Energy Group Inc (1251.HK)	O (01/30/2012)	HK\$1.56

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* Historical prices are not split adjusted.