

Chinasoft International | 354 HK

Solid growth achieved

- ▶ **In-line 2018 results**
- ▶ **Huawei still a major business driver**
- ▶ **Attractive valuation, maintain Outperform rating**

In-line 2018 results. Chinasoft announced FY18 revenue of RMB10.6b, up 15% YoY and in line with expectations. The company's new businesses, which include its JointForce platform, cloud and big data operations, saw revenue increase 60% YoY to reach RMB1.6b and account for 15% of total revenue, up from 11% in FY17. Since the new businesses have a higher gross margin than the traditional outsourcing business, blended gross margin for FY18 improved from 29.8% in FY17 to 30.7%. Net profit for FY18 was RMB716m, up 27% YoY and in line with Bloomberg consensus.

Huawei – the key to growth. Business from its largest customer, Huawei, remained healthy in FY18 as revenue increased 15% YoY to reach RMB5.6b, accounting for 53% of Chinasoft's total revenue in FY18, on par with FY17. Even though the US-Huawei dispute is unresolved, we are optimistic of the outcome, especially if a US-China deal can be signed in the coming months. Even in the worst-case scenario whereby Huawei is barred from the 5G market in the US, since 5G-related work accounts for a small fragment of Chinasoft's services to Huawei (low single-digit revenue contribution to Chinasoft) and because Huawei will continue to invest heavily in R&D and will still need to outsource part of the work to Chinasoft, we continue to forecast healthy 8%/8% YoY revenue growth from Huawei in FY19F/FY20F.

Valuation remains attractive, maintain Outperform. Due to uncertainty related to the macro-economy and slower-than-expected business progress towards supplying Jointforce services to the government, we trim our FY19F/20F earnings forecast by 4.0%/3.6%. As a result, we cut our target price from HK\$6.95 to HK\$6.70, still basing it on 20x FY19F P/E. Coming out of a trough following the opening salvos of the US-Huawei dispute, Chinasoft is now trading at 14x/12x FY19F/20F P/E, which remains attractive in our view given that the company is capable of sustaining earnings CAGR of 15.5% in FY18-20F. A resolution to the US-Huawei dispute could be a short-term catalyst. Maintain Outperform.

Forecast and valuation

Year to 31 Dec	2016	2017	2018	2019F	2020F
Revenue (RMB m)	6,783	9,244	10,585	12,032	13,688
YoY (%)	32.3	36.3	14.5	13.7	13.8
Net profit (RMB m)	442	566	716	826	959
YoY (%)	57.9	27.9	26.6	15.3	16.2
Fully diluted EPS (RMB)	0.20	0.22	0.26	0.30	0.35
YoY (%)	45.5	9.0	19.4	15.3	16.2
P/E(x)	24.0	19.1	16.0	13.9	11.9
DPS (HK\$)	0.01	0.02	0.02	0.02	0.03
Dividend yield (%)	0.2	0.4	0.5	0.5	0.6
P/B (x)	2.9	2.2	1.9	1.7	1.5
ROAE (%)	11.8	12.0	12.9	13.0	13.3
Net debt/equity (%)	-4.2	-21.0	-16.1	-26.4	-28.0

Source: Bloomberg, CCBIS estimates

Outperform (maintained)

Current price: **HK\$4.95**
(as at 20 Mar 2019)

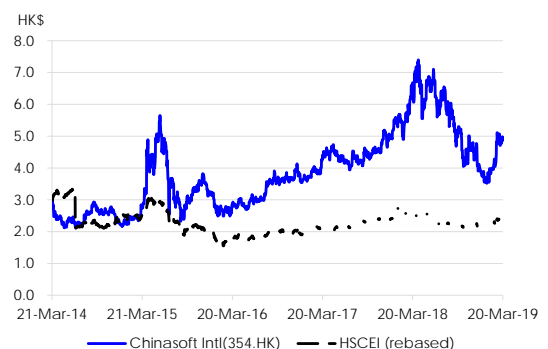
Target: **HK\$6.70**
(down from HK\$6.95)

Trading data

52-week range	HK\$3.45–7.70
Market capitalization (m)	HK\$13,754/US\$1,768
Shares outstanding (m)	2,779
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 HSCEI



