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HD **CLP: CLP's new generation**

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CLP sees changes at the helm as it exits a partnership with Exxon and seals a new one with **China** Southern Power.

Hong Kong utility CLP Holdings, controlled by the wealthy Kadoorie family, has a history in the former British colony dating back more than a century, with humble beginnings providing street lighting in Kowloon. But the **company** has made some changes at its helm as it marks a new chapter in its partnership with state-owned **China** Southern Power Grid and strives to turn its business in Australia around.

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Richard Lancaster, previously managing director of CLP's **Hong Kong** subsidiary CLP Power, assumed the reins as the parent's chief executive officer in September after his predecessor, Andrew Brandler, stepped down to join the Kadoorie family office. CLP's former chief financial officer Mark Takahashi also retired in January to be replaced by Geert Peeters, while CLP's Australian subsidiary EnergyAustralia appointed Catherine Tanna in May to succeed Richard McIndoe as its managing director.

Lancaster, who hails from Australia, is no newcomer to CLP, having worked at the **company** for over two decades. He says the **company** has kept a degree of continuity and that, with the exception of Peeters and Tanna, other senior appointments have come from within the **company**. Lancaster has been described by one banker close to the **company** as a 'nuts and bolts' guy and has held various roles at CLP, including project management, finance and power plant **operations**.

Some might wonder if Lancaster, an electrical engineer by training, might lean towards building businesses rather than buying them. His predecessor, an ex-Schroders investment banker, led CLP through a period of acquisitions, buying privatised power assets in Australia and, most recently, an additional 30% **stake** in Castle Peak Power for dollars 1.6 **billion**.

Asked how he plans to grow in the future, Lancaster told FinanceAsia that acquisitions were only part of the plan and that CLP is 'equally, if not more, focused on greenfield projects in the near future'.

'Acquisitions are just one way to grow and it has to makes sense. Our **acquisition** of Castle Peak Power made a lot of sense to our business as it provided a great opportunity for us to gain control over an important generation asset and build the platform for future growth,' Lancaster said.

China partnership

CLP opened a new chapter in its partnership with **China** Southern Power Grid when they joined forces to buy Castle Peak Power from US **oil** and gas giant Exxon Mobil. CLP raised its **stake** in May from 40% to 70% while **China** Southern Power Grid bought the remaining 30% in its first foray outside the **Chinese** mainland.

Castle Peak Power owns three **coal**-fired power stations in **Hong Kong** and generates two-thirds of CLP's electricity.

The partnership was struck at a time when **Hong Kong**'s power industry is expected to seek closer ties with the mainland now that the special administrative region's government has proposed importing electricity from **China**. It also builds on an existing relationship: The two companies already have a grid that transports power from the Guangdong Daya Bay nuclear plant, which CLP operates with Guangdong Nuclear Investment, to Hong Kong.

According to Lancaster, CLP and China Southern Power Grid have been talking on a day-to-day basis since the late 1970s, so the deal cements these ties. 'Looking ahead we see closer integration with China as being the direction and having China Southern Grid is a natural partner for us, it was just a logical move for us,' he said.

Majority control over Castle Peak Power gives CLP more flexibility and the ability to better integrate its power generation with transmission and distribution. In addition, Lancaster said, 'It will strengthen our relationship with China Southern Grid and provide a stronger platform for more opportunities.'

Partnering China Southern Power Grid from an early stage also removed some of the competition in the auction process, a banker familiar with the deal said. 'CLP played its cards brilliantly,' he said. 'Given that Castle Peak is such an important asset, it was unlikely that the Hong Kong regulators would approve a random private equity player or Thai company, and because China Southern Power was known to be participating from an early stage, it was unlikely that another Chinese (state-owned enterprise) would compete, which took out some of Exxon's ability to create the pricing tension through the auction process.'

Nonetheless, negotiations took more than a year. Lancaster said that CLP had certain rights as a major buyer of the power generated by Castle Peak, which made it difficult for Exxon to sell it to another buyer, but he declined to go into specifics.

'Where you have a long-term partnership and where there is a logical buyer, they needed to go through a process that ensured them that they would get a fair and reasonable price,' Lancaster said. 'Similarly, we were only willing to pay a fair and reasonable price and we needed to go through a process that led us to that price and ensured that both parties got a fair deal.'

CLP was advised by HSBC and Evercore. The former was the sole provider of a HKdollars 10 billion bridge financing loan and counts CLP as one of its longest standing clients, along with the likes of Swire and Jardine Fleming.

At Evercore the Castle Peak acquisition was led by Marcus Thompson, a senior managing director, who like CLP's former CEO Brandler, was an ex-Schroders banker. After the Kadoorie family sold its 25% stake in Schroders Asia more than a decade ago, a number of bankers including Brandler left to join Kadoorie family-controlled businesses. Clement Kwok, the CEO of Hongkong and Shanghai Hotels, another Kadoorie family-controlled business, was also previously from Schroders.

Glenn Fok, the head of investment banking for Hong Kong at UBS - one of the arrangers for CLP's hybrid bond - was also an ex-Schroders banker.

While Standard & Poor's views the acquisition of Castle Peak as positive for CLP's business, the debt it has taken on to fund the purchase puts a strain on the company. In May, S&P affirmed its A rating on CLP Power with a negative outlook. 'We think this acquisition is positive for CLP Power, in terms of enhanced control,' Gloria Lu, an analyst at S&P, said. 'However, CLP Holdings' financial strength has been strained by its expansion into unregulated businesses in Australia and India and its latest acquisition places further pressure on its credit profile, as it has been mainly funded by debt.'

