THEMATIC REPORT

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Mining Sector to Restarting Engine in 2HCY22

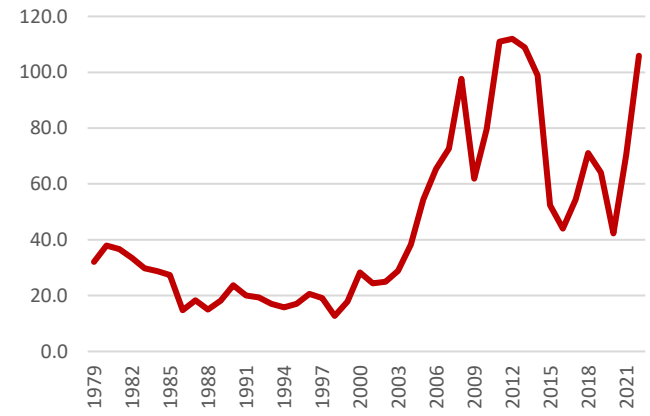
KEY HIGHLIGHTS

- **Overall IPI on uptrend yet sluggish mining output despite of domestic economic reopening & firming external demand, where mining output contracted -2.1%yoy in 5MCY22**
- **2HCY22 expected to see rebound in mining production. With global energy prices projected to stay elevated, we believe this is positive for mining output to rebound in 2HCY22 and 2023, especially with the resumption of Gumusut-Kakap oilfields among others**
- **Looking at the current uptrend in global energy prices, we expect the Malaysian Government to record higher-than-expected petroleum-related revenue this year. We estimate the petroleum-related revenue to come in at RM73.7b in 2022.**
- **All in, we maintain our positive stance on the oil and gas sector, with a renewed caution on the uncertainties of the demand shift, brought forth by: (i) unceasing geopolitical tensions, (ii) tighter crude supply, (iII) hiking prices of raw materials, and (iv) severely tightened monetary policy. Refinery and shipping of hydrocarbon products may face impediments from the shift of global crude oil and LNG supply to meet demands from Europe and India, and soon China; potentially impacting transportation of feedstocks to SE Asian region in general. Meanwhile, the high commodity prices are expected to remain elevated hence benefit exploration and production (E&P), as well as the retail for petrochemical products**

ECONOMICS & POLICY

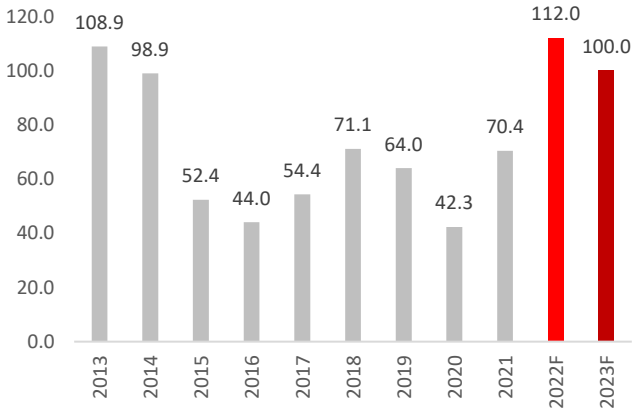
In the environment of elevated global energy prices. Oil price (Brent) shot up and remained above USD100pbd since Mar-22, after the start of the Ukraine-Russia conflict, resulting in the average Brent crude oil price to be at USD105.85pbd for 1HCY22. The last time oil price hit above USD100pbd was in Aug-14. With the current Ukraine-Russia war and Middle East geopolitical tensions, we believe global energy prices including Brent crude oil to stay elevated in 2HCY22 and 2023. However, on the demand side, tightening monetary policy in developed and developing markets may moderate global oil consumption particularly next year. Henceforth, we forecast the oil price to average USD112pbd for 2022 and trend slightly lower at the range of USD95~105pbd for 2023.

