

Halliburton

Few Holes in a Story That Keeps Getting Better

We spent last week on the road in Europe with CFO Mark McCollum, which reinforced our view that the bull case on Halliburton continues to strongly outweigh any of the bear arguments, of which there are few. With the North American pressure pumping market tightening, HAL is going to be testing pricing in the coming months, providing upside to margin targets. We edged up 2014/2015 EPS above consensus to \$4.00/\$5.20, with an additional \$0.15/\$0.35 in EPS upside from share buybacks. Our detailed note begins on Page 2.

- **With the North America market tightening, HAL is starting to push pricing...will they put Tier 2 players in their place with new capacity?** With only 10-12% excess industry capacity and 80% of HAL's hp on 24 hrs, the time is now to start pushing pricing. If successful, HAL likely starts adding capacity in addition to accelerating the Q10 pump rollout, which should make the tier 2 players nervous in light of HAL's considerable cost advantage.
- **Few concerns about an IOC slowdown, emerging IPM opportunities with NOCs.** A lot of talk about IOC capital discipline, but Halliburton isn't seeing a slowdown in the offshore market, nor do they see excess service capacity. NOCs are getting more creative in looking to fund activity with service company balance sheets, creating a growing opportunity set for HAL that must be balanced against higher project risk.
- **Swirling currents in Latin America.** The one soft spot is LatAm where margins should appreciably improve in 2015. Petrobras has agreed to re-tender the drilling contracts on lower activity levels, with costs right-sizing by 2Q15. Mexico reform is getting close and onshore service contracts could materialize in 2H14 followed by IOC offshore tenders in 1H15. Even Venezuela is improving with a recent agreement on receivables and additional activity.
- **Raising EPS estimates slightly, more upside from buybacks.** We raised 2014/2015 EPS to \$4.00/\$5.20 from \$3.95/5.10 primarily on modest tweaks to our NAM margin and revenue progression, but could see upside on buybacks. We expect HAL to raise its dividend in the coming quarters (we model +20% to \$0.18/qtr in 4Q14) to stay within 10-15% of net income but with plans to distribute 30-35% of operating cash flows, we could see ~\$2bn in buybacks in 2014 (would add ~\$0.15 to our '14 EPS) and another ~\$2.5bn in 2015 (adds ~\$0.35 to our '15 EPS).

Halliburton Company (HAL;HAL US)

FYE Dec	2013A	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)					
Q1 (Mar)	0.67	0.73A	0.73A	1.12	1.14
Q2 (Jun)	0.73	0.91	0.91	1.22	1.24
Q3 (Sep)	0.83	1.13	1.13	1.32	1.35
Q4 (Dec)	0.93	1.18	1.23	1.44	1.48
FY	3.15	3.95	4.00	5.10	5.20
Bloomberg EPS FY (\$)	3.10	-	3.98	-	5.10

Source: Company data, Bloomberg, J.P. Morgan estimates.

See page 11 for analyst certification and important disclosures.

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Overweight

HAL, HAL US

Price: \$66.94

▲ Price Target: \$78.00
Previous: \$77.00

Oil Services and Equipment

J. David Anderson, PE, CFA ^{AC}

Bloomberg JPMA ANDERSON <GO>

William S Thompson

Samantha Hoh, CFA

J.P. Morgan Securities LLC

Price Performance



Company Data

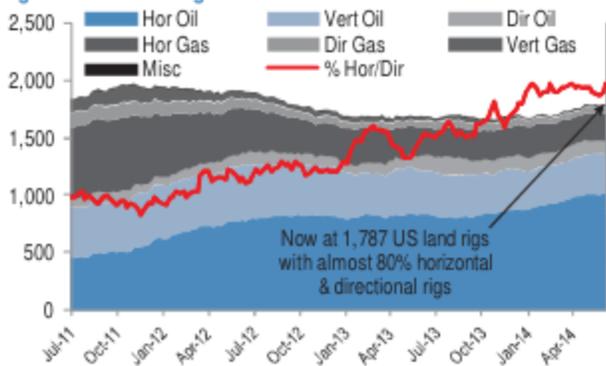
Price (\$)	66.94
Date Of Price	11 Jun 14
52-week Range (\$)	67.35-40.12
Market Cap (\$ mn)	62,321.14
Fiscal Year End	Dec
Shares O/S (mn)	931
Price Target (\$)	78.00
Price Target End Date	31-Dec-14

Halliburton on the Road

After spending last week on the road in Europe with Halliburton CFO Mark McCollum, our conviction as one of the top names to own in services has only grown stronger.

