



Equity Research
Information Technology/
China

Kevin Tam

+852 2135 0236

kevin.tam@oriental-patron.com.hk

OP Express

Not Rated

Close price: **HK\$13.06**

Key Data

HKEx code	861	HK
12 Months High (HK\$)	6.12	
12 Month Low (HK\$)	3.31	
3M Avg Dail Vol. (mn)	3.91	
Issue Share (mn)	1,671.41	
Market Cap (HK\$m)	9,961.59	
Fiscal Year	12/2019	
Major shareholder (s)	Guangzhou City Investment (23.2%)	

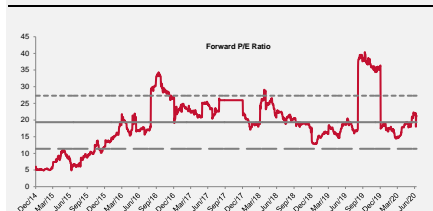
Source: Company data, Bloomberg, OP Research
Closing price are as of 09/07/2020

Price Chart



Absolute %	41.4	71.5	43.0
Rel. MSCI CHINA %	25.8	43.7	29.9

PE Chart



Company profile

Digital China Holdings (DCH) operates as a holding company. The Company, through its subsidiaries, focuses on big data, internet of things, and artificial intelligence technologies, as well as provides industry chain, smart city, and system integration services.

Digital China (861 HK)

Thrive on data servicing capabilities

Growing big data business tree. Leverage on access to big data, Digital China is climbing up the value chain from an IT service provider to big data company. Its Smart city and Smart industry chain have just breakeven and are in the early stage of profitability expansion. Management aims to derive more business from this big data ecosystem. DCH has a couple of major new projects on hand and some of them may spin off or be disposed in a couple of years.

Booming e commerce to drive demand for logistics enhancement. As a supplementary logistics provider to enhance efficiency, Smart Industry Chain provides big data analytics, robotic warehouse sorting, Jieyun Bao real time tracking and Jieyun Express for cargo receipt and signing services. DCH is actively acquiring B2C clientele in fast moving consumer goods (e.g. P&G) and auto segment, through its competitive edges in big data analytics and nationwide servicing. The segment is expected to achieve 20% top line growth for FY20E.

Big data capability from Yan Cloud to give an edge to Smart City. DCH's proprietary DaaS, Yan Cloud (燕雲) gives it a distinct competitive edge. Yan Cloud connects, shares, integrates and operates different data sources in a secure, cost effective and efficient manner. One example of Yan Cloud's application is the Health Code, which tracks and monitors potential disease carrier during the Covid 19 pandemic. We are buoyant on the segment's outlook: (i) current order backlog is more than sufficient to cover 2 years of revenue; (ii) around half of current revenue came from new customers, indicating land and expand opportunities.

Undemanding valuations. Digital China is capable to achieve double digit bottom line growth going forward and the current valuation at trailing 35.3x PER is not demanding. Taking away its 40% stake in DCITS (000555 SZ), DCH has a residual market cap at HK\$3,270 mn, which is below the FY19 combined revenue of Smart Industry China, Smart City and other business (mainly tech park rental revenue related) at HK\$6,643 mn.

Risks. (1) prolonged recession; (2) government cuts IT spending or delays payment; (3) political and policy risk in relation to provincial government.

