

## Sound Global (967 HK)

**Underperform** (downgraded)

Target price: HK\$4.75



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### Stock performance



Source: Bloomberg

### Key data

Mar 13 close (HK\$)	7.00
Shares in issue (m)	1,780
Major shareholder	Sound Env. (31%)
Market cap (HK\$ bn)	12.5
3M avg. vol. (m)	3.7
52W high/low (HK\$)	9.47 / 5.66

Source: Bloomberg

No longer a re-rating play; downgrade to Underperform

**Postponement of results announcement a negative surprise** When all investors were supposed to have read how its 2014 earnings maintained high growth YoY following the short seller attack, Sound Global (SG) surprised by postponing the announcement "as the audit of the Group's annual results for the year ended 31 December 2014 has not been completed". Trading in the company's shares has been suspended as management expects the company not to be able to announce 2014 result by Apr 30.

**Major de-rating event** We see this as a major de-rating event for SG. First, we believe it has just ruined all its efforts to rebuild investor confidence following the short seller report. Although there had not been any disagreements between SG and the HKEX and Deloitte in previous years regarding its EPC contracts and financial reports, this delay simply triggers further panic. Second, it was a fatal mistake to rush towards the results announcement without considering that Deloitte would take a more rigorous approach to the 2014 results, meaning more time was required. We do not understand why SG was so eager to take the risk of announcing its results as early as mid-March instead of taking the more conservative approach of announcing towards the end of March. We believe management did not recognize that sentiment towards the company is still fragile even though the share price has rebounded by more than 50% from its Feb lows.

**Management's stake increase and share buyback unlikely to help** Chairman Wei Yibo mentioned the possibility of increasing his stake, and proposed that SG starts a share buyback, after the blackout period during a teleconference held last month. However, we do not expect these measures to have the desired effect as the results delay has already caused further trust issues for investors.

**No longer a re-rating play; rating slashed to Underperform** SG's execution ability has disappointed us as we had expected the company to handle such a critical event with extra care. As such, we see no further room for re-rating given the big hit to investor confidence. We leave our earnings forecasts unchanged, but slash our valuation benchmark from 19x to 8.2x 2015E P/E (1 SD below its average historical forward P/E) to factor in the trust issues. We cut our target price from HK\$11.20 to HK\$4.75 and downgrade SG from Buy to Underperform. We suggest investors switch to BEWG (371 HK; Buy).

**Upside risks:** 1) Better-than-expected 2014/15 results; 2) Substantial M&A which would lead to significant value accretion for the company; 3) Bigger-than-expected share repurchasing scheme.

### Stock valuation

	Turnover (Rmb m)	Net profit (Rmb m)	EPS (Rmb)	EPS YoY (%)	P/E	BPS (Rmb)	P/B	ROE (%)
2012	2,652	428	0.331	3.3	17.0	2.05	4.2	16.2
2013	3,140	423	0.328	-1.0	17.2	2.38	3.6	13.8
2014E	4,025	597	0.398	21.2	14.2	2.45	3.5	16.3
2015E	5,183	831	0.467	17.3	12.1	3.53	2.5	13.2
2016E	6,370	1,079	0.606	29.9	9.3	4.14	2.1	14.6

Sources: Company data, GF Securities (HK)

Note: Calculated based on diluted shares.

