



Rating
Buy

Asia
China

Utilities
Utilities

Company
**China Everbright
Int'l**

Reuters 0257.HK Bloomberg 257 HK Exchange HSI Ticker 0257

Date
14 August 2018

Forecast Change

Price at 14 Aug 2018 (HKD)	6.90
Price target - 12mth (HKD)	8.80
52-week range (HKD)	12.62 - 6.90
HANG SENG INDEX	27,937

Lower target price on rights issue but long-term value emerges; In-line 1H18

Lower target price on rights issue; in-line 1H18 results

China Everbright International (CEI) announced a surprise rights issue at lunchtime on 14 Aug, despite in-line 1H18 results. We lower our target price to HKD8.8 driven by 1) lower EPS forecasts and 2) longer receivable days assumptions. After the 21% share price decline today, we see value in CEI - the stock is trading at 7.6x PE and 1.05x PB (15% ROE) in 2019e. Looking further ahead and focusing only on operational earnings, CEI is trading at 16x recurring operational earnings in 2020e, looking attractive as 1) CEI should still generate decent operational earnings growth and 2) HK utility names are trading at 16x PE in 2020e with very low earnings growth. Maintain Buy on CEI's long-term value and we expect the share price to be driven by 1) earnings (especially operations earnings) growth and 2) potential share-incentive scheme for management.

Surprise rights issue

CEI would enlarge its share count by 37% with the rights issue at HKD6.0/share. Net proceeds from the rights issue should be HKD9,912m and this will be used to 1) develop waste-to-energy (WTE) projects (60% of proceeds); 2) pursue other environmental businesses such as technological R&D, equipment manufacturing, waste sorting, atmospheric monitoring and testing etc. (25% of proceeds) and 3) repay bank loans and use as general working capital (15% of proceeds). We now expect CEI's Net debt/Equity to be 58% by Dec 2018 (vs 102% previously), driven by the rights issue.

Earnings and target price revisions

We lower our EPS forecasts by 8%/23%/18% for 2018/19/20e as we factor in 1) the dilutive effect from the rights issue and 2) lower RMB exchange rate assumptions, partially offset by 1) lower finance cost assumptions and 2) higher operational earnings assumptions. Our target price is lowered to HKD8.8 on back of 1) the EPS decrease and 2) longer receivable turnover days assumptions.

Key takeaways from post-results briefing

CEI decided to do the rights issue as they see great potential in both WTE and other emerging business areas. CEI plans to develop into a full-service and full value chain environmental player and targets to become a leading player in the global environmental protection industry in 5-10 years. Management mentioned that the rights issue price was set at 25% discount to the theoretical ex-rights price so as to benefit existing shareholders. Management expects proceeds to be

Valuation & Risks

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Key changes

TP	12.80 to 8.80	↓	-31.2%
Sales (FYE)	26,780 to 26,855	↑	0.3%
Op prof margin (FYE)	30.9 to 31.5	↑	1.8%
Net profit (FYE)	4,358.8 to 4,517.6	↑	3.6%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-30.0	-37.8	-33.3
HANG SENG INDEX	-2.1	-11.4	2.5

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	15.5
Net debt/equity (%)	57.7
Book value/share (HKD)	5.84
Price/book (x)	1.2
Net interest cover (x)	6.4
Operating profit margin (%)	31.5

Source: Deutsche Bank



put into projects generating returns no lower than current projects but did not provide a split for proceeds use of greenfield vs M&A and China vs overseas.

Major highlights from 1H18 results

Recurring profit (after stripping out pre-tax net loss of HKD3m) was HKD2.2bn, up 24% yoy and in line with DBE. CEI declared a dividend of HKD0.12/share (flat yoy), representing a payout ratio of 24%. Net debt/equity was 89% as of Jun 2018, up from 80% as of Dec 2017. Effective finance cost marginally rose from 3.5% in FY17 to 3.7% in 1H18.

