Corporate Update | Friday, 21 October 2022

Ranhill Utilities Berhad

(5272 | RAHH MK) Utilities | Water

Maintain BUY

Proxy to Sabah Power

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

KEY INVESTMENT HIGHLIGHTS

- **4%-5% capacity factor improvement from higher dispatch to East Sabah**
- **Incremental demand from new manufacturing plants to account for 12% of Sabah's power capacity**
- **Exploring solar+BESS, wind and geothermal in Sabah, solar VPPA for RSAJ in the works**
- **Earnings impact from RSAJ tariff hike could be much stronger than expected**
- **Maintain BUY at unchanged TP of RM0.67**

We visited Ranhill's CCGT power plants in Kota Kinabalu, Sabah recently. The meeting was hosted by Ranhill Power's CEO, Ir. Dr. Zahrul Faizi as well as the management team at both Ranhill Power Division and Ranhill Utilities Bhd.

Largest IPP in Sabah. As a quick background, Ranhill is the largest IPP in Sabah controlling a 30% market share. It operates two CCGT (combined cycle gas turbine) power plants under 60%-owned Ranhill Powertron (RP1) and 80%-owned Ranhill Powertron 2 (RP2), each with 190MW capacity, located at the Kota Kinabalu Industrial Park, Sabah. RP1 and RP2 operate under PPAs with SESB till 2029 and 2032 respectively, the former under a BOO (Build-Operate-Own) arrangement and the latter, BOT (Build-Operate-Transfer). The power division contributes circa 10% to the group's annual earnings.

Grid upgrade to address East Sabah undercapacity. The Sabah power system suffers from frequent interruptions, partly contributed by undercapacity in East Sabah. Load in East Sabah is partly supported by capacity from West Sabah, but is currently limited to 216MW given grid limitations. Upgrade works of the West to East transmission link is currently being undertaken which will improve West to East dispatch capacity by +85% to 400MW in 2023 (See Exhibit 1 & Table 1).

Load factor to improve upon grid upgrade completion. Ranhill's power plants are expected to benefit from higher power dispatch from West to East Sabah once the grid upgrade is completed. The group estimates a 4-5% improvement in capacity factor from the current average of 71%. According to management, every 10% improvement in capacity factor is expected to improve RP1's PAT by RM1m/annum, while for RP2, a larger RM2.5m/annum. RP2's earnings are more sensitive to changes in capacity factor given its PPA structure which has lower weighting on capacity payment (which is a fixed payment provided the plant is made available to the grid, regardless of load factor) and higher weighting on variable operating rate (which is paid only on dispatch of power), compared to RP1. Assuming a 5% improvement in combined load factor post-grid upgrade, we estimate circa RM1.3/annum incremental earnings or a 3.6% enhancement to the overall group's FY22F earnings base.

RETURN STATISTICS	
Price @ 20th October 2022 (RM)	0.36
Expected share price return (%)	+85.7
Expected dividend yield (%)	+5.4
Expected total return (%)	**+91.1**

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	1437.72
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)	463.91
52-wk price range	RM0.35 - RM0.66
Beta vs FBM KLCI (x)	0.63
Monthly volatility (%)	15.03
3-mth average daily volume (m)	0.85
3-mth average daily value (RM'm)	0.36
Top Shareholders (%)	
Hamdan (L) Foundation	20.05
Cheval Infrastructure Fund	18.88
Mohamad Hamdan	10.22

