



China Everbright Int'l (257 HK) The winner in incineration industry

- Waste-to-energy capacity to expand by 23%/22%YoY in 2017E/2018E
- EPC business revenue would continue to grow strongly by 32%/19%YoY in 2017E/18E
- Net profit growth of 20%/16%YoY in 2017E/18E is the bright spot
- Spin-off of biomass business would reduce net gearing and fund future growth
- Maintain **BUY** with TP of HK\$13.40 implies 18x 2017E P/E and 3.0x 2017E P/B

Company Report

May 22, 2017

Rating: **BUY**

TP: **HK\$ 13.40**

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Waste-to-energy capacity to expand by 23%/22% YoY in 2017E/2018E. CEI has 27,150t/day of capacity under the construction or preparation stage, which is equivalent to its existing operating capacity (2016: 28,167t/day). Management guided that total capex for 2017 (for waste-to-energy and wastewater) will not be less than RMB 7.0bn. Capex is likely to remain high given the current unit investment cost for waste-to-energy at ~RMB 0.5mn/t/day. We believe its waste-to-energy capacity is likely to expand robustly by 23%/22% YoY in 2017E/18E.

Net profit growth of 20%/16%YoY in 2017E/18E as the bright spot. Supported by solid waste-to-energy capacity growth and robust EPC revenue growth, CEI's 2017E net profit would expand strongly by 20%YoY. As CEI would continue to boost its environmental business going forward, we estimate its 2018E net profit would increase by 16%YoY.

Spin-off of biomass business would reduce net gearing. CEI has spun off its biomass and renewable energy business, which was listed on HKEx on May 8, 2017 (China Everbright Greentech, 1257 HK). The spin-off would bring in ~HK\$3bn of new capital to CEI. Based on our estimates, CEI's net gearing ratio would fall from 106% to 91% in 2017E, easing the need of equity fundraising.

Maintain BUY with TP of HK\$13.40. The spin-off of biomass business would provide sufficient capital for CEI's expansion. We adjust our balance sheet assumptions to incorporate impacts of the spin-off. Our DCF-derived TP at HK\$13.40 (HK\$13.30 previously) implies 18x 2017E P/E and 3.0x 2017E P/B. Reiterate **BUY**.

Risks. (1) Slower-than-expected capacity growth; (2) Default risk; (3) Policy risks; (4) Surge in maintenance costs; (5) Public resistance to incinerator construction

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (HK\$ mn)	8,528	13,971	18,301	21,998	26,093
Chg (% YoY)	34.2	63.8	31.0	20.2	18.6
Net profit (HK\$ mn)	2,085	2,785	3,337	3,878	4,453
Chg (% YoY)	22.4	33.6	19.8	16.2	14.8
EPS (HK\$)	0.47	0.62	0.74	0.86	0.99
Chg (% YoY)	22.4	33.6	19.8	16.2	14.8
BVPS (HK\$)	3.84	3.88	4.40	4.92	5.57
Chg (% YoY)	5.7	1.1	13.4	11.8	13.2
P/E (x)	21.18	15.86	13.24	11.39	9.92
P/B (x)	2.57	2.54	2.24	2.00	1.77
ROE (%)	12.12	16.01	16.92	17.58	17.83
ROA (%)	5.13	5.62	5.70	5.53	5.40
DPS (HK\$)	0.19	0.20	0.22	0.26	0.30
Dividend yield (%)	1.88	2.08	2.27	2.63	3.02
Net gearing (%)	53.2	83.8	91.3	106.6	115.5

Source(s): Bloomberg, ABCI Securities estimates

Share price (HK\$)	9.85
Est. share price return	36.0%
Est. dividend yield	2.3%
Est. total return	38.3%
Previous Rating & TP	BUY
Previous Report Date	Apr 24, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	11.1/7.8
Issued shares (mn)	4,483
Market cap (HK\$ mn)	44,020
3-mth avg daily turnover(HK\$ mn)	92
Major shareholder(s) (%)	
China Everbright Hld	41.4%

