

03 October 2019

## Oil & Gas

### In a Gradual Recovery

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## NEUTRAL



Brent prices have been showing signs of stability, trading within the USD55-70/barrel range throughout most of the year. In recent weeks, drone strikes in Saudi Aramco which affected roughly half the country's output ignited a sharp albeit temporary surge in crude prices, although a sooner-than-expected restoration of production put a firm halt on the surge. Continued production compliance from OPEC and Russia has helped eased supply-side worries, although the U.S.-China trade tensions are currently spurring some demand-side concerns. Overall, we maintain our projected 2019-2020 average Brent price of USD65/barrel, with oil majors comfortable at current levels for increasing investments. That said, with the stabilising of oil prices, we expect a gradual rise in global investments within the upstream space, with Petronas also guiding for increased focus in upstream despite being committed to pay higher dividends. Globally, thus far, we have noticed increased jobs in engineering/construction from the Middle-east and floaters from South America. Locally, players have also started to enjoy an uptick in contract flows for the past 4-5 quarters from various upstream value-chains (e.g. floaters, fabrication, maintenance and drilling). Nonetheless, while these are clear signs of a bottoming-out, we note that the recovery process could be long and gradual, with cost optimisation still key. For stock picks, consistently solid counters (e.g. YINSON, DIALOG, SERBADK) have continued to outperform benchmarks, although value-hunting investors could seek for heavily discounted counters with turnaround potential (e.g. MHB, SAPNRG, PANTECH). We continue to be selective, favouring defensive names with clear earnings outlook, with top picks for the quarter such as MISC and SERBADK. Maintain NEUTRAL on the sector, given limited upside from Petronas-related counters, although with increase sanguinity.



**Brent crude stabilising at current price range.** Brent prices have been trading within the USD55-70/barrel range throughout most of 2019, barring some occasional up and down spikes (YTD-average of USD65/barrel). In recent weeks, drone strikes in Saudi Aramco's refineries affected about 5.7m barrels per day, which makes up roughly half of the country's oil output, igniting a sharp albeit temporary surge in Brent crude prices to as high as USD69/barrel mid-last month. However, the quicker-than-expected restoration of production, on top of maintaining export volumes using spare inventories and production capacity quickly put a firm halt on the surge. That said, OPEC and Russia's continued compliance towards self-imposed production cuts have helped eased supply-side worries, with the U.S.-China trade war tensions causing greater demand-side concerns. Overall, we maintain our projected 2019-2020 average Brent price assumptions at USD65/barrel. We believe this price range to be relatively

comfortable for oil majors to commit to higher investments.

**Investments in upstream expected to recover.** On the back of gradually steadying oil prices, we expect to see greater investments in the upstream space for the coming years. Locally, despite already committed to higher dividend pay-outs in 2019, Petronas has maintained its higher capex spending guidance, with increased focus on upstream. Globally, we have also witnessed increased flow of engineering/construction jobs from the Middle-east while floater demand has jumped rapidly from South America.

**Improvement in local contract flow.** Meanwhile, local players have also started to see uptick of contracts flow in the past 4-5 quarters. As expected, the newer jobs came mostly from the upstream space, such as floaters, fabrication, maintenance and drilling. While this can be seen as a clear sign of a bottoming-out, we note that the recovery process could be long and gradual, with many of the local players still plagued with earnings uncertainties and balance sheet constraints, all while cost optimisation still remains a key theme for new job tendering.

**Disparity in valuations between gainers and losers.** The Bursa Malaysia Energy Index (index of oil and gas counters, excluding Petronas-related names) managed YTD gains of 34%, far outperforming FBMKLCI at -6% returns. Biggest contributors of weighted gains were from YINSON, DIALOG and SERBADK – little surprise there, given their resilient record of superb growth and earnings delivery. As such, we are witnessing a disparity in valuations being formed between outstanding companies within the sector, as compared to the majority of lacklustre oil and gas names. In fact, barring a few names (DAYANG, DIALOG and YINSON), most of the counters within our coverage are currently trading at discounted valuations of -1SD or more below its mean valuations, and as such, some of our OUTPERFORM calls (e.g. MHB, SAPNRG, PANTECH) were selected given that the turnaround stories could not justify the discounted valuations.

