13 July 2018 | Sector Update

Power Sector

***Maintain* POSITIVE**

Takeaways from Minister's townhall

INVESTMENT HIGHLIGHTS

- **Renewable energy push to reduce reliance on imported fuel**
- **Minister of the view that current reserve capacity is excessive**
- **Four power plant contracts to be cancelled**
- **Maintain POSITIVE on Power. Top picks are Tenaga (TP: RM16.30) and YTL Power (TP: RM1.20)**

We attended the new Minister of Energy, Science, Technology, Environment and Climate Change's maiden townhall in Putrajaya yesterday. Below are the key takeaways:

Reducing reliance on imported fuel. Given that it is a cheap fuel source, coal contribution to the generation mix has soared from just 8.3% in 1996 to 54% now. However, coal is an entirely imported fuel source which poses risk to supply sustainability, other than being a big contributor to greenhouse gas emission. As such, the new Minister aims to aggressively increase contribution of Renewable Energy (RE) to the mix from just 2% currently to 20% "in the future".

Price, technology, efficiency is key. The push for RE is not entirely new and efforts had been taken previously to increase RE contribution to the system e.g. Large Scale Solar (LSS) projects. Solar accounts for the bulk of Malaysia's RE. However, there is the issue of getting RE sources to reach grid parity for it to be cost competitive and gain a larger share of generation mix without burdening end-consumers. To give a yardstick, in cycle-2 of the LSS awards, the average bid was ~37sen/kwh, which is at 19%-54% premium to the grid's displaced cost of 24sen-31sen/kwh. Current solar panel technologies allow for an average 4-hours/day (for Malaysia) of power generation which is still very low. Moreover, the LSS already entails a 21-year PPA (which ties in with expected life of solar panels) and already allows only 8%-10% IRR to operators. Technological development to improve solar panel generation ability and pricing are critical factors for meaningful development of solar-based RE going forward.

Four projects to be cancelled. The Minister also announced it will be cancelling four power plant projects, where details will be announced soon. Among the major projects in the pipeline, we think Edra's Track 4B with a massive 2242MW capacity in Malacca could come under scrutiny given that it was a directly awarded project. While Track 4A (TNB-SIPP) was a controversial project awarded on a directly negotiated basis (previously to the TNB-YTL-SIPP consortium) back in 2014, the project is already well underway (28% completion). Tadmax, is another directly negotiated power plant project at Pulau Indah. Others might involve LSS project awards e.g. Quantum Solarwhich was the first to be awarded LSS projects under the LSS initiative on a direct award basis. Ranhill was recently awarded a 300MW CCGT project in Sandakan Sabah. There has yet to be any development announced on the project so far.

EXHIBIT 1: LIST OF DIRECTLY NEGOTIATED POWER PLANT PROJECTS IN RECENT YEARS

Owner	Project	Comment
TNB-SIPP	Track 4A 1440MW CCGT	awarded on direct nego basis
Edra	Track 4B 2242MW CCGT	awarded on direct nego basis
Tadmax	Pulau Indah 1000MW CCGT	awarded on direct nego basis
Quantum Solar Park	Melaka LSS 50MW	awarded on direct nego basis
Quantum Solar Park	Kedah LSS 50MW	awarded on direct nego basis
Quantum Solar Park	Terengganu LSS 50MW	awarded on direct nego basis

**LSS – Large Scale Solar, CCGT – Combined Cycle Gas Turbine*

Too much capacity? The Minister indicated that the country already attains abundant reserve capacity of 30%, which is apparently much higher than most countries. This inflates the sector's cost (as the non-utilised IPPs still need to be paid capacity payment) which in turn is passed on to consumers' via electricity tariffs. Demand on the other hand had been growing by 2%-3% in recent years (except 2016 which was inflated by a heatwave occurrence). Meanwhile, three 1st gen PPA extensions (combined capacity of 1660MW, or ~ 6% of installed capacity) are scheduled to expire up till 2020. While there is no indication of an ideal or target reserve capacity, the new Minister indicated that the abundant reserve capacity gives the industry decent time to build up its RE capacity within the next 3-7 years, without the need for much more major new plant-ups in the near-term. This suggests in the near future, sector opportunities could tilt heavily towards RE project awards and a dearth of future fossil fuel plants.

Aims to introduce more competition. The Minister also indicated that it intends to introduce competition within the electricity retail space, which is currently dominated by Tenaga. However, opening up the retail space alone to induce competitive tariffs to consumers could be challenging without reviewing the wholesale space – as Tenaga is also currently the single buyer from the power generators. One suggestion by a participant during the townhall was to allow RE generators to sell directly to consumers, which directly creates competition among the generators and possibly induce more competitive rates for consumers.

Near-term impact. Given the indication of excessive reserve capacity at the current 30%, the pace of any major plant-ups in the near-term is likely to be impacted. Although the new Minster's intention is to champion RE, we think the shift is for RE to eventually dilute contribution from fossil fuel rather than near-term, outright replacement. There is the issue of feasibility to induce RE in a big way into the system too which will have to be sorted out. Positively, most if the incumbent players e.g. **Tenaga (BUY, TP: RM16.30)** and **Malakoff (non-rated)** are already paving way into the RE space (in particular, solar), while **Cypark (non-rated)** has been moving aggressively into RE in recent years. Meanwhile, the four IPP cancellations are likely to hit selective players, the majority of which are likely to be non-listed.

We remain POSITIVE on the power sector. **Tenaga's (BUY, TP: RM16.30)** share price has been bashed down quite substantially, presumably given the perceived risk on its ability to attain a tariff hike, and secondly, given Tenaga's reasonably high foreign shareholding (of 24%) among index stocks. Given substantial price depreciation in the past month, we see value emerging. Our TP remains unchanged at RM16.30, and our BUY call is reaffirmed. Dividend yields are now attractive at 5.3% (+ve spread against 10yr MGS of 4.26%) while valuations are cheap at 11x FY18F earnings, a substantial discount to the market's 16x-17x.

Our second sector pick is **YTL Power (BUY, TP: RM1.20).** After having seen share price retrace 14% in the past month, risk reward is attractive at current price levels; the stock is trading at just 8x FY18F PER while dividend yields are now attractive at 6%/7% (FY18F/19F) even at just 50% payout ratio assumption. Furthermore, the market has yet to factor in the incremental value of 80%-owned Tg. Jati and YTLP's 45% stake in a Jordanian shale oil power plant (due for operations mid-2020) which carry attractive IRRs of low and high teens respectively.

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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.