

Chinasoft (354 HK)

Strong demand despite near-term margin pressure

Chinasoft delivered strong FY21 revenue at RMB18.4bn (+30% YoY), with cloud/traditional IT outsourcing revenue growth of +63% YoY/ +21% YoY respectively. Net profit was at RMB1,137mn (+19% YoY), in-line with our forecast although GPM missed (-2.6 pct pts YoY). We think Chinasoft will continue to benefit from Huawei's software-centric transformation and FY23E IT service demand remains strong, reflected from its workforce addition (+21% YoY to 92k as of FY21).

- FY21 revenue in-line but margins missed.** Chinasoft delivered strong revenue growth of +30% YoY to RMB18,398mn in FY21. In terms of revenue mix, emerging business (mostly Cloud related) grew at +63% YoY to RMB5.3bn while traditional IT service business was up +21% YoY to RMB13bn. However, gross margin declined -2.6 pct pts YoY to 26.7%, below both our and consensus estimates. Company attributed the decrease to 1) sacrificing short-term profits to ensure rapid revenue growth with major clients, 2) reduced/ exempted social security provident fund in 2020, and 3) increased investment in new businesses and more mid-to-high-end technical staff hired. Operating profit declined 16% YoY to RMB796mn although opex ratio slightly improved to 22.3% in FY21 (vs. 22.5% in FY20). Net profit was at RMB1,137mn (+19% YoY), in-line with our and consensus forecast, thanks to higher gov't subsidies and disposal gain of its subsidiary Catapult.
- Huawei to remain committed in Cloud and R&D.** On 28 Mar 2022, Huawei announced FY21 results. Although revenue was down 29% YoY to RMB637bn, R&D increased at +0.5% YoY to RMB143bn. Huawei Cloud remained as the core growth with revenue growth of +34% YoY to RMB20bn.
- 21% YoY increase in employee no. reflects strong customers' demand in FY23E.** Chinasoft added over 16k employees in FY21 (+21% YoY). As Chinasoft IT service business is labour-intensive, we think the additional employees reflect strong IT demand from customers in FY23E. We now expect Chinasoft FY22E revenue growth of +23% YoY to RMB22.4bn.
- Maintain BUY.** We keep FY22-23E revenue forecast but adjusted down net profit by 2-7% to reflect lower margins. Maintain BUY with new target price of HK\$10.52 (prior HK\$11.26), based on unchanged 23x FY22E P/E.

Earnings Summary

(YE 31 Dec)	FY20	FY21	FY22E	FY23E	FY24E
Revenue (RMB mn)	14,101	18,398	22,361	27,133	31,341
YoY growth (%)	17%	30%	22%	21%	16%
Net profit (RMB mn)	955	1,137	1,267	1,669	2,079
EPS (RMB)	0.32	0.36	0.40	0.52	0.66
YoY growth (%)	13%	13%	11%	32%	25%
Consensus EPS (RMB)	0.32	0.36	0.54	0.70	n.a.
PE (x)	19.2	17.0	15.2	11.7	9.3
EV/Sales (x)	1.1	0.7	0.5	0.4	0.3
Dividend Yield (%)	0.00	0.00	0.00	0.00	0.00
ROE (%)	12%	11%	10%	12%	14%
Net debt to equity	net cash				

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$10.52**
 (Previous TP **HK\$11.26**)
 Up/Downside **+50.5%**
 Current Price **HK\$6.99**

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Stock Data

Mkt Cap (HK\$ mn)	21,688
Avg 3 mths t/o (HK\$ mn)	136.40
52w High/Low (HK\$)	16.28/ 5.28
Total Issued Shares (mn)	3,094

Source: Bloomberg

Shareholding Structure

Chen Yuhong- Chairman	12.4%
UBS Group AG	10.1%
ESOP	6.0%

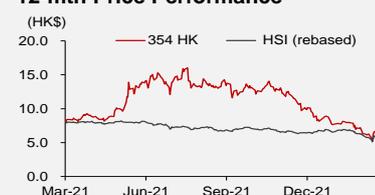
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-5.2%	-1.8%
3-mth	-32.6%	-29.0%
6-mth	-49.9%	-43.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

