GREATER KUALA LUMPUR

THE NATURAL OIL & GAS HUB IN ASIA

Part 1: O&G SERVICE COMPANIES REGIONAL ENGINEERING HUB IN GREATER KUALA LUMPUR

September 2015

PREFACE

The oil and gas industry is undergoing a challenging period given the current low oil prices which has plunged from above USD100 per barrel to below USD60 per barrel in the recent months.

As a result, oil and gas companies, be it National Oil Companies (NOCs), International Oil Companies (IOCs), exploration and production companies, services companies, are all relooking at their operating structure to adapt to this new environment.

International oil and gas (O&G) service companies are embarking on various cost reduction strategies in order to remain competitive. One such measure that is gaining momentum amongst international O&G service companies is to relocate regional headquarters/engineering centres from high cost centres such as Singapore and Perth to a more cost competitive city namely, Greater Kuala Lumpur (KL).

In the first of our two part series, InvestKL explores the reasons why Greater KL makes perfect sense for international O&G service companies to relocate or to set up their regional headquarters/engineering centres in the city. The next article will focus on how international O&G companies can make Greater KL as a platform for regional/global businesses.

PART 1: GREATER KL – A NATURAL CHOICE FOR O&G SERVICE COMPANIES TO ESTABLISH REGIONAL ENGINEERING HUB

The sharp decline in oil prices to under USD50 per barrel in January 2015 has certainly sent large shockwaves for the oil and gas players, raising questions on whether this large price dip is temporary and a potential reversal could likely occur soon. While many players may have been relieved given the recovery in the oil prices in the past several months in between USD50 to USD70 per barrel, market players continue to remain sceptical and uncertain of what lies ahead for them.

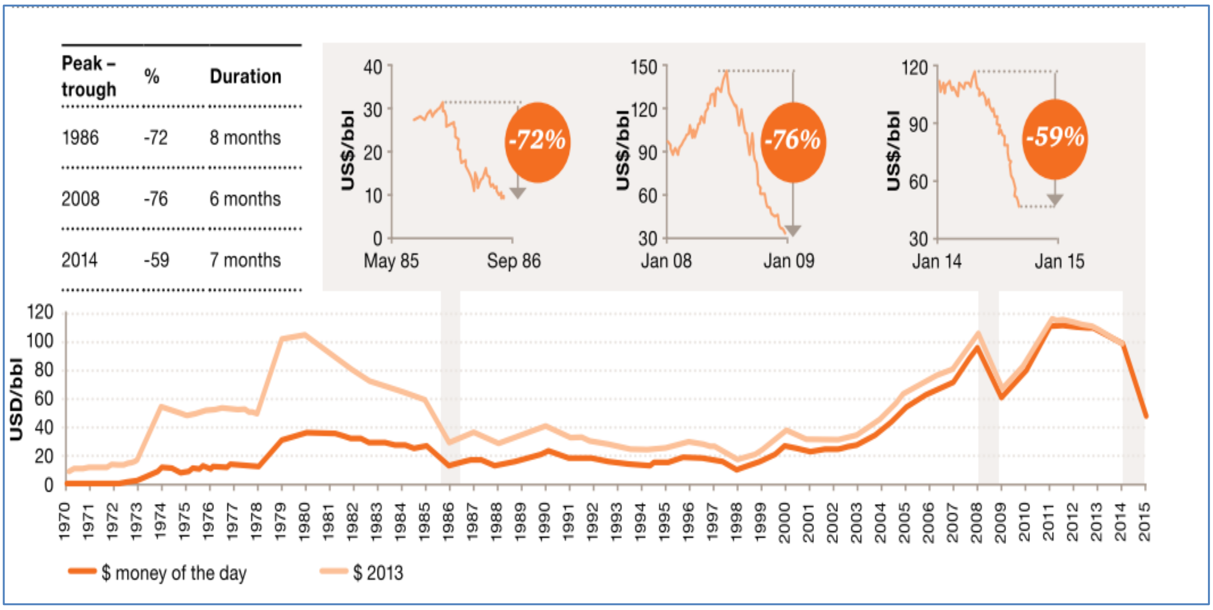


Figure 1: Structural downward Price corrections in the oil market (1986, 2008 & 2014)[1]

The usual reasons have underpinned the black gold's downward price trend, however the dynamics of the oil and gas price and the supply and demand trend have changed quite considerably in the last 5 years. Judging by the consensus' price outlook in the short to intermediate term, oil and gas players can only remain hopeful of the glory days of USD100 per barrel and above oil price, as this is in the past.

