

Last Closing: HK\$4.50

Upside: +54%

Target Price: HK\$6.68→

Environmental Sector

## Yunnan Water (6839.HK)

### Takeaways from teleconference on recent acquisition



#### Financial Highlights

Y/E 31 Dec	2014	2015	2016E	2017E	2018E
Revenue (Rmb m)	1,101	1,558	2,893	3,313	3,077
YoY growth (%)	59.8	41.6	85.6	14.5	-7.1
Net profit (Rmb m)	166	287	409	502	579
EPS (Rmb)	0.193	0.240	0.343	0.421	0.485
Vs. Consensus (+/- %)			-0.1	-1.5	-10.1
EPS growth (%)	-28.4	24.5	42.5	22.8	15.3
P/E (x)	19.6	15.7	11.0	9.0	7.8
P/B (x)	1.4	1.1	1.0	1.0	0.9
Dividend yield (%)	0.0	2.6	3.8	4.2	4.8

Source: Company, BOCOM Int'l estimates

- **We hosted a teleconference with YNW's management on August 1 to obtain the details of the recent acquisition of 50% stake in 24 water treatment projects. Mr. Wang Yong (CFO) and Mr. Zhang Liang (board secretary) joined the conference.**
- **Further geographical expansion in Eastern China:** The target company owns 9 water supply projects (840kt/day of total capacity), 12 wastewater treatment projects (555kt/day of total capacity) and 3 reclaimed water projects (145kt/day of total capacity). These 24 projects are mainly located in 10 major cities in Eastern China (including Liaoning, Hebei, Jiangsu, Tianjin, Shandong).
- **IRR target of >11% after YNW's takeover:** Concerning the loss-making situation of the target company, YNW's management is confident that administrative expenses could be reduced after YNW's takeover. Meanwhile, YNW expects the delayed payment of water treatment fee to the target company from some local governments could be collected, so further impairment of receivables would be limited. Also, there could be potential increase in treatment fee in some of the water treatment projects since local governments should fulfill the conditions stated in the BOT contracts. YNW targets to turn around the target company within 1-2 years upon takeover. Moreover, including some of the technical upgrades to be done, YNW's management estimates the target company could achieve IRR of >11%.
- **Bank/debt financing plan for the acquisition:** Regarding the acquisition of the first 50% stake of the target company from Mitsui, management of YNW plans to fund the consideration with internal resources (40%) and overseas debt issue (60%). Currently, YNW is arranging the refinancing of around US\$110mn bank borrowings of the target company.
- **Awaiting the acquisition of remaining 50% stake from Hyflux.** Management of YNW indicated that they are eager to complete the acquisition of the remaining 50% stake from Hyflux as soon as possible. We view this as a crucial step in the turnaround process of the target company, given YNW could start the cost saving measures and negotiation with local governments. Looking forward, YNW's management indicated they will only work on 2-3 acquisitions apart from this deal so that they can centralize resources on execution.



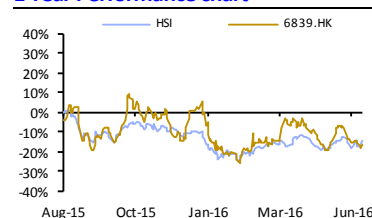
- YNW could achieve further geographical expansion as the target company owns water projects mainly in Eastern China.
- IRR of the target company could reach >11% after the acquisition is completed.
- It is expected that YNW will finance the acquisition with internal resources and further debt issue.

#### Stock data

52w High (HK\$)	5.44
52w Low (HK\$)	3.55
Market cap (HK\$m)	5,369.5
Issued shares (m)	1,193.2
Avg daily vol (m)	0.97
1-mth change (%)	11.1
YTD change (%)	-12.6
50d MA (HK\$)	4.17
200d MA (HK\$)	4.36
14-day RSI	70.22

Source: Company data, Bloomberg

#### 1 Year Performance chart



Source: Company data, Bloomberg

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**Figure 1: Water treatment projects of the target company**

Location	Project type	Capacity in operation (kt/day)	Capacity under concession (kt/day)
Liaoning	Water supply	40	40
	Wastewater treatment	60	60
	Reclaimed water	50	50
Hebei	Water supply	40	40
	Wastewater treatment	80	260
	Reclaimed water	40	45
Anhui	Water supply	35	35
	Wastewater treatment	50	50
Chongqing	Wastewater treatment	20	20
Hubei	Water supply	60	170
Jiangxi	Water supply	30	30
Tianjin	Wastewater treatment	50	100
	Reclaimed water	5	50
Shandong	Water supply	50	100
Zhejiang	Wastewater treatment	40	100
Jiangsu	Wastewater treatment	150	250
	Water supply	140	140
<b>Total</b>		<b>940</b>	<b>1,540</b>

