Oil & Gas

OVERWEIGHT

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Opportunities in Mid-stream and Upstream

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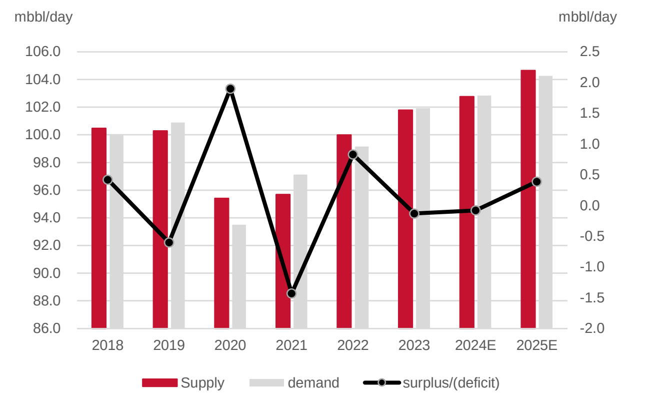
We maintain OVERWEIGHT on the sector. We keep our Brent crude oil price forecasts at USD84/bbl and USD79/bbl for CY24 and CY25 based on the assumption that OPEC+ will discontinue production cuts by the end of CY24 and gradually ramp up production in CY25. These oil price levels are supportive of local upstream investment, especially considering the under-investment by producers in the early 2020s. We favor owners of offshore supply vessel (OSV) and jack-up rigs on favourable rates on the back of a supply crunch and the midstream storage segment due to arbitrage opportunities arisng from a contango in the oil market and oil traders having to structurally hold higher inventories as part of supply-chain risk management amidst heightened geo-political tensions. Our sector top picks are DIALOG (OP; TP: RM3.18), PETDAG (OP; TP: RM23.70) and VELESTO (OP; TP: RM0.34).

1. Upstream

Brent crude price forecast maintained. We keep our CY24 and CY25 Brent crude price forecasts at **USD84/bbl** and **USD79/bbl**, largely in line with the median forecast reported by Bloomberg of USD84/bbl and USD80/bbl, respectively. Year-to-date, Brent crude prices have averaged USD84.2/bbl. Seasonally, we expect Brent prices to weaken slightly in 3QCY24 and strengthen in 4QCY24 as winter impacts the Western economies. An interesting observation is that the forward Brent price implied is at USD80/bbl, which is a discount to the median forecast by analysts as compiled by Bloomberg, reflecting weaker crude market sentiment among oil traders for 2024.

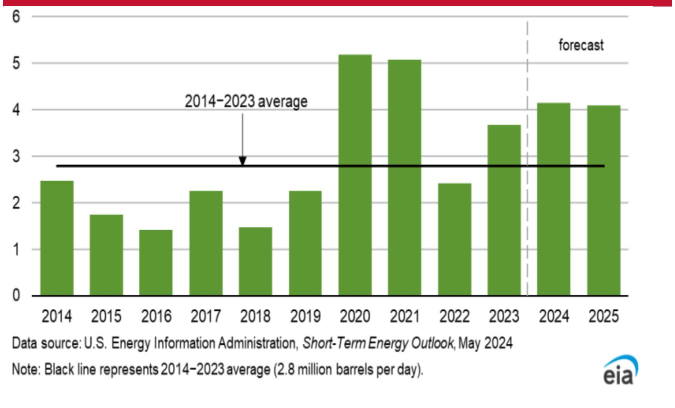
Base case assumptions. We expect that the voluntary OPEC+ production cuts will continue throughout 2024 before increasing production in 2025, leading to a better supplied oil market in 2025. In our view, OPEC+ will gradually unwind its production cuts in late-2024, increasing production by 1m barrels per day, thereby reducing the production cut from 2.2m barrels per day to 1.2m barrels per day. In 2024, production growth will primarily be driven by non-OPEC+ countries, including the US, Canada, Brazil, and Guyana. We also note that OPEC's spare production capacity is above the 2014-2023 average, giving it the ability to ramp up production quickly if needed. We expect demand growth for crude oil to increase by 0.8m barrels per day in 2024, slightly lower than the EIA's expectations, bringing the global crude market to a balanced state overall for 2024.

