Corporate Snippet

Mon, 19 Mar 2007

Andes Cheng
(852) 2533 3721
andescheng@sbie2capital.com

FY07 outlook remains positive — China Utilities

China Power Int'l (2380 HK, HK$4.00) — BUY (unchanged)

Target price: HK$5.36 (+34.0%)

Results lower than expected. China Power International reported a 6.2% increase in earnings to RMB702.8m in FY12/06A, or RMB0.221 per share, below our forecast of RMB879.9m and the market consensus forecast of RMB787.0m, due to higher-than-expected fuel costs, staff, repair and maintenance costs and other operating expenses. The company proposed a final dividend of RMB0.080 per share, representing a payout ratio of 41.0%. Its turnover rose 19.3% to RMB5,202.9m, below our projection of RMB5,264.6m, gross generation up 19.5% YoY to 24.0m MWh and net generation 19.0% YoY to 22.3m MWh.

Above average utilization hours. Shentou I Power Plant acquired in 1H FY12/05A provided full-year contribution to the group, and the plant's net generation almost doubled in FY12/06A. Due to overhaul of generation units at the company's wholly-owned Pingwei Power Plant I, utilization hours at the plant dropped by 281 hours to 6,420 hours and as a result, net generation declined 4.3% YoY. Utilization at its wholly-owned Yaomeng Power Plant I increased by 13 hours and net generation 0.5% YoY. It is worth noting that utilization at all the company's power plant were above the national average of 5,221 hours.

Another tariff-hikes is expected. Thanks to the coal-electricity linkage system, the government increased the on-grid tariff in 30 June 2006. As a result, the tariff of Pingwei Power Plant I rose 2.5% YoY, Yaomeng Power Plant I 6.9%, Shentou Power Plant I 15.1% and the group's 50.0%-owned Changshu Power Plant 8.2%. As the contractual coal price for 2007 increased 5.0%+, another round of tariff hikes is expected this year.

Unit fuel cost dropped. Fuel costs increased 15.9% YoY to RMB3,075.0m, against our projection of RMB2,992.4m and accounted for 69.2% of the total operating costs. The increase was mainly due to higher consumption (full scale operation of mine-mouth Shantou I Power Plant) and higher coal prices. The company's unit fuel cost dropped 2.6% to RMB138.0/MWh, thanks to better fuel efficiency and contribution from Shantou I. The net coal consumption rate at both Pingwei Power Plant I and Yaomeng Power Plant I decreased by 3.0 grams/KWh and at Shentou I by 1.0 grams/KWh.

Costs to rise further. Staff costs rose 12.6% YoY, 16.8% above our projection, due to the acquisition of Shentou I in 1H FY12/05A and the distribution of bonus and welfare funds. Repair and maintenance costs surged 44.2% YoY, 24.7% higher than our projection, as the acquisition of Shentou I enlarged the company's generating assets scale. Other operating expenses soared 67.7% YoY, 7.3% higher than our projection, due to higher emission discharge and water fees, the acquisition of Shentou I, accelerating construction and revaluation deficits on the company's property, plants and equipment. With three power plants commencing operations between 3Q FY12/07F and 4Q FY12/08F and the government's strengthened environmental protection enforcement, we expect all costs other than fuel costs to rise further.

Table 1: Financial summary

Year to Mar	Net profit HK$m	EPS HK$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	661.9	0.211	(23.1)	18.9	2.0	21.4	0.7	10.2	7.1	19.7
06A	702.8	0.221	4.7	18.1	1.8	19.7	2.0	10.0	6.6	67.1
07F	1,088.5	0.302	36.6	13.1	2.0	12.6	1.8	14.2	9.2	47.8
08F	1,471.8	0.408	35.2	9.7	1.8	9.6	2.9	17.1	11.2	36.5
09F	1,814.2	0.504	23.5	7.9	1.4	7.4	3.9	18.5	11.9	12.4

Catalysts for FY12/07F. The group's profit from associates will increase thanks to its 25.0% stake in Shanghai Power acquired at the end of 2006. With Pingwei Power Plant II coming on stream in 3Q FY12/07F, the company's attributable installed capacity will be boosted by 22.6% YoY to 6,520MW in FY12/07F. Should it acquire Liaoning Qinghe Electric Power (installed capacity 1,200MW) this year, China Power's installed capacity will increase to 7,720MW but contribution from the new generating units will be limited to three months.

Undemanding valuation. We revise up our earnings projection for FY12/07F by 0.6% to RMB1,088.5m, to reflect a 7.0% increase in the contractual coal price, a 22.6% increase in the company's installed capacity and a 20.0% increase in the on-grid tariff. Based on a WACC of 7.3%, we slash our DCF-based target price HK$5.36 from HK$6.12. Our target price still represents an upside of 34.0%. Trading at PEG of 0.7x for FY12/07F, the valuation is still not demanding, compared with the sector's average PEG of 2.4x for FY12/07F. We reiterate our BUY recommendation on the group.

Table 2: Peer group comparisons

Company name	Ticker	Year End	Price (HK$)	Market Cap (US$m)	P/E (x) FY07F	P/E (x) FY08F	EV/EBITDA (x) FY07F	EV/EBITDA (x) FY08F	PEG (x) FY07F
Huaneng Power	902 HK	Dec	6.86	12,363	14.1	13.0	23.6	21.4	2.2
Datang Power	991 HK	Dec	7.57	7,559	12.9	11.7	4.6	4.1	4.5
CR Power	836 HK	Dec	11.80	5,799	15.3	12.8	10.5	8.3	1.6
CPI	2380 HK	Dec	4.00	1,846	13.1	9.7	12.6	9.6	0.6
HPI	1071 HK	Dec	2.82	3,561	11.8	9.3	3.8	2.9	0.6
Average					*13.7*	*12.0*	*13.7*	*12.0*	*2.4*

Source: SBI E2-Capital, Bloomberg

Financial position. As of the end of FY12/06A, the company's net debt stood at RMB5,344.1m, representing a net gearing ratio of 67.1%. The company raised HK$1.7b from the placement of 470.0m shares at HK$3.70 each in November 2006. Its capex for FY12/07F is budgeted at RMB5.5b, excluding the acquisition of Liaoning Qinghe Electric Power, which the company manages on behalf of its parent CPI Group. Yaomeng Power Plant II and Huanggang Dabieshan Power Plant are scheduled to commence operations in 2H FY12/08F. In its development plan, capex was budgeted at RMB10.0b for FY12/05A-12/09F, which implies another round of fund raising.