

CHINA CERAMICS CO., LTD.
2Q 2014 Earnings Call
August 18, 2014
8:00 a.m. ET

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

Operator: Hello. My name is Felicia and I will be your conference operator today. At this time I would like to welcome everyone to the China Ceramics Second Quarter 2014 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 key pad. To withdraw your question press the pound key.

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

Please go ahead sir.

David Rudnick: Thank you, Felicia.

Good morning ladies and gentlemen, and good evening to those who are joining us from China. Welcome to China Ceramics Second Quarter 2014 Earnings Conference Call. With us today are China Ceramics Chairman Chief Executive Officer Mr. Jiadong Huang, and its Chief Financial Officer, Mr. Edmund Hen.

Before I turn the call over to Mr. Huang, may I remind our listeners that during this call, managements 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. I want to refer to you to more detailed discussion of the risks and uncertainties in 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, August 18, 2014. China Ceramics assumes no obligation to update of these projections in the future as market conditions change.

And now it is my pleasure to turn the call over to China Ceramics Chairman CEO, Mr. Jiadong Huang, and China Ceramics CFO, Mr. Edmund Hen. Precept Investor Relations' Sophie Wang will be translating for Mr. Huang.

Mr. Huang you may proceed.

Jiadong Huang: (Foreign Language).

Thank you David.

On behalf of the company, I would like to welcome everyone to our second quarter 2014 earnings conference call.

(Foreign Language).

We are pleased to report improved revenue and gross profit performance for the second quarter as compared to the same period a year ago consistent with the more normalized operating environment.

Revenue increased 21 percent from the second quarter while gross profits rose nine percent. The second quarter also saw an 11 percent increase in sales

volume, and a nine percent rise in average selling price as compared to the second quarter of 2013.

(Foreign Language).

However, higher advertising costs promotes newly developed ceramic tiles and losses attributable to foreign currency agreements impeded our profitability in quarter. As stated previously, I, the company's largest shareholder, and an affiliate of mine, agreed to assume these agreements. As a result, the company will not be required to fund any losses related to these agreements, and it will neither suffer any for future liabilities arising under those agreements, nor realize any benefits arising under those agreements.

(Foreign Language).

In the second quarter, we maintained a reduced utilization of existing operating plant capacity in order to adjust to the market environment and lower our operating costs. We are currently utilizing planned production facilities capable of producing 43 million square meters of ceramic tiles per year out of our total annual production capacity of 72 million square meters of ceramic tile. This was a 54 percent increase over what was utilized at this time last year. We hope to bring additional capacity online moving forward as our business sector continues to improve.

(Foreign Language).

In addition to the improved market environment, we believe that our close relationships with our customers account for our volume and price increases in the second quarter, and that our marketing will enable us to continue to penetrate Tier 2 and Tier 3 markets and generate solid results in the quarters ahead. While our business sector continues to be highly competitive, our brand name recognition and reputation for quality and services has enabled us to raise our average selling price over the past year.

(Foreign Language).

The urbanization and demographic trends in China are long term phenomenon that we believe will reach a rising future demands for our products even as the real estate in construction environment fluctuates from time to time. Recent government proposals promoting urbanization as vital to continued domestic economy growth should improve the macroeconomic conditions under which we operate and enable us to extend our footprint into new geographical urban areas. We continue to be strategically positioned as a producer of high end ceramic tiles, and we will continue to innovate and offer a superior product mix to our customers so as to sustain our competitive advantage.

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.

I will now move on to a more detailed discussion of our financial results for the second quarter ended, June 30th 2014.

Our revenue for the second quarter end, June 30th 2014, was RMB 268.6 million or US dollar, 43.3 million, an increase of 20.6 percent from the second quarter 2013. The sales volume of ceramic tiles in the second quarter was 9.2 million square meters, an increase of 10.8 percent as compared to the sales volume in the year-ago quarter and our average selling price, or ASP, rose 9.0 percent as compared to the same period a year ago. The rise in ASP reflects a more normalized market environment, as alluded to by Mr. Huang, and continues a trend of pricing increases that have occurred since the fourth quarter of 2012 when we temporarily reduced pricing on certain on certain of our products to retain market position.

