



Clear waters ahead; initiating on SIIC and CEW with Buy

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Positive view reaffirmed; top picks: SIIC and CEW

The newly-announced Water Pollution Control Plan and the unprecedented government focus on environmental protection reaffirm our positive view on the water industry. Large-cap SOE stocks have been traded strongly, we now see more upside for smaller SOE players. They have a higher growth rate, more potential to surprise and beat market expectations, and a more attractive valuation. We initiate coverage on SIIC Environment (SIIC) and China Everbright Water (CEW) with Buy and designate them as our sector top picks.

Key Changes

Company	Target Price	Rating
CEWL.SI	- to 1.32(SGD)	NR to Buy
SIIC.SI	- to 0.28(SGD)	NR to Buy
0270.HK	12.00 to 12.30(HKD)	-
0257.HK	11.80 to 14.00(HKD)	-

Source: Deutsche Bank

Top picks

SIIC Environment (SIIC.SI),SGD0.21	Buy
China Everbright Water (CEWL.SI),SGD1.02	Buy

Source: Deutsche Bank

Pollution control plan unveiled; over RMB1.9tr investment needed by 2020

The Water Pollution Control Plan released in April will lead to over RMB1.9tr of total investment in the water industry by 2020, as estimated by the Ministry of Environmental Protection. More detailed implementation plans and the 13th five-year plans will be announced by central and local governments in 2H15-2016, unveiling tightening discharge rules, paving the way for water tariff hikes, and promoting the involvement of specialist operators.

Strong growth upholds premium valuation, leading SOEs to gain market share

New project wins should remain strong over the next few years, supporting premium valuations for the sector. Leading SOEs can gain market share in the currently scattered municipal water industry, leveraging on their better relationship with local governments and access to cheap financing. Management with a commercially-driven mindset, good employee incentive plans, and a wider footprint also help. BEWG, as the role model for the new SOE, has proven to be successful. We believe SIIC and CEW can emulate BEWG's strong growth and emerge as leading SOE players in the sector.

Smaller players still under-researched; initiating SIIC and CEW with Buy

We see greater upside potential for SIIC and CEW. These smaller players are under-researched, and the market (including us) has relatively conservative expectations for them while the track record is still being built. Compared to BEWG and CEI, SIIC offers higher earnings growth but is trading at over a 10% discount on 2015E EV/EBIT. A potential dual listing in Hong Kong and an asset injection could also be positive share price catalysts. Valuation multiples for CEW appear high in 2015, as adjusted earnings growth could be temporarily affected by the reverse takeover of HanKore. However, the strong growth will resume from 2016, with a 43% adjusted earnings CAGR in 2015-17E, the highest among peers. CEW could gain from the good reputation and synergy of its parent CEI in getting new projects. It may also consider listing in Hong Kong to improve its trading liquidity. Please see individual company sections for valuation/risks.

Maintaining Buy on BEWG and GDI and Hold on CEI

BEWG is still fundamentally the best company in the water industry, with the unique advantage of a motivated private management team and track record. We also remain positive on GDI on dividend lift and potential upside from water project acquisitions. We are revising our price target for CEI mainly to incorporate higher growth in the water industry through the 74.4% stake in CEW, but we maintain a Hold rating on valuation. Please see individual company sections for valuation/risks.



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Investment summary

More upside potential for smaller names; top picks: SIIC and CEW

The environmental stocks have risen 26% on average since the beginning of 2014 and 22% YTD, largely in line with the MSCI China Index. Although the valuation is not cheap for the sector, we expect increasing policy support, good momentum in new project wins and strong earnings growth to support a premium valuation, as the Chinese government realises the urgency to control pollution and the large capex required.

We are initiating coverage of SIIC and CEW with Buy and have designated them our sector top picks with more upside potential than for peers'. We remain positive on BEWG and GDI and keep our Hold rating on CEI.

Valuation comparison

We think the risk-reward is more attractive for the smaller SOE companies (SIIC and CEW) than larger market cap names (BEWG and CEI). In comparing valuations, we think EV/EBIT is more meaningful than P/E considering different gearing levels. All else being equal, P/E tends to be lower for a company with higher gearing, as the cost of equity increases as gearing rises.

Figure 1: Valuation comps

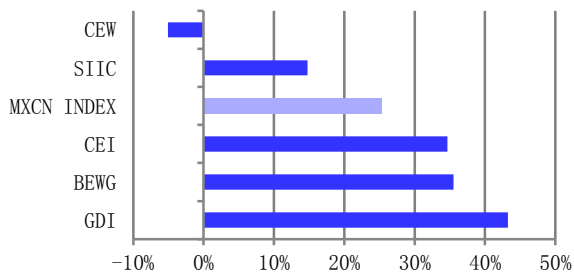
Share price as of June 5, 2015		Valuations										Returns & Gearing (%)										
Company	Ticker	Price	Rating	Price target	% to target	Mkt. Cap. US\$m	avg. daily trade US\$, 1m	EPS CAGR 2015-17E	Earnings CAGR 2015-17E	EV/EBIT 15E	16E	17E	PE 15E	16E	17E	P/BV 15E	Net debt/Total capital 15E	16E	15E	16E	15E	16E
On reported earnings basis (concession accounting)																						
SIIC Environment	SIIC SP	SGD0.21	Buy	SGD0.28	33%	1,725	4.3	32%	35%	20.3	17.2	14.5	29.7	22.7	17.1	2.2	21.9	36.2	8.0	9.2	0.0	0.7
CEW	CEWL SP	SGD1.025	Buy	SGD1.32	29%	1,969	2.7	45%	46%	21.0	15.4	13.0	33.5	21.6	16.0	2.1	5.9	21.0	6.5	9.1	0.0	0.5
BEWG	371 HK	HKD6.6	Buy	HKD7.20	9%	5,832	13.0	22%	22%	18.4	14.7	13.2	26.2	20.5	17.7	2.6	51.3	54.0	13.0	15.5	1.4	1.8
GDI	270 HK	HKD10.86	Buy	HKD12.30	13%	8,703	11.6	11%	11%	14.0	12.5	9.2	17.5	16.0	14.2	2.1	(33.7)	(42.7)	12.4	12.8	3.0	3.7
CEI	257 HK	HKD13.98	Hold	HKD14.00	0%	8,057	11.2	25%	25%	18.4	15.1	11.4	26.8	20.6	17.0	3.5	25.3	37.2	13.6	15.9	0.9	1.2
Average ex. GDI								31%	32%	19.5	15.6	13.0	29.1	21.3	16.9	2.6	26.1	37.1	10.3	12.4	0.6	1.0
On adjusted earnings basis (normal accounting)																						
SIIC Environment	SIIC SP	SGD0.21						32%	35%	27.3	22.6	19.0	38.3	29.0	22.1				6.5	7.6		
CEW	CEWL SP	SGD1.025						42%	43%	32.4	25.9	20.1	53.4	38.5	26.6				4.2	5.4		
BEWG	371 HK	HKD6.6						26%	27%	31.5	24.3	20.3	38.2	29.7	23.9				9.6	11.9		
GDI	270 HK	HKD10.86						11%	11%	14.0	12.5	9.2	17.5	16.0	14.2				12.4	12.8		
CEI	257 HK	HKD13.98						27%	27%	31.4	26.0	21.9	50.2	39.3	31.2				8.1	9.8		
Average ex. GDI								32%	33%	30.6	24.7	20.3	45.0	34.1	26.0				7.1	8.7		

Source: Deutsche Bank, Bloomberg Finance LP

As shown in the figures below, the large-cap names, including CEI, BEWG and GDI, are relatively well-owned by institutional investors and have outperformed since the beginning of 2014. The shares for smaller names are more volatile and underperforming. Of these, we think SIIC and CEW are high-quality SOE companies, which have ambitious strategies and are well positioned to grow in capacity. We believe they have the potential to copy the success of BEWG over the next few years.

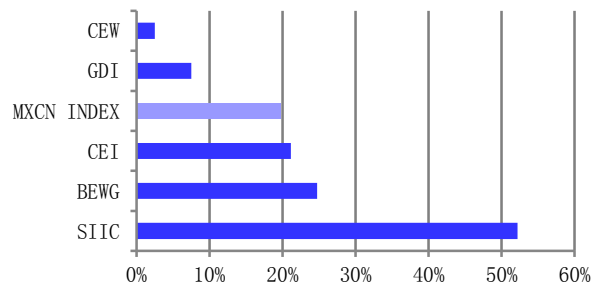


Figure 2: Share price return since 1 Jan 2014



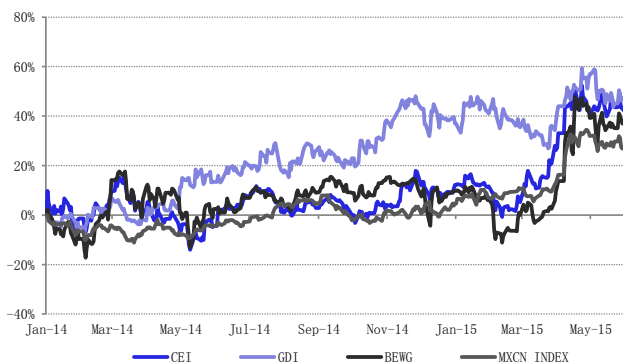
Note: Date as of 5 June 2015
 Source: Deutsche Bank, Bloomberg Finance LP

Figure 3: Share price return YTD



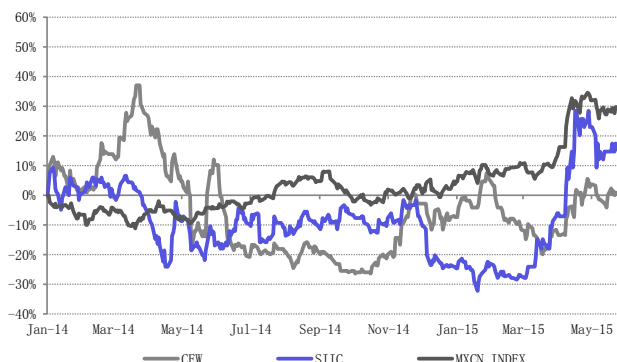
Note: Date as of 5 June 2015
 Source: Deutsche Bank, Bloomberg Finance LP

Figure 4: Share price performance since 1 Jan 2014 – big names



Source: Deutsche Bank, Bloomberg Finance LP

Figure 5: Share price performance since 1 Jan 2014 – smaller names



Source: Deutsche Bank, Bloomberg Finance LP

SIIC Environment (SIIC): We expect over 30% share price upside potential for SIIC. The company aims to add 1-1.5mt/d of designed capacity annually from 5.4mt/d as at end-2014. We expect the company to deliver an adjusted earnings CAGR of 35% in 2015-17E, driven by a c.30% CAGR in average operational capacity, economies of scale and a reduction in the borrowing rate. SIIC's earnings growth is higher than the c.27% average for BEWG and CEI, but it is trading at more than a 10% discount in terms of 2015E adjusted EV/EBIT compared to the two larger names.

Higher growth but cheaper valuation for SIIC

We think a potential dual listing in Hong Kong and an asset injection could serve as positive share price catalysts for SIIC. The company could also benefit the most from the tightening discharge rules and the upgrading of existing facilities, with the largest proportion of sub-Grade 1A projects.

Potential dual listing and asset injection could be catalysts

China Everbright Water (CEW): We expect c.28% share price upside potential for CEW. CEW management intends to become one of the leading water companies in China, with designed capacity increasing from 3.4mt/d by end-2014 to over 10mt/d in 3-5 years' time. The reputation and synergy of its parent CEI should help in getting new projects.

Reputation and synergy with CEI help growth

CEW's 2015 adjusted earnings growth could be relatively muted at c.20% due to disproportionately higher SG&A expenses from the consolidation of HanKore after the completion of the reverse takeover (RTO) in December 2014. More expensive borrowings from HanKore will be refinanced with cheaper

Strong growth to resume in 2016, after temporary impact of HanKore RTO



debt during the course of 2015, resulting in a higher average interest rate in 2015 before normalising again in 2016. We expect an adjusted-earnings CAGR of 43% in 2015-17E from the low base. Therefore, although CEW's valuation multiple appears high in 2015E, it still looks attractive, given it has the highest growth rate in the sector.

Only five brokers cover SIIC and only one covers CEW. Market expectations, including our own, are relatively conservative for these smaller players, as they are still building up their track record. Therefore, there could be more potential for them to deliver positive surprises in new project wins, especially considering their lower base. Every 1mt/d of extra capacity is equivalent to 18% and 30% of the 2016E average operational capacity for SIIC and CEW, respectively.

More upside for smaller players to beat market expectation

Both companies are currently Singapore-listed but could consider dual listing in Hong Kong, which would improve their liquidity, attract more investor interest, and remove the valuation discount.

Beijing Enterprises Water (BEWG): We believe BEWG deserves a premium valuation as the industry leader with the unique advantage of having a motivated private management team and cheap SOE funding. We think BEWG can deliver growth even higher than the market expects. Although the upside potential to our price target has narrowed to about 10%, we still view this as a long-term core investment. BEWG's adjusted P/E looks the lowest among peers. This is partly due to its highest gearing levels. On an adjusted EV/EBIT basis, BEWG is still trading at a discount to CEI for 2016-17.

China Everbright International (CEI): CEI is the most expensive among peers on both an adjusted P/E and adjusted EV/EBIT basis. We are lifting our price target for CEI mainly to incorporate the higher growth in the water industry through the 74.4% stake in CEW, but we maintain our Hold rating, as we believe the valuation has already priced in the strong growth. We think its strong project pipeline, and therefore the non-cash construction profits under concession accounting, could sustain strong reported earnings growth in the next few years and, in turn, a high valuation. However, further upside in the share price depends on maintaining a high rate of project wins, given that market expectations are already high.

Guangdong Investment (GDI): As GDI is not a growth stock, its valuation matrix is not directly comparable to other high growth environmental stocks. GDI is more comparable to Hong Kong utilities, which are trading at c.17x P/E and with a 3.3% dividend yield on average. GDI is trading largely on a par with HK utilities in terms of 2015E P/E, but with a 9ppt higher EPS CAGR in 2015-17E. Although GDI's 2015E dividend yield is lower at 3.0%, its free cash flow yield should increase to c.10% in 2017 (compared to c.4% for HK utilities). We expect the company to gradually increase its dividend payout ratio by c.5ppt annually.

Please note that we adjust for the impact from concession accounting in our valuation comparison (as is the case for all of the companies under discussion in this report, unless otherwise specified), by excluding the non-cash construction profits, construction cost savings (if any), and effectively fewer depreciation charges compared to normal accounting (as financial receivables are amortised using the effective interest method instead of on a straight-line basis), as shown in Figure 6 and Figure 7 below.



The earnings distortion is highest for CEI (at nearly 50%), due to a large amount of construction activities for WTE BOT projects and relatively higher gross margin booked for BOT construction revenue (15-20% for WTE projects plus another c.10% from construction cost saving, vs. 23.9% for BEWG, c.25% for CEW and c.12% for SIIC).

Figure 6: Reconciliation from concession accounting to normal accounting for SIIC and CEW

(Rmb m)	2014	2015E	2016E	2017E	(HK\$ m)	2014	2015E	2016E	2017E
SIIC					CEW				
Reported recurring profits - concession accounti	229	340	471	625	Reported recurring profits - concession accounti	293	449	708	957
Less: Construction profit	(28)	(56)	(72)	(90)	Less: Construction profit	(13)	(132)	(322)	(389)
Less: Construction cost saving	-	-	-	-	Less: Construction cost saving	(10)	-	-	-
Add: Amortisation of financial assets	69	80	115	182	Add: Amortisation of financial assets	112	184	210	296
Less: Depreciation	(113)	(140)	(192)	(291)	Less: Depreciation	(176)	(280)	(310)	(423)
Total adjustment before tax and MI	(72)	(115)	(148)	(199)	Total adjustment before tax and MI	(87)	(229)	(422)	(516)
Total adjustment after tax and MI	(42)	(75)	(100)	(138)	Total adjustment after tax and MI	(59)	(164)	(307)	(377)
Recurring profits under normal accounting	188	266	371	487	Recurring profits under normal accounting	234	285	401	580
Diff, normal vs. concession	18%	22%	21%	22%	Diff, normal vs. concession	20%	36%	43%	39%
Recurring EPS - concession accounting (HK\$)	0.02	0.03	0.04	0.06	Recurring EPS - concession accounting (HK\$)	0.15	0.17	0.27	0.37
Recurring EPS - normal accounting (HK\$)	0.02	0.03	0.03	0.04	Recurring EPS - normal accounting (HK\$)	0.12	0.11	0.15	0.22
PE reported (x)	29.7	22.7	17.1		PE reported (x)	33.5	21.6	16.0	
PE adjusted to normal accounting (x)	38.3	29.0	22.1		PE adjusted to normal accounting (x)	53.4	38.5	26.6	
EV/EBIT adjusted to normal accounting (x)	27.3	22.6	19.0		EV/EBIT adjusted to normal accounting (x)	32.4	25.9	20.1	

Note: Prices as of xx June 2015
 Source: Company data, Deutsche Bank estimates

Figure 7: Reconciliation from concession accounting to normal accounting for BEWG and CEI

(HK\$ m)	2014	2015E	2016E	2017E	(HK\$ m)	2014	2015E	2016E	2017E
BEWG					CEI				
Reported recurring profits - concession accounti	1,611	2,202	2,835	3,301	Reported recurring profits - concession accounti	1,703	2,341	3,050	3,683
Less: Construction profit	(587)	(773)	(1,000)	(958)	Less: Construction profit	(519)	(1,034)	(1,689)	(1,634)
Less: Construction cost saving	-	-	-	-	Less: Construction cost saving	(269)	(292)	(199)	(537)
Add: Amortisation of financial assets	444	544	737	979	Add: Amortisation of financial assets	337	464	698	1,018
Less: Depreciation	(601)	(788)	(1,013)	(1,287)	Less: Depreciation	(437)	(592)	(805)	(1,163)
Total adjustment before tax and MI	(744)	(1,016)	(1,276)	(1,266)	Total adjustment before tax and MI	(888)	(1,455)	(1,995)	(2,316)
Total adjustment after tax and MI	(459)	(696)	(873)	(866)	Total adjustment after tax and MI	(669)	(1,094)	(1,455)	(1,673)
Recurring profits under normal accounting	1,152	1,507	1,962	2,434	Recurring profits under normal accounting	1,034	1,247	1,595	2,011
Diff, normal vs. concession	29%	32%	31%	26%	Diff, normal vs. concession	39%	47%	48%	45%
Recurring EPS - concession accounting (HK\$)	0.19	0.25	0.32	0.37	Recurring EPS - concession accounting (HK\$)	0.38	0.52	0.68	0.82
Recurring EPS - normal accounting (HK\$)	0.13	0.17	0.22	0.28	Recurring EPS - normal accounting (HK\$)	0.23	0.28	0.36	0.45
PE reported (x)	26.2	20.5	17.7		PE reported (x)	26.8	20.6	17.0	
PE adjusted to normal accounting (x)	38.2	29.7	23.9		PE adjusted to normal accounting (x)	50.2	39.3	31.2	
EV/EBIT adjusted to normal accounting (x)	31.5	24.3	20.3		EV/EBIT adjusted to normal accounting (x)	31.4	26.0	21.9	

Note: Prices as of 5 June 2015
 Source: Company data, Deutsche Bank estimates

Peer comparison

We compare major operational and financial matrices for the water companies below.

GDI enjoys the highest unlevered return (measured by EBIT over invested capital) due to its profitable raw water supply business to Hong Kong. Despite its net cash position, it still earns the highest ROE among peers.

CEI also has a relatively high unlevered return (measured by adjusted EBIT under normal accounting over invested capital, as is the case below) because of the higher return profile for its waste-to-energy (WTE) business. The company had previously mentioned that the equity IRR for WTE is c.12-15% vs. 10-12% for wastewater projects. Its ROE is lower than BEWG, however, due to its lower gearing.

Among the three pure water players, unlevered returns for CEW were highest in 2014 (excluding the impact of the reverse takeover of HanKore in December



2014), because its projects were mainly self-constructed before 2010 (without an acquisition premium) and are more mature. Its return declined in 2015 temporarily, after the consolidation of HanKore and the consideration shares issued. We expect the return to improve for all three water companies in 2015-17, with the increasing utilisation rate and assets being amortised down on existing projects, and due to economies of scale.

Apart from the unlevered return, the differences in ROE among the three pure water players can be explained by different gearing levels. We expect ROE to improve as the companies continue to leverage up to a higher but still-acceptable gearing level.

Figure 8: Return and gearing comparison, adjusted for concession accounting

	2014	2015E	2016E	2017E
ROE, adjusted				
BEWG	8.1%	9.6%	11.9%	13.8%
SIIC	6.0%	6.5%	7.6%	9.4%
CEW	8.5%	4.2%	5.4%	7.3%
CEI	7.4%	8.1%	9.8%	11.6%
GDI	12.5%	12.4%	12.8%	13.5%
Net debt to equity				
BEWG	90%	104%	116%	127%
SIIC	34%	27%	56%	78%
CEW	24%	11%	28%	54%
CEI	22%	34%	59%	89%
GDI	-28%	-27%	-31%	-39%
Adjusted EBIT over invested capital				
BEWG	7.5%	6.9%	8.2%	9.1%
SIIC	7.6%	7.5%	8.1%	8.4%
CEW	9.9%	6.2%	7.5%	8.7%
CEI	10.2%	10.1%	10.6%	10.6%
GDI	18.7%	16.8%	17.4%	20.2%

Source: Deutsche Bank estimates, Company data

Of the pure water players, we consider BEWG is still fundamentally the best, with the unique advantage of a motivated private management team and track record. BEWG has larger capacity (Figure 10 & Figure 11) and a wider nationwide footprint, so all regional offices can go after new projects. Meanwhile, both SIIC and CEW are credible SOE companies and meet all the key criteria for becoming leading players in the Chinese water industry (Figure 9).

BEWG and CEW had similar wastewater utilisation rates and unit cash gross profits in 2014. SIIC's unit gross profit (ex. O&M projects) appeared low. We think this is because a relatively high proportion (about 60-70% vs. 45% for BEWG and 20% for CEW) of its existing projects are projects with lower than Grade 1A discharge standards and, in turn, a lower unit investment cost (Figure 14 and Figure 15).

Figure 9: Key criteria to becoming a leading environmental player

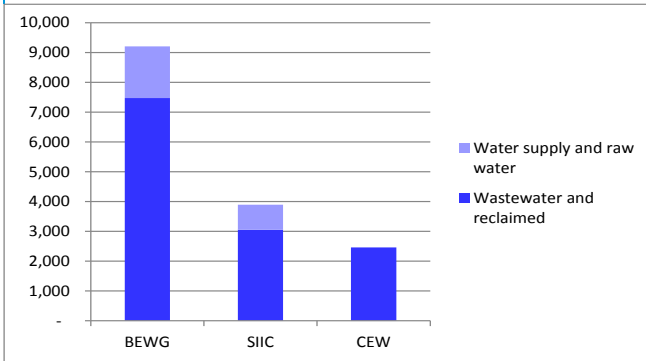
	SOE	Low funding cost	Nationwide footprint	Management shares/share options	Other performance-driven incentives/bonus	Corporate culture	Room to gear up
SIIC	Yes, local gov owned	Yes, 5.9% in 2014, trending down in future	Yes, 15 provinces presence	Share (share option) incentive schemes in place since 2012, but no shares/options granted yet	Improving	Improving	Yes, net debt/equity of 34% by end-2014
CEW	Yes, central gov owned	Yes, 5.2% in 2014, higher in 2015E, but new borrowing rate trending below 5%	Partly, 5 provinces presence but with synergy from CEI's other businesses in sourcing new projects	Partly; only some employees originally from HanKore have shares (fully exercised from options granted in 2013)	Yes	Improving	Yes, net debt/equity of 17% by end-2014
BEWG	Yes, local gov owned	Yes, 5.2% in 2014, newly secured 7-year bond at 3.9% rate	Yes, 23 provinces presence	Yes, management holds c.7% stake and employee share options of c.5% stake	Yes	Best and unique, with private management team acquired by Beijing Enterprises Holdings	Yes, but to a lesser extent, net debt/equity of 91% by end-2014
GDI	Yes, local gov owned	Yes, 2.5% in 2014	No, mainly in Guangdong	Yes, but management's effective stake is c.0.6%	Not quite	Improving; but management tend to be more conservative	Yes, significant net cash position
CEI	Yes, central gov owned	Yes, 4.7% in 2014	Partly, 9 provinces presence	Partly, last round of share option scheme adopted in 2003 already expired in 2013 (with options granted in 2003/2006), so only some long-serving employees have shares	Yes	Improving	Yes, net debt/equity of 22% by end-2014

Source: Deutsche Bank, Company data



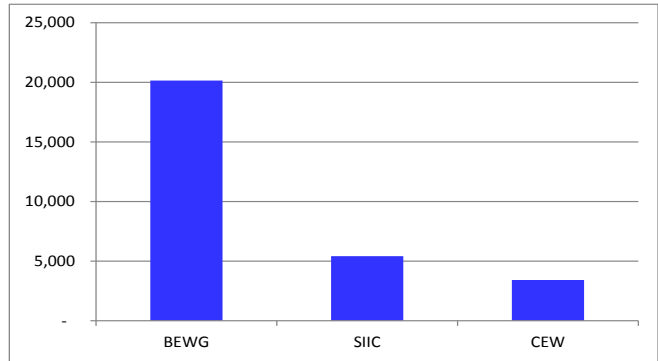


Figure 10: Consolidated operational capacity (kt/d), end-2014



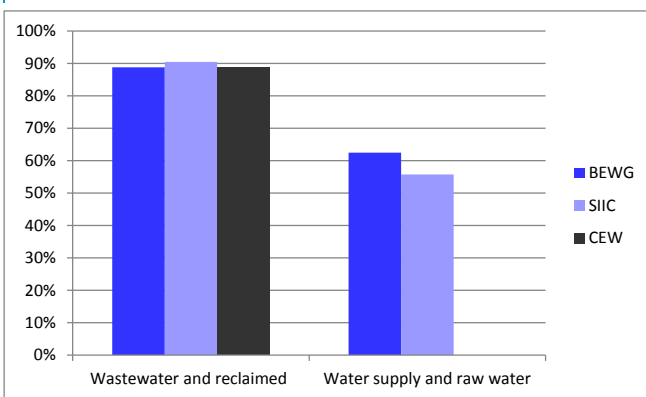
Source: Deutsche Bank, Company data

Figure 11: Total designed capacity (kt/d), end-2014



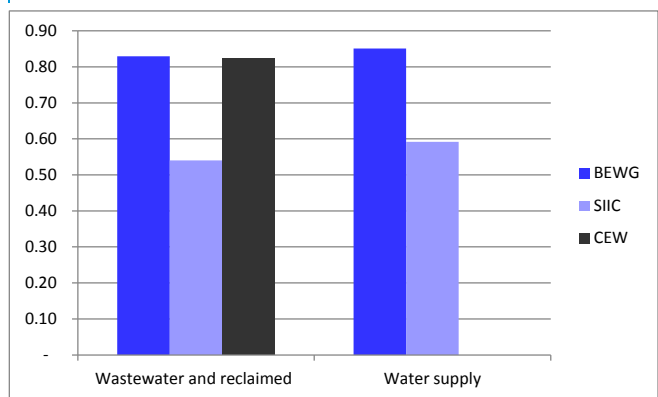
Note: On all entity basis, except for SIIC where it only includes the attributable 25% stake in Longjiang in calculating its 5.4mt/d total designed capacity by end-2014
 Source: Deutsche Bank, Company data

Figure 12: Utilisation rate, 2014



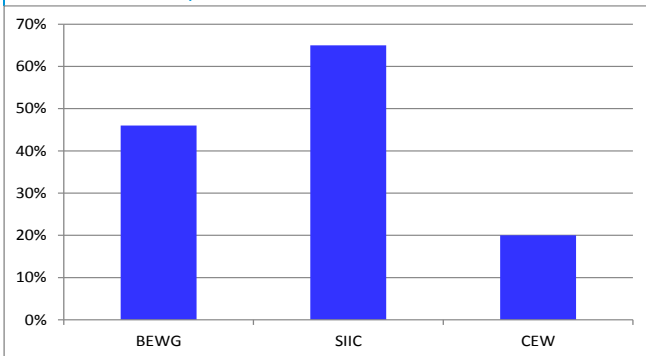
Source: Deutsche Bank, Company data

Figure 13: Estimated unit cash gross profit (RMB/cum)



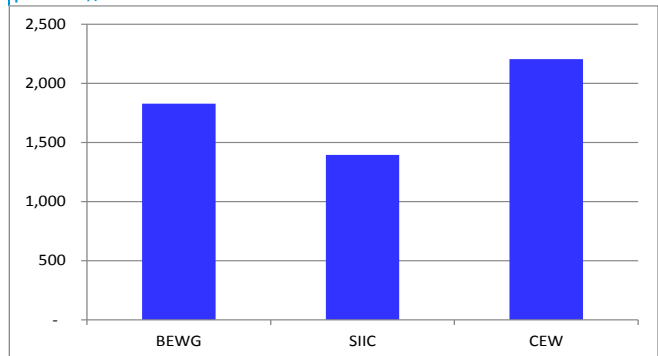
Note: The data for SIIC excludes the gross profits and volumes under O&M service
 Source: Deutsche Bank estimates, Company data

Figure 14: Proportion of projects with discharge standard below Grade 1A, end-2014



Source: Deutsche Bank, Company data

Figure 15: Estimated average unit investment cost (RMB per t/d), end-2014



Note: The unit investment cost is estimated by using gross amount for financial receivables and intangible assets (excluding construction profit), divided by consolidated operational capacity by year-end. Source: Deutsche Bank, Company data



Increasing policy support

There has been an increasing focus on environmental protection from both the public and the government in China. With pollution levels at an alarming high, the Chinese government has declared war on pollution. It is determined to curb the illegal discharge of pollutants and is increasing policy support to encourage investment in the environmental protection sector, as shown in Figure 16.

Figure 16: Major government policies on environmental protection

Document title	Government agency	Key message	Date
Anti Soil pollution action plan	China State Council (To be approved)	<ul style="list-style-type: none"> * Include 5 technical guidances on soil pollution * Total market size for soil pollution control to reach Rmb690bn by 2020 	2016 (est)
Innovate financing methods, expand financing channels	The People's Bank of China (To be approved)	<ul style="list-style-type: none"> * Support the development of innovative financing mechanisms, allow companies to use emission rights as collateral * Encourage government to introduce private investors in construction projects through public-private partnership 	1H15 (est)
Promote pilot project on trading of emission rights and carbon emissions rights	Ministry of Finance (To be approved)	<ul style="list-style-type: none"> * Promoting the pilot scheme for the paid use and trading of emission right * Accelerates the adjustment of the discharge standard for major pollutants, and implements differentiated pollutant fee policy 	1H15 (est)
Water Pollution Control Action Plan	China State Council	<ul style="list-style-type: none"> * Fully restore the water eco system by 2050 * Improve municipal water discharge standards to 1A by 2017 * Reduce industrial wastewater pollution discharge * Promote water conservation * Local government to be held responsible for environmental standards 	Apr-15
Wastewater tariff adjustment plan	NDRC, Ministry of Finance	<ul style="list-style-type: none"> * Set the minimum wastewater treatment fees charged to end-users in urban areas to be achieved by end-2016: in cities should be no less than Rmb0.95/t for households and Rmb1.4/t for nonresidential; while in counties and towns, it should be no less than Rmb0.85/t for households and Rmb1.2/t for nonresidential. 	Jan-15
Promote third-party control of environmental pollution	China State Council	<ul style="list-style-type: none"> * Encourage polluting enterprises to purchase services from pollution treatment enterprises * Encourage government to purchase environmental monitoring services from market * Build a list of recommended pollution treatment enterprises to pollution emitters in key industries 	Jan-15
Notice on the enhanced law enforcement on environmental protection	China State Council	<ul style="list-style-type: none"> * Ask to improve environmental laws, regulations and standards * Introduce "zero-tolerance" on polluting industries, black lists of repeated offenders, and greater scrutiny from general public via 12369 Hotline 	Dec-14
Guidance on encouraging innovative financing mechanism and promote social investment in key sectors	China State Council	<ul style="list-style-type: none"> * Encourage social capital to participate in the construction and operation of water supply and water conservancy project through public-private partnership (PPP) * Improve water price formation mechanism * Government will prioritize support for projects invested by social capital via subsidies, capital injection, low-interest loan, etc. 	Nov-14
Accelerate the implementation of progressive water tariff	NDRC	<ul style="list-style-type: none"> * Implement progressive water tariff throughout China by 2015 * Three tiered water tariff system: Tier 1, accounts for 80% of total usage; tier 2 accounts for the remaining 15% and tier 3 accounts for the last 5 percent * Pricing ratio split: Tier 1: Tier 2 : Tier 3, 1: 1.5: 3 * Water supply enterprise to publicly released information on their operating cost 	Dec-13
Regulations on Municipal Water drainage and water treatment	China State Council	<ul style="list-style-type: none"> * First regulation set on the water drainage market * Promote privatisation; encourage the use of concession agreements * Set construction, design, operations, standards for the water treatment industry * Water treatment fee collected from the end users (residential/industrial) needs to be at least as high as the operating cost of the water treatment plant * Water treatment fees collected can only be used for the operation/construction of water treatment plants 	Oct-13
Accelerate the development of the environmental protection industry	China State Council	<ul style="list-style-type: none"> * Total output value of the environmental protection industries will increase by 15% CAGR by 2015 to Rmb4.5 trillion and form a new pillar industry for China's economic growth * Key areas of environmental protection: denitrification and desulphurization equipment, new water treatment technologies and equipment, integrated system solution for solid waste treatment, technologies for remediation of contaminated soil, development and application of environmental monitoring instruments. * By 2015, wastewater treatment capacity to increase to 200mn tons/day and solid waste treatment capacity to increase to 870,000tons/day 	Aug-13
12th Five Year Plan on Municipal Waste Treatment and Municipal Water treatment	China State Council	<ul style="list-style-type: none"> * Wastewater treatment capacity target of 208mn tons/by 2015 vs. 125mn in 2010 * Wastewater treatment rate to reach 85% by 2015 vs. 77.5% in 2010 * Water recycling to increase to 15% vs. <10% in 2010 * Solid waste treatment capacity of 871,000tons.day by 2015 vs. 456,917tons/day in 2010 * Municipal waste incineration capacity to account for 35% (20% in 2010) of waste treated by 2015 (coastal region at 48%) * Municipal waste treatment rate to reach 90% by 2015 vs. 63.5% in 2010 	Apr-12

Source: Deutsche Bank, Water Pollution Control Plan

Tightening pollution control

The amendment of the Environmental Protection Law came into effect from 1 January 2015. It reinforces government responsibility and authority in supervising and monitoring environmental pollution. It specifies that environmental protection will be key in the **performance evaluation of local government officials**. It also emphasises total volume control of pollutant discharges and **removes the cap on fines** that can be charged to polluters.



