**midf RESEARCH**

**13 November 2018 | Corporate Update**

# Tenaga Nasional

***Weakness anticipated against an inflated 1H18***

***Maintain* BUY**

***Revised* Target Price: RM16.80**

***(previously RM16.90)***

- **Anticipate weaker earnings from weaker demand growth and RM, IBR provisions expected in 4Q18**
- **Most of these factored in, but FY18F earnings tweaked for higher tax rate assumption**
- **FY19F pretax to grow 5% on natural rise in regulated earnings and new plant commissioning**
- **TP tweaked lower to RM16.80 but BUY maintained**

**Weaker earnings anticipated.** We anticipate weaker earnings for Tenaga's upcoming 3Q18. This is on the back of an expected: (1) Weaker demand growth compared to a strong 1H18 (2) Higher effective fuel cost. Gama Enerji took an impairment last quarter – it is uncertain if there is more to be taken in the upcoming quarter.

**IBR provisions in 4Q18.** Unlike RP1 which essentially allowed Tenaga to keep excess demand, RP2 switches to a revenue cap model (except for customer services). Provisions are likely to be made in 4Q18 for any excess revenues – which also means that 1H18 earnings were slightly inflated. RP2 entails demand growth forecast of 1.8%-2%, relative to 1H18 actual demand growth of 2.7%. The strong demand growth in 1H18 (which hit a new peak demand of 18,010MW in June) is also unlikely to be sustainable given changes in weather patterns. The extent of IBR provision will depend on the net growth achieved for the full year.

**Higher fuel cost.** There has been a divergence in thermal coal price trends since around July 2018 – 6000kcal rose while 5500kcal dropped, though the divergence has started to narrow. While Tenaga consumes mainly 5500kcal coal which saw average price dropping 5%qoq to USD69.7/tonne (FOB), the RM weakened in 3Q18. In RM and CIF terms, we estimate coal price to have increased by 7%qoq. Coal accounts for ~58% of generation mix and gas another 39%.

**Tax incentives expiring.** Our checks also suggest that effective tax rates for FY18F is likely to rise against past three FY's 9%-13% rate as Tenaga's tax reinvestment allowance gradually expires. Effective tax rates are likely to be higher this year at the mid-to-high teen levels before fully normalising to the low 20% level next year.

**Earnings tweaked down.** Our FY18F is tweaked down by 7% to reflect the expected higher effective tax rates in FY18 vs. our earlier estimate of 11%-12%. Our FY19F is left unchanged as we had already factored in full normalisation of tax rates. Our forecasts are now 5%/8% below consensus' FY18F/19F.

| RETURN STATS | |
|---|---|
| Price (12 Nov 2018) | RM14.84 |
| Target Price | RM16.80 |
| Expected Share Price Return | +13.2% |
| Expected Dividend Yield | +4.5% |
| **Expected Total Return** | **+12.4%** |

| STOCK INFO | |
|---|---|
| KLCI | 1,696.14 |
| Bursa / Bloomberg | 5347/TNB MK |
| Board / Sector | Main |
| Syariah Compliant | Yes |
| Issued shares (mil) | 5678.18 |
| Market cap. (RM'm) | 84,264.20 |
| Price over NA | 1.43 |
| 52-wk price Range | RM13.5 - RM16.3 |
| Beta (against KLCI) | 0.92 |
| 3-mth Avg Daily Vol | 6.62m |
| 3-mth Avg Daily Value | RM101m |
| Major Shareholders (%) | |
| Khazanah Nasional | 28.8% |
| EPF | 12.1% |
| Skim ASB | 8.9% |

