

China State Construction International

3311 HK

Target (HKD): 17.40 → 14.60

Upside: 37.2%

20 Mar price (HKD): 10.64

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

2015-17E: improved gearing and steady contract wins

Kelvin Lau

(852) 2848 4467

kelvin.lau@hk.daiwacm.com

- 2014 results were in line with our and market expectations
- Management's cash-collection effort worked positively in 2014 and we expect gearing to gradually decline in 2015-17
- CSCI remains our top sector pick; reiterating Buy (1)

■ What's new

CSCI recorded 2014 net profit of HKD3.5bn, up 26% YoY, in line with our expectations and the Bloomberg consensus. We believe the major concerns from investors are cash collection and contract growth, especially in Hong Kong.

■ What's the impact

Robust affordable-housing demand in China led CSCI's profit growth in 2014. Its overall gross-profit margin (GPM) was flat YoY as the GPM from China increased from 20% in 2013 to 23% in 2014, which offset the GPM decline in Hong Kong (from 7.3% in 2013 to 6.6% in 2014) and Macau (from 15% in 2013 to 4% in 2014). The GPM decline in Hong Kong and Macau was caused by some major housing and casino projects not reaching the 30% threshold of completion, and which therefore could not record gross

profit. CSCI expects its Hong Kong and Macau GPMs to return 7-8%, and believes China has room to improve further.

The net cash outflow from operating activities declined to HKD1.7bn in 2014 (2013: 3.1bn) due to better-than-before cash-collection efforts. However, net debt-equity still increased by 9pp YoY to 37% as at end-2014 due to the one-off capital investment of HKD1.5bn related to the Macau project. Management expects the current net gearing of 37% to be the peak.

We believe CSCI may slow down contract growth (but maintain 20% YoY in net profit) in order to prevent net gearing from exceeding its 40% guidance. We see a low risk of share placement as CSCI is likely issuing shares to its parent company in exchange for future asset acquisition from it. Also, management has little incentive to undertake a share placement as CSCI's share price has been weak in the past 6 months.

CSCI remains optimistic on the China market in 2015 as relocation housing is likely to increase by 23% YoY, according to the government. CSCI does expect a pick-up in contracts in Hong Kong for 2H15 due to the launch of additional housing projects. Its 2015 revenue target remains HKD68bn, but we expect it to revise this up to HKD70bn.

We revise down our 2015-16E EPS by 15-17% as we expect CSCI to slow down contract growth in order to better control gearing. Accordingly, we revise down our new-contract assumptions for 2015-16 by 1.2-1.4%. As such, we lower our 12-month target price to HKD14.60 (from HKD17.40), based on an

unchanged PER of 11x on 2016E BVPS.

■ What we recommend

CSCI remains our top sector pick as we expect healthy contract wins and better control on gearing to be key revenue drivers. The major risk to our call would be an unexpected slowdown in the government's relocation-housing scheme.

■ How we differ

Our 2015-16E EPS are 4-7% lower than consensus on expectations of slower contract growth.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(5.1)	(7.0)	n.a.
Net profit change	(11.4)	(13.5)	n.a.
Core EPS (FD) change	(15.3)	(17.3)	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	10.62-14.08
Market cap (USDbn)	5.50
3m avg daily turnover (USDm)	9.50
Shares outstanding (m)	4,012
Major shareholder	China Overseas Holdings (58.3%)

Financial summary (HKD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	41,062	49,801	59,806
Operating profit (m)	5,205	6,708	8,293
Net profit (m)	4,240	5,446	6,748
Core EPS (fully-diluted)	1.043	1.339	1.659
EPS change (%)	19.1	28.4	23.9
Daiwa vs Cons. EPS (%)	(7.1)	(4.0)	n.a.
PER (x)	10.2	7.9	6.4
Dividend yield (%)	3.0	3.8	4.7
DPS	0.317	0.407	0.505
PBR (x)	1.8	1.5	1.3
EV/EBITDA (x)	8.9	7.1	6.0
ROE (%)	19.3	20.8	21.9

Source: FactSet, Daiwa forecasts

■ CSCI FY14 results (HKDm)

	1H14	2H14	FY2014	1H14	2H14	FY14
Revenue	14,259	20,181	34,440	23.9	27.9	26.2
Gross profit	2,002	2,741	4,743	23.5	29.0	26.6
Pre-tax income	1,767	2,281	4,048	26.3	28.5	27.5
Net Profit- Shareholders	1,465	1,992	3,457	24.9	26.4	25.7
Dividend	428	602	1,030	22.3	28.9	26.1
Reported EPS (HK\$)	0.38	0.51	0.89	24.8	26.0	25.5
DPS (HK\$)	0.11	0.15	0.26	22.1	28.6	25.8
Gross margin (%)	14	14	14	(0.05)	0.12	0.04
Net margin (%)	10	10	10	0.1	(0.1)	(0.0)
Net gearing ratio (%)			37			9.3

