

Tenaga Nasional (TNB MK)

Policy uncertainty

Government delays RP3 and ICPT implementation

Electricity tariffs are unchanged into 2022. The unexpected delay to the implementations of both RP3 (2022-2024) and the ICPT (pass-through) mechanism inevitably raises regulatory concerns for Tenaga. Downgrade to HOLD with a lower MYR9.60 TP (DCF-based) as we price in concerns over elevated regulatory risks. We prefer Mega First (MFCB MK, BUY, CP: MYR3.50, TP: MYR4.30) in the utilities space.

Net tariff unchanged until further notice

The regulator has announced that the prevailing 39.45sen/kWh base tariff and 2.0sen/kWh tariff rebate will both be maintained from 1 Jan 2022 until further notice. Net tariff from Jan 22 is thus unchanged at 37.45sen/kWh. This is on the back of the government having postponed the implementation of both RP3 and the ICPT mechanism. While we understand the government's rationale (politically challenging for a tariff hike amid the current floods), the move would inevitably raise regulatory concerns for Tenaga.

Financial impact likely not material

The regulatory terms of RP2 extension year (2021) are to be maintained into 2022. We believe this in itself is not a material issue to Tenaga (we had previously flagged a potential earnings uplift in FY21). Separately, Tenaga was already under-recovering on generation costs since 2Q21 due to elevated coal prices. The continuation of the tariff rebate into 2022 would thus result in a further depletion of the Industry Fund, whose outstanding balance remains undisclosed.

Downgrade to HOLD

Our earnings forecasts are unchanged. We have however lowered our TP (DCF-based assuming 8.4% WACC and 1% LT growth) to MYR9.60 (from MYR12.00 TP) as we raise our discount rate to reflect heightened regulatory risks. While valuations are attractive, we think the stock is unlikely to re-rate with the affirmation of ad-hoc intervention to the tariff determination process.

FYE Dec (MYR m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	50,940	43,976	48,501	49,332	50,179
EBITDA	14,440	13,860	16,128	16,507	16,794
Core net profit	5,078	4,459	5,369	5,198	5,544
Core FDEPS (sen)	89.3	77.9	93.8	90.8	96.9
Core FDEPS growth(%)	(6.2)	(12.7)	20.4	(3.2)	6.7
Net DPS (sen)	100.0	80.0	56.5	54.7	58.3
Core FD P/E (x)	14.8	13.4	10.0	10.3	9.6
P/BV (x)	1.3	1.1	0.9	0.9	0.9
Net dividend yield (%)	7.5	7.7	6.0	5.9	6.2
ROAE (%)	8.5	7.4	9.4	8.8	9.1
ROAA (%)	3.1	2.5	3.0	2.8	3.0
EV/EBITDA (x)	7.5	7.0	5.6	5.5	5.3
Net gearing (%) (incl perps)	52.6	62.7	60.7	58.1	55.1
Consensus net profit	-	-	4,840	4,750	5,127
MKE vs. Consensus (%)	-	-	10.9	9.4	8.1

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HOLD

[Prior:BUY]

Share Price MYR 9.34
 12m Price Target MYR 9.60 (+8%)
 Previous Price Target MYR 12.00

Company Description

Tenaga Nasional engages in the generation, transmission, distribution and sale of electricity and the provision of other related services.

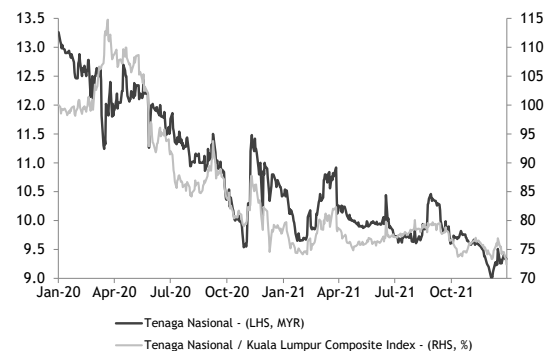
Statistics

52w high/low (MYR)	10.92/9.02
3m avg turnover (USDm)	9.2
Free float (%)	55.2
Issued shares (m)	5,705
Market capitalisation	MYR53.3B USD12.8B

Major shareholders:

Khazanah Nasional Bhd	25.6%
Employees Provident Fund	16.2%
Permodalan Nasional Bhd	9.7%

