

Sound Global (967 HK)

Buy (maintained)

Target price: HK\$11.20



Wallace Cheng

SFC CE No. AKX251

wallacecheng@gfgroup.com.hk

+852 3719 1049

GF Securities (Hong Kong) Brokerage Limited
29-30/F, Li Po Chun Chambers
189 Des Voeux Road Central
Hong Kong

Solid defense against allegation report; maintain Buy

Solid defense against allegation report Sound Global (SG) has issued a clarification announcement with a solid defense against Emerson's Analytics' (EA) allegation report. Key highlights: 1) SG's auditor Deloitte has confirmed that there is no change in their audit opinions on SG's prospectus and financial statements during 2010-13; 2) The missing EPC contracts that EA was unable to find were under direct negotiation with local governments and SOEs; 3) The CR appraisal report used the wrong classification for business segments and Chinese GAAP, which is the main discrepancy when compared to the financials reported under IFRS; 4) The company undertook BT construction of the pipe network and pump stations related to the BOT water projects. The apparent "delay" in revenue booking was mainly because the formal commencement date of the BOT projects was in 2013/14; 5) Regarding the Jingzhou Project, SG did start the project in Feb 2008. The company admits that the late approval from the shareholder meeting for the connected transaction was a minor failure in its corporate governance and says it will improve; 6) Management stated that: i) the company will conduct a share repurchase; ii) Chairman Wen Yibo will increase his stake in the company in order to stabilize the share price.

Easy defense against EA's weak comeback Shortly after SG gave its first clarification, EA issued another report to question the classification of "biggest customer". Management explained clearly that "biggest customer" referred to an external customer, and that was why revenue from Anshan BOT projects were treated as being from an internal customer. It is common for short sellers to issue follow-up reports. Yet, we believe this one was weak.

Outlook remains sound During today's conference call, management promised to improve transparency for its EPC contracts. Another positive is that all previous EPC contracts were reviewed by HKEX, who have raised no further questions. Meanwhile, management targets to increase revenue from its operation segment to over 30% of total revenue in three years and maintains its acquisition target of 1mt in capacity for municipal wastewater treatment in the next five years.

Good buying opportunity We are satisfied with SG's clarification. The allegations from EA have been proved to be one-sided and without solid ground, in our view. We believe the detailed explanation in the company's announcement and management's strong determination to protect minority shareholders' interests should alleviate investor concerns. Although we believe SG's share price will remain weak in the short term, we expect it to pick up after SG announces a concrete share buy-back plan, or when management increases its stake. We maintain our Buy rating.

Stock performance



Source: Bloomberg

Key data

Feb 13 close (HK\$)	7.58
Shares in issue (m)	1,780
Major shareholder	Sound Env. (31%)
Market cap (HK\$ bn)	13.5
3M avg. vol. (m)	3.7
52W high/low (HK\$)	9.47 / 5.66

Source: Bloomberg

Stock valuation

	Turnover (Rmb m)	Net profit (Rmb m)	EPS (Rmb)	EPS YoY (%)	P/E	BPS (Rmb)	P/B	ROE (%)
2012	2,652	428	0.331	3.3	18.2	2.05	4.7	16.2
2013	3,140	423	0.328	-1.0	18.3	2.38	4.0	13.8
2014E	4,025	597	0.398	21.2	15.1	2.45	3.9	16.3
2015E	5,183	831	0.467	17.3	12.9	3.53	2.7	13.2
2016E	6,370	1,079	0.606	29.9	9.9	4.14	2.3	14.6

Sources: Company data, GF Securities (HK)

Note: Calculated based on diluted shares.

