

Company Report: China Water Affairs (00855 HK)

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公司报告: 中国水务 (00855 HK)

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Expansion Strategy Starting to Take Effect, Maintain "Buy"

扩张策略渐见成效, 维持“买入”

- **China Water Affairs' (00855 HK, "CWA" or the "Company") FY20 revenue increased 4.7% YoY to HK\$8,694 million. Shareholders' net profit increased 19.7 % YoY to HK\$1,639 million. Results slightly exceeded expectation.** Gross margin increased by 1.5 ppts YoY to 43.2% mainly due to increase in revenue contribution from higher gross margin water supply operation and sewage treatment operation services, as well as the increase in gross margin of property development and investment business.
- **We expect city water supply and construction operation revenue to grow at a CAGR of 9.3% in FY20-FY23.** Although construction services revenue should remain stable over the next three years, connection income and water supply operation services revenue should maintain fast growth due to continuation of urban-rural integration. **We expect environmental protection revenue to grow at a CAGR of 12.9% in FY20-FY23,** with construction services revenue maintaining steady growth and sewage treatment and drainage operation services revenue maintaining faster growth.
- Our EPS estimates are HK\$1.037, HK\$1.133 and HK\$1.250 for FY21-FY23, respectively. Given the nationwide presence of its projects and ownership of a large network of water supply pipelines, the Company is better positioned to benefit from the long-term development and growth of the water industry in China compared with local water players. **We slightly raise the TP to HK\$8.30, representing 8.0x/ 7.3x/ 6.6x FY21/ FY22/ FY23 PER. Reiterate "Buy".**
- **中国水务(00855 HK, “公司”) 2020 财年收入同比增 4.7%至 86.94 亿港元。股东净利润同比增 19.7%至 16.39 亿港元。业绩略超预期。**毛利率同比上升 1.5 个百分点至 43.2%，主要因为高毛利率供水业务和污水处理业务的收入贡献增加，以及房地产开发和投资业务的毛利率增加。
- **我们预计 2020-2023 财年间城市供水及建设经营业务收入将以 9.3%的年复合增长率增长。**尽管未来三年建设服务收入将保持稳定，但由于城乡一体化的持续发展，接驳收入和供水运营服务收入将保持快速增长。随着建设服务收入保持稳定增长，污水处理和排水运营服务收入保持较快增长，**我们预计 2020-2023 财年间环保业务收入将保持 12.9%的年复合增长率。**
- 我们对 2021-2023 财年的每股盈利预测分别为 1.037 港元、1.133 港元及 1.250 港元。鉴于其项目范围覆盖全国且拥有庞大的供水管网，公司在受惠于中国水务产业的长期发展和增长的过程中，相比本地水厂而言优势明显。**我们略微上调目标价至 8.30 港元，对应 8.0/7.3/6.6 倍的 2021/2022/2023 财年年市盈率。重申“买入”评级。**

Rating:

Buy

Maintained

评级:

买入 (维持)

6-18m TP 目标价:

HK\$8.30

Revised from 原目标价:

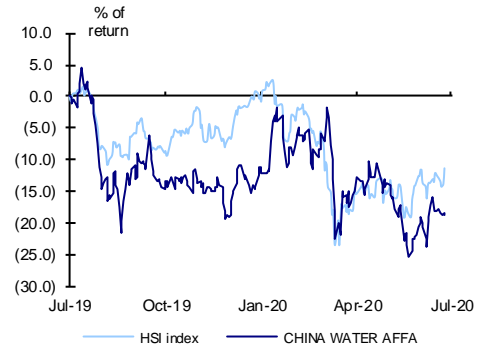
HK\$8.10

Share price 股价:

HK\$5.980

Stock performance

股价表现



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	10.3	2.9	(16.6)
Rel. % to HS Index 相对恒指变动 %	4.5	(7.4)	(7.7)
Avg. Share price(HK\$) 平均股价 (港元)	5.6	5.7	6.0

Source: Bloomberg, Guotai Junan International.

Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
03/31	(HK\$ m)	(HK\$ m)	(HK\$)	(△%)	(x)	(HK\$)	(x)	(HK\$)	(%)	(%)
2019A	8,302	1,369	0.851	17.2	7.0	4.954	1.2	0.280	4.7	18.1
2020A	8,694	1,639	1.021	20.0	5.9	5.304	1.1	0.300	5.0	19.9
2021F	9,467	1,665	1.037	1.6	5.8	6.027	1.0	0.315	5.3	18.3
2022F	10,429	1,819	1.133	9.3	5.3	6.830	0.9	0.330	5.5	17.6
2023F	11,428	2,007	1.250	10.3	4.8	7.731	0.8	0.350	5.9	17.2

Shares in issue (m) 总股数 (m)	1,606.9	Major shareholder 大股东	Mr. Duan Chuan Liang 43.1%
Market cap. (HK\$ m) 市值 (HK\$ m)	9,609.3	Free float (%) 自由流通比率 (%)	56.9
3 month average vol. 3 个月平均成交股数 ('000)	1,856.4	FY21 Net gearing (%) FY21 净负债/股东资金 (%)	83.4
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)	7.520 / 5.050	FY21 Est. NAV (HK\$) FY21 每股估值 (港元)	10.5

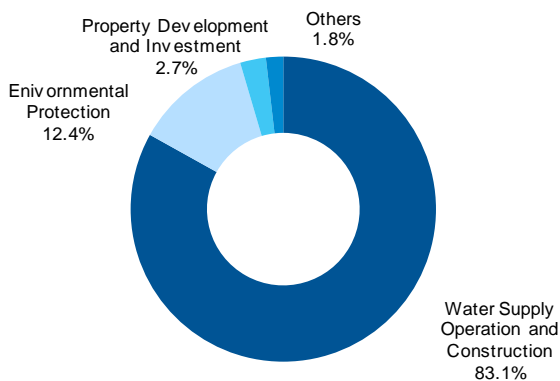
Source: the Company, Guotai Junan International.

FY20 Shareholders' net profit increased 19.7% YoY to HK\$1,639 million. Results slightly exceeded expectation. China Water Affairs' (00855 HK, "CWA" or the "Company") FY20 revenue increased 4.7% YoY to HK\$8,694 million. Shareholders' net profit increased 19.7% YoY to HK\$1,639 million. Results slightly exceeded expectation, mainly due to the contribution from the excess of the investor's share of the NAV of associate's identifiable assets and liabilities over the cost of the investment in Kangda International (06136 HK), amounting to HK\$215 million. Overall gross margin increased by 1.5 pts YoY to 43.2%, mainly due to the increase in revenue contributions from higher gross margin water supply operation and sewage treatment operation services, as well as the increase in gross margin of property development and investment business. Selling expenses ratio remained unchanged at 2.3%. Administrative expenses ratio increased 0.6 pts YoY to 8.5%. Finance costs ratio increased 1.1 pts YoY to 4.9%. In addition, the Company raised its full-year dividend by 7.1% to HK\$0.30 despite much capital expenditure pending, showing that the Company has full confidence on its cash flow.

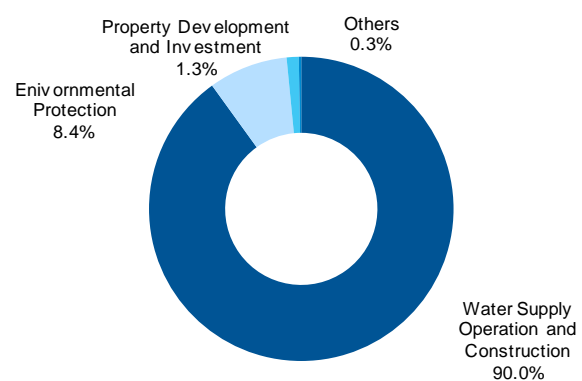
Table 1: CWA's Business Overview

	As at 31 March 2020
Design Capacity	19.5 million tons/day
- Current Operation	13.8 million tons/day
- Under Construction	1.9 million tons/day
- Future Expansion	3.9 million tons/day
Project Coverage	Over 110 cities
Serving Accounts	~5.7 million
Potential Reaching Population	~30.0 million
Pipeline Length	Over 150,000 km

Source: the Company.

Figure 1: CWA's Segment Revenue Composition in FY20 **Figure 2: CWA's Segmental Profit Composition in FY20**


Source: the Company.



Source: the Company.

