25 September 2020

Utilities | Utilities

Ranhill Utilities (RAHH MK)

Buy

Another All-Weather Stock Pick; BUY

Target Price (Return):	MYR1.23 (44.7%)
Price:	MYR0.85
Market Cap:	USD216m
Avg Daily Turnover (MYR/USD)	0.36m/0.09m

- **Initiate coverage with BUY and SOP-based MYR1.23 TP, 45% upside and 4% yield** – following a 20% discount to account for uncertainties in tariff revisions and implying 3.4x FY21F EV/EBITDA (close to +1SD from its 5-year mean). We think this is fair, given the potential rerating catalysts stemming from the extension of Ranhill Powertron I (RPI), Kedah-Thailand cross-border electricity sales, higher-than-expected rate hikes for Ranhill Utilities' Johor water operations, and further wins in water and renewable energy – yet to be priced in.
- **Well-established as an integrated water supply group.** Ranhill is an established and sustainable environment and power entity, with over five decades of expertise. Since 1999, through subsidiary Ranhill SAJ (SAJ), it has been managing and operating potable water supply as the exclusive source-to-tap water provider in Johor, Malaysia's third most populous state.
- **Defensive earnings stream from long-term regulated concessions.** We expect the group to generate stable revenue in the coming years, sustained by scheduled water tariff hikes, and population growth. We consider future earnings streams to be more predictable, with lower risk, given the somewhat guaranteed pricing, customers, and a product that people simply cannot live without.
- **Potentially doubling its earnings from Kedah-Thailand cross-border electricity sales.** Ranhill is still in the midst of coordinating a Government to Government MoU for cross-border electricity sale – the prerequisite to negotiate the project. The estimated internal rate of return (IRR) for the 25-year build, own and operate project is 8-9%, but we understand said project could potentially double Ranhill's earnings base. Further upside could stem from future investments into overseas concessions and ventures into solar energy, with capacity of at least 50 MW.
- **Attractive valuation with decent yield.** Compared to its peers in the KL Utilities Index (KLUT) (Figure 4), Ranhill currently trades at a c.65% discount to average peer FY21F EV/EBITDA, which – in our view – is undemanding, given the decent pipeline of near-term catalysts. Dividend yield of 4% is attractive in the current interest rate environment, supported by robust cash flows from SAJ's water supply operations.
- **Risks to our call include** licencing risks, timeliness of tariff revisions, lower-than-expected water consumption and developer contributions, escalating costs for its water business, and failing to meet the capacity and energy payment conditions for both its power plants.

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	1,560	1,630	1,544	1,642	1,682
Recurring net profit (MYRm)	42	81	64	53	65
Recurring net profit growth (%)	(41.5)	91.8	(21.7)	(16.7)	22.6
Recurring P/E (x)	17.85	10.27	14.35	17.23	14.06
P/B (x)	1.4	1.6	1.5	1.4	1.3
P/CF (x)	4.90	2.38	5.06	3.06	4.68
Dividend Yield (%)	7.1	5.9	4.0	4.1	4.1
EV/EBITDA (x)	2.75	2.34	2.93	2.53	2.40
Return on average equity (%)	7.5	14.3	10.6	8.3	9.6
Net debt to equity (%)	112.0	89.0	80.1	57.6	48.9

Source: Company data, RHB

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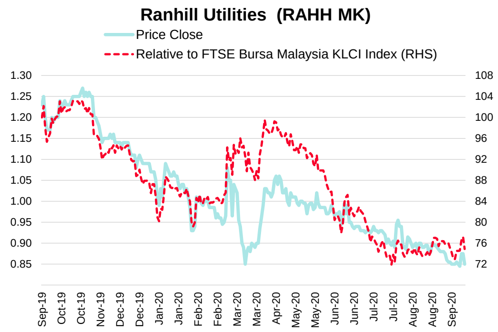
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(20.6)	(5.0)	(9.6)	(3.4)	(31.5)
Relative	(15.1)	(0.7)	(9.5)	(19.6)	(25.7)
52-wk Price low/high (MYR)					0.85 – 1.27



Source: Bloomberg

Note:
Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

Financial Exhibits

Asia
Malaysia
Utilities
Ranhill Utilities
RAHH MK
Buy

Valuation basis

SOP Valuation

Key drivers

i. Stable operations;
ii. Favourable outcome on water tariff hikes.

Key risks

i. Licencing risk;
ii. Timeliness of tariff revisions;
iii. Lower-than-expected water consumption and developer contributions;
iv. Escalating costs for its water business;
v. Failing to meet the capacity and energy payment conditions for both its power plants.

Company Profile

Ranhill is an established and sustainable environment and power entity with over five decades of expertise. Since 1999, through its subsidiary SAJ, it manages and operates potable water supply as the exclusive provider of source-to-tap water in Johor, the third most populous state in Malaysia.

Financial summary (MYR)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Recurring EPS	0.05	0.08	0.06	0.05	0.06
DPS	0.06	0.05	0.03	0.03	0.03
BVPS	0.62	0.54	0.58	0.61	0.65
Return on average equity (%)	7.5	14.3	10.6	8.3	9.6

Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Recurring P/E (x)	17.85	10.27	14.35	17.23	14.06
P/B (x)	1.4	1.6	1.5	1.4	1.3
FCF Yield (%)	15.6	34.3	13.2	26.1	14.8
Dividend Yield (%)	7.1	5.9	4.0	4.1	4.1
EV/EBITDA (x)	2.75	2.34	2.93	2.53	2.40
EV/EBIT (x)	7.57	5.55	8.96	8.29	7.76

Income statement (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover	1,560	1,630	1,544	1,642	1,682
Gross profit	471	562	453	465	477
EBITDA	601	657	568	592	600
Depreciation and amortisation	(383)	(380)	(382)	(412)	(414)
Operating profit	219	277	185	180	186
Net interest	(68)	(44)	(33)	(62)	(45)
Pre-tax profit	158	243	170	136	159
Taxation	(72)	(112)	(72)	(58)	(68)
Reported net profit	42	81	64	53	65
Recurring net profit	42	81	64	53	65

Cash flow (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Change in working capital	(44)	140	40	85	83
Cash flow from operations	154	350	180	298	195
Capex	(36)	(64)	(60)	(60)	(60)
Cash flow from investing activities	(87)	(61)	(42)	(42)	(42)
Dividends paid	(86)	(68)	(52)	(45)	(46)
Cash flow from financing activities	(11)	(324)	(204)	(183)	(190)
Cash at beginning of period	411	356	454	388	461
Net change in cash	56	(35)	(66)	73	(37)
Ending balance cash	471	322	388	461	424

