Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

PAX Global (327 HK)

Improving outlook in 2018 but lack of near-term catalysts

- **We expect FY18E NP to recover with 70% YoY (vs -45% YoY in FY17E) following Kashuo impairment and R&D increase in FY17E**
- **2018E outlook: share gain in LACIS (mPOS)/ USCA (multilane/ ECR)/ APAC (Japan/India), offsetting continued China weakness**
- **Trimmed FY17/18E/19E EPS by 36%/4%/1% for R&D/ impairment; Maintain NEUTRAL with new TP HK$4.03 (on lowered 8x FY18E P/E)**

Focus on overseas expansion despite domestic weakness

We forecast solid FY17E/18E revenue growth of 14%/10% YoY driven by continued overseas expansion in LACIS/USCA/EMEA/APAC while China revenue will remain soft on intense competition. Excluding Kashou impairment, FY17E net profit will decline 21% YoY given increased R&D expenses for smart POS in China. We believe investment will start to bear fruit in 2018, as mgmt. indicated China UnionPAY began to provide RMB400 subsidy for smart POS since 2H17. We trimmed FY17E/18E/19E EPS by 36%/4%/1% to reflect R&D investment, Kashuo impairment offsetting stronger revenue from EMEA/ LACIS/ APAC.

Robust mPOS sales in LACIS; Smart POS to begin from USCA

By region, we expect **LACIS** to deliver 80%/15% YoY sales growth in FY17E/18E due to strong trad-POS/ mPOS sales with Pagseguro and Cielo. For **EMEA**, we expect better revenue growth of 5% YoY in FY17E (vs. guidance 0% YoY) given share gain on Ingenico's weakness after Bambora's acquisition. For **China**, we believe weakness will stabilise with 5% YoY decline in FY18E (vs -25% YoY in FY17E) given competition, while smart POS should ramp in FY18E. As for **APAC**, we expect 25%/ 15% YoY growth in FY17E/18E driven by M&A in South Korea and new subsidiaries in Japan/India, and FY20E Olympics in Japan. In **USCA**, we expect continued client/order wins with smart terminal e-series will drive 40%/+45% YoY sales growth in FY17E/18E.

Lack of catalysts in near term; Maintain NEUTRAL

Despite PAX's solid global share gains, we believe current valuation of 6.9x is fair given lack of near-term catalysts and slower revenue growth in FY18/19E. We maintain Neutral and lowered TP to HK$4.03 based on 8x FY18E P/E (vs prev 10x on down-cycle P/E with lower visibility). We recommend keeping an eye on overseas expansion progress and new product (smart terminals) performance in USCA/ China.

Financials

HK$ mn	2015	2016	2017E	2018E	2019E
Revenue	2,871	2,915	3,310	3,633	4,015
Growth (%)	21%	2%	14%	10%	10%
Net profit	621	601	329	560	642
Growth (%)	58%	-3%	-45%	70%	15%
EPS (HK$)	0.56	0.54	0.30	0.50	0.58
DPS (HK$)	0.04	0.08	0.05	0.08	0.09
P/E (x)	6.2	6.4	11.7	6.9	6.0
P/B (x)	1.2	1.1	1.0	0.9	0.8
ROE (%)	20%	17%	9%	13%	13%

Sources: Company data, CMS (HK) estimates

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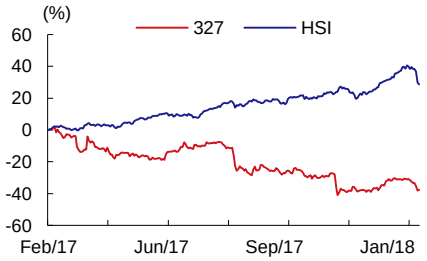
WHAT'S NEW

TP and EPS revised down

NEUTRAL

Previous	NEUTRAL
Price	HK$3.47
12-month Target Price (Potential upside)	HK$4.03 (+16%)
Previous	HK$5.23

Price Performance



Source: Bigdata

%	1m	6m	12m
327 HK	(4.1)	(29.5)	(36.0)
HSI	(1.5)	9.3	29.7

Industry: Hardware Technology	
Hang Seng Index	30451
HSCEI	12380
Key Data	
52-week range (HK$)	3.25-5.77
Market cap (HK$ mn)	3873
Avg. daily volume (mn)	4.28
BVPS (HK$)	3.43
Shareholdings Structure	
Hi Sun Technology (818 HK)	33.0%
KOPERNIK GLOBAL Investment	7.06%
FIL Limited	5.88%
No. of shares outstanding (mn)	1,100.2
Free float	65.46%

