



Aug 19, 2016
Company Report
Rating: BUY
TP: HK\$ 13.00

H-Share price (HK\$) 9.97
Est. share price return 30.4%
Est. dividend yield 1.7%
Est. total return 32.1%

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Key Data

Market share (HK\$mn)	44,693
3-mth avg. daily turnover (HK\$ mn)	85
52-week high/low (HK\$)	13.00/7.11
Issued shares (mn)	4,484
Major shareholder(s) (%): China Everbright Hld	41.4

Source(s): Company, Bloomberg, ABCI Securities

1H16 Revenue breakdown (%)

EPC	61.5
Operation	23.5
Others	15.0

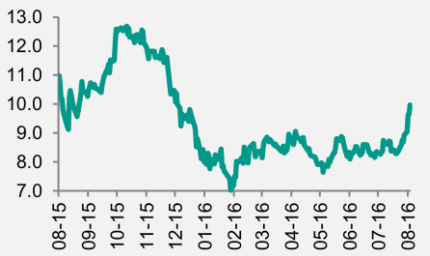
Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	19.26%	13.03%
3-mth	27.31%	11.34%
6-mth	24.19%	5.29%

*Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

China Everbright Int'l (257 HK)
Solid earnings growth ahead; maintain BUY

- In line with expectations, 1H16 net income surged 21% YoY to HK\$1.2bn, equivalent to 47%/46% of Bloomberg's and our full-year estimates
- Waste-to-energy capacity was up 32% YoY to 19,700t/day; on-grid power generation rose 33% YoY to 1,175GWh
- Wastewater capacity was up 42% YoY to 3.72mn m³/day; treatment volume surged 32% YoY to 538mn m³
- For 2017E, capacities for waste-to-energy and wastewater businesses are likely to increase 25%/5%YoY, which should support net income to grow by 22% YoY. Maintain BUY

1H16 net income in line with expectations. China Everbright Int'l (CEI) announced its 1H16 results on Aug 15. Net income was HK\$ 1,209 mn (+21% YoY), equivalent to 47%/46% of Bloomberg and our full-year estimates. Historically, 1H net income contributed to 45% of CEI's full-year total. Hence, the results are broadly in line with our estimates.

Strong growth in construction segment boosted net income but suppressed margins. The construction segment recorded a 62%YoY growth on 106%YoY growth in wastewater construction. However, gross margins of this segment were thin at ~15-20%, hence dragging down overall GPM from 44% in 2H15 to 42% in 1H16.

Robust growth of 25%/25% YoY in waste-to-energy capacity in 2016E/17E. For the waste-to-energy operation, 26,600t/day of capacity is under construction or preparation, exceeding its existing operating capacity at 19,700t/day. This suggests a promising capacity growth in the future. In addition, management guided that overall capex for 2016 should not be less than RMB 5bn (2015: RMB 5bn). Capex is likely to remain high going forward given the current unit investment cost for waste-to-energy is as high as ~RMB 0.5mn/t/day. We estimate CEI's waste-to-energy capacity would expand by 25%/25% YoY in 2016E/17E.

Wastewater capacity growth may slow to 4%/5% YoY in 2016E/17E. Thanks to the M&A with Dongda Group (acquired in Aug2015), CEI's wastewater capacity expanded by 43% YoY to 3.72mn m³/day in 1H16. CEI's wastewater capacity under construction or preparation is 1.03mn m³/day. Without accounting for any M&A projects in upcoming years, we estimate CEI's wastewater capacity should grow by modest 4%/5%YoY growth in 2016E/17E.

TP at HK\$13.00; maintain BUY. We cut our 2016E/17E earnings projections by 7%/7% due to a lower margin assumption. Nonetheless, we estimate CEI's earnings growth in 2016E/17E would increase by 20%/22% YoY on the back of robust waste-to-energy capacity growth (+25%/25% YoY in 2016E/17E). We roll over our valuation basis from 2016 to 2017 and our DCF-derived TP arrives at HK\$13.00 (HK\$12.20 previously), equivalent to 23x/19x 2016/17E P/E and 3.0x/2.6x 2016 P/B. We expect EPS to grow by 20% CAGR during 2015-18E. Maintain BUY.

