

Tenaga Nasional (TNB MK)

Pass-through still intact

A welcome relief, albeit temporary

The government has upheld Tenaga's pass-through mechanism for 2H22 largely through direct compensation, thus alleviating a near-term overhang. Nevertheless, elevated coal prices means ICPT concerns would likely resurface again in six months time. Maintain HOLD with a lower MYR8.70 TP (-6%, DCF-based). We prefer YTL Power (YTLP MK, BUY, CP: MYR0.67, TP: MYR0.90) in the utilities space.

Tariffs unchanged

The government has announced that the prevailing tariff rates will be maintained into 2H22. Thus domestic (household) users will continue to enjoy a 2.0sen/kWh rebate, while industrial and commercial users will continue to bear a 3.7sen/kWh surcharge. The government, in turn, will cover subsidies worth MYR5.8b. Tenaga has separately disclosed that the pass-through mechanism (ICPT) is intact for 2H22.

Recovering a substantial amount

We have previously highlighted the possibility of the government directly compensating Tenaga, given Malaysia's status as a net energy beneficiary. At the time of writing, the government's payment details have yet to be disclosed. We estimate c.MYR1.2b would be recovered from the 3.7sen/kWh surcharge on industrial and commercial users. Coupled with the MYR5.8b of direct subsidies by the government, we estimate Tenaga should recover c.MYR7.0b for 2H22.

A possible repeat

Our earnings forecasts are unchanged. We however lower our TP to MYR8.70 from MYR9.30 (DCF-based assuming a higher 8.7% WACC vs. 8.4% previously and unchanged 1% LT growth) to reflect a heightened risk profile from potentially long-drawn ICPT concerns. Coal prices have remained elevated, meaning ICPT concerns could resurface again in six months time. In our view, it would take a couple more rounds of successful pass-through to permanently convince the market of the integrity of the mechanism.

| FYE Dec (MYR m) | FY20A | FY21A | FY22E | FY23E | FY24E |
|------------------------------|--------|--------|--------|--------|--------|
| Revenue | 43,976 | 52,630 | 48,844 | 49,677 | 50,525 |
| EBITDA | 13,860 | 15,326 | 15,430 | 15,725 | 16,077 |
| Core net profit | 4,459 | 5,141 | 4,660 | 5,021 | 5,205 |
| Core FDEPS (sen) | 77.9 | 89.5 | 81.1 | 87.4 | 90.6 |
| Core FDEPS growth(%) | (12.7) | 14.8 | (9.4) | 7.7 | 3.7 |
| Net DPS (sen) | 80.0 | 40.0 | 36.6 | 39.5 | 40.9 |
| Core FD P/E (x) | 13.4 | 10.4 | 10.1 | 9.4 | 9.0 |
| P/BV (x) | 1.1 | 0.9 | 0.8 | 0.8 | 0.7 |
| Net dividend yield (%) | 7.7 | 4.3 | 4.5 | 4.8 | 5.0 |
| ROAE (%) | 7.4 | 7.6 | 8.0 | 8.3 | 8.2 |
| ROAA (%) | 2.5 | 2.8 | 2.5 | 2.7 | 2.7 |
| EV/EBITDA (x) | 7.0 | 6.4 | 5.9 | 5.7 | 5.4 |
| Net gearing (%) (incl perps) | 62.7 | 72.7 | 68.1 | 62.6 | 57.1 |
| Consensus net profit | - | - | 4,660 | 5,016 | 5,203 |
| MKE vs. Consensus (%) | - | - | (0.0) | 0.1 | 0.0 |

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HOLD

| | |
|-----------------------|-----------------|
| Share Price | MYR 8.19 |
| 12m Price Target | MYR 8.70 (+10%) |
| Previous Price Target | MYR 9.30 |

Company Description

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

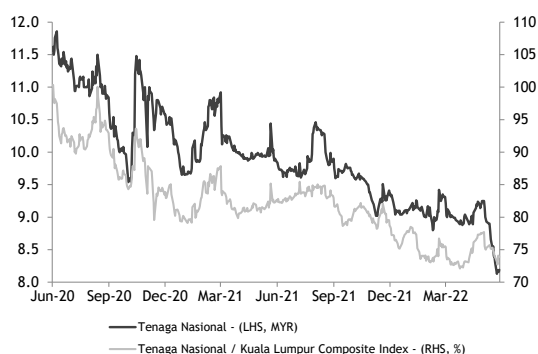
Statistics

| | |
|------------------------|------------|
| 52w high/low (MYR) | 10.46/8.13 |
| 3m avg turnover (USDm) | 8.3 |
| Free float (%) | 55.6 |
| Issued shares (m) | 5,705 |
| Market capitalisation | MYR46.7B |
| | USD10.6B |