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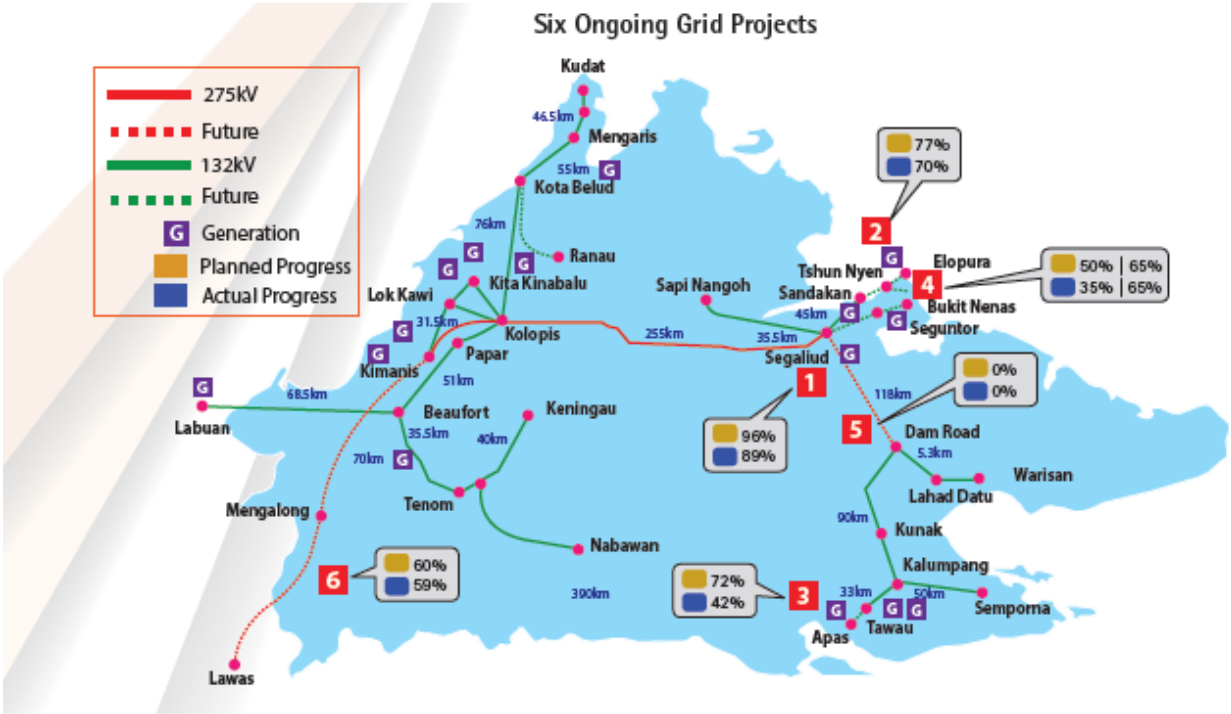
RANHILL: EARNINGS SUMMARY

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)	4.7	7.5	13.9	13.1	10.9
EV/EBITDA (x)	1.7	2.6	2.4	2.4	2.3
Net Dividend (sen)	5.0	4.0	2.2	1.9	2.3
Net Dividend Yield (%)	13.9	11.0	6.2	5.4	6.4

Source: Company, 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

Exhibit 2: Power flow in the Sabah grid



Source: EC, MIDFR

Demand gap-up driven by new manufacturing plants. Sabah's power system currently entails a reserve margin of 23% vs. total dependable capacity of 1267MW. Two new manufacturing plants in KKIP are expected to contribute to incremental demand of 150MW, or an additional +14% against the current peak demand of 1046MW. At the same time, significant new capacity is only expected to come on-stream from 2024 onwards:

(1) South Korea's **SK Nexilis**'s new manufacturing plant located at Kota Kinabalu Industrial Park (KKIP) is expected to commence operations in 2023. SK Nexilis is a producer of copper foil used in EV batteries. With annual production capacity of 50K tons/annum, the new facility in KKIP is expected to triple SK Nexilis' global copper foil manufacturing capacity. This new plant in KKIP is expected to lift power demand by 70MW once in operations next year, accounting for some 5.5% of Sabah's total dependable power capacity of 1268MW.

(2) China's **Kibing Group**, a glass manufacturer for PV applications is investing in a new solar glass manufacturing plant in KKIP (part of a total RM2b investment in Sabah which also includes silica sand mining and silica processing plant in Kudat). Once completed in 2024, Kibing's KKIP plant is expected to lift power demand by an additional 80MW, accounting for 6% of Sabah current dependable power capacity.

Over the next 2 years, incremental load from the two new manufacturing plants is expected to be distributed among the existing West Sabah IPPs including RP1 and RP2. Combined with improved dispatch capacity to East Sabah of an additional 184MW from 2023 onwards, we estimate incremental load of 334MW for West Sabah IPPs, making up 26% of existing dependable capacity in the next 2 years - this should drive a further gap-up in load factor at the IPPs, resulting in improved earnings going forward.

