China Ceramics Co., Ltd.

4Q and FYE 2012 Earnings Conference Call

JiaDong Huang - CEO, Edmund Hen - CFO

Moderator - David Rudnick, CCG Investor Relations,
Translation - Mabel Zhang, CCG Investor Relations

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Operator: Good morning, my name is Melissa, and I will be your conference operator today. At this time I would like to welcome everyone to the China Ceramics fourth quarter and fiscal year end 2012 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. I would now like to turn the call over to your host, David Rudnick of CCG Investor Relations. You may begin your conference.

David Rudnick: Thank you, Melissa. Good morning, ladies and gentlemen, and good evening for those of you who are joining us from China. Welcome to China Ceramic's fourth quarter and fiscal year-end 2012 earnings conference call. With us today are China Ceramics chairman and Chief Executive Officer, Mr. Jia Dong Huang, and the 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 and I refer you to the more detailed discussion of the risks and uncertainties with the Company's filings, and with the Securities and Exchange Commission.

In addition, any projections as to the Company's future performance represent management's estimates as of today, April 24, 2013. China Ceramics assumes no obligation to update these projections in the future as market conditions change.

To supplement its financial results presented in accordance with IFRS, management may make references to certain non-GAAP financial measures, which the Company believes provides meaningful additional information to understand the Company's performance. A statement reconciling any non-GAAP measures to the nearest GAAP equivalents can be found on the earnings press release distributed 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. CCG's Mabel Zhang will be translating for Mr. Huang. Mr. Huang, you may proceed.

Jia Dong Huang: (Speaking in Chinese).

Mabel Zhang: Thank you, David. On behalf of the Company, I would like to welcome everyone to our fourth quarter and fiscal year end 2012 earnings conference call.

Jia Dong Huang: (Speaking in Chinese).

Mabel Zhang: We achieved relatively sound financial results for the full year 2012, and despite the challenging market environment that has prevailed in our sector over the last six months of the year, we were able to generate steady revenues for the full year though with a fall-off in profitability relative to 2011.

As we had communicated to the market last year, we expected that the general slowdown of the construction industry in China would have a negative impact on our revenues in the fourth quarter, and the fourth quarter of 2012 did see a substantial decrease in the sales volume of ceramic tiles relative to the fourth quarter of 2011. Our average selling price also fell in the quarter from the year ago fourth quarter due to intensified price competition in our sector.

Jia Dong Huang: (Speaking in Chinese).

Mabel Zhang: Despite the fourth quarter's disappointing results, we believe that the operating fundamentals of our business are sound. We are cautiously optimistic about an improved outlook in the second quarter of 2013 with a pick-up in product demand and a rebound in pricing.

However, in order to adjust to current market conditions, and reduce operating costs, we shut down some plant capacity during the fourth quarter. We are currently utilizing production facilities capable of producing 46 million square meters per year out of a total annual productive capacity of 72 million square meters. We will continue to monitor the macroeconomic environment and act with prudence in terms of utilizing our full production capacity.

Jia Dong Huang: (Speaking in Chinese).

Mabel Zhang: We applied discounts to our ceramic tile products in the fourth quarter in order to compete head-on with competitors and retain our customers and market share. Although the average selling price for our ceramic tiles in the fourth quarter declined 13.8% from the year-ago quarter, we anticipate a return to a more normalized pricing environment once the business conditions in our building materials sector improves.

Jia Dong Huang: (Speaking in Chinese).

Mabel Zhang: We are confident that organization in demographic trends in China are a long-term phenomenon that will lead to raising future demands for our products as current real estate fluctuations moderate over time. We continue to be strategically positioned as a producer of high-end ceramic tiles that are becoming a standard in many new construction and development projects in China.

Even as we adopt measures in the short-term to enable us to reach our customers more effectively, we are confident that our branding and positioning will enable us to successfully execute upon our long-term strategy, which is to be a preeminent producer of specialized building materials products.

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 earnings results in more detail. Thank you.

Edmund Hen: Thank you, Mr. Huang, and thank you, Mabel. I will now move on to a more detailed discussion of our preliminary financial results for the fourth quarter and full year ended December 31, 2012.

Our revenue for the fourth quarter 2012 was RMB 245.3 million; or U.S. dollar, 40 million, down 39.3 percent from RMB 404.5 million; or U.S. dollar, 63.8 million in the fourth quarter of 2011.

