

Shifting to margin improvement in 2023

Cut TP to HKD5.8; maintain Buy rating

TP cut to HKD5.8 and maintain Buy rating; focus on margin rather than growth as first priority into 2023F; the stock is trading at 11x 2024F P/E

As a result of declining contribution from key customers as well as the COVID-19 situation in 2022, Chinasoft suffered weak FY22 results. Considering the weak momentum of business from Huawei, we see Chinasoft has changed its strategy from market share gain to margin improvement. We believe 2023 will be a transformation year for Chinasoft, with a de-concentration process from some of its key customers in the cornerstone business and embracing the new business opportunities ahead. We cut our FY23-24F revenue forecasts by 27%/29% while cut GPM by 3.4pp/3.1pp. We now expect Chinasoft to deliver 11% revenue CAGR and 28% earnings CAGR in FY23-25F. We cut our TP to HKD5.8 (implying 17% upside), based on 13x 2024F EPS of CNY0.39 (16x P/E earlier; 13x is in line with its historical median of 13x, while below our 2022-25F earnings CAGR of 28%). We maintain our Buy rating and expect the business to gradually recover and more importantly, GPM to recover in FY23F from a low base in FY22.

De-concentration from some key customers in the cornerstone business

Chinasoft suffered from revenue/GPM decline and employee downsizing at its cornerstone business in FY22, mainly from Huawei's impact. Its key customers' concentration ratio was also down to 73% in 2022 from 78% in 2021. According to the company, such a situation may continue into FY23, with revenue decline from some key customers. On the other hand, the number of new emerging customers is on the rise and Chinasoft sees the number of customers with contribution above CNY6mn on an annual basis increase from 160 in 2021 to 190 in 2022, showing a positive momentum. Looking forward, we expect the company will maintain the de-concentration process and focus more on profitability rather than the market share of its cornerstone business.

Embracing new business with margin improvement; still a solid long-term outlook

Looking forward, beyond the cornerstone business, Chinasoft also actively targets emerging businesses such as cloud, HarmonyOS, vehicles-related opportunities and targets to enjoy meaningful growth within these segments. By working closely with its key customers (but not purely rely on them), Chinasoft plans to explore those new areas and pave the way for a multi-year growth, when the overall market and customers' situation recover. We expect a recovery trend on margin and profit into FY23F for Chinasoft and believe a more evident recovery trend is likely into next few years.

Year-end 31 Dec	FY22	FY23F		FY24F		FY25F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	20,005	27,715	20,295	32,461	23,097		27,119
Reported net profit (mn)	759	1,691	971	2,027	1,228		1,579
Normalised net profit (mn)	759	1,691	971	2,027	1,228		1,579
FD normalised EPS	25.18c	53.11c	31.67c	62.70c	39.42c		9.82c
FD norm. EPS growth (%)	-34.4	23.5	25.8	18.0	24.5		-75.1
FD normalised P/E (x)	17.0	—	13.5	—	10.9	—	43.6
EV/EBITDA (x)	6.9	—	4.8	—	3.6	—	2.7
Price/book (x)	1.1	—	1.1	—	1.0	—	1.0
Dividend yield (%)	1.3	—	1.6	—	2.0	—	2.5
ROE (%)	6.4	12.1	7.7	12.7	9.0		10.6
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Company data, Nomura estimates

Rating Remains **Buy**

Target price Reduced from HKD 9.90 **HKD 5.80**

Closing price 31 March 2023 **HKD 4.97**

Implied upside **+16.7%**

Market Cap (USD mn) 1,916.5
ADT (USD mn) 22.0

Relative performance chart



Source: Thomson Reuters, Nomura

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Key data on Chinasoft International

Performance

(%)	1M	3M	12M		
Absolute (HKD)	-11.7	-26.8	-23.4	M cap (USDmn)	1,916.5
Absolute (USD)	-11.7	-27.2	-23.6	Free float (%)	90.7
Rel to Hang Seng Index	-14.4	-29.5	-15.7	3-mth ADT (USDmn)	22.0

Income statement (CNYmn)

