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# China Everbright International 0257 HK

## Turning Trash into Treasure

- *Recommended a Buy rating at a target price of HKD8.0, representing a potential upside of 12.8%.*
- *CEI has a strong project pipeline which is expected to translate into HKD1.7b recurring income and operational cash flow to the Company each year after the projects become operational in 2015*
- *CEI's WTE projects are mainly located in coastal areas where the government has set higher target incineration rates*
- *CEI is the only company in the PRC with gas emissions complying with Euro 2000 standard, which is currently the most stringent in the world, for all its WTE projects*

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**Stock Data**

Rating	BUY
Price (HK\$)	7.09
Target Price (HK\$)	8.0
12m Price Range (HK\$)	3.61-7.41
Market cap. (HK\$m)	28,740.8
3M average Daily t/o (HK\$)	84,839,402.1
Free float (%)	56.1

Source: Bloomberg

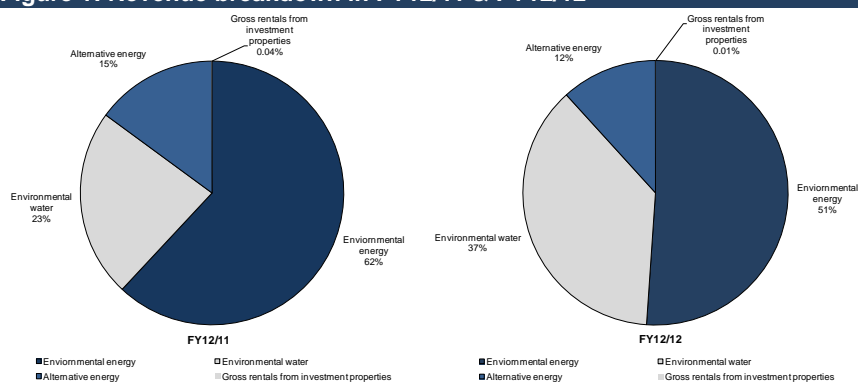
**Financial Summary**

Year to Dec	13E	14E	15E
Turnover (HK\$m)	5,985	8,043	5,336
Gross profit (HK\$m)	2,030	2,637	2,643
Net profit (HK\$m)	947	1,170	1,341
EPS (HK\$)	0.23	0.29	0.33
DPS (HK\$)	0.05	0.06	0.07
P/E (x)	30.3	24.6	21.4
P/B (x)	3.0	2.8	2.5
Dividend Yield (%)	0.7%	0.8%	0.9%

Source: Company data, bloomberg

CEI is a leading WTE operator in China, which mainly focuses on construction and operation of environmental protection assets such as waste-to-energy (WTE), wastewater treatment (WWT) and other alternative energy (biomass, methane to energy and solar power). WTE business is the largest source of revenue of the Company, contributing 62% and 51% of the total revenue in FY12/11 and FY12/12 (See Figure 1 & 2). The business of the Company is expanding in coastal provinces such as Jiangsu, Shandong, Guangdong, Anhui, Zhejiang and Hainan.

**Figure 1: Revenue breakdown in FY12/11 & FY12/12**



Source: Company data

In terms of daily processing capacity, CEI commands a market share of around 10% in China's WTE market. Currently, the Company has 10 WTE projects in operation with a cumulative daily processing capacity of 9,650 tonnes and 3 solid waste landfill projects in operation with a designed storage capacity of 852,000m<sup>3</sup>.

For environmental water business, the Company has 12 WWT projects and 3 reusable water projects in operation with daily treatment capacity of 1.63mm<sup>3</sup> and daily reusable water supply capacity of 56,800m<sup>3</sup>.

The Company also has 13 alternative energy projects in operation, including Methane-to-energy projects, photovoltaic energy projects, biomass power generation projects and heat pump projects. However, management suggested that this segment is not their major business and they will mainly focus on WTE and WWT projects going forward.

