

Company Report

CMEC (1829 HK)

Lack of momentum amid changing EPC landscape

■ 1H2016 EPC business dropped 19.9% YoY. We believe CMEC is facing keener competition from other Chinese construction companies that are also “going out” as well. Outlook is bleak

■ New business development missed expectations. Net cash per share is higher than its share price, but the company failed to make effective use of its cash to generate profit growth

■ 1H revenue of newly effective contracts and EPC business plummeted. We cut 2016-18E net profit by 31%/38%/33%. Given its fair asset quality, we set our new TP at HK\$4.33, representing 1x 2016E PB. Downgrade to NEUTRAL

No edge in overseas EPC competition

Against the backdrop of “Belt & Road” and domestic infrastructure slowdown, nearly all Chinese infrastructure companies have stepped up efforts to expand overseas markets. The company is facing competition from the leading CEEC (3996 HK) and other Chinese peers. Both ROA and ROE of other Chinese firms are 5ppt and 3ppt lower compared to CMEC’s, implying their lower demand for gross margin. CMEC’s 1H2016 EPC newly effective contracts have dropped 42.8% while EPC revenue has slid 19.9%. These are the results of the intensifying competition.

Slow progress of investment-driven EPC

As at the end of June, cash on hand amounted to RMB19.8bn, with interest-bearing liabilities of just RMB600mn. But “investment-driven EPC” proposed in 2015 is unlikely to become its new growth driver.

Lower profit forecast/rating on growing uncertainties

In the face of fierce competition from Chinese peers who have lower demand for gross margin. We think CMEC’s revenue is under downside pressure in the short term, and gross margin in the long run as well. We cut 2016-18E revenue by 45%/48%/56% and 2016-18E profit by 31%/38%/33%. Uncertainties have substantially risen amid competition, but its cashflow from backlog remains strong. Net cash per share is estimated to be HK\$5.1 and expected to increase further. Given its operational pressure and fair asset quality, we set our new TP at HK\$4.33 (1x 2016E PB) and downgraded it to NEUTRAL. The target PB is 1x, higher than industry average of 0.77x, underpinned by its better debt to assets ratio (2%) compared to the industry average (22%).

Financials

RMB mn	2014	2015	2016E	2017E	2018E
Revenue	23,747	20,757	17,050	18,564	18,936
Growth (%)	10.8%	-12.6%	-17.9%	8.9%	2.0%
Net profit	2,119	2,052	1,791	2,010	2,099
Growth (%)	8.2%	-3.2%	-12.7%	12.3%	4.4%
EPS (RMB)	0.51	0.50	0.43	0.49	0.51
DPS (RMB)	0.19	0.21	0.20	0.17	0.20
P/E (x)	7.66	7.91	9.07	8.08	7.74
P/B (x)	1.23	1.14	1.07	0.99	0.91
ROE (%)	16.1%	14.5%	11.8%	12.2%	11.8%

Sources: Company data, CMS (HK) estimates

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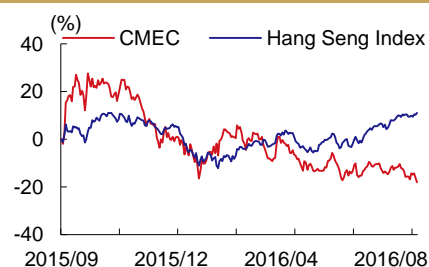
WHAT'S NEW

Earnings forecast, rating/target price downgraded

NEUTRAL

Previous	BUY
Price	HK\$4.63
12-month Target Price (Potential downside)	HK\$4.33 (-6%)
Previous	HK\$8.26

Price Performance



Source: Bigdata

%	1m	6m	12m
1829 HK	(4.5)	(18.8)	(19.3)
HSI	4.7	19.3	9.3

Construction

HSI	23162
HSCEI	9606

Key Data

52-week range (HK\$)	4.58-7.36
Market cap (HK\$ mn)	4205
Avg. daily volume (mn)	3.32
BVPS (HK\$)	3.38