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**Maintain NEUTRAL.** Despite a slightly more optimistic tone, we continue to remain NEUTRAL towards the sector, given limited upside to Petronas-linked counters with the exception of MISC. Nonetheless, while traders could find some value in heavily discounted stocks within the upstream space (e.g. SAPNRG, MHB, PANTECH), we remain selective with our stock picks for a long-term investment approach, favouring more defensive names with stable dividend, clear earnings delivery coupled with a palatable balance sheet. **Preferred picks for the quarter include MISC and SERBADK.** Note our changes to our calls for DAYANG and UZMA (both to UP from MP), given recent strength in share price providing gain-realising opportunities.

### List of preferred picks

| Top Picks                          | Comments   |
|------------------------------------|--|
| <b>MISC</b><br>(OP; TP: RM8.80 )   | We like MISC given its stable dividend yield of ~4%, being one of the better ones among FBMKLCI constituent stocks, which provides some defensive support to its share price and thereby limiting the counter's downside risk over the long-term. MISC is seeking to tap into the global mega-FPSO market with active tenders in Brazil. Fruition of this would be another key re-rating catalyst. Meanwhile its low-base in FY18A could help set-up earnings recovery potential for the next 1-2 years (FY19E earnings growth of +30%). |
| <b>SERBADK</b><br>(OP, TP: RM4.80) | SERBADK has one of the best ROEs within the sector, coupled with its spotless track record of earnings growth recovery. Forward earnings are underpinned by its current order-book of RM8.7b, and we expect more contract wins to continue as management targets to hit RM10b order-book by year-end. Current TP is derived from 15x PER on FY20E.   |

### Changes in Calls

| Company       | Previous Rating | Previous TP (RM) | Current Rating | Current TP | Remarks  |
|---------------|-----------------|------------------|----------------|------------|--|
| <b>DAYANG</b> | MP              | 1.45             | UP             | 1.45       | Recent strength in share price provides gain-realising opportunity. SoP-TP implies forward PBV of 1.4x, which is already at +1SD premium against its 5-year mean. Note that our valuations have already taken into account full share-base dilution from the proposed corporate exercises (~20% dilution). |
| <b>UZMA</b>   | MP              | 0.61             | UP             | 0.61       | Recent strength in share price could provide gain-realising opportunity. Ascribed valuations close to -1.5SD below its 5-year mean, given lingering earnings delivery risks and absence of dividend in the foreseeable future to support valuations.   |

Source: Kenanga Research

### Brent Crude Oil Price Chart



Source: Bloomberg, Kenanga Research

**Commentary:** Brent oil prices have been trading between the USD55-70/barrel range for most of YTD-2019 (2019-YTD average of USD65/barrel versus USD71/barrel in 2018)

