China Power International (2380)

Company update

BUY

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Stock price short-term catalyst: next acquisition

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Industry	China Power sector
Price	HK$ 4.35
Target price	HK$5.80 (+33%)
Stock code	2380
H-shr Market cap.	HK$15,684mn
H-share O/S	3,605mn
52wk high/low	HK$5.34/2.80
NAV per share	HK$2.6
Major shareholder	China Power Development Ltd (55.37%)

➢**Next acquisition likely materialized by the end of this year or early next year.** In its 1HFY07 interim result presentation, China Power International (CPI) disclosed that its total installed capacity in 2010 would hit 15GW, indicating that about 4GW capacity addition would possibly come from asset injection. This year CPI started to review its parent's hydro plants as acquisition targets. However, its parent's coal-fired plants under its management are small-scaled, failing to meet its acquisition standards amid rising coal prices. We believe that CPI will likely make acquisition of 1,200MW or over attributable capacity either by the end of this year or early next year.

➢**Possible targets: Qinghe Power Plant or hydro plants.** CPI was not eager before to acquire Qinghe Plant because of its small capacity. With the installed capacity up to 1,200MW (42x100MW+4x200MW) and tariffs much below the provincial benchmark, Qinghe sees rising coal cost eat up its profits significantly this year. Qinghe plans to add 1,200MW (2x600MW) new capacity with 600MW scheduled to be operational next year. It is highly possible that CPI only acquires Qinghe's new capacity of 1,200MW. CPI's top management shows preference to add hydro capacity to diversify its investments. Possible hydro plant target includes Yellow River Hydropower Development Co.Ltd. (黄河上游水电开发有限责任公司) and Hunan Wuling Hydropower Ltd. (湖南五凌电力有限公司).

➢**Cost control expected to improve**. 1HFY07 net profit was down 24% yoy excluding loss in the fair value of CB of Shanghai Electric Power due to high coal and maintenance costs. CPI is going to restructure, divesting non-core asset to alleviate labor cost. Coupled with improving performance of Pingwei II, CPI's cost control is expected to improve going forward.

➢**Target price of HKD5.80**. Our target price is based on 19x PE2009. We believe that CPI deserves a valuation at 6% premium to the average PE multiples of IPPs traded in Hong Kong on improving operating performance and very likely acquisition deal in the near-term.

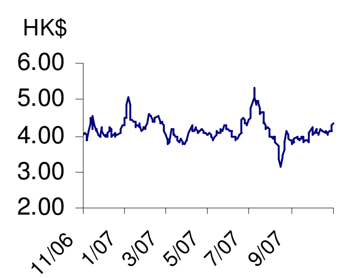
HK$=RMB1.03

Earning Summary

Year-end 31 Dec	05A	06A	07E	08E	09E
Turnover (Rmb m)	4,362	5,203	6,093	9,504	11,925
Growth (%)	30%	19%	17%	56%	25%
Net Profit (Rmb m)	662	703	596	931	1,099
Growth (%)	4%	6%	-15%	56%	18%
EPS (Rmb)	0.21	0.22	0.17	0.26	0.30
Growth (%)	-22%	6%	-15%	56%	18%
PER (x)	21	20	27	17	14
DPS (Rmb)	0.08	0.08	0.08	0.08	0.08
Yield (%)	1.8%	1.8%	1.8%	1.8%	1.8%

Source: company information, FSSL

Price Performance



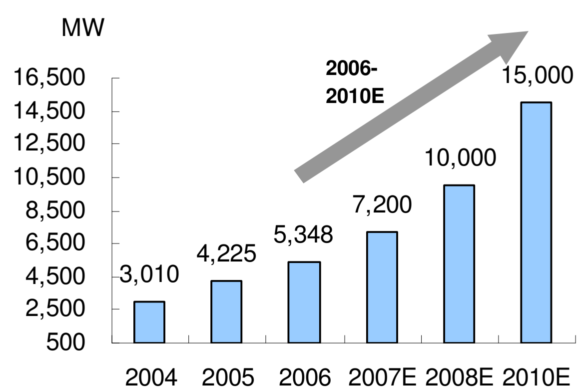
Source: Bloomberg

Next acquisition

In its 1HFY07 interim result presentation, China Power International (CPI) disclosed that its total installed capacity in 2010 would hit 15GW, indicating that about 4GW capacity addition would possibly come from asset injection. CPI's management promised one acquisition every year. With 1,081MW attributable capacity from the Shanghai Electric Power deal, we expect CPI is looking for capacity of at least 1,200MW as acquisition target for 2007-2008. We estimate capacity addition of total 4GW during 2007-2010 will likely be achieved through asset injection to meet CPI's capacity target at 15GW in 2010.

