

CHINA CERAMICS CO., LTD.
3Q 2013 Earnings Call
November 13, 2013
8:00 a.m. ET

Speakers:

Mr. Jaidong Huang, CEO
Mr. Edmund Hen, CFO

Operator: Good morning. My name is Arnica and I will be conference operator today. At this time, I'd like to welcome everyone to the China Ceramics Third Quarter 2013 Earnings Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

I would now like to turn the conference over to David Rudnick.

David Rudnick: Thank you, Arnica. Good morning, ladies and gentlemen, and good evening to those of you who are joining us from China. Welcome to China Ceramics Third Quarter 2013 Earnings Conference Call. With us today are China Ceramics Chairman and Chief Executive Officer, Mr. Jia Dong Huang; and Chief Financial Officer, Mr. Edmund Hen.

Before I turn the call over to Mr. Huang, may I remind our listeners that during this call, management's prepared remarks contain forward-looking statements which are subject to risks and uncertainties, and management may make additional forward-looking statements in response to your questions. Therefore, the company claims protection of the Safe Harbor for forward-looking statements that is contained in the Private Securities Litigation

Reform Act of 1995. Actual results may differ from those discussed today. Refer to more detailed discussion of the risks and uncertainties with the company's filings with the Securities and Exchange Commission.

In addition, any projections as the company's future performance represent management's estimates as of today, November 13, 2013. China Ceramics assumes no obligation to update projections in the future as market conditions changed. To supplement its financial results presented in accordance with IFRS, management may make references that are non-GAAP financial measures, which the company believes provide some meaningful additional information to understand the company's performance. A statement reconciling any non-GAAP measures to nearest GAAP equivalents can be found in the earnings press release issued earlier today.

And now, it's my pleasure to turn the call over to China Ceramics, Chairman and CEO, Mr. Jia Dong Huang; and China Ceramics, CFO, Mr. Edmund Hen. Precept's Sandy Qin will be translating for Mr. Huang. Mr. Huang, you may proceed.

Jia Dong Huang: Thank you, David. On behalf of the company, I would like to welcome everyone to our third quarter 2013 earnings conference call.

We are pleased to report strong top-line financial performance for the third quarter as our revenue grew at 53 percent over that of the second quarter. The increase was driven by a 50 percent sequential rise in the sales volume of our ceramic tiles as well as a moderate increase in our average selling price. We believe that the market environment in the real estate and construction sectors has begun to normalize, although some pricing sensitivity among our customers continues.

For the fourth quarter, we expect a seasonal slowdown consistent with the construction building cycle and an opportunity it involved our business into higher-margin sectors through additional ceramic tile offerings for both our current and new potential customers.

Well, our top line was strong to promote products that meet current and expected customer demand. We wrote down asset attributable to the

replacement of certain components at our Hengda facility in the third quarter that affected the quarter's profitability. However, our cash flow growth was strong with a 50 percent increase in EBITDA from the second quarter. In addition, with our upgraded and new facilities, we continue to differentiate ourselves from our competition due to our capability to operate efficiently and produce new lines of innovative and high performance ceramic tiles.

In the third quarter, we utilized the plant production facilities capable of producing 35 million square meters of ceramic tiles out of an annual production capacity of 72 million square meters of ceramic tiles. This represents an increase from the second quarter where we utilized the plant production facilities capable of producing 28 million square meters a year. As market conditions improve, we will look to bring additional capacity online.

We are also intent upon regaining the product pricing levels that were in place prior to the macroeconomic difficulties that began in late 2012. Our modern facilities enable us to optimize our product mix and develop hundreds of customized products including those of our better performing products which could ultimately enhance our margins.

We believe that we continue to be well-positioned in our industry and that our superb name-brand recognition, customer-centric focus, and strategic marketing optimally position us to ultimately improve our pricing power as market conditions strengthen. Further company development in the quarter was that we established our new subsidiary, Fujian Hengdali Construction Material Company Limited for future trading activities with such entities as China State Decoration Group Company Limited.

With that, I would like to turn over the call to the company's Chief Financial Officer, Mr. Edmund Hen, who will discuss the company's third quarter results in more detail. Thank you.

Edmund Hen: Thank you Mr. Huang. I will now move on to a more detailed discussion of our preliminary financial results for the third quarter end, September 30, 2013.