Balance sheet (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total cash and equivalents	356	454	388	461	424
Tangible fixed assets	574	579	584	586	586
Total investments	155	161	179	197	215
Total assets	3,336	3,040	2,678	3,450	3,026
Short-term debt	90	93	93	93	93
Total long-term debt	1,113	1,073	983	893	803
Total liabilities	2,579	2,240	1,820	2,538	2,061
Total equity	757	800	859	912	966
Total liabilities & equity	3,336	3,040	2,678	3,450	3,026

Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Revenue growth (%)	5.5	4.5	(5.3)	6.3	2.4
Recurrent EPS growth (%)	(41.5)	73.8	(28.4)	(16.7)	22.6
Gross margin (%)	30.2	34.5	29.3	28.3	28.4
Operating EBITDA margin (%)	38.6	40.3	36.8	36.1	35.7
Net profit margin (%)	2.7	5.0	4.1	3.2	3.9
Dividend payout ratio (%)	126.0	66.1	57.0	70.0	57.0
Capex/sales (%)	2.3	3.9	3.9	3.7	3.6
Interest cover (x)	1.74	2.82	2.21	1.65	2.12

Source: Company data, RHB

Valuation And Recommendation

Figure 1: Ranhill's SOP valuation

Assets	Stake	FY21F FCFE	Per share	Remark
Water Asset - SAJ	80%	1,388.0	1.29	CoE 7.3%
Ranhill Powertron I	60%	54.3	0.05	CoE 8.4%
Ranhill Powertron II	80%	70.0	0.07	CoE 8.4%
Associates		143.2	0.13	8x FY21F Target PE
No. of shares		1,072.9		
Gross value		1,655.5	1.54	
20% SOP discount			-0.31	
SOP		**1,324.4**	**1.23**	

Source: Company data, RHB

Initiate coverage with BUY and TP of MYR1.23 based on SOP valuation with a 20% discount applied, implying an FY21F EV/EBITDA of 3.4x (close to +1SD from its 5-year mean) – we think this is fair given the potential rerating catalyst stemming from the extension of the RPI, Kedah-Thailand cross border electric sales, higher-than-expected rate hikes for its Johor water operations, and further wins relating to water and renewable energy, which has yet to be priced in.

Compared to its peers in the KLUT (Figure 4), Ranhill currently trades at a c.65% discount to average peer FY21F EV/EBITDA, which, in our view, is undemanding, given the favourable risk reward proposition. Dividend yield of 4% is attractive in the current interest rate environment, supported by robust cash flow from SAJ's water supply operations.

Key parameters are as follows:

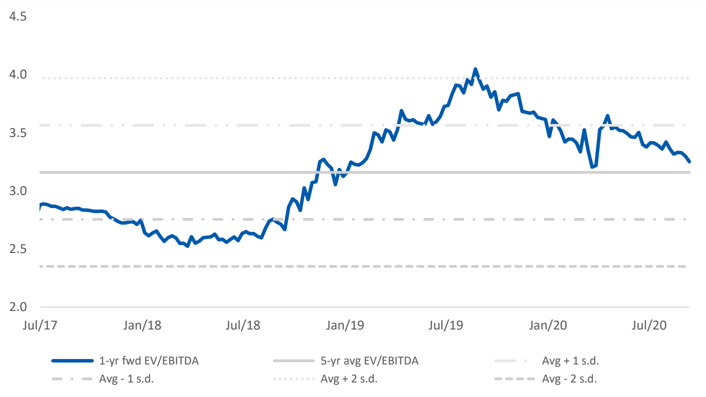
i. **Water assets:** We use DCF-FCFE to value the 80% stake in SAJ, the group's subsidiary that owns the exclusive license to provide source-to-tap water supply services throughout Johor. The concession term is up to 2045, with average blended tariffs to increase 7% at the start of each operating period (from OP5 onwards). We expect water consumption to grow at 3% pa. We apply a CoE of 7.3% (beta of 0.8x, risk-free rate of 2.9%, equity risk premium of 5.51%);

ii. **RPI:** We use DCF-FCFE to value the 60% stake in RPI. The concession is up to Oct 2029. This takes into account the planned capacity rate financial (CRF), which is currently at MYR22.24 per kW per month. We expect capacity factor to stay at 70% and equivalent available factor at 94%. We apply a CoE of 8.4% (beta of 1x, risk-free rate of 2.9%, equity risk premium of 5.51%);

iii. **Ranhill Powertron II (RPII):** We use DCF-FCFE to value the 80% stake in RPII. The toll concession is up to Apr 2023. This takes into account a two-tier CRF of MYR36.50 per kW per month, and MYR23.80 per kW per month from 2023 onwards. We expect capacity factor to stay at 65% and equivalent available factor at 94%. We apply a CoE of 8.4% (beta of 1x, risk-free rate of 2.9%, equity risk premium of 5.51%);

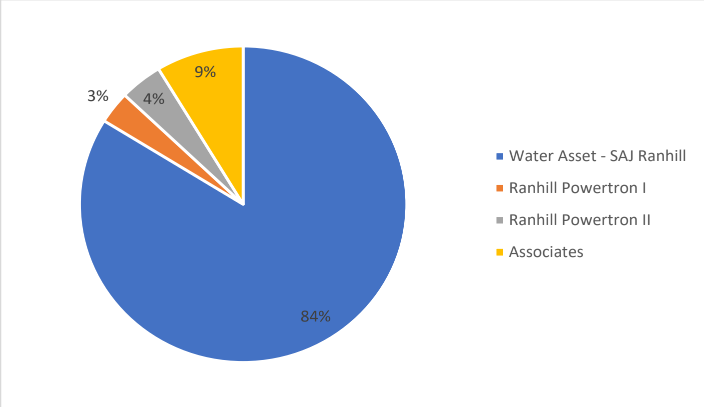
iv. **Associates:** We use FY21F target P/E of 8x to value associates. They are mainly in waste management and a water treatment plant in China.