Gross profit for the second quarter of 2014 was RMB 24.2 million or US dollar 3.9 million, an increase of 9.0 percent from the second quarter of 2013. The year-over-year increase in gross profit was due to a rise in both sales volume and ASP. Our gross profit margin for the second quarter was 9 percent

compared to 10 percent for the same period of 2013, with the slight decrease primarily caused by an increase in material and labor costs.

Profits before taxes for the second quarter of 2014 was RMB 3.2 million or US dollar 0.5 million, as compared to RMB 9.9 million or US dollar 1.6 million in the second quarter of 2013. The year over year decrease was due to a rise in advertising fees associated with newly developed ceramic tiles and realized and unrealized losses on derivative financial instruments.

Net profit for the second quarter of 2014 was RMB 0.7 million or US dollar 0.1 million, as compared to RMB 9.6 million or US dollar 1.5 million for the same period of 2013.

Earnings per fully diluted share were RMB 0.03 or US dollar 0.01 for the second quarter of 2014 as compared to RMB \$0.47 or US\$ 0.08.

For the six months ended June 30, 2014, revenue was RMB 477.4 million, or US dollar 77.0 million, an increase of 28.4 percent as compared to the six months ended June 30, 2013. Gross profit was RMB 33.5 million, or US dollar 5.4 million, up 22.7 percent from the same period of 2013. Gross margin for the six months ended June 30, 2014 was 7.0 percent compared to 7.3 percent for the same period of 2013. Our net loss for the six months ended June 30, 2013 was RMB 70.8 million, or US dollar 11.4 million compared to net profit of RMB 4.2 million, or US dollar 0.7 million for the same period of 2013. The loss per fully diluted share for the six months ended June 30, 2014 was RMB 3.47, or US dollar 0.56 as compared to earnings per fully diluted share of RMB 0.21, or US dollar 0.03 for the first six months of 2013.

Turning to our balance sheet, as of June 30, 2014, we had cash and bank balances of RMB 128.1 million, or US dollar 20.7 million, compared to RMB 28.8 million, or US dollar 4.7 million as of December 31, 2013. The increase in cash and bank balances was the result of an increase in operating cash flows before working capital changes and a decrease in trade payables during the first half of 2014. As of the end of the second quarter, our debt consisted was

RMB 84.7 million or US dollar 13.7 million, as compared to debt is RMB 99.7 million or US dollar 16.3 million as of year-end fiscal 2013.

As of June 30, 2014, we had an inventory turn of 131 days compared to 124 days as of December 31, 2013. Trade receivables turnover was 184 days as of June 30, 2014 compared with 185 days as of December 31, 2013. The methodology for the second quarter of 2013 uses revenues for the trailing twelve months, consistent with what was used in the previous period. The Company typically extends a credit period of 90 days to our customers, and had extended the credit period to 150 days to address the funding pressures among some distributors attributable to the challenging market conditions in China's real estate industry since the second quarter of 2012.

Moving on to our business outlook, as discussed by our CEO, Mr. Huang, our outlook for the remainder of 2014 is for a stable macroeconomic environment and more normalized operating conditions relative to last year.

We believe that the real estate and construction sectors continue to exhibit sound long-term fundamentals as continued urbanization and demographic changes are expected to promote the building of new residential properties throughout urban areas of China. The Government recently issued proposals to bring down barriers attributable to a nationwide household registration system in order to promote urbanization. This is consistent with its long-stated position that the greatest potential for expanding domestic demand and sustaining economic growth in China lies in urbanization. Since urbanization leads to new property development and housing construction, this recent proposal and other similar measures could positively impact the Company's business.

The Company is currently utilizing plant facilities capable of producing 43 million square meters of ceramic tiles annually out of an annual production capacity of 72 million square meters that is available to the Company. We will bring its unused annual productive capacity online as customer demand dictates and when there are further signs of an improvement in China's real estate and construction sector.

The Company believes that further pricing power will be gradual and that it has the potential to transition demand towards premium ceramic tiles once current market inventory of companies who have exited the space is worked thorough market channels. The Company's new marketing showroom and proven research and development program along with its upgraded and modern plant facilities enable it to differentiate itself and offer a deeper platform of products and services consistent with this strategy. The Company plans to widen its market to include meaningful penetration into emerging urban geographical areas so as to develop a major competitive footprint in new markets.

Before we move to Q&A, we would like to clarify two issues.

