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Technology | Software & Services

Software & Services

Overweight

1H18 Preview: Solid Growth In General

We see solid growth from companies in software and IT services sector:

- We continue to like Chinasoft for its strong earnings growth and margins improvement trend;
- For Kingdee, we forecast a less than 60% cloud revenue growth. The company may see short-term pressure on the stock price. However, we think the less than expected cloud revenue growth is largely due to a revenue recognition policy change as its long-term fundamentals are still intact. Therefore, a stock price correction may present buying opportunities;
- Kingsoft should have another weak quarter, but 2H18 could see profit surge sequentially from new mobile games;
- We also like VST for its better-than-peers growth rate and margin improvement trend, though a bit concerned on its foreign exchange loss for FY18-19F, given the CNY depreciation vs the USD.

Chinasoft – solid revenue growth coupled with margins improvement. We expect Chinasoft's 1H18 revenue to grow YoY by 18% to CNY4.9bn and profit to grow 29% to CNY317m. The margins improvements are mainly driven by a very high growth from new businesses that exhibit higher margins, namely cloud, *JointForce* and big data.

Kingdee – softer cloud revenue growth due to a revenue recognition policy change. Kingdee's 1H17 cloud revenue was based on a cash basis, while from 2H17 onwards it was done on an accrual basis. As a result, we see only 45% revenue growth from its cloud revenue in 1H18, lower than the 60% revenue CAGR forecast over the next few years from the company. If both halves get adjusted to an accrual basis, we estimate the growth to be c.60%. We note that FY17 full year numbers were already adjusted on an accrual basis in the FY17 annual results this past March. Thus, only the amount in 1H17 was impacted. On a full-year basis, we are still confident the company can achieve c.60% growth. Overall, we see a profit of CNY155m driven mainly by the traditional enterprise resource planning business (which we estimate to grow 15% YoY in revenue).

Kingsoft – online game. We expect 2Q18 sales to be CNY1.3bn (flattish QoQ and YoY). The online games unit should see a sequential decline in revenue and OPM, as there is not much revenue contribution from additional online games this quarter. Overall, we expect the company to book a CNY50-100m loss (1Q18 CNY118m profit and 2Q17 250m profit). Our estimates reflect the higher interest expense (non-cash item related to the preferred shares of cloud business, estimated at CNY80m per quarter) and a FX loss (as CNY depreciated while Kingsoft holds some amount of cash in USD currency) amounting to CNY60m for 2Q18.

VST – we are expecting earnings to grow 27% YoY and reach HKD365m in 1H18 both on strong revenue growth (expecting HKD27.4bn +14% YoY) and margins improvement.

Sinosoft – solid growth expected at c.20% growth on both topline and bottom line for 1H18, mainly driven by its e-government businesses. We are also expecting a share-based compensation cost of c.CNY50-60m to kick in during 2H18.

Digital China – margins are getting better. We are expecting 1H18 to turn profitable vs a huge loss in 1H17 as we see Digital China is downsizing its loss-making smart city businesses. Also, there should be a lower non-operating loss for FY18F.

Stocks Covered: 6
Ratings (Buy/Neutral/Sell): 5 / 1 / 0
Last 12m Earnings Revision Trend: Positive

Top Picks

Kingdee (268 HK) – BUY
Chinasoft (354 HK) – BUY

Target Price

HKD 10.63
HKD 7.77

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-19F	P/B (x) Dec-19F	Yield (%) Dec-19F
Chinasoft International	BUY	HKD6.13	HKD7.77	26.8	14.7	1.9	-
Kingdee	BUY	HKD8.69	HKD10.63	22.3	49.4	4.5	-
Kingsoft	BUY	HKD19.00	HKD32.50	71.0	10.4	1.5	0.6
Sinosoft Technology	BUY	HKD2.65	HKD3.56	34.3	9.2	1.6	1.4
VSTEC Holdings	BUY	HKD4.25	HKD5.64	32.6	5.7	0.9	5.3
Digital China	NEUTRAL	HKD4.08	HKD4.28	4.8	16.8	0.6	1.5

Source: Company data, RHB

Analyst

Yujie Li

+852 2103 5680

li.yu.jie@rhbgroup.com



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Neutral: Share price may fall within the range of +/- 10% over the next 12 months

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Not Rated: Stock is not within regular research coverage

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RHB Research Institute Sdn Bhd Level 3A, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur 50400 Malaysia Tel : +(60) 3 9280 8888 Fax : +(60) 3 9200 2216	RHB Securities Hong Kong Ltd. 12 th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	RHB Research Institute Singapore Pte Ltd. 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211
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