

Chinasoft (354 HK)

Benefiting from localization trend with KaihongOS

Chinasoft hosted an investor call on 11 Jan to discuss the latest updates regarding KaihongOS development. We believe the key takeaways is that Chinasoft is benefiting from the localization trend in a broader sense, from KaihongOS, Kunpeng (ARM) cloud migration, ERP application software and IoT products. After a year of workforce restructuring, we expect Chinasoft revenue growth to accelerate in FY23E as enterprise digitalization and IT spending will pick up with loosened COVID restrictions in China. Maintain BUY with new target price of HK\$9.14.

■ **KaihongOS for IoT based on OpenHarmony.** Chinasoft cooperated with Shenzhen Kai Hong Digital Industry Development (SZ Kai Hong) to develop Kaihong OS (R&D on middleware/ kits/ domestic chip compatibility, etc.) based on OpenHarmony and IoT devices management platform. SZ Kai Hong is a JV set up by BJ Chinasoft and Shenzhen Capital and that Huawei indirectly owns 20% stake. SZ Kai Hong strategically focuses on manufacturing, transportation, infrastructure, healthcare, finance and education industries which have strong demand in digitalization. Chinasoft's revenue related to KaihongOS includes IoT products sales and IT outsourcing services. We expect such revenue to be RMB2.5bn in FY22E, accounting for 12% of revenue.

■ **New Businesses: benefiting from localization demand in a broader sense.** Instead of involving in Windows PC system replacement, Chinasoft New Businesses segment growth is driven by localization trend in a broader sense including 1) KaihongOS R&D, 2) Huawei Cloud migration based on Kunpeng (ARM) chipsets, 3) application software such as Huawei ERP project and 4) IoT devices R&D based on Kaihong OS. We expect Chinasoft New Businesses revenue to grow 34%/25% YoY in FY22-23E.

■ **Traditional IT Outsourcing: steady growth.** We expect Chinasoft to maintain a steady growth in traditional IT outsourcing business with +5%/13% YoY in FY22-23E. The slowdown in FY22 was due to the COVID resurgence in 2H22 and that telecom and internet customers scaled back in IT spending. We expect demand to pick up gradually in FY23E as macro environment improves.

■ **Maintain BUY.** We lowered FY22 net profit by 6% but raised FY23-net profit by 3% as we expect enterprise digitalization and hence IT spending to reaccelerate with China COVID policy change. Maintain BUY with new target price of HK\$9.14 (prior HK\$7.79) as we roll forward to 15x fully diluted FY24E P/E (in-line with 3-year mean).

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	14,101	18,398	20,865	24,436	27,773
YoY growth (%)	17.1	30.5	13.4	17.1	13.7
Net profit (RMB mn)	954.9	1,136.9	1,171.5	1,435.1	1,674.1
Diluted EPS (RMB)	0.32	0.36	0.38	0.46	0.54
YoY growth (%)	12.6	12.9	5.3	22.5	16.7
Consensus EPS (RMB)	0.32	0.36	0.42	0.50	0.61
Diluted P/E (x)	14.9	26.1	16.3	13.3	11.4
EV/Sales (x)	1.2	0.8	0.6	0.5	0.4
Yield (%)	0.5	0.3	0.5	0.6	0.7
ROE (%)	12.5	11.2	9.7	10.8	11.4
Net gearing (%)	(22.8)	(31.2)	(43.6)	(42.4)	(44.4)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$9.14**
 (Previous TP) HK\$7.79
Up/Downside **+28.3%**
Current Price **HK\$7.12**

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Stock Data

Mkt Cap (HK\$ mn) 21,552.3
 Avg 3 mths t/o (HK\$ mn) 6.3
 52w High/Low (HK\$) 8.90/4.83
 Total Issued Shares (mn) 3027.0
 Source: FactSet