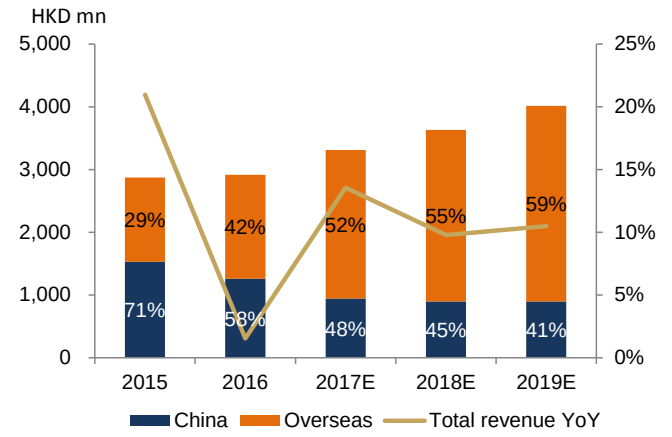
Source: Bigdata, Bloomberg, CMS(HK)

Related Research

1. PAX Global (327 HK) – Acquisition of Korean POS market leader is positive to PAX's overseas strategy (04/07/2017)
2. PAX Global (327 HK) - NDR takeaways: China recovery on track and overseas solid growth; Strong 2H17 to follow a weak 1H17 (16/06/2017)

