OCBC Investment Research

SINGAPORE **Company Update**

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Asia Power Corp

Reuters: ASPW.SI
Bloomberg: API SP

Sector: Industrial

Price S$0.155

Rating: Upgrade to **Outperform**

Y/E 30-Dec	6M 2002A	6M 2003A	2004F	2005F
Net Profit (S$m)	1.1	0.9	5.4	5.9
EPS (cents)	0.3	0.3	1.7	1.9
EPS Growth (%)	*-*	*-15*	*+500*	*+10*
Consensus EPS	-	-	1.5	1.7
PER (x) @ S$0.155	47.0	55.4	9.2	8.4
NTA (S$)	0.15	0.15	0.19	0.20

Performance (%)	1mth	3mth	12mth
Absolute	+3	-3	-14
Relative against STI	-0	-11	-31

Market Capitalisation :	S$	50m
Issued Shares :		321m
30-day avg daily vol ('000) :		45

Note: FY02 & FY03 figures are for 6 mths due to change of year-end from Jun to Dec

Associates momentum continuing into 2H

- **2H looks set to exceed our earlier estimates**
- **Associates are likely to maintain contribution level in the 2H**
- **Raising FY04 earnings by 11% to S$5.38m**
- **Upgrading to OUTPERFORM**
- **Raising medium term fair value estimate to 23 cents.**

Following its 2Q04 results, we visited Asia Power Corporation (API) to get an update on its prospects for the 2H of the year. Management remained fairly optimistic of delivering in the 2H of the year. With the flow-through effect of the restructuring of the past few years, the group is now ready to move on to the next phase of its growth strategy and it is on the lookout for other opportunities in related businesses. While its Xinbao power plant has traditionally turned in significantly lower earnings in the second half of the year due to lower tariffs, the deficiency this round will be compensated by higher contributions from associates. Just to reiterate, associates already saw a robust 159% YoY rise in earnings to S$2.4m in 1H04. With the still strong take-up rate for its Huayuan plant, due to its ideal locale in Jiangsu province, we are raising FY04 earnings estimate from S$4.8m to S$5.38m – largely to reflect higher sustainable associates contribution. As highlighted previously, API has been consistent in its dividend payout, paying out at least 0.5 cents per year. Management has no fixed dividend policy, but if profits sustain above S$5m per year, there is the possibility of a higher payout. In the mean time, we are retaining our DPS projection of 0.5 cent for this year. At the current price of 15.5 cents, yield is 3.2%. We are upgrading the stock to OUTPERFORM and raising medium term fair value estimate to 23 cents for valuation of 13x 2-year blended earnings and P/B of 1.2x.

Good demand will continue to buoy 2H04 performance. We visited the management of Asia Power Corp Ltd (API) recently to get an update on developments post 1H results. In particular, we noted that the tight supply situation in Jiangsu province is likely to continue and will buoy earnings contribution from associate, Changzhou Huayuan Electric Power Company Ltd (Huayuan), which came into its fold in Jun 2003. This is a 59.6MW combined-cycle, peaking plant and has proven to be an efficient plant with a smaller work force, but with profitability matching the bigger capacity 225MW Heilongjiang Asiapower Xinbao Heating & Power Company (Xinbao) plant.

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In addition, its first half performance was affected by a one-off provision of S$0.72m, which will not recur in the second half. Overall, we are seeing more focused earnings for the group after the restructuring of its operations over the past few years. This included start-up losses of some of the newly acquired ventures.

Having weathered the restructuring and with the better-than-expected 1H04 results, management is now turning its attention to grow the next leg of its operation. It is looking at other business opportunities in power-related areas. There are opportunities in this area as the Chinese government is still divesting power-related assets. Recently, the Chinese government announced plans to sell 11 power plants for US$2 billion. The key rationale for the divestment is the government's efforts, which are aimed at alleviating the chronic shortage of electricity in China. These 11 plants have a combined capacity of 6,470 MW and are located in the central north-west and eastern part of China. This situation highlights the present power shortage situation in China with 24 provinces facing power shortages. The situation is especially anxious in cities such as Shanghai. While the size of these plants are big compared to API's investments so far, it is an indication of the power shortage situation in China, which could eventually pave the way for better tariffs.

Associates contribution likely to sustain at 1H level. Based on current market conditions, with demand remaining good in Jiangsu province, associates' contribution is likely to remain stable in 2H04. Earlier on, we were conservative in our projections because the 51%-owned Xinbao plant has traditionally delivered poorer earnings in the 2H of the year as it typically used up all the higher tariffs allocation by the 1H of the calendar year, leaving the 2H with lower tariffs. However, this is not the same situation at the new associate, Huayuan, as demand stays strong and it will continue to enjoy good take-up rates. Also, it is located in Jiangsu province, which is still experiencing strong demand. This entity saw a full ramp-up in output by end-2003. Based on API's 25% stake, this operation contributed profits of S$0.88m for the first six months of this year. The main reasons for the considerably better performance from this operation were the shortage of power in the Jiangsu region and lower operating costs. Huayuan is able to generate greater efficiency from a smaller workforce of slightly more than 100 employees compared to around 1,500 employees working on the 225MW Xinbao plant. In addition, it is located in a region that will continue to require electricity even during the winter months. With higher revenue and lower operating cost, Huayuan is definitely a more profitable unit.

