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## Risks and gains of O&G sector

>2



# O&G sizzles but beware of the risks

Investors should focus on expertise and track record of the management

Raison D'etre by RISEN JAYASEELAN

THE oil and gas (O&G) space is sizzling and there's no sign of it cooling off any time soon. There are deals aplenty being made. Just this week *StarBiz* reported that exploration giant Murphy Oil was looking at hiving off stakes in its assets in the country at a whopping price of some US\$2bil to US\$3bil (RM6.62bil to RM9.93bil).

Any local listed company buying these assets would see itself being transformed into a major O&G producer, overnight. The question of course, is whether one can afford such a price tag and whether the returns from that investment will be worth it. Also, the proposed sale by Murphy Oil doesn't seem to include any management control over those assets.

Another notable development *StarBiz* highlighted was Petronas being close to selling 10% in Canadian shale gas concern Progress Energy at a valuation of twice what the national O&G company paid back in 2012.

This is significant because Petronas came under flak for presumably paying too much to buy Progress Energy then. But now it's sitting pretty on an asset whose value keeps rising.

Then, there was the exciting development at Scomi Energy Bhd two Fridays ago, when savvy investors Tan Sri Quek Leng Chan and his associate Paul Poh, swooped in to get a block of shares at a seemingly mouth-watering discount.

By Monday, the buyers of this block of 11.5% of Scomi Energy - that included Norway's oil fund, Norges and Lembaga Tabung Haji - were sitting on a 42% paper gain.

Scomi Energy and another O&G company, Uzma Bhd, whose shares have enjoyed a spectacular 67% rise over the last six months - are said to be bidding and close to securing risk service contracts from Petronas.

Late last year saw another exciting O&G play enter the market: Barakah Offshore Petroleum Bhd, which is 166% up from its reverse takeover price of 65 sen.

Barakah made such an impact that dealers now talk of finding the "next Barakah" in the form of listed companies hoping to see an O&G asset injection.

Investors are also chasing a number of other O&G companies.

But making money from the O&G business isn't easy. Our market has seen its fair share of O&G companies that had stumbled in the past.

As examples, consider the stories of Ramunia Holdings Bhd, KNM Group Bhd Malaysia Marine, Heavy Engineering Holdings Bhd (MMHE) and the Scomi group. These stocks were at one point the darling of investors.

But at some point, they struggled to execute their businesses well. O&G fabricator Ramunia had slipped into PN17 status in June 2010. To quote from a Maybank research report dated April 2010: "Ramunia is in bad shape operationally and financially. It faces declining order book,

earnings and shareholders funds due to poor project execution and negative cash flows."

KNM Group Bhd was another high-flying oil and gas player. But it too did stumble, suffering a quarterly loss in 2009 and a full year loss at group level in 2011. Among the reasons for its losses was its high fixed cost and debt levels. Its aggressive overseas expansion also saw it having to provide for foreseeable losses in Brazil, Canada and Indonesia.

The Scomi group had encountered similar problems with its overseas assets while giant fabricator MMHE had suffered from higher-than-expected expenses incurred from some of its projects and from the share of losses from jointly controlled entities' performance.

One problem is that the O&G business, like many other sectors, is cyclical. You may invest during peak times but then get saddled with high fixed costs and low utilisation rates when the cycle hits a downturn.

Getting the right expertise to executive projects profitably is another challenge.

Investors shouldn't get carried away with

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'companies saying they are going to morph into an O&G concern. Such things don't necessarily happen overnight. In the case of Barakah, it took the company two years to finalise its reverse takeover.

And if you are talking about the exploration and production segment, then remember that the oil majors took many years to get to where they are today.

The golden rule of looking for companies whose management have the right expertise and track record shouldn't be forgotten in these bullish days of the O&G sector.

Senior news editor Risen Jayaseelan is betting that the O&G space will continue to sizzle in the weeks and months to come, with deals taking place left, right and centre and thereby offering opportunities aplenty for astute and well-informed investors.



**Making money from the O&G business isn't easy. The local market has seen its fair share of O&G companies that had stumbled in the past.**