Major shareholders:

| | |
|--------------------------|-------|
| Khazanah Nasional Bhd | 25.6% |
| Employees Provident Fund | 15.9% |
| Permodalan Nasional Bhd | 9.7% |

Price Performance



| | | | |
|-----------------------|------|------|------|
| | -1M | -3M | -12M |
| Absolute (%) | (10) | (12) | (17) |
| Relative to index (%) | (4) | (3) | (10) |

Source: FactSet

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| | |
|---|---|
| Risk Rating & Score¹ | 38.0 (High) |
| Score Momentum² | +2.1 |
| Last Updated | 19 Nov 2021 |
| Controversy Score³ (Updated: 3 Dec 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.

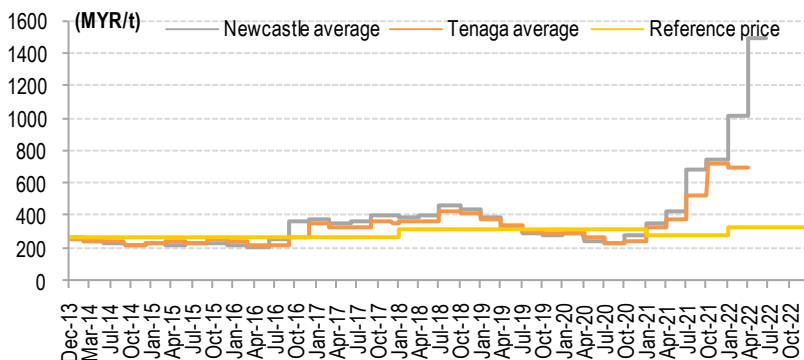
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven 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).

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 38.53sen/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 36.28sen/kWh. |
| Jul-15 | The 2.25sen/kWh tariff rebate will continue throughout 2H15. Effective tariff is thus maintained at 36.28sen/kWh. |
| Jan-16 | Base tariff is unchanged, but tariff rebate is reduced to 3.9% (or 1.52sen/kWh). Effective tariff thus rises to 37.01sen/kWh. |
| Jul-16 | Base tariff and tariff rebate (1.52sen/kWh) are unchanged. Effective tariff remains at 37.01sen/kWh. |
| Jan-17 | Base tariff and tariff rebate (1.52sen/kWh) are unchanged. Effective tariff remains at 37.01sen/kWh. |
| Jul-17 | Base tariff and tariff rebate (1.52sen/kWh) are unchanged. Effective tariff remains at 37.01sen/kWh. |
| Jan-18 | Tariff schedule maintained, implying a 2.6% hike in base tariff to 39.45sen/kWh. Tariff rebate (1.52sen/kWh) is unchanged and is funded directly by the government. Effective tariff is now at c.37.93sen/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. |
| Feb-22 | Base tariff maintained at 39.45sen/kWh. A 3.7sen/kWh tariff surcharge is introduced, with the government funding a 2.0sen/kWh tariff rebate for household users. Effective tariff is thus raised by 15.2% to 43.15sen/kWh. |
| Jul-22 | 3.7sen/kWh tariff surcharge is maintained for commercial and industrial users, while households continue to enjoy a 2.0sen/kWh tariff rebate. Effective tariff is unchanged at 43.15sen/kWh. |

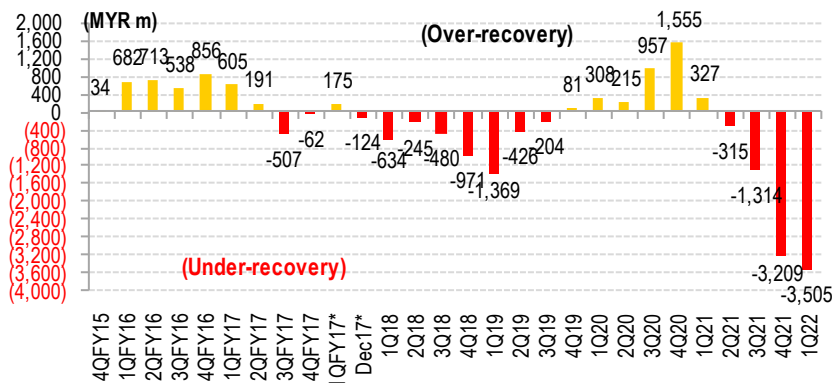
Source: Tenaga, Energy Commission, Maybank IBG Research

