Company Report: CSC Development (00830 HK)

公司报告：中国建筑兴业 (00830 HK)

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2 September 2022

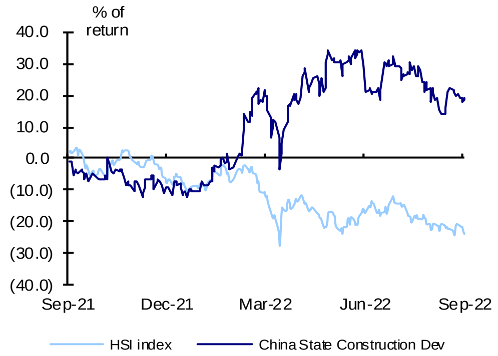
Global Leader in High-End Curtain Wall Engineering, Initiate with "Buy"

高端幕墙工程的世界级领导者，首予"买入"评级

- **Rating and TP: We initiate with a rating of "Buy" and a target price of HK$2.66, representing 9.3x/ 6.6x/ 4.6x 2022/ 2023/ 2024 EV/EBITDA.**
- **Investment Theme:** We expect that the HKSAR government will significantly increase spending on public buildings in the next five years, driving demand for high-end curtain walls. Being the only high-end curtain wall engineering company with central SOE background in China, it is much easier for the Company to obtain new contracts in the Greater Bay Area compared with its peers. In addition, the Company's BIPV business will be a long-lasting revenue growth driver.
- **Our Views:** 1) The market thinks the high-end curtain wall market is saturated;' we think that there is still substantial room to grow. 2) High-end curtain wall market competition is not as keen as the market thinks. 3) Potential new contracts from COLI (00688 HK) are highly underestimated by the market.
- **Catalysts:** 1) Loss from overseas markets will quickly narrow. 2) Receipt of first-ever BIPV contracts worth HK$101 million. 3) Placement of new shares at premium price showed market confidence.
- **Risks:** 1) New contracts from the public sector in Hong Kong might not meet expectations. 2) Epidemic prevention measures might delay spending in new resort facilities in Macau. 3) Change in supporting policies for BIPV projects might delay demand.
- **评级及目标价：首次覆盖给予"买入"评级，目标价 2.66 港元，相当于 9.3 倍 /6.6 倍 /4.6 倍 2022 /2023 /2024 年 EV/EBITDA。**
- **投资故事：**我们预计未来五年香港特区政府将大幅增加公共建筑支出，推动对高端幕墙的需求。作为国内唯一一家央企背景的高端幕墙工程公司，公司在大湾区较同业更容易获得新合同。此外，公司的光伏建筑（BIPV）业务将成为收入的长期增长动力。
- **我们的观点：**1）市场认为高端幕墙市场已经饱和，但我们认为仍有较大的增长空间。2）高端幕墙市场竞争并没有市场想象的那么激烈。3）来自中国海外发展（00688 HK）的潜在新合约被市场高度低估。
- **催化剂：**1）海外市场亏损将迅速收窄。2）首次获得价值 1.01 亿港元的光伏建筑工程合同。3）溢价配售新股显示市场对公司的信心。
- **风险：**1）香港公共部门的新合同可能不如预期。2）防疫措施变动可能导致澳门新度假村设施的投资延迟。3）光伏建筑项目支持政策的变化或使需求延后。

Rating:	**Buy** Initial
评级：	**买入** (首次覆盖)
6-18m TP 目标价:	**HK$2.66**
Share price 股价:	HK$2.110

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 %	1.0	(2.8)	17.2
Rel. % to HS Index 相对恒指变动 %	2.6	5.3	43.0
Avg. Share price(HK$) 平均股价（港元）	2.1	2.2	2.0

Source: Bloomberg, Guotai Junan International.

Year End 年结 12/31	Turnover 收入 (RMB m)	Net Profit 股东净利 (RMB m)	EPS 每股净利 (RMB)	EPS 每股净利变动 (△%)	PER 市盈率 (x)	BPS 每股净资产 (RMB)	PBR 市净率 (x)	DPS 每股股息 (RMB)	Yield 股息率 (%)	ROE 净资产收益率 (%)
2020A	4,536	194	0.090	11.1	19.7	0.651	2.7	0.030	1.7	15.4
2021A	6,295	292	0.135	50.0	12.7	0.775	2.2	0.047	2.7	19.0
2022F	8,625	416	0.189	40.0	9.8	1.000	1.8	0.063	3.4	21.5
2023F	11,460	607	0.269	42.3	6.9	1.185	1.6	0.090	4.9	24.9
2024F	14,913	863	0.382	42.0	4.8	1.478	1.2	0.127	6.9	28.7

Shares in issue (m) 总股数 (m)	5,037.6	Major shareholder 大股东	CSCI 70.8%
Market cap. (HK$ m) 市值 (HK$ m)	10,629.3	Free float (%) 自由流通比率 (%)	29.2
3 month average vol. 3 个月平均成交股数 ('000)	2,867.5	FY22 Net gearing (%) FY22 净负债/股东资金 (%)	2.3
52 Weeks high/low (HK$) 52 周高/低 (HK$)	2.490 / 1.530	FY22 Est. NAV (HK$) FY22 每股估值（港元）	3.5

Source: the Company, Guotai Junan International.

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1. Core Ideas

Earnings Forecasts & TP

We forecast China State Construction Development's (00830 HK) (CSCD, or the "Company") EPS for 2022/ 2023/ 2024 to be HK$0.189/ HK$0.269/ HK$0.382, respectively, which represents YoY growth of 39.3%/ 42.6%/ 42.1%. With valuation method using peers comparison for EV/EBITDA ratio, we arrive at a TP of HK$2.66 for CSCI, representing 9.3x/ 6.6x/ 4.6x 2022/ 2023/ 2024 EV/EBITDA. Initiate with "Buy" rating.

Investment Theme

1. HKSAR government will significantly increase spending in buildings.
2. The only high-end curtain wall engineering company with SOE background in China.
3. Building-integrated photovoltaics (BIPV) business is a long-lasting growth driver.

Our Views

1. The high-end curtain wall market still has substantial room for growth despite contrasting market view.
2. High-end curtain wall market competition is not as keen as the market thinks.
3. Increase in potential new contracts from COLI (00688 HK) is highly underestimated by the market.

Catalysts

1. Loss from overseas markets will quickly narrow.
2. Receipt of first-ever BIPV contracts worth HK$101 million.
3. Placement of new shares at premium price shows market confidence.

Risk Factors

1. New contracts from the public sector in Hong Kong might not meet expectations.
2. Epidemic prevention policies might delay spending in new resort facilities in Macau.
3. Change in supporting policies for BIPV projects might delay demand.

2. Company Introduction

2.1 Company Background

The Company is a global provider of one-stop building facade solutions. China State Construction Development Holdings Limited was established in Hong Kong in 1969 and has become one of the largest and most competitive curtain wall engineering companies in the world. In particular, the Company's market share in curtain walls in commercial buildings in Hong Kong is 30%-40%, and that in high-ended residential buildings in Hong Kong is 15%-25%, making it the largest company in terms of revenue, with the largest market share in curtain wall business in Hong Kong. Over the years, from its fundamental business in mainland China, Hong Kong and Macao, the Company has successfully entered into many overseas markets such as the UK, US, Canada, Dubai, Singapore, Japan, Australia and Chile, etc., with its business reaching 5 continents, 11 countries and 43 cities, and has been involved in nearly 900 landmark buildings. The Company's customers are generally developers and main contractors of property development projects worldwide. A number of international developers and main contractors have included CSCD in their lists of preferred building facade solutions providers.

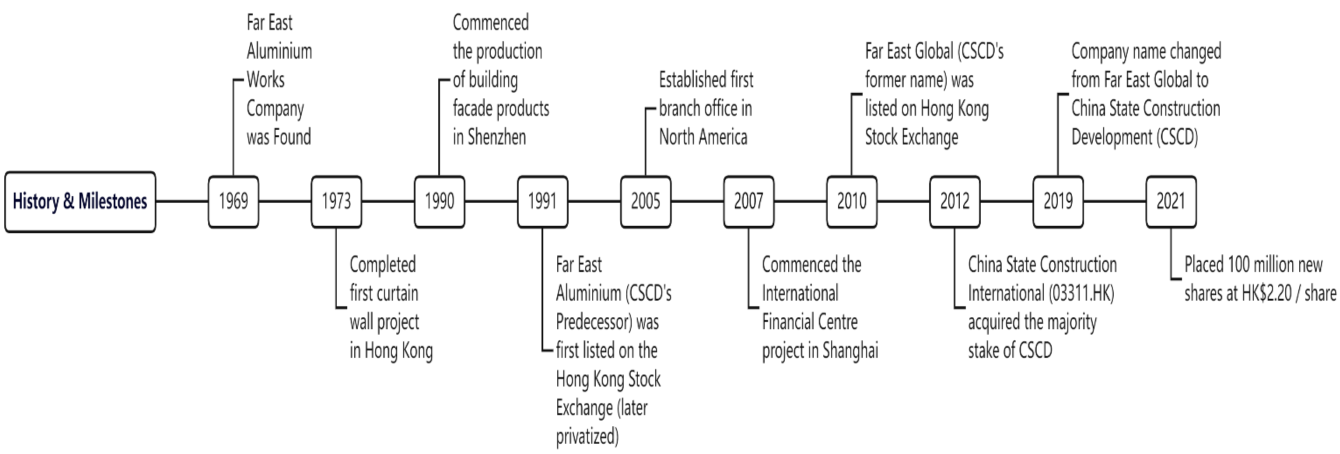
Figure 1: Times Square in Hong Kong

Source: the Company.

