Oil & Gas

Activities to Sustain Despite Softer Oil Prices

NEUTRAL

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We maintain our NEUTRAL call for the sector, as well as our average Brent crude oil price assumption of USD80/bbl in CY23 (vs. USD99/bbl in CY22). Oil prices are likely to be capped over the immediate term amidst a supply overhang (as selective Asian markets are well fed with Russian crude exports re-routed from its traditional European market). Nonetheless, the weaker YoY oil prices should not deter industry spending. Petronas is looking at a capex of RM300b for the next five years (averaging to ~RM60b per year) – representing a 43% increase from the previous five-year period, while global offshore E&P capex continues to remain on the rise. We see opportunities in selective contractor names, i.e. ARMADA (OP; TP: RM0.75) and WASEONG (OP; TP: RM0.97). Meanwhile, DIALOG (OP; TP: RM3.10) and YINSON (OP; TP: RM3.65) are our preferred picks within the big-cap space.

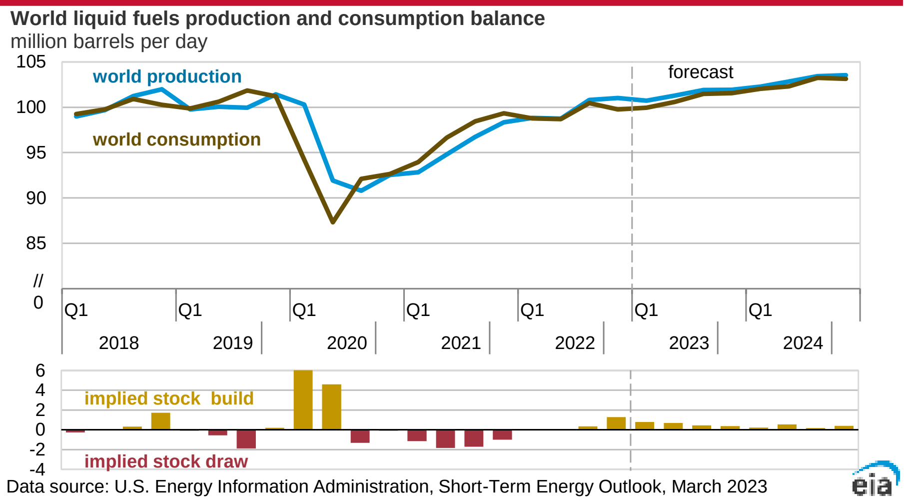
Oil prices to be capped amidst a supply overhang. Oil prices are likely to be capped over the immediate term amidst a supply overhang as Russian oil has gradually found its way back to the system. India, and to a lesser extent, China are now well fed with Russian crude exports at discounted prices, re-routed from its traditional European market.

Recall, oil prices surged in CY22 following the Russian-Ukrainian conflict, leading to swift sanctions on Russian oil exports. This coupled with the steep recovery in oil demand especially in the EU and North America as the world transitioned into a post-pandemic era, as well as OPEC's inability to ramp up productions in a short period of time, led to a global shortage that drove oil prices up.

As at Feb 2023, Russia's oil production was at near pre-war levels, with India and China accounting for >70% of the country's crude exports. Note that Russia is the third largest oil producer in the world, only behind the US and Saudi Arabia, contributing to ~10% of global productions. Hence, a resurgence of Russian oil back into the circulation of global markets will have a significant impact to the global supply-demand balance.

On the demand-side, China's reopening will remain the biggest driver for demand growth throughout CY23, especially in the 2H (while the demand growth for the rest of the world plateaus as the economies having recovered fully from the pandemic). Given the increased production from the US and OPEC, the oil market is well prepared to cope when global oil demand finally returns to the pre-pandemic level of >100m barrels per day. We maintain our current Brent crude oil price assumption of USD80/bbl in CY23 (vs. an average of USD99/barrel in CY22).

