



# OIL & GAS

*Petronas' loss crimps dividend prospects*

**OVERWEIGHT**

(Maintained)

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*Rationale for report: Sector update*

## Investment Highlights

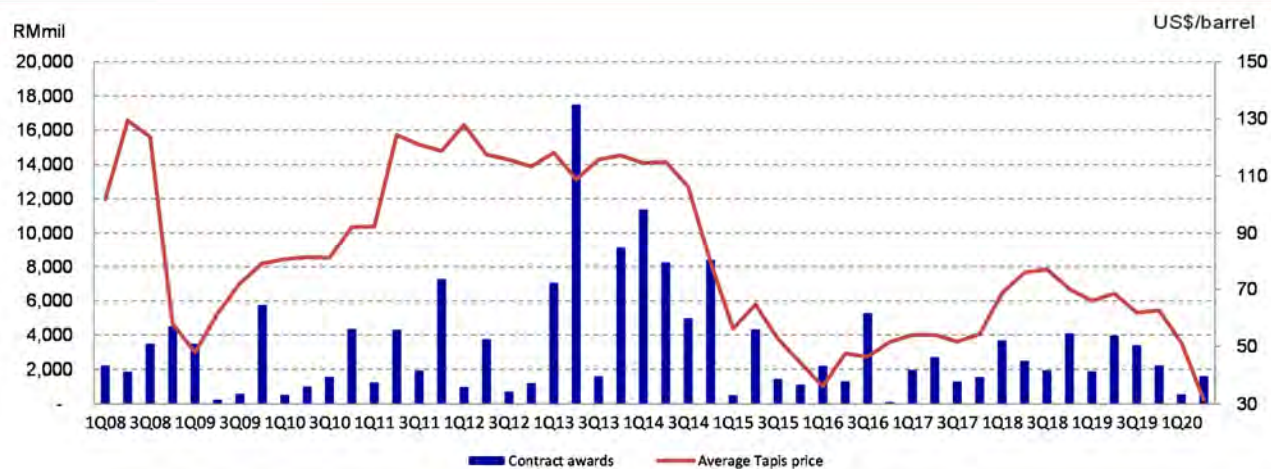
- **Petronas' 2Q2020 core results reversed to a loss of RM689mil.** Excluding impairments of RM21bil for assets due to the group's less optimistic long-term crude oil price outlook amid the global transition to renewable energy, Petroliaam Nasional's (Petronas) results reversed from a 1Q2020 core net profit of RM8.5bil to an unsurprising 2Q2020 loss of RM689mil due to lower product prices, weighed down by the Covid-19 global lockdown together with the earlier Saudi-Russian price war. During the quarter, average Brent crude oil prices fell 39% to US\$31/barrel, with futures temporarily reversing to an abnormally negative US\$38/barrel in April this year. All 3 core divisions suffered 2Q2020 losses, with the worst in the upstream segment which bore 59% of the loss, followed by gas & new energy (40%). This 2Q2020 loss dragged 1H2020 core net profit down 65% YoY to RM8.7bil (See Exhibit 3).
- **Global drop in demand cuts crude production down 17% QoQ.** Petronas' 2Q2020 crude oil production fell 17% QoQ and 15% YoY to 2mil barrels of oil equivalent (BOE), largely due to lower demand during the global lockdown. This likewise dragged 1HFY20 output by 7% YoY to 2.3mil BOE.
- **Capex spending shrank 26% QoQ.** Petronas' 2Q2020 capex shrank 26% QoQ to RM6.3bil with upstream accounting for 76% of the drop. Geographically, the reduction was more pronounced overseas as the proportion of Petronas' domestic spending rose to 58% from 53% in 1Q2020. Petronas affirmed that the announced cuts of 21% for capital and 12% operating expenditure this year remained on track, with potentially higher savings generated towards the end of the year. Besides cost compression focus and deferment of selected projects, the group highlighted a portfolio shift towards liquefied natural gas and renewable energy investments which could mean reduced upstream interest in greenfield projects with low prospective returns.  
Even though a measure of optimism has returned for crude oil prices, we expect oil producers to proceed with their planned production cuts for this year given that demand globally remains depressed amid the prolonged Covid-19 movement restrictions and social distancing measures which could mean potentially long-term changes in energy usage. So far, 20% to 30% capex reductions for 2020 have been announced by Exxon Mobil, Royal Dutch Shell, Saudi Aramco and Petrobras. In 1H2020, new contract awards to Malaysian operators dropped 62% YoY to RM2.2bil, with the worst fallout yet to come in 2H2020 onwards.
- **No dividends declared so far in 2020.** While Petronas declared a 2019 dividend of RM24bil, the group did not declare any interim dividend in that year. Likewise, we are not surprised that Petronas has yet to declare any dividends to date for 1H2020 given the current losses and uncertain prospects for the rest of the year. However, given Petronas' net cash of RM64bil and reserves of RM351bil, we expect Petronas to still declare some dividends, albeit potentially lower, by the end of the year as the group is likely to experience a turnaround in 2HFY20 on higher crude oil prices and demand expectations.
- **Remain cautious on selected highly geared companies.** Against the backdrop of a sharp demand drop in upstream oil services, we remain cautious on companies with high gearing levels such as Sapura Energy, which needs to restructure its RM10bil debt by the end of this year. As there is a risk that Velesto could reverse to a loss in 2HFY20 due to lower rig utilisation, balance sheet risks may re-emerge next year.
- **Maintain 2020 oil price forecast at US\$40–US\$45/barrel and 2021 at US\$45–50/barrel.** YTD, Brent crude oil prices have averaged US\$42/barrel with the current spot price also at US\$42/barrel from the year-low of US\$14/barrel on 22 April 2020. This is supported by US crude oil inventories declining by 6% to 508mil barrels currently from the all-time high of 541mil barrels in June. Hence, we maintain our crude oil price forecast at US\$40–US\$45/barrel for 2020, in line with Petronas' near-term view, and US\$45–US\$50/barrel for 2021. For comparison, the EIA's *Short-Term Outlook* projects crude oil price at US\$41/barrel for 2020 and US\$50/barrel for 2021.
- **Maintain OVERWEIGHT call** with 5 BUY calls vs only 2 SELLS and 1 HOLD. Despite the ongoing volatility of crude oil prices, the down cycle may have reached a bottom with the worst experienced in April this year when Brent spot prices fell to a low of US\$14/barrel while futures inverted to an abnormal negative price due to lack of storage capacity. We recommend **Petronas Gas**, as the group's optimal capital structure strategy and resilient earnings base translates to highly compelling dividend yields. We also like **Dialog Group** and **Serba Dinamik Holdings** due to their resilient non-cyclical tank terminal and maintenance-based operations while **Petronas Chemicals Group** has a high correlation to the recent oil price upturn. Even though **Bumi Armada** is still likely to experience asset impairments towards the end of the year, the company has shown stabilising profitability from improved operating performance of its floating production, storage and offloading vessel, Armada Kraken together with a stronger balance sheet.

