Corporate Update | Monday, 26 September 2022

Ranhill Utilities Berhad

(5272 | RAHH MK) Utilities | Water

Maintain BUY

Opportunity in Sabah Power

***Unchanged* Target Price: RM0.67**

KEY INVESTMENT HIGHLIGHTS

- **Ranhill's Sabah power plants are beneficiaries of the state's power grid upgrade**
- **Potential new plant-ups to address power capacity mismatch**
- **Huge opportunity to be unlocked from Sabah's 101GW RE potential**
- **Maintain BUY at unchanged TP of RM0.67**

RETURN STATISTICS	
Price @ 23rd Sep. 2022 (RM)	0.40
Expected share price return (%)	+67.5
Expected dividend yield (%)	+4.8
Expected total return (%)	**+72.0**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	16.7	14.7
3 months	13.8	-5.5
12 months	-32.1	-28.6

KEY STATISTICS	
FBM KLCI	1,424.98
Syariah compliant	Yes
F4BGM Index	Yes
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	1289.68
Estimated free float (%)	46.49
Market Capitalisation (RM'm)	515.87
52-wk price range	RM0.38 - RM0.71
Beta vs FBM KLCI (x)	0.61
Monthly volatility (%)	15.03
3-mth average daily volume (m)	0.87
3-mth average daily value (RM'm)	0.37
Top Shareholders (%)	
Hamdan (L) Foundation	20.05
Cheval Infrastructure Fund	18.88
Mohamad Hamdan	10.22

Power interrupted. Sabah's electricity supply system has been facing the issue of frequent interruptions for many years. This is reflected by its relatively high System Average Interruption Duration Index (SAIDI) compared to Peninsular Malaysia (See Chart 1 and 2). One of the issues faced by the supply system is a mismatch in supply capacity; West Sabah is significantly oversupplied with estimated excess of 362MW capacity vs. demand in key cities while East Sabah faces significant shortage of an aggregate 139MW, based on findings by the EC (see Chart 3). Under the 12MP, SAIDI for Sabah is targeted to reduce to 150 minutes by 2025, a significant improvement compared to the 332 minutes recorded in 2021 and 393 minutes in 2022 (annualised).

Sabah power grid upgrade. As one of the measures to address East Sabah's undercapacity situation, major upgrades of the Sabah power grid, in particular the links within East Sabah was planned a few years back and is currently underway. These revolve around 6 key projects costing an estimated RM840m involving upgrading works, new transmission lines and PMUs throughout critical phases of the network (see Exhibit 1 and Table 1). Upon completion, the upgrade will improve the grid's capacity to transfer power from West to East Sabah, allowing 400MW of additional capacity to be dispatched (from 216MW previously). Additionally, construction works on the Southern Link transmission network project is expected to commence under the 12MP period, which should unlock further capacity for energy transfers and improve grid stability.

Largest IPP in Sabah. Via its two CCGT power plants in Kota Kinabalu (West Sabah) with a combined 380MW capacity, Ranhill stands as the largest IPP in Sabah with a 29% share of Sabah's estimated total capacity of 1320MW. 60% owned Ranhill Powertron 1 (RP1) operates under a PPA with Sabah Electricity Sdn Bhd (SESB) until 2029 under a BOO arrangement while 80%-owned RP2's PPA lasts until 2032 under a BOT arrangement. We believe the group is well positioned to benefit from higher dispatch by West Sabah IPPs once the West-to-East Sabah grid upgrade works is completed next year.

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RANHILL: EARNINGS SUMMARY

FYE Dec	FY19	FY20	FY21	FY22F	FY23F
Revenue (RM'm)	1,551.8	1,468.1	1,531.1	1,784.6	1,813.9
EBIT (RM'm)	298.0	80.7	93.6	150.0	164.4
Pretax Profit (RM'm)	209.9	95.5	93.7	118.6	142.4
Net Profit (RM'm)	65.7	37.7	30.6	35.7	42.9
Core Net Profit (RM'm)	65.7	51.5	32.1	35.7	42.9
FD EPS (sen)	7.6	4.8	2.6	2.8	3.3
EPS growth (%)	40.4	(37.2)	(46.0)	6.1	20.1
PER (x)	5.2	8.3	15.4	14.5	12.1
EV/EBITDA (x)	1.7	2.7	2.5	2.5	2.4
Net Dividend (sen)	5.0	4.0	2.2	1.9	2.3
Net Dividend Yield (%)	12.5	9.9	5.6	4.8	5.8

