

# Chinasoft International

## Soft FY23 results, call takeaways: revenue back on growth track with margin recovery

**Analyst Name** - Daley Li, CFA

Employed by a non-US affiliate of BofAS and is not registered/qualified as a research analyst under the FINRA rules.

**Analyst Email** - daley.li2@bofa.com

**Analyst Designation** - Research Analyst

**Analyst Region** - Merrill Lynch (Hong Kong)

**Analyst Phone** - +852 3508 5365

**Analyst Name** - Harry Zhuang

Employed by a non-US affiliate of BofAS and is not registered/qualified as a research analyst under the FINRA rules.

**Analyst Email** - harry.zhuang@bofa.com

**Analyst Designation** - Research Analyst

**Analyst Region** - Merrill Lynch (Hong Kong)

**Analyst Phone** - +852 3508 7998

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Reiterate Rating	Price	Price Objective	Upside	Market Cap	Average Daily Value	2024E EPS	2025E EPS	2026E EPS
BUY	4.55 HKD	6.50 ▼ from 7.20 HKD	42.9%	13,227 HKD(mn)	17.82 USD(mn)	0.30 ▼ from 0.38 CNY	0.45 ▼ from 0.51 CNY	0.53 CNY

all data as of 5 April 2024

## Key takeaways

- Chinasoft recently reported its FY23 results, and we hosted a post-results group call for Chinasoft management.
- FY23 net profit was down 6% YoY to Rmb713mn, 10%+ below consensus estimates, mainly due to 14% YoY drop in top-line.
- Lower PO to HK\$6.5 mainly on our estimates revisions. Reiterate Buy on expected top-line growth recovery, improving margin.

ERP: enterprise resource planning

GPM: gross profit margin

opex: operating expense

PO: price objective

SOE: state-owned enterprise

## Solid recovery in FY24E on strong emerging business growth

Chinasoft recently reported its FY23 results, and we hosted a post-results group call for Chinasoft management. FY23 net profit declined 6% YoY to Rmb713mn, 10%+ below consensus estimate, mainly due to 14% YoY drop of top-line even under stringent cost control (opex down 15% YoY). Chinasoft has shown positive signs, with revenue bottoming from the trough level in 1H23 and NPM improvement (+2.3ppts YoY) in 2H23. Looking into FY24E, we expect solid revenue recovery for Chinasoft, mainly driven by strong expansion of emerging business. In view of soft legacy business growth, we cut our FY24-25E revenue estimates by 12-13%. As a result of our estimate revisions and rolling over valuation, we adjust our PO to HK\$6.5 (from HK\$7.2) based on 17x 12 months forward P/E (from 16x), still set at its historical average. We reiterate our Buy rating given the expected top-line growth recovery ahead with improving margin.

## Emerging business to drive growth with legacy business steady

We expect legacy business to have steady revenue growth in FY24E as the soft revenue of Chinasoft's largest client should be largely mitigated by the strong growth of SOEs (i.e., telecom operators and banks). Internet clients are expected to achieve largely flat YoY growth in FY24E versus a YoY decline in FY23E. On the flip side, emerging business (38% of total revenue in FY23) is expected to achieve 25-30% YoY growth in FY24E, in our view, mainly supported by incremental revenue from HarmonyOS-related business, AI computing operation, JointPilot, ERP, etc.

## Striving for better GPM via new business and cost control

Looking forward, management targets to further improve GPM through (1) a rising portion of high-margin business under the "1+3" strategy, (2) increasing sales of proprietary technologies (e.g., KaihongOS, JointPilot, LLM Agent) by transforming into software and hardware products, and (3) integration of finance and quality to reduce cost and enhance operating efficiency. Thanks to continuing stringent cost control, management is confident on NPM expansion in FY24-25E. As for shareholder return, Chinasoft raised the dividend payout ratio to 30% in FY23 (from 18% in FY22), which could have further upside in the future.

### Estimates & Valuation

Estimates (Dec) (CNY)	2022A	2023A	2024E	2025E	2026E
Net Income (Adjusted - mn)	759	713	890	1,296	1,541
EPS	0.261	0.259	0.304	0.446	0.530
EPS Change (YoY)	-36.1%	-0.9%	17.6%	46.5%	18.9%
Dividend / Share	0.049	0.074	0.092	0.156	0.212
Free Cash Flow / Share	0.195	0.240	0.244	0.360	0.432
<b>Valuation (Dec)</b>					
P/E	15.52x	15.97x	13.82x	9.43x	7.93x
Dividend Yield	1.22%	1.79%	2.18%	3.71%	5.04%
EV / EBITDA*	9.02x	8.92x	7.79x	6.04x	5.30x
Free Cash Flow Yield*	4.65%	5.42%	5.83%	8.56%	10.27%

