

Last Closing: HK\$ 3.15

Upside: +27%

Target Price: HK\$ 4.00↓

Environmental Sector

Yunnan Water (6839.HK)

Weak 1H17 results expected

UP MP OP

Financial Highlights

Y/E 31 Dec	2015	2016	2017E	2018E	2019E
Revenue (RMB m)	1,558	2,866	4,991	5,042	5,555
YoY growth (%)	41.6	83.9	74.1	1.0	10.2
Net profit (RMB m)	286	388	418	471	558
EPS (RMB)	0.240	0.325	0.350	0.395	0.468
EPS growth (%)	24.1	35.8	7.6	12.8	18.4
P/E (x)	11.4	8.4	7.8	6.9	5.8
BVPS (Rmb)	3.40	3.55	3.80	4.13	4.52
P/B (x)	0.8	0.8	0.7	0.7	0.6
Dividend yield (%)	3.7	3.7	2.6	2.9	3.4

Source: Company, BOCOM Int'l estimates

- 1H17 earnings muted on surging financing cost:** We estimate Yunnan Water (YNW) to post Rmb81m net profit for 1H17, up 1% YoY from Rmb80m net profit in 1H16. Total revenue and gross profit in 1H17 are expected to have surged 108%/67% YoY to Rmb1.8bn/Rmb463m, given: (i) the consolidation of the 24 wastewater and water supply projects from Galaxy Newspring (GNS), and (ii) contribution of EPC contracts from PPP projects. Overall GPM is estimated to have slid from 32.0% in 1H16 to 25.6% in 1H17, due to: (i) our conservative estimate of 10% operational GPM for GNS projects; and (ii) lower GPM for EPC revenue from PPP projects (15% vs 26% from other EPC and equipment sales). However, overall net profit was dragged by the 219% YoY increase in financing cost after YNW almost doubled its debt level (perpetual instruments inclusive) to Rmb11bn in 1H17 under our estimate.
- What has actually gone wrong?** We believe the overall development has derailed from our expectation, largely due to the slow contribution from newly acquired/obtained projects relative to the rising financing cost and increasing need for working capital. Our understanding is that YNW will slow down the pace of acquiring operational/greenfield wastewater or water supply projects, while seeking to secure more PPP projects with good return (IRR >5%). Overall, we slash our 2017-19E net profit by 16%/18%/8% to Rmb418m/471m/558m, respectively.
- More conservative TP to factor in lower earnings visibility:** We reset our valuation benchmark to 8.8x 2018E P/E, which is 1 S.D. below historical average forward P/E. Coupled with the earnings cut, we slash our target price from HK\$5.88 to HK\$4.00. We believe such valuation should have factored in: (i) earnings growth slowdown to 13% CAGR during 2016-19E from 24%/36% in 2015/16; (ii) uncertainty on slower-than-expected earnings recovery from projects under GNS; and (iii) increasing net gearing from 85% in 2016 to 94%/103% in 2017/18E, respectively.
- Negatives largely factored in, awaiting positive catalysts:** YNW is currently trading at 6.9x 2018E P/E, which has ~23% discount to peers. We believe the sharp correction in share price in recent month (down ~14% in past 30 days) should have factored in an even more bearish scenario of YoY decline in YNW's 2017E earnings. We argue that revenue from the PPP projects could partially compensate for the surge in financing cost, such that YNW should still post a moderate YoY gain of 7.6% in 2017E net profit. Given the distressed valuation, we still maintain Buy on YNW. Near-term catalyst could be the re-election of management board on Aug 28. We believe the new management board could bring in improvement plan on the overall project execution and reset corporate development.



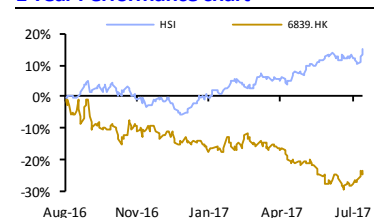
- We expect YNW to post weak 1H17 results with flattish growth YoY.
- We adjust 17E/18E/19E earnings forecast by -16%/-18%/-8% on slow contribution from new projects amid surging financing cost.
- We lower TP to HK\$4.00. Maintain Buy after sharp correction has sent valuation to distressed levels.

