

30 January 2023

Petronas Gas

Business As Usual under RP2

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We hold the view that terms stipulated under the Regulatory Period 2 (RP2) will have neutral impact on PETGAS as a lower WACC is cushioned by a growing regulated asset base, while the yearly adjustments on forex fluctuation and gas prices will reduce earnings volatility. As such, PETGAS's earnings will remain stable with >90% being safeguarded by the Incentive-Based Regulation (IBR) framework, anchoring a consistent and generous dividend payout. We keep our forecasts relatively unchanged, tweak our TP marginally up to RM17.13 (from RM17.00) and maintain our MARKET PERFORM call.

The key takeaways from PETGAS conference call last Friday pertaining to the RP2 are as follows:

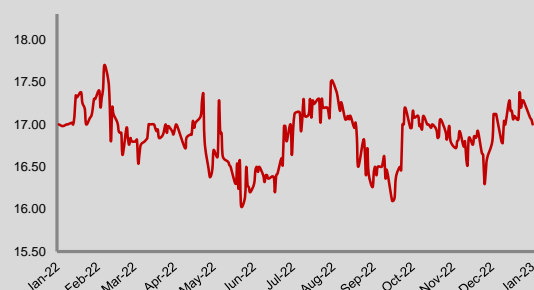
1. Future earnings to remain neutral given a high asset base to mitigate a lower WACC. There was no disclosure of regulated asset base (RAB) by the company but it has guided for RM2b increment of RAB over the 3-year RP2 period, i.e., 2023 to 2025. Similarly, the quantum of WACC was not disclosed as well but we believe to be at the highest range of 7%. The company expects insignificant cut in WACC in the future which we believe could also indicate that the new rate is in line with other utilities players in the region.
2. A new component Tariff C of RM0.553/GJ for high-pressure gas via Peninsular Gas Utilisation (PGU) II Sector 3, on top of the Tariff T of RM1.063/GJ for RP2 via existing PGU network, from RM1.129/GJ in RP1. This Tariff C is for gas export to Singapore with reserved capacity of 200MMSCFD (total charges Tariff T plus Tariff C). To also note that Tariff T in 2023 is RM1.061/GJ. This additional tariff also helps to lower WACC as well as lower revenue expected in 2023 on the yearly forex adjustment from the strong USD in 2022. Meanwhile, the new Tariff T of RM1.063/GJ came slightly higher than our assumption of RM1.045/GJ.
3. Besides the yearly forex adjustment, the authority has also approved 100% cost pass-through on gas price (yearly adjustment) to shippers which will mitigate risk on opex fluctuations. To refresh, PETGAS's earnings were hit by higher internal gas consumption (IGC) costs in FY22 given the escalating gas prices. With these two adjustments in place, PETGAS's earnings will remain stable.
4. The approved tariff of RM3.455/GJ for regasification terminal Sg. Udang (RGTSU), which is the same as our assumption, remains unchanged from RP1 but the approved tariff for regasification terminal Pengerang (RGTP) is reduced to RM3.165/GJ from RM3.485/GJ in RP1. We had expected tariff for RGTP to remain at RM3.485/GJ.

Neutral on earnings. As expected, the RP2 has neutral impact given that the expected lower WACC will be negated by higher RAB while the gas price and forex pass-through help to stabilise earnings. We see mildly positive impact from the new tariff as Tariff T of PGU came slightly higher than our expectations. To align with the new tariffs coupled with new component of Tariff C from 2023, we upgraded FY23F earnings slightly by 0.5% while keeping FY22F's unchanged. Accordingly, FY23F NDPS is also increased proportionally based on unchanged payout of 85%.

MARKET PERFORM ↔

Price : **RM17.00**
Target Price : **RM17.13** ↑

Share Price Performance



KLCI 1,497.55
YTD KLCI chg 0.1%
YTD stock price chg -0.7%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	PTG MK Equity
Market Cap (RM m)	33,638.4
Shares Outstanding	1,978.7
52-week range (H)	17.70
52-week range (L)	15.92
3-mth avg daily vol:	554,489
Free Float	15%
Beta	0.7

Major Shareholders

Petroleum Nasional Bhd	51.0%
Employees Provident Fund	14.5%
Kumpulan Wang Persaraan	10.0%

Summary Earnings Table

FY Dec (RM m)	2021A	2022F	2023F
Turnover	5649	5891	5763
EBIT	2660	2543	2523
PBT	2642	2490	2482
Net Profit (NP)	1989	1784	1897
Core Net Profit	2025	1784	1897
Consensus (NP)		1794	1889
Earnings Revision (%)		-	+0.5
Core EPS (sen)	102.3	90.1	95.8
CNP growth (%)	1.2	-11.9	6.3
NDPS (sen)	82.0	76.6	81.5
BV/Share (RM)	6.62	7.38	7.52
NTA/Share (RM)	6.62	7.38	7.52
Core PER (x)	16.8	18.9	17.7
PBV (x)	2.60	2.30	2.26
Price/NTA (x)	2.60	2.26	2.22
Gearing (%)	N Cash	N Cash	N Cash
Dividend Yield (%)	4.8	4.5	4.8

30 January 2023

We continue to like PETGAS for its earnings stability of which >90% is safeguarded by the IBR framework, and the RP2 has reinforced its earnings stability, anchoring decent dividend yields of 4-5%. However, its valuation is already rich at current levels. Having reflected the terms under the RP2, we raise our SoP-based TP slightly to RM17.13 (see Page 4) from RM17.00. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 6).

