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Tariff hikes benefit TNB and Petronas

But power-hungry sectors will feel the squeeze

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IT is not surprising that Tenaga Nasional Bhd's (TNB) share price soared to new highs over the week following the announcement of an electricity tariff hike for next year.

The national utility company is obviously the biggest beneficiary of the new structure that will come into force by Jan 1, 2014, as the model incorporates a base tariff hike that could enhance the company's bottom line.

According to industry experts, a base tariff adjustment for TNB is justified, not because it could boost the company's earnings, but because it is necessary for the company to cover its rising operational costs and capital expenditure (capex) or investments in electricity-supply infrastructure.

As it stands, TNB's net profits have been consistently coming in below its capex. For instance, in the financial year ended Aug 31, 2012 (FY12), TNB's net profit stood at RM4.2bil, but its capex was way higher at RM7bil.

According to MyPower Corp, a special-purpose agency that drives reform in Malaysia's power sector, if TNB's net profit does not grow in line with its debts and assets, the company will not be able to effectively serve future customers.

TNB yesterday closed at RM11, up from its last traded price of RM9.89 before the Government's announcement on Monday of a tariff adjustment.

Affin Research, in its report argues, that the base tariff hike is the first crucial step towards the rollout of the long-awaited incentive-based regulation (IBR) mechanism for TNB.

"The imminent IBR would provide good earnings visibility and cashflow prowess to TNB in the future," the local research house explains.

According to TA Research, the base tariff hike alone is estimated to boost TNB's revenue by an additional RM1bil. While the research house concedes that higher tariffs could probably dampen demand for electricity in the short term, it believes the net impact for TNB remains encouragingly positive, with around 8% to 12% upgrade in earnings for FY14 to FY16.

Necessary reform

To recap, the Government had announced over the week that the average electricity tariff in Peninsular Malaysia and Sabah and Labuan would increase by about 15% with effect from Jan 1, 2014. That would translate into an increase of 4.99 sen per kilowatt-hour (kWh) from the current average of 33.54 sen/kWh to 38.53 sen/kWh for Peninsular Malaysia and five sen/kWh increase for Sabah and Labuan from the current average of 29.52 sen/kWh to 34.52 sen/kWh.

Sarawak is not affected by the tariff hike as its power supply and distribution are managed by state-owned Sarawak Energy Bhd.

The new electricity tariff structure includes a base tariff hike of 2.69%, or 0.9 sen/kWh, for TNB.

The other components contributing to the electricity tariff hike are increases in the costs of fuels such as piped gas, liquefied natural gas (LNG) and coals.

Under the new structure, the domestic gas price would be raised from the current subsidised rate of RM13.70 per million metric British thermal unit (mmbtu) to RM15.20 per mmbtu, while the price of imported LNG would be fixed at RM41.68 per mmbtu. The base price for coal, on the other hand, would be raised from US$85 (S$106.44) per tonne to US$87.50.

In addition to the tariff hike, payment to renewable energy fund will be raised from 1% to 1.6% from next month. This will affect all electricity consumers, except for domestic users who consume less than 300kWh per month.

It is a long-overdue adjustment – and a rather painful one at that – but it is necessary for the long-term good of the country's economy. The move to increase electricity tariffs is in line with the Government's subsidy rationalisation programme to improve its fiscal health.

According to analysts, while the increase in fuel prices is neutral to TNB's bottom line, it provides certainty that the highly anticipated fuel-cost pass-through (FCPT) mechanism could be implemented in the near future.

Besides TNB, the other group to benefit from the power sector reform is the Petroliam Nasional Bhd (Petronas) group, which has been

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supplying 70% of its total gas output to the power sector at substantially subsidised rates.

TA Reseach points out that Petronas Gas Bhd will benefit indirectly as foregone revenue in the form of subsidy that has to borne by its parent, Petronas Holdings Bhd, can now be diverted to build new capacity as the industry moves towards market pricing gradually.

"It will not benefit from higher gas prices directly, which will accrue to the parent company, as its revenue is derived from the volume of gas processed and distributed through its pipelines," TA Research explains.

"Nevertheless, reducing subsidy and moving away from regulated prices have the potential to increase third-party demand for its regasification facilities in the long run," it says.

