

China Communications Construction - H

Dredging restructuring plan unveiled; Results in line with Op-CF and ZPMC turnaround as key highlights

Restructuring plan for dredging business unveiled: CCCC will resume trading today after releasing a preliminary plan for the spin-off of its dredging business (trading was suspended during yesterday's afternoon session). CCCC will create a separate business entity (and make an initial cash contribution) namely CCCC Dredging, which will then issue stock to CCCC in exchange for relevant dredging assets. After these transactions have been completed, the plan is for CCCC Dredging to seek a separate listing in an overseas market. We view the spin-off plan positively as we believe the dredging segment will be able to raise capital to build capacity and more easily enhance profitability through greater vertical integration as a separate entity.

- **FY14 result inline with two key positives:** CCCC's NPAT came in at Rmb14B, up 11% Y/Y, inline with JPMe and street consensus. Order intake amounted to Rmb608B, up 12% Y/Y, 3% ahead of our expectation driven by design and port machinery. We highlight below two key positives:

- 1) **Positive #1 Port machinery segment (i.e. ZPMC) reported a remarkable turnaround:** ZPMC, a drag on CCCC's bottom line since end of the last GFC, recorded an operating profit of Rmb1.8B in 2014, forming 8% of profit. ZPMC, loss making during 2010-2012, achieved break even in 2013, while EBIT margin in 2014 expanded to 6.9% (from 0.3% oya). Order flow was robust last year, up c20% Y/Y while backlog coverage ratio rose to 1.2x of revenue. The segment will also benefit from China's OBOR plan, as part of CCCC's offering of total solutions for waterway infrastructure.
- 2) **Positive #2: Op-CF surged 58% Y/Y in 4Q14:** Op-CF was a positive inflow of Rmb21B in 4Q14, offsetting the outflow in 9M14 (totaling Rmb17B). Its cash generation capability was impressive to us, in light of the tight credit conditions and the fact that CCCC deals a lot with local governments. The restoration of cash generation in 4Q also alleviated stress on the balance sheet, as net gearing dropped to 119% at year-end, down from 148% as of 1H14.

China Communications Construction - H (Reuters: 1800.HK, Bloomberg: 1800 HK)

Rmb in mn, year-end Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Total Revenue (Rmb mn)	295,321	331,798	364,256	396,604	431,357
Net Profit (Rmb mn)	12,277	12,568	14,282	15,358	17,133
EPS (Rmb)	0.79	0.78	0.88	0.95	1.06
DPS (Rmb)	0.19	0.19	0.21	0.23	0.26
Revenue growth (%)	0.4%	12.4%	9.8%	8.9%	8.8%
EPS growth (%)	(0.2%)	(1.9%)	13.6%	7.5%	11.6%
ROE	15.7%	13.8%	14.2%	13.8%	13.8%
P/E (x)	11.6	11.8	10.4	9.6	8.6
P/BV (x)	1.7	1.6	1.4	1.3	1.1
EV/EBITDA (x)	7.7	8.3	7.2	7.0	6.4
Dividend Yield	2.1%	2.0%	2.3%	2.5%	2.8%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Overweight

1800.HK, 1800 HK

Price: HK\$11.42

Price Target: HK\$13.70



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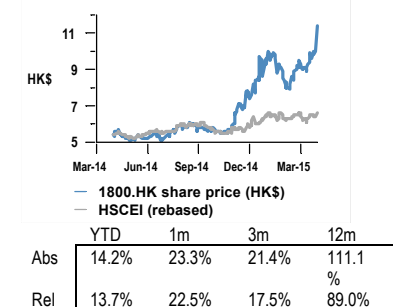
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Price Performance



Company Data

Shares O/S (mn)	16,175
Market Cap (HK\$ mn)	184,716
Market Cap (\$ mn)	23,824
Price (HK\$)	11.42
Date Of Price	30 Mar 15
Free Float(%)	-
3M - Avg daily vol (mn)	43.11
3M - Avg daily val (HK\$ mn)	396.21
3M - Avg daily val (\$ mn)	51.1
HSCEI	1,1898.09
Exchange Rate	7.75
Price Target End Date	31-Dec-15

