OIL & GAS

Maintain POSITIVE

OGSE subindustry championing the season, thus far

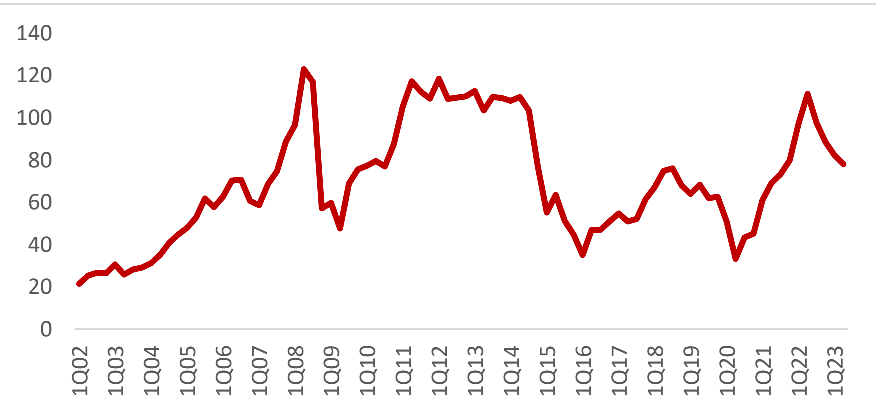
KEY INVESTMENT HIGHLIGHTS

- **Earnings season in North America for 2QFY23 had begun, with Oil and Gas sector lagging behind other sectors in revenue and earnings**
- **However, only the OGSE subindustry performed with +20%yoy in revenue. Major OGSE players had also performed well for 2QFY23**
- **We expect Malaysian OGSE companies may mirror this performance**
- **Maintain POSITIVE on the O&G sector**
- **Top picks for the sector are MISC (BUY, TP: RM8.16) and Dialog (BUY, TP:RM3.28)**

OGSE companies' earnings expected to continue to be upbeat. Malaysia a hub of Oil and Gas Services and Equipment (OGSE) companies in Malaysia plays a crucial role in supporting Malaysia's Oil and Gas sector in terms of operations and growth. To date, there are approximately 2,400 local OGSE companies that are involved in all operations, most notably in the upstream division of exploration, development, production and decommissioning. Earnings season for 2QFY23 had begun in North America, and OGSE companies had been the only exception in an otherwise lacklustre sector performance, as collective revenue soared +20%yoy for the subindustry. As such, we continue to be upbeat on Malaysian OGSE performance.

Brent crude price had fallen. Brent price have fallen from an average of USD111 in 2QFY22 to USD78 in 2QFY23, which dragged down the expectations of oil and gas activities to return back to pre-pandemic levels. This was due to the slow growth in demand from China and the Russian oil embargo earlier this year. Additionally, the market had been grasping on the worry for a recession that could mirror the oil market crisis of 1QCY15 after a peak in 4QCY14.

CHART 1: Brent Crude Oil Price (USD/bl)



Source: Bloomberg, MIDFR

COMPANY IN FOCUS

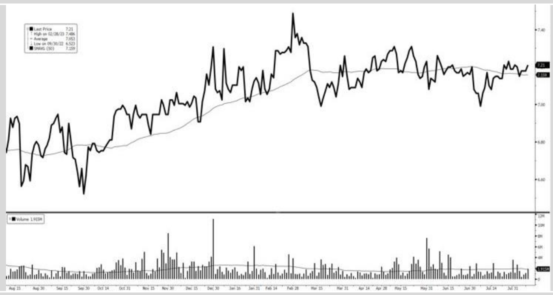
MISC Bhd

Maintain **BUY** | Unchanged Target Price: RM8.16

Price @ 9 August 2023: RM7.21

- Resilient earnings in 1QFY23 due to robust tanker rates in 1QCY23
- Increased global capex by +13% in CY23 in upstream in line with higher demand for FPSO
- Long-term contractual stability for its charter ships

