OPERATING ENVIRONMENT AND OUTLOOK

As an integrated chemicals company, there are a range of external factors that influence not only on our day-to-day operations but also our resource management and ability to create long term value. With operating costs that are closely correlated to global oil prices and products that have a widespread presence in every aspect of life, we need to effectively anticipate and mitigate potential impacts to the business. Therefore, we continuously and closely monitor our operating environment especially in the context of global economic performance, business sentiment, geopolitical issues and supply-demand cycles. This proactive approach is integral to our commitment to creating value in response to the dynamic challenges posed by these external factors.

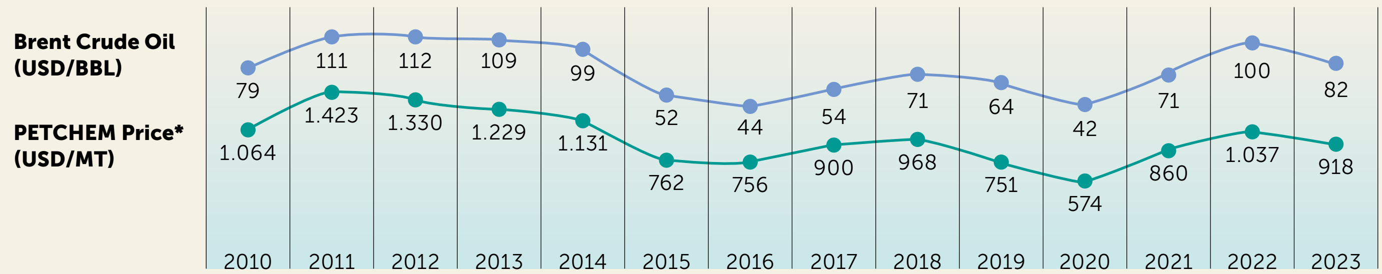
MACROECONOMIC UNCERTAINTIES

The year 2023 presented a complex landscape for the petrochemical industry, marked by a sluggish economic recovery, persistent high inflation, and significant price volatility in energy markets. These factors collectively shaped a challenging environment for companies within the sector.

The anticipated global economic recovery, spurred by China's reopening in late 2022, fell short of expectations. Despite hopes for a robust demand resurgence, China's recovery was hampered by weak domestic demand and high inflation impacts on its trading partners, leading to reduced export demand. This, coupled with a decline in the property sector despite government stimuli, contributed to a moderated global GDP growth rate of 3.1%, down from 3.5% in 2022. The chemical industry, sensitive to economic shifts, experienced reduced demand as businesses scaled back on investments and restocking, exacerbating the effects of new global capacities coming online. Additionally, geopolitical tensions and OPEC+ production cuts kept oil prices elevated, increasing feedstock costs and squeezing margins further.

High inflation remained a formidable challenge, dampening consumer spending and escalating production costs through rising goods, services, and labour costs. These pressures necessitated a recalibration of operational practices and financial frameworks within the industry. Companies faced the dual task of managing escalated costs while navigating supply chain disruptions, requiring innovative strategies to ensure resilience and sustainable growth.

Energy price volatility, influenced by geopolitical events, OPEC+ decisions, and fluctuating global economic conditions, added another layer of complexity. Crude oil, naphtha, and natural gas prices witnessed fluctuations, impacted by tensions in the Middle East and strategic production adjustments by major oil producers. These fluctuations influenced feedstock prices, contributing to thinner margins for chemical producers as the industry grappled with lower chemical prices and spreads compared to the previous year.



* *Simple average market price of methanol, ethylene, propylene, butadiene, benzene and paraxylene*

Source : Platts, ICIS

IMPACT ON STAKEHOLDER GROUPS

Stakeholders of the petrochemical industry navigated a complex landscape resulting from economic uncertainty and industry-specific challenges in 2023.