Source: Company, MIDFR

Chart 1: Sabah's SAIDI

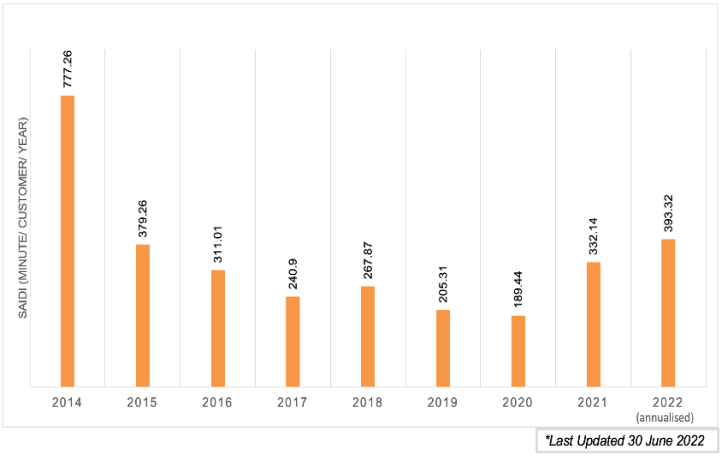
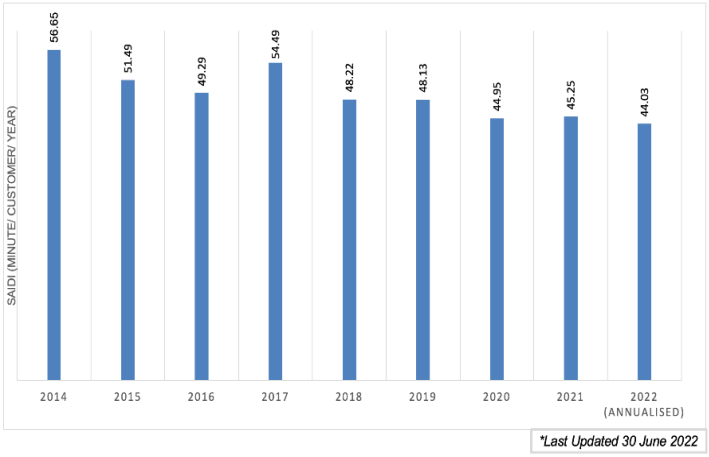
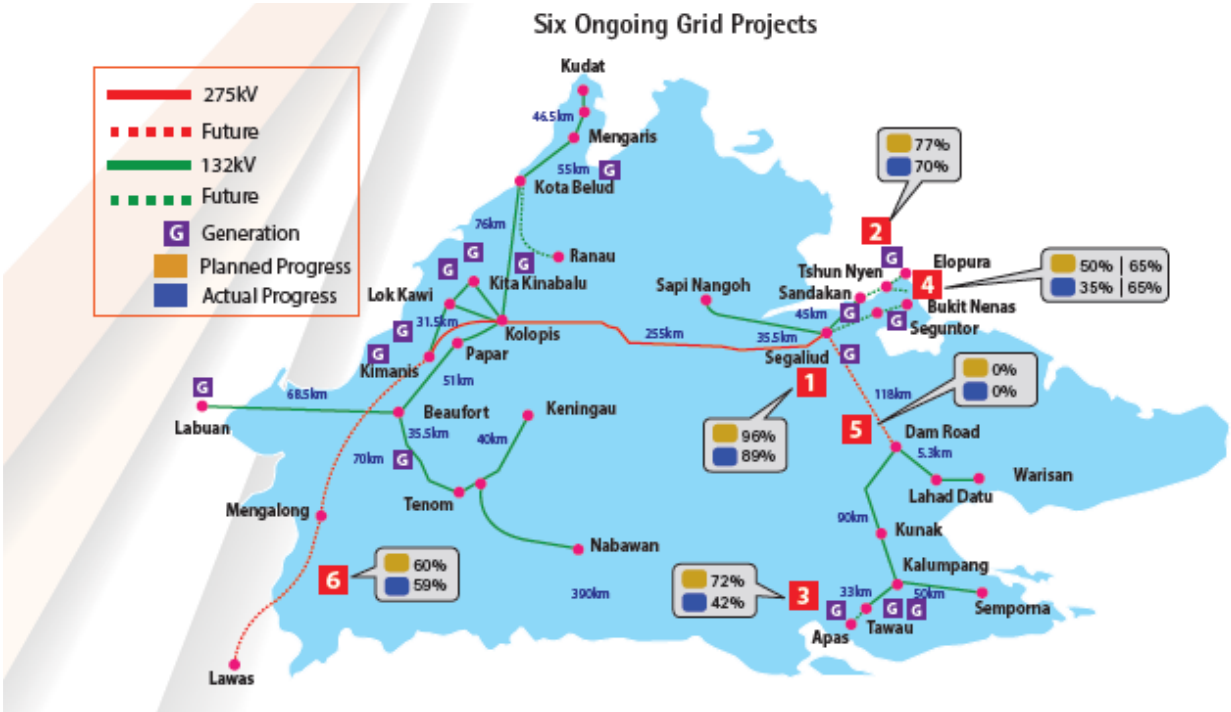


