ELL ENVIRONMENTAL HOLDINGS LIMITED

RESEARCH REPORT

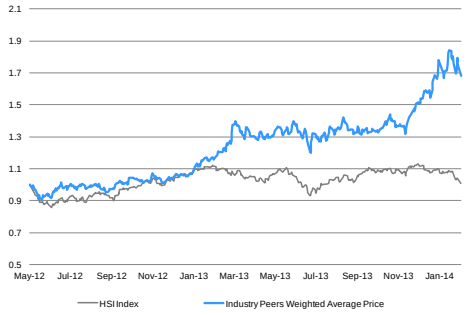
Key Themes

ELL Environmental Holdings Ltd. (ELL) is expected to benefit from the PRC government's target to reduce industry pollution, manage municipal pollution and recover rural rivers. The action plan for water pollution control is expected to be published in 2014, which aims to improve the quality of China's water by 30-50% through investments in technologies such as wastewater treatment.

Group Profile

Founded in 2002, the Group entered into the first BOT agreement with Haian County Construction Bureau, for the construction of its first municipal wastewater treatment project in Haian, Nantong City, Jiangsu Province. It expanded into industrial wastewater treatment in 2003, with the BOT agreement from Rugao ETDZ Administrative Committee. Later in 2013, it acquired Rugao Honghao, and further diversified into heavy metal wastewater treatment. As of today, total treatment capacity amounted to 83,500 tons per day.

HK Listed Peers Performance vs. HSI



Source: Bloomberg as of August 27,2014

Basic Share Information

Adjusted Equity Value (HK$ mn)	430 – 501
Valuation Range (2014 P/E)	12x – 14x

* **Professional fees is excluded from the adjusted net profit**

Major Shareholders

Everbest Environmental	62.5%
Wealthy Sea	37.5%

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RESEARCH REPORT

"Premium Margin Wastewater Treatment Play"

"ELL is at a sweet spot to gain from the Chinese government's target to reduce water pollution. Albeit operating on a smaller scale, it enjoys premium margins as a niche-player in county-level wastewater treatment projects. It diversified into the treatment of heavy metal wastewater with the acquisition of Rugao Honghao, where treatment margins are much higher than municipal and general industrial wastewater, in 2013. We estimate a fair equity value of HK$430-501mn, at 12-14x 2014 P/E, based on ~36% to 45% discount to the peers average of 22.0x."

Early Mover Advantage– ELL has accumulated almost ten years of operating history in the treatment of wastewater since the commencement of its first project, the Haian Hengfa Facility in 2005. It is amongst the earliest providers of customized and integrated wastewater treatment services in Nantong city, Jiangsu Province. Its other two projects were results of invitations by local government authorities to negotiate a BOT agreement without having to undergo competitive tender process. **This suggests that ELL's existing customers would likely invite ELL for competitive tender for new projects in the same region in the future. The switching cost could be high for customers because the BOT agreements do not expressly grant any termination rights to customers**

Above-industry Average Margins– ELL enjoyed high gross and operating margins of over 75% and 70% respectively in 2011-13, which were the highest among industry peers with gross and operating margins ranging from 30-67% and 13-58% respectively (see Figure 19). We believe this is attributable to guaranteed revenue under the BOT business model, absence of construction revenue and depreciation expenses.

Upward Adjustments on Wastewater Treatment Tariff– Tariff rate adjustments usually take place every three to four years due to inflation as an industry norm. For, ELL we expect the next tariff adjustment to come in 2015, with an estimated increase of ~3% for Haian Hengfa and Rugao Hengfa and another 3% hike in 2019E (see Figure 20). It should be easy to gain approval for tariff adjustment especially after the facility upgrade works carried out in 2014.

Expansion Beyond Nantong City– ELL has a proven track record of operating wastewater treatment facilities in China, and this can help ELL to easily replicate the same business model in other cities beyond the Jiangsu province. We believe this can be supported by ELL's internal funds from its operating cash inflow, as well as higher leverages through bank financings since ELL has been in a net cash position for the past three financial years.

Fair Equity Value Ranges HK$430-501mn at 12-14x 2014E P/E– We derive our estimate of the fair equity value for ELL based on comparable P/E analysis on HK and PRC listed companies. **Since the scale of ELL's wastewater treatment capacity is smaller than its peers, we believe it is justified to apply a 36% to 45% trading discount to the peers' average of 22.0x, thus arriving at a fair equity value range of HK$430mn to HK$501mn based on 2014E P/E of 12x-14x for ELL. It represents** ~14% to 26% discount to the value derived from our 10-year DCF analysis.

Forecasts and Valuations	Dec 12	Dec 13	Dec 14E	Dec 15E	Dec 16E
Total Revenue (HKDmn)	**47**	**65**	**91**	**116**	**71**
Revenue Growth	*5.3%*	*38.8%*	*40.3%*	*26.5%*	*-38.7%*
EBIT (HKDmn)	**34**	**50**	**32**	**44**	**51**
EBIT Growth	*9.9%*	*46.5%*	*-36.3%*	*36.5%*	*17.0%*
Net Profit (HKDmn)	**25**	**32**	**12**	**31**	**37**
Net Profit Growth	*6.2%*	*27.0%*	*-61.8%*	*149.6%*	*19.5%*
***Adjusted Net Profit (HKDmn)**	**26**	**33**	**36**	**31**	**37**
Adjusted Net Profit Growth	*5.2%*	*30.8%*	*7.2%*	*-13.9%*	*19.5%*
Fair Equity Value @ 12x P/E	***306***	***401***	***430***	***370***	***442***
@ 13x P/E	**332**	**434**	**466**	**401**	**479**
@ 14x P/E	**358**	**468**	**501**	**432**	**516**

Source: Company data, Quam estimates
***Adjusted Net Profit exclude professional fees expenses, calculation of fair equity value is based on adjusted net profit.**

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1.1 Fair Equity Ranges at 12x to 14x 2014E P/E – We derive our estimate of the fair equity value for ELL based on comparable P/E analysis on HK and PRC listed companies. We crosscheck our valuation using the DCF analysis since ELL is under long-term concession contracts with high revenue visibility.

ELL's fair equity value estimated at HK$430-501mn

Overall, the HK-listed and PRC-listed peers are trading at an average 2014E P/E of 22.0x. Among them, the market leaders such as China Everbright International (257 HK) and Beijing Enterprises Water (371 HK) trade at 2014E P/E of 27.6x and 28.2x respectively, whereas, medium-sized players such as Sound Global (895 HK) trades at 15.9x P/E**. Since the scale of ELL's wastewater treatment capacity is smaller than its peers, we believe it is justified to apply a 36% to 45% trading discount to the peers' average of 22.0x, thus arriving at a fair equity value range of HK$430mn to HK$501mn based on 2014E P/E of 12x-14x for ELL.**

Figure 1: Valuations and Comparables

Name	Ticker	Mkt Cap (bn HK$)	Currency	Last Price	2014 P/E (x)	2015 P/E (x)	PEG (x)	Sales growth (%)	Op Profit Margin (%)	Cap Ex/ Sales (x)	ROIC (%)	ROA (%)	Dvd Yield (%)	Net Gearing (%)	EV/ EBITDA (X)
HK-listed															
Dongjiang Environmental	895 HK	12.67	HKD	30.3	30.2	19.1	0.6	4.4	13.3	20.2	6.7	6.5	N/A	19%	N/A
Sound Global	967 HK	11.44	HKD	7.8	15.9	12.1	0.7	18.4	24.5	0.2	8.8	5.4	N/A	-9%	11.9
China Everbright Int'l	257 HK	48.42	HKD	10.8	27.6	21.2	1.2	56.0	39.0	1.1	8.9	7.0	0.9	-18%	21.5
Beijing Enterprises Water	371 HK	46.34	HKD	5.4	28.2	22.1	1.0	71.9	26.7	0.7	4.3	2.9	1.0	-87%	34.2
China Water Affairs	855 HK	3.99	HKD	2.9	11.0	N/A	N/A	22.0	25.7	30.1	5.0	2.2	1.8	-57%	9.2
CT Environmental	1363 HK	9.24	HKD	6.4	28.3	25.3	1.0	26.3	58.2	27.1	17.1	14.8	0.5	-14%	30.7
Guangdong Investment	270 HK	57.29	HKD	9.2	14.8	14.1	N/A	3.3	50.2	3.2	9.4	10.7	2.6	12%	9.7
Tianjin Capital Environ.	1065 HK	12.91	HKD	5.4	21.1	18.6	N/A	4.5	35.5	46.5	5.5	2.6	1.9	-68%	N/A
Dynagreen Environmental	1330 HK	4.34	HKD	4.2	25.3	15.7	N/A	4.6	25.9	0.4	8.0	5.2	0.0	-100%	16.0
Kangda International Environ.	6136 HK	6.43	HKD	3.1	17.0	13.3	N/A	34.1	33.2	0.9	9.5	5.4	0.0	-1.8	16.9
Average		**21**			**22**	**18**	**1**	**25**	**33**	**13**	**8**	**6**	**1**	**-1**	**19**
A-share listed															
Chongqing Water Group	601158 CH	31.37	CNY	6.5	12.6	12.2	N/A	0.9	35.4	12.7	N/A	9.3	N/A	-0.8%	12.5
Beijing Water Business	300055 CH	8.63	CNY	37.7	36.3	28.7	1.1	33.0	17.9	18.5	N/A	5.7	N/A	59%	39.9
Beijing Originwater Techno	300070 CH	41.13	CNY	38.4	26.4	19.0	0.6	75.3	27.7	6.4	N/A	12.3	N/A	21%	35.2
Beijing Capital Co. Ltd.	600008 CH	18.46	CNY	8.4	23.1	19.7	N/A	24.1	20.7	34.4	N/A	2.3	N/A	-75%	18.3
Jiangxi Hongcheng Waterworks	600461 CH	3.92	CNY	11.9	18.8	17.4	M/A	13.7	19.9	29.2	N/A	2.5	N/A	-1.1	10.6
Average		**21**			**23**	**19**	**1**	**29**	**24**	**20**	**N/A**	**6**	**N/A**	**0**	**23**
Average of all		21			22	18	1	26	30	15	8	6	1	0	21

Source: Bloomberg as of Aug 27,2014, Quam Research

Figure 2: Equity Valuation

Equit Valuation	2013	2014E	2015E
***Adjusted Net Profit (HKD mn)**	33.4	35.8	30.8
P/E (x)			
9	300.6	322.4	277.5
10	334.0	358.2	308.3
11	367.5	394.0	339.2
12	400.9	429.8	370.0
13	434.3	465.6	400.8
14	467.7	501.4	431.7
15	501.1	537.3	462.5
16	534.5	573.1	493.3
17	567.9	608.9	524.2

Source: Quam Estimate

**Adjusted Net Profit excluded the impact from professional fees, which is a non-tax deductible expenses and one-off in nature.*

14% to 26% discount to DCF value

1.2 DCF Valuation – The fair equity value range derived from our comparable PE analysis above represents ~14% to 26% discount to the value of HK$581mn, derived from our 10-year DCF analysis. Our DCF analysis is based on a 11.2% WACC and a terminal growth rate of 1.0%.

