

Sanli Environmental Limited

Date: 10 June 2019

BUY
(Maintained)

Target Price: S\$0.290
(+54.0%)

FY2019 earnings impacted by competition at O&M

SANLI SP

Price: S\$0.188 (as at 7 June 2019)



Price performance	1M	3M	6M	1Y
Sanli	4.4%	-6.0%	-21.7%	-24.8%
Catalist Index	-3.9%	-5.1%	-13.9%	-33.3%

Market capitalization	\$50.5 million		
Current Price	S\$0.188		
Shares outstanding	268.7 million		
Free Float	22.6%		
Major shareholder	Typha Holdings	54.7%	
	Temasek Holdings	8.0%	
Recommendation of other brokers	N/A		

Source: Bloomberg, Company data, SAC Advisors, SGX

Analyst

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FY19 revenue fell 5.6% to S\$71.4m, due to a 31% decline in O&M revenue to S\$13.5m, with keen competition from contractors hit by low construction demand in other sectors. On the other hand, EPC revenue gained 3% to S\$57.8m. Sanli's edge in design and construction of water and waste treatment plant sets it apart from other contractors.

Besides the smaller share of higher-margined O&M business, net profit was impacted by a 16.9% rise in administrative expenses to S\$6.1m, as Sanli gained inroad into Myanmar with S\$4.3m contract secured.

Singapore construction output projected to rise. According to the Building and Construction Authority, construction output in 2019 is estimated at S\$28 – 30bn, an increase from S\$27bn in 2018. The higher volume will help ease competitive pressure on contract pricing and manpower needs.

Diversification into industrial wastewater treatment. In anticipation of the growing demand for management of industrial water use for water-intensive industries in Singapore, Sanli has set up a business development unit to tap on the potential business opportunities. The Public Utilities Board and the National Research Foundation recently launched a S\$26m fund to help industries implement water management solutions.

Orderbook of S\$198m. Sanli's orders on hand amounted to S\$198m, bulk of these are EPC projects to be delivered over the next 3 years.

Maintain BUY at lower target price of S\$0.290 per share. With keen competition and higher labour costs, we expect margins to remain under pressure. However, earnings would be sustained with a strong orderbook and an uptick in the construction sector. After factoring in lower margin, we arrived at a revised target price of S\$0.290 per share, derived from DCF model (WACC: 5.5% and terminal growth: 2.0%).

Key risks: Reliant on Singapore public sector projects.

Key Financials

Year ended March (S\$'000)	FY2016A	FY2017A	FY2018A	FY2019A	FY2020E	FY2021E
Revenue	57,264	64,314	75,609	71,350	72,796	74,345
% Growth	53.3%	12.3%	17.6%	-5.6%	2.0%	2.1%
Gross profit	11,248	10,399	10,871	9,761	9,959	10,171
Gross profit margin (%)	19.6%	16.2%	14.4%	13.7%	13.7%	13.6%
Net profit attributable to owners (before IPO expenses)	5,942	5,172	4,300	2,220	2,285	2,268
Net profit attributable to owners	5,942	5,172	3,069	2,220	2,285	2,268
% Growth	82.0%	-13.0%	-40.7%	-27.7%	2.9%	-0.7%
Net margin (%)	10.4%	8.0%	4.1%	3.1%	3.1%	3.1%
EPS* (S\$ cents)	2.94	2.56	1.19	0.83	0.85	0.84
P/E (x)	6.4	7.3	15.8	22.8	22.1	22.3
EV/EBITDA (x)	6.5	6.1	9.5	11.1	10.4	9.8
Net Debt/Equity	Net cash					

*EPS for FY16 and FY17 were calculated based on the Company's enlarged share capital of 202,256,124 shares

FY19 results review

Sanli Environmental reported a dip in revenue in FY2019 due to increased competition in the O&M segment. The Group announced full year revenue of S\$71.4 million for FY2019, which is a 5.6% decline from S\$75.6 million achieved in FY18. The fall in revenue was mainly attributed to lower contribution from the O&M segment, which was 30.6% lower year-on-year to S\$13.5 million. This was partially offset by a slight growth of 3.0% in revenue from the EPC segment to S\$57.8 million.

