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KUCHING: Tenaga Nasional Bhd's (TNB) under-recovery will likely remain elevated due to high fuel prices brought on by the ongoing crisis in Ukraine, analysts observed.

In a report, the research team at MIDF Amanah Investment Bank Bhd (MIDF Research) pointed out that fuel prices remain elevated as the war in Ukraine has created a global energy crunch and exacerbated concerns over coal supplies in a market already in a tight balance.

"The high fuel price has resulted in TNB significantly under-recovering generation cost; under-recovery stood at RM3.5 billion in the first quarter of 2022 (1Q22), a further rise compared with RM3.2 billion and RM1.3 billion in 4Q21 and 3Q21 respectively.

"Exacerbating this is a weaker ringgit, which will further inflate effective fuel cost," it said.

Nevertheless, it highlighted that the government's subsidy has alleviated some concern on TNB's first half of 2022 (1H22) under-recovery.

"However, given that fuel

prices remain elevated moving into 2H22, we still expect TNB's under-recovery and working capital requirement to remain elevated which in turn is expected to pressure free cash flow (FCF) generation.

"Receivables has seen significant uptick in the past two quarters given the lag in passing through generation cost under-recovery amid high fuel prices," MIDF Research added.

Beyond the elevated working capital requirement, it noted that underlying revenue upside is muted despite a macro upcycle.

"This is because TNB's regulated entities operate largely on a revenue-cap basis, meaning any excess annual electricity demand growth beyond the 1.7 per cent stipulated under RP3 and any variation in average selling prices compared with the base tariff is adjusted through the revenue adjustment mechanism," it explained.

However, it pointed out that the mechanism positions TNB well as a defensive in a macro downcycle as it provides a floor to earnings.

All in, MIDF Research maintained its 'neutral' call on the stock.