

LK (600388.SH)

In the first three quarters, the results of were solid, with large shareholders completing the overweight

Hong Kong | Environmental Protection | Company report

4 December 2017

Summary of Investment

- Major shareholders increased their holdings, and the margin of safety appeared;
- The wide market space in the non-electric field is urgently needed to be released;

Investment Rating

As an industry leader, the company will certainly benefit from the promising market space for future non-electric treatment sector. We forecast that the company's net income for 2017-2018 will be RMB732 million and RMB815 million, respectively; EPS will be RMB0.69 and RMB0.76, respectively; equivalent to the PE ratio in 2017/2018 of 23.0/20.7. We give a target price of RMB20.0 for "Buy" rating. (Closing price as at 30 Nov 2017)

Historical P/E Valuation



Source: Wind, Phillip Securities(HK)Research

Steady Growth in the First Three Quarters

Longking was listed in 2000 and is the first listed company in the field of environmental protection equipment manufacturing in China. The company's main products include flue gas dust collection, FGD, SNCR, electrical control equipment, and bulk material conveying, which are widely used in the air pollution control of electric power, building materials, metallurgy, chemical industry and light industry. In 2016, the revenue of the company exceeded RMB8 billion for the first time. In 2012-2016, the revenue composite growth of the company was 17.3%, and the compound growth rate of net profit attributable to the parent company recorded 22.9%. The company recorded sustainable growth.

Buy

CMP: RMB 15.75
(Closing price as at 30 Nov 2017)
TARGET: RMB 20.00 (27%)

COMPANY DATA

O/S SHARES (MN) :	1069
MARKET CAP (RMB MN) :	16,838
52 - WK HI/LO (RMB):	18.98/11.62

SHARE HOLDING PATTERN , %

Fujian dongzheng investment co. LTD	17.17
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PRICE PERFORMANCE , %

	1-Month	3-Month	1-Year
LK	-13.22	4.13	19.94
SSE	-1.84	0.67	2.82

PRICE VS. SSE



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMBmn	FY15	FY16	FY17E	FY18E
Revenue	7391	8024	8698	9567
Net Profit	560	664	732	815
P/E,x	30.3	25.4	23.0	20.7
EPS, RMB	0.52	0.62	0.69	0.76
P/B, x	4.7	4.2	3.7	3.3
BVPS, RMB	3.3	3.7	4.2	4.8
ROE, %	15.7	16.6	16.2	15.9

Source: Company reports, Phillip Securities Est.

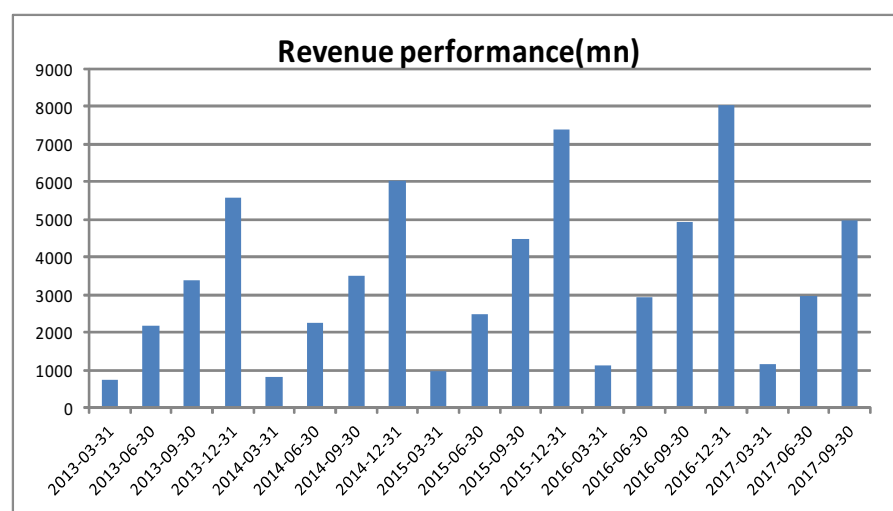
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Longking recorded a revenue of RMB4.971 billion, up by 0.86% yoy, a net profit attributable to parent company of RMB470 million, up by 9.59% yoy, and 11.87% yoy after deduction of non-recurring profit and loss. Equivalent earnings per share were RMB0.44. The figure was RMB0.4 in the same period of last year. Specifically, Q1, Q2 and Q3 reported revenues of RMB1.14 billion, RMB1.81 billion and RMB2.01 billion, respectively, and net profits of RMB84 million, RMB142 million and RMB245 million, respectively. Profits are in line with expectation.



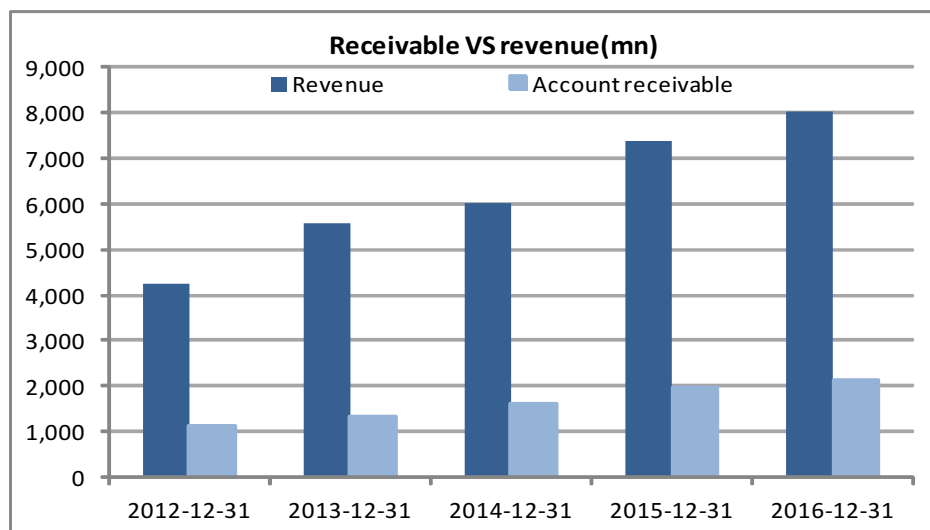
Source: Wind, Phillip Securities(HK)Research

