

Oil & Gas

NEUTRAL

Upstream Buoyed by OPEC+ Production Cuts



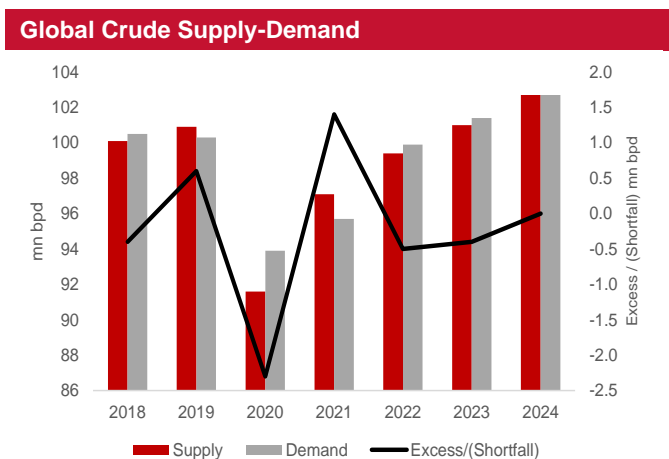
By **Kylie Chan Sze Zan** / kyliechan@kenanga.com.my

We remain NEUTRAL on the sector with preference for the upstream segment (FPSO in particular) while still cautious on the downstream segment. In 4QCY23, we expect Brent crude to trend higher towards the USD90/bbl level (which will bring 2023 average to USD84/bbl) driven largely by OPEC+ production cuts which cushion the weak demand from China. Looking forward to 2024, we expect Brent price to average at USD86/bbl, with stronger prices expected in the 1H, and thereafter gradually easing as supply from non-OPEC producers catches up. Overall, we believe the current crude oil price levels are conducive for the ramp-up in upstream capex while downstream product prices will remain under pressure due to weak demand. Our sector top picks are YINSON (OP; TP: RM3.65) and DIALOG (OP; TP: RM3.10).

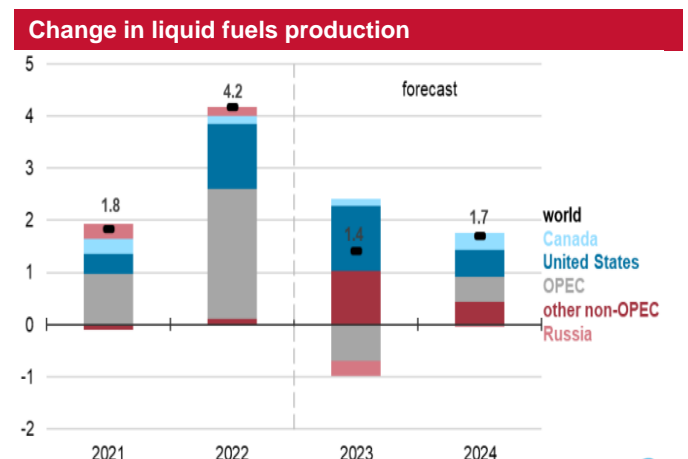
1. Upstream

Supply factor dominates. Despite weak demand from China due to various economic challenges, crude oil prices have crept up in recent months following the decision by OPEC+ to extend its production cuts to end-2023. Saudi Arabia has cut 1m bbls per day voluntarily and Russia has also planned to cut oil exports by 300,000 bbls per day. The overall market will turn to drawing crude inventories as opposed to inventory builds. This will be a departure from what happened in 2022 and 1HCY23 where despite the production cuts by OPEC+, the global crude market experienced inventory build-ups.

Market to be balanced in 2024. In 2024, according to EIA, global crude market is expected to remain largely balanced (slightly surplus) with growth in production expected from UEA, Iran and Venezuela (which could result in 0.6m bbls per day production increase from OPEC YoY). Therefore, we believe crude prices would be rather stable or slightly weaker starting 2QCY24 as supply catches up with the demand. This is evident as well for expected inventory builds by EIA on global oil inventories in 2024 (in contrast to inventory draw in 2HCY23). In 2024, based on EIA numbers, the majority of increase in crude production would stem from Canada, United States and OPEC, providing buffer for majority of annual increase in expected crude demand. Therefore, throughout 2024, we do not expect large swings in crude oil prices (from current price ranges) assuming that the market would be largely balanced (with some inventory builds expected in 2HCY24 by EIA).



