

Chinasoft Intl. | 354 HK

Sailing through cloud migration

Cathy Chan, CFA

(852) 3911 8271
cathychan@ccbintl.com

Ronnie Ho

(852) 3911 8259
ronnieho@ccbintl.com

- ▶ **New businesses to provide the next leg of growth**
- ▶ **More major customers mitigate concentration risk**
- ▶ **Positive profit growth ahead**

New businesses to fuel growth. With cloud migration and digital transformation rapidly taking place in China, we see Chinasoft's new businesses to become the next growth engine of the company. Chinasoft's new businesses mainly include 1) cloud migration and management services and cloud-based software solutions; 2) Jointforce, a crowdsourcing platform that connects SMEs and local governments with software engineers, and 3) big data services. After robust 50% YoY growth in 2020, we expect revenue from new businesses to surge 67% YoY to reach RMB5b in 2021F, contributing 30% of total revenue. We hold a positive view on the company's transformation from traditional IT-services to Internet-IT services which will not just favor revenue growth but also margin expansion.

Working with more major customers to diversify revenue sources. Revenue concentration with Huawei (>50% of total revenue in 2019) has been a major concern to investors. To mitigate this concentration risk, we see that Chinasoft is taking a proactive approach to cultivate other major customers such as Tencent, Alibaba and Baidu. Revenue from these major customers grew over 40% YoY in 2020. Chinasoft aims to get each top 10 client to contribute over US\$100m annual sale in 3 years; currently only Huawei and HSBC are above that threshold.

Positive profit growth ahead. We raise our 2020-2022F earnings estimates by 3-9% as we assume higher revenue from new businesses and higher margins amid rising contribution from new businesses. We expect Chinasoft to deliver 24% earnings CAGR in 2019-2022F. We roll forward our valuation base from 2021F to 2022F and raise our target price from HK\$7.95 to HK\$12.20, based on 20x P/E versus 18x P/E previously to reflect stronger earnings momentum and ample market liquidity. **Downside risks** include 1) slower-than-expected growth in new businesses, 2) slower-than-expected diversification of client base, and 3) stricter sanctions on Huawei imposed by the US.

Forecast and valuation

Year to 31 December	2018	2019	2020F	2021F	2022F
Revenue (Rmbm)	10,585	12,042	14,190	17,028	20,434
YoY (%)	14.5	13.8	17.8	20.0	20.0
Net profit (Rmbm)	716	755	925	1,164	1,375
YoY (%)	26.6	5.5	22.5	25.9	18.2
Fully Diluted EPS (Rmb)	0.26	0.28	0.34	0.43	0.51
YoY (%)	19.4	9.9	21.2	25.9	18.0
P/E(x)	32.6	30.1	25.3	18.5	15.6
DPS (HK\$)	0.02	0.02	0.02	0.03	0.04
Dividend yield (%)	0.2	0.2	0.2	0.3	0.4
P/B (x)	3.8	3.5	3.2	2.5	2.2
ROAE (%)	12.9	12.1	13.4	14.7	15.1
Net debt/equity (%)	(16.1)	(12.3)	(11.5)	(11.2)	(10.8)

Source: Bloomberg, CCBIS estimates

Outperform (maintained)

Current price:

HK\$9.55
(as at 20 Jan 2021)

Target:

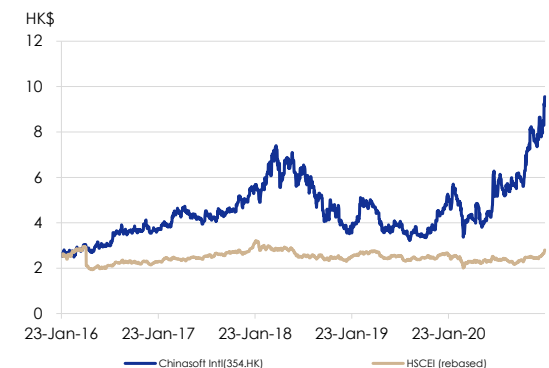
▶ **HK\$12.20**
(up from HK\$7.95)

