

# Chinasoft (354 HK)

## US is reviewing Huawei export license policy

According to WSJ, the Biden's administration is reviewing Huawei export license policy. The US may not grant new licenses to US companies (e.g. Qualcomm, Intel) for sales to Huawei over national security concerns. The new action would extend the covered products from 5G technology to even older 4G products. We think this could affect Huawei's product development roadmap and thus Chinasoft's revenue and margin outlook. Suggest investors to focus on margin trend in Mar results announcement.

### ■ US may further restrict exports to Huawei, including older 4G products.

WSJ [reported](#) that the Biden's administration is considering revoking export license issued to US suppliers (e.g. Qualcomm, Intel) for sales to Huawei over national security concerns. Huawei was placed on the Entity List since 2019 but that technology below 5G could be sold to Huawei by US suppliers under existing rules. The new action would extend the covered products from 5G technology to even older 4G products. According to the news, the White House is telling Commerce to cut off the 4G sales of Huawei. According to Commerce Department's spokesman, the Commerce approved roughly 70% of the export control license applications last year involving China. On the other hand, BIS has approved Huawei licenses valued at US\$61.4bn between Nov 2020 and Apr 2021 after Huawei being put into the Entity List.

### ■ Huawei product development plan could be affected, negative to Chinasoft revenue and margin.

We think the move implies a heightened US-China tension. Although Huawei should have piled up inventory for the short-term use but it may hurt Huawei's product development plan. Chinasoft provides IT services such as software and hardware product development, testing, life cycle management etc. to Huawei. The Company derived 54% of revenue from Huawei in FY21, based on our estimate. The potential new restrictions may affect Huawei's product development roadmap and hence revenue and margin to Chinasoft.

### ■ Share price could be under pressure in the near term, wait until more colors on margin.

While we are positive on the long-term software localization trend and enterprises' IT spending recovery post COVID, we are concerned the earnings downside risk that Huawei may squeeze suppliers' margin further amid tougher business environment. We have not adjusted our earnings forecast. Maintain BUY with unchanged target price of HK\$9.14.

### 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	13.8	11.3	9.7
EV/Sales (x)	1.0	0.7	0.5	0.4	0.3
Yield (%)	0.5	0.3	0.6	0.7	0.8
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\$9.14**)

Up/Downside **53.1%**

Current Price **HK\$5.97**

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### Stock Data

Mkt Cap (HK\$ mn)	17,042.1
Avg 3 mths t/o (HK\$ mn)	6.7
52w High/Low (HK\$)	8.17/4.83
Total Issued Shares (mn)	3027.0
Source: FactSet	

### Shareholding Structure

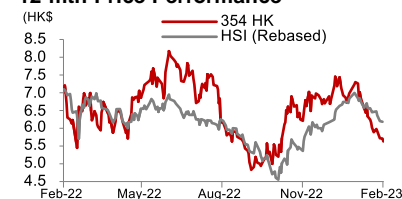
Chen Yuhong- Chairman	10.8%
UBS Group AG	10.0%
Source: HKEx	

### Share Performance

	Absolute	Relative
1-mth	-18.0%	-9.5%
3-mth	-15.1%	-20.2%
6-mth	-8.8%	-8.0%

Source: FactSet

### 12-mth Price Performance



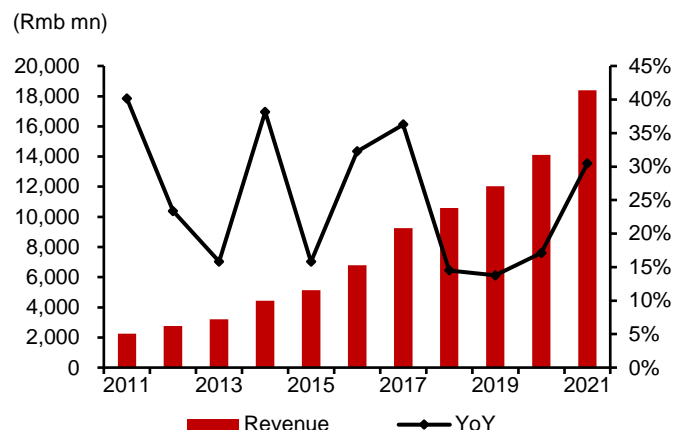
Source: FactSet

### Related Reports

- Chinasoft (354 HK) – "Benefiting from localization trend with KaihongOS" – 11 Jan 2023 ([link](#))
- Chinasoft (354 HK) – "FY1H22 beat, workforce restructuring in progress" – 30 Aug 2022 ([link](#))

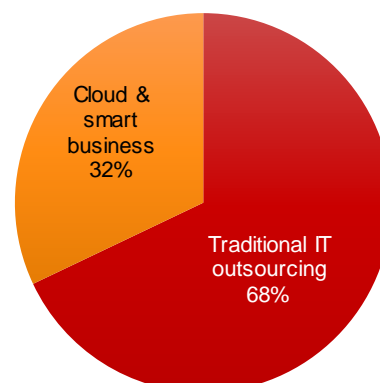
## Focus Charts

**Figure 1: Revenue and growth**



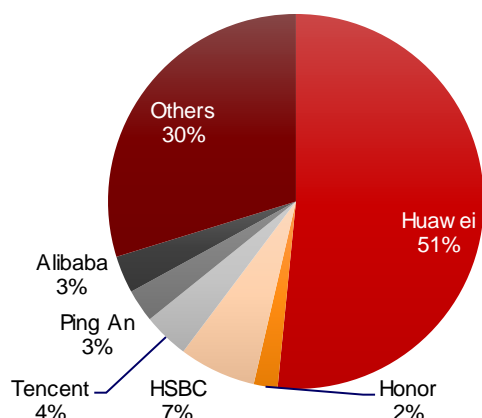
Source: Company data, CMBIGM estimates

**Figure 2: Revenue mix (FY1H22)**



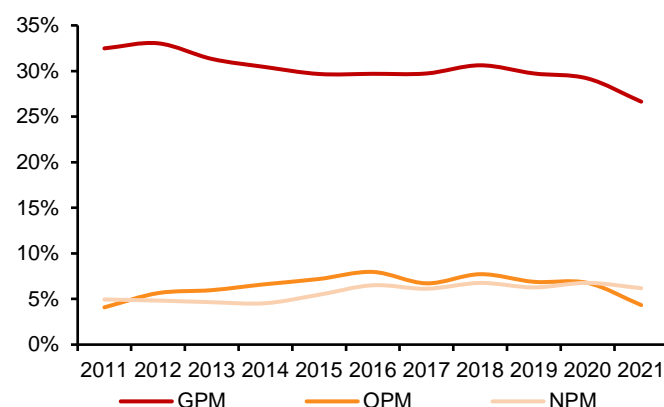
Source: Company data, CMBIGM estimates

**Figure 3: Revenue mix by customer (FY1H22)**



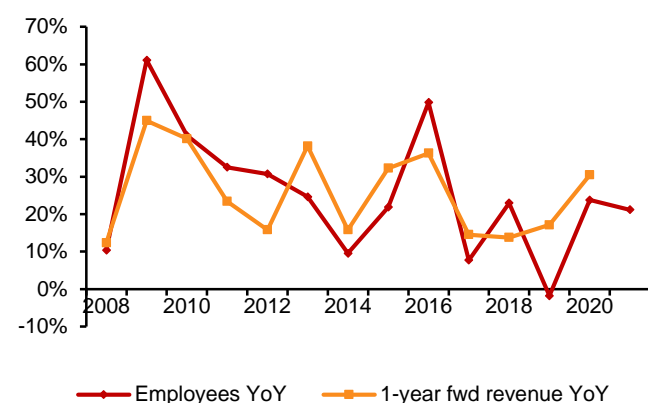
Source: Company data, CMBIGM estimates

**Figure 4: Margins**



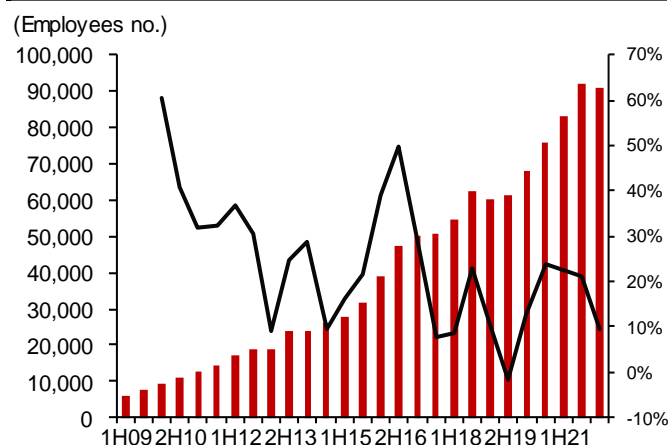
Source: Company data, CMBIGM

**Figure 5: Forward revenue and employees growth**



Source: Company data, CMBIGM

**Figure 6: Chinasoft employee trend**



Source: Company data, CMBIGM

## Operating model

Figure 7: 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
<b>Revenue breakdown</b>					
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
<b>Growth YoY</b>					
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

