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CIMB Research Report

INITIATING COVERAGE

12 September 2007

MALAYSIA

YTL Power International

Global utility play

OUTPERFORM

RM2.40 @11/09/07

Target: RM3.30

Utilities

YTLP MK / YTLP.KL

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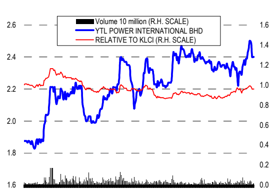
- **Utilities arm of YTL Corp.** YTL Power is the global utilities arm of YTL Corporation. It owns power plants in Malaysia and Indonesia, water concession assets in the UK under Wessex Water and a 33.5% stake in Electranet, which owns and operates a power transmission network in Australia. Overseas assets contributed some 79% of FY07 EBIT including associates.
- **Modest earnings prospects but …** We project modest annual earnings growth of 9-11% for FY09-10, fuelled mainly by higher efficiency for its power plants in Indonesia and above-average price hikes for Wessex Water. However, for FY08, the bottomline is set to contract by 15% in the absence of deferred tax credits.
- **… ample M&A-led opportunities.** Nevertheless, there is room for YTL Power to expand its earnings base by i) leveraging its cash hoard to seize lucrative M&A opportunities, ii) bidding for Singapore's power assets and iii) utilising its Wessex expertise to tap into the local water industry.
- **Starting coverage with OUTPERFORM call.** Given the 38% upside to our SOP-based target price of RM3.30, we initiate coverage on YTL Power with an OUTPERFORM call. Key re-rating catalysts include i) earnings-enhancing acquisitions, ii) further re-rating of UK water stocks, iii) opportunities in the local water industry and iv) treasury share distributions. Investors with a higher risk appetite could consider its 2000/2010 warrants (RM1.00, YTLPW, exercise price RM1.39, expiry 8 Jan 2010) which are currently in the money.

Financial summary

FYE Jun	2006	2007	2008F	2009F	2010F
Revenue (RM m)	3,758.1	4,068.0	4,374.2	4,533.3	4,645.7
EBITDA (RM m)	1,965.7	2,285.9	2,452.1	2,560.1	2,697.5
EBITDA margins (%)	52.3	56.2	56.1	56.5	58.1
Pretax profit (RM m)	1,112.4	1,300.3	1,464.2	1,603.9	1,743.6
Net profit (RM m)	874.5	1,269.1	1,083.5	1,202.9	1,307.7
EPS (sen)	16.9	24.0	20.5	22.7	24.7
EPS growth (%)	+14%	+41%	-15%	+11%	+9%
P/E (x)	14.2	10.0	11.7	10.6	9.7
FD EPS (sen)	16.9	24.0	17.3	19.2	20.8
FD P/E (x)	14.2	10.0	13.8	12.5	11.6
Gross DPS (sen)	10.0	15.3	15.3	15.3	15.3
Dividend yield (%)	4.2	6.4	6.4	6.4	6.4
P/NTA (x)	2.3	2.2	1.9	1.8	1.6
ROE (%)	15.3	20.7	15.4	15.8	15.7
Net gearing (%)	137.3	131.0	101.7	89.9	76.6
P/CF (x)	16.7	11.7	14.3	12.7	11.5
EV/EBITDA (x)	10.5	9.1	8.1	7.6	7.1
% change in EPS estimates	-	-	-	-	-
CIMB/Consensus (x)	-	-	1.10	1.16	1.20

Source: Company, CIMB/CIMB-GK estimates, Reuters Estimates

Price chart



Source: Bloomberg

Market capitalisation & share price info

Market cap	RM12.7bn
12-mth price range	RM2.51/RM1.82
3-mth avg daily volume	RM2.9m
# of shares (m)	5,296.3
Est. free float (%)	20
Conv. secs (m)	889.4m / 394.7m
Conv. price (RM)	RM1.39 / RM2.277

Share price perf. (%)	1M	3M	12M
Relative	2.7	6.0	(4.9)
Absolute	2.6	0.4	28.0

Major shareholders	% held
YTL Corporation	60.4
Employees Provident Fund	7.9
Bara Aktif Sdn Bhd	4.0

Source: Company, CIMB/CIMB-GK Research, Bloomberg, Reuters Estimates

Background

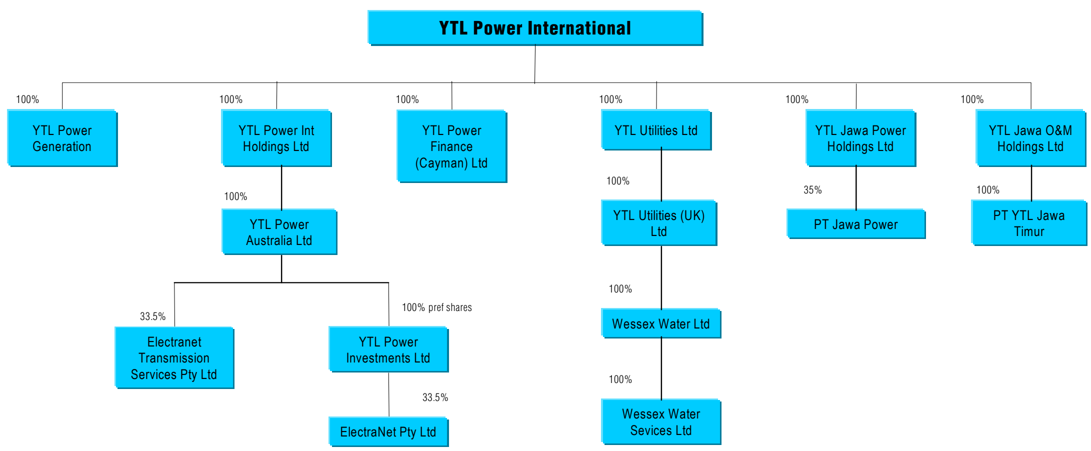
Utilities arm of YTL Group. YTL Power International (YTL Power) is the global utilities arm of YTL Corporation (YTL MK, RM7.35, Not Rated). The company was established in Oct 96 to house the group's power-related investments. In May 97, it made history as the first company to be listed under the infrastructure project company (IPC) category on the Main Board of Bursa Malaysia.

Started off as a local power play. YTL Power's roots can be traced back to 1993 when its subsidiary, YTL Power Generation Sdn Bhd, became Malaysia's first IPP following a nationwide power blackout in 1992 and the government's drive to privatise the electricity industry. Back then, the group had two power generation plants under its belt.

Evolving into a global utilities group. Nevertheless, since 2000, YTL Power has been on an aggressive acquisition trail, snapping up utility assets from near and afar. It has successfully transformed itself from just a local power generator to a global utilities group. It currently owns power assets in Malaysia (100% YTL Power Generation), Indonesia (35% in Jawa Power) and Australia (33.5% stake in Electranet). It is also exposed to water concession assets in the UK through its 100% stake in Wessex Water (Figure 1).

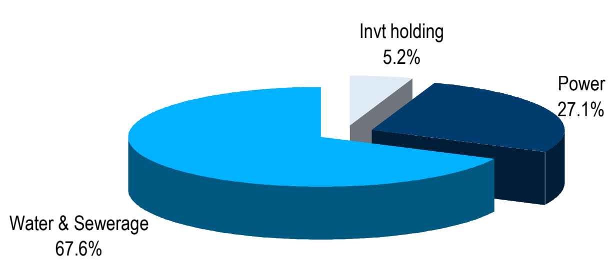
Wessex is the largest EBIT contributor. In FY07, Wessex Water accounted for 68% of group EBIT including associates. The power division made up another 27% while investment holding contributed the remaining 5% in the form of dividend and interest income (Figure 2). Over the years, Wessex Water has become an increasingly dominant contributor, reinforcing the shift in the group's earnings profile from a pure local power base to a more diversified global utilities base (Figure 3). Interestingly, YTL Power derived approximately 79% of its EBIT (including associates' contribution) from overseas assets, a clear indication of its success overseas.

