

Huawei's' cloud and AI partnership to drive growth

Revenue recovers modestly, GPM to stabilize

Action: Maintain Buy with new TP of HKD5.6, implying ~17% upside

As one of the largest IT services providers in China and a key partner to Huawei (unlisted), Chinasoft International's business performance was under pressure in 2023, which in our view was due to IT spending curbs by the government and enterprise segments, fierce competition, as well as slower order growth from Huawei. Looking forward, we expect the company's cornerstone business – IT outsourcing services – to recover from the trough with 3% y-y revenue growth in FY24F (-20% in FY23), driven by solid demand from emerging sectors such as telecom. Meanwhile, Huawei's cloud and AI business expansion may lead to accelerated growth in the company's emerging business segment. We revise down our FY24-25F revenue by 19.7%-19.6% and earnings by 32.0%-35.7% to reflect the slower IT spending of most enterprise segments, and estimate revenue/earnings CAGRs of 14%/19% over FY23-26F. We retain Buy with a lower TP of HKD5.6 (HKD5.8 previously), based on 14x FY25F EPS of CNY0.36, which is lower than its historical median P/E range of 16x. The stock is currently trading at 12x FY25F EPS.

Huawei's cornerstone business may take time to recover, but cloud, AI, and harmonious OS could offset the weakness in traditional outsourcing services

In the past few years, Huawei has been proactively transforming itself to expand into new business frontiers such as cloud, auto and AI, and to mitigate the impact of the US government's sanctions on its smartphone/telecom business. While the core business still faces challenges, we believe Chinasoft will leverage its strong partnership with Huawei and ride the new digital wave. Specifically, for FY24F, we project the company's AIGC business line (Huawei's Ascend data center operation, large language model, AI integrated machine, previously under the "Joint Force" segment) will record CNY300mn+ revenue (vs <CNY100mn in FY23), and its industry solution revenue based on harmonious OS cloud will more than double from ~CNY300mn to over CNY700mn.

GPM to improve on product mix change, expense control with stable head count

Chinasoft's GPM has stabilized in FY23 (+0.4pp y-y) due to a change in product mix, and we believe the trend should continue as we estimate 8%/23% revenue CAGRs for the IT outsourcing services (<10% GPM) / cloud intelligent (>30% GPM) business over FY23-26F. Meanwhile, we think the company's headcount will remain stable in FY24F, leading to continued earnings uptick on the back of effective expense control.

Year-end 31 Dec	FY23	FY24F		FY25F		FY26F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	17,117	23,097	18,551	27,119	21,810	0	25,653
Reported net profit (mn)	713	1,228	835	1,579	1,015	0	1,199
Normalised net profit (mn)	713	1,228	835	1,579	1,015	0	1,199
FD normalised EPS	25.06c	39.42c	28.83c	9.82c	34.44c		40.01c
FD norm. EPS growth (%)	-0.5	24.5	15.1	-75.1	19.5		16.2
FD normalised P/E (x)	15.9	–	13.7	–	11.8	–	10.0
EV/EBITDA (x)	8.8	–	7.7	–	6.6	–	5.6
Price/book (x)	1.0	–	0.9	–	0.9	–	0.9
Dividend yield (%)	1.5	–	2.0	–	2.7	–	3.7
ROE (%)	6.0	9.0	6.9	10.6	7.8		8.6
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 5.80 **HKD 5.60**

Closing price 8 April 2024 **HKD 4.77**

Implied upside **+17.4%**

Market Cap (USD mn) 1,770.8
ADT (USD mn) 16.2

Relative performance chart



Source: LSEG, Nomura

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Key data on Chinasoft International

Performance

(%)	1M	3M	12M		
Absolute (HKD)	-4.2	-8.8	-8.4	M cap (USDmn)	1,770.8
Absolute (USD)	-4.3	-9.1	-8.2	Free float (%)	90.7
Rel to Hang Seng Index	-6.5	-11.9	9.3	3-mth ADT (USDmn)	16.2

Income statement (CNYmn)

