Chinasoft International | 354 HK

Solid growth achieved

In-line 2018 results

Huawei still a major business driver

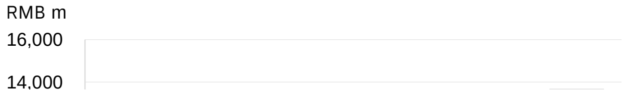
Attractive valuation, maintain Outperform rating

In-line 2018 results. Chinasoft announced FY18 revenue of RMB10.6b, up 15% YoY and in line with expectations. The company's new businesses, which include its JointForce platform, cloud and big data operations, saw revenue increase 60% YoY to reach RMB1.6b and account for 15% of total revenue, up from 11% in FY17. Since the new businesses have a higher gross margin than the traditional outsourcing business, blended gross margin for FY18 improved from 29.8% in FY17 to 30.7%. Net profit for FY18 was RMB716m, up 27% YoY and in line with Bloomberg consensus.

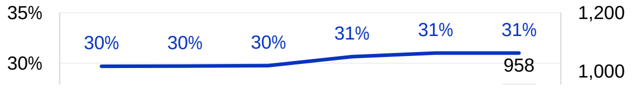
Huawei – the key to growth. Business from its largest customer, Huawei, remained healthy in FY18 as revenue increased 15% YoY to reach RMB5.6b, accounting for 53% of Chinasoft's total revenue in FY18, on par with FY17. Even though the US-Huawei dispute is unresolved, we are optimistic of the outcome, especially if a US-China deal can be signed in the coming months. Even in the worst-case scenario whereby Huawei is barred from the 5G market in the US, since 5G-related work accounts for a small fragment of Chinasoft's services to Huawei (low single-digit revenue contribution to Chinasoft) and because Huawei will continue to invest heavily in R&D and will still need to outsource part of the work to Chinasoft, we continue to forecast healthy 8%/8% YoY revenue growth from Huawei in FY19F/FY20F.

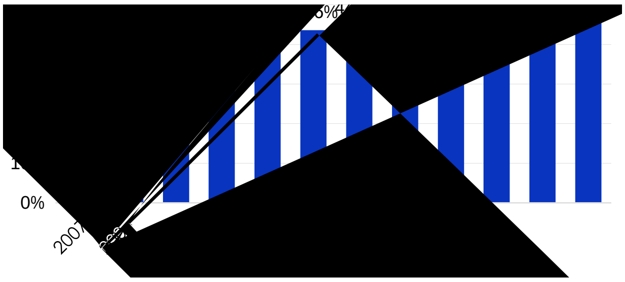
Valuation remains attractive, maintain Outperform. Due to uncertainty related to the macro-economy and slower-than-expected business progress towards supplying Jointforce services to the government, we trim our FY19F/20F earnings forecast by 4.0%/3.6%. As a result, we cut our target price from HK$6.95 to HK$6.70, still basing it on 20x FY19F P/E. Coming out of a trough following the opening salvos of the US-Huawei dispute, Chinasoft is now trading at 14x/12x FY19F/20F P/E, which remains attractive in

Chinasoft – revenue mix (RMB m)



Chinasoft – net income (RMB m) & margin ratios (2015-20F)





Source: Company data, CCBIS

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 2019F	New forecast 2020F	Previous forecast 2019F	Previous forecast 2020F	% change 2019F	% change 2020F
RMB m						
Revenue	12,032	13,688	12,224	13,936	-1.6	-1.8
Gross profit	3,730	4,243	3,728	4,251	0.0	-0.2
Opex	-2,635	-2,998	-2,591	-2,941	1.7	1.9
Operating profit	1,095	1,246	1,137	1,310	-3.7	-4.9
Net profit	826	959	860	995	-4.0	-3.6
%						
Gross margin	31.0	31.0	30.5	30.5	-	-
OPEX to sales	-21.9	-21.9	-21.2	-21.1	-	-
OPM	9.1	9.1	9.3	9.4	-	-
Net margin	6.9	7.0	7.0	7.1	-	-