The year-over-year decrease in revenue was due to a 29.8 percent decrease in the sales volume of ceramic tiles to 8.7 million square meters in the fourth quarter of 2012 from the fourth quarter of 2011. As well as a 13.8 percent decrease in the Company's average selling price versus the comparable year-ago quarter. We attribute the reduced sales volume in the quarter to the challenging business conditions in China's construction sector and the decrease in our average selling price to competitive pressures and our strategy to hold our market position.

Gross profit for the fourth quarter of 2012 was RMB 29.3 million; or U.S. dollar, 4.9 million as compared to our RMB 139.4 million or U.S. dollar, 21.9 million for the fourth quarter of 2011. The year-over-year decrease in gross profit was due to lower sales volume and a decrease in average sales price of our ceramic tiles in the most recent quarter.

Our gross profit margin for the fourth quarter was 12 percent compared to 34.5 percent for the same period of 2011 and was caused primarily by a decrease in the average selling price of ceramic tiles in the quarter. Profits before taxes for the fourth quarter of 2012 was RMB 18.6 million or U.S. dollar 3.2 million as compared to RMB 125.4 million; or U.S. dollar 19.7 million in the fourth quarter of 2011.

Net profit for the fourth quarter of 2012 was RMB 13.3 million; or U.S. dollar, 2.3 million as compared to RMB 92.2 million; or U.S. dollar 14.5 million in the same period of 2011. The year-over-year decrease in net profits was the result of lower gross profit in the period. Earnings per fully diluted share were RMB 0.65 or U.S. dollar 0.11 for the fourth quarter of 2012 as compared to RMB 4.51 or U.S. dollar 0.71 in the comparable quarter of 2011. EPS in the fourth quarter of 2012 fiscal 2012 was computed using 20.4 million shares.

Non-GAAP net profit, which excluded share-based compensation expenses was RMB 14.6 million or U.S. dollar 2.5 million in the fourth quarter of 2012 as compared to RMB 97.5 million; or U.S. dollar, 15.3 million in the fourth quarter of 2011.

And non-GAAP earnings per fully diluted share which exclude the share-based compensation expenses was RMB 0.71 or U.S. dollar 0.12 in the fourth quarter of 2012 as compared to RMB 4.77; or U.S. dollar 0.75 in the same period of 2011.

For the full year-end December 31, 2012, revenue was RMB 1,444.9 million or U.S. dollar 230.7 million, a decrease of 3.1 percent as compared to fiscal year 2011. Gross profit was RMB 381 million or U.S. dollar, 60.8 million, down 18.5 percent from 2011. Gross margin for the full year 2012 was 26.4 percent compared to 31.3 percent for 2011. Net profit for the year was RMB 243.8 million; or U.S. 28.9 million down 17.2 percent from the full year 2011. Non-GAAP net profit, which excludes share-based compensation expenses, was RMB 249.5 million or U.S. 39.8 million, a decrease of 20 percent from 2011. Fully diluted EPS for the full year 2012 was RMB 11.93; or U.S. dollar, 1.91. On a non-GAAP basis fully diluted EPS was RMB 12.21; or U.S. dollar 1.95.

Turning to our balance sheet, as of December 31, 2012, we had cash and bank balances of RMB 89.4 million; or U.S. dollar 14.4 million compared to RMB 42.1 million or U.S. dollar 6.7 million as of December 31, 2011. The decrease in cash and bank balances over the year was the result of sustained profitability and a modest level on capital expenditure during the year.

Our total debt is RMB 60 million or U.S. dollar 9.6 million as of fiscal year-end 2012, having substantially reduced our debt during the year from RMB 185 million or U.S. dollar 29.4 million as of fiscal year-end 2011.

As of December 31, 2012, we had an inventory turnover of 101 days compared to 84 days as of December 31, 2011. The increase in inventory turnover reflects the decrease in sales volume of ceramic tiles which resulted in the slower moving of finished goods at the year-end of 2012.

Moving onto a further business review and outlook, as discussed by our CEO, Mr. Huang, as a result of slowdown in China’s construction and real estate sectors, we experienced a construction in both our sales volume and average selling prices in the fourth quarter of 2012 relative to the comparable year-ago quarter; as well as the third quarter in 2012. The Company’s sales volume decreased 29.8 percent in the fourth quarter of 2012 as compared to the year-ago quarter in our average selling price decreased to 13.7 percent as compared to the fourth quarter in 2011.

Given the market environment and intensified competition, in the fourth quarter we increased our sales efforts and enacted a temporary strategy to reduce the selling prices of our ceramic tile products in order to retain our market position. We have been strategic in terms of those products for which we have temporarily reduced prices in order to avoid a widespread predatory pricing environment or an erosion of our name brand for when a more normalized operating environment returns.

