Headline	TNBs future valuations at risk		
MediaTitle	The Edge Financial Daily		
Date	17 Oct 2016	Language	English
Circulation	15,000	Readership	50,000
Section	Home Business	Page No	13
ArticleSize	118 cm²	Journalist	N/A
PR Value	RM 5,681		

TNB's future valuations at risk

Tenaga Nasional Bhd
(Oct 14, RM14.42)
Maintain add recommendation with an unchanged target price of RM17: With a net gearing of 33%, Tenaga Nasional Bhd's (TNB) balance sheet is under-leveraged compared to its peers, which has resulted in a less-than-optimal cost of capital for TNB. This, in our opinion, penalises TNB's current share price and poses a risk to its future valuations.

TNB's transmission and distribution (T&D) assets are regulated by the incentive-based regulation (IBR) and generate about half of its earnings before interest and taxes. In the current regulatory term (2014 to 2017), the IBR allows these assets to earn a return on capital of 7.5%, the assets' weighted average cost of capital (WACC) as estimated by the regulator based on the capital asset pricing model.

As it is in the interest of the regulator to lower the T&D profit earned from consumers, there is a risk that the regulator may assume a more efficient capital structure when setting the WACC for the T&D assets in the next regulatory term. This could result in the T&D assets earning less than their cost of capital and raising the need to increase its gearing level.

One way to raise gearing is to retain less of its earnings. Its current dividend payout ratio is only effectively 25%. We believe it could pay at least 70% of its profit as dividend, which translates into an up to 6.5% yield in financial year 2017.

However, a bigger challenge to lowering the T&D assets' WACC lies in estimating the cost of equity. The current WACC of 7.5% is anchored on TNB's stock beta from 2004 to 2012. In theory, TNB has a below-average systematic risk because of its stable earnings. In practice, however, its beta is 1.1 (since the IBR started in 2014) as it is a market proxy for foreign investors. It is also a heavyweight in the FBM KLCI and has high liquidity.

On top of that, TNB has other businesses that range from power generation to port operation, which have different business risk profiles compared to T&D. As such, TNB's beta may not reflect the systematic risk of its T&D assets. A separate listing of the T&D divisions will allow the beta of the T&D assets to be accurately measured and ensure that the T&D assets earn a fair rate of return from consumers, in our view.

If the spin-off happens, the T&D divisions could be worth RM68 billion to RM87 billion, whereas the remaining net assets could be worth RM27 billion to RM55 billion. The combined market capitalisation could be RM95 billion to RM142 billion or 17% to 75% higher than its current market capitalisation. — *CIMB Research, Oct 13*

Tenaga Nasional Bhd

FYE AUG (RM MIL)	2014A	2015A	2016F	2017F	2018F
Revenue	40,859	43,287	45,473	45,474	47,716
Operating Ebitda	12,054	13,922	15,066	15,701	16,522
Net profit	6,467	6,118	7,502	7,632	7,708
Core EPS (RM)	1.07	1.20	1.33	1.35	1.37
Core EPS growth (%)	11.0	12.3	10.9	1.7	1.0
FD core P/E (x)	13.48	12.00	10.82	10.63	10.53
DPS (RM)	0.29	0.29	0.37	0.38	0.38
Dividend yield (%)	2.02	2.02	2.60	2.64	2.67
EV/Ebitda (x)	8.15	6.94	6.67	6.31	5.95
P/FCFE (x)	na	na	18.02	22.85	28.94
Net gearing (%)	39.9	33.3	37.5	31.6	27.8
P/BV (x)	1.88	1.72	1.54	1.40	1.28
ROE (%)	14.9	15.0	15.0	13.8	12.7
CIMB/consensus EPS (x)			1.03	1.03	1.02

Sources: Company data, CIMB forecasts