ORIENTAL PATRON 東英

Equity Research
IT Solution/ China

ChinaSoft Int'l (354 HK)

Yuji Fung
+852 2135 0236
yuji.fung@oriental-patron.com.hk

Dallas Cai
+852 2135 0248
dallas.cai@oriental-patron.com.hk

Company Update

BUY
UNCHANGED

Close price:	**HK$3.55**
Target Price:	**HK$6.23 (+75%)**
Prior TP:	**HK$8.50**

Key Data

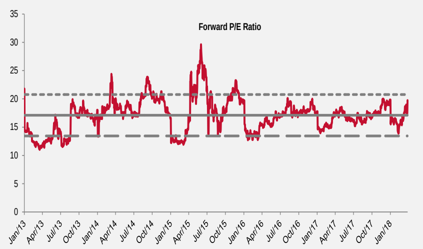
HKEx code		354
12 Months High	(HK$)	7.70
12 Month Low	(HK$)	3.45
3M Avg Dail Vol.	(mn)	14.19
Issue Share	(mn)	2,431.31
Market Cap	(HK$mn)	8,631.16
Fiscal Year		12/2017
Major shareholder (s)		Dr. Chen Yu Hong (11.01%)

Source: Company data, Bloomberg, OP Research
Closing price are as of 07/01/2019

Price Chart

	1mth	3mth	6mth
Absolute %	**-12.6**	**-17.4**	**-40.2**
Rel. MSCI CHINA %	**-8.2**	**-13.2**	**-23.1**

PE



Company Profile

ChinaSoft is a global leading IT outsourcing and solution service company

FY18E results preview

- **We expect Chinasoft (CSI) to see FY18E revenue/core earnings up 14%/1% yoy to RMB10,525mn/RMB725mn with 1.2ppts improvement in GPM to 31%.**
- **We revise down our FY18/19E core earnings estimate by 7.9%/13.4% to RMB725mn/RMB768mn as we expect higher staff costs.**
- **Maintain BUY with TP revised down to HK$6.23 from HK$8.50 based on 20x FY19E PE, at par to peers' average.**

We expect resilient FY18E revenue. We expect Chinasoft (CSI) to deliver resilient FY18E revenue of RMB10,525mn, of which TPG/IIG segment contributes RMB8,758mn/RMB1,549mn respectively, representing 15%/30% yoy growth. For the emerging business, we expect RMB700mn/500mn/600mn sales from cloud/big data/AI-integrated Joint Force services, leading to 1.2ppts improvement in overall GPM to 31% from 29.8% in FY17. We estimate FY18E core earnings up 1.3% yoy to RMB725mn.

We revise down our FY18/19E core earnings estimates by 7.9%/13.4% to RMB725mn/RMB768mn. We maintain our previous FY18/19E revenue forecasts but revise down our FY18/19E GPM by 0.9%/1.2% to 31.0%/31.0% as we expect higher engineers' salaries and stricter enforcement on the collection of employee social insurance contribution by China Tax Bureau starting from 2019E. We estimate engineer salaries to contribute to over 80% of its Cost of Sales and other staff costs to take up over 50% of its total opex. As a result, our FY18/19E diluted EPS is revised down by 7.0%/12.6% to HK$0.294/HK$0.311 respectively.

Maintain BUY. We maintain our BUY rating on CSI with TP HK$6.23 revised down from HK$8.50 based on 20x FY19E PE (from previous 24x FY19E PE), at par to peers average.

