

TM warrants see more interest

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The Edge 12/09/05
Telekom Malaysia Bhd (TM)'s warrants have not been trading in-the-money of late. Prior to the telecommunications giant announcing its second-quarter results on Aug 25, its share price stood at RM11, with the warrant trading at RM1.82.

Currently, it is trading at RM1.55, with its mother share trading at RM10.30 and a calculated gearing of six times. TM's call warrant has a strike price of RM9.21 and is expiring in November 2007.

Analyst Chan King Yew of Avenue Securities says the warrants are only about 4% undervalued and have an intrinsic fair value of RM2.10 before any dividend adjustments.

Taking into account that TM pays out about 35 sen per year per share in dividends, and considering that there are two more years to go before the warrant expires, this becomes 70 sen. Adjusted for present value, this translates into 67 sen.

Ultimately, says Chan, the call warrant has a post-dividend intrinsic value of only RM1.62, with a conservative volatility rate of about 20%.

In a recent research note, JP Morgan recommended an overweight evaluation on the counter's mother share, placing its target price at RM12.81.

Based on this target share price, the warrant price has the potential to rise by about 90 sen if the mother share price reaches the JP Morgan target price of RM12.81. Analysts say investors may be enticed into investing in the warrant based on the potential gains through the relatively high gearing.

However, the upside will only come if the mother share price increases.

Cashing out on the warrant at the current price of RM1.55 may be more costly than expected as a 5% premium over the strike price of RM9.21 has to be paid to convert each unit of warrant into a share. (This is in addition to the purchase price of the warrant.)

Based on the RM10.30 price, the warrant remains out-of-the-money, as it is about 92 sen cheaper to purchase the underlying share than it is to purchase and convert the warrant.

TM's warrants may nonetheless be an attractive option for investors who would like to gain some exposure into the telco heavy-weight.

But most investors who turn to blue-chip counters are inevitably seeking high dividends. And with the TM warrant, the dividend payment could be an opportunity cost, which could subsequently bring down the value of the warrant considerably.

Since the news of the RM470 million compensation payment and the 45% drop in net profits due to its voluntary separation scheme, TM's underlying stock has not been at its usual RM11 stance.

Its unanticipated second-quarter results, ended June 30, 2005, reported a decline in TM's net profits to RM426 million compared with the RM952 million garnered in the same quarter in 2004.

The market reacted, causing the share price to drop 70 sen to RM10.30 on Sept 1.

The counter was hit again when TM announced on Sept 2 that it was ordered to recompense the German unit DeTeAsia Holdings GmbH the sum of RM470 million after being found liable for a breach of a supplemental agreement involving the latter and Celcom (M) Bhd.

The reparation disbursement is expected to hit TM's bottom line, even if it does not fork out the sum this quarter, as provisions still need to be made.

Within the following two days, TM's counter shed another 20 sen to close at RM10.10 on Sept 3.

The counter has since recaptured some interest and impetus, which is made apparent by the share price climbing back up to RM10.40 on Sept 9.

TM's participation in a global roadshow, to be led by Prime Minister Datuk Seri Abdullah Ahmad Badawi, may be able to spur some fresh foreign interest in the counter, possibly raising the value of both the share and warrant prices.

Analysts say TM is well poised to attract foreign institutional investment, as it is a highly liquid counter with a large market capitalisation.

In terms of volume, TM's call warrant saw the most activity of all the call warrants listed on the exchange last Friday, with some 5,000 changing hands, suggesting that investors may already be seeing the potential influx of foreign investment. //

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