

## Beijing Enterprises Water Group (371 HK)

**Buy** (maintained)

Target price: HK\$6.70



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Targeting to double total capacity by 2018; maintain Buy

**Decent growth in 2014** Net profit jumped 65% YoY to HK\$1,794m in 2014, 10% higher than our estimate and consensus. Revenue surged 39% YoY to HK\$8,925m, in line with our expectation. We highlight that EBIT was 15% ahead of our estimate, given: 1) the HK\$76m gain on the bargain purchase of a subsidiary; 2) a total gain of HK\$265m from the disposal of a subsidiary and land; 3) FX gain of HK\$95m. The company's effective tax rate of 22.1% in 2014 was also lower than our estimate of 23%. During the period, BEWG added 4.65mt/day in new capacity, taking total daily design capacity (including projects not yet in operation) to 20.2mt/day (up 21% YoY).

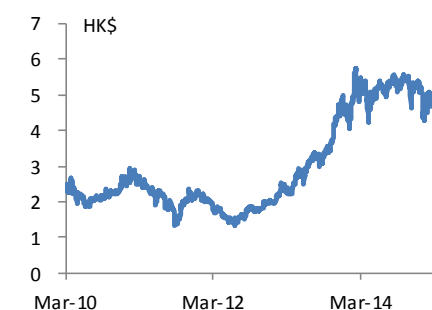
**Aiming for 40mt total capacity by the end of 2018** Management targets to add 3mt in new capacity in 2015. Compared to the 4.6mt added in 2014, this number may seem small, but management has emphasized that they still have projects of 20mt in talks, which could mean further upside in total new capacity added during the year. Management has maintained its target of reaching total capacity of 40mt by the end of 2018, representing a 100% increase from the current project portfolio size. For 2015, management has given guidance of: 1) 40-45% YoY topline growth; 2) 30-35% net profit growth; 3) 50% YoY operation revenue growth from water projects. We believe these targets are achievable given our expectation for a stable tariff increase of 2% YoY and >5mt of new capacity going into operation during the year.

**Possible spin-off to yield company/trust** BEWG's net gearing has remained above 80% in recent years. Instead of seeking further equity financing, management has come up with a creative plan to spin off a basket of assets to a yield company/trust, with potential funding of up to US\$300m. We believe BEWG may choose to hold less than 50% of the yield company to lower gearing further.

**Maintain Buy** We raise our 2015/16 net profit forecasts slightly by 5%/3% to factor in a better utilization rate. We keep our valuation benchmark at 26x 2015E P/E (historical average +1.5SD), which we believe reflects BEWG's leadership in the industry and the rapid capacity growth ahead. We raise our target price from HK\$6.50 to HK\$6.70, and maintain our Buy rating.

**Downside risks** 1) slower-than-expected M&A progress; 2) lower-than-expected tariff growth in next the two years; 3) slower ramp-up in green field or newly acquired projects.

### Stock performance



Source: Bloomberg

### Key data

|                      |                    |
|----------------------|--------------------|
| Mar 30 close (HK\$)  | 5.10               |
| Shares in issue (m)  | 8,708              |
| Major shareholder    | Beijing Ent. (44%) |
| Market cap (HK\$ bn) | 58.3               |
| 3M avg. vol. (m)     | 16.4               |
| 52W high/low (HK\$)  | 5.62/ 4.13         |

Source: Bloomberg

### Stock valuation

|       | Turnover<br>(HK\$ m) | Net profit<br>(HK\$ m) | EPS<br>(HK\$) | EPS YoY<br>(%) | P/E  | BPS<br>(HK\$) | P/B | ROE<br>(%) |
|-------|----------------------|------------------------|---------------|----------------|------|---------------|-----|------------|
| 2013  | 6,407                | 1,084                  | 0.129         | 18.3           | 52.1 | 1.58          | 4.3 | 8.2        |
| 2014  | 8,926                | 1,817                  | 0.209         | 62.4           | 32.1 | 1.81          | 3.7 | 11.5       |
| 2015E | 12,039               | 2,266                  | 0.260         | 24.7           | 25.7 | 1.99          | 3.4 | 13.1       |
| 2016E | 15,504               | 2,927                  | 0.336         | 29.2           | 19.9 | 2.22          | 3.0 | 15.2       |
| 2017E | 19,584               | 3,683                  | 0.423         | 25.8           | 15.8 | 2.50          | 2.7 | 16.9       |

Sources: Company data, GF Securities (HK)

Note: Calculated based on diluted shares.

