

Nat Resources & Energy
Water Utilities
Equity – Hong Kong

Reduce

Target price (HKD)	8.70
Share price (HKD)	9.90
Upside/Downside (%)	-12.1

Performance	1M	3M	12M
Absolute (%)	-0.9	-3.9	33.1
Relative ^A (%)	1.5	-4.3	11.9

Index^A HSCEI

RIC 0270.HK
 Bloomberg 270 HK

Market cap (USDm) 7,985
 Market cap (HKDm) 61,925

Enterprise value (HKDm) 44551
 Free float (%) 38

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Thomas Zhu*, CFA

Analyst
 The Hongkong and Shanghai Banking Corporation Limited
 +852 2822 4325
 thomaszhu@hsbc.com.hk

Anderson Chow*

Analyst
 The Hongkong and Shanghai Banking Corporation Limited
 +852 2996 6669
 andersonchow@hsbc.com.hk

Tracy Li*

Associate

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Guangdong Investment (270 HK)

Reduce: Bigger steps needed; FY14 in-line

- ▶ **FY14 results in-line but net cash position declined on higher available-for-sale investments**
- ▶ **620ktpd of water capacity addition in 2014 but pre-tax margin of only 6%**
- ▶ **Establish a Reduce rating on slow acquisition and high valuation multiple; set fair value TP at HKD8.70**

FY14 results in line: Guangdong Investment reported in-line FY14 results after market close on 30 March: operating profit was HKD4.3bn, up 5% y-o-y while net income was HKD4.4bn, down 1% y-o-y. The company recorded property re-valuation gain of HKD892m in 2014, up 21% y-o-y.

Guangdong Investment declared final dividend of HKD0.2 per share, representing 2% final dividend yield.

Cash balance reached HKD7.0bn by end 2014 (from HKD6.5bn by end 2013). However, net cash position declined from HKD4.0bn by end 2013 to HKD3.1bn by end 2014, driven by the substantial increase in available-for-sale investments.

Positive steps...: Guangdong Investment acquired total water capacities of 620ktpd in 2014 (sewage capacities of 280ktpd and water supply capacities of 340ktpd) with total consideration of HKD679m. The newly-acquired water assets generated revenue of HKD138m, representing only 1.6% of GDI's total revenue. Pre-tax profit was only HKD8.5m from these assets in 2014, indicating low pre-tax margin of 6%.

Guangdong Investment plans to continue monitoring investment opportunities in water resources, accelerate the building of a comprehensive water resources management industrial chain and also seek M&A.

...but too small: While we like Guangdong Investment's efforts in acquiring water assets, we think the current steps are too small. We calculate that it adds little value to Guangdong Investment for it to acquire 620ktpd of water capacities generating 6% pre-tax margin, which is much lower than that of over 20% for a major peer. Also, Guangdong Investment is trading at 14.4x 12-month forward PE and 1.9x PB, both above the average level plus one standard deviation since 2010.

Establish a Reduce rating and set a fair value TP of HKD8.70. We would welcome clearer guidance from management on how to effectively deploy its cash, either through value-accretive acquisition or substantially increasing the dividends.

Financials & valuation

Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (HKDm)				
Revenue	7,990	8,426	10,673	11,406
EBITDA	5,126	5,559	6,313	6,544
Depreciation & amortisation	-1,062	-1,049	-1,037	-1,026
Operating profit/EBIT	4,064	4,510	5,276	5,519
Net interest	10	3	35	98
PBT	6,045	6,333	5,947	6,269
HSBC PBT	6,045	6,333	5,947	6,269
Taxation	-1,099	-1,138	-1,189	-1,254
Net profit	4,426	4,397	4,257	4,488
HSBC net profit	4,426	4,397	4,257	4,488

Cash flow summary (HKDm)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Cash flow from operations	4,726	3,600	6,885	6,815
Capex	919	-102	-102	-102
Cash flow from investment	-1,388	-4,794	-596	-724
Dividends	-1,340	-1,622	-1,436	-1,405
Change in net debt	-2,290	839	-5,270	-4,588
FCF equity	4,806	1,525	5,712	5,540