Chart 2: Peninsular Malaysia's SAIDI



Source: EC, MIDFR

Exhibit 1: Six key grid upgrade projects in Sabah



Source: EC, MIDFR

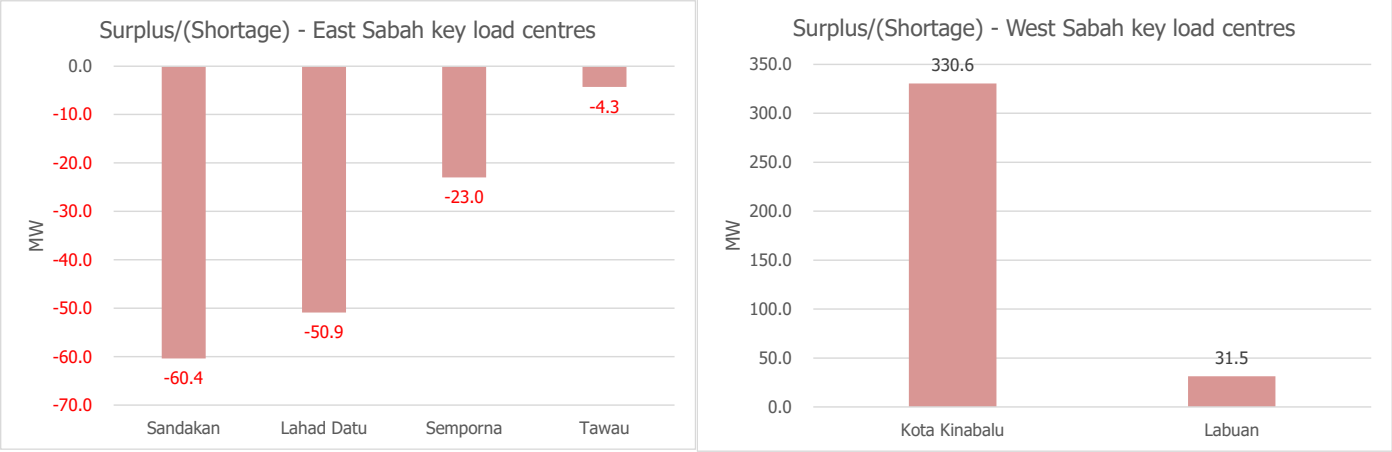
Table 1: Detail of key grid upgrade projects in Sabah

No.	Grid Upgrade Projects
1	New line 132kV (Segaliud to Seguntor + 15MVA transformer)
2	New line 132kV (Sandakan-Elopura)
3	New PMU and new line 132kV Apas
4	New PMU and PPU Bukit Nenas, New line 132kV (Tshun Nyen-Sandakan-Seguntor)
5	Upgrading 132kV to 275kV (Segaliud to Damroad) + 240MVA at Damroad
6	New line 275kV (Kimanis-Mengalong)

