



China Everbright Int'l (257 HK)

Two engines to boost earnings; reiterate BUY

- China Everbright Int'l (CEI) announced 1H17 results on Aug 15, 2017. Net profit surged 49% YoY to HK\$ 1.8bn, beating both Bloomberg consensus and our estimates
- We expect EPC business to maintain strong growth of 40%/26%YoY for 2017E/18E.
- 45%/25%YoY expansion in waste-to-energy (WTE) capacity in 2017E/18E; net profit to increase 28%/16%YoY for the same period
- Maintain **BUY** with TP of HK\$ 13.90, which implies 18x/15x 2017E/18E P/E and 3.1x/2.8x 2017E/18E P/B

1H17 earnings beat expectations. 1H17 net profit was HK\$ 1,796mn (+49%YoY), equivalent to 52%/54% of Bloomberg and our full-year estimates. The results are better than expected. We believe EPC and WTE operation businesses would be the two major growth engines going forward.

EPC business revenue would increase by 40%/26% YoY in 2017E/18E. Benefiting from the government-led environmental effort, rising urbanization in China, and the adoption of the public-private partnership (PPP) for public facilities, CEI's EPC business would enjoy solid growth as demand for WTE and wastewater facilities would stay strong. Revenue of EPC business jumped 84% YoY in 1H17, and we believe such momentum would persist in the next few years. We expect CEI's EPC revenue to increase by 40%YoY and 26%YoY in 2017E and 2018E.

Robust growth of 45%/25% YoY in WTE capacity for 2017E/18E. CEI currently has a capacity of 30,050t/day under construction or preparation stage, which is similar to its 1H17 operating capacity of 30,100t/day. Management guided that total capex for 2017 (WTE and wastewater) would be ~RMB 10bn (2016: RMB 7.0bn). Such aggressive capex plan, together with the capacity expansion underway, implies significant growth in its WTE capacity (1H17: +53% YoY). WTE capacity growth is likely to be 45%/25% YoY in 2017E/18E.

TP at HK\$ 13.90; maintain BUY. We continue to favor CEI for its rapid expansion in WTE capacity and strong growth in EPC business. The Group will also benefit from China's push for urban incineration and PPP. We expect the Group to deliver a 20% EPS CAGR in 2016-19E. Our TP at HK\$ 13.90 implies 18x/15x 2017E/18E P/E and 3.1x/2.8x 2017E/18E P/B. Maintain **BUY**.

Risks: 1) Customer default risk; 2) Air pollution concern may slow down incinerator construction; 3) Construction risk; 4) Tariff risk; 5) Policy risk; 6) Fundraising activities to finance upcoming M&A ; 7) High net gearing ratio may lead to fundraising concern.

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (HK\$ mn)	8,528	13,971	19,178	24,097	28,766
Chg (% YoY)	34.2	63.8	37.3	25.6	19.4
Net profit (HK\$ mn)	2,085	2,785	3,561	4,131	4,807
Chg (% YoY)	22.4	33.6	27.9	16.0	16.4
EPS (HK\$)	0.47	0.62	0.79	0.92	1.07
Chg (% YoY)	22.4	33.6	27.9	16.0	16.4
BVPS (HK\$)	3.84	3.88	4.43	4.99	5.70
Chg (% YoY)	5.7	1.1	14.3	12.6	14.1
P/E (x)	22.11	16.55	12.94	11.16	9.59
P/B (x)	2.68	2.65	2.32	2.06	1.80
ROE (%)	12.12	16.01	17.91	18.45	18.81
ROA (%)	5.13	5.62	5.50	5.39	5.44
DPS (HK\$)	0.19	0.20	0.24	0.28	0.32
Yield (%)	1.80	1.99	2.32	2.69	3.13
Net gearing (%)	53.2	83.8	108.6	126.9	130.5

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Sep 7, 2017

Rating: BUY

TP: HK\$ 13.90

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Share price (HK\$)	10.36
Est. share price return	34.2%
Est. dividend yield	2.3%
Est. total return	36.5%
Previous Rating & TP	BUY
Previous Report Date	May 11, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	11.1/8.2
Issued shares (mn)	4,483
Market cap (HK\$ mn)	46,441
3-mth avg daily turnover(HK\$ mn)	94
Major shareholder(s) (%)	
China Everbright Hld.	41.4%

