



July 7, 2015

Sector Rating:
OVERWEIGHT

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Key Data

| | |
|----------------------------|-------|
| Avg.15E P/E (x) | 26.70 |
| Avg.15E P/B (x) | 3.20 |
| Avg.15E Dividend Yield (%) | 1.40 |

Source(s): Company, Bloomberg, ABCI Securities

Sector performance (%)

| | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | (17.55) | (10.40) |
| 3-mth | (12.01) | (14.47) |
| 6-mth | 5.79 | (1.99) |

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year sector performance



Source(s): Bloomberg, ABCI Securities

Environmental Protection Sector Bright future ahead

Investment themes

- ❖ Increasing urbanization and severe pollution of surface water in China are likely to enhance the government's push for wastewater treatment, suggesting great opportunities for relevant operators
- ❖ Landfill has become an increasingly less viable method in tackling urban solid waste due to increasing transportation cost and growing concerns over underground water pollution. Incineration will be the major solid waste treatment alternative in China.
- ❖ We initiate coverage on Beijing Enterprises Water (371 HK) and China Everbright Int'l (257 HK) with a BUY rating

Increasing urbanization and severe pollution of surface water in China are likely to spur demand for wastewater treatment facilities and services.

According to the China Water Resources Report issued by the Ministry of Water Resources, as of end-2013, more than 30%/70% of China's surface/underground water was heavily polluted and cannot be used for drinking or agricultural purposes. In addition, the National Development and Reform Commission (NDRC) believes that China will achieve an urbanization rate of 60% by end-2020E, up from 54% in 2013. At the same time, the Chinese government targets to raise cities' wastewater treatment rate from 77% at end-2010 to 85% by end-2015E. As such, the current wastewater treatment system will be subject to significant capacity pressure, thus engendering strong demand for new wastewater treatment capacity.

Waste-to-energy treatment is the major trend worldwide and China is likely to accelerate adoption in urban areas.

The waste-to-energy method has been widely used in European countries and other developed countries such as the U.S. and Japan. As urbanization increases in China, we believe waste-to-energy should be the key method in processing solid waste in urban areas. Currently, more than 40% of residential waste was treated via waste-to-energy in developed countries compared to 30% in China. Hence, China would need to boost its waste-to-energy capacity in the future. According to the 12th Five-year plan on urban residential waste treatment issued by the State Council on Apr 19, 2012, China targets to boost waste-to-energy capacity in urban area from 90kt/day by end-2010 to 307kt/day by end-2015E, indicating a 28% CAGR during the period. This suggests waste-to-energy will become a major waste treatment method, which in turn will benefit the incineration operators in urban areas.

Positive sector outlook; BUY Beijing Enterprises Water and China Everbright Int'l.

We are positive on the outlook for the wastewater and solid waste treatment sectors as increasing urbanization rate and improving living standard should spur demand for waste treatment. Our top picks include Beijing Enterprises Water (371 HK, BUY), which has a leading position in the wastewater treatment market and its assets located in coastal areas should help reduce the company's default risk. ; we also favor China Everbright Int'l (257 HK, BUY) based on its prime asset quality and SOE background that enable it to benefit from China's incineration era.

Risk factors: (1) High gearing of operators; (2) Policy risks; (3) Default risk.

Sector Valuation Summary (data as of July 6, 2015)

| Company | Ticker | Rating | Price (HK\$) | TP (HK\$) | FY15E P/E(x) | FY16E P/E (x) | FY15E P/B (x) | FY16E P/B (x) | FY15E Yield (%) | FY16E Yield (%) |
|---------------------------------|--------|--------|--------------|-----------|--------------|---------------|---------------|---------------|-----------------|-----------------|
| Beijing Enterprises Water (BEW) | 371 HK | Buy | 5.70 | 7.70 | 28.90 | 23.60 | 3.80 | 3.30 | 1.00 | 1.30 |
| China Everbright Int'l (CEI) | 257 HK | Buy | 12.64 | 16.50 | 32.20 | 25.20 | 4.10 | 3.60 | 0.80 | 1.00 |

Source(s): Companies, ABCI Securities estimates



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Investment summary

China's increasing urbanization and improving living standard should facilitate environmental protection campaign in China; specifically, there are urgent needs to address the wastewater and solid waste issues.

Wastewater treatment sector

- ◆ **More than 30% of surface water is polluted.** According to the China Water Resources Report issued by the Ministry of Water Resources, as of end-2013, more than 30%/70% of China's surface/underground water was heavily polluted and cannot be used for drinking or agricultural purposes - an issue considered to be a threat to social stability. As the nationwide precipitation reveals a downtrend, wastewater treatment and reducing pollution become critical. Regaining freshwater resources would help resolve the problem of water shortages.
- ◆ **Increasing urbanization to pressure wastewater treatment capacity.** The National Development and Reform Commission (NDRC) believes that China will achieve an urbanization rate of 60% by end-2020E, up from 54% in 2013. At the same time, the Chinese government targets to raise cities' wastewater treatment rate from 77% at end-2010 to 85% by end-2015E. As such, the current wastewater treatment system will be subject to significant capacity pressure, thus engendering strong demand for new wastewater treatment capacity.
- ◆ **Stock picks.** We believe Beijing Enterprises Water (371 HK, BUY) will benefit from the government's strong push for wastewater treatment; the company's assets, which are mostly located in affluent coastal regions, should help reduce default risk.

Solid waste treatment sector

- ◆ **China to accelerate waste-to-energy treatment in urban areas.** Waste-to-energy is the process of generating energy from the incineration of waste. According to the China Environmental Yearbook, China targets to raise the proportion of waste incinerated from the current 30% at end-2013 to 35% by end-2015E to reduce the use of land and natural resources. In addition, according to the 12th Five-year plan on urban residential waste treatment issued by the State Council on Apr 19, 2012, China targets to boost waste-to-energy capacity in urban area from 90kt/day by end-2010 to 307kt/day by end-2015E, indicating a 28% CAGR during the period. This suggests waste-to-energy will become a major waste treatment method, which in turn will benefit the incineration operators in urban areas.
- ◆ **Waste-to-energy is the major trend worldwide; China has much room to improve.** The waste-to-energy method has been widely used in European countries and other developed countries such as the U.S. and Japan. As urbanization increases in China, we believe waste-to-energy would be the key method in processing solid waste in urban areas. Currently, more than 40% of residential waste was treated via waste-to-energy in developed countries compared to 30% in China. Hence, China would need to boost its waste-to-energy capacity in the future.
- ◆ **Stock picks.** China Everbright Int'l (257 HK, BUY) is the leading waste-to-energy operator in China-its prime asset quality and SOE background should benefit from China's entering into the incineration era.

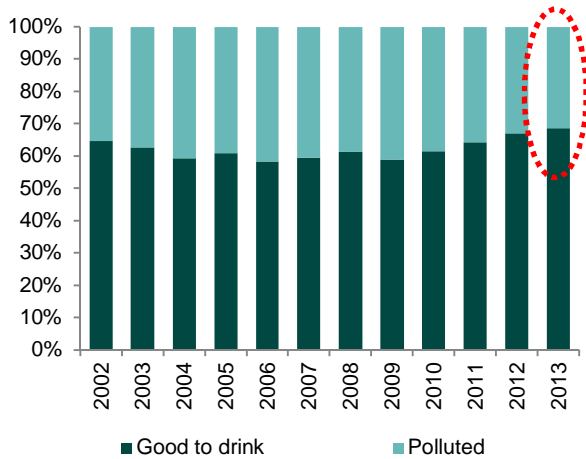
Wastewater treatment industry

China's water issue is pressing

China's increasing urbanization rate and improving living standard would engender strong demand for wastewater treatment service and facilities in the coming decade. In addition, China's worsening water pollution nationwide may undermine social stability and the government would need to address the issue promptly.

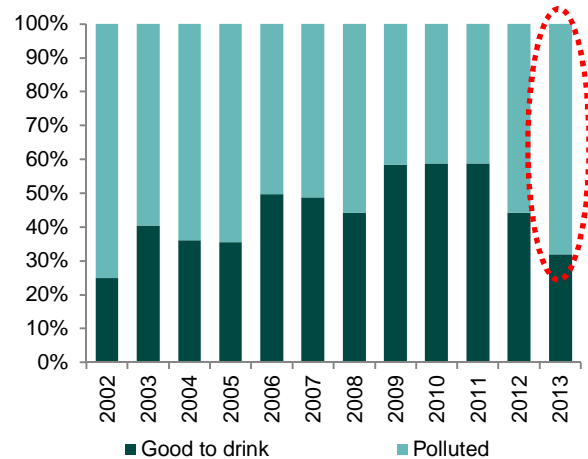
More than 30% of surface water is polluted. According to the China Water Resources Report issued by the Ministry of Water Resources, as of end-2013, more than 30%/70% of China's surface/underground water was heavily polluted and cannot be used for drinking or agricultural purposes-an issue considered to be a threat to social stability. As the nationwide precipitation reveals a downtrend, wastewater treatment and pollution reduction become critical. Regaining freshwater resources would help ease the problem of water shortage.

Exhibit 1: Rivers: More than 30% of major rivers were polluted



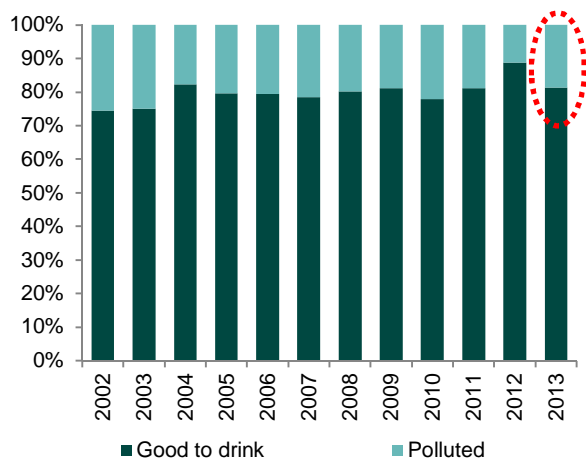
Source(s): Ministry of Water Resources, ABCI Securities

Exhibit 2: Lakes: nearly 70% were polluted



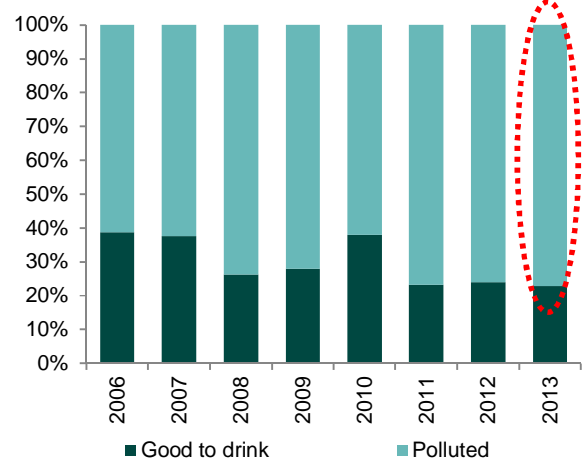
Source(s): Ministry of Water Resources, ABCI Securities

Exhibit 3: Reservoirs: around 20% were polluted



Source(s): Ministry of Water Resources, ABCI Securities

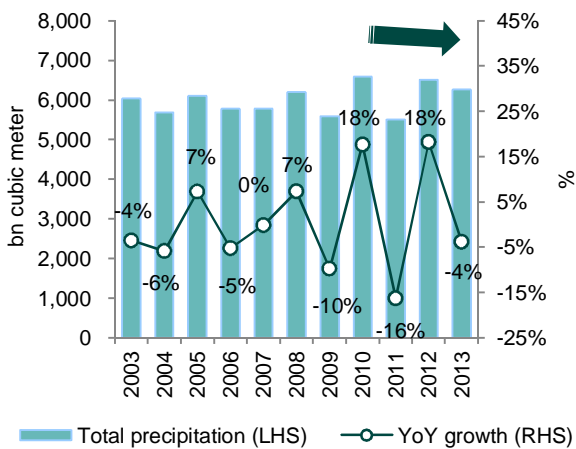
Exhibit 4: Underground water was polluted



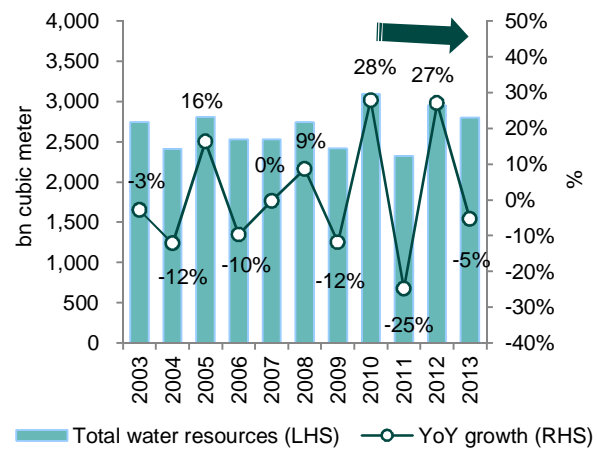
Source(s): Ministry of Water Resources, ABCI Securities

The lack of water resources drives up tariffs

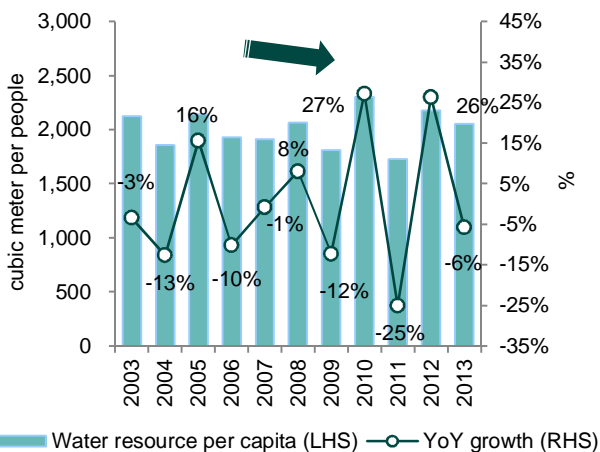
According to China's Ministry of Water Resources, as of end-2013, China had 2.8tn m³ of freshwater resources. The country possesses the 4th largest water resource in the world that accounts for 6% of global water resources. However, China has only 2,055 m³ of water per capita, ranking 121st globally with a level equivalent to a quarter of the global average. The Ministry of Water Resources estimates that by 2020, China's population may reach 1.45bn, which may lower its water resources per capita further. Increasing demand and limited freshwater resources have driven up water tariffs in China. According to the NDRCA's data, China's average water tariff rose at 5% CAGR from RMB 0.99/ton at Jan 2000 to RMB 2.06/ton by Jan 2015.

Exhibit 5: Total precipitation has remained stable


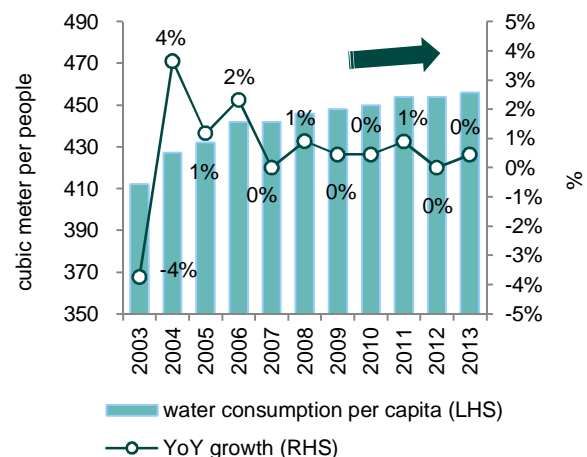
Source(s): Ministry of Water Resources, ABCI Securities

Exhibit 6: Total water resource showed limited improvement in recent years


Source(s): Ministry of Water Resources, ABCI Securities

Exhibit 7: Water resource per capita declines on rising population


Source(s): Ministry of Water Resources, ABCI Securities

Exhibit 8: Increasing water consumption per capita suggests more water resources are needed


Source(s): Ministry of Water Resources, ABCI Securities

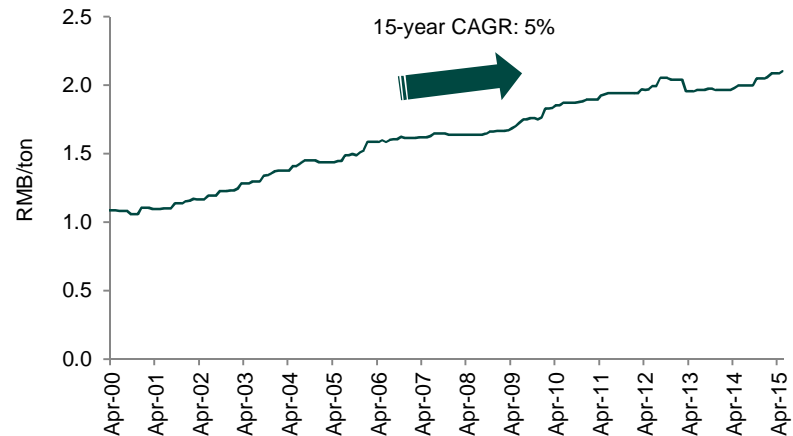
Increasing consumption urges the government to reduce water pollution

As economic growth and living standard improve, demand for freshwater in China also increases. According to the Ministry of Water Resources, average water resource per capita in developed countries is around 600 m³ per person per year, which is 30% higher than China's 456 m³ per person per year as of end-2013. We believe as the GDP per capita in China nears that in the developed countries, water consumption per capita is likely to rise, urging the government to reduce water pollution and recapture freshwater resources.

Uneven population and water resources distribution

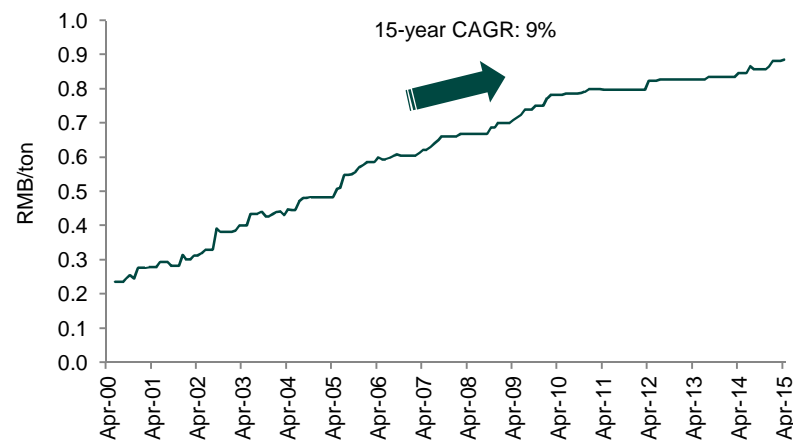
Although northern China accounts for half of the country's total land area, the area accounts for 9% of total precipitation; its water resources was less than 5% of the national total. Another issue facing northern China is the uneven rainfall with 62% of precipitation occurring in the summer rainy season (June- Sep), making full utilization of rainfall resources difficult. Hence, reducing water resources pollution and securing safety water resources in northern China becomes increasingly critical.

