

# Chinasoft International | 354 HK

## Cooperation with Baidu in AI a sign of its high standing

Joining with Baidu to develop AI

New products showcased at World Intelligent Manufacturing Summit 2017

Potential from new business initiatives

### Outperform (maintained)

Current price:

**HK\$4.84**

(as at 8 Dec 2017)

Target:

► **HK\$5.95**

(maintained)

**Partnering with Baidu.** Last Thursday, Chinasoft announced that it had partnered with Baidu to develop AI, big data and cloud products and solutions. Together with Tencent, Alibaba and Iflytek, Baidu is one of China's four national AI innovation platforms. For its part, Chinasoft brings years of big data and cloud development to the table. It has extensive experience serving giant tech clients such as Huawei, Microsoft and Tencent. It also boasts longstanding relationships with industrial clients in the areas of finance, manufacturing, telecom and public services. The fact that Baidu is willing to partner with Chinasoft is a testament to the latter's standing among technical firms in China.

**Present at the World Intelligent Manufacturing Summit 2017.** Chinasoft participated in the World Intelligent Manufacturing Summit 2017 in Nanjing last week following a one-day NDR with CCBI on Wednesday. At the summit, Chinasoft introduced an updated version of its manufacturing execution system (MES). Attendees were invited to an on-site visit to the Hefei Cigarette Factory, where Chinasoft's private cloud MES system is in use. Chinasoft also released a more affordable public version of its cloud MES, which we believe will make it accessible to a larger pool of customers. We expect higher MES sales to raise Chinasoft's gross margin profile as gross margin of c.60% for MES is approximately double the margin of most of the company's other products and services.

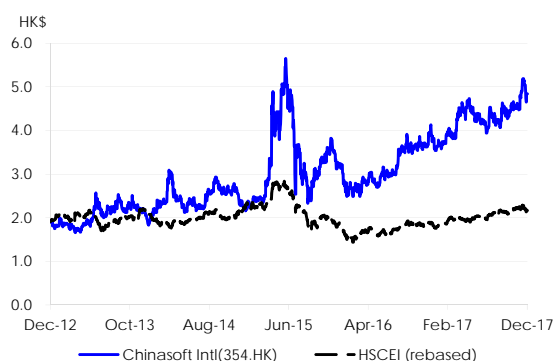
**On-track business growth; maintain Outperform.** Assuming Chinasoft effectively leverages its expertise in IT services, AI, big data and cloud, we forecast it will deliver revenue and net profit CAGR for FY17-19F of 22% and 21%. We expect company revenue to break the RMB10b mark in 2018F, a feat that would signal its arrival as one of China's largest domestic software companies. With the shares trading at an attractive 17x FY18 P/E, we maintain our Outperform rating and HK\$5.95 target price based on 20x FY18F P/E. We believe our FY18F forecasts are subject to upside potential depending on the progress made by Chinasoft's new business initiatives including the Jointforce platform and business development with Baidu.

### Trading data

52-week range	HK\$3.51 – 5.38
Market capitalization (m)	HK\$11,615/US\$1,493
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 (%)	23

Source: Bloomberg, CCBIS estimates

### Share price vs HSCEI



Source: Bloomberg, CCBIS

### 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)	30.6	23.5	19.8	16.7	13.7
DPS (HK\$)	–	0.01	0.02	0.03	0.04
Dividend yield (%)	–	0.3	0.5	0.6	0.7
P/B (x)	3.0	2.4	2.2	1.9	1.7
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

