

Sanli Environmental Limited

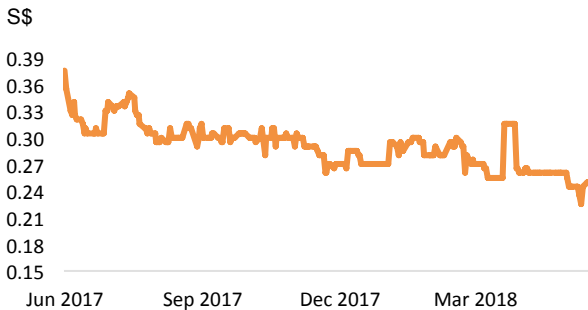
Date: 25 May 2018

BUY
(Maintained)

Target Price: S\$0.360
(+44%)

SANLI SP

Price: S\$0.250 (as at 24 May 2018)



Price performance	1M	3M	6M	1Y
Sanli	0.0%	(14.2%)	(14.2%)	N/A
Catalist Index	-8.3%	-10.6%	-14.4%	1.7%

Market capitalization	\$64.5 million		
Current Price	S\$0.240		
Shares outstanding	268.7 million		
Free Float	20.2%		
Major shareholder	Management	Heliconia Capital Management	75% 8%
Recommendation of other brokers	N/A		

Source: Company data, Bloomberg, SAC Advisors

Analyst

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Hiring ramped up in view of S\$6.5 billion in potential contracts roll-out

Sanli Environmental reported FY18 results that saw revenue continue to be challenged by the challenging O&M environment. The Group registered a full year revenue of S\$75.6 million for FY18, a reversal from the decline seen in their HY18 results when revenue declined by 8.9% y-y. For the FY18, revenue registered a 17.6% increase on a y-y basis. The increase in the Group's turnover was mainly attributed to the increase in contribution from its EPC segment of S\$12.3 million, or a 28.1% y-y growth, partially offset by a 5.0% decline in the O&M segment.

Profit before tax excluding one-off IPO tax expenses declined by 19.1% as management ramped up hiring in view of potential contract roll out by PUB. The weaker top-line also translated into a weaker profit before tax of 19.1% when we strip out one-off IPO expenses of S\$1.2 million. The decrease was also contributed mainly by an increase in employees' remuneration of S\$1.2 million as a result of an increase in headcount and salaries. During our meeting with the management at the FY18 results briefing, the management team talked about the increased hiring that the Group has embarked on in view of the potential contracts that PUB will be rolling out, impacting their bottom-line in the near-term.

Sanli has ramped up hiring in view of the potential S\$6.5 billion in contract value to be rolled out by PUB. The PUB is expected to roll out a total of 14 contracts at the end of this year and 2019 for the Deep Tunnel Sewerage System (Phase 2). Management has guided that they intend to bid for 12 out of the 14 contracts with a contract value of S\$6 billion. The management is optimistic that they will win 1 to 2 contracts from this, with contract values ranging from S\$200 million to S\$500 million.

Key risks: Reliant on Singapore public sector projects.

Key Financials

Year ended March (S\$'mn)	FY2015A	FY2016A	FY2017A	FY2018A	FY2019E	FY2020E
Revenue	37.3	57.3	64.3	75.6	99.2	122.0
% Growth	92.4%	53.3%	12.3%	17.6%	24.0%	23.0%
Gross profit	6.4	11.2	10.4	10.9	15.9	19.5
Gross profit margin (%)	17.1%	19.6%	16.2%	14.4%	16.0%	16.0%
Profit attributable to owners (before IPO expenses)	3.2	5.9	5.2	3.1	7.1	8.8
Profit attributable to owners	3.2	5.9	5.2	4.3	7.1	8.8
% Growth	84.6%	82.0%	(13.0%)	(17.3%)	49.1%	23.2%
Profit after tax margin (%)	8.7%	10.4%	8.0%	4.0%	7.2%	7.2%
EPS (S\$ cents)*	1.5	2.7	2.4	1.2	2.6	3.3
P/E (x)	19.5	10.8	12.3	20.0	9.2	7.5
EV/EBITDA (x)	13.4	7.3	8.1	8.7	6.0	4.9
Net Debt/Equity			Net cash	Net cash	Net cash	Net cash
Dividend yield	N/A	N/A	N/A	1.2%	1.8%	2.2%

*EPS for FY15, FY16 and FY17 were calculated based on the pre-Invitation share capital of 216,657,813 shares

N/A: Not applicable

O&M segment shows sign of recovery

Sanli Environmental reported FY18 results that saw revenue continue to be challenged by the challenging O&M environment.

