

## Grandblue ENV (600323.SH)

Operates steadily and its growth rate is in line with expectations

Hong Kong | Environmental Protection | Company report

27 March 2018

### Summary of Investment

- Steady operations and stable improvement in operational efficiency;
- Sound cash flow and attractive valuation;

### Investment Rating

We are optimistic about the sound growth potential in the Company's future performance. It is forecast that net profits of the Company in 2018 and 2019 will reach RMB745 million and RMB860 million, respectively, earnings per share (EPS) will be RMB0.97 and RMB1.12, respectively, the current valuation level is attractive, and the target price will be RMB18.0, with a "Buy" rating. (Closing price as at 23 Mar 2018)

### Buy

CMP: RMB 13.59

(Closing price as at 23 Mar 2018)

TARGET: RMB18.00 (32%)

#### COMPANY DATA

O/S SHARES (MN) :	766
MARKET CAP (RMB MN) :	10,414
52 - WK HI/LO (RMB):	16.53/12.56

#### SHARE HOLDING PATTERN , %

Foshan nanhai water supply group co., LTD	17.98
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#### PRICE PERFORMANCE , %

	1-Month	3-Month	1-Year
Grandblue ENV	3.01	-9.94	-2.76
SSE	-0.78	-1.02	0.46

### Historical P/E valuation



Source: Wind, Phillip Securities(HK)Research

#### PRICE VS. SSE



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

RMBmn	FY16	FY17	FY18E	FY19E
Revenue	3690	4202	4807	5451
Net Profit	509	652	745	860
P/E,x	20.6	16.0	14.0	12.1
EPS, RMB	0.66	0.85	0.97	1.12
P/B, x	2.2	2.0	1.8	1.6
BVPS, RMB	6.30	6.95	7.67	8.50
ROE, %	10.5	12.2	12.7	13.2

Source: Company reports, Phillip Securities Est.

### Steady Growth throughout the Year, in Line with Expectations

In 2017, Grandblue Environment recorded a revenue of RMB4.202 billion, up by 13.87% y-o-y, net profit attributable to the parent company was RMB652 million, up by 28.25% y-o-y, and net profit attributable to the parent company excluding non-recurring items was RMB594 million, up by 20.64% y-o-y. EPS excluding non-recurring items was RMB0.78. The figure was RMB0.66 over the same period of last year. Performance was in line with expectations and growth was stable on the whole.

Research Analyst

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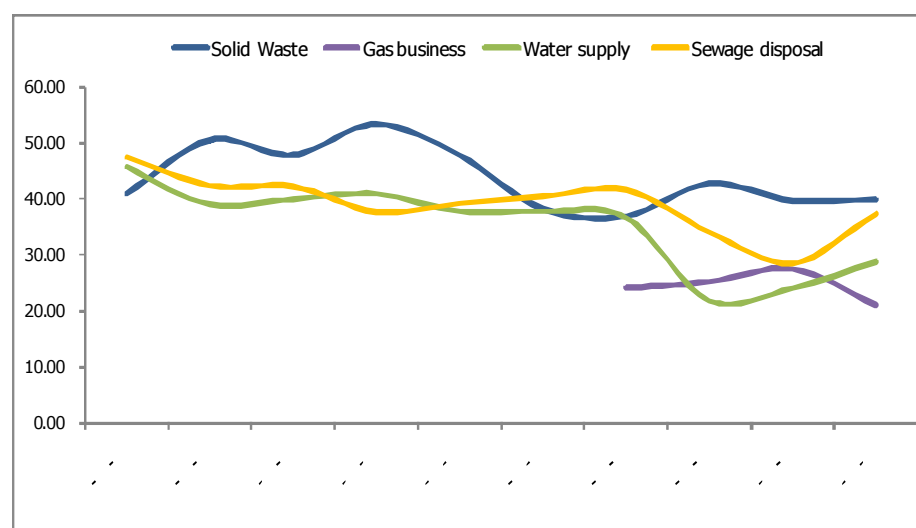
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With respect to profitability, gross margin fell by 0.76pct to 31.63% and net profit margin rose by 1.52pct to 16.59%, the latter of which was mainly due to the increase of non-recurring profit and loss arising from the increase of government grants. The period cost rate fell by 1.8%, of which sales expense decreased by 0.27pct to 1.66%, administration expenses decreased by 0.19pct to 6.99%, and financial expense decreased by 1.34pct to 4.26%.

Cash flow recovery was of relatively good condition, and net operating cash flow rose by 28% y-o-y to RMB1.509 billion. Book capital increased to RMB1.294 billion and the asset-liability ratio was 56.79%, down by 1.47pct y-o-y, and the financial leverage was on an obvious decline in the last three years. The Company forecasts an annual capital expenditure of RMB2.7 billion in 2018, and the sound financial structure shall support its business expansion.

### Business Gross profit margins(%)



Source: Wind, Phillip Securities(HK)Research

### Substantial Increase of Gross Margin in Water Business

With respect to revenue structure, water supply business contributed RMB1.108 billion to revenues, up by 4.33% y-o-y; revenue of sewage treatment was RMB188 million, up by 17.85% y-o-y; revenue of solid waste treatment was RMB1.428 billion, up by 7.01% y-o-y. Water supply and sewage treatment business saw a significant rise in gross margin, mainly due to cost reduction in electricity fee and repair charge and the decrease of water loss rate, rising by 4.8% and 8.8% to 28.85% and 37.27%, respectively. Gross margin of the solid waste treatment business basically remained unchanged, slightly up by 0.19pct y-o-y to 40.05%.

The gas service reaped a revenue of RMB1.479 billion, up by 21.57% y-o-y. The main reason behind the relatively rapid growth was that the shift to natural gas as required by environmental policies drove the increase of sales volume by 27.8% y-o-y and the sales volume of liquefied gas rose by 22.89% y-o-y, whereas gross margin fell by 6.57pct y-o-y to 21.05%. This was mainly due to the y-o-y decrease in price difference between purchase and sale of natural gas and liquefied gas, and cost offset by tax rebate, etc. In December 2017, the Company acquired the remaining 30% equities in

Nanhai Gas with RMB437 million. In 2017, Nanhai Gas reported a revenue of RMB1.479 billion and net profit of RMB138 million, and the consolidation in 2018 shall improve profitability and overall performance.

Gross Margin Trends of Main Business (%)

## Steady Progress of Projects and Operational Efficiency Improvement Assisted by Renovation & Expansion

The Company is proactively committed to the upgrading & reconstruction and renovation & expansion of all projects in a bid to improve operational efficiency. At present, the water supply production capacity is 1.36 million tons/day, sewage treatment is 583,000 tons/day, of which the Second Water Plant Phase IV expansion project (250,000 tons/day) and the sewage treatment plant upgrading & reconstruction project (20,000 tons/day) are expected to be put into operation in mid-2018. In addition, efforts are made to accelerate ongoing projects such as Foshan City Solid Waste Treatment Industrial Park Phase III project (1,500 tons/day), C&G Jinjiang upgrading & reconstruction project (500 tons/day), C&G Anxi renovation & expansion project (750 tons/day), C&G Langfang renovation & expansion project (500 tons/day), and the supporting gas project for the gas company's "Shelv" Phase II, which is expected to secure steady growth in future earnings.

The Company has made new achievements in business expansion. First, it firmly implements the strategy of "mega solid waste". The Company has obtained the environmental impact assessment (EIA) approval for the Foshan green industrial waste project in collaboration with REMONDIS of Germany, which is expected to dispose 93,000 tons of hazardous waste each year. Second, it becomes the controlling shareholder of Tuowang Bio. The Company has obtained four BOT or PPP projects for harmless treatment of dead livestock and concession operation of cyclic resource utilization. Third, it increases capital in Blue Bay Company and invests in the watershed management project of the Lishui River, so as to march towards the watershed management sector. In general, the expansion of new business shall create new growth for future performance.