### Stock performance

Performance over	1M	3M	12M
Absolute	1	6	25
Relative (%) to HSCEI	4	6	10

Source: Bloomberg, CCBIS

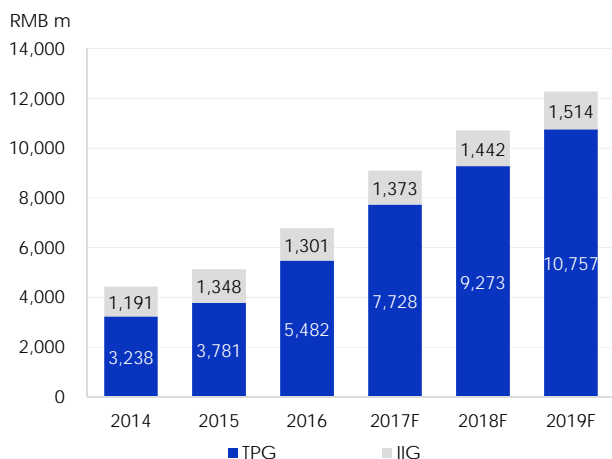
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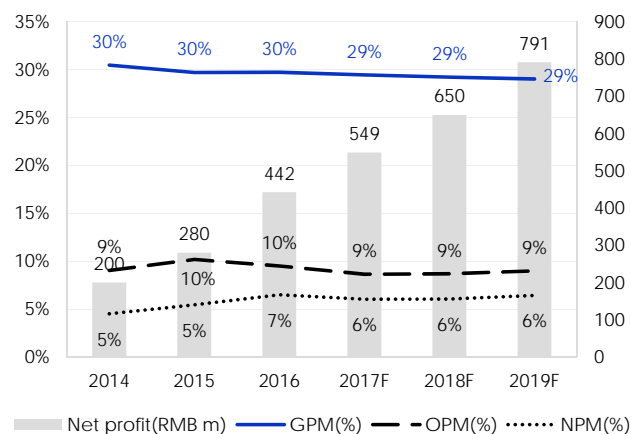
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## Chinasoft – revenue mix (RMB m)



