

China Water Affairs (855 HK)

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Company Update

BUY

UNCHANGED

Close price: **HK\$4.28**

Target Price: **HK\$6.70 (+56.5%)**

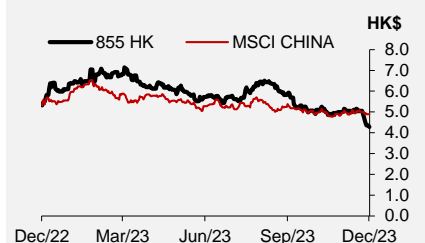
Previous TP: **HK\$8.75**

Key Data

HKEx code	855 HK
12 Months High (HK\$)	7.56
12 Month Low (HK\$)	4.26
3M Avg Dail Vol. (mn)	1.44
Issue Share (mn)	1,632.32
Market Cap (HK\$mn)	6,986.34
Fiscal Year	03/2023
Major shareholder (s)	Mr. Duan (28.9%)

Sources: Company data, Bloomberg, OP Research
Closing price are as of 4 Dec 2023

Price Chart



	1mth	3mth	6mth
Absolute %	-14.6	-27.8	-26.1
Rel. MSCI CHINA %	-13.1	-20.3	-18.0

PE



Company Profile

China Water Affairs Group ("CWA") is a cross region city water supply operator in China. As at Mar 2023, CWA's daily water supply capacity reached ~10.3mn tons. It also engaged in fields like sewage treatment, pipeline direct drinking water and real estate.

FY1H24 earnings missed, improvement expected in FY2H24E

- Profit attributable to shareholders down 14.9% yoy to HK\$825.9mn on the back of 0.9% yoy increase in revenue to HK\$6.85bn.
- Interim DPS was HK\$0.13. CWA will maintain a 30% dividend payout ratio.
- City water supply expected to recover in 2H, direct drinking water shines
- Maintain BUY with new TP of HK\$6.70, representing FY24E PER of 6.0x.

FY1H24 earnings declined. The decline in net profit was due to the combined effects of : (1) a 5.8% depreciation of RMB against HK\$; (2) a 39.1% yoy increase in finance costs under a jump in offshore financing costs; and (3) a decrease in revenue from other side-businesses and the lower share of associates results. Excluding the FX effect, profit attributable to shareholders in RMB declined 9.9% yoy.

Stable outlook for City water supply. In FY1H24, revenue from the city water business (supply + installation& maintenance + construction) declined 1.0% yoy to HK\$4.62bn. The decline was due to (1) the almost-flat growth in volume of water sold (+1.2% yoy); (2) the delay in tariff adjustment. Only 1 water supply project was approved to adjust tariffs; and (3) the lesser demand for installation services in the weak property market. We expect revenue from the city water supply business to averagely grow at a low single-digit yoy rate in future.

Pipeline direct drinking water shines. In FY1H24, revenue rose 160.6% yoy to HK\$1.03bn. The segment contributes 15.0% of the total revenue, as compared to 9.2% for FY23. Total served population exceeded 7mn in Sept 2023 (Mar 2023 :4.45mn). CWA has unleashed the profitability of the business. The segmental profit jumped 175.1% yoy to HK\$335.3mn. CWA accumulates more direct drinking projects outside its water supply area. In FY1H24, CWA announced 3 new projects outside water supply areas which has potential new customer of 1.7mn. CWA will prioritize capital resources to develop more pipeline direct drinking water projects. We anticipate the business to grow at a CAGR of 42.7% between FY24E and FY26E, thanks to the rapidly growing customer base.

Mixed outlook for environmental protection business. In FY1H24, revenue grew 19.9% yoy to HK\$637.4mn. Mobil Petrochemical Wastewater Treatment Project in Huizhou, which focuses on industry waste treatment, is under trial. We expect the project to significantly boost service revenue in the future. CWA said it will slow down the development of new environmental projects. This suggests a decline in revenue from construction services.

Improvement expected in FY2H24E. This is driven by (1) an improving water sales prospect which is suggested by the recent China economic data; and (2) more projects are expected to receive approval for the tariff adjustments in the near term. It is understood there are more projects are close to receive the approvals. Meanwhile, pipeline direct drinking is projected to continue growing rapidly. Given the increasing revenue contribution from the business, it will become the major earnings driver of CWA.

Earnings revision. We cut CWA's EPS forecast for FY24E/FY25E by 14.6%/18.5% to factor (1) the higher offshore finance costs; (2) the slowdown in the development of city water supply and environmental protection projects. The high single-digit growth in revenue from water supply will offset by a decline in revenue from construction services; and (3) the aversive impact of the property market on the installation activities for the city water service. We anticipate CWA's EPS to grow at a CAGR of 7.5% in the next three fiscal years. This is mainly driven by the pipeline-direct drinking water business.