Shareholding Structure

Chen Yuhong- Chairman 10.8%
 UBS Group AG 10.0%
 Source: HKEx

Share Performance

	Absolute	Relative
1-mth	3.0%	-4.3%
3-mth	44.1%	13.2%
6-mth	-6.8%	-8.2%

Source: FactSet

12-mth Price Performance



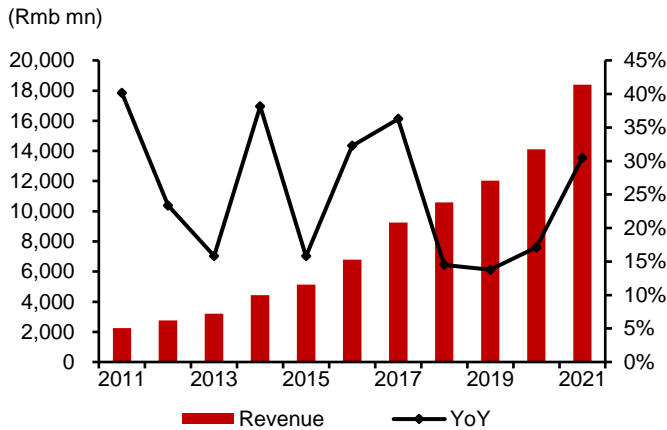
Source: FactSet

Related Reports

- Chinasoft (354 HK) – "FY1H22 beat, workforce restructuring in progress" – 30 Aug 2022 ([link](#))
- Chinasoft (354 HK) – "Shenzhen to provide subsidies in building Harmony/ Euler ecosystem" – 15 July 2022 ([link](#))

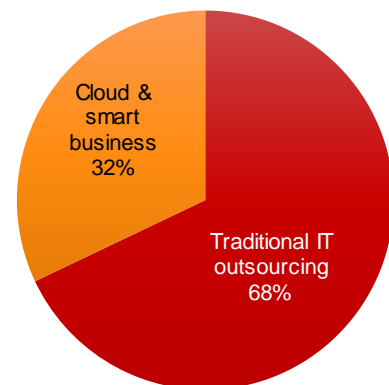
Focus Charts

Figure 1: Revenue and growth



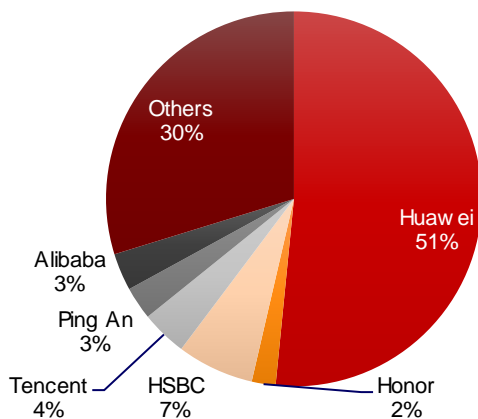
Source: Company data, CMBIGM estimates

Figure 2: Revenue mix (FY1H22)



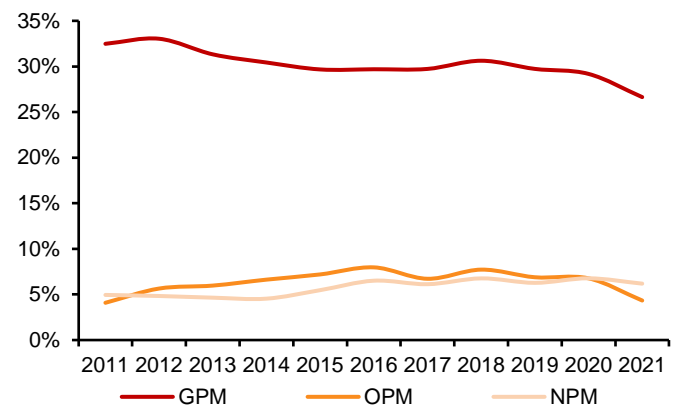
Source: Company data, CMBIGM estimates

Figure 3: Revenue mix by customer (FY1H22)