Table 2: Sabah's Power Capacity Status

	West Cost	East Coast	Total
Dependable Capacity (MW)	1048	219	1267
Peak demand (MW)	702	344	1046
Reserve Margin	49%	-38%	23%
West-East Capacity Transfer (MW)	216		Maximum transfer capacity
	216		Average transfer

Source: Company MIDFR

Table 3: Key indicators of Ranhill's Sabah power plants

	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%*
Capacity Factor	76.7%	69.2%	68.8%	
RP2 (Capacity: 190MW)				
Equivalent Availability Factor	93.57%	95.86%	97.59%	*94%*
Unplanned Outage Rate	2.85%	2.96%	1.77%	*4%*
Capacity Factor	63.6%	68.7%	70.5%	

Source: Company, MIDFR

Bidding for new 100MW CCGT power plant. A tender for a new 100MW CCGT power plant in Sabah which is targeted for COD (commercial operation date) in 2024 has been called by the EC (Energy Commission), in which Ranhill had submitted a bid. The plant was originally planned to be located in East Sabah under the State's power generation development plan (PGDP). However, given challenges in supplying gas to the East Coast, the planned power plant has been relocated to the West Coast where gas supply is available, leveraging instead, on the improved dispatch capacity once the West to East transmission link upgrade is completed next year. Outcome of the 100MW plant tender is expected in October 2022. However, we do not rule out some minor delays due to the upcoming general elections. We gather that there are only four bidders for the project (including Petronas) - management believes Ranhill has a competitive edge in its strong track record operating the largest capacity in Sabah as well as a competitive cost base by partly leveraging on its existing infrastructure. Ranhill conservatively expects a mid-single-digit project IRR for its bid.

More capacity to be tendered out. To cater for increased demand, there is another 100MW gas powered capacity expected to be tendered out by the EC which will be relocated to the West Coast with a targeted COD in 2025. Other than these, the Upper Padas hydropower project is expected to be completed in 2027 contributing an additional 192MW in 2027.

Table 4: Sabah generation development plan

Year	West Coast	East Coast	Retirement	Status
2021	Telekosang Hydro		Tawau (47MW), TSH (10MW)	*Plant 1: 24MW (COD: Dec 2022), Plant 2: 16MW (COD: Dec 2022)*
2022	Sarawak Interconnection (50MW)			
2023				
2024		New Capacity of 100MW	Diesel Genset (135MW)	*Move to West Coast where gas supply is available*
2025		New Capacity of 100MW		*Move to West Coast where gas supply is available*
2026	*Potentially: (1) Sg. Maligan hydro (31MW) (2) Ulu Padas hydro (129MW)*		Patau-Patau (103MW) - old plant operated since 1983 and frequently shut down for rectifications	
2027		Upper Padas Hydroelectric (192MW)		
2028				
2029			RP1 CCGT (190MW), Sepangar Bay CCGT (100MW)	*Ranhill has made a proposal to extend the PPA up to 2037*