## EXHIBIT 1: VALUATION MATRIX

Stocks	CALL	Price			Mkt Cap	FYE	EPS (sen)		EPS growth (%)		PE		BV (RM)	P/BV (x)	ROE (%)	NDPS	Div Yield (%)	Net gearing (%)
		(RM)	(RM)	Up/down side (%)			RMmil	FY20F	FY21F	FY20F	FY21F	FY20F						
Bumi Armada	BUY	0.29	0.47	62.1	1,701	Dec	2.0	2.2	96.8	12.8	14.7	13.1	0.57	0.5	3.5	-	-	261.9
Dialog Group	BUY	3.71	4.85	30.7	20,918	June	10.7	11.7	12.3	9.9	34.8	31.6	0.73	5.1	15.3	3.1	0.8	16.2
MISC	HOLD	7.62	7.70	1.0	34,014	Dec	38.2	39.1	5.9	2.4	19.9	19.5	4.00	1.9	4.8	33.0	4.3	17.1
Petronas Chemicals Group	BUY	5.55	7.05	27.0	44,400	Dec	20.8	32.4	(40.8)	55.9	26.7	17.1	3.46	1.6	5.5	11.1	2.0	(33.3)
Petronas Gas	BUY	17.36	21.30	22.7	34,351	Dec	106.1	108.0	11.3	1.8	16.4	16.1	4.24	4.1	15.7	98.0	5.6	5.1
Sapura Energy *	SELL	0.13	0.05	(60.0)	1,992	Jan	(1.8)	(0.6)	(66.1)	(65.1)	(6.9)	(19.7)	0.58	0.2	(3.2)	-	-	112.7
Serba Dinamik	BUY	1.75	2.20	25.9	5,900	Dec	17.1	19.4	6.4	13.4	10.2	9.0	0.98	1.8	20.2	5.1	2.9	57.8
Velesto Energy	SELL	0.14	0.09	(35.7)	1,150	Dec	(0.3)	(0.3)	(166.1)	17.6	(52.4)	(44.6)	0.7	0.2	(0.8)	-	-	27.6

