9 January 2023

Energy & Petrochemicals | Regional Oil & Gas

Regional Oil & Gas

Overweight (Maintained)

Expecting a Balanced Oil Market; OVERWEIGHT

Stocks Covered	18
Rating (Buy/Neutral/Sell):	14 / 3 / 1
Last 12m Earnings Revision Trend:	Positive

- **OVERWEIGHT; Top Picks: Bumi Armada, Dayang Enterprise, Yinson, Bangchak Corp and PTT Oil and Retail Business (PTTOR).** We cut our average Brent crude oil price for 1Q23F to USD85/bbl (2023: USD88/bbl), but also think that it will take some time before the impact of China's reopening of borders is felt – this may gather momentum in 2Q23-3Q23. Concerns over soft demand remain, but OPEC+ should still be a major price support. That said, we expect a more balanced oil market in the medium term, with the theoretical supply deficit estimated at 0.2mbpd in 2023.
- **We lower our 2023 Brent crude oil price forecast to USD88/bbl from USD90/bbl, and maintain 2024-2025 projections at USD80/bbl.** Our 1Q23 estimate drops to USD85/bbl as it will take some time before the impact of China's border reopening is felt – it may pick up in 2Q23-3Q23. Overall global crude oil demand should remain healthy, registering positive growth of 2.2mbpd this year. Note that apart from global economic uncertainties, there is also an increased risk of a supply disruption following the commencement of the EU embargo on Russian oil and the implementation of a price cap. For now, we may see a sudden decline in crude exports, but these should eventually be re-routed to other countries as time goes by – premised on the overall global demand being largely unaffected still.
- **Relatively balanced oil market in 2023.** The International Energy Agency's (IEA) December Oil Market Report highlighted that Organisation for Economic Co-operation and Development (OECD) industry oil stocks have increased by 17m bbl to 2.77bn bbl in October, or 150m bbl below its 5-year average. Preliminary data for the US, Europe and Japan show industry stocks rose by 3m bbl in November. Currently, the inventory is above 2010-2014 levels, when oil prices averaged at >USD100/bbl. Based on our assumptions, we expect a relatively balanced market in 2023, with the estimated quarterly deficit-to-surplus ranging from -0.7mbpd to +0.8mbpd. Therefore, it is reasonable to assume that oil prices may stay above USD80/bbl. Meanwhile, a weak economic outlook – or, in the worst case, a recession – would bring down global demand significantly. With OPEC's commitment to cut production, this may somehow provide strong support for oil prices.
- **Sector view.** We believe oil companies will maintain capex and opex spending plans, which will benefit upstream service providers (Yinson, Dayang Entepise and Coastal Contracts). For Malaysia, the overall expectations of upstream activities by services players remain fairly robust. Also, there could be a potential increase in rates for new contracts, to cater for the rising cost of materials. For Thailand, we like PTTOR and Bangchak Corp – both Top Picks – on the basis of their oil & retail business recovery, which in turn would be supported by their nationwide oil & retail service branches in Thailand and neighbouring countries.

Company Name	Rating	Target	% Upside (Downside)	P/E (x) Dec-23F	P/B (x) Dec-23F	ROAE (%) Dec-23F	Yield (%) Dec-23F
Bangchak Corp	Buy	THB39.00	27.9	7.7	0.8	11.2	5.4
Bumi Armada	Buy	MYR0.61	29.2	3.7	0.5	15.7	-
Coastal Contracts	Buy	MYR2.76	11.9	7.9	0.8	10.7	-
Dayang Enterprise	Buy	MYR1.58	20.6	11.4	1.0	9.1	1.1
Dialog	Buy	MYR2.96	22.3	25.7	2.7	10.9	1.7
IRPC	Buy	THB4.50	53.1	9.1	0.7	7.6	6.8
Malaysia Marine & Heavy Engineering	Buy	MYR0.59	(4.6)	29.2	0.6	2.0	-
MISC	Buy	MYR8.10	12.3	14.9	0.9	6.2	4.6
Petronas Chemicals	Neutral	MYR9.34	11.1	11.1	1.6	15.2	4.5
Petronas Dagangan	Neutral	MYR22.58	1.3	26.3	3.8	14.5	3.0
PTT	Buy	THB51.00	56.9	8.4	0.9	11.1	5.7
PTT Exploration & Production	Buy	THB193.00	15.2	10.6	1.4	13.1	3.8
PTT Global Chemical	Buy	THB73.00	57.8	8.3	0.6	7.5	5.5
PTT Oil and Retail Business	Buy	THB35.00	48.9	19.9	2.4	12.7	1.5
Sapura Energy	Sell	MYR0.02	(50.0)	na	na	100.7	-
Star Petroleum Refining	Buy	THB11.70	20.0	6.4	0.9	14.7	3.9
Thai Oil	Buy	THB68.00	25.9	9.6	0.8	8.9	4.6
Yinson	Buy	MYR3.14	27.7	19.4	2.6	14.3	0.8

