



# Company Report

## CMEC (1829 HK)

April 5, 2013

### Rating: Buy

TP: HK\$6.57

#### Key data

H-Share price (HK\$)	5.65
Upside potential (%)	16.3
52Wk H/L(HK\$)	7.61/5.34
Issued shares (mn)	4,125
H-share	908
Domestic share	3,217
H-Market cap (HK\$mn)	5,966
30-day avg daily vol (HK\$mn)	69.91
Auditors	KPMG
Major shareholder (%)	
SINOMACH	77.99

Source: Company & Bloomberg

#### Revenue breakdown by product (%)

Int'l engineering contracting	62.19
Trading	33.64
Others	4.17

\*Based on FY2012 results

Source: Company

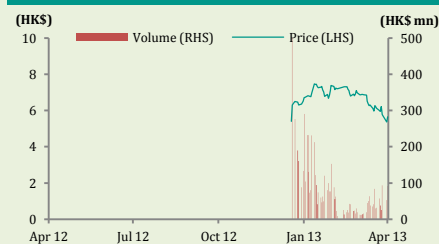
#### Share performance (%)

	Absolute	Relative <sup>1</sup>
1-mth	-17.76	-16.94
3-mth	-16.05	-12.31
6-mth	N/A	N/A

<sup>1</sup>: Relative to Hang Seng Index

Source: Bloomberg

#### 1 year price performance



Source: Bloomberg

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Previous report

Date: February 5, 2013

Rating: Buy

Target price: HK\$8.21

### Expecting robust growth in FY2014/15

Huge backlog with 2.4x of our estimated FY2013 revenue from int'l engineering construction (IEC) contract business, is the major earnings growth driver of CMEC for the following years. The high margin power projects newly signed in 2012 is expected to take meaningful delivery in FY2014-15. We believe GPM will improve gradually. In view of its growth momentum in FY2014/15 and relatively high profitability against its comparable Chinese peers, we set TP at HK\$6.57 (or est. FY2014 PER 7.7x). Maintain "Buy"

**Huge backlog backing revenue growth.** The signed and effective new contracts are boosting up the order book of the Group. The amount of backlog was USD7,058mn (~Rmb43,760mn) as of end 2012, which is equal to 3.3x of total revenue of IEC contract business in FY2012 or 2.4x of our estimated revenue of IEC contract business in FY2013.

**Expecting GPM to rebound in FY2014.** Its gross profit margin was dropping from 20.7% in 2HFY2011 to 16.7% in 2HFY2012, due to decline of GPM of ongoing IEC projects. The ongoing projects which have commenced before 2012 will continue to contribute a significant portion of total gross profit in FY2013. The newly effective contracts in FY2012 (which are expected to have GPM at 24% in average) will start to have meaningful contribution in FY2014-15. We expect GPM of IEC business to stabilize in FY2013 and rebound gradually in FY2014-15.

**Value stock for mid-to-long run.** As robust growth is expected in FY2014-15, investors should prepare a bit longer investment horizon. Its FY2012 ROAE of 25.18% is higher than its comparable Chinese peers (9.1-18.5%). The counter is trading at 9.12x FY2013E PER vs H-share peer avg. 9.21x and A-share peer avg. 6.92x. Its strong balance sheet position and promised min. payout of 35% provide est. gross yield of 3.61%/3.84% for FY2012/2013 respectively.

**Risk factors:** Delivery of IEC contracts business; GPM contraction; Un-proportional increase in operating expenses; Exchange rate risk; Geo-political risk

#### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue (Rmb mn)	19,077	20,518	21,296	23,163	29,466	35,828
Chg (%YoY)	-1.09	7.55	3.79	8.77	27.21	21.59
Net Income (Rmb mn)	1,136	1,475	1,928	2,052	2,815	3,374
Chg (%YoY)	85.21	29.78	30.69	6.46	37.16	19.87
EPS (Rmb)	0.344	0.447	0.467	0.497	0.682	0.818
Chg (%YoY)	85.21	29.78	4.53	6.46	37.16	19.87
PER (x)	-	-	9.71	9.12	6.65	5.55
NBV (Rmb)	1.199	1.632	2.405	2.823	3.331	3.910
PBR (x)	-	-	1.89	1.61	1.36	1.16
DPS (Rmb)	0.040	0.043	0.164	0.174	0.239	0.286
Yield (%)	-	-	3.61	3.84	5.26	6.31
ROAA (%)	5.00	5.70	6.30	5.80	7.00	7.60
ROAE (%)	32.59	31.58	25.18	19.03	22.17	22.59
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company, ABCI Securities estimates



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### Investment Themes

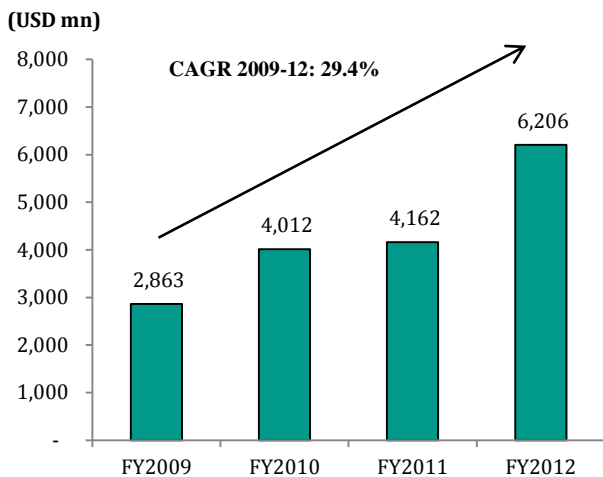
### Strong backlog backing revenue growth in FY13-14

Revenue of the Group grew by 3.8% YoY from Rmb20,518mn in FY2011 to Rmb21,296mn in FY2012, of which, the international engineering construction contract business revenue of the Group increased by 9.9% YoY from Rmb12,055mn in FY2011 to Rmb13,245mn in FY2012.

Looking forward, as the strong backlog of the Group, which increased by 33.5% YoY from USD5,285mn (~Rmb32,767mn) as at end 2011 to USD7,058mn (~Rmb43,760mn) as at end 2012, a strong growth is expected for the following years.

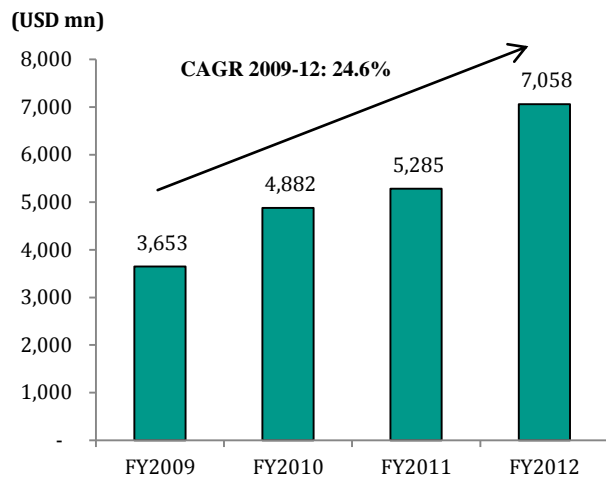
For the power-related infrastructure construction contract business of the Group, which is the major source of income for the Group (accounted for 47.2% of total revenue and 65.3% of total gross profit in FY2012), the total backlog for the sector increased by 49.1% YoY from USD4,162mn (~Rmb25,804mn) as at end 2011 to USD6,206mn (~Rmb38,477mn) as at end 2012.

