COMPANY UPDATE

Dialog Group (DLG MK)

Storage In A Sweet Spot For 2023; Expansion Catalyst May Be Near-term Event

We see a more persistent storage upside in 2023, as new sanctions and various price caps on Russian products are stimulating blending, realignments and re-exports of fuels. These amplify the need for fuel security and storage tanks demand. However, our forecast is unchanged, as we account for existing projects' earnings risk. Still, we believe storage sentiment is a strong reason for an expansion catalyst (Pengerang Phase 3) to materialise. Retain BUY with an adjusted target price of RM2.85.

WHAT'S NEW

- **Six-month lease for Singapore crude/fuel oil storage surged by 20% yoy,** according to storage players interviewed by Reuters last month. The key driver is the blending of crude and products segment - traders are making huge profit margins from the blending of cheap fuel supplies from Russia, with crude and product shipment from other sources, before re-exporting to the end customers (mostly East Asia). The profit margins from such business can be more than double vs the typical 10-12%. Through this "loophole", oil traders and financial/insurance institutions can still ensure compliance of sanctions (ie not trading Russian fuel directly). This is causing oil tanks in key distribution hubs like Fujairah and the Singapore region to be snapped up.
- **This is a sharp contrast to the industry's situation a year ago,** when inventories were hitting critical lows. In late-22, both Dialog and Vopak guided on the inflection point of the storage industry as offtakers rushed to secure tanks for fuel security. Pengerang Independent Terminal's (PITSB) utilisation and average rates have improved from 80% to 90%, and from S$5 to S$6/cbm respectively. Note that 5 Feb 23 marks the beginning of the trilemma of: a) European Union (EU) ban on seaborne transportation services and US$60/bbl price cap of Russian oil products, b) G7 coalition's US$100/bbl price cap for premium-to-crude products like diesel, and c) G7's US$45/bbl price cap for discount-to-crude products like fuel oil. Even with a 55-day grace period, the sanctions are expected to significantly disrupt product flows between East and West further.
- **Oil storage well-positioned in a sweet spot.** We still see upside room for PITSB's rates, by referencing early-20 and the previous peak cycles, during which Singapore storage rates were as high as S$7-9/cbm. With a possible major realignment of trades and arbitrage windows after 5 February (the US$100/bbl level is akin to "no cap", as it is high enough for traders to cover the cost to "disguise" Russian barrels in diesel), we think there will be more sustainable demand for blending of products. Assuming oil price remains in the US$80-90/bbl range, and with China's reopening that will boost oil demand (especially jet fuel), these will ultimately support high refinery margins and storage tank demands.

KEY FINANCIALS

Year to 30 Jun (RMm)	2021	2022	2023F	2024F	2025F
Net turnover	1,610	2,319	2,605	2,638	2,610
EBITDA	533	574	580	714	779
Operating profit	307	334	318	431	475
Net profit (rep./act.)	543	508	541	629	665
Net profit (adj.)	500	504	531	629	665
EPS (sen)	7.9	8.0	8.4	10.0	10.5
PE (x)	32.2	31.9	30.3	25.5	24.2
P/B (x)	3.5	3.2	3.0	2.8	2.6
EV/EBITDA (x)	29.0	27.0	26.6	21.7	19.8
Dividend yield (%)	1.1	1.1	1.2	1.4	1.4
Net margin (%)	33.7	21.9	20.8	23.8	25.5
Net debt/(cash) to equity (%)	10.5	10.4	8.6	9.7	10.6
Interest cover (x)	20.2	14.3	14.9	17.0	17.3
ROE (%)	12.4	10.5	10.3	11.2	11.0
Consensus net profit	-	-	584	635	680
UOBKH/Consensus (x)	-	-	0.91	0.99	0.98

Source: Dialog Group Bhd, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	RM2.55
Target Price	RM2.85
Upside	+11.9%
(Previous TP	*RM2.35)*

COMPANY DESCRIPTION

Dialog provides engineering, procurement, construction and commissioning services and plant maintenance services. The company also owns tank terminals that store oil and gas while marketing specialty chemicals and equipments.

