

**THE UPSTREAM PLAYER IN MALAYSIA OIL
AND GAS INDUSTRY: VALUATION OF OIL AND
GAS COMPANIES**

MOHD ZAMRUL AZUAR BIN MD ALI

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ABSTRACT

This study was conducted to evaluate the upstream oil and gas companies in Malaysia. Since late 1990s, stock market analysts have focused strongly on short-term accounting return measures, such as Return on Average Capital Employed (ROACE) and Reserve Replacement Ratio (RRR) for benchmarking and valuation of international oil and gas companies. Consequently, exaggerated capital discipline among oil and gas companies may have reduce their willingness to invest for future reserves and production growth. This is the reason why this study focuses on the market capitalization of oil and gas company. The aim of this study is to examine the relationship between market capitalization with ROACE and RRR of the oil companies.

To determine the effect of ROACE and RRR to the market capitalization of oil company, this study using seven upstream oil and gas company in Malaysia. The time horizon is from the year 1992 to 2006 which is 15 years. The income statement and balance sheet are used to gather the ROACE and RRR information from of each company. There are two methods of data analysis used in this study; the time series regression and pooled regression analysis. The first method is done by analyzing each company separately. Researcher found out that there is no significant relationship between ROACE and RRR to the market capitalization of the oil company. Then the pooled regression is conducted in order to examine the relationship. By pooled the data from each company, researcher found out that RRR is significant contributor to the market capitalization of the oil company. The researcher findings do not support the general perception of ROACE as an important valuation metric in oil and gas industry.

CHAPTER ONE

INTRODUCTION

1.1 Overview of Oil and Gas Industry In Malaysia

Petroleum exploration in Malaysia started at the beginning of the 20th century in Sarawak, where oil was first discovered in 1909 and first produced in 1910. Prior to 1975, petroleum concessions were granted by state governments, where oil companies have exclusive rights to explore and produce resources. The companies then paid royalties and taxes to the government. This state of affairs ceased on April 1, 1975 as a result of the Petroleum Development Act (1974), whereby PETRONAS became the custodian of petroleum resources with rights to explore and produce resources. Since then the industry has developed to become one of our most important economic sectors. It is also a sector which has taken advantage of the most demanding, challenging business environment and exciting engineering and technological advances and therefore should be of great interest to the people who involve in the sector.

Furthermore, Malaysia is blessed with a broad, shallow continental shelf (330,000 km²) and some prospective deepwater areas. In total, Malaysia has 565,555 km² available for oil and gas exploration, 205,500 km² of which are currently covered by Production Sharing Contracts (PSCs). Until 1993, exploration and production were carried out on the broad continental shelf (water depth of 25 to 200 meters) off the coast of the states of Sabah and Sarawak in East Malaysia, and off Terengganu's coast in Peninsular Malaysia. The country's deeper offshore areas, with water depths of 200