Chart 1: Brent Crude Oil (USDpbd)



Source: CEIC, MIDFR

Chart 2: Brent Crude Oil Forecast (USDpbd)



Source: CEIC, MIDFR

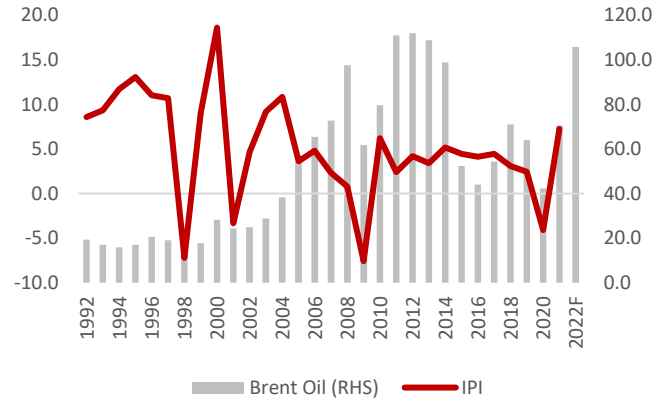
Overall IPI on uptrend yet sluggish mining output. In post-pandemic era, Malaysia's overall industrial production improved significantly underpin by robust manufacturing output and external demand. As of 5MCY22, overall IPI grew by +4.4%yoy (2021: +8.8%) while manufacturing output rose by +6.4%yoy (2021: +12.0%) and electricity output by +3.1%yoy (2021: +2.7%). Despite of domestic economic reopening & firming external demand, mining output contracted -

2.1%yoy in 5MCY22. The primary output growth recorded +1.4%yoy in 2021 in which mainly due to very low-base effects as mining production already in contractionary since 2018.

2HCY22 expected to see rebound in mining production. With global energy prices projected to stay elevated, we believe this is positive for mining output to rebound in 2HCY22 and 2023. As of 5MCY22, natural gas production increased by +1.3%yoy (2021: +7.5%) while crude petroleum decreased by -6.5%yoy (2021: -5.8%). Output growth for crude petroleum has been on contractionary since 2017. The cliff-fall and plateaued of oil price trend from average USD98.9pbd in 2014 to average USD57.2pbd in 2015~2019 had among others caused the sluggish Malaysia's crude petroleum expansion rate. Looking ahead, we are optimistic that the crude petroleum production to increase steadily in 2HCY22 onwards especially driven by elevated global energy prices. Brent crude oil price has been above USD70pbd steadily since Jun-21 and projected to remain elevated between USD95~105pbd in 2023.

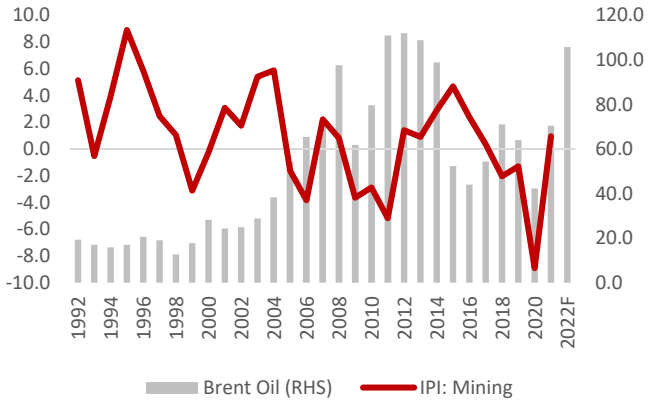
Resumption of Gumusut-Kakap oilfields. About 120km off the coast of Sabah, two oilfields named Gumusut and Kakap fields experienced unscheduled maintenance exercise that would last 150 days from Dec-21 and expected completion time by May-22. The floating production system which connected to the oilfields, has a daily processing capacity of 150,000 barrels of crude oil, almost 25% of Malaysia's daily production capacity in 2019. With the resumption of Gumusut-Kakap oilfields among others will provide additional boost to Malaysia's crude petroleum production in 2HCY22 onwards.

Chart 3: Brent Crude Oil (USDpbd) vs. IPI (YoY%)



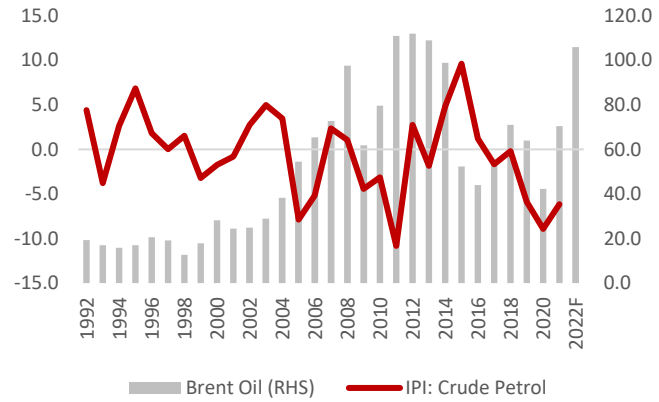
Source: CEIC, MIDFR

Chart 4: Brent Crude Oil (USDpbd) vs. Mining IPI (YoY%)