Source(s): Company, ABCI Securities

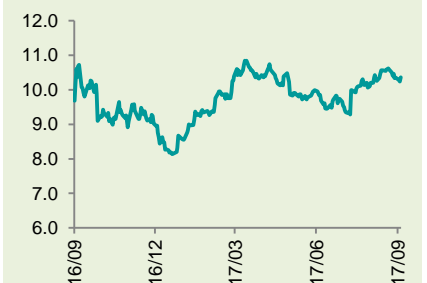
Share Performance

	Absolute	Relative*
1-mth	0.00	(0.95)
3-mth	7.02	1.42
6-mth	(1.52)	(12.31)

*Relative to HSCEI

Source(s): Bloomberg, ABCI Securities

1-Year share price performance(HK\$)



Source(s): Bloomberg, ABCI Securities



1H17 results highlights

1H17 earnings beat expectations

China Everbright Int'l (CEI) announced its 1H17 results on Aug 15. Net profit was HK\$1,796mn (+49%YoY), 20% higher than Bloomberg consensus (4 observations) and equivalent to 52%/54% of Bloomberg /our full-year estimates. Historically, 1H earnings contributed to 45% of CEI's full-year earnings. Based on our revised assumptions, we estimate the Group to deliver an earnings growth higher than 20% YoY for 2017E.

Thanks to the push for PPP, EPC segment would see strong growth

EPC segment revenue jumped 84%YoY, partially attributable to China's push for PPP nationwide (encouraging private capital to invest in public facilities) that spurred demand for urban facility construction. The government would continue to promote PPP in the next few years because: 1) it can lower the financial burden of local governments in urban facility investment; 2) it represents an investment channel for private capital. CEI's EPC segment would enjoy robust growth despite the margins may decline (EPC has a lower EBITDA margin at ~ 20%).

Robust growth in operation segment is a long-term positive.

Revenue from the operation segment (WTE, wastewater and greentech) climbed 44%YoY, driven by 41%/81%YoY growth in WTE and greentech operations (greentech business is managed by China Everbright Greentech [1257 HK, NR] where CEI holds a 69.7% stake). Stable cash flow and higher EBITDA margin (~50%) in the operation segment would be a long-term positive to CEI.

Stable account receivable turnover day and improving net gearing

Account receivable turnover day was 86 days in 1H17, similar to 87 days in 2016. Due to increasing cash flow from the operation segment, net gearing ratio declined mildly from 84% by end-2016 to 77% in 1H17. An improving net gearing ratio would facilitate capacity expansion.

Key assets located in wealthier regions means a stronger cash flow

By end-June 2017, 54% of total CEI's WTE capacity was located in tier-1/2 cities. Residents in these regions usually have a higher disposable income, which usually implies a lower default risk and a more stable cash flow for incineration operators.



Results summary		1H16	1H17	YoY
Income Statement				
Revenue	HK\$m	5,421	9,142	69%
Operation income	HK\$m	3,334	6,131	84%
EPC	HK\$m	1,272	1,834	44%
Others	HK\$m	815	1,177	44%
Op. profit	HK\$m	2,045	3,005	47%
Net profit	HK\$m	1,209	1,796	49%
Basic EPS	HK\$	0.27	0.40	49%
Ratios				
Op. margin	%	37.7%	32.9%	-5ppt
Net margin	%	22.3%	19.6%	-3ppt
Net gearing/(Net cash)	%	67%	77%	10ppt
Waste-to-energy (WTE)				
Installed capacity	t/day	19,700	30,100	53%
On-grid power	GWh	1,175	1,521	29%
Waste treated	mt	4.20	5.22	24%
Wastewater				
Installed capacity	mn m ³ /day	3.72	3.96	6%
Wastewater treated	mn m ³	538	568	5%

Source(s): Company data



2018 outlook

EPC business revenue would increase by 40%/26%YoY in 2017E/18E.