Figure 3: DCF Valuation

Assumptions		Benchmark basis
Beta	0.9	Average Beta of HK listed waste treatment companies
Market premium (rm-rf)	13.2%	HS Index 4-yr historical return (26/8/10 - 26/8/14) YTD average
Risk free rate (rf)	2.1%	HKMA Exchange Fund Notes 10 yr
Cost of equity (re)	13.9%	
Cost of debt (rd)	5.9%	Average of its borrowing rate from the USD and PRC loan
MV (equity) (HK$mn)	$333	
MV (MI)	28.5	
MV (preference share)		
Debt	-	
Total	$362	
E/ (D+E+MI+P)	70%	
MI/ (D+E+MI+P)	0%	
P/(D+E+MI+P)	0%	
D/ (D+E+MI+P)	30%	
Country risk premium	0%	
Terminal growth (g)	1.0%	
WACC	11.2%	

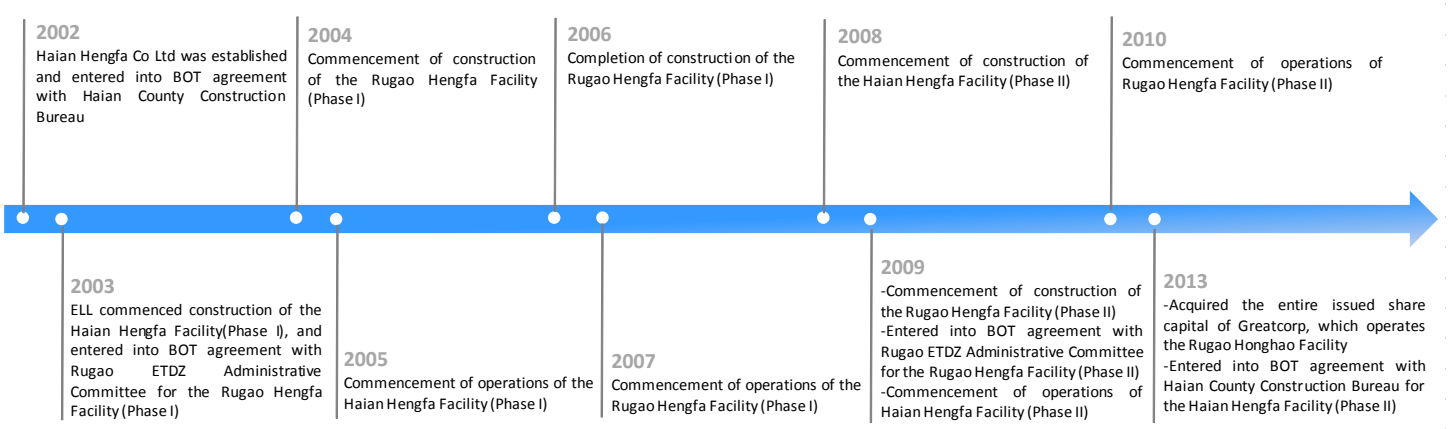
DCF	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
WACC @ 11.2%										
FCF (HK$mn)	(34.6)	(12.8)	52.6	35.8	36.1	37.4	37.8	37.6	39.8	37.8
Discount Factor	0.90	0.81	0.73	0.65	0.59	0.53	0.48	0.43	0.38	0.35
Discounted FCF (HK$mn)	(31.1)	(10.4)	38.2	23.4	21.2	19.8	18.0	16.1	15.3	13.1
Present value of estimated FCF (HK$mn)	124									
Terminal Value (HK$mn)	374									
Enterprise Value (HK$mn)	498									
+ Cash & Cash Equivalent	121									
- Debt	10									
- Minority Interest	29									
Equity Value	**581**									

Source: Quam Estimate

2. Business Overview

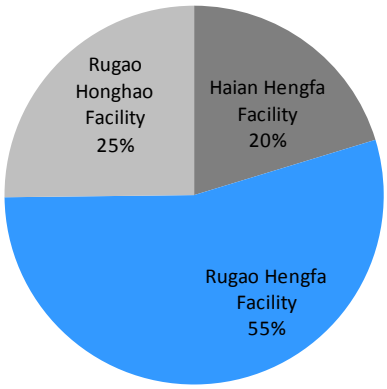
Established in 2002, ELL Environmental Holdings Limited (ELL) is a one-stop provider of wastewater treatment services for municipal, industrial and heavy metal wastewater based in Jiangsu Province, using the "Build-Operate-Transfer" (BOT) business model. As at the end of May, 2014, ELL was operating three plants with a total wastewater treatment capacity of 83,500 tons/day (tpd) under a minimum guaranteed wastewater treatment volume by its customers. ELL's customers are mainly government partners, namely the Haian County Construction Bureau and Rugao ETDZ Administrative Committee. Its revenue is derived from construction services, operation services from water treatment facilities and finance income (the imputed interest income on receivables under service concession arrangement).

Figure 4: Roadmap



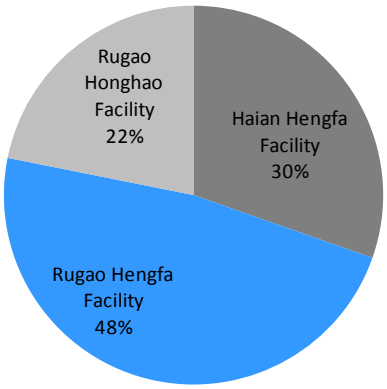
Source: Company, Quam Securities

Figure 5: Breakdown of Revenue by Facilities - 2013



Source: Company, Quam Securities

Figure 6: Breakdown of Revenue by Facilities–Jan-May 2014



Source: Company, Quam Securities

Figure 7: Projects in Operation (as of May 2104)

Construction	Commencement Date		Name of Projects	Province	Location	Type	Industry		Service concession period	Expansion Format	Investment / consideration (HKD mn) (up to May 31, 2014)	Land Area (m2)	ELL Stake	Designed Capacity (tons/ day)
			BOT Projects											
2002	12/18/2002	BOT	Haian Hengfa - Phase I	Jiangsu	Haian, Nantong City	M	N/A	Wastewater treatment	34 yrs till 2036	Greenfield	21.8	Combined	70%	20,000
2009	11/26/2013		Haian Hengfa - Phase II			M	N/A	Wastewater treatment	22.5 yrs till 2036	Greenfield	42		70%	20,000
			Sub-total								**63.8**	**33,319**		**40,000**
2004	2/7/2007	BOT	Rugao Hengfa - Phase I	Jiangsu	Rugao ETDZ, Rugao City	M&I (~95% I, 5-10% M)	N/A	Wastewater treatment	28 yrs till 2035	Greenfield	28.9	Combined	100%	20,000
2010	4/29/2010		Rugao Hengfa - Phase II			M&I (~95% I, 5-10% M)	N/A	Wastewater treatment	25 yrs till 2035	Greenfield	61		100%	20,000
			Sub-total								**89.9**	**40,308**		**40,000**
2010	11/15/2011	BOT	Rugao Honghao	Jiangsu	Rugap ETDZ, Rugao City	I	Heavy Metal	Wastewater treatment	28 yrs till 2039	Acquisition	62.6	19,333	100%	3,500
			TOTAL								**216.3**	**92,960**		**83,500**

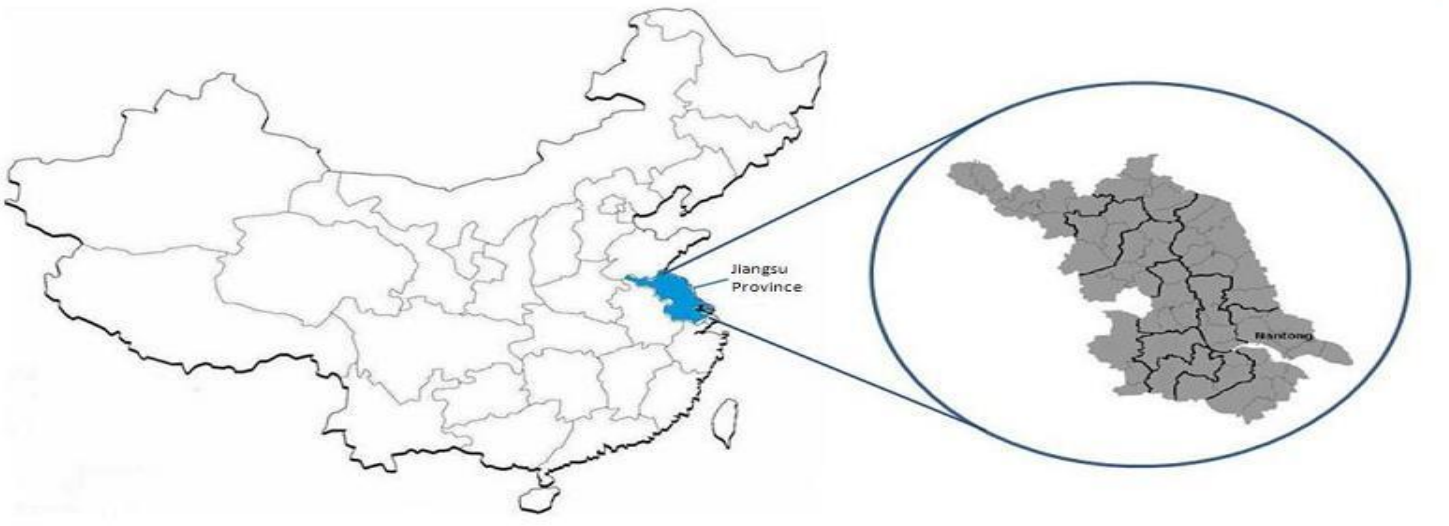
Source: Company data, Quam Securities

2.1 Operating Plants – ELL currently has three wastewater treatment facilities in operation in Jiangsu Province, namely Haian Hengfa Municipal Wastewater Treatment Facility, Rugao Hengfa Municipal and Industrial Wastewater Treatment Facility and Rugao Honghao Heavy Metal Wastewater Treatment Facility. The total wastewater treatment capacity is 83,500 tpd, all of which are at a relatively early stage of their concession periods. The number of years for the concession period of the facilities ranges from 22.5 to 34 years.

ELL owns 70% stake in Haian Hengfa Facility

2.1.1 Haian Hengfa Facility – Haian Hengfa Facility, the first wastewater treatment facility of ELL, commenced operations in 2005. It provides municipal wastewater treatment services to the residents of Haian County in Nantong City, with a site area of ~33,319m². Under the BOT agreement, ELL's client is the Haian County Construction Bureau. The facility is 70% owned by ELL and the remaining 30% is owned by the Haian Construction Development Investment. By 2009, ELL had expanded the facility and doubled the wastewater treatment capacity to 40,000 tpd. ELL commenced upgrade works on the facility in Mar 2014, in order to achieve a higher water standard. The upgrade works are expected to complete in Sept 2014. The facility treated 3.5mn tons of wastewater and reached a utilization rate of 56.9% for the first five months of FY2014.

Figure 8: Nantong City Location Map



Source: Quam Securities

2.1.2 Rugao Hengfa Facility – Rugao Hengfa Facility is located in the Rugao ETDZ, a state-level economic and technological development zone in Rugao city, with a site area of ~40,308m². Under the BOT agreement, ELL's customer is the Rugao ETDZ Administrative Committee. The Facility commenced operations in Feb 2007, treating a mixture of municipal and industrial wastewater discharged by households living nearby and factories operating in the Rugao ETDZ. ELL expanded to double its wastewater treatment capacity to 40,000 tpd in May 2010. The company plans to

commence upgrade works on the facility in Aug 2014, in order to achieve a higher water standard. The upgrade is expected to complete in Dec 2014. The facility treated 3.2mn tons of wastewater and reached a utilization rate of 52.4% for the first five months of FY2014.

