

Chinasoft International Ltd (354.HK)

Sales will soon break RMB10 billion target

Hong Kong | TMT | Company report

10 April 2017

Investment Summary

Chinasoft International outperformed expectations in 2016, mainly thanks to Huawei's rapidly increased contributions and decreased expense ratios. We believe that the company will continuously benefit from Mainland China's informatization, IT production localization, offshore IT outsourcing market and the strong growth of emerging businesses such as cloud computing, and the major clients' contributions will rise steadily. In addition, the enhancement of technological capacity and its self-owned IP, the improvement of the platform's efficiency and the rise of cloud services' contributions will also boost the company's profitability and enable the rapid growth of its performance. We give the company an estimation of 24x EPS in 2017 and the target price is HK\$5.8, with the "Buy" rating maintained. **(Closing price as at 6 Apr 2017)**

Buy (Maintain)

CMP: HKD 4.61
(Closing price as at 6 Apr 2017)
TARGET: HKD 5.80 (+25.9%)

COMPANY DATA

O/S SHARES (MN):	2,392
MARKET CAP (HKDMN):	11,027
52 - WK HI/LO (HKD):	4.67/ 2.65

Peer Comparison

Ticker	Company	MV (HKD:mn)	PE-TTM	PE-2017F	PE-2018F	PB	EV/EBITD
0777.HK	NetDragon	11350	--	194.18	43.11	2.64	-134.96
3888.HK	Kingsoft	27694	--	23.79	16.64	3.14	23.65
0696.HK	Travelsky Technology	58374	21.58	20.9	18.57	3.79	23.30
0268.HK	Kingdee	9531	29.59	33.39	25.21	2.45	32.58
	Average		25.585	27.145	25.21	3.12	32.58
0354.HK	Chinasoft International	11027	20.9	19.1	14.6	2.22	21.22

Source: Wind, Phillip Securities (HK) Research

SHARE HOLDING PATTERN, %

Chen Yuhong :	12.24
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PRICE PERFORMANCE, %

	1M	3M	1Y
CSI	18.07	24.73	65.12
HSI	14.66	16.30	44.37

PRICE VS. HSI

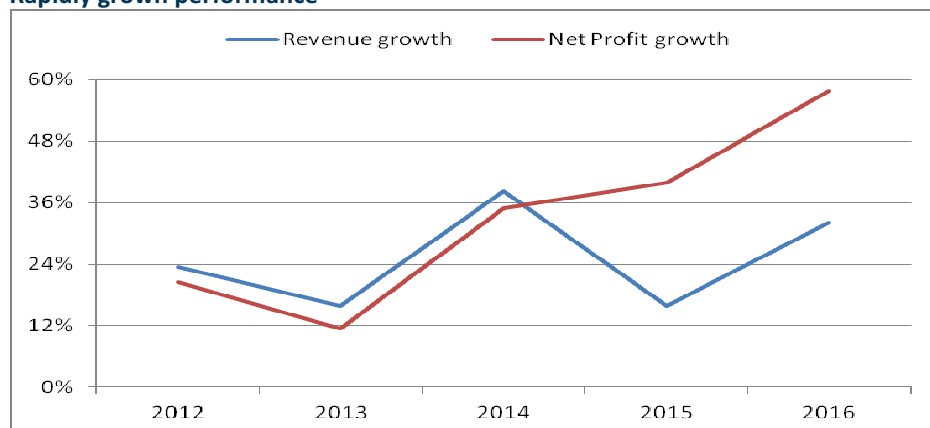


Source: Phillip Securities (HK) Research

2016 Results Outperformed Expectations

In terms of comprehensive competitiveness, Chinasoft International Ltd is ranked as one of the top ten enterprises which provide software and information technology services in China, with its main business types divided into Technical Professional Services Group (TPG) business and Internet Inquiry Scientific Services Group (IIG) business and covering telecommunication, finance and Internet and other industries. In 2016, the company's revenue increased by 32.3% to RMB6.78 billion. The net profit attributed to the parent company rose by 57.9% to RMB440 million and after adjustment, the net profit attributed to the parent company soared by 96.2% to RMB490 million. Both exceeded market expectations.