[1]*Source: Opportunities in Adversity, A new dawn for oil and gas, February 2015, PWC*

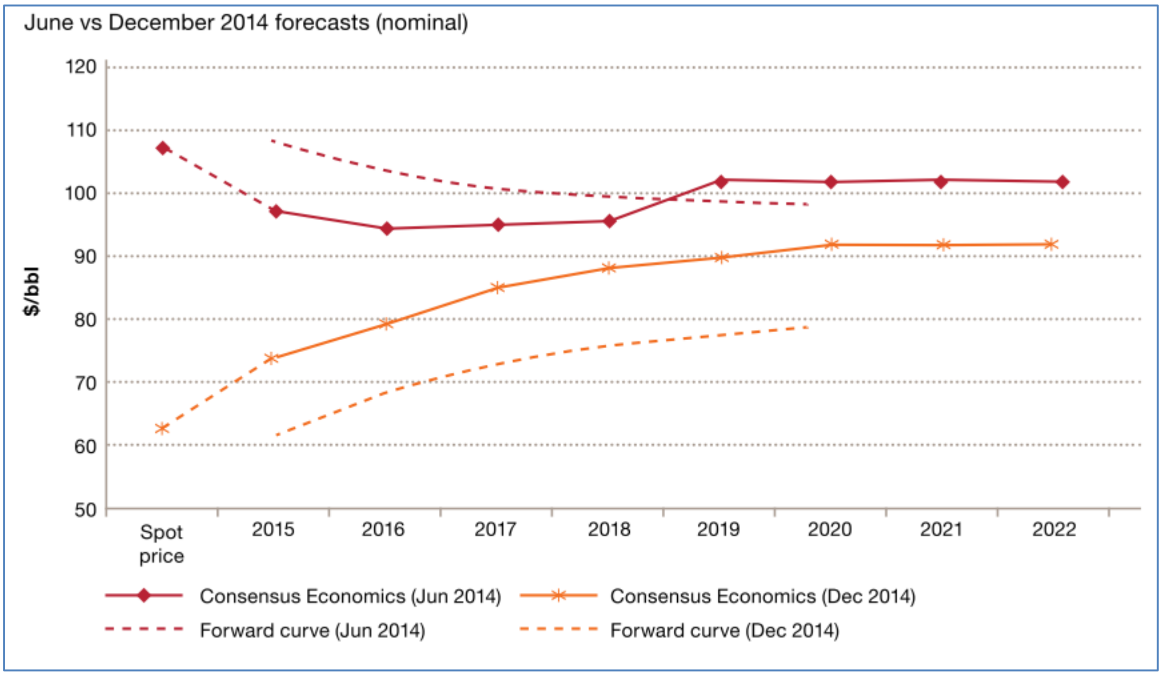


Figure 2: Evolution of brokers forecast compared to the forward curve (June vs Dec 2014)[2]

Strategies to remain competitive

That being said, NOCs, IOCs, independent oil companies and O&G services companies around the world in the recent months have begun to reassess their long term strategy by relooking at their joint venture agreements, existing and future contract projects on strategic allocation of resources. While this process continues, large or small companies have begun to implement quick short term measures, pursuing aggressive cost reduction strategies in order to remain competitive and to survive at the present oil price. Some of these measures include refinancing existing debt, slashing capex, supply chain optimisation, liquidity management and of course head count reduction.