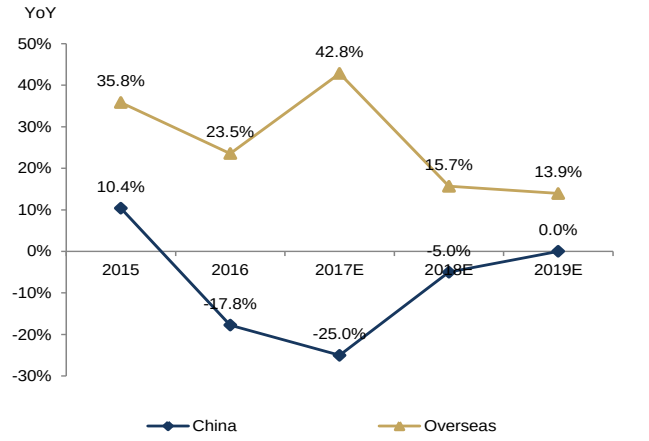
Focus charts

Figure 1: Slower FY17-19E revenue growth



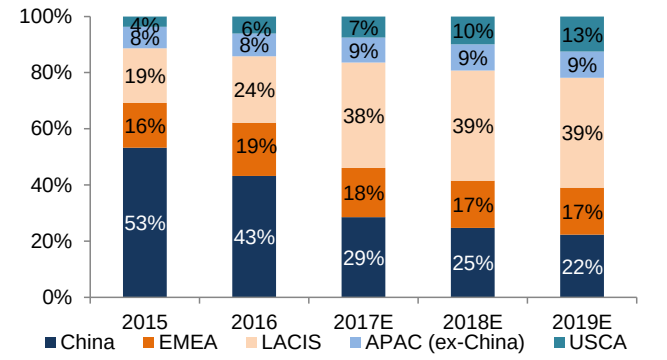
Sources: Company, CMS (HK) estimates

Figure 2: Expect overseas revenue growth to decelerate on intense competition



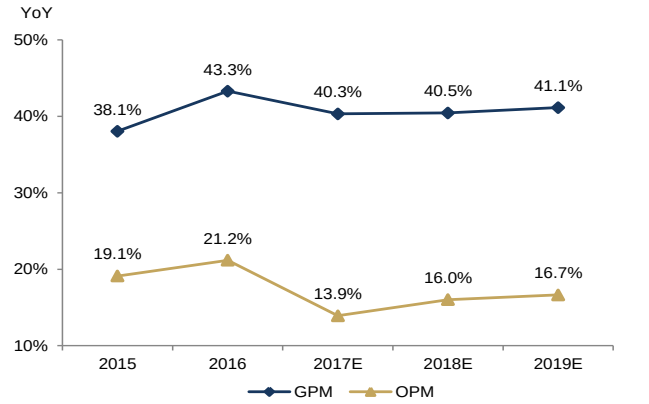
Sources: Company, CMS (HK) estimates

Figure 3: FY15-FY19E revenue mix



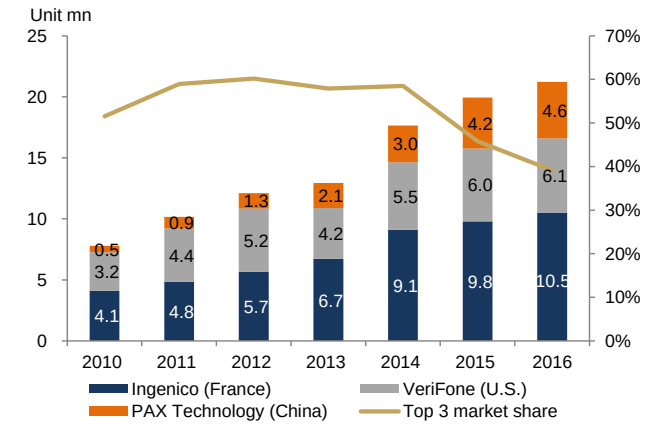
Sources: Company, CMS (HK) estimates

Figure 4: Gross margin to remain under pressure



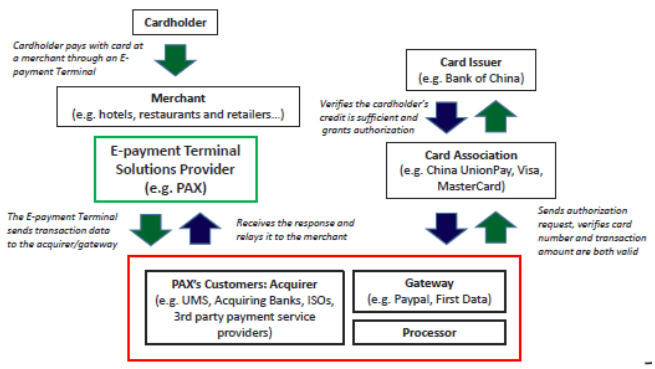
Sources: CMS (HK) estimates

Figure 5: PAX gained global market share amid industry consolidation



Sources: Company, CMS (HK)

Figure 6: China payment value chain



Source: Company, CMS (HK)

Business update

Strong LACIS, USCA/ APAC on track, EMEA recovery and China weakness

By region, we expect **LACIS** to deliver solid revenue (+80%/+15% YoY in FY17E/18E) backed by better traditional POS sales and robust client demand in mPOS with Pagseguro (model D210, D200, and D180) and Cielo (model S920, D200). Pagseguro, a major client of PAX in LACIS, provides online/mobile payment-based e-commerce service for commercial operations. PAX Global is Pagseguro's sole source of manufacturer on POS devices and Pagseguro recorded impressive POS sales growth of 171%/141%/72% from 1Q17-3Q17 (figure 7), in-line with PAX's momentum in LACIS.

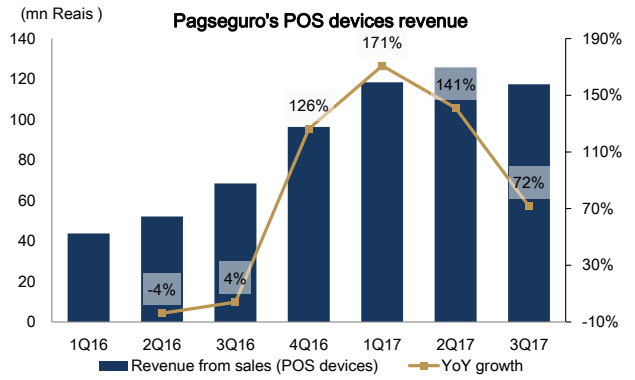
For **EMEA**, we estimate better-than-expected revenue (+5% YoY in FY17E vs. prev. guidance of 0% YoY) driven by stronger sales in Germany/ Belgium and share gain from Ingenico after acquisition of a merchant acquirer – Bambora. Ingenico, one of the major competitors of PAX global across different regions, showed slowdown in Europe & Africa sales since 2Q17 (figure 8).

