

Huatai Research

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Equity | China | Construction Materials

BUY | TP HKD24.20**Maintained**

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Forming the strongest coalition in hazardous waste industry

A cooperation between two leaders; lift TP; reiterate BUY

China Conch Venture (Conch Venture) announced (4 December) the signing of a strategic cooperation agreement with Dongjiang Environment (895 HK), another leader in the hazardous waste industry. On existing projects, the two parties will seek complementary advantages to optimize profitability. And to expand their market, they will try to form a JV in Guangdong initially. Details of the business arrangement will be further discussed. We identify two profound implications for Conch Venture: 1) it is a stamp of recognition for both co-incineration technology and the company's capability; and 2) potential synergy will help its market expansion, lifting operational efficiency as well as adding to its industry expertise. We raise 2017E/2018E earnings by 5.0/13.1%, on: 1) a more optimistic view of the industrial solid waste business; and 2) higher associate income prompted by cement price hike. Higher earnings estimates and rollover of our SOTP valuation base to 2018E lift our TP by 24% to HKD24.2 (from HKD19.5). Reiterate BUY.

Potential synergies: four advantages for Conch Venture

1) The cooperation gives market access in Guangdong, a major hazardous waste (HW) generator (1mn tonnes for harmless treatment in 2015, 8.8% of China total). Conch Venture associate Conch Cement operates 14.6mtpa clinker capacity in Guangdong, which can be turned into 800ktpa of HW capacity if fully utilized. 2) Rooted in Guangdong, Dongjiang Environment can share its transportation network and customer resources with Conch Venture. 3) Both parties can enhance profitability on existing projects via combination of complementary advantages, which could also accelerate the progress of new projects. 4) Conch Venture can beef up its expertise in areas other than cement kiln co-incineration, thereby expanding to full HW coverage, from 36 types currently.

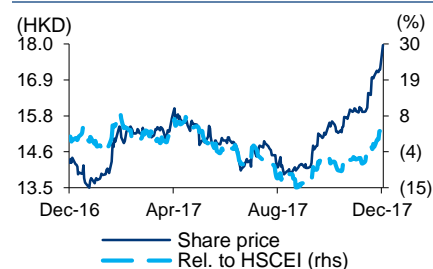
ISW set to drive robust growth in core earnings

Even without this cooperation, Conch Venture's industrial solid waste (ISW) business is already set to enjoy steadfast growth in the coming years. Thanks to the government's greater emphasis on and closer supervision of the environment, profitability in the ISW business is likely to remain high. With projects ramping in Mian County, Huaining and Huaibei, Conch Venture's operational capacity has increased to 375ktpa from at (end-2016: 270ktpa), and it still has another 1,600ktpa of capacity under construction or in a preparatory stage. We estimate sound ISW business development, starting in 2018, will drive 2018E-2020E core business earnings CAGR of 34.2%. Downside risk: slower-than-expected project ramp-up.

Key data

Target price (HKD)	24.20
Previous target price (HKD)	19.50
Closing price (HKD as of 4 Dec)	17.96
Upside +/- (%)	35
Mkt cap (USDmn)	4,147
6m avg daily val (USDmn)	6.39
52wk price range (HKD)	17.96/13.50
BVPS (RMB)	9.83

Share performance



Source: FactSet

Financials

YE 31 Dec	FY15	FY16	FY17E	FY18E	FY19E
Revenue (RMBmn)	2,057	2,032	2,535	2,805	3,197
yoy%	17.7	(1.2)	24.7	10.7	14.0
Net profit (RMBmn)	1,944	1,981	3,188	3,424	3,583
yoy%	(13.1)	1.9	61.0	7.4	4.6
EPS (diluted, RMB)	1.077	1.097	1.766	1.897	1.985
PE (x)	14.1	13.9	8.6	8.0	7.7
PB (x)	1.7	1.5	1.3	1.2	1.1
EV EBITDA (x)	11.8	11.5	7.2	6.6	6.1
Dividend yield (%)	2.1	1.7	1.7	2.2	2.3
Free cashflow yield (%)	(0.3)	(0.7)	0.6	0.8	1.3

Source: Company data, Huatai HK Research estimates

Huatai Financial Holdings (Hong Kong) Limited is abbreviated as Huatai HK throughout this report.