Global Crude Supply-Demand



Source: EIA, Kenanga Research

OPEC Surplus Oil Production Capacity



Source: EIA, Kenanga Research

Petronas to refocus its capex on domestic upstream. Petronas largely maintains its guidance of RM60b capex for 2024. However, we notice that the share of domestic capex rose by 20% YoY in 1QCY24, compared to the group's total capex increase of 2% YoY. Additionally, 10% of the capex was allocated to cleaner energy solutions and decarbonization projects (i.e., renewables and carbon capture & storage). We believe that this trend will continue throughout 2024, benefiting upstream service providers listed in Malaysia. For context, 1QCY24 domestic capex was RM5.5b, representing 52% of total capex. Assuming the total capex reaches RM60b, domestic capex will hit RM31.2b in 2024, a 19% increase compared to 2023. Therefore, we believe this bodes well for local upstream service providers, particularly those who own offshore assets like jack-up rigs and OSV.

Local upstream services industry already booming. The domestic upstream service players are already observing a strong pick-up in demand from Petronas and other oil producers. The short-term daily charter rate (DCR) for accommodation work boats (AWB) was quoted at RM150,000 for shorter-duration charters (three months or less), exceeding the levels seen during the previous bull market in 2013-2014. Mid-sized anchor handling tug supply (AHTS) vessels, with approximately 5000 bhp, are seeing recent transacted DCRs of RM40,000/day or below, still lower than their previous peak of RM47,000. This implies that the majority of demand is still directed towards brownfield maintenance jobs rather than greenfield projects. Therefore, if the ramp-up in activity continues in the coming months, we believe there will be more upside to AHTS DCRs.

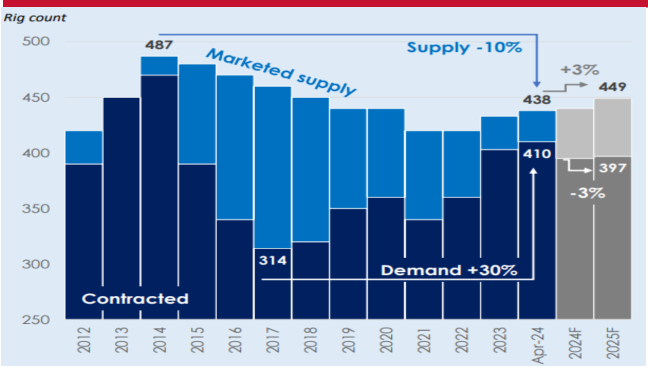
The OSV market still not topping yet. In our view, the OSV market, both domestically and globally, has not yet reached its peak despite some subsegments of vessels achieving all-time high DCRs. One major reason for this view is that the domestic OSV supply is not expected to grow significantly in 2024 and 2025, as we have yet to see large order flows for OSV new builds. **KEYFIELD** has plans for one new build, while **PERDANA (NOT RATED)** has yet to announce any expansion plans as of this writing. Aside from vessel sale announcements, **NAM CHEONG** (previously an OSV shipbuilder) has not secured any major shipbuilding jobs for new build OSVs. **COASTAL (NOT RATED)** has secured shipbuilding contracts for three vessels: a subsea support maintenance vessel and two support and utility vessels. Overall, we believe that the supply increase in the local OSV market is still far from catching up with the incoming demand from Petronas and other oil producers.

Global orders for OSV in China yards surging, but still not sufficient to cater for the supply gap. According to Seatrade Maritime News, the Chinese shipyards are currently experiencing high utilisation rates, due to the strong global demand for container ships, LNG carriers and other specialised ships. Therefore, this makes the China shipyards less incentivised to allocate more yard space for the construction of new OSV vessels. Therefore, we do not foresee a significant expansion of the OSV supply market both domestically and globally in 2024 and even 2025. According to S&P Global, approximately 89 new OSVs will be delivered globally by the end of 2024, which is insignificant compared to 3,200 working OSVs globally.

Upstream topside maintenance and HUC market booming. The upstream services market, particularly maintenance and hook-up and commissioning (HUC) services, experienced a significant increase in activities in 1HCY24. This trend is expected to continue throughout the rest of 2024 as Petronas ramps up its brownfield activities to boost production on its existing fields. **DAYANG (NOT RATED)** and **CARIMIN (NOT RATED)** posted strong revenue growth and EBIT margin expansion in 1QFY24, and we expect this momentum to be sustained in the coming quarters. Consequently, this will drive the demand for AWB vessels, as they are typically utilised for offshore maintenance works.

