

China Power International: IPP with highest growth

Recommendation: BUY (initiating coverage)

China Utilities

Price	HK\$4.88	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$6.12 (+25.4%)	Dec	RMBm	RMB	Δ %	x	x	x	%	%	%	
12 mth range	HK\$2.40-4.63	04A	635.8	0.275	(4.7)	17.8	2.5	21.4	0.5	13.2	13.2	Cash
Market cap.	US\$2,078.2m	05A	661.9	0.211	(23.1)	23.1	2.2	20.6	1.6	10.2	7.1	21.7
Daily t/o, 3 mth	US\$10.3m	06F	879.9	0.275	30.2	17.8	2.4	14.8	1.9	12.4	8.2	29.3
Free float %	44.6%	07F	1,082.5	0.300	9.3	16.3	2.1	13.3	2.3	13.8	9.1	46.9
Ticker	2380.HK/2380 HK	08F	1,684.4	0.467	55.6	10.4	1.9	9.0	3.6	19.1	12.6	35.6

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +7.9%, +20.4%, +32.6%

Actual price changes (1 mth, 3 mth, 12 mth): +13.8%, +34.2%, +73.3%

Consensus EPS (06F-07F): HK\$0.25, HK\$0.33

Key points:

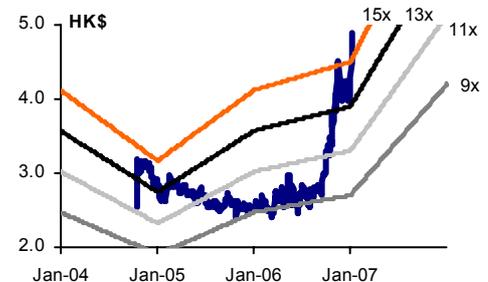
- Three-year earnings and EPS CAGR forecast at 36.5% and 30.3%, respectively.
- Three-year gross installed capacity CAGR projected at 27.5%.
- Shanghai Electric Power to be earnings growth catalyst.
- Assets injections from parent.
- Stabilized coal price and tariff to boost profitability.
- IPP with highest growth potential and attractive valuation.
- DCF-based target price of HK\$6.12 implying a 25.4% upside.

High growth potential, undemanding valuation. We expect China Power International (CPI)'s earnings and EPS to grow at a three-year CAGR of 36.5% and 30.3%, respectively, thanks to its aggressive capacity expansion. Its 25.0% interest in Shanghai Electric Power (600021 CH, RMB5.24, NR) should be the bottom line growth catalyst, given Shanghai Electric Power's aggressive capacity expansion plan. Asset injections are expected from its parent, China Power Investment Corporation (CPI Group), which is sitting on 30GW of generating assets. The share price of China Resources Power (836 HK, HK\$12.08, NR) has surged four-fold since the company's listing in November 2003, given its strong installed capacity growth. However, China Resources Power's earnings growth is expected to slow down due to the lack of power assets from its parents. CPI will replace China Resources Power as the HK-listed China IPP with the highest growth potential, in terms of installed capacity expansion. Its valuation is attractive against its peers, in terms of PEG for FY12/07F. Our DCF-based target price of HK\$6.12/share implies a potential upside of 25.4%. Thus, we initiate coverage on CPI with a BUY recommendation.

Capacity expansion. CPI's net capacity stood at 4,255MW as of end-June 2006. The company has three green-field projects under construction: 100.0%-owned Pingwei Power Plant II, 100.0%-owned Yaomeng Power Plant II and 89.0%-owned Huanggang Dabieshan Power Plant. Pingwei Power Plant II, with installed capacity of 1,200MW, is expected to come on stream in 2Q or 3Q, 2007, Yaomeng Power Plant II, with 1,200MW, in 1Q or 2Q, 2008, and Huanggang Dabieshan Power Plant, with 1,200MW, in 3Q or 4Q, 2008. The acquisition of a 25.0% stake in Shanghai Electric Power boosted CPI's installed capacity by 1,065MW. Thus, we expect its gross installed capacity to grow a three-year CAGR of 27.5% between 2006 and 2009 and reach 8,816MW in 2009, while net installed capacity is forecast at 7,108MW.