Please refer to end pages for analyst certification and required disclosures.

Key charts

Fig.1. Summary of key revisions

	New	Old	Chg (%)			
TP (HKD)	24.2	19.5	24.1			
	2017E			2018E		
	New	Old	Chg (%)	New	Old	Chg (%)
Operating data						
MSW treated ('000 tonnes)	1,310	1,073	22.2	1,742	1,717	1.5
HW and ISW treated ('000 tonnes)	113	223	(49.3)	436	355	22.8
HW and ISW treatment fee (RMB/t)	1,100	500	120.0	1,100	450	144.4
Financial data (RMBmn)						
Revenue	2,535	2,336	8.5	2,805	2,513	11.6
Investment income from Conch Cement	2,700	2,581	4.6	2,764	2,508	10.2
Net profit	3,188	3,038	5.0	3,424	3,028	13.1

Source: Company data, Huatai HK Research estimates

Fig.2. SOPT valuation

Target price (HKD)	24.2		
Valuation of core business (RMBmn)		Valuation of equity investment (RMBmn)	
Energy saving and environmental protection		Investment in Anhui Conch	
1y forward EBITDA	1,091	1y forward net profit for Anhui Conch	15,335
Target EV EBITDA multiple	11.0x	Interest in Anhui Conch (%)	18.0
<i>Peer valuations:</i>			
<i>Historical EV EBITDA for CEI</i>	<i>12.5x</i>		
<i>Historical EV EBITDA for Dynagreen</i>	<i>10.3x</i>		
<i>Historical EV EBITDA for Canvest</i>	<i>11.3x</i>	Target PE multiple for Anhui Conch	12.5x
Fair value	12,004	Fair equity value	34,546
Other operating business (mainly port business)		Investment in others	
1y forward EBITDA	91	1y forward net profit	50
Target EV EBITDA multiple	10.0x	Target multiple	5.0x
Fair value	913	Fair equity value	250
Core business sum-up			
Fair enterprise value for core business	12,917		
Net debt	446		
Minority interest	821		
Fair equity value for core business	11,650		
Conglomerate discount (%)	20.0		
Fair equity value for Conch Venture (RMBmn)	37,157	Fair equity value for Conch Venture (HKDmn)	43,714
		Target price (HKD)	24.2
Number of shares outstanding	1,805	Implied 2017E PE	11.7x
CNY-HKD	0.88	Implied 2018E PE	10.9x

