

## Canvest Environmental Protection Group

### New project announcement; strong growth momentum with policy support

#### New project announcement

On 6 March 2017, Canvest announced that it was awarded a new waste treatment project in Xinyi, Maoming, Guangdong Province. The processing capacity of the Xinyi plant is planned to be 750 tons/day (Phase I: 500 tons/day; Phase II: 250 tons/day). The BOT concession right shall last 30 years. The Xinyi plant represents c9.5% addition to Canvest's total existing processing capacity.

#### Strong growth momentum to continue

This affirms our belief that the new-project-winning momentum will continue for Canvest, with the support from its government-backed strategic partners Guangdong Finance Investment International, BOC&UTRUST and 2<sup>nd</sup> largest shareholder Shanghai Industrial Holdings Limited. According to the 13<sup>th</sup> Five-Year Plan, China's municipal waste incineration capacity will increase by c150% from 2015 to 2020, and particularly Guangdong's planned waste incineration treatment capacity is set to quadruple by 2020.

#### Environmental investment - contributor to 2017 GDP growth

At the 2017 National People's Congress, Premier Li Keqiang announced that the 2017 GDP growth target is around 6.5%. With the government's tightened property market policy stance and reduced tax support for auto sales in 2017, we believe a key driver for GDP growth this year should be infrastructure investment. Environmental protection investment could well be a key area that central and local governments support, because of its positive externality and publicity, apart from the GDP contribution. We believe that the completion rate of the waste incineration investment target in 2017-2020 will be very high, unlike in previous years when the government was still very much focused on the old economy while trying to boost GDP growth.

#### Reiterate Buy rating; price target HK\$5.19, 13% upside

Since our initiation on 20 Feb 2017, the stock price has moved up by 13%. Our PT of HK\$5.19 is derived with the DCF method, assuming 7.58% WACC, and 3% long-term growth rate. This implies 22.2x/17.6x 2017e/2018e PE.

#### 2016 results: Positive profit alert; new asset-light operating model

Canvest will report full year results for 2016 in late March 2017. On 16 Feb 2017, the company issued a positive profit alert of 45% yoy increase in 2016 earnings, due to expanded waste treatment capacity, increasing construction revenue and income from managed project. Currently our valuation has not factored in management fee income 2017e onwards for lack of clarity on detailed revenue booking method, which leaves potential upside in our forecast.

#### Catalysts: Strong reported earnings expected for 2016e-2019e; potential new project announcements would provide upside surprise

We estimate Canvest will complete construction for 5 WTE projects by 2017e, and another 5 by 2019e. Our project forecast is conservative and currently only includes the ones already announced (excluding the new Xinyi plant); any announcement of new quality projects and management fee income from managed projects (asset-light model) could provide upside surprise.

**Stock code: 1381.HK**
**Rating: Buy**

Price target (HK\$)	5.19
Current price (HK\$, 9 Mar 2017)	4.61
Upside/downside %	13%
Market cap (HK\$ m)	9,378
Market cap (US\$ m)	1,210
Avg daily turnover (HK\$ m)	16.3

Source: Bloomberg, AMTD Equity Research

#### Key forecasts

(HK\$ m)	2016e	2017e	2018e	2019e
Reported net profit	391	535	677	845
yoy %	44%	37%	26%	25%
Reported revenue	1,701	2,312	2,566	3,062
yoy %	44%	36%	11%	19%
Adj. net profit	257	310	438	539
yoy %	66%	21%	41%	23%
Adj. revenue	846	1,036	1,370	1,592
yoy %	46%	22%	32%	16%
EBITDA margin	40%	39%	45%	45%
Net debt	1,631	1,294	1,760	1,924
EPS	0.19	0.23	0.29	0.36
BPS	1.33	1.80	2.05	2.37

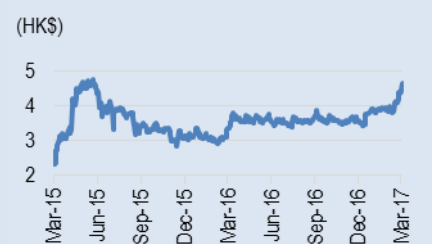
Source: Company data, AMTD Equity Research

#### Valuation

	2016e	2017e	2018e	2019e
P/E	24.0x	19.5x	15.4x	12.3x
P/BV	3.5x	2.5x	2.2x	1.9x
ROE	15.5%	15.5%	15.1%	16.4%
ROA	8.0%	8.4%	8.7%	9.7%