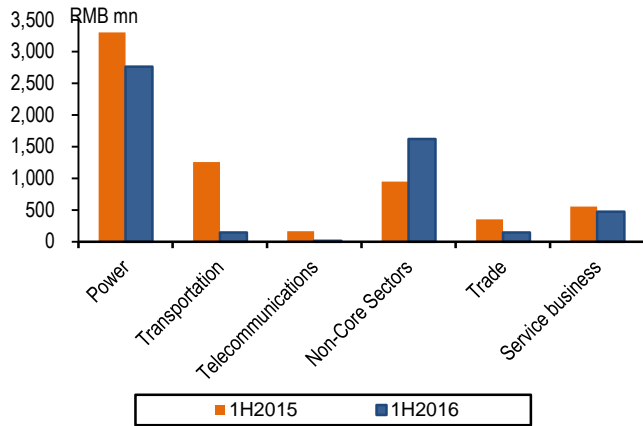
China National Machinery Industry Corporation	77.21%
No. of shares outstanding (mn)	908
Free float	81.2%

Related Research

1. CMEC (1829 HK) - Capital efficiency and revenue to increase upon acquisition of CNCEC, 2016/02/22

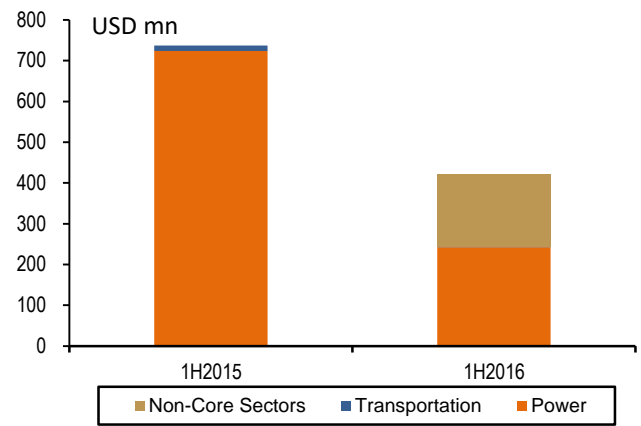
Focus charts

Figure 1: 1H2016 revenues by sector



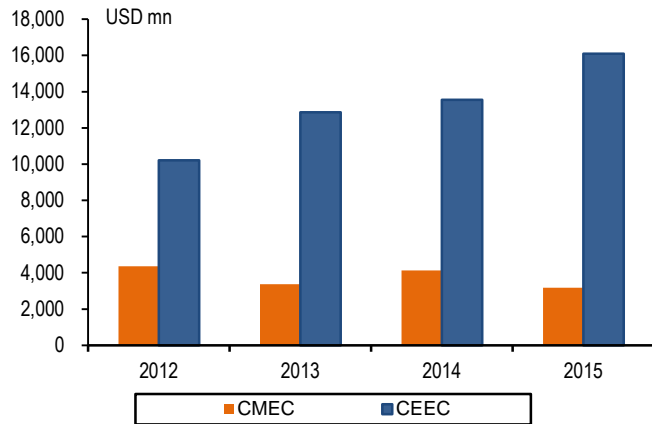
Sources: Company data, CMS (HK)

Figure 2: 1H2016 new contracts



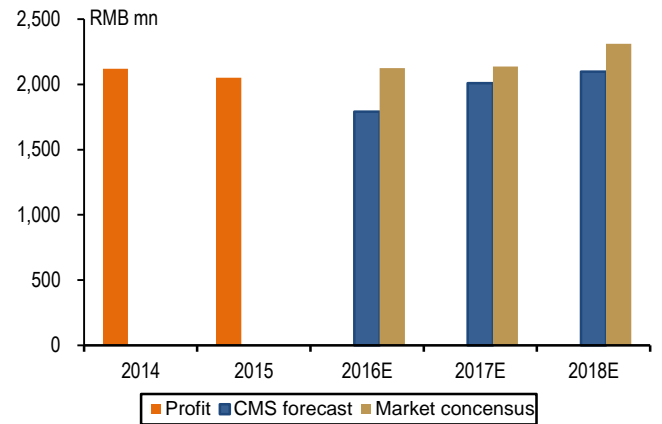
Sources: Company data, CMS (HK)

