NOMURA

China water and environment

EQUITY: WATER & ENVIRONMENT

Rising tides lift all boats

But some will sail faster than others: SGL and BEW are our top picks

Global Markets Research

28 August 2014

Action: Finding the flagships in the fleet

We reiterate our positive stance on the China Water & Environment sector with three initiations in this report. We further distinguish between the stocks in our WWT coverage by their business natures and growth models: 1) policy-driven rural plays; 2) established municipal plays; and 3) niche industrial plays.

- **Rural WWT.** This space tends to be run by large private companies. While returns could be higher than for municipal projects (given lower competition), there could be more case-specific execution risks. We anticipate increased government-required FAI and fiscal subsidies to ramp up capacity. We estimate a 60% capacity CAGR in this segment in the next three years.
- **Municipal WWT.** This space is occupied by large SOEs, with access to cheap capital and close ties to local governments. We expect SOEs to lead market consolidation via M&As and to post steady capacity growth. We expect the top 10 players to hit 40% market share by 2018, vs 20% now.
- **Industrial WWT.** This is a small and niche segment, with entry barriers in the form of technical know-how, and as such the area offers relatively higher profitability than regular WWT. This is where we see players offering the highest growth rate, given their low base currently.

Top picks: SGL (Buy) and BEW (Buy); also favour CTEG (Buy)

Hovercraft — Sound Global (967 HK, BUY): SGL is our top pick given its 1) first-mover advantage in the under-penetrated rural WWT market; 2) asset injection opportunities; and 3) re-rating potential to achieve the WWT operators' average multiple of circa 20x 2014F P/E. We are 12% above consensus on FY14/15F earnings.

Cruiser — Beijing Enterprises Water (371 HK, BUY): BEW is our top pick among SOE WWT plays given: 1) it is the largest WWT operator, and can continue to grow via M&A and expansion into sludge treatment and standard upgrades; 2) its track record in obtaining and executing projects; and 3) its attractive PEG at 0.7. We are 16% above consensus on FY14/15F earnings.

Speedboat — CT Environmental Group (1363 HK, BUY): We expect CTEG, a niche player in textile WWT, to rapidly expand its scope to include WWT of wider industries and also sludge treatment, which enjoys relatively high profitability. We project a 44% earnings CAGR for FY14-16F.

Fig. 1: China water and environment: Coverage and rating summary

Company	Ticker	Rating	Price (HKD)	PT (HKD)	Upside (%)
Sound Global	967 HK	Buy*	8.03	10.90	35.7%
Beijing Enterprises Water	371 HK	Buy	5.20	6.50	25.0%
CT Environmental	1363 HK	Buy*	6.23	7.70	23.6%
China Everbright Int'l	257 HK	Buy	10.86	13.10	20.6%
Kangda Environmental	6136 HK	Buy*	3.18	3.70	16.4%
Guangdong Investment	270 HK	Reduce	9.59	7.4 ↑	-22.8%

Note: * Initiating coverage. Pricing as of 22 August 2014. Source: Company data, Nomura estimates

Anchor themes

We prefer: 1) large SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

We see more potential from the rural WWT market and therefore prefer first movers here. Consensus prefers the municipal WWT market.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

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Investment thesis

With the maturing of China's waste water treatment (WWT) industry, the market has been divided into mainly three sub-sectors: municipal / rural / industrial, with different business natures and therefore investment philosophies. We conduct an analysis on each sub-sector and outline our preferred picks below.

Sub-market differentiation — Go acquiring? Go wild? Go expert?
With the rapid development over the past decade, China's WWT industry looks to have become more rational and organized, with industry participants taking time to develop different strategies to leverage off their competitive advantages. We think the industry can be divided into three major sub-sectors:

- **Municipal:** High penetration, with major growth to come from acquisitions.
- **Rural:** Low penetration, with ample organic growth opportunities, while having higher risk from tariff collection issues.
- **Industrial:** High technology threshold with high profitability, with no guaranteed treatment volume and high sensitivity to industrial growth.

Fig. 2: Comparison between different sub-markets

	Municipal	Rural	Industrial
Penetration ratio	>70%	<30%	NA
Technology threshold	Low, mature	High, immature	High, mature
Major participants	Large-scale SOEs and private companies	Private companies	Small-scale private companies
Unit project scale	>10 kilo tons/day	1-10 kilo tons/day	>10 kilo tons/day
Project nature	BOT/TOT	BOT	BOO
IRR	10-12%	12-15%	>15%
Risk factor	None	Tariff collection	Tariff collection, economic growth
Our covered stocks	BEW, CEI, SGL, Kangda	SGL	CT Env.

Note: BOT: Build-Operate-Transfer; TOT: Transfer-Operate-Transfer; BOO: Build-Own-Operate
Source: Nomura research

Although we remain positive overall on China's water industry and expect rapid growth to be sustained for our covered companies through either acquisitions or organic growth, we expect the growth potential in rural areas — mostly organic growth through new projects — to be the strongest and most promising among the sub-segments in the next couple of years. Therefore, we prefer Sound Global given its re-rating potential from the shift to operational business and its expansion focus in rural regions. We also remain positive on BEH as the top quality name in the sector, with strong execution abilities in acquisitions from both the open market and local governments.

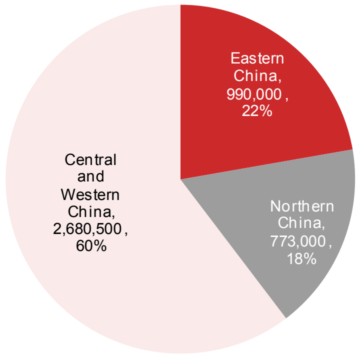
Central government support to continue — not only the CNY2tn action plan
While we are waiting for the Action Plan of Water Pollution Control to be reviewed and published by the State Council, we note the National Development and Reform Commission (NDRC) quietly announced more than 20 provincial investment plans in July, with total capacity of 4.4mn tonnes/day and investment of CNY23bn. We maintain our view that China's government will continue its strong support for the WWT industry and investment from central government will result in large amounts of follow-on investment from local governments and private capital.

Fig. 3: Investment plans for water pollution control in key basins

Province	Issue date	No. of projects	WWT capacity (tons/day)	Investment (CNYmn)
Henan	3-Jul-14	52	1,450,000	577
Inner Mongolia	4-Jul-14	34	559,000	4,250
Jiangsu	8-Jul-14	15	407,500	2,830
Shaanxi	9-Jul-14	20	338,000	1,980
Shandong	4-Jul-14	34	230,000	1,400
Hebei	3-Jul-14	21	205,000	138
Anhui	7-Jul-14	16	192,000	950
Chongqing	11-Jul-14	9	160,100	1,060
Heilongjiang	9-Jul-14	13	144,000	1,130
Zhejiang	7-Jul-14	22	120,000	1,160
Ningxia	7-Jul-14	4	115,000	150
Guizhou	14-Jul-14	21	104,700	750
Sichuan	17-Jul-14	17	93,500	1,190
Jilin	10-Jul-14	11	70,000	760
Qinghai	11-Jul-14	3	65,000	270
Yunnan	4-Jul-14	18	64,000	3,460
Gansu	7-Jul-14	3	50,000	350
Shanxi	8-Jul-14	5	41,500	220
Liaoning	7-Jul-14	4	25,000	200
Hubei	17-Jul-14	14	6,700	260
Shanghai	9-Jul-14	1	2,500	20
Tianjin	8-Jul-14	1	n.a.	100
Total		**338**	**4,443,500**	**23,205**

Source: NDRC, Nomura research

Fig. 4: Summary of projects by regions



Source: NDRC, Nomura research

Stocks for action: SGL (Buy) and BEW (Buy) are our top picks, followed by CTEG (Buy) and CEI (Buy); Reduce on GDI

Our order of preference for China water and environment names:

SGL > BEW > CTEG > CEI > Kangda > GDI

Sound Global (967 HK, Buy, TP: HKD10.90) — Not only construction, let's operate

- **Re-rating potential in near term:** SGL is rapidly transforming its image as an EPC service provider to WWT operators by rapidly obtaining BOT projects, which should lead to a re-rating, we think.
- **Unique strategy to expand rural WWT market:** SGL has first-mover advantage in the rural WWT market, which has great market potential in the next couple of years, backed by the central government's support. SGL also avoids the fierce competition in the municipal WWT market.
- **Potential asset injections:** The parent group and sister company have WWT assets that can be injected to SGL.
- **Valuation is attractive. SGL is our top Buy with a SOTP-based TP of HKD10.90.**

Beijing Enterprises Water (371 HK, Buy, TP: HKD6.50) — A non-stop Cruiser

- **Strong capacity growth to sustain:** Leveraging on its financing sources and SOE background, BEW can achieve a 30%+ capacity CAGR in the next five years.
- **Leading position to welcome favourable policies:** As the largest WWT operation in China, BEW should benefit the most from upcoming favourable policies.
- **Future upside from emerging business:** Sludge treatment and discharge standard upgrades will offer profitability improvement opportunities for existing projects.
- **Valuation:** High valuation justified given strong earnings profile; attractive 0.73x PEG.

CT Environment Group (1363 HK, Buy, TP: HKD7.70) — Niche market star

- **Rapid capacity growth in next three years:** CTEG will see rapid capacity expansion in both industrial WWT and sludge/waste treatment businesses, with 2013-16F capacity CAGRs of 31% and 184%, respectively.
- **Higher margin than for traditional municipal WWT projects:** CTEG enjoys higher margins for its industrial WWT projects at 75%, vs 40-60% for municipal projects.
- **Robust 2013-16F earnings profile:** CTEG to post EPS CAGR of 32% over FY13-16F.
- **Valuation:** PEG as low as 0.5x; valuation undemanding even considering discount due to small base and private nature.

China Everbright Int (257 HK, Buy, TP: HKD13.10) — Steady WTE with better WWT

- **Steady WTE business:** 9 projects obtained YTD 2014 with capacity of 10,000/tonnes; 4,900 tonnes/day to commence in 2H14, leading to a 30% rise in operation revenue.
- **Potential upside from WWT business:** Target to boost WWT capacity through acquisitions in the open market.
- **Valuation:** Looks undemanding on PEG of 0.78x with 2013-15F EPS CAGR of ~31%.

Kangda Env (6136 HK, Buy, TP: HKD3.70) — Surfing the wave of IPO

- **Rapid organic growth in base camp:** Given the under-penetration in Kangda's base camp (Henan and Shandong), the company should achieve steady organic growth.
- **Acquisition growth to surge after listing:** The capital raise from IPO as well as the widened financing channel will help Kangda achieve acquisition-led growth.
- **Valuation:** Trading at 17x/12x FY14/15F EPS, respectively, valuation looks cheap.

Guangdong Investment (270 HK, Reduce, TP: HKD7.40) — Low visibility in growth

- **Two market speculations cannot materialize in near term:**
  - Acceleration in M&As: M&A announced was done in 2013; no M&As YTD 2014.
  - Acceleration in parent asset injection: SOE reform is likely to happen first for central government-owned enterprises, not province-owned enterprises.
- **New raw water supply contract may miss expectation:** As CNY experienced depreciation from end-2013 and CPI remains low, the water tariff hike in the new contract may be lower than expected.
- **Valuation seems full** at 18.5x 2014F P/E vs. flattish 2013-15F EPS CAGR of 7.2%.

Valuation comparison

Fig. 5: China water: Valuation comparison

						P/E (x)			P/B (x)			Yield (%)		
Company	Ticker	Rating	Price (HKD)	PT (HKD)	Upside (%)	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
CHINA WATER & ENVIRONMENT														
Sound Global	967 HK	Buy	8.03	10.90	35.7%	18.8	15.5	11.9	2.6	2.2	1.8	na	na	na
Beijing Enterprises Water	371 HK	Buy	5.20	6.50	25.0%	40.1	27.2	19.3	3.3	3.0	2.6	1.0	1.3	1.9
CT Environmental	1363 HK	Buy	6.23	7.70	23.6%	31.0	25.2	17.0	7.7	5.0	4.0	0.5	0.6	0.9
China Everbright Int'l	257 HK	Buy	10.86	13.10	20.6%	33.3	24.5	19.3	3.6	3.2	2.9	0.8	1.1	1.4
Kangda Env	6136 HK	Buy	3.18	3.70	16.4%	na	17.0	12.0	na	1.7	1.5	na	1.2	1.7
Guangdong Investment	270 HK	Reduce	9.59	7.40	-22.8%	19.6	18.5	17.4	2.2	2.0	1.8	2.4	1.8	1.9
Average						**28.6**	**21.3**	**16.2**	**3.9**	**2.9**	**2.4**	**1.2**	**1.2**	**1.5**

Note: Pricing as on 22 August 2014

Source: Company data, Bloomberg, Nomura estimates

Municipal WWT — Large to get larger

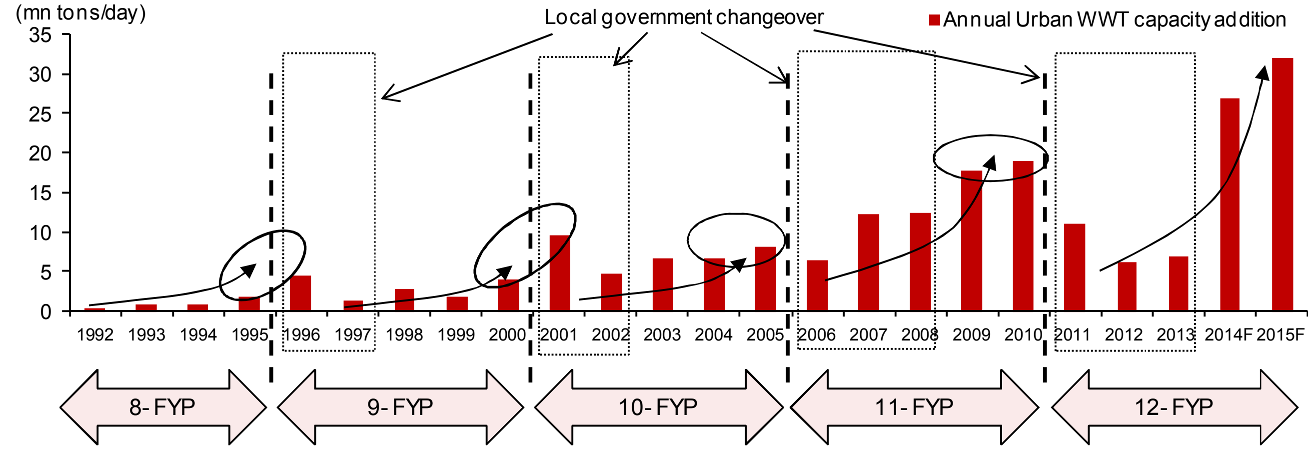
With the rapid development in the urban WWT industry over the past decade, the penetration ratio in urban areas has increased to above 80%. However, the market is fragmented, with thousands of players and 50% of capacity owned by local governments. Therefore, we expect the market to go through a consolidation period, with large players to become larger through acquisitions rather than via new projects.

Go acquiring — market is entering consolidation

The penetration ratio is already nearly 90% for cities…

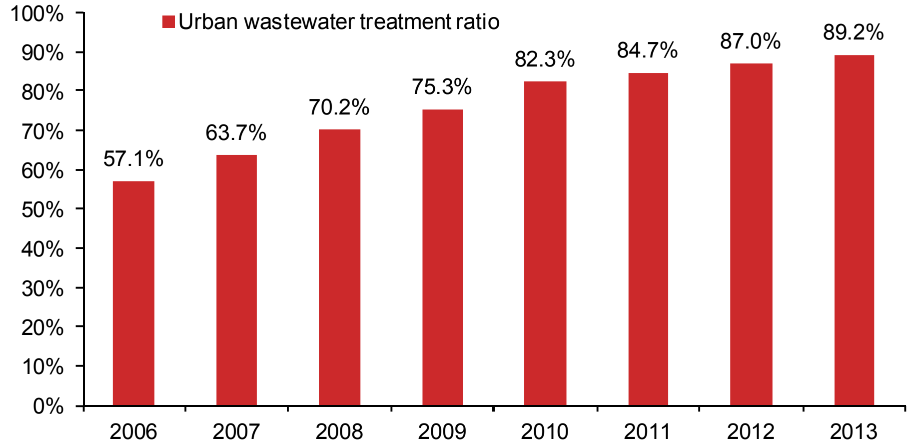
With the central government's growing awareness of the need to control water pollution, the treatment capacity (and in turn the WWT penetration ratio) in urban regions has been increased rapidly since the 11th FYP (2006-10). Current penetration in cities rose sharply from 57.1% in 2006 to 82.3% by 2010, and steadily reached 89.2% by end-2013.

Fig. 6: WWT capacity addition in the past 20 years



Source: Company data, Nomura research

Fig. 7: Urban WWT ratio (2006-13)

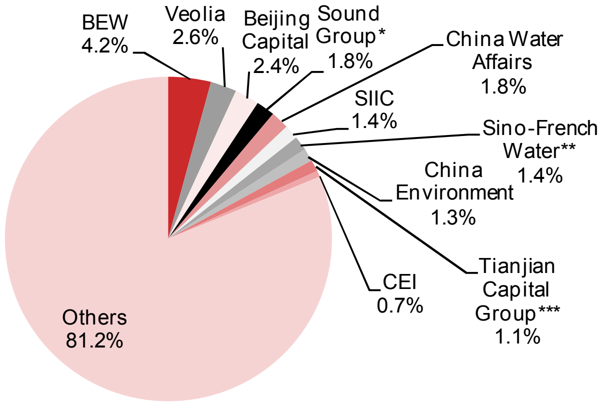


Source: Company data, Nomura research

…With a fragmented market…

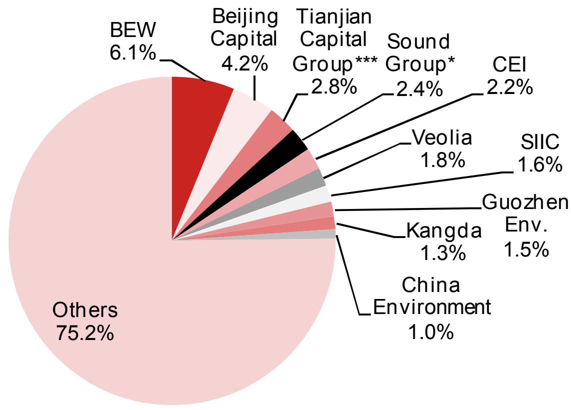
According to h20-China's yearbook of China's water industry, capacity (including water supply and WWT) at the top-10 water operators only accounted for 18.8% of total capacity. In the WWT sector, there were nearly 1,000 private players by end-2013, with the top-10 players accounting for only 25% of market share.

Fig. 8: Market share breakdown of the water industry



* Sound Group includes SGL Env and SGL
** Sino-French Water is the JV of Suez and NWS
*** Tianjin Capital Group incl. Tianjin Capital and its parent
Source: Company data, Nomura research

Fig. 9: Market share breakdown of the WWT segment



* Sound Group incl SGL Env. and SGL
** Sino-French Water is the JV of Suez and NWS
*** Tianjin Capital Group incl. Tianjin Capital and its parent
Source: Company data, Nomura research

…And local governments to give up their role of operators…

Since 2013, the central government, in various ways, has pushed the privatization of public-service assets owned by local governments, to achieve:

- **The shift of local governments' function:** The exit from WWT operations will help local governments better execute their supervision function, so as to ensure the discharge quality.
- **The improvement of operating efficiency:** As WWT assets owned by local governments generally suffer from issues to do with bureaucracy and an inability to lay off employees, privatization should lead to relatively high operating efficiency.
- **The easing of capital restraints on local governments:** Due to the severe issues surrounding local governments' debt repayments, as well as the relatively tight monetary policy exerted by the central government, local governments' financial budgets have been quite tight in recent years, which has created issues in terms of making further investments to build or upgrade WWT projects.

Fig. 10: Recent policies on the privatization of utility assets owned by local governments

Policy	Issued bureau	Content
The Decision of 18th CPC	NPC	Promote local governments to purchase public services through contracts
The Promotion of PPP method in public services	MoF	Encourage the development of Public-Private-Partnership for municipal infrastructure investments
The Guidance of Governmental Purchasing of Public Services	MEP	Detailed guidance and regulations to ensure the healthy development of governmental purchasing of public services

Source: NPC, MoF, MEP, Nomura research

Currently ~50% of WWT projects in terms of capacity are owned by local governments, on our estimates, which means huge market potential for future capacity additions at non-government players amid potential privatization in the next couple of years.

…Large players to become giants through acquisitions

We see consolidation of China's WWT market as making for a golden age for large players, especially SOEs, to achieve rapid capacity growth through acquisitions from both local governments and small operators in the open market.

Acquisitions from the local governments — backyard for SOEs

We believe that large SOEs will grasp most of the opportunities from the privatization of local governments' WWT assets, as:

- SOEs have better relationships with local governments, given their same ultimate parent — the country.

- Local governments could avoid accusations of losing state-owned assets if they transfer assets to SOEs vs selling to private names, especially amid the recent anti-corruption moves.

Acquisitions in the open market — capital battlefield

In terms of the acquisitions of other small players, the listed companies (usually also the relatively large-scale names) with relatively ample financing sources and lower costs have the best chance to nail deals, we think. The major players to be acquired would be:

- **Foreign players to exit:** Previously, largely foreign companies participated in the WWT industry given their leading technology. However, with the development of domestic water companies, technology is no longer an issue and local governments seem to prefer Chinese companies to manage WWT / water supply plants given that they are utilities in nature.
- **Small players to be purchased:** Given the central government's requirement for a higher wastewater discharge standard (from 1B to 1A) and the focus on the operating efficiency of the utility sector, we believe small players will be limited by their relatively lower efficiency and outdated technology, plus by diminishing financing resources under China's tightening monetary policy.

Consequently, we believe large SOEs (eg, BEW, CEI) should be the strongest players in the municipal WWT market, resulting from rapid capacity growth through acquisitions, and such acquisitions could sustain given the current market consolidation.

Rural WWT — Virgin land, for the brave

Unlike municipal WWT projects, which have large unit scale and high payment assurance, rural WWT projects require brave trailblazers to develop small-scale projects in large amounts and take the risk of tariff collection, and the reward of decent profits.

Go wild — High returns, for the brave

Market underdeveloped — poor penetration ratio in rural regions

According to the Ministry of Housing and Urban-Rural Development (MHURD), the treatment ratio of wastewater was less than 30% for townships and ~8% for villages at end-2013 (vs 89% for urban regions). Development of WWT for townships and villages remains slow, with the treatment ratio rising 3pps and 1pp pa since 2008. However, the discharge amount of untreated wastewater from townships equals the total amount for cities and counties, and the amount from villages is 1.5x that of urban regions.

Fig. 11: China water: Treatment ratio comparison – 2013

	Discharge volume (000' ton / day)	Treatment ratio	Untreated volume (000' ton / day)
City	114,180	87%	14,500
County	23,360	75%	5,780
Township	**26,770**	**28%**	**19,260**
Village	**32,200**	**8%**	**29,720**

Source: Ministry of Housing and Urban-rural Development, Nomura research

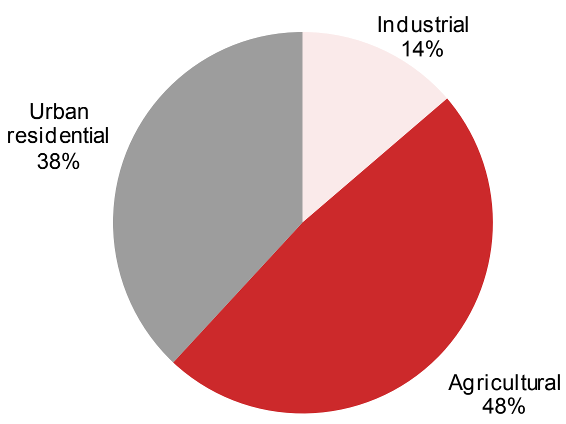
Fig. 12: China water: Investment in rural WWT by 2030

Total rural population (mn)	**500**
Unit infrastructure investment (CNY/person)	5,000
Total infrastructure investment (bn CNY)	**2,500**
Operation cost (CNY/person/yr)	60
Total operation cost (bn CNY/yr)	**30**

Source: Ministry of Housing and Urban-Rural Development, Nomura research

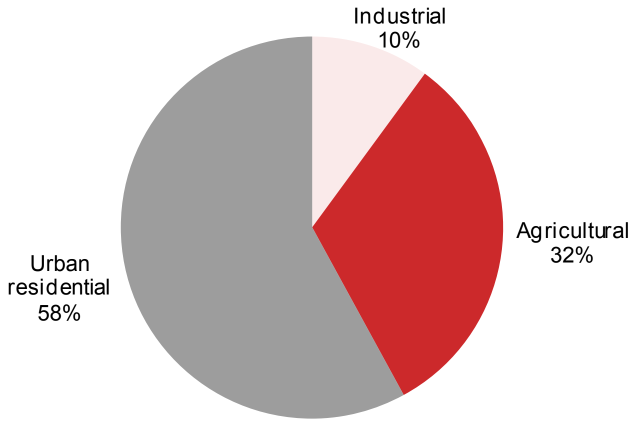
As shown in Figures 13 & 14, the agricultural sector emits more water pollutants than the industrial and urban residential sectors, according to the statistics from MEP. The key issue is the scattered distribution of agricultural pollution sources, especially the livestock and poultry farms (accounting for more than 95% / 75% of the COD / Ammonia-N emissions, according to MEP).

Fig. 13: China water: COD pollution source breakdown — 2013



Source: MEP, Nomura research

Fig. 14: China water: Ammonia-N source breakdown — 2013



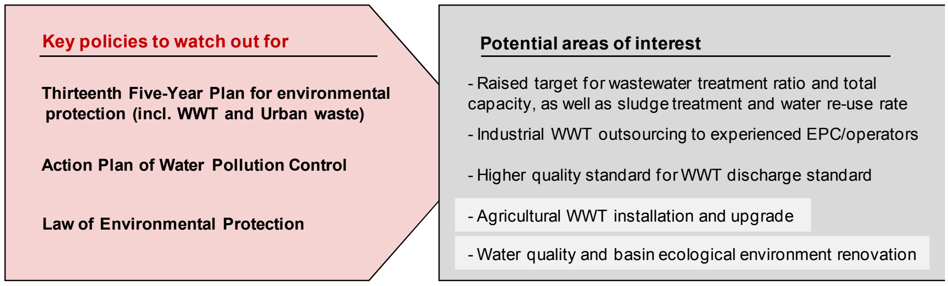
Source: MEP, Nomura research

In our opinion, the solution to entirely control such pollution sources is either to install WWT facilities for individual farms or to construct a large scale of pipelines to transmit wastewater to centralized WWT plants in the region.

Central government to mostly develop WWT industry in rural regions

Following the large improvement in urban WWT, the central government is moving its focus to WWT development in rural regions, which is still almost virgin land, requiring large investment. In addition to the 12th FYP, which encourages the construction of centralized WWT facilities in rural regions, we think upcoming policies will largely increase the importance of rural WWT as well as the investment scale required.

Fig. 15: China water: Upcoming policies to support the rural WWT development



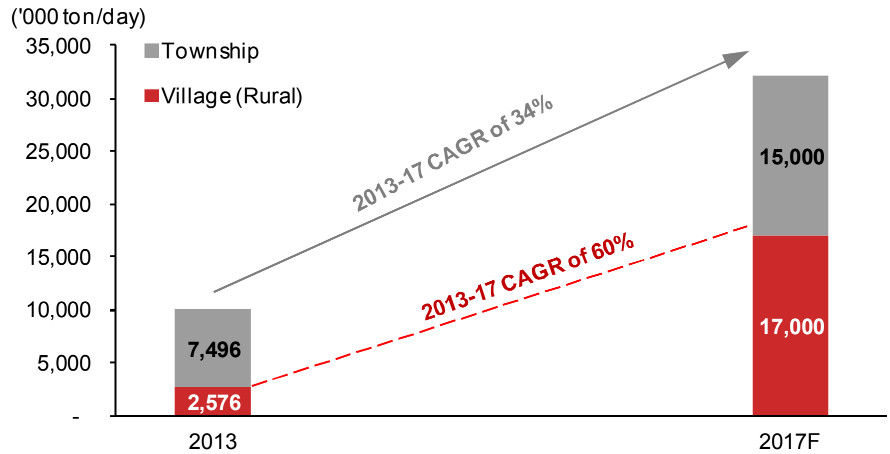
Source: MEP, Industry paper, Nomura research

Actually since 2014, several provincial governments (eg, Beijing, Shandong, Fujian) have already issued policies to accelerate the construction of rural WWT facilities, including various supportive measures:

- Financing support from local banks with discounted interest rates.
- Priority in land usage approval.
- Preferential power tariffs from both lower prices and governmental subsidies.
- VAT exemption.

According to the central government, the treatment ratio in rural regions is targeted to reach 50% in the next 3-5 years, implying annual capacity growth of c. 60%, which is strong organic growth for WWT operators.

Fig. 16: China water: Capacity growth forecast from 2013 to 2017



Source: Ministry of Housing and Urban-rural Development, Nomura estimates

Package contract — Solution to concerns on scale and fee collection

WWT operators generally are concerned when evaluating rural WWT projects, given: 1) the unit scale of a single project is small (i.e. <10 kilo tons/day); and 2) there is relatively high likelihood of delays in tariff collection resulting from low affordability from local governments in rural regions. Therefore, some pioneers in this sub-market endeavour to secure their tariff collection by signing package contracts, which is a contract signed with higher-level governments (city/county level) for several rural projects (townships/villages). Such package contracts have a large total scale and the fee collection is guaranteed by the higher-level governments, which mitigates the risk of any delay or even default in tariff payments.