Trading data

52-week range	HK\$ 9.90 – 3.30
Market capitalization (m)	HK\$ 25,733/US\$3,308
Shares outstanding (m)	2,695
Free float (%)	80
3M average daily T/O (m share)	14.7
3M average daily T/O (US\$m)	8.4
Expected return (%) – 12 month	27.7

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI



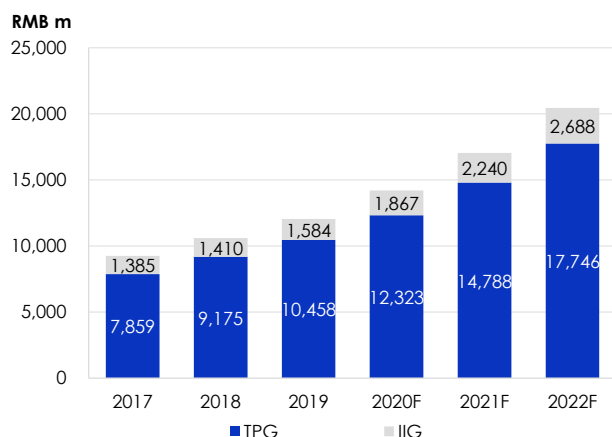
Source: Bloomberg

Stock performance

Performance over	1M	3M	12M
Absolute	22	64	85
Relative (%) to HSCEI	8	46	78

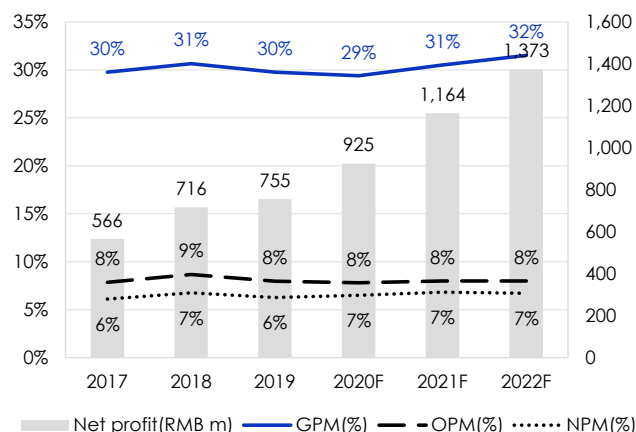
Source: Bloomberg

Chinasoft – revenue mix (RMB m)



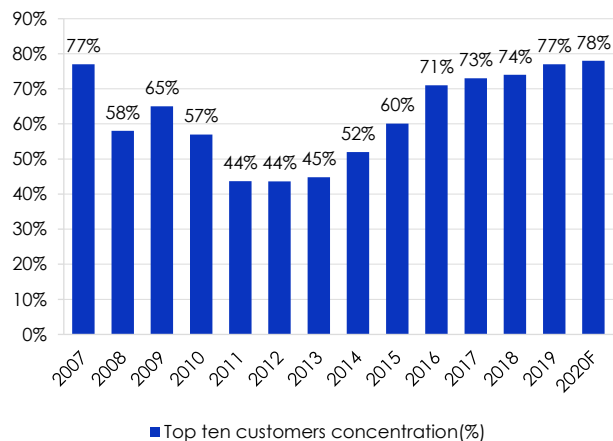
Source: Company data, CCBIS estimates

Chinasoft – net income (RMB m) and margin ratios



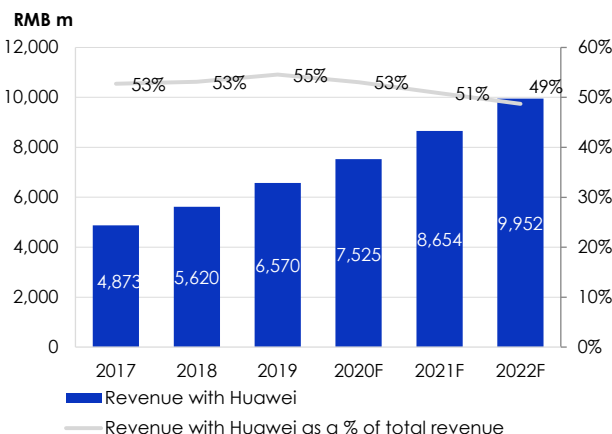
Source: Company data, CCBIS estimates

Chinasoft – top-10 customers by revenue contribution (%)



