

6 November 2014

HC INTERNATIONAL (2280.HK)

Positive profit alert in falling stock price, a buying opportunity

Rating: **Buy**

HONG KONG | SOFTWARE | COMPANY REPORT

- HC Intl 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.
- Both the GPM and NPM increased steady from 84.7% and 9.4% in 2011 to 94.7% and 22% in 1H14.
- Stock price dropped since the first quarter, the current price is about the same as of one year ago when forecasted profit growth is 37%, implied attractive valuation.
- We initiate the rating of HC Intl as “Buy” with target price of HK\$ 14.92, equivalent to 37.7x/28x of 2014 and 2015 forecasted EPS.

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

FYE Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenue (RMB mn)	549	838	1,089	1,416	1,770
Net Profit (RMB mn)	67	153	210	283	337
EPS (HKD)	0.142	0.311	0.396	0.533	0.635
P/E (X)	62.1	28.3	22.2	16.5	13.9
BVPS (HKD)	0.940	2.051	2.302	2.835	3.470
P/B (X)	9.4	4.3	3.8	3.1	2.5
DPS (HKD)	0.00	0.00	0.00	0.00	0.00
Div. Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: PSR est.

*All multiples & yields based on current market price

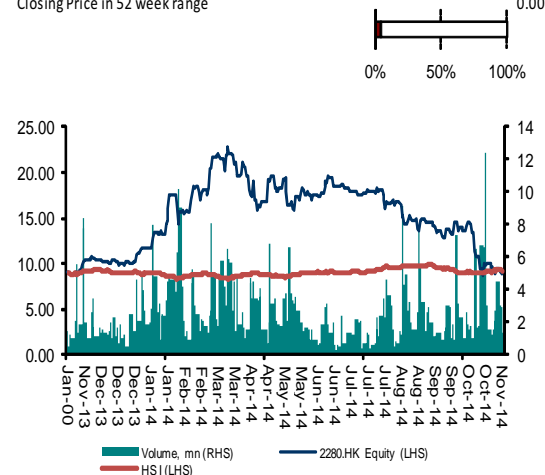
Target Price (HKD)	14.92
Forecast Dividend (HKD)	0.00
Closing Price (HKD)	8.80
Potential Upside	69.5%

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%

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.

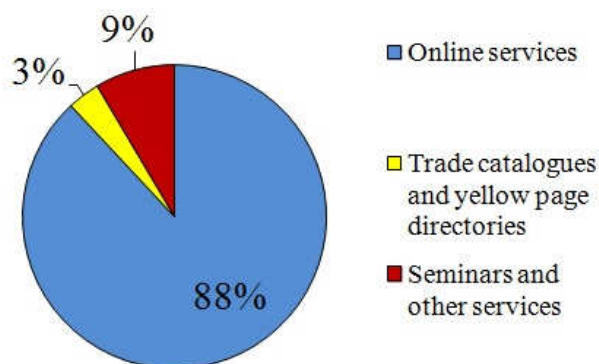
HC - Minsheng e-Loan Credit Card: clients could apply business credit card to Minsheng Bank for trading purpose based on their creditworthiness on hc360.com.

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.

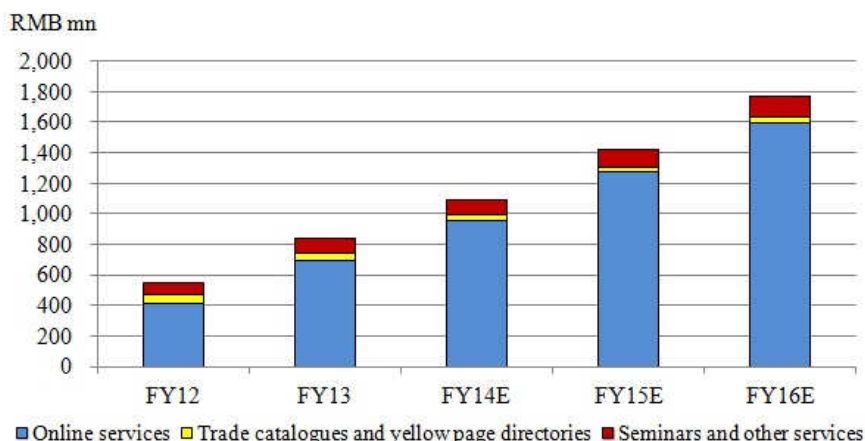
In the future, we expect the proportion of online service revenue continues to increase, revenue from seminars stays flat, while revenue from trade catalogues and yellow page will decline.