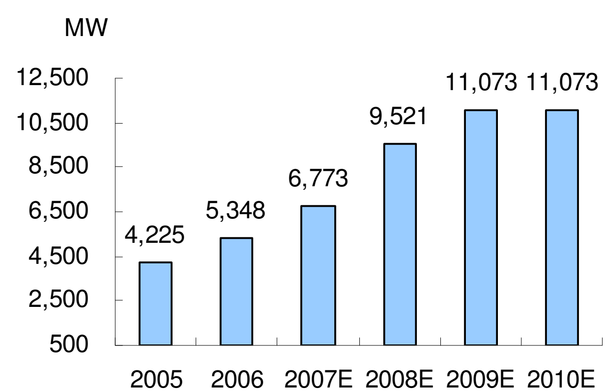
Due to small capacity of the managed coal-fired power plants for its parent, CPI started to eye its parent's hydro plants this year. We believe that CPI will likely make acquisition of 1,200MW or over installed capacity either by the end of this year or early next year.

Figure 1: Total attributable capacity forecast by CPI



Source: Company information

Figure 2: CPI's total attributable capacity in our model



Source: Company information, FSSL

Next possible acquisition targets

Possible acquisition targets of CPI include Qinghe Power Plant, Yellow River Hydropower Development Co. Ltd. (黄河上游水电开发有限责任公司) and Hunan Wuling Hydropower Ltd Wuling Hydropower Ltd. (五凌电力有限公司).

CPI was reluctant in acquiring Qinghe Plant due to small capacity of the latter. With the installed capacity up to 1,200MW (42x100MW+4x200MW) and tariffs much below the provincial benchmark, Qinghe sees rising coal cost eat up its profit significantly this year. Qinghe plans to add 1,200MW (2x600MW) new capacity with 600MW scheduled to be operational next year and another 600MW under the preparation stage for construction. It is highly possible that CPI only acquires Qinghe's new capacity 1,200MW. In addition, CPI's top management shows preference to add hydropower generation capacity to diversify its investments. Possible hydro plant targets include

Yellow River Hydropower Development Co Ltd. and Wuling Hydropower Ltd.

Yellow River Hydropower Development Co Ltd

Yellow River Hydropower Development Co Ltd. (Yellow River) ranks no. 1 among the hydropower industry in the Western China, no. 2 nation-wide after Three Gorges Hydro Development Corp. With total installed capacity about 5,650MW currently, Yellow River aims at over 10,000MW generation capacity in 2010. There is no competition between Yellow River and Three Gorges as Three Gorges' output is supplied to East China Grid, Central China Grid and South China's grid while Yellow River's output goes to Northwest Grid. CPI's parent holds 87.1% stake of Yellow River which is currently building a big hydro project, Laxiwa(拉西瓦) with capacity of 2,800MW (6x700MW). In 2006, with average utilization of 3,800 hours, Yellow River's net profit reached Rmb457m on revenue of Rmb 2.87bn and its ROE hit 22.02%.

Hunan Wuling Hydropower Ltd.

Hunan Wuling Hydropower Ltd. (Wuling) is 67.95% owned by CPI's parent. With total installed capacity 3,052MW currently, Wuling sets capacity target in 2010 at 10,000MW. As a key hydro power plant in Hunan province, Wuling supplies power to Central China Gird. In 2006, with average utilization of 3,384 hours, Wuling's net profit hit Rmb 376m on turnover of Rmb 1.83bn and its ROE touched 10.25%.

