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UPDATE

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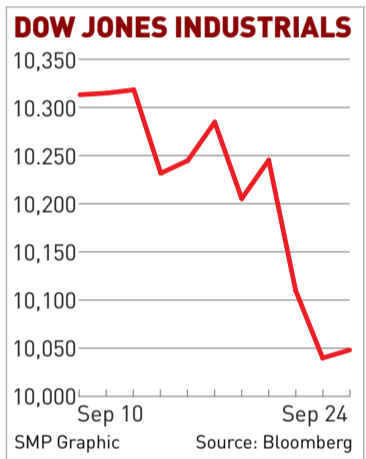


Hong Kong share prices are likely to slip back this week with worries about rising oil prices weighing on sentiment, dealers say.

Public holidays set for Wednesday and Friday are also likely to keep many investors sidelined. Market players are unlikely to want to take fresh positions ahead of the expiry of the futures contract on Tuesday.

While rising oil prices should give energy stocks a boost, other sectors are likely to come under profit-taking pressure.

For the week the Hang Seng Index closed down 158.09 points, or 1.20 per cent, at 13,066.84. AFP



Wall Street's modest six-week rally appeared to stall over the past week, leaving analysts pondering whether the market is headed for a correction or even a steep fall in the days ahead.

In the week to Friday, the Dow Jones Industrial Average tumbled 2.31 per cent to 10,047.24 while the S&P 500 broad-market index sank 1.63 per cent to 1,110.11. The Nasdaq dropped 1.60 per cent for the week to close on Friday at 1,879.48. AFP

EXCHANGE RATES

*Per 100 units
Rates yesterday

| HK\$ | Bid | Ask |
|------|--------|--------|
| € | 14.081 | 14.085 |
| £ | 6.1813 | 6.1835 |
| *¥ | 7.0483 | 7.0514 |
| S\$ | 4.6113 | 4.6139 |
| A\$ | 5.5715 | 5.5745 |
| C\$ | 6.1207 | 6.1235 |
| Baht | 0.1884 | 0.1886 |
| NZ\$ | 5.2097 | 5.2181 |
| *Won | 0.6789 | 0.6789 |
| M\$ | 2.0523 | 2.0526 |
| NT\$ | 0.2305 | 0.2312 |
| Euro | 9.5733 | 9.5735 |
| Peso | 0.1382 | 0.1385 |
| Yuan | 0.9423 | 0.9424 |

Source: Bloomberg

Spooked by coal costs, investors are too negative on China's energy stocks, writes Andy Mantel

Plug into mainland's listless power shares

If you have been reading the newspaper headlines this summer, you will know the blackouts in major cities and selective rural areas throughout China were indicative of a massive electricity shortage.

Now ranking as the second-largest energy consumer in the world, the nation simply cannot keep pace. This year 24 of 27 provinces have suffered power shortages. Demand in the third quarter is estimated to exceed capacity by 30,000 megawatts, according to the China Electricity Council.

Coal is the major fuel source for about 67 per cent of China's power generation. The country has rich coal resources but faces difficulties transporting it to power plants.

In the first half of this year, the price of coal soared more than 50 per cent, but the central government capped prices at 8 per cent above end-of-May levels to reduce pressure on mainland power producers.

Because of these high prices and transportation bottlenecks, listed Chinese power companies have performed poorly this year. I believe negative concerns have been overdone and it is a good time to accumulate power-related shares, given the mainland's growing energy needs.

H-share Huaneng Power International is one of the largest independent power producers in China with a total generation capacity of 18,832MW.

It is listed in Shanghai and Hong Kong and also in New York by way of American depositary receipts.

Huaneng Power has 16 wholly owned power plants in seven provinces along the east coast.

Since listing in the mid 1990s the company has gradually expanded by acquiring quality assets from its parent company Huaneng Interna-

MANTEL'S CHOICE

| | Price on recommendation Jan 21 | Friday price |
|--|--------------------------------|--------------|
| China Resources | \$10.40 | \$10.15 |
| Qiao Xing Universal Telephone (Nasdaq short) | US\$15.00 | \$8.13 |
| | Feb 29 | |
| Kwang Sung Electronics | \$1.76 | \$1.25 |
| Weichai Power | \$10.50 | \$14.60 |
| | Mar 28 | |
| Jitin Chemical | \$1.68 | \$1.59 |
| GES | \$0.665 | \$0.725 |
| | May 28 | |
| CNOOC | \$3.325 | \$3.95 |
| Zhenhai Refining | \$6.60 | \$8.00 |
| | Jul 16 | |
| CIMC | \$11.88 | \$14.24 |
| Shanghai Petrochemical | \$2.75 | \$2.975 |
| | Aug 13 | |
| Nanjing Panda | \$1.49 | \$1.48 |
| Guangdong Kelon | \$2.875 | \$2.80 |
| | Sep 24 | |
| Huaneng Power | \$6.20 | \$6.20 |
| Guangdong Power | \$4.92 | \$4.92 |

SMP Graphic

tional Power Development Corporation. Recently it received approvals from the State Council to invest in Yingkou Power Plant Phase II and Qinbei Power Plant Phase II.

