

Equity Research | China | Industrial

3 May 2016

## 1Q16 results slightly missed estimates; Maintain BUY

- CRG's 1Q16 revenue edged up slightly by 1.4% YoY to RMB128.1bn, but net profit growth of 9.8% YoY missed our expectations (32.3% in 4Q15 vs. 3.0% in 3Q15) due to margin constraint (Gross margin: 11.4% in 4Q15 vs. 11.0% in 1Q16; EBIT margin: 2.7% in 4Q15 vs. 2.4% in 1Q16; Net margin: 2.3 % in 4Q15 vs. 1.8% in 1Q16).
- We maintain our BUY rating but after revising down our FY16-17 earnings forecast by 8.3%/6.0%, we have lowered our PT to HKD8.30 (from HKD9.30), implying 34.3% potential upside.

**CRG's 1Q16 results slightly missed our expectations.** CRG's revenue came in at RMB128.1bn in 1Q16, up 1.4% YoY, while earnings grew 9.8% YoY. Based on PRC GAAP, gross margin improved by 0.2ppts YoY to 8.1% in 1Q16. In addition, both EBIT and net margin edged up marginally by 0.1pptsYoY to 2.4%/1.8% in 1Q16, respectively.

**Sequential decline in margins aroused worries.** We want to highlight that CRG's margins saw a sequential decline in the 1Q of 2016 (gross margin: 11.4% in 4Q15 vs. 11.0% in 1Q16; EBIT margin: 2.7% in 4Q15 vs. 2.4% in 1Q16; Net margin: 2.3 % in 4Q15 vs. 1.8% in 1Q16), and thus expect upside to margins will continue to be capped in FY16.

**1Q16 saw solid new order growth but likely to slow down in 2H16.** During 1Q16, CRG's total new orders amounted to RMB189.2bn, up 20.6% YoY. In particular, new order growth of the property sector increased by 29.8% YoY. The other sectors also recovered as expected (infrastructure: up 16.0% YoY, design & consulting: up 9.2% YoY, manufacturing: up 12.0% YoY). However, we expect new order growth to slow down in 2H16, due to the high base in 2H15.

**Revise down FY16-17 earnings forecast, mainly due to margin bottleneck and VAT impacts.** We expect the company's margins to be consistently constrained in FY16, due to: 1) rising material costs; 2) domestic low-margin railway/road projects rollout; 3) VAT reform impacts (based on our estimates, tax burden will increase by no less than 80% of COGS deductible, which will negatively impact Chinese EPC contractors earnings in the short term).

**Maintain Buy but revise down PT to HK\$8.3, based on 12.3x FY16 PER (previously 12.6x).** CRG is currently trading at 9.1x FY16E PER and 0.8x FY16E PBR, which still looks undemanding compared to its historical average of 15.4x and 1.2x. After trimming our 2016E/17E earnings by 8.3%/6.0%, we lowered our price target to HKD8.3, pegging on 12.3x PER (previous 12.6x), implying 34.3% potential upside. Our target PER multiple represents 20% discount to historical average to mirror its expected slowing sequential new order growth, margins pressure and VAT reform impacts. Maintain Buy rating.

# CRG

## (390.HK)

### BUY

(unchanged)

<b>Price Target</b>	<b>HK\$8.3</b>
(Revision)	(-10.8%)
(upside)	(34.3%)

EPS revision	2016E	2017E
	(-8.3%)	(-6.0%)

Close price	HK\$6.18
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Market cap.	HK\$192.8bn
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Free float	39.4%
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52-week range	HKD4.21–HKD11.26
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3-mth ave. T/O	106.6
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*Price as of 29 April 2016*

#### Stock rel HSI performance (%)



#### Analyst

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**Figure 1: CRG's 1Q16 results**

