

29 January 2018 | 1QFY18 Results Review

Tenaga Nasional

"Bonus" earnings not sustainable

- **1QFY18 within estimates**
- **RP1 earnings inflated by favourable customer mix**
- **"Bonus" regulated earnings not sustainable in RP2**
- **Downgrade to HOLD from BUY; TP trimmed to RM16.30**

Within expectation. Tenaga reported earnings of RM1.8b for its 1QFY18, which was within expectations accounting for 27% of ours and 25% of consensus. Tenaga is changing its year end to Dec from Aug and as such will announce a Dec17 quarter result soon.

Result takeaways. Despite strong demand growth of 3.6% in the same time last year, 1Q18 demand grew by a further 1.2%. Operating earnings were flattish while net profit was down given higher finance cost, mainly from 51%-owned SPG's (Southern Power Generation) Sukuk issuance for Project 4A.

Enjoyed "bonus" earnings in RP1. Average 1QFY18 rates achieved was 39.46sen/kwh against RP1's base rate of 38.53sen/kwh given a more favourable customer mix than RP1 forecast (See Exhibit 2); industrial consumers are charged lower tariffs while commercial and domestic segments are charged higher. As the proportion of higher priced commercial and residential segment volumes were higher than forecast, Tenaga enjoyed "bonus" earnings in 1QFY18 and also for the most part of RP1 (2015-17). After getting more clarity from management on RP2, we see possibilities of negative earnings impact on Tenaga, in the sense that the "bonus" earnings explained above is unlikely to sustain into RP2. This is because the reference price in calculating Tenaga's revenues for RP2 is based on the actual average tariff achieved at end RP1 which is 39.45sen instead of RP1's 38.53sen.

Inflated earnings not sustainable. As such, while average allowable returns are higher for RP2 as we had argued previously (by circa 11% on our estimates given a higher asset base), the "bonus" earnings which inflated Tenaga's profits in RP1 is unsustainable. Tenaga's RP1 regulated earnings was inflated by the "bonus" earnings coming from higher than forecast average rates – average RP1 allowable return was RM3.4b/annum (7.5% WACC, average asset base: RM46b) but actual regulated earnings achieved is estimated to have been around RM4.4b given the more favourable average rates. Given the absence of the "bonus" earnings in RP2 (partly offset by higher RP2 allowable return of an average RM3.8b, 7.3% WACC, average asset base: 53b), we estimate Tenaga's regulated earnings to be impacted by RM500-600m/annum or circa 7% per annum.

Downgrade to HOLD

Revised (TP): RM16.30

(from RM16.80)

RETURN STATS

Price (29 Jan2018)	RM15.84
Target Price	RM16.30
Expected Share Price Return	+2.9%
Expected Dividend Yield	+4.5%
Expected Total Return	+7.4%

STOCK INFO

KLCI	1,767.92
Bursa / Bloomberg	5347/TNB MK
Board / Sector	Main
Syariah Compliant	Yes
Issued shares (mil)	5652.3
Par Value (RM)	1.00
Market cap. (RM'm)	77,776.12
Price over NA	1.43
52-wk price Range	RM13.0 - RM14.9
Beta (against KLCI)	1.02
3-mth Avg Daily Vol	9.61m
3-mth Avg Daily Value	RM131m
Major Shareholders (%)	
Khazanah Nasional	28.21%
KWAP	13.94%
Skim ASB	6.66%

INVESTMENT STATISTICS

FYE Dec	FY15	FY16	FY17F	FY18F	FY19F
Revenue (RM'm)	43,286.8	44,531.5	48,682.4	50,573.5	53,266.0
EBIT (RM'm)	7,695.3	9,072.0	9,427.5	9,160.5	9,710.9
Pre-tax Profit (RM'm)	7,133.7	8,456.8	8,833.9	8,290.5	8,454.8
Core net profit (RM'm)	5,978.9	7,757.6	7,860.1	7,373.8	6,379.5
FD EPS (sen)	105.9	137.5	139.3	130.7	113.0
EPS growth (%)	27.7	29.7	1.3	(6.2)	(13.5)
PER (x)	15.0	11.5	11.4	12.1	14.0
Net Dividend (sen)	29.0	32.0	61.0	71.9	62.2
Net Dividend Yield (%)	1.8	2.0	3.9	4.5	3.9

