

China Everbright Water Limited

Sluggish growth ahead

16 November 2016

SINGAPORE | UTILITIES | RESULTS

- HK\$1,879mn revenue met 74% of our full year expectations of HK\$2,536mn.
- HK\$687mn gross profit met 61% of our full year expectations of HK\$1,135mn.
- HK\$286mn net profit met 54% of our full year expectations of HK\$527mn.
- Due to lower than expected performance in 9M16, we revise downwards our FY17e net profit forecast by 29% to HK\$475mn, implying expected EPS of 18.2 HK cents (3.2 SG cents). We maintain our **"Accumulate"** call with a lowered TP of **S\$0.63 (from S\$0.69)**, implying a potential return of 18.4% from closing price.

Results at a glance

(HK\$ mn)	9M16	9M15	y-y (%)	Comments
Revenue	1,879.3	1,356.3	↑ 38.6	Due mainly to the increase construction revenue from the expansion and upgrading projects
Gross profit	686.8	634.3	↑ 8.3	Due mainly to the increase in construction services whose margin is lower than the operation segment
Operating profit	580.6	520.4	↑ 11.6	HK\$91mn of value-added tax refund was offset by HK\$53mn of FX losses due to financing leases pegged to USD as RMB depreciated
Net profit	285.6	312.6	↓ (8.6)	Due to the increase of finance costs, resulting from more borrowings, as well as the increase of tax expenses

Source: Company, Phillip Securities Research (Singapore)

Unfavourable sales mix shift to lower margin segment; Shrinking gross profit margin is likely to continue into 1HFY17

The sales mix is c.48% Construction Revenue to c.35% Operation Revenue in 9M16, as compared to 9M15's c.35% Construction Revenue to c.39% Operation Revenue. Gross profit margin ("GPM") for Construction Services is less than half of Operation Services'. 9M16 GPM for Construction Services was c.21%, while Operating Services' was 50%. These resulted in 10.2 percentage points lower GPM at 36.5% in 9M16. Management guided that the group needs to accelerate the construction in 4QFY16 and FY17. Currently, the construction process of several projects, such as Sponge City and upgrading works on Dongda's plants, are falling behind the schedule. In addition, China Everbright Water Limited ("CEWL") was also subjected to HK\$29mn of value-added tax, which further suppress GPM. Therefore, we expect that gross profit growth will remain single digit in 4Q16 and 1HFY17.

Multiple measures to alleviate interest burden and FX risks

The group incurred one-off HK\$53mn of FX losses due to the liquidation of several financing leases pegged to USD. In Jul-16, CEWL repaid its last piece of USD denominated financing lease worth of US\$73mn, which resulted in HK\$7mn losses in 3Q16. As of Sep-16, RMB and foreign currency (USD & HKD) denominated loans took up 62% and 38% of HK\$5bn of total borrowings respectively. Moving forward, CEWL will gradually take up heavier weight in RMB debts. Besides, the group has been refinancing loans for lower interest rates. According to management, the borrowing cost averaged at 4.1% per annum in 9M16 as compared to 4.8% in 9M15. Moreover, CEWL's solid financing backup could lower its borrowing cost further. The current banking facilities amounted to RMB9.3bn, of which RMB5bn is from China Development Bank, RMB2.5bn is from AAA-rated Panda bonds, and the remaining c.RMB1.8bn is from other foreign and domestic banks.

Accumulate (Maintained)

CLOSING PRICE	SGD 0.535
FORECAST DIV	SGD 0.004
TARGET PRICE	SGD 0.630
TOTAL RETURN	18.4%

COMPANY DATA

OS SHARES (MN) :	883
MARKET CAP (USD mn / SGD mn) :	619 / 892
52 - WK HI/LO (SGD) :	1.1 / 0.97
3M Average Daily T.O (mn) :	1.16

