"Honey & Ash"
Hong Kong Email Alert

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CITICS 中信証券國際 CITIC Securities International

China Power Generation Sector (NEUTRAL): Stabilizing earnings for thermal, and short-term re-rating for hydro as the Mainland moves from the dry to the high-water period

Event:

Listed power generation companies have all announced their 1H10 results. For the Mainland power generation sector as a whole, net profit (excl. non-recurring gains and losses) increased 20.8% YoY in 1H10 (thermal: +16.3% YoY; hydropower: +24.9% YoY) and 16.3% YoY in 2Q10. Net profit of hydropower generation surged 87.7% QoQ on increased seasonal earnings, while thermal power declined 6.5% YoY (+3.7% QoQ) due to rising coal prices. By region, thermal power plants in coastal areas fared better, while those in other areas continued to be weak. 3Q10E data appears less than satisfactory on a YoY basis based on pre-announcements of some companies, but will likely continue to rise QoQ.

Comment:

❖ Stabilizing thermal profit and seasonal surge of hydropower profit. In 1H10, the Mainland power generation sector posted net profit (excl. non-recurring gains and losses) of Rmb7.92bn (+20.8% YoY), including thermal profit of Rmb5.52bn (+16.3% YoY). After restructuring of major assets in Sep 10, Yangtze Power's hydropower generation posted net profit of Rmb2.06bn (+24.9% YoY), and its power grid booked net profit of Rmb340m (+107.4% YoY) driven by the resumption of demand. In 2Q10, the power generation sector logged net profit of Rmb5.16bn (+16.3% YoY). In particular, earnings growth rates for the three sub-sectors were: (i) thermal: -6.5% YoY; (ii) hydropower: +62.1% YoY; and (iii) power grid: +79.2% YoY. From a trend perspective, sector earnings rebounded after falling to a low level in 4Q09. Thermal earnings remained relatively stable (+3.7% QoQ). Hydropower earnings surged 87.7% QoQ due to seasonal factors, while power grid shot up 451.5% QoQ due to rebounding demand and higher self-sufficiency.

❖ Returning demand helped offset coal price hikes, with thermal earnings rising 6.5% YoY and 3.7% QoQ. Excluding non-recurring gains and losses, the thermal sub-sector recorded 2Q10 net profit of Rmb2.81bn (-6.5% YoY). Although the sub-sector's 2Q10 revenue surged 38.6% YoY on rebounding demand, a 2.4ppt decline in gross margin resulted in weaker profitability. 2Q10 revenue rose 3.8% QoQ. Given the slight fluctuation of coal prices during the period, gross margin was 12.4% (basically flat vs. 1Q10). Excluding non-recurring gains and losses, 2Q10 net profit rose 3.7% QoQ.

❖ Coastal thermal plants posted better results than their inland peers. In 2Q10, gross margin rose in about half of the Mainland provinces and declined in the rest. Xinjiang, Zhejiang, Inner Mongolia, Beijing, Liaoning and Guangdong saw relatively higher gross margins, while Tianjin, Hunan, Anhui, Hubei and Shanxi recorded negative gross profits. EPS changes were broadly in line with the rising and declining trends of gross margins. Based on absolute EPS value, Inner Mongolia, Beijing, Guangdong and Zhejiang ranked at the forefront with relatively higher gross margin, while Tianjin, Shanxi, Jilin, Heilongjiang, Shandong, Hunan, Liaoning and Hebei suffered losses on the whole.

❖ 3Q10E outlook: Weak YoY growth and rebounding QoQ growth. Pre-announcements of 3Q10E results by some listed power producers (2 hydro and 1 thermal expecting higher earnings; 2 forecasting a turnaround; 1 warning of decrease; and 7 looking for continued losses) depicted not-so-bright prospects for the industry. According to these pre-announcements, most companies will see some QoQ improvement in 3Q10E. However, it should be noted that 2Q10 earnings had been quite low for most companies, resulting in a stronger QoQ rebound than the industry average. By segment, thermal earnings will likely continue to rise QoQ as the number of utilization hours is expected to remain unchanged in 3Q10E (subject to local governments' efforts in restricting intensive-energy consumption) and the recent downtrend in coal prices. Hydropower will see a substantial QoQ earnings rebound due to seasonal factors as China transitions from the dry to high-water period.

- NEUTRAL rating remains with focus on individual shares. We continue to rate the sector NEUTRAL, as it is difficult to see what a reasonable earnings level is given the excessive reliance of sector profitability on coal prices and electricity tariff adjustment (both in terms of timing and magnitude of adjustment). Under the current market environment, we suggest focusing on:
  - The short-term re-rating of hydropower generation brought about when moving from the dry to the high-water period, such as Yangtze Power and Guiguan Electric Power;
  - For thermal power plays, focus on Shenzhen Energy, Inner Mongolia MengDian HuaNeng, Guodian Power and Jingneng Thermal Power, given undemanding valuations, high growth and financing. In Hong Kong, we favor Huaneng Power (00902.HK).

Peers' comparisons – China Power Generation Industry

	Price	PER (x)			PEG (x)	P/B (x)	Yield (%)	RoE (%)
Company	**(HK$)**	**09**	**10E**	**11E**	**09-11E**	**10E**	**10E**	**10E**
Hong Kong - average		***13***	***16***	***12***	***1.2***	***1.1***	***2.7***	***7***
CR Power (00836.HK)	17.08	14	14	12	1.5	1.9	2.3	14
Huaneng Power (00902.HK)	4.68	10	12	12	NA	1.1	4.3	9
Datang Int'l (00991.HK)	3.20	20	18	13	0.9	1.1	2.8	7
China Power (02380.HK)	1.66	10	14	11	NA	0.6	2.7	4
Huadian Power (01071.HK)	1.85	9	21	13	NA	0.7	1.5	3

Source: Respective companies, Bloomberg, CSI

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Investment rating system

Performance of stock or sector relative to MSCI-China Index over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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