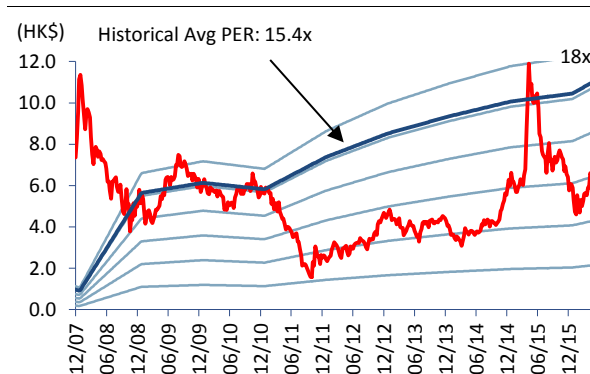
(Rmb Mn)	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	1Q16 YoY
<b>Revenue</b>	<b>180,892</b>	<b>126,287</b>	<b>148,494</b>	<b>157,371</b>	<b>191,951</b>	<b>128,090</b>	<b>1.4%</b>
<b>Total Cost</b>	<b>(176,247)</b>	<b>(123,485)</b>	<b>(145,240)</b>	<b>(153,396)</b>	<b>(187,266)</b>	<b>(125,164)</b>	<b>1.4%</b>
COGS	(158,433)	(112,600)	(131,629)	(140,249)	(170,004)	(113,968)	1.2%
Interest expense	(79)	(43)	21	(24)	(27)	(25)	-42.8%
Handling charges and commissions expenses	(0)	(0)	0	-	-	-	n.a
Business tax	(6,170)	(3,994)	(4,444)	(4,684)	(6,880)	(4,073)	2.0%
Selling and distribution costs	(577)	(533)	(438)	(533)	(839)	(590)	10.7%
Administrative expenses	(9,237)	(5,008)	(5,906)	(6,221)	(9,487)	(5,153)	2.9%
Finance costs	349	(1,342)	(903)	(1,208)	1,056	(1,247)	-7.1%
Asset Impairment Loss	(2,101)	35	(1,942)	(477)	(1,085)	(107)	-403.7%
FV gains on financial assets at fair value through profit or loss	(154)	(34)	42	(56)	45	8	-123.6%
Net Investment Income	177	48	314	228	366	87	83.5%
<b>EBIT</b>	<b>4,667</b>	<b>2,816</b>	<b>3,611</b>	<b>4,147</b>	<b>5,097</b>	<b>3,022</b>	<b>7.3%</b>
Non-Operating Income	614	122	209	262	709	247	102.2%
Non-Operating Expense	(373)	(67)	(192)	(52)	(355)	(89)	32.5%
<b>PBT</b>	<b>4,908</b>	<b>2,871</b>	<b>3,628</b>	<b>4,357</b>	<b>5,451</b>	<b>3,180</b>	<b>10.8%</b>
Income taxes	(1,793)	(720)	(1,373)	(1,190)	(1,237)	(826)	14.6%
<b>PAT</b>	<b>3,115</b>	<b>2,150</b>	<b>2,255</b>	<b>3,167</b>	<b>4,214</b>	<b>2,354</b>	<b>9.5%</b>
Minority Interest	171	(79)	478	(63)	135	(80)	1.9%
<b>Net Profit post-exceptionals</b>	<b>3,286</b>	<b>2,072</b>	<b>2,732</b>	<b>3,104</b>	<b>4,349</b>	<b>2,274</b>	<b>9.8%</b>
<b>Gross profit- PRC GAAP</b>	<b>22,459</b>	<b>13,687</b>	<b>16,866</b>	<b>17,122</b>	<b>21,947</b>	<b>14,123</b>	<b>3.2%</b>
<b>Gross profit- International GAAP</b>	<b>16,289</b>	<b>9,693</b>	<b>12,422</b>	<b>12,438</b>	<b>15,067</b>	<b>10,049</b>	<b>3.7%</b>
<i>Gross margin- PRC GAAP</i>	<i>12.4%</i>	<i>10.8%</i>	<i>11.4%</i>	<i>10.9%</i>	<i>11.4%</i>	<i>11.0%</i>	<i>0.2 ppt</i>
<i>Gross margin- International GAAP</i>	<i>9.3%</i>	<i>7.9%</i>	<i>8.6%</i>	<i>8.1%</i>	<i>8.1%</i>	<i>8.1%</i>	<i>0.2 ppt</i>
<i>EBIT margin- PRC GAAP</i>	<i>2.6%</i>	<i>2.2%</i>	<i>2.4%</i>	<i>2.6%</i>	<i>2.7%</i>	<i>2.4%</i>	<i>0.1 ppt</i>
<i>EBIT margin- International GAAP</i>	<i>2.5%</i>	<i>3.4%</i>	<i>3.1%</i>	<i>3.5%</i>	<i>2.2%</i>	<i>3.5%</i>	<i>0.0 ppt</i>
<i>Net margin- PRC GAAP</i>	<i>1.8%</i>	<i>1.6%</i>	<i>1.8%</i>	<i>2.0%</i>	<i>2.3%</i>	<i>1.8%</i>	<i>0.1 ppt</i>
<i>Net margin- International GAAP</i>	<i>1.9%</i>	<i>1.7%</i>	<i>1.9%</i>	<i>2.0%</i>	<i>2.4%</i>	<i>1.8%</i>	<i>0.1 ppt</i>

