

02 October 2014 | Sector update

Oil & Gas sector

Reiterate POSITIVE

Local oil and gas service providers to remain resilient

WTI Crude: USD90.73pb

- Global crude oil prices have slumped dramatically in the second half of the year
- Despite weak crude oil prices, local oil and gas stocks are expected to remain resilient
- Local offshore activity levels are expected to remain buoyant
- Reiterate POSITIVE stance on oil and gas sector

Global oil price movements. Global crude oil prices have taken a rough beating thus far in the second half of this year. From its high of USD107.26pb achieved in June 2014, the West Texas Intermediate (WTI) price has since slumped by -15.4% to a near two-year low of USD90.73. Year-to-date, WTI price has been sluggish, retreating by -7.4% from the year's opening price of USD98.42pb. However, from the average year-to-date perspective, WTI price is still buoyant at USD99.57pb. This is higher compared with 2013 and 2012's average price of USD98.02pb and USD94.15pb respectively. One of the main reasons for the steep drop in oil prices the past couple of weeks was due to the expanding oil stockpile in the U.S., increasing global supply and also an anticipated decrease in demand growth from top consumers China and Europe.

Stocks on Bursa Malaysia. Despite global oil prices taking a steep dive, locally listed oil and gas stocks continued to remain resilient. In our opinion, this was largely due to the lack of strong short-term correlation between the revenue drivers of these stocks and the global oil price movements. The reason for this is simple – our locally listed oil and gas stocks are mostly service providers and not oil producers. Hence they are not directly linked to the sale of crude oil. Having said the above, it is undeniable that should oil prices fall further to below the breakeven levels, the service providers would arguably be affected as oil producers may then decide to downsize, defer or even call-off some of their capital expenditure programme. But that is not the case as yet with oil prices still hovering above USD90pb and year-to-date average WTI price is close to USD100pb.

Correlation. Naturally, crude oil prices would have a strong correlation with price trends of oil producers as the companies derive its revenue from the extraction and sale of hydrocarbons. Logically, we would then expect a weaker correlation between oil prices and oil and gas service providers as its revenue is not derived from the sale of hydrocarbons. Table 1 and Table 2 show the correlation between oil prices and sample companies.

Table 1: Correlation between WTI crude oil price and international oil companies (oil producers)

Company	Royal Dutch Shell	British Petroleum	Total S.A	Statoil	Exxon Mobil	Chevron	Petroleo Brasileiro	Petro China
Correlation	0.7	-0.3	-0.1	0.3	0.7	0.7	0.2	0.5
Strength	Strong	-	-	Weak	Strong	Strong	Weak	Moderate

Table 2: Correlation* between WTI crude oil price and locally-listed companies (service providers)**

Company	Dayang	KNM Group	Gas Malaysia	Petronas Gas	Petronas Chemicals	Bumi Armada	MMHE	Wah Seong	Dialog Group
Correlation	0.4	0.1	0.6	0.5	0.6	0.2	-0.1	0.2	0.6
Strength	Moderate	Weak	Moderate	Moderate	Moderate	Weak	-	Weak	Moderate

* Data sample taken from 2006 to present

** Sample is based on stocks under MIDFR's coverage

From Table 1, we note that Shell, ExxonMobil and Chevron have strong positive correlations with WTI oil prices. However, from Table 2, none of the stocks under our universe of coverage have strong positive correlations with WTI oil price. Moreover, most of the companies which have moderate relationships are, in essence, downstream utilities companies. In addition, we ran the correlation test for other service providers from the offshore support vessel chartering segment. For Perisai Teknologi Bhd, Alam Maritim and Perdana Petroleum, the correlations with WTI oil price are between weak to moderate. From these simple observations, we can safely conclude that (i) our locally-listed oil and gas service providers are resilient, at least in the short-term, to negative global oil price movements, and (ii) this condition holds true for as long as the prevailing oil prices remain above its production breakeven cost.

We continue to believe that the local oil and gas sector shall remain vibrant. Our view is premised on sustained capital expenditure and operating expenditure commitments by global oil producers. Although there are views that the WTI and Brent prices will hover around the USD90pb level for an extended period of time, it is a norm for global producers to plan capital expenditure based on a long-term oil price assumption of approximately USD90pb. In Malaysia, the average breakeven cost for shallow water oil production is approximately USD20-30pb. Deepwater breakeven cost is markedly higher at approximately between USD50-70pb. As such, there is still a large price gap for oil producers to profit from the production of oil and gas and, more importantly, to continue on with their capital expenditure programme.

Maintain POSITIVE. We are reiterating our **POSITIVE** stance on the oil and gas sector. Our top buys are **Dayang Enterprise Holdings Bhd** (BUY; TP: RM4.37) and **SapuraKencana Petroleum Bhd** (BUY; TP: RM5.59). 

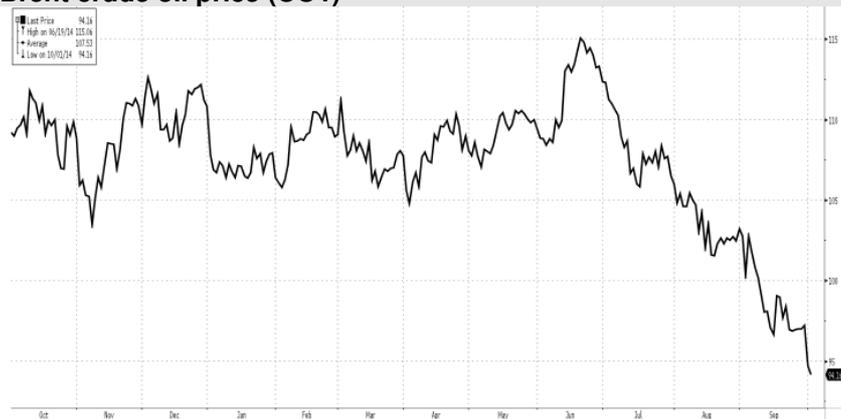
DAILY PRICE CHART

West Texas Intermediate crude oil price (CL1)



Source: Bloomberg, MIDFR

Brent crude oil price (CO1)



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.