The increasingly competitive O&M segment continued to pose a challenge to the Group's turnover. Since FY2017, the O&M segment has been experiencing negative growth and the challenging environment has continued to persist in the Group's latest FY2019 results. In tandem with the fall in revenue, the decline in the higher-margin O&M segment also caused gross profit to ease 10.2% to S\$9.8 million and gross profit margin to taper by 70 basis points to 13.7% for FY2019.

Profit before tax declined by 26.4% as administrative expenses increased. The weaker top-line translated into a weaker profit before tax of S\$2.8 million for FY2019. The 26.4% drop in profit before tax was also largely a result of an 16.9% increase in administrative expenses to S\$6.1 million. The increase in administrative expenses was mainly due to higher employees' remuneration as a result of an increase in salaries and headcount for the Group's business development department. Additionally, the Group also incurred additional professional fees, advertising, exhibition, travelling and office expenses in its expansion into Myanmar.

Diversification into industrial wastewater treatment. In anticipation of the growing importance of the management of industrial water use for many water-intensive business in Singapore, the Group has invested in a business development department to capitalize on the potential business opportunities arising from the growing demand for water management solutions. The Public Utilities Board and the National Research Foundation recently launched a S\$26m fund to help industries implement water management solutions. The Fund will defray the cost of implementing water saving technologies and hope to increase industrial water savings by three million gallons per day ever year.

On the other hand, the public sector water and waste management industry is expected to remain strong, supported by ongoing and upcoming projects, such as the NEWater, desalinated water and Deep Tunnel Sewerage System (DTSS). Sanli is expected to continue to leverage on its established track record and strong capabilities to secure more projects in the future.

Business Overview:

Sanli is an environmental engineering company with more than 10 years of track record in water and waste management. Leveraging its technical know-how and industry knowledge, it provides total solutions and services to customers in an efficient and cost-effective manner. Its expertise is in the design, supply, delivery, installation, commissioning, maintenance, repair and overhaul of mechanical and electrical equipment as well as instrumentation and control systems in wastewater treatment plants, water reclamation plants, NEWater plants, waterworks, service reservoirs, pumping stations and incineration plants.

Revenue (S\$'000)	FY19	FY18
EPC	57,824	56,115
O&M	13,526	19,494
Total	71,350	75,609

Source: SAC Advisors, Company data

FY19 results review

Sanli made inroad into Myanmar. Sanli secured two EPC contracts from the Myanmar government, worth a total of 4.9 billion Myanmar Kyat (Ks) or approximately S\$4.3 million. The contract wins marked Sanli's successful foray into the Myanmar market and are a testament to the Group's capabilities. The Group hopes to continue to capitalize on its expertise to secure more contracts in Myanmar and to grow its footprint regionally.

Sanli has an outstanding order book of S\$198.0 million as of 2 April 2019. Sanli announced various contract wins since the end of FY2018. This includes a subcontract work from Boskalis / Penta-Ocean Joint Venture for the supply and installation of mechanical (water management) package works at Pulau Tekong, a S\$51.0 million worth of EPC contract from the PUB, S\$8.3 million worth of O&M contracts from the PUB and 2 EPC contracts from the Myanmar government. The outstanding order book as of 2 April 2019 stood at S\$198.0 million, with an average execution period of 3 years.

Announcement Date	Contract Type	Description	Contract Size (S\$ million)	Revenue Recognition Period
15-Nov-18	EPC & O&M	EPC - supply, install, commission and test, equipment at water reclamation plants O&M - provide maintenance services for drainage, sewerage and aeration systems	54.3	FY2019 – FY2022
22-Jan-19	EPC	Construction works for the replacement of mechanical and electrical equipment at Kranji water reclamation plant	51.0	FY2020 – FY2022
	O&M	Provide maintenance services for the replaced mechanical and electrical equipment at the same water reclamation plant.	0.5	
2-Apr-19	O&M	Refurbishment of centrifugal pumps in the NEWater Factories and Waterworks	7.8	FY2020 – FY2023
	EPC	Supply water meters of various sizes to the Myanmar government	1.8	FY2020 – FY2023
	EPC	Supply of pipes and accessories to the Myanmar	2.5	FY2020 – FY2023

Source: SAC Advisors, Company data

Maintain BUY at a lower target price of S\$0.290 per share. Faced with increased competition and labour costs, we expect the challenging operating environment to cap margin expansion. Yet, Sanli's sizeable order book points to its strength and dominance in the water and waste treatment industry. Factoring in slower growth and rising costs, we arrived at a revised target price at S\$0.290 per share, which is derived from DCF model (weighted average cost of capital: 5.5% and terminal growth: 2.0%). The target price is 54.0% above the current share price of S\$0.188 per share.

