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Best of Decade Energy Stocks Cheap in Asia: Riskless Return

By Adam Haigh - Aug 8, 2012

Energy stocks, which have returned 54 percent more on a risk-adjusted basis than any other industry in the Asia Pacific in the past decade, are trading at valuations 22 percent below their historic average, luring IG Investment Management Ltd. and Lion Global Investors Ltd.

The MSCI Asia Pacific Energy Index rose 18.6 percent in the past 10 years after adjusting for price swings, beating every group on the regional equity gauge, according to the BLOOMBERG RISKLESS RETURN RANKING. That's more than double the risk- adjusted gains of the more volatile S&P 500 Energy Index during the decade through Aug. 3. The Asian energy measure added 0.7 percent at 6:39 p.m. today in Hong Kong, compared with a 0.4 percent gain by the broader index.

Investors in the industry, which includes Cnooc Ltd. (883), China's largest offshore oil producer, and Reliance Industries Ltd. (RIL), India's biggest natural gas maker, more than quintupled their money over the decade, rewarding them for enduring the second-highest volatility of the 10 industry groups. Lion Global, IG Investment and BNP Paribas SA are buying after a sputtering global economy has driven valuations on the gauge to an average 10.7 times estimated earnings, 22 percent below the five-year average, according to data compiled by Bloomberg.

"You'd want a strong, relatively overweight position for the longer term," said IG's Tim Leung, whose Investors Pacific International Fund beat 88 percent of its peers in the past three years. "There's structural growth for energy in Asia and emerging markets because of the consumption story in China. The near term is harder to forecast and there will be volatility."

Leung helps manage about $1.5 billion at IG Investment Management in Hong Kong. Cnooc shares account for 2.8 percent of the Investors Pacific fund, according to data compiled by Bloomberg.

Household Demand

Growth from China to India and Malaysia is propelling higher consumption of electricity at factories and households among the world's fastest growing economies. Power demand will almost double in the Asia Pacific region by 2030, according to the Asian Development Bank.

The International Energy Agency estimates global oil consumption will reach a record 89.9 million barrels a day this year, a 16 percent increase since 2001. China surpassed the U.S. as the world's biggest energy user in 2010.

The risk-adjusted return, which isn't annualized, is calculated by dividing total return by volatility, or the degree of daily price-swing variation, giving a measure of income per unit of risk. A higher volatility means the price of an asset can swing dramatically in a short period of time, increasing the potential for unexpected losses compared with a security whose price moves at a steady rate.

483 Percent

Investors that captured the MSCI Asia Pacific Energy (MXAP0EN) index's 483 percent gain in the past ten years endured a volatility of 25.9, which is 20 percent higher than the average for the 10 sectors on the benchmark during the period, the data show. Only the MSCI Asia Pacific Materials Index (MXAP0MT) had bigger swings in the region.

"The volatility of stocks within the energy sector can vary widely, and not all the energy names are therefore highly volatile," said Jan de Bruijn, Singapore-based head of Asian equities at Lion Global Investors, where he helps oversee $22.4 billion. "Our energy portfolios reflect this. We still see value in energy stocks, in particular the upstream exploration and production players. Demand for energy should continue to grow in the longer term, with demand coming from emerging markets."

U.S. Returns

Volatility among Asian energy company stock prices is 13 percent lower than price swings on the S&P 500 Energy Index (S5ENRS) in the U.S., the data show. The American gauge returned 9 percent during the ten year period on a risk-adjusted basis, less than half the returns of the Asian measure.

Shanghai-listed Inner Mongolia Yitai Coal Co. (900948) posted the largest risk-adjusted return on the 43-member Asian energy gauge over the 10-year period, the data show. Inner Mongolia has the biggest coal reserves among all Chinese provinces, with about 700 billion tons at the end of 2008, according to the regional government's website. The company has a market value of $9 billion, according to data compiled by Bloomberg.

Petronas Dagangan Bhd. (PETD) posted the third-biggest risk- adjusted return, with the lowest volatility over the 10 years, the data show. The retailing arm of Malaysia's state-run oil company Petroliam Nasional Bhd. has expanded outside of the southeast Asian country where it already supplies 51 percent of liquefied petroleum gas, according to its 2011 annual report. Its shares surged to a record high Aug. 3.

Index Heavyweight

Price swings for Petronas Dagangan Berhad were half those of Inner Mongolia Yitai Coal, the data show. The analysis is based on the gauge's constituents as of Aug. 3.

Cnooc accounts for 13 percent of the Asian energy gauge, its biggest constituent, and trades for 8.5 times estimated earnings, data compiled by Bloomberg show. PetroChina Co. (857), Asia's largest company by market value and No. 2 by weight on the energy gauge, trades for a multiple of 9.9. PetroChina's crude production is the highest among the world's integrated oil companies, according to Bloomberg Industries production data through the end of 2011.

"The reality of this business is that costs are going up and oil prices in the longer term still seem in a secular uptrend," said Neil Beveridge, Hong Kong-based analyst at Sanford C. Bernstein & Co. Cnooc shares are "fairly cheap and with good growth ahead of it."

Cnooc agreed July 23 to pay $27.50 a share for Calgary- based Nexen Inc. (NXY) in a takeover deal valued at $15.1 billion. If successful, it will be the biggest overseas takeover by a Chinese company.

Bears Multiplying

Some investors looking to emulate the market-beating returns of energy stocks of the past 10 years are wary that a slowdown in economic growth in China may weaken energy demand and curb profit growth. Investors are more bearish on the industry than at any time since February 2007, according to a July 17 Bank of America Corp. survey of money managers that have $708 billion in client assets.

Earnings-per-share will rise 4.8 percent in 2012 for Asian energy shares and gain 9.4 percent next year, data compiled by Bloomberg show. That's less than the 20 percent per-share profit growth forecast on the broader Asian benchmark this year and 14 percent in 2013.

Whether or not the returns can be repeated in the next 10 years shouldn't stop investors buying energy shares while they are out of favor, said Erwin Sanft, chief strategist for Asia equities at BNP Paribas in Hong Kong, who has an overweight position on energy shares in Asia.

Relative Gain

The Asia-Pacific energy gauge soared 617 percent in the global-equity bull market between October 2002 and October 2007, compared with a 157 percent gain on the MSCI All-Country World Index (MXWD) of global developed and emerging market stocks. The energy gauge fell 17 percent since then. That's left the shares trading with a price-earnings ratio 17 percent below the MSCI All- Country World.

Emerging economies such as China, India and Indonesia will provide all of next year's oil-demand growth, with China alone accounting for more than 30 percent of the global expansion, according to International Energy Agency estimates July 12.

"People have sort of given up on energy stocks," said Sanft. "It's the cheapest sector now. Energy companies have very stable cashflow and high margins. We're looking in Thailand, India, the Korean refining sector and the Chinese oil and gas sector."