

Company Report: Dongjiang Environmental (00895 HK)

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公司报告: 东江环保 (00895 HK)

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17 May 2019

Abundant Pipeline Supports Future Growth, Maintain "Accumulate"

充足的储备产能支持未来增长, 维持“收集”

- Dongjiang Environmental Protection's (00895 HK or "DJEP") 1Q2019 revenue increased 6.4% YoY to RMB807 million. Shareholders' net profit decreased 11.0% YoY to RMB108 million. Results were slightly worse than expected, mainly due to higher-than-expected increase in expense. Overall gross margin slightly improved 0.7 ppts to 36.1%.
- We expect industrial waste recycling revenue CAGR to be 14.4% and industrial waste treatment and disposal revenue CAGR to be 22.6% in 2018-2021. In addition, we expect overall gross margin to stay between 33.3% and 34.7% in 2019-2021, and expect the Company to have enough financial resources to pay for funding needs for the next three years even without equity financing.
- Our 2019-2021 EPS estimates are RMB0.517, RMB0.707 and RMB0.886, respectively. Although 1Q2019 results missed expectation, the Company's growth prospects remain intact alongside an abundant pipeline to be put into operation over the next three years. Slightly revise down the TP to HK\$9.00, representing 2019/ 2020/ 2021 PER of 15.0x/ 11.0x/ 8.7x. Maintain "Accumulate".
- 东江环保 (00895 HK) 2019 年 1 季度收入同比增长 6.4%至 8.07 亿元(人民币, 下同)。股东净利润同比跌 11.0%至 1.08 亿元。业绩差于预期, 主要由于高于预期的费用增加。2019 年 1 季度公司整体毛利率轻微改善 0.7 个百分点至 36.1%。
- 于 2018 至 2021 年间, 我们预计工业资源化利用收入的年复合增长率为 14.4%, 工业废物处理处置收入的年复合增长率为 22.6%。此外, 我们预计整体毛利率于 2019 至 2021 年将维持于 33.3%至 34.7%之间, 并预计公司有足够的财政资源, 在无需做股权融资的情况下, 满足其资金需要。
- 我们对 2019 至 2021 年的每股盈利预测分别为 0.517 元、0.707 元和 0.886 元。即使 2019 年 1 季度业绩差于预期, 但公司的增长前景并不受影响, 因未来三年将有充足的储备项目投入营运。略微下调目标价至 9.00 港元, 相当于 15.0/ 11.0/ 8.7 倍的 2019/ 2020/ 2021 年预期市盈率。维持“收集”的投资评级。

Rating: **Accumulate**
Maintained

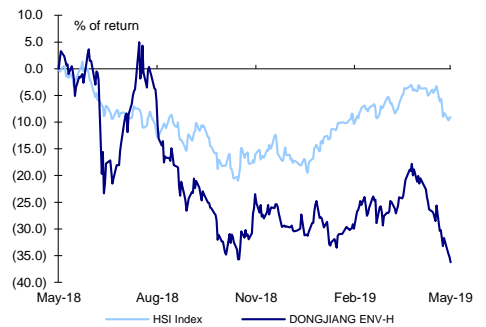
评级: **收集 (维持)**

6-18m TP 目标价: **HK\$9.00**
Revised from 原目标价: HK\$9.70

Share price 股价: **HK\$7.630**

Stock performance

股价表现



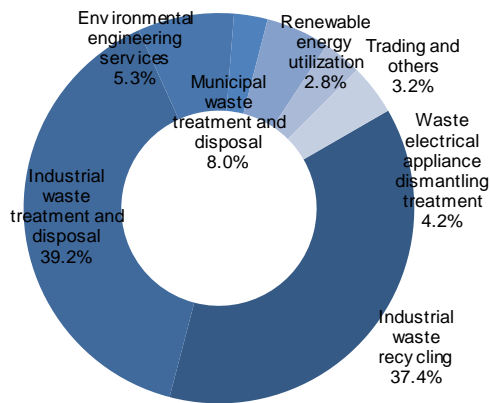
Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	(20.2)	(8.9)	(37.3)
Rel. % to HS Index 相对恒指变动 %	(14.0)	(10.3)	(28.1)
Avg. Share price(HK\$) 平均股价 (港元)	8.6	8.9	9.4

Source: Bloomberg, Guotai Junan International.

