

Asian Daily

Chinasoft (0354.HK)

Growth outlook intact, but with short term GM pressure

Maintain OUTPERFORM

Previous Rating: OUTPERFORM

Target price (HK\$): 9.70

Previous target price (HK\$): 12.90

- Chinasoft reported FY21 results—top line/bottom line were in-line with CSe. However, GM declined 4.8 pp YoY to 26.0% in 2H21, 5.1 pp below CSe. OP declined 31% YoY to Rmb470mn, missed CSe by 37%, but offset by government subsidies, disposal gain of its subsidiary Catapult and other income.
- Sales to Huawei grew 20% YoY, accounting for 50-55% of revenue mix in 2021, with likely continued teens growth rate in 2022. Emerging business (cloud, big data, jointforce, etc.) will likely grow at 60% YoY.
- Management maintains its long-term targets of Rmb30bn revenue in 2023 and US\$10bn revenue in 2026. Specifically in 2022, company expects 20-30% in revenue growth and 15-20% growth in profit, while expecting to face GM pressure primarily on client strategy adaptation and rising labour cost.
- We lower our 2022/23E EPS by 6%/8% to reflect higher gross margin pressure. Introduce 2024E. Our new TP of HK\$9.70 (from HK\$12.90) is based on 18.1x P/E multiple (1 SD of three-year historical average, inline with Huawei ITS peers, from 22.6x) to 2022E sales. Maintain OUTPERFORM on intact long-term growth.

Results recap: Chinasoft (CSI) reported FY21 revenue/NI of Rmb18.4bn/Rmb1.14bn, +31%/19% YoY, +1%/-1%, vs CSe. The 2H21 revenue/NI of Rmb10.1bn/Rmb619mn, +25%/12% YoY, +2%/-2%, vs CSe. The 2H21 revenue/NI of Rmb10.1bn/Rmb619mn, +25%/12% YoY, +2%/-2%, vs CSe. The 2H21 GM declined 4.8 pp YoY to 26.0%, 5.1 pp below CSe. OP declined 31% YoY to Rmb470mn, missed CSe by 37%, but offset by government subsidies, disposal gain of its subsidiary Catapult and other income.

TPG grew 34% YoY to Rmb16.6bn (90% of revenue), IIG increased 4% YoY to Rmb1.8bn (10% of mix), TPG growth was higher than prior CSe, but IIG below. TPG segment margins declined 2 pp YoY to 7.3%, while IIG improved 1 pp YoY to 8.3%. ITO business reached 21% YoY to Rmb13bn (71% mix, vs 77% in 2020, or 74% in 1H21). Cloud intelligence service business grew 61% YoY to Rmb5.3bn (29% of mix, vs 23% in 2020 or 26% in 1H21).

Key takeaways from AIC and management call:

(1) 2023 target intact: Management previously set the long-term targets – Rmb30bn revenue in 2023 and US\$10bn revenue in 2026, remain on track. In 2022, the company expects 20-30% in revenue growth and 15-20% growth in profit. Huawei remains a key customer, with over 50-55% contribution and will likely grow 15-20% YoY in 2022. Emerging business will grow at 60% YoY.

(2) GM pressure persist short term: Management attributed 2H21 GM decline of 5 pp YoY to 26% to (1) expansion of share at the key customers, including gaining traction in the Harmony and auto business at Huawei; (2) labour cost increase; and (3) normalising social security provident fund in 2021. The company will target to gradually improve GM, but expect to be at similar level in 2022, as it continues to sacrificed short-term profits to seize first mover advantage and market share with major clients, and increase the reserve of mid-to-high end technical talents, as well as face macro challenges.

(3) Customer diversification: While key customer Huawei is still expected to grow at teens growth rate YoY (from 20% YoY in 2021,

