

Company Report

China Everbright Intl (257 HK)

Unexpected rights issue shocked the market

■ CEI's 1H18 results in line, but the rights issue crashed share price

■ We cut TP to HK\$9.5 due to share dilution effect on rights issue.

We maintain our BUY given CEI's positive long-term growth prospect

1H18 results in line

CEI's 1H18 recurring net profit grew by 25% YoY to HK\$2.2bn, largely in line with our estimate. Surge in net profit was mainly driven by 74% YoY increase in operation revenue (24 projects commencing operation) and an OPM expansion of 1.6ppts due to the shift to higher margin operation service. An interim DPS of HK\$0.12 was declared, same as last year.

WTE business remains as the key earnings contributor

In 1H18, net profit generating from WTE business accounted for 55% of total EBITDA. CEI maintains a strong project pipeline for its WTE segment; a total of 13,700tpd and 14,850tpd of projects are now under construction and in preparation, respectively. We expect WTE segment to remain its key earnings contributor in the next few years.

Greentech becomes the long-term earnings driver

A total of 25 biomass and HWT projects were under construction during 1H18, leading construction revenue to rise by 43% YoY. With 7 projects commenced operation in 1H18, operating revenue jumped 72% YoY. CEI secured 10 biomass/HWT projects and made breakthrough in environmental remediation business by winning 2 new projects. The rapid expansion in the three business lines will continue to drive the strong growth of Greentech segment.

Unexpected rights issue crashed the share price today

CEI's gearing ratio (total liabilities/total asset) stood at 61% in 1H18. Mgmt. used to emphasize that they had room to gear up to 70% to fund its capex. Hence, its proposed rights issue (10:27) raising HK\$10bn shocks the market; the subscription price of HK\$6.0 is 31% discount to Monday's closing price and the share capital will be enlarged by 37%, accordingly. 60%, 25% and 15% of net proceeds will be used for financing its WTE projects, other environmental protection business, and working capital and repayment of bank loans, respectively. Though the rights issue may accelerate the development of WTE and new business, which should benefit CEI in the long term, a substantially discounted rights issue amidst the tumbling market does send a negative signal to investors.

Financials

Year ended 31 Dec (HK\$ mn)	2016	2017	2018E	2019E	2020E
Revenue	13,971	20,043	26,583	32,738	37,762
Gross profit	5,310	7,133	9,280	10,887	12,242
Reported net profit	2,785	3,533	4,362	5,115	5,827
Recurring net profit	2,825	3,476	4,362	5,115	5,827
Recurring EPS (HK\$)	0.63	0.78	0.89	0.83	0.95
Core P/E (x)	11.0	8.9	7.7	8.3	7.3
P/B (x)	1.8	1.4	1.0	1.1	1.0
Dividend yield (%)	3.0	3.5	4.0	3.7	4.3
ROE (%)	16.1	17.7	15.0	13.7	14.2
Net debt / equity (%)	73.5	72.0	41.8	54.6	63.5

Sources: Company data, CMS (HK) estimates

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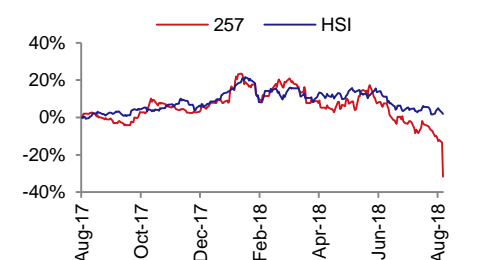
WHAT'S NEW

TP changes

BUY

Previous Rating	BUY
Price	HK\$6.90
12-month Target Price (Potential up/downside)	HK\$9.5 (37.7%)
Previous Target Price	HK\$13.0

Price Performance



Source: Bloomberg

%	1m	6m	12m
257 HK	(30.0)	(42.5)	(31.7)
HSI	(2.7)	(11.7)	1.8

Sector: Environmental Protection

Hang Seng Index	27,753
HSCEI	10,744

Key Data

52-week range (HK\$)	12.8-6.51
Market cap (HK\$ mn)	30,931
Avg. daily volume (mn)	10.96
BVPS (HK\$) (2018E)	7.24

