

What's new?

- ❑ **Egat, Banpu, and CLP are entering into a MOU.**
- ❑ **Egat is to raise Ratch's stake from 45% to 60% by acquiring 15% stake from Banpu at Bt43.86 a piece.**
- ❑ **Egat will then divest Egco (25.5%) to Banpu (24.99%) and CLP (0.42%) for Bt82.58 a piece.**
- ❑ **This is a perfect solution for Egat to better capture value in its associates and solve conflicts of interest in new capacity bidding.**
- ❑ **Banpu is a real winner with a huge divestment gain and equity income.**
- ❑ **Investors should hold on to Ratch for potential delisting tender offer.**
- ❑ **This deal is neutral for Egco.**
- ❑ **We maintain BUY for Banpu and Ratch with a new Bt220/share target price for Banpu. Our target price for Ratch is under review.**
- ❑ **We are downgrading Egco to UNDERPERFORM.**

Perfect solutions

Egat, Banpu (BANPU – Bt128 – BUY), and China Light Power (2HK – HK\$37.3 – SELL) have entered into a MoU to reorganise its stakes in Ratch (RATCH TB – Bt49 – BUY) and Egco (EGCOMP TB – Bt90 – U-PF). Egat will seek to raise its stake in Ratch from currently 45% to 60% by acquiring 14.99% stake in Ratch from Banpu for Bt43.86 a piece, 10% below closing price. Egat will then divest its entire stake in Egco (25.5%) to Banpu (24.99%) and CLP (0.42%) for Bt82.58 a piece, 8% below closing price. The transaction prices were determined based on average closing prices for the past 15 days.

Figure 1

Details of asset swap deal

	Ratch	Egco	Cash payment by Banpu
Buyer	Egat	Banpu	
Seller	Banpu	Egat	
Total shares outstanding (m)	1,450	525	
Acquisition stake (%)	14.99%	24.99%	
No of shares (m)	217	131	
Acquisition price (Bt/share)	43.86	82.58	
Total (Btm)	9,533	10,835	1,302

Source: CLSA Asia-Pacific Markets

Make sense for Egat. Rationale behind this deal is for Egat to better capture value in its associates on the wake of its upcoming IPO in March-April. According to Egat, this is the only available solution to restructure its cross shareholding in Ratch and Egco before the IPO. To buy back Ratch and Egco shares will be time consuming. Egat and Banpu expect to finalise the transaction by mid-Feb. Only Egat and Egco will likely remain as listed entities with no shareholding relationship, thus doing away with conflict of interest issues for new capacity bidding in the future. Egat's IPO will be more attractive with higher stake in Ratch.

Figure 2

Major shareholders before and after the transaction

	Ratch		Egco	
	Before	After	Before	After
Egat	45%	60%	25.41%	0%
Banpu	14.99%	0%	0%	24.99%
CLP	0%	0%	22.42%	22.84%

Source: CLSA Asia-Pacific Markets

Banpu is a real winner. If the transaction takes place, Banpu will get a double benefit.

- First, it will be able to book a huge gain from divesting Ratch. Banpu's holding cost of Ratch shares is around Bt14/share. This suggests Bt4.5bn gain (net of 30% tax) implying Bt17/share incremental EPS versus our normal case 2004 EPS of Bt11, implying 255% upside. The Bt1.9bn (Bt7/share) tax obligation may actually be reduced significantly with effective tax planning.
- Second, by holding 24.99% stake in Egco, Banpu will be able to equity account net profit of its associate – something Banpu has long wanted to do with its Ratch's stake but unsuccessfully. We see no major upside to our Banpu's earnings forecast because we already assumed that Banpu will take equity income from Ratch. Besides, Ratch and Egco have roughly the same amount of net profit. But we expect consensus EPS for Banpu will be upgraded on the back of this deal by as much as 80-90%, excluding one-off Ratch divestment gain. In addition, Banpu should be able to secure four board seats in Egco (same as Egat), while only one seat in Ratch.

Hold on to Ratch for delisting. Ratch will potentially be delisted from the SET. Under the SEC regulations, Egat will be required to launch a tender offer to acquire up to 100% stake in Ratch at Bt43.83/share – i.e. no premium to the transaction price. Egat's governor commented that Egat will decide before the IPO whether it will eventually delist Ratch. The delisting of the remaining 40% stake will involve at least Bt29bn cash payment based on Ratch's closing price. While the current tender offer price of Bt43.83/share is probably too low to delist Ratch, we expect Egat to launch another tender offer to finally delist Ratch at a premium. After all, the entire purpose for this transaction is to have a clear separation between Egat- and privately owned listed power firms. It therefore does not make sense to list Ratch's 40% stake in the market. If the delisting does not come through, Ratch's growth prospect can only be strengthened with Egat's full support.

One downside though for Ratch is that the potential to acquire stake in the BLCP project is now zero, in favour of Egco.

Neutral for Egco. This transaction is neutral for Egco. The company will lack Egat's support even though the bidding process for new capacity under the new regulatory framework should be more transparent and on equal footing. One positive sign though is that Egco might be able to acquire higher stake in the BLCP project from Banpu who is currently holding 50% stake. Immediate upside is however not clear.

Figure 3

Summary of Pros and Cons

	Pros	Cons
Banpu	Equity accounting Egco's profit Bt17 nett divestment gain Potential 4 board seats in Egco Possible higher coal sales to CLP's coal plants in China	Cash payment of Bt1.3bn upfront Bt1.9bn tax liability
Ratch	Upside from delisting tender offer More support from Egat	No more BLCP project
Egco	Possible higher stake in BLCP	No more Egat support
Egat	More attractive IPO Ease of implementation No conflict of interest of new bidding	

Source: CLSA Asia-Pacific Markets

Recommendation

We maintain BUY for Banpu and Ratch. Our target price for Banpu is upgraded to Bt220/share. Ratch's target price is under review for potential upgrade. Any correction because of lower tender offer price than market price is an opportunity to accumulate Ratch for delisting tender offer. However, we are downgrading Egco to UNDERPERFORM. Egco looks set to underperform with Egat's IPO. This transaction does not provide immediate upside for the company.

Banpu's new target price at Bt220. We are upgrading Banpu's NPV to Bt220/share, from Bt130/share previously, based on various factors.

- First, we are lowering WACC of Banpu's Indonesian asset from 18.1% to 9.6% based on lower 8.5% risk free rate (15% before), 5% risk premium (8% before), and 5% interest cost (10% before).
- Second, we raise our average coal price assumption for 2004 from US\$23.6 to US\$24.5, implying 10% appreciation in line with management guidance. We expect a stronger 15% price appreciation in 2005 when most contract prices are due for adjustment to be in line with strong spot price trend in 2004.
- Our new target price for Aromatics Thailand (ATC TB – Bt68 – BUY) of Bt77/share versus Bt52/share previously also means higher value to Banpu.
- Lastly, we roll over our NPV from 2004 to 2005.

Our new target price implies 17x 05CL PE.

Note: In the interests of timeliness, this document was not edited.

Additional information is available upon request

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