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MALAYSIA EQUITY



LIBERALISING GAS SUPPLY IN MALAYSIA

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EXECUTIVE SUMMARY

LIBERALISING GAS SUPPLY IN MALAYSIA

- Malaysia is one of the world's top natural gas producers (14th place globally) and among top 10 producers in Asia. In terms of exports, Malaysia is the world's second-largest exporter of liquefied natural gas (LNG) and the second-largest oil and natural gas producer in Southeast Asia.
- **National gas reserves.** According to the Oil & Gas Journal, Malaysia has approximately 83 trillion cubic feet (Tcf) of proved natural gas reserves as of January 2014 - making it the third-largest natural gas reserve holder in the Asia-Pacific region. More than half of the country's natural gas reserves are located in East Malaysia, predominantly offshore Sarawak. Most of Malaysia's gas reserves are associated with oil basins, although Sabah and Sarawak have found an increasing amount of non-associated gas reserves that have offset some of the declines from mature oil and gas basins offshore Peninsular Malaysia.
- **Malaysia's energy consumption mix.** Malaysia's primary energy consumption is still hydrocarbon-based primarily petroleum and other liquids (40%), natural gas (36%), followed by coal (17%) and the remaining consisting hydroelectric especially in Sarawak (3%) and biomass and waste (4%). In contrast with total energy consumption, electricity generation in particular (Malaysia ex-Sarawak) still relies heavily on coal due to its relatively cheaper price per energy output. Up to 2020, coal is expected to still dominate the electricity generation industry as the primary feedstock, making up to 65% of total generation mix compared with 26% from gas.
- **Natural gas a better choice.** Natural gas is certainly a cleaner and more efficient alternative for industrial and electricity generation use compared with coal and heavy oil. Because natural gas requires minimal processing before reaching end users and produces higher calorific values, natural gas is easier to combust and produce cleaner energy - this reduces greenhouse effect and emissions.
- **Energy security.** Although Malaysia is one of the world's largest LNG exporters, the nation is currently experiencing a geographic disparity of natural gas supply and demand among its regions. The more developed and industrialised northern, western and southern part of Peninsular Malaysia demand more natural gas to fuel the power and industrial sectors. On the other hand, while Sabah and Sarawak produce natural gas, it currently lacks the local demand for it. To meet pressing gas needs in Peninsular Malaysia, PETRONAS has developed various regasification terminals to secure supply from the global gas market - the first being the regasification terminal in Sungai Udang, Melaka and the second (under construction) in Pengerang, Johor.
- **Gas Supply (Amendment) 2016.** Due to the crucial nature of natural gas to our nation as one of the main exports and also as an important feedstock for industrial use, ensuring a secure supply and distribution of gas is essential for the nation. The Gas Supply (Amendment) 2016 which was passed on 14 June 2016 serves to ensure gas security in Malaysia by liberalising the sector and allowing third party operators to import, regasify, transport, distribute, ship, retail via licensee pipe and use natural gas. There are three main objectives of the amended act which are: (i) to allow third parties to access gas infrastructure for the supply of gas to consumers, (ii) to promote healthy competition in the gas supply industry, and (iii) to enable gas consumers to benefit from competitive prices, better services and enhance sustainability.



A. INTRODUCTION TO NATURAL GAS

- **What is natural gas?** By definition, natural gas is a hydrocarbon primarily made up of methane. It is a form of fossil fuel used for heating, cooking, electricity generation, feedstock for petrochemical processing, etc. Natural gas is found in deep underground rock formations or associated with other hydrocarbon reservoirs in coal beds and as methane clathrates. Natural gas and petroleum, another form of fossil fuel, are typically found in close proximity. Most natural gas was created over time by two mechanisms, namely biogenic and thermogenic. Biogenic gas is created by methanogenic organisms in marshes, bogs, landfills, and shallow sediments. Deeper in the earth, at greater temperature and pressure, thermogenic gas is created from buried organic material.
- **Downstream gas industry in Malaysia.** The downstream sector of Malaysia's natural gas industry consists primarily of domestic consumption and exports. However, since about 82% of the country's natural gas demand is located in Peninsular Malaysia, domestic consumption practically refers to gas consumed in this part of the country. On the other hand, a significant portion of the natural gas produced offshore Sarawak is exported in the form of LNG. Thus, Malaysia's natural gas exports are primarily referred to exports of LNG via Bintulu, Sarawak.
- **Gas infrastructure in Malaysia.** The backbone pipeline grid of Peninsular Malaysia's gas infrastructure is the Peninsular Gas Utilisation (PGU) project. The PGU currently distributes gas from (i) offshore Terengganu (to be treated and processed before being introduced into the grid), and (ii) imported LNG via Sungai Udang Regasification terminal. The gas treatment and processing is done at six Petronas Gas Berhad's gas processing plants located in Kertih and Santong, Terengganu (capacity of 2,060mmscfd of methane). Apart from that, the PGU also links the Trans Thailand-Malaysia Gas Pipeline System in Changlun, Kedah and the Malaysia-Thai Joint Development Area in Songkhla, Thailand.
- **Natural gas, a cleaner and more efficient option for electricity generation.** Natural gas is rated to be up to 50% cleaner compared with other fossil fuel when used as a feedstock for electricity generation. Natural gas emits 50-60% less carbon dioxide when combusted in an efficient natural gas power plant as compared with emissions from a typical coal power plant. Globally, natural gas power plants are faster to construct and requires less footprint and faster to ramp up or down depending on power requirements. In terms of efficiency, natural gas is much more efficient compared with coal. For instance, if the source energy is 100MMBtu of natural gas, approximately 92MMBtu of it is able to be delivered to customers. However, in the case of coal, a similar amount of source energy will only yield circa 32MMBtu to the customers.

B. THE GAS SUPPLY (AMENDMENT) BILL 2016

I. GAS SUPPLY ACT 1993

- The Gas Supply Act 1993 is an act to provide the licencing of the supply of gas to consumers through pipelines and related matters, the supply of gas at reasonable prices, the control of gas supply pipelines, installations and appliances with respect to matters relating to safety of persons and for purposes connected therewith. This act however only encompasses the supply of gas to consumers through pipelines relating to: (i) downstream of the last flange of the city gate station, or (ii) from the filling connection of a storage tank or cylinder specifically used for reticulation or delivery of gas to any apparatus in any premises.