Exhibit 9: China's tap water tariff has been on an uptrend due to lack of water resources and rising living standard



Source(s): Wind, ABCI Securities

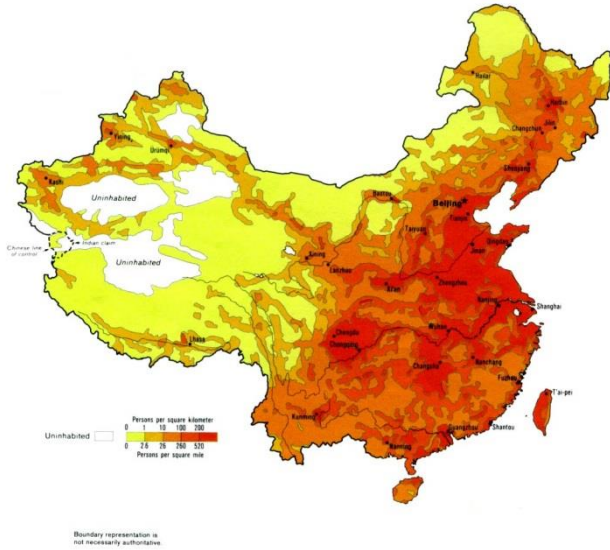
Exhibit 10: China's wastewater tariff has been on an uptrend due to increased awareness of environmental protection



Source(s): Wind, ABCI Securities

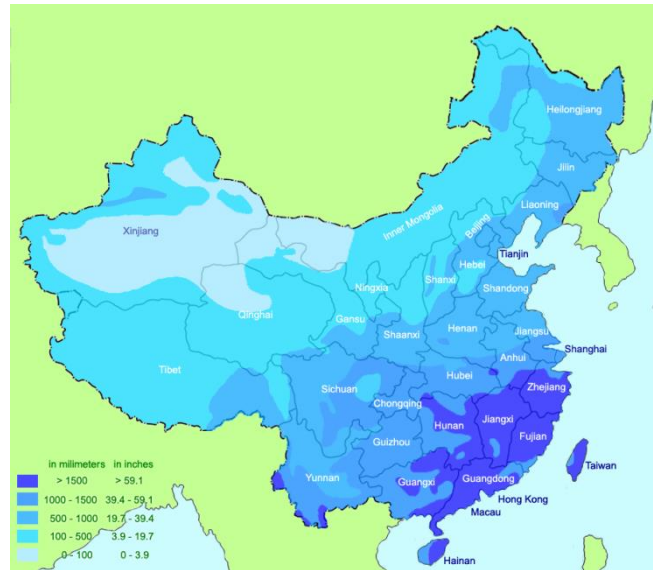
Exhibit 11: China's population density

China: Population Density



Source(s):Xinhuanet.com

Exhibit 12: China's annual precipitation by region



Source(s): 91q8.com

Exhibit 13: China's water pollution



Source(s): zys365.com

Exhibit 14: China's water pollution



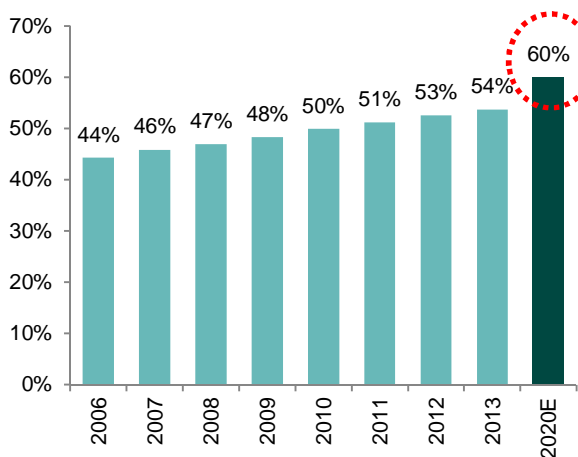
Source(s): s1.djying.com/

Emerging business opportunities in urban water treatment

Increased urbanization and higher urban wastewater treatment rate to put pressure on wastewater treatment system

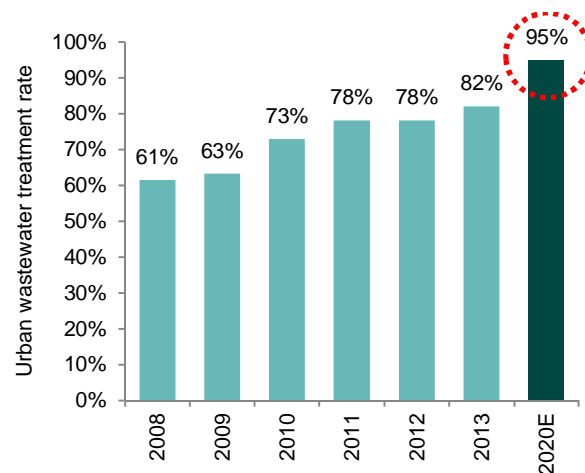
The Chinese government continues to push for urbanization, putting pressure on cities' wastewater treatment systems. The National Development and Reform Commission (NDRC) believes that China will achieve an urbanization rate of 60% by end-2020E, up from 54% in 2013, suggesting an extra 140 mn people will move into urban areas and placing great pressure on wastewater treatment capacity. At the same time, according to China's 12th Five-Year Plan on wastewater facilities construction, the Chinese government targets to raise cities' wastewater treatment rate from 78% at end-2010 to 85% by end-2015E. In the latest announcement of Action Plan for Water Pollution, issued by the State Council on Apr 2, 2015, China targets a 95% urban wastewater treatment rate by end-2020E. As such, the current wastewater treatment system will be stretched and demand for new wastewater treatment capacity will increase.

Exhibit 15: Rising urbanization in China to drive water treatment facilities demand



Source(s): NDRC, ABCI Securities estimates

Exhibit 16: China's urban wastewater treatment rate will trend up



Source(s): MEP, ABCI Securities estimates

9% CAGR growth in urban wastewater treatment volume in 2013-2020E will create enormous business opportunities

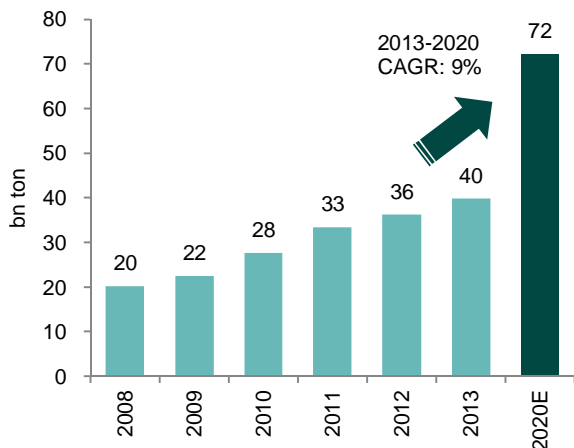
As China continues to accelerate urbanization and urban wastewater treatment rate, total volume of urban wastewater to be treated should see strong growth in coming years. If we assume China's urbanization to reach 60% and wastewater treatment rate in urban areas to reach 95% by end-2020E, total wastewater treatment volume should be 72bn ton, which represents a 80% increase on wastewater treatment volume from end-2013 (~40bn ton), or a 9% CAGR during 2013-2020E. This rapid growth should bring great opportunities for urban wastewater treatment operators.

Investment in nationwide wastewater treatment capacity to reach RMB500bn

According to the 12th Five-Year Plan on wastewater facilities construction issued in Apr 2012, China targets to add 83mt/day of new capacity for wastewater treatment by end-2015E, a notable 67% increase from that of end-2010. In addition, the government targets to invest RMB 430bn in wastewater treatment facilities, which presents a significant opportunity for wastewater treatment operators. As urban population continues to grow, we

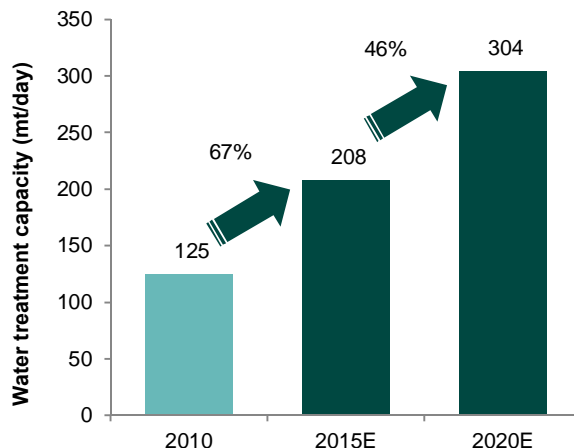
expect urban wastewater treatment capacity to reach 304mt/day by end-2020E, representing an additional capacity of 96mt/day or a 46% capacity increase from the 2015 level. If we assume the unit capacity cost for wastewater treatment facilities to stay at the current RMB 5,200/t/day, total new investment during 2015E-2020E should reach RMB 500bn.

Exhibit 17: China's urban wastewater treatment volume is expected to expand by 9% CAGR during 2013-2020E



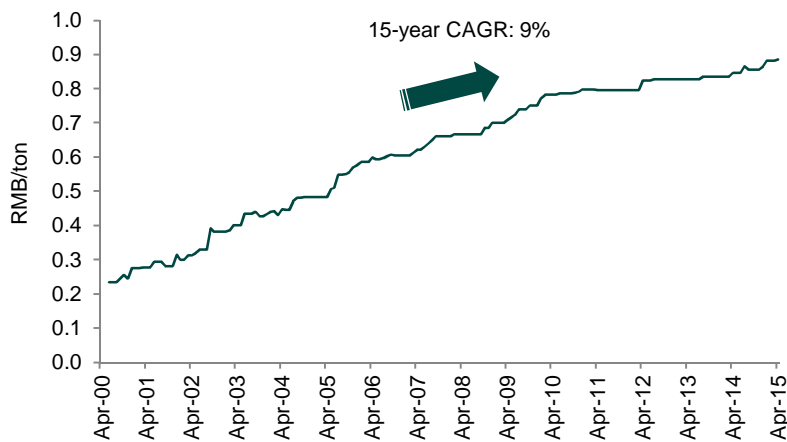
Source(s): MEP, ABCI Securities estimates

Exhibit 18: China targets to increase wastewater treatment capacity by 46% from 2015E-2020E



Source(s): NDRC, ABCI Securities estimates

Exhibit 19: China's wastewater tariff has been trending up since 2000



Source(s): Wind, ABCI Securities



Major concerns

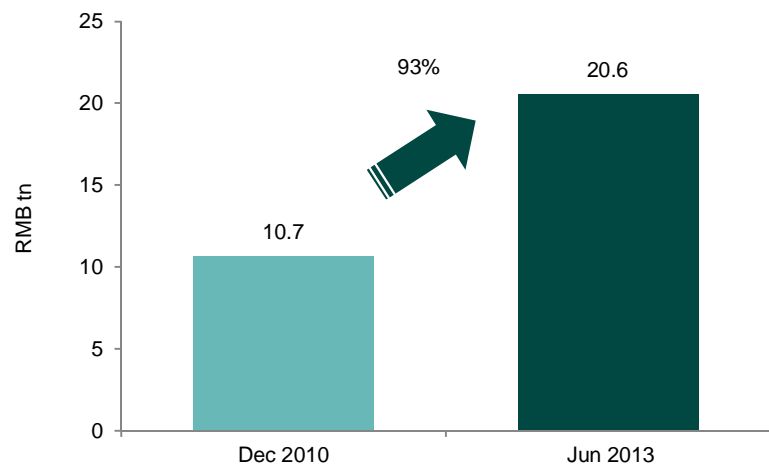
Rising debts of local governments

Rising local government debt may limit investment in wastewater treatment. According to China's National Audit Office, as of June 2013, total government debt was RMB 20.6tn, equivalent to 40% of China's 2012 GDP. For some local governments, debt levels are equivalent to three times the annual income. We believe the high debt level may reduce wastewater treatment investment in some regions as it may not be considered as a priority. Furthermore, mounting debts of the local governments may increase default risk for wastewater treatment operators as these governments may not be able to repay the construction costs upon project completion.

High net gearing may compromise balance sheet

Business model of China's wastewater treatment operators relies heavily on operating income to finance acquisitions. As the operators speed up their M&A activities, operating cash flow is likely to be stretched, driving up the net gearing. We believe the wastewater treatment operators in China are likely to ramp up equity fundraising on the rising M&A trend. Hence, their balance sheets, as well as share prices, are likely to be compromised.

Exhibit 20: China's local government debts trend up



Source(s): National Audit Office, ABCI Securities

Solid waste treatment industry

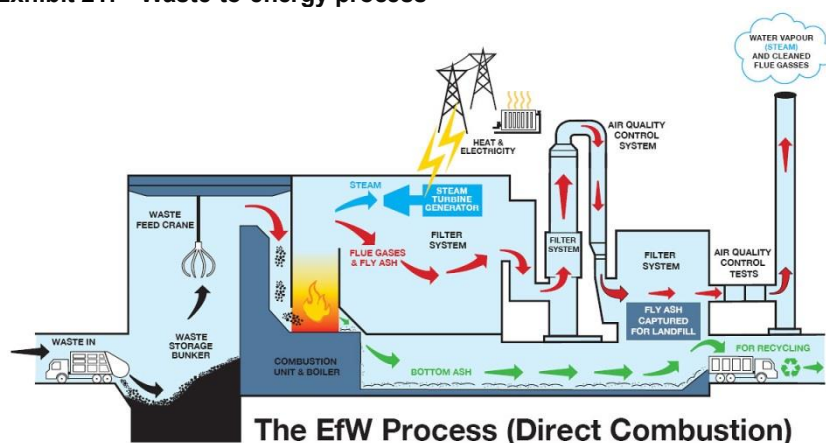
Background information

Increased urbanization will likely aggravate residential waste issues in China's major cities. As public concern over land resources and underground water pollution increases, landfill treatment is no longer considered an acceptable method for treating residential waste. China is likely to increase the use of incineration, which should boost demand for incineration plants and incineration technology such as waste-to-energy.

Waste-to-energy technology

Waste-to-energy refers to the process of generating power through the incineration of waste. High temperature from incineration can boil water to generate electricity. This technology is likely to further improve the efficiency of combustion (separation of corrosive components, such as ash, from the converted fuel, thereby allowing a higher combustion temperature) and should benefit environmental protection.

Exhibit 21: Waste-to-energy process



Source(s): arc21.org.uk

Solid waste can be usually classified into 3 major classes:

Residential waste

The waste produced by residential activities, also known as municipal solid waste, usually includes biodegradable waste (like food and kitchen waste, paper, etc.), recyclable waste (glass, cans etc.), and electrical waste (TVs, computers etc.). In China, besides biodegradable and recyclable wastes, all other types of residential solid waste will go to the landfill.

Industrial waste

The waste produced by industrial activities including material that is rendered useless during the manufacturing process. Industrial waste usually is produced in factories, mills and mining operations. Solid industrial waste presents major challenges worldwide as they do not decompose easily. Currently, the common treatment method in China is landfill.

Hazardous waste

The waste that has one or more of hazardous traits of toxicity, ignitability, reactivity, or corrosivity. This type of waste is usually produced during industrial activities and has to be specially treated as they are harmful to human's health. Hazardous waste includes medicines, batteries, mercury thermometers, etc.

Exhibit 22: Industrial waste in China

Source(s):NEA

Exhibit 23: Hazardous waste in China

Source(s): NEA

Industrial waste—a headache to government

Industrial waste includes metallurgical slag, mining waste, chemical waste, etc., which pollutes the land and water resources. In China, industrial waste produced has been increasing since 2003, growing at 14% CAGR in 2003-2012 because of the rapid growth in industrial activity with very limited monitoring. The government's target to reduce industrial waste has been included in the 12th Five-Year plan (2010-2015). More specifically, the Ministry of Industry and Information Technology (MIIT) issued an Industrial Solid Waste 12th Five-year plan stating that the government targets to increase the recycle rate of industrial solid waste from 40% in 2010 to 50% by end-2015E. Industrial waste treatment is a key issue of China's environmental protection. The quantity of industrial waste is 19 times higher than that of residential waste in 2012, making it the largest source of pollution in China.

Insufficient capacity for hazardous waste treatment in the future

Hazardous waste includes medical waste, chemical solvents, medicine, etc., which are corrosive, toxic, and damaging to health. Based on MIIT data, in 2010, there were only 1,500 licensed hazardous waste treatment plants in China with a total treatment capacity of 23mn tons/year. Hazardous waste produced has been increasing and the government estimates total volume could reach 60mn tons in 2015E, suggesting that the treatment capacity will need to increase by 158% or at 21% CAGR from 2010-2015E.



Emerging opportunities in solid waste treatment industry

Rising urbanization to aggravate the pollution issue

Continued rise in urbanization and the government's increased adoption of incineration treatment will be the long-term trends. The National Development and Reform Committee (NDRC) estimates the urbanization rate in China will reach 60% by end-2020, up from the current 54% at end-2013, suggesting that an extra 140 mn people will move into urban areas. Living waste per capita in urban areas is maintaining a downtrend; however, a rising population could be an issue for local governments due to increased pollution and potential public health issues.

China to accelerate adoption of waste-to-energy treatment technology in urban area

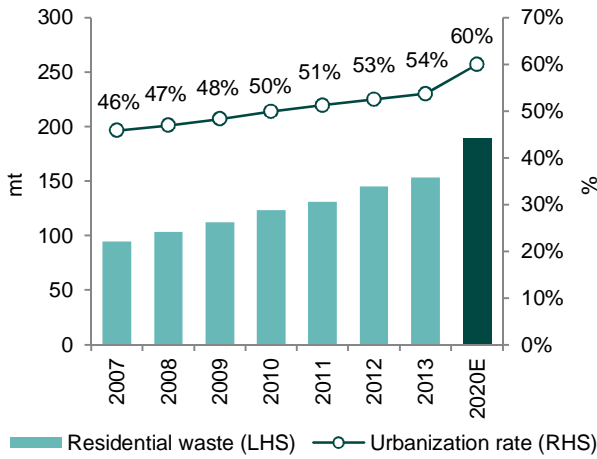
Historically, more than 70% of residential waste has been disposed of via landfills in China. The government targets to reduce its use as limited land resources and landfills may pollute underground water. According to the China Environmental Yearbook, China targets to raise the proportion of waste incinerated from the current 30% at end-2013 to 35% by end-2015E. In addition, according to the 12th Five-year plan on urban residential waste treatment issued by the State Council on Apr 19, 2012, China targets to boost waste-to-energy capacity in urban area from 90kt/day by end-2010 to 307kt/day by end-2015E, indicating a 28% CAGR during the period. This suggests waste-to-energy is set to be a major waste treatment trend, benefitting incineration operators in urban areas.

Waste-to-energy is the key method in tackling solid waste pollution; China has much room to improve

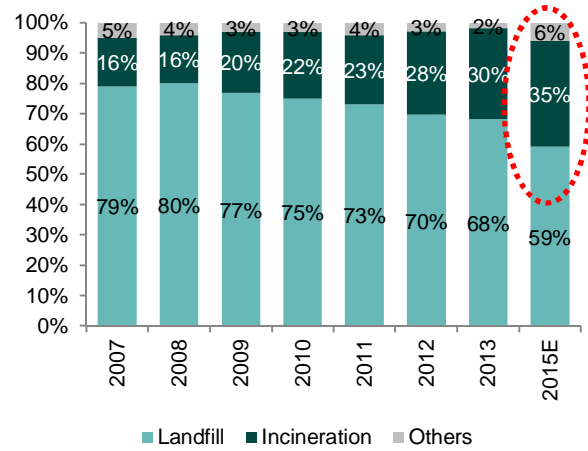
The waste-to-energy method has been widely used in European countries and other advanced economies such as the U.S. and Japan. Key advantages of this technology include: 1) it can generate power through trash combustion for energy-saving purpose; 2) it can reduce nearly 95% of toxic gases in trash combustion; 3) it can process large amount of trash without using up land resources; 4) it would not pollute underground and surface water resources. As urbanization trends up in China, we believe waste-to-energy should be the key method in tackling solid waste in urban areas as the cities are expanding in scale. Currently, more than 40% of residential waste on average was treated via the waste-to-energy method in developed countries like Germany, Japan, Sweden, etc. as compared to China's 30%. This indicates that China has much room to improve.

SOE players should benefit from financing cost and asset quality

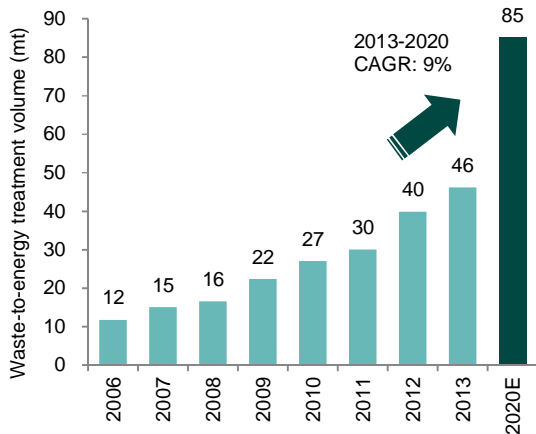
SOE players usually can benefit more than private enterprises in solid waste treatment industry. First, SOE can enjoy a lower financing cost from local banks (usually 5% for SOEs vs. 7% for non-SOEs). The lower borrowing cost should help SOEs acquire new projects without significantly driving up their gearing ratios. Second, SOE have a closer tie with local governments that gives these companies an advantage over the private and overseas competitors in acquiring projects.

Exhibit 24: Higher urbanization will increase the amount of residential waste in major cities


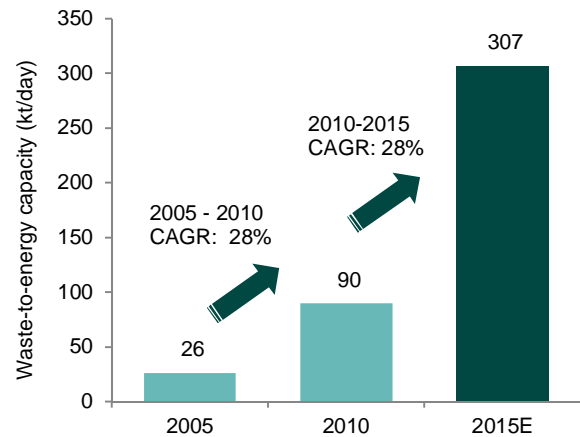
Source(s): Bloomberg, MEP, ABCI Securities estimates

Exhibit 25: Waste-to-energy to become a major waste treatment method in China


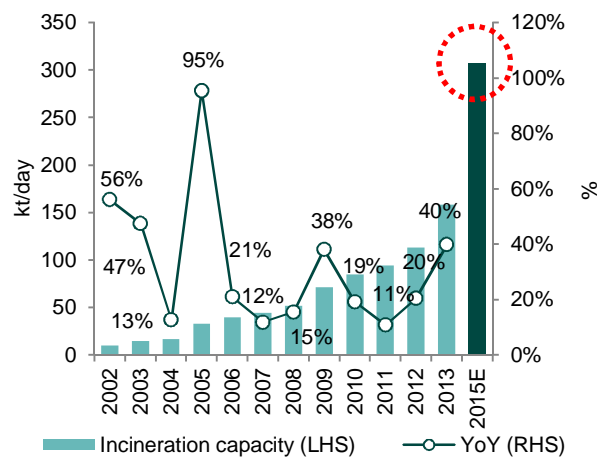
Source(s): MEP, ABCI Securities estimates

Exhibit 26: China's living waste processed via the waste-to-energy method is likely to grow at 9% CAGR during 2013-2020E


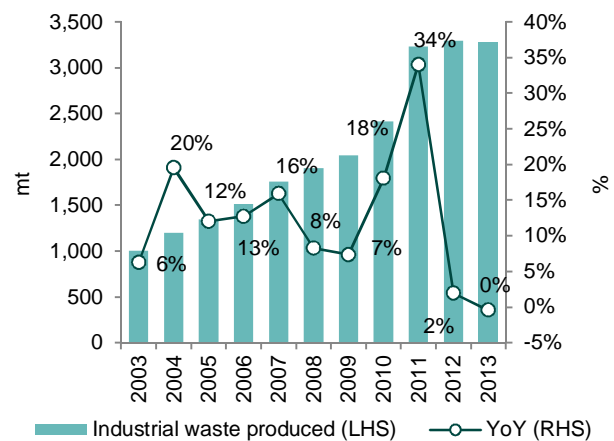
Source(s): MEP, ABCI Securities estimates

Exhibit 27: China aims to triple the waste-to-energy capacity during 2010-2015E period


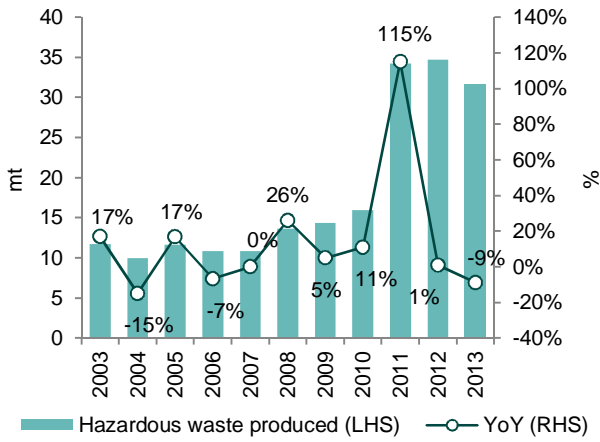
Source(s): MEP, ABCI Securities estimates

Exhibit 28: China's waste-to-energy capacity to grow rapidly


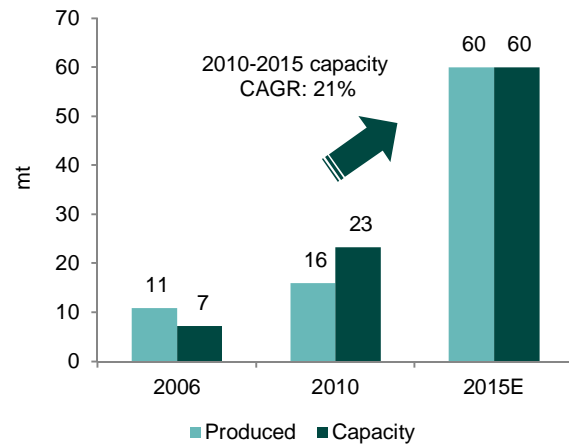
Source(s): MEP, ABCI Securities estimates

Exhibit 29: China's industrial waste produced


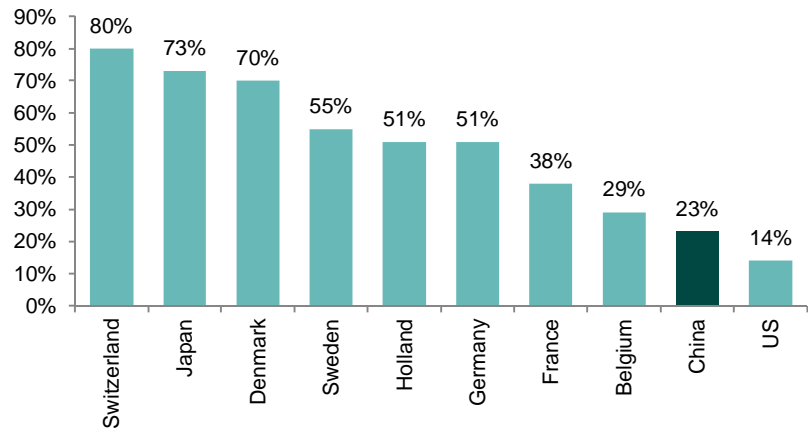
Source(s): MEP, ABCI Securities estimates

Exhibit 30: China's hazardous waste produced


Source(s): MEP, ABCI Securities

Exhibit 31: China's hazardous waste capacity


Source(s): MEP, ABCI Securities estimates

Exhibit 32: Global waste-to-energy treatment as a percentage to overall residential waste treated (2011)


Source(s): ABCI Securities

Major risks

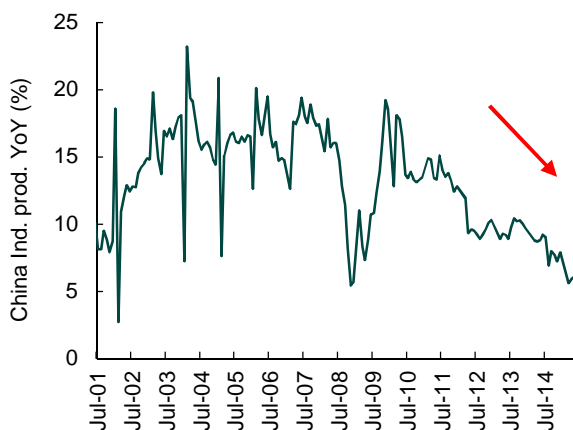
Default risk from industrial and hazardous waste customers

Residential solid waste treatment fee is paid by residents and therefore, the operators should have a lower default risk. However, default rate among operators of industrial and hazardous waste treatment may increase against the backdrop of slowing industrial activities in China. Since Dec 2009, China's industrial production has been on a downtrend and the monthly industrial production growth rose 6.1% YoY only in May 2015. We believe the rising default risk among industrial and hazardous waste customers is likely to deter private capital investment in waste treatment operation and therefore slow down the nationwide adoption of the waste-to-energy treatment.

Air pollution concern may hinder construction of incinerators

China's worsening air pollution raises concerns from the public regarding the construction of incinerators. As incineration can produce toxic pollutants such as sulfur dioxide, dioxin, furans etc., public resistance to incinerator construction can represent a potential challenge to business expansion of solid waste treatment operators.

Exhibit 33: Slowdown in China's industrial production may increase default risk to solid waste treatment operators



Source(s): Bloomberg, ABCI Securities

Exhibit 34: Protest against incineration construction in China



Source(s): nanzao.com



July 7, 2015
Company Report
Rating: BUY
TP: HK\$ 7.70

| | |
|-------------------------|--------|
| Share price (HK\$) | 5.70 |
| Est. share price return | 35.09% |
| Est. dividend yield | 1.40% |
| Est. total return | 36.49% |

Analyst: Kelvin Ng
Tel: (852) 2147 8869
Email: kelvinn@abci.com.hk

Key Data

| | |
|-------------------------------------|-----------|
| Market share (HK\$m) | 49,667 |
| 3-mth avg. daily turnover (HK\$ mn) | 113 |
| 52-week high/low (HK\$) | 7.31/4.13 |
| Issued shares (mn) | 8,707 |
| Major shareholder(s) (%): | |
| Beijing Enterprises Hld | 43.92 |

Source(s): Company, Bloomberg, ABCI Securities

FY14 Revenue breakdown (%)

| | |
|--------------------|--------------|
| Wastewater | 87.75 |
| Operation | 36.41 |
| Construction | 51.34 |
| Water distribution | 9.10 |
| Others | 3.14 |

Source(s): Company, ABCI Securities

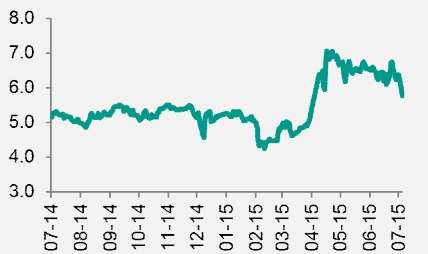
Share performance (%)

| | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | -17.42% | -10.27% |
| 3-mth | -12.01% | -8.48% |
| 6-mth | 5.38% | -2.40% |

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance



Source(s): Bloomberg, ABCI Securities

Beijing Enterprises Water (371 HK)

Market leader with strong fundamentals

- China's urban wastewater volume is estimated to grow by 9% CAGR in 2013-2020E on increased urbanization, presenting great opportunities for the Group
- Rising tap and wastewater tariffs over the long term will improve margins for wastewater treatment operators
- We expect the Group's wastewater capacity to expand by 23% YoY in 2015E and boost earnings by 28%YoY
- We initiate coverage on Beijing Enterprises Water (BEW, 371 HK) with a **BUY** rating. Our TP HK\$7.70 is derived from a 11% WACC and represents 29x/24x FY15E/16E P/E and 3.8x/3.1x FY15E/16E P/B.

Urban wastewater volume will grow by 9% CAGR in 2013-2020E, presenting great opportunities to the Group. As China's urbanization and urban wastewater treatment rate continue to increase, total volume of urban wastewater treated should see strong growth. Assuming China's urbanization and wastewater treatment rates will reach 60% and 95% by end-2020, total wastewater treatment volume should be 72bn ton, representing a 80% increase in wastewater treatment volume from end-2013 (~40bn ton), or a 9% CAGR growth in 2013-2020. We believe this would present great opportunities for urban wastewater treatment operators like BEW.

Rising tap and wastewater tariffs as long-term positives. China's nationwide tap water tariff increased from RMB 0.99/ton in Jan 2000 to RMB 2.06/ton in Jan 2015, representing a 5% CAGR over the period. Meanwhile, wastewater tariff also recorded a more than 270% increase or 9% CAGR in 2000-2015. Given the rising living standard and urbanization rate, tap water and wastewater tariffs should continue to trend up. BEW is likely to be a beneficiary based on its exposure in both water distribution and wastewater treatment businesses.

Strong wastewater capacity growth in 2015E to boost revenue. BEW is targeting to add 3mt/day in new capacity (wastewater and water distribution) in 2015E and maintain a relatively high capacity growth in the next few years. We anticipate its wastewater capacity will increase by 1.8mt/day and 1.9mt/day in 2015E and 2016E, which translates to a YoY growth of 23%/19% YoY. In our view, strong wastewater capacity growth will boost earnings; as such, we forecast earnings to grow by 28%/23% in 2015E/16E.

Recommend BUY with TP at HK\$ 7.70. Our DCF-derived TP of HK\$ 7.70, based on an 11% WACC, is equivalent to 29x/24x 2015E/16E P/E and 3.8x/3.1x 2015E/16E P/B. We estimate a 2014-2017E EPS CAGR of 23%. Initiate with **BUY**.

Risks: (1) Default risk; (2) High net gearing ratio may prompt fundraising activities; (3) Policy risks.

Results and Valuation

| FY ended Dec 31 | 2013A | 2014A | 2015E | 2016E | 2017E |
|---------------------|-------|-------|--------|--------|--------|
| Revenue (RMB mn) | 6,406 | 8,926 | 11,692 | 14,947 | 18,323 |
| Chg (% YoY) | 71.9 | 39.3 | 31.0 | 27.8 | 22.6 |
| Net Income (RMB mn) | 1,084 | 1,794 | 2,299 | 2,826 | 3,358 |
| EBITDA (RMB mn) | 1,973 | 3,515 | 4,081 | 5,350 | 6,689 |
| Chg (% YoY) | 66.0 | 78.1 | 16.1 | 31.1 | 25.0 |
| EPS (RMB) | 0.140 | 0.208 | 0.266 | 0.327 | 0.388 |
| Chg (% YoY) | 28.7 | 48.5 | 28.1 | 22.9 | 18.8 |
| BVPS (RMB) | 1.715 | 1.826 | 2.011 | 2.310 | 2.581 |
| Chg (% YoY) | 39.9 | 6.5 | 10.1 | 14.8 | 11.8 |
| P/E (x) | 55.08 | 37.93 | 28.95 | 23.55 | 19.82 |
| P/B (x) | 4.49 | 4.22 | 3.83 | 3.33 | 2.98 |
| ROE (%) | 8.15 | 11.37 | 13.23 | 14.16 | 15.05 |
| ROA (%) | 2.45 | 3.47 | 3.56 | 3.51 | 3.48 |
| DPS (RMB) | 0.055 | 0.079 | 0.080 | 0.098 | 0.117 |
| Yield (%) | 0.71 | 1.02 | 1.04 | 1.27 | 1.51 |
| Net gearing* (%) | 84.2 | 92.3 | 153.2 | 193.8 | 230.6 |

*Net gearing=Net debt/Total equity

Source(s): Bloomberg, ABCI Securities estimates

Key positives

Urban wastewater volume will grow at a 9% CAGR over 2013-2020 and offer great opportunities.

As China's urbanization and urban wastewater treatment rate continue to rise, total volume of urban wastewater to be treated should see strong growth. If we assume urbanization rate and wastewater treatment rate in China to reach 60% and 95% by end-2020E, total wastewater treatment volume would reach 72bn ton, which represents an 80% increase in wastewater treatment volume (around 40bn ton) or a 9% CAGR in 2013-2020E. This should bring great opportunities for urban wastewater treatment operators like BEW.

23%YoY strong wastewater capacity growth in 2015E to boost revenue

BEW is targeting to add 3mt/day in new capacity (wastewater and water distribution) in 2015E and maintain a relatively strong growth rate in next few years. We anticipate its wastewater capacity to increase by 1.8mt/day and 1.9mt/day in 2015E and 2016E, equivalent to a YoY growth of 23%/19% YoY. In our view, strong wastewater capacity growth will boost earnings, and we forecast 2015E/16E earnings to increase by 28%/23% YoY. This strong organic growth will help BEW outperform peers.

Rising tap water and wastewater tariffs as long-term positives

China's nationwide tap water tariffs have been rising on increasing consumption per capita. According to the National Bureau of Statistics, China's tap water tariffs rose from RMB 0.99/ton in Jan 2000 to RMB 2.06/ton in Jan 2015, representing a 108% rise or a 5% CAGR over the period. At the same time, wastewater tariff has been trending up, recording a more than 270% increase or a 9% CAGR during 2000-2015 as the Chinese government is raising the environmental protection standards. Given the rising living standard and urbanization rate, tap water and wastewater tariffs would continue to rise. BEW, with its exposure in both water distribution and wastewater treatment businesses, should benefit from higher margins.

Fragmented market means ample room for growth

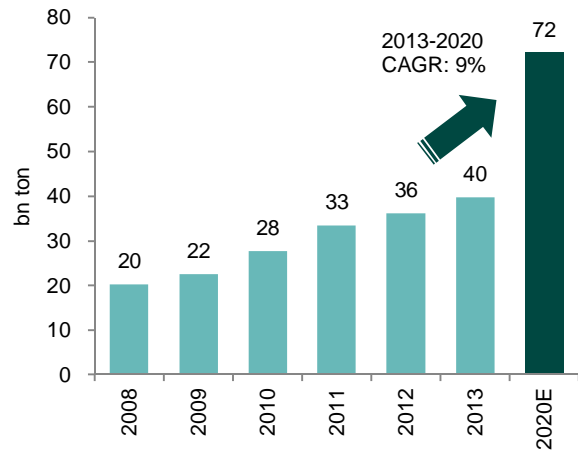
BEW is now the leading wastewater treatment operator in China by capacity after years of rapid expansion. Nonetheless, its market share by end-2013 was only ~4%, suggesting that room for growth is still ample. Furthermore, according to China Water data, aggregate market share of the top 5 wastewater treatment entities in China only amounted to 11% in China's wastewater treatment segment, indicating that the market is still fragmented, and opportunities for expansion are plentiful.

SOE with lower financing costs

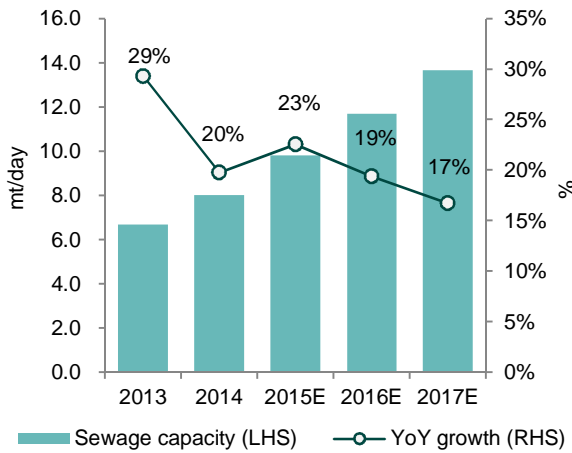
BEW is an SOE, and this status should help it maintain a strong relationship with local governments, giving the company an advantage over overseas peers and local newcomers in obtaining new contracts. SOEs also enjoy lower financing costs than private companies. According to management, BEW's interest costs are ~4%, compared to the 7% among the non-SOEs. Lower financing costs should benefit BEW in future M&A projects.

Exhibit 1: China's urban wastewater treatment rate to trend up

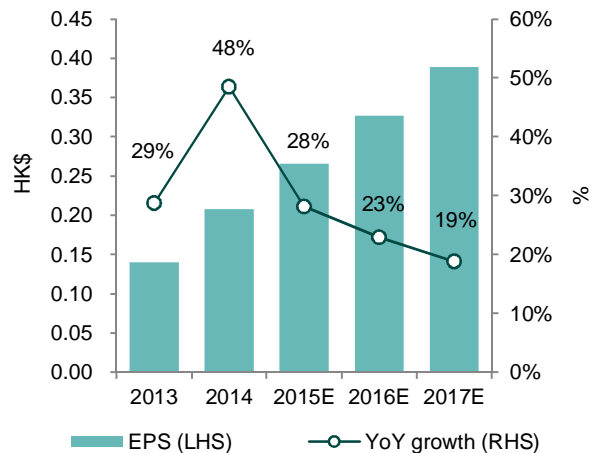

Source(s): MEP, ABCI Securities estimates

Exhibit 2: China wastewater treatment volume should grow at a 9% CAGR over 2013-2020E


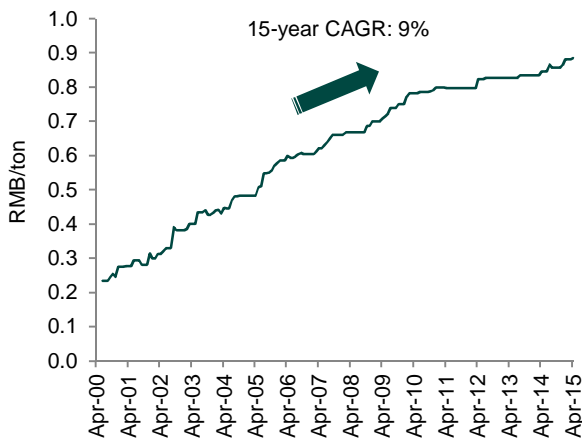
Source(s): MEP, ABCI Securities estimates

Exhibit 3: BEW's wastewater treatment capacity should continue to see strong organic growth


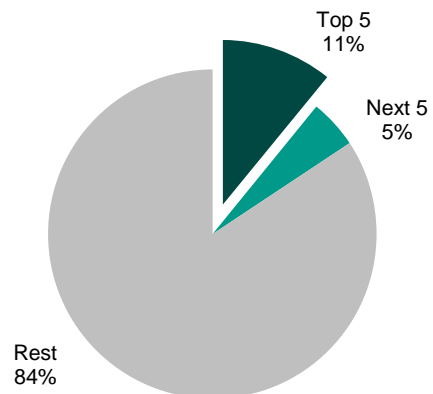
Source(s): The Company, ABCI Securities estimates

Exhibit 4: BEW's EPS growth to remain robust


Source(s): The Company, ABCI Securities estimates

Exhibit 5: Rising wastewater tariff in China


Source(s): Wind, ABCI Securities

Exhibit 6: A fragmented market suggests much growing room for BEW


Source(s): The Company, ABCI Securities

Future earnings outlook

We believe BEW would continue to benefit from China's environmental protection campaign. Wastewater treatment and water distribution businesses would continue to be the Group's key earnings drivers.

Earnings growth

Looking forward, we forecast a 32%/31% YoY growth in 2015E/16E wastewater segment revenue and a 30%/25% YoY growth in construction segment revenue. For the Group's water distribution segment, we project a 38%/35% YoY growth in 2015E/16E revenue off a low base. We therefore forecast BEW's overall net income to see a 28%/23% YoY growth in 2015E/16E.

Capacity growth

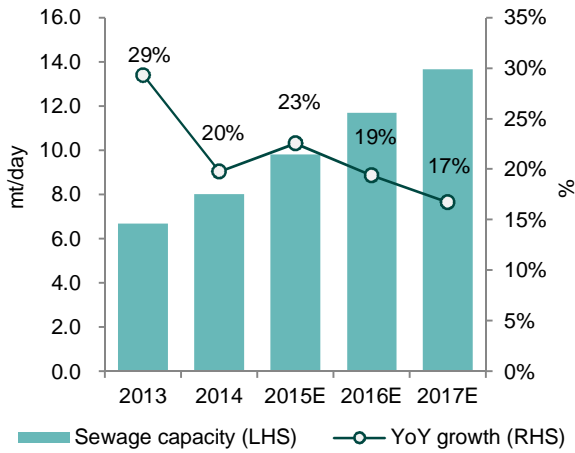
We believe BEW will continue to increase its wastewater capacity through M&A. In 2015E, we estimate the Group will add 1.8mt/day in new wastewater capacity (+23% YoY). We forecast another 1.9 mt/day in new capacity to be added in 2016E, which will result in a 19% YoY growth in wastewater capacity. For its water distribution segment, we project capacity in 2015E and 2016E will increase by 1.0mt/day and 1.3mt/day, which represents a 30% YoY growth in both years.

Gearing ratio

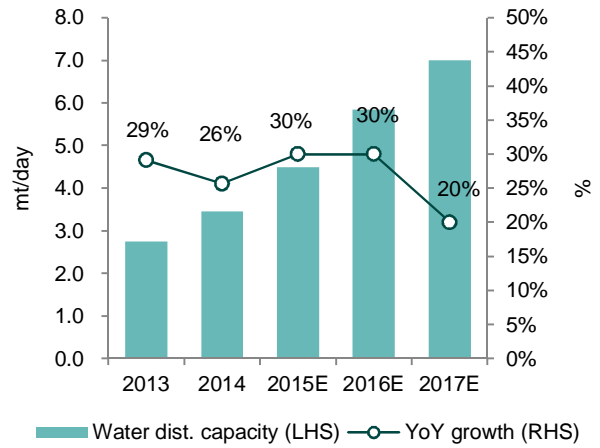
In our view, BEW will continue to ramp up its pace of wastewater project M&As; hence, its net gearing ratio will rise in the near future. Over the past years, BEW has acquired nearly 5mt/day of wastewater/water supply capacity at a total consideration of RMB 3.5 bn. Management expects its net gearing ratio to stay at ~150%-200% going forward.

Dividend policy

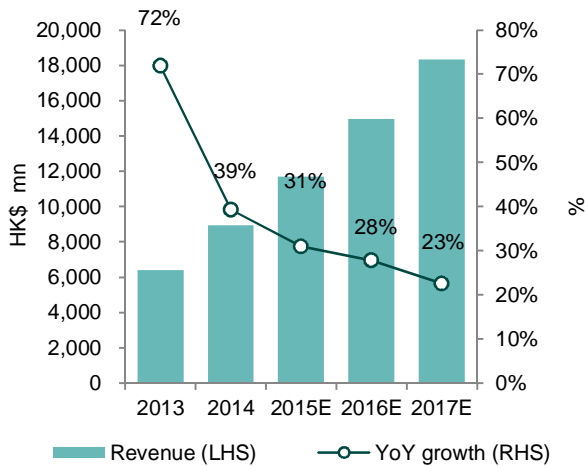
BEW's 2013/2014 dividend payouts were 39%/38%. Over the past years, BEW maintained a relatively high dividend payout ratio averaging at 37%. While increasing wastewater facilities should continue to provide strong cash flow, we expect BEW may incline to reserve capital for future M&A activities. Hence, we estimate the Group to maintain a 30% payout ratio going forward.

Exhibit 7: BEW's wastewater capacity outlook


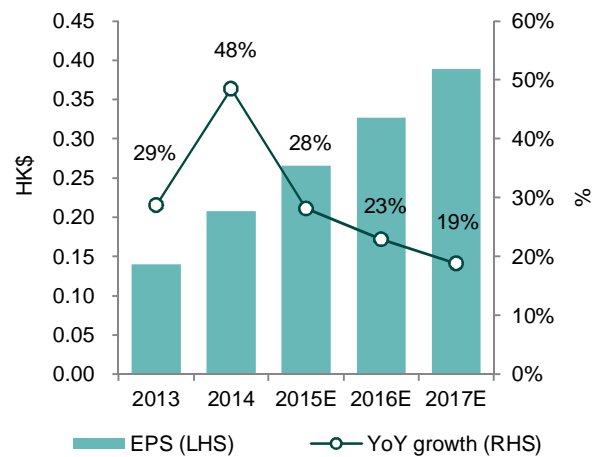
Source(s): ABCI Securities estimates

Exhibit 8: BEW's water distribution capacity outlook


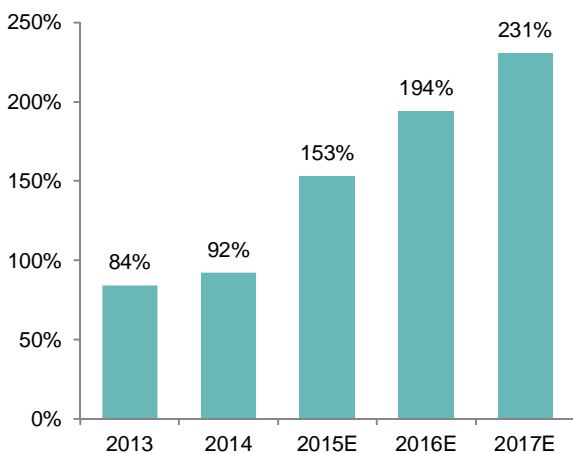
Source(s): ABCI Securities estimates

Exhibit 9: BEW's revenue outlook


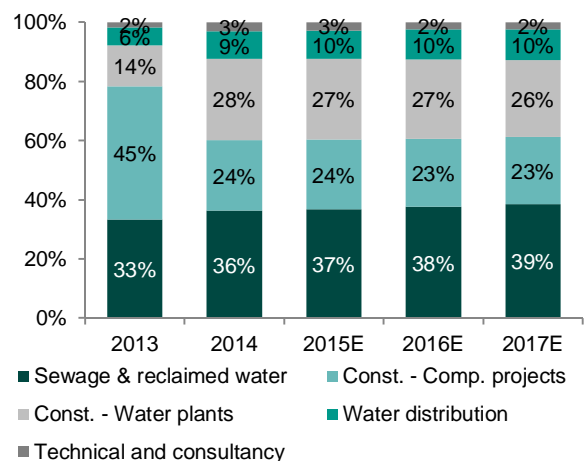
Source(s): ABCI Securities estimates

Exhibit 10: BEW's EPS outlook


Source(s): ABCI Securities estimates

Exhibit 11: BEW's net gearing ratio outlook


Source(s): ABCI Securities estimates

Exhibit 12: BEW's revenue distribution


Source(s): ABCI Securities estimates

Valuation

Initiate BUY with TP at HK\$7.70

We apply the DCF model to capture the future cash flow of BEW's increasing BOT (Build-Operate-Transfer) wastewater capacity. Our TP of HK\$7.70 is based on an 11% WACC, representing 29x/24x 2015/16E P/E, which is similar to peer average at 28x/23x among Hong Kong and Chinese players. Our TP is equivalent to 3.8x/3.3x 2015/16E PB, similar to the peer average of 3.4x/3.0x. As we estimate BEW's EPS will grow at a 23% CAGR in 2014-17E on the back of strong growth in wastewater and water distribution capacities, we believe our 2016E target P/E of 24x, equivalent to ~ 1x PEG, is undemanding.

Risks are on the upside

We believe the Company would deliver a 20% earnings growth YoY in the next two years, driven by 1) surging wastewater capacity growth on China's rising environmental protection concerns and 2) increasing water tariffs as water consumption per capita in China rises. The Company is currently trading at 22x 2015E P/E, and Bloomberg consensus projects a 3-year EPS CAGR of 25%, which translates to around 1.0x 3-year PEG. Given our expectation of strong future earnings growth, we believe the Group's current valuation is undemanding, with risks on the upside.

Share price catalysts

Future share price catalysts include 1) supportive government policies for wastewater treatment investment and 2) announcement of new wastewater facilities M&A. We believe the Group's rising wastewater treatment capacity would provide a stable cash flow and trigger a re-rating for the counter.

Exhibit 13: BEW's DCF calculation (2015E-2024E)

| BEW's DCF calculation | |
|------------------------------|-------------|
| Perpetual growth rate | 1% |
| WACC | 11% |
| Terminal value | 91,620 |
| PV of terminal value | 31,217 |
| Cum PV of CF stream | 65,527 |
| Enterprise Value | 96,743 |
| Less debt | (33,243) |
| Add cash on hand | 6,610 |
| Less: MI | (3,560) |
| Equity Value | 66,551 |
| Shares o/s | 8,643 |
| Value per share(HK\$) | 7.70 |

Source(s): The Company, ABCI Securities estimates

Exhibit 14: BEW's WACC calculation (2015E-2024E)

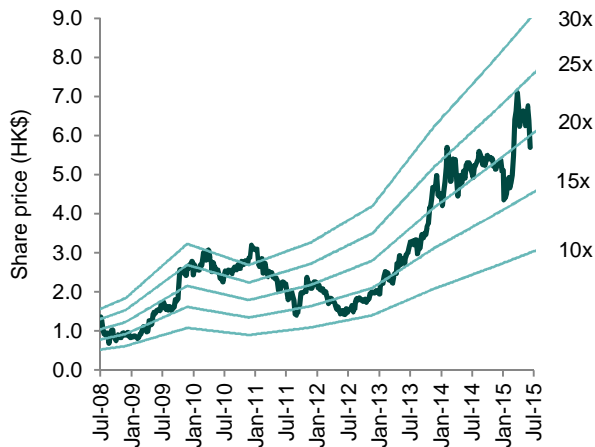
| Assumptions | |
|--------------------------------|--------------|
| Risk Free Rate of Return | 3.6% |
| Long Term Cost of Debt | 5.0% |
| Equity Risk Premium | 10.0% |
| Beta | 0.96 |
| Tax Rate | 20.0% |
| Target Debt to Total Capital | 20.0% |
| Target Equity to Total Capital | 80.0% |
| Cost of Equity | 13.2% |
| WACC | 11.4% |

Source(s): The Company, ABCI Securities estimates

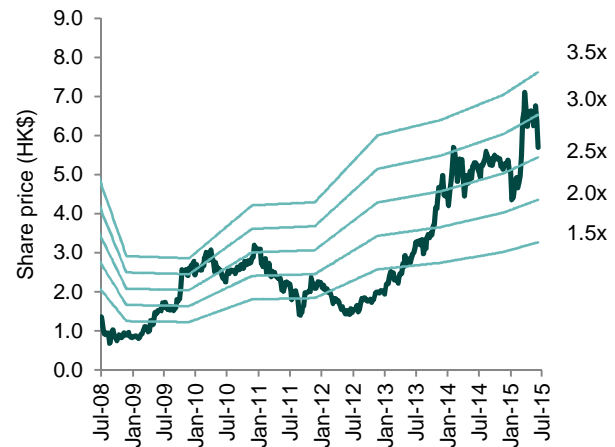
Exhibit 15: Peer comparison

| Name | Stock code | Price | Mkt Cap (USDmn) | PER (x) | | PBR (x) | | Dvd Yield | | ROE | |
|---------------------------|------------|-------|-----------------|-------------|-------------|------------|------------|-------------|-------------|-----------|-----------|
| | | | | FY15E | FY16E | FY15E | FY16E | FY15E | FY16E | FY15E | FY16E |
| HK & China | | | | | | | | | | | |
| Beijing Enterprises Water | 371 HK | 5.70 | 6,406 | 22.4 | 17.5 | 2.8 | 2.5 | 17.0 | 13.4 | 2% | 2% |
| China Everbright Intl | 257 HK | 12.64 | 7,310 | 23.9 | 18.3 | 3.2 | 2.8 | 16.1 | 12.3 | 1% | 1% |
| Ct Environmental Group | 1363 HK | 9.21 | 1,817 | 22.1 | 16.5 | 5.0 | 3.9 | 16.0 | 11.9 | 1% | 1% |
| Tianjin Capital Environ | 1065 HK | 4.81 | 1,817 | 16.5 | 16.5 | 1.3 | 1.2 | 14.2 | 13.5 | 2% | 2% |
| China Water Affairs Group | 855 HK | 3.63 | 712 | 11.3 | 10.2 | n.a. | n.a. | n.a. | n.a. | 2% | 3% |
| Chongqing Water Group | 601158 CH | 9.29 | 7,181 | 24.9 | 22.7 | 3.2 | 3.1 | 24.3 | 23.4 | 3% | 3% |
| Tianjin Capital | 600874 CH | 9.17 | 1,817 | 43.1 | 39.4 | 3.0 | 2.8 | 14.2 | 13.5 | 1% | 1% |
| Beijing Originwater | 300070 CH | 40.49 | 7,022 | 28.6 | 20.8 | 6.2 | 4.9 | 26.9 | 18.7 | 0% | 1% |
| Beijing Water Business | 300055 CH | 19.13 | 2,265 | 34.3 | 27.2 | 3.4 | 3.0 | 39.9 | 27.3 | 1% | 1% |
| Heilongjiang Interchina | 600187 CH | 6.07 | 1,423 | 46.7 | 40.5 | n.a. | n.a. | n.a. | n.a. | 3% | 3% |
| Beijing Capital Co Ltd | 600008 CH | 9.43 | 3,660 | 30.3 | 24.6 | 2.8 | 2.7 | 18.3 | 14.8 | 2% | 2% |
| Avg. | | | | 27.6 | 23.1 | 3.4 | 3.0 | 20.8 | 16.5 | 2% | 2% |
| Asia | | | | | | | | | | | |
| Manila Water Company | MWC PM | 23.80 | 1,065 | 9.7 | 9.7 | 1.3 | 1.2 | 6.4 | 6.1 | 3% | 4% |
| Ttw Pcl | TTW TB | 11.20 | 1,320 | 15.0 | 15.6 | 3.8 | 3.8 | 11.5 | 11.0 | 6% | 6% |
| Eastern Water Resources | EASTW TB | 11.60 | 570 | 13.5 | 13.1 | 2.1 | 1.9 | n.a. | n.a. | 4% | 4% |
| Avg. | | | | 12.7 | 12.8 | 2.4 | 2.3 | 8.9 | 8.5 | 5% | 5% |
| International | | | | | | | | | | | |
| Aqua America Inc | WTR US | 25.20 | 4,462 | 19.8 | 18.7 | 2.7 | 2.5 | 13.0 | 12.1 | 3% | 3% |
| American States Water | AWR US | 38.31 | 1,447 | 23.9 | 22.9 | n.a. | n.a. | 10.5 | 10.0 | 2% | 2% |
| California Water Service | CWT US | 23.54 | 1,127 | 18.5 | 17.2 | 1.8 | 1.7 | 9.0 | 8.4 | 3% | 3% |
| Avg. | | | | 20.8 | 19.6 | 2.2 | 2.1 | 10.8 | 10.2 | 3% | 3% |

Source(s): Bloomberg, ABCI Securities estimates, prices are as of July 6, 2015

Exhibit 16: BEW's fwd. PE chart


Source(s): The Company, ABCI Securities estimates

Exhibit 17: BEW's fwd. PB chart


Source(s): The Company, ABCI Securities estimates

Major risks and concerns

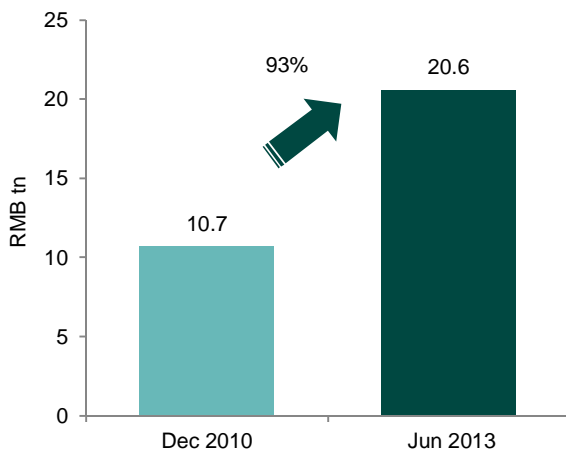
Rising local government debts

Rising local government debts may limit wastewater investment. According to China's National Audit Office, as of June 2013, total government debt was RMB 20.6tn, equivalent to 40% of China's 2012 GDP. For some local governments, debt levels are equivalent to 3 times their annual income. We believe the high debts may reduce local governments' wastewater treatment investment. Furthermore, mounting local government's debt may increase default risk for BEW, as the governments may not be able to repay the construction costs upon project completion.

High net gearing heighten equity fundraising concerns

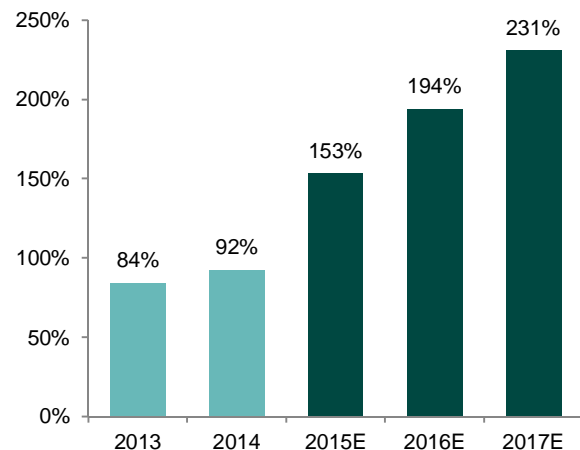
BEW's business model relies heavily on operating income from wastewater treatment business for its M&A activities. As the company accelerates its wastewater M&A activity, its operating cash flow will be stretched, driving up its net gearing ratio. The Group's net gearing ratio rose from 88% in 2009 to 92% in 2014. On Oct 17, 2013 BEW issued 350mn new shares (4.33% of total share capital) at HK\$ 3.21 to raise HK\$ 1.1bn in new capital. We believe that more equity fundraising may take place in 2015.

Exhibit 18: Rising local government debts may affect BEW's business expansion



Source(s): National Audit Office, ABCI Securities

Exhibit 19: BEW's increasing net gearing ratio heightens fundraising concerns



Source(s): The Company, ABCI Securities estimates

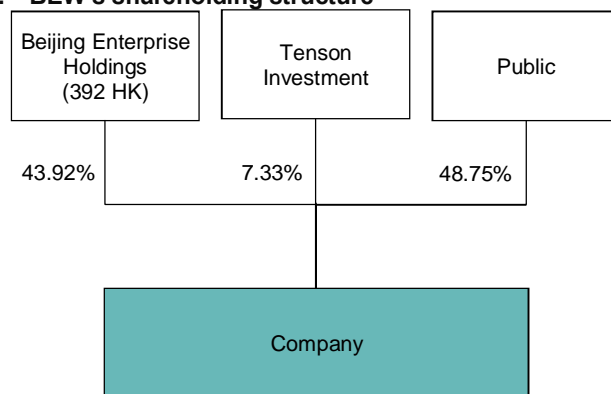
Company overview

Background

Beijing Enterprises Water (BEW) is ultimately owned by the Beijing Municipal government, which engages in water supply and wastewater treatment as well as the environmental protection business. BEW is a subsidiary of Beijing Enterprises Holdings (392 HK; NR), and as of end-2014, BEW controlled 8mt/day in domestic operating wastewater treatment capacity, making it one of the largest water treatment enterprises in China.

BEW was listed on the Main Board of the HKEx through backdoor listing in May 2008. Beijing Enterprises Holdings is the largest shareholder with a 44% stake.

Exhibit 20: BEW's shareholding structure



Source(s): The Company, ABCI Securities

Major assets and business

As of end-2014, BEW was operating 177 wastewater treatment plants and 26 water distribution plants with total operating capacities of 8mt/day and 3.4mt/day. The company specializes in wastewater treatment, reclaimed water, water supply and technical consultancy.

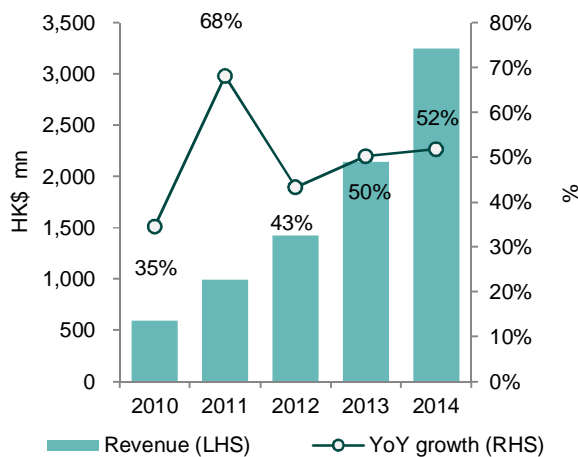
- ◆ **Wastewater treatment:** BEW's main business is wastewater treatment. It currently controls 177 treatment plants with an operating capacity of 8mt/day (China and overseas). This business contributed to 36% of BEW's total 2014 revenue with a gross margin (GM) of 61%.
- ◆ **Construction:** Another key business which contributed to 51% of BEW's 2014 revenue. This business is not as profitable as wastewater treatment with a 24% GM in 2014.
- ◆ **Water supply:** BEW controls 26 water distribution plants with 3.4mt/day in operating capacity. It is another profitable business with a 50% GM in 2014. However, this segment contributed to only 9% of 2014 revenue.
- ◆ **Technical and consultancy:** This business only contributed to 3% of 2014 revenue. However, GM can be as high as 70%, making it the company's most profitable segment.

Exhibit 21: Wastewater treatment business

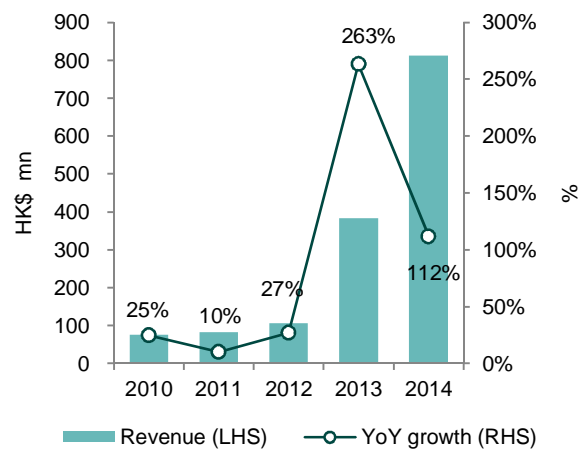

Source(s): ABCI Securities

Exhibit 22: Water distribution business


Source(s): ABCI Securities

Exhibit 23: BEW's wastewater treatment revenue trend


Source(s): The Company, ABCI Securities

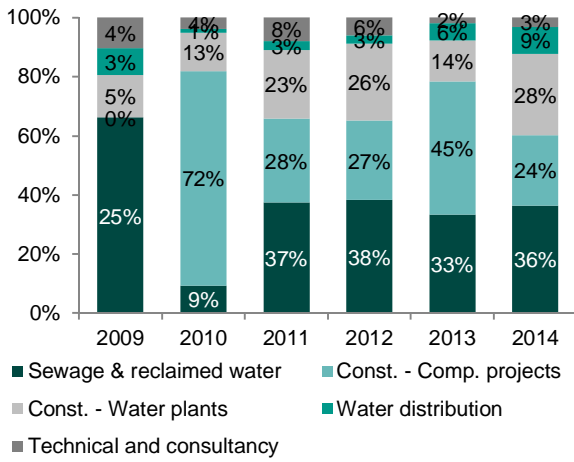
Exhibit 24: BEW's water distribution revenue trend


Source(s): The Company, ABCI Securities

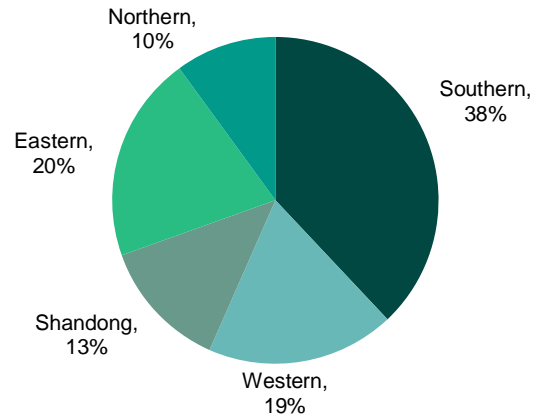
Revenue breakdown

BEW reported a 2014 revenue of HK\$ 8.9 bn, up 39% YoY, mainly driven by the 52% YoY growth in the wastewater treatment segment (accounting for 36% of overall revenue). This segment has maintained a stable growth over the years (43%/50%/52% YoY revenue growth in 2012/13/14), and we believe it will continue to be the Group's key revenue engine. Furthermore, BEW continues to boost its water distribution business. Contribution from this segment has been improving from 1% in 2010 to 9% of total revenue by end-2014.

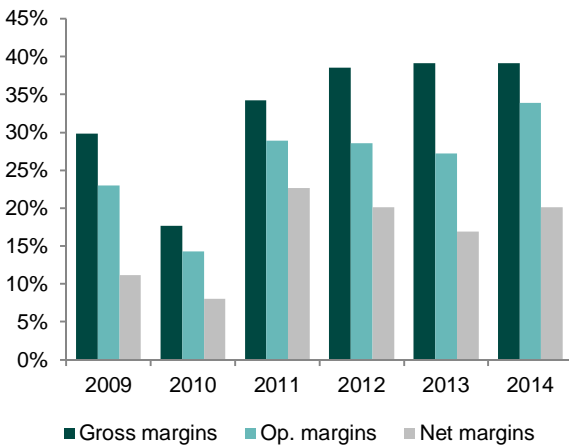
Overall gross margin saw sequential improvement from 30% in 2009 to 39% by end-2014 on increasing contribution from its high-margin wastewater treatment (2014 GM: 61%) and water distribution (2014 GM: 50%) businesses. Revenue contribution from the two businesses has risen from 28% in 2009 to 46% in 2014.

Exhibit 25: Historical revenue breakdown


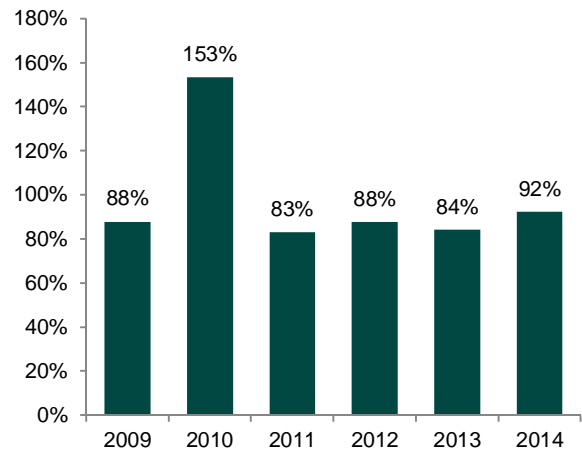
Source(s): The Company, ABCI Securities

Exhibit 26: BEW 2014 wastewater capacity breakdown (China)


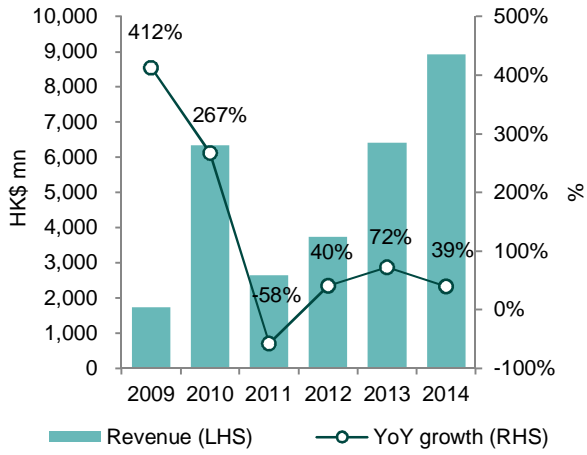
Source(s): The Company, ABCI Securities

Exhibit 27: Overall margins trend


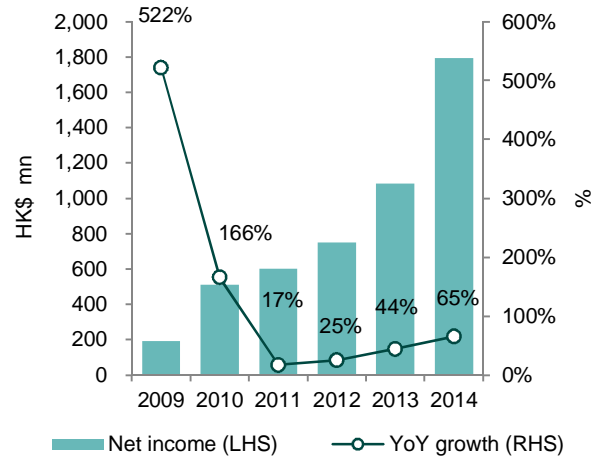
Source(s): The Company, ABCI Securities

Exhibit 28: Net gearing ratio


Source(s): The Company, ABCI Securities

Exhibit 29: Revenue growth trend


Source(s): The Company, ABCI Securities

Exhibit 30: Net income growth trend


Source(s): The Company, ABCI Securities



Consolidated income statement (2013A-2017E)

| FY Ended Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|---|---------------|---------------|---------------|---------------|----------------|
| Revenue | 6,406 | 8,926 | 11,692 | 14,947 | 18,323 |
| Sewage and reclaimed water | 5,905 | 7,833 | 10,249 | 13,061 | 16,005 |
| Water distribution | 384 | 813 | 1,121 | 1,515 | 1,892 |
| Other | 118 | 281 | 323 | 371 | 427 |
| COGS | -3,901 | -5,430 | -7,034 | -8,906 | -10,838 |
| Gross profit | 2,506 | 3,496 | 4,658 | 6,042 | 7,486 |
| SG&A | -775 | -1,066 | -1,169 | -1,495 | -1,832 |
| Net financial income (cost) | -354 | -639 | -588 | -996 | -1,448 |
| Other income and gains | 120 | 876 | 292 | 374 | 458 |
| Pre-tax profit | 1,497 | 2,667 | 3,193 | 3,925 | 4,663 |
| Income tax | -352 | -594 | -639 | -785 | -933 |
| Net profit | 1,145 | 2,073 | 2,554 | 3,140 | 3,731 |
| Profit attributable to: | | | | | |
| Minority interests | -61 | -279 | -255 | -314 | -373 |
| Equity shareholders of the Company | 1,084 | 1,794 | 2,299 | 2,826 | 3,358 |
| Basic EPS (HK\$) | 0.140 | 0.208 | 0.266 | 0.327 | 0.388 |
| DPS (HK\$) | 0.055 | 0.079 | 0.080 | 0.098 | 0.117 |

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2013A-2017E)

| As of Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|--------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Current assets | 15,212 | 15,078 | 16,647 | 17,906 | 19,019 |
| Cash and equivalent | 5,513 | 6,091 | 6,610 | 5,077 | 3,293 |
| Pledged and restricted bank deposits | 57 | 304 | 0 | 0 | 0 |
| Trade and bill receivables | 2,038 | 2,595 | 3,524 | 4,505 | 5,522 |
| Other receivables and prepayments | 6,431 | 5,910 | 6,407 | 8,190 | 10,040 |
| Inventories | 55 | 58 | 106 | 134 | 163 |
| Other current assets | 1,118 | 120 | 0 | 0 | 0 |
| Non-current assets | 28,974 | 36,563 | 47,875 | 62,644 | 77,332 |
| Property, plant and equipment | 379 | 1,243 | 2,102 | 2,958 | 3,812 |
| Lease prepayment | 0 | 0 | 0 | 0 | 0 |
| Intangible assets | 2,539 | 2,553 | 3,494 | 4,667 | 6,078 |
| Investment in JV and associates | 3,025 | 3,109 | 3,851 | 4,780 | 5,901 |
| Other receivables and deposits | 15,006 | 20,293 | 26,105 | 33,151 | 40,458 |
| Other non-current assets | 8,027 | 9,364 | 12,323 | 17,087 | 21,084 |
| Total assets | 44,187 | 51,641 | 64,522 | 80,550 | 96,351 |
| Current liabilities | 11,651 | 11,419 | 16,183 | 20,856 | 25,796 |
| Trade and bill payables | 2,755 | 3,564 | 4,818 | 6,100 | 7,423 |
| Other payables | 4,908 | 3,910 | 4,818 | 6,100 | 7,423 |
| Short term borrowings | 3,980 | 3,945 | 6,547 | 8,656 | 10,949 |
| Other current liabilities | 7 | 0 | 0 | 0 | 0 |
| Non-current liabilities | 16,611 | 21,133 | 27,396 | 35,859 | 43,998 |
| Deferred tax liabilities | 562 | 930 | 700 | 750 | 200 |
| Long-term borrowings | 12,780 | 17,022 | 26,696 | 35,109 | 43,798 |
| Other non-current liabilities | 3,269 | 3,182 | 0 | 0 | 0 |
| Total liabilities | 28,262 | 32,552 | 43,579 | 56,715 | 69,793 |
| Minority interests | -2,627 | -3,304 | -3,560 | -3,874 | -4,247 |
| Shareholders' equities | 13,298 | 15,784 | 17,383 | 19,961 | 22,312 |

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2013A-2017E)

| FY ended Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|---|---------------|---------------|---------------|---------------|---------------|
| Profit before tax | 1,497 | 2,667 | 3,193 | 3,925 | 4,663 |
| Change in depreciation and amortization | 122 | 209 | 299 | 429 | 578 |
| Change in working capital | -2,653 | -2,732 | -9,072 | -9,504 | -9,869 |
| Net financial cost (income) | 363 | 668 | 588 | 996 | 1,448 |
| Income tax paid | -177 | -277 | -594 | -639 | -785 |
| Net interest received | 0 | 0 | 0 | 0 | 0 |
| Others | -88 | -271 | -175 | -224 | -275 |
| CF Operating | -936 | 264 | -5,761 | -5,017 | -4,240 |
| Capex | -105 | -683 | -1,291 | -1,479 | -1,672 |
| Increase in intangible assets | -19 | -51 | -937 | -1,169 | -1,407 |
| Others | -2,734 | -1,000 | -1,886 | -2,288 | -2,701 |
| CF Investing | -2,857 | -1,734 | -4,114 | -4,936 | -5,780 |
| Net Capital raise | 2,297 | 0 | -6 | 0 | 0 |
| Net debt financing | 3,726 | 3,677 | 12,276 | 10,523 | 10,982 |
| Dividend payout | 0 | -10 | -690 | -848 | -1,007 |
| Interest paid | -789 | -1,105 | -1,084 | -1,153 | -1,637 |
| Others | 191 | -366 | 0 | 0 | 0 |
| CF Financing | 5,425 | 2,196 | 10,496 | 8,522 | 8,338 |
| Net change in cash | 1,632 | 726 | 621 | -1,432 | -1,682 |
| Cash at the beginning | 3,640 | 5,366 | 6,091 | 6,610 | 5,077 |
| Adjustment (Time deposit & FX effect) | 241 | -1 | -102 | -102 | -102 |
| Cash at the end | 5,513 | 6,091 | 6,610 | 5,077 | 3,293 |

Source(s): Company, ABCI Securities estimates

Key Ratio (2013A-2017E)

| FY ended Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|---|--------------|--------------|--------------|--------------|--------------|
| Sales mixed (%) | | | | | |
| Sewage and reclaimed water | 92.18 | 87.75 | 87.65 | 87.38 | 87.35 |
| Water distribution | 5.99 | 9.10 | 9.59 | 10.14 | 10.32 |
| Other | 1.83 | 3.15 | 2.76 | 2.48 | 2.33 |
| Total | 100 | 100 | 100 | 100 | 100 |
| Profit & loss ratios (%) | | | | | |
| Gross margin | 39.11 | 39.17 | 39.84 | 40.42 | 40.85 |
| Operating profit margin | 27.21 | 33.92 | 30.84 | 31.42 | 31.85 |
| Pre-tax margin | 23.37 | 29.88 | 27.31 | 26.26 | 25.45 |
| Net profit margin | 17.88 | 23.23 | 21.85 | 21.01 | 20.36 |
| Selling & administrative expenses/revenue | 12.09 | 11.94 | 10.00 | 10.00 | 10.00 |
| Effective tax rate | 23.50 | 22.27 | 20.00 | 20.00 | 20.00 |
| Growth (%) | | | | | |
| Revenue | 71.88 | 39.33 | 30.99 | 27.84 | 22.59 |
| Gross profit | 74.36 | 39.53 | 33.24 | 29.71 | 23.90 |
| Operating profit | 63.85 | 73.68 | 19.09 | 30.25 | 24.28 |
| Net profit | 32.09 | 81.01 | 23.21 | 22.91 | 18.82 |
| Balance sheet ratios | | | | | |
| Current ratio (x) | 1.31 | 1.32 | 1.03 | 0.86 | 0.74 |
| Quick ratio (x) | 0.65 | 0.79 | 0.63 | 0.46 | 0.34 |
| Cash ratio (x) | 0.48 | 0.56 | 0.41 | 0.24 | 0.13 |
| Trade and bill receivables days | 116.11 | 106.12 | 110.00 | 110.00 | 110.00 |
| Trade and bill payables turnover days | 257.82 | 239.56 | 250.00 | 250.00 | 250.00 |
| Inventory turnover days | 5.18 | 3.88 | 5.50 | 5.50 | 5.50 |
| Total debt / equity ratio (%) | 126.04 | 132.83 | 191.24 | 219.25 | 245.38 |
| Net debt / equity ratio (%) | 84.15 | 92.32 | 153.21 | 193.82 | 230.61 |
| Returns (%) | | | | | |
| ROAA | 2.9 | 3.7 | 4.0 | 3.9 | 3.8 |
| ROAE | 10.0 | 12.3 | 13.9 | 15.1 | 15.9 |
| Payout ratio | 39.28 | 37.85 | 30.00 | 30.00 | 30.00 |

Source(s): Company, ABCI Securities estimates

July 7, 2015 Company Report Rating: BUY TP: HK\$ 16.50

| | |
|-------------------------|--------|
| Share price (HK\$) | 12.64 |
| Est. share price return | 30.54% |
| Est. dividend yield | 1.01% |
| Est. total return | 31.55% |

Analyst: Kelvin Ng
 Tel: (852) 2147 8869
 Email: kelvingn@abci.com.hk

Key Data

| | |
|------------------------------------|-----------|
| Market share (HK\$ mn) | 56,674 |
| 3-mth avg daily turnover (HK\$ mn) | 109 |
| 52-week high/low (HK\$) | 163.9/9.8 |
| Issued shares (mn) | 4,484 |
| Major shareholder(s) (%): | |
| China Everbright Hld | 41.39 |

Source(s): Company, Bloomberg, ABCI Securities

FY14 Revenue breakdown (%)

| | |
|-----------------|-------|
| Waste-to-energy | 63.09 |
| Wastewater | 11.64 |
| Others | 25.26 |

Source(s): Company, ABCI Securities

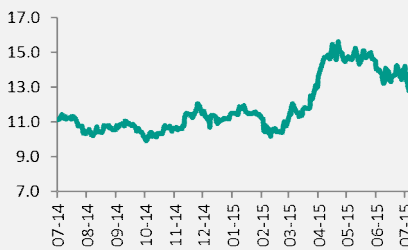
Share performance (%)

| | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | -9.59% | -2.16% |
| 3-mth | -14.01% | -10.20% |
| 6-mth | 10.17% | 2.72% |

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance



Source(s): Bloomberg, ABCI Securities

China Everbright Intđ (257 HK) Entering the incineration era

- China's rising urbanization and living standard should strongly support demand for urban waste treatment service
- Increasing transportation cost and concerns over underground water pollution has made incineration a more preferable method of urban solid waste treatment over landfill; China is set to adopt incineration nationwide
- China Everbright Intđ (CEI) is likely to expand its waste-to-energy capacity by 25%YoY, which in turn will drive up its earnings
- We initiate **BUY** with DCF-derived TP at HK\$16.50, representing 32x/25x FY15/16E P/E and 4.1x/3.6x FY15/16E P/B

Urbanization and incineration trends present significant opportunities. The National Development and Reform Commission (NDRC) estimates that China's urbanization rate will reach 60% by end-2020E, which represents a 19% rise in the urban population from end-2013. Hence, demand for urban solid waste treatment will be strong. Rising concerns regarding underground water pollution has made landfills less viable for residential waste treatment, and we estimate the use of incineration would increase. The Chinese government targets to increase incineration to overall solid waste treatment from 30% by end-2013 to 35% by end-2015E and the State Council targets a total incineration capacity of 307k tons/day by end-2015E, implying a 28% CAGR from 2010-15E. Incineration operators, therefore, will benefit from the strong demand.

25% increase in waste-to-energy capacity in 2015E/16E. We expect CEI to increase its waste-to-energy capacity with a 25% YoY growth in 2015E /2016E. The Company currently has a waste-to-energy capacity of 12,200 tons/day under construction, doubling that of the existing operating capacity. We believe CEI has strong potential in this segment.

An SOE with a solid relationship with local governments and lower financing costs. CEI is an SOE that has a strong tie with local governments, which gives the company an advantage over other overseas and local competitors in obtaining new contracts. SOEs also benefit from lower financing costs (5% for CEI vs. 7% for non-SOEs, according to management). Lower financing costs should aid CEI in future M&As and business expansion.

BUY with TP at HK\$ 16.50. Our DCF-derived TP at HK\$ 16.50 is based on a WACC of 9%, representing 32x/25x FY15/16E P/E and 4.1x/3.6x FY15/16E P/B. CEI is the key beneficiary of China's strong push for urban incineration and the 13th Five-year plan on urban solid waste to be published later this year, which we believe will serve as potential share price catalyst in the near future.

Risk factors: (1) Customer default risk; (2) Air pollution concern may slow down construction of incinerators; (3) Policy risks.

Results and Valuation

| FY ended Dec 31 | 2013A | 2014A | 2015E | 2016E | 2017E |
|---------------------|-------|-------|-------|--------|--------|
| Revenue (RMB mn) | 5,320 | 6,355 | 8,577 | 11,363 | 14,785 |
| Chg (% YoY) | 56.0 | 19.5 | 35.0 | 32.5 | 30.1 |
| Net Income (RMB mn) | 1,325 | 1,703 | 2,296 | 2,931 | 3,688 |
| EBITDA (RMB mn) | 2,191 | 2,733 | 3,801 | 4,872 | 6,189 |
| Chg (% YoY) | 42.1 | 24.8 | 39.1 | 28.2 | 27.0 |
| EPS (RMB) | 0.326 | 0.380 | 0.512 | 0.654 | 0.823 |
| Chg (% YoY) | 40.2 | 16.5 | 34.8 | 27.7 | 25.8 |
| BVPS (RMB) | 3.291 | 3.628 | 3.997 | 4.577 | 5.260 |
| Chg (% YoY) | 49.3 | 10.2 | 10.2 | 14.5 | 14.9 |
| Target P/E (x) | 50.66 | 43.43 | 32.22 | 25.24 | 20.06 |
| Target P/B (x) | 5.01 | 4.55 | 4.13 | 3.61 | 3.14 |
| ROE (%) | 9.90 | 10.47 | 12.81 | 14.28 | 15.64 |
| ROA (%) | 5.64 | 5.46 | 6.39 | 6.77 | 7.04 |
| DPS (RMB) | 0.090 | 0.110 | 0.128 | 0.163 | 0.206 |
| Target yield (%) | 0.55 | 0.67 | 0.78 | 0.99 | 1.25 |
| Net gearing* (%) | 8.3 | 24.5 | 24.9 | 23.4 | 25.2 |

*Net gearing=Net debt/Total equity

Source(s): Bloomberg, ABCI Research estimates



Key positives

China is set to enter the era of incineration

Rising transportation costs and concerns over underground water pollution have made landfills a less viable option for residential waste treatment. Technological advancement in incineration, such as the development of waste-to-energy technology, should make it a more preferable treatment method and increase adoption nationwide. We believe waste-to-energy is likely to become the major solid waste treatment method in China. The State Council has already announced its target of attaining an incineration capacity of 307kt/day by end-2015E (a 28% CAGR from 2010-15E), suggesting that China is likely to enter the era of incineration.

Increasing urbanization and incineration use present significant opportunities

The National Development and Reform Commission (NDRC) estimates China's urbanization will reach 60% by end-2020E, which represents a 19% rise in the urban population from 2013. Treatment rate of residential solid waste in urban areas is likely to maintain an uptrend (2013: 89%) and reach 99% by end-2020, meanwhile, the Chinese government intended to increase the proportion of solid waste incinerated from 30% by end-2013 to 35% by end-2015E, and we estimate the ratio is likely to reach 45% by end-2020. If we assume residential waste per capita to decline by 1% every year in 2013-2020 due to technology advancement in reducing solid waste, residential waste produced would reach 189mt by end-2020 (2013: 153mt) and solid waste to be treated via incineration would reach 85mt (2013: 46mt) indicating a 84% increase or a 9% CAGR during 2013-2020E. This should bring great opportunities for incineration operators including CEI.

Waste-to-energy capacity to expand by 25%YoY in 2015E/16E

We believe CEI will continue to increase waste-to-energy capacity by 25% YoY in 2015E and 2016E. The company currently has a waste-to-energy capacity of 12,200t/day under construction, doubling that of the existing operating capacity. This suggests that CEI has a strong potential in increasing its revenue in the specific segment. In addition, EBITDA margin from this segment is high (2008-2014 average at 51%) which should help CEI maintaining its profitability. We estimate CEI can deliver 35%/28% YoY EPS growth in 2015/16E on the back of sustainable capacity growth of 25% YoY in 2015E and 2016E.

An SOE with solid relationships with local governments and lower financing costs

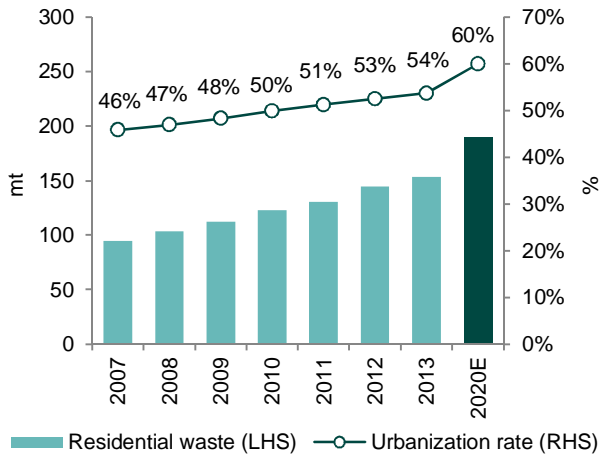
CEI is an SOE that have strong ties with local governments, which gives the company an advantage over other overseas and local competitors in obtaining new contracts. SOEs also benefit from lower financing costs (5% for CEI vs. 7% for non-SOEs, according to management). Lower financing costs should aid CEI in future M&As and business expansion.

Profitable industrial and hazardous waste businesses are future growth drivers

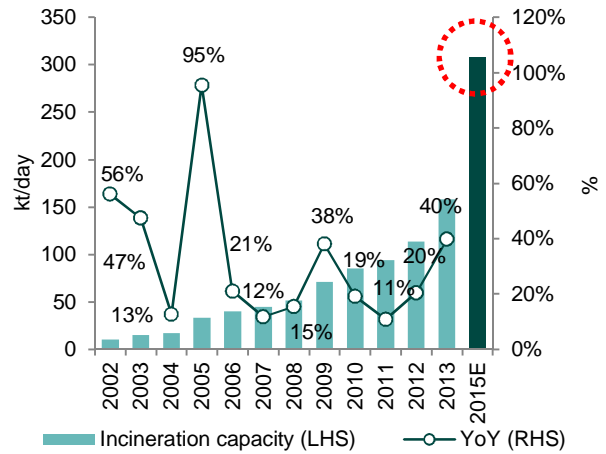
According to management, the Internal Rate of Return (IRR) of industrial waste and hazardous waste treatments can be as high as 15% and 18%, exceeding the 10% for its residential waste treatment business. The government estimates the total volume of hazardous waste could reach 60mn tons in 2015, a 90% jump from the 2013 level, which suggests that nationwide treatment capacity has to increase at a 21% CAGR from 2010-15E. This should provide opportunities for CEI to develop its industrial and hazardous waste treatment businesses, which we believe would serve as its future revenue growth engines.

Projects in affluent coastal regions reduce default risk

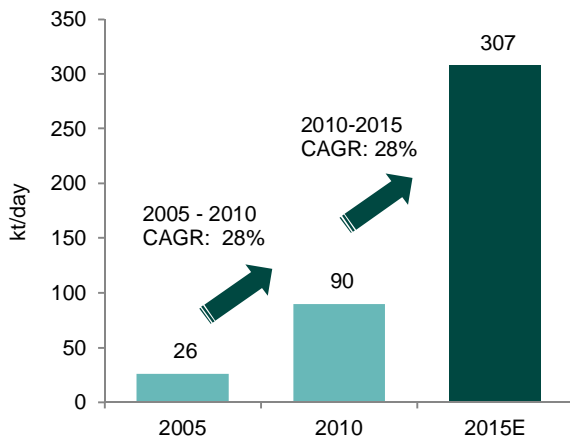
Most of CEI's existing waste-to-energy projects are located in wealthier coastal regions in China such as Suzhou, Jinan, Yixing, etc. In general, default risk is lower in more affluent regions, and this should allow the Group to maintain a strong cash flow.

Exhibit 1: Increasing urbanization is likely to spur demand for solid waste treatment


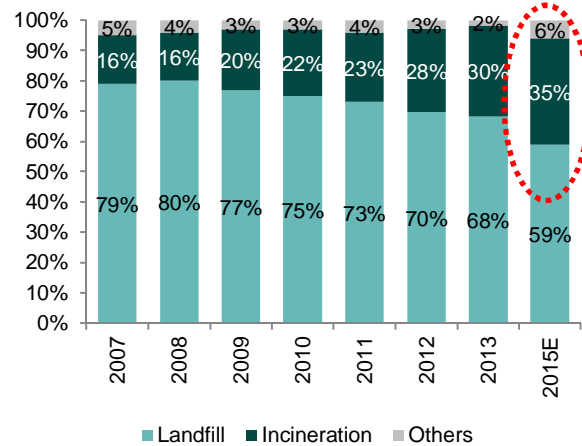
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 2: China's incineration capacity


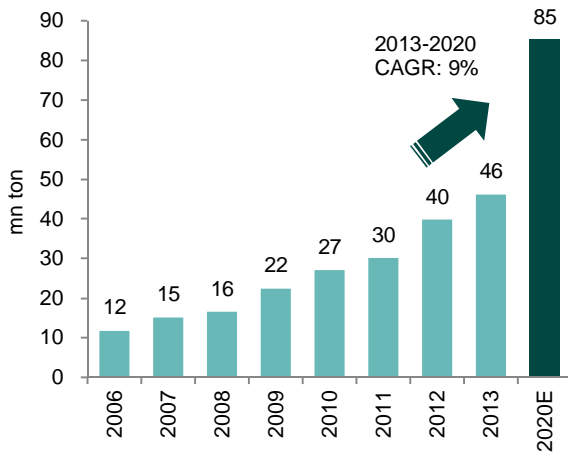
Source(s): MEP, ABCI Securities estimates

Exhibit 3: China's urban incineration treatment capacity target


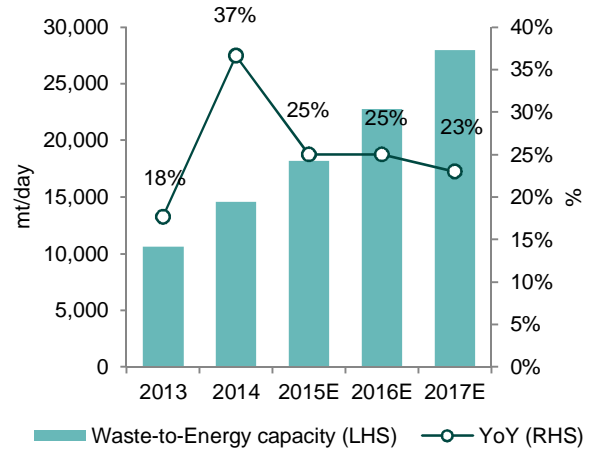
Source(s): MEP, ABCI Securities estimates

Exhibit 4: Incineration to become a major waste treatment method in China


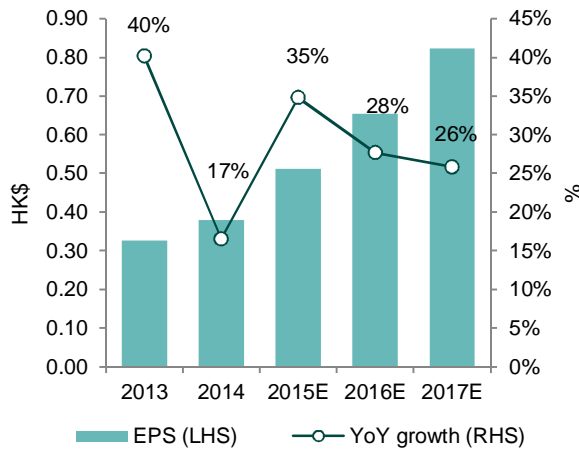
Source(s): MEP, ABCI Securities estimates

Exhibit 5: Urban incineration treatment volume is likely to expand by 9% CAGR in 2013-2020E


Source(s): MEP, ABCI Securities estimates

Exhibit 6: CEI's strong waste-to-energy capacity growth will serve as its key earnings growth driver


Source(s): MEP, ABCI Securities estimates

Exhibit 7: CEI's e EPS growth should stay strong on the high profitability of waste-to-energy projects


Source(s): The Company, ABCI Securities estimates

Exhibit 8: CEI's existing waste-to-energy projects are located along the coastal regions


Source(s): The Company, ABCI Securities

Future earnings outlook

We believe incineration will be used as one of the major disposal methods for residential waste. CEI should benefit from its advanced waste-to-energy technology; also, as an SOE, it would have an advantage over other non-SOEs in project bidding.