For **China**, we believe weakness and volatility will continue (-25%/-5% YoY in FY17E/18E sales) due to fierce competition, while we expect smart POS will bear fruit in FY18E as mgmt. indicated China UnionPAY began to provide RMB400 subsidy for Smart POS since 2H17. We expect higher operating expenses in China in FY17E, mainly due to 1) recognition of Kashuo impairment loss on intensified China payment market competition, and 2) increasing R&D expense (279mn in FY17E vs 184mn in FY16) for product innovation investment and headcount increase.

As for **APAC**, we expect continuous EMV migration with +25%/+15% YoY FY17E/18E revenue growth. Following M&A expansion in South Korea, PAX entered Japan and India by setting up subsidiaries with direct sales force to provide customized solutions. We believe it will benefit from 2020E Olympics in Japan with more traditional POS sales. We also look forward to increasing revenue contribution from India into FY17E/18E after India government's demonetization policies in 2H16.

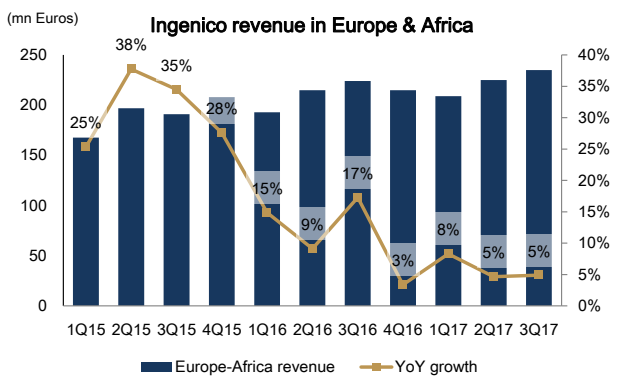
In **USCA**, we expect promising FY17E/18E with +40%/+45% YoY revenue growth on continuous client/ order wins, and launch of new smart terminal e-series (e500 etc.). We believe demand momentum in USCA will continue given delay of EMV migration in certain markets like retail and petroleum stations.

Figure 7: Strong LACIS in FY17E: PAX's major client Pagseguro in LACIS delivered strong POS devices sales since 1Q17



Sources: Company, CMS (HK); Pagseguro (PAGS US)

Figure 8: PAX's share gain in EMEA in FY17E due to Ingenico's weakness



Source: Company, CMS (HK); Ingenico (ING FP)

Software services to provide better user experience and enrich services

In 2H17, PAX Global launched PAXPAY, PAXStore and PAX terminal management system services to enhance customers' stickiness and diversify service income.

PAXPAY is an omni-channel payment gateway service enabling QR code payment (Wechat Pay, Alipay etc.), bank cards and NFC contactless. PAXPAY aims to better serve Chinese tourists through multi-channel multi-acquirer access platform.

PAXSTORE is a cloud-based (SaaS) platform that allows clients to create and manage independent white-label marketplace for software application distribution. PAX Store also provides deep data analysis of daily merchant and transaction operations for better understanding of customers.

PAX Terminal management system is a software package to efficiently manage and maintain large estates of deployed POS devices. We believe PAX's effort in developing software services will enhance its competitiveness for better user experience.

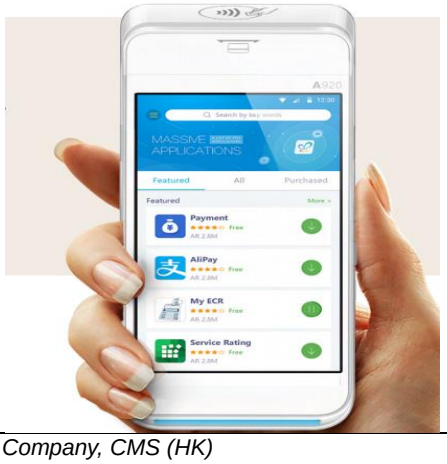
Figure 9: PAXPAY as multi-channel multi-acquirer access platform

Sources: Company, CMS (HK)

Figure 10: PAX E500 Integrated Smart Terminal

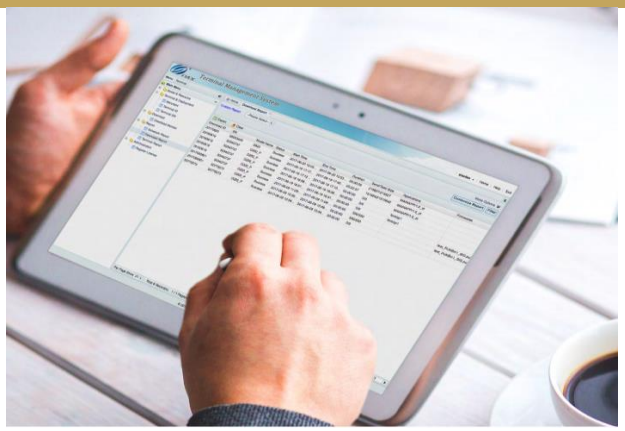
Source: Company, CMS (HK)