Higher profitability from same tariffs but much lower costs

To promote the development of rural WWT projects, the WWT tariff is generally similar to that in the nearby cities, while the costs, including capex (land/construction) as well as opex (salary/power), are actually lower, leading to higher IRR versus municipal projects. (12-15% versus 10-12%).

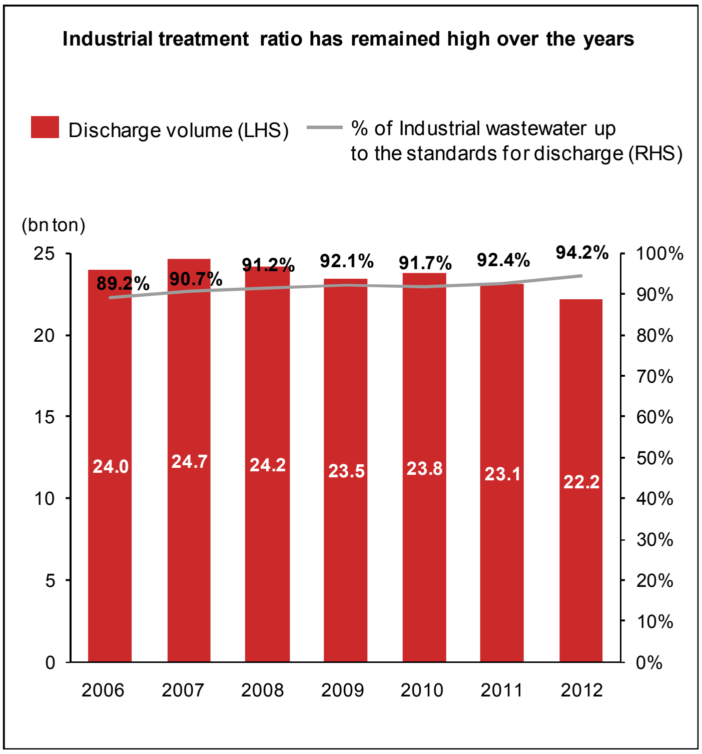
Industrial WWT — Expertise rewarded

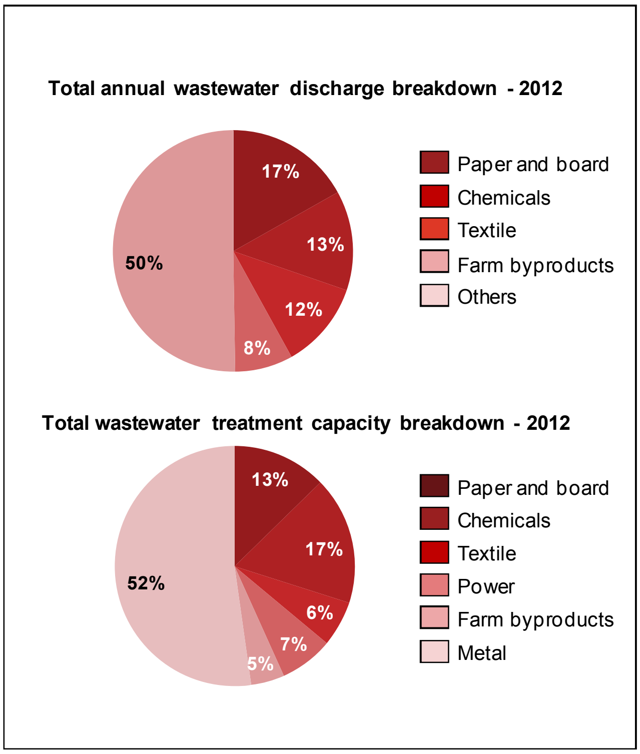
WWT technology in the residential sector (including urban/rural) is quite mature, with low thresholds, whereas the industrial WWT market needs different expertise to serve various industries. Such a niche market, though without guaranteed returns from governments, enjoys the highest margins among sub-markets in a BOO method.

Go expert — A differentiated B2B market

Zero tolerance — China to sustain its strict regulation on industrial WWT
Since 2011, China has had a "zero tolerance" policy in industrial WWT — any industrial plants directly discharging wastewater to a water body will be immediately shut down, especially for traditionally high-discharge industries such as paper and board, chemicals, textile and farm by-products.

Fig. 17: Recent development status of industrial WWT market





Source: MEP, CEIC, Nomura research

In 2013, MEP restated that their regulation on industrial WWT would be sustained and with a higher requirement on the discharge standards, especially the enhancement of the water-recycling ratio.

…From one-plant-one-facility to one-park-one-plant
Previously, the "Law of Environmental Protection", since 1979, required environmental facilities to be designed/constructed/completed simultaneously with the main industrial projects. Therefore, most industrial projects have their own WWT facilities. However, as project owners generally do not have expertise in the industrial WWT segment, most plants need to establish their own operation team specialized in WWT and thus incur relatively high costs.

Together with the development of industrial parks, the promotion of centralized industrial WWT plants operated by professionals has been initiated by local governments. The pre-planning of the wastewater collection pipelines and the aggregation of plants in the same industry helps to improve the treatment efficiency. In addition, the treatment tariff charge by industrial WWT operators is significantly lower than those industrial plants' own operating costs, thanks to the higher professionalism. Therefore, small-scale players with unique technology advantage in their focus industry discover their niche market and enjoy the benefit from relatively high entry barriers.

BOO — A B2B business model with higher returns as well as risks

The built-operate-operation (BOO) method is widely used for developing industrial WWT projects. Unlike municipal projects with BOT methods, where local governments are responsible for tariff collection and payment, they just act in an initiator/coordinator role in industrial projects. Generally, operators of industrial WWT projects need to sign contracts with customers one by one, with no guaranteed treatment volumes.

Fig. 18: Comparison between municipal and industrial WWT projects

	Municipal WWT	Industrial WWT
Method	BOT	BOO
Project nature	More utilities	More commercial
Project financing	Capex paid by operator; Bank loans secured by tariff payables	Capex paid by operator; Bank loans secured by assets of operators
Ultimate owner	Gov't	Operator
Tariff setting	Negotiation with and collect from gov't; Adjusted periodically	Negotiation with and collect from customer; Local gov't guides max price
Stability	25-30 yrs concession period with guaranteed volume at 70% of designed capacity	Exclusive service rights in certain regions; no guaranteed volume
IRR	10-12% per gov't guidance	No restriction, may>20%

Source: Nomura research

However, given more potential risks from fluctuations in treatment volumes and tariff collection, the industrial WWT projects also enjoy the highest profitability among sub-markets given industrial customers' high affordability as well as the high entry barriers.

Appendix

Fig. 19: China water and environment: Financial matrix 2011-16F

Gross profit (in mn acct. currency)	2011	2012	2013	2014F	2015F	2016F
Sound Global	722	800	958	1,190	1,545	1,868
Beijing Enterprises Water	908	1,437	2,506	3,665	4,855	5,548
CT Environmental	267	252	306	536	821	1,029
China Everbright Int'l	1,575	1,684	2,375	3,200	3,964	4,302
Kangda Env	338	442	513	674	855	1,005
Guangdong Investment	4,628	5,087	5,324	5,369	5,514	6,277
Net profit (in mn acct. currency)	**2011**	**2012**	**2013**	**2014F**	**2015F**	**2016F**
Sound Global	425	426	435	555	769	1,000
Beijing Enterprises Water	601	750	1,084	1,712	2,435	2,952
CT Environmental	165	177	224	346	528	672
China Everbright Int'l	802	913	1,305	1,984	2,486	2,647
Kangda Env	157	197	232	301	425	518
Guangdong Investment	2,510	2,768	3,045	3,240	3,317	3,376
Gross margin	**2011**	**2012**	**2013**	**2014F**	**2015F**	**2016F**
Sound Global	31.6%	30.2%	30.5%	29.0%	29.5%	30.9%
Beijing Enterprises Water	34.2%	38.6%	39.1%	36.1%	33.7%	35.4%
CT Environmental	57.7%	65.8%	63.1%	54.4%	57.7%	57.7%
China Everbright Int'l	43.0%	49.4%	44.7%	35.4%	38.3%	37.6%
Kangda Env	46.0%	44.2%	38.3%	39.0%	40.8%	46.6%
Guangdong Investment	64.6%	65.8%	66.6%	65.0%	65.0%	65.0%
Net margin	**2011**	**2012**	**2013**	**2014F**	**2015F**	**2016F**
Sound Global	18.6%	16.1%	13.8%	13.5%	14.7%	16.6%
Beijing Enterprises Water	22.6%	20.1%	16.9%	16.9%	16.9%	18.8%
CT Environmental	35.6%	46.2%	46.3%	35.1%	37.1%	37.7%
China Everbright Int'l	21.9%	26.8%	24.5%	21.9%	24.0%	23.2%
Kangda Env	21.3%	19.7%	17.3%	17.4%	20.3%	24.0%
Guangdong Investment	35.0%	35.8%	38.1%	39.2%	39.1%	35.0%

Source: Company data, Nomura estimates

Fig. 20: China water and environment: Financial matrix 2011-16F (Cont'd)

ROE	2011	2012	2013	2014F	2015F	2016F
Sound Global	18.0%	17.3%	14.8%	15.2%	16.7%	18.2%
Beijing Enterprises Water	10.0%	9.1%	10.0%	12.0%	15.1%	16.3%
CT Environmental	na	na	29.6%	23.8%	26.1%	26.3%
China Everbright Int'l	13.9%	15.5%	12.2%	14.0%	15.8%	17.0%
Kangda Env	na	0.0%	18.9%	14.0%	13.5%	14.7%
Guangdong Investment	14.8%	14.9%	17.2%	11.5%	10.9%	10.3%

Effective interest rate	2011	2012	2013	2014F	2015F	2016F
Sound Global	6.9%	6.9%	6.9%	6.9%	6.9%	6.9%
Beijing Enterprises Water	3.6%	4.5%	4.8%	4.3%	4.6%	4.6%
CT Environmental	6.1%	7.4%	6.7%	6.7%	6.7%	6.7%
China Everbright Int'l	5.6%	5.6%	4.9%	4.7%	4.7%	4.7%
Kangda Env	6.0%	7.0%	7.0%	6.8%	6.5%	6.5%
Guangdong Investment	4.2%	1.9%	2.5%	2.5%	2.5%	2.5%

Net gearing	2011	2012	2013	2014F	2015F	2016F
Sound Global	net cash	net cash	3.6%	net cash	1.6%	11.0%
Beijing Enterprises Water	84.3%	106.1%	103.6%	126.0%	116.8%	101.5%
CT Environmental	na	na	14.0%	41.6%	33.2%	18.1%
China Everbright Int'l	54.4%	38.4%	8.3%	25.6%	52.5%	77.2%
Kangda Env	net cash	147.9%	172.5%	57.6%	76.4%	92.0%
Guangdong Investment	9.1%	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

NOMURA

Sound Global 0967.HK 967 HK

EQUITY: WATER & ENVIRONMENT

Not only construction, let's operate

Initiate at Buy; TP of HKD10.90

Global Markets Research

28 August 2014

Rating Starts at	**Buy**
Target price Starts at	HKD 10.90
Closing price 22 August 2014	HKD 8.03
Potential upside	+35.7%

A strategic shift to WWT operator: from EPC to BOT

Sound Global (SGL), a reputable name in the WWT EPC segment over the past decade, recently accelerated its expansion in BOT projects after de-listing in the SGP market, which offers a re-rating opportunity, in our view.

- **Momentum in adding new BOT projects remains strong:** SGL has added 1.1mn tonnes/day of projects YTD, with investment of CNY1.7bn, on track with management's 2014 guidance of 1-2mn tonnes/day capacity adds and capex of CNY2-3bn. Newly signed capacity YTD already accounts for 50% of the total capacity signed by end-2013 (1.7mn tonnes/day).
- **Leader in rural WWT industry**: **key focus area of central government:** Riding on the government's support to lift WWT penetration in rural regions, SGL has become the first mover relative to peers to intensively develop WWT projects in rural areas, which also avoids fierce competition in municipal WWT projects. SGL aims to penetrate 400-500 towns by end-2015F vs. the current 100+ projects, implying a market share of 15-20%.

Together with a steady EPC orderbook, we see strong earnings upside and initiate coverage of SGL at Buy with a SOTP-derived TP of HKD10.90.

Catalysts: Asset injection from parent group; more favourable policies on rural WWT development

Valuation: Undemanding with 2014/15F P/Es of 15x/12x

Although SGL's valuation should see a discount to its peers given its EPC business still accounts for the majority of earnings, we see limited downside at current levels given we only apply a P/E of 13.0x (vs 12-23x for other EPC service providers) to evaluate its EPC business and a cautious assumption of 0.7mn tonnes/day capacity additions pa for its BOT projects over 2015-20F, vs the company's target of annual additions at ~1mn tonnes/day.

Anchor themes

With market differentiation emerging, we prefer: 1) large-scale SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

Our FY14/15F earnings are 7%/14% higher than consensus.

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Year-end 31 Dec	FY13	FY14F		FY15F		FY16F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	3,140	N/A	4,104	N/A	5,243	N/A	6,038
Reported net profit (mn)	423	N/A	555	N/A	769	N/A	1,000
Normalised net profit (mn)	435	N/A	555	N/A	769	N/A	1,000
FD normalised EPS	33.71c	N/A	40.27c	N/A	52.43c	N/A	68.13c
FD norm. EPS growth (%)	2.1	N/A	19.5	N/A	30.2	N/A	30.0
FD normalised P/E (x)	18.8	N/A	15.5	N/A	11.9	N/A	9.2
EV/EBITDA (x)	10.6	N/A	8.4	N/A	7.0	N/A	6.1
Price/book (x)	2.6	N/A	2.2	N/A	1.8	N/A	1.3
Dividend yield (%)	na	N/A	na	N/A	na	N/A	na
ROE (%)	14.8	N/A	15.2	N/A	16.7	N/A	18.2
Net debt/equity (%)	3.6	N/A	net cash	N/A	1.6	N/A	11.0

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Sound Global

Relative performance chart

Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	4.6	15.9	95.9	M cap (USDmn)	1,520.4
Absolute (USD)	4.6	15.9	96.0	Free float (%)	45.6
Rel to MSCI China	-0.6	5.0	81.2	3-mth ADT (USDmn)	2.8

Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	2,652	3,140	4,104	5,243	6,038
Cost of goods sold	-1,852	-2,181	-2,914	-3,698	-4,169
Gross profit	800	958	1,190	1,545	1,868
SG&A	-119	-90	-157	-236	-253
Employee share expense	0	0	0	0	0
Operating profit	681	868	1,033	1,309	1,615
EBITDA	697	885	1,043	1,319	1,624
Depreciation	-16	-17	-10	-9	-9
Amortisation	0	0	0	0	0
EBIT	681	868	1,033	1,309	1,615
Net interest expense	-164	-274	-280	-272	-271
Associates & JCEs	0	0	0	0	0
Other income	-16	-17	-10	-9	-9
Earnings before tax	502	578	743	1,028	1,336
Income tax	-76	-141	-186	-257	-334
Net profit after tax	426	437	557	771	1,002
Minority interests	0	-2	-2	-2	-2
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	426	435	555	769	1,000
Extraordinary items	2	-11	0	0	0
Reported NPAT	428	423	555	769	1,000
Dividends	0	0	0	0	0
Transfer to reserves	428	423	555	769	1,000
Valuations and ratios					
Reported P/E (x)	19.5	19.3	15.5	11.9	9.2
Normalised P/E (x)	19.6	18.8	15.5	11.9	9.2
FD normalised P/E (x)	19.6	18.8	15.5	11.9	9.2
Dividend yield (%)	na	na	na	na	na
Price/cashflow (x)	20.2	19.3	9.0	13.7	7.9
Price/book (x)	3.1	2.6	2.2	1.8	1.3
EV/EBITDA (x)	13.4	10.6	8.4	7.0	6.1
EV/EBIT (x)	13.7	10.8	8.4	7.1	6.1
Gross margin (%)	30.2	30.5	29.0	29.5	30.9
EBITDA margin (%)	26.3	28.2	25.4	25.1	26.9
EBIT margin (%)	25.7	27.7	25.2	25.0	26.7
Net margin (%)	16.1	13.5	13.5	14.7	16.6
Effective tax rate (%)	15.1	24.4	25.0	25.0	25.0
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	17.3	14.8	15.2	16.7	18.2
ROA (pretax %)	20.3	19.2	18.3	18.6	18.5
Growth (%)					
Revenue	15.9	18.4	30.7	27.8	15.2
EBITDA	12.3	26.9	17.9	26.5	23.1
Normalised EPS	0.2	2.1	19.5	30.2	30.0
Normalised FDEPS	0.2	2.1	19.5	30.2	30.0

Source: Company data, Nomura estimates

Cashflow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	697	885	1,043	1,319	1,624
Change in working capital	-109	-146	106	-385	-128
Other operating cashflow	-176	-314	-196	-266	-342
Cashflow from operations	413	424	953	667	1,153
Capital expenditure	-565	-724	-729	-911	-1,460
Free cashflow	-152	-300	224	-245	-307
Reduction in investments	-28	24	0	0	0
Net acquisitions	0	0	0	0	0
Dec in other LT assets	0	0	0	0	0
Inc in other LT liabilities	0	114	0	0	0
Adjustments	54	129	11	18	36
CF after investing acts	-125	-33	236	-226	-271
Cash dividends	-65	0	0	0	0
Equity issue	0	0	0	0	0
Debt issue	500	924	22	514	97
Convertible debt issue	-285	0	0	27	0
Others	809	-214	-291	-290	-307
CF from financial acts	959	711	-269	251	-211
Net cashflow	834	678	-34	25	-481
Beginning cash	2,131	2,965	3,643	3,609	3,634
Ending cash	2,965	3,643	3,609	3,634	3,153
Ending net debt	-131	110	-434	82	660

Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	2,965	3,643	3,609	3,634	3,153
Marketable securities	0	0	0	0	0
Accounts receivable	2,017	2,666	2,942	3,820	3,941
Inventories	24	28	32	41	47
Other current assets	1	1	1	1	1
Total current assets	5,008	6,338	6,584	7,496	7,141
LT investments	28	3	3	3	3
Fixed assets	48	50	46	43	40
Goodwill					
Other intangible assets	112	169	169	169	169
Other LT assets	1,643	2,237	2,960	3,865	5,319
Total assets	6,839	8,797	9,763	11,576	12,673
Short-term debt	1,354	2,281	2,303	2,817	2,914
Accounts payable	1,234	1,695	2,082	2,583	2,582
Other current liabilities	64	108	108	108	108
Total current liabilities	2,652	4,085	4,493	5,508	5,603
Long-term debt	923	899	899	899	899
Convertible debt	558	573	-27	0	0
Other LT liabilities	52	167	167	167	167
Total liabilities	4,185	5,723	5,531	6,573	6,669
Minority interest	11	4	6	8	10
Preferred stock	0	0	0	0	0
Common stock	833	834	894	894	894
Retained earnings	1,811	2,237	3,332	4,101	5,101
Proposed dividends	0	0	0	0	0
Other equity and reserves	0	0	0	0	0
Total shareholders' equity	2,644	3,071	4,226	4,995	5,995
Total equity & liabilities	6,839	8,798	9,763	11,576	12,673
Liquidity (x)					
Current ratio	1.89	1.55	1.47	1.36	1.27
Interest cover	4.2	3.2	3.7	4.8	6.0
Leverage					
Net debt/EBITDA (x)	net cash	0.12	net cash	0.06	0.41
Net debt/equity (%)	net cash	3.6	net cash	1.6	11.0
Per share					
Reported EPS (CNY)	33.14c	32.82c	40.27c	52.43c	68.13c
Norm EPS (CNY)	33.01c	33.71c	40.27c	52.43c	68.13c
FD norm EPS (CNY)	33.01c	33.71c	40.27c	52.43c	68.13c
BVPS (CNY)	2.05	2.38	2.88	3.40	4.82
DPS (CNY)	0.00	0.00	0.00	0.00	0.00
Activity (days)					
Days receivable	246.0	272.2	249.4	235.4	235.2
Days inventory	4.5	4.4	3.7	3.6	3.8
Days payable	208.8	245.1	236.6	230.2	226.7
Cash cycle	41.8	31.5	16.6	8.7	12.4

Source: Company data, Nomura estimates

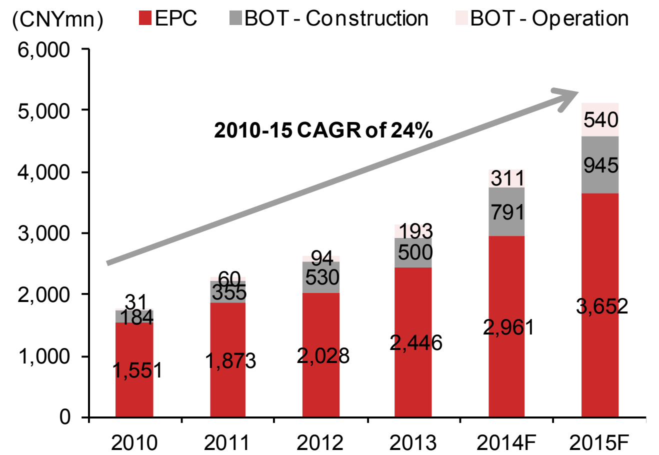
Investment thesis

Sound Global (SGL) – generally known as a construction company in China's water industry – is now striving to develop its WWT operation business in niche markets – rural regions. In our view, the strides SGL has made in the past 1.5 years illustrate management's execution abilities and strong market demand. We believe this strong trend will sustain for the next five years and lead to a re-rating for the stock.

Re-rating opportunity through business transformation

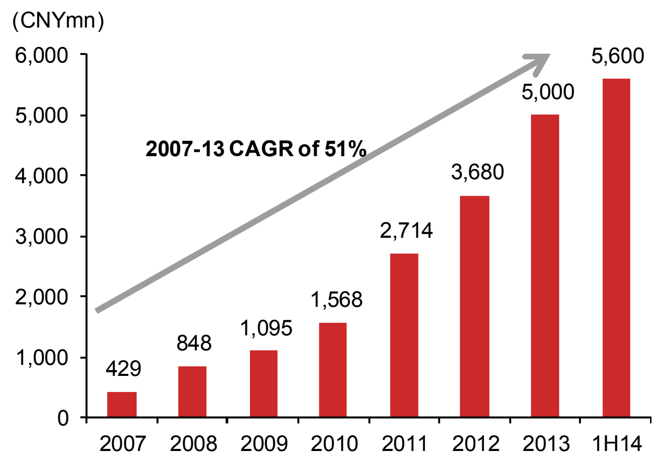
Back in 2006, Sound Global was originally engaged in the "engineering, procurement and construction" (EPC) services and manufacturing equipment for industrial and residential water treatment plants. The company initiated its operation and maintenance (O&M) business in 2009. Simultaneously, given the higher returns and sustainable cash inflow of BOT projects vs. EPC ones, the company also started accelerating integration into the downstream water value chain by expanding its WWT BOT project development. By end-1H14, SGL had BOT projects (including projects under construction/planning with concession rights secured) with total capacity of 1.73mn tonnes / day. In 2014, the project winning momentum is even stronger, with 45 water projects announced YTD, at total capacity of 1.1mn tonnes/day and total investment of CNY1.7bn (including Phase II expansion, total capacity will be 1.75mn tonnes/day with investment of CNY2.9bn). Since management targets to have 1-2mn tonnes/day of new capacity with total investment of CNY2-3bn in 2014F, we expect more project announcements in 2H14F. Overall, we believe such a business transformation (from EPC to WWT projects operator), should provide a re-rating opportunity for the company.

Fig. 21: SGL: Revenue breakdown by segment



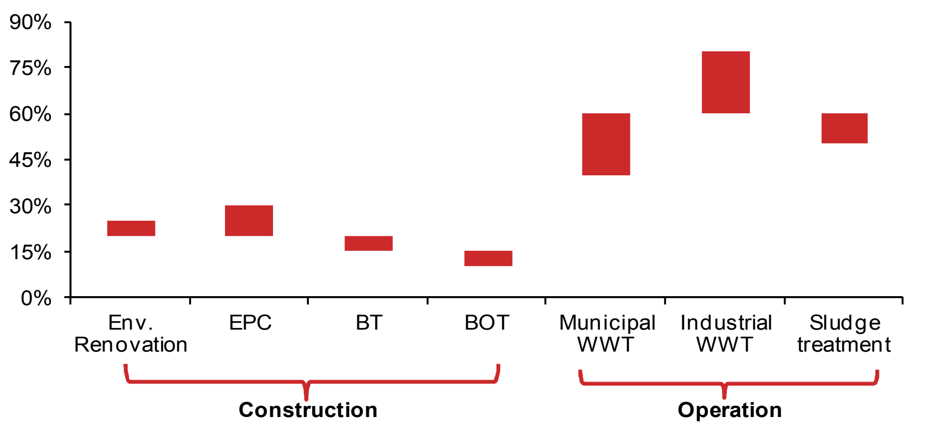
Source: Company data, Nomura research

Fig. 22: SGL: Trends of EPC order book



Source: Company data, Nomura research

Fig. 23: China water: Gross margin comparison across the value chain



Source: Company data, Nomura research

Fig. 24: SGL: New projects obtained YTD 2014

Project	Method	Obtaining nature	Capacity (000' ton/day)	Announcement date	Est. construction start date	Est. COD	Investment (CNY mn)
WWT in Sichuan Enyang	BOT	M&A	30	Aug-14	NA	NA	54
WWT in Hunan Leiyang Phase II	BOT	Bid	200	Aug-14	NA	NA	330
WWT in Fujian Xianyou Phase II	BOT	M&A	40	Jul-14	NA	NA	NA
WWT in Fujian Luoyuan Phase II	BOT	M&A	60	Jul-14	NA	NA	NA
WWT in Fujian Xianyou	TOT	M&A	10	Jul-14	Under operation	NA	28
WWT in Fujian Luoyuan	TOT	M&A	20	Jul-14	Under operation	NA	56
WWT in Sichuan Dazhou (rural)	BOT	Bid	10	Jun-14	NA	NA	200
Water supply in Shanxi Longci	BOT	Bid	NA	Jun-14	NA	NA	123
Water supply in Shanxi Longci - Pipeline	BOT	Bid	NA	Jun-14	NA	NA	123
Water supply in Anhui Taihe County (rural)	BOT	Bid	40	May-14	NA	NA	89
WWT in Anhui Taihe County (rural)	TOT	Bid	20	May-14	NA	NA	NA
WWT in Anhui Huoqiu County (Phase I) (5 rural plants)	BOT	Bid	20	May-14	NA	NA	170
WWT in Anhui Huoqiu County (Phase II) (5 rural plants)	BOT	Bid	30	May-14	NA	NA	NA
WWT in Shaanxi Dingbian (Phase II)	BOT	Bid	20	May-14	NA	NA	50
WWT in Guizhou Huangping (Phase I) (3 rural plants)	BOT	Bid	6	May-14	NA	NA	56
WWT in Guizhou Huangping (Phase I) - Pipelines	BT	Bid	NA	May-14	NA	NA	NA
WWT in Guangdong Dongguan Humen - Ningzhou (Phase I)	TOT	M&A	100	May-14	Under operation	2014	202
WWT in Guangdong Dongguan Humen - Ningzhou (Phase II)	BOT	M&A	200	May-14	100 kilo ton/day by 2014 with CNY110mn		
WWT in Guangdong Dongguan Humen - Ningzhou (Phase III)	BOT	M&A	400	May-14	NA	NA	NA
WWT in Guangdong Dongguan Humen - Haidao (Phase I)	TOT	M&A	10	May-14	Under operation	NA	NA
WWT in Guangdong Dongguan Humen - Haidao (Phase II)	BOT	M&A	30	May-14	NA	2015	NA
WWT in Guangdong Dongguan Humen - Haidao (Phase III)	BOT	M&A	50	May-14	NA	NA	NA
Water supply in Jilin Changbai Mountain	BOT	Bid	20	Mar-14	NA	NA	45
WWT in Jilin Changbai Mountain	BOT	Bid	15	Mar-14	NA	NA	50
WWT in Jilin Lishu County (Phase I)	BOT	Bid	13	Mar-14	NA	NA	55
WWT in Jilin Lishu County (Phase II)	BOT	Bid	13	Mar-14	NA	NA	NA
WWT in Shaanxi Ankang (Phase I)	BOT	Bid	15	Feb-14	NA	NA	50
WWT in Shaanxi Ankang (Phase II)	BOT	Bid	15	Feb-14	NA	NA	NA
Water supply in Western Industrial Zone of Hebei Qian'an (Phase I)	BOT	Bid	15	Feb-14	NA	NA	59
Water supply in Western Industrial Zone of Hebei Qian'an (Phase II)	BOT	Bid	15	Feb-14	NA	NA	NA
WWT in Western Industrial Zone of Hebei Qian'an (Phase I)	BOT	Bid	10	Feb-14	NA	NA	NA
WWT in Western Industrial Zone of Hebei Qian'an (Phase II)	BOT	Bid	10	Feb-14	NA	NA	NA
WWT in Fujian Sanming Jikou industrial park (Phase I)	BOT	Bid	15	Feb-14	NA	NA	51
WWT in Fujian Sanming Jikou industrial park (Phase II)	BOT	Bid	30	Feb-14	NA	NA	NA
WWT in Guizhou Xishui County (12 villiages and tow ns)	BOT	Bid	NA	Feb-14	NA	NA	260
WWT in Guizhou Xishui County (12 villiages and tow ns) - Pipelines	BT	Bid	NA	Feb-14	NA	NA	NA
WWT in Jiangsu Siyang w ood park (Phase I)	BOT	Bid	15	Jan-14	NA	end-2014	60
WWT in Jiangsu Siyang w ood park (Phase II)	BOT	Bid	15	Jan-14	NA	NA	NA
WWT in Xinjiang Urumqi Saybagh (Phase I)	BOT	Bid	50	Jan-14	NA	NA	153
WWT in Xinjiang Urumqi Saybagh (Phase II)	BOT	Bid	25	Jan-14	NA	NA	NA
No. 3 WWT in Xinjiang Yining (Phase I)	BOT	Bid	25	Jan-14	end-2013	2014	230
No. 3 WWT in Xinjiang Yining (Phase II)	BOT	Bid	25	Jan-14	NA	NA	NA
WWT in Xinjiang Tacheng (Phase I)	BOT	Bid	40	Jan-14	NA	NA	80
WWT in Xinjiang Tacheng (Phase I) - Pipelines	BT	Bid	NA	Jan-14	NA	NA	60
WWT in Anhui Fuyang	BOT	Bid	100	Jan-14	NA	NA	240
Total			**1,777**				**2,874**

Source: Company data, Nomura research

Early mover in rural WWT projects; higher return though higher risks

Unlike other industry players such as Beijing Capital, BEW, Tianjin Capital, CEI, etc., SGL is a privately owned company, which we view as a disadvantage in terms of government relationships. As such, since its transformation from EPC to operator in 2009, in 2013, SGL made another major push by shifting its focus to BOT WWT projects from urban to rural regions. Overall, we believe the rural regions are a niche market with less interest from the large SOEs, which results in a lower penetration rate than in urban regions (~10% in rural areas vs. 90% in urban ones). On a return perspective, as per SGL's management, the IRR of rural WWT projects is slightly higher than for urban projects, mainly due to the higher risks in WWT fee collection and the requirement for more operating resources. While municipal WWT projects remain the major contributor to BOT capacity, by end-2013, SGL was involved in 100 rural towns in China, which makes it the leader in the rural water treatment market in China and its penetration into rural China looks on track with management's strategy – to penetrate 400-500 towns by end-2015F.