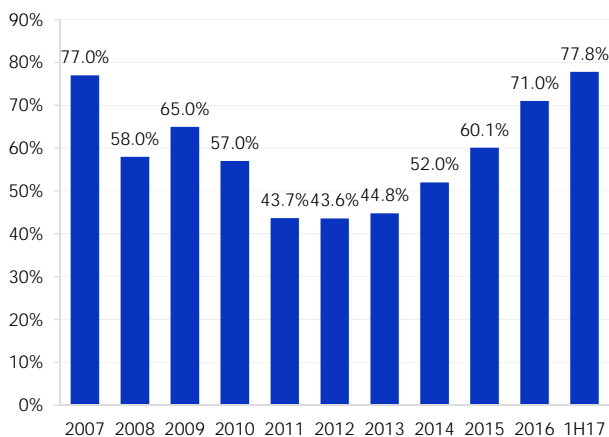
Source: Company data, CCBIS estimates

## Chinasoft – net income (RMB m) and margin ratios



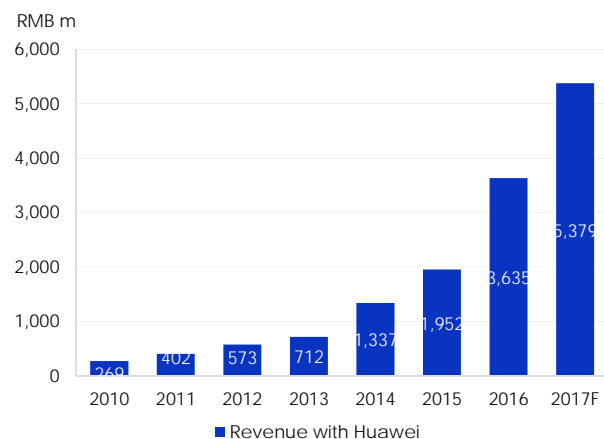
Source: Company data, CCBIS estimates

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



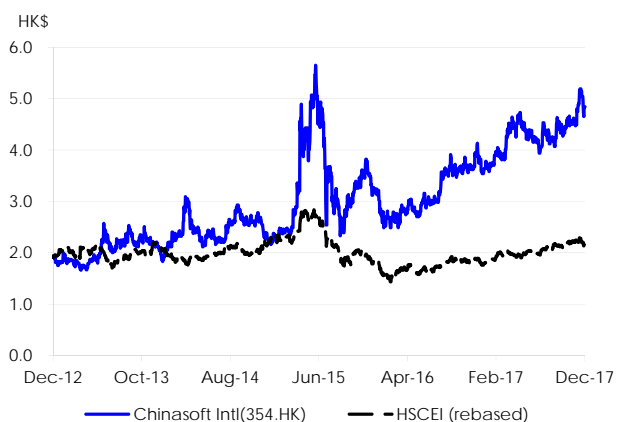
Source: Company data, CCBIS

## Chinasoft – revenue contributed by Huawei



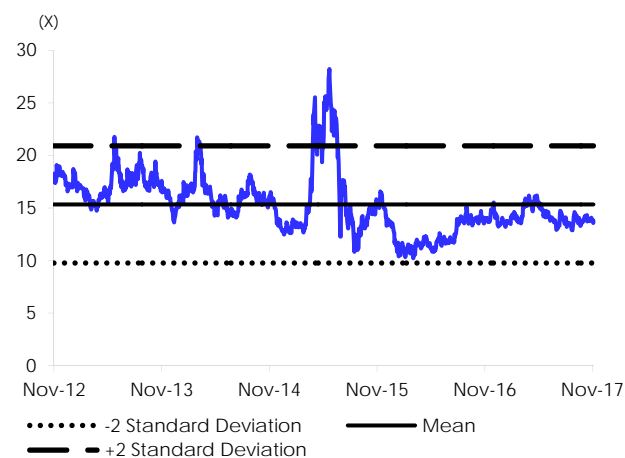
Source: Company data, CCBIS estimates

## Chinasoft – price performance vs. HSCEI



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
<b>RMB m</b>									
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
<b>%</b>									
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 <sup>#</sup>	Share price* (LC)	Market cap (US\$ m)	P/E (x)			EPS growth (%)		
					FY17F	FY18F	FY19F	FY17F	FY18F	FY19F
<b><u>HK listed</u></b>										
TravelSky	696 HK	Not Rated	21.65	8,114	24	20	18	21	16	15
Kingsoft Corp	3888 HK	Outperform	22.10	3,716	23	16	13	49	40	29
<b>Chinasoft International</b>	<b>354 HK</b>	<b>Outperform</b>	<b>4.84</b>	<b>1,493</b>	<b>20</b>	<b>17</b>	<b>14</b>	<b>10</b>	<b>18</b>	<b>22</b>
Kingdee	268 HK	Outperform	3.99	1,484	46	35	26	7	32	33
Digital China	861 HK	Not Rated	4.06	872	-49	20	14	-151	-345	44
Sinsoft	1297 HK	Not Rated	2.19	347	11	9	7	9	19	21
Chanjet	1588 HK	Not Rated	11.28	314	N/A	16	8	N/A	N/A	N/A
<b>Average</b>					<b>12</b>	<b>19</b>	<b>14</b>	<b>-7</b>	<b>-35</b>	<b>28</b>
<b><u>A-share listed</u></b>										
iFlytek	002230 CH	Outperform	60.50	12,696	163	110	79	-6	48	39
Wangsu	300017 CH	Underperform	10.05	3,660	28	26	23	-35	7	17
Aisino	600271 CH	Not Rated	21.15	5,954	24	21	17	-2	13	N/A
Hundsun	600570 CH	Not Rated	44.78	4,181	55	43	37	5	28	16
Yonyou	600588 CH	Neutral	19.80	4,381	70	48	38	6	44	28
Shiji info	002153 CH	Not Rated	27.10	4,369	69	56	45	4	23	25
Neusoft Corp	600718 CH	Not Rated	15.01	2,819	39	30	24	-71	32	24
Teamsun	600410 CH	Not Rated	9.55	1,592	N/A	N/A	N/A	N/A	N/A	N/A
YGsoft Inc	002063 CH	Not Rated	10.27	935	37	N/A	N/A	-43	N/A	N/A
<b>Average</b>					<b>60</b>	<b>48</b>	<b>37</b>	<b>-18</b>	<b>28</b>	<b>25</b>
<b><u>Global peers</u></b>										
Microsoft	MSFT US	Not Rated	84.16	649,260	25	22	19	12	10	16
Oracle	ORCL US	Not Rated	49.60	206,983	17	16	15	12	8	7
IBM	IBM US	Not Rated	154.81	143,322	11	11	11	2	1	3
SAP	SAP US	Not Rated	112.55	138,268	27	25	22	7	9	11
Accenture	ACN US	Not Rated	150.53	96,652	23	21	19	11	9	8
Salesforce	CRM US	Not Rated	103.44	74,715	77	60	47	36	29	27
Workday Inc.	WDAY US	Not Rated	104.85	22,019	108	90	68	3,127	20	33
Netsuite	N US	Not Rated	109.54	8,865	202	143	96	158	42	49
<b>Average</b>					<b>61</b>	<b>48</b>	<b>37</b>	<b>421</b>	<b>16</b>	<b>19</b>

