

## OIL AND GAS SECTOR

### COMMENT by Avenue Securities:

Most oil and gas-related stocks have delivered impressive total returns year to date in 2006 with KNM Group Bhd taking the lead (total returns of 59%), followed by Petra Perdana Bhd (43%), SapuraCrest Petroleum Bhd (41%) and Wah Seong Corporation Bhd (10%). We reckon the strong outperformance was mainly driven by positive news flow with regard to strategic alliances and acquisitions move, expectations of internal restructuring, as well as the award of new contracts among these companies.

High oil price will continue to

steer the sector. Since capital expenditure (capex) spending increases during periods of high oil prices, the main risk would be a sudden fall in prices. Nevertheless, we do not expect oil prices to drop significantly given the lack of substitute for oil and gas and people's high dependence on oil and gas as fuel source. Moreover, ongoing technology advancement will increase oil and gas reserves.

Local oil and gas supporting companies should continue to enjoy good earnings growth over the next few years due to the increased spending on exploration and production by oil majors, continued

discovery of new oil fields, rejuvenation of local oil rigs and the potential for deep-sea exploration. Moreover, oil consumption has remained on the rise over the past three decades.

The risks associated with this sector include external risks like economic slowdown in world economy, significant decline in crude oil prices that may cut the oil majors' capex, thus reducing job opportunity for Malaysian players as well as execution risks such as delays and variation orders.

Upstream players such as SapuraCrest, Petra Perdana and Scomi Group Bhd stand to benefit

### Oil & gas sector

	PER (times)		FY06	
	FY06f	FY07f	ROE (%)	DY (%)
KNM Group	11.5	6.4	32.3	0.9
Petra Perdana	11.2	10.0	17.6	0.8
Petronas Gas	16.9	16.4	13.8	4.8
SapuraCrest	10.1	12.4	15.8	1.8
Wah Seong	6.7	5.3	13.6	2.4

PER- price earnings ratio, ROE- return on equity, DY- dividend yield

Source: Avenue Securities

from the lucrative oil and gas industry in Malaysia. The development in the upstream segment will in turn benefit the downstream services and manufacturing as well as supporting operators. Our top picks

for the sector are KNM (12-mth target price of RM6.80), Petra Perdana (12-mth target price of RM3.70) and Wah Seong (12-mth target price of RM2.65).

**Recommendation:** Reaffirm OVERWEIGHT rating on the sector