iInvest Securities
Stockbroking & Wealth Management

INDEPTH RESEARCH NOTE

Woodside Petroleum – Buy

Price: A$29.00 | Price Target: A$34.00 | ASX: WPL | 19 February 2017

Woodside Petroleum (WPL) reported a solid FY17 earnings (NPAT) of $1,024m, up +18% over the prior period. More importantly, however, the Company announced a A$2.5bn equity raising to help fund its acquisition of ExxonMobil's 50% interest in the Scarborough gas field. The Company will pay a consideration of $444m, and an additional $300m depending on a positive final investment decision (FID). Whilst we are positive on the long-term thematic of LNG demand growth, we note WPL has taken some large bets in the sector, which is not without risk. Further, given the amount of capital WPL will require in the near future, the 80% dividend payout ratio will also likely come under consideration at Board meetings. Some other key highlights include: (1) Unit production cost slightly increased (+4%) to $5.2/boe. (2) An average realised price increase of ~10% at $44/boe. (3) Long-term agreement with Pertamina approved with an expected 1.1m tonnes per annum from 2019. The Company also a provided production guidance for 2018 at 85 – 90 MMboe, owing to increased LNG contribution from Wheatstone. Additionally, investment expenditure is expected to be towards the range of $2.0 – 2.5bn, with "*Wheatstone LNG spend significantly reduced following start-up of Train 1*". The free cash flow neutral price (barring Scarborough) will be at $35/bbl. Maintain Buy.

- **Surprise A$2.5bn equity raising for Scarborough.** WPL announced a $2.5bn equity raising to help fund its acquisition of ExxonMobil's 50% interest in WA-1-R, which contains the Scarborough gas field. WPL will pay a consideration of $444m, and an additional $300m contingent on positive FID. Upon completion (which is expected by 1Q18), WPL will have a 75% interest in the gas field that it intends to develop with the Burrup Hub project.

- **Is 80% dividend payout sustainable?** Given the projects in the pipeline in the medium term, we believe WPL's board will likely consider the merits of an 80% dividend payout ratio. We are not entirely against such a proposition (as long as the required return on investment is achieved) but the Company has pitched itself as a yield play and any change to this view will see the share price come under pressure.

- **Key financial headlines figures.** NPAT increased to $1,024m, up +18% over pcp and a fully-franked dividend of 98 cents per share (cps) was delivered (up +18.1% over the same period and maintaining 80% dividend payout ratio). Free cash flow was also up to $832m (+630%). Group earnings (NPAT) was largely affected by: (1) Positive price variances, with average realised price increasing by +10% to $44/boe. Specifically, a +20% jump in average brent price to $54/boe – significantly higher than WPL's price cash flow breakeven point of US$36 per barrel. (2) Negative sales volume which impacted revenue by -$392m. This was primarily due to lower NWS pipeline gas volumes, after a change in venture equity share. (3) A reduction in production costs by $29m. (4) A reduction in depreciation by $132m. (5) A $120m provision release. (6) A decrease in exploration and evaluation expense by $103m, primarily owing to reduced seismic activity and a general reduction permit costs.

- **Full year guidance revised.** Management slightly revised production guidance for 2018 at 85 – 90 MMboe, owing to increased LNG contribution from Wheatstone. WPL also sees oil being impacted by the Ngujima-Yin FPSO off-station in May 2018. Additionally, FY18 investment expenditure is being guided towards a range of $2.0 – 2.5bn, with "*Wheatstone LNG spend significantly reduced following start-up of Train 1*". Greater Enfield spend will increase as the Company begins subsea installation and drilling activities. The free cash flow neutral price (barring Scarborough) will be at $35/bbl.