The company has take steps to reduce its debt. In April, CLP Power tapped the market with a dollars 500 million inaugural hybrid, which offered a coupon of 4.25%. The hybrid, which was partly counted as equity for accounting and rating purposes, helped CLP reduce its debt levels and diversify its funding sources. It also scored the lowest coupon for a US dollar-denominated Asian hybrid, a testament to the strength of its Hong Kong operations.

'CLP Power is a strong credit utility and has been raising debt through bonds since 2002,' Lancaster said. 'One of the benefits of our hybrid is that we have a new source of funds and have been able to tap new investors.'

Barclays, HSBC, RBS and UBS were the arrangers.

Regulatory noise

Lancaster assumes the reins of the company at a time when the utility landscape faces potential change, with the Hong Kong government proposing to change the fuel mix for future power generation to reduce pollution. CLP has a de facto monopoly in the New Territories and in Kowloon, while its rival, Li Ka-shing controlled Hong Kong Electric, has a monopoly on Hong Kong Island.

The Hong Kong government launched a consultation paper in March and is seeking public feedback. One of its proposals is to import 30% of Hong Kong's power from China and another proposal is to increase the use of gas-fired generation - which is cleaner than coal - from 22% in 2012 to 60% by 2023, according to a JP Morgan report in April.

There are pros and cons to both proposals. Importing power from China would mean building expensive infrastructure. However, gas prices are linked to the international market and the cost of producing electricity will rise if gas prices rise. 'Both have merits and if anything, we want to keep our options open,' Lancaster said. 'We have a long history of importing electricity from China though Daya Bay which has been very reliable and provided affordable electricity for 20 years,' he said. 'The price of natural gas varies. At times it has been relatively cheap, but at the moment it is expensive,' he added.

In addition, there are questions over the future returns both electricity companies can have in the future. Under the current scheme of control, which governs both Hong Kong Electric and CLP, they are allowed to earn a rate of return of 9.99% on average net fixed assets for non-renewable energy and 11% on average net fixed assets for renewable energy such as solar and wind.

The scheme of control is up for renewal again in late 2018. Public discontent over the high living costs prompted the government to suggest lowering the permitted rate of return in its 2013 interim review. But as CLP and Hong Kong Electric both failed to reach an agreement with the government, there was no change to the terms.

S&P's Lu says that if both utility companies fail to reach a consensus with the government, they can operate on current terms for another five years until 2023. 'The regulatory risk that both companies face is well beyond the next five years,' said Lu, who expects the Hong Kong utility market to remain a duopoly for the foreseeable future.

'(The) government places the stability and reliability of power supply as the priority, (so) in my view it is still hard for another player to enter Hong Kong in the near term,' she said.

Australia: can he fix it?

But while its Hong Kong business has been steady, the key question for CLP is how it intends to turn around its Australian unit. CLP's electricity generation and gas retailing unit EnergyAustralia, formerly known as TRUenergy, has been struggling amid a glut in capacity.

EnergyAustralia has faced reduced demand due to the Australian government's policy to develop more renewable energy. In addition, closures of car assembly plants and aluminium smelters in Australia have exacerbated matters.

In 2013, EnergyAustralia's operating profit slumped to dollars 16 million from dollars 217 million in the previous year. That same year CLP took a dollars 400 million non-cash impairment, mainly on its investment in its Yallourn coal-fired station in Victoria State and its gas-fired assets in Australia.

'It certainly is a challenging market,' Lancaster said. 'Demand for electricity has been falling during the last four years and the previous Federal Government's policy was to encourage the development of more renewable energy capacity and to support subsidies for solar panels in houses,' he said.

CLP has taken steps to address the oversupply and closed a unit of the Wallerawang Power Station in early 2014. However, it is struggling amid an industry-wide glut. 'We are working very hard to fix what we can in Australia,' Lancaster said.

CLP's Australian unit mulled an initial public offering of shares on the Australian Securities Exchange in 2012 and mandated Bank of America Merrill Lynch, Deutsche Bank and UBS to that end, FinanceAsia reported at that time. However, that deal never made it to market and has been deferred.

'We have put plans for an IPO on hold. Certainly the market conditions are quite challenging so it is not a good time to be considering an IPO,' Lancaster said. Having a stake in a listed entity in Australia is one of the company's stated visions for 2020, but Lancaster said that the plans for an IPO for EnergyAustralia are on hold 'indefinitely'.

CLP's presence in Australia dates to 2001, when it first bought a majority stake in Yallourn Energy. In 2011, TRUenergy acquired what was then New South Wales state-owned EnergyAustralia's retail business, long-term off take contracts to buy the output from the Mount Piper and Wallerawang coal-fired power stations, plus two power station development sites - all for a total of Adollars 2 billion. TRUenergy also bought the EnergyAustralia name and the latter was renamed Ausgrid.

Does he regret the acquisitions in Australia? 'Hindsight is a wonderful thing,' he said, adding that CLP is now one of Australia's top three **energy** firms.

Still, Lancaster added that CLP's Australian business represented less than 10% of group earnings. 'We have a very strong and stable business in **Hong Kong** and we are seeing record profits from the mainland and a turnaround in our India business.'

11% - CLP's regulated return on renewable **energy**.

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