Source: EC, MIDFR

Opportunity in generation capacity build-up. Besides suffering from a shortage of capacity, East Sabah also relies heavily on expensive diesel generators. We estimate diesel capacity to account for >80% of East Sabah's capacity mix. We therefore anticipate abundant opportunities for new plant-up projects, in particular cleaner gas-powered types. Based on Sabah's power generation development plan, a total 392MW of new generation capacity is expected to come on-stream comprising 100MW in 2024 and 100MW in 2025. Another 192MW capacity from the Upper Padas hydro plant is expected to come onstream in 2027. We acknowledge however, that gas supply remains a challenge for East Sabah, which as a result could see some of the planned capacity expansion taking place in West Sabah, leveraging on the improved West-to-East transmission instead. We understand that Ranhill has submitted a bid for a 100MW gas power plant to be located in the West Coast of Sabah under a tender called by the EC. The project is expected to achieve a first COD in April 2024.

Chart 3: East Sabah suffers from shortage of power capacity



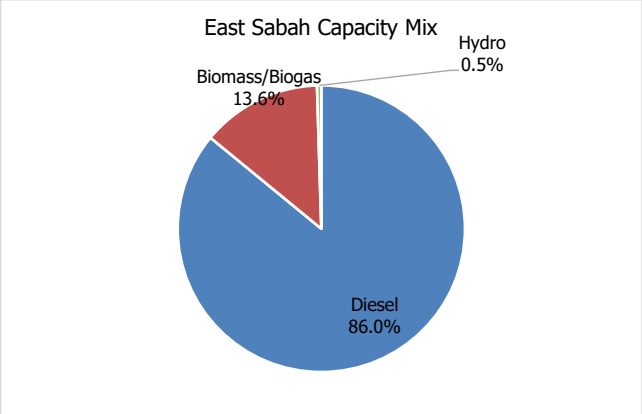
Source: EC, MIDFR

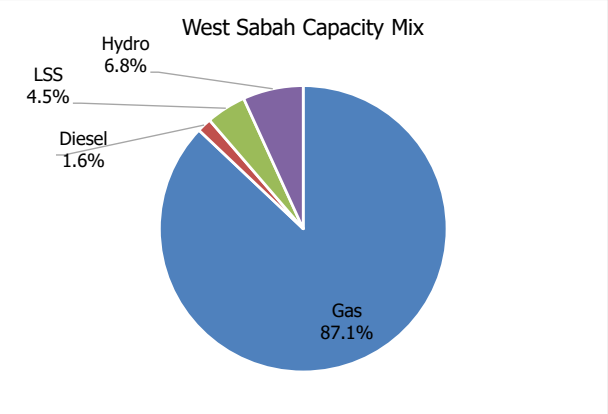
Table 2: Sabah generation development plan

Year	West Coast	East Coast	Retirement
2022	Sarawak Interconnection (30MW) (delayed, tentatively 2023)		
2023			
2024		New Capacity of 100MW	Diesel Genset (135MW)
2025		New Capacity of 100MW	
2026			Patau-Patau (103MW)
2027		Upper Padas HEP (192MW)	

Source: Sabah Electricity Supply Outlook 2019, MIDFR

Chart 4: Capacity mix comparison between West and East Coast Sabah





Source: EC, MIDFR

Table 3: Performance of Ranhill's power plants in Sabah

	FY19	FY20	FY21	*SESB KPI*
RP1 (Capacity: 190MW)				
Equivalent Availability Factor	95.07%	92.89%	92.54%	*87%*
Unplanned Outage Rate	0.99%	2.56%	1.65%	*4%*
Energy Output (GWh)	1,276	1,155	1,145	*1,129*
RP2 (Capacity: 190MW)				
Equivalent Availability Factor	93.57%	95.86%	97.59%	*94%*
Unplanned Outage Rate	2.85%	2.96%	1.77%	*4%*
Energy Output (GWh)	1,058	1,145	1,174	*1,168*

Source: Company, MIDFR

Prepping for potential RP1 extension? Ranhill recently finalized plans to raise a total RM310m from a Sukuk Murabahah program. Though the proceeds will mostly go towards financing the group's LSS4 solar plant in Bidor, Perak, a sum of RM80m has been allocated for refurbishment of the group's RP1 CCGT plant in Kota Kinabalu which entails a net capacity of 190MW. This is in preparation of a potential extension of RP1's concession, which is currently scheduled to expire in October 2029. Ranhill is proposing to the EC for a further 8-year extension to RP1's PPA till 2037 to meet the growing power demand in Sabah. To meet the generation capacity required for the extension period, the group is looking to purchase, refurbish and replace gas turbine motors at the plant as well as undertake upgrades of other plant components. We expect any extension to RP1's PPA to be a positive and value accretive to Ranhill.