Risks: (1) slower than expected revenue growth on cloud services; (2) higher than expected staff costs

Exhibit 1: Forecast and Valuation

Year to Dec (RMB mn)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	6,783	9,244	10,525	11,789	12,658
Growth (%)	32	36	14	12	7
Adj. Net Profit	493	716	725	768	842
Growth (%)	122	45	1	6	10
Diluted Adj EPS (HK$)	0.247	0.328	0.294	0.311	0.341
Adj EPS growth (%)	96	33	(10)	6	10
Change to previous EPS (%)			(7)	(13)	
Consensus EPS (HK$)			0.343	0.431	
ROE (%)	13.1	15.2	13.1	12.3	12.0
P/E (x)	15.5	11.6	13.0	12.2	11.2
P/B (x)	1.7	1.5	1.3	1.2	1.0
Yield (%)	0.4	0.5	0.4	0.4	0.5
DPS (HK$)	0.014	0.018	0.016	0.017	0.019

Source: Bloomberg, OP Research

Exhibit 2: Earnings revision

	FY18E			FY19E			
(RMB mn)	**New**	**Old**	**% Chg**	**New**	**Old**	**% Chg**	**OP Comment**
Revenue	**10,525**	**10,525**	**0.0**	**11,789**	**11,789**	**0.0**	
Gross profit	3,263	3,358	(2.8)	3,654	3,795	(3.7)	
Gross margin	31.0%	31.9%	(0.9)	31.0%	32.2%	(1.2)	
Opex	(2,400)	(2,422)	(0.9)	(2,681)	(2,681)	0.0	
EBIT	909	982	(7.5)	1,021	1,162	(12.1)	
EBIT Margin	8.6%	9.3%	(0.7)	8.7%	9.9%	(1.2)	
Adj. Net Profit	725	787	(7.9)	768	887	(13.4)	
Diluted EPS (HK$)	0.294	0.316	(7.0)	0.311	0.356	(12.6)	

Source: OP Research

Financial Summary

Year to Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Income Statement (RMB mn)					
TPG	5,414	7,616	8,758	9,634	10,116
ITG	1,160	1,192	1,549	1,936	2,324
Sales of hardware	210	436	218	218	218
Turnover	**6,783**	**9,244**	**10,525**	**11,789**	**12,658**
YoY%	32	36	14	12	7
COGS	(4,768)	(6,493)	(7,263)	(8,134)	(8,734)
Gross profit	**2,016**	**2,750**	**3,263**	**3,654**	**3,924**
Gross margin	29.7%	29.8%	31.0%	31.0%	31.0%
Other income	44	96	46	48	50
Selling & distribution	(219)	(370)	(463)	(507)	(545)
Admin	(807)	(1,086)	(1,208)	(1,349)	(1,449)
R&D	(345)	(567)	(634)	(719)	(757)
Other opex	(88)	(82)	(95)	(106)	(114)
Total opex	**(1,459)**	**(2,105)**	**(2,400)**	**(2,681)**	**(2,866)**
Operating profit (EBIT)	**601**	**742**	**909**	**1,021**	**1,108**
Operating margin	8.9%	8.0%	8.6%	8.7%	8.8%
Provisions	20	(6)	0	0	0
Finance costs	(96)	(103)	(113)	(113)	(113)
Profit after financing costs	525	633	796	909	995
Associated companies & JVs	0	0	0	0	0
Pre-tax profit	525	633	796	909	995
Tax	(115)	(71)	(119)	(136)	(149)
Minority interests	32	4	(3)	(4)	(4)
Adj. Net profit	**493**	**716**	**725**	**768**	**842**
YoY%	122	45	1	6	10
Net margin	7.3%	7.7%	6.9%	6.5%	6.7%
Reported Net profit	**442**	**566**	**673**	**768**	**842**
EBITDA	**740**	**913**	**1,022**	**1,126**	**1,200**
EBITDA margin	10.9%	9.9%	9.7%	9.6%	9.5%
EPS (RMB)	**0.205**	**0.273**	**0.245**	**0.260**	**0.284**
YoY%	96	33	(10)	6	10
DPS (HK$)	0.014	0.018	0.016	0.017	0.019

