

SECTOR UPDATE

Oil & Gas – Malaysia

Petronas Set To Embrace Volatilities In Net Zero Transition

Petronas' 1Q24 results showed that no business can escape the effects of volatility, as it experienced lower averaged realised prices, but higher costs. The local capex allocation for O&G and upstream achievements is overshadowed by the many uncertainties of existing projects (PRefChem) and the commercial settlement agreements with East Malaysia. Petronas remains steadfast in its target RM142b upstream capex for five years, with its focus on at least two overseas mega projects.

WHAT'S NEW

- Petronas' 1Q24 profit/EBITDA of RM21b/RM36b declined yoy amid volatility** (-11% / -6% yoy; 4Q23: RM16b/ RM26b), which resulted in lower LNG prices and entitled production growth (-3% yoy). While realised oil price was similar yoy, Petronas' group costs increased 3% yoy to RM70b, but domestic costs grew faster by 10% to RM48b.
- 1Q24 group/upstream capex increased to RM10.7b/0RM6.8b.** While Petronas' capex was similar yoy, local capex surged by 20%, mainly for the Sabah Near-Shore Floating LNG plant (ZLNG) and Kasawari Carbon Capture Sequestration (CCS). Non-O&G/transition capex mix was 11% (1Q23: 18%). 1Q24 upstream capex is on track vs Petronas guidance of RM142b in the next five years both locally and overseas (2023: RM27b). A key highlight in 1Q24 was Malaysia exceeding the 2m boepd production rate (from 1.8m boepd), which is a 2025 target. On the local exploration front, Malaysia achieved resource addition of 1.76b BOE in 2023. Overall, we expect local capex earmarked for asset integrity (maintenance)/production enhancement as the key focus in maintaining local production rates, other than transition and decommissioning.
- Lower oil price expectation.** Voluntary OPEC+ production cuts and geopolitical risks reduced global oil inventories by 0.3m bpd in 1H24, supporting a US\$90/bbl expectation for 2H24. Unless geopolitical risks widens, the spare OPEC+ capacity of 4m bpd and new non-OPEC supply growth may reduce oil price in 2025, based on US Energy Information Administration (EIA) which also cut its 2025 forecast by another US\$2/bbl to <US\$85/bbl. However, the sticky inflation, supply chain disruptions and yard undercapacity continue to discourage offshore marine investments. We think global offshore vessel rates have already exceeded pre-2014 levels with limited upside. However, opex pressure may still arise. According to Randstad, the salary increases for O&G sector can range 15-35%, similar to that for emerging technologies.

ACTION

- Retain MARKET WEIGHT.** The sector's trading outperformance up till 1H24 was justified by the earnings performance of upstream O&G contractors due to rising vessel rates, alongside catch-up in volume of work since COVID-19 for maintenance and production enhancement (eg the Asset Integrity Findings Backlog Closure). While 2H24 will still have newsflow of multi-year contract renewals, we believe the catalysts are mostly priced in, while execution risks alongside energy transition risks prevail.
- Top pick: MISC (BUY/Target: RM9.05).** We still like MISC as it is an underappreciated stock relative to the theme of global vessel shortage, and is trading at P/B discount to other crude tanker peers when long-term crude tanker demand is resilient. MISC is also a beneficiary of more LNG newbuild demand (especially by Qatar). We still like both Yinson and Uzma (small-cap pick) for being the most nimble companies, in non-O&G diversification and ESG developments while preserving high O&G growth. Another stock that continues to benefit from energy security and geopolitical risks is Dialog Group.

PEER COMPARISON

Company	Ticker	Rec	Share Price 30 May 24 (RM)	Target Price (RM)	Market Cap (RMm)	P/E		P/B		Interest Cover		Net Debt to Equity		ROE	
						2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F
Bumi Armada	BAB MK	HOLD	0.59	0.50	3,467.8	4.6	5.7	0.6	0.5	4.5	4.0	47.6	42.5	12.9	9.5
Dialog Group	DIG MK	BUY	2.44	3.10	13,767.9	25.3	22.9	2.6	2.5	12.4	13.1	2.1	3.0	10.6	11.0
Deleum	DLUM MK	SELL	1.36	1.25	546.1	11.3	10.6	1.2	1.2	195.0	112.8	n.a	n.a	11.3	11.5
MISC	MISC MK	BUY	8.28	9.05	36,959.8	14.6	16.9	0.9	0.9	7.2	6.9	28.1	27.5	6.4	5.4
MMHE	MMHE MK	BUY	0.50	0.60	800.0	(81.4)	(17.4)	0.6	0.5	5.1	2.6	2.3	n.a	n.a	n.a
Petronas Dagangan	PETD MK	HOLD	19.42	22.50	19,292.9	19.8	18.9	3.3	3.2	88.6	70.2	n.a	n.a	16.7	17.2
Sapura Energy	SAPE MK	HOLD	0.05	0.06	826.9	(2.0)	(5.6)	(1.1)	(0.2)	0.7	1.0	(1,009.5)	(165.2)	n.a	n.a
Uzma	UZMA MK	HOLD	1.09	1.20	422.1	10.8	10.4	0.8	0.7	5.2	5.1	26.1	47.0	7.8	7.4
Velesto Energy	VEB MK	HOLD	0.28	0.29	2,259.3	17.5	25.2	1.1	1.0	44.0	22.5	n.a	n.a	6.4	4.2
Yinson Holdings	YNS MK	BUY	2.32	3.90	7,023.7	10.4	8.2	1.4	1.3	2.7	2.9	212.6	219.1	10.3	12.4