On 16 April 2015, the State Council released the **Water Pollution Control Plan**, with an emphasis on pollution control and water conservation. Unlike previous government plans that set targets on new project capacity and total investment, this action plan is results-oriented. It sets out **quantitative targets on quality improvement for the main water bodies by 2020 and 2030** and a longer-term vision by around 2050 to fully restore the water eco-system.

Figure 17: Key points of the Water Pollution Control Plan

Content	Key Point
Result oriented target	<ul style="list-style-type: none"> *The quality of over 70%/75% of water in the seven key river basins to reach Level III or above by 2020/2030 *The quality of over 93%/95% of centralized drinking water sources in prefecture level cities and above to reach no less than Level III by 2020/2030. *The amount of foul water in urban built-up areas to be controlled within 10% of total water by 2020 and to be fully eliminated by 2030. *Fully restore the water eco system by 2050
Fully control the pollution discharged	<ul style="list-style-type: none"> *Polluting industries should apply technologies to reduce pollution discharged. *Companies, which fail to meet the requirement, will be forced to shut down. *All the industrial parks should be equipped with wastewater treatment facilities with online monitoring by end-2017 (and end-2016 for key regions). *1A discharge standard are required to meet by end-2017 for all the municipal wastewater treatment plants in environmentally sensitive areas and all the new builds in cities with poor quality water resources. *Municipal wastewater treatment rate should reach 85% in counties and 95% in cities by 2020. *Municipal sludge treatment rate should reach 90% by 2020.
Promote economic restructuring and upgrading	<ul style="list-style-type: none"> *To promote usage of reclaimed water and seawater
Promote water conservation	<ul style="list-style-type: none"> *Reduce the leakage rate of water supply pipeline to 12% and 10% by 2017 and 2020, respectively. *Contain the national total water consumption to below 670bcm by 2020. *To promote usage of reclaimed water and seawater *To reduce water consumption per GDP and per VAI by 35% and 30%, respectively, vs. the 2013 level.
Improve technology support	<ul style="list-style-type: none"> *To encourage R&D on leading technologies *Accelerate the development of environmental protection service industry.
Improve price mechanism	<ul style="list-style-type: none"> *Adopt progressive water tariff by end-2015 for households and by end-2020 for non-residential users in all cities and counties. *Diversify financing methods. *Establish incentive mechanism to promote water treatment.
Stricter supervision	<ul style="list-style-type: none"> *Relevant law enforcement and supervision will be stricter. *Environmental violations and illegal projects will be severely punished
Strengthen water management	<ul style="list-style-type: none"> *Strictly control the amount of pollutions discharged. *Implement wastewater discharge permit system.
Ensure the safety of water eco system	<ul style="list-style-type: none"> *Ensure the safety of drinking water sources. *Treat polluted underground water and river basins.
Clarified the duty of all parties	<ul style="list-style-type: none"> *Local governments are held responsible for carrying out the plan. *Local government officials will be held responsible for their misconduct in environment regulation, with lifetime liability even after their retire.
Encourage public involvement	<ul style="list-style-type: none"> *Encourage information transparency *Encourage oversight from the public.

Source: Deutsche Bank, the State Council

According to the plan, all the municipal wastewater treatment plants in environmentally sensitive areas and all the new builds in cities with poor-quality water resources are **required to meet 1A discharge standards by end-2017**. The treatment rate should reach 85% in counties and 95% in cities by 2020. All cities and counties should adopt the progressive water tariff by end-2015 for households and by end-2020 for non-residential users. The wastewater treatment tariff will be raised to fully cover the wastewater and sludge treatment cost.

The local governments are held responsible for carrying out the plan. Local government officials will be held responsible for their misconduct in environmental regulation, **with a lifetime liability even after they retire**. Detailed action plans are required to be released by local governments by end-2015.

According to the Ministry of Environmental Protection (MEP), the estimated **investment needed for environmental protection will reach c.RMB17tr** in 2016-



2020, following the issuance of the Air Pollution Control Plan (released in Sept 2013), Water Pollution Control Plan (released on 16 Apr 2015) and Soil Pollution Control Plan (already submitted to the State Council for approval).

Encouraging social investment

The Chinese government has been actively calling for social investment in the environmental protection and public utilities sectors. The local governments, especially those with limited funding, also have the incentive to invite specialist companies to invest in new projects as well as transfer/monetise the existing projects in operation, given the large amount of capex needed in the water sector to build new facilities and upgrade existing ones.

The Ministry of Finance (MoF) unveiled the first batch of 30 PPP demonstration projects with total investment of RMB180bn in Nov 2014. According to the 21st Century report on 7 June 2015, of all the PPP projects that are shown in the NDRC's database, **365 PPP projects (or 35% of total) with total investment of RMB168bn are in the environmental industry**. Of these environmental PPP projects, **most are in the water industry**, mainly wastewater treatment, recycling water, water supply and water environmental renovation projects. The waste treatment industry also has some PPP projects, including WTE, landfill, and solid/medical waste treatment etc.

For the water industry specifically, on 27 April 2015, the MEP and MOF jointly issued **guidance on promoting the cooperation between government and social capital in water protection**. Under the guidance, the local governments are encouraged to adopt the PPP (public-private partnership) model in all areas of water pollution control, including municipal and industrial wastewater, pipeline construction, water environmental renovation etc. The government should provide favourable financial policy support for PPP projects.

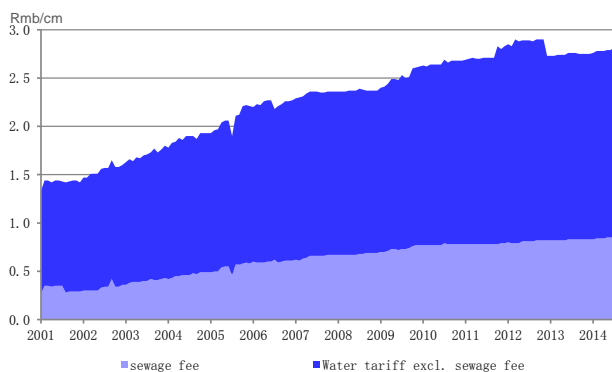
With stricter control over local government funding vehicles and more demonstration projects being rolled out, an increasing number of existing water assets owned by the local governments will come to the market, in our view.

Improving pricing mechanism for water tariffs

China's water tariff is relatively low by international standards. We expect water tariff hikes in China to accelerate, as the current water pricing mechanism is being reviewed to improve returns to encourage investment from the market.

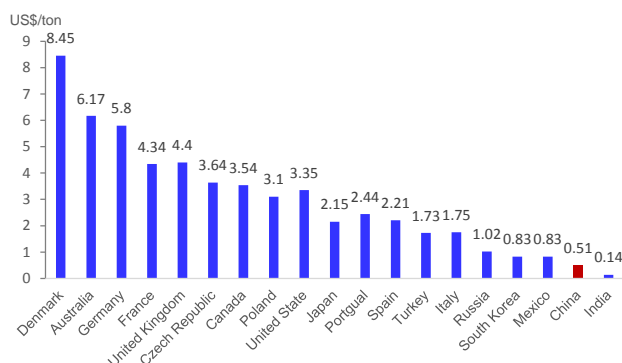


Figure 18: Water prices for 36 major cities in China



Source: CEIC

Figure 19: 2013 water tariffs by country



Source: Global water intelligence, Various Government website

- Implementing tiered water tariffs; cost transparency to be improved

The NDRC requires **all the cities to implement tiered water tariffs by the end of 2015**, according to the policy announced in January 2014. It specifies the tier-one tariff should cover 80% of water consumption, tier-two 15% and tier-three the remaining 5%. The tier-two tariffs should be at least 1.5x tier-one tariffs and tier-three at least 3x tier-one. The implementation of a tiered water tariff alone **should bring a water tariff hike of c.20%, even if there is no lift in tier-one tariff**. The recently-announced Water Pollution Control Plan also reiterated that all cities and counties are required to adopt a progressive water tariff by end-2015 for households and by end-2020 for non-residential users.

Tiered water tariff by end-2015

In addition, the government also requires **more transparent cost disclosure** for water supply utilities to the public. We think this could put pressure on local governments to improve operating efficiency and profitability, potentially by bringing in expertise from third-party specialist operators.

We believe tiered water tariff mechanisms, together with gradual water tariff hikes, and more efficient and transparent cost control should help improve profitability for water supply companies, although this is likely to be a gradual process as end-user tariff hikes for households require a public hearing.

Figure 20: Recent implementation of tiered water tariff and avg tariff hike

City	Province	Water usage per household (ton/month)	Previous water tariff (Rmb/ton)	Adjusted water tariff (Rmb/ton)	Note	Average water tariff hike
Beijing	Beijing	<=15	1.7	2.07	Effective from 1 May 2014	51%
		15-26.7	1.7	4.07		
		>26.7	1.7	6.07		
Jinan	Shandong	<=12	1.85	2.8	Effective from 1 May 2015	78%
		12-24	1.85	4.2		
		>24	1.85	8.4		
Wuxi	Jiangsu	<=15	1.66	2.36	Effective from 1 Mar 2015	66%
		15-25	1.66	3.46		
		>25	1.66	6.96		
Shijiazhuang	Hebei	<=10	2.5	2.5	To be effective from 1 Jun 2015	18%
		10-15	2.5	3.75		
		>15	2.5	7.5		
Nantong	Jiangsu	<=15	1.32	1.58	Held the hearing on 6 Jun	32%
		15-25	1.32	2.37		
		>25	2.64	4.74		
Qingdao	Shandong	<=10	1.8	2.26 / 2.76	Will hold the hearing on 15 Jun	48%
		10-17	1.8	3.39 / 4.14		
		>17	1.8	6.78 / 8.28		
Changde	Hunan	<=15	1.42	1.9	Will hold the price hearing on 17 Jun	37%
		15-25	2.13	2.85		
		>25	2.84	5.7		

Note: Average water tariff hike is estimated by assuming tier one, tier two and tier three tariffs cover 80%, 15% and 5% of water consumption. The average water tariff hike for Qingdao is calculated using the lower set of tariff changes proposed.
 Source: Deutsche Bank, Government release



- Higher end-user wastewater treatment fees will indirectly benefit operators

The central government released a **notice in Jan 2015 to establish and adjust the standard wastewater treatment fee**. According to the notice, by end-2016, the end-user wastewater treatment fee in cities should be no less than RMB0.95/t for households and RMB1.4/t for nonresidential; while in counties and towns, it should be no less than RMB0.85/t for households and RMB1.2/t for nonresidential. This compares to the average household wastewater treatment fee of RMB0.85/t in Dec 2014 in the 36 major cities (per CEIC). The local governments can raise the tariff further if it is not sufficient to cover the treatment cost and generate a reasonable profit. The notice requires the provincial governments to formulate plans for raising the wastewater treatment fee and to update the central government on implementation progress by year-end.

Minimum wastewater treatment fee by end-2016

Wastewater treatment project operators do not benefit directly from higher end-user water tariffs (because of the cost pass-through mechanism agreed upon in the concession agreement). However, this would imply that the local governments would be better enabled, in financial terms, to cope with new construction, upgrading of existing facilities to meet tighter discharge standards, and sludge treatment. Operators should benefit indirectly from more investment opportunities and the potentially higher return on incremental investment in upgrading existing projects.

- Returns for water projects to improve, especially for water supply

Returns in the water industry have been improving in the past few years but are still low in general. According to CEIC, the industry average pre-tax return on equity was only c.3.3% in the water sector in 2014. However, large listed specialist operators earned an average ROE of 9% in 2014, much better than the industry average.

Returns for listed water companies better than industry average

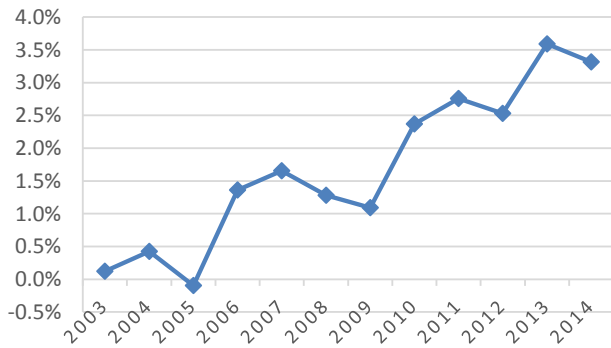
We think this is because the majority of water assets are still run by public utilities owned by the local governments. They are not primarily in pursuit of returns and are less efficient. By contrast, specialist operators are more return-driven: they demand higher tariffs and run projects more efficiently and benefit from economies of scale. This implies room for cost saving and return improvement if the projects are transferred from local governments to specialist operators.

In addition, the water supply sector has lower returns than wastewater projects, as shown in Figure 23 and Figure 24. We think this is because of low water supply tariffs (to cover both the treatment cost and pipelines), low involvement of private sector investment, and high proportion of non-revenue-generating volume (water lost through pipeline leakage or unbilled consumption) for the water supply industry.

Water supply has a lower but improving return

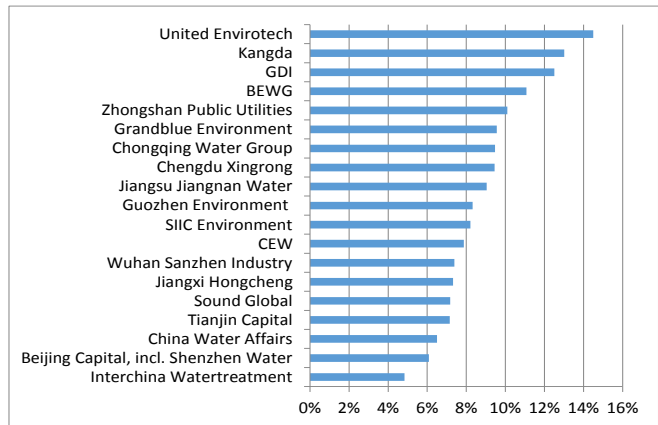


Figure 21: Pre-tax return on net assets for water industry



Source: CEIC

Figure 22: Recurring ROE of listed water stocks, 2014

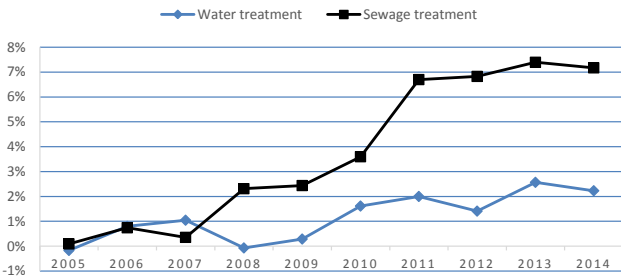


Source: Company data

Although water supply has a lower profitability for now, it has more upside with potential benefits from tariff increases, reduction in water leakage from pipeline, and better cost control after privatisation.

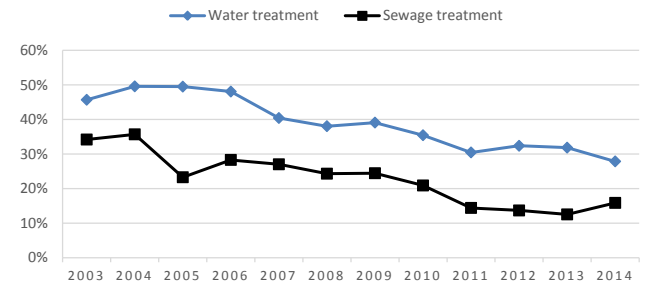
Wastewater treatment projects do not benefit directly from increases in water tariffs for end-users. However, upon the major upgrade of existing facilities, operators can negotiate with local governments on tariff increases, which can normally more than offset the higher investment and operating cost and thus improve returns to some extent.

Figure 23: Pre-tax returns on net assets: wastewater vs. water supply



Source: CEIC; Deutsche Bank

Figure 24: Proportion of loss-making companies: wastewater vs. water supply



Source: CEIC; Deutsche Bank



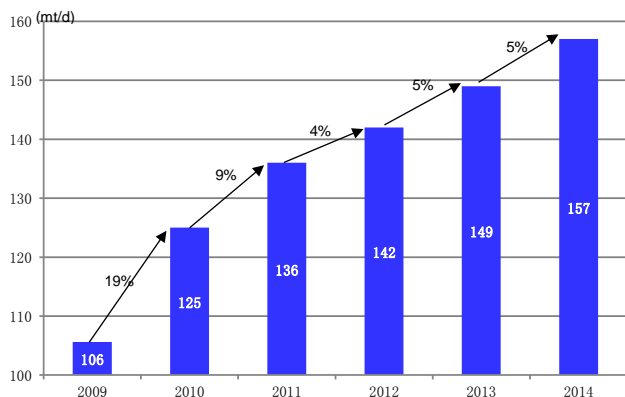
SOEs to gain market share

We expect strong growth in the municipal water industry from both new builds and market consolidation.

For new builds, we expect tap water treatment capacity to increase from 320mt/d by end-2013 to over 390mt/d by 2020, implying a 3% CAGR. We expect a faster c.6% CAGR for wastewater treatment capacity from 163mt/d by end-2013 to c.250mt/d by 2020, driven by ongoing urbanisation and the urban wastewater treatment ratio rising from 89% on the city level and 78% on the county level in 2013 to 95% and 85% by 2020, respectively.

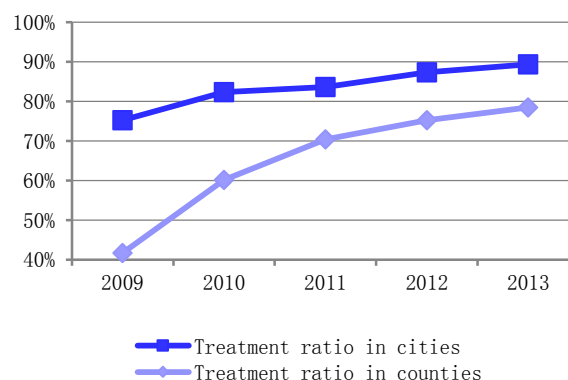
In addition to new builds, we expect great growth opportunities in the privatisation of existing facilities, with over 50% of wastewater treatment capacity still owned by local governments and even more for tap water supply projects. Upgrades of existing treatment facilities are also needed to meet tighter discharge standards.

Figure 25: Operational capacity for wastewater treatment plants in cities and counties



Source: Ministry of Housing and Urban-Rural Development, Deutsche Bank

Figure 26: Wastewater treatment ratio in cities and counties



Source: Ministry of Housing and Urban-Rural Development, Deutsche Bank

Figure 27: Estimate of municipal water supply capacity needed by 2020

	2013	2020E
Total population (m)	1,361	1,433
Urbanisation rate	56%	64%
Urban population (m)	768	917
Penetration rate for tap water supply	92%	95%
Population with access to tap water supply (m)	706	872
Water supply per capita (t/year)	109	110
Water supply (mt) - total	76,737	95,538
% of public utility out of total	83%	90%
Water supply (mt) - public utility	63,717	85,984
Utilisation rate	55%	60%
Water supply capacity (mt/d)	320	393

Source: China Urban Rural Construction Statistical Yearbook, Deutsche Bank estimates

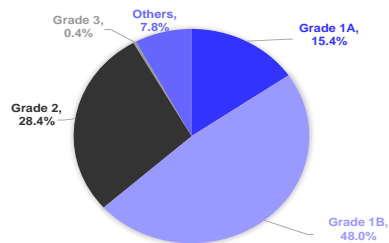
Figure 28: Estimate of municipal wastewater treatment capacity needed by 2020

	2013	2020E
Water supply (mt) - public utility	63,717	85,984
Wastewater discharge as % of water supply	95%	95%
Wastewater discharge volume (mt)	60,489	82,048
Urban wastewater treatment ratio	78%	90%
City	89%	95%
County	78%	85%
Town	c.20%	70%
Wastewater treatment volume (mt)	46,889	73,646
Wastewater treatment utilisation rate	79%	80%
Wastewater treatment capacity (mt/d)	163	252

Source: China Urban Rural Construction Statistical Yearbook, Deutsche Bank estimates



Figure 29: Capacity of urban sewage treatment plants by discharge standard, end-2010



Source: Ministry of Housing and Urban-Rural Development

Figure 30: Estimate of total investment needed to build and upgrade municipal water and wastewater treatment projects, 2014-2020E

	Water supply	Wastewater treatment
Capacity (mt/d)		
New build	73	90
Upgrade	160	75
Unit capex assumption (Rmb per t/d)		
New build	1,700	1,700
Upgrade	700	600
Investment needed (Rmb bn)	235	198
New build	123	152
Upgrade	112	45

Source: State Council, Deutsche Bank estimates

The water industry in China is relatively fragmented. As shown in Figure 31, the **ten largest players** combined account for **only a 16% market share in water supply and 18% of market share in wastewater treatment**. The 20 largest players account for c.20% of market share in water supply and 29% in wastewater (after adjusting for obvious double counting). This implies that the remaining projects are still owned by local governments or smaller players, which could choose to partner with large operators or IPO themselves.

In the municipal water industry, SOEs have competitive advantages, especially modern SOEs with good incentive plans in place. There are only three private companies in the 20 largest players. The key success factors in the water industry are government relationships and cheap funding costs, and SOEs have the advantage in both these areas.

SOEs, in general, have long been criticised for their rigid hierarchies, less return-driven mentality and low efficiency. However, some SOEs, like BEWG and CEI, have proven themselves to be highly competitive on their strong execution capability and high efficiency. The competitiveness for other SOEs, such as GDI, could potentially improve as a result of SOE reform.

Figure 31: Operational treatment capacity and market share for major players in China's water industry, end-2014

	Treatment capacity in operation (mt/d)			Market share			Type
	Water supply	Wastewater	Total	Water supply	Wastewater	Total	
1 Beijing Capital, incl. Shenzhen Water	9.0	7.0	16.0	2.7%	4.0%	3.2%	SOE
2 Shanghai Municipal Investment	7.8	5.2	13.0	2.4%	3.0%	2.6%	SOE
3 BEWG	3.5	8.0	11.5	1.0%	4.6%	2.3%	SOE
4 Veolia, excl. Shenzhen Water	9.9	1.1	10.9	3.0%	0.6%	2.2%	Foreign
5 Suez Environmental, ex. Chongqing Water JV	6.2	0.5	6.7	1.9%	0.3%	1.3%	Foreign
6 China Water Investment	5.4	0.7	6.1	1.6%	0.4%	1.2%	SOE
7 General Water (co-owned by SIIC Holdings and CECEP)	3.6	2.1	5.8	1.1%	1.2%	1.1%	SOE
8 China Water Affairs	4.3	0.3	4.6	1.3%	0.2%	0.9%	Private
9 SIIC Environment	0.8	3.8	4.6	0.3%	2.2%	0.9%	SOE
10 Xingrong Investment	2.3	2.1	4.4	0.7%	1.2%	0.9%	SOE
11 Tianjin Capital	0.2	4.0	4.3	0.1%	2.3%	0.8%	SOE
12 Sound Group	0.1	4.0	4.1	0.0%	2.3%	0.8%	Private
13 Chongqing Water	1.9	2.1	4.0	0.6%	1.2%	0.8%	SOE
14 Wuhan Sanzhen	1.6	1.3	2.9	0.5%	0.7%	0.6%	SOE
15 GDH (excluding GDI's raw water capacity)	2.5	0.4	2.9	0.7%	0.2%	0.6%	SOE
16 Jiangxi Hongcheng	1.4	1.4	2.8	0.4%	0.8%	0.6%	SOE
17 CEW	0.1	2.4	2.5	0.0%	1.4%	0.5%	SOE
18 Zhongshan Public Utilities	2.0	0.3	2.3	0.6%	0.2%	0.5%	SOE
19 Guangxi Greentown Water	1.3	0.9	2.2	0.4%	0.5%	0.4%	SOE
20 Kangda International	-	1.9	1.9	0.0%	1.1%	0.4%	Private
National total municipal capacity	330	174	504				
Top 10 largest				16.0%	17.6%	16.6%	
Top 20 largest				19.8%	28.7%	22.9%	

Notes: Shenzhen Water has 6.15mt/d of water supply capacity and 2.45mt/d of wastewater capacity. It is 40% owned by JV between Beijing Capital and Veolia, 5% owned by Veolia and 50% owned by local government

Source: Deutsche Bank, Company data



Rating
Buy

Asia
 China

Utilities
 Utilities

Company
SIIC Environment

Reuters
 SIIC.SI

Bloomberg
 SIIC SP

Price at 5 Jun 2015 (SGD)	0.21
Price target - 12mth (SGD)	0.28
52-week range (SGD)	0.24 - 0.12
HANG SENG INDEX	27,260

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Future leader; initiating with Buy

Initiating with Buy; top pick in the sector

We initiate coverage of SIIC Environment (SIIC) with a Buy. The company has the potential to become one of the leading water companies in China due to its SOE background and low funding costs. SIIC is under-researched, with its valuation at a discount to that of its peers. This is likely to change with a potential dual listing in Hong Kong. A potential asset injection could also be a positive catalyst. Our target price implies more than 30% upside potential.

Strong earnings growth ahead from capacity growth

SIIC is the environmental platform of Shanghai Industrial Holdings (SIHL, 0363.HK, NR). We expect SIIC to deliver an earnings CAGR of 35% over 2015-17, driven mainly by a c.30% CAGR in operational capacity, assuming the company matches the upper level of the company's guidance of 1-1.5mt/d p.a. SIIC may further expand its waste-to-energy business through M&A or enter other environmental areas, which could imply upside to our earnings estimates. Its conservative balance sheet leaves significant scope for SIIC to leverage up (from a 34% net debt/equity ratio by end-2014) to fund capex.

Trading at discount to peers; HK listing and asset injection potential catalysts

SIIC's earnings growth is higher than that of BEWG and CEI, but the stock is trading at a discount of more than 10% on 2015E adjusted EV/EBIT. SIIC is considering a dual listing in Hong Kong, which could help improve its trading liquidity and narrow the valuation gap. Its parent has a 45% stake in General Water (with c.6mt/d designed capacity) and the remaining 16.8% stake in Longjiang, which could be injected into SIIC. This could be a positive catalyst, if priced attractively.

DCF-based target price of S\$0.28; Buy; risks

Our DCF valuation (WACC 6.2%) incorporates long-term growth and is not affected by the mismatch between reported earnings and cash flows under concession accounting. Risks: lower-than-expected project wins; EPS dilution from potential equity placement; receivable risks from local governments.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	5.0	51.1	37.3
HANG SENG INDEX	-1.8	12.7	18.0

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (CNYm)	1,214	1,288	1,833	2,232	2,847
EBITDA (CNYm)	264	289	663	888	1,176
Reported NPAT (CNYm)	150	262	348	478	632
DB EPS FD (CNY)	0.030	0.025	0.032	0.042	0.056
DB EPS growth (%)	27.6	-17.1	29.1	30.8	32.7
PER (x)	15.0	32.7	29.7	22.7	17.1
Price/BV (x)	2.8	1.7	2.2	2.0	1.8
EV/EBITDA (x)	12.8	28.9	17.6	15.3	13.2
DPS (net) (CNY)	0.000	0.000	0.000	0.006	0.008
Yield (net) (%)	0.0	0.0	0.0	0.7	0.9
ROE (%)	7.4	8.2	8.0	9.2	11.1

Source: Deutsche Bank estimates, company data



Model updated: 07 June 2015

Running the numbers

Asia	
China	
Utilities	

SIIC Environment

Reuters: SIIC.SI Bloomberg: SIIC SP

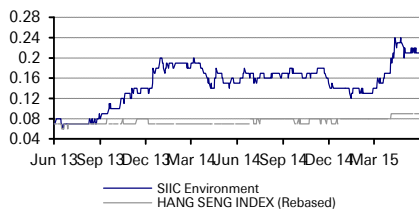
Buy

Price (5 Jun 15)	SGD 0.21
Target Price	SGD 0.28
52 Week range	SGD 0.12 - 0.24
Market Cap (m)	SGDm 2,341
	USDm 1,725

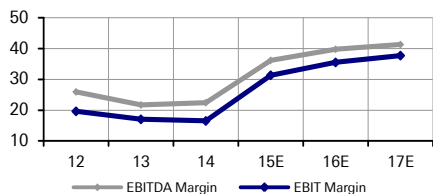
Company Profile

SIIC Environment, formally known as Asia Water Technology (Asia Water), is listed in Singapore. The company's primary business is the operation of the wastewater and water supply business in China through BOT and TOT business models. As at end-2014, SIIC owns about 70 water projects with total designed capacity of 5.4m³/d and three WTE projects with total waste treatment capacity of 3,200t/d, located across 15 provinces and municipalities in China.

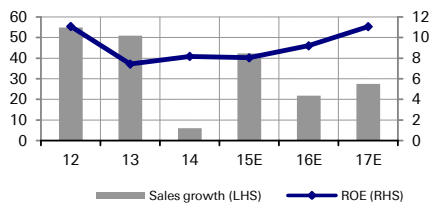
Price Performance



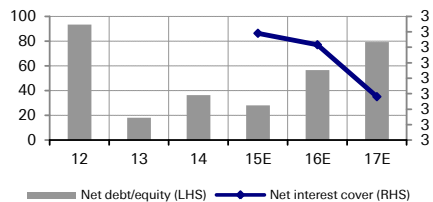
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

	2012	2013	2014	2015E	2016E	2017E
DB EPS (CNY)	0.02	0.03	0.02	0.03	0.04	0.06
Reported EPS (CNY)	0.03	0.03	0.03	0.03	0.04	0.06
DPS (CNY)	0.00	0.00	0.00	0.00	0.01	0.01
BVPS (CNY)	0.3	0.3	0.4	0.4	0.5	0.5
Weighted average shares (m)	5,051	5,512	9,058	10,547	11,149	11,149
Average market cap (CNYm)	1,449	2,497	7,402	10,695	10,695	10,695
Enterprise value (CNYm)	3,492	3,381	8,347	11,676	13,609	15,536

Valuation Metrics

P/E (DB) (x)	12.1	15.0	32.7	29.7	22.7	17.1
P/E (Reported) (x)	11.1	16.8	28.6	29.1	22.4	16.9
P/BV (x)	1.56	2.83	1.74	2.16	1.97	1.78
FCF Yield (%)	11.1	nm	1.1	2.0	nm	nm
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.7	0.9
EV/Sales (x)	4.3	2.8	6.5	6.4	6.1	5.5
EV/EBITDA (x)	16.7	12.8	28.9	17.6	15.3	13.2
EV/EBIT (x)	22.1	16.3	39.3	20.3	17.2	14.5

Income Statement (CNYm)

Sales revenue	804	1,214	1,288	1,833	2,232	2,847
Gross profit	328	418	446	863	1,118	1,442
EBITDA	209	264	289	663	888	1,176
Depreciation	12	11	11	11	11	11
Amortisation	39	46	66	78	85	92
EBIT	158	207	213	575	793	1,074
Net interest income/(expense)	22	69	114	-169	-236	-337
Associates/affiliates	16	12	60	76	94	112
Exceptionals/extraordinaries	0	0	4	0	0	0
Other pre-tax income/(expense)	9	2	18	13	13	13
Profit before tax	205	289	410	494	663	863
Income tax expense	28	74	76	91	124	163
Minorities	47	65	71	56	61	68
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	131	150	262	348	478	632
DB adjustments (including dilution)	-11	17	-33	-7	-7	-7
DB Net profit	119	168	229	340	471	625

Cash Flow (CNYm)

Cash flow from operations	258	156	236	402	-1,574	-1,410
Net Capex	-96	-208	-151	-200	-200	-200
Free cash flow	161	-52	84	202	-1,774	-1,610
Equity raised/(bought back)	0	1,272	751	917	0	0
Dividends paid	0	0	0	0	0	0
Net inc/(dec) in borrowings	81	326	-190	1,126	2,067	2,192
Other investing/financing cash flows	-210	-152	-1,380	-1,132	-132	-282
Net cash flow	32	1,396	-735	1,113	162	300
Change in working capital	87	-76	-15	-197	-2,369	-2,459

Balance Sheet (CNYm)

Cash and other liquid assets	489	1,879	1,119	2,232	2,394	2,695
Tangible fixed assets	112	100	108	80	70	59
Goodwill/intangible assets	932	1,080	1,530	1,607	1,677	1,741
Associates/investments	123	271	1,198	1,230	1,264	1,296
Other assets	3,238	3,326	4,211	5,521	7,935	10,483
Total assets	4,894	6,655	8,167	10,671	13,341	16,274
Interest bearing debt	2,169	2,473	2,676	3,801	5,869	8,061
Other liabilities	927	893	1,214	1,272	1,336	1,448
Total liabilities	3,095	3,366	3,890	5,073	7,205	9,508
Shareholders' equity	1,313	2,730	3,691	4,955	5,433	5,995
Minorities	486	560	586	642	704	771
Total shareholders' equity	1,799	3,289	4,277	5,597	6,137	6,766
Net debt	1,680	595	1,557	1,569	3,475	5,366

Key Company Metrics

Sales growth (%)	54.9	51.0	6.0	42.3	21.8	27.6
DB EPS growth (%)	24.8	27.6	-17.1	29.1	30.8	32.7
EBITDA Margin (%)	26.0	21.7	22.5	36.2	39.8	41.3
EBIT Margin (%)	19.6	17.0	16.5	31.4	35.5	37.7
Payout ratio (%)	0.0	0.0	0.0	0.0	14.8	14.8
ROE (%)	11.1	7.4	8.2	8.0	9.2	11.1
Capex/sales (%)	12.8	17.6	11.8	10.9	9.0	7.0
Capex/depreciation (x)	2.0	3.8	2.0	2.3	2.1	2.0
Net debt/equity (%)	93.4	18.1	36.4	28.0	56.6	79.3
Net interest cover (x)	nm	nm	nm	3.4	3.4	3.2

Source: Company data, Deutsche Bank estimates



Investment thesis

Outlook

SIIC is the environmental platform of Shanghai Industrial Holdings (SIHL, 0363.HK, NR). It is emerging as one of the major players in China's water industry, especially in the municipal wastewater sector. We expect SIIC to double its market share in the wastewater treatment industry, from c.2% by end-2014 to c.5% by end-2020, leveraging on its SOE background and low funding costs.