Source: Company data, Huatai HK Research estimates

Fig.3. Peer valuation comparison

Stock name	Ticker	Market cap (USDmn)	PE (x)		PB (x)		EV EBITDA (x)		ROE (%)	
			2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E
Environmental-H										
CEI	257 HK	6,000	13.0	11.0	2.0	1.8	9.7	8.1	15.5	16.3
Conch Venture	586 HK	4,150	8.6	8.0	1.3	1.2	7.2	6.6	16.7	15.7
BEWG	371 HK	6,829	12.2	9.7	2.7	2.3	8.5	6.9	22.2	23.2
Tianjin Capital - H	1065 HK	796	12.5	11.8	1.2	1.1	6.2	5.9	9.9	9.6
CTEG	1363 HK	1,043	12.9	10.4	2.4	2.0	8.6	6.9	18.4	19.2
Dongjiang-H	895 HK	1,273	17.7	14.1	2.0	1.7	10.9	8.9	11.5	11.8
Canvest	1381 HK	1,433	15.7	12.4	2.8	2.4	12.0	10.1	18.1	19.0
Dynagreen	1330 HK	568	8.2	6.8	1.2	1.1	7.0	5.6	14.7	15.6
Weighted average			13.0	10.7	2.3	2.0	9.1	7.5		
Environmental-A										
Origin Water	300070 CH	8,175	21.1	16.6	3.0	2.6	16.7	12.4	14.3	15.5
Tus Sound	000826 CH	5,171	23.6	18.6	2.5	2.2	17.4	13.5	10.4	11.9
Beijing Capital	600008 CH	3,808	35.1	31.3	2.4	2.2	16.1	14.3	6.7	7.0
Dongjiang-A	002672 CH	2,191	29.0	23.0	3.9	3.3	17.4	14.0	13.5	14.2
Tianjin Capital - A	600874 CH	2,725	36.1	34.2	3.6	3.3	15.7	15.0	9.9	9.6
Weighted average			25.4	20.8	2.8	2.5	16.9	13.3		
Environmental-Global										
Waste Management	WM US	35,523	25.5	23.5	6.7	3.2	11.2	10.7	26.1	13.5
Republic Services	RSG US	21,464	26.9	24.9	2.8	2.8	10.5	9.9	10.5	11.1
Veolia	VIE FP	14,169	20.5	17.3	1.5	1.5	6.3	6.0	7.4	8.9
Waste Connection	WCN US	18,168	32.4	29.4	3.0	2.8	15.0	13.9	9.2	9.4
Suez	SEV FP	11,261	23.7	17.7	1.5	1.4	7.1	6.3	6.1	8.0
Stericycle	SRCL US	5,715	14.9	14.9	2.1	1.9	10.4	10.1	13.9	12.7
Covanta	CVA US	2,011	-68.5	182.7	5.9	7.9	11.2	9.7	-8.6	4.3
Clean Harbors	CLH US	3,058	141.0	54.5	2.7	2.6	10.3	9.1	1.9	4.7
Weighted average	STERV FH		27.0	26.6	3.8	2.6	10.6	9.9		

Note: data as at 4 December close

Source: Bloomberg, Huatai HK Research estimates

Fig.4. Peer performance comparison

Stock name	Ticker	Market cap (USDmn)	Absolute performance (%)						1y relative (%)
			1d	1w	1m	3m	1y	ytd	vs Index
Environment-H									
Conch Venture	586 HK	4,150	4.4	4.7	13.0	27.0	25.4	30.1	7.7
CEI	257 HK	6,000	0.0	(1.3)	(4.9)	1.6	14.4	19.0	(3.3)
BEWG	371 HK	6,829	(0.2)	(1.6)	(9.1)	(5.8)	12.9	20.3	(4.9)
CTEG	1363 HK	1,043	0.0	(0.8)	10.3	17.5	(9.0)	(17.1)	(26.8)
Dongjiang-H	895 HK	1,273	(2.6)	(2.3)	(6.8)	4.3	(15.9)	(17.0)	(33.7)
Weighted average			0.7	(0.2)	(1.9)	5.5	13.0	17.5	(4.8)
Environment-A									
Dongjiang-A	002672 CH	2,191	0.2	1.1	3.1	2.4	(13.4)	(7.2)	(15.4)
Beijing Capital	600008 CH	3,808	(3.0)	(3.9)	(7.1)	(23.8)	22.8	27.3	20.7
Tus Sound	000826 CH	5,171	0.0	(4.8)	(5.6)	(2.8)	1.3	1.6	(0.8)
Shengyun	300090 CH	1,842	0.0	(11.1)	(14.1)	(8.6)	(20.8)	(20.3)	(22.9)
Grandblue	600323 CH	1,780	0.6	2.7	(2.5)	4.0	4.9	7.1	2.9
Weighted average			(0.7)	(3.6)	(5.4)	(7.3)	2.3	4.8	0.3
Environment-Global									
Waste Management	WM US	32,452	(0.5)	1.8	0.1	6.0	17.1	15.4	(3.5)
Republic Services	RSG US	21,651	(1.1)	3.0	0.5	(1.5)	15.1	12.6	(5.5)
Veolia	VIE FP	12,081	0.8	1.3	3.7	8.2	35.9	31.3	15.4
Waste Connection	WCN US	17,097	0.1	0.0	(1.0)	3.7	36.0	31.5	15.5
Suez	SEV FP	11,498	1.0	0.6	1.5	(3.0)	20.5	10.6	(0.1)
Stericycle	SRCL US	6,555	1.0	6.2	(0.6)	(6.7)	(7.7)	(13.1)	(28.2)
Covanta	CVA US	1,808	1.0	3.4	(0.6)	6.6	5.1	(1.6)	(15.4)
Clean Harbors	CLH US	3,054	(0.3)	1.7	0.9	(0.3)	0.4	(3.5)	(20.1)
Weighted average			(0.1)	1.9	0.6	2.4	20.0	16.1	(0.5)

