
HiSoft Technology (HSFT), VancelInfo Technologies (VIT): Pre-announcement of Q3 and Limited Upside in the Short-run

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Pre-announcement of Q3 and Limited Upside in the Short-run

- Pre-announcement eases some concerns over the merger and margins. We think there is some upside after a stable Q3 and Q4 announcement.
- We don't see sustainable margin improvement evidence and believe it might take additional one or two quarters to judge if the merger was successful.
- We are still positive on the new company in the longer-term, if merger is successful.

VancelInfo and HiSoft pre-announced Q3 earnings yesterday and reaffirmed their full-year guidance. VancelInfo's Q3 results and Q4 guidance were largely in-line with street consensus. HiSoft's Q3 results were in-line, and they guided slightly above street for the Q4.

We think IT outsourcing demand is fairly strong, unaffected by a weaker macro economy in China. We think expanding the financial IT outsourcing benefits both companies. The major concern on VancelInfo was whether the consensus reflected the weakness from Huawei and Nokia and contracts lost during the merger. The reaffirmation of guidance indicates that everything is on track now for VancelInfo. It seems the strained China-Japan relationship did not affect HiSoft greatly on their Japanese outsourcing business.

We think the reaffirmation of earnings and guidance eases investors' concerns on further declining margins, China macro's impacts, and unexpected events during the firms' merger.

We think there will be some upside, as margins appear to be recovering slightly in the 2H and the merger seems to be moving smoothly. However, we think a wait-and-see sentiment is still there and believe it will still take another 2-3 quarters to see if the merger was successful and if margin improvement is sustainable.

We think the main issues to look at for the next two quarters are:

- If financial IT is growing fast enough to offset business lost from Huawei and Nokia.
- If gross margin and operating margin are improving sustainably.
- No large talent lost during the merger and no negative reactions from major clients.

We are still positive on the long-term trend of the China outsourcing industry. We think the increasing IT talent pool and shrinking gap between China IT outsourcing players and India competitors will help China gain more market share in the global IT outsourcing market. Besides, the unstable Indian economy and high inflation will offset some of their advantage in IT outsourcing.

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