Source: Bloomberg, CCBIS

Stock performance

Performance over	1M	3M	12M
Absolute	22	25	-26
Relative (%) to HSCEI	19	10	-18

Source: Bloomberg, CCBIS

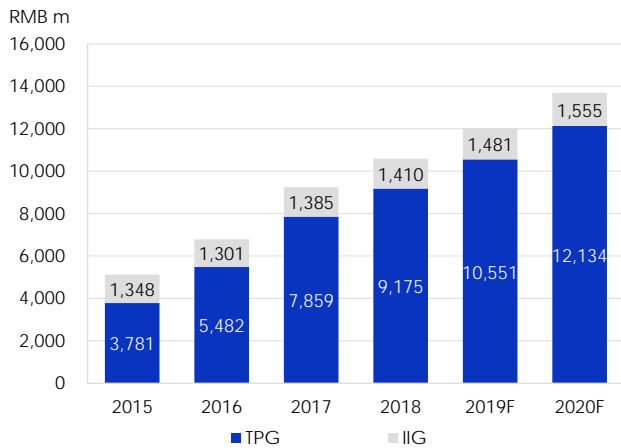
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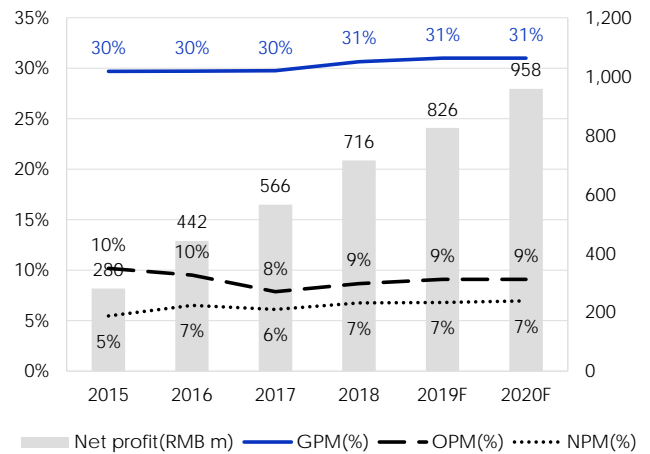
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Chinasoft – revenue mix (RMB m)



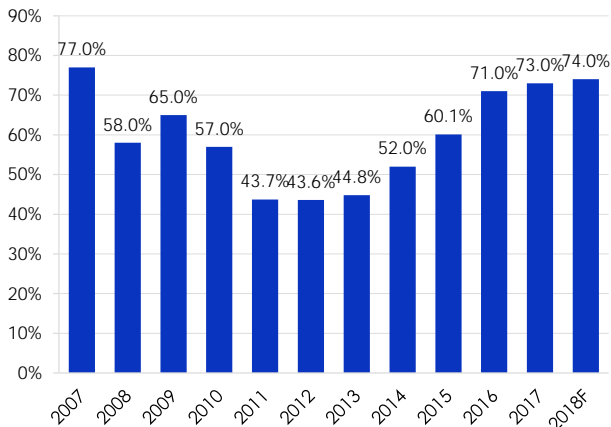
Source: Company data, CCBIS estimates

Chinasoft – net income (RMB m) & margin ratios (2015-2020F)



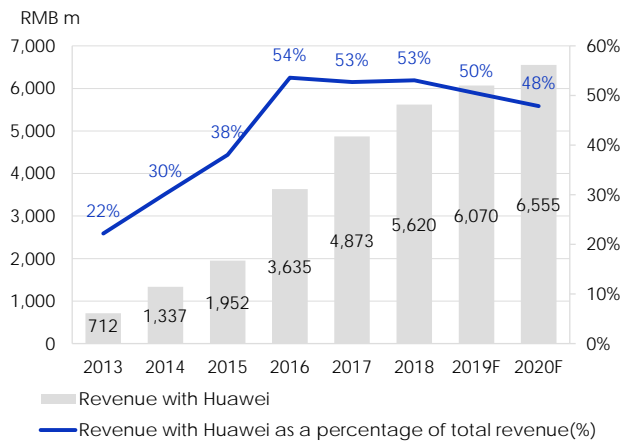
Source: Company data, CCBIS estimates

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



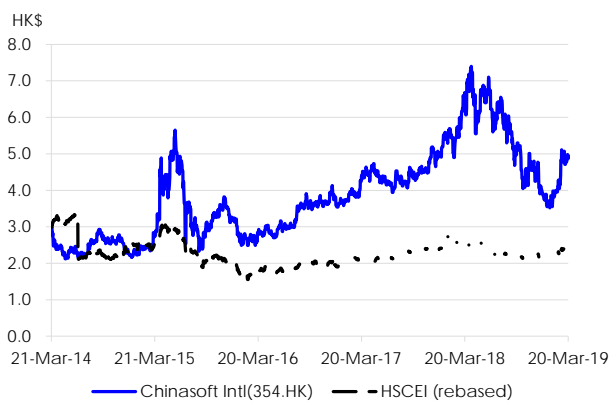
Source: Company data, CCBIS

Chinasoft – revenue from Huawei (2013-2020F)