Maintain BUY with a new TP of HK\$6.70 from HK\$8.75. Our new TP based on PER of 6.0x in FY24E. The successful spin-off and separately listed in the market will release the value of its water business.

Exhibit 1.: Forecast and Valuation

Fiscal year to Mar (HK\$ mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	12,950	14,195	14,506	15,845	16,826
Growth (%)	+25.2	+9.6	+2.2	+9.2	+6.2
Net profit	1,894	1,857	1,812	2,090	2,304
Growth (%)	+11.9	-1.9	-2.4	+15.4	+10.2
Diluted EPS (HK\$)	1.16	1.14	1.11	1.28	1.41
EPS growth (%)	+11.5	-1.9	-2.4	+15.4	+10.2
Change to previous EPS (%)			-14.6	-18.5	-18.0
Consensus EPS (HK\$)			1.22	1.35	1.47
ROE (%)	16.1	14.3	13.5	14.2	14.2
P/E (x)	3.7	3.8	3.9	3.3	3.0
P/B (x)	0.5	0.5	0.5	0.5	0.4
Yield (%)	7.9	8.0	7.8	9.0	9.9
DPS (HK\$)	0.34	0.34	0.33	0.38	0.42

Sources: Bloomberg, OP Research

Exhibit 2.: FY24 Interim results (ended Sept 2023) review

	FY1H24	FY1H23	Yoy%	Remarks
Profitability Data (in HK\$ mn)				
Revenue	6,846	6,585	+0.9%	
Gross profit	2,524	2,508	+0.6%	
Profit attributable to shareholders	826	970	-14.9%	Mainly due to: (1) unfavorable CNY/HKD movement, (2) the increase in finance costs; and (3) the lower contribution from JV.
Dividend				
DPS (HK\$)	0.13	0.16	-18.8%	Due to the decline in profit attributable to shareholders. The company said it will maintain a 30% dividend payout ratio.
Profitability ratio (%)				
Gross Margin	36.9%	37.0%	-0.1p.p.	
Operating ratio (%)				
Selling and distribution costs to rev.	1.9%	2.1%	-0.2p.p.	
Admin expenses to revenue	6.5%	6.8%	-0.3p.p.	
Effective tax rate	23.1%	24.7%	-1.6p.p.	

Source: The Company, OP research

Exhibit 3.: Earnings revision

(Fiscal year ended March)	FY24E			FY25E			OP Comments
(HK\$ mn)	New	Old	% Chg	New	Old	% Chg	
Revenue	14,506	16,001	-9.3%	15,845	17,381	-8.8%	
City water supply	8,900	9,100	-2.2%	9,111	9,600	-5.1%	To reflect the slowdown in development of new water supply projects in future, lowering revenue from the construction services.
Pipeline direct drinking water	2,246	2,400	-6.4%	3,194	3,140	+1.7%	
Environmental protection	1,320	1,621	-18.6%	1,449	1,761	-17.7%	To reflect the slowdown in development of new sewage and environmental projects.
Gross margin	38.0%	38.0%	-	38.5%	38.8%	-0.3p.p.	
Profit attributable to shareholders	1,812	2,122	-14.6%	2,090	2,561	-18.4%	In addition to the tune down of revenue forecast, we lift the forecast of finance costs under a higher off-shore financing rate.
Diluted EPS (HK\$)	1.11	1.30	-14.6%	1.28	1.57	-18.5%	

Source: OP Research

Risk: (1) Delay in the approval of tariff adjustment; (2) slower-than-expected progress to promote the direct drinking water businesses; and (3) FX impacts.

