農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

13 November 2012

# Equity Focus

# China Rail Cons (1186 HK) – Buy

## Construction & Engineering Industry

## MOR could borrow more

**Market concerns on the financial strength of the Ministry of Railway ("MOR"), a major customer of China Railway Construction ("CRCC"). We estimate the MOR is able to raise debt to finance its capital expenditures in 2013. Among CRCC's competitors, the group is able to secure more new orders because of its lower gearing.**

**MOR has rooms to leverage up.** The major customers of the Group were railway bureau and railway companies affiliated to the MOR. We believe the most important financial ratio for the MOR in debt-raising should be its interest coverage ratio. Its interest coverage ratio of 5.5x is quite healthy as most Chinese banks would accept a minimum of 2x interest coverage for infrastructure related asset. We assume the effective interest rate at 3%. It means the MOR could potentially borrow Rmb1,043bn more by 2013, which is 74% more than our estimates of Rmb600bn annual railway infrastructure spending.

**Recent October railway FAI confirms ramping up of railway spending**. The railway infrastructure FAI for October was Rmb69.8bn, up 241%YoY. It was 115% higher than the monthly average FAI spending of Rmb32.5mn in the first nine months.

**CRCC able to secure to more new orders.** With net debt/equity of 24.4% at Sep 30, the Group is able to leverage up to secure more new orders in 2013. The high gearing of its two major competitors China Railway Group (123.9%) and China Communication Construction (80.3%) will constrain them to compete with the group.

**Maintain Buy.** We set our new target price at HK$10.13 by rolling over to FY13E BV. It is based on 10% discount to its 4-year mean forward P/B of 1.41x. We maintain "Buy" rating with potential upside of 16%.

**Risk factors:** overseas project risks, higher raw materials costs, liquidity risk.

### Results and valuation

| FY ended Dec 31 | FY09A | FY10A | FY11A | FY12E | FY13E |
|---|---|---|---|---|---|
| **Revenue (Rmb mn)** | 355,521 | 470,159 | 457,366 | 495,563 | 518,612 |
| *Chg (%YoY)* | 57.2 | 32.2 | (2.7) | 8.4 | 4.7 |
| **Net Income (Rmb mn)** | 6,599 | 4,246 | 7,854 | 8,460 | 8,858 |
| *Chg (%YoY)* | 81.1 | (35.7) | 85.0 | 7.7 | 4.7 |
| **EPS (Rmb)** | 0.53 | 0.34 | 0.64 | 0.69 | 0.72 |
| *Chg (%YoY)* | 81.1 | (35.7) | 85.0 | 7.7 | 4.7 |
| **PE (x)** | - | - | 11.0 | 10.2 | 9.8 |
| **PB (x)** | - | - | 1.3 | 1.3 | 1.2 |
| **Yield (%)** | - | - | 1.4 | 1.6 | 1.6 |
| **ROAA (%)** | 2.7 | 2.5 | 2.0 | 1.9 | 1.7 |
| **ROAE (%)** | 13.2 | 7.7 | 12.7 | 12.0 | 10.3 |
| **Net gearing (%)** | Net Cash | Net Cash | 0.3 | 31.7 | 66.3 |

*Source: Company, ABCI Securities estimates (* Rmb1 = HK$1.25)*

**Key Data**

| | |
|---|---|
| H-Share price (HK$) | 8.76 |
| Target price (HK$) | 10.13 |
| Upside potential (%) | 15.6 |
| 52Wk H/L(HK$) | 8.83 /4.00 |
| Issued shares (mn) | 12,338 |
| H-shares | 2,076 |
| A-shares | 10,261 |
| Market cap | |
| H-shares (HK$mn) | 18,188 |
| A-shares (Rmbmn) | 55,206 |
| 30-day avg vol (HK$mn) | 164 |
| Major shareholder (%): | |
| CRCCG | 61.3 |

*Source: Company, Bloomberg, ABCI Securities*

**Revenue composition in 1H12 (%)**

| | |
|---|---|
| Construction operations | 87.9 |
| Survey, design and consultancy operations | 1.5 |
| Manufacturing operations | 1.9 |
| Others | 8.7 |

*Source: Company*

**Share performance (%)**

| | Absolute | Relative* |
|---|---|---|
| 1-mth | 11.3 | 10.1 |
| 3-mth | 28.5 | 20.7 |
| 6-mth | 55.9 | 45.5 |

*Source: Bloomberg*
**Relative to Hang Seng Index*

1 year price performance


*Source: Bloomberg*


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Previous report
Date: 31 October 2012
Rating - BUY

### *Estimation of MOR potential borrowing capacity*

| (Rmbmn) | |
|---|---|
| 2011 EBITDA | 193,248 |
| Minimum interest coverage (x) | 2 |
| Equivalent interest cost | 96,624 |
| Assume effective interest rate (%) | 3 |
| Principal amount | 3,220,800 |
| Less: outstanding debt at 30/9/2012 | 2,176,868 |
| **Potential additional debt amount** | **1,043,932** |
| Net debt/equity at 30/9/2012 (%) | 120 |

