

JPM-pp1

Asia Pacific Equity Research

02 March 2015

China Everbright International (257 HK)

Overweight

Price: HK\$11.02

26 Feb 2015

Price Target: HK\$13.00

PT End Date: 30 Jun 2015

Water subsidiary to triple treatment capacity by 2019

China Everbright Water (CEWL SP, Not Covered), which is 78% owned by China Everbright Int'l, aims to increase its daily water treatment capacity to >10MM tons from its current 3.4MM tons in 3-5 years (or CAGR of 24% in 5 years). A low net gearing of 18% should allow the company to gear up for acquisitions and new projects. The company will focus on municipal sewage, tap water, industrial wastewater and sludge treatment. We believe the water segment will be an important growth driver for CEI, accounting for >20% of total earnings. Maintain OW on CEI.

China Everbright Water held an analyst briefing on its first set of results since its reverse takeover of Hankore Environment in Dec 2014. Below are our key takeaways.

- **Net profit up 10% yoy.** China Everbright Water reported 2014 net profit of HK\$292MM, up 10% yoy, driven by growth in operating revenue from water treatment. However, this amount included one-off expenses of ~HK\$20MM. On a recurring basis, net profit should have been higher at ~HK\$312MM. The 2014 results included only 18 days of earnings from Hankore after the acquisition in Dec 2014. Therefore, most of the earnings are from Everbright's existing water projects.
- **Lower finance cost expected.** Management said there's room to lower Hankore's finance expense by refinancing its debt in the next 1-2 years. As per the last time Hankore reported its full year result in Aug 2014, its finance expense was 33% of total gross profit.
- **Low net gearing allows for future growth.** CEW had net gearing of 18% as of Dec 2014, but that is expected to be lowered following its share placement to IFC and RRJ. Management said they would be very comfortable with a net gearing of 50%. Historically, CEI has geared up to <75%. We believe that would likely be CEW's tolerable level as well. Management added CEW would be open to using equity funding for growth and acquisition if the opportunity arises.
- **Target to be a top water player.** Management said they aim to grow CEW's existing treatment capacity of 3.4MM tons/day to >10MM tons/day in 3-5 years. This would likely result in average new capacity addition of >1.3MM tons pa.
- **IRR of 10%-15%.** CEW has an IRR hurdle rate of 10%, while the actual returns on projects have been 10%-15%.
- **2.5MM tons of capacity in operation.** CEW currently has 2.5MM tons/day of treatment capacity under operation. Another 900k tons will likely come into commission in the next 1-2 years. While most of Everbright's existing sewage projects are Standard 1A, more than half of Hankore's projects are Standard 1B. Therefore, there would be good potential for plant upgrades.
- **Management optimistic on sector growth.** Management believes growth in the water sector will come from urbanization, increase in sewage treatment ratio, privatization and industry consolidation. Specifically, they estimate 50% of water assets are government owned. These assets may be privatized or local governments may enter into public-private partnerships with operators.

Table 1: China water valuation table



Source: Bloomberg. Consensus estimates used. LC = local currency

Investment Thesis

China Everbright Int'l (CEI) is the environmental energy arm of China Everbright Holdings, a state-owned enterprise under the State Council. CEI constructs and operates waste-to-energy (WTE), wastewater treatment and alternative energy (wind, solar, biomass, methane-to-energy) projects. The company also manufactures its own WTE equipment in China.

Valuation

Our Jun-15 PT of HK\$13.00 for CEI is determined based on a sum-of-the-parts valuation, using DCF (WACC of 8.3%, terminal growth rate of 2.3%) to value each of CEI's business segments. Our PT implies FY15E PER of 23x.

Risks to Rating and Price Target

1) Project delays could result in lower construction and operation revenue and net earnings; 2) Higher interest rates would result in lower net earnings. 3) Low utilization rates at projects would result in lower operating earnings; 4) Delays in payments from customers would put a strain on cash flow and potentially increase the need for additional borrowing; 5) Risks of a potential share placement may increase as CEI's net gearing rises. This may dilute EPS.

Utilities

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
21-Oct-11	N	1.84	2.30
21-Feb-12	N	3.53	3.90
05-Jun-12	OW	3.46	4.50
23-Aug-12	OW	4.11	4.80
07-Nov-12	OW	3.86	4.60
28-Feb-13	OW	5.16	5.30
11-Jul-13	OW	6.35	7.60
06-Aug-13	OW	7.17	8.30
24-Apr-14	OW	10.50	13.00

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