



China's Oil Majors Hit by Falling Prices in First Half

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China's national oil and gas companies saw their profits slump during the first six months of 2015, with the levels falling to the lowest in five years, according to financial reports. The first-half reports for China's "big three" oil companies - China National Petroleum Corporation (CNPC), China Petrochemical Corporation, also known as Sinopec, and China National Offshore Oil Corporation (CNOOC) - showed that CNPC's profit fell by more than 60 percent to 25.4 billion yuan (US\$3.98 billion), Sinopec by 22 percent to 25.4 billion yuan, and CNOOC by more than 50 percent to 14.7 billion yuan.

The steep drop in net profits for the big three is a direct result of the plummeting prices of global crude oil and weak economic growth, analysts said. Crude oil prices were fluctuating at around US\$100 per barrel during the first six months of 2014. Since then it has fallen by nearly half, hitting the profits of oil companies reliant on upstream businesses. From January to June, the operating profits in the oil exploration and production unit of CNPC, also referred to as PetroChina, fell by nearly 70 percent, while the profits in the upstream business of CNOOC dropped by more than 50 percent.

However, the deteriorating business in oil exploration

is not all bad news. For Sinopec, falling oil prices mean lower production costs for its downstream refining and petrochemical business, of which crude oil imports account for 80 percent. In the first half, the petrochemical company added 14.1 billion yuan to its operating income, an increase of 57 percent year-on-year, while PetroChina saw its refining and chemical business increase by 8.1 billion yuan, driving profit in the downstream sector into positive territory for the first time since 2011.

A sudden change of the market environment poses huge challenges for China's State-owned oil enterprises in terms of domestic projects' development, their participation in overseas projects and even internal management, experts said. Dong Xiucheng, a professor at Beijing-based China University of Petroleum, said that glory days of high oil prices have long gone and the downtrend will continue for a longer time, adding that when the market is good, lots of problems existing in the industry are covered. "But when it is tough, it gives players time to rethink their strategies." Though oil companies are struggling when prices are falling, it is an opportune time for the oil companies to restructure, reduce costs and create sustainable efficiency. "There is no doubt that oil companies will reduce

their investments for the long term. But a large-scale exploration in upstream will ensure that they can grow in a sustainable manner,” Dong said.

At the same time, China is preparing for a reform to merge State-owned companies which play a big role in the country’s economy. Even though details of the reform are yet to be released, reports said Sinopec and CNPC are likely to be restructured into one company. Experts said the replacement probably will open a new chapter for domestic oil and gas industry with different styles of management for each company, but ensuring stable growth will be the top priority for all the firms.

Fall in crude oil price calls for energy giants to reduce expenses

Sinopec Group plans to cut costs by recalling 40 percent of Sinopec International Petroleum Exploration & Production Corporation, the company’s subsidiary focusing on overseas oil exploration, in the wake of plunging oil prices. Up to 160 employees from Sinopec’s subsidiary focusing on overseas upstream business sector will be brought back to Sinopec’s headquarters in Beijing. “The fall in global crude prices since last summer has brought tough challenges to the production unit’s performance, which is the major reason for the relocation,” said a Sinopec official. The company recalled 100 overseas staff in 2014 as the prices of crude tumbled amid a global glut fueled by the shale gas boom in the United States and increased production in Saudi Arabia.

Record oil export from Iraq has also affected the market. The US benchmark price for West Texas Intermediate crude oil futures closed at US\$48.52 a barrel on July 30, compared with around US\$100 last summer. Liang Dan, a crude oil analyst with ICIS Energy, a Shanghai-based energy information consultancy, estimated that the global prices will continue to fluctuate at a low level in the near future.” The supply glut in the crude market has affected the refined oil products market,” she said. “It is highly likely that China’s authorities will cut retail fuel prices for the fourth time in a row this week.” Chinese oil companies started taking measures to reduce costs late last year when the fall in crude prices triggered a sharp drop in profits.

Sinopec, which owns both upstream exploration operations and downstream refining businesses, has managed to cope better with the sharp decline, unlike PetroChina, of which CNPC is the parent. PetroChina, the country’s biggest oil company, relies mainly on crude oil and natural gas production platforms and has suffered

more than other Chinese firms in the energy sector.

