12 September 2017 | Sector Update

Oil and Gas sector

***Negative* (for upstream)**
***Positive* (for downstream)**

Sustained crude oil price not translating to higher capex

- **Global crude oil prices expected to remain volatile on the upside**
- **2017 Brent crude oil price average likely to exceed our house expectations of USD50pb**
- **Sustained crude oil prices however not translating to higher capex by global oil majors**
- **Higher activity levels seen but rates remain depressed**
- **Recommend exposure into oil and gas downstream and utilities related companies**

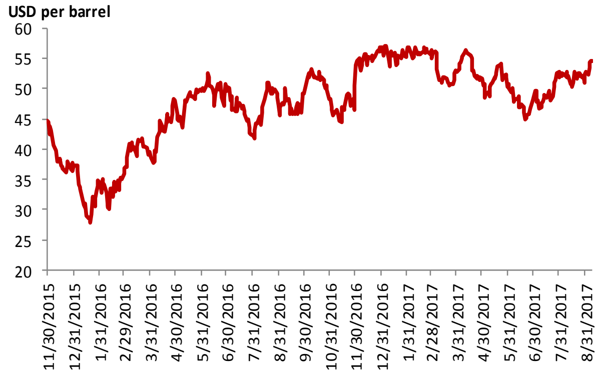
Crude oil price review. Crude oil prices for 2H17 have been relatively volatile on the upside as prices sustained above USD50pb for most times. The comparatively strong global crude oil prices in 2H17 are largely due to: (i) Positive data on U.S inventory levels; (ii) Strong macroeconomic data from the Americas and Europe; (iii) tapering in OPEC production levels; and (iv) disruptive weather phenomenon. Year-to-date 2017, Brent crude oil price averaged USD52pb and we believe that global crude prices will be able to sustain above USD50pb until year end, exceeding our house target of an average USD50pb for 2017. Our FY18 Brent crude price forecast is a conservative USD55pb premised on: (i) moderate global GDP growth; and (ii) average world liquid fuels consumption growth forecasts of +1.67% compared with production growth of +1.97% from 2017 to 2018.

Sustained global crude oil price not translating to higher capex spend. Despite the comparatively stronger global crude oil prices, value of offshore contracts remain subdued - this is contrary to traditional believes that strong crude oil price will translate to more upbeat offshore activity levels and higher value of contracts. This notion of strong and stable crude oil prices not translating to higher value of offshore project is corroborated by the expected capital expenditure (capex) plan by oil majors. On average, total capex spend by global oil majors in the exploration and production realm for 2018 is expected to decline year-over-year by -2.2%. Locally, PETRONAS has reiterated that its capex plan is largely geared towards the downstream sub segment of the oil and gas value chain. Local maintenance, repair and upkeep of offshore assets have also been slow (with long-drawn delays), with sources indicating that there will be approximately -70% fewer jobs moving forward compared with levels seen pre-2014.

Offshore assets not expected to fare well in short-medium term. Although the uptick in global crude oil prices of late has been positive in terms of offshore activity levels (evident by higher asset utilisation rates), charters rates continue to remain depressed and are expected to remain low throughout 2017 into 2018. Currently, as of July 2017, the Southeast Asian jackup utilisation rate (UR) is at 69% compared with 40% a year earlier. However, charter rates for jackups in SEA remain depressed at approximately USD50-60k per day. Current charter rates for offshore support vessels (OSV) in SEA are depressing even further to a current low of USD0.70 per brake horsepower per day (for the common 5,000bhp anchor handling tug and supply). We reiterate our view that UR and charters rates will not be staging meaningful improvements throughout 2017 into 2018.

