CHINA CERAMICS CO., LTD.

First Half 2018 Earnings Call
September 27, 2018
8:00 a.m. ET

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

Operator: Good afternoon. My name is Rey and I'll be your conference operator today. At this time, I would like to welcome everyone to the China Ceramics first half 2018 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 like to ask a question during this time, simply press star then the number one on your telephone keypad. If you will like to withdraw your question, press the pound key.

I'll now turn the conference over to Mr. David Rudnick of Precept Investor Relations. Please go ahead, sir.

David Rudnick: Good morning ladies and gentlemen and good evening to those of you who are joining us from China. Welcome to China Ceramics' Welcome to China Ceramics' first six months of 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. Gabel Cao will be translating for Mr. Huang. Mr. Huang, you may proceed.

Jiadong Huang: (In Chinese)

Gabrial Cao: Thank you, David. On behalf of the company, I would like to welcome everyone to our first half fiscal 2018 earnings conference call.

Jiadong Huang: (In Chinese)

Gabrial Cao: For the first half of 2018, we experienced top line growth of 6% as stronger market positioning enabled us to increase our average selling price by 17% compared to the same period a year ago. However, we also experienced a 9% contraction in our sales volume as compared with the first six months of last year due to the strategic decision to be more selective as to our customer base. We were able to implement three price increases over the last 18 months due to our reputation for high quality products as well as a modest improvement in operating conditions. This pricing increase enabled us to achieve a reasonable utilization of our production capacity given the current market environment.

Jiadong Huang: (In Chinese)

Gabrial Cao: During the six months ended June 30, 2018, we utilized production facilities capable of producing 21.1 million square meters of ceramic tiles for the first half of 2018 out of the Company's effective annual production capacity of 61.5 million square meters. In order to generate cash flow, we have entered into a contract to lease out an idle production line in our Hengdali facility that has the capacity to produce 10 million square meters of ceramic tiles. As we have in past quarters, we maintained a reduced utilization of existing plant capacity based on the current market environment in order to keep our operating costs low, and we will bring additional capacity online as the business environment improves.

Jiadong Huang: (In Chinese)

Gabrial Cao: For the second half of 2018, we intend to continue to strategically target second tier cities where we forecast development activity and will be careful about extending credit to customers consistent with a general tightening of customer credit in our sector. Further, various pollution regulations applicable to our sector could cause the exit of smaller, less well capitalized competitors which we believe will ultimately give us the opportunity to increase our market share. Although we anticipate that our business will slow in the second half of 2018, we believe that our business is sustainable since real estate development is vital for China's continued urbanization, which is a key element of government policy to achieve domestic economic growth.

Jiadong Huang: (In Chinese)

Gabrial Cao: 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 first 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 interim six month period ending June 30, 2018.

Our revenue for the six months ended June 30, 2018 was RMB 355.6 million or US$ 55.9 million, an increase of 5.7% from RMB 336.5 million for the same period of 2017. The increase in revenue was primarily due to the 17.1% increase in the average selling price or ASP of the Company's ceramic tile products to RMB 28.1 or US$ 4.40 in the first half of 2018 as compared to RMB 24.0 for the same period of 2017, partially offset by the 9.3% decrease in sales volume to 12.7 million square meters of ceramic tiles in the first half of 2018 from 14.0 million square meters of ceramic tiles in the first half of 2017.

Gross profit for the six months ended June 30, 2018 was RMB 44.8 million or US$ 7.0 million as compared to gross loss of RMB 7.4 million for the same period of 2017. The gross profit margin was 12.6% for the six months ended June 30, 2018, as compared to a negative 2.2% profit margin for the same period of 2017. The increase in gross profit margin was primarily due to the 16.7% increase in ASP of the Company's ceramic tiles and the decrease in depreciation expense resulting from the write-down of fixed assets at December 31, 2017.

Other income for the six months ended June 30, 2018 was RMB 7.1 million or US$ 1.1 million, as compared to RMB 7.1 million for the same period of 2017. For the six months ended June 30, 2018, other income consisted of RMB 7.1 million (US$ 1.1 million) 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 June 30, 2018 were RMB 5.7 million or US$ 0.9 million as compared to RMB 5.8 million for the same period of 2017. The year-over-year decrease in selling and distribution expenses was primarily due to an RMB 0.1 million decrease in traveling expenses.

Administrative expenses for the six months ended June 30, 2018 were RMB 10.5 million or US$ 1.6 million as compared to RMB 9.0 million for the same period of 2017.

