

China Railway Construction Corporation-A [601186.CH]

Initiate coverage: top pick, strong balance sheet to support PPP business growth

The construction sector regained market traction, led by 1) better-than-expected PPP review results and 2) the sector's strong Q1 2018 growth. As we highlighted in our previous report, central SOEs should face no downside risk in infrastructure investment, benefitting from rising PPP investment and overseas expansion. CRCC-A secured fast earnings growth by increasing its exposure to PPP investment in Q1 2018, which exceeded market expectations. We initiate our coverage on CRCC-A with a BUY rating and target price (TP) of RMB12.50. CRCC-A is our top pick in the A-share construction sector. We expect its earnings to grow at around 14% p.a. in 2018-2019E. As CRCC-A is less geared than its peers, we think it will enjoy faster earnings growth via increasing its takes in PPP investment. Our TP of RMB12.50 is based on our CRCC-H share valuation and the A/H premium (discount) assumption (Fig 5). The only downside risk to its earnings and TP is likely from the Company's conservative approach in pursuing PPPs and overseas business expansion.

Investment Highlights

- Fast earnings growth secured by increasing exposure to PPP investment:** With the slowdown in railway investment, CRCC-A secured earnings growth by increasing its exposure to PPP investment. CRCC-A reported earnings growth of 14.7% YoY in 2017 and 18.9% YoY in Q1 2018. The earnings growth was above market expectations, as the market was concerned about a slowdown in PPP investment during the project review period. The government's scrutiny of PPP projects ended in March. The results showed that the concern was overblown. A total 1,160 projects worth RMB1.2trn were removed from the PPP database. But 614 new projects worth RMB13trn were added to the database, indicating a net increase in PPP investment. With tougher regulations, CRCC-A should be able to pick good-quality PPP projects to sustain its earnings growth in the next 2-3 years.
- Margin expansion due to improving revenue mix:** CRCC-A has been conservative in its PPP business expansion. PPP investment-related revenue accounted for only c10% of its total revenue in 2017. Its overseas business accounted for only around 5% of its total revenue. So its increasing exposure to PPP investment and overseas business drove a significant margin improvement for the Company. PPP projects offer higher margins than its traditional railway projects. We expect CRCC-A's margin expansion to continue in 2018-2019E. We forecast that its gross profit margin will expand from 9.2% in 2017 to 9.4-9.7% in 2018-2019.
- Strong balance sheet supports its PPP business expansion:** CRCC-A has the lowest net gearing ratio of its peers. As at the end of 2017, its net debt/equity ratio was only 7.3% vs. 64.2% for CCC and 33.8% for CRG. Its healthy balance sheet allows CRCC-A to further increase its stake in PPP investment. Under the deleveraging environment, this gives the Company the competitive strength to gain market share from its peers.
- BUY with a TP of RMB11.80:** We set our TP at RMB12.50. Our TP is based on our CRCC-H share valuation and the historical CRCC A/H premium (discount) (Fig 5).

Y/E Dec 31	2015	2016	2017	2018E	2019E
Turnover (RMB m)	600,539	629,327	680,981	742,710	795,861
Recurring net profit (RMB m)	12,645	14,000	16,057	18,349	20,922
Net margin (%)	2.1%	2.2%	2.4%	2.5%	2.6%
Recurring EPS (RMB)	0.98	1.01	1.09	1.25	1.42
% change	3.4%	3.7%	13.8%	14.5%	14.2%
PER(x)	10.0	9.8	9.1	7.9	6.9
PBR(x)	1.2	1.0	0.9	0.8	0.7
EV/EBITDA(x)	5.1	4.8	4.1	4.0	3.9

Source: Company data, CGIS Research

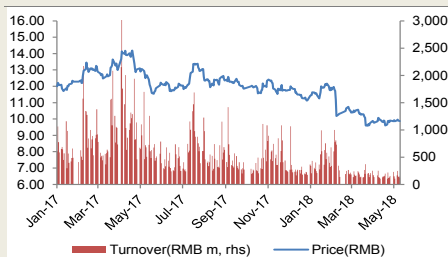
China construction sector

BUY

Close: Rmb9.87 (May 11, 2018)

Target Price: Rmb12.50(+26.6%)

