

Equity Beat

10 March 2010

Visit Note

Petronas Gas Bhd

Positioning for the 4th GPTA

Upgrade to **TRADING BUY** (from **NEUTRAL**)

Unchanged Target Price (TP): **RM10.25**

- Gas providers suffered lower gas throughput given the slowdown in demand during the recession. However, demand is climbing in tandem with higher oil price and recovering global economies.
- The electric-powered plant in Kimanis, Sabah is Petronas Gas's (PetGas) next growth catalyst. It is currently undergoing Front-End Engineering and Design (FEED) studies and is projected to be commissioned by 2013; with construction taking place earliest by 2010.
- The forthcoming 4th Gas Processing Throughput Act (GPTA) is due to be announced by end-Mac 2010. We expect the new terms to be favourable to PetGas given that successive GPTAs have been revised in its favour.
- We maintain our FY10/11 earnings forecast as we await the 4th GPTA. Our forward earnings have incorporated some degree of higher throughput fees and performance-based charges. We continue to position PetGas as a dividend-play, despite operating without a dividend-policy. Historical dividend payouts have been consistent between 60-70%. However, we are upgrade our call to **TRADING BUY** as we believe PetGas stands to benefit from the forthcoming 4th GPTA revision.

STOCK INFO

Price (9 Mac 10)	RM9.80	KLCI	1,317.94
Issued shares (mil)	1,978.73	Bursa / Bloomberg	6033 / PTG MK
Par Value (RM)	1.00	Board / Sector	Main/ Industrial
Market cap. (RM'm)	1,931.57	Syariah Compliant	Yes
Price over NA	2.47x		
52-wk price Range	RM9.40–RM10.40	Major Shareholders	
Beta (against KLCI)	0.43	Petroleum Nasional Bhd	60.66%
3-mth Avg Daily Vol	0.42m	EPF	15.32%
3-mth Avg Daily Value	RM4.11m	KWAP	9.44%

Weaker performance in 2009 due to unfavourable economic conditions. Lower gas throughputs (GPPs) in 2009 was due to lacklustre demand as a result of a decline in oil price and lower offtake by both the petrochemical industry and SMEs. In addition, Central Utility Facilities (CUFs) contribution declined due to higher feedstock costs as well as lower utilization by existing clients. Capacity utilization fell to between 70%-80% during the peak of the economic slowdown (June 08-June 09). Currently, utilization has improved back to pre-crisis levels of 95%.

Not alone affected by slower demand. Nevertheless, we believe others across the sector were not spared the predicament. Management remained positive on demand for gas, due to its primary role as an energy provider, in preference over coal or hydro due to its cost feasibility and infrastructure availability. As it continues to serve a captive market, demand for natural gas as an energy source will continue as renewable energy are currently not cost-

FYE 31 Mac	FY08	FY09	FY10E	FY11F
Revenue (RM'm)	3,125.7	3,415.1	3,166.2	3,911.7
EBIT (RM'm)	1,362.7	1,195.4	1,348.6	1,583.6
Pretax Profit (RM'm)	1,394.1	1,231.4	1,374.8	1,600.5
Net Profit (RM'm)	1,092.9	928.7	1,044.9	1,216.4
EPS (sen)	55.2	46.9	52.8	61.5
EPS growth (%)	-12.3%	-15.0%	12.5%	16.4%
PER(x)	17.7	20.8	18.5	15.9
Net Dividend (sen)	42.2	37.5	37.5	38.5
Net Dividend Yield (%)	4.3%	3.8%	3.8%	3.9%

Source: Company, Forecasts by MIDFR

feasible.

Marginal capital expenditure for expansion. Apart from its pre-planned annual capital expenditures dedicated for plant maintenance and turnaround activities (RM300m p.a), PetGas is not looking to expand its infrastructure aggressively. The group has set aside RM1.0b to overhaul and upgrade 2 of its GPPs namely GPP 2 & 3 to extend the lifespan of present GPP stations (about 20 years per station). There will be no expansion of its present capacity and no new infrastructure will be added to the present network given the steady demand from West Malaysia.