Source: Company data, 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	2014	2015	2016E	2017E	2018E
Wastewater treatment	384	420	742	419	466
Water supply	216	455	730	1,010	504
EPC & equip sales	470	597	704	844	1,012
O&M	31	79	94	113	136
WTE & hazardous waste	0	8	623	927	959
<b>Turnover</b>	<b>1,101</b>	<b>1,558</b>	<b>2,893</b>	<b>3,313</b>	<b>3,077</b>
COGS	(767)	(1,051)	(2,009)	(2,228)	(1,893)
<b>Gross profit</b>	<b>334</b>	<b>508</b>	<b>884</b>	<b>1,085</b>	<b>1,184</b>
Other income and gains	49	98	105	96	93
Selling & distribution expenses	3	12	0	0	0
Administrative expenses	(13)	(17)	(32)	(37)	(34)
Other expenses	(126)	(181)	(289)	(311)	(289)
<b>Operating profit</b>	<b>247</b>	<b>419</b>	<b>667</b>	<b>833</b>	<b>954</b>
Net finance costs	(31)	(41)	(119)	(150)	(154)
Share of profit of jce/asso	11	5	5	5	5
<b>Pre-tax profit</b>	<b>226</b>	<b>383</b>	<b>553</b>	<b>688</b>	<b>805</b>
Income tax expense	(38)	(65)	(95)	(118)	(137)
<b>After tax profit</b>	<b>188</b>	<b>317</b>	<b>459</b>	<b>571</b>	<b>667</b>
Minority interest	(21)	(32)	(50)	(68)	(88)
<b>Net profit</b>	<b>166</b>	<b>287</b>	<b>409</b>	<b>502</b>	<b>579</b>

#### Balance sheet (Rmb m)

Year ended 31 Dec	2014	2015	2016E	2017E	2018E
Cash and cash equivalents	613	1,672	956	375	396
Inventory	12	21	39	44	37
Trade and other receivables	845	1,197	1,982	1,997	1,686
Other current assets	24	35	63	77	92
<b>Total current assets</b>	<b>1,494</b>	<b>2,924</b>	<b>3,040</b>	<b>2,493</b>	<b>2,211</b>
Property, plant and equipment	1,379	1,617	2,503	2,924	2,942
Rece. under concession	1,445	1,942	2,728	3,335	3,660
Amounts due for contract works	194	404	510	713	961
Other non-current assets	508	2,715	2,716	2,718	2,723
<b>Total non-current assets</b>	<b>3,526</b>	<b>6,678</b>	<b>8,458</b>	<b>9,690</b>	<b>10,286</b>
Short term borrowings	270	1,074	1,128	1,162	1,197
Trade and other payables	877	1,038	1,927	2,075	1,763
Other current liabilities	71	78	97	120	148
<b>Total current liabilities</b>	<b>1,218</b>	<b>2,190</b>	<b>3,152</b>	<b>3,357</b>	<b>3,108</b>
Long term borrowings	869	2,026	2,621	2,702	2,787
Other non-current liabilities	212	443	443	443	443
<b>Total non-current liabilities</b>	<b>1,081</b>	<b>2,469</b>	<b>3,064</b>	<b>3,145</b>	<b>3,230</b>
Paid in capital	863	1,193	1,193	1,193	1,193
Reserves	1,522	2,865	3,155	3,485	3,876
<b>Equity attri. to shareholders</b>	<b>2,384</b>	<b>4,058</b>	<b>4,348</b>	<b>4,678</b>	<b>5,069</b>
MI	337	884	934	1,003	1,091
<b>Total Equity</b>	<b>2,721</b>	<b>4,943</b>	<b>5,282</b>	<b>5,681</b>	<b>6,160</b>

Source: Company data, BOCOM Int'l estimates

#### Cash flow (Rmb m)

Year ended 31 Dec	2014	2015	2016E	2017E	2018E
Pre-tax profit	226	383	553	688	805
Tax paid	(54)	(80)	(76)	(94)	(110)
Dep'n and amortization	58	74	77	117	132
Change in working capital	(739)	(1,175)	(835)	(696)	(583)
Others	(33)	(56)	(5)	(5)	(5)
<b>Cash from operations</b>	<b>(542)</b>	<b>(854)</b>	<b>(285)</b>	<b>10</b>	<b>239</b>
Capital expenditure	(442)	(814)	(959)	(534)	(150)
Others	139	(517)	0	0	0
<b>Cash from investing</b>	<b>(304)</b>	<b>(1,332)</b>	<b>(959)</b>	<b>(534)</b>	<b>(150)</b>
Capital injections from shareholder	294	0	0	0	1
Proceed from share issuance	0	1,514	0	0	0
Change in borrowings	542	1,835	649	115	120
Dividend paid	(111)	0	(119)	(172)	(188)
Others	(25)	(112)	0	0	0
<b>Cash from financing</b>	<b>701</b>	<b>3,237</b>	<b>529</b>	<b>(57)</b>	<b>(68)</b>
FX change	(0)	8	0	0	0
<b>Net change in cash</b>	<b>(145)</b>	<b>1,059</b>	<b>(715)</b>	<b>(581)</b>	<b>21</b>

#### Financial ratios

Year ended 31 Dec	2014	2015	2016E	2017E	2018E
Gross margin (%)	30.3	32.6	30.5	32.8	38.5
EBIT margin (%)	22.4	26.9	23.1	25.2	31.0
Net margin (%)	15.1	18.4	14.1	15.2	18.8
ROA (%)	3.3	3.0	3.6	4.1	4.6
ROE (%)	7.0	7.1	9.4	10.7	11.4
Net gearing (%)	22.1	34.7	63.8	74.1	70.4
Interest coverage (x)	7.8	10.2	5.6	5.5	6.2
Current ratio	1.2	1.3	1.0	0.7	0.7

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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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