



Company Report

CMEC (1829 HK)

July 16, 2013

Rating: BUY
TP: HK\$ 6.57

Previous Rating & TP: BUY, HK\$6.57
Previous Report: April 5, 2013

Key Data

H-Share price (HK\$)	4.18
Upside potential (%)	57.18
52Wk H/L(HK\$)	7.61/3.42
Issued shares (mn)	4,125
H-Shares (mn)	908
Domestic (mn)	3,217
Market cap	
H-shares (HK\$ mn)	3,795
3-mth avg daily turnover (HK\$ mn)	22.3
Major shareholder(s) (%):	
SINOMACH	77.99

Sources: Company, Bloomberg, ABCI Securities

FY12 Revenue breakdown (%)

Int'l engineering contracting	62.19
Trading	33.64
Others	4.17

Sources: Company, ABCI Securities

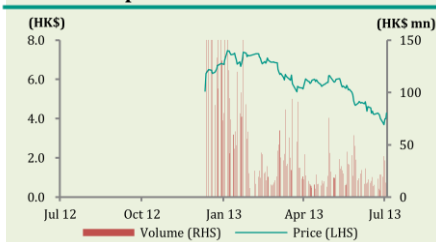
Share performance (%)

	Absolute	Relative*
1-mth	(13.28)	(14.64)
3-mth	(29.03)	(27.80)
6-mth	(44.04)	(38.50)

*Relative to HSI

Sources: Bloomberg, ABCI Securities

1-Year stock performance



Sources: Bloomberg, ABCI Securities

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New Contracts to Pick Up in 2H13

Despite the slowdown in 1H13, we expect CMEC's new contract uptake to accelerate in 2H13 based on its current project pipeline. Delivery of projects will peak in FY14-15. The stock is trading at 1.19x FY13E BVPS. With its attractive FY13E ROAE of 18.74% and FY14E ROAE of 20.53%, the current valuation is deemed attractive. We maintain our BUY rating on CMEC with TP at HK\$6.57.

Delivery on track. We expect CMEC's delivery of construction project to grow by 10.14% YoY in 1H13. Looking forward, with the large new contract (US\$ 4,365mn in FY12) turning effective in FY12, we expect project delivery will grow 16.57% YoY in 2H13.

New contract to pick up in 2H13; delivery to rally in FY14-15. We expect the growth of new effective contract amount will accelerate in 2H13. With the existing project pipeline with backlog amounting to US\$ 7,058mn, and the huge pool of projects of US\$12,102mn pending to turn effective as at end- 2012, we expect delivery will peak in FY14-15.

Lifting of Sanctions from US Government. The US government lifted the Chemical and Biological Weapons (CBW) Proliferation Sanctions against the Group. We believe CMEC will be removed from the restriction list of certain US funds. The number of potential investors may increase as a result, and a higher valuation premium should be granted for the lower liquidity risk of CMEC's shares in the market.

Maintain BUY on accelerating project pipeline. Net cash on hand as of end-2012 was RMB 18,719mn, which allows CMEC to acquire more projects in the future. The stock is trading at 1.19x FY13E BVPS. Considering with the improvement of ROAE in FY14-15, the current valuation is attractive. Maintain BUY with TP at HK\$6.57.

Risk factors: 1) Slowdown of new effective contract; 2) Foreign exchange loss; 3) Potential squeeze in profit margin of trading business.

Results and Valuation

FY ended Dec 31	2011A	2012A	2013E	2014E	2015E
Revenue (RMB mn)	20,518	21,296	23,163	26,898	35,367
Chg (% YoY)	7.55	3.79	8.77	16.12	31.48
Net Income (RMB mn)	1,472	1,928	2,018	2,577	3,358
Chg (% YoY)	29.78	30.95	4.67	27.69	30.32
EPS (RMB)	0.447	0.467	0.489	0.624	0.814
Chg (% YoY)	29.78	4.53	4.67	27.69	30.32
BVPS (RMB)	1.632	2.405	2.815	3.268	3.863
Chg (% YoY)	36.13	47.38	17.02	16.10	18.21
P/E (x)	-	7.19	6.87	5.38	4.13
P/B (x)	-	1.40	1.19	1.03	0.87
DPS(RMB)	0.043	0.164	0.171	0.219	0.285
Yield (%)	-	4.87	5.10	6.51	8.49
ROAE (%)	31.58	25.18	18.74	20.53	22.83
ROAA (%)	5.70	6.30	5.70	6.50	7.50

Sources: Company, Bloomberg, ABCI Securities estimates (RMB1.0=HK\$1.245)



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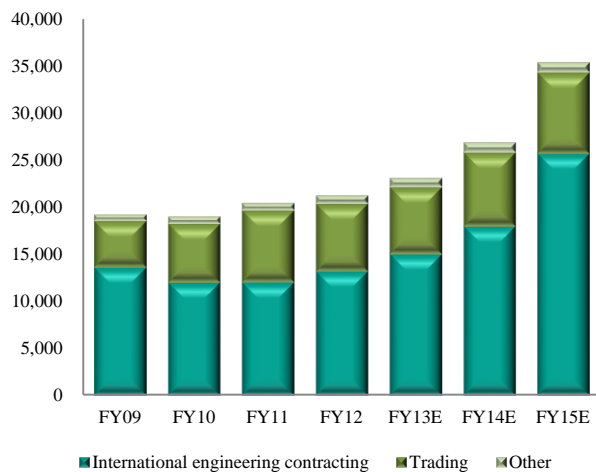
1H13 Results Preview

Accelerating Project Delivery Growth

CMEC's working capital has increased after the capital injection from IPO in Dec 2012. We therefore expect its delivery of ongoing projects to accelerate. We estimate revenue from its overseas engineering contracting segment to grow by 10.14% YoY in 1H13, and 13.45% YoY in FY13.

