

Jiangnan Water (601199.SH)

Maintained Endogenous Growth

Hong Kong | Environmental Protection | Company report

20 February 2017

The Water Industry: On the Up

The company's major businesses include tap-water manufacturing and selling, engineering installation and related water treatment business. 1) Water supply is a sustained and stable industry: Disparities between water supply and demand has been highlighted by continuous growth of water consumption driven by economic development and urbanization, residents' demand for high-quality, healthy drinking water, as well as water shortage aggravated by increased water pollution. China's water fee is inexpensive relative to that in the world, currently accounting for a mere 1.2% of personal income as contrasted with the international level of around 4%. There is still substantial room for rise. 2) The sewage treatment industry is booming with stronger policy support: The new Environmental Protection Law of PRC, "Water Pollution Control Action Plan", Construction Planning of National Urban Sewage Treatment and Recycling Facilities in the "Thirteenth Five-Year" Period and other policies have been issued. In the "13th five-year" period, the upgrading and reconstruction of urban sewage treatment facilities will present huge market for investment, with the total investment in construction reaching approximately RMB582.9 billion, higher than in the "12th five-year" period by 35.6%. Driven by intensive policies, the huge market volume in the market segments needs to be released soon.

Sound Growth in Water-Supply Strength and Rapid Growth in Engineering Installation

The tap-water business recorded a revenue of RMB231 million in 1H 2016, representing an increase of 4.1% yoy and accounting for 40.2% of total revenue, with a gross margin of around 50%. As of 2015, the company owns four ground water plants with a total designed capacity of 1.16 million ton/day. Its source of tap water, drawn from the Yangtze River belonging to surface water category II, has apparent edge in quality. In addition to the concession to operate water supply in Jiangyin city, it also owns a complete water-supply chain covering water intaking from sources, tap-water purification, sales and after-sales service. The ladder-like fee for water for residential use in Jiangyin has been implemented since January 1, 2016, and the company has also been accelerating the transformation of rural water supply pipe network for integrated development of urban and rural water supply and improvement of the principal water-supply services.

Buy

CMP: HKD 7.92
(Closing price as at 16 Feb 2017)
TARGET: HKD 10.50 (31%)

COMPANY DATA

O/S SHARES (MN) :	935
MARKET CAP (CNYMN) :	7,407
52 - WK HI/LO (CNY):	10.68 /6.81

SHARE HOLDING PATTERN , %

Jiangyin urban and rural water supply and drainage Co., Ltd.	35.19
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PRICE PERFORMANCE , %

	1-Month	3-Month	1-Year
Jiangnan Water	1.29	-9.47	-46.41
SSCI	-1.93	-9.66	-63.41

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY14	FY15	FY16E	FY17E
Revenue	749	856	1,134	1,472
Net Profit	177	270	344	438
P/E, x	41.7	27.3	21.0	16.9
EPS, RMB	0.19	0.29	0.38	0.47
P/B, x	3.7	3.4	3.0	2.7
BVPS, RMB	2.12	2.35	2.63	2.99
ROE, %	9.0	12.3	14.0	15.7

Source: Company reports, Phillip Securities Est.

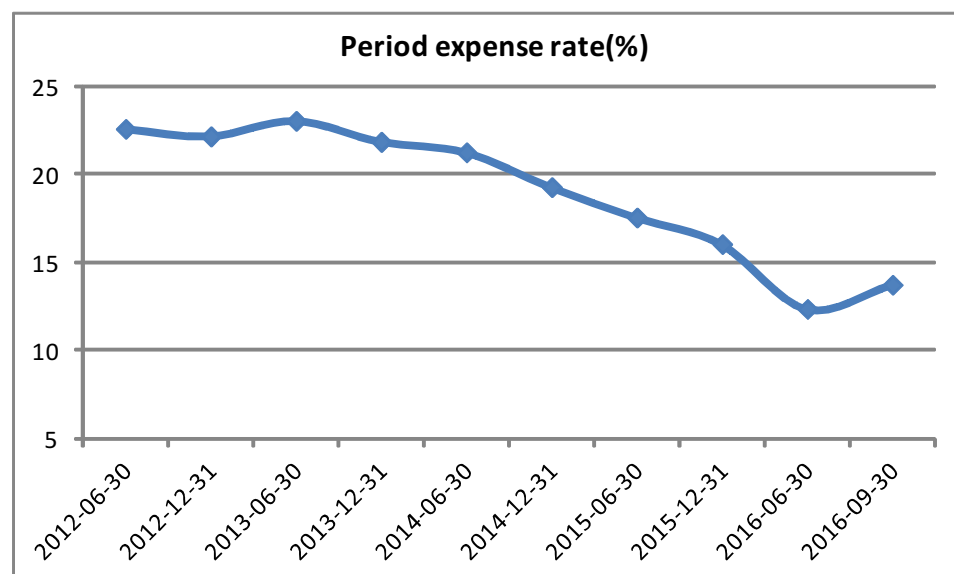
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Current water price(Jiangyin)