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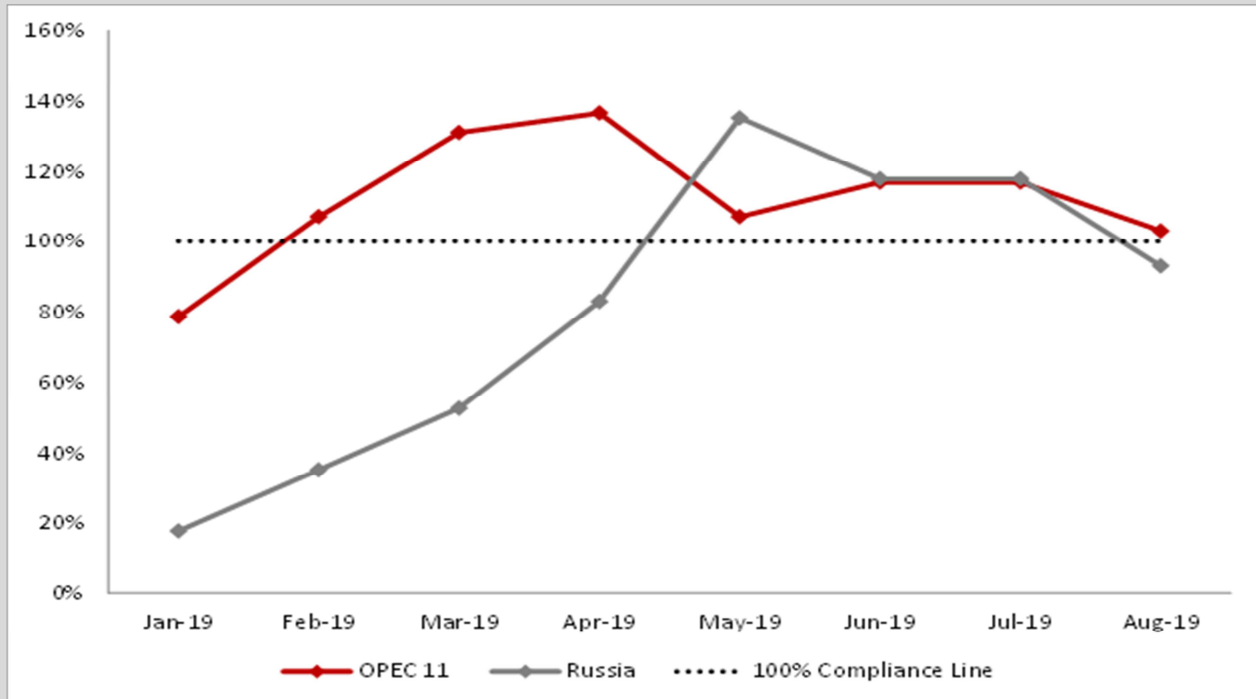
## OPEC's and Russia's Oil Cut Compliance Levels (as at August 2019)

| Production ('000 b/d) | Oct 2018 Benchmark | Pledged Cut | Output Target | Aug-19 | August 2019 Cut From Benchmark | Compliance | Compliance (Yes/No) |
|-----------------------|--------------------|-------------|---------------|--------|--------------------------------|------------|---------------------|
| Algeria               | 1,057              | -32         | 1,025         | 1,020  | -37                            | 116%       | Yes                 |
| Angola                | 1,528              | -47         | 1,481         | 1,400  | -128                           | 272%       | Yes                 |
| Ecuador               | 524                | -16         | 508           | 530    | 6                              | -38%       | No                  |
| Equatorial Guinea     | 127                | -4          | 123           | 120    | -7                             | 175%       | Yes                 |
| Gabon                 | 187                | -6          | 181           | 200    | 13                             | -217%      | No                  |
| Iraq                  | 4,653              | -141        | 4,512         | 4,780  | 127                            | -90%       | No                  |
| Kuwait                | 2,809              | -85         | 2,724         | 2,680  | -129                           | 152%       | Yes                 |
| Nigeria               | 1,738              | -53         | 1,685         | 1,950  | 212                            | -400%      | No                  |
| Republic of Congo     | 325                | -10         | 315           | 330    | 5                              | -50%       | No                  |
| Saudi Arabia          | 10,633             | -322        | 10,311        | 9,830  | -803                           | 249%       | Yes                 |
| U.A.E                 | 3,168              | -96         | 3,072         | 3,070  | -98                            | 102%       | Yes                 |
| OPEC 11               | 26,749             | -812        | 25,937        | 25,910 | -839                           | 103%       | Yes                 |
| Russia                | 11,421             | -230        | 11,191        | 11,290 | -131                           | 57%        | No                  |
| OPEC 11 & Russia      | 38,170             | -1,042      | 37,128        | 37,200 | -970                           | 93%        | Yes                 |

Source: Bloomberg, Kenanga Research

**Commentary:** Note that OPEC 11 does not include Iran, Libya and Venezuela as they were excluded from the production cut deal. Other non-OPEC members (aside from Russia) that have pledged an output cut that are not included in the table above includes Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, South Sudan and Sudan, totalling to 1.2m barrels of crude oil per day of production cut from the Oct-2018 benchmark.

