

31 December 2015

Tenaga Nasional Berhad

Price : RM13.00

Market Capitalization : RM73,366.9 mln

Market : Main Market

Sector : Trading / Services

Recommendation : BUY

Bursa / Bloomberg Code: 5347 / TNB MK
Stock is Shariah-compliant

Recent Developments

- **Acquisition of GAMA Enerji.** TNB announced on 14 December 2015 that it has proposed to acquire a 30%-equity stake in GAMA Enerji A.S (GAMA Enerji) for a cash consideration of USD243 mln. The proposed acquisition would be undertaken via a Special Purpose Vehicle (SPV) to be set up by TNB.
- GAMA Enerji is a Turkish power company involved in generation, distribution and sales of power, as well as water conveyance and treatment projects. It has stakes in power plants which have a total electricity capacity of 2,109 MW, as well as water conveyance capacity of 100 mln cubic meters. Its power plants include hydroelectric, wind power and combined cycle gas power plants.
- TNB would be acquiring the stake from GAMA Holdings, International Finance Corporation (IFC) and IFC Global Infrastructure Fund Holding I COÖPERATIEF UA (GIF). Post-acquisition, GAMA, IFC and GIF would each continue to hold 50.5%, 14.5% and 5%-stake in GAMA Enerji respectively.
- The proposed purchase is in line with TNB's 5-year International Expansion Roadmap where it aims to secure new generation capacity abroad. The Group would fund the exercise via a combination of internally generated funds and borrowings. We opine there would be no funding issue given TNB's current cash and near cash (unit trusts) holdings of about RM8.9 bln and net gearing at 0.5x.
- We are positive with the Group's international expansion as this would add more income stream in the future. We are, however, unable to gauge the potential earnings from this acquisition in absence of information provided in the announcement. In the short term though, we do not foresee material impact on TNB's earnings.
- **Additional tax assessment.** TNB announced it had on 23 November 2015 received Notices of Additional Assessment for the years of assessment 2013 and 2014 amounting to RM985.6 mln and RM1.1 bln respectively. The total of RM2.07 bln additional tax liability was a negative surprise. TNB subsequently clarified that the additional tax came about following IRB's decision to disallow TNB's reinvestment allowance (RA) claim for assessment years 2013 and 2014. The utility giant explained that IRB had originally approved the RA on 21 Jan 2013 but decided to reverse its decision via 17 June 2015 and 15 Sept 2015. TNB is appealing the additional tax assessments.
- On 14 December 2015, the High Court grants TNB leave to commence judicial review proceedings set aside the Notices. The Court also allows an interim stay on all further proceedings, including the enforcement of the Notices, until an inter-party hearing for the stay application is held.
- In the event TNB has to pay the additional taxes, its cash and near cash holdings would be reduced significantly by 23%. More importantly, this would likely mean TNB may not be able to claim RA going forward for its capex investment, resulting in much higher effective tax rate at circa 25% by comparison to 9.2%, 9.7% and 15% in FY13, FY14 and FY15 respectively. At this juncture, however, we are maintaining our earnings estimate pending outcome of the dispute.

- **Lost the Edra bid.** The cloud surrounding TNB on the possibility of it purchasing assets of Edra Energy, the energy arm of 1MDB (and hence potentially seen as a bailout effort) had since cleared with the announcement of the sale of Edra's assets to China General Nuclear Power Corp for RM9.83 bln. After months of uncertainties and investors jittery, we see this as a closure and investors can now re-focus on TNB's existing ongoing business and expansion plans.

Recap of 4QFY15 Results

Tenaga: 4QFY15 results

FYE Aug (RM mln)	Quarter-on-Quarter			Year-on-Year		Year to date		
	4QFY15	3QFY15	% chg	4QFY14	% chg	FY15	FY14	% chg
Turnover	11,744.0	9,905.7	18.6%	11,723.4	0.2%	43,286.8	42,792.4	1.2%
Operating profit	2,218.9	888.5	149.7%	2,278.0	-2.6%	8,627.6	7,181.0	20.1%
Foreign translation gains	(733.5)	171.6		153.1		(819.3)	445.3	
Net Interest cost	(91.5)	(242.7)		(153.2)		(662.7)	(617.9)	
Pre-tax profit	1,412.5	734.9	92.2%	2,309.8	-38.8%	7,133.7	7,114.7	0.3%
Tax	(602.9)	31.7		(987.8)		(1,072.8)	(687.9)	
Net profit after MI	820.9	789.4	4.0%	1,355.9	-39.5%	6,118.4	6,467.0	-5.4%
EPS (sen) - basic	14.6	14.0		24.0		108.4	114.6	
Op profit margin	18.9%	9.0%		19.4%		19.9%	16.8%	
Pre-tax margin	12.0%	7.4%		19.7%		16.5%	16.6%	
Net profit margin	7.0%	8.0%		11.6%		14.1%	15.1%	
Net assets (RM)	8.37							