Source: Bloomberg, AMTD Equity Research

#### Share price performance



Source: Bloomberg

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Figure 1: Canvest – PnL

PnL, HK\$ m	2013	2014	2015	2016e	2017e	2018e	2019e
<b>Revenue</b>	<b>390</b>	<b>794</b>	<b>1,185</b>	<b>1,701</b>	<b>2,312</b>	<b>2,566</b>	<b>3,062</b>
Cost of sales	(188)	(452)	(745)	(1,124)	(1,542)	(1,594)	(1,880)
<b>Gross profit</b>	<b>203</b>	<b>342</b>	<b>439</b>	<b>577</b>	<b>769</b>	<b>972</b>	<b>1,182</b>
<i>Gross profit margin</i>	52%	43%	37%	34%	33%	38%	39%
General and administrative expenses	(42)	(97)	(112)	(129)	(147)	(166)	(186)
Other income	14	51	49	64	66	68	70
Other gains, net	(1)	-	4	4	4	4	5
<b>EBITDA</b>	<b>220</b>	<b>402</b>	<b>500</b>	<b>687</b>	<b>901</b>	<b>1,152</b>	<b>1,392</b>
<i>EBITDA margin</i>	56%	51%	42%	40%	39%	45%	45%
<b>EBIT</b>	<b>174</b>	<b>297</b>	<b>381</b>	<b>516</b>	<b>693</b>	<b>878</b>	<b>1,071</b>
<i>EBIT margin</i>	45%	37%	32%	30%	30%	34%	35%
Net interest expenses	(26)	(62)	(51)	(77)	(91)	(118)	(121)
<i>Effective interest rate</i>			6.27%	7.30%	7.00%	6.50%	6.00%
<b>Profit before income tax</b>	<b>148</b>	<b>236</b>	<b>330</b>	<b>439</b>	<b>602</b>	<b>760</b>	<b>949</b>
Income tax expenses	(17)	(27)	(41)	(48)	(66)	(84)	(104)
<i>Effective tax rate</i>	11%	11%	12%	11%	11%	11%	11%
<b>Net profit</b>	<b>131</b>	<b>208</b>	<b>289</b>	<b>391</b>	<b>535</b>	<b>677</b>	<b>845</b>
<i>Net profit margin</i>	34%	26%	24%	23%	23%	26%	28%
Minorities		17	17	-	-	-	-
<b>Attributable profit</b>	<b>131</b>	<b>191</b>	<b>272</b>	<b>391</b>	<b>535</b>	<b>677</b>	<b>845</b>
<b>PER SHARE DATA, HK\$</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	<b>2019e</b>
EPS	0.087	0.127	0.136	0.195	0.233	0.290	0.362
Adjusted EPS	0.087	0.097	0.077	0.128	0.135	0.188	0.231
DPS				0.01	0.03	0.03	0.04
BVPS	0.45	1.54	1.17	1.35	1.83	2.05	2.37
<b>KEY RATIOS</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	<b>2019e</b>
ROAE	26%	13%	12%	15.5%	15.5%	15.1%	16.4%
ROAA	12%	8%	7%	8.0%	8.4%	8.7%	9.7%
Gross debt (HK\$ m)	382	1,029	1,420	2,020	2,239	2,476	2,617
Net debt (cash) (HK\$ m)	153	(432)	814	1,631	1,294	1,760	1,924
Net gearing	20%	-18%	35%	60%	31%	37%	35%