Positive surprises: WTE adjusted operations revenue (operations revenue + finance income) was HKD2.1bn, up 61% yoy and 39% hoh. Administration expense as % of adjusted operation revenue was 15%, down 4ppt vs 1H17. Revenue from Other segments (Envirotech + Equipment Manufacturing + International Business) reached HKD411m, up 53% yoy.

Negative surprises: WTE construction revenue was only HKD3.8bn, down 2% yoy and down 13% hoh. Receivable days (debtors/adjusted operation revenue) rose from 120 days in 1H17 to 150 days in 1H18.

This report focuses on the business segments of Environmental Energy, Envirotech, Equipment Manufacturing and International Business. The other two major segments, Greentech and Environmental Water, reported results on 6 Aug and 7 Aug, respectively, and should represent 20%/11% of CEI's 1H18 earnings. For details on Greentech and Environmental Water, please refer to [China Everbright Greentech - Solid 1H18 results; Reiterate Buy \(2018-08-06\)](#)/ [China Everbright Water - In-line 1H18 results \(2018-08-07\)](#).

Forecasts and ratios

Year End Dec 31	2016A	2017A	2018E	2019E	2020E
Sales (HKDm)	13,971	20,043	26,855	33,483	37,933
EBITDA (HKDm)	4,988	6,803	9,114	11,378	13,123
Reported NPAT (HKDm)	2,785	3,510	4,518	5,577	6,305
Reported EPS FD(HKD)	0.621	0.783	0.897	0.908	1.026
DB EPS FD (HKD)	0.638	0.781	0.897	0.908	1.026
OLD DB EPS FD (HKD)	0.638	0.781	0.972	1.176	1.255
% Change	0.0%	0.0%	-7.7%	-22.8%	-18.2%
DB EPS growth (%)	-	22.4	14.9	1.2	13.0
PER (x)	13.9	13.0	7.7	7.6	6.7
Price/BV (x)	2.3	2.2	1.2	1.1	0.9
EV/EBITDA (x)	11.4	10.7	7.1	7.0	7.0
DPS (net) (HKD)	0.205	0.240	0.184	0.227	0.257
Yield (net) (%)	2.3	2.4	2.7	3.3	3.7
ROE (%)	16.1	17.6	15.5	14.7	14.8

Source: Deutsche Bank estimates, company data



Details on the rights issue

CEI plans to issue 1,660m shares under the rights issue (vs. existing shares of 4,483m) at HKD6.0, enlarging its share capital by 37% (i.e. 10 rights shares for every 27 existing shares). CE Hong Kong, CEI's controlling shareholder with 41.6% stake (1,865m existing shares), plans to subscribe up to 801m shares comprising 1) 691m shares rights shares and 2) 110m shares by applying for excess rights shares. CE Hong Kong's ownership in CEI would be between 41.6% and 43.4% after the rights issue, depending on how many excess right shares it gets from non-participating shareholders.

Net proceeds from the rights issue should be HKD9,912m and they will be used to 1) develop waste-to-energy (WTE) projects (60% of proceeds); 2) pursue other environmental business such as technological R&D, equipment manufacturing, waste sorting, atmospheric monitoring and testing etc. (25% of proceeds) and 3) repay bank loans and be used as general working capital (15% of proceeds).

Assuming 1:3 equity/capital ratio for WTE projects, we calculate that proceeds can be used to carry out WTE projects with total investments of HKD17.8bn. We expect CEI's Net debt/Equity to decline from 102% (before the rights issue) to 58% (after the rights issue) by Dec 2018.

Key takeaways from post-results briefing

Scale and project quality are among the most important focus of the company.

CEI targets to become a leading player in global environmental protection industry in 5-10 years in terms of asset size/revenue/waste volume processed. Management also focuses a lot on project quality.