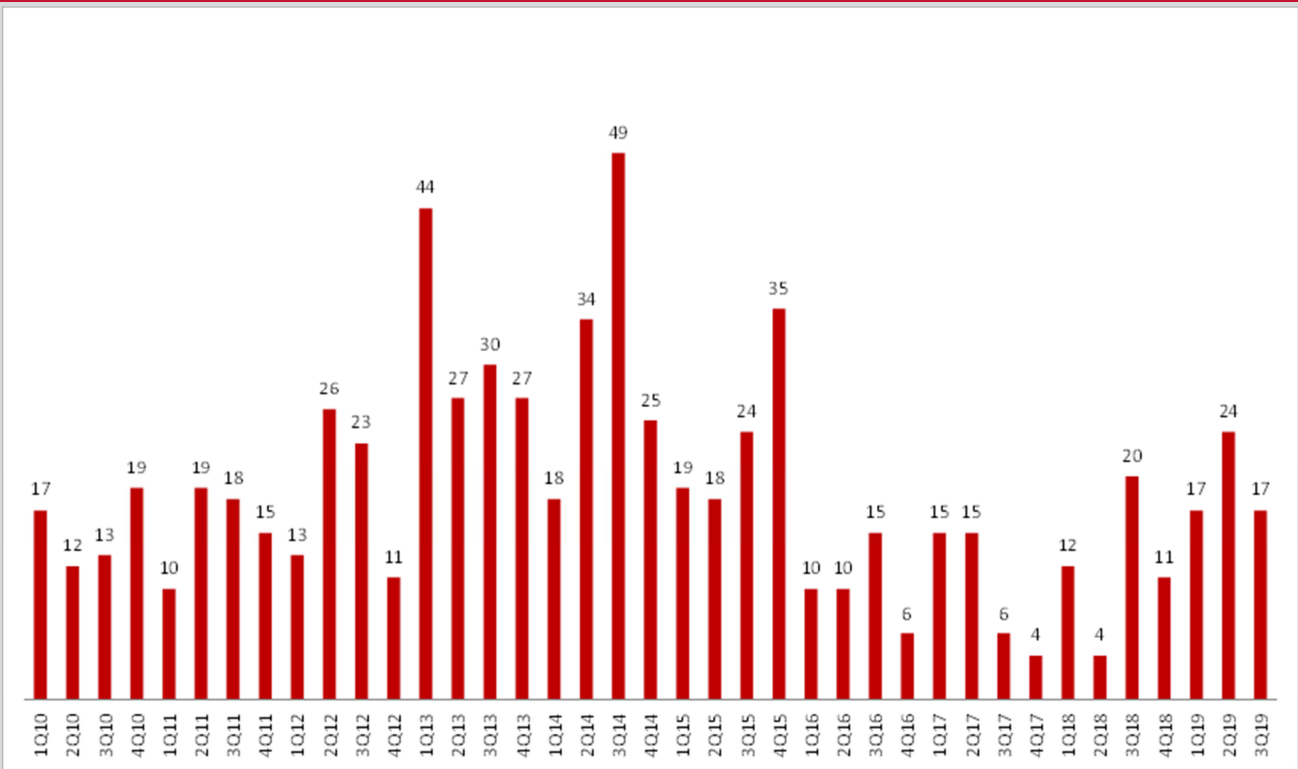
## OPEC 11 and Russia's Production Cut Compliance in 2019



Source: Bloomberg, Kenanga Research

**Commentary:** OPEC 11 had shown track record of compliance, having achieved >100% compliance since Feb-2019. Russia's compliance had been gradually increasing, reaching >100% in May-2019.

