

Chinasoft International | 354 HK

Solid business and attractive valuation

- **Solid FY19 results**
- **Positive outlook for FY20F**
- **Attractive valuation, maintain Outperform**

Solid FY19 results. Chinasoft International (Chinasoft) announced a solid set of FY19 results, with revenue up 14% YoY to reach RMB12.04b. New business, mainly cloud related, grew 25% YoY to contribute revenue of RMB2.0b. Despite the speculation swirling around Huawei in FY19, notably pressure from the US side, the company remains Chinasoft's largest customer. Revenue from Huawei in FY19 grew 17% YoY to RMB6.57b, contributing 55% of total revenue at Chinasoft, up from 53% in FY18. The company's FY19 net profit was RMB755m, up 5% YoY.

Positive outlook for FY20F. We are relatively less worried about growth at Chinasoft in FY20 compared with many of its rivals as most of Chinasoft's clients are giant companies like Huawei, PingAn, Tencent, Alibaba, China Mobile and Baidu. Unlike the more vulnerable SMEs, these corporate behemoths are less inclined to shrink development costs. Huawei anticipates only 10% YoY revenue growth in FY20, yet is preparing to raise R&D spending by a high-teen percentage, bringing it to over RMB140b. All indications are that the spending will not abate going forward. This puts Chinasoft in a good position as much of the development work at Huawei and other giant companies is likely to be outsourced to Chinasoft. We anticipate 19% YoY revenue growth and 18% YoY net profit growth at Chinasoft in FY20F.

Attractive valuation, maintain Outperform. Given Chinasoft's on-track financial performance in FY19 and its positive outlook for FY20F, we only slightly adjust our FY20F/21F earnings forecast by 1.5%/0.1%. The company is trading at 10.5x/8.7x FY20/21 P/E, which is very attractive given its five-year average P/E of 15x. We maintain our target price of HK\$5.60, still based on 15x FY20F P/E, in line with the company's five-year average. Maintain Outperform.

Forecast and valuation

Year to 31 Dec	2017	2018	2019F	2020F	2021F
Revenue (RMB m)	9,244	10,585	12,042	14,371	16,849
YoY (%)	36.3	14.5	13.8	19.3	17.2
Net profit (RMB m)	566	716	755	894	1,074
YoY (%)	27.9	26.6	5.5	18.4	20.2
Fully diluted EPS (RMB)	0.22	0.26	0.28	0.34	0.40
YoY (%)	9.0	19.4	9.9	18.4	20.2
P/E(x)	15.1	13.4	12.3	10.5	8.7
DPS (HK\$)	0.02	0.02	0.02	0.02	0.03
Dividend yield (%)	0.5	0.5	0.5	0.6	0.7
P/B (x)	1.8	1.6	1.5	1.3	1.1
ROAE (%)	12.0	12.9	11.9	12.6	13.4
Net debt/equity (%)	-21.0	-16.1	-18.3	-16.5	-16.3

Source: Bloomberg, CCBIS estimates

Outperform (maintained)

Current price:

HK\$3.92

(as at 25 Mar 2020)

Target:

► **HK\$5.60**

(maintained)

Trading data

52-week range	HK\$3.19-5.28
Market capitalization (m)	HK\$10,892/US\$1,400
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 (%)	43

