

22 January 2016 | Sector update

Oil and Gas sector *Tumultuous season ahead*

NEGATIVE (for upstream)
POSITIVE (for downstream)

- **Year-to-date, Brent and West Texas Intermediate crude oil prices have declined by -24.1% and -22.0% respectively**
- **Fear of Iranian oil flooding the market is further depressing crude oil prices**
- **Revision of 2016 average Brent crude oil price to USD40pb from USD50pb previously**
- **Further downside towards an average of USD32pb seen for 2016**
- **Revising target price for SapuraKencana Petroleum Berhad to RM2.72 (previously RM2.89)**
- **Despite the headwinds face in the upstream segment, we are POSITIVE on companies involved in the oil and gas downstream value chain**

Oil price performance. Crude oil prices started 2016 on a steep downtrend as both Brent crude oil and West Texas Intermediate (WTI) crude oil have slipped by -24.1% and -22.0% respectively in just 14 trading days. The steep declines were largely due a slew of pessimistic news such as fear of rise in Iranian exports, IMF's downward revision for economic growth, turbulent Chinese stock market and swelling U.S. crude inventories – to cite a few.

Threat from Iran. Post lifting of sanctions on Iran, the top-10 oil producing nation globally could potentially flood the market with an addition 500-to-1,000kbpd of crude oil daily. Although the surge in production would not necessarily be immediate due to various factors such as licensing and contracting, major oil producers such as Lukoil, Total, BP, Shell, Statoil, Repsol, Eni, OMV and Mol have displayed interests to return to Iran after the sanctions are lifted. (Refer to average production costs table below)

Downward revision in 2016 average crude oil price forecast. Given the persistent weaknesses in crude oil prices which are further exacerbated by news of further oversupply from key producer Iran, we are revising our average Brent crude oil forecast for 2016 to **USD40pb** from USD50pb previously. We are only expecting crude oil price to have a chance of a significant rebound in 2H16. 1H16 will continue to be marred by negative news flow from the OPEC member countries especially from the Middle East.

Econometric forecast. However, using econometric modelling by taking into account factors such as global supply and demand, USD currency rates, global commodity rates and surplus production from OPEC, we have derived a 2016 base-case average Brent crude oil price forecast of approximately **USD32pb**.

Target price revision for SapuraKencana Petroleum Berhad. For 9MFY16, approximately only 16% and 14% of the group's revenue and operating profit were derived from the Energy segment – the hydrocarbon production arm of the company. For the nine month period, a total of 3.7mbbls were lifted and the company is targeting a total of 4.5mbbls for FY16 (5.1mbbls were lifted in FY15). In 3QFY16, the average realised price was USD48pb while its 9MFY16 realised price was USD57pb. These prices are on par with the trading Brent crude price during those periods. As such, in-tune with our downgrade in average oil price forecast for 2016 to USD40pb, we are revising our FY17 earnings downwards by -6.1%. We are still maintaining our **Buy** recommendation on SapuraKencana with a revised target price of **RM2.72** per share (previously RM2.89). Our target price is based on PER17 of 13x pegged to EPS17 of 20.9sen.

Earnings summary for SapuraKencana Petroleum Berhad

FYE Jan	FY13	FY14	FY15	FY16F	FY17F
Revenue (RM m)	6,912.4	8,378.8	9,943.0	9,185.3	9,222.8
EBIT (RM m)	1,104.4	1,845.6	3,106.6	1,517.4	1,526.9
Pretax Profit (RM'm)	829.8	1,207.8	1,616.0	1,423.1	1,434.6
Net Profit (RM m)	524.6	1,086.9	1,432.8	1,267.8	1,252.0
Normalised Net Profit (RM m)	-	-	1,209.4	1,267.8	-
EPS (sen)	10.5	18.1	23.9	21.2	20.9
EPS Growth (%)	-9.8	73.10	31.80	-11.50	-1.20
PER (x)	14.6	8.4	6.4	7.2	7.3
Net Dividend (sen)	0	0	4.4	3	3.5
Net Dividend (%)	0	0	2.8	2	2.3

Recommendations. Given the volatile and relatively negative sentiment shrouding the oil and gas industry, we are recommending investors to cherry-pick stocks which are specific to the downstream segment of the oil and gas industry. For exposure into Pengerang, we are recommending **KNM Group Berhad (BUY; TP: RM0.62)** as PETRONAS, via Petronas Chemicals Berhad (NEUTRAL; TP: RM5.49) has announced three petrochemical projects within PIPC and that KNM Group stands to be a beneficiary for the supply of specialized process equipment. For investors seeking exposure in a more predictable downstream company offering stable earnings, we are recommending **Gas Malaysia Berhad (Buy; TP: RM2.87)** as the adoption of the Incentive-Based Regulation (IBR) regime will provide better earnings visibility and predictability.