Risk factors: (1).Customer default risk; (2).Air pollution concern may slow incinerator construction; (3).Construction risk; (4).Tariff risk; (5).Policy risk; (6).Fundraising activities to finance upcoming M&A; (7).Exchange rate risk.

Results and Valuation

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (HK\$ mn)	6,355	8,535	11,389	14,469	17,550
Chg (% YoY)	19.5	34.3	33.4	27.0	21.3
Net Income (HK\$ mn)	1,703	2,085	2,501	3,053	3,613
Chg (% YoY)	28.6	22.4	19.9	22.1	18.3
EPS (HK\$)	0.38	0.47	0.56	0.68	0.81
Chg (% YoY)	16.5	22.4	19.9	22.1	18.3
BVPS (HK\$)	3.63	3.84	4.40	4.95	5.11
Chg (% YoY)	10.2	5.7	14.8	12.3	3.3
P/E (x)	26.24	21.44	17.88	14.64	12.37
P/B (x)	2.75	2.60	2.26	2.02	1.95
ROE (%)	10.47	12.12	12.66	13.76	15.77
ROA (%)	5.46	5.13	5.22	5.31	5.69
DPS (HK\$)	0.11	0.19	0.17	0.20	0.24
Dividend yield (%)	1.10	1.86	1.68	2.05	2.42
Net gearing* (%)	24.5	53.2	64.2	72.7	83.0

Source(s): Company data, ABCI Securities estimates

* Total debt minus total cash on hand divided by Shareholders equity



1H16 results highlight

1H16 net income in line with expectations. China Everbright Int'l (CEI) announced its 1H16 results on Aug 15. Net income was HK\$ 1,209 mn (+21% YoY), equivalent to 47%/46% of Bloomberg's and our full-year estimates. Given that 1H net income usually contributes to 45% of CEI's full-year total, the 1H16 results are broadly in line with our expectations.

Strong growth in construction segment boosts net income but suppress margins. Construction segment (covering waste-to-energy, wastewater, and GreenTech) recorded a 62% YoY growth driven by 106% YoY growth in wastewater construction. However, segmental gross margins were thin at ~15-20%, dragging down the overall GPM from 44% in 2H15 to 42% in 1H16.

Solid growth in operation segment: A long-term positive. The operation segment (waste-to-energy, wastewater, and GreenTech) recorded a 16%YoY growth in revenue, mainly driven by 21%/43%YoY growth in waste-to-energy/alternative energy operations. Providing a stable cash flow and higher GPM (~50%) for the Group, the operation segment will continue to be a long-term positive.

Increasing account receivable turnover days and net gearing ratio are key concerns. Account receivable turnover days (A/R T/O) remained high at 124 days in 1H16 although it is slightly shorter than the 131 days in 2015. Driven by rapid expansion in capex, CEI's net gearing ratio increased from 53% in 2015 to 67% in 1H16, the highest level since 2009. We believe CEI may engage in equity fundraising with the rising net gearing.

Results summary		1H15	1H16	YoY
Income Statement				
Revenue	HK\$m	3,769	5,421	44%
EPC	HK\$m	2,063	3,334	62%
Operation	HK\$m	1,093	1,272	16%
Others	HK\$m	614	815	33%
Op. profit	HK\$m	1,694	2,045	21%
Net income	HK\$m	1,000	1,209	21%
Basic EPS	HK\$	0.22	0.27	21%
Ratios				
Op. margin	%	44.9%	37.7%	-7ppt
Net margin	%	26.5%	22.3%	-4ppt
Net gearing/(Net cash)	%	31%	67%	36ppt
Waste-to-energy				
Capacity	t/day	14,950	19,700	32%
On-grid power	GWh	882	1,175	33%
Waste treated	mt	3.26	4.20	29%
Wastewater				
Capacity	mn m ³ /day	2.62	3.72	42%
Wastewater treated	mn m ³	406	538	32%