Figure 2: 1-year forward EV/EBITDA



Source: Bloomberg, RHB

Figure 3: SOP – valuation composition



Source: RHB

Figure 4: Peer comparison

Company	Mkt cap	P/E (x)		Earnings growth (%)		P/BV (x)		ROE (%)		Div yield (%)		EV/EBITDA (x)		FCF yield (%)	
	(MYRm)	FY20F	FY21F	FY20F	FY21F	FY20F	FY21F	FY20F	FY21F	FY20F	FY21F	FY20F	FY21F	FY20F	FY21F
Utilities Peer															
Tenaga Nasional	61515	14.6	13.5	-7.3	8.3	1.0	1.0	7.2	7.5	4.4	4.3	5.2	5.1	1.9	9.7
Petronas Gas	32847	17.3	17.2	-1.8	0.5	2.6	2.5	14.7	15.0	7.8	4.8	8.6	8.4	5.7	6.5
YTL Power	5507	14.9	13.3	-16.3	11.8	0.5	0.5	3.0	3.4	6.1	6.0	10.3	9.8	-5.5	-6.7
Malakoff Corp	4950	15.1	14.1	19.0	7.4	0.9	0.9	5.9	6.3	5.3	5.7	5.4	5.2	28.8	26.3
Mega First Corp	3275	12.2	12.0	74.8	6.1	1.9	1.7	16.3	15.3	1.6	1.7	12.3	11.4	9.8	10.0
Taliworks Corp	1683	39.1	34.2	-43.4	14.3	1.8	2.0	4.4	5.5	7.9	7.9	12.1	9.8	7.4	6.9
Kumpulan Powernet	365	16.8	10.1	225.1	66.0	3.1	2.5	23.6	27.2	1.2	2.0	8.9	5.5	-3.6	-4.4
Average		**18.6**	**16.4**	**35.7**	**16.3**	**1.7**	**1.6**	**10.7**	**11.4**	**4.9**	**4.6**	**9.0**	**7.9**	**6.4**	**6.9**
RANHILL UTILITIES	**912**	**14.4**	**17.2**	**-21.7**	**-16.7**	**1.5**	**1.4**	**10.6**	**8.3**	**4.0**	**4.1**	**2.9**	**2.5**	**13.2**	**26.1**

Note: As at 22 Sep 2020
Source: Bloomberg, RHB

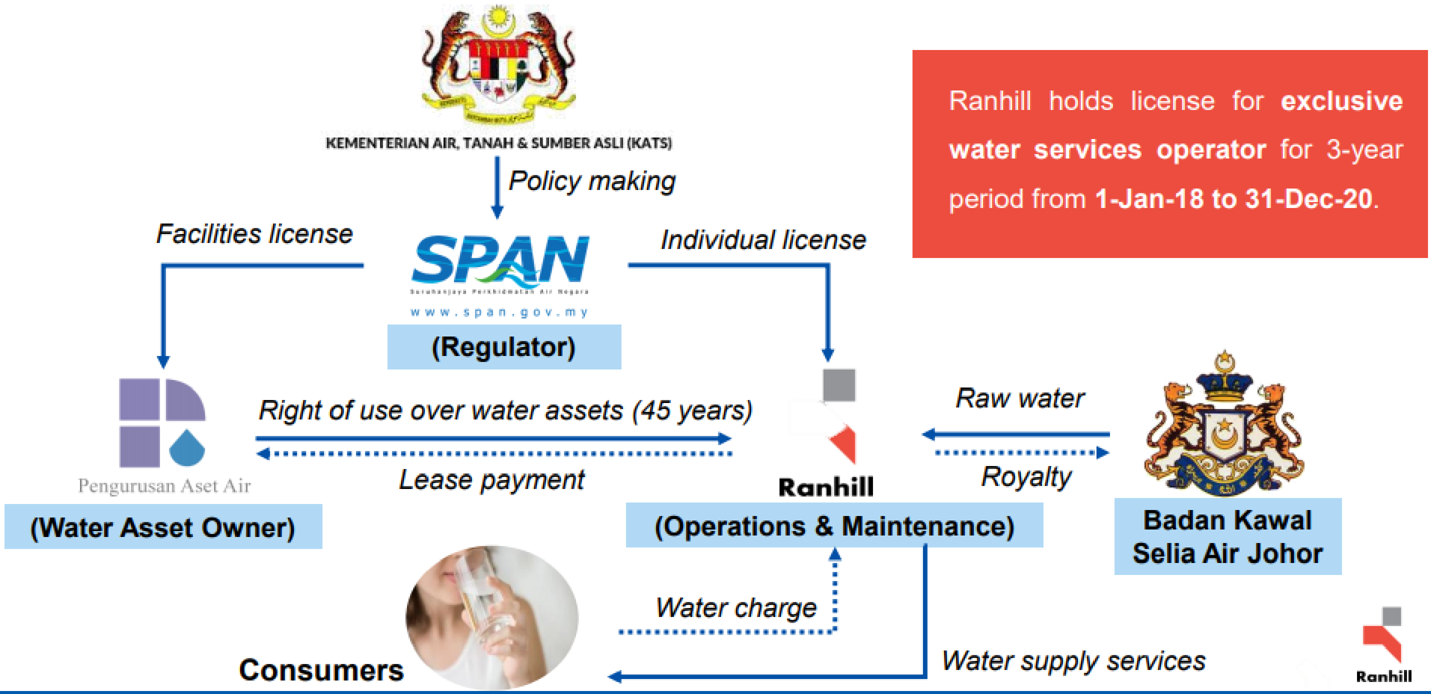
Investment Thesis

Regionally monopolistic: Source-to-tap water supply in Johor

Ranhill, through subsidiary SAJ possesses the exclusive licence to provide source-to-tap water supply services throughout Johor via a total of 44 water treatment plants with capacity of 2,026MLD. Johor is the third most populous state in the country, with a population size of 3.76m (behind Selangor and Sabah), consisting of 834,100 households (ranked second in the country).

Since Mar 2009, Johor has migrated to the licensing regime, in which the Custodian of National Water Assets (PAAB) took over ownership of the water concession asset from SAJ. Ranhill, however, reserves the right of use for the water assets for 45 years by leasing it back from PAAB. In addition, the group reserves the right to continue collecting payments on water bills from end-users in Johor.

Figure 5: Regulatory framework and licensing regime



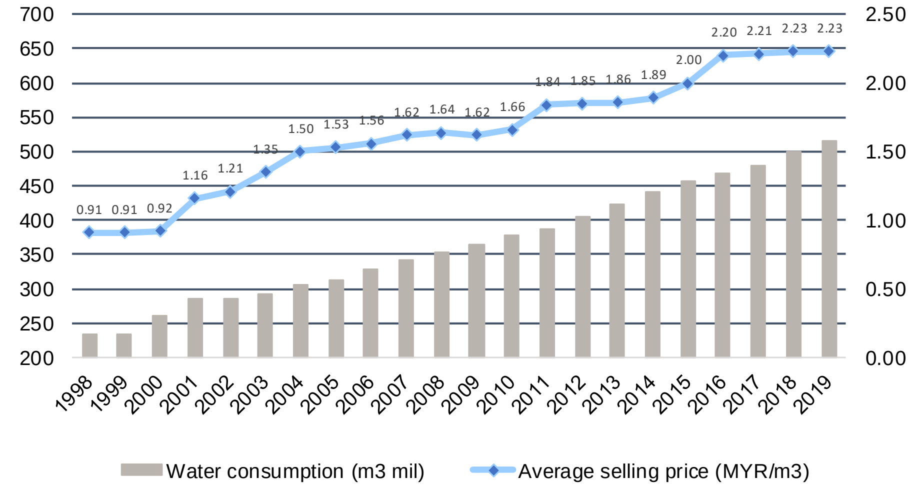
Source: Company, RHB

Defensive earnings backed by growing population

Water consumption in Johor is expected to be supported by steady population growth, as well as the growing demand from new developments within the commercial and industrial sectors. In 2018, total consumer accounts serviced by SAJ in the state increased by 2.1% YoY to 1.2m accounts, comprising 1,003,290 residential and 162,680 commercial accounts.

