SECTOR UPDATE

Oil & Gas – Malaysia

Cautiousness in Business Enquiries: Signs Of Local O&G Capex Slowdown?

Geopolitical risk may be the norm in the new world order, but we think this has been happening in Malaysia for the past six years. The highlight of this saga is when Petros took over the role of sole gas aggregator of Sarawak's gas business, followed by major changes in Petronas' top leadership roles. Although nothing is confirmed, channel checks suggest activities are slowing down. We advocate defensive stocks that are diversified or East Malaysia-based players. Maintain MARKET WEIGHT.

WHAT'S NEW

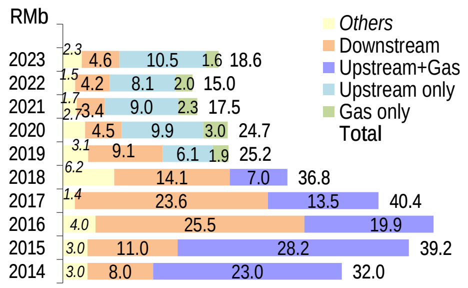
- **Geopolitical risk may be the norm in the new world order, but has been happening in Malaysia for the past six years.** We are referring to the long-drawn saga between Petronas vs East Malaysia, since the time Petronas sought a declaration under the Petroleum Development Act in Jun 18. The key milestone was Petros taking over Petronas as the sole gas aggregator for Sarawak's natural gas trading business locally and overseas (ie LNG) effective Jul 24, with a full transition by 2025. Following Sarawak's announcement on this in May 24, Petronas' website officially displayed top leadership changes effective Jul 24 (please see overleaf).
- **Petronas' domestic revenue mix declined to <30% (2022: 25%, 2023: 29%).** Petronas' overseas diversification, since its foray into LNG Canada in 2011, is a clear sign that it had anticipated this paradigm shift. Despite its total five-year upstream capex guidance of RM142b (RM28b p.a.), this paradigm shift is a key reason behind our view since 2015 that its domestic upstream capex will be relatively unexciting. However, recent developments alongside leadership changes suggest Petronas is going all out on its overseas ventures, despite Petronas' track record of unsuccessful overseas ventures, including multi-year delays in big projects in Canada and Argentina, and the winding up costs of its Mexican unit.
- **These developments might have given rise to concerns on local capex cuts**, especially Sarawak projects. Although things are "business as usual", there has been a decline in business enquiries (for future local tenders), suggesting that activity is slowing. Although this alone does not confirm the rumours, we understand from channel checks that there is a trend of increased cautiousness on O&G capex spending in the supply chain.

ACTION

- **Retain MARKET WEIGHT.** While 2H24 will still have multi-year contract awards, we think catalysts (on O&G project demand alongside higher vessel rates) are mostly priced in. Moreover, as Sarawak is the busiest region for O&G activities in Malaysia, any risks of deferral/descoping can create the possibility of a short-term de-rating in the sector's PE.
- **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 has negligible contract exposure to Sarawak projects, and is also a beneficiary of more global LNG newbuild demand especially from non-Petronas key players like ExxonMobil and Qatar. The recent deliveries of three new LNG carriers for Petronas (Puteri Sejinjang, Puteri Mayang and Puteri Mahsuri) are not expected to be part of MISC's fleet.
- **Advise defensive plays into O&G stocks with ample diversification.** Examples we recommend include Yinson Holdings (a high-growth, top-tier global FPSO player), and Dialog Group (a major storage player that could see earnings recovery from its downstream business). We understand its upstream earnings are not likely to be affected (for Dialog's Baram Junior Cluster, Petronas does not hold any equity stake).

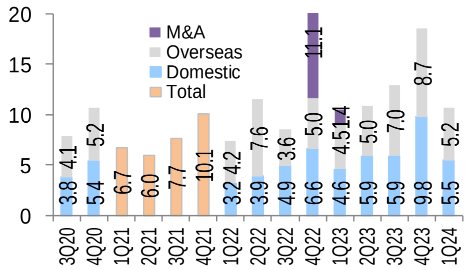
MARKET WEIGHT
(Maintained)

PETRONAS DOMESTIC CAPEX, ANNUAL BASIS



Source: Petronas

PETRONAS' CAPEX, QUARTERLY (RM BILLION)