Exhibit 4.: Peers comparison

Company	Ticker	Price	Mkt cap (US\$m)	3-mth avg t/o (US\$m)	PER Hist (x)	PER FY1 (x)	PER FY2 (x)	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)	ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %
China Water Affairs	855 HK	4.28	894	N/A	3.8	3.9	3.3	7.5	0.5	8.0	7.8	0.5	0.5	14.3	13.5	-14.6	-27.8
HSI		16,646.05			9.2	8.4	7.7	9.3	0.9	4.2	4.3	1.0	0.9	10.6	11.2	-5.8	-11.7
HSCEI		5,703.33			7.8	7.6	6.9	8.1	0.9	4.1	4.1	0.9	0.9	11.2	11.5	-5.8	-12.7
CSI300		3,460.14			12.6	12.0	10.3	11.9	1.0	2.8	2.8	1.5	1.4	11.6	11.6	-3.5	-10.1
Peers																	
Environmental protection peers - HK					6.0	5.7	5.3	14.3	1.5	10.3	10.3	0.4	0.5	1.6	9.1	-7.1	-10.7
Guangdong Invest	270 HK	5.25	4,392	6.6	7.2	7.9	7.3	2.1	3.7	11.7	11.4	0.8	0.8	10.1	10.0	-4.5	-14.4
Bj Ent Water	371 HK	1.56	2,005	2.0	11.8	5.9	5.4	36.1	0.2	10.1	9.9	0.5	0.4	6.8	7.8	-7.1	-14.3
China Everbright	257 HK	2.53	1,989	2.2	3.4	3.2	3.1	4.7	0.7	9.1	9.7	0.3	0.3	9.3	9.4	-6.6	-13.7
Kunming Dianch-H	3768 HK	0.59	78	0.0	1.7	N/A	N/A	N/A	N/A	N/A	N/A	0.1	N/A	6.5	N/A	-19.2	-18.1
Yunnan Water I-H	6839 HK	0.27	40	0.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.1	N/A	-24.9	N/A	+1.9	+6.9
Gas utilities - HK					10.1	8.4	7.6	13.5	0.6	5.2	5.3	1.1	1.0	10.8	12.3	-2.1	-0.5
Enn Energy	2688 HK	51.65	7,476	32.4	9.1	7.2	6.6	14.4	0.5	5.6	5.5	1.3	1.2	15.8	17.5	-16.5	-12.7
China Gas Holdin	384 HK	7.17	4,987	6.7	9.0	8.0	6.9	13.6	0.6	7.0	6.5	0.7	0.6	5.1	7.9	-1.2	-12.6
China Res Gas	1193 HK	24.10	7,136	8.6	11.5	9.7	9.0	12.4	0.8	4.4	5.4	1.4	1.3	13.1	13.3	+5.0	+5.9
Kunlun Energy	135 HK	7.12	7,889	10.7	10.8	8.5	7.9	13.5	0.6	3.9	4.1	0.9	0.9	9.1	10.4	+4.4	+17.3

Sources: Bloomberg, OP research

* Outliners and "N/A" entries are in excl. from the calculation of averages

Financial Summary

Fiscal year to Mar	22A	23A	24E	25E	26E
Income Statement (HK\$ mn)					
City water supply	9,316	8,729	8,900	9,111	9,269
Pipeline direct drinking water	694	1,310	2,246	3,194	3,808
Environmental protection	1,200	1,410	1,320	1,449	1,513
others	1,740	2,746	2,040	2,091	2,236
Turnover	12,950	14,195	14,506	15,845	16,826
YoY%	+25	+9.6	+2.2	+9.2	+6.2
COGS	-7,988	-8,849	-8,995	-9,739	-10,288
Gross profit	4,962	5,346	5,511	6,106	6,538
Gross margin	38.3%	37.7%	38.0%	38.5%	38.9%
Other income	235	218	187	221	221
Selling & distribution	-290	-283	-305	-317	-320
Admin	-881	-956	-986	-1,062	-1,111
R&D	0	0	0	0	0
Other opex	0	0	0	0	0
Total opex	-1,171	-1,239	-1,291	-1,379	-1,430
Operating profit (EBIT)	4,026	4,326	4,407	4,949	5,328
Operating margin	31.1%	30.5%	30.4%	31.2%	31.7%
Provisions	0	0	0	0	0
Interest Income	123	164	177	177	177
Finance costs	-468	-633	-768	-756	-709
Profit after financing costs	3,681	3,857	3,816	4,369	4,796
Associated companies & JVs	235	163	90	107	118
Pre-tax profit	3,916	4,019	3,906	4,477	4,914
Tax	-939	-931	-937	-1,074	-1,179
Minority interests	-1,084	-1,232	-1,157	-1,312	-1,431
Net profit	1,894	1,857	1,812	2,090	2,304
YoY%	+11.9	-1.9	-2.4	+15.4	+10.2
Net profit margin	14.6%	13.1%	12.5%	13.2%	13.7%
EBITDA	5,266	5,675	5,501	6,120	6,573
EBITDA margin	40.7%	40.0%	37.9%	38.6%	39.1%
EPS(HK\$), Diluted	1.16	1.14	1.11	1.28	1.41
YoY%	+11.5	-1.9	-2.4	+15.4	+10.2
DPS(HK\$)	0.34	0.34	0.30	0.38	0.42
Fiscal year to Mar	22A	23A	24E	25E	26E
Cash Flow (HK\$ mn)					
EBITDA	5,183	5,476	5,501	6,120	6,573
Chg in working cap	-106	-309	-574	418	293
Others	-711	-598	0	0	0
Operating cash	4,365	4,569	4,927	6,538	6,866
Interests paid	-449	-635	-768	-756	-709
Interest paid on lease liabilities	-19	-18	-18	-18	-18
Tax	-168	-469	-931	-937	-1,074
Net cash from operations	3,728	3,466	3,210	4,826	5,065
Capex and acquisition	-4,021	-4,613	-4,500	-4,500	-4,200
Investments	0	0	0	0	0
Dividends received	21	42	0	0	0
Interest received	123	164	164	177	177
Others	-328	295	0	0	0
Investing cash	-4,205	-4,112	-4,336	-4,324	-4,024
Issue of shares	0	0	0	0	0
Buy-back	0	0	0	0	0
Interests paid	0	0	0	0	0
Dividends paid	-522	-294	-557	-543	-627
Net change in bank loans	2,960	2,315	0	0	0
Others	146	154	0	0	0
Financing cash	2,584	1,867	-557	-543	-627
Net change in cash	2,045	1,221	-1,683	-41	414
Exchange rate or other Adj	76	-259	0	0	0
Opening cash	3,901	6,023	6,985	5,301	5,260
Closing cash	6,023	6,985	5,301	5,260	5,674
CFPS (HK\$)	1.253	0.589	-1.031	-0.025	0.254

