Corporate Update | Monday, 19 December 2022

Tenaga Nasional Berhad

(5347 | TNB MK) Utilities | Power Generation

Incrementally positive ICPT outcome

***Upgrade to* BUY**

(Previously NEUTRAL)

***Revised* Target Price: RM10.00**

(Previously RM8.45)

KEY INVESTMENT HIGHLIGHTS

- **Favorable outcome from latest ICPT review – effective tariffs for >11kV users to rise by 37%**
- **ICPT receivables could be nearing a peak given expected pick-up in ICPT recovery**
- **Reacceleration in regulated earnings growth and dividends**
- **New administration seems more willing to bite the bullet, move to targeted subsidies a potential structural positive**
- **Upgrade to BUY at revised TP of RM10.00**

Favorable ICPT outcome. The Energy Commission's latest ICPT review points to an incrementally positive outcome for Tenaga given a significantly higher ICPT pass-through allowed relative to actual ICPT under-recovery of 27sen/kwh. Summary of the latest ICPT decision:

(1) ICPT surcharge for medium and high voltage non-domestic consumers (i.e., connections of >11kV) were raised from 3.7sen/kwh previously to 20.0sen/kwh - this raises effective tariff for this group of consumers by 37%. The remaining 7.0sen/kwh (from the actual 27.0sen/kwh ICPT under-recovery) will be subsidised by the Government amounting to RM1.9b. For non-domestic consumers not affected by the latest ICPT surcharge increase (i.e., <11kV connections), including SMEs and the agriculture sector, the previous 3.7sen/kwh surcharge remains *(See Table 1)*.

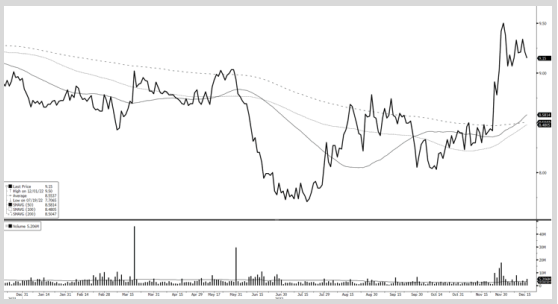
(2) Domestic consumers (i.e., residential consumers) will continue to enjoy the current 2.0sen/kwh ICPT rebate, meaning no change in effective tariff for this group of consumers. A total of RM8.8b will be subsidised by the Government to maintain the tariffs for domestic consumers and low voltage non-domestic consumers.

More certainty in cash flows. The non-domestic consumers affected by the latest decision is estimated to account for ~45% of total demand. Coupled with a larger ICPT surcharge, the direct pass-through of Tenaga's ICPT under-recovery this time around is much larger at an estimated RM5.0b-6.0b vs. RM1.6b previously i.e., around 34% of Tenaga's 2H22 outstanding ICPT is estimated to be passed through to end-consumers this time vs. just 13% in the previous review, giving better cash flow visibility. While the total amount to be subsidised by the Government is still large at RM10.8b, there is now clarity on how the sizeable end-2022 outstanding ICPT of RM16b will be managed. This contrasts with a deferred decision for an estimated sum of RM4.7b (which made up 39% of ICPT receivables) in the previous mid-2022 review.

ICPT receivables peak seen in 4Q22 and to ease from thereon. With clarity on Tenaga's ICPT pass-through, we see Tenaga's ICPT receivables peaking in 4Q22 *(see Chart 3 & 4)* before easing in 1Q-2Q23 (assuming 1H23 ICPT under-recovery remains at ~RM6b/quarter). Hence, we expect the previous constraint on Tenaga's cash flows to be gradually alleviated.

RETURN STATISTICS	
Price @ 16th Dec 2022 (RM)	9.15
Expected share price return (%)	+9.3
Expected dividend yield (%)	+4.5
Expected total return (%)	**+13.8**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	9.2	7.0
3 months	13.7	3.4
12 months	-3.8	-2.3

KEY STATISTICS	
FBM KLCI	1,478.54
Syariah compliant	Yes
F4BGM Index	Yes
ESG Grading Band (Star rating)	☆☆☆
Issue shares (m)	5717.52
Estimated free float (%)	31.33
Market Capitalisation (RM'm)	52,640.66
52-wk price range	RM7.89 - RM9.5
Beta vs FBM KLCI (x)	0.88
Monthly velocity (%)	0.00
Monthly volatility (%)	11.10
3-mth average daily volume (m)	3.31
3-mth average daily value (RM'm)	28.92
Top Shareholders (%)	
Khazanah Nasional Bhd	25.46
Employees Provident Fund Board	15.71
Amanah Saham Nasional Bhd	15.57