**Figure 1: Financial statements**

| Income Statement                |              |              |               |               |               | Balance Sheet                        |               |               |               |               |               |
|---------------------------------|--------------|--------------|---------------|---------------|---------------|--------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Year end Dec (HK\$ m)           | 2013         | 2014         | 2015E         | 2016E         | 2017E         | Year end Dec (HK\$ m)                | 2013          | 2014          | 2015E         | 2016E         | 2017E         |
| Sewage treatment & water supply | 2,525        | 4,063        | 5,991         | 8,265         | 10,919        | Cash and cash equivalents            | 5,513         | 6,091         | 4,317         | 6,550         | 8,408         |
| Construction service            | 3,764        | 4,583        | 5,728         | 6,874         | 8,249         | Inventories                          | 55            | 58            | 78            | 100           | 127           |
| Sewage technical service        | 118          | 281          | 320           | 365           | 416           | Trade and other receivables          | 3,145         | 4,196         | 5,185         | 6,075         | 7,364         |
| <b>Turnover</b>                 | <b>6,407</b> | <b>8,926</b> | <b>12,039</b> | <b>15,504</b> | <b>19,584</b> | Other current assets                 | 6,499         | 4,734         | 5,655         | 6,323         | 7,529         |
| YoY (%)                         | 74.4         | 40.4         | 39.9          | 31.0          | 27.4          | <b>Total current assets</b>          | <b>15,212</b> | <b>15,078</b> | <b>15,235</b> | <b>19,048</b> | <b>23,428</b> |
| Cost of sales                   | (3,901)      | (5,407)      | (7,117)       | (9,056)       | (11,367)      | Property, plant & equipment          | 379           | 1,243         | 1,213         | 1,185         | 1,157         |
| <b>Gross profit</b>             | <b>2,506</b> | <b>3,519</b> | <b>4,923</b>  | <b>6,447</b>  | <b>8,217</b>  | Operating concessions                | 2,523         | 2,286         | 2,652         | 2,980         | 3,593         |
| Interest income                 | 434          | 446          | 450           | 454           | 459           | Amounts due from customers           | 11,779        | 15,640        | 19,077        | 23,888        | 29,663        |
| Other income and gains, net     | 200          | 608          | 208           | 255           | 316           | Other non-current assets             | 14,294        | 17,395        | 17,937        | 18,193        | 18,734        |
| Administrative expenses         | (775)        | (1,066)      | (1,438)       | (1,851)       | (2,338)       | <b>Total non-current assets</b>      | <b>28,974</b> | <b>36,563</b> | <b>40,879</b> | <b>46,246</b> | <b>53,147</b> |
| Other operating expenses, net   | (188)        | (11)         | (14)          | (18)          | (23)          | Short-term borrowings                | 2,148         | 3,945         | 3,608         | 4,329         | 5,195         |
| <b>EBIT</b>                     | <b>2,178</b> | <b>3,496</b> | <b>4,129</b>  | <b>5,287</b>  | <b>6,630</b>  | Trade and other payables             | 7,321         | 7,035         | 9,258         | 11,782        | 14,788        |
| YoY (%)                         | 42.2         | 60.5         | 18.1          | 28.1          | 25.4          | Other current liabilities            | 2,182         | 440           | 674           | 875           | 1,129         |
| Finance costs                   | (788)        | (1,084)      | (1,018)       | (1,193)       | (1,409)       | <b>Total current liabilities</b>     | <b>11,651</b> | <b>11,419</b> | <b>13,540</b> | <b>16,986</b> | <b>21,113</b> |
| Share of loss of a jce          | 85           | 256          | 261           | 267           | 272           | Long-term borrowings                 | 8,294         | 12,530        | 12,939        | 16,173        | 20,217        |
| Share of loss of an associate   | 23           | 22           | 22            | 23            | 23            | Other non-current liabilities        | 8,317         | 8,603         | 8,676         | 8,742         | 8,807         |
| <b>Profit before tax</b>        | <b>1,497</b> | <b>2,690</b> | <b>3,394</b>  | <b>4,384</b>  | <b>5,517</b>  | <b>Total non-current liabilities</b> | <b>16,611</b> | <b>21,133</b> | <b>21,615</b> | <b>24,915</b> | <b>29,024</b> |
| Tax                             | (352)        | (594)        | (781)         | (1,008)       | (1,269)       | Share capital & reserves             | 844           | 871           | 871           | 871           | 871           |
| After tax profit                | 1,145        | 2,096        | 2,614         | 3,376         | 4,248         | Other reserves                       | 12,454        | 14,914        | 16,436        | 18,421        | 20,901        |
| Minority interests              | (61)         | (279)        | (348)         | (449)         | (565)         | <b>Equity attri. to shareholders</b> | <b>13,298</b> | <b>15,784</b> | <b>17,307</b> | <b>19,291</b> | <b>21,772</b> |
| <b>Net profit</b>               | <b>1,084</b> | <b>1,817</b> | <b>2,266</b>  | <b>2,927</b>  | <b>3,683</b>  | Minority interests                   | 2,627         | 3,304         | 3,652         | 4,101         | 4,667         |
| YoY (%)                         | 44.5         | 67.6         | 24.7          | 29.2          | 25.8          | <b>Total equity</b>                  | <b>15,924</b> | <b>19,089</b> | <b>20,959</b> | <b>23,393</b> | <b>26,438</b> |

