

## Company Report

### BJ ENT WATER (371 HK)

#### 4M19 operation on track

- The co. secured >1mtpd WWT projects in 4M19 and RMB7bn water renovation projects YTD
- Cooperation with China Three Gorges Corporation are on track
- We maintain BUY and our DCF-based TP of HK\$5.4

#### New project wins on track

For WWT and water distribution projects, in 4M19, BEW added >1mtpd water treatment capacities, achieving ~25% of mgmt.'s full year guidance of 4mtpd. As the co. is currently following more than >10.8mtpd projects, mgmt. is confident to meet its new capacity addition target in 2019. Most of the newly secured projects are greenfield projects. Mgmt. sees a slow acquisition pace given the unattractive price. For water renovation projects (mainly PPP), the co. secured 2 PPP projects in Hengshui and Yueyang with an aggregate investment amount of ~RMB7bn.

#### Expect more cooperation with CTGC

In Jun 2019, the newly set up JV among BEW, China Three Gorges Corporation (CTGV) and other entities won their 1<sup>st</sup> PPP project in Yueyang city with a total investment amount of RMB4.4bn. BEW sees ample business opportunities along Yantze River Delta as the market size of renovation projects in the region can reach to >RMB2tr. Going forward, mgmt. expects more in-depth cooperation with CTGC in both new project exploration and management involvement; for example, CTGC increased its equity stakes in BEW from 4.7% in Jan 2019 to 5% in Jun 2019 and once its stake in BEW reached 10%, it could get a board seat in BEW. Accordingly, mgmt. is confident to secure RMB20bn PPP projects with CTGC in 2019.

#### Asset light operational model for PPP projects

As emphasised by mgmt., BEW adopts asset light model for PPP projects; BEW would only contribute <10% of the investment and provide related design, EPC and operational services, which have a shorter payment period. Meanwhile, the revenue generated from consultation, EPC and operational services can largely cover BEW's investment.

#### Focus on improving cashflow in mid-term

BEW has shifted its focus from aggressive expansion to cashflow improvement in mid-term; the co. has adopted a series of measurements, e.g. stringent project selection and review, and asset collateral requirement for PPP projects. Mgmt. expects the co. to turn into positive free cashflow in the next 3-5 years.

#### Financials

Year ended 31 Dec	2017	2018	2019E	2020E	2021E
(HK\$ mn)					
Revenue	21,192	24,597	27,724	30,429	33,128
Gross profit	6,465	8,776	9,826	10,826	11,915
Reported net profit	3,717	4,471	5,306	6,157	7,054
Recurring net profit	3,582	4,284	5,306	6,157	7,054
Recurring EPS (HK\$)	0.40	0.45	0.53	0.61	0.70
Core P/E (x)	11.6	10.2	8.7	7.6	6.7
P/B (x)	2.0	1.7	1.6	1.4	1.3
Dividend yield (%)	3.3	4.0	4.6	5.3	6.1
ROE (%)	19.9	19.3	19.6	20.1	20.4
Net debt / equity (%)	102.8	112.2	103.1	108.0	109.3

Sources: Company data, CMS (HK) estimates

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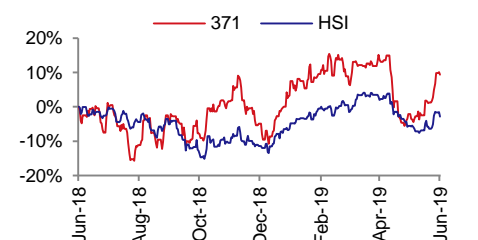
#### WHAT'S NEW

n.a.

#### BUY

Previous Rating	BUY
Price	HK\$4.63
12-month Target Price (Potential up/downside)	HK\$ 5.40 (+16.6%)
Previous Target Price	HK\$5.40

#### Price Performance



Source: Bloomberg

%	1m	6m	12m
371 HK	12.4	15.8	10.1
HSI	3.0	9.9	(2.7)

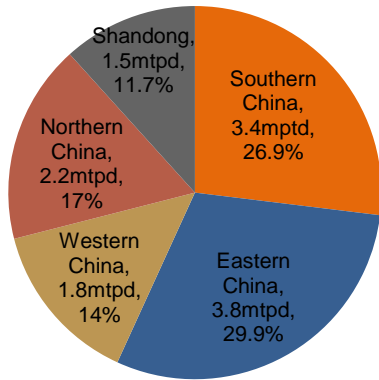
Sector: Environmental Protection	
Hang Seng Index	28,186
HSCEI	10,742
Key Data	
52-week range (HK\$)	3.46-4.99
Market cap (HK\$ mn)	46,353
Avg. daily volume (mn)	20.66
BVPS (HK\$) (2018)	2.92
Shareholding Structure	
Beijing Enterprises Group	41.2%
China Three Gorges	5.0%
Min Zhou	3.1%
BNP Paribas	2.9%
No. of shares outstanding (mn)	10,011
Free float (mn)	5,580

