

26 June 2023

Utilities | Power

## Tenaga Nasional (TNB MK)

### Buy (from Neutral)

### Limited Regulatory Risk; Upgrade To BUY

- **Upgrade to BUY from Neutral, with an unchanged MYR10.40 TP, 13% upside and c.6% FY24F yield.** Our call is premised on the limited regulatory risk as the Government continues to uphold the Imbalance Cost Pass-Through (ICPT) framework with consistent payment to Tenaga Nasional. As such, we expect the ICPT receivables to trend lower, relieving working capital pressure amidst moderating coal prices.
- **Tariff adjustments.** Last Friday, the Government announced several tariff adjustments which are: i) High-consumption domestic users with 1,500 kWh and above or equivalent to a monthly bill of MYR708 will be imposed with a 10sen/kWh surcharge, ii) surcharge reduction of 20sen/kWh to 3.7sen/kWh for new category of non-domestic consumers, namely state water and sanitation operators, and iii) surcharge reduction of 20sen/kWh to 17sen/kWh for medium-voltage and high-voltage industrial and commercial users. Domestic users with consumption of less than 1,500 kWh will continue to enjoy the same 2sen/kWh rebate. Following that, TNB announced the ICPT mechanism will remain in place for 2H23.
- **ICPT receivables to trend lower.** Such adjustments are somewhat within expectations as the domestic segment remains largely subsidised and reflects a slight decrease in average fuel prices to USD173.50/tonne in 1H23 from USD224/tonne in 2H22. The total ICPT cost to be recovered in 2H23 is estimated at MYR9bn, based on the current fuel price trend. As the Government is committed to subsidise MYR5.2bn in 2H23, we estimate that the remainder will be collected from the surcharges imposed. Note that TNB has received MYR9.13bn out of total MYR10.4bn ICPT cost recovery from the Government. This demonstrates the Government's commitment in upholding the Incentive Based Regulation (IBR) framework and ICPT mechanisms. As such, we expect ICPT receivables to be lower on the back of the lower ICPT charge.
- **Upgrade to BUY.** While keeping our earnings estimates, we upgrade TNB to BUY with an unchanged DCF-based TP of MYR10.40. We see limited regulatory risk as the Government has upheld the ICPT framework, ensuring its defensive earnings profile coupled with lesser working capital strain given the moderation of coal prices. Our TP also factors in an ESG discount of 10%, based on our ESG score of 2.5. Valuation wise, the stock is currently trading at 10.4x FY24F P/E, which is below its 5-year mean of 11.8x. Foreign shareholdings fell slightly to 12.86% as of May (4Q22: 13.1%). TNB, in our view, has to pursue its expansion in renewable energy (RE) more aggressively in order to achieve its 8.3GW target by 2025 (1Q23: 3.9GW).
- **Downside risks:** Higher operating costs and greater-than-expected plant outages.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	48,120	50,868	52,900	54,003	55,141
Recurring net profit (MYRm)	4,322	3,898	4,797	5,016	4,917
Recurring net profit growth (%)	22.0	(9.8)	23.1	4.6	(2.0)
Recurring P/E (x)	12.01	13.32	10.82	10.35	10.56
P/B (x)	0.9	0.9	0.9	0.8	0.8
P/CF (x)	3.89	5.54	2.17	2.59	2.54
Dividend Yield (%)	4.3	3.9	5.4	5.6	5.5
EV/EBITDA (x)	5.02	4.97	4.83	4.66	4.56
Return on average equity (%)	6.5	6.0	8.1	8.1	7.7
Net debt to equity (%)	72.7	83.4	71.5	64.9	57.9

Source: Company data, RHB

Target Price (Return):	MYR10.40 (+13%)
Price (Market Cap):	MYR9.20 (USD11,381m)
ESG score:	2.5 (out of 4)
Avg Daily Turnover (MYR/USD)	37.4m/8.27m

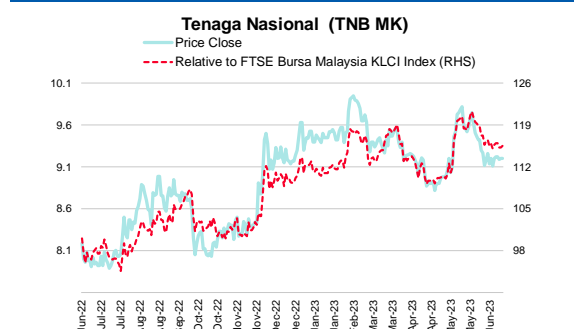
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.5)	(3.8)	(3.8)	0.3	12.7
Relative	2.5	(2.3)	(2.4)	6.0	15.5
52-wk Price low/high (MYR)				7.89	9.95



Source: Bloomberg

#### Overall ESG Score: 2.5 (out of 4)

##### E: MODERATE

TNB's thermal power plants relies heavily on coal, or fossil fuels to produce power. However, in its 2021 annual report, the group announced that its strategy will include an emphasis on being a leader of sustainable energy solutions in Malaysia and internationally. It has set a target of being completely coal-free by 2050. In 2021, TNB managed to reduce GHG emissions by 7.96m tCO<sub>2</sub>e (a 33% increase of emission mitigated compared to 2020). This feat is achieved by low carbon generation, energy efficiency and the use of renewables.

##### S: EXCELLENT

Policies on employee relations, health & safety, and community engagement are robust. It has health and safety policies and processes, and seeks to maintain a good safety record. Loss-time injury frequency improved to 1.03 in 2021 (2020: 1.29) but it recorded eight fatalities, hence the lower score for this pillar. Its community engagement focuses on outreach programmes that focuses on availability of electricity to those in need.

##### G: EXCELLENT

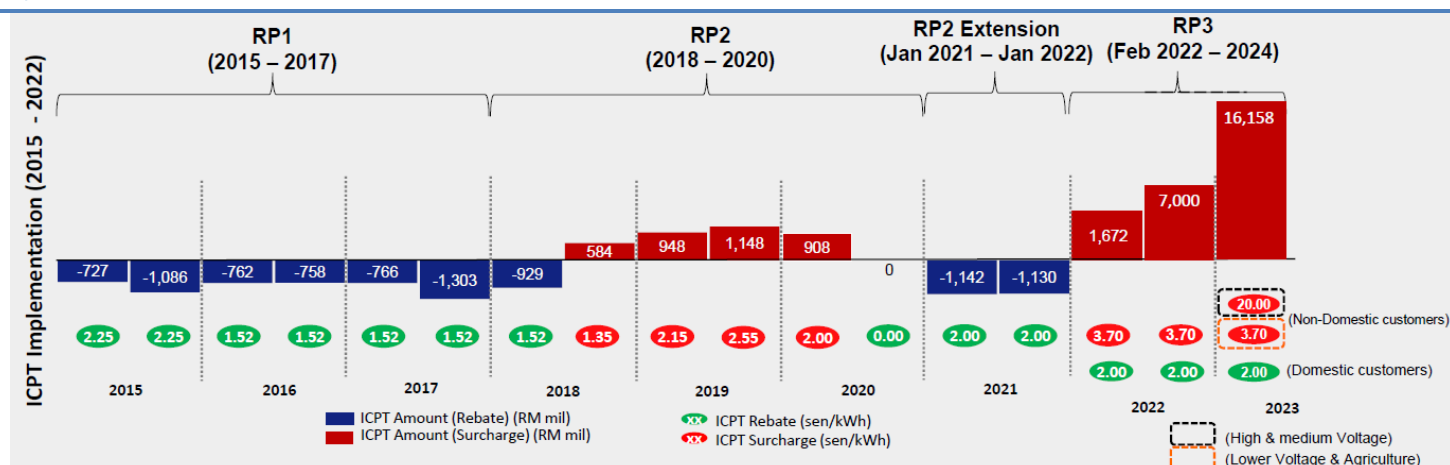
Board characteristics are within Bursa Malaysia requirements, with 67% comprising independent directors. Women comprise 33% of the Board. TNB ensures timely, reliable and accurate information is provided, within regulatory and market guidelines. Shareholder rights are protected, as the group ensures shareholders are able to participate and contribute to the general meeting.

## Financial Exhibits

<b>Asia</b>	<b>Financial summary (MYR)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
Malaysia	Recurring EPS	0.77	0.69	0.85	0.89	0.87
Utilities	DPS	0.40	0.36	0.49	0.52	0.51
<b>Tenaga Nasional</b>	BVPS	10.03	10.37	10.73	11.10	11.47
TNB MK	Return on average equity (%)	6.5	6.0	8.1	8.1	7.7
Buy						
	<b>Valuation metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
<b>Valuation basis</b>	Recurring P/E (x)	12.01	13.32	10.82	10.35	10.56
DCF	P/B (x)	0.9	0.9	0.9	0.8	0.8
	FCF Yield (%)	9.5	1.8	23.1	17.4	18.2
<b>Key drivers</b>	Dividend Yield (%)	4.3	3.9	5.4	5.6	5.5
i. Stronger earnings from non-regulated assets;	EV/EBITDA (x)	5.02	4.97	4.83	4.66	4.56
ii. High dividend payout ratios.	EV/EBIT (x)	11.67	11.00	10.61	10.22	10.21
	<b>Income statement (MYRm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
<b>Key risks</b>	Total turnover	48,120	50,868	52,900	54,003	55,141
i. Aggressive regulatory reform;	Gross profit	23,104	25,133	26,477	26,865	26,820
ii. Impairment on international assets.	EBITDA	18,775	20,812	20,253	20,356	20,012
	Depreciation and amortisation	(10,692)	(11,403)	(11,041)	(11,082)	(11,075)
<b>Company Profile</b>	Operating profit	8,083	9,410	9,212	9,273	8,937
Tenaga Nasional is engaged in the generation, transmission and distribution of electricity in Peninsular Malaysia and Sabah. The national utility company has a near-monopoly in the transmission and distribution of electricity in Peninsular Malaysia and Sabah.	Net interest	(3,370)	(3,935)	(3,477)	(3,391)	(3,304)
	Pre-tax profit	4,738	5,349	5,943	6,211	6,094
	Taxation	(874)	(1,791)	(1,032)	(1,059)	(1,014)
	Reported net profit	3,662	3,463	4,797	5,016	4,917
	Recurring net profit	4,322	3,898	4,797	5,016	4,917
	<b>Cash flow (MYRm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Change in working capital	(5,758)	(10,680)	4,759	732	1,454
	Cash flow from operations	13,344	9,378	23,980	20,029	20,452
	Capex	(8,411)	(8,429)	(12,000)	(11,000)	(11,000)
	Cash flow from investing activities	(3,963)	(14,553)	(11,357)	(10,336)	(10,314)
	Dividends paid	(4,568)	(2,181)	(2,782)	(2,909)	(2,852)
	Cash flow from financing activities	(8,819)	3,596	(7,902)	(7,964)	(7,842)
	Cash at beginning of period	6,442	6,706	4,893	9,614	11,343
	Net change in cash	562	(1,579)	4,721	1,729	2,296
	Ending balance cash	7,004	5,127	9,614	11,343	13,638
	<b>Balance sheet (MYRm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Total cash and equivalents	9,208	13,034	17,755	19,484	21,779
	Tangible fixed assets	114,106	116,577	117,536	117,454	117,379
	Total investments	1,867	1,679	1,887	2,215	2,676
	Total assets	182,601	205,922	206,199	205,864	207,432
	Short-term debt	6,993	13,262	13,262	13,262	13,262
	Total long-term debt	44,686	50,620	49,620	48,620	47,620
	Total liabilities	124,208	144,956	143,105	140,528	139,868
	Total equity	58,392	60,966	63,094	65,336	67,564
	Total liabilities & equity	182,601	205,922	206,199	205,864	207,432
	<b>Key metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Revenue growth (%)	9.4	5.7	4.0	2.1	2.1
	Recurrent EPS growth (%)	22.0	(9.8)	23.1	4.6	(2.0)
	Gross margin (%)	48.0	49.4	50.1	49.7	48.6
	Operating EBITDA margin (%)	39.0	40.9	38.3	37.7	36.3
	Net profit margin (%)	7.6	6.8	9.1	9.3	8.9
	Dividend payout ratio (%)	61.6	58.0	58.0	58.0	58.0
	Capex/sales (%)	17.5	16.6	22.7	20.4	19.9
	Interest cover (x)	2.25	2.23	2.24	2.29	2.24

Source: Company data, RHB

**Figure 1: To date, the Government has successfully managed the impact of fuel price volatility for the past 17 ICPT\* cycles since 2015**



Source: Company data

**Figure 2: DCF valuation**

NPV of forecast	117,784.1
Less (net debt)/net cash	(45,127.1)
Total equity value	72,656.9
Shares (m)	5,643.6
Additional discount for rising regulatory risk	-10%
ESG premium/(discount)	(10%)
<b>TP (MYR)</b>	<b>10.40 (Rounded up)</b>
WACC	7.2%
Long-term growth rate (%)	1.0%

Source: RHB

## Recommendation Chart

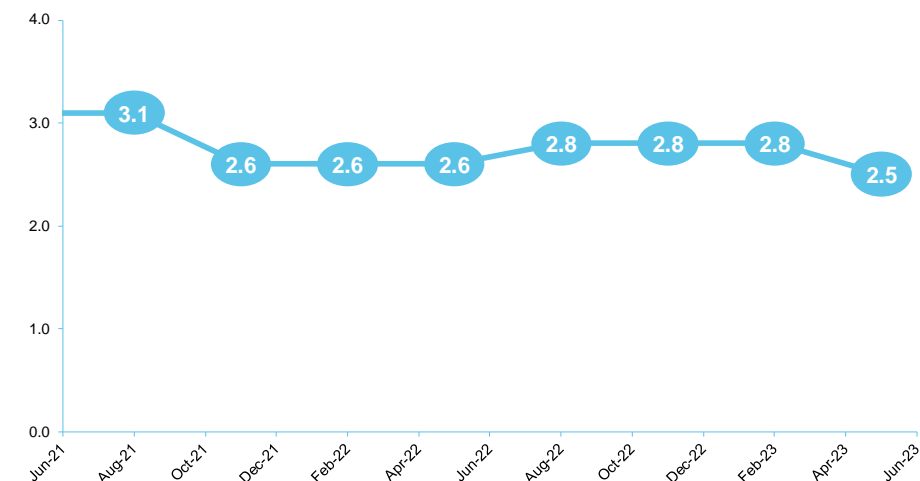


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-05-30	Neutral	10.4	9.6
2023-02-28	Neutral	10.2	9.4
2022-12-19	Neutral	9.6	9.3
2022-08-17	Neutral	9.0	8.9
2022-08-14	Neutral	8.6	8.6
2022-06-27	Neutral	8.6	8.0
2022-05-31	Buy	11.5	9.2
2022-02-25	Buy	11.5	9.0
2021-11-26	Buy	11.5	9.4
2021-03-14	Buy	12.5	10.8
2021-03-01	Buy	11.8	10.3
2020-11-26	Neutral	11.5	11.0
2020-08-31	Neutral	11.6	10.9
2020-07-02	Neutral	12.3	11.6
2020-06-10	Neutral	12.9	12.0

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

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<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
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