TNB could see major upside ahead

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WHILE Tenaga Nasional Bhd (TNB) lost out on the bidding for 1Malaysia Development Bhd’s (1MDB) energy unit Edra Global Energy Bhd, the utility giant may see a silver lining ahead as its shares look set to continue ascending due to improving fundamentals, according to analysts.

This is because with or without Edra under its stable of power assets, the utility giant has a slew of positive catalysts, going forward, while its strong capital position suggests that its shares are fundamentally undervalued at present prices.

"TNB's strong balance sheet allows it to undertake major earnings-accretive acquisitions if it wants to. If it does not, investors' focus will return to its low gearing and its ongoing projects at hand," says an analyst of a bank-backed research house with a "Buy" call on the stock.

The potential acquisition of Edra had weighed heavily on investors' sentiment towards TNB's shares throughout this year.

Last Monday, TNB was outbid by China General Nuclear Corp, which clinched the deal with 1MDB by paying RM9.6bil in cash for Edra, which owns five domestic and eight international power plants with a total capacity of 4,500MW.

In a Nov 25 commentary, Standard & Poor's said that while Edra's assets would have strengthened TNB's competitive position, it could also lead to a weaker capital structure for the group.

Now with the Edra saga out of the way, this year would have seen TNB factoring in many of the challenges that affect its bottom line, namely the drop in electricity demand growth, the weakening ringgit and the imbalance cost pass through (ICPT) mechanism.

To date, electricity demand growth was at 2.2% compared with 2.5% last year, the company disclosed in a statement on Oct 30. Electricity demand by the heavy consumers in the industrial sector tends to be a barometer for economic growth. The decrease in demand was reflective of the prevailing slowdown this year, but the economy is forecast to record a growth of 4%-5% by next year.

Meanwhile, a weaker ringgit made borrowing costs higher for servicing TNB's dollar-denominated loans while the ICPT, which reflects changes in power generation costs in the electricity tariff, has been recognised over the past two quarters. TNB's ringgit 5bil in the third quarter of financial year 2013 (Q3 FY13) as it began recognising the ICPT amount, which was previously deducted from its revenue.

The one-off recognition from this period amounted to RM1.82bil for the recognition of ICPT from January 2014 to May 2015.

The ringgit depreciation also impacted TNB's net profit in Q4 FY15, when it reported a drop in net profit to RM6.13bil from RM1.36bil in Q4 FY14. For FY15, TNB reported a net profit of RM6.13bil from RM43.23bil in revenue.

As TNB's stock price normalises to reflect these developments, as well as the conclusion of the Edra saga, research houses are highly bullish on the group.

In a Nov 23 note, JPMorgan Research reiterated its target price of RM20 for TNB's stock over the next 12 months.

"TNB remains the most undervalued utility in Asean. It is a beneficiary of a benign fuel-cost environment, solid volume growth and potential tariff reset every six months, potentially eliminating fuel cost risk," it says.

Other research houses are also forecasting a substantial upside for the stock. Both Nomura Research and Maybank IB Research have a target price of RM16 for TNB, which shares compared to its closing price of RM13.60 on Nov 27.

TNB's share price has remained flat throughout this year. However, it rebounded from a year-to-low of RM10.36 in August to RM13.60 on Nov 27, or a 31% increase.

"In the last six months alone, TNB has made a series of key acquisitions this year.

TNB acquired port operator Integranx Bhd for RM70mil in April to secure the coal supply line for its Janamanjung power plant complex in Lumut, Perak, which is expected to double in capacity by 2017.

The group also acquired a 70% stake in Jinhua East Power idex 18bil (JEP) for RM4.9mil from 1MDB in July. JDP will undertake the construction of a 2,000MW coal-fired power plant complex, codenamed Project 3B, in Negri Sembilan. JEP has already begun raising funds for Project 3B, which is expected to cost up to RM7.6bil. It is currently undertaking an RM9.8bil sukuk exercise to finance the power plant's construction.

TNB is allocating RM10.8bil in capex this year, half of which goes towards new generation projects to meet future capacity requirement of about 4,400MW. The rest is for investments in system maintenance and enhancement. (See table)

At present prices, valuations for TNB are attractive at 12 times price-earnings ratio for its FY16, says Nomura Research in a Nov 24 note.

"The next re-rating catalyst will be the continuation of the Incentive Based Regulation (IBR) which will help improve earnings visibility," the research house says.

The IBR framework allows for TNB's annual performance to be benchmarked against a set of key targets. Both the IBR and ICPT mechanisms are instrumental in determining electricity tariff rates when it comes under review every six months.

Additionally, its low net gearing of 0.15 times will support future capacity expansion, which in turn will contribute to stronger earnings, it says.