Figure11: PAXSTORE as software marketplace



Sources: Company, CMS (HK)

Figure 12: PAX Terminal management system



Source: Company, CMS (HK)

Earnings revisions

Figure 13: PAX revenue assumptions

HK$m, Dec-YE	2015	2016	2017E	2018E	2019E
China	1,530	1,258	944	896	896
Overseas	1,341	1,657	2,366	2,737	3,118
EMEA	456	554	582	611	672
LACIS	559	690	1,242	1,428	1,571
APAC	220	236	295	339	373
USCA	105	177	247	359	502
Total	2,871	2,915	3,310	3,633	4,015
YoY Growth (%)					
China		-18%	-25%	-5%	0%
Overseas		24%	43%	16%	14%
EMEA		21%	5%	5%	10%
LACIS		23%	80%	15%	10%
APAC		7%	25%	15%	10%
USCA		68%	40%	45%	40%
Total		**2%**	**14%**	**10%**	**10%**

Sources: Company, CMS (HK) estimates

Figure 14: New vs. Old estimates

	New			Old			Diff (%)		
HK$m, Dec-YE	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Revenue	3,310	3,633	4,015	3,088	3,384	3,748	7.2%	7.4%	7.1%
Gross profit	1,334	1,470	1,651	1,278	1,404	1,557	4.4%	4.7%	6.0%
Operating profit	461	582	668	501	600	669	-7.9%	-2.9%	-0.2%
Net profit	329	560	642	512	581	646	-35.7%	-3.6%	-0.7%
EPS (HKD)	0.30	0.50	0.58	0.46	0.52	0.58	-35.7%	-3.6%	-0.7%
Gross margin	40.3%	40.5%	41.1%	41.4%	41.5%	41.5%			
Operating margin	13.9%	16.0%	16.7%	16.2%	17.7%	17.9%			
Net margin	9.6%	15.6%	16.1%	16.3%	17.3%	17.4%			

Sources: Company, CMS (HK) estimates

Figure 15: CMS (HK) vs. Consensus

	CMS (HK) Est.			Consensus			Diff (%)		
HK$m, Dec-YE	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Revenue	3,310	3,633	4,015	3,183	3,559	3,952	4.0%	2.1%	1.6%
Gross profit	1,334	1,470	1,651	1,315	1,466	1,626	1.5%	0.2%	1.6%
Operating profit	461	582	668	512	597	666	-10.1%	-2.6%	0.3%
Net profit	329	560	642	450	551	606	-26.9%	1.7%	5.9%
EPS (HKD)	0.30	0.50	0.58	0.39	0.49	0.54	-24.8%	3.6%	7.2%
Gross margin	40.3%	40.5%	41.1%	41.3%	41.2%	41.1%			
Operating margin	13.9%	16.0%	16.7%	16.1%	16.8%	16.9%			
Net margin	9.6%	15.6%	16.1%	14.1%	15.5%	15.3%			

Sources: Company, CMS (HK) estimates

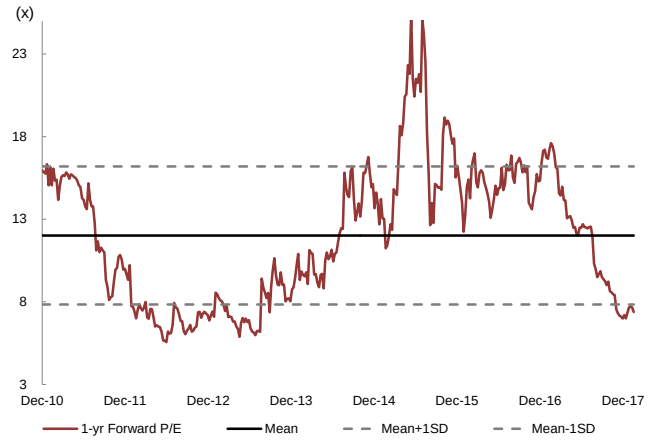
Valuation

Maintain NEUTRAL with new TP of HK$4.03

We trimmed FY17E/18E/19E EPS by 36%/4%/1% to reflect lower GPM, Kashuo impairment loss and higher R&D expense. Our new FY18E/19E EPS are 4-7% above consensus.