Year-end 31 Dec	FY21	FY22	FY23F	FY24F	FY25F
Revenue	18,398	20,005	20,295	23,097	27,119
Cost of goods sold	-13,494	-15,405	-15,465	-17,484	-20,394
Gross profit	4,904	4,600	4,830	5,613	6,726
SG&A	-3,948	-3,870	-3,875	-4,398	-5,151
Employee share expense					
Operating profit	956	731	955	1,214	1,575
EBITDA	1,400	1,337	1,759	2,100	2,523
Depreciation	-397	-556	-754	-836	-898
Amortisation	-48	-50	-50	-50	-50
EBIT	956	731	955	1,214	1,575
Net interest expense	-100	-113	-98	-82	-66
Associates & JCEs					
Other income	396	212	215	240	276
Earnings before tax	1,252	830	1,073	1,372	1,784
Income tax	-115	-71	-103	-145	-206
Net profit after tax	1,137	759	970	1,227	1,578
Minority interests	0	1	1	1	1
Other items					
Preferred dividends					
Normalised NPAT	1,137	759	971	1,228	1,579
Extraordinary items					
Reported NPAT	1,137	759	971	1,228	1,579
Dividends	-80	-180	-230	-291	-374
Transfer to reserves	1,057	580	741	937	1,205

Valuations and ratios

Reported P/E (x)	10.2	16.4	13.0	10.5	43.3
Normalised P/E (x)	10.2	16.4	13.0	10.5	43.3
FD normalised P/E (x)	10.8	17.0	13.5	10.9	43.6
Dividend yield (%)	0.6	1.3	1.6	2.0	2.5
Price/cashflow (x)	12.8	11.6	10.2	9.9	50.2
Price/book (x)	1.1	1.1	1.1	1.0	1.0
EV/EBITDA (x)	5.7	6.9	4.8	3.6	2.7
EV/EBIT (x)	8.4	12.6	8.8	6.3	4.3
Gross margin (%)	26.7	23.0	23.8	24.3	24.8
EBITDA margin (%)	7.6	6.7	8.7	9.1	9.3
EBIT margin (%)	5.2	3.7	4.7	5.3	5.8
Net margin (%)	6.2	3.8	4.8	5.3	5.8
Effective tax rate (%)	9.2	8.6	9.6	10.6	11.6
Dividend payout (%)	7.0	23.7	23.7	23.7	23.7
ROE (%)	11.1	6.4	7.7	9.0	10.6
ROA (pretax %)	9.3	6.3	7.8	9.5	11.5

Growth (%)

Revenue	30.5	8.7	1.4	13.8	17.4
EBITDA	-5.8	-4.5	31.6	19.4	20.2
Normalised EPS	8.0	-36.1	25.7	24.4	-75.8
Normalised FDEPS	12.5	-34.4	25.8	24.5	-75.1

Source: Company data, Nomura estimates

Cashflow statement (CNYmn)

Year-end 31 Dec	FY21	FY22	FY23F	FY24F	FY25F
EBITDA	1,400	1,337	1,759	2,100	2,523
Change in working capital	-89	-1,064	875	-375	-739
Other operating cashflow	-349	837	-1,350	-383	-415
Cashflow from operations	962	1,109	1,284	1,342	1,370
Capital expenditure	-287	-287	-287	-287	-287
Free cashflow	675	822	996	1,055	1,083
Reduction in investments	0	0	0	0	
Net acquisitions					
Dec in other LT assets	0	0	0	0	
Inc in other LT liabilities	98	-155	0	0	0
Adjustments	-242	-869	40	40	40
CF after investing acts	531	-203	1,036	1,095	1,123
Cash dividends	-70	-80	-180	-230	-291
Equity issue	1,619	0	0	0	0
Debt issue	173	173	-200	-200	-200
Convertible debt issue					
Others	-483	-442	-40	-40	-40
CF from financial acts	1,239	-348	-420	-470	-530
Net cashflow	1,770	-551	617	625	592
Beginning cash	3,787	5,556	5,005	5,622	6,247
Ending cash	5,556	5,005	5,622	6,247	6,839
Ending net debt	-4,536	-3,843	-4,660	-5,485	-6,277

