

25 May 2018

Construction & Engineering | Engineering & Construction

China State Construction

Buy (Maintained)

Reverse Roadshow Takeaways

Maintain BUY and TP of HKD13.20, 36% upside, based on FY18F recurring P/E of 10x or -0.5SD below 5-year forward mean. On 23 May 2018, we visited four of CSCI's major projects in Macau, including MGM Cotai, Nova II, light rail upper cover project, and a theme park. Its Macau business is expected to contribute from 2018, with earnings contribution from Nova City alone almost reaching the entire Macau contributions in 2017. China business may continue to slow due to liquidity tightening but CSCI would still be the best performer among peers.

CSCI accounts for a major share of Macau's construction market. China State Construction (CSCI) has managed its projects well in Macau and now accounts for 15-20% of Macau's construction market. We visited the following:

- CSCI's newly completed project, MGM Cotai, which commenced in mid-2014 and opened in Feb 2018. The GFA is 4.46m sqm, and is the first overseas project worth HKD10bn;
- Light rail upper cover project is under construction, and represents CSCI's strong construction capabilities. The project is ahead of schedule, with CSCI taking 60% of construction schedule to complete 90% of the project;
- Nova is the largest commercial housing complex in Macau. CSCI and Shun Tak Holding invested 30% and 70% respectively in the project.

Nova project's net profit to drive Macau earnings. The Nova project may start contributing net profit in 2018 of c.HKD800m each year for the next three years. For 2017, Macau's net profit contribution was about CNY800m, accounting for 14% of CSCI's total earnings. The Nova project is expected to become Macau's earnings driver for CSCI over the next three years.

Potential business in Macau. Macau may continue to contribute well and drive CSCI's cash construction business. Potential business in Macau may go up to HKD160bn over the next 5-10 years, including HKD70bn of government projects, HKD50bn of casino-related projects, and HKD40bn of other projects. Over the next 5-10 years, incremental revenue from Macau is expected to be at least c.HKD5bn each year.

Liquidity is still constrained but better than peers. Liquidity may still be a concern for public-private projects (PPPs) with strict bank loan requirements on PPPs. However, management is confident that compared with its peers that are private companies, its funding capability is stronger since its parent company is a state-owned enterprise (SOE) and CSCI is not limited by SOE rules.

Maintain BUY and HKD13.20 TP. Our TP is based on FY18F recurring P/E of 10x or -0.5SD below 5-year forward mean. This is also above Bloomberg consensus' peer average of 8x for its HK-listed peers. We believe this is justified given CSCI's superior ROEs and margins. Risks to our call include inability to securitise assets and a slower-than-expected China PPP market.

Target Price:	HKD13.20
Price:	HKD9.74
Market Cap:	USD6,265m
Bloomberg Ticker:	3311 HK

Share Data

Avg Daily Turnover (HKD/USD)	68.1m/8.67m
52-wk Price low/high (HKD)	9.54 - 13.7
Free Float (%)	29
Shares outstanding (m)	4,488
Estimated Return	36%

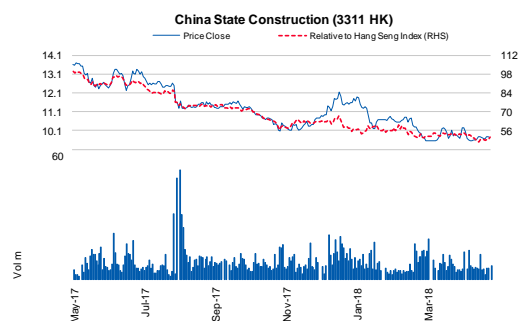
Shareholders (%)

China Overseas Holdings	63.0
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(11.0)	(1.5)	(9.5)	(6.4)	(27.5)
Relative	(13.5)	(2.9)	(7.6)	(9.6)	(48.2)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (HKDm)	46,208	50,153	56,309	68,334	75,986
Reported net profit (HKDm)	5,011	5,555	6,395	7,736	9,077
Recurring net profit (HKDm)	4,486	5,147	6,232	7,573	8,914
Recurring net profit growth (%)	5.1	14.7	21.1	21.5	17.7
Recurring EPS (HKD)	1.05	1.11	1.35	1.64	1.93
DPS (HKD)	0.31	0.33	0.38	0.46	0.54
Recurring P/E (x)	9.32	8.74	7.22	5.94	5.05
P/B (x)	1.64	1.18	1.06	0.93	0.82
P/CF (x)	15	na	48	44	165
Dividend Yield (%)	3.2	3.4	3.9	4.7	5.5
EV/EBITDA (x)	6.83	5.07	4.86	4.12	3.88
Return on average equity (%)	20.6	17.5	15.8	17.0	17.7
Net debt to equity (%)	37.7	30.5	31.7	31.4	31.8
Our vs consensus EPS (adjusted) (%)			(14.1)	(9.9)	6.0

Source: Company data, RHB

Analyst

Zhuang Dan
+852 2103 9414
zhuang.dan@rhbgroupp.com



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Financial Exhibits

Financial model updated on : 2018-03-19.

