

# HC Group (2280.HK)

## Result lower than expected, still in the transition

Hong Kong | TMT | Company Report

15 April 2019

### Investment Summary

HC Group is an information and B2B e-commerce service company in China. Its main businesses include: transaction, data and information services. Assuming 2019F P/E ratio to be 22x (the average of the past five years is 24x, we think 22x is within the reasonable range), we derive the TP to be HK\$5.79, 13.6% lower than our previous TP to reflect the slower progress of transition, and maintain a “Buy” rating, with 33.7% potential upside.. (Closing price at 11 Apr 2019)

### Performance review

The Group announced its annual results for 2018. During the period, its revenue increased by 1.85 times to RMB 10.58 billion, which was mainly from the B2B trading platform, but it was still slightly lower than our forecast, about 3.3%. In addition, the deterioration in gross profit margin was also faster than our forecast, which fell from 35.2% to 12%, 0.9% lower than our expectation. The operating profit (gross profit minus operating-related costs) was RMB 130 million, representing a decrease of approximately 55% YoY, mainly due to the decrease in gross profit and the increase in administrative expenses, partly attributable to the increase in share award and share option granted. The profit attributable to shareholders was RMB 276 million, which was 6.3% lower than our forecast.

In 2018, the Group reclassified its business into Technology-driven new retail segment, Smart industries segment and Platform and corporate services segment. During the period, the revenue of the Technology-driven new retail segment increased by 35.4%, but the profit of the segment decreased by 42%; that of the Smart industries segment jumped significantly by 327.5%, and the profit of the segment became profitable and recorded RMB 3.4 million; that of Platform and corporate services segment increased slightly by 3.5%, but the segment profit fell by about 50%.

### Business update

Through the combination of “Supply Chain + SaaS System + Service”, Technology-driven new retail segment can empower 3C and home appliance stores in third- and fourth-tier cities. The Group makes use of “zol.com.cn” to direct online users to the offline, and relies on its own SaaS system to provide supply chain services to offline.

We believe that this strategy is reasonable and the Group has sufficient advantages to conduct this business.

### Buy

**CMP** HKD 4.33

(Closing price at 11 Apr 2019)

**TARGET** HKD 5.79 (+33.7%)

#### COMPANY DATA

O/S SHARES (MN) :	1,120
MARKET CAP (HKDMN) :	4,853
52 - WK HI/LO (HKD):	5.83 / 3.86

#### SHARE HOLDING PATTERN • %

DC Holdings	30.44
Mr. Guo Jiang	15.36
Mr. Liu Jun	7.01

#### PRICE PERFORMANCE • %

	1M	3M	1Y
HC Group	-5.66	-2.26	-20.99
HSI	3.58	13.47	-3.22

#### RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

#### KEY FINANCIALS

RMB mn	FY17	FY18	FY19E	FY20E
Revenue	3,702	10,583	16,561	23,498
Net Profit	317	277	258	502
EPS, RMB	0.247	0.246	0.228	0.443
PER, x	15.17	15.20	16.45	8.45
BVPS, RMB	3.37	3.87	4.23	4.80
P/BV, x	1.11	0.97	0.89	0.78
ROE, %	8.1	6.9	5.6	9.8

Source: Company reports, Phillip Securities Est.

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First, by choosing 3C and home appliances as an entry point, the Group not only can take advantage of its “zol.com.cn”, but also avoid direct competition with Alibaba’s LST which chose fast moving consumer goods as the entry point. Besides, most of the sales of 3C and home appliances in first- and second-tier cities are monopolized by large chain stores, because their brands can bring a greater confidence to consumers, so local small stores enjoy no advantages. However, the Group is focusing on third- and fourth-tier cities, such as Henan, Hunan, Hubei, Jiangxi, Guangxi and so on, where local small shops still managed to survive. As long as there are modern management and big data, the operational efficiency of small stores is expected to be improved. At present, the profit of this segment mainly comes from the media (zol.com.cn), and the SaaS system also generated a little bit revenue, but as the GMV goes up, the source of profit in future is believed to be the supply chain solution. Currently, there are about 7,000 users in the SaaS system, of which 4,000 are paid, and the group aims to reach more than 10,000 paying users in 2019.

