国泰君安证券 GUOTAI JUNAN SECURITIES

Sector Report: Petrochemicals Sector

行业报告：石化行业

Peter Shao 邵俊樨
(852) 2509 5464
peter.shao@gtjas.com.hk

11 November 2020

Will COVID-19 Mark the Inflection Point for Energy Transition?

新冠疫情下能源转型是否将进入新节点？

- **In this report, we have explored the potential impact of COVID-19 on today's energy transition and examined the latest developments in the industry's transformation, globally.** Our key findings are as follows:

  1) The COVID-19 pandemic could accelerate today's energy transition through its profound impact on social thinking and norms, while its downside to the transition, such as economic hardship that could impede investment in green sectors, tends to be temporary. Following the pandemic, we have seen some interesting developments including IOCs announcing more ambitious transformation strategies and China ramping up its climate commitment.

  2) It appears that investors currently price in a first-mover disadvantage for BP, which adopts the most aggressive transformation strategies in the industry, while preferring companies that can balance short-term returns with long-term social licence to operate.

  3) Following China's new climate commitment of carbon neutrality by 2060, we expect more ambitious emissions targets for the nation's 14th Five-Year Plan, more rigorous implementation of China's NDCs for 2030 under the Paris Agreement, and deeper decarbonisation for 2030 onwards. To align with China's new climate ambitions, the country's oil majors will have to update their transformation strategies.

- **Maintain sector rating as "Neutral".** Taking a medium-term view, however, we expect the sector's valuation to improve as the consensus view on oil demand could be raised with further progress in combatting the pandemic.

- **在这篇报告中，我们探讨了新冠疫情对当今能源转型的潜在影响，并分析了全球范围内行业转型的最新进展。**我们的主要结论如下：

  1）在新冠疫情对社会思维及规范的深远影响下，当今能源转型进程或得到加快，而疫情对转型造成的负面影响，如经济承压导致“绿色”部门投资下降，则将相对短期。在疫情爆发后，我们观察到了一些有趣的变化，包括国际石油公司宣布了更为激进的转型策略，以及中国对于气候变化作出了更大的承诺。

  2）目前来看，投资者在定价时似乎认定在转型方面最为激进的英国石油公司（BP）具有先发者劣势，并倾向于能在维护短期收益和保障长期社会经营许可之间取得平衡的公司。

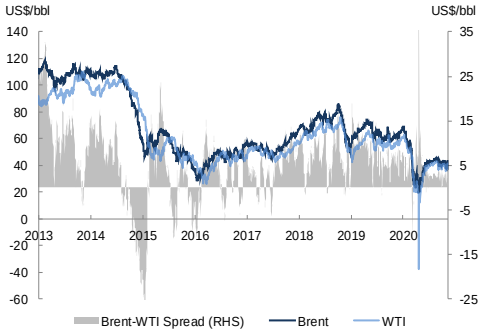
  3）在中国公布了其最新的气候变化承诺后（2060 年实现碳中和），我们预计中国将在其“十四五”规划中引入更为激进的排放目标、在执行《巴黎协定》下国家自定贡献 2030 年目标时将更为严格，以及在 2030 后将执行力度更大的减碳方针。为了配合中国最新的气候决心，中国石油巨头将需要更新其转型战略。

- **维持“中性”的行业评级。**但中期来看，由于在对抗疫情方面进一步的进展有望使市场对石油需求的一致预期得到提升，我们判断行业估值或将得到修复。

Rating: **Neutral** Maintained

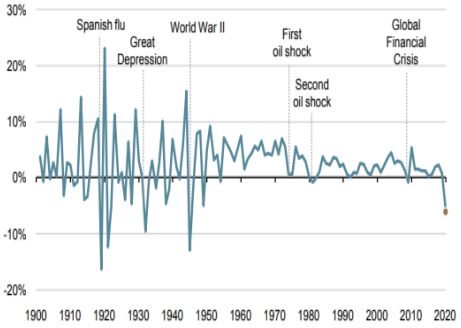
评级： **中性** (维持)

International Crude Oil Prices
国际原油价格



Source: Bloomberg.