Figure 2: Venetian Hotel in Macau

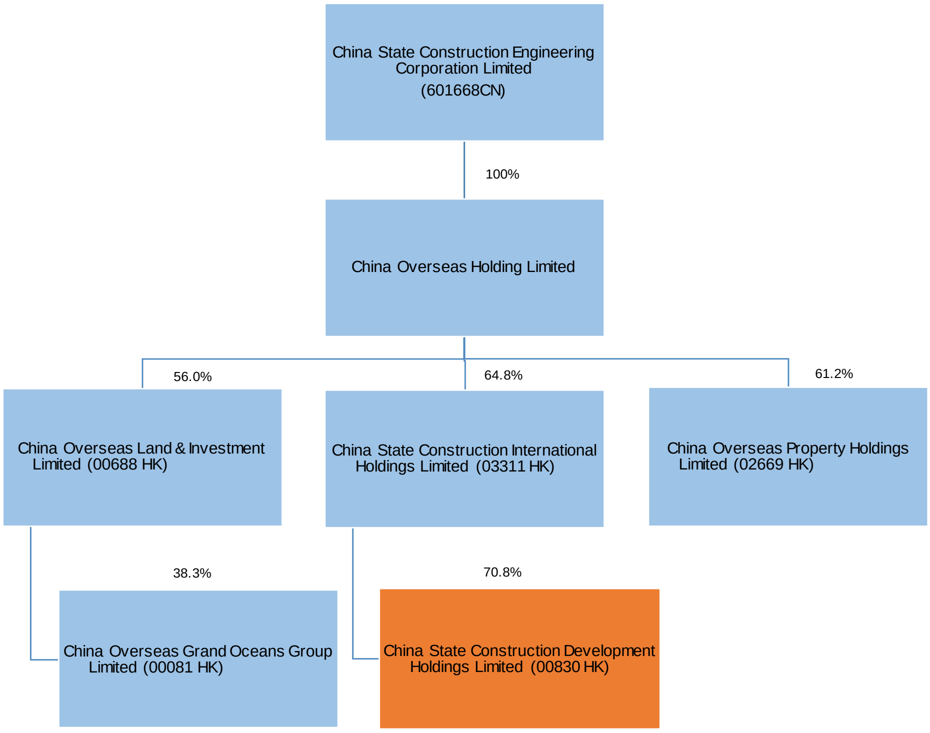
Source: the Company.

Figure 3: History and Milestones of CSCD



Source: the Company.

Figure 4: Shareholding Structure of CSCD

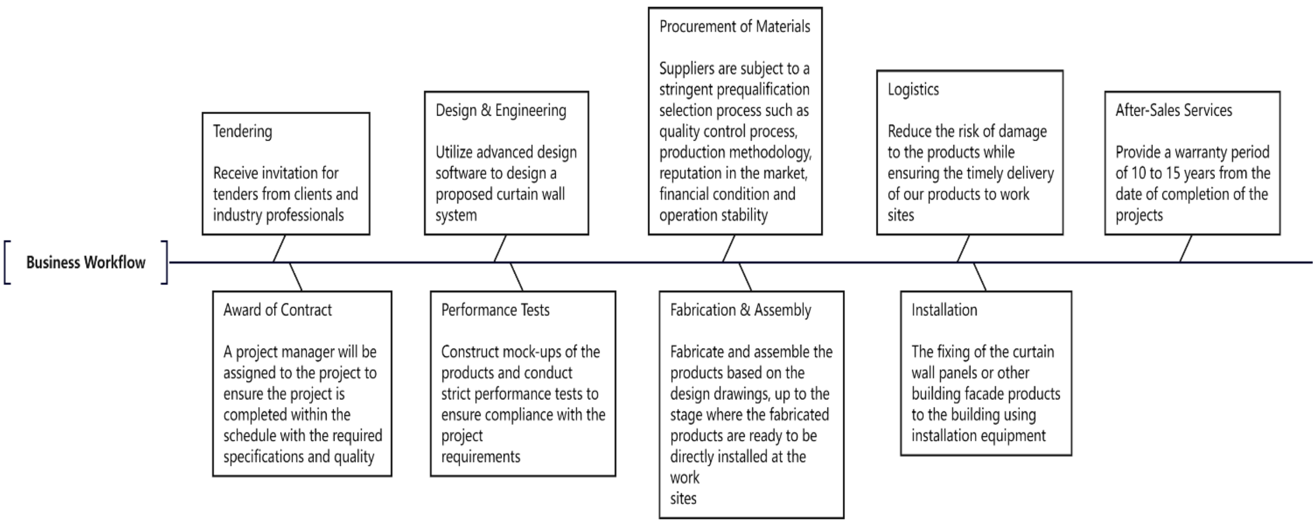


Source: the Company.

2.2 Business Model

CSCD provides customers with integrated building facade solutions that are customized to meet the technical specifications and performance requirements of projects. As a one-stop building facade solutions provider, CSCD's services range from the initial design of the building facade system, procurement of materials, fabrication and assembly of the building facade products, performance testing, installation of the products at the construction sites, to after-sales services. The Company's key products include curtain walls, glass walls and window walls, while the technical features of which vary from project to project are based on its customers' needs and specifications. Its building facade solutions are mainly applied to residential properties, commercial buildings, shopping centers, hotels, casinos and condominiums.

Figure 5: Business Workflow of CSCD



Source: the Company.

2.3 Competitive Advantage

The Company is arguably the most experienced and reputable facade solutions provider in the world. The Company, first established in 1969, is arguably the most experienced and reputable solutions provider in building facade solutions in the world. The projects it has completed or is going to complete include the Burj Khalifa in Dubai, the highest building in the world, with its super high-rise building curtain wall technology; the Murray Road Tower in Hong Kong, the most complicated project in the world with special-shaped hyperboloid unit curtain wall technology; the Shenzhen International Hotel in Shenzhen, the fastest in the world with internal installed window-wall system and MiC technology; and the Apple Store in Macau, the best quality in the world with unsupported large glass curtain wall technology. The Company's over 50 years of experience and worldwide exposure to the most difficult and sophisticated projects in the world has earned it unmatched reputation over its competitors.

The Company has unmatched core technology advantages over its competitors helping to obtain high-end projects. The Company is equipped with 5 curtain wall design institutes in Hong Kong, mainland China and North America, and has a huge lineup of expert design teams of nearly 500 people. After years of research and development and practice, the Company currently owns six core technologies, including super high-rise glass curtain wall technology, hyperbolic special-shaped complex curtain wall technology, double-layer breathing curtain wall technology, explosion-proof curtain wall technology, fire-proof curtain wall technology, and passive curtain wall technology. Among them, super high-rise glass curtain wall technology was used in the construction of the Burj Khalifa in Dubai, with a total height of 828 meters and a standard value of curtain wall wind pressure of 5.5 kPa, equivalent to a wind speed of 342 km/h, and is higher than the maximum wind pressure of the No. 10 typhoon warning category in Hong Kong (3.84 kPa, about 238 km/h wind speed). In addition, the Hong Kong Murray Road project, as the first hyperbolic special-shaped curtain wall building, has a complex shape and a total of 2,200 wall units, of which 40% are single-arc units, 20% are hyperbolic units, while the largest hyperbolic glass is 2 meters wide and 5 meters high. The processing technology involves pulling, bending and twisting; a standard technology is not yet mature in the entire industry, while production and processing face huge challenges. To solve this, the Company has built the only curtain wall bending workshop in China that deals with complex profile bending technology to ensure the production and processing of the project. Owning this core technology and know-how ensures that the Company has a huge advantage in winning high-ended projects over its competitors.

Figure 6: Murray Road Tower in Hong Kong

Source: the Company.

Figure 7: Burj Khalifah Tower in Dubai

Source: the Company.