Source: Company data, AMTD Equity Research

Figure 2: Canvest – Balance Sheet

BALANCE SHEET, HK\$ m	2013	2014	2015	2016e	2017e	2018e	2019e
<b>ASSETS</b>							
<b>Non-current assets</b>	<b>851</b>	<b>2,201</b>	<b>3,665</b>	<b>4,690</b>	<b>6,072</b>	<b>6,924</b>	<b>7,987</b>
Land use rights	171	167	154	150	147	144	140
Property, plant and equipment	472	530	965	1,286	1,591	1,480	1,350
Intangible assets	181	1,271	1,915	1,969	2,072	2,119	2,184
Long-term deposits and prepayments	27	113	120	120	120	120	120
Gross amounts due from customers for contract work		120	512	1,164	2,142	3,061	4,193
<b>Current assets</b>	<b>389</b>	<b>1,566</b>	<b>803</b>	<b>663</b>	<b>1,340</b>	<b>1,269</b>	<b>1,326</b>
Trade and other receivables	158	103	197	186	233	321	316
Gross amounts due from customers for contract work			38	88	162	231	317
Restricted deposits	6	6	157	157	157	157	157
Cash and cash equivalents	50	1,328	449	232	788	560	536
<b>Total assets</b>	<b>1,241</b>	<b>3,767</b>	<b>4,468</b>	<b>5,353</b>	<b>7,412</b>	<b>8,192</b>	<b>9,313</b>
<b>EQUITY</b>							
Share capital		20	20	20	23	23	23
Reserves	676	2,295	2,315	2,684	4,170	4,766	5,510
Attributable shareholders' equity	676	2,315	2,334	2,704	4,193	4,789	5,533
Minorities	86	103	-	-	-	-	-
<b>Total equity</b>	<b>762</b>	<b>2,418</b>	<b>2,334</b>	<b>2,704</b>	<b>4,193</b>	<b>4,789</b>	<b>5,533</b>
<b>LIABILITIES</b>							
<b>Non-current liabilities</b>	<b>324</b>	<b>882</b>	<b>1,348</b>	<b>1,605</b>	<b>1,906</b>	<b>2,083</b>	<b>2,204</b>
Deferred income tax liabilities	31	104	209	225	249	272	299
Long-term borrowings	294	776	1,099	1,298	1,575	1,729	1,823
<b>Current liabilities</b>	<b>154</b>	<b>468</b>	<b>785</b>	<b>1,044</b>	<b>1,313</b>	<b>1,321</b>	<b>1,576</b>
Trade and other payables	64	213	461	714	1,041	966	1,175
Short-term borrowings	88	253	321	330	272	355	401
<b>Total liabilities</b>	<b>479</b>	<b>1,349</b>	<b>2,134</b>	<b>2,649</b>	<b>3,218</b>	<b>3,404</b>	<b>3,780</b>

Source: Company data, AMTD Equity Research

**Figure 3: Canvest – Cash Flows**

<b>Adjusted cash flows, HK\$ m</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	<b>2019e</b>
<b>Profit before tax</b>	<b>148</b>	<b>236</b>	<b>330</b>	<b>439</b>	<b>602</b>	<b>760</b>	<b>949</b>
Adjustments for:							
Finance income arising from BOT arrangement		(4)	(20)	(25)	(57)	(105)	(150)
Profit from BOT construction	-	(41)	(97)	(148)	(220)	(204)	(248)
Waste treatment fee allocated as deduction of gross amounts due from customers	-			74	98	132	167
Depreciation of property, plant and equipment	42	36	47	69	84	111	131
Amortisation of land use rights	4	4	4	4	3	3	3
Net interest expenses	26	61	51	77	91	118	121
Income tax paid	(7)	(20)	(14)	(32)	(42)	(61)	(77)
<b>FCF before movement of working capital</b>	<b>192</b>	<b>308</b>	<b>312</b>	<b>457</b>	<b>560</b>	<b>754</b>	<b>896</b>
Changes in working capital	29	36	75	264	280	(162)	213
<b>CFFO</b>	<b>221</b>	<b>344</b>	<b>387</b>	<b>721</b>	<b>840</b>	<b>592</b>	<b>1,109</b>
BOT construction	-	(206)	(486)	(756)	(1,097)	(1,018)	(1,238)
Amortisation of intangible assets		65	68	98	121	160	187
Payments for purchase of property, plant and equipment	(33)	(207)	(367)	(390)	(390)	-	-
<b>FOCF</b>	<b>13</b>	<b>(65)</b>	<b>(682)</b>	<b>(326)</b>	<b>(525)</b>	<b>(267)</b>	<b>58</b>
Interest paid	(27)	(69)	(80)	(77)	(91)	(118)	(121)
Dividends paid	-	-	-	(22)	(64)	(81)	(101)
<b>FCF</b>	<b>(14)</b>	<b>(134)</b>	<b>(762)</b>	<b>(425)</b>	<b>(681)</b>	<b>(465)</b>	<b>(164)</b>
New borrowings		71	758	208	219	237	140
Issuance of ordinary shares		1,165		-	1,018	-	-
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>4</b>	<b>1,279</b>	<b>(858)</b>	<b>(217)</b>	<b>556</b>	<b>(228)</b>	<b>(24)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>45</b>	<b>50</b>	<b>1,328</b>	<b>449</b>	<b>232</b>	<b>788</b>	<b>560</b>
<b>Cash and cash equivalents at end of year</b>	<b>50</b>	<b>1,328</b>	<b>449</b>	<b>232</b>	<b>788</b>	<b>560</b>	<b>536</b>

Source: Company data, AMTD Equity Research

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#### Industry Rating

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

#### Stock Rating

<b>Buy</b>	Stock with potential return of over 20% over the next 12 months
<b>Hold</b>	Stock with potential return of -20% to +20% over the next 12 months
<b>Sell</b>	Stock with potential loss of over 20% over the next 12 months

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