Asset injections from parent. CPI's parent CPI Group is one of China's five national power-generating companies with power plants in 24 provinces, municipalities and autonomous regions and a total installed

Chart 1: P/E bands



Source: SBI E2-Capital

capacity of about 30GW. We believe these assets will be CPI's next acquisition targets. Currently, CPI manages on behalf of its parent five power plants with installed capacity of 2,280MW: Liaoning Qinghe Electric Power (1,200MW), Jiangxi Guixi Coal-Fired Power Plant (500MW), Jujian Shaxikou Hydro Power Plant (300MW), Wuhu Shaoda Power Development (250MW) and Zhongdian Hongze Thermal (30MW). In 2005, the company acquired from its parent Shentou I Power Plant, which it used to manage. It has also just bought from its parent a 25.0% stake in Shanghai Electric Power. We believe Qinghe Power Plant will be CPI's next target, given the plant's relatively large installed capacity. Jujian Shaxikou Hydro Power Plant (300MW) may be another acquisition candidate, as the company currently has no renewable energy assets.

Shanghai Electric Power - a growing asset. With its net installed capacity of 4,370MW, Shanghai Electric Power is the largest power producer in Shanghai, accounting for 30.0% of the market in terms of total controlled capacity in 2005. We expect CPI to book the earnings from Shanghai Electric Power as profit from associates. We believe Shanghai Electric Power may become CPI's earnings catalyst from FY12/07F thanks to its aggressive capacity expansion. The company has stakes in four power plants under construction, with an aggregate net installed capacity of 2,152.5MW: Wujing Power Plant (600MW), Zhejiang Zheneng Zhenhai Gas Power Generation (292.5MW), Shanghai Waigaoqiao Third Power Generation (600MW) and Jiangsu Xuzhou Kanshan Phase I (660MW). Jiangsu Xuzhou Kanshan Phase I is expected to start operation between 2007 and 2008, Shanghai Waigaoqiao Third Power Generation in 2008 and Wujing Power Plant between 2009 and 2010. The acquisition paves the way for CPI's foray into Shanghai, the most important electricity market in Eastern China.

Key risk from the acquisition - dilution. The proposal of Shanghai Electric Power's shareholders to offer five-year convertible notes to raise RMB1.0b has been approved by the Public Offering Review Committee of the China Securities Regulatory Commission (CSRC) and is pending for approval by the CSRC. Half of the convertible notes will be offered to existing shareholders. The conversion price is yet to be determined. According to the illustration provided in the circular regarding the acquisition, assuming a conversion price of RMB4.21 per share, CPI's equity interest in Shanghai Electric Power will be diluted to 21.7% from 25.0% should CPI not to subscribe the notes or to 23.4% if it subscribes the notes. Note that CPI's position in Shanghai Electric Power is subject to a three-year locked-up period.

Tariff hikes expected. Affected by the lower-than-average tariff of Shentou I Power Plant, CPI's average realized tariff dropped 4.6% YoY to RMB226.72/MW in 1H 2006. Shentou I Power Plant, acquired in July 2005, accounted for 33.2% of the company's total net generation in 1H06. Its tariff was 38.9% lower than that of Pingwei Power Plant I and 33.0% lower than that of Yaomeng Power Plant I. Since Shentou I is a mine-mouth plant, it charges lower-than-average tariff. The National Development and Reform Commission (NDRC) raised power tariffs in the country in June 2006, with the tariff (VAT included) at Pingwei Power Plant up 2.5%, Yaomeng Power Plant 6.9%, Shentou I Power Plant 15.1% and Changshu Power Plant 8.2%. After the hike, tariffs at Pingwei Power Plant, Yaomeng Power Plant, Shentou I Power Plant and Changshu Power Plant are still 8.9%, 7.4%, 16% and 1.4% lower, respectively, than benchmark tariffs in their operating regions. Thus, we expect more average tariff upside in 1H 2007F. Another factor that influences the tariff trend is the coal price, given the coal-electricity price linkage mechanism, but we expect coal prices to stabilize in 2007.