Year-end 31 Dec	FY22	FY23	FY24F	FY25F	FY26F
Revenue	20,005	17,117	18,551	21,810	25,653
Cost of goods sold	-15,405	-13,114	-14,119	-16,557	-19,448
Gross profit	4,600	4,003	4,431	5,253	6,205
SG&A	-3,870	-3,301	-3,624	-4,294	-5,089
Employee share expense					
Operating profit	731	702	807	960	1,116
EBITDA	1,230	1,139	1,258	1,542	1,803
Depreciation	-445	-387	-401	-532	-637
Amortisation	-55	-50	-50	-50	-50
EBIT	731	702	807	960	1,116
Net interest expense	-113	-203	-186	-170	-153
Associates & JCEs					
Other income	212	235	248	277	310
Earnings before tax	830	734	868	1,067	1,273
Income tax	-71	-21	-34	-52	-75
Net profit after tax	759	713	835	1,014	1,198
Minority interests	1	1	1	1	1
Other items					
Preferred dividends					
Normalised NPAT	759	713	835	1,015	1,199
Extraordinary items					
Reported NPAT	759	713	835	1,015	1,199
Dividends	-165	-171	-242	-345	-468
Transfer to reserves	595	542	593	670	731

Valuations and ratios

Reported P/E (x)	16.3	15.4	13.2	11.4	9.7
Normalised P/E (x)	16.3	15.4	13.2	11.4	9.7
FD normalised P/E (x)	16.9	15.9	13.7	11.8	10.0
Dividend yield (%)	1.3	1.5	2.0	2.7	3.7
Price/cashflow (x)	16.8	—	15.6	29.4	21.3
Price/book (x)	1.1	1.0	0.9	0.9	0.9
EV/EBITDA (x)	7.1	8.8	7.7	6.6	5.6
EV/EBIT (x)	11.9	14.3	12.0	10.6	9.0
Gross margin (%)	23.0	23.4	23.9	24.1	24.2
EBITDA margin (%)	6.2	6.7	6.8	7.1	7.0
EBIT margin (%)	3.7	4.1	4.3	4.4	4.3
Net margin (%)	3.8	4.2	4.5	4.7	4.7
Effective tax rate (%)	8.6	2.9	3.9	4.9	5.9
Dividend payout (%)	21.7	24.0	29.0	34.0	39.0
ROE (%)	6.4	6.0	6.9	7.8	8.6
ROA (pretax %)	6.3	5.6	5.9	6.4	6.8

Growth (%)

Revenue	8.7	-14.4	8.4	17.6	17.6
EBITDA	-12.1	-7.4	10.5	22.5	16.9
Normalised EPS	-36.1	-0.9	15.0	19.4	16.1
Normalised FDEPS	-34.4	-0.5	15.1	19.5	16.2

Source: Company data, Nomura estimates

Cashflow statement (CNYmn)

Year-end 31 Dec	FY22	FY23	FY24F	FY25F	FY26F
EBITDA	1,230	1,139	1,258	1,542	1,803
Change in working capital	-1,064	-1,153	-147	-751	-868
Other operating cashflow	599	-1,320	-378	-383	-375
Cashflow from operations	765	-1,334	733	408	560
Capital expenditure	-287	-287	-287	-287	-287
Free cashflow	478	-1,621	446	120	273
Reduction in investments	0	0	0	0	
Net acquisitions					
Dec in other LT assets	0	0	0	-222	
Inc in other LT liabilities	-155	-58	0	0	0
Adjustments	-363	-53	-114	-114	-114
CF after investing acts	-40	-1,732	332	6	-63
Cash dividends	-80	-165	-171	-242	-345
Equity issue	0	0	0	0	0
Debt issue	173	-200	-200	-200	-200
Convertible debt issue					
Others	-604	879	114	114	336
CF from financial acts	-511	514	-257	-328	-209
Net cashflow	-551	-1,217	75	-322	-272
Beginning cash	5,556	5,005	3,788	3,863	3,541
Ending cash	5,005	3,788	3,863	3,541	3,269
Ending net debt	-3,843	-1,506	-1,781	-1,659	-1,587

Balance sheet (CNYmn)

