

Chinasoft Intl. | 354 HK

Embracing opportunities from Industrial Internet

Expect solid growth in 2017 results

To benefit from "Industrial Internet" in 2018-2025F

Still attractive valuation

Expect solid 2017 results. Chinasoft International will announce FY17 results on 21 Mar, at which time we expect a solid performance starting with 35% YoY higher revenue to RMB9.17b and 26% net profit growth to RMB558m. Huawei remains Chinasoft's largest client. We expect Huawei to contribute 59% of Chinasoft's revenue in 2017, up from 54% in 2016. Huawei's embrace of cloud technology and its heavy reliance on Chinasoft is driving growth at the latter.

To benefit from Industrial Internet. Chinasoft hosted a conference call yesterday to present its progress developing products for the so-called Industrial Internet, otherwise known as Industry 4.0. Industrial Internet is a catch-all term for the integration of big data, analytical tools and wireless networks with industrial equipment. We expect Industrial Internet to be the overarching trend for China's manufacturing industry in 2018-2025F. For years, Chinasoft has been a major beneficiary of this trend. In 2017, the company upgraded HoneyComb, a smart manufacturing solution for industrial clients, and, together with Huawei, began to promote it. HoneyComb is a PaaS- and SaaS-level cloud service with seven platforms overlaying each other and offering a range of services, from raw data processing to high level tools such as industrial diagnosis. Together with Huawei, Chinasoft expects to promote HoneyComb in 49 Chinese regions/industrial zones. By 2017, Chinasoft had already signed up 10 regions.

Still attractive valuation, maintain Outperform rating. Chinasoft is trading at 23x/18x FY17F/FY18F P/E, above its five-year average of 15x. Its value beyond traditional software outsourcing has evidently been recognized. Chinasoft has a rich product line designed to meet surging demand for cloud services and big data. We forecast solid 25% earnings growth CAGR for Chinasoft in FY17-19F. In our view, its current valuation is still very attractive. We maintain our Outperform rating and raise our target price from HK\$6.45 to HK\$8.00 after raising our FY18F/FY19F earnings forecast 1.4%/2.1%. Our target remains based on 20x P/E after rolling over to FY19.

Forecast and valuation

Year to 31 Dec	2015	2016	2017F	2018F	2019F
Revenue (RMB m)	5,129	6,783	9,172	11,280	13,121
YoY (%)	15.8	32.3	35.2	23.0	16.3
Net profit (RMB m)	280	442	558	714	871
YoY (%)	40.0	57.9	26.1	28.0	22.0
Fully diluted EPS (RMB)	0.14	0.20	0.22	0.28	0.35
YoY (%)	29.1	45.5	12.3	28.0	22.0
P/E (x)	36.8	28.2	23.4	18.3	15.0
DPS (HK\$)	—	0.01	0.02	0.03	0.04
Dividend yield (%)	—	0.2	0.4	0.5	0.7
P/B (x)	3.6	2.9	2.6	2.3	2.0
ROAE (%)	9.8	11.8	12.3	13.9	14.9
Net debt/equity (%)	8.5	-4.2	8.3	10.8	8.1

Source: Bloomberg, CCBIS estimates

Outperform (maintained)

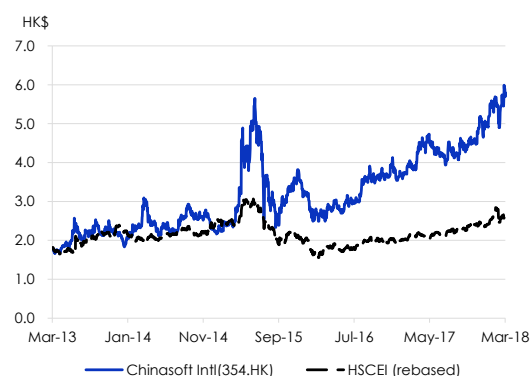
Current price:	Target:
HK\$5.82	HK\$8.00
(as at 6 Mar 2018)	(up from HK\$6.45)

Trading data

52-week range	HK\$3.79–6.24
Market capitalization (m)	HK\$14,548/US\$1,870
Shares outstanding (m)	2,508
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 (%)	38