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p>Key catalyst for the stock price:</p> <ul style="list-style-type: none"> Improving local government financing situation on back of easing credit conditions Any announcement of restructuring progress High-level guidelines to be unveiled by Chinese government in relation to One Belt One Road initiatives 	<p>Upside risks to our view:</p> <ul style="list-style-type: none"> Faster-than-expected gross margin recovery Higher-than-expected construction revenue Better-than-expected improvement in working capital turns Lower-than-expected capex in non-core businesses 	<p>Downside risks to our view:</p> <ul style="list-style-type: none"> Slower-than-expected gross margin recovery Lower-than-expected construction revenue Deteriorating working capital turns Higher-than-expected capex in non-core businesses Execution risk on overseas projects
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Key financial metrics	FY13A	FY14E	FY15E	FY16E
Revenues (LC)	331,798	364,256	396,604	431,357
Revenue growth (%)	12%	10%	9%	9%
EBITDA (LC)	27,617	35,198	38,469	42,910
EBITDA margin (%)	8%	10%	10%	10%
Tax rate (%)	23%	24%	25%	26%
Net profit (LC)	12,568	14,282	15,358	17,133
EPS (LC)	0.78	0.88	0.95	1.06
EPS growth (%)	2%	14%	8%	12%
DPS (LC)	0.19	0.21	0.23	0.26
BVPS (LC)	5.86	6.53	7.25	8.06
Operating cash flow (LC mn)	6,972	6,652	17,032	23,235
Free cash flow (LC mn)	3,768	(16,271)	(5,655)	1,672
Interest cover (X)	7.0	5.8	6.2	6.5
Net margin (%)	3.8%	3.9%	3.9%	4.0%
Sales/assets (X)	0.70	0.68	0.70	0.72
Debt/equity (%)	178%	161%	146%	132%
Net debt/equity (%)	101%	111%	111%	106%
ROE (%)	13.8%	14.2%	13.8%	13.8%
Key model assumptions	FY13A	FY14E	FY15E	FY16E
Revenue growth (%)	12.4%	9.8%	8.9%	8.8%
Gross profit margin (%)	10.2%	10.7%	10.9%	11.1%

Source: Bloomberg, Company and J.P. Morgan estimates.

Sensitivity analysis	EBITDA		EPS	
	FY15E	FY16E	FY15E	FY16E
1ppt chg in revenue growth	1%	1%	1%	1%
1ppt chg in GPM	10%	17%	10%	17%

Source: Bloomberg, Company and J.P. Morgan estimates.

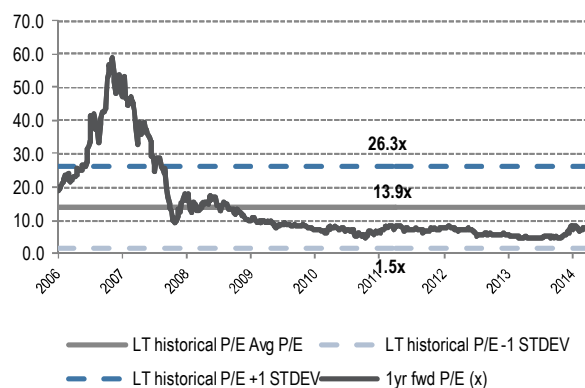
Comparative metrics	CMP LC	Mkt Cap \$Mn	P/E		EV/EBITDA		P/BV		YTD Stock perf.
			FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	
CCCC-H	11.42	40,454	9.6	8.6	10.8	9.7	1.3	1.1	22.4
CRG-H	8.11	40,557	11.2	9.8	19.7	18.9	1.3	1.2	27.1
CRCC-H	12.06	35,036	8.9	7.8	9.0	8.1	1.1	1.0	22.1
CSCI	10.7	5,536	9.0	7.0	8.1	6.4	1.8	1.5	-1.8
Sinopec Engineering	6.38	3,643	5.0	4.4	2.1	1.8	0.8	0.7	21.8
CMEC	7.47	3,974	9.8	8.7	2.5	2.1	1.7	1.5	25.8

Source: Bloomberg, Company and J.P. Morgan estimates. Prices are as of 03/30/2015

Valuation and price target basis

Our Dec-2015 PT of HK\$13.7 is derived based on DCF valuation. Our PT corresponds to an implied P/E of 11.6x/10.3x and P/B of 1.5x/1.4x on FY15/16E

CCCC—1yr forward P/E band chart



Source: Bloomberg, Company and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

Net Profit (Rmb MM)	FY15E	FY16E
JPMe old	15,358	17,133
JPMe new	15,358	17,133
% chg	0%	0%
Consensus	15,098	16,874

Source: Bloomberg, Company and J.P. Morgan estimates.