Price Performance



	-1M	-3M	-12M
Absolute (%)	1	(4)	(10)
Relative to index (%)	(2)	(5)	(7)

Source: FactSet

ESG@MKE
 Tear Sheet Insert



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Risk Rating & Score ¹	35.6 (High)
Score Momentum ²	-1.8
Last Updated	04 Aug 2021
Controversy Score ³ (Updated: 29 Jul 2021)	1 - Customer (quality & safety) incidents

Business Model & Industry Issues

- With the commissioning of Jimah East, Malaysia’s diversification into coal plants over the past decade has ended. New plants going forward will be gas or solar-based. The unit cost of generation for both gas and solar plants are for now still higher than coal, although this is essentially borne by consumers via the IBR tariff framework.
- Given the prevailing structure of PPAs in Malaysia, coal will however continue to feature very prominently in Peninsular Malaysia’s generation mix for at least the next decade. This means the “coal stigma” will continue to accompany Tenaga for the foreseeable future. Should such pressure increase, Tenaga could consider accelerating its renewable expansion (it already has international solar and wind platforms) or potentially de-merging or spinning off its generation unit.
- The push into renewables has seen the increased adoption of solar via solar farms and rooftop solar. From a land optimisation perspective, the technology is probably better suited for rooftops. With the right incentives, Tenaga’s panel leasing business could become more significant in contribution.

Material E issues

- Significant coal exposure with coal accounting for over 50% of Peninsular Malaysia’s generation mix. However, many of these coal plants are new and utilises ultra-supercritical technology. Meanwhile, the cost of insuring coal plants has risen by 10-20% annually in recent years.
- Balance of generation is largely gas-based, which is still a fossil fuel and thus create carbon emissions. In response, Tenaga has in recent years, been consciously increasing its renewable capacity in line with the government’s target of achieving a 20% renewable mix by 2025.
- Large-scale renewable facilities such as solar farms and hydro dams are typically land-intensive (a 50MW farm requires c.200 acres of land) and could have an effect on local biodiversity. In Peninsular Malaysia, there are no longer suitable sites for large dams while solar farms are typically situated on unused agricultural land.

Material S issues

- Average electricity tariffs in 2020 are c.20% higher relative to 2013 levels, steep for an essential service. Nevertheless, households have largely been insulated, with tariffs for the two lowest bands (c.70% of households) having been kept unchanged for the past decade.
- Tenaga was found liable for causing flash floods at Cameron Highlands (Bertam Valley) in 2013 having discharged water from its hydroelectric dam following heavy rains. Tenaga has since proactively engaged preventive measures such as regular cleaning of reservoir and dam, and conducting annual flood evacuation drills.
- Tenaga is a major employer in Malaysia, with a staff count of about 35,000 people of which 23,000 are represented by unions. 21% of Tenaga’s employees are female. It also owns and operates a leading university in Malaysia which enrolls c.10,000 students.

Key G metrics and issues

- Tenaga’s constitution states a minimum of 2 and a maximum of 12 directors. MoF Inc being the special shareholder of Tenaga, has the right to appoint up to six directors.
- There are presently 11 members on Tenaga’s board comprising of 1 Executive Director (President/CEO), 3 Non-Independent Non-Executive Directors (including the Chairman) and 7 Independent Non-Executive Directors.
- 3 of the 11 board members (including Chairman and President/CEO are appointees by MoF Inc and Khazanah Nasional.
- In terms of board gender and diversity, 3 of the 11 board members are female, 3 are non-bumiputeras and 7 are of non-finance/accounting backgrounds.
- Tenaga has been audited by PricewaterhouseCoopers for at least the past decade.
- The cumulative remuneration of the 6 highest-paid top executives represents less than 0.3% of Tenaga’s 2020 normalised net profit.
- Female representation at the management level remains relatively low at 22% among senior management and 7% among top management.
- Tenaga’s track record with its international acquisitions has been mixed - it has substantially impaired its associates in Turkey (fully written-off) and India a few years after acquisition.
- Tenaga’s balance sheet remains relatively under-levered, with a net debt-to-equity of just 65% at end 2020. MFRS 16 with its lease liabilities has inflated the reported net gearing to c.1.1x, still a comfortable level.