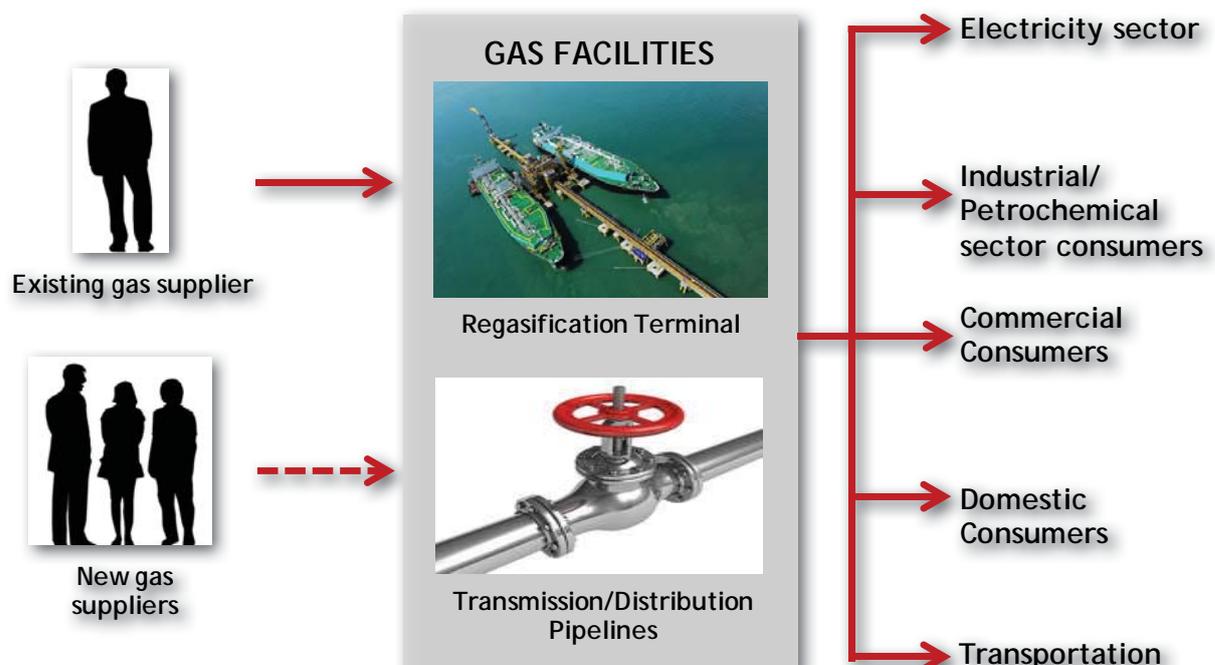
II. GAS SUPPLY (AMENDMENT) BILL 2016

- On 14 June 2016, the Gas Supply (Amendment) Bill 2016, which is an act to amend the Gas Supply Act 1993 was passed by the Dewan Rakyat. In general, this amendment serves to provide for the licensing of the import into regasification terminal, regasification, shipping, transportation, distribution, retail or use of gas in the supply of gas through pipelines and related matters, the supply of gas at reasonable prices, the control of gas supply pipelines, installations and appliances with respect to matters relating to safety of persons in the distribution, retail or use of gas and for purposes connected therewith.

III. SALIENT OBJECTIVES OF THE GAS SUPPLY (AMENDMENT) BILL 2016

- The spirit contained in the amendment is to accommodate new technologies and facilities such as the regasification terminals recently built in Malaysia. It also serves to ensure gas supply security in view

Figure 1: Third Party Access



Source: Suruhanjaya Tenaga, MIDFR

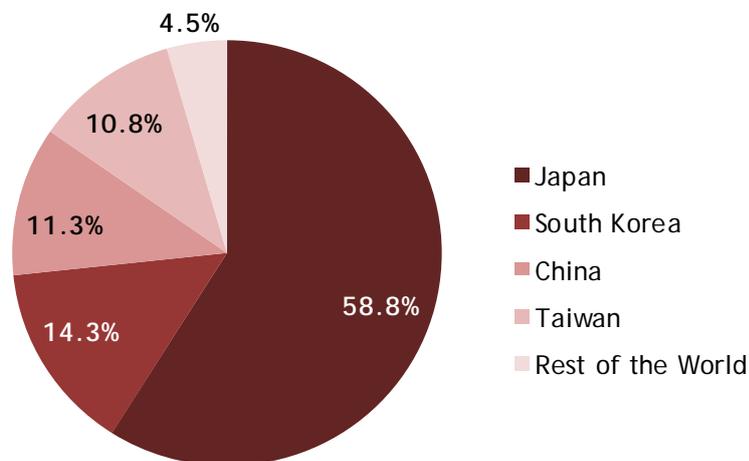
of the ever increasing importance and reliance of natural gas in our economy. The amendment sets to enhance competition with the participation of third parties in the gas supply industry by implementing Third Party Access.

- Currently, the gas supply industry in Peninsular Malaysia is a duo-poly market dominated by Petronas Gas Berhad and Gas Malaysia Berhad (both of which are companies associated with PETRONAS). Petronas Gas transports and supplies gas to customers using more than 5mmscfd of gas while Gas Malaysia serves customers using less than 5mmscfd of gas (previously below 2mmscfd). As such, with the introduction of the Third Party Access, any parties other than PETRONAS could be involved in the gas supply industry in Malaysia by becoming licensees, making use of the gas infrastructure such as regasification terminal, pipeline transmission and distribution pipelines to sell gas to consumers.

IV. CURRENT GAS SUPPLY SITUATION IN MALAYSIA

- At present, the importation of natural gas is solely done by PETRONAS. This includes the extraction of natural gas from local gas fields and transporting it to onshore terminals and the importation of natural gas from other countries to compensate for the shortfall in domestic gas supply in relation with local demand. Prices are also set via the gas sales agreement; an agreement between government of Malaysia and gas producers to sell gas in Malaysia at an agreed upon price mechanism. Because of this, the government of Malaysia seeks to liberalise and to widen the pool of gas suppliers and transporters to ensure gas supply security and to make pricing more competitive.

Figure 2: Malaysia LNG Exports (2014)

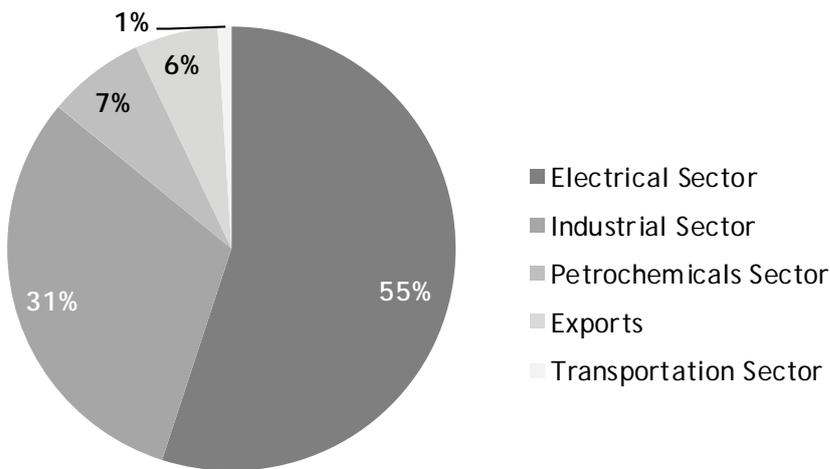


Source: Suruhanjaya Tenaga, MIDFR

V. LICENCES

- Currently, there are two types of licences for piped gas supply in Peninsular Malaysia: (i) Private Gas Licence, and (ii) Gas Utility Licence. The Private Gas Licence allows the holder to supply and use piped gas on one's own premises, e.g. restaurants. On the other hand, the Gas Utility Licence allows licence holders, i.e. Gas Malaysia Berhad and Sabah Energy Corp Sdn Bhd, to supply gas through a pipeline to a person other than a Private Gas Licence holder.