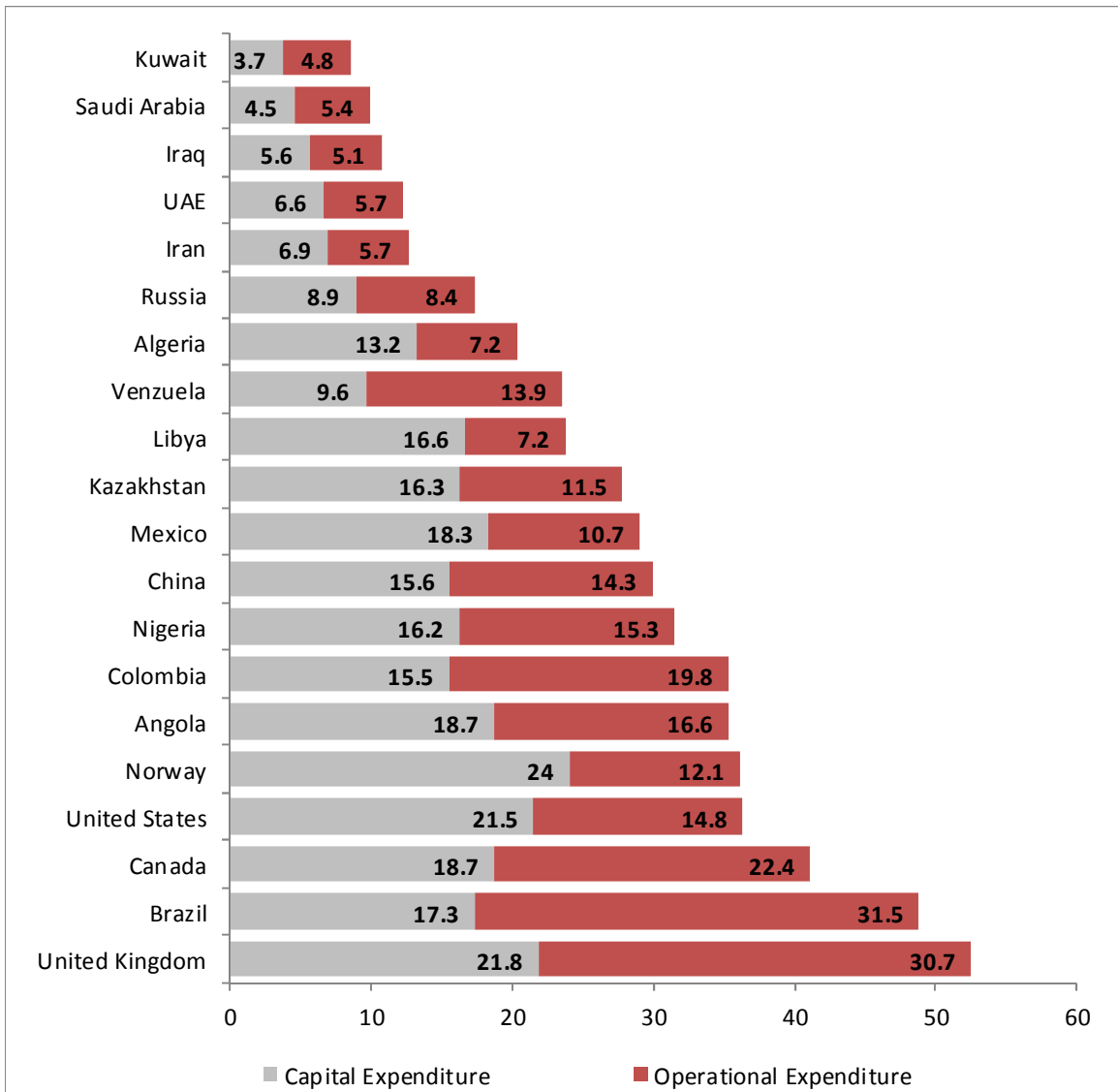


Fiscal breakeven prices for OPEC members

No.	Country	Fiscal Breakeven price (USD'pb)	Production (mbpd)
1	Saudi Arabia	105.60	10.25
2	Angola	110.00	1.79
3	Venezuela	117.50	2.38
4	Nigeria	122.70	1.9
5	Libya	269.00	0.43
6	Kuwait	49.10	2.73
7	Qatar	55.50	0.67
8	United Arab Emirates (UAE)	72.60	2.89
9	Iraq	81.00	4.2
10	Iran	87.20	2.88
11	Algeria	96.10	1.11
12	Equador	n.a.	0.53