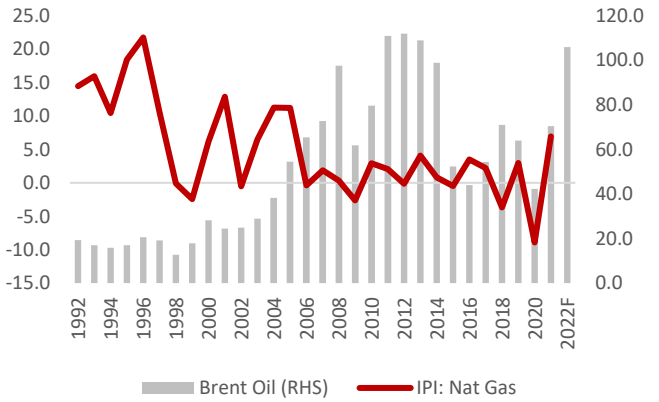
Source: CEIC, MIDFR

Chart 5: Brent Crude Oil (USDpbd) vs. Crude Petro IPI (YoY%)



Source: CEIC, MIDFR

Chart 6: Brent Crude Oil (USDpbd) vs. Natural Gas IPI (YoY%)

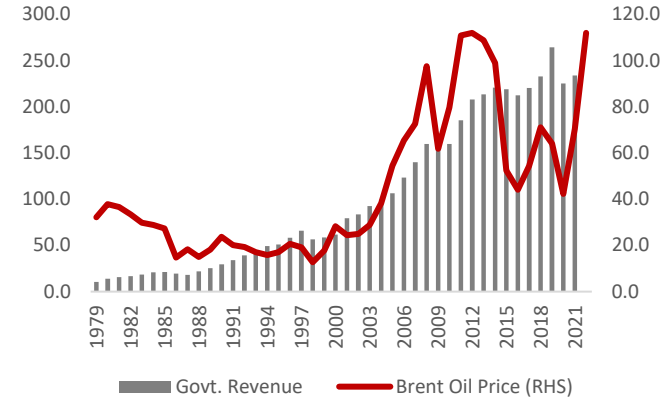


Source: CEIC, MIDFR

Positive for fiscal space. Looking at the current uptrend in global energy prices, we expect the Malaysian Government to record higher-than-expected petroleum-related revenue this year. We estimate the petroleum-related revenue to come in at RM73.7b in 2022. The National Budget 2022 was presented on the assumption of average Brent crude oil price at USD66pbd in 2022. On a flip side, the cost of fuel subsidy is set to rise as the Government is keeping retail fuel prices namely RON95 and Diesel at RM2.05 and RM2.15 per liter at current juncture. Based on historical data, financing the fuel subsidy mechanism

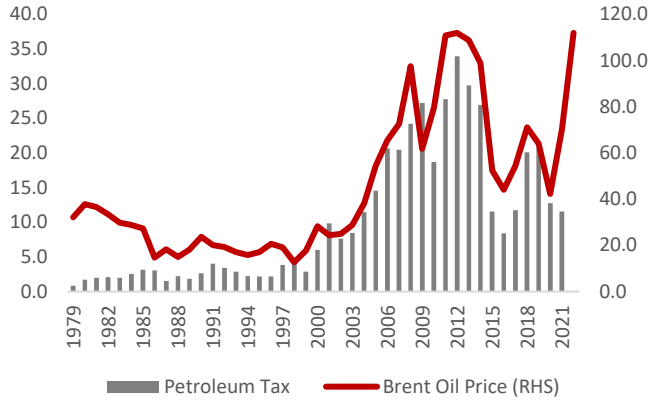
is sustainable for Malaysia given that the petroleum-related revenue is always higher than the fuel subsidy cost. Nevertheless, fuel subsidy concerns are highlighted more from the perspective of nation's wealth distribution and efficient fiscal expenditure. For instance, T20 group is seen as enjoying more fuel subsidy than B40 group due to difference in vehicle size and usage capacity. In addition, some argue that fiscal funds allocated for the subsidy is better off to be used for infrastructure or productivity improvement items.

