

29 June 2018 | Corporate Update

Tenaga Nasional

Market discounting worst case scenario?

- **Expect ICPT to remain in surcharge for 2H18**
- **Uncertainties surrounding tariff hike dragging share price**
- **However, market price already partly discounting worst case scenario, value emerging**
- **Reaffirm BUY at unchanged TP of RM16.30, 5.3% yields**

ICPT announcement coming up. The Energy Commission is slated to release the 2H18 ICPT and ultimately, the effective tariffs for 2H18. To recap, ICPT was in a surcharge position of 0.28sen/kwh for 1H18. However, effective charges to power consumers were unchanged as continuation of a 1.52sen/kwh rebate on top of the 0.28sen/kwh surcharge to consumers was footed by the EIF (Electricity Industry Fund). This amounted to a total of RM929m.

Share price dynamics. Tenaga's share price has fallen 14%-15% post-elections. One of the key risks being priced into the stock in our opinion is the uncertainty surrounding an impending tariff hike given rising fuel cost and more importantly, whether the 1.5sen/kwh ICPT rebate given previously will be maintained (RM780m-785m for a semi-annual period) and if so, who will bear the cost. Elimination of the rebate alone will raise effective tariffs to consumers by 4%. The ICPT is likely to remain in a surcharge for 2H18 (as 1H18 actual fuel costs were higher than RP2 parameters), estimated at RM302m for 2H18 (See Exhibit 2). In total, we estimate the cost to continue subsidising consumers at ~RM1.1b for 2H18.

Key moves in utilities so far. In the gas sector, the IBR was upheld with a hike in gas tariff to the non-power sector by RM1.02/mmbtu (+3.3%) a few weeks ago. This affected mainly the industrial consumers. On the flip side, in the broadband sector, the key player i.e. TM (share price) was bashed down after the Government made clear its intent to halve pricing and double broadband speeds, likely at the expense of TM's margins.

Laying out the scenarios. To gauge how much risk has been priced into Tenaga's share price, we simulate 4 possible scenarios into our valuations. Under the existing scenario, (1st scenario) we assume the incremental costs are allowed to be passed on to consumers based on IBR allowances or the Government finds means to subsidise consumers without impacting Tenaga's IBR returns. Hence, our forecasts and DCF valuation remains. (2nd scenario) If Tenaga is asked to temporarily absorb the surcharge and continue the rebate for 2H18, our DCF-based TP falls to RM16.10 OR (3rd scenario) if Tenaga is asked to do this throughout RP2, our TP falls to RM15.60. (4th scenario) In the worst case scenario if Tenaga is asked to maintain the rebate and absorb the surcharge indefinitely (assuming ICPT surcharge remains at our 2H18 assumption of RM302m), our TP falls to RM11.80.

Maintain BUY

Unchanged Target Price: RM16.30

RETURN STATS	
Price (28 June 2018)	RM13.66
Target Price	RM16.30
Expected Share Price Return	+17.8%
Expected Dividend Yield	+4.8%
Expected Total Return	+13.2%

STOCK INFO	
KLCI	1,665.68
Bursa / Bloomberg	5347/TNB MK
Board / Sector	Main
Syariah Compliant	Yes
Issued shares (mil)	5678.18
Market cap. (RM'm)	77,563.95
Price over NA	1.50
52-wk price Range	RM13.5 - RM16.3
Beta (against KLCI)	0.79
3-mth Avg Daily Vol	12.7m
3-mth Avg Daily Value	RM193m
Major Shareholders (%)	
EPF	12.7%
Skim ASB	8.7%
KWAP	5.8%

MIDF RESEARCH is a unit of MIDF AMANAH INVESTMENT BANK

Kindly refer to the last page of this publication for important disclosures

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	9,710.9
Pre-tax Profit (RM'm)	7,133.7	8,456.8	10,945.1	8,290.5	8,454.8
Core net profit (RM'm)	5,978.9	7,757.6	10,128.8	7,373.8	6,379.5
FD EPS (sen)	105.9	137.5	179.5	130.7	113.0
EPS growth (%)	27.7	29.7	30.6	(27.2)	(13.5)
PER (x)	12.9	9.9	7.6	10.5	12.1
Net Dividend (sen)	29.0	32.0	82.4	71.9	62.2
Net Dividend Yield (%)	2.1	2.3	6.0	5.3	4.6

