CHINA CERAMICS CO., LTD.

Second Half and Fiscal Year End 2017 Earnings Call
April 30, 2018
8:00 a.m. ET

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

Operator: Good afternoon. My name is Beth and I'll be your conference operator today. At this time, I would like to welcome everyone to the China Ceramics second half and fiscal year end 2017 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 would like to ask a question during this time, simply press star one on your telephone keypad. If you will like to withdraw your question, press the pound key.

David Rudnick, you may begin your conference..

David Rudnick: Good morning ladies and gentlemen and good evening to those of you who are joining us from China. Welcome to China Ceramics' six month and fiscal year end 2017 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 the Company's Chief Financial Officer, Mr. Edmund Hen, who will discuss the Company's second half 2017 earnings results. Thank you!

Edmund Hen: Thank you, avid. First of all, I will turn the call over to Mr. Jaidong, the Chairman and CEO of China Ceramics. And Weijia Dai will be translating for Mr. Huang.

Jiadong Huang: (In Chinese)

Weijia Dai: Thank you, David. On behalf of the Company, I would like to welcome everyone to our second half fiscal 2017 earnings conference call.

Jiadong Huang: (In Chinese)

Weijia Dai: For the second half of 2017, we experienced slightly improved market conditions as compared to the same period of 2016, as we aggressively marketed our products utilizing a targeted strategic approach. We were able to improve our pricing power due to the popularity of our flagship porcelain ceramic tiles abetted by our strong market presence. Our revenue rose 7.1% for the second half of 2017 from the year-ago period primarily due to an 8.5% rise in our average selling price. In addition, our cash flow was reasonably strong after adjusting for asset write-offs during the year.

Jiadong Huang: (In Chinese)

Weijia Dai: For the fiscal year ended December 31, 2017, we utilized production facilities capable of producing 31 million square meters of ceramic tiles. Consistent with our practices in past quarters, we maintained a reduced utilization of existing plant capacity based on the current market environment to keep our operating costs low. We intend to bring additional capacity online as the business environment improves.

Jiadong Huang: (In Chinese)

Weijia Dai: For the remainder 2018, we are cautiously optimistic about an improved business environment due to new land sales and continued development activity as well as the government initiative to build rental homes as a means of balancing China's urban residential dynamics. In the long-term, we believe that real estate will continue to be vital to China's economy and essential for domestic growth. We plan to target those cities in China that offer potential for new property development and will continue to forge strong relationships with larger property developers.

Jiadong Huang: (In Chinese)

Weijia Dai: With that, I would like to turn over the call to the Company's Chief Financial Officer, Mr. Edmund Hen, who will discuss the Company's second half 2017 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 six months ending December 31, 2017.

Edmund Hen: Our revenue for the six months ended December 31, 2017 was RMB 485.3 million or US$ 72.7 million, an increase of 7.1% from RMB 453.1 million or US$ 67.1 million for the same period of 2016. The year-over-year increase in revenue was primarily due to the 8.5% increase in the average selling price or ASP of the Company's ceramic tile products to RMB 27.2 or US$ 4.00 in the second half of 2017 as compared to RMB 25.1 or US$ 3.80 for the same period of 2016 which was partially offset by (ii) the 1.2% decrease in sales volume to 17.9 million square meters of ceramic tiles in the second half of 2017 from 18.1 million square meters of ceramic tiles in the second half of 2016.

Gross profit for the six months ended December 31, 2017 was RMB 57.8 million or US$ 8.7 million as compared to a gross loss of RMB 80.3 million or US$ 11.9 million for the same period of 2016. The gross profit margin was 11.9% for the six months ended December 31, 2017, as compared to a 17.7% gross loss margin for the same period of 2016, which was attributable to the latter period's 28% decrease in ASP of the Company's ceramic tiles resulting from price cuts to spur the sales of slow-moving inventory and a RMB 59.4 million or US$ 8.9 million write-off of inventory in that period.

Other income for the six months ended December 31, 2017 was RMB 7.3 million or US $1.1 million, as compared to RMB 7.0 million or US $1.0 million for the same period of 2016. Other income mainly consisted rental income the Company received by leasing out one of the production lines from its Hengdali facility pursuant to an eight-year lease contract.

Selling expenses for the six months ended December 31, 2017 were RMB 6.1 million or US $0.9 million as compared to RMB 5.8 million or US $0.8 million for the same period of 2016. The year-over-year decrease in our selling expense was mainly due to a decrease in advertising and travel expenses.