**Strong project pipeline boosts recurring income in the Future.** The Company currently has 21 projects in total that are under construction or in a preparatory stage (See Figures 3 to 6), with a total investment amount of RMB7.2b (equivalent to HK\$9.0b). These projects include 13 WTE projects, 3 solid waste landfill projects, 3 WWT projects, 1 reusable water project and 1 biomass power generation project. These projects will be under construction in 2013 and 2014 and are expected to be operational in 2015. We expect these projects, after becoming operational in 2015, will contribute HK\$1.7b recurring income and operating cash flow to the Company each year. Based on the project pipeline, we expect that the daily processing capacity of the Company's operating WTE will increase from 4,550 tonnes in 2010 to 20,550 tonnes in 2015, representing a CAGR of 35.2% during the 5-year period (See Figure 7). The growth is actually higher than the CAGR of 28.0% of the national WTE daily processing capacity during the 5-year period between 2010 and 2015.

**Table 1: CEI's project pipeline (WTE)**

<b>WTE</b>			
<b>Under construction</b>			
No. of projects	Total Investment (RMB)	Daily processing capacity (ton)	Annual power generation (Kwh)
3	1,920,018,000	3,600	403,323,000
<b>In preparatory stage</b>			
No. of projects	Total Investment (RMB)	Daily processing capacity (ton)	Annual power generation (Kwh)
10	4,252,384,000	7,300	899,360,000
<b>Landfill</b>			
<b>In preparatory stage</b>			
No. of projects	Total Investment (RMB)	Designed storage capacity (m3)	
3	395,000,000	1,350,000	
<b>WWT</b>			
<b>Under construction</b>			
No. of projects	Total Investment (RMB)	Daily waste water treatment capacity (m3)	
1	195,000,000	100,000	
<b>In preparatory stage</b>			
No. of projects	Total Investment (RMB)	Daily waste water treatment capacity (m3)	
3	151,677,000	205,000+annual reusable water supply of 1,750,000	
<b>Alternative Energy</b>			
<b>Under construction</b>			
No. of projects	Total Investment (RMB)	Average annual power generation capacity (kWh)	
1	320,000,000	184,000,000	

Source: Company data

**Adopting Higher Emission Standards Help to Capture New Projects.** Although WTE is a renewable energy, the incineration process can emit contaminants such as particulate matter, Sulphur dioxide, Nitrogen Oxides, etc. These contaminants are potentially harmful to human beings. In view of this, we believe the Chinese government will tend to favor players who adhere to higher emission standards and have less emission of contaminants during the process of incineration.

CEI will certainly be one of those as all of its projects meet both the current Chinese standard (GB18485-2001) and the standards established by the European Union. According to the Company's FY12/12 annual report, CEI is the only company in the PRC with gas emissions complying with Euro 2000 standard, which is currently the most stringent in the world, for all its WTE projects.

To comply with a more stringent standard may require additional system upgrades, thus investment. Nonetheless, we believe this can help CEI to secure more WTE projects from the government in the long-run given the Chinese government's determination to reduce pollution in the country.

**Beneficiary of Favorable Government Policies.** The Chinese government has issued the "12<sup>th</sup> Five-year Plan for waste treatment development" on 4 May 2012, stating that the government plans to raise the percentage of incineration to total waste disposal from 20% in 2010 to 35% in 2015. Most of the Company's projects are located in coastal provinces like Jiangsu, Shandong, Guangdong, Zhejiang and Hainan. These areas have relatively more developed economies and higher population density compared to other regions in China. Therefore, they are more in need of waste treatment. As shown in

Figure 9, the government has set a higher target for the abovementioned cities in terms of percentage of incineration to total waste disposed in 2015.

**Table 2: 12<sup>th</sup> FYP for Waste Treatment Development in China**

Region	2010						2015 (Target)					
	Capacity (ton/day)			%			Capacity (ton/day)			%		
	Landfill	Incineration	Others	Landfill	Incineration	Others	Landfill	Incineration	Others	Landfill	Incineration	Others
<b>National average</b>	352,038	<b>89,625</b>	15,254	77%	<b>20%</b>	3%	513,748	<b>307,155</b>	50,588	59%	<b>35%</b>	6%
Beijing	12,080	2,200	2,400	73%	13%	14%	8,746	12,900	7,250	30%	45%	25%
Tianjin	6,400	1,800	0	78%	22%	0%	7,500	6,900	1,500	47%	43%	10%
Hebei	15,249	2,450	1,100	81%	13%	6%	18,729	8,640	3,920	60%	28%	12%
Shanxi	9,595	2,800	0	77%	23%	0%	11,239	7,030	1,305	57%	36%	7%
Neimeng	19,053	0	1,247	97%	0%	11%	14,835	4,400	1,247	72%	22%	6%
Liaoning	4,801	2,040	600	70%	30%	0%	32,105	6,340	4,341	75%	15%	10%
Jilin	10,403	500	600	91%	4%	5%	13,961	6,340	500	67%	31%	2%
Heilongjiang	5,750	2,575	2,220	55%	24%	21%	22,507	3,200	2,190	81%	11%	8%
Shanghai	24,168	15,192	0	61%	39%	0%	26,598	31,242	1,000	45%	53%	2%
<b>Jiangsu*</b>	<b>22,062</b>	<b>18,535</b>	<b>755</b>	<b>53%</b>	<b>45%</b>	<b>2%</b>	<b>22,614</b>	<b>37,085</b>	<b>755</b>	<b>38%</b>	<b>61%</b>	<b>1%</b>
Anhui	7,851	1,750	0	82%	18%	0%	19,286	5,650	0	77%	23%	0%
Fujian	12,074	7,285	0	62%	38%	0%	12,263	16,495	1,400	41%	55%	4%
Jiangxi	6,241	0	0	100%	0%	0%	12,080	4,000	3,503	62%	20%	18%
<b>Shandong*</b>	<b>31,835</b>	<b>8,580</b>	<b>1,302</b>	<b>76%</b>	<b>21%</b>	<b>3%</b>	<b>38,283</b>	<b>31,280</b>	<b>5,552</b>	<b>51%</b>	<b>42%</b>	<b>7%</b>
Hebei	27,076	2,400	560	90%	8%	2%	38,690	7,000	560	84%	15%	1%
Hubei	13,159	1,000	0	90%	7%	3%	18,998	7,200	1,130	69%	27%	4%
Hunan	13,593	0	0	100%	0%	0%	25,862	7,900	870	75%	23%	3%
<b>Guangdong*</b>	<b>22,373</b>	<b>11,743</b>	<b>0</b>	<b>66%</b>	<b>34%</b>	<b>0%</b>	<b>38,043</b>	<b>41,493</b>	<b>0</b>	<b>44%</b>	<b>56%</b>	<b>0%</b>
Guangxi	9,438	1,240	400	85%	11%	4%	9,944	7,270	500	56%	41%	3%
<b>Hainan*</b>	<b>1,589</b>	<b>225</b>	<b>0</b>	<b>88%</b>	<b>12%</b>	<b>0%</b>	<b>1,014</b>	<b>1,825</b>	<b>0</b>	<b>36%</b>	<b>64%</b>	<b>0%</b>
Chongqing	8,809	1,200	0	88%	12%	0%	8,901	11,000	0	45%	55%	0%
Sichuan	16,649	2,740	1,300	81%	13%	6%	27,041	5,240	1,300	80%	16%	4%
Guizhou	5,897	0	0	100%	0%	0%	19,430	0	0	100%	0%	0%
Yunnan	7,706	2,870	1,510	64%	24%	12%	16,521	6,450	4,405	60%	24%	16%
Xizang	0	0	0	0%	0%	0%	796	0	0	100%	0%	0%
Shanxi	13,359	500	860	91%	3%	6%	18,916	7,200	1,640	68%	26%	6%
Gansu	3,793	0	0	100%	0%	0%	6,649	1,800	1,200	69%	19%	12%
Qinghai	1,441	0	0	100%	0%	0%	2,079	0	0	100%	0%	0%
Ningxia	2,905	0	0	100%	0%	0%	3,025	800	0	79%	21%	0%
Xinjiang	6,295	0	0	100%	0%	0%	10,560	1,000	0	91%	9%	0%

Source: NDRC

**Financial Highlights.** Based on current project pipeline, we forecast the Company's revenue to increase from HK\$3,410m in FY12/12 to HK\$5,336m in FY2015E, representing a CAGR of 16.1% during the 3-year period. The increase will mainly be driven by: 1) increase in construction revenue as projects in the pipeline will be under construction from 2013 and 2) increase in operation revenue, which is recurring in nature, as more projects will become operational and start revenue contribution from 2015.

We expect the Company's GPM will decline to 33.9% in FY12/13F and 32.8% FY12/14F, as the projects in the pipeline will start construction from FY12/13F, and the increasing construction income will drag down the overall GPM during the construction period.

We also forecast the Company's net profit attributable to shareholders to increase from HK\$1,123m in FY12/12A to HK\$1,341m in FY12/15F, representing a CAGR of 6.1% during the 3-year period. Net profit grows at a much slower rate than EBIT during the period because net profit in FY12/12A included profits from a discontinued operation (HK\$250m), which has since been disposed of by the Company during 2012. Stripping out the discontinued segment, we forecast the profit from continued operation to grow at a CAGR of 15.6% during the 3-year period.

**Table 3: Ratio Analysis**

	FY12/11	FY12/12	FY12/13E	FY12/14E	FY12/15E
<b>Growth (YoY)</b>					
revenue	19.0%	-2.2%	75.5%	34.4%	-33.7%
Gross profit	25.5%	17.1%	20.6%	29.9%	0.3%
Operating profit	23.2%	17.7%	17.9%	29.1%	5.9%
Net profit (including discontinued operation)	29.4%	36.5%	-14.7%	23.5%	14.6%
Net Profit from continuing operation	17.1%	18.2%	9.0%	23.5%	14.6%
<b>Margins</b>					
Gross margin	41.3%	49.4%	33.9%	32.8%	49.5%
EBIT margin	36.1%	43.5%	29.2%	28.1%	44.8%
Net profit margin (excluding discontinued operation)	21.9%	26.5%	16.5%	15.1%	26.1%
<b>Other Ratios</b>					
Return on average assets	6.8%	7.6%	5.2%	5.1%	5.4%
Return on average equity	13.6%	15.1%	10.9%	12.2%	12.7%
dividend payout ratio	20.6%	20.2%	20.0%	20.0%	20.0%
<b>Valuation Measures</b>					
P/E (x)	28.6	21.1	26.8	21.7	18.9
P/B (x)	3.8	2.9	2.7	2.4	2.2
Dividend yield	0.7%	1.0%	0.7%	0.9%	1.1%

Source: SBI E2-Capital, company data

**Table 4: Revenue breakdown by Segments (HK\$ m)**

	FY12/11	FY12/12	FY12/13E	FY12/14E	FY12/15E
Construction revenue	2,119	1,602	4,053	5,818	2,105
Operation revenue	840	1,213	1,366	1,398	2,028
Finance Income	527	595	565	826	1,202
Gross rentals from investment properties	1	0	1	1	1
<b>Total Revenue</b>	<b>3,487</b>	<b>3,410</b>	<b>5,985</b>	<b>8,043</b>	<b>5,336</b>
Waste to Energy	2,161	1,742	4,486	6,318	3,860
Waste Water Treatment	805	1,267	1,076	1,140	982
Alternative Energy	520	400	422	583	493
Gross rentals from investment properties	1	0	1	1	1
<b>Total Revenue</b>	<b>3,487</b>	<b>3,410</b>	<b>5,985</b>	<b>8,043</b>	<b>5,336</b>

Source: SBI E2-Capital, company data

**Table 5: Income Statement (HK\$ m)**

	FY12/11	FY12/12	FY12/13E	FY12/14E	FY12/15E
Revenue	3,487	3,410	5,985	8,043	5,336
Cost of Sales	(2,048)	(1,726)	(3,955)	(5,406)	(2,692)
<b>Gross Profit</b>	<b>1,438</b>	<b>1,684</b>	<b>2,030</b>	<b>2,637</b>	<b>2,643</b>
Other income	58	97	174	234	154
Administrative costs	(236)	(297)	(455)	(612)	(406)
<b>Profit from operation</b>	<b>1,260</b>	<b>1,483</b>	<b>1,749</b>	<b>2,259</b>	<b>2,392</b>
Finance costs	(241)	(313)	(484)	(697)	(601)
<b>Profit before taxation</b>	<b>1,020</b>	<b>1,171</b>	<b>1,265</b>	<b>1,563</b>	<b>1,791</b>
Income tax	(255)	(267)	(280)	(346)	(396)
<b>Profit from continuing operation</b>	<b>765</b>	<b>904</b>	<b>985</b>	<b>1,217</b>	<b>1,395</b>
Profit discontinued operation	80	250	0	0	0
<b>Profit for the year</b>	<b>845</b>	<b>1,154</b>	<b>985</b>	<b>1,217</b>	<b>1,395</b>
Profit attributable to shareholders	801	1,123	947	1,170	1,341
Minority interest	44	31	38	47	54

Source: SBI E2-Capital, company data

**Table 5: Per Share Items**

	FY12/11	FY12/12	FY12/13E	FY12/14E	FY12/15E
EPS (HKD cents)					
-basic	21.9	29.7	23.4	28.9	33.1
-diluted	21.7	29.5	23.4	28.9	33.1
DPS (HKD cents)	4.5	6.0	4.7	5.8	6.6
BVPS (HKD)	1.6	2.1	2.3	2.6	2.9

Source: SBI E2-Capital, company data

**Table 6: Balance Sheet (HK\$ m)**

	FY12/11	FY12/12	FY12/13E	FY12/14E	FY12/15E
<b>Non-Current Assets</b>					
PPE	888	1,471	1,430	1,386	1,335
Intangible assets	1,070	614	750	979	943
Other receivables and deposits	2,181	2,603	2,734	2,568	2,519
Gross amounts due from customers for contract work	5,963	6,890	10,092	14,693	15,914
Other	265	266	245	245	245
<b>Total Non-Current Assets</b>	<b>10,366</b>	<b>11,844</b>	<b>15,251</b>	<b>19,871</b>	<b>20,957</b>
<b>Current Assets</b>					
Inventories	43	65	82	118	43
Debtors, other receivables, deposits and prepayments	1,016	1,207	1,006	1,101	1,080
Gross amounts due from customers for contract work	553	644	915	1,333	1,443
Other	216	1,016	1,016	1,016	1,016
Cash and cash equivalent	1,684	1,807	2,765	3,204	88
<b>Total Current Assets</b>	<b>3,513</b>	<b>4,739</b>	<b>5,784</b>	<b>6,771</b>	<b>3,670</b>
<b>Total Assets</b>	<b>13,880</b>	<b>16,583</b>	<b>21,035</b>	<b>26,642</b>	<b>24,626</b>
<b>Current Liabilities</b>					
Bank loans	1,064	1,635	1,993	2,913	2,514
Creditors, other payables and accrued expenses	1,423	1,191	2,059	2,816	1,402
Current taxation	52	58	43	53	61
<b>Total Current Liabilities</b>	<b>2,539</b>	<b>2,884</b>	<b>4,095</b>	<b>5,782</b>	<b>3,977</b>
<b>Non-Current Liabilities</b>					
Bank loans	4,029	4,369	6,815	9,752	8,415
Other loans	177	0	0	0	0
Deferred tax liabilities	472	659	659	659	659
<b>Total Non Current Liabilities</b>	<b>4,679</b>	<b>5,028</b>	<b>7,474</b>	<b>10,412</b>	<b>9,074</b>
<b>Equity</b>					
Share capital	368	404	404	404	404
Reserves	5,822	7,946	8,711	9,656	10,739
Total Shareholder's Equity	6,190	8,350	9,115	10,060	11,143
Minority interest	472	321	351	389	432
<b>Total Equity</b>	<b>6,662</b>	<b>8,670</b>	<b>9,466</b>	<b>10,449</b>	<b>11,575</b>

Source: SBI E2-Capital, company data

**Table 7: Cash Flow Statement (HK\$ m)**

	FY12/11	FY12/12	FY12/13E	FY12/14E	FY12/15E
<b>Operating Cash flow</b>					
Profit before tax	1,135	1,459	1,265	1,563	1,791
Depreciation	27	53	49	50	50
Amortisation of intangible assets	30	29	17	17	36
Finance costs	247	315	484	697	601
Other	(7)	(261)	(42)	(51)	(56)
<b>Operating Cash flow before W/C</b>	<b>1,432</b>	<b>1,594</b>	<b>1,774</b>	<b>2,274</b>	<b>2,423</b>
Change in Working Capital	(832)	(1,766)	(2,525)	(4,249)	(2,616)
Interest received	14	25	42	51	56
Tax paid	(86)	(143)	(295)	(336)	(388)
<b>Cash flow from operation</b>	<b>528</b>	<b>(290)</b>	<b>(1,004)</b>	<b>(2,259)</b>	<b>(527)</b>
<b>Investing Activities</b>					
Purchases of PPE	(518)	(621)	(8)	(6)	0
Payment for additions of intangible assets	(428)	(103)	(153)	(245)	0
Other	72	(338)	21	0	0
<b>Cash flow from investing activities</b>	<b>(874)</b>	<b>(1,063)</b>	<b>(140)</b>	<b>(251)</b>	<b>0</b>
<b>Financing Activities</b>					
Proceeds from new bank loans	2,609	2,773	4,626	6,676	2,316
Repayment of bank loans	(1,423)	(1,815)	(1,823)	(2,818)	(4,053)
Interest paid	(247)	(315)	(484)	(697)	(601)
Dividend paid	(130)	(246)	(216)	(212)	(251)
Other	(167)	1,061	0	0	0
<b>Cash flow from financing activities</b>	<b>642</b>	<b>1,458</b>	<b>2,103</b>	<b>2,949</b>	<b>(2,589)</b>
Net increase in cash and cash equivalent	296	105	958	439	(3,116)
Cash and Cash equivalents at the Beginning of the year	1,341	1,684	1,807	2,765	3,204
Effect of foreign rate exchange	47	17	0	0	0
<b>Cash and Cash Equivalents at the End of the year</b>	<b>1,684</b>	<b>1,807</b>	<b>2,765</b>	<b>3,204</b>	<b>88</b>

Source: SBI E2-Capital, company data

**Initiate with BUY rating, with TP HK\$8.0** Our target price is based on a 2-stage DCF valuation, which gives us the fair equity valuation of CEI. Using a risk free rate of 2.4%, market risk premium of 11%, a beta of 1, and a 3% terminal growth rate after FY12/20E, we derived a fair value per share of HK\$8.0, which is equivalent to a prospective P/E of 34.2x for 2013E.

Over the past 5 years the Company had been trading at a 1-year prospective P/E of 17.8x, which is lower than the valuation derived from our DCF model. However, we believe DCF valuation is a more reasonable estimate of CEI's intrinsic value because: 1) it is not affected by the mismatch between earnings and cash flow under concession accounting method; 2) it prices in new projects obtained during the current year, which will contribute recurring income and operating cash flow to the company after they become operational in 1-2 years.

**Table 8: DCF Analysis**

	FY12/13E	FY12/14E	FY12/15E	FY12/16E	FY12/17E	FY12/18E	FY12/19E	FY12/20E
WACC@8.20%								
FCFF (HKD mn)	-1,145	-2,510	-527	1,720	2,709	2,970	2,967	2,955
Discount Factor	0.924	0.854	0.789	0.73	0.67	0.62	0.58	0.53
Discounted FCFF (HKD mn)	-1,058	-2,144	-416	1,255	1,826	1,850	1,708	1,573
PV of estimated FCFF (HKD mn)	4,595							
PV of terminal FCFF (HKD mn)	31,135							
Value of Firm (HKD mn)	35,730							
Minus: debt (HKD mn)	6,004							
Plus: cash and cash equivalent (HKD mn)	2,750							
Value of Equity (HKD mn)	32,476							
Total Share outstanding (mn)	4,054							
Equity Value per share (HKD)	8.01							

Source: SBI E2-Capital

**Table 9: Forecast Assumptions**

	FY12/13E	FY12/14E	FY12/15E
<b>WTE projects</b>			
Average waste processing capacity (1,000 tonne)	4,266	5,063	8,001
Average annual power generation (gwh)	868	1,107	2,048
Average on-grid tariff (RMB/kwh)	0.65	0.65	0.65
Soild waste treatment fees (RMB/tonne)	70	70	70
Hazardous waste treatment fees (RMB/tonne)	4,000	4,000	4,000
Industrial treatment fees (RMB/tonnes)	1,000	1,000	1,000
<b>WWT projects</b>			
Annual water supply/ waste water treatment capacity (1000 m <sup>3</sup> )	598,087	655,657	685,591
Water tariff (RMB/m <sup>3</sup> )	1.13	1.17	1.20
Reusable water price (RMB/m <sup>3</sup> )	5	5	5
<b>Alternative Energy projects</b>			
Energy Generated (gWh)	247	247	431
Effective tariff (RMB/kwh)	1.07	1.10	1.14

Source: SBI E2-Capital

**Risks** – Major risks include: 1) cancellation of favorable government policies; 2) delay or slowdown in construction progress; 3) reduction in utilization rate; 4) intense competition for new projects and 5) future placements that may dilute existing Shareholders.



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