SABAH ENTAILS HUGE RE POTENTIAL

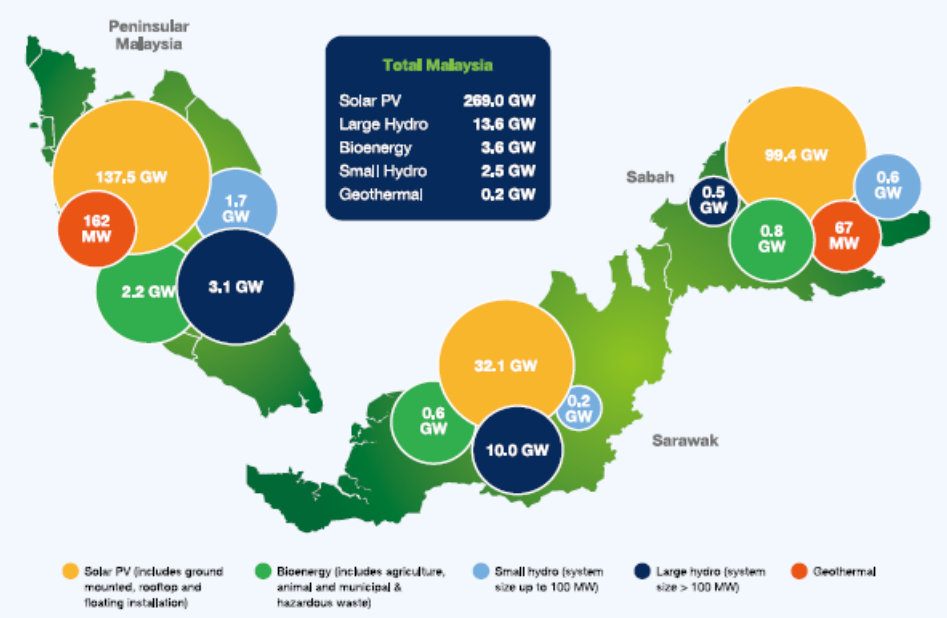
Malaysia's Renewable Energy Roadmap (MyRER) shortlisted a total of 289GW RE potential in Malaysia. Notably, some 35%, or 101GW of this potential is identified in Sabah. In fact, Sabah's RE potential is much larger than neighboring Sarawak's 42.9GW RE resource, which has seen its hydro potential being developed well.

Massive solar resource. Given Sabah's location in the Northernmost tip of the Borneo Island, the state entails very good irradiation, making it a good location for solar generation (typically, irradiation rate improves as one moves North of Malaysia – See Exhibit 3) given better proximity to the equator. Reflecting this, 98% (or 99.4GW) of Sabah's RE potential comes from solar resources, followed distantly by bioenergy at 0.8% (0.8GW), small hydro at 0.6% (0.6GW) and large hydro at 0.5% (0.5GW). Ranhill's recent 50MW package win under the LSS4 bidding cycle (Peninsular Malaysia) should provide the group with the necessary experience and track record in large scale solar development, which can be capitalized to develop Sabah's huge solar potential, we believe. Wholly-owned Ranhill Bersekutu (RBSB) is undertaking the group's LSS4 project as the main EPCC contractor. Having said that, from a broader perspective, we think the overall unlocking of Sabah's RE potential will have to come with the required improvement in grid network and capability to handle intermittence from variable RE sources as well as interconnection to RE sites.

