24/03/2007 : Broker's Call

(Source - thestar.com.my)

TENAGA NASIONAL BHD (RM11.40 as at March 22)

THE Government has ceased discussions with the independent power producers (IPPs) on how they could contribute some of their profits in return for extensions to their power purchase agreements (PPAs). Instead, it plans to impose a higher cess on the IPPs.

Comment by Hwang-DBS Vickers Research: We continue to remain positive on TNB, given its promising earnings outlook with the stronger demand following the implementation of the Ninth Malaysia Plan projects.

The next re-rating catalyst is the strengthening of the ringgit given that 46% of the company's loans are foreign currency-denominated. We estimate that every 1% appreciation in the currency will boost its FY07 earnings per share (EPS) by 2.3%.

The ceasing of PPA negotiation is neutral to TNB since it is not required to pay the higher cess rate. There is also increased certainty that Petronas will maintain the gas pricing, as there is no avenue to pass on additional costs to the IPPs. We believe that the gas price will remain so long as the cost-pass through formula is not in place.

TNB will also benefit to a small extent from grants for rural electrification, contributed by the cess fund. The company is formulating an official dividend policy, likely to be announced on April 16 with its 2QFY07 results. While TNB is unlikely to be a good dividend stock given its high capex of RM4bil per annum, we expect rising dividend per share (DPS) from FY07 onwards following the strong earnings growth of about 83% yoy for FY07 and rising free cashflow after the tariff hike effective June 1, 2006.

We believe that the incremental cashflows will be utilised towards DPS payment, though the gross yield is still likely to be below 5% as the company is looking at a sustainable DPS payout policy.

Recommendation: We reiterate our BUY call with a target price of RM14.40 based on forward price to earnings (PE) of 17 times (x). TNB's calendar year 2007 PE of 13.6x remains attractive compared with its five-year historical average of 19x. It also ranks favourably compared with Telekom Malaysia Bhd and Malayan Banking Bhd, which are trading at 15.8x and 14.5x, respectively, as well as the market PE of 16x.

MY E.G SERVICES BHD (RM1.72 as at March 22)

MYEG is a product of the Government's initiative to improve delivery in the public sector via its electronic-service solutions, most prominently known for its dominance in facilitating motor licensing procedures nationwide. Together with Konsortium Multimedia Swasta Sdn Bhd and MySPEED.com Sdn Bhd (SPEED), the company was awarded 15-year concessions by the Government in May 2000 to provide e-services for its agencies in Malaysia.

Comment by Aseambankers: The rapid rise in online transactions, acquisition of SPEED, progressive roll-out of new services from 2007-2010 and impending price revisions from tariff hikes are just some of the key drivers of a quantum leap in earnings from FY07 onwards.

Currently, its driver licensing services and e-insolvency services are the company's key earnings drivers, accounting for nearly all of its earnings before interest and tax (EBIT) in FY06. The online driving theory tests segment saw encouraging growth of 3% and 11% in FY05 and FY06. On average, it received 20,000 applications per month at a cost of RM25 each. Of this fee, 22% goes to the Road Transport Department, while MYEG collects the balance.

To date, the company has also reported up to 60,000 transactions per month for the insolvency search application service, compared with 28,000 transactions in 2005. Each transaction cost RM12, with MYEG earning a RM2 fee each.

The company has proposed to acquire a 79.5% equity stake in SPEED for RM7.9mil cash. MYEG also plans to purchase Bank Islam's remaining 20.5% stake in SPEED for RM2mil by next month.

Operationally, we anticipate SPEED to contribute about RM8mil in revenue and RM3mil in EBIT annually, given that it would offer MYEG an additional 33% and 20% market share for the online test and e-insolvency services respectively.

In addition, MYEG is entitled to seek a tariff revision on its services once every three years. We understand that it has been granted approval to charge a higher fee for the online test and e-insolvency transactions. The adjustment, effective January 2007, is purportedly about RM3 per transaction. This will bring in an additional RM2mil in profits annually. We see further upside to growth should MYEG succeed in securing rate hikes on its eight other existing services.