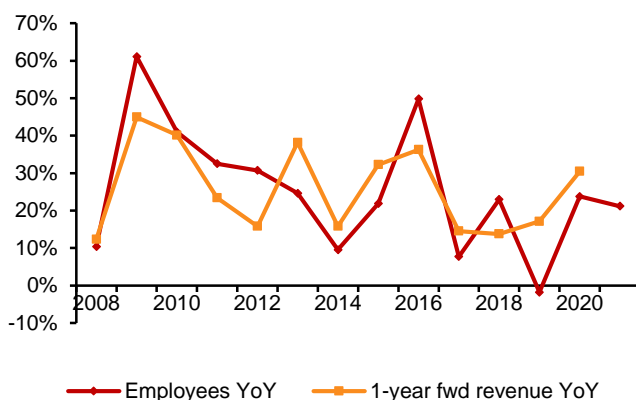
Source: Company data, CMBIGM estimates

Figure 4: Margins



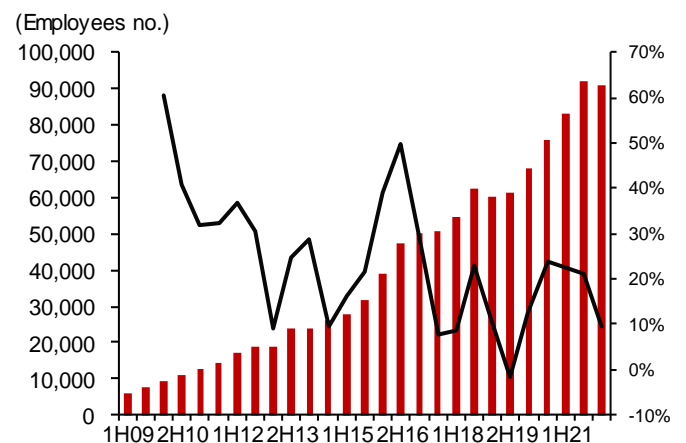
Source: Company data, CMBIGM

Figure 5: Forward revenue and employees growth



Source: Company data, CMBIGM

Figure 6: Chinasoft employee trend



Source: Company data, CMBIGM

IoT use cases based on KaihongOS

Figure 7: Applications in smart infrastructure



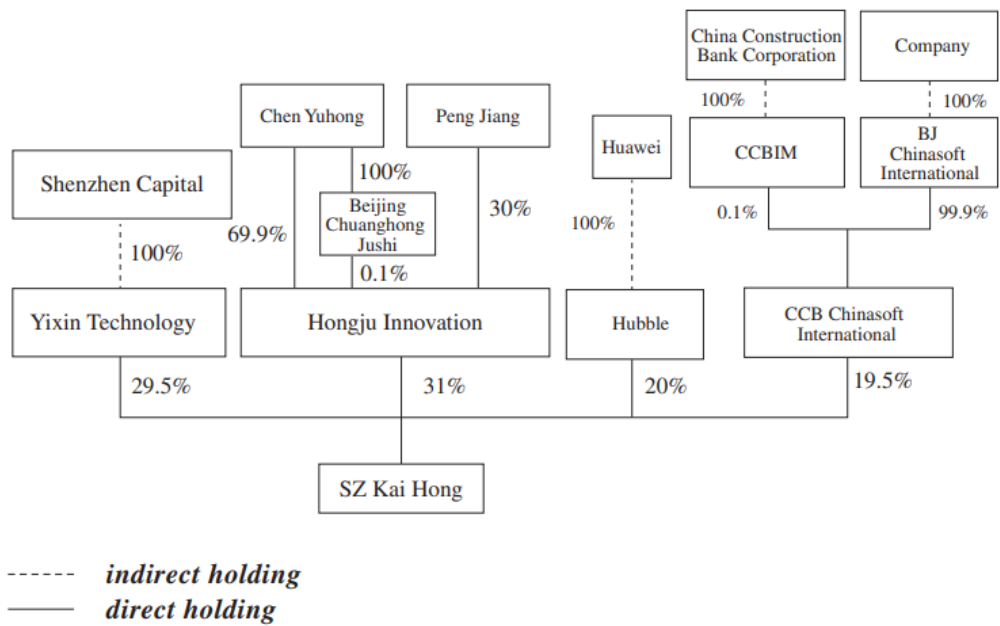
Source: Kaihong, CMBIGM

Figure 8: IoT devices management platform



Source: Kaihong, CMBIGM

Figure 9: Shareholding structure of SZ Kai Hong



Source: Company data, CMBIGM

Earnings revision

Figure 10: Earnings revision

RMB mn	2022E			2023E			2024E		
	New	Old	%Diff	New	Old	%Diff	New	Old	%Diff
Sales	20,865	22,105	-6%	24,436	25,576	-4%	27,773	30,145	-8%
Gross profit	5,062	5,357	-6%	5,760	5,916	-3%	6,688	6,990	-4%
OP Profit	897	944	-5%	1,175	1,117	5%	1,372	1,333	3%
PBT	1,248	1,323	-6%	1,557	1,510	3%	1,812	1,806	0%
Net profit	1,171	1,243	-6%	1,435	1,392	3%	1,674	1,668	0%
EPS (RMB)	0.38	0.40	-4%	0.46	0.44	5%	0.54	0.53	2%
Margins									
GM	24.3%	24.2%	3 bps	23.6%	23.1%	44 bps	24.1%	23.2%	89 bps
OPM	4.3%	4.3%	3 bps	4.8%	4.4%	44 bps	4.9%	4.4%	52 bps
PBT margin	6.0%	6.0%	-1 bps	6.4%	5.9%	47 bps	6.5%	6.0%	54 bps
Net margin	5.6%	5.6%	-1 bps	5.9%	5.4%	43 bps	6.0%	5.5%	49 bps

Source: Company data, CMBIGM estimates

Figure 11: CMBI estimates vs consensus

RMB mn	2022E			2023E			2024E		
	CMBI	Street	Diff	CMBI	Street	Diff	CMBI	Street	Diff
Sales	20,865	22,535	-7%	24,436	27,317	-11%	27,773	32,387	-14%
Gross profit	5,062	5,683	-11%	5,760	6,945	-17%	6,688	8,328	-20%
OP Profit	897	1,206	-26%	1,175	1,538	-24%	1,372	1,917	-28%
PBT	1,248	1,378	-9%	1,557	1,704	-9%	1,812	2,084	-13%
Net profit	1,171	1,290	-9%	1,435	1,566	-8%	1,674	1,865	-10%