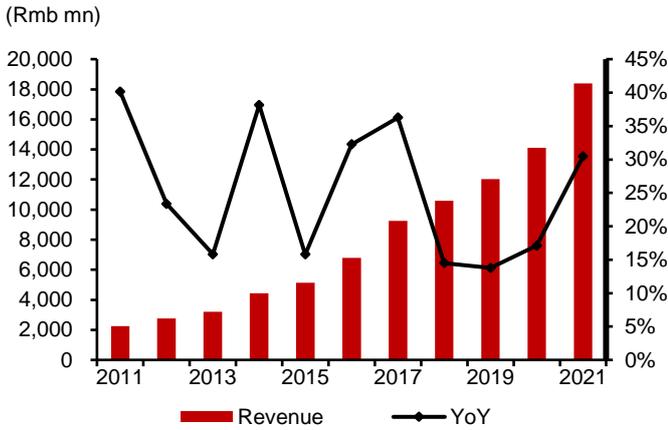
Auditor: Deloitte

Related Reports

- Chinasoft (354 HK) – “Business outlook read-through from iSoftStone” – 11 Mar 2022 ([link](#))
- Chinasoft (354 HK) – “Huawei worsening balance sheet adds uncertain” – 10 Jan 2022 ([link](#))

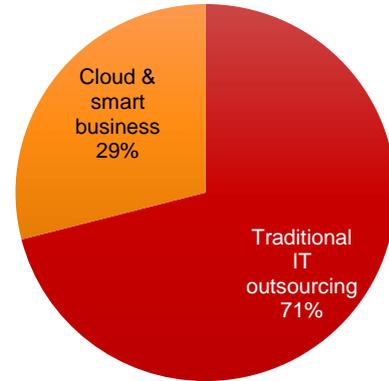
Focus Charts

Figure 1: Revenue and growth



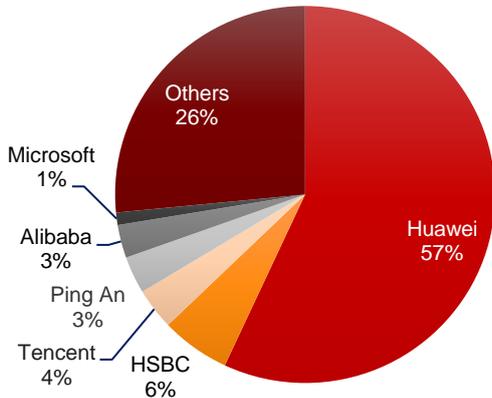
Source: Company data, CMBIGM estimates

Figure 2: Revenue mix (2021)



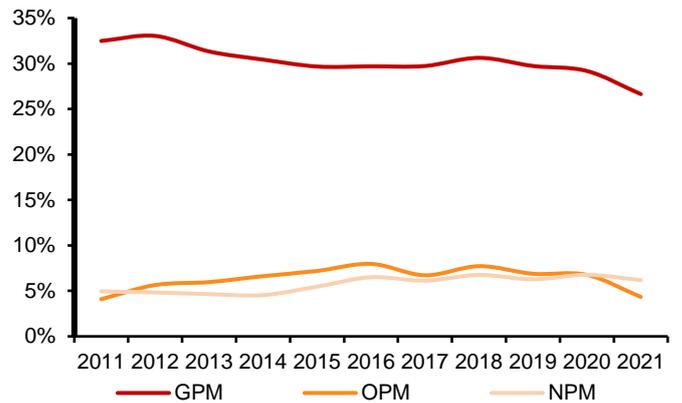
Source: Company data, CMBIGM estimates

Figure 3: Customer breakdown (2020)