Figure 1: Corporate structure



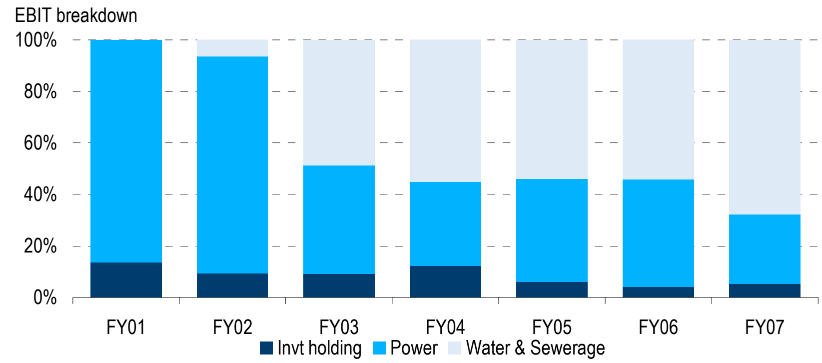
Source: Company, CIMB Research, RAM reports

Figure 2: Breakdown of FY07 EBIT including associates



Source: Company, CIMB estimates / Research

Figure 3: Rising contributions from water and sewerage business



Source: Company, CIMB estimates / Research

Owns regulated assets with non-recourse financing. Assets under its portfolio are regulated under long-term government concessions. This allows the group to enjoy relatively stable income streams and solid cash flows from its assets. Another plus is that these businesses are not dependent on their parent for funding. YTL Power's businesses in Australia and the UK are regulated ring-fenced businesses while its power plants in Malaysia and Indonesia are on non-recourse project financing.

Outlook

Wessex Water

Largest acquisition in the group's history. The group outbid its rivals in the race for the entire equity of Wessex Water, the water utility arm of Enron Corp in May 02. The deal valued the business at an implied enterprise value (EV) of £1,239.5m or a 9% discount to its regulated asset base (RAB). RAB is the capital base calculation method that the regulator used to set price limits.

Background on Wessex Water. Wessex Water, through its wholly owned Wessex Water Services Ltd (WWSL), is one of the 10 regional water and sewage treatment companies that service the UK market. The company was appointed by the UK government to supply clean water and treat and dispose of wastewater from a 10,000 sq km area in southwest England. The areas covered by the group include Dorset, Somerset, Bristol, most of Wiltshire and parts of Gloucestershire and Hampshire (Figure 4).

Figure 4 : Region covered by Wessex Water

Source: Wessex Water

Scope of business. The company supplies 1.2m customers with up to 385m litres of water everyday. The water is distributed to 500,000 properties in the region through a distribution network that includes 135 water sources, 95 treatment plants, 320 service reservoirs and more than 11,000 km of water mains. It also takes away sewage from 2.5m people in the Wessex Water region. The sewage, together with industrial water waste, is treated by 392 treatment plants, utilising a network of 1,314 pumping stations, over 15,000km of sewers and 1,090 combined sewer outflows.

UK water industry. The privatisation of the UK water industry in 1989 led to the formation of 10 water and sewerage companies (including Wessex Water) and several smaller water companies. The ring-fenced industry is tightly regulated by three key bodies, which are the United Kingdom Office of Water Services (Ofwat or the economic regulator), the Environment Agency and the Drinking Water Inspectorate. The regulators set various operational and economic regulations, which include price determination and capital investment programmes.

Licence and ownership of assets. Wessex owns all the concession assets in perpetuity. Wessex's current operating licence will expire in Aug 2014. We expect the authority to renew its licence as it has been meeting all the operating parameters set by the regulator. Furthermore, the licence can be revoked only if the operator fails to provide a reasonable quality of service to the public. The regulator is also required to give at least 25 years of notice if it wants to terminate the licence.

Water rate hike and efficiency gains to boost earnings. Ofwat regulates the water industry by putting limits on the prices charged to customers rather than on profits or rate of returns. This acts as an incentive for companies to be efficient. Apart from the price cap, Ofwat also determines the capital investment programmes. In setting the price limits, the regulator takes into account inflation, return on capital, efficiency savings and capital investment programmes.

Higher-than-average annual price increase limits... In its latest price review, Ofwat granted Wessex Water an average price hike of 5.2% p.a. for the 2005-2010 period (Figure 5). This is 0.9% pts higher than the weighted average annual increase of 4.3% accorded to the industry in recognition of its satisfactory services. This, coupled with future efficiency gains, will boost the profitability of the Wessex group.

Figure 5: Annual price increase limits set by Ofwat (%)

UK water & sewerage companies	2005-06	2006-07	2007-08	2008-09	2009-10	Average
Anglian	3.8	0.0	2.8	2.7	2.7	2.4
Dwr Cymru	14.2	3.6	4.1	3.3	2.2	5.4
Northumbrian	6.5	3.7	3.2	1.0	0.6	3.0
Severn Trent	11.8	4.8	2.0	1.7	2.3	4.5
South West	12.5	9.8	9.8	1.7	1.4	6.9
Southern	12.6	3.9	3.5	5.8	2.6	5.6
Thames	14.9	2.1	1.2	1.3	1.5	4.1
United Utilities	5.0	6.4	4.4	3.5	3.0	4.5
Wessex	8.9	4.9	5.6	4.0	2.9	5.2
Yorkshire	5.5	4.9	3.6	3.6	2.1	3.9
Weighted average	***9.4***	***4.0***	***3.4***	***2.7***	***2.2***	***4.3***

Source: OFWAT, Company, CIMB estimates / Research

… but lowest capex budget. Looking at the 5-year capital expenditure plans for the respective operators, Wessex Water's £756m projection appears to be the lowest (Figure 6). Nevertheless, on a per property basis, the £190 annual allocation is comparable with the £151 average.

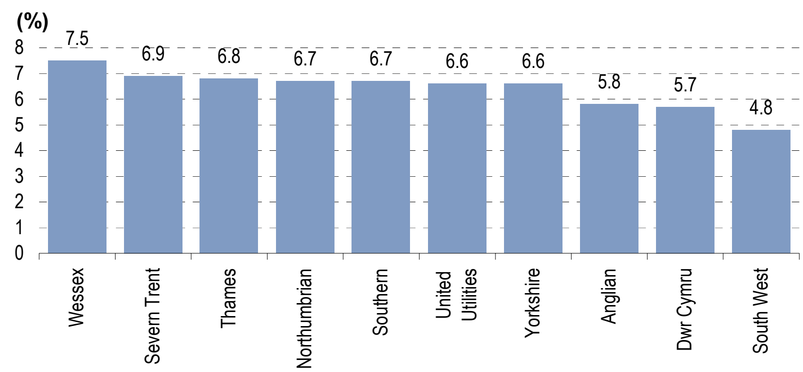
Figure 6: 5-year capital expenditure plans

	Total 5 -year capex plan £m	Annual capex per property £
Anglian	1,466	132
Dwr Cymru	1,144	177
Northumbrian	839	113
Severn Trent	2,201	125
South West	762	216
Southern	1,562	195
Thames	3,092	150
United Utilities	2,505	170
Wessex	756	190
Yorkshire	1,453	141
Total	**15,780**	**151**

Source: OFWAT, Company, CIMB estimates / Research

Well-managed and efficient water player. Among the water and sewerage companies in the UK, Wessex boasts the highest return on capital employed (ROCE) (Figure 7). ROCE achieved in the 2005/06 reporting period was 7.5%, 1.1% pts higher than the industry average of 6.4%. This is not particularly surprising since Ofwat allocates benchmark average costs to all players. As such, the more cost-efficient players will naturally enjoy a higher return. The group also scored highly on operational efficiency, being the only company to achieve Ofwat's top star rating for all seven key areas of services. Its compliance rates for drinking water, sewerage treatment and bathing water are also among the best in the country.

