

Yunnan Water (6839.HK)

Continuous High Growth to Be Expected

Hong Kong | Public Utility | Company report

23 MAY 2016

Substantial increase in business performance

In 2015, the business revenue of Yunnan Water reached RMB1.56 billion, up by 41.6% as compared to 2014. Major contribution came from several businesses, including: The sewage treatment business achieved 9.5% growth and reached RMB420 million thanks to the fact that some sewage treatment facilities raised their service unit price and that some previously acquired projects of sewage treatment facility generated profits; water supply business went up by 110.5% to RMB450 million, due to profits generated by previously acquired projects; construction and equipment sales business grew by 27%, amounting to RMB600 million.

In 2015, gross profit recorded RMB510 million, an increase of 52.1% from 2014. Gross margin rose by 2.3 % to 32.6 % as a result of increase in unit price of several water supply projects. Finally, the company achieved net profit of RMB320 million, 68.9% higher than 2014. Net profit margin increased from 17.1% in 2014 to 20.4% in 2015.

Continuous expansion of business scale, setting foot in solid waste treatment

Yunnan Water is a leading integrated service provider of urban sewage treatment and water supply industry in Yunnan Province, running the most projects of sewage treatment and water supply in Yunnan water industry. Its businesses include: sewage treatment, water supply, solid waste disposal, construction and equipment sales, and other services. By the end of 2015, there had been 52 projects of sewage treatment under construction and operation, with sewage treatment capacity of approximately 1.024 million tons per day, an annual growth rate of 17.8%. Moreover, there had been 23 concession projects of water supply, with daily capacity of approximately 646 thousand tons, an annual growth rate of 24%.

In 2015, the company, for the first time, extended to solid waste treatment business through the acquisition of Ningde and Fu'an waste-to-power projects, as well as hazardous waste projects like Shandong Tengyue and Zhengxiao Environmental Protection. The company was actively engaged in the industries of hazardous industrial and medical waste, and power generation by waste. By the end of 2015, the company had been operating four projects of solid waste treatment, with annual processing capacity of approximately 557 thousand tons. It is believed that the future emphasis will be laid on solid waste treatment business. Despite the currently low profit of the projects of solid waste treatment business, it is still a convincingly promising business. As long as it has been well established, its profitability is expected to significantly increase and it will become a new profit growth point for the company.

Buy (Maintain)

CMP: HKD 3.94

(Closing price as at 19 May 2016)

TARGET: 5.70 (+45%)

COMPANY DATA

O/S SHARES (MN) :	1193
MARKET CAP (HKDMN) :	4700
52 - WK HI/LO (HKD):	7.72/3.55

SHARE HOLDING PATTERN, %

Yunnan Water Industry Investment Co., Ltd. :	30.07
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PRICE PERFORMANCE, %

	1M	3M	1Y
Yunnan Water	-12.83	-0.25	-
HSI	-5.57	-2.37	-

KEY FINANCIALS

CNY mn	FY14	FY15	FY16F	FY17F
Net Sales	1101	1558	2506	2833
Net Profit	188	286	405	488
EPS, CNY	-	0.27	0.34	0.41
PER, x	-	12.2	9.7	8.0
BVPS, CNY	2.76	3.40	3.64	3.91
P/BV, x	1.2	1.0	0.9	0.8
ROE, %	8.4	8.9	8.0	9.1
Debt/Equity, %	84.5	94.3	100.0	100.0

Source: Company reports, Phillip Securities Est.

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Outstanding core competitiveness