Source: IMF Regional Economic Outlook Middle East Central Asia, Oct 2015, MIDFR

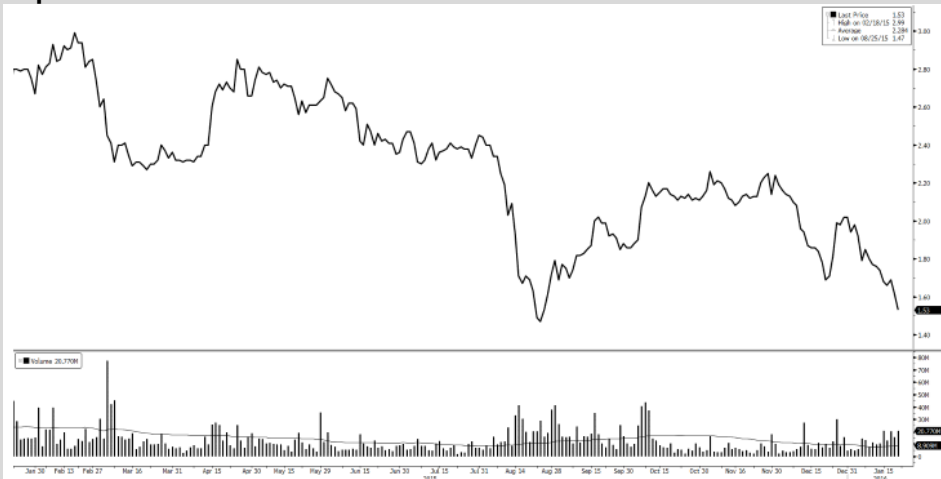
Average production cost per barrel (USD per barrel) of 20 largest oil producing countries



Source: Rystad Energy, MIDFR

DAILY PRICE CHART

SapuraKencana Petroleum Berhad



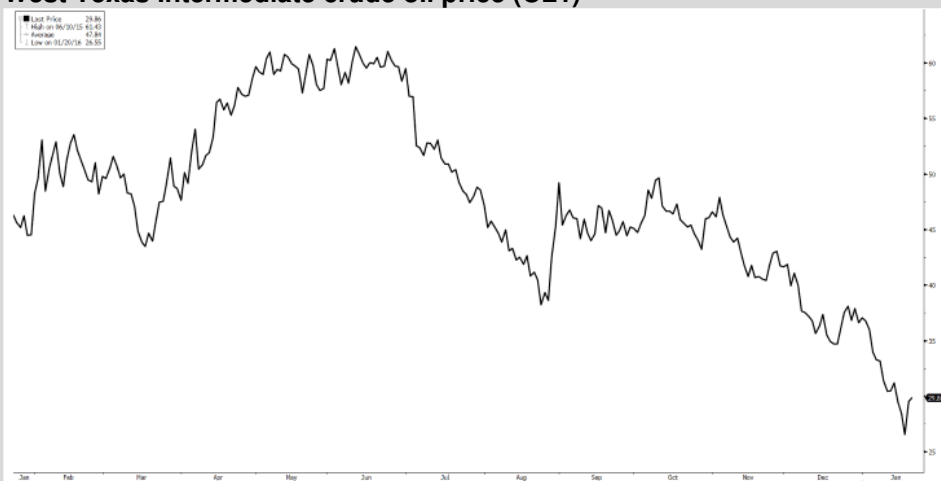
Source: Bloomberg, MIDFR

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.