Figure 3: Overseas new contracts of CEEC & CMEC



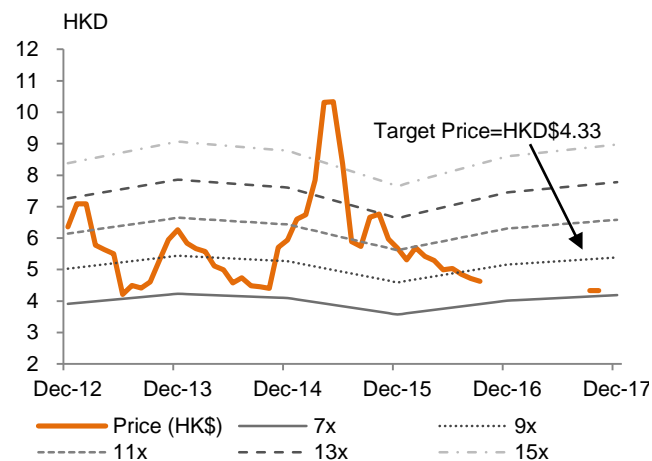
Sources: Company data, CMS (HK)

Figure 4: Net profit estimates



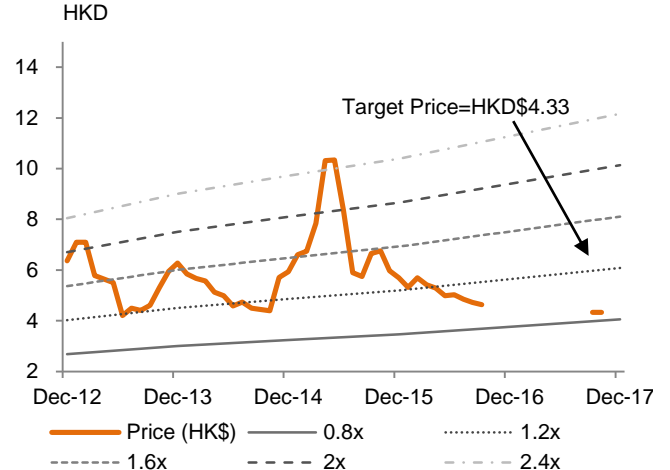
Sources: Company data, CMS (HK)

Figure 5: Forward P/E



Sources: Company data, CMS (HK)

Figure 6: Forward P/B



Sources: Company data, CMS (HK)

Financial Summary

Balance Sheet

RMB million	2014	2015	2016E	2017E	2018E
Current assets	32,221	35,415	31,989	35,267	36,995
Cash	17,986	20,345	18,323	21,541	23,094
Trading investments	0	0	0	0	0
Trade receivables	6,433	7,520	6,950	6,749	6,880
Project receivables	3,065	2,948	2,130	2,400	2,447
Other receivables	0	0	0	0	0
Inventories	260	254	237	228	224
Others	4,477	4,349	4,349	4,349	4,349
Non-current assets	5,869	6,817	6,987	7,369	7,477
Lease prepayments	1,753	1,792	1,850	1,901	1,951
Fixed assets	743	1,089	1,079	1,071	1,064
Intangible assets	9	9	4	5	7
Others	3,364	3,927	4,054	4,392	4,455
Total assets	38,090	42,232	38,976	42,637	44,471
Current liabilities	24,198	27,198	22,952	25,306	25,833
Short-term borrowings	206	428	428	428	428
Account payables	13,824	16,755	14,584	15,887	16,217
Prepaid accounts	9,826	9,471	7,583	8,546	8,713
Others	343	544	357	445	475
Long-term liabilities	729	833	842	854	865
Long-term liabilities	360	397	397	397	397
Others	369	436	446	457	469
Total liabilities	24,927	28,031	23,795	26,160	26,698
Issued capital	4,126	4,126	4,126	4,126	4,126
Retained earnings	9,011	10,041	11,021	12,316	13,612
Minority interests	26	35	35	35	35
Parents	13,163	14,201	15,181	16,477	17,773
Total equity & liabilities	38,090	42,232	38,976	42,637	44,471