Fig 1 1H14 Product Mix



Source: Company reports

Fig 2 Revenue mix estimates

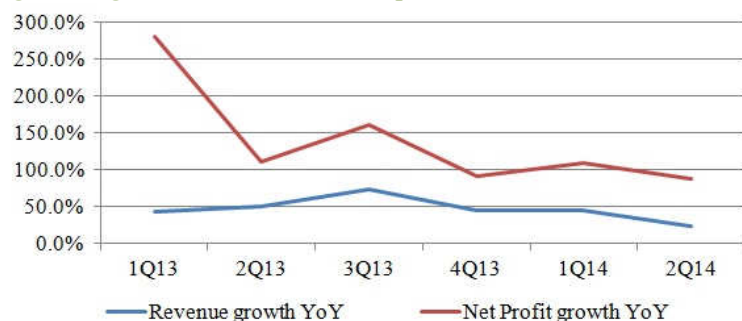


Source: PSR, Company report

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.

Fig 3 YoY growth on revenue and net profit



Source: Company report

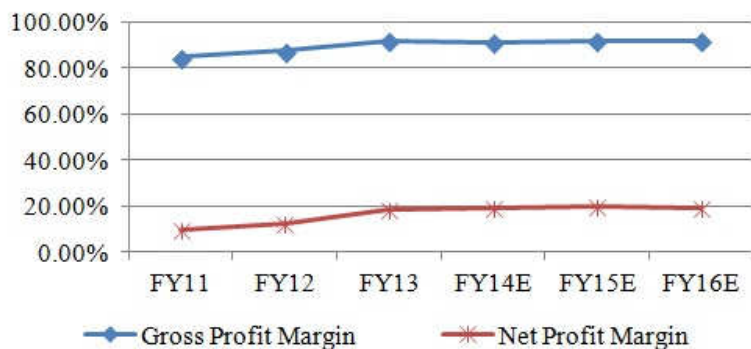
Although the growth rate dropped, profitability improved which both of the gross profit margin and net profit margin increased steady. It was expected that the margin rates would become stable in the next few years.

Table 1 GPM and NPM estimates

	FY11	FY12	FY13	FY14E	FY15E	FY16E
Gross Profit Margin	84.68%	87.48%	91.86%	91.46%	91.95%	91.98%
Net Profit Margin	9.40%	12.16%	18.30%	19.28%	19.99%	19.04%

Source: PSR, Company report

Fig 4 GPM and NPM estimates



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.

	FY12	FY13	FY14E	FY15E	FY16E
Valuation Ratios					
P/E (X)	62.1	28.3	22.2	16.5	13.9
P/B (X)	9.4	4.3	3.8	3.1	2.5
EV/EBITDA (X)	73.4	29.0	21.3	15.7	13.1
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Per share data (HKD)					
EPS	0.142	0.311	0.396	0.533	0.635
DPS	0.000	0.000	0.000	0.000	0.000
BVPS	0.940	2.051	2.302	2.835	3.470
Outstanding Shares (mn)	588.78	615.99	662.82	662.82	662.82
Growth & Margins (%)					
Growth					
Revenue	25.1%	52.7%	30.0%	30.0%	25.0%
EBIT	75.3%	153.1%	36.4%	35.7%	19.1%
Net Profit	61.9%	129.8%	36.9%	34.7%	19.1%
Margins					
Gross profit margin	87.5%	91.9%	91.5%	92.0%	92.0%
EBITDA margin	12.2%	20.3%	21.3%	22.2%	21.2%
EBT margin	14.3%	22.2%	23.1%	24.0%	22.9%
Net Profit Margin	12.2%	18.3%	19.3%	20.0%	19.0%
Income Statement (RMB mn)					
Revenue	549	838	1,089	1,416	1,770
Cost of revenue	(69)	(68)	(93)	(113)	(142)
Gross profit	480	770	996	1,302	1,628
Selling & Marketing expenses	(318)	(482)	(610)	(779)	(973)
Administrative expenses	(98)	(121)	(158)	(212)	(283)
Other income	3	3	3	3	3
Operating profit	67	170	232	314	375
Finance income	12	17	20	25	30
Finance expense	(1)	(0)	0	0	0
Profit Before Tax	78	186	252	339	405
Taxation	(13)	(35)	(43)	(58)	(69)
Profit After Tax	65	152	209	282	336
Minority interest	1	2	1	1	1
Net Profit	67	153	210	283	337
EPS	0.113	0.249	0.317	0.427	0.508

Source: Company, PSR

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Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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