AUTHOR: No author available SECTION: CORPORATE PAGE: 24 PRINTED SIZE: 449.00cm² REGION: KL
MARKET: Malaysia PHOTO: Full Color ASR: MYR 7,731.00 ITEM ID: MY0062221168

20 JAN, 2025

RP4 hints at upside for Tenaga but regulatory risks remain

The Edge, Malaysia

RP4 hints at upside for Tenaga but regulatory risks remain

Tenaga Nasional Bhd's (KL:TENAGA) share price, which almost tested the RM15 mark at the end of last year after the company proposed a base tariff hike for 2025-2027, has fallen more than 12% following the government's announcement that the proposal is still under review.

Despite the uncertainties, analysts believe Tenaga's fundamentals remain solid, although opinions are divided on the extent of the upside to its share price stemming from the increased demand for electricity given the strong pushback against the recent fourth regulatory period (RP4) proposals.

Analysts are generally positive on the proposed RP4 determination, which includes a higher base tariff, increased base capital expenditure (capex) and operating expenditure (opex), and sustained allowed cost of capital. The recent win of a 500MW large-scale solar project adds to the positive sentiment. Nevertheless, the utility giant's average target price (TP) of RM16.28 has remained largely unchanged since September, three months before the RP4 announcement.

Key areas of focus include the allowable electricity demand growth and how much of it can contribute to earnings; revenue and price caps related to its transmission, distribution and retail businesses; and clarity on how Tenaga can recoup the contingent capex meant for transition-induced grid upgrades but not included in the base tariff.

The proposed base tariff revision — a 14.2% increase to 45.62 sen/kWh from 39.95 sen/kWh — does not directly translate into bumper earnings for the utility giant. This adjustment mainly accounts for fuel price assumptions, which together with other power generation costs, make up 70% of the tariff. Just 30% of the tariff is actually related to Tenaga's regulated transmission, distribution and retail businesses.

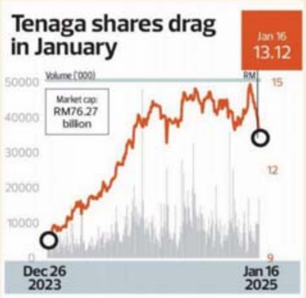
Tenaga's base grid capex for 2025-2027 is proposed at RM26.5 billion, a 28.9% increase from RM20.55 billion in RP3 (2022-2024). The opex is estimated at RM20.782 billion, up 15.7% from RM17.96 billion in RP3. Analysts view the larger capex positively as it increases the size of the company's regulated assets, which are allowed an unchanged cost of capital of 7.3%.

However, AmBank Research, which has the lowest TP at RM12.60, expects Tenaga might not fully benefit from excess electricity demand. It estimates allowable annual electricity demand growth at 3% for 2025-2027, compared to 1.7% in RP3. This contrasts with Tenaga's forecast of 5.8% to 6.3% growth in 2024 alone.

Others are more optimistic. Macquarie Equity Research — with an "outperform" rating and TP of RM16.40 — anticipates an average demand growth of 4.7% for RP4 and forecasts 33% year-on-year earnings growth in 2025. Meanwhile, TA Research expects "a more aggressive growth rate" for RP4 compared to RP3's 1.7% per annum.

Apex Research highlighted upside potential from the newly introduced contingent capex of RM16.267 billion introduced in RP4. To fund this, analysts suggest project-specific premium charges for consumers directly benefiting from these assets, such as wheeling or "system access" charges for third parties trading green electricity under the Corporate Renewable Energy Supply Scheme (CRESS).

"In a best-case scenario where all contingent capex is fully utilised, we estimate a 10.2% increase in annual average allowed return or an additional RM500 million in returns annually compared to the base case," said Apex Research.



However, RHB Research noted uncertainties about whether Tenaga will be entitled to full regulated net returns based on the total allowed capex. "We maintain our earnings estimate for now but we see an upside of 5% to 7% to our net regulatory returns if the full capex numbers are being pencilled in," it said.

While the government's RM2.39 billion allocation to maintain tariffs in 1H2025 underscores the effectiveness of the imbalance cost pass-through (ICPT) mechanism, regulatory risks persist. Historical precedents show similar risks.

In January 2022, the Energy Commission announced that the tariff rates for domestic users would be maintained, without elaborating on base tariff revisions. On Feb 24, 2022, Tenaga said in a filing that its electricity tariff rate and structure "will continue to be in effect".

At the time, the industry incorporated an RP2 base tariff of 39.45 sen/kWh. But months later, a higher base tariff of 39.95 sen/kWh emerged.

At RM13.12 per share, Tenaga's forward price-earnings ratio for FY2025 reflects these RP4 assumptions, trading at its five-year average of around 16 times. This compares with those of its peers like YTL Power International Bhd (KL:YTLP) (10.4 times), Malakoff Corp Bhd (KL:MALAKOF) (12.6 times), Mega First Corp Bhd (KL:MFCB) (9.2 times) and Solarvest Holdings Bhd (KL:SLVEST) (25.3 times).

As at Jan 16, Tenaga had 16 "buy" calls, five "hold" and one "underweight", with target prices ranging from RM12.60 to RM20.60. At its share price of RM13.12, the group's market capitalisation stood at RM76.27 billion, with trailing and forward dividend yields of 3.51% and 4.03% respectively.

For the nine months ended Sept 30, 2024 (9MFY2024), Tenaga posted a net profit of RM3.74 billion on revenue and under-recovery (to be claimed back under the incentive-based regulation) of RM49.73 billion, resulting in a net margin of 7.53%. The utility giant declared interim dividends of 25 sen per share for the nine-month period and 46 sen per share for the full year in FY2022 and FY2023.

Major shareholders of Tenaga include Khazanah Nasional Bhd (direct stake of 20.74%), the Employees Provident Fund (18.47%), Amanahraya Trustees Bhd — Amanah Saham Bumiputera (7.46%) and Kumpulan Wang Persaraan Diperbadankan (6.95%). E