国泰君安证券 GUOTAI JUNAN SECURITIES

Company Report: China State Construction International (03311 HK)

公司报告：中国建筑国际 (03311 HK)

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16 January 2019

Liquidity, Not Growth, is the Key, Maintain "Buy"

流动性，非增长，才是关键。维持“买入”

- **The Company believes that growth is not the only consideration of the Chinese government now and is willing to give up some growth to balance risks.** Although the current economic growth rate has slowed, local government demand for infrastructure is still strong. If local governments can re-leverage, this will stimulate infrastructure investment to resume growth. The Company thinks that the past logic of more new contracts representing more profits is now out of date, as the payback period for projects such as PPP projects is long. In the current environment, liquidity is more important than profitability.

- **The Company thinks that there is still plenty of room for growth in Hong Kong and Macau markets and expected that the new value from contracts from Hong Kong and Macau markets will increase from 32% of total new contracts in 2018 to between 35% and 40% in 2019. In contrast, the Company will further reduce the proportion of new contracts from PPP projects in 2019.** In addition, the Company plans to forge its 74.06% owned listed subsidiary Far East Global (00830 HK) as the flagship of the infrastructure operating projects within the China Construction Engineering Group.

- Our EPS estimates for 2018/ 2019/ 2020 are HKD1.173, HKD1.269 and HKD1.417, respectively. We think the Company will emerge as one of the winners from the market consolidation despite a short-term reduction in profitability. **We maintain the TP at HKD8.50 and "Buy" rating.**

- **公司认为现时增长已非中国政府唯一的考虑，政府可以放弃部分增长以平衡风险。**虽然现时经济增速放缓，但地方政府对基建的需求仍强劲，如果地方政府可以重新加杠杆，将刺激基建投资重拾增长。公司认为过往更多新签合同代表更多利润的逻辑现时已不合时宜，因 PPP 等项目的回款周期偏长。现时环境下流动性比盈利能力更为重要。

- **公司认为香港及澳门市场仍大有发展空间，预计香港及澳门市场新签合同额将可从 2018 年占总额的 32%增加至 2019 年的 35%至 40%。相反，公司 2019 年将进一步减少 PPP 项目的新签合同比例。**此外，公司计划将其持有 74.06%权益的上市附属远东环球(00830 HK)打造为中国建筑工程系内的基建营运项目旗舰。

- 我们对 2018/2019/2020 年的每股盈利预测分别为 1.173 港元、1.269 港元和 1.417 港元。我们认为公司将是市场整合的胜利者之一，即使短期盈利能力可能有所减低。**我们维持 8.50 港元的目标价及“买入”的投资评级。**

Rating:	**Buy** Maintained
评级：	**买入** (维持)
6-18m TP 目标价:	**HK$8.50**
Revised from 原目标价:	HK$8.50
Share price 股价:	HK$7.010

Stock performance
股价表现

Change in Share Price 股价变动	1 M 1 个月	3 M 3 个月	1 Y 1 年
Abs. % 绝对变动 %	8.2	15.3	(36.6)
Rel. % to HS Index 相对恒指变动 %	5.4	12.5	(22.2)
Avg. Share price(HK$) 平均股价（港元）	6.4	6.3	8.4

Source: Bloomberg, Guotai Junan International.

Year End 年结 12/31	Turnover 收入 (HK$ m)	Net Profit 股东净利 (HK$ m)	EPS 每股净利 (HK$)	EPS 每股净利变动 (△%)	PER 市盈率 (x)	BPS 每股净资产 (HK$)	PBR 市净率 (x)	DPS 每股股息 (HK$)	Yield 股息率 (%)	ROE 净资产收益率 (%)
2016A	46,208	5,130	1.198	6.6	5.9	5.670	1.2	0.330	4.7	21.1
2017A	50,153	5,490	1.188	(0.8)	5.9	7.543	0.9	0.350	5.0	17.3
2018F	57,726	5,924	1.173	(1.3)	6.0	8.367	0.8	0.350	5.0	14.7
2019F	64,272	6,406	1.269	8.2	5.5	9.255	0.8	0.380	5.4	14.4
2020F	72,045	7,157	1.417	11.7	4.9	10.273	0.7	0.400	5.7	14.5