Benefiting from government-led environmental effort, rising urbanization in China, as well as the adoption of the public-private Partnership (PPP) for public facilities, CEI's EPC business would enjoy solid growth as demand for WTE and wastewater facilities would stay strong. Revenue of EPC business jumped 84%YoY in 1H17, and we believe such momentum would persist in the next few year. We expect CEI's EPC revenue to increase by 40%YoY and 26%YoY in 2017E and 2018E.

Robust growth of 45%/25% YoY in WTE capacity in 2017E/18E

CEI currently has a capacity of 30,050t/day under the construction or preparation stage, which is similar to its 1H17 operating capacity of 30,100t/day. Management guided that total capex for 2017 (WTE and wastewater) would be ~RMB 10bn (2016: RMB 7.0bn). Such aggressive capex plan, together with the capacity expansion underway, implies significant growth in its WTE capacity (1H17: +53% YoY). Capacity growth in the segment would be 45%/25% YoY in 2017E/18E.

Wastewater capacity growth may slow down to 4%/5%YoY in 2017E/18E.

For the wastewater operation segment, CEI had a capacity of 0.55mn m³/day under the construction or preparation stage as of 1H17, which is equivalent to 14% of CEI's 1H17 capacity of 3.96 mn m³/day. Without any new acquisition, wastewater capacity would edge up 4%/5% YoY growth in 2017E/18E.

Margin decline to continue due to increasing proportion of lower-margin EPC business

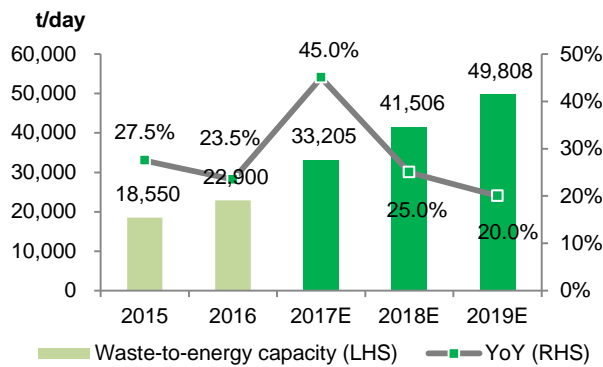
We expect overall EBITDA margin to trend down on the rising proportion of EPC business. Given the EBITDA margin of EPC business (including WTE, wastewater and greentech) is lower than that of the operation business (~20% vs. operation's ~60%), increasing contribution of EPC business to overall revenue (from 45% in 2009 to 67% in 1H17) would lower overall EBITDA margin, which may trend down to 33%-35% in the next couple of years (2009-2016 average: 40%).

Net profit growth of 28%/16% YoY in 2017E/18E, driven by revenue growth in EPC and WTE operation

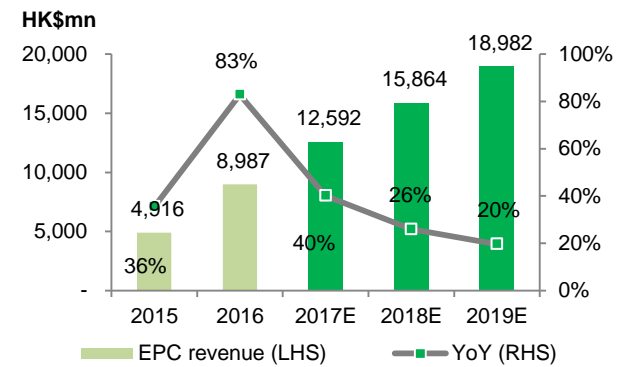
We estimate 2017E/18E net profit to increase by 28%/16%YoY, driven by the 40%/26% YoY revenue growth in EPC business and 40%/26%YoY revenue growth in the WTE business. 50% of our new full-year net profit estimate has already been achieved in 1H17, and we expect the full-year earnings growth to be 28%YoY.

