POWER

Maintain NEUTRAL

Thoughts Post-Budget 2020

KEY INVESTMENT HIGHLIGHTS

- **Budget 2020 highlights migration of current PPA system to a wholesale market and allows RE players to compete directly in the retail market - shift of demand-risk to generators could create a more competitive market vs. the essentially "guaranteed return" model that players are currently enjoying**
- **NEDA+ to be rolled out in 3Q20, to eventually function as the energy market - allows old capacity back into the system, but "effective" reserve margin may be kept in check considering 1%-2% peak demand growth**
- **Green tax incentives extended till 2023, new tax incentive introduced for solar leasing**
- **Maintain NEUTRAL on Power. YTL Power (BUY, TP: RM0.88) and Ranhill (BUY, TP: RM1.45) are our top sector picks; not ruling out potential comeback of YTL Power in the domestic power scene**

KEY MEASURES FOR THE POWER SECTOR UNDER BUDGET 2020

- **Migration of the current PPA system towards a wholesale market** in the future. RE suppliers to compete directly in the retail market.
- **GITA and GITE incentives** to be extended to 2023
- **70% tax exemption** of up to 10 years for companies undertaking solar leasing activities
- **Energy Performance Contracting** (EPC) (entailing upfront capital investment into energy saving equipment for Government buildings, repaid via savings in utility costs achieved) to be accelerated for Government buildings, prioritizing hospitals and education institutions
- **National Fibre Connectivity Plan** (NFCP) via public-private partnership. The Government is expected to bear more than half of the expected capex. Some RM21.6b spending is expected under the NFCP plan – this measure indirectly affects Tenaga, being a potential player in the NFCP rollout.

OUR VIEWS:

Migration to a wholesale market. This is not entirely new and is part of the recently announced Power Sector Reform Plan (MESI 2.0). To recap, among the key reform initiatives are: (1) To allow generators to source their own fuel to optimize cost (2) To move from a PPA regime to a capacity and energy market (3) To establish a TPA (Third Party Access) framework and network charges for the grid (4) To facilitate green energy producers and consumers (s*ee our reports dated 18th Sep 2019 & 26th Sep 2019 for more comprehensive comments)*. Generally, the Government is planning to do away with the existing PPA structure which essentially guarantees both capacity payment and energy payment (the latter, via the fuel cost pass-through mechanism). While future PPAs are still expected to involve capacity payments (which covers the fixed cost element of a power plant), there will be no more locked-in energy payments.

COMPANY IN FOCUS

Tenaga Nasional Bhd
Maintain **NEUTRAL |** Unchanged Target price: RM14.40
Price @ 11th October 2019: RM13.88

- T&D remains a natural monopoly, bulk of regulated earnings remain intact for now
- Power generation likely to see more competition in the long-run from gradual shift towards a more merchant-like market vs. traditional PPAs previously

Share price chart

YTL Power Bhd
Maintain **BUY |** Unchanged Target price: RM0.88
Price @ 11th October 2019: RM0.74

- NEDA+ provides an avenue for expired IPPs to re-enter the market via competitive bidding
- Not ruling out a potential comeback into the domestic power sector via both competitive generation market and entry into retailing

Share price chart

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Exhibit 1: MESI 2.0 Rollout Schedule

4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23
1st disclosure of Power Planning by end-2019	3rd party 100MW green contract to be piloted, to last till end-RP3		Rules for fuel sourcing liberalisation	EC to submit RP3 for endorsement, including network charges	Pilot for Electricity Time-of-Use	Full rollout of fuel sourcing liberalisation		MyPower to come out with capacity/energy market rules				Deadline to table legislation (if required) on TPA framework	EC to hold 1st capacity market auction, for rollout in 2029
EC and TNB to determine interim network charges based on RP2 (for green energy producers)			Rollout of NEDA+	EC to approve retail regulatory framework	Itemised billing based on RP3	Pilot for opening up of retail							
			MyPower & E-Care to develop rules/guidelines for TPA with regards to market participation		New tariff design and approved network charges								
					Enhanced ring-fenced governance of SB and GSO								
					Pilot for fuel sourcing liberalisation								

Source: MyPower, MIDFR

Shorter capacity contract tenures. Future capacity market contracts will have much shorter tenures than the current 21- year PPAs (anywhere between 6 months to 10 years). The impact of this move is gradual given that the last PPA will expire some time in 2045 (before taking into account the latest Tadmax and Gurun PPAs). MESTECC intends to roll out the new structure with a first capacity auction by end-2023, earliest.

NEDA+ in the immediate term. In the immediate term, NEDA+ (New Enhanced Dispatch Arrangement) will be rolled out by 3Q20 to allow expired IPPs or players with excess capacity to sell energy via spot contract to the Single Buyer. PPA-based IPPs will not be impacted as the current PPAs will still be honored. NEDA+ will eventually function as the energy market under the sector liberalization.