Administrative expenses for the six months ended December 31, 2017 were RMB 79.8 million or US$ 12.1 million as compared to RMB 35.0 million or US$ 5.2 million for the same period of 2016. The year-over-year decrease in administrative expenses was primarily due to the write-off of bad debt due to what we view as uncollectible debt associated with our vendors.

Loss from asset devaluation resulting from an impairment of non-current assets for the six months ended December 31, 2017 was RMB 36.7 million or US$ 5.5 million as compared to RMB 230.4 million US$ 34.3 million for the same period of 2016. The loss from asset devaluation resulted from an impairment of non-current assets due to decelerating growth in China and an expected contraction in the demand for the Company's products.

Net loss for the six months ended December 31, 2017 was RMB 82.2 million or US$ 12.4 million as compared to a net loss of RMB 351.3 million or US$ 52.4 million for the same period of 2016. The decrease in net loss was mainly due to increased gross profit and a lower loss from asset devaluation for the six months ended December 31, 2017 as compared to the same period of 2016.

Loss per basic and fully diluted share for the six months ended December 31, 2017 on both a basic and fully diluted basis were RMB 24.29 or US$ 3.66, as compared to basic and fully diluted earnings per share of RMB 127.47 or US$ 18.99 for the same period of 2016.

Turning to our balance sheet, as of December 31, 2017, we had cash and bank balances of RMB 2.3 million or US$ 0.4 million as compared to RMB 0.1 million or US$ 0.01 million as of December 31, 2016. Our short-term bank borrowings were nil as of both periods.

As of December 31, 2017, our inventory turn was 95 days as compared to 108 days as of December 31, 2016. We had a reversal of inventory impairment of RMB 2.73 million in 2017 as a result of an improved inventory turnover rate due to increased sales. Subsequent to the RMB 75.1 million of inventory that was impaired for the year ended December 31, 2016, we believe that the value of our current inventories is realizable.

Our trade receivables turnover as of December 31, 2017 was 206 days compared with 209 days as of fiscal year end 2016. 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.

Trade payables turnover, net of value added tax, was 32 days as of December 31, 2017 compared with 51 days as of December 31, 2016. The average turnover days was within the normal credit period of one to four months granted by our suppliers.

In terms of our plant utilization and capex, for the fiscal year ended December 31, 2017, we utilized plant capacity capable of producing 31 million square meters of ceramic tiles annually out of a total effective annual production capacity of 66 million square meters of ceramic tiles. Our Hengda facility now has an annual production capacity of 37 million square meters of ceramic tiles as a result of two old furnaces having been put out of use in the facility. The Company utilized production capacity capable of producing 9.6 million square meters of ceramic tiles for the six months ended December 31, 2017 and 18.2 million square meters of ceramic tiles for the entire fiscal year 2017.

Our Hengdali facility has an annual production capacity of 29 million square meters (not including the leasing out of production capacity to a third party) and we utilized production capacity capable of producing 7.7 million square meters of ceramic tiles for the six months ended December 31, 2017 and 12.7 million square meters of ceramic tiles for the entire fiscal year 2017.

Our annual production capacity has been effectively reduced from 72 million square meters of ceramic tiles to 66 million square meters of ceramic tiles due to an eight-year contract to lease out one of the production lines from our Hengdali facility that we entered into in March 2016. We will bring our unused production capacity online as customer demand dictates and when there are signs of improvement in China's real estate and construction sector.

We incurred RMB 5.6 million or US$ 0.9 million in capital expenditures attributable to the purchase of a kiln for RMB $4.9 million and a desulfurization tower for RMB 0.7 million for the year ended December 31, 2017. Although business conditions are subject to change, looking ahead to the remainder of 2018, we anticipate a low level of capital expenditures given the currently challenging market conditions.

Moving on to our business outlook, in fiscal 2017, we increased the pricing of our ceramic tile products by 10% each in April and July, respectively. This followed a 20% reduction in the prices of our slow-moving products beginning on October 1, 2016, that was instituted in an effort to convert some of our inventory into cash. Our renewed pricing strength in fiscal 2017 was generally accepted by the marketplace as our fiscal 2017 sales volume increased 10.6% from fiscal 2016.