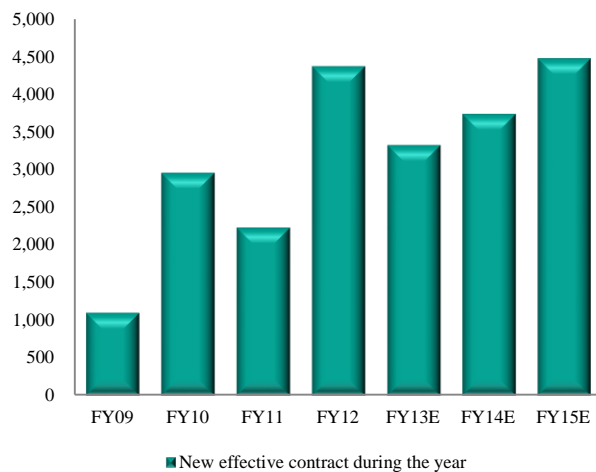
Looking forward, with the high contract value in 2012, we expect the momentum of project delivery will increase during in FY13 and FY14. Based on CMEC's existing projects on hand alone, we estimate the segment revenue will grow 6.86% YoY in FY14. Assuming that new contracts of US\$3,321mn will turn effective in 2013, the overall segmental income will grow 26.11% YoY in FY14.

Exhibit 1: Revenue growth projection in FY09–15E (RMB mn)



Sources: Company, ABCI Securities estimates

Exhibit 2: New effective contract and growth in FY09–1H13E (RMB mn)



Sources: Company, ABCI Securities estimates

Expected decline in new contract inflow

We estimate that the new effective contract of the Group to be US\$ 1,000mn in 1H13, representing a decline of 53.68% YoY from US\$ 2,159mn. We believe that the decline in new effective contract for CMEC during the 1H13 will have a negative impact on stock's valuation in the short term.

We expect the new contract intake will be back on track in 2H13 due to the positive market momentum in 5M13, as evidenced by the total new overseas contract value signed by Chinese enterprises that grew 28.9% YoY to US\$ 56,520mn during the period. We estimate that the new effective contract amount will approximate at about US\$ 2,000mn in 2H13.

In July, two new projects in Nigeria totaling US\$ 621mn, equivalent to 31.05% of our estimated new contract value in 2013 were signed. With President Xi agreeing to grant Nigeria a US\$ 1.1bn low-interest loan, we expect the two projects will commence shortly.



More Projects to enter the Pipeline

In June 2013, the Group diverted part of the proceeds from its IPO in Dec 2012 to finance six new projects, in addition to the 11 projects that the Group had originally planned to finance with the IPO proceeds. The total contract value increased from US\$ 9,524mn to US\$ 12,383mn.

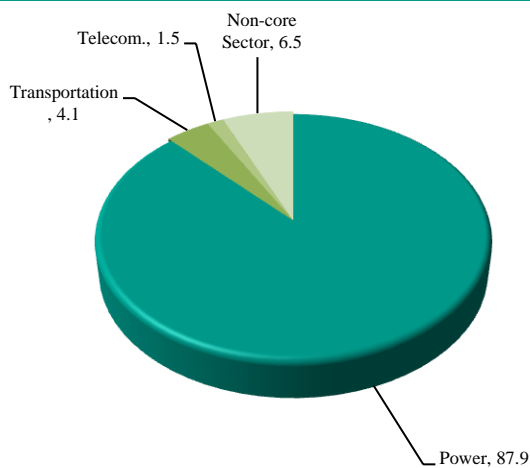
Insights from such changes in the use of proceeds:

- 1) Six new projects with a total contract value of US\$ 2,859mn were added, hinting a stronger backlog increment in 2013 and 2014. We expect the Group's new contracts to increase in 2H13 given that the Group managed to change the use of proceeds.
- 2) Among the 17 projects, 14 of them are in the power sector. It shows that the Group will focus on power facility construction in the next few years. We expect that gross profit margin (GPM) to maintain at a stable level at 17-18% in the next three years (FY13-15), because of the higher GPM of power projects. The GPM of power projects was 24.27% in FY12, while the transportation, tele- communication and non-core sectors have a GPM of 6.49%, 8.86% and 15.13%, respectively, for the same period.

Based on the plan described in its prospectus, we estimate that the total value of new contract turning effective in FY13 will be US\$ 3,321mn, down 23.92% YoY.

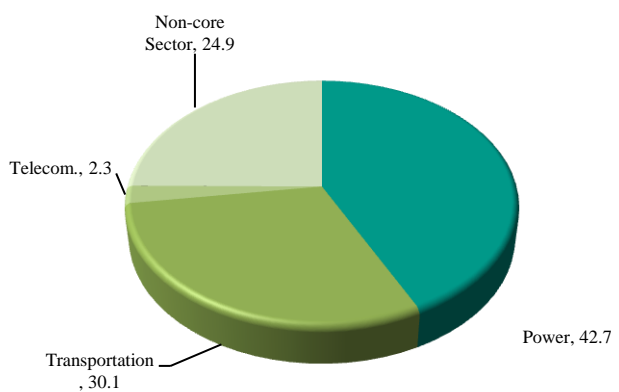
Our estimation of new effective contract of US\$ 3,321mn in FY13 excludes the transportation infrastructure project in South America with a contract amount approximated at US\$ 2,500mn.

