Headline	Tariff determination, WACC wildcard for TNB		
MediaTitle	The Malaysian Reserve		
Date	21 Dec 2017	Color	Full Color
Section	Money	Circulation	12,000
Page No	11	Readership	36,000
Language	English	ArticleSize	300 cm²
Journalist	N/A	AdValue	RM 2,776
Frequency	Daily	PR Value	RM 8,327

Tariff determination, WACC wildcard for TNB

▶ **Recommendation: Buy**
TARGET Price: RM17.38
by TA Securities Holdings Bhd (Dec 20)

Highlights

THE Energy Commission (EC) will announce details of the Regulatory Period 2 (RP2) for incentive-based regulation (IBR) framework anytime before end-2017.

Although Tenaga Nasional Bhd (TNB) is protected from fuel price inflation under the IBR mechanism, there are concerns that the group's earnings would be reduced via lowered asset returns or a deflated regulatory asset base (RAB).

Based on our estimates, every 0.1-ppt reduction in RP1's current 7.5% rate of return (RoR) will result in earnings erosion of 0.6%-0.7% pa to our FY18F-FY20F forecasts.

Earnings uncertainty from RP2. RP2 will be implemented following the end of the RP1 in 2015-2017.

According to TNB, the revision of IBR parameters for RP2 will have a neutral impact on its financials, and the final outcome is expected to be fair to all parties.

Recall that TNB's chairman Tan Sri Leo Moggie indicated that base tariff would likely be maintained for RP2. This is understandable, given that higher tariffs are counter-populist in the wake of a looming general election. Given the current reality of fuel price inflation, this implies that higher fuel costs will either be borne by consumers, the government or TNB.

ICPT turned to under-recovery in 2H17 on higher fuel costs. Recall that under RP1, the average tariff increased from 33.54 sen/kwH as at June-2011 to 38.53 sen/kwH. The bulk of the increase (82%) was mainly driven by higher fuel costs, which comprised 68% of average tariff.

Nevertheless, consumers enjoyed tariff rebates totalling RM4.1b under RP1, on the back of: 1) over-recoveries of imbalance cost pass-through (ICPT) up till June 2017; and 2) cost savings from renegotiations of first-generation power purchase agreements from June 2017 onwards.

We see more downside risks for RAB. There are two variable factors under IBR that affects TNB's earnings, namely: a) RoR or WACC; and b) average rate base or RAB.

Correspondingly, budget for new transmission and distribution investments under RP2 could turn out below expectations. On the other hand, we see upside pressure for RP1 WACC, of 7.5% given expectations of rising interest rates and current lower tax rate of 24%.

Final outcome is a wildcard. In conclusion, given the plethora of factors that influence EC's decision, the final outcome of TNB's WACC and tariff determination under RP2 is a wildcard.

We remain buyers of TNB (DCF target price: RM17.38), underpinned by: 1) earnings growth kicker and newsflow from international merger and acquisition plans — which target 3.7GW new capacity from overseas market by 2020; 2) dividend upside from proactive capital management with strong balance sheet; and 3) attractive valuation — where TNB is currently trading 1SD below historical mean FY18 P/E, and at 18% discount versus regional peers in terms of FY18 EV/Ebitda.

▶ **TENAGA NASIONAL BHD**

FYE DEC *	2016	2017E**	2018F	2019F
REVENUE (RM mil)	44,531.5	61,879.5	48,862.8	51,382.9
CORE NET PROFIT ^ (RM mil)	7,725.8	7,458.1	7,449.1	7,113.2
CORE EPS ^ (sen)	138.6	133.8	133.7	127.6
CORE PER (x)	10.7	11.1	11.1	11.7

*2015-16: FYE Aug ** 16 month for FY17 ^ 12 month Pro-Rated for FY17E