

Canvest Environmental Protection Group

Strong 2016 results; management confident on future growth

Maintain Buy: 2016 net profit increased 47% YoY, margin beat

Canvest reported a strong set of results for 2016. Net profit increased 47% YoY to HK\$400 million, consistent with the recently issued positive profit alert. Revenue increased by 40% YoY to HK\$1,654 million. Gross profit margin was 35.6%, higher than our estimated 33.9% mainly due to better than expected gross margin for waste treatment operations after favorable terms were negotiated with suppliers in 2H16. We maintain Buy on the stock and see the strong growth momentum to continue for Canvest, as the cooperation deepens with its government-backed shareholder Shanghai Industrial Holdings Limited and strategic partners Guangdong Finance Investment International and BOC&UTRUST.

Price target upgraded to HK\$5.21, 14% upside

We revise up our 2017e/2018e/2019e earnings by 6%/10%/6%, after factoring in (1) management fee income from the Zhongshan plant; (2) revenue and earnings contribution from the newly announced Xinyi WTE project; (3) margin improvement for waste treatment operations. Our price target is revised up to HK\$5.21, derived with the DCF method, assuming 7.58% WACC, and 3% long-term growth rate. This implies 21.1x/16.1x 2017e/2018e PE.

Management confident to achieve over 30% capacity growth in 2017

At the annual results investor meeting, the chairlady confirmed that Canvest should deepen cooperation with its 2nd largest shareholder Shanghai Industrial Holdings Limited to expand WTE operations. The management guided that the 2017 planned capacity should grow to 26,000+ tons/day, up by over 30% from the current 19,090 tons/day level. Together with the support from its government-backed strategic partners Guangdong Finance Investment International and BOC&UTRUST, we believe Canvest will continue its strong growth momentum in the 2017-2020 golden period. According to the 13th Five-Year Plan, China's municipal waste incineration capacity will increase by c150% from 2015 to 2020; particularly Guangdong's planned waste incineration treatment capacity is set to quadruple by 2020.

Catalysts: Strong reported earnings expected for 2017e-2019e; potential new project announcements affirm future earnings

We estimate Canvest will complete construction for 5 WTE projects by 2017e, and another 6 by 2019e. With the funding and new project acquisition support from its government-backed shareholder and strategic partners, Canvest could potentially achieve better than expected growth and become a national top player in the WTE field. We await more detailed announcement of new quality projects in 2017; and any additional announcement regarding business expansion could provide upside surprise.

Stock code: 1381.HK

Rating: Buy

| Price target (HK\$) | 5.21 |
|-----------------------------------|-------|
| Current price (HK\$, 22 Mar 2017) | 4.58 |
| Upside/downside % | 14% |
| Market cap (HK\$ m) | 9,317 |
| Market cap (US\$ m) | 1,202 |
| Avg daily turnover (HK\$ m) | 16.7 |

Source: Bloomberg, AMTD Equity Research

Key forecasts

| (HK\$ m) | 2016 | 2017e | 2018e | 2019e |
|---------------------|-------|-------|-------|-------|
| Reported net profit | 400 | 566 | 745 | 893 |
| yoy % | 47% | 41% | 32% | 20% |
| Reported revenue | 1,654 | 2,404 | 2,894 | 3,321 |
| yoy % | 40% | 45% | 20% | 15% |
| Adj. net profit | 243 | 322 | 461 | 559 |
| yoy % | 58% | 32% | 43% | 21% |
| Adj. revenue | 809 | 1,044 | 1,381 | 1,603 |
| yoy % | 39% | 29% | 32% | 16% |
| EBITDA margin | 42% | 39% | 42% | 43% |
| Net debt | 1,657 | 1,035 | 1,625 | 2,170 |
| EPS | 0.20 | 0.25 | 0.32 | 0.38 |
| BPS | 1.34 | 1.81 | 2.09 | 2.42 |

