Oil & Gas

OVERWEIGHT
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Mid-stream, Upstream Ring the Cash Register

By Lim Sin Kiat, CFA / limsk@kenanga.com.my

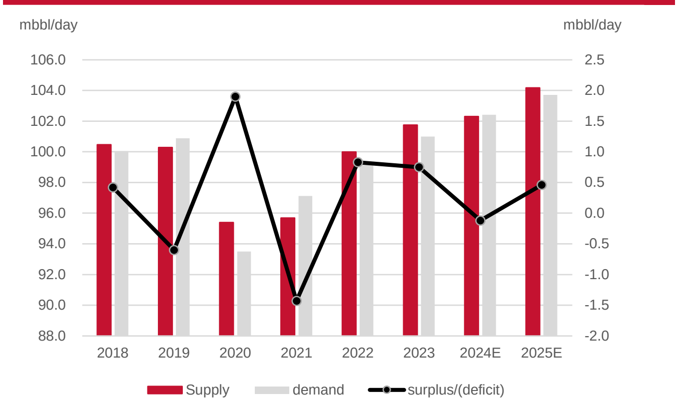
We maintain OVERWEIGHT on the sector. We maintain our Brent crude oil price assumption of USD84/bbl for CY24F and introduce CY25F assumption of USD79/bbl, assuming OPEC+ is to discontinue with production cuts by end-CY24. These oil price levels are supportive of upstream investment locally, especially considering the under-investment by producers in the early 2020s. We like: (i) offshore supply vessel (OSV) owners due to supply crunch on a surge in demand leading to strong charter rates, (ii) FPSO players given the current upcycle in the FPSO sector, and (iii) the storage segment that has shown recovery signs. Our sector top picks are DIALOG (OP; TP: RM3.10), YINSON (OP; TP: RM3.47) KEYFIELD (OP; TP: RM1.90) and ICON (REJECT OFFER; TP: RM0.80).

1. Upstream

Crude oil prices are seen largely stable in CY24. We reaffirm our CY24 Brent crude price forecast at USD84/bbl and introduce a CY25 average price assumption of USD79/bbl. These projections align closely with the US Energy Information Administration (EIA)'s forecast of USD87.0/84.8 per bbl for CY24/25. Our analysis for CY24 anticipates a deceleration in global crude production growth to +0.5m bbls per day, a contrast to the 1.8m bbls per day increase in 2023, attributing this slowdown to OPEC+ extending its production cuts through 2024 and a normaliSation in production growth from non-OPEC countries compared to the previous year. For CY25, our expectation of a slightly lower YoY Brent price is based on the anticipated conclusion of OPEC+ production cuts, leading to a 0.7m bbls per day increase, alongside continued production growth from non-OPEC sources.

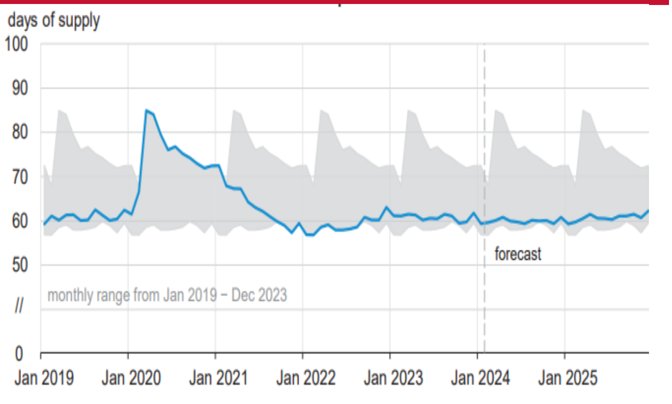
Demand assumptions. Consistent with EIA, we assume a lower demand growth of +1.4m bbls per day in 2024 compared to +1.8m bbls per day in 2023 with the growth led by non-OECD Asia countries (India and China). Meanwhile, we believe that the OECD countries will generally post flattish growth in YoY demand for crude due to global economic headwinds. Therefore, this will result in a slightly higher Brent crude price as a mild supply deficit of 0.1m bbls per day is expected for 2024. As we look towards 2025, we expect a slight softening in Brent crude prices, with an average forecast of USD80/bbl. This anticipated decline is based on projections that the crude market will experience a surplus of 0.5m bbls per day, influencing the downward adjustment in prices.