We estimate SIIC to deliver an earnings CAGR of 35% over 2015-17, driven mainly by a c.30% CAGR in average operational capacity, assuming the company can win 1.5mt/d designed capacity p.a. vs. the company's guidance of 1-1.5mt/d. SIIC should also benefit from investment opportunities arising from the tightening discharge rules, with 60-70% of its existing projects at a sub-Grade1A standard. We also believe SIIC could further expand its waste-to-energy business through M&A or enter other environmental areas. We think there is still room for SIIC to leverage up (from a 34% net debt/equity ratio by end-2014) to fund the capex.

SIIC is under-researched, with its valuation at a discount to that of its peers. This is likely to change with a potential dual listing in Hong Kong, which could increase its trading liquidity and narrow the valuation gap. We think strong project wins and major acquisitions or a possible asset injection at reasonable prices are potential catalysts for the share price.

Valuation

We derive our target price using a DCF valuation with explicit cash flows to 2050 and minimal terminal value, discounted at a 6.2% WACC (RFR of 3.9%, beta of 0.8, ERP of 5.6%, yielding a CoE of 8.4%, pre-tax CoD of 4.8% and a D/E ratio of 45:55). The DCF valuation is not affected by the mismatch between reported earnings and cash flows under concession accounting.

Risks

The main downside risks include the following: 1) rising competition for new projects; 2) regulatory risks, including delays in implementing cost pass-through for wastewater and water supply projects; 3) credit risk on the receivables from local governments or other customers; 4) lower-than-expected utilisation rate; 5) EPS dilution from potential equity placement; and 6) expansion into new businesses.



Key downside risks

Rising competition for new projects

Competition for new projects is increasing. Although SIIC has a minimum investment threshold of a project IRR of 9%, there is a risk that the company may have to slow down its project acquisitions or accept lower returns.

Adverse regulatory changes

If higher costs from inflation, an electricity price hike, or plant upgrading, etc., cannot be fully covered by tariff increases, this could negatively affect the company's profitability.

Receivables risk

The ability and willingness of the local government to pay could affect the cash flow of the project. SIIC has experienced an overdue payment for a wastewater treatment plant in Wuhan, although it has subsequently received compensation via interest income of RMB38m from the late settlement of the trade receivable from the government at an interest rate of 6.86-8.57% p.a..

SIIC also has receivables related to its EPC business, even after the EPC entity Wuhan Kaidi Water Services was disposed of in 2014. According to company management, of the RMB292m trade receivables past due but not impaired by end-2014, the majority are construction business-related. If there were any default in payment, this could adversely affect the company's profitability.

Lower-than-assumed utilisation rate

The utilisation rate could be affected by factors like network connection issues, the addition of new capacity to the network, or wastewater/water supply shortages. However, the risk is minimised to some extent by minimum treatment volume guarantees agreed upon with the local governments.

EPS dilution from potential equity placement

Owing to the capital-intensive nature of the water business, water operators typically rely on debt for 70-80% of the financing in the construction of new projects. Although SIIC's net gearing was relatively low, at only 34%, at end-2014, it is still likely to conduct an equity placement in the future to finance its business expansion.

Expansion into new businesses may not be successful

SIIC entered the WTE business in 2011 by acquiring three projects. It plans to develop other water and environment-related businesses, including sludge treatment, seawater desalination, etc. Returns could be affected if the business model is not viable or is hurt by the company's lack of experience in these new areas.



Valuation

DCF-based target price of S\$0.28

We value SIIC at S\$0.28, based on a mid-2016 DCF valuation (Figure 32), which is not affected by the mismatch between reported earnings and cash flows under concession accounting.

We assume WACC of 6.2%, explicit cash flows to 2050 and minimal terminal value. SIIC's associates and joint-controlled-entities (JCEs) are mainly the 25.3%-owned Longjiang Group and the 50%-owned Pucheng and Wenling WTE projects. We value the associates and JCEs at 2x P/BV. We value SIIC's available-for-sale investments (mainly the 3.3% stake in Canvest (1381.HK), an HK-listed WTE operator) at 1x P/BV. We estimate that every 1mt/d of new project additions, assuming a unit investment of RMB2,000 per t/d at a 9% project IRR, implies c.4% upside potential to our target price.

Figure 32: DCF valuation

(Rmb million, except noted otherwise)	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2047E	2048E	2049E	2050E
WACC calculation															
Cost of equity:															
Risk free rate		3.90%													
Equity beta		0.80													
Equity risk premium		5.60%													
Implied cost of equity		8.38%													
Cost of debt:															
Pre-tax cost of debt									4.8%						
Long-term effective tax rate									25.0%						
Cost of debt (post tax)									3.58%						
TV Growth		0.0%													
Leverage (net debt/ (net debt + equity))															45.0%
WACC		6.20%													
DCF approach															
EBIT	806	1,087	1,322	1,587	1,845	2,049	2,230	2,402	2,545	2,567	594	475	377	383	
<i>Effective tax rate</i>	22%	22%	23%	24%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
NOPAT	630	851	1,021	1,210	1,388	1,537	1,672	1,802	1,909	1,926	445	356	283	288	
Add back depreciation and amortisation	95	102	109	116	119	119	108	108	108	108	-	-	-	-	-
Adjust for working capital change	(2,369)	(2,459)	(2,415)	(2,077)	(2,168)	(1,800)	(1,573)	(1,485)	(1,134)	592	367	253	131	9	
Less: cost of construction and acquisitions	(200)	(200)	(200)	(200)	-	-	-	-	-	-	-	-	-	-	-
Free cashflow	(1,843)	(1,706)	(1,485)	(951)	(661)	(144)	208	425	883	2,626	813	609	414	296	
Terminal value														541	
Total cashflow + terminal value	(1,843)	(1,706)	(1,485)	(951)	(661)	(144)	208	425	883	2,626	813	609	414	838	
Discount factor	1.06	1.13	1.20	1.27	1.35	1.43	1.52	1.62	1.72	1.82	6.85	7.28	7.73	8.21	
Present value of free cashflow	(1,735)	(1,512)	(1,240)	(748)	(489)	(100)	136	263	514	1,439	119	84	54	102	
Sum of present value of free cashflow	13,831														
Less: total debt	(3,785)														
Add: Available for sale financial investment	127														
Less: minority interest	(642)														
Add: associates and JCEs	2,207														
Add: cash	2,232														
Equity value	14,396														
Target price (Rmb/share)	1.29														
SGD:Rmb	4.6														
Target price (SGD/share)	0.28														

Source: Deutsche Bank estimates

SIIC's share price has been relatively more volatile than that of its peers, owing to its smaller market cap and liquidity. Although the share price has rallied c.50% YTD, it has still underperformed that of peers by c.15ppt since the beginning of 2014. We believe the recent share price rally has not factored in the company's full growth potential. In our view, stronger-than-expected capacity growth, an asset injection from the parent or an HK listing could be positive share price catalysts.

With effect from 2 March 2015, the Singapore Exchange implemented a minimum trading price requirement of S\$0.20 per share for issuers on the main



board, as a continuing listing requirement, and it has granted a one-time transition period of 12 months until 1 March 2016. Therefore, SIIC has proposed consolidating every five existing shares into one share, which was approved by the EGM on 27 April 2015, and will be implemented within a year. This could, to some extent, help reduce share price volatility. This is because, for a stock price between S\$0.2 and below S\$2, the minimum trading tick is set at S\$0.5 cents, or 2.4% of SIIC's current share price, but would be less than 0.5% after the proposed share consolidation, all else being equal.

SIIC's P/E and P/B are now above their historical averages. However, we expect stronger-than-historical growth in both earnings and EPS. In the past few years, strong earnings growth has been largely offset by share issuances to fund acquisitions, similar to what happened to BEWG in its initial expansion stage. We expect less EPS dilution for SIIC going forward, as the company reduced its gearing from 92% net debt/equity at end-2012 to 34% at end-2014 (and to c.27% by end-2015, on our estimates) after the acquisition of Fudan Water, funded by consideration shares.

We think there is still room for SIIC to gear up to fund future capex. We have factored no new share placements into our forecasts. However, although we think SIIC does not need to issue equity, it may still choose to do so in the future. SIIC's parent SIHL had only a c.36% stake in SIIC after the issuance of consideration shares to acquire Fudan Water in May 2015. We think it is possible that it could increase its stake by an asset injection in exchange for new shares.

Figure 33: Major share issuance history of SIIC since 2011

	Shares issued (million)	Issue price (SGD/share)	Shares issued as % of enlarged shares	Note
24-Mar-11	1,218	0.060	34%	Rights issue
14-Sep-11	99	0.070	3%	Consideration shares for acquisition of Wenling WTE
28-Dec-11	1,203	0.064	24%	Consideration shares for acquisition of United Environment
15-Feb-13	434	0.068	8%	Consideration shares for acquisition of Nanfang Water
23-Dec-13	3,100	0.085	36%	Private placement to Triumph Power Ltd., Best Investment Co., Ltd., Dalvey Asset Holdings, CCBI Chengtou CleanTech Equity Investment Fund Co., Ltd., Newyard Worldwide Holdings Ltd.
8-Jul-14	1,000	0.158	10%	Top-up placement
21-May-15	1,560	0.132	14%	Consideration shares for acquisition of Fudan Water

Source: Deutsche Bank, Company data



Figure 34: Forward P/E

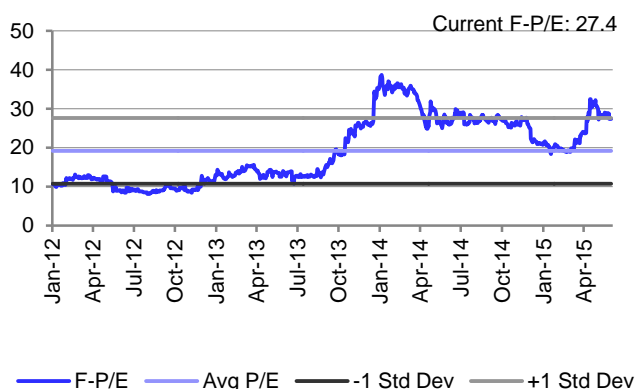
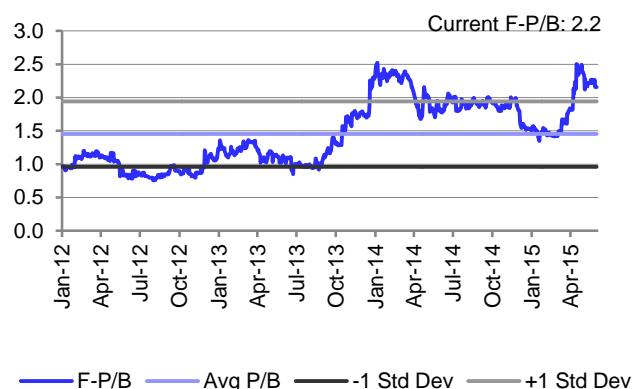


Figure 35: Forward P/B



Source: Deutsche Bank estimates, Company data, Bloomberg Finance LP

Source: Deutsche Bank estimates, Company data, Bloomberg Finance LP

We consider SIIC's valuation to be attractive compared with that of its peers. It is trading at a discount of more than 10% in terms of 2015E adjusted EV/EBIT compared with BEWG and CEI, although its 2015-17E earnings CAGR of 35% is higher than the 27% we estimate for BEWG and CEI. We think EV/EBIT is more relevant than P/E multiples, considering BEWG's much higher gearing level. In addition, as SIIC is still building up its track record, the market expectation (including our assumptions) with regard to new project wins tends to be more conservative. Therefore, there are higher chances of positive surprises, in both the water and WTE businesses.

Figure 36: Valuation comps

Share price as of June 5, 2015		Valuations										Returns & Gearing (%)															
Company	Ticker	Price	Rating	Price target	% to target	Mkt. Cap. US\$m	avg. daily trade US\$, 1m	EPS CAGR 2015-17E	Earnings CAGR 2015-17E	EV/EBIT 15E	16E	17E	15E	16E	17E	P/BV 15E	16E	17E	Net debt/Total capital 15E	16E	17E	RoE 15E	16E	17E	Dividend yield 15E	16E	17E
On reported earnings basis (concession accounting)																											
SIIC Environment	SIIC SP	SGD0.21	Buy	SGD0.28	33%	1,725	4.3	32%	35%	20.3	17.2	14.5	29.7	22.7	17.1	2.2	21.9	36.2	8.0	9.2	0.0	0.7					
CEW	CEWL SP	SGD1.025	Buy	SGD1.32	29%	1,969	2.7	45%	46%	21.0	15.4	13.0	33.5	21.6	16.0	2.1	5.9	21.0	6.5	9.1	0.0	0.5					
BEWG	371 HK	HKD6.6	Buy	HKD7.20	9%	5,832	13.0	22%	22%	18.4	14.7	13.2	26.2	20.5	17.7	2.6	51.3	54.0	13.0	15.5	1.4	1.8					
GDI	270 HK	HKD10.86	Buy	HKD12.30	13%	8,703	11.6	11%	11%	14.0	12.5	9.2	17.5	16.0	14.2	2.1	(33.7)	(42.7)	12.4	12.8	3.0	3.7					
CEI	257 HK	HKD13.98	Hold	HKD14.00	0%	8,057	11.2	25%	25%	18.4	15.1	11.4	26.8	20.6	17.0	3.5	25.3	37.2	13.6	15.9	0.9	1.2					
Average ex. GDI																											
								31%	32%	19.5	15.6	13.0	29.1	21.3	16.9	2.8	26.1	37.1	10.3	12.4	0.6	1.0					
On adjusted earnings basis (normal accounting)																											
SIIC Environment	SIIC SP	SGD0.21						32%	35%	27.3	22.6	19.0	38.3	29.0	22.1				6.5	7.6							
CEW	CEWL SP	SGD1.025						42%	43%	32.4	25.9	20.1	53.4	38.5	26.6				4.2	5.4							
BEWG	371 HK	HKD6.6						26%	27%	31.5	24.3	20.3	38.2	29.7	23.9				9.6	11.9							
GDI	270 HK	HKD10.86						11%	11%	14.0	12.5	9.2	17.5	16.0	14.2				12.4	12.8							
CEI	257 HK	HKD13.98						27%	27%	31.4	26.0	21.9	50.2	39.3	31.2				8.1	9.8							
Average ex. GDI																											
								32%	33%	30.6	24.7	20.3	45.0	34.1	26.0				7.1	8.7							

Source: Deutsche Bank estimates, Bloomberg Finance LP

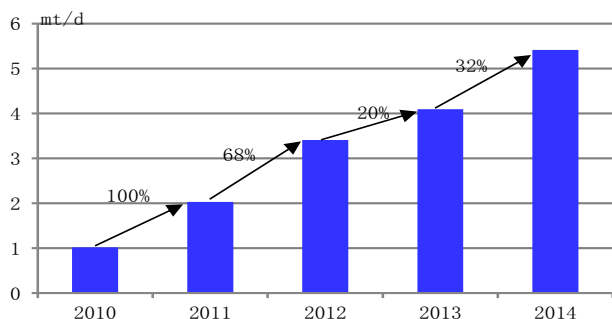


Well positioned to grow

Strong growth track record

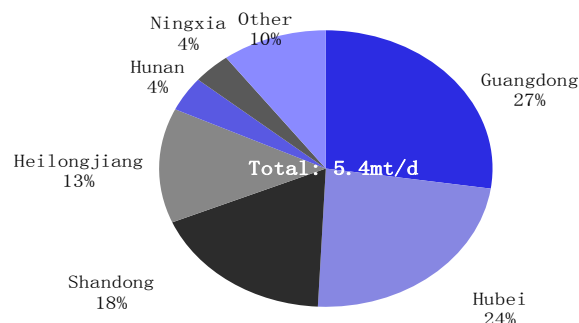
SIIC is emerging as one of the major players in China's water industry. SIHL acquired the financially distressed Asia Water Technology in 2010, and has been expanding rapidly since then. Its designed water treatment capacity increased fivefold, from c.1.0mt/d at end-2010 to 5.4mt/d (including 25% of Longjiang's total designed capacity) at end-2014. Its projects are located across 15 provinces and municipalities in China, managed by four regional offices (Figure 38). In general, companies with a nationwide footprint find it easier to win new projects, as all regional managers can target new projects.

Figure 37: Designed capacity for water treatment



Note: The designed capacity includes 25.313% of Longjiang's total designed capacity acquired in June and November 2014
 Source: Deutsche Bank; Company data

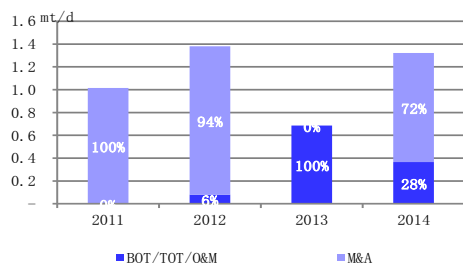
Figure 38: Capacity breakdown by province at end-2014



Note: The designed capacity includes 25.313% of Longjiang's total designed capacity acquired in June and November 2014.
 Others include Jiangsu, Shanghai, Liaoning, Shanxi, Guangxi, Fujian, Henan and Zhejiang provinces
 Source: Deutsche Bank; Company data

SIIC has achieved the majority of its growth since 2011 from M&A, as shown below. Recently, in December 2014, it completed the acquisition of a 25% stake in Longjiang Group, with a total designed capacity of c.2.9mt/d, which will help it to expand its footprint in Heilongjiang and Ningxia. On 21 May 2015, the company completed the acquisition of a 92% stake in Fudan Water, which has undertaken c.10 projects in Shanghai, Jiangsu, Zhejiang and Guangdong, with a designed water treatment capacity of more than 1mt/d.

Figure 39: Capital additions breakdown (2011-14)



Source: Deutsche Bank; Company data

Figure 40: SIIC's major acquisitions for water business

Company	Stake	Consideration (Rmb m)	Announcement date	Completion date	Designed capacity (kt/d)	Implied PE	Implied P/B
UE Group	75.5%	507	27-Oct-11	28-Dec-11	1,015	13.9	1.6
Nanfeng Water	69.4%	409	10-Jun-12	23-Jul-12	1,300	16.2	2.0
Shanghai Qingpu	100.0%	180	2-Oct-13	18-Feb-14	120	13.6	NA
Dongguan Fenggang	100.0%	79	10-Sep-14	10-Sep-14	50	16.7	NA
Dongguan Shijie	100.0%	88	10-Sep-14	10-Sep-14	60	24.6	2.1
Longjiang Group	25.3%	405	30-Jun-14	7-Nov-14	2,870*	24.6	2.1
Fudan Water	92.2%	1,548	24-Mar-15	21-May-15	1,000	17.3	2.9

Note: * SIIC only includes the attributable capacity of 726kt/d of Longjiang Group in calculating its total designed capacity of 5.4mt/d by end-2014.

Note: UN Group stands for United Environmental Group. Source: Deutsche Bank; Company data

Apart from acquiring new projects, SIIC has also successfully increased its stake in some subsidiaries. Most recently, on 29 April 2015, SIIC acquired a 14.8% stake in Nanfang Water, increasing its stake from 76.4% to 91.2%, for RMB108m.



Going forward, the company aims to rely on both BOT/TOT projects obtained directly from the local governments and M&A. M&A is a quick way to grow in size, however, compared with large-sized acquisitions, where sellers normally ask for a higher premium. Therefore, it is relatively easier to get a better return from projects obtained directly from the local governments, in our view.

Opportunity from tightening discharge rules

60-70% of SIIC's wastewater treatment plants are at sub-Grade1A discharge standards, according to company management. These projects may need to be upgraded in the future to meet tighter discharge rules. In general, operators can earn a better return from the extra investment for plant upgrades because this involves negotiations just with local governments, rather than competitive bidding.

WTE grows mainly through M&A; sludge treatment investment

SIIC entered the WTE business through the acquisition of a 50% stake in Zhejiang Wenling in 2011, and expanded the business by acquiring a 50% stake in Shanghai Pucheng and a 100% stake in Dezhou Jiajing in Sichuan in 2014.

SIIC intends to expand the business mainly through M&A to minimise the development risk for greenfield WTE projects, as it is difficult to pass public consultation for land selection.

SIIC invested in a 3.3% stake in Canvest (1381.HK), a WTE operator that was listed on the Main Board of the Hong Kong Stock Exchange on 29 December 2014, as a cornerstone investor with a lock-up period of six months. SIIC management views the investment as a strategic addition that is also complementary to its existing WTE business, and believes there may be potential strategic collaboration opportunities to be explored. The Canvest investment is currently treated as an available-for-sale financial investment on SIIC's balance sheet.

Figure 41: SIIC's acquisitions for WTE business

	Stake	Consideration (Rmb m)	Announcement date	Completion date	Designed capacity (t/d)	Implied PE
Wenling Hanyang	50%	111	31-Dec-10	20-Jul-11	1.1	20.1
Pucheng Waste	50%	530	8-Oct-13	23-Jan-14	1.05	14.0
Dazhou Jiajing	100%	119	31-Dec-13	11-Feb-14	1.05	Net loss

Source: Deutsche Bank; Company data

Besides WTE, SIIC has also started to invest in sludge treatment. In April 2015, SIIC invested in MTI Environmental Group, which is engaged in domestic sludge treatment and is an EPC contractor in the water treatment industry, jointly with IFC.



Potential asset injection

Another 16.8% stake in Longjiang

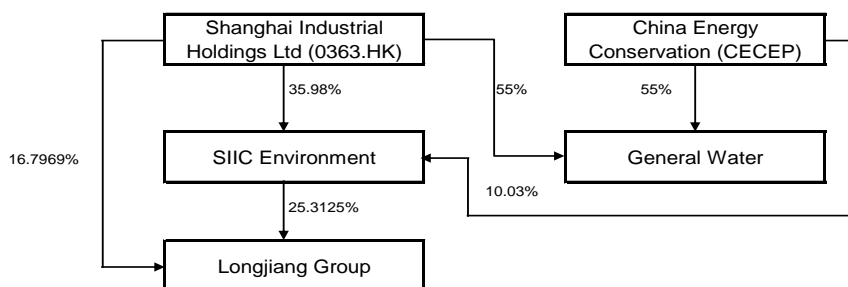
SIHL owns a c.42.1% stake in Longjiang Group, of which c.16.8% is owned directly by SIHL and the remaining 25.3% through SIIC. At end-2014, Longjiang Group had a total water treatment and supply design capacity of c.2.9m³/d and a sludge handling design capacity of 1,000t/d. According to company management, it is possible that SIHL could transfer its 16.8% stake in Longjiang to SIIC.

45% stake in General Water

SIHL owns a 45% stake in General Water, while SIIC's second-largest shareholder, China Energy Conservation and Environmental Protection Group (CECEP), owns the remaining 55% stake. As at end-2014, General Water owned 25 water supply facilities and 19 wastewater treatment plants with a total capacity of 3.9m³/d for water supply and 2.1m³/d for wastewater treatment.

We think the chances of and timing for the injection of the 45% stake in General Water are uncertain. This is because the proportion of water supply is relatively high for the company and its profitability is a bit low at the moment, according to management. CECEP may also have its own plan for General Water.

Figure 42: Parentco water assets and relationship with CECEP



Source: Deutsche Bank; Company data

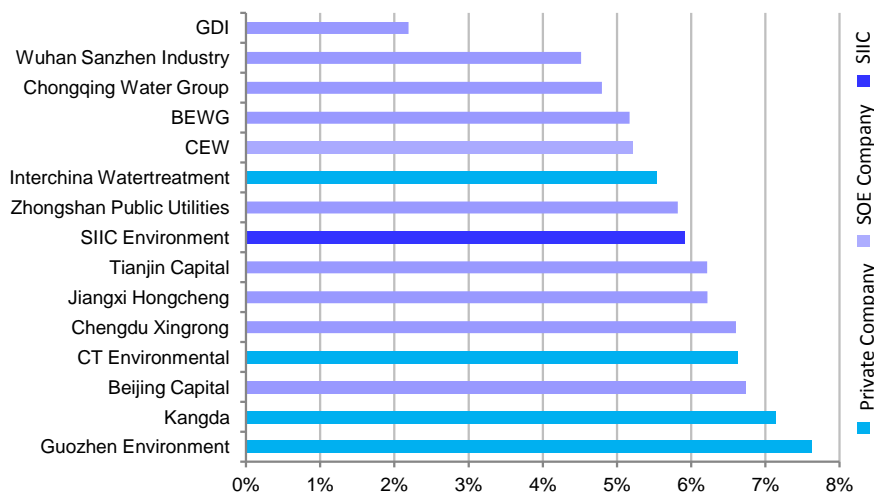
Low borrowing costs and gearing

Borrowing costs play a big role in the capital-intensive water industry. SIIC's borrowing costs have been below the PBOC benchmark rate, but the company has not been as competitive as other overseas-listed SOEs like CEI and BEWG, as it takes time to replace the more expensive borrowing of the acquired projects. We think the average borrowing cost for SIIC will trend down, as more expensive debts are refinanced at a lower rate.

Management has said that it plans to gradually replace the project-level domestic financing (more than 6%, on average) with lower-cost offshore funding (at c.4.3-4.6%) to lower financing costs. SIHL provides support to SIIC through loans with lower interest rates (4.5%, on average, in 2014, which is set at a slight premium to SIHL's own borrowing).



Figure 43: Borrowing cost comparison for peers in 2014



Source: Company data

SIIC's net debt to equity ratio declined to 34% by end-2014, after the 1bn new share placement in July 2014. This should decline further, to c.27% by end-2015, following the issuance of 1.56bn shares on 21 May 2015 for the Fudan water acquisition. We believe there is room for SIIC to increase gearing to optimise its financial structure, which, in turn, could help fund more acquisitions and improve its ROE.

Potential dual listing in Hong Kong

SIIC plans to be dual-listed in Hong Kong. According to management, the company may work on its plan to be listed in Hong Kong as early as 2H15. For stocks with a similar market cap, those listed in Hong Kong have a much higher daily turnover. We think a dual listing could improve SIIC's trading liquidity, broaden its shareholders and help narrow the valuation gaps vs. its peers.



Financial outlook

Revenue and earnings outlook

We expect SIIC to deliver reported earnings growth of 48% in 2015, and estimate a 35% earnings CAGR over 2015-17. This should be driven by both capacity expansion and more construction revenue from BOT projects.

However, as the construction revenue for BOT projects booked under concession accounting is non-cash in nature, we focus more on adjusted earnings, where we convert the earnings to normal accounting.

Figure 44: Reconciliation from concession accounting to normal accounting (Rmb m)

	2014	2015E	2016E	2017E
Reported recurring profits - concession accounting	229	340	471	625
Less: Construction profit for BOT projects	(28)	(56)	(72)	(90)
Less: Construction cost saving	-	-	-	-
Add: Amortisation of financial assets, which should have been booked as revenue under normal accounting	69	80	115	182
Less: Depreciation that should have been booked under normal accounting	(113)	(140)	(192)	(291)
Total adjustment before tax and MI	(72)	(115)	(148)	(199)
Total adjustment after tax and MI	(42)	(75)	(100)	(138)
Recurring profits under normal accounting	188	266	371	487
Diff, normal vs. concession	18%	22%	21%	22%
Recurring EPS - concession accounting (Rmb)	0.02	0.03	0.04	0.06
Recurring EPS - normal accounting (Rmb)	0.02	0.03	0.03	0.04
PE reported (x)		29.7	22.7	17.1
PE adjusted to normal accounting (x)		38.3	29.0	22.1
EV/EBIT adjusted to normal accounting (x)		27.3	22.6	19.0

Note: Prices as of 5 June 2015
 Source: Company data, Deutsche Bank estimates

As noted above, we expect adjusted earnings to record a 35% CAGR over 2015-17, driven by the c.30% CAGR of operational treatment capacity, coupled with economies of scale (as SG&A are allocated across a larger treatment volume) and a lower interest rate after the refinancing of expensive borrowings from projects acquired.

Key assumptions

Capacity: We assume that SIIC will win new projects of 1.5mt/d p.a. over 2015-20 and 1.2mt/d p.a. over 2021-23. We also expect SIIC to exceed 10mt/d of designed capacity by 2017-18 (including the attributable capacity from the 25%-owned Longjiang Group). Our assumption implies that SIIC's market share in wastewater treatment will increase from 2.2% by end-2014 to c.5% by end-2020.

Utilisation rate: We assume that utilisation for newly built plants will ramp up over three years, from 70% to 90%. We expect the average utilisation rate for the company to be relatively stable.

Water tariffs: We assume stable tariffs in general, but we expect a tariff increase of c.40% for wastewater treatment capacity upgraded from Grade 1B to Grade 1A to offset incremental costs as a result of upgrades.



Gross margin: We assume a gradual improvement in the gross margin for operations (at 55-60%) with the upgrading of existing facilities to tighter discharge standards. We assume a stable BOT construction margin of 12%, which is more conservative than the peers' average of c.25%. The company's average gross margin varies yoy with the mix change from different segments, but this should gradually increase as the proportion of recurring operation income rises.

WTE business: To be conservative, we have not assumed any new WTE projects. SIIC's strategy in this area is mainly through M&A. As the WTE industry is already quite market-driven and concentrated (with the largest 10 players accounting for c.60% of market share), it is hard to predict the timing or size of potential acquisitions from other developers.

Our key assumptions and estimates of cash revenue and the derivation of reported revenue under concession accounting are shown in Figure 45 and Figure 46.

Figure 45: Key operational assumptions

	2014	2015E	2016E	2017E	2018E
Total designed capacity for water business (kt/d), year end	5,407	6,907	8,407	9,907	11,407
Consolidated designed capacity (kt/d), year end	4,681	6,181	7,681	9,181	10,681
Addition (kt/d)		1,500	1,500	1,500	1,500
Consolidated operational capacity (kt/d), year end	3,896	4,746	6,361	8,001	9,501
Addition (kt/d)		850	1,615	1,640	1,500
Breakdown of average consolidated operational capacity (kt/d)	3,731	4,321	5,554	7,181	8,751
WWT - BOT/TOT/BOO	2,081	2,671	3,891	5,506	7,076
WWT - O&M	805	805	818	830	830
Water supply	845	845	845	845	845
Utilization rate					
WWT - BOT/TOT/BOO	95%	92%	91%	90%	90%
WWT - O&M	79%	82%	85%	88%	91%
Water supply	56%	57%	58%	59%	60%
Consolidated volume (mt)	1,125	1,316	1,719	2,258	2,795
WWT - BOT/TOT/BOO	722	901	1,288	1,811	2,335
WWT - O&M	231	240	253	266	275
Water supply	172	175	178	181	184
Water tariffs (Rmb/t)					
WWT - BOT/TOT/BOO	0.94	0.94	0.94	0.96	0.97
WWT - O&M	0.50	0.50	0.50	0.50	0.50
Water supply	1.55	1.57	1.58	1.60	1.61
Total operational capacity for WTE business (kt/d), year end	2.9	2.9	2.9	2.9	3.3
Consolidated operational capacity for WTE business (kt/d), year end	0.7	0.7	0.7	0.7	1.1
<i>Utilisation rate</i>	66%	96%	120%	120%	120%
Waste treatment volume, wet (mt)	0.2	0.2	0.3	0.3	0.4
Power output (mn kWh)	39	62	81	83	106
Waste treatment fee (Rmb/ton)	72	72	72	72	72
Power tariff (Rmb/ kWh)	0.65	0.65	0.65	0.65	0.65

Source: Company data, Deutsche Bank estimates



Figure 46: Derivation of revenue from concession arrangement

(Rmb million, unless where noted otherwise)	2014	2015E	2016E	2017E	2018E
Est. cash revenue (A)	982	1,179	1,573	2,095	2,657
WWT BOT/TOT/BOO	678	847	1,217	1,730	2,262
Water supply BOT/TOT/BOO	267	274	282	289	297
WTE	37	58	75	76	98
Amortisation of financial receivables(B)	69	80	115	182	258
<i>Amortisation rate</i>	2.4%	2.3%	2.4%	2.5%	2.6%
Imputed finance income (C)	217	265	363	551	747
<i>Implied interest rate</i>	8.0%	8.0%	8.0%	8.0%	8.0%
Operating and maintenance income under concession arrangement (D=A-B-C)	697	833	1,095	1,362	1,653
Total financial receivables	3,326	4,550	6,911	9,359	11,707
Construction activity (kt/d)					
- BOT		253	290	340	200
- Upgrade		50	150	250	300
Unit construction cost (Rmb per t/d)					
- BOT		1,500	1,500	1,500	1,500
- Upgrade		600	600	600	600
Construction cost (Rmb m)	204	409	525	660	480
Construction gross margin	12%	12%	12%	12%	12%
Construction revenue from service concession arrangement (Rmb m)	232	464	597	750	545

Source: Company data, Deutsche Bank estimates

SG&A: We expect SIIC's SG&A to increase 15% p.a over 2015-17. As operational capacity increases, SG&A will be allocated over a larger treatment volume, leading to economies of scale.