Our revenue for the third quarter ended, September 30, 2013 was RMB 340.7 million or US \$55.3 million, an increase of 53 percent from the second

quarter, but down 11.8 percent from the third quarter of 2012. The sales volume of ceramic tiles in the third quarter was 12.5 million square meters, an increase of 50.6 percent as compared to the second quarter of 2012 and a 2.9 percent increase from the 12.2 percent million square meters of ceramic tiles sold in the year of both quarter.

The average selling price or ASP in the second quarter rose 1.9 percent to RMB 27.2 per square meter from the second quarter's ASP of RMB 24.4 per square meter. But it still represents 14.2 percent decrease from the ASP of the comparable year-ago quarter.

The company attributes its substantially improved revenue to the second quarter to more normalized business conditions in China's real estate and construction sector although pricing has proved to be more resistant to recovery due to pricing concessions instituted to address the difficult market conditions that began in late 2012.

Gross profit for the third quarter of 2013 was RMB 33.3 million or US \$5.4 million, a substantial rise of 50 percent from the second quarter; but still significantly lower than the RMB 110 million or US \$17.7 million records for the third quarter of 2012. Although the sales volume has improved, the year-over-year decrease in gross profit versus the comparable year-ago quarter was due to the decrease in the average selling price of the company's ceramic tiles in the quarter. Our gross profit margin for the third quarter was 9.8 percent compared it to 28.5 percent for the same period of 2012 and was caused by a decrease in average selling price of ceramic tiles in the quarter.

We incurred a write-down of assets in the quarter of RMB \$18.9 million or US \$3.1 million attributable to both to replacement and updating of plant production equipment at the company's Hengda facility to replace one of the kilns where certain molding and casting component were updated so that new and modern ceramic tiles products more appropriate to customers' preferences and market demand could be manufactured.

Non-GAAP profit from operations before taxes, which excluded the quarter's non-GAAP, non-cash treatment of asset write-down and share-based

compensation expenses was RMB 24.8 million or US \$4.1 million in the third quarter as compared to RMB 99.2 million or US \$16 million in the last year's third quarter. However, this represented a strong and sequential improvement of about 138 percent from the second quarter's results of RMB 10.4 million or US \$1.7 million.

Non-GAAP net profit, which excluded the quarter's non-cash treatment of the asset write-down and share-based compensation expenses was RMB 23.2 million or US \$3.9 million in the third quarter ended September 30, 2013, as compared to RMB 74.1 million or US \$11.9 million in the third quarter of 2012. However, this also represent a strong sequential improvement from the second quarter of about 130 percent from the first quarter's result of RMB 10.1 million or US \$1.6 million.

On a GAAP basis, net profit for the third quarter 2013 was RMB 4.4 million or US \$0.7 million as compared to RMB 72.8 million or US \$11.7 million in the same period of 2012. The year-over-year decrease in net profit was the result of lower gross profit and the asset write-down in the current quarter.

Earnings per fully diluted share were RMB 0.21 or US \$0.03 for the third quarter of 2013 as compared to RMB 0.47 or US \$0.08 in the second quarter of 2013 and RMB 3.56 or US \$0.57 in the third quarter of 2012. Per share calculations for all the three quarters were computed using 20.4 million shares.

For the nine months ended September 30, 2013, revenue was RMB 712.6 million or US \$115.4 million, a decrease of 40.6 percent as compared to the nine months ended September 30, 2012. Gross profit was RMB 60.3 million or US \$9.8 million, down 82.8 percent from the same period of 2012. Gross margin for the first nine months was 8.5 percent compared to 29.3 percent for the same period of 2012.

Net profit for the nine months was RMB 8.6 million or US \$1.4 million compared to RMB 230.5 million or US \$36.7 million for the same period of 2012. Non-GAAP net profit adjusting for the quarter's non-cash asset write-down and share-based compensation expenses was RMB 28.6 million or US

\$4.7 million for the nine month end September 30, 2013, as compared it to RMB 234.9 million or US \$37.4 million in the same period of 2012.

Fully diluted EPS for the nine months ended September 30, 2013, was RMB 0.42 or US \$0.07 million. And on the non-GAAP adjusted basis, fully diluted EPS was RMB 1.14 or US \$0.23.