Management mentioned that the exercise price was set at 25% discount to theoretical ex-rights' price so as to benefit existing shareholders. **Purpose of the rights issue is primarily to finance potential new opportunities in both WTE and emerging business areas.** Management believes that **proceeds from the rights issue is able to finance company development in next 5 years** and sees opportunities in:

- WTE: Management expects market consolidation as tighter regulation squeezes out small players, and CEI is highly likely to participate in M&A in next few years. Management expects 200ktpd WTE capacity addition from now to 2020 in China. If CEI takes up 30% market share (similar to CEI's market share in 1H18), that translates to investment amount of RMB30bn. Assuming 1/3 to be financed through equity, RMB10bn would be required for these projects. Required return of the new WTE projects would be same with existing projects.
- Other segments including equipment manufacturing, environmental monitoring, waste sorting. Management estimates market size of air quality monitoring to be ~RMB30bn per year (RMB10m spending per county/city per year x 2600 counties). **The company targets to develop full service and full industry chain** and would focus on high-tech, asset-light, and higher return business models. Required return of new business models would be higher than that of WTE. Management expects to be industry top 3 player for each of the new segments they enter.



Management did not provide specific split on the proceeds use between domestic vs. international, or M&A vs. greenfield projects.

The group is studying on new share-based incentive plans as the current incentive scheme is not good enough for the company to become a leading environmental company in the future.

Management believes that power tariff subsidy for WTE/biomass will not be cut near term given 1) environmental protection industry is highly valued by central government, 2) unlike solar, environmental protection is not that profitable due to high operation/maintenance cost, and 3) WTE+biomass subsidy comprises only 9% of the total renewable energy subsidy needed. CEI make sure that they specifically mention in their service concession contracts that the company can adjust treatment fees in case of tariff change.

Capex plan. HKD6.6bn incurred in 1H18. Total capex (WTE+water+Greentech) would probably be ~HKD12bn in FY18.

Earnings, EPS and target price revision

We lower our EPS forecast by 8%/23%/18% for 2018/19/20e as we factor in 1) the dilution effect from the rights issue and 2) lower RMB exchange rate assumptions and partially offset by 1) lower finance costs assumptions and 2) higher operation earnings assumptions. Our economist expects USD/CNY to depreciate to 6.95 by end 2018. Our target price is lowered to HKD8.8 on back of the EPS revision and longer receivable turnover days assumptions.

Figure 1: Recurring earnings and target price revision

Company	Ticker	Recurring earnings			% of change			Recurring EPS			% of change			New	Target price		Change
		2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E		Old	Change	
CEI	0257.HK	4,518	5,577	6,305	4%	6%	12%	0.90	0.91	1.03	-8%	-23%	-18%	8.8	12.8	-31%	

Source: Company data, Deutsche Bank estimates

Figure 2: HKD/CNY foreign exchange rate forecast change

		Old			New			% change		
		2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E
HKD/CNY	Yr. end	0.87	0.87	0.87	0.89	0.89	0.89	2%	2%	2%
HKD/CNY	Average	0.85	0.87	0.87	0.86	0.89	0.89	1%	2%	2%

Source: Deutsche Bank estimates

Figure 3: DB vs. Consensus

Company name	Ticker	2018E recurring earnings			2019E recurring earnings			2020E recurring earnings		
		DB	Consensus	DBe vs. consensus	DB	Consensus	DBe vs. consensus	DB	Consensus	DBe vs. consensus
CEI	0257.HK	4,518	4,428	2%	5,577	5,312	5%	6,305	5,869	7%