Source: Company data, RHB

Top Picks	**Target Price**
Bangchak Corporation (BCP TB) – BUY	THB39.00
PTT Oil and Retail Business (OR TB) – BUY	THB35.00
Bumi Armada (BAB MK) – BUY	MYR0.61
Dayang Enterprise (DEHB MK) – BUY	MYR1.58
Yinson (YNS MK) – BUY	MYR3.14

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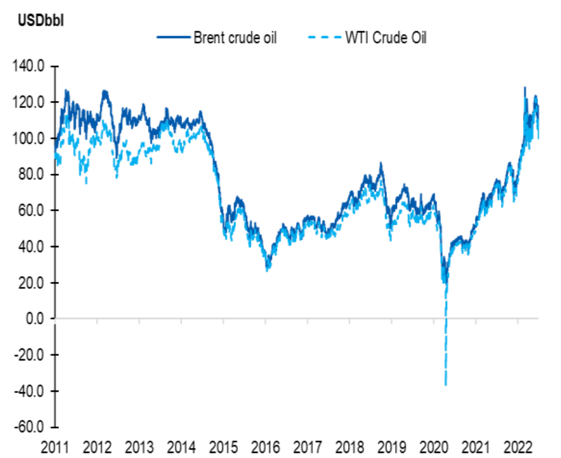
Brent and WTI price trends



Source: Bloomberg

Crude Oil Price Forecasts

We lower our Brent crude oil price forecast for 2023 to USD88 per bbl from USD90 per bbl, and maintain 2024-2025 projections at USD80 per bbl. 4Q22 crude prices averaged USD89 per bbl, bringing the YTD average to USD99 per bbl. This fell below our expectations, largely due to increased negative sentiment resulting from multiple factors, eg higher recession risks amidst weaker consumption in China. We lower our 1Q23 projection to USD85 per bbl as we believe it will take some time before the impact of China's reopening of borders can be felt – although this should garner momentum in 2Q23-3Q23. We assume overall demand to still be healthy this year, registering a positive growth of 2.2mbpd. This is also premised on a no-global recession scenario. We acknowledge the fact that, apart from global economic uncertainties, there is also an increased disruption in the supply side following the commencement of the EU embargo on Russian oil and the implementation of a price cap. For now, we may see a sudden decline in crude oil exports but there should eventually be a re-routing to other countries as time goes by – premised on the assumption that overall global demand will still be largely unaffected.

Our main assumptions are:

i. Global oil demand is projected to grow by 2.2mbpd to 100mbpd in 2022 and another 2.7mbpd to 102.7mbpd in 2023;

ii. Russia's oil and condensate production to decline by an average of 0.8mbpd to 10.0mbpd in 2023;

iii. OPEC production to average 29.2mbpd in 2023 (vs Nov 2022's 28.8mbpd). Such production levels are below than the pre-pandemic level of 29.4mbpd in 2019.

With the assumptions highlighted above, we expect a relatively balanced market with an average theoretical deficit of 0.2mbpd in 2023.