Strong operating synergy and support from controlling shareholder CSCI. After China State Construction International (CSCI, 03311 HK) acquired CSCD's predecessor, Far East Global, CSCI introduced the industry-leading management system of China Construction Group into CSCD to assist it in its automation, informatization and intelligent transformation, which greatly improved CSCD's operational efficiency. Moreover, CSCI has reorganized CSCD's upstream supplier processes and relationships, enabling the Company to obtain better and more stable supply of raw materials at more favorable prices. For business development, being the largest construction engineering contracting company with the highest market share in Hong Kong and Macau markets, CSCI has a very important role in assisting CSCD to obtain more, larger, and better-quality new contracts. For example, in February 2021, CSCI received a general contract for the construction of the Macau Galaxy Entertainment Hotel Phase 4 project worth HK$12.6 billion, then in June 2022 CSCD announced that it had won the subcontracting construction contract for the curtain wall project of the Galaxy Entertainment Hotel Phase 4 project, worth as much as HK$2.24 billion, the largest single curtain wall project contract in the Company's history. We expect that this cooperation model, of CSCI obtaining general contracts and CSCD obtaining subcontracting contracts, will continue in the future, which will not only increase the Company's profitability, but also its operating cash flow, as CSCI is unlikely to delay payments to CSCD as other general contractors might do.

Figure 8: Working Meeting in Zhuhai Office

Source: the Company.

Figure 9: Galaxy Phase 4 Project in Macau

Source: the Company.

2.4 Business Strategy

The Company is implementing the business strategy of "expanding the Hong Kong and Macau market, entering the mainland market, shrinking overseas markets, and focusing on the high-ended market". Despite overseas markets such as North America having contributed significantly in terms of revenue, they have loss-making due to low contract prices and high selling and administrative expenses. Starting three years ago, the Company decided to gradually pull out from such loss making overseas markets and reallocate those resources to Hong Kong and Macau markets, in which profit margin and cash flow are stable and the Company has a strong reputation. This is also helped by increasing facade spending by residential property developers alongside an increase in property prices, and by the Hong Kong government in public facilities such as hospitals. In addition, the Company is seeing new opportunities in high-end markets in commercial buildings and flagship retail stores such as Apple Stores (constructed 36 Apple Stores projects in Hong Kong, Macau and mainland China) and Huawei Stores in mainland China, in which demand has not been significant until the last couple of years. The Company is aware that relying on its unmatched experience, expertise and reputation, its only viable strategy is to focus on the high-end market, in which customers tend not to be price sensitive and quality, in which the Company has a huge advantage in, is the highest priority.

The Company's leading technology strategy continues to reshape the industry with the introduction of new technologies such as MiC and BIPV. The Company's Shenzhen International Hotel project was the first to adopt the push-in window wall system in high-rise buildings; the design, processing and installation of nearly 140,000 m^2 of curtain walls was completed in 144 days. The Company's push-in window and wall system uses information-based design, and automated production and modular installation procedure. Its production staff for curtain wall parts was reduced by 70% compared to traditional methods, while the external wall installation was also carried out simultaneously with the construction of the main building, which greatly reduced construction time. In addition, the Company actively deploys BIPV technology to promote the low-carbon development of curtain wall products. On 27 September 2021, the Company reached a strategic cooperation agreement with Advanced Solar Power (Hangzhou) Inc. (ASOP), the leader in cadmium telluride technology. ASOP was established in May 2008 and its first fully automatic cadmium telluride module production line with completely independent intellectual property rights was put into operation in 2011. Moreover, all ASOP's photovoltaic manufacturing equipment has been localized, and all raw materials are sourced from China. This not only greatly reduces the manufacturing cost of cadmium telluride components, but also ensure that the core technology and raw materials are not controlled by foreign countries. CSCD has completed the research and development of the first batch of BIPV curtain wall products, which can be adapted to various formats such as hospitals, schools, residential buildings, and commercial buildings, and its photoelectric conversion efficiency can reach as high as 15%; one of the very few companies that have a practical facade BIPV product in China. The Company continues to develop and utilize advanced technology to create new markets for its solutions.

Figure 10: Strategic Cooperation Between CSCD & ASOP

Source: the Company.

Figure 11: Proposed BIPV Transformation for the Production Facility in Zhuhai

Source: the Company.

Figure 12: Shenzhen International Hotel Project

Source: the Company.

Figure 13: Proposed BIPV Renewal Project (LHS is Before Renewal and RHS is After Renewal)

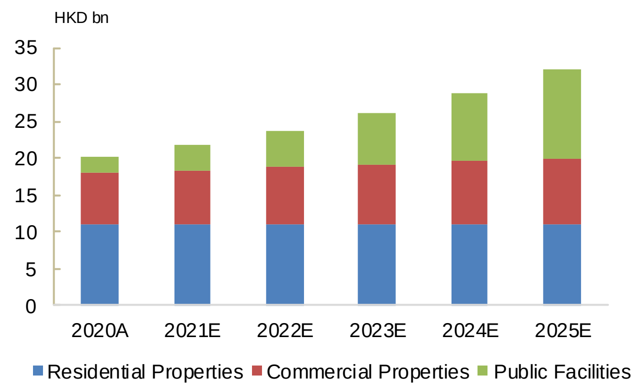
Source: the Company.

3. Key Points the Market Has Overlooked

3.1 The High-End Curtain Wall Market Still Has Substantial Room for Growth

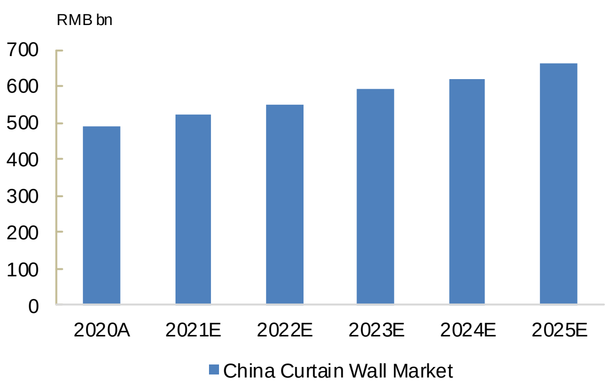
Contrary to the market's impression, the curtain wall engineering market has actually maintained steady growth even when the real estate market appears to be sluggish. Taking Hong Kong as an example, despite impact from the Covid pandemic, construction spending for residential properties and commercial properties has remained stable and hasn't decreased in the past five years. With recovery of global economies, residential and commercial construction expenditures will maintain moderate growth in the next five years and will drive spending on curtain wall projects to increase steadily. In addition, according to the 2021 policy address, the HKSAR government will continue to expand infrastructure-related investment, and the scale will reach more than HK$100 billion per year, and the government will allocate more resources to building facilities such as hospitals, public housing and integrated public buildings, which will drive demand for curtain wall works to increase significantly. Moreover, there will also be new opportunities for high-end curtain walls in Macau business. As Macau gaming licenses expire at the end of this year and is about to be reissued, and in order to welcome the increase in tourists after relaxation of border restrictions, major casino resort hotels (such as Phase IV of Galaxy Macau resort, The construction projects of MGM Phase II, Wynn, etc.) will be launched one after another, which will greatly increase demand for high-end curtain wall projects in the next 3-5 years. In addition, even though the real estate market in mainland China has been sluggish over the past two years, high-end curtain wall projects for commercial flagship stores (such as Apple Stores and Huawei Stores) and high-end residential buildings have actually continued unabated, as owners focus their resources on customers with more spending power who prefer high-end facilities. We think there is still substantial room for growth in demand for high-end curtain walls in cities in the Greater Bay Area such as Hong Kong and Macau, over the next five years.

Figure 14: Annual Curtain Wall Spending in Hong Kong



Source: the Company.

Figure 15: Annual Curtain Wall Spending in China

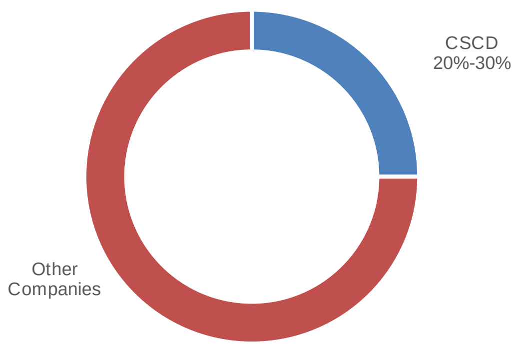


Source: the Company.