Shares in issue (m) 总股数 (m)	5,049.2	Major shareholder 大股东	COHL 62.6%
Market cap. (HK$ m) 市值 (HK$ m)	35,394.9	Free float (%) 自由流通比率 (%)	37.4
3 month average vol. 3 个月平均成交股数 ('000)	11,484.8	FY19 Net gearing (%) FY19 净负债/股东资金 (%)	31.6
52 Weeks high/low (HK$) 52 周高/低 (HK$)	12.180 / 5.380	FY19 Est. NAV (HK$) FY19 每股估值（港元）	8.5

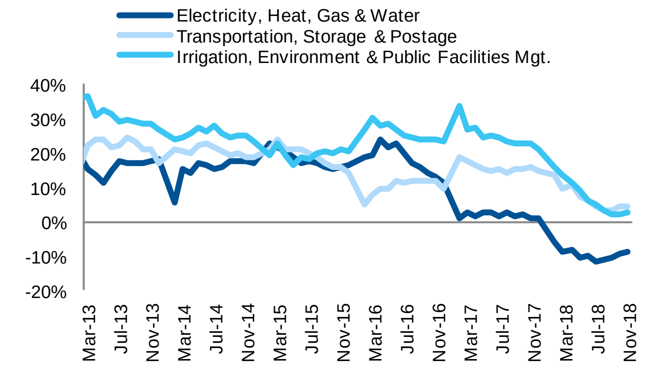
Source: the Company, Guotai Junan International.

Industry Review

Growth is not the only concern for the Chinese Government now. Despite the relaxation in monetary and financial policies recently that seems to suggest another round of "RMB4 trillion" stimulus plan similar to that in 2009 in China, the Company suggested that the situation had changed and growth is no longer the sole goal of the Chinese Government. The Government is willing to sacrifice some growth to balance risk. In addition, the PPP model is being constrained by the ability of local governments to take on new projects, as PPP projects which don't rely on government subsidies and funding are very limited. Local governments are limited by debt problems and risk awareness. If the infrastructure construction cycle is to restart again, the governments' ability and intention to take on higher leverage is key.

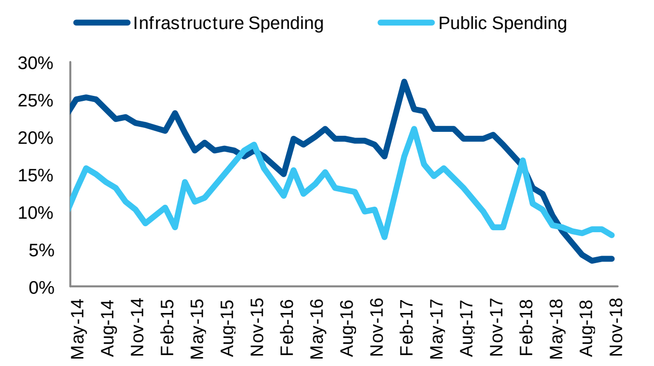
Retaining liquidity is the new logic of infrastructure construction business. In contrast to the market's view, the Company explained that infrastructure demand remained strong despite a slowdown in economic growth, while competition actually decreased among market players because many non-state-owned companies encountered severe liquidity problems during the deleveraging environment over the past two years. The traditional logic of 'more new orders = more revenue = more profit = more cash flow' is no longer valid (and was not perfectly valid in the past) due to a higher proportion of projects in the market adopting PPP models which have much longer repayment duration, resulting in liquidity problems of project owners. Having a stable and healthy cash flow is much more important to an infrastructure construction company compared with profitability, as much more projects now need strong balance sheet support/ external funding, and consistent financing is hard to obtain in the current environment.

Figure 1: Infrastructure Investment Accumulated Growth (By Segment)



Source: the Company.