Exhibit 1: Financial Summary

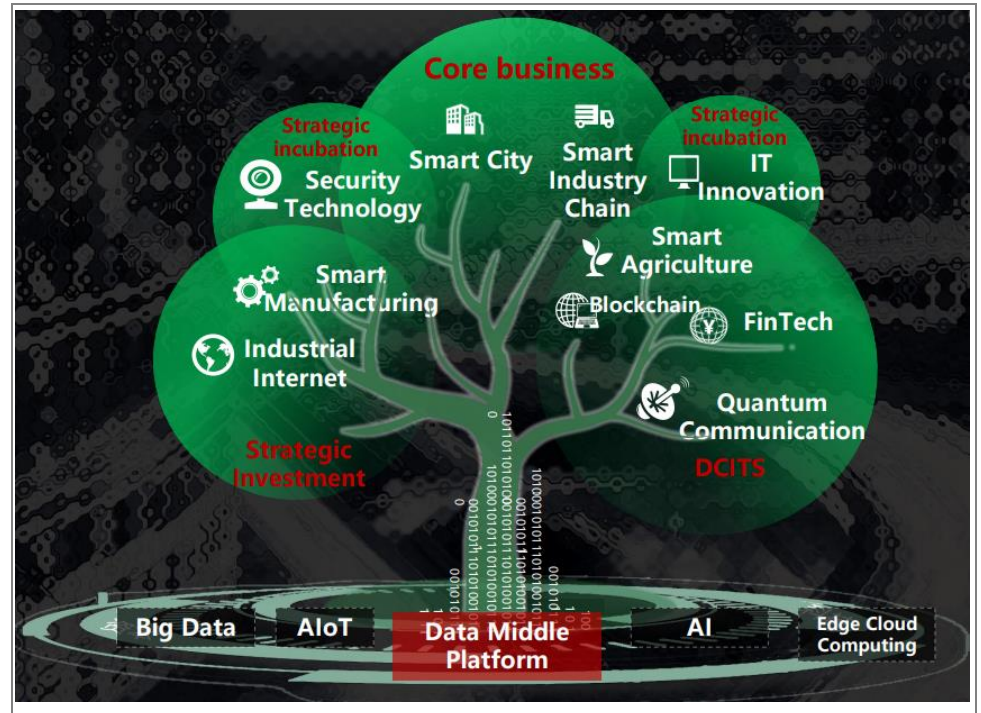
Year to August (HKD mn)	FY15	FY16	FY17	FY18	FY19
Revenue (mn)	10,630.7	12,251.4	13,246.6	15,254.5	17,727.4
Growth (%)		15.2	8.1	15.2	16.2
Net Income (mn)	661.7	389.3	-413.0	149.6	301.8
Growth (%)		-41.2	-206.1	-136.2	101.8
Gross margin (%)	20.8	20.4	20.1	19.1	17.8
Profit margin (%)	6.2	3.2	-3.1	1.0	1.7
ROE (%)	7.6	4.9	-5.1	1.7	3.4
ROA (%)	1.9	1.3	-1.6	0.6	1.2
EPS	0.6	0.3	-0.3	0.1	0.2
P/E (x)	10.99	19.51	-22.12	72.10	35.28
P/B (x)	0.84	1.17	1.19	1.22	1.21
Dividend yield (%)	-	-	-	0.48	0.99
EV/EBITDA (X)	17.2	25.2	83.4	14.8	9.8

Source: Bloomberg, OP Research

Growing big data business tree

Leverage on access to big data and its proprietary DaaS, Yan Cloud, Digital China is climbing up the value chain from an IT service provider to big data service company. Its Smart city and Smart industry chain have just breakeven and are in the early stage of profitability expansion. We see this data business tree to keep growing and management aims to derive more business from this big data ecosystem. DCH has a couple of major new projects on hand and some of them may go spin off or disposal in a couple of years.

Exhibit 2: Expanding business scope



Source: Company

Booming e commerce to drive demand for logistics enhancement

As a supplementary logistics provider to enhance efficiency, Smart Industry Chain operates big data analytics, robotic warehouse sorting, Jieyun Bao real time tracking and Jieyun Express for cargo receipt and signing, in the form of partnering with major logistics company like Cainiao or serving its own clients. The segment is split evenly between B2B and B2C while the latter is main driver. Meanwhile, the B2B segment helps major consumer electronics brands enhance logistics efficiency. B2B is more profitable because of the supply chain complexity.

Smart Industry Chain reported 42% growth in FY19 revenue to HK\$5,382 mn, while operating profit achieved breakeven at HK\$106 mn, on the back of 40% volume growth, and 31% increase in per unit output. We see room for profitability improvement as the current operating margin only stands at 2.0%. Being a proxy to e commerce, the segment is expected to achieve 20% top line growth for FY20E.

