CHINA CERAMICS CO., LTD.

Second Half and Fiscal Year End 2018 Earnings Call
April 30, 2019
8:00 a.m. ET

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

Operator: Good afternoon. Welcome to China Ceramics second half and fiscal year end 2018 earnings call. At this time, I would like to turn the call over to David Rudnick.

David Rudnick: Good morning ladies and gentlemen and good evening to those of you who are joining us from China. Welcome to China Ceramics' six month and fiscal year end 2018 earnings conference call. With us today are China Ceramics Chairman and Chief Executive Officer, Mr. Jiadong Huang and its Chief Financial Officer, Mr. Edmund Hen.

Before I turn the call over to Mr. Huang, I would like to address forward-looking statements that may be discussed on the call. Forward-looking statements involve risks and uncertainties and include, among others, those regarding revenue, operating expenses, other income and expense, taxes, and future business outlook. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements. The Company claims the safe harbor protections for such forward-looking statements as contemplated under the Private Securities Litigation Reform Act of 1995. Please refer to the documents filed by the Company with the SEC, specifically the most recent reports on Forms 20-F and 6-K, which identify important risk factors that could cause actual results to differ from those contained in the forward-looking statements. We assume no obligation to update any forward-looking statements or information, which speak as of their respective dates.

And now it's my pleasure to turn the call over to China Ceramics' Chairman and CEO, Mr. Jiadong Huang and China Ceramics' CFO, Mr. Edmund Hen. Sarah Bai will be translating for Mr. Huang. Mr. Huang, you may proceed.

Jiadong Huang: (In Chinese)

Sarah Bao: Thank you, David. On behalf of the company, I would like to welcome everyone to our second half and fiscal year end 2018 earnings conference call.

Jiadong Huang: (In Chinese)

Sarah Bao: During the second half of 2018, we experienced difficult market conditions as compared to the same period of 2017. Our revenue decreased 71% for the second half of 2018 due to a 72% decrease in our sales volume. However, after adjusting for asset write-offs, our cash flow was modestly positive for the second half of the year despite the market slowdown, and our cash flow was reasonably strong for the full year of 2018.

Jiadong Huang: (In Chinese)

Sarah Bao: For the fiscal year 2018, we utilized production facilities capable of producing 16.9 million square meters of ceramic tiles per year out of the Company's effective total annual production capacity of 56.5 million square meters of ceramic tiles. Consistent with our practices in past quarters, we maintained a reduced utilization of existing plant capacity based on the current market environment to keep our operating costs low. We intend to bring additional capacity online as the business environment improves.

Jiadong Huang: (In Chinese)

Sarah Bao: For the remainder 2019, we believe that market conditions will continue to be challenging due to government regulations to stabilize real estate prices and contain real estate development. However, urban renewal projects and an improvement in new home prices last month fueled by China's smaller tier cities could represent a potential turnaround in business conditions. In the long-term, we believe our building materials sector will continue to benefit from growth in the real estate sector due to continued urbanization and its importance to China's domestic growth. We plan to capitalize on emerging trends in the sector such as affordable housing initiatives and the Government's promotion of rental properties that could spur future growth.

Jiadong Huang: (In Chinese)

Sarah Bao: 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 second half 2018 earnings results in more detail. Thank you!

Edmund Hen: Thank you Mr. Huang! I will now move on to a more detailed discussion of our financial results for the six months ending December 31, 2018.

Our revenue for the six months ended December 31, 2018 was RMB 142.6 million or US$ 20.8 million, a decrease of 70.6% from RMB 485.3 million or US$ 72.7 million for the same period of 2017. The 70.6% year-over-year decrease in revenue was due to the 72.0% decrease in our sales volume for the six months ended December 31, 2018 compared to the same period of 2017.

Gross loss for the six months ended December 31, 2018 was RMB 46.0 million or US$ 6.7 million as compared to gross profit of RMB 57.8 million or US$ 8.7 million for the same period of 2017. The gross loss margin was 32.3% for the six months ended December 31, 2018, as compared to an 11.9% gross profit margin for the same period of 2017, which was due to (i) a 72.1% period-to-period decrease in sales volume, and (ii) an increase in the provision for inventory impairment, which was RMB 56.0 million (US$ 8.2 million) for the six months ended December 31, 2018, as compared to a reversal of inventory impairment of RMB 2.7 million or US$ 0.4 million for the same period of 2017.