Table 1: Financial highlights of Yellow River and Wuling

	Yellow River				Wuling			
Rmb m	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Turnover	828	1,487	2,151	2,868	1,683	1,918	1,813	1,834
Operating profit	207	469	908	1,139	737	874	721	876
Other income/cost	0	11	7	(52)				
Finance cost	(399)	(467)	(606)	(703)	(379)	(439)	(204)	(206)
Investment income	3	(30)	2	(1)	20		0.2	
Net profit	(189)	14	346	457	244	216	327	377
EBIT margin(%)	25	32	42	40	44	46	40	48
Net profit margin (%)	(23)	1	16	16	14	11	18	21
Net gearing(%)	92	93	92	91	80	82	82	83
ROE(%)	(0)	1	21	22	6.3	7.2	10.8	10.3
Net equity	1,623	1,494	1,856	2,297	3,167	2,831	3,216	3,673

Source: Shanghai Topbond Investment Management ltd, FSSL

Table 2: Wuling's units

Plant name	Total installed capacity	Province
Wuqiangxi Hydro Plant(五强溪水电厂)	1,200	Huan
Lingjintan (凌津滩水电厂)	270	Huan
Honghshui Hydro Plant (洪江水电站)	225	Huan
Wanshuipo Hydro Plant (碗水坡水电站)	240	Huan
Sanbanxi Hydro Plant (三板溪水电站)	1,000	Guizhou
Jingweizhou Hydro Plant (近尾洲水电站)	63	Huan
Majitang Hydro Plant (马迹塘水电站)	54	Huan

Source: Wuling

All old small-scaled units of managed plants will be replaced

Qinghe (coal-fired), Guixi (coal-fired), Shaxikou (hydro), Wuhu (coal-fired) and Wuhu Shaoda (coal-fired) belong to CPI's parent but managed by CPI. Guixi has been injected into China Power New Energy Development Co Ltd. (735 HK), a subsidiary of CPI's parent. Similar to Qinghe, Guixi, Wuhu and Wuhu Shaoda are all small-scaled plants. All of these plants will be replaced with large-scale greenfield plants under the Central Government's policy of "Replacing small plants with large efficient ones". Each coal-fired plant is allowed to build 2x600MW greenfield power generation capacity. Currently both Guixi and Wuhu have obtained NDRC's approval to build 1x600MW greenfield plant respectively and are at the preparation stage for construction. We believe these new greenfield plants will be CPI's acquisition targets in future.

Table 3: Managed power plants

Plant name	Stake	Current capacity (MW) (all are small scale)	Planned new capacity (MW)	New plant's operation schedule	Coal/Hydro
Qinghe	100%	1,200	1200 (2x600MW)	One 600MW unit to be operational in 2008, another unit 600MW to start construction in 2008	Coal
Guixi	100%	500	1200 (2x600MW)	One 600MW unit to start construction in 2008	Coal
Shaxikou		300		Injected into China Power New Energy (735 HK)	Hydro
Wuhu	NA	127.5	600 (1x 600MW)	One 600MW unit to start construction in 2008	Coal
Wuhu Shaoda	NA	112.5	600 (1x 600MW)	NA	Coal

Source: Company information

Cost control expected to improve

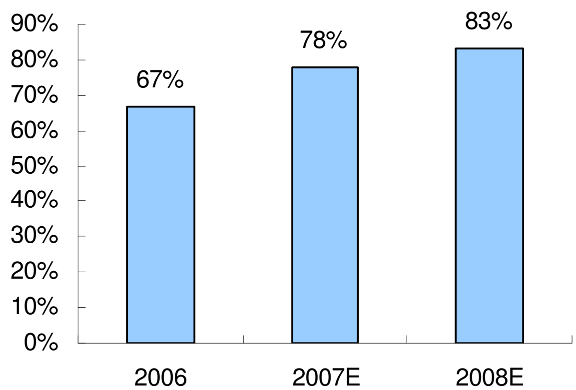
CPI reported a disappointing 1HFY07 result with net profit down 24% yoy excluding non-cash loss in the fair value of CB of Shanghai Electric Power due to high coal and maintenance cost and under performance of new-commissioned Pingwei II Plant. Its 1HFY07 fuel cost was up 17.71% yoy and other operating costs rose 15.6%. All of its subsidiary power plants are mine-mouth with unit generation capacity over 300MW, However a historical large gap between spot and contract coal prices and heavy reliance on a single supplier had CPI to face 12.5% yoy increase on 1H07 coal price, higher than 10% average. CPI's 1H07 standard coal price was Rmb440/ton, very close to the market price at the beginning of this year. We believe next year CPI will not face such a sharp increase in coal price as this year.