Asia	Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Hong Kong	Recurring EPS (HKD)	1.05	1.11	1.35	1.64	1.93
Construction & Engineering	EPS (HKD)	1.17	1.20	1.38	1.67	1.96
China State Construction	DPS (HKD)	0.31	0.33	0.38	0.46	0.54
Bloomberg 3311 HK	BVPS (HKD)	5.9	8.2	9.2	10.4	11.8
Buy	Weighted avg adjusted shares (m)	4,293	4,620	4,620	4,620	4,620
	Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Valuation basis	Recurring P/E (x)	9.32	8.74	7.22	5.94	5.05
TP of HKD13.20 is based on 10x FY18F recurring P/E, close to 5-year forward mean. Also supported by DCF valuation of HKD 13.80.	P/E (x)	8.34	8.10	7.04	5.82	4.96
	P/B (x)	1.64	1.18	1.06	0.93	0.82
	FCF Yield (%)	6.4	(13.4)	(0.5)	(0.3)	(2.0)
Key drivers	Dividend Yield (%)	3.2	3.4	3.9	4.7	5.5
Strong backlog and improving share of PPP projects.	EV/EBITDA (x)	6.83	5.07	4.86	4.12	3.88
	EV/EBIT (x)	7.32	5.32	5.14	4.33	4.08
Key risks	Income statement (HKDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Political risks in the Hong Kong market and unsuccessful promotion of PPPs by the Chinese Government.	Total turnover	46,208	50,153	56,309	68,334	75,986
	Gross profit	5,983	7,615	8,320	10,264	11,520
	EBITDA	5,374	6,738	7,368	9,071	10,178
	Depreciation and amortisation	(361)	(325)	(398)	(445)	(479)
	Operating profit	5,013	6,413	6,970	8,626	9,699
	Net interest	(542)	(871)	(900)	(1,151)	(1,167)
	Income from associates & JVs	563	892	1,639	1,892	2,494
	Exceptional income - net	859	421	200	200	200
	Pre-tax profit	5,893	6,855	7,909	9,567	11,226
	Taxation	(1,005)	(1,256)	(1,463)	(1,769)	(2,076)
	Minority interests	123	(44)	(52)	(62)	(73)
	Recurring net profit	4,486	5,147	6,232	7,573	8,914
	Cash flow (HKDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Change in working capital	(757)	(16,240)	(5,604)	(7,052)	(8,661)
	Cash flow from operations	2,867	(4,846)	940	1,034	273
	Capex	(178)	(1,178)	(1,178)	(1,178)	(1,178)
	Cash flow from investing activities	(2,126)	431	2,316	611	644
	Proceeds from issue of shares	4,811	6,356	0	0	0
	Dividends paid	(1,403)	(1,516)	(1,836)	(2,231)	(2,626)
	Cash flow from financing activities	6,498	15,253	(3,025)	(3,120)	(3,585)
	Cash at beginning of period	8,026	11,485	17,593	15,710	14,088
	Net change in cash	7,239	10,838	231	(1,476)	(2,669)
	Ending balance cash	15,101	22,322	17,824	14,234	11,419
	Balance sheet (HKDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Total cash and equivalents	11,522	17,638	15,754	14,132	11,896
	Tangible fixed assets	7,728	9,233	10,178	11,060	11,527
	Intangible assets	578	578	578	578	578
	Total investments	14,993	22,982	23,196	23,243	23,311
	Total other assets	22,732	30,247	30,382	35,765	42,766
	Total assets	86,174	118,518	122,002	136,588	149,603
	Short-term debt	1,456	2,581	2,581	2,581	2,581
	Total long-term debt	19,738	26,798	26,798	26,798	26,798
	Other liabilities	2	2	2	2	2
	Total liabilities	60,504	80,055	78,980	88,062	94,626
	Shareholders' equity	25,448	38,088	42,647	48,151	54,601
	Minority interests	222	375	375	375	375
	Total equity	25,670	38,463	43,022	48,526	54,977
	Net debt	9,672	11,742	13,625	15,247	17,483
	Total liabilities & equity	86,174	118,518	122,002	136,588	149,603
	Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Revenue growth (%)	21.6	8.5	12.3	21.4	11.2
	Recurrent EPS growth (%)	(0.5)	6.6	21.1	21.5	17.7
	Gross margin (%)	12.9	15.2	14.8	15.0	15.2
	Operating EBITDA margin (%)	11.6	13.4	13.1	13.3	13.4
	Net profit margin (%)	10.8	11.1	11.4	11.3	11.9
	Dividend payout ratio (%)	26.4	27.3	27.3	27.3	27.3
	Capex/sales (%)	0.4	2.3	2.1	1.7	1.5
	Interest cover (x)	7.28	6.00	6.52	6.60	7.42