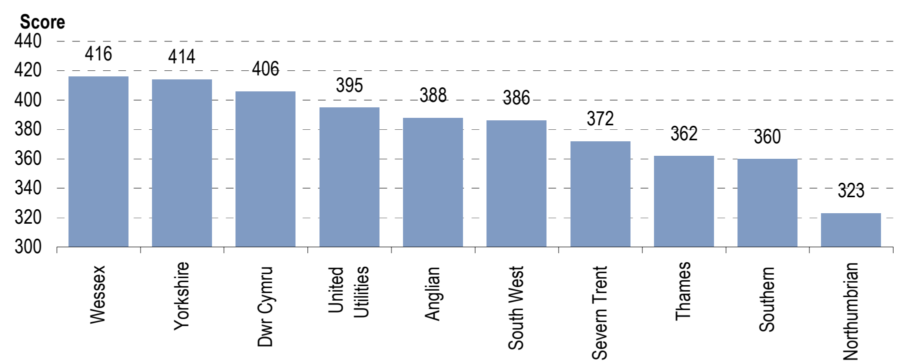
Figure 7: Wessex has the highest ROCE among UK water & sewerage companies



Source: OFWAT, Company, CIMB estimates / Research

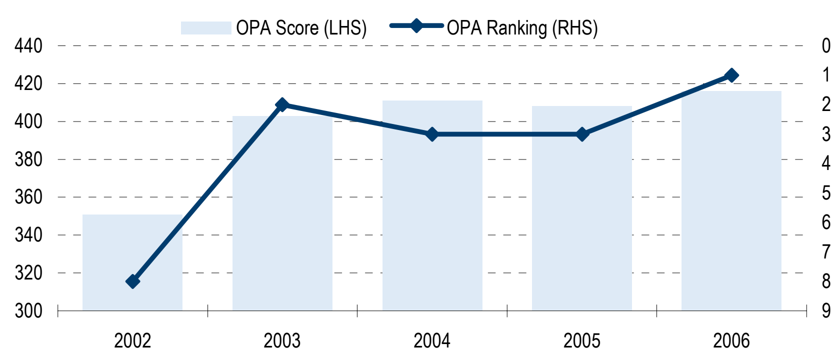
Highest OPA ranking in 2006. Wessex Water came in tops for Ofwat's recent overall performance assessment (OPA) ranking in 2006 (Figure 8). This ranking, we believe, bears further testimony to the water operator's efficiency and good management. Wessex Water has been among the top three over the past four years (Figure 9).

Figure 8: Ofwat's 2006 OPA ranking



Source: OFWAT, Company, CIMB estimates / Research

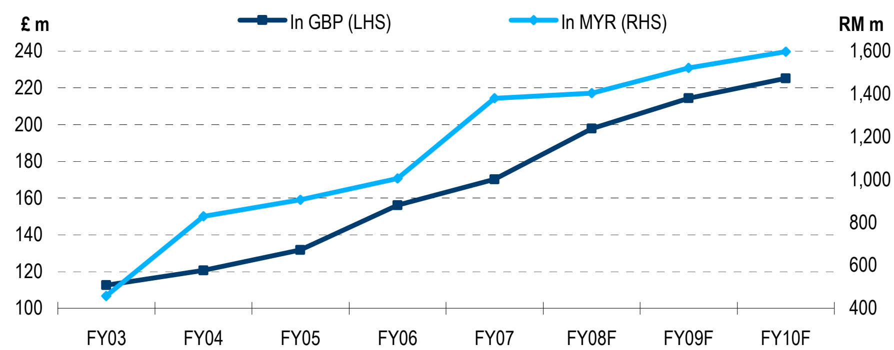
Figure 9: Wessex Water's Ofwat ranking (2002-2006)



Source: OFWAT, Company, CIMB estimates / Research

Steady and stable contributor to YTL Power. Wessex's EBIT contribution to YTL Power has been rising steadily at a CAGR of 19% over the past three years (Figure 10). In FY07, this division made up 68% of group EBIT including associates. Higher revenue, rising cost efficiency and the strong sterling were the key factors behind Wessex's higher earnings contributions. Stripping out forex gains, Wessex's organic growth rate was equally impressive at 12% over the past three years (Figure 10). We expect its bottomline to expand at a rate of 2-8% annually for FY08F-10, thanks to i) above-average annual price increase limits and ii) operational efficiency resulting from effective cost control measures.

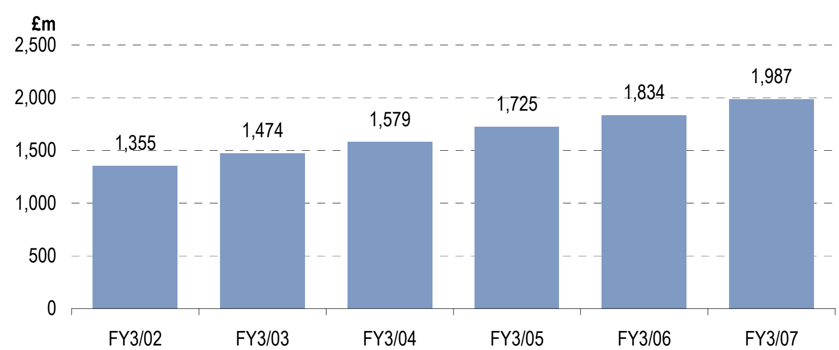
Figure 10: Wessex Water's EBIT (FY03-FY10F)



Source: Wessex Water 2004-2007 Annual Reports, Company, CIMB estimates / Research

RAB appreciated 60% since acquisition. Wessex's regulated asset base (RAB) of £1,987m as at end-Mar 07 represents a 60% increase from its acquisition price of £1,239.5m on EV basis (Figure 11). Inclusive of the 24% gain on forex, this would translate into a whopping 84% gain for YTL Power since its acquisition of Wessex. RAB is one of the key yardsticks used to value regulated assets. Based on 1.5x P/RAB and an exchange rate of RM7.1 to £1, we arrive at an enterprise value (EV) of RM21bn for Wessex Water. However, after knocking off the company's net debt from its EV, we get a value of RM12bn for this business, which is equivalent to RM2.27 per YTLP share.

Figure 11: Regulated asset base of Wessex Water (£ m)



Source: Wessex Water 2004-2007 Annual Reports, Company, CIMB estimates / Research

Peers trading at premium to RAB. Looking at some of the listed comparables for Wessex Water, we see that a common trait is the premium that they command over their RAB (Figure 12).

M&A transactions according premium to RAB. Furthermore, recent M&A transactions in the UK water sector value water assets at up to 35% premium over their RAB value. One example is Kemble Water Ltd's Dec 06 acquisition of Thames Water at a 20% premium over the latter's RAB. Similarly, in Oct last year, a consortium of Canadian and Australian pension funds paid £2.2bn for Anglian Water, valuing the water company at a 20-30% premium over its RAB.