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

INVESTMENT STATISTICS

FYE Dec	FY20	FY21	FY22F	FY23F	FY24F
Revenue (RM'm)	43,976.0	52,629.5	73,703.3	75,802.0	77,980.7
EBIT (RM'm)	7,358.8	8,083.0	9,576.1	10,098.0	10,467.3
Pre-tax Profit (RM'm)	4,163.8	4,805.7	5,942.5	6,294.4	6,473.6
Core net profit (RM'm)	3,635.1	4,519.8	4,307.5	4,693.7	4,829.7
FD EPS (sen)	64.4	80.1	76.3	83.2	85.6
EPS growth (%)	(23.0)	24.3	(4.7)	9.0	2.9
PER (x)	14.2	11.4	12.0	11.0	10.7
EV/EBITDA (x)	4.9	4.6	4.8	4.6	4.5
Net Dividend (sen)	80.0	40.0	34.3	41.6	42.8
Net Dividend Yield (%)	8.7	4.4	3.8	4.5	4.7

Source: Company, MIDFR

Expecting capex to reaccelerate. In a recent analyst briefing, management alluded to the fact that regulated capex spending has fallen behind the approved RP3 (Regulatory Period 3) capex given concerns on cash flow constraint. As of end-9M22, only 60% of approved FY22 regulated capex of RM7.17b was spent, which: (1) Drags recognition of regulated earnings (2) Drags recognition of ITA (investment tax allowance) resulting in higher-than-expected effective tax rates. With the expected relief of cash flow constraints following the latest ICPT decision, we expect Tenaga's regulated capex to reaccelerate from FY23 onwards.

Earnings revision, more optimistic on dividend outlook. As per our argument above, we raise FY23F earnings by 5.8% to reflect a reacceleration in regulated capex resulting in higher regulated earnings recognition from next year onwards. We introduce FY24F net profit at RM4.8b implying a further +2.9%yoy growth from continued expansion in Tenaga's regulated asset base. Our FY22F is left unchanged. In line with the more optimistic outlook on earnings and cash flow, we raise our dividend payout assumption to 45%/50%/50% (FY22F/23F/24F) from 40%/40%/40% previously – implied dividend yields are now higher at 3.8%/4.5%/4.7% respectively. Our new payout assumption is now closer to the higher end of Tenaga's 30%-60% payout policy.

Upgrade to BUY. Given an incrementally positive outlook, we raise Tenaga to **BUY** (from NEUTRAL previously) at a higher DCF-based **TP** of **RM10.00** (WACC: 8.5%) from RM8.45. Our new TP takes into account the improved earnings and cash flow outlook, coupled with a reduction in risk premium given: (1) Better clarity on how Tenaga's elevated ICPT receivables will be managed going forward, (2) The Government's willingness to bite the bullet and allow a reasonably large ICPT pass-through in recognition of unprecedented fuel prices, (3) The current emphasis on targeted subsidies which signals a more direct approach to ICPT pass-through going forward rather than reliance on the Government's willingness to subsidise. From a valuation standpoint, Tenaga is now trading at just 11x FY23F PER, a 23% discount to historical mean. Having said that, we acknowledge risk from: (1) Potential re-introduction of power sector liberalisation policies, (2) Potential introduction of carbon pricing, should it be introduced at an aggressive rate, (3) From an ESG standpoint; Tenaga's continued reliance on coal power generation in the medium term. Our new TP implies FY23F PER of 12x, which is still at an 15% discount to historical mean of 14x.

Table 1: Summary of 1H23 Tariff Review vs. 2H22 Tariffs

Sen/kwh	2H22 ICPT Review		1H23 ICPT review		
	Domestic	Non-domestic (All kV)	Domestic	Non-domestic (<11kV)	Non-domestic (>11kV)*
Base tariff	39.95		39.95		
ICPT under/(over) recovery	11.81		27.00		
Government Subsidy	(13.81)	(8.11)	(29.00)	(23.30)	(7.00)
ICPT surcharge/(rebate)	(2.00)	3.70	(2.00)	3.70	20.00
Effective tariff	37.95	43.65	37.95	43.65	59.95

Source: EC, MIDFR **except for H-tariffs (agriculture sector) whereby surcharge remains at 3.7sen/kwh*