Rate of Change in Global Primary Energy Demand, 1900-2020
全球一次能源需求变化率，1900-2020



Source: Bloomberg.

Company Name 公司名称	Code 编号	Price 股价(HK$)	Rating 投资评级	20 PER 市盈率(x)	21 PER 市盈率(x)	22 PER 市盈率(x)	20 ROE 净资产收益(%)	20 P/B 市净率(x)	20 Yield 股息率(%)
PetroChina	00857	2.48	Neutral	(14.1)	24.6	10.8	(2.4)	0.3	0.0
Sinopec	00386	3.55	Neutral	100.9	14.8	7.3	0.5	0.5	0.6
CNOOC	00883	8.41	Accumulate	13.4	7.8	5.4	5.5	0.7	5.6
China Risun Group	01907	2.60	Accumulate	8.1	6.3	5.7	16.2	1.2	3.7
Weighted Average. 市值加权平均			**Neutral**	**27.0**	**17.9**	**8.5**	**0.3**	**0.5**	**1.4**

Source: the Companies, Guotai Junan International, Bloomberg.

Table of Contents

1. The Potential Impact of COVID-19 on Today's Energy Transition 3

2. Is the Oil and Gas Industry Part of the Problem or Solution? 3

2.1 The roles played by the oil and gas industry amidst plausible low-carbon pathways 3

2.2 The feasible strategies for oil and gas companies during the energy transition 4

3. Examining the Latest Transformation Strategies Adopted by Oil and Gas Companies 5

3.1 IOCs – the challenge of balancing short-term returns with long-term licence to operate 5

3.2 NOCs – limited options due to broader roles and responsibilities to host countries 6

4. China's Climate Ambitions Ramped up Following COVID-19 6

5. Where are the Chinese Oil Majors Heading to? 7

6. Investment Suggestions 8

1. The Potential Impact of COVID-19 on Today's Energy Transition

While it is still early to grasp the full impact from the COVID-19 pandemic, one possible outcome is an accelerated energy transition driven by the pandemic's profound impact on social thinking and norms. The COVID-19 pandemic has encouraged behavioral changes that could result in oil demand peaking earlier, including increased preference for remote working and telecommuting, and there are potentially more changes to come as the unprecedented global health crisis has made the concepts of global threats and social responsibility less abstract among the public – this could result in growing pressure for governments to introduce new energy policies and increased focus of investors on environmental, social and governance (ESG) issues. Moreover, the huge need for financial stimulus following the pandemic also presents an opportunity to reshape our economies into more sustainable ones through reprioritising green sectors. Since the start of the pandemic, we have seen more ambitious transformation strategies announced by international oil companies (IOCs), increased discussion on ESG issues in capital markets, and greater climate commitments from China, notably the goal to achieve carbon neutrality by 2060.

However, an accelerated energy transition is just one of the many possible outcomes, depending on how a combination of competing factors that have emerged after COVID-19 will play out at the end. The downside of the pandemic is apparent, including economic hardship that could impede investment in green sectors. This is perhaps manifested in the lack of green economic recovery measures by G20 nations following the pandemic – after examining over 300 fiscal stimulus measures by G20 nations, researchers at Oxford University have found that only 4% of these measures relate to green policies that can potentially reduce long-run emissions. In addition, the pandemic is disrupting renewables with a more globalised supply chain, such as solar PV, resulting in delays in construction and increased costs. The attractiveness of power generation from fossil fuels also tends to increase in the short-to-medium term due to low oil prices, especially for price-sensitive countries.

The role of psychological, social and cultural aspects in driving energy transition should not be underestimated, especially in today's context. Psychological, social and cultural aspects, which have been largely underexposed in previous studies on energy transition, could play a greater role in today's energy transition, which is more driven by ideology (e.g. perceptions about climate change, different cost-benefit mindsets, etc.), compared with prior energy transitions (mostly driven by economic considerations and technological innovations, e.g. from wood to fossil fuels during the Industrial Revolution). We believe that it is the necessary changes in social thinking and norms that can fast-forward the energy transition in the next decades, while the negative impact brought by COVID-19 is most likely short term.