Source(s): Company data

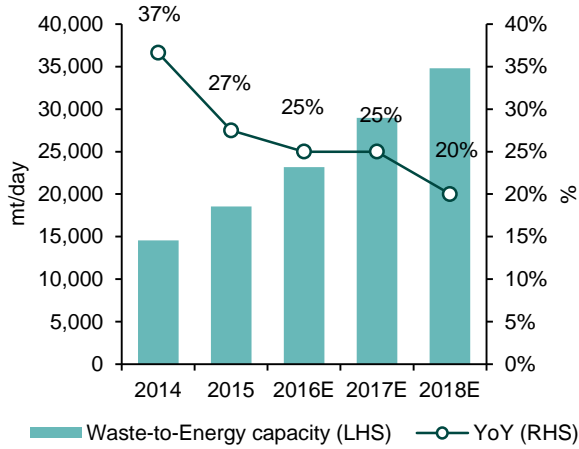
2017 outlook

Robust growth of 25%/25% YoY in waste-to-energy capacity in 2016E/17E. For the waste-to-energy operation, 26,600t/day of capacity is under construction or preparation, exceeding its existing operating capacity at 19,700t/day, suggesting a promising capacity growth in the future. In addition, management guided that overall capex for 2016 should not be less than RMB 5bn (2015: RMB 5bn). Capex is likely to remain high going forward given the current unit investment cost for waste-to-energy is as high as ~RMB0.5mn/t/day. We believe CEI's waste-to-energy capacity is likely to expand by 25%/25% YoY in 2016E/17E

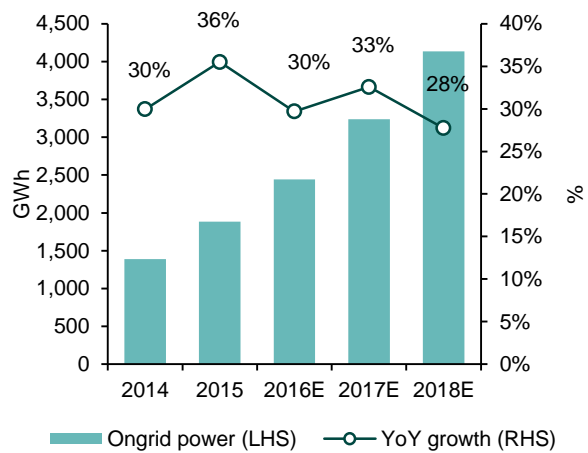
Wastewater capacity growth may slow to 4%/5% YoY in 2016E/2017E. Thanks to the M&A with Dongda Group (acquired in Aug2015), CEI's wastewater capacity expanded by 43%YoY to 3.72mn m³/day in 1H16. CEI's wastewater capacity under construction or preparation is 1.03mn m³/day. Assuming no M&A projects in the next few years, we project CEI's wastewater capacity to expand by 4%/5% YoY in 2016E/17E.

GreenTech segment serves as another income driver. The GreenTech segment includes renewable energy (biomass, wind and solar), hazardous waste treatment, and sludge treatment. In 1H16, operation revenue in the segment was up 43% YoY whereas EPC revenue recorded a 19 times jump. We believe the GreenTech segment will serve as another growth engine in the future. Possible spin-off has been mentioned by the management although details are yet to be confirmed.

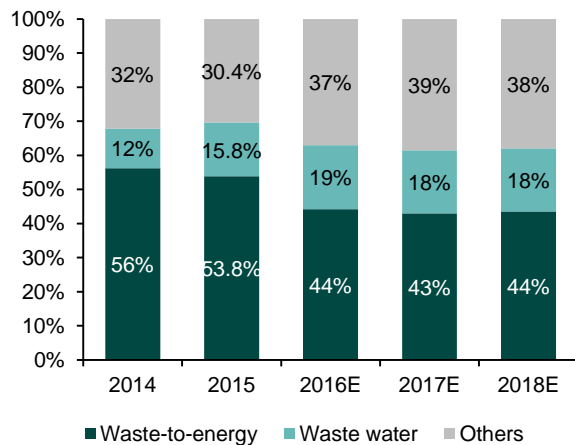
Margins will continue to narrow. CEI continues to boost its EPC business to support revenue growth. EPC revenue (include waste-to-energy, wastewater and GreenTech) jumped 62% YoY in 1H16 while operation revenue only rose by 16% YoY. Given the thinner margins in the EPC segment, CEI's future margins would continue to fall.