STOCK DATA

GICS sector	Energy
Bloomberg ticker:	DLG MK
Shares issued (m):	5,642.6
Market cap (RMm):	14,388.6
Market cap (US$m):	3,344.1
3-mth avg daily t'over (US$m):	2.7

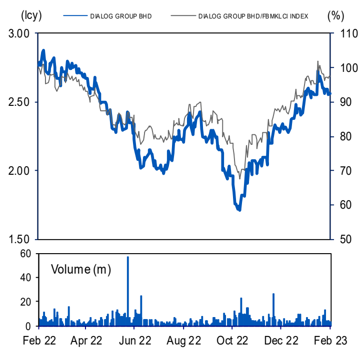
Price Performance (%)

52-week high/low RM2.88/RM1.71

1mth	3mth	6mth	1yr	YTD
5.4	23.2	14.3	(4.9)	4.1

Major Shareholders	%
Ngau Boon Keat	18.3
EPF	14.2
Azam Utama	7.6
FY23 NAV/Share (RM)	0.86
FY23 Net Debt/Share (RM)	0.07

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **We raise PITSB's JV earnings for FY23-25 by 37%/12%/9%,** and also assume a higher expansion catalyst, represented by RM0.60/share in our SOTP (previously RM0.35/share). PITSB's historical earnings can swing wildly depending on the storage industry's cycle. Hence, to reflect the positive sentiment that is not yet fully reflected in current share price, we opt to be very bullish for its near-term forecast by assuming peak utilisation/rates of 90% and S$6.5/cbm respectively for FY23. In tandem with Johor's success in attracting major foreign direct investments, and Pengerang Integrated Development's expansion phase to attract more chemical players (like ChemOne) to set up base, we assume a higher optimism for Dialog to secure new offtakers for its Pengerang Phase 3 storage terminals.
- **However, some of Dialog's projects are still facing earnings risk.** It remains uncertain if Dialog's maintenance and engineering (EPCC) projects will soon experience the earnings inflection to growth (after incurring additional project costs). For storage, we cut our forecasts for the Pengerang LNG2 (PLNG2) by 10-15%, to reflect the 9% reduction in incentive-based regulation (IBR) tariff for regulatory period (RP) 2023-25, to RM3.165/GJ/day (vs RP 2020-22). We also cut Pengerang Terminals (Two) (PT2SB) earnings slightly - although the Pengerang complex had restarted production since Dec 22, we are wary given rumours of major teething issues that prevent ramp-up to optimal production. For upstream, although the Thailand onshore Concession L53/48 will drive earnings, the earnings ramp-up for both Bayan and D21 PSC in Malaysia are delayed, presumably due to the monsoon season that is worse than normal years.
- **No value ascribed to the recent venture of Baram Jr Cluster PSC.** Dialog recently signed the Baram Junior Small Field Asset (SFA) Production Sharing Contract (PSC) with Petronas. The concession will last for 14 years at the minimum, with two years of pre-development phase followed by two years of development until first production. This PSC is part of the six Discovered Resource Opportunities (DRO) awarded under Petronas Malaysia Bid Round 2022. We do not have information on the reserves. But, unlike Dialog's existing upstream projects which are matured, production-stage assets, this venture may seem to be more exploration in nature, but nevertheless is still deemed a low-risk project for Dialog.

  This is mainly because of the new flexibility and enhanced profitability terms in the SFA and DRO PSC. In particular, the SFA terms have a full exit clause at the Year 2 cut-off point - should Dialog decide that the project is not feasible, it are allowed to fully relinquish to Petronas. At this juncture, we conservatively assume that its share price will ignore this project until the end of Year 2, ie the cut-off point to decide if the project is still a go-ahead). Should Dialog decide to relinquish, only the minimum capex commitment ie some seismic studies and drilling of at least one appraisal well, will not be recouped.