- **Gearing remains unchanged at 24%**... which is within management's target range of 10 – 30%. WPL maintained its Baa and BBB+ crdit rating. $800m US bond was issued in September 2017, with a 10.5-year maturity and a coupon of 3.7%. To date, WPL's average term to majority for debt has been extended from 4.5 to 4.7 years and the portfolio cost of debt remains at a competitive 3.7%. Management has also increased liquidity to $2.9bn, up from $2.7bn on pcp.

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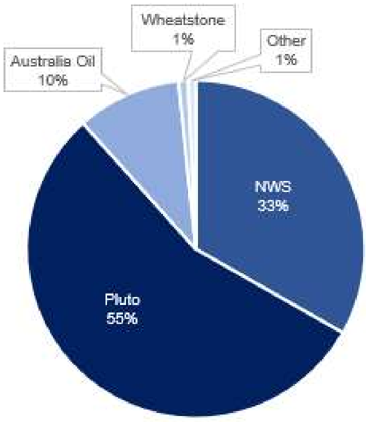
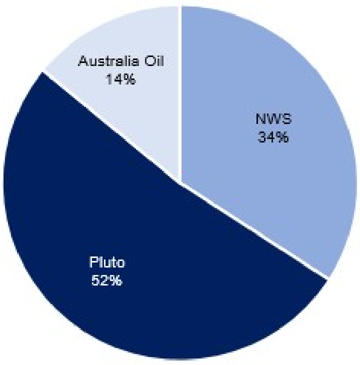
Figure 1: WPL Revenue by Segment



Source: Company

Figure 2: WPL NPAT by Segment



Source: Company

Investment Thesis

We rate WPL as a Buy for the following reasons:

- Quality assets (NWS, Pluto, Australia Oil, Browse, Wheatstone) with superior free cash flow breakeven price of $34 per barrel of brent (relative to peer group). 1H17 portfolio unit production costs were $4.90/boe, low cost operations underpinning gross margins of 48% and cash margins of 78%.
- On-going focus on cost reduction and positioning of the business for lower oil price environment.
- Strong and conservative balance sheet position.
- Strong free cash flow generation.
- Potential exploration success in Myanmar, Senegal, Gabon. However, we have not factored any success into our forecasts + valuation.
- Quality management team with solid long term strategy in place (“Horizons I, II and III”).

Key Risks

We see the following key risks to our investment thesis:

- Supply and demand imbalance in global oil/gas markets.
- Lower oil / LNG prices.
- Not meeting cost-out targets (e.g. reducing breakeven oil cash price).
- Production disruptions.

Company Description

Woodside Petroleum Ltd (WPL) explores for and produces natural gas, liquefied natural gas, crude oil, condensate, naptha and liquid petroleum gas. WPL owns producing assets in the North-West Shelf (NWS) project, Pluto LNG and Australian Oil. WPL is currently developing Browse, Sunrise, Wheatstone, Grassy Point and Kitimat LNG. WPL is currently undertaking exploration activities in Myanmar, Senegal, Morocco, Gabon, Ireland, NZ and Peru.

