

05 July 2023

## Utilities

### Defensive Earnings with Decent Yields

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**OVERWEIGHT**



We upgrade the utilities sector to **OVERWEIGHT** from **NEUTRAL** following our upgrade on **TENAGA** (OP; TP: RM10.64). We like the sector for its earnings defensiveness and decent dividend yields of 4%-6%. Furthermore, their earnings are backed by a regulated asset base model which offers recurring dividends for yield seekers. Recent easing fuel prices are positive to **TENAGA** and **PETGAS** (MP; TP: RM17.13) but negative for **GASMSIA** (MP; TP: RM3.54) as lower gas prices erode retail margins. Nonetheless, the earnings impact is neutral over the long term given the fuel cost pass-through mechanism. Our top pick for the sector is **YTLPOWER** (OP; TP: RM1.48) for the promising prospects of PowerSeraya, defensive Wessex's earnings and its exciting new data centre and digital banking ventures.

#### 1. Power Utility

**Tapering fuel costs.** We project electricity demand growth of 1.8% in 2023, 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. Meanwhile, fuel costs, both coal and gas prices are trending lower since the beginning of the year after a stellar rally in 2022 due to the global energy crisis triggered by the Russian-Ukraine war. The Indonesian benchmark coal price has retracted by 32% YTD to USD191/MT currently from USD281/MT in Dec 2022. As a result, **TENAGA** guided for a lower Imbalance Cost Pass-through (ICPT) of RM9.0b in 2HFY23 vs. RM16.2b in 1HFY23. This will result in its ICPT receivables declining to RM10.2b by June 2023, from RM16.9b in 4QFY22. In the just announced tariff review for 2HCY23, tariff surcharge for non-domestic medium and high voltage users will be reduced to 17 sen/kWh from 20 sen/kWh surcharge imposed in 1HCY23. Meanwhile, the government has also introduced a targeted subsidy for the first time as heavy domestic users (consumes >1,500 kWh) will have to pay 10 sen/kWh surcharge in 2HCY23. On the other hand, the decline in ICPT receivables would result stronger cash flows which would help to bring down **TENAGA's** debts and interest cost in 2HFY23. Recall, **TENAGA** was hit by high borrowing cost in 4QFY22 (+19% YoY to RM1.14b) as it resorted to short-term borrowing to fund its working capital due to ballooning under-recovery of fuel cost.

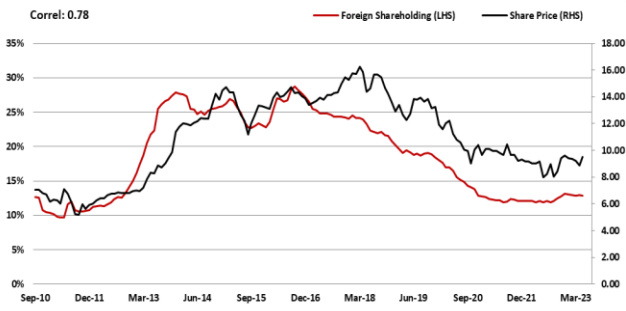
#### 2. Gas Utilities

**Mixed impact from a lower gas price.** While the movement of gas prices has neutral impact in the longer run given the regulated framework, the current declining gas price trend has a positive impact on **PETGAS** in the immediate term as low gas price leads to lower internal gas consumption (input cost) for its regulated business as well as non-regulated utilities segment. The utilities segment uses gas as fuel to generate and supply power, steam and industries gasses to industries. However, weaker gas prices work against **GASMSIA's** non-regulated retail margin which is calculated based on a fixed percentage on gas selling price.