The Group registered a full year revenue of S\$75.6 million for FY18, a reversal from the decline seen in their HY18 results when revenue declined by 8.9% y-y. For the FY18, revenue registered a 17.6% increase on a y-y basis. The increase in the Group's turnover was mainly attributed to the increase in contribution from its EPC segment of S\$12.3 million, or a 28.1% y-y growth, partially offset by a 5.0% decline in the O&M segment.

The decrease in the Group's turnover follows management's prior guidance of weakness seen in its O&M segment arising primarily from keen competition during the period. We have already seen the effects of this throughout FY18, and the challenging environment seems to have continued to persist in their latest HY18 results. Despite this, we think the worst days of the O&M sector may be over. During the FY18 results briefing, we got a sense from management that the landscape is now more favourable, and Sanli no longer find themselves

Profit before tax excluding one-off IPO tax expenses declined by 19.1% as management ramped up hiring in view of potential contract roll out by PUB.

The weaker top-line also translated into a weaker profit before tax of 19.1% when we strip out one-off IPO expenses of S\$1.2 million. The decrease was also contributed mainly by an increase in employees' remuneration of S\$1.2 million as a result of an increase in headcount and salaries. During our meeting with the management at the FY18 results briefing, the management team talked about the increased hiring that the Group has embarked on in view of the potential contracts that PUB will be rolling out, impacting their bottom-line in the near-term. We see this however, as a temporary phenomenon as management builds up capacity to prepare for the new contracts to be rolled out.

The profit was also impacted by the higher depreciation of PPE, which increased by 17.1% due to depreciation and capex spending of the Group's new leasehold property at 28 Kian Teck Drive.

Sanli ramped up hiring in view of the potential S\$6.5 billion in contract value to be rolled out by PUB.

The PUB is expected to roll out a total of 14 contracts at the end of this year and 2019 for the Deep Tunnel Sewerage System (Phase 2). Phase 1 of the DTSS contract worth S\$1.51 billion has already been awarded, and management has guided that they intend to bid for 12 out of the 14 contracts with a contract value of S\$6 billion. The management is optimistic that they will win 1 to 2 contracts from this, with contract values ranging from S\$200 million to S\$500 million. We also understood from management that the hiring was for specialists and engineers.

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	FY18	FY17
EPC	56,115	43,793
O&M	19,494	20,521
Total	75,609	64,314

Source: SAC Advisors, Company data

FY18 results review

Sanli has made small steps in entering Myanmar. Management has so far made cautious steps in Myanmar given that this is a relatively new market for them. Given the profile of the management team, we think they will proceed cautiously overseas given their traditional strengths in the local market. Management did not dwell too much on their latest overseas venture, but did hint that they are breaking even on the operating level in Myanmar.

Sanli has an outstanding order book of S\$110.2 million as of 31 March 2018, representing 1.5x FY18 revenue. Sanli announced earlier this year that it has secured four new contracts worth a total of S\$8.1 million, from both the public and private sector, bringing the Group's order book to S\$112.3 million. The contracts comprise projects in both the EPC and O&M segments. Under the EPC contracts, Sanli will supply, install, commission and test, equipment at a water reclamation plant as well as a hydrated lime storage facility, and replace treatment process equipment at a salinity plant. Under the O&M contract, Sanli will provide maintenance services for sewerage pumping and treatment system.

Maintain BUY with an unchanged target price of S\$0.360. We are keeping our rating and target price unchanged. Sanli has declared a final dividend of S\$0.0025 per share for FY2018, translating to a payout ratio of 21.9%

SAC Advisors Forecast Summary

Revenue by segment (S\$'000)	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Engineering, Procurement and Construction	12,305	23,897	31,975	43,793	56,000	69,440	85,411
Operations and maintenance	7,102	13,448	25,289	20,521	24,000	29,760	36,605
Total Revenue	19,407	37,345	57,264	64,314	80,000	99,200	122,016

Revenue % (Y-Y)	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Engineering, Procurement and Construction	N/A	94.2%	33.8%	37.0%	27.9%	24.0%	23.0%
Operations and maintenance	N/A	89.4%	88.1%	-18.9%	17.0%	24.0%	23.0%
Total Revenue	N/A	92.4%	53.3%	12.3%	24.4%	24.0%	23.0%

Revenue breakdown (%)	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Engineering, Procurement and Construction	63.4%	64.0%	55.8%	68.1%	70.0%	70.0%	70.0%
Operations and maintenance	36.6%	36.0%	44.2%	31.9%	30.0%	30.0%	30.0%
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Gross profit	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Gross profit growth	N/A	59.5%	76.2%	-7.5%	35.7%	24.0%	23.0%
Gross profit margin	20.6%	17.1%	19.6%	16.2%	16.0%	16.0%	16.0%
Gross Profit (S\$'000)	4,004	6,385	11,248	10,399	12,800	15,872	19,523