Global Crude Supply-Demand



Source: EIA, Kenanga Research

OECD Commercial Crude Oil Inventories



Source: EIA, Kenanga Research

Petronas likely to adhere to the RM60b capex target in 2024. We expect Petronas' upstream capital expenditure (capex) to continue its upward trend in CY24, with its cost structure capable of supporting Brent crude prices as low as USD75/bbl. Projecting a capex budget of around RM60b for CY24, with a significant share dedicated to upstream activities, Petronas is likely to focus on modernizing the ageing oil production platforms across Malaysia. This anticipated commitment to reaching its annual capex target marks a departure from the 2021-2023 period, during which Petronas' expenditure fell short of the RM60b mark.

Exhibit 4: Recent OSV Jobs Awarded

Date	Contract	Company	Implied DCR (RM/day)	Value (RM m)
4/3/2024	Provision of one (1) unit Platform Supply Vessel (PSV) for the Petroleum Arrangement Contractor (PAC) drilling campaign. The provision of service will commence on 31 March 2024. The contract primary period is for 100 days from the commencement date.	ICON	100,000	10.00
8/2/2024	Work order award from ROC Oil (Sarawak) Sdn Bhd (ROC) on 14 December 2023 for the provision of one (1) unit of Anchor Handling Tug & Supply (AHTS) vessel.	PERDANA	70,000	8.4
8/2/2024	Provision of one unit of Accommodation Work Barge (AWB) by T7.	PERDANA	118000	5.9
14/2/2024	The provision of one unit of Accommodation Work Barge (AWB) (Contract) for Saujana Marine Sdn Bhd. The Contract, which commenced on 15 January 2024 is for a duration of up to 240 days with one extension option of up to thirty 30 days from the Commencement Date.	PERDANA	81,852	22.1
15/2/2024	Work order extension from Saujana Marine Sdn Bhd for one unit of Accommodation Work Barge (AWB). The Contract Extension is for 220 days commencing from 24 December 2023.	PERDANA	73,636	16.2
6/3/2024	Provision of one (1) unit of Anchor Handling Tug & Supply (AHTS) vessel ("Contract") for 238 days for Petronas Carigali.	PERDANA	71,849	17.1
6/3/2024	Work order amendment and extension No. 1 from PETRONAS Carigali Sdn Bhd (PCSB) for one unit of Accommodation Work Barge. The Contract Extension involves the amendment to the extension period from the original 229 days option to a period of up to 271 days.	PERDANA	73,063	19.8
6/3/2024	Work order amendment and extension No. 1 from PETRONAS Carigali Sdn Bhd (PCSB) for one (1) unit of Anchor Handling Tug & Supply (AHTS) vessel. The Contract Extension involves the amendment to the extension period from the original 223 days option to a period of up to 140 days, commencing from 24 January 2024	PERDANA	65,000	9.1
6/3/2024	Work order amendment and extension No. 1 from PETRONAS Carigali Sdn Bhd (PCSB) for one (1) unit of Anchor Handling Tug & Supply (AHTS) vessel. The Contract Extension involves the amendment to the extension period from the original 203 days option to a period of up to 244 days	PERDANA	56,148	13.7
6/3/2024	Work order amendment and extension No. 1 from PETRONAS Carigali Sdn Bhd (PCSB) for one (1) unit of Anchor Handling Tug & Supply (AHTS) vessel. The Contract Extension involves the amendment to the extension period from the original 60 days option to a period up to 254 days commencing from 21 November 2023	PERDANA	32,677	8.3