Source: Bloomberg

MARKET WEIGHT

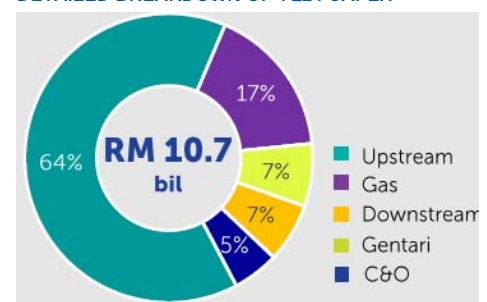
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PETRONAS SEGMENTAL PROFIT, 1Q24



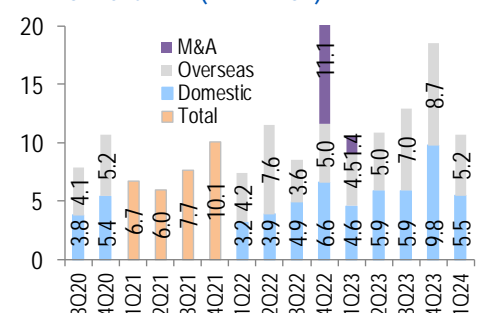
Source: Petronas

DETAILED BREAKDOWN OF 1Q24 CAPEX



Source: Petronas

PETRONAS' CAPEX (RM BILLION)



Source: Petronas *No domestic/ overseas disclosure for 2021

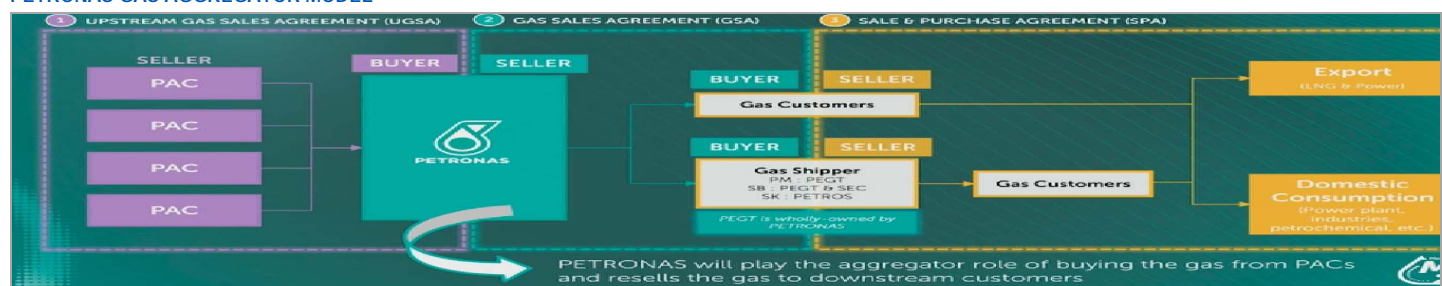
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ESSENTIALS

