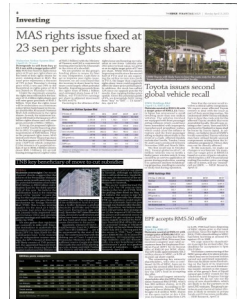


Headline	TNB key beneficiary of move to cut subsidies		
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## TNB key beneficiary of move to cut subsidies

### Utilities

**Maintain overweight:** Our recent channel checks suggest that the reform of the Peninsular Malaysia power sector is well underway with the potential formation of an initial RM3 billion to RM4 billion stabilisation fund by the third quarter (3Q) of this year. We believe the stabilisation fund is the missing piece of the “puzzle” to pave the way for the implementation of an automatic fuel cost pass through mechanism for Tenaga Nasional Bhd (TNB). This is a key rerating catalyst for the stock as it helps eliminate fuel price fluctuation risk (mostly from imported coal and in future LNG) and provides greater earnings and cash flow visibility for TNB.

We also gather that regulators are currently in talks with financial institutions to undertake the formation of a special purpose vehicle (SPV) to raise funds for the stabilisation fund. To be manned by an independent trustee man-

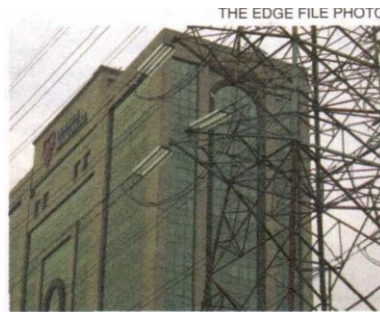
ager, the SPV’s board of directors will likely consist of TNB personnel, the appointed financial institution (to raise financing from the capital market) and the Ministry of Finance (MOF). The sole purpose of the stabilisation fund is to provide a buffer between a gradual electricity tariff hike and volatile fuel costs fluctuations (gas and coal). Since the 1997 Asian financial crisis, electricity tariff reviews and hikes have been carried out on an ad-hoc basis and steep subsidies create distortion in the sector.

Separately, winners of Tract 3 — a split between Tract 3A (1,000MW) and Tract 3B (3,000MW) — are to be announced by the end of this year. We understand that with the dishing out of Tract 3 contracts, Peninsular Malaysia will have a sufficient reserve margin into 2020. This marks the end of the planting-up cycle, at least until 2020. Further out, there is still talk of importing electricity from hydro or coal plants in Sarawak, although we believe this is still preliminary. Implicitly,

this may see the revival of the undersea cable connecting Peninsular Malaysia to Sarawak.

The sector outperformed the FBM KLCI by 1% year-to-date, thanks to the run-up of TNB. With the polling date fixed on May 5, we believe the sector is ripe for a rerating, especially for offtaker TNB as regulators could implement the automatic fuel cost pass through mechanism after the election. Elsewhere, we believe mid-2013 will see news flow picking up on: (i) the import of LNG for both the power and industrial sector as demand for gas outpaces indigenous supply streamed by Petrolim Nasional Bhd off Kertih; and (ii) potential listing of Malakoff Corp Bhd on Bursa’s Main Market (June/July 2013). Our top pick for the sector is TNB (“buy”; target price: RM8.90) for: (i) its attractive valuations; (ii) improving earnings visibility; and (iii) thematically, it is a key beneficiary of the government’s push to a gradual removal of subsidies. — *Affin IB Research, April 12*

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### Utilities peers comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RM mil)	Core PER		Core EPS gwth (%)		EV/ Ebitda (x)	P/BV (x)	ROE (%)		Net div. yield (%)	
					CY13	CY14	CY13	CY14			CY13	CY14	FY13	FY14
TNB	Buy	7.78	8.90	43,373	12.0	11.6	8.1	3.9	5.4	1.3	9.8	9.4	2.2	2.3
PGas	Reduce	18.90	16.60	37,398	24.5	20.8	17.8	5.0	14.2	4.1	17.5	19.9	3.8	4.0
YTL Corp.	Add	1.65	1.87	17,103	14.5	13.5	(1.5)	6.9	7.5	1.3	9.6	9.7	3.0	3.0
YTL Power	Buy	1.51	2.00	10,955	10.2	9.2	2.9	11.1	7.5	1.1	10.9	11.0	2.5	2.5
MMC	Add	2.65	2.80	8,069	20.4	18.4	130.3	11.0	6.6	1.1	5.9	6.3	1.5	1.5
Gas Malaysia	Add	2.90	3.00	3,724	20.6	18.8	13.5	9.7	12.3	3.7	17.9	19.6	4.8	5.3
Puncak Niaga	TR Buy	1.89	3.20	773	2.7	1.8	12.5	45.8	3.3	2.7	49.3	43.2	4.0	4.0
Simple average	-	-	-	121,395	15.0	13.4	26.2	13.3	8.1	2.2	17.3	17.0	3.1	3.1
Weighted average	-	-	-	-	14.8	13.5	9.5	9.9	-	-	-	-	-	-

Source: Bloomberg, Affin estimates