28 November 2018 | 3QFY18 Results Review

Tenaga Nasional

Weakness anticipated, hit by higher fuel cost

***Maintain* BUY**

***Unchanged* Target Price: RM16.80**

- **Core 9M18 earnings in-line with ours but behind consensus**
- **Higher fuel cost impacted earnings**
- **Capex looks to have peaked, room for higher dividends**
- **Re-affirm BUY at unchanged TP of RM16.80**

Earnings in-line. Tenaga reported 3Q18 core earnings of RM1.2b (excluding RM510m one-offs), which brought 9M18 core earnings to RM5b. This is within our expectation but below consensus accounting for 73% and 69% of our and consensus' FY18F. Given a change to FYE Dec reporting, no year-on-year comparison was available.

One-off factors. Several one-off factors impacted Tenaga's reported 3Q18 earnings namely: (1) RM290m additional provision for impairment for GAMA – as we had mentioned last quarter, 2Q18 impairment was based on TRY4.6:USD and since then, the TRY had depreciated further (2) RM220m Collective agreement (CA) for non-executive resulting in exceptionally higher staff cost. On 9M18 basis, one-offs were: (1) GAMA provisions amounted to RM496m – GAMA has already been fully written off in Tenaga's books, (2) CA clawback at RM220m (3) Exceptional provisions for delinquent accounts at RM170m.

Higher fuel cost. Coal cost recognised by Tenaga surprisingly rose significantly in 3Q18, higher by 13%qoq (at USD94/mt FOB) and more reflective of 6000kcal trends than 5500kcal trends. To recap, there has been a divergence in thermal coal price trends since around July 2018 – 6000kcal rose while 5500kcal dropped, though the divergence has now normalised and 6000kcal has been trending down. The impact of higher coal price is further compounded by weak RM trends (3Q18: RM4.09:USD vs. 2Q18: RM3.95:USD). On top of this, 3Q18 reflected higher piped gas price of RM25.70/mmbtu (vs. RM24.20/mmbtu in 1H18) in line with the gradual subsidy rollback.

Temporarily higher gas mix. Additionally, fuel cost was impacted by higher gas in the generation mix which increased to 42% from 39% last quarter. This is due to outages at Kapar Energy and Tg. Bin coal plants and is temporary. Coal mix is expected to normalise in 4Q18. Coal fuel cost is still cheaper than gas at 18sen/kwh vs. 20sen/kwh (piped gas + LNG). Other than these, 3Q18 operating expense was impacted by higher repair and maintenance cost (+22%qoq) and general expenses (+24%qoq) which typically builds up as the year progresses.

Fuel cost pressure could ease slightly. The higher fuel cost, although technically is temporary until Tenaga gets adjustments in 1H19 ICPT, will impact earnings for FY18 given the delay in recovery. Nonetheless, we expect fuel cost in 4Q18 to ease slightly given a recovery in coal mix and gradually easing coal price in the spot markets.

RETURN STATS	
Price (27 Nov 2018)	RM14.72
Target Price	RM16.80
Expected Share Price Return	+14.1%
Expected Dividend Yield	+4.3%
Expected Total Return	**+18.4%**

STOCK INFO	
KLCI	1,684.97
Bursa / Bloomberg	5347/TNB MK
Board / Sector	Main
Syariah Compliant	Yes
Issued shares (mil)	5,686.89
Market cap. (RM'm)	83,711.00
Price over NA	1.41
52-wk price Range	RM13.5 - RM16.3
Beta (against KLCI)	0.92
3-mth Avg Daily Vol	5.74m
3-mth Avg Daily Value	RM86.7m
Major Shareholders (%)	
Khazanah Nasional	28.8%
EPF	12.2%
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)	13.9	10.7	8.2	12.2	12.7
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

Underlying fundamentals intact. Whilst Tenaga was hit by a final round of impairment for GAMA, underlying fundamentals in the Turkey power sector is intact: (1) Decreasing reserve margins bodes well for merchant market pricing (2) Consumption is outgrowing new capacity additions. Gama has been posting positive EBITDA in at least the past 5 quarters (See Exhibit 1).

EXHIBIT 1: TENAGA'S OVERSEAS INVESTMENTS

EBITDA (USDm)	2Q17	3Q17	4Q17	1Q18	2Q18
Gama Enerji (30% stake)	36.4	39.1	31.6	29.5	30.6
GMR Energy (30% stake)	17.6	17.7	4.7	61.7	25.4
Vortex Solar **(RMm)** (50% stake)	NA	NA	16.2	16.1	62.5

Source: Company, MIDF

IBR provisions next quarter. 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 annual demand growth forecast of 1.8%-2%, relative to 9M18 actual demand growth of 2.7%yoy. The extent of IBR provision will depend on the net growth achieved for the full year.

Capex looks to have peaked. Tenaga's capex in FY16/17 stood at RM11b/RM12b, whilst this year's 9M18 capex stood at RM7.8b; comprising RM2.7b for generation capex and the rest (RM5b) for T&D recurring capex. Tenaga spends ~RM6b capex on T&D annually. With minimal new generation projects in the pipeline (and given the new Govt's indication of already high reserve capacity situation), we think Tenaga's capex (generation capex) is already past peak - most of the existing projects have progressed well as of 2Q18 (1) Jimah East 95% completed (2) Sepang Solar (completed) (3) Southern Power Generation (59%). This suggests room for further growth in dividend payout.

