

Asia Power Corp Ltd

A gem amidst the rubble

Recommendation: **BUY**

S\$0.12

Bloomberg: API SP

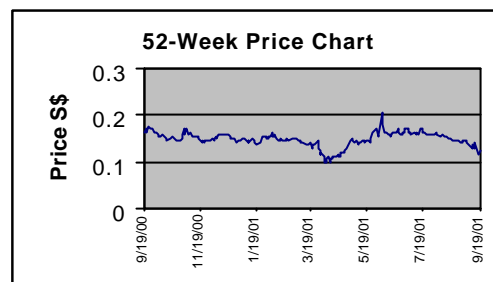
Dataline: APC.SG

Highlights

- *Undervalued growth stock of with low P/E ratio and P/NTA*
- *Attractive dividend-yield of 6.5%*
- *Newly acquired power-technology related company to fuel future growth*
- *Healthy balance sheet, poised to grow by further acquisitions*

Share Statistics

Shares (mln)	320.0
Mkt Cap (S\$m)	40.0
52-Week Range Price (S\$)	0.10 - 0.215
P/E (x)	4.65
Dividend Yield (%)	6.5
Substantial Shareholders (total direct & indirect interests)	Wong Sow Voon 66.9%, Peter Chang 61.6%



Four Year Financials

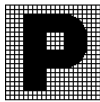
Indicators (ending 30 Jun)	FY1998	FY1999	FY2000	FY2001	Y-o-y %
Turnover (S\$'000)	37,279	65,067	60,894	108,562	78.3
Operating Profit	3,829	7,949	9,963	14,539	45.9
Profit Before Tax	3,857	8,721	12,780	19,582	53.2
Net Profit	4,872	5,201	7,360	8,262	12.3
EPS before XO (cents)	1.52	1.63	2.30	2.58	12.3
ROE (%)	26.4	18.7	16.6	16.1	-
Current Ratio (x)	0.88	1.05	1.35	1.60	-
Cash Ratio (x)	N.A.	0.36	0.55	N.A.	-
Debt/Assets (x)	N.A.	0.13	0.16	N.A.	-
Tot Debt/Eq (x)	N.A.	0.36	0.37	N.A.	-
LT Debt/ Eq (x)	N.A.	0.27	0.00	N.A.	-
NTA/sh (cents)	N.A.	11.56	13.82	13.82	0
Dividend Yield (%)	-	-	7.0	6.5	-

Asia Power is principally involved in the ownership, management and operation of four power plants in the various provinces of the PRC, as well as a power-related high-technology company.

Profitability and Operating Efficiency

Revenue was boosted by 78.3% to \$108.6 million for three reasons. First, a \$21.1 million revenue contribution by its newly acquired (for US\$5.5 million) subsidiary, Shenzhen NARI Technologies Co., Ltd

(SNARI). Second, change to a lease arrangement from the management contract of generators No.7 and No.8 of its Xinbao plant, leading to an increase in electricity generation volume. Third, a 16% increase in average on-grid electricity price from RMB0.243/KWH to RMB0.283/KWH.



Depreciation and amortisation expenses increased by 28% largely attributed to the amortisation of goodwill amounting to \$552,000 from its new acquisition.

Its Neijiang hydroelectric subsidiary experienced the longest dry season in history of the Tuojiang River, leading to a 17% revenue decline to \$2.5 million. Profits from Neijiang were reduced by \$1.2 million, offset by a \$0.6 million one-time consultancy fee. Because profit margins from hydroelectric plants are much higher than its other plants, the decline in such profits partially affected overall earnings margin.

Income tax charges rose due to the expiration of tax incentives on its Xinbao plant, and the taxable income from its new SNARI operations, further adding pressure to net earnings margin.

Indicators	FY98	FY99	FY00	FY01
Op. Profit Margin%	10.3	12.2	16.4	13.4
PBT Margin (%)	10.4	13.4	21.0	18.0
Net Profit Margin (%)	13.1	8.0	11.3	13.6
Asset Turnover (x)	0.48	0.87	0.58	0.79
ROE (%)	26.4	18.7	16.6	16.1
ROA (%)	6.2	7.0	7.1	6.0

Operating and PBT margins were slightly affected in FY01 due to the change in contract in its Xinbao generators from management based to leased based, thereby increasing cost of sales. Prior to FY01, these margins have improved steadily over the years, in part due to decreasing coal and diesel oil costs relative to production costs.