EPS (RMB)	0.38	0.41	-8%	0.46	0.51	-9%	0.54	0.61	-11%
Margins									
GM	24.3%	25.2%	-96 bps	23.6%	25.4%	-185 bps	24.1%	25.7%	-163 bps
OPM	4.3%	5.4%	-106 bps	4.8%	5.6%	-82 bps	4.9%	5.9%	-98 bps
PBT margin	6.0%	6.1%	-13 bps	6.4%	6.2%	13 bps	6.5%	6.4%	9 bps
Net margin	5.6%	5.7%	-11 bps	5.9%	5.7%	14 bps	6.0%	5.8%	27 bps

Source: Company data, CMBIGM estimates

Operating model

Figure 12: Operating model

RMB mn	2020	2021	2022E	2023E	2024E
Revenues	14,101	18,398	20,865	24,436	27,773
Cost of sales	(9,983)	(13,494)	(15,804)	(18,675)	(21,085)
Gross Profit	4,118	4,904	5,062	5,760	6,688
<i>Gross margin</i>	<i>29.2%</i>	<i>26.7%</i>	<i>24.3%</i>	<i>23.6%</i>	<i>24.1%</i>
R&D	(930)	(1,249)	(1,347)	(1,659)	(1,855)
SG&A	(2,031)	(2,699)	(2,889)	(3,311)	(3,791)
Operating Income	952	796	897	1,175	1,372
<i>Operating margin</i>	<i>6.7%</i>	<i>4.3%</i>	<i>4.3%</i>	<i>4.8%</i>	<i>4.9%</i>
Non-Operating Income	83	456	351	382	440
Profit Before Tax	1,035	1,252	1,248	1,557	1,812
Income tax (expense) gain	(87)	(115)	(78)	(123)	(140)
Minorities	(7)	(0)	(2)	(1)	(2)
Net Income to Shareholders	955	1,137	1,171	1,435	1,674
<i>Net margin</i>	<i>6.8%</i>	<i>6.2%</i>	<i>5.6%</i>	<i>5.9%</i>	<i>6.0%</i>
EPS (RMB)	0.33	0.37	0.38	0.46	0.54
Fully diluted EPS (RMB)	0.32	0.36	0.38	0.46	0.54
Revenue breakdown					
IT outsourcing	10,830	13,063	13,716	15,499	17,049
Emerging cloud business	3,271	5,335	7,149	8,937	10,724
Huawei	8,030	9,880	9,979	10,977	12,404
HSBC	830	1,180	1,357	1,493	1,642
Tencent	500	706	720	792	951
Alibaba	400	590	602	662	861
Ping An	450	550	605	666	732
Others	3,891	5,492	7,603	9,847	11,184
Growth YoY					
Revenues	17%	30%	13%	17%	14%
Gross profit	15%	19%	3%	14%	16%
Operating Income	15%	-16%	13%	31%	17%
EPS	7%	13%	2%	23%	17%