Figure 12: Listed comparables of Wessex Water trade at premiums over their RAB (£ m)

Company	Bloomberg code	Share price	Share cap	Mkt cap	Net Debt	EV	RAB	EV/RAB
		£	m	£m	£m	£m	£m	x
United Utilities Water	UU/ LN	6.63	880.2	5,831.4	3,262.4	9,093.8	6,217.3	1.46
Severn Trent	SVT LN	13.20	234.4	3,094.3	2,484.8	5,579.1	5,177.5	1.08
Pennon (South West)	PNN LN	5.92	352.8	2,086.8	1,280.6	3,367.4	2,026.9	1.66
Kelda (Yorkshire)	KEL LN	8.52	275.8	2,349.7	1,551.2	3,900.9	3,560.4	1.10
Dee Valley Water	DVW LN	9.80	4.1	40.6	26.6	67.2	52.1	1.29
Northumbrian Water	NWG LN	3.23	518.6	1,673.9	1,521.2	3,195.1	2,550.2	1.25
Average								**1.31**
Wessex Water							1,987.0	

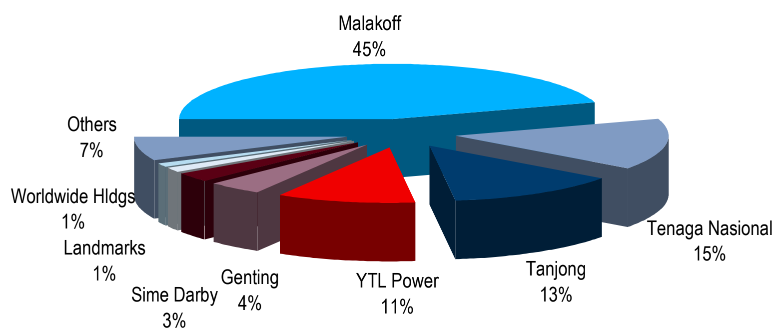
Source: Company, Ofwat, CIMB estimates / Research, Bloomberg

Power division

Malaysia

First IPP in Malaysia with 11% market share. The group owns two gas-fired power plants in Paka, Terengganu (808MW) and Pasir Gudang, Johor (404MW), through 100%-owned YTL Power Generation (YTLPG). The installed capacity of both plants adds up to 1,212MW, making YTL Power the third largest IPP in Malaysia with around 11% share of IPP generation capacity and 6% of the power generation market in Peninsular Malaysia (Figure 13). The company is the first IPP to be awarded a licence from the Director General of Electricity Supply as part of the government's plan to privatise the electricity industry in Malaysia.

Figure 13: YTL Power is Malaysia's 3rd largest IPP by capacity



Source: Company, CIMB estimates / Research, Bloomberg

"Take-or-pay" concept in PPA. YTLPG signed a power purchase agreement (PPA) with Tenaga on 31 Mar 1993 for a term of 21 years expiring on 30 Sep 2015. Under the PPA, Tenaga is obliged to "take or pay" a minimum of 7,450Gwh of electricity per annum. This represents a capacity factor of around 70%.

Fixed tariff rate at 15.5 sen/kwh. It also fixes the selling price for the minimum quantity of electricity for both plants at 15.5 sen/kwh. However, Tenaga is entitled to a 2% discount on the selling price on Sundays and a reduction in the selling price to 14 sen/kwh on nominated public holidays.

Unique PPA insulates it from demand risk. The predetermined take-up rate and price insulate the group from both demand and price fluctuations and is unique to YTL Power in the Malaysian IPP space. The group's PPA is also unique as it stipulates a minimum quantity of electricity to be sold to Tenaga, unlike the other PPAs where payments are based on a 2-tier structure – capacity and energy payments. This gives YTL Power a slight advantage as it does not need to observe minimum levels of availability and dependable capacity in order to get full payment from Tenaga.

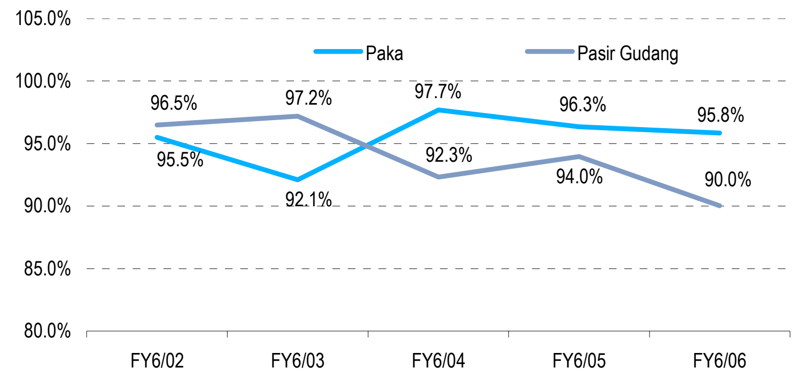
GSA with Petronas. Gas supply to YTL Power's power plants is secured via a 21-year gas supply agreement (GSA) with Petronas which also expires on 30 Sept 2015. Although the GSA has also been structured on a take-or-pay basis, there is little risk of having to pay for unconsumed gas since YTL Power already needs more than this take-or-pay amount of gas to generate the minimum quantity of electricity under its PPA.

Fuel pass-through if gas price exceeds RM6.40 per mmbtu. The government has fixed the price of gas supplied to the power industry at RM6.40 per mmbtu since 1 May 1997. However, Petronas is reportedly seeking government approval for a higher gas price. This should not affect YTL Power as under its PPA, Tenaga is required to reimburse YTL Power for the difference if gas price exceeds RM6.40 per mmbtu.

Good track record ensures full offtake payment. The combined availability of both power plants has averaged more than 90% since it was commissioned (Figure 14). This more than meets the yearly minimum quantity that YTL Power is obliged to sell to Tenaga which is equivalent to around 70% of its combined capacity. As a result, YTL Power has consistently been getting the full offtake payment from Tenaga.

Spare capacity offers growth opportunity. YTL Power's spare capacity will come in handy when there is a power shortage in Peninsular Malaysia as Tenaga may require it to supply additional electricity in such circumstances. In 2001, it entered into a supplemental agreement with Tenaga for three years ending 31 Dec 03 to supply an additional 1,400GWh p.a. to Tenaga at 10.9 sen per kwh. This boosted the plant's capacity factor to 83% during the period. However, this is unlikely to happen over the next few years as the country's reserve margin is expected to stay high at 35%.

Figure 14: Availability of YTLPG's plants over the past 5 years



Source: Company, CIMB estimates / Research

Strong operating margin and cash cow business. The operating profit margin achieved by YTL Power's plants ranks high among the IPPs (Figure 15). This, coupled with its good operating track record, enables the group to chalk up consistently RM550m operating cash flows and RM300m-350m net profit annually.

Figure 15: Comparison of selected IPPs' operating margin

IPPs	FY End	EBITDA margin
Ist Generations		
YTL Power Generation	30 June 06	56.0%
Powertek Bhd (Teluk Gong power plant)	31 Jan 07 (3 mths)	73.0%
Segari Energy Ventures	31 Aug 05	50.0%
2nd Generations		
GB3	31 Aug 05	43.0%
Pahlawan Power	31 Jan 05	52.0%
Teknologi Tenaga Perlis Consortium	31 Dec 06 (5 mths)	44.0%
Prai Power	31 Aug 06 (5 mths)	50.0%
Panglima Power	1 Jan 07 (3 mths)	58.0%

Source: RAM reports, Company, CIMB estimates / Research

35% stake in Jawa Power – Newest addition to the group

Expanded generation activity to Indonesia. YTL Power acquired a 35% stake in PT Jawa Power together with its loan stocks for US$139.4m (RM529.7m) cash and a 100% stake in the operations and maintenance company, PT Powergen Jawa Timur for US$3.6m cash (RM13.7m) in Dec 04. The other shareholders of Jawa Power are Siemens AG (50%) and PT Bumipertiwi Tatapradipta (15%). Jawa Power owns a 1,220MW coal-fired power station in Paiton Complex in east Java. The plant, comprising two generation units of 610MW each, is the second largest operational IPP in Indonesia.

PPA terms insulate earnings from demand risks. Jawa Power holds a 30-year

PPA with PT Perusahaan Listrik Negara (PLN), the Indonesian state-owned electricity company and the Indonesian equivalent of Tenaga. Under the PPA which took effect on 4 Nov 00, Jawa Power is entitled to full capacity payments from PLN as long as its plant fulfils the availability requirement of at least 83% in the contract year. This insulates the plant from demand risks. The tariff rate for Jawa Power was previously based on four components – capacity payment, fixed O&M component, energy payment and variable O&M expenses. On 8 Jul 02, Jawa Power signed a supplemental PPA with PLN, which led to a fixed long-term tariff of around 5.6 US cts for the remaining concession period.