Turning to our balance sheet, as of September 30, 2013, we had a cash and bank balances of RMB 40.1 million or US \$6.5 million compared to RMB 89.4 million or US \$14.4 million as of December 31, 2012. The decrease in cash and bank balances was the result of an increased level of receivables, acquisition of equipment, the repayment of bank borrowings in the third quarter of 2013 and the payment of a dividend.

As of the end of the third quarter, our total debt was RMB 65.6 million or US \$10.7 million as compared to total debt of RMB 60.0 million or US \$9.6 million as of year-end of fiscal 2012.

As of September 30, 2013, we had an inventory turnover of 126 days compared to 101 days as of December 31, 2012. The increase in inventory turnover reflects the decrease in sales volume of ceramic tiles which result in slower moving of finished goods at September 30, 2013, and the price reductions in the first nine months of 2013.

Trade receivables turnover was 164 days as of September 30, 2013, compared with 119 days as of December 2012. The company extended the credit period for certain customers to address funding pressure of those customers since the quarter end December 31, 2012.

In terms of our CapEx, we expended RMB 10.2 million or US \$1.7 million in the third quarter for the acquisition of equipment at Hengdali facility and expend RMB 28.4 million or US \$4.6 million to modify an existing production line at the Hengdali facility to enable the manufacturer of products that are in market demand. Although business conditions are subject to change, management anticipates a minimal level of capital expenditure for the remainder of 2013 that will be associated with small repairs and maintenance of equipment.

Moving on to our business outlook, as discussed by our CEO, Mr. Huang, as the economic climate for the real estate development and construction in China improved in the third quarter, we deployed additional capacity from that utilization in second quarter. The company is currently utilizing plant facility capable of using 35 million square meters of ceramic tiles out of an annual production capacity out of 72 million square meters that is available to the company, up from 28 million meters square meters of annual capacity in the second quarter.

As a result of a better market environment, the company's sales volume rose 50.6 percent to 12.5 million square meters for ceramic tiles as compared to the second quarter and was 2.9 percent ahead for sales volume for the third quarter in 2012. However, our average selling price or ASP increased a moderate 2.9 percent increase over that of the second quarter and still substantially lower than the year-ago comparable quarter.

As many of you recall, due to a challenging market environment, we needed to reduce our ASP beginning in December of last year in order to meet competitors' sharp discounting and retain market share. And although the third quarter sales volume reflects a substantially improved level of business activity, we have yet to recover or our pricing power from the economic slowdown that took only in the fourth quarter in 2012 and continued into this year. However, we are deploying strategy such as a more intensive and sophisticated marketing in further product diversification to recoup our previous ASP level, which we believe we will meet with progress over the next few quarters.

Our backlog of orders for delivery in October and November of 2013 is approximately RMB 155.5 million or US \$25.3 million. We estimate that our sales volume of ceramic tiles in October and November of 2013, will be approximately 5.7 million square meters, as compared to sales volume of 6 million square meters for the same period of 2012.

In addition, we estimate that our ASP is RMB 27.1 per square meter on ceramic tile for October and November 2013. This compares with our ASP of

RMB 27.2 per square meter of ceramic tiles in the third quarter of 2013 and RMB 28.2 per square meter in the fourth quarter of 2012.

The company believes that the real estate and construction sector continue to be vital area for the Chinese government to encourage in order sustaining economic growth. And that regulation has stabilized in terms of curbing some of the speculative buying occurring for investment purposes. This has been conducive to be a rebound in the sector as certain Tier 1 cities record sales growth from the second quarter and several cities reported record high prices in the land sales market. Recent signals portent a sustainable and improved real estate sector with new construction levels deemed to be within reasonable level as seen by the government.

The company believes that its strategy of implementing price cuts on select product during the market downturn of late last year and early this year in order to retain customers and maintain our reputation was successful. And although we market a wide range of both premium and value-oriented products, price sensitivity has become a factor with our customers. However, as we believe that we are entering a period of more stable market conditions, we have the ability to shift sales emphasis among the wide range of products offering, and we will strive to recoup our pricing power and regain margin, quarters ahead.

Further, we think that our new marketing showroom, development of new products from our R&D program and upgraded and modern plant facilities with customized design and product capability offering as a sustainable comparative advantage in the marketplace. We also believe that our comprehensive product suite continues to differentiate it from our competitors where some smaller producer have discontinued or contracted operation and offer us the potential for expansion and growth in the market share.