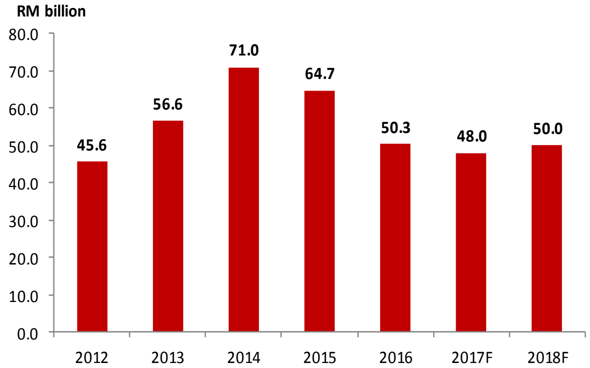
Maintain downstream POSITIVE and upstream NEGATIVE. Due to the persistent struggle in global crude oil prices to make meaningful upside recovery, relatively slower upstream activities and charter rates stress on offshore heavy assets, we are maintaining our **Negative** stance on the upstream oil and gas sub-segment. We are however reiterating our **Positive** stance on the downstream sub-segment as we see continuous growth in this sub-segment from Petronas' committed capital expenditure plan focusing on downstream oil and gas segment. We are recommending safe exposures into **Gas Malaysia Berhad (BUY; TP: RM3.50)** and **Petronas Dagangan Berhad (BUY; TP: RM28.00)**. In addition, we are recommending opportunistic buy into **Petronas Chemicals Group (BUY; TP: RM8.18)** premised on stronger demand, firmer product average selling prices and also better profit spreads. We opine that the downstream utility and retail fuel segment will continue to register commendable year-over-year earnings growth, offer above risk-free rate dividend yields and acceptable capital upside.

Figure 1 : Brent Crude Oil Price



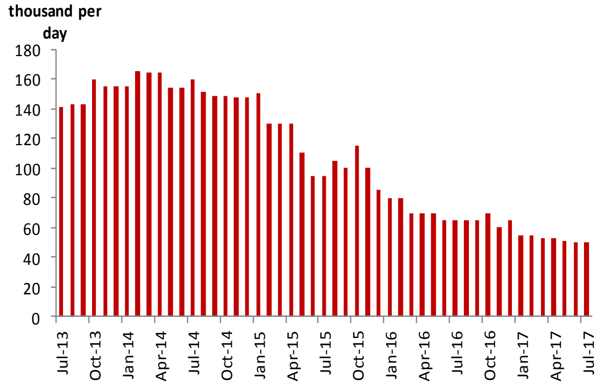
Source : Bloomberg

Figure 2 : PETRONAS Capital Expenditure (RM billion)



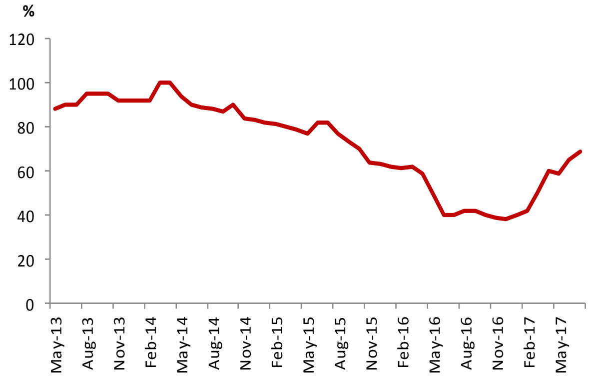
Source: PETRONAS

Figure 3 : South East Asia Jackup Rates (USD thousand)



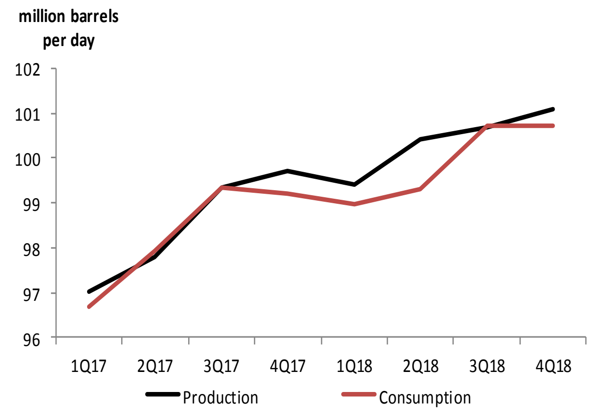
Source : IHS

Figure 4 : South East Asia Jackup Total Contract Utilisation (%)



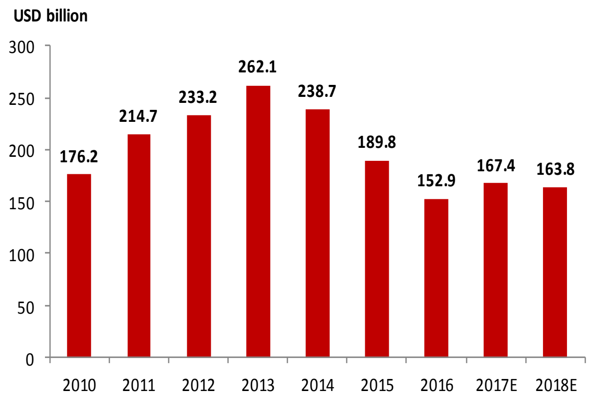
Source : IHS

Figure 5 : Global Crude Oil Production and Consumption (million barrels per day)



