

Petronas Gas (PTG MK)

A cash proxy?

Demonstrating share price resilience

PTG is not a beneficiary of higher gas prices. Nevertheless, its association with gas, coupled with a largely stable earnings trajectory post FY22 (step-down from *Cukai Makmur*, priced-in) has allowed share price to remain relatively resilient amid the current market rout. Maintain HOLD with an unchanged MYR17.20 TP. On a relative basis, we marginally prefer GMB (GMB MK, HOLD, CP: MYR2.63, TP: MYR2.90) among the gas utilities.

Stable post FY22 step-down

Recall the regulated asset base (RAB) of PTG's transport segment is derived from a sliding weighted average of depreciated replacement value and historical cost. We currently assume a c.20% tariff decline in RP2 (FY23-25E). However, with *Cukai Makmur* already suppressing PTG's FY22E net profit (we estimate c.11% net profit impact), we do not expect earnings to decline further in FY23E. Management has been on the lookout for new projects (Pulau Indah pipeline, Southern debottlenecking) to help offset the decline.

Possible volatility from IGC charges

Rising gas prices could inflate PTG's internal gas consumption (IGC) charges at the transport and regas segments. While IGC is theoretically a pass-through (the reference gas price is unknown given lack of regulatory disclosures), there are possible timing distortions which could potentially induce volatility in quarterly earnings.

Enjoying higher electricity tariffs

Pen. Malaysia's 1H22 electricity tariff surcharge of 3.7sen/kWh is largely coal price-driven. PTG's utilities segment (c.10% of group EBIT) bills electricity sales at benchmark tariffs but generates solely from gas, and thus should enjoy incremental profits. Our earnings forecasts and MYR17.20 TP (DCF-based assuming 7.2% WACC and 2% long-term growth) are unchanged.

| FYE Dec (MYR m) | FY20A | FY21A | FY22E | FY23E | FY24E |
|------------------------------|-------|----------|----------|----------|----------|
| Revenue | 5,592 | 5,649 | 5,641 | 5,437 | 5,437 |
| EBITDA | 3,543 | 3,603 | 3,676 | 3,510 | 3,524 |
| Core net profit | 1,995 | 2,020 | 1,865 | 1,939 | 1,946 |
| Core EPS (sen) | 100.8 | 102.1 | 94.3 | 98.0 | 98.4 |
| Core EPS growth (%) | 5.8 | 1.2 | (7.7) | 3.9 | 0.4 |
| Net DPS (sen) | 127.0 | 82.0 | 72.0 | 72.0 | 72.0 |
| Core P/E (x) | 17.0 | 17.6 | 18.3 | 17.6 | 17.6 |
| P/BV (x) | 2.7 | 2.7 | 2.5 | 2.4 | 2.3 |
| Net dividend yield (%) | 7.4 | 4.6 | 4.2 | 4.2 | 4.2 |
| ROAE (%) | 15.5 | 15.5 | 14.0 | 14.1 | 13.6 |
| ROAA (%) | 10.5 | 10.8 | 9.6 | 9.6 | 9.3 |
| EV/EBITDA (x) | 9.7 | 9.9 | 9.2 | 9.6 | 9.5 |
| Net gearing (%) (incl perps) | 1.1 | net cash | net cash | net cash | net cash |
| Consensus net profit | - | - | 1,922 | 1,938 | 1,916 |
| MKE vs. Consensus (%) | - | - | (2.9) | 0.0 | 1.6 |

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HOLD

| | |
|-----------------------|-----------------|
| Share Price | MYR 17.28 |
| 12m Price Target | MYR 17.20 (+4%) |
| Previous Price Target | MYR 17.20 |

Company Description

Petronas Gas is the gas infrastructure arm of national oil company PETRONAS.