Source: Company, Sabah Electricity Supply Outlook 2019, MIDFR

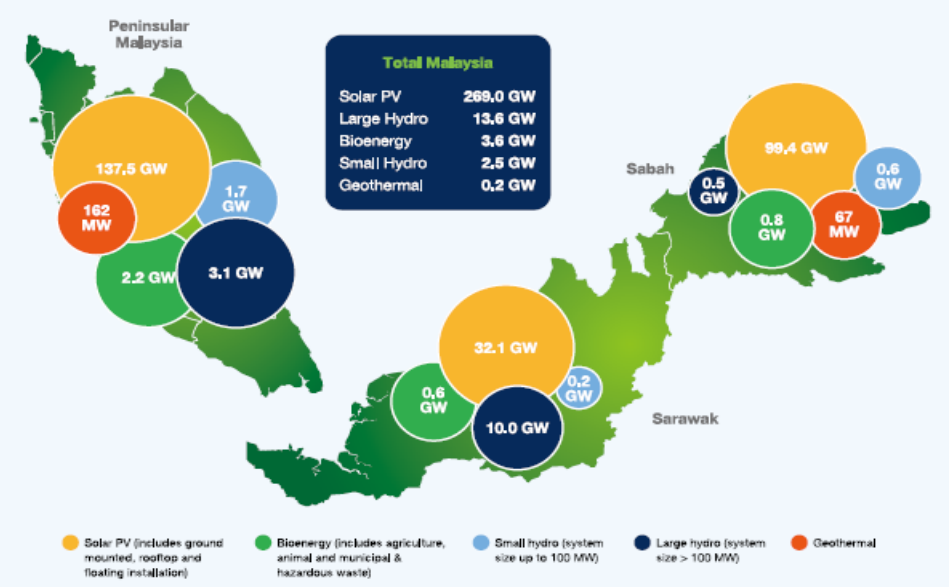
Good vibes on RP1 extension proposal. During our visit, Ranhill shared that it has submitted a proposal to the regulators to extend RP1's PPA by an additional 8 years from the original expiry in 2029. Our subsequent meeting with representatives from UPEN (State Economic Planning Unit) during the same visit suggested that there is a good chance that RP1 will see its extension approved given RP1's competitive cost and Sabah's insufficient power capacity which is coupled with scheduled

retirement of some of the existing plants over the next 7 years. It is however, still early to determine returns from the potential extension pending the actual approval and tariff determination by the regulator.

EYEING OPPORTUNITIES IN SABAH'S RENEWABLE ENERGY

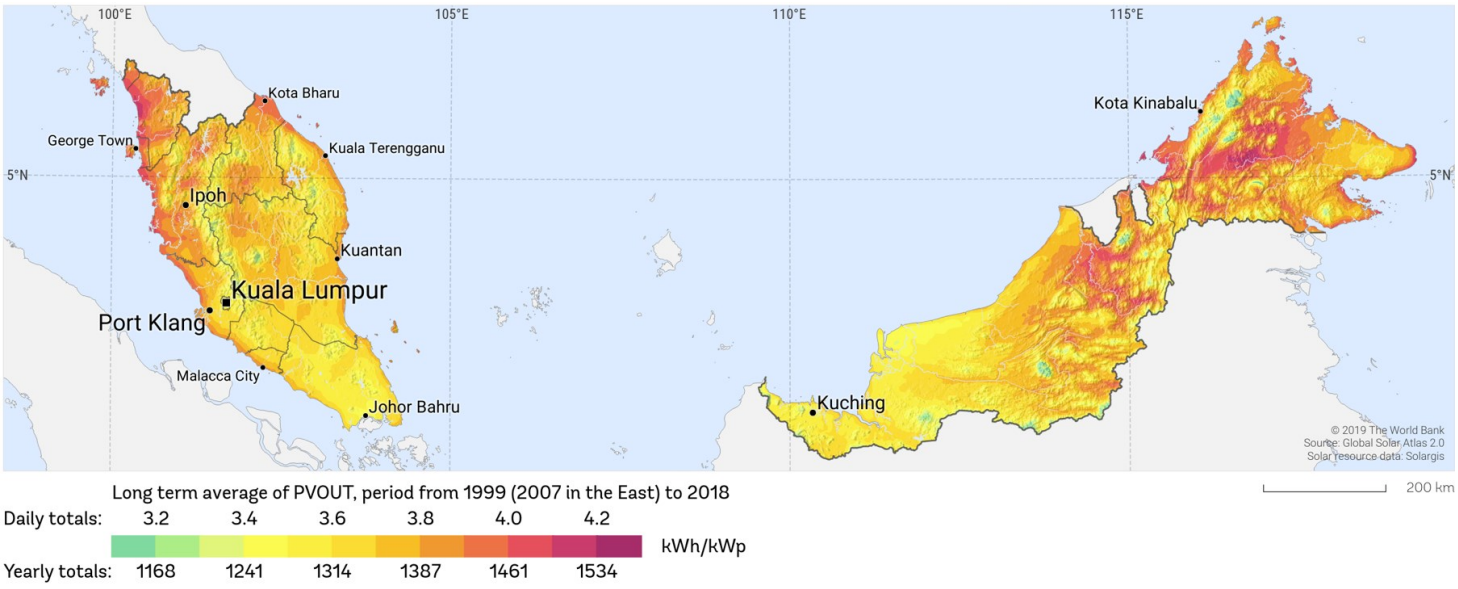
Solar+BESS as solution to East Sabah's capacity woes. Sabah accounts for over a third of the RE potential in Malaysia with an identified 101GW of RE resource. Solar in particular makes up the bulk of Sabah's RE potential whereby it enjoys the best solar irradiance levels among the states in the country. Ranhill has been making headway in the RE space with its recent 50MW win in the LSS4 bidding cycle for Peninsular Malaysia. For Sabah specifically, we gather that Ranhill has submitted a proposal to the Federal Government to for the development of solar and battery energy storage systems (BESS) to address the undercapacity situation in East Sabah, which is currently heavily reliant on expensive diesel power plants (See Chart 1). The use of solar+BESS as alternative to diesel power plants makes a viable case in our view as oil & distillate-based power generation costs as high as RM1.02/kwh (based on extrapolated FY21 statistics from Tenaga Nasional). Additionally, considering that Sabah entails a small grid, a solar+BESS setup should allow the group to get around the issue of the Sabah grid hitting its solar penetration limit (of 20%). The group has identified potential locations for solar in Sandakan, Lahad Datu and Tawau for East Sabah, as well as Kota Kinabalu in West Sabah.