Year to Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Cash Flow (RMB mn)					
EBITDA	740	913	1,022	1,126	1,200
Chg in working cap	(210)	(480)	(86)	(58)	(40)
Others	(164)	(54)	52	0	0
Operating cash	**366**	**380**	**988**	**1,068**	**1,160**
Tax	(74)	(48)	(158)	(119)	(136)
Net cash from operations	**292**	**332**	**830**	**949**	**1,024**
Capex	(304)	(160)	(182)	(204)	(219)
Investments	(48)	(51)	(34)	(38)	(41)
Dividends received	2	1	0	0	0
Sales of assets	70	4	0	0	0
Interests received	5	6	7	8	11
Others	24	(34)	0	0	0
Investing cash	**(251)**	**(234)**	**(210)**	**(234)**	**(250)**
FCF	**41**	**98**	**620**	**715**	**774**
Issue of shares	716	943	0	0	0
Buy-back	0	0	0	0	0
Minority interests	(202)	0	0	0	0
Dividends paid	0	(25)	(30)	(33)	(35)
Net change in bank loans	(444)	(431)	0	0	0
Interests paid	(88)	(75)	(113)	(113)	(113)
Others	3	21	0	0	0
Financing cash	**(14)**	**432**	**(143)**	**(146)**	**(148)**
Net change in cash	**27**	**530**	**477**	**569**	**627**
Exchange rate or other Adj	6	(44)	0	0	0
Opening cash	1,266	1,299	1,785	2,263	2,832
Closing cash	**1,299**	**1,785**	**2,263**	**2,832**	**3,458**
CFPS (HK$)					

Source: Company, OP Research

Year to Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Ratios					
Gross margin (%)	29.7	29.8	31.0	31.0	31.0
Operating margin (%)	8.9	8.0	8.6	8.7	8.8
Adj. Net margin (%)	7.3	7.7	6.9	6.5	6.7
Selling & dist'n exp/Sales (%)	3.2	4.0	4.4	4.3	4.3
Admin exp/Sales (%)	11.9	11.8	11.5	11.4	11.4
R&D exp/Sales (%)	5.1	6.1	6.0	6.1	6.0
Payout ratio (%)	5.8	5.5	5.5	5.5	5.5
Effective tax (%)	21.9	11.3	15.0	15.0	15.0
Total debt/equity (%)	32.8	32.9	29.0	25.7	22.9
Net debt/equity (%)	2.4	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	2.02	2.53	2.66	2.74	2.86
Quick ratio (x)	2.01	2.52	2.65	2.73	2.85
Inventory T/O (days)	2	1	1	1	1
AR T/O (days)	114	78	78	78	78
AP T/O (days)	92	89	89	89	89
Cash conversion cycle (days)	23	(10)	(10)	(10)	(10)
Asset turnover (x)	1.00	1.16	1.15	1.17	1.14
Financial leverage (x)	1.81	1.69	1.66	1.62	1.58
EBIT margin (%)	8.9	8.0	8.6	8.7	8.8
Interest burden (x)	0.87	0.85	0.88	0.89	0.90
Tax burden (x)	0.94	1.13	0.91	0.85	0.85
Return on equity (%)	**13.1**	**15.2**	**13.1**	**12.3**	**12.0**
ROIC (%)	**11.1**	**13.8**	**14.7**	**15.9**	**16.7**

