



# China Everbright Int'l (257 HK)

## Market leader in a growing industry

- China Everbright Int'l (CEI) is a market leader in China's growing incineration industry.
- Solid waste produced per capita in China has been increasing on rising O2O activities. Waste produced is expected to grow at 0.5% CAGR in 2017-20E
- CEI's incineration operating capacity would expand by 15%/15%YoY in 2019E/20E, which we believe would fuel earnings growth
- We estimate net profit to grow by 22%/15%YoY in 2019E/20E
- Maintain **BUY** with TP of HK\$ 8.90, which implies 10x 2019E P/E and 1.4x 2019E P/B

**Market leader in a growing industry.** According to the Ministry of Housing and Urban-Rural Development (MOHURD) data, urban solid waste treated via incineration in China accounted for 34% of total solid waste treated at end-2017, much below the 50% target set by National Development and Reform Commission (NDRC) for end-2020. This suggests China would need to drum up the use of incineration. CEI, as a market leader controlling ~12% of nationwide incineration capacity in 2017, would benefit from the uptrend.

**Solid waste produced per capita has been increasing on rising online-to-offline (O2O) activities.** According to iResearch data, O2O sales in China grew from RMB 1.9tn in 2013 to RMB 6.3tn in 2017 (35% CAGR in 2013-17). Rising O2O activities would result in more solid waste per capita in urban area, which we estimate would increase at 0.5% CAGR in 2017-20E.

**CEI's incineration operating capacity would expand by 15%/15% YoY in 2019E/20E.** CEI's capacity under construction or preparation is 40,500t/day, equivalent to 88% its existing operating capacity (2018: 46,100t/day). Given a capacity of 22,750t/day is now under construction, we expect 7,000t/day and 8,000t/day of new capacity would be added in 2019E/20E, which represents 15%/15% YoY growth during the period.

**Net profit is expected to increase by 22%/15%YoY in 2019E/20E.** Benefiting from capacity growth and tariff increment, we believe CEI's net profit would increase by 22%/15%YoY in 2019E/20E.

**TP at HK\$ 8.90; maintain BUY.** We favor CEI's leading position in the incineration industry, which we expect to bloom over the next few years based on the low penetration at present. We expect EPS to rise at 9% CAGR in 2018-21E. Our DCF-derived TP at HK\$ 8.90 implies 10.4x 2019E P/E and 1.4x 2019E P/B. Maintain **BUY**.

**Risks:** (1) Customer default risk; (2) Air pollution concern may delay incinerator construction; (3) Construction risk; (4) Tariff risk; (5) Policy risk; (6) Fundraising activities to finance M&A; (7) EPS & BVPS dilution; (8) Increase in net gearing.

### Results and Valuation

FY ended Dec 31	2017A	2018A	2019E	2020E	2021E
Revenue (HK\$ mn)	20,043	27,228	34,089	41,437	50,689
Chg (% YoY)	43.5	35.8	25.2	21.6	22.3
Net profit (HK\$ mn)	3,510	4,319	5,246	6,020	7,232
Chg (% YoY)	26.0	23.1	21.5	14.7	20.1
EPS (HK\$)	0.762	0.858	0.854	0.980	1.177
Chg (% YoY)	22.7	12.6	-0.4	14.7	20.1
BVPS (HK\$)	4.896	6.737	6.263	7.030	7.854
Chg (% YoY)	26.2	37.6	-7.0	12.3	11.7
P/E (x)	9.75	8.66	8.70	7.58	6.31
P/B (x)	1.52	1.10	1.19	1.06	0.95
ROAE (%)	17.57	15.29	14.49	14.74	15.82
ROAA (%)	5.72	5.13	4.84	4.50	4.31
DPS (HK\$)	0.23	0.25	0.26	0.29	0.35
Yield (%)	3.14	3.41	3.45	3.96	4.75
Net gearing (%)	72.0	55.4	88.8	105.8	139.5

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

June 11, 2019

Rating: **BUY**

TP: **HK\$ 8.90**

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Share price (HK\$)	7.43
Est. share price return	19.8%
Est. dividend yield	3.5%
Est. total return	23.3%
Previous Rating & TP	BUY; HK\$15.0 (pre-right issue)