Figure 9: Haian Hengfa Facility

Source: Company website, Quam Securities

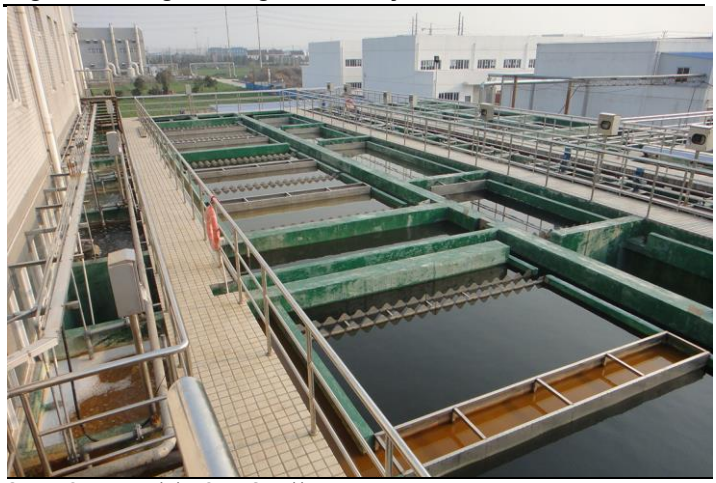
Figure 10: Rugao Hengfa Facility

Source: Company website, Quam Securities

Rugao Honghao Facility is designed to treat heavy metal wastewater

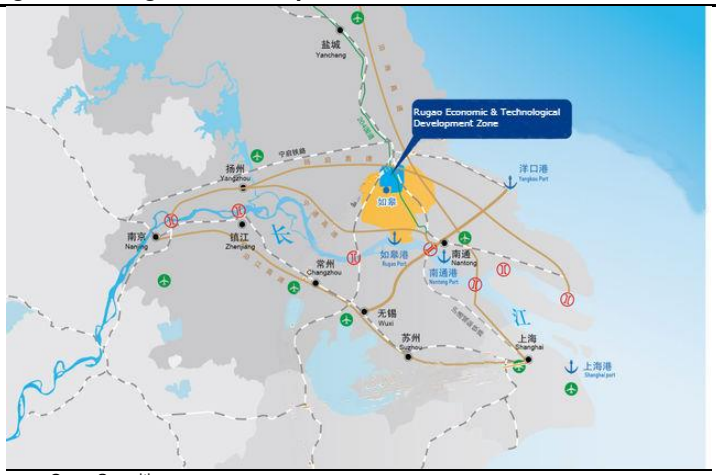
2.1.3 Rugao Honghao Facility – Rugao Honghao Facility is also located in the Rugao ETDZ with a site area of ~19,333 m². The facility, which commenced operations in Dec 2011, was designed specifically to treat heavy metal wastewater discharged by factories operating in the Rugao ETDZ, with total constructed capacity of 3,500 tpd. The facility treated 18,682 tons of wastewater, marking utilization rate at 3.5% for the first five months of FY2014. The low utilization rate was because the local government had not been able to supply sufficient wastewater to the facility for treatment. The Rugao Honghao Facility was developed to treat wastewater discharged from the Electronic, Electrical and Mechanical Industrial Park (EEM Industrial Park) in the Rugao ETDZ. The EEM Industrial Park is still in its early stage, and the number of factories operating in the EEM Industrial Park was lower than anticipated.

Figure 11: Rugao Honghao Facility



Source: Company website, Quam Securities

Figure 12: Rugao ETDZ Map



Source: Quam Securities

2.2 BOT Business Model & Project Management Process

Payments are received only after the commencement of operations

BOT Business Model - Under the BOT project model, the government authority usually grants the project company a concessionary right to build and then operate the facility for a specific period. Upon the expiry of the concession period, the company is required to transfer the facility to the local government authorities for nil consideration. The land to carry out such operations is provided by the local government authority. During the concession period, the project company is normally responsible for designing, constructing, operating and maintaining the facility as well as financing its construction. In return, the project company is granted the exclusive right to carry out operations for service payments, which includes a guaranteed minimum tariff regardless of the actual volume of wastewater treated by the wastewater treatment facility, which guarantees the company a certain level of cash payment and helps the operator to recover its investment. Under a BOT arrangement, payments are received only after the commencement of operations and paid on a monthly basis. However, the company recognizes revenue during both the construction phase and operational phase. Construction revenue is estimated on a cost-plus basis with reference to the prevailing market rate of gross margin, and is recognized on the percentage-of-completion method. Operation revenue is recognized when the relevant service is rendered. If necessary, the payments can be adjusted according to the price adjustment formula included in the BOT agreement.

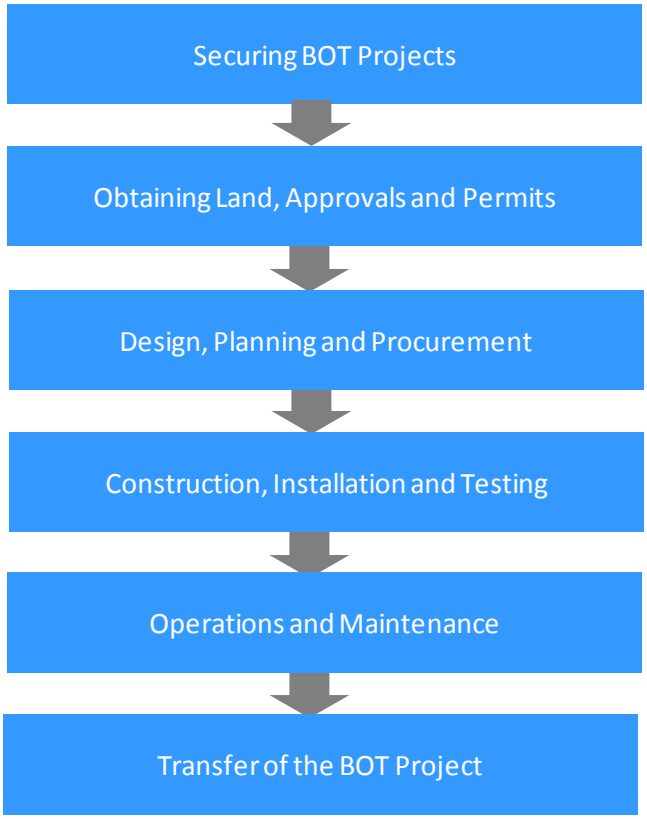
Project Financing – As at 31 May 2014, the total investment costs incurred for the three existing facilities were ~RMB199.7mn. The construction and initial investment costs were funded entirely through shareholders' loans. The day-to-day operations of each facility were mainly funded by its own cash flow and cash reserves. If any of the three facilities requires funding, the BOT agreements allow funding to be secured by a pledge of the respective wastewater treatment concessions.

ELL have not participated in any tender processes up to 31 May 2014

Project Management Process – Project management processes can be categorized into the following stages: (i) Securing suitable BOT projects: For each of ELL's existing wastewater treatment projects, ELL was invited by the relevant local government authority or administrative committee to negotiate a basis on which ELL would provide wastewater treatment services. (ii)Obtaining the necessary approvals and permits: Once the company has entered into a formal BOT agreement, it will liaise with government authorities or committees to obtain land use rights for suitable land parcels for developing the wastewater treatment facility and all the necessary approvals and permits. (iii)Design, planning and procurement: The company will hire an appropriate design consultant or institute, which will jointly prepare design proposals and plans to be discussed with the local government authorities. When the design and implementation plan have been approved by the relevant government authorities, the company begins procuring equipment, instruments and the necessary parts needed for construction and operation. (iv)Construction, Installation and testing: The company normally hires qualified contractors to construct the facilities as well as install and test relevant equipment, instruments and systems. After construction and installation, the wastewater facility is tested by the relevant environmental protection bureau to ensure that it meets the required quality standards and specifications. (v)Operation and maintenance: The company commences operation according to the required specifications as prescribed by the relevant BOT agreements, and is responsible for the maintenance and repair costs of the wastewater treatment facilities. (vi)Transfer of the BOT project: Upon the expiry of the concession period, the company is required to transfer the wastewater treatment facilities to the local government authorities for nil consideration according to the terms of the BOT agreements.

Figure 13: Flowchart of ELL's Project Management Process for BOT Projects

The construction phase usually takes 9 to 24 months



Source: Company, Quam Securities

2.3 Customers

ELL's customers are Haian County Construction Bureau and Rugao ETDZ Administrative Committee, which are the respective government authority and administrative committee in Nantong city with which ELL has entered into the BOT agreements. Haian Hengfa receives payment from the Haian County Construction Bureau, while both Rugao Hengfa and Rugao Honghao receive payments from the Rugao ETDZ Administrative Committee. For the five months ended 31 May 2014, the revenue from the Haian County Construction Bureau and the Rugao ETDZ Administrative Committee amounted to ~HK$10.8mn and ~HK$24.7mn, accounting for ~30.4% and 69.6% of total revenue respectively.

2.4 Real Property

As at 31 May 2014, ELL owns the land use rights where the Haian Hengfa Facility was constructed, with a land grant period that expires on 18 March 2031. ELL did not own any land use rights to any other land. The land use rights and building ownership rights underlying such facility are required to be transferred to Haian County Construction Bureau upon the expiry of the BOT agreements. All the properties occupied by ELL at the three wastewater treatment facilities are required to be transferred back to the local government authorities upon expiry of the relevant concession periods.

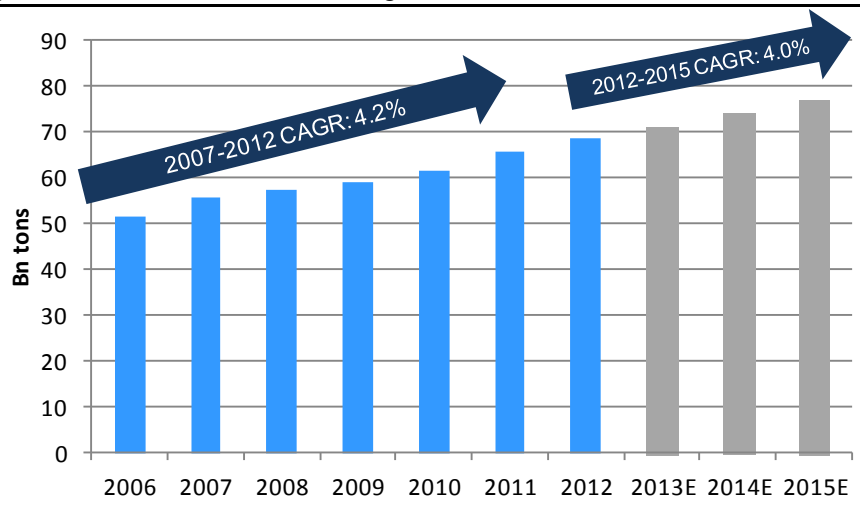
3. Industry Overview

3.1 Wastewater Discharged in China

The volume of wastewater discharged increased over the years along with the growth in water consumption. The total volume of wastewater discharged throughout China grew at a 5-year CAGR of 4.22% from 2007 to 2012. According to the Ministry of Water Resources, 68.5bn tons of wastewater was discharged in 2012. CBRE estimates that total wastewater discharge is projected to reach 77bn tons by 2015, driven by a continued net increase in water consumption caused primarily by urbanization and China's commitment to an investment-led growth strategy.

