Oil & Gas

1QCY24 Report Card: Sustained Earnings Momentum

OVERWEIGHT

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We maintain our OVERWEIGHT call on the sector. The sector's earnings delivery (against our forecasts) in 1QFY24 was comparable sequentially, with most companies beating or meeting our expectations, particularly those in the offshore support vessel (OSV) and midstream segments. We expect the earnings strength for these subsectors to sustain into coming quarters and Brent crude prices to average at USD84/bbl in 2024, a level that is conducive to upstream spending by oil majors. The upstream services sub-segment will remain the star in 2024 as Petronas ramps up in spending domestically. Our sector top picks are DIALOG (OP; TP: RM3.18), YINSON (OP; TP: RM3.47), and VELESTO (OP; TP: RM0.34).

The sector's earnings delivery (against our forecasts) in 1QFY24 was comparable sequentially with 33%/56%/11% coming in above/within/below our forecasts, vs. 38%/50%/13% during the preceding quarter. **DIALOG** exceeded expectations due to better-than-expected margins from its specialist products and plant maintenance businesses. It appears that its margins have bottomed in 1HFY24, and we expect further gains in the coming quarters as its cost structures normalize. **KEYFIELD (OP; TP: RM2.69)** outperformed expectations despite 1QFY24 being traditionally weak due to the monsoon season. The sustained boom in daily charter rates (DCR) and decent vessel utilization, supported by dynamic positioning 2 (DP2) capabilities, allowed some vessels to remain operational during the monsoon season. We expect this trend to continue in the OSV sector, as there are still no signs of overbuilding of new OSV vessels. **MISC (MP; TP: RM8.09)** delivered stronger-than-expected results due to the robust petroleum tanker market globally; however, we believe that tanker rates could be nearing their cycle peak.

YTD, Brent crude prices have averaged at USD84.2/bbl, with a slight weakness shown recently due to concerns on global demand growth. However, we still maintain our FY24-25F Brent average target of USD84-79/bbl. We expect OPEC+ to maintain their production cuts in the near term before slowly unwinding the cuts in the later part of 2024. In 2025, we expect an easier crude oil market in terms of supply but the Brent crude price level will still be conducive for oil & gas producers to ramp up their capex budget. That aside, another reason for the anticipated increase in upstream capex is also due to the underspending by oil producers in the last decade which resulted in aging infrastructure and tight market in the upstream service provider space.

We expect Petronas to meet its RM60b capex budget in 2024, with a greater emphasis on upstream investments, particularly in the local market, to address the urgent need for mitigating natural production declines. In 1QFY24, the group's capex increased slightly by 2% YoY. However, the share of domestic capex rose significantly, increasing by 20% YoY, indicating the group's growing focus on the local upstream market. The shift is beneficial for local upstream service providers, with OSV players already experiencing significant improvements in fundamentals due to a notable rise in DCR, particularly in the maintenance-focused accommodation work boat category. We believe that as the bull market progresses in the upstream services subsegment, the bullish trend will extend to the anchor handling tug & supply (AHTS) sub-segment, especially for capacity below 5000bhp, as the DCR has yet to reach its all-time highs, which the AWB category has already achieved.

We maintain **OVERWEIGHT** on the sector and favour upstream service providers and midstream player due to favourable macro-outlook. In our view, the upstream services industry is already in the middle of an upcycle with contract terms improving for the upstream service providers due to higher demand from Petronas and lesser contractor availability (compared to 2013-2014). We expect the bullish trend to sustain throughout 2024 and even 2025 as there are still no clear signs of entry in the market by new players yet. The downstream outlook remains tepid due to overcapacity globally and slow recovery in global demand but the specialty chemical market is showing early recovery signs. However, further improvement in downstream product prices still hinges on the outlook of major economies particularly China and Europe.

Our sector top picks are:-

i. **DIALOG** given the recovery in the spot tank terminal markets, gradually improving prospects of further expansion in capacities under Pengerang Phase 3 and turnaround in margins for its EPCC, plant maintenance and specialist product businesses,

ii. **YINSON** due to its multiple FPSO projects scheduled for delivery in the next two years, offering a growth trajectory to its earnings base. We are also confident in Yinson's project execution capabilities, which should enable the timely delivery of upcoming projects, and

iii. **VELESTO** as a proxy to the still bullish jack-up rig market both regionally and globally. We believe that the rigs order suspended by Saudi Aramco will be more than sufficiently absorbed by clients from other regions, and new rig supply is not increasing significantly in 2024.

Quarterly Results Performance

	1QCY24						4QCY23					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
ARMADA		1			1		1				1	
DIALOG	1			1				1			1	
KEYFIELD	1											
MISC	1			1				1			1	
PCHEM			1			1		1				1
PETDAG		1			1			1			1	
PETRONM		1							1			
VELESTO		1			1		1			1		
WASCO		1			1		1				1	
Total	**3**	**5**	**1**	**2**	**4**	**1**	**3**	**4**	**1**	**1**	**5**	**1**
Total (%)	**33**	**56**	**11**	**29**	**57**	**14**	**38**	**50**	**13**	**14**	**71**	**14**

Source: Kenanga Research, Bloomberg

Peer Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE	Net. Div. (sen)	Net Div Yld
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
BUMI ARMADA BHD	MP	0.555	0.580	4.5%	3,290.0	N	12/2024	13.8	12.6	144.4%	-8.8%	4.0	4.4	0.5	13.4%	0.0	0.0%
DIALOG GROUP BHD	OP	2.50	3.18	27.2%	14,106.5	Y	06/2024	10.2	10.6	13.9%	4.1%	24.6	23.6	2.4	10.0%	4.3	1.7%
KEYFIELD INTERNATIONAL	OP	2.35	2.69	14.5%	1,880.0	Y	12/2024	17.8	25.4	35.1%	42.3%	13.2	9.3	2.8	29.7%	3.4	1.5%
MISC BHD	MP	8.35	8.09	-3.1%	37,272.3	Y	12/2024	52.9	52.3	9.7%	-1.2%	15.8	16.0	0.9	5.9%	30.0	3.6%
PETRONAS CHEMICALS GROUP BHD	MP	6.56	6.28	-4.3%	52,480.0	Y	12/2024	34.8	41.9	71.3%	20.3%	18.8	15.7	1.3	6.8%	17.4	2.7%
PETRONAS DAGANGAN BHD	OP	17.92	23.70	32.3%	17,802.7	Y	12/2024	99.7	109.8	1.1%	10.1%	18.0	16.3	3.0	16.9%	79.8	4.5%
PETRON MALAYSIA REFINING	MP	4.86	4.74	-2.5%	1,312.2	Y	12/2024	99.6	89.6	-1.1%	-10.0%	4.9	5.4	0.5	10.6%	20.0	4.1%
VELESTO ENERGY BHD	OP	0.265	0.340	28.3%	2,177.1	Y	12/2024	1.8	2.3	46.6%	28.8%	14.9	11.6	0.8	5.7%	0.0	0.0%
WASCO BHD	OP	1.48	1.48	0.0%	1,146.0	Y	12/2024	12.1	14.8	20.0%	22.6%	12.3	10.0	1.4	12.5%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.33	3.41	46.4%	7,022.2	N	01/2025	17.4	19.4	45.2%	11.0%	13.4	12.0	1.4	10.2%	5.0	2.1%
SECTOR AGGREGATE					**142,920.6**					**33.6%**	**8.8%**	**16.0**	**14.7**	**1.5**	**11.1%**		**1.6%**

Source: Bloomberg, Kenanga Research

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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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