Source: EIA, Kenanga Research

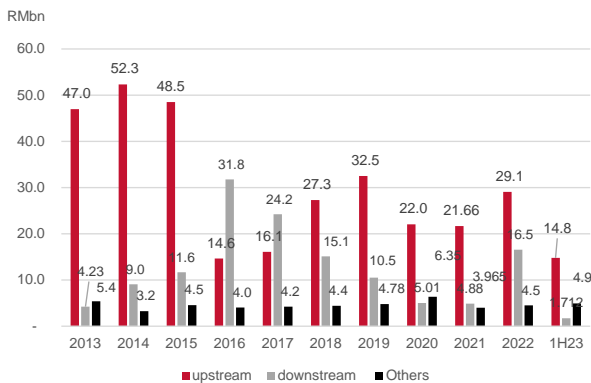


Source: EIA, Kenanga Research

USD84/bbl for 2023 and USD86/bbl for 2024, no recession in demand expected. In the remaining months of 2023, we believe Brent crude prices would trend higher towards USD90/bbl as inventory draw tighten crude market globally. This would partially offset the relatively weaker trend exhibited in 1HCY23 (USD79.50/bbl on average) and bring full year average to USD84/bbl. In 2024, we expect strength in crude oil price to sustain in the 1Q (on the back of tighter market supply and dwindling US strategic petroleum reserve after multiple inventory releases last year), and subsequently slightly weaker trend in the remaining quarters in anticipation of global crude market flipping from inventory draw position to liquidity build position. On top of that, our base case does not assume a severe recession in crude demand in 2024, implying that in the event of worse-than-expected demand, there is downside risk to our Brent crude price expectations.

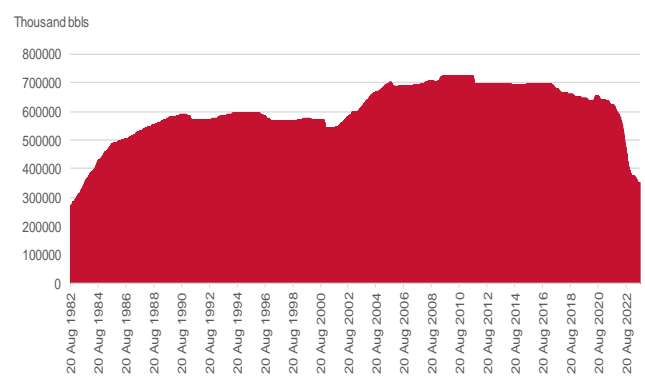
Upstream capex up-cycle still at early stage. With crude prices expected to remain at current range until next year, we believe upstream services segment in Malaysia is still at the early stages of potential upcycle. This is due to Petronas' typical lagged response to advances in crude prices based on precedents. Publicly, Petronas group has stated that they target to spend RM60b capex for the next couple of years. With no major announcements for downstream, we believe majority of the capex allocation might be directed to upstream (besides energy transition related investments such as carbon capture, hydrogen and etc). One of the justifications of the movement in capex largely stemmed from our perception that Petronas would still need to invest on its upstream assets in the coming years to sustain its production level as oil & gas would still be required in the country's transition to renewable fuel sources.

Petronas Annual Capex Breakdown



Source: EIA, Kenanga Research

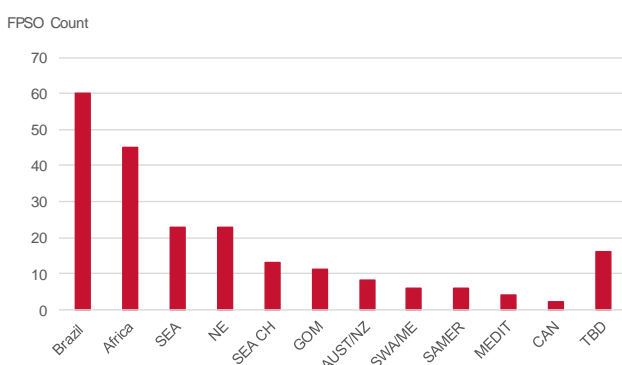
US Strategic Petroleum Reserve



Source: EIA, Kenanga Research

Positive effect on upstream services to be uneven. Amid our more bullish overall outlook on upstream services sector, we believe that the up-cycle would be uneven across subsectors within the local upstream services segment. For instance, upstream maintenance has already recorded expansion in gross margins and work order ramp-up due to clients increasing its maintenance activities. On the other hand, asset-heavy service providers (mainly asset owners like OSVs or jack up rigs) have seen strong rebounds in daily charter rates (DCR) from the bottoms back in 2020-2021 but more evidence is still needed for us to gain more conviction in the sustainability of the potential up-cycle in this sub sector (which requires sustained increase in upstream capex by Petronas group in the coming years). In addition, if capex up-cycle is shown to be sustainable, we believe DCR of OSVs and rigs would still potentially see significant upside due to under-investment in the sector both globally and domestically.