### iQmethod<sup>SM</sup> Measures Definitions

#### Business

Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations - Total Capex	N/A

#### Quality of Earnings

	Numerator	Denominator
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt} - \text{Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense

#### Valuation Toolkit

	Numerator	Denominator
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations - Total Capex	$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales

*iQmethod*<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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## Key Changes

(CNY)	Previous	Current
Price Obj.	HK\$7.20	HK\$6.50
2024E EPS	0.38	0.30
2025E EPS	0.51	0.45
2026E EPS	NA	0.53
2024E EBITDA (m)	1,602.0	1,487.2
2025E EBITDA (m)	1,983.0	1,916.9
2026E EBITDA (m)	NA	2,185.3

## Stock Data

Price	4.55 HKD
Price Objective	6.50 HKD
Date Established	5-Apr-2024
Investment Opinion	C-1-7
52-Week Range	4.19 HKD-6.98 HKD
Mrkt Val / Shares Out (mn)	1,689 USD / 2,907.0
Market Value (mn)	13,227 HKD
Average Daily Value (mn)	17.82 USD
Free Float	86.9%
BofA Ticker / Exchange	CFTLF / HKG
Bloomberg / Reuters	354 HK / 0354.HK
ROE (2024E)	7.4%
Net Dbt to Eqty (Dec-2023A)	-5.2%
Price to Book Value	1.0x

## Soft FY23 but recovery sign shown in 2H23

FY23 revenue decreased 14% YoY to Rmb17.1bn, as downstream demand still takes time to fully recover. GPM improved 0.4ppt YoY to 23.4% in FY23, thanks to (1) enhancing operational efficiency through integration of finance and quality (财智一体化) reforms of traditional business, (2) rising revenue contribution of emerging business with higher margin, and (3) reduction of low-value projects. Net profit dropped 6% YoY to Rmb713mn in FY23, while NPM expanded by 0.4ppt to 4.2%. For 2H23, GPM grew 1.9ppts YoY to 23.1%, and net profit grew 93% YoY (or 3% HoH) to Rmb362mn in 2H23, with NPM improved 2.3ppts YoY to 4.2ppts.

### Exhibit 1: Chinasoft - Estimate revisions

We cut our FY24-25E earnings forecasts by 13-20%

(RMB mn)	FY24E			FY25E			FY26E		
	New	Old	Diff (%)	New	Old	Diff (%)	New	Old	Diff (%)
Revenue	19,153	21,887	-12.5	21,934	24,931	-12.0	24,439	N.A.	N.A.
Net profit	890	1,114	-20.1	1,296	1,488	-12.9	1,541	N.A.	N.A.

Source: BofA Global Research estimates. Diff = difference.

## Exhibit 2: Chinasoft - Income statement forecast (FY22-26E)

We expect Chinasoft to post 29% earnings CAGR in FY23-26E

(Rmb million)	2022	YoY %	2023	YoY %	2024E	YoY %	2025E	YoY %	2026E	YoY %
Legacy business (IT outsourcing)	13,387	2.3%	10,667	-20.3%	11,011	3.2%	11,967	8.7%	12,803	7.0%
Emerging business	6,618	24.7%	6,450	-2.5%	8,142	26.2%	9,968	22.4%	11,637	16.7%
<b>Total revenue</b>	<b>20,005</b>	<b>8.7%</b>	<b>17,117</b>	<b>-14.4%</b>	<b>19,153</b>	<b>11.9%</b>	<b>21,934</b>	<b>14.5%</b>	<b>24,439</b>	<b>11.4%</b>
Cost of revenue	(15,405)	14.2%	(13,114)	-14.9%	(14,559)	11.0%	(16,607)	14.1%	(18,431)	11.0%
<b>Gross profit</b>	<b>4,600</b>	<b>-6.2%</b>	<b>4,003</b>	<b>-13.0%</b>	<b>4,594</b>	<b>14.8%</b>	<b>5,327</b>	<b>16.0%</b>	<b>6,009</b>	<b>12.8%</b>
Gross margin (%)	23.0%	-3.7ppt	23.4%	0.4ppt	24.0%	0.6ppt	24.3%	0.3ppt	24.6%	0.3ppt
Sales and marketing expenses	(949)	0.6%	(868)	-8.5%	(876)	0.9%	(937)	7.0%	(1,037)	10.6%
% of revenue	4.7%	-0.4ppt	5.1%	0.3ppt	4.6%	-0.5ppt	4.3%	-0.3ppt	4.2%	0.0ppt
General and administrative expenses	(1,683)	-4.2%	(1,355)	-19.5%	(1,456)	7.4%	(1,579)	8.5%	(1,760)	11.4%
% of revenue	8.4%	-1.1ppt	7.9%	-0.5ppt	7.6%	-0.3ppt	7.2%	-0.4ppt	7.2%	0.0ppt
Research and development expenses	(1,238)	-0.9%	(1,078)	-12.9%	(1,111)	3.0%	(1,206)	8.6%	(1,344)	11.4%
% of revenue	6.2%	-0.6ppt	6.3%	0.1ppt	5.8%	-0.5ppt	5.5%	-0.3ppt	5.5%	0.0ppt
<b>Operating profit</b>	<b>731</b>	<b>-23.6%</b>	<b>702</b>	<b>-4.0%</b>	<b>1,152</b>	<b>64.1%</b>	<b>1,604</b>	<b>39.3%</b>	<b>1,868</b>	<b>16.4%</b>
Operating margin (%)	3.7%	-1.5ppt	4.1%	0.4ppt	6.0%	1.9ppt	7.3%	1.3ppt	7.6%	0.3ppt
<b>Net Profit</b>	<b>759</b>	<b>-33.2%</b>	<b>713</b>	<b>-6.1%</b>	<b>890</b>	<b>24.8%</b>	<b>1,296</b>	<b>45.6%</b>	<b>1,541</b>	<b>18.9%</b>
Net margin (%)	3.8%	-2.4ppt	4.2%	0.4ppt	4.6%	0.5ppt	5.9%	1.3ppt	6.3%	0.4ppt