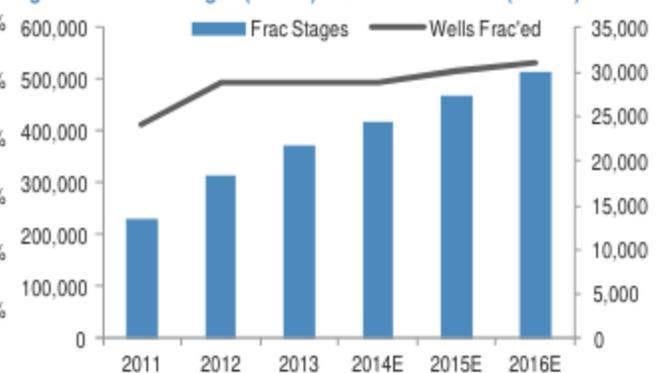
North America market may be tighter than you think. Not surprisingly, most investor questions centered on the state of the North American land market, which is clearly showing improvement across the board. Considering the U.S. onshore rig count at 1,787 (+6% Y-Y) is where they thought it would end the year (as did we), higher E&P spending in the Permian is the obvious driver. In March volumes pumped were 30% higher y-y on a 15% increase in the number of frac stages; however, the increased service intensity is limited to the Bakken, Eagle Ford, and Niobrara with the Permian in an earlier stage of development.

Figure 1: US Land Rig Count



Source: Baker Hughes and J.P. Morgan.

Figure 2: US Frac Stages (L-Axis) & US Wells Frac'ed (R-Axis) Forecast

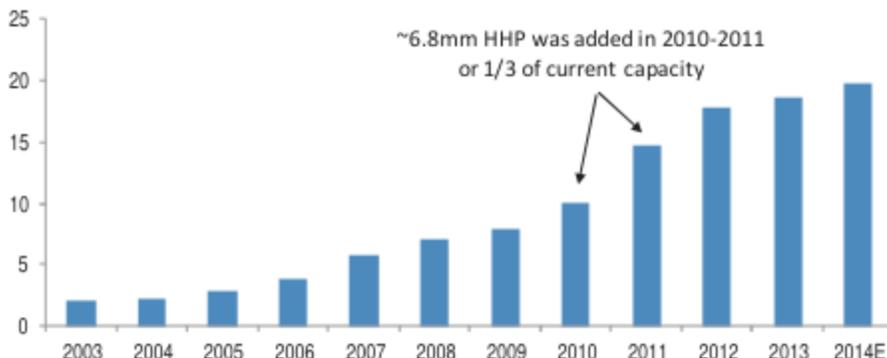


Source: PacWest and J.P. Morgan.

Despite its forecast for moderate +3% CAGR growth in wells spud and wells frac'ed in NAM from 2013-2016, PacWest forecasts +12% CAGR in total stage counts driven by a continued shift to horizontal drilling (forecasts +12% CAGR for horizontal wells frac'ed), increased lateral lengths, and decreased stage widths.

Mr. McCollum estimates the pressure pumping market has about 10-12% excess capacity currently, cut in half from the 22% overcapacity seen a year ago. Notably, this contrasts the more bearish analysis from PacWest Consulting that estimates utilization at 81% in 2014, with the difference in views likely coming from two sources (see our June 4th note "[Consultants Provide Frac Market Update: Modest Pricing Increases Offset by Cost Recovery](#)"). First, customers are demanding more horsepower on site from the second tier pressure pumpers. Second, while true horsepower attrition levels may have been overstated historically pressure pumping fleets require an overhaul every 2 to 3 years. Therefore, with an estimated 6.8mm net HHP in capacity added in NAM during the 2010-11 timeframe, effective capacity may be quite a bit less than the 17mm HHP is stated industry capacity.

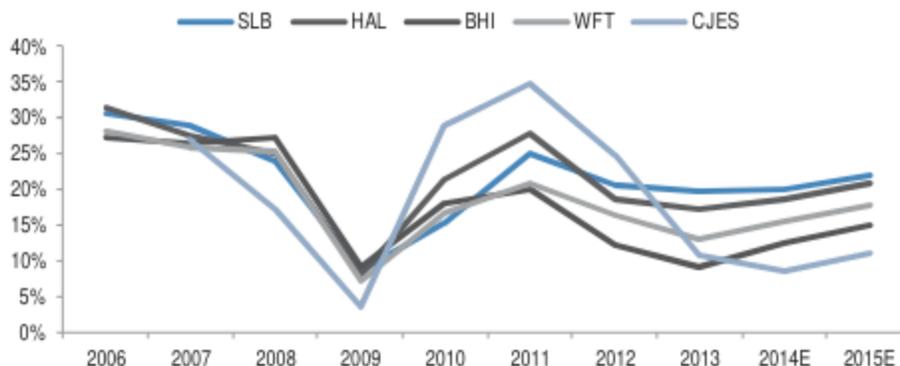
Figure 3: North America Pressure Pumping Capacity (Million HHP at Year End)



Source: PacWest and J.P. Morgan.