Exhibit 3: Breakdown of backlog as at end-2012 (%)



Source: Company

Exhibit 4: Breakdown of signed contracts pending to turn effective as at end-2012 (%)



Source: Company

Lifting of Sanctions from US Government

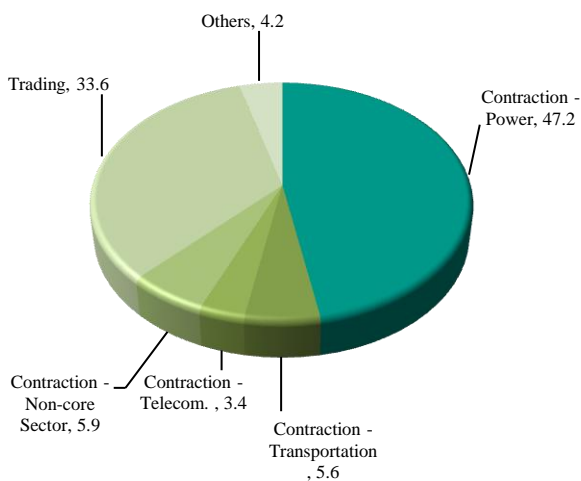
The US Government lifted the Chemical and Biological Weapons (CBW) Proliferation Sanctions against the Group. We believe this would help the Group enter the US market. Indeed, CMEC announced on July 11 that General Electric International had entered into the Memorandum of Understanding in relation to the strategic cooperation with CMEC. The two will explore the commercial cooperation in the area of power generation equipment.

We also expect the pool of potential investors will enlarge, as the Group is likely to be removed from the restriction list of certain US funds after the lifting of sanctions. Thus, we believe a higher valuation premium should be granted to CMEC for the lower liquidity risk of its equity in the stock market.

More Exposure to Non-core Sector

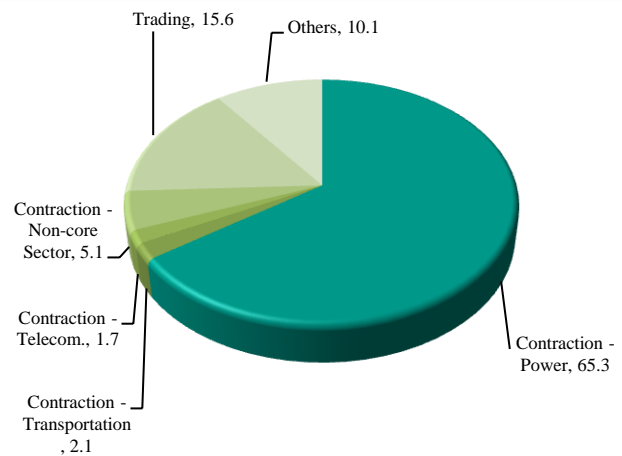
Based on the series of voluntary announcement on material projects in which the Group has newly signed or turned effective in 7M13, four out of the five projects are in the non-core sector (infrastructure construction that are not in the power facility, transportation or telecommunication sector).

Exhibit 5: Revenue breakdown in FY12 (%)



Source: Company

Exhibit 6: Gross profit breakdown in FY12 (%)



Source: Company

The total contract value of the four non-core sector projects was US\$ 728.8mn, 51.12% of the total value of the material projects announced. It reflects the Group's intention to expand beyond the power facility construction sector and make headways into other construction markets. In our view, although it can help diversify income sources in the long run, the lack of experience in developing non-core sector projects entail a higher risk of cost overrun.

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Besides, the Chinese competitors with expertise in CMEC's non-core sector, such as CAMC (002051 CH) that specializes in agricultural construction, and CCCC (1800 HK) in transportation construction, would pose challenges for CMEC upon its entrance into these markets. In order to compete with the existing players, CMEC may lower the tender cost, which in turn would drag down the overall GPM of the Group.

Increased exposure to non-core sector is one of the largest risks for the Group, and we expect the market will monitor GPM changes in the future.

Exhibit 7: List of new project intake and turning effective during 1H13

Date of announcement	Date of Contract Signed	Segment	Countries	Date of Commencement	Detail of the Project	Construction Duration (month)	Contract Value (US\$ mn)
April 4, 2013	April 12, 2013	Power	Mongolia		A heat only boiler plant and the supporting system (including three 116MW circulated fluidized bed boilers), a wagon tipper and coal transport system on the premises, an external thermal line network of approximately 910 meters, expansion of a 110KV transformer substation and 110/10KV double circuit electricity lines.	18	75.90
April 24, 2013	April 24, 2013	Non-Core	Republic of South Sudan		Design and construction of the health care centers and supply, installation and commissioning of medical apparatus and instruments supply, etc.	24	215.00
Mar 6, 2013	May 16, 2013	Non-Core	Sri Lanka		National Water Supply & Drainage Board of Sri Lanka	36	229.50
May 31, 2013	2012	Non-Core	Bangladesh	2013-May	Phase II Project of Bangladesh National Infrastructure Network. To extend the coverage of the government backbone data network and to establish data centers.	14	140.27 ¹
June 28, 2013	2010	Non-Core	Zimbabwe	2013-June	Development and rehabilitation of municipal water and sewage treatment works, restructuring of existing water plants, sewage plants and relevant clean water pumping stations and sewage pumping stations, and provision of relevant equipment as necessary.	36	144.00
July 11, 2013	July 11, 2013	Power	Nigeria		Construction of a 500MW single-cycle power station. The Group, as the EPC contractor, will provide design, supply, construction, installation, commissioning, training and warranty services in a turnkey form.	31	420.00
July 11, 2013	July 11, 2013	Power	Nigeria		Construction of a 120MW combined-cycle power station, heavy oil storage tanks and grid network update inside Bauchi Town. The Company, as the EPC contractor, will provide design, supply, construction, installation, commissioning, training and warranty services in a turnkey form.	33	201.00
						Total	1,425.67