Source: Company, MIDFR

New FYE, but earnings trimmed. We introduce new FYE Dec forecasts in this report, but underlying earnings is actually trimmed to reflect the RM500m-600m/annum expected reduction on Tenaga's regulated earnings. We expect FY18 earnings to contract 6% while FY19F earnings is expected to reduce by a further 14%. However, the latter is purely due to normalisation of tax rates as Tenaga's Reinvestment Allowance expires in FY18F. FY19F pretax earnings is actually expected to rise by 2%.

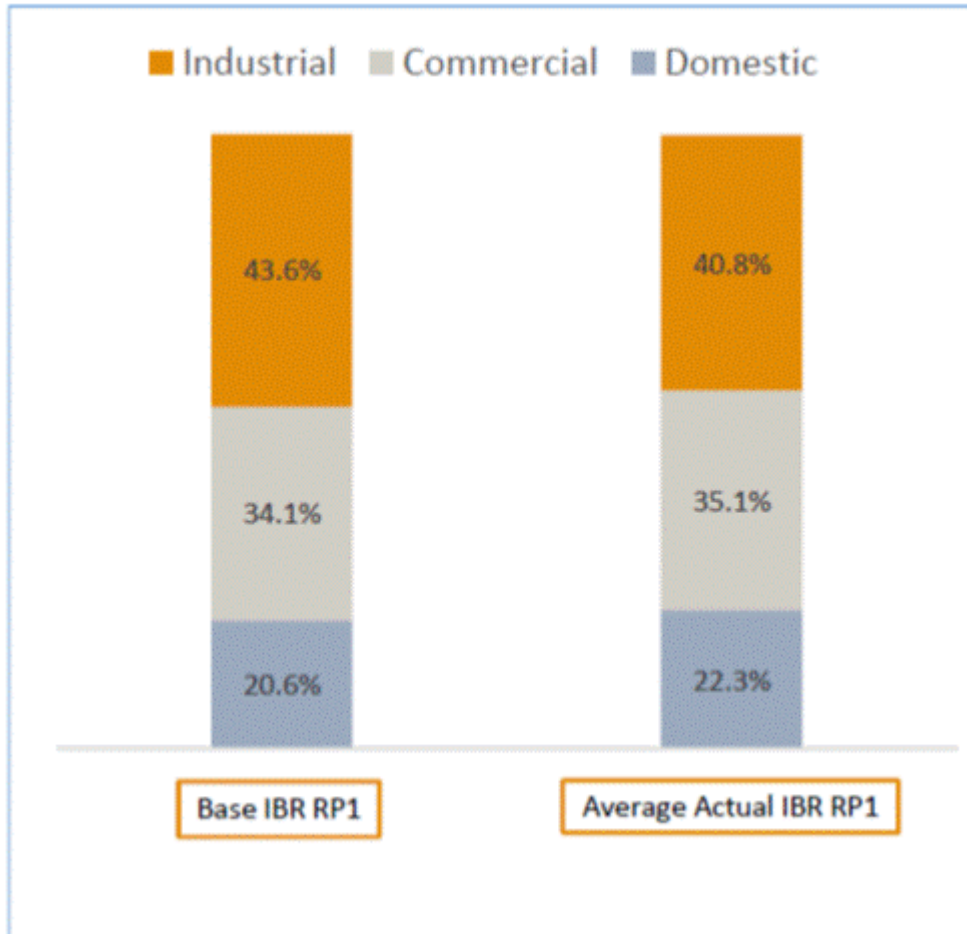
Downgrade to HOLD. We downgrade Tenaga to HOLD from BUY and trim our DCF-derived TP to RM16.30 (from RM16.80 previously). While dividend yields are still relatively attractive, the inflated earnings in RP1 is unlikely to be sustained in RP2. Furthermore, the stock has had a good run in the past 12 months and we suggest investors lock-in profits at this point.

