

Chinasoft International | 354 HK

Another grand debut

Organizes first Global Programmers' Festival in Xi'an

"Jointforce" and cloud the dual-engines of growth

Lagging share price provides good entry point

Organizes Programmers' Festival. The government of Xi'an along with Huawei, Microsoft, HSBC and Chinasoft, have all answered Beijing's call to explore business opportunities under the auspices of the One Belt, One Road initiative. They did so by hosting the Global Programmers' Festival in Xi'an on 9 Nov. Attendees included over 10,000 programmers and around 400 VIPs from 20 different countries. The event was an opportunity for Chinasoft to raise its profile and form new strategic partnerships. In Jun, Chinasoft and the Xi'an government agreed to develop Software Park, an industrial zone. A more long-term company initiative is Jointforce, a cloud-based coding platform targeting SMEs.

Jointforce and cloud the dual-engines of growth. In the last year, cloud services have served as a major catalyst for Chinasoft – so much so that Chinasoft recently partnered with tech giant Huawei to develop the business. We forecast that by the end of 2017F, revenue from Huawei will have increased 48% YoY to contribute c.60% of Chinasoft's revenue for the year. Besides cloud, Jointforce represents another potential engine of growth. By 1H17, the platform had already gathered over 180,000 development engineers and 3,000 third-party servicing partners, making it one of the largest B2B programming outsourcing platforms in China. We expect FY17F revenue from Jointforce to break RMB300m and beat the company's own beginning-of-the-year guidance for RMB200m in revenue.

Maintain Outperform rating on attractive valuation. We stick to our very positive view on Chinasoft given the company's growth prospects and attractive valuation and despite the share price, which has slightly lagged the bull market. We look for 34% YoY revenue growth and 24% net profit growth in FY17F. Chinasoft is currently trading at 19x/16x FY17/18F P/E. With the current PEG at only 0.8x, we forecast earnings CAGR of 21% for FY16-19F. In our view, the company's all-in move to cloud and the steady progress of the Jointforce platform will become catalysts in FY18-19F. We maintain our Outperform rating and HK\$5.95 target price on the stock. Our target price, based on 20x FY18 P/E, implies 31% potential upside to the current price.

Forecast and valuation

Year to 31 Dec	2015	2016	2017F	2018F	2019F
Revenue (RMB m)	5,129	6,783	9,101	10,715	12,271
YoY (%)	15.8	32.3	34.2	17.7	14.5
Net profit (RMB m)	280	442	549	650	791
YoY (%)	40.0	57.9	24.1	18.4	21.7
Fully diluted EPS (RMB)	0.14	0.20	0.22	0.26	0.32
YoY (%)	29.1	45.5	10.6	18.4	21.7
P/E (x)	28.7	22.0	18.5	15.7	12.9
Dividend per share (HK\$)	–	0.01	0.02	0.03	0.04
Dividend yield (%)	–	0.3	0.5	0.6	0.8
P/B (x)	2.8	2.3	2.0	1.8	1.6
ROAE (%)	9.8	11.8	12.1	12.8	13.8
Net debt/equity (%)	8.5	-4.2	8.0	8.4	5.4

Source: Bloomberg, CCBIS estimates

Outperform (maintained)

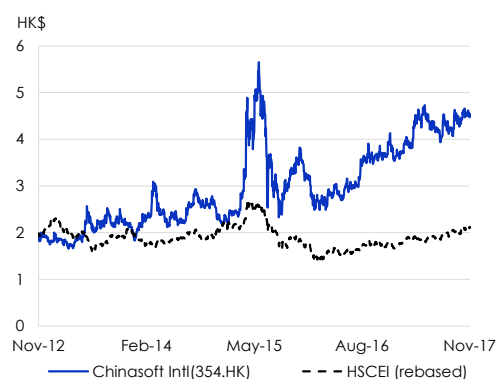
Current price:	Target:
HK\$4.54	HK\$5.95
(as at 9 Nov 2017)	(maintained)