With promising pricing signs, will HAL put the Tier 2 players in their place? In describing the North American market, Mr. McCollum depicted a more stable pressure pumping market than in the past. While he does expect the market to overbuild again, it won't get to the point of 30% overcapacity as in the past. This is partly because pricing increases won't be the "hockey stick" that drove the flurry of capacity additions from the smaller players, but it may also be a result of greater manufacturing capacity on pumps. But rather than showing concern about recent announcements of capacity additions (PacWest estimates 1.1mm of net HHP in NAM to be added in 2014), the company is more perplexed at the rationale behind the orders. Noting that Halliburton is the low cost operator in the market, the company is generating returns marginally above cost of capital (11%) on the current ~15% EBIT margins. In other words, without substantial pricing increases, the market is adding capacity at sub-cost of capital returns, which could snuff out pricing improvements before it even takes hold.

Figure 4: North America Operating Margins by Company



Source: Company reports and J.P. Morgan estimates.

With this backdrop, would it make sense for Halliburton to start adding material capacity to disincentivize the smaller players from adding more capacity? The answer may be yes. Until now, Halliburton hasn't been adding net capacity, instead replacing existing pumps with the new Q10 design, which requires 30% less maintenance with a 2-10x longer wear life than competitor designs (PacWest estimates pumps generally last for about 5,000 hours). Currently, 20% of the fleet is outfitted with the Q10, but now plans to reach 50% by year end 2015 may be

accelerated. While this is lowering HAL's operating costs and increasing effective capacity by reducing downtime from maintenance, larger scale capacity additions are now being considered.

Over the next month, the company plans to start testing higher pricing as contracts roll over, with success likely resulting in new capacity additions. Signs are clearly pointing towards pricing moving higher in 2H14 as Halliburton's utilization improved to 80% on 24-hour work in 1Q14 from 75% in 4Q13, and all of its horsepower is committed through October. The company indicated three signs for contractual pricing to move higher:

- **Cost recovery from customers.** On the majority of contracts, Halliburton is now able to pass through higher labor and logistics costs.
- **Improvement in the transactional market.** They are starting to see spot pricing moving higher – not only are we hearing it from the second tier players (CJES), but our quarterly survey of US E&Ps also confirms the trend.
- **Calendar leverage.** When Halliburton starts to control the calendar and *telling* customers when they can schedule the job instead of *being told*, then pricing leverage is clearly taking hold. We're not there yet.

Halliburton is wrestling with this question: can they add capacity but still benefit from pricing increases or at least hold pricing steady? From an internal standpoint, as long as returns remain above cost of capital, capacity should be built and market share should be gained. But looking more broadly at the market, would it be prudent for Halliburton to seek to drive the smaller players out by adding capacity and putting pressure on their returns? The risk is if it backfires because the Tier 2 players don't seem to care about returns in the first place and cheap financing is at their fingertips allowing them to build without recourse.

Confident in hitting margin targets. Halliburton's analyst day last November was notable for the aggressive North American margin targets set for 2014 and over the next 3 years. Mr. McCollum acknowledged this year's targets were a bit of a stretch when first announced (and then reiterated on the following earnings conference calls), but they now appear to be well in hand. Notably, none of the 200bp Y-Y margin improvement by 3Q14 assumes any pricing improvement, instead accomplished through costs and supply chain: 1. About half of the improvement is from improved supply chain, primarily guar pricing and potentially sand; 2. Realized cost savings from the internal mobility project that streamlines back office functions in the field; and 3. The ongoing Q10 pump rollout that reduces maintenance costs by 30% (all expensed). Keeping in mind 1Q14 NAM results included 75bp of price degradation as contracts rolled over, any pricing increases in 2H will immediately result in higher incremental margins. Additional margin upside could come from Halliburton's ability to negotiate better proppant costs with suppliers.

Figure 5: Halliburton's North American Operating Margins



Source: Company reports and J.P. Morgan estimates.

The rest of the 300bp non-pricing margin improvement by 2016 will come from internal measures derived from the Frac of Future and Battle Red initiatives. As the US land market moves further into development mode, we expect superior logistics to play an increasing role in improved margins. According to Mr. McCollum, Halliburton had the fifth largest logistics operations in the United States (behind Coca Cola, Pepsi, and WalMart), with plans to expand significantly over the next several years. Halliburton currently owns 3,500 rail cars to transport proppant to well sites, which will double to 7,000 cars, while 2/3rds of the 18,000 new hires globally this year will be in North America. We believe this gives the diversified service companies (which includes Schlumberger and to a lesser extent Baker Hughes) a distinct advantage over the smaller players. In an isolated example, a customer in the Marcellus stopped using Halliburton over pricing, but struggled to replicate operations and had to hire 7 smaller companies instead.