FY14 result review

Table 1: CCCC—FY14 results review

<i>Based on HK GAAP</i> <i>Rmb in MMs</i>	FY14 Actual	FY13 Actual	Y/Y chg%	FY14 JPMe	% Diff	2H14 Actual	2H13 Actual	Y/Y chg%	1H14 Actual	H/H chg%
Turnover	366,042	331,798	10%	364,256	0%	207,481	190,761	9%	158,561	31%
<i>Construction</i>	299,192	264,146	13%	284,857	5%	170,338	152,632	12%	128,854	32%
<i>Design</i>	21,086	19,394	9%	23,273	-9%	13,207	11,657	13%	7,879	68%
<i>Dredging</i>	27,838	32,789	-15%	36,068	-23%	14,666	18,942	-23%	13,172	11%
<i>Port machinery</i>	26,733	24,171	11%	26,820	0%	15,810	13,374	18%	10,923	45%
<i>Others</i>	4,192	3,706	13%	4,077	3%	1,535	2,555	-40%	2,657	-42%
Gross profit	39,272	33,938	16%	39,077	0%	22,636	19,682	15%	16,636	36%
<i>Construction</i>	27,117	22,931	18%	25,868	5%	15,372	13,174	17%	11,745	31%
<i>Design</i>	4,586	4,627	-1%	5,120	-10%	2,844	2,837	0%	1,742	63%
<i>Dredging</i>	3,782	4,516	-16%	4,689	-19%	2,067	2,548	-19%	1,715	21%
<i>Port machinery</i>	3,514	1,604	119%	3,114	13%	2,208	898	146%	1,306	69%
<i>Others</i>	299	207	44%	286	5%	194	133	46%	105	85%
<i>Offset & unallocated</i>	(26)	53		0		(49)	92		23	
Other gain / income, net	3,365	1,927		3,051		2,454	952		911	
Selling and admin expenses	(18,852)	(16,290)	16%	(16,853)	12%	(12,169)	(10,028)	21%	(6,683)	82%
SG&A as % of total sales	5.2%	4.9%	0.24 ppts	4.6%	0.52 ppts	5.9%	5.3%	0.61 ppts	4.2%	1.65 ppts
Operating Profits (EBIT)	23,785	19,575	22%	25,275	-6%	12,921	10,606	22%	10,864	19%
Net interest cost	(6,520)	(3,945)	65%	(6,068)	7%	(3,293)	(2,156)	53%	(3,227)	2%
Share of asso / JCE	339	222	53%	110	208%	200	184	9%	139	44%
Profit Before Tax (PBT)	17,604	15,852	11%	19,317	-9%	9,828	8,634	14%	7,776	26%
Net profit	13,985	12,568	11%	14,282	-2%	7,965	6,846	16%	6,020	32%
Net gearing									148%	
Gross margin	10.7%	10.2%	0.5 ppts	10.7%	0 ppts	10.9%	10.3%	0.59 ppts	10.5%	0.42 ppts
<i>Construction</i>	9.1%	8.7%	0.38 ppts	9.1%	-0.02 ppts	9.0%	8.6%	0.39 ppts	9.1%	-0.09 ppts
<i>Design</i>	21.7%	23.9%	-2.11 ppts	22.0%	-0.25 ppts	21.5%	24.3%	-2.8 ppts	22.1%	-0.58 ppts
<i>Dredging</i>	13.6%	13.8%	-0.19 ppts	13.0%	0.59 ppts	14.1%	13.5%	0.64 ppts	13.0%	1.07 ppts
<i>Port machinery</i>	13.1%	6.6%	6.51 ppts	11.6%	1.53 ppts	14.0%	6.7%	7.25 ppts	12.0%	2.01 ppts
EBIT Margin	6.5%	5.9%	0.6 ppts	6.9%	-0.44 ppts	6.2%	5.6%	0.67 ppts	6.9%	-0.62 ppts
<i>Construction</i>	5.2%	5.1%	0.13 ppts	5.7%	-0.47 ppts	4.6%	4.9%	-0.34 ppts	6.1%	-1.55 ppts
<i>Design</i>	12.3%	13.3%	-0.95 ppts	11.7%	0.61 ppts	11.6%	13.2%	-1.64 ppts	13.5%	-1.94 ppts
<i>Dredging</i>	9.5%	11.0%	-1.54 ppts	10.6%	-1.07 ppts	11.4%	10.2%	1.19 ppts	7.4%	4.01 ppts
<i>Port machinery</i>	6.9%	0.3%	6.59 ppts	5.4%	1.52 ppts	4.9%	-1.6%	6.5 ppts	9.8%	-4.95 ppts
Net Margin	3.8%	3.8%	0.03 ppts	3.9%	-0.1 ppts	3.8%	3.6%	0.25 ppts	3.8%	0.04 ppts
New Orders	608,417	543,261	12%	591,158	3%	328,786	290,344	13%	279,631	18%
<i>Construction</i>	496,821	450,551	10%	495,606	0%	261,270	242,229	8%	235,551	11%
<i>Design</i>	31,137	25,191	24%	25,191	24%	17,659	12,271	44%	13,478	31%
<i>Dredging</i>	42,332	39,336	8%	41,303	2%	29,464	21,235	39%	12,868	129%
<i>Port machinery</i>	33,032	27,850	19%	28,725	15%	17,176	14,449	19%	15,856	8%
Order backlog	720,669	653,706		864,455	-17%	720,669	653,706		766,906	-6%
Op-CF	4,408	6,972				21,932	17,593	25%	(17,524)	