3.2 High-End Curtain Wall Market Competition is Not as Keen as the Market Thinks

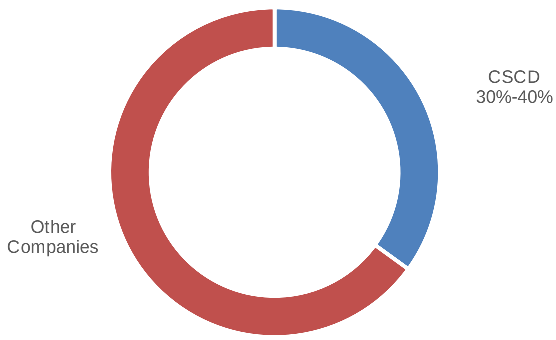
The entry barrier to the high-end curtain wall engineering market is actually very high; many competitors have actually exited the market. In addition to high requirements for hard quality traits such as experience and technology, soft quality traits such as brand, shareholders background and financial status are also important factors for customers to consider. With more than 50 years of experience in curtain wall engineering projects and undertaking the most difficult engineering projects around the world, the Company's hard quality traits and brand are unquestionable, coupled with the industry status of its controlling shareholder as CSCI (03311 HK) and its ultimate controlling shareholder CSCEC (601668 CH), while its own status as a medium-sized engineering listed company, its shareholder background and financial position far exceed most of its competitors in the market. According to newly signed contract data of major companies in the Hong Kong curtain wall engineering market in 2021, total newly signed contract value of the top ten curtain wall engineering companies was about HK$8.1 billion, of which the Company accounted for HK$4.2 billion, more than the sum of all others combined. The Company's strong competitiveness in brand, technology and shareholders' background screens it out from strong competition in the high-end curtain wall market.

Figure 16: CSCD's Market Share in the Residential Property Market in Hong Kong in 2021



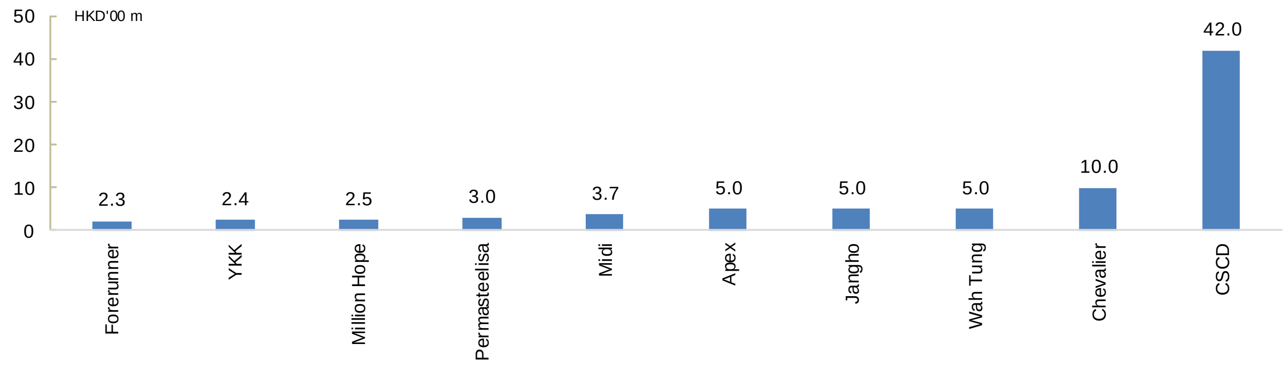
Source: the Company.

Figure 17: CSCD's Market Share in the Commercial Property Market in Hong Kong in 2021



Source: the Company.

Figure 18: New Contracts Value for Curtain Wall Projects in Hong Kong in 2021



Source: the Company.

3.3 Potential New Contracts from COLI (00688 HK) are Highly Underestimated

As one of the largest property developers in China, the affiliated China Overseas Land Investment (COLI, 00688 HK) completed projects in the Greater Bay Area with an area of 2.983 million m^2 in 2021 alone, of which Guangzhou and Shenzhen accounted for 67.5% of the total. If we conservatively assume that construction and installation cost of Guangzhou and Shenzhen properties is RMB10,000/m^2 and other areas are RMB5,000/m^2, and curtain walls on average accounts for 15% of total construction and installation cost, the potential business in curtain wall contributed by COLI in the Greater Bay Area alone will be as high as RMB3.75 billion, excluding any commercial projects in the Greater Bay Area and any projects in other regions of mainland China. With the gradual increase in new business from COLI due to increase in demand for high-end curtain wall products compared with the past, we think the market has underestimated potential new contracts COLI can contribute to CSCD.

Figure 19: Coli's Residential Property Project One Blossom Cove in Guangzhou

Source: the Company.

Figure 20: Coli's Commercial Property Project Unipark Shopping Mall in Zhuhai

Source: the Company.

4. Core Investment Logic

4.1 The HKSAR Government is Going to Significantly Increase Spending on Buildings

A higher proportion of infrastructure investment budget from the government will be allocated to public building construction compared with previous years. As the HKSAR government gradually increases infrastructure investment budget and has increased the proportion of investment in infrastructure facilities such as hospitals and complex buildings, the public curtain wall engineering market in Hong Kong will continue to grow fast. We expect the CAGR of the curtain wall engineering market for the public sector to reach 39.8% in 2020-2025, compared to CAGR of only 9.5% for the overall curtain wall engineering market for the same period in Hong Kong. Since the government's budget for infrastructure projects is generally more flexible and generous than that of private enterprises, and the quality requirements are usually higher to accommodate public interest, most government building projects use high-end curtain walls. As the undisputable leader of high-end curtain wall engineering in Hong Kong, the Company will fully benefit from the rapid growth of the new orders for curtain wall engineering projects from the government in the next five years.

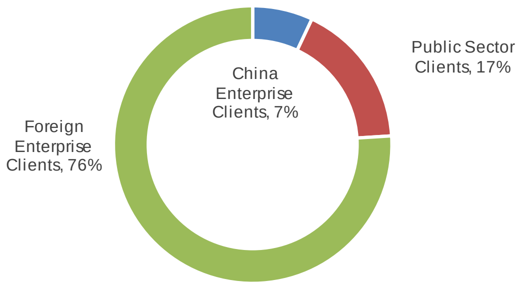
4.2 The Only Central SOE Background High-End Curtain Wall Engineering Company

The Company is the only purely curtain wall engineering and construction company with its ultimate shareholder as a central SOE in China. Shareholders' background, which represents reputation and financial capability, is of great significance to the development of the mainland China market. The Company's shareholder background with its controlling shareholder being CSCI (03311 HK) and ultimate controlling shareholder being CSCEC (601668 CH), a central SOE, is highly preferred to its clients as a sign of strong financial position, especially during economic downturns. In terms of the technology and know-how, with the exception of a few first-tier cities such as Shenzhen and Guangzhou, the level of technology of curtain wall engineering in the Greater Bay Area of the mainland is generally lower than that of Hong Kong. However, with economic development and improvement in living standards, commercial flagship stores and high-end residential buildings continue to increase, driving demand for high-end curtain walls. Combining the strong background of its shareholders and technical advantage, the Company will not encounter strong competition when it gradually develops in the Greater Bay Area market.

Figure 21: Some of CSCD's Clients

Source: the Company.

Figure 22: CSCD's Clients Structure in Mainland China

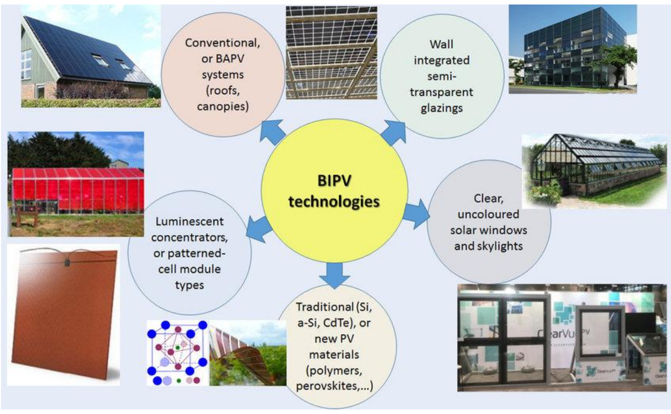


Source: the Company.

4.3 BIPV Business Is a Long-Lasting Growth Driver

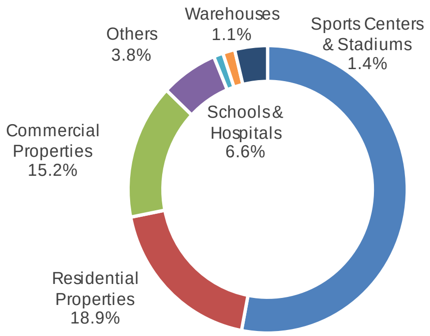
The Company has strong technology reserve in BIPV and a long-term business plan to monetize it. BIPV is an application method in which solar photovoltaic materials are used to replace traditional building materials, so that the building itself becomes a large energy source without the need for additional solar panels. Because it is considered at the design stage, the ratio of power generation rate to cost is the best, and the outer wall is usually the largest light receiving surface. A green building can supply part or all of the building's electricity, and existing buildings may also be retrofitted to become BIPV buildings. Since the price of solar panels can be amortized into the original building material it replaces, the cost of using solar energy is reduced. And incorporating solar energy in the design stage can increase the light receiving rate and have aesthetic benefits. According to a media interview with JinkoSolar, one of the largest solar products providers in China, domestic BIPV products are currently aimed at industrial and commercial roofs and commercial building curtain walls, while for new factory buildings, it must be installed. According to JinkoSolar, annual industrial and commercial potential roof area completed is 1.23 billion m^2, while current BIPV penetration rate is less than 0.5%. As a global player in curtain wall engineering projects while having strategic cooperation with the leading domestic BIPV products provider, ASOP, is poised to take advantage of the growth potential of such exponentially growing market.