Price (30-Mar-22, HK\$)	6.99	Est. pot. % chg. to TP	38.8		
Mkt cap (HK\$/US\$ mn)	21,626 / 2,763	Blue sky scenario (HK\$)	11.1		
Number of shares (mn)	3,094	Grey sky scenario (HK\$)	7.4		
Free float (%)	87.3	Performance	1M	3M	12M
52-wk range (HK\$)	16.02 - 5.45	Absolute (%)	(1.5)	(29.0)	(12.0)
ADTO-6M (US\$ mn)	22.2	Relative (%)	4.3	(18.7)	19.9
Year	12/21A	12/22E	12/23E	12/24E	
Revenue (Rmb mn)	18,398.1	23,421.4	29,862.6	36,514.6	
EBITDA (Rmb mn)	1,092.4	1,349.9	1,718.6	2,185.3	
EBIT (Rmb mn)	908.2	1,095.6	1,457.2	1,910.8	
Net profit (Rmb mn)	1,136.9	1,308.9	1,634.4	2,043.7	
EPS (CS adj.) (Rmb)	0.38	0.44	0.55	0.69	
Chg. from prev. EPS (%)	n.a.	(6.1)	(7.8)	n.a.	
Consensus EPS (Rmb)	n.a.	0.49	0.62		
EPS growth (%)	7.6	15.1	24.9	25.0	
P/E (x)	14.8	12.8	10.3	8.2	
Dividend yield (%)	0.5	0.5	0.5	0.5	
EV/EBITDA (x)	13.0	9.9	7.6	5.7	
P/B (x)	1.45	1.31	1.17	1.03	
ROE (%)	11.2	10.7	12.0	13.3	
Net debt/equity (%)	(29.1)	(32.7)	(31.6)	(31.8)	

Source: Company data, Refinitiv, Credit Suisse estimates

reaching Rmb9.8bn), other customers are ramping quickly for CSI. According to management, businesses from Ping An, Baidu and Tencent are a customer group that could reach US\$100mn in scale each and are growing at 40%+ YoY. Alibaba could increase by 20% this year, approaching US\$100mn this year. Honor was the new customer from last year after spin-off from Huawei, could reach top 3 very quickly (top 10 in 2021).

(4) Upsell and cross sell opportunities with SaaS players: CSI had entered into strategic agreement with SaaS industry players, such as Yonyou and Kingdee, to leverage its implementation capability. The scale of collaboration is relatively small at Rmb100mn, but management noted the potential.

(5) SZ Kai Hong a strategic move to Harmony OS business. The entity was established in 2021, with an initial stake of 51% from Chinasoft, focusing on building a customised OS based on the OpenHarmony framework for IoT. Given strategic investors, such as Shenzhen Capital and Huawei, management sees incremental opportunities for it to participate in government projects, as well as strengthen the existing customer relationships. The move also likely ensures the competence of the entity in developing OS products.

Figure 1: Estimate changes summary

	New			Prior			Var %		
(Rmb.mn)	2022E	2023E	2023E	2022E	2023E	2023E	2022E	2023E	2023E
Revenue	23,421	29,863	36,515	23,162	29,473	29,473	1.1%	1.3%	23.9%
GP	6,181	7,828	9,660	6,855	8,746	8,746	9.8%	10.5%	10.8%
OP	1,096	1,457	1,911	1,520	1,957	1,957	-27.9%	-25.6%	-2.4%
Tax	(132)	(164)	(204)	(135)	(173)	(173)	-2.0%	-5.2%	18.0%
NI - GAAP	1,309	1,634	2,044	1,452	1,844	1,844	-9.8%	-11.4%	10.8%
EPS - GAAP	0.44	0.55	0.69	0.47	0.60	0.60	-6.1%	-7.8%	15.3%
Margins (%)									
GM	26.4%	26.2%	26.5%	29.6%	29.7%	29.7%	-3.2%	-3.5%	-3.1%
OPM	4.7%	4.9%	5.2%	6.6%	6.6%	6.6%	-1.9%	-1.8%	-1.4%
NM	5.6%	5.5%	5.6%	6.3%	6.3%	6.3%	0.7%	0.8%	0.7%

Source: 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\$9.70 for Chinasoft International is based on 18.1x (1SD of 3-year historical average, in line with Huawei ITS peers) 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\$9.70 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 30-Mar-2022)

Chinasoft (0354.HK, HK\$6.99, OUTPERFORM[V], TP HK\$9.7)

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

0354.HK	Closing Price	Target Price	
Date	(HK\$)	(HK\$)	Rating
12-Aug-19	3.57	5.20	O
26-Mar-20	4.10	5.40	
02-Sep-20	5.72	5.80	N
18-Dec-20	7.50	7.30	
05-Feb-21	9.99	12.20	O
17-Jun-21	12.60	15.50	
24-Aug-21	13.56	15.60	
10-Jan-22	8.94	12.90	



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