Year to Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Balance Sheet (RMB mn)					
Fixed assets	820	853	970	1,107	1,258
Intangible assets & goodwill	1,240	1,176	1,156	1,148	1,155
Associated companies & JVs	104	133	133	133	133
Long-term investments	0	0	0	0	0
Other non-current assets	138	141	141	141	141
Non-current assets	**2,302**	**2,303**	**2,399**	**2,529**	**2,687**
Inventories	21	26	29	33	35
AR	2,116	1,972	2,246	2,515	2,700
Prepayments & deposits	1	1	1	1	1
Other current assets	1,491	2,665	2,665	2,665	2,665
Cash	1,299	1,785	2,263	2,832	3,458
Current assets	**4,927**	**6,449**	**7,203**	**8,045**	**8,860**
AP	1,204	1,584	1,772	1,985	2,131
Tax	130	158	119	136	149
Accruals & other payables	1	20	23	26	28
Bank loans & leases	922	686	686	686	686
CB & other debts	38	59	59	59	59
Other current liabilities	143	45	45	45	45
Current liabilities	**2,439**	**2,552**	**2,704**	**2,937**	**3,098**
Bank loans & leases	194	0	0	0	0
CB & other debts	244	954	954	954	954
Deferred tax & others	19	16	16	16	16
MI	68	64	68	71	76
Non-current liabilities	**526**	**1,034**	**1,037**	**1,041**	**1,045**
Total net assets	**4,264**	**5,166**	**5,861**	**6,596**	**7,404**
Shareholder's equity	**4,264**	**5,166**	**5,861**	**6,596**	**7,404**
Share capital	106	110	110	110	110
Reserves	4,158	5,056	5,750	6,486	7,293
BVPS (HK$)	**2.21**	**2.58**	**2.89**	**3.26**	**3.66**
Total debts	1,399	1,699	1,699	1,699	1,699
Net cash/(debts)	(100)	87	564	1,133	1,760

Exhibit 3: Peer Group Comparison

Company	Ticker	Price	Mkt cap (US$m)	3-mth avg t/o (US$m)	PER Hist (x)	PER FY1 (x)	PER FY2 (x)	EPS FY1 YoY%	EPS FY2 YoY%	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)	EV/ Ebitda Hist	EV/ Ebitda Cur Yr	Net gearing Hist (%)	Gross margin Hist (%)	Net margin Hist (%)	ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %
Chinasoft Intl	**354 HK**	**3.55**	**1,101**	**7.7**	**11.6**	**13.1**	**12.3**	**(11.1)**	**6.0**	**1.1**	**12.24**	**0.5**	**0.4**	**1.48**	**1.32**	**9.9**	**8.5**	**Net cash**	**29.8**	**6.1**	**15.2**	**13.1**	**(12.6)**	**(22.0)**
HSI		25,835.70			9.8	9.8	9.0	(0.2)	9.4	(0.6)	(17.08)	3.9	4.1	1.20	1.11						12.3	11.3	(0.9)	(2.8)
HSCEI		10,123.85			7.9	7.5	6.8	5.4	9.7	(2.0)	(3.81)	4.2	4.6	1.02	0.91						13.0	12.1	(2.4)	(3.9)
CSI300		3,054.30			11.4	9.5	8.3	19.8	15.2	4.0	2.37	2.6	3.3	1.48	1.26						12.9	13.3	(4.0)	(11.2)
Adjusted sector avg*					**21.7**	**20.3**	**17.7**	**12.1**	**13.9**	**18.1**	**1.49**	**0.9**	**1.1**	**3.26**	**3.22**	**16.1**	**12.6**	**0.0**	**35.3**	**16.2**	**14.6**	**15.0**	**(2.5)**	**(8.2)**
Infosys Ltd	INFO IN	669.85	41,903	84.6	18.9	17.8	16.1	5.7	11.2	8.9	1.99	3.3	3.7	4.47	4.43	14.1	12.4	0.0	36.0	22.7	24.1	25.0	(1.9)	(7.6)
Tata Consultancy	TCS IN	1,896.55	101,904	81.6	28.3	22.6	20.1	25.3	12.2	15.9	1.42	1.4	1.9	9.09	7.90	20.9	16.7	0.0	42.1	21.0	36.9	36.2	(4.9)	(9.8)
Cognizant Tech-A	CTSH US	63.70	36,884	270.3	25.1	14.5	13.3	73.2	8.7	27.4	0.53	1.3	1.1	3.37	3.23	11.2	9.2	0.0	38.2	10.2	13.1	18.8	(6.3)	(15.3)
Wipro Ltd-Adr	WIT US	5.06	22,897	5.1	N/A	18.4	16.4	N/A	11.8	N/A	N/A	0.3	1.1	N/A	N/A	13.4	12.2	0.0	29.2	14.7	14.3	17.6	(1.7)	(1.4)
Travelsky Tech-H	696 HK	20.45	7,636	6.4	23.2	20.1	17.6	15.3	14.6	14.4	1.40	1.5	1.5	3.26	2.99	14.5	12.8	0.0	N/A	33.4	15.8	15.8	(1.7)	13.5
Kingdee Intl Sft	268 HK	6.76	2,847	23.2	53.5	50.5	38.9	6.0	29.9	23.7	2.13	0.2	0.2	3.67	3.96	22.7	22.1	0.0	81.5	13.5	8.5	8.1	(11.6)	(13.3)
Neusoft Corp-A	600718 CH	11.36	2,060	17.2	13.2	28.2	22.6	(53.1)	24.8	(10.5)	N/A	0.8	0.7	1.56	1.51			0.0	31.0	15.0	12.0	4.8	1.3	(2.1)