Not a lot of concerns about IOC slowdown. The biggest concern investors consistently voiced was the impact from the “capital discipline” mantra that many IOCs have repeated over the past 6 months. Despite 20-25% of total revenue generated from IOCs, Halliburton continues to forecast low double digit spending growth out of the Eastern Hemisphere this year (consistent with our forecast) and has yet to see a reduction in spending or activity levels offshore. In fact, the deepwater market is progressing about how they thought it would: slow and steady. The company believes that most of the overcapacity in the deepwater rig market can be traced back to Brazil, which some had expected to reach 70 deepwater rigs by now. While there is a chance that Brazil could pick up the slack and start growing again in 2016, Halliburton continues to model modest offshore growth the next several years and does not see excess service or equipment capacity in the market, other than rigs.

Increasing IPM opportunities with NOCs. One of the more compelling growth opportunities for Halliburton over the next several years is pursuing integrated project management (IPM) work outside the U.S. With one project underway (Malaysia), another poised to begin (Humapa in Mexico), and third under negotiation (Ecuador), national oil companies are getting creative, looking to use the large cap service companies’ strong balance sheets as a means for funding activity. Mr. McCollum appeared comfortable that increases in working capital won’t be onerous to Halliburton’s balance sheet (will have to keep a close eye on receivables), but is clearly aware of the multitude of risks that IPM projects bring. Risks that include commodity prices, currency, sovereign, reservoir, and environmental, each of which

need to be properly compensated in contracts and justify a measured pace. Perhaps the most challenging aspect of these contracts is establishing a base-line for measuring the incentive portion of the contract. In other words, assuming a field increases production, how much credit goes to Halliburton for the increased production versus what would normally be achieved? Another issue is establishing the base-line for environmental risk to assure the company is only responsible for what takes place under their scope and not taking on legacy environmental risk.

Swirling currents in Latin America. Latin America is arguably the one “soft spot” in the Halliburton story as margins have disappointed in recent quarters. But while we believe the issues have been ring-fenced, the major countries in the region face unique sets of issues that will take some time to resolve. **Brazil** is the biggest concern with activity substantially below what was agreed upon when the drilling contract was signed in 2012. Recently, Petrobras has agreed to retender the contracts, but the timing is in question. Assuming the contracts are re-tendered in 2H14, Halliburton should see margin improvement by 2Q15 as costs are right-sized. The big issue will likely be around price as Halliburton presumably priced the initial contract lower based on the higher expected activity levels. With reforms waiting for secondary laws to pass over the next month or two, **Mexico** will be a growing opportunity for Halliburton, particularly if service companies are the first to be offered contracts in unconventional work. We note that our understanding was the offshore market would be the first to be offered with IOC's partnering with Pemex in both shallow and deepwater. Lastly, **Venezuela** may be showing some signs of improvement with the recently negotiated deal with PDVSA. Together with Schlumberger and Weatherford, \$2bn in work has been agreed upon, which will include payment on receivables.

Many Options with Balance Sheet and Cash Flow. We believe free cash flow generation is becoming the defining topic among large cap service companies, and has contributed to the re-rating of the stock over the past 6 months (in addition to oil prices and North America, of course). Last fall, Halliburton recapitalized the balance sheet with a \$3.0bn debt offering and subsequent \$3.3bn share buyback, but with net debt/cap at 29% as of 1Q14, investors shouldn't expect a repeat re-cap this fall. Instead, share buybacks will be coming from operating free cash flow, essentially paying out anything in excess of the \$1.5bn in cash needed to run the business. As of 1Q14, Halliburton reported \$2.1bn in cash on the balance sheet, with \$1.2bn of it set aside for a Macondo settlement, which is expected to be resolved within the next 12 months.

Mr. McCollum noted that the dividend currently paying out the low end of a stated 10-15% of net income, suggesting investors should expect an increase in the coming quarters (we model +20% to \$0.18/qtr in 4Q14), with excess cash going towards share repurchases. With the company targeting 30-35% of operating cash to be paid out in total, this implies over \$2bn in buybacks in 2014 (~32mm shares at \$70) and another ~\$2.5bn in 2015, which would add ~\$0.15/sh to 2014 EPS and \$0.35/sh to 2015.

Mr. McCollum expects capex to remain relatively flat over the next several years. He indicated North America is still the best place for the incremental dollar of spending for growth, but even if they dialed up pressure pumping capacity, it would only raise capex by 10% or so. Interestingly, one of his bigger balance sheet concerns is having available room for M&A, which would either focus on technologies or product lines

that complement the mature field business around artificial lift (ESPs or PCPs) or chemicals. That said, there was a sense of frustration that more deals haven't presented themselves...then again, with the business outlook as strong as its been in years (if not as long as we've covered the company), Halliburton doesn't need much external help.