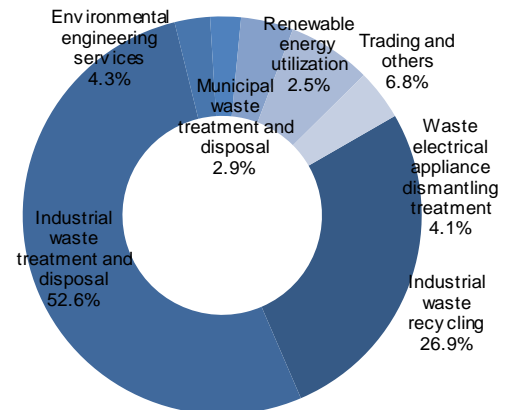
Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(△%)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2017A	3,100	473	0.547	(12.1)	11.6	4.198	1.5	0.161	2.5	13.5
2018A	3,284	408	0.467	(14.6)	14.3	4.556	1.5	0.140	2.1	10.5
2019F	3,902	452	0.517	10.7	12.5	4.994	1.3	0.140	2.2	10.7
2020F	4,632	618	0.707	36.8	9.2	5.629	1.2	0.160	2.5	13.1
2021F	5,408	774	0.886	25.3	7.3	6.423	1.0	0.200	3.1	14.5
Shares in issue (m) 总股数 (m)			887.2		Maior shareholder 大股东				Guanadong Risina 20.7%	
Market cap. (HK\$ m) 市值 (HK\$ m)			6,769.3		Free float (%) 自由流通比率 (%)				79.3	
3 month average vol. 3 个月平均成交股数 ('000)			420.6		FY19 Net gearing (%) FY19 净负债/股东资金 (%)				45.2	
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)			12.900 / 7.600		FY19 Est. NAV (HK\$) FY19 每股估值 (港元)				11.5	

Source: the Company, Guotai Junan International.

1Q2019 shareholders' net profit decreased 11.0% YoY to RMB108 million; results were worse than expected. Dongjiang Environmental Protection's (00895 HK) 1Q2019 revenue increased 6.4% YoY to RMB807 million. Shareholders' net profit decreased 11.0% YoY to RMB108 million. Results were worse than expected, mainly due to higher-than-expected increase in expenses, in particular, selling expenses was up 58.4% YoY to RMB30 million, administrative expenses up 6.9% YoY to RMB79 million and finance costs up 39.1% YoY to RMB34 million, all having increased faster than revenue. Overall gross margin slightly improved 0.7 ppt YoY to 36.1%. As at 31st March 2019, the Company had net debt of RMB2.1 billion, the same compared to end of 2018. During 1Q2019, operating cash inflow was RMB318 million, up 496% YoY.

Figure 1: DJEP's 2018 Segmental Revenue


Source: the Company.

Figure 2: DJEP's 2018 Segmental Gross Profit


Source: the Company.

Table 1: DJEP's 2018 Segmental Performance

	Revenue (RMB '000)	YoY	Gross Margin	YoY
Industrial waste recycling	1,228,372	+4.0%	25.4%	-1.9 ppts
Industrial waste treatment and disposal	1,286,740	+10.2%	47.4%	-0.3 ppts
Municipal waste treatment and disposal	262,003	+35.8%	12.7%	-0.1 ppts
Renewable energy utilization	91,447	-1.7%	31.5%	-5.1 ppts
Environmental engineering services	173,303	-38.1%	28.4%	+2.7 ppts
Trading and others	104,516	-18.1%	75.3%	+3.3 ppts
Waste electrical appliance dismantling treatment	137,700	+140.3%	34.6%	+17.3 ppts
Total	3,284,081	+5.9%	35.3%	+35.3 ppts

Source: the Company.