Price Performance



Market Cap	US\$20,322m
Shares Outstanding	13,580m
Auditor	Ernst & Young
Free Float	44.3%
52W range	HK\$9.39-13.74
3M average daily T/O	US\$23m
Major Shareholding	CRCCG (55.7%)

Sources: Company data, Bloomberg

Kelly Zou—Analyst

(852) 3698-6319

kellyzou@chinastock.com.hk

Wong Chi Man, CFA—Head of Research

(852) 3698-6317

cmwong@chinastock.com.hk

Key financials

CRCC (601186 CH)

P&L statement

(RMB m, except for per share amount)

FY ended 31 Dec	1H15	2H15	1H16	2H16	1H17	2H17
Sales Revenue	262,894	337,644	266,727	362,600	288,961	392,020
COGS	-234,091	-297,665	-239,399	-331,978	-263,410	-354,649
Gross profit	28,803	39,980	27,328	30,622	25,551	37,371
Sales tax	-7,572	-10,444	-4,397	-3,747	-1,595	-3,355
Selling and distribution costs	-1,529	-2,175	-1,796	-2,382	-1,860	-2,671
Administrative expenses	-9,977	-12,858	-10,931	-13,159	-12,132	-13,926
Other gains and losses	-210	-2,615	-435	628	122	-3,653
Total EBIT	9,515	11,887	9,769	11,962	10,085	13,766
Depreciation & Amortisation	5,531	5,585	6,059	6,140	5,816	6,604
EBITDA	15,046	17,473	15,828	18,102	15,901	20,370
Net finance costs	-2,613	-1,773	-2,034	-698	-1,329	-1,547
Profits from associates and JCEs	96	0	31	-61	9	272
Pre-Tax Profit	6,998	10,115	7,766	11,204	8,765	12,491
Tax Expense	-1,404	-2,335	-1,567	-2,552	-1,845	-2,492
Net Profit After Tax	5,594	7,780	6,199	8,652	6,920	10,000
Minority Interest	-263	-466	-377	-474	-397	-465
Reported Earnings (attributable)	5,331	7,315	5,822	8,177	6,523	9,534
Adjusted Earnings	5,331	7,315	5,822	8,177	6,523	9,534
EPS (rep)	0.43	0.55	0.43	0.60	0.48	0.70
EPS (adjusted)	0.43	0.55	0.42	0.59	0.46	0.62
DPS	0.00	0.15	0.00	0.16	0.00	0.18
% YoY growth						
Revenue	0.3%	2.0%	1.5%	7.4%	8.3%	8.1%
Gross profit	7.4%	4.9%	-5.1%	-23.4%	-6.5%	22.0%
EBIT	3.5%	11.0%	2.7%	0.6%	3.2%	15.1%
Net profit	3.4%	11.2%	9.2%	11.8%	12.0%	16.6%
Margins and ratios						
Gross profit margin	8.1%	8.7%	8.6%	7.4%	8.3%	8.7%
EBITDA Margin	5.7%	5.2%	5.9%	5.0%	5.5%	5.2%
EBIT Margin	3.6%	3.5%	3.7%	3.3%	3.5%	3.5%
Net Profit Margin	2.0%	2.2%	2.2%	2.3%	2.3%	2.4%