P2P trading for RE. The Government is also allowing a total of 100MW (with minimum blocks of 20MW each) RE capacity to be traded on a direct, P2P (peer-to-peer) model whereby Tenaga will be paid a fee for utilisation of its grid network. A TPA (third party access) framework for access to the grid is expected to be finalised by end-2022 in order to facilitate the full liberalisation of the sector.

We do not rule out a potential comeback of **YTL Power (BUY, TP: RM0.88)** in the domestic power scene via both, the competitive generation market (the migration to a wholesale market will essentially allow old/expired capacity back into the system) as well as an entry into retailing (which will be opened up as part of the liberalisation). YTL Power was only given a short-term extension for one of its plants i.e. its 1st Generation Paka IPP (585MW), which will be expiring mid-2021. As for existing players such as **Malakoff (Non-Rated)** and **Tenaga (NEUTRAL, TP: RM14.40)**, the shift of demand-risk to generators could create a much more competitive generation market vs. the essentially "guaranteed return" model they are currently enjoying.

Solar leasing and EPC: Both are new schemes launched by MESTECC earlier this year/late 2018 and is essentially the creation of new sub-segments within the power sector. The former, will benefit from the 70% tax exemption offered and is likely to encourage more new players to participate, beyond **G-Sparx (owned by Tenaga)** and **Petronas' M+**. A solar leasing company essentially finances the capex for a consumer intending to install solar PV (and maintains the solar installation) and is repaid a monthly leasing fee by the consumer. G-Sparx is targeting to offer some 1500MW of self-generation schemes for solar PV installations.

GITA and GITE: The Green Technology Investment Tax Allowance (GITA) scheme is awarded to eligible companies undertaking investments in a specific project that promotes sustainability and green environment. It entails 100% of qualifying capex incurred and can be utilised to offset against 70% of statutory income. Meanwhile, the Green Investment Tax Exemption (GITE) scheme is eligible for companies that support investments in green projects. It entails tax exemption of 100% of statutory income. Broadly, projects promoted under GITA and GITE fall under RE, Energy Efficiency, Green Building, Green Data Centres and Integrated Waste Management. The tax incentives were previously scheduled to expire in 2020, but under Budget 2020, have been extended till 2023. Power players such as **Tenaga (NEUTRAL, TP: RM14.40)** and **Cypark (Non-Rated)** are involved in RE, particularly via the Large Scale Solar programs. Meanwhile, both **Ranhill (BUY, TP: RM1.45)** and **Malakoff (Non-Rated)** are eyeing expansion into Waste-to-Energy.

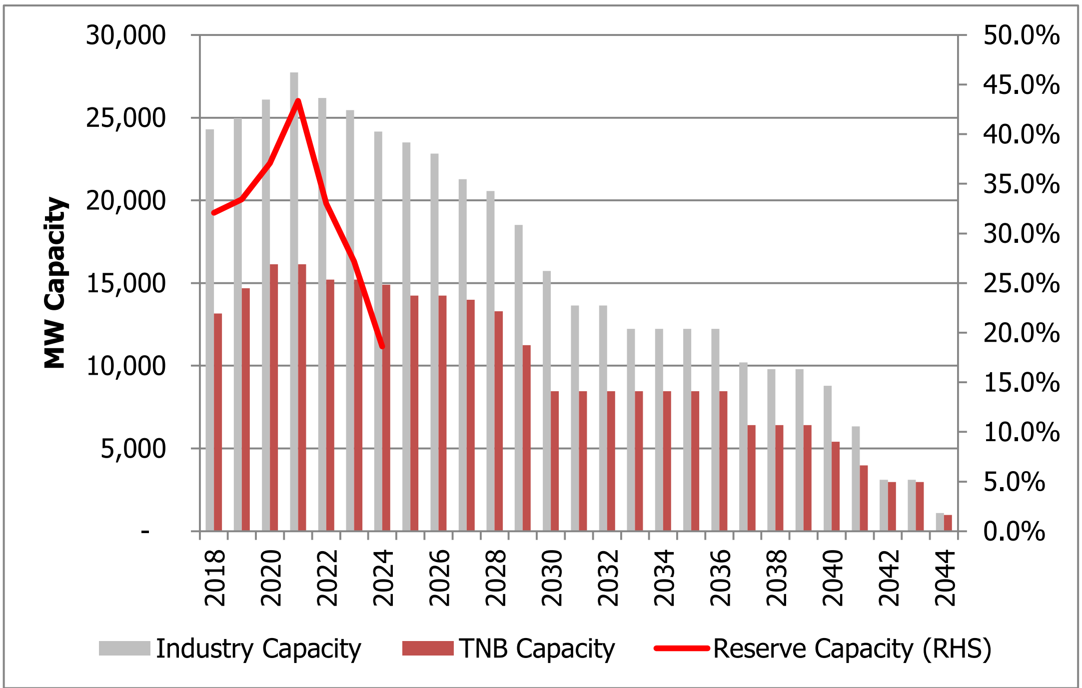
On NFCP. Tenaga has completed rollout to 1100 homes in Melaka under its pilot project, involving RM3m-RM4m capex. Fine details of its actual rollout is not forthcoming yet, but Tenaga could be looking to keep to just the wholesale segment and is targeting returns that can at least match its current regulated returns.

