

23 August 2018

Technology | Software & Services

## Chinasoft International

**Buy** (Maintained)

### Margin Improvement To Continue

**Maintain BUY with unchanged TP of HKD7.77, 29% upside, based on 16x 2019F P/E. Chinasoft reported a 45% increase in 1H18 net profit that was ahead of the company's guidance of 20-30% growth. We believe Chinasoft will continue to deliver solid revenue growth and margin improvement as its high margin businesses are growing much faster, while lower margin contributions from Huawei decelerates. Meanwhile, Chinasoft is building JointForce into a software ecosystem platform.**

**Softer growth in revenue from Huawei but better margins overall.** In 1H18, revenue grew by only 4.3% YoY against a high base, and accounted for 52% of our full-year estimates. Revenue from new businesses grew by 95% YoY in 1H18.

While Huawei generates lower GPM, the faster-growing new businesses generate higher GPM – as such, the company registered an improvement in GPM during 1H18. We expect the margin improvement to continue as the revenue mix continues to evolve in this manner.

**New businesses on track to double revenue this year.** Revenue from new businesses grew by 95% YoY in 1H18, accounting for 15.4% of total revenue vs 9.2% a year ago. Under JointForce, Chinasoft's online procurement transaction services for government IT service projects have started operations in Nanjing and will soon commence in Zhenjiang – we expect revenue and profit contributions to kick in over the short to medium term.

**Strong financial outlook for 2018F-2019F.** We keep our forecasts unchanged, though we view our estimates as conservative. Overall, we expect 22% growth in revenue and 35% growth in earnings, and we are projecting 20% and 27% growth in revenue and profit for 2019.

We are expecting a CAGR in earnings of 29% during 2017-2020F, driven mainly by margin improvement on more contributions from new businesses, and solid revenue growth from new businesses and customers such as Microsoft.

Some investors may be concerned that 1H18's operating cash flows were not satisfactory but we are expecting the figure to improve significantly in 2H18, as Chinasoft resets its terms with Huawei to improve its days sales outstanding (DSO).

**Reiterate BUY with same TP of HKD7.77.** Our TP is based on 2019F P/E of 16x (or unchanged 2018F P/E of 22x). Downside risks include a high concentration of large customers and potential labour cost increases.

Target Price: HKD7.77  
 Price: HKD6.04  
 Market Cap: USD1,870m  
 Bloomberg Ticker: 354 HK

#### Share Data

Avg Daily Turnover (HKD/USD) 84.3m/10.7m  
 52-wk Price low/high (HKD) 4.07 - 7.40  
 Free Float (%) 60  
 Shares outstanding (m) 2,585  
 Estimated Return 29%

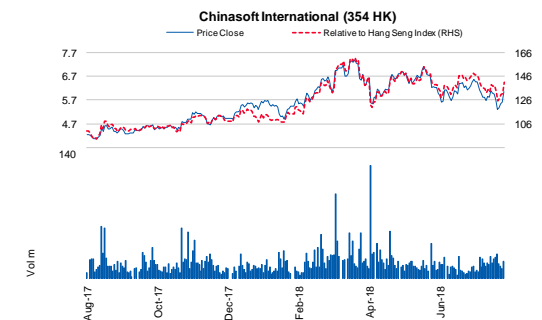
#### Shareholders (%)

Yuhong Chen 11.0  
 Microsoft 4.1  
 Huawei 3.5

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	16.4	(2.6)	(11.3)	5.2	43.5
Relative	23.7	(0.9)	(0.1)	16.9	41.3

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	6,783	9,244	11,277	13,474	15,806
Reported net profit (CNYm)	442	566	761	966	1,205
Recurring net profit (CNYm)	442	566	761	966	1,205
Recurring net profit growth (%)	57.9	27.9	34.5	26.9	24.7
Recurring EPS (CNY)	0.18	0.22	0.29	0.36	0.50
DPS (CNY)	na	na	na	na	na
Recurring P/E (x)	28.6	24.4	17.9	14.6	10.5
P/B (x)	2.69	2.45	2.14	1.85	1.59
P/CF (x)	44	407	na	40	24
Dividend Yield	na	na	na	na	na
EV/EBITDA (x)	17.8	15.4	12.4	10.5	7.7
Return on average equity (%)	11.8	12.0	13.8	15.2	16.3
Net debt to equity (%)	1.4	net cash	4.3	0.9	net cash
Our vs consensus EPS (adjusted) (%)		(1.9)	4.4	0.2	11.7

Source: Company data, RHB

#### Analyst

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## Financial Exhibits

Financial model updated on : 2018-03-27.