Source: Company data, CCBIS estimates

Chinasoft – revenue from Huawei



Source: Company data, CCBIS estimates

Chinasoft International – earnings revisions

Profit and loss	New forecast			Previous forecast			Change (%)		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
RMB m									
Revenue	14,190	17,028	20,434	14,419	16,906	19,529	-1.6	0.7	4.6
Gross profit	4,170	5,194	6,437	4,312	5,072	5,859	-3.3	2.4	9.9
Opex	-3,061	-3,831	-4,802	-3,186	-3,753	-4,296	-3.9	2.1	11.8
Operating profit	1,110	1,362	1,635	1,126	1,319	1,562	-1.4	3.3	4.6
Net profit	925	1,164	1,373	898	1,071	1,281	3.0	8.6	7.2
%									
Gross margin	29.4	30.5	31.5	29.9	30.0	30.0	(0.5)	0.5	1.5
OPEX to sales	-21.6	-22.5	-23.5	-22.1	-22.2	-22.0	0.5	(0.3)	(1.5)
OPM	7.8	8.0	8.0	7.8	7.8	8.0	0.0	0.2	0.0
Net margin	6.5	6.8	6.7	6.2	6.3	6.6	0.3	0.5	0.2

Source: CCBIS estimates

Software and AI sector peer comparison

Company	Stock code	CCBIS rating [#]	Share price* (local)	Market cap (US\$m)	P/E (x)			EPS growth(%)			P/S (x)		
					2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
HK / A share - listed													
Hikvision	002415 CH	O	60.40	87,282	42	34	29	7	22	20	9	8	6
Kingsoft Office	688111 CH	NR	460.80	32,855	255	172	123	108	48	40	85	57	41
Yonyou	600588 CH	O	45.31	22,921	181	136	107	(25)	33	27	16	14	11
Goldon Co	002410 CH	NR	90.43	16,584	247	154	109	74	61	41	26	21	17
iFlytek	002230 CH	O	47.07	16,196	89	69	51	41	29	36	8	6	5
Hundsun	600570 CH	NR	98.80	15,954	83	67	52	0	24	28	23	19	16
Kingdee	268 HK	O	32.35	14,467	N/A	684	291	(121)	(315)	135	27	22	17
Ming Yuan	909 HK	NR	56.50	14,046	273	172	114	N/A	59	51	52	36	25
Dahua	002236 CH	O	24.16	11,193	19	16	14	26	13	20	3	2	2
Kingsoft Corp	3888 HK	O	62.45	11,059	16	59	45	8,000	(73)	32	13	10	8
Youzan	8083 HK	O	3.98	8,862	N/A	N/A	N/A	(20)	(20)	(6)	30	20	14
Youzan - proportionate	8083 HK	O	3.98	8,862	N/A	N/A	N/A	(20)	(20)	(6)	59	39	26
Weimob	2013 HK	O	25.65	7,530	N/A	278	121	(144)	(363)	130	22	14	11
TravelSky	696 HK	NR	18.78	7,089	73	21	16	(73)	251	29	8	6	5
Shiji info	002153 CH	NR	29.92	4,957	116	73	57	(38)	58	29	9	8	7
Aisino	600271 CH	NR	12.78	3,662	18	15	13	(24)	19	17	1	1	1
Chinasoft Intl	354 HK	O	9.55	3,579	25	19	16	21	26	18	2	1	1
Wangsu	300017 CH	NR	6.83	2,591	56	43	29	(52)	30	47	3	2	2
Neusoft Corp	600718 CH	NR	9.77	1,877	63	36	N/A	41	74	(100)	1	1	1
YGsoft Inc	002063 CH	NR	8.64	1,473	36	33	31	14	8	8	6	5	4
Teamsun	600410 CH	NR	8.23	1,399	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Digital China	861 HK	NR	6.25	1,348	20	14	14	188	41	1	1	0	0
Chanjet	1588 HK	NR	21.80	611	44	44	45	97	(1)	(2)	8	7	5
Sinosoft	1297 HK	NR	1.66	262	8	9	8	(25)	(11)	12	3	3	2
Average					87	102	64	367	(0)	26	18	13	10
US listed													
Microsoft	MSFT US	NR	224.34	1,696,122	33	30	26	19	10	15	12	11	10
Oracle	ORCL US	NR	61.56	181,235	14	13	12	14	7	8	5	5	4
IBM	IBM US	NR	130.08	115,909	15	11	10	(34)	37	9	2	2	2
SAP	SAP US	NR	127.63	156,794	25	26	25	2	(2)	2	5	5	4
Accenture	ACN US	NR	261.67	173,250	32	29	27	8	9	9	4	4	3
Salesforce	CRM US	NR	223.44	204,547	48	63	53	60	(23)	19	12	10	8
Shopify	SHOP US	NR	1,200.98	147,502	323	320	250	2,036	1	28	52	39	29
Workday Inc	WDAY US	NR	226.79	54,430	84	78	63	51	7	25	15	13	11
Average					72	71	58	269	6	14	13	11	9