Table 2: CWA's Revenue by Segment in FY20

(HKD mn)	FY20	FY19	YoY
City Water Supply Operation and Construction	7,224	6,376	13.3%
Environmental Protection Business	1,074	1,522	(29.5%)
Property Development and Investment	237	291	(18.5%)
Others	159	113	41.0%
Total	8,694	8,302	4.7%

Source: the Company.

Table 3: CWA's Operating Profit by Segment in FY20

(HKD mn)	FY20	FY19	YoY
City Water Supply Operation and Construction	2,956	2,619	12.9%
Environmental Protection Business	276	444	(37.8%)
Property Development and Investment	42	(79)	153.5%
Others	9	9	(5.6%)

Total	3,283	2,993	9.7%
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Source: the Company.

We expect city water supply operation and construction revenue to grow at a CAGR of 9.3% in FY20-FY23. In FY20, city water supply operation and construction revenue increased 13.3% YoY to HK\$7,224 million, of which water supply operation services revenue increased 8.5% YoY, or 13.7% if excluding the impacts of exchange rate, to HK\$2,403 million. The large increase was mainly attributable to growth in water tariffs in five cities, procurement of more construction driven by the continuation of urban-rural integration, and release of new capacity from project construction completion. During the period, the Company added 330,000 tons/day of new water supply capacity through M&As in 7 cities, with large projects including the Hegang Project (80,000 tons/day), Baofeng Project (79,000 tons/day) and Wugang Project (64,000 tons/day). We expect construction services revenue to increase steadily at a CAGR of 5% in FY20-FY23, while for water supply operation services revenue and water supply connection income, we expect faster revenue CAGR compared with that of construction services revenue at 13.6% and 13.0% in FY20-FY23, respectively, due to fast release of new capacity and procurement of more construction and connection work driven by the continuation of urban-rural integration. Overall, we expect city water supply and construction operation revenue to grow at a CAGR of 9.3% in FY20-FY23.

Table 4: Breakdown of CWA's City Water Supply Revenue in FY20

(HKD mn)	FY20	FY19	YoY
Water Supply Operation Services	2,403	2,214	8.5%
Water Supply Connection Income	1,619	1,441	12.3%
Water Supply Construction Services	3,081	2,631	17.1%
Others	121	91	33.4%
Total	7,224	6,376	13.3%

Source: the Company.

We expect environmental protection revenue to grow at a CAGR of 12.9% in FY20-FY23. In FY20, environmental protection revenue decreased 29.5% YoY to HK\$1,074 million. The substantial decrease was driven by the 43.5% YoY revenue decrease in renovation and construction services due to a decrease in the number of newly signed projects in the previous years prior to the implementation of urban-rural integration policy. We think that the segment will return to 10% annual growth over the next three years for the following reasons. First, the Company's strong commitment to investment in sewage treatment aligns with the Government's long-term plan for urban-rural integration. Second, constructing a more diverse yet related business portfolio is core to the growth strategy of the Company; while the Company's water supply business is steadily growing, a growing sewage treatment business is suitable to this. We expect sewage treatment and water environmental renovation construction services revenue to increase at a CAGR of 10% in FY20-FY23. In addition, with expected release of new capacity and increase in sewage tariff, we expect sewage treatment and drainage operation services revenue to increase at an even higher CAGR of 20.6% in FY20-FY23. Overall, we expect environmental protection revenue to grow at a CAGR of 12.9% in FY20-FY23.

Table 5: Breakdown of CWA's Environmental Protection Revenue in FY20

(HK\$ mn)	FY20	FY19	YoY
Sewage Treatment and Drainage Services	334	320	4.6%
Sewage Treatment and Water Environmental Renovation Construction Services	614	1,086	(43.5%)
Others	126	117	7.9%
Total	1,074	1,522	(29.5%)

Source: the Company.