Source: Company, CSCI research

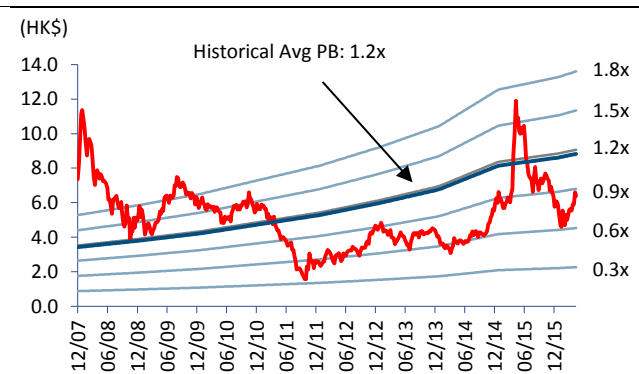
**Figure 2: Earnings forecast revision**

(In mn Rmb except otherwise indicated)	Old			New			Change		
	2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E
Revenue	668,601	726,800	n.a.	640,802	690,777	744,467	-4.2%	-5.0%	n.a.
Gross profit	55,343	60,621	n.a.	51,648	56,872	61,561	-6.7%	-6.2%	n.a.
EBIT	19,841	22,029	n.a.	18,547	21,189	23,106	-6.5%	-3.8%	n.a.
Net income, post-exceptionals	14,177	16,087	n.a.	13,006	15,121	16,740	-8.3%	-6.0%	n.a.
Net income, pre-exceptionals	14,177	16,087	n.a.	13,006	15,121	16,740	-8.3%	-6.0%	n.a.

