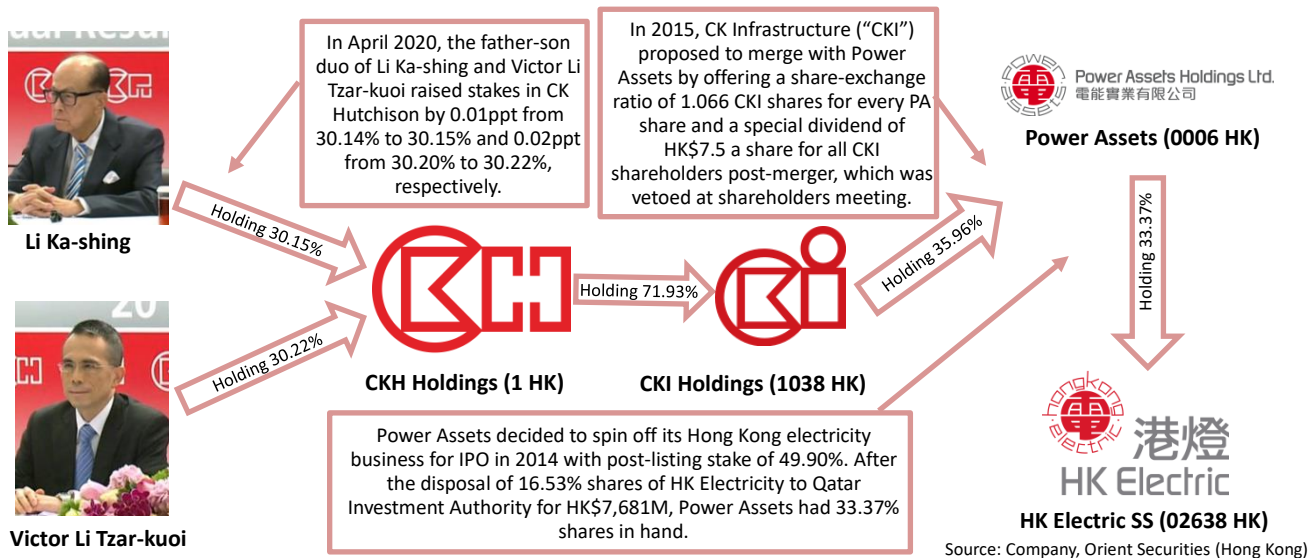


Market Wrap

HSI ▼0.64%		HSCEI ▼0.46%		Turnover HK\$103.88 bn ▼25% (30-day average)		SSE Composite ▼0.61%		SZSE Component ▼0.92%	
Sector tracking				Stock tracking					
1D	▲%	1Y	▲%	1D	▲%	1Q	▲%		
Gold	4.5	Airport	327.7	UNITAS HOLDINGS(8020)	30.6	YTO EXPRESS HOLD(6123)	387.1		
Airport	2.1	Equip	140.1	CHU KONG PETROLE(1938)	30.2	IN TECHNICAL PRO(8446)	301.4		
Machinery	0.8	Parts	127.0	ORIENTAL UNIVERS(8067)	21.2	HAINAN MEILAN IN(357)	247.4		
Printing	0.7	Household Prod	111.6	COURAGE INVESTME(1145)	18.9	WWPKG HOLDINGS C(8069)	202.4		
Logistics	0.7	Gold	78.1	GOLDEN FAITH GRO(2863)	14.3	HEBEI CONSTRUC-H(1727)	197.6		

Market Highlight
Hong Kong Utilities Series II: Power Assets (0006 HK)
Shareholding Structure