Fuel supply risks mitigated by long-term contracts. All of the coal requirements of its power plant are secured by existing long-term contracts with two mining companies in Kalimantan. This alleviates worries over fuel supply risks. The coal price is based on annual negotiations and the base annual quantity of supply under both contracts is 3.8m tonnes, with an allowable variance of 20%. The PPA also has a fuel pass-through clause, which shields its earnings from fuel risk.

Commendable track record. Historically, Jawa Power's combined availability has averaged 90%, well ahead of the minimum 83% requirement stipulated in the PPA. This higher-than-planned availability is positive as it reflects the plant's greater degree of efficiency. In terms of actual dispatch, with the exception of 2003, Jawa Power has also successfully delivered higher-than-planned quantities to PLN (Figure 16).

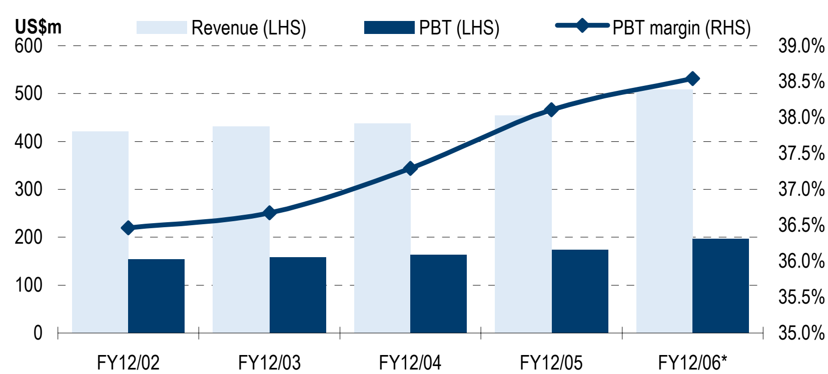
Figure 16: Jawa Power's operational figures

Plant Operations	2002	2003	2004	2005	2006	Average
Planned Availability	83%	83%	83%	83%	83%	
Actual Availability	89%	88%	85%	95%	95%	90%
Planned Dispatch	55%	70%	70%	76%	na	
Actual Dispatch	64%	66%	76%	91%	85%	76%

Source: Company, CIMB estimates / Research

Good earnings track record is sustainable. This unit, whose contributions are denominated in US dollars, accounted for 13% of the group's FY06 EBIT (including associates) in its first full year of contribution. We take a positive view of the uptrend in margins and earnings contribution from this unit over the past four years (Figure 17). This could have been due to higher power offtake from PLN as well as improved efficiency. We expect a stable income stream from this unit, thanks to the backing of the PPA and the historically prompt payment from its sole offtaker, PLN. Accordingly, this division's contribution to group earnings have notched up a respectable 2-year CAGR of 7%, of which 5% is attributable to the underlying business while the remaining 2% stemmed from the appreciation of the ringgit against the greenback.

Figure 17: Good earnings track record for Jawa Power



** Annualised 1H2006 figures*

Source: RAM reports, Company, CIMB estimates / Research

Room for expansion. We believe YTL Power is keen to spread its wings in Indonesia. This could be in the form of greenfield projects or existing plants. It is also keen to raise its stake in the Jawa power plant if the opportunity arises at the right price. We understand that PT Jawa's shareholders, including YTL Power, have the first right of refusal for their partners' stakes. Despite the higher country risk, we would be positive about such an expansion given the potential high returns and the group's strong track record in Indonesia. Furthermore, it could apply the experience gained in the O&M of the Jawa power plant to its domestic power plants which are currently managed by a subsidiary of YTL Corp. This will expand its earnings base further.

ElectraNet

South Australia's sole transmission operator. Back in late 2000, YTL Power acquired a 33.5% stake in ElectraNet for A$58.5m (RM117m). Under a 200-year concession, ElectraNet will operate and maintain South Australia's electricity transmission system which involves some 6,000km of transmission lines and 76 substations and switchyards.

Small earnings contributor. Relative to group earnings, this division's contribution is small, though relatively stable, at less than 5%. The stable contribution stems largely from a revenue cap which applies for a five-year regulatory period before adjustment. The current revenue cap of A$1,064m (A$193m p.a.) took effect on 1 Jan 03 and is valid for a 5½-year period ending 30 Jun 08.

Figure 18: SWOT analysis

Strengths	Opportunities
• Lucrative "take or pay" PPA contract • Fuel cost pass-through element in PPA • Good overseas track record • Strong management • Wessex Water ranks No.1 in Ofwat's OPA ranking	• Better capital management • Global M&A activities • Potential acquisitions of Malaysia water assets following industry restructuring exercise
Weaknesses	**Threats**
• Exposed to forex risks • Sole offtaker risks faced by its IPP assets • Interest rate risk	• Cess rate hike in Malaysia • Country risk for Indonesian power plant • Rising global liquidity

Source: CIMB Research

Being Malaysia's first IPP, YTL Power enjoys a lucrative "take or pay" PPA contract. Wessex Water's top ranking in Ofwat's OPA survey further reflects the group's strengths i.e. a good overseas track record and strong management. We see opportunities for YTL Power in the global M&A arena and also in the Malaysian water industry following the sector-wide restructuring exercise. However, a lower interest rate environment may reduce its chances of acquiring new assets as the group will face more competition from private equity funds. The company's key weakness is its relatively high exposure to forex and sole offtaker risks.

Risks

Higher cess instead of supplementary PPAs. Having made little progress in the supplementary PPA negotiations, the government decided in Mar 07 to call off the negotiations and instead impose a higher cess on IPPs. Currently, IPPs contribute 1% of their revenue to the Electricity Supply Industry Cess Fund from the generated power sent to the electricity grid. YTL Power's profitability may be squeezed by this proposal. Nevertheless, this risk is mitigated by the relatively small earnings contribution (some 18% of FY07 EBIT including associates) of its local power plants relative to group earnings. Our sensitivity analysis shows that for every 1% increase in cess rate, our net profit estimates would be lowered by up to 1% (Figure 19). Nevertheless, we believe the likelihood of higher cess rates in the near term is relatively slim.

Figure 19: Sensitivity analysis of increase in cess rate to our net profit forecasts for YTL Power

	Cess rate as a % of revenue				
Net profit	**1%**	**2%**	**3%**	**4%**	**5%**
FY08F	0.0%	-1.0%	-1.9%	-2.9%	-3.8%
FY09F	0.0%	-0.8%	-1.6%	-2.4%	-3.2%
FY10F	0.0%	-0.8%	-1.5%	-2.3%	-3.1%

Source: Company, CIMB estimates / Research

Potential share overhang. There may be a share overhang from the potential issuance of up to 1,284m new shares (24.2% of its current paid-up capital) via the exercise of outstanding warrants and conversion of guaranteed exchangeable bonds (GEB) due in 2010 (Figure 20). The exercise price for the warrant is RM1.39 on an annual step-up basis while the conversion price for the GEB is fixed at RM2.28.

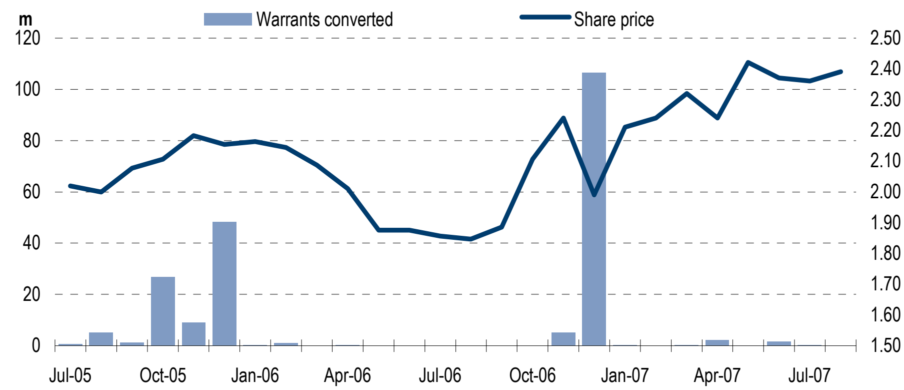
Looking back historically, there appears to be a downward pressure on YTL Power's share price when a sizeable conversion takes place (Figure 21).

