



Beijing Enterprises Water (371 HK) Strong capacity growth to boost earnings

- Beijing Enterprises Water (BEW) reported a 28% YoY growth in adjusted net profit in FY16, which is 2% below our estimate
- Benefiting from the Public-Private Partnership (PPP) business model much promoted by the Chinese government, we see BEW's EPC revenue would increase by 44%/30%YoY for 2017E/18E
- BEW's strong pipeline would boost growth in operation capacity. For 2017E/18E, we estimate wastewater capacity would expand by 18%/14%YoY while water distribution capacity would grow by 20%/15%YoY
- Maintain BUY** with TP of HK\$7.60, implying 17x 2017E P/E and 3.1x 2017E P/B

EPC business revenue would continue to grow by 44%/30%YoY in 2017E/18E. We believe BEW would benefit from the PPP business model much promoted by the Chinese government. We estimate EPC revenue would increase by 44%/30%YoY in 2017E/18E.

Wastewater capacity to expand by 18%/14% YoY in 2017E/18E. Given BEW currently has a wastewater capacity of 5.2mt/day under construction, equivalent to 49% of its existing operating capacity. Management said it would add 3mt/day of new capacity (wastewater and water distribution) in 2017. Based on these information, we estimate wastewater capacity would increase by 1.9mt/day in 2017E, representing an 18% YoY growth. Going forward, BEW would continue to expand its wastewater capacity and we expect a 14%YoY growth for 2018E.

Water distribution capacity to expand by 20%/15% YoY in 2017E/18E. For its water distribution operation business, we estimate BEW's capacity would expand by 1.1mt/day in 2017E (+20%YoY). With the rising demand for urban water distribution service driven by urbanization, we expect a 15%YoY capacity growth for 2018E.

TP at HK\$7.60; maintain BUY. We revise our assumptions for the EPC segment on increased optimism and fine-tune our projections for wastewater and water distribution based on the latest data. Our DCF-derived TP at HK\$7.60 (HK\$7.00 previously) implies 17x 2017E P/E and 3.1x 2017E P/B. With a promising 3-year EPS CAGR in 2016-19E at 24%, our TP that implies a PEG of 0.7 is realistically achievable in our view. **Maintain BUY.**

Risks. (1) Slower-than-expected capacity growth; (2) Default risk; (3) Policy risk; (4) High net gearing ratio; (5) Negative cash flow.

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (HK\$ mn)	13,503	17,355	23,963	30,173	35,932
Chg (% YoY)	51.3	28.5	38.1	25.9	19.1
Adj. net profit (HK\$ mn)	2,202	2,817	3,823	4,588	5,367
Chg (% YoY)	22.7	27.9	35.7	20.0	17.0
EPS (HK\$)	0.253	0.323	0.438	0.525	0.614
Chg (% YoY)	21.7	28.0	35.3	20.0	17.0
BVPS (HK\$)	1.857	1.894	2.467	2.834	3.264
Chg (% YoY)	1.7	2.0	30.2	14.9	15.2
P/E (x)	23.79	18.59	13.74	11.45	9.78
P/B (x)	3.24	3.17	2.44	2.12	1.84
ROE (%)	15.17	19.56	17.74	18.53	18.82
ROA (%)	3.81	3.98	3.87	3.89	3.91
DPS (HK\$)	0.095	0.119	0.131	0.158	0.184
Dividend yield (%)	1.58	1.98	2.18	2.62	3.07
Net gearing (%)	131.0	133.8	159.8	180.6	190.4

Source(s): Bloomberg, ABCI Securities estimates

Company Report

May 22, 2017

Rating: **BUY**
TP: **HK\$ 7.60**

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Share price (HK\$)	6.01
Est. share price return	26.5%
Est. dividend yield	2.2%
Est. total return	28.6%
Previous Rating & TP	BUY
Previous Report Date	Feb 27, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	6.4/4.2
Issued shares (mn)	8,738
Market cap (HK\$ mn)	53,387
3-mth avg daily turnover(HK\$ mn)	105
Major shareholder(s) (%):	
Beijing Enterprises Hld	43.9%

Source(s): Company, ABCI Securities

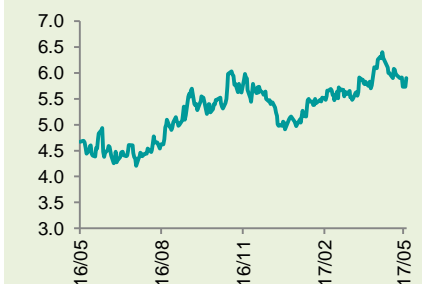
Share price performance

	Absolute	Relative*
1-mth	2.18	(1.13)
3-mth	10.71	10.96
6-mth	8.73	(1.19)

*Relative to HSCEI

Source(s): Bloomberg, ABCI Securities

1-Year sector performance(HK\$)



Source(s): Bloomberg, ABCI Securities



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Beijing Enterprises Water (371 HK, BUY)

China's Environmental Protection Sector

May 22, 2017

2016 results highlight

FY16 earnings missed consensus

Beijing Enterprises Water (BEW) has announced its FY16 results on Mar 30, 2017. Net profit was HK\$3.2bn (+31%YoY). Excluding fair value change of derivative instruments, net profit was HK\$2.8bn (+28%YoY), 8%/2% lower than Bloomberg consensus/our estimates. Installed wastewater capacity grew 19%YoY; wastewater treatment volume also increased 19%YoY; installed water distribution capacity soared 44%YoY and supply volume jumped 60%YoY.

19%YoY growth in wastewater capacity in 2016

BEW's wastewater capacity was 10.7mt/day in 2016, representing a 19%YoY increase over the 9mt/day at end-2015. Hence, wastewater treatment volume was up 19% YoY in 2016.

Water distribution capacity jumped 44%YoY, boosting volume of water supply

BEW recorded a water distribution capacity of 5.7mt/day in 2016, 44%YoY higher than 4mt/day capacity by end-2015. Such strong capacity growth contributed to the higher water supply volume that rose 60%YoY in 2016.

13%/3%YoY decline in wastewater/water supply tariffs drag earnings.

BEW's average wastewater and water supply tariffs were HK\$ 1.16/t (ex. VAT) and HK\$ 1.3/t (ex. VAT), 13%YoY and 3%YoY lower than those of 2015. The decline was mainly due to increased exposure in lower-tier cities that usually have lower tariffs, dragging down the overall earnings.

Net gearing ratio high at 134% prompts fundraising concern.

Net gearing ratio improved from 163% in 1H16 to 134% in 2016. The high gearing level will continue prompt fundraising concerns. More M&A can be expected since BEW would seek to expand its wastewater and water distribution BOT businesses. Hence, future net gearing ratio is likely to stay at ~100%.

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May 22, 2017

Results summary		2015	2016	YoY
Income Statement				
Revenue	HK\$m	13,503	17,355	29%
Operation income	HK\$m	8,331	11,309	36%
EPC	HK\$m	4,396	5,025	14%
Others	HK\$m	776	1,021	32%
Op. profit	HK\$m	3,948	5,058	28%
Net profit	HK\$m	2,455	3,227	31%
Adj. Net profit	HK\$m	2,202	2,817	28%
Basic EPS	HK\$	0.28	0.37	31%
Adj. EPS	HK\$	0.25	0.32	28%
Ratios				
Op. margin	%	29.2%	29.1%	-0.1ppt
Net margin	%	16.3%	16.2%	-0.1ppt
ROE	%	13.6%	17.1%	3.5ppt
ROA	%	3.4%	3.5%	0.1ppt
Net gearing/(Net cash)	%	131%	134%	2.8ppt
Wastewater				
Installed capacity	mt/day	9.0	10.7	19%
Treatment volume	mt	2,640	3,150	19%
Tariff	HK\$/t, ex VAT	1.33	1.16	-13%
Water distribution				
Installed capacity	mt/day	4.0	5.7	44%
Supply volume	mt	659.0	1,054.1	60%
Tariff	HK\$/t, ex VAT	1.34	1.30	-3%

Source(s): Company data



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2017 outlook

EPC business revenue would continue to increase by 44%/30%YoY in 2017E/18E

China's increased effort in improving urban wastewater treatment would support BEW. The promotion of Public-Private Partnership (PPP) business model signals that the government will fully utilize private capital to finance the construction of environmental protection facilities, and the increase in PPP projects will benefit BEW. During the FY16 results briefing, management guided that the EPC revenue would increase by 45%YoY for 2017. With more private capital entering the environmental protection business, BEW's EPC business would record strong growth with the segment's revenue increasing by 44%/30%YoY in 2017E/18E.

Wastewater capacity to expand by 18%/14% YoY in 2017E/18E

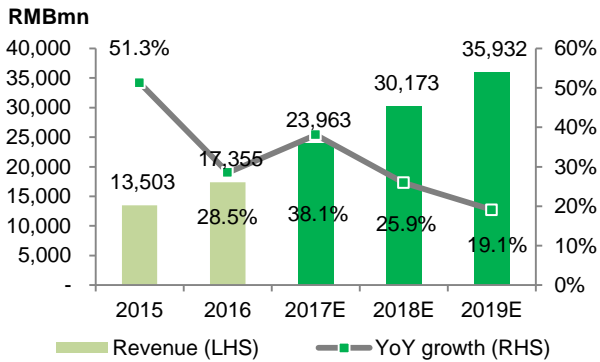
We expect BEW's wastewater capacity to record a double-digit growth in coming years. With 5.2mt/day of wastewater capacity under construction (equivalent to 49% of its existing operating capacity) and 3mt/day of new capacity (wastewater and water distribution) to be added in 2017, as guided by the management, we estimate wastewater capacity would expand by 1.9mt/day in 2017E, representing an 18% YoY capacity growth. Going forward, BEW would continue to expand its wastewater capacity and we expect a 14%YoY growth for 2018E.

Water distribution capacity to expand by 20%/15% YoY in 2017E/2018E

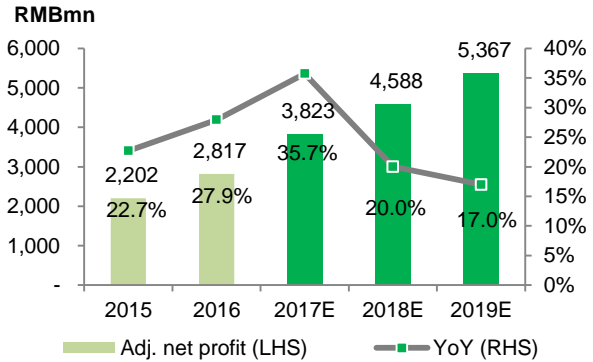
For the water distribution operation business, the Group currently has a capacity of 5.5mt/day under construction, equivalent to 95% of its existing operating capacity. We estimate the Group's capacity would increase by 1.1mt/day in 2017E (+20% YoY). With the rising demand for urban water distribution service driven by urbanization, we expect a 15%YoY capacity growth for 2018E.

Net gearing ratio would trend up

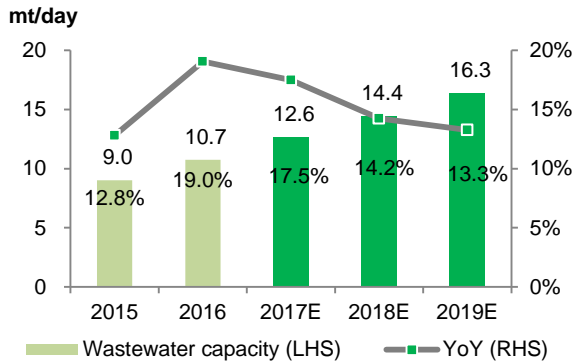
Supported by China's increased tackling of environmental issues, BEW would continue to expand its wastewater, water distribution and EPC businesses in the coming decade. With the aggressive expansion plans, we estimate net gearing ratio would be ~160% in 2017E and continue to trend up over the next few years. Fundraising activities may occur in the near term.