We expect industrial waste recycling revenue CAGR to be 14.4% in 2018-2021. During 2018, industrial waste recycling revenue increased 4.0% to RMB1,228 million, mainly due to increase in sales of higher priced metal products, in which copper products sales increased 3.5% to 56,760 tons and tin products sales increased 3.7% to 3,945 tons. These higher priced products drove up the average selling price of products of recycled metal products, from RMB14,192/ton in 2017 to RMB15,493/ton in 2018. Segmental gross profit dropped 3.4% YoY to RMB311 million, while segmental gross margin dropped 1.9 ppts YoY to 25.4% due to increased competition leading to sales price cut, increasing raw materials cost and increasing labor cost. New capacity in recycling was just put into operation in 2018, such as Xingye Dongjiang which had a 3,000 tons per year in recycling capacity, Shandong Weifang Lanhai Project which had a 15,900 tons per year recycling capacity, and projects under construction such as Jiangxi Dongjiang Project. We expect industrial waste recycling revenue to increase steadily in the next 3 years. Overall, we expect industrial waste recycling revenue to increase at a CAGR of 14.4% in 2018-2021.

We expect industrial waste treatment and disposal revenue to increase at a CAGR of 22.6% in 2018-2021. During 2018, industrial waste treatment and disposal revenue increased 10.2% to RMB1,287 million due to increase in capacity utilization and release of new capacity. Segmental gross profit increased 9.4% to RMB610 million, while segmental gross margin dropped 0.3 ppts YoY to 47.3%. The Company added 258,000 tons/year of new capacity during the year, while having another 298,000 tons/year of new capacity pipeline (excluding the 540,000 tons landfill facility in Jiangxi Province) over the next two years. We expect industrial waste treatment and disposal revenue to accelerate in growth over the next three years due to the substantial

addition in new capacity in 2018 and abundant pipeline in 2019 and 2020. Overall, we expect industrial waste treatment and disposal revenue to increase at a CAGR of 22.6% in 2018-2021.

Table 2: DJEP's Project Pipeline (tons/year)

Tons/year	Completion	Incineration	Phy. & Chem.	Comprehensive/Landfill	Detox.	Recycling
Shaoguan Green	2018	9,500	0	0	0	80,000
Xingye Dongjiang	2018	20,000	15,000	33,500	0	3,000
Shandong Weifang Lanhai	2018	60,000	120,000	0	0	15,900
2018 Total		89,500	135,000	33,500	0	98,900
Tangshan Caofeidian Wandesi	2019/2020	19,800	12,130	26,203	0	0
Nantong Dongjiang	2019/2020	20,000	15,000	0	1,800	0
Foshan Fulong	2019/2020	30,000	0	19,700	0	0
Fujian Nanping	2019/2020	20,000	0	0	0	0
Huaxin Environmental	2019/2020	19,800	0	0	3,650	0
Jiangxi Dongjiang Recycle*	2019/2020	15,000	35,000	8,000*	0	28,000
Xiamen Dongjiang	2019/2020	20,000	20,000	20,000	0	0
2019/2020 Total		144,600	82,130	65,903	5,450	28,000

Source: the Company, Guotai Junan International.

*Excluded total 540,000 tons landfill capacity.

We expect overall gross margin to stay between 33.3% and 34.7% in 2019-2021. During 2018, overall gross margin dropped slightly by 0.6 ppts. YoY to 35.3%, mainly due to the fast increase in revenue from municipal waste treatment and disposal business (up 35.8% YoY) which had a much lower gross margin (12.7%) compared with overall gross margin (35.3%), dragging it down, while gross margin of the Company's main businesses industrial waste recycling (25.4%, down 1.9 ppts YoY) and industrial waste treatment and disposal (47.4%, down 0.3 ppts YoY) were relatively stable. Despite that we expect revenue contribution from the higher gross margin industrial waste treatment and disposal business to continue climbing from 39.2% in 2018 to 43.8% in 2021 due to capacity expansion, the positive effect is unlikely enough to offset gross margin decline in other businesses due to keen competition, and gross margin will not sustainably rise. Overall, we expect gross margin to stay between 33.3% and 34.7% in 2019-2021.