Figure 23: Uses of BIPV Technologies



Source: Researchgate.

Figure 24: Estimated BIPV Market Structure in China in 2020



Source: QuestMobile, Guotai Junan International.

5. Catalysts

5.1 Loss from Overseas Markets Will Quickly Narrow

The Company plans to pull out of the North American market which has generated significant losses over the past 5 years. The North American market business is mainly carried out through its predecessor, the Gamma Group, in which Far East Global acquired 55% interest in 2011 for US$28 million. However, according to the Company's annual report, Gamma Group's performance over the past five years was sluggish, suffering losses every year with average loss reaching HK$124 million, equivalent to annual loss attributable to the Company's shareholders of HK$68 million, causing significant negative impact on the Company's financial performance. The Company plans to withdraw from the North America market after completing the backlog; it will not undertake new contracts and will concentrate resources to develop Hong Kong and Macau markets. This will have significant positive impact on the Company's financial performance.

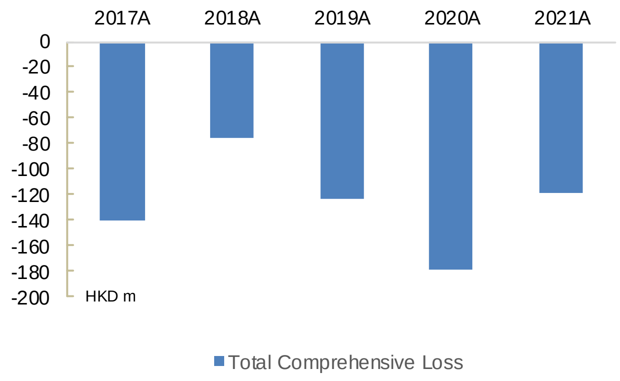
5.2 Receipt of First-Ever BIPV Contracts Worth HK$101 Million

The Company was awarded the first-ever deployment of BIPV facade project in China. On 25 July 2022, the Company was awarded a contract for the supply and installation of facade and BIPV systems for the commercial development at Laixi Qingbei Hi-Tech Park, Shandong Province, China, at a contract sum of approximately HK$101 million. This is the first of its kind contract in BIPV facade project in China, showing the Company's recognition in reputation and technology. The Company originally didn't expect significant new contracts of BIPV before 2025, and the award of such contract shows that market demand is higher than expectation, and significant new contracts might come earlier than expectation.

5.3 Placement of New Shares at Premium Price Showed Market Confidence

On June 20, the Company placed 100 million new shares to institutional investors at a price of HK$2.20 per share, at 1.9% premium to the last closing price. We think that in addition to obtaining new funds for further development, the placement can also improve its lack of market liquidity and attract the attention of market funds, which will facilitate the development of possible further financing plans in the future. Moreover, the Company announced on 24 May 2022, that it entered into its first three-year unsecured green revolving loan facility of HK$300 million with China Construction Bank (HK). The Company intends to use the proceeds from the facility to finance a number of eligible green projects under its green finance framework. The Company has completed a high amount of debt and equity financing within a short period of time, reflecting the market's high recognition of the Company's business capabilities and profitability, which can help improve its valuation level.

Figure 25: Total Comprehensive Loss of Gamma Group



Source: the Company.

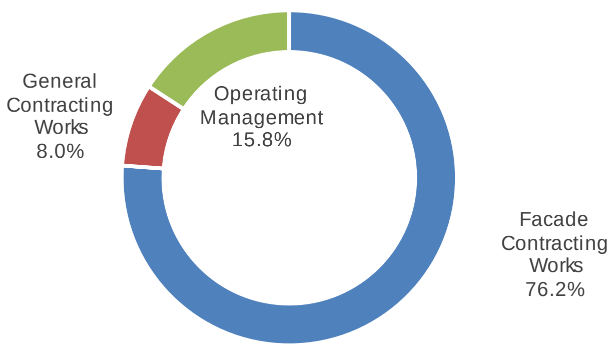
Figure 26: Award of BIPV Technology for ASOP in 2021

Source: the Company.

6. 1H2022 Results Review

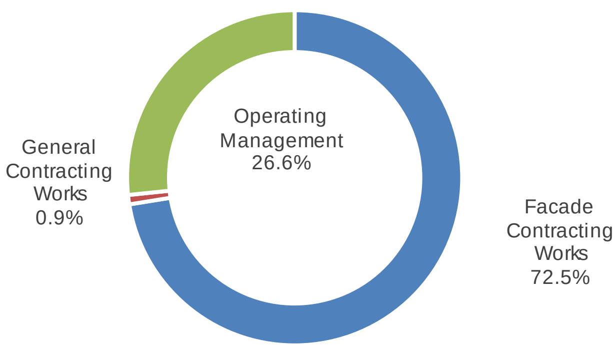
CSCD's shareholders' net profit increased 42.5% YoY to HK$322 million in 1H2022; results were in line with expectation. CSCD's revenue increased 40.8% YoY to HK$3,806 million, mainly driven by the fast increase in facade contracting works revenue, which increased 56.5% YoY to HK$2,899 million. Overall gross margin stayed flat at 14.1%, despite a significant increase in gross margin for facade contracting works business by 3.7 ppts YoY to 13.4%, due to a higher proportion of revenue contribution from higher-end facade contracting projects in Hong Kong; the increase was offset by the decrease in gross margin of general contracting works and operating management, which were negatively impacted by the poor performance in the North American market and increase in coal prices for its thermoelectric plant. During 1H2021, the Company received a record level of new contracts amounting to HK$6,009 million, while total backlog amounted to HK$13,013 million as at 30 June 2022. Going forward, the Company will allocate more resources to Hong Kong and Macau markets to boost revenue, and push forward research and business development in BIPV projects.

Figure 27: CSCD's Revenue Structure in 1H2022

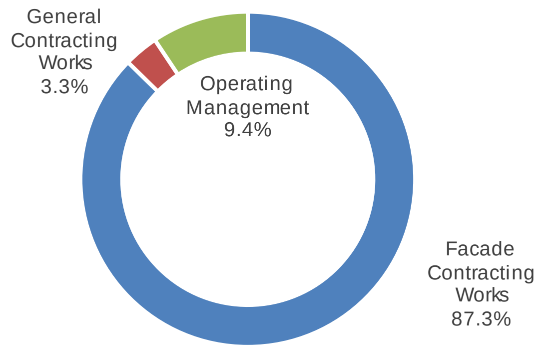
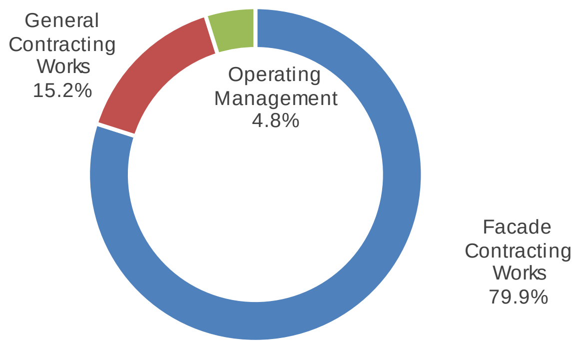


Source: the Company.

Figure 28: CSCD's Gross Profit Structure in 1H2022



Source: the Company.

Figure 29: CSCD' New Contracts Received in 1H2022	Figure 30: CSCD's Backlog as at 30 June 2022
	
Source: the Company.	*Source: the Company.*

7. Earnings Forecasts and Investment Rating

7.1 Earnings Forecasts

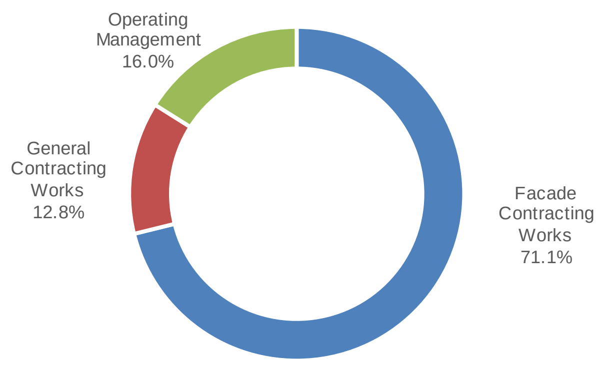
We expect CSCD's total revenue in 2022-2024 to increase 37.0% YoY, 32.9% YoY and 30.1% YoY, respectively, to HK$8,625 million, HK$11,460 million and HK$14,913 million, at a CAGR of 33.3%. Our revenue forecasts are mainly based on the following:

1) **We expect facade contracting works revenue to increase at a CAGR of 41.5% in 2021-2024.** Facade contracting works revenue benefits from increasing new contracts from the public sector in Hong Kong, new resort facilities in Macau and residential properties and commercial properties developed by COLI in mainland China, and is expected to increase by 50% YoY, 40% YoY and 35% YoY, respectively, to HK$6,717 million, HK$9,404 million and HK$12,695 million, in 2022-2024.

