

Chinasoft International | 354 HK

Joins the big leagues

Announces solid set of FY17 results

Rapid new business growth

Still attractive valuation, maintain Outperform

Solid 2017 results. Chinasoft announced solid FY17 results overnight. Revenue grew 36% YoY to reach RMB9.2b, the fastest rate of growth in the last three years. Revenue approached RMB10.0b. These results herald Chinasoft's arrival in the big leagues of domestic software service companies. Its bottom line grew 28% YoY to reach RMB566m. If excluding share-based compensation, adjusted net profit was RMB716m, up 47% YoY. The topline and bottomline were c.2% ahead of Bloomberg consensus. Its largest customer, Huawei, contributed RMB4.8b in revenue, a 34% YoY increase. Chinasoft expects its other major customers, including industry giants Tencent, Baidu, HSBC and PingAn Group, to also achieve rapid revenue growth in FY18-19.

Encouraging new business growth. Besides its traditional IT outsourcing business, Chinasoft saw new business revenue triple in FY17 to reach RMB1.0b. New businesses include big data analysis, PaaS and SaaS-level cloud and the Jointforce platform. Total revenue contribution from these sources soared from 5% in FY16 to 11% in FY17. With respect to Jointforce, the size of its engineering team, its contract value and the number of its enterprise customers all doubled in FY17. Revenue from the platform surged from less than RMB100m in FY16 to c.RMB300m in FY17. We expect revenue to double again in FY18F. The success of these new businesses has made Chinasoft less reliant on its labor-intensive outsourcing business. This trend is beginning to be reflected in the company's results: total employees in FY17 increased by 8% YoY while revenue increased 36%.

Still attractive valuation, maintain Outperform rating. Chinasoft is trading at 19x/15x FY18F/FY19F P/E, which is attractive in view of 27% net profit CAGR in FY17-19F by our estimate. Chinasoft is a major beneficiary of two enterprise industry trends: that towards cloud technology and, in the long term, towards the government's goal of realizing an "Industrial Internet" before 2025. We maintain our Outperform rating and raise our FY18F/19F earnings forecast by 4.3%/7.6% YoY. Our target price on the stock, still based on 20x FY19F P/E, rises from HK\$8.00 to HK\$8.40.

Forecast and valuation

Year to 31 Dec	2015	2016	2017	2018F	2019F
Revenue (RMB m)	5,129	6,783	9,244	11,268	13,272
YoY (%)	15.8	32.3	36.3	21.9	17.8
Net profit (RMB m)	280	442	566	734	918
YoY (%)	40.0	57.9	27.9	29.7	25.1
Fully diluted EPS (RMB)	0.14	0.20	0.22	0.28	0.35
YoY (%)	29.1	45.5	9.0	29.7	25.1
P/E (x)	39.4	30.2	24.1	18.5	14.8
Dividend per share (HK\$)	—	0.01	0.02	0.03	0.04
Dividend yield (%)	—	0.2	0.3	0.5	0.7
P/B (x)	4.2	3.4	2.8	2.5	2.1
ROAE (%)	9.8	11.8	12.5	14.2	15.5
Net debt/equity (%)	8.5	-4.2	8.1	9.4	7.0

Source: Bloomberg, CCBIS estimates

Outperform (maintained)

Current price:	Target:
HK\$6.23	HK\$8.40
(as at 26 Mar 2018)	(up from HK\$8.00)

Trading data

52-week range	HK\$3.90 – 6.93
Market capitalization (m)	HK\$16,327/US\$2,099
Shares outstanding (m)	2,621
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 (%)	35