Source: AmInvestment Bank

## EXHIBIT 2: CONTRACT AWARDS TO MALAYSIAN O&amp;G PLAYERS



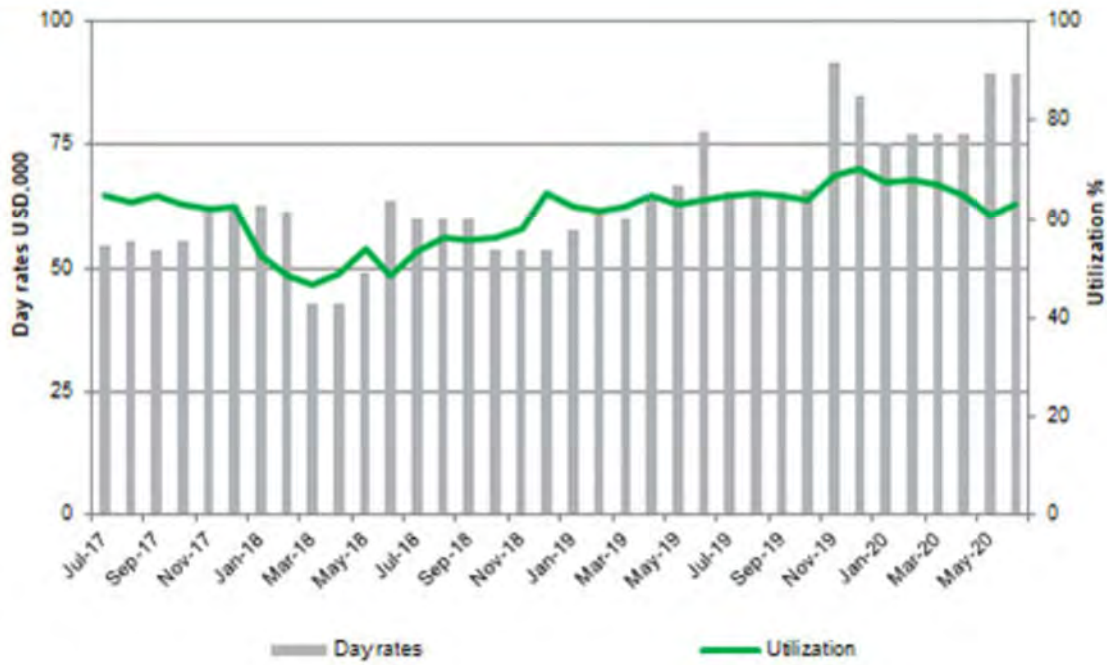
Source: AmInvestment Bank &amp; Bloomberg