As has been disclosed, as of April 30, 2014 we changed our independent registered public accountants. During the course of the 2014 year ended audit, an argument arose between the Company and our former auditor, Grant Thornton. The substance of our differences has been summarized in our Annual Report on Form 20-F and we will not belabor it here. We were confident that the issues raised by Grant Thornton were of no consequence to our results of operations or financial condition, and we believed that Grant Thornton overacted to the circumstances. Moreover, we feared that communications with Grant Thornton and our relationship with Grant Thornton had become so impaired that the circumstance would adversely affect the Company even after the matters in dispute were finally disposed of.

Towards the end of April, 2014, whether we proceeded as Grant Thornton wanted, with an independent investigation, or we changed auditors, we were not going to be able to timely file our Annual Report and we were going to have a compliance problem with the Nasdaq Stock Market. In the end we made a difficult business decision, to terminate our former auditors. We engaged Crowe Horwath Hong Kong as our new auditors and our Audit Committee and management worked diligently with our new auditor to implement additional audit procedures to address the issues raised by Grant Thornton.

Crowe Horwath Hong Kong subsequently re-audited our financials for the fiscal years 2011 and 2012 confirming the financial statements that had already been filed, and they also performed the audit of the Company's financial statements for fiscal year 2013. The results speak for themselves. All of this has been filed with the SEC as of July 31st, 2014.

This has been a challenging period for our Company and our shareholders. However, we approach the future with new vigor and we are as optimistic about our ability to enhance shareholder value as we are about our ability to improve operating results. We have showed strong period-to-period operating comparisons for the first six months with revenue and gross profit up 28.4 percent and 22.7 percent, respectively, and we are optimistic that an improving macroeconomic environment through the rest of 2014 can sustain these gains. We have also made a substantial commitment to enhance our reporting and our internal controls - including adopting additional internal review procedures, requiring our finance and accounting staff to attend education seminars and engaging an US consulting firm who has independently perform an IFRS review of our annual report.

The second issue we would like to address relates to the foreign currency agreements executed by the Company during the second quarter of 2013 and the first quarter of 2014 for investment purposes.

During 2013 and up to February 12, 2014, Renminbi had been on its upward trend when compared to the US Dollars. In fact at the end of 2013, the Company actually had made real cash gain of \$ 0.5 million. However, Renminbi started to depreciate against the dollar on February 12, 2014, the Company eventually incurred realized and unrealized losses that total \$11.6 million in connection with these agreements through June 30, 2014.

In June 2014, the company, our CEO and our board determined to terminate these agreements, and our CEO agreed to assume these foreign currency agreements and the liabilities arising under the agreements. As a result, RMB 87.8 million, or about US dollar 14.2 million will be extinguished, RMB 15.1

million, or about US dollar 2.5 million in deposits to financial institutions will be transferred to an affiliate of our CEO, and as an accounting adjustment, paid in capital will be increased by RMB 72.7 million, or about US dollar 11.7 million. Our CEO has now taken on the risk of these agreements so as to protect the company from any future losses and China Ceramics will not be required to fund any further losses related to these agreements. We will also not incur any future liabilities due to these agreements or realize any benefits from them. As mentioned by our CEO, management and the Audit Committee have taken serious measures to improve our internal control and have more strict guidelines for investments. And I would like to emphasize that the Company has no intention of entering into similar foreign exchange agreements in the future.

Now that we have addressed these two important issues, I would like to mention that we have Mr. Jianwei Liu, our Audit Committee Chairman on the call for further clarification should it be needed pertaining to these topics. At this point, we would like to open up the call to any questions pertaining to the second quarter's financial and operating performance. Operator?

Operator: And at this time if you would like to ask a question press star one on your telephone key pad. We will pause for just a moment to comply the Q and A roster. And your first question comes from the line of Howard Flinker with Flinker and Company.

Howard Flinker: In the release of the derivatives, will that add any cash to the balance sheet of China Ceramics?

Edmund Hen: No. The derivatives of the instrument has already transferred to Mr. Huang already. So we will not incur any future losses.

Howard Flinker: OK, and it will not release any cash to China Ceramics, too?

Edmund Hen: No.

Howard Flinker: OK. Second question, I am not sure about this. You said you raised prices five percent. Is that five percent included in the second quarter, or is that subsequent to the second quarter?

Edmund Hen: It's subsequent to the second quarter.

Howard Flinker: OK.

And the final question is, I am curious, why is did Huang Jiadong take the liability. I have never seen that before, for the derivatives.