Gross Margin and Net Profit Margin Increased

The gross margin in the period was 26.1%, up 1.81% from 24.29% in the same period of last year. Net profit margin 9.56%, up by 0.81% yoy, in which the quarterly net profit margin in the third quarter reached 12.19%, a sharp rise from the previous two quarters. The period cost rate was 14.59%, up 1 ppts yoy, in which the financial expense rate was up 161.5% yoy, to RMB23.56 million.

Net Operational Cash Flow Expected to Be Positive for the Year

The net operational cash flow in the first three quarters was RMB-283 million, which was slightly improved from the mid-period of RMB-356 million. The net operational cash flow will very probably be positive. The company's account receivable RMB2.026 billion, down from RMB2.147 billion of the beginning of the year. Advances received were RMB6.483 billion, up RMB510 million compared with the beginning of the year. Capital on paper reached RMB1.448 billion, down RMB1.1 billion from the start of the year, mainly because of the repayment of RMB500 million medium-term note and an increase in the net operating cash expenditure.



Source: Wind, Phillip Securities(HK)Research

Sufficient Orders In Hand, Leading Flue Gas Dust Collection Technology

The company added RMB7.8 billion of orders in the first three quarters, with RMB2.6 billion added in the third quarter. By the end of the third quarter, the orders in hand reached RMB18.1 billion. With sufficient orders in hand, sustained growth of results is guaranteed. At present, the peak of investment in thermal power industry has passed, and the newly-added scale of coal-fired power generating units is limited. There is only a certain increment of space for the ultra-low emission transformation of the existing units. With the gradual enhancement of the national policy on the emission standards of non-electric sectors such as steel and chemical industry, the demand for air treatment in the non-electric fields will soon be increased. The company has been in the market for many years, especially in the R&D of atmospheric management technology. In 2016, the R&D expenditure was RMB395 million, accounting for 4.9 percent of operating revenue. In 2016, the market share of flue gas dust collection products ranked first in the country. We believe that the solid technical reserve and R&D capability will help the company to win the first place in the market of non-electric atmosphere management.

Major Shareholders Increased Their Holdings

After changes in share options are completed, Sunshine Group holds indirectly 17.17% stock rights (183.5 million shares) of Longking by holding directly 51% stock rights of Eastright Investment & Development. In July, Sunshine Group increased its holdings of 30,284,000 shares through the trust scheme, with the shareholding ratio increased to 20%. In November, Sunshine Group continued to increase its holdings of 32,520,000 shares, with the shareholding ratio increased to 23.04%. At present, the accumulative increased amount reached RMB965 million, with an increase of about 62.8 million shares, accounting for 5.87% of the total share capital. According to estimation, Sunshine Group shares average at RMB18.8/share, and the current price has a higher margin of safety.

Risk Warnings

The bids of new units and large units in power industry reduce;

The market competition of non-electric field is fierce;

The market is not expanding as expected;

Industry policy risk;

Financials

FYE	FY14	FY15	FY16	FY17E	FY18E
Valuation Ratios					
P/E	14.6	30.3	25.4	23.0	20.7
P/B	2.1	4.7	4.2	3.7	3.3
Dividend Yield(%)	2.1%	1.0%	1.2%	1.3%	1.5%
Per share data(RMB)					
EPS,Adj+	1.08	0.52	0.62	0.69	0.76
BVPS	7.36	3.33	3.74	4.24	4.80
DPS	0.33	0.16	0.19	0.21	0.23
Growth & Margins(%)					
Growth					
Revenue	8.2%	22.6%	8.6%	8.4%	10.0%
Operating income	0.6%	22.6%	3.7%	29.1%	11.9%
Net profit	1.5%	20.9%	18.5%	10.3%	11.3%
Margins					
Gross profit margin	23.3%	22.9%	22.6%	24.8%	24.8%
Operating profit margin	8.4%	8.4%	8.1%	9.6%	9.8%
Net income margin	7.7%	7.6%	8.3%	8.4%	8.5%
Key Ratios					
ROE(%)	14.7%	15.7%	16.6%	16.2%	15.9%
ROA(%)	4.6%	4.5%	4.7%	4.7%	4.7%
Income Statement(RMB mn)					
Revenue	6,027	7,391	8,024	8,698	9,567
- Cost of Goods Sold	4,621	5,697	6,207	6,541	7,195
Gross Income	1,405	1,694	1,817	2,157	2,373
- Operating Expenses	823	922	1,031	1,131	1,228
Operating Income	509	624	647	836	935
- Net Non-Operating Losses (Gains)	(40)	(41)	(170)	(55)	(55)
Pretax Income	549	665	817	891	990
- Income Tax Expense	82	104	145	153	170
Net profit	463	560	664	732	815

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 30 Nov 2017)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

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

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

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