Kimanis 300MW power plant the next growth catalyst. The project is currently undergoing Front-End Engineering and Design (FEED) phase with construction expected to be completed by 2013. As to date, the construction portion has yet to be awarded. To re-cap, the Kimanis power plant is a 60:40 JV between Petronas Gas and Yayasan Sabah. Upon completion, operation and maintenance works will be carried out by the JV. Gas supply will be directed from Sabah's offshore deepwater fields and transferred to the proposed Sabah Oil & Gas Terminal at Kimanis, Sabah before being piped to Bintulu LNG complex, via the on-going constructing SSGP. We understand majority of the gas transmitted from Sabah will be directed towards the export market. Furthermore, the completion of the power plant will be channeled to meet the on-going energy and electricity demands of Sabah.

Mum on 4th GPTA. Management did not provide insights into the on-going 4GPTA discussion. Nevertheless based on historical revisions, we note that successive GPTA revision have been revised positively for PetGas, with higher rates. Table 1 shows the previous and our expectation of the forthcoming GPTA terms. Note that we are assuming the structure of the terms to remain status quo, with exception to the change in fixed and performance-based charges.

Table 1: Gas Processing Throughput Acts (GPTA)

	1st GPTA	2nd GPTA	3rd GPTA	Estimated 4th GPTA [#]	Comments
	1 Apr 1995 - 31 Mar 2000	1 Apr 2000 - 31 Mar 2005	1 Apr 2005 - 31 Mar 2010	1 Apr 2010 - 31 Mar 2015	
<u>Peninsular Malaysia Operations</u>					
Fixed Reservation Charge	Between RM861m to RM1,215m p.a.	RM1,638m p.a.	RM2,064m p.a.	RM2,559 p.a.	Our assumptions are based on a 20% discount to historical average revision of +30.4% at +24%. Nevertheless, it is still in-line with previous term's growth of 26%. We do not think growth for Fixed Reservation charges will vary substantially. Expect it to be in-line with historical growth rates.
Methane					
Flowrate Charge Per Unit (bscfd)	Between RM0.095/GJ to RM0.882/GJ	-	-	-	
Feedgas >2.0 - <2.2	-	RM1.90/GJ	-	-	
Feedgas >2.2	-	RM0.43/GJ	-	-	
Feedgas >2.1 - <2.4	-	-	RM1.57/GJ	RM1.69/GJ	We do not foresee a significant rise in usage in the immediate term given issued on supply curtailment and the recovering economy. As such, we employ a conservative growth rate of 8%
Feedgas >2.4	-	-	RM0.58/GJ	RM0.60/GJ	Less incentive to increase usage, as part of PetGas curtailment exercise. Hence, we expect a mere +5% increase.
Performance Based Charges					
Propane Production>140MT/hr	-	-	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	Expected to remain unchanged as the pricing mechanism is dependent on Petronas' export levels. Note that exports have grown 24.9% based on 5-year CAGR
Butane Production>100MT/hr	-	-	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	
Ethane Production	-	-	RM2.0p.m	RM2.0p.m	Expect marginal changes, if any. Mainly for domestic usage. Not a main contributor.
<u>Miri Operations</u>					
Fixed Rate	-	RM1.75/ mmbtu	RM1.82/ mmbtu	RM1.91/ mmbtu	Not to expect any significant changes given operations in East Malaysia is catered to support small operations i.e: Miri operations entail a 47km pipeline. Our forecasts incorporates a +5% growth.
<u>Bintulu Operations</u>					
Fixed Reservation charges		RM0.61m p.a.	RM0.63m p.a.	RM0.66 p.a.	
Flowrate Charges		RM1.08 /mmbtu	RM1.12 /mmbtu	RM1.17 /mmbtu	
Internal Gas Consumption		-	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	Expected to remain unchanged, given the purpose is mainly to support internal consumption.

[#] Based on MIDFR assumption that charges will growth at an average 24% and the pricing structure does not vary from GPTA3

Source: Company and MIDFR

Our take on the GPTA. Assuming prices were to take-lead from historical gains since 1995, we note EPS11 and EPS12 may potentially gain +16.4% and +16.1% higher than consensus estimates. Nevertheless, we are assuming a positively conservative revision on the forthcoming 4th GPTA reason being (i) lingering issue on supply curtailment (major gas source lies in marginal fields), (ii) delay in demand due to recovering economies but (iii) continue to expect stable on-going gas demand as it is a more cost-feasible source of power generation and caters to a captive market.