However, we believe that we needed to counter the actions of ceramic tile producers who entered portions of our market and compete head-on with them in order to protect our distributors, retain our customers and defend our market share. We believe that as business conditions in our sector recover, the overall pricing environment will also improve and help us to regain our historical gross margin levels.

Importantly, we believe that the sector's price decreases was inelastic, that is, the pricing environment had changed due to a slowdown in the construction sector and competitors' price reductions did not result in an increase in sales volume. Therefore, we expect that as ASP increases in the months ahead, we will return to normalized volume levels as the construction sector stabilizes.

Given the continued challenging climate, we are currently utilizing plant facilities that can produce 46 million square meters of ceramic tiles annually out of our annual productive capacity of 72 million square meters. This represents a decrease in plant capacity utilized from what we used in the third quarter of 2012 where we operated plant capacity capable of producing 56 million square meters of ceramic tiles annually.

In terms of our outlook for 2013, the company experienced a reduction in its backlog that is likely to result in a decline in its revenues for the first quarter of 2013 relative to the year-ago period. Our backlog of orders for delivery in the first quarter of 2013 is approximately RMB 141.9 million or US dollar 22.8 million, which would represent a decrease in revenues for the first quarter of 2013 as compared to revenues recorded in the first quarter of 2012.

This year-over-year comparison is changed from previous quarters which had generally shown strong positive year-over-year comparisons. Our backlog is an indicator of business in the next quarter under normal circumstances, though this can change as a result of unforeseen business conditions. The company estimates that its sales volume of ceramic tiles in the first quarter of 2013 will be approximately 6.1 million square meters.

As indicated in our news release to the market last September that guided as to a decline in our fourth quarter revenues, we continue to believe that the reduction in our backlog has to do with a general slowdown in the construction industry that has occurred in China as our customers were deferring orders and have been waiting to start new projects. Many developers have been waiting for the new government to come in and new guidelines and incentives by the new leadership as relates to the housing and construction industries.

As indicated in this morning's earnings press release, we believe that our average selling price could begin to normalize by the second quarter of 2013. We experienced an increase in our average selling price in February and March from the lows that occurred in the December to January time frame, where we reduced our average selling price in order to meet competitors' sharp discounting and retain market share. Further, recent data from April shows a return to a lesser discount price environment which was in place prior to December of 2012.

The fundamental growth trend for housing in China is still strong, even with news that the government is pursuing policies to mitigate speculation of expensive real estate in some big cities. Based on our proprietary research, as well as public information, we expect that for the full year 2013, real estate development and construction activity could meet or even exceed the year 2012. Further, we are confident that we can be relatively nimble and cost-effective in terms of putting capacity online to meet the sector's turnaround and growth in demand.

In order to retain our competitive edge, we will maintain its currently wide range of product offerings and continue to augment it with new products from its research and development program which has the potential to result in products that realize higher margins. The Company believes that a core competitive advantage is its ability to innovate and introduce new products into the product mix that it offers to its customers. China Ceramics' new plant facilities also have new design and production capabilities as well as the ability to operate more efficiently.

We are optimistic as to the long term prospects of our business and plan upon working even closer with our customers during these challenging times in order to take advantage of the opportunities available to us.

Before we begin the Q&A, I would like to mention a couple of other items. As many of you are aware, although we are reporting within SEC guidelines, there was a delay in announcing our fourth quarter and fiscal year end 2012 results in terms of what has been our typical practice. Since our market capitalization has been somewhat below our net book value, an IFRS standard requires the Company to assess if an impairment to the book value of our assets has occurred. Since the market price of our stock did not significantly increase after year end, we engaged an appraisal firm to provide two appraisal reports during the month of March. After review of these reports by the Company and our auditors, it was concluded that an impairment adjustment was not required to be recorded. The extra steps needed to address this issue caused the delay in announcing our 2012 results.

Also, as previously indicated, we will be paying a semi-annual cash dividend of ten cents per share payable on July 13, 2013 and January 14, 2014, with record dates of June 13, 2014 and December 13, 2013, respectively.

With that we would like to open up the call to any questions pertaining to our fourth quarter and full year 2012 financial and operating performance. Operator?

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

Your first question comes from Howard Flinker.

Edmund Hen: Yes.

Howard Flinker: (Speaking in Chinese).

Edmund Hen: (Speaking in Chinese).

Howard Flinker: I have two questions. One, do I understand that your prices are now back to where they were before the discount? And second, while volumes are increasing – orders are increasing, they're still somewhat below last year's orders?