¹ The contract value is RMB 860mn

Source: Company



Uganda Government Scouts for Chinese Companies

Government of Uganda is scouting for Chinese companies to undertake infrastructural projects in the country. We believe the intention has been strongly suggested by Amama Mbabazi, the prime minister of Uganda, who said, “Our government is concentrating on a few priorities due to insufficient funding and China is to fund a number of these.” in a meeting with officials of CMEC in Beijing during his one-week visit to China in July. The meeting at the CMEC headquarters was also attended by State Minister Charles Bakabulindi, Senior Presidential Advisor Jacqueline Mbabazi, Uganda’s Ambassador to China, Charles Madibo Wagidoso and the Commissioner for Patriotism Clubs in the Office of the President, Lt Col Henry Masiko.

Planned medium-term projects in Uganda include four hydro-electric power stations such as the 600MW Ayago and 140MW Isimba stations along the Nile River. Another 21 roads across the country have been earmarked for upgrading to bitumen standard. Li Chaoyang, CMEC’s vice president and senior engineer, expressed the Group’s interest to undertake projects in infrastructure, telecommunications, agriculture and health using Chinese technology.

Our insight

To our knowledge, the Group has not had any exposure in Uganda. Without secure funding, the contract will not turn effective should CMEC decide to undertake the projects.

In order to tighten the relationship with Uganda for stable oil and gas supply to China (similar case for Angola), it is generally expected that the Chinese government would finance the project indirectly through granting the project loans via the Chinese banks and/or export insurers. Therefore insufficient funding from the Uganda government would not be the largest risk for CMEC.

Nonetheless, with the Chinese government reinforcing the country’s “Going Out” policy, we expect news about overseas construction undertaken by the Chinese enterprises will increase in the near term. We also expect growth of new overseas projects by CMEC to accelerate as well.

In March, the Chinese President Xi Jinping said China will offer US\$ 20bn in loans to Africa for the next three years in a bid to achieve cooperation in the infrastructure development and manufacturing industries. In addition, China will also help African counties utilize their resource advantages for independent and sustainable economic development. Later in July, President Xi agreed to grant Nigeria a US\$ 1.1bn low-interest loan to build the much-needed infrastructure in the region. We believe China’s strengthened relationship with Africa will help the former secure oil supplies, as well as facilitate overseas project development by Chinese enterprises going forward.



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As of Dec 2012, CMEC's engineering contracting projects were undertaken in more than 46 countries over the world, primarily in Africa. The following map indicates the locations of CMEC's engineering contracting projects from 2009-12.

Exhibit 8: Business network of the Group



Source: Company

Exhibit 9: Geographic breakdown on revenue of the Group

	FY09 (RMB mn)	(%)	FY10 (RMB mn)	(%)	FY11 (RMB mn)	(%)	FY12 (RMB mn)	(%)
China (Mainland)	1,984	10.29	2,407	12.62	4,010	19.54	2,403	11.28
Venezuela	3	0.02	3	0.02	34	0.17	2208	10.37
Angola	1,746	9.05	1,717	9.00	850	4.14	2,082	9.78
Belarus	-	-	-	-	442	2.15	1900	8.92
Sri Lanka	1,893	9.81	1,041	5.46	2,184	10.64	1418	6.66
Equatorial Guinea	1,912	9.91	1,886	9.89	1,919	9.35	1,269	5.96
Turkey	2,978	15.44	2,438	12.78	939	4.58	1093	5.13
United States	840	4.36	907	4.75	1,257	6.13	1076	5.05
The Republic of Congo	2,031	10.53	1,932	10.13	1,575	7.68	670	3.15
Nigeria	7	0.04	554	2.90	1,339	6.53	453	2.13
Others	5,894	30.56	6,192	32.46	5,969	29.09	6,724	31.57
Total revenue	19,288	100.00	19,077	100.00	20,518	100.00	21,296	100.00

Source: Company

More projects to be undertaken - Maintain BUY on CMEC

We believe the share price weakness since 2Q13 has been the result of the flat profit growth in 1H13 and concerns pertaining to the new order intake. The market was disappointed by the lower-than-expected increases in new orders in 1H13 despite the Group's strengthened capital position since its IPO in 4Q12. However, with the "Going Out" policy of China, we expect more overseas projects will commence among the developing countries. We expect the Group will enter into new contracts in 2H13.

With the ongoing development pipeline and our estimates of new contract turning effective in the near future, we expect delivery of construction project will peak in FY15.

Although we lower our net income forecast for FY14E by 8.49% with the expected slowdown in new contract turning effective in 1H13, we expect the uptake of new contract will resume in 2H13. Therefore, we maintain our target price at HK\$6.57.

The total cash on hand as of end-2012 was RMB 19,008mn, while total debt was RMB289mn. The net cash was RMB 18,719mn, which provided the Group with sufficient working capital to take in more projects going forward. The stock is trading at 1.19x of FY13E BVPS. Considering its FY13E ROAE of 18.74% and FY14E ROAE of 20.53%, the current valuation is deemed attractive. We reiterate our **BUY** rating on CMEC.