Share price chart



Dialog Group Bhd

Maintain **BUY** | Unchanged Target price: RM3.28

Price @ 9 August 2023: RM2.27

- High potential to expand capacity in Pengerang Energy Complex for storage tank farms
- Orderly integration of upstream assets into its future operations with Petronas to bring in more revenue
- Added more capacity for sustainable solutions, in line with aspirations of NETR

Share price chart

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US energy sector low revenue from low Brent price. The US earnings season had kickstarted in the last week of July-23. To date, the Energy sector in S&P 500 (SP500-10) reported a revenue decline by -29%yoy, and earnings by -51%yoy in 2QCY23. This was in contrast with 1QCY23, where the energy sector's revenue grew +4%yoy and earnings expanded +17%yoy, as Brent was pricing at an average of USD82pb. The lower US energy sector performance for 2QFY23 was likely due to the decrease in quarterly average crude oil prices in 2QFY23.

US OGSE championed the sector. Four out of fives subindustries reported a decrease in revenue, namely (i) Oil & Gas Exploration & Production (-33%yoy), (ii) Oil & Gas Refining & Marketing (-32%yoy), (iii) Integrated Oil & Gas (-30%yoy), and (iv) Oil & Gas Storage & Transportation (-21%yoy). Oil & Gas Equipment & Services (+20%yoy) subindustry is the only one that reported revenue growth. This was attributable to a growing capex for the upstream division, overall, by approximately +58%yoy to USD790b in CY23, as upstream continued to ramp up in exploration and production activities to meet future demand growth post-pandemic, in consideration of increased demand for oil and gas products in China, India and Europe, as well as the expectation that Brent crude price will continue to be supported.

Higher capex by Big Oil despite lower earnings. Major oil players in North America had increased its capital expenditure for the upstream. Chevron and Exxonmobil, two of the Big Oil companies in the US, increased its 2QFY23 capex +30%yoy to USD8.6b and +33%yoy to USD12.6b respectively, despite the lower oil prices in the quarter. Integrated companies, such as ConocoPhillips and Murphy Oil, saw an increase in capex as well by +13-18%yoy. We opine that the increased total capex for the oil and gas upstream due to the: (i) expectations of a demand growth for oil and gas products globally, (ii) stable crude oil prices hovering between USD70-75pb, which were within the companies' breakeven operational threshold, and (iii) full return of workers and experts into the upstream services post-pandemic.

Table 1: 2QFY23 Winners under the OGSE subindustry (North America)

Company	2QFY22		1QFY23		2QFY23		%QoQ		%YoY	
/USD bil	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings
Halliburton (NYSE:HAL)	17.50	1.45	21.69	2.00	22.41	2.49	+3.3	+25.1	+28.1	+71.6
Schlumberger (NYSE:SLB)	24.81	2.66	29.87	3.92	31.19	3.99	+4.4	+1.9	+25.7	+49.9
Baker Hughes (NASDAQ:BKR)	20.46	1.21	22.04	1.34	23.30	1.88	+5.7	+40.2	+13.9	+56.3

Source: Bloomberg, MIDFR

Malaysia OGSE to follow in the footsteps? We expect Malaysian OGSE to mirror the performance of the OGSE companies overseas for the 2QFY23 earnings season, on the foundation that the capex, particularly for the upstream division, had also been increased for CY23. We believe OGSE companies encompassed in the upstream has the advantages of: (i) leveraging advanced technologies for niched and specific upstream operations, (ii) higher demand for maintenance and upgrades even during market uncertainties, (iii) a global reach that can offset regional demand fluctuations, (iv) long-term contracts that provide a degree of revenue predictability, and (v) adaptability to changing trends and diversification.

Higher capex to be the main influence. Malaysia's oil and gas domestic capex for 2023-2027 stood at RM113bil, which would translate into an annual average of RM22.6bil per year. This is comparable to RM101bil or RM20.2bil per annum for 2018-2022, which is a rise of +12%yoy. In 1QFY23, Petronas's capex rose by +42%yoy to RM10.5b, with 44% (RM4.6b) are for domestic players. This currently stood at 20% of its annual average of the domestic capex. We are expecting the capex to gradually rise in CY23, as we consider the increase in crude oil prices in early 3QFY23 and the increase in field discoveries in our local front.