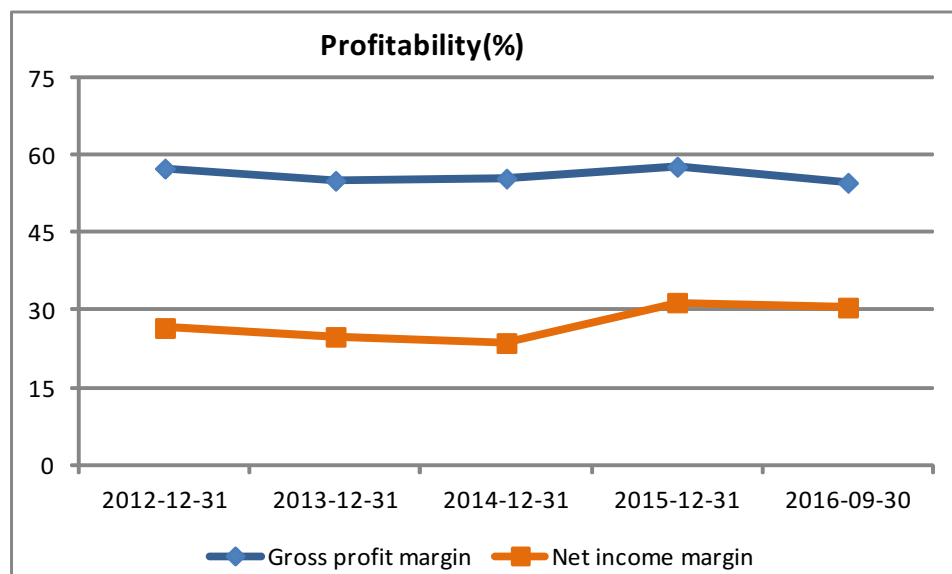
分 类	价 格 (元)	基本 水价	城市 附加费	水资 源费	污水 处理费	水利工 程水费	总水价
居 民 生 活 用 水	第一阶梯 (年用水量≤240)	1.06		0.2	1.3	0.04	2.6
	第二阶梯 (240<年用水量≤ 300)	1.59		0.2	1.3	0.04	3.13
	第三阶梯 (年用水量>300)	3.18		0.2	1.3	0.04	4.72
非居民生活用水	1.33		0.2	1.3	0.04	2.87	
工商服务业用水	1.62	0.04	0.2	1.4	0.04	3.3	
特种用水	2.82	0.04	0.2	1.4	0.04	4.5	

Source: Company Website, Phillip Securities(HK)Research

The wholly-owned subsidiary Municipal Engineering Company is mainly responsible for the engineering business, and is the only enterprise in Jiangyin that can independently undertake mid- and large-scale installation and construction of tap-water pipes. In 1H 2016, the revenue and profit from external engineering business recorded an upsurge, which can be attributed to constant expansion of the business. Among them, the revenue rocketed by 146.6% yoy to RMB328 million, the net profit soared by 127.3% yoy, and the gross margin stood at 56.88%, contributing to total-profit growth by more than 50%.



Source: Wind, Phillip Securities(HK)Research



Source: Wind, Phillip Securities(HK)Research

New Progress Made in Extension of Industrial Chain

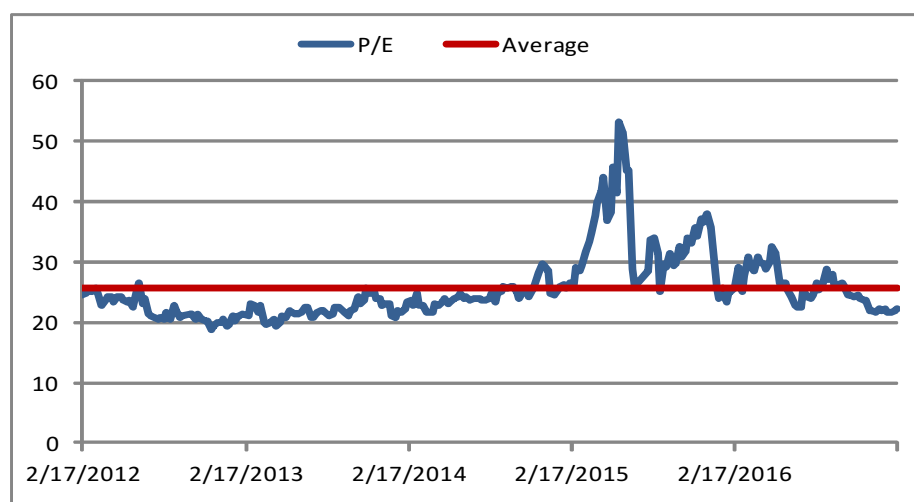
Gratifying progress has been made in extension of water industrial chain and sewage treatment business. In mid-term 2016, the Huangtang sewage treatment plant signed contract on sewage treatment with 141 companies with the contract amount rising by 25% yoy; the Nanzha sewage treatment plant undertook the construction of internal sewage pipe network of another 16 companies. The preliminary work of solid waste disposal business layout has launched. Jinxiu Jiangnan Environmental Development Company has launched the preliminary work of Jiangyin Qinwang Mountain Comprehensive Utilization of Industrial Waste Project, and the work is running smoothly.

