

Huatai Research

13 August 2018

Equity | China | Software

BUY | TP HKD8.40

Initiation

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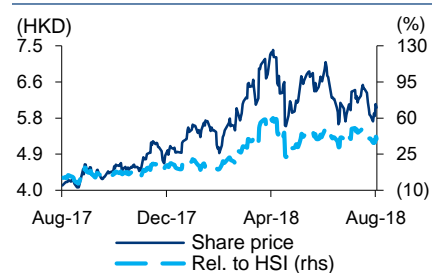
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Key data

Target price (HKD)	8.40
Closing price (HKD as of 10 Aug)	6.00
Upside +/- (%)	40
Mkt cap (USDm)	1,832
6m avg daily val (USDm)	15.49
52wk price range (HKD)	7.40/4.07
BVPS (RMB)	2.16

Share performance



Source: FactSet

New business injects new life

Upside from new business looks undervalued

We initiate coverage on Chinasoft International (CSI) at BUY. As the largest IT services provider in China by revenue, CSI offers consulting services, IT solutions, outsourcing services and training services, and grew its revenue tenfold in the past 10 years. For 2018E, we see revenue from its traditional IT service business growing by 13%, given long-established stable customer relationships. We also like CSI's upside potential, both from revenue expansion (2018E: 97%) and margin improvement prompted by new business which might be undervalued. The share is trading at 14x 2019E forward PE. Our target price of HKD8.4 is based on 22x 12-month target PE.

Long-established customer base supports revenue growth

Its biggest customer and a major CSI shareholder, Huawei has been working with CSI for almost 10 years, and accounted for 52% of total 2017 revenue. With the 5G era coming, we believe growing demand for 5G applications should bring CSI solid revenue growth from Huawei in the coming year. In 2018E, we expect CSI's dependence on Huawei to reduce to 46% of total revenue, compared with increasing revenue contribution of 15% in 2018E (2017: 13%) from six other major customers — HSBC, Microsoft, Ping An, Alibaba, Tencent and Baidu. Overall, we estimate revenue growth of 13/12/12% from traditional business in 2018E/2019E/2020E, representing 83/78/74% of total revenue (2017: 89%).

Strong growth momentum in asset-light new business

CSI achieved revenue of RMB1bn from new business in 2017, including the Jointforce platform in cooperation with Huawei, as well as cloud computing and big data services. We expect new business revenue to rise 97/49/41% and contribute 17/22/26% to total revenue in 2018E/2019E/2020E, considering: 1) popularity of cloud computing bringing growing demand for services; 2) tailwinds from Huawei Cloud market expansion; and 3) strong demand for big data services in the Internet of Things segment.

Expansion of new business to promote margin improvement

We believe CSI's diversified business layouts with Huawei, BAT, HSBC should bring CSI promising opportunities to promote new business penetration into different segments. As a result, we expect CSI to benefit from strategic cooperation with Huawei, cut operating expenses, and to engage in new business expansion in an asset-light model, and improve overall net margin from 6.1% in 2017 to 6.6/7.3/7.5% in 2018E/2019E/2020E.

Financials

YE 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Revenue (RMBmn)	6,783	9,244	11,276	13,327	15,750
yoy%	32.3	36.3	22.0	18.2	18.2
Net profit (RMBmn)	442	566	742	967	1,184
yoy%	57.9	27.9	31.3	30.2	22.5
EPS (diluted, RMB)	0.184	0.216	0.283	0.369	0.452
PE (x)	28.5	24.3	18.5	14.2	11.6
PB (x)	2.7	2.4	2.3	2.0	1.7
EV EBITDA (x)	22.9	19.9	16.5	13.7	11.7
Dividend yield (%)	0.2	0.3	0.4	0.5	0.6
Free cashflow yield (%)	0.1	1.2	0.8	2.4	3.2