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FY17 result summary…

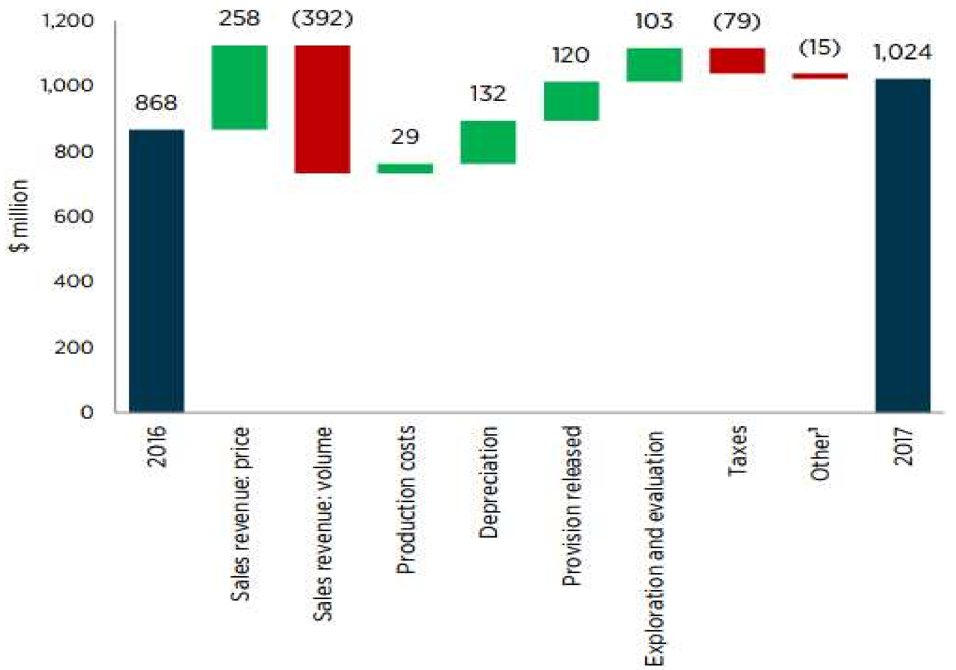
Key headline numbers for FY17 compared to FY16 by segments are presented below.

Figure 3: FY17 key headline numbers – by segment (Wheatstone not included due to limited time horizon data)

	NWS			Pluto			Australia Oil			Consolidated		
US$m	2017	2016	% chg	2017	2016	% chg	2017	2016	% chg	2017	2016	% chg
Liquified natural gas	860	801	7.4%	1,763	1,950	-9.6%				2,631	2,751	-4.4%
Pipeline natural gas	137	292	-53.1%	-	-					148	303	-51.2%
Condensate	268	279	-3.9%	145	134	8.2%				413	413	0.0%
Oil	-	-		-	-		390	302	29.1%	390	302	29.1%
Liquified petroleum gas	34	34	0.0%	-	-					34	34	0.0%
Revenue from sale of produced hydrocarbons	**1,299**	**1,406**	**-7.6%**	**1,908**	**2,084**	**-8.4%**	**390**	**302**	**29.1%**	**3,616**	**3,803**	**-4.9%**
Operating revenue	**1,299**	**1,406**	**-7.6%**	**2,155**	**2,286**	**-5.7%**	**390**	**302**	**29.1%**	**3,908**	**4,075**	**-4.1%**
Cost of sales	-620	-630	-1.6%	-158	-172	-8.1%	-124	-290	-57.2%	-990	-1,212	-18.3%
Gross profit	661	776	-14.8%	1,018	1,041	-2.2%	266	12	2116.7%	1,945	1,841	5.6%
Other income	12	11	9.1%	7	2	250.0%	8	40	-80.0%	31	56	-44.6%
Other expenses	-7	-12	-41.7%	-15	-33	-54.5%	-	-10		-326	-509	-36.0%
Profit before tax and net finance costs	**666**	**775**	**-14.1%**	**1,010**	**1,010**	**0.0%**	**274**	**42**	**552.4%**	**1,650**	**1,388**	**18.9%**

Source: Company. Note: Table above is a summary; as such line items, may not add up.