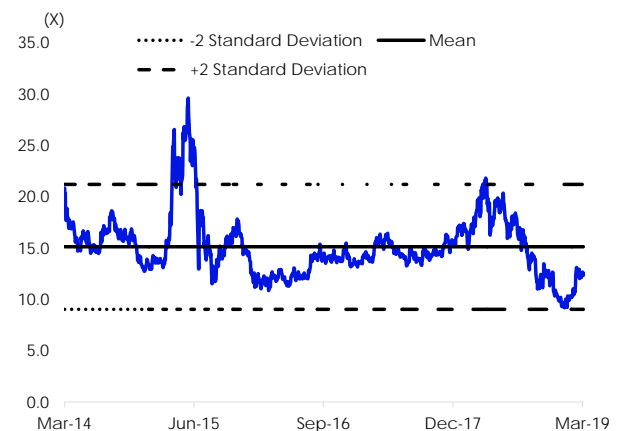
Source: Company data, CCBIS estimates

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	
	2019F	2020F	2019F	2020F	2019F	2020F
RMB m						
Revenue	12,032	13,688	12,224	13,936	-1.6	-1.8
Gross profit	3,730	4,243	3,728	4,251	0.0	-0.2
Opex	-2,635	-2,998	-2,591	-2,941	1.7	1.9
Operating profit	1,095	1,246	1,137	1,310	-3.7	-4.9
Net profit	826	959	860	995	-4.0	-3.6
%						
Gross margin	31.0	31.0	30.5	30.5	-	-
OPEX to sales	-21.9	-21.9	-21.2	-21.1	-	-
OPM	9.1	9.1	9.3	9.4	-	-
Net margin	6.9	7.0	7.0	7.1	-	-

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 (%)		
					FY18F	FY19F	FY20F	FY18F	FY19F	FY20F
HK listed										
TravelSky	696 HK	Not Rated	22.10	8,238	23	20	18	8	14	12
Kingsoft Corp	3888 HK	Outperform	17.90	3,130	117	27	21	-88	326	29
Chinasoft International	354 HK	Outperform	4.95	1,768	16	14	12	19	15	16
Kingdee	268 HK	Neutral	9.17	3,858	57	46	37	27	26	23
Digital China	861 HK	Not Rated	4.31	917	22	17	12	-282	29	40
Sinsoft	1297 HK	Not Rated	2.75	428	13	10	6	4	28	68
Chanjet	1588 HK	Not Rated	10.24	283	N/A	N/A	N/A	N/A	N/A	N/A
Average					41	22	18	-51	73	31
A-share listed										
iFlytek	002230 CH	Outperform	36.82	11,508	130	83	53	20	56	57
Wangsu	300017 CH	Underperform	13.58	4,935	26	30	22	48	-12	36
Aisino	600271 CH	Not Rated	28.91	8,043	35	27	23	1	26	N/A
Hundsun	600570 CH	Not Rated	83.88	7,740	86	66	50	20	31	31
Yonyou	600588 CH	Outperform	34.11	9,769	78	60	47	34	31	26
Shiji info	002153 CH	Not Rated	33.48	5,335	74	61	49	15	21	23
Neusoft Corp	600718 CH	Not Rated	14.90	2,765	49	34	29	-22	47	17
Teamsun	600410 CH	Not Rated	8.91	1,467	N/A	N/A	N/A	N/A	N/A	N/A
YGsoft Inc	002063 CH	Not Rated	10.76	1,365	30	N/A	N/A	80	N/A	N/A
Average					63	51	39	25	28	32
Global peers										
Microsoft	MSFT US	Not Rated	117.65	902,636	26	23	20	16	13	17
Oracle	ORCL US	Not Rated	54.04	184,690	16	14	13	12	9	8
IBM	IBM US	Not Rated	140.49	125,017	10	10	10	1	2	3
SAP	SAP US	Not Rated	113.44	139,362	24	22	20	3	10	10
Accenture	ACN US	Not Rated	166.20	106,103	23	21	19	8	9	9
Salesforce	CRM US	Not Rated	163.93	126,390	59	48	38	6	25	26
Workday Inc.	WDAY US	Not Rated	191.53	42,520	114	86	62	32	33	39
Netsuite	N US	Not Rated	109.54	8,865	202	143	96	158	42	49
Average					59	46	35	29	18	20

* Price as at close on 20 Mar 2019 (local currency)

Source: Bloomberg, CCBIS estimates

Chinasoft International – P&L assumptions

RMB m	FY15	FY16	FY17	FY18	FY19F	FY20F	1H17	2H17	1H18	2H18
Revenue breakdown										
TPG business	3,781	5,482	7,859	9,175	10,551	12,134	3,511	4,347	4,029	5,146
IIG business	1,348	1,301	1,385	1,410	1,481	1,555	634	751	785	626
Total revenue	5,129	6,783	9,244	10,585	12,032	13,688	4,145	5,099	4,814	5,771
YoY (%)	16	32	36	15	14	14	44	31	16	13
Cost of revenues	-3,606	-4,768	-6,493	-7,340	-8,302	-9,445	-3,002	-3,491	-3,424	-3,917
Gross profit	1,523	2,016	2,750	3,245	3,730	4,243	1,143	1,608	1,390	1,855
Gross profit margin (%)	30	30	30	31	31	31	28	32	29	32
Sales and marketing expense	-179	-219	-370	-496	-578	-657	-147	-223	-233	-263
General & administrative expense	-627	-807	-1,086	-1,091	-1,263	-1,437	-660	-427	-680	-411
Research and development	-195	-345	-567	-739	-794	-903	0	-567	0	-739
Total operating expense	-1,001	-1,371	-2,023	-2,326	-2,635	-2,998	-807	-1,217	-913	-1,413
Operating profit	522	645	727	919	1,095	1,246	336	391	477	441
Operating profit margin (%)	10	10	8	9	9	9	8	8	10	8
Other income, gains and losses	29	44	96	64	65	70	34	63	19	45
Allowance for doubtful debts	-62	-18	-26	0	0	0	-1	-24	0	0
Other expenses	-92	-88	-82	-68	-70	-70	-42	-40	-37	-32
Fair value gain on derivative financial instruments	-1	0	0	0	0	0	0	0	0	0
Finance costs	-93	-96	-103	-118	-120	-120	-43	-60	-59	-59
Share of results of associates	2	17	20	12	10	10	-16	35	-15	27
Gain on disposal of associates	112	0	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	0	0	0	0
Profit before tax	420	525	633	760	960	1,116	268	365	388	372
Taxation	-87	-115	-71	-44	-134	-156	-28	-44	-33	-12
Effective tax rate (%)	-21	-22	-11	-6	-14	-14	-10	-12	-8	-3
Net income	333	410	561	716	826	959	240	321	356	360
- Minority interests	53	-32	-4	0	0	0	-5	1	-3	3
Net income attributable to common shareholders	280	442	566	716	826	959	245	320	359	357
YoY (%)	40	58	28	27	15	16	4	56	46	12
Net profit margin (%)	5	7	6	7	7	7	6	6	7	6
EPS diluted (HK\$)	0.16	0.22	0.26	0.29	0.33	0.39	0.11	0.15	0.15	0.15
Diluted share volume (m)	2,123	2,400	2,621	2,779	2,779	2,779	2,508	2,621	2,789	2,779
Key ratios (%)										
EPS growth	24	36	17	13	14	16	2	53	30	0
Gross profit margin	30	30	30	31	31	31	28	32	29	32
Operating profit margin	10	10	8	9	9	9	8	8	10	8
Net profit margin	5	7	6	7	7	7	6	6	7	6
ROAE	10	12	12	13	13	13	N/A	N/A	N/A	N/A
Net debt-to-equity	8	-4	-21	-16	-26	-28	N/A	N/A	N/A	N/A

Source: Company data, CCBIS estimates

Chinasoft Intl. | 354 HK – financial summary

Profit and loss

FYE 31 Dec (RMB m)	2016	2017	2018	2019F	2020F
TPG business	5,482	7,859	9,175	10,551	12,134
IIG business	1,301	1,385	1,410	1,481	1,555
Revenue	6,783	9,244	10,585	12,032	13,688
COGS	(4,768)	(6,493)	(7,340)	(8,302)	(9,445)
Gross profit	2,016	2,750	3,245	3,730	4,243
Operating expenses	(1,371)	(2,023)	(2,326)	(2,635)	(2,998)
EBIT	645	727	919	1,095	1,246
Net financial inc. (exp.)	(96)	(103)	(118)	(120)	(120)
Others	(25)	9	(40)	(15)	(10)
Profit before tax	525	633	760	960	1,116
Tax	(115)	(71)	(44)	(134)	(156)
Total profit	410	561	716	826	959
Minority interest	32	4	0	-	-
Net profit attributable to shareholders	442	566	716	826	959
Diluted EPS (RMB)	0.20	0.22	0.26	0.30	0.35
Dividend (RMB m)	26	39	52	58	67
DPS (RMB)	0.01	0.02	0.02	0.02	0.02

