10 January 2014 | Sector update

Oil & Gas Sector

Global capex may be tapering but local scene to remain colourful

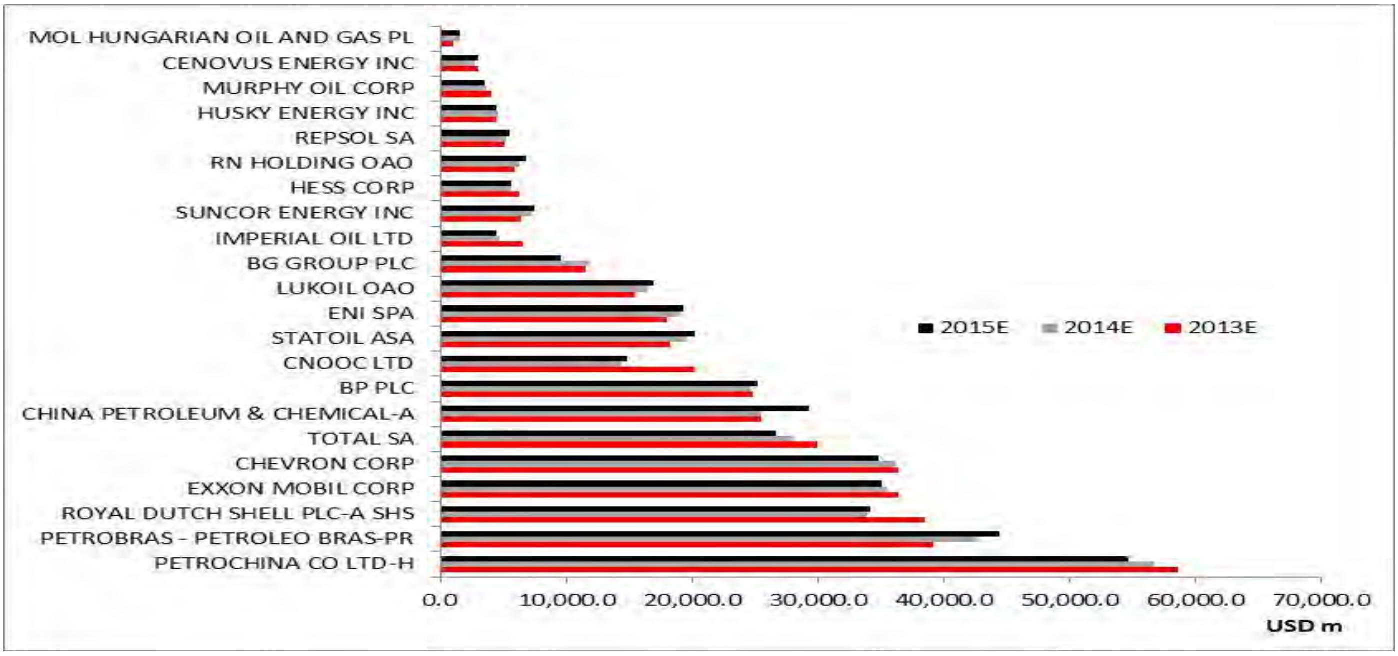
***Maintain* POSITIVE**

WTI Crude: USD92.70pb

Tapering global capex? Latest available data indicated that international oil companies (IOC) are collectively expected to cut exploration and production capex by -0.55% to USD541.3b in 2014 from a year earlier. However, capex is expected to rebound by +1.5% to USD549.5b in 2015. Albeit this minor setback in global capex expectations, 5-year historical compound annual growth rate from 2010 to 2014 (CAGR) remains strong at +6.8%.

Oil price a key determinant. Capex plans are correlated with oil prices (medium term and long term) as project owners would need to calculate the time required to recover the initial and subsequent investments. On average, capex is calculated based on an average Brent price of USD100pb and West Texas Intermediate (WTI) price of USD90pb. Hence, tapering capex could somewhat indicate less-than-bullish views on medium-to-long term oil prices. Latest Bloomberg consensus forecast for average 2014 Brent is USD103pb and for average WTI is USD97pb. Current prices are USD107pb and USD94pb respectively.