Note: data as at 4 December close

Source: Bloomberg, Huatai HK Research

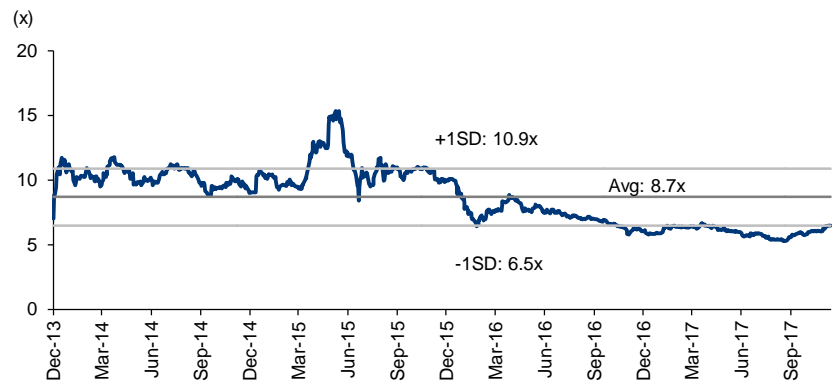
Fig.5. One-year forward PE bands

Source: Huatai HK Research estimates, Bloomberg

Fig.6. One-year forward PB bands

Source: Huatai HK Research estimates, Bloomberg

Fig.7. One-year forward EV EBITDA bands



Source: Bloomberg, Huatai HK Research estimates

Full financials

Income statement

YE 31 Dec (RMBmn)	FY15	FY16	FY17E	FY18E	FY19E
Revenue	2,057	2,032	2,535	2,805	3,197
Cost of goods sold	(1,276)	(1,235)	(1,625)	(1,663)	(1,802)
Gross profit	782	797	909	1,143	1,395
Selling and distrib cost	(29)	(26)	(32)	(36)	(41)
Admin expenses	(198)	(148)	(203)	(224)	(256)
Others oper inc/exp	60	74	114	126	144
Operating profit	615	698	788	1,009	1,242
Financial cost-net	72	48	47	65	82
Share of P&L of assoc	1,540	1,536	2,750	2,814	2,786
Others inc/exp	0	0	0	0	0
Profit before tax	2,227	2,282	3,585	3,888	4,110
Tax expense	(167)	(154)	(175)	(225)	(278)
Minority interest/other	(115)	(147)	(222)	(238)	(249)
Net profit	1,944	1,981	3,188	3,424	3,583
Depr and amortization	70	78	79	87	97
EBITDA	2,224	2,307	3,617	3,910	4,125
EPS (RMB basic)	1.077	1.097	1.766	1.897	1.985