Trading data

52-week range	HK\$2.65 – 4.81
Market capitalization (m)	HK\$10,895/US\$1,400
Shares outstanding (m)	2,400
Free float (%)	80
3M average daily T/O (m share)	14.7
3M average daily T/O (US\$ m)	8.4
Expected 12-month return (%)	31

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI



Source: Bloomberg, CCBIS

Stock performance

Performance over	1M	3M	12M
Absolute	-2	10	25
Relative (%) to HSCEI	-4	-1	0

Source: Bloomberg, CCBIS

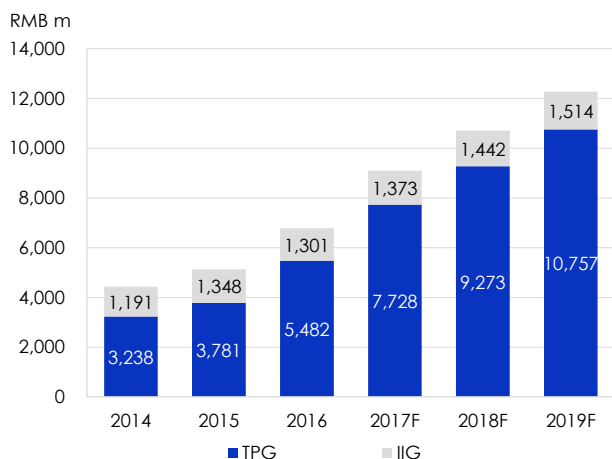
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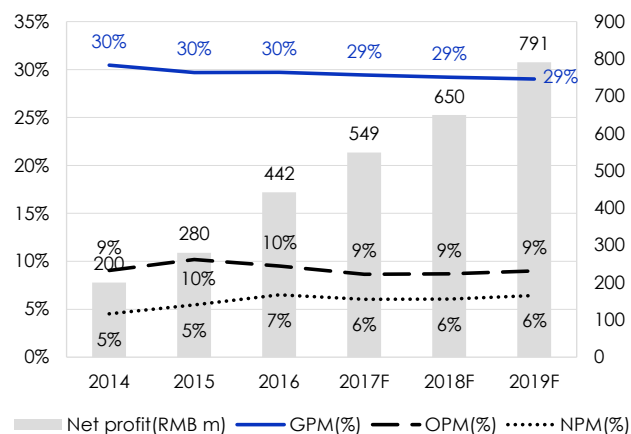
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Chinasoft – revenue mix (RMB m)