Associate and JCEs: The company's associates and JCEs are mainly the 25.3%-owned Longjiang Group (acquired in November 2014), the 50%-owned Pucheng (acquired in January 2014) and the Wenling WTE projects (acquired in 2011), which, together, accounted for 26% of SIIC's recurring net profits in 2014. We expect a gradual improvement in returns for these investments, especially for Longjiang, on its efficiency gains after the takeover and water tariff increases.

Finance expenses: We estimate that the company's finance charges will gradually decline, from 5.9% in 2014 to 5.0% in 2017, as the more expensive borrowings are refinanced at a lower interest rate and interest rate cuts in China.

1Q15 results cap

In 1Q15, SIIC reported net profit growth of only 7%. This slower earnings growth was mainly because of the upgrading of the Shanghai Pucheng WTE projects and seasonal factors for the newly acquired Longjiang Water, as there are no construction revenues in the winter season in northern China.

We expect strong earnings growth in 2H15 after the completion of the Fudan Water acquisition on 21 May 2015. According to management, owing to some accounting arrangements for Fudan Water, the profits are skewed towards 2H15, anyway, so the majority of Fudan Water's earnings will still be captured in SIIC's earnings in 2015.



Figure 47: Income statement

(Rmb million, unless where noted otherwise)	2014	2015E	2016E	2017E	2018E
Reported revenue	1,504	1,833	2,232	2,847	3,134
- Construction service for service concession arrangement	232	464	597	750	545
- Construction revenue for external contract	210	100	-	-	-
- Operating and maintenance income	697	833	1,095	1,362	1,653
- Service income	117	121	127	134	138
- Others	33	49	50	50	50
- Imputed interest income	217	265	363	551	747
Cost of sales	(919)	(1,059)	(1,210)	(1,508)	(1,516)
Gross profit	586	774	1,023	1,339	1,617
<i>Gross margin</i>	39%	42%	46%	47%	52%
- Construction service for service concession arrangement	12%	12%	12%	12%	12%
- Construction revenue for external contract	12%	12%	12%	12%	12%
- Operation	52%	54%	57%	59%	59%
Other operating income	36	20	20	20	20
Selling and distribution costs	(15)	(15)	(15)	(15)	(15)
Administrative expenses	(177)	(204)	(235)	(270)	(313)
Operating profit	429	575	793	1,074	1,309
Net finance expense	(102)	(169)	(236)	(337)	(419)
Net other income	83	89	106	125	141
Profit before tax	410	494	663	863	1,030
Taxation	(76)	(91)	(124)	(163)	(205)
<i>Effective tax rate (%)</i>	22%	22%	22%	22%	23%
Net profit	334	403	539	700	825
Minority interest	(71)	(56)	(61)	(68)	(68)
Net profit attrib. to shareholders	262	348	478	632	758
<i>YoY growth (%)</i>	20%	19%	21%	22%	24%
Recurring net profit attrib. to shareholders	229	340	471	625	751
<i>YoY growth (%)</i>	37%	48%	38%	33%	20%
Adjusted earnings under normal accounting	188	276	382	510	629
<i>YoY growth (%)</i>	37%	46%	39%	33%	23%
Weighted average shares - basic (mm)	9,058	10,547	11,149	11,149	11,149
Recurring basic EPS (Rmb)	0.02	0.03	0.04	0.06	0.07
<i>YoY growth (%)</i>		29%	31%	33%	20%
Adjusted recurring EPS (Rmb)	0.02	0.03	0.03	0.05	0.06
<i>YoY growth (%)</i>		27%	31%	33%	23%
DPS (Rmb)	0.00	0.00	0.01	0.01	0.01
<i>Div. payout ratio (%)</i>	<i>n.m</i>	<i>n.m</i>	15%	15%	15%
RoE (%)	8.2%	8.0%	9.2%	11.1%	12.0%

Source: Company data, Deutsche Bank estimates



Sensitivity analysis

Figure 48 illustrates the sensitivity of the company's earnings and valuation to the key drivers, namely the amount of construction work (in value terms) for BOT projects, unit gross profit, utilisation rates and interest rates.

Figure 48: Sensitivity to key earnings drivers

Earnings sensitivity	2015E	2016E	2017E
Rmb100m decrease in BOT construction work amount	-2.3%	-1.7%	-1.3%
Rmb0.01/cum lower unit gross profit	-2.5%	-2.5%	-2.5%
1ppt decrease in utilisation rate	-1.7%	-1.7%	-1.8%
10bps increase in interest rate	-0.6%	-0.7%	-0.8%

Source: Deutsche Bank estimates

Deutsche Bank versus consensus estimates

There are only five brokers covering the stock, so the consensus numbers are not very meaningful. Our earnings estimates are 8-9% below consensus for 2015-16, but 2% above consensus for 2017.

Figure 49: Deutsche Bank versus consensus estimates

Rmb m	Recurring net profits			Recurring EPS (Rmb)			DPS (Rmb)		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
DB	348	478	632	0.03	0.04	0.06	-	0.01	0.01
Consensus	381	520	621	0.04	0.05	0.06	-	-	NA
Diff vs. consensus	-9%	-8%	2%	-16%	-14%	-6%	NA	NA	NA

Source: Deutsche Bank estimates, Bloomberg Finance LP

Balance sheet and cash flow analysis

Owing to ongoing capex, we expect free cash flow to remain negative until after 2020. Without any new share issuances, we expect the company's net debt to equity ratio to increase from 27% by end-2015 to 56% in 2016 and 78% in 2017, and to stabilise at 90-100% until free cash flow largely breaks even around 2023.

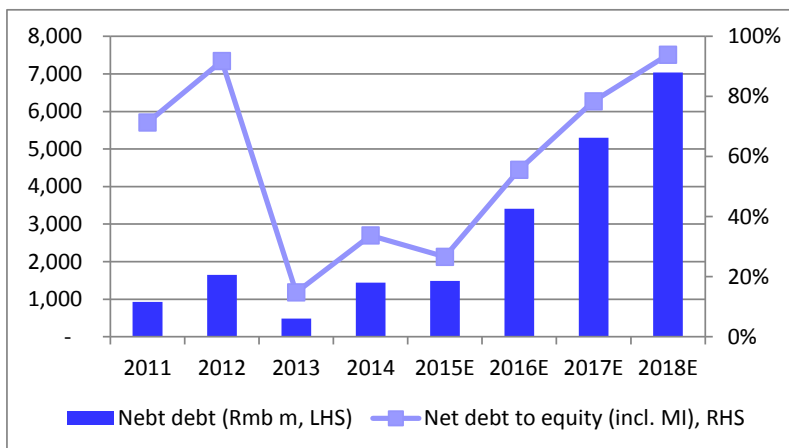
Figure 50: Capex and free cash flow estimates

(Rmb million, unless where noted otherwise)	2015E	2016E	2017E	2018E
New investment (kt/d)				
- BOT	253	290	340	200
- Upgrade	50	150	250	300
- TOT	1,300	1,300	1,300	1,300
Unit investment/construction cost (Rmb per t/d)				
- BOT	1,500	1,500	1,500	1,500
- Upgrade	600	600	600	600
- TOT	1,600	1,600	1,600	1,600
Capex (Rmb m)	2,489	2,605	2,740	2,560
Minus: est. debt assumed in acquisitions	(1,105)	-	-	-
Est. real operating cashflow	628	946	1,267	1,350
Interest paid	(154)	(175)	(247)	(348)
Capex	(2,489)	(2,605)	(2,740)	(2,560)
Free cashflow	(2,014)	(1,833)	(1,720)	(1,558)

Source: Company data, Deutsche Bank estimates



Figure 51: Net debt level and net debt to equity ratio



Source: Company data, Deutsche Bank estimates

Figure 52: Balance sheet

(Rmb million, unless where noted otherwise)	2014	2015E	2016E	2017E	2018E
Long Term Assets	6,209	7,514	9,970	12,502	14,919
Property, plant and equipment	108	80	70	59	49
Intangible assets	1,516	1,593	1,663	1,726	1,783
Receivables under service concession	3,233	4,457	6,818	9,266	11,614
Interest in JV	657	676	701	724	741
Interest in asso.	415	427	436	445	451
Others	281	281	281	281	281
Current Assets	1,958	3,157	3,372	3,772	4,034
Cash and cash equivalents	1,119	2,232	2,394	2,695	2,876
Receivables under service concession	93	93	93	93	93
Trade receivables	574	656	704	794	865
Amounts due from contract customers	70	68	68	68	68
Others	101	107	113	122	131
Total Assets	8,167	10,671	13,341	16,274	18,953
Current Liabilities	1,841	1,868	1,898	1,987	2,000
Bank and other borrowings	923	923	923	923	923
Trade payables	828	865	905	984	986
Others	89	80	70	80	92
Long Term Liabilities	2,049	3,205	5,307	7,522	9,456
Bank and other borrowings	1,703	2,862	4,946	7,138	9,056
Others	346	343	361	384	400
Total Liabilities	3,890	5,073	7,205	9,508	11,456
Total Equity	9,714	9,715	9,716	9,717	9,718
Shareholders equity	3,691	4,955	5,433	5,995	6,658
Minority interest	586	642	704	771	839
Balance sheet ratios					
BVPS (Rmb)	0.38	0.44	0.49	0.54	0.60
Total debt	2,626	3,785	5,869	8,061	9,979
Net debt (cash)	1,443	1,489	3,411	5,303	7,039
Net debt / equity, incl. MI	34%	27%	56%	78%	94%
Net debt / total capital	25%	21%	36%	44%	48%

Source: Company data, Deutsche Bank estimates



Figure 53: Cash flow statement

(Rmb million, unless where noted otherwise)	2014	2015E	2016E	2017E	2018E
EBITDA, incl. other income	286	676	901	1,189	1,431
Change in working capital	(15)	(197)	(2,369)	(2,459)	(2,415)
Income tax paid	(45)	(77)	(106)	(141)	(189)
Other adjustments	10	-	-	-	-
Cashflow from operating activities	236	402	(1,574)	(1,410)	(1,173)
Capex	(1,316)	(1,261)	(180)	(171)	(161)
Purchase of PPE	(18)	-	-	-	-
Acquisition of subsidiaries	(229)	(1,069)	-	-	-
Purchase of intangible assets	(135)	(200)	(200)	(200)	(200)
Acquisition/Incorporation of an asso	(405)	8	20	29	39
Acquisition/Capital injection into JV	(530)	-	-	-	-
Disposal	13	17	-	-	-
Others	27	87	95	108	124
Cashflow from investing activities	(1,275)	(1,157)	(85)	(63)	(37)
New loans	748	1,159	2,084	2,192	1,918
Loan repayments	(903)	-	-	-	-
Interest paid	(154)	(175)	(247)	(348)	(432)
Others	(136)	(33)	(17)	(71)	(94)
Proceeds from share issuance	751	917	-	-	-
Cashflow from financing activities	305	1,868	1,821	1,773	1,392
Net cash inflow/ (outflow)	(735)	1,113	162	300	182
Beginning cash balance	1,879	1,119	2,232	2,394	2,695
FX adj.	(25)	-	-	-	-
Ending cash balance	1,119	2,232	2,394	2,695	2,876

Source: Company data, Deutsche Bank estimates



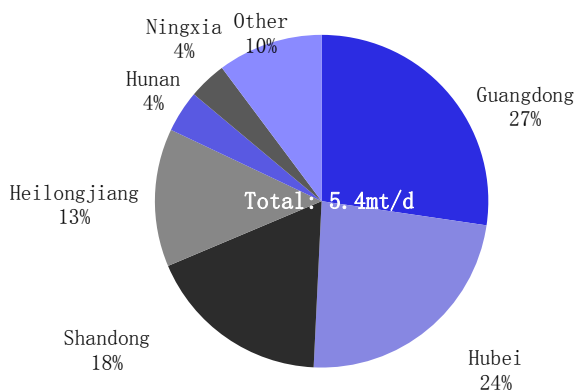
Company background

Company overview

SIIC Environment (SIIC), formerly known as Asia Water Technology (Asia Water), is listed in Singapore, with the ticker SIIC SP. The company's primary business is the operation of the wastewater and water supply business in China through BOT and TOT business models. It also entered the WTE business through a project acquisition in 2011.

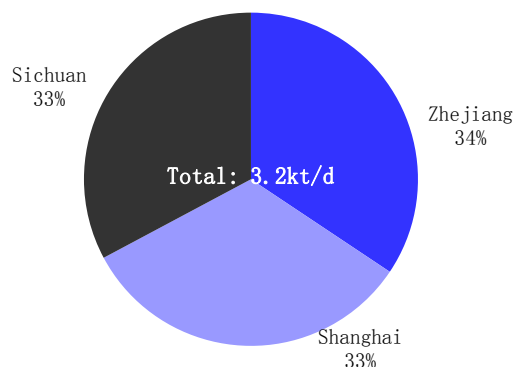
As at end-2014, SIIC owned c.70 water projects with a total designed capacity of 5.4mt/d and three WTE projects with total waste treatment capacity of 3,200t/d, located across 15 provinces and municipalities in China. After the completion of the Fudan water acquisition on 21 May 2015, SIIC now owns c.80 water projects with total designed capacity of 6.4mt/d.

Figure 54: Capacity breakdown for water treatment business at end-2014



Note: The designed capacity includes 25.313% of Longjiang's total designed capacity acquired in June and November
 Source: Deutsche Bank; Company data

Figure 55: Capacity breakdown for waste incineration at end-2014



Source: Deutsche Bank; Company data

Company history and shareholding structure

Asia Water was listed on the Singapore Exchange in 2005, and operated primarily in China through its Kaidi Water subsidiary. Asia Water experienced financial problems during the financial crisis in 2008. SIHL acquired Asia Water in February 2010. In November 2012, the company was transferred to the SGX Mainboard, and changed its name to SIIC Environment.



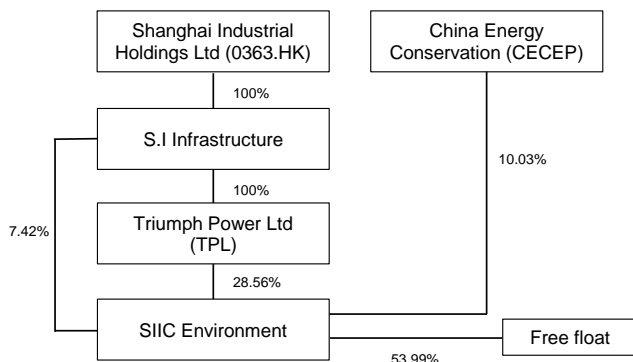
Figure 56: Key company milestones

2005	2010	2011	2012	2013	2014
Listed as Catalyst on the SGX-ST as Asia Water Technology Ltd. ("AWT")	<p>Feb 2010: SIHL acquired equity interests and convertible bonds in AWT owning 77% of enlarged share capital of AWT</p> <p>Mar 2010: Completion of restructuring with issuance of Placement Shares and Rights Shares to discharge Group's obligations under convertible bonds issued in 2007</p> <p>RunnerUp Award for the "Most Transparent Company Award" (Catalist Category) at the SIAS 11th Investors' Choice Awards 2010 for the 3rd consecutive time</p>	<p>Mar 2011: Completion of the Rights Issue to raise S\$72 mil for expansion and working capital</p> <p>RunnerUp Award for the "Most Transparent Company Award" (Catalist Category) at the SIAS 12th Investors' Choice Awards 2011 for the 4th consecutive time</p> <p>Acquired 75.5% of United Environment</p> <p>Raised the stake in Wuhan Hanxi to 80% by acquiring additional 37% of its shares</p> <p>Entered waste incineration industry by acquiring 50% of Wenling Hanyang</p>	<p>Nov 2012: Transfer to list on Mainboard of the SGX-ST</p> <p>Change of name to SIIC Environment Holdings Ltd.</p> <p>Acquired 69.4% of Nanfang</p> <p>Designed daily water treatment capacity was increased significantly from 1 million ton in 2010 to above 3 million tons</p> <p>Operations were expanded to 12 provinces</p>	<p>Dec 2013: Completed placement of 3.1 billion new ordinary shares at S\$0.085 per share to raise S\$260.2 mil for business expansion and general working capital</p> <p>Increased stake in Nanfang to 72.49%, and further increased to 76.42%</p> <p>Awarded 400,000 tons/day O&M contract by Shenzhen Municipal</p> <p>Investment in Sichuan SIIC Environment Development Co., Ltd to pursue opportunities in Sichuan Province</p> <p>Completed two tranches of equity injection into SIIC Environment</p> <p>Weifang Granted the upgrade and expansion project of Wuhan Hanxi</p>	<p>Jul 2014: Completed placement of 1.0 billion new ordinary shares at S\$0.158 per share to raise S\$154.8 million</p> <p>Jan 2014: Completed acquisition of 50% equity interest in Shanghai Pucheng Thermal Power Energy Co., Ltd.</p> <p>Feb 2014: Completed the acquisition of 100% of Shanghai Qingpu Second Wastewater Treatment Plant</p> <p>Feb 2014: Completed the acquisition of 100% of Dazhou Jiaying, thus increasing the Group's total solid waste treatment design capacity to over 3,000 tons/day</p> <p>Mar 2014: Proposed disposal of 100% equity interest in Wuhan Kaidi Water Services (mainly EPC business)</p> <p>Jun 2014: Proposed acquisition of 25.3% in Longjiang Group. The acquisition of 13.125% stake in Longjiang Group is completed in July 2014</p>

Source: Deutsche Bank, Company data

SIHL is the controlling shareholder of SIIC, which held a 41.85% stake in SIIC through the control of TPL and S.I Infrastructure at end-2014. Following the completion of the acquisition of Fudan Water (additional 1.56bn shares issued on 21 May 2015), SIHL's interest in SIIC Environment will decrease to c.36% (through TPL and S.I. Infrastructure).

Figure 57: Shareholding structure of SIIC after Fudan Water acquisition

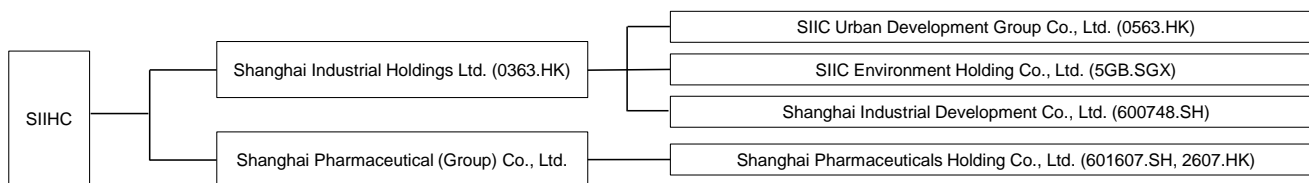


Source: Company data; Deutsche Bank

SIHL is a conglomerate listed in Hong Kong (0363.HK, NR) that is involved in real estate, medicine, infrastructure, consumer products and equity investments. It is the flagship company of Shanghai Industrial Investment (Holding) Co., Ltd. (SIHC), which holds a 58% stake in SIHL. SIHC, a "window company" established by the Shanghai government in Hong Kong in 1981, is currently wholly owned by the state-owned Assets Supervision and Administration Commission of the Shanghai Municipal Government.



Figure 58: Listed member enterprises of SIIHC



Source: Deutsche Bank, Company data

China Energy Conservation and Environmental Protection Group (CECEP), a central government-owned SOE, owns a c.10% stake in SIIC Environment, and is the second-largest shareholder. CECEP has been co-investing with SIHL in the water sector (through General Water) since 2003. It also bought SIIC shares and became SIIC's second-largest shareholder in 2011.

SIIC adopted a stock option and stock incentive scheme in April 2012, but no shares/options have been granted yet. Currently, with regard to the management team, only Mr. Yang Changmin has a 0.5% stake in SIIC, which was obtained when Mr. Yang sold United Environment, the company he founded, to SIIC in December 2011.

Figure 59: Management profile

Name	Position	Experience & Qualifications
Mr. Zhou Jun	Executive Chairman	<ul style="list-style-type: none"> * Joined SIIHC Group in April 1996 * Nearly 20 years of experience in financial investment, mergers and acquisitions, real estate and general management * Part of the senior management of SIIHC Group for a long time
Mr. Xu Zhan	CFO, Executive Director	<ul style="list-style-type: none"> * In charge of accounting, financial, treasury and tax matters. * Appointed to the Board of Directors on 5 November 2014. * Appointed CFO on 18 May 2015. * Worked at SIIHC Group for 18 years. * Rich experience in water and clean energy industries and has been involved in a number of major projects and listed company acquisitions.
Mr. Feng Jun	Executive Director	<ul style="list-style-type: none"> * In charge of operation management and solid waste business * Appointed to the Board of Directors on 15 December 2009 and was last reelected on 27 April 2011 * More than 28 years of experience in investment * Part of the senior management of SIIHC Group for a long time
Mr. Yang Changmin	Executive Director	<ul style="list-style-type: none"> * In charge of water operation management and other new businesses * Appointed to the Board of Directors on 17 February 2012 and was last elected on 27 April 2012. * Founded United Environment Co., Ltd. and had been the Chairman and General Manager for many years * More than 20 years' experience in the operation and management of water and environmental protection investment as well as project and administrative management
Mr. Yang Yihua	Executive Director	<ul style="list-style-type: none"> * Appointed to the Board of Directors on 7 April 2010 and was last reelected on 27 April 2012, on behalf of CECEP * More than 40 years of experience in enterprise operation and management
Mr. Xu Xiaobing	Executive Director	<ul style="list-style-type: none"> * In charge of M&A * Appointed to the Board of Directors on 5 November 2014. * Currently serves as the General Manager of SIIC Management (Shanghai) Limited.

Source: Company data; Deutsche Bank



Rating
Buy

Asia
 China

Utilities
 Utilities

Company
**China Everbright
 Water**

Reuters
 CEWL.SI

Bloomberg
 CEWL SP

Price at 5 Jun 2015 (SGD)	1.02
Price target - 12mth (SGD)	1.32
52-week range (SGD)	1.16 - 0.80
HANG SENG INDEX	27,260

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Ready for takeoff; initiating with Buy

Initiating with Buy; top pick in the sector

We initiate coverage of China Everbright Water (CEW) with a Buy. CEW is well positioned to become one of the leading water companies in China, supported by its SOE background, low funding cost and synergy with its parent CEI. We expect CEW to accelerate expansion after completion of the reverse takeover of HanKore as a separately listed vehicle in Dec 2014. It offers the highest earnings growth and therefore deserves a higher valuation multiple than peers.

Strong growth outlook; synergy with its parent CEI

We expect CEW to deliver a 43% EPS CAGR in 2015-17E after a temporary slowdown in 2015 with the impact from the reverse takeover (RTO). CEW aims to grow its designed capacity to over 10mt/d in 3-5 years. We conservatively assume 0.5mt/d new project wins in 2015 to allow for a transitional period after the RTO, followed by a 1.5mt/d p.a. addition to achieve total designed capacity of c.10mt/d in five years. CEW's parent CEI is known for its strong track record in the environmental sector. As CEI's water platform, CEW should benefit from CEI's reputation and synergy in sourcing new projects. There is still room for CEW to leverage up (from c.11% net debt to equity currently) to fund capex.

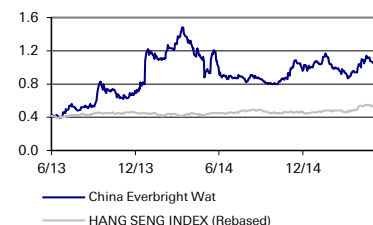
Under-researched; more attractive risk-reward than peers

CEW has underperformed peers by 25ppt YTD. Its valuation multiple appears high for 2015 due to the temporary impact of the RTO, but it looks attractive in 2017 considering its strongest growth rate. We think the market expectation is relatively conservative, as CEW is still building up its track record. There is significant potential for it to beat expectations. Every 1mt/d of extra capacity would imply an over 20% boost to the near-term earnings. Listing in Hong Kong in the future looks to be a realistic possibility, which would help improve the liquidity and re-rating of the stock.

DCF-based target price of S\$1.32; key risks

Our DCF valuation (WACC 6.2%) incorporates long-term growth and is not affected by the mismatch between reported earnings and cash flows under concession accounting. Risks: lower-than-expected project wins, EPS dilution from potential equity placement, and receivable risks from local governments.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-4.2	5.2	-1.9
HANG SENG INDEX	-1.2	12.8	18.8

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (HKDm)	1,291	1,051	1,781	2,857	3,737
EBITDA (HKDm)	488	538	755	1,135	1,565
Reported NPAT (HKDm)	266	293	449	708	957
DB EPS FD (HKD)	0.137	0.149	0.175	0.271	0.367
DB EPS growth (%)	-	8.3	17.3	55.5	35.1
PER (x)	24.3	42.1	33.5	21.6	16.0
Price/BV (x)	7.9	2.4	2.1	1.9	1.7
EV/EBITDA (x)	14.5	24.6	20.5	15.2	12.8
Yield (net) (%)	0.0	0.0	0.0	0.5	0.6
ROE (%)	16.2	7.3	6.5	9.1	11.1

Source: Deutsche Bank estimates, company data



Model updated: 07 June 2015

Running the numbers

Asia
 China
 Utilities

China Everbright Water

Reuters: CEWL.SI Bloomberg: CEWL.SP

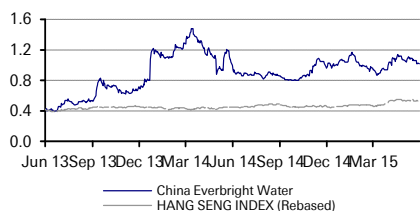
Buy

Price (5 Jun 15) SGD 1.03
 Target Price SGD 1.32
 52 Week range SGD 0.80 - 1.17
 Market Cap (m) SGDm 2,673
 USDm 1,969

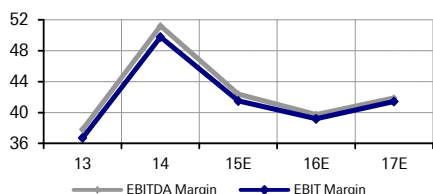
Company Profile

China Everbright Water (CEW), a 74.4 percent-owned subsidiary of China Everbright Intl, is listed in Singapore. CEW is primarily engaged in the environmental water business, such as wastewater treatment, and reusable water, etc.. Upon the completion of reverse takeover of Hankore Environment (previously known as Bio-Treat) on 12 December 2014, CEW has expanded its water business with projects located across North and Central of China, including Beijing, Jiangsu, Shandong, Shaanxi, and Henan.

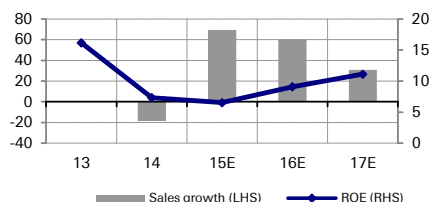
Price Performance



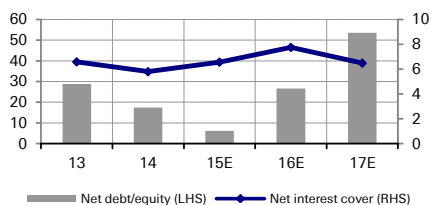
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2013	2014	2015E	2016E	2017E
DB EPS (HKD)	0.14	0.15	0.17	0.27	0.37
Reported EPS (HKD)	0.14	0.15	0.17	0.27	0.37
DPS (HKD)	0.00	0.00	0.00	0.03	0.04
BVPS (HKD)	0.8	2.5	2.8	3.1	3.5
Weighted average shares (m)	1,940	1,969	2,571	2,608	2,608
Average market cap (HKDm)	6,475	12,341	15,266	15,266	15,266
Enterprise value (HKDm)	7,093	13,227	15,507	17,287	20,102

Valuation Metrics

P/E (DB) (x)	24.3	42.1	33.5	21.6	16.0
P/E (Reported) (x)	24.3	42.1	33.5	21.6	16.0
P/BV (x)	7.88	2.41	2.05	1.88	1.68
FCF Yield (%)	3.6	2.5	1.2	nm	nm
Dividend Yield (%)	0.0	0.0	0.0	0.5	0.6
EV/Sales (x)	5.5	12.6	8.7	6.1	5.4
EV/EBITDA (x)	14.5	24.6	20.5	15.2	12.8
EV/EBIT (x)	15.0	25.3	21.0	15.4	13.0

Income Statement (HKDm)

Sales revenue	1,291	1,051	1,781	2,857	3,737
Gross profit	529	596	878	1,281	1,736
EBITDA	488	538	755	1,135	1,565
Depreciation	14	14	15	15	15
Amortisation	0	1	1	1	1
EBIT	474	523	739	1,119	1,549
Net interest income/(expense)	-72	-90	-113	-144	-239
Associates/affiliates	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	402	433	626	975	1,310
Income tax expense	112	119	157	244	327
Minorities	24	21	21	23	26
Other post-tax income/(expense)	0	0	0	0	0
Net profit	266	293	449	708	957
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	266	293	449	708	957

Cash Flow (HKDm)

Cash flow from operations	243	317	173	-1,562	-2,236
Net Capex	-12	-3	0	0	0
Free cash flow	231	313	173	-1,562	-2,236
Equity raised/(bought back)	0	0	655	0	0
Dividends paid	0	0	0	0	0
Net inc/(dec) in borrowings	-228	-149	209	1,804	2,385
Other investing/financing cash flows	68	94	-163	-194	-289
Net cash flow	72	259	875	47	-140
Change in working capital	-190	-173	-492	-2,571	-3,609

Balance Sheet (HKDm)

Cash and other liquid assets	290	681	1,556	1,603	1,464
Tangible fixed assets	170	174	159	144	130
Goodwill/intangible assets	158	1,994	2,008	2,021	2,031
Associates/investments	298	483	483	483	483
Other assets	4,474	6,780	7,347	10,074	14,052
Total assets	5,390	10,112	11,553	14,325	18,160
Interest bearing debt	864	1,824	2,033	3,838	6,487
Other liabilities	2,535	1,736	1,844	2,080	2,283
Total liabilities	3,399	3,560	3,878	5,918	8,771
Shareholders' equity	1,649	6,325	7,429	8,137	9,094
Minorities	343	226	247	270	296
Total shareholders' equity	1,991	6,551	7,676	8,407	9,389
Net debt	574	1,143	478	2,235	5,024

Key Company Metrics

Sales growth (%)	nm	-18.6	69.5	60.4	30.8
DB EPS growth (%)	na	8.3	17.3	55.5	35.1
EBITDA Margin (%)	37.8	51.2	42.4	39.7	41.9
EBIT Margin (%)	36.7	49.8	41.5	39.2	41.4
Payout ratio (%)	0.0	0.0	0.0	10.0	10.0
ROE (%)	16.2	7.3	6.5	9.1	11.1
Capex/sales (%)	1.0	0.3	0.0	0.0	0.0
Capex/depreciation (x)	0.9	0.2	0.0	0.0	0.0
Net debt/equity (%)	28.8	17.5	6.2	26.6	53.5
Net interest cover (x)	6.6	5.8	6.6	7.8	6.5

Source: Company data, Deutsche Bank estimates



Investment thesis

Outlook

We believe China Everbright Water (CEW) is well positioned to become one of the leading water companies in China, supported by its SOE background, low funding cost and synergy with its parent CEI. We expect CEW to accelerate expansion as a separately listed vehicle after the completion of the reverse takeover (RTO) of HanKore in December 2014. CEW's parent CEI is known for its strong track record in the environmental sector, especially in the waste-to-energy business. As CEI's water platform, CEW should benefit from CEI's reputation and synergy in sourcing new projects.

We expect CEW to deliver a 43% EPS CAGR in 2015-17E after a temporary slowdown in 2015 with the impact from the RTO. CEW aims to grow its designed capacity to over 10mt/d in 3-5 years from 3.4mt/d by end-2014. We assume 0.5mt/d new project wins in 2015 to allow for a transitional period after the RTO, followed by a 1.5mt/d p.a. addition to achieve total designed capacity of c.10mt/d within five years. We believe there is room for CEW to leverage up (from c.11% net debt to equity after the placement in April 2015) to fund capex.

We think the stock is under-researched, partly due to its relatively low trading liquidity. We think CEW may consider listing in Hong Kong in the future, which should help improve the liquidity and re-rating of the stock. We think strong project wins and major acquisitions at reasonable prices are potential catalysts for the share price. Buy.

Valuation

We derive our target price using a DCF valuation with explicit cash flows till 2050 and minimal terminal value, discounted at a WACC of 6.2% (RFR of 3.9%, beta of 0.8 and EQR of 5.6%, yielding a CoE of 8.4%; CoD of 4.8%; and D/E of 45:55). Our DCF valuation is not affected by the mismatch between reported earnings and cash flows under concession accounting. Every 1mt/d of extra new capacity would imply c.4% upside from our valuation.

Risks

The main downside risks include the following: 1) rising competition for new projects; 2) regulatory risks, including delays in implementing cost pass-through for wastewater and water supply projects; 3) credit risk on the receivables from local governments or other customers; 4) lower-than-expected project wins; 5) EPS dilution from potential equity placement; and 6) possible higher share price volatility due to relatively low trading liquidity.



Key downside risks

Rising competition for new projects

Competition for new projects is increasing. Although CEW's parent CEI has so far maintained a minimum investment threshold of equity IRR of 10%, there is a risk that CEW may have to accept lower returns to increase its capacity rapidly or to deliver slower capacity growth.

Receivables risk

The ability and willingness to pay of the local government could affect the cash flow of the project. In addition, CEW's existing portfolio is mainly in developed provinces with better credibility and affordability. The receivable risk may increase as the company expands into other inland regions.

Lower-than-assumed utilisation rate

The utilisation rate could be affected by factors like network connection issues, additions of new capacity to the network, or wastewater/water supply shortages, etc. However, the risk is minimised to some extent by minimum treatment volume guarantees agreed upon with the local governments.

Adverse regulatory changes

Wastewater treatment projects are normally based on 25-30-year concession agreements with the local government, with a tariff adjustment clause to reflect cost changes. However, the actual implementation of the tariff adjustment is subject to local governments' approval. If higher costs cannot be fully covered by tariff increases, it could negatively affect the company's profitability.