Chart 1: Power demand by segment

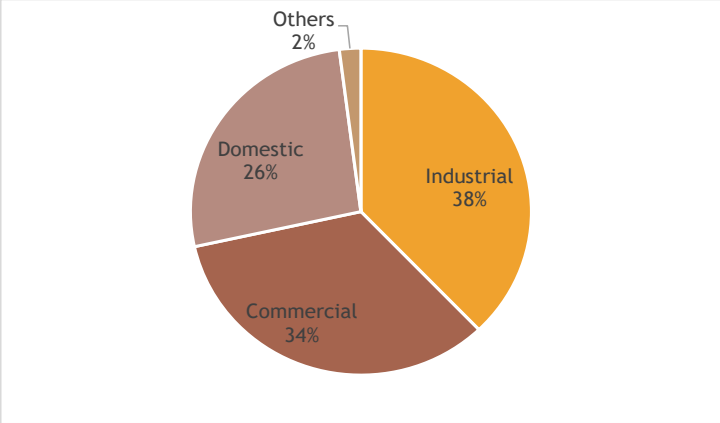
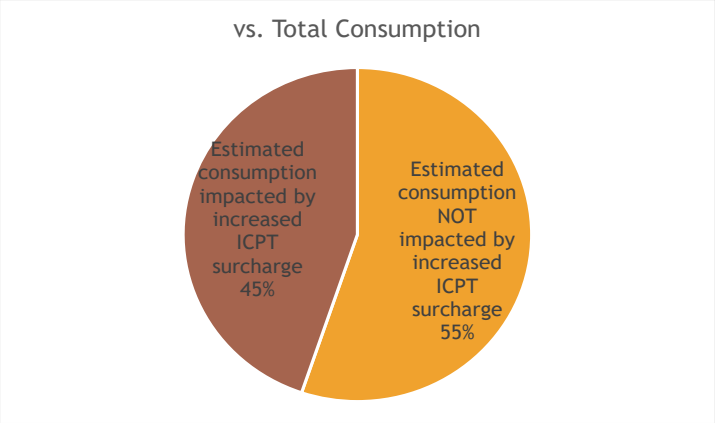


Chart 2: 45% of consumption to see higher tariffs



Source: Company, EC, MIDFR

Chart 3: ICPT subsidy/surcharge collection: To pick-up pace from 4Q22 onwards

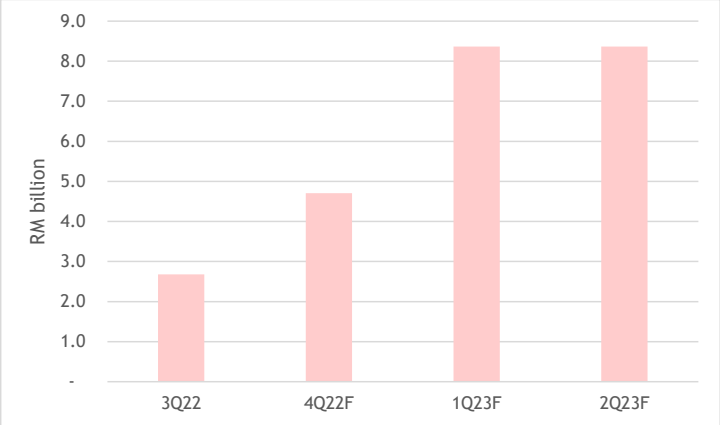
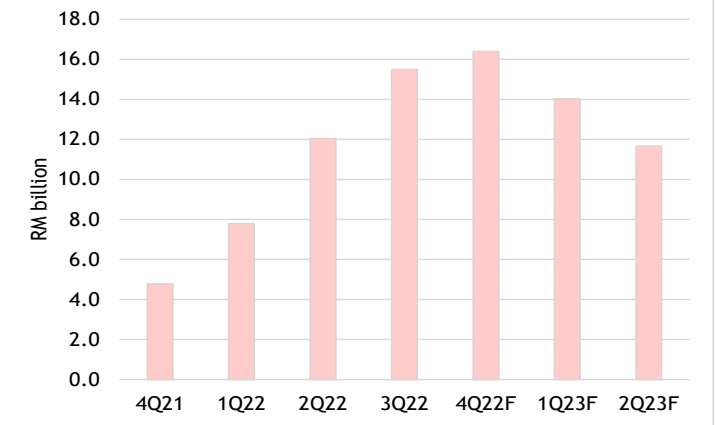


Chart 4: ICPT receivables: Peak seen in 4Q22



Source: Company, MIDFR

Chart 5: ICPT receivables movement in 2H22(e)