Source: Company data, Bloomberg Financial LP, Deutsche Bank estimates



Figure 4: 1H18 results

P&L (HKDm)	1H17	2H17	1H18	YoY	HoH
Revenue	9,142	10,901	11,784	29%	8%
Direct costs and operating expenses	(5,834)	(7,076)	(7,301)	25%	3%
Gross profit	3,308	3,825	4,484	36%	17%
<i>Gross margin</i>	36%	35%	38%		
Other revenue	247	308	345	40%	12%
Other income/(loss)	21	36	(3)	n.a.	n.a.
Administrative expenses as % of "cash" revenue	(570) 19%	(868) 23%	(756) 15%	33%	-13%
Profit from operations	3,005	3,301	4,070	35%	23%
Gross finance costs	(411)	(528)	(619)	51%	17%
Share of profits of associates	28	(30)	2	n.a.	n.a.
Share of profits of joint venture	(1)	62	44	n.a.	-29%
Profit before taxation	2,623	2,805	3,497	33%	25%
Income tax	(624)	(752)	(857)	37%	14%
<i>Effective tax rate %</i>	24%	27%	25%		
Profit from discontinued operation	-	-	-	n.a.	n.a.
Profit for the year	1,999	2,053	2,640	32%	29%
Minority Interest	(203)	(339)	(439)	116%	30%
<i>% of profit</i>	10%	17%	17%		
Net profit	1,796	1,714	2,201	23%	28%
<i>net margin (%)</i>	20%	16%	19%	-1ppt	3ppt
<i>One-offs</i>	34	(21)	(3)		
Recurring net profit	1,772	3,501	2,203	24%	-37%

Source: Company data, Deutsche Bank



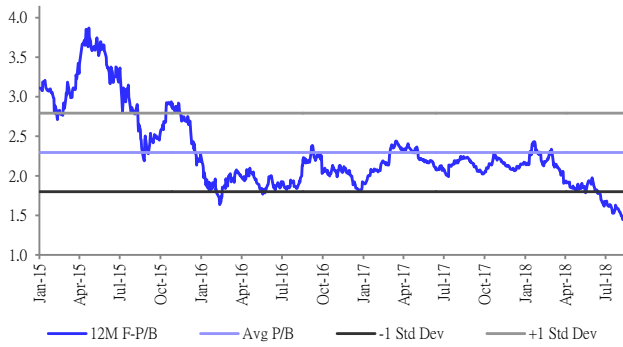
Figure 5: 1H18 results breakdown

(HKDm)	1H17	2H17	1H18	YoY	HoH
Revenue					
Environmental Energy	5,184	5,876	5,913	14%	1%
-Construction services	3,850	4,329	3,768	-2%	-13%
-Operation services	736	813	1,296	76%	60%
-Finance income	598	735	848	42%	15%
Environmental Water	1,643	1,949	2,310	41%	19%
-Construction services	977	1,134	1,241	27%	9%
-Operation services	388	491	686	77%	40%
-Finance income	277	324	383	38%	18%
Greentech	2,047	2,533	3,151	54%	24%
-Construction services	1,304	1,649	1,871	43%	13%
-Operation services	710	837	1,219	72%	46%
-Finance income	33	47	61	86%	31%
Others	269	543	411	53%	-24%
Total	9,142	10,901	11,784	29%	8%
EBITDA					
Environmental Energy(WTE)	1,988	2,202	2,644	33%	20%
Environmental Water	551	636	783	42%	23%
Greentech	729	814	1,031	41%	27%
Others	296	240	383	30%	60%
Eliminations	(263)	(507)	(365)	39%	-28%
Total	3,302	3,385	4,475	36%	32%
EBITDA margin					
Environmental Energy(WTE)	38%	37%	45%	6ppt	7ppt
Environmental Water	34%	33%	34%	0ppt	1ppt
Greentech	36%	32%	33%	-3ppt	1ppt
Others	12%	-49%	4%	-8ppt	54ppt
Overall	36%	31%	38%	2ppt	7ppt
Net profit					
Environmental Energy(WTE)	1,315	1,383	1,739	32%	26%
Environmental Water	196	202	279	42%	38%
Greentech	431	355	451	5%	27%
Total	1,942	1,940	2,468	27%	27%
Net profit margin					
Environmental Energy(WTE)	25%	24%	29%	4ppt	6ppt
Environmental Water	12%	10%	12%	0ppt	2ppt
Greentech	21%	14%	14%	-7ppt	0ppt
Overall	21%	18%	21%	0ppt	3ppt