Shareholding Structure

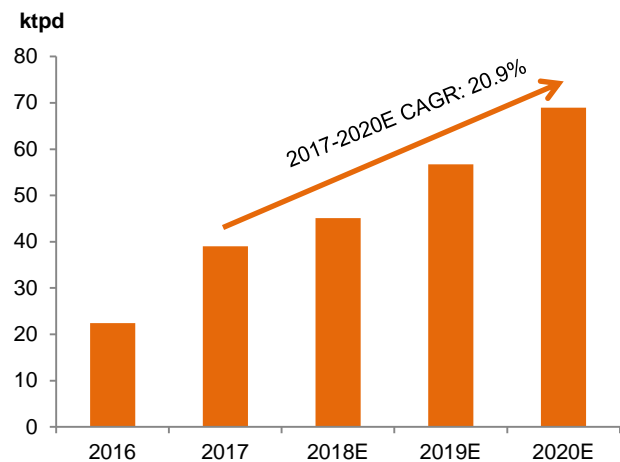
Guildford Ltd	39.2
RRJ Capital Master Fund II LP	5.9
Pictet Funds SA	2.3
Everbright Investment & Management	2.2
No. of shares outstanding (mn)	4,483
Free float (mn)	2,442

Related Research

1. China Waste Treatment – Treasure hunt in the wastes (Overweight) 20180705

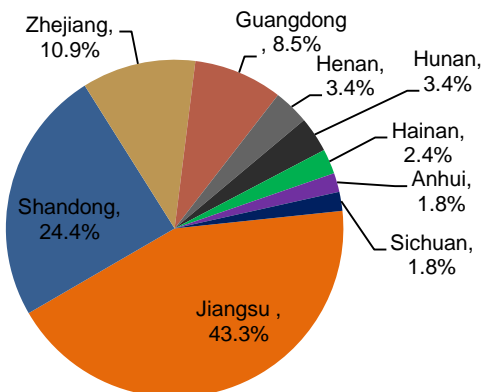
Focus charts

Figure 1: CEI – WTE capacities in operation



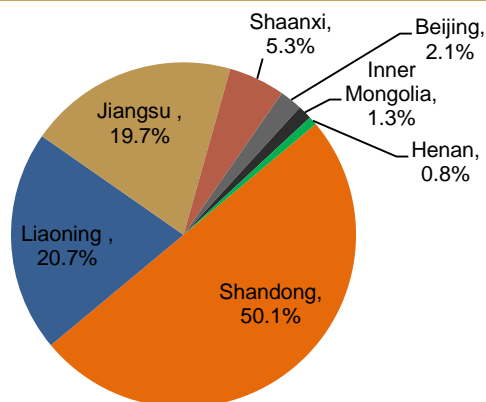
Sources: Company data, CMS (HK) estimates

Figure 2: CEI – WTE capacity in operation by province in Jul 2018



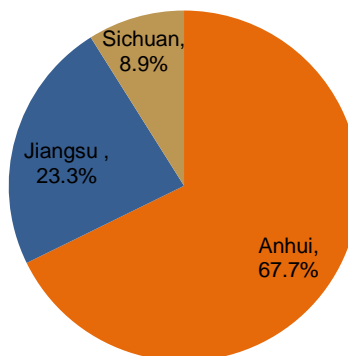
Sources: Company data, CMS (HK)

Figure 3: CEI – WWT capacity in operation by province in Jul 2018



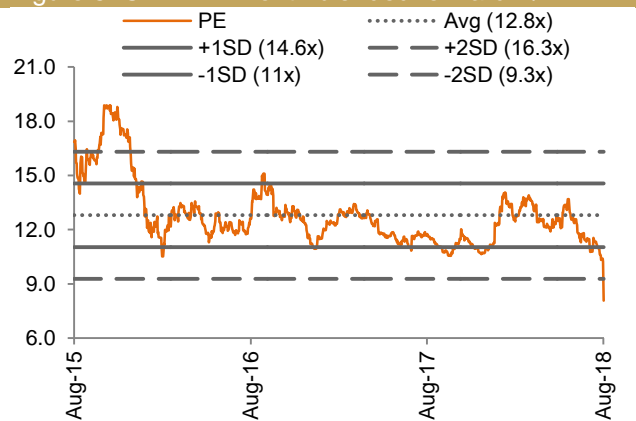
Sources: Company data, CMS (HK)