Financial Stability Maintains

The company's cash flow is abundant and stable, with the book amount ranging from RMB1 to 1.4 billion. At the same time, it has low debt burden, with the liquidity ratio and the quick ratio standing at 2.5/2.2, respectively, and the asset-liability ratio kept below 45%, less than the industry average of 50%. The abundant capital and sound finance will benefit business expansion. Moreover, during the period the company was also involved in initiating the industrial fund regarding investment and operation of environmental industry projects, which is expected to expand the investment channels, reduce the financial risks and enhance the income from investment.

Valuation and Rating

1)The company's valuation is relatively low relative to the valuation of listed companies in the same field, and in recent years it has maintained a payout ratio of more than 30%, the momentum of which is likely to continue; 2) The sustained, steady water-supply business can provide abundant and stable cash flow, and the expansion of engineering business can boost overall profitability; (3) The expansion of sewage treatment and solid waste disposal will bring great flexibility to the company's results. On this basis, we expect the 2016 and 2017 net profit attributable to the company to be 352/438 million, respectively, and EPS to be 0.38 and 0.47, respectively, and P/E ratio to be 21.0 and 16.9, respectively. The target price is 10.50, and the buy rating is given. (Closing price as at 16 Feb 2017)



Source: Bloomberg, Phillip Securities(HK)Research

Stock Code	Stock Name	PE(TTM)	PB	ROE(%)
000544.SZ	Central Plain	47.9	2.5	4.3
601368.SH	Greencity Wat	35.2	3.2	11.6
600874.SH	TCEPC	32.4	2.6	7.7
600008.SH	Beijing Capital	30.3	2.3	7.3
601158.SH	Chongqing Wat	25.9	2.8	11.6
600461.SH	Hongcheng Wa	23.7	2.0	8.3
601199.SH	Jiangnan Wat	22.6	3.0	12.9
600168.SH	WHKG	22.5	1.7	7.9
000598.SZ	XREC	20.3	2.0	10.5
000685.SZ	ZPUG	16.0	1.5	16.2
600187.SH	ICW	-	3.0	-4.5

Source: Wind, Phillip Securities(HK)Research

Risk Warnings

Risk of fluctuations in policy;

Rapid growth in operating costs;

Great difficulty in out-of-the-region expansion and fierce competition.

Financials

FYE	FY13	FY14	FY15	FY16E	FY17E
Valuation Ratios					
Price Earnings(P/E)	51.1	41.7	27.3	21.0	16.9
Price to Book(P/B)	4.0	3.7	3.4	3.0	2.6
Per share data(RMB)					
EPS,Adjusted	0.16	0.19	0.29	0.38	0.47
Book Value Per Share	1.97	2.12	2.35	2.64	2.99
Dividends Per Share	0.05	0.06	0.09	0.12	0.15
Growth & Margins(%)					
Growth					
Revenue	11.9%	28.0%	14.2%	32.5%	29.8%
Operating income	6.7%	27.2%	49.7%	30.8%	24.5%
Net profit	4.8%	21.8%	52.0%	30.7%	24.3%
Margins					
Gross profit margin	55.0%	55.5%	57.8%	57.0%	55.8%
Operating profit margin	32.1%	31.9%	41.8%	41.3%	39.6%
Net income margin	24.9%	23.7%	31.5%	31.1%	29.8%
Key Ratios					
ROE(%)	7.9%	9.0%	12.3%	14.3%	15.7%
ROA(%)	4.8%	5.3%	7.6%	8.1%	8.8%
Income Statement(RMB mn)					
Revenue	586	749	856	1,134	1,472
- Cost of Goods Sold	263	334	361	488	651
Gross Income	322	416	494	646	821
- Operating Expenses	128	145	137	173	233
Operating Income	188	239	358	468	583
- Net Non-Operating Losses (Gains)	8	(2)	1	2	1
Pretax Income	196	237	359	470	584
- Income Tax Expense	51	59	90	117	146
Net profit	146	177	270	352	438

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 16 Feb 2017)

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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