Chart 7: Brent Crude Oil (USDpbd) vs. Govt. Revenue (RMb)



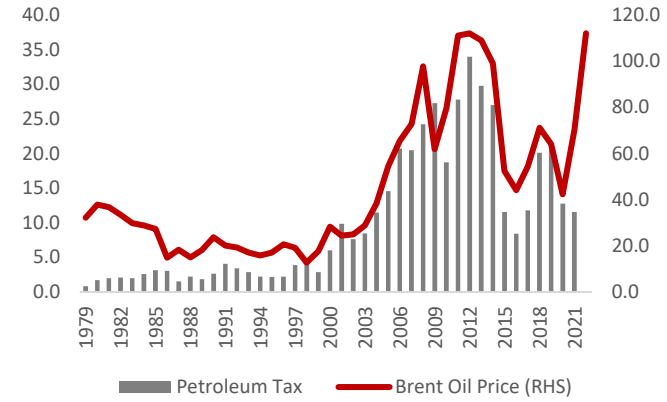
Source: CEIC, MIDFR

Chart 8: Brent Crude Oil (USDpbd) vs. Petro Tax (RMb)



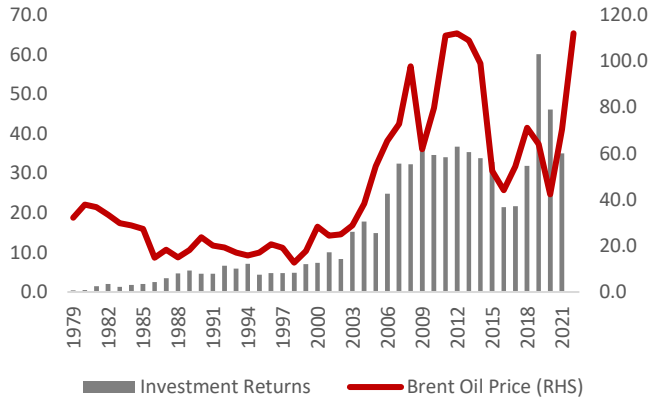
Source: CEIC, MIDFR

Chart 9: Brent Crude Oil (USDpbd) vs. Petro Royalty (RMb)



Source: CEIC, MIDFR

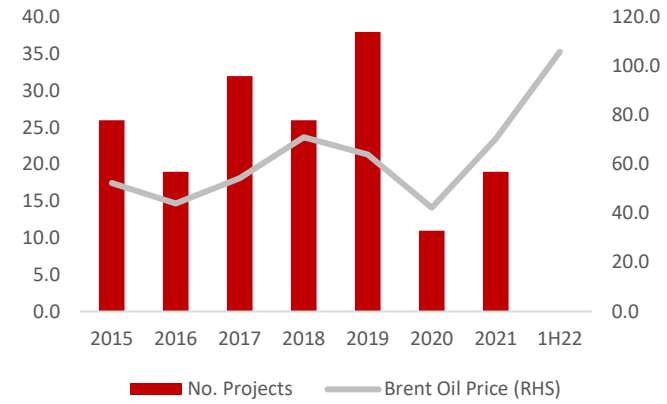
Chart 10: Brent Crude Oil (USDpbd) vs. Inv. Returns (RMb)



Source: CEIC, MIDFR

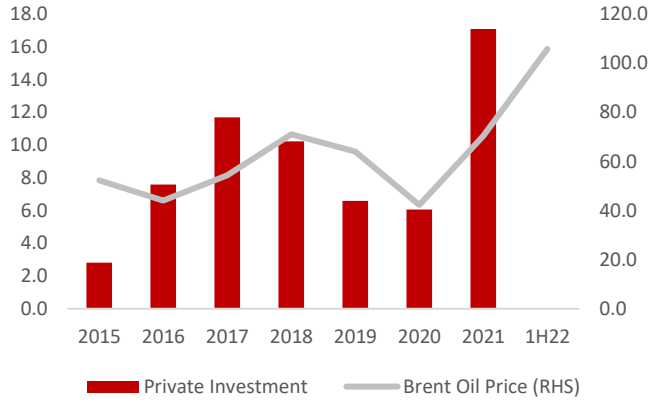
Approved private investment hit highest record in 2021. According to Malaysia Investment Development Authority (MIDA), number of projects approved for mining sector improved from record-low 11 in 2020 to 19 in 2021. Approved private investment surged to record-high RM17.1b with RM13b contributed by local investors and RM4.1b by foreign investors. We believe the uptrend was driven by the steady uptick global oil price and well above the 2015~2019 average USD57.2pbd. In fact, we notice number of projects were on increasing trend since 2017 as global oil price stabilized above USD60pbd. Apart from the prospect of elevated global energy prices, we believe the pick-up of investment activity of mining sector in 2021 will translate into higher production capacity in 2HCY22 onwards.