Source: Company data, Deutsche Bank



Figure 6: CEI 12m forward PB



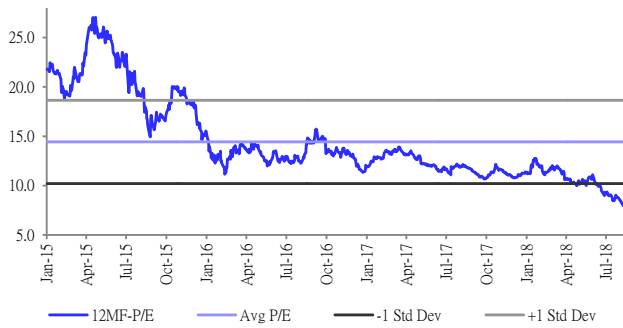
Source: Bloomberg Financial LP, Deutsche Bank

Figure 7: PB of CEI vs. MSCI China, 12m-forward



Source: Bloomberg Financial LP, Deutsche Bank

Figure 8: CEI 12m-forward PE



Source: Bloomberg Financial LP, Deutsche Bank

Figure 9: PE of CEI vs. MSCI China, 12-forward



Source: Bloomberg Financial LP, Deutsche Bank



Model updated: 14 August 2018

Running the numbers

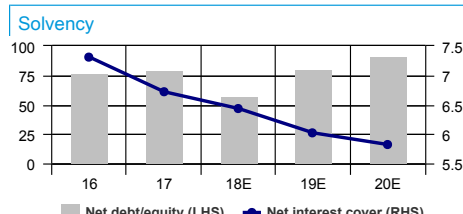
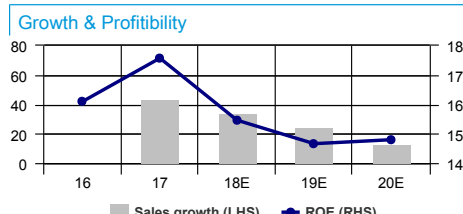
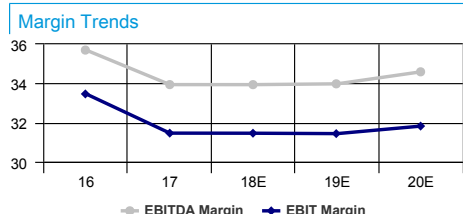
Asia
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Utilities

China Everbright Int'l
 Reuters: 0257.HK Bloomberg: 257 HK

Buy

Price (14 Aug 18)	HKD 6.90
Target Price	HKD 8.80
52 Week range	HKD 6.90 - 12.62
Market cap (m)	HKDm 34,749 USDm 4,426.7

Company Profile
 China Everbright International is primarily engaged in environmental protection project investments such as sewage water treatment, waste-to-energy and solid waste disposal. The company also operates a toll bridge in Fuzhou, Fujian province. China Everbright Int'l is controlled by China Everbright Group and has positioned itself as the environmental investment arm of its parent.



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Fiscal year end 31-Dec

	2016	2017	2018E	2019E	2020E
Financial Summary					
DB EPS (HKD)	0.64	0.78	0.90	0.91	1.03
Reported EPS (HKD)	0.62	0.78	0.90	0.91	1.03
DPS (HKD)	0.21	0.24	0.18	0.23	0.26
BVPS (HKD)	3.9	5.0	5.8	6.5	7.3
Weighted average shares (m)	4,483	4,483	5,036	6,143	6,143
Average market cap (HKDm)	39,630	45,680	34,749	34,749	34,749
Enterprise value (HKDm)	56,711	72,895	64,623	79,780	91,443

Valuation Metrics

P/E (DB) (x)	13.9	13.0	7.7	7.6	6.7
P/E (Reported) (x)	14.2	13.0	7.7	7.6	6.7
P/BV (x)	2.27	2.22	1.18	1.05	0.94
FCF Yield (%)	nm	nm	nm	nm	nm
Dividend Yield (%)	2.3	2.4	2.7	3.3	3.7
EV/Sales (x)	4.1	3.6	2.4	2.4	2.4
EV/EBITDA (x)	11.4	10.7	7.1	7.0	7.0
EV/EBIT (x)	12.1	11.6	7.6	7.6	7.6

