

**HONG KONG | ENVIRONMENT | COMPANY RESULTS**

Rating:

**Neutral**

- In H1 2014, the Company recorded revenue of 864 million RMB, up 50% yoy. The gross profit recorded 310 million RMB with a gross margin of 36%, down approximately 4 pts yoy, which was caused mainly by a higher proportion of the construction income. The recorded profit attributable to the owner of the parent company was 124 million RMB, up 17.7% yoy with earnings per share of 0.08 RMB.
- By the end of H1 2014, The pending projects had daily processing capacities of 457,000 tons/day, among which projects with daily processing capacities of 260,000 tons/day would start running by the end of 2014, and the rest projects with daily processing capacities of 197,000 tons/day would be put into use by the end of 2015. It is expected that with the projects constructed, the annual compound growth rate of the Company's processing capacity will remain around 18% for the next three years.
- In July and August, through shares acquisitions, the Company gained running projects' capacities by 240,000 tons/day and the capacities for the projects under construction by 120,000 tons/day. It is expected that the Company will keep the overall growth rate of the running projects at above 30% by means of acquisitions for the next three years, so as to ensure its leading position in the market.
- Currently, the Company has 320 million RMB in cash and 3 billion RMB of bank loans with a debt-to-capital ratio of 72.4% and an average borrowing cost rate of 6.94%, which remain basically the same compared to the same period last year. The IPO of company provided 1.3 billion HKD, therefore the Company's cash for the next three years should be enough in covering the constructions and acquisitions.
- At present, the Company is mainly running BOT and TOT projects. It only did a few acquisitions in H2 and an acquisition last year (the acquisition of Beijing Changsheng). The Company's new projects mainly have been from the acquisitions of other companies and projects for recent two years. We believe that, currently it will be hard for the Company to improve its comprehensive strength and industrial competitiveness when relying on the development strategy of horizontal acquisitions, and the Company's development potential is limited.

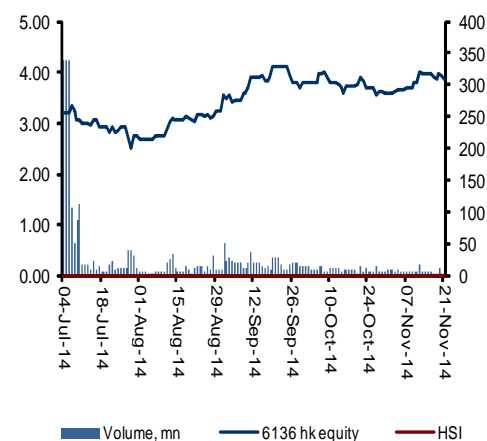
|                           |             |
|---------------------------|-------------|
| <b>Target Price (HKD)</b> | <b>4.05</b> |
| Forecast Dividend (HKD)   | 0.02        |
| Closing Price (HKD)       | 3.88        |
| <b>Potential Upside</b>   | <b>5.0%</b> |

**Company Description**

Kangda International Environmental Company Limited is a leading privately-owned wastewater treatment service provider in China, which offers customers customised and integrated wastewater treatment solutions and services mainly through service concession arrangements under BOT and TOT models. As at 31 December 2013, we had the largest total daily wastewater treatment capacity in operation among privately-owned wastewater investment and operation service providers in China and accounted for approximately 1.0% of the municipal wastewater treatment market in China in terms of daily treatment capacity in operation.

**Company Data**

|                                  |       |
|----------------------------------|-------|
| Raw Beta (Past 2yrs weekly data) | N/A   |
| Market Cap. (HKD bn)             | 8,022 |
| Enterprise Value (HKD mn)        | N/A   |
| 52 week range (HKD)              | 4.23  |

**Major Shareholders**

|                                                     |        |
|-----------------------------------------------------|--------|
| 1. Kangda Holdings Company Limited                  | 52.96% |
| 2. Baring Private Equity Asia V Holding (5) Limited | 19.59% |

**Valuation Method**

PE

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**Key Financial Summary**

| FYE                        | 12/12   | 12/13   | 12/14F  | 12/15F  |
|----------------------------|---------|---------|---------|---------|
| Operating Profit (HKD 000) | 366,969 | 445,372 | 462,308 | 566,641 |
| Net Profit, adj. (HKD 000) | 196,540 | 231,563 | 254,751 | 323,948 |
| EPS, adj. (HKD)            | 0.13    | 0.15    | 0.13    | 0.16    |
| P/E (X)                    | 23.6    | 20.4    | 23.6    | 19.2    |
| BV/PS (HKD)                | 0.74    | 0.89    | 1.28    | 1.42    |
| P/B (X)                    | 4.1     | 3.4     | 2.4     | 2.2     |
| DPS (HKD)                  | 0.00    | 0.00    | 0.02    | 0.03    |
| Div. Yield                 | 0.0%    | 0.0%    | 0.7%    | 1.0%    |

Source: Bloomberg, PSR est.