[#] CCBIS ratings: O = Outperform, N = Neutral, U = Underperform, NR = Not Rated

* Price as at close on 20 Jan 2021 (local currency)

Source: Bloomberg, CCBIS estimates

Chinasoft International – P&L assumptions

RMB m	FY17	FY18	FY19	FY20F	FY21F	FY22F	1H19	2H19	1H20	2H20F
Revenue breakdown										
TPG business	7,859	9,175	10,458	12,323	14,788	17,746	4,748	5,710	5,186	7,137
IIG business	1,385	1,410	1,584	1,867	2,240	2,688	790	794	874	992
Total revenue	9,244	10,585	12,042	14,190	17,028	20,434	5,538	6,504	6,060	8,130
YoY (%)	36	15	14	18	20	20	15	13	9	25
Cost of revenues	-6,493	-7,340	-8,459	-10,020	-11,834	-13,997	-3,971	-4,487	-4,410	-5,609
Gross profit	2,750	3,245	3,583	4,170	5,194	6,437	1,567	2,016	1,650	2,520
Gross profit margin (%)	30	31	30	29	31	32	28	31	27	31
Sales and marketing expense	-370	-496	-618	-701	-851	-1,124	-266	-352	-294	-406
General & administrative expense	-1,086	-1,091	-1,196	-1,303	-1,618	-2,043	-833	-363	-896	-406
Research and development	-567	-739	-809	-1,057	-1,362	-1,635	0	-809	0	-1,057
Total operating expense	-2,023	-2,326	-2,622	-3,061	-3,831	-4,802	-1,099	-1,524	-1,191	-1,870
Operating profit	727	919	961	1,110	1,362	1,635	468	493	459	650
Operating profit margin (%)	8	9	8	8	8	8	8	8	8	8
Other income, gains and losses	96	64	143	199	200	180	60	82	119	80
Allowance for doubtful debts	-26	0	0	0	0	0	0	0	0	0
Other expenses	-82	-68	-59	-52	-60	-60	-30	-29	-22	-30
Finance costs	-103	-118	-166	-180	-180	-200	-85	-81	-90	-90
Share of results of associates	20	12	0	0	0	0	-8	8	0	0
Profit before tax	633	760	799	1,024	1,267	1,495	390	409	443	580
Taxation	-71	-44	-42	-103	-101	-120	-31	-11	-45	-58
Effective tax rate (%)	-11	-6	-5	-10	-8	-8	-8	-3	-10	-10
Net income	561	716	757	920	1,166	1,375	359	398	398	522
- Minority interests	-4	0	2	-4	2	2	-4	6	-4	0
Net income attributable to common shareholders	566	716	755	925	1,164	1,373	363	392	402	522
YoY (%)	28	27	5	22	26	18	1	10	11	33
Net profit margin (%)	6	7	6	7	7	7	7	6	7	6
EPS diluted (HK\$)	0.26	0.29	0.32	0.38	0.52	0.61	0.15	0.16	0.16	0.21
Diluted share volume (m)	2,621	2,779	2,666	2,695	2,695	2,695	2,711	2,666	2,695	2,695
Key ratios (%)										
EPS growth	17	13	9	19	37	18	3	12	9	30
Gross profit margin	30	31	30	29	31	32	28	31	27	31
Operating profit margin	8	9	8	8	8	8	8	8	8	8
Net profit margin	6	7	6	7	7	7	7	6	7	6
ROAE	12	13	12	13	15	15	N/A	N/A	N/A	N/A
Net debt-to-equity	-21	-16	-12	-12	-11	-11	N/A	N/A	N/A	N/A