Source: Company

Petronas developing multiple projects upstream. Petronas' Activity Outlook for 2024-2026 outlines several significant projects across Malaysia, with major developments planned in Sarawak (including Kasawari, Jerun, Rosmari-Marjoram, Lang Lebah), Sabah (Gemusut Kakap redevelopment, Belud clusters), and Peninsular Malaysia (Bekok oil redevelopment, Seligi redevelopment). Over the next three years, Petronas aims to drill more than 25 wells annually, concentrating on shallow waters in Peninsular Malaysia and Sarawak, as well as deepwater wells in Sabah. Additionally, more than 45 upstream projects are slated for execution during this period, with plans to fabricate four central processing platforms (CPP). This ambitious agenda signals an escalating demand for local upstream service providers, covering a wide range of services from Offshore Supply Vessels (OSV) and drilling to well services, underscoring a period of heightened activity and opportunities in the sector.

OSV boom on the horizon. The local OSV market appears poised for an up-cycle in daily charter rates (DCR) as Petronas escalates its demand for OSVs to support production and drilling activities in 2024. Recent announcements by multiple OSV operators highlight charter wins at highly favourable DCRs. Specifically, rates for Accommodation Work Barges (AWB) and Platform Supply Vessels (PSV), which are crucial for brownfield maintenance, are approaching RM100,000/day in the spot market, nearing the all-time highs of 2013-14. Furthermore, mid-sized Anchor Handling Tug Supply (AHTS) vessels have seen spot rates reach RM33,000/day, a significant increase from the RM20,000/day observed between 2020 and 2022. With demand on the rise and a lack of new vessel construction limiting supply, we expect continued upward pressure on OSV DCRs.

Supply crunch to persist in the OSV market. The local OSV market is expected to remain constrained in 2024-2025, with no current plans among operators to enhance vessel capacities despite recent strong daily charter rates (DCR). Several factors restrict OSV players' fleet expansion, including banks' reluctance to provide loan financing, increased costs for new builds, and limited global and local yard capacities due to the high demand for FPSO and LNG projects. Additionally, the typical lead time for constructing a new OSV ranges from one to one and a half years, suggesting that any orders placed now would not materialize into new capacities until late 2025 at the earliest. This scenario is anticipated to sustain favourable conditions for existing OSV owners, enhancing market dynamics in their favour.

Upstream services market to continue its momentum into 2024. The upstream services market, particularly maintenance and production-related services, experienced a significant increase in activities in 2023. This trend is expected to continue into 2024, with Petronas likely to escalate services for its existing fields. **WASCO (OP; TP: RM1.48)** have already benefited from this uptick in activities, and their order book replenishment prospects for 2024 appear strong. Specifically, services such as well services, chemical treatments, and production enhancement initiatives are projected to maintain their momentum in 2024, supported by still favourable crude oil prices and a potentially more aggressive increase in spending by Petronas.

OSV vessels to gradually transition to higher rates in 2024. The OSV subsegment, in our view, remains underappreciated, with much of its potential upside from DCR not yet fully realized, as OSV operators are currently fulfilling existing charters at rates below the market average. In 2024, we anticipate a gradual shift by OSV players towards charters with higher rates, albeit unevenly across their fleets, as current contracts conclude. The full positive effects of these higher DCRs are expected to materialize from 2025 onwards when a larger portion of the fleet will operate at rates more aligned with global market standards. We recommend ICON as our preferred exposure to the OSV subsegment, expecting it to benefit significantly from this upward adjustment in charter rates.