Operating profit**	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Operating Profit margin	10.9%	10.3%	12.8%	10.1%	7.5%	8.9%	8.8%
Operating Profit growth y-y	N/A	80.8%	91.9%	-11.6%	-8.1%	47.2%	22.6%
Operating Profit (S\$'000)	2,120	3,833	7,357	6,503	5,975	8,795	10,780

Profit Growth (%) (Y-Y)	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Profit before tax	N/A	81.7%	92.9%	-12.7%	-8.4%	49.1%	23.2%
Profit after tax*	N/A	84.6%	82.0%	-13.0%	-7.9%	49.1%	23.2%
Profit before tax (S\$'000)	2,049	3,724	7,185	6,269	5,741	8,561	10,546
Profit after tax (S\$'000)	1,748	3,211	5,898	5,214	4,765	7,106	8,754

Profit margin (%)	Fiscal Year Ended						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Profit before tax	10.6%	10.0%	12.5%	9.7%	7.2%	8.6%	8.6%
Profit after tax*	9.1%	8.7%	10.4%	8.0%	6.0%	7.2%	7.2%
Profit after tax (excl. one off IPO expense) (S\$'000)	1,748	3,211	5,898	5,214	6,075	7,106	8,754

Source: Company data, SAC Advisors

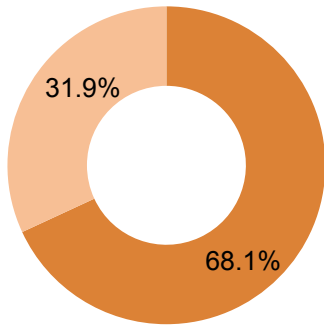
* Profit attributable to owners of the Company

** 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.

Revenue Breakdown (FY2017)



■ EPC ■ Operations and Maintenance

Source: Company data, SAC Advisors

- 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.

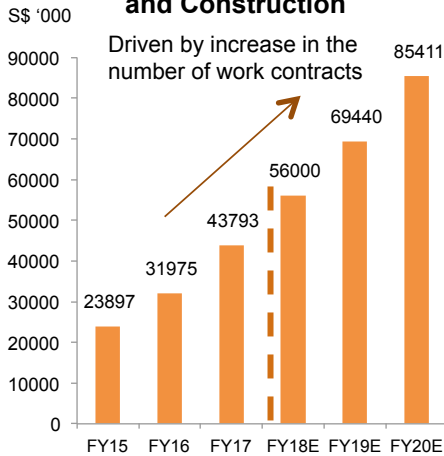
Business Segment	Products / Services
Engineering, Procurement and Construction	<ul style="list-style-type: none"> • Water Management • Waste Management
Operations and Maintenance	<ul style="list-style-type: none"> • Corrective and preventive maintenance services

Financial Summary

Revenue model

- The core business can be categorised into two business segments:
 - (a) Engineering, Procurement and Construction: Sanli provides EPC within the field of water and waste management. Its services include process upgrading of existing water treatment plants, upgrading of existing water treatment plants, upgrading of pumping station capacities, replacement of aged M&E equipment, and design and build of various treatment process systems.

Engineering, Procurement and Construction



Source: Company data, SAC Advisors

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

In the field of 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.

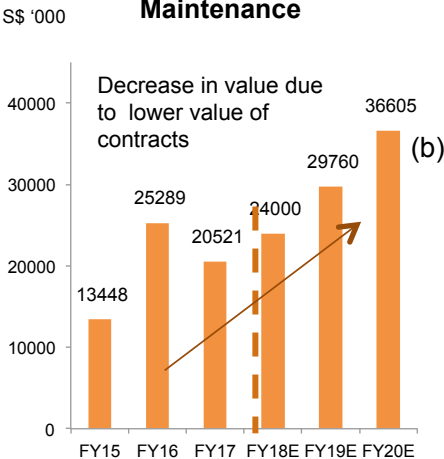
Revenue in this segment is recognised based on the stage of completion of the contract activity at the end of the reporting period. The duration of each contract is between one and three years.

Revenue from this segment accounted for S\$43.8 million or 68.1% of FY17 revenue.

(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 FY17, this segment accounted for S\$20.5 million or 31.9% of total revenue.