EXHIBIT 1: TENAGA'S "BONUS" EARNINGS IN RP1 UNLIKELY TO BE SUSTAINED

	RP1	RP2
Reference price (sen/kwh)	38.53	39.45
Average allowable return RMm)	3,439	3,837
Actual average rates (sen/kwh)	39.45	N/A
<i>Estimated "Bonus" earnings from higher than forecast average rates</i>	<i>982.8</i>	<i>N/A</i>
Actual regulated earnings (RMm)	4,422	3,837

Source: Company, MIDFR

EXHIBIT 2: TENAGA CUSTOMER MIX MORE FAVOURABLE THAN FORECAST IN RP1



Source: EC, MIDFR

EXHIBIT 2: TENAGA 1QFY18 RESULT

Financial Year End 31 August (RMm, unless otherwise stated)	1QFY17	4QFY17	1QFY18	YoY	QoQ	1QFY17	4QFY17	1QFY18
Revenue	11,241.6	12,463.8	11,607.0	3.3%	-6.9%	11,241.6	12,463.8	11,607.0
EBITDA	3,793.5	3,892.7	3,862.1	1.8%	-0.8%	3,793.5	3,892.7	3,862.1
Depreciation	(1,453.9)	(1,560.4)	(1,518.0)	4.4%	-2.7%	(1,453.9)	(1,560.4)	(1,518.0)
EBIT	2,339.6	2,332.3	2,344.1	0.2%	0.5%	2,339.6	2,332.3	2,344.1
Net interest expense	(116.0)	(234.1)	(356.9)	207.7%	52.5%	(116.0)	(234.1)	(356.9)
Translation gain/(loss)	(231.2)	(2.3)	335.6	-245.2%	-14691.3%	(231.2)	(2.3)	335.6
Associates/JVs	(3.0)	68.4	(60.9)	1930.0%	-189.0%	(3.0)	68.4	(60.9)
PBT	2,226.4	2,154.7	1,884.6	-15.4%	-12.5%	2,226.4	2,154.7	1,884.6
Tax	(206.7)	(417.9)	(63.5)	-69.3%	-84.8%	(206.7)	(417.9)	(63.5)
Minority Interest	48.0	15.3	4.9	-89.8%	-68.0%	48.0	15.3	4.9
Reported net profit	1,740.5	1,719.2	2,151.8	23.6%	25.2%	1,740.5	1,719.2	2,151.8
Core net profit	1,971.7	1,721.5	1,816.2	-7.9%	5.5%	1,971.7	1,721.5	1,816.2
EPS (sen)	30.8	30.5	38.1	23.6%	25.2%	30.8	30.5	38.1
Core EPS (sen)	34.9	30.5	32.2	-7.9%	5.5%	34.9	30.5	32.2
DPS (sen)	-	44.00	-	NA	NA	-	44.00	-
EBITDA margin	33.7%	31.2%	33.3%			33.7%	31.2%	33.3%
EBIT margin	20.8%	18.7%	20.2%			20.8%	18.7%	20.2%
Pretax margin	19.8%	17.3%	16.2%			19.8%	17.3%	16.2%
Tax rate	-9.3%	-19.4%	-3.4%			-9.3%	-19.4%	-3.4%
Core net profit margin	17.5%	13.8%	15.6%			17.5%	13.8%	15.6%
Payout ratio	0.0%	144.4%	0.0%			0.0%	144.4%	0.0%