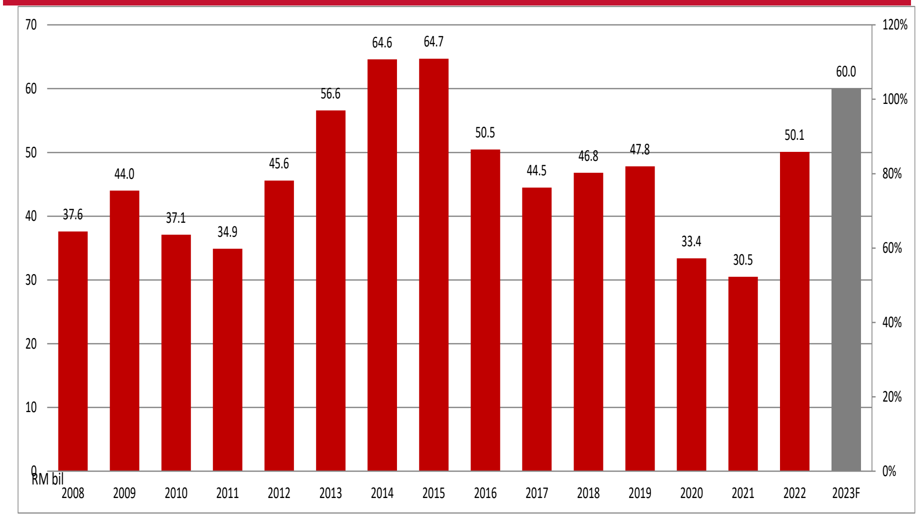
World Oil Production vs Consumption



Source: EIA

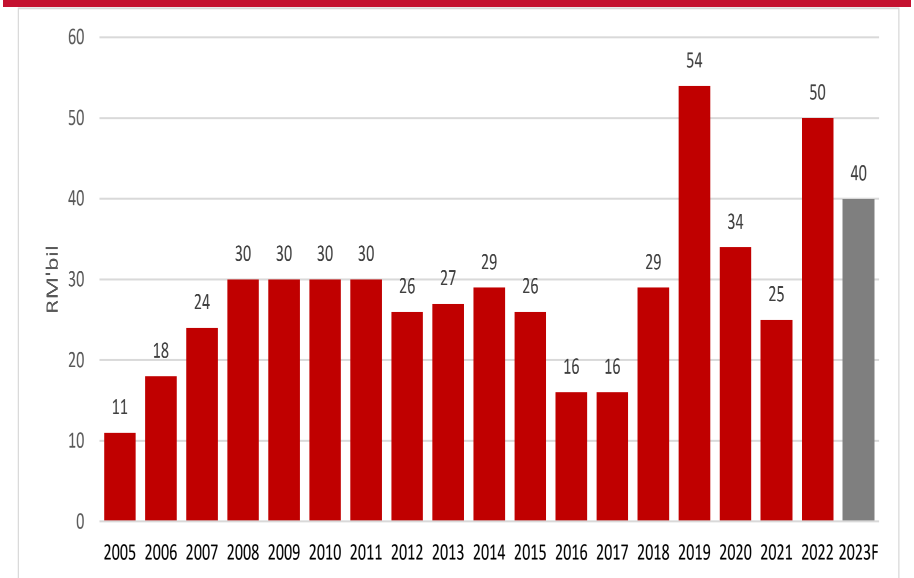
Increased Petronas capex to sustain activity levels. Going forward, Petronas is guiding a capex spending of RM300b for the next five years of FY23 – FY27 (thus averaging to ~RM60b per year) – representing a 43% increase from the previous five-year period of RM208.5b, with over 80% of it allocated for its core business in hydrocarbons. This is expected to continue sustaining local activity levels. Prime beneficiaries of higher Petronas capex, and in sustained local activity levels, include the likes of **DAYANG** (from higher demand for offshore maintenance, and hook-up and commissioning works), **UZMA (OP, TP: RM0.90)** (on higher brownfield activities – e.g., well services, oil production enhancements), as well as **VELESTO** (from pick-up in demand for jack-up drilling rigs). Meanwhile, globally, CY23 is expected to see a further ramp-up in offshore exploration and production (E&P) capex, especially from CY20-CY22 levels, as an aftermath of under-investments in the industry over the past several years. All three of our Bursa-listed FPSO players, i.e. **YINSON, MISC (MP; TP: RM7.50)**, and **ARMADA**, have been actively participating in international job bids, with opportunities emerging from Latin America, Asia Pacific and Africa. The FPSO space is starting to see a supply squeeze – i.e., many global FPSO players are already pre-occupied with jobs developing at hand, and hence, more recent bids have started to see very few bidders, making it very much an operator market. Additionally, pipe-coating player **WASEONG** will also be another prime beneficiary of the global oil and gas capex cycle – given its unique market position operating effectively in a duopoly against Canadian-listed Shawcor Ltd.