2. Is the Oil and Gas Industry Part of the Problem or Solution?

Putting oil and gas emissions into context: according to the IEA, in 2019, energy-related greenhouse gas (GHG) emissions were approximately 33.2 gt, of which around 55% was attributable to the use of oil and gas, while about 44% was attributable to the use of coal. The Intergovernmental Panel on Climate Change (IPCC) estimated that by the decade 2006-2015, human activities had already warmed the world by 0.87°C (+-0.12°C) compared to pre-industrial times, and if the current warming rate continues, the world would reach human-induced global warming of 1.5°C around 2040. To address the urgent threats to human societies and the planet, 196 countries signed the 2015 Paris Agreement with a view to holding the increase in the global average temperature to well below 2°C and pursuing efforts to limit the increase to 1.5°C. To achieve this goal, the IPCC estimated that overall human-caused GHG needs to start dropping by about 7.6% each year from now until 2030 (and beyond).

As we tackle the urgent threats from climate change, one of the key questions is whether oil and gas companies should be viewed as part of the problem or solution. The answer, in our view, largely depends on whether the oil and gas sector has an important role to play as we transit to a low-carbon world and how the sector can transform nimbly and properly:

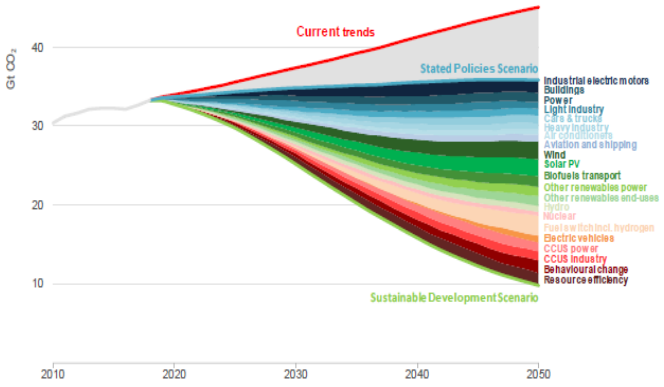
2.1 The roles played by the oil and gas industry amidst plausible low-carbon pathways

While there is a wide range of possible pathways to a low-carbon future, various plausible 'net-zero' scenarios, such as IEA's Sustainable Development Scenario (SDS) and BP's Rapid Scenario, require the oil and gas industry to provide various sorts of low-carbon fuels/ technologies and forecast an ongoing, long-term role for oil and gas amid our ever growing energy needs. For instance, the IEA's SDS projects over two-thirds of final energy consumption in 2040 to come from liquids and gases, notably natural gas, hydrogen, biomethane and advanced biofuels, for which the oil and gas industry is instrumental in not only producing, but also developing the necessary technologies to make their usage possible. Other areas of opportunities for the oil and gas

industry include electrification and renewable electricity, although the industry lacks direct expertise with the exception of offshore wind and geothermal – in this case, acquisitions or partnership is a feasible option.

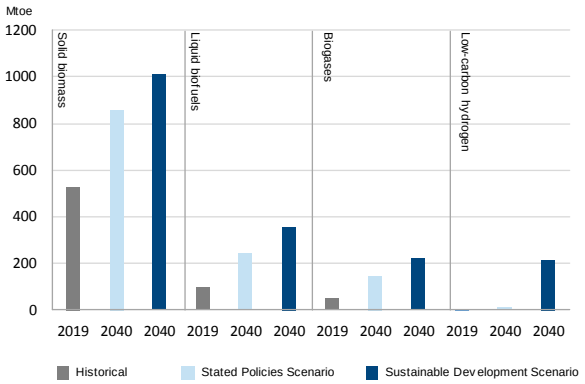
Since today's energy transition is unprecedented in its scale, breath, stake and urgency, it would be unthinkable to exclude the oil and gas industry. The transferable core competencies of oil and gas companies include 1) the capacity to manage large, complex energy projects and portfolio, 2) strong political capital, 3) expertise in geological interpretation and modelling, 4) the know-how in joint venturing and partnership, and 6) the ability to manage complex supply chains and global trading systems.