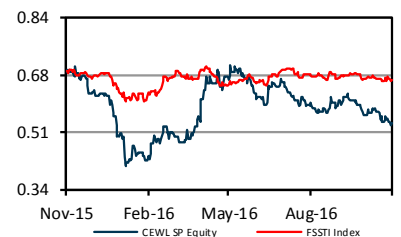
MAJOR SHAREHOLDERS (%)

CHINA EVERBRIGHT WATER HLDS LTD	74.3%
HUEI ALAN WANG YU	3.1%
DALVEY ASSET HOLDING LTD	2.7%
DAWEI CHEN	1.9%
INTERNATIONAL FINANCE CORP	1.9%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	0.0	(2.9)	8.1
STI RETURN	(4.6)	(9.2)	(16.5)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec, HK\$ mn	FY 15	FY 16e	FY 17e	FY 18e
Revenue	1,815	2,530	3,194	3,983
Gross profit	824	887	1,055	1,261
Net profit	424	395	475	542
P/E (x)	20.7	24.0	19.9	17.4
P/B (x)	1.2	1.3	1.2	1.1
EV/EBITDA	15.0	14.9	12.7	11.2
Dividend (SG Cents)	0.4	0.3	0.4	0.4
Dividend Yield, %	0.6%	0.6%	0.6%	0.6%

Source: Company Data, PSR est.

VALUATION METHOD

P/E Multiple (PER): 19.8x

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Hurdles that CEWL is confronting

Liaoning's economic contraction in 1H16 (ranked bottom in China) resulted in fiscal pressure in the province. Correspondingly, CEWL faced two challenges in terms of Dongda's projects: (i) waste water treatment plant updates and tariff hike, and (ii) collection of receivables. According to the guidance from management, there are three upgrades of Dalian's projects lag behind the expectation. Currently, the negotiation with local government is being conducted, but both parties have not sealed the contracts yet. Due to transition to a new local government, the issue of collection of receivables will be set aside temporarily. However, CEWL has assigned specific teams to actively follow up the issue. The possible solution is that local government could clear partial payables to CEWL through assets other than cash. However, the group will assess the economic feasibility of the solution. Management still has faith in working out the issues, since the China central government supports Private Public Partnership (PPP) model not only by favourable policies, but also by fiscal funding.

Investment Action

Lower GPM, FX losses, and higher tax expenses weighed against CEWL's 9M16 performance. Moving forward, we expect weaker FY17 profitability as lower GPM erodes the bottom line. We revise our FY17 EPS forecast downwards by 29% from 4.5 SG cents to 3.2 SG cents. We maintain our "Accumulate" call with a reduced TP of S\$0.63, based on lower estimated EPS of 3.2 SG cents, and the average forward PER of 19.8x.

Peer comparison

Company	Bloomberg Ticker	Mkt Cap (SGD mn)	EV (SGD mn)	EV/EBITDA TTM	P/E	FRW P/E	P/B	Net D/E (%)	ROA (%)	ROE (%)
China Everbright Water Ltd	CEWL SP	1,396.6	2,135.4	15.2	20.2	17.0	1.1	41.8	2.9	5.3
Singapore										
SIIC Environment Holdings Ltd	SIIC SP	1354.0	2236.5	15.8	16.2	14.4	1.1	42.8	3.3	7.2
Hong Kong										
Beijing Enterprises Water Group Ltd	371 HK	8,645.98	14,714.2	16.3	16.5	15.6	2.8	121.6	4.4	17.2
CT Environmental Group Ltd	1363 HK	2,334.28	2,721.1	12.5	16.3	16.2	3.7	56.0	13.4	25.7
China Water Affairs Group Ltd	855 HK	1,471.56	2,826.2	7.8	14.8	12.5	1.8	63.5	3.2	12.9
Average				12.2	15.9	14.8	2.8	80.4	7.0	18.6
China										
Beijing Originwater Technology Co Ltd	300070 CH	11,729.2	11,675.1	25.7	36.2	27.3	4.0	Net Cash	8.2	11.6
Chongqing Water Group Co Ltd	601158 CH	7,915.7	7,483.3	15.4	27.1	25.8	2.8	Net Cash	7.4	10.8
Guangxi Nanning Waterworks Co Ltd	601368 CH	2,026.9	2,478.5	24.7	37.4	N/A	3.8	77.1	3.7	11.6
Tianjin Capital Environmental Protection Group Co Ltd	600874 CH	2,293.1	2,474.2	165.2	35.0	25.7	2.8	26.9	3.6	8.2
Jiangsu Jiangnan Water Co Ltd	601199 CH	1,667.4	1,551.3	177.7	24.4	24.4	3.3	Net Cash	8.2	14.4
Wuhan Sanzhen Industry Holding Co Ltd	600168 CH	1,634.7	2,038.9	169.9	23.7	20.7	1.8	33.8	4.1	7.6
Heilongjiang Interchina Water Treatment Co Ltd	600187 CH	1,995.9	2,203.9	N/A	N/A	N/A	3.8	20.6	-1.8	-3.0
Average				96.4	30.6	24.8	3.2	39.6	4.8	8.7