Figure 4: WPL FY17 NPAT waterfall



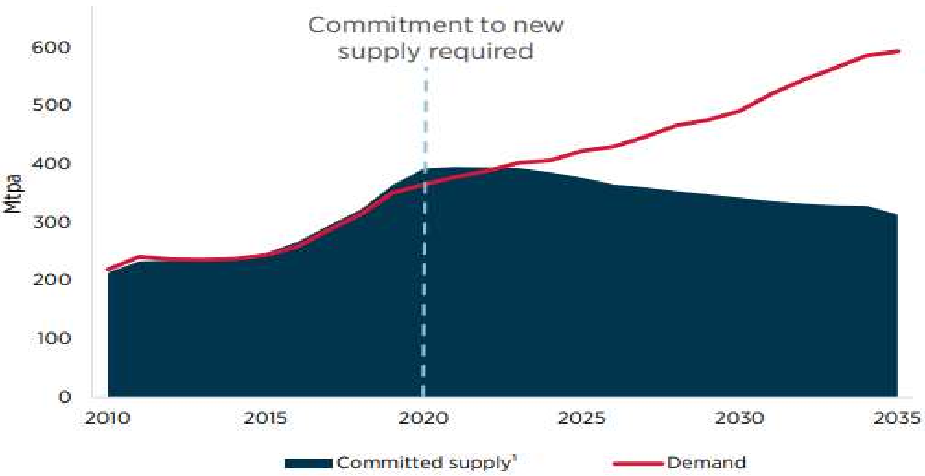
Source: Company

WPL saw an NPAT increase of +18% to $1,024m over the pcp. A key drag however was lower sales volume which negatively impacted revenue by -$392m, a result of lower volumes at North West Shelf pipeline. Offsetting this was increased average sales price that rose ~10% to $44/boe, but also other non-operational features including: (1) a decline in production costs (of $29m), (2) falling depreciation levels (of $132m), (3) a

$120m provision release, and (4) a decrease in exploration and evaluation of $103m, largely attributable to reduced seismic activity.

LNG markets. The outlook for LNG is particularly positive, with increasing demand outstripping committed supply.

Figure 5: Global supply and demand outlook



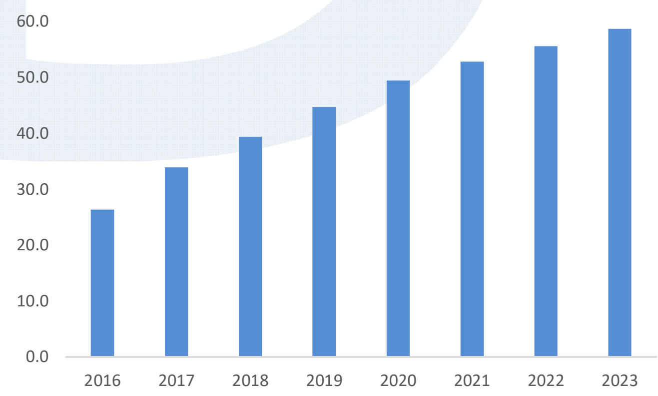
Source: Company, Wood Mackenzie LNG Service, Q2 2017. 1: committed supply means operational supply and supply under construction.

LNG demand in part has been driven by the need for clean energy and the desire to reduce coal & high-sulfur products. Asian LNG demand has been exceeding expectation and solid demand growth is estimated in 2018. Market concern with respect to oversupply is largely diminished with the focus more on investment. After a depressed start to the year, LNG spot price also recovered in the back half of 2017. We expect prices to trend higher as demand for clean energy and strong demand from China, especially with the country rolling out natural gas on a significant scale in Northern China (replacing coal as main heating source).

Figure 6: Singapore LNG spot price (USD / mmBtu)

Source: Bloomberg, BTIG

Figure 7: China LNG demand (mmtpa)