Figure-1: Energy-related CO_2 Emissions and CO_2 Emissions Reductions by Measure (SDS)



Source: IEA.

Figure-2: Global Supply of low-carbon fuels by Scenario



Source: IEA.

2.2 The feasible strategies for oil and gas companies during the energy transition

Through comprehensive literature review, we have identified three streams of strategies that are potentially feasible for oil and gas companies during the energy transition, namely **First One Out, Active Transformation, and Last Survivor.** The strategies identified here are by no means all-inclusive, but they offer a broad picture regarding plausible transformation pathways for oil and gas companies. Various strategies can exist in between these identified strategy streams, and different streams may also coexist within the same company. The selection of strategies will depend on not only endogenous factors (e.g. firm-specific factors), but also exogenous ones (e.g. other players' choices, government policies, etc.).

2.2.1 First One Out

The First One Out strategy takes advantage of a still buoyant market to dispose of assets and return value to shareholders via dividends and share buybacks before stranded asset risk mounts in the late stages of the energy transition. Oil companies adopting this strategy stream tend to believe disinvestment creates more value for shareholders than transformation. Barriers to the implementation of this strategy include resistance from company executives with vested interests (especially when company ownership is dispersed), inability to dispose of assets, and difficulty in justifying disinvestment when oil prices temporarily rise. Investors should generally welcome this strategy as it allows them to reallocate capital to other sectors, instead of oil companies making investment decisions in new areas on behalf of them.

2.2.2 Active Transformation

The Active Transformation strategy stream requires the oil company to actively participate in the energy transition by diversifying out of oil into gas, renewables and other fields and become a 'net-zero' or low-carbon energy company. This strategy stream takes the view that the 'net-zero' world will rely on the oil and gas industry to provide various low-carbon fuels (e.g. hydrogen, biofuels) and technologies (e.g. carbon capture, utilisation and storage). While the oil and gas industry does possess certain expertise that is instrumental to the energy transition, there are many areas where the industry lacks competitive strengths, notably the generation of low-carbon electricity (with the exception of off-shore wind and geothermal). For these lack-of-strength areas, acquisitions or partnership can offer immediate access to the new market while providing the industry with the know-how. ROE could drop as the industry diversifies, but the industry's valuation could be supported by a better risk profile. Challenges to this strategy stream include the potential need for cultural change, lack of direct expertise and investor skepticism. To gain support from stakeholders, a strong and credible transformation story as well as high level of clarity and transparency are needed throughout the transformation process.

2.2.3 Last Survivor

The last survivor strategy makes a strong case for oil and gas companies with vast low-cost, high quality reserves and large downstream businesses. The focus is to drive out competitors through acquisitions and cost leadership as the traditional energy market shrinks. The company adopting this strategy stream could also become a monopoly supplier of non-fuel petrochemical products, for which demand is largely unaffected by the energy transition. Despite being the last survivor in the traditional oil and gas business, the company will not be exempted from developing extensive technological know-how regarding how to reduce, capital and utilise its CO_2 emissions. However, due to its inflexibility and lack of diversification, this strategy stream is subject to higher risks and uncertainties, including increased stranded asset risk, policy uncertainties, planning risk, growing environmental concerns and uncertainty associated with the actions taken by competitors.

Table 1: Comparison of First One Out, Active Transformation and Last Survivor

Strategy Stream	Approach	Views	Implementation Barriers
First One Out	To dispose assets and return value to shareholders via dividends and share buy backs	Disinvestment creates more value for shareholders than transformation. Most appropriate when the company has high-cost reserves, high all-in costs, and distressed balance sheet	Resistance from company executives, inability to dispose assets, difficulty in justifying disinvestment when oil prices temporarily rise
Active Transformation	To actively participate in the energy transition by diversifying out of oil into gas, renewables and other fields and become a 'net-zero' company	The 'net-zero' world will rely on the oil and gas industry to provide various low-carbon fuels and technologies, and the industry can transform nimbly and properly, leveraging on its transferable core competencies. Most appropriate when the company has strong financials, transferable expertise and sound corporate governance	Lack of direct expertise in some new energy areas, investor skepticism, need for cultural change within the organisation
Last Survivor	To drive out competitors via acquisitions and cost leadership, and become a monopoly supplier of petrochemical products	Consumption of fossil fuels will remain material in absolute term in the low-carbon world, and ROE can remain at a desirable level with less competition	Growing environmental concerns, policy uncertainties, counter-actions taken by competitors

Source: Guotai Junan International.