**Figure 8: 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
<b>Margins</b>								
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%
<b>Growth (HoH)</b>								
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%
<b>Growth (YoY)</b>								
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

## Valuation

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

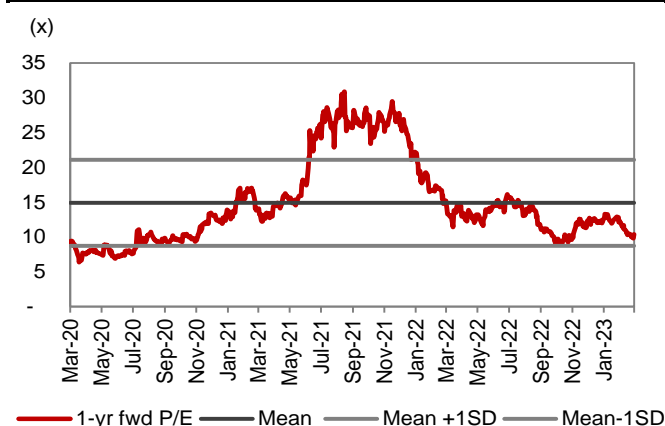
We have not adjusted our earnings forecast. Maintain BUY with target price of HK\$9.14, based on 15x fully diluted FY24E P/E (in-line with 3 year mean).

Figure 9: 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	2,758	7.12	9.14	11.3	9.7	10.8	11.4	15%	13%
iSoftStone	301236 CH	NR	3,645	38.85	N/A	13.7	10.3	16.1	17.4	22%	29%
Digital China	000034 CH	NR	2,229	22.74	N/A	15.3	12.9	15.9	16.2	9%	80%
Infosys	INFO IN	NR	76,007	1480.70	N/A	25.4	22.0	32.1	34.5	18%	14%
Tata Consultancy	TCS IN	NR	150,111	3344.90	N/A	29.2	25.6	44.7	46.5	15%	15%
Mean						18.9	15.9	24.0	25.4	16%	30%
Median						13.8	15.3	12.9	16.1	17%	15%

Source: Bloomberg, CMBIGM

Figure 10: 12M forward P/E band



Source: Company data, CMBIGM

Figure 11: 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
<b>YE 31 Dec (RMB mn)</b>						
<b>Operating</b>						
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
<b>Net cash from operations</b>	<b>754</b>	<b>1,153</b>	<b>962</b>	<b>2,720</b>	<b>675</b>	<b>1,239</b>
<b>Investing</b>						
Capital expenditure	(105)	(159)	(287)	(150)	(150)	(150)
Others	(120)	(32)	(242)	(601)	(53)	(51)
<b>Net cash from investing</b>	<b>(224)</b>	<b>(192)</b>	<b>(530)</b>	<b>(751)</b>	<b>(203)</b>	<b>(201)</b>
<b>Financing</b>						
Dividend paid	(48)	(52)	(70)	(88)	(108)	(125)
Net borrowings	52	217	173	88	273	175
Others	(653)	196	1,274	(370)	1	2
<b>Net cash from financing</b>	<b>(650)</b>	<b>362</b>	<b>1,377</b>	<b>(369)</b>	<b>166</b>	<b>52</b>
<b>Net change in cash</b>						
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
<b>Cash at the end of the year</b>	<b>2,526</b>	<b>3,787</b>	<b>5,556</b>	<b>7,510</b>	<b>8,201</b>	<b>9,342</b>
GROWTH	2019A	2020A	2021A	2022E	2023E	2024E
<b>YE 31 Dec</b>						
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
<b>YE 31 Dec</b>						
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
<b>YE 31 Dec</b>						
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
<b>YE 31 Dec</b>						
P/E	11.4	12.5	23.0	12.9	10.5	9.0
P/E (diluted)	12.3	14.9	26.1	13.8	11.3	9.7
P/B	1.4	1.6	2.5	1.2	1.1	1.0
Div yield (%)	0.6	0.5	0.3	0.6	0.7	0.8
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	0.5	0.4	0.3

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

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