

Power Assets Holdings Ltd

Plans to buy CKI debt indicate limited M&A opportunities. Downgrade to Neutral

Power Assets' plans to use 20% of its cash to buy CKI bonds is an indication management sees limited acquisition opportunities in the near term, in our view. This may also lower the chance for the issuance of a special DPS. We are downgrading PAH to Neutral as we believe purchasing CKI bonds is not the best use of its cash. CKI remains our top pick within HK utilities given the broader range of assets it can acquire.

- **Plans to use 20% of cash to buy CKI debt.** PAH has entered into an agreement with CKI to purchase the latter's bonds using up to 20% of its cash (HK\$12B). PAH said it saw this as a way for the company to get a better return on its cash. As this is a related party transaction, shareholders (ex CKI) will have to approve this during the May AGM.
- **M&A opportunities may be limited.** We believe this decision is an indication there may be few M&A opportunities for PAH in the near term. The privatization of New South Wales power grid could be a potential target, but this is still pending the outcome of the NSW election on 28 Mar. Unlike CKI, which can invest in anything infrastructure related, PAH is only limited to investing in power and gas related assets.
- **Restructuring likely off the table. Asset injection more likely.** We believe the market has been speculating on a potential restructuring or merger between PAH and CKI as a way for CKI to tap into PAH's rich cash balance. Given this move, we believe that is unlikely to happen now. However, we believe CKI may consider injecting some of its power and gas utilities into PAH in exchange for cash.
- **Downgrade to Neutral with PT of HK\$79.** PAH shares will likely react negatively in the near term to the company's decision to purchase CKI's bonds, in our view. We have lowered PAH's PT to HK\$79 after rolling over the PT to Jun-16. Our top pick in HK utilities is still CKI.

Power Assets Holdings Ltd (Reuters: 0006.HK, Bloomberg: 6 HK)

HK\$ in mn, year-end Dec	FY12A	FY13A	FY14A	FY15E	FY16E
Revenue (HK\$ mn)	10,416	11,578	2,131	1,478	1,508
Net Profit (HK\$ mn)	9,730	11,165	61,005	8,521	8,967
EPS (HK\$)	4.56	5.23	28.58	3.99	4.20
DPS (HK\$)	2.45	2.55	2.68	2.73	2.79
Revenue growth (%)	2.1%	11.2%	(81.6%)	(30.6%)	2.0%
EPS growth (%)	7.2%	14.7%	446.4%	(86.0%)	5.2%
ROCE	7.0%	6.3%	1.5%	1.2%	1.3%
ROE	16.1%	16.9%	63.4%	6.9%	7.1%
P/E (x)	16.4	14.3	2.6	18.8	17.8
P/BV (x)	2.5	2.3	1.3	1.3	1.3
EV/EBITDA (x)	21.3	21.7	60.7	69.5	65.6
Dividend Yield	3.3%	3.4%	3.6%	3.6%	3.7%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Neutral

Previous: Overweight

0006.HK, 6 HK

Price: HK\$74.95

Price Target: HK\$79.00

Previous: HK\$82.00

Hong Kong

Utilities

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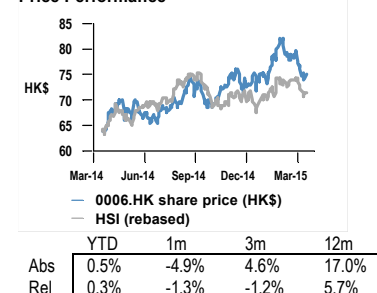
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J.P. Morgan Securities (Asia Pacific) Limited