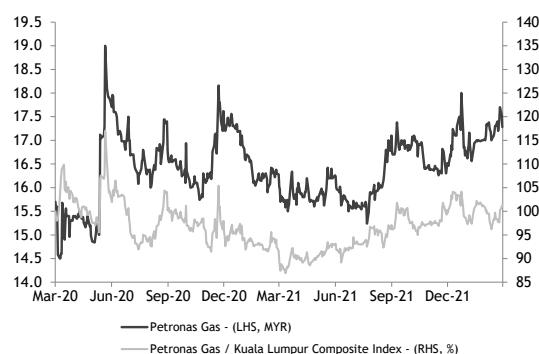
Statistics

| | |
|------------------------|---------------------|
| 52w high/low (MYR) | 18.00/15.24 |
| 3m avg turnover (USDm) | 3.4 |
| Free float (%) | 34.6 |
| Issued shares (m) | 1,979 |
| Market capitalisation | MYR34.2B USD8.2B |

Major shareholders:

| | |
|--------------------------|-------|
| Government of Malaysia | 51.0% |
| Employees Provident Fund | 13.9% |
| Kumpulan Wang Persaraan | 10.4% |

Price Performance



| | -1M | -3M | -12M |
|-----------------------|-----|-----|------|
| Absolute (%) | 2 | 5 | 6 |
| Relative to index (%) | (1) | (1) | 9 |

Source: FactSet

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| | |
|--|------------------------------|
| Risk Rating & Score ¹ | 31.8 (High) |
| Score Momentum ² | +2.4 |
| Last Updated | 03 Nov 2021 |
| Controversy Score ³ (Updated: 28 Jul 2021) | 2 - OSH (employee) Incidents |

Business Model & Industry Issues

- Midstream energy companies are viewed as enablers of fossil fuels, and thus face some degree of environmental scrutiny. Nevertheless, within the energy space, gas is the cleanest of fossil fuels and is thus deemed as more palatable for the environment.
- The main uses of gas in Malaysia are for electricity generation and industrial heating. Given the limited developmental potential of renewables and the prevailing structure of PPAs, gas will continue to feature very prominently in Malaysia for at least the next decade. The risk of stranded assets is thus low. As the gas infrastructure arm of national oil company PETRONAS, we do not expect PTG to deviate from its gas-centric business scope in the foreseeable future.
- Transactions with parent PETRONAS (also PTG's largest customer) are done on commercial terms. However, with parent PETRONAS being entirely government-owned, PTG's operations and profitability are inevitably affected by government policies. Notably, the government's implementation of Third-Party Access (for national gas supply security) had adversely impacted PTG's transportation tariffs. Separately, PTG has had to dispose its Sarawak pipelines to the Sarawak state oil entity.

Material E issues

- Within the energy space, gas is the cleanest of fossil fuels and is thus deemed more palatable for the environment relative to other fuel types (such as coal or oil).
- PTG reduced its GHG emission from 4.4mt CO2e in 2019 to 3.7mt CO2e in 2020 through plant optimisation and efficiency gains. PTG has set an emission cap of 5.0mt CO2e until 2024 and has been proactive with the installation of solar PV, air emission monitoring and emission reduction systems.
- PTG's utilities division runs a co-generation plant, which is more fuel efficient relative to conventional combined-cycle gas plants.
- Through the offering of LNG bunkering services at its Pengerang regasification facility, PTG is playing its part to promote the use of gas/LNG (which is environmentally cleaner than bunker fuel) in the shipping world.