3. Examining the Latest Transformation Strategies Adopted by Oil and Gas Companies

The landscape of the oil and gas industry is so diverse that strategic responses to the energy transition vary considerably. In this chapter, we will examine the latest developments in transformation strategies for two groups of companies, i.e. international oil companies (IOCs) and national oil companies (NOCs):

3.1 IOCs – the challenge of balancing short-term returns with long-term licence to operate

IOCs often attract the most attention when it comes to transformation due to their oversized influence on the practices and directions of the industry. European IOCs, such as BP, Total and Eni, are the pioneers in energy transformation, adopting strategies similar to the Active Transformation stream as mentioned above, while American IOCs, such as ExxonMobil and Chevron, lag behind.

Among the more climate-ambitious European IOCs, transformation strategies vary in terms of emission targets, approaches to reducing emissions, and financial implications. **This variance, as reflected in the recent BP vs. Total case, brought one key transformation issue back to the spotlight – i.e. the challenge of balancing short-term returns with long-term social licence to operate.** Following the pandemic, BP and Total updated their transformation strategies to arguably the most climate-ambitious ones among the IOCs. Interestingly, Total, which is less radical in its targets and approach, has outperformed BP by nearly 50% since 2H20 in terms of share performance. BP currently has the most radical transformation strategies among its peers, targeting a 35-40% cut in Scope 3 emissions by 2030 (excluding Rosneft), and to do so, it will cut upstream production by 40% and diversify into low-carbon electricity, renewables, and other fields (e.g. EV charging). What is different in Total's case is that while Total targets a 30% cut in its Scope 3 emissions in Europe (an ambitious but less aggressive target compared with BP's), it specifically aims to grow its total energy production by one third (from 3 to 4 mmboe/d, driven by growth in LNG and low-carbon electricity). This difference implies that Total, compared with BP, is better positioned to safeguard its short-term returns and dividends with a more stable core hydrocarbons business while embarking on the journey to decarbonisation. **We think the divergence in BP and Total's share performance indicates that the market currently prices in a first-mover disadvantage**

due to high level of uncertainty, and prefers the company that can balance short-term returns with long-term social licence to operate, rather than assigning oversized ESG premium or better risk profile to the most aggressive reformer.

The strategies adopted by American IOCs (i.e. Chevron and ExxonMobil) are more tilted towards the Last Survivor stream as discussed in Chapter 2. As opposed to their European peers, ExxonMobil and Chevron are holding their views that oil demand will recover from the cyclical low, and it is evident that both are committed to continue investing in traditional upstream and downstream businesses (although not as much as previously planned under current macro circumstances).

3.2 NOCs – limited options due to broader roles and responsibilities to host countries

NOCs include the world's largest oil and gas companies in terms of production and reserve size, notably Saudi Aramco, National Iranian Oil Company, and Qatar Petroleum. The strategic responses taken by NOCs towards the energy transition are subject to various factors, including the NOCs' non-oil burdens and the host countries' climate ambitions, political stability and regulatory quality. **While NOCs often face limited transformation options given their broader roles and responsibilities to their host countries, resulting in their strategies similar to the Last Survivor stream, a few of the large NOCs, such as Saudi Aramco and the Chinese oil majors, adopt strategies between the Active Transformation and Last Survivor streams.** Take Saudi Aramco for example, the company, whose production cost is among the lowest, is determined to keep investing in oil, both upstream and downstream, while having a small proportion of its businesses diversifying into renewables, hydrogen and other low-carbon fuels. Meanwhile, Saudi Aramco is currently at the frontier in terms of research into new technologies, such as hydrogen technologies and carbon capture, utilisation and storage (CCUS).