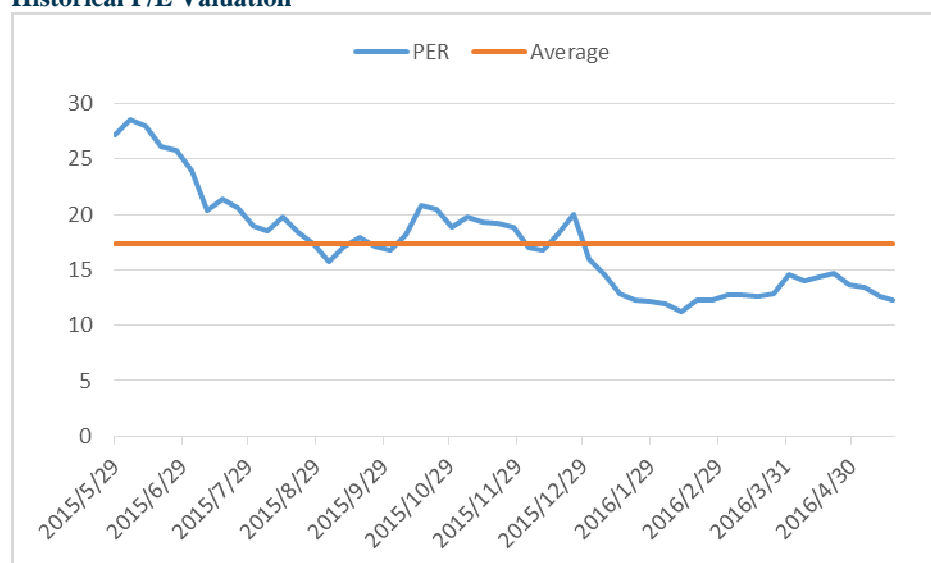
Yunnan Water has built an integrated industrial chain focused on membrane technology. This technology stems from its second largest shareholder OriginWater which enjoys a monopoly position on membrane treatment technology in China. By the end of 2014, in terms of domestic municipal projects of MBR membrane, OriginWater had processed more than half of those projects, showing strong competitiveness. On the other hand, through a non-competition agreement between the company and OriginWater, OriginWater is committed not to directly or indirectly operate in any places in Yunnan where Yunnan Water has been carrying out business, and not to trigger any direct or potential competition in any business fields, thus ensuring the promotion of membrane technology of Yunnan Water.

Yunnan Water is a public-private partnership (PPP) based on company level. Two largest shareholders of Yunnan Water are Yunnan Metropolitan Construction Investment Group, a state-owned company, and Beijing OriginWater Technology Co., Ltd., a privately-owned company. Water projects from Yunnan Metropolitan Construction Investment Group and advanced technology from Beijing OriginWater Technology Co., Ltd. established a solid foundation for the company's development in sewage treatment business. Through the early-staged cooperation with OriginWater, the company has gained lots of practical experience in the PPP model. Currently, 52% of assets of water industry are not yet marketized. Therefore, the PPP model is expected to have a large space for development in that field.

Evaluation

Yunnan Water will continue to carry out mergers and acquisitions and strategic cooperation, speeding up the layout in water and solid waste treatment business. Its core strengths lie in its sophisticated membrane technology and rich experience in the PPP model. We give the company 12-month target price of HK\$5.70, equivalent to 14 X 2016EPS. (Closing price as at 19 May 2016)

Historical P/E Valuation



Source: Phillip Securities (HK) Research

Risk warnings

With the marketization of domestic water industry, the numbers of outstanding water projects will gradually reduce;

Accounts receivable is exposed to the risk of bad debts;

Policy risk.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios	NA	NA	12.2x	9.7x	8.0x
Price Earnings	NA	1.2x	1.0x	0.9x	0.8x
Price to Book	NA	NA	0.0x	0.0x	0.1x
Dividend Yield					
Per share data(RMB)					
EPS Adjusted	NA	NA	0.27	0.34	0.41
Book Value Per Share	NA	2.76	3.40	3.64	3.91
Dividends Per Share	NA	NA	0.10	0.14	0.17
Growth& Margin					
Revenue growth	72.8%	59.8%	41.6%	60.8%	13.0%
Gross Profit growth	86.7%	28.0%	52.1%	60.4%	13.0%
Net Profit growth	59.3%	-6.5%	52.1%	41.7%	20.5%
Profitability Ratios					
Gross Margin	37.9%	30.3%	32.6%	32.5%	32.5%
Net Profit Margin	29.2%	17.1%	18.3%	16.2%	17.2%
Dividend Payout Ratio %	0.0%	0.0%	37.0%	41.2%	41.5%
Key Ratios					
Return on Assets	6.4%	4.4%	3.9%	4.0%	4.5%
Return on Equity	11.5%	8.4%	8.9%	8.0%	9.1%
Effective Tax Rate	20.4%	16.9%	17.1%	17.5%	17.5%
Liability ratio	36.0%	45.8%	48.5%	50.0%	50.0%
Income Statement(RMB: mn)					
Revenue	689	1,101	1,558	2,506	2,833
- Cost of Goods Sold	428	767	1,051	1,692	1,912
Gross Income	261	334	508	814	921
- Selling, General & Admin Expenses	87	139	198	321	364
Operating Income	242	229	394	564	682
Pretax Income	252	226	383	546	658
- Income Tax Expense	51	38	65	95	115
Income Before XO Items	201	188	317	450	543
- Minority Interests	0	0	32	45	54
Net Profit	201	188	286	405	488

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 19 May 2016)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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