Exhibit 1: CEI's future waste-to-energy capacity growth will remain robust


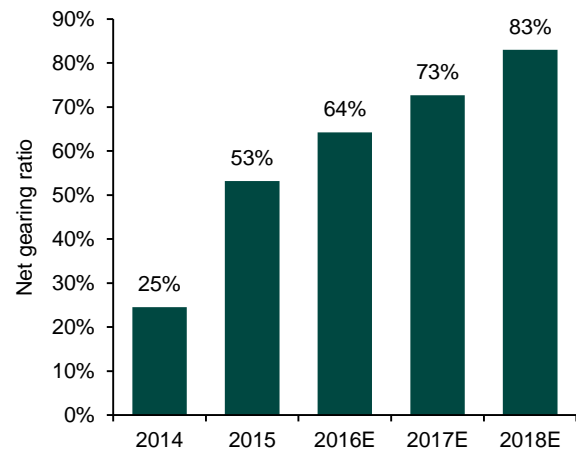
Source(s): Company data, ABCI Securities estimates

Exhibit 2: CEI's on-grid power generation will grow strongly


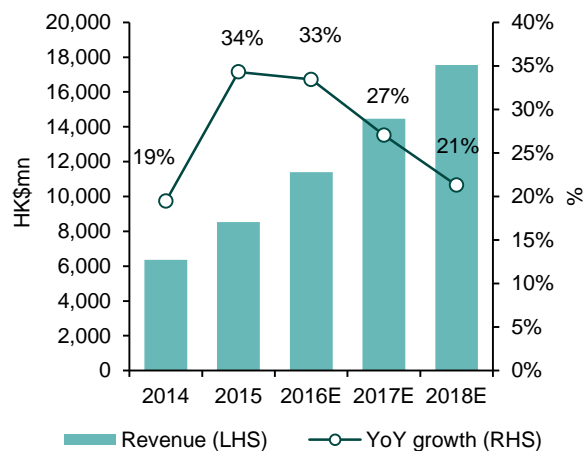
Source(s): Company data, ABCI Securities estimates

Exhibit 3: CEI's revenue distribution


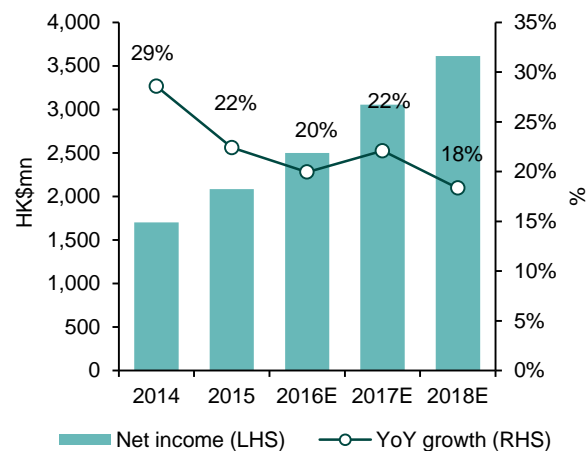
Source(s): Company data, ABCI Securities estimates

Exhibit 4: CEI's net gearing ratio is trending up


Source(s): Company data, ABCI Securities estimates

Exhibit 5: CEI's revenue outlook


Source(s): Company data, ABCI Securities estimates

Exhibit 6: CEI's net income outlook


Source(s): Company data, ABCI Securities estimates

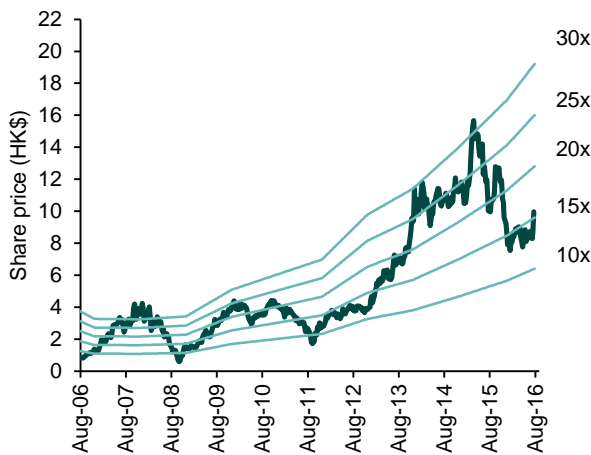
Valuation

TP at HK\$13.00; maintain BUY

CEI's 1H16 results are in line with our estimates although increased contribution from EPC has dragged overall margins. Hence, we revise down our margin assumption and cut our 2016E/17E net income estimates by 7%/7%. Nonetheless, CEI's waste-to-energy capacity should continue to grow strongly.