Source: Bloomberg, Phillip Securities Research (Singapore) Estimates

Financials

Income Statement

Y/E Dec, HK\$ mn	FY14	FY15	FY16e	FY17e	FY18e
Revenue	1,051	1,815	2,530	3,194	3,983
Cost of sales	(454)	(991)	(1,643)	(2,139)	(2,722)
Gross profit	596	824	887	1,055	1,261
Other income	13	104	129	177	191
Other operating expenses	(9)	(10)	-	-	-
Administrative expenses	(78)	(204)	(272)	(359)	(463)
Operating profit	523	714	744	872	989
Finance income	2	10	6	6	6
Finance costs	(92)	(128)	(193)	(209)	(233)
Profit before tax	433	596	557	670	763
Income tax	(119)	(172)	(161)	(194)	(221)
Net profit	314	424	395	475	542

Per share data

Y/E Dec	FY14	FY15	FY16e	FY17e	FY18e
EPS (HK Cents)	12.6	16.2	15.2	18.2	20.8
EPS (SG Cents)	2.2	3.0	2.7	3.2	3.7
DPS (HK Cents)	N/A	1.9	1.8	2.2	2.5
DPS (SG Cents)	N/A	0.35	0.32	0.38	0.43
BVPS (HK\$)	2.5	2.7	2.8	3.0	3.2
BVPS (SG Cents)	43.4	49.5	49.0	52.3	55.8

The HKD/SGD rate is based on Bloomberg forward rate as of 6th May 2016

Cash Flow

Y/E Dec, HK\$ mn	FY14	FY15	FY16e	FY17e	FY18e
CFO					
Profit before tax	433	596	557	670	763
Adjustments	122	166	285	321	365
WC changes	(173)	(635)	(530)	(705)	(633)
Cash generated from ops	382	128	311	285	494
Others	(65)	(95)	(161)	(194)	(221)
Cashflow from operations	317	33	149	91	273
CFI					
CAPEX, net	(3)	(10)	(14)	(18)	(23)
Acquisition of subsidiaries	431	(2,163)	-	-	-
Others	3	(4)	6	6	6
Cashflow from investments	430	(2,177)	(8)	(11)	(16)
CFF					
Share issuance, net	-	659	-	-	-
Loans, net of repayments	(149)	2,909	400	600	500
Dividends	-	-	(50)	(47)	(56)
Others	(339)	(614)	(193)	(209)	(233)
Cashflow from financing	(488)	2,954	157	345	211
Net change in cash	259	809	299	424	468
Effects of exchange rate	(6)	(20)	-	-	-
Ending cash	499	1289	1587	2011	2479