Water consumption grew 3% YoY to 516m cu m in 2019 (2018: 501m cu m residential users accounted for 58.9% of total water consumed in the state in 2018. However, commercial customers accounted for a higher contribution to SAJ's revenue at 62.3%. The number of commercial users in the state grew by 22.8% over the past six years, with water consumption growing by 55.8% between 2013 and 2018.

Figure 6: Growing population and solid customer base support increased water consumption



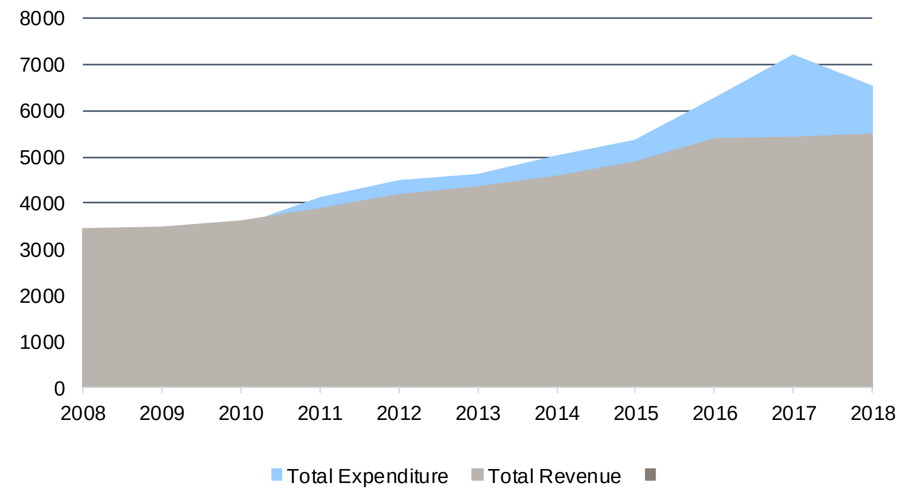
Source: Company data, RHB

Impending water tariff hike is still under review, but a call for revision looks imminent

Water tariffs in Malaysia are set and regulated by the National Water Services Commission (SPAN) and, hence, is independent of demand and supply market forces. We understand that ministers have discussed for a countrywide increase in water tariff for several states in West Malaysia. This is in view of rising operating expenditure, with the financial deficit widening at an alarming rate for the overall water sector.

Since 2010, the sector has registered eight consecutive years of loss-making, where total costs – ie operating plus capital costs, inclusive of provisions – have exceeded total revenue (from tariff and non-tariff income).

Figure 7: Total costs outpaced total revenue (FY08-FY18 CAGR of 9.8% vs 5.9%)



Source: Water & Sewerage Statistics 2019

Referring to Figure 8, Johor has the highest average revenue per cu m billed when compared to other states in Malaysia, with the average opex only representing 54% of its revenue (the lower the better). This is thanks to the political will of the Johor State Government to increase tariffs in view of rising cost of electricity and pollution.

Despite that, average total cost represents c.95% of average revenue. We are of the view that a water tariff revision is necessary to sustain the industry's ability to upgrade and maintain water assets, many of which have reached the end of their economic lifespans.

Figure 8: Johor's average opex only represents 54% of average revenue in 2018

States	Average Revenue Per m3 Billed	Average Opex Per m3 Billed	Average Total Costs Per m3 Billed	NRW (%)	NRW Per KM of Pipe Per Day (m3/KM of pipe/day)
Johor	2.25	1.22	2.14	24.80%	20
Kedah	1.1	1.15	1.2	48.50%	54
Kelantan	1.13	1.14	1.28	49.30%	37
FT Labuan	1.83	1.79	1.79	31.60%	46
Melaka	1.48	1.07	1.51	21.20%	21
Negeri Sembilan	1.4	1.13	1.48	31.90%	28
Pulau Pinang	0.99	0.78	1.04	21.70%	51
Pahang	0.79	1.37	1.39	49.10%	30
Perak	1.02	0.68	0.89	30.40%	35
Perlis	0.86	1.27	1.27	63.80%	83
Selangor	1.55	2.3	2.8	31.70%	54
Terengganu	0.85	0.65	0.79	34.60%	29
WEST MALAYSIA & FT LABUAN	**1.41**	**1.47**	**1.88**	**33.90%**	**38**

Source: Water & Sewerage Statistics 2019

The water tariff is set based on a cost setting mechanism. Simply, if the planned capex for the operating period is higher than the previous, the water tariff will then be revised upwards in order to recover the cost.

Unlike toll road operators, Ranhill will not get compensated if there is an absence in tariff increase. Instead, a portion of the planned capex for the operating period will be deferred to the next period. Nevertheless, SAJ should be able to earn a consistent profit after tax margin of 9-11%.

We believe that the Cabinet has decided not to implement any tariff increases currently due to the negative impact of COVID-19 to the economy and public. Ranhill guided for an average tariff increase of 11% in FY21F, which should support water revenue by approximately 30-40%. Due to the uncertain elements revolving around the tariff review, we impute a conservative 7% tariff increase at the start of each operating period (every three years starting FY21F).

Exceptional track record despite heavy regulation

Despite being the exclusive licence holder, Ranhill is still required to submit a 30-year business master plan, together with a rolling 3-year plan to SPAN for approval – with multiple key performance indicators and conditions to be adhered to. This suggests that efficiency is still very crucial for Ranhill in terms of its operations, despite being a monopoly. This is an indication that Johor's model for water asset management is arguably ahead of other states in Malaysia, and that water wastage in the state is at the lowest in the nation on a per km basis.

In fact, its current model is similar to the Regulatory Asset Base model to a certain extent, with the ROA being monitored by SPAN on a 3-year rolling basis.

Nevertheless, we believe the model should be more transparent in the longer term, with data available for the public to provide better education on the cost of water, as well as encourage further cost efficiency by Ranhill as a water service provider. Johor continues to have the lowest non-revenue water (NRW) level in Malaysia, which is just 20 cu m per km of pipe per day.

