

Environmental cum alternative energy play

China Utilities

China Everbright Int'l (257 HK, HK\$0.84)

Not Rated

Company background. China Everbright International (CEI) is a conglomerate mainly engaged in environmental protection, infrastructure and property investment in China. Since 2002, CEI has been actively exploring the environment protection business, including waste-to-energy incineration, urban sewage treatment and solid waste disposal, in Suzhou, Qingdao, Yixing and Zibo. Projects are mostly located in Yangtze River Delta, Pearl River Delta and Bohai Bay Area. China Everbright Holdings (the non-listed parent company) currently holds 57.4% interests in CEI.

Environment protection segment – up and coming. Given the increasing concern over the ecosystem issue in China, China government has placed environment protection as one of the key issues in its 11th Five Year development plan. CEI reported a total revenue of HK\$134m in 2005, with environment protection segment accounting for 42% (cf. 4% in 2004). While environmental projects offered zero income in 2004, this segment contributed 11% of CEI's 2005 EBIT of HK\$141m. We estimate that EBIT margin from the environment projects was around 27.6% in 2005. Depreciation and finance costs are the major costs for the environment protection projects. Usually, bank borrowing will fund two-thirds of the project investment. The company has invested in nine environmental protection projects so far, with most of the projects expected to commence operation in the next 2 years. Environment protection business should account for a major contribution of revenue and earnings going forward.

Waste-to-energy projects. The company has just started to operate its first waste-to-energy project in Suzhou in July 06. CEI collects the household wastes from the local government and then converts the wastes to produce electricity. CEI collects incomes by two ways. Firstly, CEI collects processing fees of RMB90 per tonne for handling the household wastes. Secondly, the company sells the electricity at an average price of RMB0.57 per kilowatt-hour. Meanwhile, the company is going to kick off its Suzhou methane-to-energy project in August 06. IRR for waste-to-energy project is c.10~15%. As the company usually acts as a contractor for these projects, management claims significant cost savings will be achieved.

Solid waste disposal project. This Suzhou project will start to operate in 2007. CEI simply collects the industrial wastes from industrial manufacturers and stores them safely under the ground. IRR is expected at a high teen level for solid waste disposal project.

Waste water treatment project. The company charges around RMB0.75~1 per tonne of waste water treatment. While this kind of projects does not usually offer good returns at the initial stage, management indicated that more meaningful returns will be achieved by extending the existing projects. Any extension would only increase the cost slightly (i.e. better economies of scale). Meanwhile, given that Shandong area usually suffers from scarce water supply, the company plans to move up the value chain to provide recycle water. This is particular true given that Shandong Province is a wealthy distinct.

Suzhou Environmental Protection Industrial Zone. In July 2005, the company entered into a letter of intent with Suzhou Municipal government to develop an environmental protection industrial zone. Total investment cost is around HK\$1.5b for the entire zone. While the company has already (or soon) started operating the Suzhou waste-to-energy, methane-to-energy and the solid waste disposal project, future projects will include a leachate treatment, a sludge treatment, a center for the R&D and manufacturing of environment protection equipment, a pretreatment plant for solid waste, and phase two of the Suzhou waste-to-energy plant.

Infrastructure and property investment offer steady income. CEI invested in a few infrastructure projects and property investment before expanding its footing into environment protection projects. The company did not rule out the possibility that it will dispose of these projects if someone offers a good price. A brief summary of

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. If you would like to access our research reports and know more about our services, please contact Raymond Jook, Head of Research, on (852) 2533 3715 or raymondjook@softbank.com.hk. Find our research on: sbi2capital.com, thomsononeanalytics.com and multex.com

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

Analyst certification: the views expressed in this report accurately reflects the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

these projects is as follows:

Table 1: Environment protection projects

| | Operation | Nature | Period | Investment | Daily processing | Estimated annual |
|---|-----------|--------|--------|------------|---------------------|-------------------|
| | | | (Year) | (RMBm) | capacity (ton./day) | electricity (Kwh) |
| SuNeng Waste-to-Energy Project Phase 1 | Jul-06 | BOT | 25 | 500 | 1000 | 89m |
| SuNeng Waste-to-Energy Project Phase 2 | Sep-08 | BOT | 25 | 210 | 500 | |
| Yixing Waste-to-Energy Project Phase 1 | Feb-07 | BOT | 25 | 238 | 500 | 44.5m |
| Yixing Waste-to-Energy Project Phase 2 | | BOT | 25 | 120 | 300 | |
| Jiangyin Waste-to-Energy Project Phase 1 | Early 08 | BOT | 30 | 388 | 800 | 77m |
| Jiangyin Waste-to-Energy Project Phase 2 | | BOT | 30 | | 400 | |
| Changzhou waste-to-energy Project | 2H08 | BOT | 25.5 | 412.45 | 800 | 77m |
| Suzhou methane-to-energy Project | Aug-06 | BOT | 25 | 27.9 | | 12.48m |
| Suzhou Solid Waste Disposal Project* | 2007 | BOT | 30 | 78.3 | | |
| Qingdao EB-VW waste water treatment project | Jan-05 | BOT | 25 | 206 | 150,000 | |
| Maidao extension waste water treatment project | Jul-06 | BOT | 25 | | 70,000 | |
| Haibohe extension waste water treatment project | 2006 | BOT | 25 | | 40,000 | |
| Zibo waste water treatment project | Dec-05 | TOT | 25 | 114 | 150,000 | |
| Zibo extension waste water treatment project | Jun-06 | TOT | 25 | 100 | 100,000 | |
| Jinan waste water treatment project | Oct-06 | TOT | 30 | 400 | 420,000 | |