Rapidly grown performance



Source: Company reports, Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	5129	6782	8313	10191
Net Profit	280	442	513	716
EPS, CNY	0.14	0.20	0.21	0.28
PER, x	29.2	20.9	19.1	14.6
BVPS, CNY	1.57	1.84	1.94	2.09
P/BV, x	2.6	2.2	2.1	2.0
ROE, %	9.1	11.4	11.4	14.0
Debt/Equity (%)	82.1	69.5	66.7	66.7

Source: Company reports, Phillip Securities Est.

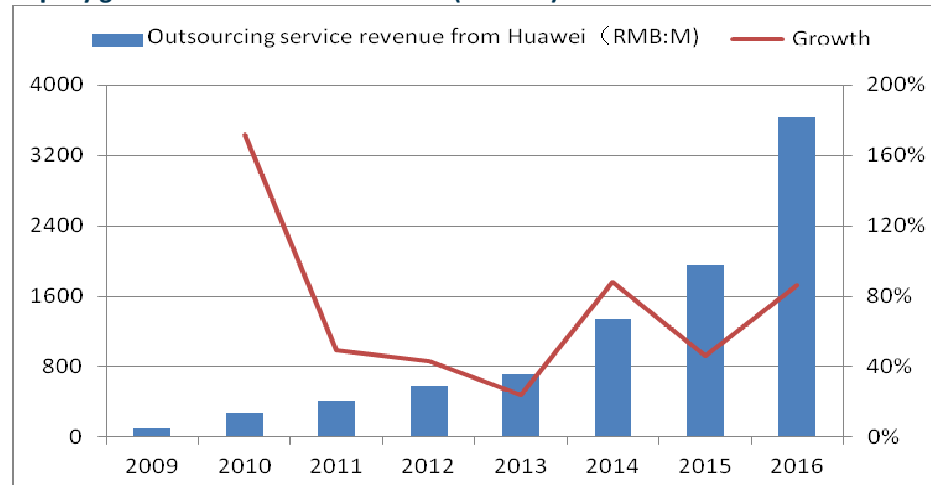
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The increase in revenue mainly came from TPG's raised income which rose by 45% to RMB5.48 billion because Huawei's boosted contributions nearly doubled. With regard to profitability, although the gross margin of 29.7% remained the same year over year, the company's TPG business continued to focus on major clients and large industries' offline IT business and enabled continuous decrease in the sales expense ratio and administrative expense ratio which dropped from last year's 3.5% and 12.2% to 3.2% and 11.9% respectively. Furthermore, the company was exempted from partial consideration payment in the acquisition of an American subsidiary company because the conditions of the valuation adjustment mechanism were not met. There was also increase in its subsidiary income and other incomes which went up by 52.7% to RMB43.72 million. All these factors contributed to the rise of the company's profit rate from 8% to 9.7%.

Key Customer Strategy Supports Continued Growth

The company has increasingly focused on certain clients and the business with Huawei retains the main drive of growth. 53.6% of the company's revenue in 2016 was contributed by Huawei, increasing from 38.1% of 2015. We believe that Huawei's business will continuously rise steadily. First of all, the company and Huawei have cooperated to deploy public clouds and big data platforms in over ten cities and to develop regional markets. Next, the company is responsible for overall customization and delivery in many fields, which proves its profound technological strength and helps gain more orders in the future. Additionally, through Huawei's powerful sales access at home and abroad, both companies will make more efforts to develop foreign business and this will introduce new clients to Chinasoft International. It is worth to mention that Huawei's increasing outsourcing demand will bring more bargaining advantages to Chinasoft International.

Rapidly grown revenue of from Huawei (RMB:bn)