Exhibit 10: Major change in our forecasts

	FY13E			FY14E			FY15E		
	Previous	New	Diff (%)	Previous	New	Chg (%)	Previous	New	Chg (%)
Revenue (RMB mn)	23,163	23,163	(0.00)	29,466	26,898	(8.72)	35,828	35,367	(1.29)
International engineering contracting	15,027	15,027	(0.00)	20,550	17,982	(12.50)	26,089	25,627	(1.77)
Trading	7,159	7,159	0.00	7,861	7,861	(0.00)	8,631	8,631	0.00
Other	977	977	(0.02)	1,055	1,055	(0.01)	1,108	1,108	(0.03)
Gross profit (RMB mn)	4,030	4,030	0.00	5,343	4,787	(10.40)	6,554	6,433	(1.84)
GPM (%)	17.40	17.40	0.00ppts	18.13	17.80	-0.33ppts	18.29	18.19	-0.10ppts
Net income (RMB mn)	2,052	2,018	(1.68)	2,815	2,576	(8.49)	3,374	3,357	(0.52)
Net margin (%)	8.86	8.71	-0.15ppts	9.55	9.58	0.02ppts	9.42	9.49	0.08ppts
EPS (RMB)	0.497	0.489	(1.61)	0.682	0.624	(8.49)	0.818	0.814	(0.52)
BVPS (RMB)	2.823	2.815	(0.30)	3.331	3.268	(1.90)	3.910	3.863	(1.21)
DPS (RMB)	0.174	0.171	(1.61)	0.239	0.219	(8.53)	0.286	0.285	(0.38)

Source: ABCI Securities estimates



Exhibit 11: Peer group valuation and earnings forecasts summary of construction contractors (July 15, 2013)

Company	Ticker	MKT CAP ¹ (HK\$ mn)	Share Price	PER (x)		EPS Change (%)		PBR (x)		ROAE (%)		
				FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	
Transportation Project Contractor												
VINCI SA	DG FP	239,647	EUR	39.58	11.27	10.88	-1.62	3.59	1.56	1.46	13.94	13.39
CHINA COM CONS-H	1800 HK	25,107	HKD	5.67	5.40	4.86	9.48	11.27	0.76	0.69	14.56	14.22
CHINA COMMUNIC-A	601800 CH	60,135	RMB	4.05	4.88	4.44	7.79	10.00	0.67	0.60	14.44	14.17
CHINA RAIL CN-H	1186 HK	14,511	HKD	6.99	7.35	6.76	10.72	8.64	0.86	0.79	12.30	11.91
CHINA RAILWAY-A	601186 CH	58,888	RMB	4.54	6.02	5.52	9.28	9.02	0.71	0.63	12.37	11.76
CHINA RAIL GR-H ²	390 HK	15,566	HKD	3.70	7.27	6.45	18.45	12.73	0.74	0.67	10.62	10.90
CHINA RAILWAY-A ²	601390 CH	55,095	RMB	2.55	6.24	5.53	18.45	12.73	0.63	0.58	10.62	10.90
BOUYGUES SA	EN FP	66,070	EUR	20.47	8.69	7.94	17.43	9.51	0.73	0.71	8.71	9.23
SKANSKA AB-B	SKAB SS	57,178	SEK	117.20	13.89	12.95	21.95	7.23	2.38	2.26	18.49	19.58
HOCHTIEF AG	HOT GR	42,268	EUR	54.28	17.39	13.99	45.21	24.28	1.31	1.24	8.86	10.55
OBRASCON HUARTE	OHL SM	28,389	EUR	28.15	9.05	8.00	-69.15	13.15	1.23	1.11	13.95	14.21
STRABAG SE-BR	STR AV	18,694	EUR	16.22	15.53	12.78	80.00	21.55	0.57	0.56	3.68	4.37
FCC	FCC SM	11,587	EUR	9.00	25.35	11.28	-104.00	124.79	0.87	0.78	4.19	7.31
Sector Weighted Average					10.09	9.06	7.17	10.95	1.20	1.12	12.63	12.69
Building Project Contractor												
CHINA STATE -A	601668 CH	126,276	RMB	3.33	5.45	4.73	17.50	15.22	0.85	0.73	17.04	17.61
CHINA STATE CONS	3311 HK	48,143	HKD	12.38	17.61	13.89	22.64	26.74	3.10	2.70	18.73	20.34
LEND LEASE GROUP	LLC AU	37,207	AUD	9.16	9.71	9.57	1.73	1.48	1.33	1.25	14.04	13.72
BAM GROEP	BAMNB NA	10,294	EUR	4.15	11.89	10.86	-144.18	9.46	1.13	1.04	12.86	21.39
FAR EAST GLOBAL	830 HK	5,173	HKD	2.40	40.00	24.00	-187.59	66.67	4.36	3.87	11.74	16.73
YUANDA CHINA HLD	2789 HK	3,229	HKD	0.52	6.96	4.80	-14.29	45.00	0.57	0.59	8.22	11.18
Sector Weighted Average					9.77	8.14	3.75	16.73	1.48	1.31	16.48	17.61
Power Project Contractor												
ACS	ACS SM	63,151	EUR	19.85	8.53	7.85	-135.20	8.64	1.95	1.75	25.23	24.12
SHANGHAI ELECT-H	2727 HK	49,940	HKD	2.60	8.42	7.82	17.15	7.66	0.80	0.74	8.88	8.10
JACOBS ENGIN GRP	JEC US	58,613	USD	57.76	17.53	15.48	10.94	13.26	1.80	1.60	10.92	11.13
HYUNDAI ENG&CONS	000720 KS	44,115	KRW	57400	10.22	7.63	80.26	33.98	1.26	1.12	13.85	14.66
SINOHYDRO GROU-A	601669 CH	33,734	RMB	2.78	5.58	4.74	16.76	17.67	0.50	0.48	15.35	16.41
WORLEYPARSONS	WOR AU	36,868	AUD	21.48	15.89	14.48	-5.92	9.69	2.54	2.42	16.38	16.98
DONGFANG ELECT-H	1072 HK	25,806	HKD	10.64	7.44	7.10	5.41	4.70	0.96	0.85	13.38	12.06
CHINA MACHINER-H²	1829 HK	17,245	HKD	4.18	6.87	5.38	4.67	27.69	1.19	1.03	18.74	20.53
CHINA CAMC -A	002051 CH	23,028	RMB	28.59	21.91	16.82	17.57	30.27	3.63	3.08	18.59	21.22
ABENGOA	ABG SM	9,153	EUR	1.88	10.65	7.38	-23.48	44.32	0.71	0.68	6.07	5.96
HARBIN ELECTRIC	1133 HK	6,884	HKD	5.00	4.86	4.74	-19.16	2.42	0.43	0.40	8.85	8.06
Sector Weighted Average					11.28	9.73	-7.80	15.94	1.55	1.40	15.26	15.38
Municipal, Civil and Water Engineering Project Contractor												
FERROVIAL SA	FER SM	95,062	EUR	12.82	31.96	29.46	-58.57	8.48	1.68	1.71	4.52	6.23
SNC-LAVALIN GRP	SNC CN	49,972	CAD	44.30	27.83	21.29	-22.34	30.72	3.09	3.03	12.46	13.09
DAEWOO ENG & CON	047040 KS	20,223	KRW	7050	10.68	7.67	70.17	39.30	0.81	0.75	7.80	10.54
CHINA GEZHOUBA-A	600068 CH	17,589	RMB	3.99	8.31	7.53	7.14	10.42	0.99	0.90	12.95	13.08
IMPREGILO	IPG IM	12,479	EUR	3.01	12.56	11.59	-83.89	8.33	0.94	0.98	3.04	4.89
Sector Weighted Average					25.33	22.00	-31.67	17.52	1.84	1.83	7.55	8.96
Weighted Average					12.33	10.78	-2.17	13.94	1.41	1.31	13.21	13.63
Median					9.71	7.85	7.79	12.73	0.96	0.90	12.46	13.08