SAC Advisors Forecast Summary

Revenue by segment (S\$'000)	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Engineering, Procurement and Construction	31,975	43,793	56,115	57,824	59,270	60,751	62,574
Operations and maintenance	25,289	20,521	19,494	13,526	13,526	13,594	13,730
Total Revenue	57,264	64,314	75,609	71,350	72,796	74,345	76,303

Revenue % (Y-Y)	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Engineering, Procurement and Construction	33.8%	37.0%	28.1%	3.0%	2.5%	2.5%	3.0%
Operations and maintenance	88.1%	-18.9%	-5.0%	-30.6%	0.0%	0.5%	1.0%
Total Revenue	53.3%	12.3%	17.6%	-5.6%	2.0%	2.1%	2.6%

Revenue breakdown (%)	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Engineering, Procurement and Construction	55.8%	68.1%	74.2%	81.0%	81.4%	81.7%	82.0%
Operations and maintenance	44.2%	31.9%	25.8%	19.0%	18.6%	18.3%	18.0%
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Gross profit	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Gross profit growth	76.2%	-7.5%	4.5%	-10.2%	1.9%	2.0%	2.5%
Gross profit margin	19.6%	16.2%	14.4%	13.7%	13.7%	13.6%	13.6%
Gross Profit (S\$'000)	11,248	10,399	10,871	9,761	9,942	10,139	10,393

Operating profit**	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Operating Profit margin	12.8%	10.1%	5.4%	4.1%	4.0%	3.9%	3.7%
Operating Profit growth y-y	91.9%	-11.6%	-37.3%	-28.3%	-0.9%	-0.7%	-3.0%
Operating Profit (S\$'000)	7,357	6,503	4,079	2,924	2,898	2,877	2,790

Profit Growth (%) (Y-Y)	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Profit before tax	92.9%	-12.7%	-38.7%	-26.4%	-0.9%	-0.7%	-3.1%
Profit after tax*	82.0%	-13.0%	-40.7%	-27.7%	2.9%	-0.7%	-3.1%
Profit before tax (S\$'000)	7,185	6,269	3,840	2,827	2,801	2,780	2,693
Profit after tax (S\$'000)	5,942	5,172	3,069	2,220	2,285	2,268	2,198

Profit margin (%)	Fiscal Year Ended						
	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Profit before tax	12.5%	9.7%	5.1%	4.0%	3.8%	3.7%	3.5%
Profit after tax*	10.4%	8.0%	4.1%	3.1%	3.1%	3.1%	2.9%

Source: Company data, SAC Advisors

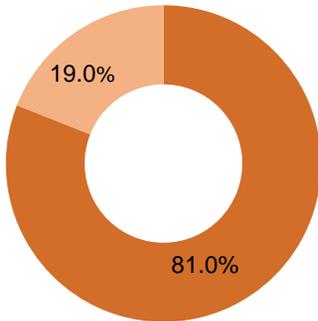
* Profit attributable to owners of the Company

** In-house estimate

Company Background

- Sanli is an environmental engineering company with more than ten years of experience in the field of water and waste management. Leveraging on its technical know-how and industry knowledge, it provides total solutions and services to customers in an efficient and cost-effective manner.
- Its expertise lies in the design, supply, delivery, installation, commissioning, maintenance, repair and overhaul of mechanical and electrical equipment as well as instrumentation and control systems. The types of infrastructure include wastewater treatment plants, water reclamation plants, NEWater plants, waterworks, service reservoirs, pumping stations and incineration plants.
- Sanli has two main business segments:
 - (a) Engineering, Procurement and Construction (“EPC”): Sanli undertakes EPC work for water and waste management. Its services include process upgrading of water treatment plants, upgrading of pumping station capacities, replacement of aged M&E equipment, and design and build of various treatment process systems. These turnkey contracts are higher in value due to equipment procurement, but margins are lower compared with maintenance business.
 - (b) Operations and Maintenance: Sanli provides operation and maintenance services for the equipment used in water and waste management infrastructure. It maintains a workshop to undertake major repair and overhaul of the equipment. It provides round the clock corrective maintenance services to the customers when the facility encounters equipment problems.