Source: Company data, CMBIGM estimates

Figure 13: Semi-annual operating model

RMB mn	1H20	2H20	1H21	2H21	1H22	2H22E	1H23E	2H23E
Revenues	6,059	8,042	8,341	10,057	10,025	10,840	11,078	13,358
Gross Profit	1,649	2,469	2,294	2,610	2,482	2,580	2,641	3,119
Operating profit	421	531	423	374	485	412	567	608
Net profit (loss)	401	554	518	619	572	600	590	846
EPS (RMB)	0.16	0.19	0.19	0.20	0.20	0.19	0.19	0.27
Margins								
Gross margin	27.2%	30.7%	27.5%	26.0%	24.8%	23.8%	23.8%	23.4%
Operating margin	6.9%	6.6%	5.1%	3.7%	4.8%	3.8%	5.1%	4.6%
Net margin	6.6%	6.9%	6.2%	6.2%	5.7%	5.5%	5.3%	6.3%
Growth (HoH)								
Revenues	-7%	33%	4%	21%	0%	8%	2%	21%
Gross Profit	-18%	50%	-7%	14%	-5%	4%	2%	18%
Operating profit	5%	26%	-20%	-12%	30%	-15%	38%	7%
Net profit (loss)	2%	38%	-6%	20%	-8%	5%	-2%	43%
Growth (YoY)								
Revenues	9%	24%	38%	25%	20%	8%	11%	23%
Gross Profit	5%	22%	39%	6%	8%	-1%	6%	21%
Operating profit	-1%	32%	0%	-30%	15%	10%	17%	48%
Net profit (loss)	11%	41%	29%	12%	10%	-3%	3%	41%

Source: Company data, CMBIGM estimates

Valuation

Chinasoft (354 HK, BUY, TP HK\$9.14)

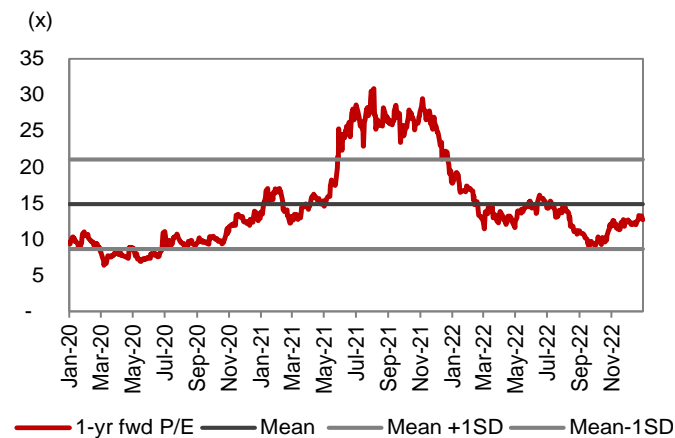
We lowered FY22 net profit by 6% but raised FY23-net profit by 3% as we expect enterprise digitalization and hence IT spending to reaccelerate with China COVID policy change. Maintain BUY with new target price of HK\$9.14 (prior HK\$7.79) as we roll forward to 15x fully diluted FY24E P/E (in-line with 3-year mean).

