Tenaga powering ahead on tariff rerating

**Recommendation:**

**Buy**

**FAIR Value:** RM14.90

by AmResearch Sdn Bhd (Jan 03)

**Investment Highlights**

**WE MAINTAIN** our ‘Buy’ call on Tenaga Nasional Bhd with a higher DCF-derived fair value of RM14.90/share (vs RM13.10/share earlier), which implies CY14F PE of 16x and a P/BV of 2.4x.

We have fine-tuned Tenaga’s FY14F/FY16F earnings by 3%-5% largely due to adjustments in our assumptions for the group’s capacity charge payments to independent power producers.

The savings from the reduction in capacity charge since March 1, 2013, for the first generation power purchase agreements which have been extended by another 10 years, will be kept in a special account, which is at the disposal of the Energy Commission Malaysia.

It is uncertain at this stage what the funds will be used for, but we think it will likely still be used as part of an earlier proposed fuel stabilisation fund, as the government has proposed for fuel subsidies to be reduced bi-annually.

Note that our forecasts have already incorporated the group’s net tariff increase of 3% arising from the hikes in electricity and natural gas prices. The net increase stems from the 2.7% increase from base tariff plus another 0.5% from the higher US$87.5/tonne (+3%) coal price embedded in the new tariff structure.

Tenaga’s valuation kicker stems from the recent electricity tariff hike of 14.9%, effective Jan 1 this year, which will drive its earnings revision cycle over the coming quarters. There is some political opposition to the tariff hikes, management holds to the view that the new rate structure will be imposed as announced.

We also expect the competitive bidding process to build new power plants to drive down the group’s prospective cost structure together with the implementation of the ongoing incentive-based regulatory measures.

Additionally, coal prices which have risen over the past two months to almost US$85 (RM279.23)/tonne (vs the US$80/tonne embedded in the new tariff) is likely to moderate postwinter season.

The earnings revision cycle from the tariff hike, commencing next month, will continue to propel the rerating focus for the group. The stock trades at a decent P/BV of 1.8x, which is at the mid-range of adjusted 1.1x-2.7x over the past five years. Tenaga also offers a fair CY14F PE of 12x, compared to the stock’s three-year average band of 10x-16x.

While foreign shareholding has risen to 27% currently vs its peak of 28% back in April 2007, this is not a concern as there is no limitation presently on foreign shareholding levels.

**‘Buy’ with higher FV**

We maintain our ‘Buy’ call on Tenaga with a higher DCF-derived fair value of RM14.90/share (vs RM13.10/share earlier), which implies CY14F PE of 16x and a P/BV of 2.4x.

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<table>
<thead>
<tr>
<th>TENAGA NASIONAL BHD</th>
<th>2013</th>
<th>2014F</th>
<th>2015F</th>
<th>2016F</th>
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</thead>
<tbody>
<tr>
<td><strong>REVENUE (RM mil)</strong></td>
<td>37,310.7</td>
<td>42,630.5</td>
<td>45,861.8</td>
<td>47,728.5</td>
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<tr>
<td><strong>CORE NET PROFIT (RM mil)</strong></td>
<td>4,120.5</td>
<td>4,940.1</td>
<td>5,696.9</td>
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<td><strong>EPS (sen)</strong></td>
<td>73.0</td>
<td>87.6</td>
<td>101.0</td>
<td>108.3</td>
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<tr>
<td><strong>PE (x)</strong></td>
<td>15.3</td>
<td>12.8</td>
<td>11.1</td>
<td>10.3</td>
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