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Reforms panning out well for TNB

Investing | Financial Brief
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Maintain buy at RM10.82 with a target price of RM13: TNB, the Energy Commission (EC) and MyPower Corp held a briefing for investors on Dec 20 on the recently announced hike in electricity tariffs in Peninsular Malaysia.

Earlier this month, the Cabinet approved a 14.89% tariff hike that will take effect in January 2014.

The tariff hike has four components: (i) 1.52% for the reduction in gas subsidies; (ii) 10.17% for the purchase of imported liquefied natural gas (LNG); (iii) 0.51% for the adjustment of coal prices; and (iv) 2.69% base tariff hike.

The EC said the base tariff hike is valid for the next four years. This means there will be no base tariff hike at least until January 2018.

On the fuel cost pass through (FCPT) mechanism, the EC has proposed that the fuel price (that is, pipeline gas, LNG and coal) be reviewed every six months and electricity tariffs adjusted accordingly.

It was mentioned that Petrolim Nasional Bhd (Petronas), which supplies pipeline gas to the power sector (RM15.20 per million British thermal unit [mmBtu] effective January 2014), has requested for a RM3 per mmBtu rise in gas price every six months until prices converge to market rates (estimated at RM40 per mmBtu).

Based on the FCPT timeline, the next tariff review is due on July 1, 2014. However, any decision on tariff adjustments will still be subject to the Cabinet's approval.

With the general election over, we sense there is now more political willpower for the FCPT to be implemented.

The FCPT is also a crucial element for TNB's proposed Incentive Based Regulation (IBR) to take off. Implementation of the IBR will provide pre-defined operating measures to assess TNB's performance, making it easier to assess the quantum of the next base tariff hike when it is due.

As for the stabilisation fund, it will



Tenaga Nasional Bhd

FYE Aug 31 (RM mil)	2012	2013	2014F	2015F	2016F
Revenue	35,848	37,131	41,918	45,368	47,042
Ebitda	9,270	10,459	11,481	13,416	14,043
Ebit	5,002	5,889	6,442	8,140	8,543
Pre-tax profit	4,395	5,253	5,790	7,441	7,804
Reported net profit	4,411	4,614	4,340	5,573	5,844
Core net profit	2,984	4,012	4,340	5,573	5,844
EPS (sen)	78.2	81.8	76.9	98.7	103.5
Core EPS (sen)	52.9	71.1	76.9	98.7	103.5
Alliance/Consensus (%)			92.0	106.6	103.5
Core EPS growth (%)	157.4	34.4	8.2	28.4	4.9
PER (x)	20.5	15.2	14.1	11.0	10.4
EV/Ebitda (x)	8.1	7.1	6.5	5.6	5.3
ROE (%)	12.6	13.1	11.4	13.3	12.7
Net gearing (%)	41.4	38.9	40.5	35.6	30.0
Net DPS (sen)	19.5	24.9	23.1	29.6	31.1
Net dividend yield (%)	1.8	2.3	2.1	2.7	2.9
BV/share (RM)	6.18	6.22	6.76	7.45	8.18
P/BV (x)	1.7	1.7	1.6	1.5	1.3

Source: Alliance Research, Bloomberg

not be used at the moment as tariff rates are still regarded as manageable with 70% of households said to be unaffected by the hike. The stabilisation fund will only kick in once tariff rates hit a higher level, although the exact quantum was not specified. The stabilisation fund was established to cushion the impact of tariff hikes as gas subsidies are gradually removed.

Savings from lower capacity payments following the first-generation power purchase agreement renewals are currently channelled into a special account, managed by TNB. It has not been decided what these savings will be used for. The original plan was for the savings to be allocated towards the stabilisation fund.

No change to our estimates as

our forecast has already captured the impact of the tariff hike, lower pipeline gas subsidies and higher LNG price.

We maintain our "buy" rating on TNB with an unchanged target price (TP) of RM13 based on free cash flow to the firm (FCFF) valuation method, which applies 8% weighted average cost of capital and 2.5% terminal growth. Our TP implies financial year 2014 ending Aug 31 (FY14) and FY15 price-earnings ratio of 16.9 times and 13.2 times respectively (calendar year 2014: 15.7 times).

We sense that sector reforms are panning out well and this should set TNB on a structural repating path. The stock remains our top pick within the utilities space. — Alliance IB Research, Dec 23