23 October 2018 | Sector Update

Power Sector

***Maintain* POSITIVE**

Charting a Greener Path

INVESTMENT HIGHLIGHTS

- **Tenaga gaining indirect exposure to future solar installations**
- **Higher consumer rebates from updated Net Energy Metering program**
- **Allowing consumers to play a bigger role in generation; part of MESI Reform 2.0 ambitions**
- **Maintain POSITIVE on Power. Top picks are Tenaga (TP: RM16.90), Ranhill (TP:RM1.15), YTL Power (TP: RM1.55) and YTL Corp (TP: RM1.55)**

Tenaga gains indirect exposure to future solar installations. Tenaga Nasional's unit, G-Sparx will be offering financing for solar self-generation packages. G-Sparx targets to offer 1500MW of self-generation for solar PV investment by 2025. This compares to the current 380MW installations. The financing scheme essentially offers a zero upfront capex solution for solar PV installation. This is to encourage premise owners, particularly residential, to install solar panels as part of the drive to increase RE contribution to 20% by 2030 from 2% currently. Depending on the actual allowable rate of return on the investments, this looks positive for Tenaga.

The move is part of the updated Net Energy Metering (NEM) program which introduces a new solar leasing mechanism under a widened supply agreement for RE (SARE). The 3 key elements of the leasing mechanism are:

(1) Tariff – to be agreed upon with utility company, in this case, Tenaga,
(2) Capex – the company investing in the solar assets, in this case, G-Sparx
(3) Electricity cost savings - the consumer

A piece for everyone. The investor (in this case G-Sparx) will earn a return on the investment into the solar panels while the customer will enjoy some saving on electricity charges according to NEM principles. Payment of monthly leasing fee (under G-Sparx) is combined in the monthly electricity bills. At previous RM6.3m/MW capex for solar projects and based on the target 1500MW self-generation solar capacity, we estimate Tenaga will have to set aside some RM9.5b capital for the program, assuming all takers take up the financing scheme. This is 28% of Tenaga's current borrowings, but the build-up, if any, should be spread out over a number of years.

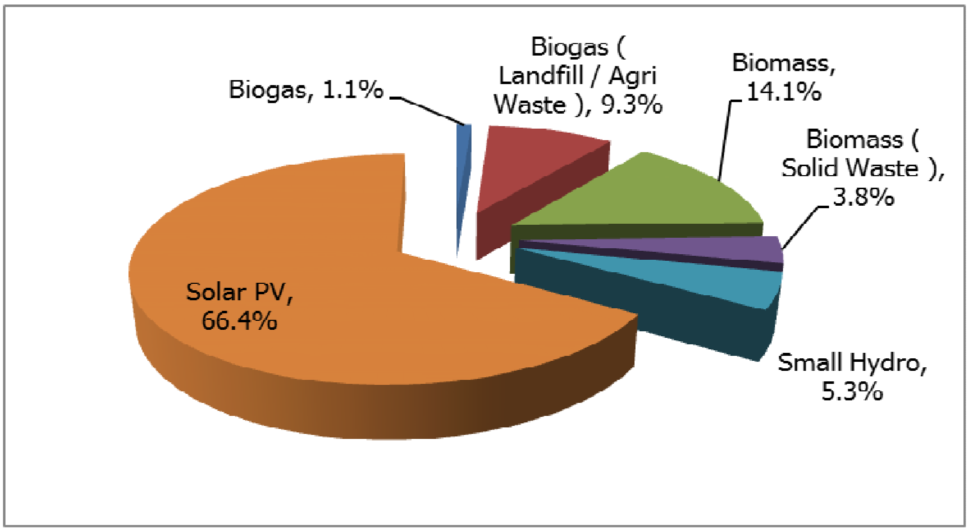
Implications from higher consumer rebates. Only 17MW of 500MW offered under the previous NEM program was taken up. This is because under the previous NEM program, excess power produced by the solar power producers are being sold back to the grid at displaced cost of 31sen/kwh compared with purchasing cost of 50sen/kwh. Under the updated NEM effective 2019; for every 1kw exported to grid, consumers will get back 1kw in rebate, ensuring the tariffs received for exporting power to the grid is the same as cost of purchasing. On initial thoughts, the impact on Tenaga could involve:

(1) If excess capacity is sold back to Tenaga (as the Single Buyer) at a higher rate of 50sen/kwh vs. 31sen/kwh previously – this essentially means additional electricity sourcing cost to Tenaga, similar to sourcing cost from existing IPPs or buying from LSS operators (first 2 cycles bid were higher than displaced cost). Cost of sourcing electricity and generation are built into tariffs under IBR.
(2) Lower electricity demand as consumers can generate electricity themselves – the impact is spread over the longer run and expected to be gradual. However, with current technologies, solar panels can only generate a maximum 4 hours/day (17% availability factor only), which means to meet electricity demand, the system will still rely a lot on more reliable sources with >90% availability factor), until storage technologies gain better scale and become more feasible.

Based on IBR principles, both these factors are likely to be reflected in tariffs i.e. cost of sourcing and generating electricity and demand fluctuations given the revenue cap model under RP2 which limits upside but also protects downside for Tenaga. All in however, the changes made to NEM's structure allows consumers to have better control and for themselves, to play a larger role as part of the generation in the system.

There is currently a total of 574MW of installed RE capacity with 66% of this comprising solar, 28% comprising biogas/biomass and another 5% form small hydro. The recently announced solar leasing program and updated Net Energy Metering program focuses mainly on solar currently.

EXHIBIT 1: MALAYSIA RENEWABLE ENERGY INSTALLED CAPACITY BY TYPE



Source: MESTECC, MIDF

Maintain POSITIVE on the power sector. Tenaga (BUY, TP: RM16.90) remains one of our top sector pick. Key catalysts: (1) Solid dividend yields of 4.6% (+ve spread against 10yr MGS of 4.04%) while valuations are cheap at 12x FY18F earnings, a substantial discount to the market's 16x-17x. (2) Peaking generation capex suggests room for dividend upside (3) Possible monetisation of backbone fibre asset via partners. (4) Potential beneficiary of updated NEM.

YTL Power (BUY, TP: RM1.55). YTL Power is one of the few local proxies to lucrative overseas power plant projects. Despite higher finance cost over the next few years, dividend yields are generous at ~4% (even at just 50% payout ratio) while valuations are at a discount to the market's 16x-17x. Key potential catalysts: (1) Financial close of Tg. Jati power plant, (2) Completion of 45% owned Jordan shale power plant mid-CY20F (3) Consolidation in Singapore power generation sector, (4) Gradual expiry of LNG supply contracts for Singapore power, (5) Potential divestment of mobile broadband business from any potential partnership.

Reaffirm BUY on Ranhill. Our current RM1.15/share TP conservatively excludes potential earnings contribution from: (1) Water-sewerage operation integration (2) The RM500m national NRW program (3) Tawau Geothermal energy project, which could drive our valuations higher to RM1.50/share (blue-sky scenario). Key catalysts: (1) Schedule rate hike for Johor water (2) Johor water-sewerage integration (3) RM500m NRW reduction contract wins (4) TGE progress into production well drilling

SECTOR VALUATION COMPARISON

		Shr Price	PE (x)		P/BV	ROE	Div Yield	Target	Total
Companies	**Rating**	**(RM)**	**FY18**	**FY19**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
Tenaga	Buy	14.58	11.2	12.6	1.5	10.6	4.4	16.90	20.3
YTL Power	Buy	1.03	11.4	11.3	0.6	5.0	4.5	1.55	55.0
Ranhill	Buy	1.01	12.0	10.2	0.7	13.6	6.8	1.15	20.7
			11.5	*11.4*	*1.0*	*9.7*	*5.2*		

Source: Bloomberg, MIDF

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	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.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.