Source: Bloomberg, CCBIS estimates

Share price vs HSCCI



Source: Bloomberg, CCBIS

Stock performance

Performance over	1M	3M	12M
Absolute	14	27	40
Relative (%) to HSCCI	18	22	23

Source: Bloomberg, CCBIS

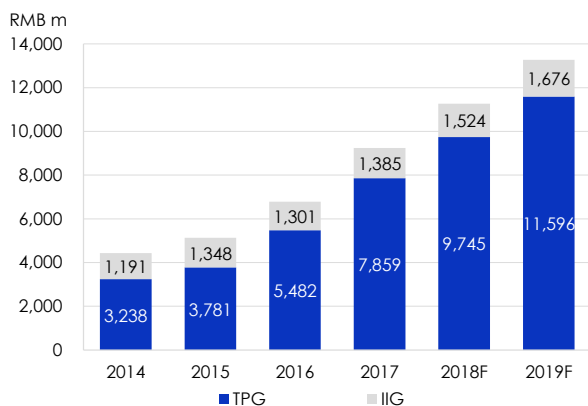
Eric Qiu, CFA

(852) 3911 8243
ericqiu@ccbintl.com

Ronnie Ho

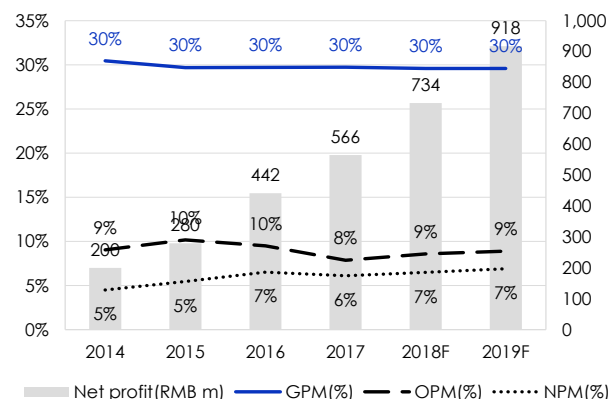
(852) 3911 8259
ronnieho@ccbintl.com

Chinasoft – revenue mix (RMB m)