Risks to our recommendation include: (i) regulatory risk, and (ii) a global recession hurting demand for power, steam and industrial gases.

Key Highlights of RP2

PGB remains profitable from regulated business segments

contributed by	... and new component and principles cushioning the impact of lower tariffs	... coupled with PGB's efforts
Higher Asset Base amid Lower WACC	Tariff C (for PGU) Revenue adjustments (FOREX and Gas Price)	Efficiency Sustainability

Source: Company

Tariff Components under IBR Guidelines

components under IBR

$$\text{Tariff} = \frac{\text{ARR}}{\text{RFC}}$$

ARR : Annual Revenue Requirement
RFC : Reserved Firm Capacity

Annual Revenue Requirement (ARR)


PROFIT	COST PASS-THROUGH				
Allowed Return	OPEX	Working Capital	Depreciation	Tax and Zakat	Incentives / Penalties
Regulated Asset Base (RAB) / CAPEX X WACC					

Reserved Firm Capacity (RFC)

	Capacity (mmscfd)
Peninsular Gas Utilities (PGU)	2550
Regas Terminal Sg. Udang (RGTSU)	500
Regas Terminal Pengerang (RGTP)	490
Total Capacity Booked	3540

Source: Company

PGU



Approved Tariff in RM/GJ/day

RP1	RP2
1.129	1.063
	0.553

- Tariff J.: Regulated tariff via existing PGU network. For 2023, tariff is RM1.061/GJ/day.
- Tariff C.: Regulated tariff for high-pressure gas via PGU II Sector 5.


- Stable earnings**
Lower revenue negated by tariff C
- Tariff C**
for pipeline shippers who require high-pressure gas
- Higher Asset Base**
for strategic growth in the future
- Gas Price**
Approved 100% cost pass through to shippers will mitigate risk on OPEX fluctuations

Growth System Integrity, Reliability and Safety

RISK

Source: Company

RGTSU



Approved Tariff in RM/GJ/day


RP1	RP2
3.455	3.455

- Stable earnings**
underpinned by same tariff as per RP1
- Higher Asset Base**
mainly for System Integrity, Reliability and Safety
- Gas Price**
Approved 100% cost pass through to shippers will mitigate risk on OPEX fluctuations
- FOREX**
Approved cost pass through via adjustment on assets value will mitigate risk on FOREX fluctuations

RISK

Source: Company

RGTP



Approved Tariff in RM/GJ/day

RP1	RP2
3.485	3.165

- Lower earnings**
resulting from lower IBR WACC
- Higher Asset Base**
negating the lower WACC and is mainly for System Integrity, Reliability and Safety
- Gas Price**
Approved 100% cost pass through to shippers will mitigate risk on OPEX fluctuations
- FOREX**
Approved cost pass through via adjustment on assets value will mitigate risk on FOREX fluctuations

RISK

Source: Company

30 January 2023

Valuation			
	RM m	RM/Share	Basis
Gas Business	26,382.3	13.33	DCF @ 8.1% WACC, g = 2%
Melaka RGT	1,288.0	0.65	DCF @ 8.1% WACC
Kimanis IPP	663.2	0.34	DCF @ 4.0% WACC
Pengerang RGT	1,974.7	1.00	DCF @ 6.0% WACC
Gas Malaysia	633.5	0.32	TP: RM3.43 @ 14.8% equity stake
Net Cash/(Debt)	2,960.9	1.50	Adjusted FY23F at group level
	33,902.7	17.13	