Bad debt expense for the six months ended June 30, 2018 was RMB 106.4 million or US$ 16.7 million, as compared to no bad debt expense for the same period of 2017, primarily due to the write-off of bad debt due to uncollectible debt associated with our customers. The Company recognizes a loss allowance for expected credit loss on its financial assets, primarily on its trade receivables, which are subject to impairment under IFRS 9, *Financial Instruments*, first effective for the current accounting period. The Company believes that it has undertaken appropriate measures to resolve its bad debt expense. The Company will continue to review each of its customers for credit quality as well as assiduously test its accounts receivables balances in each upcoming fiscal period.

Net loss for the six months ended June 30, 2018 was RMB 71.9 million or US$ 11.3 million as compared to a net loss of RMB 5.8 million for the same period of 2017. The increase in net loss was mainly due to the RMB 106.4 million or US$ 16.7 million) of bad debt expense incurred for the six months ended June 30, 2018.

Loss per basic and fully diluted share for the six months ended June 30, 2018 on both a basic and fully diluted basis were RMB 17.23 or US$ 2.71, as compared to both a basic and fully diluted loss per share of RMB 2.07 for the first half of 2017.

Turning to our balance sheet, as of June 30, 2018, we had cash and bank balances of RMB 6.0 million or US$ 0.9 million, as compared with RMB 2.3 million as of December 31, 2017.

As of June 30, 2018, our inventory turn was 109 days as compared to 95 days as of December 31, 2017. The increase in inventory turnover days was primarily due to the 9.3% decrease in our sales volume in the first half of 2018 as compared to the same period of 2017. The Company believes that the currently challenging economic environment has, in general, caused a lower turnover than normal and the Company will make a continuous effort to deplete its slow-moving stocks.

Our trade receivables turnover, net of value added tax, as of June 30, 2018 was 221 days compared with 206 days as of December 31, 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.

In terms of our plant utilization and capex, for the six months ended June 30, 2018, we utilized plant capacity capable of producing 21.1 million square meters of ceramic tiles annually out of a total annual production capacity of 61.5 million square meters. Our annual production capacity has been effectively reduced from 76 million square meters of ceramic tiles to 61.5 million square meters of ceramic tiles due to an eight-year contract to lease out one of the production lines from its Hengdali facility that we entered into in March 2016 and the disposal of a 4.5 million square meters capacity kiln at the end of 2016.

Our Hengdali facility has an annual production capacity of 32.7 million square meters and we utilized production capacity capable of producing 14.0 million square meters of ceramic tiles for the six months ended June 30, 2018. Our Hengdali facility has an annual production capacity of 28.8 million square meters, not including our leasing out 10 million square meters of production capacity to a third party, and we utilized annual capacity capable of producing 7.1 million square meters of ceramic tiles in the six months ended June 30, 2018.

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 the remainder of 2018 other than those associated with minimal upgrades, small repairs and the maintenance of equipment.

Moving on to our business outlook, for the six months ended June 30, 2018, our revenue rose 5.7% primarily due to an increase in our average selling price, attributable to our decision to raise prices on our products three times beginning in April of 2017, with our most recent increase occurring in April of 2018. Consequently, the average selling price of our ceramic tile products increased by 17.1% for the first six months of 2018 as compared to the same period of 2017. However, our strategy to select and secure more qualified accounts led to a contraction in our sales volume of 9.3% to 12.7 million square meters of ceramic tiles from 14.0 million square meters of ceramic tiles for the same period of 2017.

Looking ahead to the second half of 2018, and based on the information currently available to us, we expect market conditions to become very challenging due to a slowing domestic economy and high inventory in certain second tier cities. There is also a relatively high amount of mortgage debt, overdevelopment occurring in some areas and a high number of government regulations intended to cool prices, especially in third and fourth tier cities, which could limit the launch of new projects. However, there are also efforts to build demand in some cities where housing purchase restrictions on second homes could be loosened and there is also a portion of outdated city center housing stock that could lead to rebuilding and renovation.

We typically receive orders from customers one or two months in advance of production on a rolling basis. However, due to potentially difficult market conditions for the second half of 2018, there has been a decreased demand for our products, and as of June 30, 2018, we did not have any backlog. The Company believes that the reduction in backlog relates to a general slowdown in the construction industry in China as customers are deferring orders and/or are waiting to start new projects. We anticipate that the reduction in backlog may result in a decrease in sales volume and revenue in the second half of 2018. Under normal circumstances, our backlog is an indicator of revenues that might be expected in the next period, though it is subject to change as a result of unforeseen business conditions and events including credit payment terms.