Price Performance



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Key catalysts for the stock price: <ul style="list-style-type: none"> • New acquisitions of overseas utilities assets • Higher-than-expected regulatory resets from the UK • Lower funding costs/ interest rates 	Upside risks to our view: <ul style="list-style-type: none"> • Better-than-expected earnings growth from overseas business • Lower-than-expected funding costs • Weakening USD/HKD 	Downside risks to our view: <ul style="list-style-type: none"> • Lower-than-expected tariff hikes in HK • Strengthening USD/HKD • Higher borrowing costs • Slower inflation growth in UK and Australia
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Key financial metrics	FY13	FY14	FY15E	FY16E
Revenues (HK\$MM)	11,578	2,131	1,478	1,508
Revenue growth (%)	11.2%	-81.6%	NA	NA
EBITDA (HK\$MM)	8,038	1,794	1,539	1,596
EBITDA margin (%)	69.4%	NA	NA	NA
Tax rate (%)	7%	0%	0%	0%
Net profit (HK\$MM)	11,165	61,005	8,521	8,967
EPS (HK\$)	5.23	28.58	3.99	4.20
EPS growth (%)	14.7%	446.4%	-86.0%	5.2%
DPS (HK\$)	2.55	2.68	2.73	2.79
BVPS (HK\$)	32.53	57.67	58.58	59.61
Operating cash flow (HK\$MM)	9,619	(4,390)	1,324	1,569
Free cash flow (HK\$MM)	7,685	(4,566)	1,324	1,569
Interest cover (x)	13	-4	-2	-2
Net margin (%)	96.4%	NA	NA	NA
Sales/assets (X)	0.11	0.02	0.01	0.01
Debt/equity (%)	32.2%	8.3%	0.5%	0.4%
Net debt/equity (%)	20.8%	-41.5%	-42.4%	-43.4%
ROE (%)	17%	63%	7%	7%
Key model assumptions	FY13	FY14	FY15E	FY16E
Interest cost	2.8%	1.9%	2.0%	2.5%
HKEI net profit (HK\$MM)	5,180	3,038	3,078	3,180

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EBITDA		EPS	
Sensitivity to	FY15E	FY16E	FY15E	FY15E
100bps chg in interest cost	6.1%	6.1%	6.2%	6.2%
10% chg in GBP/HKD	5.8%	5.8%	5.9%	5.8%

Source: J.P. Morgan estimates.

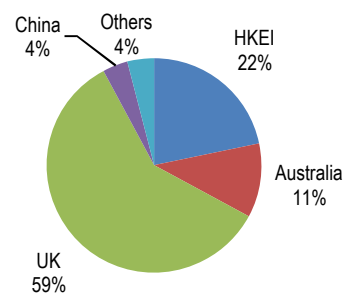
Comparative metrics		Mkt Cap \$Mn	P/E (x)		Net gearing (%)		Yield (%)		P/B (x)		ROE (%)	
Ticker			FY14E	FY15E	FY14E	FY15E	FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
CKI	1038 HK	20,868	15.6	14.9	16	16	2.9	3.1	1.8	1.7	12.6	11.8
PAH	6 HK	20,508	19.8	18.8	(41)	(42)	3.6	3.6	1.3	1.3	8.4	6.9
HKEI	2638 HK	5,879	15.1	14.9	94	94	7.0	7.6	1.0	1.0	10.1	6.4
CLP	2 HK	21,232	16.1	15.2	67	62	4.0	4.1	1.8	1.8	11.6	11.8
HKCG	3 HK	23,315	22.3	21.7	41	36	2.2	2.3	3.3	3.4	14.3	14.8
Average		18,360	17.8	17.1	35	33	18.6	4.1	1.8	1.8	11.4	10.3

Source: Bloomberg, J.P. Morgan estimates. Prices are as of last trading day.

Valuation and price target basis

Our Jun-16 PT is determined based on SOP valuation methodology, using DCF to value each segment. Our PT implies 20x FY15E P/E and 3.4% yield.

FY14 earnings breakdown



Source: Company.

JPMe vs. consensus, change in estimates

Recurring EPS (LC)	FY15E	FY16E
JPMe old	4.23	4.34
JPMe new	3.99	4.20
% chg	-6%	-3%
Consensus	4.20	4.11

Source: Bloomberg, J.P. Morgan estimates.

Downgrade to Neutral

We are downgrading Power Assets (6HK) from OW to Neutral because:

- 1) The company has announced plans to use 20% of its cash (HK\$12B) to acquire its parent company's (Cheung Kong Infrastructure) bonds. Our previous OW rating was based on the thesis that PAH would use its large cash pile (HK\$61B) for acquisitions. Management's decision to use the cash to buy its parent's debt is an indication that they don't think there will be enough M&A opportunities to use all the cash, in our view. This may also lower the possibility of the company issuing a special DPS, in our view.
- 2) We believe management's decision to acquire CKI's debt also shows that there is limited chance for CKI and Power Assets to enter into a potential restructuring, which we think is what the market has started to price in for both companies. Rather than doing a restructuring or merger, we believe Power Assets may consider purchasing CKI's gas or power projects in the future as another way for it to use its cash.
- 3) The stock has risen by 7% the past six months (vs HS Index's 0%) and is now trading close to our revised PT of HK\$79.

