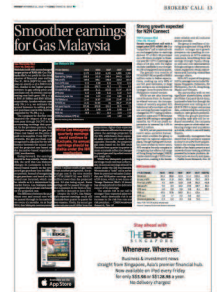


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Smoother earnings for Gas Malaysia

Gas Malaysia Bhd
(Nov 18, RM2.63)

Maintain hold with an unchanged target price of RM2.66: Gas Malaysia Bhd's net profit for the third quarter of financial year ending Dec 31, 2016 (3QFY16) rose 28% year-on-year (y-o-y) to RM43 million, thanks to the higher spread between its gas selling price and purchase cost. Its revenue and operating cost both grew 19% y-o-y to RM1.07 billion and RM1 billion respectively. As sales volume rose only 2% y-o-y, we estimate the spread between its selling price and purchase cost in RM/mmbtu expanded by 7%-8% y-o-y.

The company for the first time imputed the impact of the gas cost pass through (GCPT) in its accounting earnings this quarter. In the previous quarters, Gas Malaysia recognised its gas purchase cost based on the price it paid to its supplier. From 3QFY16 onwards, the gas purchase cost recognised is adjusted for the difference between the actual cost and the projected cost based on the incentive-based regulation (IBR) mechanism.

Going forward, the earnings should be less volatile. Under the IBR, the tariff that Gas Malaysia charges its customers is determined based mainly on the projected gas purchase cost in different periods. Instead of recognising its gas purchase cost based on the actual cost incurred, which can be volatile as it is determined by market forces, Gas Malaysia now recognises the purchase cost based on the projected cost.

The difference between the purchase cost and actual cost will be passed through to its customers every six months. As at Sept 2016, Gas Malaysia overrecovered

Gas Malaysia Bhd

FYE DEC (RM MIL)	2014A	2015A	2016F	2017F	2018F
Revenue	2,773	3,619	4,195	4,665	5,304
Operating Ebitda	256.9	191.0	246.4	244.6	255.4
Net profit	167.6	106.1	149.8	153.0	167.5
Core EPS (RM)	0.13	0.08	0.12	0.12	0.13
Core EPS growth (%)	(2.2)	(36.7)	41.3	2.1	9.5
FD core PER (x)	19.69	31.11	22.02	21.57	19.70
DPS (RM)	0.13	0.08	0.12	0.12	0.13
Dividend yield (%)	5.08	3.22	4.54	4.64	5.08
EV/Ebitda (x)	11.44	16.07	12.99	13.47	13.20
P/FCFE (x)	11.21	52.05	na	30.17	14.29
Net gearing (%)	(35.6)	(23.9)	(10.1)	(0.7)	7.5
P/BV (x)	3.26	3.40	3.40	3.40	3.40
ROE (%)	16.6	10.7	15.4	15.8	17.3
CIMB/consensus EPS (x)			1.09	1.02	1.09

Sources: Company data, CIMB forecasts

While Gas Malaysia's quarterly earnings could continue to fluctuate, its annual earnings should be stable under the IBR mechanism.

RM53.7 million worth of gas costs. From another perspective, the actual gas cost in the nine months of FY16 (9MFY16) was RM53.7 million lower than the projected cost. All else being equal, these savings will be passed through to the customers in the form of lower tariffs in January to June 2017.

Despite the GCPT, Gas Malaysia's reported earnings could still fluctuate from quarter to quarter for two reasons. Firstly, the actual gas sales volume could differ from the

projections. Higher-than-expected sales volume will raise its earnings above the earnings projected by the IBR, while lower-than-expected sales volume will result in the opposite. Secondly, the projected gas costs based on the IBR could fluctuate from quarter to quarter to more accurately reflect the changes in piped gas and liquefied natural gas usage mix.

While Gas Malaysia's quarterly earnings could continue to fluctuate, its annual earnings should be stable under the IBR mechanism. We maintain a "hold" call as we believe its premium valuation (calendar year 2018 price-earnings ratio of 20 times, which is two times of Tenaga Nasional Bhd's 10 times) has already priced in the defensive nature of its earnings.

The upside risk to our call is stronger-than-expected sales volume, while downside risk is an increase in the risk-free rate and risk premium. — *CIMB Investment Research, Nov 18*