Figure 3: Peninsular Malaysia Domestic LNG Use

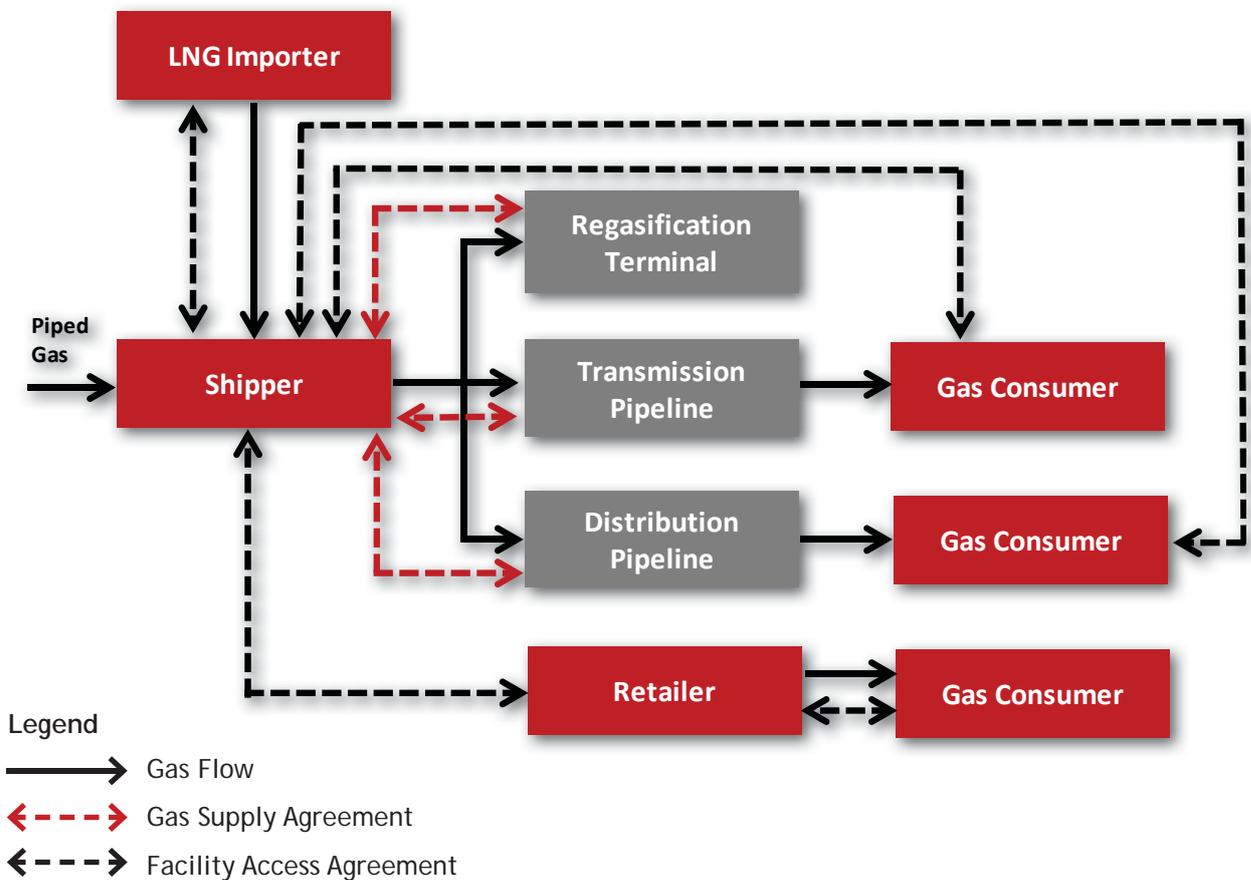


Source: Suruhanjaya Tenaga, MIDFR

VI. NEW LICENCES TO BE CREATED FROM THIRD PARTY ACCESS (TPA)

- Under the TPA, several new licences can be created. These licences are: (i) licence to import LNG, (ii) licence to ship gas via pipeline, (iii) regasification licence, (iv) gas transportation licence to transmit gas across Peninsular Malaysia, (v) gas distribution licence, and (vi) gas retail licence.

Figure 4: Flow of Gas and Agreement in the Third Party Access System

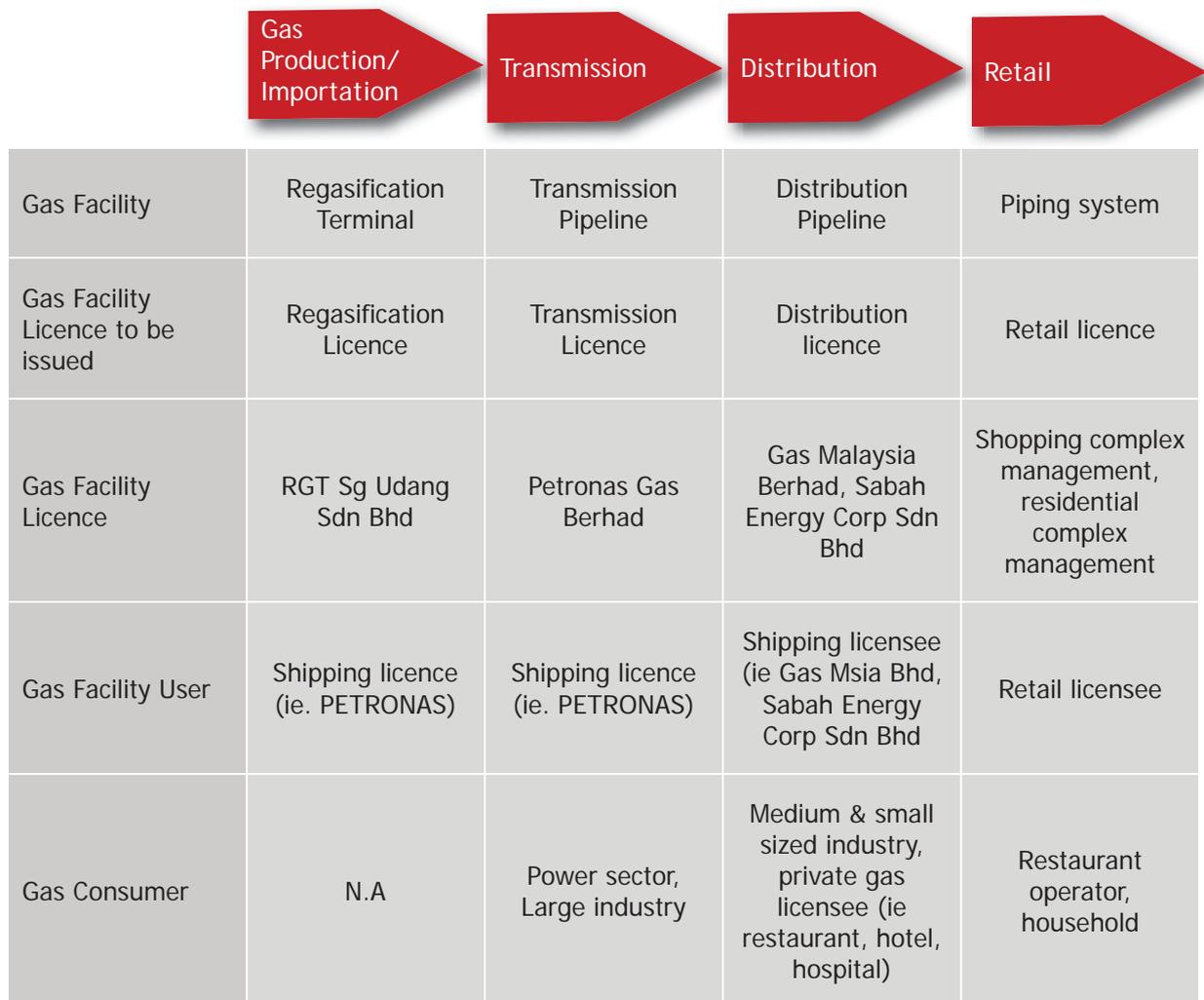


Source: Suruhanjaya Tenaga, MIDFR

VII. VARIOUS GAS SUPPLY AGREEMENTS WHICH CAN BE GENERATED

- Referring to Figure 4, an LNG importer brings in LNG cargo into Malaysia and transfers ownership of the LNG to the shipper at the loading arm of the regasification terminal. The LNG importer will enter into a gas supply agreement with the shipper. The shipper will then supply the LNG to consumers through gas facilities such as regasification terminal, transmission pipeline and distribution pipeline. At this stage, the shipper enters into a gas supply agreement with the gas consumers and a gas facility access arrangement with the gas facility owner. Retailers can also buy gas directly from the shipper via a gas supply agreement to supply gas to consumers via its own piping system. The retailer will have to enter into a gas supply agreement with the consumer.