Table 6: Capacity Breakdown as at 31 March 2020

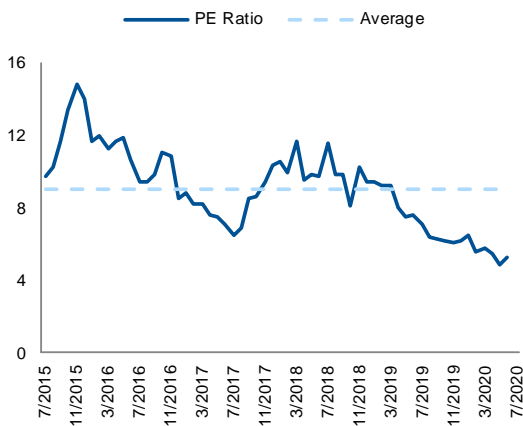
('000 m ³ /day)	Tap Water Supply	Raw Water Supply	Sewage Treatment	Kangda	Total
In Operation	6,921	1,900	633	4,272	13,726
Under Construction	1,688	20	159	0	1,867
Future Plan	3,674	0	258	0	3,932
Total	12,283	1,920	1,050	4,272	19,525

Source: the Company.

Acquisition of Kangda International (06136 HK) added significant synergy effect to the Company's sewage treatment business, however, consolidation might take some time. In April 2019, the Company acquired 600,000,000 shares of Kangda International at a price of HK\$2.00 per share, representing 29.52% equity interest, at a total consideration of HK\$1.2 billion. Further on 1 April 2020, the Company entered into a subscription agreement with Baring Private Equity Asia V Holding (5) Limited ("BPEA") to subscribe for exchangeable bonds for a consideration of approximately HK\$361.3 million (the "Exchangeable Bonds"). The bonds allow the holder to exchange, at a price of HK\$1.05 per share, for 344,129,996 shares of Kangda International, accounting for 16.93% of its total share capital. The purchase consideration will be paid by the Company's issuance of equivalent convertible bonds to BPEA, with an initial conversion price of HK\$8.05 per share, convertible into 44,886,521 shares of CWA, and will account for 2.72% of the Company's enlarged total equity. The issuance was completed on 8 May, 2020. If the exchangeable bonds are exercised, the Company will hold 46.45% of the total equity of Kangda International. Kangda International currently holds a sewage treatment capacity of 4.272 million tons/day, 307% higher than the Company's current sewage treatment capacity (including in operation, under construction and future plans), and will significantly expand the Company's exposure in sewage treatment. Although we expect the deal to add significant synergy to the Company given its large exposure in water supply, the restructuring and consolidation of Kangda International will take some time with its high gearing and diverse portfolio of sewage plants around China.

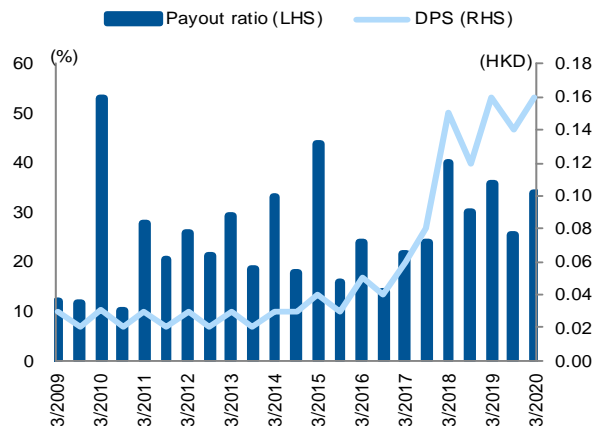
Slightly raise the TP to HK\$8.30, reiterate "Buy". Our EPS estimates are HK\$1.037, HK\$1.133 and HK\$1.250 for FY21-FY23, respectively. Given its nationwide presence of projects and ownership of a large network of water supply pipelines, the Company is much better positioned to benefit from the long-term development and growth of the water industry in China compared with local water players. The Company's strong operating cash flow enables it to have financial flexibility in acquiring suitable targets during times when local governments have difficulty repaying existing debts and funding new projects. Moreover, the Company's commitment in maintaining a 30% payout has proved achievable over the past few years and appears desirable. In terms of valuation, the Company is trading at 5.7x FY21 PER, near historical low and its 5.3% FY21 yield appears attractive. We have slightly raised the TP to HK\$8.30, representing 8.0x/ 7.3x/ 6.6x FY21/ FY22/ FY23 PER. Reiterate "Buy".

Figure 3: CWA's Historical Forward P/E



Source: Bloomberg.

Figure 4: CWA's Dividend Policy



Source: Bloomberg.

