

07 April 2016 | Sector Update

Oil and Gas sector

Negative (for upstream)
Positive (for downstream)

Downstream activity levels to remain buoyant

- **Activity levels in RAPID Pengerang expected to peak in 2016/2017**
- **Oil prices stabilised as major OPEC and non-OPEC producers try to reach an accord limiting supply**
- **Avoid stocks involved in OSV market, heavy fabrication and drilling rigs**
- **Recommend exposure in O&G stocks involved in RAPID and downstream activities to ride on potential upside in crude oil prices**
- **Maintain POSITIVE on downstream and NEGATIVE on upstream with 2016 average Brent crude oil price assumption of USD40pb**

Activity levels in RAPID expected to peak in 2016-2017. Based on the intensity and value of contracts awarded by PETRONAS in the past six months (refer to Table 1 on next page), we believe that the construction and downstream activity levels for the PETRONAS Refinery And Petrochemical Integrated Development (RAPID) would peak in 2016-2017. Apart from that, human capital requirements for RAPID would also peak during this period, from the lower skilled to highly skilled labourers.

Oil prices seem to have stabilised. During 1QFY16, Brent crude oil prices have increased by +8.6% reaching a high of USD41.8pb. The current year-to-date average price is approximately USD31.9pb. We believe that Brent crude prices could remain stable, hovering around USD40pb largely due to the anticipation that global major from OPEC and non-OPEC nations agreeing to control output to achieve price stability. In addition, the macroeconomic climate in China seems to be stabilising giving hope to sustained crude oil demand from China. The stability in crude oil prices is also a result of dwindling U.S. rig counts to fresh all-time lows compared with a year earlier. Our 2016 Brent crude oil average price is maintained at USD40pb.

Downside risk persists. Despite the current macro situation pointing towards a recovery in oil prices, we acknowledge that the upward potential in crude oil price trend is largely dependent on major OPEC and non-OPEC oil producing countries limiting supply. This poses a downside risk as the accord is highly reliant on Saudi Arabia and Iran striking a deal to limit supply together.

Avoids. Given the lacklustre upstream oil and gas exploration and production climate, we are recommending investors to avoid: (i) Oil and gas service providers which are involved in the offshore support vessels (OSV) sub-segment; (ii) Service providers whose main income is derived from heavy fabrication; and (iii) Drilling rig owners as the day charter rates (DCR) and rig demand is at a very depressed level (refer to our previous sector report dated 12 February 2016).

Potentials and opportunities. We are however recommending stocks which are: (i) Involved in RAPID projects; (ii) Have diverse business divisions and revenue streams; and (iii) Involved in downstream businesses.

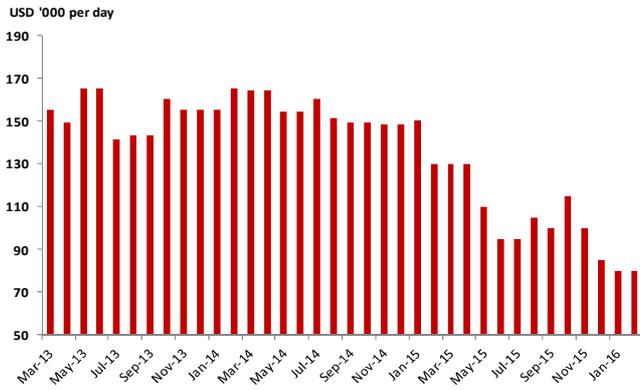
Stock recommendations. For RAPID exposure, we are recommending downstream specialty companies such as KNM Group Berhad (BUY; TP: RM0.62) and Muhibbah Engineering Berhad (BUY; TP: RM3.05). We are also recommending SapuraKencana Petroleum Berhad (BUY; TP:RM2.72) as we believe that upticks in oil prices will bode well for the stock price as the company has exposure to upstream oil and gas production as well as having a well-diversified (both business and geographical diversification) business structure. For downstream exposure, we are reiterating our Buy recommendation on Gas Malaysia Berhad (BUY; TP: RM2.87) as we believe the adoption of the Incentive-Based Regulation (IBR) regime will provide better earnings visibility and predictability.

Table 1: Contracts awarded in RAPID past six months

No.	Job	Contractor(s)	Value (RM million)	Date awarded
1	Sub-contract works including general building works for electrical substation and field auxiliary room, foundations, superstructures, internal roads, paving, underground piping, trenches, manholes, pits, basins and related works.	Ho Hup Construction and KNM Group	57.77	28-Mar-16
2	Supply of 28 275-kV NET transformers for PETRONAS' refinery in Pengerang, Johor	Siemens	na	8-Mar-16
3	Construction of linear low density polyethylene (LLDPE) plant and an ethylene glycol (EG) plant.	Samsung Engineering	3500	8-Dec-15
4	EPCC contract for a 900,000 tonnes per annum polypropylene plant	Consortium of Tecnimont S.p.A, Huanqiu Contracting & Eng. Corp, Tecnimonthqc Sdn Bhd, and TecnimontHQC S.c.a.r.l.	2000	24-Nov-15
5	Contract for utilities, interconnecting and offsite (UIO) facilities: procurement, construction and commissioning (PCC) of civil & infrastructure works at storm drain central area	WCT Construction	323	15-Dec-15
6	Construction of utilities, interconnecting and offsite facilities, engineering, procurement, construction and commissioning of substations, field auxiliary rooms, operator shelter building and local control building	WCT Construction	316	12-Nov-15
7	Construction of workers village and temporary construction facilities for the utilities, interconnecting and off-site (UIO) facilities	Mudajaya Group	489	15-Sep-15
8	Engineering, procurement, construction and commissioning for Petronas Rapid Temporary Executive Village and Petronas Rapid Temporary Management Office Facilities	Muhibbah Engineering	300	1-Dec-15
9	Contract for the design for the re-feed and engineering, procurement, construction and commissioning of the effluent treatment plant.	Muhibbah Engineering	950	3-Sep-15

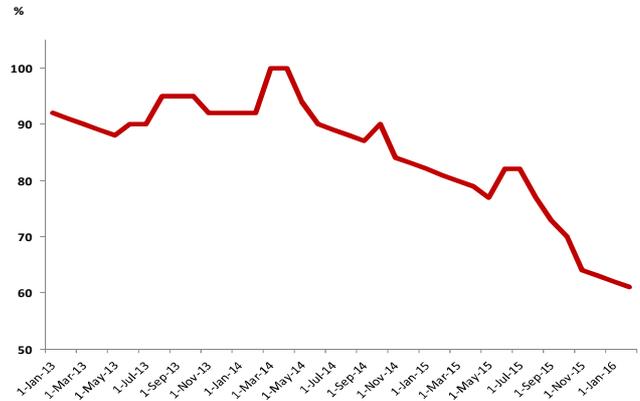
Source: Bursa Malaysia, Media, Various

Figure 1: Average Day Charter Rates for Southeast Asia Jackup 361-400 IC



Source: MIDFR, Rigzone

Figure 2: Total Contracted Utilisation for Southeast Asia Jackup 361-400 IC



Source: MIDFR, Rigzone

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 <i>rise</i> 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 <i>fall</i> 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.