**Backlog of the power-related infrastructure construction contract business for the Group, 2009-2012**



Source: Company

**Backlog of the international engineering construction contract business for the Group, 2009-2012**



Source: Company

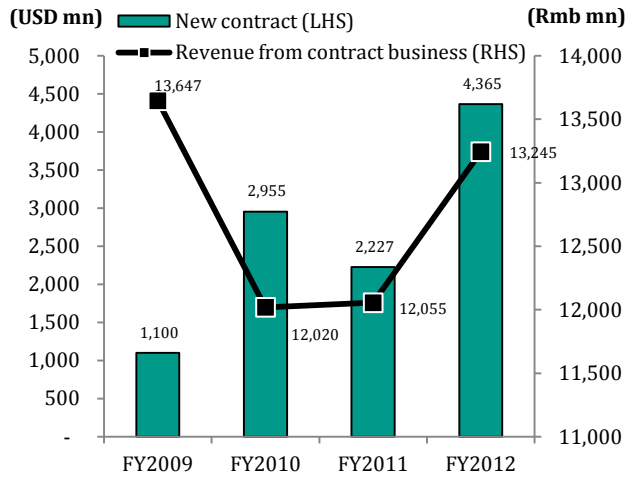
We estimate that the aggregate contract value of the signed contracts pending to be effective was USD12bn as at end 2012. With the large pool of contract of pending to be effective, the Group has secured newly effective contracts. (i.e. new contracts that became effective during a specified period)

The signed and effective new contracts are boosting up the order book of the Group. The amount of backlog was USD7,058mn (~Rmb43,760mn) as of end 2012, which is equal to 3.3x of total revenue of international engineering construction contract business in FY2012 or 2.4x of our estimated revenue of international engineering construction contract business in FY2013.

We expect that the amount of backlog will be mainly factored into the income statements in FY2013-FY2014.

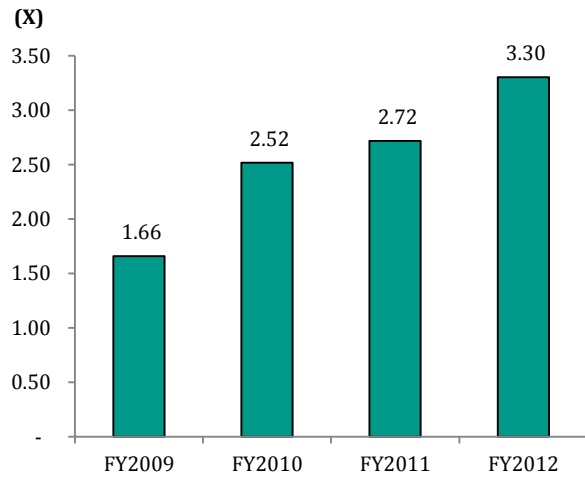


New contract value vs. total revenue from the infrastructure construction contract business, 2009-2012



Source: Company

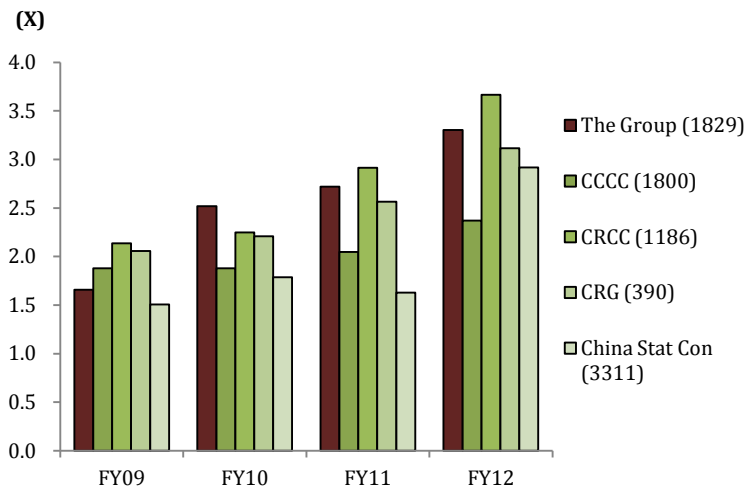
Backlog to the revenue from infrastructure construction contract business ratio, 2009-2012



Source: Company

The backlog to revenue from infrastructure construction contract business ratio of the Group was 3.3x in FY2012, against the average value of 3.0x among comparable listed peers.

Backlog to revenue from construction contract business of the construction contractors, 2009-2012



Source: Companies



### Benefit from diplomacy and foreign policy

The Group as one of the largest China’s infrastructure construction contractors (the Group was ranked seventh in terms total turnover of contracted projects overseas in 2012) is expected to be benefited from the diplomacy and foreign policy of China toward the developing countries in Africa and Asia.

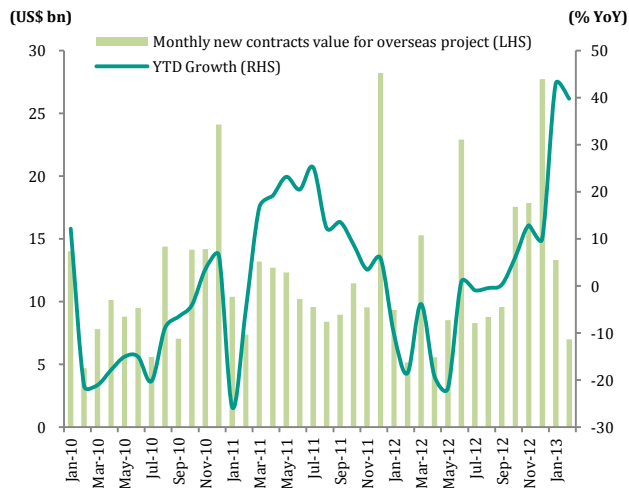
The Chinese President, XI Jinping, stated in a speech in Tanzania that China will continue to enhance cooperation with African countries in the fields of investment and financing.

Over the next three years, China will offer USD20bn worth of loans to Africa, in a bid to achieve mutual cooperation in the infrastructure development and manufacturing industries. In addition, China will also help African countries turn their resource advantage into independent and sustainable economic development.