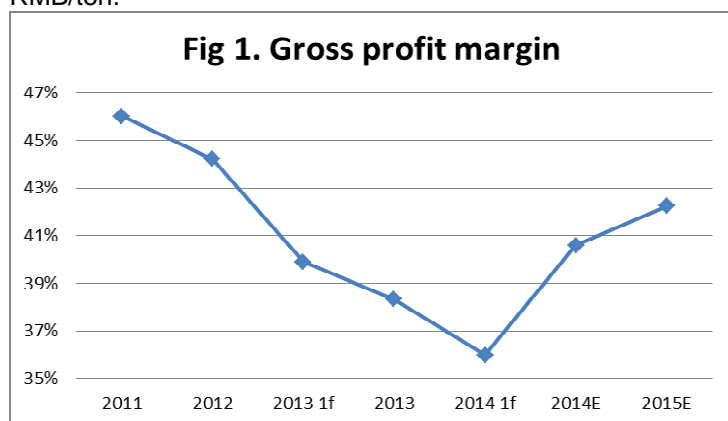
\*All multiples &amp; yields based on current market price

### **The Company's performance grows steadily**

In H1 2014, the Company recorded revenue of 864 million RMB, up 50% yoy. The gross profit recorded 310 million RMB with a gross margin of 36%, down approximately 4 ppts yoy, which was caused mainly by a higher proportion of the construction income. The recorded profit attributable to the owner of the parent company was 124 million RMB, up 17.7% yoy with earnings per share of 0.08 RMB. It can be concluded that the Company's performance had a relatively steady growth.

### **Large-scale constructions of projects**

The Company is the biggest privately-owned sewage treatment enterprise in China. By the end of H1 2014, the Company had total 48 sewage treatment projects, including 33 BOT projects and 15 TOT projects, which were located in 27 cities of 9 provinces in Northeast China, North China and Southeast China, with daily sewage processing capacity of 1,460,000 tons/day. The pending projects had daily processing capacities of 457,000 tons/day, among which projects with daily processing capacities of 260,000 tons/day would start running by the end of 2014, and the rest projects with daily processing capacities of 197,000 tons/day would be put into use by the end of 2015. The construction earning of the Company in H1 was 482 million RMB, up sharply 157% yoy. Eight sewage treatment projects and one water supply project were under construction. It is expected that with the projects constructed, the annual compound growth rate of the Company's processing capacity will remain around 18% for the next three years. The BOT operating revenue was 194 million RMB in H1, up 23.7% yoy. This was mainly due to the increased numbers of projects put into service as well as the increased quantities of sewage treatment. The treatment rate of sewage was 89.68% with an average treating cost of 1.04 RMB/ton.



Source: PSR, Company report

### **The Company concentrates on acquisitions in H2**

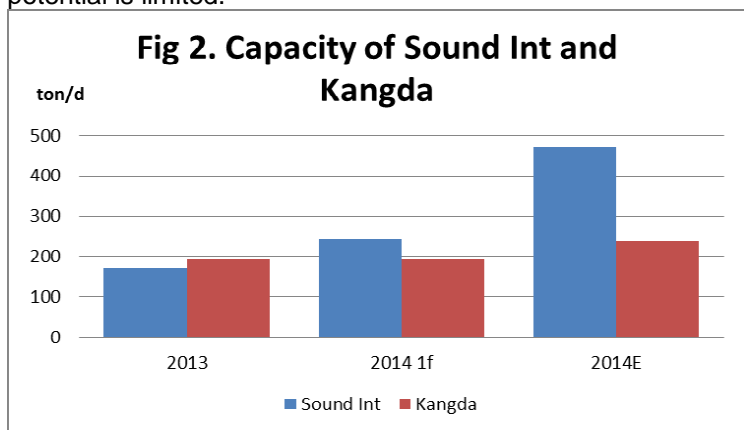
In July and August, through shares acquisitions, the Company gained 90% of the shares of four sewage treatment plants from Puyang County Water Authority and Shandong Central States Industrial Co., Ltd., as well as franchise rights of a BOT and a TOT projects in Suihua, Heilongjiang Province, which increased the running projects' capacities by 240,000 tons/day and the capacities for the projects under construction by 120,000 tons/day. The acquisitions cost total 420 million RMB. It is expected that the Company will keep the overall growth rate of the running projects at above 30% by means of acquisitions for the next three years, so as to ensure its leading position in the market.