Figure 4: CEI – Biomass plants in operation by province in Jul 2018



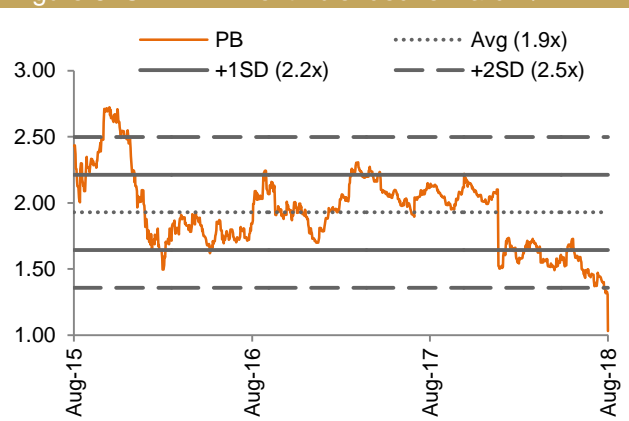
Sources: Bloomberg, CMS (HK)

Figure 5: CEI – 12-month blended forward P/E



Sources: Bloomberg, CMS (HK)

Figure 6: CEI – 12-month blended forward P/B



Sources: Bloomberg, CMS (HK)

CEI's 1H2018 results highlights

Figure 7: CEI – 1H2018 results highlights

HK\$ mn	1H2017	1H2018	% change	Comments
Revenue	9,142	11,784	28.9%	Mainly driven by +74% YoY in operation revenue
Cost of sales	(5,834)	(7,301)	25.1%	
Gross profit	3,308	4,484	35.6%	Change in revenue mix to higher margin operation revenue
<i>Gross margin</i>	36.2%	38.0%	+1.8ppts	
Other revenue	214	294	37.3%	
Other income and gains/(losses), net	21	(3)	-113.5%	
Administrative expenses	(570)	(756)	32.6%	
Operating profit	2,972	4,018	35.2%	
<i>Operating margin</i>	32.5%	34.1%	+1.6ppts	
Finance costs	(411)	(619)	50.7%	Debt level and interest rate increased by 15% and 0.4ppts
Interest income	33	52	56.3%	
Share of profits of JV and associates	28	46	63.9%	
Profit before tax	2,623	3,497	33.3%	
Income tax expense	(624)	(857)	37.3%	Effective tax rate increased slightly by 0.7ppts
Profit after taxation	1,999	2,640	32.1%	
Non-controlling interests	(203)	(439)	116.3%	
Net profit	1,796	2,201	22.6%	
<i>Net margin</i>	19.6%	18.7%	-0.9ppts	
Recurring net profit	1,761	2,204	25.1%	Fair value gain of derivative financial instrument of RMB34mn in 1H17
<i>Recurring net margin</i>	19.3%	18.7%	-0.6ppts	
Basic EPS (HK\$)	0.4006	0.4910	22.6%	
Diluted EPS (HK\$)	0.4006	0.4910	22.6%	
Interim DPS (HK\$)	0.1200	0.1200	0.0%	
Other financial data (HK\$ mn)				
Total cash & cash equivalent	10,838	9,084	-16.2%	
Total debt	31,454	36,047	14.6%	
Net debt (cash)	20,616	26,963	30.8%	
Shareholders' fund	28,644	31,697	10.7%	
Net debt (cash) / equity	72.0%	85.1%	+13.1ppts	
Operating data				
<u>Environmental Energy</u>				
Designed daily household waste processing capacity				
- In operation (tonnes)	28,300	45,800	61.8%	1H18: 54 projects vs 1H17: 32 projects
- Under construction (tonnes)	14,750	13,700	-7.1%	1H18: 14 projects vs 1H17: 20 projects
- In preparatory stage (tonnes)	12,500	14,850	18.8%	1H18: 17 projects vs 1H17: 13 projects
Actual processed household waste (mn tonnes)	5.22	8.62	65.2%	
Power generated (MWh)	1,521,241	2,519,605	65.6%	
<u>Environmental Water</u>				
Designed daily WWT capacity (mn m3)	3.82	3.84	0.5%	
Actual treated waste water (mn m3)	568	612	7.9%	
<u>Greentech</u>				
Biomass designed annual on-grid electricity generation				
- In operation (MWh)	1,362,000	2,584,381	89.7%	1H18: 19 projects vs 1H17: 10 projects
- Under construction (MWh)	1,554,000	1,992,312	28.2%	1H18: 13 projects vs 1H17: 10 projects
- In preparatory stage (MWh)	2,474,472	2,256,263	-8.8%	1H18: 17 projects vs 1H17: 18 projects
Hazardous waste annual designed processing capacity				
- In operation (tonnes)	131,000	173,980	32.8%	1H18: 10 projects vs 1H17: 8 projects
- Under construction (tonnes)	40,000	100,000	150.0%	1H18: 4 projects vs 1H17: 2 projects
- In preparatory stage (tonnes)	423,000	617,000	45.9%	1H18: 19 projects vs 1H17: 16 projects
Actual hazardous waste processed (tonnes)	55,000	69,000	25.5%	