Houses geothermal resource. Interestingly, Sabah also houses one of only two geothermal resources in the country located in Tawau, Sabah (with the other located at Ulu Slim, Perak). We understand that Ranhill is putting in a 2nd attempt to develop Tawau's geothermal resource entailing a 67MW potential. However, so far there has been no concrete outcome

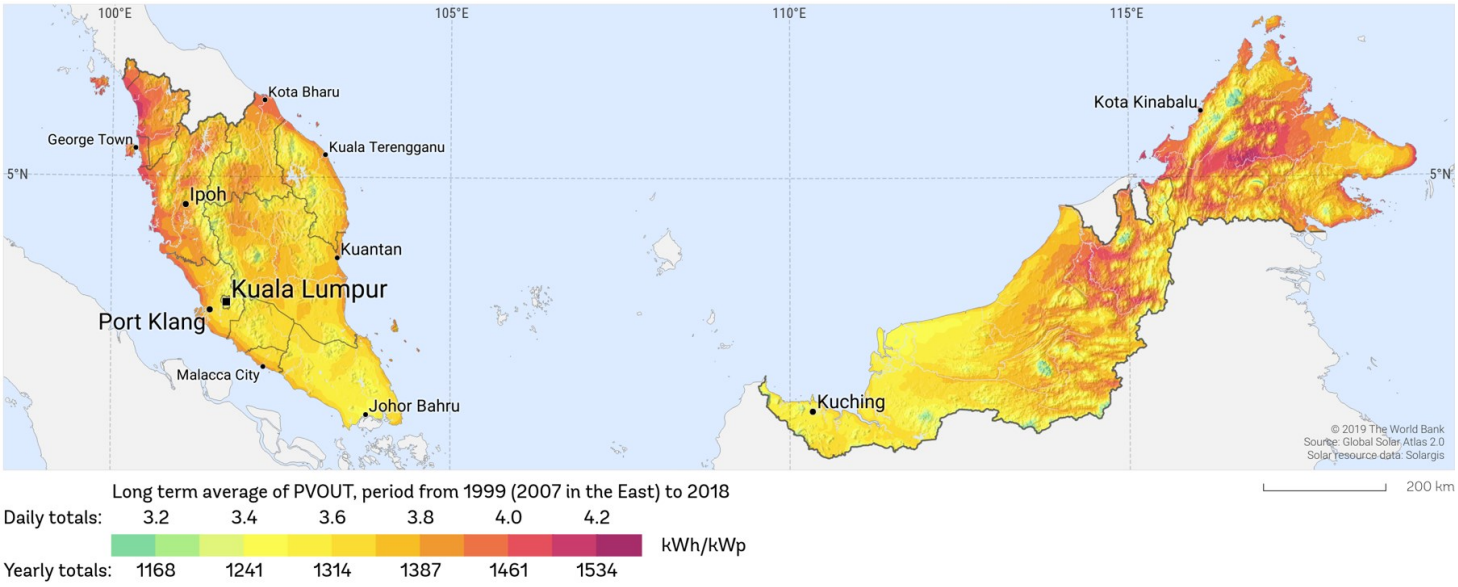
from discussions with the regulators. While understandably, geothermal is an expensive RE source (estimated capital cost of USD4.5m/MW), geothermal gets around the typical intermittence and poor capacity factor issue associated with solar RE given comparable reliability to traditional power plants and up to 30-year plant life before major refurbishments are required.

Exhibit 2: 289GW of RE potential in Malaysia



Source: SEDA, MIDFR

Exhibit 3: Malaysia solar irradiation map – Sabah entails one of Malaysia's best solar irradiations



Source: World Bank Group, MIDFR

New water tariffs could remove a key overhang. A key overhang for Ranhill has been the delay in tariff hike for 80%-owned RSAJ (water operator for the state of Johor), which has been overdue since 2015. However, the Federal Government had in late-July approved a nationwide water tariff increase for the non-domestic sector of an average 25sen/m³ in late-July this year. We understand that the tariff hike for Johor is awaiting the final 'green light' by the State Government. While Johor already has the highest tariffs in Malaysia, we expect Johor's tariff hike to track the national average increase closely with the hike for the 2nd tariff band possibly coming in only slightly lower. We also expect a marginal increase in minimum monthly rates for the non-domestic sector, which currently stands at RM30/month. While tariff hikes tend to be politically sensitive, we think the Government is tactical in not increasing domestic (residential) tariffs and instead focusing on the commercial/industrial sectors (which are profit-making entities). Despite the absence of tariff hike for the domestic sector, we note that the non-domestic sector is the main contributor to RSAJ's revenue given higher blended tariffs and volumes garnered with a typical 60:40 non-domestic:domestic split for the latter prior to the pandemic. We estimate the tariff hike