Source: Petronas *No domestic/ overseas disclosure for 2021

PETRONAS REVENUE MIX** (RM BILLION)

Source: Petronas **:Overseas (Dark Green), Exports (Green), Domestic (Blue)

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PEER COMPARISON

Company	Ticker	Rec	Share Price 19 July 24 (RM)	Target Price (RM)	Market Cap (RMm)	P/E 2024F (x)	P/E 2025F (x)	P/B 2024F (x)	P/B 2025F (x)	Interest Cover 2024F (x)	Interest Cover 2025F (x)	Net Debt to Equity 2024F (%)	Net Debt to Equity 2025F (%)	ROE 2024F (%)	ROE 2025F (%)
Bumi Armada	BAB MK	SELL	0.57	0.50	3,378.9	4.5	5.6	0.6	0.5	4.5	4.0	47.6	42.5	12.9	9.5
Dialog Group	DLG MK	BUY	2.40	3.10	13,542.3	22.6	21.0	2.4	2.3	13.1	13.8	3.0	2.3	11.0	11.2
Deleum	DLUM MK	HOLD	1.31	1.25	526.0	10.9	10.2	1.2	1.1	195.0	112.8	n.a	n.a	11.3	11.5
MISC	MISC MK	BUY	8.65	9.90	38,611.4	15.3	17.6	1.0	0.9	7.2	6.9	28.1	27.5	6.4	5.4
MMHE	MMHE MK	BUY	0.47	0.60	744.0	(75.7)	(16.2)	0.5	0.5	5.1	2.6	2.3	n.a	n.a	n.a
Petronas Dagangan	PETD MK	HOLD	16.86	17.50	16,749.6	17.2	16.4	2.8	2.8	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	n.a	n.a	n.a	n.a
Uzma	UZMA MK	HOLD	1.13	1.20	491.9	10.7	8.6	0.8	0.7	5.1	4.5	47.0	57.1	7.4	8.7
Velesto Energy	VEB MK	BUY	0.24	0.29	1,930.7	14.9	21.5	0.9	0.9	44.0	22.5	n.a	n.a	6.4	4.2
Yinson Holdings	YNS MK	BUY	2.39	3.90	7,136.9	10.7	8.4	1.4	1.3	2.7	2.9	212.6	219.1	10.3	12.4

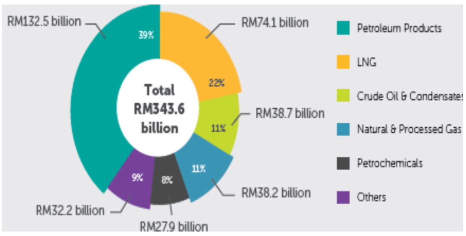
Source: Bloomberg

- **Other defensive plays include East Malaysia-based companies.** Sarawakian stocks like: a) Dayang Enterprise (NR) and its offshore support vessel (OSV) arm Perdana Petroleum (NR), b) Reservoir Link (NR), c) KKB Engineering (NR), d) Ocean Vantage (NR), and Sabah-based players like e) Petra Energy and f) Coastal Contract.
- **Cut Petronas Dagangan's target price to RM17.50 (previous: RM22.50).** Lacking updates from management, we have increased the discount from 10% to 30% on its DDM-based valuation, and the 30% equals to the pre-COVID-19 fuel volume mix arising from diesel, implying a huge loss in market share under the new targeted diesel subsidy scheme.