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Balance Sheet

Y/E Dec, HK\$ mn	FY14	FY15	FY16e	FY17e	FY18e
ASSETS					
Cash and cash equivalents	681	1,769	2,108	2,591	3,109
Trade and other receivables	331	642	745	864	991
Financial receivables	667	893	766	790	723
Inventories	29	11	10	10	10
Total current assets	1,709	3,315	3,629	4,256	4,834
PP&E	174	163	162	166	175
Financial receivables	6,219	7,713	8,471	9,180	9,931
Intangible assets	951	1,440	1,362	1,264	1,146
Goodwill	1,044	1,269	1,269	1,269	1,269
Trade and other receivables	16	40	46	53	61
Total non-current assets	8,403	10,624	11,310	11,932	12,581
Total Assets	10,112	13,939	14,939	16,189	17,415
LIABILITIES					
Borrowings	763	2,395	2,395	2,395	2,395
Trade and other payables	600	475	685	840	1,025
Other financial liabilities	23	-	-	-	-
Current tax liabilities	20	52	52	52	52
Total current liabilities	1,405	2,922	3,132	3,287	3,472
Borrowings	1,062	2,424	2,824	3,424	3,924
Other payables	264	241	241	241	241
Deferred tax liabilities	829	1,055	1,080	1,080	1,080
Total non-current liabilities	2,155	3,720	4,144	4,744	5,244
Total liabilities	3,560	6,642	7,276	8,032	8,717
Shareholders equity	6,325	7,061	7,256	7,725	8,237
Non-controlling interests	226	236	406	432	461

Valuation Ratios

Y/E Dec	FY14	FY15	FY16e	FY17e	FY18e
P/E(x)	46.4	20.7	24.0	19.9	17.4
P/B (x)	2.3	1.2	1.3	1.2	1.1
EV/EBITDA (x)	28.7	15.0	14.9	12.7	11.2

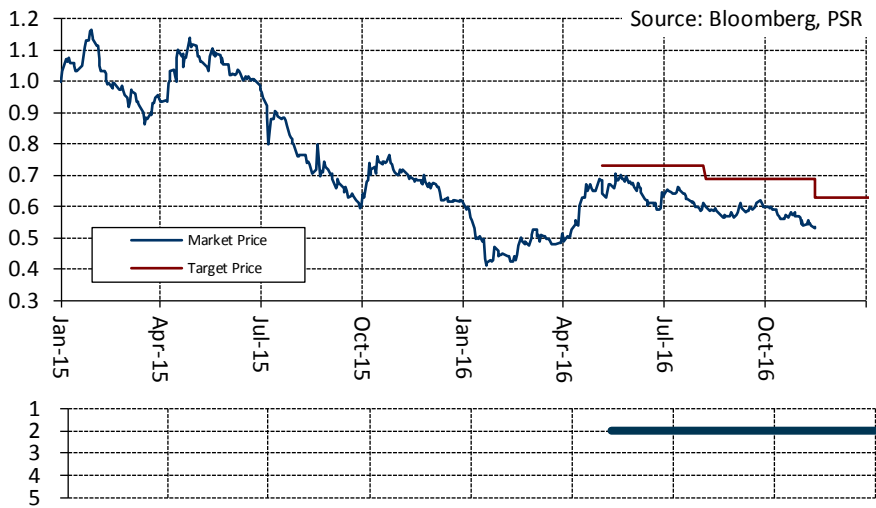
Growth & Margins (%)

Growth					
Revenue	-19%	73%	39%	26%	25%
Gross profit	13%	38%	8%	19%	20%
EBIT	10%	37%	4%	17%	13%
NPAT	8%	35%	-7%	20%	14%
Margins					
GPM	56.8%	45.4%	35.1%	33.0%	31.7%
OPM	49.8%	39.4%	29.4%	27.3%	24.8%
NPM	29.9%	23.3%	15.6%	14.9%	13.6%

Key Ratios

ROE (%)	5%	6%	5%	6%	6%
ROA (%)	3%	3%	3%	3%	3%
Dividend Yield (%)	N/A	0.6%	0.5%	0.6%	0.7%
Net Debt or (Net Cash)	1,143	3,049	3,111	3,227	3,209
Gearing (%)	35%	48%	49%	50%	50%

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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