Higher cost

The new electricity tariff structure that will be implemented next month will undoubtedly hit everyone's pockets – from the man on the street to small and medium enterprises and corporate giants – whether directly or indirectly through secondary impact on the prices of other goods and services.

For many businesses, especially those already struggling with squeezed margins, the electricity tariff hike couldn't have come at a worse time.

The Federation of Malaysian Manufacturers (FMM), for one, has already voiced its disappointment over the rate and timing of the hike.

The organisation, which represents more than 2,500 manufacturing and industrial service companies in the country, thinks the quantum of increase is too huge and the one-month notice given too short.

Under the revised tariff, commercial and industrial users will see an average increase of 16.85%. This means the average power tariff for commercial users will increase from the current 41.01 sen/kWh to 47.92 sen/kWh, while that for industrial users will increase from 30.94 sen/kWh to 36.15 sen/kWh. But users under the Special Industrial Tariff (SIT) category will continue to enjoy discounted rates.

Bearing the brunt

"While the manufacturing sector appreciates the need to rationalise subsidies and increase energy tariff rates, this large increase in electricity rates will impose further difficulties when the industry is already facing rising costs from the full implementation of minimum wage and minimum retirement age," FMM says in a statement.

"There is also the impending increase in gas pricing and various other proposals in the pipeline such as unemployment insurance, environmental cess and increase in renewable energy fund contributions, all of which would again increase the cost of doing business significantly."

Notably, power-hungry industries such as steel and cement will be the most affected by the tariff hike.

According to RHB Research, the new electricity tariff is expected to translate into 1.8% of additional production cost for steel players and 2.9% of additional production cost for cement players in Malaysia, except for those operating in Sarawak such as Cahya Mata Sarawak Bhd as well as Press Metal Bhd, which has an aluminium smelting operation in the state.

RHB Research argues that the tariff hike is still painful for local steel players, which are already struggling to survive, despite the fact that the hike will likely result in only a small increase in production cost.

"Malaysian steel mills are barely surviving judging from their recent quarterly results... the new electricity tariff will translate into around US$11 (RM35) per tonne extra steelmaking conversion costs, thus putting further pressure on the already paltry margin," RHB Research explains.

It, however, expects the impact of a power tariff hike on steel maker Ann Joo Resources Bhd to be less severe, thanks to the latter's recently-commissioned mini blast furnace which saves the company around 300kWh per tonne of billet production.

According to RHB Research, cement players will feel the squeeze in their margins because

Glovemakers expected to pass costs to consumers

electricity accounts for around 17% to 20% of their production costs.

The main question is whether steel and cement manufacturers can fully pass on their costs to customers, CIMB Research says.

"Selling price increases may be inevitable but the impact could be muted by the current competitive environment for cement players (higher price rebates) and sustained macro risks (dumping from China and foreign exchange risks) for steel companies. These factors continue to weigh on the selling prices of cement and steel products," the broker explains.

The same cannot be said for glove manufacturers, which are expected to pass on their higher electricity costs to consumers.

In a statement issued over the week, the Malaysian Rubber Glove Manufacturers Association (Margma) pointed out that new electricity tariff structure would increase production costs significantly for rubber glove manufacturers.

"Electricity cost forms part of the energy costs which currently accounts for 10% of the rubber glove manufacturers' total production costs," Margma president Lim Kwee Shyan said, adding that glove prices were expected to increase in line with the electricity tariff hike.

Analysts believe the impact of higher electricity tariffs on glove manufacturers will be rather muted because of the latter's ability to pass on their costs to customers.

Affin Research, for one, expects glove manufacturers to raise their average selling price by 0.5% to 1% to offset the impact of higher tariffs.

"We think this is highly pos-

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sible similar to that in time past. However, they may still be a time lag of one to two months before the impact from the tariff increase is fully mitigated," the local research house argues.

Affin Research, however, believes the increase in average selling price of gloves will not adversely impact demand for the product, because the price adjustment is too immaterial.

Mild shock: Local steel players, which are already struggling to survive, will be affected although the tariff hike will likely result in only a small increase in production cost.

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