Figure 14: Peers' valuation

Company	Ticker	Rating	Mk Cap (US\$ mn)	Price (LC)	TP (LC)	P/E		ROE		Sales CAGR	EPS CAGR
						FY23E	FY24E	FY23E	FY24E	FY21-24	FY21-24
Chinasoft	354 HK	BUY	2,758	7.12	9.14	13.3	11.4	10.8	11.4	20%	13%
iSoftStone	301236 CH	NR	3,645	38.85	N/A	13.8	10.3	16.1	17.4	22%	29%
Digital China	000034 CH	NR	2,229	22.74	N/A	11.7	9.8	16.1	16.4	9%	84%
Infosys	INFO IN	NR	76,007	1480.70	N/A	25.3	21.8	31.3	33.2	18%	14%
Tata Consultancy	TCS IN	NR	150,111	3344.90	N/A	28.9	25.4	44.9	46.4	15%	15%
Mean						18.6	15.7	23.8	25.0	17%	31%
Median						13.8	11.4	16.1	17.4	18%	15%

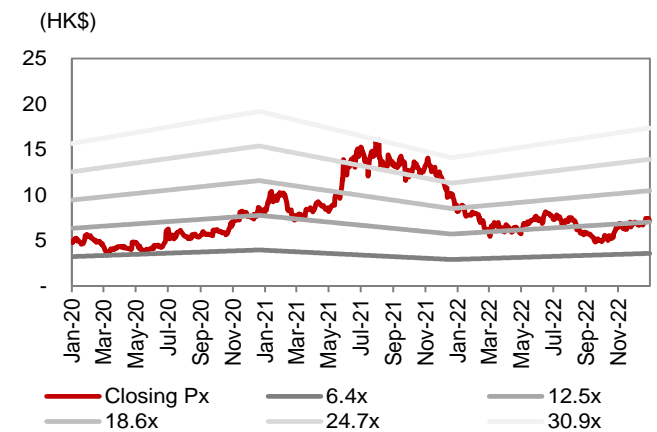
Source: Bloomberg, CMBIGM

Figure 15: 12M forward P/E band



Source: Company data, CMBIGM

Figure 16: 12M forward P/B band



Source: Company data, CMBIGM

Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	12,042	14,101	18,398	20,865	24,436	27,773
Cost of goods sold	(8,459)	(9,983)	(13,494)	(15,804)	(18,675)	(21,085)
Gross profit	3,583	4,118	4,904	5,062	5,760	6,688
Operating expenses	(2,756)	(3,167)	(4,108)	(4,165)	(4,586)	(5,316)
Selling expense	(618)	(729)	(943)	(1,064)	(1,246)	(1,416)
Admin expense	(1,196)	(1,302)	(1,756)	(1,825)	(2,065)	(2,374)
R&D expense	(809)	(930)	(1,249)	(1,347)	(1,659)	(1,855)
Others	(134)	(205)	(159)	70	385	329
Operating profit	827	952	796	897	1,175	1,372
Interest expense	(166)	(151)	(100)	(110)	(85)	(95)
Others	138	235	555	461	467	535
Pre-tax profit	799	1,035	1,252	1,248	1,557	1,812
Income tax	(42)	(87)	(115)	(78)	(123)	(140)
Minority interest	2	(7)	(0)	(2)	(1)	(2)
Net profit	755	955	1,137	1,171	1,435	1,674

BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	8,198	10,394	13,520	14,079	16,298	18,362
Cash & equivalents	2,526	3,787	5,556	7,510	8,201	9,342
Restricted cash	3,297	4,580	5,894	4,843	5,990	6,700
Other current assets	2,375	2,027	2,069	1,727	2,108	2,320
Non-current assets	2,547	2,693	3,383	3,476	3,503	3,527
PP&E	802	858	1,220	1,014	1,094	1,169
Intangibles	1,101	1,086	1,037	1,021	968	917
Other non-current assets	643	749	1,126	1,440	1,440	1,440
Total assets	10,745	13,087	16,902	17,555	19,801	21,889
Current liabilities	3,150	2,718	3,986	4,732	5,651	6,189
Short-term borrowings	1,523	368	917	2,027	2,299	2,474
Account payables	1,229	1,753	2,252	2,463	3,053	3,382
Other current liabilities	397	597	817	242	298	333
Non-current liabilities	1,062	1,592	1,290	215	215	215
Long-term borrowings	928	1,421	1,021	0	0	0
Other non-current liabilities	134	171	269	215	215	215
Total liabilities	4,211	4,311	5,276	4,947	5,866	6,404
Share capital	116	132	139	139	139	139
Capital surplus	3,145	4,735	6,294	6,223	6,223	6,223
Retained earnings	3,677	4,492	5,760	6,778	8,105	9,655
Other reserves	(471)	(605)	(589)	(554)	(554)	(554)
Total shareholders equity	6,468	8,753	11,604	12,586	13,913	15,463
Minority interest	66	23	23	22	22	22
Total equity and liabilities	10,745	13,087	16,902	17,555	19,801	21,889

CASH FLOW	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	799	1,035	1,252	1,248	1,557	1,812
Depreciation & amortization	197	170	221	140	123	126
Tax paid	(84)	(83)	(20)	(78)	(123)	(140)
Change in working capital	(516)	(533)	(887)	1,043	(882)	(559)
Others	358	564	396	367	0	0
Net cash from operations	754	1,153	962	2,720	675	1,239
Investing						
Capital expenditure	(105)	(159)	(287)	(150)	(150)	(150)
Others	(120)	(32)	(242)	(601)	(53)	(51)
Net cash from investing	(224)	(192)	(530)	(751)	(203)	(201)
Financing						
Dividend paid	(48)	(52)	(70)	(88)	(108)	(125)
Net borrowings	52	217	173	88	273	175
Others	(653)	196	1,274	(370)	1	2
Net cash from financing	(650)	362	1,377	(369)	166	52
Net change in cash						
Cash at the beginning of the year	2,646	2,526	3,787	5,556	7,510	8,201
Exchange difference	(1)	(62)	(40)	354	53	51
Cash at the end of the year	2,526	3,787	5,556	7,510	8,201	9,342
GROWTH	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Revenue	13.8%	17.1%	30.5%	13.4%	17.1%	13.7%
Gross profit	10.4%	14.9%	19.1%	3.2%	13.8%	16.1%
Operating profit	1.5%	15.1%	(16.3%)	12.6%	31.0%	16.8%
Net profit	5.5%	26.5%	19.1%	3.0%	22.5%	16.7%
PROFITABILITY	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Gross profit margin	29.8%	29.2%	26.7%	24.3%	23.6%	24.1%
Operating margin	6.9%	6.7%	4.3%	4.3%	4.8%	4.9%
Return on equity (ROE)	12.1%	12.5%	11.2%	9.7%	10.8%	11.4%
GEARING/LIQUIDITY/ACTIVITIES	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Net debt to equity (x)	(0.0)	(0.2)	(0.3)	(0.4)	(0.4)	(0.4)
Current ratio (x)	2.6	3.8	3.4	3.0	2.9	3.0
Receivable turnover days	98.6	116.9	115.3	83.6	88.2	86.8
Inventory turnover days	2.3	1.9	4.4	4.2	4.4	4.3
Payable turnover days	87.8	73.4	52.3	63.2	60.1	56.1
VALUATION	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
P/E	11.4	12.5	23.0	16.0	13.0	11.2
P/E (diluted)	12.3	14.9	26.1	16.3	13.3	11.4
P/B	1.4	1.6	2.5	1.5	1.4	1.2
Div yield (%)	0.6	0.5	0.3	0.5	0.6	0.7
EV	18,835.1	16,912.8	15,291.9	13,427.0	13,008.5	12,041.8
EV/Sales	1.6	1.2	0.8	0.6	0.5	0.4

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

Disclosures & Disclaimers

Analyst Certification

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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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