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# 'Utility stocks with cheap valuations offer higher returns'

## Utilities sector

**Maintain overweight rating:** What often stops investors from buying a seemingly undervalued stock is the fear that its price will go even lower. In this report, we argue that in the long run, utility stocks with cheap valuations offer higher returns to investors than those with rich valuations. Our analyses show that the stocks with relatively cheaper valuations — Tenaga Nasional Bhd (TNB), YTL Power International Bhd and Cypark Resources Bhd — not only offer more favourable risk-reward, but also stronger long-term earnings growth prospects than Petronas Gas Bhd, Malakoff Corp Bhd and Gas Malaysia Bhd.

Utility stocks under our coverage can be roughly divided into two camps. Firstly, those with earnings uncertainty or ambiguity, such as TNB, YTL Power and Cypark, trade at only nine to 16 times calendar year 2017 forecast (CY17F) price-earnings ratio (PER). Secondly, those with historically stable and predictable earnings, such as Petronas Gas,

Malakoff and Gas Malaysia, trade at steep valuation levels of 17 to 24 times CY17F PER.

Our analyses show that the valuations of stocks in the former camp will still be on par, if not cheaper, than those of stocks in the latter camp even if all the key earnings risks of the former materialise. This, coupled with the probability that the earnings risks may never happen, means that the former group offers far superior risk-reward than the latter.

On top of that, TNB, YTL Power and Cypark have stronger earn-

ings growth prospects than Petronas Gas, Malakoff and Gas Malaysia. Companies in the former camp, in our opinion, operate in an environment where there is an abundance of horizontal expansion opportunities.

We believe cheap utility stocks could react more strongly to positive news than to negative news as positive news gives the market a reason to buy the stocks, while the impact of negative news is buffered by their already-cheap valuations.

TNB remains our top pick for

the sector as its valuation is not only relatively cheaper, it also has a strong potential near-term rerating catalyst. TNB currently trades at only 10.8 times CY17F PER and may raise its dividend payout as part of its initiative to optimise its capital structure. — *CIMB Research, July 13*

TNB's valuation is not only relatively cheaper, it also has a strong potential near-term rerating catalyst. The Edge file photo



## Utilities sector

COMPANY	RECOM	PRICE (LC*)	TP (LC*)	MARKET CAP (US\$ MIL)	CORE PER (X)		3-YEAR EPS CAGR (%)	P/BV (X)		RECURRING ROE (%)		EV/EBITDA (X)		DIV YIELD (%)	
					CY2016	CY2017		CY2016	CY2017	CY2016	CY2017	CY2016	CY2017	CY2016	CY2017
Tenaga Nasional	Add	14.18	16.40	20,038	10.8	10.8	5.8	1.47	1.34	14.1	13.0	6.4	5.9	2.6	2.6
YTL Power International	Add	1.40	1.45	2,705	15.3	15.8	-17.9	0.99	0.99	6.4	6.3	11.6	12.8	6.4	6.4
Cypark Resources Bhd	Add	1.96	2.30	124	10.2	9.0	1.0	1.34	1.20	12.4	14.0	11.3	9.2	2.6	2.6
Petronas Gas	Hold	22.34	22.30	11,068	25.1	24.5	1.2	3.69	3.53	14.5	14.8	14.3	13.4	2.8	2.9
Gas Malaysia Bhd	Reduce	2.38	1.80	765	27.1	18.4	-0.3	3.15	3.15	11.3	17.1	15.4	11.7	3.7	5.4
Malakoff Corp	Hold	1.62	1.55	2,028	14.4	16.9	12.0	1.36	1.32	9.3	7.9	7.7	7.6	4.9	4.1
<b>Malaysia Average</b>					<b>15.2</b>	<b>14.8</b>	<b>2.2</b>	<b>2.06</b>	<b>1.94</b>	<b>12.8</b>	<b>12.4</b>	<b>9.0</b>	<b>8.5</b>	<b>3.1</b>	<b>3.1</b>

\*LC: Local currency

Source: CIMB, company reports, Bloomberg