Previous Report Date Jun 19, 2018

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	10.9/6.1
Issued shares (mn)	6,143
Market cap (HK\$ mn)	45,642
3-mth avg daily turnover(HK\$ mn)	109
Major shareholder(s) (%)	
China Everbright Hld.	42.0%

Source(s): Company, ABCI Securities

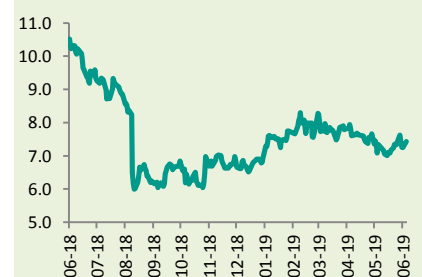
### Share Performance (%)

	Absolute	Relative*
1-mth	1.13	4.83
3-mth	(4.01)	4.19
6-mth	12.42	9.95

\*Relative to HSCEI

Source(s): Bloomberg, ABCI Securities

### 1-Year share price performance(HK\$)



Source(s): Bloomberg, ABCI Securities

## Industry overview

### Market leader in a growing industry

Historically, around 70% of residential waste has been disposed via landfills in China due to cost concern and low environmental consciousness. The proportion of residential waste incinerated has been ~20%. Due to limited land resources and the resultant underground water pollution, however, the Chinese government has been reducing such use and looking for alternatives.

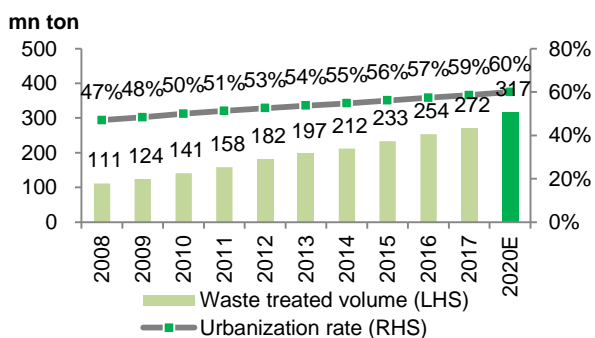
China is targeting to utilize incineration as a key solid waste treatment in urban areas. According to "The Draft of 13th FYP on Urban Residential Waste Treatment" issued by the NDRC in Sep 2016, China intends to raise the proportion of waste incinerated in urban areas from the 34% at end-2017 to 50% by end-2020E. NDRC also targets to raise incineration capacity in urban areas from 0.33mt/day by end-2017 to 0.52mt/day by end-2020, indicating a 57% jump or a 3-year CAGR of 16% during the period.

Incineration will be a major waste treatment method, presenting enormous opportunities to operators in urban areas. China Everbright Int'l (CEI), as a market leader in China controlling ~12% of incineration capacity nationwide in 2017, is set to benefit from the rising use of incineration.

### Solid waste produced per capita increased on rising O2O activities

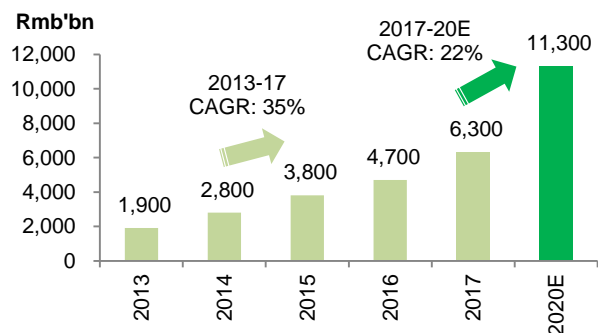
China's solid waste produced per capita has declined from 1.44kg/day in 2003 to 1.11kg/day in 2013, equivalent to -2.6% CAGR during the period. The situation, however, has reversed since then, with the figure rebounding to 1.20kg/day by end-2017. We believe the increase is driven by rising online-to-offline (O2O) activities. According to iResearch data, O2O sales in China grew from RMB 1.9tn in 2013 to RMB 6.3tn in 2017 (35% CAGR in 2013-17). We believe the change in lifestyle has increased the amount of solid waste produced; in particular, O2O shopping usually involves the use of large amounts of packaging materials. We expect solid waste produced per capita would grow at 0.5% CAGR in 2017-20E on the back of growing O2O activities.