Looking ahead to the remainder of 2018, we expect conditions to slowly improve with an expansion in residential land supply, which will ultimately result in real estate development, especially in certain Tier 2 and Tier 3 cities. In addition, the Chinese Government began a program to increase the development of rental homes, affordable housing and housing co-owned by individuals and the state to help stem real estate speculation. There have also been efforts to develop rural land into rental housing which could help to address housing shortages and stabilize price increases in Tier 1 and Tier 2 cities. These initiatives could lead to additional real estate development and help to offset inventory declines in certain regions. In addition, local governments have begun to go forward with construction projects which has resulted in property investment growth. In the long-term, we believe that the real estate sector continues to be vital to sustaining China's strong economic growth since it is an important component of China's GDP.

We typically receive orders from customers two months in advance of production on a rolling basis. We enter into dealership agreements with customers, and a sales or purchase contract each time a customer places an order. As of December 31, 2017, our backlog was approximately RMB 70.7 million (US$ 10.8 million), which represents approximately the next two months of revenue. This as compares to a backlog of approximately RMB 61.4 million or US$ 8.9 million as of December 31, 2016, a year-over-year increase of 15.1%. Under normal circumstances, our backlog is an indicator of revenues that might be expected in the next quarter, though it is subject to change due to unforeseen business conditions and events including credit payment terms.

We view the growth of the real estate sector and our building materials sector as sustainable since China's urbanization, where the population continues to shift from rural to urban areas, serves as its foundation. In addition, urbanization is expected to lead to a more consumption-driven economy, a key objective of government policy. We have refocused our efforts to where we see active real estate development and where property developers use our products as part of their finished home products. We believe we have a competitive advantage in our sector due to our comprehensive product platform, customization capabilities, marketing expertise and strong reputation. Our goal for the year ahead is to continue to strategically penetrate regions with sound fundamentals and generate sustainable sales volume consistent with current real estate development trends.

In an event that occurred after our December 31, 2017 fiscal year end, on April 24, 2018, we went effective with a capital raise of US$ 1.2 million through the sale of 770,299 shares of common stock at a purchase price of US$ 1.56 per share to certain individual investors. Proceeds from the offering shall be used for working capital and general corporate purposes. The offering was pursuant to a previously filed and effective registration statement and prospectus supplement.

At this point, we would like to open up the call to any questions pertaining to our second half and fiscal year end 2017 financial results. Operator?

Operator: Your first question comes from the line of Howard Flinker. Your line is open.

Howard Flinker: Thank you. [Foreign language]. Edmund, you said that your prices were up 5% in the second half. The earnings release says you raised prices 10% two times. How much were prices up in the second half, weren't they up two times 10%?

Edmund Hen: No, because as reported it increased by 10% and also by quarter mix on average our price has just increased about 5% for the second half annualized.

Howard Flinker: So you mean 10% for half a year, equals 5%, okay, but 10% annualized. And second, you reported a pretax loss of about $11.5 million in the second half and your write-offs of receivables and plant and inventory were about $16 or $17 million, is that correct?

Edmund Hen: Yes.

Howard Flinker: Together?

Edmund Hen: Yes.

Howard Flinker: So if I include the write-offs, you actually made some money, is that correct?

Edmund Hen: Yes, you can see on the press release the adjusted EBITDA is positive

RMB 42 million or RMB 43 million.

Howard Flinker: Yes is that for the second half or for the whole year, I overlooked it.

Edmund Hen: Yes, this is for the whole year.

Howard Flinker: So the – and the adjusted EBITDA for the second half was also positive?

Edmund Hen: Yes.

Howard Flinker: And your – from EBITDA, your depreciation and amortization is very small and you have no interest so that is almost all of your pretax profit, is that correct? In the second half?

Edmund Hen: Yes, of course.

Howard Flinker: Okay, thank you.

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

James Kahn: [In Chinese] My question is, do you anticipate needing to raise cash again in 2018.

Edmund Hen: I'm not sure but there is a high chance that we are not going to raise money in 2018 but it all depends on the economic situation.

James Kahn: Okay, thank you. And my second question is in the United States tax law, you can have a tax carryforward with a loss. Is it the same thing in China, so that assuming you start to make money at this point this year, next year or whenever, you don't have to pay taxes on it because you can carryforward your tax loss from prior years, is that right, in China?

Edmund Hen: It is similar but China has a lot of restrictions so the tax loss will be much smaller than what you calculate in the US.