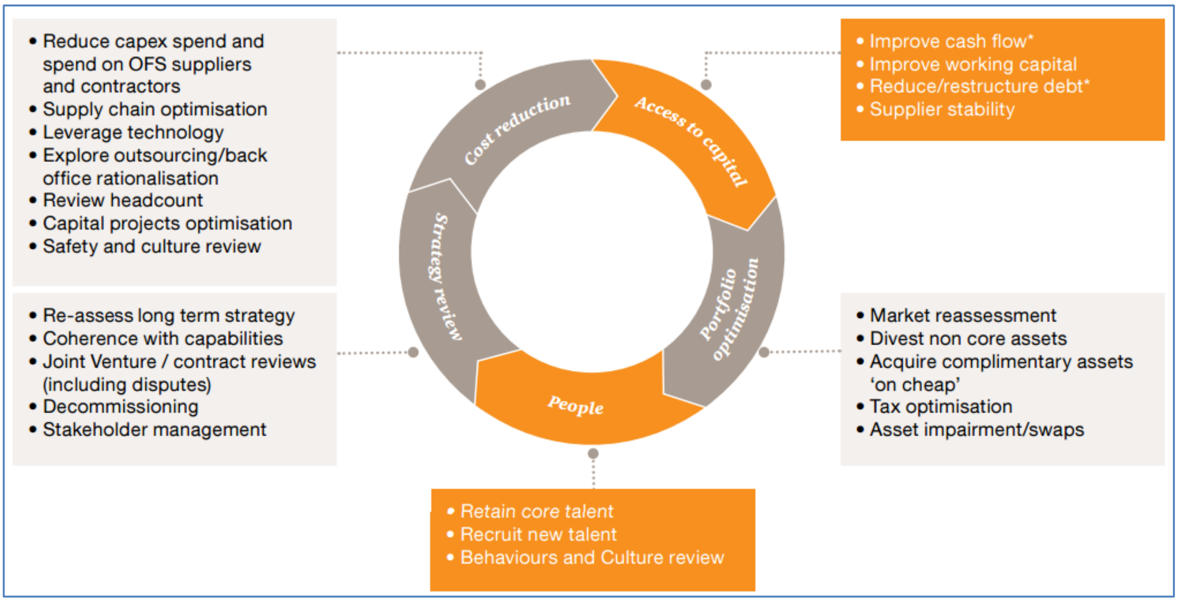


Figure 3: Against a backdrop of falling oil prices. O&G companies will have a number of issues to address[3]

[2&3] *Source: Opportunities in Adversity, A new dawn for oil and gas, February 2015, PWC*

A recent article by Forbes stated that more than 75,000 employees have been laid off from the oil price slump, especially amongst the O&G services companies. Schlumberger, the largest oil and gas services company, reported to have slashed 9,000 people while Halliburton slashed 6,600 people. Asia Pacific was not spared from these cuts despite the growing energy needs. Nevertheless, the magnitude of these cuts was milder as compared to the western hemisphere. BP Energy Outlook 2035 report stated that India and China are expected to be the key drivers behind energy demand due to its sheer population size and projected economic growth. As such, to ensure long term sustainability of energy supply, maintaining headcount or talent will be crucial.

This is especially true as engineers are valuable talent pool that plays an important role in the development of the upstream oil and gas segment. They are involved in a number of areas, from conceptual or front end engineering design (FEED) to detailed engineering, procurement services, construction management services and special studies. Most of the NOCs in Asia Pacific such as Petronas, Pertamina and PTT have maintained their staff strength despite capex and opex cuts to take account of the demand outlook for energy in the region which is expected to remain robust in the near term.

Revamping cost structure as a priority

However, in the short to intermediate term, final investment decisions (FID) are likely to be either delayed or deferred as NOCs are likely to remain on the side line till more clarity is seen on the price front. In the meantime, NOCs are using this slowdown to encourage its service providers to pursue cost reduction strategies in order to enable them to receive cost savings in this new environment. Petronas' CORAL 2.0 program is encouraging Production Sharing Contractors (PSCs) to streamline the cost structure across the value chain of the domestic petroleum industries while Indonesia's Upstream Oil and Gas Regulatory Special Task Force (SKKMigas) has instructed O&G contractors to cut cost by renegotiating contract costs.

O&G service companies are also going above and beyond the typical cost reduction strategies with a number of them are considering relocating their regional headquarters/engineering centres to a more cost competitive location. In fact, recently, PGS and Saipem have moved their regional headquarters from Singapore to Greater KL and this trend is likely to pick up by the rest of the companies. The high cost of doing business in major oil and gas hubs such as Singapore and Perth in the Asia Pacific region are beginning to push International O&G companies' regional headquarters/engineering hubs away from these cities. According to the Mercer Cost of Living survey 2015, Singapore is ranked 4th while Perth is ranked 31th most expensive city in the world as opposed to Kuala Lumpur which is ranked 113th .