In summary, we will continue to stay very close to our customers and work with them to meet their building materials needs as well as to operate efficiency, so as to generate solid returns for our shareholders.

With that, I would like to open up the call to any questions pertaining to our third quarter's financial and operating performance. Operator?

Operator: At this time, I would like to remind everyone, in order to ask a question, press star then the number one on your telephone keypad. That's star then the number one on your telephone keypad. We'll pause for a just a moment to compile the Q&A roster.

Your first question comes from Howard Flinker with Flinker & Company.

(Howard Flinker): I have three questions. First, is the write-off of plant and equipment not tax-deductible?

Edmund Hen: Yes, it's a tax deductible.

Howard Flinker: It is?

Edmund Hen: It is.

Howard Flinker: It seems that you added the whole write-off to post-tax earnings to get to the adjusted earnings per share. Did I make a mistake in calculation? Because it was, what, 4.1 million or 3.1 million pre-tax and 25 percent less after tax, is that correct?

Edmund Hen: Yes, 25 percent after tax.

Howard Flinker: Twenty-five percent less. Then I must have made a mistake in the calculation. Second, are your increases in receivables and inventory feasible? Or is that going to be a new continued level?

Edmund Hen: You mean the inventory receivable? The account receivable is maintaining 150 days and all this account receivables are collected within this period. So – and this policy was since the end of last year. So, it actually has no extension for our account receivables.

And for the inventory, we always maintain at reasonable level for our inventory level. And it still keeps that, as seen in our press release.

Howard Flinker: When your turn over of inventory is slower now than it was before, so does that mean that you're adding more inventory to serve your customers? Or is that somewhat related to the summer season?

Edmund Hen: This is a seasonal increase.

Howard Flinker: OK.

Edmund Hen: And – yes.

Howard Flinker: And finally, what's that new subsidiary, Hengdali Construction, or something like that? What's it going to do?

Edmund Hen: This company will majorly focusing on the trading activity for the company. And also the area we established that will benefit from certain type of testing benefit. So, that it will give more benefit to the company for future trading with other entities.

Howard Flinker: And the trading activity mean that you might buy some tiles from other companies to sell to the China Decoration Company or whatever it's called?

Edmund Hen: Not necessarily, the tiles; so, some stoneware or some other type of products.

Howard Flinker: Oh I see.

Edmund Hen: ... if somebody needs a certain specific type of the product.

Howard Flinker: Has that company placed orders or not yet, the China Decoration Company?

Edmund Hen: They have not placed the order at the end of the third quarter yet.

Howard Flinker: But they obviously indicated that they will?

Edmund Hen: Yes, that's the indication, yes.

Howard Flinker: OK. Thank you very much. Xie xie.

Edmund Hen: Xie xie.

Operator: Again, to ask a question, press star then the number one on your telephone keypad.

Your next question comes from James Kahn with Oppenheimer.

James Kahn: Ni hao. My question is have you noticed yet any pick-up in business from competitors that's suffered in the downturn?

Edmund Hen: Yes, we do. We do see a lot of these small competitors are suffering right now, and some of them even closed their production line. And also, some second-tier competitor also stopped their production line, a few production lines within their factory.

James Kahn: Thank you. Also, are there any international companies with whom you compete? And is there – do you foresee in the next decade, for example, any possibility of expanding overseas, away from China?

Edmund Hen: Yes. We're always looking into new opportunities. First of all, should be inside China and also we visited some overseas countries like Middle East, Japan, et cetera, to see the latest opportunity while at this level, as our overseas sales is to maintain at a single digit. So, the challenge to expand into overseas will be a bit remote from now. Although we're still looking into the new opportunity if there's any chance for us to expand further.

James Kahn: Thank you. Xie xie.

Operator: At this time, there are no further questions. You may continue with your presentation or closing remarks.

David Rudnick: OK. Thank you very much. On behalf of the entire China Ceramics management team, we'd like to thank all of you for your interest and participation on this call. This concludes China Ceramic's third quarter 2013 earnings conference call. Thank you all very much.

Operator: Ladies and gentlemen, this concludes today's conference call. You may now disconnect.