Benefits from parental asset injections; not just a privilege of SOEs

The market recently showed strong favour on utility names which had asset injections from parents, mostly for SOEs. However, we also believe that SGL has the potential for parental asset injections, from its parent Beijing Sound Environment (BSE, unlisted), and its sister company, Sound Environmental Resources (SER, 000826 CH, NR), who entered into the WWT business even earlier than SGL. Currently under BSE and SER, there are six and 13 BOT projects which have the potential to be injected into SGL. With the acquisition of the 98% stake of the Tongliao WWT project (owned by BSE) announced on 3 June, 2014, we think steps to consolidate all WWT projects into SGL have been accelerated and expect more project injections going forward.

Fig. 25: Sound Global: Potential projects to be injected from parent and sister companies

Project	Location	Method	Equity interest	Capacity (000' ton per day)	Consession period (year)
Projects owned by parent company - BSE					
Huzhou Water Supply	Zhejiang	BOT	90%	200	25
Xiaojiahe WWT	Beijing	BOT	64%	20	23
Tongliao WWT*	Inner Mongolia	BOT	98%	100	25
Zhushan WWT	Hubei	BOT	84%	30	25
Danjiangkou WWT	Hubei	BOT	16%	10	25
Tianmen WWT	Hubei	BOT	24%	210	30
Projects owned by sister company - SER					
Fuchun WWT	Zhejiang	BOT	92%	10	30
Shuyan Water Supply	Jiangsu	BOT	80%	100	23
Nanchang Xianghu WWT	Jiangxi	BOT	91%	200	22
Baotou Lucheng WWT	Inner Mongolia	BOT	90%	200 WWT + 55 Recycle	30
Yichang WWT	Hubei	BOT	70%	200	30
Yichang Linjiangxi WWT	Hubei	BOT	70%	300	30
Jinmen Xiajiawan WWT	Hubei	BOT	95%	100	25
Xiangfan Guanyinge WWT	Hubei	BOT	97%	100	25
Jingzhou WWT	Hubei	BOT	60%	80	25
Zhejiang WWT	Hubei	BOT	80%	35	25
Daye WWT	Hubei	BOT	80%	30	25
Xianning WWT	Hubei	BOT	85%	60	25
Jiayu WWT	Hubei	BOT	80%	120	30

*: Tongliao project was announced to be acquired by SGL on 3 Jun 2014

Source: Company data, Nomura research

Attractive valuation vs. peers

Currently, large SOE names in China's water and environment sector are generally trading above 25x 2014F P/E, while SGL is only trading at 15.5x P/E (2014F EPS of CNY0.40). Even considering the discount of ~15-20% as a private player, we still see the valuation as very attractive, leaving significant upside with its growing BOT/TOT business.

Key investment risks / concerns

We believe the major market concerns on SGL's development mainly come from: 1) any default risks for the rural projects given the relatively low creditability / affordability of the rural governments; 2) the potential for increasing competition due to the participation of large SOEs; and 3) the sustainability of the company's EPC orderflows.

Why do SOEs not focus on rural projects if the returns are better?
In our view, there are three key reasons for the large SOEs to postpone their moves into rural regions:

- SOEs are generally risk-averse given their special political responsibilities and thus they tend to choose stability over profitability.
- SOEs still have access to bidding for or acquiring large urban projects with relatively large capacity per single project.
- Rural projects generally also involve massive pipeline construction work, in which pure WWT operators do not have the capabilities to participate.

What does SGL do to minimize the risks from WWT fee collections?

- SGL generally signs a package contract (including several rural township / village projects) with the related city/county-level governments, which have higher credibility and affordability vs. township/village governments.
- SGL considers it more meaningful to look at the number of projects rather than project size. By end-2015F, the company expects its market share in rural China to reach 15-20% – meaning it aims to penetrate 400-500 towns.
- SGL possess a mature and qualified construction team given its well-developed EPC business, which has unique advantage in obtaining rural projects which frequently involve a lot of pipeline construction.

SGL's EPC orderbook should remain steady
With the popularization of the PPP model given the central government's view of emphasizing the importance of water pollution control, we think SGL's orderbook should remain steady and even become stronger, thanks to the: 1) upgrade of WWT discharge standards for current projects; 2) expansion of WWT projects in rural areas (including plants and pipelines); and 3) prospect of comprehensive environment enhancement projects in key basins.

Potential dilution risk already eliminated with full redemption of convertible bond
Given its remaining convertible bonds were fully converted into ordinary shares by April 2014, the dilution risk overhang has been removed. However, we see near-term profit taking pressure given the CB conversion price is CNY3.4 or HKD4.10, vs. the closing price of HKD8.03 as on 22 August 2014.

Valuation: initiate at Buy with TP of HKD10.90

We initiate coverage of SGL at Buy with a TP of HKD10.90, implying upside potential of 35.7%. Our TP of HKD10.90 is derived from a sum-of-the-parts (SOTP) methodology using the following key operational assumptions:

Fig. 26: SGL: Key operation assumptions

Key assumption	Unit	2013	2014F	2015F
EPC revenue	CNY mn	3,140	4,063	5,137
BOT revenue	CNY mn	2,446	2,961	3,652
Operation capacity	mn ton per day	1.01	1.71	2.33
Effective interest rate	%	8.7%	8.4%	8.4%

Source: Company data, Nomura estimates

Fig. 27: SGL: SOTP valuation

Value from EPC division	
Histoical average PE (x)	12.7
Standard deviation (SD)	5.1
SD below average P/E	-
PE multiplier (x)	13.0
EPS from EPC business (CNY)	0.3
Value from EPC (HKD)	**5.02**

DCF value from BOT division	
HKD	**5.89**

Price target based on SOTP	
Price target (HK$)	**10.90**
Upside	***35.7%***

Source: Nomura estimates

In terms of the valuation methods, we applied the following assumptions:

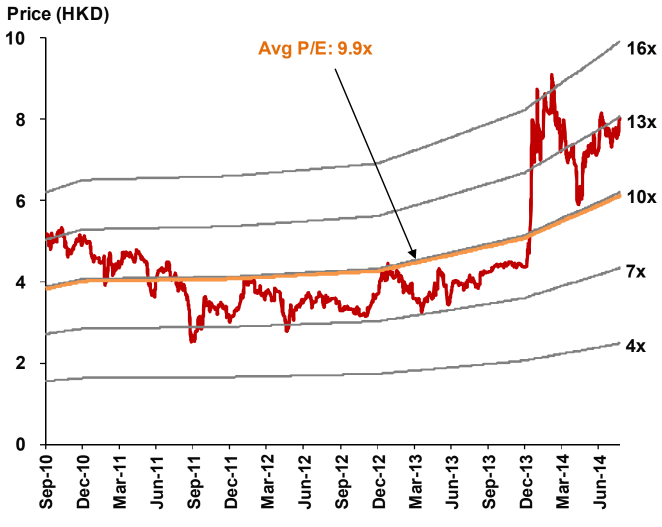
- We adopted a P/E of 13.0x to value its EPC segment, reflecting the historical mean of 12.7x since 2006; this P/E multiplier is undemanding, in our view, vs 12-25x at peers.
- We adopted a DCF method to derive the fair value of its BOT business – we assume 0.6-0.7mn tonnes of annual capacity additions over 2015-21F.

Fig. 28: SGL – DCF calculation of BOT business

WACC	Sum of PV (HK$'mn)	PV of TV (HK$'mn)	EV (HK$'mn)	Net cash/ (debt) (FY12F)	Equity Value (HK$'mn)	Shares out ('mn)	Value per share (HK$)	WACC Calculation	
4.7%	532.1	14,749.8	15,281.9	130.8	15,412.6	1,290	11.95		
5.2%	401.1	13,085.2	13,486.3	130.8	13,617.1	1,290	10.56	Equity Beta	1.10
5.7%	276.7	11,667.5	11,944.2	130.8	12,075.0	1,290	9.36	Risk Free Rate	3.50%
6.2%	158.5	10,449.9	10,608.4	130.8	10,739.2	1,290	8.32	Equity Risk Premium	7.50%
6.7%	46.2	9,396.5	9,442.8	130.8	9,573.6	1,290	7.42	Country Risk Premium	0%
7.2%	(60.4)	8,479.3	8,418.9	130.8	8,549.7	1,290	6.63	Cost of Equity	11.8%
7.7%	(161.8)	7,676.0	7,514.2	130.8	7,645.0	1,290	5.93	Cost of Debt	7.5%
8.2%	(258.1)	6,968.8	6,710.7	130.8	6,841.5	1,290	5.30	Debt/Capital	50%
8.7%	(349.6)	6,343.5	5,993.9	130.8	6,124.7	1,290	4.75	Tax	25.0%
9.2%	(436.5)	5,788.1	5,351.6	130.8	5,482.3	1,290	4.25	WACC	8.7%
9.7%	(519.2)	5,293.0	4,773.9	130.8	4,904.7	1,290	3.80		
10.2%	(597.7)	4,850.2	4,252.5	130.8	4,383.3	1,290	3.40		
10.7%	(672.3)	4,452.8	3,780.6	130.8	3,911.4	1,290	3.03	Terminal grow th rate	2%
11.2%	(743.1)	4,095.2	3,352.1	130.8	3,482.9	1,290	2.70		
11.7%	(810.5)	3,772.5	2,962.0	130.8	3,092.8	1,290	2.40		
12.2%	(874.5)	3,480.5	2,606.1	130.8	2,736.9	1,290	2.12		
12.7%	(935.2)	3,215.8	2,280.6	130.8	2,411.4	1,290	1.87		
13.2%	(993.0)	2,975.3	1,982.3	130.8	2,113.1	1,290	1.64		
13.7%	(1,047.8)	2,756.2	1,708.4	130.8	1,839.2	1,290	1.43		
14.2%	(1,099.9)	2,556.4	1,456.5	130.8	1,587.3	1,290	1.23		

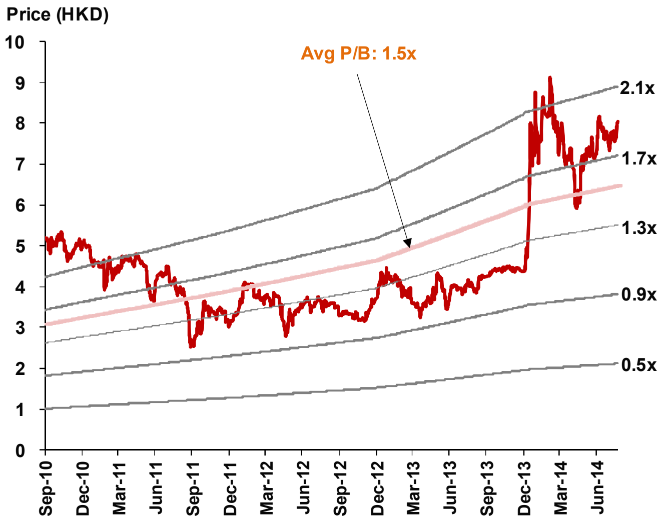
Source: Company data, Nomura estimates

Fig. 29: SGL – Historical P/E band



Source: Company data, Nomura estimates

Fig. 30: SGL – Historical P/B band



Source: Company data, Nomura estimates

Investment risks

- Lower-than-expected capacity additions in BOT/TOT projects.
- Delays or even default in WWT tariff collections from local governments in rural regions.
- Fluctuation in EPC orderbooks.

Company overview

A leading privately owned water player with both EPC and operation segments

Sound Global is a leading one-stop integrated water and wastewater treatment solutions provider in China, offering services covering the full value chain of the water and wastewater treatment industry, from design and construction of water and wastewater treatment facilities, to the operation and maintenance of water and wastewater treatment facilities and the manufacturing of water and wastewater treatment equipment.

Sound Global was initially listed as an EPC service provider on the Singapore Stock Exchange in 2006 under the name of Epure Int'l. The company then initiated its operation and maintenance (O&M) and BOT projects since 2009. The company was then also listed on Hong Kong Stock Exchange in 2010 under the name of Sound Global. Given liquidity issues and lack of peers for comparison in the Singapore market, the company was delisted from the Singapore Stock Exchange in 2013 and became a solely HK-listed company. The company also sped up its step into the downstream of water value chain by expanding its BOT/O&M business of WWT projects, especially in the rural regions.

Fig. 31: Sound Global: A review of its business segments

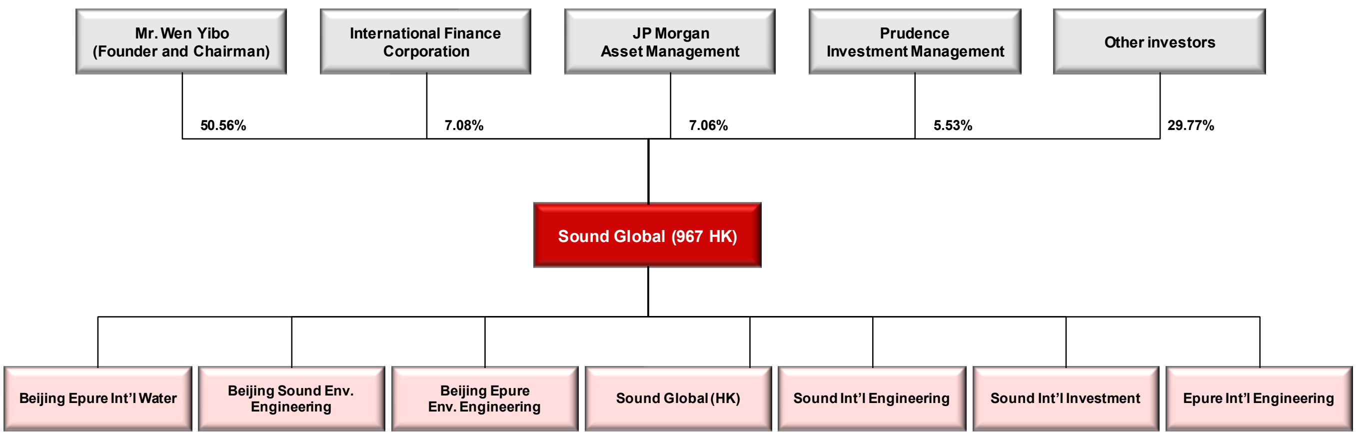
Sound Global (967 HK)

EPC service	BOT project	O&M service	Equipment Manufacturing
➢ EPC order book over CNY 5bn by the end of 2013 ➢ Captured the opportunities of facilities upgrading and equipment renovation ➢ Industrial EPC applied R&D technology breakthrough ➢ Penetrated into overseas markets	➢ 18 projects newly bidded in 2013 including three directly owned for operation through acquisitions in Beijing ➢ SMART* technology applied in over 100 towns/villages with good profitability ➢ Four industrial park projects won in 2013 with tremendous space for growth	➢ O&M revenue doubled and segment profitability tripled in 2013 with a CAGR of 85% for 2010 to 2013 ➢ Strategic emphasis placed as a future spotlight for growth	➢ Highly competitive equipment manufacturing business for both external and internal clients ➢ Segment profitability increased by 31% in 2013 ➢ Customized in-house design to facilitate patented technologies to be realized seamlessly and in a cost-efficient way

*SMART = Small & Skilful, Multiple & Modular, Active & Automatic, Rapid and Technologic

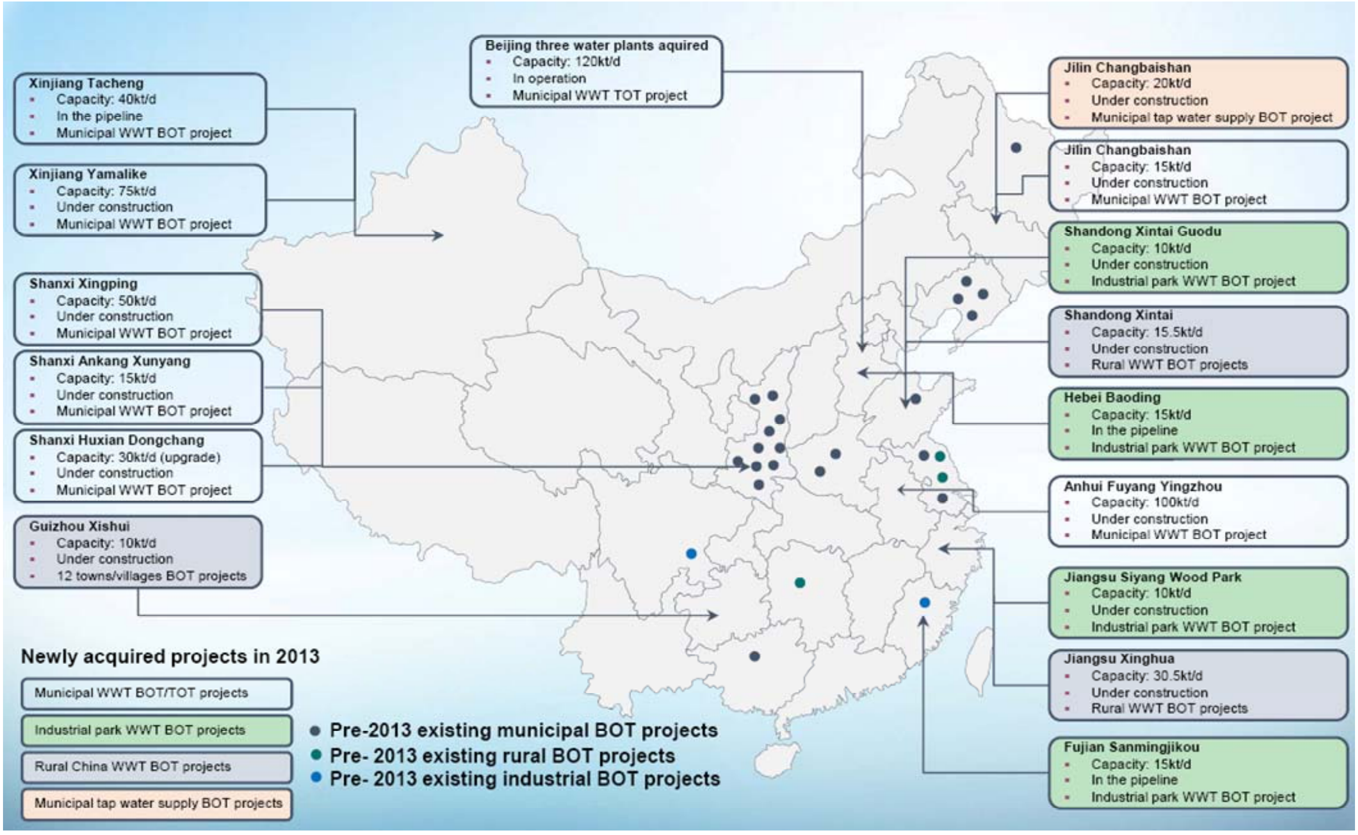
Source: Company data, Nomura research

Fig. 32: Sound Global: Company structure by end-June 2013



Source: Company data, Bloomberg, Nomura research

Fig. 33: Sound Global: Distribution of its current water projects - 2013



Source: Company data, Nomura research

Corporate governance: Professionals with solid reputations that are experts in China water sector

Given the company's parent company and sister company – sharing the same top management with SGL - were established back in the 1990s, we believe the executive team all possess ample experience and well-established industry relationships, which should ensure SGL's sustainable development in China's water industry.

Mr. Wen Yibo - Chairman of the board, Founder, Executive Director
Mr. Wen Yibo was appointed to the board on 7 November, 2005 and is responsible for charting SGL's strategic direction. Mr. Wen graduated from Tsinghua University with a master's degree in environmental engineering, in December 1989. Mr. Wen has accumulated more than 16 years of experience in the environmental protection industry. Between 1989 and 1990, Mr. Wen worked as a lecturer in the environmental engineering department of Tsinghua University. From 1990 to 1993, he was a senior engineer at the engineering division of the Planning and Design Institute of the Ministry of Chemical Engineering. In November 1993, Wen Yibo and his wife, Zhang Huiming, co-founded Beijing Sound Environmental Technology Development Company; Mr. Wen has served as chairman since then. Mr. Wen was named a senior engineer in September 1998 by the Beijing Senior Specialized Technique Qualification Evaluation Committee and was named a professor-level engineer in September 2003. Mr. Wen is also retained as a part-time professor in Tongji University and Lanzhou Jiaotong University.

Mr. Zhang Jingzhi – Executive Director, CEO
Mr. Zhang Jingzhi graduated with a bachelor's degree in management information systems from University of Science and Technology Beijing, School of Management in June 1993 and a master's degree in business administration from School of Business, Renmin University of China in April 2001. Mr. Zhang was named a senior engineer (professor level) by the Beijing Senior Specialized Technique Qualification Evaluation Committee.

In his early years, Mr. Zhang was employed by the University of Science and Technology Beijing, School of Management and Ministry of Metallurgical Industry. He joined Sound Group Limited in April 2001 and successively served as an assistant to the president and vice president. From January 2004 to March 2011, he was a director and successively as a general manager and an executive general manager of Sound Environmental Resources Co., Ltd, the shares of which are listed on Shenzhen Stock Exchange. From April 2011 to February 2013, he served as the executive chairman of Beijing Environment Sanitation Investment Co., Ltd. Mr. Zhang has many years' of management experience in listed companies. He was the general manager of Beijing Sound Environment Group Co., Ltd., responsible for overall operations. He was in charge and completed the investment, funding and implementation of nearly twenty solid waste treatment projects.

Mr. Wang Kai – Executive Director, CFO

Mr. Wang Kai graduated with both a bachelor's and master's degree in 1984 and 1990, respectively, from the School of Environmental Science and Engineering of Tsinghua University. From 1984 to 1987, Mr. Wang was the assistant engineer in Dept. of Technical Security, First Institute of the First Academy of Ministry of Nuclear Industry. From 1990 to 1998, Mr. Wang was an engineer of the Chengdu Institute of Methane Science of the Ministry of Agriculture, Second Design Institute. Mr. Wang joined Beijing Sound Environment Group Company Limited in 1998 as the chief engineer. Since August 2010, he has been appointed as the deputy general manager of Beijing Sound Environmental Engineering Company Limited.

Mr. Jiang Anping – Executive Director, Chief Engineer

Mr. Jiang Anping graduated with a bachelor's degree of engineering from the Department of Civil Engineering of Tianjin University in July 1995 and a master's degree of engineering from the Department of Environmental Science and Engineering of Tsinghua University in July 1998. He obtained his doctoral degree in engineering science from the Department of Biological Systems Engineering of Washington State University in the US in December 2009.

From July 1998 to December 1999, Mr. Jiang worked as an assistant engineer in the design department of water supply and drainage under Beijing Municipal Engineering Professional Design Institute; from January 2000 to August 2000, he was a project manager of Beijing China Union Engineering Company Limited; from September 2000 to September 2002, he was the engineer of technical design of Beijing Puresino-Boda Environmental Engineering Co., Ltd.; from October 2002 to July 2005, he worked as head of the second technology department at research and design institute of Beijing Sound Environmental Engineering Co., Ltd.; from August 2005 to June 2010, he was an assistant researcher of Washington State University; from July 2010 to present, he successively served as the chief engineer of the design and research institute, the deputy head of the design and research institute and the chief engineer of Sound Global.

Mr. Luo Liyang – Executive Director, Chief Engineer

Mr. Luo Liyang is an executive director of SGL. Mr. Luo has been the deputy general manager (marketing) of the company since March 12, 2010 and the deputy general manager and manager of the marketing department in Beijing Sound since he joined the company in May 2000. He is responsible for market planning and channel exploitation, construction and management of product platforms and establishment of SGL's sales network. Mr. Luo graduated with a bachelor's degree in environmental monitoring from Henan Normal University in July 1997. From July 1997 to March 1998, he was the vice manager of the environmental protection department of Henan Xuchang Biochemical Co., Ltd. From March 1998 to May 2000, he was the vice manager of the business department of Henan Luohe Huanhaiqing Environmental Protection Co., Ltd. Mr. Luo was accorded an engineer in December 1998 by the Henan Science and Technology Committee.

NOMURA

Beijing Enterprises Water

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EQUITY: POWER & UTILITIES

A non-stop cruiser – keeping strong growth

The best quality name; maintain Buy on sustainable steady growth prospects

Capacity growth + favourable policies = sustainable strong growth

Besides the general positive attitude towards the water sector backed by consistent government support, we see two near-term catalysts for BEW:

- **Capacity addition proceeding smoothly and will, as street expected, beat guidance:** By end-June, BEW has added 0.92mn ton/day capacity. In addition, management also disclosed that the negotiation progress on several large-scale acquisitions is proceeding smoothly with total capacity above 1mn ton/day. With another 0.55mn ton/day WWT plant in Beijing to be secured soon, we see our above-guidance (2-2.5mn ton/day addition) forecast of 3-3.5mn ton/day capacity in 2014 as achievable.
- **The biggest beneficiary from the potential publication of Action Plan of Water Pollution Control:** The Action Plan of Water Pollution Control, which we expect to lead to CNY2tn investment, has been submitted to the State Council for final review in mid-June. BEW, as China's biggest WWT player, will be the biggest beneficiary from the higher WWT discharge standards, stricter requirement for sludge treatment and huge investment in comprehensive renovation projects in key water basins, in our view.

NDR takeaways – positive on future development

On the recent non-deal roadshow (NDR) in Seoul and Tokyo, management re-emphasised its five-year strategy to double market share to 10-12% by end-2018 and expressed confidence in securing 30+% CAGR of capacity addition.

Valuation: PEG at 0.73x with 2013-15F EPS CAGR of 37%; Buy

Although we note BEW's high valuation (2014F P/E: 27x) currently, we focus more on the strong earnings profile of the company over the next 3-4 years. Given the PEG remains attractive at 0.73x with 2013-15F EPS CAGR of 37%, with more potential upside from new government policies, we reiterate Buy on BEW with TP of HKD6.50, implying 25% potential upside.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F
Currency (HKD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	6,407	10,108	10,140	13,900	14,416		15,692
Reported net profit (mn)	1,084	1,710	1,712	2,313	2,435		2,952
Normalised net profit (mn)	1,084	1,710	1,712	2,313	2,435		2,952
FD normalised EPS	12.98c	19.12c	19.13c	25.54c	26.88c		32.58c
FD norm. EPS growth (%)	32.8	38.6	47.4	33.6	40.5		21.2
FD normalised P/E (x)	40.1	N/A	27.2	N/A	19.3	N/A	16.0
EV/EBITDA (x)	31.3	N/A	24.5	N/A	18.9	N/A	15.8
Price/book (x)	3.3	N/A	3.0	N/A	2.6	N/A	2.3
Dividend yield (%)	1.0	N/A	1.3	N/A	1.9	N/A	2.4
ROE (%)	10.0	12.4	12.0	14.8	15.1		16.3
Net debt/equity (%)	103.6	89.6	126.0	88.5	116.8		101.5

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

28 August 2014

Rating Remains	**Buy**
Target price Remains	HKD 6.50
Closing price 22 August 2014	HKD 5.20
Potential upside	+25%

Anchor themes

With market differentiation emerging, we prefer: 1) large-scale SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

Our 2015/16F earnings estimates are 16% ahead of consensus.

