Transparent Regulations Are Key To Investments In Malaysia And Indonesia's Power Sector

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SINGAPORE (Standard & Poor's) Oct. 21, 2015--A stable and transparent tariff setting mechanism is important to ensure that power companies in Indonesia and Malaysia can get adequate returns from their increasing investments. Such regulations can also attract more private sector investment to the sector. That's according to a report, titled "Transparent Regulations Are Needed To Fuel Power Investments In Malaysia And Indonesia," that Standard & Poor's Ratings Services published today.

Indonesia's PT Perusahaan Listrik Negara (Persero) (PLN: BB/Positive/--; axBBB/--) and Malaysia's Tenaga Nasional Bhd. (BBB+/Stable/--; axA+/axA-1) have planned significant capital expenditure over the next four-five years to increase power capacity.

"A supportive and progressive regulatory framework can support and reinforce PLN and Tenaga's competitive position and reduce volatility in their earnings," said Standard & Poor's credit analyst Abhishek Dangra.

In the absence of such support, the credit profiles of these companies could deteriorate if the funding mix of the capital expenditure fails to reduce leverage. However, being state-owned and dominant entities in the domestic power sector, we expect Tenaga and PLN to continue to benefit from government support.

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Standard & Poor's believes the regulatory environment is gradually improving in Indonesia and Malaysia. Both governments have raised electricity tariffs over the past 24 months as part of a drive to bring tariffs closer to market-linked prices. They have also indicated that future cost adjustments will take into account fuel costs.

"Indonesia and Malaysia need to do more and to build a track record of timely adjustment and reasonable power tariffs to recover costs. Delays in tariff revisions, sometimes due to political considerations, are a key risk," said Mr. Dangra.

Full implementation of Malaysia's semi-annual fuel-cost adjustment mechanism for setting power tariffs can increase stability in Tenaga's cash flows, the report says.

Standard & Poor's expects Tenaga's proposal to acquire power assets of Edra Global Energy Bhd. to strengthen its competitive position. The valuation and capital structure Tenaga uses to acquire the Edra assets could influence the company's leverage.

The report expects PLN's expansion to not only test the company's execution capabilities but also put pressure on its already weak financial position, in the absence of any regulatory or government support. That said, PLN's dependence on subsidies is set to decrease on the back of a 35%-65% increase in tariffs for industrial users in 2014.

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