Figure 20: Details of YTL Power's warrants and exchangeable bonds

	Issue Date	Expiry Date	Exercise Price RM	Outstanding amount (m)	Conversion Ratio
Warrants	8-Jan-00	8-Jan-10	1.39	889.4	1:1
Exchangeable Bonds	9-May-05	9-May-10	2.28	394.7	1:1

Source: Company, CIMB estimates / Research

Figure 21: Warrant conversions and share price of YTL Power over the past 2 years



Source: Company, CIMB estimates / Research

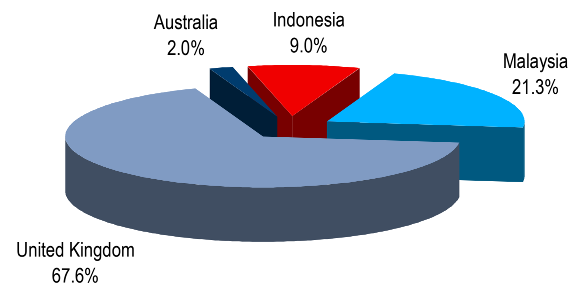
Another potential source of share overhang is its parent's proposed restricted offer for sale (ROS) exercise. In Aug 06, YTL Corp proposed a 1-for-10 ROS of YTL Power shares at RM1.00 per share. Exactly a year later, the conglomerate again proposed a ROS exercise of 1-for-15 YTL Power shares, also at RM1.00 per share. Assuming that the two largest shareholders of YTL Corp, i.e. the Yeoh family and EPF, do not sell the ROS shares, the potential share overhang is only around 37m shares or 0.7% of YTL Power's outstanding shares. Based on its average daily volume of 2.7m, it would take around 14 days to clear the potential overhang. Nevertheless, based on the experience from the first ROS, there appears to be minimal impact on YTL Power's share price during the share transfer period.

Exchange rate risks. YTL Power derives around 79% of its EBIT (including associates' contribution) from its overseas assets in Australia, the UK and Indonesia (Figure 22). This means that its core earnings would be adversely affected by a firming of the ringgit against the sterling pound, Australian dollar or the greenback. However, this would be partially offset by forex translation gains on its foreign-denominated debt.

Looking into the group's debt mix, a sizeable 66% is denominated in sterling, 19% is in ringgit and the remaining 15% in US dollars. Our rough calculation shows that every 1% appreciation in our assumption for the pound would have a 0.5% positive impact on YTL Power's core net profit due to higher translated earnings from Wessex Water. But reported net profit could be squeezed by 6.0% due to the recognition of one-off translation losses resulting from the larger pound-denominated debt.

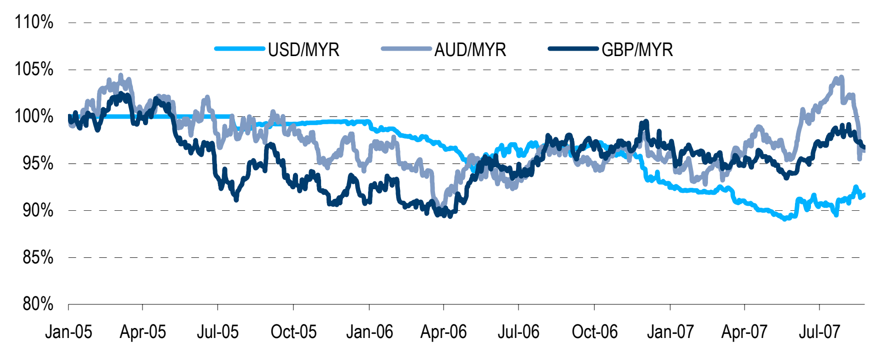
In US dollars term, the core bottomline positive impact from a 1% appreciation is somewhat smaller at 0.1% owing to its relatively smaller contribution to group earnings. However, this would be more than offset by the 1.5% negative impact resulting from the recognition of debt-related translation losses at the reported net profit level.

Figure 22: Geographical breakdown of FY07 EBIT including associates



Source: Company, CIMB estimates / Research

Figure 23: Currency movements over the past two years



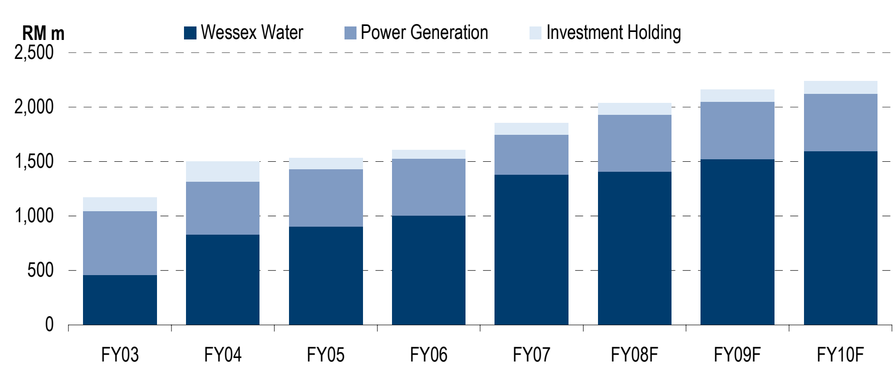
Source: OFWAT, Company, CIMB estimates / Research

Financial performance

FY07 results review. During FY07, the group reported a whopping 45% yoy growth in net profit, driven mainly by some RM185m deferred tax and higher investment income. EBIT contributions from the local power segment fell 30% yoy, dragged down by some RM156m provisions for receivables. Wessex Water, on the other hand, reported an encouraging 37% yoy increase in profit contributions as higher tariffs, along with cost control measures, widened profit margins.

Moderate earnings prospects. At the pretax level, we expect YTL Power to record moderate growth of 9-13% p.a. over the next three years, fuelled mainly by higher efficiency of its power plants in Indonesia and above-average price hikes for Wessex Water (Figure 24). Although earnings from its local power plant should return to normal after FY07's one-off provisions, we still project a 15% dip in FY08 net profit as the effective tax rate normalises after FY07's deferred tax savings. Subsequently, FY09-10 net profit growth should mirror the growth at the pretax level.

Figure 24: Composition of EBIT (FY03-FY10F)



Source: Company, CIMB estimates / Research

M&A

Unexciting in the past but… Since its acquisition of Jawa Power back in 2004, YTL Power has been silent on the M&A front despite sitting on a RM7bn cash hoard. Although the group has been scouting around, we believe its conservative screening has weeded out many potential targets which have become overpriced in the global M&A boom. Notwithstanding the lack of M&A activities, the group has steadily proven its ability to extract value from its existing assets. Since joining the YTL Power group, Wessex Water has registered organic growth of 12% while PT Jawa has racked up organic growth of 5%.

… landscape has changed. We believe that macro conditions have changed, creating opportunities for cash-rich and conservative companies like YTL Power to snap up quality assets.

Liquidity crunch a blessing in disguise? The recent market turmoil has undeniably sparked fears of an impending liquidity crunch. Although this could lead to a dent in global economic growth, we believe this puts YTL Power in a better position to scoop up deals given its strong cash position. With its international utility expertise and ready funds, asset acquisitions should be earnings enhancing for the group.