Figure 6: Halliburton Model Summary

	2012	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14E	3Q14E	4Q14E	2014E	2015E
Income Statement (\$ mm)												
Revenue												
North America	\$16,004	\$3,706	\$3,802	\$3,881	\$3,823	\$15,212	\$3,901	\$4,097	\$4,191	\$4,167	\$16,356	\$17,665
Latin America	3,694	945	944	1,002	1,018	3,909	859	906	992	1,140	3,897	4,483
Europe/Africa/CIS	4,510	1,187	1,299	1,340	1,399	5,225	1,299	1,455	1,447	1,567	5,768	6,202
Middle East/Asia	4,295	1,136	1,272	1,249	1,399	5,056	1,289	1,437	1,511	1,679	5,916	6,804
Total Revenue	\$28,503	\$6,974	\$7,317	\$7,472	\$7,639	\$29,402	\$7,348	\$7,895	\$8,142	\$8,553	\$31,938	\$35,154
Revenue Consensus	28,243	6,879	7,246	7,498	7,557	29,337	7,243	7,863	8,285	8,651	32,081	35,329
Completion & Production	17,380	4,100	4,363	4,501	4,542	17,506	4,100	4,405	4,543	4,772	17,821	19,615
Drilling & Evaluation	11,123	2,874	2,954	2,971	3,097	11,896	2,874	3,490	3,599	3,781	13,744	15,539
COGS	(\$23,741)	(\$6,000)	(\$6,191)	(\$6,230)	(\$6,363)	(\$24,784)	(\$6,303)	(\$6,619)	(\$6,601)	(\$6,891)	(\$26,413)	(\$28,237)
SG&A	(275)	(72)	(87)	(80)	(94)	(333)	(75)	(87)	(90)	(94)	(345)	(387)
Total Costs & Expenses	(\$24,016)	(\$6,072)	(\$6,278)	(\$6,310)	(\$6,457)	(\$25,117)	(\$6,378)	(\$6,706)	(\$6,690)	(\$6,985)	(\$26,759)	(\$28,623)
Total D&A	(\$1,628)	(\$448)	(\$474)	(\$481)	(\$497)	(\$1,900)	(\$510)	(\$525)	(\$540)	(\$555)	(\$2,130)	(\$2,420)
EBITDA	\$6,115	\$1,350	\$1,513	\$1,643	\$1,679	\$6,185	\$1,480	\$1,715	\$1,992	\$2,123	\$7,310	\$8,951
EBITDA Consensus	6,027	1,294	1,485	1,624	1,669	6,174	1,483	1,714	1,953	2,117	7,249	8,752
Operating Income												
North America	\$2,980	\$605	\$666	\$691	\$651	\$2,613	\$602	\$716	\$859	\$854	\$3,031	\$3,666
Latin America	607	109	101	159	157	526	100	109	144	171	524	789
Europe/Africa/CIS	593	121	161	207	209	698	146	204	246	282	878	1,105
Middle East/Asia	687	187	219	207	264	877	211	259	295	353	1,117	1,350
Total Operating Income	\$4,487	\$902	\$1,039	\$1,162	\$1,182	\$4,285	\$970	\$1,190	\$1,452	\$1,568	\$5,180	\$6,531
North America Margins	18.6%	16.3%	17.5%	17.8%	17.0%	17.2%	15.4%	17.5%	20.5%	20.5%	18.5%	20.8%
Latin America Margins	16.4%	11.5%	10.7%	15.9%	15.4%	13.5%	11.6%	12.0%	14.5%	15.0%	13.4%	17.6%
Europe/Africa/CIS Margins	13.1%	10.2%	12.4%	15.4%	14.9%	13.4%	11.2%	14.0%	17.0%	18.0%	15.2%	17.8%
Middle East/Asia Margins	16.0%	16.5%	17.2%	16.6%	18.9%	17.3%	16.4%	18.0%	19.5%	21.0%	18.9%	19.8%
Total Operating Margins	15.7%	12.9%	14.2%	15.6%	15.5%	14.6%	13.2%	15.1%	17.8%	18.3%	16.2%	18.6%
Income Taxes	(\$1,355)	(\$191)	(\$276)	(\$312)	(\$278)	(\$1,057)	(\$229)	(\$310)	(\$384)	(\$417)	(\$1,341)	(\$1,683)
Tax Rate	33%	23%	29%	29%	26%	27%	27%	29%	29%	29%	28%	28%