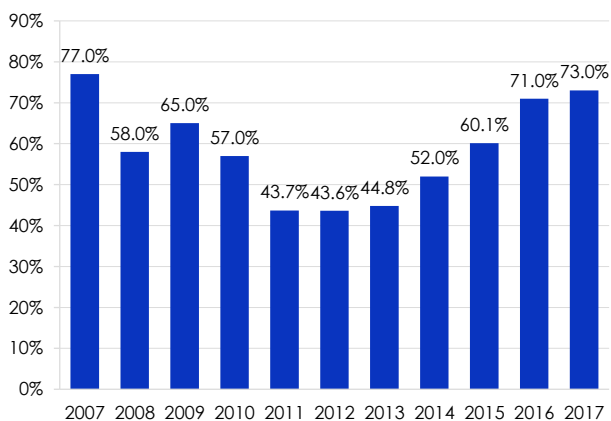
Source: Company data, CCBIS estimates

Chinasoft – net income (RMB m) and margin ratios



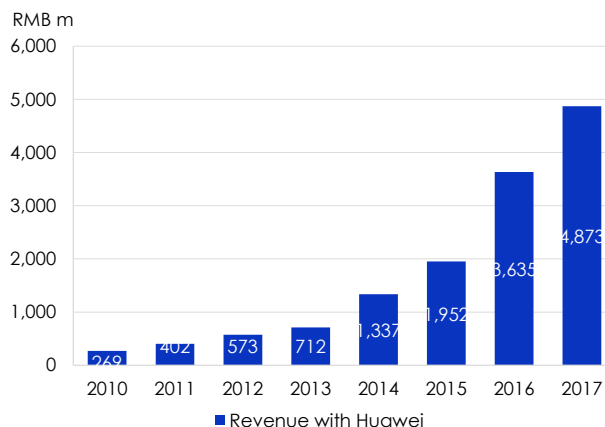
Source: Company data, CCBIS estimates

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



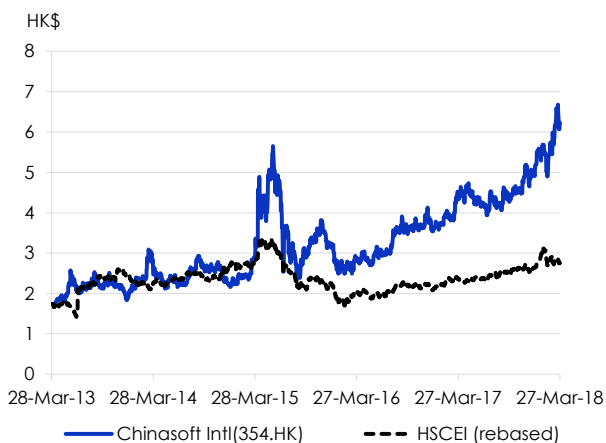
Source: Company data, CCBIS

Chinasoft – revenue contributed by Huawei



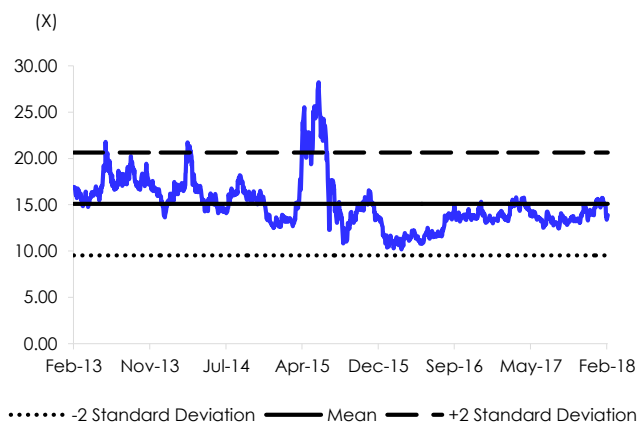
Source: Company data, CCBIS estimates

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 forecast			Previous forecast			% change		
	2017	2018F	2019F	2017F	2018F	2019F	2017	2018F	2019F
RMB m									
Revenue	9,244	11,268	13,272	9,101	11,101	12,719	1.6	1.5	4.3
Gross profit	2,750	3,335	3,929	2,679	3,242	3,688	2.7	2.9	6.5
Opex	-2,023	-2,366	-2,747	-1,892	-2,254	-2,518	6.9	5.0	9.1
Operating profit	727	969	1,181	787	988	1,170	-7.6	-1.9	0.9
Net profit	566	734	918	549	704	853	3.1	4.3	7.6
%									
Gross margin	29.8	29.6	29.6	29.4	29.2	29.0	-	-	-
OPEX to sales	-21.9	-21.0	-20.7	-20.8	-20.3	-19.8	-	-	-
OPM	7.9	8.6	8.9	8.6	8.9	9.2	-	-	-
Net margin	6.1	6.5	6.9	6.0	6.3	6.7	-	-	-

Source: CCBIS estimates

Software sector peer comparisons

	Stock	CCBIS	Share price*	Market cap	P/E (x)			EPS growth (%)		
Year ended 31 Dec	code	rating [#]	(LC)	(US\$ m)	FY17F	FY18F	FY19F	FY17F	FY18F	FY19F
<u>HK listed</u>										
TravelSky	696 HK	Not Rated	23.65	8,819	23	20	17	16	16	16
Kingsoft Corp	3888 HK	Outperform	26.20	4,587	20	15	13	5	31	17
Chinasoft International	354 HK	Outperform	6.23	2,099	24	19	15	9	30	25
Kingdee	268 HK	Outperform	8.24	3,053	63	47	32	49	35	44
Digital China	861 HK	Not Rated	4.29	917	-39	21	14	-167	-282	50
Sinosoft	1297 HK	Not Rated	2.25	355	9	8	N/A	19	21	N/A
Chanjet	1588 HK	Not Rated	12.48	345	N/A	34	N/A	N/A	N/A	N/A
Average					16	23	18	-8	-25	28
<u>A-share listed</u>										
iFlytek	002230 CH	Outperform	57.10	12,609	162	108	76	-11	49	42
Wangsu	300017 CH	Underperform	12.83	4,959	38	32	26	-38	17	25
Aisino	600271 CH	Not Rated	20.70	6,132	22	19	19	16	16	N/A
Hundsun	600570 CH	Not Rated	51.39	5,049	55	44	N/A	15	26	N/A
Yonyou	600588 CH	Underperform	36.53	8,506	89	68	51	54	30	32
Shiji info	002153 CH	Not Rated	23.71	4,022	60	49	41	3	23	20
Neusoft Corp	600718 CH	Not Rated	12.79	2,527	33	25	20	-70	35	26
Teamsun	600410 CH	Not Rated	10.88	1,908	N/A	N/A	N/A	N/A	N/A	N/A
YGsoft Inc	002063 CH	Not Rated	10.17	982	38	N/A	N/A	-45	N/A	N/A
Average					62	49	39	-10	28	29
<u>Global peers</u>										
Microsoft	MSFT US	Not Rated	93.78	722,087	26	24	21	21	7	14
Oracle	ORCL US	Not Rated	46.48	189,746	15	14	13	17	9	8
IBM	IBM US	Not Rated	153.37	141,280	11	11	10	0	2	4
SAP	SAP US	Not Rated	104.83	128,784	24	22	19	9	10	12
Accenture	ACN US	Not Rated	152.85	102,414	23	21	19	13	10	9
Salesforce	CRM US	Not Rated	118.97	87,132	58	46	35	53	27	30
Workday Inc.	WDAY US	Not Rated	131.74	27,929	110	81	62	23	36	30
Netsuite	N US	Not Rated	109.54	8,865	202	143	96	158	42	49
Average					59	45	34	37	18	20