Net gearing ratio may stay high at 109%/127% in 2017E/18E

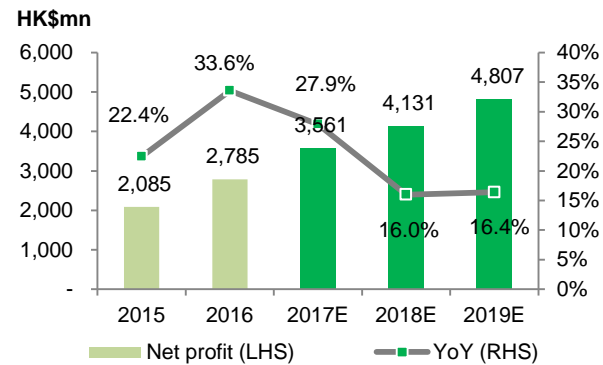
As a result of capacity growth in both WTE and wastewater operations, net gearing ratio would continue to rise. Net gearing ratio was 77% in 1H17, down 7ppt from end-2016. Such improvement can be attributed to the spinoff of the renewable energy business that was listed on HKEx on Apr 24, 2017 (China Everbright Greentech, 1257 HK). As WTE operation capacity would expand by 45%/25%YoY in 2017E/18E, we expect net gearing ratio to reach 109% and 127% for the same period. .

Exhibit 1: CEI's WTE capacity growth would remain robust in coming years


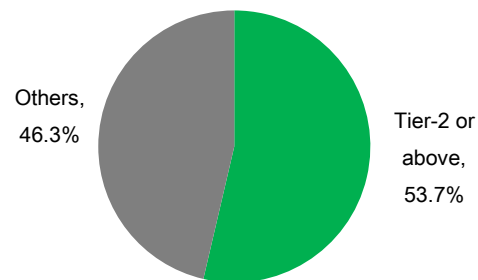
Source(s): Company, ABCI Securities estimates

Exhibit 2: CEI's EPC revenue growth should stay strong in 2017E and 2018E


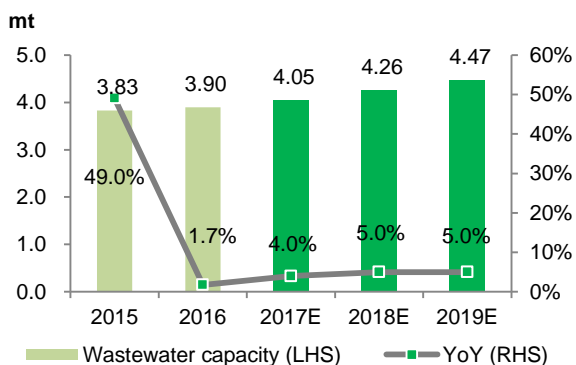
Source(s): Company, ABCI Securities estimates

Exhibit 3: CEI's net profit would rise sharply in 2017E and 2018E


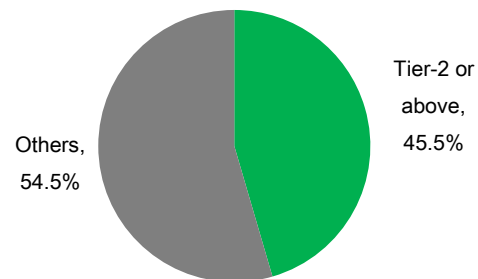
Source(s): Company, ABCI Securities estimates

Exhibit 4: CEI's WTE capacity are mostly located in wealthier regions (1H17)


Source(s): Company

Exhibit 5: CEI's wastewater capacity would see modest growth in the next few years


Source(s): Company, ABCI Securities estimates

Exhibit 6: Location of CEI's wastewater capacity (1H17)


Source(s): Company



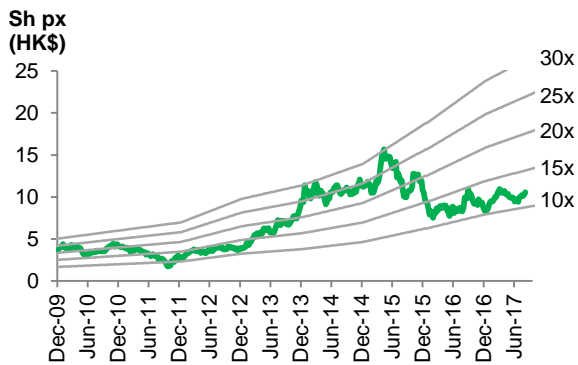
Valuation

TP at HK\$13.90; maintain BUY

Overall, CEI's 1H17 results are better than expected. Revenue of EPC business and capacity in WTE operation have been rising faster than we expected, and we believe such trends are likely to continue based on the government's objectives and the Group's capacity plan. Revising up our capacity and operation assumptions for the EPC business and WTE segment, we estimate 2017E/18E net profit to grow by 28%/16% YoY.