- **With so many domestic woes, Petronas is resharping its overseas diversification strategy.** Prime Minister Anwar's recent high-level discussion with Aramco on the Pengerang Integrated Complex seems to suggest unresolved legacy issues still linger, or that Aramco may be preparing to expand its retail fuel business using Malaysia as a base. Based on Petronas' and Petronas Chemicals' (PCHEM) 1Q24 reports, Petronas has a US\$373m integrated loan for the PRefChem complex with Aramco, in which the project completion guarantee date had been changed many times "from Dec 23, to Mar 24, to June 24 and now it is expected to be changed to Dec 25".
- **East Malaysia consolidation.** Petronas' role as a gas aggregator to purchase gas from producers via the Upstream Gas Sales Agreement (UGSA), to reselling the gas to downstream customers via GSA and Sales and Purchase Agreements, has benefits as it: a) minimises the monetisation risk and price realisation risks (based on MRP) for upstream producers like Dialog, Hibiscus and Sapura Energy, and b) minimises the supply security risk for customers like PCHEM. Hence, we opine there may be uncertainties during the transitional period for Petronas to hand over its Sarawak gas sales to Petros by 2025. Sabah will follow suit, and at the same time, Sabah Maju Jaya is still negotiating to get more asset stakes back from Petronas. Contractor-related revenue mix of Sabah jobs to Sabahans improved by 40% yoy to RM1.5b in 2023. Petronas have agreed to award 30% of these jobs to qualified Sabahan companies
- **Petronas has set a target to secure a 10% share of the global LNG market,** which implies long-term global LNG output of 52MTPA (vs about 30MTPA currently). Petronas' overseas focus is clear based on recent headlines, including: a) discovering more barrels in Suriname, b) inviting bids from five global contractors for a Floating LNG unit project (FLNG) for Argentina's Vaca Muerta gas reserve. It was speculated that in the initial phase (assuming final investment decision made in 2025), an existing PFLNG of 1.4MTPA capacity will be relocated to the field, and thereafter two new FLNG units of 4-5MTPA each, and c) Petronas' 25%-owned LNG Canada project of 15MTPA capacity (C\$40b cost), has begun commissioning for 2025 startup. It appears that PRefChem, Argentina and LNG Canada Phase 1 are now priority projects for Petronas.
- **ESG: 11% of Petronas group capex was non-O&G (1Q23: 18%).** In detail, renewables (RE) and green mobility solutions took up 7% and 1% capex mix respectively under Gentari, and the remainder 3% for CCS, circular economy or energy efficiency related projects. Gentari now operates the largest network of DC electric vehicle (EV) chargers in Malaysia. When combined with India and Thailand portfolios, Gentari has a network of 699 charging points, and a fleet of 3,012 EVs for Vehicle-as-a-Service segment. Other key ESG highlights included: a) Petronas Chemicals partnering with Sarawak Petchem to explore building a low-carbon ammonia plant in Bintulu, b) Used Cooking Oil (UCO) collection of >249 tonnes achieved via Petronas Dagangan (PETDAG), and c) MISC teaming up with respective partners to evaluate the potential of Liquid Carbon Carriers.
- **With ESG and opex developments, we foresee a consolidation period** for businesses and profit margins, as O&G and renewables are becoming increasingly integrated into long-term strategies, potentially forming a "hybrid sector". Petronas' greenhouse gas (GHG) emission of 11.3m tCO₂e in 1Q24 (Scope 1: 11.1m) is on track vs its: a) 49.5m tCO₂e target by 2024, and b) 50% cut in methane emissions for group-wide natural gas assets by 2025. While costs may grow, there should theoretically be a limit to the upside on contract/day rates, as the capex allocation is not unlimited. Key players that benefit from Petronas' net-zero or "climate mitigation" pathways include MMHE, MISC, Petronas Gas, Petronas Chemicals, Yinson and Uzma. Climate adaptation has not been strongly enforced yet, save for maritime (MISC) and downstream (PETDAG, PCHEM) subsegments.

PETRONAS GAS AGGREGATOR MODEL



Source: Petronas MBR 2024

PETRONAS COSTS ANALYSIS

	1Q24	1Q23	2023	2022
Total	69.7	68.6	271.0	280.7
- % of revenue	78%	76%	79%	75%
Strategic	52.3	52.1	200.6	226.9
- Product costs	30.0	31.6	122.0	123.0
- Tax, SST, duty	12.5	11.6	35.2	56.2
- Non price sensitive (D&A)	9.8	8.9	43.4	50.7
Operational	17.4	16.4	70.4	53.8
- Procurement	8.4	8.9	37.9	24.9
- Other opex	9.0	7.5	32.5	28.9

Source: Petronas Integrated/ Annual Reports

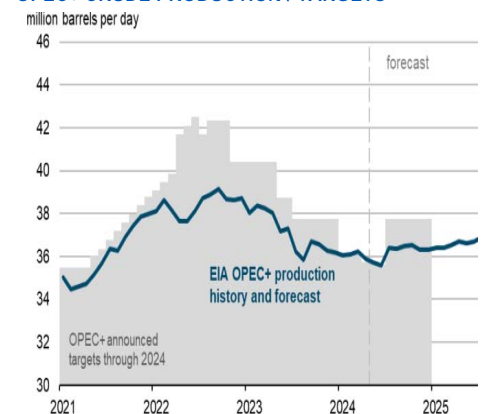
MRP * VS JCC/ BRENT



*Note: Malaysia Reference Price (MRP) is the standard gas price marker across local value chain and provide value to Malaysia Gas, which supports domestic market liberalisation (gradual subsidy removal) and the role of LNG as alternative markets for East Malaysia

Source: Petronas MBR 2024

OPEC+ CRUDE PRODUCTION / TARGETS



Source: U.S. Energy Information Administration

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