Shareholders demonstrated continued confidence in the petrochemical companies like PCG, recognising the essential nature of our products across diverse sectors such as agriculture, automotive, packaging, and personal care. This belief in the potential for long-term growth, despite economic challenges, underscores the critical role of petrochemical products in various industries.

Suppliers and service providers aligned closely with PCG, engaging in collaborative efforts to foster efficient and sustainable operational practices. These partnerships have been pivotal in addressing the economic and environmental challenges, ensuring mutual benefits amid the prevailing conditions.

However, inflationary pressures exert a significant toll on consumer-facing industries, particularly those involved in producing end products like food packaging, clothing, automotive parts, and home furnishings. Consumer sensitivity to price changes, exacerbated by potential interest rate hikes and currency devaluations against the US Dollar, such as the Malaysia Ringgit and Swedish Kroner, places additional stress on demand.

Compounding these challenges are the dynamics of higher feedstock costs coupled with lower chemical prices, squeezing margins and thereby impacting the profitability and shareholder returns of petrochemical companies. Additionally, the high energy costs, particularly in Europe, amplify production expenses. This situation is further complicated by intensified competition from Chinese suppliers who, facing reduced domestic demand, are exploring new markets, adding another layer of complexity to the industry's operational and strategic landscape.

OPERATING ENVIRONMENT AND OUTLOOK

HOW WE RESPONDED

- Sustained our sales volume anchoring on close collaboration with our customers, strong market knowledge, and optimising sales in best netback markets
- Implemented strategies aimed at regaining market share and strengthening competitiveness through exploring new opportunities and expanding market base within our specialties portfolio. This included optimisation of production and sales processes, in addition to procurement savings to boost operational efficiency and profitability
- For commodities, we run our plants at optimum capacity to minimise undisrupted production at competitive cost
- Maximise value creation through Operational Excellence and Commercial Excellence:
  - o Optimising internal processes and applying energy-efficient initiatives to manage operational costs
  - o Diversifying feedstock options and building partnerships with multiple suppliers to ensure a stable supply chain amidst price fluctuations
  - o Allocating resources to research and development initiatives that could foster innovation and sustainability
  - o Strategic pricing adjustments, coupled with a focus on product quality and value while maintaining customer loyalty
  - o Strengthening supply chain resilience through effective risk management and collaboration with partners that further enhance the industry's ability to navigate challenges during high inflation periods
  - o Explored cross-selling and procurement synergies internally to enhance market presence and profitability
  - o Exploring new product lines that do not have high dependency on specific segments and regions

OUTLOOK

Going forward, it appears that the global economy is likely to remain on this path of flat growth, especially with the slow economic revival in China and the lingering impact of tightening monetary policy in most Southeast Asia countries and beyond. According to the IMF, global GDP growth is expected to remain flat at 3.1% in 2024. The global inflation rate, meanwhile, is expected to decelerate to 5.8% in 2024 due to tighter monetary policy*. We expect to see a more solid recovery at the end of 2024, when most sectors have normalised and demand catches up with supply, bolstered by the reduction in inflationary pressures which should help to boost sales and reinvigorate demand.

Following the Middle East conflict which intensified volatility in the market, we foresee that crude oil prices will remain rangebound between USD70 - USD80 per barrel even as OPEC voluntary production cuts continue to take place. Moreover, a US crackdown on Russian oil exports could potentially disrupt supply, providing more support for prices next year. Naphtha prices are expected to remain low due to ample supply. Consequently, the derivatives including petrochemical prices will continue to be pressured amid subdued demand. The conflict has also disrupted the Middle East - Asia export route via the Suez Canal which will put upward pressure on petrochemical supply chain. Furthermore supply from the US to Asia continues to be challenging as the low water level in the Panama Canal due to the drought condition has led to shipping route congestion.

In addition, despite the spillover effects of fragile global economic recovery plus the ongoing Russian-Ukraine conflict, feedstock prices such as LNG is anticipated to remain elevated. Prices will however be lower than the peaks of 2022 as a result of the European continent's strategy to diversify import sources to reduce their dependence on Russian gas.

