

HONGKONG ELECTRIC HOLDINGS LIMITED (香港電燈)

Sector	: Utilities	Chairman	: Mr. Canning Fok Kin-ning
HKSE Code	: 00006	Group Managing Director	: Mr. Tso Kai-sum
Market Price	: HK\$46.45 (05/08/2008)		
Shares Issued	: 2,134.26m		
Mkt. Cap.	: HK\$99,136.5m		
52 weeks Hi/ Lo	: HK\$52.50 / HK\$37.45		
HSI	: 21,949.75 (05/08/2008)		
Main Business	: Electricity generation		

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2008
Interim Results Highlights

	1H2008	1H2007	Change
	HK\$ million	HK\$ million	
• Turnover	5,878	5,841	+0.6%
• Operating profit	3,596	3,602	-0.2%
• Share of results of associates	294	202	+45.5%
• Profit attributable to shareholders	3,171	2,689	+17.9%
• EPS	1.49	1.26	+18.3%
• Interim DPS	0.62	0.58	+6.9%

- Hongkong Electric ("HKE") reported a 17.9% y-o-y increase in net profit to HK\$3,171m for 1H07, attributable to the one-off HK\$310m deferred tax adjustment gain arising from the change in the Hong Kong profits tax rate from 17.5% to 16.5% and a HK\$109m or 35% y-o-y increase in overseas profit.
- As of 30 June 2008, net debt increased to HK\$1,600m (31 Dec 2007: HK\$1,315m) while cash & cash equivalents rose to HK\$12,790m (31 Dec 2007: HK\$12,180m). Net debt-to-equity ratio was 3.3% as of 30 June 2008, up from 2.7% at the end of 2007.
- EPS was HK\$1.49 and HKE declared an interim DPS of HK\$0.62, a growth of 6.9% when compared to HK\$0.58 in 1H07. Dividend payout ratio rose to 46%, up from 42% in 1H07, driven by the one-off deferred tax gain.

Business Review

- Net profit breakdown by geographical segments:

	1H2008		1H2007		Change
	HK\$	%	HK\$	%	%
Hong Kong	2,747	86.6%	2,374	88.3%	+15.7%
Overseas	424	13.4%	315	11.7%	+34.6%
Total	3,171	100.0%	2,689	100.0%	+17.9%

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- **Hong Kong operations** reported a modest 1H08 turnover growth of 0.6%, to HK\$5,878m. The meagre increase in turnover was due to a 5.9% approved tariff hike effective January 2008, which was offset by a 1.7% decline in demand growth. The decline in demand was mainly due to the cooler and wetter weather in Hong Kong in the beginning of the year, as well as the energy saving consciousness of the customers. Thanks to the reduction in the corporate tax rate that led to a one-off HK\$310m adjustment gain, net profit from HK increased 15.7% y-o-y to HK\$2,747m in 1H08.
- Net profit from **overseas operations** was up HK\$109m or 35% y-o-y to HK\$424m, as a combined result of: (1) first-time contributions from Wellington Power network (New Zealand, from Jun 2008); (2) TransAlta Power (Canada, from Dec 2007); (3) Ratchaburi Power (Thailand, from Mar 2008) and (4) translation gains on Australian income.

Outlook & Prospect

- **Heavily reliant on SOC return** The new Scheme of Control (SOC) between the Hong Kong government and the two utility companies was renegotiated in January this year, and the power companies will be subject to a 9.99% return on average net fixed assets. Compared with CLP, HKE is more heavily reliant on the local SOC return given its smaller overseas exposure. With the new SOC becoming effective on 1st January, 2009, such negative impact would become more apparent starting from FY09.
- **Capex plan under review** HKE's capex of HK\$714m in 1H08 was lower than the same period depreciation expense of HK\$985m, which drove down its net fixed asset balance. Under the SOC, SOC earnings of HKE would be determined by its net fixed asset balance. HKE disclosed that it has submitted its capex plan to the government in June 08 for the five-year period starting from 2009. The possible approval of the plan should help enlarge HKE's future net fixed asset and so the local SOC earnings.
- **Overseas expansion remains a key driver of earnings growth** Overseas earnings of HKE contributed 13.4% of total net profit in 1H08. Although management has not set a specific target for the earnings contribution by overseas investments, we believe the proportion could expand to 20%-30% in the next few years, in line with the overseas contribution at CLP Holdings. Unlike CLP that expands its businesses in emerging markets such as China, India and Southeast Asia, HKE prefers to focus on developed markets with well-established regulatory frameworks such as the UK, Australia, New Zealand and Canada. With a cash balance of HK\$12.7bn as of June 2008 and just 3% debt-to-equity ratio, HKE is well positioned to pursue aggressive acquisitions overseas to drive growth, given the low growth and lower returns in the saturated domestic market.
- **Attractive yield but limited upside** At HK\$46.45, HKE trades at 12.93x FY08E P/E, 1.94x FY08E P/B and. The valuation multiples look demanding amid the current turbulent market and we see no near term catalysts likely to deliver absolute stock price out-performance from current levels due to the absence of sizable overseas expansions in near term. However, we highlight the defensive nature of HKE as it offers a decent 4.42% FY08E dividend yield. Thus, we maintain our "Hold for Yield" call.

Recommendation: *Hold for Yield*



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