\* Price as at close on 8 Dec 2017 (local currency)

Source: Bloomberg, CCBIS estimates

## Chinasoft International – P&amp;L assumptions

RMB m	FY15	FY16	FY17F	FY18F	FY19F	1H16	2H16	1H17	2H17F
<b>Revenue breakdown</b>									
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
<b>Total revenue</b>	<b>5,129</b>	<b>6,783</b>	<b>9,101</b>	<b>10,715</b>	<b>12,271</b>	<b>2,885</b>	<b>3,898</b>	<b>4,145</b>	<b>4,956</b>
YoY (%)	16	32	34	18	15	N/A	N/A	44	27
Cost of revenue	(3,606)	(4,768)	(6,422)	(7,586)	(8,712)	(2,082)	(2,685)	(3,002)	(3,419)
<b>Gross profit</b>	<b>1,523</b>	<b>2,016</b>	<b>2,679</b>	<b>3,129</b>	<b>3,559</b>	<b>803</b>	<b>1,213</b>	<b>1,143</b>	<b>1,536</b>
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)
<b>Operating profit</b>	<b>522</b>	<b>645</b>	<b>787</b>	<b>932</b>	<b>1,104</b>	<b>300</b>	<b>345</b>	<b>336</b>	<b>451</b>
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)
<b>Net income attributable to common shareholders</b>	<b>280</b>	<b>442</b>	<b>549</b>	<b>650</b>	<b>791</b>	<b>236</b>	<b>206</b>	<b>245</b>	<b>303</b>
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
<b>Key ratios (%)</b>									
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
<b>Revenue</b>	<b>5,129</b>	<b>6,783</b>	<b>9,101</b>	<b>10,715</b>	<b>12,271</b>
COGS	(3,606)	(4,768)	(6,422)	(7,586)	(8,712)
<b>Gross profit</b>	<b>1,523</b>	<b>2,016</b>	<b>2,679</b>	<b>3,129</b>	<b>3,559</b>
Operating expenses	(1,001)	(1,371)	(1,892)	(2,197)	(2,454)
<b>EBIT</b>	<b>522</b>	<b>645</b>	<b>787</b>	<b>932</b>	<b>1,104</b>
Net financial income (exp.)	(93)	(96)	(88)	(85)	(85)
Others	(10)	(25)	(45)	(55)	(55)
<b>Profit before tax</b>	<b>420</b>	<b>525</b>	<b>654</b>	<b>792</b>	<b>964</b>
Tax	(87)	(115)	(120)	(143)	(174)
<b>Total profit</b>	<b>333</b>	<b>410</b>	<b>534</b>	<b>650</b>	<b>791</b>
Minority interest	(53)	32	15	–	–
<b>Net profit attributable to shareholders</b>	<b>280</b>	<b>442</b>	<b>549</b>	<b>650</b>	<b>791</b>
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
<b>Profit before tax</b>	<b>420</b>	<b>525</b>	<b>654</b>	<b>792</b>	<b>964</b>
Amortization & depreciation	143	144	167	190	212
Net financial charge adj.	93	96	88	85	85
Non-cash items adjusted	(21)	–	–	–	–
Change in working capital	(332)	(279)	(1,024)	(594)	(579)
Tax paid	(42)	(115)	(120)	(143)	(174)
Other	–	(79)	65	–	–
<b>Operating cash flow</b>	<b>260</b>	<b>292</b>	<b>(170)</b>	<b>330</b>	<b>509</b>
Capex	(272)	(250)	(220)	(200)	(180)
Investment	(3)	–	–	–	–
Net interest received (paid)	4	–	–	–	–
Other	(55)	(458)	(60)	(60)	(60)
<b>Investment cash flow</b>	<b>(326)</b>	<b>(708)</b>	<b>(280)</b>	<b>(260)</b>	<b>(240)</b>
Change in borrowings	242	–	–	–	–
Equity issues	326	545	–	–	–
Dividend paid	–	–	(29)	(55)	(65)
Other	(50)	(96)	(88)	(85)	(85)
<b>Financing cash flow</b>	<b>518</b>	<b>449</b>	<b>(117)</b>	<b>(140)</b>	<b>(150)</b>
<b>Change in cash flow</b>	<b>451</b>	<b>33</b>	<b>(567)</b>	<b>(70)</b>	<b>119</b>
Cash & equivalents, begin	811	1,266	1,299	732	662
Forex	3	–	–	–	–
<b>Cash &amp; equivalents, end</b>	<b>1,266</b>	<b>1,299</b>	<b>732</b>	<b>662</b>	<b>782</b>
<b>Free cash flow</b>	<b>(48)</b>	<b>119</b>	<b>(434)</b>	<b>160</b>	<b>359</b>