We expect the growth of Smart industries segment to slow down, but the gross profit margin will gradually improve. Among them, the group stated that the business strategy of Ibuychem will focus on products with higher profit margin this year, so GMV growth will slow down. Apart from Ibuychem, Union Cotton is expected to see a significant increase, mainly because the platform will focus on upstream in an attempt to resolve the issue of insufficient sources of cotton in the past. In addition, as China’s Formwork and scaffolding market continues to reform, China Formwork is also expected to enjoy a greater growth.

In relation to Platform and corporate services segment, the product of the Group and Qidian, the subsidiary of Tencent Cloud is expected to be announced at the end of April. It is expected this cooperation could bring complementary advantages. However, the cooperation between the two parties remains on the project level now. We believe that the results of this product will be one of the considerations for further cooperation between the two parties in future.

## Valuation

We expect the GPM will remain its downtrend in 2019F, but with a decreasing rate, about 8.5%, and 7.6% in 2020F, due to the increasing proportion of China Formwork and Panpass, which have higher GPM, and the improving GPM of Ibuychem. Assuming 2019F P/E ratio to be 22x (the average of the past five years is 24x, we think 22x is within the reasonable range), we derive the TP to be HK\$5.79, 13.6% lower than our previous TP to reflect the slower progress of transition, and maintain a “Buy” rating, with 33.7% potential upside. (HKD/CNY=0.8645)

## Risk

1. The presence of B2B platforms with similar functions
2. Demand for the commodity reduces due to the economic downturn
3. Suppliers refuse to cooperate with the Group

## Financials

FYE DEC	FY15	FY16	FY17	FY18	FY19F	FY20F
<b>Valuation Ratios</b>						
P/E (X), adj	64.10	20.68	15.17	15.20	16.45	8.45
P/B (X)	1.37	1.26	1.11	0.97	0.89	0.78
Dividend Yield (%)	N/A	1.2%	0.5%	N/A	0.3%	0.6%
<b>Per share data (RMB)</b>						
EPS, (Basic)	0.058	0.181	0.247	0.246	0.228	0.443
EPS, (Diluted)	0.057	0.178	0.239	0.246	0.228	0.443
DPS (HKD)	N/A	0.05	0.020	N/A	0.013	0.026
BVPS	2.74	2.98	3.37	3.87	4.23	4.80
<b>Growth &amp; Margins (%)</b>						
<b>Growth</b>						
Revenue	-5.2%	113.8%	89.1%	185.8%	56.5%	41.9%
EBIT	-85.6%	1439.0%	17.5%	-23.4%	21.1%	62.0%
Net Profit	-87.4%	1204.0%	5.5%	-12.7%	-6.9%	94.7%
<b>Margins</b>						
Gross margin	89.6%	63.9%	35.2%	12.0%	8.5%	7.6%
EBIT margin	3.0%	21.9%	13.6%	3.7%	2.8%	3.2%
Net Profit Margin	2.5%	15.4%	8.6%	2.6%	1.6%	2.1%
<b>Key Ratios</b>						
ROA	0.5%	5.0%	4.7%	3.4%	2.8%	4.9%
ROE	2.9%	6.7%	8.1%	6.9%	5.6%	9.8%
<b>Income statement (RMB mn)</b>						
Revenue	916	1,958	3,702	10,583	16,561	23,498
Gross Profit	821	1,252	1,305	1,267	1,406	1,793
EBIT	28	429	505	387	468	759
EBT	33	394	416	332	314	612
Net Profit	23	301	317	277	258	502
Minority Interest	(29)	119	50	1	3	5
Net profit for owners	53	182	268	276	255	497

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.8645) is HKDCNY1Y forward contract price on April 11 from Wind.

(Financial figures as at 11 April 2019)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

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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