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Power reform commences

TNB remains sector's top pick. For others, the excitement is elsewhere

BY ADAM AZIZ

KUALA LUMPUR: Last year, Malaysia's power sector was given a glimpse of the industry reform announced by the government under the Malaysian Electricity Supply Industry 2.0 2019-2025 initiative. It has set the tone of things to come: more excitement in the renewable space, as well as market liberalisation in different parts of the value chain that will unfold progressively.

This year will see how independent power producers (IPPs) react to the trials to open up the transmission grid, and to try out independent fuel sourcing.

That aside, many local IPPs are also making progress in their overseas ventures, which were initiated in the absence of new power purchase agreements (PPAs) in the local space — a norm for the years to come.

Pilot for third-party fuel sourcing, grid access happening this year

In the first quarter of this year (1Q20), a pilot is scheduled to facilitate up to 100 megawatts (MW) of green energy through a tripartite contract (TPC) between renewable energy (RE) supplier, purchaser and grid owner Tenaga Nasional Bhd (TNB), which is entitled to interim network charges.

The TPC is a precursor to the third-party access of TNB's transmission and distribution network. According to analysts, while a TPC could help a green IPP secure off-take, the interim network charges may also weigh on the competitiveness of the arrangement versus selling to the grid directly.

Few listed candidates have sizeable RE capacity currently — the largest being TNB itself with hydro

and solar plants, followed by Cypark Resources Bhd, which has licences for over 300MW of combined RE capacity.

Considering the small market size for TPC pilot and the interim network charges, analysts view the impact of TPC to be minimal to TNB's earnings of around RM5 billion annually, of which over 60% comes from its regulated asset base (transmission and distribution). Unfortunately the much-awaited reform to open up the electricity retail segment will not happen this year, as the pilot is scheduled for 2Q21.

Meanwhile, the pilot for independent fuel is scheduled to begin in 4Q20. Fuel cost makes up 42% of the average electricity tariff in Malaysia, and is passed down to consumers via the imbalance cost pass-through mechanism in the tariff structure.

Presently, IPPs source coal from TNB Fuel Services Sdn Bhd, while gas is sourced from Petronas Energy and Gas Trading Sdn Bhd.

For gas, regulated piped gas price for the power sector was RM28.70 per million British thermal units (mmbtu) as at October 2019, compared with the liquefied natural gas-indexed unregulated piped gas price of RM31.67/mmbtu.

Under the gas cost pass-through mechanism, the revision of RM1.50/mmbtu increase for regulated piped gas price happens every three months — meaning it could reach market parity with unregulated prices by as early as mid-2020.

In 2018, 45% of coal and gas procured for the power industry went to the IPPs. If IPPs can source fuel cheaper, they can get better margins and pass down some of the cost reduction to consumers via lower tariffs. TNB has stated before that it

supplies coal at lowest delivered cost. Interestingly, Maybank Kim Eng analyst Tan Chi Wei said in a note that TNB has also obtained liquefied natural gas cargo supply in a trial from Shell Malaysia in October last year at a price that is below TNB's subsidised cost.

Among listed IPPs with gas/coal power assets overseas are YTL Power International Bhd and Malakoff Corp Bhd. YTL Power has experience across the value chain, as it is operating a multi-utility business in Singapore which includes power generation, utilities supply (steam, natural gas and water), oil storage tank leasing and oil trading.

TA Research analyst Kylie Chan said TNB Fuel is likely to have better credit terms and bargaining power over its fuel suppliers. "This is given its larger scale as it consolidates fuel purchases from a pool of generation companies. However, we await details from the European Commission on the actual mechanics of this new practice," she said in a note.

Otherwise, if TNB needs to procure less fuel for IPPs, that would help free its cash flow for other purposes as well. TNB remains the sector's top pick, after its shares were beaten up by news of the industry reform and the additional RM4 billion tax bill it recently received. The counter has fetched 16 "buy" calls — among the highest by FBM KLCI stocks currently — and seven "hold" calls, with target prices ranging from RM13.40 to RM16.40 versus its close of RM12.98 last Friday.

More excitement in renewables, overseas projects

Additionally, the Energy Commission (EC) will introduce the revamped spot market platform dubbed New

Enhanced Dispatch Arrangement platform (Neda+) by June 2020, which will allow non-contracted IPPs to auction in both energy and capacity market, instead of just energy market available previously. Time will tell if owners of other older plants are excited to stay in the game via Neda+.

TNB decommissioned its 1,400MW gas power plant in Paka, Terengganu just two weeks ago. It was reported that YTL Power, too, has decommissioned its 390MW Pasir Gudang plant whose PPA ended in 2017. There are three expired PPAs in 2019 with combined capacity of 1,075MW, and another 322MW to add in August this year.

Meanwhile, investors should keep an eye open for the coming fourth Large Scale Solar Photovoltaic (LSS4) tenders, as the EC has announced the winning bids for the 500MW under LSS3 late last month.

Companies are also openly exploring ways to commercialise the net-energy metering (NEM) mechanism, as there is a sizeable outstanding quota of 340MW to be taken up by the public by end-2020.

Including the LSS4 — said to amount to 2,000MW — and the NEM, Malaysia is short of 2,500MW in RE generation to increase its green energy mix to 25% of total generation mix by 2025, from 2% in 2018.

Interest towards LSS and NEM projects are coming from companies of many segments, including Solarvest Holdings Bhd, oil and gas services group Uzma Bhd and infrastructure firm Pestech International Bhd to name a few.

Other interesting developments for Malaysia's utility firms are currently happening overseas. Mega First Corp Bhd's 80%-owned 260MW

Don Sahong hydro power project in Cambodia has started commercial generation since November 2019 for a 25-year period.

Don Sahong is a catalyst for Mega First, with bumper results expected in the upcoming quarter. All three analysts covering the company gave a "buy" call ranging from RM5.50 to a high of RM6. The counter closed at RM5.43 last Friday.

Over the next few months, investors should also keep an eye on YTL Power and Malakoff, two stocks with dividend yields of 6% and 7% respectively at current share price levels.

YTL Power's 45%-owned 470MW shale oil power plant in Attarat, Jordan is slated to commence its 30-year PPA beginning in the middle of this year.

If all goes well, it is also expecting to reach financial close of its 80%-owned 1,320MW Tanjung Jati A coal-fired power project in Indonesia over the next few months.

Still, as commercialisation is far away and amid concerns over its Singapore multi-utility business under YTL PowerSeraya and telecommunications business Yes 4G, most analysts are "neutral" on the stock — average target price stood at 73 sen per share, compared to its close of 81 sen last Friday.

On the other hand, Malakoff sees some upside, as its Tanjung Bin Power Plant's operation is expected to fare better after certain incidents in 2019. Some analysts are also "positive" on its takeover of Alam Flora Sdn Bhd, said to contribute 10% of its annual earnings of around RM275 million moving forward.

With seven "buy" calls of 10 analysts covering Malakoff, average target price stood at 99 sen against its close of 87 sen last Friday.