TNB’s electricity tariff may be raised by 4% under FCPT mechanism

Tenaga Nasional Bhd
(June 30, RM12.18)

Maintain buy with target price of RM14.70: June 30 has passed and the government did not announce any adjustment to electricity tariffs. Under the incentive-based regulation (IBR) framework, there is a fuel cost pass-through (FCPT) mechanism under which electricity tariffs will be reviewed every six months to adjust for fluctuations in fuel costs (coal, gas and liquefied natural gas [LNG]) and generation mix. The last electricity tariff adjustment was made on Jan 1, 2014, with the next review scheduled for June or early July.

In view of the public backlash over the award of the Track 4A power plant contract, above average inflation of 3.2% to 3.5% in the first half of 2014 (1H14) and a lack of early warning signs by the government, we believe the FCPT review is likely to be delayed to late July or early August.

That said, we believe that the government and regulator are committed to the IBR framework and that the FCPT review, while possibly delayed, will not be derailed. The government, the Energy Commission (EC) and TNB have planned for the IBR framework since 2010 and the implementation of the trial period is on schedule. As such, we believe any share price weakness would be a buying opportunity.

We maintain our earnings forecasts, “buy” rating and discounted cash flow-derived target price of RM14.70 (based on an 8% discount rate and 3% growth rate).

The global coal price remains on a downtrend, and the current Newcastle coal price of US$70.1 (RM225) per tonne is at its lowest level year-to-date (-18% lower year-on-year). Overall, we estimate 1H14 coal price to be 10% lower than that of 2H13. However, the lower coal price should be insufficient to offset higher electricity generation costs due to higher LNG input costs and usage. We estimate that LNG prices had increased by some 8% in 1H14 (versus 2H13), and higher usage of LNG due to unplanned outages at coal-fired power plants has raised TNB’s overall fuel costs.

All in, we estimate that under the FCPT mechanism, the government will need to raise electricity tariffs by 1.5 sen to two sen, or 4% to 5%.

Raising electricity tariffs has traditionally been an unpopular and politically sensitive move, and we expect this to continue to be the case.

As such we expect the government to delay the FCPT review.

— Affin Investment Bank, June 30