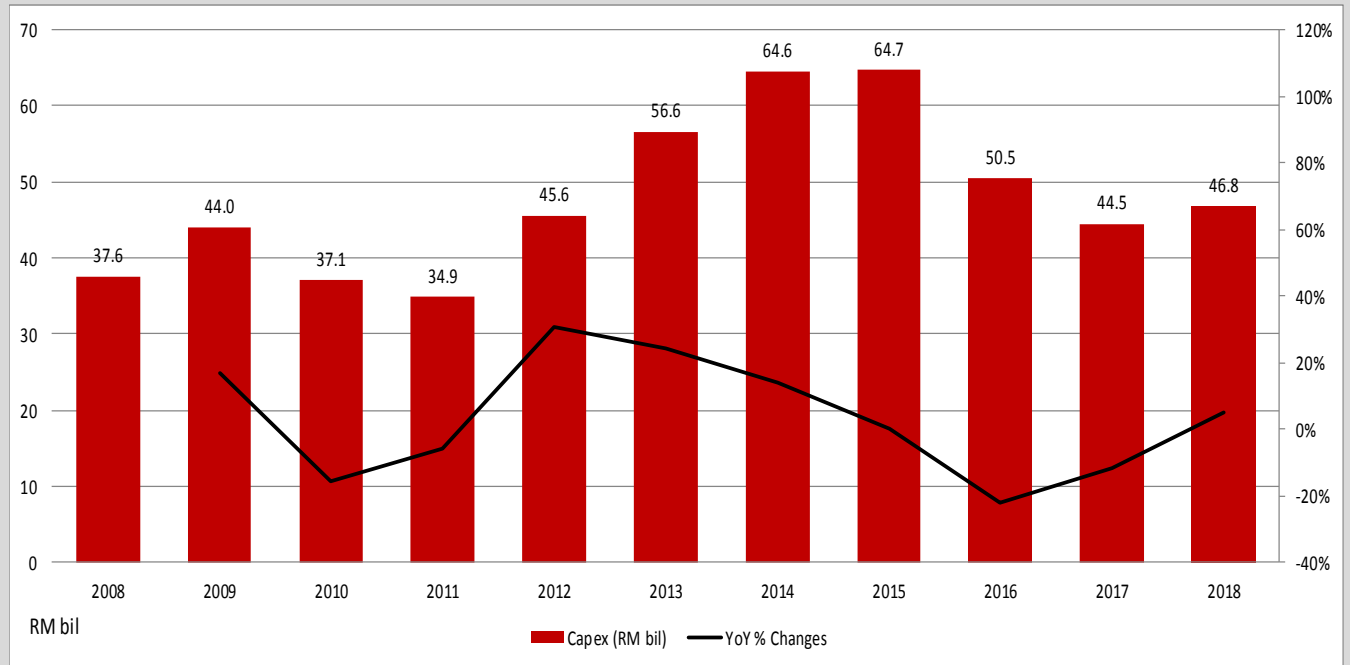
Number of Oil and Gas Contracts Announcements by Quarter



Source: Kenanga Research, Bursa Malaysia

Commentary: Contract flows have started to pick up in the past several quarters, although have yet to repeat their highs as seen in 2013-2014.

Petronas Yearly Capex Spend



Source: Petronas, Kenanga Research

Commentary: Petronas expected to increase 2019 capex to >RM50b, of which ~RM30b will be for upstream.