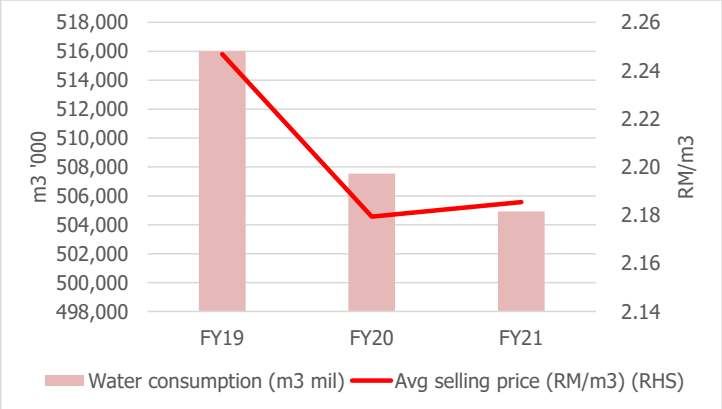
could increase RSAJ's blended tariff by 3%-5% (depending on eventual recovery of non-domestic consumption) and conservatively expect this to improve overall group earnings by 7%-12% against FY22F base.

Table 4: Johor's current water tariff by sector

Type of Use	Utilisation	Rate per cubic metre (RM)	Minimum Rate (RM) (monthly)
Domestic	0 m3 - 20 m3	0.80	7
	21 m3 - 35 m3	2.00	
	> 35 m3	3.00	
Religious Institutions / Welfare Approved	Average rate	1.60	7
Domestic Bulk	Average rate	1.60	16
Non-domestic	0 m3 - 35 m3	2.80	30
	>35 m3	3.30	
Shipping	Average rate	7.00	50
Water Treatment Company (Water Kiosk)	Average rate	7.00	50

Source: Company, MIDFR

Chart 5: RSAJ water consumption & blended tariff



Source: Company, MIDFR

Turning the corner? Having seen significant retracement in the past year, we think Ranhill's share price is close to bottoming with the contraction in RSAJ's earnings from an absence of tariff hike priced in and reflected in consensus earnings revision. We anticipate several key catalysts in FY23F: (1) Materialisation of a tariff hike for RSAJ, (2) Ranhill's LSS4 project to reach COD (commercial operation date) latest by December 2023, (3) Completion of the Sabah grid upgrade in FY23, which will improve dispatch for RP1 and RP2.

Recommendation. We maintain our **BUY** call and keep our SOP-derived **TP** at **RM0.67**. We like Ranhill for its earnings expansion prospects: (1) Expansion into Indonesia source-to-tap water supply (605MLD capacity) – in the midst of finalizing Memorandum of Agreement and Memorandum of Understanding as well as tender launch by the Indonesian authorities, (2) LSS4 project which is expected to reach COD (commercial operation date) by December 2023, (3) Completion of the Sabah Wast-East transmission line upgrade in 2023 which should drive higher dispatch from RP1/RP2 to Sabah's East Coast, (4) Potential tariff hike for RSAJ. Dividend yield remains decent at 4.8%/5.8% over FY22F/23F, while valuations are undemanding at 2.5x FY22F EV/EBITDA, circa 30% discount to historical mean.

Table 5: Ranhill Sum-of-Parts Valuation

Units/Concessions	Valuation method	Value (RMm)	Stake	Shares out.	RM/share
RP 1	DCF; EV (WACC: 7%)	63.5	60.0%	1,295.9	0.03
RP 2	DCF; EV (WACC: 7%)	179.0	80.0%	1,295.9	0.11
Water (SAJ)	DCF; EV (WACC: 9%)	1,196.4	80.0%	1,295.9	0.74
NRW	Construction Sector EV/EBITDA (9x)	77.6	100.0%	1,295.9	0.06
Associates	PER (10x)	165.8		1,295.9	0.13
RBSB/RWSB	Construction Sector EV/EBITDA (9x)	168.8		1,295.9	0.13
Gross SOP value		**1,682.4**			**1.20**
	Group net cash/(debt)	*(684.4)*		*1,295.9*	*-0.53*
SOP value		**998.0**		**1,295.9**	**0.67**

Source: Company, MIDFR

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology