

China Everbright Environment

Bloomberg: 257 HK EQUITY | Reuters: 0257.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

4 Mar 2022

BUY

Last Traded Price (3 Mar 2022): HK\$5.63 (HSI : 22,467)
Price Target 12-mth: HK\$6.90 (23% upside)

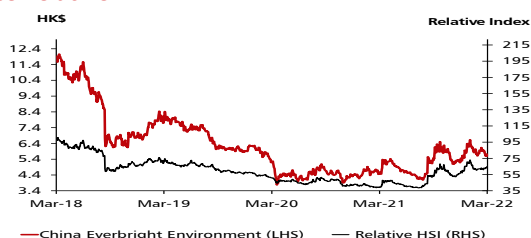
Analyst

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What's New

- A defensive play with >6% yield amid jittery market sentiment
- Rising waste treatment fee to offset loss of return from declining subsidy
- Incoming share price catalyst in the upcoming results from improving cashflows
- Market has ignored fundamental improvements, reiterate BUY on trough valuation with TP of HK\$6.90

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2020A	2021F	2022F	2023F
Turnover	42,926	53,559	52,656	40,605
EBITDA	12,754	15,433	17,496	18,216
Pre-tax Profit	9,387	11,044	12,200	12,480
Net Profit	6,016	7,612	8,440	8,655
Net Pft (Pre Ex) (core profit)	6,016	7,612	8,440	8,655
Net Profit Gth (Pre-ex) (%)	15.6	26.5	10.9	2.5
EPS (HK\$)	0.98	1.24	1.37	1.41
EPS Gth (%)	15.6	26.5	10.9	2.5
Diluted EPS (HK\$)	0.98	1.24	1.37	1.41
DPS (HK\$)	0.30	0.37	0.41	0.42
BV Per Share (HK\$)	7.34	8.27	9.25	10.24
PE (X)	5.7	4.5	4.1	4.0
P/Cash Flow (X)	nm	nm	nm	109.5
P/Free CF (X)	nm	nm	nm	nm
EV/EBITDA (X)	8.6	8.6	8.8	9.0
Net Div Yield (%)	5.3	6.6	7.3	7.5
P/Book Value (X)	0.8	0.7	0.6	0.5
Net Debt/Equity (X)	1.2	1.4	1.5	1.5
ROAE(%)	14.8	15.9	15.7	14.5
Earnings Rev (%):		Nil	Nil	Nil
Consensus EPS (HK\$)		1.20	1.28	1.35
Other Broker Recs:		B:17	S:1	H:4

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

A green defensive play with improving cashflow

Investment Thesis

A defensive play with trough valuation of around 6x. The environmental sector is relatively immune from the current Russia-Ukraine border tension and the subsequent potential downside risk in economic slowdown in China. We estimate it can achieve an 11-27% earnings growth in FY21-22, underpinned by a 13-35% growth in treatment volume/output and enhancement of operational efficiencies.

Cashflows to double from FY20. With strong growth in treatment volume, issuance of more asset-backed notes, and stringent cost control, management targets to improve adjusted operating cashflow (on PRC accounting standard) from HK\$5.2bn in FY20 to HK\$10bn within one to two years.

Climbing waste treatment fee. The average waste treatment fee of new waste-to-energy (WTE) projects is estimated at Rmb90/ton in 2021, up from Rmb77/ton in 2020. We expect that such an uptrend will continue in view of the climbing construction cost and environmental expenses. We believe a higher waste treatment fee can offset part of the shortfall in subsidy.

Valuation:

The stock is trading at an attractive FY22 PE of <5x. Even stripping out construction revenue, adjusted valuation remains undemanding at around 6x. Our target price (TP) is set at HK\$6.90, based on our target prices for China Everbright Water (1857 HK, HK\$2.10) and China Everbright Greentech (1257 HK, HK\$3.50) and 12x the 12-month rolling PE (adjusted for construction revenue) for WTE operations.

Where we differ:

We are more optimistic than the market on the growth outlook. Our FY22/23 earnings estimations are 3-6% higher than the market consensus.

Key Risks to Our View:

Slower-than-expected construction progress, fewer-than-expected project wins, and reduction of feed-in-tariffs for WTE and biomass plants will lead to lower earnings growth.

At A Glance

Issued Capital (m shrs)	6,143
Mkt Cap (HK\$m/US\$m)	34,585 / 4,425
Major Shareholders (%)	
China Everbright Holdings Co., Ltd.	43.0
Free Float (%)	57.0
3m Avg. Daily Val. (US\$m)	11.82
GICS Industry: Industrials / Commercial & Professional Service	



Watchlist the stock on Insights Direct to receive prompt updates



China Everbright Environment

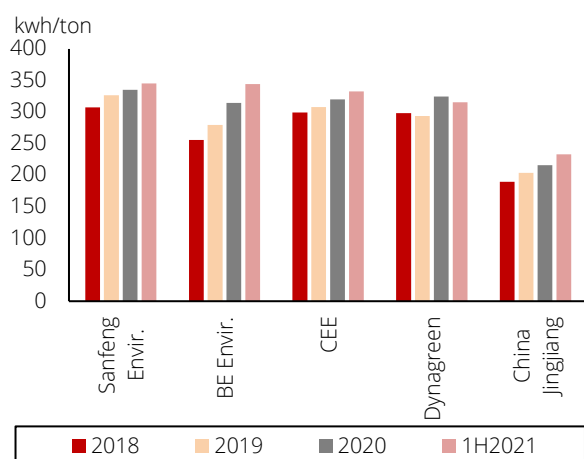
WHAT'S NEW

A high yield defensive play

China Everbright Environment's valuation has been range-trading between 3x to 5x in the past two years. We reckon investors have ignored a few positive trends which could be re-rating catalysts for the counter.

First, we reckon the internal rate of return (IRR) of WTE projects can still maintain at a reasonable level of at least 8-10%. Although WTE projects to be on-grid after the end of 2021 will be entitled to subsidy through competitive bidding, the uptrend in waste treatment of new projects can offset the loss of revenue in subsidy. In 2021, the average waste treatment fee of new projects was estimated at Rmb90 per tonne, compared with Rmb77 per tonne in 2020. We expect this trend to continue in 2022 in view of the climbing construction cost and environmental expenses.

Electricity generation per tonne

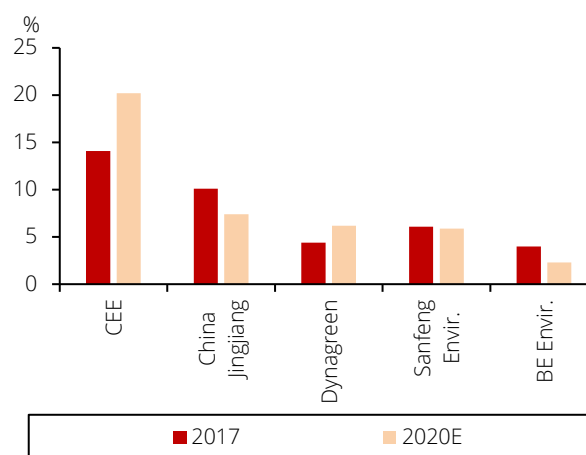


Source: Company, DBS HK

Secondly, CEE is able to continuously improve electricity generation per tonne of household waste for its WTE operation, from 299kWh/ton in 2018 to 333kWh/ton in 1H2021. This is achieved through i) adoption of more advanced grate furnace with at least two-thirds of its WTE projects using second generation equipment, and ii) more large scale projects with daily treatment capacity coming on stream, including WTE projects in Zhangjiakou, Xinyang, Yongzhou, and Xiangtan. The daily treatment capacity of these projects is at least 1,500 tonnes/day, compared with the average scale of 500-700 tonnes/day.

Third, CEE's early effort in project win is now bearing fruit with a climbing market share. We estimate that CEE's market share went from 14% in 2017 to 20% in 2020 and further to 30% in 2022, in terms of amount of treated household waste.

Market share in China WTE market



Source: Company, DBS HK

In addition, we expect the number of WTE projects under construction will decline starting 2022. Coupled with a stable capex plan for its water operation and a substantial cut in capex for its biomass business, we reckon CEE's capex has already peaked. Balance sheet is further strengthened by issue of asset-backed note (ABN) where China Everbright Greentech, CEE's investment arm in biomass and hazardous waste, issued its first ABN of Rmb569m in April 2021 with the remaining Rmb1.4bn expected to be issued before end of 2022. **Thus, we believe management's target of improving adjusted operating cashflow (on PRC standard) to HK\$10bn by 2022-23 from HK\$5.2bn in 2020 is achievable. We believe this will be a catalyst for the stock.**

Amid the current jittery investor sentiment with political tension at Ukraine border, China's environmental sector is relatively defensive and immune from the climbing oil / natural gas prices. Its operation is also less affected by the spread of omicron and we expect it to deliver 27% and 11% earnings growth for FY21 and FY22 respectively. The growth is underpinned by >30% growth in household waste

China Everbright Environment

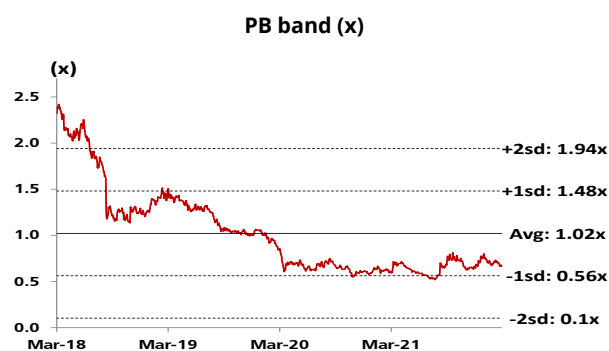
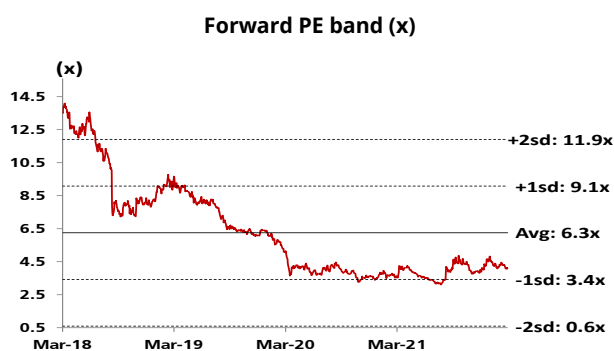
treatment volume, >25% growth in electricity generation and mid-teens growth in waste water treatment volume.

It is currently trading at an attractive FY22 PE of <5x. Even stripping out contribution from construction revenue, the adjusted valuation remains undemanding at around 6x. We reiterate our BUY rating with TP at HK\$6.90, based on our target prices for China Everbright Water (1857 HK, HK\$2.10) and China Everbright Greentech (1257 HK), HK\$3.50) and 12x the 12-month rolling PE (adjusted for construction revenue) for WTE operations.

Company Background

China Everbright Environment (CEE) is a comprehensive environmental service provider in China. Its services include waste-water treatment, waste-to-energy (WTE), and photovoltaic and biomass power generation.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

China Everbright Environment

Key Assumptions

FY Dec	2019A	2020A	2021F	2022F	2023F
Volume of treated sewage (m tons)	1,433.8	1,559.1	1,761.7	2,025.9	2,329.8
Volume of waste processed ('000 tons)	21,515.0	29,273.0	38,054.9	51,374.1	63,190.2
Amount of uploaded electricity (m kWh)	10,713.1	15,004.3	19,081.7	23,940.9	28,439.0

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenues (HK\$ m)					
Environmental Energy	21,538	26,127	37,942	35,966	22,036
Environmental Water	5,551	5,663	6,119	6,842	7,675
Greentech	9,279	9,832	8,089	8,327	9,251
Others	1,189	1,304	1,409	1,521	1,643
Total	37,558	42,927	53,559	52,656	40,605
Segmental profit (HK\$ m)					
Environmental Energy	6,661	7,999	9,884	11,238	11,053
Environmental Water	1,649	1,908	1,913	2,158	2,319
Greentech	2,891	3,113	1,925	2,017	2,052
Others	524	758	207	211	195
Total	11,726	13,779	13,929	15,623	15,619
Segmental profit Margins (%)					
Environmental Energy	30.9	30.6	26.1	31.2	50.2
Environmental Water	29.7	33.7	31.3	31.5	30.2
Greentech	31.2	31.7	23.8	24.2	22.2
Others	44.1	58.1	14.7	13.9	11.8
Total	31.2	32.1	26.0	29.7	38.5

Source: Company, DBS HK

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Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenue	37,558	42,926	53,559	52,656	40,605
Cost of Goods Sold	(26,100)	(28,823)	(36,430)	(34,234)	(22,720)
Gross Profit	11,458	14,104	17,129	18,423	17,885
Other Opng (Exp)/Inc	(1,807)	(2,754)	(3,641)	(3,302)	(2,392)
Operating Profit	9,651	11,350	13,488	15,121	15,493
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	268	219	186	205	226
Net Interest (Exp)/Inc	(1,655)	(2,182)	(2,630)	(3,126)	(3,238)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	8,264	9,387	11,044	12,200	12,480
Tax	(1,896)	(2,160)	(2,540)	(2,867)	(2,933)
Minority Interest	(1,165)	(1,211)	(893)	(893)	(893)
Preference Dividend	0	0	0	0	0
Net Profit	5,203	6,016	7,612	8,440	8,655
Net Profit before Except.	5,203	6,016	7,612	8,440	8,655
EBITDA	10,781	12,754	15,433	17,496	18,216
Growth					
Revenue Gth (%)	37.9	14.3	24.8	(1.7)	(22.9)
EBITDA Gth (%)	21.4	18.3	21.0	13.4	4.1
Opg Profit Gth (%)	19.1	17.6	18.8	12.1	2.5
Net Profit Gth (%)	20.5	15.6	26.5	10.9	2.5
Margins & Ratio					
Gross Margins (%)	30.5	32.9	32.0	35.0	44.0
Opg Profit Margin (%)	25.7	26.4	25.2	28.7	38.2
Net Profit Margin (%)	13.9	14.0	14.2	16.0	21.3
ROAE (%)	14.3	14.8	15.9	15.7	14.5
ROA (%)	4.4	4.3	4.2	3.9	3.7
ROCE (%)	7.1	7.1	6.4	6.0	5.6
Div Payout Ratio (%)	30.7	30.6	30.0	30.0	30.0
Net Interest Cover (x)	5.8	5.2	5.1	4.8	4.8

Source: Company, DBS HK

Interim Income Statement (HK\$ m)

FY Dec	1H2019	2H2019	1H2020	2H2020	1H2021
Revenue	16,226	21,332	18,378	24,549	26,495
Cost of Goods Sold	(10,573)	(15,527)	(11,888)	(16,934)	(17,995)
Gross Profit	5,653	5,805	6,489	7,615	8,501
Other Oper. (Exp)/Inc	(623)	(1,008)	(773)	(1,884)	(1,148)
Operating Profit	5,030	4,797	5,716	5,730	7,353
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	95	172	112	108	68
Net Interest (Exp)/Inc	(829)	(1,002)	(1,132)	(1,147)	(1,437)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	4,297	3,967	4,696	4,691	5,984
Tax	(1,047)	(849)	(1,066)	(1,094)	(1,380)
Minority Interest	(620)	(545)	(601)	(610)	(717)
Net Profit	2,630	2,573	3,029	2,987	3,887
Net profit bef Except.	2,630	2,573	3,029	2,987	3,887
Growth					
Revenue Gth (%)	37.7	38.1	13.3	15.1	44.2
Opg Profit Gth (%)	23.6	15.8	13.6	19.5	28.6
Net Profit Gth (%)	19.5	21.5	15.2	16.1	28.3
Margins					
Gross Margins (%)	34.8	27.2	35.3	31.0	32.1
Opg Profit Margins (%)	31.0	22.5	31.1	23.3	27.8
Net Profit Margins (%)	16.2	12.1	16.5	12.2	14.7

Source: Company, DBS HK

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Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Net Fixed Assets	5,395	7,114	7,860	8,593	9,303
Invt in Associates & JVs	1,545	1,507	1,406	1,289	1,153
Other LT Assets	82,202	111,131	139,711	161,510	165,894
Cash & ST Invt	11,743	10,861	23,030	18,430	14,212
Inventory	824	1,059	1,071	1,053	812
Debtors	17,083	25,670	30,803	36,964	44,357
Other Current Assets	560	845	3,214	2,633	1,624
Total Assets	119,352	158,187	207,096	230,471	237,355
ST Debt	10,468	10,499	11,099	11,599	12,099
Creditors	14,012	18,194	24,307	24,950	19,240
Other Current Liab	192	213	213	213	213
LT Debt	42,712	64,480	99,168	113,499	117,653
Other LT Liabilities	7,242	9,257	10,157	11,107	12,057
Shareholder's Equity	36,347	45,062	50,777	56,835	62,932
Minority Interests	8,380	10,483	11,375	12,268	13,160
Total Cap. & Liab.	119,352	158,187	207,096	230,471	237,355
Non-Cash Wkg. Capital	4,263	9,167	10,568	15,487	27,340
Net Cash/(Debt)	(41,437)	(64,118)	(87,237)	(106,669)	(115,541)
Debtors Turn (avg days)	166.0	181.8	192.4	234.9	365.5
Creditors Turn (avg days)	202.7	212.7	223.7	280.4	398.8
Inventory Turn (avg days)	11.9	12.4	11.2	12.1	16.8
Asset Turnover (x)	0.3	0.3	0.3	0.2	0.2
Current Ratio (x)	1.2	1.3	1.6	1.6	1.9
Quick Ratio (x)	1.2	1.3	1.5	1.5	1.9
Net Debt/Equity (X)	0.9	1.2	1.4	1.5	1.5
Net Debt/Equity ex MI (X)	1.1	1.4	1.7	1.9	1.8
Capex to Debt (%)	1.2	2.0	1.1	1.1	1.1
Z-Score (X)	1.1	1.0	0.9	0.9	0.9

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Pre-Tax Profit	8,264	9,387	11,044	12,200	12,480
Dep. & Amort.	863	1,186	1,758	2,170	2,498
Tax Paid	(573)	(965)	(1,640)	(1,917)	(1,983)
Assoc. & JV Inc/(loss)	(268)	(219)	(186)	(205)	(226)
(Pft)/ Loss on disposal of FAs	2	158	0	0	0
Chg in Wkg.Cap.	(17,297)	(21,688)	(23,078)	(21,776)	(15,692)
Other Operating CF	1,521	3,955	2,630	3,126	3,238
Net Operating CF	(7,487)	(8,186)	(9,472)	(6,402)	316
Capital Exp.(net)	(625)	(1,480)	(1,258)	(1,321)	(1,387)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	(293)	265	0	0	0
Div from Assoc & JV	0	0	288	322	362
Other Investing CF	(4,602)	(7,031)	(8,150)	(6,522)	(2,367)
Net Investing CF	(5,520)	(8,246)	(9,120)	(7,521)	(3,392)
Div Paid	(1,705)	(1,659)	(1,896)	(2,383)	(2,558)
Chg in Gross Debt	14,896	19,052	35,288	14,831	4,654
Capital Issues	0	0	0	0	0
Other Financing CF	(418)	(2,427)	(2,630)	(3,126)	(3,238)
Net Financing CF	12,773	14,966	30,762	9,323	(1,142)
Currency Adjustments	(159)	584	0	0	0
Chg in Cash	(394)	(882)	12,170	(4,601)	(4,218)
Opg CFPS (HK\$)	1.60	2.20	2.21	2.50	2.61
Free CFPS (HK\$)	(1.32)	(1.57)	(1.75)	(1.26)	(0.17)

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	12-Mar-21	HK\$4.85	HK\$6.60	Buy
2:	13-Aug-21	HK\$4.95	HK\$6.90	Buy

Source: DBS HK

Analyst: Patricia Yeung
Ian Chui

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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