Table 7: Peers Comparison

Company	Stock Code	Currency	Last price	Market cap(mn)	PE				PB				ROE(%)		D/Y(%)	
					19A	20F	21F	22F	19A	20F	21F	22F	20F	20F		
China Water Affairs Group	00855 HK	HKD	5.980	9,592	7.0	5.9	5.7	5.1	1.2	1.1	1.0	0.8	19.9	5.2		
Guangdong Investment Ltd	00270 HK	HKD	13.860	90,614	18.0	17.7	15.6	15.1	2.2	2.1	2.0	2.0	12.1	4.4		
Beijing Enterprises Water Gr	00371 HK	HKD	3.420	34,272	6.9	6.4	5.9	5.4	1.1	1.0	0.9	0.8	16.1	5.9		
Yunnan Water Investment -H	06839 HK	HKD	1.500	1,790	4.0	n.a.	n.a.	n.a.	0.3	n.a.	n.a.	n.a.	n.a.	n.a.		
Kangda International Environ	06136 HK	HKD	0.780	1,669	3.7	n.a.	n.a.	n.a.	0.3	n.a.	n.a.	n.a.	n.a.	n.a.		
Siic Environment Holdings Lt	00807 HK	HKD	1.290	3,358	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	7.7	n.a.		
China Water Industry Group L	01129 HK	HKD	0.224	358	3.1	n.a.	n.a.	n.a.	0.3	n.a.	n.a.	n.a.	n.a.	n.a.		
Kunming Dianchi Water Trea-H	03768 HK	HKD	1.770	1,822	4.3	4.0	4.0	3.2	0.4	0.4	0.4	0.3	9.7	6.2		
New Universe Environmental G	00436 HK	HKD	0.200	607	14.9	n.a.	n.a.	n.a.	0.7	n.a.	n.a.	n.a.	n.a.	n.a.		
Simple Average					7.7	8.5	7.8	7.2	0.8	1.2	1.1	1.0	13.1	5.4		
Weighted Average					13.9	13.8	12.3	11.8	1.8	1.8	1.7	1.6	13.5	4.8		

Source: Bloomberg.

FINANCIAL STATEMENTS AND RATIOS

Income Statement					
Year end 31 Mar (HKD m)	2019A	2020A	2021F	2022F	2023F
Total Revenue	8,302	8,694	9,467	10,429	11,428
Cost of Sales	(4,838)	(4,936)	(5,308)	(5,816)	(6,339)
Gross Profit	3,464	3,758	4,159	4,613	5,089
Administrative Expenses	(655)	(735)	(809)	(890)	(979)
Selling and Distribution Costs	(191)	(199)	(209)	(220)	(231)
Other Income / Expenses, Net	405	357	435	434	480
Operating Profit	3,022	3,181	3,576	3,938	4,360
Finance Costs	(319)	(429)	(465)	(529)	(603)
Share of Profit of JV / Associates	69	413	159	175	192
Profit Before Tax	2,772	3,165	3,270	3,584	3,950
Income Tax	(642)	(657)	(748)	(828)	(910)
Profit After Tax	2,130	2,507	2,522	2,756	3,040
Non-controlling Interest	(761)	(868)	(858)	(937)	(1,034)
Shareholders' Profit / Loss	1,369	1,639	1,665	1,819	2,007
Basic EPS	0.851	1.021	1.037	1.133	1.250
DPS	0.280	0.300	0.315	0.330	0.350

Cash Flow Statement					
Year end 31 Mar (HKD m)	2019A	2020A	2021F	2022F	2023F
Profit Before Taxation	2,772	3,165	3,270	3,584	3,950
Depreciation and Amorization	522	562	597	633	672
Change in the Working Capitals	(1,330)	1,155	(13)	(318)	(334)
Other Adjustment	(946)	(1,279)	(1,241)	(1,082)	(1,195)
Cash from Operating Activities	1,018	3,603	2,613	2,816	3,093
Capital Expenditure	(225)	(292)	(380)	(493)	(642)
Additions of Concession Rights	(2,338)	(2,689)	(3,555)	(3,763)	(3,985)
Other Investing Activities	(807)	(935)	108	219	232
Cash from Investing Activities	(3,370)	(3,916)	(3,827)	(4,038)	(4,394)
Issuance / (Repayment) of Debts	11,009	2,457	2,404	2,744	3,133
Dividends	(434)	(482)	(506)	(530)	(562)
Other Financing Activities	(6,766)	0	0	0	0
Cash from Financing Activities	3,809	1,976	1,898	2,214	2,571
Cash at Beg of Year	2,511	3,973	5,641	6,358	7,364
Net Changes in Cash	1,458	1,662	684	992	1,270
Forex	4	5	33	14	17
Cash at End of Year	3,973	5,641	6,358	7,364	8,651

Source: the Company, Guotai Junan International.