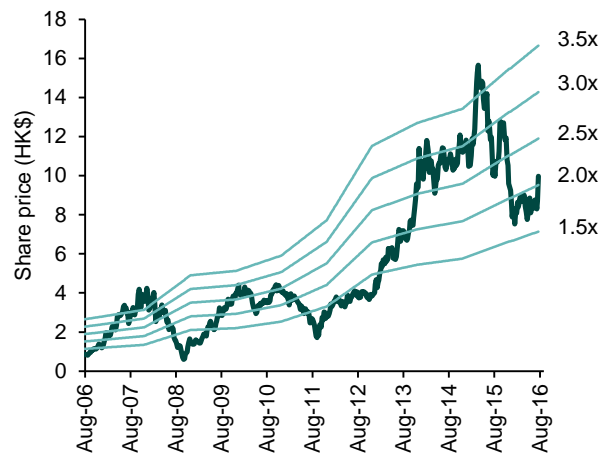
We roll over our valuation basis from 2016 to 2017 and our DCF-derived TP arrives at HK\$13.00 (HK\$12.20 previously), equivalent to 23x/19x 2016E/17E P/E and 3.0x/2.6x 2016/17E P/B. We believe China's rising urbanization and public concern on environmental issues should continue to support demand for urban incineration and wastewater treatment services. CEI is likely to achieve robust 20% EPS CAGR during 2015-18E. Our TP is equivalent to 0.95x 2017E PEG, which we deem as reasonable. Maintain **BUY**.

Exhibit 7: CEI's fwd P/E



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 8: CEI's fwd P/B



Source(s): Bloomberg, ABCI Securities estimates



Consolidated income statement (2014A-2018E)

FY Ended Dec 31 (HK\$ mn)	2014A	2015A	2016E	2017E	2018E
Revenue	6,355	8,535	11,389	14,469	17,550
Operating income	1,765	2,185	2,711	3,480	4,306
EPC	3,627	4,916	7,089	8,825	10,560
Other	963	1,434	1,589	2,163	2,685
COGS	-3,387	-4,626	-6,710	-8,710	-10,631
Gross profit	2,969	3,909	4,679	5,759	6,919
SG&A	-540	-768	-854	-1,085	-1,316
Net financial income (cost)	-318	-400	-645	-813	-1,051
Other income and gains	188	378	444	564	684
Pre-tax profit	2,299	3,119	3,624	4,425	5,236
Income tax	-534	-783	-906	-1,106	-1,309
Net profit	1,765	2,336	2,718	3,318	3,927
Profit attributable to:					
Minority interests	-62	-251	-217	-265	-314
Equity shareholders of the Company	1,703	2,085	2,501	3,053	3,613
Basic EPS (HK\$)	0.380	0.465	0.558	0.681	0.806
DPS (HK\$)	0.110	0.185	0.167	0.204	0.242

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2014A-2018E)

As of Dec 31 (HK\$ mn)	2014A	2015A	2016E	2017E	2018E
Current assets	8,487	11,488	12,824	16,794	19,368
Cash and equivalent	4,094	5,953	6,931	9,301	10,276
Pledged and restricted bank deposits	1,056	720	0	0	0
Trade and bill receivables	1,974	3,060	3,744	4,757	5,770
Other receivables and prepayments	1,211	1,547	1,872	2,378	2,885
Inventories	117	202	276	358	437
Other current assets	35	5	0	0	0
Non-current assets	22,713	29,135	35,074	40,715	44,108
Property, plant and equipment	1,511	2,350	2,922	3,556	4,122
Lease prepayment	36	151	0	0	0
Intangible assets	3,406	4,419	7,147	11,339	15,192
Investment in JV and associates	282	448	0	0	0
Other receivables and deposits	4,377	5,697	6,241	7,928	9,617
Other non-current assets	13,102	16,069	18,764	17,893	15,177
Total assets	31,200	40,623	47,897	57,509	63,476
Current liabilities	4,981	6,323	8,578	11,128	13,148
Trade and bill payables	2,302	2,794	3,676	4,773	5,825
Other payables	68	119	0	0	0
Short term borrowings	2,611	3,410	4,902	6,355	7,323
Other current liabilities	0	0	0	0	0
Non-current liabilities	8,375	14,879	17,130	21,490	24,394
Deferred tax liabilities	1,834	2,425	2,425	2,425	2,425
Long-term borrowings	6,525	12,411	14,705	19,066	21,969
Other non-current liabilities	16	43	0	0	0
Total liabilities	13,357	21,203	25,708	32,618	37,542
Minority interests	1,580	2,224	2,442	2,707	3,021
Shareholders' equities	16,263	17,196	19,747	22,184	22,913