Research analysts

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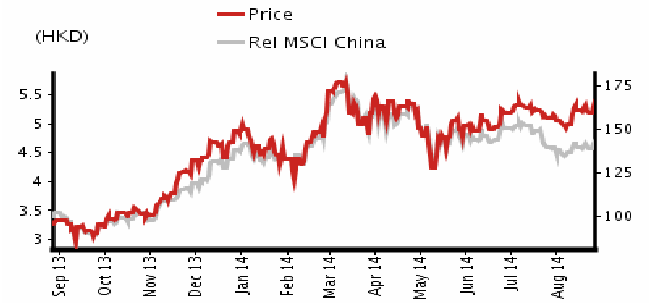
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Beijing Enterprises Water

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	-0.4	4.4	62.0	M cap (USDmn)	5,811.6
Absolute (USD)	-0.4	4.5	62.1	Free float (%)	46.1
Rel to MSCI China	-5.5	-6.5	47.3	3-mth ADT (USDmn)	9.6

Income statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	3,727	6,407	10,140	14,416	15,692
Cost of goods sold	-2,290	-3,901	-6,475	-9,561	-10,144
Gross profit	1,437	2,506	3,665	4,855	5,548
SG&A	-440	-775	-1,115	-1,442	-1,451
Employee share expense	0	0	0	0	0
Operating profit	997	1,731	2,550	3,414	4,097
EBITDA	1,067	1,852	2,676	3,540	4,223
Depreciation	-25	-34	-40	-39	-39
Amortisation	-45	-87	-87	-87	-87
EBIT	997	1,731	2,550	3,414	4,097
Net interest expense	-494	-788	-852	-947	-959
Associates & JCEs	55	108	56	57	57
Other income	534	447	602	705	763
Earnings before tax	1,092	1,497	2,356	3,229	3,958
Income tax	-225	-352	-554	-665	-850
Net profit after tax	867	1,145	1,802	2,563	3,108
Minority interests	-117	-61	-90	-128	-155
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	750	1,084	1,712	2,435	2,952
Extraordinary items	0	0	0	0	0
Reported NPAT	750	1,084	1,712	2,435	2,952
Dividends	-290	-426	-599	-852	-1,033
Transfer to reserves	461	658	1,113	1,583	1,919
Valuations and ratios					
Reported P/E (x)	47.9	36.8	26.0	18.5	15.3
Normalised P/E (x)	47.9	36.8	26.0	18.5	15.3
FD normalised P/E (x)	53.2	40.1	27.2	19.3	16.0
Dividend yield (%)	0.8	1.0	1.3	1.9	2.4
Price/cashflow (x)	95.0	na	29.0	9.7	7.2
Price/book (x)	4.2	3.3	3.0	2.6	2.3
EV/EBITDA (x)	50.2	31.3	24.5	18.9	15.8
EV/EBIT (x)	53.5	33.4	25.7	19.5	16.2
Gross margin (%)	38.6	39.1	36.1	33.7	35.4
EBITDA margin (%)	28.6	28.9	26.4	24.6	26.9
EBIT margin (%)	26.8	27.0	25.1	23.7	26.1
Net margin (%)	20.1	16.9	16.9	16.9	18.8
Effective tax rate (%)	20.6	23.5	23.5	20.6	21.5
Dividend payout (%)	38.6	39.3	35.0	35.0	35.0
ROE (%)	9.1	10.0	12.0	15.1	16.3
ROA (pretax %)	4.2	5.6	5.9	6.7	7.5
Growth (%)					
Revenue	40.4	71.9	58.3	42.2	8.8
EBITDA	63.1	73.5	44.5	32.3	19.3
Normalised EPS	21.5	30.0	41.8	40.4	21.2
Normalised FDEPS	12.4	32.8	47.4	40.5	21.2

Source: Company data, Nomura estimates

Cashflow statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	1,067	1,852	2,676	3,540	4,223
Change in working capital	1,165	912	-1,371	779	1,780
Other operating cashflow	-1,812	-2,782	299	520	532
Cashflow from operations	420	-18	1,604	4,839	6,534
Capital expenditure	-1,629	-2,900	-6,039	-4,281	-4,495
Free cashflow	-1,209	-2,918	-4,434	558	2,039
Reduction in investments	-4	4	0	0	0
Net acquisitions	0	0	0	0	0
Dec in other LT assets	-4,088	-10,705	-6,278	-3,491	-3,565
Inc in other LT liabilities	158	473	1,161	0	0
Adjustments	3,810	9,353	5,409	3,734	3,809
CF after investing acts	-1,333	-3,793	-4,142	801	2,283
Cash dividends	-345	-346	-426	-599	-852
Equity issue	0	2,297	12	0	0
Debt issue	4,096	3,692	422	869	-535
Convertible debt issue	0	0	0	0	0
Others	-74	-628	-852	-947	-959
CF from financial acts	3,676	5,015	-843	-678	-2,347
Net cashflow	2,343	1,222	-4,985	123	-64
Beginning cash	1,948	4,291	5,513	528	651
Ending cash	4,291	5,513	528	651	587
Ending net debt	8,984	13,770	19,177	19,923	19,451

Balance sheet (HKDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	4,291	5,513	528	651	587
Marketable securities	0	0	0	0	0
Accounts receivable	2,800	3,172	6,676	7,396	6,112
Inventories	30	55	37	50	66
Other current assets	6,558	6,472	6,268	7,070	6,809
Total current assets	13,679	15,212	13,509	15,166	13,574
LT investments	7	3	3	3	3
Fixed assets	528	431	429	427	425
Goodwill	1,762	2,513	3,449	3,449	3,449
Other intangible assets	17	26	26	26	26
Other LT assets	15,297	26,002	32,280	35,771	39,336
Total assets	31,290	44,187	49,696	54,842	56,813
Short-term debt	2,810	3,980	4,117	4,399	4,225
Accounts payable	1,919	2,755	4,057	5,047	5,494
Other current liabilities	4,529	4,915	5,525	6,848	6,652
Total current liabilities	9,258	11,651	13,699	16,294	16,371
Long-term debt	6,593	8,294	8,579	9,166	8,805
Convertible debt	3,871	7,009	7,009	7,009	7,009
Other LT liabilities	836	1,308	2,470	2,470	2,470
Total liabilities	20,558	28,262	31,757	34,939	34,654
Minority interest	2,264	2,627	2,717	2,845	3,000
Preferred stock	0	0	0	0	0
Common stock	691	844	866	866	866
Retained earnings	7,487	12,028	13,757	15,340	17,259
Proposed dividends	290	426	599	852	1,033
Other equity and reserves	0	0	0	0	0
Total shareholders' equity	8,467	13,298	15,222	17,058	19,158
Total equity & liabilities	31,290	44,187	49,696	54,842	56,813
Liquidity (x)					
Current ratio	1.48	1.31	0.99	0.93	0.83
Interest cover	2.0	2.2	3.0	3.6	4.3
Leverage					
Net debt/EBITDA (x)	8.42	7.43	7.17	5.63	4.61
Net debt/equity (%)	106.1	103.6	126.0	116.8	101.5
Per share					
Reported EPS (HKD)	10.86c	14.12c	20.03c	28.12c	34.09c
Norm EPS (HKD)	10.86c	14.12c	20.03c	28.12c	34.09c
FD norm EPS (HKD)	9.77c	12.98c	19.13c	26.88c	32.58c
BVPS (HKD)	1.23	1.58	1.76	1.97	2.27
DPS (HKD)	0.04	0.05	0.07	0.10	0.12
Activity (days)					
Days receivable	334.7	170.1	177.2	178.1	157.5
Days inventory	3.5	4.0	2.6	1.7	2.1
Days payable	317.1	218.7	192.0	173.8	190.2
Cash cycle	21.1	-44.6	-12.2	6.0	-30.6

Source: Company data, Nomura estimates

Takeaways from NDR in Seoul and Tokyo

From 29 to 31 July, we organised a non-deal roadshow (NDR) for BEW in Seoul and Tokyo, which received generally positive feedback from investors. During the trip, management also provided some update on the company's business development, as well as some revision on guidance:

2014 to see rapid growth, in line with year-beginning guidance, per BEW

- For 2014, the revenue from operations should increase 40-50% y-y and BT revenue should reach CNY4bn, according to management.
- The capacity addition in 2014 will beat the previous guidance of 2mn ton/day, and will also see upside vs. consensus of 3-3.5mn ton/day, per management.
- According to management, the majority of new capacity in 2014 will come from the projects acquired from local governments, rather than acquisition of other private players in the market
- Steady growth in the next five years at CAGR of 30%+, and target to expand its market share from 4-5% currently to 10-12% by end-2018, per management.
- According to management, sludge treatment and discharge standard enhancement will add to the company's future upside backed by the supportive policies likely to be issued by the central government

Other issues worth noting

- The effective interest rate may see a slight increase in 2014 to 4.2-4.3% vs. 4.05% in 2013, according to the company.
- The company views the current net gearing ratio of ~80% as healthy and has indicated that it will consider equity financing when the gearing ratio is close to 150%.

While acknowledging that growth in the development for water pollution control will likely sustain for years, investors raised concerns about BEW's competitive advantage as it faces increased competition:

BEW's major competitors, and whether increasing competition in the water market will affect the company's profitability

Currently, BEW's major competitors are other large SOEs, unlike in the past when its competitors were mostly local private players. With these SOEs trying to rapidly ramp up capacity through acquisitions, the valuations of water assets in the open market are seeing a 10-15% increase y-y and leading to margin pressure on BEW, according to the company. Therefore, the company has indicated that it will focus more on obtaining projects from local governments in the BOT/TOT mode, where the margins remain unchanged.

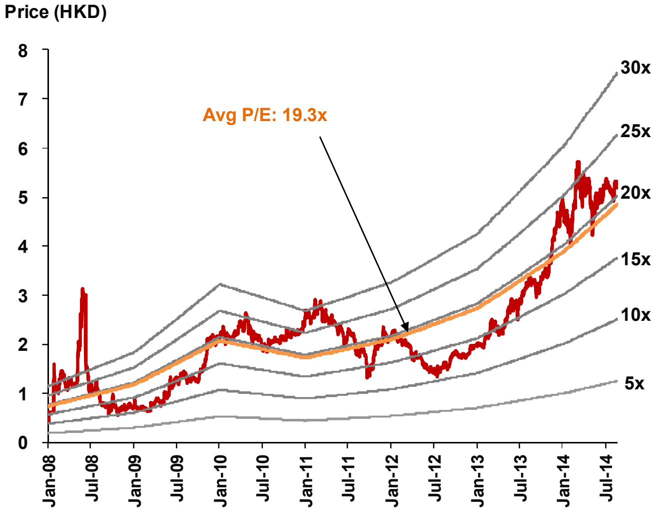
What's the core competency of the company?

Apart from 1) the relatively low financing cost; 2) ample capital; and 3) good relationship with local governments backed by its strong SOE background, management believes that BEW's unique competencies are its aggressiveness and flexible incentive mechanism (e.g. stock options granted to 150 core staff) given that the company was a pure private company before being acquired by Beijing Enterprises Holdings (BEH). Therefore, the company is a pioneer in mixed ownership (the current hot topic in SOE reform) and shows strong execution ability in results delivery, according to management.

Valuation methodology

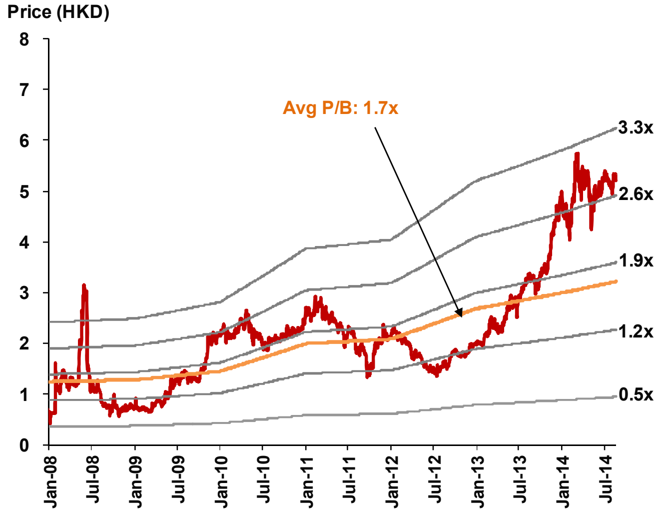
Our TP of HKD6.50 is based on DCF methodology, assuming a WACC of 7.8% and terminal growth of 2%. For our DCF valuation, cash flows are discounted back to 2015F. Our benchmark index is MSCI China.

Fig. 34: BEW: 12-month forward P/E band



Source: Bloomberg, Nomura estimates

Fig. 35: BEW: 12-month forward P/E band



Source: Bloomberg, Nomura estimates

NOMURA

CT Environment 1363.HK 1363 HK

EQUITY: WATER & ENVIRONMENT

Niche market star: Industrial WWT and sludge

Initiate at Buy with TP of HKD7.70

Global Markets Research

28 August 2014

Rating Starts at	**Buy**
Target price Starts at	HKD 7.70
Closing price 22 August 2014	HKD 6.23
Potential upside	+23.6%

Action: Initiate at Buy with TP of HKD7.70

We see CT Environmental Group (CTEG) as a unique play in the HK-listed water sector, with its focus in industrial WWT and sludge treatment projects.

- **Rapid capacity growth in next three years:** Benefitting from its aggressive acquisition strategy and steady organic growth, we expect CTEG to see rapid capacity expansion in both industrial WWT and sludge/waste treatment business, with 2013-16F capacity CAGRs of 31% and 184%, respectively.
- **Higher margin than traditional municipal WWT projects:** Given that BOO projects generally bear greater risk from potential uncertainty in utilisation and tariff collection, CTEG enjoys higher margins for its industrial WWT projects at 75%, vs. 40-60% for municipal projects.
- **Robust 2013-16F earnings profile:** We expect CTEG to record a net profit CAGR of 44% over 2013-16F, driven by 31% and 186% capacity growth from the industrial WWT and sludge segments, respectively.

Thus, we initiate coverage with a Buy rating and TP of HKD7.70, which implies upside potential of 24% from current levels.

Catalysts: Value-accretive acquisitions, higher industrial WWT standard, and favourable government policies especially on sludge treatment

Valuation: Attractive PEG of 0.5x with 32% 2013-16F EPS CAGR

The stock is trading at what we believe to be an attractive valuation at 0.5x PEG based on a 2013-16F EPS CAGR of 32%. We derive our TP of HKD7.70 using a PEG-based valuation method as we believe this better credits the company's rapid growth prospects. We adopt a PEG of 0.65x, at a c.15-20% discount to large SOEs such as CEI/BEH, which we believe fairly reflects its relatively small scale.

Year-end 31 Dec	FY13	FY14F		FY15F		FY16F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	485	N/A	986	N/A	1,423	N/A	1,783
Reported net profit (mn)	224	N/A	346	N/A	528	N/A	672
Normalised net profit (mn)	224	N/A	346	N/A	528	N/A	672
FD normalised EPS	20.11c	N/A	24.76c	N/A	36.62c	N/A	46.57c
FD norm. EPS growth (%)	15.7	N/A	23.1	N/A	47.9	N/A	27.2
FD normalised P/E (x)	31.0	N/A	25.2	N/A	17.0	N/A	13.4
EV/EBITDA (x)	29.6	N/A	19.4	N/A	11.9	N/A	9.4
Price/book (x)	7.7	N/A	5.0	N/A	4.0	N/A	3.2
Dividend yield (%)	0.5	N/A	0.6	N/A	0.9	N/A	1.1
ROE (%)	29.6	N/A	23.8	N/A	26.1	N/A	26.3
Net debt/equity (%)	14.0	N/A	41.6	N/A	33.2	N/A	18.1

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Anchor themes

With market differentiation emerging, we prefer: 1) large-scale SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

Our 2014/15F estimates are 17% higher than consensus.

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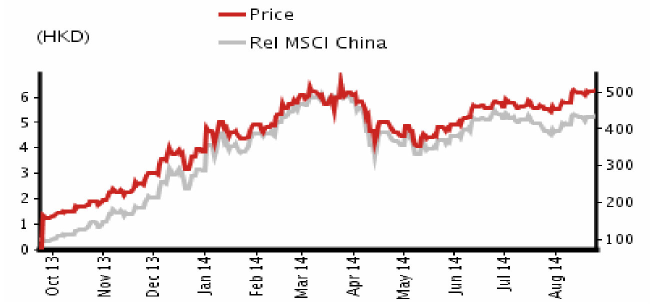
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on CT Environment

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	9.7	29.8		M cap (USDmn)	1,159.3
Absolute (USD)	9.7	29.8		Free float (%)	27.0
Rel to MSCI China	4.5	18.9		3-mth ADT (USDmn)	4.0

Income statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	384	485	986	1,423	1,783
Cost of goods sold	-131	-179	-449	-601	-754
Gross profit	252	306	536	821	1,029
SG&A	-22	-42	-89	-135	-178
Employee share expense					
Operating profit	230	265	448	686	851
EBITDA	247	286	491	817	1,011
Depreciation	-16	-21	-41	-129	-158
Amortisation	0	-1	-3	-2	-2
EBIT	230	265	448	686	851
Net interest expense	-37	-32	-45	-49	-36
Associates & JCEs	23	23	11	0	0
Other income	0	20	6	4	1
Earnings before tax	217	275	420	641	816
Income tax	-36	-49	-74	-113	-143
Net profit after tax	181	226	346	529	673
Minority interests	0	0	-1	-1	-1
Other items	-3	-1	0	0	0
Preferred dividends					
Normalised NPAT	177	224	346	528	672
Extraordinary items					
Reported NPAT	177	224	346	528	672
Dividends	0	-41	-53	-79	-100
Transfer to reserves	177	183	293	449	571

Valuations and ratios

	FY12	FY13	FY14F	FY15F	FY16F
Reported P/E (x)	35.9	31.0	25.2	17.0	13.4
Normalised P/E (x)	35.9	31.0	25.2	17.0	13.4
FD normalised P/E (x)	35.9	31.0	25.2	17.0	13.4
Dividend yield (%)	na	0.5	0.6	0.9	1.1
Price/cashflow (x)	22.8	56.9	31.2	15.4	11.4
Price/book (x)	na	7.7	5.0	4.0	3.2
EV/EBITDA (x)	35.4	29.6	19.4	11.9	9.4
EV/EBIT (x)	37.8	31.8	21.2	14.2	11.2
Gross margin (%)	65.8	63.1	54.4	57.7	57.7
EBITDA margin (%)	64.3	59.1	49.8	57.4	56.7
EBIT margin (%)	60.0	54.6	45.4	48.2	47.7
Net margin (%)	46.2	46.3	35.1	37.1	37.7
Effective tax rate (%)	16.7	17.9	17.6	17.6	17.6
Dividend payout (%)	0.0	18.5	15.4	14.9	14.9
ROE (%)	na	29.6	23.8	26.1	26.3
ROA (pretax %)	na	21.9	20.6	21.1	22.5

Growth (%)

	FY12	FY13	FY14F	FY15F	FY16F
Revenue	-0.2	26.3	103.3	44.4	25.3
EBITDA		16.0	71.5	66.4	23.7
Normalised EPS		15.7	23.1	47.9	27.2
Normalised FDEPS		15.7	23.1	47.9	27.2

Source: Company data, Nomura estimates

Cashflow statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	247	286	491	817	1,011
Change in working capital		-27	-83	-137	-92
Other operating cashflow	32	-137	-129	-95	-129
Cashflow from operations	279	122	279	585	789
Capital expenditure	-203	-157	-1,131	-491	-441
Free cashflow	75	-34	-852	95	349
Reduction in investments		0	0	0	0
Net acquisitions	0	0	0	0	0
Dec in other LT assets	0	0	0	0	0
Inc in other LT liabilities	0	0	0	0	0
Adjustments	-188	-51	0	0	0
CF after investing acts	-113	-85	-852	95	349
Cash dividends	0	0	-41	-53	-79
Equity issue	0	478	354	0	0
Debt issue	114	-56	466	-204	-163
Convertible debt issue					
Others	-43	48	-45	-49	-36
CF from financial acts	71	470	734	-306	-278
Net cashflow	-42	384	-119	-211	71
Beginning cash	52	10	395	276	65
Ending cash	10	395	276	65	136
Ending net debt		157	742	750	516

Balance sheet (HKDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	10	395	276	65	136
Marketable securities					
Accounts receivable	264	281	571	824	1,032
Inventories	1	1	3	4	6
Other current assets	21	73	73	73	73
Total current assets	296	750	923	966	1,247
LT investments	159	187	198	198	198
Fixed assets	265	512	1,601	1,964	2,247
Goodwill	9	62	60	57	55
Other intangible assets	30	47	47	46	46
Other LT assets	382	334	396	383	370
Total assets	1,141	1,892	3,225	3,614	4,163
Short-term debt	82	52	63	60	38
Accounts payable	101	138	346	463	581
Other current liabilities	13	18	18	18	18
Total current liabilities	196	208	427	542	637
Long-term debt	517	501	955	754	613
Convertible debt					
Other LT liabilities	36	55	55	55	55
Total liabilities	750	763	1,437	1,351	1,306
Minority interest	2	3	3	4	5
Preferred stock					
Common stock	0	138	144	144	144
Retained earnings	390	946	1,586	2,036	2,607
Proposed dividends	0	41	53	79	100
Other equity and reserves					
Total shareholders' equity	390	1,126	1,784	2,259	2,851
Total equity & liabilities	1,141	1,892	3,225	3,614	4,163

Liquidity (x)

	FY12	FY13	FY14F	FY15F	FY16F
Current ratio	1.51	3.61	2.16	1.78	1.96
Interest cover	6.2	8.2	10.1	14.0	23.7

Leverage

	FY12	FY13	FY14F	FY15F	FY16F
Net debt/EBITDA (x)	net cash	0.55	1.51	0.92	0.51
Net debt/equity (%)	net cash	14.0	41.6	33.2	18.1

Per share

	FY12	FY13	FY14F	FY15F	FY16F
Reported EPS (HKD)	17.38c	20.11c	24.76c	36.62c	46.57c
Norm EPS (HKD)	17.38c	20.11c	24.76c	36.62c	46.57c
FD norm EPS (HKD)	17.38c	20.11c	24.76c	36.62c	46.57c
BVPS (HKD)	na	0.81	1.24	1.57	1.98
DPS (HKD)	na	0.03	0.04	0.05	0.07

Activity (days)

	FY12	FY13	FY14F	FY15F	FY16F
Days receivable		205.0	157.6	178.8	190.5
Days inventory		2.0	1.9	2.4	2.4
Days payable		243.9	196.5	245.6	253.4
Cash cycle	0.0	-37.0	-37.0	-64.4	-60.5

Source: Company data, Nomura estimates

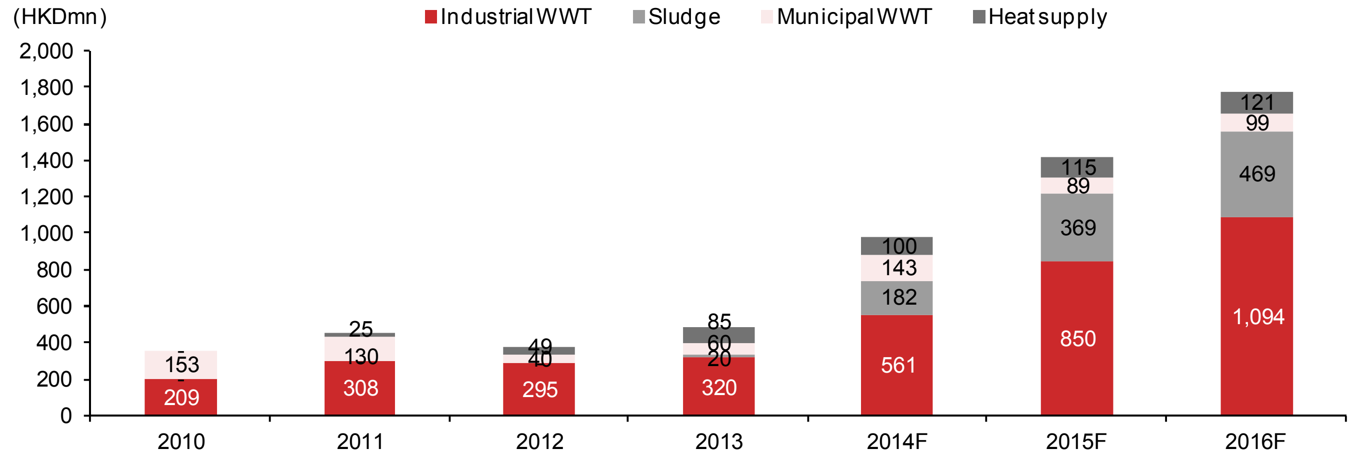
Investment thesis

Unlike other water names squeezing into the domestic municipal WWT sector, CT Environmental Group (CTEG) is now aggressively pursuing expansion in industrial WWT projects, leveraging on the ample experience of its management in the textile industry. With decent margins from its industrial WWT projects, as well as its rapidly growing roster of projects obtained through bidding as well as acquisitions, we see strong earnings growth ahead for CTEG underpinning significant upside potential for the stock.

Stand-out player with unique business exposure in industrial WWT segment

With the Chinese government's increasing emphasis on water pollution control and central government enforcement to enhance WWT discharge standards, industrial plants face growing pressure to treat the wastewater they generate, which requires the expertise of professional WWT operators. In addition, the ongoing promotion of industrial park planning also provides an opportunity to build centralised WWT plants to serve the industrial customers located in the parks. CTEG, with its experience in treating a textile plant owned by its founder, has swiftly expanded its reach to establish industrial WWT services for third parties in Guangdong province. Currently, the company commands a 30% market share of the industrial WWT sector in Guangdong province (largely BOO), according to management.

Fig. 36: CTEG: Revenue breakdown by segment



Source: Company data, Nomura estimates

Aggressive player with leading capacity growth

By end-2013, the group owned water supply capacity of 150 kt/day, WWT capacity of 415 kt/day, and sludge treatment capacity of 73 kt/year. WWT capacity by end-2013 was double that in 2011, which we think illustrates the company's strong growth momentum. YTD, the company has maintained its momentum with announcements of three projects that will add 160 kt/day of WWT capacity and 1,375 kt/year of sludge/waste treatment capacity.

Mr Tsui Cham To, founder and chairman of CTEG, started the business (currently known as Guangzhou To Kee) in Guangdong province in 1993. Over the past two decades, management has gained ample experience in project development and relationship building with local governments, which are critical in obtaining BOT/BOO projects.

Fig. 37: CTEG – Projects obtained YTD 2014

Project	Location	Nature	Type	Announcement date	Capacity	Stake	Consideration (CNY mn)
Guanghzou Yinglong	Guangdong	BOO	Industrial WWT	19-May-14	Phase I - 10 kilo ton/day Phase II & III - 15 kilo ton/day	49%*	196
Lvyou	Guangdong	BOO	Sludge/Solid waste	30-Apr-14	Sludge - 555 kilo ton/yr Waste - 820 kilo ton/yr	100%	125
Shunde Ganghui	Guangdong	BOO	Industrial WWT	21-Mar-14	60 kilo ton/day	100%	115

Note: *Acquired 49% stake in previously 46%-owned associate Yinglong project
Source: Company data, Nomura research

According to the current project pipeline and management guidance, we expect CTEG's capacity to continue its strong growth in the past 3 years and reach WWT capacity of 930 kt/day, sludge/waste capacity of 1,680 kt/year and water supply capacity of 250 kt/day, implying respective 2013-16F capacity CAGRs of 31%, 184% and 19%. The strong growth (incl. WWT and sludge treatment), we think largely driven by the company's efficiency in obtaining projects and the relatively small base, ranks the highest among CTEG's peers.