Chart 11: Brent Crude Oil (USDpbd) vs. Approved Projects (Unit)



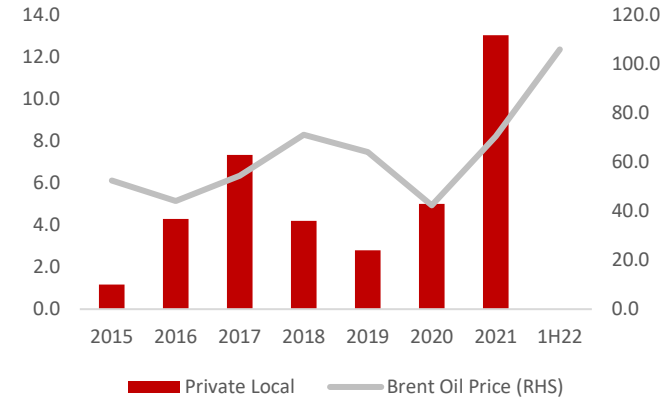
Source: CEIC, MIDFR

Chart 12: Brent Crude Oil (USDpbd) vs. Private Inv. (RMb)



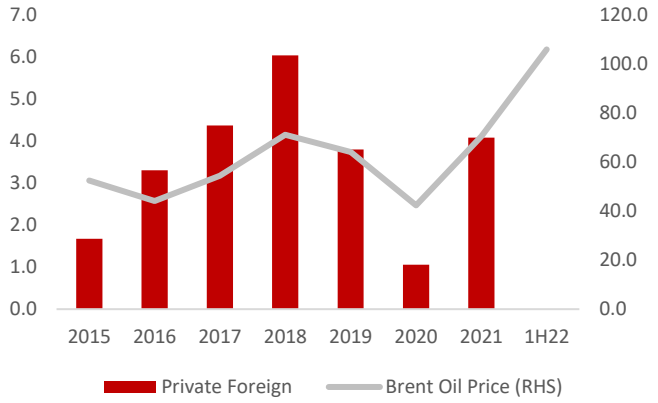
Source: CEIC, MIDFR

Chart 13: Brent Crude Oil (USDpbd) vs. Local Inv. (RMb)



Source: CEIC, MIDFR

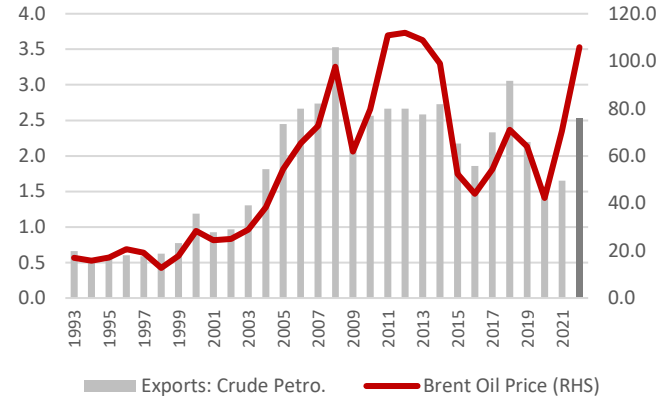
Chart 14: Brent Crude Oil (USDpbd) vs. Foreign Inv. (RMb)



Source: CEIC, MIDFR

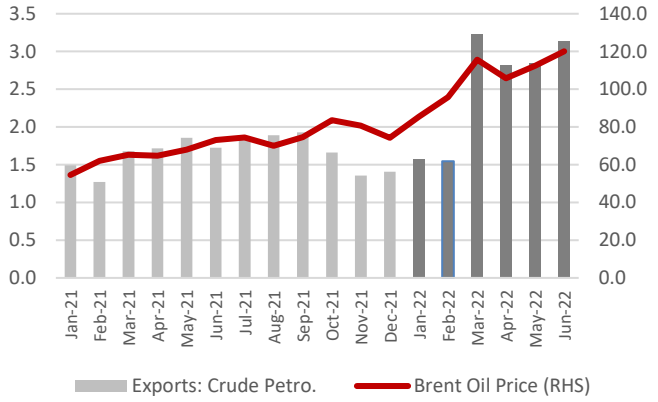
Robust external trade performances hint bright prospects in 2HCY22. Exports of crude petroleum and LNG move in tandem with the trend of global crude oil price. Looking at average monthly exports value, LNG outbound shipment averaged RM4.8b in 1HCY22 (2021: RM3.0b). The LNG average exports value peak point was at RM5.3b in 2014 and had been on an uptrend since 2010 as Brent crude oil price hovered above USD100pbd in 2011~2014. Exports of LNG registered at RM6.3b in Jun-22, the highest value since Jan-14. As for crude petroleum, the average monthly exports value was RM2.5b in 1HCY22 (2021: RM1.7b). The highest average monthly value was seen in 2008 at RM3.5b with Brent crude oil price at USD97.6pbd. Based on our observation, Malaysia's crude petroleum average monthly exports value is likely to surpass RM2.5b if Brent crude oil price to stay above USD65pbd steadily. For instance, the exports have been above RM2.8b since Mar-22, in line with the upward trend in the global oil price. Looking ahead, we are optimistic that the continuous elevated global energy prices will further boost Malaysia's mining production of both crude petroleum and LNG in 2HCY22 and 2023.

Chart 15: Brent Crude Oil (USDpbd) vs. Monthly Ave. Crude Petro. (RMb)



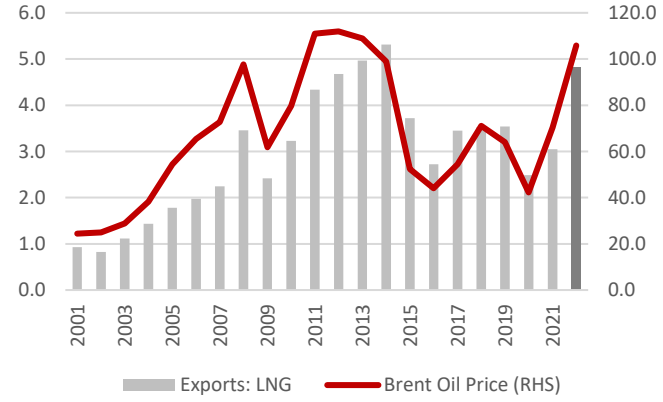
Source: CEIC, MIDFR

Chart 16: Brent Crude Oil Forecast (USDpbd) Monthly Ave. Crude Petro. (RMb)



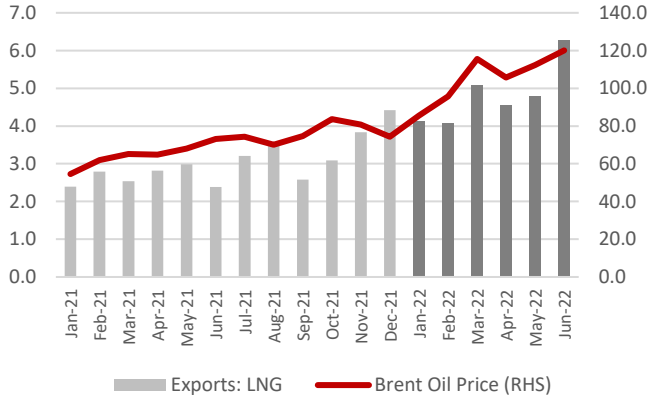
Source: CEIC, MIDFR

Chart 17: Brent Crude Oil (USDpbd) vs. Monthly Ave. LNG (RMb)



Source: CEIC, MIDFR

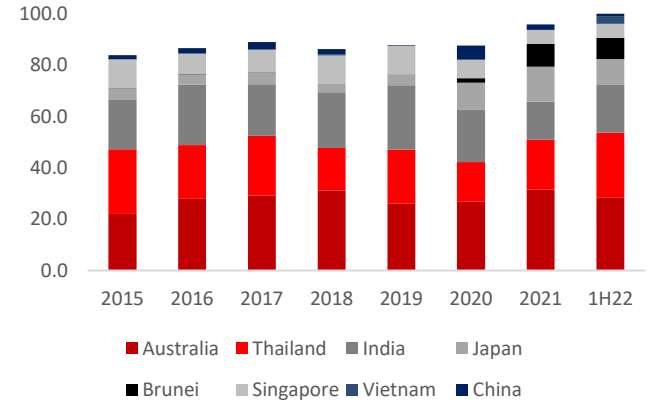
Chart 18: Brent Crude Oil Forecast (USDpbd) Monthly Ave. LNG (RMb)



Source: CEIC, MIDFR

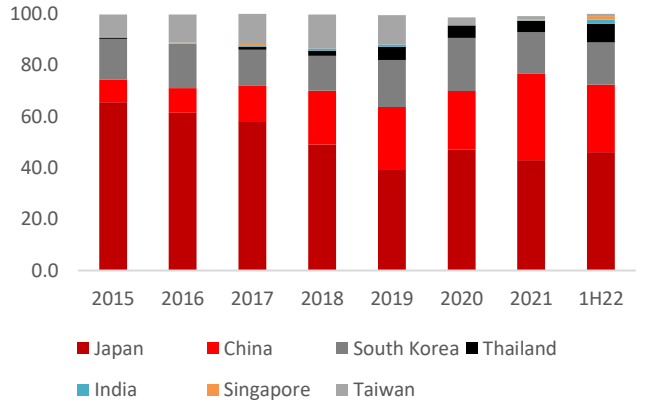
Change of exports destinations in post-pandemic. For LNG business, Malaysia's exports share destination remain status quo, led by Japan (1HCY22: 46.1% vs. 2019: 39.5%), China (1HCY22: 26.4% vs. 2019: 24.2%) and South Korea (1HCY22: 16.4% vs. 2019: 18.3%). However, we saw significant in post-pandemic for crude petroleum trade flows. Australia, Thailand and India remain as the biggest buyers for Malaysia's crude petroleum, contributing approximately 72.3% share in 1HCY22 (2019: 72.2%). As for the other 30%, we notice change of buyers especially comparing 2019 and 1HCY22. Crude petroleum exports share to Japan rose from 4.1% in 2019 to 10.2% in 1HCY22, Brunei (1HCY22: 8.3% vs. 2019: 0.1%), Vietnam (1HCY22: 2.9% vs. 2019: 0.0%) and China (1HCY22: 1.0% vs. 2019: 0.3%). On a flip side, the exports share to Singapore declined from 11.1% in 2019 to 5.5% in 1HCY22, New Zealand (1HCY22: 0.0% vs. 2019: 6.5%), Philippines (1HCY22: 0.0% vs. 2019: 2.5%) and Indonesia (1HCY22: 0.0% vs. 2019: 2.3%).

Chart 19: Exports of Crude Oil by Country (Share %)



Source: DOSM, MIDFR

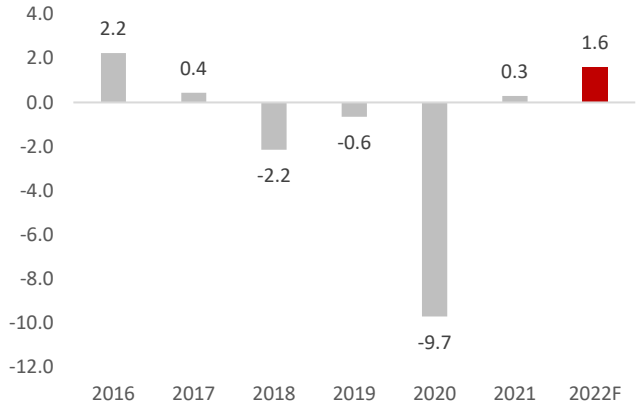
Chart 20: Exports of LNG by Country (Share %)



Source: DOSM, MIDFR

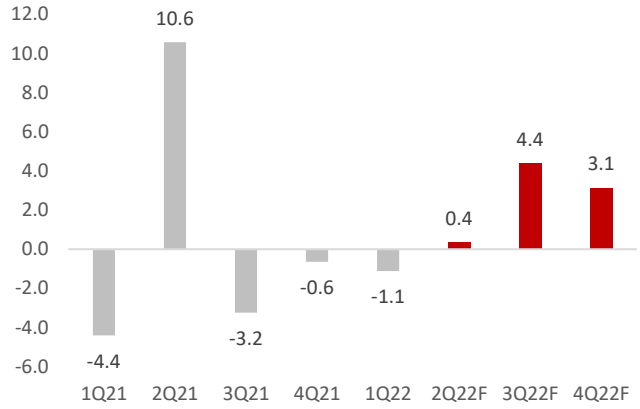
Mining GDP growth to hit 6-year high in 2022. We keep our overall Malaysia's GDP growth rate at +6.0% for this year. Among others one of the supporters is strengthening in mining sector performance +1.6% for 2022, expected to be the highest since 2017. We believe the resumption of Gumusut-Kakap oilfields and continuous elevated global energy prices will further boost mining activity in 2HCY22 with +4.4%yoy in 3QCY22F and +3.1%yoy in 4QCY22F. Moving into 2023, we foresee steady expansion path for the mining sector especially global crude oil prices set to remain above USD70.0pbd.