Figure 1: New projects announced YTD

Date	Project			Capacity (kt/day)	Concession (Years)	Standard	Contract amount (Rmb m)
12-Mar-15	Taian Economic Development Zone WWT	WWT	BOT (bid)	25	30	1A	110
25-Feb-15	Feitian Mine Phase I & II water purification station		EPC				23
24-Feb-15	Wuyi County Number 2 WWT	WWT	BOT (bid)	15	25	1A	80
16-Feb-15	Xinshao County water diversion engineering	Water Supply	BOT (bid)	50	30		180
11-Feb-15	bundled PPP WWT project in rural area of Fu'an	WWT	PPP (bid)	16	30		60
2-Feb-15	Fogang Zhanyang Domestic WWT	WWT	BOT (acq)	30	20	1B	61
15-Jan-15	Xingping Hualu Sewage Treatment	WWT	BOT (acq)	50	25	1A	98
14-Jan-15	Hongze Project Phase II	WWT	BOT (expansion)	20			100
13-Jan-15	Qingcaohe Water Plant in Jing County	Water Supply	BOT (bid)	20		106	64
8-Jan-15	33 township sewage treatment plants in Enyang District	WWT	BOT (invest)	6	30	1B	60
7-Jan-15	14 urban rural sewage treatment projects in Tongchuan	WWT	PPP (bid)	8		1B	72
<b>Subtotal</b>							
			EPC	NA			23
			WWT	170			640
			Water Supply	70			244

Sources: Company data, GF Securities (HK)

Figure 2: Forward P/E band



Figure 3: Forward P/B band



Sources: Bloomberg, GF Securities (HK)