Figure 2: Infrastructure Spending Growth Vs. Public Spending Growth



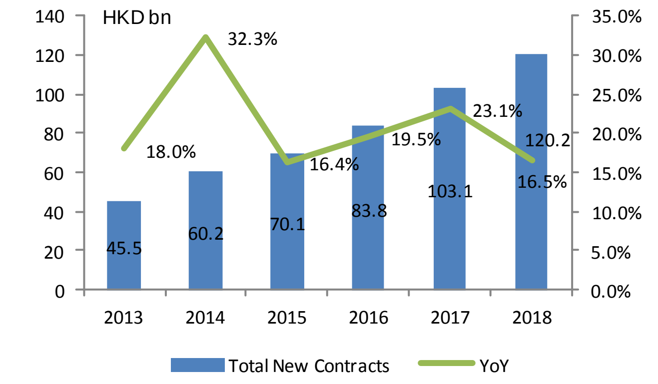
Source: the Company.

Company Updates

The Company will reduce the proportion of PPP new contracts in 2019. In 2018, 61% of its new contracts from mainland China were from non-PPP projects, such as traditional EPC, financing EPC and government procurement projects, and the remaining 39% were PPP projects, which were projects listed in the PPP national database, compared with 52% of new contracts from mainland China being from PPP projects. The Company said that this proportion will surely decrease further in 2019, yet no exact guidance was provided. The Company explained that such change in structure for new contracts, despite no change in new contracts target (both 2018 and 2019 new contracts targets were RMB120 billion), was crucial to the development of the Company. Taking a simple example, a typical EPC project and PPP project might take similar time to complete, while the Company could recoup its investment in an EPC project after 2 to 3 years after project completion, it might take over 10 years in a typical PPP project. This requires a high commitment in working capital and creates huge financial burden on the Company. In contrast to having more new contracts meaning more cash flow, this might even ultimately become having more new contracts (in PPP projects) meaning less cash flow. Hence, the Company intentionally reduced their exposure to PPP new contracts. Note that the Company does not disfavor PPP projects due to risk level. In fact the Company thinks that PPP projects listed in the PPP national database and endorsed by the government is even less risky compared with some EPC projects.

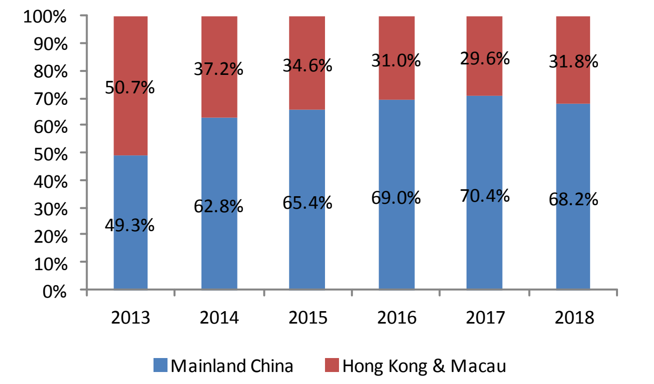
The Company will undertake a higher proportion of new projects in Hong Kong and Macau in 2019 and 2020. In 2017, 29% of its new contracts were from Hong Kong and Macau markets, which increased to 32% in 2018. The Company expects this to increase further to be between 35% and 40% in 2019. The Company explained that the strategy to increase its new contracts focus in Hong Kong and Macau was mainly due to the following: 1) In Hong Kong, some of its major competitors left the market after the Shatin-Central Railway Line construction issue, and those competitors originally occupied a total market share of 6%-8% in Hong Kong, which is significant even for the largest constructor in Hong Kong, the Company itself, which occupies a total market share of 15%. That level of market share can only be filled with large players such as the Company. 2) New infrastructure projects and casino expansion plans will be rolled out in Macau in 2019 and 2020, which will likely increase the market several times compared with 2018. 3) projects in Hong Kong and Macau are cash construction in nature, which has much lower working capital requirement and much faster cash collection, as compared with PPP projects in mainland China. The Company is likely to stick to this strategy for at least the next two to three years and emphasise liquidity rather than profitability. The Company thinks that profit margin might be under pressure due to lower profit margin of cash construction projects compared with PPP projects, while overall net profit growth might not be significantly affected as new contracts turnover to turn them into revenue and net profit is likely to be faster.