Source: Company data, Huatai HK Research estimates

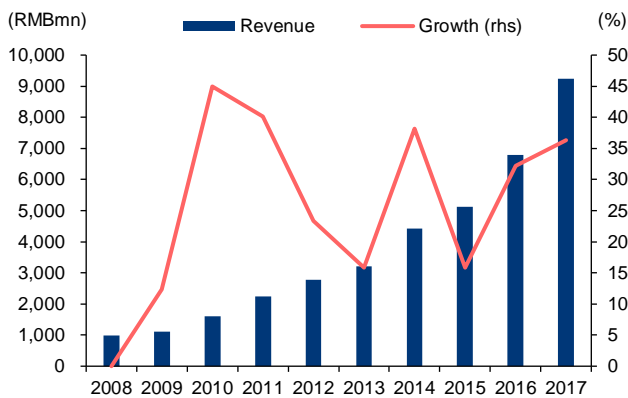
Huatai Financial Holdings (Hong Kong) Limited is abbreviated as Huatai HK throughout this report.

Please refer to end pages for analyst certification and required disclosures.

Long-established customer relationships support revenue growth

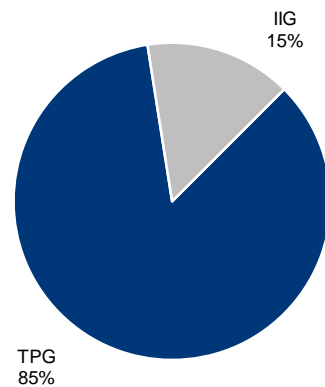
Chinasoft International (CSI) is the largest IT services provider in China, offering to customers consulting services, IT solutions, outsourcing services and training services. Given the ever-growing IT demand in China, CSI saw its revenue increase almost tenfold in the past 10 years. CSI generated its revenue from two business groups: the technology professional services group (TPG) and Internet IT services group (IIT), representing 85% and 15% of total revenue in 2017, respectively.

Fig.37. CSI: revenue



Source: Company data, Huatai HK Research

Fig.38. CSI: revenue by business type (2017)

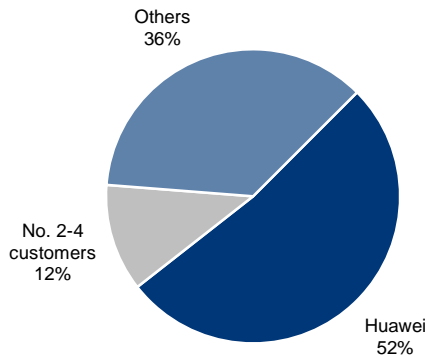


Notes: IIG – Internet IT svcs group; TPG – technology professional svcs group
 Source: Company data, Huatai HK Research

With nearly 20 years of experience in IT services, CSI has established stable long-term cooperative relationships with customers from 32 different countries in a diverse range of industries such as finance, telecommunications, manufacturing, government and Internet. As CSI's biggest customer and one of the major shareholders of CSI (with a shareholding of 3.5%), Huawei has been working with CSI for almost 10 years, and contributed 52% of CSI's total revenue in 2017. Considering Huawei's successful business expansion and growing demand for 5G applications, we believe CSI will be able to generate solid revenue growth from Huawei in the next few years.

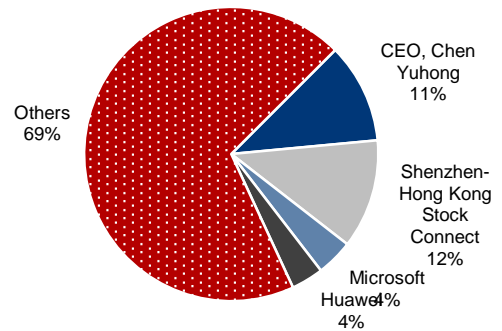
Moreover, we note that CSI has achieved considerable business expansion with other major customers by reaching strategic cooperation agreements. In 2018E, we expect CSI's dependence on Huawei to be weakened to 46%, compared with rising revenue contribution of 15% in 2018E (2017: 13%) from other six major customers — HSBC, Microsoft, Ping An, Alibaba, Tencent and Baidu. Going forward, we expect CSI to deepen cooperation with these customers, increasing their total revenue and further diversifying business layouts. Overall, we expect CSI's traditional business revenue to grow at 13/12/12% in 2018/2019/2020E, representing 83/78/74% of total revenue.