Source: company

Financial summary

■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
New order growth (YoY %)	45.7	21.5	21.5	23.7	32.3	15.7	15.8	16.4
Order book growth (YoY %)	43.8	37.9	17.9	32.6	21.7	30.4	25.2	22.2
Gross margin – HK (%)	6.3	7.3	7.1	7.3	6.6	7.0	7.0	7.0
Gross margin – China (%)	19.1	16.0	20.1	20.0	23.0	21.0	21.0	21.0
New contracts (HKDbn)	24.9	30.3	36.8	45.5	60.2	69.7	80.7	93.9
Year-end order backlog (HKDbn)	35.5	48.9	57.7	76.5	93.1	121.4	152.0	185.8

■ Profit and loss (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Hong Kong	6,237	8,708	11,089	11,134	15,285	14,483	15,717	17,780
PRC overall	4,825	7,547	8,810	13,958	15,517	22,387	30,319	38,596
Other Revenue	921	124	2,012	2,193	3,638	4,192	3,765	3,430
Total Revenue	11,983	16,379	21,911	27,286	34,440	41,062	49,801	59,806
Other income	189	422	371	437	475	488	506	525
COGS	(10,667)	(14,581)	(19,192)	(23,540)	(29,696)	(35,114)	(42,124)	(50,267)
SG&A	(472)	(554)	(740)	(1,042)	(1,033)	(1,232)	(1,475)	(1,771)
Other op. expenses	(26)	(23)	0	0	0	0	0	0
Operating profit	1,007	1,643	2,349	3,140	4,185	5,205	6,708	8,293
Net-interest inc./(exp.)	(16)	(193)	(239)	(418)	(456)	(522)	(579)	(628)
Assoc./forex/extraord./others	342	394	432	452	318	335	353	372
Pre-tax profit	1,333	1,844	2,541	3,174	4,048	5,018	6,483	8,038
Tax	(213)	(334)	(405)	(503)	(660)	(818)	(1,057)	(1,310)
Min. int./pref. div./others	(84)	(3)	(5)	79	70	40	20	20
Net profit (reported)	1,036	1,507	2,131	2,750	3,457	4,240	5,446	6,748
Net profit (adjusted)	1,036	1,507	2,131	2,750	3,457	4,240	5,446	6,748
EPS (reported)(HKD)	0.327	0.442	0.573	0.707	0.887	1.057	1.357	1.682
EPS (adjusted)(HKD)	0.327	0.442	0.573	0.707	0.887	1.057	1.357	1.682
EPS (adjusted fully-diluted)(HKD)	0.327	0.435	0.573	0.697	0.875	1.043	1.339	1.659
DPS (HKD)	0.110	0.130	0.167	0.210	0.264	0.317	0.407	0.505
EBIT	926	1,463	2,237	3,020	4,039	5,050	6,541	8,112
EBITDA	1,007	1,643	2,349	3,140	4,185	5,205	6,708	8,293

■ Cash flow (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	1,333	1,844	2,541	3,174	4,048	5,018	6,483	8,038
Depreciation and amortisation	81	180	274	293	320	328	340	354
Tax paid	(56)	(61)	(131)	(120)	(660)	(818)	(1,057)	(1,310)
Change in working capital	(850)	(2,418)	(5,426)	(6,297)	(5,106)	(3,829)	(4,328)	(5,373)
Other operational CF items	0	0	(504)	(134)	(290)	(254)	(229)	(212)
Cash flow from operations	509	(455)	(3,246)	(3,085)	(1,689)	445	1,210	1,496
Capex	(365)	(522)	(402)	(378)	(350)	(550)	(600)	(600)
Net (acquisitions)/disposals	(840)	(135)	(28)	(183)	(1,600)	0	0	0
Other investing CF items	(220)	493	(73)	661	(141)	0	0	0
Cash flow from investing	(1,425)	(164)	(504)	100	(2,091)	(550)	(600)	(600)
Change in debt	1,393	731	3,681	5,734	3,736	1,911	1,498	1,498
Net share issues/(repurchases)	0	3,584	2,271	0	0	0	0	0
Dividends paid	(252)	(430)	(523)	(703)	(895)	(1,204)	(1,340)	(1,927)
Other financing CF items	0	(991)	(407)	(986)	331	(522)	(579)	(628)
Cash flow from financing	1,141	2,894	5,022	4,046	3,172	185	(421)	(1,057)
Forex effect/others	0	0	(5)	(49)	17	0	0	0
Change in cash	225	2,275	1,267	1,012	(591)	80	189	(161)
Free cash flow	144	(977)	(3,648)	(3,463)	(2,039)	(105)	610	896

