Upgrading OXY to Buy from Hold

OXY: We upgrade OXY to Buy (from Hold) on its advantaged combination of growth and free cash flow in a moderate oil price environment. We see a number of key drivers for OXY, including: 1) Permian performance continues to exceed expectations, with likely upside to conservative 2016 target of 120 Mboe/d, 2) leading FCF generation in our coverage universe at $65/bbl WTI (1.8% post-dividend in 2016, or 5.8% pre-dividend, vs. peer average of a 2.4% FCF deficit in 2016), led by three primary Middle East projects which generate ~$1.0-$1.5 Bn/yr of FCF, 3) 2017 start-up of ethylene cracker driving ~$1.0 Bn/yr of FCF from the chemical business from 2017, 4) 2nd highest dividend yield in our coverage universe (3.9%), with FCF driving further growth and share buyback, 5) solid crude leverage in the case of a rebound in oil price, and 6) relatively attractive valuation at 6.7x 2017 EV/DACF (or 6.4x adjusted for Midstream/Chemicals segments).

Downgrading HES to Hold from Buy

We downgrade HES to Hold (from Buy) primarily on account of the company's notable outspend (second to worst in the group based on 4Q15 annualized figures). We expect investors to continue to struggle (4%/3% underperformer since recent WTI trough/in May) with HES' relatively high spend on investments that are not expected to generate near-term cash flow (North Malay Basin, US midstream, Stampede, exploration, etc); not surprisingly, HES scores last on our defensive scorecard despite offering a healthy balance sheet (4th in the group on a '16 net debt/cap basis). While an attractive valuation (5.6x 2017 EV/DACF vs group at 6.4x) and impressive liquids leverage (highest in the group) sets up well for investors looking to play a crude price bounce, our defensive-tilted outlook suggests HES's medium-term outspend/ FCF profile will remain in the spotlight.