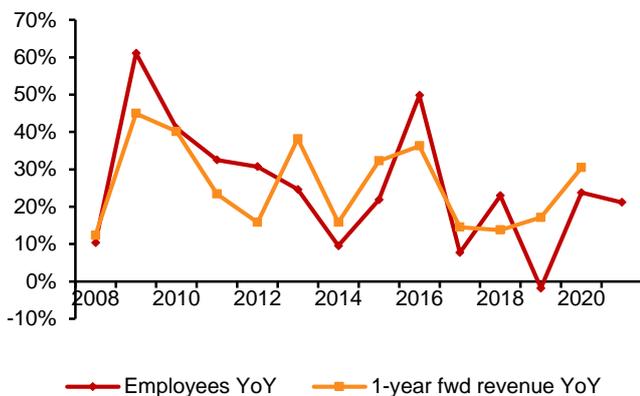
Source: Company data, CMBIGM estimates

Figure 4: Margins



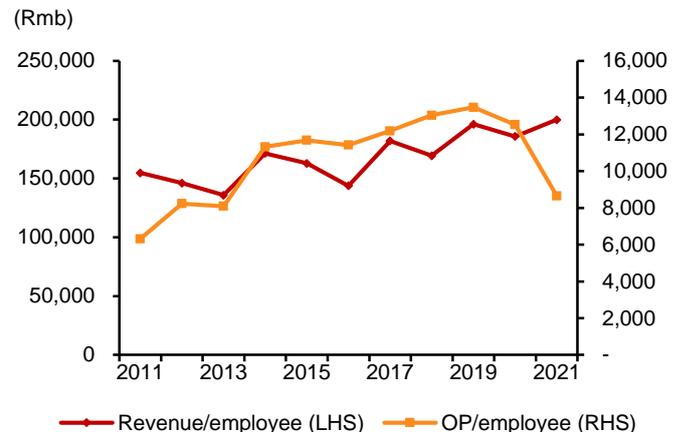
Source: Company data, CMBIGM

Figure 5: Forward revenue and employees



Source: Company data, CMBIGM

Figure 6: Revenue & operating profit per employee



Source: Company data, CMBIGM

FY21 results review

- **Revenue** was at RMB18,398mn (+30% YoY), in-line with our and consensus estimates.
 - **Emerging business** (Cloud related) was up +63% YoY to RMB5.3bn.
 - **Traditional IT Services** was up +21% YoY to RMB13.1bn.
 - **FY22E revenue** is guided at RMB23.1bn (+26% YoY), 3% above consensus
- **Gross profit** was at RMB4,904mn (+19% YoY), **below** our and consensus estimates by 7%.
- **Gross margin** was at 26.7%, (-2.6 pct pts YoY), **below** our estimate by -2.5 pct pts and consensus by -2.7 pct pts.
 - In the announcement, Company attributed the decline to:
 - 1) Ensure rapid revenue growth with major clients, Chinasoft sacrificed short-term profits.
 - 2) In 2020, social security provident fund was reduced/ exempted.
 - 3) Increased investment in new businesses and hired mid-to-high-end technical staff.
- **Operating profit** was at RMB796mn (-16% YoY), **below** our estimates by -21% and consensus by -39%.
- **Operating margin** was at 4.3% (-2.5 pct pts YoY), **below** our estimate by -1.2 pct pts and consensus by -3.0 pct pts.
- **Net profit** was at RMB1,137mn (+19% YoY), in-line with our estimates but below consensus by 7%.
- **EPS** was at RMB0.41 (+8% YoY).

Figure 7: FY21 results review

354 HK	2020	2021		2021	versus	2021	versus
RMB mn	Actual	Actual	YoY	CMBI	CMBI	Consensus	Consensus
Revenue	14,101	18,398	30%	18,166	1%	18,042	2%
Gross profit	4,118	4,904	19%	5,290	-7%	5,284	-7%
GPM	29.2%	26.7%	-2.6 pct pts	29.1%	-2.5 pct pts	29.3%	-2.7 pct pts
Operating profit	952	796	-16%	1,003	-21%	1,313	-39%
OPM	6.7%	4.3%	-2.5 pct pts	5.5%	-1.2 pct pts	7.3%	-3 pct pts
PBT	1,035	1,252	21%	1,229	2%	1,310	-4%
Tax	(87)	(115)	33%	(87)	32%	(87)	32%
Net income	955	1,137	19%	1,143	-1%	1,223	-7%
NPM	6.8%	6.2%	-0.6 pct pts	6.3%	-0.2 pct pts	6.8%	-0.6 pct pts
EPS RMB cents	37.9	40.9	8%	37.3	10%	41.8	-2%

Source: Company data, CMBIGM

Earnings revision

Figure 8: Earnings revision

RMB mn	2022E			2023E		
	New	Old	%Diff	New	Old	%Diff
Sales	22,361	22,352	0%	27,133	26,825	1%
Gross profit	5,858	6,483	-10%	7,246	7,768	-7%
OP Profit	1,066	1,308	-18%	1,484	1,618	-8%
PBT	1,362	1,447	-6%	1,798	1,823	-1%
Net profit	1,267	1,356	-7%	1,654	1,696	-2%
EPS (RMB)	0.40	0.43	-7%	0.52	0.54	-2%
Margins						
GM	26.2%	29.0%	-281 bps	26.7%	29.0%	-225 bps
OPM	4.8%	5.9%	-108 bps	5.5%	6.0%	-56 bps
PBT margin	6.1%	6.5%	-39 bps	6.6%	6.8%	-17 bps
Net margin	5.7%	6.1%	-40 bps	6.1%	6.3%	-22 bps