ESSENTIALS

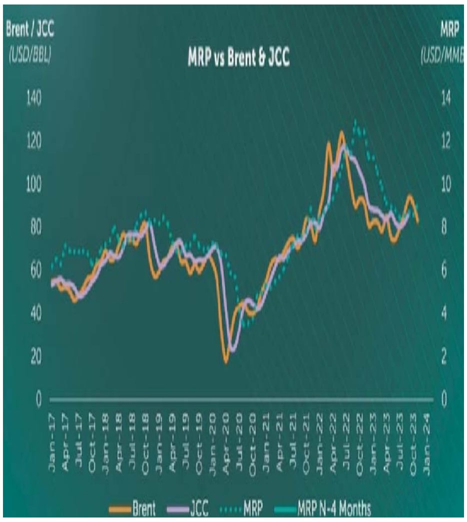
- **Upside on oil price expectation, and offshore marine rates are priced in.** Voluntary OPEC+ production cuts and geopolitical risks reduced global oil inventories by 0.5m bpd in 1H24. Recently, the US Energy Information Agency (EIA) expects inventories to decline by 0.7m bpd in 2H24 and raised its 2H24 Brent forecast from US$84/bbl to US$89/bbl. However, consensus views are divergent, with lower average 2H24/2025 Brent forecasts of US$80/bbl and US$77/bbl respectively. Unless geopolitical risks widen, the spare OPEC+ capacity of 4m bpd and new non-OPEC supply growth may reduce oil price further from 2025. Although oil prices still remain healthy, the Clarksons Offshore Index had closed in at high levels and multi-year chartering tenures (3-5 year firm periods) that are now equivalent to pre-2014 periods.
- This had benefitted key players like Velesto Energy (though not as fully exposed to the rig rate upside vs its global peers), MISC (crude tankers), and OSV players like Perdana Petroleum. A key surprise was Sapura Energy, as its crown-jewel pipelay support vessels (PSLV) fleet (which is already debt-free) successfully renewed Petrobras long-term contracts at pre-2014 rates. The PLSV's profit margin may be high enough to offset the auditor's unqualified opinion.
- **Petros' role as full gas aggregator for Sarawak is a hallmark milestone in East Malaysia consolidation.** Currently, Petronas' role as a gas aggregator is to purchase gas from producers via the Upstream Gas Sales Agreement (UGSA) and resell 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 supply security risk for customers like PCHEM.
- **In the worst-case scenario, Petronas may cut significant future capex related to Sarawak**. As there have been various changes in Petronas' mid-management level/team heads, we opine there may be uncertainties during the transitionary period for Petronas to hand over its Sarawak gas sales to Petros, from Jul 24 until 2025. Other risks may come in the form of administration hiccups: a) delays in future contract awards, or b) descoping or revisions of existing contracts, or "geopolitical" effects which may be more permanent, such as: i) higher contract work allocation/ preference to East Malaysia-based contractors, or ii) loss in retaining key customers especially in LNG, during the renewal of long-term SPAs.

PETRONAS REVENUE BY MIX



Source: Petronas

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

PETRONAS GAS AGGREGATOR MODEL

Source: Petronas MBR 2024

- **RM7b Sarawak Petchem Methanol Complex is now operational, and signifies Sarawak's entry into the global methanol market**, with a production capacity of 1.75MTPA. The plant alongside the Bintulu Additional Gas Sales Facility 2 that will supply 160 MMSCFD natural gas for methanol production are part of Sarawak's ambition to boost GDP by RM34b by 2030. The GSAs signed by Petros, Sarawak Energy and Sarawak PetChem may be Petros' first major deal since it officially became the sole gas aggregator for Sarawak this month. Petros' key 2030 target is to allocate 30% of locally produced gas for domestic demand.
- **In comparison, Petronas Chemical (PCHEM)** is already the fourth largest globally with a methanol production capacity of 2.4MTPA. The benefit to PCHEM remains unclear, as it is merely a support role as technical and marketing manager for 20 years. However, as Sarawak is committed to build a RM6b low-carbon ammonia and urea plant in Bintulu to utilise the gas produced to create its own fertiliser, this may benefit PCHEM should it opt to extend its partnership, but only in the long term.
- **Sabah will follow Sarawak's actions**, 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 has agreed to award 30% of these jobs to qualified Sabahan companies. We observed that Sabah Shell Petroleum Company (SSPC) has awarded key contracts for its operations in Sabah, to two **Sabah-based companies, Neopetro and Sazma Aviation**. Neopetro will provide an accommodation facility to house over 500 personnel during the turnaround of Shell's Gumusut-Kakap platform this year. Sazma Aviation will provide helicopter services to transport workers to Shell's offshore facilities.
- **The greater long-term repercussions on Peninsular Malaysia/Petronas are not to be underestimated.** After announcing Petros' intention to assume the gas aggregator role for Sarawak's long-term vision, Sarawak and Shell held a global launch of a ground-breaking technology of creating butter from gas via Shell's Gas-To-Liquid Microcrystalline Waxes Technology. This may potentially create a huge untappable ESG demand market in food and beverage industry, or cosmetics/beautycare. During the event, Sarawak Premier Abang Johari commented that "Shell has been with us since 1910, and are still partners to this day. Of course, we have new partners, including the national oil company. Perhaps in the queue".