Figure 5: Industry Players and Licences in Third Party Access Regulatory Framework



Source: Suruhanjaya Tenaga

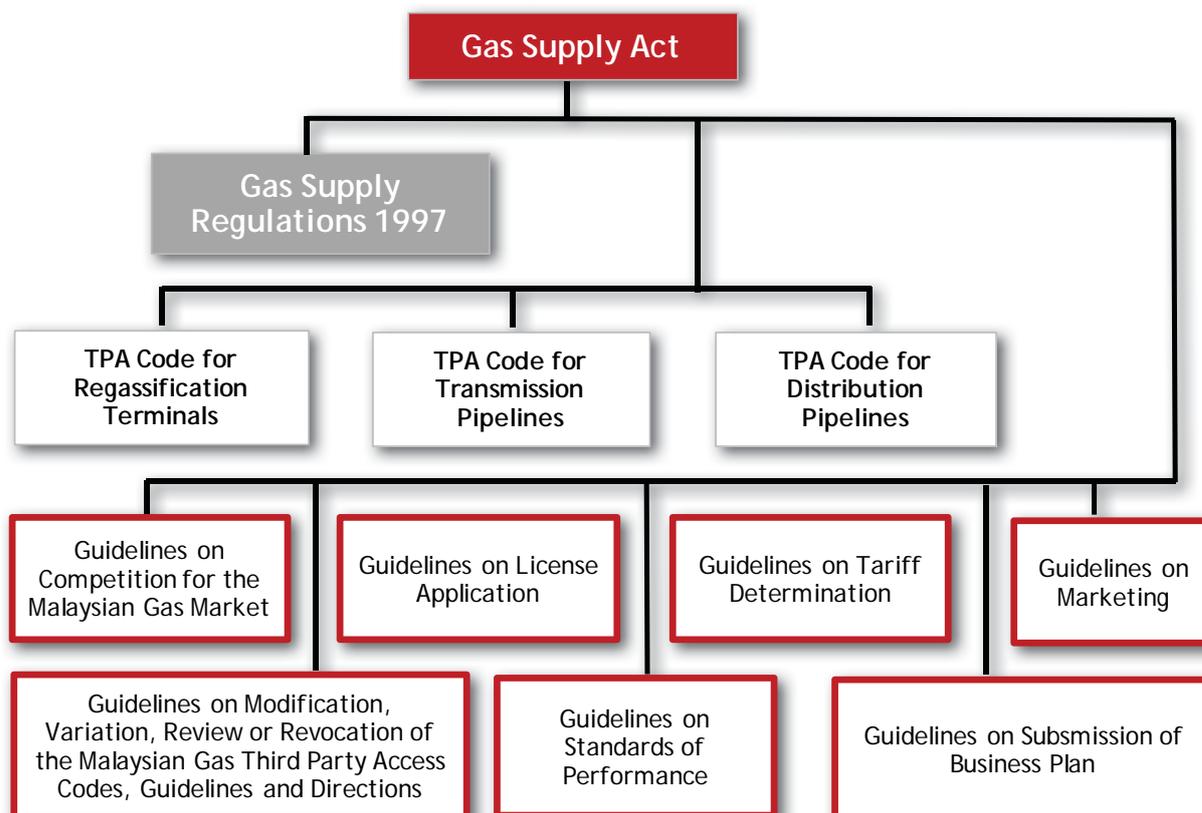
VIII. FRAMEWORK

- The licences that involve infrastructure will only be issued after approval is obtained by the Minister due to the high level of investment required to construct infrastructure facilities associated with natural gas, i.e. regasification terminals, transmission and distribution pipelines. In addition, Suruhanjaya Tenaga’s role and responsibilities will be enlarged by taking charge of issuing and approving licences that do not involve investment in major gas infrastructure.

IX. CONDITIONS PRECEDENT TO BE A LICENCE HOLDER

- There are a few conditions to be met in order for a third party to be a licence holder for any regulated activities. This is to ensure that only qualified and skilled entities are permitted to take part in the local gas market. These conditions are: (i) company incorporated in Malaysia or abroad that has been approved by the Energy Commission, (ii) paid-up capital as stipulated by Suruhanjaya Tenaga, (iii) solid financial status, (iv) relevant technical expertise, and (v) additional requirements as stipulated by Suruhanjaya Tenaga from time to time.

Figure 6: Legal Framework for Third Party Access



Source: Suruhanjaya Tenaga, MIDFR

X. SURUHANJAYA TENAGA'S ROLE IN THE NEW FRAMEWORK

- The newly passed Gas Supply (Amendment) Bill 2016 will expand the powers of the Suruhanjaya Tenaga in relation with the regulation of piped gas. Currently, Suruhanjaya Tenaga's regulatory scope covers the downstream supply of gas from the city gate station to the appliances in the consumers' premises. This explains why Gas Malaysia Berhad's business falls under Suruhanjaya Tenaga's regulatory jurisdiction but Petronas Gas' business does not. With the amended bill in place, Suruhanjaya Tenaga's regulatory scope will extend to the economic aspects of the regasification and transmission side. In addition, Suruhanjaya Tenaga will be able to regulate tariffs for regasification, transmission and distribution in order to prevent anti-competitive practices. As such, prices will be largely determined by market forces.

XI. NEW BUSINESS OPPORTUNITIES TO BE CREATED WITH TPA

Gas Transportation and Distribution

- Under the TPA system, new transporters and distributors are expected to come into existence in areas that currently have no access to piped gas. In areas with existing piped gas, a separate gas network will not be allowed in order to avoid overlap. Only areas currently without access to piped gas are open to new investors for the transportation and distribution of gas. In doing so, investors are therefore advised to perform a market research before investing in those areas.



Gas Shipping

- As gas shippers, investors will obtain their supply via LNG importers or via the gas pipelines from gas producers in Malaysia, Thailand or Vietnam. Gas shippers will sell the gas based on certain terms and enter into an agreement with operators of transmission pipelines to transport gas to consumers' premises upon payment of a fee that will be fixed by the Suruhanjaya Tenaga. Investors interested in gas shipping need significant capital and good business records to obtain the licence from the Suruhanjaya Tenaga. They also need to be able to compete with other gas shippers to ensure sustainability of the gas market in Malaysia.



Gas Retail

- Gas retail is a new segment in providing piped gas services to new settlements. Investors will be assigned one housing/condominium/business complex for the sale of gas to consumers. In comparison to other divisions in the gas market chain, gas retail does not require a huge capital. However, as gas retailers, prospective investors need to possess good safety and business records in order to be able to provide safe and effective service for gas consumers. Prospective investors should perform proper research to determine the risks involved as retailers.



Source: Energy Malaysia, MIDFR

XII. INCREASED COMPETITIONS AND OPPORTUNITIES

- With the liberalisation of the local gas market, there will be more opportunities for new entrants to participate, especially listed companies with strong balance sheet and with the ability to invest in infrastructure. Despite this, we believe that Petronas Gas Berhad and Gas Malaysia Berhad will be the immediate beneficiaries of the market liberalisation as these two companies own the largest network of pipelines in Malaysia. Petronas Gas owns and operates the 2,521km PGU on behalf of PETRONAS while Gas Malaysia owns and operates more than 2,065km of pipelines in Peninsular Malaysia connecting its customers from the main PGU. Both Petronas Gas and Gas Malaysia stand to benefit from new entrants interested in utilising their assets and facilities to participate in the local gas market.