Revised PT of HK\$79

We have lowered PAH's PT from HK\$82 to HK\$79 after factoring in 3-6% lowered EPS estimates for 2015-16E and rolling over our PT to Jun 2016. Our revised PT implies 21x 2015 P/E, 3.4% yield and a 5% upside to last closing price.

Table 1: Power Assets sum-of-the-parts valuation

Segment	Discount rate	Terminal growth rate/ exit multiple	Valuation methodology	Valuation (HK\$mn)	NAV per share (HK\$)	% of total
HKEI			Based on JPM PT HK\$6.4	28,428	13.3	16.8%
Australia	8.9%	8x EBITDA	DCF	18,275	8.6	10.8%
UK	8.4%	8x EBITDA	DCF	62,927	29.5	37.2%
China	10.0%	6x EBITDA	DCF	2,530	1.2	1.5%
Others (Thailand, New Zealand, Canada, Netherlands)	10.5%	8x EBITDA	DCF	2,932	1.4	1.7%
Net debt				54,124	25.4	32.0%
Total				169,217	79.3	100.0%

Source: J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Power Assets Holdings Ltd (Neutral; Price Target: HK\$79.00)

Investment Thesis

Power Assets Holdings is the parent company of HK Electric Investments, which is one of two integrated power suppliers in Hong Kong with an installed capacity of 3,736MW. Outside of HK, the group owns electricity/gas generation and distribution assets in Australia, the UK, Canada, New Zealand, Thailand and China. PAH is 38.87% owned by Cheung Kong Infrastructure.

Valuation

Our Jun-16 PT is determined based on a sum-of-the-parts valuation methodology (rounded down), using DCF to value each segment. Our PT implies 20x FY15E P/E and 3.4% yield.

Segment	NAV per share (HK\$)	% of total
HKEI	13.3	16.8%
Australia	8.6	10.8%
UK	29.5	37.2%
China	1.2	1.5%
Others (Thailand, New Zealand, Canada, Netherlands)	1.4	1.7%
Net debt	25.4	32.0%
Total	79.3	100.0%

Source: J.P. Morgan estimates

Risks to Rating and Price Target

Downside risks: 1) lower-than-expected tariff hikes in HK, which could result in less earnings and smaller cash flow from this segment, 2) strengthening USD/HKD, which would lower earnings from overseas segments, 3) slower inflation growth in the UK and Australia, which would result in lower revenue for the regulated utilities assets in those countries.

Upside risks: 1) better-than-expected acquisition opportunities, 2) weaker-than-expected USD/HKD, 3) stronger overseas earnings