Total wastewater discharged is estimated to grow at 4% CAGR for 2012-2015E

Figure 14: Total Wastewater Discharged Forecasts



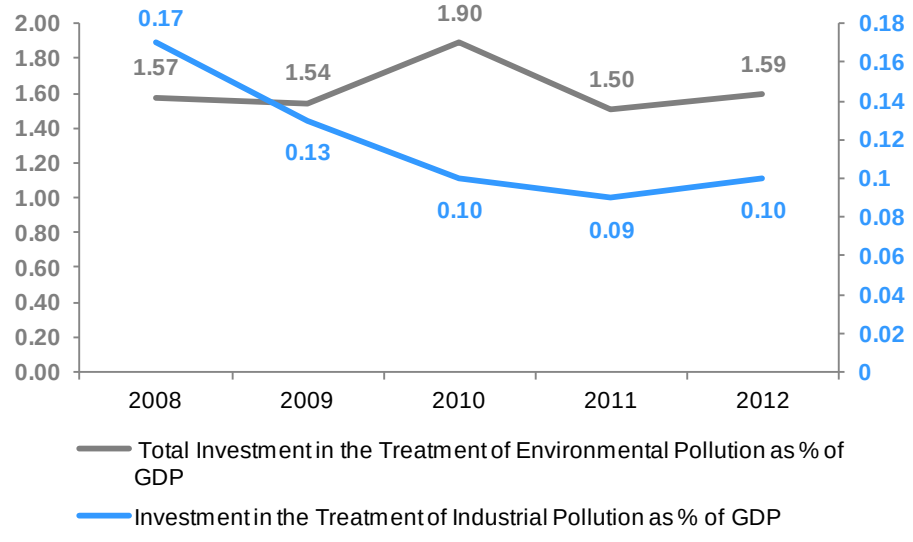
Source: National Bureau of Statistics, CBRE, Quam Securities

The market size of industrial sewage treatment market will rise by ~18% p.a., compared to ~8-9% p.a. for municipal sewage treatment in the coming two years

3.2 Municipal and Industrial Sewage Treatment Market – China's total investments in the treatment of environmental pollution accounted for only 1.59% of its GDP in 2012, compared with ~2.3% in the EU and 2.8% in the U.S. The investment in the treatment of industrial pollution in China was as low as 0.1% of its GDP in 2012, compared with 1.8% in the EU (see Figure 15). This suggests that there is a significant under-investment in the treatment of industrial pollution in China, which underlines a huge potential market. According to the estimates by Ernst & Young, the market size of the industrial sewage treatment market will undergo a double-digit increase in 2014-2015 at ~18% p.a. (see Figure 16), compared to ~8-9% p.a. increase for municipal sewage treatment market.

China is heavily under-invested in the treatment of environmental pollution compared to the EU and U.S.

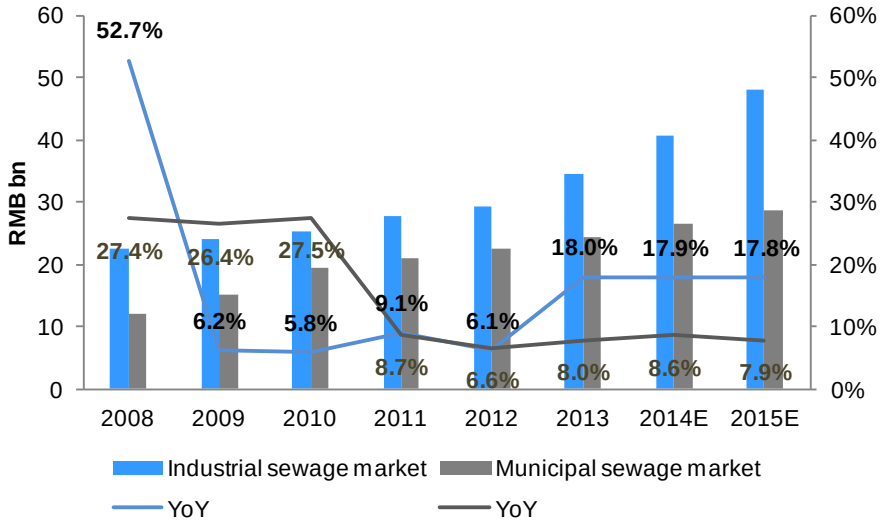
Figure 15: China's Total Investment in Treatment of Environmental Pollution as % of GDP



Source: NBSC, Quam Securities

Growth for industrial sewage market > municipal sewage market

Figure 16: Market Size of Industrial Vs. Municipal Wastewater Treatment Market in China



Source: China Environmental Protection Bulletin and Ernst & Yong estimates, Quam Securities

3.3 Competitive Landscape in Jiangsu Province

In 2013, there were ~473 municipal wastewater treatment facilities in the Jiangsu Province, up from 440 facilities in 2012. The total designed treatment capacity was 13.3mn m^3 per day in 2013, compared with 12.1mn m^3 in 2012. The actual volume of wastewater treated at these facilities in 2013 was 10.2mn m^3 per day, implying an overall utilization rate of 77%.

3.4 Favorable Government Policy in China

Jiangsu province is expected to treat an additional 2.9mn cubic meters of water per day by 2015

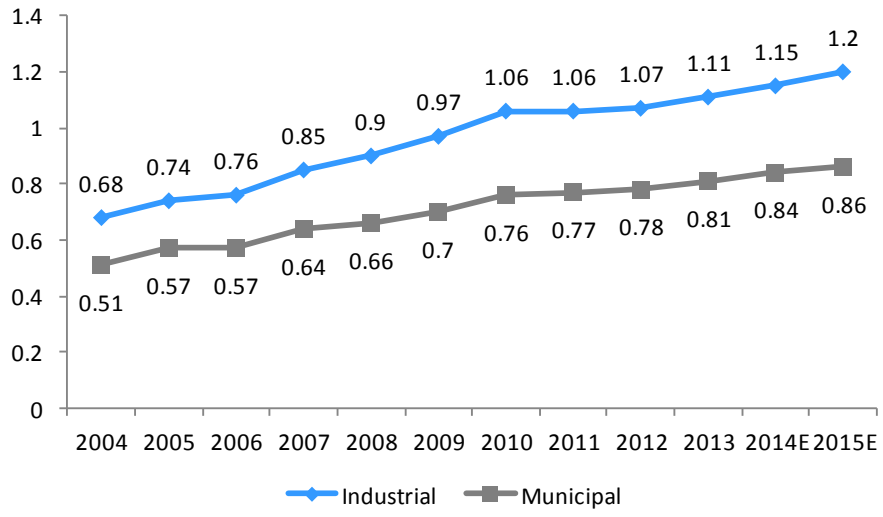
The Chinese government has poured an increasing amount of capital into the wastewater treatment industry over the past two decades, justified by the immense environmental and economic cost of water pollution. The official investment budget stated in the 12th five-year plan to develop wastewater treatment facilities was RMB430bn, compared with the RMB376bn spent from 2006 to 2010. The government has also set aggressive targets for the industry including improving the wastewater treatment rate from 77.5% in 2010 to 85% in 2015, and increasing the total municipal wastewater treatment capacity from 124.76mn m^3 in 2010 to 208.05mn m^3 per day in 2015.

3.5 Water Tariff Adjustment

Compared with global peers, China has very low water tariffs. According to Global Water Intelligence, a market researcher for the international water market, Chinese water tariff averaged US$0.49 per m^3 in 2013 versus that of the U.S. at US$3.09 per m^3 and Japan at US$2.62 per m^3. Given the low cost of water, water tariffs in China are poised to rise. Wastewater treatment tariff in China has already risen by an average of 60% for municipal users and 62% for industrial users since 2004. The average municipal wastewater treatment tariff in 2013 was ~RMB0.81 per m^3 and the industrial wastewater treatment tariff was ~RMB1.11 per m^3. At the beginning of 2014, the government introduced a three-tier system whereby the heaviest users of water will pay at least three times the base rate of water; the next tier will pay 1.5 times the base rate, whilst the rest of the users will be unaffected. The policy is considered as a precursor for further price adjustments, and will be a revenue catalyst for wastewater treatment companies.

The cumulative growth for industrial wastewater tariff was 63% since 2004

Figure 17: Average Wastewater Treatment Tariff in China



Source: H2O China, Quam Securities

4. Key Management Personnel

Mr. Chau On Ta Yuen - Chairman and Executive Director: Mr. Chau, aged 66, was appointed as ELL's executive director and chairman on 18 Mar 2014. He is mainly responsible for business development and strategic formulation of the company. Mr. Chau joined the company in Dec 2002 as a director of Everbest Water Treatment Development. Mr. Chau is currently a member of the 12th National Committee of the Chinese People's Political Consultative Conference, deputy officer of the Social and Legal Affairs Committee of the Chinese People's Political Consultative Conference and the vice chairman of the 9th board of directors of the Hong Kong Federation of Fujian Associations. Mr. Chau was awarded the Bronze Bauhinia Star by the HKSAR in 2010.

Mr. Chau holds directorships in various companies listed on HKEX. Mr. Chau has been an executive director of China Ocean Shipbuilding Industry Group Limited(651.HK) since Sept 2007, an independent non-executive director of Redco Properties Group Limited(1622.HK) since Jan 2014, an independent non-executive director of Sumpo Food Holdings Limited(1089.HK) since Dec 2010, an independent non-executive director of Come Sure Group (Holdings) Limited(794.HK) since Feb 2009, and an independent non-executive director of Good Fellow Resources Holdings Limited(109.HK) since Jul 2007, an executive director of Rosan Resources Holdings Limited(578.HK) from Mar 2000 to Nov 2006, an independent non-executive director of Hao Wen Holdings Limited(8019.HK) from Jun 2003 to Aug 2009, and an independent non-executive director of Buildmore International Limited(108.HK) from Dec 2008 to Sept 2010.

Mr. Chan Kwan – Chief Executive Officer and Executive Director: Mr. Chan Kwan, aged 32, was appointed as ELL's executive director on 25 Feb 2014 and chief executive officer on 18 Mar 2014. Mr. Chan is mainly responsible for all major affairs of ELL including project construction and operation, business development, marketing and strategic formulation. Mr. Chan joined the company in Mar 2007 as director of Everbest Water Treatment Development. Prior to joining the company, Mr. Chan was a database administrator at Panda Restaurant Group, Inc. in Los Angeles, the United States, from Feb 2005 to Dec 2006.

Mr. Chan is a member of the 11th Fujian Province Committee of the Chinese People's Political Consultative Conference, a standing committee member of the 8th board of director of the Hong Kong Federation of Fujian Associations, the chief supervisor of the 9th Hong Kong Minxi Association Ltd., the vice-president of the 10th Supervision Committee of Lung Yen Residents Association of Hong Kong Ltd, and the vice president of the Hong Kong Federation of Overseas Chinese Youth Committee.

Mr. Lui Hin Weng Samuel – Chief Financial Officer: Mr. Lui Hin Weng, aged 39, was appointed as the chief financial officer on 18 Mar 2014 and is mainly responsible for financial management and reporting, investor relations, fund raising and capital management. He assists the CEO in strategic planning and business development. He also oversees ELL's compliance with applicable laws and regulations in Hong Kong and in China as the compliance officer. Mr. Lui joined ELL in Dec 2013 as chief financial officer of Greatcorp.

Prior to joining ELL, Mr. Lui was a director within the private equity funds business at Rockstead Capital Private Limited from Dec 2011 to Oct 2013. Mr. Lui also served as the chief financial officer at Feres Pte Ltd from Jul 2009 to May 2011, a director at Merrill Lynch in Hong Kong and Singapore from May 2007 to May 2009, an assistant director of the financial sponsors group, Asia in global clients at ABN AMRO Bank N.V. from Sept 2005 to Apr 2007, vice president at project finance and advisory department at Societe Generale Asia Limited from Jul 2004 to Aug 2005, manager of project and export finance at HSBC from May 2003 to Jul 2004, senior associate at Ernest & Young from May 2002 to May 2003, and senior at Arthur Andersen from Sept 1998 to Jan 2002. Mr. Lui obtained a bachelor's degree in accountancy from Nanyang Technological University in Singapore in Jul 1998, and has been a

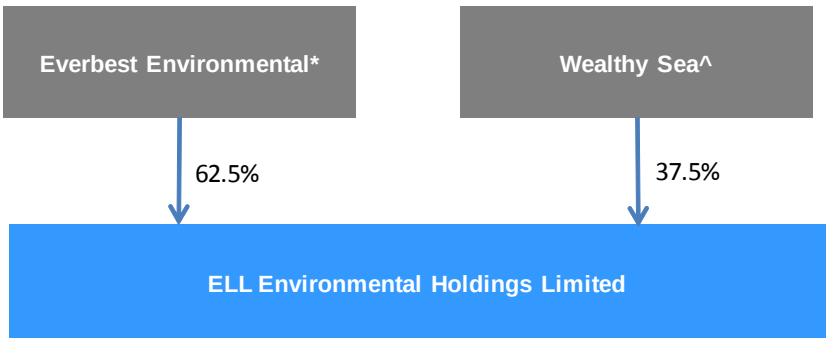
member of the Institute of Certified Public Accountants of Singapore since Oct 2002.