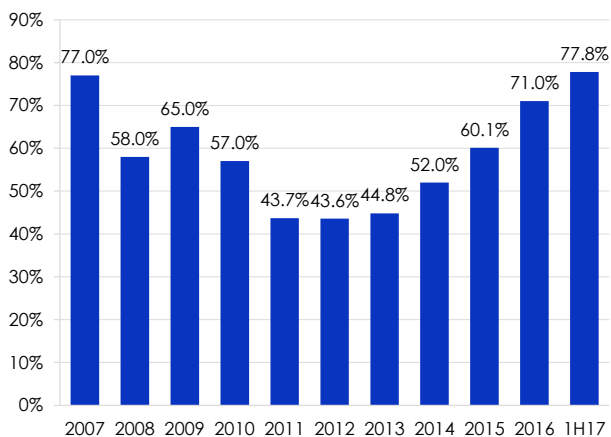
Source: Company data, CCBIS estimates

Chinasoft – net income (RMB m) and margin ratios



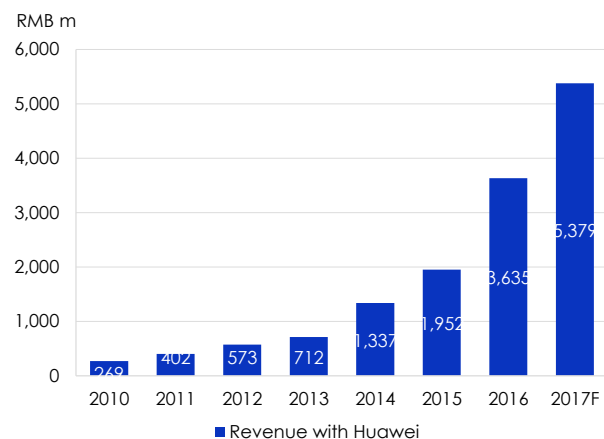
Source: Company data, CCBIS estimates

Chinasoft – top-10 customers by revenue contribution (%)



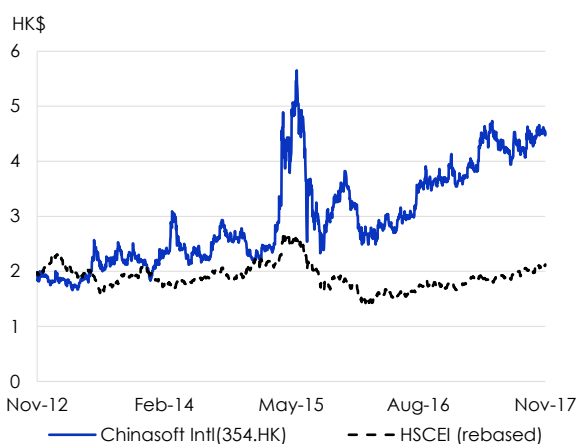
Source: Company data, CCBIS

Chinasoft – revenue contributed by Huawei



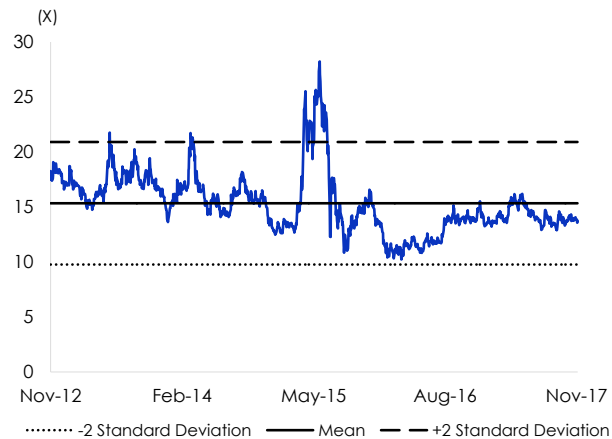
Source: Company data, CCBIS estimates

Chinasoft – price performance vs. HSCI



Source: Bloomberg, CCBIS

Chinasoft – 5-year P/E bands



Source: Bloomberg, CCBIS

Chinasoft International – earnings revisions

Profit and loss	New			Previous			% change		
	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F
RMB m									
Revenue	9,101	10,715	12,271	9,101	10,715	12,271	0.0	0.0	0.0
Gross profit	2,679	3,129	3,559	2,679	3,129	3,559	0.0	0.0	0.0
Opex	-1,892	-2,197	-2,454	-1,892	-2,197	-2,454	0.0	0.0	0.0
Operating profit	787	932	1,104	787	932	1,104	0.0	0.0	0.0
Net profit	549	650	791	549	650	791	0.0	0.0	0.0
%									
Gross margin	29.4	29.2	29.0	29.4	29.2	29.0	-	-	-
OPEX to sales	-20.8	-20.5	-20.0	-20.8	-20.5	-20.0	-	-	-
OPM	8.6	8.7	9.0	8.6	8.7	9.0	-	-	-
Net margin	6.0	6.1	6.4	6.0	6.1	6.4	-	-	-