Edmund Hen: We are on the way to get back to the normal level of the average selling price. And we are very near to the price before we discount right now. And for the second question is that the volume is still what we believe is still lower than the same period last year at this moment.

Howard Flinker: And approximately how much are the orders below last year at this time while they're recovering?

Edmund Hen: We have no final figure yet because it is still early. But probably you will be notified during the first quarter conference call, I think.

Howard Flinker: Do you not have those numbers yet?

Edmund Hen: We do not have those numbers yet.

Howard Flinker: OK, thank you.

Edmund Hen: Thank you.

Operator: Your next question comes from Steve Martin with Slater Capital Management.

Steve Martin: Hi, guys.

Edmund Hen: Hi.

Steve Martin: I guess we're all a little disappointed because you insisted on adding all that capacity when we urged you not to. And now you're not using it. What I'd like to understand is why with your volume down as much as it is, and your projected revenues down as much as they are, your inventory and receivables are flat and should be down, and your payables are down and so it seems you're paying your vendors, but you're not getting paid from your customers.

Edmund Hen: Yes, for the actual revenues that occurred during this difficult moments. We just want to give some support to our customers. And we extended some of their credit terms to more than 90 days. But at the same time, there was a – and we still some good relationship with our suppliers so we still pay them on time.

It's the reason why our account receivables and inventory, it looks a bit flat compared to the last period. And for the – I think for the capacity, we have increased it for the past few years. And so, we are we preparing for a very huge growth. But unfortunately, the downturn for the Chinese construction market, we just need to hold it back for a while. And as you can see, we did not have much capital expenditure during the past year.

Steve Martin: Right. Now let's go back. Can we go back to the inventories for a second?

Edmund Hen: Yes.

Steve Martin: If your backlog is only 22 million U.S. And you produce inventories to order, why are your inventories more than twice your backlog?

Edmund Hen: First of all, because some of our customers also have slowdown of their business. And lots of them – some of them have delayed their picking up for the inventory – for the goods. This is the reason why you can see the inventory has – the inventory turnover has gone up a little.

Steve Martin: Right. But if you know what your backlog is, why are you producing more inventory?

Edmund Hen: We – first of all, I think the inventory will be picking up very soon in the first quarter or so. And also, because of the Chinese New Year in the – we had the Chinese New Year very near to the year-end. And loss of inventory as we pick up duration this period. And for the backlogs, and also, we take about a 90 day period to produce such an inventory. So we actually have a – as you can see our potential capacity. Actually we are using less than before and we just slowed down our potential capacity during this period also in order to lower the inventory level.

Steve Martin: All right, well, I would urge you to focus on generating cash –

Edmund Hen: Yes.

Steve Martin: – and not using it. Obviously, the Chinese market is what it is. We all tried to warn you and you ignored it. So, thank you.

Operator: Your next question comes from Liang Hsu with Keane Capital.

Liang Hsu: Hi, good morning. Hi. I understand that there is a general slowdown in the real estate and construction sectors in China. But if we compare your financial performances, you know, in the recent quarter to the overall China's construction industry, it appeared that you have, you know, somewhat underperformed the industry. So, I know you have providing price concession in the fourth quarter to try to retain your market share. But are you losing market shares there? Or, you know, have you been able to retain your market share? Thank you.

And that's my first question. And my second question is just wondering if you can provide some update on the – you know, your strategic supply relationship with China Decoration? Have you, you know, made your first delivery and, you know, when do you expect you'd have more like commercial delivery to China Decoration? Thank you.

Edmund Hen: Actually at the very end of last year and our competitors entered in price war. And that forced us to reduce the price to maintain our market share. And so now what I think is our market … we still have a very positive market share in the market. And what we understand some of these small competitors have already stopped their production already, so probably we need to wait for a while before we get back to normal for our pricing or the systematic situation. And for your second question, we are still working with this China Decoration right now. We hope we – and believe we'll have contracts to deliver some of the goods to them very soon. Probably in the late second quarter or third quarter, the beginning of second or third quarter. But, at this moment we have no, any figures – can announce it to the public yet.

Liang Hsu: OK. Is it true that China Decoration is highly exposed to the more – mode of economic housing as opposed to… . In other words, if it's more exposed to the economic housing, so it's subject less to the slowdown in the construction. Because the government is supporting it. And that was somewhat, you know, because being the strategic supplier to China Decoration, you would be able to somewhat picked up on the volume.