Fig. 38: Capacity CAGR comps

Company	2013-16F CAGR
BEW - WWT+Supply	32%
CEI - WTE	35%
SGL - WWT	36%
CTEG - WWT	**31%**
CTEG - Sludge	**184%**

Source: Company data, Nomura estimates

Fig. 39: CTEG: Detailed project list and capacity summary – 2013-16F

Project	Location	Nature	Type	Capacity ('000 ton/day)			
WWT projects				**2013A**	**2014F**	**2015F**	**2016F**
Guangzhou Xinzhou Industrial Park (Phase I&II)	Zengcheng, Guangdong	BOO	Industrial	100	100	100	100
Longmen Xilin (Phase I&II)	Huizhou, Guangdong	BOO	Municipal	20	20	20	20
Yonghe Haitao (Phase I)	Zengcheng, Guangdong	BOT	Municipal	50	50	50	50
Yonghe Haitao (Phase II)	Zengcheng, Guangdong	BOT	Municipal	50	50	50	50
Yonghe Haitao (Phase III)	Zengcheng, Guangdong	BOO	Industrial	50	50	50	50
Huaihua Tianyuan (Phase I)	Huaihua, Hunan	BOT	Industrial	45	45	45	45
Huaihua Tianyuan (Phase II)	Huaihua, Hunan	BOT	Industrial		55	55	55
Sichuan Guangyuan Industrial Park (Phase I)	Guangyuan, Sichuan	BOO	Industrial		50	50	50
Sichuan Guangyuan Industrial Park (Phase II)	Guangyuan, Sichuan	BOO	Industrial			50	50
Yinglong Project (Phase I)	Zengcheng, Guangdong	BOO	Industrial	100	100	100	100
Yinglong Project (Phase II)	Zengcheng, Guangdong	BOO	Industrial		50	50	50
Yinglong Project (Phase III)	Zengcheng, Guangdong	BOO	Industrial				100
Shunde Ganghui	Shunde, Guangdong	BOO	Industrial		60	60	60
Guangfozhao (Phase I)	Huaiji, Guangdong	BOO	Municipal +			50	50
Guangfozhao (Phase II)	Huaiji, Guangdong	BOO	Industrial				50
Qingyuan Jingu Science Park	Qingyuan, Guangdong	BOO	Municipal + Industrial			50	50
Subtotal				**415**	**630**	**780**	**930**
Sludge/waste treatment projects				**2013A**	**2014F**	**2015F**	**2016F**
Yonghe Haitao (Sludge)	Huizhou, Guangdong	BOO	Sludge	73	73	73	73
Heyuan Solid Waste Phase I	Huizhou, Guangdong	BOO	Sludge		65	65	65
Heyuan Solid Waste Phase II	Huizhou, Guangdong	BOO	Sludge			105	105
Longmen Solid Waste	Huizhou, Guangdong	BOO	Sludge/Waste		63	63	63
Qingyuan Lvyou	Qingyuan, Guangdong	BOO	Sludge/Waste		555	555	555
Qingyuan Lvyou	Qingyuan, Guangdong	BOO	Sludge/Waste		820	820	820
Subtotal				**73**	**1,576**	**1,681**	**1,681**
Water supply projects				**2013A**	**2014F**	**2015F**	**2016F**
Guangzhou Xinzhou Industrial Park (Phase I&II)	Zengcheng, Guangdong	BOO	Industrial	150	150	150	150
Sichuan Guangyuan Industrial Park (Phase I)	Guangyuan, Sichuan	BOO	Industrial		50	50	50
Sichuan Guangyuan Industrial Park (Phase II)	Guangyuan, Sichuan	BOO	Industrial			50	50
Subtotal				**150**	**200**	**250**	**250**

Source: Company data, Nomura estimates

Better margins for industrial WWT and sludge business than for municipal WWT

Most of CTEG's industrial WWT and sludge projects were obtained as BOO, which is different from peers' BOT municipal WWT projects. Generally, BOO project bears more risk than BOT projects since such projects do not have the guaranteed treatment volumes backed by local governments, which may lead to some fluctuation risk in daily treatment volumes. However, they also generally command higher margins given the operators can directly negotiate the WWT tariffs with customers without government regulation (see table below right)

Fig. 40: Comparison between BOT and BOO methods

Method	BOT	BOO
Project nature	More utilities	More commercial
Project financing	Capex paid by operator; Bank loans secured by tariff payables	Capex paid by operator; Bank loans secured by assets of operators
Ultimate owner	Gov't	Operator
Tariff setting	Negotiation with and collect from gov't; Adjusted periodically	Negotiation with and collect from customer; Local gov't guides max price
Stability	25-30 yr concession period with guranteed volume at 70% of designed capacity	Exclusive service rights in certain regions; no guranteed volume
IRR	10-12% per gov't guidance	No restriction, may>20%

Source: Nomura research

Fig. 41: CTEG: Margin comparison among diff. segments

Segment	Margin	Tariff (CNY/ton)
Industrial WWT	75%	
Municipal WWT	45%	0.8-0.9
Heat supply	8%	NA
Sludge treatment	50-60%	250-280

Project	Tariff (CNY/ton)
Xinzhou I & II	5.5
Huaihua	1.3
Yinglong I	4.0
Yonghe III	3.5

Source: Company data, Nomura research

There are two main reasons that industrial WWT has higher tariffs: 1) industrial wastewater requires higher technology and operator expertise to treat (eg, COD concentration is 2,000-3,000mg/L in industrial wastewater, vs only 400mg/L in municipal wastewater); and 2) compared to residential/commercial customers, industrial customers are less sensitive to WWT tariff hikes as long as the tariffs are lower than the cost when treating by themselves.

Sludge treatment – next potential catalyst backed by government promotion

The sludge treatment industry remains underdeveloped, with the treatment rate still at a low of around 20% in 2013, vs the 12th FYP's target of 70%. According to h2o-China's 2013 report, only 50 sludge treatment projects were completed in 2013, vs 500 WWT projects completed in 2013. We believe the central government has already noticed the situation and will make a further push to get closer to the 2015F target. Therefore, we believe CTEG should benefit from the central government's promotion given its first-mover advantage as a licensed sludge treatment service provider.

Key investment risks

As discussed above, the key potential risks that we believe CTEG may come across are the unstable nature of BOO projects and increasing competition from large-scale peers chasing more attractive margins of industrial WWT projects and sludge treatment.

Strong correlation to economic development growth

Unlike municipal WWT projects which see rigid demand from households and enjoy guaranteed treatment volumes, industrial WWT projects rely on the discharge volumes from plants, which have a very strong correlation with economic development growth. That is to say, if domestic economic growth slows or the CNY continues to appreciate, leading to a deterioration in the textile industry's (CTEG's focus industry) competitive advantage as an industry with major revenue from exports, the company's projects would likely suffer from a decrease in utilisation and in turn lower profitability. Further, any major interruption in economic development could lead to payment delays or even default action by industrial customers.

Increasing competition from large-scale peers, especially SOEs

The higher technology threshold required for industrial WWT projects is unlikely to deter large WWT players from vying for the more attractive margins of this segment. Some of the bigger names, such as BEW, SGL, and Beijing Capital have already announced interest in the industrial WWT segment. CTEG's management has also conceded that the anticipated increase in market competition will likely exert pressure on current margins beyond the near term. In our view, the market remains very fragmented with ample opportunities for operators instead of severe competition.

Aggressive project acquisition strategy may lead to dilution risk

We expect CTEG to maintain its aggressive acquisition strategy to rapidly ramp up its capacity. Although current gearing seems healthy at 30-40%, we believe that the company may choose to issue shares to fund those large-scale acquisitions (eg, similar scale as Qingyuan Lvyou with total consideration of ~CNY800mn). On the other hand, given that the market would expect any share issuance to be associated with major capacity expansion which would likely be EPS-accretive, investors may even react positively to equity financing movement.

Concentration risk given the small project base and focus in Guangdong

Given the company has only 10 projects under operation currently, the reliance on each single project is high. In addition, in the company's long held focus in Guangdong province may present potential difficulties when the company targets to expand outside of Guangdong. In addition, any changes in the political environment of Guangdong province may also affect the company's project obtaining ability.

1H14 results surges 73%; in line with our optimistic view

CTEG reported 1H14 results on 27 Aug 2014, with net profit nearly doubled to CNY179mn vs. CNY90mn in 1H13. Stripping out one-off items such as gain on re-measurement of FV, recurring net profit sharply increased 73% y-y to CNY156mn (vs. CNY90mn for 1H13). The significant earnings growth was largely attributable to the successful acquisition of sludge treatment companies. With 1H14 net profit accounting for 45% of our FY14 earnings of CNY346mn, we view such outstanding results is on-track to our estimates and assure our positive view on the company.

Fig. 42: CTEG: 1H14 results review

HKD mn	1H14	1H13	y-y
Revenue	**372.9**	**221.1**	***68.7%***
- Wastewater project - BOT	35.2	34.5	*1.9%*
- Industrial water supply	24.5	24.4	*0.5%*
- Wastewater treatment operation - non-BOT	176.6	122.1	*44.7%*
- Heat supply	40.4	40.1	*0.7%*
- Sludge and solid waste treatment	96.2	-	*n.a.*
Cost of sales	(138.4)	(84.0)	*64.8%*
Gross profit	**234.5**	**137.1**	***71.1%***
Other revenue	23.5	0.1	*n.a.*
Administrative expenses	(37.5)	(18.3)	*105.0%*
Other operating expenses	(1.1)	(0.0)	*n.a.*
Operating profit	**219.5**	**118.9**	***84.6%***
Finance costs	(21.1)	(15.6)	*35.3%*
Share of profit of associates	3.7	8.8	*-58.3%*
Profit before taxation	**202.0**	**112.1**	***80.2%***
Income tax	(22.0)	(22.0)	*0.1%*
Profit for the period	**180.0**	**90.1**	***99.8%***
- Attributable to shareholders	**178.8**	**90.0**	***98.7%***
- Non-controlling interests	1.2	0.1	*n.a.*
Exceptional items	22.9	-	*n.a.*
Recurring net profits	**155.9**	**90.0**	***73.3%***
EPS (basic and diluted) - HKD	**0.13**	**0.09**	***44.4%***

Key financial ratios (%)	1H14	1H13	y-y
Gross margin	62.9%	62.0%	*0.9pp*
Operating margin	58.9%	53.8%	*5.1pp*
Recurring net profit margin	41.8%	40.7%	*1.1pp*
Effective tax rate	10.9%	19.6%	*-8.7pp*

Source: Company data, Nomura research

Valuation: Initiate coverage with Buy and TP of HKD7.70

We initiate the coverage of CTEG with a Buy rating, given our positive view on its earnings visibility with a 2013-16F EPS CAGR of 32%. As CTEG still appears to be in its rapid growth period with a relatively small base, the traditional DCF method for utility companies cannot fully reveal the company's strong earnings profile, in our view. Therefore, we adopt the PEG method to generate our TP of HKD7.70, implying potential upside of 24%. The key operation assumptions are as follows:

Fig. 43: CTEG: Key operation assumptions

	2013	2014F	2015F	2016F	*2013-16F CAGR*
Revenue (HKD mn)	**485**	**986**	**1,423**	**1,783**	***54.4%***
Industrial WWT	320	561	850	1,094	*50.6%*
Sludge	20	182	369	469	*186.3%*
Municipal WWT	60	143	89	99	*18.2%*
Heat supply	85	100	115	121	*12.7%*
Capacity (000'ton/day)					
- WWT	415	630	780	930	*30.9%*
- Sludge/Waste	73	1576	1681	1681	*184.5%*
- Water supply	150	200	250	250	*18.6%*
Net profit (HKD mn)	**224**	**346**	**528**	**672**	***44.1%***
EPS (HKD)	**0.20**	**0.25**	**0.37**	**0.47**	***32.3%***

Source: Company data, Nomura estimates

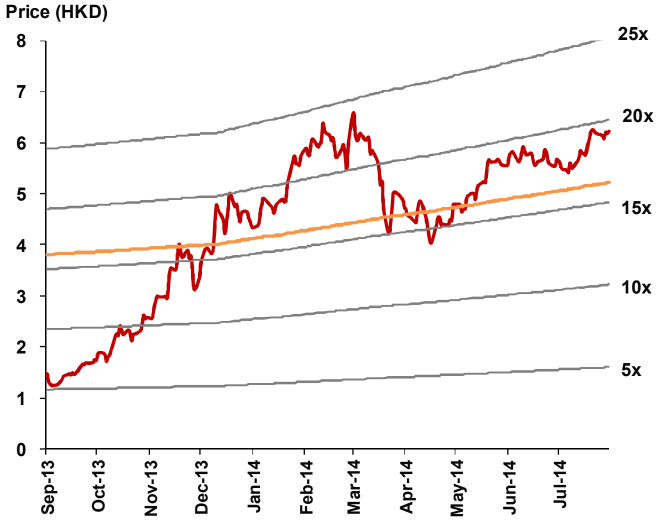
Given CTEG's nature as a private-owned company with a small capacity base, we adopted a PEG ratio (G represents the 2013-16F CAGR) at 0.65x, implying a 16%/20% discount to BEW/CEI's PEG ratio at the current level. Therefore, our TP is HKD7.70, implying 24% potential upside.

Fig. 44: CTEG: Valuation assumptions

HKD	2013A	2014F	2015F	2016F	*13-16F CAGR*
EPS	0.20	0.25	0.37	0.47	***32.3%***
CEI's 2013-15F PEG		**0.77**			
BEW's 2013-15F PEG		**0.81**			
Assumed PEG ratio		**0.65**			
Final TP		**7.70**			

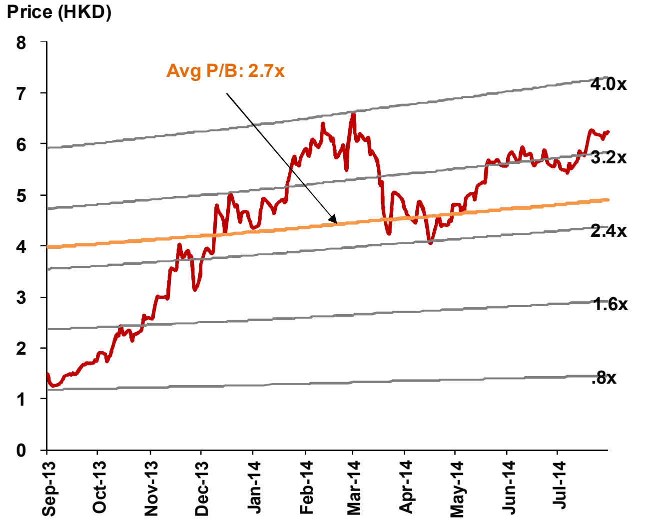
Source: Company data, Nomura estimates

Fig. 45: CTEG: Forward P/E band



Source: Company data, Nomura estimates

Fig. 46: CTEG: Forward P/B band



Source: Company data, Nomura estimates

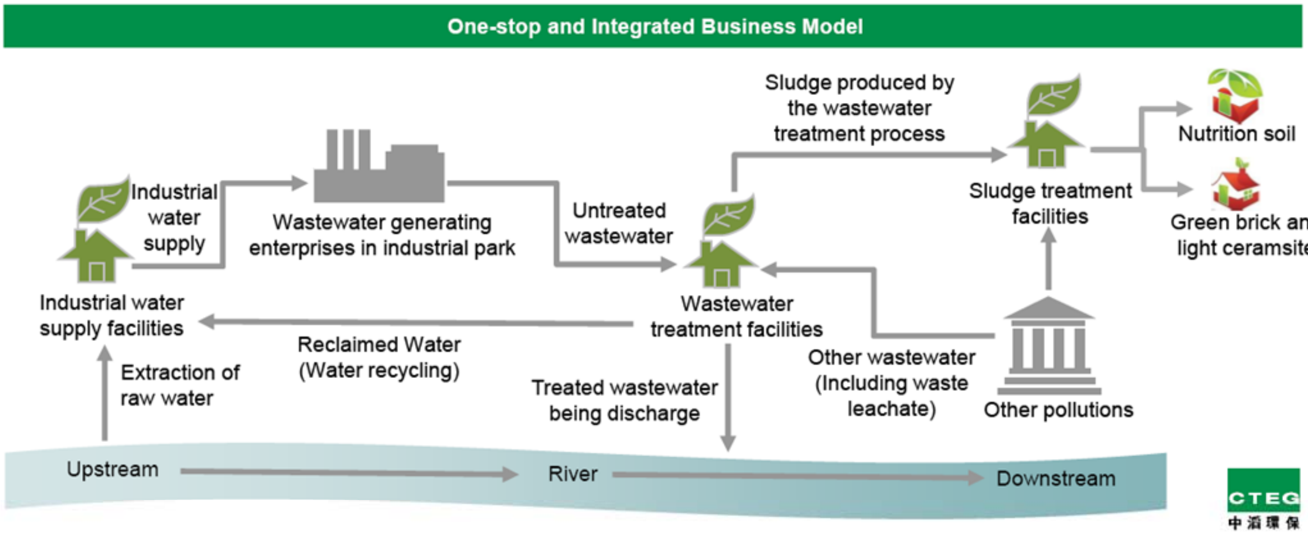
Investment risks

- Lower-than-expected utilisation at WWT plants and sludge treatment plants.
- Possible equity financing to back expansion strategy.
- Increasing competition in the industrial WWT and solid waste/sludge treatment industry.

Company overview

CTEG is a provider of one-stop centralized and customized wastewater treatment and industrial water supply services. The company's business scope focuses on industrial wastewater treatment, industrial water supply, solid waste treatment and regulated waste disposal treatment, and providing municipal wastewater treatment services and sludge treatment services. CTEG is one of the earliest centralized industrial WWT service providers for industrial parks in Guangdong province and the leading company in the WWT service for the textile industry in China. The company has received the formal Level A Qualification Certificate for the Operation of Environmental Pollution Treatment Facilities, the Permit for the Operation of Solid Waste Facilities, the Regulated Waste Disposal Permit, the High and New Tech Enterprises Certificate and the Comprehensive Utilization of Resources Certificate.

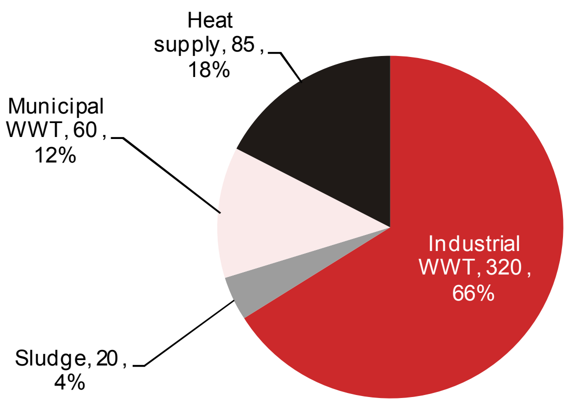
Fig. 47: CTEG: Business model



Source: Company data, Nomura research

By end-2013, industrial WWT business contributed two-third of company's top-line, while we expect the acquisition of Qingyuan Lvyou in 2014 to help to boost the growth of sludge treatment revenue. With a strong project pipeline, the company should maintain its rapid business expansion as well as its earnings growth going forward.

Fig. 48: CTEG: Revenue breakdown as at end-2013



Source: Company data, Nomura research

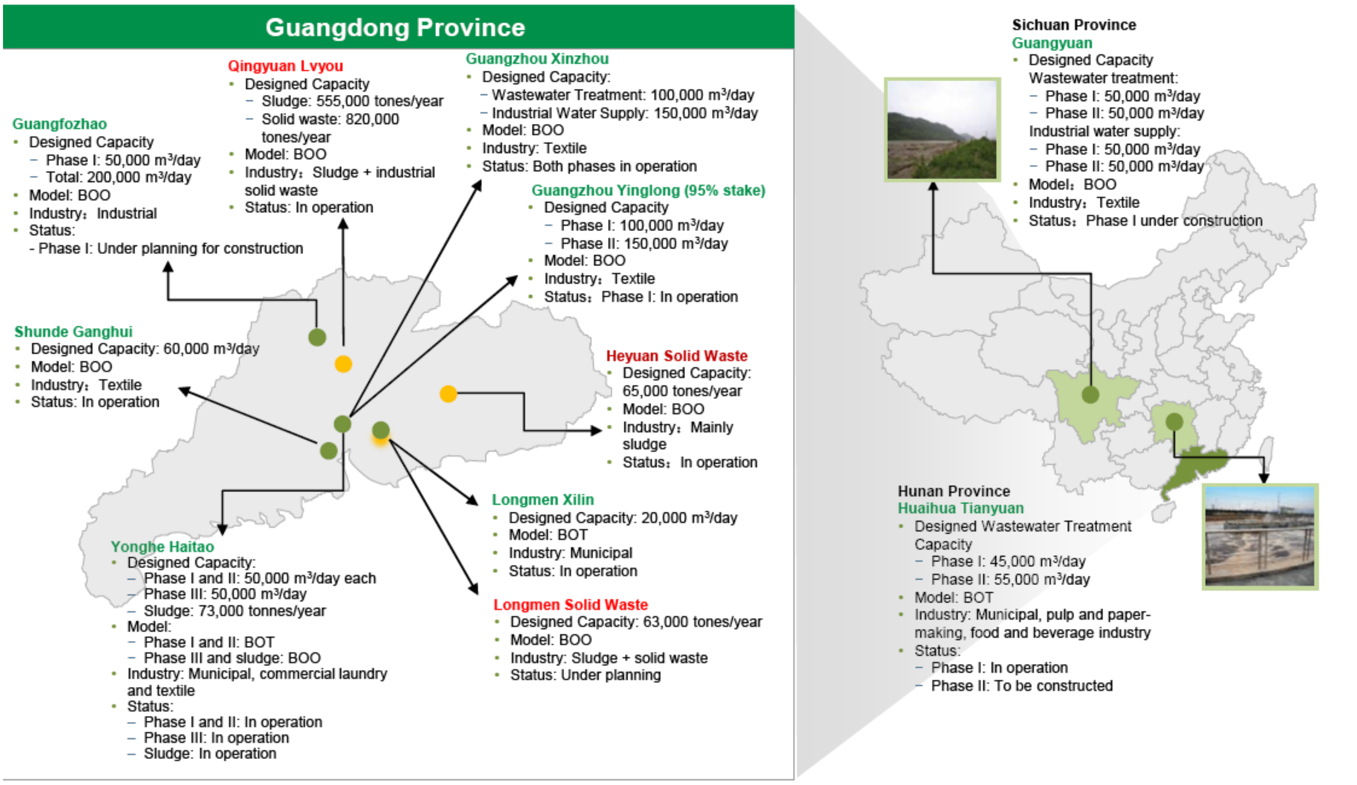
Fig. 49: CTEG: Project pipeline YTD 2014

Project under operation	Capacity (000' ton/day)
Industrial WWT	295
Municipal WWT	120
Industrial Water supply	150
Sludge/Waste	1,576 kilo ton/yr
Project in pipeline	**Capacity (000' ton/day)**
Industrial WWT	465
Municipal WWT	50
Industrial Water supply	100
Sludge/Waste	105 kilo ton/yr

Source: Company data, Nomura research

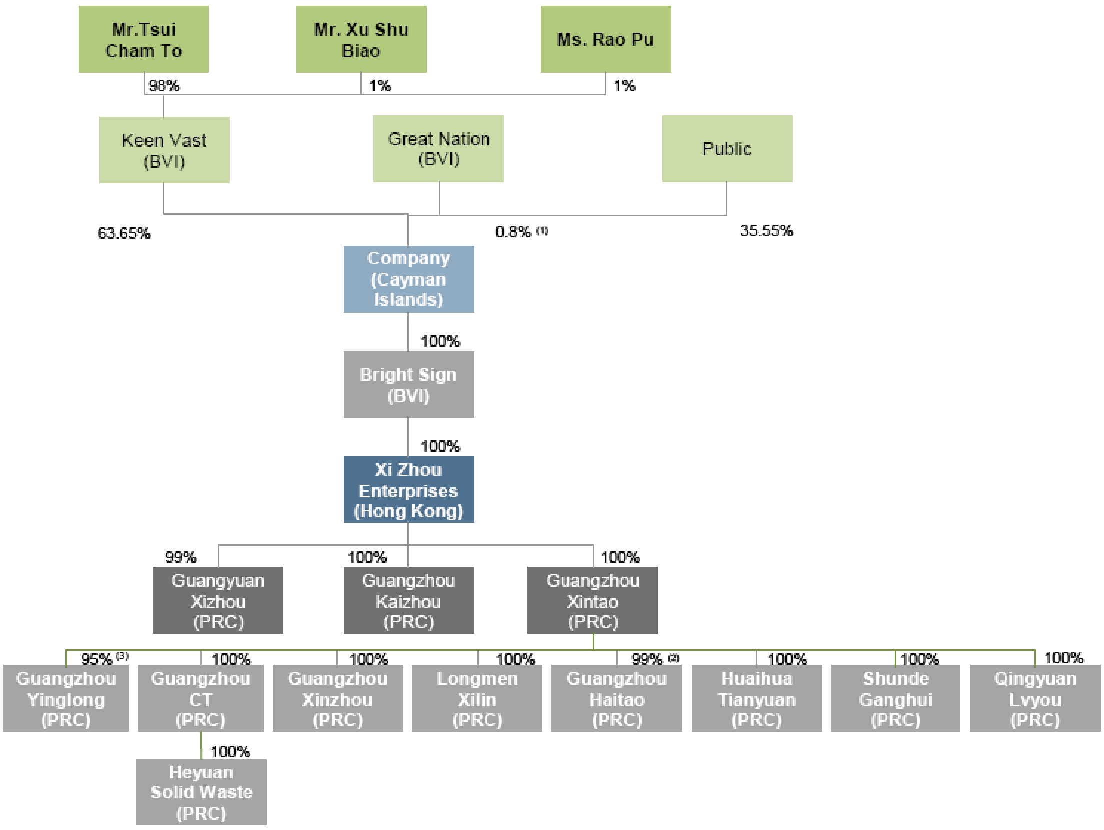
CTEG's exposure in Guangdong province is very concentrated in this region, with only two projects outside of Guangdong – one in Sichuan and the other in Hunan. We expect the company to continue to prioritise its business development in Guangdong and proactively seek across-region expansion.

Fig. 50: CTEG: Project portfolio as of June 2014



Source: Company data, Nomura research

Fig. 50a: CTEG: Corporate structure – Current



(1) – Great Nation is wholly owned by CEO. Mr. Lu Yili. (2) – The remaining 1% interest of Guangzhou Haitao is owned by Guangzhou To Kee. (3) – The remaining 5% interest of Guangzhou Yinglong is owned by Mr. Lu Zhiji, an independent third party. (4) CTEG has proposed a 60mn share subscription to Mr. Gu Yaokun, director and founder of Qingyuan Lvyou

Source: Company data, Nomura research

NOMURA

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EQUITY: POWER & UTILITIES

Steady WTE with potential boost of WWT

Near-term operation revenue surge; Buy

Global Markets Research

28 August 2014

Rating Remains	**Buy**
Target price Remains	HKD 13.10
Closing price 22 August 2014	HKD 10.86
Potential upside	+20.6%

WTE development still strong; 10,000tons/day capacity acquired YTD

- **Strong future capacity growth visibility:** With the outstanding projects obtaining capability and strong domestic market need, CEI's WTE business pipeline has maintained steady growth with another nine projects obtained YTD, implying a total 10,000tons/day capacity addition.
- **Large increase in earnings contributions from new projects that have commenced in 2014:** Following the commissioning of the Ningbo Beilun WTE projects, Nanjing WTE and Pizhou, WTE announced that both have commenced operation. Together with the potential completion of the Sanya and Shouguang projects, total capacity commenced operation will be 4,900tons/day, up ~50% from end-2013 capacity, which should lead to about 30% growth in operation revenue, per our estimate.

Mid-term catalyst: Expansion of WWT business through acquisition

After three years of slow WWT development, CEI recently increased its resource allocation in the sector and began its expansion strategy. Given the relative saturation in the urban WWT market, we expect CEI to leverage on its ample financing sources and strong SOE background to rapidly ramp up capacity through acquisition. With strong execution capability, we expect CEI to maintain decent operating efficiency in potentially enlarged WWT portfolios.

Valuation: PEG 0.78x with 2013-15F EPS CAGR of 31%; positive

Similar to other big SOE names, such as BEW (371 HK, Buy), CEI has also received pushback from investors due to the relatively high valuation (2014F P/E of ~24x, EPS of HKD0.44). However, with strong earnings visibility from secured project pipelines, and potential upside from the expected surge in WWT contributions, we maintain our positive stance on CEI. Our TP of HKD13.10 is based on DCF, assuming a WACC of 7.8% and terminal growth of 2%. For our DCF valuation, the cash flows are discounted back to 2015F.

Anchor themes

With market differentiation emerging, we prefer: 1) large-scale SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

Our FY15F earnings estimate is 8% higher than consensus.