Source: Company data, AMTD Equity Research

Valuation

| | 2016 | 2017e | 2018e | 2019e |
|------|-------|-------|-------|-------|
| P/E | 23.3x | 18.3x | 13.9x | 11.6x |
| P/BV | 3.4x | 2.5x | 2.1x | 1.8x |
| ROE | 15.8% | 16.3% | 16.4% | 17.0% |
| ROA | 7.6% | 8.1% | 8.8% | 9.4% |

Source: Bloomberg, AMTD Equity Research

Share price performance



Source: Bloomberg

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Figure 1: Canvest – 2016 earnings review, YoY comparison and key ratios

| PnL, HK\$ m | 2014 | 2015 | 2016 | 2016e | Actual vs forecast | 2016 YoY % | Comments |
|-------------------------------------|------------|--------------|--------------|--------------|--------------------|------------|--|
| Revenue | 794 | 1,185 | 1,654 | 1,701 | -3% | 40% | Construction revenue slightly lower than estimated |
| Cost of sales | (452) | (745) | (1,064) | (1,124) | -5% | 43% | |
| Gross profit | 342 | 439 | 589 | 577 | 2% | 34% | Gross profit margin better than estimated - favorable terms with supplier negotiated in 2H16 |
| <i>Gross profit margin</i> | 43% | 37% | 36% | 34% | | -4% | |
| General and administrative expenses | (97) | (112) | (123) | (129) | -5% | 10% | |
| Other income | 51 | 49 | 83 | 64 | 29% | 69% | HK\$ 35mn management income not previously factored in |
| Other gains, net | - | 4 | (2) | 4 | -139% | -141% | |
| EBITDA | 401 | 499 | 698 | 687 | 2% | 40% | |
| <i>EBITDA margin</i> | 51% | 42% | 42% | 40% | | 0% | |
| EBIT | 296 | 380 | 547 | 516 | 6% | 44% | |
| <i>EBIT margin</i> | 37% | 32% | 33% | 30% | 9% | 3% | |
| Net interest expenses | (62) | (51) | (84) | (77) | 10% | 66% | |
| <i>Effective interest rate</i> | | 6.27% | 7.30% | 7.30% | | 17% | |
| Profit before income tax | 236 | 330 | 463 | 439 | 5% | 40% | |
| Income tax expenses | (27) | (41) | (63) | (48) | 30% | 53% | Higher effective tax rate due to reduced tax exemption for China Scivest plant |
| <i>Effective tax rate</i> | 11% | 12% | 14% | 11% | | 9% | |
| Net profit | 208 | 289 | 400 | 391 | 2% | 38% | |
| <i>Net profit margin</i> | 26% | 24% | 24% | 23% | | -1% | |
| Minorities | 17 | 17 | - | - | | | |
| Attributable profit | 191 | 272 | 400 | 391 | 2% | 47% | |
| PER SHARE DATA, HK\$ | | | | | | | |
| EPS | 0.127 | 0.136 | 0.199 | | | | |
| Adjusted EPS | 0.096 | 0.077 | 0.121 | | | | |
| DPS | | | 0.03 | | | | |
| BVPS | | | 1.34 | | | | |
| KEY RATIOS | | | | | | | |
| ROAE | 13% | 12% | 16% | | | | |
| ROAA | 8% | 7% | 8% | | | | |
| Gross debt (HK\$ m) | 1,029 | 1,420 | 2,319 | | | | |
| Net debt (cash) (HK\$ m) | (432) | 814 | 1,657 | | | | |
| Net gearing | -18% | 35% | 61% | | | | |

Source: Company data, AMTD Equity Research

Figure 2: Canvest – PnL

| PnL, HK\$ m | 2014 | 2015 | 2016 | 2017e | 2018e | 2019e |
|-------------------------------------|-------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 794 | 1,185 | 1,654 | 2,404 | 2,894 | 3,321 |
| Cost of sales | (452) | (745) | (1,064) | (1,596) | (1,858) | (2,105) |
| Gross profit | 342 | 439 | 589 | 808 | 1,036 | 1,216 |
| <i>Gross profit margin</i> | 43% | 37% | 35.6% | 33.6% | 35.8% | 36.6% |
| General and administrative expenses | (97) | (112) | (123) | (140) | (158) | (177) |
| Other income | 51 | 49 | 83 | 74 | 90 | 102 |
| Other gains, net | - | 4 | (2) | - | - | - |
| EBITDA | 401 | 499 | 698 | 937 | 1,225 | 1,441 |
| <i>EBITDA margin</i> | 51% | 42% | 42% | 39% | 42% | 43% |
| EBIT | 296 | 380 | 547 | 742 | 969 | 1,141 |
| <i>EBIT margin</i> | 37% | 32% | 33% | 31% | 33% | 34% |
| Net interest expenses | (62) | (51) | (84) | (91) | (118) | (121) |
| <i>Effective interest rate</i> | | 6.27% | 7.30% | 7.00% | 6.50% | 6.00% |
| Profit before income tax | 236 | 330 | 463 | 651 | 851 | 1,020 |
| Income tax expenses | (27) | (41) | (63) | (85) | (106) | (126) |
| <i>Effective tax rate</i> | 11% | 12% | 14% | 13% | 13% | 12% |
| Net profit | 208 | 289 | 400 | 566 | 745 | 893 |
| <i>Net profit margin</i> | 26% | 24% | 24% | 24% | 26% | 27% |
| Minorities | 17 | 17 | - | - | - | - |
| Attributable profit | 191 | 272 | 400 | 566 | 745 | 893 |
| PER SHARE DATA, HK\$ | 2014 | 2015 | 2016 | 2017e | 2018e | 2019e |
| EPS | 0.127 | 0.136 | 0.199 | 0.247 | 0.319 | 0.383 |
| Adjusted EPS | 0.096 | 0.077 | 0.121 | 0.140 | 0.197 | 0.239 |
| DPS | | | 0.03 | 0.03 | 0.04 | 0.05 |
| BVPS | | | 1.34 | 1.81 | 2.09 | 2.42 |
| KEY RATIOS | 2014 | 2015 | 2016 | 2017e | 2018e | 2019e |
| ROAE | 13% | 12% | 16% | 16.3% | 16.4% | 17.0% |
| ROAA | 8% | 7% | 8% | 8.1% | 8.8% | 9.4% |
| Gross debt (HK\$ m) | 1,029 | 1,420 | 2,319 | 2,257 | 2,517 | 2,549 |
| Net debt (cash) (HK\$ m) | (432) | 814 | 1,657 | 1,035 | 1,625 | 2,170 |
| Net gearing | -18% | 35% | 61% | 24% | 33% | 38% |

Source: Company data, AMTD Equity Research

Figure 3: Canvest – Balance Sheet

| BALANCE SHEET, HK\$ m | 2014 | 2015 | 2016 | 2017e | 2018e | 2019e |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| ASSETS | | | | | | |
| Non-current assets | 2,201 | 3,665 | 5,089 | 6,317 | 7,532 | 8,902 |
| Land use rights | 167 | 154 | 140 | 137 | 134 | 131 |
| Property, plant and equipment | 530 | 965 | 1,202 | 1,491 | 1,370 | 1,229 |
| Intangible assets | 1,271 | 1,915 | 2,630 | 3,085 | 3,873 | 4,757 |
| Long-term deposits and prepayments | 113 | 120 | 295 | 295 | 295 | 295 |
| Gross amounts due from customers for contract work | 120 | 512 | 821 | 1,308 | 1,859 | 2,490 |
| Current assets | 1,566 | 803 | 972 | 1,646 | 1,463 | 1,061 |
| Trade and other receivables | 103 | 197 | 254 | 326 | 430 | 494 |
| Gross amounts due from customers for contract work | | 38 | 56 | 99 | 140 | 188 |
| Restricted deposits | 6 | 157 | 43 | 43 | 43 | 43 |
| Cash and cash equivalents | 1,328 | 449 | 619 | 1,179 | 849 | 336 |
| Total assets | 3,767 | 4,468 | 6,061 | 7,963 | 8,994 | 9,963 |
| EQUITY | | | | | | |
| Share capital | 20 | 20 | 20 | 23 | 23 | 23 |
| Reserves | 2,295 | 2,315 | 2,703 | 4,206 | 4,848 | 5,619 |
| Attributable shareholders' equity | 2,315 | 2,334 | 2,723 | 4,229 | 4,872 | 5,642 |
| Minorities | 103 | - | - | - | - | - |
| Total equity | 2,418 | 2,334 | 2,723 | 4,229 | 4,872 | 5,642 |
| LIABILITIES | | | | | | |
| Non-current liabilities | 882 | 1,348 | 2,479 | 2,434 | 2,559 | 2,599 |
| Deferred income tax liabilities | 104 | 209 | 252 | 281 | 313 | 348 |
| Long-term borrowings | 776 | 1,099 | 1,635 | 1,835 | 1,929 | 1,933 |
| Current liabilities | 468 | 785 | 859 | 1,300 | 1,563 | 1,722 |
| Trade and other payables | 213 | 461 | 568 | 919 | 1,016 | 1,146 |
| Short-term borrowings | 253 | 321 | 277 | 368 | 534 | 562 |
| Total liabilities | 1,349 | 2,134 | 3,338 | 3,734 | 4,123 | 4,321 |