As at 31 Dec	FY22	FY23	FY24F	FY25F	FY26F
Cash & equivalents	5,005	3,788	3,863	3,541	3,269
Marketable securities					
Accounts receivable	6,157	6,092	6,619	7,804	9,178
Inventories	99	96	114	133	157
Other current assets	2,339	2,969	2,969	2,969	2,969
Total current assets	13,601	12,945	13,565	14,447	15,574
LT investments					
Fixed assets	1,119	1,151	1,189	1,197	1,177
Goodwill	844	844	844	844	844
Other intangible assets	281	336	286	236	186
Other LT assets	1,121	1,792	2,191	2,489	2,711
Total assets	16,965	17,068	18,075	19,213	20,491
Short-term debt					
Accounts payable	2,043	1,663	1,990	2,340	2,748
Other current liabilities	1,510	1,300	1,371	1,473	1,596
Total current liabilities	3,553	2,962	3,360	3,813	4,344
Long-term debt	1,162	2,282	2,082	1,882	1,682
Convertible debt	0	0	0	0	0
Other LT liabilities	114	57	57	57	57
Total liabilities	4,830	5,301	5,499	5,752	6,083
Minority interest					
Preferred stock					
Common stock	137	133	133	133	133
Retained earnings	6,498	7,249	7,842	8,512	9,243
Proposed dividends					
Other equity and reserves	5,500	4,385	4,601	4,817	5,033
Total shareholders' equity	12,135	11,767	12,576	13,461	14,409
Total equity & liabilities	16,965	17,068	18,075	19,213	20,491

Liquidity (x)

Current ratio	3.83	4.37	4.04	3.79	3.59
Interest cover	6.5	3.5	4.3	5.7	7.3

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)	26.11c	25.87c	29.75c	35.52c	41.24c
Norm EPS (CNY)	26.11c	25.87c	29.75c	35.52c	41.24c
FD norm EPS (CNY)	25.18c	25.06c	28.83c	34.44c	40.01c
BVPS (CNY)	4.17	4.05	4.18	4.33	4.49
DPS (CNY)	0.06	0.06	0.08	0.11	0.15

Activity (days)

Days receivable	109.9	130.6	125.4	120.7	120.8
Days inventory	3.1	2.7	2.7	2.7	2.7
Days payable	50.9	51.6	47.3	47.7	47.7
Cash cycle	62.2	81.7	80.8	75.7	75.8

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 HKD5.60 is based on 14x 2025F EPS of CNY0.36. The target multiple we use is slightly lower than its historical average of 16x, while also below our 2023-26F earnings CAGR of 19% for Chinasoft. 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 forecast revisions

We revise down our FY24-25F revenue forecasts by 19.7%-19.6% to reflect the slower IT spending outlook from Huawei and other major internet, finance, multinational customers. We also introduce our FY26F revenue/earnings forecasts, expecting 18%/18% y-y growth. In addition, we cut FY24-25F GPM forecasts by 0.4-0.7pp to reflect further pricing pressure from the government and enterprise segments, while we believe the GPM improvement trend will persist owing to a better product mix. We cut FY24-25F opex ratio forecasts by 0.5-0.7pp to reflect stable headcount growth and a more effective expense control. As a result, our FY24-25F earnings forecasts reduce by 32.0%-35.7%.