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Year-end 31 Dec	FY13		FY14F		FY15F		FY16F
Currency (HKD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	5,320	9,050	9,050	10,320	11,551	11,358	15,165
Reported net profit (mn)	1,325	1,984	1,984	2,471	2,526	2,605	3,092
Normalised net profit (mn)	1,325	1,984	1,984	2,471	2,526	2,605	3,092
FD normalised EPS	32.57c	44.24c	44.24c	55.11c	56.33c	58.09c	68.96c
FD norm. EPS growth (%)	37.0	35.8	35.8	24.6	27.3	5.4	22.4
FD normalised P/E (x)	33.3	N/A	24.5	N/A	19.3	N/A	15.7
EV/EBITDA (x)	22.9	N/A	17.1	N/A	14.7	N/A	13.1
Price/book (x)	3.6	N/A	3.2	N/A	2.9	N/A	2.5
Dividend yield (%)	0.8	N/A	1.1	N/A	1.4	N/A	1.8
ROE (%)	12.2	14.0	14.0	15.5	15.8	14.6	17.0
Net debt/equity (%)	8.3	25.6	25.6	44.8	52.5	57.4	77.2

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Key data on China Everbright International

Relative performance chart

Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	-2.9	10.6	58.1	M cap (USDmn)	6,283.3
Absolute (USD)	-2.8	10.6	58.2	Free float (%)	51.4
Rel to MSCI China	-8.0	-0.3	43.4	3-mth ADT (USDmn)	12.2

Income statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	3,410	5,320	9,050	11,551	15,165
Cost of goods sold	-1,644	-2,828	-5,651	-7,266	-9,875
Gross profit	1,766	2,492	3,399	4,284	5,290
SG&A	-297	-392	-458	-502	-557
Employee share expense	0	0	0	0	0
Operating profit	1,469	2,100	2,941	3,782	4,733
EBITDA	1,551	2,191	3,099	3,951	4,915
Depreciation	-53	-70	-96	-107	-120
Amortisation	-30	-21	-62	-62	-62
EBIT	1,469	2,100	2,941	3,782	4,733
Net interest expense	-313	-316	-387	-544	-752
Associates & JCEs	0	0	0	0	0
Other income	68	27	39	46	41
Earnings before tax	1,224	1,812	2,592	3,284	4,021
Income tax	-280	-447	-570	-723	-885
Net profit after tax	944	1,364	2,022	2,562	3,136
Minority interests	-31	-40	-38	-36	-45
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	914	1,325	1,984	2,526	3,092
Extraordinary items	210	0	0	0	0
Reported NPAT	1,123	1,325	1,984	2,526	3,092
Dividends	-242	-366	-548	-698	-854
Transfer to reserves	881	959	1,436	1,828	2,237
Valuations and ratios					
Reported P/E (x)	36.6	33.3	24.5	19.3	15.7
Normalised P/E (x)	45.0	33.3	24.5	19.3	15.7
FD normalised P/E (x)	45.7	33.3	24.5	19.3	15.7
Dividend yield (%)	0.6	0.8	1.1	1.4	1.8
Price/cashflow (x)	63.7	20.7	15.0	15.8	10.4
Price/book (x)	5.3	3.6	3.2	2.9	2.5
EV/EBITDA (x)	33.7	22.9	17.1	14.7	13.1
EV/EBIT (x)	35.6	23.9	18.0	15.4	13.6
Gross margin (%)	51.8	46.8	37.6	37.1	34.9
EBITDA margin (%)	45.5	41.2	34.2	34.2	32.4
EBIT margin (%)	43.1	39.5	32.5	32.7	31.2
Net margin (%)	32.9	24.9	21.9	21.9	20.4
Effective tax rate (%)	22.9	24.7	22.0	22.0	22.0
Dividend payout (%)	21.5	27.6	27.6	27.6	27.6
ROE (%)	15.5	12.2	14.0	15.8	17.0
ROA (pretax %)	11.4	13.4	14.7	14.5	13.7
Growth (%)					
Revenue	-6.9	56.0	70.1	27.6	31.3
EBITDA	8.3	41.2	41.4	27.5	24.4
Normalised EPS	10.1	35.2	35.7	27.3	22.4
Normalised FDEPS	10.2	37.0	35.8	27.3	22.4

Source: Company data, Nomura estimates

Cashflow statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	1,551	2,191	3,099	3,951	4,915
Change in working capital	-556	57	538	-610	70
Other operating cashflow	-340	-113	-386	-261	-298
Cashflow from operations	655	2,134	3,251	3,080	4,688
Capital expenditure	-1,573	-2,980	-5,228	-7,063	-9,272
Free cashflow	-918	-846	-1,977	-3,983	-4,585
Reduction in investments	-12	20	0	0	0
Net acquisitions	0	0	0	0	0
Dec in other LT assets	-15	17	0	0	0
Inc in other LT liabilities	187	319	0	0	0
Adjustments	-595	-764	860	461	-25
CF after investing acts	-1,353	-1,255	-1,118	-3,522	-4,609
Cash dividends	-213	-242	-366	-548	-698
Equity issue	1,245	3,628	0	0	0
Debt issue	829	408	2,703	3,980	4,924
Convertible debt issue	0	0	0	0	0
Others	389	479	-1,247	-1,005	-728
CF from financial acts	2,249	4,273	1,090	2,427	3,498
Net cashflow	897	3,018	-28	-1,095	-1,111
Beginning cash	1,900	2,797	5,815	5,787	4,691
Ending cash	2,797	5,815	5,787	4,691	3,580
Ending net debt	3,208	1,107	3,837	8,913	14,948

Balance sheet (HKDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	2,797	5,815	5,787	4,691	3,580
Marketable securities	0	0	0	0	0
Accounts receivable	532	400	309	488	620
Inventories	65	76	62	96	134
Other current assets	1,345	1,954	1,895	2,513	3,347
Total current assets	4,739	8,244	8,053	7,788	7,682
LT investments	197	177	177	177	177
Fixed assets	1,423	1,374	1,399	1,438	1,484
Goodwill	21	21	21	21	21
Other intangible assets	614	1,096	1,034	972	910
Other LT assets	9,590	12,559	17,522	24,024	32,584
Total assets	16,583	23,471	28,205	34,419	42,857
Short-term debt	1,635	1,780	1,285	2,085	2,534
Accounts payable	1,191	1,734	2,097	2,277	3,307
Other current liabilities	58	58	70	111	156
Total current liabilities	2,884	3,572	3,452	4,472	5,997
Long-term debt	4,369	5,141	8,339	11,520	15,994
Convertible debt	0	0	0	0	0
Other LT liabilities	659	979	979	979	979
Total liabilities	7,913	9,692	12,770	16,970	22,970
Minority interest	321	405	443	480	524
Preferred stock	0	0	0	0	0
Common stock	404	448	448	448	448
Retained earnings	7,704	12,560	13,995	15,823	18,060
Proposed dividends	242	366	548	698	854
Other equity and reserves	0	0	0	0	0
Total shareholders' equity	8,350	13,374	14,992	16,969	19,363
Total equity & liabilities	16,583	23,471	28,205	34,419	42,857
Liquidity (x)					
Current ratio	1.64	2.31	2.33	1.74	1.28
Interest cover	4.7	6.7	7.6	7.0	6.3
Leverage					
Net debt/EBITDA (x)	2.07	0.51	1.24	2.26	3.04
Net debt/equity (%)	38.4	8.3	25.6	52.5	77.2
Per share					
Reported EPS (HKD)	29.65c	32.60c	44.24c	56.33c	68.96c
Norm EPS (HKD)	24.11c	32.60c	44.24c	56.33c	68.96c
FD norm EPS (HKD)	23.78c	32.57c	44.24c	56.33c	68.96c
BVPS (HKD)	2.07	2.98	3.34	3.78	4.32
DPS (HKD)	0.06	0.08	0.12	0.16	0.19
Activity (days)					
Days receivable	39.1	32.0	14.3	12.6	13.4
Days inventory	12.1	9.1	4.4	4.0	4.3
Days payable	291.0	188.8	123.7	109.9	103.5
Cash cycle	-239.8	-147.7	-105.0	-93.3	-85.8

Source: Company data, Nomura estimates

Steady 1H14 results; Reiterate Buy

In our view, CEI's steady earnings growth in 1H14 was largely attributable to: 1) 24% y-y revenue growth from WTE construction, vs only 9% y-y revenue growth for overall construction revenues (including WTE, WWT and alternative energy); and 2) construction cost savings recognised in 1H14. We remain positive on CEI as we believe our 2014F earnings forecast of HKD2.0bn (up 50% y-y) is achievable, considering the following:

WTE operation revenue boost expected in 2H14F

WTE operation revenue increased by only 5.7% in 1H14, mainly driven by the commencement of Ningbo Beilun Phase I. However, we expect operation revenues here to surge in 2H14F with the commencement of the Nanjing Phase I and Pizhou projects in end-June and early July (total capacity: 2,600 tons/day), respectively, as well as potential commissioning of the Sanya and Shouguang projects (total capacity: 1,300 tons/day). We expect 2H14F's effective operating capacity to be 30% higher than that of 1H14.

Fig. 51: CEI: Projects to fully contribute to operation revenue in 2H14F

Project	Location	COD	Processing capacity (ton/day)	Generating capacity (MW)
Nanjing Phase I	Jiangsu	29-Jun	2,000	40
Pizhou Phase I	Jiangsu	13-Jul	600	12
Sanya Phase I	Hainan	2H14	700	15
Shouguang Phase I	Shandong	2H14	600	12
Total			**3,900**	**79**
Operating capacity on 28-Jun			**10,650**	**213**
As % of operating capacity on 28-Jun			***36.6%***	***37.1%***

Source: Company data, Nomura estimates

Construction revenue should at least remain steady

According to management, 15 projects are under construction (eight WTE projects, three hazardous waste treatment (HWT) projects, two biomass projects and two wind projects). We estimate 13 of these 15 projects (ex the two wind projects) will recognise construction revenues in 2H14F, vs 11 projects in 1H14, which implies that construction revenues should at least remain steady vs 1H14. In addition, we would expect upside potential if the Wujiang, Heze projects commence construction in 2H14F.

Fig. 52: CEI: Projects to recognise construction revenue in 2H14F

Project	Type	Location	Processing capacity (ton/day)	Total investment (CNY mn)
Projects currently under construction				
Pizhou Phase I	WTE	Jiangsu	600	330
Sanya Phase I	WTE	Jiangsu	700	426
Shouguang Phase I	WTE	Hainan	600	339
Boluo Phase I	WTE	Guangdong	700	417
Weifang Phase I	WTE	Shandong	1,000	586
Rizhao Phase I	WTE	Shandong	600	350
Zhenjiang Phase II	WTE	Jiangsu	400	200
Changzhou Xinbei Phase I	WTE	Jiangsu	800	420
Binhai Eco. Development Zone	HWT	Jiangsu	Hazardous waste: 30kt/yr	186
Lianyungang Guanyun Phase I	HWT	Jiangsu	Hazardous waste: 20kt/yr	109
Zibo Qilu Chemical Ind. Park	HWT	Shandong	Hazardous waste: 90kt/yr	400
Hanshan	Biomass	Anhui	Power-gen: 30MW	320
Xuyi	Biomass	Jiangsu	Agricultural waste: 15kt/yr	170
			Subtotal	**4,253**
Projects likely to commence construction in 2H14				
Wujiang	WTE	Jiangsu	1,500	890
Heze Phase I	WTE	Shandong	600	350
			Subtotal	**1,240**
			Total	**5,493**

Source: Company data, Nomura estimates

Promising growth in 2015/16F driven by strong project pipeline, continuous government support and potential M&A

- With nine WTE projects and four other projects obtained YTD, we believe CEI's future growth has been further secured by a strong project pipeline. In addition, with projects obtained in Anhui, Hunan and Henan provinces, we believe management's strategy to expand from east to west has been firmly executed.
- The National Development and Reform Commission (NDRC) recently published a draft version of the low-carbon technology to be promoted by the central government, with total investment over next five years on WTE technology of CNY26bn, ranking No.3 among the total 34 technologies (only lower than direct-drive wind power technology and low-wind-speed power generation technology). This reaffirms the central government's continuous support to the WTE industry.
- With c.HKD5bn cash on hand, CEI's net gearing ratio appears extremely healthy at 21.7% as of end-June 2014. Given such ample capital resources, the company stated that it will pro-actively seek M&A opportunities, conditional upon the IRR hurdle rate of 10%, in both WWT and HWT markets.

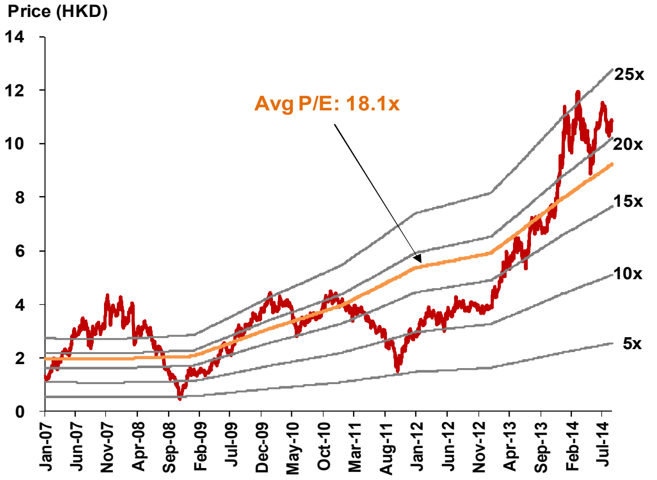
Fig. 53: CEI: Projects to commence operation in 2015/16F

WTE Project	Province	Daily capacity (ton)	Phase I (ton)	Investment (CNY mn)	Estimated COD	Phase II (ton)
Ma'anshan I & II	Anhui	1,200	800	450	2H15	400
Yiyang	Hunan	800	800	372	1H16	n.a.
Changzhou Xinbei I & II	Jiangsu	1,500	800	420	1H16	700
Nanjing II	Jiangsu	2,000	2,000	987	End-15	n.a.
Dangshan I & II	Anhui	700	400	250	End-15	300
Nanjing Gaochun	Jiangsu	500	500	320	2016	n.a.
Tengzhou	Shandong	1,000	600	339	2016	400
Pei County	Jiangsu	800	400	250	2016	400
Xinzheng	Henan	1,500	1,000	520	2016	500
Total		**10,000**	**7,300**	**3,908**		**2,700**

Other Projects	Province	Project type	Annual capacity (ton)	Investment (CNY mn)	Estimated COD
Xinyi	Jiangsu	Hazardous w aste	9,500	100	2H15
Xuyi	Jiangsu	Biomass	150,000	170	TBC
Sucheng	Jiangsu	Biomass	120,000	170	TBC
Guanyun	Jiangsu	Biomass	150,000	180	TBC
Total				**620**	

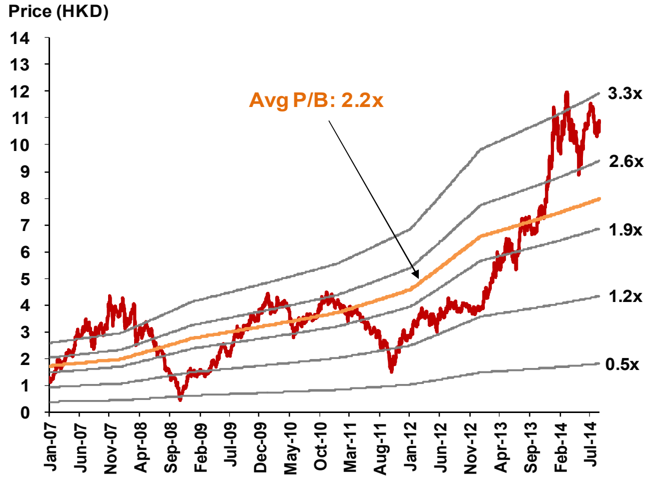
Source: Company data, Nomura research

Fig. 54: CEI: 12-month forward P/E band



Source: Bloomberg, Nomura estimates

Fig. 55: 12-month forward P/B band



Source: Bloomberg, Nomura estimates

Fig. 56: CEI: 1H14 results review

(HKD mn)	1H14	1H13	y-y
Turnover	**2,943.8**	**2,466.7**	***19.3%***
Direct costs and operating expenses	-1,592.2	-1,321.0	*20.5%*
Gorss profit	**1,351.5**	**1,145.7**	***18.0%***
Other revenue	107.1	71.9	*48.9%*
Other loss	-0.2	-0.1	*341.5%*
Administrative expenses	-208.1	-183.7	*13.3%*
Profit from operations	**1,250.4**	**1,034.0**	***20.9%***
Finance costs	-170.5	-149.6	*14.0%*
Share of results of associates	0.0	0.0	*n.a.*
Profit before taxation	**1,079.8**	**884.4**	***22.1%***
Income tax	-242.6	-218.6	*11.0%*
Profit for the period	**837.2**	**665.8**	***25.7%***
Attributable to:			
Minority interests	35.4	15.6	*126.8%*
Equity shareholders	**801.9**	**650.2**	***23.3%***
Reported EPS (HKD cents)			
- basic	17.9	16.1	*11.2%*
- diluted	17.9	16.0	*11.5%*
Key financial ratios (%)			
Gross margin	45.9	46.4	*-0.5 pp*
EBITDA margin	45.3	43.7	*1.7 pp*
Effective tax rate	22.5	24.7	*-2.2 pp*
	6/30/2014	**12/31/2013**	***h-h***
Net debt to equity ratio	21.7	18.7	*3.1 pp*

Source: Company data, Nomura research

Fig. 57: CEI: 1H14 segment results breakdown

(HKD mn)	1H14	1H13	y-y
Environmental energy project construction and operation			
Revenue	2,147	1,768	*21.4%*
EBITDA	978	790	*23.8%*
EBITDA margin %	46	45	*0.9 pp*
Environmental water project construction and operation			
Revenue	506	574	*-11.9%*
EBITDA	300	283	*6.1%*
EBITDA margin %	59	49	*10.1 pp*
Alternative energy project construction and operation			
Revenue	288	124	*132.8%*
EBITDA	95	57	*67.7%*
EBITDA margin %	33	46	*-12.9 pp*
Environmental technology and construction management			
Revenue (incl. inter-segment)	305	258	*18.1%*
EBITDA	233	132	*76.3%*
EBITDA margin %	76	51	*25.2 pp*
Property investment			
Revenue	2	0	*753.7%*
EBITDA	2	(0)	*n.a.*
EBITDA margin %	88	(4)	*n.a.*
Total			
Revenue (excl. inter-segment)	2,944	2,467	*19.3%*
EBITDA (excl. inter-segment)	1,334	1,077	*23.9%*
EBITDA margin %	45	44	*1.7 pp*

Source: Company data, Nomura research

NOMURA

Kangda Env 6136.HK 6136 HK

EQUITY: WATER & ENVIRONMENT

IPO sets the stage for rapid growth

Initiate with Buy and TP of HKD3.70

Action: Initiating with Buy and TP of HKD3.70

We expect Kangda, as the largest private player in the municipal WWT sector, to enter a rapid growth stage after its listing in Hong Kong given:

- **Organic growth to sustain in its base camp** – With most projects located in Shandong and Henan, the company can easily develop expansion projects upon existing ones and obtain potential projects given its good relationship with local governments. In addition, Shandong and Henan will see the most rapid growth in WWT capacity addition, according to NDRC.
- **Acquisition growth to surge with widened financing sources –** While the company has announced that 30% of its proceeds from the IPO will be used for acquisitions, the listed position also broadens the company's financing sources and lifts its credibility. We expect 50% of the company's future capacity growth to come from potential acquisitions.
- **Lean management + lowered financing cost = higher return:** Kangda's lean management approach in daily operations and strict project-evaluating mechanism help it to maintain low operating costs. Together with the improvement in financing cost (by 2-3pp) leveraging on the listed position, we believe the company's project return will increase.

We see a strong earnings profile (31% FY13-16F earnings CAGR) for the company and initiate coverage with a Buy rating and TP of HKD3.70.

Catalyst: Value-accretive acquisition, favourable policies on WWT sector

Valuation: Undemanding even considering discount as a private player

At HKD3.18, Kangda is trading at 17x/12x FY14/15F P/E (EPS of CNY0.15/0.21). The valuation is undemanding, in our view, even considering a 20% discount to large SOEs such as BEW/CEI, which are currently trading at c.26x/19x FY14/15F P/E.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F
Currency (CNY)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	1,340	N/A	1,729	N/A	2,094	N/A	2,157
Reported net profit (mn)	232	N/A	301	N/A	425	N/A	518
Normalised net profit (mn)	232	N/A	301	N/A	425	N/A	518
FD normalised EPS	na	N/A	14.55c	N/A	20.56c	N/A	25.07c
FD norm. EPS growth (%)	na	N/A	na	N/A	41.3	N/A	22.0
FD normalised P/E (x)	na	N/A	17.0	N/A	12.0	N/A	9.9
EV/EBITDA (x)	18.1	N/A	12.4	N/A	10.9	N/A	10.2
Price/book (x)	na	N/A	1.7	N/A	1.5	N/A	1.4
Dividend yield (%)	na	N/A	1.2	N/A	1.7	N/A	2.0
ROE (%)	18.9	N/A	14.0	N/A	13.5	N/A	14.7
Net debt/equity (%)	172.5	N/A	57.6	N/A	76.4	N/A	92.0

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

28 August 2014

Rating Starts at	**Buy**
Target price Starts at	HKD 3.70
Closing price 22 August 2014	HKD 3.18
Potential upside	+16.4%

Anchor themes

With market differentiation emerging, we prefer: 1) large-scale SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

We are one of the first houses to cover the stock, and thus no valid consensus estimates are available.

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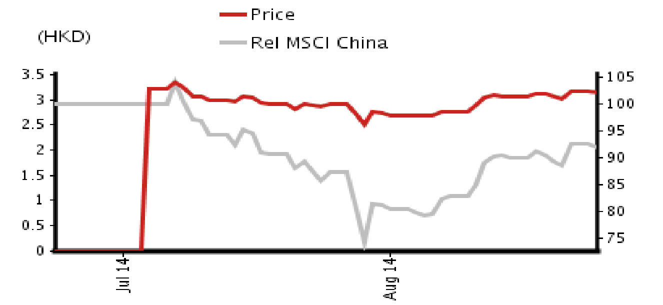
Key data on Kangda Env

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	9.3			M cap (USDmn)	848.4
Absolute (USD)	9.3			Free float (%)	28.8
Rel to MSCI China	4.1			3-mth ADT (USDmn)	13.0

Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	999	1,340	1,729	2,094	2,157
Cost of goods sold	-558	-826	-1,055	-1,239	-1,153
Gross profit	442	513	674	855	1,005
SG&A	-81	-113	-145	-176	-181
Employee share expense					
Operating profit	361	401	529	679	823
EBITDA	369	413	545	695	839
Depreciation	-9	-12	-16	-16	-16
Amortisation	0	0	0	0	0
EBIT	361	401	529	679	823
Net interest expense	-134	-168	-183	-192	-216
Associates & JCEs	0	4	4	4	4
Other income	6	45	10	18	12
Earnings before tax	233	282	360	510	624
Income tax	-36	-49	-58	-83	-103
Net profit after tax	197	233	302	427	521
Minority interests	-1	-1	-1	-2	-2
Other items					
Preferred dividends					
Normalised NPAT	197	232	301	425	518
Extraordinary items					
Reported NPAT	197	232	301	425	518
Dividends	0	0	-60	-85	-104
Transfer to reserves	197	232	241	340	415
Valuations and ratios					
Reported P/E (x)	na	na	17.0	12.0	9.9
Normalised P/E (x)	na	na	17.0	12.0	9.9
FD normalised P/E (x)	na	na	17.0	12.0	9.9
Dividend yield (%)	na	na	1.2	1.7	2.0
Price/cashflow (x)	na	na	na	na	na
Price/book (x)	na	na	1.7	1.5	1.4
EV/EBITDA (x)	18.8	18.1	12.4	10.9	10.2
EV/EBIT (x)	19.3	18.6	12.8	11.2	10.4
Gross margin (%)	44.2	38.3	39.0	40.8	46.6
EBITDA margin (%)	37.0	30.9	31.5	33.2	38.9
EBIT margin (%)	36.1	29.9	30.6	32.4	38.2
Net margin (%)	19.7	17.3	17.4	20.3	24.0
Effective tax rate (%)	15.3	17.4	16.1	16.3	16.6
Dividend payout (%)	0.0	0.0	20.0	20.0	20.0
ROE (%)	na	18.9	14.0	13.5	14.7
ROA (pretax %)	12.1	10.4	10.6	10.9	10.9
Growth (%)					
Revenue	36.0	34.1	29.1	21.1	3.0
EBITDA	26.7	11.9	31.9	27.5	20.8
Normalised EPS	na	na	na	41.3	22.0
Normalised FDEPS	na	na	na	41.3	22.0

Source: Company data, Nomura estimates

Cashflow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	369	413	545	695	839
Change in working capital	-256	-219	-136	-205	-394
Other operating cashflow	-496	-400	-918	-1,060	-1,050
Cashflow from operations	-382	-206	-509	-570	-605
Capital expenditure	-9	-12	-16	-16	-16
Free cashflow	-391	-218	-525	-586	-621
Reduction in investments	0	0	0	0	0
Net acquisitions	0	0	0	0	0
Dec in other LT assets	0	0	0	0	0
Inc in other LT liabilities	0	0	0	0	0
Adjustments	77	-215	4	4	4
CF after investing acts	-314	-433	-521	-582	-617
Cash dividends	0	0	0	-60	-85
Equity issue	601	0	1,313	0	0
Debt issue	515	327	220	252	486
Convertible debt issue					
Others	-504	-163	-183	-192	-216
CF from financial acts	612	165	1,350	1	186
Net cashflow	298	-268	829	-582	-431
Beginning cash	246	544	276	1,105	523
Ending cash	544	276	1,105	523	92
Ending net debt	1,640	2,312	1,703	2,537	3,454

Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	544	276	1,105	523	92
Marketable securities					
Accounts receivable	366	309	354	404	478
Inventories	5	3	4	5	4
Other current assets	985	1,405	1,644	1,919	2,183
Total current assets	1,900	1,993	3,107	2,850	2,758
LT investments	0	50	50	50	50
Fixed assets	76	83	92	100	107
Goodwill					
Other intangible assets	1	1	1	1	1
Other LT assets	1,900	2,587	3,448	4,435	5,387
Total assets	3,877	4,714	6,698	7,437	8,303
Short-term debt	768	785	852	929	1,076
Accounts payable	448	591	739	859	803
Other current liabilities	6	5	5	5	5
Total current liabilities	1,222	1,381	1,596	1,793	1,884
Long-term debt	1,416	1,802	1,955	2,131	2,470
Convertible debt					
Other LT liabilities	123	178	178	178	178
Total liabilities	2,761	3,361	3,730	4,102	4,532
Minority interest	7	12	14	16	18
Preferred stock					
Common stock	0	0	21	21	21
Retained earnings	1,109	1,340	2,874	3,214	3,628
Proposed dividends	0	0	60	85	104
Other equity and reserves					
Total shareholders' equity	1,109	1,340	2,955	3,319	3,753
Total equity & liabilities	3,877	4,714	6,698	7,437	8,303
Liquidity (x)					
Current ratio	1.56	1.44	1.95	1.59	1.46
Interest cover	2.7	2.4	2.9	3.5	3.8
Leverage					
Net debt/EBITDA (x)	4.44	5.59	3.12	3.65	4.11
Net debt/equity (%)	147.9	172.5	57.6	76.4	92.0
Per share					
Reported EPS (CNY)	na	na	14.55c	20.56c	25.07c
Norm EPS (CNY)	na	na	14.55c	20.56c	25.07c
FD norm EPS (CNY)	na	na	14.55c	20.56c	25.07c
BVPS (CNY)	na	na	1.43	1.61	1.82
DPS (CNY)	na	na	0.03	0.04	0.05
Activity (days)					
Days receivable	113.2	92.0	70.0	66.1	74.8
Days inventory	3.5	1.9	1.2	1.3	1.4
Days payable	279.5	229.4	230.2	235.5	263.9
Cash cycle	-162.9	-135.5	-159.0	-168.2	-187.7

Source: Company data, Nomura estimates

Investment thesis

Kangda, the largest private-owned WWT company in China, has ample project exposure and experience through providing EPC services to hundreds of WWT projects before becoming an WWT operator. With the additional capital on hand and widened funding channels after listing in the Hong Kong market (in July 2014), we believe the company will enter an even more rapid growth stage, supported by its acquisition strategy.

Strong organic growth in its base - Henan and Shandong

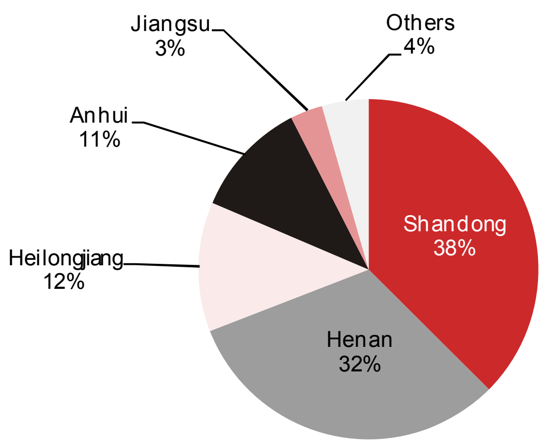
Although Kangda started from Chongqing, the company expanded its WWT operating business sharply in Henan and Shandong provinces. Unlike developed regions such as Beijing, Shanghai, Jiangsu, Guangdong, etc., Henan and Shandong are actually rapidly developing provinces while infrastructure development lags. We, therefore, view that the rapid organic growth for Kangda will remain, backed by the continuous expansion in tier 2-3 cities in these two provinces.

Fig. 58: Kangda: Current project pipeline

Project	City	Province	Method	Concession	Discharge standard	Designed capacity (ton)
Gaomi No.3 WWT Phase II	Gaomi	Shandong	BOT	25	1A	25,000
Yucheng No.2 WWT Phase II	Dezhou	Shandong	BOT	25	1A	30,000
Xingcun WWT	Haiyang	Shandong	BOT	30	1A	20,000
Binghai Shuicheng WWT	Weifang	Shandong	BOT	30	1A	10,000
Nanhai WWT Plant	Wendeng	Shandong	BOT	30	1B	25,000
Liangshan Eco. Zone WWT	Liangshan	Shandong	BOT	30	1A	20,000
Dongying Harbor Eco. Zone WWT	Dongying	Shandong	TOT	30	1A	50,000
Feng County Ind. Zone WWT	Xuzhou	Jiangsu	BOT	25	1A	2,000
Yuchuan Ind. Zone WWT Phase I	Jiyuan	Henan	BOT	28	1A	20,000
Jiaozuo WWT Phase II - Expansion	Jiaozuo	Henan	BOT	26	1A	50,000
Puyang No.2 WWT	Puyang	Henan	BOT	30	1A	50,000
Hejiagou Qunli WWT Phase II	Harbin	Heilongjiang	BOT	30	1B	100,000
Total						**402,000**

Source: Company data, Nomura research

Fig. 59: Kangda: Project summary by regions



Source: Company data, Nomura research

Fig. 60: Kangda: Top 10 provinces in terms of urban wastewater discharge amount - 2013

	Water usage population	Urban wastewater discharge
	mn	mn ton
Guangdong	45.68	6,065.89
Jiangsu	27.85	3,462.52
Shandong	28.86	2,558.70
Henan	21.08	2,399.99
Zhejiang	18.76	2,374.94
Sichuan	16.37	1,992.45
Hubei	17.82	1,883.84
Hunan	13.51	1,812.43
Anhui	13.11	1,723.84
Shanghai	23.80	1,692.90

Source: CEIC, Nomura research

In addition, we also see Kangda to benefit from the investment plans for water pollution control in key basins published by NDRC recently, as Henan's and Shandong's capacity addition plans are ranked No.1 and No.5 among 22 provinces as shown in the figure below.