**Exhibit 1: China's urbanization rate is likely to reach 60% by end-2020E**

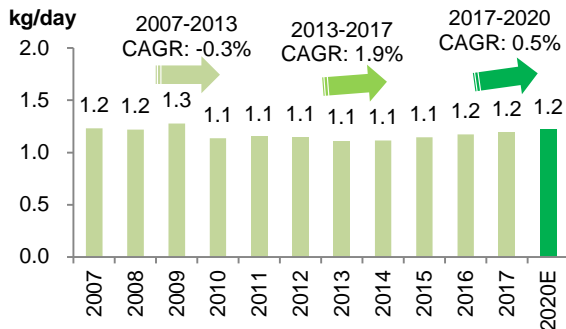


Source(s): NDRC estimates, ABCI Securities estimates

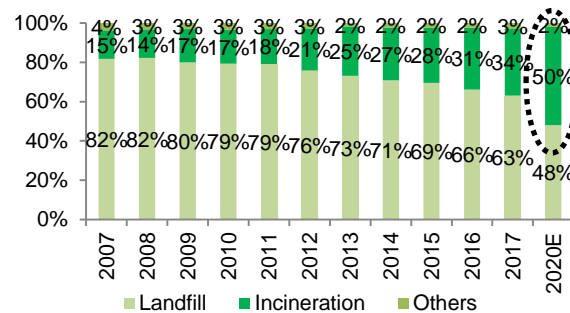
**Exhibit 2: China's O2O market size is likely to maintain a robust growth in 2017-20E**



Source(s): iResearch estimates, ABCI Securities

**Exhibit 3: Solid waste produced per capita is likely to trend up as O2O activities increase**


Source(s): MOHURD, ABCI Securities estimates

**Exhibit 4: China targets to increase the proportion of solid waste incinerated in urban areas**


Source(s): NDRC estimates, MOHURD, ABCI Securities

## Company overview

### Operating incineration capacity to expand by 15%/15% YoY in 2019E/20E

CEI has an operating capacity of 40,500t/day under construction or preparation, equivalent to 88% of its existing operating capacity (2018: 46,100t/day). Given a capacity of 22,750t/day is currently under construction, we therefore expect 7,000t/day of new capacity to be added in 2019E, boosting CEI's incineration capacity by 15%YoY. In addition, with a capacity of 17,750t/day at the preparation stage, we expect to see another 8,000t/day of new capacity to be added in 2020E, which represents a 15%YoY expansion for the year.

### Wastewater capacity growth may slow to 3%/3%YoY in 2019E/20E

CEI has 1.34mn m<sup>3</sup>/day of wastewater capacity under construction or preparation, which accounts for ~33% of CEI's existing capacity (2018: 4.01 mn m<sup>3</sup>/day). CEI's wastewater treatment business capacity would edge up by 3%/3% YoY in 2019E /20E assuming no new acquisitions would take place.

### Net gearing ratio would trend up

With the incineration/wastewater capacity expansion underway, the Group will continue to require funding. We therefore expect its net gearing ratio to reach 89% in 2019E and 106% in 2020E, which we believe may necessitate new share placement in the future.

### Prime assets in tier-1/2 cities remain a key positive

A significant proportion of CEI's operating capacity (52% for incineration and 47% for wastewater) is located at tier-1/2 cities. Residents in tier-1/2 regions, with higher disposable income, better hygienic standard, and lower default risk, would support demand and provide a steady cash flow to CEI.

### Net profit to grow by 22%/15%YoY in 2019E/20E

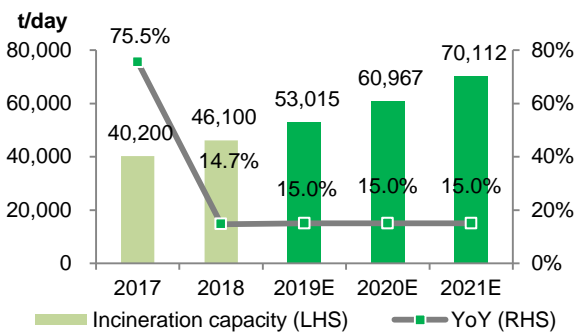
Benefiting from capacity growth in incineration business (15% YoY in 2019E/20E), growth in tariff increment (2%/2%YoY in 2019E/20E, and revenue growth expected for green tech business (41%/34%YoY in 2019E/20E), net profit growth would reach 22%/15% YoY in 2019E/20E. Our new net profit projections for 2019E/20E are 4%/2% lower than our previous estimates, backed by the reasoning that delayed approval of PPP projects would affect EPC business. We revise down revenue from EPC segment (incineration and wastewater) by 6%/7% for 2019E/20E.