Fig. 1: Chinasoft - earnings forecast revisions

(CNY mn)	2021 A	2022 A	2023 A	2024F (NOM)	2025F (NOM)	2026F (NOM)	2023 (OLD)	2024F (OLD)	2025F (OLD)	2023 Diff.	2024F Diff.	2025F Diff.
Revenue	18,398	20,005	17,117	18,551	21,810	25,653	20,295	23,097	27,119	-15.7%	-19.7%	-19.6%
% y-y	30%	9%	-14%	8%	18%	18%	1%	14%	17%			
TPG	16,622	17,930	15,021	16,072	18,804	21,625	18,110	20,645	24,361	-17.1%	-22.2%	-22.8%
% y-y	34%	8%	-16%	7%	17%	15%	1%	14%	18%			
IIG	1,776	2,075	2,096	2,479	3,006	4,028	2,185	2,452	2,758	-4.1%	1.1%	9.0%
% y-y	4%	17%	1%	18%	21%	34%	5%	12%	12%			
COGS	(13,494)	(15,405)	(13,114)	(14,119)	(16,557)	(19,448)	(15,465)	(17,484)	(20,394)	-15.2%	-19.2%	-18.8%
Gross Profit	4,904	4,600	4,003	4,431	5,253	6,205	4,830	5,613	6,726	-17.1%	-21.0%	-21.9%
OPEX	(3,948)	(3,870)	(3,301)	(3,624)	(4,294)	(5,089)	(3,875)	(4,398)	(5,151)	-14.8%	-17.6%	-16.6%
Operating profit	956	731	702	807	960	1,116	955	1,214	1,575	-26.5%	-33.6%	-39.1%
% y-y	-17%	-24%	-4%	15%	19%	16%	31%	27%	30%			
Pretax income	1,252	830	734	868	1,067	1,273	1,073	1,372	1,784	-31.6%	-36.7%	-40.2%
% y-y	21%	-34%	-12%	18%	23%	19%	29%	28%	30%			
Taxes	(115)	(71)	(21)	(34)	(52)	(75)	(103)	(145)	(206)	-79.3%	-76.6%	-74.7%
Minority interests	0	1	1	1	1	1	1	1	1			
Profit to shareholders	1,137	759	713	835	1,015	1,199	971	1,228	1,579	-26.5%	-32.0%	-35.7%
% y-y	19%	-33%	-6%	17%	22%	18%	28%	26%	29%			
Ratio Analysis												
GPM	26.7%	23.0%	23.4%	23.9%	24.1%	24.2%	23.8%	24.3%	24.8%	-0.4pp	-0.4pp	-0.7pp
OPEX	-21.5%	-19.3%	-19.3%	-19.5%	-19.7%	-19.8%	-19.1%	-19.0%	-19.0%	-0.2pp	-0.5pp	-0.7pp
OPM	5.2%	3.7%	4.1%	4.3%	4.4%	4.3%	4.7%	5.3%	5.8%	-0.6pp	-0.9pp	-1.4pp
NPM	6.2%	3.8%	4.2%	4.5%	4.7%	4.7%	4.8%	5.3%	5.8%	-0.6pp	-0.8pp	-1.2pp

Source: Company data, Nomura estimates

Fig. 2: Chinasoft - revenue forecasts by segment

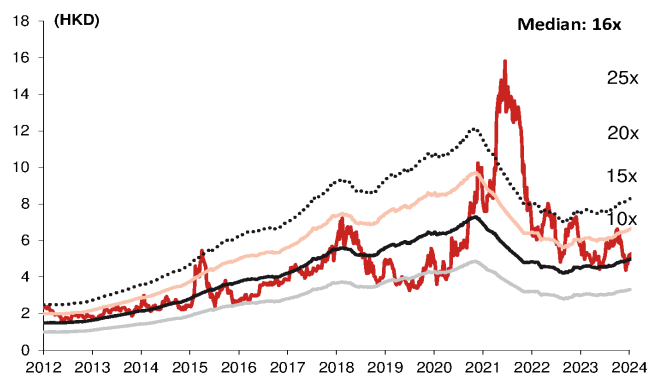
(CNY mn)	2021 A	2022 A	2023 A	2024F (NOM)	2025F (NOM)	2026F (NOM)	2023 (OLD)	2024F (OLD)	2025F (OLD)	2023 Diff.	2024F Diff.	2025F Diff.
Cornerstone business	13,095	13,387	10,661	10,988	12,143	13,641	12,717	13,402	14,588	-16.2%	-18.0%	-16.8%
As % of total sales	71%	67%	62%	59%	56%	53%	63%	58%	54%			
Cloud intelligent	5,303	6,618	6,455	7,562	9,668	12,012	7,578	9,695	12,532	-14.8%	-22.0%	-22.9%
As % of total sales	29%	33%	38%	41%	44%	47%	37%	42%	46%			

