

26 March 2019

Software & Internet | IT Services

Chinasoft International (354 HK)

Buy (Maintained)

Still Cheap Despite Short-Term Challenges

Target Price (Return) HKD5.68 (+23%)
 Price: HKD4.63
 Market Cap: USD14,71m
 Avg Daily Turnover (HKD/USD) 103m/13m

- **Keep BUY with new HKD5.68 TP from HKD6.65, 23% upside.** We see Chinasoft's revenue growth slowing although its margins should improve slightly over time. The company is facing the challenges in improving its service capability to better serve its key customers, as well as growing its new businesses to the next level. We are maintaining our BUY call given undemanding valuations (12x FY19F P/E) and Chinasoft's solid position as a beneficiary of secular growth in China's IT services industry.
- **New strategies for new businesses.** For Jointforce, management will focus on the penetration of its Yunji platform as well as increasing the number of transactions on the platform. Revenue growth at its cloud and big data operations should remain solid but likely to be slower than before due to a higher base and lack of key competency, in our view. Overall, we now have lower expectations for its new businesses.
- **TPG business slowed to single-digit growth.** While management guided for only single-digit revenue growth for its technology and professional group (TPG) business, we are still positive on this segment, which is expected to enjoy solid growth over the long term. According to media reports, its key customer, Huawei is expected to register solid revenue growth in 2019 and beyond – we believe Chinasoft will benefit after it upgrades its capability and service level.
- **Forecast changes.** We lower our revenue forecasts for the reasons mentioned above. We expect margins to improve slightly as its higher-margin new businesses begin to grow faster and contribute more towards total revenue and earnings. As a result, we reduced our FY19F-20F earnings by 0.1% and 5.8%. Our EPS forecasts are lowered by 5.7% and 11.1% for FY19F-20F, as the number of shares has increased after some CBs were converted to shares over the past year.
- **Our new TP is based on FY19F P/E of 15x from 16x,** given slower projected growth on our new forecasts. Downside risks include a high concentration of large customers, weaker demand due to a weak economy, and potential labour cost increases.

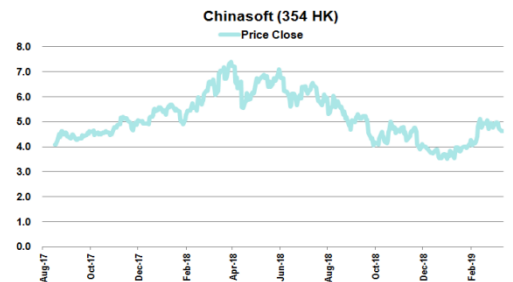
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	19.0	(6.3)	23.1	(9.4)	(25.5)
Relative	8.7	(4.8)	11.9	(13.1)	(19.6)
52-wk Price low/high (HKD)	3.45 – 7.70				



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (CNYm)	9,244	10,585	11,769	13,132	14,704
Recurring net profit (CNYm)	566	721	822	946	1123
Recurring net profit growth (%)	27.9	27.5	14.0	15.0	18.8
Recurring P/E (x)	17.0	13.3	12.1	10.2	8.6
P/BV (x)	1.8	1.6	1.4	1.2	1.1
P/CF (x)	172.9	N/M	7.1	12.3	10.5
Dividend Yield (%)	0.5	0.5	0.8	0.9	1.1
EV/EBITDA (x)	11.4	9.6	8.4	7.5	6.6
ROE (%)	10.8	11.9	12.1	12.2	12.8
Net debt to equity (%)	8.8	7.7	6.8	6.0	5.3
Interest coverage (x)	6.9	7.3	9.5	11.8	13.7

Sources: Bloomberg, RHB, Company

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Figure 1: Forecast changes

(CNY '000)	FY19F			FY20F		
	Original	New	Change	Original	New	Change
Internet IT services business	1,548,891	1,493,357	(3.6%)	1,768,834	1,633,733	(7.6%)
Technical professional services busi	10,702,481	10,275,838	(4.0%)	12,468,390	11,498,662	(7.8%)
Total revenue	12,251,372	11,769,195	(3.9%)	14,237,224	13,132,395	(7.8%)
Cost of sales and services	(8,576,573)	(8,132,514)	(5.2%)	(9,980,294)	(9,061,353)	(9.2%)
Gross profit	3,674,799	3,636,681	(1.0%)	4,256,930	4,071,043	(4.4%)
<i>Gross profit margin</i>	<i>30.0%</i>	<i>30.9%</i>		<i>29.9%</i>	<i>31.0%</i>	
Selling & Marketing expenses	(504,757)	(529,614)	4.9%	(587,997)	(590,958)	0.5%
G&A expenses	(1,359,902)	(1,200,458)	(11.7%)	(1,566,095)	(1,339,504)	(14.5%)
R&D expenses	(747,334)	(817,959)	9.5%	(854,233)	(919,268)	7.6%
Other income / (expenses)	(81,698)	(82,964)	1.5%	(90,131)	(91,467)	1.5%
Operating profit	981,108	1,005,686	2.5%	1,158,473	1,129,846	(2.5%)
<i>Operating profit margin</i>	<i>8.0%</i>	<i>8.5%</i>		<i>8.1%</i>	<i>8.6%</i>	
Interest income	6,810	6,810	-	3,629	3,629	-
Interest expense	(105,756)	(105,756)	-	(95,856)	(95,856)	-
Share of profits of associates	42,985	17,722	(58.8%)	62,328	25,697	(58.8%)
Profit / Loss before income tax e:	925,146	924,462	(0.1%)	1,128,574	1,063,315	(5.8%)
Income tax benefit / (expense)	(101,766)	(101,691)	(0.1%)	(124,143)	(116,965)	(5.8%)
Non-controlling interests	360	360	-	370	370	-
Net profit - Reported	823,020	822,411	(0.1%)	1,004,061	945,981	(5.8%)
<i>NPM</i>	<i>6.7%</i>	<i>7.0%</i>		<i>7.1%</i>	<i>7.2%</i>	
EPS - Reported (CNY)	0.343	0.324	(5.7%)	0.419	0.372	(11.1%)