Table 2: Sensitivity Analysis on Average Percentage change on Performance Based Charges

Assumed average changes of Fixed and Flow Rate charges in Peninsular and East Malaysia Operations	-20%	-10%	+0%	+10%	+20%	+25%	+30%	+35%
EPS10 (sen)	46.8	50.6	52.8	58.0	61.7	63.6	65.4	67.3
EPS11 (sen)	47.5	51.4	61.5	59.0	62.8	64.7	66.7	68.6

*Note: Please refer to Table 3 at appendix for the detailed breakdown of the forecasts
Source: Company and MIDFR*

Remain a dividend play. We believe the group should be able to repeat FY09's dividend payment despite funding the RM1.0b GPP capex rejuvenation over the next 3 years and remaining committed to its annual RM200-300m p.a operational capex. As to date, the group has a net cash position of RM1.39b with RM366.3m of free cash flow. Note that PetGas has no dividend policy, but trades with a historical div payout between 60%-70% in the last 5 years.

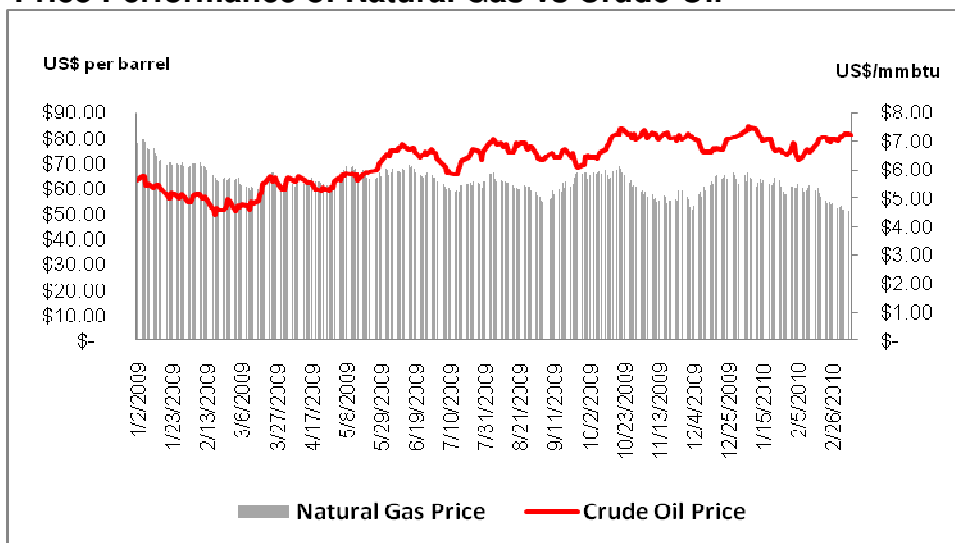
Upgrade to TRADING BUY with unchanged TP of RM10.25. We are confident that the 4GPTA will be more beneficial to PetGas than the current agreement. However, we are keeping our FY10/11 earnings unchanged pending details of the new GPTA structure. Nevertheless, we are raising our recommendation to TRADING BUY, as we expect heightened interest on PetGas leading up to the 4GPTA announcement.

Our TP valuation is derived from DCF based on beta of 0.65x, WACC of 8% and terminal growth rate of 2.50%. Over the long term horizon, PetGas remains as one of the better defensive counters given its steady earnings, sustainable cash flows, healthy balance sheet and decent dividend yields. The counter is currently trading at 18.5x PER EPS 10, above regional peers of 12.9x. 

