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26 October 2018 | Sector Update

Power Sector

***Maintain* POSITIVE**

Muted impact from IPP cancellations

INVESTMENT HIGHLIGHTS

- **MESTECC Minister revealed names of cancelled Independent Power Producer (IPP) Projects**
- **Cancellations involve 3 listed companies – Malakoff, Tenaga, Ranhill**
- **No impact to valuations as these projects were never part of announced pipeline, hence not factored into projections**
- **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)**

Cancelled IPPs revealed. Yesterday, MESTECC Minister, YB Yeo Bee Yin revealed details of the four IPP projects that were cancelled (See Table below). The Minister indicated that these projects did not comply with terms and conditions stipulated and that the cancellation has no financial or legal implication on the Government. The cancellation however, is expected to save some RM1.26b in electricity tariffs for consumers.

Cancelled Projects	Capacity (MW)	Companies Involved
Gas plant, Kapar, Selangor	700	Malakoff, Tenaga
Gas plant, Paka, Terengganu	1400	Aman Majestic, Tenaga
CCGT plant, Sandakan, Sabah	300	Sabah Development Energy (Sabah State Govt), SM Hydro (Ranhill)
Solar Power	400	Edra

Source: Bloomberg, MIDF

No impact on valuations for Tenaga. The 2 cancelled projects involving Tenaga were still in planning stages and were never part of Tenaga's announced pipeline of generation projects, which currently comprise of 3 key projects: (1) Sepang Solar (50MW) (2) Jimah East (2000MW) (3) Southern Power Generation (1440MW) - these announced projects are not affected. The 2 cancelled projects have yet to enter into any agreement/PPA and were not built into our projections and valuations for Tenaga (BUY, TP: RM16.90)

Sandakan CCGT cancellation not entirely a surprise. To recap, in February 2017, Ranhill, via wholly-owned SM Hydro Energy, which has a 30% stake in a consortium (another 70% owned by Sabah Development Energy, a company ultimately owned by Sabah State Government) received a Conditional Letter of Award from the Energy Commission (EC) to develop a 300MW CCGT plant in Sandakan, East Sabah. The consortium was also instructed to commence negotiations with Petronas and the company identified by the Government to develop the Trans-Sabah Gas Pipeline (now cancelled) to ascertain terms and conditions of gas supply for the project.

Opting for a stronger grid instead. Sandakan CCGT was originally intended to partly address the severe power under-capacity in East Sabah. The change in Government brought uncertainty surrounding the project as the new MESTECC Minister instead prefers to strengthen the West-to-East grid to enable a more efficient supply of power from West (oversupplied) to East Sabah (undersupplied) – current 275kv lines are only able to dispatch 216MW due to constraints of existing transmission tower ratings. The grid upgrade (targeted to complete end-2019 involving Segaliud-Dam Road-Kalumpang transmission) will enable an additional 200MW to be dispatched from West Sabah. On top of this a 275KV Southern link transmission (Sipitang-Upper Padas-Kalumpang-Tawau) will be constructed by 2024 which will enable an additional 600MW to be dispatched from West Sabah. The extension of the IBR framework to include Sabah (announced in the recent 11MP Mid-Term Review recently) should facilitate the development of the enhanced West-to-East Sabah grid, estimated to cost over RM2b.

No impact on valuations for Ranhill. Given uncertainties surrounding the Sandakan CCGT project, we had already conservatively excluded Sandakan CCGT from our forecasts and valuations (current TP of RM1.15/share) for Ranhill. Whilst Sandakan CCGT is part of our potential blue-sky valuation of RM1.50/share, it only accounted for 3% (5sen/share) of the blue-sky valuation with the bulk (24sen/share or 16% of valuations) coming from SAJ's potential expansion into sewerage operations in Johor. *Our blue-sky valuation is merely to illustrate what our TP could be if potentials in the pipeline were to materialise.*

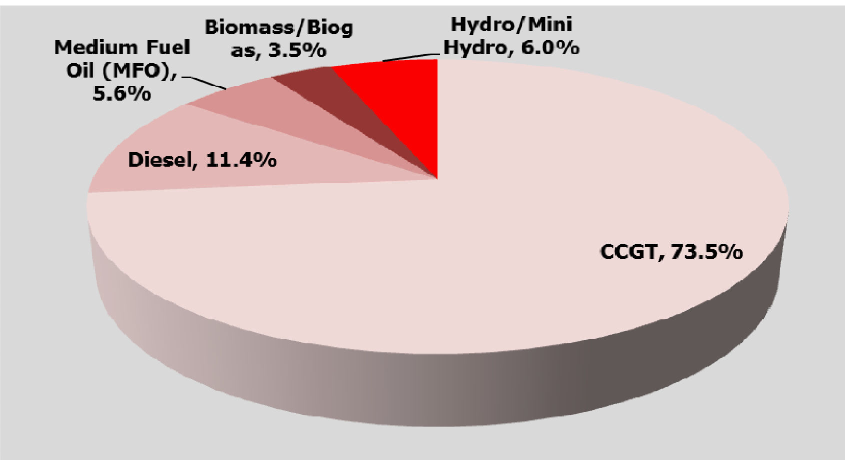
Requirement for baseload plants? Despite plans to upgrade the grid, the load centres in Sabah is heavily lopsided to the West (See Exhibit 2); East Sabah might still require baseload plants for system stability as a whole. Additionally, the more expensive diesel and fuel oil plants are expected to be taken out of the system upon expiry, the last diesel IPP being the 60MW Stratavest Libaran plant end-2019. Meanwhile, SESB-owned diesel plants will only be used as peaking plants going forward. There is a proposal to break up the initial plan for the Sandakan 300MW CCGT into three equal load centres (3x100MW) in Sandakan-Lahad Datu-Tawau to better distribute the load and enable better system management in the case of outages. The proposal is subject to final decision by MESTECC/EC/SESB/Sabah State Government. This is especially if the current planned 180MW Upper Padas hydro project faces stumbling blocks or cancellation. On top of this, Ranhill's 27%-owned 30MW geothermal development in East Sabah is targeted to come on-stream in FY20F.

