

Last Closing: HK\$4.06

Upside: +57%

Target Price: HK\$6.35→

Environmental Sector

Yunnan Water (6839.HK)

PPP projects bring in earnings enhancement starting 2017

 UP MP **OP**

Financial Highlights

Y/E 31 Dec	2014	2015	2016E	2017E	2018E
Revenue (Rmb m)	1,101	1,558	2,625	4,032	3,637
YoY growth (%)	59.8	41.6	68.5	53.6	-9.8
Net profit (Rmb m)	166	287	392	536	574
EPS (Rmb)	0.193	0.240	0.329	0.449	0.481
Vs. Consensus (+/- %)			0.2	0.7	-15.7
EPS growth (%)	-28.4	24.5	36.7	36.7	7.1
P/E (x)	18.6	14.9	10.9	8.0	7.5
P/B (x)	1.3	1.1	1.0	0.9	0.8
Dividend yield (%)	0.0	2.8	3.9	4.7	5.0

Source: Company, BOCOM Int'l estimates

- PPP projects to start contributing in 2017E:** Following the acceleration of PPP development in 2016, we expect YNW's new PPP projects to have significant contribution in 2017-18E. To recap, YNW obtained 3 sizable PPP projects in 4Q16, namely: (1) watercourse comprehensive treatment in Erhai Main River; (2) black and odorous water treatment in Jinshui River; and (3) WWT and WS PPP project in Jianshui County. With total project size of Rmb1.67bn, we forecast the water environment renovation projects of Jinshui River and Erhai Main River should be able to add Rmb613m/Rmb634m of EPC revenue in 2017/18E. Meanwhile, we expect construction of the WWT (42kt/day) and WS (108kt/day) plants to start this year and to be completed in 2018E.
- New JVs formed to further explore municipal solid waste and WWT:** Apart from strong progress from PPP projects, YNW formed 2 sizable new JVs to strengthen its water treatment and solid waste treatment portfolio. The JV with Zhejiang Haiyun, for which YNW will pay Rmb539m cash for its 49% stake, should help YNW to tap into the Zhejiang market. We expect Haiyun to inject 4 WWT/WS projects into the JV starting 2Q17. YNW also announced a new JV with Yunnan Sidu. According to YNW's management, YNW intends to acquire new WTE projects, likely to be greenfield projects. Under the 13th FYP of municipal solid waste treatment, the government aims to add 356.2kt/day incineration capacity to 591.4kt/day by 2020E. We believe there should be plenty of opportunities for YNW to obtain new WTE projects in the near term. Currently, we do not factor in any contribution from these 2 JVs, pending new projects injected/obtained at the JV level.
- 2017-18E earnings revised up 5-9%:** After fine-tuning our financial model and adding in the contribution from PPP projects, we lift our 2017/18E profit forecast for YNW by 9.1%/5.0% to Rmb536m/574m, representing a 26% CAGR during 2015-18E. It is worth noting that we still keep Galaxy Newspring (GNS) at the associate level, given the transaction of the remaining 50% stake from Hyflux has not been completed. Despite this slight delay, the company still targets to publish the circular of the deal by the end of Feb 2017 and complete the transaction by 1H17E.
- Lowest valuation level since listing; Maintain Buy:** YNW is now trading at 8.0x 2017E P/E, which is at: (i) -1 S.D. from its forward P/E historical average of 11.3x; and (2) the lowest level since its listing in 2015. We believe the delay in closing the GNS deal should have been priced in. We view the FY16 results as a positive catalyst which could help reverse the de-rating since 2H16. We now price YNW at 12.5x 2017E P/E (previous: 16x), which has a 25% discount to our 17x valuation benchmark to the sector leader, BEWG (371.HK; BUY). Our target price is maintained at HK\$6.35 by rolling over to 2017E P/E. Maintain Buy.



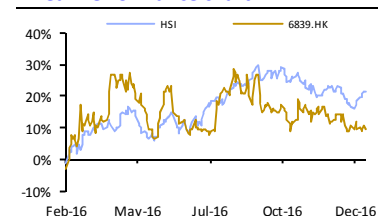
- New PPP projects are expected to contribute to YNW starting 2017E.
- YNW also formed 2 new JVs to invest in water treatment and solid waste treatment in China.
- We revise up our 17E/18E earnings forecast by 9.1%/5.0%.
- YNW is trading at the lowest P/E level since listing. Maintain Buy.