We expect the Company to have enough financial resources to pay for funding needs for the next three years even without equity financing. During 2018, the Company spent RMB847 million in capital expenditure, and another RMB361 million in dividends and interest expenses, while operating cash inflow was RMB898 million, leaving a gap of RMB310 million, which can be easily matched with its RMB1,054 million cash position. In addition, as at 31st December 2018, the Company's debt ratio and net gearing ratio stood at 52.0% and 45.2%, respectively, lower than the industry average, with much room for increasing its leverage. We expect that operating cash inflow will increase from RMB849 million in 2019 to RMB871 million in 2020 and to RMB1,393 million in 2021, while the funding gap (operating cash inflow – capital expenditure – distribution of dividends and interest expenses) to narrow from RMB90 million in 2019 to RMB87 million in 2020, and to a surplus of RMB385 million in 2021. As such, we expect the Company to have enough financial resources to pay for its funding needs for the next three years even without equity financing.

Slightly revise down the TP to HK\$9.00 on missed 1Q2019 results, maintain "Accumulate". Our EPS forecasts for 2019/ 2020/ 2021 are RMB0.517, RMB0.707 and RMB0.886, respectively. Although the Company's 1Q2019 results were worse than expected, we think that it was mainly due to increase in compliance costs with the tightening of regulatory environment, as well as the Company's higher operating costs as a result of strengthening of governance and internal control, while its revenue growth is still in line with expectations. In addition, the Company has a strong pipeline of projects and a large amount of new capacity will be put into operation in the next three years, especially for hazardous waste treatment and disposal capacity which has higher gross profit margin compared with other business segments. We think that the growth rate of revenue and profit will accelerate compared with the past two years. Based on the worse-than-expected 1Q2019 results, we have slightly lowered the target price to HK\$9.00, equivalent to 15.0x/ 11.0x/ 8.7x 2019/ 2020/ 2021 P/E. As current valuation is still low compared with growth prospects, the "Accumulate" rating has been maintained.

Table 3: Peers Valuation

Company	Stock Code	Currency	Last price	Market Cap HKD m	PE				PB				ROE(%)	D/Y(%)	ROA(%)
					18A	19F	20F	21F	18A	19F	20F	21F	19F	19F	19F
Dongjiang Environmental-H	00895 HK	HKD	7.630	10,372.4	13.7	11.3	9.8	9.4	1.4	1.2	1.1	0.9	13.4	2.3	5.3
China Everbright Intl Ltd	00257 HK	HKD	7.280	44,720.9	8.5	8.3	7.0	6.1	1.3	1.2	1.0	0.9	14.7	3.7	5.8
Dynagreen Environmental Pr-H	01330 HK	HKD	3.850	11,162.7	13.0	10.2	7.8	6.4	1.4	1.2	1.1	1.1	12.1	3.3	3.7
New Universe Environmental G	00436 HK	HKD	0.340	1,017.0	13.7	n.a.	n.a.	n.a.	1.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Capital Environment Holdings	03989 HK	HKD	0.190	2,687.4	12.4	10.4	6.7	4.8	0.7	0.5	0.5	0.4	5.7	n.a.	2.1
Beijing Enterprises Environm	00154 HK	HKD	0.770	1,155.3	4.4	n.a.	n.a.	n.a.	0.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Weigang Environmental Techno	01845 HK	HKD	1.010	1,346.7	17.4	n.a.	n.a.	n.a.	9.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Canvest Environmental Protec	01381 HK	HKD	3.580	8,788.7	11.7	9.9	8.5	7.3	1.7	1.4	1.3	1.1	15.3	1.6	7.9
Simple Average					11.8	10.0	7.9	6.8	2.1	1.1	1.0	0.9	12.2	2.7	5.0
Weighted Average					10.0	9.0	7.4	6.3	1.5	1.2	1.1	1.0	14.0	2.6	5.6

Source: Bloomberg, Guotai Junan International.