Specifically, the tightening of wastewater discharge standards may require upgrading of existing facilities, leading to a higher investment and operating cost. Operators can negotiate with local governments on tariff increase. However, if the tariff increase is not enough, the return could be adversely affected.

EPS dilution from potential equity placement

Due to the capital-intensive nature of the water business, water operators typically rely on debt for 70-80% of the financing in the construction of new projects. Although CEW's net gearing is relatively low at only c.11% after the completion of the recent share placement in April 2015, it is still possible to conduct an equity placement in the future to finance its business expansion.



Valuation

DCF-based target price of S\$1.32

We value CEW at S\$1.32, based on a mid-2016 DCF valuation (Figure 32), which is not affected by the mismatch between reported earnings and cash flows under concession accounting. We assume a WACC of 6.2%, explicit cash flow till 2050 with minimal terminal value.

We estimate that every 1mt/d of new project addition, assuming unit investment of RMB2,000 per t/d at a 9% project IRR, implies c.4% upside to our target price.

Figure 60: DCF valuation

(HKD million, except noted otherwise)	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2047E	2048E	2049E	2050E
WACC calculation														
Cost of equity:														
Risk free rate		3.90%												
Equity beta		0.80												
Equity risk premium		5.60%												
Implied cost of equity		8.38%												
Cost of debt:														
Pre-tax cost of debt								4.8%						
Long-term effective tax rate								25.0%						
Cost of debt (post tax)								3.57%						
TV Growth		0.0%												
Leverage (net debt/ (net debt + equity))														45.0%
WACC		6.20%												
DCF approach														
EBIT	1,119	1,549	2,004	2,321	2,586	2,927	3,223	3,503	3,657	3,678	585	353	214	188
Effective tax rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
NOPAT	840	1,161	1,503	1,741	1,939	2,195	2,417	2,627	2,743	2,759	439	265	160	141
Add back depreciation and amortisation	52	54	56	58	59	59	59	59	59	59	1	1	1	1
Adjust for working capital change	(2,571)	(3,609)	(3,803)	(3,546)	(3,021)	(2,356)	(1,923)	(1,798)	(565)	704	341	190	27	(15)
Less: cost of construction and acquisitions	(50)	(50)	(50)	(50)	-	-	-	-	-	-	-	-	-	-
Free cashflow	(1,729)	(2,443)	(2,294)	(1,797)	(1,023)	(102)	553	888	2,237	3,521	781	456	189	127
Terminal value														211
Total cashflow + terminal value	(1,729)	(2,443)	(2,294)	(1,797)	(1,023)	(102)	553	888	2,237	3,521	781	456	189	338
Discount factor	1.06	1.13	1.20	1.27	1.35	1.43	1.52	1.62	1.72	1.82	6.85	7.28	7.73	8.21
Present value of free cashflow	(1,628)	(2,166)	(1,915)	(1,413)	(757)	(71)	363	549	1,302	1,929	114	63	24	41
Sum of present value of free cashflow	20,354													
Less: total debt	(2,431)													
Less: minority interest	(247)													
Add: associates and JCEs	-													
Add: cash	1,556													
Equity value	19,818													
Target price (HKD/share)	7.60													
SGD:HKD	5.8													
Target price (SGD/share)	1.32													

Source: Deutsche Bank estimates

Trading history for CEW in its current form is limited after the completion of the RTO in December 2014. CEI announced its intention to conduct the RTO in December 2013, but it required about half a year to complete due to diligence and negotiations, with the deal terms finalised in June 2014. The share price had been volatile in tandem with market expectations on whether the deal would happen or not and on the deal pricing.

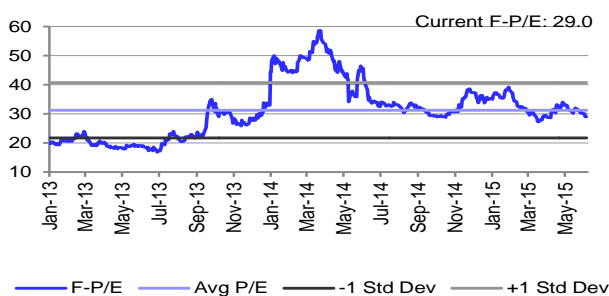
CEW's share price has not performed much since the completion of the RTO and has underperformed peers by 25ppt YTD. We think some investors are still waiting for the company to demonstrate its track record in getting new projects. Strong project wins and major acquisitions at reasonable prices are potential catalysts to the share price.



Only one broker covers CEW at the moment. Trading liquidity may also be a concern for some investors. CEW may consider listing in Hong Kong in the future, in our view, which should help improve the liquidity and re-rating of the stock.

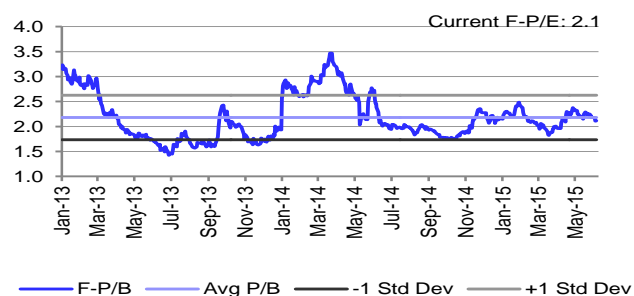
We believe there is still room for CEW to gear up to fund future capex, with a net debt to equity ratio of only c.11% after the recent placement to IFC and RRJ as strategic investors completed in April 2015. We have factored in no new share placement in our forecasts. However, although we think CEW does not need to issue equity, it may still choose to do so in the future. CEI has a c.74.4% stake in CEW, so CEI can still keep a controlling stake even if CEW issues new shares to the market.

Figure 61: Forward P/E



Source: Deutsche Bank estimates, Company data, Bloomberg Finance LP

Figure 62: Forward P/B



Source: Deutsche Bank estimates, Company data, Bloomberg Finance LP

CEW's 2015 adjusted earnings growth (adjusted from concession accounting to normal accounting) could be relatively muted at c.20%, due to the disproportionately higher SG&A expenses after the consolidation of HanKore in Dec 2014. More expensive borrowings from HanKore will be refinanced with cheaper financing in the course of 2015, resulting in a higher interest rate in 2015 before normalising again in 2016. We expect an adjusted earnings CAGR of 43% in 2015-17E.

Therefore, although CEW's EV/EBIT multiple appears high in 2015E, it looks more attractive than CEI in 2016-17E. Compared to BEWG, CEW's EV/EBIT is largely on par in 2017, but this is based on our relatively more conservative forecasts for CEW, while our assumption for BEWG has already allowed for better-than-management-guided capacity addition. We think EV/EBIT is more relevant than P/E multiples, considering BEWG's much higher gearing level.

Figure 63: Valuation comps

Share price as of June 5, 2015		Valuations										Returns & Gearing (%)										
Company	Ticker	Price	Rating	Price target	% to target	Mkt. Cap. US\$m	avg. daily trade US\$, 1m	EPS CAGR 2015-17E	Earnings CAGR 2015-17E	EV/EBIT 15E	EV/EBIT 16E	EV/EBIT 17E	PE 15E	PE 16E	P/BV 15E	Net debt/Total capital 15E	RoE 16E	Dividend yield 15E	Dividend yield 16E			
On reported earnings basis (concession accounting)																						
CEW	CEWL SP	SGD1.025	Buy	SGD1.32	29%	1,969	2.7	45%	46%	21.0	15.4	13.0	33.5	21.6	16.0	2.1	5.9	21.0	6.5	9.1	0.0	0.5
SIIC Environment	SIIC SP	SGD0.21	Buy	SGD0.28	33%	1,725	4.3	32%	35%	20.3	17.2	14.5	29.7	22.7	17.1	2.2	21.9	36.2	8.0	9.2	0.0	0.7
BEWG	371 HK	HKD6.6	Buy	HKD7.20	9%	5,832	13.0	22%	22%	18.4	14.7	13.2	26.2	20.5	17.7	2.6	51.3	54.0	13.0	15.5	1.4	1.8
GDI	270 HK	HKD10.86	Buy	HKD12.30	13%	8,703	11.6	11%	11%	14.0	12.5	9.2	17.5	16.0	14.2	2.1	(33.7)	(42.7)	12.4	12.8	3.0	3.7
CEI	257 HK	HKD13.98	Hold	HKD14.00	0%	8,057	11.2	25%	25%	18.4	15.1	11.4	26.8	20.6	17.0	3.5	25.3	37.2	13.6	15.9	0.9	1.2
Average ex. GDI																						
On adjusted earnings basis (normal accounting)																						
CEW	CEWL SP	SGD1.025						42%	43%	32.4	25.9	20.1	53.4	38.5	26.6				4.2	5.4		
SIIC Environment	SIIC SP	SGD0.21						32%	35%	27.3	22.6	19.0	38.3	29.0	22.1				6.5	7.6		
BEWG	371 HK	HKD6.6						26%	27%	31.5	24.3	20.3	38.2	29.7	23.9				9.6	11.9		
GDI	270 HK	HKD10.86						11%	11%	14.0	12.5	9.2	17.5	16.0	14.2				12.4	12.8		
CEI	257 HK	HKD13.98						27%	27%	31.4	26.0	21.9	50.2	39.3	31.2				8.1	9.8		
Average ex. GDI																						
31% 32% 19.5 15.6 13.0 29.1 21.3 16.9 2.6 26.1 37.1 10.3 12.4 0.6 1.0																						
30.6 24.7 20.3 45.0 34.1 26.0																						

Source: Deutsche Bank, Bloomberg Finance LP

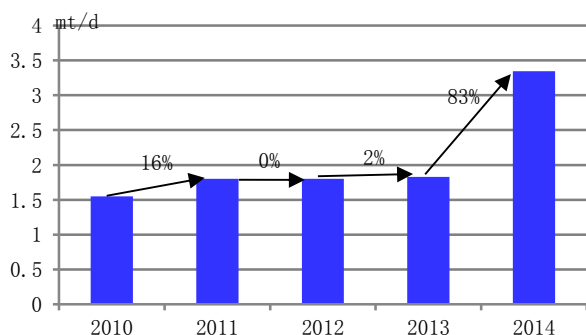


Ready to take off

Growth in water business to accelerate

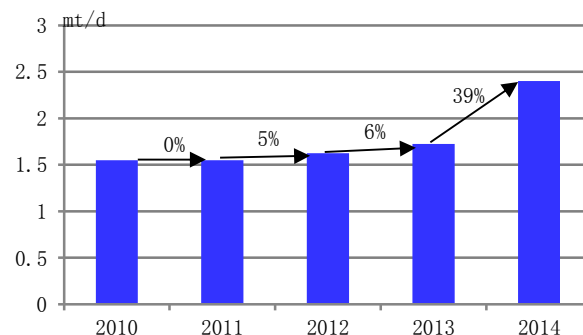
CEW was wholly owned by CEI before the acquisition of Singapore-listed HanKore. Its expansion in the water industry was slow in the past, with only a 6% CAGR in designed capacity in 2010-2013, as CEI focused more on the waste-to-energy business, which has a higher return than water. After acquiring HanKore in December 2014, the designed capacity of CEW nearly doubled from c.1.8mt/d at end-2013 to c.3.4mt/d at end-2014, with operational capacity increased from c.1.7mt/d at end-2013 to c.2.4mt/d at end-2014.

Figure 64: Designed capacity for wastewater treatment



Source: Deutsche Bank; Company data

Figure 65: Operational capacity for wastewater treatment



Source: Deutsche Bank; Company data

After completing the RTO and the internal integration in 1H15, CEW is now ready to accelerate expansion in China's water industry. In May 2015, CEW announced its first new wastewater treatment project after RTO in Ju County, Shandong Province, with designed capacity of 40kt/d through TOT contract.

CEW plans to expand through both M&A and BOT/TOT projects. Company management aims to increase its designed capacity to over 10mt/d in 3-5 years' time. This implies annual capacity addition of 1.3-2.2mt/d p.a. on average.

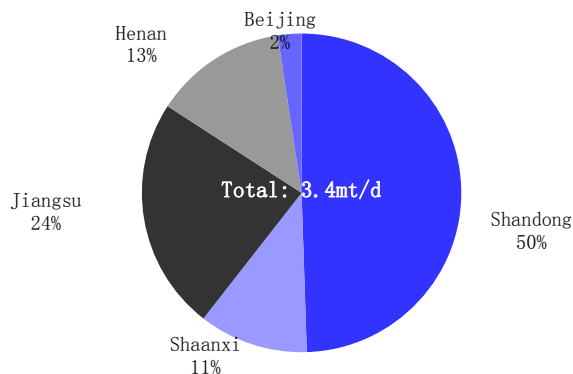
Reputation and synergy with CEI

Being a subsidiary of CEI, CEW benefits from the credibility and track record that CEI has established in the environmental protection industry. Although CEW only has a presence in five provinces so far, it can work with CEI to win new projects, leveraging on each other's connections with the local governments.

CEI is also known for its strong execution capability in securing and constructing WTE projects, with capable management and employees, competitive performance-based compensation and corporate culture. We expect similar merits to apply to CEW, which should help support its rapid growth.

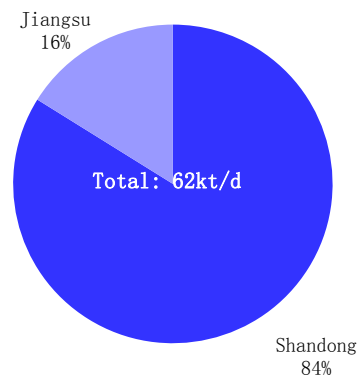


Figure 66: Capacity breakdown for wastewater treatment business at end-2014



Source: Deutsche Bank; Company data

Figure 67: Capacity breakdown for reusable water business at end-2014

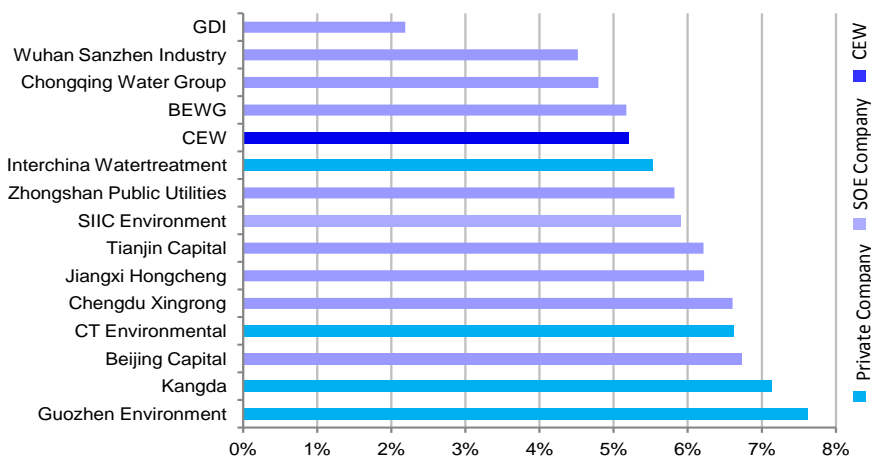


Source: Deutsche Bank; Company data

Low funding cost and gearing

Funding is a critical factor in the capital-intensive water industry. CEW's average bank borrowing cost was 5.2% in 2014, and although this will temporarily increase in 2015, until it refinances the more expensive borrowings from HanKore c.7-8% interest rate. The long-term cost should be close to that of its parent CEI (c.4.7% in 2014).

Figure 68: Borrowing cost comparison for peers in 2014



Source: Company data

Upon the completion of the private issuance of 120.7m shares to IFC and RRJ on 21 Apr 2015, we estimate CEW's net gearing ratio has declined to c.11%. There is room for CEW to increase gearing to optimise financial structure, which in turn could help fund more acquisitions and improve its ROE.

No plan yet, but listing in HK could be a good choice

CEW does not have any explicit plan to list in Hong Kong at the moment. But we think CEW may consider such option to improve its trading liquidity. This could help broaden its investor base and the valuation.



Financial outlook

Revenue and earnings outlook

We expect CEW to deliver reported earnings growth of 53% in 2015E and a 46% CAGR in 2015-17E. This is driven by both capacity expansion and more construction revenue from BOT projects.

However, as the construction revenue for BOT projects booked under concession accounting is non-cash in nature, we focus more on adjusted earnings, where we convert the earnings to normal accounting (Figure 44).

Figure 69: Reconciliation from concession accounting to normal accounting

	2014	2015E	2016E	2017E
Reported recurring profits - concession accounting	293	449	708	957
Less: Construction profit for BOT projects	(13)	(132)	(322)	(389)
Less: Construction cost saving	(10)	-	-	-
Add: Amortisation of financial assets, which should have been booked as revenue under normal accounti	112	184	210	296
Less: Depreciation that should have been booked under normal accounting	(176)	(280)	(310)	(423)
Total adjustment before tax and MI	(87)	(229)	(422)	(516)
Total adjustment after tax and MI	(59)	(164)	(307)	(377)
Recurring profits under normal accounting	234	285	401	580
Diff, normal vs. concession	20%	36%	43%	39%
Recurring EPS - concession accounting (HK\$)	0.15	0.17	0.27	0.37
Recurring EPS - normal accounting (HK\$)	0.12	0.11	0.15	0.22
PE reported (x)		33.5	21.6	16.0
PE adjusted to normal accounting (x)		53.4	38.5	26.6
EV/EBIT adjusted to normal accounting (x)		32.4	25.9	20.1

Note: Prices as of 5 June 2015
 Source: Deutsche Bank estimates, Company data

We expect a temporary slowdown in CEW's adjusted earnings to c.20% in 2015E, due to disproportionately higher SG&A expenses after the consolidation of HanKore in Dec 2014. More expensive borrowings at HanKore will be refinanced with cheaper financing in the course of 2015, with the unsecured note payable of S\$50m, at a fixed interest rate of 7.5%, redeemable only in August 2015. This will result in a higher interest rate in 2015E before normalising again in 2016E.

We then expect adjusted earnings CAGR of 43% in 2015-17E, driven by the 35% CAGR of average operational treatment capacity, coupled with economics of scale (as SG&A are allocated across a larger treatment volume) and a lower interest rate after the refinancing of expensive borrowings by HanKore.

Key assumptions

Capacity: We are assuming CEW will win new projects with designed capacity of 0.5mt/d in 2015, to allow for the transitional period after the RTO. We assume capacity addition to accelerate to 1.5mt/d p.a. in 2016-2020 and 1.2mt/d p.a. in 2021-2023.

We also expect CEW to have c.10mt/d of designed capacity within five years by end-2019. Our assumption is at the low end of the company's target to increase designed capacity to over 10mt/d in three to five years' time. Our



assumption implies that CEW's market share in wastewater treatment will increase from 1.4% by end-2014 to over 4% by end-2020E.

Utilisation rate: We assume utilisation for newly built plants to ramp up in three years from 70% to 90%. We expect the average utilisation rate for the company to be relatively stable.

Water tariffs: We assume stable tariffs in general, but a tariff increase of c.40% for wastewater treatment capacity upgraded from Grade 1B to Grade 1A to offset incremental costs as a result of upgrades.

Gross margin: We assume a stable gross margin of c.60% for water project operations and 25% for the BOT construction margin per management guidance. The company's average gross margin varies yoy due to the mix change of different segments, but it should gradually trend up towards the operational margin as a proportion of recurring operational revenue increases.

The key assumptions and estimates of cash revenue and derivation of reported revenue under concession accounting are shown in Figure 70 and Figure 71.

Figure 70: Key operational assumptions

	2014	2015E	2016E	2017E	2018E
Total designed treatment capacity (kt/d) - year end	3,482	3,982	5,482	6,982	8,482
WWT	3,420	3,920	5,420	6,920	8,420
Reusable water	62	62	62	62	62
Addition		500	1,500	1,500	1,500
Consolidated operational treatment capacity (kt/d) - year end	2,459	2,766	3,920	5,625	7,379
WWT	2,403	2,704	3,859	5,563	7,317
Reusable water	57	62	62	62	62
Addition		307	1,154	1,704	1,754
Consolidated average treatment capacity (kt/d)	1,866	2,613	3,343	4,772	6,502
WWT	1,810	2,553	3,281	4,711	6,440
Reusable water	57	59	62	62	62
Consolidated actual processed volume (mt)	641	874	1,097	1,555	2,120
WWT	622	854	1,077	1,534	2,099
Reusable water	19	20	21	21	21
Utilisation rate					
WWT	94%	92%	90%	89%	89%
Reusable water	92%	92%	92%	92%	92%
Tariffs (Rmb/ton)					
WWT	1.2	1.2	1.2	1.2	1.2
yoy		-6%	0%	1%	1%
Reusable water	3.0	3.0	3.0	3.0	3.0
yoy		0%	0%	0%	0%

Source: Company data, Deutsche Bank estimates

Figure 71: Derivation of revenue from concession arrangement

(HK\$ million, except noted otherwise)	2014	2015E	2016E	2017E	2018E
Est. cash revenue from service concession arrangement (A)	1,047	1,336	1,676	2,374	3,259
Finance income from service concession arrangement (B) = (E) x (F)	311	482	525	711	980
- Implied interest rate (F)	7%	7%	7%	7%	7%
Amortisation of financial receivables (C)	112	184	210	296	424
- Amortisation rate	2.5%	2.6%	2.7%	2.8%	2.9%
Operation income from service concession arrangement (D) = (A) - (B) - (C)	625	670	941	1,367	1,855
Financial receivables (E)	6,887	7,500	10,158	14,003	17,885
Construction activity (kt/d)					
- BOT		152	354	404	454
- Upgrade		20	100	200	200
Unit construction cost (Rmb per t/d)					
- BOT		2,000	2,000	2,000	2,000
- Upgrade		600	600	600	600
Construction cost (HK\$ m)		396	967	1,168	1,294
Construction gross margin		25%	25%	25%	25%
Construction revenue from service concession arrangement (HK\$ m)		527	1,290	1,558	1,726

Source: Company data, Deutsche Bank estimates



SG&A: We expect CEW's SG&A to rise 120% in 2015E after the consolidation of expenses from HanKore, while moderating to a 15% p.a. increase in 2016-17E. As the operational capacity increases, the SG&A will be allocated over a larger treatment volume, leading to economies of scale.

Finance expenses: We expect the company's finance charges to increase as a result of debt financing to fund capacity growth. We assume the average cost of debt would first increase from 5.2% in 2014 to 5.5% in 2015E due to the impact from HanKore before trending down to 4.8% in 2017E, similar to the average borrowing cost for CEI.

Figure 72: Income statement

(HK\$ million, except noted otherwise)	2014	2015E	2016E	2017E	2018E
Reported revenue	1,051	1,781	2,857	3,737	4,662
- Construction revenue from service concession arrangement	107	527	1,290	1,558	1,726
- Finance income from service concession arrangement	311	482	525	711	980
- Operation income from service concession arrangement	625	670	941	1,367	1,855
- Construction revenue from external contracts	6	67	67	67	67
- Discharge fees from waste-water treatment and recycling	3	35	35	35	35
Cost of sales	-454	-903	-1,576	-2,001	-2,411
Cost of sales, operational	-365	-448	-549	-773	-1,057
Construction cost from services concession arrangement	-94	-396	-967	-1,168	-1,294
Construction cost saving from services concession arrangement	10	-	-	-	-
Construction cost for external contracts	-5	(60)	(60)	(60)	(60)
Gross profit	596	878	1,281	1,736	2,251
<i>Gross margin</i>	<i>57%</i>	<i>49%</i>	<i>45%</i>	<i>46%</i>	<i>48%</i>
<i>Operation and finance income</i>	<i>61%</i>	<i>62%</i>	<i>63%</i>	<i>63%</i>	<i>63%</i>
<i>Construction from service concession arrangement</i>	<i>21%</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>
<i>Construction from external contracts</i>	<i>10%</i>	<i>10%</i>	<i>10%</i>	<i>10%</i>	<i>10%</i>
Other income and gains	4	28	28	28	28
Administrative expenses	(78)	(167)	(190)	(216)	(276)
Results from operating activities	523	739	1,119	1,549	2,004
Net finance cost	(90)	(113)	(144)	(239)	(366)
Profit before tax	433	626	975	1,310	1,638
Taxation	-119	-157	-244	-327	-409
<i>Effective tax rate (%)</i>	<i>27%</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>
Net profit	314	470	731	982	1,228
Minority interest	(21)	(21)	(23)	(26)	(28)
Net profit attrib. to shareholders, reported under concession accounting	293	449	708	957	1,200
YoY growth (%)	10%	53%	58%	35%	25%
Adjusted earnings under normal accounting	240	285	401	580	765
YoY growth (%)	-	19%	41%	44%	32%
Weighted average shares - basic (mm)	1,969	2,571	2,608	2,608	2,608
Recurring basic EPS (HK\$)	0.15	0.17	0.27	0.37	0.46
YoY growth (%)	8%	17%	56%	35%	25%
Adjusted recurring EPS (HK\$)	0.12	0.11	0.15	0.22	0.29
YoY growth (%)	-	-9%	39%	44%	32%
DPS (HK\$)	0.00	0.00	0.03	0.04	0.05
Div. payout ratio (%)	-	-	10%	10%	10%
RoE (%)	7.3%	6.5%	9.1%	11.1%	12.4%

Source: Deutsche Bank estimates, Company data

Sensitivity analysis

Figure 73 illustrates the sensitivity of the company's earnings and valuation to the key drivers.



Figure 73: Sensitivity analysis of recurring reported earnings

	2015E	2016E	2017E
HK\$100m decrease in BOT construction work amount	-4.0%	-2.6%	-1.9%
Rmb0.01/cum lower unit gross profit	-1.8%	-1.4%	-1.5%
1ppt decrease in utilisation rate	-1.2%	-1.0%	-1.1%
10bps increase in interest rate	-0.3%	-0.3%	-0.4%

Source: Deutsche Bank estimates

Balance sheet and cash flow analysis

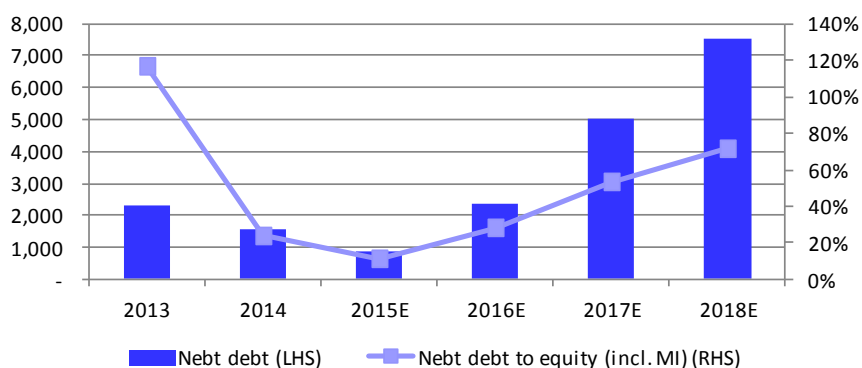
Due to the ongoing capex, we expect the free cash flow to remain negative until after 2020. Without any new share issuance, we expect the company's net debt to equity ratio to increase from 11% by end-2015E to 28% in 2016E, 54% in 2017E, 72% in 2018E and to stabilise at c.80% until free cashflow is largely breakeven around 2022E.

Figure 74: Capex and free cash flow estimates

(HK\$ million, except noted otherwise)	2015E	2016E	2017E	2018E	2019E	2020E
New investment (kt/d)						
- BOT	152	354	404	454	353	200
- Upgrade	20	100	200	200	200	200
- TOT	150	800	1,300	1,300	1,300	1,300
Unit investment/construction cost (Rmb per t/d)						
- BOT	2,000	2,000	2,000	2,000	2,000	2,000
- Upgrade	600	600	600	600	600	600
- TOT	1,600	1,600	1,600	1,600	1,600	1,600
Capex (HK\$ m)	697	2,577	3,785	3,911	3,655	3,271
Est. real operating cashflow	823	975	1,509	1,826	2,078	2,465
Interest paid	(116)	(154)	(249)	(376)	(501)	(609)
Capex	(697)	(2,577)	(3,785)	(3,911)	(3,655)	(3,271)
Free cashflow	11	(1,757)	(2,525)	(2,461)	(2,079)	(1,415)

Source: Deutsche Bank estimates

Figure 75: Net debt (HK\$ m, LHS) and net debt-to-equity ratio (RHS)



Source: Deutsche Bank estimates, Company data



Figure 76: Consolidated balance sheet

(HK\$ million, except where noted otherwise)	2014	2015E	2016E	2017E	2018E
Long Term Assets	8,403	8,961	11,675	15,631	19,651
Property, plant and equipment	174	159	144	130	115
Financial receivables	4,484	5,128	7,818	11,697	15,617
Intangible assets	951	965	977	988	996
Goodwill	1,044	1,044	1,044	1,044	1,044
Other receivables, incl. some TOT financial receivable	1,752	1,666	1,693	1,773	1,879
Current Assets	1,709	2,593	2,650	2,529	2,758
Cash and cash equivalents	681	1,556	1,603	1,464	1,670
Trade and other receivables	515	515	515	515	515
Financial receivables	483	483	483	483	483
Others	29	38	48	67	90
Total Assets	10,112	11,553	14,325	18,160	22,409
Current Liabilities	1,405	1,481	1,636	2,006	2,252
Bank and other borrowings	763	763	763	763	763
Trade payables	600	675	831	1,201	1,446
Others	43	43	43	43	43
Long Term Liabilities	2,155	2,397	4,282	6,764	9,610
Bank and other borrowings	1,062	1,271	3,075	5,725	8,462
Trade and other payables, mainly related party borrow	264	264	264	-	-
Others	829	862	943	1,040	1,148
Total Liabilities	3,560	3,878	5,918	8,771	11,862
Total Equity	6,551	7,676	8,407	9,389	10,547
Shareholders equity	6,325	7,429	8,137	9,094	10,223
Minority interest	226	247	270	296	324
Balance sheet ratios					
BVPS (HK\$)	2.54	2.85	3.12	3.49	3.92
Total debt	2,247	2,431	3,987	6,487	9,225
Net debt (cash)	1,566	875	2,384	5,024	7,555
Net debt / equity, incl. MI	24%	11%	28%	54%	72%
Net debt / total capital	19%	10%	22%	35%	42%

Source: Deutsche Bank estimates, Company data



Figure 77: Consolidated cash flow statement (HK\$ m)

Consolidated cashflow statement	2014	2015E	2016E	2017E	2018E
EBIT	523	739	1,119	1,549	2,004
Depreciation	14	15	15	15	15
Amortisation	10	36	38	40	41
Change in working capital	(173)	(492)	(2,571)	(3,609)	(3,803)
Income tax paid	(65)	(124)	(163)	(230)	(302)
Other adjustments	8	-	-	-	-
Operating cash flows	317	173	(1,562)	(2,236)	(2,045)
Capex	314	(50)	(50)	(50)	(50)
Acquisition of associates	1	-	-	-	-
Acquisition of subsidiaries	431	(50)	(50)	(50)	(50)
Acquisition of additional interest in a subsidiary	(114)	-	-	-	-
Purchase of PPE	(3)	-	-	-	-
Interest received	2	4	10	10	9
Cashflow from investing activities	316	(46)	(40)	(40)	(41)
Capital contributions from MI					
New loans	118	209	1,804	2,385	2,738
Loan repayments	(267)	-	-	-	-
Interest paid	(92)	(116)	(154)	(249)	(376)
Dividend payment	-	-	-	-	(71)
Others	(133)	-	-	-	-
Proceeds from share issuance	-	655	-	-	-
Cashflow from financing activities	(374)	748	1,650	2,136	2,291
Net cash inflow/ (outflow)	259	875	47	(140)	206
Beginning cash balance	247	499	1,374	1,421	1,282
FX adj.	(6)	-	-	-	-
Ending cash balance	499	1,374	1,421	1,282	1,488

Source: Deutsche Bank estimates, Company data



Company background

Company overview

China Everbright Water (CEW) is a 74.4%-owned subsidiary of China Everbright Intl (CEI). It was listed in Singapore through the reverse takeover (RTO) of Hankore Environment (HanKore) completed on 12 December 2014. CEW is primarily engaged in the environmental water business, mainly wastewater treatment and reusable water.

Before the RTO, CEW only had wastewater projects in Jiangsu and Shandong. CEW now has projects in three more provinces (Beijing, Shaanxi and Henan) after consolidating HanKore. As at end-2014, CEW owned and operated 32 wastewater treatment projects, with a designed daily treatment capacity of c.3.4mt/d, 4 reusable water projects and 2 wastewater source heat pump projects.

Company history

Bio-treat, listed on the Singapore Exchange in 2004, defaulted on its S\$206m convertible bonds in 2008. Mr. Chen Dawei participated in the restructuring and became the controlling shareholder in late 2010. Bio-treat was renamed HanKore Environment at the same time.

CEI is primarily engaged in environmental protection project investments, including waste-to-energy, solid waste disposal, sewage water treatment and alternative energy. CEI entered the water business via a partnership with Veolia, establishing the Qingdao project in 2003. It then secured more projects in Shandong and later in Jiangsu province. CEI announced in December 2013 that it signed a framework agreement with HanKore and proposed to inject all of its water business into HanKore in return for shares. After due diligence and negotiation, the conditional sale and purchase agreement was signed on 2 June 2014 and the deal was completed on 12 December 2014. HanKore was renamed China Everbright Water accordingly.

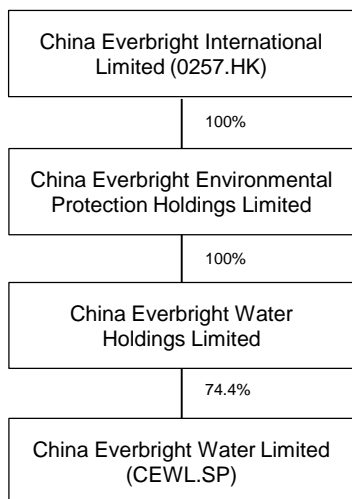
Shareholding structure

After the RTO, CEI held a c.78% stake in CEW. Following the completion of the issuance of 120.7m new ordinary shares to IFC and RRJ at an issue price of S\$0.94/share on 21 April 2015, CEI's stake in CEW declined to 74.4%.