## INVESTMENT STATISTICS

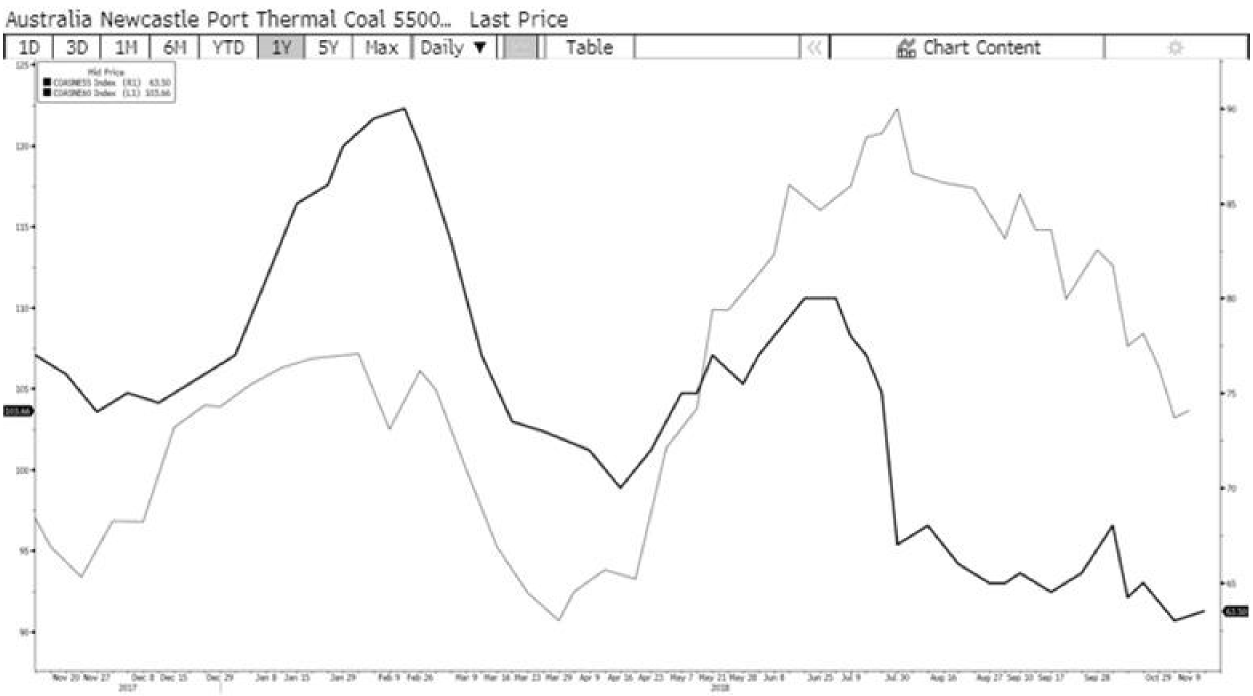
| FYE Dec ** | FY15 | FY16 | 16MFY17* | FY18F | FY19F |
|---|---|---|---|---|---|
| Revenue (RM'm) | 43,286.8 | 44,531.5 | 63,244.0 | 50,573.5 | 53,266.0 |
| EBIT (RM'm) | 7,695.3 | 9,072.0 | 12,512.6 | 9,160.5 | 9,539.5 |
| Pre-tax Profit (RM'm) | 7,133.7 | 8,456.8 | 10,945.1 | 8,290.5 | 8,672.5 |
| Core net profit (RM'm) | 5,978.9 | 7,757.6 | 10,128.8 | 6,834.9 | 6,544.9 |
| FD EPS (sen) | 105.9 | 137.5 | 179.5 | 121.1 | 116.0 |
| EPS growth (%) | 27.7 | 29.7 | 30.6 | (32.5) | (4.2) |
| PER (x) | 14.0 | 10.8 | 8.3 | 12.3 | 12.8 |
| Net Dividend (sen) | 29.0 | 32.0 | 82.4 | 66.6 | 63.8 |
| Net Dividend Yield (%) | 2.0 | 2.2 | 5.6 | 4.5 | 4.3 |
| Payout ratio | 26.7% | 24.5% | 48.1% | 55.0% | 55.0% |

** 16-month period due to change in financial year end from Aug to Dec*
*** FYE Aug prior to FY17*
*Source: Company, MIDF*

**Fundamentals remain intact.** Notwithstanding the earnings adjustment to reflect a higher effective tax rate, underlying operating earnings forecasts are left unchanged as we had: (1) Already anticipated the potential provisions year end to return excess revenues (2) Higher coal price/forex; and the higher cost should be offset by higher ICPT surcharge in the next review. We forecast FY19F core pretax earnings growth of 4.6% (FY18F yoy growth not available given FYE change) driven by new plant commissioning (2000MW Jimah East, 50MW Sepang Solar) and natural expansion in regulated earnings from gradually rising Regulated Asset Base (RAB).