Fig. 61: Kangda: Henan and Shandong rank high in the future investment plan

Province	Issue date	No. of projects	WWT capacity (ton/day)	Investment (CNY mn)
Henan	3-Jul-14	52	1,450,000	5,770
Inner Mongolia	4-Jul-14	34	559,000	4,250
Jiangsu	8-Jul-14	15	407,500	2,830
Shaanxi	9-Jul-14	20	338,000	1,980
Shandong	4-Jul-14	34	230,000	1,400
Hebei	3-Jul-14	21	205,000	138
Anhui	7-Jul-14	16	192,000	950
Chongqing	11-Jul-14	9	160,100	1,060
Heilongjiang	9-Jul-14	13	144,000	1,130
Zhejiang	7-Jul-14	22	120,000	1,160
Ningxia	7-Jul-14	4	115,000	150
Guizhou	14-Jul-14	21	104,700	750
Sichuan	17-Jul-14	17	93,500	1,190
Jilin	10-Jul-14	11	70,000	760
Qinghai	11-Jul-14	3	65,000	270
Yunnan	4-Jul-14	18	64,000	3,460
Gansu	7-Jul-14	3	50,000	350
Shanxi	8-Jul-14	5	41,500	220
Liaoning	7-Jul-14	4	25,000	200
Hubei	17-Jul-14	14	6,700	260
Shanghai	9-Jul-14	1	2,500	20
Tianjin	8-Jul-14	1	n.a.	100
Total		**338**	**4,443,500**	**28,398**

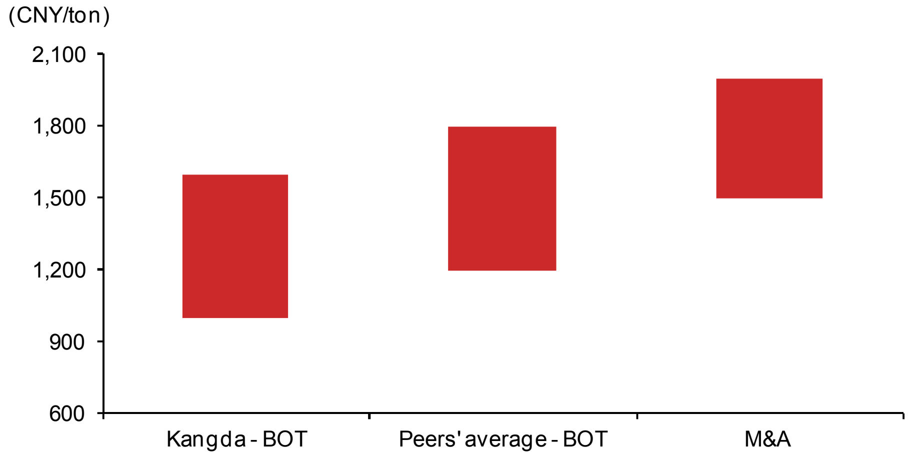
Source: Company data, Nomura research

Organic growth leads to lower construction cost

With the increasing competition in the acquisition market driven by SOE competitors, the gap in unit capex between acquisitions and BOT projects has widened. Therefore, we believe that Kangda will enjoy the benefit from lower unit capex given its major growth will be driven by organic growth through BOT projects.

In addition, given the less-developed status of its projects' geographic exposure, as well as the ample construction experience Kangda accumulated through its prior EPC business, the company's construction cost is also lower than its peers, at c.CNY1,000/ton for Standard 1B WWT project and CNY1,600/ton for Standard 1A project, vs. peers at CNY1,200/ton and CNY1,800/ton, respectively.

Fig. 62: Kangda – BOT/TOT/M&A capex comparison



Note: The low end of unit capex is for Grade 1B project and high end is for Grade 1A project
Source: Company data, Nomura estimates

Further growth backed by the listed position

Capital restraints partially resolved

For unlisted companies, especially private-owned companies, the bottleneck that hinders their capacity growth is capital. As the whole market has entered a consolidation period (penetration in tier 1-2 cities is high while the market is very fragmented), it is painful for players who have the operating capability, while has not enough capital to complete such acquisitions, in our view.

Fig. 63: China – Recent acquisition capital needs

Project	Acquirer	Consideration (mn CNY)
Portugal Water	BEW	950
7 WWT projects in Donguan	BEW	504
60% stakes of BCEG's WWT projects	BEW	270
2 subsidiaries of Standard Water	BEW	1,350
9 projects of Salcon	BEW	955
3 WWT plants of Beijing Municipal Group	Sound Group	240
Ezhou Environmental Protection	Sound Group	36
Beijing Tiandiren	Interchina Water	550
Beijing Changsheng	Kangda	181

Source: Company data, Nomura research

Fig. 64: Kangda – Acquisition of Beijing Changsheng

Project	Location	Stake	Standard	Designed capacity (ton/day)
Jixi WWT Phase I	Anhui	100%	1B	15,000
Ningguo WWT Phase I	Anhui	100%	1B	40,000
Dacheng WWT Phase I	Hebei	100%	1A	15,000
Huashan WWT Phase I	Anhui	100%	1A	10,000
Yucheng No.2 WWT Phase I	Shandong	100%	1A	30,000
Yuchuan Ind. Zone WWT Phase I	Henan	100%	1A	20,000
Nanchang Qingshan Lake WWT	Jiangxi	20%	1B	50,000
Total				**180,000**
Total proceeds				**CNY181 mn**
Replacement cost				**CNY1,300/ton per day**

Source: Company data, Nomura research

Before having investment from Baling, the company as a private company, has restricted financing sources; and therefore can only locate its capital to more profitable BOT projects. However, right after getting capital from Baling, the company completed its first acquisition of Beijing Changsheng, with a total consolidated WWT capacity of 0.13mn ton/day (+10% of its total capacity by then). Therefore, with the funds raised through the IPO and the potential widening of funding sources through overseas borrowing as relatively low interest and/or further equity financing, we see upside potential to the company's capacity growth with the help of likely acquisitions in the market. According to the company, 30% of its IPO proceeds (~HKD331mn) will be used for future acquisitions, and 50% of the future capacity growth will come from acquisitions.

In August 2014, the company announced the acquisition of Puyang No.2 WWT Plant, Yanggu Company, Xin County Company, Liaocheng Company, Jiaxiang Company and Suihua Company, with total operating capacity of 190 kt/day and 50 kt/day under construction and 120kt/day in pipeline. The valuation of these acquired assets is ~1.0x 2013 P/B, according to our analysis, which seems undemanding.

Fig. 65: Kangda: Projects acquired after IPO in July 2014

Project	Location	Stake	Status	COD	Standard	Designed capacity (ton/day)	Considertaion (CNY mn)
Puyang No.2 WWT	Henan	100%	Operating	Sep-14	1A	50,000	56.9
Yanggu WWT Phase I	Shandong	90%	Operating	Sep-14	1A	40,000	
Liaocheng WWT	Shandong	90%	Operating	Sep-14	1A	15,000	
Jiaxiang No.2 WWT	Shandong	90%	Operating	Sep-14	1A	15,000	
Xin County Phase I	Shandong	90%	Operating	Sep-14	1A (post renovation finished in Sep	20,000	CNY270mn for 90% of the stakes
Xin County Phase II	Shandong	90%	Under construction	Sep-14		20,000	
Liaocheng WWT - expansion	Shandong	90%	Under construction	Sep-14	1A	15,000	
Jiaxiang No.2 WWT - expansion	Shandong	90%	Under construction	Sep-14	1A	15,000	
Suihua WWT Phase I	Heilongjiang	100%	Operating	Sep-14	1A	50,000	93.0
Suihua WWT Phase II	Heilongjiang	100%	Pipeline	2016	1A	50,000	n.a.
Yanggu WWT Phase II	Shandong	90%	Pipeline	2H15	1A	40,000	n.a.
Xin County Phase III	Shandong	90%	Pipeline	2H15	1A	30,000	n.a.
Total						**360,000**	

Source: Company data, Nomura estimates

Agile monkey among SOE elephants

Higher IRR through strict pre- and post- investment management

We admit that those big elephants – large SOEs with cash and relationships – have certain advantages in obtaining projects, but Kangda does have its unique advantage as a private company, including:

- **Strict and detailed evaluation mechanism on potential projects**

  To ensure the collection of water tariff from the local government and the return of a project, Kangda implements a series of key indicators to evaluate a project.

Fig. 66: Kangda: Criteria of project evaluation

Indicator	Criteria
IRR	Hurdle rate of 8-10% for Phase I project
Urbanization	Rapid enough to have Phase II expansion in near term
Tariff collection	Stable WWT tariff charged from end users
Guaranteed volume	Normally 80%/90%/100% of the designed capacity for Yr 1/2/3
Payment guarantee	Included in the annual budget of the local government

Source: Company data, Nomura research

Fig. 67: Kangda: Mechanism of tariff adjustment

Indicator	Criteria
Inflow water quality	The concentration of COD/BOD
Discharge standard	Standard required to be met
Inflation	Link to CPI or average salary level
Operation cost	Link to power tariff, rental price, and etc.
Tax rate adjustment	Any adjustment in applied tax preference

Source: Company data, Nomura research

- **Lean management leading to lower cost structure**

  The company adopts the "target costing" method to wisely control its operating cost. To motivate the executives of local WWT plants to achieve cost saving, the company will grant them bonus at a certain proportion of further saving beyond the cost target. For instance, the company's unit power consumption is only ~0.15kWh/ton vs. industry average of 0.2-0.3kWh/ton, and power cost accounts for 30-40% of total operational cost in a WWT project.

Therefore, according to the company, its IRR of WWT projects is 3-4pp higher than the market average.

Fig. 68: Kangda – Project list YTD 2014

Project	City	Province	Method	COD	Concession	Discharge standard	Designed capacity (ton)
Jixi WWT Phase I	Xuancheng	Anhui	BOT	Jun-09	30	1B	15,000
Ningguo WWT Phase I	Ningguo	Anhui	BOT	Mar-10	30	1B	40,000
Huashan WWT Phase I	Chaohu	Anhui	BOT	Oct-10	30	1A	10,000
Suzhou South No.1 WWT	Suzhou	Anhui	TOT	Oct-06	28	2	80,000
Suzhou South No.2 WWT	Suzhou	Anhui	TOT	Oct-13	25	1A	80,000
Daxing Caiyu Eco. Zone WWT Phase I	Beijing	Beijing	BOT	Sep-06	30	Beijing III	15,000
Dacheng WWT Phase I	Langfang	Hebei	BOT	Feb-10	25	1A	15,000
Hejiagou Qunli WWT Phase I	Harbin	Heilongjiang	TOT	Sep-11	30	1B	150,000
Jiaozuo WWT Phase I	Jiaozuo	Henan	TOT	Nov-06	26	2	100,000
Jiaozuo WWT Phase II	Jiaozuo	Henan	BOT	Jul-09	26	1A	100,000
Wanfang Ind. Zone Phase I	Jiaozuo	Henan	BOT	Dec-09	26	1B	25,000
Shangqiu WWT Phase I	Shangqiu	Henan	TOT	May-07	30	1B	80,000
Shangqiu WWT Phase II	Shangqiu	Henan	BOT	Oct-10	30	1A	100,000
Liangyuan Ind. Zone WWT	Shangqiu	Henan	BOT	Jan-14	25	1A	20,000
Linying WWT	Luohe	Henan	TOT	Sep-08	30	1B	30,000
Zhulan WWT	Wugang	Henan	TOT	Nov-12	30	1A	20,000
Baoshan Eco. Zone WWT Phase I	Hebi	Henan	BOT	May-14	30	1A	15,000
Baoshan Eco. Zone Water supply	Hebi	Henan	BOT	Jun-14	30	SH3099-2000	31,300
Feng County WWT Phase I	Xuzhou	Jiangsu	BOT	Jan-06	25	1A	20,000
Feng County WWT Phase II	Xuzhou	Jiangsu	BOT	Jul-09	25	1A	20,000
Feng County Eco. Zone WWT Phase I	Xuzhou	Jiangsu	BOT	Jul-12	29	1A	20,000
Huadian WWT	Huadian	Jilin	TOT	Feb-14	30	1B	30,000
Gaomi No.1 WWT	Gaomi	Shandong	TOT	Sep-11	30	1B	35,000
Gaomi No.2 WWT Phase I	Gaomi	Shandong	BOT	Apr-06	25	1B	50,000
Gaomi No.2 WWT Phase II	Gaomi	Shandong	BOT	Oct-08	25	1B	50,000
Gaomi No.3 WWT Phase I	Gaomi	Shandong	BOT	May-11	25	1B	25,000
Nanfang WWT Phase I	Linxin	Shandong	BOT	Aug-09	25	1B	40,000
Yuhe WWT	Weifang	Shandong	BOT	Sep-10	30	1B	100,000
Yucheng No.2 WWT Phase I	Dezhou	Shandong	BOT	Jul-13	25	1A	30,000
Rushan Residential WWT Phase I	Rushan	Shandong	TOT	Dec-11	30	1A	20,000
Rushan Residential WWT Phase II	Rushan	Shandong	BOT	Jan-14	21	1A	25,000
Rushan Industrial WWT Phase I	Rushan	Shandong	TOT	Dec-11	30	1B	20,000
Haiyang WWT	Haiyang	Shandong	TOT	Nov-05	22	1B	20,000
Guangrao WWT Phase I	Dongying	Shandong	TOT	Sep-08	26	1B	50,000
Guangrao WWT Phase II	Dongying	Shandong	TOT	Sep-08	26	1B	50,000
Shan County Ind. Zone WWT	Heze	Shandong	BOT	Jun-14	28	1A	40,000
Jibei Hi-Tech Zone WWT	Jining	Shandong	BOT	Jun-14	30	1A	25,000
Ninghe WWT Phase I	Tianjin	Tianjin	TOT	Mar-11	30	1B	30,000
Total							**1,626,300**

Source: Company data, Nomura research

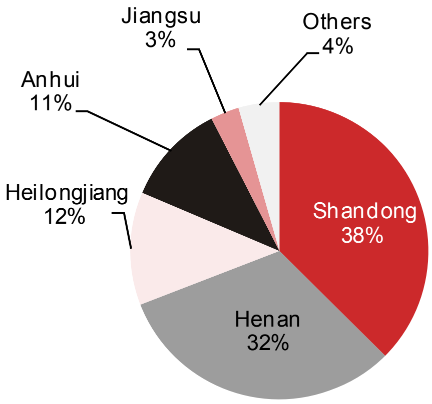
Major investment risks

Obtaining projects unsustainable in future, especially out of Shandong and Henan

Unlike SOEs, private companies generally have a relatively distant relationship with local governments. Although majority of the greenfield projects should go through the open tender process, the local governments have the right to pick and approve the winner. Therefore, we may see Kangda, especially while bidding for projects outside Shandong and Henan, to have some disadvantages and in turn a slowdown in projects development.

Fig. 69: Kangda – Concentration risk in Shandong and Henan

Province	No. of projects	Total capacity (ton/day)
Shandong	22	760,000
Henan	13	641,300
Heilongjiang	2	250,000
Anhui	5	225,000
Jiangsu	4	62,000
Others	0	90,000
Jilin	1	30,000
Tianjin	1	30,000
Beijing	1	15,000
Hebei	1	15,000



Source: Company data, Nomura research

Higher valuation on assets to be acquired

With more and more competitors entering the WWT industry, we expect the valuation of the WWT assets will increase, especially for those owned by other private companies. Therefore: 1) Kangda may face difficulties in securing acquisitions amid the fierce competition; and 2) the profitability of such projects may be affected even if Kangda manages to nail deals.

Fig. 70: IRR sensitivity analysis on unit capex

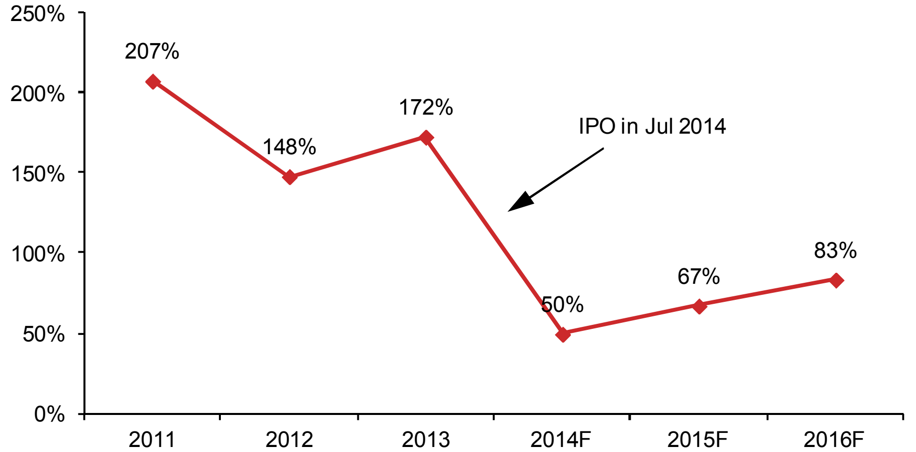
Sensitivity Analysis of Wastewater Treatment project							
		Unit capex in CNY per ton/day					
		1,300	1,400	1,500	1,600	1,700	1,800
Utilization Rate	60%	12.1%	10.9%	9.8%	8.9%	8.1%	7.4%
	65%	13.4%	12.2%	11.0%	10.1%	9.2%	8.4%
	70%	14.8%	13.4%	12.2%	11.2%	10.3%	9.4%
	75%	16.2%	14.7%	13.4%	12.3%	11.3%	10.4%
	80%	17.6%	16.0%	14.6%	13.4%	12.4%	11.4%
	85%	19.0%	17.3%	15.8%	14.6%	13.4%	12.4%
	90%	20.4%	18.6%	17.0%	15.7%	14.5%	13.4%
	95%	21.7%	19.9%	18.2%	16.8%	15.5%	14.4%
	100%	23.1%	21.1%	19.4%	17.9%	16.6%	15.4%

Source: Company data, Nomura estimates

Dilution risk arising from aggressive capacity addition plan

Given the company's ambitious plan to triple capacity by end-2017, we believe the capital raised through the IPO, together with a reasonable gearing level, cannot fully cover the capex needed, which may lead to a potential equity financing need in the mid-term.

Fig. 71: Kangda: Net gearing level



Source: Company data, Nomura estimates

Strong earnings growth in 1H14

Kangda reported 1H14 results on 27 Aug 2014, with net profit up 18.4% to CNY125mn. Stripping out one-off items such as IPO -elated expenses, disposal gain/loss, FX adj., etc., recurring net profit surged 60% y-y to CNY131mn (vs. CNY82mn for 1H13). The strong earnings growth came in in line with our estimates, with 1H14 net profit accounting for 43% of our FY14 earnings forecast of CNY301mn.

With consolidation of the projects acquired in August, as well as potential projects obtaining/acquired, we remain positive on Kangda's 2H14 results and ahead.

Fig. 72: Kangda: 1H14 results review

CNY mn	1H14	1H13	*y-y*	Comments
Revenue	**864**	**575**	***50.2%***	
- Construction	558	334	*67.1%*	Due to 5 new projects commenced construction
- Operating	195	158	*23.6%*	Due to 0.2mn ton increase of operating capacity
- Financial income	110	83	*32.5%*	Due to increase of projects under construction and operating
Cost of sales	(553)	(346)	*60.0%*	
Gross profit	**311**	**230**	***35.4%***	
Other income and gains	10	30	*-66.9%*	Due to the lapse of one-off items such as bargaining gain
Selling and distribution expenses	(3)	(2)	*36.4%*	
Administrative expenses	(64)	(52)	*24.5%*	Due to the one-off IPO expenses of ~CNY12mn
Other expenses	-	(3)	*-100.0%*	
Operating profit	**253**	**202**	***25.0%***	
Finance costs	(96)	(79)	*22.5%*	Due to the increase of bank borrow ings
Share of profit/loss of associates	4	1	*241.8%*	Due to the contribution of a project of Beijing Changsheng
Profit before tax	**160**	**125**	***28.4%***	
Income tax	(36)	(20)	*82.3%*	
Profit for the period	**125**	**105**	***18.4%***	
- Attributable to shareholders	**124**	**105**	*17.7%*	
- Non-controlling interests	1	0	*694.0%*	
Exceptional items	(7)	23	*-129.1%*	Incl. FX adj. disposal gain/loss, IPO expenses, etc.
Recurrning net profit	**131**	**82**	***59.7%***	
Key financial ratios (%)	**1H14**	**1H13**	***y-y***	**Comments**
Gross margin	36.0%	39.9%	*-3.9pp*	Due to the relatively large proportion of construction revenue
Operating margin	29.3%	35.2%	*-5.9pp*	
Recurring net profit margin	15.1%	14.2%	*0.9pp*	
Effective tax rate	22.3%	15.7%	*6.6pp*	Due to the expiration of several WWT plants' tax preference period
Net gearing ratio	181.0%	172.5%	*8.6pp*	Gearing level largely dropped to ~60% post IPO

Source: Company data, Nomura research

Fig. 73: Kangda: BOT business 1H14 results summary

	Construction			Operation		
CNY mn	1H14	1H13	y-y	1H14	1H13	y-y
Revenue	482	188	*157.0%*	194	157	*23.8%*
Gross profit	96	37	*161.0%*	97	75	*28.8%*
Gross margin	*19.9%*	*19.6%*	*0.3pp*	*50.0%*	*48.1%*	*1.9pp*

Source: Company data, Nomura research

Valuation – Initiating coverage with Buy and TP of HKD3.70

Given our positive view on the whole China WWT sector and the company's upside potential from the increased financing ability after the IPO, we initiate coverage of Kangda with a Buy rating. Given its relatively large project base and high concentration on the WWT operation business, we adopt the same DCF method to value the stock as its peers' BEW and CEI. We discount the future 10 years' cash flows back to 2015F and apply a terminal growth of 2%, and therefore generate our TP of HKD3.70, implying a 16.4% upside potential.

Fig. 74: Kangda: Key operational assumptions

Key assumption	Unit	2013	2014F	2015F
BT revenue	CNY mn	302	243	173
BOT revenue	CNY mn	1,030	1,393	1,729
Operation capacity	mn ton per day	1.39	1.83	2.63
Effective interest rate	%	7.0%	6.8%	6.5%

Source: Company data, Nomura estimates

At HKD3.18, the company is trading at 17x 2014F P/E (EPS: HKD0.15) vs. SOE peers' c.26x. Even factoring in a fair discount of 20% to large SOEs such as BEW/CEI, the current valuation is still undemanding, in our view.

Fig. 75: Kangda: Key valuation assumptions and DCF matrix

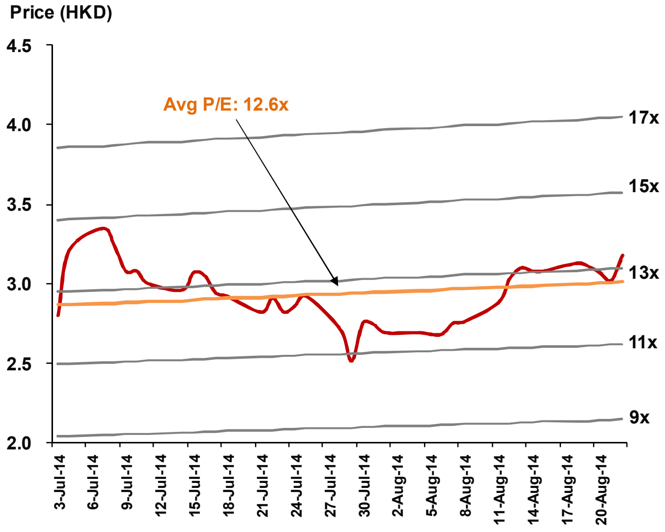
FCF (CNY mn)	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Reporting revenue	2,093.8	2,157.3	2,487.7	2,865.3	3,277.2	3,750.8	4,183.9	4,421.4	4,594.8	4,222.8
...Growth rate	*21%*	*3%*	*15%*	*15%*	*14%*	*14%*	*12%*	*6%*	*4%*	*-8%*
EBIT (non-IFRIC)	507.9	685.3	864.4	1,072.5	1,294.6	1,533.6	1,756.0	1,898.3	2,014.4	2,137.1
Depreciation/amortization	7.6	8.7	9.8	10.9	12.0	13.1	14.2	15.3	16.1	17.2
EBITDA	515.5	694.0	874.2	1,083.4	1,306.5	1,546.7	1,770.2	1,913.6	2,030.5	2,154.3
...EBITDA margin	*25%*	*32%*	*35%*	*38%*	*40%*	*41%*	*42%*	*43%*	*44%*	*51%*
less:tax	(82.9)	(103.5)	(124.8)	(150.6)	(179.9)	(212.3)	(243.6)	(261.4)	(274.8)	(274.9)
minority interest	(2.0)	(2.4)	(2.9)	(3.5)	(4.2)	(5.0)	(5.7)	(6.1)	(6.4)	(6.4)
change in working capital	68.9	(129.9)	(11.0)	(17.9)	(16.6)	(8.7)	(10.2)	(17.6)	(20.0)	(266.5)
CAPEX	(1,261.4)	(1,216.0)	(1,280.0)	(1,280.0)	(1,280.0)	(1,280.0)	(1,280.0)	(1,280.0)	(1,280.0)	(862.0)
Leveraged FCF	(761.8)	(757.7)	(544.6)	(368.6)	(174.1)	40.7	230.7	348.5	449.3	744.5

WACC	Sum of PV (CNY'mn)	PV of TV (CNY'mn)	EV (CNY'mn)	Net cash/ (debt) (FY15F)	Equity Value (CNY'mn)	Shares out ('mn)	Value per share (CNY)
4.4%	(1,163.7)	21,748.2	20,584.5	2,397.3	22,981.8	2,068	11.12
4.9%	(1,195.6)	17,209.5	16,013.9	2,397.3	18,411.2	2,068	8.90
5.4%	(1,225.9)	14,045.7	12,819.8	2,397.3	15,217.1	2,068	7.36
5.9%	(1,254.5)	11,723.1	10,468.6	2,397.3	12,865.9	2,068	6.22
6.4%	(1,281.5)	9,952.2	8,670.8	2,397.3	11,068.1	2,068	5.35
6.9%	(1,307.0)	8,562.4	7,255.4	2,397.3	9,652.7	2,068	4.67
7.4%	(1,331.1)	7,446.4	6,115.3	2,397.3	8,512.6	2,068	4.12
7.9%	(1,353.8)	6,533.7	5,179.9	2,397.3	7,577.2	2,068	3.66
8.4%	(1,375.3)	5,775.8	4,400.5	2,397.3	6,797.8	2,068	3.29
8.9%	**(1,395.5)**	**5,138.4**	**3,742.9**	**2,397.3**	**6,140.2**	**2,068**	**2.97**
9.4%	(1,414.6)	4,596.5	3,181.9	2,397.3	5,579.2	2,068	2.70
9.9%	(1,432.6)	4,131.6	2,699.0	2,397.3	5,096.3	2,068	2.46
10.4%	(1,449.5)	3,729.4	2,279.8	2,397.3	4,677.1	2,068	2.26
10.9%	(1,465.5)	3,379.0	1,913.5	2,397.3	4,310.8	2,068	2.09
11.4%	(1,480.5)	3,071.8	1,591.3	2,397.3	3,988.6	2,068	1.93
11.9%	(1,494.6)	2,801.0	1,306.5	2,397.3	3,703.8	2,068	1.79
12.4%	(1,507.8)	2,561.2	1,053.4	2,397.3	3,450.7	2,068	1.67
12.9%	(1,520.2)	2,347.7	827.5	2,397.3	3,224.8	2,068	1.56
13.4%	(1,531.9)	2,157.0	625.1	2,397.3	3,022.4	2,068	1.46
13.9%	(1,542.8)	1,985.9	443.1	2,397.3	2,840.4	2,068	1.37

WACC Calculation	
Equity Beta	1.2
Risk Free Rate	3.50%
Equity Risk Premium	7.50%
Country Risk Premium	0%
Cost of Equity	12.5%
Cost of Debt	7.0%
Debt/Capital	50%
Tax	25.0%
WACC	8.9%
Terminal growth rate	2%

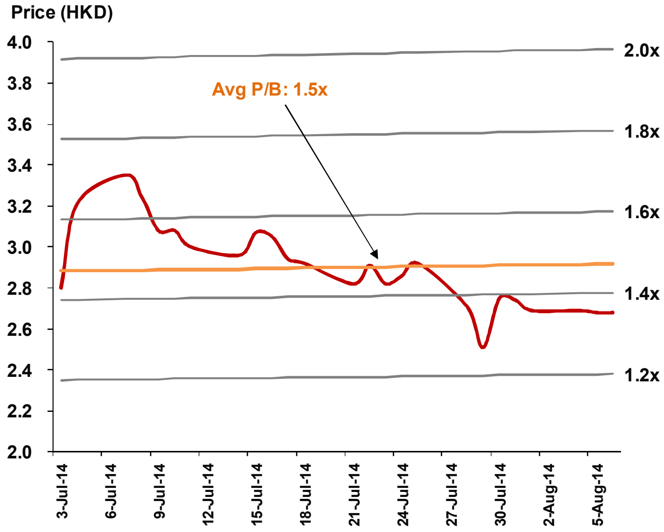
Source: Company data, Nomura estimates

Fig. 76: Kangda: Forward 12-month P/E band



Source: Bloomberg, Nomura estimates

Fig. 77: Forward 12-month P/B band



Source: Bloomberg, Nomura estimates

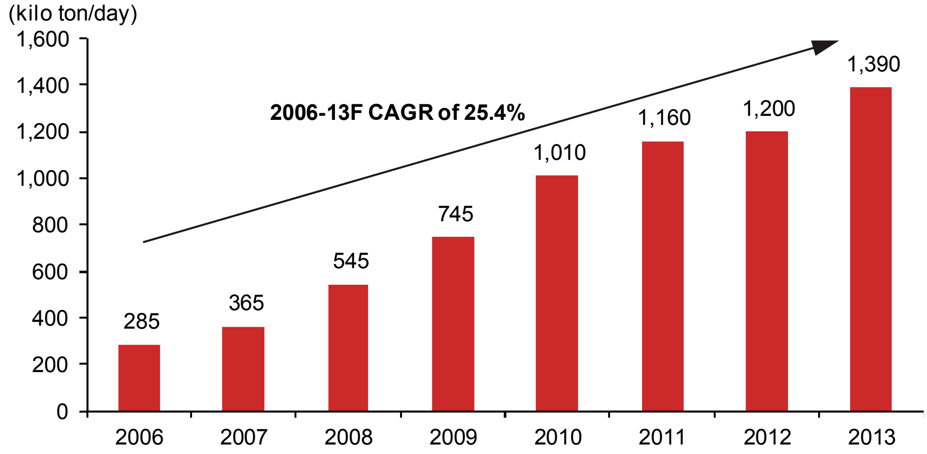
Investment risks:

- Lower-than-expected capacity addition due to the increasing competition or slow pace in geographic expansion.
- Higher-than-expected unit capex needed, especially in the acquisition market.
- Unexpected interest rate hike.

