

18 June 2014 | Sector update

## Oil & Gas sector

Spike in oil prices – short term trading opportunity

**Reiterate POSITIVE**

WTI Crude: USD106.5pb

- The West Texas Intermediate & Brent crude prices have jumped +4% and +4.1% respectively in June 2014
- Main cause for the surge is the prospect of supply disruption due to Iraq
- The spike in oil prices offers potential opportunistic trading ideas
- Consider short term exposure in Malaysian offshore services counters

**Security and political turmoil in Iraq.** In recent weeks, the alleged militant group called the Islamic State in Iraq and Syria (ISIS) has been on an offensive in northern region of Iraq. News reports have indicated that ISIS have overrun Iraq's 2<sup>nd</sup> largest city, Mosul and have previously set foot in Falluja and parts of Ramadi. Latest news reports have shown that gun battles have erupted in the city of Baquba, less than 60km from the north of Baghdad.

**Iraq as a major oil producer.** Iraq is currently the 2<sup>nd</sup> in terms of largest oil reserves after Saudi Arabia amongst the Organization of the Petroleum Exporting Countries (OPEC), producing approximately 3.4mbpd of oil. This represents around 3.75% of the total global oil production. Although most of the turmoil is situated in the northern part of Iraq and most of the major oil fields are located in the southern region of the country, this turmoil brings worries to the oil infrastructure such as pipelines and refineries. Around 10% of the oil export passes through the north. Latest reports have also indicated that Iraq's largest oil refinery Baiji has been shut down and its foreign staff evacuated. Media sources also noted that Baiji is one of three oil refineries in Iraq and only produces oil from the north. The other two are in the south.

**Short term opportunity of Malaysian oil and gas service providers.** Although we do not wish for the turmoil and bloodshed to persist, we do see a short term opportunistic trading window for local oil and gas counters involved in offshore services. We believe that the increase in oil prices and the threat of global oil supply will cause oil producing countries such as Malaysia to boost production levels to take opportunity of high oil prices and to meet global demand. Companies which could see potential immediate business impact from sudden increase in offshore activities are offshore support vessel (OSV) operators and drilling equipment suppliers. OSV operators could charge 20-30% higher rates for spot charters to ferry workers and equipment, and equipment suppliers could see immediate demand for drilling fluids, mud etc. The table below shows the potential short term beneficiaries:

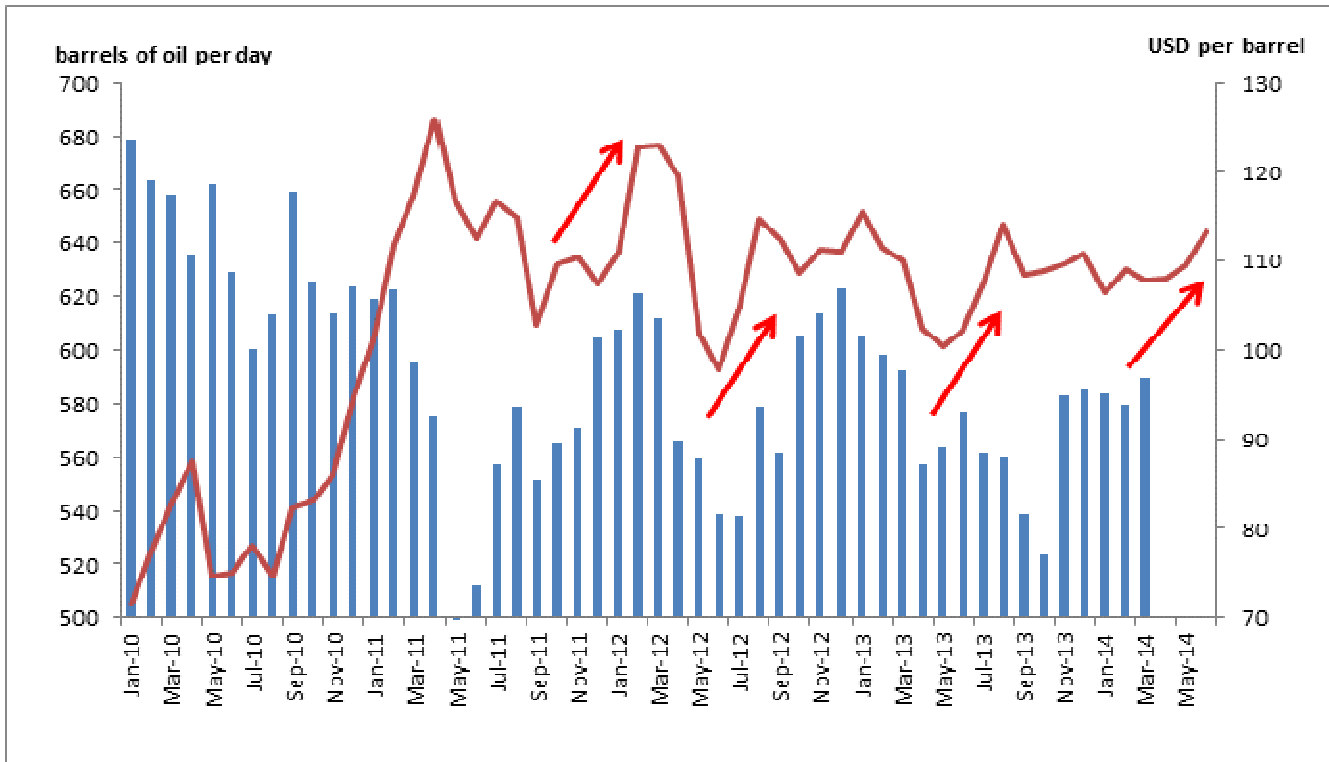
**Table 1: Potential short term offshore service providers beneficiaries**

No.	Company	Business
1	SapuraKencana (BUY)	OSV, offshore support services, engineering
2	Bumi Armada (BUY)	OSV
3	SILK Holdings (NR)	OSV
4	Alam Maritim (NR)	OSV
5	Uzma (NR)	Drilling chemicals, fluids, mud, water injection services
6	Scomi Energy (NR)	Drilling fluids and chemicals
7	Deleum (NR)	Slickline services

Source: MIDFR

NR = Not rated

Chart 1: Malaysia daily production rate (left hand side blue bar) versus oil prices (right hand side red line)



Source: Bank Negara Malaysia, Bloomberg

**Room for Malaysia’s oil production to rise further.** Under the National Depletion Policy, production is limited to 3% of oil initially in place (OIIP). As a result of this policy, the total production of crude oil is currently limited to about 650,000 barrels per day. Since 4Q2010, Malaysia’s oil production has not exceed 650kbpd and from the chart above, there is clearly more headroom for production to rise as oil prices increase.

**Maintain POSITIVE on sector.** We are maintaining our **POSITIVE** stance on the oil and gas sector riding on sustained support from PETRONAS capex spending, international oil companies spending, stubbornly high oil prices, positive sentiments from the increased activities from PETRONAS’ RAPID project in Pengerang. 

## DAILY PRICE CHART

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



Source: Bloomberg, MIDFR

### Brent crude oil price (CO1)



Source: Bloomberg, MIDFR

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

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).  
(Bank Pelaburan)  
(A Participating Organisation of Bursa Malaysia Securities Berhad)

## DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

### 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.