Net Income	\$2,551	(\$13)	\$677	\$707	\$798	\$2,169	\$623	\$774	\$961	\$1,044	\$3,403	\$4,424
Diluted Shares (Avg)	928	931	928	894	854	902	853	850	850	850	851	850
EPS (Adjusted, Diluted)	\$3.00	\$0.67	\$0.73	\$0.83	\$0.93	\$3.15	\$0.73	\$0.91	\$1.13	\$1.23	\$4.00	\$5.20
EPS Consensus	2.97	0.57	0.72	0.82	0.89	3.10	0.71	0.91	1.11	1.23	3.98	5.09
Dividend per Share	\$0.36	\$0.13	\$0.13	\$0.13	\$0.15	\$0.53	\$0.15	\$0.15	\$0.15	\$0.18	\$0.63	\$0.72
Cash Flow Statement (\$ mm)												
Total Working Capital Changes	(\$1,026)	(\$864)	(\$219)	\$108	\$538	(\$437)	(\$172)	(\$116)	(\$492)	\$548	(\$232)	(\$376)
Cash from Operations	\$3,654	\$349	\$1,122	\$1,078	\$1,898	\$4,447	\$954	\$1,183	\$1,009	\$2,147	\$5,294	\$6,468
Capital Expenditures	(\$3,566)	(\$685)	(\$711)	(\$679)	(\$859)	(\$2,934)	(\$643)	(\$750)	(\$773)	(\$813)	(\$2,979)	(\$3,252)
Cash from Investing	(\$3,688)	(\$651)	(\$540)	(\$676)	(\$1,003)	(\$2,870)	(\$674)	(\$750)	(\$773)	(\$813)	(\$3,010)	(\$3,252)
Increase (decrease) in LT Debt	\$0	\$0	\$0	\$2,968	\$0	\$2,968	\$0	\$0	\$0	\$0	\$0	\$0
Cash from Financing	(\$172)	(\$145)	(\$1,184)	(\$338)	(\$87)	(\$1,754)	(\$514)	(\$127)	(\$127)	(\$152)	(\$920)	(\$609)
Cash at End of Period	\$2,484	\$2,029	\$1,412	\$1,491	\$2,356	\$2,356	\$2,123	\$2,429	\$2,538	\$3,721	\$3,721	\$6,328
Balance Sheet (\$ mm)												
Property, Plant, & Equip. (Net)	10,257	10,509	10,753	10,949	11,322	11,322	11,463	11,688	11,922	12,179	12,179	13,011
Total Assets	\$27,410	\$27,684	\$27,418	\$27,948	\$29,223	\$29,223	\$29,256	\$30,178	\$30,970	\$32,090	\$32,090	\$36,353
Long-term Debt, Net of Current	4,820	4,820	4,820	7,816	7,816	7,816	7,816	7,816	7,816	7,816	7,816	7,816
Stockholder Equity	15,765	15,710	15,337	12,788	13,581	13,581	13,725	14,372	15,207	16,099	16,099	19,914
Cash Flow Metrics												
Free Cash Flow	\$88	(\$336)	\$411	\$399	\$1,039	\$1,513	\$311	\$433	\$236	\$1,335	\$2,315	\$3,216
FCF/share (diluted)	\$0.09	(\$0.36)	\$0.44	\$0.45	\$1.22	\$1.68	\$0.36	\$0.51	\$0.28	\$1.57	\$2.72	\$3.78
Operating Free Cash Flow	\$1,993	\$741	\$634	\$859	(\$182)	\$2,052	\$598	\$932	\$1,226	\$369	\$3,124	\$4,255
Balance Sheet Metrics												
Book Value (per share)	\$16.98	\$16.87	\$16.53	\$14.30	\$15.90	\$15.06	\$16.09	\$16.91	\$17.89	\$18.94	\$18.92	\$23.43
Net Debt	\$2,336	\$2,791	\$3,408	\$6,325	\$5,460	\$5,460	\$5,693	\$5,387	\$5,278	\$4,095	\$4,095	\$1,488
Total Debt/Capital	23.4%	23.5%	23.9%	37.9%	36.5%	36.5%	36.3%	35.2%	33.9%	32.7%	32.7%	28.2%
Net Debt/Capital	12.9%	15.1%	18.2%	33.1%	28.7%	28.7%	29.3%	27.3%	25.8%	20.3%	20.3%	7.0%
Return on equity	19.2%	15.9%	17.4%	21.2%	24.2%	19.4%	18.3%	22.0%	26.0%	26.7%	22.9%	24.6%
Return on capital (Net Debt)	17.9%	14.8%	15.6%	17.1%	18.3%	16.6%	14.4%	17.2%	20.4%	21.8%	18.7%	22.6%