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) FY18F	P/E (x) FY19F	P/E (x) FY20F	EPS growth (%) FY18F	EPS growth (%) FY19F	EPS growth (%) FY20F
HK listed										
TravelSky	696 HK	Not Rated	22.10	8,238	23	20	18	8	14	12
Kingsoft Corp	3888 HK	Outperform	17.90	3,130	117	27	21	-88	326	29
Chinasoft International	**354 HK**	**Outperform**	**4.95**	**1,768**	**16**	**14**	**12**	**19**	**15**	**16**
Kingdee	268 HK	Neutral	9.17	3,858	57	46	37	27	26	23
Digital China	861 HK	Not Rated	4.31	917	22	17	12	-282	29	40
Sinosoft	1297 HK	Not Rated	2.75	428	13	10	6	4	28	68
Chanjet	1588 HK	Not Rated	10.24	283	N/A	N/A	N/A	N/A	N/A	N/A
Average					**41**	**22**	**18**	**-51**	**73**	**31**
A-share listed										
iFlytek	002230 CH	Outperform	36.82	11,508	130	83	53	20	56	57
Wangsu	300017 CH	Underperform	13.58	4,935	26	30	22	48	-12	36
Aisino	600271 CH	Not Rated	28.91	8,043	35	27	23	1	26	N/A
Hundsun	600570 CH	Not Rated	83.88	7,740	86	66	50	20	31	31
Yonyou	600588 CH	Outperform	34.11	9,769	78	60	47	34	31	26
Shiji info	002153 CH	Not Rated	33.48	5,335	74	61	49	15	21	23
Neusoft Corp	600718 CH	Not Rated	14.90	2,765	49	34	29	-22	47	17
Teamsun	600410 CH	Not Rated	8.91	1,467	N/A	N/A	N/A	N/A	N/A	N/A
YGsolf Inc	002063 CH	Not Rated	10.76	1,365	30	N/A	N/A	80	N/A	N/A
Average					**63**	**51**	**39**	**25**	**28**	**32**
Global peers										
Microsoft	MSFT US	Not Rated	117.65	902,636	26	23	20	16	13	17
Oracle	ORCL US	Not Rated	54.04	184,690	16	14	13	12	9	8
IBM	IBM US	Not Rated	140.49	125,017	10	10	10	1	2	3
SAP	SAP US	Not Rated	113.44	139,362	24	22	20	3	10	10
Accenture	ACN US	Not Rated	166.20	106,103	23	21	19	8	9	9
Salesforce	CRM US	Not Rated	163.93	126,390	59	48	38	6	25	26
Workday Inc.	WDAY US	Not Rated	191.53	42,520	114	86	62	32	33	39
Netsuite	N US	Not Rated	109.54	8,865	202	143	96	158	42	49
Average					**59**	**46**	**35**	**29**	**18**	**20**

* Price as at close on 20 Mar 2019 (local currency)

Source: Bloomberg, CCBIS estimates

Chinasoft International – P&L assumptions

RMB m	FY15	FY16	FY17	FY18	FY19F	FY20F	1H17	2H17	1H18	2H18
Revenue breakdown										
TPG business	3,781	5,482	7,859	9,175	10,551	12,134	3,511	4,347	4,029	5,146
IIG business	1,348	1,301	1,385	1,410	1,481	1,555	634	751	785	626
Total revenue	**5,129**	**6,783**	**9,244**	**10,585**	**12,032**	**13,688**	**4,145**	**5,099**	**4,814**	**5,771**
YoY (%)	16	32	36	15	14	14	44	31	16	13
Cost of revenues	-3,606	-4,768	-6,493	-7,340	-8,302	-9,445	-3,002	-3,491	-3,424	-3,917
Gross profit	**1,523**	**2,016**	**2,750**	**3,245**	**3,730**	**4,243**	**1,143**	**1,608**	**1,390**	**1,855**
Gross profit margin (%)	30	30	30	31	31	31	28	32	29	32
Sales and marketing expense	-179	-219	-370	-496	-578	-657	-147	-223	-233	-263
General & administrative expense	-627	-807	-1,086	-1,091	-1,263	-1,437	-660	-427	-680	-411
Research and development	-195	-345	-567	-739	-794	-903	0	-567	0	-739
Total operating expense	-1,001	-1,371	-2,023	-2,326	-2,635	-2,998	-807	-1,217	-913	-1,413
Operating profit	**522**	**645**	**727**	**919**	**1,095**	**1,246**	**336**	**391**	**477**	**441**
Operating profit margin (%)	10	10	8	9	9	9	8	8	10	8
Other income, gains and losses	29	44	96	64	65	70	34	63	19	45
Allowance for doubtful debts	-62	-18	-26	0	0	0	-1	-24	0	0
Other expenses	-92	-88	-82	-68	-70	-70	-42	-40	-37	-32
Fair value gain on derivative financial instruments	-1	0	0	0	0	0	0	0	0	0
Finance costs	-93	-96	-103	-118	-120	-120	-43	-60	-59	-59
Share of results of associates	2	17	20	12	10	10	-16	35	-15	27
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**	**760**	**960**	**1,116**	**268**	**365**	**388**	**372**
Taxation	-87	-115	-71	-44	-134	-156	-28	-44	-33	-12
Effective tax rate (%)	-21	-22	-11	-6	-14	-14	-10	-12	-8	-3
Net income	333	410	561	716	826	959	240	321	356	360
- Minority interests	53	-32	-4	0	0	0	-5	1	-3	3
Net income attributable to common shareholders	**280**	**442**	**566**	**716**						

Chinasoft Intl. | 354 HK – financial summary

Profit and loss

FYE 31 Dec (RMB m)	2016	2017	2018	2019F	2020F
TPG business	5,482	7,859	9,175	10,551	12,134
IIG business	1,301	1,385	1,410	1,481	1,555
Revenue	**6,783**	**9,244**	**10,585**	**12,032**	**13,688**
COGS	(4,768)	(6,493)	(7,340)	(8,302)	(9,445)
Gross profit	**2,016**	**2,750**			

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

Analyst certification:

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