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI



Source: Bloomberg, CCBIS

Stock performance

Performance over	1M	3M	12M
Absolute	14	24	48
Relative (%) to HSCEI	17	13	26

Source: Bloomberg, CCBIS

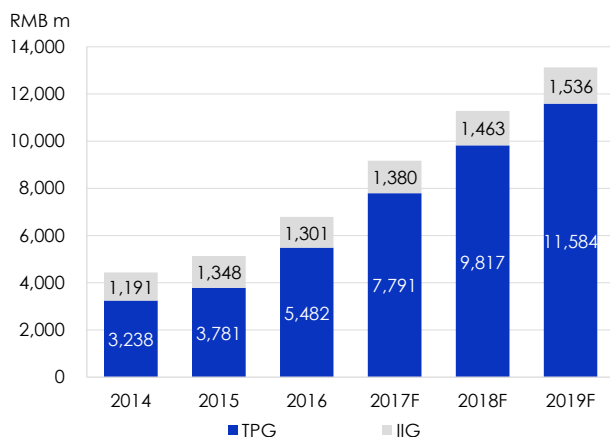
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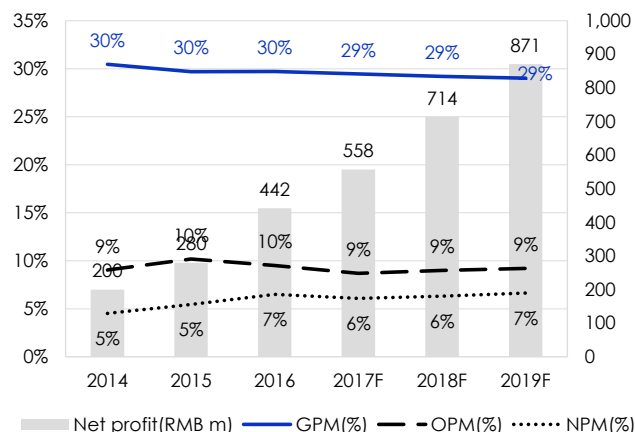
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Chinasoft – revenue mix (RMB m)



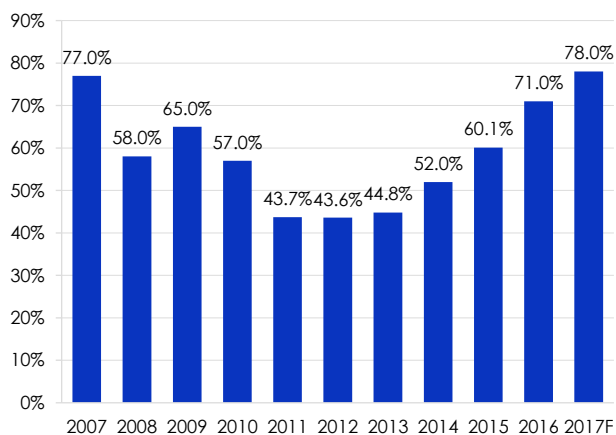
Source: Company data, CCBIS estimates

Chinasoft – net income (RMB m) and margin ratios



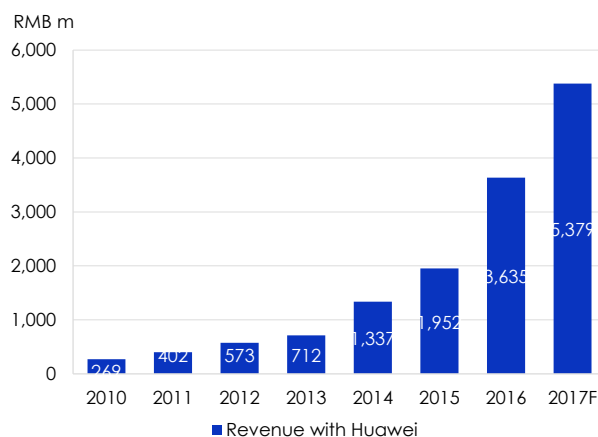
Source: Company data, CCBIS estimates

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



Source: Company data, CCBIS

Chinasoft – revenue contributed by Huawei



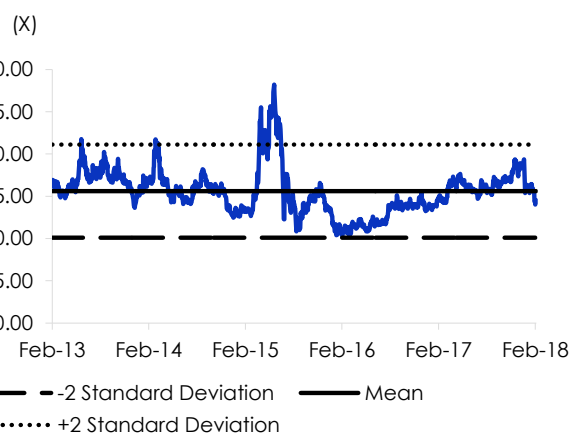
Source: Company data, CCBIS estimates

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 forecast			Previous forecast			% change		
	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F
RMB m									
Revenue	9,172	11,280	13,121	9,101	11,101	12,719	0.8	1.6	3.2
Gross profit	2,701	3,294	3,805	2,679	3,242	3,688	0.8	1.6	3.2
Opex	-1,903	-2,279	-2,598	-1,892	-2,254	-2,518	0.6	1.1	3.2
Operating profit	798	1,015	1,207	787	988	1,170	1.5	2.8	3.2
Net profit	558	714	871	549	704	853	1.6	1.4	2.1
%									
Gross margin	29.4	29.2	29.0	29.4	29.2	29.0	-	-	-
OPEX to sales	-20.7	-20.2	-19.8	-20.8	-20.3	-19.8	-	-	-
OPM	8.7	9.0	9.2	8.6	8.9	9.2	-	-	-
Net margin	6.1	6.3	6.6	6.0	6.3	6.7	-	-	-