According to Ministry of Commerce (“MOC”), the total new contract value was increasing since 4Q2012. The total new contract value in overseas market was up 39.8% YoY in 1-2M13 vs. -18.5% YoY in 1-2M12 and 10.0% YoY in full year 2012

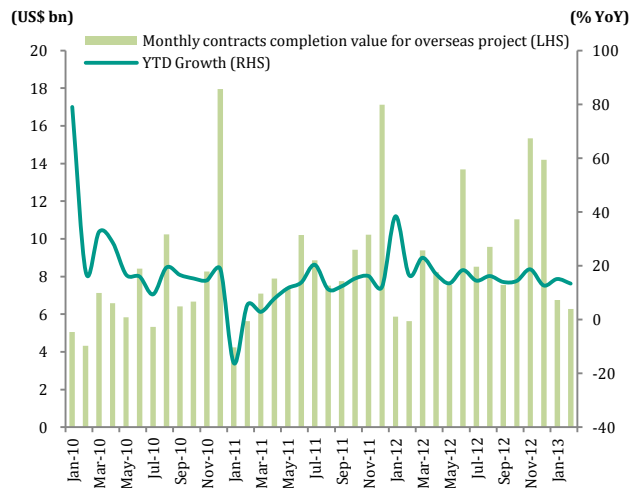
The strong growth in new contract flow is expected to translate into revenue recognition of the contractors for the following years.

Monthly new contract value of overseas project by China’s enterprises and the YTD growth, 2010-2M2013



Source: MOC

Monthly completion value of overseas project by China’s enterprises and the YTD growth, 2010-2M2013



Source: MOC

## Expecting gross profit margin of power projects to stabilize in FY13

The gross profit margin (“GPM”) of the international engineering contracting business was dropping from 28.2% in 2HFY2011 to 22.4% in 1HFY2012 and to 19.5% in 2HFY2012. The GPM of power sector international engineering contracting business was dropping from 30.3% in 2HFY2011 to 25.9% in 1HFY2012 and to 22.7% in 2HFY2012. The reason on the drop of profitability was primarily due to the completion or near completion of certain power projects with relatively higher gross profit margins in Africa and Asia in 2011. The GPM of the Group was distorted by the high margin projects in 2011.

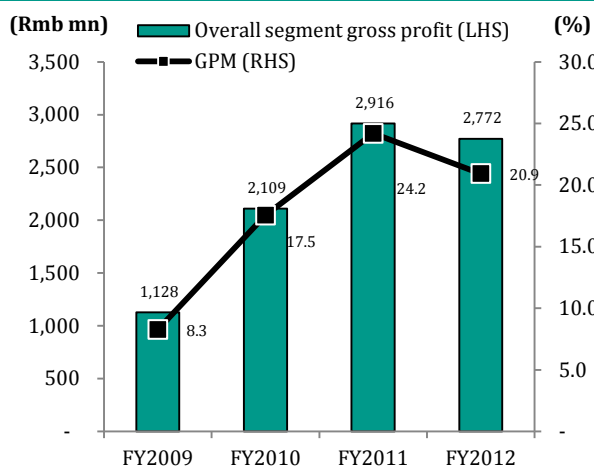
Looking forward, we expect that the gross profit margins of power projects to stabilize in range of 22-24%, and the transportation projects to stabilize in range of 7-8%

### Gross profit breakdown of the Group

	FY09 (%)	FY10 (%)	1H11 (%)	2H11 (%)	FY11 (%)	1H12 (%)	2H12 (%)	FY12 (%)
<b>Overall GPM</b>	<b>9.12</b>	<b>15.42</b>	<b>14.75</b>	<b>20.67</b>	<b>17.83</b>	<b>18.39</b>	<b>16.71</b>	<b>17.52</b>
<b>International engineering and construction contracts</b>	<b>8.26</b>	<b>17.55</b>	<b>19.43</b>	<b>28.18</b>	<b>24.18</b>	<b>22.44</b>	<b>19.51</b>	<b>20.93</b>
Power	8.06	20.67	23.52	30.27	27.21	25.88	22.65	24.27
Transportation	7.90	1.73	5.51	9.30	7.04	15.17	-0.22	6.49
Telecommunications	5.36	31.14	-	13.04	13.04	8.04	9.58	8.86
Non-core sectors	13.32	1.24	2.58	25.32	16.95	6.55	21.47	15.13
<b>Trading business</b>	<b>6.98</b>	<b>7.35</b>	<b>5.04</b>	<b>6.36</b>	<b>5.67</b>	<b>7.61</b>	<b>8.62</b>	<b>8.13</b>
International trade	6.91	7.15	6.48	5.54	6.00	8.21	7.96	8.08
Domestic trade	7.62	8.07	2.50	8.46	4.98	5.08	10.38	8.33
<b>Others</b>	<b>42.94</b>	<b>48.59</b>	<b>55.80</b>	<b>28.36</b>	<b>39.73</b>	<b>47.81</b>	<b>38.16</b>	<b>42.57</b>

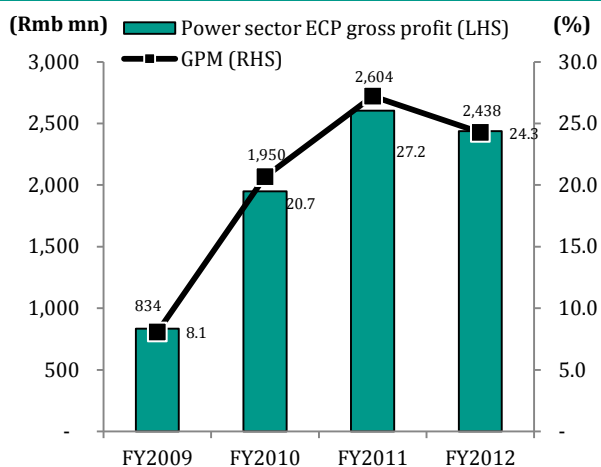
Source: Company

### Overall gross profit and GPM of international engineering and construction contracts, 2009-2012



Source: Company

### Gross profit and GPM of power sector engineering and construction contracts, 2009-2012



Source: Company

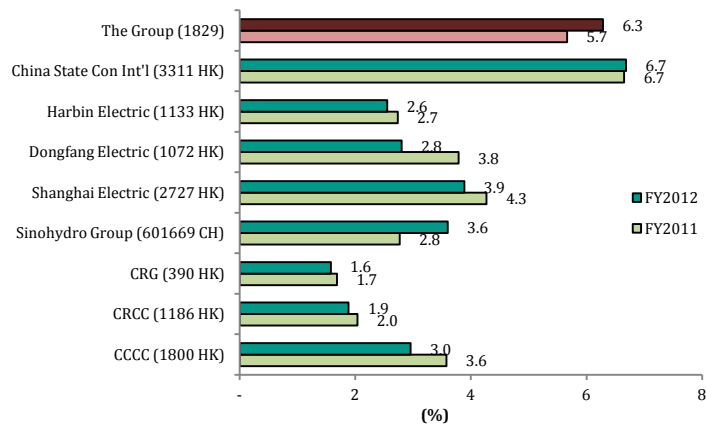


### Asset-light business model continuing to deliver outstanding profitability

The Group adopts an asset-light operating model as it subcontracts substantially all of the construction works which are capital intensive. It puts the focus on execution, management and supervision of the projects as well as achieving high internal efficiency. We believe that the asset-light operating model is one the major reason of which the Group can post a relatively high assets return compared with its peers.

The return on average assets (“ROAA” = Total net profit to group/average assets during the year) of the Group were 5.7% in FY2011 and 6.3% in FY2012, which was the highest among the peers of which they conduct the construction works.

