

China Water Affairs Group

H120 results

Valuation ignoring growth potential

China Water Affairs (CWA) continues to offer the prospect of attractive growth in EPS despite the fall in environmental protection construction revenue. The requirement for expenditure on the water sector in China remains intact and the current rating of the shares appears undemanding.

Year end	Revenue (HK\$m)	PBT* (HK\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
03/18	7,580	2,462	71.8	23.0	8.1	4.0
03/19	8,302	2,772	85.1	28.0	6.8	4.8
03/20e	8,757	3,169	98.2	33.0	5.9	5.7
03/21e	9,894	3,402	105.6	38.0	5.5	6.5

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H120 EPS shows continued growth

In H120, CWA's key financial benchmarks showed continued growth versus H119, with revenue +5.1% (Edison FY20e: +16.9%), EPS +36.6% (FY20e: +14.3%) and DPS +16.7% (FY20e: +17.9%). The dominant (80%+ of revenues) water supply business performed strongly, (+13.4% in H1 versus Edison FY20e +13.3%) despite negative currency movements, helped by volume growth (c.10%) and tariff hikes (4.8%). The overall shortfall in the H1 revenue growth rate versus our FY20e resulted, in large part, from a marked reduction in the revenue contribution from the environmental protection renovation and construction services (-46.3%), leading to an overall decline in the environmental segment revenue of 29.2% (Edison FY20e +35%). Operating margins remained constant at c 37%, and despite the lower than expected revenues, EPS of HK54.8c (+36.6%) significantly exceeded our forecasts, boosted by a stronger than anticipated associate line (+859% versus Edison FY20e of +161%, benefiting from a fair value adjustment to the recently acquired holding in Kangda International (KIE)), lower minority interests and a lower tax charge (22.7% versus Edison FY20e 28%). The DPS was increased by 16.7%, to HK14c (Edison FY20e +17.9%).

Long-term investment opportunity remains intact

We have revised our forecasts to reflect a more cautious view on environmental protection construction revenues (FY20 and beyond) but an enhanced contribution from associates (FY20e), lower minority payments and a lower tax rate. Our revised EPS forecast for FY20e of HK98.2c represents an increase of c 1% versus our previous estimate (FY21e -6.2%). Despite a general slowdown in Chinese fixed asset investment there is a requirement for further significant investment in the water sector and the government continues to appear favourably disposed to private investment in the sector.

Valuation: Undemanding rating

At current levels, CWA is trading on a FY20e P/E ratio of 5.9x (compared to an average of 15.0x for a group of selected Hong Kong- and China-listed peers) and a two-year PEG ratio of 0.6x (peers at c 2.0x). At a P/E of 10x, which is still below the peer group average, CWA would trade at HK\$9.8 (a PEG ratio of c 1.0x).

Utilities

3 December 2019

Price **HK\$5.82**
Market cap **HK\$9335m**

Net debt (HK\$bn) at 30 September 2019 11.0

Shares in issue 1,604m

Free float 66%

Code 855

Primary exchange HK

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (1.9) (6.1) (34.4)

Rel (local) 0.6 (9.0) (32.6)

52-week high/low HK\$8.87 HK\$5.64

Business description

China Water Affairs (CWA) is a pioneer in the privatisation of water supply assets in China. The company seeks to create growth via volume/price increases.

Next events

FY20 results June 2020

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China Water Affairs Group is a research client of Edison Investment Research Limited

Exhibit 1: Financial summary

	HK\$m	2017	2018	2019	2020e	2021e
Year end 31 March		HKFRS	HKFRS	HKFRS	HKFRS	HKFRS
PROFIT & LOSS						
Water supply revenue		4,874	6,204	6,376	7,268	8,330
Environmental Protection		531	814	1522	1065	1119
Other segments		303	562	404	424	445
Revenue total		5,708	7,580	8,302	8,757	9,894
EBITDA		2,646	3,097	3,507	3,899	4,473
Operating Profit		2,271	2,691	3,022	3,289	3,785
Amortization		315	334	404	480	528
Depreciation		60	71	81	130	160
Net Interest expense		(251)	(289)	(319)	(493)	(570)
Profit Before Tax		1,963	2,462	2,772	3,169	3,402
Tax		(583)	(701)	(642)	(729)	(783)
Profit After Tax		1,379	1,762	2,130	2,440	2,620
Net profits contributable to shareholders		853	1,141	1,369	1,586	1,703
Average Number of Shares Outstanding (m)		1,505	1,571	1,609	1,606	1,604
EPS - fully diluted (c)		55.4	71.8	85.1	98.2	105.6
Dividend per share (c)		20.0	23.0	28.0	33.0	38.0
EBITDA Margin (%)		46.4	40.9	42.2	44.5	45.2
Operating Margin (%)		39.8	35.5	36.4	37.6	38.3
BALANCE SHEET						
Fixed Assets		15,689	19,581	24,493	28,666	31,561
Intangible Assets		10,316	13,499	16,514	19,534	22,506
Plant, property and equipment		1,127	1,695	2,020	1,990	1,930
Investment properties		1,173	909	912	915	918
Investment in associates		635	661	676	1,483	1,275
Other		2,438	2,817	4,371	4,744	4,931
Current Assets		9,942	9,008	11,332	11,911	9,910
Properties Under Development		690	1,370	1,274	1,274	1,274
Properties Held for Sale		289	597	816	816	816
Inventory		285	348	531	560	633
Trade and Bills Receivables		872	1,055	1,243	1,311	1,481
Due from Non-controlling Equity Holders of Subsidiaries		251	260	288	323	347
Due from Associates		409	563	227	227	227
Prepayments, Deposits and Other Receivables		1,743	1,293	1,550	1,635	1,847
Pledged Deposits		783	570	645	645	645
Deposits and cash		4,314	2,511	3,973	4,335	1,855
Other		307	440	785	784	784
Current Liabilities		7,393	8,649	10,019	11,977	10,005
Trade and Bills Payables		1,097	1,626	2,410	1,400	1,500
Accrued Liabilities, Deposits and Other Payables		2,102	2,306	1,979	2,529	2,822
Short-term Borrowings		3,206	3,450	3,437	5,656	3,165
Other		988	1,267	2,192	2,392	2,517
Long Term Liabilities		9,275	8,786	12,903	14,026	15,102
Long-term Borrowings		8,123	7,432	11,494	12,494	13,494
Other long term liabilities		1,152	1,354	1,409	1,532	1,608
Shareholders' Equity		8,963	11,154	12,902	14,573	16,363
		-	-	-	-	-
CASH FLOW						
Net Cash Flows from Operating Activities		1,452	1,632	1,429	2,554	3,276
Purchase of property, plant and equipment		(92)	(100)	(100)	(100)	(100)
Increase in concession rights for water supply and sewage processing		(1,808)	(2,500)	(2,500)	(3,500)	(3,500)
Acquisitions/disposals		(283)	0	0	(1,200)	0
Increase in prepayments and other receivables		(1,226)	0	0	0	0
Others		(134)	(171)	(708)	159	164
Net Cash Flows from Investing Activities		(3,543)	(2,771)	(3,308)	(4,641)	(3,436)
Dividends		(135)	(369)	(450)	(530)	(610)
Shares issue and/or options exercised		(38)	301	0	(34)	0
Other		245	(362)	(183)	(205)	(220)
Net Cash Flow		(2,020)	(1,569)	(2,513)	(2,857)	(989)
Opening net debt (CWA definition)		4,213	6,232	7,801	10,313	13,170
Closing net debt/(cash)		6,232	7,801	10,313	13,170	14,160

Source: Company data, Edison Investment Research

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