### **The financial status is still promising**

Currently, the Company has 320 million RMB in cash and 3 billion RMB of bank loans with a debt-to-capital ratio of 72.4% and an average borrowing cost rate of 6.94%, which remain basically the same compared to the same period last year. The IPO of company provided 1.3 billion HKD, therefore the Company's cash for the next three years should be enough in covering the constructions and acquisitions.

### **The development direction is comparatively monotonous**

At present, the Company is mainly running BOT and TOT projects. It only did a few acquisitions in H2 and an acquisition last year (the acquisition of Beijing Changsheng ). The Company's new projects mainly have been from the acquisitions of other companies and projects for recent two years. Let us look at the biggest privately-owned sewage treatment enterprise—Sound Global Limited (967.HK) for comparison. Sound Global Limited has gained total 14 new projects in H2 2014 by ways of acquisition, bid-winning and government cooperation. The overall sewage processing scale is over 600,000 tons/day, which shows its strong bidding ability and the influences among local governments. And also look at CT Environmental Group Limited (1363.HK) for comparison, who is mainly engaged in processing industrial sewage. Aside of expanding the scale of sewage treatment projects, CT Environmental Group Limited is constantly upgrading the technology of sludge treatment, so as to improve the efficiency of the whole sewage treatment process as well as the profit ability. Therefore, we believe that, currently it will be hard for the Company to improve its comprehensive strength and industrial competitiveness when relying on the development strategy of horizontal acquisitions, and the Company's development potential is limited.



Source: PSR, Company report

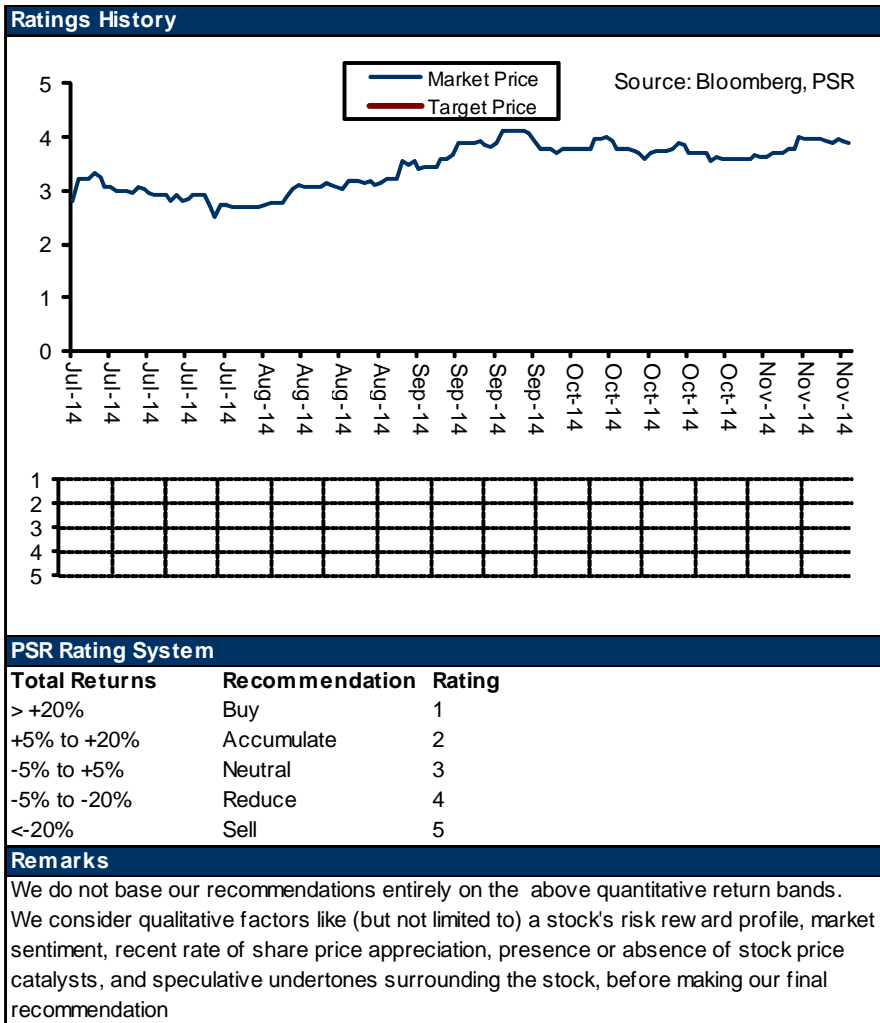
### **Valuation**

The Company is well funded for the moment, the new projects under construction are sufficient to ensure a steady growth of the earnings for the next two years. However, in the long run, the development potential of the Company is limited due to the simple development strategy of the Company at present. We have made a comparison between the valuation levels of other three sewage treatment companies listed in Hongkong and thus given the Company a 12 months target price of 4.05 HKD, which is equal to a P/E ratio of 20 times for 2015. Therefore the Company's investment rating is "Neutral".