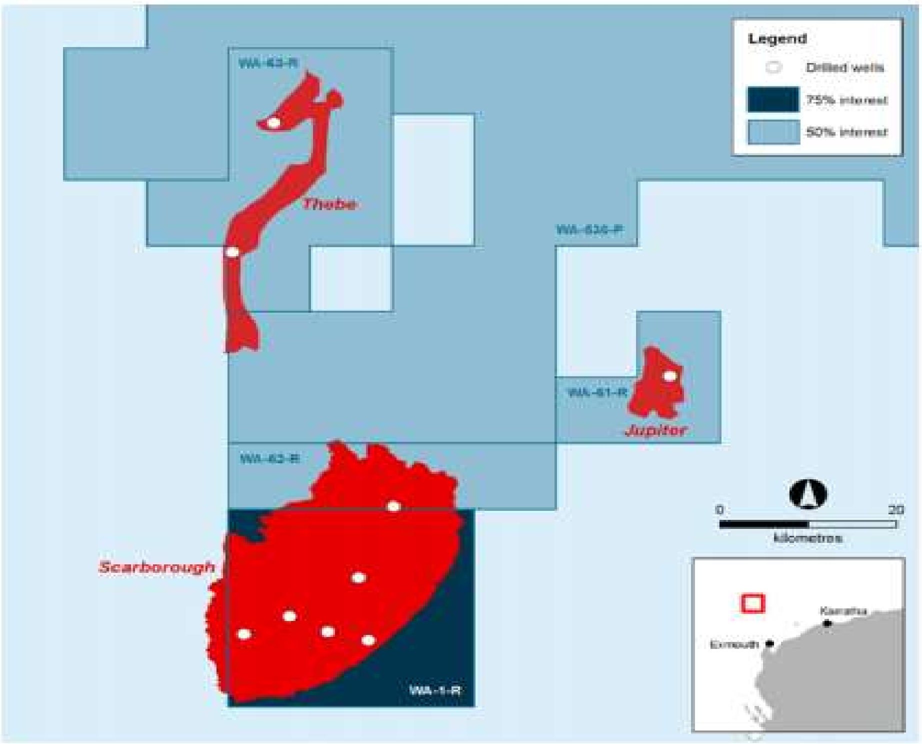


Source: Bloomberg, BTIG

Scarborough Acquisition…

Along with its full year results, WPL also announced a $2.5bn equity raising to help fund its acquisition of ExxonMobil's 50% interest in WA-1-R, which contains the Scarborough gas field. WPL will pay a consideration of $444m, and an additional $300m contingent on positive FID. Upon completion (which is expected by 1Q18), WPL will have a 75% interest in the gas field that it intends to develop with the Burrup Hub project.

Figure 8: Scarborough, Thebe and Jupiter gas fields



Source: Company

Entitlement offer and price. Fully underwritten 1 for 9 pro-rata accelerated renounceable entitlement offer with retail entitlements trading to raise $2.5bn. The offer price is at $27.00 per new share – which is a discount of 10.3% to dividend adjusted TERP of $30.11 (13 Feb-18).

Approvals required. WPL will need to get all necessary approvals including whether BHP exercises its pre-emption rights (which is unlikely in our view). If BHP does not pre-empt, WPL's interest increases to 75%, if BHP does exercise its pre-empt WPL's interest will be 50%.

Balance sheet post transaction. Post the capital raising, WPL's balance sheet will retain a solid position, on pro forma basis: (1) net debt reduces to $3.3bn (from $4.7bn); (2) gearing of 16% reduces to the lower end of WPL's target range of 10-30%; and (3) investment grade credit rating maintained.

Figure 9: WPL Financial Summary

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Year-end Dec ($millions)

PROFIT & LOSS (P&L)	FY14A	FY15A	FY16A	FY17E	FY18E	FY19E
Sales Revenue	**5,030.0**	**4,075.0**	**3,908.0**	**4,591.9**	**4,821.5**	**5,303.6**
Operating Expenses	3,050.0	1,341.0	1,054.0	977.3	1,074.5	1,154.1
EBITDA	**1,980.0**	**2,734.0**	**2,854.0**	**3,614.6**	**3,747.0**	**4,149.6**
% Margin	*39.4%*	*67.1%*	*73.0%*	*78.7%*	*77.7%*	*78.2%*
Depreciation & Amortisation	1,539.0	1,346.0	1,204.0	1,675.9	2,059.5	2,240.2
EBIT	**441.0**	**1,388.0**	**1,650.0**	**1,938.8**	**1,687.5**	**1,909.3**
% Margin	*8.8%*	*34.1%*	*42.2%*	*42.2%*	*35.0%*	*36.0%*
NPAT	26.0	868.0	1,024.0	1,551.0	1,350.0	1,527.4
Underlying NPAT	**882.8**	**851.9**	**1,024.0**	**1,551.0**	**1,350.0**	**1,527.4**
Underlying EPS (cps)	1.06	1.01	1.20	1.82	1.59	1.80
DPS (cps)	1.08	0.82	0.97	1.47	1.28	1.45
Growth Rates:						
Revenue		-19.0%	-4.1%	17.5%	5.0%	10.0%
EBIT		214.7%	18.9%	17.5%	-13.0%	13.1%
Underlying NPAT		-3.5%	20.2%	51.5%	-13.0%	13.1%