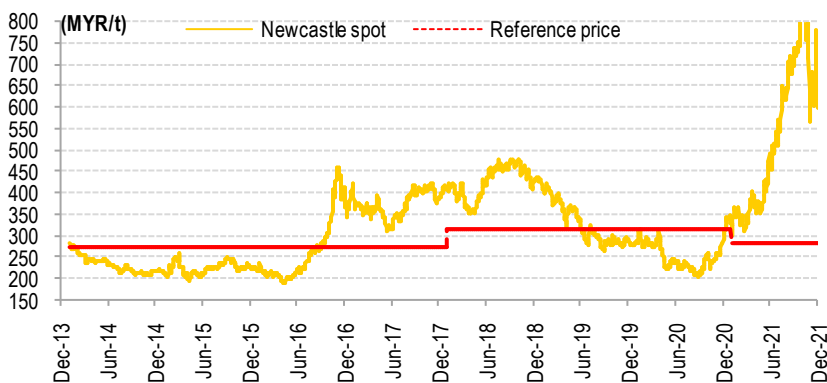
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: Tariff history - Peninsular Malaysia

Date	Details
Jun-11	7.1% hike in tariff to 33.5sen/kWh. Gas price increased by 28% to RM13.70/mmBTU. A 1% feed-in-tariff for renewable energy fund beginning 1st Sept 2011.
Jan-14	14.9% hike in blended tariff to 38.5sen/kWh. Gas price increased by 11% to RM15.20/mmBTU. Feed-in-tariff for renewable energy fund raised to 1.6%.
Mar-15	Base tariff is unchanged, but a 5.8% (or 2.25sen/kWh) tariff rebate is offered to customers effective Mar-Jun 2015. Effective tariff thus falls to 36.3sen/kWh.
Jul-15	The 2.25sen/kWh tariff rebate will continue throughout 2H15. Effective tariff is thus maintained at 36.3sen/kWh.
Jan-16	Base tariff is unchanged, but tariff rebate is reduced to 3.9% (or 1.52sen/kWh). Effective tariff thus rises to 37.0sen/kWh.
Jul-16	Base tariff and tariff rebate (1.52sen/kWh) are unchanged. Effective tariff remains at 37.0sen/kWh.
Jan-17	Base tariff and tariff rebate (1.52sen/kWh) are unchanged. Effective tariff remains at 37.0sen/kWh.
Jul-17	Base tariff and tariff rebate (1.52sen/kWh) are unchanged. Effective tariff remains at 37.0sen/kWh.
Jan-18	Tariff schedule maintained, implying a 2.6% hike in base tariff to c.39.5sen/kWh. Tariff rebate (1.52sen/kWh) is unchanged and is funded directly by the government. Effective tariff is now at c.38.0sen/kWh.
Jul-18	Tariff rebate (1.52sen/kWh) is removed and a surcharge (1.35sen/kWh) is implemented, with the household portion being funded by the government. Effective tariff is now at 40.8sen/kWh, representing a 7.6% increase.
Mar-19	Tariff surcharge increased to 2.55sen/kWh, with the household portion again being funded by the government. Effective tariff is now at 42.0sen/kWh, representing a 2.9% increase.
Jul-19	Base tariff and tariff surcharge (2.55sen/kWh) are unchanged, with the household portion again being funded by the government. Effective tariff remains at 42.0sen/kWh.
Jan-20	Tariff surcharge lowered to 2.0sen/kWh, with the household portion again being funded by the government. Effective tariff is now at 41.45sen/kWh, representing a 1.3% decrease.
Jul-20	Tariff surcharge removed. Effective tariff is back at 39.45sen/kWh, representing a 4.8% decrease.
Jan-21	Tariff rebate of 2.0sen/kWh offered. Effective tariff is at 37.45sen/kWh, representing a 5.1% decrease.
Jul-21	Tariff rebate of 2.0sen/kWh maintained. Effective tariff is unchanged at 37.45sen/kWh.
Jan-22	Tariff rebate of 2.0sen/kWh maintained. Effective tariff is unchanged at 37.45sen/kWh.

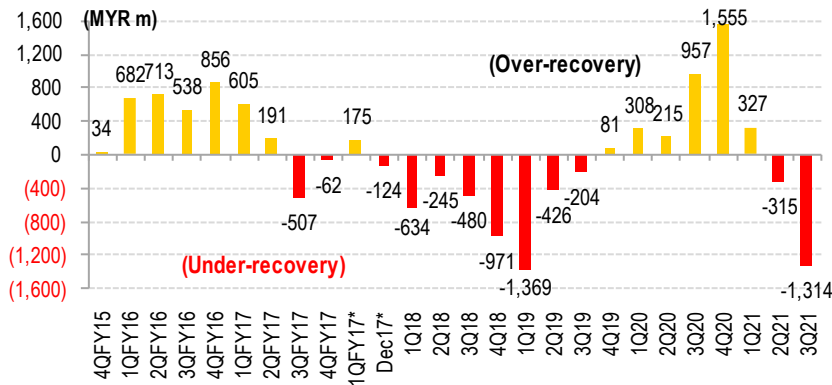
Source: Tenaga, Energy Commission, Maybank IBG Research

Fig 2: Coal prices



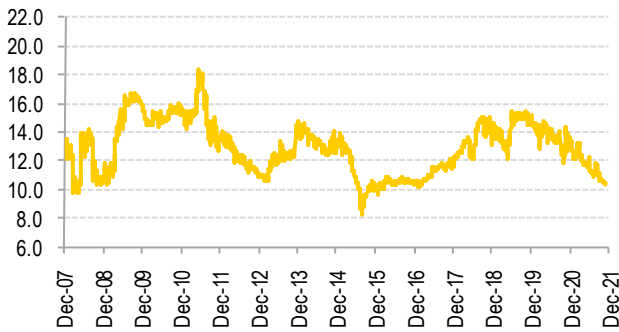
Source: Bloomberg, Maybank IBG Research

Fig 3: Generation cost imbalances



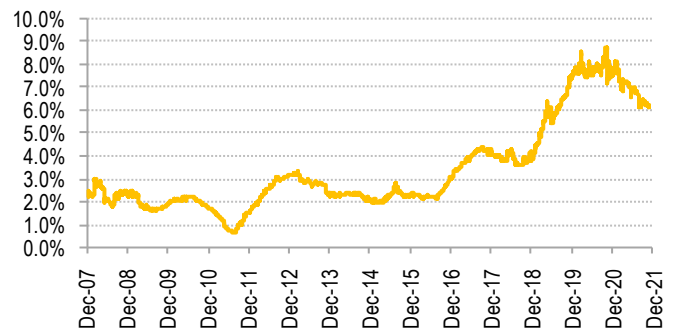
Source: Company. *Change of financial year end from Aug to Dec.

Fig 4: Trailing PER



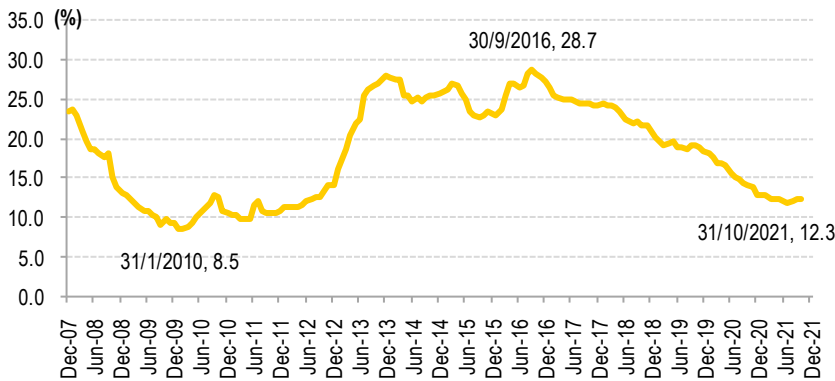
Source: Bloomberg, Maybank IBG Research

Fig 5: Trailing net yield



Source: Bloomberg, Maybank IBG Research

Fig 6: Foreign shareholding



Source: Company

Risk statement

There are several risk factors for our earnings estimates, price target, and rating for Tenaga. Regulatory developments, such as the determination of regulated returns, have direct impact on earnings. Changes in electricity demand patterns or plant outages could also result in loss of earnings for Tenaga.