Balancing the demand equilibrium could benefit Ranhill's power plant in Sabah

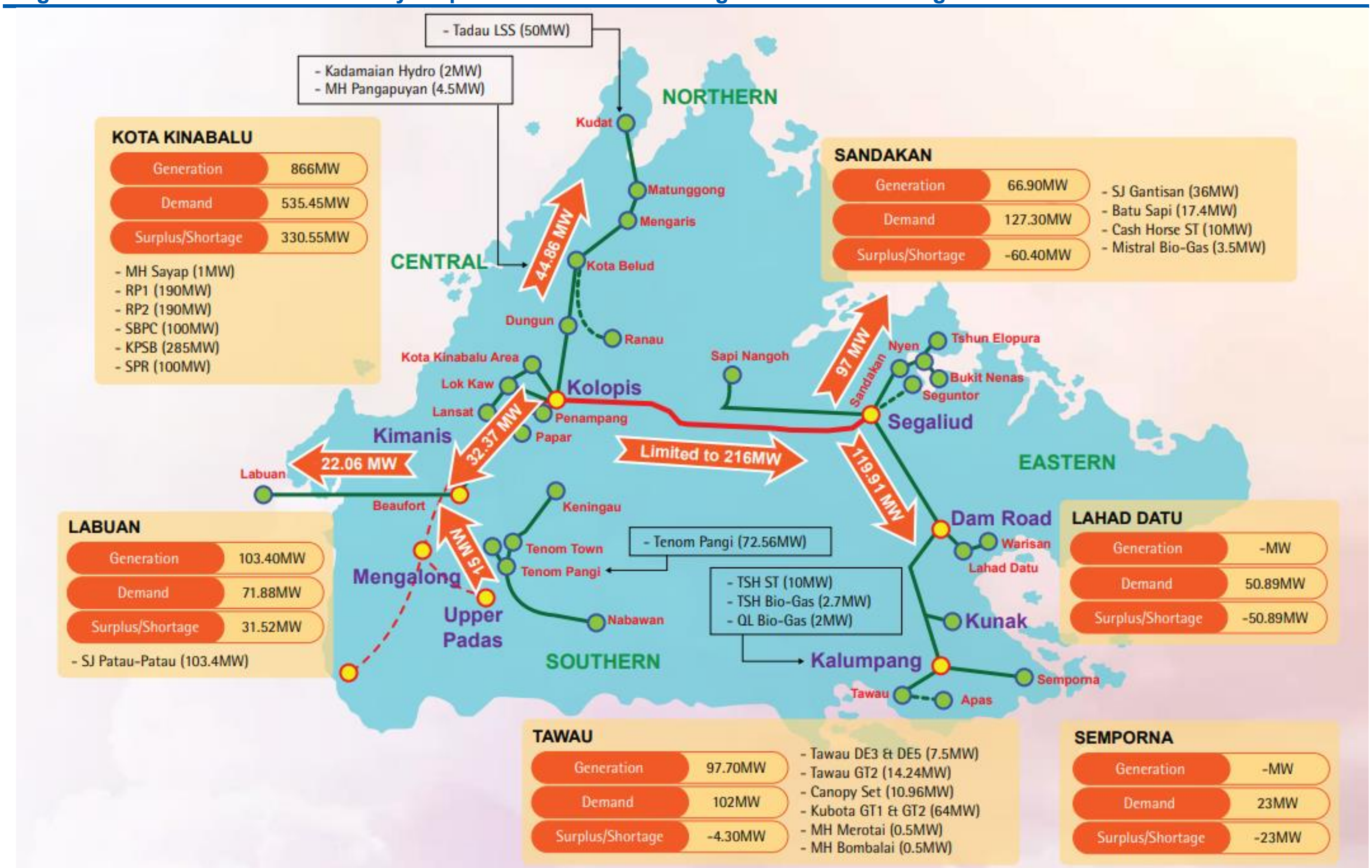
Ranhill owns and operates two Combined Cycle Gas Turbines power plants through its subsidiaries – RPI (190MW) and RPII (190MW) – which are both located at the Kota Kinabalu Industrial Park. The combined 380MW of energy is equivalent to approximately 32.5% of the total installed capacity of independent power producers in Sabah.

We understand that RPII suffers from lower demand, with FY19 capacity factor at 66% vs 80% at RPI – mainly due to higher electricity price point and overcapacity in the west coast of Sabah. Positively, according to the Sabah Electricity Supply Industry Outlook 2019, one of the Annual Transmission Development Plan's outcomes is to enhance the 275kV Kolopis-Segaliud line by installing a new transformer of 240MVA at the transmission main intake or PMU dam road.

Upon completion of this work, the Kolopis-Segaliud line will be able to transfer up to 400MW from the west coast to the east coast of Sabah. Hence, we think the oversupply situation in the west grid should resolve itself.

Additionally, Ranhill seeks to further extend its concession term for RPI by an additional 10 years. As at current juncture, the group is still in discussions with Sabah Electricity, given that its new steam turbine could last for another decade. Potential upside stemming from the extension of concession has yet to be priced into our earnings forecasts.

Figure 9: Kota Kinabalu's electricity surplus of 330MW vs shortages over at the east grid



Source: Sabah Electricity Supply Industry Outlook 2019

Building up experience in wastewater treatment plant

To date, Ranhill has successfully completed more than 150 water, wastewater, and water reclamation treatment plants across Asia through its associate company. Currently, in Thailand, Ranhill operates seven fully-owned concessions with an aggregate capacity of 114MLD. In China, through its 40% interest in Ranhill Water Hong Kong, the group has 12 waste water treatment plants, with an aggregate capacity of 232MLD.

While its overseas associate does not contribute much to overall earnings, we think such experience and track record is – in itself – valuable, as it solidifies Ranhill's core competency as a water utility player. An upside could stem from government-driven policies, which includes the water sector transitioning into a circular economy for water, sanitation and wastewater (closed water loop system).

Under the Green Technology Master Plan, one of the targets in water sector for wastewater treatment aims for 33% of treated effluent to be recycled. Recall back in 2018, SAJ signed a joint billing deal with Indah Water Konsortium or IWK, which involves incorporating the prevailing water supply tariff and sewerage tariff rate in a single bill. Also, Ranhill eyes to eventually take over the sewerage operations in Johor.