Source: Kenanga Research

Income Statement						Financial Data & Ratios					
FY Dec (RM m)	2019A	2020A	2021A	2022F	2023F	FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	5458	5592	5649	5891	5763	Growth (%)					
EBITDA	3694	3687	3643	3591	3594	Revenue	-0.7	2.5	1.0	4.3	-2.2
Depreciation	-1138	-1017	-983	-1047	-1071	EBITDA	-0.4	-0.2	-1.2	-1.4	0.1
EBIT	2556	2670	2660	2543	2523	Operating Income	-0.6	4.5	-0.4	-4.4	-0.8
Interest Expense	-230	-220	-175	-183	-172	Pre-tax Income	5.5	6.0	1.2	-5.7	-0.3
Associate	137	160	157	130	132	Net Income	7.9	3.8	-1.0	-10.3	6.3
Exceptional/FV	0	0	0	0	0	Core Net Income	4.2	6.2	1.2	-11.9	6.3
PBT	2463	2610	2642	2490	2482						
Taxation	-479	-528	-530	-623	-496	Profitability (%)					
Minority Interest	-49	-73	-122	-84	-89	EBITDA Margin	67.7	65.9	64.5	61.0	62.4
Net Profit	1935	2010	1989	1784	1897	Operating Margin	46.8	47.7	47.1	43.2	43.8
Core Net Profit	1884	2001	2025	1784	1897	PBT Margin	45.1	46.7	46.8	42.3	43.1
						Net Margin	35.5	35.9	35.2	30.3	32.9
						Core Net Margin	34.5	35.8	35.9	30.3	32.9
						Effective Tax Rate	19.4	20.2	20.1	25.0	20.0
						ROA	9.2	9.7	10.0	10.0	10.2
						ROE	14.8	15.5	15.5	13.6	12.9
						DuPont Analysis					
						Net margin (%)	34.5	35.8	35.9	30.3	32.9
						Assets Turnover (x)	0.3	0.3	0.3	0.3	0.3
						Leverage Factor (x)	1.5	1.5	1.5	1.4	1.4
						ROE (%)	14.2	15.8	15.5	12.2	12.7
						Leverage					
						Debt/Asset (x)	0.20	0.18	0.18	0.15	0.14
						Debt/Equity (x)	0.29	0.26	0.26	0.20	0.19
						Net Debt/(Cash)	123	-141	335	2317	2961
						Net Debt/Equity (x)	-0.01	0.01	-0.03	-0.16	-0.20
						Valuations					
						Core EPS (sen)	95.2	101.1	102.3	90.1	95.8
						NDPS (sen)	82.0	127.0	82.0	76.6	81.5
						BV/share (RM)	6.69	6.39	6.62	7.38	7.52
						NTA/share (RM)	6.69	6.39	6.62	7.38	7.52
						Core PER (x)	17.5	17.0	16.8	18.9	17.7
						Net Div. Yield (%)	4.8	7.5	4.8	4.5	4.8
						PBV (x)	2.48	2.69	2.60	2.30	2.26
						P/NTA (x)	2.48	2.69	2.60	2.26	2.22
						EV/EBITDA (x)	8.9	9.3	9.2	8.7	8.5

Source: Kenanga Research

30 January 2023

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
GAS MALAYSIA BHD	MP	3.27	3.54	8.26%	4,198.7	Y	12/2022	30.2	27.1	54.0%	-10.1%	10.8	12.1	3.6	33.7%	27.1	8.3%
MALAKOFF CORP BHD	OP	0.685	0.940	37.23%	3,347.6	Y	12/2022	6.3	6.5	-2.2%	3.6%	10.9	10.5	0.6	5.7%	5.0	7.3%
PETRONAS GAS BHD	MP	17.00	17.13	0.76%	33,638.4	Y	12/2022	90.1	95.4	-11.9%	5.8%	18.9	17.8	2.3	12.9%	76.6	4.5%
SAMAIDEN GROUP BHD	OP	0.815	0.860	5.52%	313.8	Y	06/2023	4.7	5.5	16.9%	15.9%	17.3	14.9	2.5	15.5%	0.0	0.0%
TENAGA NASIONAL BHD	OP	9.55	10.17	6.49%	54,941.9	Y	12/2022	76.0	91.5	-9.5%	20.5%	12.6	10.4	0.9	7.5%	38.0	4.0%
YTL POWER INTERNATIONAL BHD	OP	0.730	1.04	42.47%	5,914.6	N	06/2023	6.5	7.0	103.7%	9.0%	11.3	10.4	0.5	4.1%	5.0	6.8%
Simple Average					102,354.9					-3.9%	13.8%	13.9	12.2	1.7	13.2%		5.2%

Source: Kenanga Research

Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★	★	★	
	Community Investment	★	★	★		
	Workers Safety & Wellbeing	★	★	★		
	Corporate Governance	★	★	★		
	Anti-Corruption Policy	★	★	★		
	Emissions Management	★	★	★		
SPECIFIC	Transition to Renewables	★	★	★		
	Reliable Energy & Fair Tariff	★	★	★		
	Effluent/Waste Management	★	★	★		
	Ethical Practices	★	★	★		
	Supply Chain Management	★	★	★		
	Customer Satisfaction	★	★	★		
OVERALL		★	★	★		

☆ denotes half-star
 ★ -10% discount to TP
 ★★ -5% discount to TP
 ★★★ TP unchanged
 ★★★★ +5% premium to TP
 ★★★★★ +10% premium to TP

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock’s Expected Total Return is MORE than 10%
 MARKET PERFORM : A particular stock’s Expected Total Return is WITHIN the range of -5% to 10%
 UNDERPERFORM : A particular stock’s Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector’s Expected Total Return is MORE than 10%
 NEUTRAL : A particular sector’s Expected Total Return is WITHIN the range of -5% to 10%
 UNDERWEIGHT : A particular sector’s Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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