

Green development continues

- **Stronger earnings growth in FY21 driven by climb in operation revenue**
- **Reduce, reuse, and recycle to support carbon neutrality**
- **Sector valuation remains attractive despite outperformance in FY21**
- **Top pick: [China Everbright Environment \(257 HK\)](#)**

Expect 12%-27% earnings growth in FY21. We expect most environmental service providers under our coverage to report an earnings growth of 12%-27% in FY21, mainly driven by growth in operational capacity and treatment volume. The exception is China Everbright Greentech (CEG), which is expected to report an earnings decline in FY21 due to a substantial drop in construction revenue and gross margin pressure from higher raw material cost in its biomass business and weaker demand for hazardous waste treatment.

Green development. Looking ahead, although the environmental service sector is not a major beneficiary of China's carbon neutrality plan, the sector can still support the enhancement of waste recycling. In particular, the implementation of waste sorting for household waste treatment and the comprehensive use of solid waste can enhance recycling and help carbon reduction. For the water sector, apart from the utilisation of sewage and sludge, service providers will focus on water recycling and energy efficiency enhancement. As these green developments are less capital intensive, we believe the capex of environmental service providers can continue its downtrend to help improve cash flow.

Top pick. With the exception of CEG, the rest of the environmental service providers under our coverage outperformed HSI in 2021 by 11%-58%. Despite the strong performance, they are trading at a very attractive prospective PE of <5x only. In particular, the valuation of China Everbright Environment, a leading player in the environmental service, of around 4x FY22 PE, has not reflected the growth potential from its emerging businesses, such as eco-recycling, and improvement in cashflow (on PRC accounting standard) from HK\$5.2bn in FY20 to HK\$10bn in one to two years.

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Recommendation & valuation

Company		Price	Mkt Cap	Recom
		Local\$	US\$m	
Beijing Ent Water (371 HK)	HKD	3.12	4,064	BUY
China Everbright Greentech (1257 HK)	HKD	2.72	722	BUY
China Everbright Environment (257 HK)	HKD	5.95	4,697	BUY
China Everbright Water (1857 HK)	HKD	1.85	680	BUY

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK")



FY21 results preview

DBS FY21 estimates

Company	Crncy	Sales	YoY growth	Earnings	YoY growth	Market earnings estimates	DBSV vs. consensus	Comments
Beijing Enterprises Water * (371 HK, BUY)	HK\$m	26,354	3.9%	4,702	12.4%	4,700	0.0%	As BEW continues with its asset-light strategy, capex for comprehensive renovation projects has been reduced significantly. The shortfall in turnover is offset by low-teen growth in sewage services and technical services, resulting in low single digit growth in total turnover. With construction revenue accounting for a lower percentage of total turnover of 48% (FY20: 52%), gross margin should climb 2ppts to 40.4%. This also helped attributable profit to climb around 12%. Operationally, we expect BEW to add around 3m tons of daily capacity to its project portfolio, bringing the total treatment capacity to 42m tons per day. Total treatment volume is estimated to grow 14% to around 5bn tons. With slower capex, we estimate net debt-equity ratio to decline 8ppts to 124%.
China Everbright Greentech (1257 HK, BUY)	HK\$m	8,089	-17.8%	1,159	-22.8%	1,271	-8.7%	We expect CEG's turnover and net profit to decline because of various reasons. First, with a substantial drop in number of biomass projects under construction, construction revenue is expected to decline significantly. Second, weak economic growth led to weak demand for hazardous waste treatment with lower ASP and gross margin. Third, raw material cost for biomass business was also high. Despite these, we expect free cashflow to improve with 1) lower capex of HK\$3bn; 2) sales of Rmb800m asset-backed notes and 3) higher amount of subsidies of Rmb200m received. We estimate net debt-equity ratio to decline 1ppts to 124%.
China Everbright Environment (257 HK, BUY)	HK\$m	53,559	24.8%	7,612	26.5%	7,320	4.0%	Robust earnings growth is underpinned by 1) jump in operational capacity of 42%; 2) 30-40% growth in WTE treatment volume and electricity sales volume; and 3) 25% growth in construction revenue. New project wins will decline but the company is pursuing new areas for growth, such as waste-sorting, kitchen waste treatment, etc. Improvement in cashflow is expected to be substantial, on the back of issue of asset-backed notes, climbing operating revenue and lower capex.
China Everbright Water (1857 HK, BUY)	HK\$m	6,333	11.8%	1,241	21.1%	1,241	0.0%	Robust earnings growth is mainly driven by low-teens growth in treatment volume and tariff hike of 9%. Construction revenue is expected to stay flat. The company has steady deal flow and we expect new project wins to climb >50% to Rmb1.7bn in FY21. More focus will be put in enhancing the management of water resources and water ecology system for the conservation of the water environment where the company will adopt more digitalisation and intelligent system in operation and management.

Source: Companies, DBS HK

China Environmental Service Sector

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*Share price appreciation + dividends

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