

Rating: Buy  
 S&P 500: 1213

## **CNOOC Limited**

### **Natural Gas Progress**

<i>Symbol</i>	CEO	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$mm)</i>	4,300
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	54.23	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	12/28/04	<i>Adjusted Reserves/Production NTM</i>	9.6
<i>Shares (mm)</i>	411	<i>EV/Ebitda</i>	5.1
<i>Market Capitalization (US\$mm)</i>	22,300	<i>PV/Ebitda</i>	5.6
<i>Debt (US\$mm)</i>	0	<i>Undeveloped Reserves (%)</i>	52
<i>Enterprise Value (EV) (US\$mm)</i>	22,300	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	29.53
<i>Present Value (PV) (US\$mm)</i>	24,300	<i>Present Value Proven Reserves(US\$/boe)</i>	12.77
<i>Net Present Value (US\$/share)</i>	59	<i>Present Value Proven Reserves(US\$/mcfe)</i>	2.13
<i>Debt/Present Value</i>	0.00	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.63
<i>McDep Ratio - EV/PV</i>	0.92	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	3.3	<i>Indicated Annual Dividend (US\$/sh)</i>	1.79

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

The Peoples Republic of China holds 81% of the outstanding shares.

### **Summary and Recommendation**

We continue to recommend current purchase of the American Depositary Shares of **CNOOC Limited (CEO)** the “independent producer” of China-domiciled oil and gas companies. A long reserve life for natural gas points to further production gains after volume jumped in the third quarter. Business risk is partly shifted to other companies and financial risk is low as there is no net debt on the company’s balance sheet. Dividend yield of 3.3% is the highest for independent producers in our coverage. Already a good performer in 2004, the stock has additional 9% appreciation potential to reach our estimate of net present value of \$59 a share assuming a constant real oil price of \$35 a barrel for light, sweet crude.

### **Oil for Cash, Gas for Growth**

Oil accounts for 90% of estimated present value as we estimate now (see table Functional Cash Flow and Present Value). The oil present value to cash flow multiple, PV/Ebitda, appears low by 0.5 times in the current correlation for thirty companies. As far as we know, CNOOC’s reserves are stated consistently with peer companies.

The 12% share for natural gas looks low relative to ultimate potential. The long adjusted reserve life points to potential rapid production growth. Indeed that may have begun with the startup of new production in the South China Sea.

A small proportion of reserves are reported for Indonesia, the only location outside China. We expect additions for Australia where the company is a participant in development on the Northwest Shelf.

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**CNOOC Limited**  
**Functional Cash Flow and Present Value**

	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
Natural Gas	340	17.8	8.4	2,900	12%
Oil	3,960	8.0	5.4	21,400	88%
	4,300	9.6	5.7	24,300	100%
Debt (US\$mm)					-
Net Present Value (US\$mm)					24,300
Shares (mm)					411
Net Present Value (US\$/sh)					59

Production growth shows up in historical results. We arbitrarily hold the trends flat for the next several quarters (see table Next Twelve Months Operations).

CNOOC's wellhead price for natural gas is understated by world standards. It probably reflects concessions to users who once had cheap oil alternatives and may have had cheap coal. That is changing with recent oil price increases. Also while China burns far too much coal, even that commodity has been affected by mining and transportation bottlenecks. Since much of CNOOC's business is with other state-owned entities (SOE), the government has a lot to say about prices. We expect higher price for natural gas eventually, but we do not count on it and do not project any increase for the next twelve months

**CNOOC Limited**  
**Next Twelve Months Operations**

	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>Twelve</i>
										<i>Months</i>
<b>Volume</b>										
Natural gas (bcf)	29	33	35	35	133	35	35	35	35	140
Natural Gas (mmcf/d)	323	361	384	384	363	384	384	384	384	384
Days	91	91	92	92	366	90	91	92	92	365
Oil (mmb)	28	28	31	31	118	30	31	31	31	123
Oil (mbd)	307	307	338	338	322	338	338	338	338	338
Total gas & oil (bcf)	197	202	222	222	843	217	219	222	222	880
Total gas & oil (mbd)	360	371	402	402	383	402	402	402	402	402
<b>Price</b>										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.64	6.10	5.75	7.10	6.15	6.21	6.11	6.20	6.57	6.27
Company	2.55	3.15	2.87	2.87	2.87	2.87	2.87	2.87	2.87	2.87
Oil (\$/bbl)										
WTI Cushing	35.23	38.34	43.89	48.40	41.47	41.29	41.37	40.78	40.22	40.92
Company	30.72	33.64	40.28	44.42	37.54	37.89	37.96	37.42	36.91	37.54
Total gas & oil (\$/mcf)	4.74	5.15	6.10	6.68	5.71	5.77	5.78	5.70	5.63	5.72
<b>Revenue (\$mm)</b>										
Natural Gas	75	103	101	101	381	99	100	101	101	402
Oil	857	939	1,253	1,381	4,430	1,153	1,168	1,164	1,148	4,632
Other										
Total	932	1,042	1,354	1,483	4,811	1,252	1,268	1,265	1,249	5,034