Material S issues

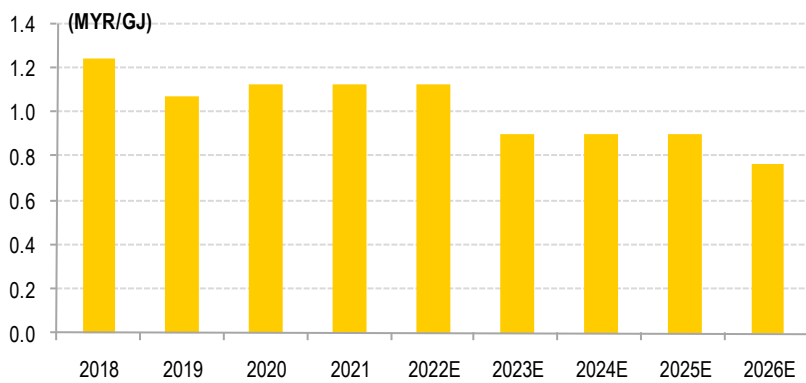
- PTG's pipelines are relatively dated. There has not been any material expansion of PTG's pipelines in the past decade. Thus, the typical native land encroachment issues faced by pipeline companies do not presently apply to PTG.
- Health and safety risks are managed in accordance with prevailing PETRONAS group-wide requirements. There have not been major health and safety mishaps (no fatalities) in recent years. Two incidents of injuries were nevertheless reported in 2019.
- PTG has implemented various CSR programmes in the areas of education, environment and social support, in collaboration with Yayasan PETRONAS (the CSR arm of parent PETRONAS) and other NGOs. The male-female split of PTG's 1,765 strong workforce stood at 87%-13% as at 2020. Female representation at the management level stood at a more commendable 33%.

Key G metrics and issues

- Being part of the PETRONAS group (51%-owned), PTG's governance practices are heavily influenced by parent PETRONAS.
- The Board currently has 10 Directors, comprising of 1 Executive Director (CEO/MD, a PETRONAS appointee), 3 Non-Independent Non-Executive Directors (including the chairman, all PETRONAS appointees) and 6 Independent Non-Executive Directors.
- There are presently 4 women on the Board (40% representation). PTG is supportive of the 30% female representation threshold at the Board.
- PTG discloses only the remuneration details of its CEO. In 2020, the CEO's remuneration of MYR1.5m amounted to <0.1% of PTG's net profit.
- PTG has been audited by KPMG for at least the past decade.
- PTG has not undertaken any material M&As in recent years. Transactions with parent PETRONAS (also PTG's largest customer) are done on commercial terms.
- With parent PETRONAS being entirely government-owned, PTG's operations and profitability are inevitably affected by government policies. The government's implementation of Third-Party Access to enhance gas supply security had adversely impacted PTG's transportation tariffs. Separately, PTG has had to dispose its Sarawak pipelines to the Sarawak state oil entity.
- PTG does not have a formal dividend policy, having in the past maintained a c.70% payout ratio. Nevertheless, it has in recent years adopted a more aggressive stance on capital management, having declared special dividends in 2019 and 2020 respectively.

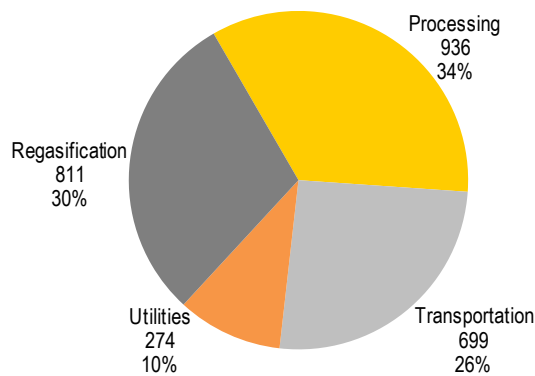
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