Fig.39. CSI: revenue by customer



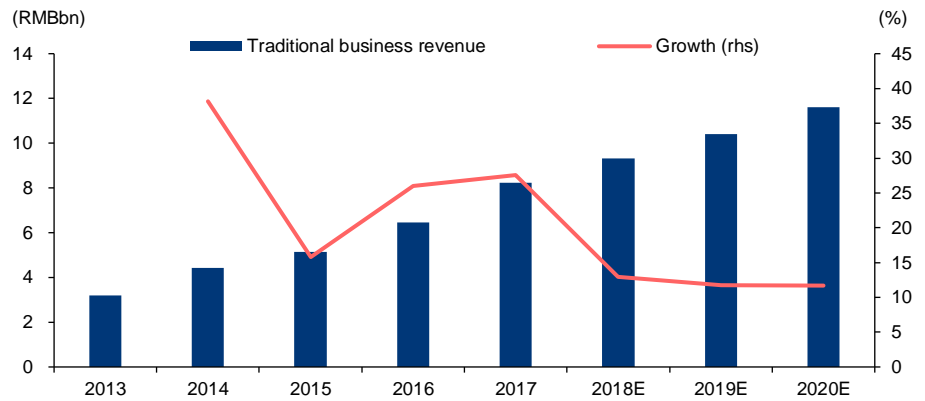
Source: Company data, Huatai HK Research

Fig.40. CSI: equity structure



Source: Company data, Huatai HK Research

Fig.41. CSI: traditional business revenue



Source: Company data, Huatai HK Research estimates

New business with well-run asset-light model brings upsides

CSI achieved revenue of RMB1bn from new business in 2017, including its Jointforce platform, cloud computing and big data services. Specifically, the Jointforce platform, considered a subtracting platform, has been commercialized for three years, with cumulative contract value exceeding RMB1.3bn and representing 30% of new business revenue by end-2017. CSI has expanded Jointforce resources to 23 cities and provinces across China, signed a strategic cooperation agreement with the Nanjing municipal government and plans to promote this business model cross the country. By doing so, CSI has managed to expand its IT services business by subtracting orders to third parties to avoid burdening itself with asset expansion. We expect CSI to take full advantage of existing customer relationships with its major customers, sign more contracts and drive margin improvement together with revenue increment through better economies of scale.

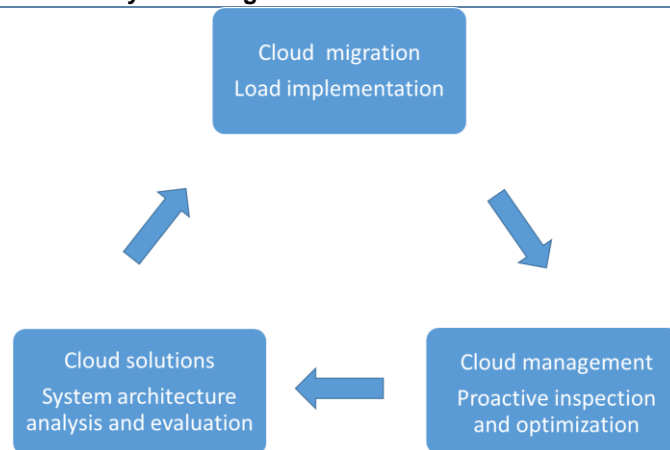
Fig.42. CSI Jointforce: cloud software parks launched in 15 cities



Source: Company data, Huatai HK Research

As for the cloud computing business, CSI has been working on cloud services since 2013, focusing on cloud solutions, migration, operations and training. Moreover, in 2017, CSI reached an official strategic agreement dubbed “Sailing in the Same Boat” with its top customer Huawei, launched “Intelligent Manufacturing Cloud” solutions and made breakthroughs in Kunshan and Chongqing. We believe CSI will benefit from its close cooperation with Huawei as well as the rapid spread of Huawei Cloud, which is considered to be an option for enterprises to deploy IaaS, thereby bringing CSI opportunities to provide cloud migration services and cloud solutions.