Mr. Wang Zili – Deputy General Manager, Haian Hengfa Facility: Mr. Wang Zili, aged 51, was appointed as the deputy general manager, Haian Hengfa Facility on 18 Mar 2014. Mr. Wang joined the company in Feb 2005 and is mainly responsible for overseeing operational matters related to the Haian Hengfa Facility. Prior to joining the company, Mr. Wang was vice chairman and general manager at Beijing Solar Power Nutritious Engineering Development Co., Ltd., a deputy general manager at National Youth Services Centre and researcher at Zhuzhou Electric Locomotive Research Institute, and worked at Shenzhen Recruitment Services Company. Mr. Wang obtained a bachelor's degree in engineering from Dalian Railway Institute in Jul 1983.

Mr. Zhou Yinbing – Deputy General Manager, Rugao Hengfa Facility: Mr. Zhou Yinbing, aged 36, was appointed as the deputy general manager, Rugao Hengfa Facility on 18 Mar 2014 and is mainly responsible for overseeing operational matters related to the Rugao Hengfa Facility and the Rugao Honghao Facility. Mr. Zhou joined the company in Feb 2004. Prior to joining the company, Mr. Zhou worked at Nantong Feilong Towngas Fittings Factory from Sept 1997 to Feb 2004, providing technological support in the production department. Mr. Zhou obtained an associate degree in business administration from Open University of China in Jul 2006, and a diploma in applied electrical and mechanical technology from Jiangsu Province Nantong School of Agriculture in Jun 1997. Mr. Zhou is qualified as a wastewater treatment technological management administrator by the Jiangsu Province Housing and Urban-Rural Development in Dec 2011, an engineer by Jiangsu Province Environmental Protection Department in Jan 2008, a work safety administrator by Rugao Administration of Work Safety in Jun 2006.

5. Shareholding Structure

Figure 18: Shareholding Structure



Source: Company, Quam Securities
**Everbest Environmental is held as to 50%, 30% and 20% by Ms. Wong, Ms. Chan and Mr. Chan respectively. Ms. Wong is the mother of both Ms. Chan and Mr. Chan*
^Wealthy Sea is held as to 90% and 10% by Mr. Chau and Ms. Wong Mei Ling, the spouse of Mr. Chau, respectively

6. Investment Thesis

6.1 Early Mover Advantage in Wastewater Treatment

High switching cost faced by its customers

6.1.1 Nearly Ten Years of Operating History in Nantong City– ELL's first project, the Haian Hengfa Facility in Nantong City, Jiangsu Province, is a municipal wastewater treatment BOT project. It commenced operation in 2005, accumulating nearly ten years of operating history. It is amongst the earliest providers of customized and integrated wastewater treatment services from design, construction management, procurement to operation and maintenance of the wastewater treatment project in Nantong City, a county-level city. Subsequently, the local government in the neighboring Rugao City invited ELL for a municipal and industrial wastewater treatment BOT project in Rugao ETDZ, an economic zone and technological development zone for high-tech industries in 2004 and later the Rugao Honghao Facility, which treats heavy metals, in 2010.

ELL enjoys an early-mover advantage in these regions, as these three facilities were a part of the local governments' town planning schemes. The switching cost could be high for customers because the BOT agreements do not expressly grant any termination rights to customers, which means that they need to continue paying the guaranteed treatment fees disregarding the level of wastewater supplied to its facilities. Its customers would incur additional costs to build up new infrastructures operated by another project company. Besides, the Haian Hengfa Facility is 30% owned by the Haian Construction Development Investment, which is wholly-owned by Haian County Government Office of the State Owned Assets Supervision and Management. **This suggests that ELL's existing customers would most likely invite ELL for competitive tender for new projects in the same region in the future.**

Guaranteed revenue stream protects ELL from fluctuations in the actual volume of wastewater treated

6.1.2 Guaranteed Tariff and Treatment Volume– ELL's revenue stream is highly visible and secured. The BOT agreements for all of ELL's facilities are under a guaranteed tariff (or base tariff). The weighted average price charged per ton of wastewater treated was ~RMB1.4-1.5 from FY2011-13 (see Figure 20 or 21). The revenue is calculated based on the agreed maximum capacity of the wastewater treatment facilities (irrespective of the actual volume of wastewater treated). This means the agreed maximum capacity of the respective wastewater treatment facility is the same as its designed capacity. If the actual wastewater treated falls short of the agreed maximum capacity (or designed capacity), the revenue from the un-utilized capacity is calculated at ~75% to 90% of the base tariff. This suggests that ELL earns a guaranteed amount of income regardless of the actual volume of wastewater treated, which protects ELL from fluctuations in the supply of wastewater provided to its facilities.

Premium margins due to its unique BOT agreements

6.1.3 Above-industry Average Margins– ELL's overall gross profit margins for FY2011/12/13 were 76.4%/ 77.9%/ 75.8% and operating profit margins were 70.5%/ 73.6% 77.5% 70.5%, which is the highest compared to industry peers' gross and operating margins ranging from 30-67% and 13-58% accordingly (see Figure 19). We believed ELL's ability to enjoy a historically above-industry average gross margin are attributable to:

i) **Guaranteed revenue under the BOT business model, calculated based on its designed capacity**, unlike other players which are calculated based on minimum treatment level, which is usually lower than the designed capacity;

ii) **Absence of construction revenue in FY2011-13,** where gross profit margin is usually lower. According to CBRE Limited, an independent third-party valuer, the construction margins of the market comparables range from 2.6% to 58.0%. The construction margins used for ELL's BOT projects range from 11.2% to 17.3%, which is much lower than the gross profit

margin in the operation of wastewater treatment facilities. ELL did not book any revenue from construction during the period FY2011-13, since the construction of Haian Hengfa and Rugao Hengfa Facilities have already been completed in 2005 and 2007 respectively. The Rugao Honghao was acquired by ELL in February 2013. We assumed a construction margin of 14.3% in Haian Hengfa Facility and 11.0% in Rugao Hengfa Facility, where improvement works are expected to begin in 2014 and we expect it to complete by Sept 2014 and 2015 respectively;

iii) **Absence of depreciation expenses under the BOT business model,** all three of ELL's facilities are under the BOT agreement, where these projects will be transferred to the government at the end of the concession period. Hence, there is no depreciable assets, except the amortization on the financial assets. ELL commands an overall high net margin compared to its peers, as players in the industry operates projects under a mixture of business models, i.e. BOO (build-operate-own) and TOT (transfer-operate-transfer) in Mainland China (see Figure 19).

Figure 19: Peers Comparison – Key Operational Figure, 2013

	ELL Environmental N/A	CT Environmental 1363 HK	Dongjiang Environmental 895 HK	Sound Global 967 HK	China Everbright 257 HK	Beijing Enterprise 371 HK	Guangdong Investment 270 HK	China Water Affairs 855 HK	Dynagreen 1330 HK	Kangda 6136 HK	Average
Sales (HKD mn)	**65**	485	2,018	4,027	5,320	6,407	7,990	2,251	1,251	1,718	**3,496**
Net profit (HKD mn)	**32**	224	267	543	1,325	1,084	4,426	286	194	297	**961**
Margins %											
- Gross margin	**75.8%**	63.1%	29.8%	30.5%	44.7%	39.1%	66.6%	43.1%	N/A	38.3%	**44.4%**
- Operating margin	**77.5%**	58.4%	13.3%	23.7%	39.0%	27.2%	50.2%	26.3%	26.0%	33.2%	**33.0%**
- net margin	**49.7%**	46.3%	13.2%	13.5%	24.9%	16.9%	55.4%	12.7%	15.5%	17.3%	**24.0%**
Effective tax rate	**29.3%**	19.5%	10.3%	24.9%	24.7%	23.5%	18.2%	31.3%	18.6%	17.4%	**20.9%**
ROIC	**16.5%**	17.1%	6.8%	8.9%	8.4%	4.4%	9.3%	4.7%	8.0%	9.5%	**8.6%**
DVD yield (ind. Gross	**N/A**	0.6%	1.3%	N/A	0.8%	1.0%	3.0%	1.9%			**1.4%**

Source: Company data, Bloomberg & Quam Securities

High competitive edge in bidding for BOT projects in the future

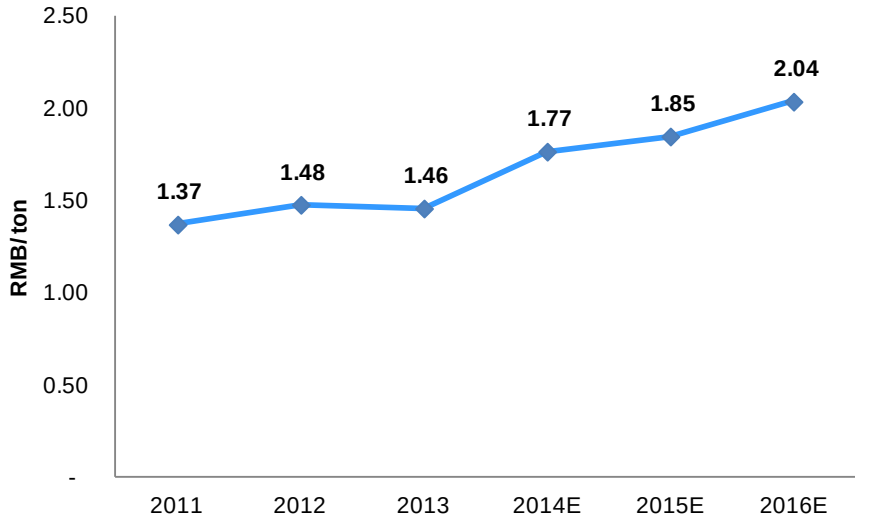
6.1.4 Strong Working Relationships with Local Governments– According to the Public Utility Concession Rules, municipal public utility authorities are required to award public utility projects through competitive tender processes. However, ELL was invited by the local government authority to negotiate a BOT agreement without undergoing any competitive tender process. This suggests that ELL has established good working relationships with its track record of stable operation and expertise and capabilities in wastewater treatment, thus giving it a higher competitive edge when bidding for BOT projects in the future. When existing treatment volume reaches its maximum designed capacity, ELL will have strong bargaining power to bid for expansion projects especially in Rugao ETDZ, where ELL is the only provider of treating heavy metal wastewater.

6.2 Tariff Rate Adjustment

6.2.1 Potential Wastewater Treatment Tariff Adjustment– Under the BOT agreement, adjustments on wastewater treatment tariff is based on changes in operation and management costs due to adjustments in government policies or inflation. Any tariff rate adjustment is subject to consent by the relevant customers. Tariff rate adjustments usually took place every three to four years for BOT projects in China, which is an industry norm according to rate of inflation. We expect the next tariff rate adjustment to take place in 2015E with an estimated increase of ~3% for Haian Hengfa and Rugao Hengfa and another 3% hike in 2019E. We expect it is easy for ELL to adjust tariff in 2015, especially after the facility upgrade works carried out in 2014 and 2015 (see Figure 20).

