

27 March 2023

Utilities

Softening Fuel Prices Largely a Boon

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NEUTRAL



We remain **NEUTRAL** on the sector as most key stocks are fully valued. Having said that, the sector offers earnings defensiveness, particularly due to their regulated asset base model which provides recurring dividends for yield seekers. Recent softening of fuel prices augurs well for fuel consumers **TENAGA** (MP; TP: RM10.00) and **PETGAS** (MP; TP: RM17.13), but works against **GASMSIA** (MP; TP: RM3.54) as lower gas prices erode retail margins. Meanwhile, it is business as usual for IPPs such as **YTLPOWER** (OP; TP RM: RM1.09) and **MALAKOF** (OP; TP: RM0.95) as their earnings are secured by water-tight PPAs. Our top pick for the sector is **YTLPOWER**.

Power utility: Fuel costs are tapering. We project electricity demand growth of 1.8% in CY23, which is slightly higher than the guided growth of 1.7% under the RP3 parameter. The demand growth will be driven largely by the recovery in the industrial sector in Peninsular Malaysia. In terms of fuel costs (for both coal and gas), we believe they have already peaked in 4QCY22. For instance, the Indonesian benchmark coal price has retracted by 5% YTD to an average of USD291/MT from USD307/MT in 4QCY22. As a result, **TENAGA** guided for a lower Imbalance Cost Pass-through (ICPT) of RM12.0b in 2HFY23 vs. RM16.2b in 1HFY23 (**TENAGA** will fully recover the amount from: (i) a 20 sen/kWh ICPT surcharge from non-domestic customers, and (ii) a RM10.4b payment from the government. This will result in its ICPT receivables declining to RM12b by June 2023, from RM16.9b in 4QFY22. A strong cashflow will help to bring down **TENAGA**'s debts and interest serving cost. Recall, **TENAGA** was hit by high borrowing cost in 4QFY22 as it resorted to short-term borrowing to fund working capital due to ballooning under-recovery of fuel cost.

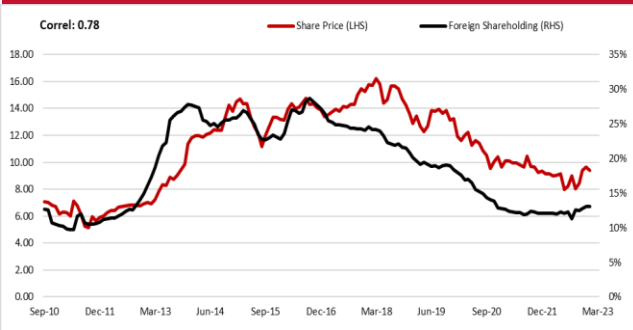
Gas utilities: Earnings intact despite lower WACC under RP2. A lower WACC under the RP2 for gas utilities commencing Jan 2023 is cushioned by the expanding regulated asset base (RAB). We estimate that the WACC under RP2 is at a high 7% for **PETGAS** and 7.3%-7.5% for **GASMSIA**. Additionally, under RP2, **PETGAS** is allowed to pass through forex fluctuation and gas prices.

The softening of fuel prices recently augurs well for **TENAGA**. This is because while it can pass on the higher fuel costs under the ICPT regime, there is always a time lag. Similarly, lower gas prices are positive to **PETGAS** as its non-regulated business, namely, the utilities division uses gas as fuel to generate and supply power, steam and industries gasses to industries. On the flip side, weaker gas prices work against **GASMSIA** as its retail margins are calculated based on a fixed percentage on the gas price.

PowerSeraya drives YTLPOWER's earnings growth. With improved operating environment (higher retail price and stable input cost) in Singapore, PowerSeraya and the newly acquired Tuaspring (effective June 2022) should deliver sustained profitability. Recall that PowerSeraya (FYE June) posted pre-tax losses of RM242.1m and RM172.4m in FY19 and FY20, respectively, before turning around with a PBT of RM591.4m in 1HFY23. PowerSeraya will continue to drive **YTLPOWER's** earnings growth. Meanwhile, **MALAKOF** should also see improved earnings stability having completed the low-pressure turbine blade failure repair works in Feb 2022 at its 1,000MW coal-fired power plant Tanjung Bin Energy. To recap, the failure resulted in unplanned outages from 4QFY21 to 1QFY22. On the other hand, **SAMAIDEN** (OP; TP: RM1.15) is expected to see a stronger 2HFY23 on accelerated progress billings from its order book of c.RM325m that will keep it busy for the next 2-3 years.

We remain **NEUTRAL** on the sector as most key stocks are fully valued. Having said that, the sector offers earnings defensiveness, particularly due to their regulated asset base model, and hence recurring dividends for yield seekers. **YTLPOWER** is our sector top pick for: (i) improved earnings prospects with the turnaround of PowerSeraya, and, (ii) resilient Wessex Water's earnings, which should anchor a dividend yield of c.6%.