Coal prices



Source: Bloomberg, Maybank IBG Research

Generation cost imbalances



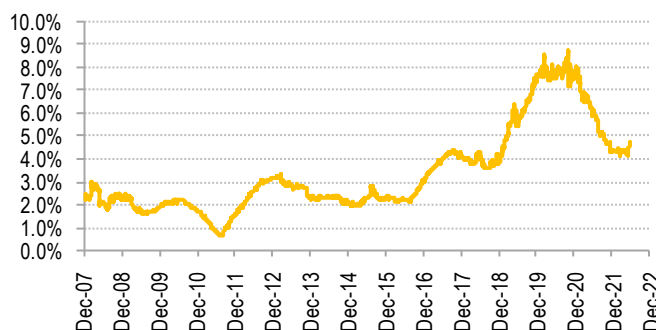
Source: Company. *Change of financial year end from Aug to Dec.

Trailing PER



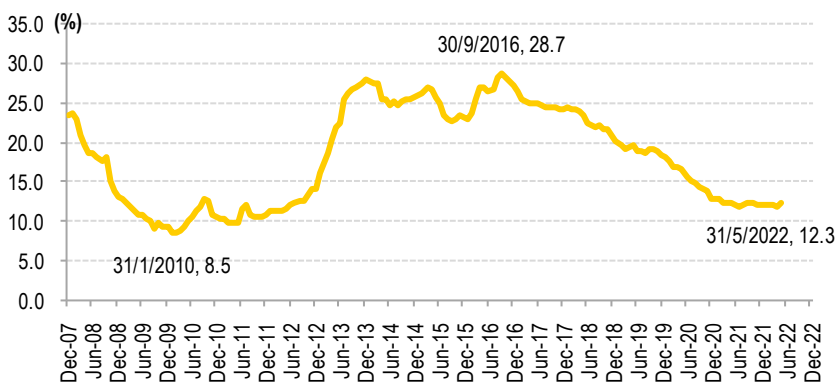
Source: Bloomberg, Maybank IBG Research

Trailing net yield



Source: Bloomberg, Maybank IBG Research

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 | FY20A | FY21A | FY22E | FY23E | FY24E |
|-------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Key Metrics | | | | | |
| P/E (reported) (x) | 15.6 | 13.2 | 10.1 | 9.3 | 9.0 |
| Core P/E (x) | 13.3 | 10.4 | 10.1 | 9.3 | 9.0 |
| Core FD P/E (x) | 13.4 | 10.4 | 10.1 | 9.4 | 9.0 |
| P/BV (x) | 1.1 | 0.9 | 0.8 | 0.8 | 0.7 |
| P/NTA (x) | 2.9 | 2.5 | 2.0 | 1.8 | 1.6 |
| Net dividend yield (%) | 7.7 | 4.3 | 4.5 | 4.8 | 5.0 |
| FCF yield (%) | 14.5 | 9.2 | 10.9 | 12.6 | 13.5 |
| EV/EBITDA (x) | 7.0 | 6.4 | 5.9 | 5.7 | 5.4 |
| EV/EBIT (x) | 14.2 | 12.0 | 11.1 | 10.7 | 10.2 |
| INCOME STATEMENT (MYR m) | | | | | |
| Revenue | 43,976.0 | 52,629.5 | 48,843.9 | 49,676.9 | 50,524.9 |
| EBITDA | 13,859.6 | 15,326.4 | 15,430.2 | 15,725.2 | 16,077.2 |
| Depreciation | (7,021.2) | (7,218.1) | (7,302.8) | (7,411.4) | (7,513.1) |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | 6,838.4 | 8,108.3 | 8,127.5 | 8,313.8 | 8,564.1 |
| Net interest income / (exp) | (1,638.2) | (1,909.6) | (2,141.4) | (2,179.6) | (2,205.1) |
| Associates & JV | 76.5 | 193.5 | 193.5 | 193.5 | 193.5 |
| Exceptionals | (253.0) | (858.0) | 0.0 | 0.0 | 0.0 |
| Other pretax income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 5,023.7 | 5,534.2 | 6,179.6 | 6,327.7 | 6,552.5 |
| Income tax | (793.9) | (1,048.7) | (1,316.9) | (1,104.2) | (1,144.6) |
| Minorities | (23.7) | (202.9) | (202.9) | (202.9) | (202.9) |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 4,206.1 | 4,282.6 | 4,659.8 | 5,020.7 | 5,205.0 |
| Core net profit | 4,459.1 | 5,140.6 | 4,659.8 | 5,020.7 | 5,205.0 |
| BALANCE SHEET (MYR m) | | | | | |
| Cash & Short Term Investments | 13,415.4 | 9,208.4 | 12,304.7 | 16,037.6 | 20,062.7 |
| Accounts receivable | 10,216.8 | 13,976.9 | 13,381.9 | 13,065.7 | 13,150.3 |
| Inventory | 1,583.8 | 1,977.1 | 1,830.9 | 1,859.3 | 1,885.6 |
| Property, Plant & Equip (net) | 113,213.1 | 114,105.6 | 115,802.8 | 117,391.5 | 118,378.4 |
| Intangible assets | 35,340.3 | 35,149.6 | 35,149.6 | 35,149.6 | 35,149.6 |
| Investment in Associates & JVs | 1,339.2 | 1,867.1 | 1,995.6 | 2,124.1 | 2,252.6 |
| Other assets | 6,324.7 | 6,315.9 | 6,315.9 | 6,315.9 | 6,315.9 |
| Total assets | 181,433.3 | 182,600.6 | 186,781.4 | 191,943.7 | 197,195.2 |
| ST interest bearing debt | 6,409.1 | 6,992.5 | 6,992.5 | 6,992.5 | 6,992.5 |
| Accounts payable | 10,534.1 | 8,596.7 | 7,832.1 | 7,850.5 | 7,856.8 |
| LT interest bearing debt | 43,043.5 | 44,685.7 | 46,911.3 | 49,136.9 | 51,362.5 |
| Other liabilities | 63,997.0 | 63,933.0 | 63,933.0 | 63,933.0 | 63,933.0 |
| Total Liabilities | 123,983.4 | 124,208.2 | 125,669.2 | 127,913.2 | 130,145.1 |
| Shareholders Equity | 55,833.2 | 56,608.4 | 59,171.3 | 61,932.6 | 64,795.4 |
| Minority Interest | 1,616.7 | 1,784.0 | 1,940.9 | 2,097.8 | 2,254.7 |
| Total shareholder equity | 57,449.9 | 58,392.4 | 61,112.2 | 64,030.4 | 67,050.1 |
| Total liabilities and equity | 181,433.3 | 182,600.6 | 186,781.4 | 191,943.7 | 197,195.2 |
| CASH FLOW (MYR m) | | | | | |
| Pretax profit | 5,023.7 | 5,534.2 | 6,179.6 | 6,327.7 | 6,552.5 |
| Depreciation & amortisation | 7,021.2 | 7,218.1 | 7,302.8 | 7,411.4 | 7,513.1 |
| Change in working capital | (1,006.9) | (5,798.0) | (23.4) | 306.1 | (104.6) |
| Other operating cash flow | 5,685.5 | 5,233.7 | (193.5) | (193.5) | (193.5) |
| Cash flow from operations | 15,518.6 | 13,353.9 | 14,089.9 | 14,927.2 | 14,827.9 |
| Capex | (6,909.7) | (8,415.5) | (9,000.0) | (9,000.0) | (8,500.0) |
| Free cash flow | 8,608.9 | 4,938.4 | 5,089.9 | 5,927.2 | 6,327.9 |
| Dividends paid | (5,235.8) | (4,568.4) | (2,096.9) | (2,259.3) | (2,342.3) |
| Equity raised / (purchased) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in Debt | 2,004.5 | 1,886.0 | 2,225.6 | 2,225.6 | 2,225.6 |
| Other invest/financing cash flow | (2,795.2) | (1,688.1) | (2,122.4) | (2,160.6) | (2,186.1) |
| Effect of exch rate changes | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash flow | 2,582.4 | 567.9 | 3,096.3 | 3,732.9 | 4,025.2 |

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|--|----------|----------|----------|----------|----------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | (13.7) | 19.7 | (7.2) | 1.7 | 1.7 |
| EBITDA growth | (4.0) | 10.6 | 0.7 | 1.9 | 2.2 |
| EBIT growth | (8.5) | 18.6 | 0.2 | 2.3 | 3.0 |
| Pretax growth | (14.1) | 10.2 | 11.7 | 2.4 | 3.6 |
| Reported net profit growth | (14.2) | 1.8 | 8.8 | 7.7 | 3.7 |
| Core net profit growth | (12.2) | 15.3 | (9.4) | 7.7 | 3.7 |
| Profitability ratios (%) | | | | | |
| EBITDA margin | 31.5 | 29.1 | 31.6 | 31.7 | 31.8 |
| EBIT margin | 15.6 | 15.4 | 16.6 | 16.7 | 17.0 |
| Pretax profit margin | 11.4 | 10.5 | 12.7 | 12.7 | 13.0 |
| Payout ratio | 108.4 | 53.4 | 45.0 | 45.0 | 45.0 |
| DuPont analysis | | | | | |
| Net profit margin (%) | 9.6 | 8.1 | 9.5 | 10.1 | 10.3 |
| Revenue/Assets (x) | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 |
| Assets/Equity (x) | 3.2 | 3.2 | 3.2 | 3.1 | 3.0 |
| ROAE (%) | 7.4 | 7.6 | 8.0 | 8.3 | 8.2 |
| ROAA (%) | 2.5 | 2.8 | 2.5 | 2.7 | 2.7 |
| Liquidity & Efficiency | | | | | |
| Cash conversion cycle | (12.9) | 13.5 | 39.6 | 38.6 | 37.1 |
| Days receivable outstanding | 76.0 | 82.7 | 100.8 | 95.8 | 93.4 |
| Days inventory outstanding | 19.1 | 15.8 | 18.5 | 17.6 | 17.6 |
| Days payables outstanding | 108.0 | 85.1 | 79.7 | 74.9 | 73.9 |
| Dividend cover (x) | 0.9 | 1.9 | 2.2 | 2.2 | 2.2 |
| Current ratio (x) | 0.9 | 1.0 | 1.1 | 1.2 | 1.4 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Net gearing (%) (incl perps) | 62.7 | 72.7 | 68.1 | 62.6 | 57.1 |
| Net gearing (%) (excl. perps) | 62.7 | 72.7 | 68.1 | 62.6 | 57.1 |
| Net interest cover (x) | 4.2 | 4.2 | 3.8 | 3.8 | 3.9 |
| Debt/EBITDA (x) | 3.6 | 3.4 | 3.5 | 3.6 | 3.6 |
| Capex/revenue (%) | 15.7 | 16.0 | 18.4 | 18.1 | 16.8 |
| Net debt/ (net cash) | 36,037.2 | 42,469.8 | 41,599.1 | 40,091.8 | 38,292.3 |

Source: Company; Maybank IBG Research

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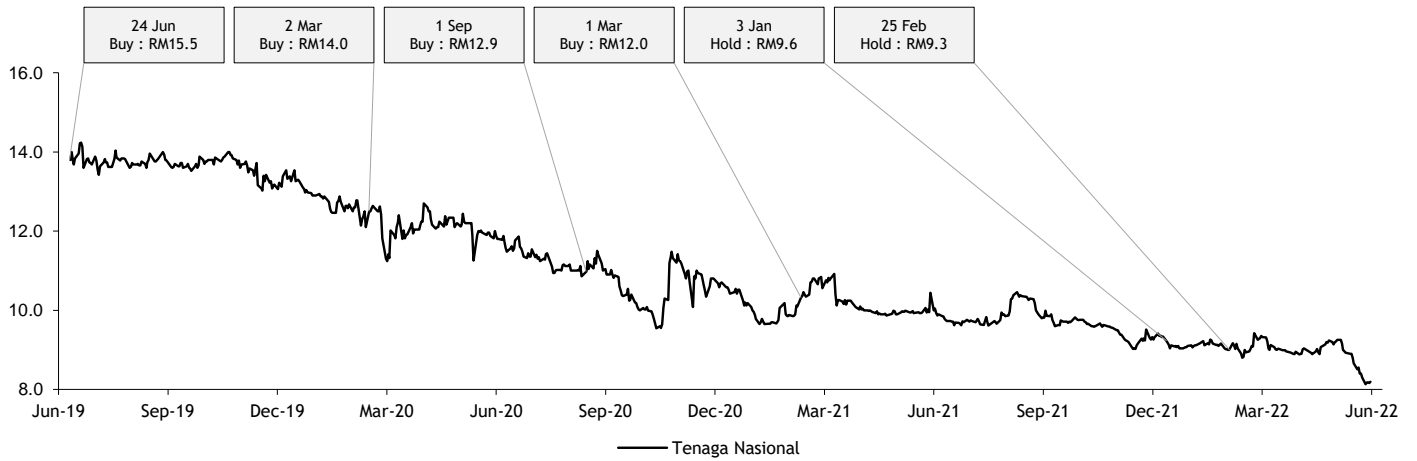
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