Petronas Yearly Capex (RM bil)



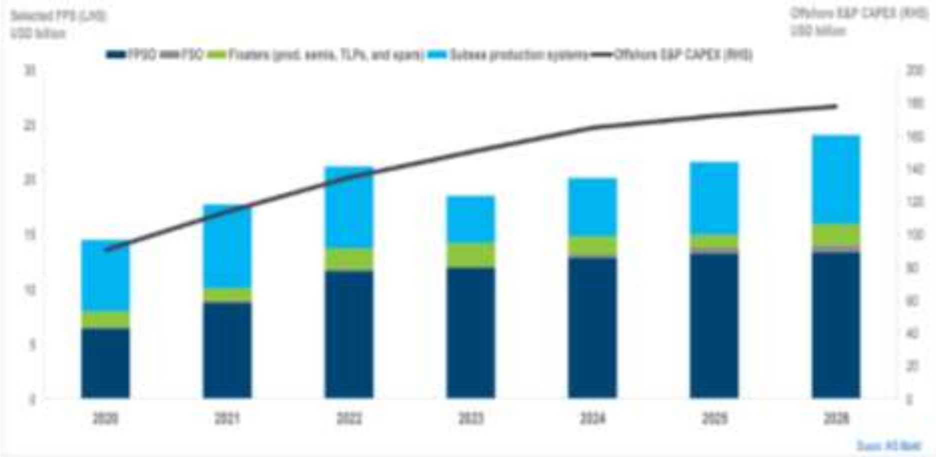
Source: Petronas, Kenanga Research

Petronas Yearly Dividends (RM bil)



Source: Petronas, Kenanga Research

Global Offshore E&P Capex Spending / Global Floater Project Awards



Source: IHS Markit, MISC

Maintain NEUTRAL on the sector, given (i) limited catalyst on Petronas-linked big-cap names, coupled with (ii) weak downstream product spreads. We see opportunities in selective contractor such as **ARMADA** and **WASEONG**. Meanwhile, **DIALOG** and **YINSON** are our preferred picks within the big-cap space.

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net. Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
BUMI ARMADA BHD	OP	0.630	0.750	19.05%	3,728.4	N	12/2023	13.1	13.6	1.0%	3.5%	4.8	4.6	0.6	13.9%	0.0	0.0%
DAYANG ENTERPRISE HLDGS BHD	OP	1.34	1.90	41.79%	1,551.4	Y	12/2023	11.2	12.6	12.0%	11.8%	11.9	10.7	1.0	8.6%	3.0	2.2%
DIALOG GROUP BHD	OP	2.35	3.10	31.91%	13,260.1	Y	06/2023	9.5	9.9	5.1%	4.8%	24.8	23.7	2.4	10.2%	2.8	1.2%
MISC BHD	MP	7.28	7.50	3.02%	32,496.1	Y	12/2023	47.0	48.9	-11.6%	4.1%	15.5	14.9	0.9	5.6%	33.0	4.5%
PETRONAS CHEMICALS GROUP BHD	MP	7.13	7.80	9.40%	57,040.0	Y	12/2023	65.3	52.2	-18.9%	-20.0%	10.9	13.7	1.4	12.9%	33.0	4.6%
PETRONAS DAGANGAN BHD	MP	21.00	24.00	14.29%	20,862.5	Y	12/2023	83.2	87.6	11.0%	5.2%	25.2	24.0	3.6	14.4%	83.3	4.0%
PETRON MALAYSIA REFINING	MP	4.42	4.35	-1.58%	1,193.4	Y	12/2023	81.9	91.9	-26.6%	12.2%	5.4	4.8	0.5	9.6%	16.0	3.6%
UZMA BHD	OP	0.615	0.900	46.34%	216.5	Y	06/2023	7.7	9.9	85.0%	28.5%	8.0	6.2	0.4	5.1%	0.0	0.0%
VELESTO ENERGY BHD	UP	0.210	0.190	-9.52%	1,725.3	Y	12/2023	0.7	1.3	-36.1%	73.3%	28.3	16.3	0.7	2.6%	0.0	0.0%
WAH SEONG CORP BHD	OP	0.785	0.970	23.57%	607.8	Y	12/2023	10.7	12.8	6.1%	19.1%	7.3	6.1	0.9	13.4%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.55	3.65	43.14%	7,411.6	N	01/2024	20.8	25.2	-18.4%	21.2%	12.2	10.1	1.6	13.7%	2.0	0.8%
Sector Aggregate					**140,093.1**					**-11.7%**	**-5.9%**	**13.2**	**14.1**	**1.3**	**10.0%**		**1.9%**

Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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