C. GENERATING ELECTRICITY USING NATURAL GAS

I. PENINSULAR MALAYSIA'S ELECTRICITY GENERATION LANDSCAPE

- As at end-December 2015, with the commissioning of 250MW Hydroelectric Plant (HEP) Hulu Terengganu, the total installed capacity of electricity generation in Peninsular Malaysia stood at 20,710MW. Out of the total installed capacity, approximately 52% is fuelled by gas.

Figure 7: Installed Capacity by Type

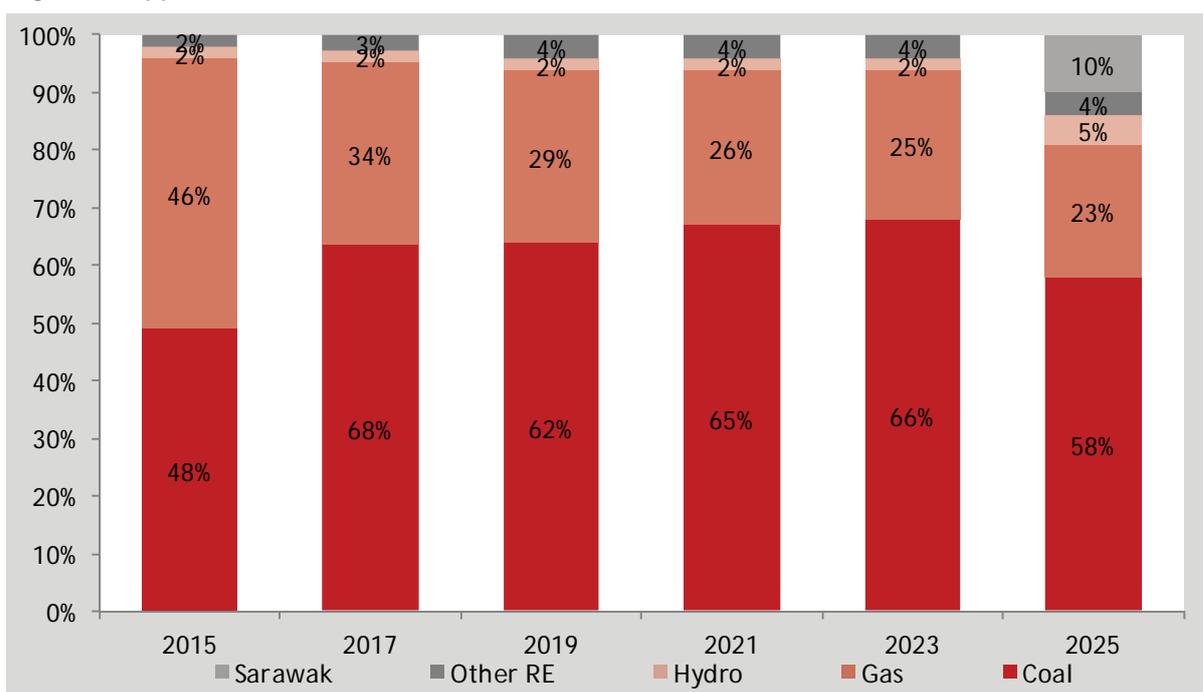
Type	Fuel	Capacity (MW)
Conventional Thermal	Coal	8,066
Combined Cycle Gas Turbine (CCGT)	Gas	8,030
Conventional Thermal	Gas	564
Open Cycle Gas Turbine (OCGT)	Gas	1,901
Hydroelectric	Hydro	2,149
Total Capacity (MW)		20,170

Source: Peninsular Malaysia Electricity Supply Industry Outlook 2016

II. COMMISSIONING OF SUNGAI UDANG REGASIFICATION TERMINAL

- Prior to the commissioning of the first Regasification Terminal (RGT) at Sungai Udang, Melaka in 2013, the power sector in Peninsular Malaysia was faced with an acute curtailment of its gas supply. The situation could have threatened the reliability and security of the electricity supply system if not for closely coordinated actions by all key stakeholders related to the sector. Subsequently, the operationalisation of RGT Sungai Udang enables the importation of LNG which boosted the supply capacity into the PGU system by another 500mmscfd, further relieving the power sector from gas shortages and curtailments

Figure 8: Approved Generation Mix (2015-2025)