2) **We expect general contracting works revenue to increase at a CAGR of 5.0% in 2021-2024**. The Company derived approximately 65% of general contracting works revenue from the North American market in 2021, and it plans to gradually pull out from such market due to low gross margin and high administrative costs. With a backlog of HK$2.0 billion as at 30 June 2022, even if the Company does not receive new orders from such market, it will take the Company at least 3 years to complete the backlog. In addition, there are still new orders for other markets to be received each year for general contracting works. Hence, we expect revenue to still post mild growth in 2022-2024 to complete the backlog as soon as possible, and expect general contracting works revenue to increase by 5% in each year of 2022-2024, to HK$847 million, HK$889 million and HK$934 million, respectively.

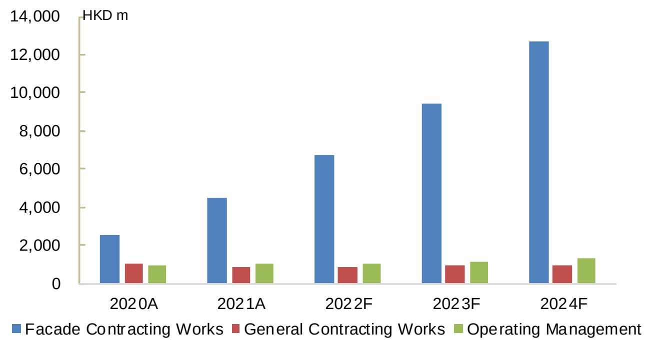
3) **We expect operating management revenue to increase at a CAGR of 8.3% in 2021-2024.** Operating management business mainly constitutes the supervision business, its thermoelectricity operation and other investment projects. Considering that the businesses are relatively stable, we forecast operating management revenue to increase by 5% YoY, 10% YoY and 10% YoY, respectively, to HK$1,061 million, HK$1,167 million and HK$1,283 million, in 2022-2024.

Figure 31: CSCD's Revenue Structure in 2021



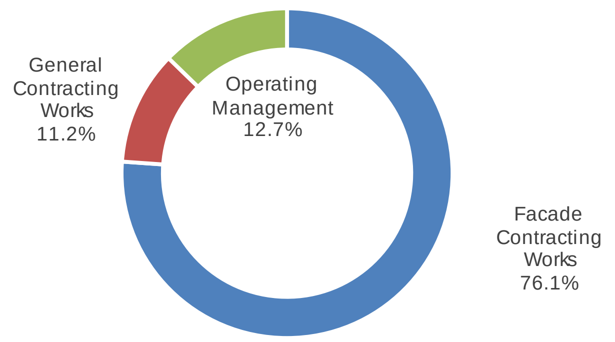
Source: the Company, Guotai Junan International.

Figure 32: CSCD's Revenue



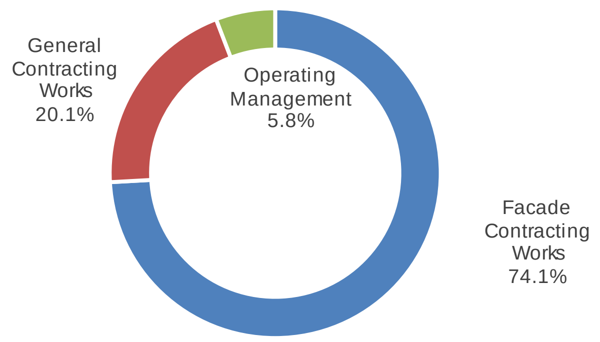
Source: the Company, Guotai Junan International.

Figure 33: CSCD's New Contracts Received in 2021



Source: the Company.

Figure 34: CSCD's Backlog as at 31 December 2021



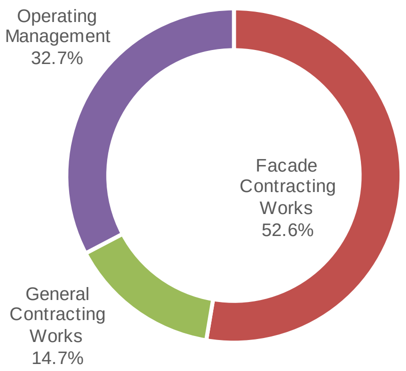
Source: the Company, Guotai Junan International.

We expect shareholders' net profit in 2022-2024 to increase 39.3% YoY, 42.6% YoY and 42.1%, respectively, to HK$416 million, HK$607 million and HK$863 million, at a CAGR of 43.5%. Our earnings forecasts are mainly based on the following:

1) For gross profit margin, in 2022 we expect it to remain unchanged from that in 2021 at 10.8%, mainly due to expected increase in gross margin for facade contracting works business, with a higher revenue contribution from higher-gross-margin high-end curtain wall business, to be offset by the decrease in gross margin of general contracting works business in the North American market, and by the increase in cost of coal of its thermoelectric plant of operating management business. We expect overall gross margin to increase to 11.2% in 2023 and 11.6% in 2024, due to increase in gross margins for facade contracting works business, and recovery in gross margin for operating management business.

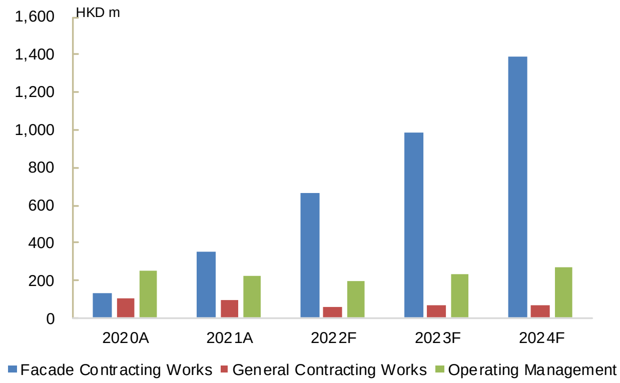
2) For selling and distribution expenses ratio, we expect it to decline from 4.4% in 2021 to 4.0% in 2022, and further to 3.7% in 2023 and 3.4% in 2024, due to cost savings for selling expenses with a contraction of business in the North American market, and economies of scale with continuous fast expansion in Hong Kong and Macau business.

Figure 35: CSCD's Gross Profit in 2021



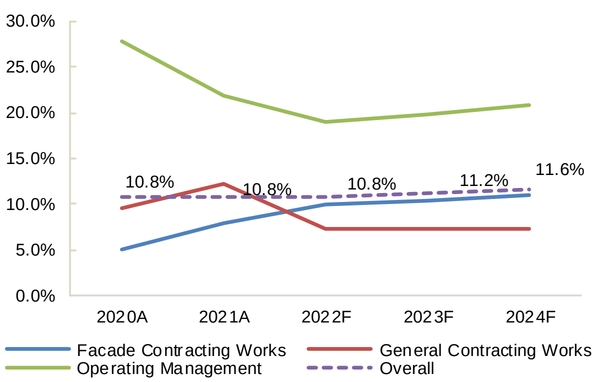
Source: the Company.

Figure 36: CSCD's Gross Profit



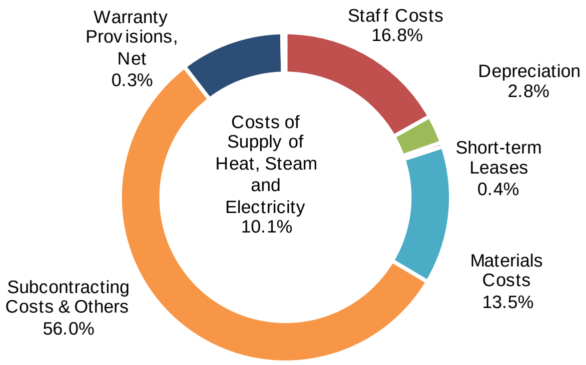
Source: the Company, Guotai Junan International.