* Price as at close on 26 Mar 2018 (local currency)

Source: Bloomberg, CCBIS estimates

Chinasoft International – P&L assumptions

RMB m	FY15	FY16	FY17	FY18F	FY19F	1H16	2H16	1H17	2H17
Revenue breakdown									
TPG business	3,781	5,482	7,859	9,745	11,596	2,288	3,194	3,511	4,347
IIG business	1,348	1,301	1,385	1,524	1,676	597	704	634	751
Total revenue	5,129	6,783	9,244	11,268	13,272	2,885	3,898	4,145	5,099
YoY (%)	16	32	36	22	18	N/A	N/A	44	31
Cost of revenues	-3,606	-4,768	-6,493	-7,933	-9,344	-2,082	-2,685	-3,002	-3,491
Gross profit	1,523	2,016	2,750	3,335	3,929	803	1,213	1,143	1,608
Gross profit margin (%)	30	30	30	30	30	28	31	28	32
Sales and marketing expense	-179	-219	-370	-406	-465	-112	-107	-147	-223
General & administrative expense	-627	-807	-1,086	-1,307	-1,513	-391	-416	-660	-427
Research and development	-195	-345	-567	-654	-770	0	-345	0	-567
Total operating expense	-1,001	-1,371	-2,023	-2,366	-2,747	-503	-868	-807	-1,217
Operating profit	522	645	727	969	1,181	300	345	336	391
Operating profit margin (%)	10	10	8	9	9	10	9	8	8
Other income, gains and losses	29	44	96	100	110	48	-4	34	63
Allowance for doubtful debts	-62	-18	-26	-25	-25	-11	-7	-1	-24
Other expenses	-92	-88	-82	-80	-80	-41	-47	-42	-40
Fair value gain on derivative financial instruments	-1	0	0	0	0	0	0	0	0
Finance costs	-93	-96	-103	-100	-100	-39	-57	-43	-60
Share of results of associates	2	17	20	20	20	10	7	-16	35
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	633	884	1,106	266	258	268	365
Taxation	-87	-115	-71	-150	-188	-48	-67	-28	-44
Effective tax rate (%)	-21	-22	-11	-17	-17	-18	-26	-10	-12
Net income	333	410	561	734	918	219	191	240	321
- Minority interests	53	-32	-4	0	0	-18	-15	-5	1
Net income attributable to common shareholders	280	442	566	734	918	236	206	245	320
YoY (%)	40	58	28	30	25	N/A	N/A	4	56
Net profit margin (%)	5	7	6	7	7	8	5	6	6
EPS diluted (HK\$)	0.16	0.22	0.26	0.34	0.42	0.11	0.10	0.11	0.15
Diluted share volume (m)	2,123	2,400	2,621	2,621	2,621	2,400	2,400	2,508	2,621
Key ratios (%)									
EPS growth	24	36	17	30	25	37	21	2	53
Gross profit margin	30	30	30	30	30	28	31	28	32
Operating profit margin	10	10	8	9	9	10	9	8	8
Net profit margin	5	7	6	7	7	8	5	6	6
ROAE	10	12	12	14	16	N/A	N/A	N/A	N/A
Net debt-to-equity	8	-4	8	9	7	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	2017	2018F	2019F
TPG business	3,781	5,482	7,859	9,745	11,596
IIG business	1,348	1,301	1,385	1,524	1,676
Revenue	5,129	6,783	9,244	11,268	13,272
COGS	(3,606)	(4,768)	(6,493)	(7,933)	(9,344)
Gross profit	1,523	2,016	2,750	3,335	3,929
Operating expenses	(1,001)	(1,371)	(2,023)	(2,366)	(2,747)
EBIT	522	645	727	969	1,181
Net financial income (exp.)	(93)	(96)	(103)	(100)	(100)
Other	(10)	(25)	9	15	25
Profit before tax	420	525	633	884	1,106
Tax	(87)	(115)	(71)	(150)	(188)
Total profit	333	410	561	734	918
Minority interest	(53)	32	4	–	–
Net profit attributable to shareholders	280	442	566	734	918
Diluted EPS (RMB)	0.14	0.20	0.22	0.28	0.35
Dividend (RMB m)	–	26	39	73	92
Dividend per share (RMB)	0.00	0.01	0.02	0.03	0.04