Results in 1H20

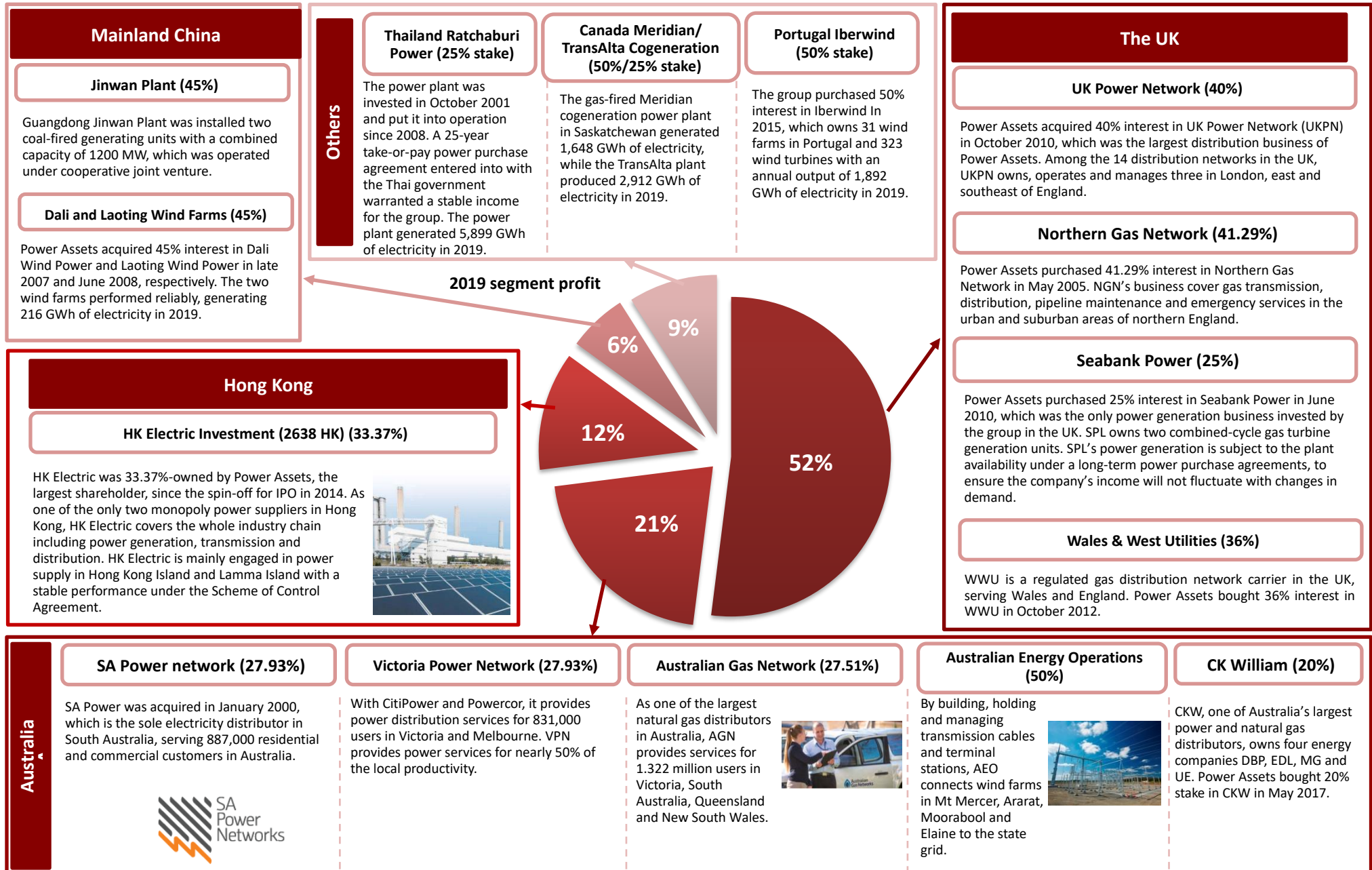
In 1H20, the group suffered a stinging decline in profit, while the UK region recorded a profit of HK\$842M, down by 53.86% over HK\$1.825B of earnings in 1H19. The decline in profit was mainly due to the UK corporate tax rate maintaining 19% instead of reducing to 17% as previously announced, resulting in a one-time non-cash adjustment, which had a negative impact on the group's results of approximately HK\$780M.

As for the mainland business, since the group transferred the operations of two coal-fired power stations to their respective JV partners pursuant to the terms of the relevant cooperation agreement, the mainland business currently involves two wind farms and one coal-fired power station only. Therefore, earnings from the mainland business slid to HK\$28M, a decrease of 88.98% from the profit of HK\$254M in 1H19.

As for the Hong Kong business, with new gas-fired generating units being put into operation, the permitted profit climbed, which further allowed HK Electric to achieve more earnings. The profit from the Hong Kong business was HK\$271 in 1H20, a yoy hike of 14.35%. Despite the slump in the profit in 1H20 due to a series of negative factors, the group sticks to their dividend policy with a dividend distribution of HK\$0.77 per share.

Unaudited profit (HK\$ mn)	1H20	1H19	YoY
The UK	842	1825	-53.86%
Hong Kong	271	237	+14.35%
Australia	663	742	-10.65%
Mainland	28	254	-88.98%
Gross profit	2262	3791	-40.33%
Dividend	HK\$0.77/share	HK\$0.77/share	/

Global Presence



2000

SAPN (Australia)

Investors	Consideration	Stake
PA	A\$3.4B	50%
CKI		50%

SAPN, the sole power distributor in South Australia, booked solid revenue while enjoying a monopoly status by entering into a control agreement with the Australian government, serving 887,000 users. As the first overseas project of Power Assets, it acquired 50% interest in ESTA in 2001, and was renamed SA Power Network (SAPN) later. By now, Power Assets holds 27.93% stake in SAPN.