Stock data

52w High (HK\$)	4.85
52w Low (HK\$)	3.55
Market cap (HK\$m)	4,844.4
Issued shares (m)	1,193.2
Avg daily vol (m)	0.41
1-mth change (%)	-0.2
YTD change (%)	-0.2
50d MA (HK\$)	4.07
200d MA (HK\$)	4.25
14-day RSI	55.55

Source: Company data, Bloomberg

1 Year Performance chart



Source: Company data, Bloomberg

Wallace Cheng
 Wallace.cheng@bocomgroup.com
 Tel: (852) 3766 1810

Figure 1: Change in forecast

	Old forecast			New forecast			Change		
	2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E
Revenue (Rmb m)	2,625	3,148	2,866	2,625	4,032	3,637	0.0%	28.1%	26.9%
Net profit (Rmb m)	392	491	546	392	536	574	0.0%	9.1%	5.0%
EPS (Rmb)	0.328	0.411	0.458	0.329	0.449	0.481	0.0%	9.1%	5.0%

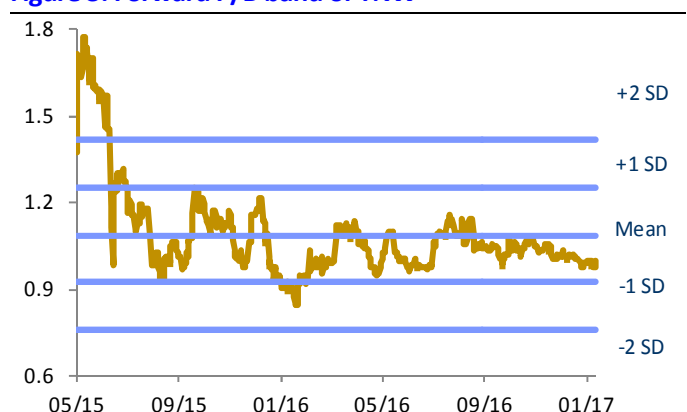
Source: BOCOM Int'l estimates

Figure 2: Forward P/E band of YNW



Source: Bloomberg, BOCOM Int'l

Figure 3: 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	2014	2015	2016E	2017E	2018E
Wastewater treatment	384	420	735	632	574
Water supply	216	455	706	1,154	634
EPC & equip sales	470	597	769	1,522	1,699
O&M	31	79	86	95	105
WTE & hazardous waste	0	8	330	629	625
Turnover	1,101	1,558	2,625	4,032	3,637
COGS	(767)	(1,051)	(1,805)	(2,880)	(2,442)
Gross profit	334	508	820	1,152	1,195
Other income and gains	49	98	145	190	213
Other gains	3	12	12	12	12
Selling expenses	(13)	(17)	(29)	(44)	(40)
Administrative expenses	(126)	(181)	(284)	(371)	(382)
Operating profit	247	419	665	940	999
Net finance costs	(31)	(41)	(134)	(190)	(187)
Share of profit of jce/asso	11	5	0	(15)	(15)
Pre-tax profit	226	383	531	734	797
Income tax expense	(38)	(65)	(91)	(125)	(136)
After tax profit	188	317	440	609	661
Minority interest	(21)	(32)	(48)	(73)	(87)
Net profit	166	287	392	536	574

Balance sheet (Rmb m)

Year ended 31 Dec	2014	2015	2016E	2017E	2018E
Cash and cash equivalents	613	1,672	2,978	1,321	1,325
Inventory	12	21	35	56	48
Trade and other receivables	845	1,197	1,798	2,430	1,993
Other current assets	24	35	63	70	77
Total current assets	1,494	2,924	4,875	3,878	3,443
Property, plant and equipment	1,379	1,617	2,503	3,849	3,825
Rece. under concession	1,445	1,942	2,669	3,342	3,688
Amounts due for contract works	194	404	520	584	671
Other non-current assets	508	2,715	3,379	3,899	3,884
Total non-current assets	3,526	6,678	9,071	11,673	12,068
Short term borrowings	270	1,038	1,765	1,059	1,049
Trade and other payables	877	1,074	1,731	2,683	2,275
Other current liabilities	71	78	96	121	148
Total current liabilities	1,218	2,190	3,592	3,863	3,471
Long term borrowings	869	2,026	4,647	5,538	5,429
Other non-current liabilities	212	443	443	443	443
Total non-current liabilities	1,081	2,469	5,090	5,981	5,872
Paid in capital	863	1,193	1,193	1,193	1,193
Reserves	1,522	2,865	3,138	3,509	3,882
Equity attri. to shareholders	2,384	4,058	4,331	4,702	5,075
MI	337	884	932	1,005	1,093
Total Equity	2,721	4,943	5,263	5,707	6,167