Net profit margins have increased steadily since 1999, although this is likely to experience downward pressure due to the cessation of tax incentives in coming years.

ROE may appear to be on the downward trend, but this can be largely explained by its substantial boost to its equity as a result of its IPO in 1999.

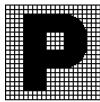
Liquidity and Leverage

Through the fresh injection of cash through its IPO in 1999, and maintenance of positive operating cash flow Asia power has improved its balance sheet, positioning itself favourably to make acquisitions. Its current ratio has improved steadily since then, from 1.05 in 1999, to 1.60 presently. As a result of enriched cash position, it has been able to fully pay down its long-term debts as of FY00.

Peer Analysis

	AP	Huanen	Heilong-jiang	Guang-dong	Shantou	Hydro-electric	Ceske
Mkt CapS\$m	0.04b	5.12b	1.49b	0.47b	0.42b	4.36b	1.88b
Price S\$	0.11	0.10	1.02	1.89	2.00	38.5	3.17
PER x	4.7	9.6	19.9	24.4	132.6	27.1	5.6
Op Prof Mag %	15.0	31.5	30.0	23.4	2.3	19.0	24.4
Net Prof Mgn %	13.6	20.0	29.4	23.6	17.5	10.4	13.7
ROE %	16.1	11.1	10.4	9.0	2.7	11.8	5.8
ROA %	6.0	6.1	8.1	5.7	2.7	5.3	3.3
LT Debt-Eqty x	0.1*	47.25	0	16.2	0	63.6	38.4
Tot Debt -Eqty	36.7*	59.9	10.4	17.4	0	78.7	42.9
Current Ratio x	1.6	1.42	3.38	2.25	6.6	0.79	0.77
Cash Ratio x	0.55*	0.33	2.53	1.33	4.42	0.02	0.23
P/Bk x	0.87	1.03	1.89	2.05	3.66	2.69	0.31
Country	PRC	PRC	PRC	PRC	PRC	Spain	Czech

*FY00



Comparing Asia Power to four Chinese, a Spanish, and Czech energy producers which also have a combination of coal and hydroelectric plants shows that despite having poorer operating and net profit margins compared to its peers, Asia Power's P/E, ROE are the most attractive, while ROA is also at the high end. Additionally, its balance sheet ratios such as debt-to-equity, current, and cash ratios are comparable. It is also one of two to be trading under book value

Recommendation

Asia Power will continue to grow, as it adopts a 'growth-by-acquisition' strategy. It has a healthy balance sheet, which puts it in a position to adopt such a strategy. Its revenue streams are fairly secure, with fixed electricity prices, and agreements with power bureaus to purchase a minimum amount of electricity each year. With a P/E less than five, a P/NTA less than one, and a tax-exempt dividend yield of 6.5%, this counter is attractive. The only note of caution is its lack of trading volume. We call a BUY.

Group Structure

Asia Power Corporation Limited, the investment holding company, owns the following:

- (i) 51% of Heilongjiang Asiapower Xinbao heating & Power Co. Ltd ('Xinbao'): a 225MW co-generation (electricity and heat) coal plant serving Qiqihar City.
- (ii) 100% of Asia Power (Neijiang) Hydroelectricity Co. Ltd: a 13.5MW hydroelectric plant in Neijiang.
- (iii) 25% of Changzhou Changya Electric Power Co, Ltd: a 51 MW peaking diesel plant in Changzhou, and a similar 48 MW in Yangzhou, selling electricity at peak periods, and less or no electricity in the off-peak periods.
- (iv) 61% of Asia Technologies Limited, which in turn owns 52% of Shenzhen NARI Technologies Co. Ltd: Hi-tech company specialising in the design, manufacture and

assembly of computerised automation systems for the regulation of electricity flow and the protection of power grids. Asia Power's stake was acquired for US\$5.5 million in the past year. Remarkably, this business has already returned S\$5.5 million in earnings to Asia Power in FY01.