Source: Company reports, Bloomberg, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Halliburton (*Overweight; Price Target: \$78.00*)

Investment Thesis

We believe HAL is exhibiting its pressure pumping cost advantage with a fleet that is 85% on long-term contracts and 75% working on 24-hour operations. With 2014 earnings revisions likely to the upside going forward, we expect multiple expansion with more investors looking toward the considerable growth in 2014/2015 EPS amid conservative assumptions. We also think there is a free option for gas recovery, which could dramatically improve frac utilization and pricing.

Valuation

We continue to rate Halliburton Overweight but raised our Dec 2014 price target slightly to \$78 (from \$77) as we maintain our 15.0x target. Our target multiple is close to where HAL traded mid-stage last cycle. HAL currently trades at 12.9x our 2015E EPS, a 19% discount to SLB and a 6% discount to BHI. Our target multiple for HAL is an 17% discount to SLB but a 5% premium to our target multiple for BHI as we expect HAL to see continued relative multiple expansion given its strong international growth and superior North America operations. Furthermore, expect the company to continue to buy back shares as free cash flow ramps, but don't include buybacks in our model.

Risks to Rating and Price Target

Potential liability from involvement in Macondo blowout

Halliburton performed cementing services on the ill-fated Macondo well that led to one of the largest oil spills in history. While we continue to believe that Halliburton acted properly throughout the well construction process, Halliburton faces civil penalties resulting from its involvement in the disaster. Our expectation is for a settlement in the \$300-500mm range.

The possibility of a large acquisition could pressure shares

In the wake of the Smith and BJ acquisitions, M&A discussions naturally shifted to Halliburton. We do not believe Halliburton needs to get bigger, and it is unlikely to make a significant acquisition, but it could see shares under pressure on this thesis. We believe smaller, technology-focused acquisitions are more likely, particularly in artificial lift (ESPs) and well testing.

Halliburton: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Revenues	29,402	31,938	35,154	37,087	Revenues	7,348A	7,895	8,142	8,553
Cost of products sold	(24,784)	(26,413)	(28,237)	(29,331)	Cost of products sold	(6,303)A	(6,619)	(6,601)	(6,891)
Gross profit	4,618	5,525	6,917	7,756	Gross profit	1,045A	1,277	1,541	1,662
SG&A	(333)	(345)	(387)	(408)	SG&A	(75)A	(87)	(90)	(94)
DD&A	(1,900)	(2,130)	(2,420)	(2,740)	DD&A	(510)A	(525)	(540)	(555)
Other operating expenses					Other operating expenses				
Operating Income	4,285	5,180	6,531	7,348	Operating Income	970A	1,190	1,452	1,568
EBIT	4,285	5,180	6,531	7,348	EBIT	970A	1,190	1,452	1,568
EBITDA	6,185	7,310	8,951	10,088	EBITDA	1,480A	1,715	1,992	2,123
Net interest income / (expense)	(331)	(372)	(368)	(360)	Net interest income / (expense)	(93)A	(93)	(93)	(93)
Income applicable to minority interests	(10)	(3)	(12)	(12)	Income applicable to minority interests	6A	(3)	(3)	(3)
Pretax income	3,911	4,747	6,119	6,944	Pretax income	846A	1,087	1,349	1,465
Taxes	(1,057)	(1,341)	(1,683)	(1,875)	Taxes	(229)A	(310)	(384)	(417)
Tax rate (%)	27.0%	28.2%	27.5%	27.0%	Tax rate (%)	27.1%A	28.5%	28.5%	28.5%
Reported net income	2,169	3,403	4,424	5,057	Reported net income	623A	774	961	1,044
Non-recurring items, disc ops	675	0	0	0	Non-recurring items, disc ops	0A	0	0	0
Adjusted net income	2,844	3,403	4,424	5,057	Adjusted net income	623A	774	961	1,044
Average diluted shares outstanding	902	851	850	850	Average diluted shares outstanding	853A	850	850	850
EPS	3.15	4.00	5.20	5.95	EPS	0.73A	0.91	1.13	1.23
EPS growth rate (%)	5.1%	26.8%	30.1%	14.3%	EPS growth rate (%)	9.0%A	24.8%	35.7%	31.5%
Dividend per share	0.53	0.63	0.72	0.84	Dividend per share	0.15A	0.15	0.15	0.18
WTI crude price (\$/bbl)	-	-	-	-	WTI crude price (\$/bbl)	-	-	-	-
Henry Hub natural gas price (\$/mcf)	-	-	-	-	Henry Hub natural gas price (\$/mcf)	-	-	-	-
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	2,356	3,721	6,328	9,855	Valuation				
Other current assets	11,348	11,883	12,707	13,103	P/E (adjusted)	21.2	16.7	12.9	11.3
Total current assets	13,704	15,604	19,035	22,958	P/CF	13.6	10.8	8.8	7.4
Net PP&E	11,322	12,179	13,011	13,701	Enterprise value/EBITDA	8.2	6.8	5.2	4.3
Other assets	4,197	4,307	4,307	4,307	EV/DACF	-	-	-	-
Total assets	29,223	32,090	36,353	40,967	Ratios				
Total debt	7,816	7,816	7,816	7,816	Net debt/equity	40.1%	25.4%	7.5%	(8.4%)
Total liabilities	15,608	15,964	16,412	16,679	Net debt/capital	26.0%	18.1%	5.8%	(6.8%)
Minority interests	34	27	27	27	Net coverage ratio	12.9	13.9	17.7	20.4
Preferred stock	-	-	-	-	ROE	19.4%	22.9%	24.6%	22.9%
Shareholders' equity	13,581	16,099	19,914	24,260	ROCE	14.9%	16.4%	18.3%	17.9%
Net income	2,169	3,403	4,424	5,057	Yield and cash returns				
DD&A	1,900	2,130	2,420	2,740	CFPS	4.93	6.22	7.61	9.02
Deferred taxes	-	-	-	-	FCF yield	2.9%	4.5%	6.1%	7.9%
Change in working capital	(437)	(232)	(376)	(128)	Dividend yield	0.8%	0.9%	1.1%	1.3%
Other	815	(7)	0	0	Dividend payout ratio	21.8%	15.8%	13.8%	14.1%
Cash flow from operations	4,447	5,294	6,468	7,669	Buyback yield	7.0%	0.8%	0.0%	0.0%
Capex	(2,934)	(2,979)	(3,252)	(3,431)					
Other investing cashflows	64	(31)	0	0					
Dividends	(465)	(533)	(609)	(711)					
Share buybacks (net)	(4,079)	(500)	0	0					
Change in debt	2,968	0	0	0					
Other financing cashflows	(178)	113	0	0					
Change in cash	(128)	1,365	2,607	3,528					
Free cash flow	1,755	2,582	3,483	4,501					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