Source: Company data, CMBIGM estimates

Figure 9: CMBI estimates vs consensus

RMB mn	2022E			2023E		
	CMBI	Street	Diff	CMBI	Street	Diff
Sales	22,361	22,352	0%	27,133	27,356	-1%
Gross profit	5,858	6,628	-12%	7,246	8,196	-12%
OP Profit	1,066	1,669	-36%	1,484	2,108	-30%
PBT	1,362	1,720	-21%	1,798	2,230	-19%
Net profit	1,267	1,606	-21%	1,654	2,092	-21%
EPS (RMB)	0.40	0.50	-19%	0.52	0.61	-13%
Margins						
GM	26.2%	29.7%	-345 bps	26.7%	30.0%	-325 bps
OPM	4.8%	7.5%	-270 bps	5.5%	7.7%	-224 bps
PBT margin	6.1%	7.7%	-160 bps	6.6%	8.2%	-153 bps
Net margin	5.7%	7.2%	-152 bps	6.1%	7.6%	-155 bps

Source: Company data, CMBIGM estimates, Bloomberg

Operating model

Figure 10: Operating model

RMB mn	2020	2021	2022E	2023E	2024E
Revenues	14,101	18,398	22,361	27,133	31,341
Cost of sales	(9,983)	(13,494)	(16,503)	(19,887)	(22,885)
Gross Profit	4,118	4,904	5,858	7,246	8,455
<i>Gross margin</i>	<i>29.2%</i>	<i>26.7%</i>	<i>26.2%</i>	<i>26.7%</i>	<i>27.0%</i>
R&D	(930)	(1,249)	(1,583)	(1,843)	(2,158)
SG&A	(2,031)	(2,699)	(3,161)	(3,918)	(4,494)
Operating Income	952	796	1,066	1,484	1,868
<i>Operating margin</i>	<i>6.7%</i>	<i>4.3%</i>	<i>4.8%</i>	<i>5.5%</i>	<i>6.0%</i>
Non-Operating Income	83	456	296	314	385
Profit Before Tax	1,035	1,252	1,362	1,798	2,253
Income tax (expense) gain	(87)	(115)	(98)	(146)	(183)
Minorities	(7)	(0)	(4)	(3)	(5)
Net Income to Shareholders	955	1,137	1,267	1,654	2,074
<i>Net margin</i>	<i>6.8%</i>	<i>6.2%</i>	<i>5.7%</i>	<i>6.1%</i>	<i>6.6%</i>
EPS (RMB)	0.33	0.37	0.40	0.52	0.66
Fully diluted EPS (RMB)	0.32	0.36	0.40	0.52	0.66
Revenue breakdown					
IT outsourcing	10,830	13,063	14,891	17,423	19,688
Emerging cloud business	3,271	5,335	7,470	9,711	11,653
Huawei	8,030	9,664	11,113	12,558	14,190
HSBC	830	872	872	872	872
Tencent	500	725	979	1,175	1,409
Alibaba	400	620	868	1,128	1,467
Ping An	450	698	977	1,172	1,406
Others	3,891	5,821	7,553	10,230	11,996
Growth YoY					
Revenues	17%	30%	22%	21%	16%
Gross profit	15%	19%	19%	24%	17%
Operating Income	15%	-16%	34%	39%	26%
EPS	7%	13%	8%	31%	25%

Source: Company data, CMBIGM

Figure 11: Semi-annual operating model

RMB mn	1H19	2H19	1H20	2H20	1H21	2H21
Revenues	5,538	6,504	6,059	8,042	8,341	10,057
Gross Profit	1,567	2,016	1,649	2,469	2,294	2,610
Operating profit	426	401	421	531	423	374
Net profit (loss)	363	392	401	554	518	619
EPS (RMB)	0.15	0.16	0.16	0.19	0.19	0.20
Margins						
Gross margin	28.3%	31.0%	27.2%	30.7%	27.5%	26.0%
Operating margin	7.7%	6.2%	6.9%	6.6%	5.1%	3.7%
Net margin	6.5%	6.0%	6.6%	6.9%	6.2%	6.2%
Growth (HoH)						
Revenues	-4%	17%	-7%	33%	4%	21%
Gross Profit	-16%	29%	-18%	50%	-7%	14%
Operating profit	14%	-6%	5%	26%	-20%	-12%
Net profit (loss)	2%	8%	2%	38%	-6%	20%
Growth (YoY)						
Revenues	15%	13%	9%	24%	38%	25%
Gross Profit	13%	9%	5%	22%	39%	6%
Operating profit	-3%	7%	-1%	32%	0%	-30%
Net profit (loss)	1%	10%	11%	41%	29%	12%