Power Assets Holdings Ltd: Summary of Financials

Income Statement						Cash flow statement					
HK\$ in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E	HK\$ in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E
Revenues	11,578	2,131	1,478	1,508	1,538	Pre-tax profit	11,591	8,170	8,533	8,979	9,217
% change Y/Y	11.2%	(81.6%)	(30.6%)	2.0%	2.0%	Depr. & amortization	1,981	151	0	0	0
EBITDA	8,038	1,794	1,539	1,596	1,639	Change in working capital	1,554	556	1	1	1
% change Y/Y	(4.3%)	(77.7%)	(14.2%)	3.7%	2.7%	Taxes	(897)	(6,306)	(12)	(13)	(13)
EBIT	6,057	1,643	1,539	1,596	1,639	Others	(4,610)	(6,961)	(7,198)	(7,399)	(7,591)
% change Y/Y	(6.5%)	(72.9%)	(6.3%)	3.7%	2.7%	Cash flow from operations	9,619	(4,390)	1,324	1,569	1,615
EBIT Margin	52.3%	77.1%	104.1%	105.9%	106.6%	Capex	(1,934)	(176)	0	0	0
Net Interest	(603)	464	665	894	924	Disposal/(purchase)	-	-	-	-	-
Associates	6,226	6,961	7,198	7,399	7,591	Free cash flow	7,685	(4,566)	1,324	1,569	1,615
Other Income	(89)	(898)	(869)	(910)	(936)	Other	(35)	29,681	6,446	6,586	6,720
Earnings before tax	11,591	8,170	8,533	8,979	9,217	Cash flow from investing	(1,969)	29,505	6,446	6,586	6,720
% change Y/Y	10.5%	(29.5%)	4.4%	5.2%	2.7%	Cash flow from financing	(6,412)	29,527	(15,395)	(6,082)	(6,206)
Tax	(814)	(13)	(12)	(13)	(13)	Beginning cash	5,385	6,650	61,291	53,666	55,739
as % of EBT	7.0%	0.2%	0.1%	0.1%	0.1%	Ending cash	9,250	61,291	53,666	55,739	57,868
Exceptional items	-	52,928	-	-	-	DPS	2.55	2.68	2.73	2.79	2.84
Net income (reported)	11,165	61,005	8,521	8,967	9,204						
% change Y/Y	14.7%	446.4%	(86.0%)	5.2%	2.7%						
Shares outstanding	2,134	2,134	2,134	2,134	2,134						
EPS (reported)	5.23	28.58	3.99	4.20	4.31						
% change Y/Y	14.7%	446.4%	(86.0%)	5.2%	2.7%						
Balance sheet						Ratio Analysis					
HK\$ in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E	HK\$ in millions, year end Dec	FY13	FY14	FY15E	FY16E	FY17E
Cash and cash equivalents	7,894	61,291	53,666	55,739	57,868	EBITDA margin	69.4%	84.2%	104.1%	105.9%	106.6%
Accounts receivable	1,651	810	810	810	810	Net profit margin	96.4%	2862.7%	576.5%	594.8%	598.6%
Inventories	948	0	0	0	0						
Others	1	0	0	0	0						
Current assets	10,494	62,101	54,476	56,549	58,678	Sales per share growth	11.2%	(81.6%)	(30.6%)	2.0%	2.0%
						Sales growth	11.2%	(81.6%)	(30.6%)	2.0%	2.0%
LT investments	44,611	74,066	74,066	74,066	74,066	Net profit growth	14.7%	446.4%	(86.0%)	5.2%	2.7%
Net fixed assets	49,122	32	32	32	32	EPS growth	14.7%	446.4%	(86.0%)	5.2%	2.7%
Others	1,010	75	75	75	75	Interest coverage (x)	13.3	NM	NM	NM	NM
Total Assets	105,237	136,274	128,649	130,722	132,851	Net debt to equity	20.8%	(41.5%)	(42.4%)	(43.4%)	(44.4%)
Liabilities						Sales/assets	0.1	0.0	0.0	0.0	0.0
Short-term loans	500	0	643	512	377	Assets/equity	1.6	1.3	1.1	1.0	1.0
Payables	4,109	2,698	2,698	2,698	2,698	ROE	16.9%	63.4%	6.9%	7.1%	7.2%
Others	343	2	2	2	2	ROCE	6.3%	1.5%	1.2%	1.3%	1.3%
Total current liabilities	4,952	2,700	3,343	3,212	3,077	ROA	10.8%	50.5%	6.4%	6.9%	7.0%
Long-term debt	21,845	10,204	0	0	0						
Other liabilities	9,002	282	283	284	286						
Total Liabilities	35,799	13,186	3,627	3,497	3,362						
Shareholder's equity	69,438	123,088	125,022	127,225	129,488						
BVPS	32.53	57.67	58.58	59.61	60.67						

Source: Company reports and J.P. Morgan estimates.

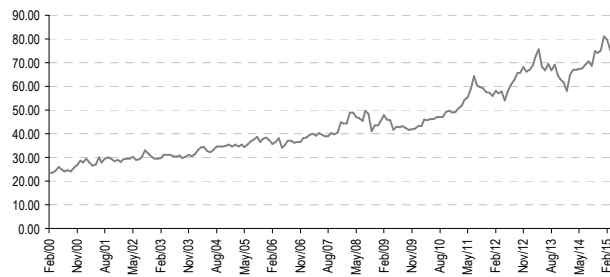
JPM Q-Profile

Power Assets Holdings Limited (HONG KONG / Utilities)

As Of: 13-Mar-2015

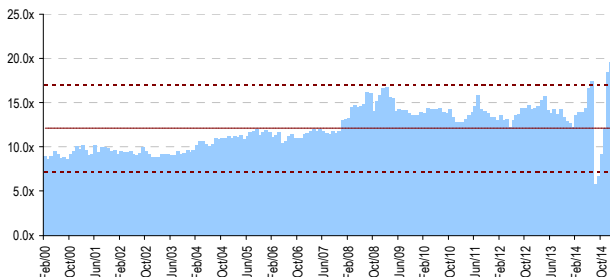
Local Share Price

Current: 75.30



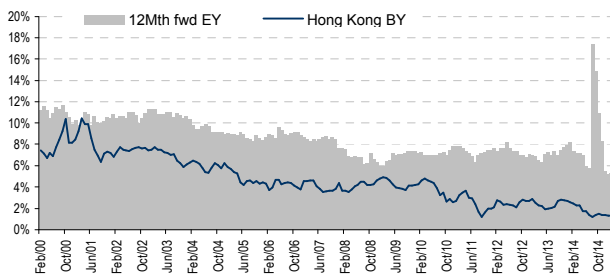
PE (1Yr Forward)