Figure 37: CSCD's Gross Margin



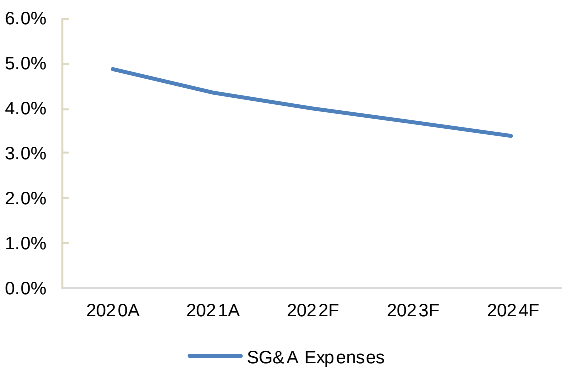
Source: the Company, Guotai Junan International.

Figure 38: CSCD's Costs of Sales in 2021



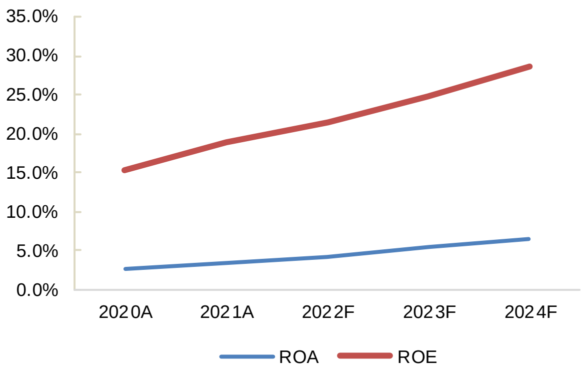
Source: the Company, Guotai Junan International.

Figure 39: CSCD's Selling & Distribution Expenses Ratio



Source: the Company, Guotai Junan International.

Figure 40: CSCD's ROA & ROE



Source: the Company, Guotai Junan International.

Table 1: CSCD's Earnings Forecasts

HKD mn	2020A	2021A	2022F	2023F	2024F
Facade Contracting Works	2,565	4,478	6,717	9,404	12,695
General Contracting Works	1,055	807	847	889	934
Operating Management	916	1,010	1,061	1,167	1,283
Total Revenue	**4,536**	**6,295**	**8,625**	**11,460**	**14,913**
YoY	*(1.8%)*	*38.8%*	*37.0%*	*32.9%*	*30.1%*
Gross Profit	**488**	**677**	**931**	**1,281**	**1,728**
Gross profit margin	*10.8%*	*10.8%*	*10.8%*	*11.2%*	*11.6%*
Operating Profit	**256**	**396**	**573**	**842**	**1,202**
Operating profit margin	*5.7%*	*6.3%*	*6.6%*	*7.3%*	*8.1%*
Shareholders' net profit	**194**	**292**	**416**	**607**	**863**
Net profit margin	*4.3%*	*4.6%*	*4.8%*	*5.3%*	*5.8%*
Basic EPS (HKD)	0.090	0.135	0.189	0.269	0.382
DPS (HKD)	0.030	0.047	0.063	0.090	0.127

Source: the Company, Guotai Junan International.

7.2 Valuation and Investment Rating

Initiate with "Buy" rating with a TP of HK$2.66. We expect the high-end curtain wall engineering business to grow rapidly as the Hong Kong government increases investment in hospitals and government complexes over the next few years, and the penetration rate of high-end curtain walls for residential and commercial buildings in the Greater Bay Area continues to increase. In addition, the Company recently obtained its first facade BIPV project in the Chinese market, proving that its comprehensive strength in the BIPV market has been recognized. Considering the advantages of the Company's brand, technology and shareholder background, the company's development in high-end curtain wall projects and BIPV projects will outperform its peers, so the valuation should be worth a premium compared to its peers. We give the Company a target price of HK$2.66 based on relative valuation method, corresponding to 2022/ 2023/ 2024 EV/EBITDA of 9.3x/ 6.6x/ 4.6x. Initiate with "Buy" rating.

Table 2: Peers Comparison – Revenue and Shareholders' Net Profit

Companies	Stock	Market	Revenue			CAGR	Shareholders' Net Profit			CAGR
	Code	Cap	2019A	2020A	2021A	2018-2021	2019A	2020A	2021A	2019-21
China State Construction Dev	00830 HK	4,827	4,619	4,536	6,295	14.1%	176	194	292	16.9%
Million Hope Industries Hold	01897 HK	207	300	536	718	24.0%	24	46	29	8.1%
Jangho Group Co Ltd-A	601886 CH	10,095	18,805	18,050	20,789	9.0%	353	948	(1,003)	N/A
Zhejiang Yasha Decoration-A	002375 CH	6,727	10,786	10,787	12,076	9.5%	426	317	(888)	N/A
Weighted average			**13,605**	**13,214**	**15,305**	**9.5%**	**341**	**609**	**(726)**	**N/A**

Source: the Company, Guotai Junan International.
Note: Only purely curtain wall engineering companies are included for comparison here.

Table 3: Peers Comparison – Gross Margin and Net Margin

Companies	Stock	Market	Gross Margin			Net Margin		
	Code	Cap	2019A	2020A	2021A	2019A	2020A	2021A
China State Construction Dev	00830 HK	4,827	11.8%	10.8%	10.8%	3.8%	4.3%	4.6%
Million Hope Industries Hold	01897 HK	207	16.4%	14.0%	7.6%	8.1%	8.6%	4.0%
Jangho Group Co Ltd-A	601886 CH	10,095	18.4%	18.3%	17.2%	1.9%	5.3%	(4.8%)
Zhejiang Yasha Decoration-A	002375 CH	6,727	14.4%	14.3%	7.2%	3.9%	2.9%	(7.4%)
Weighted average			**16.0%**	**15.6%**	**12.9%**	**2.9%**	**4.4%**	**(3.8%)**

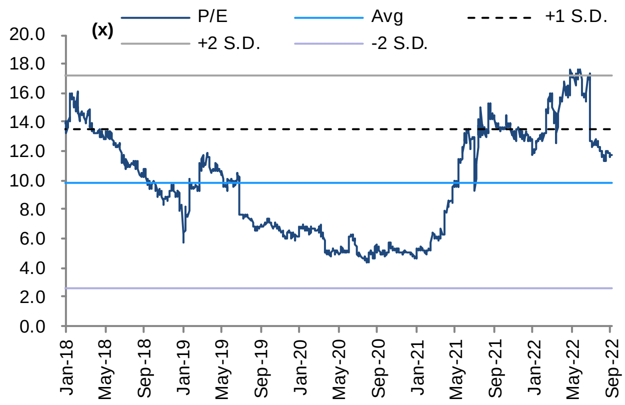
Source: the Company, Guotai Junan International.
Note: Only purely curtain wall engineering companies are included for comparison here.

Table 4: Peers Comparison - Valuation

Company	Stock Code	Currency	Last price	Market cap(mn)	PE				PB				ROE(%)	D/Y(%)	EV/EBITDA
					21A	22F	23F	24F	21A	22F	23F	24F	22F	22F	22F
HK Listed Curtain Wall Related Engineering Companies															
China State Construction Dev	00830 HK	HKD	2.110	4,759	15.6	11.1	8.1	5.7	2.7	2.3	1.8	1.4	20.6	3.0	7.2
China State Construction Int	03311 HK	HKD	9.360	47,152	6.9	6.0	5.2	4.6	0.8	0.7	0.7	0.6	13.2	5.1	8.5
Sundart Holdings	01568 HK	HKD	0.380	820	2.2	n.a.	n.a.	n.a.	0.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Million Hope Industries Hold	01897 HK	HKD	0.490	205	5.4	8.2	n.a.	n.a.	0.4	0.4	n.a.	n.a.	4.5	6.2	6.1
Hanison Construction Holding	00896 HK	HKD	1.140	1,260	4.5	8.1	n.a.	n.a.	0.3	0.3	n.a.	n.a.	3.7	10.2	12.1
Yuanda China Holdings Ltd	02789 HK	HKD	0.034	211	13.4	n.a.	n.a.	n.a.	0.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Changsha Broad Homes Indus-H	02163 HK	HKD	7.970	3,886	10.1	6.0	6.7	n.a.	0.8	0.7	0.7	1.0	2.6	n.a.	9.8
Simple Average					8.3	7.9	6.7	5.2	0.8	0.9	1.0	1.0	8.9	6.1	8.7
Weighted Average					7.8	6.5	5.6	4.7	1.0	0.9	0.8	0.7	12.9	5.0	8.6
China Listed Curtain Wall Related Engineering Companies															
Changjiang & Jinggong Buil-A	600496 CH	CNY	4.070	8,192	11.9	9.6	8.1	7.0	1.1	1.0	0.9	0.8	10.5	1.0	6.9
Center International Group-A	603098 CH	CNY	30.950	16,676	515.8	52.1	29.2	23.5	6.3	5.6	4.8	4.0	11.8	0.5	28.4
Suzhou Gold Mantis Constr -A	002081 CH	CNY	5.040	13,383	n.a.	6.7	6.0	6.0	1.2	1.0	0.9	0.8	15.6	2.5	3.5
China Fangda Group Co Ltd-A	000055 CH	CNY	5.500	4,564	26.2	n.a.	n.a.	n.a.	1.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Jangho Group Co Ltd-A	601886 CH	CNY	8.650	9,800	n.a.	13.7	10.6	8.7	1.5	1.4	1.3	1.1	10.3	2.3	n.a.
China State Construction -A	601668 CH	CNY	5.110	214,285	4.1	3.8	3.4	3.0	0.6	0.5	0.5	0.4	14.6	5.3	5.7
Zhejiang Yasha Decoration-A	002375 CH	CNY	4.970	6,660	n.a.	n.a.	n.a.	n.a.	0.9	n.a.	n.a.	n.a.	5.0	n.a.	n.a.
Simple Average					139.5	17.2	11.5	9.6	1.8	1.9	1.7	1.4	11.3	2.3	11.1
Weighted Average					39.8	7.5	5.6	4.8	1.1	0.9	0.8	0.7	14.0	4.6	7.1
Overall Simple Average					56.0	12.5	9.7	8.4	1.3	1.4	1.4	1.3	10.2	4.0	9.8
Overall Weighted Average					34.2	7.4	5.6	4.8	1.0	0.9	0.8	0.7	13.8	4.7	7.3