Source: Company data, AMTD Equity Research

Figure 4: Canvest – Cash Flows

| Adjusted cash flows, HK\$ m | 2014 | 2015 | 2016e | 2017e | 2018e | 2019e |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| Profit before tax | 236 | 330 | 463 | 651 | 851 | 1,020 |
| Adjustments for: | | | | | | |
| Finance income arising from BOT arrangement | (4) | (20) | (34) | (40) | (64) | (91) |
| Profit from BOT construction | (41) | (97) | (141) | (228) | (252) | (284) |
| Waste treatment fee allocated as deduction of gross amounts due from customers | | | 33 | 44 | 59 | 74 |
| Depreciation of property, plant and equipment | 36 | 47 | 70 | 91 | 121 | 142 |
| Amortisation of land use rights | 4 | 4 | 4 | 3 | 3 | 3 |
| Net interest expenses | 61 | 51 | 84 | 91 | 118 | 121 |
| Income tax paid | (20) | (14) | (20) | (55) | (75) | (91) |
| FCF before movement of working capital | 308 | 312 | 460 | 557 | 760 | 894 |
| Changes in working capital | 36 | 75 | 195 | 279 | (8) | 67 |
| CFFO | 344 | 387 | 655 | 836 | 753 | 960 |
| BOT construction | (206) | (486) | (515) | (1,136) | (1,256) | (1,417) |
| Amortisation of intangible assets | 65 | 68 | 77 | 100 | 133 | 156 |
| Payments for purchase of property, plant and equipment | (207) | (367) | (307) | (381) | - | - |
| FOCF | (65) | (682) | (90) | (580) | (371) | (301) |
| Interest paid | (69) | (80) | (84) | (91) | (118) | (121) |
| Dividends paid | - | - | (55) | (78) | (102) | (123) |
| FCF | (134) | (762) | (229) | (749) | (590) | (545) |
| New borrowings | 71 | 758 | 399 | 291 | 260 | 33 |
| Issuance of ordinary shares | 1,165 | | - | 1,018 | - | - |
| Net increase/(decrease) in cash and cash equivalents | 1,279 | (858) | 170 | 560 | (330) | (513) |
| Cash and cash equivalents at beginning of year | 50 | 1,328 | 449 | 619 | 1,179 | 849 |
| Cash and cash equivalents at end of year | 1,328 | 449 | 619 | 1,179 | 849 | 336 |

Source: Company data, AMTD Equity Research

IMPORTANT DISCLOSURES

AMTD Investment Ratings

Industry Rating

| | |
|--------------------|---|
| Overweight | Industry sector expected to outperform the market over the next 12 months |
| Neutral | Industry sector expected to perform in-line with the market over the next 12 months |
| Underweight | Industry sector expected to underperform the market over the next 12 months |

Stock Rating

| | |
|-------------|---|
| Buy | Stock with potential return of over 20% over the next 12 months |
| Hold | Stock with potential return of -20% to +20% over the next 12 months |
| Sell | Stock with potential loss of over 20% over the next 12 months |

Analyst Certification

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