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Asia Pacific Equity Research

31 August 2015

# China Everbright International (257 HK)

Overweight

Price: HK\$10.14

31 Aug 2015

Price Target: HK\$16.60

PT End Date: 30 Jun 2016

Water acquisition to add 30% treatment capacity

China Everbright International's water subsidiary will acquire a group of water projects in Liaoning and Inner Mongolia with total treatment capacity of 1.1MM tons/day. This will allow the company to fulfill its 2015 capacity addition with one transaction. We are waiting for more details on the projects, but on first look, the acquisition price seems reasonable. The water subsidiary will be able fund the acquisition by gearing up its balance sheet. We maintain our OW rating on CEI.

- **Acquisition for Rmb800MM.** China Everbright Water (CEWL SP, Not Covered), a 74.4%-owned wastewater treatment subsidiary of China Everbright International, announced it will acquire a 90% stake of Dalian Dongda Water Co for Rmb800MM. CEW will acquire over a three-year period the remaining 10% stake from Dongda Group for a sum of up to Rmb203MM. As part of this transaction, CEW will lend Dalian Dongda Rmb1B so that it can repay all of its outstanding debt.
- **Projects to be acquired:** Dalian Dongda is a sewage treatment operator in Liaoning Province and Inner Mongolia. It currently has 17 sewage projects, mainly on a BOT (build, operate, transfer) and TOT (transfer, operate, transfer) basis, with total treatment capacity of 1.125MM tons/day. This will add c30% to CEW's existing treatment capacity of 3.5MM tons/day. Its current projects are in Beijing, Jiangsu, Shandong, Shaanxi, and Henan.
- **JPM comments.** With this acquisition, CEW has met its full year target to add 1MM tons/day of treatment capacity. The acquisition price implies 2014 P/E of 22x and 2014 P/B of 3.8x, vs CEI's 26x 2014 P/E and 2.8x P/B. The enterprise value of Rmb1.8B implies a capacity acquisition cost of Rmb1,821/ton of treatment capacity. This is largely inline with the investment cost of new sewage treatment capacity.
- **Details at analyst briefing.** CEW management will host an analyst briefing tomorrow to provide more details on this transaction. We will have more after the briefing.

Table 1: Details of the acquisition

in Rmb MM

RMB MM			
Acquisition price for 90% stake	800.0		
Debt to be assumed	1,044.0		
<b>Enterprise value</b>	<b>1,844.0</b>		
Financials of the asset (RMB MM)	31-Dec-14	31-Dec-13	yoy
Turnover	233.5	181.9	28%
Net Profit before taxation and extraordinary items	50.2	41.0	22%
Net Profit after taxation and extraordinary items	39.1	33.4	17%
Net Asset	236.6	331.5	-29%
<b>Implied acquisition valuation</b>			
P/E (x)	22.7	26.6	
P/B (x)	3.8	2.7	
Sewage treatment capacity (MM tons/day)	1.1		
EV / treatment capacity (Rmb/ton)	1,821		

Source: Company reports and J.P. Morgan estimates.

## 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) and alternative energy (wind, solar, biomass, methane-to-energy) projects. The company also manufactures its own WTE equipment in China. CEI operates and constructs wastewater treatment plants via its majority-owned subsidiary China Everbright Water (CEWL SP, not covered).

## Valuation

Our Jun-16 PT of HK\$16.6 for CEI is determined based on a sum-of-the-parts valuation, using DCF (WACC of 8.0%, terminal growth rate of 2.3%) to value each of CEI's business segments. Our PT implies FY16E PER of 25x.

Segment	Discount rate	Terminal growth rate/ exit multiple	Valuation methodology	Valuation (HK \$mn)	NAV per share (HK\$)	% of total
Waste-to-energy	8.0%	2.3%	DCF	37,414	8.3	42.3%
Water	8.0%	2.3%	DCF	36,729	8.2	41.6%
Alternative energy	8.0%	2.3%	DCF	14,248	3.2	16.1%
Net debt				(11,899)	(2.7)	
Minority interest				(2,030)	(0.5)	
<b>Total</b>				<b>74,461</b>	<b>16.6</b>	100.0%

Source:

## 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	1.83	2.30
21-Feb-12	N	3.57	3.90
05-Jun-12	OW	3.50	4.50
23-Aug-12	OW	4.11	4.80
07-Nov-12	OW	3.87	4.60
28-Feb-13	OW	5.16	5.30
11-Jul-13	OW	6.35	7.60
06-Aug-13	OW	7.02	8.30
24-Apr-14	OW	10.50	13.00
01-Apr-15	OW	13.16	14.80
11-Jun-15	OW	13.20	16.60

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