

24 January 2017 | Sector Update

## Oil and Gas sector

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

### ***Unenthusiastic utilisation and day rates***


- **Marketed utilisation rate for overall rigs within Asia Pacific region as at end-December 2016 is still weak at 51%**
- **Market for Southeast Asia jackup rigs (361-400 IC) remains weak although average day charter rates (DCR) have inched up to USD75k per day**
- **Utilisation rates for jackups remain depressed at 38% indicating persistent supply glut**
- **Utilisation rates for tender rigs is currently at 50% in South East Asia**
- **Maintain POSITIVE on downstream and NEGATIVE on upstream with 2017 average Brent crude oil price assumption of USD50pb**

**Offshore drilling market remains lacklustre.** Despite the pickup and stabilisation of global crude oil prices (year-to-date 2017 average at USD55.5pb compared with 2016 average of USD45.1pb), the offshore drilling market is still unenthusiastic as utilisation rates for overall rigs in Asia Pacific is still hovering at just above >50%. We believe that utilisation rates and average day charters rates will remain in a lull for an extended duration throughout this year as offshore exploration and new production activities remain subdued. The call of OPEC and other non-OPEC major oil producers to contain crude production serves as a potential dampener to further offshore drilling.

**Capex to benefit existing production fields, maintenance works and downstream projects.** In 2016, capital expenditure (CAPEX) for major global oil and gas producers including independent exploration and production companies had declined by close to -30%yoy. In 2017 however, the outlook remains rosier as CAPEX is expected to pick up pace by a humble +2.8%. We believe that the bulk of the capex is maintenance in nature and dedicated to enhancing productions in existing fields, as well as lucrative downstream projects. Locally, PETRONAS' FY17 CAPEX is expected to hover at levels seen in 2016 as the bulk of CAPEX will be dedicated towards RAPID in Pengerang, Johor, similar in trend with that of other international oil majors.

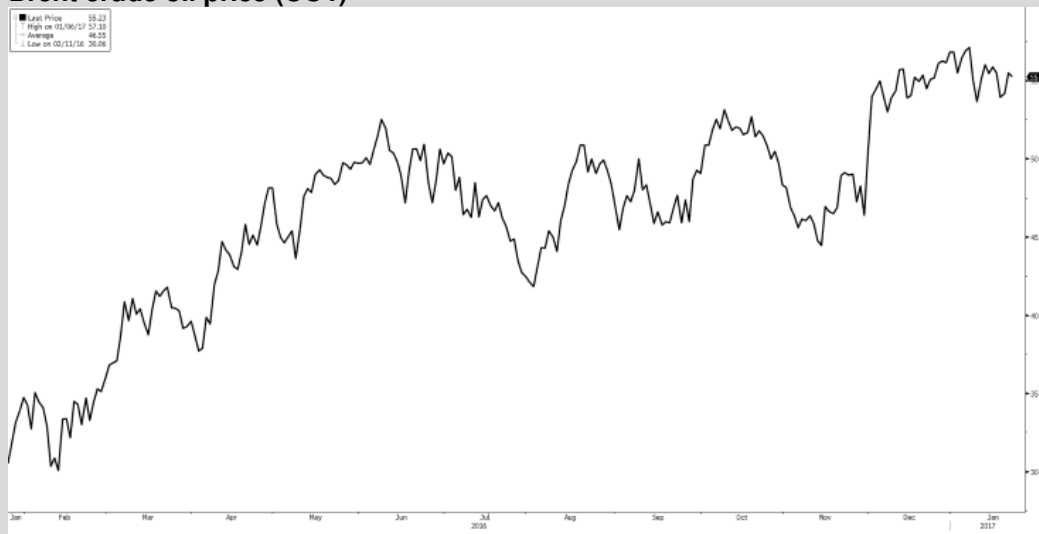
**Poor utilisation rates persist and even poorer DCR.** Utilisation rates for 361-400 IC jackup rigs in Southeast Asia have further deteriorated to 38%, one of the lowest monthly levels recorded since the slump in crude oil prices in the summer of 2014. On a slightly brighter note, the average day charter rates (DCR) have ticked up to USD75k per day from a low of USD65k per day recorded in 3QCY16. As was seen in the recent proposal to demerge **UMW Oil and Gas Berhad** (unrated) from **UMW Holdings Bhd** (Trading Buy; TP: RM5.15) and to then merge the former with **Icon Offshore Berhad** (unrated) and Orkim Sdn Bhd (unlisted), such a corporate exercise we believe is a strategic move to diversify the income stream from largely relying on jackup rigs to include other services in the oil and gas services value chain.