Income Statement (HKDm)

Sales revenue	13,971	20,043	26,855	33,483	37,933
Gross profit	5,623	7,629	10,512	13,058	15,017
EBITDA	4,988	6,803	9,114	11,378	13,123
Depreciation	163	219	273	328	379
Amortisation	150	278	393	524	673
EBIT	4,675	6,306	8,448	10,527	12,072
Net interest income/(expense)	-640	-938	-1,313	-1,748	-2,073
Associates/affiliates	63	60	91	91	91
Exceptionals/extraordinary	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	4,099	5,428	7,226	8,869	10,089
Income tax expense	1,062	1,376	1,855	2,282	2,600
Minorities	252	542	854	1,010	1,185
Other post-tax income/(expense)	0	0	0	0	0
Net profit	2,785	3,510	4,518	5,577	6,305
DB adjustments (including dilution)	76	-9	0	0	0
DB Net profit	2,861	3,501	4,518	5,577	6,305

Cash Flow (HKDm)

Cash flow from operations	221	-3,102	-5,390	-5,938	-2,108
Net Capex	-3,189	-3,552	-4,008	-5,295	-4,907
Free cash flow	-2,968	-6,654	-9,398	-11,233	-7,016
Equity raised/(bought back)	0	0	9,912	0	0
Dividends paid	-874	-1,121	-1,103	-1,262	-1,485
Net inc/(dec) in borrowings	6,220	8,810	8,490	11,535	5,461
Other investing/financing cash flows	-1,780	3,086	-1,313	-1,748	-2,073
Net cash flow	597	0	0	0	0
Change in working capital	-4,330	-9,846	-13,765	-16,438	-14,088

Balance Sheet (HKDm)

Cash and other liquid assets	6,341	8,657	15,252	12,548	7,440
Tangible fixed assets	3,187	4,190	4,724	5,668	5,946
Goodwill/intangible assets	7,250	10,340	13,152	16,656	20,239
Associates/investments	651	1,671	1,762	1,853	1,944
Other assets	32,104	48,265	66,084	85,401	103,979
Total assets	49,532	73,123	100,974	122,127	139,548
Interest bearing debt	21,616	31,454	39,944	51,479	56,940
Other liabilities	8,071	13,026	18,205	22,499	28,454
Total liabilities	29,687	44,480	58,150	73,978	85,394
Shareholders' equity	17,389	22,554	35,881	40,197	45,016
Minorities	2,456	6,089	6,943	7,953	9,138
Total shareholders' equity	19,845	28,644	42,824	48,149	54,154
Net debt	15,275	22,797	24,693	38,931	49,500

Key Company Metrics

Sales growth (%)	nm	43.5	34.0	24.7	13.3
DB EPS growth (%)	na	22.4	14.9	1.2	13.0
EBITDA Margin (%)	35.7	33.9	33.9	34.0	34.6
EBIT Margin (%)	33.5	31.5	31.5	31.4	31.8
Payout ratio (%)	33.0	30.7	20.5	25.0	25.0
ROE (%)	16.1	17.6	15.5	14.7	14.8
Capex/sales (%)	22.8	17.7	14.9	15.8	12.9
Capex/depreciation (x)	10.2	7.2	6.0	6.2	4.7
Net debt/equity (%)	77.0	79.6	57.7	80.9	91.4
Net interest cover (x)	7.3	6.7	6.4	6.0	5.8

Source: Company data, Deutsche Bank estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
China Everbright Int'l	0257.HK	6.90 (HKD) 14 Aug 2018	14

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <https://research.db.com/Research/Disclosures/CompanySearch>. Aside from within this report, important risk and conflict disclosures can also be found at <https://research.db.com/Research/Topics/Equities?topicId=RB0002>. Investors are strongly encouraged to review this information before investing.

Important Disclosures Required by U.S. Regulators

Disclosures marked with an asterisk may also be required by at least one jurisdiction in addition to the United States. See Important Disclosures Required by Non-US Regulators and Explanatory Notes.