Cash flow

FYE 31 Dec (RMB m)	2015	2016	2017F	2018F	2019F
Profit before tax	420	525	633	884	1,106
Amortization & depreciation	143	144	167	190	212
Net financial charge adj.	93	96	103	100	100
Non-cash items adjust.	(21)	–	–	–	–
Change in working capital	(332)	(279)	(1,062)	(757)	(744)
Tax paid	(42)	(115)	(71)	(150)	(188)
Other	–	(79)	65	–	–
Operating cash flow	260	292	(165)	266	487
Capex	(272)	(250)	(220)	(200)	(180)
Investment	(3)	–	–	–	–
Net interest rec.(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	–	–	(26)	(39)	(73)
Other	(50)	(96)	(103)	(100)	(100)
Financing cash flow	518	449	(129)	(139)	(173)
Change in cash flow	451	33	(574)	(133)	73
Cash & equivalents, begin	811	1,266	1,299	725	592
Forex	3	–	–	–	–
Cash & equivalents, end	1,266	1,299	725	592	665
Free cash flow	(48)	119	(470)	37	269

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2015	2016	2017F	2018F	2019F
Cash and equivalents	1,266	1,299	725	592	665
Pledge dep., restrict. cash	45	1	1	1	1
Receivables	3,005	3,607	5,168	6,282	7,384
Inventory	30	21	21	21	21
Total current assets	4,346	4,927	5,914	6,895	8,071
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	8,264	9,315	10,518
Short-term borrowings	1,297	922	922	922	922
Trade and bills payable	942	1,205	1,704	2,061	2,419
Other current liabilities	299	312	312	312	312
Total current liabilities	2,539	2,439	2,938	3,295	3,653
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	3,396	3,753	4,111
Share capital	2,202	2,759	2,759	2,759	2,759
Reserves & retained profits	1,046	1,505	2,045	2,739	3,584
Shareholders' equity	3,247	4,264	4,804	5,499	6,343
Minority interest	239	68	64	64	64
Total equity	3,486	4,333	4,868	5,563	6,407
Total equity and liabilities	6,348	7,229	8,264	9,315	10,518

Ratios

FYE 31 Dec	2015	2016	2017F	2018F	2019F
Growth (%)					
Revenue	15.8	32.3	36.3	21.9	17.8
EBITDA	22.8	18.8	13.3	29.6	20.3
EBIT	30.4	23.5	12.7	33.3	21.9
Net profit	40.0	57.9	27.9	29.7	25.1
Profitability (%)					
Gross margin	29.7	29.7	29.8	29.6	29.6
EBITDA margin	13.0	11.6	9.7	10.3	10.5
EBIT margin	10.2	9.5	7.9	8.6	8.9
Net margin	5.5	6.5	6.1	6.5	6.9
Tax rate	20.7	21.9	11.3	17.0	17.0
Efficiency (days)					
Inventory turnover	3	2	1	1	1
Trades receivable	98	96	97	100	102
Trades payable	89	82	82	87	87
Returns & leverage (%)					
ROAA	4.8	6.5	7.3	8.3	9.3
ROAE	9.8	11.8	12.5	14.2	15.5
Net debt (cash)/equity	8.5	(4.2)	8.1	9.4	7.0
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****Analyst certification:**

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CCB International Securities Limited
12/F, CCB Tower, 3 Connaught Road, Central, Hong Kong
Tel: (852) 3911 8000 / Fax: (852) 2537 0097