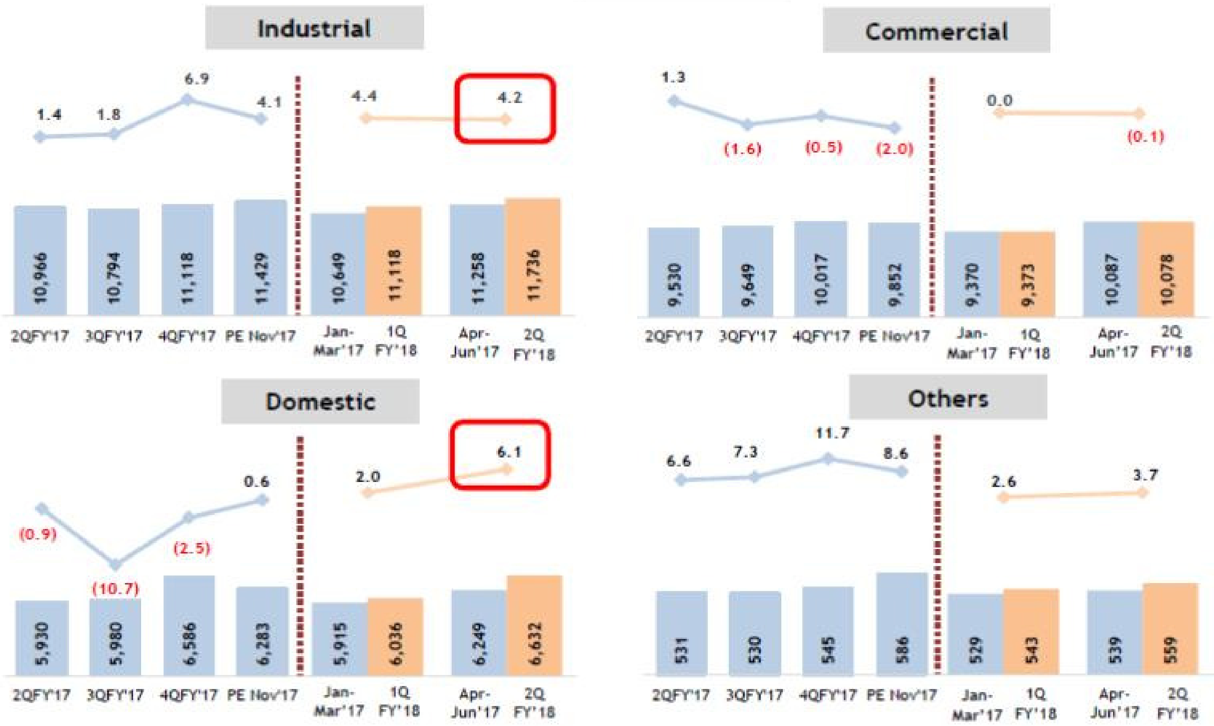
**Recommendation.** We maintain our BUY call on Tenaga at a slightly lower TP of RM16.80 (from RM16.90) given the earnings revision in this report. Key catalysts: (1) Decent dividend yields of 4.5% (+ve spread against 10yr MGS of 4.1%) while valuations are cheap at 12x FY18F earnings relative to the market's 16x-17x. (2) Peaking capex suggests room for dividend upside (3) Possible monetisation of backbone fibre asset via partners.