BACKGROUND OF SABAH POWER SITUATION

Capacity situation in Sabah. While Sabah's power outages is a known issue, this mainly impacts the East Coast where there is massive capacity shortage. East Sabah is estimated to account for just 17% of total Sabah power capacity. There are no CCGT plants in the East Coast with the majority of capacity comprising diesel and fuel oil plants; the Government is subsidising 49.5sen/litre for all plants using diesel and fuel oil in the state, which is a heavy burden. In the West Coast of Sabah, there is actually an oversupply situation, with an estimated capacity of 1100MW, or 83% of Sabah's total generating capacity. The oversupply largely originated from the coming on-stream of the Kimanis CCGT power plant plant (285MW), which was meant to cater for the Sabah O&G Industrial Park (SOGIP) in Sipitang. Demand from SOGIP however was well below expectations; take-up was estimated at just 40MW.

Diesel IPPs will not be renewed. To reduce the subsidy burden borne by the Government, diesel IPPs which are reaching expiry will not be renewed (e.g. Sandakan Power Corporation and Serudong Power Plant terminated in 2015/17) – this impacts mainly East Coast capacity which is where the majority of diesel plants are located. Diesel plants account for 11% of Sabah capacity with 80% of this located in East Coast. With these diesel plant capacity possibly being taken out (total 119MW located in East Sabah), accounting for 55% of East Sabah capacity, there will be a need to balance out power generation between East and West Sabah, regardless of Sabah's grid plans.

EXHIBIT 1: DIESEL IS 2ND LARGEST CONTRIBUTOR TO SABAH POWER CAPACITY



Source: EC, Company, MIDF

EXHIBIT 2: GENERATING POWER PLANTS IN SABAH

EAST SABAH		
Power Plant	**Capacity (MW)**	**Type**
Seguntor Bio-Energy/Kina Biopower	20.0	Biomass
Batu Sapi GT/Labuk Canopy Genset	25.4	Diesel
IPP Stratavest Libaran	*15.0*	*MFO*
Cash Horse Biomass	10.0	Biomass
TSH Bioenergy	10.0	Biomass
TSH Biogas	2.7	Biogas
Tawau	30.0	Diesel
Teck Guan Biomass	3.0	Biomass
IPP Serudong Power	*36.0*	*MFO*
Mini hydro Bombalai	0.8	Mini Hydro
Mini hydro Merotai	0.8	Mini Hydro
Kubota	64.0	Diesel
Total	***217.7***	
WEST SABAH		
Power Plant	**Capacity (MW)**	**Type**
Melangkap/Sayap	1.6	Mini Hydro
Esajadi Sg. Pangapuyan	4.5	Mini Hydro
Esajadi Sg. Kedamaian	2.0	Mini Hydro
IPP SBPC	*100.0*	*CCGT*
IPP ARL	*22.7*	*MFO*
IPP RP1	*190.0*	*CCGT*
Melawa	31.5	Diesel
IPP RP2	*190.0*	*CCGT*
SPR Energy	100.0	CCGT
Kimanis Power	285.0	CCGT
Patau-Patau	104.5	CCGT
Tenom Pangi	69.0	Hydro
Total	***1,100.8***	
TOTAL SABAH CAPACITY	**1,318.5**	

Source: Company, MIDF

EXHIBIT 3: GENERATING POWER PLANTS IN SABAH

Source: EC, Company, MIDF

EXHIBIT 4: SABAH ELECTRICITY GRID

Source: EC, Company, MIDF

Maintain POSITIVE on the power sector. Tenaga (BUY, TP: RM16.90) remains one of our top sector picks. 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 the new solar leasing mechanism to support the solar Net Energy Metering program.

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 RM1.45/share (blue-sky scenario, excluding Sandakan CCGT). 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. Valuation is undemanding at 9x FY19F earnings and dividend yield of 6% is attractive.

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.

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	14.00	10.7	12.1	1.5	10.6	4.6	16.90	25.3
YTL Power	Buy	0.93	10.3	10.2	0.6	5.0	4.9	1.55	71.6
Ranhill	Buy	0.92	11.0	9.3	0.7	13.6	6.4	1.15	31.4
			10.7	*10.5*	*1.0*	*9.7*	*5.3*		

Source: Bloomberg, MIDF

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DISCLOSURES AND DISCLAIMER

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.