Unit 3 of Pingwei II Plant is the first commissioned unit among the "Anhui to East" (皖电东送). Pingwei II was commissioned ahead of schedule and the relevant policies for "Anhui to East" have not yet been available.

Although CPI's utilization hours were higher than the provincial average in 1H07, its lower-than-provincial-average tariffs make it more vulnerable to rising coal cost. CPI's rising ratio of unit 600MV generation capacity and mine-mouth plants will partly offset rising coal cost.

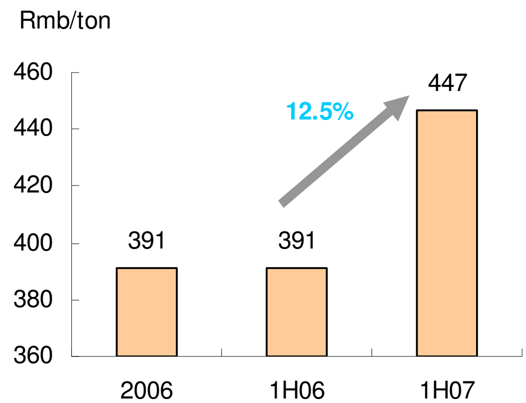
CPI is going to restructure, divesting non-core asset to alleviate labor cost. In 2005 and 2006, CPI's maintenance cost accounted for 5-6% of total operating costs. By contrast, China Resources Power (836 HK)'s maintenance cost accounted only 2% of total operating costs. We believe that there is plenty room for CPI to reduce its maintenance cost. Coupled with improving performance of Pingwei II, CPI's cost control is expected to improve going forward.

Figure 3: 600MW plants as % of total consolidated capacity



Source: Company information, FSSL

Figure 4: CPI's standard coal prices



Source: Company information, FSSL

Buy with target price of HK$ 5.80

We derive our target price of HKD5.80 by applying 6% premium over the average Hong Kong listed IPPs' 18x PE2009 on improving operating performance and possible acquisition in the near-term.

Table 4: Valuation peer comparison (share prices as of 2 Nov 07)

		PE (x)				Dividend Yield (%)				ROE (%)			
Company name	**Ticker**	**2006**	**2007E**	**2008E**	**2009E**	**2006**	**2007E**	**2008E**	**2009E**	**2006**	**2007E**	**2008E**	**2009E**
China Resources Power	*836 HK*	*44*	*34*	*24*	*21*	*1*	*1*	*1*	*1*	*15*	*18*	*22*	*21*
Datang Power	991 HK	30	26	22	22	1	2	2	2	13	14	15	15
Huadian Power	1071 HK	26	24	19	18	1	1	2	2	9	9	11	11
Huaneng Power	902 HK	17	16	15	14	3	3	4	4	15	14	13	14
China Power	2380 HK	20	27	17	14	2	2	2	2	8	6	9	10
Average		28	25	19	18	2	2	2	2	12	12	14	14

Source: Company information , Bloomberg, FSSL

Table 5: Sensitivity analysis on 1,200MW acquisition on CPI's financial performance

	Without M&A in 2008		Asset injection of 1,200MW capacity in 2008	
	08E	09E	08E	09E
Turnover (Rmb m)	9,504	11,925	10,024	13,552
Net Profit (RMb m)	596	931	1,037	1,405
EPS (Rmb)	0.26	0.30	0.29	0.39