Exhibit 1: BEW would show strong revenue growth on more EPC projects and increasing scale of operation


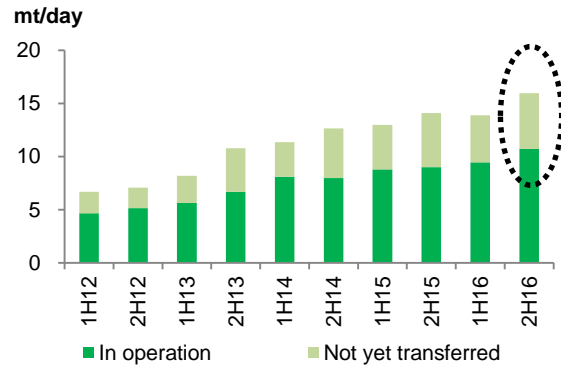
Source(s): Company, ABCI Securities estimates

Exhibit 2: BEW's net profit would show impressive growth in 2017E and 2018E


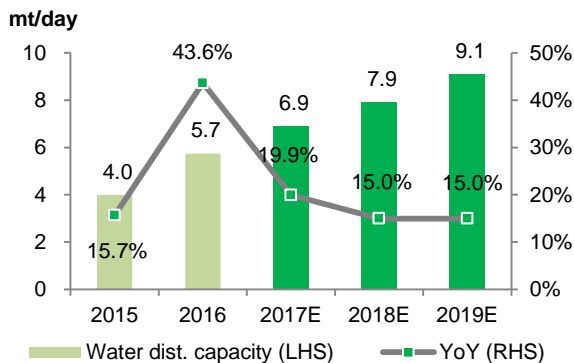
Source(s): Company, ABCI Securities estimates

Exhibit 3: BEW's wastewater treatment capacity would expand at mid-teens levels in coming years


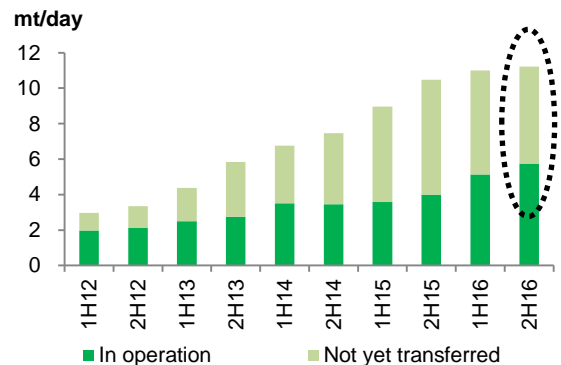
Source(s): Company, ABCI Securities estimates

Exhibit 4: BEW has numerous wastewater treatment projects in the pipeline


Source(s): Company, ABCI Securities

Exhibit 5: BEW's water distribution capacity would continue to grow strongly


Source(s): Company, ABCI Securities estimates

Exhibit 6: Numerous water distribution projects on hand suggests robust capacity growth ahead


Source(s): Company, ABCI Securities



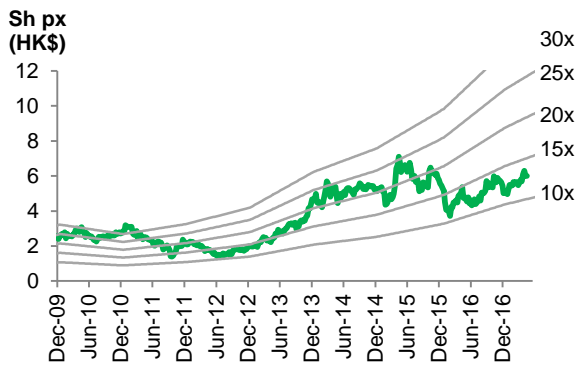
Valuation

TP at HK\$7.60; maintain BUY

BEW's 2016 results fell slightly below our forecasts. With the Group's aggressive expansion plan and numerous projects in the pipeline, we estimate its wastewater/water distribution capacities would expand by 18%/20%YoY for 2017E. Supported by the government's promotion of the PPP business model nationwide, we estimate EPC revenue is likely to jump 44%YoY in 2017E. Adjusted net profit for 2017E/18E would increase by 36%/20%YoY for 2017E/18E.