2005

NGN (UK)

Investors	Consideration	Stake
PA	£557M	40%
CKI	£277M	19.9%

Northern Gas Network (NGN), a pilot project for HKE entering the UK market, supplies natural gas and related services for 2.7 million users across the North of England. Upon the acquisition, NGN was held by CKI (40% stake) and HKE (19.9% stake), thereby CKI became the de facto controller.

2010

Seabank Power (UK)

Investors	Consideration	Stake
CKI	£211M (Approximately HK\$2,508M)	50%

Seabank Power is the group's sole power generation project in the UK, with a capacity of 1,148 MW. CKI acquired 50% of Seabank Power at a price of HK\$2,500M in May 2010, and then sold a half to Power Assets for HK\$1,234M on June 4.

2010

EDF Energy (UK)

Investors	Consideration	Stake
CKI	£5,775M (Approximately HK\$70B)	40%
PA		40%
LKS Foundation		20%

Five months later, CKI led Power Assets and Li Ka Shing Foundation to initiate the acquisition of EDF Energy in the UK with HK\$70B, which was the largest investment in the group's history. EDF Energy, the largest distributor in the UK, is responsible for 28% of the country's power transmission.

Mergers and acquisitions of PA

WWU (UK)

Investors	Consideration	Stake
CKA	£645M (Approximately 7,753M)	30%
CKI		30%
PA		30%
LKS Foundation		10%

Power Assets, CK Asset, CKI and Li Ka Shing Foundation jointly invested in the UK's WWU gas distribution network in 2012. Following the acquisition, NGN and WWU under CK Group provide gas distribution services for about a quarter of British people, covering 27% of land area of the UK.

2012

Envestra (Australia)

Investors	Consideration	Stake
CKA	HK\$14.4B	33.33%
CKI		33.33%
PA		33.33%

In 2014, the CKI Consortium privatized Australia's Envestra, one of Australia's largest gas distributors with 1.322 million users. Not only did the group stretch the business coverage in Australia, the constant revenue stream also made Australia gradually outpace Hong Kong as the group's second largest source of income.

2014

Duet (Australia)

Investors	Consideration	Stake
CKA	A\$7,408M	40%
CKI	(Approximately	40%
PA	42,450M)	20%

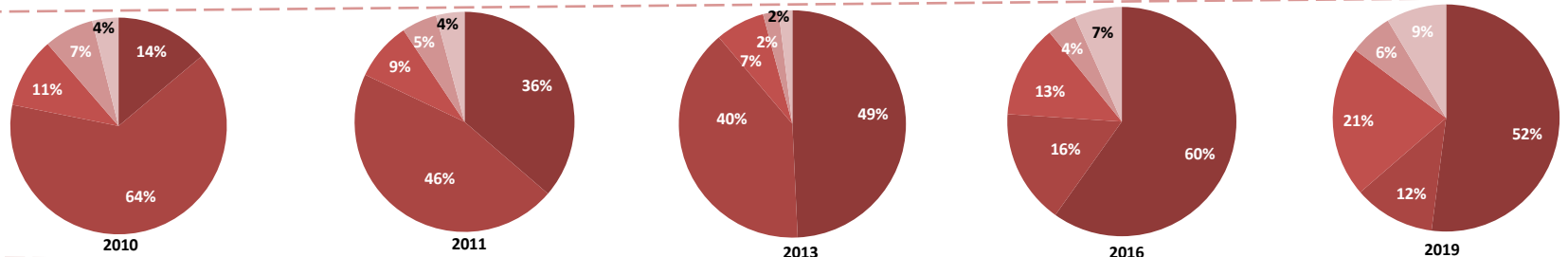
Three years later, the CKI Consortium privatized Australia's Duet, an energy group that owns and operates four energy companies and three gas distributors in Victoria, Australia. Duet was the second largest investment of the CKI Consortium following EDF energy, and was renamed CK William upon the takeover.