VALUATION	FY14A	FY15A	FY16A	FY17E	FY18E	FY19E
PE multiple (x)	21.7	22.8	19.1	12.6	14.5	12.8
P/B ratio (x)	1.6	1.2	1.3	1.2	1.2	1.2
Dividend Yield (%)	4.7	3.6	4.2	6.4	5.6	6.3
EV/Sales (x)	5.0	6.1	6.4	5.5	5.2	4.7
EV/EBIT (x)	56.8	18.0	15.2	12.9	14.8	13.1

BALANCE SHEET SUMMARY	FY12A	FY13A	FY14A	FY15A	FY16A	FY17A
Cash	2,422.0	2,223.0	3,268.0	122.0	285.0	318.0
Current Receivables	449.0	284.0	300.0	227.0	198.0	284.0
Current Inventories	241.0	192.0	247.0	170.0	149.0	186.0
Property, Plant & Equipment	20,555.0	19,633.0	18,881.0	21,840.0	22,673.0	23,069.0
Other	1,143.0	1,438.0	1,386.0	1,480.0	1,448.0	1,544.0
Total Assets	**24,810.0**	**23,770.0**	**24,082.0**	**23,839.0**	**24,753.0**	**25,401.0**
Current Payables	268.0	216.0	286.0	283.0	197.0	237.0
Total Debt	4,340.0	3,764.0	2,586.0	4,441.0	4,973.0	5,065.0
Other Liabilities	4,375.0	3,832.0	4,551.0	4,090.0	3,921.0	4,219.0
Total Liabilities	**8,983.0**	**7,812.0**	**7,423.0**	**8,814.0**	**9,091.0**	**9,521.0**
Shareholders Equity	**15,827.0**	**15,958.0**	**16,659.0**	**15,025.0**	**15,662.0**	**15,880.0**
Net Debt / Equity	12.1%	9.7%	-4.1%	28.7%	29.9%	29.9%
Net Debt / (ND+E)	10.8%	8.8%	-4.3%	22.3%	23.0%	23.0%

CASH FLOW SUMMARY	FY12A	FY13A	FY14A	FY15A	FY16A	FY17A
Net Income	2,983.0	1,749.0	2,414.0	26.0	868.0	1,024.0
Depn & Amortisation	1,217.0	1,266.0	1,462.0	1,539.0	1,346.0	1,204.0
Other Non-cash Adj.	-650.0	436.0	869.0	813.0	377.0	142.0
Changes in Non-cash capital	-75.0	-121.0	40.0	64.0	-22.0	15.0
Operating Cash Flow	**3,475.0**	**3,330.0**	**4,785.0**	**2,442.0**	**2,569.0**	**2,385.0**
Capital Expenditure	-1,914.0	-710.0	-697.0	-1,819.0	-1,622.0	-1,390.0
Free Cash Flow	**1,561.0**	**2,620.0**	**4,088.0**	**623.0**	**947.0**	**995.0**

Source: BTIG, Company, Bloomberg

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Recommendation Rating Guide	Total Return Expectations on a 12-mth view
Speculative Buy	Greater than +30%
Buy	Greater than +10%
Neutral	Greater than 0%
Sell	Less than -10%