In our view, China's urbanization trend, where hundreds of millions of people will move from rural areas into China's cities, will continue into the foreseeable future and will favor a sustainable building materials sector. We are becoming ever more focused on the consolidating property developer sector and are looking to work with larger developers across a variety of projects.

Also, our sector is viewed to have excessive production capacity and government mandates to convert to cleaner and more expensive fuel sources could ultimately result in smaller, less well capitalized competitors exiting the space. We believe that we have a competitive advantage in our sector due to our extensive product platform, customization capabilities, marketing expertise and reputation to quickly and expertly meet our customers' needs.

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 first half 2018 financial results. Operator?

Operator: At this time, I would like to ask everyone as a reminder, to ask an audio question, please press star then the number one on your telephone keypad. We'll pause for just a moment.

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

Howard Flinker: Hello everybody. Edmund, you failed to mention something that I calculated and that I want to correct, or check to see if it is correct. The way I see it, if you excluded your receivable write-off, which is a non-cash write-off, your cash inflow was RMB 40 million or $6.4 million for the six months. Is that correct? Depreciation was the reversal over the receivable minus the loss. Is that correct?

Edmund Hen: Yes. You are correct. If you do not count our cash inflow from operations.

Howard Flinker: That's $1.50 a share or 9.7 million yen, correct, in six months.

Edmund Hen: Yes. Approximately that.

Howard Flinker: Yes. Okay. And you and I have talked about the companies' closing because of the environmental restrictions. Do you think that in the last two years more than 50% of the competitors have gone out of business?

Edmund Hen: I think so in Fujian province. There're a lot of provinces …

Howard Flinker: And in Jiangxi.

Edmund Hen: Jiangxi.

Howard Flinker: Jiangxi. Right. I suppose some competitors have gone out of business too. Is that correct?

Edmund Hen: Yes. We have notice it.

Howard Flinker: Is it as many our bigger percentage in the Jiangxi as in Fujian or not yet?

Edmund Hen: I think Fujian is more significant. It's about 50%.

Howard Flinker: About 50%. Okay.

Edmund Hen: It's not for sure. So it's just …

Howard Flinker: No, we know, it's a guess. And finally, the government of China changed the taxes recently and also the necessary contribution to retirement and pensions. Is that going to put more pressure on some of these weaker competitors?

Edmund Hen: Yes. They will come under the pressure in the coming years.

Howard Flinker: So the reduction in industry-wide capacity in Fujian, and maybe even Jiangxi, could be more than 50%, correct?

Edmund Hen: This is only an estimate.

Howard Flinker: Yes. But there is - the pension expense is going to add more pressure to competition. Correct? More pressure.

Edmund Hen: Correct.

Howard Flinker: All right. So now -- it could be bigger than 50%. We'll see.

Edmund Hen: Yes.

Howard Flinker: Okay. All right. I suggest next time -- you mentioned, because most people don't bother to calculate, what the cash inflow was, because that's a very large number for a company like yours. And you might point it out more clearly next time.

Edmund Hen: Yes. We may do that.

Howard Flinker: Okay. [Foreign Language]

Edmund Hen: Thank you.

Howard Flinker: Your welcome.

Operator: Your next question comes from the line of James Kahn. Your line is open. Please ask your question.

James Kahn: Thank you for this conference call. My question is, can you tell us something about what has happened between June 30th and now, which is almost three months? Has there been any backlog?

Edmund Hen We -- because at the end -- from June, we have changed our strategy a bit. So we did not have backlog as of June 30th, we only chose to quality customer to do direct business with them. So from the June 30th to now, I can only say that we do have some good revenue, but that is a little bit lower or slower than the same period of last year.

James Kahn: You mean it's slower to collect your receivables?

Edmund Hen: One, the revenue growth. So revenue growth is much lower than we thought.

James Kahn: Okay. What about the cash situation? I see that relative to a year ago there's more cash on hand now which is good. That was as of June 30th. Can you tell us anything about the cash on hand now?

Edmund Hen: The cash on hand is approximately the same. There is not too much difference. I mean, well, we maintain it about the same level.

James Kahn: Okay. Well, I'm certainly glad that you were able to raise prices by as much as you have. And that you have returned to profitability. But, I guess, as you say the situation is still challenging in China. If it ever becomes non-challenging, which typically, I guess, it will eventually, that should be very good for you. But for now, I'm glad that you're profitable.

Edmund Hen: Thank you.

Operator: There are no further questions at this time. You may continue, sir.

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' first six months 2018 earnings call. Thank you all very much.

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