**Singapore IPP to sustain YTLPOWER's earnings growth.** **YTLPOWER's** solid earnings from PowerSeraya is expected to sustain at least in the next 2-3 years as the good retail price is likely to be supported by no plant-up in Singapore while input cost, i.e., gas prices are likely remain low as it has locked in low gas prices, secured during the early days of the pandemic which will last for the next 2-3 years, keeping its fuel cost low. Meanwhile, Wessex Water should turn profitable from 4QFY23 (FYE: Jun) thanks to a c.9% tariff hike to adjust for inflationary adjustment from April 2023, while Attarah Power Plant in Jordan which just commenced operation end-May is a new earnings source for **YTLPOWER**. On the other hand, the sharp decline of coal prices has negative impact on **MALAKOF** (OP; TP: RM0.80) as its 1QFY23 results were hit badly by fuel margin loss of RM70m as its weighted average coal cost came in higher than the applicable coal price (ACP). However, as the drop in ACP is gradual of late, the impact on earnings will be less significant in the medium term. **SAMAIDEN** (OP; TP: RM1.15) is expected to see stronger earnings from 4QFY23 (FYE: Jun) on accelerated progress billings from its order book of c.RM246m that will keep it busy for the next 2-3 years.

We upgrade the utilities sector to **OVERWEIGHT** from **NEUTRAL** following our upgrade on **TENAGA** in May. We continue to like the sector for its earnings defensiveness, particularly due to their regulated asset base model, and hence recurring decent dividend yield of 4%-6% for yield seekers. **YTLPOWER** remains our sector top pick for the promising prospects of PowerSeraya, defensive Wessex Water's earnings and its exciting new data centre and digital banking ventures.