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

China Communications Construction - H (*Overweight; Price Target: HK\$13.70*)

Investment Thesis

CCCC has been diversifying its revenue stream, transforming its business model from a pure EPC contractor to a service provider/infra asset operator. This business transformation has been underappreciated, in our view, overshadowed by concerns about local governments' funding situation, as reflected in CCCC's attractive valuation compared to its mid-cycle average multiples.

We see further room for cost-cutting and efficiency gains through continued emphasis on SOE reform and ongoing restructuring. We expect CCCC to de-leverage by way of improving cash generation amid China's easing credit conditions, equity fundraising (issue of preference shares) and asset monetization (through sale of held-for-sale financial assets/non-strategic investments, receivable securitization and sale of BOT assets).

Additionally, we view CCCC as the key beneficiary of China's OBOR initiative, given its established track record in overseas markets and strong government backing (from its ultimate parent, the Ministry of Communication). We therefore expect the release of the detailed OBOR policy to be a major positive price catalyst for CCCC. We remain OW.

Valuation

Our Dec-15 PT of HK\$13.70 is based on our DCF valuation. Our PT implies a FY15/16E P/E of 11.6x/10.3x and P/BV of 1.5x/1.4x.

DCF assumptions

WACC = 9.3%
Cost of equity = 11.3%
Risk-free rate = 5.0%
Equity risk premium = 7.0%
Beta = 0.9x
Cost of debt = 4.6%
Target D/E = 30%
Terminal growth = 0%

Risks to Rating and Price Target

Key downside risks include: (1) weaker-than-expected transport FAI; (2) execution risks associated with overseas projects and BT/BOT-type projects; (3) slower-than-expected in-sourcing progress of CCCC's dredging business; and (4) an unexpected shift toward credit tightening in China.