In turn, CEI is c.41.4%-owned by China Everbright Group (CEG), a state-owned enterprise established in 1983 and under the supervision of the State Council. CEG's major businesses include financial services, environmental protection, and convention and exhibition services. Upon the completion of the restructuring of the group in May 2015, it was divided into two companies, with the China Everbright Financial Holding Company managing the financial assets and the China Everbright Industrial Company controlling non-financial assets.

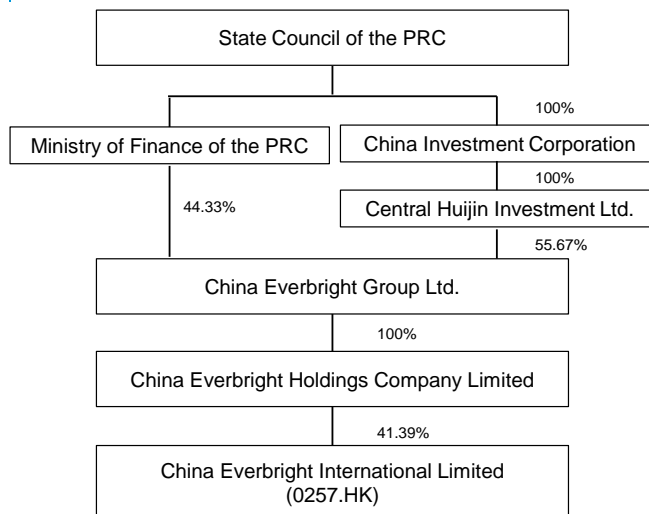


Figure 78: Shareholding structure of CEW



Source: Deutsche Bank; Company data

Figure 79: Shareholding structure of CEI



Source: Deutsche Bank; Company data

Management profile

Before the RTO, HanKore adopted a share option scheme in October 2011 and granted 365m share options to key management and certain employees on 15 November 2013, which had been fully exercised as at 31 December 2014. Therefore, only the management members and employees that were originally from HanKore have CEW shares.

Of the directors and senior management, only Mr. Chen Dawei (Executive Director and Vice-Chairman), Mr. Lin Zheyang (Vice President) and three Independent Directors have CEW shares, a c.2% stake in total.



Figure 80: Management profile

Name	Position	Experience & Qualifications
Mr. Wang Tianyi	Executive Director, Vice-Chairman and CEO	<ul style="list-style-type: none"> * The Executive Director and General Manager of CEI * Previously served as the President of Shandong Academy of Science and the Deputy Mayor of Jinan City of Shandong Province * Doctorate's degree in Economics, Master's degree in Management and a Bachelor's degree in Electronics from Tsinghua University
Mr. Chen Dawei	Executive Director and Vice-Chairman	<ul style="list-style-type: none"> * Joined the Group as the President in September 2010, and was appointed the Executive Chairman and CEO of the Group from May 2011 to December 2011, whereupon he relinquished his position as CEO and was re-designated as Executive Chairman from December 2011 to December 2014. * Extensive experience in Chinese enterprises management, mergers and acquisitions. * Served as the founder and CEO of Beijing Revolution Science and Technology Co., Ltd., the President of Tianjin Com-link Water Treatment Engineering & Technology Co., Ltd and the Executive Director of Beijing Juntai Investment Management Limited. before joined
Mr. An Xuesong	Executive Director and Standing Vice-President	<ul style="list-style-type: none"> * The Deputy General Manager of CEI * Comprehensive experience and knowledge in mergers and acquisitions, project investment and management, accounting management and risk management * Served at The General Office of Hubei Jingzhou Municipal People's Government, China Everbright Bank Ltd and Guangdong Technology Venture Capital Group Ltd. before joined * Holds CPA in China and CIIA
Mr. Chen Xiaoping	Non-Executive Director and Chairman	<ul style="list-style-type: none"> * The Executive Director and CEO of CEI * A Standing Director of China Environmental Culture Promotion Association * Previously served as a department head in the Bureau of Investigation & Supervision of The People's Bank of China, the Assistant Governor of China Everbright Bank Company Limited and the President of the Bank's Guangzhou Branch. * Rich experience and extensive knowledge in banking, capital market and management
Mr. Yang Zhiqiang	Non-Executive Director	<ul style="list-style-type: none"> * The Chief Legal Officer of CEI * Previously served as the Legal Assistant and PRC legal consultant of Livasiri & Co., the lawyer of Beijing Xinghe Legal Firm and Jiade Legal Firm, Shenzhen branch.
Mr. Luo Junling	Vice-President	<ul style="list-style-type: none"> * Responsible for the operation management * Worked in the the International Business Department of China Construction Bank, Fujian Branch, Finance Manager of Fujian Guang Min Road Bridge Construction Co., Ltd., and CPA of Fujian Min Xing Accounting Firm prior to joining
Mr. Tao Junjie	Vice-President	<ul style="list-style-type: none"> * Responsible for the engineering construction * Has rich experience in engineering construction and operation management * Holds the certificate of Certified Supervision Engineer and the title of Engineering Technology Researcher.
Mr. Changsong	Financial Controller	<ul style="list-style-type: none"> * Responsible for the finance management * Extensive experience in finance, investment, banking and budget management * Worked at China Merchants Bank and China Merchants Petrochemical prior to joining CEI in 2006 * A member of the ACCA
Mr. An Yili	Chief Engineer	<ul style="list-style-type: none"> * Responsible for technology research and development management * Served as the Vice-Chief Engineer of China Everbright Environmental Protection Engineering Technology (Shen Zhen) Co., Ltd., Greater China Senior Project Manager of CH2M HILL. Served as the General Engineer and General Manager of Infrastructure Department of General Water of China Co., Ltd * Served as the Chief Engineer and General Manager of Engineering Management Center of China Guodian
Mr. Lin Zheyang	Vice-President	<ul style="list-style-type: none"> * Joined as the Executive Director from May 2011 to December 2014 and was re-designated the Vice-President in December 2014 * Currently the Chairman of Ancient Jade Capital Management Co., Ltd. and the Vice-Chairman and Senior Vice-President of SF Express Limited. * Served as the Deputy Director of the Department of Foreign Trade of the Ministry of Commerce of the PRC.

Source: Company data; Deutsche Bank



Rating
Buy

Asia
 China

Utilities
 Utilities

Company
BEWG

Reuters
 0371.HK

Bloomberg
 371 HK

Price at 5 Jun 2015 (HKD)	6.60
Price target - 12mth (HKD)	7.20
52-week range (HKD)	7.12 - 4.28
HANG SENG INDEX	27,260

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A good long-term investment; Buy

Industry leader deserves premium valuation; reiterating Buy

BEWG, as the industry leader, has the unique advantage of having a motivated private management team and cheap SOE funding. We believe BEWG can deliver growth even higher than the market expects, while it is still cheaper than CEI and A-share peers. Although the upside from our share price target is only c.10% now, we still view it as a good long-term investment.

Capacity additions likely to exceed market expectations

BEWG management guides new project wins of at least 3mt/d in 2015. This guidance looks conservative, as the company also aims to double its total designed capacity from 20mt/d at end-2014 to 40mt/d by end-2018, which implies average project wins of c.5mt/d p.a. We think BEWG can beat its guidance again in 2015. We assume project wins of 4mt/d p.a. for 2015-18. Every 1mt/d p.a. additional new project win implies c.HK\$0.1/share value creation, assuming a project IRR of 9% and WACC of 6%.

Valuation relatively attractive

Adjusted for non-cash construction-related profits under concession accounting, BEWG is trading at 38x 2015E P/E, which is over 20% cheaper than CEI, although with a similar earnings CAGR of c.27% in 2015-17E. BEWG is also cheaper than A-share listed peers, with the most comparable national player Beijing Capital (600008.SS, NR) at c.60x 2015E P/E.

DCF-based target price of HK\$7.2; key risks

Our DCF valuation (WACC 6%) incorporates LT growth and is not affected by the mismatch between reported earnings and cash flows under concession accounting. Risks: lower-than-expected project wins, EPS dilution from potential equity placement, and receivables risk from local governments.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	0.9	34.1	33.3
HANG SENG INDEX	-1.8	12.7	18.0

Source: Deutsche Bank

Forecasts And Ratios

	2013A	2014A	2015E	2016E	2017E
Year End Dec 31					
Sales (HKDm)	6,406	8,926	11,679	15,184	17,298
EBITDA (HKDm)	1,888	3,270	3,730	4,978	5,958
Reported NPAT (HKDm)	1,084	1,794	2,145	2,816	3,291
Reported EPS FD(HKD)	0.140	0.203	0.245	0.320	0.373
DB EPS FD (HKD)	0.135	0.182	0.252	0.323	0.374
DB EPS growth (%)	14.8	35.4	38.2	28.1	15.9
PER (x)	22.2	28.1	26.2	20.5	17.7
Price/BV (x)	3.1	2.9	3.4	3.0	2.7
EV/EBITDA (x)	19.3	18.9	18.0	14.4	13.0
DPS (net) (HKD)	0.052	0.078	0.092	0.120	0.140
Yield (net) (%)	1.7	1.5	1.4	1.8	2.1
ROE (%)	10.0	12.3	13.0	15.5	16.3

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close



Model updated: 06 May 2015

Running the numbers

Asia
 China
 Utilities

BEWG

Reuters: 0371.HK Bloomberg: 371 HK

Buy

Price (5 Jun 15) HKD 6.60
 Target Price HKD 7.20
 52 Week range HKD 4.28 - 7.12
 Market Cap (m) HKDm 45,210
 USDm 5,831

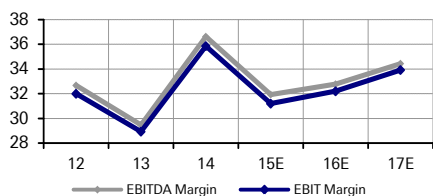
Company Profile

Beijing Enterprises Water is a state-owned enterprise that specializes in sewage treatment, water supply, reclaimed water and desalination business. It is currently one of the leading integrated water and sewage treatment provider in China, with its water plants located across 14 provinces and municipalities. Beijing Enterprises Holdings is largest shareholder.

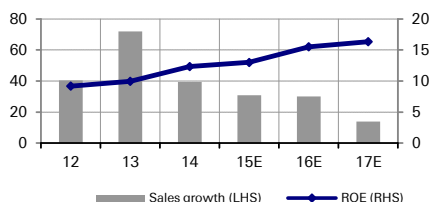
Price Performance



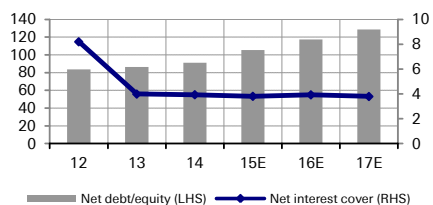
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

	2012	2013	2014	2015E	2016E	2017E
DB EPS (HKD)	0.12	0.13	0.18	0.25	0.32	0.37
Reported EPS (HKD)	0.11	0.14	0.20	0.25	0.32	0.37
DPS (HKD)	0.04	0.05	0.08	0.09	0.12	0.14
BVPS (HKD)	1.2	1.6	1.8	2.0	2.2	2.4
Weighted average shares (m)	6,909	7,756	8,643	8,727	8,767	8,807
Average market cap (HKDm)	12,317	23,146	44,268	45,210	45,210	45,210
Enterprise value (HKDm)	21,147	36,518	61,863	67,086	71,911	77,452

Financial Summary

	2012	2013	2014	2015E	2016E	2017E
P/E (DB) (x)	15.2	22.2	28.1	26.2	20.5	17.7
P/E (Reported) (x)	16.2	21.3	25.2	26.9	20.6	17.7
P/BV (x)	1.63	3.09	2.92	3.35	3.04	2.75
FCF Yield (%)	nm	nm	nm	nm	nm	nm
Dividend Yield (%)	2.2	1.7	1.5	1.4	1.8	2.1
EV/Sales (x)	5.7	5.7	6.9	5.7	4.7	4.5
EV/EBITDA (x)	17.4	19.3	18.9	18.0	14.4	13.0
EV/EBIT (x)	17.7	19.7	19.3	18.4	14.7	13.2

Valuation Metrics

	2012	2013	2014	2015E	2016E	2017E
Sales revenue	3,727	6,406	8,926	11,679	15,184	17,298
Gross profit	1,462	2,540	3,564	4,654	6,149	7,377
EBITDA	1,218	1,888	3,270	3,730	4,978	5,958
Depreciation	25	34	68	86	88	89
Amortisation	0	0	0	0	0	0
EBIT	1,193	1,854	3,201	3,644	4,890	5,869
Net interest income/(expense)	-145	-465	-812	-956	-1,244	-1,546
Associates/affiliates	55	108	278	278	278	278
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	1,102	1,497	2,667	2,967	3,924	4,602
Income tax expense	225	352	594	668	906	1,075
Minorities	117	61	279	154	202	236
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	761	1,084	1,794	2,145	2,816	3,291
DB adjustments (including dilution)	49	-41	-184	58	19	10
DB Net profit	810	1,044	1,611	2,202	2,835	3,301

Income Statement (HKDm)

	2012	2013	2014	2015E	2016E	2017E
Cash flow from operations	-427	-936	264	-2,704	-2,659	-2,861
Net Capex	-38	-42	-634	-30	-30	-30
Free cash flow	-466	-978	-370	-2,734	-2,689	-2,891
Equity raised/(bought back)	0	2,297	0	90	90	90
Dividends paid	-346	-345	-495	-806	-1,058	-1,236
Net inc/(dec) in borrowings	4,096	5,206	3,343	6,109	6,804	5,756
Other investing/financing cash flows	-916	-2,793	-1,753	-956	-1,244	-1,546
Net cash flow	2,368	3,387	725	1,703	1,903	173
Change in working capital	-2,368	-9,695	-6,856	-6,014	-7,033	-8,043

Cash Flow (HKDm)

	2012	2013	2014	2015E	2016E	2017E
Cash and other liquid assets	4,291	5,513	6,091	7,794	9,072	9,245
Tangible fixed assets	528	431	1,299	1,243	1,185	1,126
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	2,419	3,025	3,109	3,387	3,666	3,944
Other assets	24,053	35,218	41,142	48,395	56,912	65,609
Total assets	31,290	44,187	51,641	60,819	70,835	79,923
Interest bearing debt	13,275	19,283	23,490	29,599	35,778	41,535
Other liabilities	7,284	8,979	9,062	10,549	12,335	13,288
Total liabilities	20,558	28,262	32,552	40,148	48,114	54,822
Shareholders' equity	8,467	13,298	15,784	17,213	19,061	21,205
Minorities	2,264	2,627	3,304	3,458	3,660	3,896
Total shareholders' equity	10,731	15,924	19,089	20,671	22,721	25,101
Net debt	8,984	13,770	17,400	21,805	26,706	32,290

Balance Sheet (HKDm)

	2012	2013	2014	2015E	2016E	2017E
Sales growth (%)	40.4	71.9	39.3	30.8	30.0	13.9
DB EPS growth (%)	50.0	14.8	35.4	38.2	28.1	15.9
EBITDA Margin (%)	32.7	29.5	36.6	31.9	32.8	34.4
EBIT Margin (%)	32.0	28.9	35.9	31.2	32.2	33.9
Payout ratio (%)	36.3	37.2	37.6	37.5	37.5	37.5
ROE (%)	9.2	10.0	12.3	13.0	15.5	16.3
Capex/sales (%)	1.0	0.7	7.1	0.3	0.2	0.2
Capex/depreciation (x)	1.5	1.2	9.3	0.3	0.3	0.3
Net debt/equity (%)	83.7	86.5	91.2	105.5	117.5	128.6
Net interest cover (x)	8.2	4.0	3.9	3.8	3.9	3.8

Key Company Metrics

	2012	2013	2014	2015E	2016E	2017E
Net debt/equity (LHS)	83.7	86.5	91.2	105.5	117.5	128.6
Net interest cover (RHS)	8.2	4.0	3.9	3.8	3.9	3.8

Source: Company data, Deutsche Bank estimates



Investment thesis

Outlook

As the leading integrated wastewater and water supply company in China, BEWG should be the key beneficiary of the country's rapid growth in the environmental protection sector. Growth opportunities will come from new-build of wastewater treatment plants, privatisation of existing treatment facilities owned by local governments, and the upgrade of existing treatment facilities to meet tighter discharge standards. Water supply projects could also see a gradual improvement in returns with water tariff hikes.

We expect a strong adjusted earnings CAGR of 27% in 2015-17E, given the visible pipeline of projects. We believe BEWG's strong growth can be supported by lower financing costs and a more motivated management team with a stock incentive plan. We believe it can grow faster than management guidance and market expectations; Buy.

Valuation

Our target price is derived using the DCF method, incorporating a 6% WACC (CoD 5%; RFR 3.9%, 0.85 beta, 5.6% ERP yielding an 8.7% CoE), which incorporates longer-term growth and is not affected by the mismatch between reported earnings and cash flows under concession accounting. Although the P/E multiple looks high compared to the historical range, we believe BEWG deserves such a premium because of its unique advantages, strong growth, and the more favourable government policies in the water industry.

Risks

The main downside risks include: 1) credit risk on the receivables from local governments; 2) delays in implementing cost pass-through for wastewater and water supply projects; 3) rising competition for new water projects; 4) stress on managerial and financial resources from rapid expansion; 5) political or foreign exchange risks for overseas investment; 6) EPS dilution from potential share placements; and 7) any delay in project construction due to the relatively high reliance on earnings from construction activities in the near term (as opposed to recurring earnings from operational wastewater and water supply projects).



Valuation and earnings forecasts

We value BEWG at HK\$7.2, based on a mid-2016 DCF valuation (Figure 81), assuming BEWG can win 4mt/d of new projects annually in 2015-18 and 2-3mt/d p.a. in 2019-23.

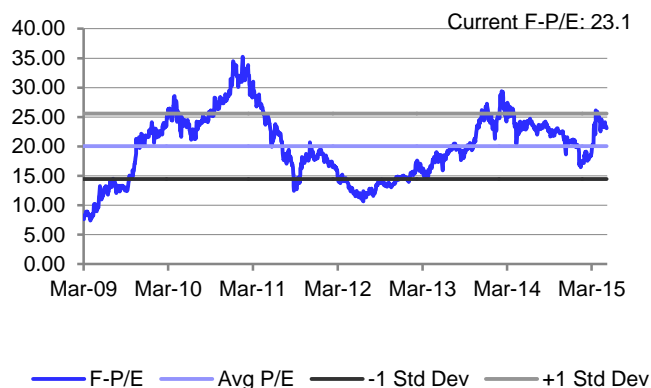
Figure 81: DCF valuation

(HK\$ million, except noted otherwise)	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2047E	2048E	2049E	2050E
WACC calculation																
Cost of equity:																
Risk free rate	3.90%															
Equity beta	0.85															
Equity risk premium	5.60%															
Implied cost of equity	8.66%															
Cost of debt:																
Pre-tax cost of debt	5.00%															
Long-term effective tax rate	25.00%															
Cost of debt (post tax)	3.75%															
TV Growth	0.0%															
WACC	6.0%															
DCF approach																
EBIT	4,890	5,869	6,581	7,544	8,316	8,977	9,470	10,083	10,485	10,353	1,230	848	476	194		
Effective tax rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
NOPAT	3,675	4,410	4,945	5,658	6,237	6,733	7,103	7,562	7,864	7,765	923	636	357	145		
Add back depreciation and amortisation	88	89	91	92	94	96	97	99	100	102	116	116	116	116		
Adjust for working capital change	(7,033)	(8,043)	(7,028)	(4,940)	(4,452)	(2,666)	(1,749)	(999)	2,075	4,312	590	297	53	(97)		
Less: cost of construction and acquisitions	30	30	30	30	30	30	30	30	30	30	30	30	30	30	0	
Free cashflow	(3,241)	(3,514)	(1,962)	840	1,909	4,192	5,481	6,692	10,069	12,209	1,658	1,079	556	164		
Terminal value																2,756
Total cashflow + terminal value	(3,241)	(3,514)	(1,962)	840	1,909	4,192	5,481	6,692	10,069	12,209	1,658	1,079	556	2,921		
Discount factor	1.06	1.12	1.19	1.26	1.34	1.42	1.50	1.59	1.68	1.78	6.37	6.75	7.16	7.58		
Present value of free cashflow	(3,058)	(3,130)	(1,649)	667	1,429	2,962	3,655	4,211	5,980	6,843	260	160	78	385		
Sum of present value of free cashflow	81,899															
Less: total debt	(29,599)															
Less: minority interest	(3,458)															
Add: associates and JCEs	6,775															
Add: cash	8,098															
Equity value	63,714															
Target price (HK\$/share)	7.2															

Source: Deutsche Bank estimates

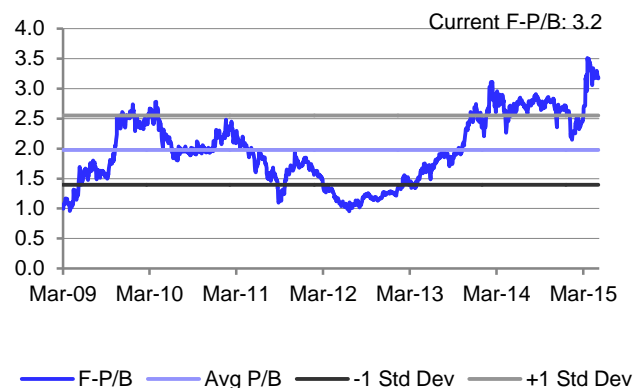
BEWG's share price has risen 25% YTD, and is now trading at c.23.1x 12-month forward P/E on reported earnings, above its historical average. However, it is still relatively cheaper than CEI. If adjusted for non-cash construction-related profits under concession accounting, BEWG is trading at 38x 2015E P/E, which is over 20% cheaper than CEI, although with a similar adjusted earnings CAGR of c.27% in 2015-17E. BEWG is also 7% cheaper than CEI on an EV/EBIT basis in 2016-17.

Figure 82: Forward P/E



Source: Deutsche Bank estimates, Company data, Datastream

Figure 83: Forward P/B



Source: Deutsche Bank estimates, Company data, Datastream



Figure 84: Reconciliation from concession accounting to normal accounting for CEI and BEWG

(HK\$ m)	2014	2015E	2016E	2017E	(HK\$ m)	2014	2015E	2016E	2017E
BEWG					CEI				
Reported recurring profits - concession accounti	1,611	2,202	2,835	3,301	Reported recurring profits - concession accounti	1,703	2,341	3,050	3,683
Less: Construction profit	(587)	(773)	(1,000)	(958)	Less: Construction profit	(519)	(1,034)	(1,689)	(1,634)
Less: Construction cost saving	-	-	-	-	Less: Construction cost saving	(269)	(292)	(199)	(537)
Add: Amortisation of financial assets	444	544	737	979	Add: Amortisation of financial assets	337	464	698	1,018
Less: Depreciation	(601)	(788)	(1,013)	(1,287)	Less: Depreciation	(437)	(592)	(805)	(1,163)
Total adjustment before tax and MI	(744)	(1,016)	(1,276)	(1,266)	Total adjustment before tax and MI	(888)	(1,455)	(1,995)	(2,316)
Total adjustment after tax and MI	(459)	(696)	(873)	(866)	Total adjustment after tax and MI	(669)	(1,094)	(1,455)	(1,673)
Recurring profits under normal accounting	1,152	1,507	1,962	2,434	Recurring profits under normal accounting	1,034	1,247	1,595	2,011
Diff, normal vs. concession	29%	32%	31%	26%	Diff, normal vs. concession	39%	47%	48%	45%
Recurring EPS - concession accounting (HK\$)	0.19	0.25	0.32	0.37	Recurring EPS - concession accounting (HK\$)	0.38	0.52	0.68	0.82
Recurring EPS - normal accounting (HK\$)	0.13	0.17	0.22	0.28	Recurring EPS - normal accounting (HK\$)	0.23	0.28	0.36	0.45
PE reported (x)		26.2	20.5	17.7	PE reported (x)		26.8	20.6	17.0
PE adjusted to normal accounting (x)		38.2	29.7	23.9	PE adjusted to normal accounting (x)		50.2	39.3	31.2
EV/EBIT adjusted to normal accounting (x)		31.5	24.3	20.3	EV/EBIT adjusted to normal accounting (x)		31.4	26.0	21.9

Note: Price as of 5 June 2015
 Source: Company data, Deutsche Bank estimates

Figure 85: Key assumptions and revenue forecasts, 2013-17E

HK\$ m	2013	2014	2015E	2016E	2017E
Capacity forecasts ('000 t/d)					
Year end contracted capacity	16,708	20,150	24,150	28,150	32,150
Additions	6,214	3,442	4,000	4,000	4,000
Operational capacity	9,486	11,453	15,253	20,053	24,253
Additions	2,192	1,967	3,800	4,800	4,200
Breakdown of operational capacity					
Sewage and reclaimed water	6,678	7,942	10,222	13,102	15,622
Water supply (incl. seawater desalination)	2,750	3,420	4,940	6,860	8,540
Overseas	59	91	91	91	91
Utilisation rate					
Sewage and reclaimed water	80%	89%	87%	87%	87%
Water supply	52%	62%	64%	66%	68%
Tariff (HK\$/cm)					
Sewage and reclaimed water	1.22	1.27	1.29	1.30	1.32
Water supply	2.49	2.29	2.31	2.34	2.36
Est. cash revenue (A)	2,839	4,506	5,863	7,984	10,329
Sewage and reclaimed water treatment services	2,157	3,318	4,154	5,427	6,820
Water supply services	214	541	1,064	1,912	2,864
No. 9 water plant	240	240	240	240	240
Amortisation of financial receivables (B)	315	444	544	737	979
Imputed finance income (C)	701	1,186	1,601	2,057	2,564
Operation income (D=A-B-C)	1,824	2,877	3,718	5,190	6,786
Reported revenue by segment (C+D)	2,525	4,063	5,319	7,246	9,350
Sewage and reclaimed water treatment services	2,141	3,250	4,038	5,236	6,524
Water supply services, incl. No.9 water plant	384	813	1,281	2,010	2,826
Total financial receivables	20,365	27,492	34,878	43,528	52,359
Breakdown by account name					
Amounts due from contract customers	5,388	6,858	9,033	10,857	11,121
Receivables under concession arrangement	12,886	17,240	22,834	29,649	37,816
Trade and bills receivables	2,091	3,394	3,011	3,022	3,422
Breakdown by segment					
Receivables relating to BOT and TOT projects	15,143	21,674	28,042	35,810	43,799
Relating to BT	4,869	5,432	6,190	6,915	7,662
Receivables for consultancy service and others	353	386	646	803	898

Source: Deutsche Bank estimates, Company data



Figure 86: BEWG income statement summary, 2013-17E

(HK\$ million, except noted otherwise)	2013	2014	2015E	2016E	2017E
Reported revenue	6,406	8,926	11,679	15,184	17,298
Sewage treatment and construction services	5,905	7,833	10,033	12,736	14,012
Sewage treatment services	2,141	3,250	4,038	5,236	6,524
Construction revenue for BT/EPC	2,882	2,125	2,762	3,315	3,481
Construction revenue for BOT	882	2,458	3,233	4,185	4,008
Water supply	384	813	1,281	2,010	2,826
Technical and Consultancy services	118	281	365	438	460
Operating expenses	-3,901	-5,430	-7,111	-9,123	-10,010
Sewage treatment and construction services	-3,705	-4,938	-6,352	-7,974	-8,449
Sewage treatment cost	-693	-1,276	-1,544	-1,972	-2,441
Construction cost for BT/EPC	-2,222	-1,791	-2,348	-2,818	-2,958
Construction cost for BOT	-790	-1,871	-2,460	-3,185	-3,050
Water supply cost	-178	-407	-649	-1,017	-1,422
Technical and Consultancy services	-17	-85	-110	-132	-139
Gross profit	2,506	3,496	4,568	6,061	7,288
Sewage treatment and construction services	2,200	2,895	3,681	4,762	5,563
Sewage treatment services	1,448	1,974	2,494	3,265	4,083
Construction for BT/EPC	660	334	414	497	522
Construction for BOT	92	587	773	1,000	958
Water supply	205	405	632	993	1,404
Technical and Consultancy services	100	196	255	306	321
Gross profit margin	39%	39%	39%	40%	42%
Sewage treatment services	68%	61%	62%	62%	63%
Construction for BT/EPC	23%	16%	15%	15%	15%
Construction for BOT	10%	24%	24%	24%	24%
Water supply, ex. No. 9 water plant	44%	50%	51%	51%	51%
Technical and Consultancy services	85%	70%	70%	70%	70%
Other income and gains	200	608	168	217	248
One offs including acquisition gains	122	440	-	-	-
Others (including government subsidy)	77	168	168	217	248
Interest income from BT projects	111	174	218	186	192
Sales/marketing expense	-	-	-	-	-
Administrative expense	(775)	(1,066)	(1,289)	(1,547)	(1,827)
Other operating expense	(188)	(11)	(20)	(26)	(33)
Impairment/FX gain/loss	(3)	(8)	-	-	-
Others	(184)	(3)	(20)	(26)	(33)
Operating profit	1,854	3,201	3,644	4,890	5,869
Net finance expense	-465	-812	-956	-1,244	-1,546
Share of JC and associates	108	278	278	278	278
Profit before tax	1,497	2,667	2,967	3,924	4,602
Taxation	-352	-594	-668	-906	-1,075
Effective tax rate (%)	23.5%	22.3%	22.5%	23.1%	23.4%
Net profit	1,145	2,073	2,298	3,018	3,527
Net margin (%)	18%	23%	20%	20%	20%
Minority interest	(61)	(279)	(154)	(202)	(236)
Net profit attrib. to shareholders	1,084	1,794	2,145	2,816	3,291
YoY growth (%)	43%	65%	20%	31%	17%
Recurring net profit attrib. to shareholders	1,044	1,611	2,202	2,835	3,301
YoY growth (%)	29%	54%	37%	29%	16%
Per share					
Weighted average shares - basic (mm)	7,756	8,643	8,727	8,767	8,807
Recurring Basic EPS (HK\$)	0.13	0.19	0.25	0.32	0.37
Recurring EPS growth (%)	15%	38%	35%	27%	16%
DPS (HK\$)	0.05	0.08	0.09	0.12	0.14
Div. payout ratio (%)	37%	38%	38%	38%	38%

Note * Recurring net profit attrib. to shareholders in 2014-17 exclude share option expenses.
 Source: Deutsche Bank estimates, Company data



Figure 87: BEWG balance sheet and cash flow statements summary, 2013-17E

(HK\$ million, except where noted otherwise)	2013E	2014E	2015E	2016E	2017E
Consolidated balance sheet					
Long Term Assets	28,974	36,563	43,378	51,328	59,053
Property, plant and equipment	431	1,299	1,243	1,185	1,126
Operating concession	2,523	2,286	2,152	2,018	1,885
Receivables under service concession	11,779	15,640	20,739	26,794	34,132
Trade receivables	53	799	301	302	342
Amounts due from contract customers	5,361	6,817	8,943	10,748	11,010
Investments in JCE and associates	3,025	3,109	3,387	3,666	3,944
Others	5,803	6,614	6,614	6,614	6,614
Current Assets	15,212	15,078	17,441	19,507	20,871
Cash and cash equivalents	5,513	6,091	7,794	9,072	9,245
Receivables under service concession	1,107	1,601	2,096	2,855	3,684
Trade receivables	2,038	2,595	2,710	2,720	3,080
Amounts due from contract customers	27	40	90	109	111
Others	6,527	4,751	4,751	4,751	4,751
Total Assets	44,187	51,641	60,819	70,835	79,923
Current Liabilities	11,651	11,419	15,488	19,014	21,394
Bank and other borrowings	3,980	3,945	6,775	8,816	10,543
Trade payables	2,755	3,564	4,667	5,988	6,570
Others	4,915	3,910	4,046	4,209	4,281
Long Term Liabilities	16,611	21,133	24,660	29,100	33,428
Bank and other borrowings	8,294	12,530	15,808	20,571	24,601
Bonds	7,009	7,016	7,016	6,391	6,391
Others	1,308	1,587	1,836	2,138	2,437
Total Liabilities	28,262	32,552	40,148	48,114	54,822
Total Equity	15,924	19,089	20,671	22,721	25,101
Shareholders equity	13,298	15,784	17,213	19,061	21,205
Minority interest	2,627	3,304	3,458	3,660	3,896
Balance sheet ratios					
BVPS (HK\$, end of period bal.)	1.58	1.81	1.97	2.17	2.40
Total debt	19,283	23,490	29,599	35,778	41,535
Net debt (cash)	13,770	17,400	21,805	26,706	32,290
Net debt / equity	86%	91%	105%	118%	129%
Net debt / total capital	46%	48%	51%	54%	56%
Consolidated cashflow statement					
	2013	2014	2015E	2016E	2017E
Profit before tax	1,497	2,667	2,967	3,924	4,602
Net finance cost	354	639	956	1,244	1,546
Other non-recurring item (gain/loss on disposal)	(122)	(440)	-	-	-
Depreciation and Amortisation	122	209	86	88	89
Change in working capital	(9,695)	(6,856)	(6,014)	(7,033)	(8,043)
Share of profit of JCEs and Associates	(108)	(278)	(278)	(278)	(278)
Others	7,193	4,601	-	-	-
Operating cash flows	(759)	541	(2,283)	(2,055)	(2,085)
Tax paid	(177)	(277)	(420)	(604)	(776)
Net cash used in operating activities	(936)	264	(2,704)	(2,659)	(2,861)
Purchase of fixed assets	(42)	(634)	(30)	(30)	(30)
Purchases of operating concessions	(19)	(51)	-	-	-
Acquisition of subsidiaries, associates & investment	(2,800)	(1,051)	-	-	-
Disposal of associate	-	230	-	-	-
Others	3	(228)	378	412	429
Cashflow from investing activities	(2,857)	(1,734)	348	382	399
Capital contributions from MI	34	333	-	-	-
New loans	1,994	7,548	6,109	6,804	6,638
Loan repayments	(3,180)	(4,205)	-	-	(882)
Bonds addition	6,391	-	-	-	-
Interest paid	(789)	(1,105)	(1,335)	(1,656)	(1,974)
Dividend payment	(345)	(495)	(806)	(1,058)	(1,236)
Others	684	220	-	-	-
Proceeds from share issuance	2,297	-	90	90	90
Cashflow from financing activities	7,086	2,297	3,968	4,090	2,546
Net cash inflow/ (outflow)	3,293	827	1,613	1,813	83
Beginning cash balance	3,640	5,366	6,091	7,794	9,072
FX adj.	94	(102)	-	-	-
Ending cash balance	7,027	6,091	7,794	9,072	9,245

Source: Deutsche Bank estimates, Company data



Rating
Buy

Asia
 China

Utilities
 Utilities

Company
**Guangdong
 Investment**

Reuters: 0270.HK
 Bloomberg: 270 HK

Price at 5 Jun 2015 (HKD)	10.86
Price target - 12mth (HKD)	12.30
52-week range (HKD)	11.76 - 8.58
HANG SENG INDEX	27,260

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Faster flow of dividends; Buy

Faster flow of dividends; reiterating Buy

With best-in-class returns from its cash-cow raw water business, GDI remains a Buy with 13% upside. Despite its net cash position, growth is relatively lower as GDI has been more conservative in expansion than its peers. However, we estimate it can still deliver a 10% earnings CAGR in 2015-17E from its existing businesses and a potential dividend payout lift of c.5ppt p.a. We reiterate Buy.