Cash Flow Statement

RMB million	2014	2015	2016E	2017E	2018E
Operating cash flow	4,149	3,440	-874	3,678	2,070
Net profit	2,765	2,777	2,339	2,625	2,740
D&A	90	102	157	158	159
Finance costs	-513	-442	-396	-457	-486
Investment income	159	-466	-9	-8	-7
Working capital chgs	2,388	2,027	-2,338	1,919	282
Others	-48	62	0	0	0
CF from IA	-334	-691	235	296	327
Capital expenditure	-345	-615	-200	-200	-199
Other investments	-679	-1,306	35	96	128
CF from FA	-482	-591	-1,384	-756	-844
Acquisition of subsidiary	0	0	-532	0	0
Change in borrowings	252	260	0	0	0
Changes in reserves	62	16	0	0	0
Dividends	-789	-846	-813	-717	-805
Others	-6	-21	-571	-39	-39
Net cash flow	3,333	2,158	-2,022	3,218	1,553

Profit & Loss Statement

RMB million	2014	2015	2016E	2017E	2018E
Revenue	23,747	20,757	17,050	18,564	18,936
Cost of sales	-19,932	-17,367	-14,313	-15,695	-16,150
Gross margin	3,814	3,391	2,736	2,869	2,786
Other income	15	15	17	19	21
Other net income	-93	-22	0	0	0
Sales and marketing expenses	-1,116	-1,129	-840	-819	-739
Admin expenses	-574	-615	-422	-368	-282
Other operating expenses	48	-63	-63	-63	-63
Financial income	720	1,244	562	640	672
Financial expenses	-51	-43	348	348	347
Profit before tax	2,765	2,777	2,339	2,625	2,740
Income tax	-645	-723	-546	-612	-639
Profit after tax	2,120	2,054	1,793	2,013	2,101
Profit attributable to:					
Equity holders of the parent	2,119	2,052	1,791	2,010	2,099
Non-controlling interests holders	0	2	2	2	2
EPS (RMB)	0.51	0.50	0.43	0.49	0.51

Financial Ratios

	2014	2015	2016E	2017E	2018E
YoY growth rate					
Revenue	10.8%	-12.6%	-17.9%	8.9%	2.0%
Gross profit	1.9%	-11.1%	-19.3%	4.9%	-2.9%
Net profit	8.2%	-3.2%	-12.7%	12.3%	4.4%
Profitability					
Gross margin	16.1%	16.3%	16.0%	15.5%	14.7%
NP margin	8.9%	9.9%	10.5%	10.8%	11.1%
ROE	16.1%	14.5%	11.8%	12.2%	11.8%
ROA	5.6%	4.9%	4.6%	4.7%	4.7%
Liquidity					
Debt to asset	1.5%	2.0%	2.1%	1.9%	1.9%
Net debt to equity	N. cash	N. cash	N. cash	N. cash	N. cash
Liquid ratio (x)	1.33	1.30	1.39	1.39	1.43
Quick ratio (x)	1.32	1.29	1.38	1.38	1.42
Operating efficiency					
Asset turnover (x)	0.62	0.49	0.44	0.44	0.43
Inventory turnover days	91.34	81.69	71.95	81.28	84.49
AR turnover days	3.96	2.74	2.43	2.73	2.73
AP turnover days	1.72	1.23	1.16	1.16	1.16
Per share ratios (RMB)					
Recurring EPS	0.51	0.50	0.43	0.49	0.51
CFPS	1.01	0.83	-0.21	0.89	0.50
BVPS	3.19	3.44	3.68	3.99	4.31
DPS	0.19	0.21	0.20	0.17	0.20
Valuation ratios					
PE	7.66	7.91	9.07	8.08	7.74
PB	1.23	1.14	1.07	0.99	0.91
EV/EBITDA	6.92	9.47	9.61	8.66	8.37

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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