Because China, like the U.S., is a net importer of oil, it taxes domestic production at normal business rates rather than the high rates that exporting countries often impose. Of course that is

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the only sensible approach. Windfall profits taxes and price controls were a bitter experience for the U.S. the last time oil increased rapidly in price. We are gratified to see that CNOOC's reported crude oil price responds to world economic trends.

Price and volume trends are reported quarterly, but financial results are reported only semi-annually. It may be months yet before we learn financial details for the six months now concluding. Results are likely to be strong (see table Next Twelve Months Financial Results).

<b>CNOOC Limited</b>							
<b>Next Twelve Months Financial Estimates</b>							
	<i>Year</i>	<i>H1</i>	<i>H2E</i>	<i>Year</i>	<i>H1E</i>	<i>H2E</i>	<i>Next Twelve Months</i>
	<i>2003</i>	<i>6/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>6/30/05</i>	<i>12/31/05</i>	<i>12/31/05</i>
<b>Revenue (mmRMB)</b>							
Natural Gas (from Q table)	<b>2,480</b>	1,474	1,665	<b>3,140</b>	1,647	1,665	<b>3,313</b>
Oil (from Q table)	<b>25,680</b>	14,840	20,005	<b>34,845</b>	19,179	19,106	<b>39,183</b>
Other	<b>(44)</b>	(129)	(129)	<b>(258)</b>	(129)	(129)	<b>(258)</b>
Total	<b>28,116</b>	16,028	21,541	<b>37,569</b>	20,697	20,642	<b>42,238</b>
<b>Expense</b>							
Fixed	<b>3,266</b>	1,452	1,452	<b>2,903</b>	1,452	1,452	<b>2,903</b>
Variable	<b>3,266</b>	1,452	1,928	<b>3,380</b>	1,853	1,848	<b>3,781</b>
Other	-			-			-
<b>Ebitda</b>	<b>21,628</b>	13,411	18,290	<b>31,701</b>	17,521	17,471	<b>35,812</b>
Exploration	<b>848</b>	551	551	<b>1,102</b>	551	551	<b>1,102</b>
Deprec., Deplet., & Amort.	<b>4,643</b>	2,648	2,648	<b>5,296</b>	2,648	2,648	<b>5,296</b>
<b>Ebit</b>	<b>16,137</b>	10,212	15,091	<b>25,303</b>	14,322	14,272	<b>29,414</b>
Interest	-	-	-	-	-	-	-
<b>Ebt</b>	<b>16,137</b>	10,212	15,091	<b>25,303</b>	14,322	14,272	<b>29,414</b>
Income Tax	<b>4,627</b>	3,221	5,282	<b>8,503</b>	5,013	4,995	<b>10,295</b>
<b>Net Income</b>	<b>11,510</b>	6,991	9,809	<b>16,800</b>	9,310	9,277	<b>19,119</b>
<b>Shares (millions)</b>	<b>41,107</b>	41,124	41,124	<b>41,124</b>	41,124	41,124	<b>41,124</b>
Per share (RMB)	<b>0.28</b>	0.17	0.24	<b>0.41</b>	0.23	0.23	<b>0.46</b>
Ebitda Margin	<b>77%</b>	84%	85%	<b>84%</b>	85%	85%	<b>85%</b>
Tax Rate	<b>29%</b>	32%	35%	<b>34%</b>	35%	35%	<b>35%</b>

### Looking Overseas

News reports have CNOOC talking to industry leaders in Australia, Myanmar, South America and other potential energy suppliers to China. The company has already used the leverage of its association with the consuming country to gain positions in liquefied natural gas projects in Indonesia and Australia.

The company readily raised a billion dollars recently with a successful convertible zero coupon debt issue. CNOOC obviously has financial capacity to invest in overseas as well as domestic projects. Maintaining access to capital can be motivation to pay careful attention to the rights of existing shareholders.

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