Asia  
Hong Kong  
Technology  
**Chinasoft International**  
Bloomberg 354 HK  
Buy

### Valuation basis

FY19F P/E of 16x.

### Key drivers

- Increase in outsourcing demand from large clients;
- Capturing long-tail customers using its *JointForce* platform;
- Penetrating overseas markets.

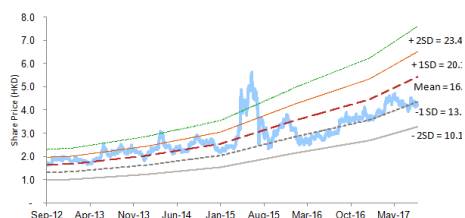
### Key risks

- Uncertainties in *JointForce*'s development;
- High customer concentration;
- Rising labour cost in China.

### Company Profile

Founded in 2000, Chinasoft International (Chinasoft) has extensive experience in consulting, technology services and outsourcing services, and in-depth expertise in serving main industries such as government and manufacturing, finance, telecommunications, and high tech. The company also engages in cloud services. In 2014, it launched *JointForce*, an online marketplace that connects programmers and businesses.

### Chinasoft's 5-year forward P/E chart



Source: Bloomberg

Financial summary	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Recurring EPS (CNY)	0.18	0.22	0.29	0.36	0.50
EPS (CNY)	0.18	0.22	0.29	0.36	0.50
BVPS (CNY)	1.96	2.16	2.46	2.84	3.32
Weighted avg adjusted shares (m)	2,400	2,621	2,585	2,670	2,397

Valuation metrics	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Recurring P/E (x)	28.6	24.4	17.9	14.6	10.5
P/E (x)	28.6	24.4	17.9	14.6	10.5
P/B (x)	2.69	2.45	2.14	1.85	1.59
FCF Yield (%)	(0.4)	(0.9)	(2.7)	1.7	3.4
EV/EBITDA (x)	17.8	15.4	12.4	10.5	7.7
EV/EBIT (x)	22.2	19.2	15.0	12.3	8.8

Income statement (CNYm)	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Total turnover	6,783	9,244	11,277	13,474	15,806
Gross profit	2,016	2,750	3,419	4,108	4,852
EBITDA	720	891	1,129	1,356	1,618
Depreciation and amortisation	(144)	(177)	(194)	(204)	(214)
Operating profit	576	714	934	1,152	1,404
Net interest	(91)	(97)	(109)	(110)	(113)
Income from associates & JVs	17	20	30	43	62
Pre-tax profit	525	633	855	1,086	1,354
Taxation	(115)	(71)	(94)	(119)	(149)
Minority interests	32	4	(0)	(0)	(0)
Recurring net profit	442	566	761	966	1,205

Cash flow (CNYm)	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Change in working capital	(271)	(713)	(1,226)	(818)	(865)
Cash flow from operations	285	34	(259)	351	536
Capex	(339)	(158)	(110)	(110)	(110)
Cash flow from investing activities	(295)	(158)	(109)	(110)	(110)
Proceeds from issue of shares	575	0	0	0	0
Cash flow from financing activities	(14,497)	520,521	(134,486)	(158,251)	(168,764)
Cash at beginning of period	1,266	1,299	1,785	1,394	1,592
Net change in cash	(14,507)	520,397	(134,854)	(158,010)	(168,338)
Ending balance cash	(13,241)	521,696	(133,069)	(156,615)	(166,746)

Balance sheet (CNYm)	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Total cash and equivalents	1,300	1,786	1,394	1,592	1,964
Tangible fixed assets	820	853	825	792	752
Intangible assets	1,240	1,176	1,119	1,059	995
Total other assets	243	274	307	351	415
Total assets	7,229	8,752	9,601	10,899	12,447
Short-term debt	922	686	0	0	0
Total long-term debt	194	0	700	700	700
Total liabilities	2,897	3,522	3,643	4,017	4,413
Shareholders' equity	4,264	5,166	5,893	6,817	7,968
Minority interests	68	64	64	65	65
Total equity	4,333	5,230	5,958	6,881	8,033
Net debt	62	(147)	259	62	(310)
Total liabilities & equity	7,229	8,752	9,601	10,899	12,447