Company overview

Kangda International Environmental Company Limited, with more than 15 years' experience in the China WWT industry, currently has 49 BOT/TOT projects, mainly in tier 2-3 cities, with operating treatment capacity amounting to 1.5mn ton/day. The founder and the current president Zhao Junxian started the business in Chongqing and experienced a major capacity expansion in Shandong and Henan. Since its first BOT project back in 2003, the company's capacity has experienced rapid growth at 2006-13 CAGR of 25.4%.

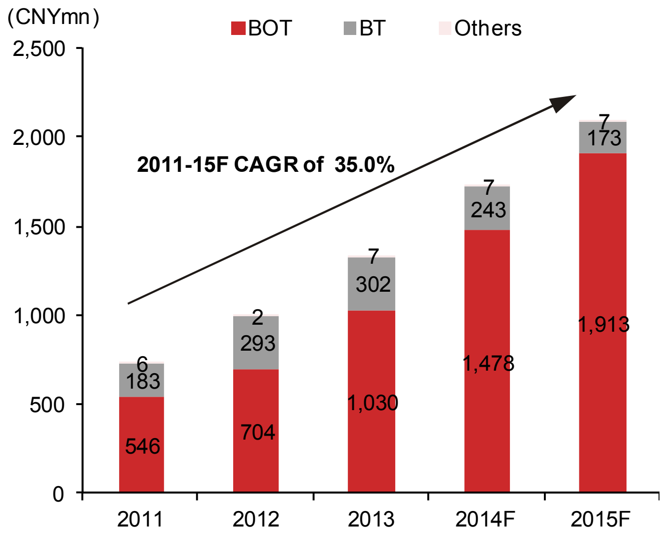
Fig. 78: Kangda: Capacity growth in the past decade



Source: Company data, Nomura research

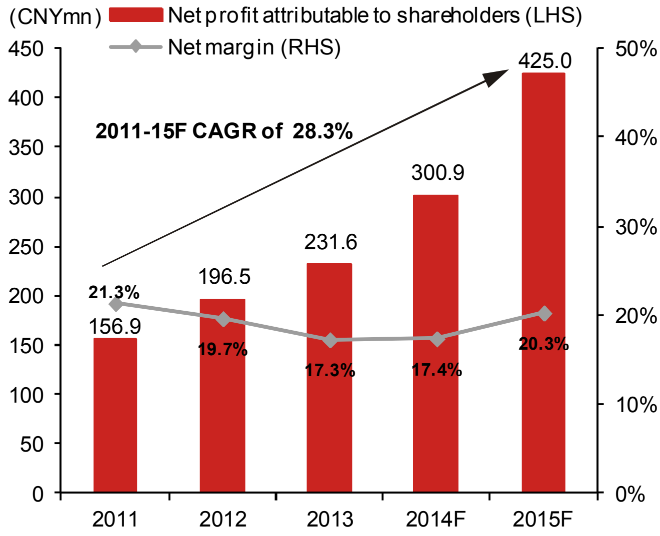
Emerging from an EPC company, Kangda currently enjoys earnings contribution mainly from BOT/TOT projects, which enjoy higher margin than the construction business and more stable cash inflows in the long term. As a result, the top-line and bottom-line growth remained steady at 2011-13 CAGR of 35% and 22%, respectively.

Fig. 79: Kangda: Revenue CAGR in 2011-13



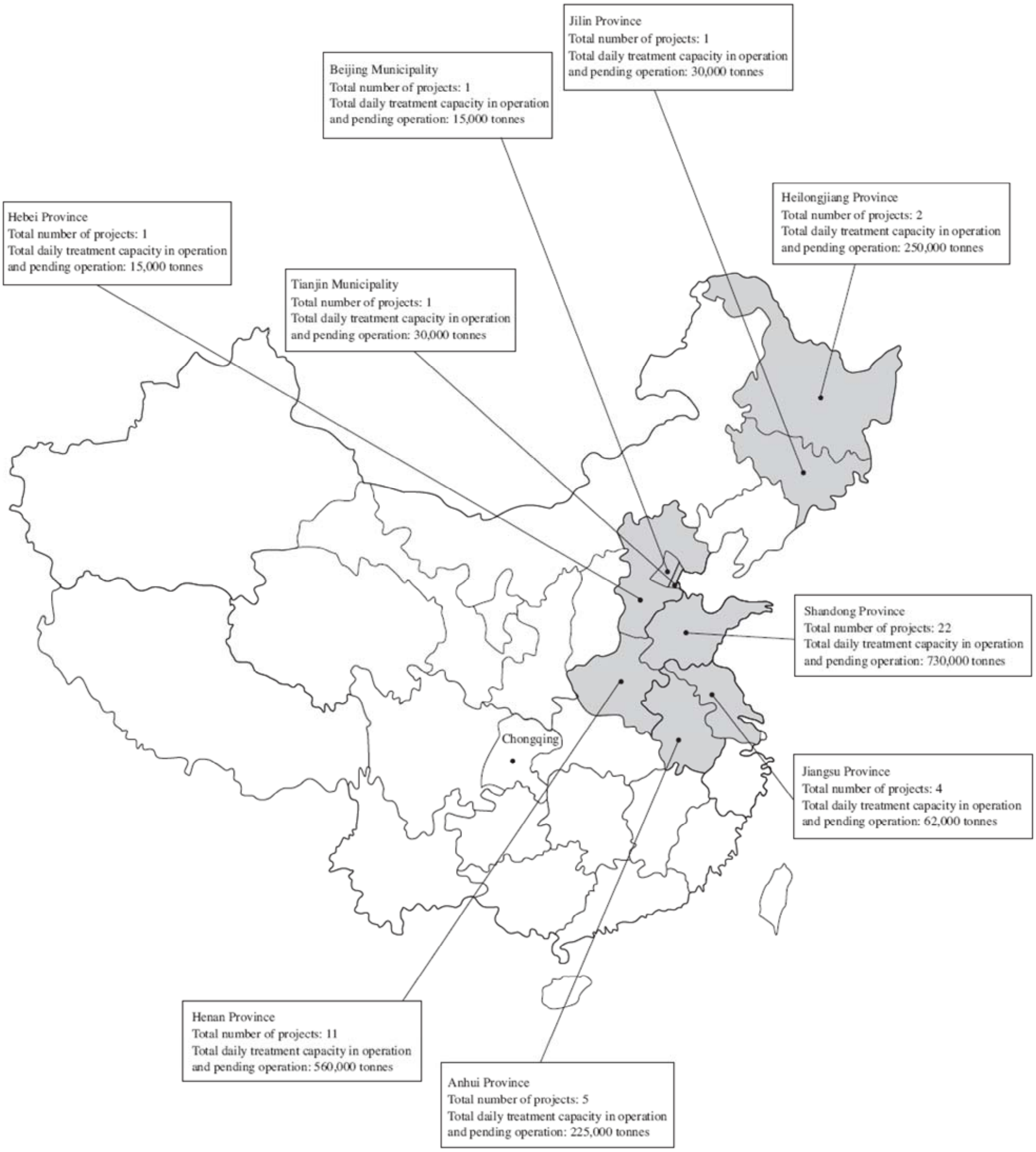
Source: Company data, Nomura estimates

Fig. 80: Kangda: Earnings CAGR in 2011-13



Source: Company data, Nomura estimates

Fig. 81: Kangda: Geographic exposure of projects



Source: Company data, Nomura research

A strong management team with ample experience

Mr. Zhao Junxian (赵隽贤), aged 61, is the founder of Kangda. He is the company's executive Director, and the chairman of the Board, responsible for strategic development and planning, overall operational management, market development and major decision making. He was appointed as a Director on 22 August 2011. He has acted as a director and the chief executive officer of Kangda Group since the beginning of the establishment of Kangda Group until September 2012. He has also served as a director of Jilin Kangda and Hebi Kangda since September 2011 and February 2012, respectively. Mr. Zhao Junxian has about 25 years of experience in the environmental protection and wastewater treatment industry and was awarded for several times for his valuable contribution to the development of environmental protection and his expertise in environmental protection technology by relevant environmental protection industry associations from 2004 to 2009.

Mr. Zhang Weizhong (张为众), aged 62, is the chief executive officer and an executive Director. He was appointed as the Director on 15 March 2013. He was appointed as the president of Kangda Group on 26 September 2012. He graduated from Sichuan Radio and TV University located in Chengdu City, Sichuan Province, with a college degree in industrial accounting in July 1986. Mr. Zhang Weizhong has over 40 years of experience in the field of accounting and about 15 years of experience management and has obtained the qualification of senior accountant in the PRC.

Ms. Liu Zhiwei (刘志伟), aged 49, is the executive Director and was appointed as a Director on 15 May 2012. She joined the company in 1996 and has served various positions, including chief accountant, chief officer of asset management department, deputy chief financial officer, audit director, executive director and vice president, and is currently responsible for the investor relationship and risk control matters of the group. Ms. Liu has approximately 20 years of experience in the field of accounting. She obtained the qualification of senior accountant in the PRC granted by the People's Government of Chongqing Municipal in November 2000.

Mr. Gu Weiping (顾卫平), aged 59, is the executive Director and was appointed as a Director on 15 May 2012. He joined the group in 1996 and has served various positions, including general manager assistant, vice president and deputy chairman. He is currently responsible for the management of administrative and human resource affairs of the group. He has also served as a director of Hebi Kangda and Dongying Kangda since February 2012 and November 2012, respectively. He obtained the qualification of environmental engineer in the PRC granted by the People's Government of Chongqing Municipal.

NOMURA

Guangdong Investment

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EQUITY: POWER & UTILITIES

Low visibility in new growth points

Reiterate Reduce on flattish earnings growth

Global Markets Research

28 August 2014

Rating Remains	**Reduce**
Target price Increased from 7.00	HKD 7.40
Closing price 22 August 2014	HKD 9.59
Potential downside	-22.8%

Share price rally on overly optimistic market expectations

After dropping by ~9% in the three weeks following our coverage assumption in March, Guangdong Investment (GDI) shares have rallied strongly, we believe on market expectations of two key catalysts: 1) acceleration of WWT project acquisitions; and 2) acceleration of parent injection amid SOE reforms. However, we remain cautious on these "catalysts" considering the following:

- **Only one small-scale WWT acquisition YTD:** We think the market's misunderstanding of accelerating WWT project acquisitions comes from GDI's announcement in its 1Q report of the acquisition of two small-scale WWT projects. As announced on the parent company's website, the two projects were actually acquired in Dec 2013. Therefore, we note that there has been only one WWT acquisition so far in 2014 with a capacity of 40,000 tons/day and WWT accounted for less than 0.1% of total 1H14 earnings.
- **SOE reforms will first test water in central government-owned enterprises:** The pilot project for SOE reforms recently announced by the NDRC has triggered market enthusiasm on GDI's "long anticipated, but yet to materialise" parent asset injection. While the promotion of SOE reforms will likely lead to re-consideration of asset injection plans, we think the central government will be cautious in extending such reforms to provincial government-owned enterprise (eg, GDH), to prevent potential loss of state assets resulting from corruption.
- **Water supply tariff growth may decline:** For the next three-year HK water supply contract, we expect growth of c.3%, vs the current 4.6%, mainly on recent CNY depreciation and low CPI.

Flattish earnings from 2014-16F; valuations seem full

GDI is trading at 18.5x 2014F EPS of HKD0.52, similar to the peer average of c.20x, while its 2013-15F EPS CAGR of 7.2% lags the peer average of c.30%. Valuations appear full, in our view. We roll over to 2015F valuation and fine-tune our TP to HKD7.40.

Year-end 31 Dec	FY13	FY14F		FY15F		FY16F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	7,990	8,260	8,260	8,483	8,483		9,658
Reported net profit (mn)	4,426	3,205	3,240	3,288	3,317		3,376
Normalised net profit (mn)	3,045	3,205	3,240	3,288	3,317		3,376
FD normalised EPS	48.83c	51.36c	51.94c	54.64c	55.11c		56.09c
FD norm. EPS growth (%)	10.4	0.9	6.4	6.4	6.1		1.8
FD normalised P/E (x)	19.6	N/A	18.5	N/A	17.4	N/A	17.1
EV/EBITDA (x)	11.4	N/A	11.4	N/A	10.9	N/A	10.4
Price/book (x)	2.2	N/A	2.0	N/A	1.8	N/A	1.7
Dividend yield (%)	2.4	N/A	1.8	N/A	1.9	N/A	1.9
ROE (%)	17.2	11.5	11.5	11.0	10.9		10.3
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Anchor themes

With market differentiation emerging, we prefer: 1) large-scale SOEs in the consolidating municipal market; 2) experienced private players with strong construction capabilities in rural markets; and 3) small and agile private players with a focus on the industrial WWT market.

Nomura vs consensus

Our FY15F earnings estimate is 15% below consensus.

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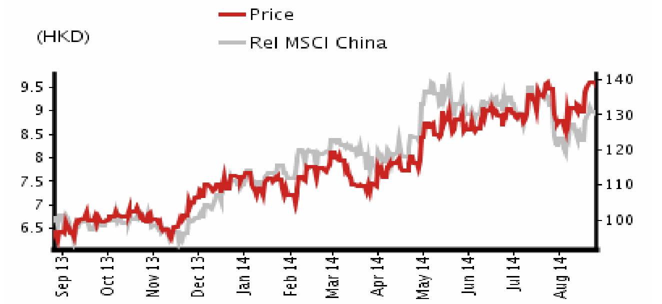
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Guangdong Investment

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	2.1	11.5	50.3	M cap (USDmn)	7,722.2
Absolute (USD)	2.2	11.6	50.4	Free float (%)	38.9
Rel to MSCI China	-3.0	0.6	35.6	3-mth ADT (USDmn)	8.2

Income statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	7,736	7,990	8,260	8,483	9,658
Cost of goods sold	-2,649	-2,666	-2,891	-2,969	-3,380
Gross profit	5,087	5,324	5,369	5,514	6,277
SG&A	-1,231	-1,260	-1,224	-1,176	-2,006
Employee share expense	0	0	0		0
Operating profit	3,856	4,064	4,146	4,338	4,272
EBITDA	4,915	5,123	5,204	5,397	5,496
Depreciation	-1,059	-1,059	-1,059	-1,059	-1,224
Amortisation	0	0	0		0
EBIT	3,856	4,064	4,146	4,338	4,272
Net interest expense	54	215	168	154	353
Associates & JCEs	152	313	255	268	268
Other income	-1	71	-1	-1	-2
Earnings before tax	4,061	4,664	4,567	4,758	4,890
Income tax	-738	-1,099	-1,013	-1,123	-1,223
Net profit after tax	3,322	3,565	3,554	3,636	3,668
Minority interests	-554	-520	-313	-319	-292
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	2,768	3,045	3,240	3,317	3,376
Extraordinary items	646	1,381	0	0	0
Reported NPAT	3,414	4,426	3,240	3,317	3,376
Dividends	-1,247	-1,435	-1,051	-1,075	-1,094
Transfer to reserves	2,167	2,991	2,190	2,241	2,281
Valuations and ratios					
Reported P/E (x)	17.5	13.5	18.5	17.4	17.1
Normalised P/E (x)	21.6	19.6	18.5	17.4	17.1
FD normalised P/E (x)	21.7	19.6	18.5	17.4	17.1
Dividend yield (%)	2.1	2.4	1.8	1.9	1.9
Price/cashflow (x)	13.2	12.7	15.0	13.0	12.2
Price/book (x)	2.5	2.2	2.0	1.8	1.7
EV/EBITDA (x)	12.6	11.4	11.4	10.9	10.4
EV/EBIT (x)	16.0	14.2	14.1	13.4	13.2
Gross margin (%)	65.8	66.6	65.0	65.0	65.0
EBITDA margin (%)	63.5	64.1	63.0	63.6	56.9
EBIT margin (%)	49.8	50.9	50.2	51.1	44.2
Net margin (%)	44.1	55.4	39.2	39.1	35.0
Effective tax rate (%)	18.2	23.6	22.2	23.6	25.0
Dividend payout (%)	36.5	32.4	32.4	32.4	32.4
ROE (%)	14.9	17.2	11.5	10.9	10.3
ROA (pretax %)	12.5	12.9	12.3	12.3	11.7
Growth (%)					
Revenue	8.0	3.3	3.4	2.7	13.8
EBITDA	5.6	4.2	1.6	3.7	1.8
Normalised EPS	10.3	10.0	6.4	6.1	1.8
Normalised FDEPS	10.4	10.4	6.4	6.1	1.8

Source: Company data, Nomura estimates

Cashflow statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	4,915	5,123	5,204	5,397	5,496
Change in working capital	-382	2,694	-629	-259	-179
Other operating cashflow	17	-3,101	-593	-701	-599
Cashflow from operations	4,550	4,716	3,982	4,437	4,717
Capital expenditure	-126	-141	-2,194	-2,465	-1,724
Free cashflow	4,424	4,575	1,788	1,972	2,993
Reduction in investments	-367	-4,606	0	0	0
Net acquisitions	-397	3,618	0	0	0
Dec in other LT assets	288	391	-51	-54	-54
Inc in other LT liabilities	70	323	0	0	0
Adjustments	-139	-974	51	54	54
CF after investing acts	3,878	3,328	1,788	1,972	2,993
Cash dividends	-1,170	-1,340	-1,435	-1,051	-1,075
Equity issue	2	11	116	24	33
Debt issue	-1,210	-293	-624	163	82
Convertible debt issue	0	0	0	0	0
Others	-571	354	0	0	0
CF from financial acts	-2,948	-1,268	-1,943	-863	-960
Net cashflow	929	2,059	-156	1,109	2,033
Beginning cash	3,543	4,472	6,532	6,376	7,485
Ending cash	4,472	6,532	6,376	7,485	9,518
Ending net debt	-172	-2,521	-2,940	-3,832	-5,724

Balance sheet (HKDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	4,472	6,532	6,376	7,485	9,518
Marketable securities	432	5,037	5,037	5,037	5,037
Accounts receivable	3,123	521	1,229	1,506	1,992
Inventories	57	79	71	73	83
Other current assets	0	4	4	4	4
Total current assets	8,084	12,174	12,717	14,105	16,634
LT investments	0	0	0	0	0
Fixed assets	12,656	13,712	15,569	17,658	18,635
Goodwill	266	266	266	266	266
Other intangible assets	14,124	13,320	12,598	11,916	11,439
Other LT assets	2,231	1,840	1,891	1,945	1,998
Total assets	37,362	41,312	43,042	45,889	48,972
Short-term debt	554	1,251	574	593	631
Accounts payable	2,521	2,631	2,700	2,720	3,037
Other current liabilities	484	494	494	494	494
Total current liabilities	3,559	4,376	3,769	3,808	4,162
Long-term debt	3,746	2,759	2,862	3,060	3,163
Convertible debt	0	0	0	0	0
Other LT liabilities	1,672	1,996	1,996	1,996	1,996
Total liabilities	8,978	9,131	8,626	8,864	9,321
Minority interest	4,346	4,868	5,181	5,500	5,793
Preferred stock	0	0	0	0	0
Common stock	3,117	3,120	3,129	3,131	3,134
Retained earnings	19,674	22,759	25,055	27,319	29,630
Proposed dividends	1,247	1,435	1,051	1,075	1,094
Other equity and reserves	0	0			
Total shareholders' equity	24,038	27,313	29,235	31,525	33,858
Total equity & liabilities	37,362	41,312	43,042	45,889	48,972

	FY12	FY13	FY14F	FY15F	FY16F
Liquidity (x)					
Current ratio	2.27	2.78	3.37	3.70	4.00
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Per share					
Reported EPS (HKD)	54.76c	70.97c	51.94c	55.11c	56.09c
Norm EPS (HKD)	44.41c	48.83c	51.94c	55.11c	56.09c
FD norm EPS (HKD)	44.21c	48.83c	51.94c	55.11c	56.09c
BVPS (HKD)	3.86	4.38	4.86	5.24	5.63
DPS (HKD)	0.20	0.23	0.17	0.18	0.18
Activity (days)					
Days receivable	143.5	83.2	38.7	58.8	66.3
Days inventory	8.2	9.3	9.5	8.8	8.4
Days payable	341.8	352.6	336.5	333.2	311.7
Cash cycle	-190.2	-260.1	-288.3	-265.5	-237.0

Source: Company data, Nomura estimates

Valuation methodology and risks

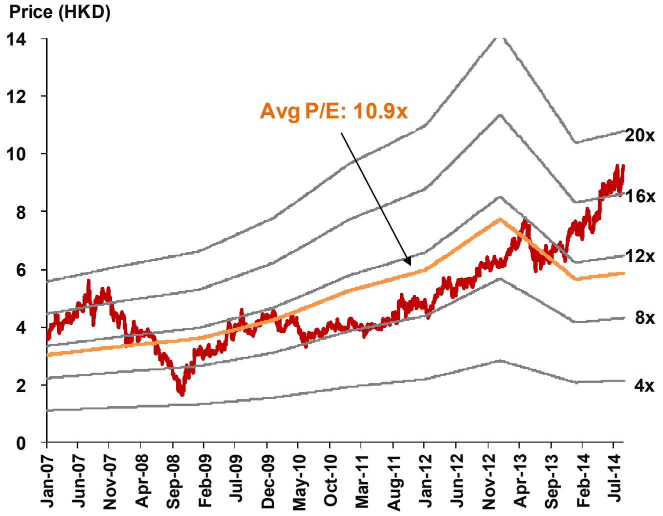
We remain cautious and fine-tune our TP to HKD7.40 (from HKD7.00) after updating our earnings model based on actual 2013 results and rolling over our valuation to 2015F. Our TP is based on SOTP methodology (unchanged), with separate valuations for its water distribution, property investment, power generation, department store, hotel operations and management businesses given their different business models: 1) Water distribution, power generation, and department stores – we value these three segments using a DCF model, assuming WACC of 11.6%/10.4%/14.3% (note that the water and power businesses are utilities, which generally have lower WACC than department stores); 2) property investment and hotel management – we value these two segments using an NAV method by applying a discount of 45% to its latest reported NAV, in line with our China property team's assumptions for Guangzhou R&F Properties (2777 HK, Buy); and 3) Net cash – we value the company's net cash on hand using a P/B method with a discount P/B of 0.80, as we don't believe GDI can utilise its net cash (incl. available-for-sale investments) effectively in the short term.

Fig. 82: GDI: SOTP valuation

Y/E 31 DEC	Valuation			2015F (HKD)	Portion (%)
Water distribution	DCF	@	11.6%	4.6	62.7%
Property investment (incl. malls, office buildings, and hotels)	NAV+discount	@	45.0%	0.9	11.9%
Power generation	DCF	@	10.4%	0.5	6.4%
Department store	DCF	@	14.3%	0.2	3.2%
Corporate value - operating business				**6.2**	**84.3%**
Net cash / (debt)	P/B	@	0.80x	1.2	15.6%
Equity value				**7.4**	**100.0%**
Target price				**7.4**	

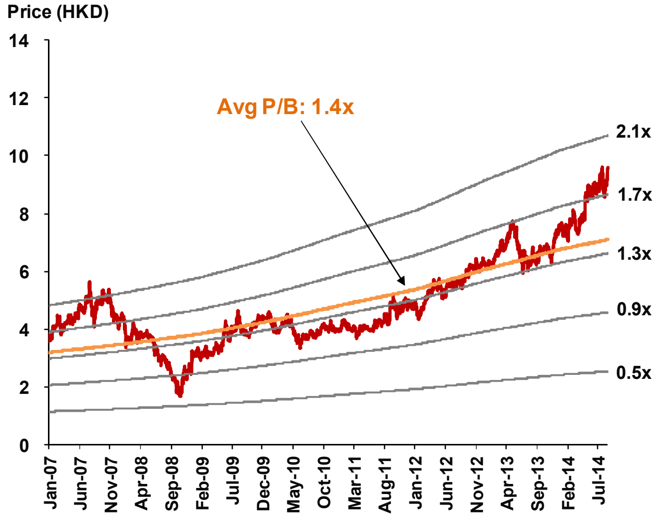
Source: Company data, Nomura estimates

Fig. 83: GDI: 12-month forward P/E band



Source: Bloomberg, Nomura estimates

Fig. 84: GDP: 12-month forward P/B band



Source: Bloomberg, Nomura estimates

Upside risks

- Value accretive M&A – any significant value accretive M&A in the short term would have a material impact on the company's earnings growth;
- Asset injection – Faster-than-expected asset injection would also largely spike the earnings profile of the company.
- Water/power tariff hike – Any unexpected rapid growth in the water/power tariff would lift the company's profitability.

Appendix A-1

Analyst Certification

I, Yuwen Tang, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Previous rating	Date of change	Sector rating
CT Environment	1363 HK	HKD 6.41	27-Aug-2014	Buy	Not rated	28-Aug-2014	N/A
China Everbright International	257 HK	HKD 10.80	27-Aug-2014	Buy	Rating Suspended	05-Mar-2014	N/A
Guangdong Investment	270 HK	HKD 9.18	27-Aug-2014	Reduce	Rating Suspended	05-Mar-2014	N/A
Beijing Enterprises Water	371 HK	HKD 5.35	27-Aug-2014	Buy	Rating Suspended	05-Mar-2014	N/A
Kangda Env	6136 HK	HKD 3.11	27-Aug-2014	Buy	Not rated	28-Aug-2014	N/A
Sound Global	967 HK	HKD 7.80	27-Aug-2014	Buy	Not rated	28-Aug-2014	N/A

Rating and target price changes

Issuer	Ticker	Old stock rating	New stock rating	Old target price	New target price
CT Environment	1363 HK	Not rated	Buy	N/A	HKD 7.70
Guangdong Investment	270 HK	Reduce	Reduce	HKD 7.00	HKD 7.40
Kangda Env	6136 HK	Not rated	Buy	N/A	HKD 3.70
Sound Global	967 HK	Not rated	Buy	N/A	HKD 10.90

CT Environment: Valuation Methodology Our TP of HKD7.70 is derived from a PEG method to reflect the company's rapid growth prospects in the next couple of years from a small base. We apply a PEG ratio of 0.65x, implying 16%/20% discounts to BEW/CEI, reflecting CTEG's nature as a private player. Our benchmark index is MSCI China.

CT Environment: Risks that may impede the achievement of the target price The major risks to our current TP are: 1)lower-than-expected utilisation at WWT plants and sludge treatment plants; 2) possible equity financing to ensure its expansion strategy; and 3)increasing competition in the industrial WWT and solid waste/sludge treatment industry.

Guangdong Investment: Valuation Methodology Our TP of HKD7.00 for Guangdong Investment (270 HK)is based on SOTP methodology, with separate valuations for its water distribution, property investment, power generation, department store, hotel operations and management businesses given their different business models: 1) Water distribution, power generation, and department stores – we value these three segments using a DCF model, assuming WACCs of 11.6%/10.4%/14.3% (Water and power business are utilities, which have lower WACC vs. department stores), respectively; 2) property investment and hotel management: we value these two segments using an NAV method by applying a discount of 45% to its latest reported NAV, in-line with our China Property Team's assumption for Guangzhou R&F Properties (2777 HK); and 3) Net cash – we value the company's net cash on hand using a P/B method with a discount P/B of 0.80, as we believe GDI cannot utilize its net cash (incl. available-for-sale investments) on hand effectively in the short term. The relative benchmark index for Guangdong Investment is the MSCI China Index.

Guangdong Investment: Risks that may impede the achievement of the target price Upside risks include: 1) value accretive M&A – any significant value accretive M&A happening in the short-term would have a material impact on the company's earnings growth; 2) asset injection – faster-than-expected asset injection would also largely spike the earnings profile of the company; and 3) water/power tariff hike – any unexpected rapid growth in the water/power tariff would lift the company's profitability.

Kangda Env: Valuation Methodology Our TP of HKD3.70 is based on DCF methodology, as in the case of peers BEW and CEI. We discount the future 10 years' cash flow back to 2015F at a WACC of 8.9%, and apply a terminal growth of 2%. The benchmark index for the stock is MSCI China.

Kangda Env: Risks that may impede the achievement of the target price The main risks to our TP include: 1) lower-than-expected capacity addition due to the increasing competition or slow pace in geographic expansion; 2) higher-than-expected unit capex needed, especially in the acquisition market; and 3) unexpected interest rate hike.

Sound Global: Valuation Methodology Our target price of HKD10.90 is derived from a sum-of-the-parts (SOTP) methodology. We value the EPC business at 13.0x P/E (at the stock's historical average since 2006) over FY14F EPS of CNY0.31 (EPC portion) and the BOT business using DCF, assuming a WACC of 8.7% and a terminal growth of 2%. Our benchmark index is MSCI China.

Sound Global: Risks that may impede the achievement of the target price Our target price is subject to our growth assumptions in treatment volumes, tariffs, capacity and EPC ordebooks. Changes in the macro landscape and government regulations over the water industry may result in key changes in our forecasts, and hence our target price. In addition, unexpected increase of finance costs may post downside risk to our TP.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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STOCKS

A rating of **'Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of **'Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of **'Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of **'Suspended'**, indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as **'Not rated'** or shown as **'No rating'** are not in regular research coverage. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies. Benchmarks are as follows: **United States/Europe/Asia ex-Japan**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan:** Russell/Nomura Large Cap.

SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan prior to 21 October 2013

STOCKS

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