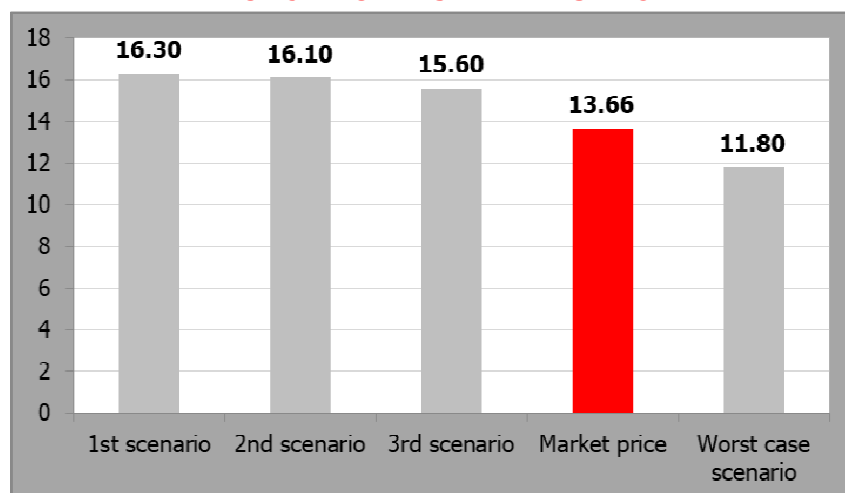
* 16-month period due to change in financial year end from Aug to Dec

** FYE Aug prior to FY17

Source: Company, MIDF

Market price already partly reflects worst case scenario. Based on the scenarios drawn above, current market price of RM13.66 suggests that the market has not just priced in the 2nd and 3rd scenario, but also, is already partially pricing in the worst case scenario. As the new Government aims to be pro-business (although at the same time has implemented populist policies) and given that the IBR is a transparent framework, allowing only reasonable returns to Tenaga and allowing tariffs to reflect actual market fuel cost, we think the worst case scenario is unlikely to pan out.

EXHIBIT 1: IMPACT ON DCF-BASED TP BASED ON DIFFERENT ICPT DECISION SCENARIOS




Source: Company, MIDF

EXHIBIT 2: 2H18 FUEL COST UNDER RECOVERY ESTIMATES

ICPT estimates		
Fuel cost (RMm)	1H18 estimates	RP2
Gas	4,852	4,417
LNG	190	-
Coal	4,815	5,138
Distillate	95	95
Oil	86	86
Total fuel cost	10,038	9,736
Over-recovery / (Under-recovery)	(302)	-
Generation mix		
	1H18 estimates	RP2
Gas & LNG	41.1%	31.9%
Coal	54.0%	62.0%
Others	4.9%	6.1%
GAS		
Avg LNG price (RM/mmbtu)	30.10	35.00
Subsidised gas price (RM/mmbtu) 2H18	25.70	24.20
COAL		
Coal price (CIF) (USD/MT)	86.30	75.00
Coal price (CIF) (RM/MT)	340.0	316.1
Average USD:MYR	3.94	4.21

Source: Company, MIDF

Is EIF sufficient? In its 1Q18 teleconference, Tenaga indicated that there was an injection of ~RM1.5b into the EIF at the start of the year originating from opex savings and financial savings from a shortfall in capex spend in RP1 – we estimate the bulk of the RM1.5b is from the opex savings. The 1H18 subsidy will take out an estimated RM929m, leaving around ~RM571m balance. However, to maintain the 1.5sen/kwh rebate alone requires an estimated RM780-RM785m. This is before taking into account any ICPT surcharge for 2H18.

Time to bottom fish? Tenaga's share price has been bashed down quite substantially, presumably given the perceived risk on its ability to attain a tariff hike, and secondly, given Tenaga's reasonably high foreign shareholding (of 24%) among index stocks. Given substantial price depreciation in the past month, we now see value emerging. Our TP remains unchanged at RM16.30, and our BUY call is reaffirmed. Dividend yields are now attractive at 5.3% (+ve spread against 10yr MGS of 4.26%) while valuations are cheap at 11x FY18F earnings, a substantial discount to the market's 16x-17x. 

