

China Water Affairs Group

Strong growth trajectory continues

Interim results

The H118 results and publication of the full interim report confirmed China Water Affairs Group's (CWA) strong growth trajectory. In our view the outlook for the company remains positive. We have increased our EPS and DPS forecasts for CWA and raised our fair value from HK\$6.7/share to HK\$8.0/share.

Year end	Revenue (HK\$m)	PBT* (HK\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
03/17	5,708	1,963	55.4	20.0	13.9	2.6
03/18e	7,069	2,279	64.9	19.6	11.9	2.5
03/19e	8,075	2,641	72.1	21.7	10.7	2.8
03/20e	9,219	3,041	83.0	25.0	9.3	3.2

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

Continuing growth evident at the H118 results

Interim figures from CWA demonstrated a continuation of the strong growth trajectory that has been evident in recent years. Group revenue rose by 16.3% to HK\$3,514m, while operating profits (excluding FV movements in derivatives and investment properties) rose by 40.7% to HK\$1,344m. EPS (basic) increased by 22.9% to HK\$28.43 cents. Driving overall growth was the rise (+10.4%) in revenue and segmental profits (+22.8%) at the key water supply and construction business (c 94% of group revenues). The water business continues to benefit from the widespread adoption of the public-private partnership (PPP) model and the integration of urban and rural water systems. A turnaround in the performance of the associate business and tight control of costs, which fell by 6.2% to HK\$287m despite the top line growth, also helped boost profitability.

Outlook remains positive

We expect the outlook to remain positive for CWA and the business to continue to grow. We believe this growth will be generated by both the geographical expansion of the business within China, facilitated by the factors cited above, as well as growth from the existing operations, underpinned by increases in tariffs and consumption. CWA plans, in part, to fund this expansion by recycling capital from the disposal of non-core businesses. Surplus capital generated by disposals could also be used to boost dividend payments, although we do not include this in our forecasts.

Valuation: Upside remains for investors

Following the publication of the interim report we have adjusted our earnings forecasts for FY18 and beyond (FY18e EPS +8% to HK\$0.649). Given CWA's announcement of its intention to pay not less than 30% of basic EPS as a DPS, we have also raised our DPS forecasts (FY18e DPS + 64% to HK\$0.196). We have revisited our valuation, which increases from HK\$6.71/share to HK\$8.0/share. At our revised value of HK\$8.0/share, CWA would trade on a P/E multiple of 12.3x and an EV/EBITDA multiple of c 7.8x. We believe such multiples are sustainable for a company that we expect to grow EPS by c 14% CAGR in 2017-20e.

Utilities

24 January 2018

Price **HK\$7.70**
Market cap **HK\$12,327m**

Net debt (HK\$m) at 30 September 2017	7,740
Shares in issue	1,600.9m
Free float	48.7%
Code	855
Primary exchange	HK
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	10.5	29.2	41.8
Rel (local)	(0.8)	11.1	(1.4)
52-week high/low	HK\$7.7	HK\$4.2	

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 and acquisitions. It is a constituent of the FTSE Environmental Opportunities Asia Pacific Index.

Next events

FY18 results	June 2018
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Exhibit 1: Financial summary

	HK\$m	2017	2018e	2019e	2020e
31 March		HKFRS	HKFRS	HKFRS	HKFRS
PROFIT & LOSS					
Water supply revenue		4,874	6,033	6,987	8,077
Sewage treatment		531	719	755	793
Other segments		303	317	333	349
Revenue TOTAL		5,708	7,069	8,075	9,219
EBITDA		2,647	2,968	3,404	3,884
Operating Profit		2,271	2,548	2,909	3,325
Amortization		316	350	390	429
Depreciation		60	70	105	130
Net Interest expense		(251)	(324)	(333)	(359)
Profit Before Tax		1,963	2,279	2,641	3,041
Tax		(583)	(638)	(739)	(851)
Profit After Tax		1,379	1,641	1,901	2,190
Net profits contributable to shareholders		853	1,017	1,160	1,336
Average Number of Shares Outstanding (m)		1,505	1,559	1,601	1,601
EPS - fully diluted (HK c)		55.4	64.9	72.1	83.0
Dividend per share (c)		20.0	19.6	21.7	25.0
EBITDA Margin (%)		46.4	42.0	42.2	42.1
Operating Margin (%)		39.8	36.0	36.0	36.1
BALANCE SHEET					
Fixed Assets		15,689	17,797	19,649	21,457
Intangible Assets		10,316	12,266	13,976	15,647
Plant, property and equipment		1,127	1,157	1,152	1,122
Investment properties		1,173	1,321	1,488	1,675
Investment in associates		635	560	475	380
Other		2,438	2,493	2,558	2,633
Current Assets		9,942	8,445	8,791	9,429
Properties Under Development		690	550	550	550
Properties Held for Sale		289	500	550	550
Inventory		285	355	405	463
Trade and Bills Receivables		872	1,945	1,240	1,415
Due from Non-controlling Equity Holders of Subsidiaries		252	298	355	408
Due from Associates		408	408	408	408
Prepayments, Deposits and Other Receivables		1,743	1,309	2,478	2,829
Pledged Deposits		783	783	783	783
Deposits and cash		4,314	1,991	1,717	1,717
Other		307	306	306	306
Current Liabilities		7,393	7,470	7,158	6,873
Trade and Bills Payables		1,097	1,483	1,300	1,400
Accrued Liabilities, Deposits and Other Payables		2,102	2,809	3,199	3,654
Short-term Borrowings		3,206	2,073	1,374	345
Other		988	1,104	1,285	1,474
Long Term Liabilities		9,275	8,350	9,484	10,631
Long-term Borrowings		8,123	7,123	8,123	9,123
Other long term liabilities		1,152	1,227	1,361	1,508
Shareholders' Equity		8,963	10,422	11,798	13,381
		-	-	-	-
CASH FLOW					
Net Cash Flows from Operating Activities		1,453	2,217	2,014	2,735
Purchase of property, plant and equipment		(92)	(100)	(100)	(100)
Increase in concession rights for water supply and sewage processing		(1,808)	(2,300)	(2,100)	(2,100)
Acquisitions/disposals		(283)	0	0	0
Increase in pre-payments and other receivables		(1,226)	0	0	0
Others		(134)	173	138	99
Net Cash Flows from Investing Activities		(3,543)	(2,227)	(2,062)	(2,101)
Dividends		(135)	(305)	(348)	(401)
Shares issue and/or options exercised		(38)	274	0	0
Other		245	(150)	(178)	(205)
Net Cash Flow		(2,019)	(191)	(574)	29
Opening net debt (CWA definition)		4,213	6,232	6,423	6,997
Closing net debt/(cash)		6,232	6,423	6,997	6,968
Net debt to equity ratio (CWA definition)		70%	62%	59%	52%

Source: China Water Affairs Group, Edison Investment Research

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