

CHINA CERAMICS CO., LTD.

Second Half Fiscal 2019 Earnings Call

May 20, 2020

8:00 a.m. ET

Speakers:

Ms. Meishuang Huang, CEO

Mr. Edmund Hen, CFO

Operator: Welcome to the China Ceramics Second Half of 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. To ask a question during this session, you would need to press star one. Please be advised that today's call is being recorded. Thank you. If you need any help during this call, please star. I would now like to hand the conference call over to your speaker for today, David Rudnick. Sir, take it away.

David Rudnick: Thank you, Carlo. Good morning ladies and gentlemen and good evening to those of you who are joining us from China. Welcome to China Ceramics' second half and fiscal year end 2019 earnings conference call. With us today are China Ceramics' Chief Executive Officer, Ms. Meishuang Huang and its Chief Financial Officer, Mr. Edmund Hen.

Before I turn the call over to Ms. 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' CEO, Ms. Meishuang Huang and China Ceramics' CFO, Mr. Edmund Hen. Sarah Bai will be translating for Ms. Huang. Ms. Huang, you may proceed.

Meishuang Huang: (In Chinese)

Sarah Bai: Thank you, David. On behalf of the Company, I would like to welcome everyone to our second half and fiscal year end 2019 earnings conference call.

Meishuang Huang: (In Chinese)

Sarah Bai: During the second half of 2019, we continued to experience challenging market conditions as we did in the same period of 2018. However, as a result of a 15% average price decrease of our products in October 2019, our revenue increased modestly in the second half of 2019 due to a robust increase in our sales volume.

Meishuang Huang: (In Chinese)

Sarah Bai: For fiscal year 2019, we utilized production facilities capable of producing 12.4 million square meters of ceramic tiles per year out of our effective total annual production capacity of 51.6 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.

Meishuang Huang: (In Chinese)

Sarah Bai: In December 2019, a novel strain of coronavirus was reported in Wuhan, China which the World Health Organization has declared a global pandemic. The pandemic disrupted supply chains and affected production and sales across a range of industries in China as a result of quarantines, facility closures, travel and logistics restrictions and related public health orders. Consequently, we have experienced a significant adverse effect on our business from the pandemic in the first four months of 2020. Although our manufacturing plants are now fully operational, our production was halted due to the pandemic for most of the month of February. The disruption of normal business activity has resulted in a reduced demand for our products as evidenced by a high number of purchase order cancellations which have resulted in reduced sales.

Meishuang Huang: (In Chinese)

Sarah Bai: However, in the long-term we believe that 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. Further, we believe that local governments will take measures to stimulate

property sales and pent-up consumer demand for residential properties due to the coronavirus will ultimately benefit our building materials sector.

Meishuang Huang: (In Chinese)

Sarah Bai: 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 2019 earnings results in more detail. Thank you!

Edmund Hen: Thank you Ms. Huang! I will now move on to a more detailed discussion of our financial results for the six months ending December 31, 2019.

Our Revenue for the six months ended December 31, 2019 was RMB 150.2 million or US\$ 21.4 million, a 5.3% increase from RMB 142.6 million or US\$ 20.8 million for the same period of 2018. The year-over-year increase in revenue was due to (i) the 25.5% increase in our sales volume to 6.3 million square meters of ceramic tiles for the second six months of 2019 compared to 5.0 million square meters of ceramic tiles for the same period of 2018, offset by (ii) the 16.0% decrease in average selling price to RMB 24.0 or US\$ 3.41 for the second six months of 2019 from RMB 28.6 or US\$ 4.05 for the same period of 2018.

Gross profit for the six months ended December 31, 2019 was RMB 66.0 million or US\$ 9.4 million compared to a gross loss of RMB 46.0 million or US\$ 6.7 million for the same period of 2018. The gross profit margin was 44.0% as compared to a 32.3% gross loss margin for the same period of 2018.