Source(s): Company, ABCI Securities

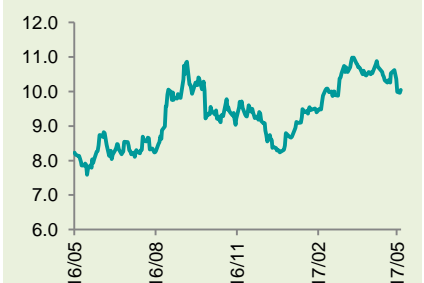
Share price performance (%)

	Absolute	Relative*
1-mth	(6.01)	(8.85)
3-mth	(1.30)	(0.41)
6-mth	2.60	(7.22)

*Relative to HSCEI

Source(s): Bloomberg, ABCI Securities

1-Year sector performance(HK\$)



Source(s): Bloomberg, ABCI Securities



2017 outlook

EPC business revenue would grow strongly by 32%/19%YoY in 2017E/18E

Supported by the government's increased environmental effort and rising urbanization in China, CEI's EPC business will enjoy a solid growth on rising demand for waste-to-energy and wastewater facilities. Revenue from EPC business surged 83%YoY in 2016. We expect the segment to maintain a robust momentum over the next few years, with revenue expanding by 32%YoY and 19%YoY in 2017E and 2018E.

Waste-to-energy capacity to jump 23%/22% YoY in 2017E/2018E

CEI has 27,150t/day of capacity under construction or preparation stage, which is equivalent to its existing operating capacity (2016: 28,167t/day). Management guided that total capex for 2017 (waste-to-energy and wastewater) will not be less than RMB 7.0bn. Capex is likely to remain high given the current unit investment cost for waste-to-energy at ~RMB0.5mn/t/day. We believe its waste-to-energy capacity is likely to expand robustly by 23%/22% YoY in 2017E/18E.

Wastewater capacity growth may slow to 5%/5%YoY in 2017E/2018E.

CEI has 0.89mn m³/day of capacity under construction or preparation, which is equivalent to ~23% of CEI's existing capacity (2016: 3.9 mn m³/day). Assuming no new acquisitions will take place, CEI's wastewater treatment business capacity would edge up by 5% each year in 2017E /18E.

Bright spot: Net profit growth of 20%/16%YoY in 2017E/2018E.

Supported by solid waste-to-energy capacity growth and robust EPC revenue growth, we estimate CEI's 2017 net profit growth would increase by 20%YoY. With CEI expanding its environmental business, we believe its 2018 net profit growth would be solid at 16%YoY.

Key assets located in wealthier regions suggest lower default risk.

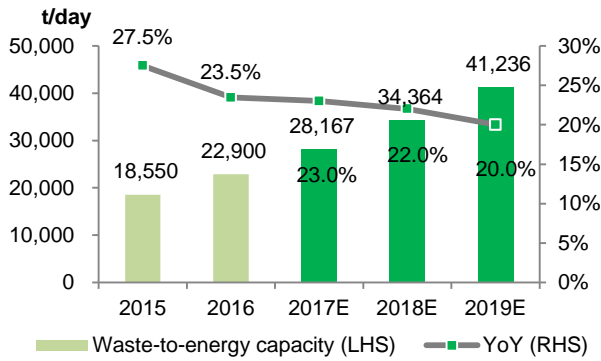
Around 51% of CEI's 2016 waste-to-energy operating capacity is located in tier-1/2 cities. For wastewater capacity, ~46% is located in tier-1/2 or above cities. Since default risk is lower for residents in wealthier cities because of the higher disposable expenditure, CEI's high exposure in wealthier cities would be positive to its cash flow and net profit in the long term.

Spin off of biomass business would reduce net gearing

CEI has spun off its biomass and renewable energy business, which was listed on HKEx on May 8, 2017 (China Everbright Greentech, 1257 HK. CEI sold 28% of shares to public shareholders and now holds a 72% stake). The spin-off would bring in ~HK\$3bn of new capital to CEI. Based on our estimates, CEI's net gearing ratio would fall from 106% to 91% in 2017E, easing the need of equity fundraising.