Challenges in the macro picture remains, but Malaysia may be stable. The performance of OGSE subindustry can be influenced by a combination of factors that contribute to its relatively better performance compared to other subindustries. However, several key challenges remain for OGSEs, including, but not related to: (i) broader economic fluctuations, (ii) shifts in energy demand, (iii) supply chain disruptions, and (iv) changes to governmental policies. However, we also note that S&P

500 oil and gas companies are more susceptible to the European energy crisis, major divestments from the upstream division that hampers production, US government mandates and the ongoing Russia-Ukraine war, as compared to our regional and local front. As such, we view Malaysian OGSE to have better stability.

Maintain POSITIVE. At this juncture, we maintain **POSITIVE** on the sector, particularly for the local OGSE companies, ahead of the 2QFY23 performance results. We understood that the lower Brent average price in 2QCY23 and the slow growth in China's economic recovery would have an impact to the earnings of Oil and Gas companies for 2QFY23, however, the advantages for OGSE companies in terms of contractual projects and maintenance services would be the fundamental that keeps the OGSE subindustry to remain resilient in CY23.

Under our coverage and in the top 15 OGSE companies (according to MPRC) are **Bumi Armada (BUY, TP:RM0.83)**, **Dialog Group (BUY, TP:RM3.28)**, **Deleum (BUY, TP:RM1.26)** and **MISC (BUY, TP:RM8.16).** Our top pick would be MISC Bhd, which had been a major player in the floating production, storage and offloading (FPSO) shipping segment. The company has also a wider reach around the globe, providing not only offshore assets for the upstream division, but also maintenance services for drilling platforms and marine vehicles. MISC has also been actively participating in the bid to reduce emissions in the shipping subindustry, aspired by their net-zero carbon emission plans, by involving in the development of renewable energies and cleaner fuel engines.

Table 2: 1QCY23 results summary of Malaysian OGSE under coverage

Company	1QFY22		4QFY22		1QFY23		%QoQ		%YoY	
/RM mil	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings
MISC	2,868	355	4,173	600	3,078	544	-26.2	-9.3	+7.4	+53.4
Bumi Armada	529	186	605	211	544	201	-10.1	-4.6	+2.8	+8.2
Deleum	103	8	316	14	123	9	-60.9	-33.7	+20.1	+12.5
Company	3QFY22		2QFY23		3QFY23		%QoQ		%YoY	
/RM mil	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings	Revenue	Earnings
Dialog	593	133	797	127	803	134	+0.7	+5.4	+35.3	+0.7

Source: Company, MIDFR

Table 3: Comparison of Malaysian OGSE performance under coverage

Stock	Rec.	TP (RM)	Price @ 9-Aug-23 (RM)	Core EPS (sen)		Core PER (x)		Upstream Operations
				FY23E	FY24F	FY23E	FY24F	
MISC	BUY	8.16	7.21	51.0	59.0	16.0	13.8	FSO, FPSO, MVS, Land Transport, Warehousing
ARMADA	BUY	0.83	0.51	13.7	15.1	6.0	5.5	Offshore Construction, OSV, Pipeline, Maintenance, Underwater, MVS, Decommissioning
DLG	BUY	3.28	2.27	10.7	10.9	30.6	30.1	Field Development, Upstream Consultancy, Platform Fabricator, Onshore/Offshore Construction, Onshore Tanks, Pipeline, Drilling and Well Services, Lab, Maintenance, HSSE, Decommissioning, Mechanical Products
DLUM	BUY	1.26	0.90	12.6	16.2	10.0	7.8	Platform Fabricator, Drilling

Source: Company, MIDFR

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DISCLOSURES AND DISCLAIMER

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology