Corporate Update | Wednesday, 17 August 2022

Tenaga Nasional Berhad

(5347 | TNB MK) Utilities | Power Generation

***Maintain* NEUTRAL**

Highlights from Tenaga's Investor Day

***Unchanged* Target Price: RM8.45**

KEY INVESTMENT HIGHLIGHTS

- **Aiming to reduce emission intensity by 35% by 2035 and net zero by 2050**
- **Another 2-3 years before Genco embarks on a listing, obtaining good valuations could be a challenge as 48% of capacity is derived from coal**
- **Exploring early retirement of coal plants and repowering with new technologies**
- **Maintain NEUTRAL at unchanged TP of RM8.45**

Fast tracking decarbonisation. Targeting net zero emission while growing EBIT by 140% by 2050 from FY21 base. 58% of EBIT in 2050 to be derived from future generation sources and green business from 24% in FY21. By 2035, Tenaga aims to reduce emissions intensity by 35% (current GHG emission: 0.59tCO2/MWh) and reduce coal capacity by 50% with complete phase-put of coal by 2045. Industrywide in Malaysia, Tenaga sees solar capacity rising from 2GW in 2020 to 6GW by 2025, 9GW by 2030, 21GW by 2035 and 33GW by 2045. Tenaga is also looking to explore new green energy alternatives such as green hydrogen. Overall, the energy transition pathway for Tenaga will require annual capex of RM9-14b between 2022-2030, RM10-20b per annum between 2030-40 and RM15-24b per annum between 2040-50.

Plant repowering. While stuck with long-term PPAs, Genco is looking at accelerating decarbonisation with early retirement of coal plants. This effectively shortens the PPA tenure (hence technically, IRR) and will require regulator and shareholders' approval, but Tenaga should still be able to meet obligations to bondholders. Coal plants outlined for early retirement are KEV (retired 1 year early), Janamanjung 1-3 (2 years early) as well as Janamanjung 4-5 and Jimah East which will be retired 4 years earlier. These coal plants as well as selected expiring gas plants are aimed to be repowered with green technology PPAs - PPAs expiring before 2030 will be repowered as gas incorporating hydrogen co-firing and carbon capture utilization & storage (CCUS), while PPAs expiring after 2030 are to transition to green hydrogen CCGT/CCGT + CCUS/nuclear SMR (small modular reactors). Cost is high currently for the new technologies (CCGT + CCUS: 58-71sen/kwh, Green Hydrogen CCGT: 101-148sen/kwh) vs. 30-35sen/kwh for coal and 25-30sen/kwh for gas but is targeted to reach parity and turn cheaper vs. traditional fuels by 2050.

Incorporation of CCUS to involve stake dilution. As CCUS is still a costly technology while at the same time, tariffs in PPAs are fixed, Genco is looking into the option of acquiring the technology in exchange for Genco's stake in the respective plants. This could see Genco diluting its stake in the plants involved (up to a minimum 51% as Genco intends to maintain majority control) and may possibly lower future earnings accretion from these PPAs.

RETURN STATISTICS	
Price @ 16th August 2022 (RM)	8.89
Expected share price return (%)	-5.0
Expected dividend yield (%)	+3.5
Expected total return (%)	**-1.5**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-11.1	-4.3
3 months	-9.0	-1.9
12 months	-17.3	-10.2

KEY STATISTICS	
FBM KLCI	1,518.78
Syariah compliant	Yes
F4BGM Index	Yes
ESG Grading Band (Star rating)	☆☆☆
Issue shares (m)	5717.52
Estimated free float (%)	31.34
Market Capitalisation (RM'm)	50,828.75
52-wk price range	RM8.04 - RM10.5
Beta vs FBM KLCI (x)	0.84
Monthly velocity (%)	0.00
Monthly volatility (%)	11.10
3-mth average daily volume (m)	4.07
3-mth average daily value (RM'm)	36.15
Top Shareholders (%)	
Khazanah Nasional Bhd	25.58
Employees Provident Fund Board	15.90
Amanah Saham Nasional Bhd	15.21

Analyst:
Hafriz Hezry
hafriz.hezry@midf.com.my
03-2173 8392

INVESTMENT STATISTICS

FYE Dec	FY19	FY20	FY21	FY22F	FY23F
Revenue (RM'm)	50,939.7	43,976.0	52,629.5	48,703.3	50,464.1
EBIT (RM'm)	8,206.8	7,358.8	8,083.0	9,576.1	9,760.0
Pre-tax Profit (RM'm)	5,277.1	4,163.8	4,805.7	5,942.5	5,956.4
Core net profit (RM'm)	4,721.9	3,635.1	4,519.8	4,426.3	4,436.9
FD EPS (sen)	83.7	64.4	80.1	78.4	78.6
EPS growth (%)	(19.8)	(23.0)	24.3	(2.1)	0.2
PER (x)	10.6	13.8	11.1	11.3	11.3
EV/EBITDA (x)	4.4	4.8	4.5	4.7	4.6
Net Dividend (sen)	100.0	80.0	40.0	31.4	31.4
Net Dividend Yield (%)	11.2	9.0	4.5	3.5	3.5

Source: Company, MIDFR

Genco IPO not immediate, will require another 2-3 years. Genco is also looking at the possibility of an IPO around 2-3 years down the road. Meantime, efforts are focused on optimizing Genco's operations. Around 48% of Genco's capacity currently comprise of coal – we foresee obtaining good valuation for Genco could be a challenge. A positive, should this be in the form of a spin-off, is that it will remove substantial ESG drag from Tenaga as 99% of the group's emissions is currently coming from generation. Genco also aims to tap on regional gas and hydro potential. Overall, it is looking at 460MW of new gas and hydro capacity from within the region (Vietnam, Thailand and Indonesia for gas & Laos and Indonesia for hydro) by 2030 which will add to its existing 14GW capacity. In terms of segmentation, Genco will continue to house existing traditional fuel capacity while RE will be in the form of hydro power plants. 48% of Genco capacity comprise of coal, 33% gas and 18% hydro currently.

New energy division. The New Energy Division (NED) which houses Tenaga's RE operations (ex-hydro) has a long-term target of reaching 7.2GW RE capacity by 2030, 9.9GW by 2040 and 14.3GW by 2050 – from 0.7GW in 2022. Current RE capacity comprise of mainly 119MW wind capacity in Turkey (minority stake), 165MW wind and 365MW solar capacity in the UK, 26MW solar capacity in India (minority-owned) and 126MW solar capacity in Malaysia. Current assets are generating 7% equity IRR (most were acquired as operational assets hence relatively lower IRR) but could rise to 7%-9% as the group increases development assets. Of the 3.6GW deal flow that NED has in the pipeline for the UK/EU and Asia Pacific markets, 91% and 80%respectively are development assets. NED will require equity investment of USD4b by 2030 to hit its 7.2GW RE target, USD5.5b within 2031-2040 to hit 9.9GW and another USD6.5b within 2041-2050 to hit 14.3GW. EBIT is expected to ultimately rise to USD700-900m by 2050 once the targets are achieved. Operations are split into two; Development Companies which houses greenfield/brownfield RE asset development and RA Fund which will house operational assets. The group is looking at potential monetization of NED via accessing public funds or private equity markets targeted in 2028.

Transmission operations. Tenaga's grid transmission operations will play a role in supporting decarbonisation. Essentially, the grid aims build advanced and flexible operations capabilities and invest in network expansion to support increasing variable RE (VRE) penetration and growth in peak load. It will also focus on reducing its own decarbonisation and continuously conserve forest and natural environment with the establishment of the Grid Green Code of Conduct. Grid operations is also looking to play a key role in accelerating the ASEAN power grid development to mitigate system stability. Overall, grid-related regulated asset base (RAB) is expected to rise by 61% to RM45b by 2050 from RM28b in 2022 with circa 11% of 2050 RAB comprising energy transition and decarbonisation assets. At this RAB, the grid operations expected to generate earnings of RM3b by 2050. Meanwhile, the distribution network's RAB is expected to increase by 50% from RM36b in 2022 to RM54b in 2050 with 20% comprising energy transition elements.

Recommendation. We like Tenaga's energy transition ambitions which is necessary to manage climate change and address potential risk from carbon pricing in the future. These are, however, long term in nature - we anxiously await concrete progress and acknowledge execution risk involved. Near-to-mid term measures however, may weigh on profitability given: (1) Earnings impact from early coal plant retirement and stake dilution from CCUS incorporation, (2) Potential near-to-mid term impact from carbon pricing introduction in Malaysia. Share price has been driven by rumors of a Genco IPO as early as next year, but Tenaga has clarified that this will only probably materialize 2-3 years down the road. Near-term, cash flows and dividend prospects are weighed by elevated cost under recovery given still high fuel cost. Maintain **NEUTRAL** at unchanged **TP of RM8.45**.

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077(23878 – X)).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (197501002077 (23878 – X)) for distribution to and use by its clients to the extent permitted by applicable law or regulation.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that MIDF Investment believes are reliable at the time of publication. All information, opinions and estimates contained in this report are subject to change at any time without notice. Any update to this report will be solely at the discretion of MIDF Investment.

MIDF Investment makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such. MIDF Investment and its affiliates and related companies and each of their respective directors, officers, employees, connected parties, associates and agents (collectively, "Representatives") shall not be liable for any direct, indirect or consequential loess, loss of profits and/or damages arising from the use or reliance by anyone upon this report and/or further communications given in relation to this report.

This report is not, and should not at any time be construed as, an offer, invitation or solicitation to buy or sell any securities, investments or financial instruments. The price or value of such securities, investments or financial instruments may rise or fall. Further, the analyses contained herein are based on numerous assumptions. This report does not take into account the specific investment objectives, the financial situation, risk profile and the particular needs of any person who may receive or read this report. You should therefore independently evaluate the information contained in this report and seek financial, legal and other advice regarding the appropriateness of any transaction in securities, investments or financial instruments mentioned or the strategies discussed or recommended in this report.

The Representatives may have interest in any of the securities, investments or financial instruments and may provide services or products to any company and affiliates of such companies mentioned herein and may benefit from the information herein.

This document may not be reproduced, copied, distributed or republished in whole or in part in any form or for any purpose without MIDF Investment's prior written consent. This report is not directed or intended for distribution to or use by any person or entity where such distribution or use would be contrary to any applicable law or regulation in any jurisdiction concerning the person or entity.

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology