

# Chinasoft (354 HK)

## On a slow road to recovery

Chinasoft delivered a weak set of FY22 results with revenue of RMB20.0bn (+9% YoY) and net profit of RMB759mn (-33% YoY) mainly due to GPM erosion (-3.7 ppts to 23.0%) despite better opex control (opex -2% YoY). We think the road to recovery will be slow but 1) lower reliance on Huawei (49% of FY22 revenue vs. 54% in FY21), 2) continued workforce restructuring (-11% YoY in FY22) will help margin recovery. Key catalyst being Huawei's new product launch related to MetaERP and Pangu large AI model. Maintain BUY.

### ■ FY22 missed on GPM erosion but opex control better than feared.

Chinasoft delivered moderate revenue growth of +9% YoY to RMB20.0bn in FY22. Net profit was down 33% YoY to RMB759mn, missing our/consensus estimates by 35%/ 37% respectively. In terms of revenue mix, Cloud intelligent services grew at +24% YoY to RMB6.62bn while traditional IT service business was up merely 2% YoY to RMB13.4bn. GPM remained under pressure, down 3.7 pct pts YoY to 23.0% mainly due to 1) COVID-19 and 2) extra staff costs related to demand fluctuations from Huawei. Meanwhile, opex control was better than expected (-2% YoY to RMB4bn).

### ■ On-going customer diversification since Huawei business faces headwinds.

As we [highlighted](#) earlier, US export restrictions have affected Huawei's product development roadmap as well as revenue and margin to Chinasoft. Huawei's revenue contribution to Chinasoft decreased to 49% in FY22 (vs. 54% in FY21) and we expect it to decline further to 35% in FY25E with the ramp-up of SOE customers such as China Mobile (revenue +25% YoY in FY22) and China Telecom (+39% YoY).

### ■ FY23E focus on profitability and cash flow improvement.

Chinasoft highlighted in the results conference call that profitability and cash flow management will be the focus in FY23E. Chinasoft has 82,140 employees in FY22 (-11% YoY) and we expect workforce restructuring to continue (-3% YoY to 80k by end of FY23E). Lower opex will help net margin recover to 4.3% in FY23E (vs. 3.8% in FY22), implying +20% YoY in net profit.

### ■ Maintain BUY.

We cut FY23-24E net profit forecast by 34-37% to reflect 1) slow top-line recovery post COVID-19 and 2) lower opex ratio. Maintain BUY with new target price of HK\$6.08 (prior HK\$9.14), based on unchanged 15x FY24E P/E. We think gradual improvement in net margin will drive re-rating. Key catalyst is Huawei's new product launch related to MetaERP and Pangu large AI model as Chinasoft provides IT services to assist Huawei in new product development.

### Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	18,398	20,005	21,069	23,264	25,888
YoY growth (%)	30.5	8.7	5.3	10.4	11.3
Net profit (RMB mn)	1,136.9	759.4	909.9	1,099.5	1,377.4
Diluted EPS (RMB)	0.36	0.25	0.29	0.36	0.45
YoY growth (%)	12.9	(31.8)	19.8	20.8	25.3
Consensus EPS (RMB)	0.36	0.25	0.49	0.61	na
P/E (x)	12.4	18.2	15.2	12.6	10.0
EV/Sales (x)	0.5	0.5	0.3	0.3	0.2
Yield (%)	0.3	0.9	0.5	0.6	0.8
ROE (%)	11.2	6.4	7.3	8.2	9.4
Net gearing (%)	(31.2)	(25.4)	(47.5)	(48.0)	(48.6)

Source: Company data, Bloomberg, CMBIGM estimates

## BUY (Maintain)

**Target Price** **HK\$6.08**

(Previous TP) HK\$9.14

**Up/Downside** **19.5%**

**Current Price** **HK\$5.09**

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### Stock Data

Mkt Cap (HK\$ mn)	15,407.5
Avg 3 mths t/o (HK\$ mn)	152.6
52w High/Low (HK\$)	8.17/4.83
Total Issued Shares (mn)	3027.0

Source: FactSet

### Shareholding Structure

Chen Yuhong- Chairman	10.8%
UBS Group AG	9.0%

Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	-9.6%	-11.9%
3-mth	-25.0%	-27.0%
6-mth	5.4%	-10.6%

Source: FactSet

### 12-mth Price Performance



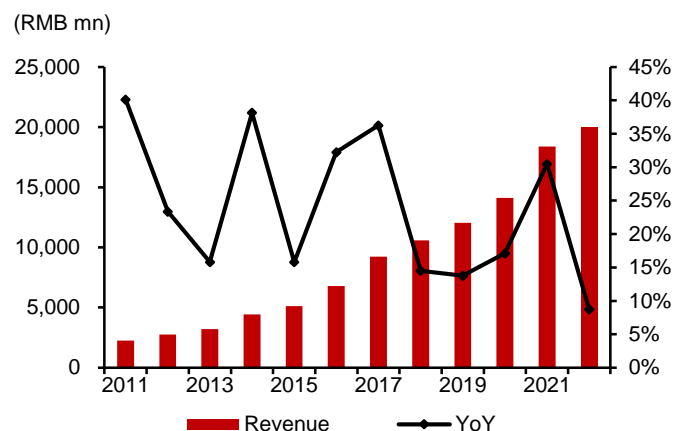
Source: FactSet

### Related Reports

- China Software & IT Services – “Implications of Huawei MetaERP” – 20 Mar 2023 ([link](#))
- Chinasoft (354 HK) – “US is reviewing Huawei export license policy” – 2 Mar 2023 ([link](#))
- Chinasoft (354 HK) – “Benefiting from localization trend with KaihongOS” – 11 Jan 2023 ([link](#))

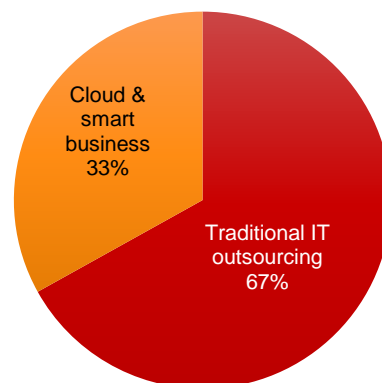
## Focus Charts

**Figure 1: Revenue and growth**



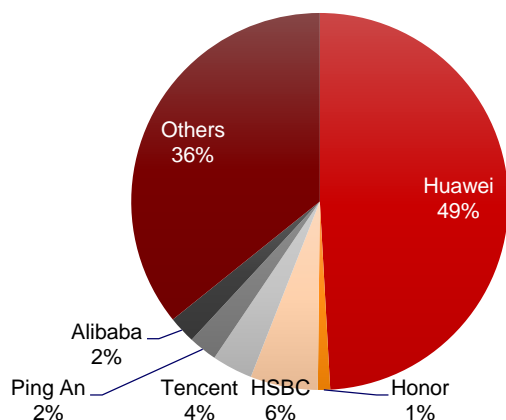
Source: Company data, CMBIGM estimates

**Figure 2: Revenue mix (2022)**



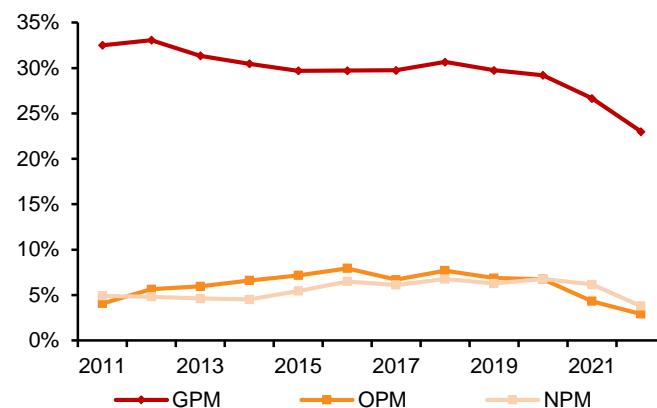
Source: Company data, CMBIGM estimates

**Figure 3: Customer breakdown (FY22)**



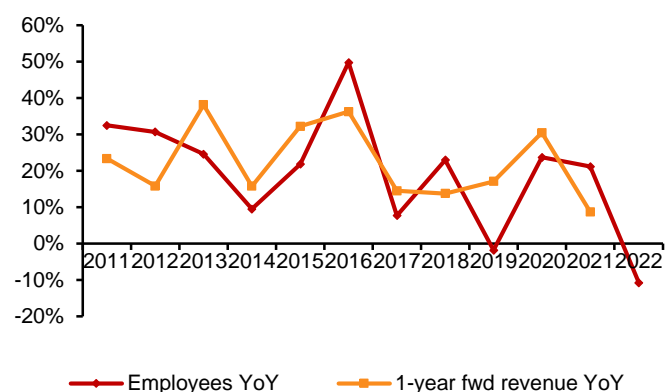
Source: Company data, CMBIGM estimates

**Figure 4: Margins**



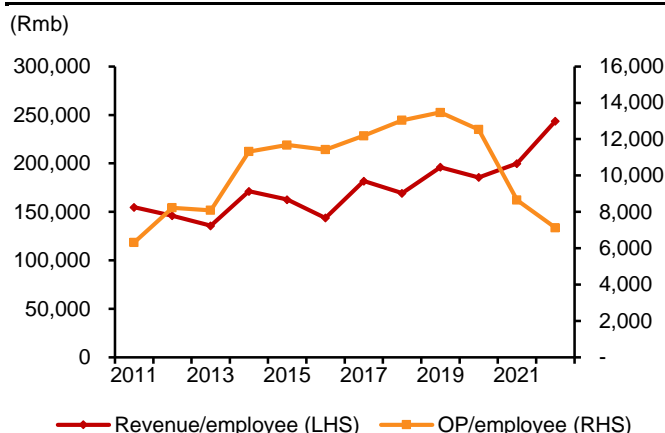
Source: Company data, CMBIGM

**Figure 5: Forward revenue and employees**



Source: Company data, CMBIGM

**Figure 6: Revenue & operating profit per employee**



Source: Company data, CMBIGM

## FY22 results review

- **Revenue** was at RMB20,005mn (+9% YoY), **below** our estimates by -4% and consensus by -9%.
  - **Cloud intelligent services** was up +24% YoY to RMB6.6bn.
  - **Traditional IT Services** was up +2% YoY to RMB13.4bn.
- **Gross profit** was at RMB4,600mn (-6% YoY), **below** our estimates by -9% and consensus by -16%.
- **Gross margin** was at 23.0%, (-3.7 pct pts YoY), **below** our estimate by -1.3 pct pts and consensus by -2.0 pct pts.
  - Company attributed the decline to:
    - 1) The COVID-19 impact.
    - 2) Increased one-time costs caused by fluctuations in demand from major customers.
- **Operating profit** was at RMB586mn (-26% YoY), **below** our estimates by -35% and consensus by -47%.
- **Operating margin** was at 2.9% (-1.5 pct pts YoY), **below** our estimate by -1.4 pct pts and consensus by -2.2 pct pts.
- **Net profit** was at RMB759mn (-33% YoY), **below** our estimates by -35% and consensus by -37%.
- **EPS** was at RMB0.26 (-36% YoY).

Figure 7: FY22 results review

354 HK	2021	2022		2022	versus	2022	versus
RMB mn	Actual	Actual	YoY	CMBI	CMBI	Consensus	Consensus
Revenue	18,398	20,005	9%	20,865	-4%	21,947	-9%
Gross profit	4,904	4,600	-6%	5,062	-9%	5,481	-16%
<b>GPM</b>	<b>26.7%</b>	<b>23.0%</b>	<b>-3.7 pct pts</b>	<b>24.3%</b>	<b>-1.3 pct pts</b>	<b>25.0%</b>	<b>-2 pct pts</b>
Operating profit	796	586	-26%	897	-35%	1,111	-47%
<b>OPM</b>	<b>4.3%</b>	<b>2.9%</b>	<b>-1.5 pct pts</b>	<b>4.3%</b>	<b>-1.4 pct pts</b>	<b>5.1%</b>	<b>-2.2 pct pts</b>
PBT	1,252	830	-34%	1,248	-33%	1,336	-38%
Tax	(115)	(71)	-38%	(78)	-9%	(132)	-46%
Net income	1,137	759	-33%	1,171	-35%	1,205	-37%
<b>NPM</b>	<b>6.2%</b>	<b>3.8%</b>	<b>-2.4 pct pts</b>	<b>5.6%</b>	<b>-1.9 pct pts</b>	<b>5.5%</b>	<b>-1.7 pct pts</b>
EPS RMB cents	40.9	26.1	-36%	38.7	-33%	40.8	-36%

Source: Company data, CMBIGM

## Earnings revision

Figure 8: Earnings revision

RMB mn	2023E			2024E		
	New	Old	%Diff	New	Old	%Diff
Sales	21,069	24,436	-14%	23,264	27,773	-16%
Gross profit	4,564	5,760	-21%	4,862	6,688	-27%
OP Profit	715	1,175	-39%	910	1,372	-34%
PBT	1,006	1,557	-35%	1,219	1,812	-33%
Net profit	910	1,435	-37%	1,100	1,674	-34%
EPS (RMB)	0.30	0.47	-37%	0.36	0.55	-34%
<b>Margins</b>						
GM	21.7%	23.6%	-191 bps	20.9%	24.1%	-318 bps
OPM	3.4%	4.8%	-141 bps	3.9%	4.9%	-103 bps
PBT margin	4.8%	6.4%	-160 bps	5.2%	6.5%	-129 bps
Net margin	4.3%	5.9%	-155 bps	4.7%	6.0%	-130 bps

Source: Company data, CMBIGM estimates

Figure 9: CMBI estimates vs consensus

RMB mn	2023E			2024E		
	CMBI	Street	Diff	CMBI	Street	Diff
Sales	21,069	26,529	-21%	23,264	31,754	-27%
Gross profit	4,564	6,717	-32%	4,862	8,225	-41%
OP Profit	715	1,463	-51%	910	1,897	-52%
PBT	1,006	1,655	-39%	1,219	2,063	-41%
Net profit	910	1,480	-39%	1,100	1,815	-39%
EPS (RMB)	0.30	0.48	-37%	0.36	0.58	-37%
<b>Margins</b>						
GM	21.7%	25.3%	-366 bps	20.9%	25.9%	-500 bps
OPM	3.4%	5.5%	-212 bps	3.9%	6.0%	-206 bps
PBT margin	4.8%	6.2%	-146 bps	5.2%	6.5%	-126 bps
Net margin	4.3%	5.6%	-126 bps	4.7%	5.7%	-99 bps

Source: Company data, CMBIGM estimates, Bloomberg

## Operating model

Figure 10: Operating model

RMB mn	2021	2022	2023E	2024E	2025E
Revenues	18,398	20,005	21,069	23,264	25,888
Cost of sales	(13,494)	(15,405)	(16,504)	(18,401)	(20,521)
Gross Profit	4,904	4,600	4,564	4,862	5,367
<i>Gross margin</i>	<i>26.7%</i>	<i>23.0%</i>	<i>21.7%</i>	<i>20.9%</i>	<i>20.7%</i>
R&D	(1,249)	(1,238)	(1,408)	(1,524)	(1,676)
SG&A	(2,699)	(2,632)	(2,595)	(2,895)	(3,241)
Operating Income	796	586	715	910	1,189
<i>Operating margin</i>	<i>4.3%</i>	<i>2.9%</i>	<i>3.4%</i>	<i>3.9%</i>	<i>4.6%</i>
Non-Operating Income	456	244	291	309	340
Profit Before Tax	1,252	830	1,006	1,219	1,529
Income tax (expense) gain	(115)	(71)	(96)	(120)	(152)
Minorities	(0)	(1)	(0)	(0)	(0)
Net Income to Shareholders	1,137	759	910	1,100	1,377
<i>Net margin</i>	<i>6.2%</i>	<i>3.8%</i>	<i>4.3%</i>	<i>4.7%</i>	<i>5.3%</i>
EPS (RMB)	0.37	0.25	0.30	0.36	0.46
Fully diluted EPS (RMB)	0.36	0.25	0.29	0.36	0.45
<b>Revenue breakdown</b>					
IT outsourcing	13,063	13,387	13,789	14,892	16,679
Emerging cloud business	5,335	6,618	7,280	8,372	9,209
Huawei	9,882	9,827	9,335	9,242	9,150
HSBC	1,180	1,159	1,274	1,402	1,542
Tencent	706	697	766	843	927
Alibaba	590	467	514	565	622
Ping An	550	490	538	592	652
Others	5,490	7,366	8,640	10,619	12,996
<b>Growth YoY</b>					
Revenues	30%	9%	5%	10%	11%
Gross profit	19%	-6%	-1%	7%	10%
Operating Income	-16%	-26%	22%	27%	31%
EPS	13%	-32%	20%	21%	25%

Source: Company data, CMBIGM

**Figure 11: Semi-annual operating model**

RMB mn	1H20	2H20	1H21	2H21	1H22	2H22
Revenues	6,059	8,042	8,341	10,057	10,025	9,980
Gross Profit	1,649	2,469	2,294	2,610	2,482	2,118
Operating profit	421	531	423	374	485	101
Net profit (loss)	401	554	518	619	572	188
EPS (RMB)	0.16	0.19	0.19	0.20	0.20	0.06
<b>Margins</b>						
Gross margin	27.2%	30.7%	27.5%	26.0%	24.8%	21.2%
Operating margin	6.9%	6.6%	5.1%	3.7%	4.8%	1.0%
Net margin	6.6%	6.9%	6.2%	6.2%	5.7%	1.9%
<b>Growth (HoH)</b>						
Revenues	-7%	33%	4%	21%	0%	0%
Gross Profit	-18%	50%	-7%	14%	-5%	-15%
Operating profit	5%	26%	-20%	-12%	30%	-79%
Net profit (loss)	2%	38%	-6%	20%	-8%	-67%
<b>Growth (YoY)</b>						
Revenues	9%	24%	38%	25%	20%	-1%
Gross Profit	5%	22%	39%	6%	8%	-19%
Operating profit	-1%	32%	0%	-30%	15%	-73%
Net profit (loss)	11%	41%	29%	12%	10%	-70%

Source: Company data, CMBIGM

## Valuation

### Chinasoft (354 HK, BUY, TP HK\$6.08)

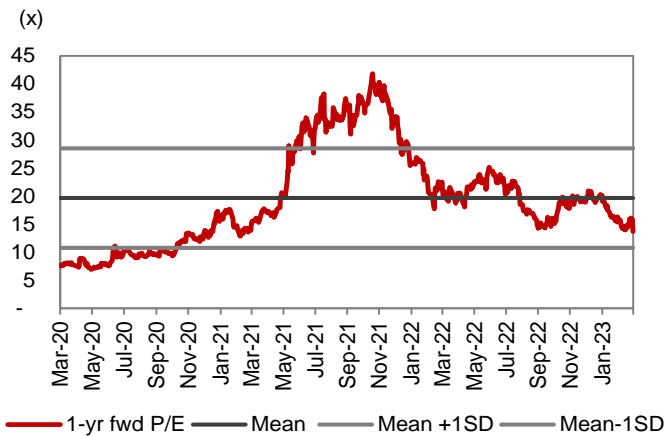
Maintain BUY with new target price of HK\$6.08 (prior HK\$9.14), based on unchanged 15x fully diluted FY24E P/E (in-line with 3-year mean).

Figure 12: Peers' valuation

Company	Ticker	Rating	Mk Cap (US\$ mn)	Price (LC)	TP (LC)	P/E		ROE		Sales CAGR FY21-24	EPS CAGR FY21-24	
						FY23E	FY24E	FY23E	FY24E			
Chinasoft	354 HK	BUY	1,963	5.09	6.08	15.2	12.6	7.3	8.2	8%	0%	
iSoftStone	301236 CH	NR	4,341	47.00	N/A	17.3	13.3	16.6	17.5	23%	27%	
Digital China	000034 CH	NR	2,940	30.23	N/A	16.6	14.0	15.6	15.9	8%	80%	
Infosys	INFO IN	NR	69,791	1383.55	N/A	23.5	20.3	32.1	34.5	18%	14%	
Tata Consultancy	TCS IN	NR	139,653	3138.90	N/A	27.1	23.8	44.7	46.5	15%	15%	
						<b>Mean</b>	<b>19.9</b>	<b>16.8</b>	<b>23.3</b>	<b>24.5</b>	<b>14%</b>	<b>27%</b>
						<b>Median</b>	<b>17.3</b>	<b>14.0</b>	<b>16.6</b>	<b>17.5</b>	<b>15%</b>	<b>15%</b>

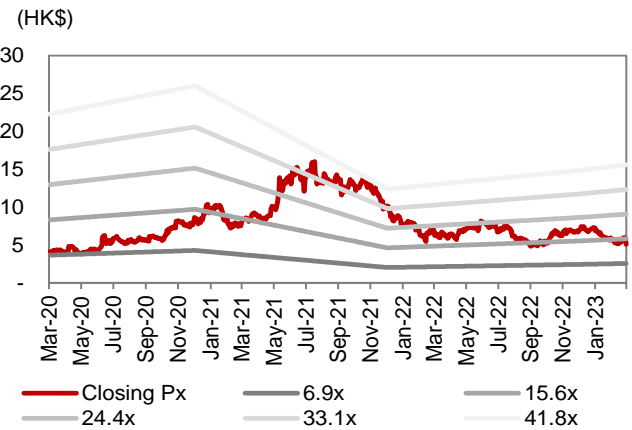
Source: Bloomberg, CMBIGM

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	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
<b>Revenue</b>	<b>14,101</b>	<b>18,398</b>	<b>20,005</b>	<b>21,069</b>	<b>23,264</b>	<b>25,888</b>
Cost of goods sold	(9,983)	(13,494)	(15,405)	(16,504)	(18,401)	(20,521)
<b>Gross profit</b>	<b>4,118</b>	<b>4,904</b>	<b>4,600</b>	<b>4,564</b>	<b>4,862</b>	<b>5,367</b>
<b>Operating expenses</b>	<b>(3,167)</b>	<b>(4,108)</b>	<b>(4,014)</b>	<b>(3,849)</b>	<b>(3,952)</b>	<b>(4,178)</b>
Selling expense	(729)	(943)	(949)	(924)	(1,020)	(1,135)
Admin expense	(1,302)	(1,756)	(1,683)	(1,671)	(1,875)	(2,106)
R&D expense	(930)	(1,249)	(1,238)	(1,408)	(1,524)	(1,676)
Others	(205)	(159)	(145)	153	467	739
<b>Operating profit</b>	<b>952</b>	<b>796</b>	<b>586</b>	<b>715</b>	<b>910</b>	<b>1,189</b>
Interest expense	(151)	(100)	(113)	(113)	(142)	(155)
Others	235	555	357	404	450	494
<b>Pre-tax profit</b>	<b>1,035</b>	<b>1,252</b>	<b>830</b>	<b>1,006</b>	<b>1,219</b>	<b>1,529</b>
Income tax	(87)	(115)	(71)	(96)	(120)	(152)
Minority interest	(7)	(0)	(1)	(0)	(0)	(0)
<b>Net profit</b>	<b>955</b>	<b>1,137</b>	<b>759</b>	<b>910</b>	<b>1,100</b>	<b>1,377</b>

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
<b>Current assets</b>	<b>10,394</b>	<b>13,520</b>	<b>13,601</b>	<b>16,325</b>	<b>17,704</b>	<b>19,428</b>
Cash & equivalents	3,787	5,556	5,005	8,981	9,735	10,683
Restricted cash	4,580	5,894	6,157	5,283	5,715	6,277
Other current assets	2,027	2,069	2,439	2,061	2,254	2,468
<b>Non-current assets</b>	<b>2,693</b>	<b>3,383</b>	<b>3,364</b>	<b>2,116</b>	<b>2,214</b>	<b>2,305</b>
PP&E	858	1,220	1,119	(61)	93	237
Intangibles	1,086	1,037	1,124	1,066	1,010	957
Other non-current assets	749	1,126	1,111	1,111	1,111	1,111
<b>Total assets</b>	<b>13,087</b>	<b>16,902</b>	<b>16,965</b>	<b>18,441</b>	<b>19,918</b>	<b>21,733</b>
<b>Current liabilities</b>	<b>2,718</b>	<b>3,986</b>	<b>3,553</b>	<b>4,472</b>	<b>4,868</b>	<b>5,331</b>
Short-term borrowings	368	917	766	1,949	2,089	2,263
Account payables	1,753	2,252	2,043	2,267	2,502	2,763
Other current liabilities	597	817	744	256	277	305
<b>Non-current liabilities</b>	<b>1,592</b>	<b>1,290</b>	<b>1,277</b>	<b>992</b>	<b>1,055</b>	<b>1,133</b>
Long-term borrowings	1,421	1,021	1,162	878	941	1,019
Other non-current liabilities	171	269	114	114	114	114
<b>Total liabilities</b>	<b>4,311</b>	<b>5,276</b>	<b>4,830</b>	<b>5,464</b>	<b>5,923</b>	<b>6,464</b>
Share capital	132	139	137	137	137	137
Capital surplus	4,735	6,294	6,014	6,014	6,014	6,014
Retained earnings	4,492	5,760	6,498	7,339	8,357	9,632
Other reserves	(605)	(589)	(539)	(539)	(539)	(539)
<b>Total shareholders equity</b>	<b>8,753</b>	<b>11,604</b>	<b>12,110</b>	<b>12,951</b>	<b>13,969</b>	<b>15,245</b>
Minority interest	23	23	25	25	25	25
<b>Total equity and liabilities</b>	<b>13,087</b>	<b>16,902</b>	<b>16,965</b>	<b>18,441</b>	<b>19,918</b>	<b>21,733</b>



<b>CASH FLOW</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec (RMB mn)</b>						
<b>Operating</b>						
Profit before taxation	1,035	1,252	830	1,006	1,219	1,529
Depreciation & amortization	170	221	1,333	90	51	59
Tax paid	(83)	(20)	(71)	(96)	(120)	(152)
Change in working capital	(533)	(887)	(766)	869	(368)	(488)
Others	564	396	367	0	0	0
<b>Net cash from operations</b>	<b>1,153</b>	<b>962</b>	<b>1,693</b>	<b>1,869</b>	<b>782</b>	<b>948</b>
<b>Investing</b>						
Capital expenditure	(159)	(287)	(150)	(150)	(150)	(150)
Others	(32)	(242)	(1,000)	(69)	(56)	(53)
<b>Net cash from investing</b>	<b>(192)</b>	<b>(530)</b>	<b>(1,150)</b>	<b>(219)</b>	<b>(206)</b>	<b>(203)</b>
<b>Financing</b>						
Dividend paid	(52)	(70)	(154)	(68)	(81)	(102)
Net borrowings	217	173	(10)	898	203	252
Others	196	1,274	(893)	0	0	0
<b>Net cash from financing</b>	<b>362</b>	<b>1,377</b>	<b>(1,057)</b>	<b>830</b>	<b>122</b>	<b>150</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	2,526	3,787	5,556	5,005	8,981	9,735
Exchange difference	(62)	(40)	(37)	1,495	56	53
<b>Cash at the end of the year</b>	<b>3,787</b>	<b>5,556</b>	<b>5,005</b>	<b>8,981</b>	<b>9,735</b>	<b>10,683</b>
<b>GROWTH</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
Revenue	17.1%	30.5%	8.7%	5.3%	10.4%	11.3%
Gross profit	14.9%	19.1%	(6.2%)	(0.8%)	6.5%	10.4%
Operating profit	15.1%	(16.3%)	(26.4%)	22.0%	27.3%	30.7%
Net profit	26.5%	19.1%	(33.2%)	19.8%	20.8%	25.3%
<b>PROFITABILITY</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
Gross profit margin	29.2%	26.7%	23.0%	21.7%	20.9%	20.7%
Operating margin	6.7%	4.3%	2.9%	3.4%	3.9%	4.6%
Return on equity (ROE)	12.5%	11.2%	6.4%	7.3%	8.2%	9.4%
<b>GEARING/LIQUIDITY/ACTIVITIES</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
Net debt to equity (x)	(0.2)	(0.3)	(0.3)	(0.5)	(0.5)	(0.5)
Current ratio (x)	3.8	3.4	3.8	3.7	3.6	3.6
Receivable turnover days	116.9	115.3	110.8	90.3	88.4	87.3
Inventory turnover days	1.9	4.4	2.4	2.5	2.4	2.4
Payable turnover days	73.4	52.3	63.2	60.1	47.8	49.5
<b>VALUATION</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
P/E (diluted)	14.0	12.4	18.2	15.2	12.6	10.0
P/B	1.6	2.5	1.5	1.1	1.0	0.9
Div yield (%)	0.5	0.3	0.9	0.5	0.6	0.8
EV	11,521.3	9,900.4	10,441.8	7,364.6	6,813.5	6,117.0
EV/Sales	0.8	0.5	0.5	0.3	0.3	0.2

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

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