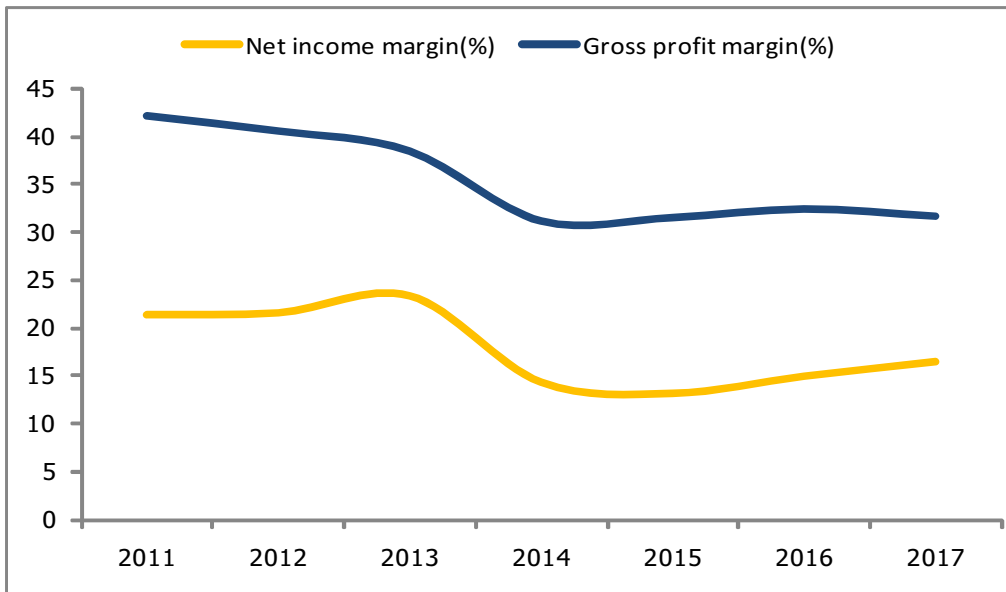
## Risk Warnings

Risk may arise from environmental policies;

Project expansion falling short of expectations;

Drop of gas price and intensifying market competition.

**Profit margins trend(%)**



Source: Wind, Phillip Securities(HK)Research

## Financials

FYE	FY14	FY15	FY16	FY17	FY18E	FY19E
<b>Valuation Ratios</b>						
P/E	27.7	25.6	20.6	16.0	14.0	12.1
P/B	3.1	2.4	2.2	2.0	1.8	1.6
<b>Per share data(RMB)</b>						
EPS,Adj+	0.49	0.53	0.66	0.85	0.97	1.12
BVPS	4.35	5.74	6.30	6.95	7.67	8.50
<b>Growth &amp; Margins(%)</b>						
<b>Growth</b>						
Revenue	243.2%	37.8%	9.9%	13.9%	14.4%	13.4%
Operating income	70.9%	9.6%	22.5%	41.4%	7.2%	16.0%
Net profit	32.0%	30.5%	26.2%	28.2%	14.2%	15.5%
<b>Margins</b>						
Gross profit margin	31.1%	31.5%	32.4%	31.6%	31.8%	32.3%
Operating profit margin	18.6%	14.8%	16.5%	20.5%	19.2%	19.6%
Net income margin	12.7%	12.0%	13.8%	15.5%	15.5%	15.8%
<b>Key Ratios</b>						
ROE(%)	9.3%	9.2%	10.5%	12.2%	12.7%	13.2%
ROA(%)	3.8%	3.5%	4.0%	4.8%	5.1%	5.5%
<b>Income Statement(RMB mn)</b>						
Revenue	2,435	3,357	3,690	4,202	4,807	5,451
- Cost of Goods Sold	1,678	2,300	2,495	2,873	3,279	3,691
Gross Income	758	1,057	1,195	1,329	1,529	1,761
- Operating Expenses	287	539	543	542	607	687
Operating Income	454	498	609	862	924	1,071
- Net Non-Operating Losses (Gains)	-13	-78	-139	-38	-109	-114
Pretax Income	467	576	749	900	1,033	1,185
- Income Tax Expense	116	130	192	202	237	273
Net profit	309	403	509	652	745	860

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 23 Mar 2018)

**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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