FPSOs By Region



Source: Yinson, Kenanga Research

FPSO Contracting and Fleet Count

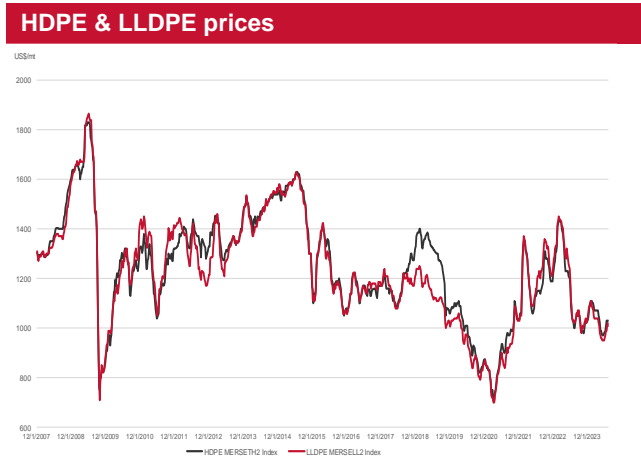


Source: Yinson

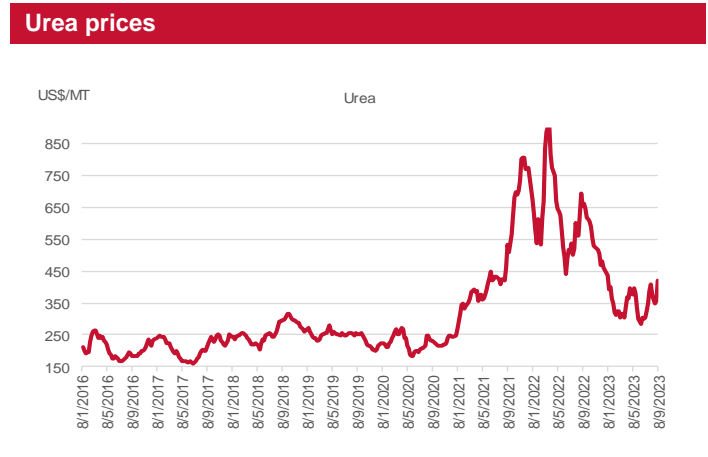
More FPSO jobs amidst fewer contractors with proven track record. FPSO contractors would still be in high demand by clients in the coming year (2024) as Brazil and Africa would still see more contract announcements. Due to the importance of project execution and funding capability, barrier of entry into FPSO market remains high. **YINSON** remains as one of the top FPSO contractors in the world and we believe they remain in very favourable negotiation position with clients. To note, its top competitors (in terms of track record and trust from the clients) namely SBM and Modec already have their hands full with 15-20 contracts to be executed, causing competition for new FPSO contracts to be lower than previous years. Therefore, we believe FPSO contractor with track record and more balance sheet headroom would benefit from this trend in FPSO industry in the coming years.

22 September 2023

2. Midstream and Downstream



Source: Bloomberg, Kenanga Research



Source: Bloomberg, Kenanga Research

Downstream outlook largely benign. Downstream sector's outlook remains uncertain with demand growth for products expected to slow in 2023 due to weak China recovery. This already had impact on petrochemical prices with polyethylene prices (HDPE & LDPE) dropping to USD1,000/mt level compared to 2022 levels (USD1,300-1,400/mt). We believe this could sustain throughout rest of 2023 and even in 2024 until global economy shows more signs of stronger growth. On the supply side, China is expected to still press ahead with their petrochemical capacity additions (in line with their long-term plan to be self-sufficient in petrochemicals). Based on Offshore Technology, global petrochemical capacity would see 35.3% growth in capacity from 2021 to 2030 with China accounting for majority of the upcoming capacity additions.