Source: CCBIS estimates

Software sector peer comparisons

Year ended 31 Dec	Stock code	CCBIS rating#	Share price* (LC)	Market cap (US\$ m)	P/E (x)			EPS growth (%)		
					FY17F	FY18F	FY19F	FY17F	FY18F	FY19F
HK listed										
TravelSky	696 HK	Not Rated	20.30	7,617	22	19	17	21	15	15
Kingsoft Corp	3888 HK	Outperform	21.35	3,588	21	15	12	57	39	25
Chinasoft International	354 HK	Outperform	4.54	1,400	19	16	13	24	18	22
Kingdee	268 HK	Outperform	4.25	1,582	49	37	28	7	32	33
Digital China	861 HK	Not Rated	4.55	979	-55	22	16	-151	-345	44
Sinsoft	1297 HK	Not Rated	2.46	391	12	10	9	5	18	20
Chanjet	1588 HK	Not Rated	12.60	351	N/A	17	9	N/A	N/A	N/A
Average					11	19	14	-6	-36	27
A-share listed										
iFlytek	002230 CH	Outperform	59.32	12,406	161	108	79	-7	48	38
Wangsu	300017 CH	Underperform	8.90	3,230	25	23	19	-35	10	18
Aisino	600271 CH	Not Rated	19.36	5,431	24	22	17	-9	8	N/A
Hundsun	600570 CH	Not Rated	53.51	4,979	64	50	42	7	28	19
Yonyou	600588 CH	Neutral	24.88	5,486	86	59	48	8	45	25
Shiji info	002153 CH	Not Rated	25.55	4,105	64	52	42	5	23	23
Neusoft Corp	600718 CH	Not Rated	16.34	3,059	43	30	26	-71	43	15
Teamsun	600410 CH	Not Rated	10.74	1,784	N/A	N/A	N/A	N/A	N/A	N/A
YGsoft Inc	002063 CH	Not Rated	11.34	1,029	41	N/A	N/A	-43	N/A	N/A
Average					63	49	39	-18	29	23
Global peers										
Microsoft	MSFT US	Not Rated	84.56	652,346	25	23	20	11	11	14
Oracle	ORCL US	Not Rated	50.54	210,906	17	16	15	12	8	8
IBM	IBM US	Not Rated	151.57	140,322	11	11	11	2	1	3
SAP	SAP US	Not Rated	114.60	140,787	27	25	23	7	9	12
Accenture	ACN US	Not Rated	144.89	96,673	22	20	19	11	9	8
Salesforce	CRM US	Not Rated	105.03	75,485	80	62	49	35	29	27
Workday Inc.	WDAY US	Not Rated	110.88	23,063	134	101	74	2,663	33	37
Netsuite	N US	Not Rated	109.54	8,865	202	143	96	158	42	49
Average					65	50	38	362	18	20

* Price as at close on 9 Nov 2017 (local currency)