Sources: Company data, CMS (HK)

Figure 8: CEI – 1H2018 key financial highlights by segment

	1H2017	1H2018	% change	Comments
Turnover by segment (HK\$ mn)				
Environmental energy project construction and operation	5,184	5,913	14.1%	Driven by +76% YoY in operation services revenue
Environmental water project construction and operation	1,643	2,310	40.6%	Driven by 1) +27% YoY from construction services revenue due to the construction of sponge city, river-basin ecological restoration project and expansion of water supply project; and 2) +77% YoY from operation services revenue due to tariff hikes and commencement of operation of new projects.
Greentech project construction and operation	2,047	3,151	53.9%	Driven by +43% YoY and +71% YoY from construction and operation services revenue respectively
Others	269	411	53.2%	
	9,142	11,784	28.9%	
Turnover by segment, % of total				
Environmental energy project construction and operation	56.7%	50.2%	-6.5ppts	
Environmental water project construction and operation	18.0%	19.6%	+1.6ppts	
Greentech project construction and operation	22.4%	26.7%	+4.3ppts	
Others	2.9%	3.5%	+0.6ppts	
	100.0%	100.0%		
EBITDA (HK\$ mn)				
Environmental energy project construction and operation	1,988	2,644	33.0%	
Environmental water project construction and operation	551	783	41.9%	
Greentech project construction and operation	729	1,031	41.4%	
Others	296	383	29.5%	
	3,565	4,841	35.8%	
EBITDA margin ratio (%)				
Environmental energy project construction and operation	38.4%	44.7%	+6.3ppts	
Environmental water project construction and operation	33.6%	33.9%	+0.3ppts	
Greentech project construction and operation	35.6%	32.7%	-2.9ppts	

Sources: Company data, CMS (HK)

Maintain BUY, but cut TP to HK\$9.5

We trimmed our 2018-20 earnings forecast by 1-4% mainly due to our higher assumption of MI. Together with the share dilution effect on the rights issue, we cut our DCF-based target price by 27% to HK\$9.5 based on a WACC of 7.7% and a terminal growth rate of 3.9%. We maintain our BUY rating underpinned by CEI's positive long-term growth prospect.