Current: 17.9x



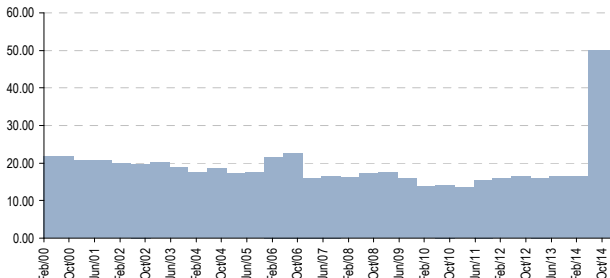
Earnings Yield (& Local Bond Yield)

Current: 6%



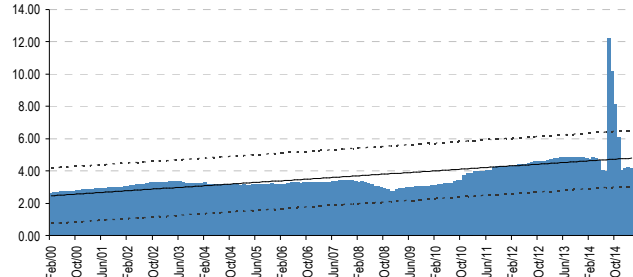
ROE (Trailing)

Current: 63.46



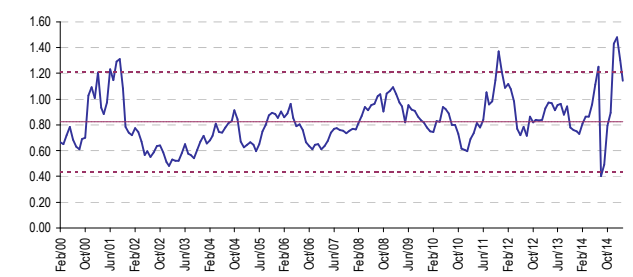
12 Mth Forward EPS

Current: 4.20



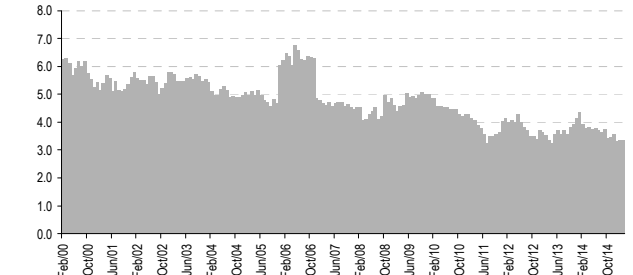
P/E Relative to Hong Kong Index

Current: 1.14



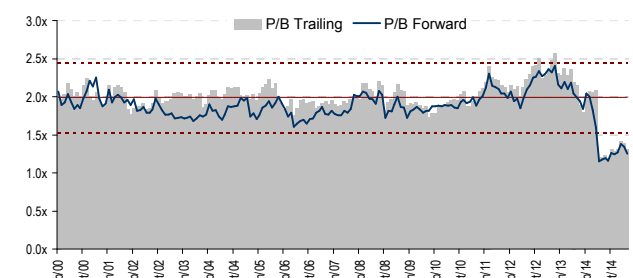
Dividend Yield (Trailing)

Current: 3.36



Price/Book (Value)

Current: 1.3x



Summary

Power Assets Holdings Limited
HONG KONG
Utilities

TICKER 6 HK

As Of: 13-Mar-15
Local Price: 75.30
EPS: 4.20

	Latest	Min	Max	Median	Average	2 S.D. +	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	17.91x	5.76	19.52	11.80	12.13	17.05	7.22	-68%	9%	-34%	-32%
P/BV (Trailing)	1.31	1.18	2.57	1.99	1.99	2.45	1.53	-10%	97%	53%	52%
Dividend Yield (Trailing)	3.36x	3.23	6.77	4.81	4.78	6.48	3.08	-4%	102%	43%	42%
ROE (Trailing)	63.46	13.40	63.46	17.48	19.56	35.78	3.34	-79%	0%	-72%	-69%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