2017

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Earnings by geography	The UK	With acquisitions of 40% interest in UK Power network and 25% interest in Seabank Power in 2010, the group's earnings in the UK surged since then. UKPN is the UK's largest distributor and Seabank Power is the only power generation project held by the group in the UK. The power generation revenue can be guaranteed under a control agreement.				Although revenue of the four companies held by the group steadily improved from 2016, the Brexit caused a rapid depreciation of the pound, directly leading to a sharp downturn in the group's earnings in the UK in 2016-2017.				With a gentle recovery of the pound exchange rate in 2018, the group's earnings eyed a restoration, whilst four investees performed solidly by serving a number of stable customers.	
	HK	HKE obtained 9.99% of permitted profit margin due to the 10-year profit control agreement signed in 2008. During the period, HEC's debt cost maintained low as its investment was small and no large debt was incurred. Therefore, they booked reliable earnings in Hong Kong market which has become an important source of income.			HKE, the power generation division, was spun off for listing on the HKEX in 2014. After the IPO, Power Assets held 33.37% of HKE. HKE entered into a new control agreement with the HK government in 2017, which required that HKE lowered the permitted profit margin by 20% from 9.99% to 8%. As the permitted profit margin was directly linked to the fixed asset investment of HKE in the control agreement, a series of financing and investing activities were carried out to widen the margin, resulting in a hike in the debt cost. Net profits were declining year over year.						
	Australia	In 2012, the group purchased Australian Energy Operations which operates cables and terminal stations, connecting multiple wind farms to the state grid. The group acquired a 27.51% stake in Australian Gas Network in 2014. As one of the largest gas distributor in the Australian market, AGN's earnings were subject to a control agreement, but the turnover maintained stable. In virtue of the above acquisitions, the group's profit in Australia firmly climbed. However, most of the increase in profit was offset, showing slight growth of the business in Australia since the exchange rate of Australian dollar against Hong Kong dollar continuously depreciated from 2013.						In 2017, the group invested in CK William which owns four energy companies. The investment greatly boosted the group's earnings in Australia. With a stable exchange rate of Australian dollar against US dollar, the results in Australia swelled solidly.			
	Mainland	Since setting foot on the mainland market in 2007, the group holds 3 coal-fired power plants and 2 wind power farms, of which coal-fired power plants are operated under joint venture agreements.		As the growth of power demand slowed down in the mainland, coupled with sufficient hydro-electric power in the west, new gas and nuclear power, the demand for coal-fired power in the Pearl River Delta region further declined. In addition, the state's new emission indicators required the group to upgrade their coal-fired power plants.		Climbing coal price booted power generation cost in 2015-2017, thus the group's earnings grew slower with depreciation of Renminbi against Hong Kong dollar. Moreover, the group vigorously called for bid via power trading platform to reap fruitful results of the three coal-fired power plants. With completion of environmental upgrade plans for some power plants, sliding coal prices and large appreciation of Renminbi in 2018, the group logged positive earnings.					
	Others	A 25-year take-and-pay power purchase agreement was entered into with the local power authority in Thailand when the Ratchaburi power plant was officially put into operation in 2008 following the completion of construction from 2001, which brought reliable income to the group. In addition, Enviro Energy Holding, a waste-to-energy power plant in the Netherlands, invested by the group in 2013, intended to convert local waste into electricity, tentatively making investment in new sustainable energy technologies. Moreover, Wellington Electricity (New Zealand's fourth largest power distributor) and Canadian Power invested in 2007 and 2008, respectively, contributed sound cash returns to the company.					In 2015, the group purchased a 50% stake in Iberwind wind farm which provides nearly 15% of wind power and meets 3% of electricity demand in Portugal. Wind power incurs no raw material costs, offering a stable income stream. Husky Midstream, an oil pipeline network company with stable customers and revenue in Canada, was invested in July 2016, helping boost the group's profitability.				