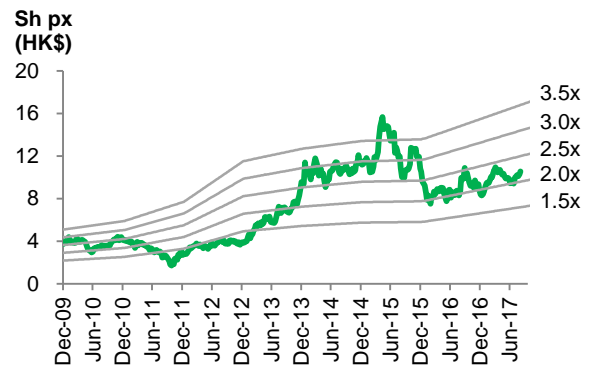
We roll over valuation basis from 2017 to 2018 and our DCF-derived TP at HK\$13.90 (HK\$13.40 previously) is equivalent to 18x/15x 2017E/18E P/E and 3.1x/2.8x 2017E/18E P/B. We expect 2016-19F EPS CAGR to be 20% and our TP implies a PEG of 0.9. CEI will benefit from China's push for incineration of solid waste and PPP in the utility projects. In addition, most of its WTE assets are located in tier-1/2 cities with higher cash flow and lower default risk. Reiterate **BUY**.

Exhibit 7: CEI's fwd P/E chart



Source(s): Company, ABCI Securities estimates

Exhibit 8: CEI's fwd P/B chart



Source(s): Company, ABCI Securities estimates



Consolidated income statement

FY Ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Revenue	8,528	13,971	19,178	24,097	28,766
Operation income	2,185	2,854	3,827	4,590	5,300
EPC	4,916	8,987	12,592	15,864	18,982
Other	1,428	2,130	2,759	3,642	4,484
Cost of sales	-4,626	-8,662	-12,281	-15,716	-18,895
Gross Profit	3,903	5,310	6,897	8,381	9,871
SG&A expenses	-768	-1,059	-1,304	-1,687	-2,014
Net financial income (cost)	-400	-593	-794	-1,181	-1,460
Other income/ (expenses)	384	442	537	675	805
Profit before tax	3,119	4,099	5,335	6,188	7,202
Tax	-783	-1,062	-1,334	-1,547	-1,801
Net profit	2,336	3,037	4,002	4,641	5,402
Profit attributable to:					
Minority interest	251	252	440	511	594
Equity shareholders of the Company	2,085	2,785	3,561	4,131	4,807
Basic EPS (RMB)	0.465	0.621	0.794	0.921	1.072
DPS (RMB)	0.185	0.205	0.238	0.276	0.322

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet

As of Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Current assets	11,488	12,307	17,645	19,684	22,610
Cash	5,953	6,341	10,572	10,786	11,982
Pledged and restricted bank deposits	720	697	0	0	0
Trade and bill receivables	3,060	3,337	4,466	5,612	6,699
Other receivables and prepayments	1,547	1,569	2,102	2,641	3,152
Inventories	202	362	505	646	777
Other current assets	5	2	0	0	0
Non-current assets	29,135	37,225	47,109	57,004	65,715
Property, plant & equipment	2,350	3,029	4,275	5,047	5,823
Investment properties	151	152	152	152	152
Intangible assets	4,419	7,250	12,814	16,634	20,562
Investment in JV and associates	448	573	573	573	573
Deferred tax assets	5,697	6,494	7,881	9,903	11,822
Other non-current assets	16,069	19,726	21,413	24,695	26,783
Total Assets	40,623	49,532	64,754	76,689	88,325
Current Liabilities	6,323	9,314	14,772	18,413	21,688
Trade and bill payables	2,794	4,804	6,729	8,611	10,353
Other payables	119	97	0	0	0
Short term borrowings	3,410	4,412	8,043	9,801	11,335
Other current assets	0	0	0	0	0
Non-current liabilities	14,879	20,373	27,203	32,479	37,081
Deferred tax liabilities	2,425	3,076	3,076	3,076	3,076
Long-term borrowings	12,411	17,203	24,128	29,404	34,005
Other non-current assets	43	94	0	0	0
Total Liabilities	21,203	29,687	41,975	50,892	58,769
Minority interests	2,224	2,456	2,896	3,407	4,001
Shareholders' equities	17,196	17,389	19,883	22,390	25,555