Source: Company, CSCI research

**Figure 3: CRG PER Band**


Source: Company, CSCI research

**Figure 4: CRG PBR Band**


Source: Company, CSCI research

**Figure 5: CRG Financial Summary**

<b>Income Statement</b> (RMB mn except otherwise indicated)					
	2014	2015	2016E	2017E	2018E
<b>Revenue (net of business tax)</b>	592,965	604,103	640,802	690,777	744,467
YoY growth	9.4%	19%	6.1%	7.8%	7.8%
<b>COGS</b>	(544,017)	(554,482)	(589,154)	(633,905)	(682,905)
<b>Gross profit</b>	48,947	49,621	51,648	56,872	61,561
YoY growth	2.14%	14%	4.1%	10.1%	8.2%
<b>Gross profit margin</b>	8.3%	8.2%	8.1%	8.2%	8.3%
<b>SG&amp;A expenses</b>	(3,108)	(3,250)	(3,310)	(3,582)	(3,846)
<b>R&amp;D expenses</b>	-	-	-	-	-
<b>Other operating income/loss</b>	-	-	-	-	-
<b>EBITDA</b>	24,824	24,882	27,279	31,275	34,810
YoY growth	14.4%	0.2%	9.6%	14.6%	11.3%
<b>EBITDA margin</b>	4.2%	4.1%	4.3%	4.5%	4.7%
<b>Depreciation</b>	(6,053)	(6,817)	(7,485)	(8,759)	(10,095)
<b>Amortization</b>	(909)	(952)	(1,247)	(1,327)	(1,609)
<b>EBIT</b>	17,861	17,112	18,547	21,189	23,106
YoY growth	8.2%	-4.2%	8.4%	12.2%	9.0%
<b>EBIT margin</b>	3.0%	2.8%	2.9%	3.1%	3.1%
<b>Interest income</b>	2,99	2,728	2,829	2,560	2,566
<b>Interest expense</b>	(6,790)	(6,184)	(5,448)	(4,524)	(4,128)
<b>Profit/loss from associates</b>	700	956	956	956	956
<b>Profit/loss from acquisition/disposal</b>	-	-	31	31	31
<b>Other non-operating income/loss</b>	1,343	1,694	1,694	1,694	1,694
<b>Pretax income</b>	15,313	16,307	18,910	21,907	24,225
YoY growth	13.3%	6.5%	16.0%	15.9%	10.6%
<b>PBT margin</b>	2.6%	2.7%	3.0%	3.2%	3.3%
<b>Income tax</b>	(4,637)	(4,521)	(5,242)	(6,073)	(6,716)
<b>Effective tax rate</b>	30.3%	27.7%	27.7%	27.7%	27.7%
<b>Minority interest (VS item)</b>	(316)	472	(662)	(714)	(769)
<b>Net income, post-exceptionals</b>	10,360	12,258	13,006	15,121	16,740
YoY growth	10.5%	18.3%	6.1%	14.3%	10.7%
<b>Net margin</b>	1.7%	2.0%	2.0%	2.2%	2.2%
<b>Post-exceptional items - gain/(loss)</b>	876.5	1,325.3	-	-	-
<b>Net income, pre-exceptionals</b>	9,483	10,932	13,006	15,121	16,740
YoY growth	13.5%	15.3%	10.0%	14.3%	10.7%
<b>Net margin</b>	1.6%	1.8%	2.0%	2.2%	2.2%

<b>Cash Flow Statement</b> (RMB mn except otherwise indicated)					
	2014	2015	2016E	2017E	2018E
<b>Operating activities</b>					
Profit before taxes	5,313	6,307	8,910	21,907	24,225
Depreciation and amortization	6,962	7,769	8,732	10,086	11,705
Net profit/loss on asset sales	-	-	(31)	(31)	(31)
Increase/decrease in working capital	(5,819)	6,424	(3,528)	(7,464)	(336)
Other operating cash flow items	1,063	258	(9,285)	(10,950)	(12,303)
<b>Net CF flow from operating activities</b>	19,420	30,758	14,799	13,548	23,260
<b>Investing activities</b>					
Capital expenditure	(9,561)	(14,905)	(21,598)	(22,948)	(22,948)
Acquisition/divestiture	-	93	-	-	-
Proceeds from disposal of assets	1,202	1,153	3,158	3,158	3,158
Other investment cash flow items	(3,976)	(1,896)	1,507	760	632
<b>Net CF flow from investing activities</b>	(12,334)	(15,555)	(16,933)	(19,030)	(19,158)
<b>Financing</b>					
Dividends paid	(1,406)	(2,158)	(2,158)	(2,290)	(2,662)
Share repurchase/issue	-	20,927	-	-	-
Increase/decrease in debt&notes payable	(5,177)	1,129	(8,812)	5,302	637
Change in Minority interests	937	90	(392)	(335)	(275)
Other financing cash flow items	(8,419)	(10,566)	(5,148)	(4,524)	(4,128)
<b>Net CF flow from financing activities</b>	(14,065)	9,421	(16,510)	8,153	(6,429)
<b>Total cash flow</b>	(6,979)	24,625	(18,644)	2,672	(2,327)