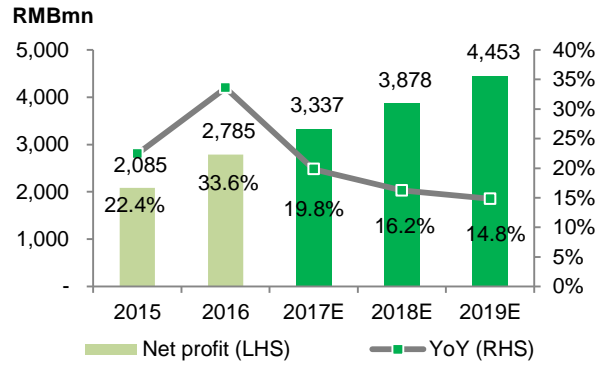


Exhibit 1: CEI's waste-to-energy capacity growth would remain robust in coming years



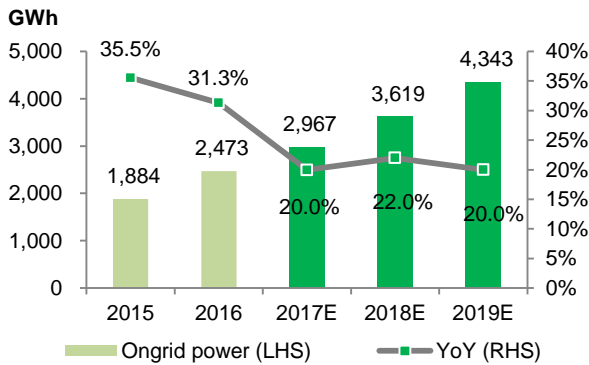
Source(s): Company, ABCI Securities estimates

Exhibit 2: CEI's net profit would undergo mid-teens growth in 2017E/18E



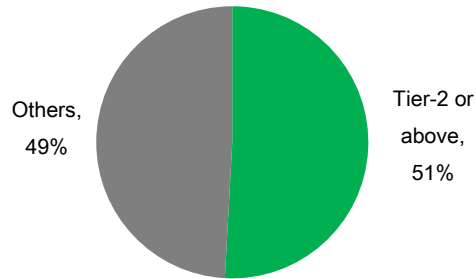
Source(s): Company, ABCI Securities estimates

Exhibit 3: CEI's power output outlook



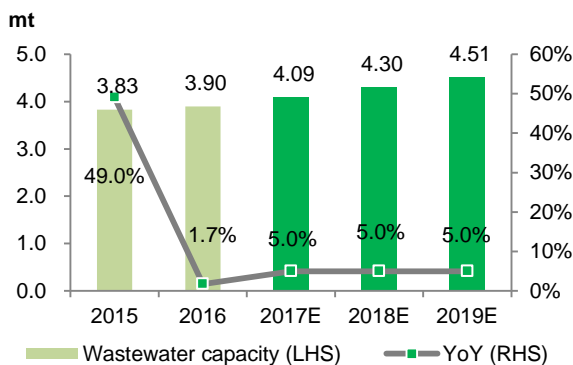
Source(s): Company, ABCI Securities estimates

Exhibit 4: CEI's waste-to-energy capacity located in wealthier regions (2016)



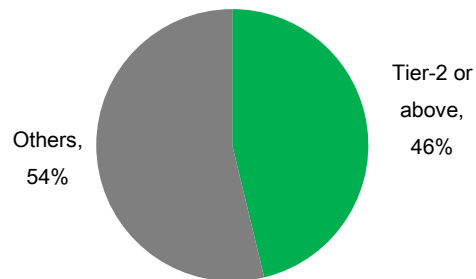
Source(s): Company, ABCI Securities

Exhibit 5: CEI's wastewater capacity would grow moderately over the next few years