Source: Company data, Nomura estimates

Valuation methodology and risks

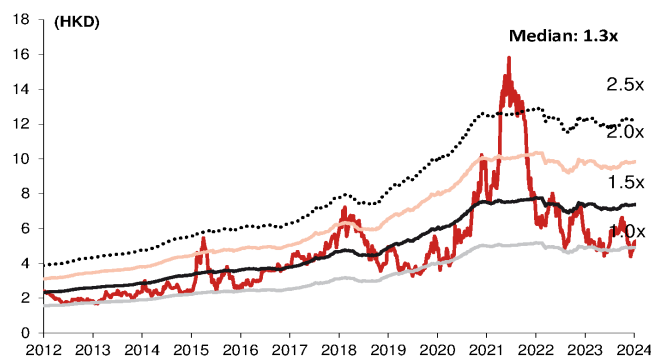
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Fig. 3: Chinasoft: 12-month-forward P/E band



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

Fig. 4: 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

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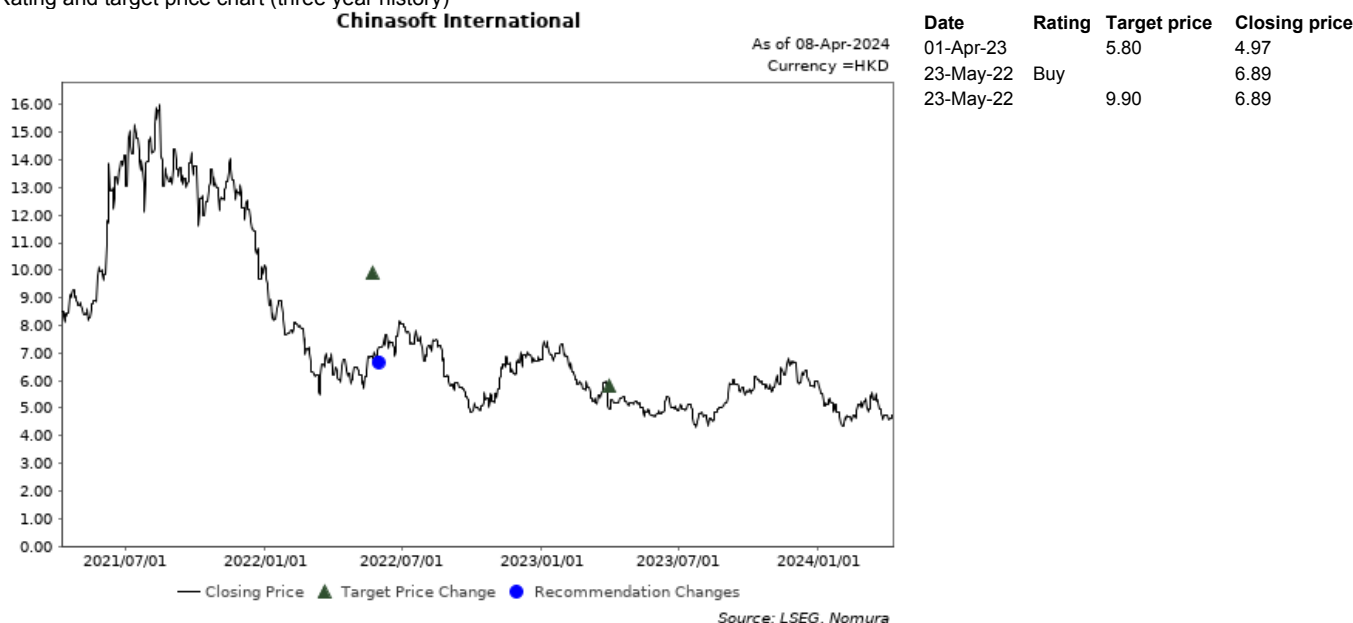
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Chinasoft International	354 HK	HKD 4.77	08-Apr-2024	Buy	N/A	

Chinasoft International (354 HK)

HKD 4.77 (08-Apr-2024) Buy (Sector rating: N/A)

Rating and target price chart (three year history)

Chinasoft International



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

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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 March 2024.

*The Nomura Group as defined in the Disclaimer section at the end of this report.

** As defined by the EU Market Abuse Regulation

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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/m/Disclosures>; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan**: Russell/Nomura Large Cap.

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Target Price

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