#### Related Research

1. BJ ENT WATER (371 HK) – Asset light transformation on track 2019/03/27 (BUY)
2. Environmental Protection Sector – 2018 results review: another entry point for WTE (OVERWEIGHT) 2019/05/02
3. Environmental Protection Sector – 2018 results preview: Expecting earnings growths are in line (OVERWEIGHT) 2019/02/14
4. BJ ENT WATER (371 HK) – Cooperation with China Three Gorge Cooperation 2019/01/21 (BUY)
5. Environmental Protection Sector – Stick with industrial leaders with substantial capital 2019/01/15 (OVERWEIGHT)
6. BJ ENT WATER (371 HK) – Stable but healthy growth 2018/11/01 (BUY)
7. BJ ENT WATER (371 HK) – Eye on M&A opportunities 2018/08/29 (BUY)

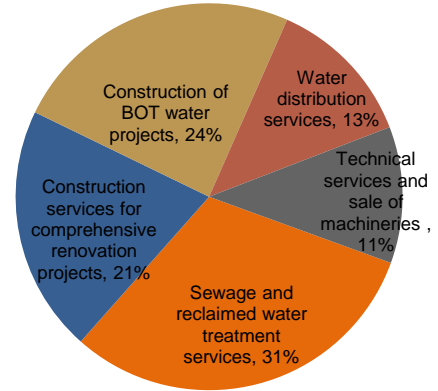
Focus charts

Figure 1: BEW – Sewage and reclaimed water treatment projects allocation in China in 2018



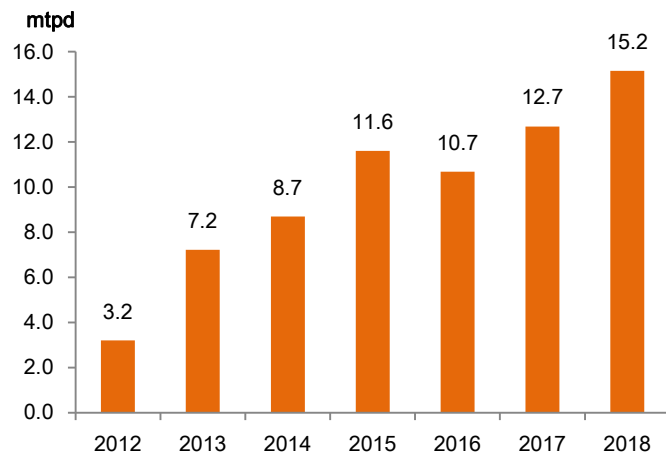
Sources: Company data, CMS (HK)

Figure 2: BEW – 2018 net profit breakdown



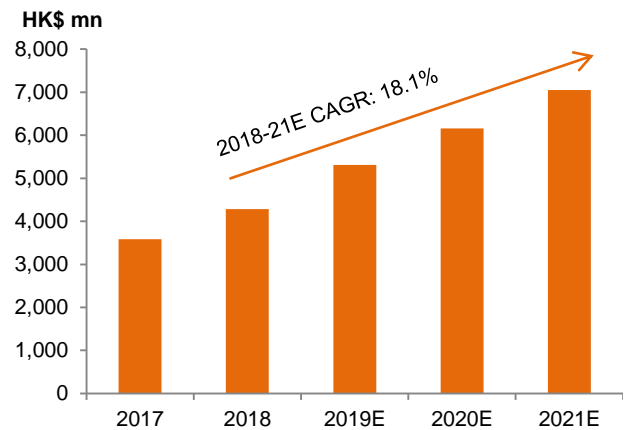
Sources: Company data, CMS (HK)