Source: Company, MIDFR

EXHIBIT 3: TENAGA 1QFY18 RESULT – UNITS REVENUE/COST

Unit Revenue/Cost Analysis	1QFY17	4QFY17	1QFY18	YoY	QoQ
Average tariff achieved for TNB sale (sen/kwH)	39.38	39.65	39.46	0.2%	-0.5%
Demand sales volume (GWh)	27,811	28,265	28,150	1.2%	-0.4%
Unit Revenue (RM/kwh)	0.3938	0.3965	0.3946	0.2%	-0.5%
Unit Cost (RM/kwH) - Total cost	0.327	0.375	0.343	5.0%	-8.6%
Unit Cost (RM/kwH) - IPP & TNB Fuels	0.056	0.173	0.179	217.4%	3.8%
Unit Cost (RM/kwH) - Repair & maintenance	0.016	0.021	0.010	-39.6%	-53.2%
Unit Cost (RM/kwH) - General expenses	0.022	0.039	0.017	-21.4%	-56.2%
Unit Cost (RM/kwH) - Staff cost	0.033	0.038	0.038	13.2%	-0.6%
Gross Electricity Sale Revenue (RMm):	11,518.5	11,793.9	11,692.1	1.5%	-0.9%
TNB	10,952.7	11,206.3	11,108.5	1.4%	-0.9%
EGAT	13.5	1.3	0.7	-94.8%	-46.2%
SESB	448.4	449.1	452.7	1.0%	0.8%
LPL	103.9	137.2	130.2	25.3%	-5.1%

Source: Company, MIDFR

EXHIBIT 4: TENAGA 1QFY18 RESULT – GENERATION MIX BY FUEL TYPE

Generation Mix (Includes IPPs)	1QFY17 (%)	4QFY17 (%)	1QFY18 (%)	Variance (%) YoY
Gas & LNG	42.2	40.1	36.9	(5.2)
Coal	54.4	53.5	56.9	2.4
Distillate	0.1	0.1	0.0	(0.0)
Oil	0.4	0.3	0.0	(0.4)
Hydro	3.0	6.0	6.2	3.2
Fuel Cost Composition	1QFY17 (%)	4QFY17 (%)	1QFY18 (%)	Variance (%) YoY
Gas & LNG	52.1	47.0	42.0	(10.1)
Coal	46.8	51.7	57.7	10.9
Distillate	0.3	0.8	0.3	(0.1)
Oil	0.8	0.6	0.1	(0.8)