**Tender rigs not fairing any better.** Although the general utilisation rates for tenders are generally better (50%) compared with that of jackups in the South East Asian region, the average day charter rates for tenders are still very much depressed at approximately USD128k per day – a four-year low. Excluding assets which are under construction, retired, destroyed, deemed non-competitive or cold stacked, the average utilisation rate would have been 67%, up from 64% in January 2016.

**Recommendations.** In view of the volatile and relatively negative sentiment shrouding the upstream segment of oil and gas industry, we are recommending investors to avoid oil and gas service providers which are asset heavy, labour intensive and have high gearing levels. Instead, we are advising investors to cherry-pick stocks which are at reasonable valuation levels and are positioned in a niche segment of the oil and gas services value chain. We are bullish on **Deleum Bhd (BUY; TP:RM1.25)** as it offers niche services in the oil and gas industry and **Gas Malaysia Berhad (BUY; TP:RM3.07)** for its earnings clarity and dividend attractiveness. 

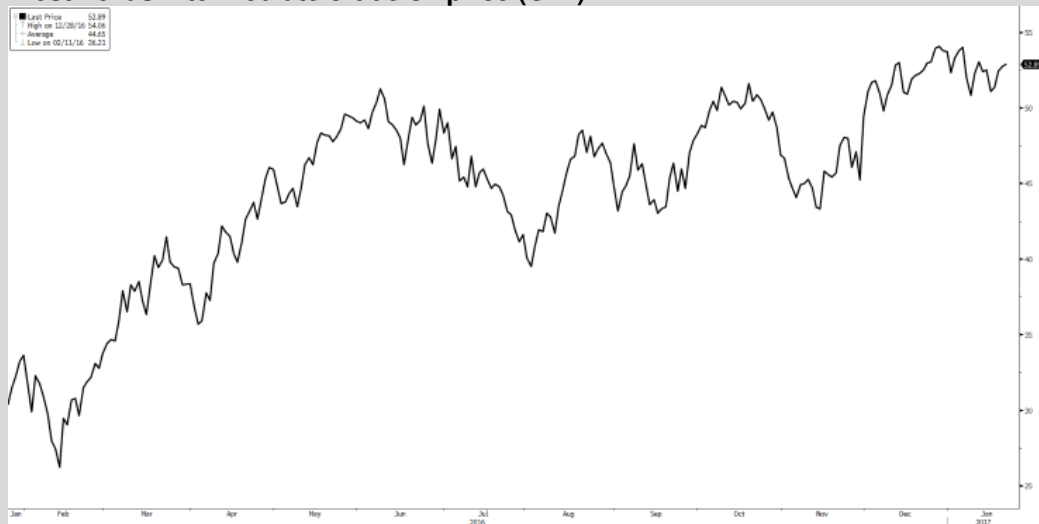
## DAILY PRICE CHART

### Brent crude oil price (CO1)



Source: Bloomberg, MIDFR

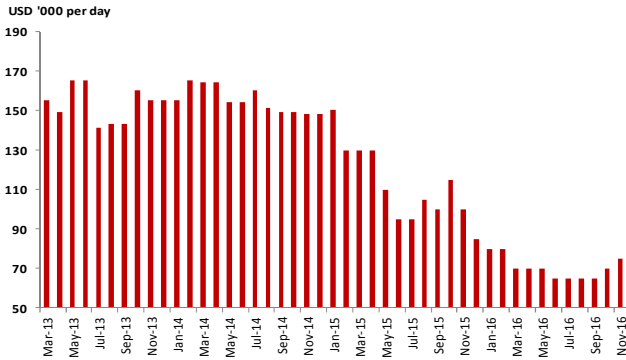
### West Texas Intermediate crude oil price (CL1)



Source: Bloomberg, MIDFR

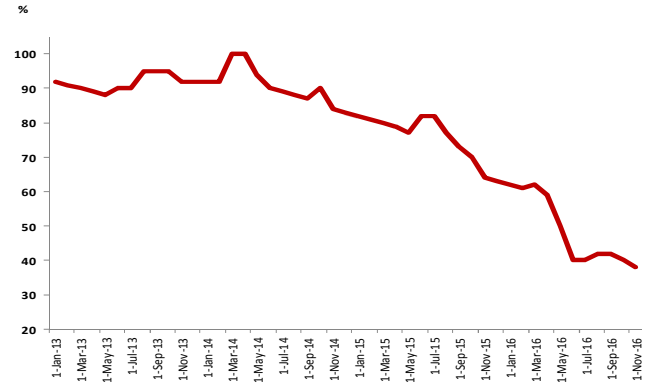
Aaron Tan Wei Min  
aaron.tan@midf.com.my  
03-2772 1650

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



Source: MIDFR, Rigzone, IHS, InfieldRig

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



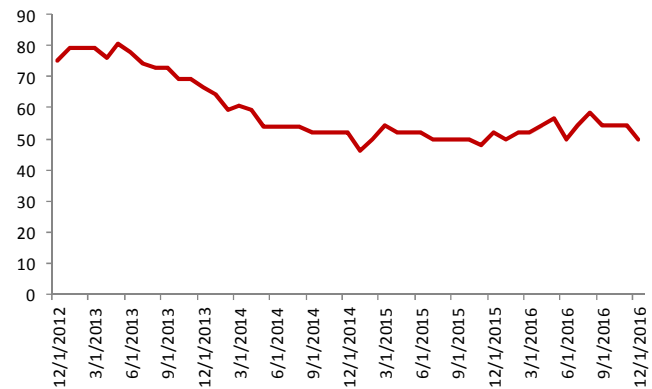
Source: MIDFR, Rigzone, IHS, InfieldRig

**Figure 3: Utilisation Rates for Global Tender Rigs**



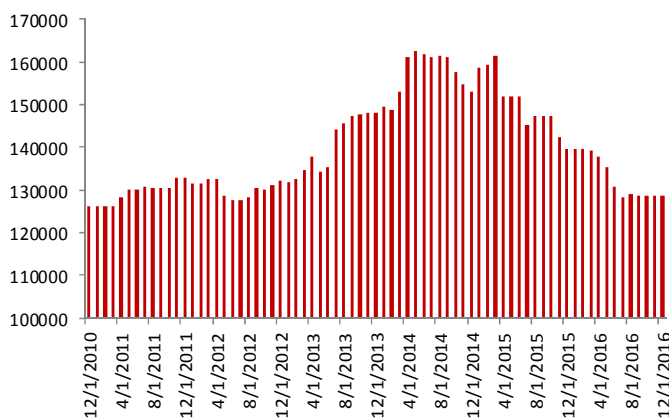
Source: MIDFR, Rigzone, IHS, InfieldRig

**Figure 4: Utilisation Rates for Southeast Asia Tender Rigs**



Source: MIDFR, Rigzone IHS, InfieldRig

**Figure 5: Average Day Charter Rate for Tender rigs**



Source: MIDFR, Rigzone IHS, InfieldRig

**Table 1: Current Utilisation Rate for Rigs Worldwide**

Rigs	Total Rigs	Contracted	Available	Current Utilisation
Drillship	96	65	31	67%
Jackup	405	226	179	55%
Semisub	117	64	53	54%
Tenders	28	19	9	67%
<b>TOTAL</b>	<b>646</b>	<b>374</b>	<b>222</b>	<b>57%</b>

Source: MIDFR, Rigzone IHS, InfieldRig

\*Utilisation is for drillships, semisubs, jackups and tender rigs

\*\*excludes assets which are under construction, retired, destroyed, deemed non-competitive or cold stacked

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#### 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.