Source: Peninsular Malaysia Electricity Supply Industry Outlook 2016, MIDFR

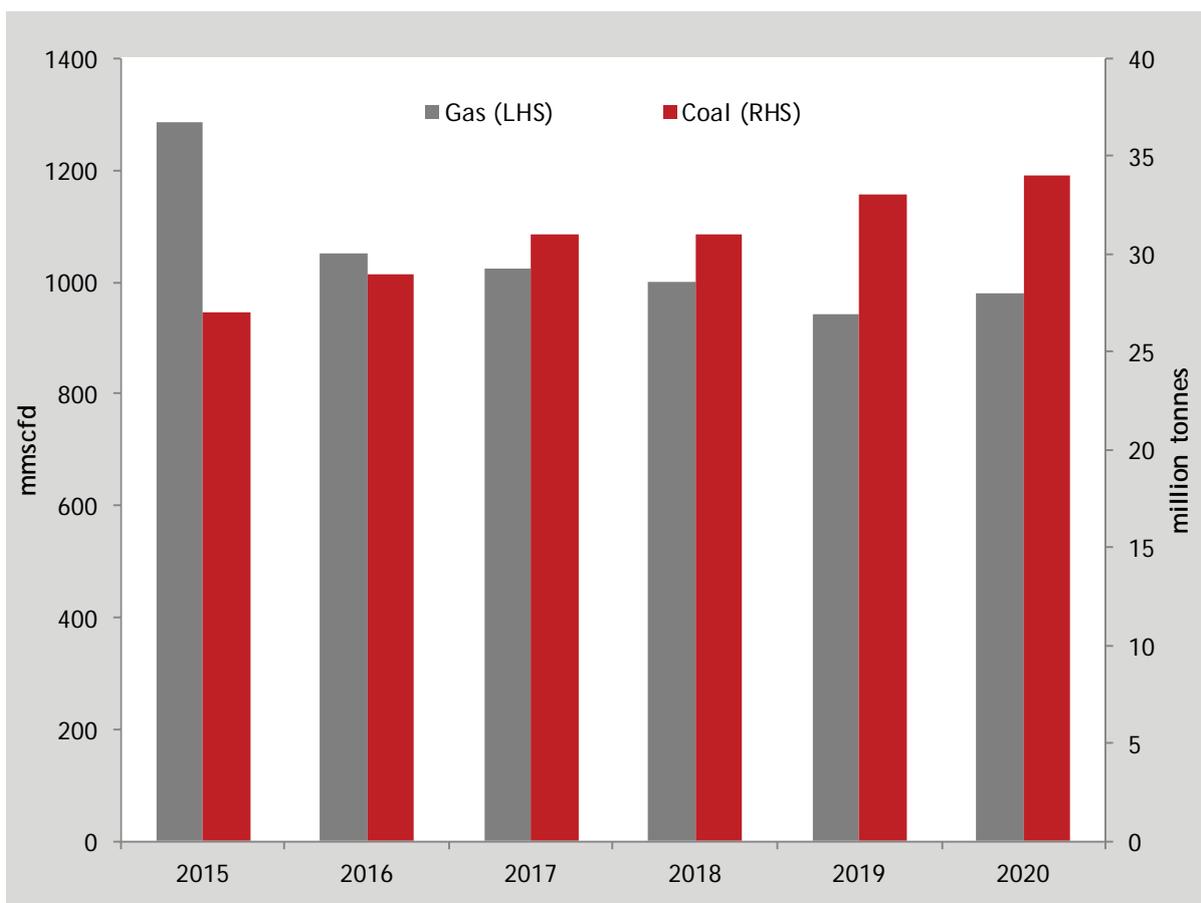
III. GAS PRICING IN PENINSULAR MALAYSIA

- In line with national efforts to rationalise subsidies on fuel and gas, the government has decided to increase the price of piped gas by RM1.50 per mmBtu every six months until it reaches market price. From January 2016, the regulated price of piped gas has increased to RM18.20 per mmBtu from RM16.70 per mmBtu previously. This regulated price however, is still below the market price of MFO at RM25 per mmBtu. Hence the Government is still providing circa 30% gas subsidy to the power sector.

IV. LEAST-COST BASIS

- Despite the overall environmental benefit of using gas for power generation, Tenaga Nasional Berhad still conduct its generation planning based on a 'least-cost' basis. As such, when coal prices are projected to be lower than that of gas, more coal plants will be built, e.g. TNB Janamanjung in Perak. Other fuel components in the determination of electricity tariff, which are LNG and coal, are set at market prices. At RM43.69 per mmBtu, the average price of LNG for power sector throughout 2015 was higher than the regulated gas price. However, it is still lower than its alternative fuel which is diesel, at an average price of RM52.57 per mmBtu. The lowest alternative fuel option to the system is coal which is set through the Applicable Coal Price (ACP) mechanism averaging at RM10.57 per mmBtu in 2015.

Figure 9: Projected Gas and Coal Consumptions



Source: Peninsular Malaysia Electricity Supply Industry Outlook 2016

Note: The forecasted trend for primary energy supply for 2015 to 2020 showing a decline in the dependence on natural gas owing to the retirement of gas turbine units and the development of new coal power plants

D RELATED COMPANIES

Petronas Gas Berhad

NEUTRAL

Largest gas processor and distributor in Malaysia

Target Price (TP): RM19.63

INVESTMENT HIGHLIGHTS

- Petronas Gas Bhd's (PetGas) is the largest gas processor and distributor in Malaysia
- The company has four core businesses; processing, transportation, utilities and regasification
- Operates 2,521km of PGU pipeline network with gas capacity of 3,000mmscfd
- NEUTRAL with Target Price of RM19.63 per share

Business overview. PetGas is in the business of processing PETRONAS' natural gas piped from offshore fields and transporting the processed gas via Peninsular Gas Utilisation (PGU) pipeline network to PETRONAS' customers in Malaysia and Singapore. In addition, the Company also supplies steam and industrial gases for its customers at Kertih Integrated Petrochemical Complex in Terengganu and Gebeng Industrial Area in Pahang. Moreover, PetGas is also in the business of regasifying LNG at its terminal in Sungai Udang Melaka which only began operations in 2013.

Gas Processing. Gas Processing is one of PetGas's primary business segments and is operated by its Gas Processing and Utilities (GPU) Division. The company's six plants in Terengganu are divided into two complexes, Gas Processing Kertih (GPK) and Gas Processing Santong (GPS). The complexes have a combined capacity to process over 2,000mmscfd of feedgas for PETRONAS and receive gas processing fees, comprising mainly fixed reservation charges under a 20-year Gas Processing Agreement (GPA) with PETRONAS. The six plants have the capability to produce salesgas, ethane, propane and butane for its customers.

Gas Transportation. Gas Transportation is operated by the Gas Transmission and Regasification (GTR) Division where the company manages gas transmission pipelines covering Peninsula Malaysia known as the Peninsular Gas Utilisation (PGU) pipeline network. The main Control Centre is located in Segamat, Johor and the salesgas is transported to PETRONAS' customers via the 2,521km PGU pipeline. The current PGU pipeline network has the capacity to transport up to 3,000 mmscfd of gas.

RETURN STATS	
Price (28 October 2016)	RM21.94
Target Price	RM19.63
Expected Share Price Return	-10.5%
Expected Dividend Yield	+2.6%
Expected Total Return	-7.9%

STOCK INFO	
KLCI	1,669.74
Bursa / Bloomberg	6033 / PETGAS MK
Board / Sector	Main / Trading Services
Syariah Compliant	Yes
Issued shares (mil)	1,978.7
Par Value (RM)	1.00
Market cap. (RM'm)	43,373.8
Price over NA	4.1x
52-wk price Range	RM20.90 - RM23.60
Beta (against KLCI)	0.88
3-mth Avg Daily Vol	1.10m
3-mth Avg Daily Value	RM24.4m
Major Shareholders (%)	
Petroleum Nasional Berhad	60.66
Employees Provident Fund	10.73
Kumpulan Wang Persaraan	5.67
PNB and its associated funds	5.14

The company also transports small volumes of salesgas for PETRONAS' customers via the gas distribution system in Miri and Bintulu, Sarawak, as well as manage the gas pipeline in Kimanis, Sabah. Gas transportation fee is received based on capacity booking following the 20-year Gas Transportation Agreements (GTA) with PETRONAS.

Utilities. Utilities division is operated by the GPU Division and divided into the two complexes of Utilities Kertih (UK) in Terengganu and Utilities Gebeng (UG) in Pahang. Both are strategically located at Kertih Integrated Petrochemical Complex and Gebeng Industrial Area respectively and provide a competitive edge to the petrochemical plants and surrounding industries with reliable supply of electricity, steam, industrial gases and other by-products like liquid oxygen, liquid nitrogen, demineralised water, raw water, cooling water and boiler feed water. Utilities revenue is received from the volume of products sold to customers.

Regasification. Regasification is operated by the GTR Division. PetGas operates and maintains the offshore liquefied natural gas (LNG) Regasification Terminal Sungai Udang (RGTSU) in Melaka, which began commercial operations in 2Q2013. The facility receives vessels carrying PETRONAS' LNG imported from around the world, stores it in two floating storage units and converts the LNG into gas before injecting it into the PGU pipeline network for distribution to PETRONAS' customers. Regasification fee is received based on capacity underwritten from the 20-year Regasification Service Agreement (RSA) with PETRONAS.

Impact of third party access to PetGas. PetGas has indicated that it welcomes the introduction of the third party access to its gas infrastructure in support of ensuring gas supply security to the domestic gas market. Apart from that, the liberalisation is positive for the company as it will allow PetGas to further monetise its various gas infrastructure from regasification to transportation to distribution to end customers.