## EXHIBIT 1: THERMAL COAL – 6600KCAL VS 5500KCAL PRICE TRENDS




*Source: Bloomberg, MIDF*

**EXHIBIT 2: TENAGA BENEFITTED FROM STRONG DEMAND GROWTH IN 1H18**




*Source: Company, MIDF*

| Income Statement | FY15 | FY16 | 16MFY17 | FY18F | FY19F |
|---|---|---|---|---|---|
| **Revenue** | **43,286.8** | **44,531.5** | **63,244.0** | **50,573.5** | **53,266.0** |
| Operating expenses | (35,591.5) | (35,459.5) | (50,731.4) | (41,413.0) | (43,726.6) |
| **EBIT** | **7,695.3** | **9,072.0** | **12,512.6** | **9,160.5** | **9,539.5** |
| Net interest expense | (662.7) | (740.3) | (1,660.9) | (972.7) | (969.7) |
| Associates | 101.1 | 93.3 | 91.3 | 102.7 | 102.7 |
| **PBT** | **7,133.7** | **8,456.8** | **10,945.1** | **8,290.5** | **8,672.5** |
| Taxation | (1,072.8) | (746.0) | (1,605.1) | (1,409.4) | (2,081.4) |
| Minority Interest | (57.5) | (46.8) | (3.7) | 46.2 | 46.2 |
| Net profit | 6,118.4 | 7,367.6 | 9,659.7 | 6,834.9 | 6,544.9 |
| **Core net profit** | **5,978.9** | **7,757.6** | **10,128.8** | **6,834.9** | **6,544.9** |
| Consensus net profit | 6,118 | 7,268 | N/A | 7,200.0 | 7,139.0 |

| Balance Sheet | FY15 | FY16 | 16MFY17 | FY18F | FY19F |
|---|---|---|---|---|---|
| **Non-current assets** | **98,340.0** | **106,146.9** | **114,491.7** | **108,493.1** | **111,776.9** |
| PPE | 90,300.3 | 91,437.8 | 93,089.0 | 97,600.2 | 100,884.0 |
| Investments in associate | 634.7 | 1,699.3 | 2,937.8 | 2,726.0 | 2,726.0 |
| Others | 7,405.0 | 13,009.8 | 18,464.9 | 8,166.9 | 8,166.9 |
| | | | | | |
| **Current assets** | **18,795.0** | **26,755.3** | **27,520.7** | **30,157.5** | **30,098.8** |
| Inventories | 843.8 | 950.2 | 1,009.4 | 1,048.6 | 1,104.5 |
| Receivables | 8,639.4 | 5,929.0 | 6,298.4 | 6,927.9 | 7,296.7 |
| Others | 402.3 | 9,024.7 | 2,934.7 | 3,680.9 | 3,680.9 |
| Cash & equivalent | 8,909.5 | 10,851.4 | 17,278.1 | 18,500.0 | 18,016.6 |
| **TOTAL ASSETS** | **117,135.0** | **132,902.2** | **142,012.4** | **138,650.6** | **141,875.7** |
| | | | | | |
| Share capital | 5,643.6 | 5,643.6 | 11,124.9 | 11,124.9 | 11,124.9 |
| Minority Interest | 258.9 | 258.9 | 473.4 | 258.9 | 258.9 |
| Reserves | 41,564.4 | 46,697.2 | 45,986.5 | 46,959.1 | 49,904.3 |
| **TOTAL EQUITY** | **47,466.9** | **52,599.7** | **57,584.8** | **58,342.9** | **61,288.1** |
| | | | | | |
| **Non-current liabilities** | **54,075.9** | **64,218.5** | **69,101.1** | **63,742.3** | **63,640.3** |
| Long-term borrowings | 22,713.1 | 22,945.5 | 37,038.4 | 32,379.4 | 32,277.4 |
| Deferred tax liabilities | 7,054.1 | 7,054.1 | 7,054.1 | 7,054.1 | 7,054.1 |
| Others | 24,308.7 | 34,218.9 | 25,008.6 | 24,308.8 | 24,308.8 |
| | | | | | |
| **Current liabilities** | **15,592.2** | **16,084.0** | **15,326.5** | **16,565.4** | **16,947.3** |
| Short-term borrowings | 1,985.8 | 1,985.8 | 1,808.1 | 1,985.8 | 1,985.8 |
| Payables | 10,411.5 | 6,010.3 | 6,342.3 | 6,711.7 | 7,093.6 |
| Others | 3,194.9 | 8,087.9 | 7,176.1 | 7,867.9 | 7,867.9 |
| | | | | | |
| **TOTAL LIABILITIES** | **69,668.1** | **80,302.5** | **84,427.6** | **80,307.7** | **80,587.6** |