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	24.30	9,078	27	23	20	20	16	16
Kingsoft Corp	3888 HK	Outperform	27.45	4,814	23	21	16	83	8	34
Chinasoft International	354 HK	Outperform	5.80	1,870	23	18	15	12	28	22
Kingdee	268 HK	Outperform	5.67	2,105	64	49	36	8	33	35
Digital China	861 HK	Not Rated	4.34	929	-27	21	15	-198	-227	44
Sinsoft	1297 HK	Not Rated	2.14	338	10	9	7	9	19	21
Chanjet	1588 HK	Not Rated	11.84	328	N/A	11	8	N/A	N/A	N/A
Average					20	22	17	-9	-20	30
A-share listed										
iFlytek	002230 CH	Outperform	58.02	12,708	165	109	78	-11	51	41
Wangsu	300017 CH	Underperform	12.40	4,754	35	31	25	-36	15	23
Aisino	600271 CH	Not Rated	21.15	6,214	24	21	18	-2	12	N/A
Hundsun	600570 CH	Not Rated	51.35	5,004	63	55	44	-4	15	26
Yonyou	600588 CH	Neutral	40.27	9,300	151	107	82	0	41	30
Shiji info	002153 CH	Not Rated	28.15	4,736	73	58	49	2	25	20
Neusoft Corp	600718 CH	Not Rated	13.60	2,666	36	27	21	-71	36	28
Teamsun	600410 CH	Not Rated	11.50	2,000	N/A	N/A	N/A	N/A	N/A	N/A
YGsoft Inc	002063 CH	Not Rated	10.84	1,038	39	N/A	N/A	-43	N/A	N/A
Average					73	58	45	-21	28	28
Global peers										
Microsoft	MSFT US	Not Rated	93.64	721,009	26	24	21	20	8	15
Oracle	ORCL US	Not Rated	51.29	212,320	17	16	15	11	8	9
IBM	IBM US	Not Rated	156.95	144,577	11	11	11	0	2	4
SAP	SAP US	Not Rated	104.60	128,502	24	22	19	5	10	15
Accenture	ACN US	Not Rated	158.85	102,237	24	22	20	13	9	9
Salesforce	CRM US	Not Rated	122.50	88,482	60	47	37	52	28	28
Workday Inc.	WDAY US	Not Rated	132.92	27,913	111	81	63	23	36	29
Netsuite	N US	Not Rated	109.54	8,865	202	143	96	158	42	49
Average					60	46	35	35	18	20