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)	(43,555.2)
EBIT	7,695.3	9,072.0	12,512.6	9,160.5	9,710.9
Net interest expense	(662.7)	(740.3)	(1,660.9)	(972.7)	(1,358.8)
Associates	101.1	93.3	91.3	102.7	102.7
PBT	7,133.7	8,456.8	10,945.1	8,290.5	8,454.8
Taxation	(1,072.8)	(746.0)	(1,605.1)	(870.5)	(2,029.2)
Minority Interest	(57.5)	(46.8)	(3.7)	46.2	46.2
Net profit	6,118.4	7,367.6	9,659.7	7,373.8	6,379.5
Core net profit	5,978.9	7,757.6	10,128.8	7,373.8	6,379.5
Consensus net profit	6,118	7,268	N/A	7,257	7,255
Balance Sheet	FY15	FY16	16MFY17	FY18F	FY19F
Non-current assets	98,340.0	106,146.9	114,491.7	103,252.5	104,707.7
PPE	90,300.3	91,437.8	93,089.0	94,600.2	96,055.4
Investments in associate	634.7	1,699.3	2,937.8	485.4	485.4
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	35,640.6	50,287.8
Inventories	843.8	950.2	1,009.4	1,048.6	1,104.5
Receivables	8,639.4	5,929.0	6,298.4	11,084.6	11,674.8
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	19,826.4	33,827.6
TOTAL ASSETS	117,135.0	132,902.2	142,012.4	138,893.1	154,995.5
Share capital	5,643.6	5,643.6	11,124.9	5,643.6	5,643.6
Minority Interest	258.9	258.9	473.4	258.9	258.9
Reserves	41,564.4	46,697.2	45,986.5	52,682.9	55,553.7
TOTAL EQUITY	47,466.9	52,599.7	57,584.8	58,585.4	61,456.2
Non-current liabilities	54,075.9	64,218.5	69,101.1	63,742.3	76,592.0
Long-term borrowings	22,713.1	22,945.5	37,038.4	32,379.4	45,229.1
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	93,539.3

Cash Flow Statement	FY15	FY16	16MFY17	FY18F	FY19F
Operating activities					
PBT	7,133.7	8,456.8	10,945.1	8,290.5	8,454.8
Depreciation & Amortization	5,294.2	5,722.2	6,105.0	5,349.3	5,405.3
Chgs in working capital	3,901.6	(164.5)	(96.6)	(4,455.9)	(264.1)
Interest expense	(662.7)	(740.3)	(1,660.9)	(972.7)	(1,358.8)
Tax paid	(810.8)	(746.0)	(1,605.1)	(870.5)	(2,029.2)
Others	(3,416.6)	764.3	(1,129.0)	926.5	1,312.6
CF from Operations	11,439.4	13,292.5	12,558.5	8,267.1	11,520.7
Investing activities					
Capex	(10,363.7)	(11,142.8)	(12,336.8)	(7,000.0)	(7,000.0)
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)	(6,860.5)	(6,860.5)
Financing activities					
Dividends paid	(1,636.7)	(1,637.7)	(2,205.9)	(4,055.6)	(3,508.7)
Net proceeds in borrowings	(1,775.2)	9,063.4	4,473.6	9,199.1	12,849.7
Others	(839.8)	(886.7)	(1,041.0)	-	-
CF from Financing	(4,251.7)	6,539.0	1,226.7	5,143.5	9,341.0
Net changes in cash	(5,638.6)	1,435.6	1,100.1	6,550.1	14,001.2
Beginning cash	7,871.5	1,982.1	3,411.5	4,512.9	11,063.0
Overdrafts, Deposits & Forex	0.2	(6.2)	1.3	-	-
Ending cash	2,233.1	3,411.5	4,512.9	11,063.0	25,064.2
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%	-27.2%	-13.5%
EBITDA margin	30.0%	29.7%	30.1%	28.7%	28.4%
PATAMI margin	13.8%	17.4%	16.0%	14.6%	12.0%
ROE	12.6%	14.7%	17.6%	12.6%	10.4%
ROA	5.1%	5.8%	7.1%	5.3%	4.1%
Net gearing	33%	27%	37%	25%	22%
Book value/share (RM)	8.41	9.32	10.20	10.38	10.89
PBV (x)	1.6	1.5	1.3	1.3	1.3
EV/EBITDA (x)	7.4	6.7	6.1	6.3	6.0
FCF yield (%)	1.4	2.8	0.1	1.6	5.9
Gross gearing (%)	52%	47%	67%	59%	77%

DAILY PRICE CHART



Source: Bloomberg, MIDFR

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

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (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 (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

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 we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD 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.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

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 <i>rise</i> 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 <i>fall</i> 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.