Balance sheet (CNYmn)

As at 31 Dec	FY21	FY22	FY23F	FY24F	FY25F
Cash & equivalents	5,556	5,005	5,622	6,247	6,839
Marketable securities					
Accounts receivable	5,894	6,157	5,777	6,557	7,720
Inventories	163	99	164	113	210
Other current assets	1,906	2,339	2,081	2,081	2,081
Total current assets	13,520	13,601	13,644	14,998	16,851
LT investments					
Fixed assets	1,220	1,119	2,044	1,958	1,842
Goodwill	844	844	844	844	844
Other intangible assets	193	281	231	181	131
Other LT assets	1,126	1,121	1,261	1,350	1,406
Total assets	16,902	16,965	18,023	19,330	21,073
Short-term debt					
Accounts payable	2,252	2,043	2,295	2,587	3,026
Other current liabilities	1,734	1,510	1,560	1,621	1,704
Total current liabilities	3,986	3,553	3,855	4,208	4,730
Long-term debt	1,021	1,162	962	762	562
Convertible debt	0	0	0	0	0
Other LT liabilities	269	114	114	114	114
Total liabilities	5,276	4,830	4,931	5,085	5,407
Minority interest					
Preferred stock					
Common stock	139	137	137	137	137
Retained earnings	5,760	6,498	7,239	8,176	9,381
Proposed dividends					
Other equity and reserves	5,728	5,500	5,716	5,932	6,148
Total shareholders' equity	11,627	12,135	13,092	14,245	15,667
Total equity & liabilities	16,902	16,965	18,023	19,330	21,073

Liquidity (x)

Current ratio	3.39	3.83	3.54	3.56	3.56
Interest cover	9.6	6.5	9.8	14.8	23.8

Leverage

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

Per share

Reported EPS (CNY)	40.89c	26.11c	32.81c	40.81c	9.88c
Norm EPS (CNY)	40.89c	26.11c	32.81c	40.81c	9.88c
FD norm EPS (CNY)	38.40c	25.18c	31.67c	39.42c	9.82c
BVPS (CNY)	3.79	3.83	4.00	4.23	4.52
DPS (CNY)	0.03	0.06	0.07	0.09	0.11

Activity (days)

Days receivable	103.9	109.9	107.3	97.7	96.1
Days inventory	2.9	3.1	3.1	2.9	2.9
Days payable	54.2	50.9	51.2	51.1	50.2
Cash cycle	52.6	62.2	59.2	49.5	48.7

Source: Company data, Nomura estimates

Company profile

Chinasoft is a software and information technology solutions services provider. The company engages in the development and provision of information technology solutions services, IT outsourcing services and cloud related services, such as consulting, cloud managed services etc. It operates business mainly through Technical Professional Services (TPG) and Internet Information Technology (IT) Services (IIG) segments.

Valuation Methodology

Our TP of HKD5.80 is based on 13x 2024F EPS of CNY0.39. The target multiple we use is in line with its historical average, while below our 2022-25F earnings CAGR of 28% for Chinasoft, albeit from a low base. The benchmark index for this stock is HSI Index.

Risks that may impede the achievement of the target price

Downside risks include: 1) slower-than-expected cornerstone business expansion with key customers due to the loss of wallet share or slower growth rate from key customers; 2) slower-than-expected development of cloud intelligent business due to market competition or self-development issue; and 3) lower-than-expected operating efficiency which has a negative impact on the company's profitability.

ESG

Chinasoft is principally engaged in software and information technology services and its production activities have minimal impact to the environment. By providing IT and cloud services to its customers, the company enables enterprises to transform and develop their own digital intelligence as well as improve their operating efficiency to build a green production and lifestyle eventually.