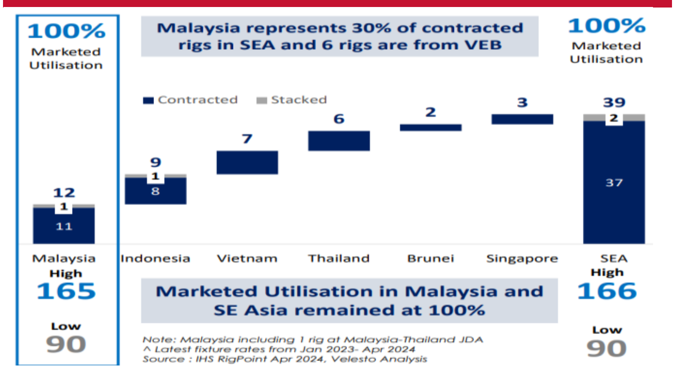
Demand for energy infrastructure will drive the demand for pipelines. According to GlobalData, 196,130 km of new trunk oil and gas pipelines will be laid from the time of writing until 2023. This is almost double the 102,000 km of new pipelines built over the past seven years. In our view, the global oil and gas infrastructure has been underinvested since 2014 due to the weakness in crude prices and the rising focus on ESG initiatives by major oil producers. In the coming years, we believe there will be a shift back to infrastructure spending in the oil and gas sector, as the industry realises the need for oil and gas to bridge the gap to a zero-carbon future. Consequently, we believe that the pipe coating industry will benefit from this structural trend, particularly incumbent players with strong track records, such as **WASCO (OP; TP: RM1.70)**.

Jack-up Rig Supply & Demand



Source: EIA, Kenanga Research

ASEAN Jack-up Rig Count



Source: EIA, Kenanga Research

The jack-up rig market to remain tight in supply. We are not overly concerned about Saudi Aramco's decision to suspend 17 rigs to date, as the demand from other high-demand regions, such as Southeast Asia and West Africa, will likely absorb the additional supply. According to Westwood, the global supply of jack-up rigs will see only modest growth through the delivery of new rigs and multiple reactivations. Westwood expects rig utilisation to reach 96% in 2024, indicating a very tight rig market supply. In Southeast Asia, the utilisation rate of jack-up rigs was at 90% as of early June 2024, according to Baker Hughes. Therefore, we maintain our view that jack-up rig DCR will remain on a bullish trend in 2024, with premium rigs expected to command DCRs of USD120,000-170,000, while standard jack-up rigs are expected to command DCRs of USD80,000-115,000.

2. Midstream

Optimism remains for the tank terminal market. The demand for tank terminal storage has been buoyed by: (i) the oil futures curve having recently switched to contango (the futures price of a commodity being higher than the spot price) from backwardation, which incentivises oil traders to stock up crude oil inventories to be sold at higher prices down the road, and (ii) oil traders having to structurally hold more inventories as part of supply-chain risk management amidst heightened geo-political tensions.

In the Straits region, the supply of tank terminals appears tight due to generally high utilisation rates, according to Insight Global. The Jurong Port tank terminals in Singapore are experiencing high utilisation rates and have recently completed their phase 2 expansion, adding storage capacity of 330,000 cbm. According to Advario (Jurong Port's JV partner for the storage operations), all of the tank farms are already fully occupied by clients. Additionally, the diversion of vessels from traditional routes, such as the Red Sea, has resulted in increased maritime traffic, further driving demand for storage services in Singapore. Therefore, we believe that demand for storage capacities in this region will remain robust. **DIALOG** is poised to benefit from this high activity in Singapore, as more additional activities will likely be directed to Pengerang, Johor.

DIALOG is poised for a steady enhancement in earnings from its independent tank terminals, with spot tank rates currently at SGD6.0-6.5/cbm/day, close to the recent 5-year high of SGD7/cbm/day. Specifically, the Pengerang area in Johor is expected to attract additional downstream projects in 2024 and 2025, driven 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 and the independent tank terminals it currently owns.

3. Downstream

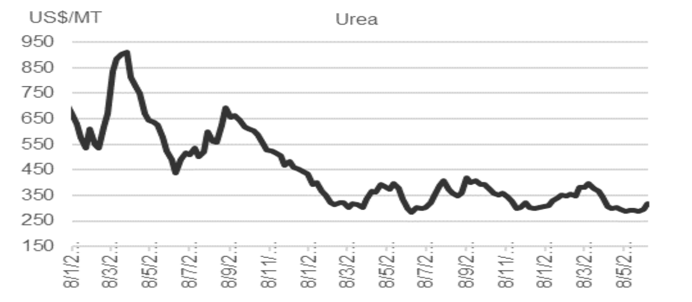
Still awaiting better economic recovery in Asia. Downstream product prices, which bottomed out in 2023, are projected to maintain a benign outlook into 2024, primarily due to a sluggish global economic climate, notably in China, where growth continues to decelerate. Concurrently, China is pursuing a structural trend towards achieving full petrochemical self-sufficiency by 2030, marked by a multi-year increase in cracker and petrochemical capacities. This expansion is expected to cap any significant upside in downstream product prices. There are some early signs of recovery in the specialty market, with the European market showing initial growth, but we have yet to gather evidence of a sustained uptrend for the chemicals market.