Competitive Strengths

Strengths of specific plants

- (i) Xinbao (coal-powered plant)
 - As a co-generation plant of both electricity and heat/steam, Xinbao achieves higher production efficiency by drawing in extra revenue by providing heat and steam with minimal additional amount of coal. There is a continuous demand for heat because of the long harsh winters, lasting as long as six months, experienced in Heilongjiang Province, which is the northern most province in PRC.
 - Not only does Xinbao meet environmental standards, the government actually promotes its operations because its co-generation function is environmentally a better alternative to individual homes heating up their own homes with stoves.
- (ii) Neijiang (hydroelectric plant)
 - Low cost base as water is its raw material
 - Non-pollutive
 - Hydro power projects given priority by PRC's Ninth and Tenth Five-Year Plans.
 - Additional higher-margin revenue obtained by selling directly to end-user.
- (iii) Changya (peaking light diesel plant)
 - Receives revenue even if electricity not produced
 - As a peaking power plant, it receives higher tariffs for electricity supply during peak periods than those provided by base-load plants.
 - As a combined cycle power plant, where heat produced from gas turbine is channeled to drive additional steam turbine, higher production efficiency is achieved



- Use of light diesel oil less pollutive than regular diesel.

Geographical and fuel mix diversification

- Asia Power's three plants are located in three different provinces, reducing the impact of possible adverse changes to local economics conditions or, climate conditions, or power demand.
- The location of the three different plants is also strategic—close to raw material supply sources and end users—so as to reduce transportation and transmission costs. Xinbao is close to coal mines in the Heilongjiang Province and Inner Mongolia Autonomous Region, and close to its endusers in the industrial city of Qihar. Neijiang is located on the Tuojiang River from which it draws its water sources, and is also located in Neijiang City. Changya is well located within an industrial park within Changzhou City which is efficiently served by transportation infrastructure.
- The utilization of three different raw materials—coal, diesel, and water—will mitigate any negative impact of adverse changes in the market or regulated prices of a particular fuel type.

Good relationship with local authorities

The fuel efficiency of co-generation and combined cycle nature of Asia Power's plants has earned support of the government. Furthermore, support of the provincial and local authorities is evident in the equity stake that the employees of these authorities have in the Xinbao and Changya operations. In the case of Xinbao, 49% is held by Qihar Xinbao, whose substantial shareholders include Haufu, a company owned in majority by employees of the local power bureau, Heilongjiang Electric Power Corp. Changya is 52% owned by Changgong, a subsidiary of the local power bureau. Such links are vital in the business and legal landscape like that of PRC's.

Outlook and Prospects

Growth Prospects

Energy use is tied closely to economic activity. With China's GDP projected to grow at an annual 7-8%, the energy needs of China is also expected to grow. In the

Ninth (1996-2000) and Tenth (2001-2005) Five-year plans, hydroelectricity and larger-scaled coal plants are promoted.

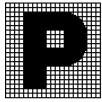
Its power-related technology arm, SNARI, is expected to grow even more impressively. Currently contributing to over 20% of net earnings, that figure is expected to grow to around 50% in three years. More R&D will be invested to improve the technologies and also bring in foreign designs to its systems.

Deregulation of China power industry

China's state power sector is preparing for deregulation. China's monopoly, State Power Corp. is preparing to sever its regulatory role and sell of its power generators. The goals of deregulation are to (1) completely separate power generation from power transmission and distribution; (2) to implement a market driven electricity pricing mechanism through the establishment of seven regional pools to cater to the nation's energy needs; and (3) to invest in high-voltage, large scale power grids, thus enabling the transmission of electricity from west to east. The net effect is that while power generation and retail distribution is currently controlled by the state-owned bureaus, they will be opened up to private companies, thereby increasing competition.

Asia Power stands to benefit from the deregulation. First, the sale of state-owned generation companies at discounted prices will offer Asia Power acquisition opportunities in line with its expansion goals. Second, the state's effort to improve transmission and distribution will mean more parts of China will gain access to electricity, thereby increasing demand, and perhaps restore some balance to the energy demand-supply equilibrium.

The timeline for deregulation, however, remains unclear. It is only this year that much opposition to power industry deregulation has died down after years of discussion. Still, the fiasco in Californian energy deregulation has called for a more cautious approach, and it is unclear how long more, perhaps as long as a few years, it will take to iron out the details to implement these policy shifts.



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