

Electric power sector

■ Industry Overview

Alert: Newsflow on new nuclear safety standards

- **New nuclear safety standards** — The *Nikkei* reported on October 26 that the Nuclear Regulation Commission will draw up new safety standards for the resumption of operations at nuclear plants as soon as January and after public comments and other processes, out the new standards into force in July. A July implementation was referenced in documentation from the committee dated October 19 but the *Nikkei* is more detailed on the event flow, mentioning for instance that a draft bill for the new standards will be drawn up in March.
- **New safety standards: details and application** — The outlines announced by the committee on October 25 include 1) tsunami countermeasures that exceed any expected wave, 2) terrorism countermeasures, and 3) decisions on safety based on the stress tests formulated by NISA. These are based on the various debates that have been had since the disaster and come as no surprise. If nuclear plant safety checks are conducted after the new standards come into force, then it looks as if there will be no escaping our conclusion that restarts will occur only in FY3/14 H2.
- **Nuclear restarts: future focal points** — We see the key points as being 1) who bears responsibility for the final decision on restarts, 2) who explains the case for restarts to the local authorities, and 3) whether safety checks can be carried out when the committee's outlines are compiled into a draft. Progress is being made on safety standards but as ever there are many uncertainties.
- **Rate hikes at Kansai Electric and Kyushu Electric** — Various media are reporting that Kansai Electric and Kyushu Electric will announce hikes on October 29 and 30, respectively. This is in line with previous reports that they aim to lift rates in April next year. The dates are the days results announcements are due from the duo; we think the timing is propitious for statements of intent from the companies' presidents.
- **Fracture-zone survey at Hokuriku Electric** — Hokuriku Electric has pushed back the timing of the publication of an interim report on the fracture-zone survey at the Shika nuclear power plant to early December from end-October and the final report to end-March or after from end-January. This is because it will add to the survey based on opinions solicited at hearings. Given that the Nuclear Regulation Commission was established after the initial survey plan was drawn up, delays accompanying additions to the survey come as no surprise. Concerns about the discovery of an active fault look set to weigh on Hokuriku Electric's share price but we think there is a chance that it will pay a ¥25 H1 dividend, which it currently says is unset, and we note the possibility that the shares could rally in the short run.
- **Reference reports** — See our October 22 memo [EPCOs - Nikkei reports rate hikes for five companies](#); our October 23 memo [Electric power sector - Kansai Electric to forgo dividend, transmission regulations to be relaxed \(Nikkei\)](#); and our October 24 memo [Electric power sector - Hokkaido, Kyushu Electric, also to skip dividends \(Nikkei\)](#) for more details.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Hokuriku Electric Power

(9505.T; ¥852; 2)

Valuation

This company has a Neutral rating. We have not assigned a target price and therefore no valuation methodology is applicable.

Risks

Downside risks to the share price include 1) changes in nuclear power laws/regulations or major problems at nuclear plants resulting in a large increase in the expenditure burden or nuclear plants being idled for a long time; and 2) a rise in interest rates diminishing the appeal of stocks with high dividend yields. Upside risks include 1) increased popularity of high-dividend stocks due to tax code revisions or a plunge in long-term interest rates, which could push investors into stocks with high dividend yields; and 2) environmental issues drawing market attention to Hokuriku Electric's low generating unit prices and heavy use of generating methods with low CO2 emissions, such as hydroelectric plants, as competition intensifies.

Kansai Electric Power

(9503.T; ¥614; 2H)

Valuation

There have been a number of negative developments for the sector since the eastern Japan earthquake: 1) there has been little favorable progress toward restarting nuclear facilities; 2) a coherent energy policy has yet to be determined; 3) there are concerns of systemic reform, and 4) the example of TEPCO suggests that real profitability is unlikely even if rates are hiked. Therefore, we do not look for expectations for sector profit generation to mount any time soon. We do not think Kansai Electric will pay a dividend, and feel that the market will focus on how much its shareholders' equity is likely to deteriorate. In light of this, we base our target price of ¥630 on the average FY3/14E BPS under two scenarios: 1) our pessimistic scenario that assumes DTA reversals and 2) our main scenario wherein a restart of nuclear facilities and price hikes in FY3/14 lead to smaller losses. Our target PBR works out to 0.64x, within the range seen at Tohoku Electric (which has not paid dividends) since September 2011. As such we see this multiple as appropriate.

Risks

Downside risks include 1) rising long-term interest rates and increasing inflationary expectations, 2) the introduction of asymmetric regulations (break-ups or the forced disposal of assets, etc.), and 3) substantial increases in the burden of safety-related costs at nuclear power plants due to changes in regulations, for example. Upside risks to our target price include the following: 1) legal problems, such as environmental taxes, for which the burden size and duration is unclear over along period, becoming clearer, as was the case with nuclear "back-end" costs; and 2) rising demand growth rates.

Uncertainty has intensified since the March 11 disaster, as the suspension of nuclear facilities has been prolonged and discussions about systemic reform have

heated up. As the risk that share prices will react strongly to political decisions (policy directions, etc.) has risen, we assign a High Risk (H) rating.

Kyushu Electric Power

(9508.T; ¥617; 3H)

Valuation

There have been a number of negative developments for the sector since the eastern Japan earthquake: 1) there has been little favorable progress toward restarting nuclear facilities; 2) a coherent energy policy has yet to be determined; 3) there are concerns of systemic reform, and 4) the example of TEPCO suggests that real profitability is unlikely even if rates are hiked. Therefore, we do not look for expectations for sector profit generation to mount any time soon. We do not think Kyushu Electric will pay a dividend, and feel that the market will focus on how much its shareholders' equity is likely to deteriorate. In light of this, we base our target price on the average FY3/14E BPS under two scenarios: 1) our pessimistic scenario that assumes DTA reversals and 2) our main scenario wherein a restart of nuclear facilities and price hikes in FY3/14 lead to smaller losses. Our target PBR works out to 0.51x, below the ten-year bottom for Kyushu Electric of 0.57x but within the range seen at Tohoku Electric (which has not paid dividends) since September 2011. As such we see this multiple as appropriate.

Risks

Risks to our target price for Kyushu Electric include the following, and if any of these factors turn out differently than we expect, the share price may diverge from our target price. The shares could diverge on the upside on: 1) expectations that nuclear power facilities that are currently shut down will be restarted soon; and 2) the deregulation debate getting bogged down, which could lead to competitive conditions in Kyushu Electric's area being better than expected, which, in turn, could allow greater room for optimism on its profit outlook. On the other hand, the shares could diverge on the downside if: 1) sudden changes in nuclear policy lead to a long-term suspension of nuclear power operations that have been a stable earnings source for the company; 2) the scope of liberalization in the customer base spreads, with customers able to leverage their buying power and press more aggressively for price cuts; or 3) regulations are introduced in an asymmetrical fashion, with companies that are perceived to be too strong in certain regions being targeted (possibly resulting in breakups or forced sales of assets).

Uncertainty has intensified since the March 11 disaster, as the suspension of nuclear facilities has been prolonged and discussions about systemic reform have heated up. As the risk that share prices will react strongly to political decisions (policy directions, etc.) has risen, we assign a High Risk (H) rating.

Appendix A-1

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IMPORTANT DISCLOSURES

Kansai Electric Power (9503)

Ratings and Target Price History Fundamental Research

Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	13-Jan-10	*2L	*2,250	2,130
2	14-Jun-11	*1S	*1,600	1,277
3	27-Sep-11	*2H	*1,450	1,384

* Indicates change

	Date	Rating	Target Price	Closing Price
4	7-Oct-11	Stock rating system changed		
5	14-Dec-11	*1H	*1,400	1,121
6	16-Mar-12	*2H	1,400	1,388

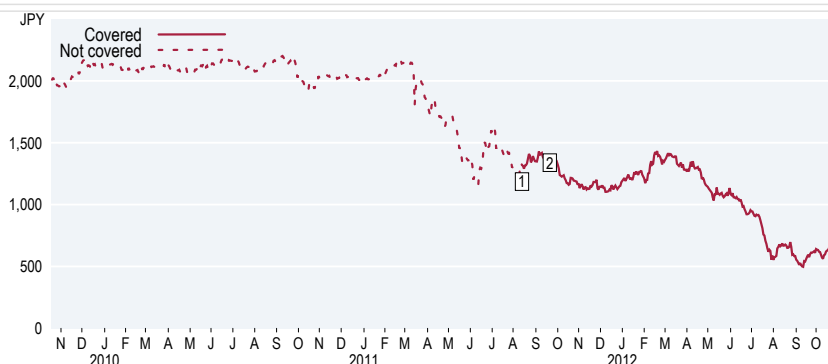
	Date	Rating	Target Price	Closing Price
7	8-Jun-12	2H	*1,250	1,052
8	6-Sep-12	2H	*630	513

Rating/target price changes above reflect Eastern Standard Time

Kansai Electric Power (9503)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	12-Aug-11	*ADD MP	-	1,319

* Indicates change

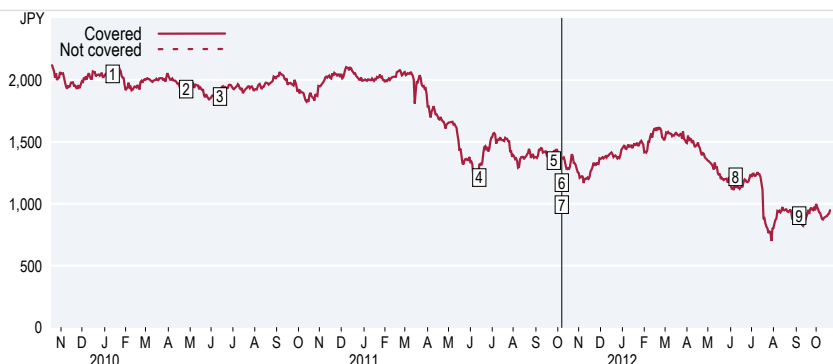
	Date	Rating	Target Price	Closing Price
2	21-Sep-11	*REM MP	-	1,355

Rating/target price changes above reflect Eastern Standard Time

Hokuriku Electric Power (9505)

Ratings and Target Price History Fundamental Research

Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	13-Jan-10	2L	*2,200	2,090
2	27-Apr-10	*1L	*2,250	1,958
3	14-Jun-10	1L	*2,200	1,922

* Indicates change

	Date	Rating	Target Price	Closing Price
4	14-Jun-11	*2S	*1,450	1,317
5	27-Sep-11	*2H	1,450	1,425
6	7-Oct-11	Stock rating system changed		

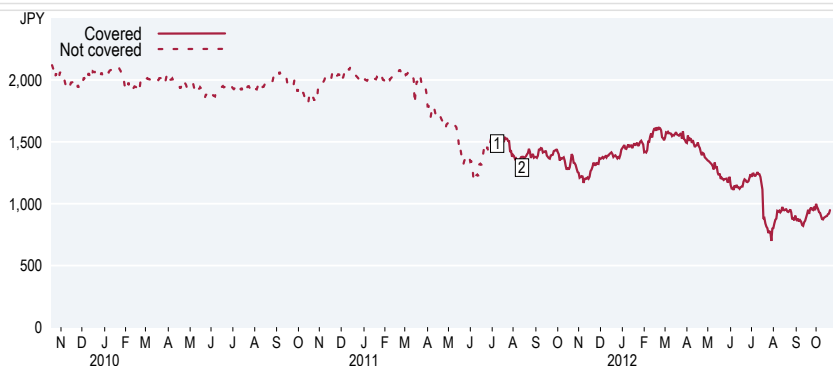
	Date	Rating	Target Price	Closing Price
7	7-Oct-11	*2	-	1,363
8	8-Jun-12	*1H	*1,400	1,129
9	6-Sep-12	*2	-	856

Rating/target price changes above reflect Eastern Standard Time

Hokuriku Electric Power (9505)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	8-Jul-11	*ADD LP	-	1,508

* Indicates change

	Date	Rating	Target Price	Closing Price
2	12-Aug-11	*REM LP	-	1,379

Rating/target price changes above reflect Eastern Standard Time

Kyushu Electric Power (9508)

Ratings and Target Price History Fundamental Research

Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	13-Jan-10	2L	*1,900	1,973
2	14-Jun-10	2L	*1,950	1,966
3	14-Jun-11	*2S	*1,300	1,187

* Indicates change

	Date	Rating	Target Price	Closing Price
4	27-Sep-11	*3H	*1,150	1,295
5	5-Oct-11	3H	*1,050	1,127
6	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	14-Dec-11	*2H	*1,100	1,077
8	6-Sep-12	*3H	*440	511

Rating/target price changes above reflect Eastern Standard Time

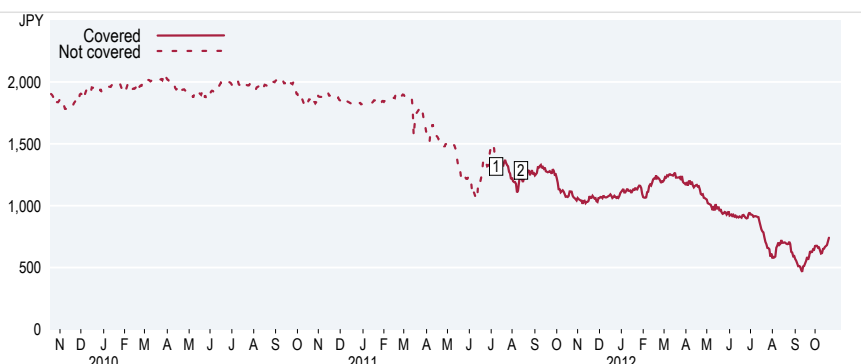
Kyushu Electric Power (9508)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Takashi Miyazaki



Date	Rating	Target Price	Closing Price
1 8-Jul-11	*ADD LP	-	1,367

Date	Rating	Target Price	Closing Price
2 12-Aug-11	*REM LP	-	1,221

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 5 Oct 2012

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
51%	38%	11%	7%	85%	7%
50%	47%	45%	59%	47%	50%

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