** Outliners and "N/A" entries are in red and excl. from the calculation of averages*

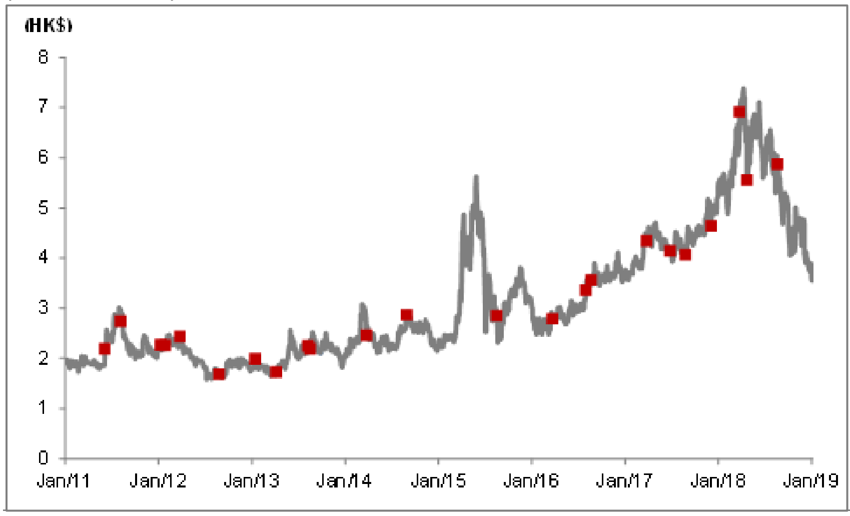
Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
20/12/2018	Tian Lun Gas	1600	A different coal-to-gas tale from Henan	BUY	Yuji Fung/Dallas Cai
11/12/2018	Sunny Optical	2382	November saw resilient shipments	BUY	Yuji Fung/Dallas Cai
11/12/2018	Q Tech	1478	November shipments in line with expectations	BUY	Yuji Fung/Dallas Cai
10/12/2018	Anta Sports	2020	Acquisition of Amer comes to a deal	BUY	Dallas Cai
03/12/2018	China Youzan	8083	December foresight bears fruit	BUY	Yuji Fung/Dallas Cai
03/12/2018	Ju Teng Intl	3336	Positive profit alert for FY18E	BUY	Yuji Fung/Dallas Cai
26/11/2018	Truly Intl	732	3Q18 turnover flat as expected	BUY	Yuji Fung/Dallas Cai
19/11/2018	Ausnutria Dairy	1717	Nurturing by global layout	BUY	Dallas Cai
13/11/2018	361 Degrees Intl	1361	Introduce new investor to kids' wear business	BUY	Yuji Fung/Dallas Cai
12/11/2018	Sunny Optical	2382	Oct shipments up to expectations	BUY	Yuji Fung/Dallas Cai
12/11/2018	Q Tech	1478	Shipment growth looms on horizon	BUY	Yuji Fung/Dallas Cai
07/11/2018	China Youzan	8083	3Q18 results in line with expectations	BUY	Yuji Fung/Dallas Cai
02/11/2018	CH Display OPT	334	TCL Group ups stakes for turnaround and advance on opportunities	BUY	Yuji Fung/Dallas Cai
30/10/2018	TCL Electronics	1070	Revised up full year shipments target	BUY	Yuji Fung/Dallas Cai
26/10/2018	CH Display OPT	334	New client order lifts Sept shipments to record high	BUY	Yuji Fung/Dallas Cai
23/10/2018	Li Ning	2331	Solid set of 3Q18 operations data	BUY	Dallas Cai
23/10/2018	361 Degrees Intl	1361	3Q18 operations data in-line with expectations	BUY	Yuji Fung/Dallas Cai
16/10/2018	TCL Electronics	1070	3Q18 shipments set record high	BUY	Yuji Fung/Dallas Cai
12/10/2018	Sunny Optical	2382	Upbeat September handset-related shipments	BUY	Yuji Fung/Dallas Cai
12/10/2018	Anta Sports	2020	Solid 3Q18 operations data	BUY	Dallas Cai
09/10/2018	Xtep Intl	1368	Solid 3Q18 sales, worries on earnings	BUY	Dallas Cai
17/09/2018	CH Display OPT	334	Upgrade on new client orders to lift earnings	BUY	Yuji Fung/Dallas Cai
06/09/2018	Ju Teng Intl	3336	1H18 strong RMB puts GPM down	BUY	Yuji Fung/Dallas Cai
04/09/2018	Lifetech SCI	1302	1H18 results beat	BUY	Dallas Cai
04/09/2018	Truly Intl	732	1H18 results wide off mark	BUY	Yuji Fung/Dallas Cai
04/09/2018	Regal Intl Airport	357	1H18 results beat on the margins	HOLD	Yuji Fung
31/08/2018	Q Tech	1478	1H18 earnings off on GPM	HOLD	Yuji Fung/Dallas Cai