Exhibit 3: Some 35% of Malaysia's 289GW RE potential is located in Sabah



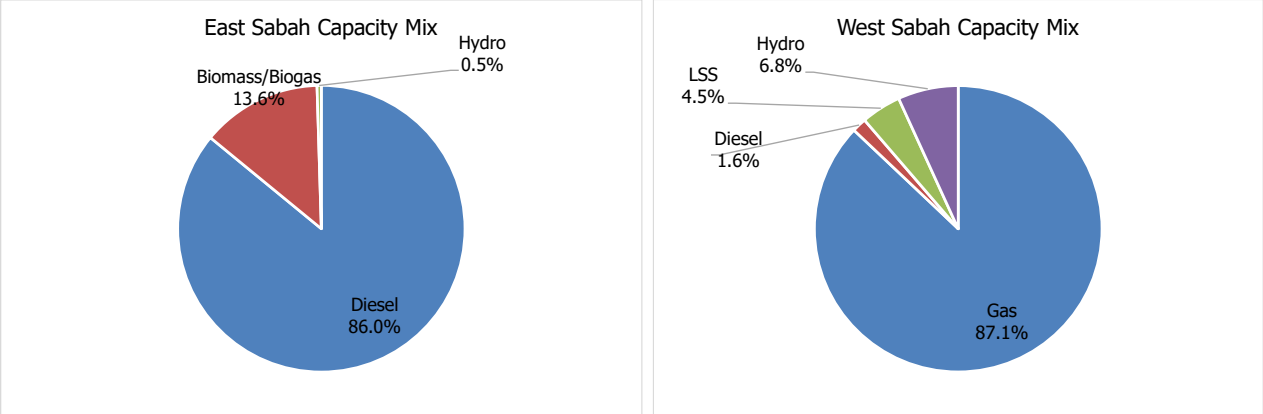
Source: SEDA, MIDFR

Exhibit 4: Malaysia solar irradiation map – Sabah entails one of Malaysia's best solar irradiations



Source: World Bank Group, MIDFR

Chart 1: East Coast Sabah is heavily reliant on expensive diesel power plants



Source: EC, MIDFR

Exploring wind power. Ranhill had back in 2017 proposed the construction of a 50MW wind farm in Kudat. We learnt that there is sufficient wind resource in this area to justify the proposal, at estimated 5.0-6.5m/s wind speed based on a 70m-120m mast height setup. However, at potential levelized tariff of 90sen/kwh (based on the given windspeed), it was challenging to justify the use of wind power as an alternative to Sabah's heavily subsidised gas power plants (which sources gas at just RM6.40/mmbtu compared to Peninsular Malaysia's ~RM30/mmbtu). As the capital cost for wind power infrastructure continued to reduce over the years coupled with improvements in capacity factor, Ranhill is considering revisiting this proposal. Global average installed cost for onshore wind has reduced by some 29% over the past decade, and by 15% since 2017 specifically, to USD1355/kw (RM6.2m/MW) in 2020. Our subsequent meetings with UPEN and Sabah Electricity Sdn Bhd (SESB) confirm that the regulators are relooking at proposals to revive the Kudat wind project.

