

Malaysia oil & gas: Go big or go home

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KUALA LUMPUR, Aug 25 — The US\$4 billion (RM11.92 billion) merger of two of Malaysia's larger oil and gas firms, Kencana and SapuraCrest, sent a clear message to their local rivals: size matters.

Small oil and gas services companies dot the Malaysian market and analysts think it makes strategic sense if firms join hands to add value to their portfolio.

"Everyone these days wants to be a one-stop solution provider," OSK analyst Jason Yap Wah Ming said. As state-owned oil giant Petronas starts calling for bids to develop its oil assets, there will be more M&A deals in one to three years, analysts say.

Likely beneficiaries will be those companies that offer under one roof a myriad of services such as maintenance, fabrication operations, and marine vessel charter.

In the case of Kencana and SapuraCrest's merger, a natural "fit" was found with Kencana's vessel fabrication expertise and SapuraCrest's installation capabilities.

Given the current landscape of the industry, likely buyers include Petronas' engineering arm Malaysia Marine, which has cash and cash equivalents of RM2 billion.

Already, Malaysia Marine has shown its hand and bought conglomerate Sime Darby's deepwater fabrication yard in Ramunia for RM695 million.

But as Petronas' main engineering arm, Malaysia Marine wants to further bulk up in anticipation of more contracts under the new Petronas spending plan, analysts say.

Another possible buyer is integrated service provider Dayang, which is valued at RM1 billion.

It already has diverse set of services and could benefit from scaling up to take on bigger projects. It could also become a target itself for the same reason, according to an oil and gas analyst at TA Research.

"Smaller companies may have expertise in certain segments but do not have capital, so the bigger ones may not mind absorbing them," OSK's Yap said.

There may also be mergers among companies in the same subsector to kill competition. Offshore support vessel firms such as MISC, Alam Maritim and Perdana Petroleum have been cannibalising each other's charter rates in an overly crowded space and analysts have long maintained that they would benefit from consolidation to improve their margins.

There is already increasing market chatter that companies are eyeing each other. Malaysian financial daily The Edge reported last week that Perdana Petroleum may sell its 30 per cent stake in Petra Energy, a maintenance provider.

A spokesperson for Perdana Petroleum declined to comment on the possible sale of its stake in Petra Energy.

However, he told Reuters that charter rates did need to improve if offshore support vessel

operators were to boost their earnings.

Meanwhile, MISC reported a 71 per cent decline in its Q1 net profits last week mainly due to weakness in its liner business, and said it expected the weakness to continue.

M&A status quo

The Malaysian government has already made sector consolidation a key agenda in its 10-year plan of economic rejuvenation and its control of Petronas can help reshape the industry.

The plan has two targets — to boost supplies of local oil and gas, but more importantly, to establish Malaysia as a key oilfield services hub to boost foreign investment and to raise national income levels.

Despite the impetus for change, mergers and acquisitions between smaller Malaysian oil and gas companies may be easier said than done.

A banker involved with the Kencana and SapuraCrest merger said pitching ideas to smaller companies has been difficult because they are wedded to the status quo.

“They’ve been working under the old regime for so long that unless they change their mindset, they aren’t going to be realistic about valuations,” the banker said.

Sofiyah Yahya, president of the Malaysian Oil and Gas Services Council, agrees and says the government and Petronas will have to drive the consolidation process.

“The environment must be there to receive the new way of doing business,” he said. “If you don’t broaden the road, why would I want to drive a bigger car?”

Presently, Malaysian companies still depend on foreign participation when it comes to large awards such as the recent Balai Cluster contract and the Berantai field contract in January.

For its part, state giant Petronas has accelerated its capital expenditures for field development to RM300 billion over the next five years from RM35 billion in 2010/11, which means there will be plenty of work for oil and gas firms in the months to come.

Petronas on Tuesday announced a US\$5.1 billion upstream gas project with its production sharing partners, which include Malaysian companies, that would also see the construction of a pipeline.

A TA Research analyst said that with incoming foreign investments, total capex spending in Malaysia could climb to RM500 billion over a five-year period.

Malaysian companies will have to gear up operationally to make the most of these opportunities.

“Even now, when it comes to the big projects, foreigners are taking chunks and subcontracting to smaller Malaysian players,” Sofiyah Yahya, the MOGS council president, added.

“In future, like a shark, Malaysian companies are going to eat chunks of meat” and not “nibbling at bits and pieces.”

The goal is to eventually create regionally competitive firms that are less dependent on Petronas, which tailors contracts specifically for Malaysian companies.

"Consolidation needs to be done," Sofyan added. "In Malaysia, if they want a cup of coffee...tenders are given out for the spoon, the coffee and the saucer. When you go overseas, they want to know you can just supply a cup of coffee." — Reuters

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