PTG's transport tariff



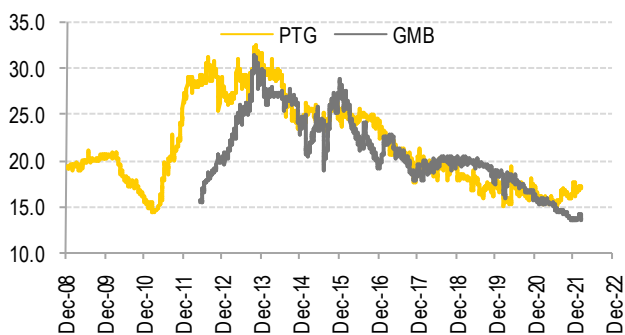
Source: Company, Maybank IBG Research

PTG's EBIT breakdown - FY21



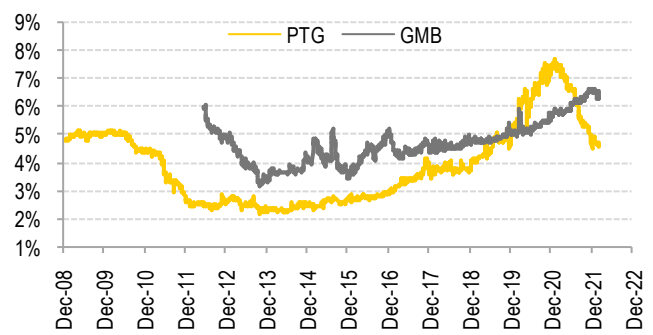
Source: Company, Maybank IBG Research

Trailing PER



Source: Company, Maybank IBG Research

Trailing net yield



Source: Company, Maybank IBG Research

Risk statement

There are several risk factors for our earnings estimates, target price and rating for PTG. Regulatory developments, such as the determination of regulated returns, have a direct impact on earnings. Unscheduled outages could also result in earnings losses for PTG.

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|------------------------|-------|-------|-------|-------|-------|
| Key Metrics | | | | | |
| P/E (reported) (x) | 16.2 | 16.2 | 18.3 | 17.6 | 17.6 |
| Core P/E (x) | 17.0 | 17.6 | 18.3 | 17.6 | 17.6 |
| P/BV (x) | 2.7 | 2.7 | 2.5 | 2.4 | 2.3 |
| P/NTA (x) | 2.7 | 2.7 | 2.5 | 2.4 | 2.3 |
| Net dividend yield (%) | 7.4 | 4.6 | 4.2 | 4.2 | 4.2 |
| FCF yield (%) | 7.1 | 5.9 | 4.9 | 5.2 | 5.2 |
| EV/EBITDA (x) | 9.7 | 9.9 | 9.2 | 9.6 | 9.5 |
| EV/EBIT (x) | 13.6 | 13.6 | 12.6 | 13.4 | 13.3 |

INCOME STATEMENT (MYR m)

| | | | | | |
|-----------------------------|-----------|---------|---------|-----------|-----------|
| Revenue | 5,592.1 | 5,648.6 | 5,641.5 | 5,437.4 | 5,437.4 |
| EBITDA | 3,543.5 | 3,602.7 | 3,675.6 | 3,509.7 | 3,524.4 |
| Depreciation | (1,016.9) | (983.0) | (987.2) | (1,003.0) | (1,017.7) |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | 2,526.6 | 2,619.7 | 2,688.4 | 2,506.7 | 2,506.7 |
| Net interest income / (exp) | (98.9) | (90.7) | (95.0) | (94.4) | (91.5) |
| Associates & JV | 159.8 | 157.1 | 153.1 | 160.2 | 165.5 |
| Exceptionals | 22.7 | (44.5) | 0.0 | 0.0 | 0.0 |
| Other pretax income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 2,610.2 | 2,641.7 | 2,746.5 | 2,572.5 | 2,580.8 |
| Income tax | (527.9) | (530.3) | (778.0) | (530.7) | (531.3) |
| Minorities | (72.7) | (122.5) | (103.2) | (103.2) | (103.2) |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 2,009.6 | 1,988.9 | 1,865.3 | 1,938.6 | 1,946.2 |
| Core net profit | 1,995.3 | 2,020.0 | 1,865.3 | 1,938.6 | 1,946.2 |

BALANCE SHEET (MYR m)