Earnings growth

Looking forward, we forecast waste-to-energy operation revenue to grow by 54%/31% YoY in 2015E/16E and wastewater treatment operation revenue to expand by 68%/37% YoY growth in 2015E/16E off the low base (the 2 segments only contributed to 13% and 10% of CEI's 2014 total revenue). We believe the waste-to-energy segment (include both operation and construction) will continue to see strong organic growth on China's push for incineration, which would boost CEI's overall earnings. We therefore expect CEI's earnings to go up by 35%/28% YoY in 2015E/16E.

Capacity growth

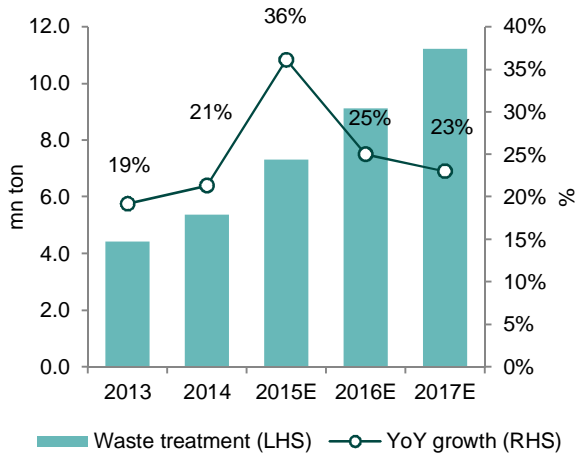
We expect nationwide waste-to-energy treatment capacity to continue to trend up due to government's advocating of such use in the urban regions. We anticipate CEI to add 3,638 tons/day in new capacity in 2015E, representing a 25% YoY growth. We also forecast a 25% YoY capacity growth in 2016E as CEI maintains its pace of expansion. For its wastewater treatment business, we believe the Group will achieve a 25%/23% YoY growth in 2015/16E capacity on strong demand for wastewater treatment service by China's urban residents.

Net gearing ratio

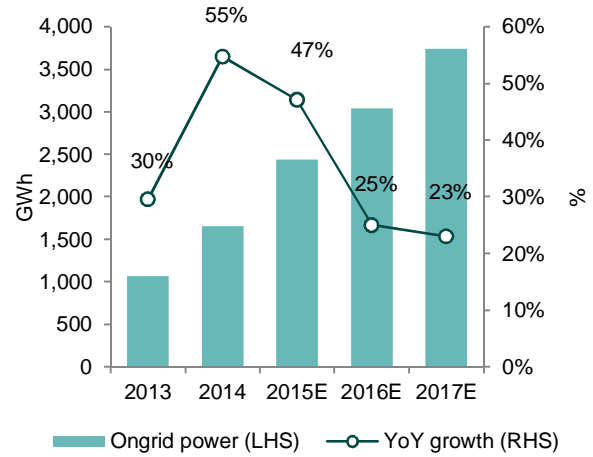
After the share placement in Dec 2013, CEI's net gearing ratio fell from 41% in 1H13 to 8% at end-2013. But as the Group has paced up its wastewater business acquisition since 2014, net gearing ratio rose from 8% in 2013 to 25% in 2014. As cash flow from waste-to-energy and wastewater treatment operations remain strong, CEI's net gearing ratio should be maintained at a relatively low level in 2015E. While management targets to maintain a net gearing ratio below 60%, we believe increasing cash flow from the Group's waste-to-energy operation should keep its net gearing ratio below 50% over the long run.

Dividend policy

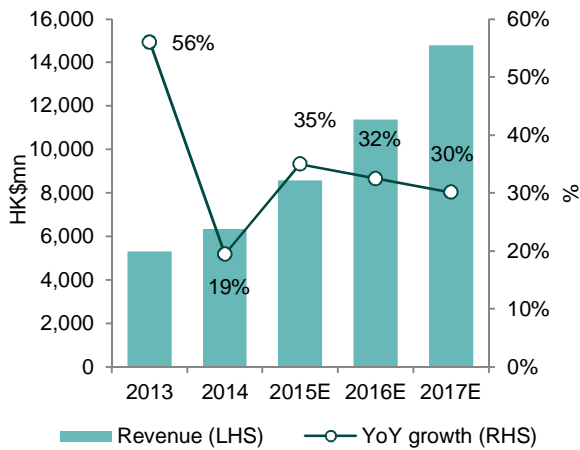
CEI had a 28% and 29% dividend payout ratio in 2013 and 2014. While management has not announced any long-term payout guidance, its average payout ratio was 22% in 2008-2014; together with its low net gearing (25% in 2014), the Group should be able to sustain its payout ratio at a similar level. Hence, we estimate CEI payout ratio to be 25% going forward.

Exhibit 9: CEI's residential waste treatment volume (waste-to-energy)


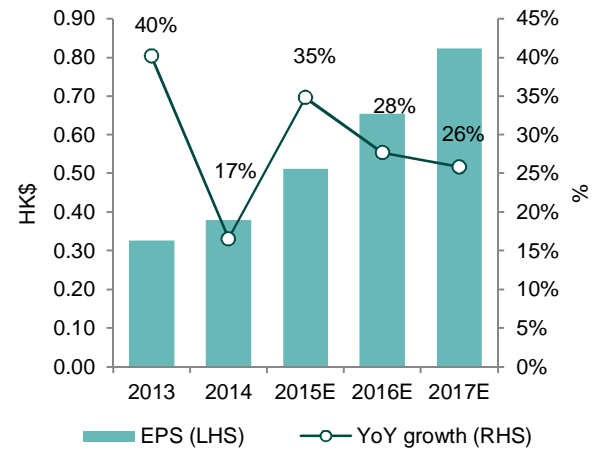
Source(s): The Company, ABCI Securities estimates

Exhibit 10: CEI's on-grid power (waste-to-energy)


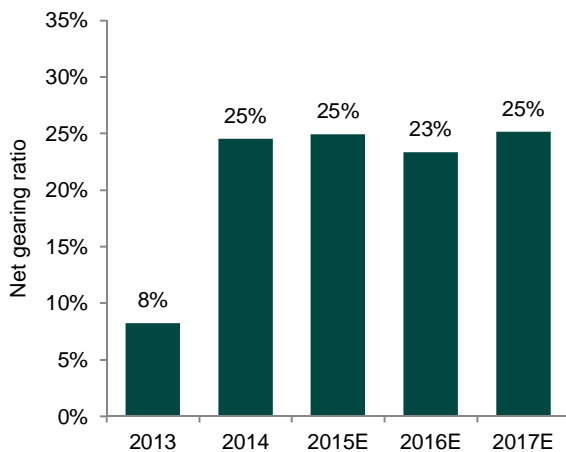
Source(s): The Company, ABCI Securities estimates

Exhibit 11: CEI's revenue growth outlook


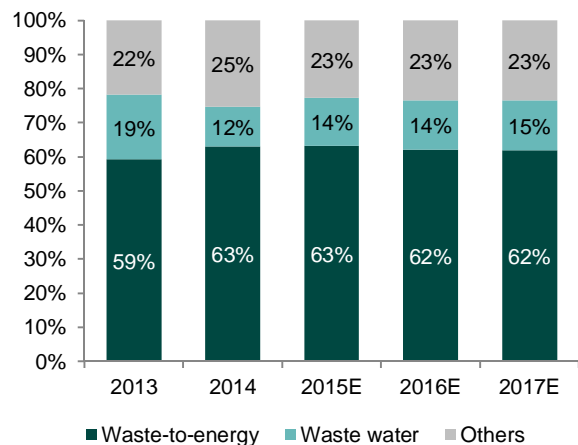
Source(s): The Company, ABCI Securities estimates

Exhibit 12: CEI's EPS growth outlook


Source(s): The Company, ABCI Securities estimates

Exhibit 13: CEI's net gearing ratio outlook


Source(s): The Company, ABCI Securities estimates

Exhibit 14: CEI's revenue breakdown


Source(s): The Company, ABCI Securities estimates

Valuation

Initiate BUY with TP at HK\$ 16.50

We believe DCF is the most appropriate method as it captures CEI's strong future cash flow from its waste-to-energy and wastewater treatment operations.

Our TP of HK\$16.50 is based on a 9% WACC, and is equivalent to 32x/25x 2015/16E P/E, which represents a premium to the peer average of 22x/18x among global waste treatment players. CEI is one of the few Hong Kong-listed Chinese incinerator operators with sizable capacities in China's affluent coastal regions. We believe operations in these regions entail a lower default risk and higher profitability given the rising living standards. We estimate CEI's EPS to grow at a 29% CAGR in 2014-17E, driven by the government's advocating of the use of incineration for waste disposal. In our view, CEI deserves a valuation premium over peers, given its quality assets, sustainable earnings growth, and SOE status.

A key beneficiary of the government's push for incineration

We believe the Chinese government is likely to increase the use of incineration in urban regions as 1) rising urbanization may aggravate pollution problems and 2) worsening underground water pollution has made landfill a less viable option for residential waste treatment. As the Chinese government targets to raise the proportion of residential waste disposed of via incineration from 25% in 2012 to 35% by end-2015E, we believe CEI will maintain a sustainable earnings growth going forward.

Share price catalysts

Future share price catalysts include announcements from 1) the government on development of incinerators in urban areas and 2) successful bid of waste-to-energy projects by CEI.

Exhibit 15: CEI's DCF calculation (2015E-2024E)

| CEI's DCF calculation | |
|------------------------------|--------------|
| Perpetual growth rate | 1% |
| WACC | 9% |
| Terminal value | 112,731 |
| PV of terminal value | 47,308 |
| Cum PV of CF stream | 32,790 |
| Enterprise Value | 80,098 |
| Less debt | (11,402) |
| Add cash on hand | 6,936 |
| Less: MI | (1,651) |
| Equity Value | 73,981 |
| Shares o/s | 4,484 |
| Value per share(HK\$) | 16.50 |

Source(s): The Company, ABCI Securities estimates

Exhibit 16: CEI's WACC calculation (2015E-2024E)

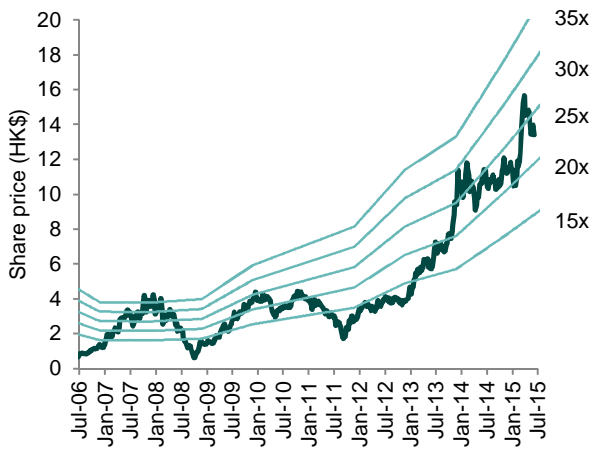
| Assumptions | |
|--------------------------------|-------------|
| Risk Free Rate of Return | 2.4% |
| Long Term Cost of Debt | 5.0% |
| Equity Risk Premium | 10.0% |
| Beta | 0.90 |
| Tax Rate | 25.0% |
| Target Debt to Total Capital | 30.0% |
| Target Equity to Total Capital | 70.0% |
| Cost of Equity | 11.4% |
| WACC | 9.1% |

Source(s): The Company, ABCI Securities estimates

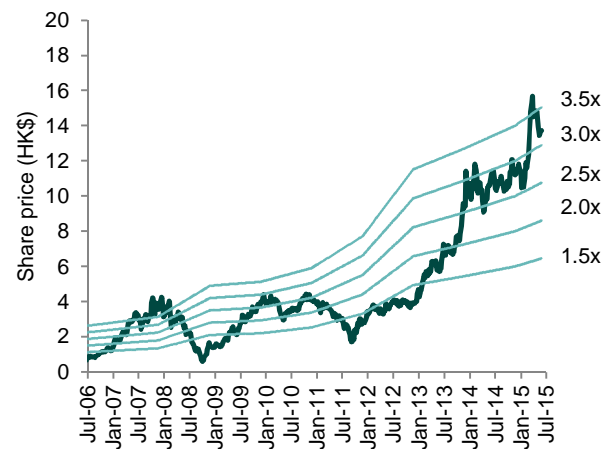
Exhibit 17: Peer comparison

| Name | Stock code | Price | Mkt Cap (USDmn) | PER (x) | | PBR (x) | | Dvd Yield | | ROE | | |
|-----------------------------|------------|-------|-----------------|-------------|-------------|------------|------------|-------------|-------------|-----------|-----------|--|
| | | | | FY15E | FY16E | FY15E | FY16E | FY15E | FY16E | FY15E | FY16E | |
| HK & China | | | | | | | | | | | | |
| China Everbright Intl | 257 HK | 12.64 | 7,310 | 23.9 | 18.3 | 3.2 | 2.8 | 16.1 | 12.3 | 1% | 1% | |
| Dongjiang Environmental | 895 HK | 12.92 | 2,188 | 19.2 | 11.8 | 1.6 | 1.2 | 21.9 | 15.1 | 1% | 2% | |
| Avg. | | | | 21.6 | 15.1 | 2.4 | 2.0 | 19.0 | 13.7 | 1% | 1% | |
| Asia | | | | | | | | | | | | |
| Asahi Holdings Inc | 5857 JP | 2,100 | 620 | 10.2 | 9.3 | n.a. | n.a. | 7.2 | 6.8 | 3% | 3% | |
| Daiseki Co Ltd | 9793 JP | 2,400 | 882 | 23.9 | 21.6 | 1.9 | 1.7 | 8.0 | 7.5 | 1% | 1% | |
| Transpacific Industries | TPI AU | 0.77 | 909 | 27.3 | 20.1 | 0.7 | 0.7 | 5.8 | 5.1 | 2% | 3% | |
| Avg. | | | | 20.5 | 17.0 | 1.3 | 1.2 | 7.0 | 6.5 | 2% | 2% | |
| International | | | | | | | | | | | | |
| Republic Services Inc | RSG US | 39.66 | 13,934 | 19.6 | 18.1 | 1.8 | 1.8 | 8.3 | 8.0 | 3% | 3% | |
| Waste Connections Inc | WCN US | 47.18 | 5,844 | 23.9 | 21.3 | 2.6 | 2.5 | 11.2 | 10.6 | 1% | 1% | |
| Clean Harbors Inc | CLH US | 52.00 | 3,051 | 29.3 | 23.0 | 2.4 | 2.2 | 8.0 | 7.4 | n.a. | n.a. | |
| Waste Management Inc | WM US | 46.53 | 21,302 | 18.7 | 17.3 | 3.6 | 3.3 | 8.8 | 8.4 | 3% | 3% | |
| Progressive Waste Solutions | BIN CN | 33.53 | 3,059 | 20.8 | 17.8 | 2.3 | 2.1 | 8.7 | 8.0 | 2% | 2% | |
| Avg. | | | | 22.4 | 19.5 | 2.5 | 2.4 | 9.0 | 8.5 | 2% | 2% | |

Source(s): Bloomberg, ABCI Securities estimates, prices are as of 6 July 2015

Exhibit 18: CEI's fwd PE chart


Source(s): The Company, ABCI Securities estimates

Exhibit 19: CEI's fwd PB chart


Source(s): The Company, ABCI Securities estimates

Major risks

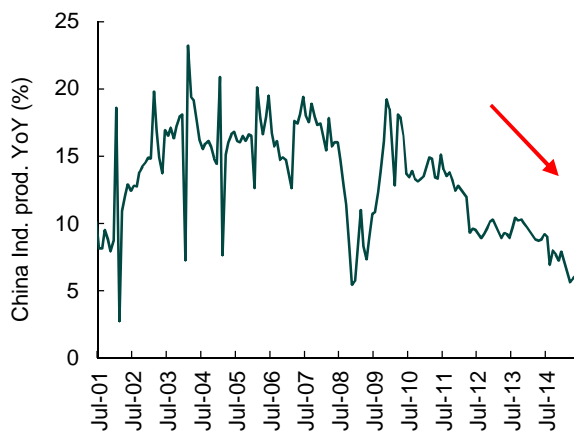
Default risk from industrial and hazardous waste customers

Default risk from industrial and hazardous waste customers may increase against the backdrop of slowing industrial activities in China. Maintaining its downtrend since Dec 2009, China's monthly industrial production growth rose 6.1% YoY in May 2015. Nonetheless, management revealed that it may aim to increase revenue contribution from its industrial and hazardous waste treatment business.

Air pollution concerns may delay construction of incinerators

Despite the fact that waste-to-energy technology can significantly reduce air pollutants through complete combustion, concerns over the release of toxic pollutants such as sulfur dioxide, dioxin, furans, etc. that are usually produced by traditional incineration plants may result in public resistance against construction of waste-to-energy plants.

Exhibit 20: China's weakening industrial production increases default risk among CEI's customers



Source(s): Bloomberg, ABCI Securities

Exhibit 21: Protest against incineration construction



Source(s): nanzao.com

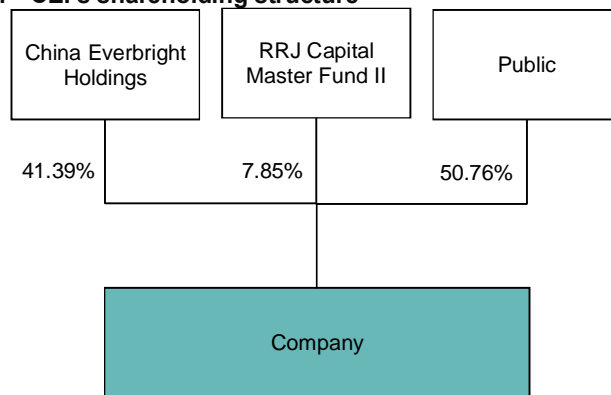
Company overview

Background

China Everbright International (CEI) is one of the largest integrated environmental solutions providers in China. The company mainly invests in environmental energy, environmental water, and alternative energy. As of end-2014, CEI controlled 14,550 tons/day of waste-to-energy capacity and 938m sqm/year of wastewater capacity.