SARAWAK METHANOL COMPLEX

Source: Sarawak Public Communications Unit (UKAS)

GLOBAL LNG EXPORTS BY NATION

	2022 (MT)	Market share (%)	Vs 2021 (MT)
Qatar	79.04	20.3	+2.08
Australia	78.50	20.2	-0.02
US	***75.44***	***19.4***	***+8.41***
Russia (to Europe)	***20.75***	***5.3***	***+1.29***
Russia (to Asia)	11.32	2.9	+1.17
Malaysia *	27.60	7.1	+2.66
Nigeria	14.22	3.7	-2.20
Indonesia	14.00	3.6	+0.18
TOTAL	389.19	100%	+16.89

**Note: Malaysia's LNG market share was 7%. Malaysia used to be the 3rd largest LNG supplier globally before it lost the position to the US in 2019*

Petronas aims to boost its global LNG market share to 10%. This implies a need to boost global LNG capacity of 55MTPA by 2030, vs 40MTPA currently (which includes Petronas' share of Gladstone LNG in Australia)

Key new LNG export projects that are of paramount importance to Petronas include LNG Canada, Argentina (with YPF), and Indonesia (Masadi)

Source: GIIGNL (Global LNG Importers Association) 2023 Report

O&G STOCKS THAT MAY BENEFIT/ARE AT RISK OF POTENTIAL CHANGES IN LOCAL CAPEX

	Details/ Our take	Risks
Dayang Enterprise, and its OSV arm Perdana Petroeleum (NR)	a) Renowned player in the hookup commissioning and modification, construction and maintenance space, with reasonably large market share in terms of hiring the O&G manpower for the jobs b) Regarded as a Sarawakian company	Lacking overseas diversification
Velesto Energy (BUY/ Target: RM0.29)	a) Based on Petronas Activity Outlook, all of Petronas' 13 local jackup (JU) rigs for 2024 are contracted. However, a potential 6/13 JU rigs out of the total 14/15 demand for 2025/26 horizon may not yet be contracted. b) We see negligible earnings risks for 2024 horizon. We understand if any, the termination clauses, and clauses for alternative day rates (due to waiting-on-weather, repairs, standby, force majeure, mobilisation etc) are favourable to the rig players. This is unlike in the past, when zero-rates may be enforced. c) Balance sheet is lean and able to withstand such cash flow stress	a) Lacking overseas diversification. However, our channel checks indicate that rig Naga 3 may likely be employed in Indonesia in 2025 (though it may be in the form of a JV structure).. b) Competition. Ocean Vantage (NR) is a Sarawak-based company that is the exclusive agent for Noble Corp's rigs. JU rig Noble Tom Pressor was deployed in Apr 24 for an 11 firm well job for Shell until Jun 26. Noble has two JU rigs that are available for work, namely Noble Interceptor and Noble Highlander.
Petronas Dagangan (PETD, HOLD/ Target: RM17.50)	Previously, we cut our target price to RM22.50 after applying a 10% discount on its DDM-based valuation. At that time, we assumed PETD may not retain all of its Peninsular Malaysia diesel market share under the Skim Kawalan Diesel Subsidi 2.0. Lacking updates from management, market now assumes a 30% discount. 30% equals to its pre-COVID-19 fuel volume mix arising from diesel.	a) More huge costs to roll out the new Liquefied Petroleum Gas cylinder tanks under the PetroNiaga, an associate in Sarawak b) Petronas recently opened a fuel station in Brazil. Uncertainties may arise if the Brazil business is injected into PETD
Malaysia Marine & Heavy Engineering (MMHE, BUY/ Target: RM0.60)	a) We estimate about 50% of its orderbook (ie Kasawari) is related to Sarawak projects. Kasawari Carbon Capture and Storage project, an Alliance project structure with Petronas, may also face risk of descoping. b) However, in line with Petronas' overseas focus, we understand MMHE's tenderbook is heavily geared towards overseas projects, including offshore wind.	a) We estimate about 50% of its orderbook is related to Sarawak. Kasawari Carbon Capture and Storage – an Alliance project structure with Petronas - may face risk of descoping. b) Competition, as the six-year Frame Agreement for Offshore Structure Works will expire by Jan 25. Competitors include Sarawak-based yards like OceanMight (under KKB Engineering) and Brooke Dockyards.

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