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Tenaga Nasional

Lower earnings risk, higher profit visibility

BY KATHY FONG

Tenaga Nasional Bhd (TNB), which won the Company of the Year award last year, also bagged an award at *The Edge* Billion Ringgit Club this year — the highest returns to shareholders over three years among the largest companies listed on Bursa Malaysia.

The utility giant's share price slightly more than doubled between 2013 and 2016, giving a three-year compound annual return of 27.5%. It climbed from RM6.42 as at end-2012 to a high of RM14.67 in January 2015 before retracing to RM13.94 as at end-March this year.

In fact, the heavyweight blue chip was hovering around RM6 levels for most of 2013. Investors who had snapped it up then should be patting themselves on the back. The stock is probably also one of the better safe havens among the 30 component counters of the FBM KL Composite Index at a time economic headwinds are blowing strong.

The powerful upward trend of TNB's share price was mainly fuelled by the implementation of the imbalance cost pass through (ICPT) mechanism last year and an electricity tariff hike prior to that. The low prices of fuel, namely coal, which gave a much-needed boost to earnings, added to TNB's appeal among investors.

The ICPT mechanism, which allows TNB to pass down incremental fuel costs to consumers without profiteering, is considered a major game changer for the group. Gone are the days when TNB had to live with margins being squeezed whenever it had to burn expensive fuels while tariff hikes happened only once in a blue moon. In a nutshell, the ICPT mechanism is expected to lighten the social obligation burden on the government-linked company. With the mechanism in place, TNB will have better earnings visibility.

The group's revenue and net profit rose between the financial year ended Aug 31, 2012 (FY2012), and FY2015, driven by higher tariffs and steady fuel costs as well as an increase in electricity sales. Revenue increased from RM35.85 billion in FY2012 to RM43.29 billion in FY2015 — a historical high. Pre-tax profit grew at a three-year compound annual growth rate of 7% to RM7.13 billion in FY2015 while net profit expanded from RM4.41 billion in FY2012 to RM6.12 billion FY2015.

Thanks to the improved earnings, TNB has been generous in rewarding its shareholders. It declared a dividend per share of 25 sen in FY2013 and 29 sen in both FY2014 and FY2015. The group's dividend policy is to pay out 40% to 60% of annual free cash flow from operations (less normalised capital expenditure and interest servicing).

For the nine months ended May 31, 2016, its net profit rose to RM5.61 billion from RM5.29 billion in the previous corresponding period. The higher profit was in line with a 6% year-on-year increase in revenue to RM33.29 billion.

Should an investor have bought 10,000 TNB shares at RM6.40 apiece on Jan 4, 2013, his investment of RM64,000 would have increased to RM132,300, based on the last traded price of RM13.23 on Dec 31, 2015. In addition, the investor would also have received dividends totalling RM8,300 during the three financial years. For the three-year period, the return to the investor would have been 120% — a handsome gain for such a heavyweight counter.

Meanwhile, the value of the block of 10,000 TNB shares continues to appreciate — it was worth RM144,200, based on the Aug 5 closing price. Analysts who track the stock believe that the rally still has legs as the blue chip is trading at mid-teen earnings multiples.

As the ICPT mechanism has removed a sizeable earnings risk from TNB, some fund managers opine that the stock deserves better premium on clearer earnings visibility going forward. However, a downside risk is the likelihood of TNB being asked to invest in power generation projects with parties that may lack the expertise or financial muscle. E

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