Financial Statements and Ratios

Income Statement						Balance Sheet					
Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F	Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F
Total Revenue	3,100	3,284	3,902	4,632	5,408	Fixed Assets	3,345	3,931	4,522	5,119	5,733
Cost of Sales	(1,988)	(2,125)	(2,602)	(3,038)	(3,532)	Long-term Investments	472	352	392	436	484
Gross Profit	1,112	1,159	1,300	1,594	1,876	Intangible Assets	2,159	2,106	2,315	2,545	2,797
Other Income and Gains	112	226	260	309	361	Other Non-current Assets	228	267	274	293	312
Selling and Distribution Expenses	(69)	(99)	(125)	(148)	(173)	Total Non-current Assets	6,204	6,656	7,503	8,393	9,326
Administrative Expenses	(415)	(466)	(530)	(615)	(697)	Inventories	313	300	368	417	82
Other Expenses	(53)	(134)	(164)	(190)	(219)	Bills and Accounts Receivables	781	753	871	1,201	1,550
Share of Profits of JV	22	13	15	19	22	Contract Assets	0	96	114	135	158
Operating Profit	709	700	758	968	1,171	Cash & Cash Equivalents	1,242	1,054	780	376	461
Finance Costs	(99)	(134)	(136)	(141)	(146)	Other Current Assets	700	886	971	1,066	1,170
Share of Profits of JVs / Associates	12	(7)	(5)	(6)	(9)	Total Current Assets	3,036	3,088	3,104	3,194	3,420
Profit Before Tax	623	558	617	821	1,015	Total Assets	9,240	9,744	10,607	11,587	12,746
Income Tax	(69)	(84)	(93)	(123)	(152)	Short-term Borrowings	1,873	1,834	1,834	1,834	1,834
Profit After Tax	553	474	524	698	862	Account Payables	705	708	824	914	1,009
Non-controlling Interest	(80)	(66)	(73)	(80)	(88)	Contract Liabilities	0	152	186	217	253
Shareholders' Profit / Loss	473	408	452	618	774	Other Current Liabilities	592	830	911	1,022	1,140
Basic EPS	0.547	0.467	0.517	0.707	0.886	Total Current Liabilities	3,170	3,524	3,755	3,987	4,236
DPS	0	0	0	0	0	Long-term Borrowings	293	436	595	684	787
						Bonds Payables	1,290	903	903	903	903
						Other Non-current Liabilities	166	196	207	222	238
						Total Non-current Liabilities	1,748	1,534	1,704	1,809	1,927
						Total Liabilities	4,918	5,058	5,460	5,796	6,163
						Share Capital	888	887	887	887	887
						Reserves	2,841	3,155	3,543	4,106	4,811
						Total Shareholders' Equity	3,729	4,042	4,430	4,993	5,698
						Minority Interest	593	644	717	797	885
						Total Equity	4,322	4,686	5,147	5,790	6,583
						Total Equity and Liabilities	9,240	9,744	10,607	11,587	12,746
						BVPS	4.198	4.556	4.994	5.629	6.423
Cash Flow Statement						Financial Ratios					
Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F	2017A	2018A	2019F	2020F	2021F	
Profit Before Tax	553	474	524	698	862	Gross Margin (%)	35.9	35.3	33.3	34.4	34.7
Depreciation and Amortization	259	325	372	469	582	Operating Margin (%)	22.9	21.3	19.4	20.9	21.6
Change in Working Capitals	(244)	(103)	(120)	(344)	21	Net Margin (%)	15.3	12.4	11.6	13.3	14.3
Other Operating Activities	103	202	72	49	(72)	ROA (%)	5.4	4.3	4.4	5.6	6.4
Cash from Operating Activities	671	898	849	871	1,393	ROE (%)	13.5	10.5	10.7	13.1	14.5
Capital Expenditure	(933)	(970)	(639)	(649)	(672)	Net Gearing Ratio (%)	51.2	45.2	49.6	52.6	46.5
Other Investing Activities	(60)	15	(386)	(456)	(456)	Interest Coverage (x)	7.1	5.2	5.6	6.9	8.0
Cash from Investing Activities	(993)	(955)	(1,025)	(1,105)	(1,127)						
Issue of Shares	11	13	0	0	0						
Net Borrowings	661	208	159	89	103						
Dividends	(270)	(361)	(260)	(265)	(288)						
Other Financing Activities	2	3	0	0	0						
Cash from Financing Activities	404	(136)	(101)	(176)	(186)						
Cash at Beg of Year	1,140	1,222	1,029	752	343						
Net Changes in Cash	83	(193)	(278)	(409)	80						
Forex Changes	(0)	0	0	0	0						
Add: Non-pledged Time Deposits over 3M	21	25	29	33	38						
Cash at End of Year	1,242	1,054	780	376	461						

Source: the Company, Guotai Junan International.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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