A steadily rising tariff

Figure 20: *Weighted Average Tariff/ ton of Wastewater Treated



Source: Company data, Quam Securities Estimates
**FY2011-13 is calculated by summing the historical three year average of base tariff fee of respectively facilities, times their respective percentage of wastewater treated to the Group's total wastewater treated. For our estimate figures, it is calculated by a summation of our estimated base tariff for that financial year times their respective percentage of wastewater treated to the Group's total wastewater treated.*

6.3 Ramping Up the Rugao Honghao Facility

Rugao ETDZ was promoted to state-level ETDZ in Jan 2013

6.3.1 Increases in Wastewater Supply for Treatment– Rugao Honghao Facility is located inside the Rugao ETDZ (Economic and Technological Development Zone), which is a provincial development zone approved by the Jiangsu Government and established in 1993, with a planned area of 45 square km. It houses over 500 enterprises and forms an industrial layout, which focuses on auto parts, electronics, textiles, clothing, food and new materials. The Rugao Honghao Facility was developed to treat wastewater discharged from the electronic, electrical and mechanical manufacturing plants in the Electronic, Electrical and Mechanical Industrial Park in the Rugao ETDZ. The utilization rate of the Rugao Honghao Facility was low at 2.0% in 2013, because of insufficient wastewater supplied to the facility for treatment, since the Industrial Park is still at its early stage of development. We expect utilization rate of the Rugao Honghao Facility will gradually increase to 4%/7%/25% in 2014/15/16E accordingly, especially after Rugao ETDZ has been promoted to a state-level ETDZ in Jan 2013 (see Figure 21).

Ramping up of the Rugao Honghao Facility is expect to contribute positively to Group's gross margin

6.3.2 Higher Tariff Charges on Heavy Metal Wastewater Treatment– The treatment of heavy metal wastewater procedure is more sophisticated than industrial and municipal wastewater because the heavy metal wastewater is highly toxic. It requires analysis of the chemical composition and the decision to choose which chemicals to be applied in the treatment process. Hence, the treatment tariff for Rugao Honghao is the highest, compared to Haian Hengfa and Ruguao Hengfa Facilities in 2013. Due to a higher treatment tariff, the gross profit margin for Rugao Honghao is also the highest at 92.2% in 2013, compared to ELL's other two facilities (see Figure 25). **Hence, we expect a higher utilization rate going forward will enhance the Group's gross margin going forward.** We estimate gross margin to reach 77.0% in 2016E, an increase from the level of 75.8% in 2013 (See Figure 24).

6.3 Expansion Beyond the Nantong City

ELL can easily replicate its business in other areas

Expansion Beyond the Nantong City– ELL has a proven track record of operating wastewater treatment facilities in China, and this can help ELL to easily replicate the same business model in other cities beyond the Jiangsu province. We believe this can be supported by ELL's internal funds from its strong operating cash inflow, as well

as higher leverage through bank financings since ELL's has been in a net cash position in the past three financial years.

6.4 Favorable Government Policy in China

The 4th revision on environmental law is expected to pass in 2014

6.4.1 Revisions to the Environmental Protection Law- On Apr 24, 2014, China's top legislature adopted its fourth revision to the Environmental Law, which went into effect in 1989, by expanding the law to 70 articles from 47 and imposes heavier penalties to environment-related wrongdoings. The focus is more on pollution with policies covering discharge standards to government collaborations across sectors, fines and incentives. The new law states that economic and social development should be coordinated with environmental protection and encourages studies on the impact environmental quality causes on public health, urging prevention and control of pollution-related diseases. It also states that China should establish and improve on environmental and health monitoring, survey and risk assessment mechanisms. The fourth revision is expected to pass this year.

Stricter discharge requirements

6.4.2 Action Plan for Water Pollution Prevention and Control – The action plan is expected to be published in 2014, with pollution control targets to significantly reduce industry pollution, manage municipal pollution and recover rural rivers. The plan is still being finalized but the budget has been set at RMB2tri, exceeding the RMB1.7tri China plans to spend battling its more publicized air pollution crisis. The plan will aim to improve the quality of China's water by 30-50%, through investments in technologies such as wastewater treatment, recycling and membrane technology.

7. Key Assumptions

Figure 21: Key Revenue Assumptions

	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
A. Haian Hengfa - Actual Operating Figures													
Designed annual capacity (mn tons)	*14.6	*14.6	*14.6	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60
Utilization rate	61.4%	59.9%	64.0%	70.0%	70.0%	75.0%	77.0%	79.0%	81.0%	83.0%	85.0%	87.0%	89.0%
Actual wastewater processed (mn tons)	8.96	8.74	9.34	10.22	10.22	10.95	11.24	11.53	11.83	12.12	12.41	12.70	12.99
Unused capacity (mn tons)				4.38	4.38	3.65	3.36	3.07	2.77	2.48	2.19	1.90	1.61
% of guaranteed/ tariff on processed wastewater				85%	85%	85%	85%	85%	85%	85%	85%	85%	85%
Over-utilized capacity (mn tons)	*1.82	*1.71	*2.04	0	0	0	0	0	0	0	0	0	0
Construction Margin				14.30%									
B. Rugao Hengfa													
Designed annual capacity (mn tons)	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60	14.60
Utilization rate	34.7%	48.1%	52.7%	55.0%	55.0%	60.0%	62.0%	64.0%	66.0%	68.0%	70.0%	72.0%	74.0%
Actual wastewater processed (mn tons)	5.06	7.02	7.70	8.03	8.03	8.76	9.05	9.34	9.64	9.93	10.22	10.51	10.80
Unused capacity (mn tons)	9.54	7.58	6.90	6.57	6.57	5.84	5.55	5.26	4.96	4.67	4.38	4.09	3.80
% of guaranteed/ tariff on processed wastewater	67%	61%	59%	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%
Construction Margin				11.0%	11.0%								
C. Honghao													
Designed annual capacity (mn tons)	N/A	N/A	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.28
Utilization rate	N/A	N/A	2.0%	4.0%	7%	25%	30%	35%	40%	45%	50%	55%	60%
Actual wastewater processed (mn tons)	N/A	N/A	0.03	0.05	0.09	0.32	0.38	0.45	0.51	0.57	0.64	0.70	0.77
Unused capacity (mn tons)	N/A	N/A	1.15	1.23	1.19	0.96	0.89	0.83	0.77	0.70	0.64	0.57	0.51
% of guaranteed/ tariff on processed wastewater	N/A	N/A	61%	75%	75%	75%	75%	75%	75%	75%	75%	75%	75%
**Overall Weighted Average of Treatment Tariff/ ton of Wastewater Treated (RMB/ ton)	1.4	1.5	1.5	1.8	1.8	2.0	2.1	2.1	2.3	2.3	2.4	2.4	2.4

Source: Company Data, Quam Estimates

**Our calculation of utilization rate for Haian Hengfa is based on the actual designed capacity of 40,000 tons/ day, consisting of capacity from both Phase I and II of Haian Hengfa, instead of 20,000 tons/day. Due to protracted negotiations with the Hain County Construction Bureau, a BOT agreement officially recognizing phase II of the Haian Hengfa Facility was not signed until 26 Nov, 2013. Hence, the minimum guaranteed tariff for the Haian Hengfa Facility was calculated based on agreed maximum capacity of 40,000 tons/day starting from 4 Jan, 2014 onwards. In our assumptions presented above, there are no unused capacity as reported historically for 2011-2013, basing on a designed capacity of 20,000 tons/day historically.*

***FY2011-13 is calculated by summing the historical three year average of base tariff fee of respectively facilities, times their respective percentage of wastewater treated to the Group's total wastewater treated. For our estimate figures, it is calculated by a summation of our estimated base tariff for that financial year times their respective percentage of wastewater treated to the Group's total wastewater treated.*

7.1 Wastewater Treatment Operation Services

Treatment Tariff– We expect ELL will be able to raise the wastewater treatment fees by ~3% in 2015E for Haian Hengfa and Rugao Hengfa facilities after the completion of facility upgrade constructions in 2014E and 2015E respectively. We further expect another 3% hike in 2019E. We keep the treatment services fee flat for Rugao Honghao, since the average tariff is already at a large premium to Haian Hengfa and Rugao Hengfa.

Utilization rate- We assume utilization rates for Haian Hengfa, Rugao Hengfa and Rugao Honghao facilities of 70.0%, 55.0% and 4.0% respectively in 2014E, increases of 6ppts., 2.3ppts. and 2.0ppts accordingly. The increases for Haian Hengfa and Rugao Hengfa are mainly due to the facility upgrades. For Rugao Honghao, the volume of wastewater treated totaled 18,682 tons in the first five months of 2014, which is already equivalent to 72.8% of the total wastewater treated in 2013, due to an increase in the wastewater supplied to Rugao Honghao. Thus, we expect utilization rate for Rugao Honghao to pick up more rapidly as it continues to ramp up, following the development of Rugao ETDZ.

Tariff on un-utilized capacity- We expect the tariff on un-utilized capacity (i.e. designed capacity minus actual wastewater treatment volume) to be 85%, 90% and 75% of the guaranteed wastewater treatment fees for capacity which was utilized for Haian Hengfa, Rugao Hengfa and Rugao Honghao respectively, the same level as they were in the past throughout our forecast periods.

7.2 Construction Services

Project completion- We estimate a total capex of HK$61.8mn for the facilities upgrade in Haian Hengfa (~HK$10.2mn) and Rugao Hengfa (~HK$51.6mn) in 2014E and 2015E. The construction work for these two facilities is to begin in 2014E. We assume the construction work for Haian Hengfa to be fully completed in 2014E, whereas 20% of the construction work for Rugao Hengfa will be completed in 2014E and the remaining 80% in 2015E. Hence, capex is estimated at ~HK$23mn in 2014E and ~HK$46mn in 2015E.

8. Financials

8.1 Accounting Treatment for Service Concession Arrangements– ELL provides wastewater treatment services under BOT agreements. Based on the HKFRS (IFRIC – Int 12: Service Concession Arrangements), revenue breaks down into three segments namely, i) construction services, ii) wastewater treatment facilities operation services and iii) imputed interest income on receivables under service concession arrangements.

Non-cash revenue

i) **Construction services revenue**– Both the revenue from construction services and imputed interest income are non-cash items, because the revenue relating to construction services are estimated to be fully recovered through the guaranteed tariffs to be received over the entire life of the service concession arrangement. As such, the revenue in respect of the construction services is first recognized in the income statement for the period of construction according to the percentage of completion method. While the receivable related to the construction services will be billed to the customers over the operational phase of the service concession arrangement.

Benchmark of operational performance

ii) **Operation services revenue**- For revenue from wastewater treatment facilities, ELL will record the amount of revenue when the wastewater treatment services are being provided, The wastewater treatment fee billed for a given year comprises the fee from rendering of wastewater treatment services during that year and the fee related to construction services which has already been recognized as receivable under the service concession during the construction period.

Non-cash revenue

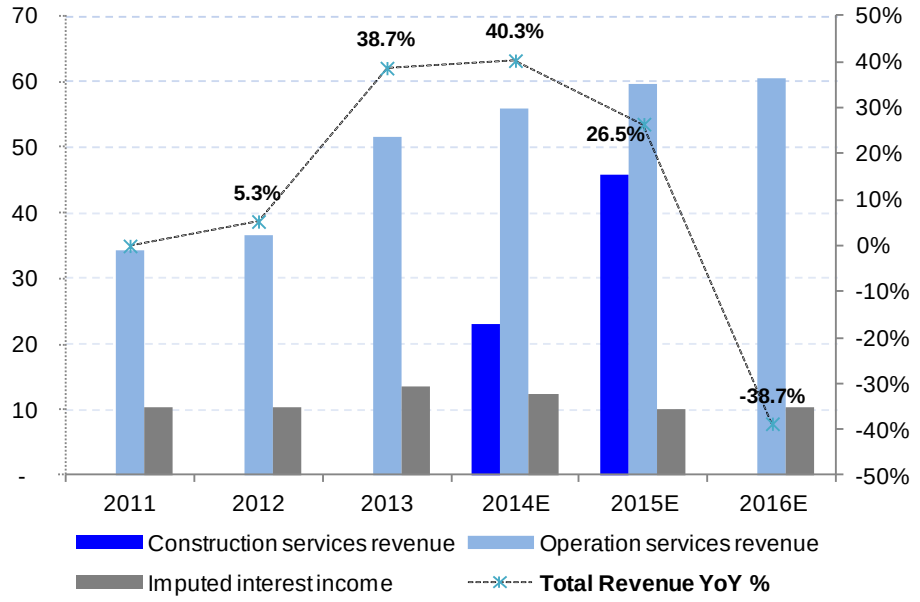
iii) **Imputed interest income**- For the imputed interest, it is recognized on the receivables under service concession arrangements on an accrual basis based on the effective interest method by applying the rate that exactly discounts the estimated future cash receipts of wastewater treatment fees collected over the service concession period to the net carrying amount of the receivables.