Dividend payout lift likely; FCF yield rising to c.10% in 2017

GDI's cash balance had reached a record high of HK\$15.2bn by end-2014 and it continues to pile up. We estimate GDI's FCF yield will rise to c.10% in 2017E after the completion of the power and commercial property projects under construction. We expect GDI to raise its dividend payout ratio by 5ppt p.a. in the next few years. This, together with a c.10% core earnings CAGR, implies a 3.0% 2015E dividend yield with c.20% p.a. EPS growth in 2015-17.

Still potential for water acquisition and injection; not growth at any cost

The company is still looking for potential investment opportunities in the water sector. However, management stressed that it will maintain its return threshold and will not grow at any cost. Asset injection from GDH is also likely given the backdrop of SOE reform in Guangdong province, although the timing is uncertain, with management focus still on external opportunities for now.

SOTP valuation of HK\$12.3 does not factor in new acquisitions; key risks

Our target price is based on a NAV discount method for commercial property and DCF for the other segments. We are raising our target price to HK\$12.3, as we are rolling to a mid-2016 valuation. This does not reflect any new acquisitions. If GDI gears up to 30% net debt to total capital to make water acquisitions (based on end-2014 shareholders' equity), this could imply c.11% target price upside potential, assuming a 9% project IRR and 6% WACC. Key risks include rising bond yields and expensive acquisitions or injections.

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (HKDm)	7,990	8,426	8,769	9,856	11,631
EBITDA (HKDm)	5,157	6,473	5,510	5,925	6,640
Reported NPAT (HKDm)	4,426	4,397	3,873	4,258	4,782
Reported EPS FD(HKD)	0.708	0.703	0.619	0.680	0.764
DB EPS FD (HKD)	0.551	0.576	0.619	0.680	0.764
OLD DB EPS FD (HKD)	0.516	0.563	0.614	0.672	-
% Change	6.9%	2.2%	0.8%	1.3%	-
DB EPS growth (%)	23.5	4.5	7.6	9.9	12.3
PER (x)	12.3	18.9	17.5	16.0	14.2
Price/BV (x)	1.7	2.2	2.1	2.0	1.8
EV/EBITDA (x)	7.3	9.6	11.3	10.1	8.5
DPS (net) (HKD)	0.230	0.280	0.330	0.400	0.480
Yield (net) (%)	3.4	2.6	3.0	3.7	4.4
ROE (%)	17.2	15.3	12.4	12.8	13.5

Source: Deutsche Bank estimates, company data

Key changes

Price target	12.00 to 12.30	↑	2.5%
Sales (FYE)	8,812 to 8,769	↓	-0.5%
Op prof margin (FYE)	52.7 to 50.6	↓	-4.0%
Net profit (FYE)	3,859.9 to 3,873.4	↑	0.3%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-7.0	9.9	26.6
HANG SENG INDEX	-1.8	12.7	18.0

Source: Deutsche Bank



Model updated: 08 June 2015

Running the numbers

Asia
China
Utilities

Guangdong Investment

Reuters: 0270.HK Bloomberg: 270 HK

Buy

Price (5 Jun 15)	HKD 10.86
Target Price	HKD 12.30
52 Week range	HKD 8.58 - 11.76
Market Cap (m)	HKDm 67,478
	USDm 8,703

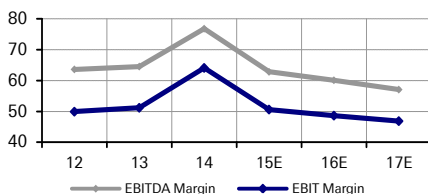
Company Profile

Guangdong Investment's (GDI) primary business is the supply of raw water to Hong Kong and Dongguan/Shenzhen. In addition, the company owns stakes in several power plants and toll roads located in Guangdong. The company also has a property portfolio, which includes office towers, hotels and department stores located in Guangdong, Tianjin and Hong Kong. GDI is controlled by GDH Limited, which is a provincial-owned conglomerate.

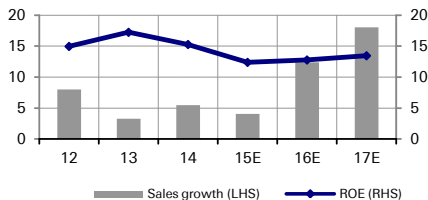
Price Performance



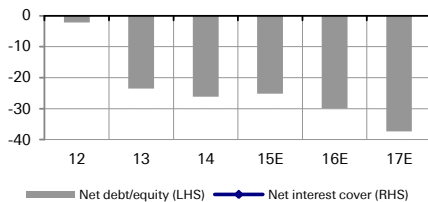
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2012	2013	2014	2015E	2016E	2017E
DB EPS (HKD)	0.45	0.55	0.58	0.62	0.68	0.76
Reported EPS (HKD)	0.55	0.71	0.70	0.62	0.68	0.76
DPS (HKD)	0.20	0.23	0.28	0.33	0.40	0.48
BVPS (HKD)	3.9	4.4	4.9	5.2	5.5	5.9
Weighted average shares (m)	6,232	6,237	6,240	6,241	6,242	6,243
Average market cap (HKDm)	34,600	42,134	67,769	67,478	67,478	67,478
Enterprise value (HKDm)	36,140	37,740	62,169	62,009	59,868	56,358

Valuation Metrics

P/E (DB) (x)	12.4	12.3	18.9	17.5	16.0	14.2
P/E (Reported) (x)	10.2	9.5	15.4	17.5	16.0	14.2
P/BV (x)	1.58	1.73	2.24	2.10	1.97	1.85
FCF Yield (%)	12.1	12.8	5.5	3.2	6.9	9.7
Dividend Yield (%)	3.6	3.4	2.6	3.0	3.7	4.4
EV/Sales (x)	4.7	4.7	7.4	7.1	6.1	4.8
EV/EBITDA (x)	7.3	7.3	9.6	11.3	10.1	8.5
EV/EBIT (x)	9.4	9.2	11.5	14.0	12.5	10.3

Income Statement (HKDm)

Sales revenue	7,736	7,990	8,426	8,769	9,856	11,631
Gross profit	4,922	5,157	6,473	5,510	5,925	6,640
EBITDA	4,922	5,157	6,473	5,510	5,925	6,640
Depreciation	246	256	261	261	319	377
Amortisation	814	811	810	810	810	810
EBIT	3,863	4,090	5,402	4,439	4,796	5,453
Net interest income/(expense)	54	215	310	365	462	646
Associates/affiliates	152	313	312	415	494	493
Exceptionals/extraordinary	780	1,355	0	0	0	0
Other pre-tax income/(expense)	73	70	78	78	78	78
Profit before tax	4,922	6,045	6,101	5,297	5,830	6,670
Income tax expense	954	1,099	1,138	1,006	1,110	1,298
Minorities	554	520	566	418	462	590
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	3,414	4,426	4,397	3,873	4,258	4,782
DB adjustments (including dilution)	-624	-979	-797	0	0	0
DB Net profit	2,790	3,447	3,600	3,873	4,258	4,782

Cash Flow (HKDm)

Cash flow from operations	4,503	4,661	5,105	5,689	5,854	6,618
Net Capex	-324	712	-1,385	-3,552	-1,160	-52
Free cash flow	4,178	5,373	3,720	2,137	4,694	6,566
Equity raised/(bought back)	2	11	2	0	0	0
Dividends paid	-1,170	-1,340	-1,498	-1,875	-2,122	-2,497
Net inc/(dec) in borrowings	-1,051	-238	1,281	-2,859	-945	0
Other investing/financing cash flows	-552	-2,013	-3,074	-821	-1,806	-4,334
Net cash flow	1,407	1,793	432	-3,419	-178	-265
Change in working capital	-82	2,570	397	353	36	90

Balance Sheet (HKDm)

Cash and other liquid assets	4,904	11,569	15,210	12,612	14,239	18,308
Tangible fixed assets	3,100	3,086	3,650	5,381	5,690	5,364
Goodwill/intangible assets	14,391	13,586	13,166	12,361	11,557	10,752
Associates/investments	2,203	1,703	1,659	1,685	1,716	1,747
Other assets	12,765	11,368	13,931	15,505	16,115	16,249
Total assets	37,362	41,312	47,615	47,545	49,316	52,420
Interest bearing debt	4,300	4,010	5,872	3,013	2,068	2,068
Other liabilities	4,678	5,121	6,079	6,452	6,571	6,800
Total liabilities	8,978	9,131	11,951	9,465	8,639	8,868
Shareholders' equity	24,038	27,313	30,267	32,265	34,400	36,686
Minorities	4,346	4,868	5,397	5,815	6,277	6,866
Total shareholders' equity	28,384	32,182	35,664	38,080	40,677	43,552
Net debt	-604	-7,559	-9,337	-9,599	-12,171	-16,240

Key Company Metrics

Sales growth (%)	8.0	3.3	5.5	4.1	12.4	18.0
DB EPS growth (%)	9.4	23.5	4.5	7.6	9.9	12.3
EBITDA Margin (%)	63.6	64.5	76.8	62.8	60.1	57.1
EBIT Margin (%)	49.9	51.2	64.1	50.6	48.7	46.9
Payout ratio (%)	36.5	32.4	39.8	53.2	58.6	62.7
ROE (%)	15.0	17.2	15.3	12.4	12.8	13.5
Capex/sales (%)	10.0	5.7	17.4	40.5	11.8	0.4
Capex/depreciation (x)	0.7	0.4	1.4	3.3	1.0	0.0
Net debt/equity (%)	-2.1	-23.5	-26.2	-25.2	-29.9	-37.3
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates



Investment thesis

Outlook

We rate GDI a Buy. We like its core defensive water business, which benefits from the three-yearly revenue reset for bulk water sales to Hong Kong. The company has strong financial resources, but it has been relatively conservative in acquiring new water projects. While there is still potential for water project acquisitions and asset injection, given the historical-high but still-rising cash balance, we expect the company to continue lifting the dividend payout ratio by c.5ppt annually. This, coupled with a 10% recurring earnings CAGR in 2015-17E, is attractive to investors, in our view.

Valuation

Our SOTP-derived target price is based on the NAV discount method for the commercial property segment and DCF methodology for the other segments. Our target price and earnings forecast do not factor in any new acquisitions. If GDI gears up to a modest level of 30% net debt to total capital, it could free up a total investment of about HKD27bn (based on shareholders' equity as of end-end-2014), which is equivalent to about 10.5mt/d of water projects. We estimate this could create about 20% earnings upside and add HKD1.3/per GDI share, assuming project IRR of 9%, WACC of 6% and ROE of 10%.

Risks

Key downside risks:

- Lower-than-expected revenue for raw water sales to Hong Kong in future revenue resets after 2017
- Lower-than-expected tariff for the Shenzhen and Dongguan raw water businesses
- Higher-than-expected tariff cuts, coal costs, lower-than-expected utilisation rates for its thermal plant business
- Lower-than-expected rental yields for its commercial property project, especially for new projects under development
- Acquisition or asset injection at expensive valuation



Valuation and earnings forecasts

We value GDI using a sum-of-the-parts method. Figure 88 shows our SOTP breakdown by segment. We value its commercial property segment on a NAV discount model used by our property research team (Figure 89) and the other segments by DCF.

Figure 88: SOTP target price breakdown by segment

HK\$ m	Discounted explicit cash flow	PV of terminal value	Total	Per share (HK \$)
DCF method				
Water distribution (WACC of 6.0%)	38,986	1,052	40,038	6.4
Department stores (WACC of 8.0%)	1,809	997	2,807	0.4
Electric power (WACC of 8.0%)	4,924	2,843	7,767	1.2
Hotel O&M (WACC of 8.0%)	2,274	1,117	3,391	0.5
NAV discount method				
Property investment and dev.	N.A.	N.A.	13,919	2.2
Sum of present value of free cashflow			67,922	10.9
Less: total debt			(2,461)	(0.4)
Add: cash			3,583	0.6
Add: Assoc & JC			2,022	0.3
Add: Invest			9,029	1.4
Less: minority interest			(5,815)	(0.9)
Equity value (HK\$ in millions)			76,460	12.3

Source: Deutsche Bank estimates

Figure 89: Key assumptions and EV valuation for commercial property segment

Property	Monthly gross rental rates (HK\$/sqm)	GFA (sqm)	Occupancy rate	Revenue (HK\$ m)	Cap rate	NAV (HK\$ m)	Discount to NAV	Discount to end-2015	End-2015 EV (HK\$ m)
Guangzhou Teemall (shopping mall)	521	160,000	99%	991	8.00%	12,391	30%	1.00	8,673
Guangzhou Teemall East Tower (office)	169	113,380	90%	206	8.00%	2,580	30%	1.00	1,806
Tianjin Teem (shopping mall) *	194	193,100	80%	359	9.50%	3,779	30%	0.70	1,840
Panyu Wanbo CBD Project (shopping mall and office) *	198	250,000	80%	475	9.50%	5,002	30%	0.70	2,436
Guangdong Investment Tower				50	5.50%	904	30%	1.00	633
Capex for Tianjin and Panyu CBD discounted to end-2015E									(1,868)
Total EV (HK\$ m)									13,919
Total EV per share (HK\$)									2.2

Source: Deutsche Bank estimates

Compared with Chinese water peers, GDI is trading at a deep discount. This is because of much stronger growth for the water peers. Compared with Hong Kong utilities, GDI is trading on a similar P/E multiple to Power Assets, which also has acquisition potential. However, GDI should have higher earnings growth, even with our blue-sky acquisitions. It also has a much higher free cash flow yield in the medium term (c.10%) than Power Assets (c.4%), and therefore GDI has the potential to lift the dividend payout in the absence of major acquisitions.



Figure 90: Valuation comps vs. water peers

Share price as of June 5, 2015		Valuations										Returns & Gearing (%)															
Company	Ticker	Price	Rating	Price target	% to target	Mkt. Cap. US\$m	avg. daily trade US\$, 1m	EPS CAGR 2015-17E	Earnings CAGR 2015-17E	EV/EBIT 15E	16E	17E	15E	16E	17E	P/BV 15E	16E	17E	Net debt/Total capital 15E	16E	17E	RoE 15E	16E	17E	Dividend yield 15E	16E	
On reported earnings basis (concession accounting)																											
GDI	270 HK	HKD10.86	Buy	HKD12.30	13%	8,703	11.6	11%	11%	14.0	12.5	9.2	17.5	16.0	14.2	2.1	(33.7)	(42.7)	12.4	12.8	3.0	3.7					
SIIC Environment	SIIC SP	SGD0.21	Buy	SGD0.28	33%	1,725	4.3	32%	35%	20.3	17.2	14.5	29.7	22.7	17.1	2.2	21.9	36.2	8.0	9.2	0.0	0.7					
CEW	CEWL SP	SGD1.025	Buy	SGD1.32	29%	1,969	2.7	45%	46%	21.0	15.4	13.0	33.5	21.6	16.0	2.1	5.9	21.0	6.5	9.1	0.0	0.5					
BEWG	371 HK	HKD6.6	Buy	HKD7.20	9%	5,832	13.0	22%	22%	18.4	14.7	13.2	26.2	20.5	17.7	2.6	51.3	54.0	13.0	15.5	1.4	1.8					
CEI	257 HK	HKD13.98	Hold	HKD14.00	0%	8,057	11.2	25%	25%	18.4	15.1	11.4	26.8	20.6	17.0	3.5	25.3	37.2	13.6	15.9	0.9	1.2					
Average ex. GDI								31%	32%	18.3	13.4	10.9	28.9	21.2	16.7	2.7	25.5	36.8	10.7	12.9	0.6	1.1					

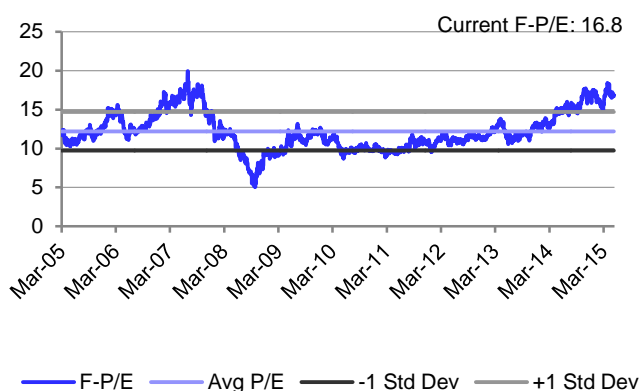
Source: Company data, Deutsche Bank estimates, Bloomberg Finance LP

Figure 91: Valuation comps vs. HK utilities

Share price as of June 5, 2015		Performance										Valuations						Returns & Gearing (%)												
Company	Ticker	Price	Rating	Price target	% to target	Mkt. Cap. US\$m	avg. daily trade US\$, 1m*	EPS CAGR 2014-16E	Absolute 3m	Relative 3m	P/E 15E	16E	17E	EV/EBIT 15E	16E	17E	P/BV 15E	16E	17E	Net debt/Total capital 15E	16E	17E	RoE 15E	16E	17E	Dividend yield 15E	16E	17E	FCF yield 15E	16E
GDI	270 HK	HKD10.86	Buy	HKD12.30	13%	8,703	11.6	11%	7%	(12%)	17.5	16.0	14.2	14.0	12.5	9.2	2.1	2.0	(33.7)	(42.7)	12.4	12.8	3.0	3.7	3.2	6.9				
HK Utilities																														
CLP	2 HK	HKD67.4	Hold	HKD65.0	(4%)	21,965	22.3	5%	(1%)	(19%)	16.0	15.0	14.4	15.2	15.4	14.6	1.9	1.8	40.4	40.0	11.9	12.0	4.0	4.1	2.0	3.8				
HK & China Gas	3 HK	HKD16.6	Sell	HKD15.00	(10%)	22,517	34.0	7%	3%	(16%)	23.7	21.7	20.7	18.0	16.0	14.6	3.1	2.9	19.5	15.8	13.6	13.8	2.3	2.6	2.2	2.7				
PAH	6 HK	HKD72.85	Hold	HKD77.0	6%	20,056	25.0	(2%)	(7%)	(23%)	19.1	20.0	19.8	67.2	69.3	68.1	1.2	1.2	(72.0)	(71.3)	6.5	6.1	3.7	3.7	4.2	4.0				
PAH adjusted for cash																														
CKI	1038 HK	HKD64.2	Hold	HKD67.0	4%	20,203	17.4	(1%)	(4%)	(21%)	16.7	17.2	16.9	24.7	23.3	21.9	1.5	1.4	8.6	7.8	9.9	8.8	3.3	3.4	0.2	4.1				
CKI adjusted for cash																														
Average								(2%)	(20%)	17.5x	17.5x	17.7x	31.3x	31.0x	29.8x	1.8x	1.8x	(0.9)	(1.9)	10.8	10.3	3.3	3.5	2.1	3.6					
Median								(3%)	(20%)	16.3x	16.5x	16.9x	21.4x	19.6x	18.2x	1.7x	1.6x	14.1	11.8	11.4	10.5	3.5	3.6	2.1	3.9					

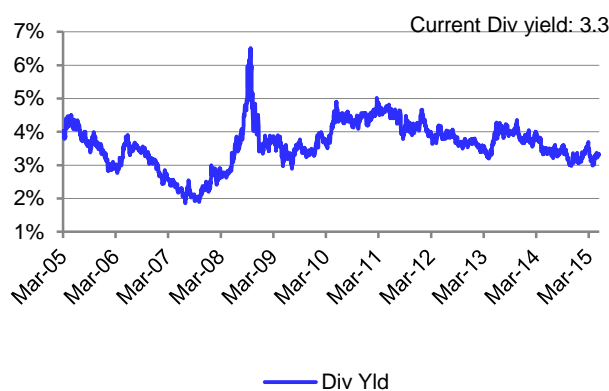
Source: Company data, Deutsche Bank estimates, Bloomberg Finance LP

Figure 92: Forward P/E



Source: Deutsche Bank estimates, Company data, Bloomberg Finance LP

Figure 93: Forward dividend yield



Source: Deutsche Bank estimates, Company data, Bloomberg Finance LP

We estimate c.10% recurring earnings CAGR for GDI over 2015-17, driven by higher raw water revenue to Hong Kong as proposed in October 2014 and the commissioning of new units at the Zhongshan power plant in mid-2016.



Figure 94: Revenue and profit breakdown by segment (HK\$'000)

	2013	2014	2015E	2016E	2017E
Revenue	7,990,015	8,426,285	8,769,498	9,855,871	11,631,053
- Water distribution	4,934,479	5,302,117	5,572,226	5,884,226	6,181,800
- Property investment and dev.	1,092,673	1,160,459	1,179,394	1,276,215	1,627,597
- Department stores	771,857	783,707	797,538	813,489	829,759
- Electric power generation	497,891	478,816	506,791	1,166,460	2,278,348
- Toll roads and bridges	14,362	0			
- Hotel O&M	678,753	701,186	713,549	715,481	713,549
- Others	-				
Operating income	5,074,619	5,479,863	4,517,311	4,873,668	5,530,520
- Water distribution	2,860,524	3,017,974	3,129,414	3,370,226	3,609,014
- Property investment and dev.	1,540,326	1,733,270	855,790	916,384	938,781
- Department stores	252,088	247,502	243,307	239,372	235,196
- Electric power generation	302,147	326,358	165,209	223,402	623,935
- Toll roads and bridges	(4,200)	-	-	-	-
- Hotel O&M	134,185	119,176	123,592	124,282	123,592
- Others	(10,451)	35,583	-	-	-
Attributable profits	4,426,117	4,397,130	3,873,384	4,257,568	4,782,178
- Water distribution	2,125,353	2,274,685	2,371,099	2,528,266	2,699,608
- Property investment and dev.	889,016	1,078,316	456,381	478,106	461,919
- Department stores	155,385	201,665	165,771	163,257	160,589
- Electric power generation	477,183	494,312	495,762	606,290	818,995
- Toll roads and bridges	51,909	-	-	-	-
- Hotel O&M	98,235	89,881	92,988	93,458	92,988
- Others	629,036	258,273	291,383	388,191	548,080
Recurring profits	3,446,837	3,599,940	3,873,384	4,257,568	4,782,178
- Water distribution	2,125,353	2,274,685	2,371,099	2,528,266	2,699,608
- Property investment and dev.	524,374	377,931	456,381	478,106	461,919
- Department stores	155,385	201,665	165,771	163,257	160,589
- Electric power generation	343,684	397,506	495,762	606,290	818,995
- Toll roads and bridges	51,909	-	-	-	-
- Hotel O&M	98,235	89,881	92,988	93,458	92,988
- Others	147,898	258,273	291,383	388,191	548,080

Source: Company data, Deutsche Bank estimates



Figure 95: GDI income statement summary, 2013-2017E

Consolidated income statement	2013A	2014A	2015E	2016E	2017E
<i>(HK\$'000, except noted otherwise)</i>					
Revenue	7,990,015	8,426,285	8,769,498	9,855,871	11,631,053
Water	4,934,479	5,302,117	5,572,226	5,884,226	6,181,800
Electricity	497,891	478,816	506,791	1,166,460	2,278,348
Toll road and bridges	14,362	0	0	0	0
Property investment	1,092,673	1,160,459	1,179,394	1,276,215	1,627,597
Department store	771,857	783,707	797,538	813,489	829,759
Hotel and hotel management	678,753	701,186	713,549	715,481	713,549
EBITDA	5,157,389	6,472,815	5,509,995	5,924,620	6,639,753
<i>EBITDA margin (%)</i>	<i>65%</i>	<i>77%</i>	<i>63%</i>	<i>60%</i>	<i>57%</i>
Water	3,727,714	3,884,756	3,996,851	4,238,331	4,477,801
Electricity	121,364	322,179	161,030	276,823	734,956
Toll road and bridges	(7,955)	0	0	0	0
Property investment	841,305	1,766,063	888,583	949,177	971,574
Department store	225,951	214,253	210,058	206,123	201,947
Hotel and hotel management	258,527	249,058	253,474	254,164	253,474
Others	(9,517)	36,506	0	0	0
Depreciation and amortisation	(1,067,024)	(1,070,848)	(1,070,580)	(1,128,848)	(1,187,129)
EBIT	4,090,365	5,401,967	4,439,415	4,795,772	5,452,624
<i>EBIT margin (%)</i>	<i>51%</i>	<i>64%</i>	<i>51%</i>	<i>49%</i>	<i>47%</i>
Share of profits from JCs and associates	313,406	311,546	415,032	494,463	493,132
Other revenue	70,497	77,896	77,896	77,896	77,896
Other non-recurring gain/ (loss)	1,355,275	0	0	0	0
Writeback/ (loss) on impairment	0	0	0	0	0
Net interest income/ (expense)	215,354	309,539	365,125	461,614	645,894
	0				
Profit before tax	6,044,897	6,100,948	5,297,468	5,829,744	6,669,546
Taxation	(1,098,511)	(1,138,168)	(1,006,371)	(1,110,382)	(1,297,792)
<i>Effective tax rate (%)</i>	<i>18%</i>	<i>19%</i>	<i>19%</i>	<i>19%</i>	<i>19%</i>
Profit after tax before MI	4,946,386	4,962,780	4,291,097	4,719,362	5,371,754
Minority interest	(520,269)	(565,650)	(417,713)	(461,794)	(589,576)
Net profit	4,426,117	4,397,130	3,873,384	4,257,568	4,782,178
<i>Net profit margin (%)</i>	<i>55%</i>	<i>52%</i>	<i>44%</i>	<i>43%</i>	<i>41%</i>
DB est. of recurring earnings	3,446,837	3,599,940	3,873,384	4,257,568	4,782,178
yoy	24%	4%	8%	10%	12%
Per share					
Weighted average shares - diluted (mm)	6,256	6,255	6,256	6,257	6,257
Diluted EPS (HK\$)	0.708	0.703	0.619	0.680	0.764
Diluted recurring EPS (HK\$)	0.551	0.576	0.619	0.680	0.764
yoy	24%	4%	8%	10%	12%
DPS (HK\$)	0.23	0.28	0.33	0.40	0.48
yoy	15%	22%	18%	21%	20%
Div. Payout	32%	40%	53%	59%	63%
Div. Payout over recurring earnings	42%	49%	53%	59%	63%

Source: Company data, Deutsche Bank estimates



Figure 96: Balance sheet and cash flow statement, 2013-2017E

Consolidated balance sheet	2013A	2014A	2015E	2016E	2017E
<i>(HK\$'000, except noted otherwise)</i>					
Long Term Assets	29,138,372	31,143,592	33,651,094	33,712,530	32,607,991
Net PP&E	3,085,632	3,649,550	5,381,469	5,689,570	5,364,057
Operating rights/ intangibles	13,320,172	12,858,007	12,053,540	11,249,073	10,444,606
Receivables under SCA	0	463,392	463,392	463,392	463,392
Interest in JCs and assoc.	1,702,873	1,659,479	1,685,299	1,716,061	1,746,740
Others	11,029,695	12,976,556	14,530,786	15,057,827	15,052,589
Current Assets	12,174,068	16,008,381	13,430,492	15,140,134	19,348,759
Cash and liquid assets	11,569,123	15,209,805	12,611,719	14,239,069	18,308,255
Inventory	79,462	94,468	88,500	90,023	92,075
Receivables	521,451	651,211	677,376	758,145	895,531
Others	4,032	52,897	52,897	52,897	52,897
Current Liabilities	4,375,873	6,133,562	5,561,975	4,735,792	4,965,056
Short-term debt	1,250,920	2,441,308	1,496,593	551,877	551,877
Tax payable	494,427	528,440	528,440	528,440	528,440
Account payable	2,630,526	3,163,814	3,536,943	3,655,475	3,884,739
Long Term Liabilities	4,755,049	5,817,652	3,902,873	3,902,873	3,902,873
Long-term debt	2,759,361	3,431,045	1,516,266	1,516,266	1,516,266
Others	1,995,688	2,386,607	2,386,607	2,386,607	2,386,607
Minority interest	4,868,196	5,397,407	5,815,120	6,276,915	6,866,491
Shareholders Funds	27,313,322	30,266,744	32,265,010	34,400,477	36,685,723
Balance Sheet Ratios					
BVPS (end of period balance)	4.38	4.85	5.17	5.51	5.88
Total debt	3,733,908	5,320,476	2,460,982	1,516,266	1,516,266
Net debt (cash)	(7,835,215)	(9,889,329)	(10,150,738)	(12,722,803)	(16,791,989)
Net debt / equity	-24%	-28%	-27%	-31%	-39%
Net debt / equity (excl. minority interest)	-29%	-33%	-31%	-37%	-46%
Consolidated Cashflow Statement					
EBITDA	5,157,389	6,472,815	5,509,995	5,924,620	6,639,753
Adjustments	17,513	(846,999)	820,040	577,838	630,174
Net interest (paid) / received	215,354	309,539	365,125	461,614	645,894
Tax paid	(728,962)	(830,088)	(1,006,371)	(1,110,382)	(1,297,792)
Cashflow from Operations	4,661,294	5,105,267	5,688,789	5,853,689	6,618,030
Investing Cashflow	(1,388,337)	(4,450,332)	(4,373,052)	(2,965,259)	(4,385,680)
Capex (excl. cap. Interest)	(455,737)	(1,469,834)	(3,552,262)	(1,159,522)	(51,912)
Purchase of investments / securities	(4,482,273)	(3,026,890)	(820,789)	(1,805,737)	(4,333,768)
Disposal	1,167,650	85,004	-	-	-
Others	2,382,023	(38,612)	-	-	-
Financing Cashflow	(1,567,773)	(214,621)	(4,734,613)	(3,066,817)	(2,496,932)
Net proceeds from share issuance	10,591	1,692	-	-	-
Net proceeds from borrowing	(238,000)	1,281,355	(2,859,495)	(944,716)	-
Dividends paid	(1,340,364)	(1,497,668)	(1,875,118)	(2,122,101)	(2,496,932)
FX adj.	87,701	(8,751)	-	-	-
Net Cashflow	1,792,885	431,563	(3,418,875)	(178,386)	(264,582)

Source: Company data, Deutsche Bank estimates



Rating
Hold

Asia
 China

Utilities
 Utilities

Company
**China Everbright
 Int'l**

Reuters: 0257.HK
 Bloomberg: 257 HK

Price at 5 Jun 2015 (HKD)	13.98
Price target - 12mth (HKD)	14.00
52-week range (HKD)	15.66 - 9.95
HANG SENG INDEX	27,260

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Growth potential priced in; Hold

Good company but fully priced; Hold

CEI is highly rated as a leading waste-to-energy (WTE) operator in China. However, its valuation is the most expensive among peers, at c.50x 2015E P/E, if adjusted for non-cash construction profits under concession accounting. We believe that the share price has already factored in strong blue-sky growth. The share price is close to our target price, even after we factor in the growth potential from its 74%-owned Singapore-listed China Everbright Water (CEW). We recommend Hold on balanced risk reward.

Strong blue-sky growth in waste and water priced in

CEI has secured six WTE projects with phase I capacity of 3.2kt/d YTD, largely in line with our assumption of 8kt/d for FY15. Growth in its water business should accelerate following the separate listing of CEW as a dedicated water platform, with plans to grow its designed capacity of over 10mt/d in 3-5 years' time. However, we believe that the share price has already allowed for strong growth. Besides, CEI is expanding in biomass, although we believe that CEI has yet to build a track record in this area with higher risks.

Earnings and price target changes

We are keeping 2015-16E earnings largely unchanged, but raising 2017E earnings by 5%. This is to better reflect WTE grate efficiency (higher-than-expected power output per ton of waste treated per 2014 results) and higher growth from CEW, which is partly offset by the delay in construction of some WTE projects. We are raising our target price to HK\$14.0 mainly on higher valuation from CEW, better WTE efficiency and rolling to mid-2016 valuation.

New DCF-based target price of HKD14.0; key risks

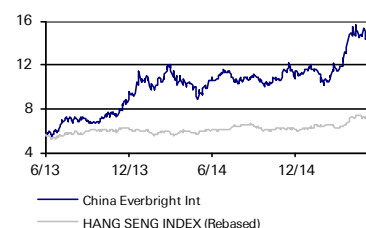
We use DCF to capture longer-term growth potential and to avoid a mismatch between earnings and cash flows under concession accounting. Risks: accelerated project wins could imply upside potential to the share price; a slowdown in project wins or new projects with low treatment fees could imply downside potential.