Figure 9: CEI – key assumptions, EPS and target price revision

		Old	New	% chg
Key assumptions				
Adjusted weighted average diluted shares (in mn)	2018E	4,483	4,898	9.3%
	2019E	4,483	6,143	37.0%
	2020E	4,483	6,143	37.0%
Non-controlling interests (HK\$ mn)	2018E	695	877	26.3%
	2019E	802	1,028	28.2%
	2020E	904	1,171	29.5%
Recurring earnings (HK\$ mn)	2018E	4,532	4,362	-3.7%
	2019E	5,236	5,115	-2.3%
	2020E	5,903	5,827	-1.3%
DCF target price (HK\$)		13.00	9.50	-26.9%

Sources: CMS (HK) estimates

Catalysts and key risks

The near term catalysts and upside risks to our forecast are: 1) more projects are secured; and 2) faster-than-expected M&As.

The key downside risks to our target price include: 1) fiercer-than-expected market competition resulting in slower capacity expansion and lower project returns; 2) project delays; 3) higher-than-expected raw materials cost for biomass; and 4) subsidy payment delays of biomass electricity tariff.

Financial Summary

Balance Sheet

Year ended 31 Dec (HK\$m)	2016	2017	2018E	2019E	2020E
Property, plant and equipment	3,029	4,025	4,368	4,657	4,919
Associates & JCE	573	792	871	965	1,074
Intangible assets	5,686	8,593	12,196	17,160	22,347
Goodwill	1,563	1,747	1,747	1,747	1,747
Other receivables and gross amounts due from customers for contract work	25,958	37,859	47,192	56,517	65,195
Others	414	470	475	481	492
Non-current assets	37,225	53,486	66,849	81,528	95,774
Other receivables and gross amounts due from customers for contract work	4,906	8,287	10,330	12,371	14,271
Pledged bank deposits and deposits with bank	697	2,181	2,181	2,181	2,181
Cash	6,341	8,657	16,536	11,643	7,185
Others	363	512	685	865	1,009
Current assets	12,307	19,637	29,732	27,059	24,646
Total assets	49,532	73,123	96,581	108,587	120,420
Interest-bearing borrowings	4,414	5,415	6,307	6,841	7,376
Creditors, other payables and accrued expenses	4,804	8,505	11,980	15,560	18,426
Tax payable	97	114	147	172	196
Current liabilities	9,316	14,035	18,433	22,574	25,997
Interest-bearing borrowings	17,201	26,039	30,145	32,608	35,071
Other payables	94	94	133	172	204
Deferred tax liabilities	3,076	4,312	5,454	6,290	7,047
Non-current liabilities	20,370	30,445	35,731	39,070	42,321
Total liabilities	29,687	44,480	54,165	61,643	68,319
Total net assets	19,845	28,644	42,417	46,944	52,101
Share capital	7,405	7,405	10,148	10,148	10,148
Reserves	9,984	15,149	25,330	28,862	32,886
Shareholder's equity	17,389	22,554	35,478	39,010	43,034
Minority interests	2,456	6,089	6,938	7,934	9,067
Total Equity	19,845	28,644	42,417	46,944	52,101
Total debts	21,616	31,454	36,451	39,449	42,446
Net cash/(debts)	(14,578)	(20,616)	(17,734)	(25,625)	(33,080)
BVPS (HK\$)	3.88	5.03	7.24	6.35	7.01

Cashflow Statement

Year ended 31 Dec (HK\$m)	2016	2017	2018E	2019E	2020E
Operating profit	4,669	6,165	8,039	9,511	10,825
Dep. & Amort.	313	497	323	364	408
Chg in working cap	(4,330)	(9,846)	(8,036)	(7,926)	(7,825)
Others	(143)	368	623	355	331
Interest received	46	84	133	188	133
Tax paid	(335)	(370)	(528)	(681)	(847)
Net cash from operations	221	(3,102)	554	1,811	3,025
Capex	(520)	(839)	(1,150)	(1,188)	(1,228)
Acquisition of subsidiaries	(1,042)	(36)	0	0	0
Additions of intangible assets	(2,637)	(2,716)	(3,937)	(5,431)	(5,813)
Others	(36)	(1,242)	0	0	0
Net cash from investments	(4,236)	(4,833)	(5,087)	(6,619)	(7,041)
Issue/ buyback of shares	(8)	0	9,912	0	0
Dividends paid	(874)	(1,121)	(1,213)	(1,467)	(1,693)
Net change in debt	6,220	7,665	5,000	3,000	3,000
Others	(625)	3,399	(1,287)	(1,619)	(1,749)
Net cash from financing	4,713	9,944	12,412	(86)	(442)
Net change in cash	698	2,009	7,879	(4,894)	(4,458)
Adjustments	(311)	308	0	0	0
Opening cash	5,953	6,341	8,657	16,536	11,643
Closing cash	6,341	8,657	16,536	11,643	7,185

