Looming uncertainty poses risks

Petronas Gas' (PTG) 2Q17 core earnings of RM418.7m brought 1H17 earnings to RM878.9m (+4% yoy), which was within expectations-accounting for 49% of our and consensus full year estimate. On the whole, 1H17 earnings was bolstered by stronger gas transportation, utilities and the regasification segments. PTG declared a 16sen DPS which brought YTD payout to 31sen as compared to 28sen in 1H16. From a valuation standpoint, PTG might appear quite attractive at current level (trading at -0.5SD of its forward 5-years PE mean of 20.4x). However, we believe that current risk-reward is skewed towards the downside in the short term due to the uncertainty in the upcoming third party access (TPA) framework which could impact earnings. As such, we downgrade the stock to a HOLD (from Buy) with a lower target price of RM19.30.

1H17 results in line with expectations

PTG reported 4.1% yoy increase in revenue at RM2.3bn driven by stronger gas transportation (+1.3% yoy on better operational efficiency), utilities (+15.1% yoy as a result of better demand and upward revision in fuel gas price) and regasification (+3.1% yoy attributed to higher storage fees) segments. Operating profit for gas transportation and regasification segments improved 3.5% and 12.6% yoy as both benefited from lower repair and maintenance cost. Meanwhile operating profit for the utilities segment was 5.4% higher yoy underpinned by higher demand and better fuel gas price. With higher recorded revenue and relatively flat overall margin, core net profit increased by 3.7% yoy to RM878.9m.

Strong utilities segment drive 2Q17 growth

Revenue improved 4.9% yoy in 2Q17 to RM1.2bn driven by the stronger utilities segment (+14.9%) supported by stronger demand and better ASP as a result of an upward revision in fuel gas price. EBITDA margin improved 2.7ppt to 65.2%, which also helped to support the core net profit which increased 3.2% yoy to RM418.7m.

Downgrade to Hold

Despite results falling in line with our forecasts, we tweaked our earnings slightly lower by 3%–5% on minor housekeeping. We fine-tuned our capex as well as our earlier finance cost assumptions. We lower our SOTP-based target price to RM19.30 as we adjust our WACC assumptions and roll forward to 2018E valuation. Downgrade to HOLD considering the unfavorable risk-reward currently.

Earnings & Valuation Summary

FYE 31 Dec	2015A	2016A	2017E	2018E	2019E
Revenue (RMm)	4,456.0	4,561.3	4,661.0	5,077.1	5,470.2
EBITDA (RMm)	2,958.5	2,967.5	3,245.0	3,592.6	3,899.7
Pretax profit (RMm)	2,409.5	2,106.8	2,298.1	2,551.0	2,776.1
Net profit (RMm)	1,987.5	1,739.1	1,749.3	1,941.5	2,112.6
EPS (sen)	100.4	87.9	88.4	98.1	106.8
PER (x)	18.7	21.4	21.3	19.2	17.6
Core net profit (RMm)	1,776.5	1,746.6	1,749.3	1,941.5	2,112.6
Core EPS (sen)	89.8	88.3	88.4	98.1	106.8
Core EPS growth (%)	(0.6)	(1.7)	0.2	11.0	8.8
Core PER (x)	21.0	21.3	21.3	19.2	17.6
Net DPS (sen)	60.0	62.0	57.5	63.8	69.4
Dividend Yield (%)	3.2	3.3	3.1	3.4	3.7
EV/EBITDA (x)	12.3	12.5	11.5	10.4	9.5
Chg in EPS (%)			(2.6)	(3.2)	(4.6)
Affin/Consensus (%)			1.0	1.0	1.1

Source: Company, Affin Hwang estimates

Result Note

Petronas Gas

PTG MK
Sector: Oil & Gas

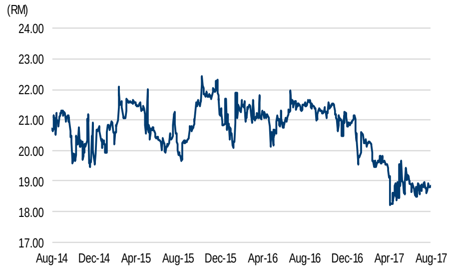
RM18.82 @ 15 August 2017

HOLD (downgrade)

Upside: +3%

Price Target: RM19.30

Previous Target: RM20.72



Price Performance

	1M	3M	12M
Absolute	0.1%	1.3%	-15.1%
Rel to KLCI	-0.9%	1.6%	-19.1%

Stock Data

Issued shares (m)	1,978.7
Mkt cap (RMm)/(US$m)	37239.7/8669.9
Avg daily vol - 6mth (m)	0.9
52-wk range (RM)	18.1-22.5
Est free float	19.4%
BV per share (RM)	6.10
P/BV (x)	3.09
Net cash/(debt) (2Q17)	(572.9)
ROE (2018E)	15.1%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

PETRONAS	60.7%
EPF	10.3%
KWAP	5.2%

Source: Affin Hwang, Bloomberg

Tan Jianyuan, ACCA
(603) 2146 7538
Jianyuan.tan@affinhwang.com

Risks to our call

Key upside risks to our call include more favourable outcome for the upcoming TPA; downside risk would be a delay in the commencement of Pengerang RGT (later than 4Q17) and operational discruption of existing assets.