Source: Company, BofA Global Research estimates

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## Exhibit 3: Chinasoft - Annual and semi-annual results

Chinasoft revenue declined 14% YoY in FY23 while recovering 3% HoH in 2H23

(RMB million)	Semi-annual								Annual			
	1H22	YoY %	2H22	YoY %	1H23	YoY %	2H23	YoY %	2022	YoY %	2023	YoY %
Legacy business (IT outsourcing)	6,755	8.8%	6,632	-3.6%	5,150	-23.8%	5,517	-16.8%	13,387	2.3%	10,667	-20.3%
Emerging business	3,270	53.5%	3,348	5.4%	3,300	0.9%	3,150	-5.9%	6,618	24.7%	6,450	-2.5%
<b>Total revenue</b>	<b>10,025</b>	<b>20.2%</b>	<b>9,980</b>	<b>-0.8%</b>	<b>8,450</b>	<b>-15.7%</b>	<b>8,667</b>	<b>-13.2%</b>	<b>20,005</b>	<b>8.7%</b>	<b>17,117</b>	<b>-14.4%</b>
Cost of revenue	(7,544)	24.7%	(7,861)	5.6%	(6,449)	-14.5%	(6,665)	-15.2%	(15,405)	14.2%	(13,114)	-14.9%
<b>Gross profit</b>	<b>2,482</b>	<b>8.2%</b>	<b>2,118</b>	<b>-18.8%</b>	<b>2,001</b>	<b>-19.4%</b>	<b>2,002</b>	<b>-5.5%</b>	<b>4,600</b>	<b>-6.2%</b>	<b>4,003</b>	<b>-13.0%</b>
Gross margin (%)	24.8%	-2.7ppt	21.2%	-4.7ppt	23.7%	-1.1ppt	23.1%	1.9ppt	23.0%	-3.7ppt	23.4%	0.4ppt
Sales and marketing expenses	(511)	13.3%	(438)	-11.1%	(421)	-17.7%	(447)	2.2%	(949)	0.6%	(868)	-8.5%
% of revenue	5.1%	-0.3ppt	4.4%	-0.5ppt	5.0%	-0.1ppt	5.2%	0.8ppt	4.7%	-0.4ppt	5.1%	0.3ppt
Admin and R&D expenses	(1,445)	4.6%	(1,475)	-9.1%	(1,210)	-16.3%	(1,223)	-17.1%	(2,921)	-2.8%	(2,433)	-16.7%
% of revenue	14.4%	-2.1ppt	14.8%	-1.4ppt	14.3%	-0.1ppt	14.1%	-0.7ppt	14.6%	-1.7ppt	14.2%	-0.4ppt
<b>Operating profit</b>	<b>525</b>	<b>13.9%</b>	<b>206</b>	<b>-58.4%</b>	<b>370</b>	<b>-29.6%</b>	<b>332</b>	<b>61.5%</b>	<b>731</b>	<b>-23.6%</b>	<b>702</b>	<b>-4.0%</b>
Operating margin (%)	5.2%	-0.3ppt	2.1%	-2.9ppt	4.4%	-0.9ppt	3.8%	1.8ppt	3.7%	-1.5ppt	4.1%	0.4ppt