### Listing of China Everbright Water (CEW, 1857 HK) would offer a fundraising vehicle for CEI

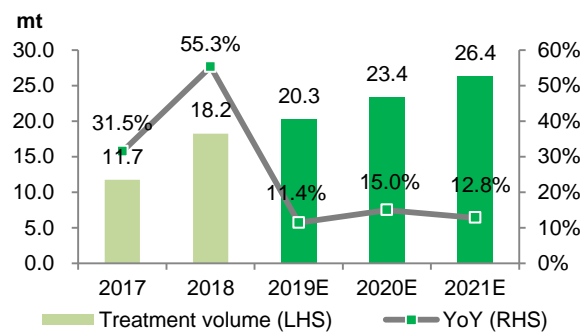
CEI's subsidiary, China Everbright Water (CEW, 1857 HK), was listed on HKEx main board in May 2019. We believe the listing would provide a new fundraising vehicle for CEI for its future development and be beneficial to its balance sheet.

### Waning of Public-Private Partnership (PPP) would adversely affect EPC segment

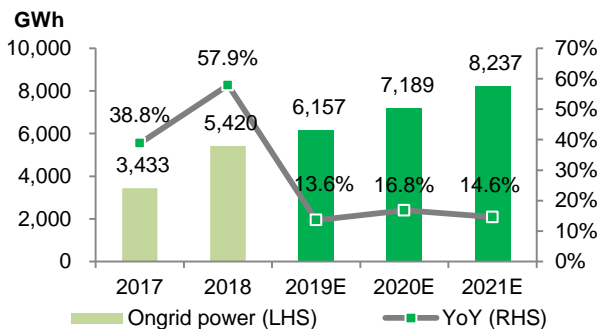
Public-Private Partnership (PPP) was first introduced by the Chinese government in 2016 to attract private capital into urban facilities. However, as reported cases of low-quality projects and scams increase, approval for new PPP projects has slowed. We believe this shift in attitude in PPP would drag down revenue in the Group's EPC segment.

**Exhibit 5: CEI's incineration capacity growth would remain robust in coming years**


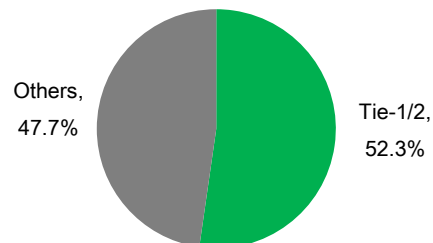
Source(s): Company, ABCI Securities estimates

**Exhibit 6: CEI's incineration treatment volume would trend up**


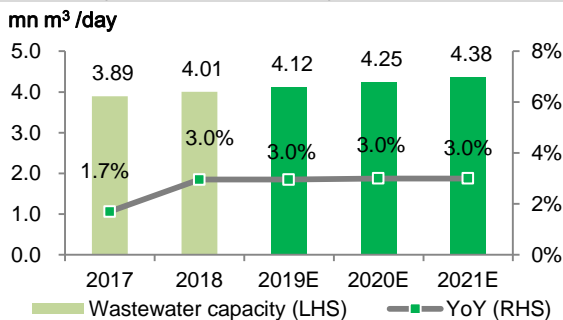
Source(s): Company, ABCI Securities estimates

**Exhibit 7: CEI's power output outlook**


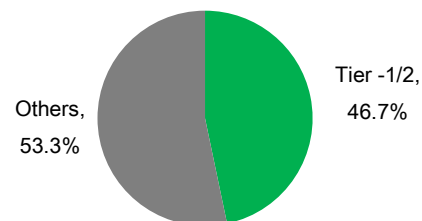
Source(s): Company, ABCI Securities estimates

**Exhibit 8: Over half of CEI's incineration capacity is located in wealthier regions (2018)**


Source(s): Company, ABCI Securities

**Exhibit 9: CEI's wastewater capacity would grow moderately over the next few years**


Source(s): Company, ABCI Securities estimates

**Exhibit 10: Almost half of CEI's wastewater capacity is located in wealthier regions (2018)**


Source(s): Company, ABCI Securities

## Risk factors

### **Right issue hampers investor confidence**

CEI has announced right issue at HK\$6.00 (31.4% discount to share price at announcement date) on Aug 14, 2018, its first fundraising activity since Dec 2013. A total of HK\$9.9bn was raised and shares were diluted by 37% - the greatest dilution based on its track record (previous new share placement dilution at 15%, 10% and 11% in 2009, 2012 and 2013). We believe the exercise, to a certain extent, has hampered investor confidence. Dilution effects caused by the right issue will be fully reflected in 2019E EPS and BVPS.

