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Power demand growth expected to be sustained in 2019

Power sector

Maintain overweight: For the cumulative nine months of 2018, power demand in Peninsular Malaysia registered a +2.7% growth driven by industrial and domestic segments, in line with our expectations of +2.5% for 2018. We expect the power demand growth to sustain at +2% to +2.5% in 2019, based on 0.5 times of gross domestic product forecast of +4.6% for the year.

The implementation of incentive-based regulation (IBR) and imbalance cost pass-through (ICPT) remains intact for 2018 to 2020. Under the new ministry of energy, science, technology, environment and climate change (Mestecc), minister Yeo Bee Yin approved for a second time a hike of up to 2.55 sen per kWh in average tariff — on top of a base tariff of 39.45 sen per kWh — to 42 sen per kWh for the first half of 2019 (1H19), from the current level of 40.80 sen per kWh in 2H18. Exceptionally for the domestic segment, the government will continue subsidising it through the Kumpulan Wang Industri Elektrik and maintain the average tariff for the segment at 39.45 sen per kWh during the period.

Mestecc is a strong proponent of renewable energy (RE), targeting 20% of the country's power generation from RE, including large-scale hydropower generation, by 2025. Given new large-scale hydropower plants' limited potential in Peninsular Malaysia, we expect Mestecc to push for more solar power projects in future, to partially replace the outgoing power plants and fulfil growing power demand. The government had recently announced the awarding of 550MW large-scale solar (LSS) for Peninsular Malaysia and Sabah — as part of its existing target of 2,200MW LSS for 2017 to 2020 for Peninsular Malaysia and Sabah — and net energy metering for private solar photovoltaic projects.

Tenaga Nasional Bhd (TNB) also initiated the Supply Agreement for RE for solar energy products. Large independent power producer players would be negatively affected by the government's aspiration towards RE, as they face the risk of lower capacity replacement — each LSS capacity is only up to 30MW — for their expiring power purchase agreements.

We maintained our "overweight" rating on the power sector, given its earnings and dividend sustainability amid an increasing market uncertainty in 2019. We maintained our "buy" recommendation on TNB with a target price (TP) of RM16.40, and YTL Power International Bhd with a TP of RM1.25. We maintained our "buy" recommendation on TNB with an unchanged discounted cash flow to equity-derived TP of RM16.40. TNB's earnings remain shielded under the IBR/ICPT mechanisms. The disappointing third quarter of financial year 2018 (3QFY18) results were affected by the RM420 million fuel cost under-recovered during the quarter, which would be recovered in the following 4QFY18.

We maintained our "buy" recommendation on YTL Power with an unchanged TP of RM1.25 based on a 15% discount to sum of parts of RM1.47. YTL Power is currently trading at an attractive 0.5 times price-to-book, while its high dividend payout is sustainable from the stable Wessex Water Services Ltd and Paka power plant, offsetting the uncertainty in Seraya Power before a potential recovery when Seraya Power ends the take-or-pay contract for liquefied natural gas supply by calendar year 2020. Further, the commencement of Attarat Power in Jordan and Jawa Power in Indonesia by 2020 would provide a further upside in earnings for the group. — *Hong Leong Investment Bank Research, Jan 14*

Power sector peers comparison

STOCK	MKT CAP (RM MIL)	PRICE (RM)	TARGET (RM)	RATING	FYE	PER (X) FY18/19	PER (X) FY19/20	P/B (X) FY18/19	P/B (X) FY19/20	ROE (%) FY18/19	YIELD (%) FY18/19
Tenaga	78,820.3	13.86	16.40	Buy	Dec	11.3	10.7	1.3	1.2	11.7	4.3
YTLP	6,792.6	0.89	1.25	Buy	June	11.1	10.1	0.5	0.5	5.1	5.6
Malakoff	3,959.2	0.81	NR	NR	Dec	18.8	15.9	0.7	0.6	3.5	5.8

Source: Hong Leong Investment Bank Research