The company also has five new services, currently in development stage, which are slated for commercial roll out in 2008-2009.

Recommendation: Our base case scenario price target tags MYEG at RM1.76, based on a target FY08 earnings multiple of 11x. Nevertheless, MYEG could potentially trade at higher values. Hypothetically, we estimate MYEG's blue sky EPS at 20 sen. Based on 11x-12x earnings multiples (tagged to peers' average valuations), MYEG is valued at RM1.76-RM2.40. This implies a potential upside of up to 47% over a 12-month period.

KEJURUTERAAN SAMUDRA TIMUR (97 sen as at March 22)

THE company has secured a four-year contract from Petronas Carigali worth RM150mil-RM180mil for the provision of tubular handling equipment and services for drilling and work-over programmes.

The contract ends February 2011 and will boost its order book for the tubular works segment.

Comment by OSK Research: The outlook for Kejuruteraan Samudra is starting to look brighter as in addition to this contract, the land rig in India and pipe threading arm are expected to be profitable as well.

In FY05, the group had added on close to RM30mil worth of new equipment in preparation for bigger contracts.

Tubular handling is Kejuruteraan Samudra's core strength and hence we believe that this latest contract will run smoothly.

The company is one of the only local players in offshore Malaysia providing tubular equipment and services. As a result, it is awarded contracts by default by Petroliam Nasional Bhd.

The project is expected to contribute about RM35mil-RM38mil in revenue annually and estimated EBIT margins of 14-15%. This is similar to what was achieved in FY06.

The only downside to the stock is the company's joint venture with Gagie Corp to carry out a RM200mil downfishing contract. This venture has yet to take off because of the lack of equipment and continues to hurt Kejuruteraan Samudra's bottomline.

Recommendation: Based on the estimated contributions from the latest project, our FY07 forecast is raised by 10.7%.

This brings up our fair value to RM0.92 from RM0.83 previously. Still, we continue to be cautious in our earnings projections and maintain a NEUTRAL call on the stock.

GENTING BHD (RM39.75 as at March 22)

Genting, through its 97.7% subsidiary Genting Sanyen (M) Sdn Bhd, has announced the disposal of its paper and packaging business for RM745mil cash to Paperbox Holdings Ltd. Genting has also disposed of its 25 million 14% redeemable non-convertible cumulative preference shares to the purchaser. The group is expected to incur a loss of RM179mil from the disposal.

Comment by TA Securities: We concur with the management that they have paid a full and fair price for the packaging business as the total cash consideration works out to 41.3x 2006 PER (including some impairment losses from the business in 2006) and 12.1x 2007 PER. This is in comparison to the 13x 2007 PER for the manufacturing stocks within our coverage, which is fair in our view. This proposal to sell the paper and packaging business is widely known and is part of the broader picture for Genting to review its strategic options for its portfolio of investments, which includes the possibility of disposing of its non-core gaming assets.

We view this disposal positively as it would enable the group to concentrate on growing its core operations in gaming. As not much growth is expected to come from the paper and packaging division without further investments, we feel that the group's financial resources would be better utilised elsewhere. The funds could be used for Sentosa or for working capital.

Genting would only lose the contribution from this division starting from July onwards. This, however, will be offset by the interest income generated from the RM745mil cash. Hence, FY07 net profit would be marginally adjusted downwards by 0.08% to RM1.52bil. Similarly, FY08 has been revised downwards after factoring in the loss in earnings from the paper division offset by the lower interest expense. Hence, FY08's net profit has been adjusted downwards by 1.95% to RM1.54bil.

Recommendation: Taking into account the loss of net income for four and a half months from the packaging business but factoring in the higher cash from the disposal, our fair value has been adjusted to RM41.60 after using revised net asset value as our valuation methodology. At that level, total return amounts to 15.7%, which causes us to maintain our BUY call.