1: The market capital value of the companies are translated into HKD;

2: ABCI Securities estimates;

Sources: Bloomberg, ABCI Securities estimates

**農銀國際**

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

China Machinery Engineering Corporation**Consolidated income statement (FY11A-FY15E)**

FY Ended Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
Revenue	20,518	21,296	23,163	26,898	35,367
International engineering contracting	12,055	13,245	15,027	17,982	25,627
Trading	7,689	7,163	7,159	7,861	8,631
Other	774	888	977	1,055	1,108
COGS	(16,859)	(17,564)	(19,133)	(22,110)	(28,933)
Gross profit	3,659	3,732	4,030	4,787	6,433
SG&A	(1,385)	(1,565)	(1,749)	(2,057)	(2,708)
Other income and gains	(287)	449	446	752	813
Pre-tax profit	1,987	2,616	2,727	3,482	4,538
Income tax	(515)	(688)	(709)	(905)	(1,180)
Net profit	1,472	1,928	2,018	2,577	3,358
Profit attributable to:					
Minority interests	(3)	0	1	1	1
Equity shareholders of the Company	1,475	1,928	2,018	2,576	3,357
Basic EPS (RMB)	0.447	0.467	0.489	0.624	0.814
DPS (RMB)	0.043	0.164	0.171	0.219	0.285

*Sources: Company, ABCI Securities estimates***Consolidated balance sheet (FY11A-FY15E)**

As of Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
Current assets	19,331	27,936	29,115	35,565	38,104
Cash and equivalent	9,516	19,008	20,146	26,264	26,333
Trade and bill receivables	3,381	3,052	3,706	4,018	6,138
Construction contracts	3,176	3,191	2,036	1,981	1,576
Inventories	212	226	522	326	783
Other current assets	3,046	2,459	2,705	2,975	3,273
Non-current assets	7,277	6,834	6,520	7,687	8,396
Property, plant and equipment	392	444	856	1,248	1,627
Lease prepayment	1,630	1,827	1,792	1,757	1,723
Intangible assets	5	8	6	5	5
Trade and other receivables	107	39	183	199	303
Construction contracts	4,774	4,114	2,488	2,972	2,928
Other non-current assets	369	402	1,194	1,506	1,811
Total assets	26,608	34,770	35,635	43,252	46,500
Current liabilities	20,497	24,271	23,069	28,637	28,994
Trade and bill payables	8,320	9,596	6,895	10,406	10,481
Receipts in advance	10,316	12,710	14,799	16,350	16,972
Short term borrowings	160	134	90	90	90
Other current liabilities	1,701	1,831	1,285	1,791	1,451
Non-current liabilities	737	582	959	1,138	1,572
Long-term payables	131	61	393	576	1,009
Long-term borrowings	226	155	105	55	5
Other non-current liabilities	381	366	461	507	558
Total liabilities	21,234	24,853	24,028	29,775	30,566
Minority interests	(6)	(3)	(3)	(2)	(1)
Shareholders' equities	5,380	9,920	11,609	13,479	15,935

Sources: Company, ABCI Securities estimates

**農銀國際**

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

China Machinery Engineering Corporation**Consolidated cash flow statement (FY11A-FY15E)**