Operation services revenue supported by upward tariff adjustment and higher utilization rate

8.2 Revenue Growth Boost by Construction Income in 2014-15E– ELL's total revenue growth jumped 38.7% in 2013, while revenue from the operation of wastewater treatment services surged 41.2% YoY due to inorganic expansion of the Rugao Honghao Facility, of which ELL completed the acquisition in Feb 2013. We expect the rapid increase in revenue to continue in 2014-15E, rising by 40.3% YoY in 2014E and 26.5% YoY in 2015E. **The strong revenue growth is driven by the contribution of construction services revenue and higher operation services revenue of +8.5% YoY in 2014E and +6.9% YoY in 2015E from a rising utilization rate and wastewater treatment fees.** We expect revenue in 2016E to drop 38.7% YoY because of the absence of construction services revenue, as the construction of facilities upgrade for Haian Hengfa and Rugao Hengfa will be fully completed by 2015E. Revenue from operation services is expected to grow by 1.0% in 2016E, normalized after a 3% upward adjustment in wastewater treatment tariff in 2015E.

Revenue in 2016E will drop due to an absence of construction services revenue

Figure 22: Revenue Breakdown by Segments



Source: Company Data, Quam Estimate

Figure 23: Revenue Breakdown by Businesss Segments

HKD mn	2011	2012	2013	2014E	2015E	2016E
- Construction Services	-	-	-	23.1	45.8	-
- Operation Services (BOT)	34.3	36.5	51.5	55.9	59.8	60.4
- Finance Income	10.3	10.4	13.6	12.3	10.0	10.4
Total Revenue	**44.6**	**46.9**	**65.1**	**91.3**	**115.6**	**70.8**
%/ Total Revenue						
- Construction Services	-	0%	0%	25%	40%	-
- Operation Services (BOT)	77%	78%	79%	61%	52%	85%
- Finance Income	23%	22%	21%	13%	9%	15%

Source: Company Data, Quam Estimate

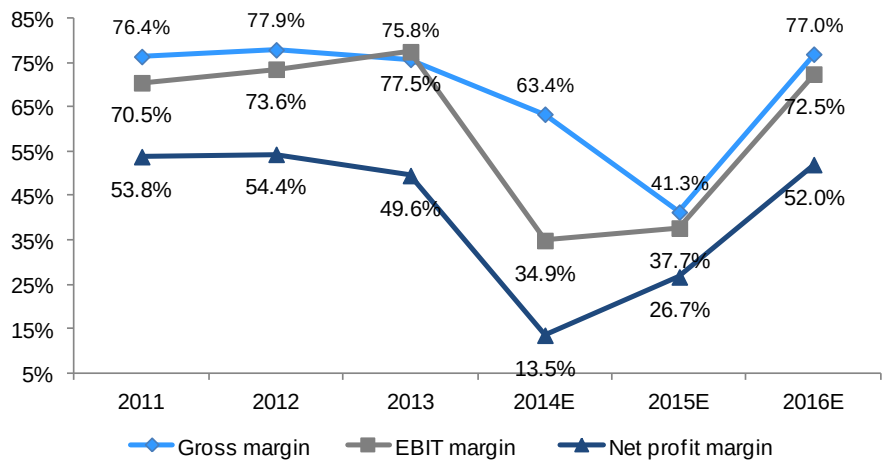
8.3 Gross Margin to Surpass 2013 Level in 2016E– ELL's gross margin were >70% in 2011-2013, which is much higher than industry peers' average ~44% (see Figure 19). For cost of sales, overhead costs (mainly consisting of electricity costs) usually made up the majority of ~48-54% of the total cost of sales in 2011-2013. Going forward, with the construction work for facility upgrades in Haian Hengfa and Rugao Hengfa in 2014E and 2015E, we expect ELL's overall gross margin to drop to 63.4% and 41.3% respectively, as margin from construction is much lower than operation services. ELL's gross margins for Haian Hengfa, Rugao Hengfa and Rugao Honghao were 62.5%, 73.1% and 92.2% respectively in 2013 (see Figure 25). **Gross margin is expected to return to >70% level and surpass 2013 from 2016E onwards without any construction works, as well as greater contribution from the Rugao**

Honghao Facility which is positive for the overall gross margin as this facility commands a higher gross margin from the treatment of heavy metal wastewater, compared to general industrial wastewater and municipal wastewater.

8.4 Operating Profit– For operating costs, administrative expenses usually account for a majority of the total operating costs. Administrative expenses (excluding professional fees and staff costs) accounted for 3.1%-3.9% of total revenue in 2011-2013, while professional fees alone accounted for 0.1% and 2.5% of total revenue in 2012 and 2013 respectively. **Going forward, we expect professional fees/ total revenue to reach 24.0% in 2014E but will not recur as it is one-off in nature. As a result, ELL's operating profit margin is expected to drop to 34.9% in 2014E, affected by the double-whammy effect of the one-off professional fees and a lower gross margin as mentioned above.**

Gross margin from construction services revenue is much lower than operation services revenue, resulted in the dilution of the Group's gross margin in 2014-15E

Figure 24: Margin Analysis



Source: Company Data, Quam Estimate

Figure 25: Gross Margin Breakdown by Facilities

	2011	2012	2013
Haian Hengfa	60.20%	63.10%	62.50%
Rugao Hengfa	82.40%	83.20%	73.10%
Rugao Honghao			92.20%
Overall gross margin	**76.40%**	**77.90%**	**75.80%**

Source: Company Data, Quam Estimate

Figure 26: Cost of Sales Breakdown

Cost of sales/ Revenue (%)	2011	2012	2013	2014E	2015E	2016E
Cost of sales	**23.6%**	**22.1%**	**24.2%**	**36.6%**	**58.7%**	**23.0%**
- Overhead	12.1%	11.8%	11.7%	6.6%	11.7%	11.7%
- Direct labour	5.2%	5.4%	4.6%	2.9%	4.6%	4.6%
- Repair & maintenance	4.1%	3.4%	4.4%	2.2%	4.4%	4.4%
- Raw materials	2.1%	1.4%	3.6%	2.4%	2.4%	2.4%
- Construction costs	0.0%	0.0%	0.0%	22.5%	35.6%	0.0%

Source: Company Data, Quam Estimate

Figure 27: SG&A & *Other Revenue Breakdown

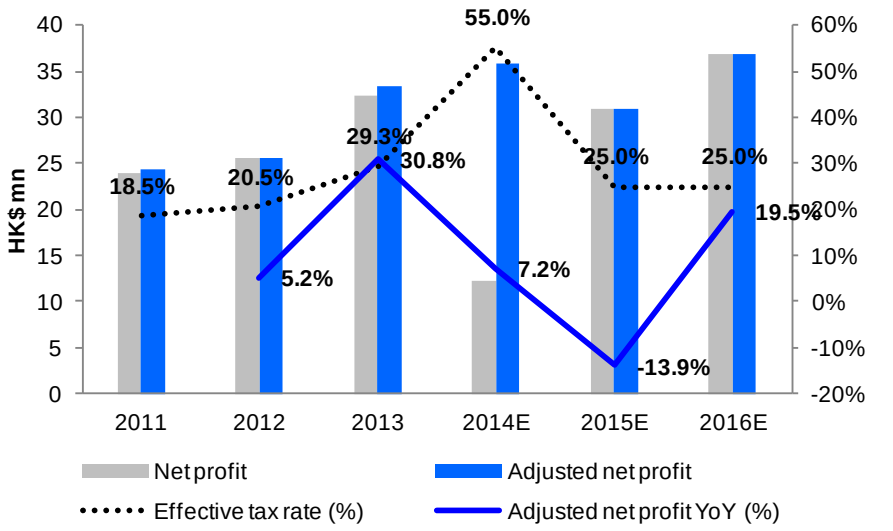
SG&A & Other Revenue/ Revenue	2011	2012	2013	2014E	2015E	2016E
SG&A & Other Revenue	**5.9%**	**4.4%**	**-1.7%**	**28.5%**	**3.6%**	**4.5%**
- Administrative expenses	3.9%	3.1%	3.1%	3.1%	2.5%	2.5%
- Staff costs	2.5%	2.3%	1.4%	2.6%	2.1%	3.0%
- Professional fees	0.8%	0.1%	2.5%	24.0%	0.0%	0.0%
- Other revenues	-1.2%	-1.2%	-8.7%	-1.2%	-1.0%	-1.0%

Source: Company Data, Quam Estimate
**Other revenues includes interest income, net exchange gains, government subsidies, refund of sewage discharge fees and gain on bargain purchase of subsidies.*

Adjusted net profit to rise by 2.8% in 2014E

8.5 Net Profit– Professional fees incurred in 2011-2014E are non-tax deductible expenses but one-off in nature. This is expected to raise the effective tax rate from 29.3% in 2013 to 55.0% in 2014E (see Figure 28), resulting in an estimated ~62% YoY drop in reported net profit to HK$12.4mn. We expect the adjusted net profit (excluding impact of professional fees) to increase only 7.2% YoY to HK$35.8mn in 2014E and drop 13.9% YoY to HK$30.8mn in 2015E, mainly due to the gross margin dilution from higher construction services revenue recognition. The gross margin will drop from 75.8% in 2013 to 63.4% in 2014E and 41.3% in 2015E. Gross margin in 2015E is much lower than 2014E because more construction services revenue will be recognized in 2015E due to the facility upgrade in Rugao Hengfa. **The adjusted net profit will regain growth in 2016E by +19.5% YoY, as gross margin is expected to exceed the level achieved in 2013 without construction services revenue recognition and greater contribution from the higher-margin Rugao Honghao Facility.**

Figure 28: Net Profit Vs Adjusted Net Profit Trend (2011 – 2016E)



Source: Company Data, Quam Estimate

Effective tax rate to drop to 25% in 2015E from 55% in 2014E

8.6 Effective Tax Rate– ELL is subject to PRC enterprise income taxes of 25% as its operating subsidiaries are located in Mainland China. The effective tax rate increased substantially from 20.5% in 2012 to 29.3% in 2013 due to the expiration of a tax holiday for Rugao Hengfa at the end of 2012. We expect it to increase to 55.0% in 2014E due to the non-tax deductible professional fees, while falling back to 25% in 2015E as the Haian Hengfa had obtained preferential income tax treatment in Feb 2014.

8.7 Receivables Under Service Concession Arrangements– The receivables under service concession arrangements included the consideration receivables for construction services at initial recognition, imputed interest on such receivables, which would be recognized from time to time, and consideration receivables for wastewater treatment service rendered. Such receivables under service concession arrangements are separated into current and non-current assets portion. The current assets portion includes billed tariffs, which remain unsettled, and consideration for construction services due to be received by ELL within 12 months from the end of each reporting period. The non-current portion represents consideration for construction services due to be received by ELL beyond 12 months from the end of each reporting period. We calculate the receivables turnover days based on the current assets portion. The receivables turnover days were 242 days, 276 days and 256 days in 2011-2013 respectively. The decline in receivables days were due to the receipt of lump sum payments from ELL's customers as a result of management's effort to collect the outstanding receivables**. We assume receivables days to be maintained at 256 days and a cash conversion cycle of 207 days,** since ELL has limited inventory, while payable turnover days are stable at ~57 days.