Urea market to normalise at lower levels compared to 2022 boom. Following 2022 boom in prices (caused by China export ban and initiation of Russia-Ukraine war), urea prices have largely corrected down to near historical averages at USD350-400/mt as the supply chain has been gradually normalised since start of 2023 coupled with lower natural gas prices (which typically accounts for trend of feedstock costs for urea production). Hence, we believe, on a YoY basis, urea average prices would very likely to be lower in 2023 compared to 2024. Nevertheless, in the event of any unexpected surge in urea prices in the future, we do not discount the possibility of China banning exports of urea again (which would result in tight supply in the global market).

Bullish outlook on upstream services balanced by muted downstream outlook. All in, we maintain our **NEUTRAL** view on the sector. In our view, the focus on the sector would still be in the upstream services segment as upstream capex is expected to gradually ramp up in 2H CY23 and 2024 albeit potential fundamental impact would be uneven across subsectors within upstream services. In our opinion, within the services segment, upstream maintenance and FPSO has already shown signs of significant pick-up in activities. With OPEC+'s strong intention in supporting crude oil prices, we believe Brent crude price would be at levels conducive (USD80/bbl and above) for further ramp-up in oil producer spending in 2024 despite slower demand growth. Positive outlook in the upstream segment is being offset by our rather bearish outlook on downstream as ASPs of downstream products is expected to remain under pressure due to weak global demand and capacity additions (particularly in China).

Our top picks for the sector are:

YINSON due to: (i) strong FPSO orderbook pipeline with multiple major FPSO jobs under conversion stage which provides significant earnings growth in coming years, (ii) strong project execution track record which positions the company to benefit from strong structural demand for FPSO contractors anticipated in the coming years, and (iii) it being one of the first local oil & gas company invest in green technology companies (solar, e-mobility and etc) which in our view would help with the company's long-term energy transition agenda

DIALOG underpinned by: (i) recovery in demand for independent tank terminal storage after weak FY23 market with utilisation generally above 90% for existing terminals, (ii) active diversification into upstream production assets (recent endeavour involves potential development of small field asset in Baram Junior cluster) which enables the group to capitalize on oil price rallies, and (iii) still significant expansion potential in Tanjung Langsat (200,000 cbm incremental capacity) and Pengerang with 500 acres of land to be developed on which coincides with gradual ramp-up in activity observed in the Johor market.

22 September 2023

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	0.555	0.600	8.1%	3,287.1	N	12/2023	11.0	13.6	-15.4%	23.6%	5.0	4.1	0.6	11.8%	0.0	0.0%
DIALOG GROUP BHD	OP	2.13	3.10	45.5%	12,018.7	Y	06/2024	9.9	10.3	11.6%	3.9%	21.5	20.7	1.9	8.9%	3.0	1.4%
MISC BHD	MP	7.13	7.60	6.6%	31,826.5	Y	12/2023	57.5	55.0	8.1%	-4.3%	12.4	13.0	0.8	6.8%	33.0	4.6%
PETRONAS CHEMICALS GROUP BHD	UP	7.31	6.20	-15.2%	58,480.0	Y	12/2023	25.0	43.2	-69.0%	72.9%	29.3	16.9	1.5	5.0%	12.0	1.6%
PETRONAS DAGANGAN BHD	MP	23.02	24.90	8.2%	22,869.3	Y	12/2023	106.0	92.6	41.3%	-12.6%	21.7	24.9	4.0	18.3%	106.0	4.6%
PETRON MALAYSIA REFINING	MP	4.69	4.65	-0.9%	1,266.3	Y	12/2023	103.0	97.8	-7.6%	-5.0%	4.6	4.8	0.5	11.9%	21.0	4.5%
UZMA BHD	OP	0.805	1.05	30.4%	311.7	Y	06/2024	10.2	10.5	1.3%	3.0%	7.9	7.7	0.6	7.4%	0.0	0.0%
VELESTO ENERGY BHD	UP	0.260	0.190	-26.9%	2,136.1	Y	12/2023	0.6	1.3	-45.8%	104.6%	41.2	20.2	0.9	2.2%	0.0	0.0%
WASCO BHD	OP	1.06	0.890	-16.0%	820.8	Y	12/2023	6.9	9.9	-31.6%	43.4%	15.3	10.7	1.3	8.8%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.51	3.65	45.4%	7,296.0	N	01/2024	20.8	25.2	-18.4%	21.2%	12.1	9.9	1.6	13.7%	2.0	0.8%
Sector Aggregate					140,312.4					-34.0%	20.1%	17.9	14.9	1.4	9.5%		1.8%

Source: Bloomberg, 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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KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my