4. China's Climate Ambitions Ramped up Following COVID-19

China has recently ramped up its climate ambitions at the nexus of the COVID-19 pandemic, rising populism and anti-globalisation, putting pressure on China's three oil majors to transform accordingly. On 22nd September 2020, Chinese President Xi Jinping surprised the UN general assembly by pledging that China would achieve carbon neutrality by 2060, marking the first time the nation has established a long-term climate goal. Prior to this, China's climate ambitions as conveyed via its Nationally Determined Contributions (NDCs) under the Paris Agreement included peaking CO_2 emissions by 2030 and increasing the share of non-fossil fuels in primary energy consumption to around 20% by 2030. China's new climate commitment is bound to have far-reaching implications on the strategic direction for the country's oil and gas industry.

On 12th October, the Institute for Climate Change and Sustainable Development at Tsinghua University (ICCSD) released its research findings on China's low-carbon development strategies and transition pathways that are aligned with the long-term goals under the Paris Agreement – the first authoritative roadmap to emerge after China's new commitment of carbon neutrality. If China is to follow the recommendations of the ICCSD, we expect more ambitious emissions targets for the 14th Five-Year Plan, more rigorous implementation of China's NDCs for 2030, and deeper decarbonisation for 2030 onwards. The primary findings and recommendations of the ICCSD are summarised and discussed as follows:

- **The ICCSD proposes a two-stage transformation pathway.** In the first stage, recognising the complexity of and inertia in China's energy sector, the ICCSD does not envisage China to immediately embark on a journey to the 2°C/1.5°C scenario under the Paris Agreement, but strive for a 'reinforced policy scenario', which requires more ambitious climate targets in China's NDCs for 2030 and the 14th Five-Year Plan. In the second stage, the ICCSD suggests much tougher measures after 2030 to bring China in line with the 1.5°C scenario over the long term.

- **ICSSD's 1.5°C scenario:** non-fossil fuels in China will account for over 85% in the energy mix by 2050; in China's power sector, over 90% of the electricity will be generated by non-fossil fuels, and less than 5% by coal in 2050; the share of primary energy for electricity generation in China will increase from the current 45% to about 85% by 2050; all CO_2 emissions should be net zero by 2050; the application of hydrogen energy in the industrial, transportation and power sectors need to be strengthened, and negative technologies, such as CCUS, also need to be scaled up; to achieve the scenario, China will need new investment of around RMB138 trillion, over 2.5% of annual GDP.

- **ICSSD's policy recommendations:** 1) establishing ambitious energy saving and emission reduction targets in the 14th Five-Year Plan (2021-2025) – this includes lowering energy intensity per unit of GDP by no less than 14%, increasing the share of non-fossil energy to around 20%, lowering CO_2 intensity per unit of GDP by around 19-20%, containing total CO_2

emissions at less than 10.5 billion tons, and striving to peak coal consumption or even achieve negative growth; 2) reinforcing China's NDCs targets, notably raising the CO_2 intensity per unit of GDP to over 65% compared to 2005 level (previously 40-45%), raising the share of non-fossil energy to around 25% (previously 20%), and striving to peak CO_2 emission between 2025-2030; 3) incorporating long-term low-carbon development goals and strategies for 2050 into China's future economic and social development.

5. Where are the Chinese Oil Majors Heading to?

To align with China's new climate commitment of carbon neutrality by 2060, the Chinese oil majors will have to update their transformation strategies. The Chinese oil majors (i.e. PetroChina, Sinopec, CNOOC) currently focus on reducing operational emissions and growing natural gas production as strategic responses to the energy transition, while their long-term climate strategies are arguably unclear and their exposure to renewables/ new energy areas is relatively small.

CNOOC

As one of the largest independent oil and gas E&P companies in the world, CNOOC's current transformation strategy focuses on reducing operational emissions (Scope 1-2 GHG emissions), growing natural gas production (50% of total upstream production by 2035), and strengthening cost leadership (CNOOC's all-in costs in offshore China are among the lowest globally at below US$30/bbl). CNOOC entered offshore wind power business in 2019 and recently commissioned an offshore wind project in Jiangsu province, but its overall exposure to renewables remains limited. CNOOC currently lacks clarity in terms of its long-term climate strategies and does not have a Scope 3 emissions target.