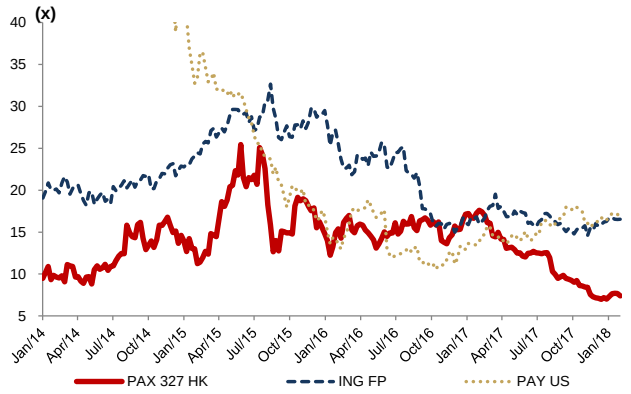
We maintain NEUTRAL with new TP of HK$4.03 based on lowered 8x FY18E P/E (vs prev 10x on down-cycle P/E with lower earnings visibility). We recommend investors to stay on the sidelines until we see signs of stabilised margins and better visibility into FY18E.

Figure 16: PAX 1-yr fwd P/E band



Sources: Bloomberg, CMS (HK) estimates

Figure 17: Industry 1-yr fwd P/E comparison



Sources: Bloomberg, CMS (HK) estimates

Figure 18: Peers comparison

Company	Ticker	Rating	Market Cap (US$ mn)	Current Price (LC$)	TP (LC$)	Upside	P/E (x)		P/B (x)		ROE (%)	
							FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
PAX Global	327 HK	NEUTRAL	478	3.47	4.03.	16%	11.7	6.9	1.0	0.9	13%	13%
China												
SZZT Electronics	002197 CH	NR	817	10.04	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Fujian Newland	000997 CH	NR	2,556	16.00	n.a.	n.a.	24.2	20.4	3.8	3.3	20%	18%
Nexgo	300130 CH	NR	813	19.40	n.a.	n.a.	46.8	26.8	3.0	2.6	8%	12%
Simple Avg							**35.5**	**23.6**	**3.4**	**2.9**	**14%**	**15%**
Overseas												
Ingenico	ING FP	NR	6,727	88.06	n.a.	n.a.	18.8	16.5	2.8	2.5	16%	16%
VeriFone	PAY US	NR	1,920	17.40	n.a.	n.a.	13.4	11.8	2.5	2.3	18%	21%
Simple Avg							**16.1**	**14.1**	**2.7**	**2.4**	**17%**	**18%**

Sources: Bloomberg, CMS (HK) estimates

Financial Summary

Balance Sheet

HK$ million	2015	2016	2017E	2018E	2019E
Current assets	**4,021**	**4,220**	**4,610**	**5,172**	**5,849**
Cash & equivalents	2,144	2,207	2,213	2,727	2,963
Account receivables	1,261	1,347	1,614	1,637	1,956
Inventories	562	597	702	720	833
Restricted cash	9	0	0	0	0
Other current assets	44	69	79	87	96
Non-current assets	**12**	**68**	**70**	**72**	**72**
PPE	11	68	70	71	72
Leasehold land	0	0	0	0	0
Other non-current assets	0	0	0	0	0
Total assets	**4,032**	**4,289**	**4,680**	**5,244**	**5,921**
Current liabilities	**988**	**925**	**1,052**	**1,135**	**1,260**
ST borrowings	0	0	0	0	0
Account payables	711	662	745	797	887
Other payables	231	227	265	291	321
Tax payables	46	36	43	47	52
Other current liabilities	0	0	0	0	0
Non-current liabilities	**0**	**0**	**0**	**0**	**0**
LT borrowings	0	0	0	0	0
Other non-current liabilities	0	0	0	0	0
Total liabilities	**988**	**925**	**1,052**	**1,135**	**1,260**
Share capital	111	111	111	111	111
Reserves	2,966	3,355	3,630	4,106	4,651
Minority interest	0	0	0	0	0
Shareholders' equity	**3,078**	**3,466**	**3,740**	**4,216**	**4,762**
Total equity & liabilities	**4,065**	**4,391**	**4,793**	**5,351**	**6,022**