Big data capability from Yan Cloud to give an edge to Smart City

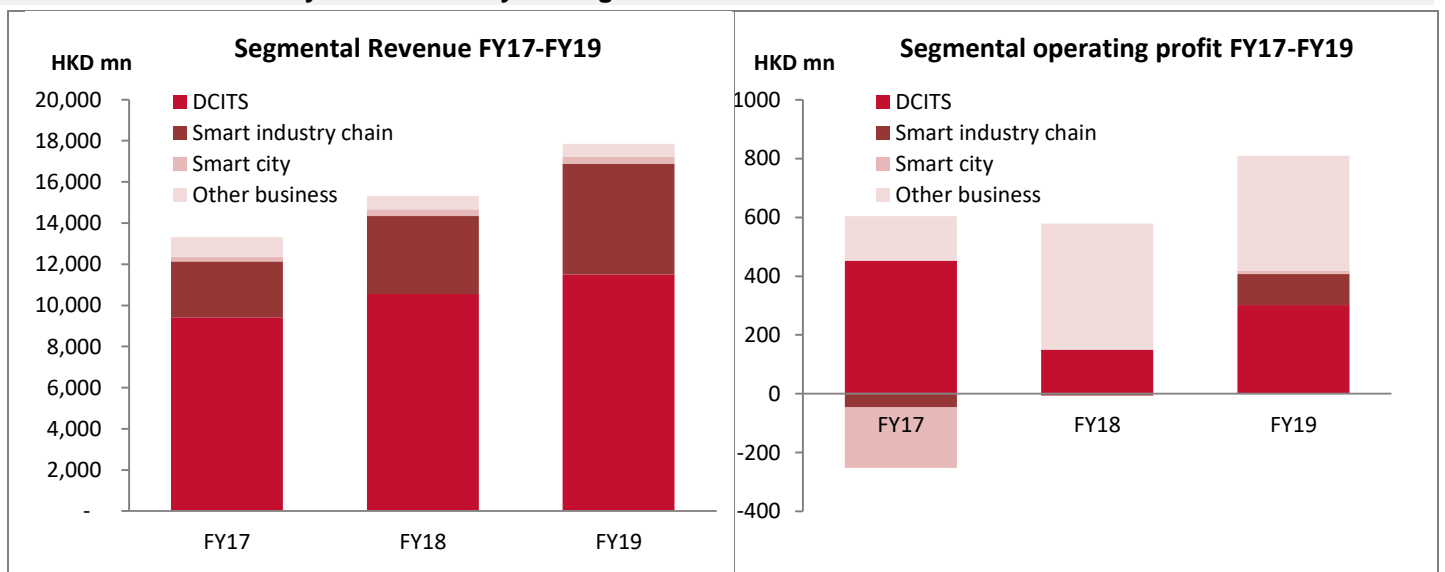
DCH sees rising dominance in Smart City solution, thanks to its proprietary DaaS, Yan Cloud (燕雲) which gives DCH a distinct competitive edge. Being rewarded the 1st class national technology innovation, Yan Cloud connects, shares, integrates and operates different data sources in a secure, cost effective and efficient manner, which is important for big data analytics across different servers and formats. One example of Yan Cloud's application is the Health Code, which tracks and monitors potential disease carrier during the Covid 19 pandemic.

83% 1Q20 revenue growth for Smart City

DCH's Smart City business is driven by the CTO 3.0 transformation, in which information technology enables digitalization across various industries. On application front, DCH is expanding smart solutions in public services like medical & healthcare, security, and traffic control etc. DCH is ramping up profitability on riding the learning curve and its fixed cost structure. Though segmental revenue stayed flat at HK\$327 mn in FY19 due to delayed booking, segmental profit surged 359% to HK\$11.5 mn. We are buoyant on the segment's outlook because: (i) current order backlog is more than sufficient to cover 2 years of revenue, (ii) around half of current revenue came from new customers, indicating land and expansion opportunities.

DCH's 40.4% stake in DCITS (000555 SZ) still accounted for 65%/37% of its consolidated FY19 revenue/ operating profit. Despite being viewed as less sexy business, we see mid to high double digit operating profit going forward: (i) financial institutions will accelerate switching to China based core banking system, and (ii) more financial related revenue to raise profitability.

