

01 July 2019 | Sector Update

Power

ICPT surcharge stays for 2H19

KEY HIGHLIGHTS

- ICPT surcharge stays for 2H19, slightly higher than 1H19 average of 2.15sen
- Continuation of ICPT underpins Tenaga's earnings visibility; share price has recovered strongly
- Revenue and regulatory adjustments already provided for in Tenaga's FY18 and quarterly earnings
- Maintain POSITIVE on Power; Tenaga (TP: RM14.40) and Ranhill (TP: RM1.35) remain our top picks

ICPT stays for 2H19, effectively higher surcharge. The Energy Commission (EC) announced that the Government has agreed to continue with the ICPT implementation for 2H19. Although underlying ICPT surcharge for in 1H19 (for implementation in 2H19) stood at RM1.59b (2.94sen/kwh) this is partly offset by two key adjustments amounting to a total RM444m to reduce it to RM1.15b (2.55sen/kwh), which is effectively higher than the 1H19 average ICPT surcharge of 2.15/kwh – recall that the hike in 1H19 ICPT surcharge implementation was done in a staggered manner i.e. 1.35sen/kwh for Jan-Feb19 and 2.55sen/kwh for Mar-Jun19. As in the past, the ICPT surcharge only applies to non-domestic consumers while domestic consumers are subsidised by the Government.

EXHIBIT 1: 1H19 ICPT IMPLEMENTATION WAS STAGGERED

Balance to be Pass-Through to Non-Domestic / Residential	Jan	Feb	Mar	Apr	May	June	Total
ICPT rates (sen/kwh)	1.35	1.35	2.55	2.55	2.55	2.55	2.15

Source: Company, MIDF

Surcharge was partly cushioned. The 2.55sen/kwh net ICPT (or RM1.15b in absolute terms), is derived after adjusting for (1) Tenaga's revenue adjustment of RM337m (See Exhibit 3) (2) Subsidy from EIF (Electricity Industry Fund) of RM107m. The RM337m revenue adjustments from Tenaga had already been recognised (provided for) in Tenaga's FY18 and 1Q19 earnings.

EXHIBIT 2: 1H19 ICPT (FOR 2H19 IMPLEMENTATION)

	RMm	sen/kwh
ICPT for period Jul-Dec19	1,592.0	2.94
Adjustments to cushion the ICPT impact	(443.7)	
1) Subsidy from EIF (Electricity Industry Fund)	(107.0)	
2) Revenue adjustments in accordance with IBR mechanism	(336.7)	
Balance to be passed through to non-domestic consumers	1,148.3	2.55

Source: Company, MIDF

EXHIBIT 3: REVENUE ADJUSTMENT BREAKDOWN

	Item	RMm	Comments
1	Tenaga ARA (Annual Revenue Adjustment)	76.0	From FY18 balance, passed on via ICPT on annual basis as have to use full year adjustments
2	Refund of excess SB WC & Interest on customer deposit	62.8	From 1Q19 amount of RM31.4m, assumed to be the same for 2Q19
3	Refund of other income related to regulated business	74.2	From actual 4Q18 amount, as of 1Q19 amount is RM93.5m - balance after utilisation of RM19.3m
4	ECS balance for RP1	123.7	One-off amount from RP1. After dispute, amount agreed between TNB and EC is lower vs. RM180.3m previously
	Total	336.7	

Source: Company, MIDF

Fuel cost higher than RP2 parameters. What drove the ICPT surcharge in 1H19 (for implementation in 2H19) was mainly the higher price of coal, which averaged at USD99.2/mt compared to RP2 (Regulatory Period 2) parameter of USD75/mt.

Tenaga's earnings already on quarterly adjustment. From 1Q19, Tenaga adjusts for ARA (as well as other regulatory adjustments) on a quarterly basis, meaning reported quarterly earnings reflect the actual underlying RP2 IBR assumptions and the accompanying expected ICPT revenue adjustments, save for coal cost adjustments which lags by a quarter. The announced ICPT surcharge of 2.55sen/kwh implemented in 2H19 is essentially just a cash flow impact to Tenaga's books. Nonetheless, continuation of the ICPT mechanism by the Government underpins Tenaga's solid earnings visibility.

Strong share price recovery. Tenaga's share price has recovered strongly by 23% in the past month, underpinning our view that the valuation de-rating seen on Tenaga had been overdone, mainly due to concerns on the pending MESI Reform and concerns on continuation of ICPT (or ultimately IBR). At the most recent low of RM11.24/share previously, Tenaga's market cap shrunk 18x more than consensus' earnings adjustment of RM1b, post-ARA announcement. Release of MESI reform details should provide better clarity for the market to assess the impact and remove the overhang, which could lead to further valuation re-rating on Tenaga, while concerns on the ARA recognition has been addressed following the release of 1Q19 results which outperformed consensus expectations. Our BUY call and TP of RM14.40/share for Tenaga is reaffirmed.

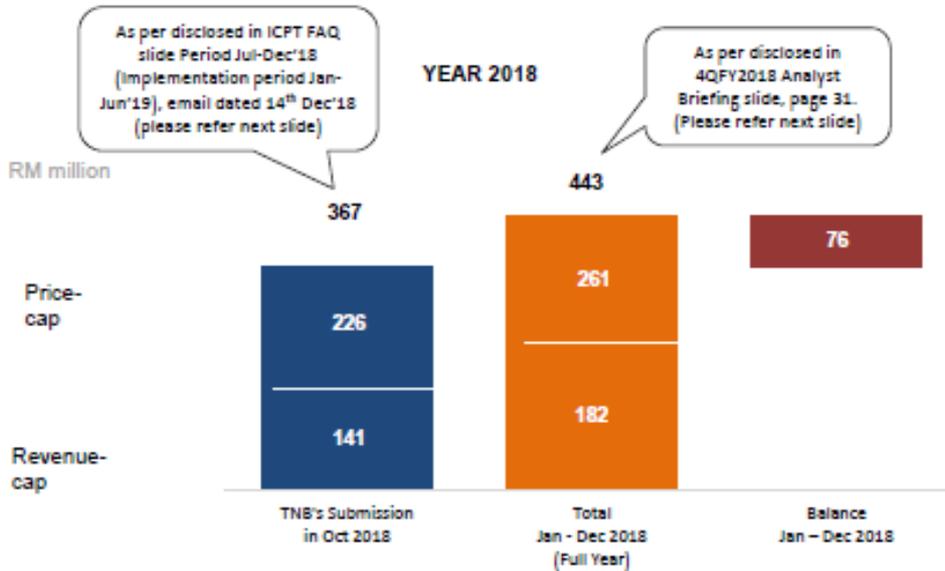
Reaffirm BUY on Ranhill (TP: RM1.35). Key catalysts: (1) Scheduled rate hike for Johor water (2) Johor water-sewerage integration (3) RM500m NRW-reduction contract wins (4) Progress in 1150MW Kedah CCGT power export to Thailand. At current share price, dividend yields are solid at 4.6%.

SECTOR VALUATION MATRIX

Companies	Rating	Shr Price (RM)	PE (x)		P/BV (x)	ROE (%)	Div Yield (%)	Target Price (RM)	Total Upside (%)
			FY18	FY19					
Tenaga	BUY	13.60	14.1	13.6	1.4	9.1	3.7	14.40	10
YTL Power	NEUTRAL	0.82	10.3	10.3	0.5	4.3	2.7	0.88	10
Ranhill	BUY	1.25	16.6	14.3	0.7	14.4	4.2	1.35	12
			13.7	12.7	0.9	9.3	3.5		

Source: Bloomberg, MIDF

EXHIBIT 4: BALANCE FROM TENAGA FY18 ARA



Source: Company, MIDF

EXHIBIT 5: DETAILS OF OTHER REGULATORY ADJUSTMENTS

Components of Other Regulatory Adjustment	(RM mn)
Excess Revenue for Revenue Cap & Price Cap	218.7
Refund of Interests on Customer Deposits	15.5
Refund of Excess Single Buyer Working Capital	15.9
Refund of Other Income Related to Regulated Business	93.5
Capex ECS (Efficiency Carryover Scheme)	51.1
OPEX ECS (Efficiency Carryover Scheme)	129.2
Total	523.9

FAQ 3

- The amount for Jan-Mar 2019 period (1QFY2019) is RM31.4mn. The amount is equally provided for Apr-Jun 2019 period making up the total amount of RM62.8mn for Jan-Jun 2019.

FAQ 4

- Refund of Other Income Related to Regulated Business for Jan-Mar'19 is RM93.5mn, which includes the actual amount of Oct'18 - Dec'18 of RM74.2mn.
- Please take note that the amount earlier reported in 4QFY2018 Analyst Briefing slide for Refund of Other Income Related to Regulated Business Jan-Dec 2018 of RM80.9mn includes estimated amount for Oct-Dec'18.

FAQ 5

- Previously reported CAPEX and OPEX ECS in 1QFY2019 Analyst Briefing slide:
 - CAPEX ECS - RM51.1mn
 - OPEX ECS - RM129.2mn
- After finalization of some disputed items, TNB and EC have agreed to ECS numbers as follows:
 - CAPEX ECS - RM51.3mn
 - OPEX ECS - RM72.4mn
- * Any differentials between reported and finalized numbers will be adjusted in the following quarters.

Source: Company, MIDF

Hafriz Hezry
 hafriz.hezry@midf.com.my
 03-2173 8392

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

(Bank Pelaburan)

(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

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 <i>rise</i> 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 <i>fall</i> 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.