| | | | | | |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Cash & Short Term Investments | 3,138.9 | 3,782.5 | 4,175.1 | 4,661.2 | 5,171.0 |
| Accounts receivable | 744.5 | 889.6 | 896.5 | 864.0 | 864.0 |
| Inventory | 44.9 | 46.0 | 47.4 | 45.6 | 45.6 |
| Property, Plant & Equip (net) | 13,216.2 | 13,272.4 | 13,485.2 | 13,682.2 | 13,864.5 |
| Intangible assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Investment in Associates & JVs | 773.7 | 856.8 | 899.4 | 945.2 | 993.9 |
| Other assets | 426.4 | 338.9 | 338.9 | 338.9 | 338.9 |
| Total assets | 18,344.6 | 19,186.1 | 19,842.5 | 20,537.2 | 21,278.0 |
| ST interest bearing debt | 145.2 | 168.2 | 252.1 | 335.9 | 419.8 |
| Accounts payable | 839.1 | 1,069.0 | 1,065.5 | 1,026.9 | 1,026.9 |
| LT interest bearing debt | 3,134.3 | 3,278.9 | 3,362.8 | 3,446.6 | 3,530.4 |
| Other liabilities | 1,258.0 | 1,330.0 | 1,330.0 | 1,330.0 | 1,330.0 |
| Total Liabilities | 5,376.1 | 5,846.6 | 6,010.8 | 6,139.9 | 6,307.6 |
| Shareholders Equity | 12,634.8 | 13,098.6 | 13,539.2 | 14,053.1 | 14,574.7 |
| Minority Interest | 333.8 | 240.9 | 292.5 | 344.1 | 395.7 |
| Total shareholder equity | 12,968.5 | 13,339.5 | 13,831.7 | 14,397.2 | 14,970.4 |
| Total liabilities and equity | 18,344.6 | 19,186.1 | 19,842.5 | 20,537.2 | 21,278.0 |

CASH FLOW (MYR m)

| | | | | | |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|
| Pretax profit | 2,610.2 | 2,641.7 | 2,746.5 | 2,572.5 | 2,580.8 |
| Depreciation & amortisation | 1,016.9 | 983.0 | 987.2 | 1,003.0 | 1,017.7 |
| Adj net interest (income)/exp | 98.9 | 90.7 | 95.0 | 94.4 | 91.5 |
| Change in working capital | 203.7 | (27.0) | (11.8) | (4.4) | 0.0 |
| Cash taxes paid | (390.4) | (436.5) | (778.0) | (530.7) | (531.3) |
| Other operating cash flow | (168.3) | (116.0) | (153.1) | (160.2) | (165.5) |
| Cash flow from operations | 3,371.0 | 3,135.9 | 2,885.8 | 2,974.6 | 2,993.0 |
| Capex | (955.7) | (1,028.4) | (1,200.0) | (1,200.0) | (1,200.0) |
| Free cash flow | 2,415.3 | 2,107.4 | 1,685.8 | 1,774.6 | 1,793.0 |
| Dividends paid | (2,611.9) | (1,523.6) | (1,424.7) | (1,424.7) | (1,424.7) |
| Equity raised / (purchased) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in Debt | (597.6) | 261.6 | 167.7 | 167.7 | 167.7 |
| Other invest/financing cash flow | (88.6) | (201.9) | (36.2) | (31.6) | (26.2) |
| Effect of exch rate changes | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash flow | (882.8) | 643.6 | 392.7 | 486.0 | 509.9 |