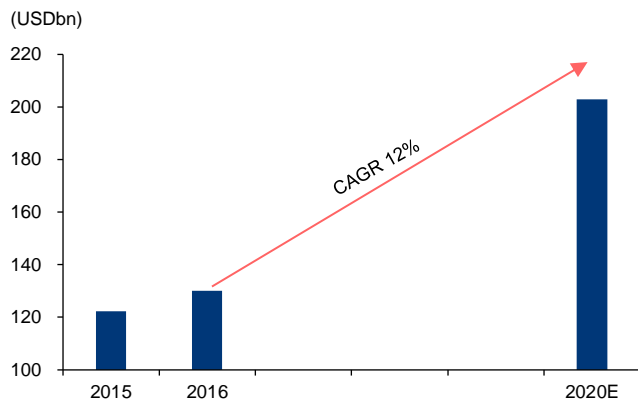
Fig.43. CSI: cloud lifecycle management



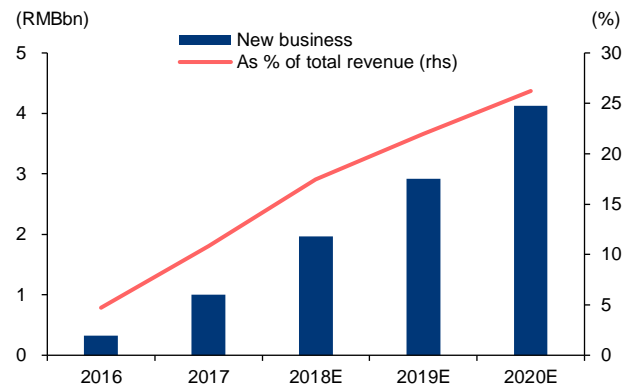
Source: Company data, Huatai HK Research

According to IDC, the global big data and analytic market is expected to grow from USD130bn in 2016 to USD203bn in 2020E, indicating a CAGR of 12%. We believe the China market will grow at an even-higher rate considering the lag in development in China’s IT industry. Recognized as the “2017 Top 100 Big Data Company in China”, CSI will continue to provide high quality big data services and profit off of growing big data needs in the Internet of Things (IoT) and Artificial Intelligence (AI) segments, in our view.

Based on the analysis above, we expect CSI to double its new business revenue in 2018E, which would contribute 17% to total revenue (2017: 11%), and drive revenue growth going forward. Meanwhile, we believe increasing contribution from new business should help improve EBIT margin and net margin as it makes CSI run its business in an asset-light model, implying lower operating expense in the coming years.

Fig.44. Big data market: global expansion

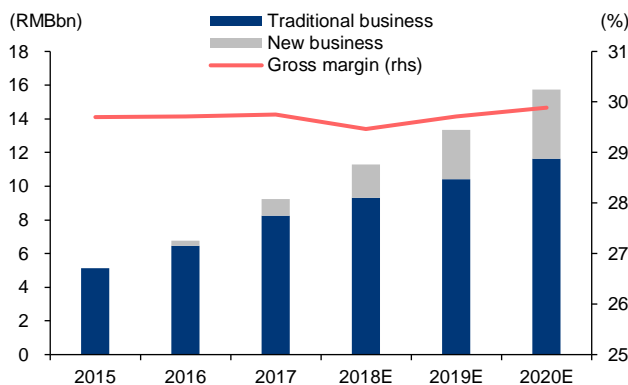
Source: IDC, Company data, Huatai HK Research estimates