Apart from Huayuan, Changzhou Suyuan Electric Power Company (Suyuan), another associate, is also likely to maintain its performance in the 2H of 2004 as Suyuan's peaking plants are also located in Jiangsu province, although in less high-demand region when compared to Huayuan. Suyuan operates two plants and contributed S$0.89m in the 1H of the year. Suyuan's lower profits as compared to Huayuan (from two plants at Suyuan versus one plant from Huayuan) is largely explained by difficult conditions and lower contributions from the diesel-operated peaking plant, which is located in an area that is seeing lower demand.

Besides the Huayuan and Suyuan plants, the other associate, 35%-owned Shenzhen NARI Technologies Company Ltd, is also likely to continue with its strong 1H performance. It generated profits of S$0.59m during the first six months of the year and is likely to sustain this performance in the 2H of the year due to the nature of its operation. Shenzhen NARI is involved in the design, manufacture and assembly of computerised automation systems used for the regulation of electricity flow and the protection of power grid systems. Its clients are largely the provincial power plants and the income source is fairly stable as most of the power grids are generally old and need constant upgrading.

Overall, earnings contribution from its associates looks sustainable into the second half of the year and looks set to beat our earlier slightly conservative estimate.

Delivered strong set of 1H04 earnings. API posted a strong 173% YoY rise in 1H04 net earnings to S$3.6m, up from S$1.4m in 1H03. The stronger-than-expected 1H04 improvement came from a sharp turnaround in other operating income from a loss of S$1.44m to a profit of S$0.12m, lower finance costs (down 29% YoY), higher associates contribution

(+159% YoY) and lower tax rate. Associates saw a strong 159% YoY improvement to S$2.4m in 1H04. This came from two newly acquired associates in June 2003, which contributed profits of less than $1m. Huayuan accounted for profits of S$881,000, while 33%-owned Shanghai Witlong Electric Company Ltd contributed S$84,000.

Revenue rose 5.3% YoY to S$45.6m in 1H04. However, cost of sales rose from 78% in 1H03 to 81% by 1H04. This was due to rising costs for Xinbao pertaining to coal price, depreciation, staff costs and rental of machineries. This led to a decline in gross profit margin from 22.3% to 18.8% as gross profit fell from S$9.65m to S$8.57m. Apart from this, operating margin also fell from 12.5% in 1H03 to 11.3% in 1H04. However, with higher contribution from associates and lower taxes, net profit saw a 167% rise to S$3.6m.

Prospects & valuation. According to management, demand remains strong in China, resulting in power shortage situation. While oil and coal prices have been on the uptrend these past few months, the group was able to pass this on as electricity tariffs moved up to compensate for the effect of rising fuel costs. In the past, its performance in the first half of the calendar year was significantly stronger than the second half. This was largely due to significantly lower contribution from the Xinbao plant. For this year, the continuing earnings momentum from its associates will mitigate any shortfall in contribution from Xinbao in the 2H.

With the above, we have raised our FY04 earnings from S$4.83m to S$5.38m, up 11%. In addition, we have also taken a look at some of the Hong Kong-listed, China-based power plants. While these plants are of significantly bigger scale, we noted that these six stocks (including Datang International Power Generation Company, Huadian Power International Corp & Huaneng International Power) are trading at an average P/B of 1.4x and yield of 2.2%.

While we were conservative in our earnings projection earlier on following a somewhat erratic earnings pattern of the past, we are starting to see more definitive earnings coming through from this year. With the upward revision in our FY04 earnings, we have also upped our recommendation from MARKET PERFORM to **OUTPERFORM.** This is to partially reflect the current market weakness for small-to-mid cap stocks, with the share price now at 15.5 cents compared to our initiation report price of 17.5 cents. In addition, based on 1.2x P/B (pegging it at a discount to the HK-listed power stocks) and 13x two-year blended earnings, we are raising medium term fair value estimate from 19 cents to 23 cents. At 23 cents, this gives FY04 valuation of 13.7x, P/B of 1.2x and yield of 2.2%. The group has been paying out dividend of at least 0.5 cent per year and using current share price of 15.5 cents, this translates into yield of about 3.2%.