### **Negative free cash flow may raise concern on further fundraising exercise**

Amid the escalation of Sino-US trade war and the resulting volatility in stock market, investors are seeking for safe havens – stocks with high earnings visibility and positive free cash flow. CEI, with its negative free cash flow and continuous funding need for capacity expansion, may not fit such criteria. Nonetheless, we remain positive on its long-term outlook since the development of China's incineration industry is still at its nascent stage-growth potential of the segment and CEI are therefore enormous.

In our model, we assume capex and M&A would increase in 2019E-21E. Hence, net gearing ratio would keep rising during the period. At end-2018, intangible assets accounted for 15.1% of total assets and 42.4% of total equity. Our financial forecasts may deviate from actual outcomes if the actual capacity expansion deviates from our expectations.

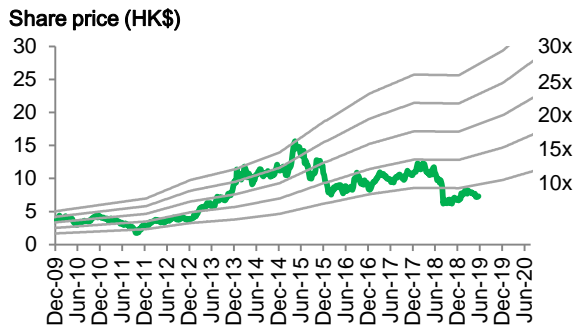
## Valuation

### TP at HK\$8.90; maintain BUY

We favor CEI's leading position in incineration industry, which we believe will undergo strong growth over the next few years based on the low penetration rate of incineration in China (2017: 34%, below the 50% target by end-2020).

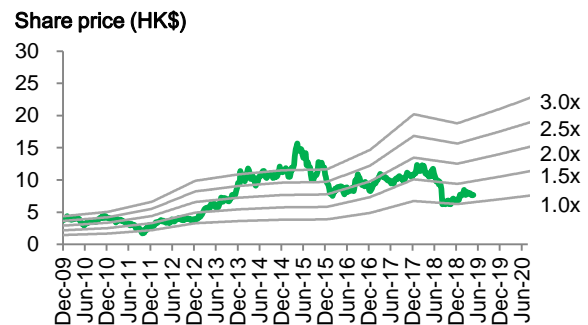
Our DCF-derived TP (post right issue) at HK\$ 8.90 (HK\$ 15.00 previously, pre-right issue), equivalent to 10.4x 2019E P/E and 1.4x 2019E P/B. The slashed TP (-40%) is resulted from 1) CEI's 37% share dilution arising from right issue in 2018; 2) downward revision of net profit by 4%/2% for 2019E/20E. Nonetheless, we believe CEI, as China's leading incineration operator with the largest capacity, would benefit enormously as China shifts to adopt incineration as a key solid waste treatment method in urban areas. We expect CEI's EPS to rise at 9% CAGR in 2018-21E. Maintain **BUY**.