Opportunities down south? According to press reports, Singapore's Temasek Holdings Pte Ltd will start the bidding process for three domestic power-generation companies over the next few weeks, with the first company expected to be sold by year-end. Sources said the state-owned investment company's preference would be to sell the companies to foreigners rather than local players. Given YTL Power's experience in foreign field and efficiently run operations, Singapore's merchant market should bode well for the company. Although it is too early to gauge the return, assuming a conservative 10% return versus YTL Power's 6% cost of funds, the asset could rake in an additional return of 4% to such an investment.

Wessex expertise for local water play? We also see opportunities for YTL Power in the local water industry, following the industry-wide restructuring efforts undertaken by the government in an effort to formulate a more holistic approach in the management of water services. In particular, existing water operators are expected to migrate to a licensing regime within a 2-year timeframe following the enactment of the two new Water Acts by Jan 08. This creates opportunities for YTL Power to form JVs with state governments or bid for licences given its proven track record in nurturing Wessex Water into the top ranking water and sewerage company. Under the licensing regime, water operators need to meet KPIs, failing which their licences would be revoked. Another regulatory change that works in YTL Power's favour is the extension of water operators' scope from just water services to water and sewerage services. With Wessex Water, YTL Power has established international expertise in managing water supply and sewerage services.

Valuation and recommendation

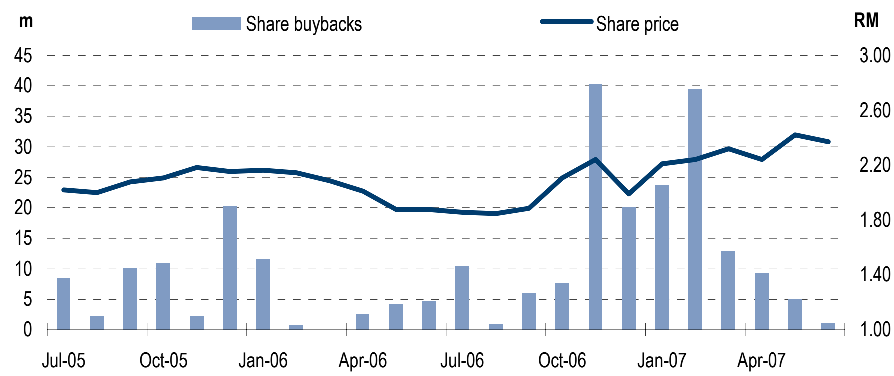
Share buybacks support share price. YTL Power has been actively buying back its shares over the past few years. In total, it has bought back 646.8m shares (12% of its current paid-up capital) at a cost of RM1,476.0m (Figure 25). These share buybacks provided considerable support to the share price (Figure 26).

Figure 25: Share buyback record

Financial year	Amt of buy back (m)	Value (RMm)	Avg price	Total share cap	% of paid-up cap
2001	108.6	149.2	1.37	4,459.4	2.4%
2002	32.0	44.7	1.40	4,510.1	0.7%
2003	4.3	6.3	1.47	4,577.3	0.1%
2004	107.2	187.0	1.75	4,612.5	2.3%
2005	187.8	358.0	1.91	4,996.8	3.8%
2006	78.2	168.1	2.15	5,163.1	1.5%
2007	254.7	562.6	2.21	5,296.3	4.8%
Total	**772.9**	**1,476.0**	**1.75**		

** FY01-04 numbers adjusted for 1:2 share split on 12 July 2004*
Source: Company, Bursa Malaysia announcements, CIMB estimates / Research

Figure 26: Share buyback record versus share price



Source: Company, Bursa Malaysia announcements, CIMB estimates / Research

Can afford 1-for-28 treasury share distribution. Some of the shares that YTL Power bought back have been distributed to its shareholders in the form of a dividend-in-specie in 2001, 2005 and 2006. Over the past five years, it has given shareholders a total of 433m shares. It has 190.1m treasury shares left, which suggests that it can afford a 1-for-28 share distribution (Figure 27). This is equivalent to a payout of 9 sen per share or 4% based on the last closing price.

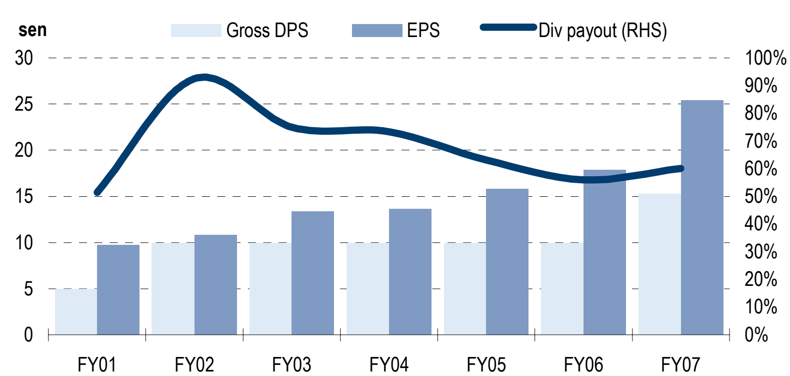
Figure 27: Historical treasury shares dividend

Financial year	Share dividend	Amt of treasury shares distributed (m)
2001	1- for -50 shares	44.6
2005	1-for-25 shares	190.3
2006	1-for-25 shares	198.1
2007	Treasury shares balance	190.1

Source: Company, CIMB estimates / Research

Attractive dividend yields. YTL Power has a formal 20% cash dividend policy where the group has consistently paid out 10 sen gross DPS from FY02 to FY06. During FY07, the group declared a higher 15 sen payout which translates into a 60% gross payout policy. In terms of yields, the 6% offered is also attractive. Including the share dividends that were paid out in Feb 07, FY07's dividend yield would be an attractive 10.4%.

Figure 28: YTL Power's historical dividend payout



Source: Company, CIMB estimates / Research

Low foreign shareholding. Despite its large market capitalisation of RM12bn, YTL Power's foreign shareholding level is low at about 5%, partly because of its small free float of 20%. We expect foreign interest in the company to improve due to the following: (1) rising free float after the 1-for-15 distribution of YTL Power shares at RM1.00 each by its parent, and (2) increasing awareness of YTL Power's value as a cheap indirect play on the UK water and sewerage sector through Wessex Water.

SOP valuation of RM3.30 per share. Given its diverse businesses, we have valued the stock based on the sum of its parts (SOP). The power plants are valued using the DCF method, 1.3x (EV/RAB - net debt) is tagged to the Australian transmission operator and Wessex Water is rated at 1.5x RAB, a 15% premium over its peers given its superior management and efficiency traits. This gives us an FD SOP value of RM3.30.

Figure 29: Sum-of-parts value of YTL Power

Details	Method	Stake (%)	Value (RM'm)
Paka and Pasir Gudang power plants	DCF value @ 8.2%	100	3,360
Jawa power plant	DCF value @ 10.2%	35	2,363
Electranet	1.3x EV/RAB - net debt	33.5	385
Wessex Water	EV/RAB of 1.5x	100	21,162
Net debt	as at 30 June 2007		(8,025)
Total SOP value			19,245
Basic no of shares			5,296
SOP value per share			3.63
Fully diluted SOP value			21,720
Fully diluted no of shares			6,580
Fully diluted SOP value			**3.30**

Source: Company, CIMB estimates / Research, Bloomberg

Initiate coverage with OUTPERFORM call. The stock offers 38% upside to our SOP target price of RM3.30. As such, we are initiating coverage with an OUTPERFORM call. Sentiment could be helped by the rally of UK water and utility stocks and the firming of the UK currency. Key re-rating catalysts for YTL Power are: i) earnings-enhancing acquisitions, ii) further re-rating of UK water stocks, iii) opportunities from the local water industry and iv) treasury share distributions. Investors with a higher risk appetite could consider its 2000/2010 warrants (RM1.00, YTLPW, exercise price RM1.39, expiry 8 Jan 2010) which are currently in the money.