FY ended Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
Profit before tax	1,987	2,616	2,727	3,482	4,538
Change in depreciation and amortization	72	99	113	136	153
Change in working capital	1,434	(20,939)	(23,936)	(20,486)	(14,882)
Net financial cost (income)	(174)	1,444	1,012	871	861
Income tax paid	(683)	(3,705)	(3,858)	(4,344)	(4,872)
Interest received	195	3,308	5,448	5,834	6,113
Others	192	24,421	20,220	21,633	8,641
CF Operating	3,023	7,244	1,726	7,127	552
Increase in PP&E	(51)	(84)	(486)	(490)	(494)
Increase in intangible assets	(1,001)	(237)	(0)	(0)	(0)
Others	324	(2,548)	353	246	970
CF Investing	(728)	(2,869)	(134)	(244)	475
Capital injection	20	610	-	-	-
Net debt financing	(1,450)	(97)	(94)	(50)	(50)
Dividend payout	(698)	(354)	(675)	(706)	(902)
Interest paid	(20)	(11)	(140)	(10)	(7)
Others	18	2,401	455	1	1
CF Financing	(2,130)	2,549	(454)	(766)	(958)
Net change in cash	165	6,924	1,138	6,118	69
Cash at the beginning	9,623	9,516	19,008	20,146	26,264
Adjustment (Time deposit & FX effect)	(272)	2,568	-	-	-
Cash at the end	9,516	19,008	20,146	26,264	26,333

Sources: Company, ABCI Securities estimates

**農銀國際**

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

China Machinery Engineering Corporation**Key Ratio (FY11A-FY15E)**

FY ended Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
Sales mixed (%)					
International engineering contracting	58.75	62.19	64.87	66.85	72.46
Trading	37.47	33.64	30.91	29.23	24.41
Other	3.77	4.17	4.22	3.92	3.13
Total	100.00	100.00	100.00	100.00	100.00
Profit & loss ratios (%)					
Gross margin	17.83	17.52	17.40	17.80	18.19
Operating profit margin	10.45	9.69	8.92	9.46	9.81
Pre-tax margin	9.69	12.28	11.77	12.95	12.83
Net profit margin	7.19	9.05	8.71	9.58	9.49
Selling & marketing expenses/revenue	4.77	5.10	5.36	5.44	5.51
Administrative expenses / revenue	1.98	2.24	2.19	2.20	2.15
Effective tax rate	25.91	26.30	26.00	26.00	26.00
Growth (%)					
Revenue	7.55	3.79	8.77	16.12	31.48
Gross profit	24.36	1.99	7.99	18.79	34.39
Profit from operations	39.69	(3.81)	0.19	23.09	36.42
Net profit	29.78	30.69	4.67	27.69	30.32
Balance sheet ratios					
Current ratio (x)	0.94	1.15	1.26	1.24	1.31
Quick ratio (x)	0.93	1.14	1.24	1.23	1.29
Cash ratio (x)	0.46	0.78	0.87	0.92	0.91
Trade and bill receivables days	51.00	56.38	55.00	55.00	55.00
Trade and bill payables turnover days	175.08	186.15	157.30	142.80	131.75
Inventory turnover days	4.19	4.55	7.13	7.00	7.00
Total debt / equity ratio (%)	7.18	2.91	1.68	1.08	0.60
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROAA	5.70	6.30	5.70	6.50	7.50
ROAE	31.58	25.18	18.74	20.53	22.83
Payout ratio	9.59	35.01	35.00	35.00	35.00

Sources: Company, ABCI Securities estimates

Area of Concern

New effective contract growth slowing down

The growth on new effective contract of CMEC was expected to drop by 53.68% YoY, while the overall new contract value in overseas by Chinese enterprises, was US\$ 56,520mn in 5M2013, up 28.9%.

We believe the lower-than-expected new contract growth is the major concern of the market over CMEC. The stock has retreated by 29.03% in three months. Looking forward, we expect new contract growth to improve in 2H13.

Foreign exchange loss

The total foreign exchange (FX) exposure was RMB 9,618mn as at end-2012. We expect an exchange loss of RMB 267.87mn for 1H13.

Exhibit 12: Assets and liabilities of CMEC in foreign currencies (translated into RMB) at end-2012

	USD (RMB mn)	EUR (RMB mn)	Others (RMB mn)
Cash and cash equivalents	1,800	237	3,194
Trade and other receivables	1,807	307	1
Construction contracts	6,658	76	104
Borrowings	(223)	(12)	0
Trade and other payables	(2,240)	(135)	(46)
Gross exposure arising from recognized assets and liabilities	7,803	473	3,252
Notional amounts of foreign currency forward exchange contracts	(1,909)		
Net exposure arising from recognized assets and liabilities	5,893	473	3,252

Source: Company

Exhibit 13: Sensitivity analysis on change in profit after tax of foreign rate based on assets and liability at end 2012

	Increase / (decrease) in foreign exchange rate (%)	Increase / (decrease) in profit after tax (RMB mn)
USD	5	221
USD	(5)	(221)
EUR	10	35
EUR	(10)	(35)
Others	5	122
Others	(5)	(122)

