

Asian Daily

Chinasoft (0354.HK)

Upgrade on better visibility of future growth, rerate supported by potential CDR issuance

Upgrade to **OUTPERFORM**

Previous Rating: **NEUTRAL**

Target price (HK\$): **12.20**

Previous target price (HK\$): 7.30

- We upgrade Chinasoft to **OUTPERFORM** from **Neutral** given Huawei ban impact manageable with upside from Huawei's accelerating R&D for "8+n" strategy, growth from new KA customers, e.g., BAT, Honor, etc., and fast growing new business with increasing rev share.
- We see market likely priced in worst timing of Huawei impact, and further upside supported by Huawei's growth in cloud/non-smartphone business incl. auto. Chinasoft (CSI) headcount increase of 15%+ during 2020 also demonstrates its business resilience, while mgmt expects 10-15% YoY growth from Huawei rev contribution.
- We see CSI's proposed CDR listing, with a cap of 15% of Co.'s total enlarged shares post issuance, will likely drive re-rate of the stock aligned with global/China IT service peers average. We see the proceeds will be used for cloud/other business expansion, well-aligned to support its emerging business growth.
- We lift 2020-22E EPS by 1%/4%/8% to factor in GM/mix improvement. Our new TP of HK\$12.20 (from HK\$7.30) is based on global/China IT service peers' average PE of 18.4x and roll-over to 2022E EPS.

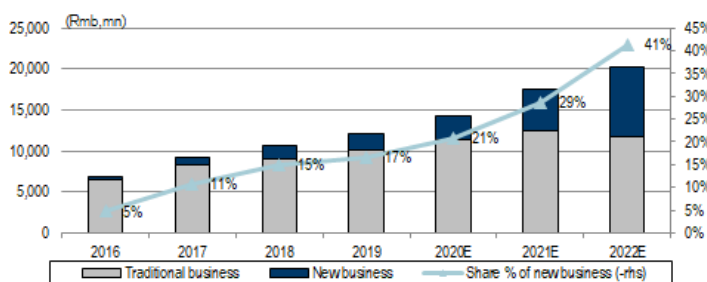
Price (04-Feb-21, HK\$)	9.37	Est. pot. % chg. to TP	30.2	
Mkt cap (HK\$/US\$ mn)	27,217 / 3,511	Blue sky scenario (HK\$)	16.3	
Number of shares (mn)	2,905	Grey sky scenario (HK\$)	11.7	
Free float (%)	84.2	Performance	1M 3M 12M	
52-wk range (HK\$)	10.40 - 3.37	Absolute (%)	13.3 48.7 92.0	
ADTO-6M (US\$ mn)	24.7	Relative (%)	3.5 36.6 47.0	
Year	12/19A	12/20E	12/21E	12/22E
Revenue (Rmb mn)	12,041.9	14,336.2	17,581.0	20,175.4
EBITDA (Rmb mn)	1,093.5	1,299.9	1,671.2	2,033.3
EBIT (Rmb mn)	901.8	1,077.0	1,440.9	1,792.2
Net profit (Rmb mn)	780.1	977.8	1,271.6	1,610.4
EPS (CS adj.) (Rmb)	0.29	0.34	0.44	0.55
Chg. from prev. EPS (%)	n.a.	0.8	3.8	8.2
Consensus EPS (Rmb)	n.a.	0.34	0.42	0.52
EPS growth (%)	4.9	15.1	30.1	26.6
P/E (x)	26.7	23.2	17.8	14.1
Dividend yield (%)	0.3	0.4	0.4	0.4
EV/EBITDA (x)	20.1	16.1	12.1	9.5
P/B (x)	3.22	3.1	2.79	2.47
ROE (%)	12.5	14.2	16.1	17.5
Net debt/equity (%)	(10.1)	(23.2)	(28.1)	(34.4)

Source: Company data, Refinitiv, Credit Suisse estimates

Huawei's new business and Honor separation supportive

We see the Huawei impact more manageable despite US sanction, as Huawei is accelerating its R&D for its "8+n" devices, as well as its auto business. Chinasoft has been involved in the development of Huawei's HMS system, including R&D for both hardware and software solutions. The new Honor has potential to reach US\$100 mn contribution as a future KA customer. We expect Honor to expand its R&D and operating teams, making up some of Huawei's reduced contribution to CSI. We believe Huawei's R&D expenses are front-loaded for longer-term revenue contribution. As addressed in our 2021 Greater China Tech/Internet Conference, CSI employees have increased by 15%+ during 2020 to meet the demand from key clients such as Huawei. Mgmt still expects Huawei contribution of stable growth at 10-15% YoY, and it can account for 60% of Huawei's IT outsourcing budget.