Earnings call takeaways

- Considering the business situation of its cornerstone customer (Huawei, unlisted) as well as the COVID-19 situation last year in China, Chinasoft suffered a GPM decline in FY22 while also downsizing its number of employees, which is having an impact on its margins as well. Looking forward, targeting at cloud, HarmonyOS, vehicles and other new emerging business, Chinasoft expects a recovery trend on margin and profit into FY23.
- In terms of client mix, the key customer concentration ratio for the company declined to 73% in 2022 from 78% in 2021. Meanwhile, the company sees the number of customers with contribution above CNY6mn on an annual basis increase from 160 to 190, showing a positive momentum.
- Regarding the latest topic on AIGC and GPT, management believes that within the IT services outsourcing market, KPO (knowledge process outsourcing) business might see more challenges ahead compared to ITO (information technology outsourcing) business. Hence, Chinasoft targets to catch up or narrow the gap with global peers in the IT service market.
- On the relationship with Huawei, management said that they have cooperated with Huawei Cloud for five years and enjoyed a 10% market share for Huawei cloud-related business. Looking forward, the company continues to set the target of achieving 10% from Huawei cloud-related business, and expecting to enjoy solid growth, especially for those demand related independent and controllable technology trend. Meanwhile, the company is also actively involved in Huawei MetaERP business and upcoming Pangu pre-trained large language model. For the vehicle-related business, Chinasoft will help Huawei for HarmonyOS penetrating into the next generation intelligent cockpit and autonomous driving business of the auto supply chain.

Earnings forecast revisions

While seeing plenty of business opportunities ahead, we believe 2023F to be a transformation year for Chinasoft, reallocating more resources to new emerging business rather than its traditional cornerstone business, especially from some key customers.

We lower our FY23-24F revenue forecasts for Chinasoft by 27%/29% and also cut GPM by 3.4pp/3.1pp, considering a low base effect in 2022. Meanwhile, we believe the company will have a tight control on its opex for operational efficiency improvement. Hence, we cut our opex forecasts for Chinasoft in FY23-24F by 35%/37%. As a result, our net profit forecast for FY23-24F are 43%/39% lower than our previous expectations.

Fig. 1: Chinasoft - earnings forecasts revisions

(CNY mn)		2020 A	2021 A	2022 A	2023F (NOM)	2024F (NOM)	2025F (NOM)	2023F (OLD)	2024F (OLD)	2023F Diff.	2024F Diff.
Revenue		14,101	18,398	20,005	20,295	23,097	27,119	27,715	32,461	-26.8%	-28.8%
	% y-y	17%	30%	9%	1%	14%	17%	39%	17%		
TPG		12,396	16,622	17,930	18,110	20,645	24,361	25,450	30,063	-28.8%	-31.3%
	% y-y	19%	34%	8%	1%	14%	18%	42%	18%		
IIG		1,705	1,776	2,075	2,185	2,452	2,758	2,265	2,399	-3.5%	2.2%
	% y-y	8%	4%	17%	5%	12%	12%	9%	6%		
COGS		(9,983)	(13,494)	(15,405)	(15,465)	(17,484)	(20,394)	(20,189)	(23,581)	-23.4%	-25.9%
Gross Profit		4,118	4,904	4,600	4,830	5,613	6,726	7,526	8,880	-35.8%	-36.8%
OPEX		(2,962)	(3,948)	(3,870)	(3,875)	(4,398)	(5,151)	(5,920)	(6,950)	-34.5%	-36.7%
Operating profit		1,157	956	731	955	1,214	1,575	1,606	1,930	-40.5%	-37.1%
	% y-y	20%	-17%	-24%	31%	27%	30%	120%	20%		
Pretax income		1,035	1,252	830	1,073	1,372	1,784	1,904	2,309	-43.7%	-40.6%
	% y-y	30%	21%	-34%	29%	28%	30%	129%	21%		
Taxes		(87)	(115)	(71)	(103)	(145)	(206)	(214)	(282)	-52.0%	-48.6%
Minority interests		7	0	1	1	1	1	0	0		
Profit to shareholders		955	1,137	759	971	1,228	1,579	1,691	2,027	-42.6%	-39.4%
	% y-y	26%	19%	-33%	28%	26%	29%	123%	20%		
Ratio Analysis											
GPM		29.2%	26.7%	23.0%	23.8%	24.3%	24.8%	27.2%	27.4%	-3.4pp	-3.1pp
OPEX		-21.0%	-21.5%	-19.3%	-19.1%	-19.0%	-19.0%	-21.4%	-21.4%	2.3pp	2.4pp
OPM		8.2%	5.2%	3.7%	4.7%	5.3%	5.8%	5.8%	5.9%	-1.1pp	-0.7pp
NPM		6.8%	6.2%	3.8%	4.8%	5.3%	5.8%	6.1%	6.2%	-1.3pp	-0.9pp