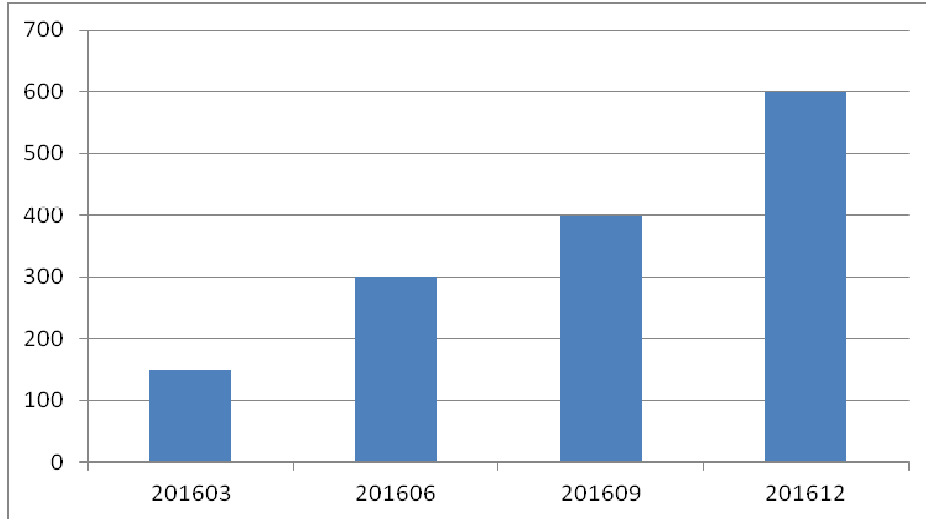
Source: Company reports, Phillip Securities (HK) Research

Furthermore, the company has been designated as HSBC's only strategic partner in China since 2016. It won the bid for the global project and HSBC's contributions to its revenue doubled in the same year, which shows that the company's technology is highly acknowledged. The company has also become Tencent's highest-level access cooperative partner and both of the companies will work together to build the ecological system for enterprises - "Internet+". Considering the rapid increase in research and development with the research and development expense ratio rising from 3.8% to 5.1%, we predict the continuous growth of its major clients' contributions to the revenue, thanks to the enhancement of the technology. Specifically, TPG business will retain the growth of over 20% and therefore, help the company reach the revenue milestone of RMB10 billion.

JointForce Platform Upgrades its Profit Model

With JointForce centralized, the company’s online business by the end of 2016 had had over 1,000 registered development teams, nearly 3,000 contractor companies, over 130,000 contractor engineers, approximately 200,000 outsourcing companies and over RMB 600 million outsourced projects, with a trend of rapid expansion.

Total demand released on JointForce platform (RMB: mn)



Source: Company reports, Phillip Securities (HK) Research

Moreover, the JointForce platform and Huawei Cloud have agreed on mission-level strategic cooperation. Meanwhile, the profit model of the platform has changed from a commission model to a membership model, which will promote user loyalty and all involved parties will boost the vitality of JF’s ecological system. Based on these indications, the GMV of JF platform will reach RMB500-600 million in 2017 and the income will exceed RMB200 million.

Risks

Excessive Growth of Labor Costs
 The implementation risk on JointForce platform and cloud computing business.

Financials

FYE	2014	2015	2016	2017F	2018F
Valuation Ratios					
Price Earnings	38.2x	29.2x	20.9x	19.1x	14.6x
Price to Book	3.1x	2.6x	2.2x	2.1x	2.0x
Per share data(RMB)					
EPS Adjusted	0.11	0.14	0.20	0.21	0.28
Book Value Per Share	1.33	1.57	1.84	1.94	2.09
Growth & Margin					
Revenue growth	38.2%	15.8%	32.2%	22.6%	22.6%
Gross Profit growth	34.2%	12.9%	32.4%	23.1%	22.6%
Net Profit growth	34.9%	40.0%	57.9%	16.1%	39.6%
Profitability Ratios					
Gross Margin	30.5%	29.7%	29.7%	29.9%	29.9%
Net Profit Margin	4.5%	5.5%	6.5%	6.2%	7.0%
Key Ratios					
Return on Assets	4.0%	4.8%	6.5%	6.8%	8.4%
Return on Equity	8.4%	9.1%	11.4%	11.4%	14.0%
Effective Tax Rate	14.2%	20.7%	22.0%	15.0%	15.0%
Liability ratio	49.5%	45.1%	41.0%	40.0%	40.0%
Income Statement(RMB: mn)					
Revenue	4,429	5,129	6,782	8,313	10,191
- Cost of Goods Sold	3,080	3,606	4,766	5,832	7,149
Gross Income	1,349	1,523	2,016	2,481	3,042
- Selling, General & Admin Expenses	1,058	1,161	1,462	1,783	2,186
Operating Income	350	409	599	756	934
Pretax Income	297	420	525	561	784
- Income Tax Expense	42	87	115	84	118
Income Before XO Items	255	333	410	477	666
- Minority Interests	55	53	-32	-36	-50
Net Profit	200	280	442	513	716

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 6 Apr 2017)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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