Edmund Hen: This is because the derivative product was not a good idea, and why then have the company suffer? He arranged the mechanics by which he will take any further loss by himself. And please be assured that the company learned from this event, and that our decision making, governance and transparency will be better for it.

Howard Flinker: It wasn't a good idea in the beginning, but I still am curious. I have never seen anybody take responsibility for a corporate mistake. What was the reasoning of Huang Jiadong to absorb that very large loss?

Edmund Hen: May I have your question again?

Howard Flinker: Sure. You said that Huang Jiadong took it because it was corporate mistake, but still corporate mistakes happen all the time, and I haven't seen Chief Executives take the loss themselves. What was going through Huang Jiadong's mind when he said, I'm going to transfer the loss to me instead of to the company?

Edmund Hen: In the first place, what we noticed that the (RMB) has an upward swing in 2005.

Howard Flinker: Alright.

Edmund Hen: And initial decision to have this foreign exchange contract was something the company would benefit from a strong RMB and actually, we had a cash gain of U.S. dollar 0.5 million at the end of 2013 and that was recorded in the

financial results. But the RMB started to depreciate against the U.S. dollar since February earlier this year, and that was a total surprise for us.

Howard Flinker: And taking it to the next step, I am guessing now, did Jaidong Huang decide that he was responsible for this mistake, and that's why he took the loss himself starting in the third quarter of this year?

Edmund Hen: And you know that's a function of his interest in the company's shareholders. Rather than having somebody suffer. Mr. Huang arranged a mechanism by which he personally took on the future losses himself related to this contract.

Howard Flanker: OK. (Shi shi ni men)

Operator: Your next question comes from the line of James Kahn with Oppenheimer.

James Kahn: Good morning. I applaud the decision to take the loss himself instead of giving it to the shareholders, and I think it's a wonderful gesture of honesty. I just want to clarify one thing based on the last question. Does this mean that the 11 million that was lost in the last quarter is coming back, or just that no future losses will occur?

Edmund Hen: Just future loss might have occurred.

James Kahn: So, the loss – so even though he guaranteeing against future losses the past loss is still there, and still hurts the company to the tune of 11 million dollars, is that correct?

Edmund Hen: No, the past loss has already transferred to Mr. Huang.

James Kahn: Oh, ok. So, that means – so money is coming back, or – what actually happened – I am confused about the – you said that there was no cash coming into the balance sheet. So, you are just saying that a liability is being removed, is that correct?

Edmund Hen: Correct.

James Kahn: OK. And my second question is, in Grant Thornton, in the letters that they sent to you, the second letter said that you did not address the question of the

difference between the taxes that you declared you had paid on your return with Grant Thornton, and the taxes that the local authorities collected. Can you please explain the discrepancy?

Edmund Hen: The descriptions are in our filings and are specific in terms of the differences, and the outcome. And in – and we trying to be as transparent as possible. I would like to point out then, none of the issue, will an issue as Crowe Horwath Hong Kong, who are not only comfortable with our procedures, but they made no adjustment in the audit to our financial years 2011 and 2012, and have no difficulties with 2013 audit. In sum, we communicated to Grant Thornton that there was no problem with our financial statements and in the end there was not. However, as there is still outstanding litigation, the prudent thing to do is to refer you back to our public filings in terms of the details, and not delve into the details of this further in the call.

James Kahn: There is still outstanding litigation you are saying, and that is why you can't explain the difference between the two numbers? Is that right?

Edmund Hen: You may refer back to our public filings and that is where we express it in the terms of the difference and outcomes.

James Kahn: OK. Well, in closing I just want to say that you went through a difficult period where sales were down, and now things seem to be turning, and I am happy about that. Thank you.

Edmund Hen: Thank you very much.

Operator: Again, if you would like to ask a question press star one on your telephone key pad. And your next questions comes from the line of John Sheehy, a private investor.

John Sheehy: Hello, everybody. Thank you for hosting the call, and congratulations on getting back to a more normal situation. Could you share some comments about demand for some of the tile types where you were in high margins in the past, like the rustic tiles, ultra-thin tiles, and the extra-large size tiles?

Edmund Hen: Yes, for the newer tiles we see that some of this high price tiles, the demand is coming back, and also we found these ultrathin tiles is still our major contribution from the revenue. And also you can see that because our higher price tiles is selling better in the second quarter, we have a small profit for the second quarter, and also we have a plan to increase our selling price by five to ten percent in our third quarter.