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI



Source: Bloomberg, CCBIS

Stock performance

Performance over	1M	3M	12M
Absolute	-22	-12	-16
Relative (%) to HSCEI	-12	3	0

Source: Bloomberg, CCBIS

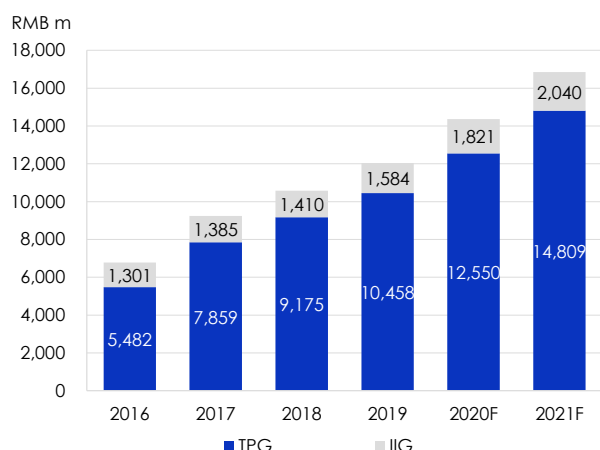
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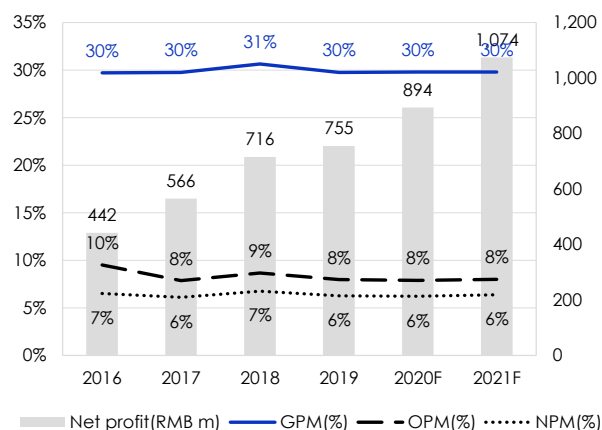
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Chinasoft – revenue mix (RMB m)