Fig 1: Results comparison

FYE 31 Dec (RM m)	2Q17	qoq % chg	yoy % chg	1H17	yoy % chg	Comment
Revenue	1,173.5	*0.4*	*4.9*	2,342.7	*4.1*	Revenue increased 4.1% yoy supported by stronger gas transportation, utilities and regasification segment
Op costs	(408.5)	*5.8*	*(2.7)*	(794.8)	*3.7*	
EBITDA	765.0	*(2.3)*	*9.4*	1,547.9	*4.4*	
EBITDA margin (%)	*65.2*	*-1.8ppt*	*2.7ppt*	*66.1*	*0.1ppt*	
Depn and amort	(230.6)	*1.0*	*8.6*	(458.9)	*10.1*	
EBIT	534.4	*(3.6)*	*9.8*	1,089.0	*2.1*	
EBIT margin (%)	*45.5*	*-1.9ppt*	*2ppt*	*46.5*	*-0.9ppt*	Margin was relatively flat supported by gas transportation, utilities and regasification segment but offsetted by weaker gas processing segment.
Int expense	(25.8)	*(1.7)*	*15.6*	(52.2)	*13.1*	
Int and other inc	17.4	*14.2*	*(3.4)*	32.7	*30.4*	
Associates and JVs	4.5	*(85.1)*	*(73.8)*	35.0	*25.7*	
EI	6.6	*119.7*	*n.m*	9.6	*218.5*	2Q17 core net profit has excluded RM0.4m PPE disposal loss and RM7m unrealised forex gain
Pretax profit	**537.1**	*(6.9)*	*7.9*	**1,114.2**	*3.5*	
Core pretax	530.5	*(7.6)*	*6.2*	1,104.5	*2.9*	
Tax	(111.2)	*(2.4)*	*17.9*	(225.1)	*(0.3)*	
Tax rate (%)	*20.7*	*1ppt*	*1.8ppt*	*20.2*	*-0.8ppt*	1H17 effective tax rate was relatively unchanged
MI	(0.6)	*n.m*	*n.m*	(0.5)	*n.m*	
Net profit	**425.3**	*(8.2)*	*5.3*	**888.6**	*4.4*	
EPS (sen)	21.5	*(8.2)*	*5.3*	44.9	*4.4*	
Core net profit	**418.7**	*(9.0)*	*3.2*	**878.9**	*3.7*	1H17 earnings is in line with our expectations accounting for 49% of our full year forecasts.

Source: Affin Hwang, company data

Fig 2: SOTP valuation for Petronas Gas

Sum of parts valuation	Value (RM m)	Value per share (RM)	Remarks
Gas Processing Segment	10,724.8	5.42	NPV of FCFF at 7.4% WACC, 2% LTG
Gas Transportation Business	14,677.8	7.42	NPV of FCFF at 7.4% WACC, 2% LTG
Centralised Utilities Facilities	4,794.3	2.42	NPV of FCFF at 7.4% WACC, 2% LTG
100% stake in Malacca regassification terminal	5,040.9	2.55	NPV of FCFF at 7.4% WACC, 2% LTG
65% stake in Pengerang regasification terminal	2,817.6	1.42	NPV of FCFF at 7.4% WACC, 2% LTG
14.8% stake in Gas Malaysia	611.9	0.31	In-house TP of RM3.22
60% stake in Kimanis Power Plant	167.1	0.08	NPV of FCF at 7.4%
Sums of Parts Value	**38,834.4**	**19.63**	
Net cash / (debt)	(644.5)	(0.33)	As at end-2018
SOP Equity Value	**38,189.9**	**19.30**	

Source: Affin Hwang forecasts

AFFIN HWANG CAPITAL

Out think. Out perform.

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is printed and published by:
Affin Hwang Investment Bank Berhad (14389-U)
A Participating Organisation of Bursa Malaysia Securities Berhad

22nd Floor, Menara Boustead,
69, Jalan Raja Chulan,
50200 Kuala Lumpur, Malaysia.

T : + 603 2146 3700
F : + 603 2146 7630
research@affinhwang.com

www.affinhwang.com