Cash flow statement

YE 31 Dec (RMBmn)	FY15	FY16	FY17E	FY18E	FY19E
EBITDA	2,224	2,307	3,617	3,910	4,125
Financing costs	(72)	(48)	(47)	(65)	(82)
Chg in working capital	(498)	(575)	17	(16)	(94)
Tax	(167)	(154)	(175)	(225)	(278)
Other	(1,422)	(1,483)	(3,074)	(3,212)	(3,123)
Operating cash flow	65	46	339	391	548
Capital expenditure	(155)	(230)	(184)	(184)	(184)
Other investing activ's	1,322	516	1,009	1,050	1,057
Investing cash flow	1,167	286	825	866	873
Increase in debt	(270)	65	65	65	65
Increase in equity	0	0	0	0	0
Dividends paid	(665)	(569)	(453)	(730)	(784)
Other financing activ's	(23)	5	0	0	0
Financing cash flow	(958)	(499)	(388)	(665)	(719)
Change in cash	275	(167)	775	592	702
Cash at start of year	2,058	2,332	2,166	2,941	3,533
Effect of forex rate chg	0	0	0	0	0
Year-end cash	2,332	2,166	2,941	3,533	4,236

Balance sheet

YE 31 Dec (RMBmn)	FY15	FY16	FY17E	FY18E	FY19E
Inventories	246	164	187	215	226
Acc & bill receivable	1,076	993	1,122	1,317	1,485
Cash & cash equiv	2,332	2,166	2,941	3,533	4,236
Other current assets	2	18	18	18	18
Total current assets	3,656	3,341	4,268	5,083	5,966
Fixed assets	998	1,030	1,135	1,233	1,321
Intangible assets	0	0	0	0	0
Other long-term assets	13,845	15,842	18,000	20,292	22,521
Total long-term asset:	14,843	16,872	19,135	21,524	23,841
Total assets	18,500	20,213	23,404	26,608	29,807
Accounts payable	1,172	1,215	1,384	1,591	1,676
Short-term loans	50	60	70	79	89
Other liabilities	48	57	57	57	57
Total current liabs	1,270	1,331	1,510	1,727	1,822
Long-term debt	480	535	591	646	701
Other long-term liabs	0	0	0	0	0
Total long-term liabs	480	535	591	646	701
Equity	14	14	14	14	14
Reserves/other items	16,244	17,733	20,468	23,162	25,961
Shareholder equity	16,258	17,747	20,482	23,176	25,976
Minority interest	491	599	821	1,059	1,308
Total equity	16,749	18,347	21,303	24,235	27,284
BVPS (RMB basic)	9.01	9.83	11.35	12.84	14.39

Valuation

YE 31 Dec (x)	FY15	FY16	FY17E	FY18E	FY19E
PE	14.1	13.9	8.6	8.0	7.7
PB	1.7	1.5	1.3	1.2	1.1
EV EBITDA	11.8	11.5	7.2	6.6	6.1
Dividend yield (%)	2.1	1.7	1.7	2.2	2.3
FCF yield (%)	(0.3)	(0.7)	0.6	0.8	1.3

Performance

YE 31 Dec	FY15	FY16	FY17E	FY18E	FY19E
Growth (%)					
Revenue	17.7	(1.2)	24.7	10.7	14.0
Gross profit	36.3	2.0	14.0	25.7	22.1
Operating profit	27.1	13.6	12.9	28.0	23.2
Net profit	(13.1)	1.9	61.0	7.4	4.6
EPS	(13.1)	1.9	61.0	7.4	4.6
Profitability ratios (%)					
Gross profit	38.0	39.2	35.9	40.7	43.6
EBITDA	108.1	113.5	142.7	139.4	129.0
Net profit	94.5	97.5	125.8	122.0	112.1
ROE	12.5	11.6	16.7	15.7	14.6
ROA	10.9	10.2	14.6	13.7	12.7
Solvency (x)					
Net gearing ratio (%)	(10.8)	(8.6)	(10.7)	(11.6)	(12.6)
Current ratio	2.9	2.5	2.8	2.9	3.3
Quick ratio	2.7	2.4	2.7	2.8	3.1
Operating capability (days)					
Total assets t/o ratio (x)	0.1	0.1	0.1	0.1	0.1
Receivable	188	176	159	169	167
Payable	331	354	306	344	335
Inventory	69	48	41	47	45
Cash conversion cycle	(73)	(130)	(106)	(129)	(122)

Source: Company data, Huatai HK Research estimates

Analyst Certification

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