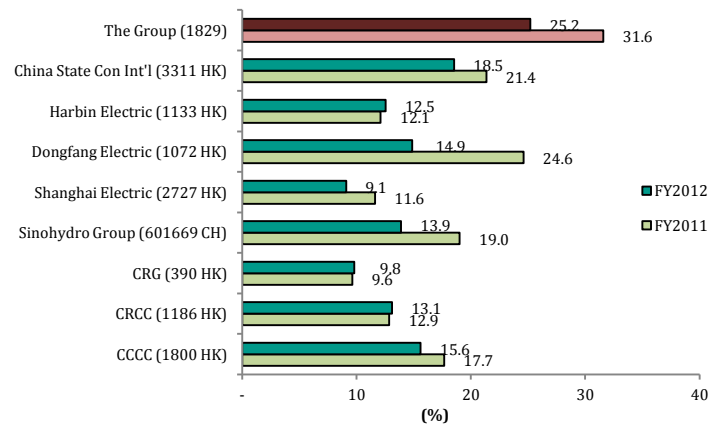
#### ROAA of the Group and the peers



1: The ROAA of Sinohydro Group (601669 CH) for FY2012 was estimated  
Source: Companies, Bloomberg

The return on average equity (“ROAE” = Net profit attributed to equity owner of the company/average equity attributable to the equity owners of the company during the year) of the Group were 31.6% in FY2011 and 25.2% in FY2012, which is the highest among the peers of which they implement the construction works.

#### ROAE of the Group and the peers



1: The ROAE of Sinohydro Group (601669 CH) for FY2012 was estimated  
Source: Companies, Bloomberg

## Outlook FY2013 and FY2014

### Depending on the progress of its backlog orders

The revenue growth of its international contracting business in FY2013-14 is subject to the progress of its ongoing projects in the backlog. The amount of backlog at the end of FY2012 represented 3.3x of the booked revenue of its construction contracts business for FY2012. Hence, the orders book will keep the Group very busy for coming two to three years. The outstanding business risk is the project execution risk. We predict the revenue will grow by 8.8% YoY in FY2013, of which revenue from the construction contracts business (estimated to accounted for 75.4% of total gross profit in FY2013) will grow by 13.5% YoY in FY2013.

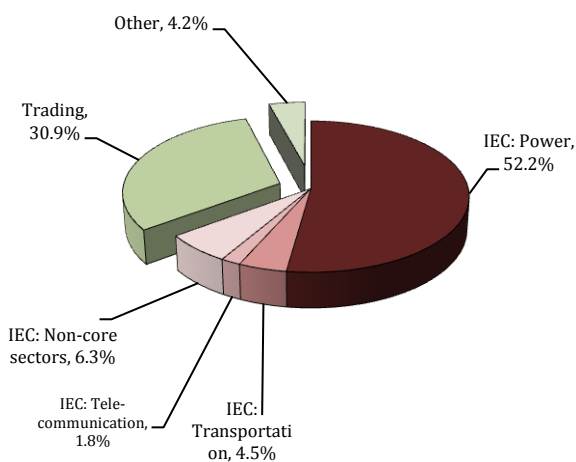
### Gross profit margin of construction contracts business take longer time to rebound

The gross profit margin in FY2012 reflects the average profitability of ongoing projects. The amount of newly effective contracts in FY2012 represented 61.8% of the outstanding backlog at the end of FY2012. Hence, the ongoing projects which have commenced before 2012 will continue to contribute a significant portion of total gross profit in FY2013. The newly effective contracts in FY2012 will start to have meaningful contribution in FY2014-15. We assume gross profit margins will maintain stable in FY2013, and rebound gradually in FY2014-15

### Power projects remain business focus

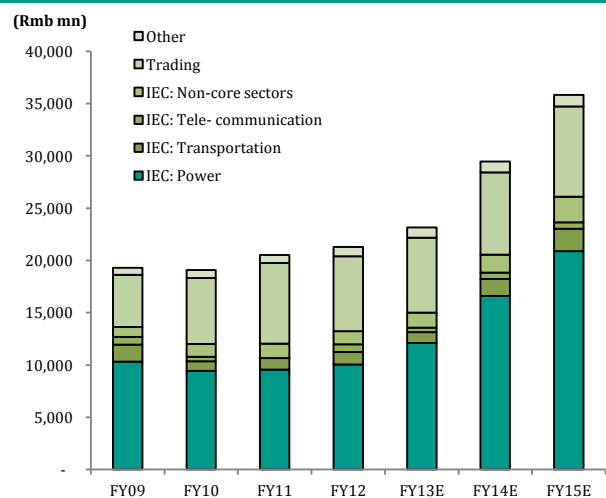
Power projects accounted for 87.9% of its total backlog value at the end of FY2012, representing 94.4% of total amount of new effective contracts for FY2012. Although project concentration risk is high statistically, this is inevitable given that the power projects business segment is the core business of the Group and the management has long proven track record in completion of power projects. We believe the Group will seek diversification geographically.

**Estimated product mix of the Group, FY2013E**



Source: ABCI Securities estimates

**Revenue projection of the Group, FY2009-FY2015E**



Source: Company, ABCI Securities estimates



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**Key data of half-year breakdown on earnings of the Group**

	1HFY11	2HFY11	FY11	1HFY12	2HFY12	FY12
<b>Revenue</b>	<b>9,839</b>	<b>10,679</b>	<b>20,518</b>	<b>10,354</b>	<b>10,942</b>	<b>21,296</b>
<b>International engineering contracting</b>	<b>5,507</b>	<b>6,548</b>	<b>12,055</b>	<b>6,426</b>	<b>6,819</b>	<b>13,245</b>
Power	4,339	5,230	9,569	5,021	5,026	10,047
Transportation	660	444	1,104	524	678	1,202
Telecommunication	-	2	2	346	388	734
Non-core sectors	508	871	1,379	536	726	1,262
<b>Trading</b>	<b>4,011</b>	<b>3,678</b>	<b>7,689</b>	<b>3,522</b>	<b>3,641</b>	<b>7,163</b>
<b>Other</b>	<b>321</b>	<b>453</b>	<b>774</b>	<b>406</b>	<b>482</b>	<b>888</b>
Cost of sales	(8,387)	(8,471)	(16,859)	(8,450)	(10,199)	(18,649)
<b>Gross profit</b>	<b>1,452</b>	<b>2,208</b>	<b>3,659</b>	<b>1,904</b>	<b>1,828</b>	<b>3,732</b>
<b>GPM (%)</b>	<b>14.75</b>	<b>20.67</b>	<b>17.83</b>	<b>18.39</b>	<b>16.71</b>	<b>17.52</b>
<b>GPM breakdown:</b>						
<b>International engineering contracting</b>	<b>19.43</b>	<b>28.18</b>	<b>24.18</b>	<b>22.44</b>	<b>19.51</b>	<b>20.93</b>
Power	23.52	30.27	27.21	25.88	22.65	24.27
Transportation	5.51	9.30	7.04	15.17	-0.22	6.49
Telecommunication	N/A	13.04	13.04	8.04	9.58	8.86
Non-core sectors	2.58	25.32	16.95	6.55	21.47	15.13
<b>Trading</b>	<b>5.04</b>	<b>6.36</b>	<b>5.67</b>	<b>7.61</b>	<b>8.62</b>	<b>8.13</b>
<b>Other</b>	<b>55.80</b>	<b>28.36</b>	<b>39.73</b>	<b>47.81</b>	<b>38.16</b>	<b>42.57</b>
<b>Operating profit</b>	<b>851</b>	<b>1,294</b>	<b>2,145</b>	<b>1,095</b>	<b>968</b>	<b>2,063</b>
<b>Operating profit margin (%)</b>	<b>8.65</b>	<b>12.12</b>	<b>10.45</b>	<b>10.58</b>	<b>8.84</b>	<b>9.69</b>
Financial income	205	197	402	249	334	583
Financial expenses	(196)	(363)	(560)	(3)	(27)	(30)
<b>Pretax profit</b>	<b>859</b>	<b>1,128</b>	<b>1,987</b>	<b>1,341</b>	<b>1,275</b>	<b>2,616</b>
Income tax	(217)	(298)	(515)	(352)	(353)	(704)
<b>Net profit</b>	<b>642</b>	<b>830</b>	<b>1,472</b>	<b>989</b>	<b>939</b>	<b>1,928</b>
Minority interest	(3.43)	0.88	(2.55)	0.98	(0.51)	0.47
<b>Net profit to equity owners</b>	<b>639</b>	<b>836</b>	<b>1,475</b>	<b>990</b>	<b>937</b>	<b>1,928</b>
<b>Net profit margin (%)</b>	<b>6.49</b>	<b>7.83</b>	<b>7.19</b>	<b>9.57</b>	<b>8.56</b>	<b>9.05</b>