Source: Company data, Nomura estimates

Looking at revenue by segment, we cut our cornerstone business forecasts by 21%/23% for FY23-24F, following a de-concentration trend from its key customers. Meanwhile, we also cut our cloud intelligent business forecasts for Chinasoft by 35%/36% for the next two years, as a result of a low-base effect in 2022, due mainly to Huawei's cloud-related business impact and COVID-19 situation in China.

Fig. 2: Chinasoft - revenue forecasts by segment

(CNY mn)		2020 A	2021 A	2022 A	2023F (NOM)	2024F (NOM)	2025F (NOM)	2023F (OLD)	2024F (OLD)	2023F Diff.	2024F Diff.
Cornerstone business		10,901	13,095	13,387	12,717	13,402	14,588	16,011	17,282	-20.6%	-22.5%
As % of total sales		77%	71%	67%	63%	58%	54%	58%	53%		
Cloud intelligent		3,200	5,303	6,618	7,578	9,695	12,532	11,704	15,179	-35.2%	-36.1%
As % of total sales		23%	29%	33%	37%	42%	46%	42%	47%		

Source: Company data, Nomura estimates

We are now more cautious compared with peers as we are 9-21% lower on our top line forecasts for Chinasoft into FY23-25F and also 12%-25% lower vs consensus estimates on bottom line, based on the current business update from Chinasoft and considering current market situation and business strategy from the company. We believe a downward revision trend for consensus estimates is likely.

Fig. 3: Chinasoft - Nomura vs Bloomberg consensus

CNY mn	FY2022		FY2023F (NOM)	FY2023F (CON)	diff	FY2024F (NOM)	FY2024F (CON)	diff	FY2025F (NOM)	FY2025F (CON)	diff
Revenue	20,005		20,295	24,568	-17%	23,097	29,066	-21%	27,119	29,838	-9%
Operating Profit	731		955	1,307	-27%	1,214	1,736	-30%	1,575	1,941	-19%
Pretax Profit	830		1,073	1,476	-27%	1,372	1,859	-26%	1,784	2,102	-15%
Net Profit	759		971	1,302	-25%	1,228	1,622	-24%	1,579	1,802	-12%
EPS	0.26		0.33	0.44	-25%	0.41	0.55	-25%	0.10	0.62	-84%

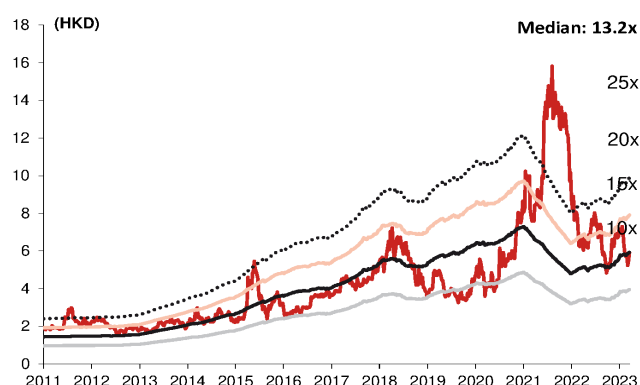
Source: Company data, Bloomberg consensus, Nomura estimates

Valuation methodology and investment risks

We cut our TP for Chinasoft from HKD9.9 to HKD5.8 (implying ~17% upside), based on