P&L	2015	2016	2017	2018E	2019E
Sales Revenue	600,539	629,327	680,981	742,710	795,861
COGS	-531,756	-571,378	-618,059	-672,556	-718,899
Gross profit	68,782	57,950	62,922	70,155	76,963
Sales tax	-18,016	-8,144	-4,950	-5,399	-5,786
Selling and distribution costs	-3,704	-4,178	-4,531	-4,942	-5,295
Administrative expenses	-22,836	-24,090	-26,058	-29,708	-31,834
Other gains and losses	-2,825	193	-3,531	-3,002	-2,702
Total EBIT	21,402	21,731	23,851	27,104	31,346
Depreciation & Amortisation	11,117	12,200	12,420	14,451	14,951
EBITDA	32,519	33,930	36,271	41,554	46,297
Net finance costs	-4,385	-2,732	-2,876	-3,109	-3,959
Profits from associates and JCEs	96	-29	281	295	309
Pre-Tax Profit	17,113	18,970	21,256	24,290	27,696
Tax Expense	-3,739	-4,119	-4,337	-4,956	-5,651
Net Profit After Tax	13,374	14,851	16,919	19,334	22,046
Minority Interest	-729	-851	-862	-985	-1,123
Reported Earnings (attributable)	12,645	14,000	16,057	18,349	20,922
Adjusted Earnings	12,645	14,000	16,057	18,349	20,922
EPS (rep)	0.98	1.02	1.16	1.33	1.52
EPS (diluted)	0.98	1.01	1.09	1.25	1.42
DPS	0.15	0.16	0.18	0.25	0.28
% YoY growth					
Revenue	1.2%	4.8%	8.2%	9.1%	7.2%
Gross profit	5.9%	-15.7%	8.6%	11.5%	9.7%
EBIT	7.5%	1.5%	9.8%	13.6%	15.7%
Net profit	7.8%	10.7%	14.7%	14.3%	14.0%
Margins and ratios					
Gross profit margin	8.5%	7.9%	8.5%	8.7%	8.9%
EBITDA Margin	5.4%	5.4%	5.3%	5.6%	5.8%
EBIT Margin	3.6%	3.5%	3.5%	3.6%	3.9%
Net Profit Margin	2.1%	2.2%	2.4%	2.5%	2.6%

Source: Company data, CGIS Research

Revenue breakdown (Rmb m)	2015	2016	2017	2018E	2019E
Construction operations	519,313	540,135	584,128	622,096	662,532
Survey, design and consultancy	10,080	12,257	14,539	15,992	17,592
Manufacturing	14,688	14,341	14,235	15,659	17,225
Real estate	28,671	38,320	42,587	46,846	51,531
Other business	46,930	47,302	59,170	65,087	71,596
Elimination	-19,143	-23,027	-33,678	-22,970	-24,614
Total	600,539	629,327	680,981	742,710	795,861

% of total

Construction operations	86%	86%	86%	84%	83%
Survey, design and consultancy	2%	2%	2%	2%	2%
Manufacturing	2%	2%	2%	2%	2%
Real estate	5%	6%	6%	6%	6%
Other business	8%	8%	9%	9%	9%
Elimination	-3%	-4%	-5%	-3%	-3%
Total	100%	100%	100%	100%	100%

% YoY chg

Construction operations	1.4%	4.0%	8.1%	6.5%	6.5%
Survey, design and consultancy	11.9%	21.6%	18.6%	10.0%	10.0%
Manufacturing	23.4%	-2.4%	-0.7%	10.0%	10.0%
Real estate	15.0%	33.7%	11.1%	10.0%	10.0%
Other business	-15.0%	0.8%	25.1%	10.0%	10.0%
Elimination	-4.8%	20.3%	46.3%	-31.8%	7.2%
Total	1.2%	4.8%	8.2%	9.1%	7.2%

Source: Company data, CGIS Research

Key financials

CRCC (601186 CH)

Balance sheet, cash flow statements and ratios

(RMB m, except for per share amount)