Stock data

52w High (HK\$)	4.85
52w Low (HK\$)	3.14
Market cap (HK\$ m)	3,758.6
Issued shares (m)	1,193.2
Avg daily vol (m)	1.03
1-mth change (%)	-13.7
YTD change (%)	-22.6
50d MA (HK\$)	3.48
200d MA (HK\$)	3.88
14-day RSI	25.07

Source: Company data, Bloomberg

1 Year Performance chart



Source: Company data, Bloomberg

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Figure 1: Earnings forecast

Y/E 31 Dec (RMB m)	2016	2017E	1H16	2H16	1H17E	2H17E
Revenue	2,866	4,991	868	1,998	1,807	3,183
Cost of sales	(1,986)	(3,759)	(590)	(1,396)	(1,344)	(2,415)
Gross profit	880	1,231	278	602	463	768
Other income	160	184	44	116	51	133
Other gains	8	12	4	5	5	7
Selling expenses	(23)	(40)	(13)	(10)	(23)	(17)
Administrative expenses	(331)	(399)	(142)	(189)	(184)	(216)
Operating profit	694	988	170	524	313	675
Finance costs - net	(220)	(439)	(63)	(157)	(202)	(237)
Share of p/l of asso and jce	42	5	(0)	42	2	3
Profit before income tax	517	554	107	410	113	441
Income tax expenses	(102)	(110)	(17)	(85)	(22)	(88)
Profit for the year	414	444	89	325	90	354
MI	(26)	(27)	(9)	(17)	(9)	(17)
Net profit	388	418	80	308	81	336
GPM (%)	30.7	24.7	32.0	30.1	25.6	24.1
OPM (%)	24.2	19.8	19.6	26.2	17.3	21.2
NPM (%)	13.5	8.4	9.2	15.4	4.5	10.6

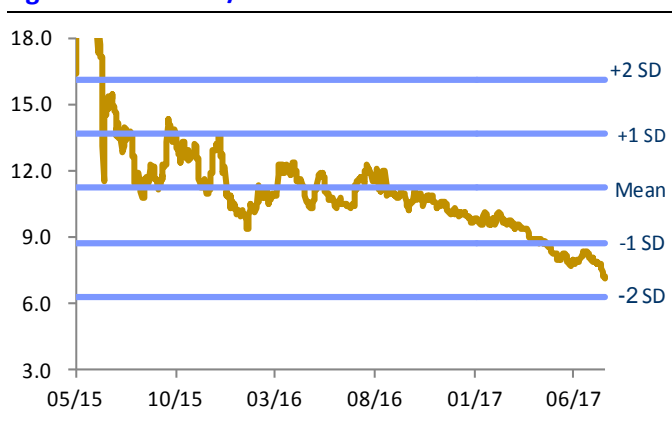
Source: Company data, BOCOM Int'l

Figure 2: Change in forecast

	Old forecast			New forecast			Change (%)		
	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Revenue (RMB m)	4,182	3,964	3,531	4,991	5,042	5,555	19.3	27.2	57.3
Net profit (RMB m)	497	575	606	418	471	558	-16.0	-18.1	-7.9
EPS (RMB)	0.417	0.482	0.508	0.350	0.395	0.468	-16.0	-18.1	-7.9

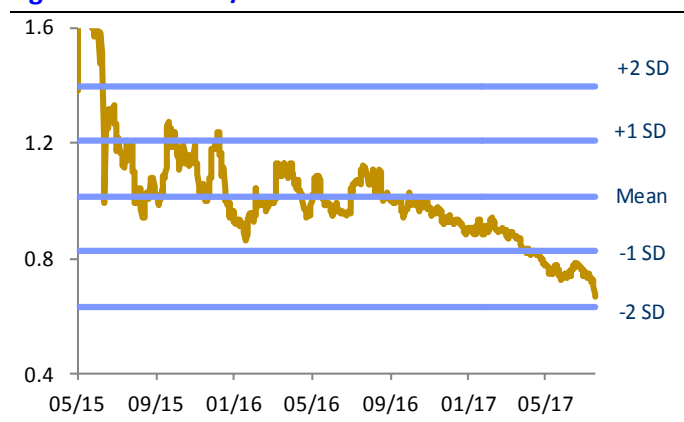
Source: BOCOM Int'l estimates

Figure 3: Forward P/E band of YNW



Source: Bloomberg, BOCOM Int'l

Figure 4: Forward P/B band of YNW



Source: Bloomberg, BOCOM Int'l

Figure 5: Valuation summary

Company name	Stock ticker	Rating	TP	CP	Reporting Currency	EPS		EPS Consensus		P/E		P/B		Yield FY17E (%)
						FY17E	FY18E	FY17E	FY18E	FY17E (x)	FY18E (x)	FY17E (x)	FY18E (x)	
Environment			(HK\$)	(HK\$)										
BEWG	371 HK	Buy	7.55	6.42	HKD	0.444	0.573	0.461	0.576	14.4	11.2	3.0	2.5	2.2
Kangda	6136 HK	Buy	2.35	1.49	RMB	0.219	0.267	0.220	0.265	5.8	4.8	0.7	0.6	2.3
YN Water	6839 HK	Buy	4.00	3.15	RMB	0.350	0.395	0.460	0.538	7.8	6.9	0.7	0.7	2.6
Canvest	1381 HK	Buy	5.16	4.27	HKD	0.240	0.290	0.242	0.306	17.8	14.7	2.2	2.0	0.8
CEG	1257 HK	Buy	7.00	5.47	HKD	0.445	0.585	0.475	0.563	12.3	9.4	1.2	1.1	0.0
CTEG	1363 HK	Neutral	1.73	1.41	RMB	0.109	0.126	0.111	0.136	11.0	9.5	1.9	1.6	2.6
CEI	257 HK	NA	NA	10.34	HKD	NA	NA	0.769	0.908	13.4	11.4	2.3	2.0	2.5
Dynagreen	1330 HK	NA	NA	3.93	RMB	NA	NA	0.442	0.519	7.6	6.5	1.1	0.9	2.3
Dongjiang	895 HK	NA	NA	10.40	RMB	NA	NA	0.574	0.701	15.4	12.6	2.0	1.7	0.7
Average										11.7	9.7	1.7	1.5	1.8