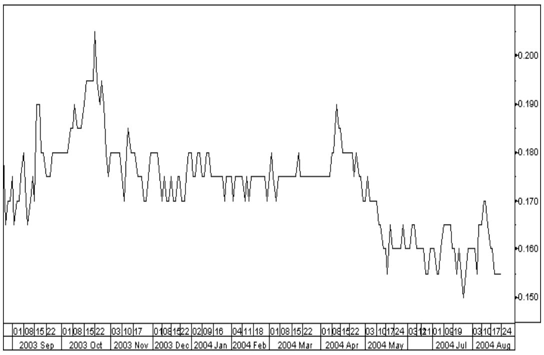
	Stake	Location	Investment Date	Installed Capacity	Type
Asia Power (Neijiang) Hydroelectricity Co	60%	Sichuan	Feb-98	13.5MW	Hydro power plant, run-of-river
Heilongjiang Asiapower Xinbao Heating & Power Co	51%	Heilongjiang	May-98	225MW	Coal-fired power plant
Changzhou Suyuan Electric Power Company - Changzhou plant	25%	Jiangsu	Mar-99	51MW	Combined-cycle, peaking power plant
Changzhou Suyuan Electric Power Co - Yangzhou plant	25%	Jiangsu	Jan-01	48MW	Heavy diesel-fired, peaking power plant
Sichuan Anning River Energy Development Co - Sankeshu Station	30%	Sichuan	May-02	52MW	Hydro power plant, diversion. Under construction. Expected to be operational by end-2004.
Changzhou Huayuan Electric Power Company	25%	Jiangsu	Jun-03	59.6MW	Combined-cycle, peaking power plant

EARNINGS FORECAST Year Ended 31 Dec (S$m)	12-mth to Jun 03A	6-mth to Dec 03A	FY04F	FY05F
Power Plant	80.6	39.6	84.2	88.2
Others	0.1	0.0	0.8	1.1
Revenue	**80.7**	**39.6**	**85.0**	**89.3**
Cost of sales	-70.0	-37.3	-73.0	-75.9
Gross profits	10.7	2.3	12.0	13.4
Pre-tax profits	6.2	1.4	10.3	11.6
Net Profits	**2.4**	**0.9**	**5.4**	**5.9**
EPS (cents)	1.4	0.3	1.7	1.9
DPS (cents)	0.5	0.3	0.5	0.5
NAV (cents)	15.9	15.3	18.5	19.9
KEY RATIOS				
Revenue growth (%)	-15.7%	-51.0%	114.8%	5.0%
Pre-tax growth (%)	-57.3%	-77.4%	639.6%	12.6%
Net Profit growth (%)	-61.5%	-63.3%	503.7%	10.2%
Pre-tax profit margin (%)	7.6%	3.5%	12.1%	13.0%
Net profit margin (%)	3.0%	2.3%	6.3%	6.6%

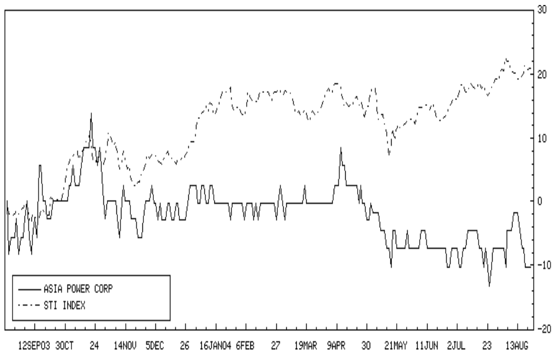
SUMMARY BALANCE SHEET As at 31 Dec (S$m)	Jun 03A	Dec 03A	FY04F	FY05F
Share capital	26.6	26.6	26.7	26.7
Reserves	30.5	28.3	32.4	37.1
Shareholders' Funds	**57.1**	**55.0**	**59.1**	**63.8**
Fixed assets	67.6	72.1	79.0	82.7
Current assets	65.0	52.3	59.3	69.3
Current liabilities	38.4	38.7	44.0	45.4
Long-term liabilities	13.2	8.8	9.2	14.8
Others	23.9	21.9	26.0	28.1
Assets less Liabilities	**57.1**	**55.0**	**59.1**	**63.8**

SUMMARY CASH FLOW Year Ended 31 Dec (S$m)	Jun 03A	Dec 03A	FY04F	FY05F
Pretax profits	6.0	1.4	10.3	11.6
Depreciation	3.8	2.1	2.5	2.5
Others	-1.0	-2.4	-4.8	-5.2
Changes in working capital	-12.6	19.0	-6.7	-2.1
Operating cash flow	**-3.8**	**20.1**	**1.3**	**6.9**
Net cash used in investing activities	-8.0	-5.5	-1.5	-1.4
Cash flow from financing activities	15.1	-12.1	-6.5	-7.0
Change in cash/(debt)	3.3	2.5	-6.7	-1.5
End cash/(debt)	15.5	17.8	11.1	9.6

Price Chart



Asia Power Corp vs STI



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