Figure 3: BEW – Capacities not yet commenced /transferred



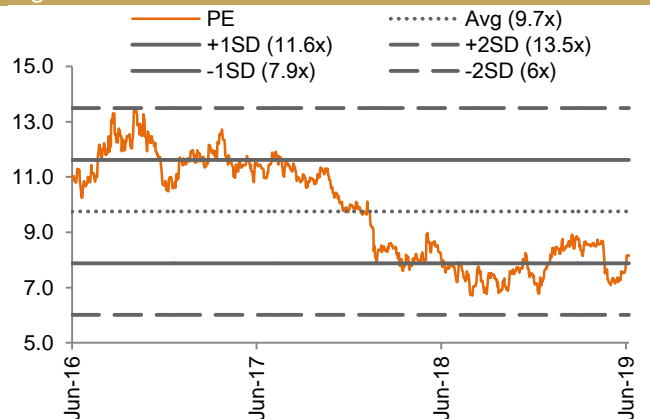
Sources: Company data, CMS (HK)

Figure 4: BEW – Core profit forecasts



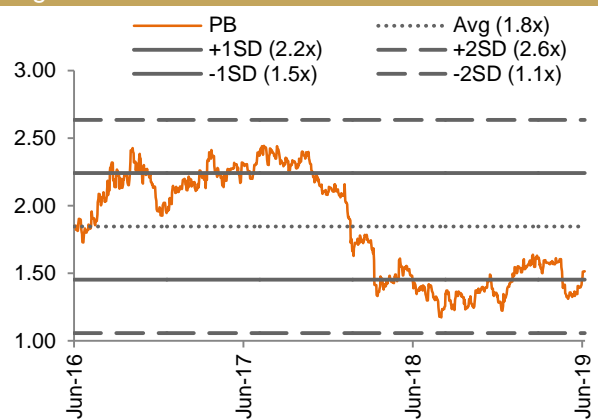
Sources: Company data, CMS (HK) estimates

Figure 5: BEW – 12-month blended forward P/E



Sources: Bloomberg, CMS (HK) estimates

Figure 6: BEW – 12-month blended forward P/B



Sources: Bloomberg, CMS (HK) estimates

## Impose stringent standard on its projects to ensure profitability and sustainability

**Traditional water treatment projects:** BEW is setting up a management platform to control its projects' quality. The company keeps reviewing its projects' operation and require those projects, which don't meet the company's standards in project return (e.g. project IRR: >8% and equity IRR: >12%) and wastewater input, to undergo rectification. The company will exit those projects which fail to turn around after the revision.

**PPP projects:** The company will only focus on PPP projects located in the 1<sup>st</sup> and 2<sup>nd</sup> tier cities, in which local governments have good credibility and strong financial positions. To ensure on-time payment collection, the company would require local governments to 1) pledge other WWT plants and related facilities as collaterals; and 2) pay extra interests for any delayed payment.

With the above mentioned measurements, the company targets to turn into positive free cash flow in the next 3-5 years.

## Maintain BUY and DCF-based TP at HK\$5.4

We maintain BUY and DCF-based TP of HK\$5.4. Shares are trading at 8.7x 2019E P/E, 10% discount to its 3-year historical average P/E of 9.7x.

### Key risks

The key upside risks include: 1) acceleration of project wins with CTGC; 2) acceleration of WWT plant upgrades and tariff hikes; and 3) higher return from new projects (esp. PPP projects).

The key downside risks include: 1) keener-than-expected market competition resulting in slower capacity expansion and lower project return; and 2) higher-than-expected execution risk for its PPP projects