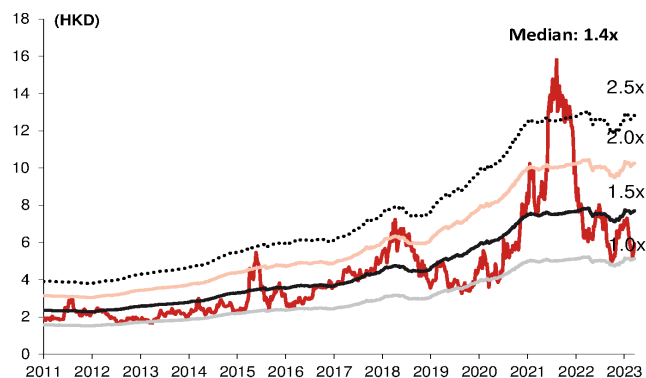
13x (previously 16x) 2024F EPS of CNY0.39. Our target multiple of 13x is in line with its historical median level of 13x, while below our 2022-25F earnings CAGR of 28% for Chinasoft, albeit from a low base. As FY22 was a challenging year for Chinasoft, we see the company now changing its strategy and focusing more on new emerging businesses which should help them on margin recovery into the future. Looking forward, while there might be continuous cornerstone business adjustment impact on top line growth within FY23F, we expect the business to gradually recover and more importantly, GPM to recover in FY23F from a low base in FY22. We maintain our Buy rating. We think the company is having the right strategy to focus on the quality of existing business and new emerging opportunities in the market and believe the company will eventually re-accelerate its business growth in foreseeable future.

Fig. 4: Chinasoft: 12-month-forward P/E band



Source: Company data, Bloomberg Finance L.P., Nomura estimates

Fig. 5: Chinasoft: 12-month-forward P/B band



Source: Company data, Bloomberg Finance L.P., Nomura estimates

Downside risks include: 1) slower-than-expected cornerstone business expansion with key customers due to the loss of wallet share or slower growth rate from key customers; 2) slower-than-expected development of cloud intelligent business due to market competition or self-development issue; and 3) lower-than-expected operating efficiency which has a negative impact on the company's profitability.

Appendix A-1

Analyst Certification

I, Joel Ying, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Chinasoft International	354 HK	HKD 4.97	31-Mar-2023	Buy	N/A	

Chinasoft International (354 HK)

HKD 4.97 (31-Mar-2023) Buy (Sector rating: N/A)

Rating and target price chart (three year history)

Chinasoft International

As of 31-Mar-2023
Currency = HKD

Date	Rating	Target price	Closing price
23-May-22	Buy		6.89
23-May-22		9.90	6.89



Source: ThomsonReuters, Nomura research

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of HKD5.80 is based on 13x 2024F EPS of CNY0.39. The target multiple we use is in line with its historical average, while below our 2022-25F earnings CAGR of 28% for Chinasoft, albeit from a low base. The benchmark index for this stock is HSI Index.

Risks that may impede the achievement of the target price Downside risks include: 1) slower-than-expected cornerstone business expansion with key customers due to the loss of wallet share or slower growth rate from key customers; 2) slower-than-expected development of cloud intelligent business due to market competition or self-development issue; and 3) lower-than-expected operating efficiency which has a negative impact on the company's profitability.

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As at 31 December 2022.

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** As defined by the EU Market Abuse Regulation

Definition of Nomura Group's equity research rating system and sectors

The rating system is a relative system, indicating expected performance against a specific benchmark identified for each individual stock, subject to limited management discretion. An analyst's target price is an assessment of the current intrinsic fair value of the stock based on an appropriate valuation methodology determined by the analyst. Valuation methodologies include, but are not limited to, discounted cash flow analysis, expected return on equity and multiple analysis. Analysts may also indicate expected absolute upside/downside relative to the stated target price, defined as (target price - current price)/current price.

STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended**', indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as '**Not rated**' or shown as '**No rating**' are not in regular research coverage. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies. Benchmarks are as follows: **United States/Europe/Asia ex-Japan**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx>; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan**: Russell/Nomura Large Cap.

SECTORS

A '**Bullish**' stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months. A '**Neutral**' stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months. A '**Bearish**' stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months. Sectors that are labelled as '**Not rated**' or shown as '**N/A**' are not assigned ratings. Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia. **Japan/Asia ex-Japan**: Sector ratings are not assigned.

Target Price

A Target Price, if discussed, indicates the analyst's forecast for the share price with a 12-month time horizon, reflecting in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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