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (HKDm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	3,728	5,481	6,884	8,137	7,470	7,549	7,738	7,577
Inventory	118	150	185	163	160	190	227	271
Accounts receivable	4,163	4,736	7,109	10,024	12,542	14,954	18,136	21,780
Other current assets	908	4,035	6,986	10,729	14,158	14,158	14,158	14,158
Total current assets	8,917	14,402	21,164	29,053	34,330	36,850	40,259	43,786
Fixed assets	1,454	1,870	2,191	2,672	2,827	3,049	3,309	3,555
Goodwill & intangibles	4,056	4,936	6,332	7,158	7,309	7,309	7,309	7,309
Other non-current assets	4,252	5,525	8,147	13,567	22,113	28,001	34,819	43,175
Total assets	18,679	26,733	37,835	52,450	66,579	75,210	85,697	97,825
Short-term debt	0	1,298	50	263	588	1,001	1,001	1,001
Accounts payable	4,117	5,176	7,152	13,020	17,261	21,610	27,124	33,568
Other current liabilities	4,115	5,103	5,895	9,479	13,371	11,542	10,861	9,953
Total current liabilities	8,232	11,577	13,097	22,761	31,221	34,153	38,986	44,522
Long-term debt	5,351	4,961	10,001	12,465	14,235	15,734	17,233	18,732
Other non-current liabilities	473	698	883	1,037	1,125	1,125	1,125	1,125
Total liabilities	14,056	17,236	23,982	36,263	46,581	51,012	57,344	64,379
Share capital	74	90	97	97	97	97	97	97
Reserves/R.E./others	4,545	9,401	13,413	15,836	19,730	23,970	28,144	33,258
Shareholders' equity	4,619	9,490	13,510	15,934	19,827	24,067	28,241	33,355
Minority interests	4	7	343	253	168	128	108	88
Total equity & liabilities	18,679	26,733	37,835	52,450	66,576	75,207	85,693	97,822
EV	41,933	40,858	43,536	45,338	44,659	46,451	47,742	49,382
Net debt/(cash)	1,623	778	3,168	4,591	7,354	9,186	10,496	12,156
BVPS (HKD)	1.459	2.784	3.476	4.099	4.941	5.998	7.039	8.313

■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	23.5	36.7	33.8	24.5	26.2	19.2	21.3	20.1
EBITDA (YoY)	104.3	63.2	43.0	33.7	33.3	24.4	28.9	23.6
Operating profit (YoY)	128.9	58.1	52.9	35.0	33.7	25.0	29.5	24.0
Net profit (YoY)	53.7	45.5	41.4	29.0	25.7	22.6	28.4	23.9
Core EPS (fully-diluted) (YoY)	49.3	32.7	31.9	21.5	25.6	19.1	28.4	23.9
Gross-profit margin	11.0	11.0	12.4	13.7	13.8	14.5	15.4	16.0
EBITDA margin	8.4	10.0	10.7	11.5	12.2	12.7	13.5	13.9
Operating-profit margin	7.7	8.9	10.2	11.1	11.7	12.3	13.1	13.6
Net profit margin	8.6	9.2	9.7	10.1	10.0	10.3	10.9	11.3
ROAE	25.5	21.4	18.5	18.7	19.3	19.3	20.8	21.9
ROAA	6.1	6.6	6.6	6.1	5.8	6.0	6.8	7.4
ROCE	10.6	11.4	11.3	11.4	12.7	13.3	14.9	16.3
ROIC	21.3	16.3	14.5	14.0	14.6	14.3	15.5	16.4
Net debt to equity	35.1	8.2	23.4	28.8	37.1	38.2	37.2	36.4
Effective tax rate	16.0	18.1	15.9	15.9	16.3	16.3	16.3	16.3
Accounts receivable (days)	110.1	99.2	98.7	114.6	119.6	122.2	121.3	121.8
Current ratio (x)	1.1	1.2	1.6	1.3	1.1	1.1	1.0	1.0
Net interest cover (x)	59.5	7.6	9.3	7.2	8.9	9.7	11.3	12.9
Net dividend payout	33.6	29.4	29.2	29.7	29.8	30.0	30.0	30.0
Free cash flow yield	0.3	n.a.	n.a.	n.a.	n.a.	n.a.	1.4	2.1

Source: FactSet, Daiwa forecasts

■ Company profile

China State Construction International Holdings Limited (CSCI) is an integrated construction company, engaged in construction, civil-engineering operations, and other peripheral operations. It is the largest construction contractor in Hong Kong. The company has extensive international contracting experience, and is actively engaged in the infrastructure market in Mainland China.

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