| Cash Flow Statement         |                |                |                |              |              | Financial Ratio       |      |      |       |       |       |
|-----------------------------|----------------|----------------|----------------|--------------|--------------|-----------------------|------|------|-------|-------|-------|
| Year end Dec (HK\$ m)       | 2013           | 2014E          | 2015E          | 2016E        | 2017E        |                       | 2013 | 2014 | 2015E | 2016E | 2017E |
| Pre-tax profit              | 1,497          | 2,690          | 3,394          | 4,384        | 5,517        | Gross margin (%)      | 39.1 | 39.4 | 40.9  | 41.6  | 42.0  |
| Tax paid                    | (177)          | (356)          | (546)          | (807)        | (1,015)      | EBIT margin (%)       | 34.0 | 39.2 | 34.3  | 34.1  | 33.9  |
| Dep'n and amortization      | 122            | 209            | 196            | 213          | 227          | Net margin (%)        | 16.9 | 20.4 | 18.8  | 18.9  | 18.8  |
| Change in working capital   | (2,653)        | (6,028)        | (3,332)        | (3,771)      | (5,471)      | ROA (%)               | 2.5  | 3.5  | 4.0   | 4.5   | 4.8   |
| Others                      | 275            | 1,241          | 735            | 903          | 1,113        | ROE (%)               | 8.2  | 11.5 | 13.1  | 15.2  | 16.9  |
| <b>Cash from operations</b> | <b>(936)</b>   | <b>(2,245)</b> | <b>447</b>     | <b>922</b>   | <b>371</b>   | Net gearing (%)       | 84.2 | 92.3 | 94.9  | 94.0  | 97.3  |
| Capital expenditure         | (42)           | (640)          | (50)           | (50)         | (49)         | Interest coverage (x) | 2.8  | 3.2  | 4.1   | 4.4   | 4.7   |
| Others                      | (2,816)        | 491            | (481)          | (460)        | (762)        | Current ratio         | 1.3  | 1.3  | 1.1   | 1.1   | 1.1   |
| <b>Cash from investing</b>  | <b>(2,857)</b> | <b>(149)</b>   | <b>(531)</b>   | <b>(510)</b> | <b>(811)</b> |                       |      |      |       |       |       |
| Proceed from share issuance | 2,297          | 0              | 0              | 0            | 0            |                       |      |      |       |       |       |
| Change in borrowings        | 3,692          | 4,206          | 72             | 3,956        | 4,909        |                       |      |      |       |       |       |
| Dividend paid               | (346)          | (495)          | (744)          | (942)        | (1,203)      |                       |      |      |       |       |       |
| Others                      | (218)          | (593)          | (1,018)        | (1,193)      | (1,409)      |                       |      |      |       |       |       |
| <b>Cash from financing</b>  | <b>5,425</b>   | <b>3,118</b>   | <b>(1,690)</b> | <b>1,822</b> | <b>2,298</b> |                       |      |      |       |       |       |
| FX change                   | 94             | 0              | 0              | 0            | 0            |                       |      |      |       |       |       |
| Other adjustment            | 147            | 0              | 0              | 0            | 0            |                       |      |      |       |       |       |
| <b>Net change in cash</b>   | <b>1,873</b>   | <b>725</b>     | <b>(1,774)</b> | <b>2,234</b> | <b>1,858</b> |                       |      |      |       |       |       |

Sources: Company data, GF Securities (HK)

## Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

| Company ratings     |  |
|---------------------|--|
| <b>Buy</b>          | Stock expected to outperform benchmark by more than 15%                      |
| <b>Accumulate</b>   | Stock expected to outperform benchmark by more than 5% but not more than 15% |
| <b>Hold</b>         | Expected stock relative performance ranges between -5% and 5%                |
| <b>Underperform</b> | Stock expected to underperform benchmark by more than 5%                     |
| Sector ratings      |  |
| <b>Positive</b>     | Sector expected to outperform benchmark by more than 10%                     |
| <b>Neutral</b>      | Expected sector relative performance ranges between -10% and 10%             |
| <b>Cautious</b>     | Sector expected to underperform benchmark by more than 10%                   |

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