Figure 1: New business revenue share to reach 41% in 2022



Source: Company data, Credit Suisse estimates

Fast-growing new business to account for a larger rev share

We estimate the emerging business to grow at 50-60% YoY over 2019-21, along with the company's new initiatives of strategic co-operation with local governments at Suzhou (for auto network) and Shenzhen (as a new cloud headquarter). Cloud migration was not affected by the Huawei sanction, as Intel was granted license to supply CPU to Huawei by the US government. We also expect Ping An

and BAT contribution of fast growth of 30-60% YoY, and other KA customers such as Bytedance, Xiaomi, and PDD could reach US\$100 mn scale in 3-5 years. We expect revenue share from new business to increase from 17% in 2019 to 41% in 2022. Management expects 2021 NI could go back to near 30% YoY growth, similar to 2017/18 level, and sees the core business GM improving 0.2-0.5 pp YoY. We expect increasing revenue share from the emerging business (~40% GM) should drive gradual improvement in the blended GM.

Catalysts. Near-term catalysts include new developments in Huawei ban, signing new KA customers, updates from CDR issuance, etc.

Upgrade to **OUTPERFORM**

On 26-Jan-2021, CSI BoD approved the issue/listing of CDRs on an exchange platform in PRC. The potential CDR issuance of no more than 15% of the enlarged shares of CSI, will likely drive future stock rerating. We lift 2020-22E EPS by 1%/4%/8% each to factor in GM/mix improvement, revisit our valuation comp with new a TP of HK\$12.20 (from HK\$7.30) based on global and Chinese IT service peers' average PE of 18.4x, and roll over to 2022E EPS given better visibility of future growth.

Figure 2: Global and Chinese IT service peers comp table

IT Service	Ticker	Mkt cap (US\$Bn)	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022			
Accenture	ACN.N	184	33	30	27	3.7	3.4	3.1	28%	27%	27%	32%	32%	32%	11%	11%	11%	3%	8%	1%	10%	11%	
IBM	IBM.N	107	14	11	9	1.5	1.4	1.4	37%	49%	48%	49%	50%	50%	11%	13%	15%	6%	2%	3%	-33%	30%	18%
Infosys	INFY.BO	74	33	28	23	5.8	5.4	4.8	25%	31%	37%	30%	35%	35%	18%	19%	20%	8%	8%	14%	5%	21%	21%
Wipro	WIPR.BO	32	25	22	20	3.7	3.6	3.6	17%	25%	22%	29%	32%	32%	15%	17%	17%	3%	-2%	8%	11%	15%	10%
DHC Software	002365.SZ	4	29	28	24	2.6	2.1	1.9	5%	5%	5%	28%	28%	28%	6%	6%	7%	6%	26%	11%	24%	16%	3%
Tajj	002368.SZ	2	31	23	17	1.7	1.3	1.1	12%	14%	17%	24%	24%	24%	5%	6%	6%	22%	33%	22%	33%	36%	37%
Chinasoft	0354.HK	4	26	19	16	1.8	1.4	1.2	13%	15%	15%	30%	30%	30%	7%	7%	7%	19%	29%	13%	14%	33%	19%
Digital China	0861.HK	1	18	15	11	0.9	0.4	0.3	5%	6%	7%	18%	18%	18%	3%	3%	3%	20%	19%	20%	78%	20%	31%
China average		25.9	20.5	17.1	1.6	1.3	1.1	9%	10%	11%	23%	25%	25%	5%	5%	6%	17%	27%	16%	40%	26%	23%	19%
Total average		28.2	21.5	18.4	2.7	2.4	2.2	18%	22%	22%	30%	31%	31%	9%	10%	11%	10%	10%	12%	18%	20%	19%	19%

Source: IBES, Credit Suisse estimates

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Chinasoft (0354.HK)

Method: Our target price of HK\$12.20 for Chinasoft International is based on global and Chinese peers' average of 18.4x and 2022E EPS (earnings per share). Our OUTPERFORM rating is based on Chinasoft International's strong growth in IT services for enterprise clients including tech companies and banks, together with stabilised and improving margins. We also see largest customer risk likely priced in with further upside. The company's CDR listing could be supportive of a potential rerate.

Risk: Risks to our target price of HK\$12.20 and OUTPERFORM rating for Chinasoft International include: (1) weaker-than-expected demand in OSG/PSG, margin downsides from wage changes or client concentration risk, (2) weaker smart cloud growth, (3) volatility from key client business adjustment, (4) higher-than-expected opex for investment in R&D or new businesses, and (5) EPS dilution from an equity placement.

Companies Mentioned (Price as of 04-Feb-2021)

ByteDance (Unlisted)

Chinasoft (0354.HK, HK\$9.37, OUTPERFORM[V], TP HK\$12.2)

Honor (Unlisted)

Pinduoduo Inc (PDD.OQ, \$193.11)

Ping An (601318.SS, Rmb79.62)

Xiaomi (1810.HK, HK\$27.55)

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3-Year Price and Rating History for Chinasoft (0354.HK)

0354.HK	Closing Price	Target Price	
Date	(HK\$)	(HK\$)	Rating
05-Feb-18	5.41	6.90	O
28-Mar-18	6.93	8.10	
02-May-18	6.16		*
17-Aug-18	5.53	8.10	O
04-Jan-19	3.55	4.80	
21-Mar-19	4.77	5.60	
12-Aug-19	3.57	5.20	
26-Mar-20	4.10	5.40	
02-Sep-20	5.72	5.80	N
18-Dec-20	7.50	7.30	



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