PetroChina

As a member of the Oil and Gas Climate Initiative (OGCI), PetroChina has recently pledged to have a net-zero emissions profile by 2050 – but concrete strategies are yet to be released and the company has yet to disclose its Scope 3 emissions. Currently, PetroChina targets a 10% CAGR in its natural gas production by 2025, and plans to increase its share of gas in the production mix over the long run. PetroChina also invests in carbon emissions technology such as methane management and CCUS. However, besides lack of clarity in its long-term climate strategies, PetroChina also lags behind in its development in renewables/ new energy sources compared with the other two Chinese oil majors – PetroChina is still in the relatively early stages in its development in new energy, including geothermal energy, bio-fuels, solar energy, and battery charging stations.

Sinopec

As one of the world's largest oil traders and Asia's largest refining and petrochemical company by capacity, Sinopec is approaching the energy transition by focusing on hydrogen business, reducing operational emissions (Scope 1-2 GHG emissions), and increasing the proportion of gas in its production mix. Sinopec is China's largest hydrogen producer, providing around 3 million tons of hydrogen in 2019. Sinopec is also actively involved in the development of CCUS and carbon trading. However, Sinopec has yet to specify its long-term climate strategies, and it currently does not have a Scope 3 emissions target.

Active Transformation or Last Survivor? The strategies currently taken by Chinese NOCs seem to sit between the Active Transformation and Last Survivor streams (more tilted to Last Survivor) as discussed in Chapter 2. If viewing the three Chinese NOCs as a whole, they do possess vast low-cost, low-emission reserves as well as huge downstream businesses and markets, and if sticking to the Last Survivor strategy stream, they could be integrated to become a competitive low-cost producer of traditional fuels for the hard-to-abate sectors and a monopoly supplier of petrochemical products in Asia. However, the three oil majors, as China's NOCs with broader roles and responsibilities, are bound to align their strategic responses with the nation's grand climate scheme, and China will require their active participation to achieve its long-term climate targets, notably in the areas of cleaner fuels (e.g. natural gas, bio-fuels, hydrogen), renewable energy (e.g. offshore wind, geothermal), negative carbon technologies (e.g. CCUS), and energy efficiency enhancement, where their core competencies can be a good fit.

What about the 7-Year Action Plans of the Chinese oil majors? Previously, the Chinese oil majors have embarked on a journey to grow their upstream productions (e.g. the 7-Year Action Plans) to support China's energy security strategy. During 1-3Q20, their upstream productions increased by around 2-5% yoy. However, we believe China's NOCs are bound to adjust their strategies following China's new carbon neutrality commitment, and this could lead to reduction in their upstream productions. **We believe, over the short-run, China's energy security strategy will still entail an increase in upstream production (but with more growth coming from natural gas as a transitional fuel), given the inertia in China's energy system. But over the**

long-run (2030-2060), China's energy security strategy does not conflict with the nation's long-term climate ambition, which envisages a dominant proportion of cleaner and renewable energies in the energy mix, and reduced dependency of fossil-fuels. Chinese NOCs can be an important part of China's long-term low-carbon development by providing various sorts of cleaner fuels (e.g. natural gas, hydrogen, bio-fuels), renewables (e.g. offshore wind, geothermal) and negative carbon technologies (e.g. CCUS).

6. Investment Suggestions

Things to watch out for investors: there is a great deal of interest in how China's 2060 carbon neutrality commitment will affect the 14th Five-Year Plan, which is currently being drafted, and consequently how the Chinese oil majors will adjust their transformation strategies accordingly. It will be interesting to see if the Chinese oil majors will subsequently establish Scope 3 emissions targets, further clarify their long-term climate targets and transformation approaches, enhance its emissions disclosure, incorporate climate goals into management remuneration, etc. We believe more details and clarity in transformation strategies will boost market sentiment for China's oil majors. However, in light of the BP vs. Total case, implementing aggressive transformation strategies could result in capital market pricing in the first-mover disadvantage and the market appears to prefer companies that can balance short-term returns with long-term climate obligations.