- TNB reported a net profit of RM6.1 bln on the back of RM43.3 bln revenue for the full year. Excluding forex translation loss of RM819.3 mln, core net profit came in at RM6.9 bln which was ahead of our estimate of RM6.3 bln.
- Revenue for the Group was up by a marginal 1.2% y-o-y in FY15, lifted by 2.2% y-o-y growth in unit electricity sales but adjusted for the RM1.8 bln over-recovery of the Imbalance Cost Past Through (ICPT) from January 2014 to May 2015 that was recognized in 3QFY15.
- TNB's opex in FY15 saw a reduction of 2.2% y-o-y mainly due to lower fuel generation cost. Reduced consumption of LNG as well as oil & distillate, coupled with lower commodity prices (coal and LNG) contributed to the lower cost. Coal and LNG prices averaged at RM236/mt and RM45.21/mmbtu in FY15 respectively, vs. RM244.6/mt and RM46.45/mmbtu a year ago.
- The weakening of Ringgit against the Yen and USD has taken a toll on the Group's performance with the recognition of RM819.3 mln in foreign translation loss. This is mainly due to its foreign assets as well as borrowings denominated in Yen and USD. Meanwhile, TNB's effective tax rate in FY15 was 15% vs. the 25% statutory rate, mainly owing to utilization of reinvestment allowance incentive.
- Looking forward, we have our FY16 and FY16 core earnings (excluding foreign translation gain/loss) estimates for TNB at RM6.9 bln and RM7.0 bln respectively. Given the current challenging economic environment, we anticipate slow growth in electricity sales. The prevailing weakness in Ringgit would continue to weigh earnings down as well. On a brighter note, however, the ICPT mechanism would enable the Group to better manage its cost structure and improve earnings stability, while the low commodity prices would help cushion the impact from weak Ringgit.
- The board has proposed a final single tier dividend of 19 sen for the quarter under review, subject to shareholders' approval. If approved, this brings total FY15 dividend to 29 sen.

Recommendation

We maintain our **Buy** recommendation on TNB with a DCF-derived fair value of **RM15.45** (unchanged). Its prospective FY16 valuation at PER 10.5x appears to be attractive vis-à-vis its average historical PER of 15x. Apart from the attractive valuation, we like TNB for its improved earnings stability under the ICPT mechanism, rising coal generation mix, and low coal price which would support earnings going forward. Moderating factors include prolonged weak Ringgit and lower-than-expected electricity demand growth.

Per Share Data				P&L Summary				
FYE Aug	FY14	FY15	FY16e	FYE Aug (RM mln)	FY14	FY15	FY16e	FY17f
Book Value (RM)	7.66	8.45	9.39	Revenue	42,792.4	43,286.8	44,715.3	46,280.3
Cash Flow (RM)	2.01	2.02	2.22	Operating profit	7,181.0	8,627.6	8,902.8	9,302.3
Earnings (sen)	114.6	108.4	123.6	Net Int Exp	(617.9)	(662.7)	(682.6)	(703.1)
Net Dividend (sen)	29.0	29.0	30.0	Pre-tax Profit	7,114.7	7,133.7	8,305.2	8,684.3
Payout Ratio	25.3%	26.7%	0.0%	Eff. Tax Rate	9.7%	15.0%	16.0%	19.0%
PER (x)	11.3	12.0	10.5	Net Profit	6,467.0	6,118.4	6,976.4	7,034.3
P/Cash Flow (x)	6.5	6.4	5.9	Operating Margin (%)	16.8%	19.9%	19.9%	20.1%
P/Book Value (x)	1.7	1.5	1.4	Pre-tax Margin (%)	16.6%	16.5%	18.6%	18.8%
Net Dividend Yield	2.2%	2.2%	2.3%	Net Margin (%)	15.1%	14.1%	15.6%	15.2%
ROE	15.0%	12.8%	13.2%					
Net Gearing (x)	0.4	0.5	0.5					

TNB's last 12-month share price chart



Source: Bloomberg

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RATING GUIDE

BUY	Price appreciation expected to exceed 10% within the next 12 months
SELL	Price depreciation expected to exceed 10% within the next 12 months
HOLD	Price movement expected to be between -10% and +10% over the next 12 months from current level

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