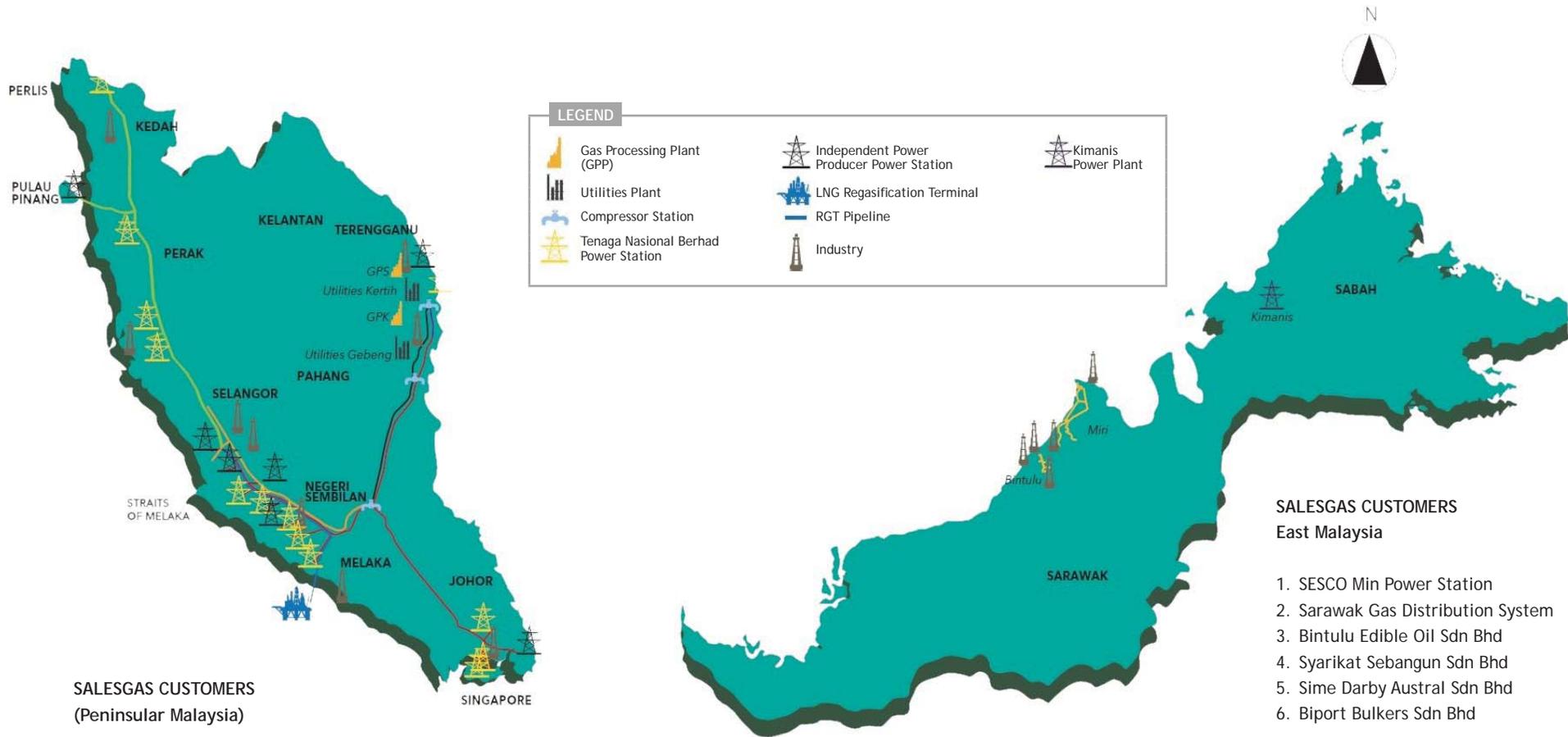
Maintain NEUTRAL. We are maintaining our **NEUTRAL** stance on PetGas with an unchanged FY17 TP of RM19.63 per share. Our TP is premised on forward PER17 of 21.2x pegged to EPS17 of 92.6sen. The target PER is based on PetGas' rolling four-quarter average PER over six years.



INVESTMENT STATISTICS

FYE 31 Dec	FY13	FY14	FY15	FY16F	FY17F
Revenue (RM'm)	3,892.10	4,391.70	4,455.96	4,780.50	4,934.90
EBIT (RM'm)	1,903.70	2,142.10	2,016.96	2,195.10	2,230.10
Pretax Profit (RM'm)	1,896.40	2,354.50	2,002.11	2,208.50	2,244.50
Net Profit (RM'm)	2,078.70	1,843.20	1,987.45	1,798.10	1,832.00
EPS (sen)	105.1	93.2	100.44	90.9	92.6
EPS growth (%)	48.00	-11.40	7.70	0.80	1.90
PER(x)	21.1	23.8	22.1	23.7	23.2
Net Dividend (sen)	55	55	60	55	55
Net Dividend Yield (%)	2.5	2.5	2.7	2.6	2.6

Source: MIDFR



SALESGAS CUSTOMERS (Peninsular Malaysia)

- | | |
|---------------------------------|---|
| 1. TNB Paka | 11. Port Dickson Power |
| 2. YTL Paka | 12. Genting Senayan Power |
| 3. TNB Pasir Gudang | 13. TNB Serdang |
| 4. YTL Pasir Gudang | 14. TNB Connaught Bridge |
| 5. Senoko Energy | 15. TNB Kapar |
| 6. Keppel Energy | 16. GB3 Lumut |
| 7. Pahlawan Power Tanjung Kling | 17. Segari Energy Ventures |
| 8. Panglima Power, Teluk Gong | 18. Prai Power |
| 9. Powertek, Teluk Gong | 19. TNB Gelugor |
| 10. TNB Tuanku Jaafar | 20. Technology Tenaga Perlis Consortium |

SALESGAS CUSTOMERS East Malaysia

1. SESCO Min Power Station
2. Sarawak Gas Distribution System
3. Bintulu Edible Oil Sdn Bhd
4. Syarikat Sebangun Sdn Bhd
5. Sime Darby Austral Sdn Bhd
6. Biport Bulklers Sdn Bhd

PGB TOTAL PIPELINE LENGTH (IN OPERATION)

	Length (km)
Main	1,690
Lateral	429
Liquid	373
Sarawak	39
RGTSU	30
Total	2,561

Gas Malaysia Berhad

The 'last mile' supplier of gas

BUY

Target Price (TP): RM2.92

INVESTMENT HIGHLIGHTS

- Gas Malaysia's (GMB) acts as the 'last mile' operator to clients consuming 5mmscfd and below
- Currently operates approximately 2,065km of pipeline in Peninsula Malaysia
- Plans to increase pipelines by an additional 730km in the next four years
- BUY with Target Price of RM2.92 per share premised on strong sales, good dividend yield and strong potential upside

Business background. GMB is a 'last mile' provider of natural gas for consumers consuming 5mmscfd of gas and below. Industries which consume less than 5mmscfd are mainly non-power producing in nature. In addition to that, the company has other non-regulated businesses which are the power generation system with heat recovery (ie. Combined Heat & Power) and alternative gas distribution (ie. virtual pipeline).

Pipeline system. GMB currently has about 2,065km of pipeline in Peninsula Malaysia. In the next four years, the company plans to increase the pipelines by an addition 730km (Northern Region 190km, Central Region 250km, Southern Region 270km and Eastern Region 20km).

Non-regulated businesses. Apart from the regulated business (gas transportation), GMB has other non-regulated business that would contribute in a more significant manner starting in FY16-17. These non-regulated businesses are: (i) Virtual Pipeline; (ii) Combined Heat & Power (expected contribution in 4Q16) and; (iii) Bio-Compressed Natural Gas. Given the typical gestation period for new businesses, we are anticipating a net profit contribution of less than 10% for FY16 from these new ventures which will naturally increase (in value) moving forward.

Incentive-based regulation (IBR) framework. Moving forward, we are expecting the IBR framework to provide earnings clarity to the company. In addition, the IBR will provide financial neutrality to the company with respect with any gas costs fluctuations. Management guided that the increase in volume of gas sold and number of customers will sustain for 2H16.

