Positive profit alert in falling stock price, a buying opportunity

HC International (2280.HK)

Financial Highlights

HC International had issued positive profit alert for its 3Q results, which net profit and revenue for the first nine months were expected to grow over 50% yoy and 20% yoy respectively. The growth seemed slowing down from the interim results of which profit and revenue up 95.8% yoy and 30% yoy respectively. However, in the past few years, the gross profit margin and net profit margin increased steady from 84.7% and 9.4% in 2011 to 94.7% and 22% in 1H14, implied strongly improved profitability.

How we view this

HC Intl had just transferred from HKEx GEM board to the main board at Oct 10, 2014. However, the stock price suffered from serious selling pressure afterwards. We could not find the reason of price drop from its financial statements, which showed solid growth in the past few years. One of the explanations might be that investors were concerning on the slowing down of revenue and profit growth. Another reason we thought was the fund outflow in the software sector, which many of the well performing companies were suffered since the first quarter this year.

Investment Action

In our view, we believe the price drop was overreaction of the market since the current price is about the same as of one year ago, with net profit up over 50% yoy for the first three quarters. Coupled with the company’s steady performance in the past few years, we tend to believe the current price undervalued. Thus, we give an initial rating to HC Intl as “Buy” with target price of HK$ 14.92, equivalent to 37.7x/28x of 2014 and 2015 forecasted EPS.

Key Financial Summary

<table>
<thead>
<tr>
<th>FYE Dec</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14E</th>
<th>FY15E</th>
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</tr>
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<tr>
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<td>153</td>
<td>210</td>
<td>283</td>
<td>337</td>
</tr>
<tr>
<td>EPS (HKD)</td>
<td>0.142</td>
<td>0.311</td>
<td>0.396</td>
<td>0.533</td>
<td>0.635</td>
</tr>
<tr>
<td>P/E (X)</td>
<td>62.1</td>
<td>28.3</td>
<td>22.2</td>
<td>16.5</td>
<td>13.9</td>
</tr>
<tr>
<td>BVPS (HKD)</td>
<td>0.940</td>
<td>2.051</td>
<td>2.302</td>
<td>2.835</td>
<td>3.470</td>
</tr>
<tr>
<td>P/B (X)</td>
<td>9.4</td>
<td>4.3</td>
<td>3.8</td>
<td>3.1</td>
<td>2.5</td>
</tr>
<tr>
<td>DPS (HKD)</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Div. Yield (%)</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Source: PSR est.

*All multiples & yields based on current market price

Rating:

Buy

Target Price (HKD) 14.92
Forecast Dividend (HKD) 0.00
Closing Price (HKD) 8.80
Potential Upside 69.5%

Company Description

HC International is a leading PRC SMEs focused B2B e-commerce platform operator. Its provides also business information through trade catalogues and yellow page directories, and search engine services. The company has transferred from HKEx GEM board to the main board at Oct 10, 2014.

Company Data

- Raw Beta (Past 2yrs weekly data): N/A
- Market Cap. (HKD bn): 5,833
- Enterprise Value (HKD mn): 4,926
- 52 week range (HKD): 8.00 - 23.65
- Closing Price in 52 week range: 0.00

Major Shareholders

1. DIGITAL CHINA HOLDINGS LTD. (861.HK) 20.78%
2. Guo Jiang 8.98%
3. Kent C. McCarthy 8.91%
4. Guo Fansheng 8.71%
5. 2280.HK Equity (LHS)

Valuation Method

- PE

Analyst

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Business
With the largest shareholder Digital China (861.HK), HC Intl was focused on the SME B2B e-commerce in the mainland, which provided transaction and business information online platform "hc360.com", to match its buyer and seller clients. Revenue was coming from subscription fee from paying users as well as online advertisement income.

The primarily online products included Biao-Wang Search, Mai-Mai-Tong, Cai-Gou-Tong, Micro-Portal online and HuiFuBao.

Biao-Wang Search: Cooperated with search engine service providers like Baidu, 360 Search, Sogou and Google for SMEs to promote their brand names. There was also the mobile version.

Mai-Mai-Tong: A trading platform for SMEs to display product, precisely search/ match demand quickly, tailor-made services and direct sales. There was a new version, which build up micro shops at Wechat that end clients were able to access the shops by mobile terminals.

HuiFuBao: On-line B2B transaction service, which facilitated high value payment and improved the payment security.

HC – Minsheng e-Loan Credit Card: clients could apply business credit card to Minsheng Bank for trading purpose based on their creditworthiness on hc360.com.

Offline products included the Trade Catalogues and Yellow Page Directories, which provided market and corporate information with its huge database, and trading fairs and seminars.

The revenue proportion of online service increased steady to 88% in 1H14, while the revenue from trade catalogues and yellow page actually fell during these years.

In the future, we expect the proportion of online service revenue continues to increase, revenue from seminars stays flat, while revenue from trade catalogues and yellow page will decline.

Fig 1 1H14 Product Mix

Source: Company reports
Growth slowed down while margins improved

From the positive profit alert, the growth on revenue and net profit for the first three quarters will reach over 20% and 50% yoy. However, the growth slowed down when compared to the 30% and 95.8% yoy in the interim results. And it became more obvious when compared to the yoy growth for the previous quarters.