It is also bidding for 11 power plants valued at about US\$2 billion with 7800MW capacity.

Huaneng Power recorded first-half turnover of 12.9 billion yuan and profits of 2.5 billion yuan, increases of 23 per cent and 9 per cent respectively. Unit fuel costs increased 26 per cent to 123 yuan per MW hour.

The growth in power generation is mainly due to the acquisition of two power plants last year. The

company has a valuation of 14 times current earnings with a 3.6 per cent dividend yield. I expect sell-side consensus estimates to be revised upwards within the next year as concerns about higher fuel costs ease.

Huaneng Power's H shares are trading at a 25 per cent discount to its mainland-traded A shares.

Shenzhen B share Guangdong Electric Power builds and operates power plants mainly in Guangdong province.

At the end of last year the company's installed generation capacity was 3,150MW, accounting for 9 per cent of the total installed gener-

ation capacity of the entire province. The total generation volume was 19.1 billion KWH, and on-grid volume totalled 17.8 billion KWH, up 14.1 per cent and 14.6 per cent respectively year on year.

Among the five power plants it owned, the wholly owned Shajiao A and 76 per cent-held Zhanjiang are its major operating units. The other three power plants are in Yuejia, Yuejiang, and Maoming.

In the first half of this year, Guangdong Electric Power recorded turnover of 3.4 billion yuan and profits of 595 million yuan, increases of 26 per cent and 2 per cent respectively.

The company benefited from the strong power demand in Guangdong and a small tariff increase at the beginning of the year. Management minimised the effect of a 20 per cent increase in unit fuel costs during the period by lowering operating expenses and finance costs.

Guangdong Electric Power intends to expand its operations to Guizhou province. It plans to spend 5.7 billion yuan to build a hydroelectric plant in Beipanjiang and another 3.6 billion yuan to expand capacity of a thermal power plant in Pannan. Together with a 12.9 per cent increase in planned power generation volume, this provides a solid growth path for the company.

The B share has a valuation of 12 times current price/earnings, a 5 per cent dividend yield, and a return on equity of 16 per cent.

The company's B shares trade at a 28.7 per cent discount to its A shares.

Andy Mantel is managing director of Pacific Sun Investment Management and manager of The China Mantou Fund

WHAT THE BROKER SAYS

Core Pacific-Yamaichi sees three downside risks for Denway Motors, which has recently announced a net profit of HK\$924.22 million for the first six months, up 37.1 per cent year on year.

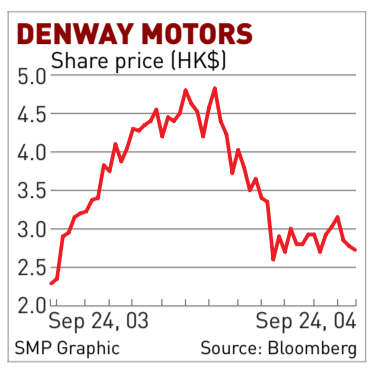
It says China's motor industry has had three rounds of price reductions since May because of the supply-demand imbalance, and does not think Denway's strong sales momentum is sustainable, especially as competitors have lowered prices.

Earnings are expected to peak this year as its sales target of 200,000 units is close to capacity of 240,000 units a year. The company is likely to cut prices by 5 to 10 per cent in the first half of next year due to rising competition.

The government is to suspend its tax break for companies that produce sedans to European emission standards, which will lead to reduction in turnover for Guangzhou Honda, 47.5 per cent owned by Denway.

The broker has maintained its net profit forecast of \$2.28 billion for 2004 but has recommended investors sell the stock.

DBS Vickers Securities, on the other hand, recommends Denway as a "buy" and sets a 12-month price target of \$3.40.



The broker says although pricing pressure is looming it expects Denway to outperform its peers on the back of superior cost efficiency and marketing. It appears Guangzhou Honda's margin expansion has continued despite increasing sales of low-margin economy cars. This implies better economies of scale and the ability to pass on the cost to suppliers. It believes Guangzhou Honda will probably maintain its prices this year, but pressure will mount next year.

Denway's sales target this year is daunting but not impossible because of the launch of new products. The broker maintains its net profit forecast of \$2.20 billion.

The counter closed at \$2.725 on Friday.

WHAT THE BROKER SAID

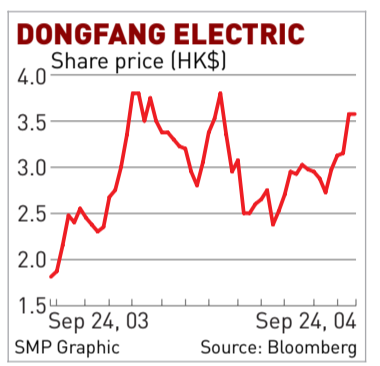
About a year ago CLSA rated Dongfang Electric, one of the three major suppliers of power generation equipment in China, as "outperform", ready to ride on the upswing as power demand increased.