Revenue Breakdown (FY2019)



■ EPC ■ Operations and Maintenance

Source: Company data, SAC Advisors

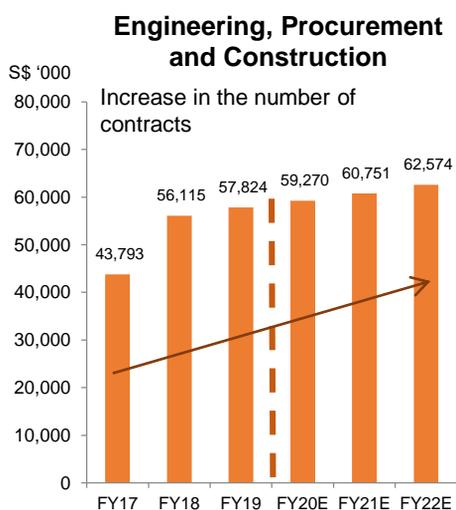
Business Segment	Products / Services
Engineering, Procurement and Construction	<ul style="list-style-type: none"> • Water Management • Waste Management
Operations and Maintenance	<ul style="list-style-type: none"> • Corrective and preventive maintenance services

Financial Summary

Revenue model

- The core business can be categorised into two business segments:

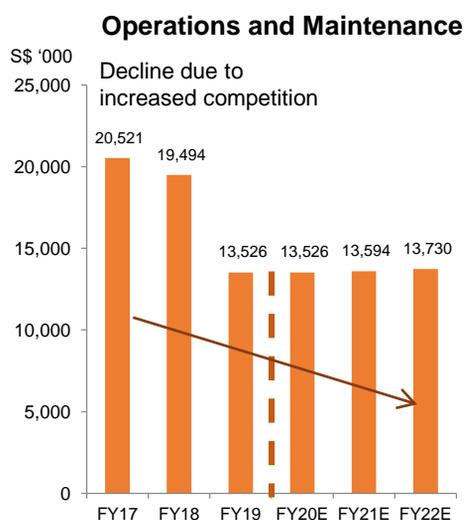
- (a) Engineering, Procurement and Construction: Sanli provides EPC work for water and waste management. Its services include process upgrade of existing water treatment plants, pumping station capacities, replacement of aged M&E equipment, and design and build of various treatment process systems.



Source: Company data, SAC Advisors

For water management projects, Sanli provides engineering solutions and services for the treatment of raw water before it is channelled to residences, businesses and industries. It also provides engineering solutions and services to treat used water released from residences, businesses and industries, where pollutants and toxins in wastewater are eliminated or reduced to an acceptable level before they are discharged into the environment or used by industrial users.

For waste management, Sanli provides engineering solutions and services to their customer in the public sector for the treatment of refuse in incineration plants in Singapore.



Source: Company data, SAC Advisors

Revenue is booked based on the stage of completion of the contract. Each contract takes between one to three years to complete. EPC contracts generated revenue of S\$57.8 million or 81.0% of FY19 revenue, and gross margin of 12.5%, due to a higher equipment content.

- (b) Operations and Maintenance: It provides operation and maintenance services for installed equipment in water and waste management infrastructure. It maintains a workshop to perform major repair and overhaul of these equipment. These corrective maintenance services are available 24 hours a day and seven days a week, to their customers when their facility experiences equipment problems.

Revenue in this segment is recognised when the service is delivered. In FY19, this segment accounted for S\$13.5 million or 19.0% of total revenue, at a higher gross margin of 18.7%.