Fig.45. CSI: new business revenue growth

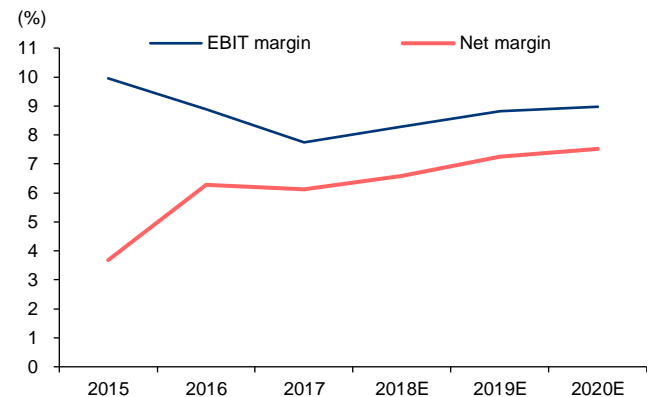
Source: Company data, Huatai HK Research estimates

Earnings estimates

We estimate that CSI's total revenue will grow at 22/18/18% to reach RMB11/13/16bn in 2018/2019/2020E. Despite headwinds in gross margin improvement, as traditional business with low gross margin still represents the biggest proportion of total revenue, we predict improving EBIT margin of 8.3/8.8/9.0% and net profit margin of 6.6/7.3/7.5% in 2018/2019/2020E.

Fig.46. CSI: revenue by business type and gross margin

Source: Company data, Huatai HK Research estimates

Fig.47. CSI: EBIT margin and net margin

Source: Company data, Huatai HK Research estimates

Fig.48. CSI earnings estimates: Huatai vs consensus

(RMBmn)	2018E			2019E			2020E		
	Consensus	Huatai	Diff (%)	Consensus	Huatai	Diff (%)	Consensus	Huatai	Diff (%)
Revenue	11,157	11,276	1.1	13,298	13,327	0.2	15,835	15,750	(0.5)
Gross margin (%)	30.1	29.5	(0.6bp)	30.3	29.7	(0.6bp)	30.2	29.9	(0.3pp)
Operating profit	925	934	0.9	1,164	1,174	0.9	1,384	1,415	2.2
Operating margin (%)	8.3	8.3	0	8.8	8.8	0	8.7	9.0	0.2pp
Net profit	747	742	(0.6)	950	967	1.7	1,172	1,184	1.1
EPS (diluted, RMB)	0.287	0.283	(1.3)	0.359	0.369	2.8	0.441	0.452	2.5

Source: Bloomberg, Huatai HK Research estimates

Full financials

Income statement

YE 31 Dec (RMBmn)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	6,783	9,244	11,276	13,327	15,750
Cost of goods sold	(4,768)	(6,493)	(7,954)	(9,368)	(11,043)
Gross profit	2,016	2,750	3,323	3,959	4,707
Selling and distrib cost	(219)	(370)	(451)	(533)	(630)
Admin expenses	(807)	(1,086)	(1,188)	(1,353)	(1,575)
Others oper inc/exp	(387)	(578)	(750)	(899)	(1,087)
Operating profit	603	716	934	1,174	1,415
Financial cost-net	(78)	(83)	(97)	(84)	(80)
Profit before tax	525	633	837	1,090	1,335
Tax expense	(115)	(71)	(95)	(123)	(151)
Net profit	442	566	742	967	1,184
Depr and amortization	144	166	161	172	182
EBITDA	747	882	1,095	1,346	1,597
EPS (RMB basic)	0.203	0.236	0.283	0.369	0.452