* Storage capacity of 140k m³

Source: Company data and SBI E2-Capital

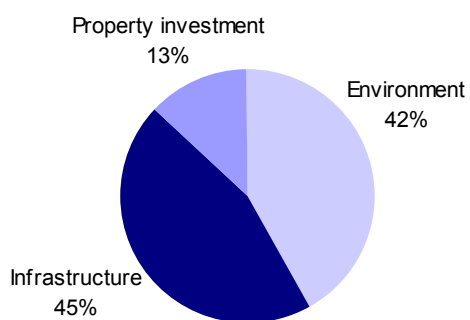
- CEI holds an 80% interest in Fuzhou Qingzhou Bridge (remaining 20% is held by China Everbright Holding). Total investment cost was around RMB700m. Average daily traffic flow increased to 23k in 2H05, compared to 8.4k in 1H03, on the back of the continual growth in the traffic flow of the “Tungsan Expressway”. In 2005, annual toll revenue exceeded RMB65m and profit contribution amounted to HK\$27m. It is expected that the traffic flow of Qingzhou Bridge will rise further upon the opening of the highway to Fuzhou Airport in 2006.
- CEI currently holds a 15% interest in Mawan Power in Shenzhen, which owns two power plants. Annual generation capacity is over 5b kilowatt hour. With strong cash flow, the project does not require any borrowing from bank. This project pays a dividend of HK\$99m in 2005. In 2005, attributable profit after taxation from Mawan Power amounted to HK\$68m.
- Major property investments (value of HK\$200m) include Far East Finance Center (HK), Shanghai Trade Square and International Apartments, Central Business Building (Shenzhen), Tower of Education, Science & Technology Building (Shenzhen) and Zhongshan Garden (Shenzhen).

Competitive advantages. With the first mover advantage, the company has established a sizeable foothold (e.g. 4 waste-to-energy projects in the Suzhou area compared with one or two for peers) in the Suzhou area. For instance, CEI will account for over half of the household wastes in SuNeng region. Besides that, CEI is also an established enterprise with market capitalization of exceeding HK\$2.5b, resulting in higher financial muscle when funding its investment.

Borrowing may be required. CEI did a placement to raise HK\$321m in April. At the end of 1H06, the company had cash on hand of around HK\$700~800m, with a net gearing ratio of 46%. Annual capex is around HK\$1b. The company may increase its borrowing if it needs to acquire more projects.

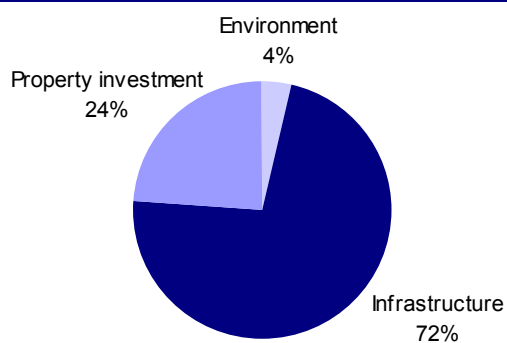
Consensus valuation. The stock trades at consensus 20.8x FY12/06 P/E and 11.9x FY12/07 P/E.

Chart 1: Revenue breakdown in 2005



Source: Company data

Chart 2: Revenue breakdown in 2004



Source: Company data

Table 2: P&L

| Year to Dec (HK\$m) | 2003 | 2004 | 2005 |
|---|---------------|--------------|--------------|
| Turnover | 83.6 | 65.2 | 133.8 |
| Gross profit | 28.9 | 50.5 | 90.7 |
| Other revenue | 12.0 | 4.6 | 12.4 |
| Distribution costs | (1.3) | - | - |
| Administrative expenses | (30.3) | (35.5) | (55.3) |
| Other operating expenses | (33.5) | (6.1) | - |
| Valuation gains on investment properties | (17.0) | 14.8 | 25.2 |
| Operating profit | (41.2) | 28.3 | 73.0 |
| Finance costs | (31.4) | (27.6) | (32.1) |
| Share of results of associates | 109.9 | 80.9 | 68.0 |
| Share of valuation gains on investment properties | (13.3) | 4.3 | - |
| Share of profit of jointly controlled entity | 32.0 | - | - |
| Gain on sale of discontinued operation | 19.6 | - | - |
| Profit before tax | 75.5 | 85.9 | 109.0 |
| Tax | (17.8) | 0.3 | 11.9 |
| Minority interests | 0.8 | (0.6) | (15.5) |
| Net profit | 56.8 | 86.8 | 105.3 |
| <i>Gross margin (%)</i> | <i>34.6</i> | <i>77.4</i> | <i>67.7</i> |
| <i>Operating margin (%)</i> | <i>(49.3)</i> | <i>43.4</i> | <i>54.6</i> |
| <i>Net margin (%)</i> | <i>68.0</i> | <i>133.0</i> | <i>78.7</i> |

Source: Company data and SBI E2-Capital