Other Companies Discussed in This Report (all prices in this report as of market close on 17 March 2015)
Cheung Kong Infrastructure (1038.HK/HK\$64.60/Overweight)

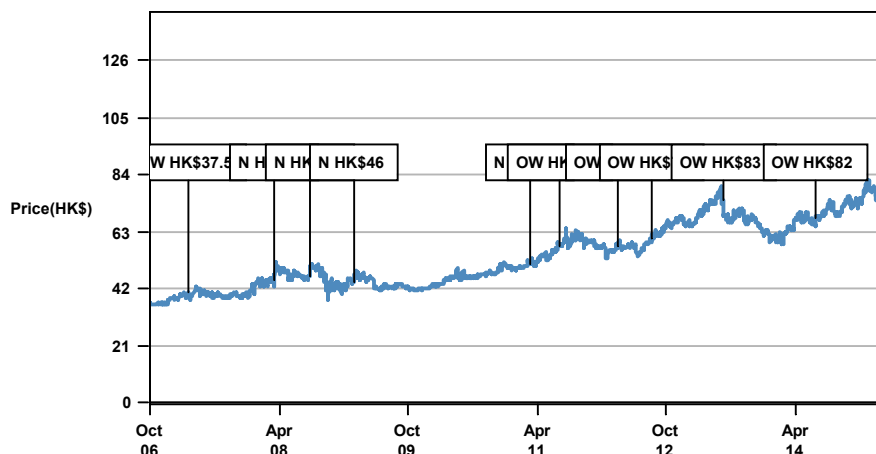
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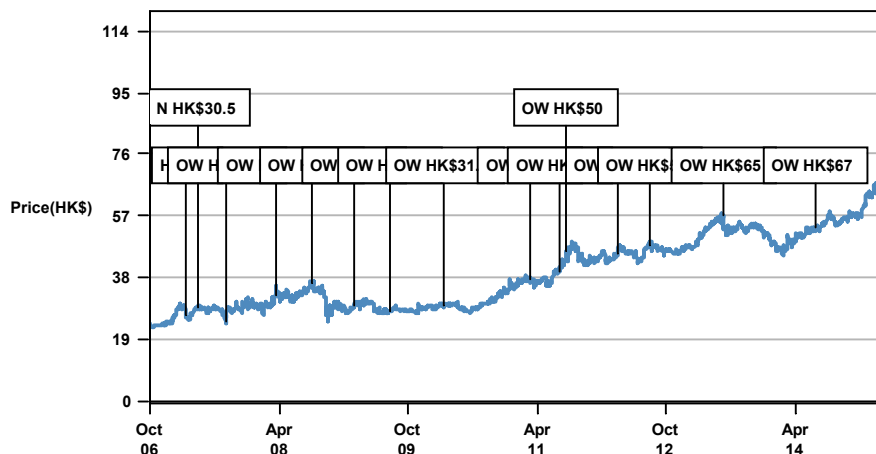
Power Assets Holdings Ltd (0006.HK, 6 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
08-Mar-07	UW	40.30	37.50
06-Mar-08	N	44.80	46.00
06-Aug-08	N	46.45	48.00
12-Feb-09	N	44.20	46.00
03-Mar-11	N	51.10	54.00
07-Jul-11	OW	57.90	65.00
09-Mar-12	OW	57.45	69.00
25-Jul-12	OW	60.20	70.00
29-May-13	OW	74.75	83.00
27-Jun-14	OW	67.95	82.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Mar 08, 2007.

Cheung Kong Infrastructure (1038.HK, 1038 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
19-Apr-07	N	28.80	30.50
16-Aug-07	OW	24.90	28.50
17-Mar-08	OW	32.40	34.30
14-Aug-08	OW	36.25	37.00
12-Feb-09	OW	29.75	32.00
17-Jul-09	OW	27.80	31.00
04-Mar-10	OW	29.35	31.50
03-Mar-11	OW	37.50	42.00
07-Jul-11	OW	39.70	48.00
03-Aug-11	OW	46.15	50.00
09-Mar-12	OW	45.55	54.00
19-Jul-12	OW	47.80	56.00
29-May-13	OW	57.15	65.00
27-Jun-14	OW	53.25	67.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Apr 19, 2007.

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