## Financial Summary

### Balance Sheet

Year ended 31 Dec (HK\$m)	2017	2018	2019E	2020E	2021E
Fixed assets	3,842	4,223	4,516	4,807	5,096
Associates & JV	10,653	11,692	12,700	13,925	15,408
Operating concessions	4,191	3,914	4,029	4,108	4,152
Receivables under services concession arrangement	33,323	27,613	28,489	29,303	30,008
Amounts due from contract customers	15,060	34,723	42,407	49,496	55,956
Trade receivables, prepayment and other receivables	3,847	5,501	6,668	7,709	8,748
Others	6,007	6,739	6,691	6,698	6,705
<b>Non-current assets</b>	<b>76,922</b>	<b>94,404</b>	<b>105,500</b>	<b>116,046</b>	<b>126,074</b>
Amounts due from contract customers	876	3,009	3,660	4,272	4,830
Receivables under services concession arrangement	2,615	3,252	3,356	3,452	3,535
Trade receivables, prepayment and other receivables	9,598	11,579	13,669	15,345	16,979
Cash	9,939	12,938	11,711	6,728	4,596
Restricted cash and pledged deposits	46	657	657	657	657
Others	465	542	556	565	574
<b>Current assets</b>	<b>23,539</b>	<b>31,976</b>	<b>33,608</b>	<b>31,019</b>	<b>31,170</b>
<b>Total assets</b>	<b>100,461</b>	<b>126,381</b>	<b>139,108</b>	<b>147,065</b>	<b>157,243</b>
Trade payables	11,688	17,873	19,688	19,603	19,092
Accruals & other payables	6,770	8,885	10,903	11,942	12,923
Bank loans	4,689	4,292	4,559	4,827	5,362
Corporate bonds, note payable and others	3,853	4,431	5,120	2,329	4,661
Others	694	1,036	1,228	1,208	1,352
<b>Current liabilities</b>	<b>27,693</b>	<b>36,517</b>	<b>41,499</b>	<b>39,910</b>	<b>43,390</b>
Bank loans	21,444	27,782	29,514	31,246	34,711
Corporate bonds, note payable and others	13,966	19,524	18,786	21,535	19,166
Others	4,317	4,747	5,074	5,716	6,298
<b>Non-current liabilities</b>	<b>39,726</b>	<b>52,052</b>	<b>53,375</b>	<b>58,497</b>	<b>60,174</b>
<b>Total liabilities</b>	<b>67,420</b>	<b>88,569</b>	<b>94,874</b>	<b>98,407</b>	<b>103,565</b>
<b>Total net assets</b>	<b>33,041</b>	<b>37,812</b>	<b>44,235</b>	<b>48,659</b>	<b>53,678</b>
Share capital	879	941	1,004	1,004	1,004
Reserves	19,905	24,548	27,718	31,395	35,609
<b>Shareholder's equity</b>	<b>20,785</b>	<b>25,490</b>	<b>28,722</b>	<b>32,399</b>	<b>36,613</b>
Perpetual capital instruments	6,623	6,351	9,096	9,337	9,578
Minority interests	5,634	5,972	6,417	6,922	7,488
<b>Total equity</b>	<b>33,041</b>	<b>37,812</b>	<b>44,235</b>	<b>48,659</b>	<b>53,678</b>
Total debts	43,952	56,028	57,980	59,937	63,900
<b>Net cash/(debts)</b>	<b>(33,967)</b>	<b>(42,433)</b>	<b>(45,612)</b>	<b>(52,552)</b>	<b>(58,647)</b>
<b>BVPS (HK\$)</b>	<b>2.37</b>	<b>2.73</b>	<b>2.90</b>	<b>3.22</b>	<b>3.63</b>

### Cashflow Statement

Year ended 31 Dec (HK\$m)	2017	2018	2019E	2020E	2021E
Operating profit	5,279	7,360	8,353	9,347	10,388
Dep. & amort.	405	511	552	601	651
Chg in working cap	(12,279)	(13,358)	(8,696)	(10,550)	(10,213)
Others	421	482	(579)	(394)	(339)
Tax paid	(541)	(567)	(632)	(755)	(887)
<b>Net cash from operations</b>	<b>(6,714)</b>	<b>(5,573)</b>	<b>(1,003)</b>	<b>(1,751)</b>	<b>(401)</b>
Capex	(1,208)	(996)	(948)	(958)	(971)
Others	1,093	(2,013)	521	490	457
<b>Net cash from investments</b>	<b>(115)</b>	<b>(3,010)</b>	<b>(428)</b>	<b>(468)</b>	<b>(513)</b>
Issue/ buyback of shares	0	3,602	2,567	0	0
Dividends paid	(1,227)	(1,600)	(1,969)	(2,285)	(2,618)
Net change in debt	6,275	12,654	1,952	1,958	3,963
Others	(1,079)	(1,616)	(2,346)	(2,436)	(2,563)
<b>Net cash from financing</b>	<b>3,968</b>	<b>13,040</b>	<b>203</b>	<b>(2,763)</b>	<b>(1,218)</b>
<b>Net change in cash</b>	<b>(2,861)</b>	<b>4,458</b>	<b>(1,227)</b>	<b>(4,982)</b>	<b>(2,132)</b>
Adjustments	1,887	(116)	329	329	329
Opening cash	10,912	8,596	12,608	11,381	6,399
<b>Closing cash</b>	<b>9,939</b>	<b>12,938</b>	<b>11,711</b>	<b>6,728</b>	<b>4,596</b>