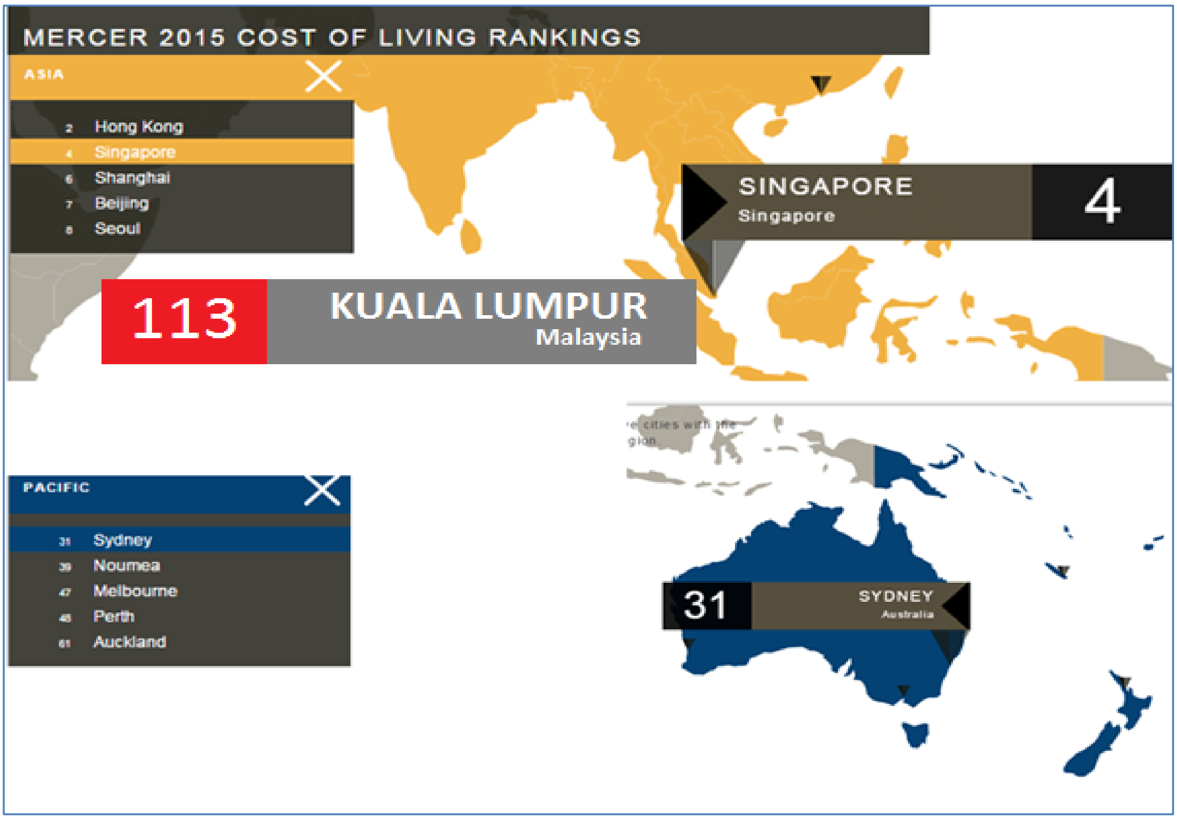
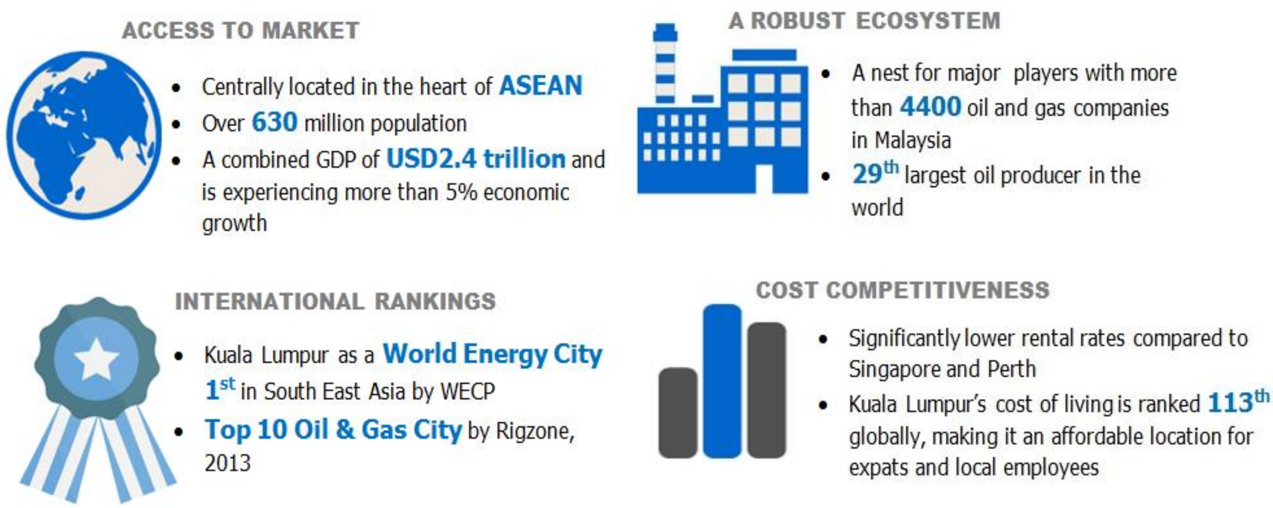