Source: Company



## Maintain “Buy” to CMEC

Looking forward, thanks for the huge backlog on hand and the large pool of contracts pending to be effective, it provides a good visibility on income for the coming years.

Furthermore, under the favorable policy of China’s Government toward the foreign countries, especially the developing countries in Africa, we are positive with the growth prospect for the overseas construction industry.

With considering to the long and solid working history of the Group (over 30 years) with the governments in the developing countries, and the good fund sourcing capability for its customers, we believe the strong project sourcing power of the Group will be maintained.

We have downward adjusted our earnings forecast for the Group after discussing with the management on its delivery schedule. Besides, we believe the higher margin projects of CMEC’s backlog pool to take a longer time to initiate and give a meaningful contribution in FY2014-15. So, we cut down our GPM forecast.

Based on DCF valuation method and PE multiple comparison method, we believe the fair value of CMEC is 10.61x FY2013E PER. Our new target price is HK\$6.57 (down from HK\$8.21). The counter is trading at 9.12x FY2013E PER, although it is higher than the valuation of the domestic construction contractors, such as CCCC (1800 HK), CRG (390 HK) and CRCC (1186 HK), considering its higher profitability, we think the current valuation of the Group is not demanding. We maintain our “Buy” rating on CMEC.

### Major change of our forecast

	Our Forecast	FY12A Actual Results	Diff (%)	FY13E			FY14E		
				Previous	New	Chg (%)	Previous	New	Chg (%)
<b>Revenue (Rmb mn)</b>	<b>22,813</b>	<b>21,296</b>	<b>-6.65</b>	<b>27,072</b>	<b>23,163</b>	<b>-14.44</b>	<b>33,928</b>	<b>29,466</b>	<b>-13.15</b>
International engineering contracting	14,594	13,245	-9.24	17,482	15,027	-14.05	22,706	20,550	-9.49
Power	12,157	10,047	-17.36	14,689	12,099	-17.64	18,518	16,612	-10.29
Transportation	860	1,202	39.76	1,101	1,039	-5.62	2,041	1,614	-20.90
Telecommunication	333	734	120.44	755	427	-43.46	719	598	-16.84
Non-core sectors	1,244	1,262	1.46	937	1,462	56.07	1,428	1,726	20.88
Trading	7,246	7,163	-1.15	8,520	7,159	-15.97	10,045	7,861	-21.75
Other	973	888	-8.69	1,070	977	-8.69	1,177	1,055	-10.35
<b>Gross profit (Rmb mn)</b>	<b>4,163</b>	<b>3,732</b>	<b>-10.36</b>	<b>5,041</b>	<b>4,030</b>	<b>-20.05</b>	<b>6,479</b>	<b>5,343</b>	<b>-17.54</b>
GPM (%)	18.25	17.52	-0.73ppts	18.62	17.40	-1.22ppts	19.10	18.13	-0.96ppts
<b>Net income (Rmb mn)</b>	<b>2,007</b>	<b>1,928</b>	<b>-3.95</b>	<b>2,523</b>	<b>2,052</b>	<b>-18.65</b>	<b>3,226</b>	<b>2,815</b>	<b>-12.75</b>
Net margin (%)	8.80	9.05	0.25ppts	9.32	8.86	-0.46ppts	9.51	9.55	0.04ppts
EPS (Rmb)	0.486	0.467	-3.95	0.611	0.497	-18.65	0.782	0.682	-12.75
BVPS (Rmb)	2.420	2.405	-0.61	2.995	2.823	-5.76	3.593	3.331	-7.31
DPS (Rmb)	0.146	0.164	12.12	0.183	0.174	-5.07	0.235	0.239	1.82