Source: Bloomberg

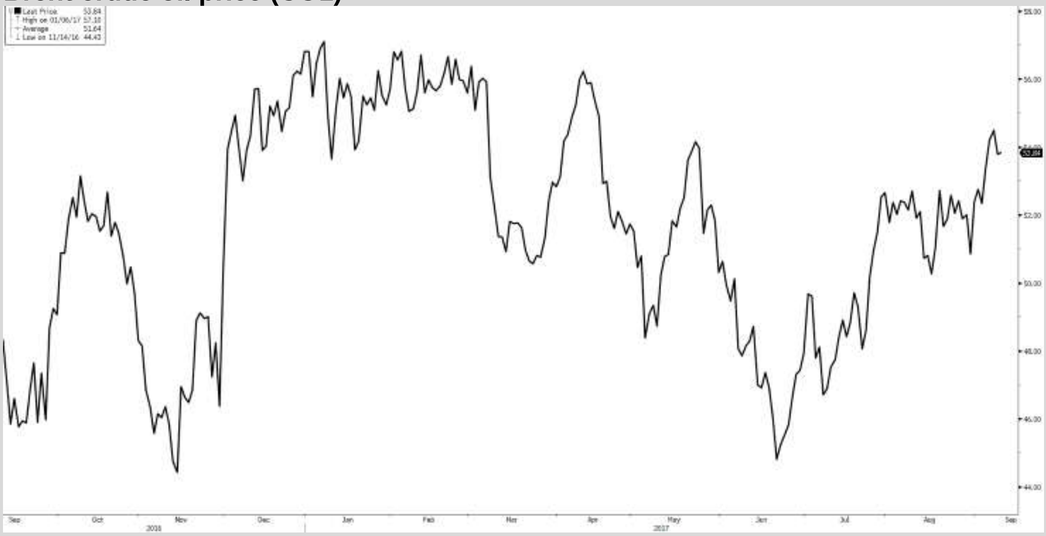
Figure 6 : Global Oil Major Exploration and Production CAPEX



Source: Companies, Bloomberg

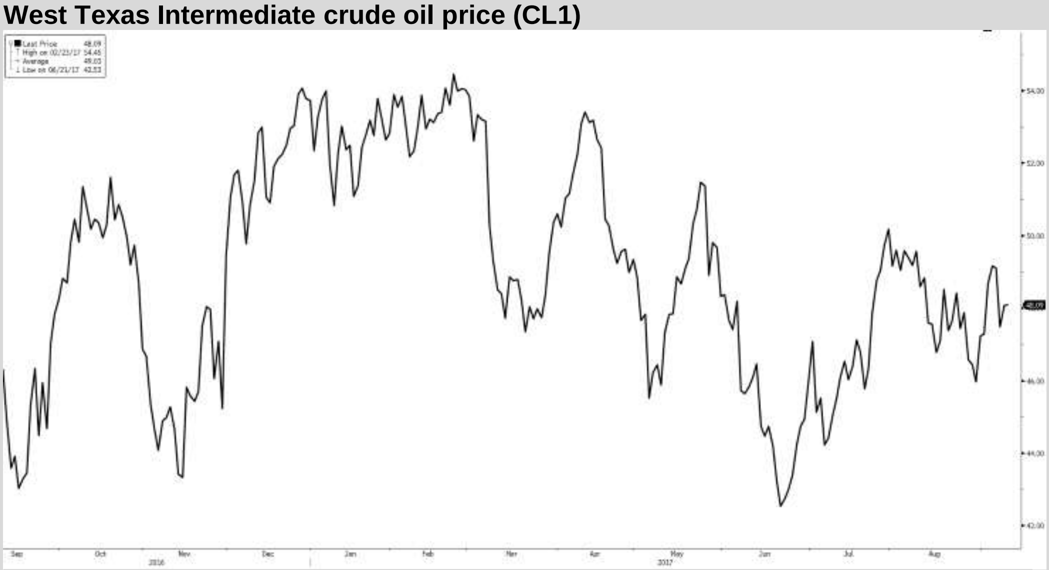
DAILY PRICE CHART

Brent crude oil price (CO1)



Source: Bloomberg, MIDFR

West Texas Intermediate crude oil price (CL1)



Source: Bloomberg, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.