Source: Company

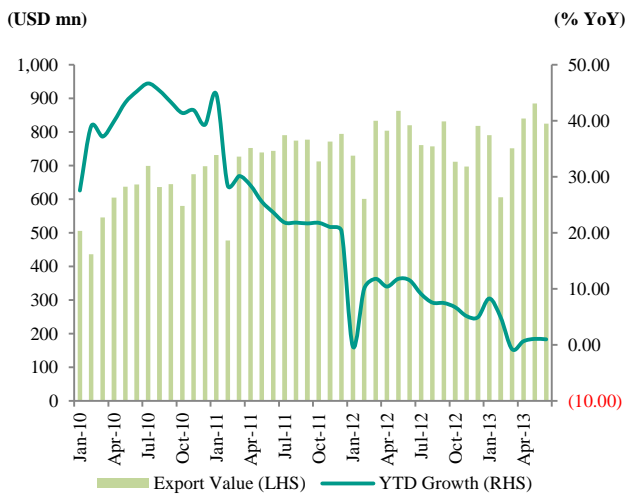


Potential squeeze in profit margin of trading business

The profit margin of trading business of the Group may narrow under the weak export environment of China. The growth on export value (in terms of USD) of the engine and power generation equipment decelerated to 1.0% in 1H13, and the growth of export volume (in terms of unit) declined to -1.3% in 1H13. The weakening export trading of power generation equipment may squeeze the GPM of the trading business of the Group.

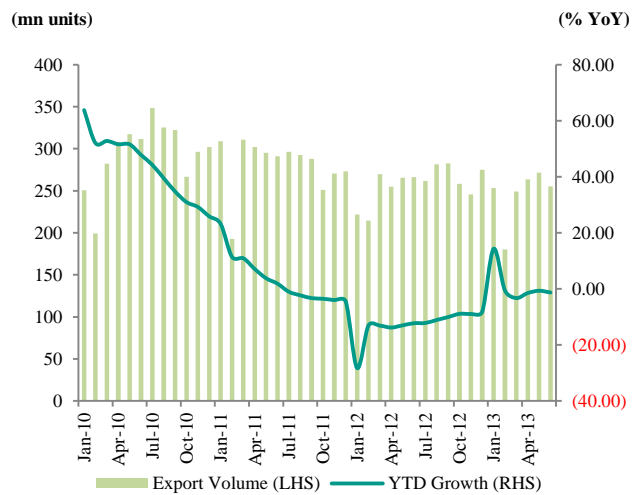
Trading business contributed 33.64% of revenue and 15.59% of gross profit in FY12. The GPM of trading business was 8.13% in FY12. We expect it to reduce to 7.96% in FY13.

Exhibit 14: Export value of engine and power generation equipment, 1M10 – 1H13



Source: China Customs Statistics

Exhibit 15: Export volume of engine and power generation equipment, 1M10 – 1H13



Source: China Customs Statistics



Appendix I - Competitiveness of the Group among peers

With CMEC's long history in the construction of power facilities in developing countries, the Group has a better risk control on the engineering and construction projects.

According to the Ministry of Commerce in China, the Group was ranked seventh in terms total turnover of contracted projects overseas in 2012 and ninth in terms of total value of newly-signed contracts in 2012.

Exhibit 16: Top 10 Chinese Enterprises in Contracted Projects Overseas in 2012

Rank	Total turnover of contracted projects overseas	Total value of newly-signed contracts
1	华为技术有限公司 <i>Huawei Technologies Co., Ltd.</i>	华为技术有限公司 <i>Huawei Technologies Co., Ltd.</i>
2	中国水利水电建设股份有限公司 <i>Sinohydro Group Ltd (601669 CH)</i>	中国水利水电建设股份有限公司 <i>Sinohydro Group Ltd (601669 CH)</i>
3	中国建筑工程总公司 <i>China State Construction Engineering Corporation (Note 1)</i>	中国建筑工程总公司 <i>China State Construction Engineering Corporation (Note 1)</i>
4	中兴通讯股份有限公司 <i>ZTE Corporation (763 HK)</i>	中信建设有限责任公司 <i>CITIC Construction Co., Ltd.</i>
5	中国港湾工程有限责任公司 <i>China Harbour Engineering Co., Ltd. (Note 2)</i>	中国葛洲坝集团股份有限公司 <i>China Gezhouba Group Co., Ltd. (600068 CH)</i>
6	中信建设有限责任公司 <i>CITIC Construction Co., Ltd.</i>	中国港湾工程有限责任公司 <i>China Harbour Engineering Co., Ltd. (Note 2)</i>
7	中国机械设备工程股份有限公司 The Group	中兴通讯股份有限公司 <i>ZTE Corporation (763 HK)</i>
8	山东电力基本建设总公司 <i>Shandong Electric Power Construction Corporation</i>	中国土木工程集团有限公司 <i>China Civil Engineering Construction Corporation (Note 3)</i>
9	中国葛洲坝集团股份有限公司 <i>China Gezhouba Group Co., Ltd. (600068 CH)</i>	中国机械设备工程股份有限公司 The Group
10	中国路桥工程有限责任公司 <i>China Road and Bridge Corporation (Note 2)</i>	中铁国际经济合作有限公司 <i>China Railway Int'l Economic Cooperation Co., Ltd. (Note 4)</i>

Note 1: Parent group of China State Construction Engineering Corp Ltd (601668 CH) and China State Construction International Holdings Ltd (3311 HK);

Note 2: Subsidiaries of China Communications Construction Co Ltd (1800 HK; 601800 CH)

Note 3: A subsidiary of China Railway Construction Corp Ltd (1186 HK; 601186 CH)

Note 4: A subsidiary of China Railway Group Ltd (390 HK; 601390 CH)

Sources: Ministry of Commerce, ABCI Securities

Except Huawei Technologies and ZTE Corp, in which the business focus is on the telecom industry, the other among the top ten domestic contractors are engaged in overseas infrastructure projects in various sectors such as power, roadways, railways, ports, etc. Aside from these sizeable enterprises, numerous domestic contractors of smaller scale will also compete with the Group in securing overseas infrastructure construction projects.

Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ 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	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 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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