

China Water Affairs Group

H1 results

Strong performance delivers growth

Interim results confirmed that China Water Affairs Group (CWA) continues to grow rapidly. We remain optimistic about CWA's capacity to extend this growth trajectory and see the 50% increase in the interim dividend payment as evidence of management's confidence in the outlook. In our view, the rating of the shares does not reflect the growth prospects.

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	15.5	2.3
03/18	7,580	2,462	71.8	23.0	12.0	2.7
03/19e	8,593	2,873	83.2	30.0	10.3	3.5
03/20e	10,002	3,415	98.4	35.0	8.7	4.1

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

H119 growth broadly in line with FY19 estimates

CWA achieved growth in revenue, net profit to shareholders, EPS and DPS (versus H118) of 17.9%, 20.3%, 14.9% and 50% respectively. The outcome compared to our previously published FY19 projections for year-on-year growth of 18% in revenue, 15.5% in net profits 13% in EPS and 13% in DPS. The core business of water supply and environmental protection, saw revenue increase by 21.5% and operating profits by 19.3%. The core business now accounts for 96.6% of group revenues and 98.7% of profits, up 3% and 2% respectively. Increases in water volume sold, tariff hikes, new connections and contribution from new projects all contributed to increased profits. The environmental business in particular, which CWA has earmarked for a separate listing, achieved rapid growth in revenues and operating profits (+81.0% versus Edison FY19e +21%) and contributed 18.9% of group profits. Net debt of HK\$8,299m is expected to decline in H2, with FY19 disposals of at least HK\$780m of non-core assets and the receipt of HK\$423.8m from strategic investors in the environmental business.

Outlook of continuing growth; forecasts revised

We have made some adjustments to our FY19 estimates and we now forecast revenue of HK\$8,593m (HK\$8,935m) and EPS of HK\$0.832 (HK\$0.815). We have also increased our DPS forecast to HK\$0.30 (HK\$0.262) following the large interim increase. We believe the macro operating environment remains favourable for CWA given the government's desire to see investment in infrastructure, a recognition of the need for tariffs to reflect market-based pricing and CWA's ability to increase capacity via project expansion and M&A. We see the announced 50% increase in the H1 DPS as an indication of management's confidence in the future.

Valuation: Growth provides valuation upside

Applying blended peer group market multiples to our revised forecasts for CWA indicates a valuation of HK\$10.5/share, while the application of the peer group P/E multiple produces a valuation of HK\$11.7/share. In our view, the rating does not appear to reflect CWA's continuing growth prospects, and the PEG ratio for CWA, at 0.7x, stands at a discount to a peer group average multiple of 1.1x.

Utilities

13 December 2018

Price **HK\$8.59**
Market cap **HK\$13,821m**

Net debt (HK\$m) at 30 September 2018 8,299

Shares in issue 1,608.9m

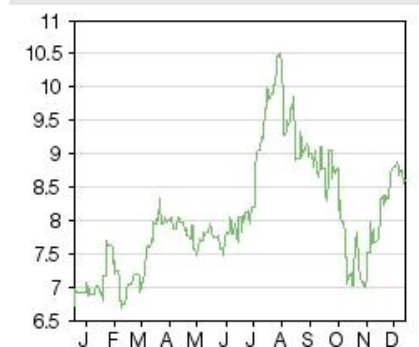
Free float 48.4%

Code 855

Primary exchange HK

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 11.7 (5.6) 19.8

Rel (local) 9.3 (5.0) 31.7

52-week high/low HK\$10.5 HK\$6.7

Business description

China Water Affairs 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

FY19 results June 2019

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Exhibit 1: Financial summary