Although the growth rate dropped, profitability improved which both of the gross profit margin and net profit margin increased steadily. It was expected that the margin rates would become stable in the next few years.

<table>
<thead>
<tr>
<th>Table 1 GPM and NPM estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit Margin</td>
</tr>
<tr>
<td>Net Profit Margin</td>
</tr>
</tbody>
</table>

Source: PSR, Company report
On hand sufficient cash for further M&A activities
As at 1H14, the company held on hand over RMB 970 mn cash. After netting the current liabilities, there was still over RMB 300 mn cash for M&A activities. The company had announced at the end of September to acquire 56% stake of Panpass Information Technology with consideration of RMB 108 mn, and would establish a joint venture Zhejiang Huicong with Hui De, which principally engaging in investment in real estate.

Potential Risks
Growth online service slows faster than expected;
Increasing micro-credit loan raises the risk on doubtful loan.
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<td>3.8</td>
<td>3.1</td>
</tr>
<tr>
<td>EV/EBITDA (X)</td>
<td>73.4</td>
<td>29.0</td>
<td>21.3</td>
<td>15.7</td>
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<tr>
<td>Dividend Yield (%)</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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<tr>
<td><strong>Per share data (HKD)</strong></td>
<td></td>
<td></td>
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<tr>
<td>EPS</td>
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</tr>
<tr>
<td>Outstanding Shares (mn)</td>
<td>588.78</td>
<td>615.99</td>
<td>662.82</td>
<td>662.82</td>
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<tr>
<td><strong>Growth &amp; Margins (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>25.1%</td>
<td>52.7%</td>
<td>30.0%</td>
<td>30.0%</td>
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<tr>
<td>EBIT</td>
<td>75.3%</td>
<td>153.1%</td>
<td>36.4%</td>
<td>35.7%</td>
</tr>
<tr>
<td>Net Profit</td>
<td>61.9%</td>
<td>129.8%</td>
<td>36.9%</td>
<td>34.7%</td>
</tr>
<tr>
<td><strong>Margins</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross profit margin</td>
<td>87.5%</td>
<td>91.9%</td>
<td>91.5%</td>
<td>92.0%</td>
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<tr>
<td>EBITDA margin</td>
<td>12.2%</td>
<td>20.3%</td>
<td>21.3%</td>
<td>22.2%</td>
</tr>
<tr>
<td>EBT margin</td>
<td>14.3%</td>
<td>22.2%</td>
<td>23.1%</td>
<td>24.0%</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>12.2%</td>
<td>18.3%</td>
<td>19.3%</td>
<td>20.0%</td>
</tr>
<tr>
<td><strong>Income Statement (RMB mn)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>549</td>
<td>838</td>
<td>1,089</td>
<td>1,416</td>
</tr>
<tr>
<td>Cost of revenue</td>
<td>(69)</td>
<td>(68)</td>
<td>(93)</td>
<td>(113)</td>
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<tr>
<td>Gross profit</td>
<td>480</td>
<td>770</td>
<td>996</td>
<td>1,302</td>
</tr>
<tr>
<td>Selling &amp; Marketing expenses</td>
<td>(318)</td>
<td>(482)</td>
<td>(610)</td>
<td>(779)</td>
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<tr>
<td>Administrative expenses</td>
<td>(98)</td>
<td>(121)</td>
<td>(158)</td>
<td>(212)</td>
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<tr>
<td>Other income</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Operating profit</td>
<td>67</td>
<td>170</td>
<td>232</td>
<td>314</td>
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<tr>
<td>Finance income</td>
<td>12</td>
<td>17</td>
<td>20</td>
<td>25</td>
</tr>
<tr>
<td>Finance expense</td>
<td>(1)</td>
<td>(0)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Profit Before Tax</td>
<td>78</td>
<td>186</td>
<td>252</td>
<td>339</td>
</tr>
<tr>
<td>Taxation</td>
<td>(13)</td>
<td>(35)</td>
<td>(43)</td>
<td>(58)</td>
</tr>
<tr>
<td>Profit After Tax</td>
<td>65</td>
<td>152</td>
<td>209</td>
<td>282</td>
</tr>
<tr>
<td>Minority interest</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
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<td>Net Profit</td>
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</tr>
</tbody>
</table>

Source: Company, PSR
PHILIP RESEARCH STOCK SELECTION SYSTEMS

<table>
<thead>
<tr>
<th>Total Return</th>
<th>Recommendation</th>
<th>Rating</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;+20%</td>
<td>Buy</td>
<td>1</td>
<td>&gt;20% upside from the current price</td>
</tr>
<tr>
<td>+5% to +20%</td>
<td>Accumulate</td>
<td>2</td>
<td>+5% to +20% upside from the current price</td>
</tr>
<tr>
<td>-5% to +5%</td>
<td>Neutral</td>
<td>3</td>
<td>Trade within ±5% from the current price</td>
</tr>
<tr>
<td>-5% to -20%</td>
<td>Reduce</td>
<td>4</td>
<td>-5% to -20% downside from the current price</td>
</tr>
<tr>
<td>&lt;-20%</td>
<td>Sell</td>
<td>5</td>
<td>&gt;20% downside from the current price</td>
</tr>
</tbody>
</table>

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