11 April 2016 | Sector Update

Power

Maintain POSITIVE

Sitting pretty

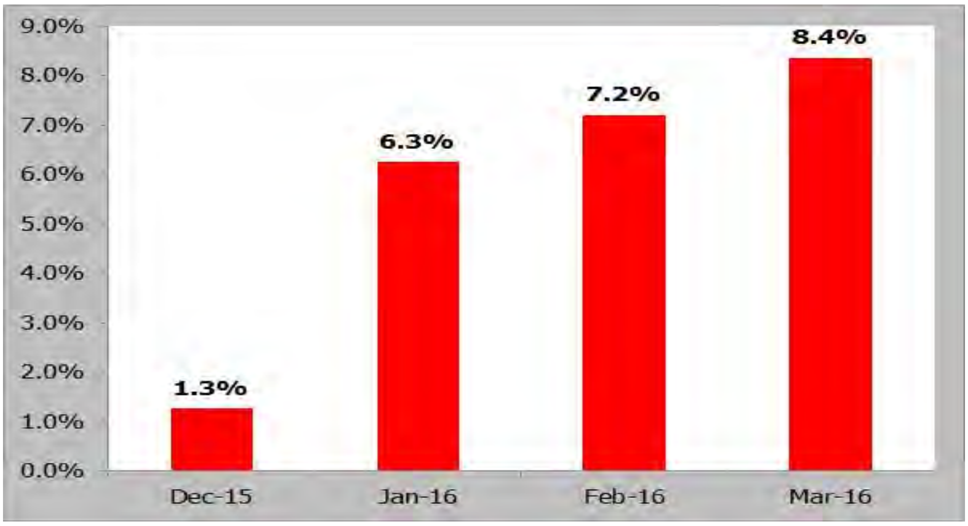
INVESTMENT HIGHLIGHTS

- **The 2QFY16 is likely to be a strong one for the sector based on latest generation data from Tenaga**
- **The strong demand also comes with an effective increase in tariff (given a reduction in ICPT rebate) from Jan 2016**
- **More importantly, sector players are positioned well for expansion and dividend growth given deeply underleveraged balance sheets and strong FCF generation.**
- **Maintain POSITIVE on Power; top pick is Tenaga (BUY, TP: RM15.60/share).**
- **Foreign shareholding is close to a trough.**

El-Nino and Equinox heatwave is a blessing. The exceptionally strong 1QFY16 demand growth (Tenaga) of 3.2% may sustain or even gain strength in 2QFY16 given the heatwave that has hit the country in the past few months and against a weaker base in 2QFY15 (which was 1.4% lower than 1QFY15). The heatwave has driven peak power demand to new highs twice so far this year, i.e. at 17,175MW in March 2016 to the latest 17,350MW. This compares to the previous peak demand of 16,901MW almost 2 years ago.

Possible upward tweaks. Our FY17F electricity growth assumption stays at 3% for now, but there could be small upward tweaks if demand does not drop too drastically beyond this heatwave-driven demand period. Underpinning our view, Tenaga's system generation up till early March shows up to 8%yoy growth (a range of between 5%-8%yoy growth). This compares to Tenaga's 1QFY16 demand sales growth of 3.2% and FY15 demand sales growth of 2.2%.