Edmund Hen: Yes. As you may notice, China Decoration is a state owned business and they have a minority of the business operation. And the economic housing is one of their revenue I think. And they also have lots of offices projects. And I am not sure how and what is their – is a revenue mix within their corporation. But I think that will really help us to have a more stable revenue pattern in the future if we can have a very good relationship, business relationship with them.

Liang Hsu: OK, thank you.

Edmund Hen: Thank you.

Operator: Your next question comes from Chris White with Greenstone.

Chris White: Yes, Edmund, first of all I think I heard you on the call where you said you like to take care of your customers. I would just like to make the statement that we would appreciate it if you take care of your shareholders with the same manner.

And given the fact that you told me that you wouldn't be discounting pricing. And I have you on record as doing that in December. It's pretty disappointing and a bit of a knock to your credibility personally, mate. So, very disappointing.

Now, with regards to the dividend, I appreciate that. I am stressing and it's obviously noticeable that investors are only looking to really invest in companies that think about shareholders and returning capital. Given the slowdown in your business today and the low utilization, can you, or Paul, or Bill please talk to the fact about the dividend policy? The thought behind implementing that in Q4? And returning future capital to shareholders either by increasing that dividend or buyback as the business turns around. And can you or the Board please address that question? Thank you.

Paul Kelly: Do you want me to answer that Edmund?

Edmund Hen: Yes, please do. Thank you, Paul.

Paul Kelly: The Board as Edmund indicated announced an annual dividend. The Board has undertaken a dividend policy which it hopes to continue to replicate in future years. It wasn't our intention to have two back to back special dividends. The idea was that this would be an annual dividend.

And, of course, as long as everything is within our own power. I mean, there are obviously strange things that could happen in the future, which could effect any business or any economic situation, or so forth.

To the second aspect of the… And by the way let me just say in terms of the dividend. One would hope that if we grow as we expect, the dividend will grow in a commensurate fashion. Now and we have not considered, if we had considered a buyback that would have been announced. That has not been something which the Board has considered or which it has any statements regarding.

Chris White: So, Paul, can I clarify how you think about the dividend? Is it a percent of your free cash flow going forward? Can we have a little bit more clarification on that just so we could think about how that would turn around relative to the business?

Paul Kelly: I think in general as I indicated to you. You know, a growing business, growing earnings equals growing dividend. We're not formulaic as far as that's concerned. Because we can see forward as a Board to what our needs may be for cash generated and there may be some needs under certain circumstances which are necessary to be put back into the business rather than being paid externally. So naturally a growing business means that you've got growing cash flow, you've got growing cash. But we don't have a formula that we would be adhering to at this point.

Chris White: Right. Well, you know, I do want to say I appreciate working with you and the Board through this. And we do appreciate this return, you know, in thinking about shareholders rather than just spending. But it's very disappointing to see some of the underlying business aspects that's – has gone on, you know, with the (increment) and everything here in the fourth quarter. I think – I feel lucky that I value the Company on a book value basis and not based on the current metrics of the underlying income statement. I'll leave it for others.

Paul Kelly: Could I also say, Edmund. I think it would be good to extrapolate on another aspect here which relates to the price cuts that were in effect in December and that carried over in part into early January. The – as you mentioned, the company has given additional terms in terms of accounts receivable to help customers to better match off their deliveries with the slowdowns by some of the developers.

But what that does is it changes somewhat for some portion of our business because everybody doesn't get longer trade terms. It changes the product cycle which everybody has gotten used to that the backlog at the end of a particular quarter is a very good indicator for the coming quarter.

Obviously, if you have terms that are beyond 90 days, the tendency would be for those sales to actually hit the income statement, not in the next quarter but in the quarter after that. So, I would say that I would be mindful of this and not necessarily apply the same market that you did previously in a different economic environment. That's all I have to say on that.

Chris White: Thanks, Paul.

Operator: Once again, if you would like to ask a question, press star one.

Paul Kelly: Actually if I could extrapolate on my own answer just a second ago. In pushing forward that means that an order may not actually be booked as a sale until during the second quarter thereafter. And so there would be some lag if those sales represented any discounts and a restoration of normal pricing would be something that you wouldn't necessarily see in the quarter after that becomes a general market situation. But rather something that would be seen more in the second quarter thereafter.

Operator: There are no further questions. I will now turn the call over to David Rudnick of CCG.

David Rudnick: Thank you, Melissa. 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 Ceramics' fourth quarter and fiscal year-end 2012 earnings conference call. Thank you all very much.

Operator: This concludes today's conference call. You may now disconnect.

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