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	15.4	15.6	9.9	10.3	9.6
Core P/E (x)	14.8	13.3	9.9	10.3	9.6
Core FD P/E (x)	14.8	13.4	10.0	10.3	9.6
P/BV (x)	1.3	1.1	0.9	0.9	0.9
P/NTA (x)	3.9	2.9	2.4	2.2	2.0
Net dividend yield (%)	7.5	7.7	6.0	5.9	6.2
FCF yield (%)	12.0	14.5	9.5	10.1	11.2
EV/EBITDA (x)	7.5	7.0	5.6	5.5	5.3
EV/EBIT (x)	14.4	14.2	10.2	10.0	9.9
INCOME STATEMENT (MYR m)					
Revenue	50,939.7	43,976.0	48,500.6	49,332.4	50,179.2
EBITDA	14,439.9	13,859.6	16,128.3	16,507.4	16,794.0
Depreciation	(6,964.0)	(7,021.2)	(7,245.6)	(7,472.9)	(7,688.6)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	7,475.9	6,838.4	8,882.7	9,034.5	9,105.3
Net interest income / (exp)	(1,501.6)	(1,638.2)	(1,890.0)	(1,891.7)	(1,883.3)
Associates & JV	52.6	76.5	80.0	80.0	80.0
Exceptionals	(177.2)	(253.0)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	5,849.7	5,023.7	7,072.7	7,222.8	7,302.0
Income tax	(1,032.7)	(793.9)	(1,678.3)	(2,000.0)	(1,733.3)
Minorities	84.2	(23.7)	(25.0)	(25.0)	(25.0)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	4,901.2	4,206.1	5,369.5	5,197.8	5,543.7
Core net profit	5,078.4	4,459.1	5,369.5	5,197.8	5,543.7
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	14,251.6	13,415.4	13,346.2	13,683.0	14,385.3
Accounts receivable	8,342.4	10,216.8	9,301.5	9,461.0	9,623.4
Inventory	1,925.3	1,583.8	1,668.7	1,696.7	1,728.5
Property, Plant & Equip (net)	109,966.0	113,213.1	114,967.5	116,494.6	117,805.9
Intangible assets	38,505.3	35,340.3	35,340.3	35,340.3	35,340.3
Investment in Associates & JVs	1,441.4	1,339.2	1,354.2	1,369.2	1,384.2
Other assets	4,415.2	6,324.7	6,324.7	6,324.7	6,324.7
Total assets	178,847.2	181,433.3	182,303.1	184,369.4	186,592.4
ST interest bearing debt	3,479.3	6,409.1	6,409.1	6,409.1	6,409.1
Accounts payable	9,323.3	10,534.1	9,325.2	9,381.5	9,456.1
LT interest bearing debt	41,932.4	43,043.5	43,043.5	43,043.5	43,043.5
Other liabilities	64,830.0	63,997.0	63,997.0	63,997.0	63,997.0
Total Liabilities	119,565.1	123,983.4	122,774.5	122,830.8	122,905.4
Shareholders Equity	57,981.8	55,833.2	57,981.0	60,060.1	62,277.6
Minority Interest	1,300.3	1,616.7	1,547.6	1,478.5	1,409.4
Total shareholder equity	59,282.1	57,449.9	59,528.6	61,538.6	63,687.0
Total liabilities and equity	178,847.2	181,433.3	182,303.1	184,369.4	186,592.4
CASH FLOW (MYR m)					
Pretax profit	5,849.7	5,023.7	7,072.7	7,222.8	7,302.0
Depreciation & amortisation	6,964.0	7,021.2	7,245.6	7,472.9	7,688.6
Change in working capital	80.3	(1,006.9)	(378.5)	(131.1)	(119.7)
Other operating cash flow	7,109.1	5,685.5	(80.0)	(80.0)	(80.0)
Cash flow from operations	19,898.0	15,518.6	14,071.6	14,376.2	14,941.0
Capex	(10,854.4)	(6,909.7)	(9,000.0)	(9,000.0)	(9,000.0)
Free cash flow	9,043.6	8,608.9	5,071.6	5,376.2	5,941.0
Dividends paid	(3,014.1)	(5,235.8)	(3,221.7)	(3,118.7)	(3,326.2)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(2,643.6)	2,004.5	0.0	0.0	0.0
Other invest/financing cash flow	(8,355.0)	(2,795.2)	(1,919.1)	(1,920.8)	(1,912.4)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(4,969.1)	2,582.4	(69.2)	336.8	702.4

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	1.1	(13.7)	10.3	1.7	1.7
EBITDA growth	(1.4)	(4.0)	16.4	2.3	1.7
EBIT growth	(8.3)	(8.5)	29.9	1.7	0.8
Pretax growth	15.9	(14.1)	40.8	2.1	1.1
Reported net profit growth	31.6	(14.2)	27.7	(3.2)	6.7
Core net profit growth	(6.3)	(12.2)	20.4	(3.2)	6.7
Profitability ratios (%)					
EBITDA margin	28.3	31.5	33.3	33.5	33.5
EBIT margin	14.7	15.6	18.3	18.3	18.1
Pretax profit margin	11.5	11.4	14.6	14.6	14.6
Payout ratio	116.0	108.4	60.0	60.0	60.0
DuPont analysis					
Net profit margin (%)	9.6	9.6	11.1	10.5	11.0
Revenue/Assets (x)	0.3	0.2	0.3	0.3	0.3
Assets/Equity (x)	3.1	3.2	3.1	3.1	3.0
ROAE (%)	8.5	7.4	9.4	8.8	9.1
ROAA (%)	3.1	2.5	3.0	2.8	3.0
Liquidity & Efficiency					
Cash conversion cycle	(6.3)	(11.5)	(11.0)	(7.3)	(6.3)
Days receivable outstanding	65.5	76.0	72.4	68.5	68.5
Days inventory outstanding	14.5	18.8	16.3	16.6	16.6
Days payables outstanding	86.4	106.2	99.8	92.4	91.4
Dividend cover (x)	0.9	0.9	1.7	1.7	1.7
Current ratio (x)	1.1	0.9	1.0	1.0	1.0
Leverage & Expense Analysis					
Asset/Liability (x)	1.5	1.5	1.5	1.5	1.5
Net gearing (%) (incl perps)	52.6	62.7	60.7	58.1	55.1
Net gearing (%) (excl. perps)	52.6	62.7	60.7	58.1	55.1
Net interest cover (x)	5.0	4.2	4.7	4.8	4.8
Debt/EBITDA (x)	3.1	3.6	3.1	3.0	2.9
Capex/revenue (%)	21.3	15.7	18.6	18.2	17.9
Net debt/ (net cash)	31,160.1	36,037.2	36,106.4	35,769.6	35,067.3

Source: Company; Maybank

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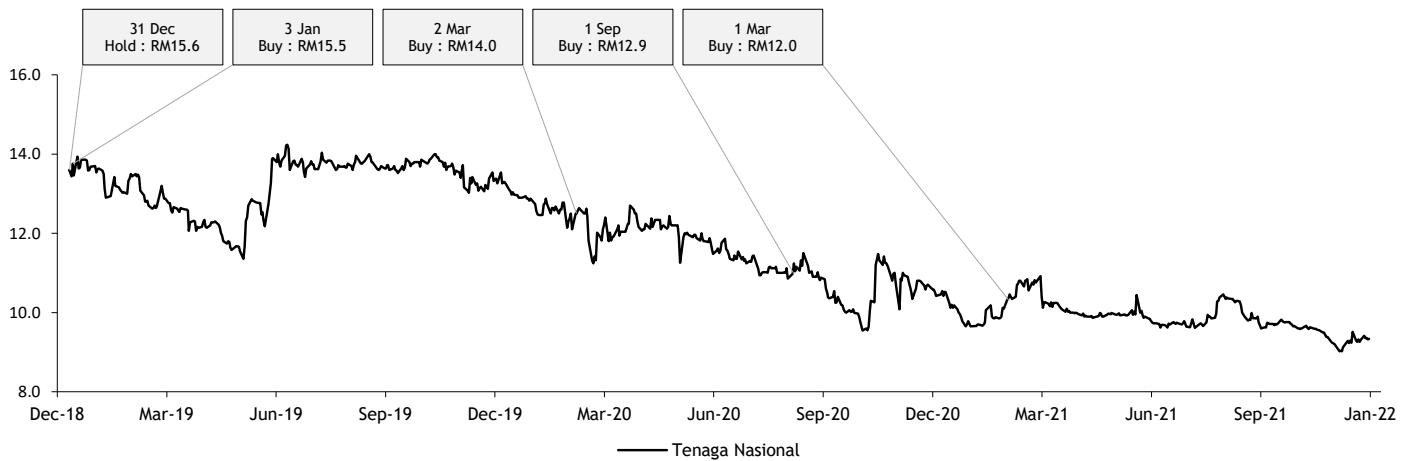
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