Cashflow Statement

HK$ million	2015	2016	2017E	2018E	2019E
Operating cashflow	**317**	**250**	**44**	**581**	**310**
Net income before tax	658	678	365	645	739
Depr. and amortisation	5	10	8	9	9
Share-based payments	15	4	0	0	0
Interest income	(20)	(15)	(26)	(27)	(33)
Other operating cash flow	43	(17)	0	0	0
Change in working capital	(315)	(314)	(263)	29	(320)
Income tax paid	(69)	(96)	(39)	(76)	(86)
Investing cashflow	**14**	**(9)**	**16**	**17**	**23**
Capital expenditure	(5)	(15)	(10)	(10)	(10)
Financial assets (net)	0	0	0	0	0
Interest income	21	16	26	27	33
Purchse of subsidiaries	(1)	(10)	0	0	0
Financing cashflow	**(4)**	**(91)**	**(54)**	**(84)**	**(96)**
Net proceeds - borrowings	0	0	0	0	0
Net proceeds - share issue	0	0	0	0	0
Dividend paid	(22)	(67)	(54)	(84)	(96)
Other financing cashflow	18	(24)	0	0	0
Net change in cash	327	149	6	514	236
Cash at year end	**2,144**	**2,207**	**2,213**	**2,727**	**2,963**

Sources: Company data, CMS (HK) estimates

Profit & Loss Statement

HK$ million	2015	2016	2017E	2018E	2019E
Revenues	**2,871**	**2,915**	**3,310**	**3,633**	**4,015**
Cost of sales	(1,778)	(1,653)	(1,975)	(2,164)	(2,363)
Gross profit	**1,092**	**1,262**	**1,334**	**1,470**	**1,651**
Selling expense	(236)	(297)	(408)	(405)	(450)
R&D expense	(158)	(184)	(279)	(276)	(305)
Other admin expense	(150)	(163)	(186)	(206)	(228)
Operating profit	**549**	**618**	**461**	**582**	**668**
Interest income	20	15	26	27	33
Interest expense	0	(11)	(5)	(5)	(5)
Other non-op items	89	57	(118)	41	43
Pre-tax profit	**658**	**678**	**365**	**645**	**739**
Income tax expense	(38)	(75)	(46)	(80)	(91)
After-tax profit	**620**	**603**	**319**	**566**	**648**
Non-controlling interests	(0)	3	(11)	6	6
Net profit	**621**	**601**	**329**	**560**	**642**
Basic EPS (HKD)	**0.56**	**0.54**	**0.30**	**0.50**	**0.58**

Financial Ratios

	2015	2016	2017E	2018E	2019E
YoY growth rate					
Revenue	21%	2%	14%	10%	10%
Operating profit	40%	13%	-25%	26%	15%
Net profit	58%	-3%	-45%	70%	15%
Profitability					
Gross margin	38%	43%	40%	40%	41%
Operating margin	19%	21%	14%	16%	17%
Net margin	22%	21%	10%	15%	16%
ROE	20%	17%	9%	13%	13%
ROA	15%	14%	7%	11%	11%
Liquidity					
D/A	0%	0%	0%	0%	0%
ND/A	-53%	-51%	-47%	-52%	-50%
Current ratio	4.1	4.6	4.4	4.6	4.6
Quick ratio	2.2	2.5	2.2	2.5	2.4
Operating efficiency					
Asset turnover	0.71	0.68	0.71	0.69	0.68
Inventory turnover	3.16	2.77	2.81	3.00	2.84
AR turnover	2.28	2.16	2.05	2.22	2.05
AP turnover	2.50	2.49	2.65	2.72	2.67
Per share ratios (HKD)					
EPS	0.56	0.54	0.30	0.50	0.58
CFPS	0.29	0.22	0.04	0.52	0.28
BPS	2.79	3.14	3.39	3.82	4.32
DPS	0.04	0.08	0.05	0.08	0.09
Valuation ratios					
P/E	6.2	6.4	11.7	6.9	6.0
P/B	1.2	1.1	1.0	0.9	0.8
EV/EBITDA	3.1	2.6	3.5	1.9	1.3

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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