

Last Closing: HK\$3.98

Upside: +48%

Target Price: HK\$5.88↓

Environmental Sector

Yunnan Water (6839.HK)

Patience is needed before new projects bring in more contribution



Financial Highlights

Y/E 31 Dec	2015	2016	2017E	2018E	2019E
Revenue (RMB m)	1,558	2,866	4,182	3,964	3,531
YoY growth (%)	41.6	83.9	45.9	-5.2	-10.9
Net profit (RMB m)	286	388	497	575	606
EPS (RMB)	0.240	0.325	0.417	0.482	0.508
EPS growth (%)	24.1	35.8	28.1	15.7	5.4
P/E (x)	14.7	10.8	8.5	7.3	6.9
Book value (Rmb)	3.40	3.55	3.87	4.22	4.57
P/B (x)	1.0	1.0	0.9	0.8	0.8
Dividend yield (%)	2.8	2.8	3.9	4.5	4.7

Source: Company, BOCOM Int'l estimates

- New projects fuelled robust earnings growth in FY16:** Yunnan Water (YNW) announced FY16 results with net profit surging 35.8% YoY to Rmb388m, in line with our estimate of Rmb393m. Driven by contribution from newly acquired projects and better growth in EPC revenue, solid waste and EPC/equipment sales segments brought in positive surprise with topline 29%/44% ahead of our estimates. However, the 4x jump in financing cost to Rmb220m, which was 64% higher than our expectation, partially offset the positives from the operation side. YNW announced a final dividend of Rmb0.1/share, representing 31% payout ratio (vs 42% in FY15).
- Diversified portfolio with big leap in size after acquiring GNS:** Regarding project operation, YNW owns 84/40 WWT/WS projects (52/23 in FY15) with total processing capacity of 2.43mt/1.57mt (1.02mt/0.65mt in FY15), with GNS' projects included. During FY16, utilization rate reached 71.7%/70.1%. For the solid waste segment, YNW had 4 hazardous waste treatment projects in operation, while the WTE project in Yuxi was still under construction. Other projects included WTE project (processing capacity of 700t/day) in Thailand and landfill project (processing capacity of 1kt/day) in Indonesia.
- Capex expected to remain at high level in FY17:** YNW's net gearing increased from 27.8% in FY15 to 57.4% in FY16 as a result of rapid M&A and more project wins. Total capex amounted to Rmb4.1bn in FY16. Management expects FY17 capex to stay high at Rmb4.2bn, given capex/working capital required for the PPP projects, the 3 new JVs and projects in GNS, as well as new M&A. As a result, we expect net gearing to further surge to 85.2% in FY17.
- Undemanding valuation should have factored in investors' concerns; Maintain Buy:** We adjust FY17-18E net profit forecast by -7.1%/+1.5% to factor in changes in project progress, operational data and gross profit assumptions. We leave our valuation benchmark unchanged at 12.5x 2017E P/E (25% discount to our 17x valuation benchmark to sector leader BEWG). Our target price is lowered from HK\$6.35 to HK\$5.88. We understand more time is needed for re-rating, given investors' concern on overall delivery of contribution from new projects after rapid M&As in FY16. We argue that the undemanding valuation of 8.5x 2017E P/E has factored in investors' concerns. Despite the cut in target price, we retain Buy on YNW.



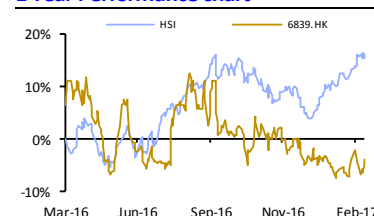
- YNW registered 35.8% YoY growth in net profit in FY16, in line with our expectation.
- WWT/WS capacity increased to 2.43mt/1.57mt after rapid M&As in FY16.
- We adjust 17E/18E earnings forecast by -7.1%/+1.5%. TP is lowered to HK\$5.88. Maintain Buy.

Stock data

52w High (HK\$)	4.85
52w Low (HK\$)	3.88
Market cap (HK\$m)	4,749.0
Issued shares (m)	1,193.2
Avg daily vol (m)	1.02
1-mth change (%)	-1.2
YTD change (%)	-2.2
50d MA (HK\$)	4.02
200d MA (HK\$)	4.20
14-day RSI	40.46

Source: Company data, Bloomberg

1 Year Performance chart



Source: Company data, Bloomberg

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Figure 1: Results highlights