Source: Company data, RHB

Figure 1: MGM Cotai



Source: Company

Figure 2: MGM Cotai



Source: RHB

Figure 3: Nova project



Source: RHB

Figure 4: Nova project



Source: RHB

Figure 5: Light rail upper cover project



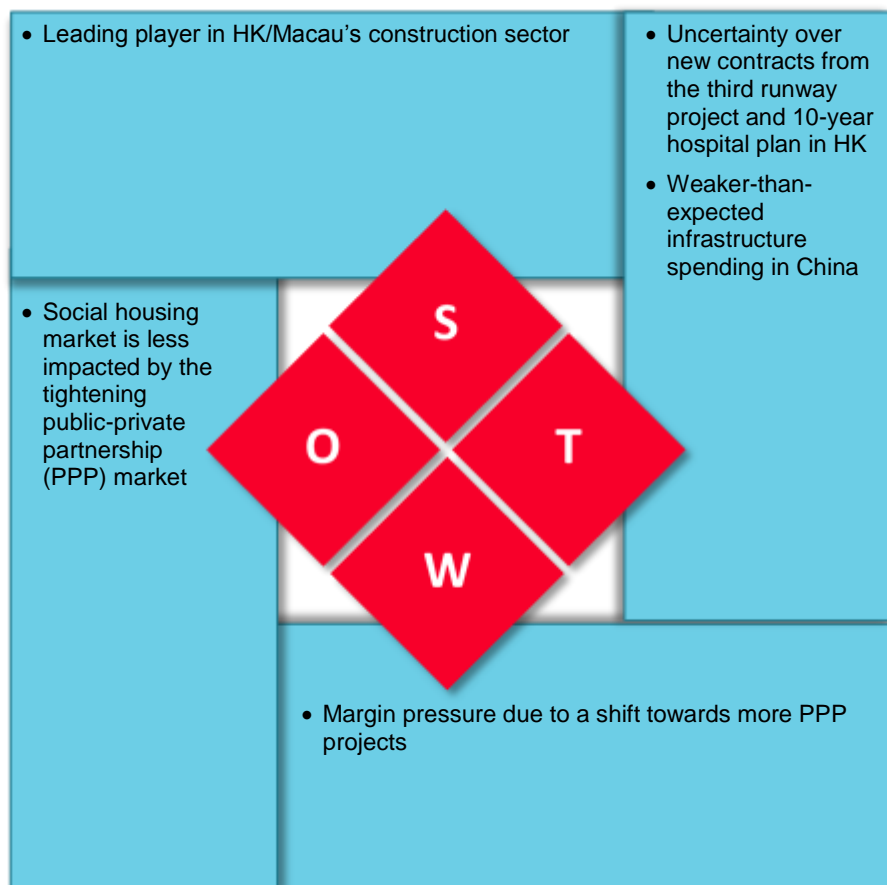
Source: Company

Figure 6: Theme park

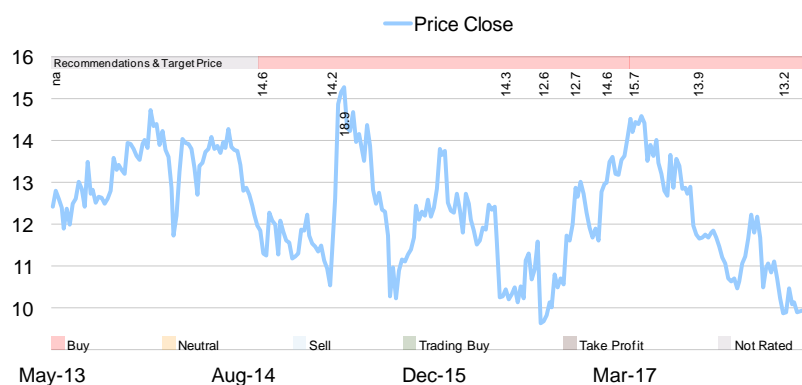


Source: RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-03-19	Buy	13.2	10.3
2017-08-24	Buy	13.9	11.3
2017-03-22	Buy	15.7	14.2
2017-01-16	Buy	14.6	12.4
2016-10-31	Buy	12.7	11.3
2016-08-16	Buy	12.6	9.6
2016-06-28	Buy	14.3	9.5
2016-05-16	Buy	14.3	10.4
2015-04-22	Buy	18.9	14.2
2015-03-23	Buy	14.2	10.8

Source: RHB, Bloomberg

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Kuala Lumpur	Hong Kong	Singapore
RHB Research Institute Sdn Bhd Level 3A, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur 50400 Malaysia Tel : +(60) 3 9280 8888 Fax : +(60) 3 9200 2216	RHB Securities Hong Kong Ltd. 12 th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	RHB Research Institute Singapore Pte Ltd. 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211
Jakarta	Shanghai	Bangkok
PT RHB Sekuritas Indonesia Wisma Mulia, 20th Floor Jl. Jenderal Gatot Subroto No. 42 Jakarta 12710, Indonesia Tel : +(6221) 2783 0888 Fax : +(6221) 2783 0777	RHB (China) Investment Advisory Co. Ltd. Suite 4005, CITIC Square 1168 Nanjing West Road Shanghai 20041 China Tel : +(8621) 6288 9611 Fax : +(8621) 6288 9633	RHB Securities (Thailand) PCL 10th Floor, Sathorn Square Office Tower 98, North Sathorn Road, Silom Bangrak, Bangkok 10500 Thailand Tel: +(66) 2 088 9999 Fax : +(66) 2 088 9799