14. Deutsche Bank and/or its affiliate(s) has received non-investment banking related compensation from this company within the past year.

Important Disclosures Required by Non-U.S. Regulators

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For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <https://research.db.com/Research/Disclosures/CompanySearch>

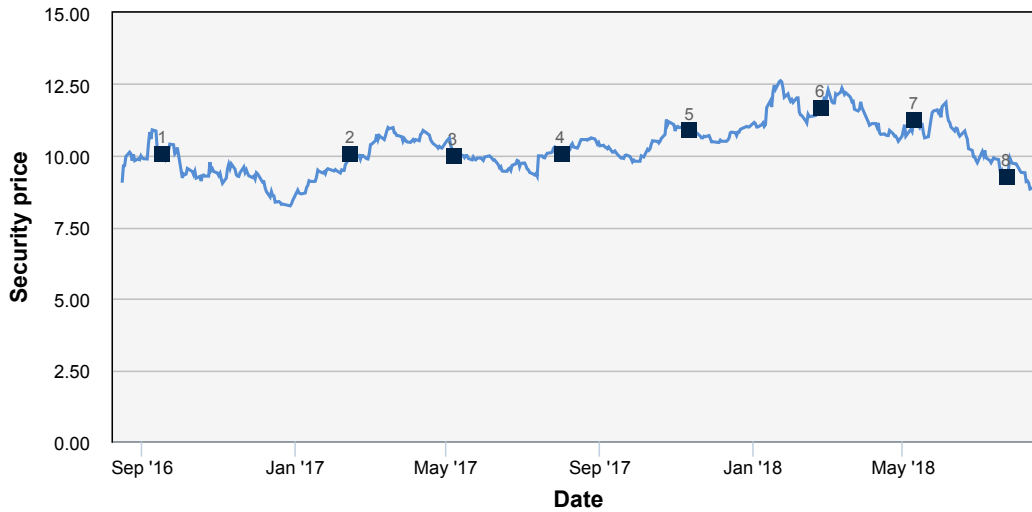
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Thomas Zhu



Historical recommendations and target price. China Everbright Int'l (0257.HK)

(as of 08/14/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	09/18/2016	Buy, Target Price Change HKD 12.70	Thomas Zhu, CFA	5.	11/12/2017	Buy, Target Price Change HKD 13.50	Thomas Zhu, CFA
2.	02/14/2017	Buy, Target Price Change HKD 11.80	Michael Tong, CFA	6.	02/25/2018	Buy, Target Price Change HKD 13.90	Thomas Zhu, CFA
3.	05/08/2017	Buy, Target Price Change HKD 12.20	Thomas Zhu, CFA	7.	05/10/2018	Buy, Target Price Change HKD 12.70	Thomas Zhu, CFA
4.	08/02/2017	Buy, Target Price Change HKD 12.70	Thomas Zhu, CFA	8.	07/23/2018	Buy, Target Price Change HKD 12.80	Thomas Zhu, CFA

Equity Rating Key

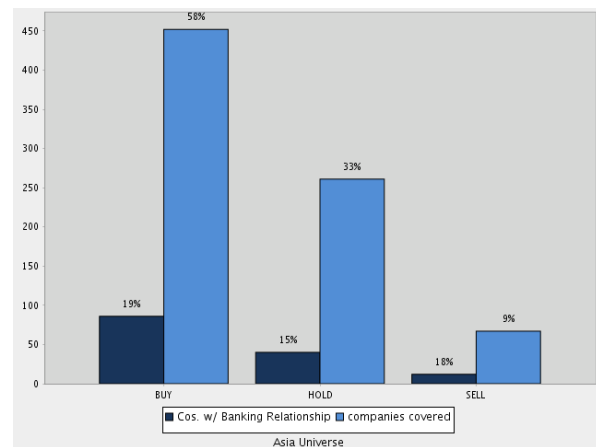
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Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

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Equity rating dispersion and banking relationships





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