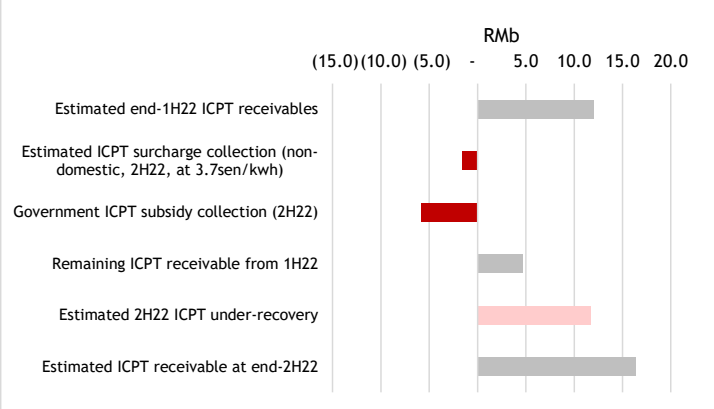
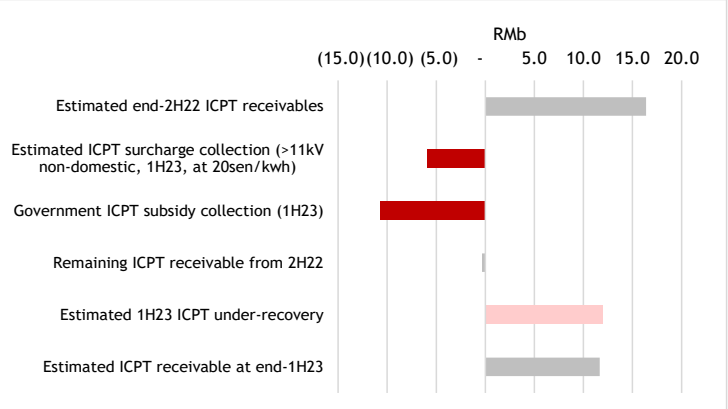


Chart 6: ICPT receivables movement in 1H23(e)



Source: Company, EC, MIDFR

Chart 7: Tenaga: ICPT under-recovery trend

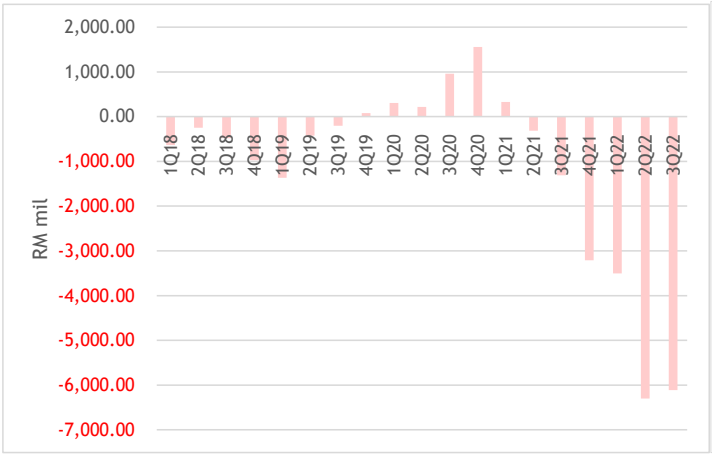
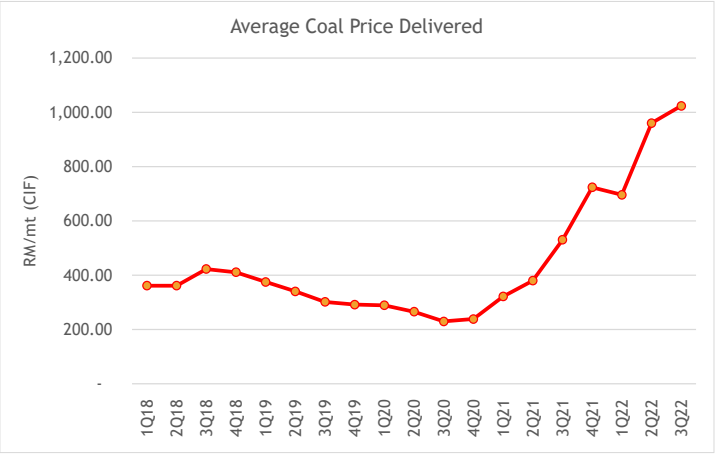


Chart 8: Tenaga: Average coal price delivered



Source: Company, MIDFR

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