Source: Company data, RHB

Figure 2: Chinasoft's annual P&L

FYE Dec 31									
CNY '000	FY13	FY14	FY15	FY16	FY17	FY18	FY19F	FY20F	FY21F
Internet IT services	n.a	1,191,372	1,348,419	1,301,446	1,385,036	1,410,158	1,493,357	1,633,733	1,756,263
<i>Growth%</i>	n.a	n.a	0	(3.5%)	6.4%	1.8%	5.9%	9.4%	7.5%
Technical professional services	n.a	3,237,830	3,780,692	5,481,921	7,858,648	9,174,855	10,275,838	11,498,662	12,947,494
<i>Growth%</i>	n.a	n.a	16.8%	45.0%	43.4%	16.7%	12.0%	11.9%	12.6%
Total Revenue	3,205,985	4,429,202	5,129,111	6,783,367	9,243,684	10,585,013	11,769,195	13,132,395	14,703,757
<i>Growth%</i>	15.8%	38.2%	15.8%	32.3%	36.3%	14.5%	11.2%	11.6%	12.0%
Cost of sales and services	(2,200,799)	(3,080,046)	(3,605,903)	(4,767,529)	(6,493,218)	(7,340,356)	(8,132,514)	(9,061,353)	(10,145,592)
Gross profit	1,005,186	1,349,156	1,523,208	2,015,838	2,750,466	3,244,657	3,636,681	4,071,043	4,558,165
<i>Margin%</i>	31.4%	30.5%	29.7%	29.7%	29.8%	30.7%	30.9%	31.0%	31.0%
Selling and distribution costs	(175,369)	(219,789)	(178,581)	(219,022)	(369,729)	(495,524)	(529,614)	(590,958)	(646,965)
Administrative expenses	(512,223)	(664,752)	(627,264)	(806,614)	(1,086,325)	(1,091,148)	(1,200,458)	(1,339,504)	(1,499,783)
Research and development expenses	(52,156)	(64,161)	(195,318)	(345,269)	(567,313)	(739,434)	(817,959)	(919,268)	(999,855)
Allowance for doubtful debts	(24,613)	(27,103)	(62,055)	(17,958)	(25,862)	(35,200)	(35,308)	(39,397)	(44,111)
Amortisation of intangible assets	(49,803)	(80,676)	(91,961)	(88,012)	(81,742)	(68,402)	(92,108)	(95,408)	(98,708)
Other income, gains and losses	59,878	83,909	41,943	37,127	94,764	44,764	44,452	43,338	48,838
Operating profit	250,900	376,584	409,972	576,090	714,259	859,713	1,005,686	1,129,846	1,317,579
<i>Margin%</i>	7.8%	8.5%	8.0%	8.5%	7.7%	8.1%	8.5%	8.6%	9.0%
Interest income	1,958	2,847	4,316	4,781	5,727	12,175	6,810	3,629	3,629
Interest expenses	(47,296)	(84,385)	(92,509)	(95,735)	(102,915)	(117,987)	(105,756)	(95,856)	(95,856)
Share of results of associates	(1,138)	1,429	1,907	17,492	19,763	12,222	17,722	25,697	37,260
Others gains / (loss)	494	764	96,308	21,959	(4,065)	(5,669)	0	0	0
Profit before taxation	204,918	297,239	419,994	524,587	632,769	760,454	924,462	1,063,315	1,262,612
<i>Margin%</i>	6.4%	6.7%	8.2%	7.7%	6.8%	7.2%	7.9%	8.1%	8.6%
Income tax expense	(4,890)	(42,183)	(87,010)	(114,754)	(71,462)	(44,283)	(101,691)	(116,965)	(138,887)
<i>Effective tax rate%</i>	2.4%	14.2%	20.7%	21.9%	11.3%	5.8%	11.0%	11.0%	11.0%
Profit for the year	200,028	255,056	332,984	409,833	561,307	716,171	822,771	946,351	1,123,725
<i>Growth%</i>	33.2%	27.5%	30.6%	23.1%	37.0%	27.6%	14.9%	15.0%	18.7%
Non-controlling interests	51,727	55,018	52,928	(32,248)	(4,260)	368	360	370	370
Reported net profit	148,301	200,038	280,056	442,081	565,567	715,803	822,411	945,981	1,123,355
<i>Growth%</i>	11.3%	34.9%	40.0%	57.9%	27.9%	26.6%	14.9%	15.0%	18.8%
<i>Margin%</i>	4.6%	4.5%	5.5%	6.5%	6.1%	6.8%	7.0%	7.2%	7.6%

Source: RHB

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