RETURN STATS

Price (28 October 2016)	RM2.55
Target Price	RM2.92
Expected Share Price Return	+14.5%
Expected Dividend Yield	+4.3%
Expected Total Return	+18.8%

STOCK INFO

KLCI	1,669.74
Bursa / Bloomberg	5209 / GMB MK
Board / Sector	Main / Trading Services
Syariah Compliant	Yes
Issued shares (mil)	1,284.0
Par Value (RM)	0.50
Market cap. (RM'm)	3,274.2
Price over NA	3.3x
52-wk price Range	RM1.93 - RM2.49
Beta (against KLCI)	0.73
3-mth Avg Daily Vol	0.35m
3-mth Avg Daily Value	RM0.89m
Major Shareholders (%)	
Anglo Oriental Annuities	30.93
Tokyo Mitsui Gas	18.50
Petronas Gas	14.80
Lembaga Tabung Haji	7.54

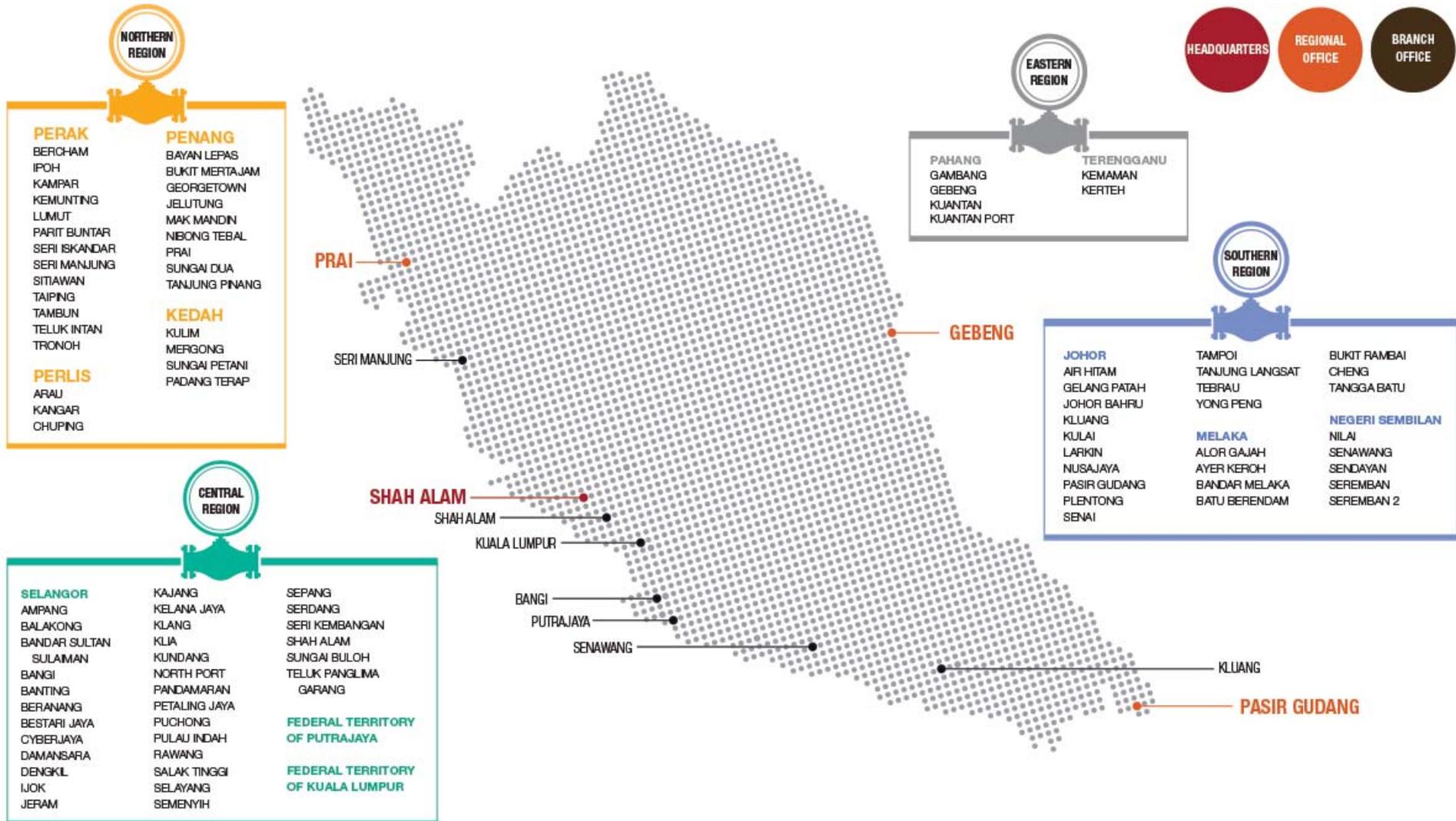
Maintain BUY. We are maintaining our BUY recommendation with an unchanged target price of RM2.92 per share. Our TP valuation is based on Gordon Growth Model with a risk-free rate (rfr) assumption of 3.9%, market-risk premium of 6.1%, beta of 0.6x and a terminal growth rate of 4%.



INVESTMENT STATISTICS

FYE Dec	FY13	FY14	FY15	FY16F	FY17F
Revenue (RM m)	2,317.20	2,773.50	3,619.00	3,617.10	4,169.80
EBIT (RM m)	259	220	151.1	166.3	188.6
Pretax Profit (RM'm)	220.9	213.1	143.6	170.3	192.6
Net Profit (RM m)	123	167.6	106.2	131.1	148.3
EPS (sen)	13.4	13.1	8.3	10.2	11.5
EPS Growth (%)	5.3	-2.2	-36.4	23.1	13.1
PER (x)	17.2	17.6	27.7	22.5	19.9
Net Dividend (sen)	13.4	13.1	8	10.2	10.4
Net Dividend (%)	5.5	5.4	3.3	4.2	4.3

Source: MIDFR



D. CONCLUSION

- **Gas Supply (Amendment) Bill 2016.** On 14 June 2016, the Gas Supply (Amendment) Bill 2016, which is an act to amend the Gas Supply Act 1993 was passed by the Dewan Rakyat. This amendment serves to provide for the licensing of the import into regasification terminal, regasification, shipping, transportation, distribution, retail or use of gas in the supply of gas through pipelines and related matters, the supply of gas at reasonable prices, the control of gas supply pipelines, installations and appliances with respect to matters relating to safety of persons in the distribution, retail or use of gas and for purposes connected therewith. The amendment sets to enhance competition with the participation of third parties in the gas supply industry by implementing Third Party Access.
- **National gas supply security.** At this stage in Malaysia's energy sector, industry liberalisation is crucial to ensure adequate and varied supply of gas from multiple sources, greater access to gas especially in areas far from the main PGU, fair and competitive pricing mechanism and to attract potential investors into the gas sector.
- **Opportunities with TPA.** With the introduction of the Third Party Access (TPA), there will be bound to be more business opportunities available for both Petronas Gas Berhad and Gas Malaysia Berhad. Apart from further monetising their existing infrastructure, both companies will also be able to venture into new businesses within the gas supply industry which they have not previously been in. We believe that the chances of these two companies obtaining approvals and licences for these new ventures will be high as they have decades of proven track record and financial strength.
- **In conclusion,** we are supportive of the Gas Supply (Amendment) Bill 2016 as it is in line with our national agenda of ensuring gas supply security while reducing subsidies on gas. On the corporate side, this bill amendment will encourage efficiency and help open new markets and opportunities within the sector.





**MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X)
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