Balance sheet

YE 31 Dec (RMBmn)	FY16	FY17	FY18E	FY19E	FY20E
Inventories	21	26	32	38	44
Acc & bill receivable	3,606	4,636	5,655	6,684	7,899
Cash & cash equiv	1,300	1,786	1,689	1,980	2,368
Other current assets	1	1	1	1	1
Total current assets	4,927	6,449	7,377	8,702	10,312
Fixed assets	820	853	861	862	856
Intangible assets	1,240	1,176	1,144	1,106	1,064
Other long-term assets	243	274	274	274	274
Total long-term assets	2,302	2,303	2,279	2,242	2,194
Total assets	7,229	8,752	9,656	10,944	12,507
Accounts payable	1,356	1,763	2,159	2,543	2,997
Short-term loans	922	686	500	500	500
Other liabilities	160	104	104	104	104
Total current liabs	2,439	2,552	2,762	3,146	3,601
Long-term debt	439	954	954	954	954
Other long-term liabs	19	16	16	16	16
Total long-term liabs	458	970	970	970	970
Equity	106	110	110	110	110
Shareholder equity	4,264	5,166	5,860	6,764	7,872
Minority interest	68	64	64	64	64
Total equity	4,333	5,230	5,924	6,828	7,936
BVPS (RMB basic)	1.96	2.16	2.24	2.58	3.00

Valuation

YE 31 Dec (x)	FY16	FY17	FY18E	FY19E	FY20E
PE	28.5	24.3	18.5	14.2	11.6
PB	2.7	2.4	2.3	2.0	1.7
EV EBITDA	22.9	19.9	16.5	13.7	11.7
Dividend yield (%)	0.2	0.3	0.4	0.5	0.6
FCF yield (%)	0.1	1.2	0.8	2.4	3.2

Cash flow statement

YE 31 Dec (RMBmn)	FY16	FY17	FY18E	FY19E	FY20E
EBITDA	747	882	1,095	1,346	1,597
Financing costs	91	97	59	51	47
Chg in working capital	(418)	(687)	(629)	(650)	(767)
Tax	(115)	(71)	(95)	(123)	(151)
Other	(14)	112	(179)	(157)	(152)
Operating cash flow	292	332	252	466	574
Capital expenditure	(278)	(177)	(138)	(135)	(134)
Other investing activ's	27	(58)	23	22	25
Investing cash flow	(251)	(234)	(115)	(113)	(109)
Increase in debt	(73)	275	(186)	0	0
Increase in equity	0	0	0	0	0
Dividends paid	0	(25)	(48)	(63)	(77)
Other financing activ's	59	182	0	0	0
Financing cash flow	(14)	432	(234)	(63)	(77)
Change in cash	27	530	(97)	291	388
Cash at start of year	1,311	1,300	1,786	1,689	1,980
Effect of forex rate chg	6	(44)	0	0	0
Year-end cash	1,344	1,786	1,689	1,980	2,368

Performance

YE 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Growth (%)					
Revenue	32.3	36.3	22.0	18.2	18.2
Gross profit	32.3	36.4	20.8	19.2	18.9
Operating profit	18.1	18.8	30.4	25.8	20.5
Net profit	57.9	27.9	31.3	30.2	22.5
EPS	44.7	16.0	20.1	30.2	22.5
Profitability ratios (%)					
Gross profit	29.7	29.8	29.5	29.7	29.9
EBITDA	11.0	9.5	9.7	10.1	10.1
Net profit	6.5	6.1	6.6	7.3	7.5
ROE	11.8	12.0	13.5	15.3	16.2
ROA	6.5	7.1	8.1	9.4	10.1
Solvency (x)					
Net gearing ratio (%)	1.4	(2.8)	(4.0)	(7.7)	(11.5)
Current ratio	2.0	2.5	2.7	2.8	2.9
Quick ratio	2.0	2.5	2.7	2.8	2.9
Operating capability (days)					
Total assets t/o ratio (x)	0.9	1.1	1.2	1.2	1.3
Receivable	191	181	181	181	181
Payable	102	98	98	98	98
Inventory	2	1	1	1	1
Cash conversion cycle	91	84	84	84	84