Figure 10: International concession assets

Thailand Concessions

No	Description	Capacity (MLD)	Concession type	Expiration of concession/license
1	Amata City Chonburi Concession (Industrial Estate)	24	Wastewater/BOT	2028
		10.5	Potable water/BOT	2028
		10	Potable water/BOT	2033
2	Amata City Rayong Potable Water Treatment Plant	15	Potable water/BOT	2032
3	Amata City Rayong Wastewater Treatment Plant	15	Wastewater/BOT	2043
4	Asian Institute of Technology	1.5	Wastewater/BOT	2020
5	Amata City Chonburi Concession	10.5	Potable water/BOT	2039
6	Amata City Rayong Concession	10	Wastewater/BOT	2039
		10.5	Potable water/BOT	2039
7	Amata City Rayong Concession	7	Reclaim water/BOT	2039
		114		

China Concessions

No.	Description	Capacity (MLD)	Concession type	Expiration of concession/ license
1	Xiaolan Wastewater Treatment Plant (Phase I)	30	Wastewater/BOT	2038
2	Xiaolan Wastewater Treatment Plant (Phase II)	50	Wastewater/BOT	2042
3	Yingkou Wastewater Treatment Plant	30	Wastewater/TOT	2046
4	Hefei Wastewater Treatment Plant	30	Wastewater/BOT	2036
5	Yihuang Wastewater Treatment Plant (Phase I)	5	Wastewater/BOT	2045
6	Wanzai Wastewater Treatment Plant (Phase I)	5	Wastewater/BOT	2044
7	Chongren Wastewater Treatment Plant	10	Wastewater/BOT	2046
8	Yongxin Wastewater Treatment Plant	10	Wastewater/BOT	2046
9	Yongfeng Wastewater Treatment Plant	10	Wastewater/BOT	2047
10	Wanzai Wastewater Treatment Plant (Phase II)	7.5	Wastewater/BOT	2047
11	Fengxin Wastewater Treatment Plant	34	Wastewater/TOT & BOT	2048
12	Yihuang Wastewater Treatment Plant (Phase II)	10	Wastewater/BOT	2048
		232		

Source: Company data, RHB

Kedah-Thailand cross border electricity sale could double its earnings

Ranhill is still in the midst of coordinating for a government-to-government MoU for cross border electricity sale, which is the prerequisite for the negotiation of the project. To recap, earlier in Feb 2019, Ranhill entered into a collaboration agreement with Thailand-based Treasure Specialty to develop a 1,150MW combined cycle gas turbine power plant in Kedah for power export to Southern Thailand.

We are positive on the potential outcome of the discussion as the business case is strong for this project given that Southern Thailand faces a gas supply shortage, hence limiting the country's power capacity. The current arrangement for the project is to be funded by 75% debt and 25% equity – the latter of which will be 70% funded by Ranhill and 30% by its JV partner. The estimated IRR for this 25-year build, own and operate project is 8-9%, but we understand that earnings from the said project could potentially double Ranhill's earnings base. We have yet to impute any earnings contributions into our forecasts.

Opportunities within the water and renewable energy space

Ranhill continues to seek expansion regionally, with a penchant for businesses with long-term assets, leveraging off its vast experience in the industry. In Thailand specifically, Ranhill is targeting to increase its water concession asset capacity to 174MLD by 2022 from 114MLD currently, which could include further industrial water and wastewater treatment projects.

Another key focus country is Indonesia, where several MoUs were inked with Jasa Sarana back in 26 Nov 2019, to explore opportunities in West Java relating to infrastructure development, consisting of geothermal power plant, mini hydro, and waste management.

Additionally, Ranhill has expressed an interest to participate in the renewable energy space, which we think highly of given that the Government's Renewable Energy Transition Roadmap. The latter aims to achieve a 20% mix energy generation by 2035. We understand Ranhill is looking into solar energy projects with a capacity of at least 50MW.

Financial Overview

2Q20 core earnings declined by 29% YoY to MYR13.2m (-27% QoQ) despite 2Q20 revenue remaining flat QoQ at MYR378.9m (-13% YoY). 1H20 revenue declined by 11% with PAT declining 22%.

The decrease was primarily due to lower water revenue and lower developer contribution, coupled with MYR2.6m discount to the B40 income group in SAJ of approximately MYR39.7m as a result of the Movement Control Order, lower EPC revenue from Ranhill Water Technology of MYR18.1m, and reduction in power tariff (Capacity Payment Revenue-Capacity Rate Financial) upon full repayment of project loan – as stipulated in the power purchase agreement – which contributed to the lower revenue of c.MYR35m.

Figure 11: Ranhill's 2Q20 results

FYE Dec (MYRm)	2Q19	1Q20	2Q20	QoQ (%)	YoY (%)	1H19	1H20	YoY (%)	Comments
Revenue	424.0	368.3	368.9	0%	(13%)	829.0	737.2	(11%)	Lower water revenue and reduction in power tariffs.
EBITDA	159.4	147.4	134.7	(9%)	(16%)	317.3	282.1	(11%)	
EBITDA margin (%)	*38%*	*40%*	*37%*			*38%*	*38%*		Robust margins despite the pandemic.
Finance cost	(25.5)	(21.9)	(20.3)	8%	21%	(52.2)	(42.2)	19%	Lower finance costs on full repayment of loans for power.
Share of Associate	2.1	3.8	4.6	19%	115%	4.6	8.4	83%	
Pre-tax profit	50.3	41.3	29.6	(28%)	(41%)	99.9	70.9	(29%)	
Pre-tax margin (%)	12%	11%	8%			12%	10%		
Tax	(19.0)	(13.9)	(8.8)	37%	54%	(35.7)	(22.8)	36%	
Effective tax rate (%)	38%	34%	30%			36%	32%		
Minority interest	(12.6)	(9.2)	(7.6)	18%	40%	(24.2)	(16.7)		
PATAMI	18.7	18.2	13.2	(27%)	(29%)	40.0	31.4	(22%)	
Core PATAMI	18.7	18.2	13.2	(27%)	(29%)	40.0	31.4	(22%)	
Core net margin (%)	*4%*	*5%*	*4%*			*5%*	*4%*		

Source: Company data, RHB

Figure 12: Ranhill's 2Q20 segmental results

FYE Dec (MYRm)	2Q19	1Q20	2Q20	QoQ (%)	YoY (%)	1H19	1H20	YoY (%)	Comments
Revenue									
Environment	325.4	303.9	303.4	0%	-7%	659.6	607.4	-8%	Lower water revenue.
Power	66.4	64.3	65.5	2%	-1%	169.4	129.8	-23%	Reduction in power tariff for RPI.
Adjusted PAT									
Environment	64.0	33.7	28.3	-16%	-56%	72.1	61.9	-14%	
Power	(11.6)	7.9	6.2	-21%	154%	22.6	14.1	-38%	
PAT Margins									
Environment	*20%*	*11%*	*9%*			*11%*	*10%*		
Power	*-18%*	*12%*	*10%*			*13%*	*11%*		

Source: Company data, RHB

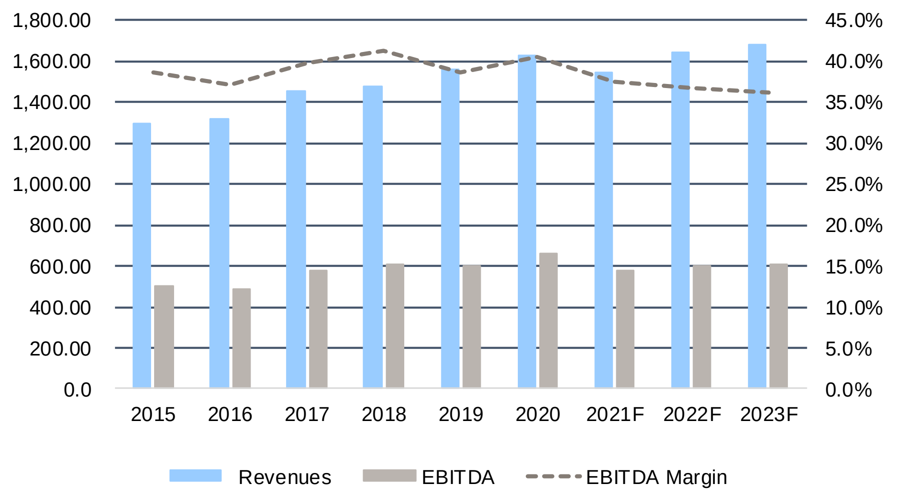
Historically, Ranhill's overall revenue grew on a 7% CAGR from FY15 onwards. This is largely due to robust water revenue, which is supported by increases in water consumption and tariff hikes. On that, we note that Ranhill did not receive a water tariff hike in its current operating period (FY18-FY20), but – positively – water revenue remains resilient, and also grew 5.6% and 3.5% in FY18 and FY19.

Moving forward, we expect FY20F overall revenue to decline by 5.3% due to the reduction of power tariff for RPI, and subsequently grow by 6.3% on the back of an assumed 7% increase in water tariff as Ranhill enters a new operating period.

Following that, based on a 40% effective tax rate assumption, we expect FY21F-22F core net profit to come in at MYR64m and MYR53m (-22% and -17% YoY), as we expect lower margins from RPI moving forward and higher financing costs at the beginning of every new operating period in FY21F.

Taken together, we note that FY20F-21F EBITDA is expected to drop by 12% and 4.3% YoY.

Figure 13: Ranhill's EBITDA margin is expected to remain stable



Source: Company data, RHB

Solid financial position. Ranhill's 2Q20 gearing level is at approximately 1.33x, which is an improvement from 1.45x in FY19. While this appears to be high, we note that the group operates an asset light model for its water business, in which water operation assets are leased from PAAB for a pre-agreed fee.

Management remains focused on paring down its gearing to 1.0x, which we think could be done through the repayments of *sukuk* for its power operations. Interest coverage ratio remains healthy at 2.0x.

Official dividend payout policy of 50-70% of net profit. In light of the current economic situation, coupled with the low interest rate environment, dividend payments should provide attractive and sustainable cash flow for shareholders. Historically, the group has declared annual DPS of 5-8 sen since 2016. We expect Ranhill to declare c.3.5 sen DPS for FY20F-22F, which translates to an average payout of 60% for the three years.

We think the dividend payout is sustainable, given the overall high cash flows from its operations. These are also sufficient post repayments of debt and leases.