Operations and Maintenance



Source: Company data, SAC Advisors

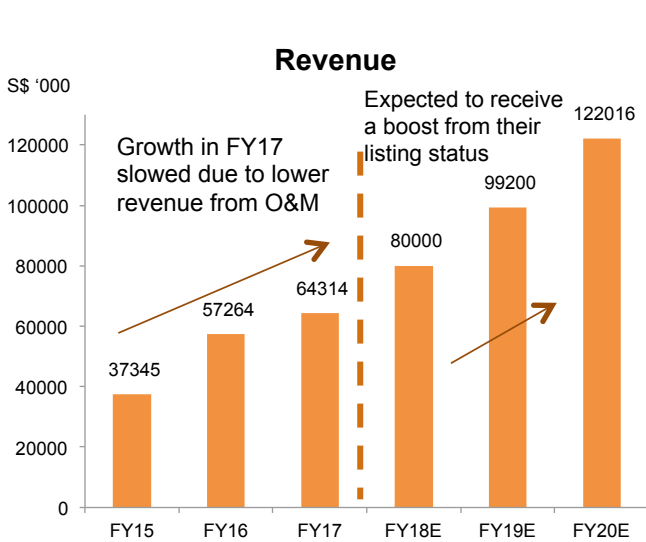
Revenue Breakdown (%)	FY16	FY17	FY18E	FY19E	FY20E
Engineering, Procurement and Construction	55.8%	68.1%	70.0%	70.0%	70.0%
Operations and Maintenance	44.2%	31.9%	30.0%	30.0%	30.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company data, SAC Advisors

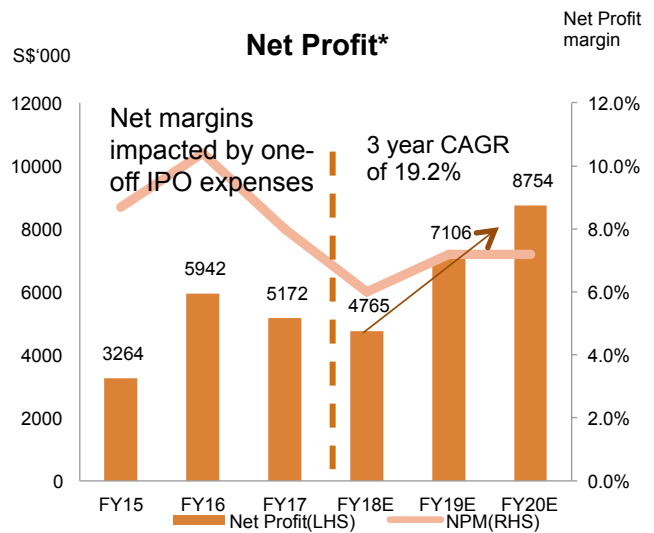
Financial Summary

Revenue expected to receive a boost from new listing status

Sanli’s revenue increased by a compounded annual growth rate (“CAGR”) of 31.2% from FY15 to FY17, due to increases in revenue for both EPC and their operations and maintenance (“O&M”) segment. The increase over the years is mainly due to an increase in the number of contracts secured and the recognition of revenue for work done in relation to contracts secured in prior years.



Source: Company data, SAC Advisors



Source: Company data, SAC Advisors

*Profit after tax attributable to owners of the Company

The slow down in revenue growth in FY17 was attributed to a decline in the O&M segment due to the lower value of contracts recognised during this period, though this was mitigated by an increase in revenue from the EPC segment. We think investors should not be unduly worried about the decline in the O&M segment as the execution of service and maintenance contracts actually increased in the last financial year. Moreover, we expect that Sanli will be better able to secure new and larger contracts moving forward due to their listing status and L6 certification.

Moving forward, we expect that net margins for Sanli will dip in FY18E due to one-off IPO expenses of about S\$1.3 million. However, this is expected to remain stable at about 7.2% moving forward, and we expect net profit to increase by a three year CAGR of 19.2% driven by new contract wins from a higher imputed win rate.

Income Statement (S\$'000)

FYE 31 Mar	2016	2017	2018F	2019F	2020F
Revenue	57,264	64,314	80,000	99,200	122,016
Cost of contracted works	(46,016)	(53,915)	(67,200)	(83,328)	(102,493)
Gross Profit	11,248	10,399	12,800	15,872	19,523
Other income	172	164	165	165	165
Administrative expenses	(3,512)	(3,437)	(6,190)	(6,250)	(7,687)
Other operating expenses	(551)	(623)	(800)	(992)	(1,220)
Finance	(172)	(234)	(234)	(234)	(234)
Profit/(Loss) before tax	7,185	6,269	5,741	8,561	10,546
Income tax	(1,287)	(1,055)	(976)	(1,455)	(1,793)
Profit/(Loss) for the year/period	5,898	5,214	4,765	7,106	8,754
Profit/(Loss) attributable to owners of company	5,942	5,172	4,765	7,106	8,754
Earnings/(Loss) per share:					
-Basic (cents)	2.24	1.93	1.77	2.64	3.26
-Diluted (cents)	2.24	1.93	1.77	2.64	3.26