China Communications Construction - H: Summary of Financials

Income Statement						Cash flow statement					
Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenues	295,321	331,798	364,256	396,604	431,357	Earnings before tax	15,551	15,852	19,317	21,043	23,726
% change Y/Y	0.4%	12.4%	9.8%	8.9%	8.8%	Depr. & amortization	6,987	8,042	9,923	11,301	12,671
Gross Margin	11.0%	10.2%	10.7%	10.9%	11.1%	Change in working capital	(10,718)	(19,589)	(15,011)	(8,793)	(5,997)
EBITDA	26,212	27,617	35,198	38,469	42,910	Taxes	(3,790)	(3,580)	(4,556)	(5,173)	(6,070)
% change Y/Y	15.4%	5.4%	27.4%	9.3%	11.5%	Others	5,277	6,247	(3,021)	(1,346)	(1,095)
EBITDA margin	8.9%	8.3%	9.7%	9.7%	9.9%	Cash flow from operations	13,307	6,972	6,652	17,032	23,235
EBIT	19,225	19,575	25,275	27,168	30,239	Capex	(6,535)	(6,258)	(27,560)	(27,398)	(26,507)
% change Y/Y	18.6%	1.8%	29.1%	7.5%	11.3%	Others	5,785	2,410	27,560	27,398	26,507
EBIT Margin	6.5%	5.9%	6.9%	6.9%	7.0%	Cash flow from investing	(19,504)	(28,086)	(24,426)	(26,112)	(25,476)
Net Interest	(3,784)	(3,945)	(6,068)	(6,246)	(6,643)	Free cash flow	9,634	3,768	(16,271)	(5,655)	1,672
Earnings before tax	15,551	15,852	19,317	21,043	23,726	Equity raised/(repaid)	-	-	-	-	-
% change Y/Y	3.5%	1.9%	21.9%	8.9%	12.8%	Debt raised/(repaid)	36,321	42,787	0	0	0
Tax	(3,790)	(3,580)	(4,556)	(5,173)	(6,070)	Dividends paid	(3,037)	(3,079)	(3,449)	(3,709)	(4,137)
as % of EBT	24.4%	22.6%	23.6%	24.6%	25.6%	Other	(4,322)	(5,146)	(2,412)	(592)	(635)
Net income (reported)	12,277	12,568	14,282	15,358	17,133	Cash flow from financing	28,962	34,562	(5,860)	(4,300)	(4,773)
% change Y/Y	4.4%	2.4%	13.6%	7.5%	11.6%	Net change in cash	22,266	13,735	(23,617)	(13,362)	(6,997)
Shares outstanding	16,175	16,175	16,175	16,175	16,175	Effect of exchange rate	(499)	287	18	18	18
EPS (reported)	0.79	0.78	0.88	0.95	1.06	Beginning cash	45,237	67,503	81,238	57,621	44,259
% change Y/Y	(0.2%)	(1.9%)	13.6%	7.5%	11.6%	Ending cash	67,503	81,238	57,621	44,259	37,262
						DPS	0.19	0.19	0.21	0.23	0.26
Balance sheet						Ratio Analysis					
Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Inventories	27,113	32,850	36,064	38,180	40,343	EBITDA margin	8.9%	8.3%	9.7%	9.7%	9.9%
Trade debtors	111,842	129,870	145,568	158,496	170,020	EBIT margin	6.5%	5.9%	6.9%	6.9%	7.0%
Bank balances and cash	67,503	81,238	57,621	44,259	37,262	Net margin	4.2%	3.8%	3.9%	3.9%	4.0%
Other current assets	65,150	74,895	84,774	91,901	99,559	Sales growth	0.4%	12.4%	9.8%	8.9%	8.8%
Current assets	271,608	318,853	324,027	332,836	347,185	Net profit growth	4.4%	2.4%	13.6%	7.5%	11.6%
Net fixed assets	65,761	64,644	82,281	98,378	112,214	EPS growth	(0.2%)	(1.9%)	13.6%	7.5%	11.6%
Other non-current assets	96,908	133,948	141,197	148,954	156,328	Net debt to total capital	44.4%	50.2%	52.7%	52.7%	51.4%
Total Assets	434,277	517,445	547,505	580,168	615,727	Net debt to equity	79.8%	100.9%	111.4%	111.2%	105.6%
Liabilities						Sales/assets	0.7	0.7	0.7	0.7	0.7
Short-term loans	69,187	87,818	87,818	87,818	87,818	Assets/equity	5.1	5.2	5.3	5.1	4.8
Payables	165,972	198,064	215,444	234,576	255,131	ROE	15.7%	13.8%	14.2%	13.8%	13.8%
Others	19,027	18,853	20,330	21,802	23,383	ROCE	7.1%	5.9%	6.7%	6.9%	7.2%
Total current liabilities	254,186	304,735	323,592	344,196	366,332						
Long-term debt	75,058	99,157	99,157	99,157	99,157						
Other liabilities	8,920	8,712	8,603	8,501	8,406						
Total Liabilities	338,164	412,604	431,352	451,854	473,894						
Minority interest	9,454	9,980	10,459	10,971	11,494						
Shareholder's equity	86,659	94,861	105,694	117,343	130,339						
BVPS	5.36	5.86	6.53	7.25	8.06						

Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile

China Communications Construction Co. Ltd. Class H (CHINA / Industrials)

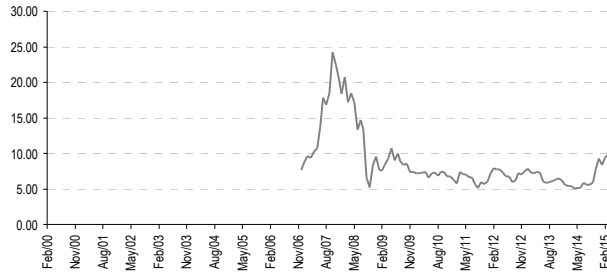
As Of: 27-Mar-2015

Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

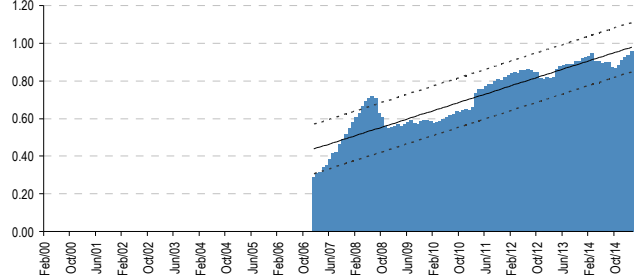
Local Share Price

Current: 9.91



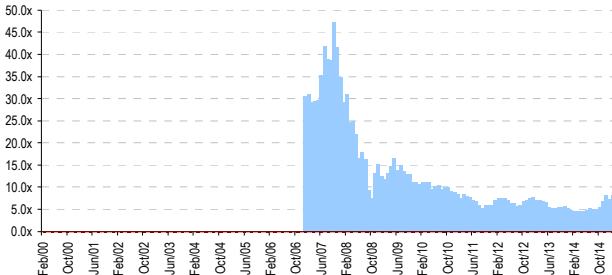
12 Mth Forward EPS

Current: 0.96



PE (1Yr Forward)

Current: 8.3x



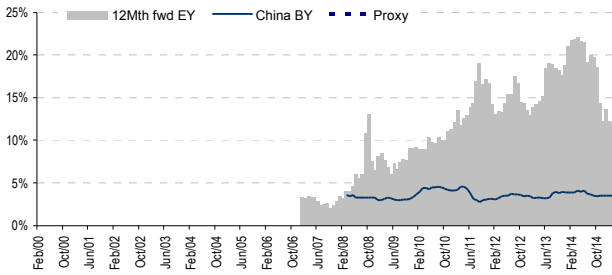
P/E Relative to China Index

Current: 0.86



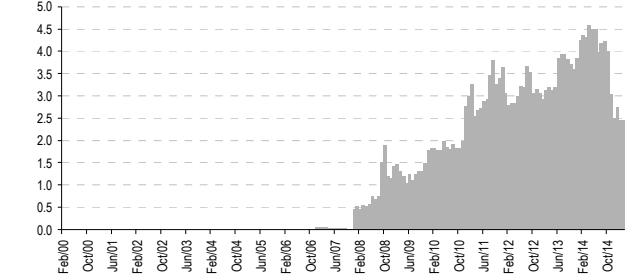
Earnings Yield (& Local Bond Yield)