Figure 3: CSCI's New Contracts for 2013-2018



Source: the Company.

Figure 4: CSCI's New Contracts by Regions for 2013-2018



Source: the Company.

Far East Global (00830 HK) will become the infrastructure projects operator for CSCEC. On 7 January 2019, the Company sold two infrastructure projects, the Nan Chang Bridge and the Nan Chang Zhong Hai Xin Ba Yi Bridge, to its 74.06% held listed subsidiary Far East Global ("FEG", 00830 HK) for HKD295 million, a step which marked the start of its securitization of its operating assets. The Company explained that FEG will become the flagship of infrastructure operating assets of CSCEC, their parent company, and propose to change the company name of FEG to China State Construction Development Holdings Limited ("CSCD") to better reflect this position. We think the restructuring can make better use of the listed platform FEG, yet the Company can securitize its operating assets and raise more capital to fund business development. We think a clear separation of businesses can help potential value release and is beneficial to both companies.

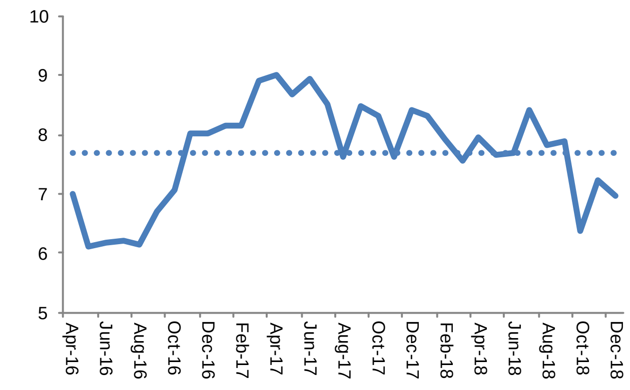
We keep the TP at HKD8.50 and maintain "Buy". Our EPS estimates for 2018/ 2019/ 2020 are HKD1.173, HKD1.269 and HKD1.417, respectively. We think the Company's strategy in focusing more in cash construction projects in Hong Kong and Macau might affect short-term profitability with reduced margin. However, the downturn is compensated by much better operating cash inflow and partially offset by faster asset turnover (due to lower working capital requirement). We agree with the Company's view that liquidity, not growth, is the most critical factor the Company should stick to during transforming the infrastructure construction market and think the Company will emerge through the difficult time and become one of the few winners in market consolidation. We keep the TP unchanged at HKD8.50 and maintain "Buy" rating.

