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Volume growth vital for Gas Malaysia

PETALING JAYA: Although there is uncertainty over the margin spread in the new Regulatory Period 2018-2020 (RP2), Kenanga Research remains optimistic on Gas Malaysia's steady volume growth while there is a new source of income arising from retail margin under the third party access structure.

"We believe the market should have priced in the uncertainty as its share price has been hovering at the current level for the past one year despite improving results," the research house said in a report.

It added that the RP2 margin spread is the key for future earnings. Gas Malaysia is in the final year of RP1 before the new RP2 is implemented next January.

Given the case of Tenaga Nasional Bhd, which saw its rate of return on regulated asset base (RAB) fell to 7.3% in RP2 from 7.5% in RP1, fears of Gas Malaysia facing the same fate have been depressing the stock.

"However, management believes it should be awarded a higher rate of return given higher risk of demand. In any case, a 0.2% reduction will not have any material impact to earnings, amounting to RM3.8 million based on RM1.9 billion RAB in FY19. As such, volume growth is vital to its bottom line as a 0.2% reduction is unlikely to exert a big impact on its margin spread of RM1.80-2.00/mmbtu which it had maintained near to RM2.00/mmbtu in the past two financial years," said Kenanga.

Gas Malaysia's third-quarter (Q319) results missed expectation slightly due to one-off loan hedging cost but it raked in another record sales volume again at 51.4 million mmbtu.

"Going forth, volume growth remains its key earnings driver while we believe impact from the cut in rate of return, if any, could be minimal given its relatively small RAB of RM1.9 billion."

Post-results, Kenanga trimmed Gas Malaysia's FY19 forecast by 2% mainly on 66%-owned JV company Gas Malaysia Energy Advance Sdn Bhd losses and higher interest assumption but keep FY20 estimates unchanged.

"We maintain our market perform with unchanged target price of RM3 a share, which is supported by decent dividend yield of 4-5%."

Meanwhile, Affin Hwang Capital cut Gas Malaysia's FY19-21 earnings per share (EPS) forecasts to factor in weaker JV profit.

"We lower our FY19-20 EPS forecasts by 4% as we now assume combined heat & power business to record RM4 million/RM2 million losses as compared to RM4 million/RM6 million profit previously. We understand that the business will continue to see earnings volatility due to the hedging element and may be affected by unforeseen unscheduled disruption operationally."

It maintained a hold call on the stock and lowered its target price to RM2.85.