Under-investment in the power sector in recent years had created pent-up demand for equipment and Dongfang, after seeing its operating results in the past depressed by controls on increasing power generation capacity, was poised to capitalise. The company was expected to have contracts of four billion yuan by the end of 2003, enough to ensure strong revenue growth in 2004 and 2005.

CLSA said it conservatively values Dongfang at 10 times 2004 expected net earnings, a 9 per cent discount to the average price/earnings within its China stock universe.

The counter was trading at HK\$1.81 a day ago.

In March, Dongfang announced an operating profit of 48.57 million



yuan for 2003. This compared with 91.17 million yuan in 2002, which was increased by more than 15 million yuan due to an accounting change.

In August, Dongfang announced an operating profit in the half year to June of 57.67 million yuan, compared with 35.29 million yuan in the 2003 period.

The counter closed on Friday at \$3.575.

H shares shrug off the alarming level of inflation

INVESTMENT TIPS

PAUL PONG

I have to confess the recent rebound of H shares really took me by surprise.

The consumer price index is rising at 5 to 5.3 per cent annually, an alarming level of inflation. So I believe China's macro tightening measures will be sustained for some time.

China shares performed poorly at first in the past two weeks, but the peaceful completion of the transfer of power, together with speculation the government may reverse some of its economic tightening measures, triggered a rally. The benchmark overcame the 4,500 level, and even surged above resistance at 4,700, a five-month high.

This momentum has slowed slightly during the last few trading days.

The H-share index closed at 4,538.68, advancing 5.86 per cent over the past two weeks.

Thanks to the performance of H shares and retail stocks, my portfolio gained 3.09 per cent over the two-week period. Since its launch in February, my selection of stocks has lost 2.9 per cent, but outperformed the H-share index, which fell 4.4 per cent. For the eight-month period, the Hang Seng Index is basically unchanged. Clothing retailer Esprit, my favourite in the portfolio, reported a better-than-expected net profit of \$2 billion for the last financial year, up 55 per cent. The company had 32 per cent sales growth, mostly driven by its European operation. There is room to grow further, as its presence in key markets is comparatively low. Moreover, retail sales will be boosted by improving consumer confidence.

The company announced attractive final and special dividends. The dividends were excluded

from my portfolio's return computation.

Although local banks boosted interest rates last week, the returns on cash deposits are still much lower than inflation. In order to preserve wealth, investors should look for potential opportunities and prepare to invest. Look for reasonably valued stocks offering high dividend yields and promising growth.

One of my favourites is Café de Coral, which offers dividend yield of about 4 per cent. I expect the company will benefit from the influx of mainland visitors and the improving economy. I will invest 7 per cent of my portfolio in the share with all my available cash.

With increasing competition and rising operating costs, the share price of Cathay Pacific Airways was soft for a period. I may consider liquidating this stock when the oil price retreats.

Paul Pong is managing director of Pegasus Fund Managers

PEGASUS' PORTFOLIO

| Stock | No of shares | Average Entry price | Current price | Market value |
|--|--------------|---------------------|--|--------------|
| Beijing Capital Airport | 34,000 | \$2.60 | \$2.75 | \$93,500 |
| BYD | 4,500 | \$22.00 | \$23.20 | \$104,400 |
| Café de Coral | 16,000 | \$8.10 | \$8.10 | \$129,600 |
| Cathay Pacific | 14,000 | \$14.125 | \$13.30 | \$186,200 |
| Chow Sang Sang | 30,000 | \$3.075 | \$3.275 | \$98,250 |
| Esprit Holdings | 8,500 | \$29.025 | \$39.60 | \$336,600 |
| Hang Fung Gold Technology | 64,000 | \$1.40 | \$1.34 | \$85,760 |
| Ningbo Yidong Electronic | 155,000 | \$0.64 | \$0.60 | \$93,000 |
| PetroChina | 24,000 | \$3.875 | \$4.025 | \$96,600 |
| Ping An Insurance (Group) | 2,000 | \$10.33 | \$11.35 | \$22,700 |
| Sa Sa International | 76,000 | \$2.65 | \$3.65 | \$277,400 |
| TPV Technology | 20,000 | \$4.425 | \$4.775 | \$95,500 |
| Yanzhou Coal | 14,000 | \$8.10 | \$9.55 | \$133,700 |
| Zhejiang Expressway | 36,000 | \$5.075 | \$5.15 | \$185,400 |
| Starting capital: \$2 million | | | | |
| Total portfolio value: \$1,941,975 | | | | |
| Portfolio loss: \$58,025 | | | | |
| Cash (excluding dividends and trading costs): \$3,365 | | | | |
| | | | Hang Seng Index loss | |
| | | | (February 6, 2004 - September 24): 1.82% | |
| | | | Portfolio loss | |
| | | | (Feb 6 - Sep 24): 2.90% | |
| | | | H-share index loss | |
| | | | (Feb 6 - Sep 24): 4.76% | |

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