Source: Company data, CMBIGM

Valuation

Chinasoft (354 HK, BUY, TP HK\$10.52)

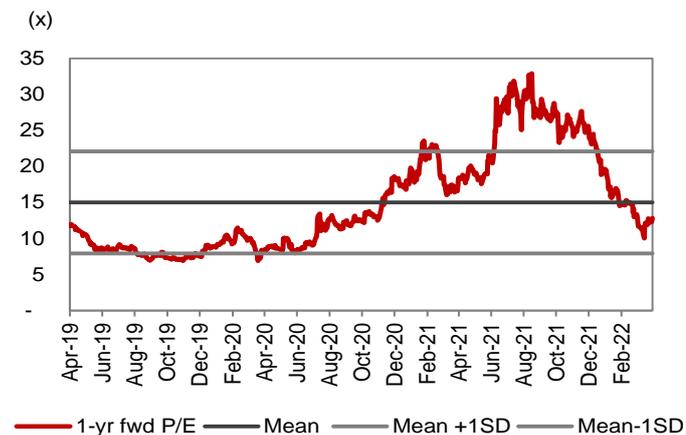
We trimmed FY22-23E net profit by 2-7% mainly to reflect lower margins. Maintain BUY with lowered target price of HK\$10.52 (prior HK\$11.26), based on unchanged 23x FY22E fully diluted EPS, in-line with peers average.

Figure 12: Peers' valuation

Company	Ticker	Rating	Mk Cap (US\$ mn)	Price (LC)	TP (LC)	P/E		ROE		Sales CAGR FY20-23	EPS CAGR FY20-23
						FY21E	FY22E	FY21E	FY22E		
Chinasoft	354 HK	BUY	2,763	6.99	10.52	17.0	15.2	11.1	10.4	24%	18%
Digital China	000034 CH	NR	1,497	14.40	N/A	12.0	9.3	14.8	16.3	9%	25%
Infosys	INFO IN	NR	105,494	1903.95	N/A	41.6	35.7	28.4	30.0	16%	18%
Tata Consultancy	TCS IN	NR	181,805	3731.55	N/A	42.1	35.5	38.0	41.2	11%	11%
					Mean	27.3	22.8	23.4	25.3	15%	20%
					Median	27.6	23.1	21.6	23.2	13%	21%

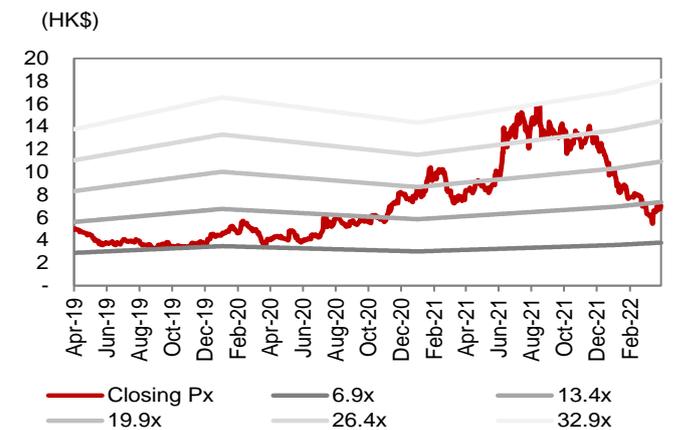
Source: Bloomberg, CMBIGM

Figure 13: 12M forward P/E band



Source: Company data, CMBIGM

Figure 14: 12M forward P/B band



Source: Company data, CMBIGM

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	14,101	18,398	22,361	27,133	31,341
Cost of sales	(9,983)	(13,494)	(16,503)	(19,887)	(22,885)
Gross profit	4,118	4,904	5,858	7,246	8,455
Selling exp	(729)	(943)	(1,095)	(1,328)	(1,534)
Admin exp	(1,302)	(1,756)	(2,067)	(2,589)	(2,959)
R&D exp	(930)	(1,249)	(1,583)	(1,843)	(2,158)
Other operating exp.	(205)	(159)	(47)	(3)	65
Operating profit	952	796	1,066	1,484	1,868
Finance costs	(151)	(100)	(112)	(128)	(142)
Other non-oper exp.	235	555	407	443	526
Pre-tax profit	1,035	1,252	1,362	1,798	2,253
Income tax expense	(87)	(115)	(98)	(146)	(183)
Minority interests	(7)	(0)	(4)	(3)	(5)
Net profit to shareholders	955	1,137	1,267	1,654	2,074