John Sheehy: OK. Thank you for that information. Then have you developed any sales through your relationship with China State Decoration?

Edmund Hen: Yes, actually we are still working with them – but this is a state owned company. Going through their sales channel we need to go through a lot of relationship background in China, and we are happy to do business with them, and we are still following up with some projects from them.

John Sheehy: OK, then have you developed any new exclusive, or primary supply relationships with real-estate developers?

Edmund Hen: Yes. We always have some new real estate developers. For example we have already become exclusive to distributors and Evergrande, which is (inaudible), and also supply some goods to – some products to real-estate developer in China.

John Sheehy: So, are you – will you be the exclusive supplier to Evergrande, one of the largest developers in China?

Edmund Hen: Yes. We are one of the exclusive suppliers for the ceramics to them.

John Sheehy: OK, thank you so much for that information.

Edmund Hen: Thank you.

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

And your next question comes from the line of Duane Roberts of SHS Fund.

Duane Roberts: Good morning.

Can you give us a snapshot of what the housing market looks like right now in China?

Edmund Hen: The housing market right now is still relatively low compared to two or three years ago and we see building and construction becoming more stable rate since one and a half years ago. And we believe that after this period, the building market will have steady growth but that may happen next year, or the middle of next year. And now it's still at a very stable and quiet period.

Duane Roberts: So, from your analysis you are saying that the housing market is basically not dropping at this point?

Edmund Hen: In terms of the housing market, we found that for the major city the prices rest still stand a very high price already, but for some Tier Two and Tier Three cities, the supply of the housing is in excess of demand, so the housing prices just stay at a very stable – very stable rate right now; new projects have some growth or increase in price.

Duane Roberts: OK, all right that is good. And so at one point, there were cities growing out of nowhere, basically, in China where the people – where the government would go in and just developed basically a whole new city. Is that still happening, or has that slowed down, or what's going on with that right now?

Edmund Hen: May I have your question again?

Duane Roberts: Yes.

At one point cities were growing really fast, multiple cities were growing really fast in mainland China. A lot of people were moving from, from what I read, a lot of people were moving from the countryside into these major cities. Do you still have growth there, or has that stopped – have people stopped moving from the countryside into the major cities?

Edmund Hen: Actually, it happens always. And even now a lot of people from the rural area would like to move to the urban area. But the government has done some spending on rural area to fill up some kind type of local city from this local

area. So, I think that the movement from the rural area to urban area in terms of the growth rate is not such as ten to twenty years ago.

Duane Roberts: OK. One of the reasons why people would move from the countryside to the major cities is because of jobs, which spurs housing – and the housing market. What do you think – your analysis of what the job market is like right now in China?

Edmund Hen: It's still pretty good, especially in the major cities but for some traditional business, for labor intensive businesses, I think the growth rate will be much lower than before.

Duane Roberts: All right, that is good analysis. So, what percentage of the tile market in China do you have?

Edmund Hen: The building market always has its ups and downs, and the tile business is still very popular now in China, and a lot of this housing, building, and other some commercial building still would like to use tiles in China.

Duane Roberts: So, what percentage of the tile market do you guys own, does your company own?

Edmund Hen: Sorry? The tile market?

Duane Roberts: Yes. What percentage does your firm own? How much like you guys have ten percent, five percent?

Edmund Hen: We believe we have about 3 to 5 percent of the market in China.

Duane Roberts: Are the acquisition opportunities for you guys to look forward to then?

Edmund Hen: We always look into some good businesses, and we are still looking for some potential businesses to acquire. We will have – we will take it seriously on this topic.

Duane Roberts: Any acquisition opportunities outside of the Mainland?

Edmund Hen: Of course. There is always the opportunity, but before we acquire this factory or new business we have to do our own due diligence. And we also look for some work with projects before we make the decision.

Duane Roberts: All right.

Thank you very much.

Edmund Hen: Thank you.

Operator: Again, if you would like to ask a question press star one on your telephone key pad. And there are no further questions at this time. I would like to hand the conference over to Mr. Rudnick for any closing remarks.

David Rudnick: Thank you.

On behalf of the entire China Ceramics management team we would like to thank all of you for your interest and participation in this call. This concludes China Ceramics Second Quarter 2014 Earnings Call. Thank you all very much.

Operator: Thank you.

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

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