Key changes

Price target	11.80 to 14.00	↑	18.6%
Sales (FYE)	11,888 to 11,153	↓	-6.2%
Op prof margin (FYE)	31.7 to 34.4	↑	8.7%
Net profit (FYE)	2,384.7 to 2,341.2	↓	-1.8%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-6.8	13.2	30.2
HANG SENG INDEX	-1.2	12.8	18.8

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (HKDm)	5,320	6,355	11,153	16,579	18,294
EBITDA (HKDm)	2,243	2,870	4,023	5,377	6,837
Reported NPAT (HKDm)	1,325	1,703	2,341	3,050	3,683
DB EPS FD (HKD)	0.326	0.380	0.522	0.680	0.821
OLD DB EPS FD (HKD)	0.326	0.398	0.533	0.700	-
% Change	0.0%	-4.6%	-2.1%	-2.8%	-
DB EPS growth (%)	39.6	16.6	37.5	30.3	20.8
PER (x)	19.8	28.2	26.8	20.6	17.0
Price/BV (x)	3.5	3.2	3.5	3.1	2.7
EV/EBITDA (x)	12.2	18.5	17.6	14.4	12.8
DPS (net) (HKD)	0.085	0.110	0.131	0.170	0.205
Yield (net) (%)	1.3	1.0	0.9	1.2	1.5
ROE (%)	12.2	11.5	13.6	15.9	16.9

Source: Deutsche Bank estimates, company data



Model updated: 08 June 2015

Running the numbers

Asia
 China
 Utilities

China Everbright Int'l

Reuters: 0257.HK Bloomberg: 257 HK

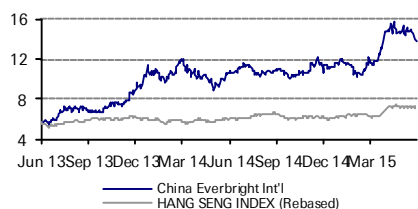
Hold

Price (5 Jun 15) HKD 13.98
 Target Price HKD 14.00
 52 Week range HKD 9.95 - 15.66
 Market Cap (m) HKDm 62,682
 USDm 8,085

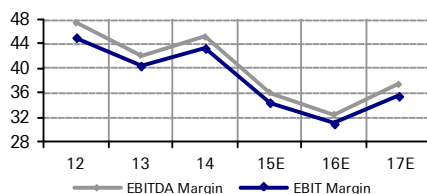
Company Profile

China Everbright International is primarily engaged in environmental protection project investments such as sewage water treatment, waste-to-energy and solid waste disposal. The company also operates a toll bridge in Fuzhou, Fujian province. China Everbright Int'l is controlled by China Everbright Group and has positioned itself as the environmental investment arm of its parent.

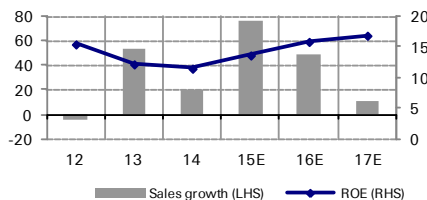
Price Performance



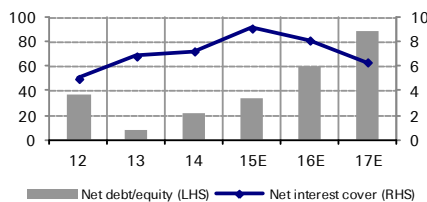
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2012	2013	2014	2015E	2016E	2017E
DB EPS (HKD)	0.23	0.33	0.38	0.52	0.68	0.82
Reported EPS (HKD)	0.29	0.33	0.38	0.52	0.68	0.82
DPS (HKD)	0.06	0.09	0.11	0.13	0.17	0.21
BVPS (HKD)	2.1	3.0	3.6	4.0	4.6	5.2
Weighted average shares (m)	3,809	4,067	4,484	4,484	4,484	4,484
Average market cap (HKDm)	14,019	26,182	48,038	62,682	62,682	62,682
Enterprise value (HKDm)	17,351	27,262	53,093	70,708	77,647	87,582

Valuation Metrics

P/E (DB) (x)	15.8	19.8	28.2	26.8	20.6	17.0
P/E (Reported) (x)	12.5	19.8	28.2	26.8	20.6	17.0
P/BV (x)	1.90	3.48	3.18	3.47	3.07	2.69
FCF Yield (%)	nm	nm	nm	nm	nm	nm
Dividend Yield (%)	1.6	1.3	1.0	0.9	1.2	1.5
EV/Sales (x)	5.0	5.1	8.4	6.3	4.7	4.8
EV/EBITDA (x)	10.5	12.2	18.5	17.6	14.4	12.8
EV/EBIT (x)	11.0	12.7	19.3	18.4	15.1	13.5

Income Statement (HKDm)

Sales revenue	3,484	5,320	6,355	11,153	16,579	18,294
Gross profit	1,376	1,774	2,170	3,536	4,984	6,106
EBITDA	1,654	2,243	2,870	4,023	5,377	6,837
Depreciation	53	70	79	79	79	79
Amortisation	29	21	36	103	165	262
EBIT	1,571	2,153	2,754	3,841	5,133	6,496
Net interest income/(expense)	-315	-316	-381	-422	-632	-1,025
Associates/affiliates	0	0	-1	0	0	0
Exceptionals/extraordinaries	235	0	0	0	0	0
Other pre-tax income/(expense)	-32	-25	-74	-115	-137	-164
Profit before tax	1,459	1,812	2,300	3,304	4,364	5,307
Income tax expense	305	447	534	727	1,014	1,259
Minorities	31	40	62	236	300	365
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	1,123	1,325	1,703	2,341	3,050	3,683
DB adjustments (including dilution)	-235	0	0	0	0	0
DB Net profit	889	1,325	1,703	2,341	3,050	3,683

Cash Flow (HKDm)

Cash flow from operations	-605	-679	-503	-510	-3,364	-6,244
Net Capex	-69	-302	-1,219	-1,662	-2,601	-2,485
Free cash flow	-674	-982	-1,722	-2,172	-5,965	-8,729
Equity raised/(bought back)	1,245	3,628	0	0	0	0
Dividends paid	-213	-263	-448	-562	-674	-842
Net inc/(dec) in borrowings	807	810	1,139	2,000	6,500	10,000
Other investing/financing cash flows	-268	-175	577	0	0	0
Net cash flow	897	3,018	-454	-734	-139	430
Change in working capital	-581	686	2,766	843	1,588	-989

Balance Sheet (HKDm)

Cash and other liquid assets	2,797	5,815	5,150	4,416	4,277	4,707
Tangible fixed assets	12,206	15,322	21,106	25,546	34,633	44,947
Goodwill/intangible assets	634	1,117	3,406	4,960	7,390	9,607
Associates/investments	197	431	511	511	511	511
Other assets	750	786	1,027	1,489	1,879	2,577
Total assets	16,583	23,471	31,200	36,922	48,691	62,350
Interest bearing debt	6,004	6,921	9,137	11,137	17,637	27,637
Other liabilities	1,908	2,771	4,220	5,927	8,519	8,972
Total liabilities	7,913	9,692	13,357	17,064	26,156	36,609
Shareholders' equity	8,350	13,374	16,263	18,043	20,419	23,260
Minorities	321	405	580	816	1,116	1,481
Total shareholders' equity	8,670	13,779	17,843	19,859	22,535	25,741
Net debt	3,208	1,107	3,986	6,720	13,359	22,929

Key Company Metrics

Sales growth (%)	-4.9	52.7	19.5	75.5	48.7	10.3
DB EPS growth (%)	7.6	39.6	16.6	37.5	30.3	20.8
EBITDA Margin (%)	47.5	42.2	45.2	36.1	32.4	37.4
EBIT Margin (%)	45.1	40.5	43.3	34.4	31.0	35.5
Payout ratio (%)	20.2	26.1	29.0	25.0	25.0	25.0
ROE (%)	15.5	12.2	11.5	13.6	15.9	16.9
Capex/sales (%)	20.6	5.7	19.2	14.9	15.7	13.6
Capex/depreciation (x)	8.7	3.3	10.6	9.1	10.6	7.3
Net debt/equity (%)	37.0	8.0	22.3	33.8	59.3	89.1
Net interest cover (x)	5.0	6.8	7.2	9.1	8.1	6.3

Source: Company data, Deutsche Bank estimates



Investment thesis

Outlook

As a leading WTE operator with a strong growth outlook, with 25% EPS CAGR in 2015-17E, we are positive on the business outlook. However, we believe that the current valuation is no longer attractive and has already allowed for significant blue-sky growth. Nevertheless, we agree that the strong project pipeline, together with strong reported earnings growth due to more projects commencing construction, should support premium valuation.

We expect the project wins for WTE to be front-end loaded. Therefore, new project wins for CEI could remain high in the next one to two years before moderating in the medium term. Growth in the hazardous waste division should accelerate as CEI leverages its relationship with local governments and its reputation in WTE. We also believe that CEI will accelerate its expansion in the water industry after the reverse takeover of HanKore (now renamed China Everbright Water, CEW) as a separate listed platform. However, we believe that CEI has yet to establish a track record in biomass.

Valuation

We derive our target price using DCF valuation, which is not affected by the mismatch between reported earnings and cash flows under concession accounting. We assume CEI's market share in WTE to increase from 7% currently to over 10% by end-2020E, and also assume blue-sky projects in the water and hazardous waste businesses. We estimate that each RMB100m of additional total investment would add about HK\$0.01/share to our valuation, assuming a project IRR of 10% and WACC of 6%.

Risks

Key upside/(downside) risks:

- Higher/(lower)-than-expected additions in WTE, wastewater treatment and hazardous waste treatment projects.
- Variations on operating assumptions for the WTE projects, solid waste disposal projects and the alternative energy business, given that there is limited transparency for these businesses.
- Acceleration/(delay) in the construction progress of new projects.
- Higher/(lower)-than-expected construction cost savings and government subsidies.
- EPS dilution risk from potential share placement.



Valuation

We are raising our target price to HK\$14.0 from HK\$11.8, mainly to reflect higher growth in its water business through the 74%-owned CEW, higher-than-expected power output per ton of waste treated per 2014 results and rolling to mid-2016 valuation.

Our target price is derived from a DCF valuation, which can capture the longer-term growth potential, and is not affected by the mismatch between earnings and cash flows under concession accounting. CEI has a large number of projects that are expected to begin construction in the next couple of years, and the related construction profits could support strong reported earnings growth and high valuation, in our view.

However, the stock is trading at 50x 2015E P/E, if adjusted for non-cash construction profits booked under concession accounting (see Figure 99). We believe that such valuation has already factored in significant expectation for blue-sky opportunities. For more upside potential in share price, CEI needs to deliver stronger-than-expected project wins. Any slowdown on this record or new projects with low treatment fees could imply downside risk to CEI's share price.

Regarding the extent to which CEI can exceed expectations on water project acquisition after the completion of the reverse takeover of HanKore by CEW, we believe that there is potential for investors to switch to the Singapore-listed CEW (Buy, CP – S\$1.02), given its higher growth outlook and a more attractive valuation multiple than that of CEI.

Figure 97: DCF valuation

WACC calculation														
Cost of equity:														
Risk free rate		3.90%												
Equity beta		0.70												
Equity risk premium		5.60%												
Implied cost of equity		7.82%												
Cost of debt:														
Pre-tax cost of debt		4.90%												
Long-term effective tax rate		25.0%												
Cost of debt (post tax)		3.68%												
TV Growth		0.0%												
WACC		6.0%												
Leverage (net debt / (net debt + equity))														
		45.0%												
(HK\$'000, except noted otherwise)														
	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E ...	2048E	2049E	2050E
NOPAT	4,597	5,816	6,135	6,719	7,154	7,628	8,168	8,102	8,062	7,882	7,882	541	314	205
Add back depreciation and amortisation	79	79	79	79	79	79	79	79	79	79	79	-	-	-
Adjust for working capital change	(1,725)	826	1,909	1,230	847	259	416	1,483	604	138	138	(230)	(202)	(72)
Adjust for finance receivables change	(11,756)	(12,867)	(8,794)	(7,052)	(5,740)	(5,224)	(4,446)	(568)	559	1,903	613	259	-	-
Less: cost of construction and acquisitions	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(7)	(7)	-	-	-
Free cashflow	(8,811)	(6,151)	(677)	970	2,334	2,736	4,211	9,090	9,298	9,996	9,996	924	371	132
Terminal value @ 0.0% perpetual growth														2,208
Total cashflow + terminal value		(8,811)	(6,151)	(677)	970	2,334	2,736	4,211	9,090	9,298	9,996	924	371	2,341
Discount factor	1.00	1.06	1.12	1.19	1.26	1.34	1.42	1.50	1.59	1.69	1.79	6.84	7.25	7.69
Present value of free cashflow		(8,312)	(5,475)	(569)	768	1,744	1,928	2,801	5,703	5,504	5,582	135	51	305
Sum of present value of free cashflow		68,788												
Less: total debt		(11,137)												
Add: cash		4,416												
Add: associate and JCs		845												
Add: investments		229												
Less: minority interest		(2,179)												
Equity value		62,765												
Current no. of shares outstanding ('000)		4,484												
Equity value per share (HK\$)		14.0												

Source: Deutsche Bank estimates

Earnings forecasts

We are keeping our 2015-16E earnings largely unchanged, but raising 2017E earnings by 5%. This is to reflect better WTE grate efficiency (higher-than-expected power output per ton of waste treated per 2014 results) and higher



growth from CEW, which is partly offset by the delay in construction of some WTE projects.

Figure 98, Figure 100 and Figure 101 show our key operational assumptions and our forecasts for earnings and balance sheet. We also show a reconciliation of earnings from concession accounting to normal accounting in Figure 99, which is adjusted for non-cash construction profit for BOT projects and the difference in depreciation schedule and revenue recognition.

- WTE: We are factoring in 8kt/d for 2015E, 7kt/d in 2016E and 4kt/d p.a. in 2017-20E, including expansionary phases for existing projects. We are reflecting higher power output per unit of waste generated, as shown in its 2013 annual result.
- Water: We are factoring in our forecasts for the 74%-owned CEW. The earnings changes to our previous forecasts are limited in 2015, due to the relatively-high SG&A and interest rate from HanKore. We are raising our assumption for capacity wins from 0.5mt/d p.a. to 1.5mt/d p.a. from 2016-2020 and 1.2mt/d in 2021-23, in line with our forecasts for CEW.
- Hazardous waste: We estimate annual project wins of 100kt/year in 2015-20, with a total investment of about RMB700m.
- Alternative energy: We only factor in all of the projects announced so far with no blue sky projects. Although the company is expanding in biomass, it has yet to establish a track record in this area. We assume such investment to be value neutral for now. Therefore, adding blue sky projects has limited impact on our valuation.



Figure 98: Operational summary, 2013-2017E

	2013	2014	2015E	2016E	2017E	Deutsche Bank comment
Total investment (Rmb m)	2,552,756	6,434,650	5,641,153	10,260,456	10,545,967	
Waste-to-energy	1,927,366	1,912,818	3,549,002	5,424,326	5,079,879	
Water treatment projects	345,611	3,969,610	696,534	2,577,460	3,785,202	
Alternative energy	150,341	346,844	1,127,172	1,892,197	1,172,853	
Hazardous waste treatment	124,165	200,000	262,958	360,878	502,325	
Waste-to-energy						
Total capacity signed (tons/day)	20,950	32,250	40,250	47,250	51,250	High utilisation rates as reported (>100% reflecting the difference between actual waste processed and waste burnt in furnace)
yoy growth (tons/day)	2,300	11,300	8,000	7,000	4,000	
Operating capacity (tons/day, time-weighted)	9,700	11,867	16,417	20,217	28,592	
yoy growth %	18%	22%	38%	23%	41%	
Avg. waste processing utilisation (%)	125%	124%	124%	126%	124%	Avg processing fee changes due to project mix change. Assuming new projects earnings Rmb65/t treatment fee
Volume processed ('000 tons)	4,423	5,365	7,427	9,314	12,930	
yoy growth %	20%	21%	38%	25%	39%	
Avg. processing fee (Rmb per ton)	72	74	76	76	74	Unified tariff of Rmb0.65/kWh (incl VAT) for new projects for the first 280kWh per ton of waste received and the coal-fired benchmark tariff for the remaining power output
yoy growth %	1%	3%	3%	0%	-3%	
Electricity sold (MWh)	1,052,199	1,654,513	2,220,346	2,763,676	3,762,152	
yoy growth %	27%	57%	34%	24%	36%	
Electricity sold / waste processed (kWh/t)	238	308	299	297	291	
Avg. tariff (Rmb/ MWh, incl. VAT)	650	634	635	636	637	
yoy growth %	4%	-2%	0%	0%	0%	
Wastewater treatment						
Avg. treatment capacity ('000 cm/ day)	1,528	1,810	2,553	3,281	4,711	Lower avg. tariff in 2015E due to lower water tariffs for projects from HanKore with lower discharge standards
yoy growth %		18%	41%	29%	44%	
Avg. plant utilisation (%)	94%	94%	92%	90%	89%	
Volume processed (mil cm)	526	622	854	1,077	1,534	
yoy growth %		18%	37%	26%	42%	
Avg. tariff (Rmb/ cm)	1.25	1.25	1.18	1.18	1.19	
yoy growth %		0%	-6%	0%	1%	
Hazardous waste treatment						
Volume processed ('000 tons)	68	57	274	300	464	Average treatment fee change due to mix change, assuming incineration projects with higher treatment fee
yoy growth %	53%	-17%	380%	10%	54%	
Avg. processing fee (Rmb per ton)	1,300	800	1,303	1,562	1,381	
yoy growth %	30%	-38%	63%	20%	-12%	

Source: Company data, Deutsche Bank estimates

Figure 99: Reconciliation from concession accounting to normal accounting

(HK\$ m)	2014	2015E	2016E	2017E
Reported recurring profits - concession accounting	1,703	2,341	3,050	3,683
Less: Construction profit	(519)	(1,034)	(1,689)	(1,634)
Less: Construction cost saving	(269)	(292)	(199)	(537)
Add: Amortisation of financial assets, which should have been booked as revenue under normal accounting	337	464	698	1,018
Less: Depreciation that should have been booked under normal accounting	(437)	(592)	(805)	(1,163)
Total adjustment before tax and MI	(888)	(1,455)	(1,995)	(2,316)
Total adjustment after tax and MI	(669)	(1,094)	(1,455)	(1,673)
Recurring profits under normal accounting	1,034	1,247	1,595	2,011
Diff, normal vs. concession	39%	47%	48%	45%
Recurring EPS - concession accounting (HK\$)	0.38	0.52	0.68	0.82
Recurring EPS - normal accounting (HK\$)	0.23	0.28	0.36	0.45
PE reported (x)		26.8	20.6	17.0
PE adjusted to normal accounting (x)		50.2	39.3	31.2
EV/EBIT adjusted to normal accounting (x)		31.4	26.0	21.9

Source: Company data, Deutsche Bank estimates



Figure 100: CEI income statement summary, 2013-2017E

(HK\$'000, except noted otherwise)	2013	2014	2015E	2016E	2017E	Deutsche Bank comment
Reported revenue	5,319,866	6,355,120	11,152,782	16,578,829	18,293,987	
Wastewater treatment	1,283,630	1,050,754	1,780,772	2,856,998	3,737,279	Construction services reflect the fair value booked for capex spent by the company (but no cashflow impact)
- Construction services	449,779	112,079	527,469	1,289,516	1,557,903	
- Operational services	558,461	627,960	771,243	1,042,454	1,468,331	
- Finance income	275,390	310,715	482,060	525,028	711,044	Finance income (arised due to the new accounting std. for service concession contract) was calculated by applying an imputed interest rate on the gross amount due from offtakers on B/S.
Waste-to-energy	3,616,152	4,652,019	7,634,645	10,831,789	11,765,101	
- Construction services	2,516,997	3,165,556	5,198,363	7,704,647	7,512,691	
- Operational services	635,427	843,943	1,689,811	2,134,399	2,908,029	
- Finance income	463,728	642,520	746,471	992,743	1,344,380	
Alternative energy	415,939	643,917	1,728,936	2,881,612	2,783,177	
- Construction services	150,804	349,821	1,127,172	1,892,197	1,172,853	
- Operational services	259,867	292,818	597,129	984,915	1,605,970	
- Finance income	5,268	1,278	4,634	4,499	4,354	
Property investment and mgmt	4,145	8,430	8,430	8,430	8,430	
Other income	469,750	699,695	486,928	393,484	731,577	
Construction cost savings	204,774	268,743	292,303	198,859	536,952	
Government subsidy	162,931	266,317	185,064	185,064	185,064	
Others	102,045	164,635	9,561	9,561	9,561	
Reported EBITDA	2,243,283	2,869,667	4,023,364	5,377,489	6,837,351	
Waste water treatment	660,043	558,012	906,021	1,309,169	1,764,413	
Waste-to-energy	1,541,318	2,146,327	2,821,735	3,663,746	4,557,818	
Alternative energy	146,147	259,502	389,783	508,595	629,974	
Property investment	3,216	4,299	4,299	4,299	4,299	
Others	-107,441	-98,473	-98,473	-108,320	-119,152	
EBITDA margin	42%	45%	36%	32%	37%	
Waste water treatment	51%	53%	51%	46%	47%	
Waste-to-energy	43%	46%	37%	34%	39%	
Alternative energy	35%	40%	23%	18%	23%	
Depreciation & amortisation	-90,697	-115,411	-182,321	-244,487	-341,695	Low depreciation rate as new BOT/TOT projects will no longer be booked as PP&E but instead recorded as financial assets/amt due from offtakers
Depreciation	-70,080	-79,481	-79,481	-79,481	-79,481	
Amortisation	-20,617	-35,930	-102,840	-165,006	-262,214	
Net interest income/(expense)	-315,579	-380,775	-422,081	-632,001	-1,024,846	
Share of assoc. & JCs	-	(635)	-	-	-	
Other income/ (expense)	-25,354	-73,813	-114,773	-137,444	-163,516	
Profit before tax	1,811,653	2,299,033	3,304,189	4,363,558	5,307,294	
Taxation	-447,455	-533,990	-726,922	-1,013,511	-1,259,247	
Effective tax rate (%)	24.7%	23.2%	22.0%	23.2%	23.7%	
Minority interest	-39,531	-61,896	-236,052	-300,309	-364,821	
Net profit	1,324,667	1,703,147	2,341,216	3,049,738	3,683,227	
Net margin (%)	25%	27%	21%	18%	20%	
Recurring net profit	1,324,667	1,703,147	2,341,216	3,049,738	3,683,227	
yoy growth (%)	49%	29%	37%	30%	21%	
Per share						
Weighted average shares - diluted (m)	4,067	4,484	4,484	4,484	4,484	
EPS based on HK(IFRIC) 12	0.33	0.38	0.52	0.68	0.82	We stripped out one-off items such as disposal gain, FX gain, property reval. gain
Recurring EPS growth (%)	40%	17%	37%	30%	21%	
DPS (HK\$)	0.085	0.110	0.131	0.170	0.205	
Div. payout ratio (%)	28%	29%	25%	25%	25%	

Source: Company data, Deutsche Bank estimates



Figure 101: CEI balance sheet and cash flow statement, 2013-2017E

Consolidated balance sheet	2013	2014	2015E	2016E	2017E	Deutsche Bank comment
<i>(HK\$'000, except where noted otherwise)</i>						
Long Term Assets	17,094,128	25,280,399	31,274,963	42,792,392	55,323,331	Receivables under service concession agreement refers to income that will be received from undertaking BOT/TOT projects; it will likely increase with the number of BOT/TOT projects and their corresponding construction revenue; Similar to PPE assets booked on balance sheet, but is classified as a receivable as the asset has to be returned after 20-30 years when the concession period expires.
Net PP&E and finance lease rec.	15,321,645	21,105,798	25,546,226	34,633,441	44,947,322	
Investment properties	177,442	172,938	172,938	172,938	172,938	
Interest in leasehold land	35,739	35,717	35,717	35,717	35,717	
Intangible assets	1,096,453	2,571,006	4,125,142	6,555,356	8,772,414	
Goodwill	20,793	834,845	834,845	834,845	834,845	
Interest in associates	254,380	281,628	281,628	281,628	281,628	
Other financial assets	176,710	229,012	229,012	229,012	229,012	
Deferred tax assets	10,966	49,455	49,455	49,455	49,455	
Current Assets	6,376,919	5,919,395	5,646,909	5,898,134	7,026,263	
Cash and liquid assets	5,814,606	5,150,149	4,416,173	4,277,417	4,707,130	
Accout. rec. and prepayment	486,789	651,796	1,034,635	1,359,208	1,928,710	
Inventories	75,524	117,450	196,100	261,510	390,423	
Current Liabilities	3,572,037	4,981,410	6,401,019	8,516,258	8,389,050	
Short-term debt	1,779,867	2,611,369	2,611,369	2,611,369	2,611,369	
Trade payable and accrued exp.	1,733,757	2,302,381	3,721,990	5,837,229	5,710,021	
Tax payable	58,413	67,660	67,660	67,660	67,660	
Long Term Liabilities	6,119,889	8,375,414	10,662,290	17,639,529	28,219,377	
Long-term debt	5,141,254	6,525,142	8,525,142	15,025,142	25,025,142	
Deferred tax liab.	978,635	1,834,422	2,121,298	2,598,537	3,178,385	
Other long-term liab.	-	15,850	15,850	15,850	15,850	
Minority Interest	404,857	1,579,714	1,815,766	2,116,074	2,480,895	
Shareholders Funds	13,374,264	16,263,256	18,042,797	20,418,665	23,260,271	
Balance sheet and return ratios						
BVPS (HK\$, end of period bal.)	2.98	3.63	4.02	4.55	5.19	
Total debt	6,921,121	9,136,511	11,136,511	17,636,511	27,636,511	
Net debt (cash)	1,106,515	3,986,362	6,720,338	13,359,094	22,929,381	
Net debt / equity (%)	8%	22%	34%	59%	89%	
Net debt / equity (excl. minority) (%)	8%	25%	37%	65%	99%	
Return on asset (%)	6%	5%	6%	6%	6%	
Return on equity (%)	12.2%	11.5%	11.8%	13.5%	14.3%	
Consolidated cashflow statement						
EBITDA	2,243,283	2,869,667	4,023,364	5,377,489	6,837,351	Other adj. mainly comes from change in financial assets receivables, which arises due to the booking of construction revenues (for BOT projects) and capex on acquisitions (for TOT projects) for WTE and wastewater treatment projects under HK(IFRIC) Int 12
Working capital adj.	685,972	2,766,116	843,347	1,587,813	(989,139)	
Other adj.	(3,164,095)	(5,647,413)	(4,514,423)	(9,161,101)	(10,387,654)	
Net interest (paid) / received	(288,240)	(318,338)	(422,081)	(632,001)	(1,024,846)	
Tax paid	(156,403)	(173,341)	(440,045)	(536,272)	(679,399)	
Cashflow from operations	(679,483)	(503,309)	(509,839)	(3,364,072)	(6,243,687)	
Investing cashflow	(551,181)	(560,793)	(1,662,462)	(2,600,816)	(2,484,980)	Capex for BOT/TOT projects inWTE and wastewater treatment is not included in investing cashflow (but in operating cashflow as financial assets receivables) based on HK(IFRIC) Int 12.
Capex (excl. cap. interest)	(302,490)	(1,219,223)	(1,662,462)	(2,600,816)	(2,484,980)	
Dividends received	3,539	10,477	-	-	-	
Disposal	191	535	-	-	-	
Others	(252,421)	647,418	-	-	-	
Financing cashflow	4,209,134	663,525	1,438,325	5,826,131	9,158,379	Capex for biomass and hazardous waste treatment projects are shown in investing cashflow as "the payments of addition of intangible assets"
Net proceeds from share issuance	3,627,605	-	-	-	-	
Net proceeds from borrowing	810,315	1,139,407	2,000,000	6,500,000	10,000,000	
Dividends paid	(263,032)	(448,372)	(561,675)	(673,869)	(841,621)	
Others	34,246	(27,510)	-	-	-	
FX adj.	39,627	(53,038)	-	-	-	
Net cashflow	3,018,097	(453,615)	(733,976)	(138,757)	429,713	

Source: Company data, Deutsche Bank estimates



Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
BEWG	0371.HK	6.41 (HKD) 8 Jun 15	7
China Everbright Water	CEWL.SI	1.02 (SGD) 8 Jun 15	NA
SIIC Environment	SIIC.SI	0.21 (SGD) 8 Jun 15	NA
Guangdong Investment	0270.HK	10.76 (HKD) 8 Jun 15	14,15
China Everbright Int'l	0257.HK	13.70 (HKD) 8 Jun 15	14

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Historical recommendations and target price: BEWG (0371.HK)

(as of 6/8/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

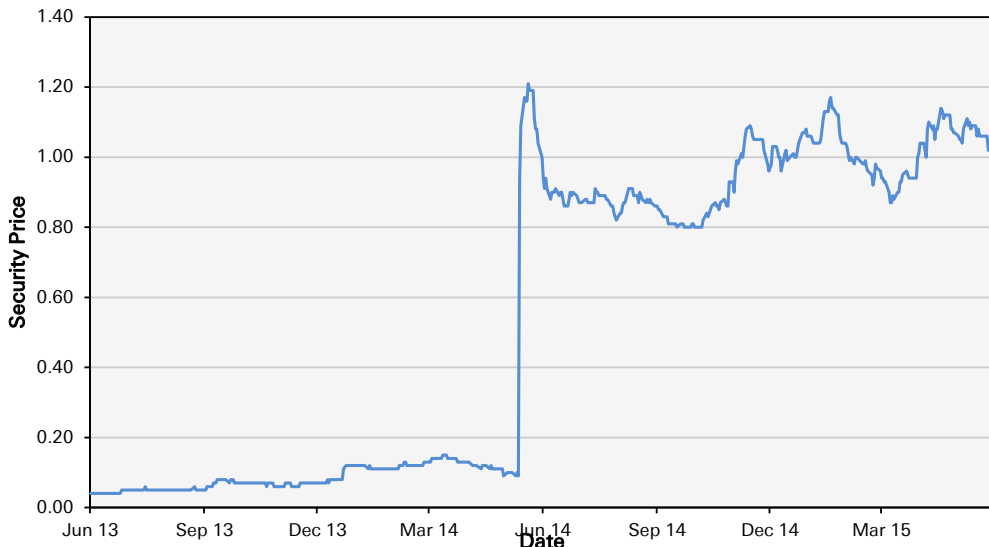
- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

1.	28/10/2013:	Buy, Target Price Change HKD4.20	4.	28/08/2014:	Buy, Target Price Change HKD6.10
2.	06/12/2013:	Buy, Target Price Change HKD5.10	5.	04/12/2014:	Buy, Target Price Change HKD6.60
3.	27/03/2014:	Buy, Target Price Change HKD6.00	6.	06/05/2015:	Buy, Target Price Change HKD7.20

Historical recommendations and target price: China Everbright Water (CEWL.SI)

(as of 6/8/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

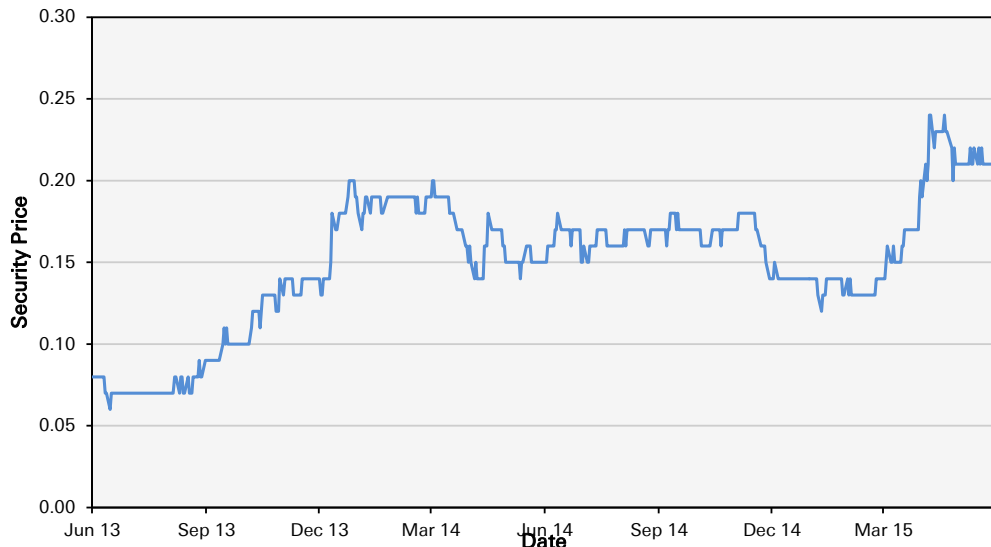
- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002



Historical recommendations and target price: SIIC Environment (SIIC.SI)

(as of 6/8/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

Historical recommendations and target price: Guangdong Investment (0270.HK)

(as of 6/8/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

- | | |
|---|---|
| 1. 13/11/2013: Upgrade to Buy, Target Price Change HKD8.70 | 3. 04/12/2014: Upgrade to Buy, Target Price Change HKD12.00 |
| 2. 24/07/2014: Downgrade to Hold, Target Price Change HKD9.20 | |



Historical recommendations and target price: China Everbright Int'l (0257.HK)

(as of 6/8/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

1. 06/08/2013:	Sell, Target Price Change HKD3.90	3. 14/09/2014:	Upgrade to Hold, Target Price Change HKD10.60
2. 14/03/2014:	Sell, Target Price Change HKD7.50	4. 04/12/2014:	Hold, Target Price Change HKD11.80

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Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

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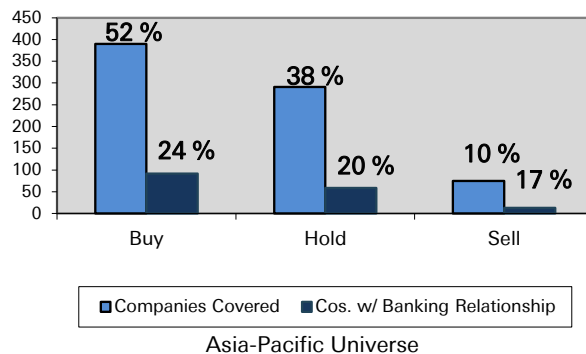
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Equity rating dispersion and banking relationships





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