Figure 1: IOCs expected capex spends



Source: Bloomberg consensus, MIDFR

Other probable causes for spending cut. Apart from the volatile oil price movements and expectations, other probable causes for tapering capex are:

(i) Increased production from existing wells driving prices down – increased production from non-OPEC sources.
(ii) Bleak global growth outlook (expectations), applying downward pressure on oil consumption
(iii) Pressure on IOCs to increase returns to investors (in form of dividends)
(iv) Relatively low gas prices (Henry hub prices)

Local oil and gas scene to remain resilient. Although there could be a marginal dip in global IOC capex spend in 2014, the expected nominal value remains high. In addition, local oil and gas companies are expected to be shielded by Petronas' own capex, the rate of which is expected to remain in high gear until 2015. Many Bursa-listed company earnings will also continue to be supported by contracts which were won in 2013.

Opportunities abound. Locally, there are still quite a substantial amount of works that could see rollouts in 2014. These include the central processing platform turnkey gig (worth approx. USD1.5b as reported by Upstream Online), jobs from the North Malay Basin, jobs from the Thai-Malaysia Joint Development Area, inspection, repair and maintenance (IRM) works (Pan Malaysia system), engineering, procurement, construction and commissioning (EPCC) as well as RAPID jobs at a later stage. We are expecting Petronas to play catch-up with the five year planned capex in 2014 and 2015 with approx. RM150b more to spend.

Actionable ideas. We recommend investor to maintain long positions in companies which have:

(i) Won significant amount of contracts in 2013;
(ii) Sizable orderbook with long burn rates;
(iii) Vessel charterers with sizable long term charter contracts

We either recommend investors to maintain shareholdings in the following companies in Table 1 or to increase exposure should share prices retreat. Following recent FBMKLCI's rapid rise, arguably ahead of earnings fundamentals, we anticipated potential price corrections. As such, we are still maintaining our recommendation on our stocks with Buy calls.

Table 1: Orderbook and new contracts secured in 2013

No.	Company	Current orderbook (RM m)	Contracts won in 2013 (RM m)*
1	SapuraKencana Petroleum	>24,000	11,212.0
2	Bumi Armada	>9,000 + 6,000 extensions	1,691.0
3	Dayang Enterprise	>4,000	3,813.6
4	Barakah Offshore (Not rated)	>2,200	2,025.0
5	Puncak Niaga (GOM Resources)**	>2,700	2,187.3

**Values of new contracts secured are best approximations*
*** Puncak Niaga Holdings Bhd is currently grouped under Water (Utilities) with BUY recommendation @ RM4.04*
Source: MIDFR, companies

Table 2: O&G stocks under coverage

Company	Last Price (RM)	TP (RM)	Upside (%)	Call	EPS (sen)		PER (x)	
					FY13F	FY14F	FY13F	FY14F
Dialog	3.40	3.15	-7.4	NEUTRAL	9.7	11.2	32.5	28.1
KNM	0.47	0.40	-14.9	SELL	3.2	3.3	12.5	12.1
SapuraKencana	4.67	4.86	4.1	BUY	9	19.8	54.0	24.5
Petronas Chemicals	6.70	6.96	3.9	NEUTRAL	47.7	49.7	14.6	14.0
MMHE	3.81	3.36	-11.8	NEUTRAL	12.7	17.7	26.5	19.0
Petronas Gas	23.28	20.30	-12.8	NEUTRAL	79.6	96.7	25.5	21.0
Wah Seong	1.88	1.76	-6.4	NEUTRAL	11.3	14.7	15.6	12.0
Bumi Armada	4.05	4.83	19.3	BUY	16.9	23.0	28.6	21.0
Gas Malaysia	4.00	3.65	-8.8	NEUTRAL	14.0	15.5	26.1	23.5
Dayang Enterprise	5.61	6.08	8.4	BUY	38	40.9	16.0	14.9

Source: MIDFR

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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.