Chart 21: Mining GDP (YoY%)



Source: CEIC, MIDFR

Chart 22: Quarterly Forecast Mining GDP (YoY%)



Source: CEIC, MIDFR

OIL AND GAS SECTOR.....Maintain POSITIVE

War and tight supply continue to elevate crude oil prices. The sanctions on Russia's energy exports since May CY22 will support crude oil prices to remain elevated, on top of the continuous global tight crude supply. In consideration with the general recovery from Covid-19 pandemic, we opine that demand for hydrocarbon products will continue to be robust, with risks on inflation and tightened monetary policy that could pose as hurdles for demand growth. Brent crude price is expected to remain elevated to an average of USD112pb in CY22 and USD105pb in CY23, as Brent crude price reach an expected balanced plateau in the range of +/- USD5pb.

Upstream continue to ride on crude rally. For upstream, the elevated prices bode well for more exploration and production (E&P) activities, and since the start of CY22, the rate of production globally had increased in tandem with the rising number of drilling awards and positive earning growths for E&P companies globally. Similarly, local exploration is expected to have a growth in production by about +26% in the next two years, working on a threshold crude price of USD60-80pb.

Manageable setbacks in midstream for storage and shipping. We are expecting a manageable setback on storage and shipping subsectors, as growing demand, maintenance/shutdown and uncertain climate conditions are high risks in the midstream. Asian gas stock is also reportedly lagging in replenishment rate, causing LNG to continue trading at USD33-40 mmBtu per week. Meanwhile, LNG carriers are facing reroutes to the European region as Europe scrambled for gas supply after cutting its dependency of Russia. Europe is set to meet an 80% gas storage by end-CY22. In our local front, we are expecting a shift in regasification demand from Europe to Asia, subsequently benefitting dry-docking operations, with risks of increased refinery tax, shipping insurance and steel prices to remain in the foreseeable future.

Downstream to grow despite inflation fears. The petrochemical industry is expected to continue to grow well in the long run, with the demand for petrochemical products continuing to increase worldwide, despite the decarbonisation movement taking place immaculately for the sector. Regionally and locally, we are expecting the petrochemical markets to remain sanguine on the support of strong regulatory policies and increase in natural gas production, despite high costs and tight supply of imported feedstocks. Feedstock prices is expected to remain elevated amid the loss of Russian crude into global refineries. However, considering a continuous tightening of crude supply worldwide, we believe the refinery subsector in our local front will see a downward trend in terms of volume intake before rebalancing in tandem with an expected balanced crude price and elevated total crude production.

Maintain POSITIVE with caution. All in, we maintain our positive stance on the oil and gas sector, with a renewed caution on the uncertainties of the demand shift, brought forth by: (i) unceasing geopolitical tensions, (ii) tighter crude supply, (iII) hiking prices of raw materials, and (iv) severely tightened monetary policy. Refinery and shipping of hydrocarbon products may face impediments from the shift of global crude oil and LNG supply to meet demands from Europe and India, and soon China; potentially impacting transportation of feedstocks to SE Asian region in general. Meanwhile, the high commodity prices are expected to remain elevated hence benefit exploration and production (E&P), as well as the retail for petrochemical products.

Our top pick for this sector is **PETRONAS CHEMICALS (BUY, TP: RM11.93)** as the group rides on the strength of higher commodity prices, coupled with its proactive move to establish a stronger end-market primarily in eco-friendly and sustainable feedstocks and petrochemical products in the Asia-Pacific and SE Asian regions. We are also on the lookout for **DIALOG (BUY, TP: RM3.96)** for its future E&P endeavours through acquisition activities of mature fields with high potential reserves, as well as the full utilization of its storage farms as Pengerang Integrated Complex resumed operations to full capacity starting April this year.

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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