EXHIBIT 2: TENAGA'S SYSTEM GENERATION YOY GROWTH PICKED UP SIGNIFICANTLY

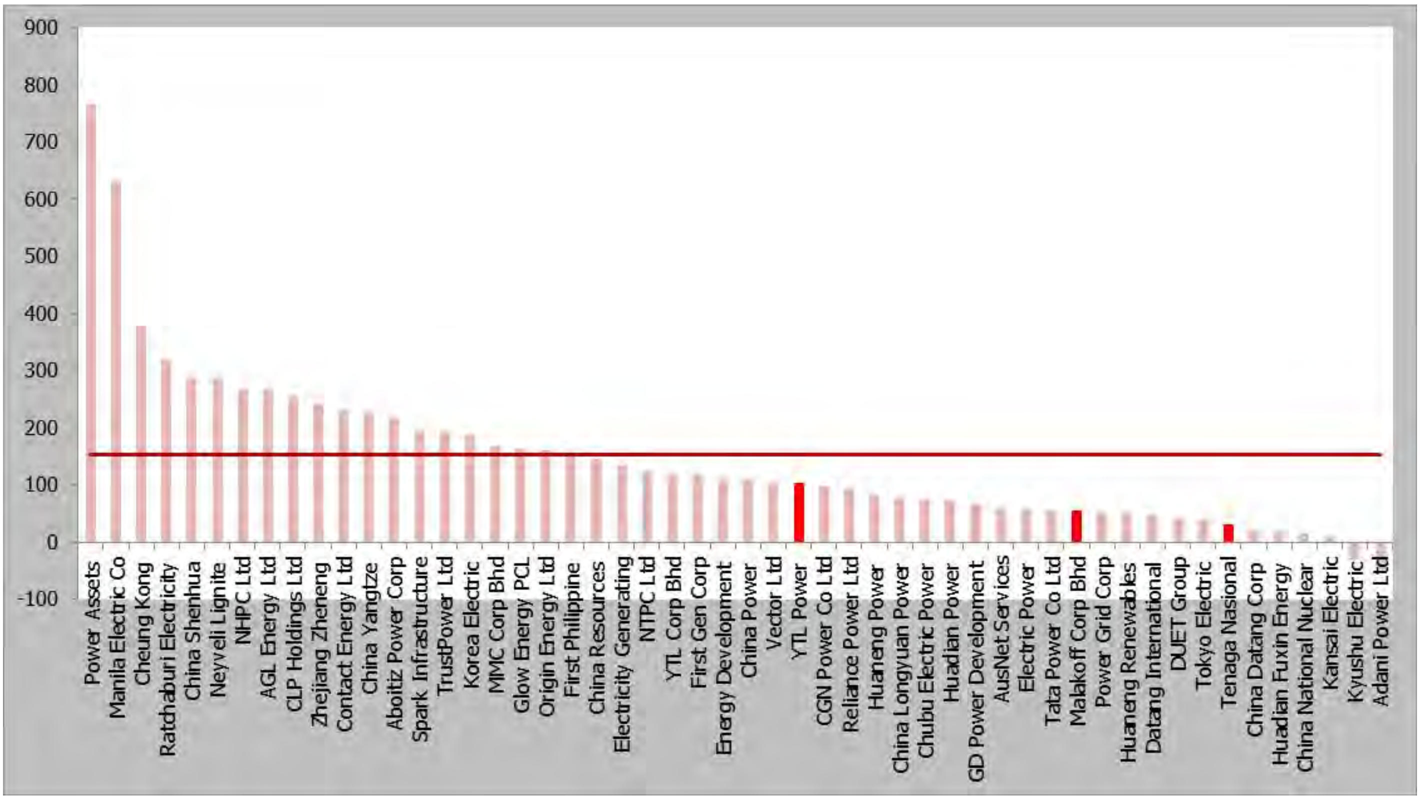


Source: Energy Commission, MIDFR **** March data up till 3rd March only.***

Tenaga gets to keep benefits from incremental volume. Benefits from incremental volume will accrue 100% to Tenaga. Under the IBR framework, growth assumption is set at 3% per annum (for the current regulatory period up till end-2017). If there is a shortfall, Tenaga is not compensated but on the flip side, if there is stronger than expected demand, such as the case currently, the benefits will accrue directly to Tenaga.

KINDLY REFER TO THE LAST PAGE OF THIS PUBLICATION FOR IMPORTANT DISCLOSURES

EXHIBIT 2: TENAGA'S BALANCE SHEET AMONG MOST UNDERLVERAGED IN THE REGION



Source: Bloomberg, MIDFR

Sitting pretty. Most importantly, all the local power players are sitting on strong balance sheets, i.e. low net gearing of 0.35x -1.20x relative to regional average of 1.5x. Tenaga, in fact, is one of the most underleveraged among regional peers at just 0.35x net debt-to-equity. This positions the local power sector strategically to capitalize on acquisition or expansion opportunities that may arise in the current downcycle, particularly overseas. We also see scope for dividend upside - besides an underleveraged balance sheet, Tenaga entails strong FCF yields of 6%-7% (FY16F) while YTL Power entails FCF yields of up to 13% (FY16F).

PPA extension improves IPP visibility. The recent extension of first generation PPAs improves earnings visibility for the independent power producers (IPP), albeit some of the extensions are short-term, i.e. ~3 years. Among the renewals recently include: (1) Malakoff's PD Power extended up till February 2019, and (2) Powertek's Teluk Gong plant extended up till December 2018. YTL Power's Paka plant has been renewed up till December 2018, but its Pasir Gudang plant has yet to see any renewal.

Capacity additions to maintain a comfortable reserve margin. While peak demand has hit new highs this year, reserve margin should remain comfortable given the addition of 2.8GW of new capacity this year. Key capacity additions this year include: (1) Malakoff's Tanjung Bin plant (1000MW) commissioned in March 2016, (2) TNB's Prai plant (1071MW), and (3) Ulu Jelai hydro (372MW). By year end, total installed capacity is estimated to expand by 13%yoy to ~25GW and reserve margin to improve to 31%, assuming the current peak demand of 17,350MW remains unchanged.

Foreign shareholding is close to trough. As of Dec 2015, Tenaga's foreign shareholding stood at ~23%, close to its trough of 22.8% and versus a high of ~27%.

EXHIBIT 3: TENAGA'S FOREIGN SHAREHOLDING CLOSE TO ITS TROUGH

Source: Company, MIDFR

We maintain POSITIVE on the power sector. Key catalysts over the next 12 months: (1) Dividend upside – all power players attain great balance sheet position and are generating strong FCF yields of 7% - 13%, (2) Overseas expansion, (3) Completion of Edra sale removes a big overhang on Tenaga, and (4) Resolution of Tenaga's RM2b tax dispute with the Inland Revenue Board.

VALUATION AND RECOMMENDATION

		Shr Price	EPS (sen)		PE (x)		Div Yield	Target
Companies	**Rating**	**(RM)**	**FY16F**	**FY17F**	**FY16F**	**FY17F**	**(%)**	**Price (RM)**
Tenaga *	Buy	14.42	116.1	123.4	12.4	11.7	3.5	15.60
YTL Power	Neutral	1.49	11.5	14.1	13.0	10.6	6.0	1.60

Source: Bloomberg, Companies, MIDFR

Syed Muhammed Kifni
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 >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.