Source: Company data, CCBIS estimates

Chinasoft Intl. | 354 HK – financial summary

Profit and loss

FYE 31 December (Rmb m)	2018	2019	2020F	2021F	2022F
TPG business	9,175	10,458	12,323	14,788	17,746
IIG business	1,410	1,584	1,867	2,240	2,688
Revenue	10,585	12,042	14,190	17,028	20,434
COGS	(7,340)	(8,459)	(10,020)	(11,834)	(13,997)
Gross profit	3,245	3,583	4,170	5,194	6,437
Other income	–	–	–	–	–
Operating expenses	(2,326)	(2,622)	(3,061)	(3,831)	(4,802)
EBIT	919	961	1,110	1,362	1,635
Net financial inc(exp)	(118)	(166)	(180)	(180)	(200)
JV & associate	–	–	–	–	–
Others	(40)	4	94	85	60
Forex	–	–	–	–	–
Profit before tax	760	799	1,024	1,267	1,495
Tax	(44)	(42)	(103)	(101)	(120)
Total profit	716	757	920	1,166	1,375
Extraordinary items	–	–	–	–	–
Minority interest	(0)	(2)	4	(2)	–
Net profit attrib to shareholder	716	755	925	1,164	1,375
Core profit					
Reported EPS (HK\$)	–	–	–	–	–
Diluted EPS (Rmb)	0.26	0.28	0.34	0.43	0.51
Core EPS (Rmb)	–	–	–	–	–
Dividend (Rmb)(m)	52	48	55	70	82
DPS (Rmb)	0.02	0.02	0.02	0.03	0.03

Cash flow

FYE 31 December (Rmb m)	2018	2019	2020F	2021F	2022F
Profit before tax	760	799	1,024	1,267	1,495
Amort. & depr.	192	197	213	229	244
Net financial charge adj.	118	166	180	180	200
Non-cash items adj.	67	93	–	–	–
Change in working capital	(743)	(516)	(825)	(1,029)	(1,230)
Tax paid	(82)	(84)	(103)	(101)	(120)
Other	(152)	–	–	–	–
Operating cash flow	161	656	488	546	589
Disposal of fixed assets	–	–	–	–	–
Capex	(151)	(105)	(160)	(160)	(160)
Investment	–	(85)	–	–	–
Net interest rec.(paid)	–	27	–	–	–
Other	(16)	(62)	(50)	(50)	(50)
Investment cash flow	(167)	(224)	(210)	(210)	(210)
Change in borrowings	984	52	–	–	–
Equity issues	109	–	–	–	–
Amount due	–	–	–	–	–
Dividend paid	(37)	(48)	(48)	(55)	(70)
Other	(203)	(259)	(180)	(180)	(200)
Financing cash flow	853	(255)	(228)	(235)	(270)
Change in cash flow	847	176	50	100	110
Cash & equivalents, begin	1,785	2,646	2,526	2,576	2,676
Forex	14	(1)	–	–	–
Cash & equivalents, ending	2,646	2,821	2,576	2,676	2,786
Free cash flow	11	551	328	386	429