EARNINGS REVISION/RISK

- **No change to overall group earnings forecasts.** We believe the recent macro trends show stronger support for a more sustained uptrend in rates and earnings in the independent/spot storage terminals. However, we take the new earnings risks in consideration, and assume for now that the storage upside is almost entirely offset by the delay risks for the Malaysia upstream projects and minor hiccups in the industrial storage terminals. We may fine-tune our assumptions as both Vopak and Dialog will report their 4Q22 results by 15-16 Feb 23.

STOCK VALUATION/ RECOMMENDATION

- **Retain BUY with adjusted target price of RM2.85 (from RM2.35),** which implies FY23F PE of 34x (vs 28x earlier). Our target price upgrade does not reflect near-term earnings catalysts, but instead reflects a prolonged positive sentiment for storage (we boosted DCF for PITSB), which may increase the likelihood for Dialog's long-awaited expansion catalyst (new storage terminals for Phase 3). Although we note that the upside to our target price is not meaningful, we believe the expansion catalyst could be a near-term event. Hence, our current BUY call is a trade on sentiment, and we advise investors to accumulate on weakness.

ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG) UPDATES

- **Environmental**
  - **Carbon (CO_2) emission reduction.** Although greenhouse gas emissions increased in FY21, DLG is installing solar power generation assets to offset this
  - **Safety (HSE).** Nil Lost Time Injury (LTI) frequency in FY22 (FY21: 0.00)
- **Social**
  - **Diversity.** 19% female representation in the management team
  - **>RM440m donations since inception of MyKasih** (set up by the founder)
- **Governance**
  - Five out of nine board members are independent with diverse backgrounds, even though there is family representation in the management team

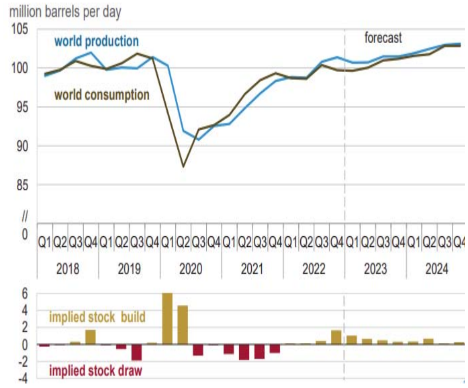
JV SEGMENTS AND FORECASTS

RMm	FY20	FY21*	FY22*
JV/associate line	242.0	227.4	251.6
Pengerang Phase 1, JV	44.8	72.0	49.4
Pengerang 2, JV	145.8	39.9	81.0
Other JV	35.1	35.6	35.6
Pengerang LNG	16.3	79.9	85.6
RMm (forecasts)	**FY23**	**FY24**	**FY25**
JV/associate line	321.2	316.8	318.2
Pengerang Phase 1, JV	77.0	65.4	66.4
Pengerang 2, JV	85.0	94.9	95.1
Other JV and POEC	79.2	77.8	78.0
Pengerang LNG	80.1	78.7	78.6

** No disclosure of PT2SB JV earnings for FY21/FY22 - they were lumped together with the other JV immaterial JV earnings of RM75m/ RM117m respectively*

Source: Dialog, UOB Kay Hian

CRUDE SUPPLY-DEMAND AND INVENTORY



Source: EIA Feb 23 Short Term Energy Outlook

SOTP VALUATION (FY23)