Source: Bloomberg, CCBIS estimates

Chinasoft International – P&L assumptions

RMB m	FY15	FY16	FY17F	FY18F	FY19F	1H16	2H16	1H17	2H17F
Revenue breakdown									
TPG business	3,781	5,482	7,728	9,273	10,757	2,288	3,194	3,511	4,216
IIG business	1,348	1,301	1,373	1,442	1,514	597	704	634	740
Total revenue	5,129	6,783	9,101	10,715	12,271	2,885	3,898	4,145	4,956
YoY (%)	16	32	34	18	15	N/A	N/A	44	27
Cost of revenues	-3,606	-4,768	-6,422	-7,586	-8,712	-2,082	-2,685	-3,002	-3,419
Gross profit	1,523	2,016	2,679	3,129	3,559	803	1,213	1,143	1,536
Gross profit margin (%)	30	30	29	29	29	28	31	28	31
Sales and marketing expense	-179	-219	-261	-321	-368	-112	-107	-147	-114
General & administrative expense	-627	-807	-1,205	-1,339	-1,472	-391	-416	-660	-545
Research and development	-195	-345	-426	-536	-614	0	-345	0	-426
Total operating expense	-1,001	-1,371	-1,892	-2,197	-2,454	-503	-868	-807	-1,085
Operating profit	522	645	787	932	1,104	300	345	336	451
Operating profit margin (%)	10	10	9	9	9	10	9	8	9
Other income, gains and losses	29	44	59	50	50	48	-4	34	25
Allowance for doubtful debts	-62	-18	-6	-15	-15	-11	-7	-1	-5
Other expenses	-92	-88	-82	-90	-90	-41	-47	-42	-40
Fair value gain on derivative financial instruments	-1	0	0	0	0	0	0	0	0
Finance costs	-93	-96	-88	-85	-85	-39	-57	-43	-45
Share of results of associates	2	17	-16	0	0	10	7	-16	0
Gain on disposal of associates	112	0	0	0	0	0	0	0	0
Loss arising from changes in fair value of contingent consideration payable on acquisition of a subsidiary	3	20	0	0	0	0	20	0	0
Profit before tax	420	525	654	792	964	266	258	268	386
Taxation	-87	-115	-120	-143	-174	-48	-67	-28	-93
Effective tax rate (%)	-21	-22	-18	-18	-18	-18	-26	-10	-24
Net income	333	410	534	650	791	219	191	240	293
- Minority interests	53	-32	-15	0	0	-18	-15	-5	-10
Net income attributable to common shareholders	280	442	549	650	791	236	206	245	303
YoY (%)	40	58	24	18	22	N/A	N/A	4	47
Net profit margin (%)	5	7	6	6	6	8	5	6	6
EPS diluted (HK\$)	0.16	0.22	0.25	0.30	0.36	0.11	0.10	0.11	0.14
Diluted share volume (m)	2,123	2,400	2,508	2,508	2,508	2,400	2,400	2,508	2,508
Key ratios (%)									
EPS growth	24	36	14	18	22	37	21	2	45
Gross profit margin	30	30	29	29	29	28	31	28	31
Operating profit margin	10	10	9	9	9	10	9	8	9
Net profit margin	5	7	6	6	6	8	5	6	6
ROAE	10	12	12	13	14	N/A	N/A	N/A	N/A
Net debt-to-equity	8	-4	8	8	5	N/A	N/A	N/A	N/A

Source: Company data, CCBIS estimates

Chinasoft International | 354 HK – financial summary

Profit and loss

FYE 31 Dec (RMB m)	2015	2016	2017F	2018F	2019F
TPG business	3,781	5,482	7,728	9,273	10,757
IIG business	1,348	1,301	1,373	1,442	1,514
Revenue	5,129	6,783	9,101	10,715	12,271
COGS	(3,606)	(4,768)	(6,422)	(7,586)	(8,712)
Gross profit	1,523	2,016	2,679	3,129	3,559
Operating expenses	(1,001)	(1,371)	(1,892)	(2,197)	(2,454)
EBIT	522	645	787	932	1,104
Net financial inc. (exp.)	(93)	(96)	(88)	(85)	(85)
Others	(10)	(25)	(45)	(55)	(55)
Profit before tax	420	525	654	792	964
Tax	(87)	(115)	(120)	(143)	(174)
Total profit	333	410	534	650	791
Minority interest	(53)	32	15	–	–
Net profit attributable to shareholders	280	442	549	650	791
Diluted EPS (RMB)	0.14	0.20	0.22	0.26	0.32
Dividend (RMB m)	–	29	55	65	79
Dividend per share (RMB)	0.00	0.01	0.02	0.03	0.03