**Figure 4: Financial statements**

Income Statement						Balance Sheet					
Year end Dec (Rmb m)	2012	2013	2014E	2015E	2016E	Year end Dec (Rmb m)	2012	2013	2014E	2015E	2016E
Turnkey projects and services	2,446	2,883	3,661	4,467	5,450	Cash and cash equivalents	2,912	3,534	2,379	3,073	1,707
Equipment fabrications	112	64	57	60	63	Trade and other receivables	1,433	1,569	1,971	2,538	3,120
O&M	94	193	306	655	857	Amounts due from customers	584	1,097	1,665	2,406	3,329
<b>Turnover</b>	<b>2,652</b>	<b>3,140</b>	<b>4,025</b>	<b>5,183</b>	<b>6,370</b>	Other current assets	79	139	146	157	167
YoY (%)	15.9	18.4	28.2	28.8	22.9	<b>Total current assets</b>	<b>5,008</b>	<b>6,338</b>	<b>6,161</b>	<b>8,174</b>	<b>8,324</b>
COGS	(1,852)	(2,181)	(2,796)	(3,599)	(4,415)	Property, plant & equipment	48	50	51	52	54
<b>Gross profit</b>	<b>800</b>	<b>958</b>	<b>1,230</b>	<b>1,584</b>	<b>1,955</b>	Land use right	43	78	76	75	74
YoY (%)	10.8	19.7	28.3	28.8	23.4	Service concession	1,643	2,237	3,397	4,908	6,792
Other operating income	54	95	134	196	277	Other non-current assets	97	95	93	91	89
Other expenses	2	(11)	(16)	(26)	(38)	<b>Total non-current assets</b>	<b>1,831</b>	<b>2,460</b>	<b>3,617</b>	<b>5,127</b>	<b>7,008</b>
Distribution expenses	(38)	(38)	(56)	(78)	(102)	Short-term borrowings	465	764	1,031	1,124	1,225
Research and development	(24)	(20)	(28)	(41)	(57)	Trade and other payables	1,171	1,654	2,120	2,729	3,348
Administrative expenses	(118)	(132)	(177)	(228)	(287)	Other current liabilities	127	151	242	368	527
<b>EBIT</b>	<b>677</b>	<b>851</b>	<b>1,086</b>	<b>1,407</b>	<b>1,747</b>	<b>Total current liabilities</b>	<b>1,763</b>	<b>2,569</b>	<b>3,393</b>	<b>4,220</b>	<b>5,100</b>
YoY (%)	14.9	25.8	27.5	29.6	24.2	Long-term borrowings	889	1,518	1,639	1,705	1,773
Finance costs	(174)	(285)	(288)	(296)	(305)	Senior notes	923	899	908	908	908
<b>Profit before income tax</b>	<b>503</b>	<b>566</b>	<b>798</b>	<b>1,111</b>	<b>1,443</b>	Other non-current liabilities	610	738	165	165	165
Income tax expense	(76)	(141)	(198)	(276)	(359)	<b>Total non-current liabilities</b>	<b>2,421</b>	<b>3,154</b>	<b>2,712</b>	<b>2,778</b>	<b>2,846</b>
<b>After tax profit</b>	<b>428</b>	<b>425</b>	<b>600</b>	<b>835</b>	<b>1,084</b>	Share capital	833	833	833	833	833
Minority interest	0	(2)	(3)	(4)	(5)	Reserves	1,811	2,237	2,834	5,458	6,537
<b>Net profit</b>	<b>428</b>	<b>423</b>	<b>597</b>	<b>831</b>	<b>1,079</b>	<b>Equity attributable to</b>	<b>2,644</b>	<b>3,070</b>	<b>3,667</b>	<b>6,292</b>	<b>7,371</b>
YoY (%)	3.3	(1.0)	41.0	39.2	29.9	Non-controlling interests	11	4	7	11	16
						<b>Total equity</b>	<b>2,655</b>	<b>3,074</b>	<b>3,674</b>	<b>6,303</b>	<b>7,387</b>
Cash Flow Statement						Financial Ratio					
Year end Dec (Rmb m)	2012	2013	2014E	2015E	2016E	2012	2013	2014E	2015E	2016E	
Pre-tax profit	503	566	798	1,111	1,443	Gross margin (%)	30.2	30.5	30.5	30.6	30.7
Tax paid	(57)	(66)	(119)	(166)	(215)	EBIT margin (%)	25.5	27.1	27.0	27.1	27.4
Dep'n and amortization	16	17	8	8	8	Net margin (%)	16.1	13.5	14.8	16.0	16.9
Change in working capital	(694)	(621)	(1,661)	(2,205)	(2,764)	ROA (%)	6.3	4.8	6.1	6.2	7.0
Others	126	221	277	285	294	ROE (%)	16.2	13.8	16.3	13.2	14.6
<b>Cash from operations</b>	<b>(106)</b>	<b>117</b>	<b>(697)</b>	<b>(967)</b>	<b>(1,235)</b>	Net gearing (%)	NC	4%	30%	9%	28%
Capital expenditure	(5)	(6)	(6)	(6)	(6)	Interest coverage (x)	3.9	3.0	3.8	4.8	5.7
Others	(14)	(143)	11	11	11	Current ratio	2.8	2.5	1.8	1.9	1.6
<b>Cash from investing</b>	<b>(19)</b>	<b>(150)</b>	<b>5</b>	<b>5</b>	<b>5</b>						
Proceed from share issuance	0	0	0	1,794	0						
Change in borrowings	1,138	924	(175)	158	169						
Dividend paid	(65)	0	0	0	0						
Others	(110)	(264)	(288)	(296)	(305)						
<b>Cash from financing</b>	<b>963</b>	<b>660</b>	<b>(463)</b>	<b>1,657</b>	<b>(135)</b>						
FX change	(0)	(6)	0	0	0						
<b>Net change in cash</b>	<b>838</b>	<b>622</b>	<b>(1,155)</b>	<b>694</b>	<b>(1,365)</b>						

Sources: Company data, GF Securities (HK)

## Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

### Company ratings

<b>Buy</b>	Stock expected to outperform benchmark by more than 15%
<b>Accumulate</b>	Stock expected to outperform benchmark by more than 5% but not more than 15%
<b>Hold</b>	Expected stock relative performance ranges between -5% and 5%
<b>Underperform</b>	Stock expected to underperform benchmark by more than 5%

### Sector ratings

<b>Positive</b>	Sector expected to outperform benchmark by more than 10%
<b>Neutral</b>	Expected sector relative performance ranges between -10% and 10%
<b>Cautious</b>	Sector expected to underperform benchmark by more than 10%

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