Headline	Liberalisation of electricity retail sector may result in more		
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Liberalisation of electricity retail sector may result in more competitive tariffs for consumers

Utilities sector

Maintain overweight: Energy, Science, Technology, Environment and Climate Change Minister Yeo Bee Yin said a study is being conducted to determine whether liberalising the electricity retail sector will result in more competitive tariffs for consumers. If the government decides to proceed with the plan, it would mean Tenaga Nasional Bhd (TNB) is no longer the sole choice for consumers in Peninsular Malaysia to buy electricity.

TNB's share price retraced 4% last Friday, partly as a result of the said news. We believe the selldown is unwarranted, and the share price weakness an opportunity to accumulate for sustainable dividend yields of 4%. Opening up the retail market, where TNB has a natural monopoly, will not hurt TNB because it earns 2% or 0.96 sen per kilowatt hour (kWh) of base electricity tariff of 39.45 sen per kWh of revenue from the retail market. The Incentive-based Regulation (IBR) is based on return of regulated asset base. The retail segment is asset-light, therefore TNB earns minimal profits as Peninsular Malaysia's only provider of retail electricity.

Key rerating catalysts include TNB or independent power producers (IPPs) such as Malakoff Corp Bhd, YTL Power International Bhd or Edra Global Energy Bhd winning new solar power plant contracts from the upcoming Large Scale Solar 3 (LSS3) tender; an active capital management; and market reforms eliminating the fuel risk for TNB.

Our top pick is TNB with a target price (TP) of RM15.10 for its good earnings visibility under the IBR framework and an undemanding valuation. At our discounted cash flow-based TP, the stock would trade at 15 times financial year 2019 (FY19) price-earnings ratio (PER) and 7.6 times enterprise value per earnings before interest, taxes, depreciation and amortisation.

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TNB is trading at an attractive 13.6 times 2019 PER, below the market's mid-teens valuation. Given a strong cash flow visibility under the IBR framework, we believe the valuation discount is unwarranted. An active capital management will provide the scope for a further share price upside. The stock offers a 4% dividend yield for 2019.

Gas Malaysia Bhd (TP: RM2.90) offers stable operations and a mandate to pay out at least 70% of net profit to shareholders. We have projected a 5% net dividend yield for 2019 as the IBR implementation — a 7.5% return on assets — will anchor earnings, and any fluctuations in gas prices will be passed to industrial end-users. Gas Malaysia offers a 5% to 6% top-line growth thanks to a strong take-up from the glove manufacturing, food and beverage, and glass sectors. A better entry level is at RM2.50, providing an upside of 15%. — *UOB Kay Hian, July 8*