Exhibit 11: CEI's fwd P/E chart



Source(s): Company, ABCI Securities estimates

Exhibit 12: CEI's fwd P/B chart



Source(s): Company, ABCI Securities estimates



**Consolidated income statement**

<b>FY Ended Dec 31 (HK\$ mn)</b>	<b>2017A</b>	<b>2018A</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
<b>Revenue</b>	<b>20,043</b>	<b>27,228</b>	<b>34,089</b>	<b>41,437</b>	<b>50,689</b>
Operation income	3,896	6,396	8,727	11,647	15,766
EPC	13,322	16,599	19,777	22,951	26,658
Other	2,825	4,233	5,585	6,838	8,265
<b>Cost of sales</b>	<b>(12,911)</b>	<b>(17,797)</b>	<b>(22,691)</b>	<b>(27,417)</b>	<b>(33,541)</b>
<b>Gross Profit</b>	<b>7,133</b>	<b>9,431</b>	<b>11,398</b>	<b>14,019</b>	<b>17,148</b>
SG&A expenses	(1,438)	(1,899)	(2,386)	(3,108)	(3,802)
Net financial income (cost)	(854)	(1,263)	(1,574)	(2,437)	(3,190)
Other income/ (expenses)	588	730	890	1,081	1,323
<b>Profit before tax</b>	<b>5,428</b>	<b>6,998</b>	<b>8,328</b>	<b>9,556</b>	<b>11,479</b>
Tax	(1,376)	(1,729)	(2,082)	(2,389)	(2,870)
<b>Net profit</b>	<b>4,052</b>	<b>5,270</b>	<b>6,246</b>	<b>7,167</b>	<b>8,609</b>
Profit attributable to:					
Minority interest	542	951	999	1,147	1,377
<b>Equity shareholders of the Company</b>	<b>3,510</b>	<b>4,319</b>	<b>5,246</b>	<b>6,020</b>	<b>7,232</b>
<b>Basic EPS (HK\$)</b>	<b>0.762</b>	<b>0.858</b>	<b>0.854</b>	<b>0.980</b>	<b>1.177</b>
<b>DPS (HK\$)</b>	<b>0.234</b>	<b>0.253</b>	<b>0.256</b>	<b>0.294</b>	<b>0.353</b>

Source(s): Company, ABCI Securities estimates

**Consolidated balance sheet**

<b>As of Dec 31 (HK\$ mn)</b>	<b>2017A</b>	<b>2018A</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
<b>Current assets</b>	<b>19,637</b>	<b>29,664</b>	<b>32,641</b>	<b>39,850</b>	<b>49,282</b>
Cash	8,657	12,136	16,819	20,266	26,386
Pledged and restricted bank deposits	2,181	3,838	0	0	0
Trade and bill receivables	5,589	7,537	9,274	11,160	13,837
Other receivables and prepayments	2,698	5,492	5,715	7,454	7,823
Inventories	510	659	833	970	1,236
Other current assets	2	2	0	0	0
<b>Non-current assets</b>	<b>53,486</b>	<b>65,457</b>	<b>89,023</b>	<b>106,291</b>	<b>140,522</b>
Property, plant & equipment	4,025	4,410	5,646	7,154	9,333
Investment properties	171	213	213	213	213
Intangible assets	10,340	14,397	20,279	27,447	37,583
Investment in JV and associates	792	1,014	1,014	1,014	1,014
Deferred tax assets	8,866	1,572	11,503	4,390	15,052
Other non-current assets	29,291	43,851	50,367	66,072	77,327
<b>Total Assets</b>	<b>73,123</b>	<b>95,122</b>	<b>121,664</b>	<b>146,141</b>	<b>189,804</b>
<b>Current Liabilities</b>	<b>14,033</b>	<b>15,234</b>	<b>19,740</b>	<b>23,129</b>	<b>31,962</b>
Trade and bill payables	8,505	10,168	12,213	13,327	17,917
Other payables	114	132	0	0	0
Short term borrowings	5,414	4,935	7,527	9,802	14,045
Other current assets	0	0	0	0	0
<b>Non-current liabilities</b>	<b>30,446</b>	<b>39,192</b>	<b>55,675</b>	<b>70,902</b>	<b>99,293</b>
Deferred tax liabilities	4,312	5,301	5,301	5,301	5,301
Long-term borrowings	26,040	33,591	50,374	65,601	93,991
Other non-current assets	94	299	0	0	0
<b>Total Liabilities</b>	<b>44,480</b>	<b>54,426</b>	<b>75,415</b>	<b>94,031</b>	<b>131,255</b>
Minority interests	6,089	6,769	7,769	8,915	10,293
<b>Shareholders' equities</b>	<b>22,554</b>	<b>33,926</b>	<b>38,480</b>	<b>43,195</b>	<b>48,257</b>