CEI used to concentrate on infrastructure construction and timber businesses in China. In 2004, the company shifted its main business to environmental solutions and has since become one of the largest solution providers in China. China Everbright Holdings is the Group's largest shareholder with a 41% stake.

Exhibit 22: CEI's shareholding structure



Source(s): The Company, ABCI Securities

Major assets and business

CEI's main businesses include construction and operation of waste-to-energy, wastewater treatment and alternative energy generation. As of 2014, CEI was operating 15 waste-to-energy plants and 23 wastewater treatment plants.

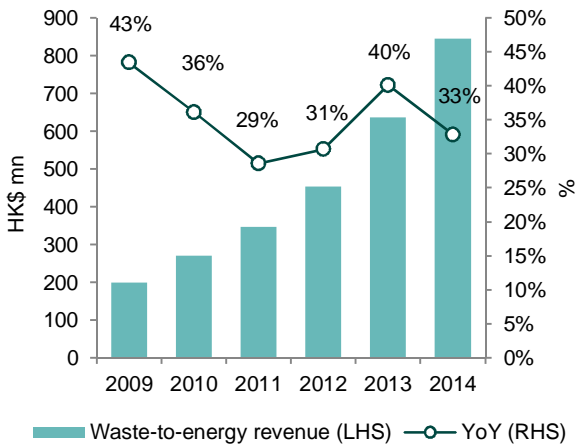
- ◆ **Waste-to-energy:** By end-2014, CEI was operating 15 waste-to-energy plants for residential waste with a capacity of 14,550 tons/day. The company has 16 plants with a total capacity of 12,200 ton/day under construction.
- ◆ **Wastewater treatment:** CEI was operating 23 wastewater treatment plants with a capacity of 2.56mn sqm/day as of end-2014. The company has 14 plants with a total capacity of 1.03mn sqm/year under construction.
- ◆ **Alternative energy:** By end-2014, CEI was operating 8 photovoltaic projects and 2 biomass power generation projects. Total electricity generation was 325 GWh in 2014.

Exhibit 23: Waste-to-energy business

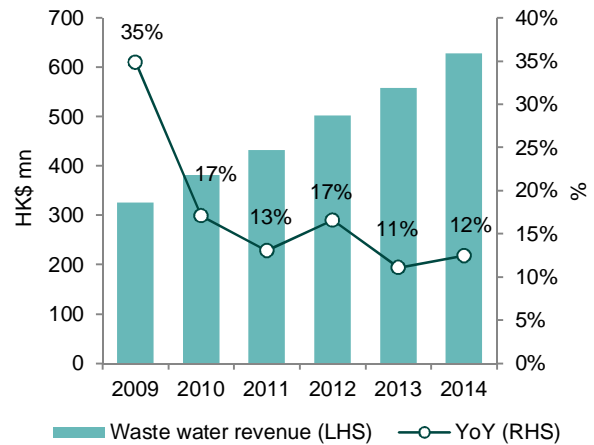

Source(s): the Company

Exhibit 24: Wastewater business


Source(s): the Company

Exhibit 25: Waste-to-energy business


Source(s): The Company, ABCI Securities

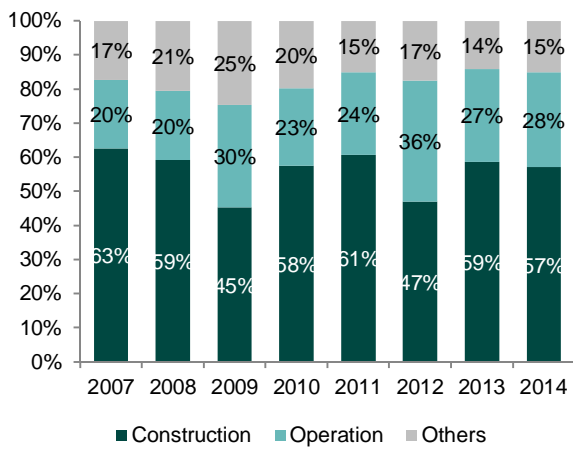
Exhibit 26: Wastewater business


Source(s): The Company, ABCI Securities

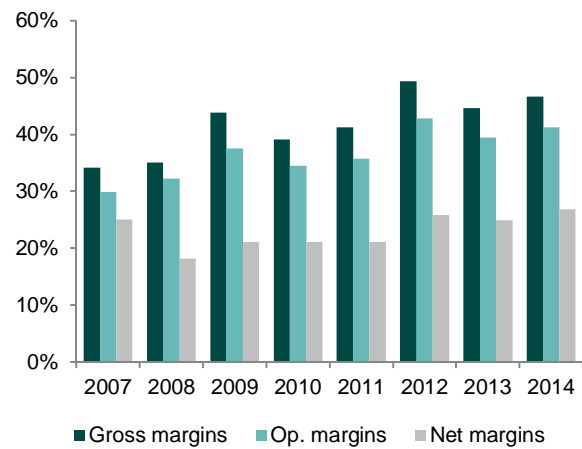
Revenue breakdown

CEI reported a 2014 revenue of HK\$ 6.4bn, up 20% YoY, mainly driven by 26% YoY growth in the waste-to-energy construction segment (accounting for 50% of overall revenue). The waste-to-energy operation segment grew 33% YoY (accounting for 13% of overall revenue). Unlike the construction segment, the waste-to-energy operation segment maintained a stable growth with revenue rising by 31%/40%/33% YoY in 2012/13/14. We believe waste-to-energy operation segment will continue to be CEI's revenue engine.

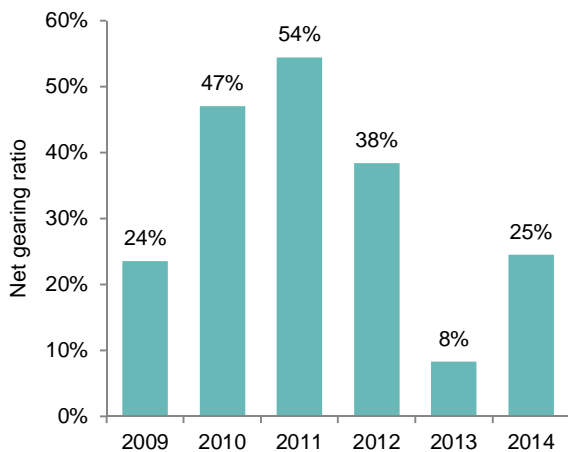
2014 gross margin improved 2 ppt from 45% in 2013 to 47% mainly due to the increased segment revenue of waste-to-energy operation that entailed a higher margin.

Exhibit 27: Historical revenue breakdown


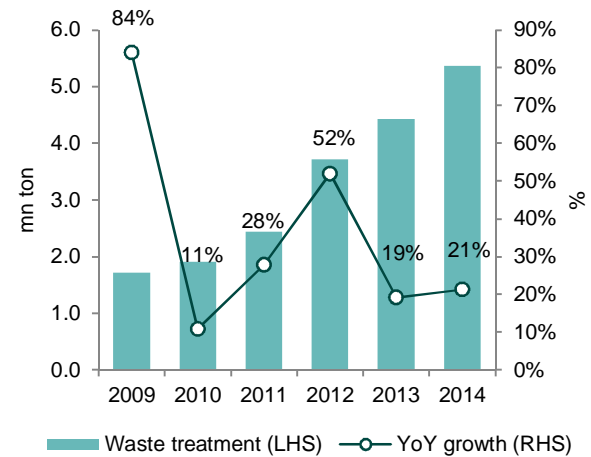
Source(s): The Company, ABCI Securities

Exhibit 28: CEI's historical margins


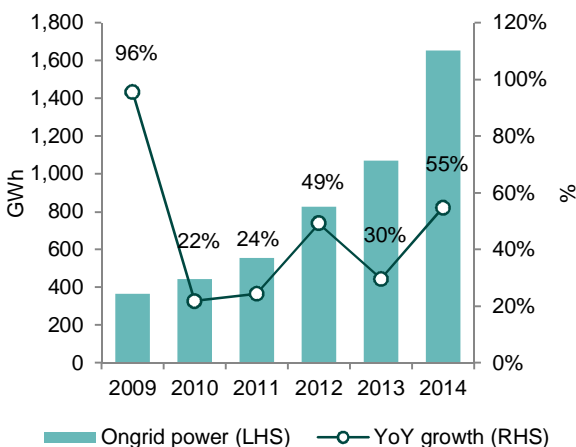
Source(s): The Company, ABCI Securities

Exhibit 29: CEI's net gearing ratio trend


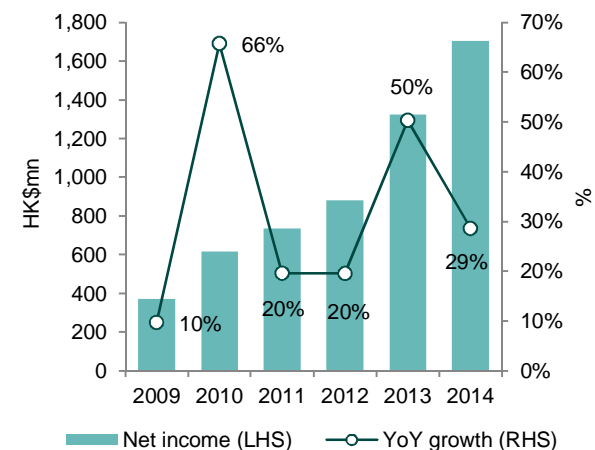
Source(s): The Company, ABCI Securities

Exhibit 30: CEI's residential waste treatment volume (waste-to-energy)


Source(s): The Company, ABCI Securities

Exhibit 31: CEI's on-grid power (waste-to-energy)


Source(s): The Company, ABCI Securities

Exhibit 32: CEI's net income growth


Source(s): The Company, ABCI Securities



Consolidated income statement (2013A-2017E)

| FY Ended Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|---|--------------|--------------|--------------|---------------|---------------|
| Revenue | 5,320 | 6,355 | 8,577 | 11,363 | 14,785 |
| Operation income | 1,454 | 1,765 | 2,738 | 3,652 | 4,759 |
| EPC | 3,118 | 3,627 | 4,751 | 6,200 | 8,042 |
| Other | 749 | 963 | 1,089 | 1,510 | 1,985 |
| COGS | -2,944 | -3,387 | -4,587 | -6,265 | -8,322 |
| Gross profit | 2,375 | 2,969 | 3,990 | 5,098 | 6,463 |
| SG&A | -392 | -540 | -600 | -795 | -1,045 |
| Net financial income (cost) | -288 | -318 | -405 | -501 | -644 |
| Other income and gains | 117 | 188 | 172 | 227 | 296 |
| Pre-tax profit | 1,812 | 2,299 | 3,156 | 4,029 | 5,070 |
| Income tax | -447 | -534 | -789 | -1,007 | -1,267 |
| Net profit | 1,364 | 1,765 | 2,367 | 3,022 | 3,802 |
| Profit attributable to: | | | | | |
| Minority interests | -40 | -62 | -71 | -91 | -114 |
| Equity shareholders of the Company | 1,325 | 1,703 | 2,296 | 2,931 | 3,688 |
| Basic EPS (HK\$) | 0.326 | 0.380 | 0.512 | 0.654 | 0.823 |
| DPS (HK\$) | 0.090 | 0.110 | 0.128 | 0.163 | 0.206 |

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2013A-2017E)

| As of Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|--------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Current assets | 8,244 | 8,487 | 10,939 | 14,796 | 19,588 |
| Cash and equivalent | 4,426 | 4,094 | 6,936 | 10,111 | 13,487 |
| Pledged and restricted bank deposits | 1,389 | 1,056 | 0 | 0 | 0 |
| Trade and bill receivables | 1,377 | 1,974 | 2,350 | 2,957 | 3,848 |
| Other receivables and prepayments | 941 | 1,211 | 1,527 | 1,557 | 2,025 |
| Inventories | 76 | 117 | 126 | 172 | 228 |
| Other current assets | 36 | 35 | 0 | 0 | 0 |
| Non-current assets | 15,227 | 22,713 | 25,012 | 28,497 | 32,816 |
| Property, plant and equipment | 1,374 | 1,511 | 1,779 | 2,136 | 2,607 |
| Lease prepayment | 36 | 36 | 0 | 0 | 0 |
| Intangible assets | 1,117 | 3,406 | 4,502 | 6,980 | 10,158 |
| Investment in JV and associates | 254 | 282 | 0 | 0 | 0 |
| Other receivables and deposits | 3,024 | 4,377 | 4,700 | 6,226 | 8,101 |
| Other non-current assets | 9,422 | 13,102 | 14,032 | 13,155 | 11,950 |
| Total assets | 23,471 | 31,200 | 35,951 | 43,293 | 52,404 |
| Current liabilities | 3,572 | 4,981 | 5,993 | 8,018 | 10,557 |
| Trade and bill payables | 1,734 | 2,302 | 3,142 | 4,291 | 5,700 |
| Other payables | 58 | 68 | 0 | 0 | 0 |
| Short term borrowings | 1,780 | 2,611 | 2,851 | 3,727 | 4,857 |
| Other current liabilities | 0 | 0 | 0 | 0 | 0 |
| Non-current liabilities | 6,120 | 8,375 | 10,386 | 13,014 | 16,405 |
| Deferred tax liabilities | 979 | 1,834 | 1,834 | 1,834 | 1,834 |
| Long-term borrowings | 5,141 | 6,525 | 8,552 | 11,180 | 14,571 |
| Other non-current liabilities | 0 | 16 | 0 | 0 | 0 |
| Total liabilities | 9,692 | 13,357 | 16,379 | 21,032 | 26,962 |
| Minority interests | -405 | -1,580 | -1,651 | -1,741 | -1,855 |
| Shareholders' equities | 13,374 | 16,263 | 17,922 | 20,520 | 23,586 |

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2013A-2017E)

| FY ended Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|---|--------------|--------------|---------------|---------------|---------------|
| Profit before tax | 1,812 | 2,299 | 3,156 | 4,029 | 5,070 |
| Change in depreciation and amortization | 91 | 115 | 240 | 342 | 475 |
| Change in working capital | -2,424 | -2,676 | 1,146 | 466 | -7 |
| Net financial cost (income) | 288 | 318 | -52 | -69 | -101 |
| Income tax paid | -156 | -173 | -534 | -789 | -1,007 |
| Net interest received | 27 | 62 | 52 | 69 | 101 |
| Others | -2 | -68 | -43 | -57 | -74 |
| CF Operating | -364 | -123 | 3,965 | 3,992 | 4,457 |
| Capex | -56 | -216 | -366 | -477 | -619 |
| Increase in intangible assets | -246 | -870 | -2,073 | -2,701 | -3,505 |
| Others | -648 | 647 | 0 | 0 | 0 |
| CF Investing | -950 | -439 | -2,439 | -3,177 | -4,124 |
| Net Capital raise | 3,628 | 0 | 0 | 0 | 0 |
| Net debt financing | 807 | 1,187 | 2,266 | 3,504 | 4,522 |
| Dividend payout | -263 | -448 | -493 | -574 | -733 |
| Interest paid | -316 | -381 | -457 | -570 | -745 |
| Others | 38 | -75 | 0 | 0 | 0 |
| CF Financing | 3,894 | 283 | 1,316 | 2,360 | 3,043 |
| Net change in cash | 2,579 | -279 | 2,842 | 3,175 | 3,376 |
| Cash at the beginning | 1,807 | 4,426 | 4,094 | 6,936 | 10,111 |
| Adjustment (Time deposit & FX effect) | 40 | -53 | 0 | 0 | 0 |
| Cash at the end | 4,426 | 4,094 | 6,936 | 10,111 | 13,487 |

Source(s): Company, ABCI Securities estimates

Key Ratio (2013A-2017E)

| FY ended Dec 31 (HK\$ mn) | 2013A | 2014A | 2015E | 2016E | 2017E |
|---|--------------|--------------|--------------|--------------|--------------|
| Sales mixed (%) | | | | | |
| Operation income | 27.33 | 27.77 | 31.92 | 32.14 | 32.18 |
| EPC | 58.60 | 57.08 | 55.39 | 54.57 | 54.39 |
| Other | 14.07 | 15.15 | 12.69 | 13.29 | 13.43 |
| Total | 100 | 100 | 100 | 100 | 100 |
| Profit & loss ratios (%) | | | | | |
| Gross margin | 44.65 | 46.71 | 46.52 | 44.87 | 43.71 |
| Operating profit margin | 39.47 | 41.20 | 41.02 | 39.37 | 38.15 |
| Pre-tax margin | 34.05 | 36.18 | 36.79 | 35.46 | 34.29 |
| Net profit margin | 25.64 | 27.77 | 27.59 | 26.59 | 25.72 |
| Selling & administrative expenses/revenue | 7.37 | 8.49 | 7.00 | 7.00 | 7.07 |
| Effective tax rate | 24.70 | 23.23 | 25.00 | 25.00 | 25.00 |
| Growth (%) | | | | | |
| Revenue | 56.01 | 19.46 | 34.97 | 32.47 | 30.12 |
| Gross profit | 41.08 | 24.97 | 34.41 | 27.76 | 26.78 |
| Operating profit | 43.94 | 24.67 | 34.39 | 27.13 | 26.09 |
| Net profit | 50.91 | 29.38 | 34.10 | 27.67 | 25.83 |
| Balance sheet ratios | | | | | |
| Current ratio (x) | 2.31 | 1.70 | 1.83 | 1.85 | 1.86 |
| Quick ratio (x) | 2.01 | 1.43 | 1.55 | 1.63 | 1.64 |
| Cash ratio (x) | 1.63 | 1.03 | 1.16 | 1.26 | 1.28 |
| Trade and bill receivables days | 94.46 | 113.35 | 100.00 | 95.00 | 95.00 |
| Trade and bill payables turnover days | 214.92 | 248.15 | 250.00 | 250.00 | 250.00 |
| Inventory turnover days | 9.36 | 12.66 | 10.00 | 10.00 | 10.00 |
| Total debt / equity ratio (%) | 51.75 | 56.18 | 63.62 | 72.64 | 82.37 |
| Net debt / equity ratio (%) | 8.27 | 24.51 | 24.92 | 23.37 | 25.19 |
| Returns (%) | | | | | |
| ROAA | 6.6 | 6.2 | 6.8 | 7.4 | 7.7 |
| ROAE | 12.2 | 11.5 | 13.4 | 15.2 | 16.7 |
| Payout ratio | 27.63 | 28.96 | 25.00 | 25.00 | 25.00 |

Source(s): Company, ABCI Securities estimates

Disclosures

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Definition of equity rating

| Rating | Definition |
|--------|---|
| Buy | Stock return \geq Market return rate |
| Hold | Market return \pm 6% \leq Stock return $<$ Market return rate |
| Sell | Stock return $<$ Market return \pm 6% |

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2010-2014

Time horizon of share price target: 12-month

Definition of share price risk

| Rating | Definition |
|-----------|--|
| Very high | $2.6 \leq$ 180 day volatility/180 day benchmark index volatility |
| High | $1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6 |
| Medium | $1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5 |
| Low | 180 day volatility/180 day benchmark index volatility $<$ 1.0 |

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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