CNPC recently held a work conference to focus on rebuilding the firm’s reputation and maintaining stable growth. Wang Yilin, head of the group, called for the corporation to shift into quality growth by increasing efficiency. “The company will accelerate reform and innovation to improve management levels,” he said. As crude prices fall, it is more economical for China to import directly from the international market rather than investing in overseas exploration. Historically, China has suffered from high crude prices in its drive for economic growth. State-owned companies such as CNPC and Sinopec were encouraged to invest heavily in overseas assets to ensure supply.

PetroChina to boost gas supplies

Facing the situation of a low oil price, PetroChina plans flexible gas prices and year-round supplies to boost sales. The country’s biggest natural gas producer, is said to be offering large industrial users flexible prices and a promise of year-round supply as it seeks to boost sales amid slowing demand and ample supply. The company has set up natural gas sales units in provinces including Henan and Jiangsu and cities such as Shanghai to reach out to manufacturers and power generators.

An economy growing at the slowest pace in 25 years is curtailing demand and compelling. “China is facing a gas glut as supply exceeds demand,” Bloomberg Intelligence analysts Wang Lu and Miranda Wang said in a recent research note. “Amid slower industrial output growth, the competitive edge of gas has been eroded by a slump in Brent crude and a slow adjustment in gas prices.”

“PetroChina sells about 45 percent of its natural gas directly to large industrial customers and the rest through utilities to other industrial and residential users,” said Shi Yan, an analyst at UOB-Kay Hian Ltd in Shanghai. The company is offering large users, such as power plants and fertilizer makers, guaranteed year-round direct supply to counter concerns that increased residential demand for heating in the winter will interrupt deliveries, according to the sources. PetroChina is also open to negotiating flexible prices for supply in the summer, when demand is lower. Reportedly, Sinopec is also promoting gas sales to customers such as power plants.

China’s natural gas production, including coal-bed methane and shale gas, increased 4.3 percent to 67.4 billion cubic meters in the first half of 2015 from the same period a year earlier. Consumption increased at a slower pace of 1.4 percent to 91.5 billion cubic meters, according

to the National Energy Administration. Imports of natural gas via pipelines are up nearly 15 percent in the first half of the year to 12.3 million metric tons, while inbound shipments of liquefied natural gas fell about 4 percent to 9.5 million tons, according to customs data. PetroChina had global natural gas output of 85.8 billion cubic meters and Sinopec produced 20.3 billion cubic meters in 2014, according to their annual reports.

Domestically, PetroChina Southwest Oil and Gas Field Company completed testing of the 16th exploitation well at the Longwangmiao formation in the Moxi block of the Anyue gas field in southwestern China's Sichuan Basin in late July this year. The Moxi 009-2-H2 well, which daily produces 2.02 million cubic meters of feed gas, is one of the top six high output wells among the 16 exploration wells drilled at the present time. The company plans to finish the construction of 30 development wells by the beginning of next year, enabling the Longwangmiao formation to produce 11 billion cubic meters of natural gas annually.

The reservoir of Longwangmiao Formation is a major breakthrough made by the company in natural gas exploration. Located in Sichuan Province's Suining and Ziyang cities and Chongqing's Tongnan county, the natural gas reserves of the formation has been proven for 440 billion cubic meters, one of the largest in China. The company has finished two projects with a total annual production capacity of 5 billion cubic meters. Another

project with 6 billion cubic meters capacity is expected to finish construction in October and go into full operation in the first quarter of next year. China burnt 178.6 billion cubic meters of natural gas last year, according to National Development and Reform Commission, the country's top planner. Development of the Longwangmiao Formation not only contributes to the regional economic development of Sichuan and Chongqing, but also helps the country optimize energy structure and reduce air pollution. The company is expected to produce 16 billion cubic meters of natural gas this year, generating revenue of 43.5 billion yuan. It aims to produce 30 billion cubic meters of natural gas annually by 2020.

Meanwhile, CNPC also steps up its efforts for gas imports. For example, construction of the Chinese section of the China-Russia East-Route Natural Gas Pipeline began at the end of June, 2015, further boosting energy cooperation between the two countries. The Chinese section of the 3,968-kilometer east-route natural gas pipeline originates in northeast China's Heilongjiang Province and terminates in Shanghai in the east. It is the largest China-Russia cooperation project and is conducive to diversifying both countries' energy strategy and guaranteeing energy security, Chinese Vice Premier Zhang Gaoli said at the construction commencement ceremony.