Urea prices back to historical averages. Urea prices are expected to range between USD250-300/mt in 2024, which is close to the average seen in the years before 2020 (pre-COVID). We do not anticipate a repeat of situations where China limits its exports of fertilisers, as occurred in 2022. Additionally, the feedstock cost pressure from natural gas is much lower, with Henry Hub natural gas prices recently recorded at USD2-2.50/MMBTU. The lower cost incentivises urea producers to ramp up production, thereby expanding the global supply of urea.

Petrochemical Prices Slightly Off the Bottom

Source: ICIS, Kenanga Research

Urea Prices Back to Historicla Average



Source: Bloomberg, Kenanga Research

We advocate focusing on the upstream services subsegment within the local oil and gas sector, particularly in the OSV segment, due to the anticipated pick-up in vessel demand coupled with tightening vessel supply, as well as the jack-up drilling segment. Additionally, we favour the midstream segment, particularly tank terminals, as the market shows signs of bottoming out, and the surge in projects related to low-carbon storage offers growth opportunities for tank terminal operators. The downstream segment is showing early signs of recovery, but we believe it is still too premature to take a long-term positive view on this sector due to persisting global economic uncertainties.

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. **PETDAG** as we believe the market's selldown on the stock on concerns over lower demand for diesel and petrol following fuel subsidy rationalisation is overdone as the demand for fuel is inelastic. We also like its growing Mesra convenience store chain, leveraging on its extensive petrol station network.
3. **VELESTO** as a proxy to the still bullish jack-up rig market both regionally and globally. We believe that the rig orders suspended by Saudi Aramco will be more than sufficiently absorbed by clients from other regions as a result of the expected ramp-up in drilling activities by other oil producers, and new rig supply will not increase significantly in 2024 due to the high costs of new build rigs.

Peer 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	MP	0.555	0.580	4.5%	3,290.0	N	12/2024	13.8	12.6	144.4%	-8.8%	4.0	4.4	0.5	13.4%	0.0	0.0%
DIALOG GROUP BHD	OP	2.50	3.18	27.2%	14,106.5	Y	06/2024	10.2	10.6	13.9%	4.1%	24.6	23.6	2.4	10.0%	4.3	1.7%
KEYFIELD INTERNATIONAL	OP	2.35	2.69	14.5%	1,880.0	Y	12/2024	17.8	25.4	35.1%	42.3%	13.2	9.3	2.8	29.7%	3.4	1.5%
MISC BHD	MP	8.35	8.09	-3.1%	37,272.3	Y	12/2024	52.9	52.3	9.7%	-1.2%	15.8	16.0	0.9	5.9%	30.0	3.6%
PETRONAS CHEMICALS GROUP BHD	MP	6.56	6.28	-4.3%	52,480.0	Y	12/2024	34.8	41.9	71.3%	20.3%	18.8	15.7	1.3	6.8%	17.4	2.7%
PETRONAS DAGANGAN BHD	OP	17.92	23.70	32.3%	17,802.7	Y	12/2024	99.7	109.8	1.1%	10.1%	18.0	16.3	3.0	16.9%	79.8	4.5%
PETRON MALAYSIA REFINING	MP	4.86	4.74	-2.5%	1,312.2	Y	12/2024	99.6	89.6	-1.1%	-10.0%	4.9	5.4	0.5	10.6%	20.0	4.1%
VELESTO ENERGY BHD	OP	0.265	0.340	28.3%	2,177.1	Y	12/2024	1.8	2.3	46.6%	28.8%	14.9	11.6	0.8	5.7%	0.0	0.0%
WASCO BHD	OP	1.48	1.48	0.0%	1,146.0	Y	12/2024	12.1	14.8	20.0%	22.6%	12.3	10.0	1.4	12.5%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.33	3.41	46.4%	7,022.2	N	01/2025	17.4	19.4	45.2%	11.0%	13.4	12.0	1.4	10.2%	5.0	2.1%
SECTOR AGGREGATE					**142,920.6**					**33.6%**	**8.8%**	**16.0**	**14.7**	**1.5**	**11.1%**		**1.6%**

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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