Figure 29: Receivables under Service Concession Arrangements

	2011	2012	2013	2014E	2015E	2016E
Current assets portion	29.6	40.5	50.8	64.0	81.0	49.5
Non-current assets portion	206.8	208.2	289.6	282.1	294.2	261.0
Receivables under service concession arrangements	**236.4**	**248.6**	**340.4**	**346.1**	**375.2**	**310.5**
Receivables turnover days	**242.8**	**273.5**	**255.9**	**255.9**	**255.9**	**255.9**

Source: Company Data, Quam Estimate

8.8 Finance Costs– As at the end of May, 2014 ELL has total interest-bearing bank borrowings of HK$13.6mn, a decline from HK$18mn in 2013 because ELL had fully repaid in Oct 2013 the bank loan it drew down in Oct 2012. The bank borrowings are in USD with an interest rate of ~4.5%(floating rate at 1.25% of the USD prime rate). We estimate total bank borrowings to reach HK$10mn by the end of 2014E, hence finance cost to be lowered to ~HK$1mn.

8.9 Capital Expenditure– ELL incurred minimal capex in 2011-2013 for maintenance purposes. Although the construction of Rugao Honghao Facility was completed in 2011, ELL acquired it in Feb 2013, thus there was no major capex. We estimate a capex of ~HK$23mn in 2014E and ~HK$46mn in 2015E for the facilities upgrades in Haian Hengfa (HK$10.2mn) and Rugao Hengfa (HK$51.6mn).

8.10 Dividend Policy– ELL does not have a formal dividend policy. Future dividends is subject to its operating results and expansion plans. Hence, we assume a zero dividend payout in our forecast.

Figure 30: Key Operational and Financial Data: 1st-five months (Jan-May), 2014

HKD mn (FYE Dec)	2014 (Jan-May)	2013 (Jan-May)	YoY Change
Actual wastewater processed (mn tons)			
- Haian Hengfa	3.5	3.5	
- Rugao Hengfa	3.2	2.6	
- Rugao Honghao	0.0	0.0	
Total	**6.7**	**6.2**	**8.6%**
Revenue	35.5	25.0	42.2%
Cost of Revenue	(13.4)	(4.8)	N/A
Gross Profit	**22.1**	**20.2**	**9.6%**
Gross Margin %	*62.3%*	*80.8%*	*-18.5 ppt*
Administrative expenses	(1.6)	(0.5)	220.0%
Staff costs	(1.1)	(0.5)	120.0%
Professional fees	(11.7)	(0.04)	33357.1%
Other revenue	0.1	3.4	-96.5%
Operating EBIT	**7.8**	**22.5**	**-65.3%**
EBIT Margin	*35.3%*	*111.7%*	*-76.4 ppt*
EBITDA	**19.5**	**22.6**	**-13.5%**
Net interest income/ (expenses)	(0.4)	(0.3)	5.9%
Associates & JCE's	-	-	N/A
Non-recurring items	-	-	N/A
Pre-tax Profit	**7.5**	**22.2**	**-66.4%**
Income tax expenses	(5.4)	(5.7)	-5.1%
Minority Interests	**(1.0)**	**(0.6)**	50.0%
Profit for the Year	**1.1**	**15.8**	**-93.3%**

Source: Company Data, Quam Securities

9. Major Risks

Over-reliance on Two Major Customers – ELL derives all of its revenue from Haian County Construction Bureau and Rugao ETDZ Administrative Committee. If these government authorities cease the use of ELL's services, the company's operations will be materially and adversely affected.

Revenue from Lower-margin Construction Works will Dilute the Group's Margin – ELL has started upgrading the Haian Hengfa Facility and the Rugao Hengfa Facility, which is expected to be completed in FY2014. The company plans to recognize revenue from construction services in FY2014. However, the GPM from construction services is expected to be lower than the GPM of wastewater treatment operations. As such, the GPM and NPM in FY2014 is expected to be adversely affected by the revenue recognition of construction services.

Project Delays from Changes in the PRC Government's Budget – ELL relies on its customers to invest the necessary funds in establishing the pipeline network and pumping stations to supply wastewater to its wastewater treatment facilities. As such, the company's projects may be subject to delays as a result of the changes in the PRC government's budgets.

Expanding Outside China to Overseas Markets – In the future, the company may pursue opportunities in wastewater treatment and other environmental protection projects in and outside China. Expanding outside China involves uncertainties and challenges due to the company's unfamiliarity. If any of the new projects is mismanaged, it could adversely affect its business, financial condition and results.

High Gross Margin May Not be Able to Sustain – The Rugao Hengfa Facility and Rugao Honghao Facility command higher GPM than that of the Haian Hengfa Facility. If the volume of wastewater treated decreases or the operating costs increase for these facilities, GPM may be adversely affected.

Operational Results may not be Directly Proportional to the Increased Amounts of Wastewater Treated – The company's operational results may not be directly proportional to the increased amounts of wastewater treated by the facilities, as the additional operating costs incurred for treating such increased amounts may partially offset or even exceed the additional revenue gained from treating the increased volume of wastewater. Higher utilization rate does not render higher profits because of greater variable costs under a guaranteed revenue.

10. Financial Statements

Revenue boosted by construction income

Professional fees is non-tax deductible but non-recurring

Adjusted net profit for 2015E will drop because of the gross margin dilution from greater contribution of construction revenue

Income Statement (HKD mn)	Dec 12	Dec 13	Dec 14E	Dec 15E	Dec 16E
Revenue	47	65	91	116	71
- Construction Services	-	-	23	46	-
- Operation Services (BOT)	36	52	56	60	60
- Finance Income (Imputed interest)	10	14	12	10	10
Cost of goods sold	(10)	(16)	(33)	(68)	(16)
Gross Profit	**37**	**49**	**58**	**48**	**55**
Administrative expenses	(1)	(2)	(2.8)	(3)	(2)
Staff costs	(1)	(1)	(2.4)	(2)	(2)
Professional fees	(0)	(2)	(21.9)	-	-
Other revenue	1	6	1.1	1	1
Operating EBIT	**34**	**50**	**32**	**44**	**51**
EBITDA	35	51	32	44	52
Depreciation and amortisation	0	0	0	1	0
Net interest	(0)	(2)	(1)	(0)	0
Non-recurring items	-	-	-	-	-
Share of profit of an associate	-	-	-	-	-
Income Tax Expense	(7)	(14)	(17)	(11)	(13)
Minority interests	(2)	(2)	(2)	(2)	(2)
Profit for the Year	**25**	**32**	**12**	**31**	**37**
***Adjusted Profit for the Year**	**26**	**33**	**36**	**31**	**37**

Professional fees, which is one-off in nature and non-tax deductible are excluded from the calculation of adjusted net profit

Gross margin from construction revenue is much lower than operation services revenue, resulted in the dilution of the Group's gross margin in 2014-15E

Gross margin to surpass 2013 Level in 2016E

Ratio Analysis	Dec 12	Dec 13	Dec 14E	Dec 15E	Dec 16E
Growth (YoY %)					
Revenue	5.3%	38.8%	40.3%	26.5%	-38.7%
EBIT	9.8%	46.2%	-36.8%	36.7%	17.8%
EBITDA	9.9%	46.5%	-36.3%	36.5%	17.0%
Net profit	6.2%	27.0%	-61.8%	149.6%	19.5%
Adjusted net profit	5.2%	30.8%	7.2%	-13.9%	19.5%
Margins					
Gross margin	77.9%	75.8%	63.4%	41.3%	77.0%
EBIT margin	73.6%	77.5%	34.9%	37.7%	72.5%
EBITDA margin	73.9%	78.0%	35.4%	38.2%	72.9%
Net profit margin	54.3%	49.7%	13.5%	26.7%	52.0%
Other Ratios					
Sales/ avg. assets	11.8%	15.1%	19.4%	22.2%	13.2%
Return on average assets	6.4%	7.5%	2.6%	5.9%	6.9%
Return on average equity	16.1%	16.7%	4.7%	9.5%	10.2%
ROIC	16.0%	16.5%	5.2%	9.9%	10.7%
Dividend payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%

We estimate ~HKD61.8mn capex for facility upgrade in 2014-15E

Healthy cash level

Limited bank borrowings

Net cash position

Cashflow Statement (HKD mn)	Dec 12	Dec 13	Dec 14E	Dec 15E	Dec 16E
Operating Cashflow					
Profit Before Tax	34	48	31	43	51
Depreciation and Amortization	0	0	0	1	0
Income Tax Paid	(7)	(14)	(17)	(11)	(13)
Other	3	12	9	(14)	7
Operating Cashflow before W/C	**30**	**46**	**24**	**19**	**45**
Change in Working Capital	(34)	(13)	(27)	(0)	15
Cash flow from operations	**(4)**	**33**	**(3)**	**19**	**60**
Investing Activities					
Purchases of PPE	(0)	(1)	(23)	(45)	(1)
Amounts due from related parties	(20)	103	1	-	-
Other	-	-	8	(12)	33
Cash flow from investing activities	**(20)**	**101**	**(15)**	**(57)**	**33**
Financing Activities					
Other	-	-	80	-	-
Amounts fue to related parties	15	(81)	(9)	-	-
Increases/ (decreases) in debt	25	(7)	(8)	(10)	-
Dividend paid	-	-	-	-	-
Cashflow from financing activities	**40**	**(89)**	**63**	**(10)**	**-**
Net Increase in Cash and Cash Equivalents	**15**	**46**	**46**	**(49)**	**93**
Cash and Cash Equivalents at Beginning of the Year	14	30	76	121	73
Cash and Cash Equivalents at End of the Year	**30**	**76**	**121**	**73**	**165**

Balance Sheet (HKD mn)	Dec 12	Dec 13	Dec 14E	Dec 15E	Dec 16E
Non-Current Assets					
PPE	1	3	25	70	71
Prepaid lease payments	51	6	22	4	3
Other	208	290	282	294	261
Total Non-Current Assets	**261**	**298**	**329**	**368**	**335**
Current Assets					
Accounts Receivables	40	51	64	81	50
Inventories	0	0	1	2	0
Cash and Cash Equivalents	30	76	121	73	165
Other	103	1	-	-	-
Total Current Assets	**173**	**127**	**186**	**155**	**215**
Total Assets	**434**	**426**	**516**	**523**	**550**
Current Liabilities					
Accounts Payable	1	2	5	11	3
Bank borrowings	25	18	10	-	-
Other	138	62	55	51	42
Total Current Liabilities	**164**	**82**	**70**	**61**	**45**
Non-Current Liabilities					
Bank borrowings	-	-	-	-	-
Deferred tax liabilities	23	35	43	27	32
Other	74	93	93	93	93
Total Non-Current Liabilities	**97**	**129**	**136**	**120**	**125**
Total Liabilities	**261**	**210**	**206**	**182**	**170**
Equity					
Share Capital	25	27	109	110	112
Reserves	149	188	201	232	268
Total Shareholder's Equity	**173**	**215**	**309**	**342**	**380**

Key Ratios	Dec 12	Dec 13	Dec 14E	Dec 15E	Dec 16E
Net debt (HK$mn)	-5	-58	-111	-73	-165
Net debt to equity	-2.7%	-27.0%	-36.0%	-21.3%	-43.5%
Net debt/ EBITDA	-0.1x	-1.1x	-3.4x	-1.6x	-3.2x
Capex/ Sales	1.0%	2.2%	25.3%	39.6%	1.4%
Current ratio	1.6x	2.1x	3.5x	2.6x	4.9x
Quick ratio	0.2x	1.2x	2.0x	1.2x	3.7x
Interest coverage	70.1x	20.4x	40.3x	151.6x	N/A
Avg Inventory (days)	4	8	8	8	8
Avg Receivables (days)	273	256	256	256	256
Avg Payables (days)	52	57	57	57	57
Cash conversion cycle (days)	226	207	207	207	207

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