The Russian part of the east-route pipeline began construction in eastern Siberia last September. Negotiations on details for a proposed western route are



The Moxi 009-2-H2 well in the Anyue gas field was under test on July 24, 2015.

still underway. “The construction progress of the east route of the pipeline is of great strategic significance. It lifts China-Russia mutual trust and cooperation to a new height,” said Professor Liu Yijun with China University of Petroleum. CNPC and Russian gas giant Gazprom signed a deal for the East-Route Gas Project on May 21, 2014. The 30-year contract will see the east-route pipeline begin providing China with 38 billion cubic meters of natural gas annually from 2018. Under the bilateral agreement, Russia will export 70 billion cubic meters of natural gas to China every year upon completion of both the east- and west-route gas pipelines. Strengthening energy cooperation is of great significance to safeguarding the two countries’ energy security. Russia’s energy export to Europe is under great pressure due to the impact of the Ukraine crisis, making it look to the east for a solution.

To reduce its reliance on coal and combat pollution, China also needs to import more natural gas. The gas project is a win-win deal for both countries, said Feng Yujun, head of the Russia Research Institute of China Institutes of Contemporary International Relations. “The pipeline will provide secure and reliable clean energy for China’s economic development and a long-term stable market for the rich natural gas resources in Russia,” he said. Aside from natural gas, the two countries should fully utilize their complementary advantages to expand all-round cooperation in oil, nuclear energy, coal and electricity.

CNOOC profit drops sharply in H1

CNOOC Ltd, China’s biggest offshore oil and gas explorer, posted a 56 percent decline in profit for the first six months of this year. Net income dropped to 14.73 billion yuan (US\$2.3 billion) from 33.59 billion yuan a year earlier, the Beijing-based explorer said in a statement in late August. CNOOC, which depends purely on oil exploration and production for revenue, is most exposed to the oil’s plunge this year and must rely on cost cuts and capital spending curbs to boost profit, said Laban Yu, a Hong Kong-based analyst at Jefferies Group LLC.

The strategy paid off last year, when it posted a surprise 6.6 percent profit increase. Brent crude has averaged about US\$59 a barrel in the first half of the year, down 45 percent from the same period in 2014. CNOOC’s oil and gas sales fell to 77 billion yuan in the first six months from 117 billion yuan a year ago. “There isn’t much CNOOC can do to improve earnings prospects in the second half if crude prices fail to rebound,” Yu said before the earnings were released. Net production for the period rose 14 percent to 240 million barrels of oil equivalent.

“The development of the company in the future will be driven by both production and economic efficiency instead of only by production volume,” Chairman Yang Hua said in the statement. “We will emphasize economic production volume rather than focus solely on production growth.” Yang added that CNOOC’s efforts to reduce costs and enhance efficiency in development and production operations achieved “outstanding results”, and oil and gas production significantly increased year on year.

In foreign cooperation area, the country’s biggest offshore oil and gas explorer has recently signed two oil production sharing contracts. The deal with Sydney-listed Roc Oil Company’s China branch is for two blocks in the South China Sea. According to the contract, ROC will act as the operator during the exploration period. CNOOC will then have the right to participate in up to 51 percent of the working interest in any commercial discoveries of the blocks. The two blocks are located in the Pearl River Mouth Basin in the South China Sea. Block 16/07 covers a total area of 2,743 square kilometers and has a water depth of about 100 meters. Block 03/33 covers a total area of 2,367 square kilometers and has a water depth of 65 to 145 meters.

CNOOC - the country’s third-biggest State-owned oil company - has pledged to exercise extra prudence in its operations and resort to strict cost controls to make itself more competitive amid dwindling oil prices. Yang Hua, chairman of CNOOC’s chairman, recently said lower oil prices have put pressure on him, and he will focus on the company’s strategy development to help achieve value for shareholders. He said the volatility in oil prices is partly due to the imbalance between supply and demand, and it’s difficult to predict the future trend. CNOOC’s five-year plan aims for a compound annual growth rate of 6 to 10 percent from 2011 to 2015, and this will remain unchanged.

“Under the harsh circumstances, the company’s overall production and operations remained stable in the first quarter. Our cost control and enhanced efficiency measures were executed effectively and achieved good results. We will continue to strengthen our internal operations management, exercise strict cost control and enhance efficiency to proactively respond to the impact of low oil prices and to effectively promote various production and operational plans,” said CNOOC Ltd’s Chief Executive Officer Li Fanrong. CNOOC Ltd is the Hong Kong-listed arm of CNOOC, which has pledged to cut spending by roughly one-third compared with a year ago. 