Sources: Company, OP Research

Fiscal year to Mar	22A	23A	24E	25E	26E
Ratios					
Gross margin (%)	38.3	37.7	38.0	38.5	38.9
Operating margin (%)	31.1	30.5	30.4	31.2	31.7
Net margin (%)	14.6	13.1	12.5	13.2	13.7
Selling & dist'n exp/Sales (%)	2.2	2.0	2.1	2.0	1.9
Admin exp/Sales (%)	6.8	6.7	6.8	6.7	6.6
Payout ratio (%)	29.3	29.8	30.0	30.0	30.0
Effective tax (%)	24.0	23.2	-24.0	-24.0	-24.0
Total debt/equity (%) ¹	105.0	104.8	95.7	85.6	76.7
Net debt/equity (%) ³	76.1	73.8	74.3	66.5	58.3
Current ratio (x)	0.9	0.8	0.8	0.8	0.8
Quick ratio (x)	0.8	0.8	0.8	0.8	0.8
Inventory T/O (days)	38	27	27	27	27
AR T/O (days)	44	50	60	55	50
AP T/O (days)	214	223	210	210	210
Cash conversion cycle (days)	-132	-146	-123	-128	-133
Asset turnover (x)	0.2	0.2	0.2	0.2	0.2
Financial leverage (x)	4.4	4.6	4.6	4.4	4.2
EBIT margin (%)	31.1	30.5	30.4	31.2	31.7
Interest burden (x)	1.0	0.9	0.9	0.9	0.9
Tax burden (x)	0.5	0.5	0.5	0.5	0.5
Return on equity (%)	16.1	14.3	13.5	14.2	14.2
Fiscal year to Mar	22A	23A	24E	25E	26E
Balance Sheet (HK\$ mn)					
Fixed assets	3,373	3,338	3,456	3,568	3,675
Intangible assets	26,504	29,123	32,322	35,431	38,162
Goodwill	1,476	1,419	1,419	1,419	1,419
Financial assets	397	461	461	461	461
Right-of-use assets	1,367	1,303	1,303	1,303	1,303
Other non-current assets	7,450	7,633	7,723	7,830	7,948
Non-current assets	40,566	43,278	46,685	50,014	52,969
Inventories	832	650	665	720	761
AR	1,562	1,954	2,385	2,388	2,305
Contracted assets	880	1,482	1,514	1,654	1,756
Prepayments & deposits	2,384	2,635	2,756	3,011	3,197
Other current assets	4,819	4,180	3,958	3,958	3,958
Cash	6,023	6,985	5,301	5,260	5,674
Current assets	16,499	17,886	16,579	16,990	17,651
AP	4,674	5,404	5,175	5,603	5,919
Tax	2,597	3,027	3,027	3,027	3,027
Accruals & other payables	2,676	3,132	3,191	3,486	3,702
Bank loans	7,692	8,021	6,833	6,833	6,833
Leases & other debts	1,232	1,402	1,596	1,743	1,851
Other current liabilities	303	193	193	193	193
Current liabilities	19,248	21,178	20,015	20,885	21,525
Bank loans & leases	14,171	15,607	16,795	16,795	16,795
Deferred tax	1,314	1,270	1,270	1,270	1,270
Other non current liabilities	1,847	1,936	1,936	1,936	1,936
Non-current liabilities	17,333	18,814	20,002	20,002	20,002
Total net assets	20,483	21,172	23,247	26,117	29,093
Shareholder's equity	12,969	12,993	13,911	15,469	17,014
Share capital	16	16	16	16	16
Reserves	12,953	12,977	13,895	15,453	16,998
MI	7,514	8,179	9,336	10,648	12,079
BVPS (HK\$)	7.95	7.96	8.52	9.48	10.42