REGIONAL COMPARISON	Country	PER		PBV (x)
		FY09	FY10	
Xinao Gas	Hong Kong	21.33	17.36	3.89
Gail India	India	17.28	14.66	3.39
Perusahaan Gas Negara	Indonesia	16.43	14.41	8.83
S-Oil Corp	South Korea	11.14	8.69	1.76
New Zealand Refining Co. Ltd	New Zealand	187.78	20.74	1.97
SUI Northern Gas Pipeline	Pakistan	8.09	6.55	0.92
Petrochina Co.	Singapore	13.37	10.56	1.72
Petronas Gas	Malaysia	19.88	18.35	2.50
Simple Average		15.36[#]	12.94[#]	3.28[#]

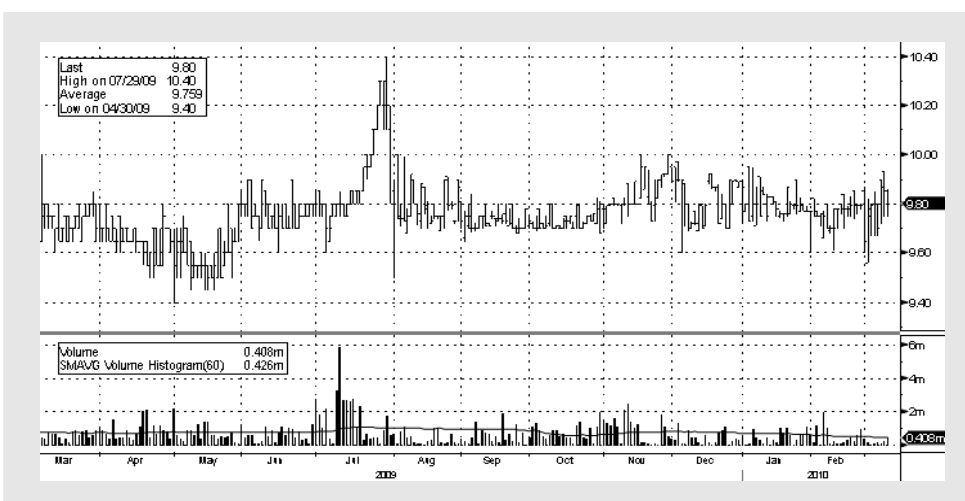
[#]Excluding New Zealand Refining Co. Ltd
Source: Bloomberg

Price Performance of Natural Gas vs Crude Oil



Source: Bloomberg

DAILY PRICE CHART



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Table 3: Sensitivity Analysis on Percentage change on Fixed and Performance-Based Charges

<u>Peninsular Malaysia Operations</u>	Current under 3rd GPTA	-20%	-10%	+0%	+10%	+20%	+25%	+30%	+35%
Fixed Reservation Charge (RM'm p.a)	2,064	1,651.2	1,857.6	2,064.0	2,270.4	2,476.8	2,580.0	2,683.2	2,786.4
Flowrate Charge Per Unit (bscfd) (RM/GJ)									
Feedgas >2.0 - <2.2	-	-	-	-	-	-	-	-	-
Feedgas >2.2	-	-	-	-	-	-	-	-	-
Feedgas >2.1 - <2.4	RM1.57/GJ	1.26	1.41	1.57	1.73	1.88	1.96	2.04	2.12
Feedgas >2.4	RM0.43/GJ	0.46	0.52	0.43	0.64	0.70	0.73	0.75	0.78
Performance Based Charges									
Propane Production>140MT/hr (RM'm)	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales	30% margins of PETRONAS export sales
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Ethane Production (RM'm p.m)	RM2.0p.m	24.0	24.0	24.0 p.a	24.0	24.0	24.0	24.0	24.0
Miri Operations									
Fixed Rate (RM/mmbtu)	RM1.82/mmbtu	1.45	1.63	RM1.82/mmbtu	2.00	2.18	2.27	2.36	2.45
Bintulu Operations									
Fixed Reservation charges (RM'm p.a.)	RM0.63m p.a	0.50	0.56	RM0.63m p.a	0.69	0.75	0.78	0.81	0.85
Flowrate Charges (RM/mmbtu)	RM1.12/mmbtu	0.89	1.00	RM1.12/mmbtu	1.23	1.34	1.40	1.45	1.51
Internal Gas Consumption	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.	PetGas to purchase at an agreed price.
EPS11 (sen)		46.8	50.6	52.8	58.0	61.7	63.6	65.4	67.3
EPS10 (sen)		47.5	51.4	61.5	59.0	62.8	64.7	66.7	68.6

Source: Company and MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the overall market over the next 12 months.