Figure 1: Demand/supply and crude oil prices/forecasts

	2019	2020	2021	2022	1Q23F	2Q23F	3Q23F	4Q23F	2023F
Crude oil price (USD/bbl)									
Brent ,RHB (new)	64	43	71	99	85	90	90	85	88
Brent ,RHB (old)	64	43	71	99	95	90	90	85	90
World oil demand and supply balance (mbpd)									
Total demand	100.2	91.2	96.9	99.6	101.9	100.7	102.0	103.4	102.0
YoY change	1.0	-9.0	5.7	2.6	1.5	2.5	2.5	2.3	2.2
Total non-OPEC	65.6	63.0	63.7	65.6	66.5	66.9	67.2	67.9	67.1
OPEC NGLs	5.2	5.2	5.3	5.4	5.4	5.5	5.4	5.4	5.4
Total non-OPEC +OPEC NGLs	70.8	68.2	69.0	71.0	71.9	72.3	72.6	73.3	72.6
YoY change	2.1	-2.7	0.8	2.0	1.3	2.4	1.6	1.1	1.6
OPEC	29.4	25.7	26.4	28.8	29.1	29.2	29.3	29.3	29.2
Total production	100.2	93.9	95.3	99.8	101.0	101.5	101.9	102.6	101.8
Balance	0.0	2.7	-1.6	-0.2	0.8	-0.8	0.1	0.8	0.2

Note: Data as at Dec 2022
Source: OPEC, RHB

Impact on equities

Oil prices have been fairly weak in the past two months and we have seen companies with exploration and exploration businesses, like PTT Exploration & Production, seeing a concurrent selldown in their share prices. However, the share prices of Malaysian oil & gas (O&G) companies, as evidenced by the Bursa Malaysia Energy Index, have been trending otherwise, surging as high as >20% from low levels in end-October. This was also backed by their strong 3Q22 results (announced in end-Nov 2022). As our oil prices are projected to average at USD88/bbl this year, we believe this will continue to encourage oil companies to maintain their capex and opex spending plans, which will be a boon to upstream services players (Yinson, Dayang Enteprise and Coastal Contracts). For Malaysia, the overall expectations of upstream activities by service providers remain fairly robust.

There could also be an upward revision of rates for new contracts, to cater for the rising cost of materials. That said, we believe margins will not be able to return to pre-pandemic levels amidst rising cost pressures that include higher logistics and equipment costs.

Meanwhile, in Thailand, we like oil retailing players now, as the economy continues to recover and businesses bounce back. Tourism is recovering after the COVID-19 pandemic, leading to a pick-up in demand for transportation services. Gasoline, diesel and aviation oil consumption, as such, is likely to recover. The oil retailing businesses are also doing better, as this is a high season for oil consumption and consumer spending. The Thai Government also plans to introduce measures to spur tourism, retail businesses and transportation activities. Premised on this, we like PTTOR and Bangchak Corp – both Top Picks – on the basis of the recovery of their oil retail businesses. This, in turn, is underpinned by both companies' nationwide oil retail branches in Thailand and neighbouring countries.

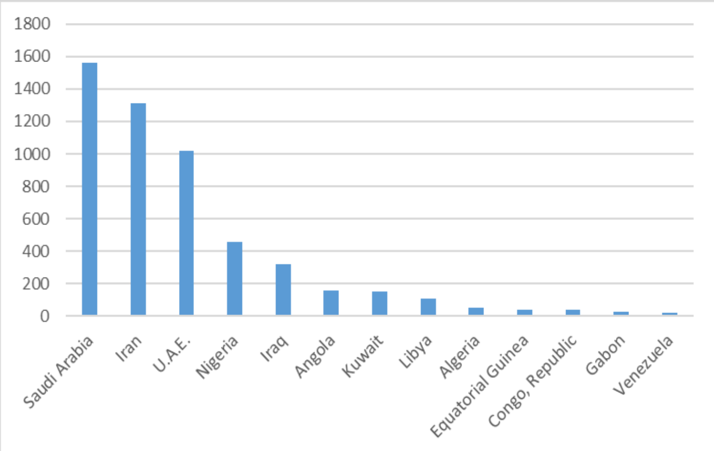
Global oil demand likely to stay healthy in 2023

As per OPEC's monthly report for Dec 2022, oil demand for 2022 and 2023 should stay largely unchanged from Nov 2022 levels. Global oil demand growth is still estimated at 2.5mbpd YoY, taking total demand to 99.6mbpd for 2022F (premised on global GDP growth of 2.8% YoY). For 2023, with a relatively lower global economic growth of 2.5% YoY, global oil demand is projected by OPEC to increase by 2.2mbpd YoY. The non-OECD region is projected to chart higher growth, at 1.9mbpd, vs OECD regions' 0.3mbpd in 2023F. Note that China and India are the largest growth factors, on the back of a recovery in transportation fuel and firm industrial fuel demand, including petrochemical feedstock.

No major action from OPEC+ but the cartel remains a major price supporter

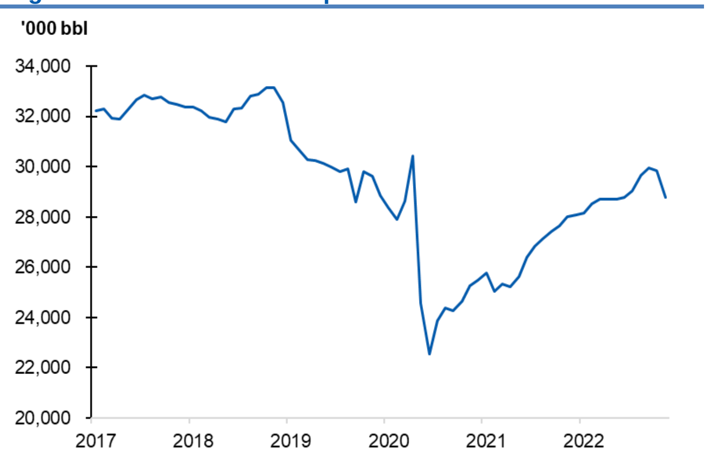
In early Dec 2022, OPEC+ decided to maintain production levels. The frequency of the monthly meetings has been adjusted to every two months for the Joint Ministerial Monitoring Committee, with additional meetings to be hosted anytime to address market developments, if necessary. The 35th OPEC and non-OPEC Ministerial Meeting is scheduled on 4 Jun 2023. We believe the cartel will stay intact – and that it is still one of the strongest influencers in the world in terms of oil supply. According to Reuters, OPEC produced additional 120kbpd of oil MoM (to total 29mbpd) in December, largely due to the rebound in production in Nigeria.

Figure 2: OPEC's spare capacity



Source: Bloomberg

Figure 3: OPEC – crude oil production



Source: Bloomberg

EU price cap and its impact on the oil market

The EU's embargo on Russian oil started on 5 Dec with a price cap of USD60 per bbl, which also includes a mechanism to adjust prices to 5% below market price. We understand that the Urals grade was trading close to this level but saw a steeper decline in early December to USD40/bbl level in North-West Europe. Such a price cap will be reviewed in mid-January and every two months. A 45-day transitional period would apply to vessels carrying Russian oil loaded before 5 Dec, but a grace period of 90 days will be given after the regular review for vessels not to be caught.

The price cap review is an EU-specific mechanism that will require unanimity among the 27 countries that make up the bloc, for any changes to the price level. Once a change is agreed upon by the EU, it will then be discussed at the Group of Seven or G7 level, which includes the US, Canada, Britain and Japan.

If a third country-flagged vessel intentionally carries Russian oil above the price cap, EU operators will be prohibited from insuring, financing and servicing this vessel for the transport of Russian oil or petroleum products for 90 days after the cargo purchased above the price cap has been unloaded. If an EU-flagged vessel violates the price cap, it will be subject to the consequences that follow under each member state's national legislation.

The Russian Government has estimated a 0.5mbpd decline in production and IEA projected a 1.4mbpd drop production in 1Q23. Overall, we may see a sudden decline in crude exports, but there should eventually be a re-routing to other countries as time goes by – premised on overall global demand remaining largely unaffected. We believe the impact of the EU sanction will be partially cushioned by stronger take-up rates from Asia, including China and India, which has been the case since the Russia-Ukraine war broke out. There has also been market talk about potential ways to bypass such regulations including ship-to-ship transfers mid-ocean to hide the origin of the oil products.

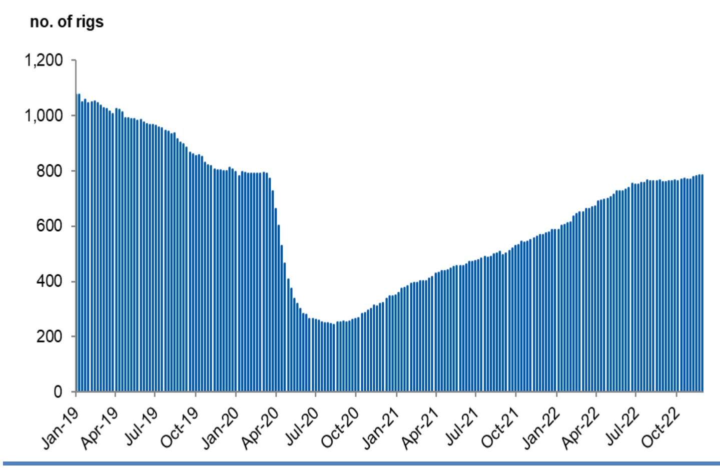
US production remains as a laggard

The US Energy Information Administration (EIA) expects US crude production to improve by 0.5mbpd YoY to 12.3mbpd in 2023. Although this would make the US the producer that delivers the strongest output growth in 2023, such forecasts have been adjusted downwards since the beginning of the year. This is despite the strong rig count numbers. The US rig count is still on an uptrend, albeit, at a decelerating pace – it stood at 784 in early December, up by about 38% from a year ago, but still pointed to a gap from the 900-1,000 levels recorded in 2018-2019.

Despite the strong rig count, US production increased by just 0.4mbpd on average to 12.1mbpd since early 2022. There seems to be no change in shale producers’ strategies, especially in their capex spending, to merely match the natural decline rate or single-digit production growth plan. Meanwhile, they continued to face supply chain disruptions, workforce shortages and equipment bottlenecks – which hampered their production growth. Things got worse when cost inflation hit almost all the items, ie raw materials, labour and equipment, lifting their breakeven levels to high USD50s-low USD60s levels.

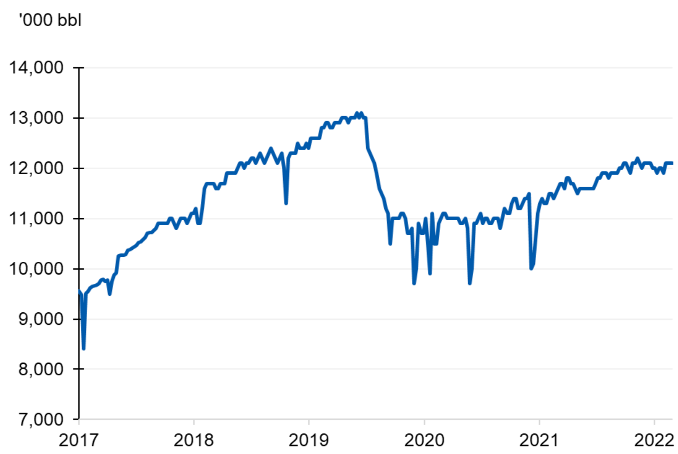
Based on the EIA’s latest Drilling Productivity Report, total drilled but uncompleted (DUC) wells in the US started to increase marginally in November to 4,408 (+0.2%). This suggests drilling may surpass fracking activities.

Figure 4: US rig count



Source: Bloomberg

Figure 5: US crude oil production



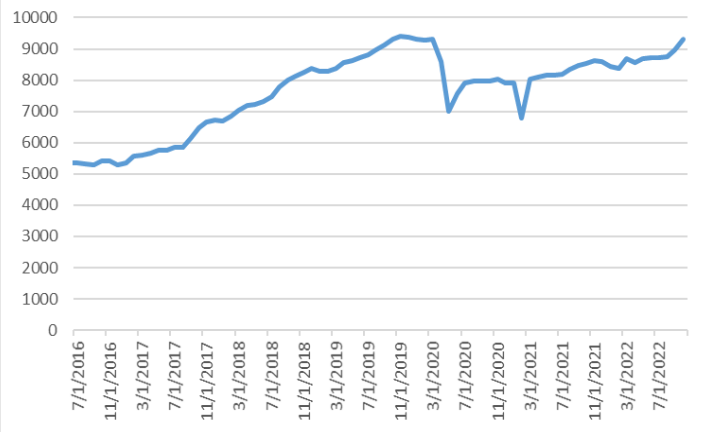
Source: Bloomberg

Figure 6: US annual oil production to accelerate in 2023

(mbpd)	2016	2017	2018	2019	2020	2021	2022	2023
US crude oil production	8.84	9.35	10.99	12.29	11.28	11.25	11.87	12.34
US crude oil production growth	-0.6	0.51	1.64	1.3	-1.01	-0.03	0.62	0.47

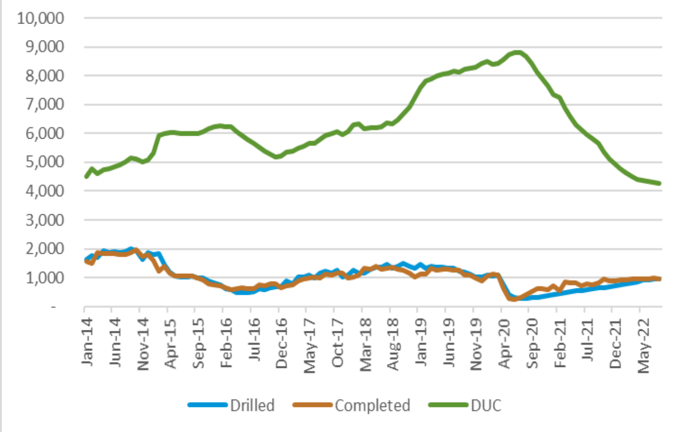
Source: EIA, RHB

Figure 7: US shale production



Source: Bloomberg

Figure 8: Newly drilled, completed wells and DUCs in the US

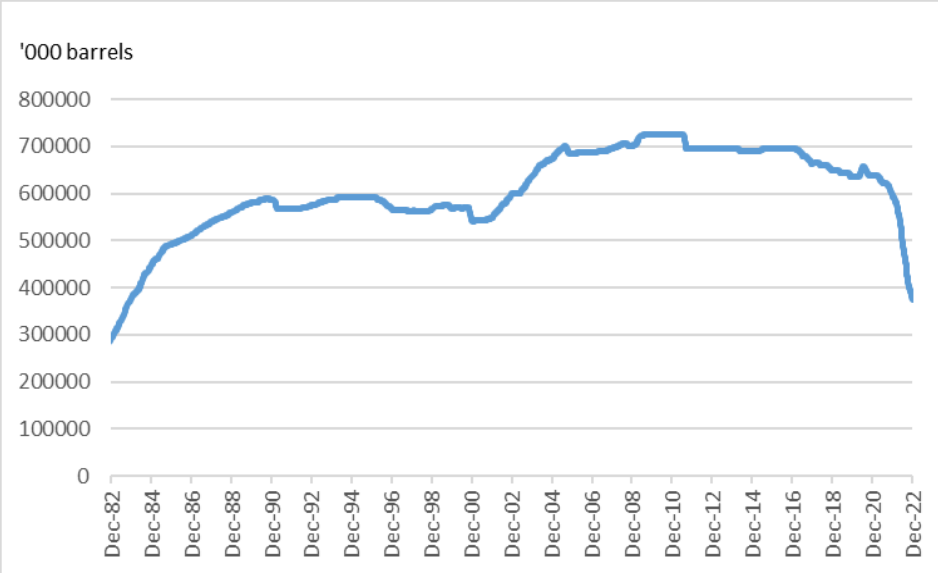


Source: Bloomberg

US to replenish SPR in 2023

Meanwhile, the US announced its plan to replenish the Strategic Petroleum Reserve (SPR) after it released an unprecedented 180m bbl to cool down energy prices. Based on the EIA's disclosure, the US' SPR stock level was at 375m as of end-Dec 2022 – about 211m lower vs the start of this year, before the release plan was announced. This also marks the lowest level since 1984, although it is still well above what the US is required under the agreement with allies in the IEA. At such a low level of SPR, it leaves President Joe Biden with very few options to curb energy prices, as further draining the reserve could heighten the national security risk and make the US vulnerable to another major supply disruption. As such, the replenishment plan is essential to strengthen its reserve, leveraging on the recent weakness in WTI when it traded to USD70/bbl level.

Figure 9: The US' SPR stock levels (1981-2021)



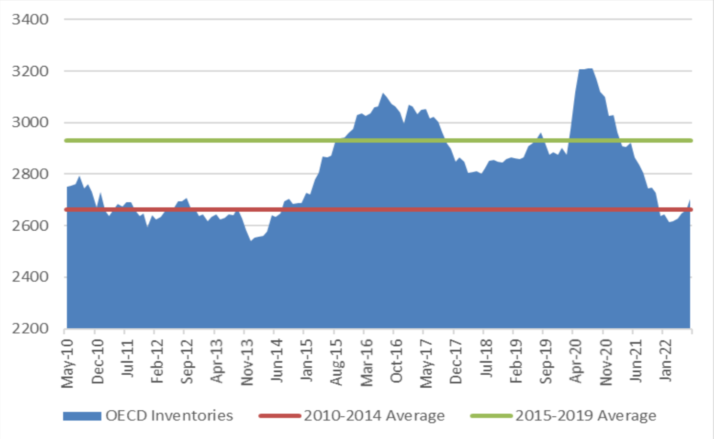
Source: EIA

OECD inventories level are slightly above 2010-2014 levels

The IEA's December Oil Market Report highlighted that OECD industry oil stocks increased by 17m bbl to 2.77bn bbl in October, or 150m bbl below its 5-year average. Despite so, OECD government stocks fell by 20m bbls. Preliminary data for the US, Europe and Japan show industry stocks increased by 3m bbls in November. Currently, the inventory level is above 2010-2014 levels, of which oil prices had averaged at above USD100/bbl. Based on our assumptions, we expect a relatively balanced market on average in 2023, with the estimated quarterly deficit-to-surplus range of -0.7mbpd to +0.8mbpd. Therefore, it is reasonable to assume that oil prices could stay above USD80/bbl.

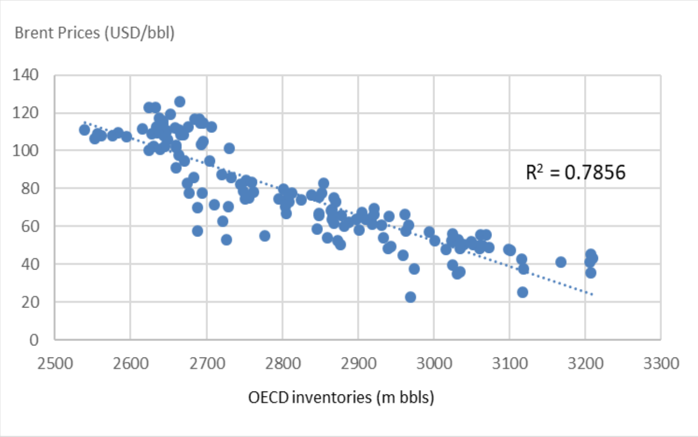
On demand, a weak economic outlook – or, in the worst case, a recession – could bring down global demand significantly. With OPEC's commitment to cut production, this may somehow provide a strong support for oil prices.

Figure 10: OECD inventories are slightly above the 2010-2014 averages



Source: Bloomberg

Figure 11: OECD inventory levels are strongly correlated with oil prices



Source: Bloomberg

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