* Price as at close on 6 Mar 2018 (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	7,791	9,817	11,584	2,288	3,194	3,511	4,280
IIG business	1,348	1,301	1,380	1,463	1,536	597	704	634	747
Total revenue	5,129	6,783	9,172	11,280	13,121	2,885	3,898	4,145	5,027
YoY (%)	16	32	35	23	16	N/A	N/A	44	29
Cost of revenues	-3,606	-4,768	-6,471	-7,986	-9,316	-2,082	-2,685	-3,002	-3,468
Gross profit	1,523	2,016	2,701	3,294	3,805	803	1,213	1,143	1,558
Gross profit margin (%)	30	30	29	29	29	28	31	28	31
Sales and marketing expense	-179	-219	-263	-327	-380	-112	-107	-147	-116
General & administrative expense	-627	-807	-1,208	-1,410	-1,588	-391	-416	-660	-548
Research and development	-195	-345	-432	-541	-630	0	-345	0	-432
Total operating expense	-1,001	-1,371	-1,903	-2,279	-2,598	-503	-868	-807	-1,096
Operating profit	522	645	798	1,015	1,207	300	345	336	462
Operating profit margin (%)	10	10	9	9	9	10	9	8	9
Other income, gains and losses	29	44	59	40	40	48	-4	34	25
Allowance for doubtful debts	-62	-18	-6	-15	-15	-11	-7	-1	-5
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	-88	-90	-90	-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	666	870	1,062	266	258	268	397
Taxation	-87	-115	-123	-157	-191	-48	-67	-28	-95
Effective tax rate (%)	-21	-22	-18	-18	-18	-18	-26	-10	-24
Net income	333	410	543	714	871	219	191	240	302
- Minority interests	53	-32	-15	0	0	-18	-15	-5	-10
Net income attributable to common shareholders	280	442	558	714	871	236	206	245	312
YoY (%)	40	58	26	28	22	N/A	N/A	4	52
Net profit margin (%)	5	7	6	6	7	8	5	6	6
EPS diluted (HK\$)	0.16	0.22	0.26	0.33	0.40	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	15	28	22	37	21	2	49
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	7	8	5	6	6
ROAE	10	12	12	14	15	N/A	N/A	N/A	N/A
Net debt-to-equity	8	-4	8	11	8	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	7,791	9,817	11,584
IIG business	1,348	1,301	1,380	1,463	1,536
Revenue	5,129	6,783	9,172	11,280	13,121
COGS	(3,606)	(4,768)	(6,471)	(7,986)	(9,316)
Gross profit	1,523	2,016	2,701	3,294	3,805
Operating expenses	(1,001)	(1,371)	(1,903)	(2,279)	(2,598)
EBIT	522	645	798	1,015	1,207
Net financial income (exp.)	(93)	(96)	(88)	(90)	(90)
Other	(10)	(25)	(45)	(55)	(55)
Profit before tax	420	525	666	870	1,062
Tax	(87)	(115)	(123)	(157)	(191)
Total profit	333	410	543	714	871
Minority interest	(53)	32	15	–	–
Net profit attributable to shareholders	280	442	558	714	871
Diluted EPS (RMB)	0.14	0.20	0.22	0.28	0.35
Dividend (RMB m)	–	29	56	71	87
DPS (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	666	870	1,062
Amortization & depreciation	143	144	167	190	212
Net financial charge adj.	93	96	88	90	90
Non-cash items adjust.	(21)	–	–	–	–
Change in working capital	(332)	(279)	(1,051)	(781)	(682)
Tax paid	(42)	(115)	(123)	(157)	(191)
Other	–	(79)	65	–	–
Operating cash flow	260	292	(188)	212	491
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	–	–	(29)	(56)	(71)
Other	(50)	(96)	(88)	(90)	(90)
Financing cash flow	518	449	(117)	(146)	(161)
Change in cash flow	451	33	(585)	(194)	89
Cash & equivalents, begin	811	1,266	1,299	714	520
Forex	3	–	–	–	–
Cash & equivalents, end	1,266	1,299	714	520	609
Free cash flow	(48)	119	(453)	41	340

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2015	2016	2017F	2018F	2019F
Cash and equivalents	1,266	1,299	714	520	609
Pledge dep., restrict. cash	45	1	1	1	1
Receivables	3,005	3,607	5,128	6,288	7,300
Inventory	30	21	21	21	21
Total current assets	4,346	4,927	5,864	6,829	7,931
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	8,214	9,250	10,379
Short-term borrowings	1,297	922	922	922	922
Trade and bills payable	942	1,205	1,675	2,054	2,384
Other current liabilities	299	312	312	312	312
Total current liabilities	2,539	2,439	2,910	3,288	3,618
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	3,367	3,746	4,076
Share capital	2,202	2,759	2,759	2,759	2,759
Reserves & retained profits	1,046	1,505	2,034	2,691	3,491
Shareholders' equity	3,247	4,264	4,793	5,451	6,250
Minority interest	239	68	53	53	53
Total equity	3,486	4,333	4,846	5,504	6,304
Total equity and liabilities	6,348	7,229	8,214	9,250	10,379

Ratios

FYE 31 Dec	2015	2016	2017F	2018F	2019F
Growth (%)					
Revenue	15.8	32.3	35.2	23.0	16.3
EBITDA	22.8	18.8	22.3	24.8	17.8
EBIT	30.4	23.5	23.8	27.2	18.9
Net profit	40.0	57.9	26.1	28.0	22.0
Profitability (%)					
Gross margin	29.7	29.7	29.4	29.2	29.0
EBITDA margin	13.0	11.6	10.5	10.7	10.8
EBIT margin	10.2	9.5	8.7	9.0	9.2
Net margin	5.5	6.5	6.1	6.3	6.6
Tax rate	20.7	21.9	18.5	18.0	18.0
Efficiency (days)					
Inventory turnover	3	2	1	1	1
Trades receivable	98	96	97	100	102
Trades payable	89	82	81	85	87
Returns & leverage (%)					
ROAA	4.8	6.5	7.2	8.2	8.9
ROAE	9.8	11.8	12.3	13.9	14.9
Net debt (cash)/equity	8.5	(4.2)	8.3	10.8	8.1
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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