Source(s): Company, ABCI Securities estimates



**Consolidated cash flow statement**

FY ended Dec 31 (HK\$ mn)	2017A	2018A	2019E	2020E	2021E
Profit before tax	5,428	6,998	8,328	9,556	11,479
Change in depreciation and amortization	497	620	985	1,335	1,830
Change in Working Capital	(9,846)	(12,386)	(11,059)	(8,544)	(17,932)
Net financial cost (income)	854	1,263	(160)	(168)	(203)
Income tax paid	(370)	(498)	(1,729)	(2,082)	(2,389)
Net interest received	84	113	160	168	203
Others	251	(476)	(106)	(128)	(157)
<b>Operating cash flow</b>	<b>(3,102)</b>	<b>(4,366)</b>	<b>(3,581)</b>	<b>137</b>	<b>(7,169)</b>
Capex	(839)	(905)	(1,621)	(2,002)	(2,829)
Increase in intangible assets	(2,716)	(4,274)	(6,483)	(8,009)	(11,316)
Others	(1,278)	(2,319)	0	0	0
<b>Investing cash flow</b>	<b>(4,833)</b>	<b>(7,498)</b>	<b>(8,103)</b>	<b>(10,012)</b>	<b>(14,145)</b>
Net Capital raise	0	9,924	0	0	0
Net debt financing	8,810	7,990	19,375	17,502	32,633
Dividend payout	(1,138)	(1,198)	(1,275)	(1,574)	(1,806)
Interest paid	(920)	(1,368)	(1,734)	(2,606)	(3,393)
Others	3,191	304	0	0	0
<b>Financing cash flow</b>	<b>9,944</b>	<b>15,652</b>	<b>16,366</b>	<b>13,323</b>	<b>27,434</b>
<b>Net change in cash</b>	<b>2,009</b>	<b>3,789</b>	<b>4,682</b>	<b>3,448</b>	<b>6,120</b>
Cash at the beginning	6,341	8,657	12,136	16,819	20,266
Adjustment (Time deposit & FX effect)	308	(309)	0	0	0
<b>Cash at the end</b>	<b>8,657</b>	<b>12,136</b>	<b>16,819</b>	<b>20,266</b>	<b>26,386</b>

Source(s): Company, ABCI Securities estimates

**Key ratio**

FY ended Dec 31 (HK\$ mn)	2017A	2018A	2019E	2020E	2021E
<b>Sales mixed (%)</b>					
Operation income	19.44	23.49	25.60	28.11	31.10
EPC	66.47	60.96	58.02	55.39	52.59
Other	14.10	15.55	16.38	16.50	16.30
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Profit &amp; loss ratios (%)</b>					
Gross margin	35.59	34.64	33.44	33.83	33.83
Operating profit margin	31.04	29.75	28.74	28.63	28.63
Pre-tax margin	27.08	25.70	24.43	23.06	22.65
Net profit margin	20.22	19.35	18.32	17.30	16.98
Selling & administrative expenses/revenue	7.18	6.98	7.00	7.50	7.50
Effective tax rate	25.36	24.70	25.00	25.00	25.00
<b>Growth (%)</b>					
Revenue	43.46	35.85	25.20	21.55	22.33
Gross profit	34.33	32.22	20.86	23.00	22.32
Operating profit	34.42	30.18	20.93	21.12	22.32
Net profit	33.43	30.06	18.52	14.75	20.13
<b>Balance sheet ratios</b>					
Current ratio (x)	1.40	1.95	1.65	1.72	1.54
Quick ratio (x)	1.17	1.54	1.32	1.36	1.26
Cash ratio (x)	0.77	1.05	0.85	0.88	0.83
Trade and bill receivables days	81.28	87.98	90.00	90.00	90.00
Trade and bill payables turnover days	188.14	191.48	180.00	170.00	170.00
Inventory turnover days	12.32	11.98	12.00	12.00	12.00
Total debt / equity ratio (%)	139.46	113.56	150.47	174.57	223.88
Net debt / equity ratio (%)	71.97	55.42	88.83	105.81	139.45
<b>Returns (%)</b>					
ROAA	5.72	5.13	4.84	4.50	4.31
ROAE	17.57	15.29	14.49	14.74	15.82
Payout ratio	30.65	29.52	30.00	30.00	30.00

Source(s): Company, ABCI Securities estimates



## Disclosures

### Analyst Certification

I, Ng King Chuen, Kelvin, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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### Definition of equity rating

Rating	Definition
Buy	Stock return rate $\geq$ Market return rate (10%)
Hold	- Market return rate (-10%) $\leq$ Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months  
Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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