### Profit & Loss Statement

Year ended 31 Dec (HK\$m)	2017	2018	2019E	2020E	2021E
<b>Turnover</b>	<b>21,192</b>	<b>24,597</b>	<b>27,724</b>	<b>30,429</b>	<b>33,128</b>
COGS	(14,728)	(15,821)	(17,899)	(19,603)	(21,213)
<b>Gross profit</b>	<b>6,465</b>	<b>8,776</b>	<b>9,826</b>	<b>10,826</b>	<b>11,915</b>
Other income and gains, net	911	1,066	1,275	1,479	1,665
Admin	(1,753)	(2,206)	(2,468)	(2,674)	(2,900)
Other opex	(343)	(276)	(279)	(284)	(292)
<b>Total opex</b>	<b>(1,186)</b>	<b>(1,416)</b>	<b>(1,473)</b>	<b>(1,479)</b>	<b>(1,527)</b>
<b>Operating profit</b>	<b>5,279</b>	<b>7,360</b>	<b>8,353</b>	<b>9,347</b>	<b>10,388</b>
Finance costs, net	(1,177)	(1,682)	(1,805)	(1,911)	(2,065)
Share of results of associates & JVs	1,078	914	1,220	1,483	1,794
Others	135	187	0	0	0
<b>Pre-tax profit</b>	<b>5,315</b>	<b>6,779</b>	<b>7,768</b>	<b>8,920</b>	<b>10,117</b>
Tax	(875)	(1,549)	(1,637)	(1,859)	(2,081)
<b>Profit after tax</b>	<b>4,441</b>	<b>5,230</b>	<b>6,131</b>	<b>7,061</b>	<b>8,036</b>
Minority interest	(483)	(513)	(583)	(663)	(742)
Holder of perpetual capital instruments	(240)	(246)	(241)	(241)	(241)
<b>Net profit</b>	<b>3,717</b>	<b>4,471</b>	<b>5,306</b>	<b>6,157</b>	<b>7,054</b>
Non-core items adj.	(135)	(187)	0	0	0
<b>Core profit</b>	<b>3,582</b>	<b>4,284</b>	<b>5,306</b>	<b>6,157</b>	<b>7,054</b>
EBITDA	5,684	7,871	8,905	9,948	11,038
Basic EPS (HK\$)	0.42	0.48	0.54	0.61	0.70
Fully diluted core EPS (HK\$)	0.40	0.45	0.53	0.61	0.70
DPS (HK\$)	0.16	0.18	0.21	0.25	0.28

### Financial Ratios

	2017	2018	2019E	2020E	2021E
<b>YoY growth rate (%)</b>					
Turnover	22.1	16.1	12.7	9.8	8.9
EBITDA	8.3	38.5	13.1	11.7	11.0
Operating profit	6.7	39.4	13.5	11.9	11.1
Core profit	32.3	19.6	23.9	16.0	14.6
Fully diluted core EPS	31.6	13.1	17.3	14.3	14.6
DPS	30.3	18.2	16.1	15.7	14.3
<b>Margins (%)</b>					
Gross margin	30.5	35.7	35.4	35.6	36.0
EBITDA margin	26.8	32.0	32.1	32.7	33.3
EBIT margin	24.9	29.9	30.1	30.7	31.4
Net margin (Core profit)	16.9	17.4	19.1	20.2	21.3
Effective tax rate (%)	21.3	27.3	25.0	25.0	25.0
Total opex as % of rev	5.6	5.8	5.3	4.9	4.6
Interest coverage (x)	4.5	4.4	4.6	4.9	5.0
Dividend payout (%)	39.0	40.3	40.3	40.3	40.3
<b>Net debt/equity (%)</b>	<b>102.8</b>	<b>112.2</b>	<b>103.1</b>	<b>108.0</b>	<b>109.3</b>
Net debt/total cap (%)	50.7	52.9	50.8	51.9	52.2
Current ratio (x)	0.8	0.9	0.8	0.8	0.7
<b>Returns (%)</b>					
Asset turnover (x)	0.2	0.2	0.2	0.2	0.2
Financial leverage (x)	4.9	4.9	4.9	4.7	4.4
EBIT margin (%)	30.6	34.4	34.5	35.6	36.8
Interest burden (x)	0.8	0.8	0.8	0.8	0.8
Tax burden (x)	0.7	0.7	0.7	0.7	0.7
<b>ROE (%)</b>	<b>19.9</b>	<b>19.3</b>	<b>19.6</b>	<b>20.1</b>	<b>20.4</b>
<b>ROIC (%)</b>	<b>8.8</b>	<b>8.5</b>	<b>8.8</b>	<b>9.4</b>	<b>9.5</b>

Sources: Company data, CMS (HK) estimates

## Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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