| Cash Flow Statement | FY15 | FY16 | 16MFY17 | FY18F | FY19F |
|---|---|---|---|---|---|
| **Operating activities** | | | | | |
| PBT | 7,133.7 | 8,456.8 | 10,945.1 | 8,290.5 | 8,672.5 |
| Depreciation & Amortization | 5,294.2 | 5,722.2 | 6,105.0 | 5,349.3 | 5,576.7 |
| Chgs in working capital | 3,901.6 | (164.5) | (96.6) | (299.2) | (42.8) |
| Interest expense | (662.7) | (740.3) | (1,660.9) | (972.7) | (969.7) |
| Tax paid | (810.8) | (746.0) | (1,605.1) | (1,409.4) | (2,081.4) |
| Others | (3,416.6) | 764.3 | (1,129.0) | 926.5 | 923.5 |
| **CF from Operations** | **11,439.4** | **13,292.5** | **12,558.5** | **11,885.0** | **12,078.9** |
| | | | | | |
| **Investing activities** | | | | | |
| Capex | (10,363.7) | (11,142.8) | (12,336.8) | (10,000.0) | (9,000.0) |
| Others | (2,462.6) | (7,253.1) | (348.3) | 139.5 | 139.5 |
| **CF from Investments** | **(12,826.3)** | **(18,395.9)** | **(12,685.1)** | **(9,860.5)** | **(8,860.5)** |
| | | | | | |
| **Financing activities** | | | | | |
| Dividends paid | (1,636.7) | (1,637.7) | (2,205.9) | (3,759.2) | (3,599.7) |
| Net proceeds in borrowings | (1,775.2) | 9,063.4 | 4,473.6 | 9,199.1 | (102.1) |
| Others | (839.8) | (886.7) | (1,041.0) | (2,240.6) | - |
| **CF from Financing** | **(4,251.7)** | **6,539.0** | **1,226.7** | **3,199.3** | **(3,701.8)** |
| | | | | | |
| Net changes in cash | (5,638.6) | 1,435.6 | 1,100.1 | 5,223.8 | (483.4) |
| **Beginning cash** | **7,871.5** | **1,982.1** | **3,411.5** | **4,512.9** | **9,736.7** |
| Overdrafts, Deposits & Forex | 0.2 | (6.2) | 1.3 | - | - |
| **Ending cash** | **2,233.1** | **3,411.5** | **4,512.9** | **9,736.7** | **9,253.2** |

| Ratios | FY15 | FY16 | 16MFY17 | FY18F | FY19F |
|---|---|---|---|---|---|
| | | | | | |
| Revenue growth | 1.2% | 2.9% | 42.0% | -20.0% | 5.3% |
| EBITDA growth | 3.9% | 13.9% | 25.8% | -22.1% | 4.2% |
| Net profit growth | 27.7% | 29.7% | 30.6% | -32.5% | -4.2% |
| EBITDA margin | 30.0% | 29.7% | 30.1% | 28.7% | 28.4% |
| PATAMI margin | 13.8% | 17.4% | 16.0% | 13.5% | 12.3% |
| ROE | 12.6% | 14.7% | 17.6% | 11.7% | 10.7% |
| ROA | 5.1% | 5.8% | 7.1% | 4.9% | 4.6% |
| Net gearing | 33% | 27% | 37% | 27% | 27% |
| Book value/share (RM) | 8.41 | 9.32 | 10.20 | 10.34 | 10.86 |
| PBV (x) | 1.8 | 1.6 | 1.5 | 1.4 | 1.4 |
| EV/EBITDA (x) | 8.0 | 7.2 | 6.6 | 6.9 | 6.6 |
| FCF yield (%) | 1.3 | 2.6 | 0.3 | 2.3 | 3.7 |
| Gross gearing (%) | 52% | 47% | 67% | 59% | 56% |

**DAILY PRICE CHART**

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*Source: Bloomberg, MIDFR*

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| **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. |