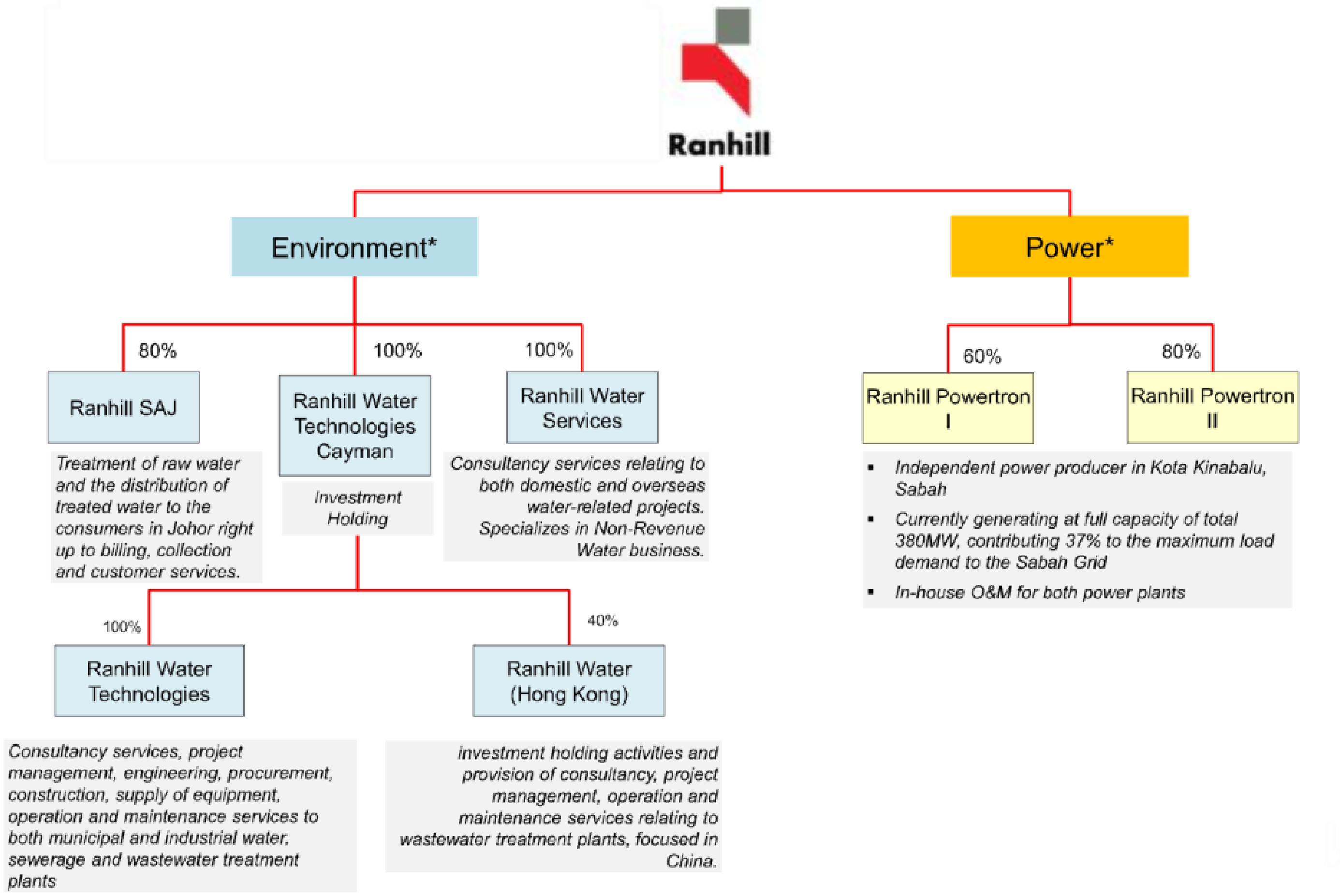
Company Background

Founded in 1973, Ranhill is an established and sustainable environment and power entity with over five decades of expertise. Since 1999, through its subsidiary SAJ, it manages and operates potable water supply in Johor as the exclusive provider of source-to-tap water in Malaysia. It was first listed on Bursa Malaysia in 2001, but was subsequently delisted in 2011 to undergo restructuring activities. The group saw a relisting through a reverse takeover on 16 Mar 2016.

Ranhill's environment sector generates income from three distinct sources: source-to-tap water supply managed by SAJ, NRW business managed by Ranhill Water Services, and water & wastewater treatment operated by Ranhill Water Technologies.

On the other hand, its power sector generates revenue from two primary sources, which are the power generation carried out by RPI and RPII, as well as the operations & maintenance of both the two power plants managed by Ranhill Power O&M and Ranhill Power II O&M.

Figure 14: Ranhill's corporate structure



Source: Company, RHB

Board of Directors

Tan Sri Azman Yahya is the Independent Non-Executive Chairman. He graduated from the London School of Economics with a degree in economics. Tan Sri Azman started his career at KPMG in London and has accumulated vast experience. This includes becoming the Chief Executive of Amanah Merchant; being tasked by the Government to set up and head Danaharta (the national asset management company) to acquire, manage, and resolve NPLs in the banking sector, and assigned to be the Chairman of the Corporate Debt Restructuring Committee, which was set up by Bank Negara Malaysia. He was appointed as the Chairman/Non-Independent Non-Executive Director on 1 Sep 2014 and re-designated as Chairman/Independent Non-Executive Director effective 2 Feb 2019.

Tan Sri Hamdan Mohamad is the Executive Director, President and Chief Executive. After graduating with a Master of Science in Engineering from Imperial College of Science & Technology, he started his career as a structural engineer at the engineering consulting firm of Ranhill Bersekutu in 1981 and has since held various executive positions in the Ranhill group of companies. Tan Sri Hamdan successfully spearheaded Ranhill's expansion from an engineering and consulting based firm to a full-fledged organisation that engineers, constructs, owns and operates facilities in diverse segments including infrastructure, environment, power as well as oil and gas. He was appointed as Executive Director and the President and Chief Executive on 1 Dec 2015.

Dato Sri Lim Haw Kuang was appointed as Executive Director on 1 Sep 2014. He graduated with a degree in Computer Science from Imperial College. He worked for Shell for 34 years and held various senior executive positions. He is also a board member of Bank Negara Malaysia.

Datuk Abdullah Karim was appointed as Senior Independent Non-Executive Director on 13 Nov 2018. Datuk Abdullah carries with him over 39 years' experience in the oil and gas industry, having had a long career with Petroliam Nasional or Petronas, which he joined in 1977.

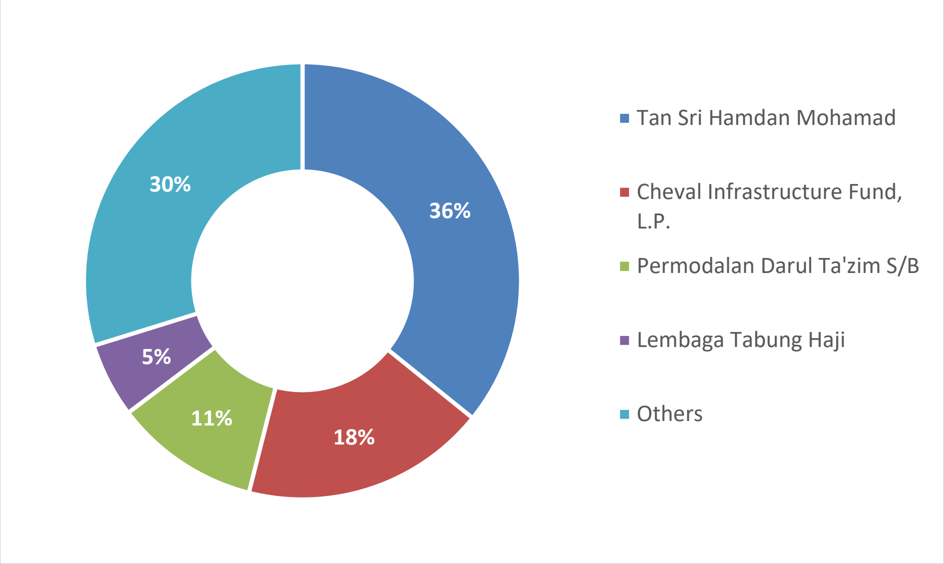
Lim Hun Soon @ David Lim was appointed as Independent Non-Executive Director on 1 Dec 2015. He serves as the Chairman of the audit committee. He carries with him over 33 years of experience at KPMG and over 10 years as an examiner for company law examinations conducted by MICPA.

Leow Peen Foong is the independent Non-Executive Director since 2 Mar 2018. She was formerly the chief operating officer of SPAN before she retired from the position in Nov 2017. During her tenure in SPAN, she was involved in determining the policy and direction of the Malaysian water services industry reform from its conception which resulted in the passing of the Water Services Industry Act, 2006.

Loong Mei Yin was appointed Non-Independent Non-Executive Director on 16 Nov 2016. She brings with her more than 25 years of financial industry experience, in areas of growth capital private equity investing and investment banking. Her area of expertise includes investments in urban sustainability, namely in water and wastewater treatment, and integrated waste management and waste-to-energy segments. Loong also focuses on investments across several sectors, including in the pharmaceutical, property development, and manufacturing sectors.

Abu Talib Abdul Rahman was appointed Independent Non-Executive Director on 1 Dec 2015. Abu Talib started his career as a banker in an agriculture bank before enhancing his work experience in a merchant bank, as well as a commercial bank. He left the commercial bank and worked as an advocate and solicitor after getting called to the Bar in 1986. Abu Talib's area of legal expertise encompasses corporate law, corporate secretarial, corporate finance and banking, commercial contracts, construction and private finance initiative projects with the Government.

Figure 15: Shareholder analysis



Source: Company data, RHB

Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-09-25			

Source: RHB, Bloomberg

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