James Kahn: Okay. Can you tell me about how much smaller?

Edmund Hen: I have to go into detail for that. Probably we can have a separate discussion on this matter.

James Kahn: Okay, thank you.

Operator We have a follow-up question from Howard Flinker. Your line is open.

Howard Flinker Is the main difference between the use of tax loss carryforwards in China and the U.S., in China you have to spread them out pit over a longer period time?

Edmund Hen Yes, and also that would be typical for the tax losses, not as dynamic as in U.S. So there is a lot of restriction item in China. So, we may have a separate discussion on this. So we can go into detail for the conversation.

Howard Flinker Okay. Thank you.

Operator: Again, if you would like to ask a question, it is star one on your telephone keypad. There are no further questions. We do have a follow-up question from James Khan. Your line is open.

James Kahn: A follow-up question, I noticed in looking at the balance sheet that your – let's see, I'm sorry, I'm trying to find it. You have net current value of in U.S. dollars of about $91 million, is that correct - of assets – net of liabilities?

Edmund Hen You mean the balance sheet of our – yes, you mean the noncurrent asset of the property and equipment.

James Kahn: Yes, the noncurrent assets, yes? It says, RMB 597 million, $91 million.

Edmund Hen: You mean the net current assets?

James Kahn: Yes, that's right.

Edmund Hen: Around US $91 million.

James Kahn: Okay, so in terms of valuing your company, even though of course, I would not like it ever to be liquidated, if you were to liquidate your company, if you decided to shut down business and give the money back to the shareholders. Is that – what you think is the realizable value of the entire business assets and the like?

Edmund Hen: I would definitely tell you if the company one day is going into liquidation, but not now.

James Kahn: You would tell me if the company does go into liquidation, but you will not tell me now, is that what you are saying.

Edmund Hen: We do not have a plan for the liquidation.

James Kahn: No, of course not, I meant in terms of perceiving this as a valuable company, if it's worth a lot more in net current assets and its liquidation value is in excess of its share price. That is something that we can consider in valuing the shares. Do you agree?

Edmund Hen: Yes, you may, for the net you may value the – you may see the Company's value from the net assets, which is a common estimate for every company.

James Kahn: Right. So, I would close by saying that in the United States it is very rare to find a company like yours whose net current assets are so much greater than the share price, net current assets per share are so much greater than the share price, which suggests to me that your company may still be very undervalued.

Edmund Hen: Yes, we all think so, that the company is undervalued.

James Kahn: Thank you.

Edmund Hen: Thank you.

Operator: Your next question comes from the Paul Sonz. Your line is open.

Paul Sonz: Good morning. I saw that you, there was a provision for bad debt. And so you wrote off a certain amount of bad debt. I wanted to – in the receivables that you have in the current assets, could you comment on how you are doing in converting of receivables to cash and whether you are making progress there or if the level of receivables staying constant, how do you see, how do you see the debts from your customers. And do you still see that you have to offer terms in order to make sales.

Edmund Hen: We changed the terms from to time as you can see, we – for the typical period, for those we have a longtime relationship and we believe that they have been paying, we can provide a long period for them for the credit terms. Well when we notice, there is some dangers or difficulties in collecting the money, we may ask for some strengthened rules for them. And ask them to pay back us as soon as possible. For most of our customer have a very long time relationship and in this very difficult economic situation, we understand some of the customer is also in difficulty. So, for whatever we can see, we will deal with them and work with them to collect the money.

Paul Sonz: What is average age of your receivables.

Edmund Hen: As you can see from our press release, it is about 206 days.

Paul Sonz: 206?

Edmund Hen: Yes, the receivables turnover.

Paul Sonz: Is that lengthening or growing shorter?

Edmund Hen: It will maintain about the same level as last year.

Paul Sonz: I see, so in general you feel that your receivables are going to diminish over the next few months, or you feel like your receivables, will just stay the same.

Edmund Hen: We will feel for the coming one or two months of receivables, we will be staying above the same level and we will try to keep it at about the same level, because we feel the current level is good for our customers and us at this point.

Paul Sonz: Thank you.

Operator: There are no further questions. I'll turn the call back to our presenters for closing remarks.

David Rudnick: 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' second half and fiscal year end 2017 earnings call. Thank you all very much.

Operator: This concludes today's conference, you may now disconnect. Thank you.

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