Historical earnings

- UK
- HK
- Australia
- Mainland
- Others



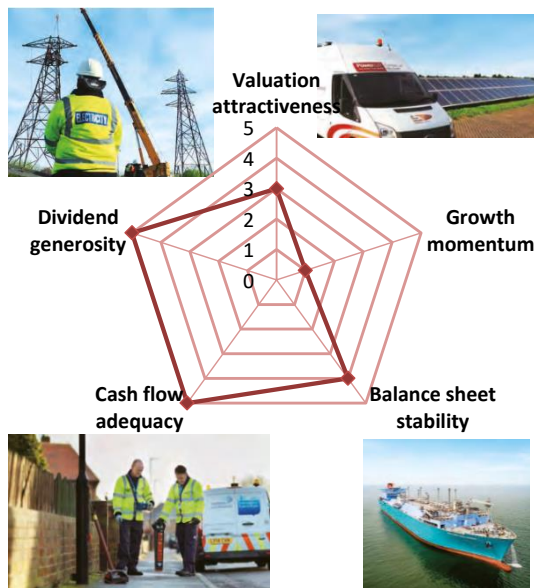
Earnings		Revenue by geography		Financial Summary			
(HK\$mn)		■ UK ■ HK ■ Australia ■ Mainland ■ Others		(HK\$mn)	2017	2018	2019
				Share of profit of JV/associates	6154	6356	5510
				EBIT	8416	7690	7174
				Net profit	8319	7636	7131
				ROE (%)	7.78	8.53	8.44
				EPS (HKD)	3.90	3.34	3.58
				DPS (HKD)	2.80 + 13.5(SD)	2.80	2.80
				Cash deposit	25407	5229	4876
				Dividend payout (%)	418	78	84
<p>A one-time gain of HK\$900M was recorded from the disposal of properties in 2017, while the subsequent decline was caused by the soft British pound amid the Brexit and the new control agreement implemented in HK.</p>		<p>Globally diversified business was built with the UK as the main source of income, and Australia and Hong Kong as the group's second and third largest markets.</p>		<p>Stable cash flow and generous dividend payout, such as a special dividend of HK\$13.5 per share in 2017, led to a large drop in cash deposits.</p>			

Strength

- The power business is scattered around the world, being less affected by changes in the supply and demand of a single economy
- The group is engaged in power generation, power and gas distribution, oil pipelines, new energy, etc., showing quite a diversity of business

Opportunity

- The world entered the rate-cut cycle, thus the declined risk-free rate made stable dividend-paying companies more attractive to investors



Weakness

- As the UK and Australia are the main sources of income, the group's earnings are subject to uncontrollable risks such as exchange rate

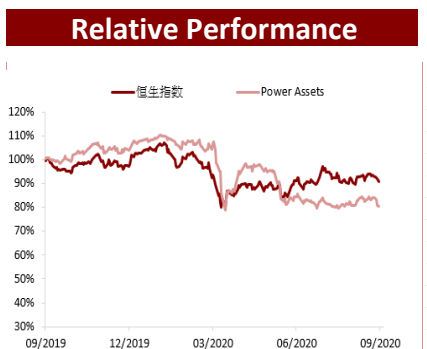
Threat

- The control agreements signed with authorities of those countries may further squeeze the group's profit margins in the future
- Too many acquisitions and dividend distribution caused a serious decline in liquidity. Credit tightening may bring in debt problems

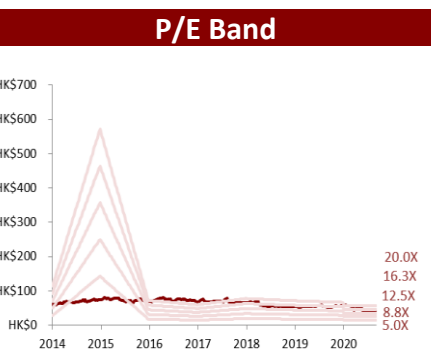
Key Risk
<ul style="list-style-type: none"> ■ As the main source of income, the UK's political instability such as Brexit affects the exchange rate of the pound, which may harm the group's earnings ■ A tightening of control agreements by various countries will limit the growth of the group's earnings

Valuation	
P/E	12.77x
P/B	1.06x
Dividend Yield	6.69%

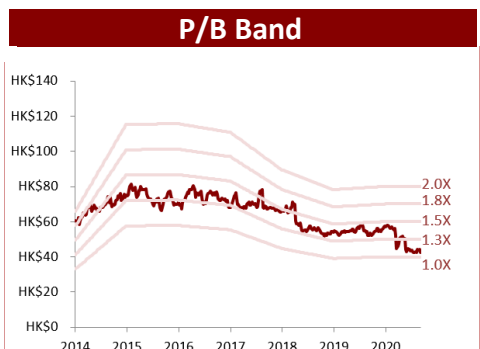
Our Opinion	
👍	With generous dividend policy and abundant cash flow, it maintains high dividend distribution year after year
👍	Stable monopoly business generates continuous stable profit and cash flow
👎	It may suffer uncontrollable exchange rate risks caused by political instability like Brexit



The share price underperformed the HSI in the past year.



The P/E ratio is 12.77x, which is lower than the 5-year average P/E ratio of 16.19x



The P/B ratio is 1.06x, which is lower than its 5-year average of 1.572x.

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- (3) I am not, directly or indirectly, supervised by or reporting to our Investment Banking Department;
- (4) the subject company(ies) do(es) not fall into the restriction of the quiet period as defined in paragraph 16.5(g) of SFC Code of Conduct;
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