Higher supply and transport de-bottlenecking to keep coal price flat. China's coal demand is projected at 2.5b tons in 2007 while the country's production capacity should reach about 2.3b t.p.a., representing an annual growth rate of 3.1%, with another 800m t.p.a capacity under construction. About 4,800 small mines will be shut down between 2007 and 2008. In November 2006, an export tariff of 5.0% was introduced, which should reduce coal exports and increase domestic supply. Worth noting is that the volume of coal transported by railway increased by 4.4% YoY in the first nine months of 2006, slower than the annual growth rate of 13.5% in 2004 and 7.1% in 2005, suggesting that after the expansion in rail capacity, transportation bottlenecks have eased. Nevertheless, any change in the contractual coal pricing mechanism will be the swing factor for domestic coal prices. If the annual coal procurement conference in Qinhuangdao is cancelled, coal and power producers may negotiate contractual coal prices individually and as a result some, especially small producers and those located away from coal mines, may lose their bargaining power.

Valuation and target price. Driven by capacity growth and the contribution from Shanghai Electric Power, we project CPI's earnings and EPS to increase at a three-year CAGR of 36.5% and 30.4%, respectively, offering the highest earnings growth potential among HK-listed IPPs. Trading at a PEG of 0.5x for FY12/07F, its valuation is attractive against the sector average PEG of 1.6x for FY12/07F. Assuming a 3.7% risk-free rate, a beta of 0.62x, a 7.2% WACC and a 1% terminal growth rate, we arrived at our DCF-based target price of HK\$6.12/share, implying an upside of 25.4%. Our current earnings model does factor in any new capacity other than the three known green-field projects under construction or any contribution from Shanghai Electric Power. Thus, our earnings forecast and valuation are subject to risk on the upside. Any M&A, new green-field projects or

expansion in Shanghai Electric Power's installed capacity would boost our valuation.

Table 1: Peer group comparisons

Company name	Ticker	Year End	Price (HK\$)	Market cap (US\$m)	P/E (x)		EV/EBITDA (x)		3-yr EPS CAGR (%)	PE/G (x) FY07F
					FY07F	FY08F	FY07F	FY08F		
Huaneng Power	902 HK	Dec	7.59	2,977	15.7	14.2	6.1	5.5	10.1	1.6
Datang Power	991 HK	Dec	9.22	1,694	15.5	14.6	5.1	4.5	12.8	1.2
CR Power	836 HK	Dec	12.08	5,914	15.9	13.3	10.4	8.6	6.8	2.3
CPI	2380 HK	Dec	4.88	2,259	16.3	10.4	13.3	9.0	30.4	0.5
HPI	1071 HK	Dec	3.28	603	13.8	10.8	4.2	3.2	19.3	0.7
<i>Average</i>					<i>15.8</i>	<i>12.5</i>	<i>9.0</i>	<i>7.2</i>		<i>1.6</i>

Source: SBI E2-Capital, Bloomberg

Fund raising activities and auditor. CPI placed 470.0m new shares at HK\$3.70 each to raise HK\$1.7b in November 2006. Following the placement, the group's total issued share capital increased from 3,135.1m shares to 3,605.1m. PricewaterhouseCoopers has been CPI's auditor since its listing in October 2004.

Management team. The company's management team led by Li Xiaolin has significant experience in developing, constructing, managing, operating and acquiring power plants in China. Ms. Li has been the vice-chairman of the CPI's board, executive director and chief executive officer since March 2004. She has over 20 years of extensive experience in the power industry in the PRC, especially in power investment and management. Prior to joining CPI Holdings in October 1994, she served as the head of the International Economic and Trade Department of the Ministry of Electric Power, an associate head of the International Economic and Trade Department of the Ministry of Energy and an engineer of the Equipment Introduction Office of the Beijing Power Supply Bureau.

Risk factors. 1) Higher-than-expected coal price; 2) Drop in utilization hours at CPI's generation units; 3) Rise in overhead costs and interest rates.