Balance sheet	2015	2016	2017	2018E	2019E
Inventories	245,591	265,781	266,604	285,606	305,286
Cash	121,934	128,702	141,206	145,628	156,468
Trade and other receivables	130,522	137,778	153,529	172,960	191,879
Advances to suppliers	23,194	19,956	18,784	20,487	21,953
Other receivables	40,572	45,921	55,279	60,268	64,564
Current portion of non-current assets	11,916	9,618	8,592	8,592	8,592
Other current assets	1,518	3,544	8,904	8,904	8,904
Total current assets	575,248	611,300	652,898	702,445	757,646
Long-term equity investment	4,158	7,936	17,870	23,664	29,474
Investment properties	0	3,340	3,647	3,757	3,863
PPE, net	45,004	45,235	49,845	49,891	49,619
Other intangible assets	35,865	45,680	40,156	52,693	65,051
Goodwill	103	195	201	201	201
Deferred tax assets	2,374	2,811	3,577	3,577	3,577
Trade and other receivables	24,886	29,613	40,662	51,990	59,690
Available-for sale financial assets	6,546	6,555	8,382	8,382	8,382
Other non-current assets	1,912	6,680	4,650	4,650	4,650
Total non-current assets	120,848	148,045	168,989	198,804	224,506
Total assets	696,096	759,345	821,887	901,249	982,151
Trade and other payables	252,255	289,977	323,492	352,015	376,271
Amounts due to contract customers	75,981	88,332	85,683	93,449	100,137
Short-term loans	75,805	43,001	59,701	68,133	78,782
Other payables and accruals	46,903	50,625	49,798	54,199	57,989
Defined benefit obligations	8,596	9,069	10,160	10,160	10,160
Tax payable	9,500	5,578	5,964	5,964	5,964
Other current liabilities	14,838	4,417	8,859	8,859	8,859
Total current liabilities	483,879	490,999	543,655	592,779	638,161
Long-term loans	78,457	113,934	94,505	107,852	124,710
Deferred tax liabilities	430	276	289	289	289
Provision	0	0	0	0	0
Trade and other payables	2,209	1,843	1,963	1,963	1,963
Defined benefit obligations	1,416	969	604	604	604
Other non-current liabilities	885	2,607	2,223	2,223	2,223
Total non-current liabilities	83,398	119,630	99,584	112,931	129,789
Total liabilities	567,277	610,629	643,239	705,710	767,950
Shareholders Fund	111,665	131,187	149,412	165,317	182,856
Minority Interest	17,154	17,529	29,237	30,222	31,345
Total S/H Equity	128,819	148,716	178,649	195,539	214,201
Total Liab & S/H Fund	696,096	759,345	821,887	901,249	982,151

Cash flow statement	2015	2016	2017	2018E	2019E
EBITDA	32,519	33,930	36,271	41,554	46,297
Net Interest Paid	-4,202	-2,564	-2,898	-3,109	-3,959
Tax Paid	-3,838	-8,632	-4,703	-4,956	-5,651
Change in Working Cap	18,908	7,451	-13,951	-15,761	-17,327
Others	2,786	4,389	7,787	0	0
Operating Cash Flow	46,173	34,574	22,506	17,729	19,360
Acquisitions	1,063	-2,572	-8,837	-5,500	-5,500
Capex	-27,144	-29,816	-30,231	-27,143	-27,143
Asset Sales	2,465	2,965	1,781	0	0
Others	-720	3,150	600	0	0
Investing Cashflow	-24,336	-26,273	-36,688	-32,643	-32,643
Dividend (ordinary)	-1,851	-2,037	-2,173	-2,444	-3,383
Equity Raised	10,275	10,610	5,000	0	0
Debt Movements	-2,025	-1,913	19,820	21,780	27,506
Others	-4,644	-6,208	4,026	0	0
Financing Cashflow	1,755	453	26,673	19,335	24,124
Exchange difference	121	310	-633	0	0
Net Chg in Cash/debt	23,713	9,063	11,859	4,422	10,840
FCF	21,837	8,301	-14,181	-14,914	-13,283
	2015	2016	2017	2018E	2019E
Valuation					
PE(x)	10.0	9.8	9.1	7.9	6.9
EPS growth (%)	3.4	3.7	13.8	14.5	14.2
Yield(%)	1.5	1.6	1.8	2.5	2.9
PEG(%)	2.9	2.6	0.7	0.5	0.5
EV/EBITDA(x)	5.1	4.8	4.1	4.0	3.9
PB(x)	1.2	1.0	0.9	0.8	0.7
Operational					
Revenue growth(%)	1.2	4.8	8.2	9.1	7.2
EBIT margin(%)	3.6	3.5	3.5	3.6	3.9
Net profit margin(%)	2.1	2.2	2.4	2.5	2.6
Days receivables	114	115	115	118	122
Days payables	242	256	261	259	262
Days inventories	163	163	157	150	150
Current ratio(x)	1.2	1.2	1.2	1.2	1.2
Quick ratio(x)	0.7	0.7	0.7	0.7	0.7
Asset/equity(x)	5.4	5.1	4.6	4.6	4.6
Net debt/equity(%)	25.1%	19.0%	7.3%	15.5%	22.0%
EBITDA interest coverage(x)	5.4	6.9	6.2	6.5	6.3
ROE(%)	11.3	10.7	10.7	11.1	11.4

Source: Company data, CGIS Research

Figure 4: Earnings estimates: CGIS new vs. consensus estimates (RMB m, except for EPS)