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	531	734	797
Tax paid	(54)	(80)	(73)	(100)	(109)
Dep'n and amortization	58	74	77	117	174
Change in working capital	(739)	(1,175)	(830)	(446)	(402)
Others	(33)	(56)	0	15	15
Cash from operations	(542)	(854)	(295)	320	475
Capital expenditure	(442)	(814)	(959)	(1,458)	(150)
Others	139	(517)	(668)	(539)	0
Cash from investing	(304)	(1,332)	(1,627)	(1,997)	(150)
Capital injections from shareholder	294	0	0	0	0
Proceed from share issuance	0	1,514	0	0	0
Change in borrowings	542	1,835	3,348	185	(120)
Dividend paid	(111)	0	(119)	(165)	(201)
Others	(25)	(112)	0	0	0
Cash from financing	701	3,237	3,228	20	(321)
FX change	(0)	8	0	0	0
Net change in cash	(145)	1,059	1,306	(1,657)	4

Financial ratios

Year ended 31 Dec	2014	2015	2016E	2017E	2018E
Gross margin (%)	30.3	32.6	31.2	28.6	32.9
EBIT margin (%)	22.4	26.9	25.3	23.3	27.5
Net margin (%)	15.1	18.4	14.9	13.3	15.8
ROA (%)	3.3	3.0	2.8	3.4	3.7
ROE (%)	7.0	7.1	9.1	11.4	11.3
Net gearing (%)	22.1	33.8	78.8	111.8	101.1
Interest coverage (x)	7.8	10.2	5.0	4.9	5.4
Current ratio	1.2	1.3	1.4	1.0	1.0

BOCOM International



Unit 1701, 17/F, Low Block, Grand Millennium Plaza, 181 Queen's Road Central, Hong Kong

Main: + 852 2297 9888

Fax: + 852 2766 3183

www.bocomgroup.com

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

Research Team

Head of Research

@bocomgroup.com

Raymond CHENG, CFA, CPA, CA (852) 3766 1818 raymond.cheng

Banks/ Non-Bank Financials

Shanshan LI, CFA (86) 10 8800 9788 - 8058 lishanshan
 Li WAN, CFA, FRM (86) 10 8800 9788 - 8051 wanli
 Hannah HAN (852) 3766 1858 hannah.han
 Jennifer ZHANG (852) 3766 1850 yufan.zhang

Consumer

Summer WANG, CFA (852) 3766 1808 summer.wang
 Oliver LIU (852) 3766 1835 oliver.liu

Environmental Services

Wallace CHENG (852) 3766 1810 wallace.cheng

Gaming & Leisure

Alfred LAU, CFA, FRM (852) 3766 1807 alfred.lau

Healthcare

David LI (852) 3766 1811 david.li

Internet

Yuan MA, PhD (86) 10 8800 9788 - 8039 yuan.ma
 Connie GU, CPA (86) 10 8800 9788 - 8045 conniegu
 Mengqi SUN (86) 10 8800 9788 - 8048 mengqi.sun

Head of Research/ Strategy

@bocomgroup.com

Hao HONG, CFA (852) 3766 1802 hao.hong

Strategy

Karen TAN (852) 3766 1825 karen.tan
 Grace HUA, CFA (852) 3766 1837 Grace.hua

Property

Alfred LAU, CFA, FRM (852) 3766 1807 alfred.lau
 Philip TSE, CFA, FRM (852) 3766 1815 philip.tse
 Carmen WONG (852) 3766 1830 carmen.wong

Renewable Energy

Louis SUN (86) 21 6065 3606 louis.sun

Technology

Chris YIM (852) 3766 1803 christopher.yim

Transportation & Industrials

Geoffrey CHENG, CFA (852) 3766 1809 geoffrey.cheng
 Fay ZHOU (852) 3766 1816 fay.zhou

Automobile & Defense

Angus CHAN (852) 3766 1805 angus.chan

Analyst Certification

The authors of this report, hereby declare that: (i) all of the views expressed in this report accurately reflect their personal views about any and all of the subject securities or issuers; and (ii) no part of any of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report; (iii) no insider information/ non-public price-sensitive information in relation to the subject securities or issuers which may influence the recommendations were being received by the authors.