Balance Sheet					
Year end 31 Mar (HKD m)	2019A	2020A	2021F	2022F	2023F
PP&E	2,921	3,522	4,169	4,700	5,343
Interest in Associates	676	2,228	2,387	2,562	2,754
Deposits and Prepayments	1,500	895	940	987	1,036
Concession Rights	15,293	17,558	20,668	23,963	27,458
Receivables under Concession Arrangements	1,079	1,032	1,208	1,269	1,332
Others Non-current Assets	3,023	3,380	3,439	3,514	3,591
Total Non-current Assets	24,493	28,614	32,811	36,994	41,514
Inventories	531	630	448	489	525
Trade and Bills Receivables	1,243	1,325	1,525	1,751	1,991
Prepayments Deposit and Other					
Receivables	1,550	1,597	1,739	1,916	2,100
Pledged Deposit	645	963	987	1,012	1,037
Cash & Cash Equivalents	3,973	5,641	6,358	7,364	8,651
Other Current Assets	3,390	3,132	3,409	3,714	4,050
Total Current Assets	11,332	13,289	14,466	16,246	18,353
Total Assets	35,825	41,903	47,277	53,240	59,867
Short-term Loans	3,437	4,091	4,500	4,950	5,445
Trade and Bills Payables	2,410	3,107	3,341	3,661	3,990
Accrued Liabilities, Deposits Received and Other Payables	1,979	2,483	2,607	2,737	2,874
Other Current Liabilities	2,192	2,655	3,055	3,373	3,691
Total Current Liabilities	10,019	12,336	13,503	14,721	16,001
Long-term Loans	11,494	13,298	15,293	17,587	20,225
Other Non-current Liabilities	1,409	2,170	2,367	2,592	2,823
Total Non-current Liabilities	12,903	15,468	17,659	20,178	23,047
Total Liabilities	22,922	27,804	31,162	34,900	39,048
Share Capital	16	16	16	16	16
Reserves	7,954	8,492	9,651	10,940	12,384
Total Shareholders' Equity	7,970	8,508	9,667	10,956	12,400
Minority Interest	4,932	5,591	6,448	7,385	8,419
Total Equity	12,902	14,099	16,115	18,341	20,819
Total Equity and Liabilities	35,825	41,903	47,277	53,240	59,867
BVPS	4.954	5.304	6.027	6.830	7.731

Financial Ratios					
	2019A	2020A	2021F	2022F	2023F
Gross Margin	41.7	43.2	43.9	44.2	44.5
Operating Margin	36.4	36.6	37.8	37.8	38.2
Net Margin	16.5	18.9	17.6	17.4	17.6
ROA (%)	4.8	4.6	4.0	3.8	3.8
ROE (%)	18.1	19.9	18.3	17.6	17.2
Net Gearing Ratio (%)	84.9	83.3	83.4	82.7	81.7
Interest Coverage (x)	9.5	7.4	7.7	7.4	7.2

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

DISCLOSURE OF INTERESTS

- (1) The Analysts and their associates do not serve as an officer of the issuer mentioned in this Research Report.
- (2) The Analysts and their associates do not have any financial interests in relation to the issuer mentioned in this Research Report.
- (3) Except for GUOTAI JUNAN I (01788 HK), JINSHANG BANK (02558 HK), ZHONGLIANG HLDG (02772 HK), BINHAI INVESTMENT (02886 HK), HAITIAN ANTENNA (08227 HK), Guotai Junan and its group companies do not hold equal to or more than 1% of the market capitalization of the issuer mentioned in this Research Report.
- (4) Guotai Junan and its group companies have not had investment banking relationships with the issuer mentioned in this Research Report within the preceding 12 months.
- (5) Guotai Junan and its group companies are not making a market in the securities in respect of the issuer mentioned in this Research Report.
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