Other income for the six months ended December 31, 2019 was RMB 7.5 million or US\$ 1.1 million, the same totals as for the same period of 2018. Other income primarily consists of 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 and distribution expenses for the six months ended December 31, 2019 were RMB 5.6 million or US\$ 0.8 million, a slight increase RMB 5.3 million or US\$ 0.8 million for the same period of 2018.

Administrative expenses for the six months ended December 31, 2019 were RMB 9.2 million or US\$ 1.3 million as compared to RMB 7.5 million or US\$ 1.1 million for the same period of 2018. The increase in administrative expenses was primarily due increased start-up and related expenses from our newly incorporated entity.

Bad debt expense for the six months ended December 31, 2019 entailed a reversal of bad debt of RMB 125.2 million or US\$ 17.8 million, as

compared to bad debt expense of RMB 210.1 million or US\$ 30.6 million for the same period of 2018. We recognized a loss allowance for an expected credit loss on financial assets, primarily on our trade receivables, which are subject to impairment under International Financial Reporting Standards. We believe that we have undertaken appropriate measures to resolve the bad debt expense going forward. We will continue to review credit worthiness of each of our customers and continuously test our trade receivables balance in each upcoming fiscal period.

Net profit for the six months ended December 31, 2019 was RMB 183.7 million or US\$ 26.1 million as compared to a net loss of RMB 346.8 million or US\$ 50.6 million for the same period of 2018. The increase in net income was mainly due to the increase in gross profit and the reversal of bad expense.

Profit per basic share and fully diluted share for the six months ended December 31, 2019 were RMB 30.67 or US\$ 4.36 as compared to loss per basic and fully diluted share of RMB 75.95 US\$ 11.07 for the same period of 2018.

Adjusted EBITDA was RMB 8.0 million or US\$ 1.1 million for the six months ended December 31, 2019, adjusted for non-cash deductions as compared to adjusted EBITDA of RMB 10.2 million for the same period of 2018.

Turning to our balance sheet, as of December 31, 2019, we had cash and bank balances of RMB 8.2 million or US\$ 1.2 million, as compared with RMB 9.0 million or US\$ 1.3 million as of December 31, 2018.

As of December 31, 2019, our inventory turn was 217 days as compared to 117 days as of December 31, 2018. The increase in inventory turnover days was primarily due to the 27.0% decrease in our sales volume for fiscal year 2019 as compared to fiscal year 2018 and the reversal of an inventory impairment provision in fiscal 2019.

Our trade receivables turnover, net of value added tax, as of December 31, 2019 was 194 days compared with 233 days as of December 31, 2018. The decrease in trade receivables turnover was primarily due to the improved collection of our trade receivables.

Our trade payables turnover, net of value added tax, was 30 days as of December 31, 2019 compared with 26 days as of December 31, 2018. 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 6.4 million square meters of ceramic tiles for the six months ended December 31, 2019 and 12.4 million square meters of ceramic tiles for fiscal 2019 out of a total annual production capacity of 51.6 million square meters.

Our Hengda facility has an annual production capacity of 22.8 million square meters of ceramic tiles as a result of two old furnaces having been put out of use at the facility. The Company utilized production capacity at our Hengda facility capable of producing 2.9 million square meters of ceramic tiles for the six months ended December 31, 2019.

Our Hengdali facility has an annual production capacity of 28.8 million square meters, which excludes our leasing out 10 million square meters of production capacity to a third party, and we utilized production capacity at our Hengdali facility capable of producing 3.5 million square meters of ceramic tiles for the six months ended December 31, 2019.

We review the level of capital expenditures throughout the year and make adjustments subject to market conditions. Although business conditions are subject to change, we anticipate a modest level of capital expenditures for 2020 other than those associated with minimal upgrades, small repairs and the maintenance of equipment.