TENAGA: Share Price vs. Foreign Shareholding



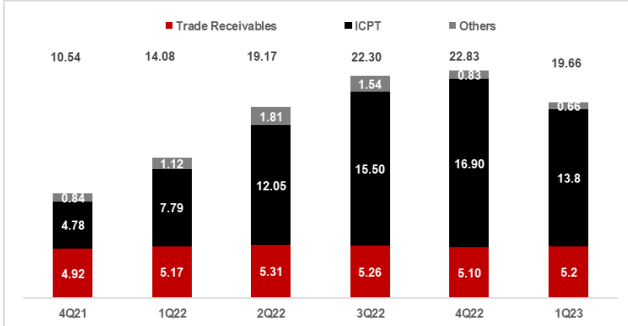
Source: Company/Bloomberg

Indonesia Coal Benchmark Price



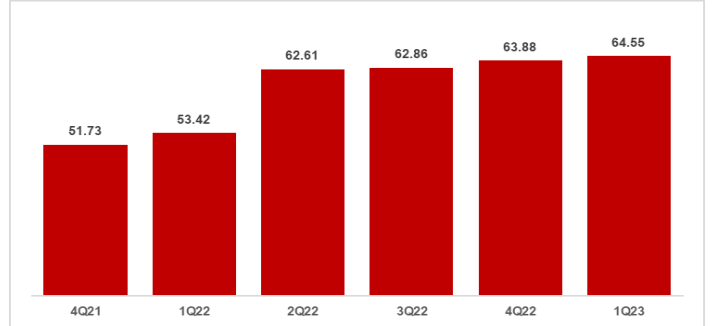
Source: Bloomberg

TENAGA: Trade & Other Receivables



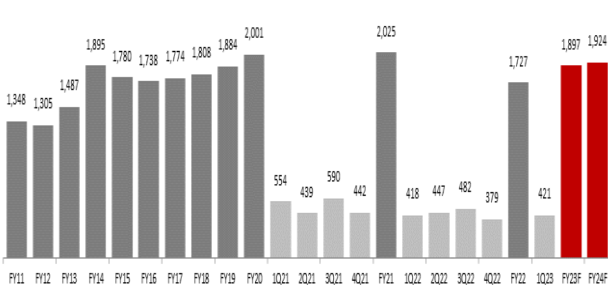
Source: Bloomberg

TENAGA: Borrowings



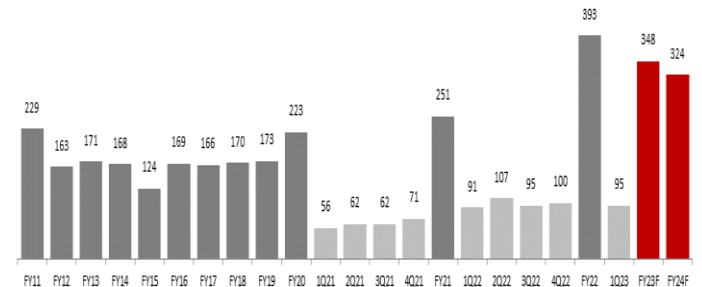
Source: Company

PETGAS: Profitability



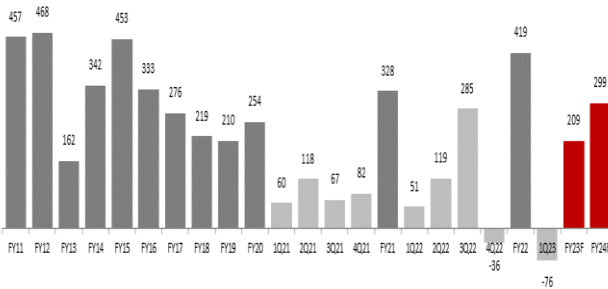
Source: Company

GASMSIA: Profitability



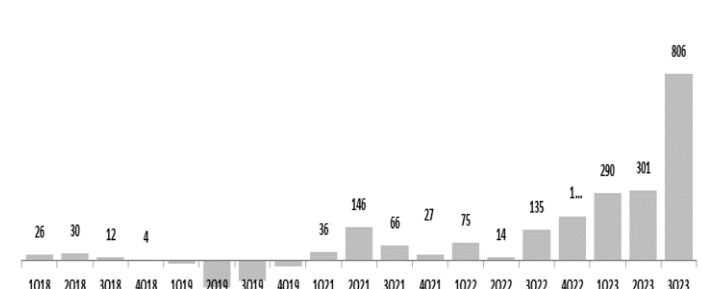
Source: Company

MALAKOF: Profitability



Source: Company

YTLPOWR: PowerSeraya Quarterly PBT



Source: Company

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## Peer Table Comparison

Name	Rating	Last Price @ 16/6/2023 (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.				
<b>Stocks Under Coverage</b>																	
GAS MALAYSIA BHD	MP	3.08	3.54	14.9%	3,954.7	Y	12/2023	27.1	25.2	-11.5%	-6.8%	11.4	12.2	2.9	26.2%	19.0	6.2%
MALAKOFF CORP BHD	OP	0.595	0.800	34.5%	2,907.7	Y	12/2023	4.2	6.0	-50.2%	43.4%	14.3	9.9	0.5	3.7%	3.3	5.5%
PETRONAS GAS BHD	MP	16.90	17.13	1.4%	33,440.6	Y	12/2023	95.8	97.2	9.8%	1.4%	17.6	17.4	2.5	14.3%	81.5	4.8%
SAMAIDEN GROUP BHD	OP	1.03	1.15	11.7%	399.0	Y	06/2023	3.2	4.4	0.5%	35.0%	31.8	23.6	4.0	13.5%	0.0	0.0%
TENAGA NASIONAL BHD	OP	9.13	10.64	16.5%	52,838.3	Y	12/2023	83.2	84.4	24.1%	1.4%	11.0	10.8	0.9	8.0%	41.6	4.6%
YTL POWER INTERNATIONAL BHD	OP	1.27	1.48	16.5%	10,289.7	N	06/2023	15.0	12.3	374.2%	-18.3%	8.4	10.3	0.7	8.3%	5.0	3.9%
<b>Sector Aggregate</b>					<b>103,830.1</b>					<b>27.2%</b>	<b>-0.7%</b>	<b>12.3</b>	<b>12.4</b>	<b>1.9</b>	<b>12.3%</b>		<b>4.2%</b>

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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