Exhibit 3: Smart Industry and Smart City turning into breakeven



Source: Company,

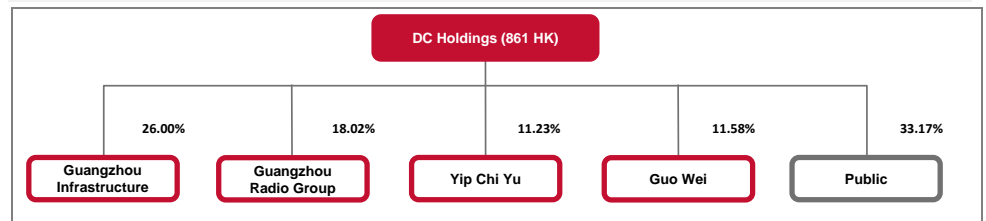
Appendix I: Financials Summary

(HKD mn)	FY16	FY17	FY18	FY19
Income Statement				
Revenue	12,251.4	13,246.6	15,254.5	17,727.4
Gross Profit	2,503.7	2,665.3	2,909.4	3,154.8
Other Operating Income	89.1	83.9	62.4	64.6
Operating Expenses	2,292.2	2,721.6	2,916.7	2,627.5
Selling, General & Admin	1,634.4	1,997.0	1,913.9	1,843.2
Prov For Doubtful Accts	70.7	135.6	272.0	94.6
Other Operating Expense	587.1	589.0	730.8	689.7
Operating Income (Loss)	300.7	27.6	55.1	591.8
Pretax Income	137.7	-47.8	281.5	546.7
Income Tax Expense (Benefit)	148.7	143.6	61.1	96.5
Minority Interest	159.3	221.6	70.9	148.3
Net Income, GAAP	389.3	-413.0	149.6	301.8
Income Statement				
Total Assets				
Cash, Cash Equivalents & STI	5,554.6	4,370.0	3,491.2	2,819.3
Accounts & Notes Receiv	4,258.4	5,556.0	5,051.8	5,417.0
Inventories	1,223.7	1,526.9	1,326.4	1,873.6
Other ST Assets	1,236.9	2,052.9	1,294.1	2,179.9
Total Current Assets	13,048.5	13,505.8	12,314.9	12,816.8
Property, Plant & Equip, Net	1,156.5	1,236.4	1,082.4	1,261.2
LT Investments & Receivables	4,458.0	7,554.1	5,146.4	5,009.7
Other LT Assets	5,053.1	5,619.3	6,944.5	6,463.3
Total Noncurrent Assets	10,667.6	14,409.8	13,173.3	12,734.3
Total Assets	23,716.1	27,915.6	25,488.2	25,551.1
Liabilities & Shareholders' Equity				
Payables & Accruals	3,965.8	5,145.2	4,901.3	5,941.1
ST Debt	5,199.0	5,297.0	3,592.3	3,572.0
Other ST Liabilities	1,327.8	1,778.4	1,623.6	1,400.9
Total Current Liabilities	10,492.6	12,220.5	10,117.2	10,914.0
LT Debt	2,465.9	2,583.9	2,606.4	1,686.4
Other LT Liabilities	285.7	316.2	367.9	387.3
Total Noncurrent Liabilities	2,751.6	2,900.2	2,974.3	2,073.7
Total Liabilities	13,244.2	15,120.7	13,091.5	12,987.6
Share Capital & APIC	2,960.1	4,832.8	4,832.8	4,811.0
Retained Earnings	1,851.0	1,355.6	1,354.4	1,558.6
Other Equity	2,357.5	2,921.4	2,663.2	2,566.8
Equity Before Minority Interest	7,168.6	9,109.8	8,850.3	8,936.4
Minority Interest	3,303.3	3,685.1	3,546.4	3,627.0
Total Equity	10,471.9	12,794.9	12,396.7	12,563.5
Cash Flow Statement				
Cashflow from operating	-227.1	896.5	71.5	793.3
Cashflow from investing	-855.5	-982.8	24.6	161.0
Cashflow from financing	-863.0	1,046.3	-1,651.5	-1,271.6
Net cash changes	-2,040.1	1,086.1	-1,579.4	-314.7