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## Peer Comparison

| Name                         | Price @          | Market   | Shariah | Current | Revenue Growth |              | Core Earnings Growth |              | PER (x) - Core Earnings |             |             | PBV (x)    |            | ROE (%)     | Net Div. Yld. (%) | Target     | Rating |
|------------------------------|------------------|----------|---------|---------|----------------|--------------|----------------------|--------------|-------------------------|-------------|-------------|------------|------------|-------------|-------------------|------------|--------|
|                              | 20 Sep 2019 (RM) |          |         |         | Cap (RM'm)     | Compliant    | FYE                  | 1-Yr. Fwd.   | 2-Yr. Fwd.              | 1-Yr. Fwd.  | 2-Yr. Fwd.  | Hist.      | 1-Yr. Fwd. | 2-Yr. Fwd.  | Hist.             | 1-Yr. Fwd. |        |
| BUMI ARMADA BERHAD           | 0.330            | 1,939.3  | N       | 12/2019 | -15.9%         | 0.0%         | 34.4%                | 2.3%         | 8.6                     | 6.4         | 6.2         | 0.6        | 0.6        | 9.0%        | 0.0%              | 0.200      | UP     |
| DAYANG ENTERPRISE HLDGS BHD  | 1.60             | 1,543.7  | Y       | 12/2019 | 22.2%          | 4.4%         | -33.9%               | 9.1%         | 9.4                     | 14.2        | 13.0        | 1.4        | 1.3        | 9.5%        | 0.0%              | 1.45       | UP     |
| DIALOG GROUP BHD             | 3.47             | 19,564.9 | Y       | 06/2020 | 17.7%          | 6.1%         | 4.5%                 | 9.7%         | 36.5                    | 34.9        | 31.9        | 5.2        | 4.9        | 14.4%       | 1.2%              | 4.15       | OP     |
| MALAYSIA MARINE AND HEAVY EN | 0.865            | 1,384.0  | Y       | 12/2019 | -10.1%         | 43.0%        | 845.5%               | 139.3%       | N.A.                    | 95.4        | 39.9        | 0.6        | 0.6        | 0.6%        | 0.0%              | 1.05       | OP     |
| MISC BHD                     | 7.75             | 34,594.0 | Y       | 12/2019 | 3.1%           | -2.9%        | 30.2%                | 5.3%         | 26.2                    | 20.1        | 19.1        | 1.0        | 1.0        | 4.9%        | 3.9%              | 8.80       | OP     |
| PANTECH GROUP HOLDINGS BHD   | 0.495            | 371.2    | Y       | 02/2020 | 1.3%           | 5.9%         | 1.3%                 | 6.4%         | 8.5                     | 8.4         | 7.9         | 0.7        | 0.6        | 7.6%        | 3.2%              | 0.690      | OP     |
| PETRONAS CHEMICALS GROUP BHD | 7.69             | 61,520.0 | Y       | 12/2019 | -13.9%         | 4.8%         | -30.3%               | 14.5%        | 12.4                    | 17.7        | 15.5        | 2.0        | 1.9        | 11.1%       | 2.8%              | 7.70       | MP     |
| PETRONAS DAGANGAN BHD        | 23.40            | 23,246.8 | Y       | 12/2019 | -5.6%          | 2.0%         | 12.9%                | 7.7%         | 27.8                    | 24.6        | 22.8        | 3.9        | 3.8        | 15.6%       | 2.8%              | 22.45      | MP     |
| SAPURA ENERGY BHD            | 0.290            | 4,622.4  | Y       | 01/2020 | 5.9%           | 20.7%        | -445.5%              | 236.1%       | N.A.                    | N.A.        | 56.8        | 0.3        | 0.3        | -1.4%       | 0.0%              | 0.330      | OP     |
| SERBA DINAMIK HOLDINGS       | 4.37             | 6,417.3  | Y       | 12/2019 | 23.2%          | 14.3%        | 17.2%                | 13.3%        | 16.7                    | 14.3        | 12.6        | 3.1        | 2.7        | 20.2%       | 2.1%              | 5.25       | OP     |
| UZMA BHD                     | 0.915            | 292.8    | Y       | 06/2020 | -7.6%          | -0.1%        | 117.5%               | 44.1%        | 30.2                    | 13.9        | 9.6         | 0.6        | 0.6        | 4.2%        | 0.0%              | 0.610      | UP     |
| VELESTO ENERGY BHD           | 0.315            | 2,587.9  | Y       | 12/2019 | 5.3%           | 6.2%         | 119.7%               | 152.0%       | N.A.                    | 170.3       | 67.6        | 0.9        | 0.9        | 0.5%        | 0.0%              | 0.350      | OP     |
| WAH SEONG CORP BHD           | 0.640            | 493.1    | Y       | 12/2019 | -47.7%         | -7.7%        | -18.8%               | -18.1%       | 7.8                     | 9.6         | 11.8        | 0.5        | 0.5        | 5.4%        | 0.0%              | 0.620      | MP     |
| YINSON HOLDINGS BHD          | 6.70             | 7,239.5  | Y       | 01/2020 | 0.1%           | 70.1%        | -17.9%               | 66.8%        | 27.5                    | 33.5        | 20.1        | 4.2        | 3.8        | 11.9%       | 0.9%              | 7.75       | OP     |
| <b>Simple Average</b>        |                  |          |         |         | <b>-1.6%</b>   | <b>11.9%</b> | <b>45.5%</b>         | <b>49.2%</b> | <b>19.2</b>             | <b>35.6</b> | <b>23.9</b> | <b>1.8</b> | <b>1.7</b> | <b>8.1%</b> | <b>1.2%</b>       |            |        |

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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