Other income for the six months ended December 31, 2018 was RMB 7.5 million or US $1.1 million, as compared to RMB 7.3 million or US $1.1 million for the same period of 2017. Other income mainly consisted rental income the Company received by leasing out one of the production lines from its Hengdali facility pursuant to an eight-year lease contract.

Selling expenses for the six months ended December 31, 2018 were RMB 5.3 million or US $0.8 million as compared to RMB 6.1 million or US $0.9 million for the same period of 2017. The year-over-year decrease in our selling expense was mainly due to lower sales during the current period.

Administrative expenses for the six months ended December 31, 2018 were RMB 7.5 million or US $1.1 million as compared to RMB 8.2 million or US $0.7 million for the same period of 2017. The year-over-year decrease in administrative expenses was primarily due to a decrease in office and travel expenses.

Bad debt expense for the six months ended December 31, 2018 was RMB 210.1 million or US$ 30.6 million, as compared to RMB 71.6 million or US$ 10.8 million for the same period of 2017, with the increase due to the write-off of bad debt due to a rise in uncollectible debt associated with our customers. We believe that we have undertaken appropriate measures to resolve the bad debt expense. We will continue to review each of our customers for credit quality as well as assiduously test our accounts receivables balances in each upcoming fiscal period.

Loss from asset devaluation resulting from an impairment of non-current assets, fixed assets and land use rights, for the six months ended December 31, 2018 was RMB 85.0 million or US$ 12.9 million as compared to RMB 36.7 million or US$ 5.5 million for the same period of 2017. The loss from asset devaluation resulted from an impairment of non-current assets due to decelerating growth in China and an expected contraction in the demand for the Company's products.

Net loss for the six months ended December 31, 2018 was RMB 346.8 million or US$ 50.6 million as compared to a net loss of RMB 82.2 million or US$ 12.4 million for the same period of 2017.

Loss per basic and fully diluted share for the six months ended December 31, 2018 were RMB 75.95 or US$ 11.07, as compared to RMB 24.29 or US$ 3.66 for the same period of 2017.

Adjusted EBITDA was RMB 10.2 million or US$ 1.5 million for the six months ended December 31, 2018, adjusted for the write-off of fixed assets and land use rights, the inventory impairment provision, and bad debt expense, as compared to RMB 51.6 million or US$ 7.8 million, adjusted for the write-offs of fixed assets, slow-moving inventory, and bad debt expense for the same period of 2017.

Turning to our balance sheet, as of December 31, 2018, we had cash and bank balances of RMB 9.0 million or US$ 1.3 million as compared to RMB 2.3 million or US$ 0.4 million as of December 31, 2017.

As of December 31, 2018, our inventory turn was 117 days as compared to 95 days as of December 31, 2017. We recorded an inventory impairment provision of RMB 56.0 million or US$ 8.2 million in 2018 and a reversal of an inventory impairment provision of RMB 2.7 million or US$ 0.4 million in 2017. Subsequent to the inventory impairment for fiscal year 2018, we believe that the value of our current inventories is realizable.

Our trade receivables turnover as of December 31, 2018 was 223 days as compared to 206 days as of fiscal year end 2017. The increase in trade receivables turnover days was primarily due to a continued difficult economic environment which has prompted us to offer extended credit terms to certain customers resulting in a higher trade receivables turnover figure than normal.

Our trade payables turnover was 26 days as of December 31, 2018 as compared to 43 days as of December 31, 2017. The average turnover days was within the normal credit period of one to four months granted by our suppliers.

In terms of our plant utilization and capex,

We utilized plant capacity capable of producing 4.7 million square meters of ceramic tiles for the six months ended December 31, 2018 and 16.9 million square meters of ceramic tiles for fiscal 2018 out of a total annual production capacity of 56.5 million square meters. Our annual production capacity has been reduced from 66 million square meters of ceramic tiles as of December 31, 2017 to 56.5 million square meters of ceramic tiles due to our having retired two old furnaces at the Hengda facility in July of 2018.