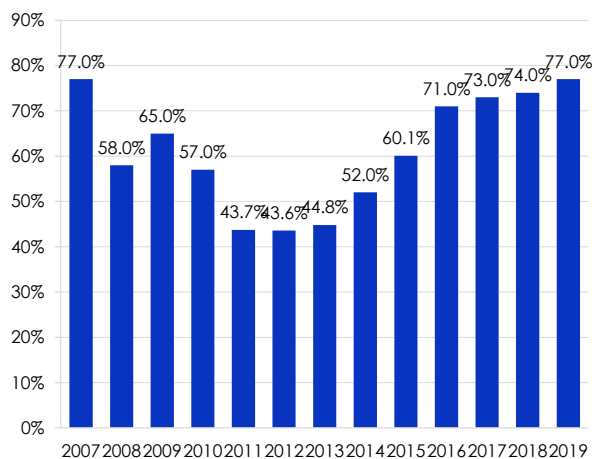
Source: Company data, CCBIS estimates

Chinasoft – net income (RMB m) and margin ratios



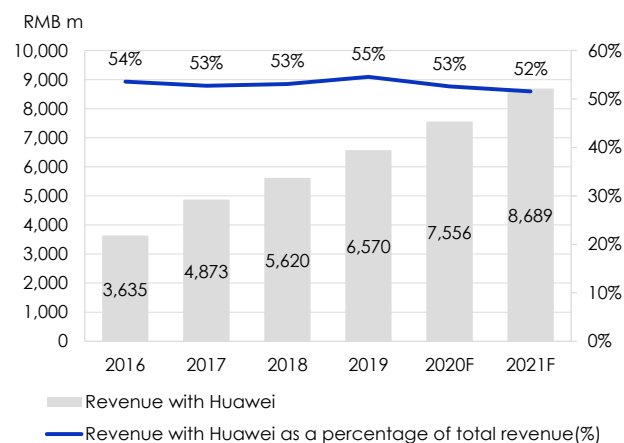
Source: Company data, CCBIS estimates

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



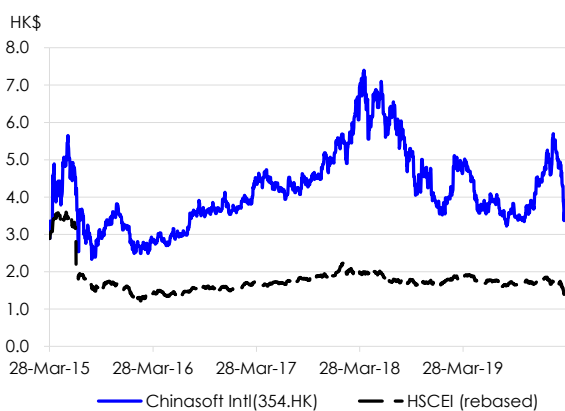
Source: Company data, CCBIS estimates

Chinasoft – revenue from Huawei



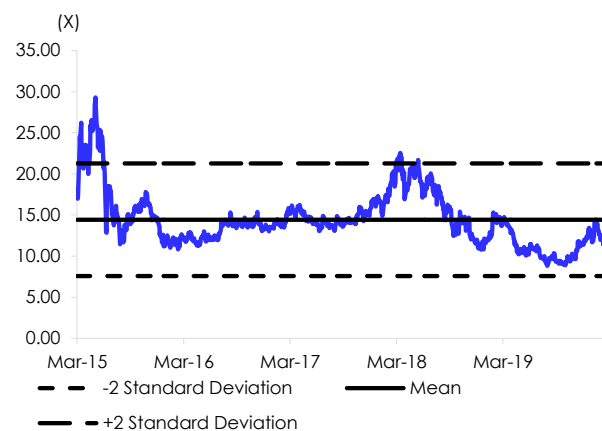
Source: Company data, CCBIS estimates

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 (%)		
	2019	2020F	2021F	2019F	2020F	2021F	2019	2020F	2021F
RMB m									
Revenue	12,042	14,371	16,849	12,003	14,028	15,931	0.3	2.4	5.8
Gross profit	3,583	4,283	5,021	3,635	4,278	4,875	-1.4	0.1	3.0
Opex	-2,622	-3,147	-3,673	-2,721	-3,135	-3,529	-3.6	0.4	4.1
Operating profit	961	1,135	1,348	914	1,143	1,346	5.1	-0.7	0.1
Net profit	755	894	1,074	733	908	1,075	3.0	-1.5	-0.1
%									
Gross margin	29.8	29.8	29.8	30.3	30.5	30.6	-	-	-
OPEX to sales	-21.8	-21.9	-21.8	-22.7	-22.4	-22.2	-	-	-
OPM	8.0	7.9	8.0	7.6	8.2	8.5	-	-	-
Net margin	6.3	6.2	6.4	6.1	6.5	6.8	-	-	-

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 (%)		
					FY19F	FY20F	FY21F	FY19F	FY20F	FY21F
HK listed										
TravelSky	696 HK	Not Rated	14.36	5,419	15	14	12	-2	4	17
Kingsoft Corp	3888 HK	Outperform	24.20	4,284	N/A	37	25	600	89	48
Kingdee	268 HK	Outperform	10.30	4,416	98	78	50	0	25	55
Chinasoft International	354 HK	Outperform	3.92	1,400	12	11	9	10	18	20
Weimob	2013 HK	Not Rated	5.00	1,443	134	45	N/A	N/A	197	N/A
Youzan	8083 HK	Not Rated	0.73	1,456	-24	-33	N/A	N/A	-29	N/A
Digital China	861 HK	Not Rated	3.47	748	32	15	N/A	-45	109	N/A
Sinosoft	1297 HK	Not Rated	1.16	183	4	4	3	31	16	15
Chanjet	1588 HK	Not Rated	8.50	238	N/A	N/A	N/A	N/A	N/A	N/A
Average					38	21	23	101	54	34
A-share listed										
Hikvision	002415 CH	Outperform	28.85	37,908	21	18	14	11	19	23
Dahua	002236 CH	Outperform	16.92	7,156	16	13	11	15	22	21
Kingsoft Office	688111 CH	Not Rated	235.89	15,290	148	102	77	N/A	46	32
Yonyou	600588 CH	Outperform	42.38	14,923	97	95	78	71	2	23
iFlytek	002230 CH	Outperform	35.99	11,126	96	63	45	36	52	41
Hundsun	600570 CH	Not Rated	89.54	10,111	55	57	46	112	-4	25
Aisino	600271 CH	Not Rated	20.61	5,397	22	19	16	15	13	N/A
Shiji info	002153 CH	Not Rated	30.95	4,647	70	58	46	1	22	27
Wangsu	300017 CH	Underperform	8.16	2,793	22	33	21	6	-32	57
Neusoft Corp	600718 CH	Not Rated	12.18	2,128	111	55	N/A	29	100	N/A
Teamsun	600410 CH	Not Rated	12.41	1,917	N/A	N/A	N/A	N/A	N/A	N/A
YGsoft Inc	002063 CH	Not Rated	13.53	1,613	50	N/A	N/A	N/A	N/A	N/A
Average					64	51	39	33	24	31
Global peers										
Microsoft	MSFT US	Not Rated	146.92	1,117,480	26	23	21	23	11	14
Oracle	ORCL US	Not Rated	45.94	144,876	12	11	10	13	8	8
IBM	IBM US	Not Rated	105.85	94,038	8	8	7	3	6	5
SAP	SAP US	Not Rated	106.40	130,713	20	18	15	8	11	15
Accenture	ACN US	Not Rated	151.82	96,859	20	19	17	4	8	9
Salesforce	CRM US	Not Rated	147.06	131,619	46	38	29	9	24	28
Workday Inc.	WDAY US	Not Rated	135.73	31,489	61	49	39	23	24	28
Netsuite	N US	Not Rated	109.54	8,865	N/A	N/A	N/A	N/A	N/A	N/A
Average					28	24	20	12	13	15