Profit & Loss Statement

Year ended 31 Dec (HK\$m)	2016	2017	2018E	2019E	2020E
Turnover	13,971	20,043	26,583	32,738	37,762
COGS	(8,662)	(12,911)	(17,303)	(21,851)	(25,520)
Gross profit	5,310	7,133	9,280	10,887	12,242
Other revenue	418	471	653	836	1,035
Admin	(1,059)	(1,438)	(1,894)	(2,212)	(2,452)
Total opex	(641)	(967)	(1,241)	(1,376)	(1,417)
Operating profit	4,669	6,165	8,039	9,511	10,825
Finance costs, net	(593)	(831)	(1,109)	(1,389)	(1,573)
Share of Associates & JCE	63	60	79	95	108
Change in fair value of derivative financial instruments	(29)	72	0	0	0
Exceptional item	(11)	(15)	0	0	0
Pre-tax profit	4,099	5,451	7,009	8,217	9,361
Tax	(1,062)	(1,376)	(1,769)	(2,074)	(2,362)
Profit after tax	3,037	4,075	5,240	6,143	6,999
Minority Interest	(252)	(542)	(877)	(1,028)	(1,171)
Net profit	2,785	3,533	4,362	5,115	5,827
Non-core items adj.	40	(57)	0	0	0
Core profit	2,825	3,476	4,362	5,115	5,827
EBITDA	4,982	6,662	8,362	9,876	11,234
Basic EPS	0.62	0.79	0.89	0.83	0.95
Fully diluted core EPS (HK\$)	0.63	0.78	0.89	0.83	0.95
DPS (HK\$)	0.21	0.24	0.28	0.26	0.29

Financial Ratios

Year ended 31 Dec (HK\$m)	2016	2017	2018E	2019E	2020E
YoY growth rate (%)					
Turnover	63.8	43.5	32.6	23.2	15.3
EBITDA	37.7	33.7	25.5	18.1	13.8
Operating profit	36.0	32.1	30.4	18.3	13.8
Core profit	41.7	23.1	25.5	17.3	13.9
Fully diluted core EPS	41.7	23.1	14.9	(6.5)	13.9
DPS	10.8	17.1	14.9	(6.5)	13.9
Margins (%)					
Gross margin	38.0	35.6	34.9	33.3	32.4
EBITDA margin	35.7	33.2	31.5	30.2	29.7
EBIT margin	33.4	30.8	30.2	29.1	28.7
Net margin (Core profit)	20.2	17.3	16.4	15.6	15.4
Effective tax rate (%)	26.3	25.5	25.5	25.5	25.5
Total opex as % of rev	4.6	4.8	4.7	4.2	3.8
Interest coverage (x)	7.9	7.4	7.2	6.8	6.9
Dividend payout (%)	32.5	31.0	31.0	31.0	31.0
Net debt/equity (%)	73.5	72.0	41.8	54.6	63.5
Net debt/total cap (%)	42.3	41.9	29.5	35.3	38.8
Current ratio (x)	1.3	1.4	1.6	1.2	0.9
Returns (%)					
Asset turnover (x)	0.3	0.3	0.3	0.3	0.3
Financial leverage (x)	2.6	3.1	2.9	2.8	2.8
EBIT margin (%)	33.8	31.0	30.5	29.3	29.0
Interest burden (x)	0.9	0.9	0.9	0.9	0.9
Tax burden (x)	0.7	0.6	0.6	0.6	0.6
ROE (%)	16.1	17.7	15.0	13.7	14.2
ROIC (%)	9.1	9.2	9.1	8.7	8.9

Sources: Company data, CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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