Our Hengda facility has an annual production capacity of 27.7 million square meters of ceramic tiles as a result of the two old furnaces having been put out of use at the facility. The Company utilized production capacity capable of producing 2.3 million square meters of ceramic tiles for the six months ended December 31, 2018 and 9.8 million square meters of ceramic tiles for fiscal 2018.

Our Hengdali facility has an annual production capacity of 28.8 million square meters, excluding our leasing out 10 million square meters of production capacity to a third party, and we utilized production capacity capable of producing 2.4 million square meters of ceramic tiles for the six months ended December 31, 2018 and 7.1 million square meters of ceramic tiles for fiscal 2018.

Moving on to our business outlook, sales in the second half of 2018 sharply decreased due to an unexpected slowdown in China's real estate sector. In an effort to bolster sales, in July of 2018, we decreased the pricing of our ceramic tile products by an average of 10%. This follows a pricing increase of 5% that we instituted in April of 2018 following three price raises beginning in April of 2017. However, the 10% price decrease in July 2018 could not offset the sudden fall in our sales volume due to deteriorating market conditions that persisted through the second half of 2018, and we do not believe that further price decreases would have had a beneficial effect upon sales volume. To address the current market environment, we plan upon expanding our sales force to procure new customers, increasing our marketing to large property developers in targeted cities, and bolstering our R&D efforts to develop new products in order to expand our market.

Looking ahead to the remainder of 2019, and based on the information currently available to us, we expect market conditions to continue to be challenging due to a slowing domestic economy and government regulations intended to stabilize real estate prices and slow real estate development. For example, the central government has imposed lending curbs, higher mortgage rates and down payments, a price cap on new developments and restrictions on the number of homes each family can buy. This has led to some restraint on the part of property developers to develop new residential housing due to continued uncertainty, resulting in a slowing construction sector.

We believe that China's property market is resilient long-term, and that despite specific austerity measures in certain cities, there is substantial potential for property development in many regions. New home prices in China showed a recent monthly uptick reversing four months of decreases which was fueled by China's smaller third and fourth tier cities, a sector in which the Company is particularly focused.

We typically receive orders from customers one or two months in advance of production on a rolling basis. However, due to the potential for continued difficult market conditions in 2019, there has been a decreased demand for our products, and as of December 31, 2018, we did not have any backlog. The Company believes that the reduction in backlog has to do with a general slowdown in the construction industry in China as customers are continuing to defer orders and/or are waiting to start new projects.

Our building materials sector is continuing to work through excessive production capacity while government mandates to convert to cleaner and more expensive fuel sources could result in smaller, less well capitalized competitors exiting the space. We believe that we have a competitive advantage in our sector due to our brand name recognition, extensive product platform, marketing expertise and modernized operating efficiencies.

This business outlook reflects the Company's current and preliminary views, which are subject to change and is subject to risks and uncertainties, as well as risks and uncertainties identified in the Company's public filings.

At this point, we would like to open up the call to any questions pertaining to our second half and fiscal year end 2018 financial results. Operator?

Operator: At this time, I would like to ask everyone in order to ask questions, please press star then the number one on your telephone keypad.

Operator: We haveThe first question comes from Howard Flinker. Your line is open, please ask your question.

Howard Flinker: I have one simple question. How many shares do you have outstanding?

Edmund Hen: You mean total outstanding shares?

Howard Flinker: Yes

Edmund Hen: Currently, about six million shares.

Howard Flinker: Six million or 4.6.

Edmund Hen: Six million.

Howard Flinker: Approximately or exactly.

Edmund Hen: Approximately.

Howard Flinker: Ok, thank you.

Howard Flinker: Is that exactly six million shares?

Edmund Hen: Approximately that.

Operator: At this time, I would like to remind everyone that in order to ask questions, please press star then the number one on your telephone keypad. There are no further questions at this time. I would like to turn the call over to our speakers.

David Rudnick: Thank you, everyone. On behalf of the entire China Ceramics management team, we want to thank all of you for your interest and participation on this call. This concludes China Ceramics' second half and fiscal year end 2018 earnings call. Thank you all very much.

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