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement

FY ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Profit before tax	3,119	4,099	5,335	6,188	7,202
Change in depreciation and amortization	184	313	610	793	987
Change in Working Capital	-4,839	-4,330	-4,939	-4,729	-3,082
Net financial cost (income)	400	593	-70	-106	-108
Income tax paid	-217	-335	-1,062	-1,334	-1,547
Net interest received	52	46	70	106	108
Others	-236	-166	0	0	0
Operating cash flow	-1,538	221	-56	919	3,560
Capex	-661	-520	-1,497	-1,077	-1,138
Increase in intangible assets	-421	-2,637	-5,987	-4,308	-4,553
Others	-1,594	-1,079	0	0	0
Investing cash flow	-2,676	-4,236	-7,483	-5,385	-5,692
Net Capital raise	660	-8	3,000	0	0
Net debt financing	6,793	6,220	10,555	7,035	6,135
Dividend payout	-565	-906	-919	-1,068	-1,239
Interest paid	-458	-646	-865	-1,287	-1,568
Others	-226	53	0	0	0
Financing cash flow	6,204	4,713	11,771	4,680	3,328
Net change in cash	1,989	698	4,232	214	1,196
Cash at the beginning	4,094	5,953	6,341	10,572	10,786
Adjustment (Time deposit & FX effect)	-130	-311	0	0	0
Cash at the end	5,953	6,341	10,572	10,786	11,982

Source(s): Company, ABCI Securities estimates

Key ratio

FY ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Sales mixed (%)					
Operation income	25.62	20.43	19.96	19.05	18.42
EPC	57.64	64.33	65.66	65.84	65.99
Other	16.74	15.24	14.39	15.12	15.59
Total	100	100	100	100	100
Profit & loss ratios (%)					
Gross margin	45.76	38.00	35.96	34.78	34.31
Operating profit margin	41.33	33.13	31.96	30.58	30.11
Pre-tax margin	36.57	29.34	27.82	25.68	25.04
Net profit margin	27.39	21.73	20.87	19.26	18.78
Selling & administrative expenses/revenue	9.01	7.58	6.80	7.00	7.00
Effective tax rate	25.11	25.91	25.00	25.00	25.00
Growth (%)					
Revenue	34.20	63.82	37.27	25.65	19.37
Gross profit	31.47	36.05	29.90	21.52	17.77
Operating profit	34.62	31.34	32.42	20.22	17.55
Net profit	32.32	30.02	31.78	15.98	16.39
Balance sheet ratios					
Current ratio (x)	1.82	1.32	1.19	1.07	1.04
Quick ratio (x)	1.54	1.11	1.02	0.89	0.86
Cash ratio (x)	1.06	0.76	0.72	0.59	0.55
Trade and bill receivables days	130.98	87.19	85.00	85.00	85.00
Trade and bill payables turnover days	220.50	202.45	200.00	200.00	200.00
Inventory turnover days	15.96	15.24	15.00	15.00	15.00
Total debt / equity ratio (%)	92.00	124.30	161.80	175.10	177.42
Net debt / equity ratio (%)	53.19	83.83	108.63	126.93	130.53
Returns (%)					
ROAA	5.8	6.2	6.2	5.8	5.8
ROAE	12.5	16.1	19.1	19.5	20.1
Payout ratio	39.79	33.00	30.00	30.00	30.00

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 - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 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

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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