Segments	Valuation	RM/ share
Diluted shares	*6.3b shares*	
Core business	18x P/E on net profit, ex-associates (cut from 22x)	0.92
Kertih Terminal	400,000m³, 30% stake, WACC 9%	0.05
Tanjung Langsat 1 and 2	740,000 m³, 100% stake, WACC: 9%	0.30
Pengerang : Phase 1 and 2	PT2SB recovery offsetting PITSB's weakness	1.04
D35 PSC + Bayan OSC + POEC Thai	Assume O&G price of US$90-100/bbl, but higher WACC of 12%	0.15
Pengerang Phase 3/potential expansion	Expansion potential for PLNG2 and Langsat, and a smaller likelihood for Phase 3 expansion	0.60
(-) Net debt	Including warrant proceed	(0.15)
SOTP		2.85
Implied P/E	+1SD of 10 year average	33.8x
Implied P/B		3.3x

Source: UOB Kay Hian

PROFIT & LOSS

Year to 30 Jun (RMm)	2022	2023F	2024F	2025F
Net turnover	2,319	2,605	2,638	2,610
EBITDA	574	580	714	779
Deprec. & amort.	239	262	283	305
EBIT	334	318	431	475
Total other non-operating income	n.a.	n.a.	n.a.	n.a.
Associate contributions	252	321	317	318
Net interest income/(expense)	(40)	(39)	(42)	(45)
Pre-tax profit	550	610	705	748
Tax	(44)	(59)	(69)	(73)
Minorities	2	(10)	(8)	(10)
Net profit	508	541	629	665
Net profit (adj.)	504	531	629	665

BALANCE SHEET

Year to 30 Jun (RMm)	2022	2023F	2024F	2025F
Fixed assets	2,711	2,709	2,928	3,147
Other LT assets	3,341	3,653	3,926	4,178
Cash/ST investment	1,840	1,915	1,979	2,077
Other current assets	956	1,198	1,212	1,194
Total assets	8,847	9,475	10,044	10,595
ST debt	337	735	785	844
Other current liabilities	811	1,067	1,057	974
LT debt	2,027	1,646	1,758	1,891
Other LT liabilities	19	19	19	19
Shareholders' equity	5,054	5,399	5,808	6,240
Minority interest	598	608	616	626
Total liabilities & equity	8,847	9,475	10,044	10,595

CASH FLOW

Year to 30 Jun (RMm)	2022	2023F	2024F	2025F
Operating	519	886	964	983
Pre-tax profit	550	610	705	748
Tax	(70)	(59)	(69)	(73)
Deprec. & amort.	239	262	283	305
Working capital changes	(265)	10	(23)	(66)
Other operating cashflows	65	64	67	70
Investing	(293)	(800)	(800)	(800)
Capex (growth)	(290)	(500)	(500)	(500)
Investments	(127)	(300)	(300)	(300)
Others	123	0	0	0
Financing	153	(10)	(100)	(85)
Proceeds from borrowings	499	215	163	193
Loan repayment	(40)	(39)	(42)	(45)
Others/interest paid	(307)	(186)	(220)	(233)
Net cash inflow (outflow)	379	77	64	98
Beginning cash & cash equivalent	1,453	1,838	1,915	1,979
Changes due to forex impact	8	0	0	0
Ending cash & cash equivalent	1,840	1,915	1,979	2,077

KEY METRICS

Year to 30 Jun (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	24.7	22.3	27.1	29.8
Pre-tax margin	23.7	23.4	26.7	28.6
Net margin	21.9	20.8	23.8	25.5
ROA	6.0	5.9	6.4	6.4
ROE	10.5	10.3	11.2	11.0
Growth				
Turnover	44.0	12.3	1.3	(1.0)
EBITDA	7.5	1.1	23.0	9.1
Pre-tax profit	(7.5)	10.9	15.6	6.0
Net profit	(6.5)	6.5	16.3	5.7
Net profit (adj.)	0.8	5.4	18.5	5.7
EPS	0.8	5.4	18.5	5.7
Leverage				
Debt to total capital	29.5	28.4	28.4	28.5
Debt to equity	46.8	44.1	43.8	43.8
Net debt/(cash) to equity	10.4	8.6	9.7	10.6
Interest cover (x)	14.3	14.9	17.0	17.3

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