Source: ABCI Securities estimates



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## Peer Groups Valuation

### Peer group valuation and earnings forecasts summary

Code	Stocks	Share price	Report Currency	FY12 EPS	FY13E EPS	FY13 EPS Chg	FY13 NBV /share	FY12E PER (x)	FY13E PER (x)	FY13E PEG (x)	FY13E P/B (x)
	<b>Listing in HK</b>	(HK\$)									
<b>1829 HK</b>	<b>CMEC</b>	<b>5.65</b>	<b>Rmb</b>	<b>0.467</b>	<b>0.497</b>	<b>6.42%</b>	<b>2.823</b>	<b>9.71</b>	<b>9.12</b>	<b>1.42</b>	<b>1.60</b>
3311 HK	China State Cons	10.26	HK\$	0.573	0.704	22.86%	4.042	17.91	14.57	0.64	2.54
1800 HK	China Comm Cons	7.25	Rmb	0.749	0.829	10.68%	5.985	7.76	7.01	0.66	0.97
1186 HK	China Rail Cons	6.95	Rmb	0.687	0.749	9.02%	6.500	8.11	7.44	0.82	0.86
390 HK	China Railway	3.74	Rmb	0.345	0.380	10.14%	4.086	8.69	7.89	0.78	0.73
	<b>Average</b>							<b>10.43</b>	<b>9.21</b>	<b>0.86</b>	<b>1.34</b>
	High							17.91	14.57	1.42	2.54
	Low							7.76	7.01	0.64	0.73
	<b>A-share mkts peers</b>	(Rmb)									
601669 CH	Sinohydro	3.44	Rmb	0.442	0.526	19.00%	4.542	7.78	6.54	0.34	0.76
601668 CH	China State Cons Eng	3.39	Rmb	0.520	0.610	17.31%	3.940	6.52	5.56	0.32	0.86
601800 CH	China Comm Cons	4.99	Rmb	0.749	0.829	10.68%	5.985	6.66	6.02	0.56	0.83
600068 CH	China Gezhouba	5.04	Rmb	0.448	0.534	19.20%	4.108	11.25	9.44	0.49	1.23
601186 CH	China Rail Cons	4.95	Rmb	0.687	0.749	9.02%	6.500	7.21	6.61	0.73	0.76
601390 CH	China Railway	2.79	Rmb	0.345	0.380	10.14%	4.086	8.09	7.34	0.72	0.68
	<b>Average</b>							<b>7.92</b>	<b>6.92</b>	<b>0.53</b>	<b>0.85</b>
	High							11.25	9.44	0.73	1.23
	Low							6.52	5.56	0.32	0.68
	<b>Overseas peers</b>	(local)									
DG FP	Vinci SA	35.31	EUR	3.571	3.522	-1.37%	25.880	9.89	10.03	-7.31	1.36
EN FP	Bouygues SA	20.92	EUR	2.000	2.480	24.00%	21.695	10.46	8.44	0.35	0.96
WOR AU	Worleyparsons	24.17	AUD	1.437	1.538	7.03%	8.699	16.82	15.72	2.24	2.78
000720 KS	Hyundai Eng	64,300	KRW	3,116	5,052	62.13%	46,567	20.64	12.73	0.20	1.38
JEC US	Jacobs Eng	52.54	USD	2.969	3.334	12.29%	32.125	17.70	15.76	1.28	1.64
	<b>Average</b>							<b>15.10</b>	<b>12.53</b>	<b>-0.65</b>	<b>1.62</b>
	High							20.64	15.76	2.24	2.78
	Low							9.89	8.44	-7.31	0.96

Share prices based on Apr 3, 2012;

Forex: Rmb0.8017/HK\$

Source: Bloomberg, ABCI Securities estimates

**農銀國際**

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

China Machinery Engineering Corporation

**Financial Statements Projection****Consolidated income statements forecast**

FY ended Dec 31 (Rmb mn)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E
<b>Revenue</b>	<b>19,077</b>	<b>20,518</b>	<b>21,296</b>	<b>23,163</b>	<b>29,466</b>	<b>35,828</b>
International engineering contracting	12,020	12,055	13,245	15,027	20,550	26,089
Trading	6,296	7,689	7,163	7,159	7,861	8,631
Other	762	774	888	977	1,055	1,108
Cost of sales	(16,135)	(16,859)	(17,564)	(19,133)	(24,123)	(29,274)
<b>Gross profit</b>	<b>2,942</b>	<b>3,659</b>	<b>3,732</b>	<b>4,030</b>	<b>5,343</b>	<b>6,554</b>
Other revenue	19	10	12	14	12	12
Other expenses, net	(10)	(3)	(25)	(30)	(36)	(43)
Selling and distribution	(806)	(978)	(1,087)	(1,241)	(1,602)	(1,974)
Administrative expenses	(290)	(406)	(478)	(517)	(645)	(773)
Other operating expenses	(320)	(136)	(91)	(198)	(181)	(227)
<b>Profit from operations</b>	<b>1,535</b>	<b>2,145</b>	<b>2,063</b>	<b>2,058</b>	<b>2,890</b>	<b>3,549</b>
Finance income	412	402	583	795	925	1,019
Finance expenses	(386)	(560)	(30)	(79)	(10)	(7)
<b>Pre-tax profit</b>	<b>1,561</b>	<b>1,987</b>	<b>2,616</b>	<b>2,774</b>	<b>3,805</b>	<b>4,561</b>
Tax expenses	(429)	(515)	(688)	(721)	(989)	(1,186)
<b>Net profit</b>	<b>1,132</b>	<b>1,472</b>	<b>1,928</b>	<b>2,053</b>	<b>2,815</b>	<b>3,375</b>
Attributable to:						
Minority interests	(4.31)	(2.55)	0.47	0.61	0.80	1.04
<b>Net profit to equity owner</b>	<b>1,136</b>	<b>1,475</b>	<b>1,928</b>	<b>2,052</b>	<b>2,815</b>	<b>3,374</b>

Source: Company, ABCI Securities estimates

**Income statement key ratios forecast**

FY	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E
<b>Sales mixed (%)</b>						
International engineering contracting	63.0	58.8	62.2	64.9	69.7	72.8
Trading	33.0	37.5	33.6	30.9	26.7	24.1
Other	4.0	3.8	4.2	4.2	3.6	3.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Profit &amp; loss ratios (%)</b>						
Gross profit margin	15.4	17.8	17.5	17.4	18.1	18.3
Operating profit margin	8.0	10.5	9.7	8.9	9.8	9.9
Pre-tax margin	8.2	9.7	12.3	12.0	12.9	12.7
Net profit margin	6.0	7.2	9.1	8.9	9.6	9.4
Selling & marketing expenses/revenue	4.2	4.8	5.1	5.4	5.4	5.5
Administrative expenses / revenue	1.5	2.0	2.2	2.2	2.2	2.2
Effective tax rate	27.5	25.9	26.3	26.0	26.0	26.0
<b>Growth (%)</b>						
Revenue	(1.1)	7.6	3.8	8.8	27.2	21.6
Gross profit	67.2	24.4	2.0	8.0	32.6	22.7
Profit from operations	175.1	39.7	(3.8)	(0.2)	40.4	22.8
Net profit	85.2	29.8	30.7	6.5	37.2	19.9

Source: Company, ABCI Securities estimates



**Consolidated balance sheets forecast**

As of Dec 31 (Rmb mn)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E
<b>Current assets</b>	<b>18,620</b>	<b>19,331</b>	<b>27,936</b>	<b>28,860</b>	<b>35,822</b>	<b>35,361</b>
Cash and equivalent	5,079	5,171	12,089	12,280	16,996	15,281
Time deposits	4,347	3,955	4,351	4,786	5,264	5,791
Restricted deposits	198	390	2,568	2,825	3,108	3,418
Trade and other receivables	4,919	6,427	5,511	6,411	7,731	8,806
Construction contracts	3,903	3,176	3,191	2,036	2,319	1,345
Inventories	175	212	226	522	404	719
<b>Non-current assets</b>	<b>6,768</b>	<b>7,277</b>	<b>6,834</b>	<b>6,810</b>	<b>8,774</b>	<b>8,860</b>
Property, plant and equipment	345	392	444	1,465	1,849	2,219
Investment properties	32	32	16	27	25	22
Intangible assets	7	5	4	3	2	2
Lease prepayment	74	1,630	1,586	1,542	1,500	1,459
Trade and other receivables	282	107	39	183	235	274
Construction contracts	5,705	4,774	4,114	2,488	3,479	2,498
Other non-current assets	323	336	631	1,100	1,684	2,386
<b>Total assets</b>	<b>25,388</b>	<b>26,608</b>	<b>34,770</b>	<b>35,669</b>	<b>44,596</b>	<b>44,221</b>
<b>Current liabilities</b>	<b>19,446</b>	<b>20,497</b>	<b>24,271</b>	<b>23,069</b>	<b>29,631</b>	<b>26,591</b>
Trade and other payables	9,605	9,671	10,943	7,718	13,431	9,827
Receipts in advance	8,671	10,316	12,710	14,799	15,579	16,063
Borrowings	576	160	134	90	90	90
Other	594	350	484	462	531	611
<b>Non-current liabilities</b>	<b>1,977</b>	<b>737</b>	<b>582</b>	<b>959</b>	<b>1,226</b>	<b>1,502</b>
Trade and other payables	321	131	61	393	664	940
Borrowings	1,260	226	155	105	55	5
Other	396	381	366	461	507	558
<b>Total liabilities</b>	<b>21,423</b>	<b>21,234</b>	<b>24,853</b>	<b>24,028</b>	<b>30,857</b>	<b>28,094</b>
<b>Minority interests</b>	<b>4</b>	<b>(6)</b>	<b>(3)</b>	<b>(3)</b>	<b>(2)</b>	<b>(1)</b>
<b>Shareholders' equities</b>	<b>3,961</b>	<b>5,380</b>	<b>9,920</b>	<b>11,644</b>	<b>13,740</b>	<b>16,129</b>

