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TENAGA NASIONAL BHD

By UOB Kay Hian Research
Rating: Hold (downgraded)
Target Price: RM17.70

TNB's regulated business is expected to generate a net profit in 2018 that is similar to 2017's level, said UOB Kay Hian Research (UOBKH Research).

The research house said that this implied pedestrian earnings for 2018 to 2020 with sustainable dividends of 4.6% (based on a 60% payout).

"Positively, the company may start to pay quarterly dividends.

"We trim earnings by 4% as regulatory period 2's demand growth is expected to drop to 2% (versus our expectation of 3%)," it said.

In a recent publication by the Energy Commission dated March 30, 2018, the regulator highlighted that the average return on asset for RP2 is RM3.8bil.

"Together with operating expenditure and capital expenditure efficiency carried over from RP1, TNB is expected to earn approximately RM4bil annually for its transmission and distribution businesses in 2018-2020 based on a regulated weighted average cost of capital (WACC) of 7.3%," the research house said.

To recap, UOBKH Research said that the allowable return for RP2 is based on a WACC of 7.3% vs TNB's initially-proposed range of 7.4% to8.8%.

It said that in the longer run, TNB's earnings upside will come from potential cost savings as it moves towards automation and the SMART metering (based on RP2 capex approval of RM18.8bil).

"The move towards greater efficiency is captured in the 4% increase in annual capex in RP2 versus 3% in RP1. For example, automation will help TNB reduce staff, administration and repair & maintenance costs," it said.

UOBKH Research downgraded TNB to a hold with a target price of RM17.70, given a lack of near-term re-rating catalysts.

It advised investors to accumulate at RM15 for sustainable 5% dividend yields.