Figure 1: Financial statements

Income Statement						Balance Sheet					
Year ended Dec (Rmb m)	2012	2013	2014E	2015E	2016E	Year ended Dec (Rmb m)	2012	2013	2014E	2015E	2016E
Turnkey projects and services	2,446	2,883	3,661	4,467	5,450	Cash and cash equivalents	2,912	3,534	2,379	3,073	1,707
Equipment fabrications	112	64	57	60	63	Trade and other receivables	1,433	1,569	1,971	2,538	3,120
O&M	94	193	306	655	857	Amounts due from customers	584	1,097	1,665	2,406	3,329
Turnover	2,652	3,140	4,025	5,183	6,370	Other current assets	79	139	146	157	167
YoY (%)	15.9	18.4	28.2	28.8	22.9	Total current assets	5,008	6,338	6,161	8,174	8,324
COGS	(1,852)	(2,181)	(2,796)	(3,599)	(4,415)	Property, plant & equipment	48	50	51	52	54
Gross profit	800	958	1,230	1,584	1,955	Land use right	43	78	76	75	74
YoY (%)	10.8	19.7	28.3	28.8	23.4	Service concession	1,643	2,237	3,397	4,908	6,792
Other operating income	54	95	134	196	277	Other non-current assets	97	95	93	91	89
Other expenses	2	(11)	(16)	(26)	(38)	Total non-current assets	1,831	2,460	3,617	5,127	7,008
Distribution expenses	(38)	(38)	(56)	(78)	(102)	Short-term borrowings	465	764	1,031	1,124	1,225
Research and development	(24)	(20)	(28)	(41)	(57)	Trade and other payables	1,171	1,654	2,120	2,729	3,348
Administrative expenses	(118)	(132)	(177)	(228)	(287)	Other current liabilities	127	151	242	368	527
EBIT	677	851	1,086	1,407	1,747	Total current liabilities	1,763	2,569	3,393	4,220	5,100
YoY (%)	14.9	25.8	27.5	29.6	24.2	Long-term borrowings	889	1,518	1,639	1,705	1,773
Finance costs	(174)	(285)	(288)	(296)	(305)	Senior notes	923	899	908	908	908
Profit before income tax	503	566	798	1,111	1,443	Other non-current liabilities	610	738	165	165	165
Income tax expense	(76)	(141)	(198)	(276)	(359)	Total non-current liabilities	2,421	3,154	2,712	2,778	2,846
After tax profit	428	425	600	835	1,084	Share capital	833	833	833	833	833
Minority interest	0	(2)	(3)	(4)	(5)	Reserves	1,811	2,237	2,834	5,458	6,537
Net profit	428	423	597	831	1,079	Equity attributable to	2,644	3,070	3,667	6,292	7,371
YoY (%)	3.3	(1.0)	41.0	39.2	29.9	Non-controlling interests	11	4	7	11	16
						Total equity	2,655	3,074	3,674	6,303	7,387
Cash Flow Statement						Financial Ratio					
Year ended Dec (Rmb m)	2012	2013	2014E	2015E	2016E	2012	2013	2014E	2015E	2016E	
Pre-tax profit	503	566	798	1,111	1,443	Gross margin (%)	30.2	30.5	30.5	30.6	30.7
Tax paid	(57)	(66)	(119)	(166)	(215)	EBIT margin (%)	25.5	27.1	27.0	27.1	27.4
Dep'n and amortization	16	17	8	8	8	Net margin (%)	16.1	13.5	14.8	16.0	16.9
Change in working capital	(694)	(621)	(1,661)	(2,205)	(2,764)	ROA (%)	6.3	4.8	6.1	6.2	7.0
Others	126	221	277	285	294	ROE (%)	16.2	13.8	16.3	13.2	14.6
Cash from operations	(106)	117	(697)	(967)	(1,235)	Net gearing (%)	NC	4%	30%	9%	28%
Capital expenditure	(5)	(6)	(6)	(6)	(6)	Interest coverage (x)	3.9	3.0	3.8	4.8	5.7
Others	(14)	(143)	11	11	11	Current ratio	2.8	2.5	1.8	1.9	1.6
Cash from investing	(19)	(150)	5	5	5						
Proceed from share issuance	0	0	0	1,794	0						
Change in borrowings	1,138	924	(175)	158	169						
Dividend paid	(65)	0	0	0	0						
Others	(110)	(264)	(288)	(296)	(305)						
Cash from financing	963	660	(463)	1,657	(135)						
FX change	(0)	(6)	0	0	0						
Net change in cash	838	622	(1,155)	694	(1,365)						

Sources: Company data, GF Securities (HK)

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings

Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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29-30/F, Li Po Chun Chambers, 189 Des Voeux Road Central, Hong Kong

Tel: +852 3719 1111 Fax: +852 2907 6176 Website: <http://www.gfgroup.com.hk>