Source(s): Company, ABCI Securities estimates

Exhibit 6: CEI's wastewater capacity located in wealthier regions (2016)



Source(s): Company, ABCI Securities



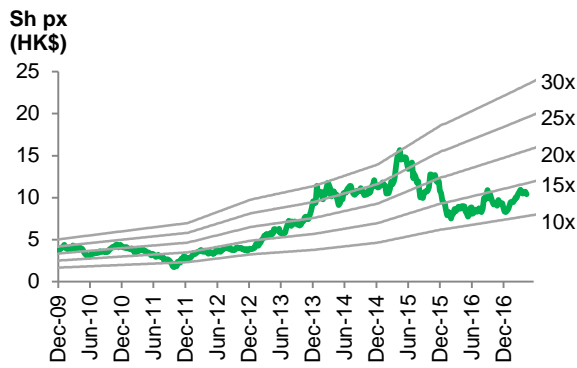
Valuation

TP at HK\$13.40; maintain BUY

In our view, CEI's EPC business would deliver impressive growth. Also, expanding capacity in waste-to-energy and wastewater segments would support bottom line growth. We expect net profit to increase 20%/16%YoY for 2017E/18E

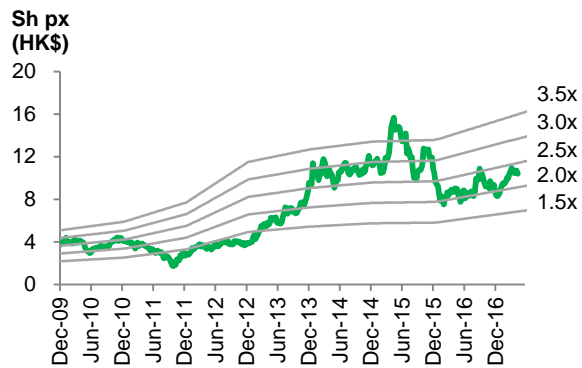
The spin-off of biomass business would provide sufficient capital for CEI to implement its expansion plan. We adjust our balance sheet assumptions to reflect the impacts of the spin-off. Our DCF-derived TP at HK\$13.40 (HK\$13.30 previously) implies 18x 2017E P/E and 3.0x 2017E P/B. Reiterate **BUY**

Exhibit 7: CEI's fwd P/E chart



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 8: CEI's fwd P/B chart



Source(s): Bloomberg, ABCI Securities estimates



Consolidated income statement

FY Ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Revenue	8,528	13,971	18,301	21,998	26,093
Operation income	2,185	2,854	3,387	3,958	4,556
EPC	4,916	8,987	11,891	14,197	16,962
Other	1,428	2,130	3,024	3,842	4,575
Cost of sales	-4,626	-8,662	-11,648	-14,180	-16,945
Gross Profit	3,903	5,310	6,653	7,817	9,148
SG&A expenses	-768	-1,059	-1,373	-1,650	-1,957
Net financial income (cost)	-400	-593	-794	-974	-1,251
Other income/ (expenses)	384	442	512	616	731
Profit before tax	3,119	4,099	4,999	5,810	6,671
Tax	-783	-1,062	-1,250	-1,452	-1,668
Net profit	2,336	3,037	3,749	4,357	5,003
Profit attributable to:					
Minority interest	251	252	412	479	550
Equity shareholders of the Company	2,085	2,785	3,337	3,878	4,453
Basic EPS	0.465	0.621	0.744	0.865	0.993
DPS	0.185	0.205	0.223	0.259	0.298