More upside to our SOP value. There is upside to our SOP value if the group enters into a sizeable earnings-enhancing acquisition or if M&A deals set new benchmarks for water/utilities stocks in the UK. Our sensitivity analysis suggests that every 0.1x increase in the EV/RAB multiple that we use in our Wessex valuation adds RM0.22 or 7% to our SOP value (Figure 30).

Figure 30: Sensitivity of YTL Power's SOP to Wessex's valuation (RM)

EV/RAB for Wessex Water	1.3x	1.4x	1.5x	1.6x	1.7x	1.8x
Fully diluted SOP of YTL Power	**2.87**	**3.09**	**3.30**	**3.52**	**3.73**	**3.94**
Share price of YTL Power	2.40	2.40	2.40	2.40	2.40	2.40
Upside to share price	19.7%	28.6%	37.5%	46.5%	55.4%	64.3%

Source: Company, CIMB estimates / Research, Bloomberg

Sector comparisons

	Bloomberg ticker	Recom.	Price	Mkt cap	Core P/E (x) CY07	CY08	3-yr EPS CAGR (%)	P/NTA (x) CY07	ROE (%) CY07	CY08	Div yield (%) CY07
Tenaga	TNB MK	O	9.90	42,832.3	12.3	11.7	52.4	1.8	19.1	15.7	4.2
Tanjong	TJN MK	O	17.60	7,097.3	14.3	13.1	12.9	2.3	16.4	16.5	5.0
YTL Power	YTLP MK	O	2.40	12,711.1	11.6	13.1	4.7	2.1	18.1	15.6	6.4
Simple average					**12.8**	**12.6**	**23.3**	**2.0**	**17.9**	**15.9**	**5.2**

O = Outperform, N = Neutral, U = Underperform, NR = Not Rated, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research, Bloomberg, Reuters Estimates

Financial tables

PROFIT & LOSS (RM m, FYE Jun)	2006	2007	2008F	2009F	2010F
Revenue	3,758.1	4,068.0	4,374.2	4,533.3	4,645.7
Operating expenses	(1,792.4)	(1,782.1)	(1,922.1)	(1,973.2)	(1,948.2)
EBITDA	1,965.7	2,285.9	2,452.1	2,560.1	2,697.5
Depreciation & amortisation	(532.2)	(579.1)	(596.8)	(607.3)	(617.5)
EBIT	1,433.6	1,706.9	1,855.3	1,952.8	2,080.0
Net interest & invt income	(487.4)	(591.9)	(586.7)	(548.3)	(539.7)
Associates' contribution	166.2	185.4	195.5	199.4	203.4
Exceptional items	-	-	-	-	-
Pretax profit	**1,112.4**	**1,300.3**	**1,464.2**	**1,603.9**	**1,743.6**
Tax	(237.9)	(31.2)	(380.7)	(401.0)	(435.9)
Minority interests	-	-	-	-	-
Net profit	**874.5**	**1,269.1**	**1,083.5**	**1,202.9**	**1,307.7**
Wt. shares (m)	4,931.1	5,296.3	5,296.3	5,296.3	5,296.3
Shares at year-end (m)	5,163.1	5,296.3	5,296.3	5,296.3	5,296.3

BALANCE SHEET (RM m, 30 Jun)	2006	2007	2008F	2009F	2010F
Fixed assets	14,123.4	14,885.8	14,904.8	15,246.0	15,554.1
Intangible assets	441.3	441.3	441.3	441.3	441.3
Other long-term assets	1,671.4	1,531.4	1,582.3	1,632.1	1,685.0
Total non-current assets	**16,236.2**	**16,858.5**	**16,928.4**	**17,319.4**	**17,680.4**
Cash and equivalents	4,740.1	6,029.8	6,121.7	6,877.4	5,244.3
Stocks	153.3	160.9	167.1	169.9	172.4
Trade debtors	1,071.5	909.2	1,138.5	1,179.9	1,171.0
Other current assets	43.1	44.5	46.7	49.1	51.5
Total current assets	**6,008.1**	**7,144.4**	**7,474.0**	**8,276.3**	**6,639.2**
Trade creditors	50.6	59.2	65.8	66.9	67.9
Short-term borrowings	1,064.7	1,033.0	1,014.7	2,758.3	1,582.9
Other current liabilities	960.7	1,004.8	1,047.1	1,084.7	1,114.0
Total current liabilities	**2,076.0**	**2,097.0**	**2,127.5**	**3,910.0**	**2,764.8**
Long-term borrowings	11,541.9	13,022.0	12,255.5	10,976.1	10,048.0
Other long-term liabilities	2,897.5	2,756.9	2,993.6	3,079.5	3,167.8
Total long-term liabilities	**14,439.4**	**15,778.9**	**15,249.1**	**14,055.7**	**13,215.8**
Shareholders' funds	**5,729.0**	**6,127.0**	**7,025.7**	**7,630.0**	**8,339.1**
Minority interests	0.0	0.0	0.0	0.0	0.0
NTA/share (RM)	1.02	1.07	1.24	1.36	1.49

CASH FLOW (RM m, FYE Jun)	2006	2007	2008F	2009F	2010F
Pretax profit	1,112.4	1,300.3	1,464.2	1,603.9	1,743.6
Depreciation & non-cash adjustments	532.2	579.1	596.8	607.3	617.5
Working capital changes	90.7	(317.1)	441.9	58.1	112.6
Cash tax paid	(179.5)	(237.9)	(31.2)	(380.7)	(401.0)
Others	(117.3)	(136.7)	(195.5)	(199.4)	(203.4)
Cash flow from operations	**1,438.5**	**1,187.6**	**2,276.1**	**1,689.3**	**1,869.4**
Capex	(652.5)	(762.3)	(800.0)	(800.0)	(800.0)
Net investments & sale of FA	(264.3)	186.3	-	-	-
Others	50.1	-			
Cash flow from investing	**(866.8)**	**(576.0)**	**(800.0)**	**(800.0)**	**(800.0)**
Debt raised/(repaid)	(161.2)	1,448.4	(784.9)	464.3	(2,103.6)
Equity raised/(repaid)	222.4	174.8	-	-	-
Dividends paid	(355.3)	(746.7)	(598.6)	(598.6)	(598.6)
Cash interest & others	(47.0)	(198.7)	-	-	-
Cash flow from financing	**(341.1)**	**677.8**	**(1,383.5)**	**(134.3)**	**(2,702.2)**
Change in cash	**230.6**	**1,289.4**	**92.6**	**754.9**	**(1,632.8)**
Change in net cash/(debt)	**391.8**	**(159.0)**	**877.5**	**290.6**	**470.8**
Ending net cash/(debt)	**(7,866.4)**	**(8,025.4)**	**(7,147.9)**	**(6,857.3)**	**(6,386.6)**

KEY RATIOS (FYE Jun)	2006	2007	2008F	2009F	2010F
Revenue growth (%)	2.4	8.2	7.5	3.6	2.5
EBITDA growth (%)	(0.9)	16.3	7.3	4.4	5.4
Pretax margins (%)	29.6	32.0	33.5	35.4	37.5
Net profit margins (%)	23.3	31.2	24.8	26.5	28.1
Interest cover (x)	2.6	2.7	2.9	3.1	3.5
Effective tax rates (%)	21.4	2.4	26.0	25.0	25.0
Net dividend payout (%)	40.6	58.8	55.3	49.8	45.8
Debtors turnover (days)	106.1	88.9	85.4	93.3	92.4
Stock turnover (days)	14.2	14.1	13.7	13.6	13.4
Creditors turnover (days)	6.1	4.9	5.2	5.3	5.3

Source: CIMB/CIMB-GK Research

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   (b) -.

(iii) As of 12 September 2007, the analysts, Ivy Ng & Soh May Yee who prepared this report, owns and has an interest in the securities in the following company or companies covered or recommended in this report.
   (c) -.

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