Exhibit 2: Outgoing vs. Incoming Capacity by Key Players

2019-2029 (MW) (Cumulative)						
Operator	**Outgoing capacity**	**Portion of outgoing capacity**	**Incoming capacity**	**Net incoming/(outgoing) capacity**	**Hydro**	**Net (ex-hydro)**
TNB	5,352	47%	3,440	(1,912)	1,299	**(613)**
Edra	2,151	19%	2,242	91	-	**91**
Malakoff	2,729	24%	-	(2,729)	-	**(2,729)**
Total	**10,233**		**5,682**	**(4,551)**		**(3,251)**

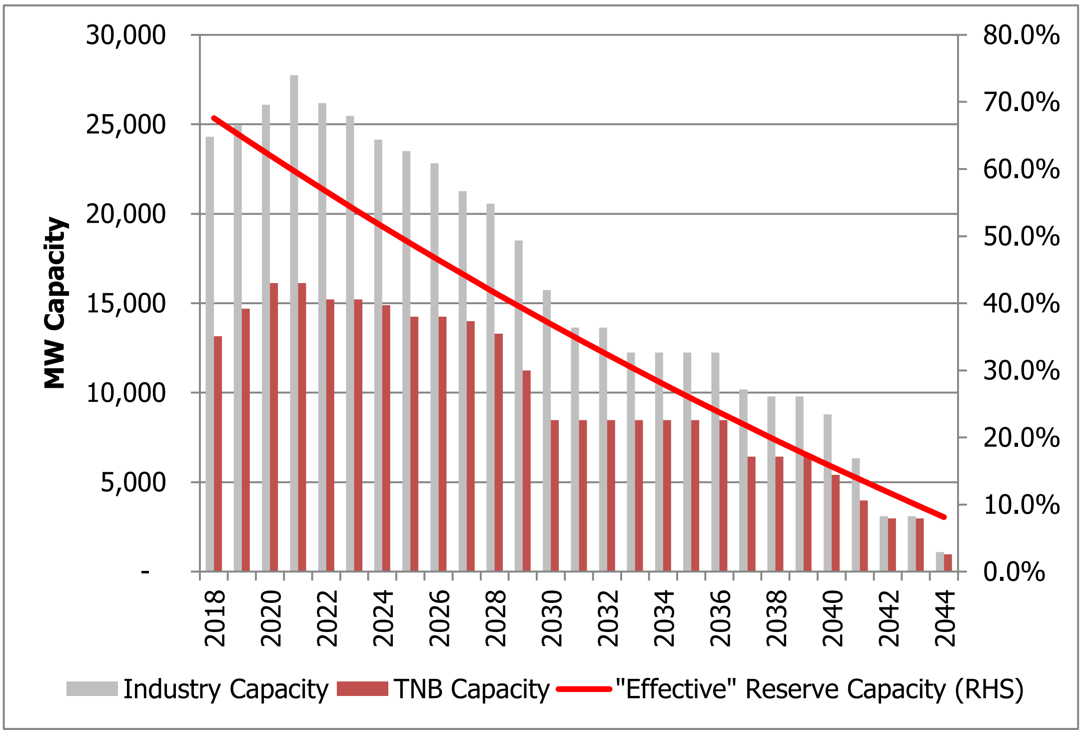
Source: EC, MIDFR

Exhibit 3: Industry PPA Capacity vs. Reserve Margin (@ 1.7% Peak Demand Growth)



Source: EC, MIDFR

Exhibit 4: "Effective' Reserve Margin (@ 1.7% Peak Demand Growth) – Assuming Old Capacities Return to the Market



Source: EC, MIDFR

PEER COMPARISON TABLE

		Shr Price	PE (x)		P/BV	ROE	Div Yield	Target	Total
Companies	**Rating**	**(RM)**	**FY19**	**FY20**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
Tenaga	NEUTRAL	13.88	14.1	13.6	1.4	9.1	3.7	14.40	7.4
Ranhill	BUY	1.28	17.0	14.6	0.7	14.4	4.1	1.45	17.4
YTL Power *	BUY	0.74	10.8	9.0	0.5	4.3	6.9	0.88	29.2
YTL Corp*	NEUTRAL	0.97	38.8	23.3	0.7	3.1	3.0	1.03	9.2

*Source: Company MIDFR   *FY20/FY21*

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.