Cash flow

FYE 31 Dec (RMB m)	2015	2016	2017F	2018F	2019F
Profit before tax	420	525	654	792	964
Amortization & depreciation	143	144	167	190	212
Net financial charge adj.	93	96	88	85	85
Non-cash items adjust.	(21)	–	–	–	–
Change in working capital	(332)	(279)	(1,024)	(594)	(579)
Tax paid	(42)	(115)	(120)	(143)	(174)
Other	–	(79)	65	–	–
Operating cash flow	260	292	(170)	330	509
Capex	(272)	(250)	(220)	(200)	(180)
Investment	(3)	–	–	–	–
Net interest received (paid)	4	–	–	–	–
Other	(55)	(458)	(60)	(60)	(60)
Investment cash flow	(326)	(708)	(280)	(260)	(240)
Change in borrowings	242	–	–	–	–
Equity issues	326	545	–	–	–
Dividend paid	–	–	(29)	(55)	(65)
Other	(50)	(96)	(88)	(85)	(85)
Financing cash flow	518	449	(117)	(140)	(150)
Change in cash flow	451	33	(567)	(70)	119
Cash & equivalents, begin	811	1,266	1,299	732	662
Forex	3	–	–	–	–
Cash & equivalents, end	1,266	1,299	732	662	782
Free cash flow	(48)	119	(434)	160	359

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2015	2016	2017F	2018F	2019F
Cash and equivalents	1,266	1,299	732	662	782
Pledge dep., restrict. cash	45	1	1	1	1
Receivables	3,005	3,607	5,089	5,977	6,833
Inventory	30	21	21	21	21
Total current assets	4,346	4,927	5,843	6,661	7,636
Property, plant and equip.	538	820	878	988	1,062
Intangible assets	283	231	221	181	135
Other non-current assets	1,181	1,251	1,251	1,251	1,251
Total non-current assets	2,002	2,302	2,350	2,421	2,448
Total assets	6,348	7,229	8,193	9,082	10,084
Short-term borrowings	1,297	922	922	922	922
Trade and bills payable	942	1,205	1,664	1,957	2,234
Other current liabilities	299	312	312	312	312
Total current liabilities	2,539	2,439	2,898	3,192	3,468
Long-term borrowings	263	194	194	194	194
Other non-current liabilities	60	263	263	263	263
Total non-current liabilities	323	458	458	458	458
Total liabilities	2,862	2,897	3,356	3,649	3,926
Share capital	2,202	2,759	2,759	2,759	2,759
Reserves & retained profits	1,046	1,505	2,025	2,620	3,345
Shareholders' equity	3,247	4,264	4,784	5,379	6,105
Minority interest	239	68	53	53	53
Total equity	3,486	4,333	4,837	5,432	6,158
Total equity and liabilities	6,348	7,229	8,193	9,082	10,084

Ratios

FYE 31 Dec	2015	2016	2017F	2018F	2019F
Growth (%)					
Revenue	15.8	32.3	34.2	17.7	14.5
EBITDA	22.8	18.8	20.9	17.6	17.4
EBIT	30.4	23.5	22.0	18.5	18.5
Net profit	40.0	57.9	24.1	18.4	21.7
Profitability (%)					
Gross margin	29.7	29.7	29.4	29.2	29.0
EBITDA margin	13.0	11.6	10.5	10.5	10.7
EBIT margin	10.2	9.5	8.6	8.7	9.0
Net margin	5.5	6.5	6.0	6.1	6.4
Tax rate	20.7	21.9	18.4	18.0	18.0
Efficiency (days)					
Inventory turnover	3	2	1	1	1
Trades receivable	98	96	98	102	103
Trades payable	89	82	82	87	88
Returns & leverage (%)					
ROAA	4.8	6.5	7.1	7.5	8.3
ROAE	9.8	11.8	12.1	12.8	13.8
Net debt (cash)/equity	8.5	(4.2)	8.0	8.4	5.4
Liquidity (x)					
Current ratio	1.7	2.0	2.0	2.1	2.2
Quick ratio	1.7	2.0	2.0	2.1	2.2

Rating definitions:

Outperform (O) – expected return > 10% over the next twelve months

Neutral (N) – expected return between -10% and 10% over the next twelve months

Underperform (U) – expected return < -10% over the next twelve months

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