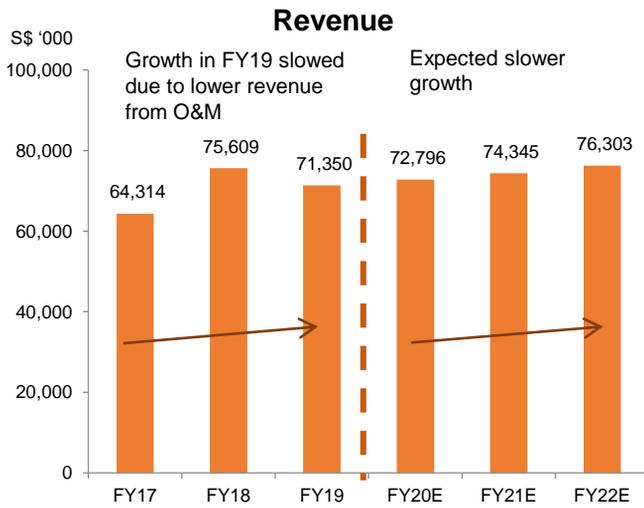
Revenue Breakdown (%)	FY17	FY18	FY19	FY20E	FY22E
Engineering, Procurement and Construction	68.1%	74.2%	81.0%	81.4%	81.7%
Operations and Maintenance	31.9%	25.8%	19.0%	18.6%	18.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company data, SAC Advisors

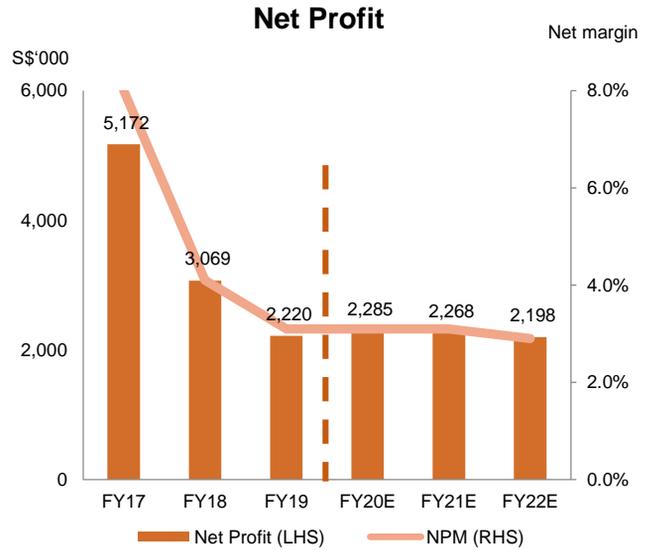
Financial Summary

Revenue expected to remain stable in the next 2 years

From FY2017 to FY2019, revenue from the EPC segment posted growth whereas revenue from the O&M segment had experienced a decline, which could be attributable to increased competition. Accordingly, the decrease in higher margin O&M segment has a consequential effect on the Group's bottom line. Gross margin fell from 16.2% in FY2017 to 13.7% in FY2019, and net margin fell from 8.0% to 3.1%.



Source: Company data, SAC Advisors



Source: Company data, SAC Advisors

Moving forward, we expect growth to ease for Sanli. Based on the current order book of S\$198.0 million, the bulk of which are EPC work, which are expected to be booked over 3 years. Sanli's order book is expected to contribute approximately S\$66.0 million revenue per year in the next 3 financial years, which represents about 87% to 92% of our projected revenue.

As EPC contracts command a lower margin due to a higher equipment component, we do not see room for gross margin to rise above the current level of 13.7%. Furthermore, with its push into Myanmar, we also expect additional marketing costs to cap net profit growth.

Income Statement (S\$'000)

FYE 31 Mar	2017	2018	2019	2020F	2021F
Revenue	64,314	75,609	71,350	72,796	74,345
Cost of contract works	(53,915)	(64,738)	(61,589)	(62,837)	(64,174)
Gross profit	10,399	10,871	9,761	9,959	10,171
Other income	164	321	375	375	375
Administrative expenses	(3,437)	(5,246)	(6,131)	(6,333)	(6,542)
Other operating expenses	(623)	(1,867)	(1,081)	(1,103)	(1,126)
Finance expenses	(234)	(239)	(97)	(97)	(97)
Profit before income tax	6,269	3,840	2,827	2,801	2,780
Income tax expense	(1,055)	(785)	(645)	(515)	(512)
Profit for the year	5,214	3,055	2,182	2,285	2,268
Profit/(loss) attributable owners of company	5,172	3,069	2,220	2,285	2,268
Earnings per share (Cents)	2.56	1.19	0.83	0.85	0.84

Cash Flow Statement (S\$'000)