Figure 4: Major oil and gas hubs in Asia Pacific such as Singapore & Sydney are expensive locations for O & G companies since the slump in oil prices[4]

Greater Kuala Lumpur as an O&G hub in ASEAN

Greater KL, the capital city of Malaysia, is in a sweet spot to accommodate O&G services players to set up their regional headquarters and provide regional engineering support at a much lower cost while maintaining their engineering talent to ride through the storm. Furthermore, such move will allow O&G service companies to benefit once the oil price recovers as a lower cost structure will consequently boost its profit margins in the near future.



[4]*Source: https://www.imercer.com/content/2015-cost-of-living-infographic.aspx*

O&G Talent Availability

Greater KL has a long history in the oil and gas industry with experienced local engineers and at same time, able to generate over 20,000 new engineering graduates annually to service the industry locally and regionally. In addition, many talented and experienced are drawn back to home as they are made redundant due to the downturn. To sweeten the deal, the Returning Experts Programme (REP) by the government allows returning Malaysians to enjoy numerous benefits. The government recognises the need to nurture technical talent, specifically engineers, geosciences professionals and those in specialised supervisory and trade categories through development programs and support from foreign talents in the event specific specialisation are lacking in the local market with the hope of knowledge transfer to the local engineers.

The Returning Experts Programme (REP)

- Optional 15% flat tax rate
- Tax exemption on personal effects
- Tax exemption on car
- PR status for foreign spouse and children

Oil and Gas Skill Development Programs

- Industry Centre of Excellence (ICoE) by Ministry of Education
- Structured Internship Program (SIP) by TalentCorp, in collaboration with Malaysian Petroleum Resources Corp (MPRC) and the University of Technology Malaysia (UTM)

Oil and Gas Academies

- 13 higher learning institutes
- 4 skills training centres
- Equipped with state of the art engineering, marine, enhanced oil recovery and deep-water technologies

Greater KL's value propositions have certainly attracted reputable international O&G companies such as Schlumberger, Halliburton, Petrofac, Aker Solutions and Technip to choose Greater KL as their regional headquarter/engineering hub. This momentum is likely to continue in the near term, more so with the realisation of ASEAN Economic Community this year where policymakers are pushing for the creation of single duty free market with substantial liberalisation of service sub-sectors.

KEY TAKEAWAYS

- Oil prices outlook is likely to remain challenging in the short to intermediate term following the following the change in the supply and demand dynamics amongst the global oil players as well as the weakening in the global demand for the commodity.

- O & G services companies are under pressure to pursue cost reduction strategies such as head count reduction, relocation to a lower cost country, supply chain optimisation and other measures to remain competitive in this current environment

- Reduction in O & G talent is likely to haunt the industry especially in the long term given the outlook for O&G demand for China and India is likely to remain robust

- Many of the O&G services companies are relocating their regional headquarters /engineering centres from higher cost locations such as Singapore and Perth to a more cost competitive city such as Kuala Lumpur. PGS and Saipem are an example.

- Aside from Greater KL being recognised as a world energy city by the WECP, Greater KL also benefits from proximity to clients, strong talent pool, availability of projects, cost competitiveness and a springboard to ASEAN and beyond.

In our next article, we will focus on how O&G service companies can enter Greater KL to set up their regional headquarters and use it as a platform for regional or global activities

---

Disclaimer: *The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of any organisations. Examples of analysis performed within this article are only examples. The situation is different on case to case basis as they are based only on very limited and dated open source information. Assumptions made within the analysis are not reflective of the position of any organisations in the region.*