

Buy Recommendation

GLOBAL FOCUS LIST, DEVELOPED

WILLIAM O'NEIL+CO.

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Chinasoft International (CSFT.HK)

Bloomberg Ticker

354 HK

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Buy Price (01/04/2023)

HKD 7.45

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O'Neil Rankings

| | |
|------------------|----|
| EPS Rank | 93 |
| RS Rating | 83 |
| Datagraph Rating | 58 |
| Composite Rating | 93 |
| Acc/Dist Rating | A+ |
| SMR Rating | B |

Company Information

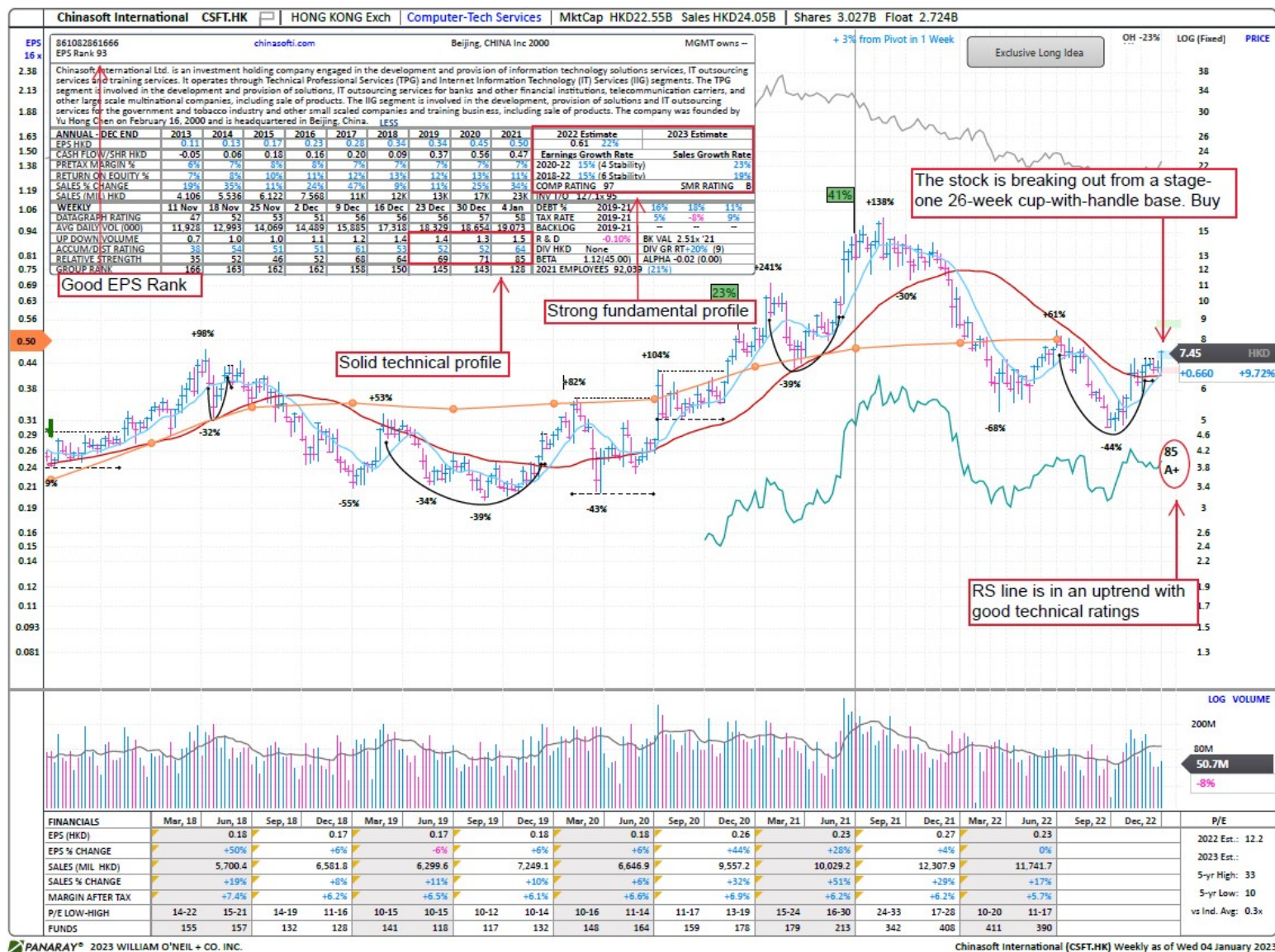
| | |
|---------------------|--------------|
| Market cap | USD 2.89 bil |
| 52-week high/low | HKD 10/5 |
| P/E | N/A |
| 50-day avg vol | 19.07 mil |
| FY 2022 ROE | 11 |
| 3/5 year rev growth | 23%/19% |
| 3/5 year EPS growth | 15%/15% |

Chinasoft International (Chinasoft) provides IT solutions to global companies. The company provides traditional IT solutions such as application development and maintenance, managed services, and other IT outsourcing solutions, as well as new-age services such as full-stack cloud capabilities, big data, etc. Industry estimates that Chinasoft is ranked third in the China cloud migration services market with a ~6% domestic market share. Key clients include Huawei, HSBC, Tencent, and Ping An.