Historical recommendations and target price: Chinasoft Intl (354 HK)

(as of 07/01/2019)



	DATE	RATING	TP	CLOSE		DATE	RATING	TP	CLOSE
1	09 Apr 2013	HOLD	2.2	1.73	9	24 Aug 2016	BUY	5.80	3.57
2	12 Aug 2013	HOLD	2.2	2.25	10	29 Mar 2017	BUY	6.67	4.36
3	20 Aug 2013	HOLD	1.9	2.19	11	28 Jun 2017	BUY	6.20	4.15
4	28 Mar 2014	HOLD	2.70	2.46	12	28 Aug 2017	BUY	6.30	4.07
5	02 Sep 2014	HOLD	3.40	2.87	13	07 Dec 2017	BUY	7.50	4.65
6	20 Aug 2015	BUY	3.30	2.85	14	28 Mar 2018	BUY	8.80	6.93
7	24 Mar 2016	HOLD	3.04	2.79	15	26 Apr 2018	BUY	8.80	5.57
8	04 Aug 2016	HOLD	4.50	3.36	16	23 Aug 2018	BUY	8.50	5.87

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Buy (B)	We expect this stock outperform the relevant benchmark greater than 15% over the next 12 months.
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Sell (S)	We expect this stock to underperform the relevant benchmark greater than 15% over the next 12 month.
Relevant Benchmark	Represents the stock closing price as at the date quoted in this report.

CONTACT

27/F, Two Exchange Square,
8 Connaught Place, Central, Hong Kong

www.oriental-patron.com.hk
yuji.fung@oriental-patron.com.hk

Tel: (852) 2135 0236
Fax: (852) 2135 0295