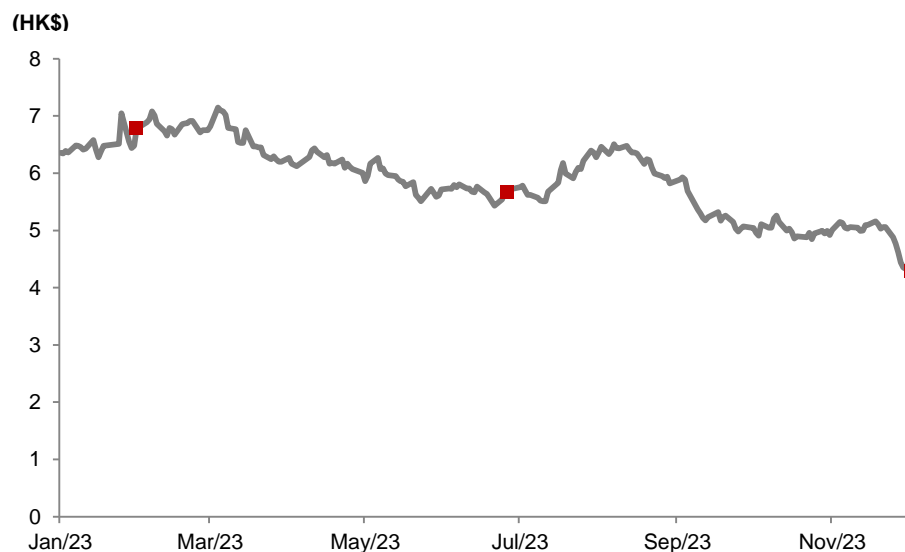
¹ Based on the total equity, rather than the equity attributable to shareholders.

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
04/09/2023	Newborn Town	9911	1H23 results beats, Blued as a new growth engine	BUY	John Siah
18/08/2023	361 Degrees	1361	1H23 net profit rose 27.7%, resumes dividend payout	BUY	John Siah
04/08/2023	Greentown Mgmt	9979	Impressive results in 1H23 backed by strong contracts growth	BUY	John Siah
04/08/2023	Xinyi Energy	3868	1H23 net profit in-line, dividend payout ratio cut to 49%	HOLD	John Siah
04/08/2023	361 Degrees	1361	1H23 net profit grows by more than 25%	BUY	John Siah
31/07/2023	Edvantage Group	382	9M22/23 operating results in-line with expectation	BUY	John Siah
03/07/2023	China Water Affairs	855	FY22/23 earnings slightly declined, pipeline direct drinking water shines	BUY	John Siah
22/05/2023	Newborn Town	9911	Fine-tuning content ecology to further monetize new social networking products	BUY	John Siah
05/05/2023	China Edu Group	839	FY1H23 results up to expectations	BUY	John Siah
04/05/2023	Edvantage Group	382	FY1H23 results showed the strong organic growth	BUY	John Siah
27/04/2023	New Higher Edu	2001	FY1H23 results in-line	BUY	John Siah
19/04/2023	361 Degrees	1361	2023Q1 sales bounced as expected	BUY	John Siah
24/03/2023	Micro Connect	-	Releasing the investment value of SMEs in China through technological innovation(中/ENG)	NR	John Siah
02/03/2023	Xinyi Energy	3868	FY22 results miss, expecting a rebound for FY23E	BUY	John Siah
24/02/2023	Edvantage Group	382	FY23Q1 operations on track	BUY	John Siah

Historical recommendations and target price: China Water Affairs (855.HK)

(as of 4 Dec 2023)



	Date	Rating	TP	Close
1	5 Feb 2023	BUY	HK\$9.50	HK\$6.85
2	3 Jul 2023	BUY	HK\$8.75	HK\$5.92
3	5 Dec 2023	BUY	HK\$6.70	HK\$4.28

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