H1 FY22 revenue by segment (growth y/y): IT solutions, 68% (+10%); and emerging business, 32% (+51%).

O'Neil Methodology

- The stock is breaking out from a stage-one 26-week cup-with-handle base. Buy.
- Fundamental profile: EPS Rank 93. Composite Rating of 97. SMR Rating of B.
- Technical setup: RS line is trending higher with an RS Rating of 85 and an A/D Rating of A+.



Growth Drivers

Steady Growth in China's IT Industry

- As per industry research, China's IT services market is expected to reach \$72B by 2023 and grow at a steady pace of 9.7% over the next four years to reach \$104B by 2027.
- This growth is mainly driven by digital transformation needs and the local government's increased focus on making China a hub for IT outsourcing.
- Chinasoft derives nearly 70% of its revenue from its legacy IT services business. While its emerging cloud business is expected to grow much faster, the company will benefit from the steady growth and demand visibility in the overall China IT services market.

Strong Customer Partnerships

- Over the years, Chinasoft has developed key strategic partnerships with several large Chinese corporates. The company boasts a blue-chip customer base, including HSBC, Huawei, Tencent, Microsoft, Sony, JD.com, etc.
- Huawei, Ping An, Tencent, Alibaba, and HSBC are the company's key clients.
 - As of 2020, Chinasoft's share of Huawei's outsourcing budgets was ~50% and was ranked the #1 vendor for its outsourcing needs.
 - Chinasoft accounted for 15% of Ping An's outsourcing budget and was its #1 outsourcing vendor.
 - The company was ranked the #2 vendor for the outsourcing needs of Tencent and Baidu and #3 for Alibaba.
- As of H1 2022, the top five customers accounted for ~70% of its total group revenue, down ~200 bps y/y. The company has 196 large customers (customers contributing more than RMB 6M in service revenue over the last 12

months). This is up 29% y/y.

- As the Chinese economy rebounds, the IT budgets of its large clients are expected to expand, which in turn is expected to accelerate revenue growth for the company over the next few years

Emerging Businesses to Drive Future Growth

- As of H1 2022, Chinasoft derived ~32% of its revenue from its emerging businesses, i.e., its full-stack cloud capabilities, big data business, and Jointforce platform. Revenue for the segments was up 51% y/y and is the primary driver of the company's double-digit revenue growth over the next several years.
- Chinasoft has developed expertise as a cloud broker, building a one-stop, end-to-end service system, including cloud migration, implementation, development, and management. The company has emerged as a first-tier distributor of Huawei Cloud in 13 provinces and cities in China and had an overall market share of ~6%, ranking third in China's cloud migration services sector.
- In its big data business, Chinasoft offers end-to-end data engineering services with capabilities in data governance, data asset management, and data applications. Some of its key clients in this segment include China Tobacco, Huawei, China Construction Bank, and Haitong.
- The company's JointForce initiative, a platform that connects local governments and SMEs with IT solution providers, is growing strongly. In H1 2022, the platform has serviced 930 projects for 438 government and enterprise customers (+37% y/y) with a total project amount of up to RMB 3.8B, achieving a gross transaction value of RMB 1.6B.

Attractive Valuation

- Consensus expects FY23 EPS of RMB 0.5 (+20% y/y). Based on FY22E EPS of HKD 0.47 (RMB 0.41), it is trading at a PE of 15.9x and a PEG ratio of 0.80.
- Given the improving prospects of the Chinese economy, Chinasoft's long-standing track record of steady growth (30% revenue CAGR over the last 18 years), and rising revenue diversification, we believe the company is attractively valued at current prices.

H1 FY22 Results

- The company reported revenue of RMB 10.0B (+20% y/y), in line with estimates. Net profit rose 10% y/y to RMB 572M, beating consensus by 9%. EPS stood at RMB 0.2 (+4% y/y).
- Gross profit was RMB 2.5B (+8% y/y), 6% below consensus, and gross margin was 24.8% (-280 bps y/y), 140bps below consensus. This weakness was mainly driven by higher labor costs and disruptions due to the COVID-19 pandemic.
- Operating margin was 4.8% (down 30 bps y/y), 80 bps above consensus.
- The company is guiding for 20%+ revenue growth in FY22.

Looking Forward

- Chinasoft's legacy business revenues are tied to the IT budgets of its large clients. IT budgets tend to expand as the domestic economy rebounds. Any key commentary regarding this from the company's large clients is a key monitorable.
- Next catalyst: H2 FY22 results in March.

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