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|--|--------|----------|----------|----------|-----------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | 2.5 | 1.0 | (0.1) | (3.6) | 0.0 |
| EBITDA growth | 1.6 | 1.7 | 2.0 | (4.5) | 0.4 |
| EBIT growth | 7.4 | 3.7 | 2.6 | (6.8) | 0.0 |
| Pretax growth | 6.0 | 1.2 | 4.0 | (6.3) | 0.3 |
| Reported net profit growth | 3.8 | (1.0) | (6.2) | 3.9 | 0.4 |
| Core net profit growth | 5.8 | 1.2 | (7.7) | 3.9 | 0.4 |
| Profitability ratios (%) | | | | | |
| EBITDA margin | 63.4 | 63.8 | 65.2 | 64.5 | 64.8 |
| EBIT margin | 45.2 | 46.4 | 47.7 | 46.1 | 46.1 |
| Pretax profit margin | 46.7 | 46.8 | 48.7 | 47.3 | 47.5 |
| Payout ratio | 125.1 | 81.6 | 76.4 | 73.5 | 73.2 |
| DuPont analysis | | | | | |
| Net profit margin (%) | 35.9 | 35.2 | 33.1 | 35.7 | 35.8 |
| Revenue/Assets (x) | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Assets/Equity (x) | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| ROAE (%) | 15.5 | 15.5 | 14.0 | 14.1 | 13.6 |
| ROAA (%) | 10.5 | 10.8 | 9.6 | 9.6 | 9.3 |
| Liquidity & Efficiency | | | | | |
| Cash conversion cycle | (42.6) | (61.3) | (70.6) | (71.3) | (70.0) |
| Days receivable outstanding | 54.7 | 52.1 | 57.0 | 58.3 | 57.2 |
| Days inventory outstanding | 7.5 | 5.7 | 5.8 | 6.0 | 5.9 |
| Days payables outstanding | 104.8 | 119.1 | 133.4 | 135.7 | 133.2 |
| Dividend cover (x) | 0.8 | 1.2 | 1.3 | 1.4 | 1.4 |
| Current ratio (x) | 3.9 | 3.6 | 3.7 | 3.9 | 4.0 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 3.4 | 3.3 | 3.3 | 3.3 | 3.4 |
| Net gearing (%) (incl perps) | 1.1 | net cash | net cash | net cash | net cash |
| Net gearing (%) (excl. perps) | 1.1 | net cash | net cash | net cash | net cash |
| Net interest cover (x) | 25.6 | 28.9 | 28.3 | 26.5 | 27.4 |
| Debt/EBITDA (x) | 0.9 | 1.0 | 1.0 | 1.1 | 1.1 |
| Capex/revenue (%) | 17.1 | 18.2 | 21.3 | 22.1 | 22.1 |
| Net debt/ (net cash) | 140.5 | (335.3) | (560.3) | (878.7) | (1,220.8) |

Source: Company; Maybank IBG Research

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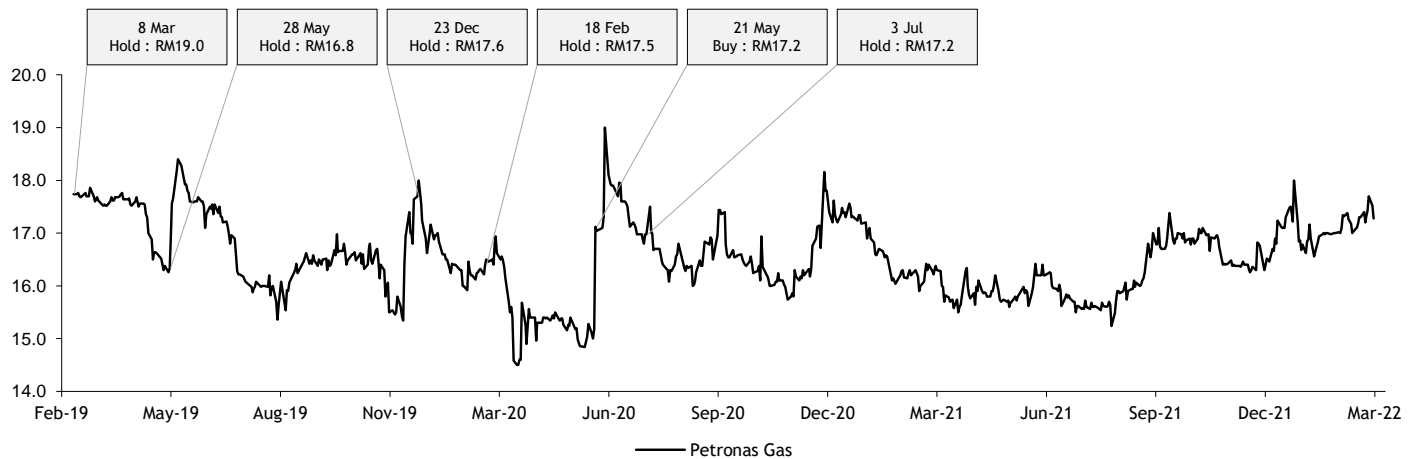
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