* Price as at close on 25 Mar 2020 (local currency)

Source: Bloomberg, CCBIS estimates

Chinasoft International – P&L assumptions

RMB m	FY16	FY17	FY18	FY19	FY20F	FY21F	1H18	2H18	1H19	2H19
Revenue breakdown										
TPG business	3,781	5,482	7,859	10,458	12,550	14,809	4,029	5,146	4,748	5,710
IIG business	1,348	1,301	1,385	1,584	1,821	2,040	785	626	790	794
Total revenue	5,129	6,783	9,244	12,042	14,371	16,849	4,814	5,771	5,538	6,504
YoY (%)	16	32	36	14	19	17	16	13	15	13
Cost of revenues	-3,606	-4,768	-6,493	-8,459	-10,089	-11,828	-3,424	-3,917	-3,971	-4,487
Gross profit	1,523	2,016	2,750	3,583	4,283	5,021	1,390	1,855	1,567	2,016
Gross profit margin (%)	30	30	30	30	30	30	29	32	28	31
Sales and marketing expense	-179	-219	-370	-618	-733	-842	-233	-263	-266	-352
General & administrative expense	-627	-807	-1,086	-1,196	-1,437	-1,685	-680	-411	-833	-363
Research and development	-195	-345	-567	-809	-977	-1,146	0	-739	0	-809
Total operating expense	-1,001	-1,371	-2,023	-2,622	-3,147	-3,673	-913	-1,413	-1,099	-1,524
Operating profit	522	645	727	961	1,135	1,348	477	441	468	493
Operating profit margin (%)	10	10	8	8	8	8	10	8	8	8
Other income, gains and losses	29	44	96	143	150	150	19	45	60	82
Allowance for doubtful debts	-62	-18	-26	0	0	0	0	0	0	0
Other expenses	-92	-88	-82	-59	-60	-60	-37	-32	-30	-29
Fair value gain on derivative financial instruments	-1	0	0	0	0	0	0	0	0	0
Finance costs	-93	-96	-103	-166	-180	-200	-59	-59	-85	-81
Share of results of associates	2	17	20	0	0	0	-15	27	-8	8
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	799	971	1,168	388	372	390	409
Taxation	-87	-115	-71	-42	-78	-93	-33	-12	-31	-11
Effective tax rate (%)	-21	-22	-11	-5	-8	-8	-8	-3	-8	-3
Net income	333	410	561	757	894	1,074	356	360	359	398
- Minority interests	53	-32	-4	2	0	0	-3	3	-4	6
Net income attributable to common shareholders	280	442	566	755	894	1,074	359	357	363	392
YoY (%)	40	58	28	5	18	20	46	12	1	10
Net profit margin (%)	5	7	6	6	6	6	7	6	7	6
EPS diluted (HK\$)	0.16	0.22	0.26	0.32	0.37	0.45	0.15	0.15	0.15	0.16
Diluted share volume (m)	2,123	2,400	2,621	2,666	2,666	2,666	2,789	2,779	2,711	2,666
Key ratios (%)										
EPS growth	24	36	17	9	18	20	30	0	3	12
Gross profit margin	30	30	30	30	30	30	29	32	28	31
Operating profit margin	10	10	8	8	8	8	10	8	8	8
Net profit margin	5	7	6	6	6	6	7	6	7	6
ROAE	10	12	12	12	13	13	N/A	N/A	N/A	N/A
Net debt-to-equity	8	-4	-21	-18	-16	-16	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)	2017	2018	2019	2020F	2021F
TPG business	7,859	9,175	10,458	12,550	14,809
IIIG business	1,385	1,410	1,584	1,821	2,040
Revenue	9,244	10,585	12,042	14,371	16,849
COGS	(6,493)	(7,340)	(8,459)	(10,089)	(11,828)
Gross profit	2,750	3,245	3,583	4,283	5,021
Operating expenses	(2,023)	(2,326)	(2,622)	(3,147)	(3,673)
EBIT	727	919	961	1,135	1,348
Net financial inc. (exp.)	(103)	(118)	(166)	(180)	(200)
Other	9	(40)	4	16	20
Profit before tax	633	760	799	971	1,168
Tax	(71)	(44)	(42)	(78)	(93)
Total profit	561	716	757	894	1,074
Minority interest	4	0	(2)	–	–
Net profit attributable to shareholders	566	716	755	894	1,074
Diluted EPS (RMB)	0.22	0.26	0.28	0.34	0.40
Dividend (RMB m)	39	52	48	54	64
DPS (RMB)	0.02	0.02	0.02	0.02	0.02