TENAGA: Share Price vs. Foreign Shareholding



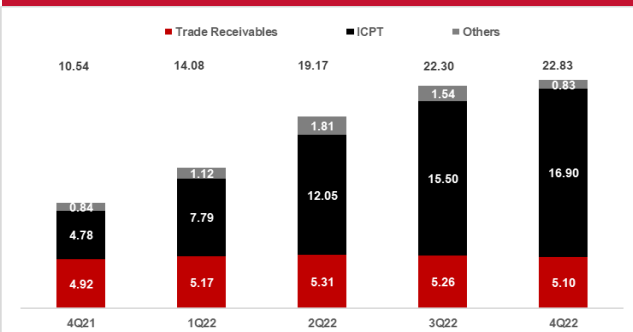
Source: Company/Bloomberg

Indonesia Coal Benchmark Price



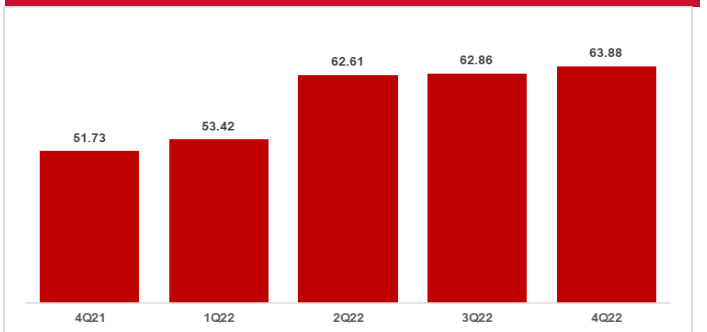
Source: Company/DIBots

TENAGA: Trade & Other Receivables



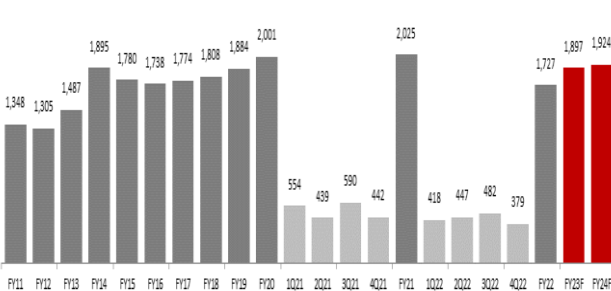
Source: Bloomberg

TENAGA: Borrowings



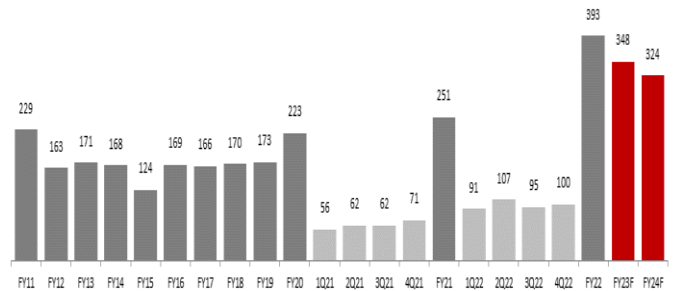
Source: Company

PETGAS: Profitability



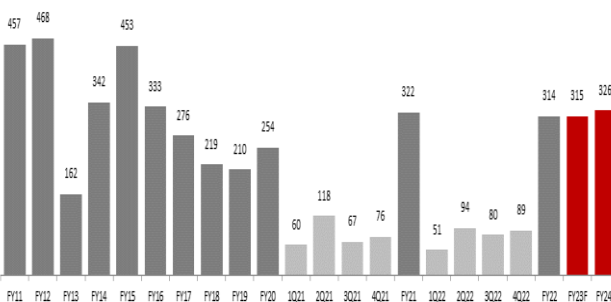
Source: Company

GASMSIA: Profitability



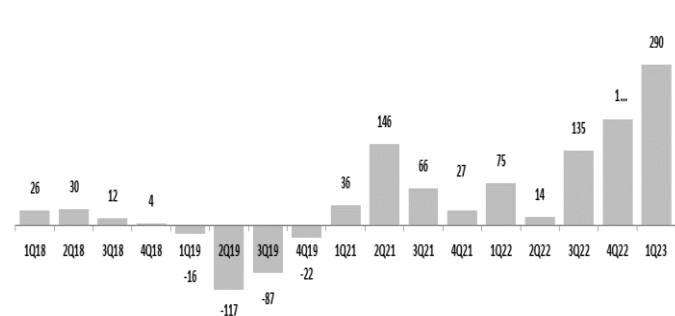
Source: Company

MALAKOF: Profitability



Source: Company

YTLPOWR: PowerSeraya Quarterly PBT



Source: Company

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Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
GAS MALAYSIA BHD	MP	3.14	3.54	12.74%	4,031.8	Y	12/2023	27.1	25.2	-11.5%	-6.8%	11.6	12.4	2.9	26.2%	19.0	6.1%
MALAKOFF CORP BHD	OP	0.685	0.950	38.69%	3,347.6	Y	12/2023	6.5	7.1	3.7%	8.4%	10.5	9.7	0.6	5.9%	5.2	7.6%
PETRONAS GAS BHD	MP	16.12	17.13	6.27%	31,897.2	Y	12/2023	95.8	97.2	9.8%	1.4%	16.8	16.6	2.4	14.3%	81.5	5.1%
SAMAIDEN GROUP BHD	OP	0.920	1.15	25.00%	354.2	Y	06/2023	4.7	5.5	16.9%	15.9%	19.5	16.9	2.8	15.5%	0.0	0.0%
TENAGA NASIONAL BHD	MP	9.54	10.00	4.82%	54,884.4	Y	12/2023	83.2	84.4	24.1%	1.4%	11.5	11.3	0.9	8.0%	41.6	4.4%
YTL POWER INTERNATIONAL BHD	OP	0.855	1.09	27.49%	6,927.3	N	06/2023	9.8	10.6	207.9%	8.9%	8.8	8.0	0.5	6.1%	5.0	5.8%
Sector Aggregate					101,442.4					24.4%	2.1%	12.5	12.2	1.7	12.7%		4.8%

Source: Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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