Recommendation. We re-affirm our **BUY** call at unchanged **TP of RM16.80**. Key catalysts: (1) Decent dividend yields of 4.3% while valuations are cheap at 12.7x 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. We expect consensus to revise down earnings this morning. Any weakness is an opportunity to accumulate.

EXHIBIT 2: TENAGA 3Q18 RESULT

Financial Year End 31 Dec (RMm)	2Q18	3Q18	QoQ	9M18
Revenue	12,497.9	13,073.8	4.6%	37,845.7
EBITDA	**3,567.4**	**3,096.2**	**-13.2%**	**10,885.2**
Depreciation	(1,553.0)	(1,621.7)	4.4%	(4,706.6)
EBIT	2,014.4	1,474.5	-26.8%	6,178.6
Net interest expense	(333.3)	(356.0)	6.8%	(918.8)
Forex translation gain/(loss)	(169.6)	(166.7)	-1.7%	(247.3)
Associates & JVs	(2.1)	(84.7)	3933.3%	(163.8)
FV of financial instruments	13.8	45.9		8.8
Pretax profit (before forex translation)	1,693.5	1,071.3	-36.7%	5,091.2
Tax	(255.5)	(393.2)	53.9%	(947.3)
Minority Interest	31.1	10.4	-66.6%	38.6
Reported net profit	1,237.3	501.0	-59.5%	3,858.0
Core net profit	**1,782.9**	**1,177.7**	**-33.9%**	**4,991.3**
Reported EPS (sen)	21.8	8.8	-59.5%	67.9
Core EPS (sen)	**31.4**	**20.7**	**-33.9%**	**87.9**
DPS (sen)	30.27	-	NA	30.27
EBITDA margin	28.5%	23.7%		28.8%
EBIT margin	16.1%	11.3%		16.3%
Pretax margin (pre-forex transation)	13.6%	8.2%		13.5%
Tax rate	-15.1%	-36.7%		-18.6%
Core net profit margin	14.3%	9.0%		13.2%

Source: Company, MIDF

EXHIBIT 3: TENAGA 3Q18 RESULT BREAKDOWN

Unit Revenue/Cost Analysis	2Q18	3Q18	QoQ
Average tariff achieved for TNB sale (sen/kwH)	**39.76**	**39.81**	**0.1%**
Demand sales volume (GWh)	**29,005**	**28,917**	**-0.3%**
Unit Revenue (RM/kwh)	0.3976	0.3981	0.1%
Unit Cost (RM/kwH) - Total cost	**0.368**	**0.408**	**10.7%**
Unit Cost (RM/kwH) - IPP & TNB Fuels	0.195	0.224	15.4%
Unit Cost (RM/kwH) - Repair & maintenance	0.016	0.020	22.0%
Unit Cost (RM/kwH) - General expenses	0.019	0.018	-7.0%
Unit Cost (RM/kwH) - Staff cost	0.030	0.038	24.2%
Gross Electricity Sale Revenue (RMm):	**12,103.3**	**12,160.2**	**0.5%**
TNB	11,531.0	11,512.8	-0.2%
EGAT	0.4	-	-100.0%
SESB	469.8	466.6	-0.7%
LPL	81.9	161.6	97.3%
Tenaga Wind Ventures	20.2	19.2	-5.0%

Source: Company, MIDF

EXHIBIT 4: TENAGA 3Q18 GENERATION MIX

Generation Mix (Includes IPPs)	2Q18 (%)	3Q18 (%)	Variance (%) YoY
Gas & LNG	38.7	42.3	0.1
Coal	57.8	54.3	(0.1)
Distillate	0.1	0.0	(0.1)
Oil	0.1	0.0	(0.4)
Hydro	3.4	3.3	0.4
Fuel Cost Composition	**2Q18 (%)**	**3Q18 (%)**	**Variance (%) YoY**
Gas & LNG	45.3	45.6	(6.4)
Coal	54.2	54.3	7.6
Distillate	0.4	0.0	(0.3)
Oil	0.1	0.0	(0.8)

Source: Company, MIDF

EXHIBIT 5: TENAGA 3Q18 COST ANALYSIS

Cost Analysis (RMm)	2Q18	3Q18	QoQ
IPP purchase cost	3,889.6	4,255.2	9.4%
- Capacity payment	*981.2*	*1,039.1*	5.9%
- Energy payment	*2,908.4*	*3,216.1*	10.6%
Fuel costs	2,736.2	3,275.3	19.7%
Repair & Maintenance	466.1	566.8	21.6%
Staff cost	875.7	1,084.5	23.8%
TNB General Expenses	548.4	508.4	-7.3%
Subsi. COS & Opex	614.4	479.0	-22.0%
Depreciation & Amortisation	1,553.0	1,621.7	4.4%
Total	**10,683.4**	**11,790.9**	**10.4%**

Source: Company, MIDF

EXHIBIT 6: 3Q18 DEMAND GROWTH

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
				-5.1%	-8.3%
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)	1.9	1.7	1.5	1.4	1.4
EV/EBITDA (x)	8.4	7.6	6.9	6.9	6.6
FCF yield (%)	1.2	2.4	0.1	2.3	3.7
Gross gearing (%)	52%	47%	67%	59%	56%

DAILY PRICE CHART

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.