Balance Sheet (S\$'000)

FYE 31 Mar	2016	2017	2018F	2019F	2020F
As at 31 Mar					
Cash and bank balances	6,624	11,484	22,900	27,551	33,358
Trade, other receivables and others	7,011	6,665	9,066	10,749	12,749
Contract work-in-progress in excess of billings	8,218	5,812	6,400	7,936	9,761
Available for sale investments	257	257	257	257	257
Total current assets	21,853	24,218	39,363	48,333	59,239
Property, plant and equipment	5,747	5,648	5,781	5,844	5,887
Available for sale investments	524	267	267	267	267
Total non-current assets	6,271	5,915	6,048	6,111	6,154
Total assets	28,124	30,133	44,671	52,064	62,279
Trade and other payables	8,020	12,556	14,182	16,430	19,103
Borrowings	2,847	854	854	854	854
Other current liabilities	1,857	5,063	4,224	4,224	4,224
Total current liabilities	12,724	18,473	19,260	21,508	24,181
Borrowings	3,730	2,882	2,882	2,882	2,882
Finance leases	355	268	268	268	268
Total non-current liabilities	4,085	3,150	3,150	3,150	3,150
Total liabilities	16,809	21,623	22,410	24,658	27,331
Share Capital	1,500	1,500	13,270	13,270	13,270
Translation reserves	(16)	(35)	(35)	(35)	(35)
Retained earnings	9,873	7,045	9,026	14,711	21,714
Net equity	11,357	8,510	22,261	27,946	34,949
Total liabilities and equity	28,124	30,133	44,671	52,064	62,279

Cash Flow Statement (S\$'000)

FYE 31 Mar	2016	2017	2018F	2019F	2020F
Profit/(Loss) before tax	7,185	6,269	5,741	8,561	10,546
Depreciation & amortisation	414	492	492	462	432
Change in working capital	(4,336)	8,029	(1,363)	(971)	(1,153)
Others	(142)	(397)	(790)	(1,269)	(1,607)
Net Cash (used in)/ from operations	3,121	14,393	4,080	6,783	8,218
Purchase of PPE	(695)	(429)	(625)	(525)	(475)
Others	(483)	58	48	48	48
Net Cash (used in)/ from investing	(1,178)	(371)	(577)	(477)	(427)
Net change in debt	1,518	(928)	(2000)	0	0
Net change in equity	0	0	11,100	0	0
Dividends	(900)	(8,000)	(1,184)	(1,707)	(2,082)
Others	(172)	(234)	(234)	(234)	(234)
Net Cash (used in)/ from financing	446	(9,162)	7,913	(1,655)	(1,985)

Ratios

FYE 31 Mar	2016	2017	2018F	2019F	2020F
Profitability (%)					
Gross margin	19.6%	16.2%	16.0%	16.0%	16.0%
Operating margin	12.8%	10.1%	7.5%	8.9%	8.8%
Pretax margin	12.5%	9.7%	7.2%	8.6%	8.6%
Liquidity (x)					
Current ratio	1.7	1.3	2.0	2.2	2.3
Quick ratio	1.7	1.3	2.0	2.2	2.3
Interest coverage ratio	42.8	27.8	25.5	37.6	46.1
Net Debt to Equity	Net cash	Net cash	Net cash	Net cash	Net cash
Valuation (x)					
P/E	10.8	12.3	16.6	11.2	9.1
Core P/E	13.2	15.3	13.0	11.2	9.1
Core P/E at target price	16.4	18.6	15.9	13.6	11.1
P/B	7.0	9.3	3.6	2.8	2.3
EV/EBITDA	7.3	8.1	8.7	6.1	5.0
Cash Conversion Cycle					
Trade receivable days	31	32	32	32	32
Inventory days	N/A	N/A	N/A	N/A	N/A
Trade payable days	55	47	51	51	51
CCC days	-24	-15	-19	-19	-19
Returns					
Return on equity	52.3%	60.8%	21.4%	25.4%	25.0%
Return on capital employed	33.1%	42.2%	18.3%	22.4%	22.6%
Dividend payout ratio			20.0%	20.0%	20.0%
Dividend yield	N/A	N/A	1.2%	1.8%	2.2%

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