Balance sheet summary (HKDm)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Intangible fixed assets	13,586	13,166	12,048	11,285
Tangible fixed assets	3,180	3,823	2,860	2,699
Current assets	12,174	16,008	18,403	22,596
Cash & others	6,532	7,002	8,907	12,995
Total assets	41,312	47,615	47,501	50,921
Operating liabilities	4,580	5,700	5,652	6,011
Gross debt	2,555	3,865	500	0
Net debt	-3,977	-3,137	-8,407	-12,995
Shareholders funds	27,313	30,267	33,242	36,275
Invested capital	14,247	17,158	14,895	13,191

Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Y-o-y % change				
Revenue	3.3	5.5	26.7	6.9
EBITDA	4.4	8.4	13.6	3.7
Operating profit	5.4	11.0	17.0	4.6
PBT	22.8	4.8	-6.1	5.4
HSBC EPS	29.6	4.5	-8.0	5.4

Ratios (%)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Revenue/IC (x)	0.6	0.5	0.7	0.8
ROIC	31.9	28.0	26.6	32.0
ROE	17.2	16.1	13.4	12.9
ROA	12.7	11.8	10.1	10.2
EBITDA margin	64.2	66.0	59.2	57.4
Operating profit margin	50.9	53.5	49.4	48.4
EBITDA/net interest (x)				
Net debt/equity	-12.4	-8.8	-21.5	-30.4
Net debt/EBITDA (x)	-0.8	-0.6	-1.3	-2.0
CF from operations/net debt				

Per share data (HKD)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EPS reported (fully diluted)	0.71	0.70	0.68	0.72
HSBC EPS (fully diluted)	0.71	0.70	0.68	0.72
DPS	0.23	0.30	0.22	0.23
Book value	4.38	4.85	5.33	5.81

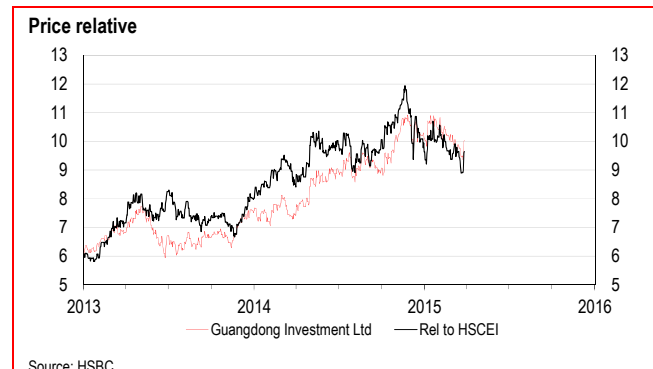
Key forecast drivers

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Water tariff to HK (HKD/m3)	3	4	4	4
Water tariff to GD/SZ (HKD/m3)	1	1	1	1
Water supplied (m m3)	1,817	2,450	2,464	2,464
Rental revenue (HKD m)	1,093	1,140	1,206	1,246
Hotel revenue (HKD m)	679	674	662	667
Deptmt store revenue (HKD m)	772	815	843	872

Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	5.7	5.3	3.7	3.1
EV/EBITDA	8.9	8.0	6.3	5.3
EV/IC	3.2	2.6	2.7	2.6
PE*	13.9	13.3	14.5	13.8
P/Book value	2.3	2.0	1.9	1.7
FCF yield (%)	9.7	3.2	11.9	11.6
Dividend yield (%)	2.3	3.0	2.2	2.4