## EXHIBIT 3: PETRONAS' RESULTS

YE 31 Dec (RMmil)	1HFY19	1HFY20	YoY (%)	2QFY19	1QFY20	2QFY20	QoQ (%)	YoY (%)
Upstream	20,041	13,973	(30.3)	10,914	9,695	4,278	(55.9)	(60.8)
Gas & New Energy	38,729	31,593	(18.4)	16,649	19,988	11,605	(41.9)	(30.3)
Downstream	55,434	41,976	(24.3)	28,239	26,713	15,263	(42.9)	(46.0)
Corporate & others	6,914	6,087	(12.0)	3,322	3,197	2,890	(9.6)	(13.0)
<b>Revenue</b>	<b>121,118</b>	<b>93,629</b>	<b>(22.7)</b>	<b>59,124</b>	<b>59,593</b>	<b>34,036</b>	<b>(42.9)</b>	<b>(42.4)</b>
Operating costs	(63,428)	(87,104)	37.3	(31,022)	(37,972)	(23,683)	(37.6)	(23.7)
<b>EBITDA</b>	<b>57,690</b>	<b>6,525</b>	<b>(88.7)</b>	<b>28,102</b>	<b>21,621</b>	<b>10,353</b>	<b>(52.1)</b>	<b>(63.2)</b>
Depreciation	(18,269)	(17,703)	(3.1)	(8,830)	(8,917)	(8,786)	(1.5)	(0.5)
<b>EBIT</b>	<b>39,421</b>	<b>(11,178)</b>	<b>(&gt;100)</b>	<b>19,272</b>	<b>12,704</b>	<b>1,567</b>	<b>(87.7)</b>	<b>(91.9)</b>
Finance costs	(1,820)	(1,546)	(15.1)	(587)	(663)	(883)	33.2	50.4
Associates	512	53	(89.6)	312	121	(68)	(>100)	(>100)
Net impairment/write-back	263	(26,415)		179	(4,671)	(20,778)		
<b>Pre-tax profit</b>	<b>38,113</b>	<b>(12,671)</b>	<b>(&gt;100)</b>	<b>19,176</b>	<b>7,491</b>	<b>(20,162)</b>	<b>(&gt;100)</b>	<b>(&gt;100)</b>
Tax	(9,173)	(3,848)	(58.1)	(4,484)	(2,971)	(877)	(70.5)	(80.4)
Upstream	12,869	(11,816)	(>100)	7,651	1,925	(13,741)	(>100)	(>100)
Gas & New Energy	7,260	(6,254)	(>100)	2,491	2,908	(9,162)	(>100)	(>100)
Downstream	2,886	(1,414)	(>100)	1,460	(1,165)	(249)	(78.6)	(>100)
Corporate & others	4,419	1,110	(74.9)	2,272	19	1,091	>100	(52.0)
Inter-co adjustments & others	1,506	1,855	23.2	818	852	1,022	20.0	24.9
<b>Profit after tax</b>	<b>28,940</b>	<b>(16,519)</b>	<b>(&gt;100)</b>	<b>14,692</b>	<b>4,520</b>	<b>(21,039)</b>	<b>(&gt;100)</b>	<b>(&gt;100)</b>
MI	(4,006)	(1,160)	(71.0)	(1,848)	(732)	(428)	(41.5)	(76.8)
<b>Net profit</b>	<b>24,934</b>	<b>(17,679)</b>	<b>(&gt;100)</b>	<b>12,844</b>	<b>3,788</b>	<b>(21,467)</b>	<b>(&gt;100)</b>	<b>(&gt;100)</b>
<b>Core net profit</b>	<b>24,671</b>	<b>8,736</b>	<b>(64.6)</b>	<b>12,665</b>	<b>8,459</b>	<b>(689)</b>	<b>(&gt;100)</b>	<b>(&gt;100)</b>
EBITDA margin (%)	32.5	(11.9)		47.5	36.3	30.4		
Pre-tax margin (%)	31.5	(13.5)		32.4	12.6	(59.2)		
Effective tax rate (%)	24.1	(30.4)		23.4	39.7	(4.3)		
<b>Petronas' production (average daily '000boe)</b>								
-oil	939	872	(7.1)	939	962	783	(18.6)	(16.6)
-gas	1,479	1,383	(6.5)	1,457	1,502	1,264	(15.8)	(13.2)
<b>Total</b>	<b>2,418</b>	<b>2,255</b>	<b>(6.7)</b>	<b>2,396</b>	<b>2,464</b>	<b>2,047</b>	<b>(16.9)</b>	<b>(14.6)</b>
Sales exp	(3,620)	(3,930)	8.6	(1,864)	(2,008)	(1,922)	(4.3)	3.1
Admin exp	(6,176)	(5,257)	(14.9)	(2,756)	(3,391)	(2,832)	(16.5)	2.8
<b>Capex breakdown</b>								
Upstream	(6,751)	(7,844)	16.2	n/a	(4,752)	(3,092)	(34.9)	n/a
Downstream	(4,710)	(1,776)	(62.3)	n/a	(1,103)	(673)	(39.0)	n/a
Gas & New Energy	(2,669)	(2,960)	10.9	n/a	(1,612)	(1,348)	(16.4)	n/a
Corp & others	(1,570)	(2,220)	41.4	n/a	(1,018)	(1,202)	18.0	n/a
<b>Total</b>	<b>(15,700)</b>	<b>(14,800)</b>	<b>(5.7)</b>	<b>(7,400)</b>	<b>(8,486)</b>	<b>(6,314)</b>	<b>(25.6)</b>	<b>(14.7)</b>
<b>Capex breakdown</b>								
Malaysia	(9,577)	(8,140)	(15.0)	(4,348)	(4,498)	(3,642)	(19.0)	(16.2)
International	(6,123)	(6,660)	8.8	(3,052)	(3,988)	(2,672)	(33.0)	(12.5)
<b>Total</b>	<b>(15,700)</b>	<b>(14,800)</b>	<b>(5.7)</b>	<b>(7,400)</b>	<b>(8,486)</b>	<b>(6,314)</b>	<b>(25.6)</b>	<b>(14.7)</b>