Due to these events, most chemical producers are likely to face thin margins from high feedstock prices while being weighed down by sluggish demand and slow economic growth.

* *Based on IMF World Economic Outlook Database in October 2023*

OPERATING ENVIRONMENT AND OUTLOOK

INTENSIFIED SUSTAINABILITY

OVERVIEW

The emphasis on sustainable business practices has grown stronger, with increased attention and demands from policymakers, regulators, financiers, investors, consumers, and advocacy groups. This is evident in the shifts in policies and the rising investments in low-carbon and decarbonisation initiatives. These changes are expected to accelerate the peak in oil demand, posing challenges for industry players reliant on oil revenue and those with higher operational costs which will also impact downstream chemicals. Furthermore, demand of sustainable feedstock is gaining traction as major economies begin to translate their net-zero commitments into tangible policies and regulations, including the implementation of carbon pricing. For instance, the Carbon Border Adjustment Mechanism (CBAM) is the world's first carbon border tax introduced by the European Union (EU) aims to mitigate the carbon emission of imported goods, strengthening the drive toward industry decarbonisation and encouraging international partners and nations to proactively address climate change.

IMPACT ON STAKEHOLDER GROUPS

- Growing demand by customers for low carbon products, environmentally friendly options with recyclable packaging, higher renewable content, and a focus on cost-effectiveness. The requirements vary based on market segments, with end-users in advanced economies often leading the adoption to address regulatory pressures and fulfil sustainability agendas
- Heightened scrutiny by shareholders and investors on how companies are managing their sustainability risks and opportunities, including details about decarbonisation plans and how they are embedding sustainability practices within their operations
- Mandatory disclosure requirements by Government agencies and regulators, i.e; Bursa Malaysia's Main Market Listing Requirement (MMLR) in relation to enhanced sustainability reporting framework, the European Financial Reporting Advisory Group's Corporate Sustainability Reporting Directive (CSRD) and IFRS S1 and S2

HOW WE RESPONDED

- Continued development of innovative product solutions that addresses customer needs including:
  - o Sustained co-creation efforts with customers to develop products with a higher Renewable Carbon Index
  - o Launched six new ISCC PLUS certified products to support Finite Material Neutral ambition, which is to gradually shift from virgin fossil raw materials and energy at our production plants globally to renewable, recycled or recovered sources
- Progressed feasibility study into the production of sustainable methanol via Project Air
- Drove GHG reduction within our assets in line with our NZCE roadmap to reduce the carbon footprint of our products and realise our commitment to achieving net zero aspirations by 2050
- Sanctioned Final Investment Decision to build an advanced chemical recycling plant in August 2023, in order to produce pyrolysis oil which is a feedstock for circular polymers to address customer demand for sustainable food packaging as well as to unlock opportunities in the circular economy in Malaysia
- Expanded our efforts in assessing sustainability as well as climate risk and opportunities to better understand its impact on PCG business and operations around the world
- Expanded Be Green, our flagship social impact programme, internationally for the first time starting with Indonesia followed by Thailand to deliver greater value in countries where we are present
- Continue to improve sustainability and climate disclosure strategy from our TCFD Report published in 2022 through alignment with domestic and international regulations and by assessing the recently introduced in 2023 International Financial Reporting Standards (IFRS) S1 and S2 Sustainability Disclosure Standards and CSRD for our European entity

Cleaning parts of Lat Phrao Canal in Thailand through our Be Green programme.

OUTLOOK

Our sustainability agenda will continue to prioritise how to further transform the business in ways that will directly support the transition to a low carbon and circular economy. We will also address new regulations, anticipate the expectations of our investors and consumers, as well as fulfil sustainability reporting obligations. We are resolute in directing our resources towards responsible operations with environmental and social responsibility at the core. We will also continue to evaluate opportunities in the circular economy which includes CO_2 utilisation, sustainable products, the New Plastics Economy (NPE); and in community welfare, as well as climate change mitigation and adaptation.