Source: Company, MIDFR

EXHIBIT 5: TENAGA 1QFY18 RESULT – COST ANALYSIS

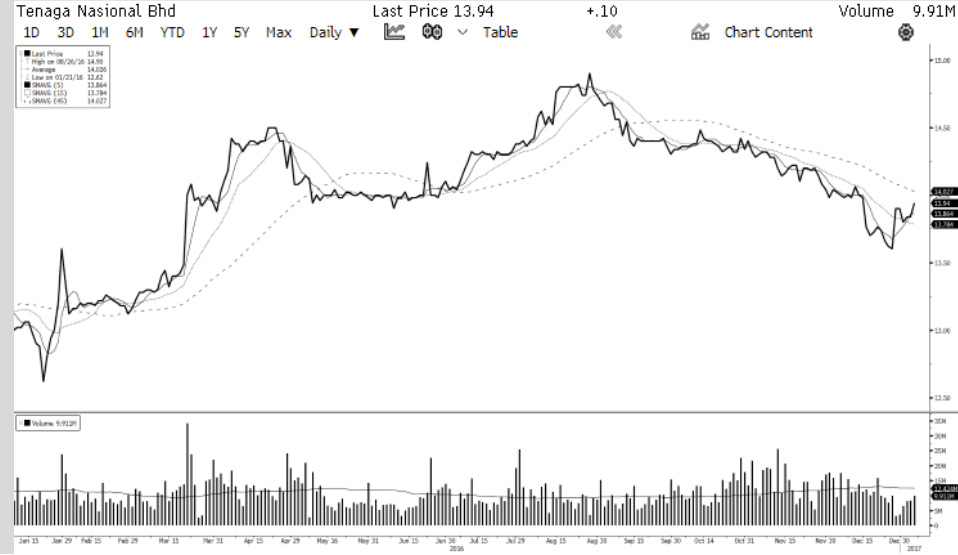
Cost Analysis (RMm)	1QFY17	4QFY17	1QFY18	YoY	QoQ	Composition 1QFY18
IPP purchase cost	3,280.3	3,751.0	3,650.4	11.3%	-2.7%	34%
- Capacity payment	1,114.8	1,105.9	983.3	-11.8%	-11.1%	9%
- Energy payment	2,165.5	2,645.1	2,667.1	23.2%	0.8%	25%
Fuel costs	2,219.6	2,231.9	2,377.0	7.1%	6.5%	22%
Repair & Maintenance	455.4	597.3	278.4	-38.9%	-53.4%	3%
Staff cost	928.1	1,074.2	1,063.4	14.6%	-1.0%	10%
TNB General Expenses	612.2	1,116.4	486.9	-20.5%	-56.4%	5%
Subs. COS & Opex	136.7	276.8	281.5	105.9%	1.7%	3%
Depreciation & Amortisation	1,453.8	1,560.4	1,518.0	4.4%	-2.7%	14%
Total	9,086.1	10,608.0	9,655.6	6.3%	-9.0%	91%

Source: Company, MIDFR

Income Statement	FY15	FY16	FY17F	FY18F	FY19F
Revenue	43,286.8	44,531.5	48,682.4	50,573.5	53,266.0
Operating expenses	(35,591.5)	(35,459.5)	(39,254.8)	(41,413.0)	(43,555.2)
EBIT	7,695.3	9,072.0	9,427.5	9,160.5	9,710.9
Net interest expense	(662.7)	(740.3)	(696.4)	(972.7)	(1,358.8)
Associates	101.1	93.3	102.7	102.7	102.7
PBT	7,133.7	8,456.8	8,833.9	8,290.5	8,454.8
Taxation	(1,072.8)	(746.0)	(927.6)	(870.5)	(2,029.2)
Minority Interest	(57.5)	(46.8)	46.2	46.2	46.2
Net profit	6,118.4	7,367.6	7,860.1	7,373.8	6,379.5
Core net profit	5,978.9	7,757.6	7,860.1	7,373.8	6,379.5
Consensus net profit	6,118	7,268	7,263	7,304	7,319
Balance Sheet	FY15	FY16	FY17F	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	FY17F	FY18F	FY19F
Operating activities					
PBT	7,133.7	8,456.8	8,833.9	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)	(696.4)	(972.7)	(1,358.8)
Tax paid	(810.8)	(746.0)	(927.6)	(870.5)	(2,029.2)
Others	(3,416.6)	764.3	(659.8)	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	FY17F	FY18F	FY19F
Revenue growth	1.2%	2.9%	9.3%	3.9%	5.3%
EBITDA growth	3.9%	13.9%	5.0%	-6.6%	4.2%
Net profit growth	27.7%	29.7%	1.3%	-6.2%	-13.5%
EBITDA margin	30.0%	29.7%	30.1%	28.7%	28.4%
PATAMI margin	13.8%	17.4%	16.1%	14.6%	12.0%
ROE	12.6%	14.7%	13.6%	12.6%	10.4%
ROA	5.1%	5.8%	5.5%	5.3%	4.1%
Net gearing	33.3%	26.8%	37.5%	24.8%	21.8%
Book value/share (RM)	8.41	9.32	10.20	10.38	10.89
PBV (x)	1.9	1.7	1.6	1.5	1.5
EV/EBITDA (x)	8.4	7.6	6.9	7.2	6.8
FCF yield (%)	1.2	2.4	0.1	1.4	5.1

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.