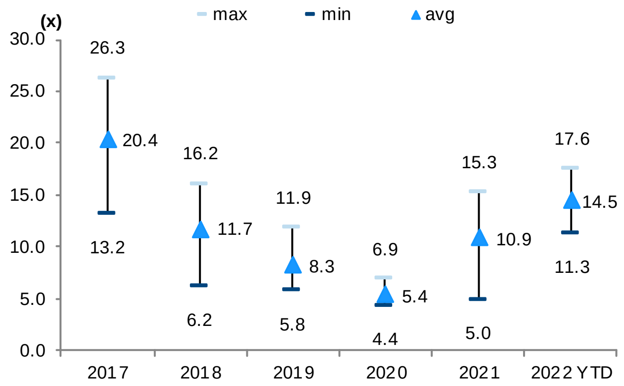
Source: Bloomberg.

Figure 41: CSCD's Historical PER Graph



Source: Bloomberg.

Figure 42: CSCD's Historical PER Range



Source: Bloomberg.

8. Risk Factors

1. **New contracts from the public sector in Hong Kong might not meet expectations.** Although the HKSAR policy address proposed to continue to increase infrastructure investment, there is no rigid target for investment in buildings such as hospitals and complexes. In addition, the government has not rigidly stipulated that the relevant curtain walls must be constructed with high-end glass curtain walls. If the related spending is lower than expected, new contracts from the public sector may be lower than expected.

2. **Change in epidemic prevention measures might delay spending in new resort facilities in Macau.** We think that casino hotels are spending huge amounts of money to build new entertainment facilities in order to attract more tourists. If changes in epidemic prevention policy affects the customs clearance process, the number of customers visiting Macau will be reduced, and the desire of tourists to travel to Macau will be affected in the long run. From a demand perspective, it will delay timetables of owners for building new recreational facilities. From the perspective of financing, the current reduction in cash flow of casino hotels and worse cash flow expectations for new projects will reduce the financing ability of owners and reduce the scale of their capital expenditures.

3. **Change in supporting policies for BIPV projects might delay demand.** Although BIPV is the trend of the times, it is not cost-effective in the short and medium term due to the technology still not being mature while market scale is still small. The popularization of related building applications is highly dependent on the promotion of government departments, including requiring a proportion of new governmental facilities to use BIPV technology, and encouraging the market to apply it through electricity subsidies. If support falls faster than expected, it will significantly reduce the demand for BIPV buildings.

Financial Statements and Ratios

Income Statement

Year end 31 Dec (HKD m)	2020A	2021A	2022F	2023F	2024F
Total Revenue	4,536	6,295	8,625	11,460	14,913
Cost of Sales	(4,047)	(5,618)	(7,693)	(10,179)	(13,185)
Gross Profit	488	677	931	1,281	1,728
Investment and Other Income / Gains, Net	22	23	25	27	30
SG&A Expenses	(222)	(274)	(345)	(424)	(507)
Finance Costs	(32)	(30)	(38)	(42)	(48)
Operating Profit	256	396	573	842	1,202
Share of Profit of an Associate	0	0	0	0	0
Profit Before Tax	256	396	573	842	1,202
Income Tax	(73)	(112)	(166)	(244)	(349)
Profit After Tax	183	284	407	598	854
Non-controlling Interest	11	8	9	10	9
Shareholders' Profit / Loss	194	292	416	607	863
Basic EPS	0.090	0.135	0.189	0.269	0.382
DPS	0.030	0.047	0.063	0.090	0.127

Cash Flow Statement

Year end 31 Dec (HKD m)	2020A	2021A	2022F	2023F	2024F
Profit Before Tax	256	396	573	842	1,202
Depreciation and Amortisation	15	20	24	26	27
Change in Working Capital	76	(223)	(245)	(533)	(658)
Other Operating Activities	347	193	353	334	571
Cash from Operating Activities	321	185	294	227	389
Capital Expenditure	(196)	(228)	(30)	(30)	(30)
Other Investing Activities	18	48	5	5	6
Cash from Investing Activities	(179)	(181)	(25)	(25)	(24)
Issuance / (Repurchase) of Shares	0	0	219	0	0
Issuance / (Repayment) of Debts	192	268	91	100	109
Drawdown / (Repayment) of Related Parties Loans	(245)	(62)	0	0	0
Dividends	0	(129)	(101)	(139)	(202)
Other Financing Activities	(49)	(48)	(33)	(37)	(43)
Cash from Financing Activities	(102)	30	176	(76)	(136)
Cash at Beg of Year	827	858	928	1,377	1,501
Net Changes in Cash	40	35	446	126	229
Forex	(9)	35	3	(3)	3
Cash at End of Year	858	928	1,377	1,501	1,733

Source: the Company, Guotai Junan International.

Balance Sheet

Year end 31 Dec (HKD m)	2020A	2021A	2022F	2023F	2024F
Property, Plant and Equipment	2,108	2,269	2,283	2,302	2,321
Interests in an Associate	0	5	5	5	6
Goodwill	130	113	113	113	113
Other Non-current Assets	308	234	169	169	169
Total Non-current Assets	2,545	2,621	2,571	2,590	2,609
Inventories	137	154	197	261	338
Contract Assets	1,452	2,450	3,170	4,331	5,723
Trade and Other Receivables	1,321	1,499	1,746	1,972	2,181
Amounts Due from Related Parties	884	878	966	1,062	1,168
Cash & Cash Equivalents	858	928	1,377	1,501	1,733
Other Current Assets	191	280	324	345	449
Total Current Assets	4,843	6,189	7,780	9,472	11,591
Total Assets	7,389	8,810	10,351	12,062	14,200
Short-term Borrowings	651	825	907	998	1,097
Contract Liabilities	778	911	957	1,053	1,158
Trade Payables, Other Payables and Accruals	1,465	2,072	2,827	3,729	4,815
Amounts Due to Related Parties	1,555	1,868	1,910	1,954	1,998
Other Current Liabilities	199	245	321	425	560
Total Current Liabilities	4,647	5,921	6,922	8,158	9,628
Long-term Borrowings	411	509	518	527	536
Contract Liabilities	756	767	767	767	767
Other Non-current Liabilities	250	28	34	42	49
Total Non-current Liabilities	1,417	1,303	1,319	1,335	1,351
Total Liabilities	6,064	7,225	8,241	9,493	10,980
Share Capital	22	22	23	23	23
Reserves	1,381	1,649	2,182	2,651	3,311
Total Shareholders' Equity	1,403	1,671	2,205	2,673	3,334
Minority Interest	(78)	(86)	(95)	(104)	(113)
Total Equity	1,325	1,585	2,110	2,569	3,220
Total Equity and Liabilities	7,389	8,810	10,351	12,062	14,200
BVPS	0.651	0.775	1.000	1.185	1.478

Financial Ratios

	2020A	2021A	2022F	2023F	2024F
Gross Margin	10.8	10.8	10.8	11.2	11.6
Operating Margin	5.7	6.3	6.6	7.3	8.1
Net Margin	4.3	4.6	4.8	5.3	5.8
ROA (%)	2.5	3.5	4.2	5.3	6.5
ROE (%)	15.4	19.0	21.5	24.9	28.7
Net Gearing Ratio (%)	15.4	25.6	2.3	0.9	Net Cash
Interest Coverage (x)	9.1	14.4	16.2	20.9	25.8

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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