Source: Bloomberg

Appendix II: Shareholding and management

Exhibit 4: Shareholding structure



Source: Company, OP Research

Key management profile of Digital China Holdings

Mr. Guo Wei, age 57, is the Chairman, CEO and Executive Director of the group. He joined the group since 2001 and was appointed as the Chairman in 2007. He served as Executive Director in the Legend group which he joined in 1988. Mr. Guo also serves as the chairman of Digital China Information. He was a Standing Committee Member of the 11th & 12th National Committee of the Chinese people's Political Consultative Conference, and the Chairman of Beijing Informatization Association and the Chairman of the 6th Council of China Non-Governmental Science Technology Entrepreneurs Association. He holds a Master degree of Chinese Academy of Science.

Mr. Lin Yang, age 53, is the Vice Chairman and Executive Director of the group. He joined the group since 2001 and served as CEO from 2011-2018. He joined Legend group in 1990. Mr. Lin also served as the vice Chairman of Digital China Information. He also served as the Director of IT Channel Profession Council, under the MIIT (Ministry of Industry and Information Technology). He holds a MBA degree from Cheung Kong Graduate School of Business.

Exhibit 5: Peer Group Comparison

Company	Ticker	Price	Mkt cap (US\$m)	3-mth avg t/o (US\$m)	PER						Div yld			P/B		EV/		Net gearing	Gross margin	Net margin	ROE Hist	ROE FY1	Sh px 1-mth	Sh px 3-mth
					PER Hist (x)	FY1 (x)	PER FY2 (x)	EPS YoY%	EPS YoY%	3-Yr Cagr (%)	PEG (x)	Hist (%)	FY1 (%)	P/B Hist (x)	FY1 (x)	Ebitda Hist	Ebitda Cur Yr							
Digital China	861 HK	5.96	1,285	2.3	32.6	21.3	14.9	52.9	42.9	36.9	0.6	1.6	1.5	1.1	1.0	12.2	15.8	19.4	17.8	1.7	3.4	5.0	39.6	69.3
HSI		26210.16			11.4	12.2	10.3	-6.1	18.3	7.4	1.64	3.5	3.3	1.06	1.02					9.2	8.4	4.6	7.9	
HSCEI		10781.89			9.0	9.4	8.3	-4.0	12.6	6.4	1.47	3.7	3.6	1.13	1.06					12.6	11.3	6.3	9.9	
CSI300		4840.77			18.5	15.8	13.7	16.9	15.7	4.9	3.25	1.7	1.9	2.18	2.01					11.8	12.7	19.8	28.4	
Adjusted sector avg*					65.7	42.9	31.7	50.0	33.7	34.9	1.54	0.2	0.4	4.20	4.51	42.0	35.2	7.5	28.3	6.4	7.3	10.2	20.9	32.4
Miracle Automa-A	002009 CH	8.38	444	5.6	44.1	20.0	11.5	121.1	73.8	N/A	N/A	N/A	1.0	1.54	1.37	16.0	N/A	73.1	19.5	2.3	1.4	6.8	11.3	9.1
Zhongbai Holdi-A	000759 CH	7.14	695	3.8	466.7	N/A	204.0	N/A	N/A	62.0	N/A	0.7	N/A	1.55	1.55	10.1	N/A	6.2	22.3	0.1	-5.8	-4.8	6.6	2.3
Shenzhen Sunli-A	300348 CH	23.67	2,446	73.1	117.3	64.7	47.2	81.3	37.2	43.7	1.48	0.0	0.2	16.07	9.29	84.6	55.7	0.0	51.7	10.5	11.6	13.2	47.5	55.4
Huagong Tech -A	000988 CH	27.17	3,906	101.9	54.3	41.0	33.2	32.6	23.5	21.2	1.93	0.2	0.2	4.46	4.08	44.2	28.0	0.0	25.3	9.2	6.6	10.1	23.4	31.1
Inspur Electro-A	000977 CH	44.7	9,208	270.6	67.1	47.1	35.1	42.3	34.3	35.2	1.34	0.2	0.2	5.81	5.24	53.5	28.5	0.0	12.0	1.8	10.2	11.5	13.9	17.3
Beijing Suprmp-A	300036 CH	29.24	1,879	34.0	59.7	45.9	35.6	30.0	29.0	29.1	1.58	0.2	0.5	6.98	5.52	48.0	35.4	0.0	54.8	12.6	11.5	12.1	24.6	20.3
Fujian Boss So-A	300525 CH	40.92	1,628	20.7	97.3	60.4	44.6	60.9	35.5	43.4	1.39	0.2	0.3	9.72	8.01	70.3	47.9	0.0	64.5	11.9	9.5	13.2	27.8	60.2
Enjoyor Co Ltd-A	300020 CH	12.28	1,151	46.6	53.4	N/A	N/A	N/A	N/A	N/A	N/A	0.2	N/A	2.41	N/A	39.0	N/A	34.1	23.2	7.2	4.3	N/A	20.0	26.3