The authors of this report further confirm that (i) neither they nor their respective associates (as defined in the Code of Conduct issued by the Hong Kong Securities and Futures Commission) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of the report; (ii) neither they nor their respective associates serve as an officer of any of the Hong Kong listed companies covered in this report; and (iii) neither they nor their respective associates have any financial interests in the stock(s) covered in this report except for one coverage analyst who is holding shares of Shimao Property Holdings Limited.

Disclosure of relevant business relationships

BOCOM International Securities Limited, and/or its associated companies, has investment banking relationship with Bank of Communications, China Huinong Capital Group Limited, Guolian Securities Co. Ltd., Bank of Zhengzhou Co. Ltd., Human Health Holdings Limited, COFCO Meat Holdings Limited, Hebei Yichen Industrial Group Corporation Limited, China Aircraft Leasing Group Holdings Limited, Orient Securities Company Limited, Wuxi Construction and Development Investment Co. China Development Bank Financial Leasing Co., Ltd, Phoenix Healthcare Group Co. Ltd, Everbright Securities Company Limited, China First Capital Group Limited, Jiayuan International Group Limited, Luzhou Xinglu Water (Group) Co., Ltd., Postal Savings Bank of China Co., Ltd., China Merchants Securities Co., Limited, Shandong International Trust Co., Ltd, Guangdong Kanghua Healthcare Co., Ltd CSC Financial Co., Ltd and BOCOM International Holdings Company Limited within the preceding 12 months.

BOCOM International Global Investment Limited currently holds more than 1% of the equity securities of Orient Securities Company Limited.

BOCOM International Global Investment Limited currently holds more than 1% of the equity securities of Everbright Securities Company Limited.

Disclaimer

By accepting this report (which includes any attachment hereto), the recipient hereof represents and warrants that he is entitled to receive such report in accordance with the restrictions set forth below and agrees to be bound by the limitations contained herein. Any failure to comply with these limitations may constitute a violation of law.

This report is strictly confidential and is for private circulation only to clients of BOCOM International Securities Ltd. This report is being supplied to you strictly on the basis that it will remain confidential. No part of this report may be (i) copied, photocopied, duplicated, stored or reproduced in any form by any means or (ii) redistributed or passed on, directly or indirectly, to any other person in whole or in part, for any purpose without the prior written consent of BOCOM International Securities Ltd.

BOCOM International Securities Ltd, its affiliates and related companies, their directors, associates, connected parties and/or employees may own or have positions in securities of the company(ies) covered in this report or any securities related thereto and may from time to time add to or dispose of, or may be interested in, any such securities. Further, BOCOM International Securities Ltd, its affiliates and its related companies may do and seek to do business with the company(ies) covered in this report and may from time to time act as market maker or have assumed an underwriting commitment in securities of such company(ies), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform investment banking, advisory, underwriting, financing or other services for or relating to such company(ies) as well as solicit such investment, advisory, financing or other services from any entity mentioned in this report. In reviewing this report, an investor should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest.

The information contained in this report is prepared from data and sources believed to be correct and reliable at the time of issue of this report. This report does not purport to contain all the information that a prospective investor may require and may be subject to late delivery, interruption and interception. BOCOM International Securities Ltd does not make any guarantee, representation or warranty, express or implied, as to the adequacy, accuracy, completeness, reliability or fairness of any such information and opinion contained in this report and accordingly, neither BOCOM International Securities Ltd nor any of its affiliates nor its related persons shall be liable in any manner whatsoever for any consequences (including but not limited to any direct, indirect or consequential losses, loss of profits and damages) of any reliance thereon or usage thereof.

This report is general in nature and has been prepared for information purposes only. It is intended for circulation amongst BOCOM International Securities Ltd's clients generally and does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. The information and opinions in this report are not and should not be construed or considered as an offer, recommendation or solicitation to buy or sell the subject securities, related investments or other financial instruments thereof.

The views, recommendations, advice and opinions in this report may not necessarily reflect those of BOCOM International Securities Ltd or any of its affiliates, and are subject to change without notice. BOCOM International Securities Ltd has no obligation to update its opinion or the information in this report.

Investors are advised to make their own independent evaluation of the information contained in this research report, consider their own individual investment objectives, financial situation and particular needs and consult their own professional and financial advisers as to the legal, business, financial, tax and other aspects before participating in any transaction in respect of the securities of company(ies) covered in this report. The securities of such company(ies) may not be eligible for sale in all jurisdictions or to all categories of investors.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to any law, regulation, rule or other registration or licensing requirement.

BOCOM International Securities Ltd is a wholly owned subsidiary of Bank of Communications Co Ltd.