

China Water Affairs Group

Water regulation remains positive

Regulatory news

Utilities

4 October 2018

Price **HK\$8.30**
Market cap **HK\$13,354m**

Net debt (HK\$m) at 31 March 2018 7,801

Shares in issue 1,608.9m

Free float 48.44%

Code 855

Primary exchange HK

Secondary exchange N/A

Share price performance



Business description

China Water Affairs Group 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.

Analyst

Graeme Moyse +44 (0) 20 3077 5700

industrials@edisongroup.com
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We believe that the outlook for regulation of the Chinese water sector remains positive and would caution against read-across from current proposals for gas regulation in Chongqing, as substantial differences exist between the two industries. Valuations in excess of HK\$10/share are sustainable for China Water Affairs Group (CWA), in our view.

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	15.0	2.4
03/18	7,580	2,462	71.8	23.0	11.6	2.8
03/19e	8,935	2,829	81.5	26.2	10.2	3.2
03/20e	10,481	3,384	97.5	29.4	8.5	3.5

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

The National People's Congress Standing Committee of Chongqing is currently proposing a cancellation of the network connection fee paid to gas companies. We are unaware of any intention on the part of the authorities to extend the policy regarding connection charges to other industries such as water. CWA has not been contacted with regard to its connection charges in Chongqing. In 2018, connection charges accounted for c 18% of CWA's total revenues.

It is important to be aware that the recent economic policy document (943 June 2018) from the NDRC advocated the establishment of a price-adjustment mechanism that reflects the cost of water, so that the residential water price is no longer below cost level and prices in the non-residential section of the market allow for a reasonable profit level. The fact that many state-owned enterprises operate at a loss in the water sector also affords CWA a degree of regulatory protection, in our view. An analysis of returns (Bloomberg, 3 October 2018) also shows that gas companies earn returns in excess of those achieved by CWA (CWA's returns are between 18% and 52% lower than the gas companies' on average over the past five years).

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