FPSO outlook remains robust. According to Energy Maritime Associates, the global capex on FPSO could potentially reach USD123b for 2024-2028 (compared to USD100b in 2020-2023). Within the FPSO space, Brazil will still lead the space in terms of capex at USD38b to be spent followed by Africa. Due to high barriers of entry for new entrants, the top five FPSO players in the world will continue to dominate the industry due to their project execution track record and ability to tap into multiple routes of financing for FPSO projects particularly in the high interest rate environment. YINSON, which is one of the top five globally, remains in a favourable position when bidding for new FPSO jobs in the coming years as demand for reliable FPSO players will still exceed supply for the foreseeable future.

2. Midstream

Early signs of optimism for tank terminal market. Following a period of subdued activity in 2022, the global storage market experienced resurgence in utilisation and storage day rates in 2023. DIALOG has indicated a storage rate of SGD 6.5/cbm/day, marking a considerable rise from the 2022 low of SGD 5.5/cbm/day. Similarly, VOPAK, a leading global storage terminal operator, noted an occupancy rate increase to 91% in 2023, up from 88% the previous year. VOPAK's investor relations literatures highlight an ongoing robust demand for crude oil storage, driven by the global rebalancing of trade flows and heightened supply security concerns.

DIALOG is poised for a steady enhancement in earnings from its independent tank terminals. Specifically, the Pengerang area in Johor is expected to attract additional downstream projects in 2024, encouraged by the availability of affordable land and improved governmental stability. Over the longer term, this is likely to boost demand for various types of storage (including crude oil, downstream products, and possibly renewable products), potentially increasing demand for storage capacity in DIALOG's Pengerang Phase 3 project.

3. Downstream

Still awaiting better economic recovery in Asia. Downstream product prices, which reached their bottom in 2023, are projected to maintain a benign outlook into 2024, primarily due to a sluggish global economic climate, notably in China, where growth continues to decelerate. Concurrently, a structural trend towards achieving full petrochemical self-sufficiency in China by 2030 is underway, marked by a multi-year increase in cracker and petrochemical capacities. This expansion is expected to cap any significant upside in downstream product prices. According to insights from ICIS, the ripple effect of this trend will likely compel other regions, including Europe, Singapore, South Korea, and Taiwan, to gradually phase out older facilities lacking economies of scale, aiming to maintain market equilibrium.

Urea prices to remain flattish. We do not expect major changes in price trends in urea prices which is our base case for 2024 at USD375/mt. This is not a large deviation from the 2023 average prices of RM350/mt. China's urea exports remain restricted, but this could ease in the future as its urea output has increased in 2023. One of the largest buyers, Brazil, is having a potential downside to demand for urea as the replanting of crops might be lower in scale compared to 2023 due to the dry season, resulting in lower demand for urea. Demand growth from India is expected to slow as well as it looks to expand its local urea production capacity to reduce its reliance on imports. Additionally, natural gas prices are currently low, at USD 1.8/mmbtu, compared to the USD 2-3/mmbtu range observed in 2023. Therefore, feedstock cost will decrease as well for urea products, which partially limits the potential upside for urea in 2024.

Petrochemical Prices Slightly Off the Bottom

Source: ICIS, Kenanga Research

Urea Prices Still Flattish

Source: Bloomberg, Kenanga Research

We advocate focusing on the upstream services subsegment within the local oil & gas sector, especially in the OSV segment on the anticipation of the pick-up in demand for vessels coupled with tightening vessel supply. Additionally, we favour the midstream segment, particularly tank terminals, as the market indicates signs of bottoming out, and the surge in projects related to low-carbon storage offers growth opportunities for tank terminal operators. The downstream segment does not appear promising in the short to medium term due to global demand concerns.