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
<b>Total current assets</b>	<b>4,346</b>	<b>4,927</b>	<b>5,843</b>	<b>6,661</b>	<b>7,636</b>
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
<b>Total non-current assets</b>	<b>2,002</b>	<b>2,302</b>	<b>2,350</b>	<b>2,421</b>	<b>2,448</b>
<b>Total assets</b>	<b>6,348</b>	<b>7,229</b>	<b>8,193</b>	<b>9,082</b>	<b>10,084</b>
Short-term borrowings	1,297	922	922	922	922
Trade and bill payable	942	1,205	1,664	1,957	2,234
Other current liabilities	299	312	312	312	312
<b>Total current liabilities</b>	<b>2,539</b>	<b>2,439</b>	<b>2,898</b>	<b>3,192</b>	<b>3,468</b>
Long-term borrowings	263	194	194	194	194
Other non-current liabilities	60	263	263	263	263
<b>Total non-current liabilities</b>	<b>323</b>	<b>458</b>	<b>458</b>	<b>458</b>	<b>458</b>
<b>Total liabilities</b>	<b>2,862</b>	<b>2,897</b>	<b>3,356</b>	<b>3,649</b>	<b>3,926</b>
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
<b>Shareholders' equity</b>	<b>3,247</b>	<b>4,264</b>	<b>4,784</b>	<b>5,379</b>	<b>6,105</b>
Minority interest	239	68	53	53	53
<b>Total equity</b>	<b>3,486</b>	<b>4,333</b>	<b>4,837</b>	<b>5,432</b>	<b>6,158</b>
<b>Total equity and liabilities</b>	<b>6,348</b>	<b>7,229</b>	<b>8,193</b>	<b>9,082</b>	<b>10,084</b>

### Ratios

FYE 31 Dec	2015	2016	2017F	2018F	2019F
<b>Growth (%)</b>					
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
<b>Profitability (%)</b>					
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
<b>Efficiency (days)</b>					
Inventory turnover	3	2	1	1	1
Trades receivable	98	96	98	102	103
Trades payable	89	82	82	87	88
<b>Returns &amp; leverage (%)</b>					
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
<b>Liquidity (x)</b>					
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**Analyst certification:**

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