Positive Outlook For The Temporary Power Rental Industry In The Near To Medium Term

Analyst: Haryo Koconegoro

PEFINDO views the outlook of the temporary power rental industry as positive in the near to medium term. This is driven by strong demand for electricity in the country which continues to outpace the growth of the electricity supply provided mainly by PT Perusahaan Listrik Negara (PPLN/$_{id}$AAA/Stable outlook), the only integrated electricity producer in Indonesia engaged in the generation, transmission, and distribution of electricity throughout the country.

We believe there are several factors that will continue to necessitate PPLN and other businesses to rely on the temporary power rental business to improve the reliability of the nation's electricity supply. These factors are: demand for electricity that continues to outpace supply, the slow pace of investment in new capacity, black-outs and brown-outs that continue to happen in some parts of Indonesia, the fact that there are many isolated areas in Indonesia that are not connected to the main transmission lines, the recovery time needed of ageing electricity infrastructure and, to some extent, the impact of climate change in causing electricity failures.

Demand for electricity continues to outpace supply

As electricity is one of our basic needs, Indonesia's continued positive economic growth and high population will continue to boost demand. As a rule of thumb, every 1% of economic growth translates to 1.2% to 1.5% growth in electricity demand. Given that Indonesia's economy has been growing on average at approximately 6.0% per year in the past 10 years, it is estimated that increased electricity demand will reach at least 7.5% annually in the near to medium term. The strong demand is supported by the commitment of Indonesia's government to improve the national electrification ratio that remains relatively low compared to neighboring countries. In 2013, the ratio was 80.4%, up from 76.2% in 2012, and is expected to reach more than 95% by 2019. On the other hand, electricity supply growth continues to lag demand on account of many hurdles faced by PPLN in trying to increase its electricity capacity. One of the fastest solutions for electricity shortages is by using temporary power solution providers. PEFINDO estimates that 10% of electricity produced by PPLN is currently acquired from rental generators (provided by temporary power solution providers). This means that from the 216,189 GWh of electricity produced by PPLN in 2013, it is estimated that 21,618 GWh was rented.

Exhibit 1. Portion of rented electricity to total electricity produced

	2012	2011	2010	2009	2008	2007	2006	2005	2004
Total energy produced (GWh)	200,317.6	183,420.9	168,381.8	156,797.3	149,436.5	142,440.8	133,108.4	127,369.8	120,244.3
Energy rented (GWh)	18,070.8	13,885.7	8,233.2	5,194.5	4,706.9	3,257.3	2,804.3	3,105.3	3,078.5
% of rented energy to total	9.0%	7.6%	4.9%	3.3%	3.1%	2.3%	2.1%	2.4%	2.6%

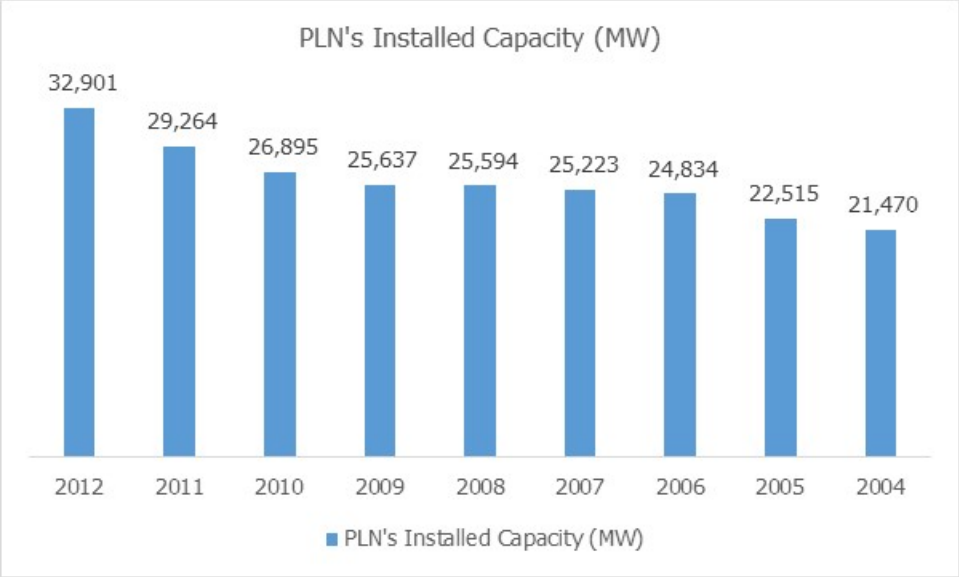
Source: PPLN statistics 2012

Pace of investment to increase electricity capacity not fast enough

The investment in new generating capacity and the maintenance of existing capacity remain far below levels required to keep the supply in line with accelerating demand. This is further complicated by the complexity and high cost of constructing a large-scale power plant. Construction lead times for long-term plants may take two to four years before being commissioned and becoming operational, and this does not take into account additional hurdles such as land clearing and technological issues that are commonly encountered in Indonesia. Furthermore, construction costs can reach a range of USD1.5 million to USD 7.0 million per megawatt constructed, depending on the technology employed. Power plant projects are also contractually complex, requiring the hiring of specialists and an understanding of the financial, technical, socio-economic, environmental, and legal aspects of the construction, as well as assessing the long-term impact of the plant.

According to PPLN's long-term development plan, the country will need additional electricity capacity of close to 60,000 MW or 6,000 MW annually for the next 10 years. From 2004 to 2012, PPLN only managed to increase its own (excluding IPP and lease) installed capacity from 22,000 MW in 2004 to 33,000 MW in 2012, or only 1,400 MW per year. As such, assuming the additional capacity will continue at this rate, the electricity deficit will be 46,000 MW by 2023.

Exhibit 2. PPLN's own (excluding IPP and lease) installed capacity



Source: PPLN statistics 2012

Black-outs and brown-outs continue in some parts of Indonesia

Electricity shortages are common across Indonesia due to insufficient generation capacity. For example, West Java region accounts for 50% of electricity demand and is the largest market in Indonesia, but its reserve margin is only 3%. Consequently, despite ongoing transfers of electricity from neighboring regions, black-outs and rolling brown-outs continue to frequently occur. Another example is North Sumatera, which receives electricity transfers from Central and South Sumatera to meet demand. However, limitations in existing transmission infrastructure prevent electricity from being transferred effectively and in sufficient quantity, leading to continued power supply deficits. PEFINDO believes that in the near term, reserve margins are expected to decline and the power supply across Indonesia will continue to be limited, with continued electricity supply disruptions in many regions. Black-outs and brown-outs are not only bad for the economy, but are also a sensitive issue that requires a prompt and decisive solution. The ideal solution would be to add additional capacity by building new power plants in the affected regions. However, due to the complexity and large funding requirements for power plant projects, their commissioning and operation may take time. As a quick solution is needed, PPLN resorts to renting additional electricity capacity from a temporary power solution provider.

Many isolated areas in the country not connected to a major transmission network

According to PPLN, there are more than 100 isolated electricity networks spread across the country, mainly in provinces in East Indonesia, such as Maluku, North Maluku, Papua, West Papua, NTB, NTT and Riau Islands that are not linked to the nation's six major interconnected transmission networks. Furthermore, there are several islands within the interconnected networks still operating under isolated systems such as Nias, Belitung, Buton, Selayar, Karimun Jawa, and Bawean. On the one hand, the government needs to make sure, through PPLN, that the electrification ratio in these remote areas will improve along with Indonesia's economic development. However, the decision to invest in a power plant in these isolated areas may not be economically viable as the number of prospective users may be limited or too small for PPLN to justify building a dedicated power plant. PEFINDO therefore believes that given

the unique landscape of the Indonesian archipelago, the need for a temporary power solution, as one of the alternative solutions for electricity shortages in these isolated areas, will continue to exist.

Old electricity infrastructure needs recovery time

Over the next 10 years, it is expected that a great deal of investment will be needed to replace old distribution and transmission lines and generating plants to keep track with rising electricity consumption. Given the environmental and safety concerns associated with an ageing power infrastructure, an extensive overhaul will be needed in order to meet the growing demand for electricity. We expect around one-third of the new generation capacity is needed to replace plants that will be retired in the next 10 years. As such, a temporary power solutions provider is one of the quick fixes needed by PPLN for additional power support for periods when electricity facilities are undergoing maintenance, being replaced, or being upgraded to newer and more efficient technology.

Changing weather patterns may cause electricity failures

Due to increased CO2 emissions brought about by increased coal demand in countries such as China and India, extreme weather conditions have become more frequent, which is a clear sign of worsening climate change. Climate change is expected to increase the duration, frequency, and intensity of heat waves and droughts, causing electricity shortages in countries that obtain large shares of their electricity from renewable sources, and also by wearing out transmission infrastructure due to extended heat. Some 10% of PPLN's generating capacity is currently provided by renewable sources, which may be significantly affected by worsening climate change. In Indonesia, for the fast track program phase two, the plan is 40% of the expected 17,918 MW capacity will be generated from renewable energy sources. Although this is favorable from the viewpoint of energy sustainability, the increased dependence on renewable resources also increases the likelihood of power disruptions as they are more sensitive to adverse weather conditions brought about by climate change. As most renewable energy sources are more expensive than conventional sources and are unable to provide reliable dedicated power during peak demand, temporary power solutions remain essential to provide stability and additional capacity during extreme weather periods when renewable sources are affected.

Long-term growth potential uncertain

Although temporary power rental in our view has good prospects in the near to medium term, its potential growth in the long run is uncertain. The growth will be highly dependent on government policy and the state budget to increase the electrification ratio. As power rental companies mostly use diesel generators that are more costly in fuel consumption, temporary power rental should only be procured by PPLN if there is no long-term power provider nearby. Competition in this segment has also become more intensive with the presence of global players trying to tap into the fast growing domestic market. PEFINDO currently only rates one temporary power rental company, PT Sumberdaya Sewatama (SSMM/$_{id}$A/Stable outlook). It is estimated it supplies more than 44% of PPLN's power production through high speed diesel rental, but it is estimated to have a 20% share of the domestic power rental market. PEFINDO views the key factors that determine the success of the temporary power rental business include the company's market position, the profile of its power generator set, how diversified its sources of revenues are and its operating management. The main challenge facing the industry is central government policy that may be less supportive of temporary power rental in the long term as the electrification ratio is expected to improve.

Exhibit 3. Selected ratios of SSMM and peer(s)

Company		EBITDA Margin (%)		Debt/Equity (x)		Debt/EBITDA (x)		EBITDA/Interest (x)		Current rating/Outlook
Ticker	Full name	2013	2012	2013	2012	2013	2012	2013	2012	
SSMM	Sumberdaya Sewatama	49.7%	51.4%	2.8	2.6	2.9	2.7	3.4	3.9	idA/stable
PPLN	Perusahaan Listrik Negara	23.0%	21.3%	2.6	1.8	5.8	5.8	1.8	1.8	idAAA/stable

Source: PEFINDO database