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net profit	1,035	1,252	1,362	1,798	2,253
Depreciation/amortization	170	109	117	110	114
Change in working capital	(533)	(185)	576	(701)	(848)
Others	480	122	(98)	(146)	(183)
Net cash from operating	1,153	1,298	1,957	1,061	1,335
Capex	(159)	(150)	(150)	(150)	(150)
Others	(32)	(221)	(43)	(42)	(40)
Net cash from investing	(192)	(371)	(193)	(192)	(190)
Net borrowings	217	1,176	1,014	321	383
Dividend paid	0	(69)	(95)	(124)	(155)
Others	145	(188)	4	3	5
Net cash from financing	362	919	922	200	233
Net change in cash	1,323	1,847	2,686	1,069	1,379
Cash at beginning of the year	2,526	3,787	5,556	8,582	9,693
Exchange difference	(62)	96	340	42	40
Cash at the end of the year	3,787	5,556	8,582	9,693	11,111

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	10,394	13,520	15,979	18,271	21,134
Cash & equivalents	3,787	5,556	8,582	9,693	11,111
Account receivables	4,580	5,894	5,428	6,329	7,425
Amount due from customers	1,904	1,741	1,599	1,848	2,156
Other current assets	123	328	370	402	441
Non-current assets	2,693	3,383	3,119	3,159	3,195
PPE	858	1,220	1,000	1,081	1,157
Intangible assets	1,086	1,037	993	951	911
Other non-current assets	749	1,126	1,126	1,126	1,126
Total assets	13,087	16,902	19,098	21,430	24,329
Current liabilities	2,718	3,986	5,121	5,824	6,686
ST borrowings	368	917	2,043	2,265	2,530
Account payables	1,753	2,252	2,794	3,228	3,767
Accrued expense	117	181	0	0	0
Other current liabilities	480	635	285	331	388
Non-current liabilities	1,592	1,290	1,178	1,277	1,395
LT borrowings	1,421	1,021	909	1,008	1,126
Other non-current liabilities	171	269	269	269	269
Total liabilities	4,311	5,276	6,300	7,101	8,080
Share capital	132	139	139	139	139
Capital surplus	4,735	6,294	6,294	6,294	6,294
Retained earnings	4,492	5,760	6,932	8,463	10,382
Other reserves	-605	-589	-589	-589	-589
Minority interest	23	23	23	23	23
Total equity	8,776	11,627	12,799	14,329	16,248
Total liabilities and equity	13,087	16,902	19,098	21,430	24,329

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue mix					
Emerging cloud business	17%	23%	29%	33%	36%
Traditional IT outsourcing	83%	77%	71%	67%	64%
Growth (%)					
Revenue	17%	30%	22%	21%	16%
Gross profit	15%	19%	19%	24%	17%
Operating profit	15%	-16%	34%	39%	26%
Net profit	26%	19%	11%	31%	25%
Profit & loss ratio (%)					
Gross margin	29.2%	26.7%	26.2%	26.7%	27.0%
Operating margin	6.7%	4.3%	4.8%	5.5%	6.0%
Net profit margin	6.8%	6.2%	5.7%	6.1%	6.6%
Balance sheet ratio					
Receivable turnover days	117	115	87	84	85
Amount due days	49	34	26	25	25
Payable turnover days	63	60	61	58	59
Current ratio (x)	3.82	3.39	3.12	3.14	3.16
Net debt to equity	net cash				
Profitability (%)					
ROE	12.5%	11.1%	10.4%	12.2%	13.6%
ROIC	13.5%	10.1%	13.7%	19.0%	21.5%
Per share data (RMB)					
EPS (RMB)	0.32	0.36	0.40	0.52	0.66
DPS (RMB)	0.03	0.03	0.03	0.04	0.05
BVPS (RMB)	2.93	3.68	4.05	4.54	5.15

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CMBIGM Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIGM

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

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