Source: FSSL

Summary of Financials

Profit and Loss Statements					
FY-end Dec (Rmb m)	05A	06A	07E	08E	09E
Revenue	4,362	5,203	6,093	9,504	11,925
Other income	76	75	56	46	30
Fuel costs	(2,652)	(3,075)	(3,816)	(6,029)	(7,797)
Depreciation	(320)	(376)	(480)	(773)	(918)
Stuff costs	(315)	(355)	(503)	(623)	(655)
Repairs and mainter	(184)	(266)	(248)	(418)	(507)
Other operating expe	(226)	(369)	(388)	(428)	(472)
Operating profit	739	838	714	1,279	1,606
Finance cost	(118)	(133)	(225)	(380)	(485)
Associate's profit	122	102	196	237	264
Tax	(82)	(104)	(89)	(205)	(277)
Minority interest	1	1	1	(1)	(9)
Net profit	662	703	596	931	1,099
Depreciation	320	376	480	773	918
EBITDA	1,060	1,214	1,194	2,052	2,525
Growth					
Revenue (%)	30%	19%	17%	56%	25%
EBITDA (%)	14%	15%	-2%	72%	23%
EPS (%)	-22%	6%	-15%	56%	18%

Ratio Analysis	05A	06A	07E	08E	09E
Margins					
EBIT margin (%)	17%	16%	12%	13%	13%
EBITDA margin (%)	24%	23%	20%	22%	21%
Net margin (%)	15%	14%	10%	10%	9%
Operating Performance					
SG&A / revenue (%)	5%	7%	6%	4%	4%
Effective tax rate (%)	11%	13%	13%	18%	20%
Dividend payout (%)	37%	41%	48%	31%	26%
Inventory turnover days	22	20	20	20	20
Payable days	24	17	17	17	17
Receivable days	67	60	60	60	60
Financial					
Net debt to equity	27%	59%	103%	130%	102%
Revenues / total assets	37%	30%	28%	38%	49%
Total assets / equity	2	2	2	2	2
Interest coverage	6	6	3	3	3
ROE	10%	8%	6%	9%	10%

Balance Sheet					
FY-end Dec (Rmb m)	05A	06A	07E	08E	09E
Cash&cash equilvale	2,188	1,447	1,036	383	804
Trade receivable	804	861	1,008	1,572	1,973
Inventories	266	287	336	525	658
Other current assets	228	224	224	224	224
Current assets	3,485	2,819	2,605	2,704	3,660
Fixed assets	5,343	8,207	12,627	15,954	15,857
Investment in associ	836	851	2,578	2,653	2,754
Other L-T investmer	2,044	5,254	3,589	3,589	2,060
Total assets	11,709	17,130	21,398	24,900	24,332
S-T bank loan	888	2,424	2,424	2,424	2,424
Trade payables	287	240	281	439	551
Short-term liabilities	545	965	965	965	965
Total current liab.	1,719	3,629	3,670	3,828	3,939
L-T bank loan	2,714	3,812	7,732	10,432	8,932
Others	456	584	584	584	584
Total liabilities	4,889	8,025	11,986	14,844	13,455
Minority interest	11	26	25	26	36
Shareholders' eqt.	6,808	9,079	9,387	10,030	10,841

Cash Flow Statement					
FY-end Dec (Rmb m)	05A	06A	07E	08E	09E
PBT	744	806	685	1,137	1,386
Depreciation and amortati	321	377	480	773	918
Change in Working Capt.	(136)	158	(155)	(595)	(422)
Tax Paid	(93)	(104)	(89)	(205)	(277)
Others	(173)	197	(234)	(264)	(274)
Operating CF	663	1,434	687	846	1,330
CAPEX	(1,085)	(3,271)	(4,900)	(3,000)	(821)
Acquisition & others	(1,652)	(3,073)	171	(911)	1,701
Investing activities CF	(2,738)	(6,344)	(4,729)	(3,911)	880
Change in Debt	1,486	2,777	3,920	2,700	(1,500)
Change in Equity	0	1,700	0	0	0
Dividends	(83)	(288)	(288)	(288)	(288)
Other Financing Activities	(205)	2	0	0	0
Financing activities CF	1,197	4,191	3,632	2,412	(1,788)
Chang in cash	(877)	(719)	(410)	(653)	421
Cash at the beginning	3,064	2,188	1,447	1,036	383
Cash at the end	2,188	1,469	1,036	383	804

Source: Company information, FSSL

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