Our top picks for the sector are:

1. **DIALOG** underpinned by: (i) recovery in demand for independent tank terminal storage from a 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 assets in Baram Junior cluster) which enables the group to capitalise 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 a gradual ramp up in activity observed in the Johor market.
2. **YINSON** due to: (i) a strong FPSO order book pipeline with multiple major FPSO jobs under the conversion stage which provides significant earnings growth in coming years, (ii) a 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) being one of the first local oil & gas company investing in green technology (solar, e-mobility, etc) which in our view would help with the company's long-term energy transition agenda
3. **KEYFIELD** due to: (i) it being a beneficiary of the incoming upcycle of the local accommodation work barge (AWB) market as the supply deficit of vessels persists. With the upstream maintenance activities ramping up further in 2024, the company is well-placed to capitalise on this trend. (ii) its improved balance sheet following restructuring and the disposal of a jack-up rig in 2022, providing considerable flexibility for future asset expansion and (iii) its young fleet age of eight years bodes well for the company as clients typically prefers younger vessels with lower breakdown risks.
4. **ICON** due to: (i) it being a beneficiary of the incoming upcycle of the local OSV market as the supply deficit of vessels persists. With Petronas and other local oil & gas producers expected to increase their demand for OSV vessels, the company is well-placed to capitalize on this trend (ii) its improved balance sheet following restructuring and the disposal of a jack-up rig in 2022, providing considerable flexibility for future asset expansion and (iii) its high operating leverage which could lead to significant benefits during the DCR upcycle, especially as the company's cost base stabilizes following significant inflation in FY23.

Peer Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (sen) 1-Yr. Fwd.	Core EPS (sen) 2-Yr. Fwd.	Core EPS Growth 1-Yr. Fwd.	Core EPS Growth 2-Yr. Fwd.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) 1-Yr. Fwd.	ROE 1-Yr. Fwd.	Net. Div. (sen) 1-Yr. Fwd.	Net Div Yld 1-Yr. Fwd.
Stocks Under Coverage																	
BUMI ARMADA BHD	MP	0.580	0.580	0.0%	3,435.1	N	12/2024	13.8	12.6	144.4%	-8.8%	4.2	4.6	0.5	13.4%	0.0	0.0%
ICON OFFSHORE BHD	OP	0.715	0.800	11.9%	387.3	Y	12/2024	5.3	8.1	285.3%	52.9%	13.4	8.8	1.0	8.0%	0.0	0.0%
KEYFIELD INTERNATIONAL	OP	0.900	1.90	111.1%	NA	N	NA	15.4	17.9	17.1%	15.6%	5.8	5.0	1.1	26.1%	3.1	3.4%
MISC BHD	MP	8.01	7.51	-6.2%	35,754.6	Y	12/2024	51.9	53.9	7.0%	3.9%	15.4	14.9	0.9	5.8%	30.0	3.7%
PETRONAS CHEMICALS GROUP BHD	MP	6.83	6.88	0.7%	54,640.0	Y	12/2024	44.9	45.9	111.1%	2.3%	15.2	14.9	1.3	8.7%	22.4	3.3%
PETRONAS DAGANGAN BHD	MP	21.66	23.70	9.4%	21,518.2	Y	12/2024	99.7	109.8	1.1%	10.1%	21.7	19.7	3.6	16.9%	79.8	3.7%
PETRON MALAYSIA REFINING	MP	4.90	4.74	-3.3%	1,323.0	Y	12/2024	99.6	89.6	-1.1%	-10.0%	4.9	5.5	0.5	10.6%	20.0	4.1%
VELESTO ENERGY BHD	OP	0.275	0.340	23.6%	2,259.3	Y	12/2024	1.8	2.3	46.6%	28.8%	15.5	12.0	0.9	5.7%	0.0	0.0%
WASCO BHD	OP	1.35	1.48	9.6%	1,045.3	Y	12/2024	12.1	14.8	20.0%	22.6%	11.2	9.1	1.3	12.5%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.35	3.41	45.1%	7,113.6	N	01/2025	17.4	19.4	45.2%	11.0%	13.5	12.1	1.4	10.2%	5.0	2.1%
SECTOR AGGREGATE					**144,410.2**					**42.3%**	**4.2%**	**15.0**	**14.4**	**1.3**	**11.2%**		**27.9%**

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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Published by:

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