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 30 Mar 2015

Income statement, HKD m

	2013	2014	YoY	2H13	1H14	2H14	YoY	HoH
Revenue	7,990	8,426	5%	3,852	4,316	4,110	7%	-5%
COGS	2,666	2,778	4%	1,381	1,282	1,495	8%	17%
Gross profit	5,324	5,648	6%	2,471	3,034	2,615	6%	-14%
<i>Gross margin</i>	67%	67%		64%	70%	64%		
Selling and distribution expenses	166	188	13%	94	83	104	11%	25%
<i>% of revenue</i>	2%	2%		2%	2%	3%		
Admin expenses	1,093	1,182	8%	611	579	603	-1%	4%
<i>% of revenue</i>	14%	14%		16%	13%	15%		
Operating profit	4,064	4,279	5%	1,766	2,371	1,908	8%	-20%
<i>Operating margin</i>	51%	51%		46%	55%	46%		
Share of profit of a jointly-controlled entity	51	-	-100%	-	-	-	n.a.	n.a.
Share of profits less losses of associates	262	312	19%	149	161	151	1%	-7%
Finance costs	(60)	(79)	32%	(30)	(36)	(43)	44%	19%
Interest income	70	82	17%	50	30	52	4%	74%
Changes in fair value of investment properties	736	892	21%	418	618	274	-34%	-56%
Other operating (expenses)/income, net	150	107	-29%	159	87	20	-87%	-77%
Other revenue/(loss)	772	509	-34%	258	234	276	7%	18%
Profit before tax	6,045	6,101	1%	2,770	3,464	2,637	-5%	-24%
<i>Pre-tax margin</i>	76%	72%		72%	80%	64%		
Tax (expenses)/credits	(1,099)	(1,138)	4%	(469)	(666)	(472)	1%	-29%
<i>Tax rate</i>	18%	19%		17%	19%	18%		
Profit after tax	4,946	4,963	0%	2,301	2,798	2,165	-6%	-23%
Minority interest	520	566	9%	303	329	237	-22%	-28%
Net income	4,426	4,397	-1%	1,998	2,469	1,928	-4%	-22%
<i>Net margin</i>	55%	52%		52%	57%	47%		

Source: Company data, HSBC

Valuation and risks

We set a fair value TP of HKD8.70. Our target price is based on a sum-of-the-parts valuation approach. We value the water and electricity businesses based on DCF (WACC of 6.2% for water, WACC of 8.0% for electricity), the property and hotel businesses at a 30% discount to NAV (unchanged and in line with the discount HSBC property team uses), and the department store business based on a 30% discount to the average PE of its peers (unchanged and in line with the discounts of HSBC conglomerate team uses for department stores). We establish a Reduce rating (vs Underweight under our old model).

SOTP valuation, HKD

	Valuation methodology	Value
Existing water asset	DCF (WACC of 6.2%)	5.57
Property	30% discount to NAV	1.55
Electricity	DCF (WACC of 8.0%)	0.85
Hotel	30% discount to NAV	0.54
Department store	30% discount to peer PE	0.18
Total		8.70

Source: HSBC

Upside risks: faster-than-expected water tariff rises and faster-than-expected value-accretive acquisitions.

Disclosure appendix

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The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

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Upside/Downside is the percentage difference between the target price and the share price.

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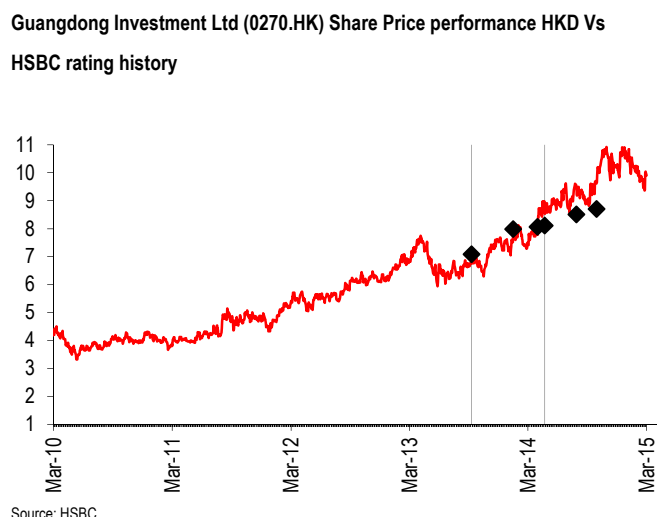
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For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
N/A	Neutral	07 October 2013
Neutral	Underweight	20 May 2014
Target Price	Value	Date
Price 1	7.07	07 October 2013
Price 2	7.98	12 February 2014
Price 3	8.06	28 April 2014
Price 4	8.10	20 May 2014
Price 5	8.50	26 August 2014
Price 6	8.70	27 October 2014

Source: HSBC

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Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
GUANGDONG INVESTMENT LTD	0270.HK	9.90	30-Mar-2015	6

Source: HSBC

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Issuer of report

The Hongkong and Shanghai Banking Corporation Limited

Level 19, 1 Queen's Road Central
Hong Kong SAR

Telephone: +852 2843 9111

Fax: +852 2596 0200

Website: www.research.hsbc.com

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