P & L (RMBm)	04A	05A	06F	07F	08F	Cash Flow (RMBm)	04A	05A	06F	07F	08F
Year to Dec						Year to Dec					
Turnover	3,373.9	4,437.7	5,304.2	6,117.8	8,682.4	EBIT	593.1	636.6	954.8	999.3	1,662.8
% chg	15.6	31.5	19.5	15.3	41.9	Depre./amort.	325.6	320.5	378.4	475.9	522.4
Gross profit	608.1	698.1	980.2	1,015.0	1,681.4	Net int. paid	65.2	19.4	163.8	94.5	81.5
						Tax paid	(21.1)	(92.7)	(100.0)	(150.0)	(200.0)
EBITDA	918.8	957.1	1,333.1	1,475.2	2,185.2	Dividends received	-	93.1	136.2	188.5	130.7
Depre./amort.	(325.6)	(320.5)	(378.4)	(475.9)	(522.4)	Gross cashflow	962.9	976.8	1,533.1	1,608.1	2,197.4
EBIT	593.1	636.6	954.8	999.3	1,662.8	Chgs. in working cap.	(44.7)	(135.6)	95.4	(55.1)	(176.3)
Net int. income/(exp.)	(65.2)	(19.4)	(163.8)	(94.5)	(81.5)	Operating cashflow	918.1	841.2	1,628.5	1,553.0	2,021.2
Other income/(exp.)	2.9	3.9	9.1	9.1	9.1	Capex	(981.0)	(2,316.8)	(1,737.6)	(964.1)	(934.7)
Exceptionals	-	-	-	-	-	Free cashflow	(62.9)	(1,475.5)	(109.2)	588.9	1,086.5
Associates	150.8	122.5	188.5	302.2	302.1	Dividends paid	-	(83.1)	(247.7)	(329.1)	(404.9)
Jointly-controlled entit.	-	-	-	-	-	Net distribution to MI	-	-	-	-	-
Pre-tax profit	681.7	743.7	988.6	1,216.2	1,892.5	Investments	-	(567.9)	(1,665.1)	-	-
Tax	(46.4)	(82.4)	(109.6)	(134.8)	(209.8)	Disposals	2.2	1.3	-	-	-
Minority interests	0.6	0.7	0.9	1.1	1.8	New shares	2,604.7	-	-	-	-
Net profit	635.8	661.9	879.9	1,082.5	1,684.4	Others	(205.2)	(345.4)	(318.2)	(179.6)	(153.7)
% chg	5.1	4.1	32.9	23.0	55.6	Net cashflow	2,338.8	(2,470.6)	(675.0)	(1,585.0)	527.9
Dividends	(460.3)	(247.7)	(329.1)	(404.9)	(630.0)	Net (debt)/cash - Beg.	(1,281.3)	1,057.5	(1,413.1)	(2,088.1)	(3,673.0)
Retained earnings	175.5	414.2	550.8	677.6	1,054.4	Net (debt)/cash - End.	1,057.5	(1,413.1)	(2,088.1)	(3,673.0)	(3,145.1)
EPS (RMB) - Basic	0.275	0.211	0.275	0.300	0.467						
EPS (RMB) - F.D.	0.275	0.210	0.226	0.278	0.433						
DPS (RMB)	0.027	0.079	0.091	0.112	0.175						
No. sh.s o/s (m) - W.A.	2,315.9	3,135.1	3,202.1	3,605.1	3,605.1	Interim Results (RMBm)	04A	05A	06A		
No. sh.s o/s (m) - Y.E.	3,135.0	3,135.1	3,605.1	3,605.1	3,605.1	Six months to Jun					
No. sh.s o/s (m) - F.D.	2,315.9	3,147.3	3,893.2	3,893.2	3,893.2	Turnover	1,664.9	1,645.7	2,491.2		
						% chg		(1.2)	51.4		
Margins (%)						Profit from operations	350.7	268.4	352.2		
Gross	18.0	15.7	18.5	16.6	19.4	Interest expenses	(40.1)	(36.0)	(46.1)		
EBITDA	27.2	21.6	25.1	24.1	25.2	Associates	83.9	51.2	42.1		
EBIT	17.6	14.3	18.0	16.3	19.2	Jointly-controlled entit.	-	-	-		
Pre-tax	20.2	16.8	18.6	19.9	21.8	Pre-tax profit	394.5	283.6	348.1		
Net	18.8	14.9	16.6	17.7	19.4	Tax	(24.7)	(33.5)	(41.5)		