	1H16	2H16	2015A	2016A	2016E	YoY%	Derivation
Revenue	868	1,998	1,558	2,866	2,628	83.9%	9.1%
Cost of sales	-590	-1,396	-1,051	-1,986	-1,807	89.0%	10.0%
Gross profit	278	602	508	880	821	73.3%	7.1%
Other income	44	116	98	160	146	64.4%	10.0%
Other gains — net	4	5	12	8	12	-32.4%	-32.4%
Selling expenses	-13	-10	-17	-23	-29	32.7%	-21.3%
Administrative expenses	-142	-189	-181	-331	-284	82.7%	16.6%
Operating profit	170	524	419	694	667	65.7%	4.2%
Finance costs — net	-63	-157	-41	-220	-134	434.4%	64.2%
Share of (loss)/profit of asso and jce	-0	42	5	42	0	766.2%	NM
Profit before income tax	107	410	383	517	533	35.0%	-3.0%
Income tax expenses	-17	-85	-65	-102	-91	56.6%	12.6%
Profit for the year	89	325	317	414	442	30.5%	-6.2%
MI	-9	-17	-32	-26	-48	-17.1%	-45.7%
Net profit	80	308	286	388	393	35.8%	-1.3%
GPM	32.0%	30.1%	32.6%	30.7%	31.2%		
OPM	19.6%	26.2%	26.9%	24.2%	25.4%		
NPM	9.2%	14.2%	18.3%	13.5%	15.0%		

	1H16	2H16	2015A	2016A	2016E	YoY%	Derivation
Revenue							
Wastewater treatment	252	376	420	628	737	49.6%	-14.7%
Water supply	309	330	455	639	706	40.7%	-9.4%
Solid waste	109	317	8	425	330	5073.7%	29.0%
EPC & Equipment Sales	166	944	597	1,110	769	85.9%	44.3%
Others	32	32	79	63	86	-19.5%	-26.8%
Total	868	1,998	1,558	2,866	2,628	83.9%	9.1%
Gross profit							
Wastewater treatment	128	190	208	318	298	53.1%	6.8%
Water supply	70	49	109	120	170	10.2%	-29.8%
Solid waste	31	57	1	88	129	6859.1%	-31.4%
EPC & Equipment Sales	38	292	144	330	176	128.5%	87.0%
Others	10	14	46	24	48	-48.5%	-50.4%
Total	278	602	508	879	821	73.3%	7.1%
Gross margin							
Wastewater treatment	50.8%	50.4%	49.4%	50.6%	40.4%		
Water supply	22.7%	15.0%	23.9%	18.7%	24.1%		
Solid waste	28.9%	18.0%	15.5%	20.8%	39.1%		
EPC & Equipment Sales	22.9%	30.9%	24.2%	29.7%	22.9%		
Others	31.1%	43.5%	58.3%	37.3%	55.0%		
Total	32.0%	30.1%	32.6%	30.7%	31.2%		

Source: The Company, BOCOM Int'l

Figure 2: Revenue and gross profit forecast

(Rmb m)	2015	2016	2017E	2018E	2019E
Revenue					
Wastewater treatment	420	628	735	726	663
Water supply	455	639	1,204	721	625
Solid waste	8	425	582	569	379
EPC & equipment sales	597	1,110	1,592	1,871	1,780
O&M	79	63	70	77	84
Total	1,558	2,866	4,182	3,964	3,531
Gross profit					
Wastewater treatment	208	318	389	467	486
Water supply	109	120	256	223	230
Solid waste	1	88	100	115	98
EPC & equipment sales	144	330	323	386	400
O&M	46	24	28	31	34
Total	508	880	1,095	1,221	1,248
Gross margin					
Wastewater treatment	49.4%	50.6%	52.9%	64.3%	73.3%
Water supply	23.9%	18.7%	21.3%	30.9%	36.8%
Solid waste	0%	20.8%	17.1%	20.1%	26.0%
EPC & equipment sales	24.2%	29.7%	20.3%	20.6%	22.5%
O&M	58.3%	37.3%	40.0%	40.0%	40.0%
Overall gross margin	32.6%	30.7%	26.2%	30.8%	35.4%

Source: Company data, BOCOM Int'l

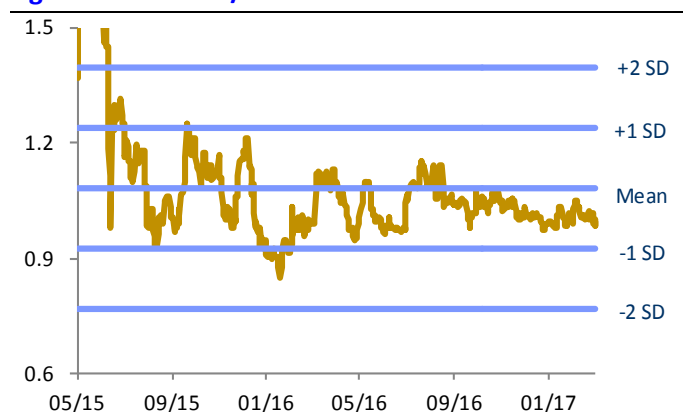
Figure 3: Change in forecast

	Old forecast			New forecast			Change		
	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Revenue (Rmb m)	4,032	3,637	NA	4,182	3,964	3,531	3.7%	9.0%	NA
Net profit (Rmb m)	535	567	NA	497	575	606	-7.1%	1.5%	NA
EPS (Rmb)	0.449	0.475	NA	0.417	0.482	0.508	-7.1%	1.5%	NA

Source: BOCOM Int'l estimates

Figure 4: Forward P/E band of YNW

Source: Bloomberg, BOCOM Int'l

Figure 5: Forward P/B band of YNW

Source: Bloomberg, BOCOM Int'l

Company background

Yunnan Water is one of the leading integrated environmental service providers in municipal wastewater treatment and water supply industries in Yunnan province. Major shareholders are Yunnan Metropolitan Construction (under Yunnan SASAC) and Beijing Origin Water (300070.CH; NR).