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2014A-2018E)

FY ended Dec 31 (HK\$ mn)	2014A	2015A	2016E	2017E	2018E
Profit before tax	2,299	3,119	3,624	4,425	5,236
Change in depreciation and amortization	115	184	363	532	693
Change in working capital	-2,676	-4,839	362	-505	-546
Net financial cost (income)	318	400	-67	-69	-93
Income tax paid	-173	-217	-783	-906	-1,106
Net interest received	62	52	67	69	93
Others	-68	-236	0	0	0
CF Operating	-123	-1,538	3,566	3,546	4,277
Capex	-216	-661	-709	-804	-767
Increase in intangible assets	-870	-421	-4,016	-4,554	-4,346
Others	647	-1,594	0	0	0
CF Investing	-439	-2,676	-4,725	-5,358	-5,113
Net Capital raise	0	660	0	0	0
Net debt financing	1,187	6,793	3,678	5,814	3,871
Dividend payout	-448	-565	-829	-750	-916
Interest paid	-381	-458	-712	-882	-1,144
Others	-75	-226	0	0	0
CF Financing	283	6,204	2,137	4,181	1,811
Net change in cash	-279	1,989	978	2,369	976
Cash at the beginning	4,426	4,094	5,953	6,931	9,301
Adjustment (Time deposit & FX effect)	-53	-130	0	0	0
Cash at the end	4,094	5,953	6,931	9,301	10,276

Source(s): Company, ABCI Securities estimates

Key Ratio (2014A-2018E)

FY ended Dec 31 (HK\$ mn)	2014A	2015A	2016E	2017E	2018E
Sales mixed (%)					
Operating income	27.77	25.60	23.80	24.06	24.53
EPC	57.08	57.60	62.24	60.99	60.17
Other	15.15	16.80	13.96	14.95	15.30
Total	100	100	100	100	100
Profit & loss ratios (%)					
Gross margin	46.71	45.80	41.09	39.80	39.42
Operating profit margin	41.20	41.30	37.49	36.20	35.82
Pre-tax margin	36.18	36.54	31.82	30.58	29.84
Net profit margin	27.77	27.37	23.87	22.94	22.38
Selling & administrative expenses/revenue	8.49	9.00	7.50	7.50	7.50
Effective tax rate	23.23	25.11	25.00	25.00	25.00
Growth (%)					
Revenue	19.46	34.29	33.45	27.04	21.30
Gross profit	24.97	31.67	19.72	23.06	20.15
Operating profit	24.67	34.62	21.14	22.68	20.04
Net profit	29.38	32.32	16.38	22.08	18.34
Balance sheet ratios					
Current ratio (x)	1.70	1.82	1.49	1.51	1.47
Quick ratio (x)	1.43	1.54	1.24	1.26	1.22
Cash ratio (x)	1.03	1.06	0.81	0.84	0.78
Trade and bill receivables days	113.35	130.89	120.00	120.00	120.00
Trade and bill payables turnover days	248.15	220.50	200.00	200.00	200.00
Inventory turnover days	12.66	15.96	15.00	15.00	15.00
Total debt / equity ratio (%)	56.18	92.00	99.29	114.59	127.84
Net debt / equity ratio (%)	24.51	53.19	64.19	72.67	82.99
Returns (%)					
ROAA	6.2	5.8	5.7	5.8	6.0
ROAE	11.5	12.5	13.5	14.6	16.0
Payout ratio	28.96	39.79	30.00	30.00	30.00

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

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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 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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