Table 1: Peers Valuation

Company	Stock Code	Currency	Last price	Market cap(mn)	PE				PB				ROE(%)	D/Y(%)	ROA(%)
					17A	18F	19F	20F	17A	18F	19F	20F	19F	19F	19F
China State Construction Int	3311 HK	HKD	7.010	35,395	5.9	6.0	5.2	4.5	0.9	0.8	0.7	0.7	14.7	5.6	4.7
Nws Holdings Ltd	659 HK	HKD	16.820	65,643	11.5	10.8	11.3	9.6	1.3	1.3	1.2	1.2	11.2	4.5	6.9
China Railway Group Ltd-H	390 HK	HKD	7.480	184,248	9.2	8.4	7.1	6.2	1.0	0.9	0.8	0.7	11.8	2.2	2.3
China Railway Construction-H	1186 HK	HKD	11.360	168,640	8.5	7.3	6.3	5.7	0.9	0.8	0.7	0.7	12.3	2.5	2.2
China Communications Const-H	1800 HK	HKD	7.820	186,572	5.2	5.4	4.9	4.3	0.6	0.5	0.5	0.5	11.0	4.0	2.4
Metallurgical Corp Of Chin-H	1618 HK	HKD	1.920	68,943	6.4	5.6	4.7	3.8	0.5	0.4	0.4	0.4	8.8	4.8	1.7
China Railway Signal & Com-H	3969 HK	HKD	5.930	52,147	13.5	11.8	9.9	8.7	1.8	1.7	1.5	1.3	15.8	3.8	6.5
China Energy Engineering C-H	3996 HK	HKD	0.880	26,455	4.2	4.0	3.7	3.5	0.4	0.4	0.4	0.4	11.3	5.0	2.4
China Machinery Engineerin-H	1829 HK	HKD	3.830	15,801	8.1	5.8	5.6	5.3	0.8	0.8	0.7	0.7	14.3	7.5	4.6
Sinopec Engineering Group-H	2386 HK	HKD	7.300	32,324	24.3	11.9	9.1	8.3	1.1	1.0	1.0	0.9	11.1	5.4	4.7
Simple Average					9.7	7.7	6.8	6.0	0.9	0.9	0.8	0.7	12.2	4.5	3.8
Weighted Average					8.7	7.5	6.6	5.8	0.9	0.8	0.8	0.7	11.8	3.6	3.1

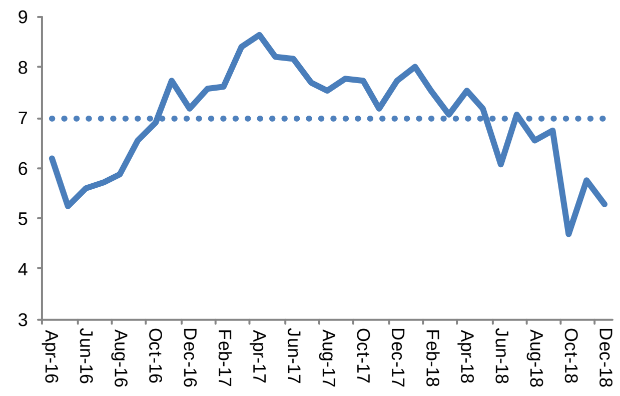
Source: Bloomberg.

Figure 5: CSCI's Forward EV/EBITDA



Source: Bloomberg.

Figure 6: CSCI's Forward PE



Source: Bloomberg.

Financial Statements and Ratios

Income Statement

Year end 31 Dec (HKD m)	2016A	2017A	2018F	2019F	2020F
Total Revenue	46,208	50,153	57,726	64,272	72,045
Cost of Sales	(40,225)	(42,537)	(48,620)	(54,375)	(61,220)
Gross Profit	5,983	7,615	9,107	9,897	10,825
Investment and Other Income / Gains, Net	1,260	748	368	372	391
SG&A Expenses	(1,106)	(1,395)	(1,385)	(1,478)	(1,585)
Operating Profit	6,137	6,968	8,089	8,791	9,631
Finance Costs	(688)	(1,070)	(1,246)	(1,520)	(1,634)
Share of Profits of JVs / Associates	563	892	685	836	1,022
Profit Before Tax	6,012	6,790	7,529	8,106	9,019
Income Tax	(1,005)	(1,256)	(1,554)	(1,642)	(1,795)
Profit After Tax	5,007	5,534	5,974	6,464	7,224
Non-controlling Interest	123	(44)	(51)	(58)	(67)
Shareholders' Profit / Loss	5,130	5,490	5,924	6,406	7,157
Basic EPS	1.198	1.188	1.173	1.269	1.417
DPS	0.330	0.350	0.350	0.380	0.400