Source: Bloomberg, BOCOM Int'l estimates for covered stocks

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	860	881	864
Water supply	455	639	1,368	709	657
EPC & equip sales	597	1,110	2,224	2,986	3,525
O&M	79	63	70	77	84
Solid waste	8	425	470	390	425
Turnover	1,558	2,866	4,991	5,042	5,555
COGS	(1,051)	(1,986)	(3,759)	(3,618)	(3,921)
Gross profit	508	880	1,231	1,424	1,634
Other income and gains	98	160	184	212	233
Selling & distribution expenses	12	8	12	12	12
Administrative expenses	(17)	(23)	(40)	(40)	(44)
Other expenses	(181)	(331)	(399)	(479)	(583)
Operating profit	419	694	988	1,128	1,252
Net finance costs	(41)	(220)	(439)	(508)	(517)
Share of profit of jce/asso	5	42	5	5	5
Pre-tax profit	383	517	554	625	740
Income tax expense	(65)	(102)	(110)	(124)	(147)
After tax profit	317	414	444	501	593
Minority interest	(32)	(26)	(27)	(30)	(36)
Net profit	286	388	418	471	558

Balance sheet (RMB m)

Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Cash and cash equivalents	1,672	4,130	2,794	1,699	1,615
Inventory	21	27	74	71	77
Trade and other receivables	1,197	2,724	2,724	3,177	3,044
Other current assets	35	205	235	259	284
Total current assets	2,924	7,086	5,826	5,205	5,020
Property, plant and equipment	1,617	2,326	3,781	3,760	3,740
Rece. under concession	1,942	2,860	4,436	5,627	6,840
Amounts due for contract works	404	660	834	1,030	1,265
Other non-current assets	2,715	7,126	6,875	6,639	6,419
Total non-current assets	6,678	12,972	15,925	17,057	18,265
Short term borrowings	1,038	2,609	2,739	2,712	2,685
Trade and other payables	1,074	2,859	3,502	3,371	3,652
Other current liabilities	78	233	255	280	309
Total current liabilities	2,190	5,701	6,496	6,363	6,647
Long term borrowings	2,026	5,690	5,062	5,289	5,528
Other non-current liabilities	443	1,422	1,422	1,422	1,422
Total non-current liabilities	2,469	7,111	6,483	6,711	6,950
Paid in capital	1,193	1,193	1,193	1,193	1,193
Reserves	2,865	3,047	3,346	3,733	4,197
Equity attri. to shareholders	4,058	4,241	4,539	4,927	5,390
MI	884	3,006	4,233	4,263	4,298
Total Equity	4,943	7,246	8,771	9,189	9,688

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	554	625	740
Tax paid	(80)	(63)	(88)	(99)	(117)
Dep'n and amortization	74	210	362	411	395
Change in working capital	(1,175)	(1,683)	(1,183)	(1,993)	(1,064)
Others	(56)	(70)	(5)	(5)	(5)
Cash from operations	(854)	(1,088)	(360)	(1,062)	(51)
Capital expenditure	(814)	(1,796)	(1,560)	(150)	(150)
Others	(517)	(1,416)	0	0	0
Cash from investing	(1,332)	(3,212)	(1,560)	(150)	(150)
Proceed from share issuance	1,514	0	0	0	0
Change in borrowings	1,835	6,810	703	200	212
Dividend paid	0	(119)	(119)	(84)	(94)
Others	(112)	47	0	0	0
Cash from financing	3,237	6,738	583	117	118
FX change	8	21	0	0	0
Net change in cash	1,059	2,458	(1,336)	(1,095)	(84)

Financial ratios

Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Gross margin (%)	32.6	30.7	24.7	28.2	29.4
EBIT margin (%)	26.9	24.2	19.8	22.4	22.5
Net margin (%)	18.3	13.5	8.4	9.3	10.0
ROA (%)	3.0	1.9	1.9	2.1	2.4
ROE (%)	7.0	9.2	9.2	9.6	10.3
Net gearing (%)	27.8	85.0	93.5	103.3	101.0
Interest coverage (x)	10.2	3.2	2.3	2.2	2.4
Current ratio	1.3	1.2	0.9	0.8	0.8

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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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