

# China Water Affairs Group

Company update

## FY18 exceeds forecasts

**Better-than-expected growth in profitability in FY18, a higher than forecast DPS and a favourable market outlook are clearly positive for China Water Affairs (CWA). We forecast continuing growth over the next few years and have raised our valuation to HK\$10 per share. At that price, CWA would trade on a forward-looking P/E multiple of 13.1x, a c 15% discount to our group of selected peers.**

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	16.1	2.2
03/18	7,580	2,462	71.8	23.0	12.4	2.6
03/19e	8,803	2,804	76.2	24.5	11.7	2.7
03/20e	10,021	3,246	88.2	26.6	10.1	3.0

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

## FY18 extends growth trend

CWA posted continuing year-on-year growth in group revenue (HK\$7,580m +32.8%), recurring operating profit (HK\$2,718m +37.5%) and EPS (71.8c +29.6%). The growth reported exceeded our expectations for both revenue (HK\$7,069m), and EPS (64.9c). The performance was aided by tariff hikes, acquisitions and an improvement in the cost to income ratio. The core water business (c 82% of group revenues) saw revenues and operating profits increase by 25.1% (to HK\$6,204m) and 30.1% (to HK\$2,401.9m) respectively. The DPS was increased to 23.0c (Edison FY18e 19.6c) and represented c 32% of basic EPS. As CWA continues to expand the scope of its operations, net debt rose to HK\$7,801m, but the balance sheet remains healthy and the ratio of total liabilities to total assets reduced from 65% to 61%, helped by the recovery of HK\$833m from the sale of non-core assets.

## Favourable outlook for FY19 and beyond

CWA has achieved five-year CAGR of 33.3% in core water profits and the outlook continues to appear promising. CWA's strong market position should allow it to take advantage of the incremental privatisation of the Chinese water system as China seeks to address regional water imbalances, integrate urban and rural water supply and improve water quality. Targeted acquisitions, funded by organic cash flow and an increased pace of non-core disposals, tariff increases, capacity expansions and the strategic co-operation agreement with Toray in the high-margin drinking water market should provide for growth at CWA.

## Valuation: Increasing forecasts and valuation

We have revised our forecast and valuation on the back of the strong FY18 results. We now forecast EPS of 88.2c for 2020 (previously 83.0c) and expect a CAGR in EBIT of c 14% for the period 2018-21 (c 27% CAGR 2013-18). We have also reassessed our valuation, which increases from HK\$8.0 per share to HK\$10.0 per share. At that price, CWA trades on an FY19e P/E of 13.1x (a discount to a group of 10 Chinese and international peers at c 15.1x) and a PEG ratio of c 1.3x (c 1.4x for peer group).

Utilities

4 July 2018

**Price** **HK\$8.92**
**Market cap** **HK\$14,352m**

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

Shares in issue 1,609m

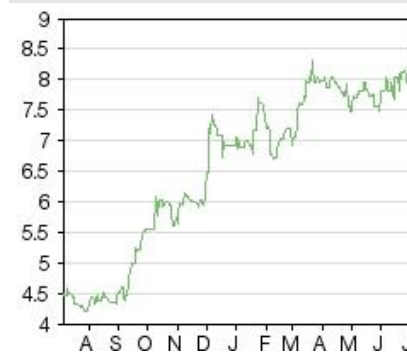
Free float 48.4%

Code 855

Primary exchange HK

Secondary exchange N/A

### Share price performance



%	1m	3m	12m
Abs	13.4	10.2	94.7
Rel (local)	21.2	16.5	75.9

52-week high/low	HK\$8.9	HK\$4.2
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### 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

### Next events

AGM 7 September 2018

Interim results December 2018

### Analyst

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**Exhibit 1: Financial summary**

	HK\$m	2017	2018*	2019e	2020e	2021e
31-March		HKFRS	HKFRS	HKFRS	HKFRS	HKFRS
<b>PROFIT &amp; LOSS</b>						
Water supply revenue		4,874	6,204	7,358	8,504	9,804
Sewage treatment		531	814	854	897	942
Other segments		303	562	591	620	651
Revenue TOTAL		5,708	7,580	8,803	10,021	11,397
EBITDA		2,646	3,097	3,574	4,075	4,636
Operating Profit		2,271	2,691	3,079	3,516	4,004
Amortization		315	334	390	429	472
Depreciation		60	71	105	130	160
Net Interest expense		(251)	(289)	(340)	(346)	(320)
Profit Before Tax		1,963	2,462	2,804	3,246	3,769
Tax		(583)	(701)	(785)	(909)	(1,055)
Profit After Tax		1,379	1,762	2,019	2,337	2,714
Net profits contributable to shareholders		853	1,141	1,231	1,426	1,655
Average Number of Shares Outstanding (m)		1,505	1,571	1,609	1,609	1,609
EPS - fully diluted (HK c)		55.4	71.8	76.2	88.2	102.4
Dividend per share (c)		20.0	23.0	24.5	26.6	30.9
EBITDA Margin (%)		46.4	40.9	40.6	40.7	40.7
Operating Margin (%)		39.8	35.5	35.0	35.1	35.1
<b>BALANCE SHEET</b>						
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	9,454	9,369	11,635
Properties Under Development		690	1,370	1,370	1,370	1,370
Properties Held for Sale		289	597	550	550	550
Inventory		285	348	404	460	523
Trade and Bills Receivables		872	1,055	1,225	1,395	1,586
Due from Non-controlling Equity Holders of Subsidiaries		251	260	330	382	444
Due from Associates		409	563	563	563	563
Prepayments, Deposits and Other Receivables		1,743	1,293	1,502	1,710	1,944
Pledged Deposits		783	570	570	570	570
Deposits and cash		4,314	2,511	2,500	1,930	3,645
Other		307	440	440	440	440
Current Liabilities		7,393	8,649	8,014	6,531	6,958
Trade and Bills Payables		1,097	1,626	1,300	1,400	1,500
Accrued Liabilities, Deposits and Other Payables		2,102	2,306	2,694	3,095	3,520
Short-term Borrowings		3,206	3,450	2,571	363	-
Other		988	1,267	1,449	1,673	1,938
Long Term Liabilities		9,275	8,786	9,911	11,081	12,282
Long-term Borrowings		8,123	7,432	8,432	9,432	10,432
Other long term liabilities		1,152	1,354	1,480	1,649	1,850
Shareholders' Equity		8,963	11,154	12,590	14,281	16,244
		-	-	-	-	517
<b>CASH FLOW</b>						
Net Cash Flows from Operating Activities		1,452	1,632	2,539	3,372	3,824
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)	(394)	(428)	(497)
Shares issue and/or options exercised		(38)	301	0	0	0
Other		245	(362)	(189)	(219)	(254)
Net Cash Flow		(2,020)	(1,569)	(132)	638	1,077
Opening net debt (CWA definition)		4,213	6,232	7,801	7,932	7,294
Closing net debt/(cash)		6,232	7,801	7,932	7,294	6,217

Source: Company data, Edison Investment Research. Note: \*While the FY18 P&L and balance sheet have been reported, the cash flow has not and remain Edison estimates.

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