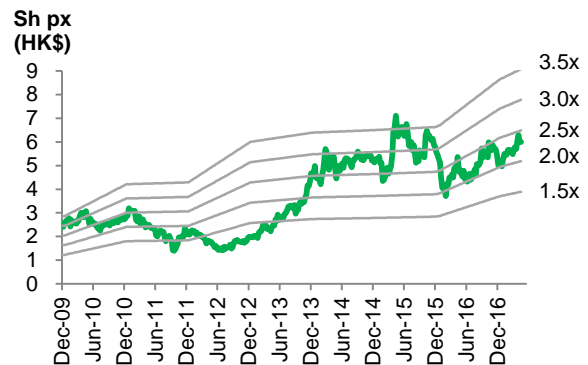
We revise our assumptions for the EPC segment on increased optimism and fine-tune our projections for wastewater and water distribution segments based on the latest data. Our DCF-derived TP at HK\$7.60 (HK\$7.00 previously) implies 17x 2017E P/E and 3.1x 2017E P/B. With a promising 3-year EPS CAGR in 2016-19E at 24%, our TP that implies a PEG of 0.7 is attractive. Maintain BUY.

Exhibit 7: BEW's fwd P/E chart



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 8: BEW's fwd P/B chart



Source(s): Bloomberg, ABCI Securities estimates



Consolidated income statement

FY Ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Revenue	13,503	17,355	23,963	30,173	35,932
EPC	8,331	11,309	16,293	21,181	25,418
Operation income	4,396	5,025	5,833	6,787	7,868
Other	776	1,021	1,838	2,205	2,646
Cost of sales	-8,536	-11,570	-16,278	-20,754	-24,772
Gross Profit	4,967	5,785	7,685	9,419	11,160
SG&A expenses	-1,226	-1,538	-2,157	-2,716	-3,234
Net financial income (cost)	-831	-1,198	-1,265	-1,657	-2,053
Other income/ (expenses)	635	1,595	1,174	1,478	1,761
Profit before tax	3,546	4,644	5,437	6,525	7,633
Tax	-778	-971	-1,142	-1,370	-1,603
Net profit	2,768	3,673	4,296	5,155	6,030
Profit attributable to:					
Minority interest	-312	-389	-473	-567	-663
Equity shareholders of the Company	2,455	3,227	3,823	4,588	5,367
Adj. Equity shareholders of the Company	2,202	2,817	3,823	4,588	5,367
Basic EPS (HK\$)	0.282	0.370	0.438	0.525	0.614
Adj. EPS (HK\$)	0.253	0.323	0.438	0.525	0.614
DPS (HK\$)	0.095	0.119	0.131	0.158	0.184

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet

As of Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Current assets	18,153	21,975	22,471	25,295	28,481
Cash	6,374	10,921	7,438	6,567	6,329
Pledged and restricted bank deposits	269	135	0	0	0
Trade and bill receivables	2,959	3,024	4,596	5,787	6,891
Other receivables and prepayments	6,746	6,348	9,191	11,573	13,782
Inventories	99	91	446	569	679
Other current assets	1,705	1,456	800	800	800
Non-current assets	46,339	59,072	76,275	92,724	108,739
Property, plant & equipment	1,380	2,831	4,100	5,200	6,504
Investment properties	0	0	0	0	0
Intangible assets	3,005	3,374	4,007	4,599	5,304
Investment in JV and associates	4,466	5,685	6,274	6,919	7,690
Other receivables and deposits	23,253	26,032	34,174	42,680	50,568
Other non-current assets	14,235	21,150	27,719	33,326	38,672
Total Assets	64,492	81,047	98,746	118,019	137,220
Current Liabilities	17,773	20,615	27,516	35,376	43,619
Trade and bill payables	5,786	9,843	11,150	14,215	16,967
Other payables	5,309	5,907	7,340	9,179	10,830
Short term borrowings	6,615	4,812	9,026	11,982	15,822
Other current assets	63	52	0	0	0
Non-current liabilities	26,428	33,665	38,938	46,572	53,110
Deferred tax liabilities	1,321	1,691	1,500	1,500	1,500
Long-term borrowings	21,226	28,326	32,851	39,321	44,812
Other non-current assets	3,881	3,648	4,587	5,752	6,797
Total Liabilities	44,201	54,280	66,454	81,949	96,729
Minority interests	4,107	3,961	4,434	5,001	5,664
Perpetual capital instruments	0	6,305	6,305	6,305	6,305
Shareholders' equities	16,184	16,501	21,553	24,765	28,522

Source(s): Company, ABCI Securities estimates



FY ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Profit before tax	3,546	4,644	5,437	6,525	7,633
Change in depreciation and amortization	207	302	443	541	658
Change in Working Capital	-6,859	-7,879	-11,987	-11,236	-10,595
Net financial cost (income)	893	1,309	1,265	1,657	2,053
Income tax paid	-253	-329	-971	-1,142	-1,370
Net interest received	0	0	0	0	0
Others	-160	-546	-407	-513	-611
Operating cash flow	-2,627	-2,500	-6,219	-4,168	-2,232
Capex	-2,475	-588	-1,812	-1,695	-2,042
Increase in intangible assets	-195	-649	-604	-565	-681
Others	-1,085	-792	-645	-608	-726
Investing cash flow	-3,755	-2,029	-3,062	-2,868	-3,450
Net Capital raise	0	6,463	0	0	0
Net debt financing	9,062	5,595	8,739	9,425	9,331
Dividend payout	-18	-102	-1,147	-1,376	-1,610
Interest paid	-1,189	-1,483	-1,401	-1,491	-1,884
Others	-791	-1,004	0	0	0
Financing cash flow	7,065	9,469	6,191	6,558	5,837
Net change in cash	683	4,940	-3,090	-478	155
Cash at the beginning	6,091	6,374	10,921	7,438	6,567
Adjustment (Time deposit & FX effect)	-400	-392	-393	-393	-393
Cash at the end	6,374	10,921	7,438	6,567	6,329

Source(s): Company, ABCI Securities estimates

Key ratio

FY ended Dec 31 (HK\$ mn)	2015A	2016A	2017E	2018E	2019E
Sales mixed (%)					
EPC	61.70	65.16	67.99	70.20	70.74
Operation income	32.56	28.96	24.34	22.49	21.90
Other	5.75	5.88	7.67	7.31	7.36
Total	100	100	100	100	100
Profit & loss ratios (%)					
Gross margin	36.78	33.33	32.07	31.22	31.06
Operating profit margin	29.24	29.14	26.27	25.42	25.26
Pre-tax margin	26.26	26.76	22.69	21.63	21.24
Net profit margin	20.50	21.16	17.93	17.08	16.78
Selling & administrative expenses/revenue	9.08	8.86	9.00	9.00	9.00
Effective tax rate	21.94	20.90	21.00	21.00	21.00
Growth (%)					
Revenue	51.28	28.53	38.08	25.91	19.08
Gross profit	42.08	16.47	32.85	22.57	18.48
Operating profit	30.39	28.11	24.47	21.83	18.34
Net profit	33.50	32.70	16.95	20.01	16.98
Balance sheet ratios					
Current ratio (x)	1.02	1.07	0.82	0.72	0.65
Quick ratio (x)	0.54	0.68	0.44	0.35	0.30
Cash ratio (x)	0.37	0.54	0.27	0.19	0.15
Trade and bill receivables days	79.99	63.60	70.00	70.00	70.00
Trade and bill payables turnover days	247.42	310.51	250.00	250.00	250.00
Inventory turnover days	4.24	2.87	10.00	10.00	10.00
Total debt / equity ratio (%)	172.03	200.82	194.30	207.16	212.59
Net debt / equity ratio (%)	130.98	133.82	159.79	180.64	190.40
Returns (%)					
ROAA	4.2	4.4	4.3	4.2	4.2
ROAE	15.4	19.7	20.1	19.8	20.1
Payout ratio	33.70	32.18	30.00	30.00	30.00

Source(s): Company, ABCI Securities estimates



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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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