Cash flow

FYE 31 Dec (RMB m)	2016	2017	2018F	2019F	2020F
Profit before tax	525	633	760	960	1,116
Amortization & depreciation	144	178	194	211	228
Net financial charge adj.	96	103	118	120	120
Non-cash items adjusted	-	154	-	-	-
Change in working capital	(279)	(687)	(996)	79	(527)
Tax paid	(115)	(48)	(44)	(134)	(156)
Other	(79)	-	400	-	-
Operating cash flow	292	332	432	1,235	780
Capex	(250)	(160)	(200)	(180)	(180)
Other	(458)	(74)	(60)	(60)	(60)
Investment cash flow	(708)	(234)	(260)	(240)	(240)
Change in borrowings	-	(431)	-	-	-
Equity issues	545	943	-	-	-
Dividend paid	-	(25)	(39)	(52)	(58)
Other	(96)	(54)	695	(120)	(120)
Financing cash flow	449	432	656	(172)	(178)
Change in cash flow	33	530	828	823	362
Cash & equivalents, begin	1,266	1,299	1,785	2,646	3,469
Forex	-	(44)	33	-	-
Cash & equivalents, end	1,299	1,785	2,646	3,469	3,832
Free cash flow	119	(25)	(137)	1,051	592

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2016	2017	2018	2019F	2020F
Cash and equivalents	1,299	1,785	2,646	3,469	3,832
Pledge dep., restrict. cash	1	1	19	19	19
Receivables	3,607	4,637	5,495	6,107	6,935
Inventory	21	26	64	64	64
Total current assets	4,927	6,449	8,225	9,659	10,850
Property, plant and equip.	820	853	838	901	954
Intangible assets	231	179	148	114	73
Other non-current assets	1,251	1,271	1,278	1,278	1,278
Total non-current assets	2,302	2,303	2,264	2,293	2,305
Total assets	7,229	8,752	10,488	11,952	13,155
Short-term borrowings	922	686	1,676	1,676	1,676
Trade and bills payable	1,205	1,605	1,542	2,233	2,534
Other current liabilities	312	262	508	508	508
Total current liabilities	2,439	2,552	3,726	4,416	4,717
Long-term borrowings	194	-	-	-	-
Other non-current liabilities	263	970	731	731	731
Total non-current liabilities	458	970	731	731	731
Total liabilities	2,897	3,522	4,457	5,147	5,448
Share capital	2,759	2,920	3,095	3,095	3,095
Reserves & retained profits	1,505	2,246	2,872	3,645	4,547
Shareholders' equity	4,264	5,166	5,967	6,740	7,642
Minority interest	68	64	65	65	65
Total equity	4,333	5,230	6,032	6,805	7,707
Total equity and liabilities	7,229	8,752	10,488	11,952	13,155

Ratios

FYE 31 Dec	2016	2017	2018	2019F	2020F
Growth (%)					
Revenue	32.3	36.3	14.5	13.7	13.8
EBITDA	18.8	14.6	23.0	17.3	12.8
EBIT	23.5	12.7	26.3	19.2	13.8
Net profit	57.9	27.9	26.6	15.3	16.2
Profitability (%)					
Gross margin	29.7	29.8	30.7	31.0	31.0
EBITDA margin	11.6	9.8	10.5	10.9	10.8
EBIT margin	9.5	7.9	8.7	9.1	9.1
Net margin	6.5	6.1	6.8	6.9	7.0
Tax rate	21.9	11.3	5.8	14.0	14.0
Efficiency (days)					
Inventory turnover	2	1	2	3	2
Trades receivable	96	81	79	86	86
Trades payable	82	79	78	83	92
Returns & leverage (%)					
ROAA	6.5	7.1	7.4	7.4	7.6
ROAE	11.8	12.0	12.9	13.0	13.3
Net debt (cash)/equity	(4.2)	(21.0)	(16.1)	(26.4)	(28.0)
Liquidity (x)					
Current ratio	2.0	2.5	2.2	2.2	2.3
Quick ratio	2.0	2.5	2.2	2.2	2.3

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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