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

Source: Bloomberg

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
02/07/2020	S-Enjoy Service	1755	New share incentives with strong commitment	BUY	Megan Jin
02/07/2020	TCL Electronics	1070	Inject smartphone business at start of 5G replacement cycle	BUY	Dallas Cai
30/06/2020	Yeahka	9923	From payment to Fintech	BUY	Kevin Tam
19/06/2020	Powerlong CM	9909	Moving into the fast lane	NR	Dallas Cai
11/06/2020	Xtep Intl	1368	More promising prospect from FY21E	BUY	Megan Jin
08/06/2020	Edvantage Group	382	Campus capacity enlarged further	BUY	Megan Jin
04/06/2020	S-Enjoy Service	1755	Robust expansion continues	BUY	Megan Jin
04/06/2020	Greentown Services	2869	Placing for new growth initiatives - city services most likely	HOLD	Dallas Cai
28/05/2020	A-Living	3319	Positive read-across from April property sales	BUY	Dallas Cai
25/05/2020	HKBN	1310	Challenging to becoming BN leader	NR	Kevin Tam
18/05/2020	Skyworth	751	The sky getting clear	NR	Kevin Tam
14/05/2020	Ausnutria Dairy	1717	Premium products brought up GPM in 1Q20	BUY	Megan Jin/Dallas Cai
14/05/2020	China Youzan	8083	1Q loss narrowed as economies of scale kicking in	BUY	Dallas Cai
05/05/2020	HKTv	1137	HK based ecommerce on the rise	BUY	Kevin Tam/Megan Jin
23/04/2020	Edvantage Group	382	License fee saving may come earlier	BUY	Megan Jin/Dallas Cai
22/04/2020	361 Degrees Intl	1361	1Q20 retail sales in line	BUY	Megan Jin
21/04/2020	Xtep Intl	1368	1Q20 sales performance better than feared	BUY	Megan Jin/Dallas Cai
20/04/2020	Li-Ning	2331	1Q20 delivered satisfactory retail sales	BUY	Megan Jin/Dallas Cai
16/04/2020	Anta Sports	2020	Robust online FILA sales to drive 1Q20 sales beat	BUY	Dallas Cai/Megan Jin
15/04/2020	China Youzan	8083	FY19 GMV saw growth acceleration	BUY	Dallas Cai
02/04/2020	Greentown Services	2869	FY19 results largely in line	HOLD	Dallas Cai
31/03/2020	TCL Electronics	1070	FY19 results up to expectations	BUY	Dallas Cai
30/03/2020	Li-Ning	2331	A head start in FY20E with resilient operation	BUY	Dallas Cai/Megan Jin
27/03/2020	CH Display OPT	334	Lower order visibility ahead in FY20E	HOLD	Dallas Cai
27/03/2020	ChinaSoft Int'l	354	Cloud business ready to accelerate in FY20E	BUY	Dallas Cai
25/03/2020	Anta Sports	2020	FY20E strive for positive growth	BUY	Dallas Cai/Megan Jin
25/03/2020	China Overseas PPT	2669	FY19 results up to expectations	HOLD	Dallas Cai

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CONTACT

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

www.oriental-patron.com.hk
kevin.tam@oriental-patron.com.hk

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