Key metrics	Dec-16	Dec-17F	Dec-18F	Dec-19F	Dec-20F
Revenue growth (%)	32.3	36.3	22.0	19.5	17.3
Recurrent EPS growth (%)	39.6	17.2	36.4	22.9	38.9
Gross margin (%)	29.7	29.8	30.3	30.5	30.7
Operating EBITDA margin (%)	10.6	9.6	10.0	10.1	10.2
Net profit margin (%)	6.5	6.1	6.7	7.2	7.6
Capex/sales (%)	5.0	1.7	1.0	0.8	0.7
Interest cover (x)	6.02	6.94	8.11	9.96	12.13

Source: Company data, RHB

Figure 1: Annual P&amp;L

FYE Dec 31

CNY '000	FY13	FY14	FY15	FY16	FY17	FY18F	FY19F	FY20F
<b>Internet IT services</b>	n.a	1,191,372	1,348,419	1,301,446	1,385,036	1,595,561	1,846,065	2,108,206
<i>Growth%</i>	n.a	n.a	0	(3.5%)	6.4%	15.2%	15.7%	14.2%
<b>Technical professional services</b>	n.a	3,237,830	3,780,692	5,481,921	7,858,648	9,681,854	11,627,907	13,697,675
<i>Growth%</i>	n.a	n.a	16.8%	45.0%	43.4%	23.2%	20.1%	17.8%
<b>Total Revenue</b>	3,205,985	4,429,202	5,129,111	6,783,367	9,243,684	11,277,416	13,473,972	15,805,880
<i>Growth%</i>	15.8%	38.2%	15.8%	32.3%	36.3%	22.0%	19.5%	17.3%
Cost of sales and services	(2,200,799)	(3,080,046)	(3,605,903)	(4,767,529)	(6,493,218)	(7,858,103)	(9,365,758)	(10,953,475)
<b>Gross profit</b>	1,005,186	1,349,156	1,523,208	2,015,838	2,750,466	3,419,312	4,108,214	4,852,405
<i>Margin%</i>	31.4%	30.5%	29.7%	29.7%	29.8%	30.3%	30.5%	30.7%
Selling and distribution costs	(175,369)	(219,789)	(178,581)	(219,022)	(369,729)	(448,841)	(525,485)	(616,429)
Administrative expenses	(512,223)	(664,752)	(627,264)	(806,614)	(1,086,325)	(1,277,731)	(1,525,254)	(1,790,806)
Research and development expenses	(52,156)	(64,161)	(195,318)	(345,269)	(567,313)	(690,178)	(824,607)	(951,514)
Allowance for doubtful debts	(24,613)	(27,103)	(62,055)	(17,958)	(25,862)	(33,832)	(40,422)	(47,418)
Amortisation of intangible assets	(49,803)	(80,676)	(91,961)	(88,012)	(81,742)	(88,025)	(91,325)	(94,625)
Impairment loss - goodwill	0	0	0	0	0	0	0	0
Other income, gains and losses	59,878	83,909	41,943	37,127	94,764	53,762	51,271	52,695
<b>Operating profit</b>	250,900	376,584	409,972	576,090	714,259	934,467	1,152,393	1,404,309
<i>Margin%</i>	7.8%	8.5%	8.0%	8.5%	7.7%	8.3%	8.6%	8.9%
Interest income	1,958	2,847	4,316	4,781	5,727	6,360	5,973	3,184
Interest expenses	(47,296)	(84,385)	(92,509)	(95,735)	(102,915)	(115,256)	(115,755)	(115,755)
Share of results of associates	(1,138)	1,429	1,907	17,492	19,763	29,645	42,985	62,328
Others gains / (loss)	494	764	96,308	21,959	(4,065)	0	0	0
<b>Profit before taxation</b>	204,918	297,239	419,994	524,587	632,769	855,215	1,085,595	1,354,065
<i>Margin%</i>	6.4%	6.7%	8.2%	7.7%	6.8%	7.6%	8.1%	8.6%
Income tax expense	(4,890)	(42,183)	(87,010)	(114,754)	(71,462)	(94,074)	(119,415)	(148,947)
<i>Effective tax rate%</i>	2.4%	14.2%	20.7%	21.9%	11.3%	11.0%	11.0%	11.0%
<b>Profit for the year</b>	200,028	255,056	332,984	409,833	561,307	761,141	966,180	1,205,118
<i>Growth%</i>	33.2%	27.5%	30.6%	23.1%	37.0%	35.6%	26.9%	24.7%
Non-controlling interests	51,727	55,018	52,928	(32,248)	(4,260)	250	360	370
<b>Reported net profit</b>	148,301	200,038	280,056	442,081	565,567	760,891	965,820	1,204,748
<i>Growth%</i>	11.3%	34.9%	40.0%	57.9%	27.9%	34.5%	26.9%	24.7%
<i>Margin%</i>	4.6%	4.5%	5.5%	6.5%	6.1%	6.7%	7.2%	7.6%

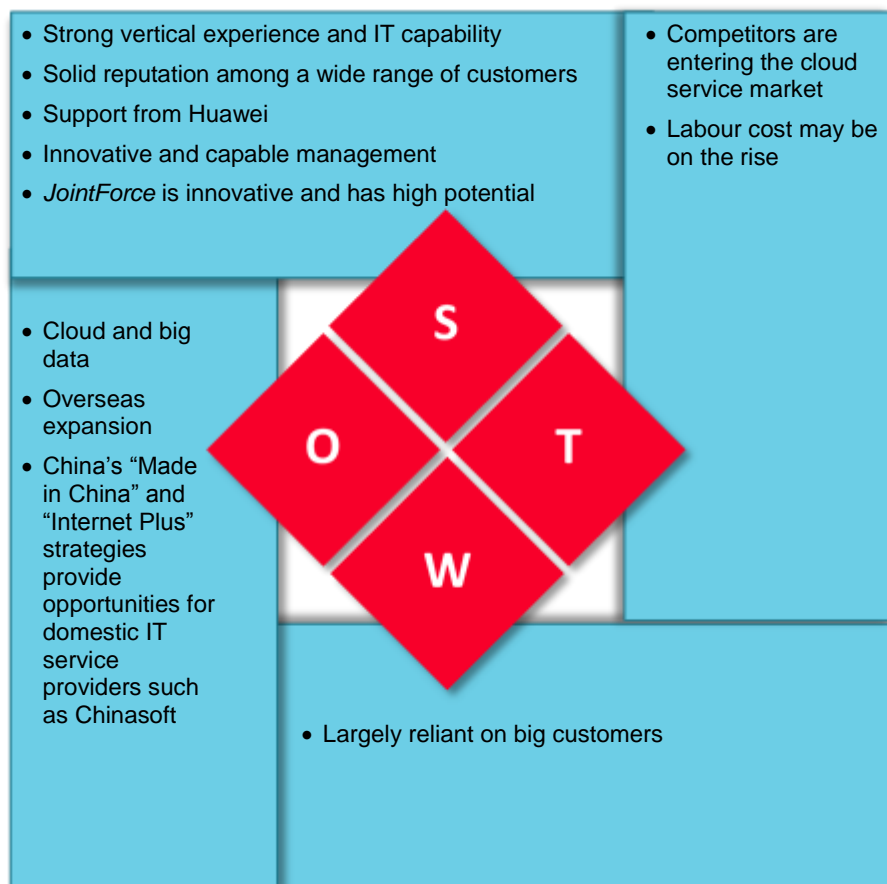
Source: RHB, Company data

Figure 2: Actual results

FYE Dec	1H16	2H16	1H17	2H17	1H18	1H18	
CNY '000							
	Actual	Actual	Actual	Actual	Actual	YoY	HoH
<b>Internet IT services (IIG)</b>	<b>597,068</b>	<b>704,378</b>	<b>633,610</b>	<b>751,426</b>	<b>784,601</b>	<b>23.8%</b>	<b>4.4%</b>
<i>YoY Growth</i>	-5.3%	-1.9%	6.1%	6.7%	23.8%		
<b>Technical professional services (TPG)</b>	<b>2,287,883</b>	<b>3,194,038</b>	<b>3,511,450</b>	<b>4,347,198</b>	<b>4,029,252</b>	<b>14.7%</b>	<b>-7.3%</b>
<i>YoY Growth</i>	30.1%	57.9%	53.5%	36.1%	14.7%		
<b>Total revenue</b>	<b>2,884,951</b>	<b>3,898,416</b>	<b>4,145,060</b>	<b>5,098,624</b>	<b>4,813,853</b>	<b>16.1%</b>	<b>-5.6%</b>
<i>YoY Growth</i>	20.8%	42.3%	43.7%	30.8%	16.1%		
Cost of sales and services	(2,082,316)	(2,685,213)	(3,002,387)	(3,490,831)	(3,423,801)		
<b>Gross profit</b>	<b>802,635</b>	<b>1,213,203</b>	<b>1,142,673</b>	<b>1,607,793</b>	<b>1,390,052</b>	<b>21.6%</b>	<b>-13.5%</b>
<i>Margin%</i>	27.8%	31.1%	27.6%	31.5%	28.9%		
Selling and distribution costs	(112,217)	(106,805)	(146,944)	(222,785)	(233,003)	58.6%	4.6%
Administrative expenses	(390,651)	(415,963)	(659,774)	(426,551)	(679,967)	3.1%	59.4%
R&D expenses	0	(345,269)	0	(567,313)	0	N/A	N/A
Allowance for doubtful debts	(11,382)	(6,576)	(1,401)	(24,461)	(145)		
Other expense	(41,479)	(46,533)	(41,759)	(39,983)	(36,641)		
Impairment loss - goodwill	0	0	0	0	0		
Other income, gains and losses	48,113	(10,986)	33,879	60,885	22,682		
<b>Operating profit</b>	<b>295,019</b>	<b>281,071</b>	<b>326,674</b>	<b>387,585</b>	<b>462,978</b>	<b>41.7%</b>	<b>19.5%</b>
<i>Margin%</i>	10.2%	7.2%	7.9%	7.6%	9.6%		
Interest income	0	4,781	0	5,727	0		
Interest expenses	(39,039)	(56,696)	(43,064)	(59,851)	(59,290)		
Share of results of associates	10,148	7,344	(15,509)	35,272	(15,265)		
Others gains / (loss)	0	21,959	0	(4,065)	0		
<b>Profit before taxation</b>	<b>266,128</b>	<b>258,459</b>	<b>268,101</b>	<b>364,668</b>	<b>388,423</b>	<b>44.9%</b>	<b>6.5%</b>
<i>Margin%</i>	9.2%	6.6%	6.5%	7.2%	8.1%		
Income tax expense	(47,509)	(67,245)	(27,656)	(43,806)	(32,618)		
<i>Effective tax rate%</i>	17.9%	26.0%	10.3%	12.0%	8.4%		
Non-controlling interests	(17,618)	(14,630)	(5,025)	765	0		
<b>Net profit - Reported</b>	<b>236,237</b>	<b>205,844</b>	<b>245,470</b>	<b>320,097</b>	<b>355,805</b>	<b>44.9%</b>	<b>11.2%</b>
<i>YoY growth%</i>	69.1%	46.6%	3.9%	55.5%	0.0%		
<i>Margin%</i>	8.2%	5.3%	5.9%	6.3%	0.0%		
<b>Net profit excluding share option expense</b>	<b>243,910</b>	<b>243,456</b>	<b>317,007</b>	<b>398,512</b>	<b>381,805</b>	<b>20.4%</b>	<b>-4.2%</b>
<i>YoY growth%</i>	N/A	N/A	30.0%	63.7%	0.0%		
<i>Margin%</i>	8.5%	6.2%	7.6%	7.8%	0.0%		

Source: RHB, Company data, Bloomberg

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-03-28	Buy	7.77	6.93
2018-03-09	Buy	6.77	6.16
2017-08-24	Buy	5.92	4.22
2017-07-19	Buy	5.73	4.45
2017-03-29	Buy	5.32	4.37
2016-09-13	Buy	4.51	3.50
2016-08-25	Buy	4.29	3.56
2016-08-04	Buy	3.83	3.37
2016-06-29	Buy	3.69	3.01
2016-03-24	Buy	3.69	2.80

Source: RHB, Bloomberg



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**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

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

**Take Profit:** Target price has been attained. Look to accumulate at lower levels

**Sell:** Share price may fall by more than 10% over the next 12 months

**Not Rated:** Stock is not within regular research coverage

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