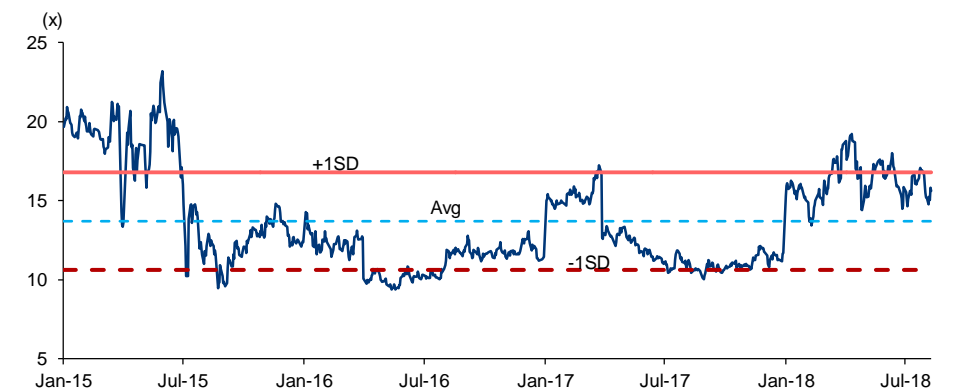
Source: Company data, Huatai HK Research estimates

Valuation methodology and risks statement

CSI is trading at 14x 2019E forward PE, close to its historical average. We believe CSI deserves a greater premium considering: 1) stable traditional revenue growth given close cooperation with Huawei and other major customers; and 2) it is running new business in an asset-light model, which is helping it expand business and cut operating cost at the same time, improving net margin as a result. We derive our target price of HKD8.4 from a relative approach based on 22x 12-month target PE.

Key downside risk: slower-than-expected new business market expansion.

Fig.49. CSI: 12-month forward PE



Source: Company data, Bloomberg, Huatai HK Research

Fig.50. CSI: peer valuation

Stock	Code	Price (local)	Mkt cap (USDbn)	PE (x)				PS (x)				2018-2020E CAGR (%)	
				2017	2018E	2019E	2020E	2017	2018E	2019E	2020E	EPS	Revenue
Chinasoft	354 HK	6.0	1.8	24.3	18.5	14.2	11.6	1.4	1.1	0.9	0.8	27.9	19.4
H shares													
Kingdee	268 HK	11.1	4.6	87.8	93.9	72.5	53.2	13.8	11.4	9.2	7.3	24.6	23.8
Travelsky	696 HK	21.4	8.0	24.4	20.2	17.2	15.3	8.5	7.1	6.3	5.6	16.5	12.9
Sinosoft	1297 HK	2.9	0.5	9.9	11.4	9.5	8.2	3.8	4.3	3.6	3.2	18.7	17.7
A shares													
Neusoft	600718 CH	12.8	2.3	15.1	31.4	25.8	21.1	21.1	2.0	1.7	1.5	(10.9)	14.6
China Software	600536 CH	27.9	2.0	184.4	100.1	74.6	58.1	58.1	2.6	2.2	1.8	47.4	16.6
Insigma	600797 CH	9.8	1.5	34.1	25.9	20.6	18.1	18.1	2.7	2.3	2.0	19.2	16.9
2345 Network	002195 CH	4.4	2.8	20.4	14.9	11.3	8.8	8.8	5.3	4.2	3.3	19.4	22.0
Overseas-listed													
Infosys	INFO IN	1,385.5	43.8	15.9	18.9	17.3	15.6	15.6	3.8	3.5	3.2	7.6	10.4
Wipro	WIT US	5.1	22.9	16.7	18.4	17.0	17.0	17.0	2.7	2.5	2.5	6.9	5.5
IBM	IBM US	144.5	131.9	11.6	10.5	10.3	9.9	9.9	1.6	1.6	1.6	3.5	0.8

Note: data as at 10 August close

Source: Wind, Bloomberg, Huatai HK Research estimates