For Financial Summary at the end of report

| FYE                                              | FY11             | FY12             | FY13             | FY14F            | FY15F            |
|--------------------------------------------------|------------------|------------------|------------------|------------------|------------------|
| <b>Valuation Ratios</b>                          |                  |                  |                  |                  |                  |
| P/E (X)                                          | 30.6             | 23.6             | 20.4             | 23.6             | 19.2             |
| P/B (X)                                          | 6.7              | 4.1              | 3.4              | 2.4              | 2.2              |
| Dividend Payout ratio                            | 0.00%            | 0.00%            | 0.00%            | 15.38%           | 18.75%           |
| Dividend Yield                                   | 0.00%            | 0.00%            | 0.00%            | 0.65%            | 0.98%            |
| <b>Per share data (RMB)</b>                      |                  |                  |                  |                  |                  |
| EPS, reported                                    | 0.10             | 0.13             | 0.15             | 0.13             | 0.16             |
| EPS, adj.                                        | 0.10             | 0.13             | 0.15             | 0.13             | 0.16             |
| DPS                                              | 0.00             | 0.00             | 0.00             | 0.02             | 0.03             |
| BVPS                                             | 0.46             | 0.74             | 0.89             | 1.28             | 1.42             |
| <b>Growth</b>                                    |                  |                  |                  |                  |                  |
| Revenue                                          | -                | 36.0%            | 34.1%            | 12.3%            | 12.0%            |
| Operating income                                 | -                | 28.8%            | 21.4%            | 3.8%             | 22.6%            |
| Net Income, adj.                                 | -                | 25.3%            | 17.8%            | 10.0%            | 27.2%            |
| <b>Key Ratios</b>                                |                  |                  |                  |                  |                  |
| Current ratio                                    | 121.39%          | 155.51%          | 144.31%          | 147.00%          | 113.70%          |
| Gross profit margin                              | 46.00%           | 44.21%           | 38.32%           | 40.59%           | 42.24%           |
| Net profit margin                                | 21.35%           | 19.67%           | 17.28%           | 16.93%           | 19.22%           |
| Return on average assets                         | -                | 5.83%            | 5.39%            | 4.62%            | 4.81%            |
| Return on average equity                         | -                | 21.90%           | 18.91%           | 13.09%           | 12.02%           |
| Liability/asset                                  | 76.00%           | 71.21%           | 71.30%           | 59.55%           | 60.30%           |
| <b>Income statement (thousand RMB)</b>           |                  |                  |                  |                  |                  |
| <b>Operating revenue</b>                         | <b>734,886</b>   | <b>999,315</b>   | <b>1,339,679</b> | <b>1,504,900</b> | <b>1,685,260</b> |
| Cost of good sell                                | (396,821)        | (557,537)        | (826,258)        | (894,128)        | (973,480)        |
| <b>Gross profit</b>                              | <b>338,065</b>   | <b>441,778</b>   | <b>513,421</b>   | <b>610,772</b>   | <b>711,780</b>   |
| Other net profit                                 | 22,219           | 10,129           | 48,455           | 19,630           | 19,630           |
| Administrative expenses                          | (68,283)         | (73,631)         | (103,906)        | (158,648)        | (154,378)        |
| <b>Operating profit</b>                          | <b>284,923</b>   | <b>366,969</b>   | <b>445,372</b>   | <b>462,308</b>   | <b>566,641</b>   |
| Interest expense                                 | (99,402)         | (133,900)        | (167,698)        | (144,564)        | (159,020)        |
| <b>Profit before tax</b>                         | <b>185,521</b>   | <b>233,069</b>   | <b>281,679</b>   | <b>321,449</b>   | <b>411,326</b>   |
| Income tax                                       | (28,631)         | (35,696)         | (49,050)         | (65,698)         | (86,378)         |
| Effective income tax rate                        | 15.43%           | 15.32%           | 17.41%           | 20.44%           | 21.00%           |
| <b>Net profit for the period</b>                 | <b>156,890</b>   | <b>197,373</b>   | <b>232,629</b>   | <b>255,751</b>   | <b>324,948</b>   |
| Minority interest                                | 0                | 833              | 1,066            | 1,000            | 1,000            |
| <b>Net profit attributable to equity holders</b> | <b>156,890</b>   | <b>196,540</b>   | <b>231,563</b>   | <b>254,751</b>   | <b>323,948</b>   |
| Dividend paid                                    | 0                | 0                | 0                | 40,000           | 60,000           |
| <b>Balance Sheet (thousand RMB)</b>              |                  |                  |                  |                  |                  |
| <b>Cash or cash equivalent</b>                   | <b>245,774</b>   | <b>543,754</b>   | <b>275,562</b>   | <b>546,417</b>   | <b>300,529</b>   |
| Account receivable                               | 428,155          | 541,868          | 714,398          | 836,786          | 920,465          |
| Inventory                                        | 5,214            | 5,313            | 3,108            | 4,002            | 4,002            |
| Receivables under service concession arrangement | 1,486,887        | 1,828,396        | 2,571,274        | 3,612,020        | 4,614,424        |
| PPE                                              | 68,210           | 73,016           | 80,303           | 80,506           | 80,506           |
| Other non-current assets                         | 8,212            | 75,106           | 69,053           | 83,872           | 83,872           |
| <b>Total Assets</b>                              | <b>2,869,617</b> | <b>3,876,800</b> | <b>4,713,807</b> | <b>6,311,515</b> | <b>7,151,710</b> |
| Cash payable                                     | 377,077          | 407,695          | 537,452          | 694,128          | 763,541          |
| Short term loan                                  | 662,412          | 768,171          | 785,341          | 976,679          | 1,269,683        |
| Other current liability                          | 36,605           | 46,088           | 58,371           | 53,723           | 53,723           |
| Long term loan                                   | 1,006,827        | 1,415,632        | 1,802,048        | 1,820,503        | 2,011,528        |
| Other non-current liability                      | 98,109           | 123,113          | 177,865          | 213,742          | 213,742          |
| <b>Total Liabilities</b>                         | <b>2,181,030</b> | <b>2,760,699</b> | <b>3,361,077</b> | <b>3,758,775</b> | <b>4,312,217</b> |
| Shareholders' equity                             | 686,137          | 1,108,818        | 1,340,381        | 2,552,740        | 2,839,493        |
| Minority interest                                | 2,450            | 7,283            | 12,349           | 13,278           | 13,278           |
| <b>Total shareholders' equity</b>                | <b>688,587</b>   | <b>1,116,101</b> | <b>1,352,730</b> | <b>2,552,740</b> | <b>2,839,493</b> |
| Total shareholders' equity and liabilities       | 2,869,617        | 3,876,800        | 4,713,807        | 6,311,515        | 7,151,710        |

Source: PSR



**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

| Total Return | Recommendation | Rating | Remarks                                      |
|--------------|----------------|--------|----------------------------------------------|
| >+20%        | Buy            | 1      | >20% upside from the current price           |
| +5% to +20%  | Accumulate     | 2      | +5% to +20% upside from the current price    |
| -5% to +5%   | Neutral        | 3      | Trade within $\pm$ 5% from the current price |
| -5% to -20%  | Reduce         | 4      | -5% to -20% downside from the current price  |
| <-20%        | Sell           | 5      | >20% downside from the current price         |

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

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