*Note: Interest coverage = EBITDA/interest expense*
*Source: MOR, ABCI Securities estimates*

### *Key financial data & ratio of MOR*

| (Rmbmn) | 31/12/2010 | 31/12/2011 | 30/9/2012 |
|---|---|---|---|
| Total assets | 3,293,738 | 3,979,637 | 4,304,416 |
| Total liabilities | 1,891,801 | 2,412,675 | 2,660,660 |
| Total equity | 1,401,937 | 1,566,962 | 1,643,756 |
| Net debt | 1,346,162 | 1,743,578 | 1,975,272 |
| (Rmbmn) | FY10 | FY11 | 9M12 |
| Total Revenues | 685,701 | 819,676 | 695,294 |
| Profit before tax | 66,783 | 70,708 | 42,452 |
| Profit after tax | 15 | 31 | (8,541) |
| | 31/12/2010 | 31/12/2011 | 30/9/2012 |
| Net debt to equity ratio | 96.0% | 111.3% | 120.2% |
| Total equity to total assets | 42.6% | 39.4% | 38.2% |
| EBITDA/Interest expense (x) | 6.5 | 5.2 | 5.5 |
| EBITDA/(ST loans + interest exp.) | 1.0 | 1.2 | 1.6 |
| ROAA | 0.001% | 0.001% | -0.206% |
| ROAE | 0.001% | 0.002% | -0.532% |

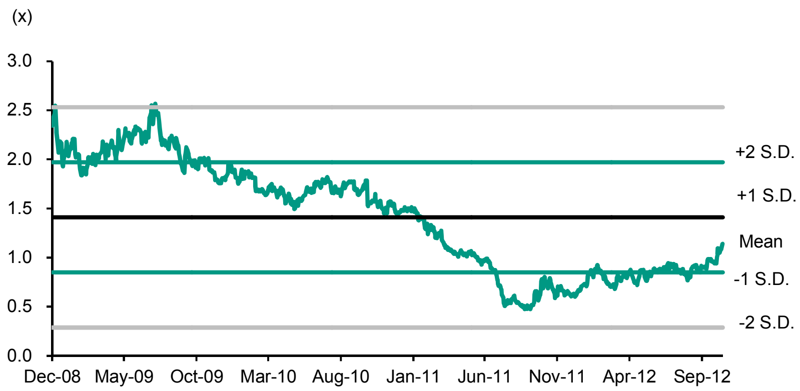
*Note: Interest coverage = EBITDA/interest expense*
*Source: MOR, ABCI Securities estimates*

***Recent new orders of CRCC (1186 HK)***

| Date | Project | Type | Details | Value (mn) | Period (mth) |
|---|---|---|---|---|---|
| Sep-12 | Jiangsu Roadway | BT | Suzhou City, Jiangsu Province, the 2nd phase of the western extension(Wuzhong section) | Rmb1,120 | 24.0 |
| Sep-12 | Sichuan Municipal | BT | Financial headquarters of the business district of Chengdu, Sichuan Province | Rmb1,517 | 13.0 |
| Sep-12 | Nigeria airport terminals | Contractor | The construction of five new airport terminals at the airports in Abuja, Lagos, Kano, Port Harcourt, Enugu and six new cargo terminals in Abuja, Lagos, Kano, Port Harcourt, Enugu and Asaba, Nigeria。 | US$683 | 18.0 |
| Oct-12 | Liaoning Roadway | BT | Liaoyang, Liaoning Province to Shenyang, Liaoning Expressway | Rmb3,338 | 24.0 |
| Oct-12 | Liaoning Roadway | BT | Panjin Liaobin Shugang Expressway project | Rmb1,875 | 24.0 |
| Nov-12 | Qingdao Metro | Contractor | Qingdao Metro Line 2 of a civil works construction | Rmb3,699 | 24.0 |

*Source: Company, ABCI Securities*

***CRCC (1186 HK) – Forward PB band chart***




*Source: Company, Bloomberg, ABCI Securities estimates*

# Disclosures

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**Definition of equity rating**

| Rating | Definition |
|---|---|
| Buy | Stock return ≥ Market return rate |
| Hold | Market return – 6% ≤ Stock return < Market return rate |
| Sell | Stock return < Market return – 6% |

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate from 2007-2011
Time horizon of share price target: 12-month

**Definition of share price risk**

| Rating | Definition |
|---|---|
| Very high | 2.6 ≤180 day volatility/180 day benchmark index volatility |
| High | 1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6 |
| Medium | 1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5 |
| Low | 180 day volatility/180 day benchmark index volatility < 1.0 |

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.
Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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