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	15,446	18,775	22,322
Cash	5,953	6,341	8,450	10,357	12,332
Pledged and restricted bank deposits	720	697	0	0	0
Trade and bill receivables	3,060	3,337	4,262	5,123	6,076
Other receivables and prepayments	1,547	1,569	2,256	2,712	3,217
Inventories	202	362	479	583	696
Other current assets	5	2	0	0	0
Non-current assets	29,135	37,225	43,056	51,333	60,094
Property, plant & equipment	2,350	3,029	3,732	4,575	5,496
Investment properties	151	152	152	152	152
Intangible assets	4,419	7,250	10,595	14,657	19,133
Investment in JV and associates	448	573	573	573	573
Deferred tax assets	5,697	6,494	7,521	9,040	10,723
Other non-current assets	16,069	19,726	20,483	22,336	24,016
Total Assets	40,623	49,532	58,503	70,108	82,416
Current Liabilities	6,323	9,314	12,995	16,235	19,581
Trade and bill payables	2,794	4,804	6,382	7,770	9,285
Other payables	119	97	0	0	0
Short term borrowings	3,410	4,412	6,613	8,465	10,296
Other current assets	0	0	0	0	0
Non-current liabilities	14,879	20,373	22,914	28,470	33,964
Deferred tax liabilities	2,425	3,076	3,076	3,076	3,076
Long-term borrowings	12,411	17,203	19,838	25,394	30,888
Other non-current assets	43	94	0	0	0
Total Liabilities	21,203	29,687	35,909	44,705	53,545
Minority interests	2,224	2,456	2,868	3,348	3,898
Shareholders' equities	17,196	17,389	19,725	22,056	24,973

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	4,999	5,810	6,671
Change in depreciation and amortization	184	313	513	703	918
Change in Working Capital	-4,839	-4,330	-3,769	-3,096	-2,654
Net financial cost (income)	400	593	-70	-84	-104
Income tax paid	-217	-335	-1,062	-1,250	-1,452
Net interest received	52	46	70	84	104
Others	-236	-166	0	0	0
Operating cash flow	-1,538	221	681	2,167	3,483
Capex	-661	-520	-925	-1,122	-1,263
Increase in intangible assets	-421	-2,637	-3,699	-4,486	-5,053
Others	-1,594	-1,079	0	0	0
Investing cash flow	-2,676	-4,236	-4,624	-5,608	-6,316
Net Capital raise	660	-8	3,000	0	0
Net debt financing	6,793	6,220	4,836	7,407	7,325
Dividend payout	-565	-906	-919	-1,001	-1,163
Interest paid	-458	-646	-865	-1,058	-1,354
Others	-226	53	0	0	0
Financing cash flow	6,204	4,713	6,052	5,348	4,808
Net change in cash	1,989	698	2,109	1,908	1,975
Cash at the beginning	4,094	5,953	6,341	8,450	10,357
Adjustment (Time deposit & FX effect)	-130	-311	0	0	0
Cash at the end	5,953	6,341	8,450	10,357	12,332

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	18.51	17.99	17.46
EPC	57.64	64.33	64.97	64.54	65.01
Other	16.74	15.24	16.52	17.46	17.53
Total	100	100	100	100	100
Profit & loss ratios (%)					
Gross margin	45.76	38.00	36.35	35.54	35.06
Operating profit margin	41.33	33.13	31.65	30.84	30.36
Pre-tax margin	36.57	29.34	27.31	26.41	25.57
Net profit margin	27.39	21.73	20.49	19.81	19.18
Selling & administrative expenses/revenue	9.01	7.58	7.50	7.50	7.50
Effective tax rate	25.11	25.91	25.00	25.00	25.00
Growth (%)					
Revenue	34.20	63.82	30.99	20.20	18.62
Gross profit	31.47	36.05	25.31	17.49	17.03
Operating profit	34.62	31.34	25.15	17.09	16.78
Net profit	32.32	30.02	23.47	16.22	14.82
Balance sheet ratios					
Current ratio (x)	1.82	1.32	1.19	1.16	1.14
Quick ratio (x)	1.54	1.11	0.98	0.95	0.94
Cash ratio (x)	1.06	0.76	0.65	0.64	0.63
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	134.10	153.51	164.91
Net debt / equity ratio (%)	53.19	83.83	91.26	106.55	115.53
Returns (%)					
ROAA	5.8	6.2	6.2	6.0	5.8
ROAE	12.5	16.1	18.0	18.6	18.9
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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