2018E	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS	742,710	27,104	41,554	18,349	1.25	1.33
Consensus	740,003	26,667	40,049	18,354	1.34	1.35
Diff %						
CGIS vs. consensus	0.4%	1.6%	3.8%	0.0%	-7.3%	-1.2%
2019E	Sales	EBIT	EBITDA	Net profit	EPS Adj	EPS GAAP
CGIS	795,861	31,346	46,297	20,922	1.42	1.52
Consensus	801,504	29,817	44,556	21,257	1.54	1.55
Diff %						
CGIS vs. consensus	-0.7%	5.1%	3.9%	-1.6%	-7.5%	-1.7%

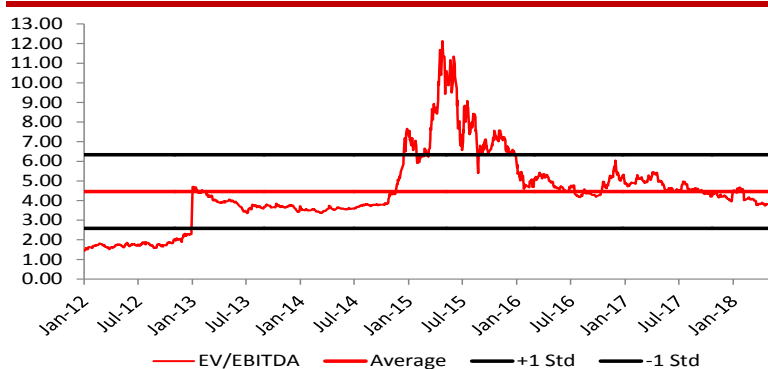
Source: Bloomberg, CGIS Research

Figure 5: Target price EV/EBITDA multiple calculation

Assumption	
2018E EBITDA (Rmb m)	41,554
Target EV/EBITDA multiple	3.8x
EV (Rmb m)	157,906
Net debt (Rmb m)	30,357
Target fair value (Rmb m)	127,549
FX	0.81
No of shares (mn)	13,580
Target price (HK\$/share)	11.60
H/A discount	-25.0%
A-share target share price (Rmb)	12.50
% upside to current price	26.6%

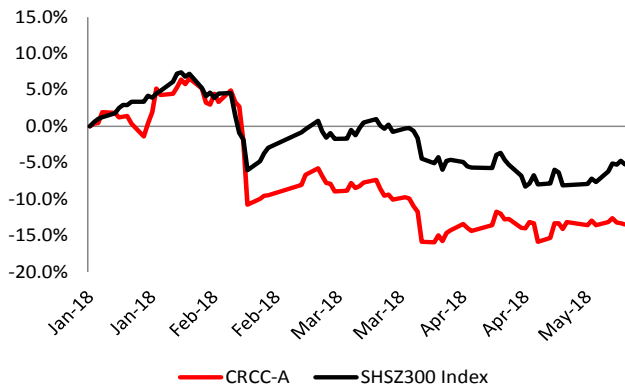
Source: CGIS Research

Figure 6: CRCC-A share 12-mth forward EV/EBITDA band



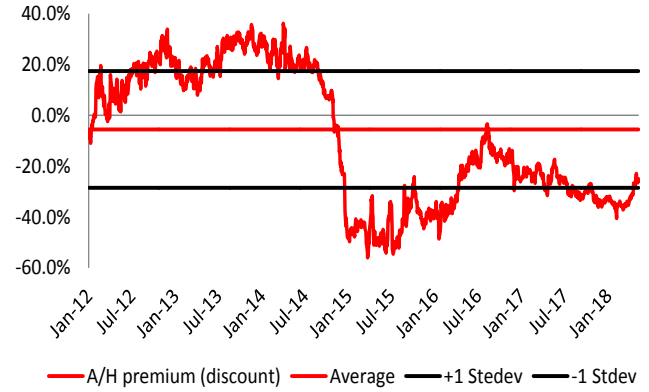
Source: Bloomberg, Company data, CGIS Research

Figure 7: CRCC-A share performance CYTD



Source: Bloomberg, CGIS Research

Figure 8: CRCC-A/H premium/discount band



Source: Bloomberg, CGIS Research

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- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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