

Headline	Positive outlook forecast for power sector in second half
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Positive outlook forecast for power sector in second half

PETALING JAYA: The power utilities sector remains positive given its defensive earnings with good visibility, despite a challenging second half envisioned for industry players, said Kenanga Research.

In a sector update report yesterday, the research house said the power utilities sector is still a good avenue for investors who are looking for a defensive play.

"The valuation for the overall sector is not demanding at 2018 calendar year price-earnings ratio of 12 times, which is below the FBM KLCI's 16 times," said Kenanga Research.

Going forward, the second half of 2017 is deemed challenging for the industry players as Tenaga Nasional Bhd (TNB) will continue to witness rising fuel costs, though this is earnings neutral to TNB on a lagged basis that will pass through to the consumers eventually.

In addition, the new power purchase agreement (PPA) extension for Malakoff Corp Bhd's Segari Energy, which takes effect in July, will see its capacity payment reduced by at least half from the previous PPA term.

Likewise, YTL Power International Bhd will face the same fate for its Paka Power Plant when the new PPA extension starts in September.

As for Pestech International Bhd, its work progress in Cambodia will be affected tremendously, as the second half of the year is a raining season.

However, on a positive note, Pestech is expecting its first recurring income running over 25 years, when the build-operate-transfer (BOT) asset in Cambodia is ready by year-end.

Kenanga Research found that the recent results for the sector during the first quarter

of 2017 was disappointing, with TNB being hit by bad debt provision and higher interest cost while Malakoff was dragged by higher operating and maintenance costs.

Results for YTL Power were affected by higher losses at the Paka Power Plant and weaker Wessex Water earnings whereas Pestech experienced margin compression as the current projects were in the early stages, which yielded lower profit margin.

In early May, TNB returned as SIPP Energy Sdn Bhd's partner in the Track 4A project via the acquisition of a 51% stake in Southern Power Generation Sdn Bhd.

Following the acquisition, the project can begin construction to meet the scheduled commercial operations by July 2020.

Meanwhile, YTL Power has finally resolved the land lease issue with TNB for its Paka Power Plant.

Both YTL Power and TNB have signed the

PPA extension and land lease agreement in mid-May to enable the independent power producer (IPP) to start operation from September 2017 over three years and 10 months.

"TNB remains as our top pick for the sector given its undemanding valuation, which is supported by its quality earnings profile and index weighting status.

"TNB earnings are fairly defensive with the imbalance cost pass-through framework which has a fuel cost pass-through mechanism eliminating fuel cost risk while profitability of IPPs is backed by PPAs, which guarantee capacity payment as long as requirements are met.

"We continue to like small cap Pestech as our alternative sector play for its earnings growth story in Indochina, with near-term strong contract flows expected," said Kenanga Research.