Cash Flow Statement

Year end 31 Dec (HKD m)	2016A	2017A	2018F	2019F	2020F
Profit Before Tax	6,012	6,790	7,529	8,106	9,019
Depreciation and Amortisation	361	364	432	440	451
Change in Working Capital	(2,019)	(10,843)	(5,229)	(3,341)	(7,152)
Other Operating Activities	(1,487)	(1,157)	(800)	(735)	(930)
Cash from Operating Activities	2,867	(4,846)	1,932	4,470	1,388
Capital Expenditure	(178)	(1,410)	(676)	(756)	(947)
Other Investing Activities	(5,513)	(3,390)	(229)	(203)	(578)
Cash from Investing Activities	(5,691)	(4,800)	(905)	(959)	(1,525)
Issuance of Shares	4,810	6,307	0	0	0
Issuance / (Repayment) of Debts	3,741	5,148	9,013	323	355
Dividends	(2,084)	(2,536)	(2,672)	(3,118)	(3,306)
Other Financing Activities	30	6,334	1,694	(749)	2,472
Cash from Financing Activities	6,498	15,253	8,035	(3,544)	(479)
Cash at Beg of Year	8,026	11,484	17,571	27,064	27,506
Net Changes in Cash	3,674	5,607	9,062	(33)	(617)
Forex	(216)	480	432	475	522
Add: Pledged bank deposits	0	22	27	32	39
Cash at End of Year	11,485	17,593	27,091	27,538	27,450

Balance Sheet

Year end 31 Dec (HKD m)	2016A	2017A	2018F	2019F	2020F
Property, Plant and Equipment	2,494	3,819	4,011	4,081	4,298
Interest in Associates / JVs	9,020	14,527	15,212	16,047	17,069
Concession Operating Rights	5,234	5,414	5,272	5,129	4,983
Long-term Receivables	21,820	29,095	32,004	35,205	38,725
Interests in Infrastructure Project Investments	1,495	3,294	3,623	3,986	4,384
Other Non-current Assets	5,968	6,892	7,481	8,130	8,845
Total Non-current Assets	46,031	63,041	67,604	72,578	78,306
Inventories	131	214	207	216	253
Trade and Other Receivables	17,644	22,136	25,310	28,573	33,011
Amounts Due from Customers	6,486	10,979	11,309	12,808	14,729
Amounts Due from JVs	2,847	3,728	4,329	4,820	5,403
Cash & Cash Equivalents	11,485	17,593	27,091	27,538	27,450
Other Current Assets	1,551	827	927	1,065	1,226
Total Current Assets	40,144	55,478	69,173	75,019	82,072
Total Assets	86,174	118,518	136,778	147,597	160,378
Short-term Borrowings	1,456	2,581	3,226	3,548	3,903
Trade Payables, Other Payables and Accruals	29,000	33,194	37,940	42,432	47,773
Other Current Liabilities	9,260	16,224	16,277	17,373	18,702
Total Current Liabilities	39,716	51,998	57,443	63,353	70,378
Long-term Borrowings	428	3,479	11,731	11,667	11,694
Other Non-current Liabilities	20,360	24,578	24,747	24,868	24,902
Total Non-current Liabilities	20,788	28,057	36,477	36,534	36,596
Total Liabilities	60,504	80,055	93,920	99,887	106,974
Share Capital	112	126	126	126	126
Reserves	25,336	37,961	42,118	46,605	51,742
Total Shareholders' Equity	25,448	38,088	42,244	46,731	51,868
Minority Interest	222	375	614	979	1,536
Total Equity	25,670	38,463	42,858	47,710	53,404
Total Equity and Liabilities	86,174	118,518	136,778	147,597	160,378
BVPS	5.670	7.543	8.367	9.255	10.273

Financial Ratios

	2016A	2017A	2018F	2019F	2020F
Gross Margin	12.9	15.2	15.8	15.4	15.0
Operating Margin	13.3	13.9	14.0	13.7	13.4
Net Margin	11.1	10.9	10.3	10.0	9.9
ROA (%)	6.0	4.6	4.3	4.3	4.5
ROE (%)	21.1	17.3	14.7	14.4	14.5
Net Gearing Ratio (%)	37.8	40.8	35.5	31.6	29.1
Interest Coverage (x)	8.9	6.5	6.5	5.8	5.9

Source: the Company, Guotai Junan International.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance>15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance>5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance<-5%; Or the fundamental outlook of the sector is unfavorable.

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