Cash flow

FYE 31 Dec (RMB m)	2017	2018	2019F	2020F	2021F
Profit before tax	633	760	799	971	1,168
Amortization & depreciation	178	192	207	223	239
Net financial charge adj.	103	118	166	180	200
Non-cash items adjusted	154	67	–	–	–
Change in working capital	(687)	(743)	(442)	(840)	(897)
Tax paid	(48)	(82)	(42)	(78)	(93)
Other	–	(152)	–	–	–
Operating cash flow	332	161	688	457	616
Capex	(160)	(151)	(160)	(160)	(160)
Other	(74)	(16)	(50)	(50)	(50)
Investment cash flow	(234)	(167)	(210)	(210)	(210)
Change in borrowings	(431)	984	–	–	–
Equity issues	943	109	–	–	–
Dividend paid	(25)	(37)	(52)	(48)	(54)
Other	(54)	(203)	(166)	(180)	(200)
Financing cash flow	432	853	(218)	(228)	(254)
Change in cash flow	530	847	260	19	153
Cash & equivalents, begin	1,299	1,785	2,646	2,906	2,925
Forex	(44)	14	–	–	–
Cash & equivalents, end	1,785	2,646	2,906	2,925	3,078
Free cash flow	(25)	164	515	268	422

Balance sheet

FYE 31 Dec (RMB m)	2017	2018	2019F	2020F	2021F
Cash and equivalents	1,785	2,646	2,906	2,925	3,078
Pledge dep., restrict. cash	1	19	19	19	19
Receivables	4,637	5,495	5,991	7,133	8,347
Inventory	26	64	64	64	64
Total current assets	6,449	8,225	8,981	10,141	11,508
Property, plant & equip.	853	838	865	881	886
Intangible assets	179	148	124	95	60
Other non-current assets	1,271	1,278	1,278	1,278	1,278
Total non-current assets	2,303	2,264	2,266	2,253	2,224
Total assets	8,752	10,488	11,247	12,394	13,732
Short-term borrowings	686	1,676	1,676	1,676	1,676
Trade and bills payable	1,605	1,542	1,597	1,898	2,215
Other current liabilities	262	508	508	508	508
Total current liabilities	2,552	3,726	3,780	4,082	4,399
Other non-current liabilities	970	731	731	731	731
Total non-current liabilities	970	731	731	731	731
Total liabilities	3,522	4,457	4,511	4,813	5,130
Share capital	2,920	3,095	3,095	3,095	3,095
Reserves & retained profits	2,246	2,872	3,575	4,420	5,441
Shareholders' equity	5,166	5,967	6,670	7,515	8,536
Minority interest	64	65	66	66	66
Total equity	5,230	6,032	6,736	7,582	8,603
Total equity and liabilities	8,752	10,488	11,247	12,394	13,732

Ratios

FYE 31 Dec	2017	2018	2019F	2020F	2021F
Growth (%)					
Revenue	36.3	14.5	13.8	19.3	17.2
EBITDA	14.6	22.7	5.2	16.3	16.8
EBIT	12.7	26.3	4.6	18.2	18.7
Net profit	27.9	26.6	5.5	18.4	20.2
Profitability (%)					
Gross margin	29.8	30.7	29.8	29.8	29.8
EBITDA margin	9.8	10.5	9.7	9.5	9.4
EBIT margin	7.9	8.7	8.0	7.9	8.0
Net margin	6.1	6.8	6.3	6.2	6.4
Tax rate	11.3	5.8	5.3	8.0	8.0
Efficiency (days)					
Inventory turnover	1	2	3	2	2
Trades receivable	81	79	84	81	82
Trades payable	79	78	68	63	63
Returns & leverage (%)					
ROAA	7.1	7.4	6.9	7.6	8.2
ROAE	12.0	12.9	11.9	12.6	13.4
Net debt (cash)/equity	(21.0)	(16.1)	(18.3)	(16.5)	(16.3)
Liquidity (x)					
Current ratio	2.5	2.2	2.4	2.5	2.6
Quick ratio	2.5	2.2	2.4	2.5	2.6

Source: Company data, CCBIS estimates

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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