Equity Beat
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03 December 2014 | Sector Note

Oil & Gas sector

***Reiterate* POSITIVE**

Expect oil prices to find support at current levels

- **Crude oil prices continued to be suppressed by global supply pressure**
- **We are expecting global crude oil price to average between USD75-85pb in 2015**
- **Despite the negative sentiments on crude oil prices, we are expecting local offshore activities to remain resilient**
- **Reiterate POSITIVE on sector moving into 2015**

Oil price in 2014. Since the start of 2014, global Brent crude oil prices have slumped by more than 30%, from above USD100pb to levels breaching below USD70pb. The main cause of the generally weak oil prices was the abundance in global supply. This matter was further exacerbated by the Organization of Petroleum Exporting Countries' (OPEC) reluctance to reduce oil production to below 30mbpd. Year-to-date average price of Brent crude is nonetheless remains above USD100pb.

Oil price outlook into 2015. As alluded to in page 13 of our thematic report dated 17 November 2014 titled *Living in a world of cheaper oil*, we pointed that "As such, [crude oil] prices may soon reach the sweet spot plausibly in the range of USD75-80pb where price equilibrium support is met." True enough, the price of Brent crude oil recently reached and even breached the so-called sweet spot. Even so, we are sanguine that prices shall revert higher in due course to reflect the fiscal as well as asset breakeven levels of major producers. Nonetheless, we do not expect prices to rebound back to the levels last seen in the second quarter of 2014. Hence moving forward into 2015, we are now expecting Brent crude oil price to average between USD75-85pb, which is in line with the estimated price equilibrium support.

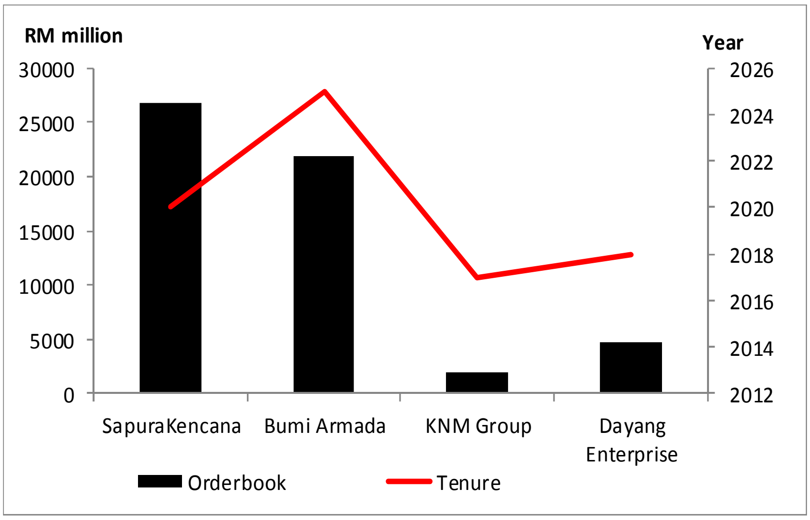
Local activities to remain robust. Despite the weakness in global crude oil prices, we are still expecting local oil and gas activities to remain robust, premised on the notion that our current oil production is still below 600kbpd. The latest available average production rate for Malaysia is at 580kbpd. As such, we are expecting offshore production activities to continue to remain robust, benefitting offshore service providers. Offshore support vessel operators are confident that charter rates will stay firm at USD1.85-2.00 per brake horsepower while offshore engineering and services providers noted that tenders are still being called.

The year of consolidation. Moving forward, 2015 could be a year of mergers and acquisitions within the local oil and gas services industry. Hence we could expect to see some small service providers merging among themselves or with the larger ones in order (i) to offer more holistic services and product offerings, (ii) to better compete with regional service providers, as well as (iii) to protect their profitability margins. Apart from that, we could also expect 2015 to be a year of increased acquisition activities of oil and gas assets such as offshore hydrocarbon fields. The main reason which could drive asset acquisitions is the rationalization of valuations. For example, when SapuraKencana recently announced its intention to acquire stakes in a few Vietnamese oilfields from PETRONAS, the long term average price forecast used in the valuation was sub-USD90pb, as opposed to previous examples of acquisitions which were valued at long-term prices in excess of USD90pb.

Rationalisation of valuations. For the past several years, we have seen the valuations for mid-to-large market capitalisation oil and gas services companies trading at price-to-earnings ratio (PER) multiples of between 20-30 times. However, since the recent slump in global crude oil prices, these mid-to-large sized service providers are now trading with PER in the teens. Moving forward, investors could expect this more tepid multiple as the 'new norm' in the valuation oil and gas service providers.

Advocating stocks with strong orderbooks. Although we remain **POSITIVE** on the sector, we advise investors to be selective on oil and gas stocks. We are advocating stocks with (i) strong orderbooks, (ii) diversified sources of income, and (iii) long burn rates. Companies with strong orderbooks and long burn rates would be more resilient against violent fluctuations in industry sentiments, crude oil prices and during quiet periods of new contracts scarcity. In addition, due to the global nature of the oil and gas industry, geopolitical risks remain a concern. Notable recent example of geopolitical risks in 2014 were the fiasco involving Petróleo Brasileiro S.A. a.k.a Petrobras of Brazil which affected oil and gas services providers associated with the company. As such, we also favour service providers with well diversified sources of income and also companies with local contracts which are easier to monitor.

Chart 1: Orderbook and burn-rate



Source: MIDFR, Companies

DAILY PRICE CHART

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 *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.