Current: 12%



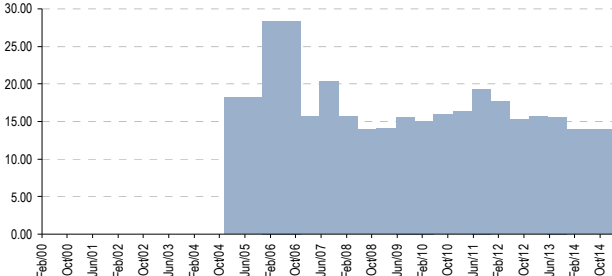
Dividend Yield (Trailing)

Current: 2.45



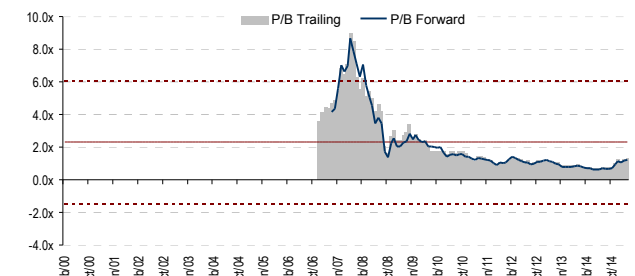
ROE (Trailing)

Current: 13.88



Price/Book (Value)

Current: 1.3x



Summary

China Communications Construction Co.		TICKER		1800 HK		As Of:		27-Mar-15			
CHINA						Local Price:		9.91			
Industrials						EPS:		0.96			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	8.27x										
P/BV (Trailing)	1.32	0.69	9.28	1.40	2.30	6.08	-1.48	-47%	602%	6%	74%
Dividend Yield (Trailing)	2.45x	0.02	4.58	2.48	2.24	4.97	-0.49	-99%	87%	1%	-8%
ROE (Trailing)	13.88	13.85	28.35	15.67	17.22	25.34	9.11	0%	104%	13%	24%

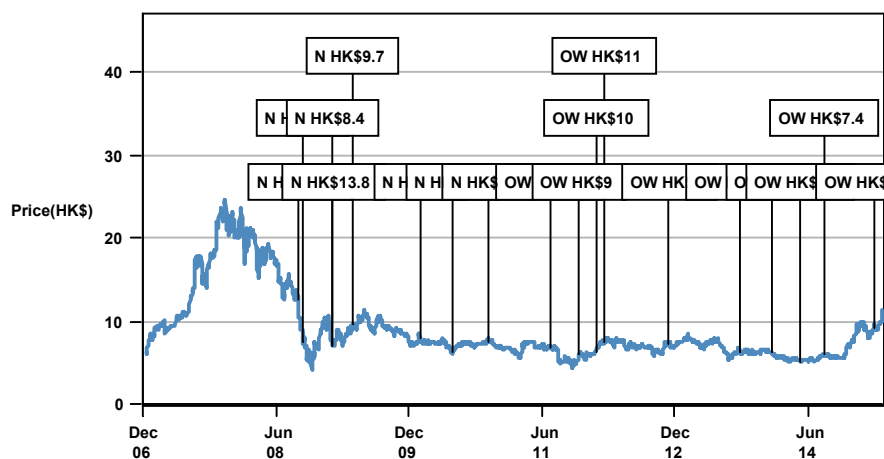
Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

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China Communications Construction - H (1800.HK, 1800 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Sep 04, 2008.

Date	Rating	Share Price (HK\$)	Price Target (HK\$)
04-Sep-08	N	12.44	13.80
18-Sep-08	N	7.58	7.90
22-Jan-09	N	7.11	13.80
23-Jan-09	N	7.11	8.40
15-Apr-09	N	9.59	9.70
17-Jan-10	N	7.87	8.60
27-May-10	N	6.17	6.80
22-Oct-10	N	7.56	7.80
02-Jul-11	OW	6.69	8.60
31-Oct-11	OW	6.11	9.00
09-Jan-12	OW	6.35	10.00
15-Feb-12	OW	7.43	11.00
31-Oct-12	OW	7.22	9.00
27-Aug-13	OW	6.27	9.40
31-Dec-13	OW	6.25	8.00
30-Apr-14	OW	5.15	6.50
02-Aug-14	OW	5.91	7.40
26-Feb-15	OW	9.11	13.70

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IB clients*	56%	49%	33%
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IB clients*	75%	67%	52%

*Percentage of investment banking clients in each rating category.

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