Source: Company, ABCI Securities estimates

**Balance sheets key ratios forecast**

FY	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E
<b>Balance sheet ratios</b>						
Current ratio (x)	1.0	0.9	1.2	1.3	1.2	1.3
Quick ratio (x)	0.9	0.9	1.1	1.2	1.2	1.3
Cash ratio (x)	0.3	0.3	0.6	0.7	0.7	0.7
Trade and bill receivables turnover days	35.0	51.0	56.4	55.0	55.0	55.0
Trade and bill payables turnover days	161.9	175.1	186.2	157.3	142.8	131.8
Inventory turnover days	4.0	4.2	4.6	7.1	7.0	7.0
Total debt / equity ratio (%)	46.3	7.2	2.9	1.7	1.1	0.6
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Returns (%)</b>						
ROAA	5.0	5.7	6.3	5.8	7.0	7.6
ROAE	32.6	31.6	25.2	19.0	22.2	22.6
Payout ratio	11.7	9.6	35.0	35.0	35.0	35.0
<b>Per share data (Rmb)</b>						
Pro-forma issued shares (mn)	3,300	3,300	4,126	4,126	4,126	4,126
Pro-forma FD EPS	0.344	0.447	0.467	0.497	0.682	0.818
BVPS	1.199	1.632	2.405	2.823	3.331	3.910
DPS	0.040	0.043	0.164	0.174	0.239	0.286

Source: Company, ABCI Securities estimates



*Consolidated cash flow statements forecast*

YE Dec 31 (Rmb mn)	FY10A	FY11A	FY12E	FY13E	FY14E	FY15E
<b>Profit before tax</b>	<b>1,561</b>	<b>1,987</b>	<b>2,616</b>	<b>2,774</b>	<b>3,805</b>	<b>4,561</b>
Depreciation and amortization	41	72	105	121	143	159
Change in working capital	4,291	1,434	3,625	883	4,508	(2,022)
Income tax paid	(445)	(683)	(987)	(1,035)	(1,420)	(1,702)
Others	155	18	(233)	(1,495)	(813)	(1,474)
<b>CF Operating</b>	<b>5,603</b>	<b>2,828</b>	<b>5,125</b>	<b>1,248</b>	<b>6,223</b>	<b>(479)</b>
Increase in PP&E	(16)	(51)	(726)	(478)	(481)	(484)
Increase in intangible assets	(6)	(1,001)	(0)	(0)	(0)	(0)
Other	(2,159)	519	(0)	(264)	(258)	283
<b>CF Investing</b>	<b>(2,180)</b>	<b>(533)</b>	<b>(726)</b>	<b>(743)</b>	<b>(740)</b>	<b>(201)</b>
Capital injection	100	20	2,970	455	-	-
Net debt financing	(427)	(1,450)	(97)	(94)	(50)	(50)
Dividend payout	(272)	(698)	(354)	(675)	(718)	(985)
Others	(52)	(2)	-	-	1	1
<b>CF Financing</b>	<b>(652)</b>	<b>(2,130)</b>	<b>2,520</b>	<b>(314)</b>	<b>(767)</b>	<b>(1,034)</b>
<b>Net change in cash</b>	<b>2,770</b>	<b>165</b>	<b>6,918</b>	<b>191</b>	<b>4,716</b>	<b>(1,715)</b>
Cash at the beginning	2,353	5,079	5,171	12,089	12,280	16,996
Effect of foreign exchange rate	(44.6)	(73.2)	(0.2)	-	0.2	0.1
<b>Cash at the end</b>	<b>5,079</b>	<b>5,171</b>	<b>12,089</b>	<b>12,280</b>	<b>16,996</b>	<b>15,281</b>

Source: Company, ABCI Securities estimates



## Area of Concern

### Low revenue growth of construction contracts business

Although the Group had huge backlog in order book, the revenue of construction contracts business segment (ie. its international contracting business) edged up mildly 9.87% YoY and contributed 60.88% of total revenue of the group for FY2012. We worry the progress of some of its construction projects may be slower-than-expected. The backlog surged 33.6% to US\$7,058.4mn (or approx. Rmb46,978mn, at Rmb6.2306/US\$ at 31/12/2012) at the end of FY2012, representing 3.32x of booked construction contracts business revenue for FY2012.

### Gross profit margin contraction

Gross profit margin of its international contracting business segment edged down in FY2012. Gross profit margin of the group declined to 17.53% in FY2012 from 17.84% in FY2011. The overall gross profit margin was dragged down by margin contraction of its int'l contracting business segment but margin improvement in trading and other business segments.

Proportion of gross profit contributed by international contracting business segment to total gross profit reduced to 74.2% in FY2012 from 79.7% in FY2011. Gross profit of its international contracting business reduced to 20.9% in FY12 from 24.2% in FY2011. All four sub-segments (power, transportation, telecommunications and non-core sectors) of international contracting business segment recorded decline in gross profit margins. In particular, the gross profit margin of its power sub-segment, which is the major profit contributor to the group and generated 65.3% of total gross profit of the Group for FY2012, reduced by 2.9ppt to 24.3% in FY2012 from 27.2% in FY2011. The Group explained the contraction of gross margin in FY2012 was due to some high margin power projects were completed in FY2011.

### Un-proportional increase in operating expenses

Although total gross profit inched up 1.98% YoY, EBIT was down 3.79% YoY in FY2012. The decline in EBIT was the result of faster increase in operating expenses. Total revenue was up 3.75% YoY in FY2012, selling & marketing expenses and general administrative expenses surged 11.08% YoY and 17.69% YoY in FY2012 respectively. The un-proportional increase in the latter two cost items is the result of the sharp increase in new contracts and listing-related services fees. Newly effective contract value surged 96% YoY to US\$2,226.8mn (or approx. Rmb13,874.3mn, at Rmb6.2306/US\$ at 31/12/2012) in FY2012, which represent 1.05x of booked revenue of its construction contracts business in FY2012.