<b>Balance Sheet</b> (RMB mn except otherwise indicated)					
	2014	2015	2016E	2017E	2018E
<b>Assets</b>					
Cash and cash equivalents	68,679	93,304	74,660	77,331	75,005
Fledged deposits	8,675	7,414	7,065	6,478	9,137
Bill and trade receivables	217,161	203,586	211,728	226,470	244,100
Inventories	44,934	30,110	31,315	33,495	36,102
Other receivables	-	-	-	-	-
<b>Other current assets</b>	205,853	230,995	245,944	268,823	286,159
<b>Total current assets</b>	545,303	565,410	571,512	614,596	650,503
<b>Net PP&amp;E (including AUC)</b>	48,119	51,707	58,105	64,579	69,716
<b>Net intangibles</b>	42,972	45,382	48,723	51,984	54,963
Equity investments	6,561	8,053	9,009	9,965	10,921
Investments in securities or other	9,615	9,173	9,179	9,179	9,179
<b>Total investments</b>	16,176	17,232	18,188	19,144	20,100
LT deferred tax assets	4,281	4,367	4,367	4,367	4,367
LT trade and bills receivables	11,547	11,671	12,381	13,346	14,383
<b>Other long term assets</b>	14,650	17,899	17,899	17,899	17,899
<b>Total assets</b>	683,047	713,668	731,173	785,915	831,931
<b>Liabilities</b>					
Accounts payable	345,714	358,291	372,090	396,371	425,033
Short-term debt	90,559	79,461	50,199	44,919	44,919
<b>Other current liabilities</b>	34,867	32,695	34,740	37,379	40,268
<b>Total current liabilities</b>	471,140	470,447	457,028	478,669	510,220
Long-term debt	92,734	93,748	113,748	133,748	133,748
LT trade and bills payable	7,463	7,500	7,969	8,575	9,237
Deferred tax liabilities	1,103	920	920	920	920
<b>Other LT liabilities</b>	1,543	1,651	1,651	1,651	1,651
<b>Total non-current liabilities</b>	102,843	103,819	124,288	144,894	145,556
<b>Total liabilities</b>	573,983	574,267	581,317	623,563	655,776
<b>Common shareholders' equity</b>					
Issued capital	21,300	22,844	22,844	22,844	22,844
Reserves	77,420	107,743	118,590	131,421	145,499
<b>Common shareholders' equity</b>	98,720	130,587	141,434	154,265	168,343
<b>Minority interests</b>	10,344	8,814	8,422	8,087	7,812
<b>Total liabilities and equity</b>	683,047	713,668	731,173	785,915	831,931

<b>Ratio Analysis</b>					
	2014	2015	2016E	2017E	2018E
<b>Valuation</b>					
P/E (x)	11.7	10.8	9.1	7.8	7.1
P/B (X)	1.1	0.9	0.8	0.8	0.7
EV/EBITDA (X)	10.3	8.7	8.3	7.6	6.9
Dividend yield(%)	1.3	1.8	1.9	2.2	2.5
FCF yield (%)	-0.6	1.1	-0.2	-0.3	0.3
<b>Profitability</b>					
Gross margin (%)	8.3	8.2	8.1	8.2	8.3
EBIT margin (%)	3.0	2.8	2.9	3.1	3.1
Net margin (%)	1.6	1.8	2.0	2.2	2.2
SG&A/revenue (%)	5.2	5.4	5.2	5.2	5.2
ROE (%)	10.2	9.5	9.6	10.2	10.4
ROA (%)	1.4	1.6	1.8	2.0	2.1
<b>Liquidity &amp; Leverage</b>					
Current Ratio (X)	12	12	13	13	13
Quick Ratio (X)	1.1	1.1	1.2	1.2	1.2
Net debt/equity (%)	143.7	78.4	79.0	80.2	74.9
Total debt/equity (%)	213.3	149.8	131.8	130.4	119.5
Total liabilities/total assets (%)	84.0	80.5	79.5	79.3	78.8
EBIT interest coverage ration (x)	2.6	2.8	3.6	4.7	5.6
<b>Efficiency</b>					
Inventory days	30.7	24.7	19.0	18.7	18.6
A/R days	125.5	127.1	118.3	115.8	115.4
A/P days	200.0	215.4	212.3	208.3	207.5

Source: Company, CSCI research





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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Buy</b>	12-month absolute total return: $\geq 10\%$
<b>Hold</b>	12-month absolute total return: $> -10\%$ but $< 10\%$
<b>Sell</b>	12-month absolute total return: $\leq -10\%$

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