Revisiting geothermal. In 2015, Ranhill was involved in the initial development of a geothermal project in Tawau, Sabah. We gather that the group is still keen to continue to explore the geothermal potential with the support of the Federal Government and is currently awaiting the reinstatement of a Feed-in-Tariff (FiT) quota for geothermal development. Based on Malaysia's Renewable Energy Roadmap, Tawau houses one of only two geothermal resources in the country (with the other located at Ulu Slim, Perak).

DEVELOPMENTS IN PENINSULAR MALAYSIA

Targeting early completion of LSS4 plant. As for the group's current 50MW LSS4 development in Batang Padang, Perak, we gather that the project is progressing smoothly. A RM310m Sukuk program was recently launched with the 1st tranche (of RM122m) to fund the solar plant development having secured sufficient takers, we understand. Ranhill is targeting for early completion of the plant in September 2023 vs. the extended deadline granted by the EC which is by December 2023. Positively, the 4-year PPA extension granted by the EC for the project is expected to raise IRR by 1ppt.

Solar power for RSAJ could enhance bottomline significantly. Ranhill is also exploring substituting part of 80%-owned Ranhill SAJ's (RSAJ) current electricity consumption with self-generated solar power. The water assets managed by RSAJ consumes an average load of 150MW, translating into electricity cost of around RM114m/annum. Substitution with solar could potentially reduce this cost by a quarter from the current effective tariff of ~40sen/kwh that it is currently paying and enhance RSAJ's PBT by RM25m-30m/annum (i.e., 18%-21% of group pretax profit). The group is exploring adopting the Virtual PPA mechanism for this with an initial 50MW capacity. The solar plant is expected to be located in Johor with the land lease already secured.

A booster from RSAJ tariff hike. Another positive outcome from our meeting with Ranhill Utilities' management present at the meeting was in regards to the potential tariff hike for RSAJ. To recap, the Federal Government had already approved an average 25sen/m3 tariff hike for the non-domestic sector nationwide. Ranhill expects a 4.6% impact to revenue from the hike (which is within our earlier estimated 3%-5% range). However, the impact to bottomline could be much larger than our earlier expectation as most of the increase will likely flow down to bottomline. This is given that RSAJ is currently operating at well below its regulated 9% PAT margin. In a base case scenario, we expect Ranhill's annual earnings to return to the

RM40m-RM50m level once the tariff hike is implemented. It is currently pending the final approval and implementation by the Johor State Government, whereby we expect further clarity on this post-General Elections.

Table 5: 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

Reaching an inflection point? Having seen significant retracement in the past year, we opine Ranhill's share price is closing in on an inflection point with the contraction in RSAJ's earnings from a delay in tariff hike well priced in and reflected in consensus earnings revisions. In contrast, we anticipate several key catalysts to materialize in FY23F: (1) A tariff hike for RSAJ, (2) Commissioning of Ranhill's LSS4 project by September 2023, (3) Completion of the Sabah grid upgrade in FY23 and commencement of SK Nexilis' copper foil manufacturing plant in KKIP, which will increase load and improve dispatch for RP1 and RP2. Any earlier than expected commencement of the solar VPPA for RSAJ is a bonus catalyst, in our view.

Recommendation. We maintain our **BUY** call and keep our SOP-derived **TP** at **RM0.67**. We like Ranhill for its earnings expansion prospects: (i) 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, (ii) LSS4 project which is expected to reach COD (commercial operation date) by September 2023, (iii) Completion of the Sabah Wast-East transmission line upgrade in 2023 which should drive higher dispatch from RP1/RP2 to Sabah's East Coast, (iv) An imminent 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 6: 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