Source: Petronas

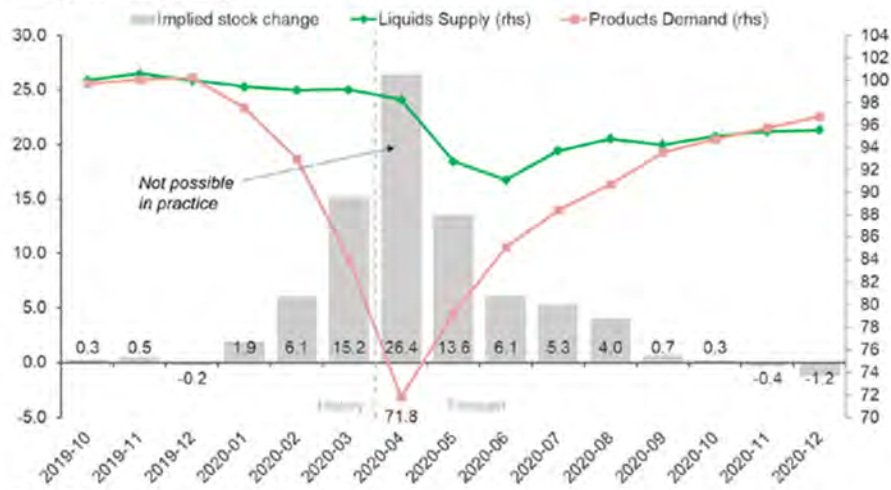
**EXHIBIT 4: SOUTHEAST ASIA JACK-UP CHARTER RATES (361-400 FEET, INDEPENDENT CANTILEVERED)**



Source: IHS

**EXHIBIT 5: IMPACT OF COVID-19 ON OIL INVENTORIES**

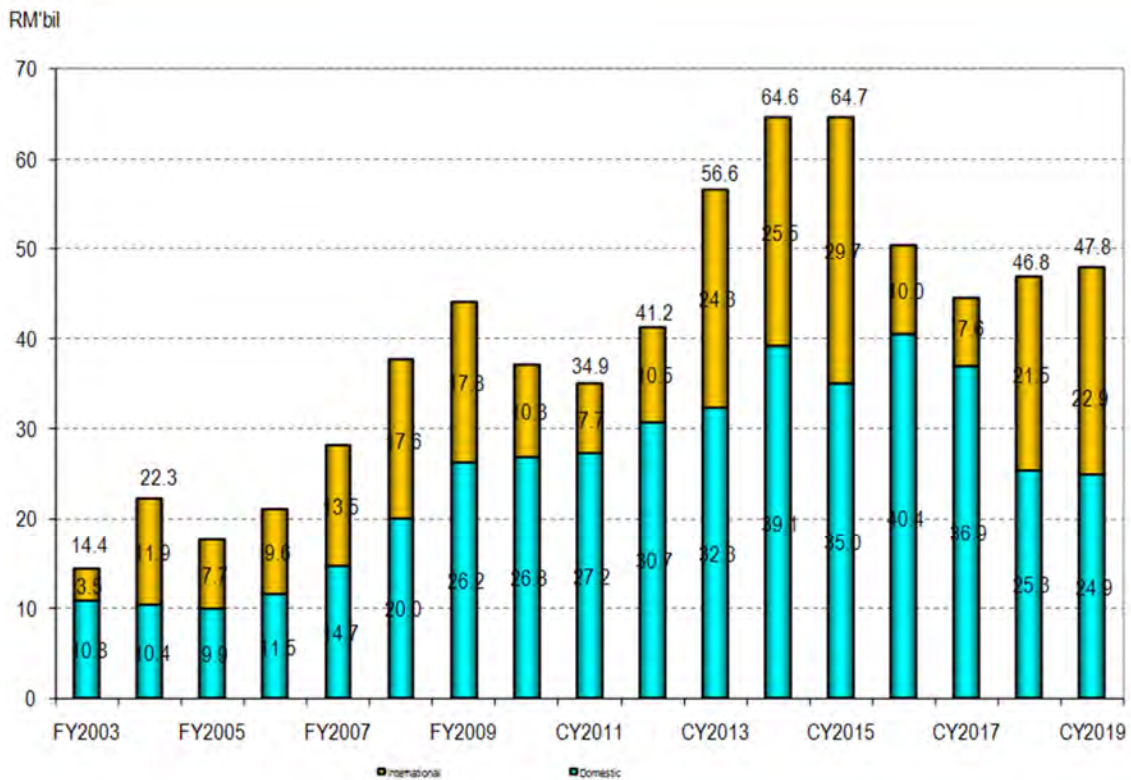
**Global liquids supply and demand balances, monthly**  
Million barrels per day



Source: Rystad Energy research and analysis, OilMarketCube

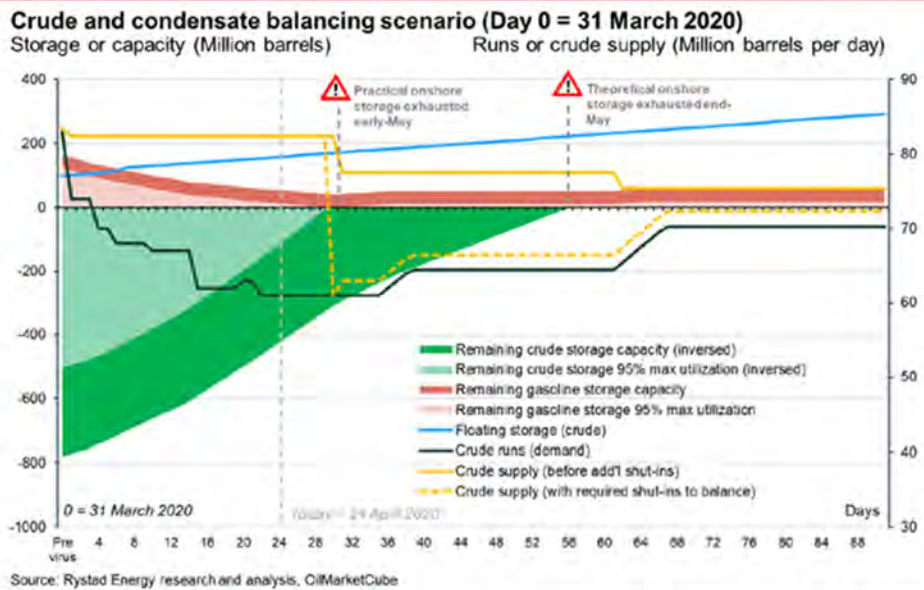
Source: Rystad Energy

EXHIBIT 6: PETRONAS' CAPEX



Source: Petronas

EXHIBIT 7: IMPACT OF COVID-19 ON OIL STORAGE CAPACITY



Source: Rystad Energy research and analysis, OilMarketCube

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