FYE 31 Mar	2017	2018	2019	2020F	2021F
Profit before income tax	6,269	3,840	2,827	2,801	2,780
Depreciation & amortisation	492	576	1,077	947	1,020
Change in working capital	8,029	(9,732)	(942)	2,553	(161)
Others	(397)	(1,650)	(616)	(488)	(485)
Net Cash (used in)/ from operations	14,393	(6,966)	2,346	5,812	3,155
Purchase of PPE	(429)	(5,434)	(1,888)	(1,133)	(793)
Others	58	356	180	70	70
Net Cash (used in)/ from investing	(371)	(5,078)	(1,708)	(1,063)	(723)
Net change in equity	0	11,042	0	0	0
Net change in debt	(1,162)	(1,181)	(491)	(97)	(97)
Dividends paid	(8,000)	0	(672)	(457)	(454)
Others	0	53	0	0	0
Net Cash (used in)/ from financing	(9,162)	9,914	(1,163)	(554)	(551)

Balance Sheet (S\$'000)

FYE 31 Mar	2017	2018	2019	2020F	2021F
Cash and cash equivalents	11,484	9,354	8,829	13,024	14,905
Trade and other receivables	6,665	15,686	16,282	16,308	16,655
Contract work-in-progress in excess of billings	5,812	13,477	15,435	12,375	12,639
Other assets	257	0	267	267	267
Total current assets	24,218	38,517	40,813	41,974	44,466
Property, plant and equipment	5,648	10,500	11,157	11,345	11,118
Other non-current assets	267	267	0	0	0
Total non-current assets	5,915	10,767	11,157	11,345	11,118
Total assets	30,133	49,284	51,970	53,319	55,584
Borrowings	854	271	271	271	271
Trade and other payables	12,556	19,820	21,622	21,141	21,591
Billings in excess of contract work-in-progress	760	450	260	260	260
Other current liabilities	4,303	1,047	572	572	572
Total current liabilities	18,473	21,588	22,725	22,244	22,694
Borrowings	2,882	2,611	2,340	2,340	2,340
Other non-current liabilities	268	180	252	252	252
Total non-current liabilities	3,150	2,791	2,592	2,592	2,592
Total liabilities	21,623	24,379	25,317	24,836	25,286
Share capital	1,500	21,297	21,297	21,297	21,297
Treasury reserves	(35)	(22)	(31)	(31)	(31)
Merger reserve	0	(6,755)	(6,755)	(6,755)	(6,755)
Capital reserve	0	232	482	482	482
Retained earnings	7,045	10,114	11,662	13,490	15,305
Equity attributable to shareholders	8,510	24,866	26,655	28,483	30,298
Non-controlling interests	0	39	(2)	0	0

Ratios

FYE 31 Mar	2017	2018	2019	2020F	2021F
Profitability (%)					
Gross profit margin	16.2%	14.4%	13.7%	13.7%	13.7%
Operating profit margin	10.1%	5.4%	4.1%	4.0%	3.9%
Profit before tax margin	9.7%	5.1%	4.0%	3.8%	3.7%
Profit after tax margin	8.0%	4.1%	3.1%	3.1%	3.1%
Liquidity (x)					
Current ratio	1.3	1.8	1.8	1.9	2.0
Quick ratio	1.3	1.8	1.8	1.9	2.0
Interest coverage ratio	27.8	17.1	30.1	29.9	29.7
Net Debt to Equity	Net cash				
Valuation (x)					
P/E	7.3	15.8	22.8	22.1	22.3
Core P/E	9.8	11.7	22.8	22.1	22.3
Core P/E at target price	15.0	18.1	35.0	34.0	34.3
P/B	5.9	2.0	1.9	1.8	1.7
EV/EBITDA	6.1	9.5	11.1	10.4	9.8
Cash Conversion Cycle					
Trade receivable days	39	54	82	82	82
Inventory days	N/A	N/A	N/A	N/A	N/A
Trade payable days	70	91	123	123	123
CCC days	N/A	N/A	N/A	N/A	N/A
Returns					
Return on equity	52.1%	18.4%	8.6%	8.3%	7.7%
Return on capital employed	48.1%	20.7%	10.3%	9.6%	9.0%
Dividend payout ratio	0.0%	0.0%	30.3%	20.0%	20.0%

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