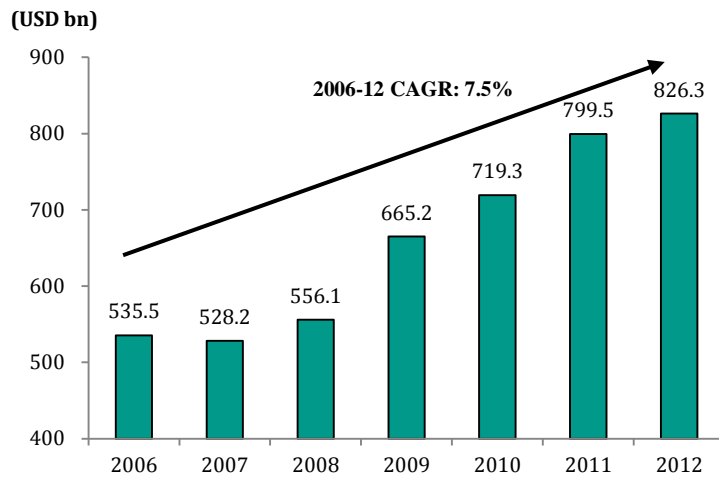


## Industry Analysis

### Global Infrastructure Engineering Industry

The total new contract value of infrastructure engineering projects for the developing countries has experienced a faster growth than that in the global market. The Group focuses on the power infrastructure project in developing countries outside China. The fast growth on the developing countries' infrastructure is supporting the long term growth of the Group.

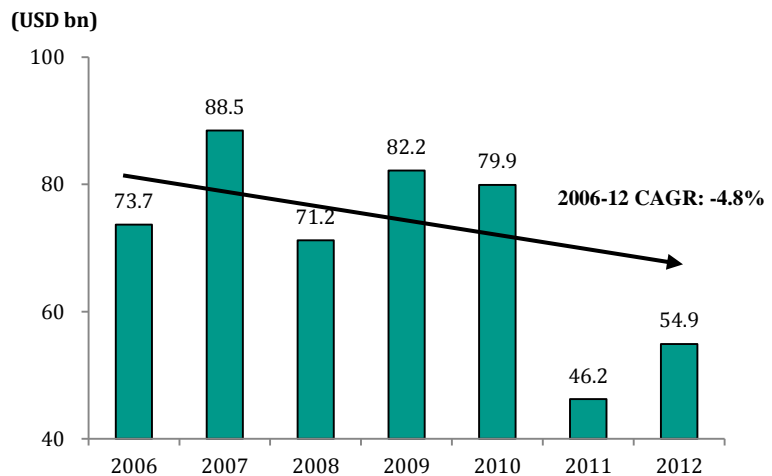
#### *Total new contract value of infrastructure engineering projects in developing countries, 2006-2012*



Source: Ipsos Report

The total new contract value of infrastructure engineering projects in developing countries was USD881.2bn in 2012, 16.1x on that in developed countries at USD54.9bn. The new contract value in developing countries grew at a CAGR of 7.5% from 2006 to 2012, which was higher than that in developed countries at -4.8% during the same period of time.

#### *Total new contract value of infrastructure engineering projects in developed countries, 2006-2012*



Source: Ipsos Report

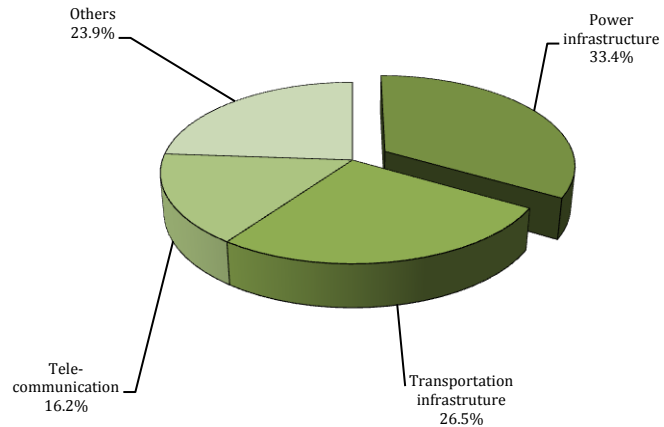




### Power infrastructure construction in developing countries

According to the Ipsos report, the total new contract value was USD826.3bn in developing countries, 2012, where the power-related infrastructure accounted for 33.4% of total new contract value. The huge demand for power infrastructure benefit the long run development of the Group

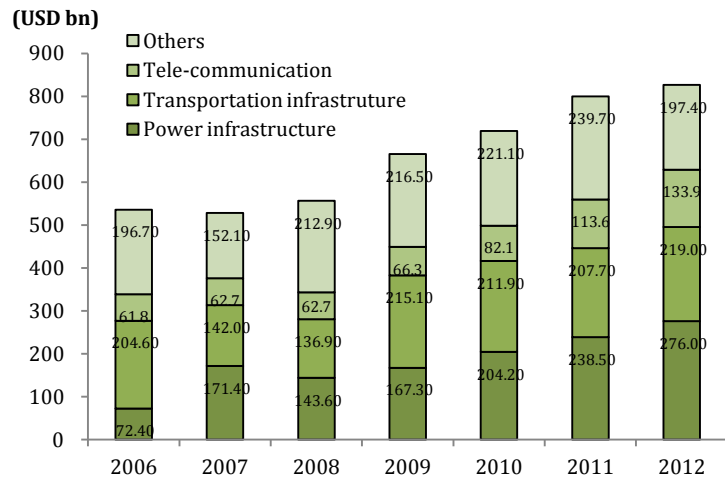
#### Breakdown of new contract value of infrastructure engineering project in developing countries in 2012



Source: Ipsos Report

The electricity planning problem in many developing countries is more complicated than in developed countries. The challenge is not only to substitute investment in cost-effective reductions in electricity use for investments in power plants as in developed countries but also to obtain financing for any electricity-related investment. Power development is difficult because electric power industries are among the most capital-intensive in an economy, draining scarce financial resources.

#### Total new contract value of infrastructure engineering projects in developing countries, 2006-2012



Source: Ipsos Report



## Competitiveness of the Group among the peers

With the long history for the Group to build the power facilities in developing countries, it helps the Group to have a better risk control on the engineering and construction projects.

According to the Ministry of Commerce, 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.

### 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 <i>The Group</i>	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 <i>The Group</i>
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)

Source: Ministry of Commerce, ABCI Securities

Except Huawei Technologies and ZTE Corp which their business focuses are in telecom industry, the other eight enterprises in the top 10 domestic contractors are engaged in infrastructure projects in various sectors such as power, roadways, railways, ports, etc. They are potential competitors of the Group in various types of infrastructure projects outside China. Besides the top ten enterprises in above table, there are many domestic contractors which their business scale may be smaller than the Group will also compete with the Group.



## Disclosures

I, Chan Sung-yan, Philip, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

I, Wong Cheuk Wai, Steve, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

### Disclosures of Interests

ABC Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

### 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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