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 December (Rmb m)	2018	2019	2020F	2021F	2022F
Cash & equivalents	2,646	2,526	2,576	2,676	2,786
Pledge dep., restricted cash	19	13	13	13	13
Receivables	5,495	5,605	7,033	8,423	10,092
Assets held for sale	–	–	–	–	–
Inventory	64	54	54	54	54
Other current assets	–	–	–	–	–
Total current assets	8,225	8,198	9,676	11,167	12,945
Property, plant & equip.	838	802	813	813	803
Intangible assets	148	127	113	95	71
JV & associate	–	–	–	–	–
Other non-current assets	1,278	1,617	1,617	1,617	1,617
Total non-current assets	2,264	2,547	2,544	2,525	2,491
Total assets	10,488	10,745	12,220	13,692	15,436
Short-term borrowings	1,676	1,523	1,523	1,523	1,523
Trade & bill payable	1,542	1,251	1,853	2,215	2,654
Other current liabilities	508	375	375	375	375
Total current liabilities	3,726	3,150	3,752	4,114	4,552
Long-term borrowings	–	200	200	200	200
Other non-current liabilities	731	862	862	862	862
Total non-current liabilities	731	1,062	1,062	1,062	1,062
Total liabilities	4,457	4,211	4,813	5,175	5,614
Share capital	3,095	3,262	3,262	3,262	3,262
Reserves and retained profits	2,872	3,206	4,083	5,191	6,494
Shareholders' equity	5,967	6,468	7,344	8,453	9,756
Minority interest	65	66	62	64	66
Total equity	6,032	6,534	7,406	8,517	9,822
Total equity and liabilities	10,488	10,745	12,220	13,692	15,436

Ratios

FYE 31 December	2018	2019	2020F	2021F	2022F
Growth (%)					
Revenue	14.5	13.8	17.8	20.0	20.0
EBITDA	22.7	4.3	14.2	20.3	18.1
EBIT	26.3	4.6	15.5	22.8	20.0
Net profit	26.6	5.5	22.5	25.9	18.2
Core net profit	–	–	–	–	–
Profitability (%)					
Gross margin	30.7	29.8	29.4	30.5	31.5
EBITDA margin	10.5	9.6	9.3	9.3	9.2
EBIT margin	8.7	8.0	7.8	8.0	8.0
Net margin	6.8	6.3	6.5	6.8	6.7
Core net margin	–	–	–	–	–
Tax rate	5.8	5.3	10.1	8.0	8.0
Efficiency (days)					
Inventory turnover days	2	3	2	2	1
Trade receivables days	79	90	86	80	80
Trade payable days	78	60	57	63	63
Returns & leverage (%)					
ROAA	7.4	7.1	8.1	9.0	9.4
ROAE	12.9	12.1	13.4	14.7	15.1
Net debt (cash)/equity	(16.1)	(12.3)	(11.5)	(11.2)	(10.8)
Liquidity (x)					
Current ratio	2.2	2.6	2.6	2.7	2.8
Quick ratio	2.2	2.6	2.6	2.7	2.8

Rating definitions:**Outperform (O) – expected return > 10% over the next twelve months****Neutral (N) – expected return between -10% and 10% over the next twelve months****Underperform (U) – expected return < -10% over the next twelve months****Analyst certification:**

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CCB International Securities Limited
12/F, CCB Tower, 3 Connaught Road, Central, Hong Kong
Tel: (852) 3911 8000 / Fax: (852) 2537 0097