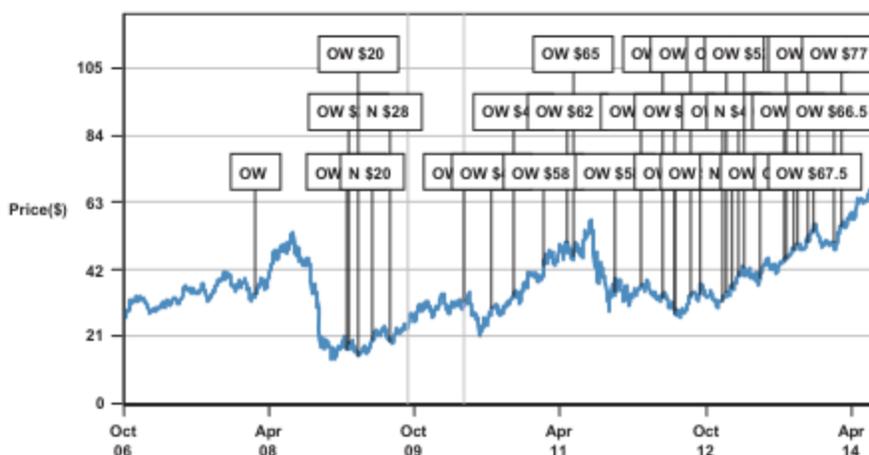
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Halliburton (HAL, HAL US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Break in coverage Feb 04, 2008 - Jan 14, 2009.

Date	Rating	Share Price (\$)	Price Target (\$)
04-Feb-08	OW	34.71	--
14-Jan-09	OW	17.20	26.00
27-Jan-09	OW	18.87	23.00
04-Mar-09	OW	14.92	20.00
21-Apr-09	N	19.96	20.00
02-Jul-09	N	19.38	28.00
06-Apr-10	OW	32.20	39.00
19-Jul-10	OW	30.27	45.00
07-Oct-10	OW	33.62	49.00
27-Jan-11	OW	43.40	58.00
25-Apr-11	OW	50.63	62.00
23-May-11	OW	46.16	65.00
24-Oct-11	OW	35.32	58.00
30-Jan-12	OW	37.10	52.00
23-Apr-12	OW	33.29	45.00
05-Jun-12	OW	29.12	44.00
06-Jun-12	OW	28.13	42.00
31-Jul-12	OW	33.55	47.00
11-Sep-12	OW	34.27	43.00
27-Nov-12	OW	32.04	45.00

18-Dec-12	OW	34.80	44.00
08-Jan-13	N	36.19	42.00
28-Jan-13	N	40.28	45.00
19-Feb-13	OW	42.81	52.00
23-Apr-13	OW	39.29	53.00
23-Jul-13	OW	45.08	54.00
25-Jul-13	NR	45.98	--
26-Aug-13	OW	48.44	57.00
11-Sep-13	OW	50.32	64.50
22-Oct-13	OW	50.66	65.00
08-Nov-13	OW	53.90	67.50
22-Jan-14	OW	50.54	66.50
26-Feb-14	OW	55.58	77.00

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