Yunnan Water (6839.HK): Financial Statements

Profit & loss (Rmb m)					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Wastewater treatment	420	628	735	726	663
Water supply	455	639	1,204	721	625
EPC & equip sales	597	1,110	1,592	1,871	1,780
O&M	79	63	70	77	84
Solid waste	8	425	582	569	379
Turnover	1,558	2,866	4,182	3,964	3,531
COGS	(1,051)	(1,986)	(3,087)	(2,743)	(2,283)
Gross profit	508	880	1,095	1,221	1,248
Other income	98	160	192	214	237
Other gains — net	12	8	12	12	12
Selling expenses	(17)	(23)	(33)	(32)	(28)
Administrative expenses	(181)	(331)	(418)	(476)	(494)
Operating profit	419	694	847	940	976
Net finance costs	(41)	(220)	(212)	(208)	(203)
Share of profit of jce/asso	5	42	5	5	5
Pre-tax profit	383	517	640	738	778
Income tax expense	(65)	(102)	(109)	(126)	(133)
After tax profit	317	414	530	612	645
Minority interest	(32)	(26)	(34)	(36)	(38)
Net profit	286	388	497	575	606

Balance sheet (Rmb m)					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Cash and cash equivalents	1,672	4,130	1,788	1,592	1,401
Inventory	21	27	61	54	45
Trade and other receivables	1,197	2,724	2,521	2,172	1,935
Other current assets	35	205	230	240	249
Total current assets	2,924	7,086	4,599	4,057	3,630
Property, plant and equipment	1,617	2,326	3,931	3,903	3,877
Rece. under concession	1,942	2,860	4,345	4,810	5,031
Amounts due for contract works	404	660	563	649	773
Other non-current assets	2,715	7,126	7,107	7,092	7,077
Total non-current assets	6,678	12,972	15,946	16,454	16,758
Short term borrowings	1,038	2,609	1,565	1,550	1,534
Trade and other payables	1,074	2,859	2,876	2,555	2,126
Other current liabilities	78	233	255	280	307
Total current liabilities	2,190	5,701	4,697	4,385	3,968
Long term borrowings	2,026	5,690	6,764	6,593	6,431
Other non-current liabilities	443	1,422	1,427	1,427	1,427
Total non-current liabilities	2,469	7,111	8,191	8,020	7,858
Paid in capital	1,193	1,193	1,193	1,193	1,193
Reserves	2,865	3,047	3,425	3,837	4,255
Equity attri. to shareholders	4,058	4,241	4,618	5,030	5,448
MI	884	3,006	3,039	3,076	3,114
Total Equity	4,943	7,246	7,658	8,106	8,562

Source: Company data, BOCOM Int'l estimates

Cash flow (Rmb m)					
Year ended 31 Dec	2015	2016E	2017E	2018E	2019E
Pre-tax profit	383	517	640	738	778
Tax paid	(80)	(82)	(87)	(101)	(106)
Dep'n and amortization	74	88	129	198	196
Change in working capital	(1,175)	(470)	(1,233)	(526)	(536)
Others	(56)	(42)	(5)	(5)	(5)
Cash from operations	(854)	10	(557)	303	326
Capital expenditure	(814)	(959)	(1,710)	(150)	(150)
Others	(517)	(668)	13	0	0
Cash from investing	(1,332)	(1,627)	(1,696)	(150)	(150)
Proceed from share issuance	1,514	0	0	0	0
Change in borrowings	1,835	5,234	31	(186)	(178)
Dividend paid	0	(119)	(119)	(163)	(189)
Others	(112)	0	0	0	0
Cash from financing	3,237	5,115	(89)	(349)	(366)
FX change	8	0	0	0	0
Net change in cash	1,059	3,498	(2,342)	(196)	(190)

Financial ratios					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Gross margin (%)	32.6	30.7	26.2	30.8	35.4
EBIT margin (%)	26.9	24.2	20.3	23.7	27.6
Net margin (%)	18.3	13.5	11.9	14.5	17.2
ROA (%)	3.0	1.9	2.4	2.8	3.0
ROE (%)	7.0	9.2	10.8	11.4	11.1
Net gearing (%)	27.8	57.4	85.2	80.6	76.4
Interest coverage (x)	10.2	3.2	4.0	4.5	4.8
Current ratio	1.3	1.2	1.0	0.9	0.9

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Rating System
Company Rating

Buy: Expect more than 20% upside in 12 months

LT Buy: Expect more than 20% upside but longer than 12 months

Neutral: Expect low volatility

Sell: Expect more than 20% downside in 12 months

Sector Rating

Outperform ("OP"): Expect more than 10% upside in 12 months

Market perform ("MP"): Expect low volatility

Underperform ("UP"): Expect more than 10% downside in 12 months

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