						Minority interests	(0.1)	(0.2)	(0.6)		
Balance Sheet (RMBm)	04A	05A	06F	07F	08F	Net profit	369.7	249.9	306.0		
Year to Dec						% chg		(32.4)	22.5		
Fixed assets	4,989.8	8,043.6	9,402.7	11,597.2	12,180.2	EPS (RMB) - Basic	0.180	0.080	0.096		
Intangible assets	-	166.9	166.9	297.1	297.1	DPS (RMB)	-	-	-		
Other LT assets	13.8	12.9	12.9	12.9	12.9						
Cash	3,064.2	2,187.9	1,448.4	1,055.4	1,119.3	Shareholding Structure					
Accounts receivable	644.2	803.8	873.8	1,011.0	1,435.6					Shares o/s (m)	%
Other receivables	174.9	143.2	192.0	222.1	315.4	China Power Development				1,996.5	55.4
Inventories	114.5	265.9	163.0	186.2	263.3	Public				1,608.6	44.6
Due from related co.s	15.4	8.3	-	-	-	Total				3,605.1	100.0
Other current assets	32.9	76.0	128.3	70.5	71.0						
Total assets	9,049.6	11,708.5	12,388.1	14,452.3	15,694.7						
Accounts payable	(237.2)	(286.6)	(316.2)	(365.8)	(519.4)	Background					
Other payable	(328.8)	(476.3)	(545.6)	(631.3)	(896.4)	Listed on the HKEX on October 2004, China Power International (CPI) is the flagship company of China Power Investment Corporation (CPI Group), one of the five largest national power generating groups in China. It engaged in the investment, development, operation and management of power plants in China. The group's attributable installed capacity is 5,317MW currently.					
	(31.6)	(20.5)	(30.1)	(14.9)	(24.7)						
Due to related co.s	(5.1)	(91.7)	(95.9)	(95.9)	(95.9)						
ST debts	(853.7)	(887.5)	(1,774.0)	(929.9)	(898.7)						
Other current liab.	(212.2)	-	-	-	-						
LT debts	(1,153.0)	(2,713.5)	(1,762.5)	(3,798.5)	(3,365.7)						
Other LT liabilities	-	(413.1)	(413.1)	(413.1)	(413.1)						
Total liabilities	(2,821.6)	(4,889.1)	(4,937.3)	(6,249.3)	(6,213.8)	Key Ratios	04A	05A	06F	07F	08F
Share capital	3,323.1	3,323.1	3,323.1	3,323.1	3,323.1	Net gearing (%)	Cash	21.7	29.3	46.9	35.6
Reserves	2,902.2	3,485.3	4,117.6	4,871.0	6,150.5	Net ROE (%)	13.2	10.2	12.4	13.8	19.1
Shareholders' funds	6,225.3	6,808.4	7,440.7	8,194.1	9,473.6	EBIT ROCE (%)	12.3	6.8	8.9	8.4	12.5
Minority interest	2.7	11.0	10.1	9.0	7.2	Dividend payout (%)	72.4	37.4	37.4	37.4	37.4
Total	6,228.0	6,819.4	7,450.8	8,203.1	9,480.9	Effective tax rate (%)	6.8	11.1	11.1	11.1	11.1
Capital employed	8,234.7	10,420.4	10,987.3	12,931.4	13,745.2	Net interest coverage (x)	9.1	32.9	5.8	10.6	20.4
Net (debt)/cash	1,057.5	(1,413.1)	(2,088.1)	(3,673.0)	(3,145.1)	A/R turnover (days)	59.8	59.5	57.7	56.2	51.4
						A/P turnover (days)	20.0	21.5	20.7	20.3	18.6
						Stock turnover (days)	14.0	18.6	18.1	12.5	11.7

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