	HK\$m	2017	2018	2019e	2020e	2021e
31-March		HKFRS	HKFRS	HKFRS	HKFRS	HKFRS
PROFIT & LOSS						
Water supply revenue		4,874	6,204	6,726	8,042	9,112
Sewage treatment		531	814	1627	1709	1794
Other segments		303	562	239	251	264
Revenue total		5,708	7,580	8,593	10,002	11,170
EBITDA		2,646	3,097	3,644	4,246	4,836
Operating Profit		2,271	2,691	3,149	3,687	4,204
Amortization		315	334	390	429	472
Depreciation		60	71	105	130	160
Net Interest expense		(251)	(289)	(340)	(347)	(319)
Profit Before Tax		1,963	2,462	2,873	3,415	3,970
Tax		(583)	(701)	(805)	(956)	(1,112)
Profit After Tax		1,379	1,762	2,069	2,459	2,858
Net profits contributable to shareholders		853	1,141	1,339	1,591	1,849
Average Number of Shares Outstanding (m)		1,505	1,571	1,609	1,609	1,609
EPS - fully diluted (c)		55.4	71.8	83.2	98.4	114.4
Dividend per share (c)		20.0	23.0	30.0	35.0	40.0
EBITDA Margin (%)		46.4	40.9	42.4	42.5	43.3
Operating Margin (%)		39.8	35.5	36.6	36.9	37.6
BALANCE SHEET						
Fixed Assets		15,689	19,581	21,061	22,524	23,849
Intangible Assets		10,316	13,499	15,209	16,880	18,408
Plant, property and equipment		1,127	1,695	1,690	1,660	1,600
Investment properties		1,173	909	705	546	424
Investment in associates		635	661	576	481	376
Other		2,438	2,817	2,882	2,957	3,042
Current Assets		9,942	9,008	9,355	9,344	11,520
Properties Under Development		690	1,370	1,370	1,370	1,370
Properties Held for Sale		289	597	550	550	550
Inventory		285	348	394	459	512
Trade and Bills Receivables		872	1,055	1,196	1,392	1,555
Due from Non-controlling Equity Holders of Subsidiaries		251	260	306	364	423
Due from Associates		409	563	563	563	563
Prepayments, Deposits and Other Receivables		1,743	1,293	1,466	1,706	1,906
Pledged Deposits		783	570	570	570	570
Deposits and cash		4,314	2,511	2,500	1,930	3,631
Other		307	440	440	440	440
Current Liabilities		7,393	8,649	7,922	6,480	6,798
Trade and Bills Payables		1,097	1,626	1,300	1,400	1,500
Accrued Liabilities, Deposits and Other Payables		2,102	2,306	2,549	2,996	3,297
Short-term Borrowings		3,206	3,450	2,617	359	-
Other		988	1,267	1,456	1,725	2,001
Long Term Liabilities		9,275	8,786	9,929	11,135	12,346
Long-term Borrowings		8,123	7,432	8,432	9,432	10,432
Other long term liabilities		1,152	1,354	1,497	1,703	1,914
Shareholders' Equity		8,963	11,154	12,566	14,253	16,226
		-	-	-	-	-
CASH FLOW						
Net Cash Flows from Operating Activities		1,452	1,632	2,568	3,547	3,943
Purchase of property, plant and equipment		(92)	(100)	(100)	(100)	(100)
Increase in concession rights for water supply and sewage processing		(1,808)	(2,500)	(2,100)	(2,100)	(2,000)
Acquisitions/disposals		(283)	0	0	0	0
Increase in prepayments and other receivables		(1,226)	0	0	0	0
Others		(134)	(171)	112	112	104
Net Cash Flows from Investing Activities		(3,543)	(2,771)	(2,088)	(2,088)	(1,996)
Dividends		(135)	(369)	(483)	(563)	(644)
Shares issue and/or options exercised		(38)	301	0	0	0
Other		245	(362)	(175)	(208)	(242)
Net Cash Flow		(2,020)	(1,569)	(178)	688	1,060
Opening net debt (CWA definition)		4,213	6,232	7,801	7,978	7,291
Closing net debt/(cash)		6,232	7,801	7,978	7,291	6,230
Net debt to equity ratio (CWA definition)		70%	70%	63%	51%	38%

Source: Company accounts, Edison Investment Research. Note: CWA's interim results did not include the publication of a cash flow statement.

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