We maintain sector rating as "Neutral". Taking a medium-term view, however, we expect the sector's valuation to improve as further progress in combatting the COVID-19 pandemic could raise the market's consensus view on future oil demand. Currently, we do not have a top pick given the amount of uncertainty ahead.

Our current investment rating for CNOOC (00883 HK) is "Accumulate" with a TP of HK$8.30. CNOOC's share price has surged by around 14% since our last Company Report (on 27th Oct), in which we argued that CNOOC's share still enjoyed upside potentially given the chance of raised market consensus on oil demand with further progress in combating COVID-19. CNOOC is currently approaching the energy transition by increasing gas production, maintaining cost leadership, bringing down operational emissions, and focusing on offshore wind. Our TP of HK$8.30 has a 21.5% discount to our DCF-derived NAV of HK$10.58/share and corresponds to 2020-2022 P/B of 0.8x/ 0.7x/ 0.7x, respectively. Given improved market sentiment, which drove CNOOC's stock price above our TP, and the likelihood of CNOOC's further clarifying its transformation strategies in line with China's new climate ambition, we will consider increasing our TP (with less discount to the NAV) in our next Company Report.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance >15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance >5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance <-5%; or the fundamental outlook of the sector is unfavorable.

DISCLOSURE OF INTERESTS

(1) Except for SHENZHEN INTERNATIONAL (00152 HK), the Analysts and their associates do not serve as an officer of the issuer mentioned in this Research Report.

(2) The Analysts and their associates do not have any financial interests in relation to the issuer mentioned in this Research Report.

(3) Except for GUOTAI JUNAN I (01788 HK),JXR (01951 HK),JINSHANG BANK (02558 HK),HAITIAN ANTENNA (08227 HK),Guotai Junan and its group companies do not hold equal to or more than 1% of the market capitalization of the issuer mentioned in this Research Report.

(4) Guotai Junan and its group companies have had investment banking relationships with CHINA PETROLEUM & CHEMICAL- H SHARES (00386 HK),CHINA RISUN GROUP (01907 HK) mentioned in this Research Report within the preceding 12 months.

(5) Guotai Junan and its group companies are not making a market in the securities in respect of the issuer mentioned in this Research Report.

(6) Guotai Junan and its group companies have not employed an individual serving as an officer of the issuer mentioned in this Research Report. There is no officer of the issuer mentioned in this Research Report associated with Guotai Junan and its group companies.

DISCLAIMER

This Research Report does not constitute an invitation or offer to acquire, purchase or subscribe for securities by Guotai Junan Securities (Hong Kong) Limited ("Guotai Junan"). Guotai Junan and its group companies may do business that relates to companies covered in research reports, including investment banking, investment services, etc. (for example, the placing agent, lead manager, sponsor, underwriter or invest proprietarily).

Any opinions expressed in this report may differ or be contrary to opinions or investment strategies expressed orally or in written form by sales persons, dealers and other professional executives of Guotai Junan group of companies. Any opinions expressed in this report may differ or be contrary to opinions or investment decisions made by the asset management and investment banking groups of Guotai Junan.

Though best effort has been made to ensure the accuracy of the information and data contained in this Research Report, Guotai Junan does not guarantee the accuracy and completeness of the information and data herein. This Research Report may contain some forward-looking estimates and forecasts derived from the assumptions of the future political and economic conditions with inherently unpredictable and mutable situation, so uncertainty may contain. Investors should understand and comprehend the investment objectives and its related risks, and where necessary consult their own financial advisers prior to any investment decision.

This Research Report is not directed at, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject Guotai Junan and its group companies to any registration or licensing requirement within such jurisdiction.

© 2020 GuotaiJunan Securities (Hong Kong) Limited. All Rights Reserved.
27/F., Low Block, Grand Millennium Plaza, 181 Queens' Road Central, Hong Kong.
Tel.: (852) 2509-9118 Fax: (852) 2509-7793Website: www.gtja.com.hk