Moving on to our business outlook, in an effort to bolster sales, in October 2019 we decreased the pricing of our ceramic tile products by an average of 15%. As a result, our sales volume increased by 26.0% in the second half of 2019 which resulted in a 5.3% increase in sales for the six months ended December 31, 2019 on a year-over-year basis. We viewed this as encouraging as it signaled slightly improving market conditions for the six-month period since a decrease in our product pricing affected the demand for such products. Conversely, in July of 2018 we decreased the pricing of our ceramic tile products by an average of 10% but our sales volume declined which evidenced deteriorating market conditions.

In order to supplement and expand our current market reach, in 2019, we announced plans to enter the ceramic tile market in Southeast Asia to capitalize upon the increased level of the region's new building construction while its climate conditions make it an ideal fit for many of our ceramic tile products. Although this effort was temporarily halted due to the coronavirus pandemic, we have redeployed this strategy with the goal to diversify our business by generating revenue outside of China.

A key element of this diversification strategy is to bolster our R&D efforts in order to expand our market. Last year, we developed a new type of exterior ceramic tile designed to cool temperatures of buildings which,

once fully tested and certified as planned for this summer, will target the Southeast Asia market.

We are also focused upon diversifying our operational capabilities to fuel our growth. We formed a new subsidiary, Chengdu Future Talented Management and Consulting Co, Limited, which provides computer server consulting that includes on-site training and online problem-solving to maintain computer systems and internet connectivity, engage in troubleshooting and repair as needed, and to provide overall technical support. Although we expect this subsidiary to contribute only a modest amount of revenue in 2020, we believe that this venture represents a substantial growth sector which could lead to additional high technology growth opportunities.

Because of the significant uncertainties surrounding the COVID-19 pandemic, the related financial impact on the year 2020 cannot be reasonably ascertained at this time. The pandemic disrupted supply chains and affected production and sales across a range of industries in China as a result of quarantines, facility closures, travel and logistics restrictions and related public health orders. Although our manufacturing capabilities have resumed normal operations, our production was halted for most of the month of February and our logistics functions are still lagging due to certain regions that remained closed through April. Consequently, we anticipate that our sales orders will be significantly reduced for the first four months of 2020 as compared to the same period in 2019.

As reported, China's economy declined 6.8% in the first quarter of 2020 following many years of high growth. Although factories across China have restarted, many of its international global markets are still in lockdown and business has not yet returned to normal. It remains to be seen what the economic recovery in China will look like for the rest of 2020 and what stimulus programs the central Government might enact.

In terms of the real estate and construction sectors, the deleveraging of China's property developers could continue in 2020 as occurred in 2019 due to limited borrowing and resulting cash flow issues. Also, new home sales declined by an estimated 90% from a year ago during the period of China's lockdown as potential buyers were not able to view properties. However, early sales data indicates that pent-up demand has already resulted in substantial buying activity as consumers are eager to secure properties in China's major cities. In addition, some restrictive measures have been loosened in different cities to support the housing market. As previously noted, China's real estate sector has been resilient over time and has been a key driver of China's economic growth.

Notwithstanding the above-referenced macroeconomic challenges, we believe that the long-term fundamentals of the real estate and construction sectors remain intact and these fundamentals will emerge as business conditions normalize. China's urbanization trend continues to underpin its economic growth and the need for housing leads to a sustained demand for our building materials products. We believe that we have a competitive advantage in our sector due to our innovation, brand name recognition and our ability to meet our customers' needs.

This business outlook reflects the Company's current and preliminary views and is based on the information currently available to us, 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 2019 financial results. 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. Our first question comes from the line of Howard Flinker. Your line is now open.

Howard Flinker: (In Chinese, salutations and good wishes)

Edmund Hen: (In Chinese, salutations and good wishes)

If there are no more questions, I would like to pass the call along to David Rudnick.

David Rudnick: Thank you, Carlo. On behalf of the entire China Ceramics management team, I want to thank all of you for your interest and participation on this call. This concludes China Ceramics' second half and fiscal year end 2019 earnings call. Thank you.

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