

Chinasoft (354 HK)

Accelerating growth in FY21E

Chinasoft delivered in-line FY20 results with net profit growth of +26% YoY despite the impact from COVID-19 in 1H20. Revenue from Huawei grew at +22% YoY, which reaffirmed our view that Huawei will survive amid US ban given strong cash and patents on hand while demanding more IT services from Chinasoft to build its software ecosystem. More than expected employees were added in FY20 (+24% YoY to 76k), which could imply strong growth outlook in FY21E. Maintain BUY.

- **FY20 core profit +15% YoY.** Chinasoft delivered solid revenue growth of +17% YoY to RMB14,101mn in FY20 despite the impact from COVID-19 (2H20 revenue rebounded strongly at +24% YoY). Operating profit was +15% YoY RMB952m, in-line with our estimate. Net profit was at RMB955m, beating our forecast by 8% mainly on higher government subsidies (other income +76% YoY to RMB313m).
- **Huawei revenue not slowing amid U.S. sanction.** Revenue from Huawei in FY20 increased by 22% YoY to RMB8,030m (57% of FY20 revenue) although Huawei was under U.S. ban. This confirmed our previous view that Huawei will survive given strong cash position and long-accumulated standard essential patents (to receive license fee). Huawei is likely to demand more IT services from Chinasoft as it transforms from hardware to software/service focus (e.g. Harmony OS/ IoT products/ Huawei cloud).
- **Increase in employees reflect strong demand in FY21E.** IT service is a labor-intensive business. Increase in no. of employees can largely reflect next year growth outlook. In FY20, Chinasoft increased no. of employees to 75,956 (+24% YoY EoP). This could suggest accelerating revenue growth in FY21E. We are positive that non-Huawei tech clients are growing fast (Alibaba/ Tencent/ Baidu/ Ping An growing at 40%+ YoY in FY20).
- **Maintain BUY.** We raised FY21-22E net profit by 2-4% mainly to reflect stronger revenue growth. Maintain BUY with new target price of HK\$11.57 (prior HK\$11.35), based on unchanged 22x FY22E P/E, 50% premium to five-year mean given accelerating growth with better margins. Chinasoft is trading at 15.1x FY22E, 46% discount to Indian IT service peers Infosys and Tata Consultancy of 28x FY22E P/E but with higher sales and EPS CAGR growth in FY20-22E.

Earnings Summary

(YE 31 Dec)	FY19	FY20	FY21E	FY22E	FY23E
Revenue (RMB mn)	12,042	14,101	17,308	20,298	23,530
YoY growth (%)	10%	15%	24%	18%	16%
Net profit (RMB mn)	755	955	1,156	1,383	1,639
EPS (RMB)	0.28	0.32	0.39	0.46	0.55
YoY growth (%)	10%	13%	21%	20%	19%
Consensus EPS (RMB)	0.28	0.35	0.43	0.53	0.60
PE (x)	24.6	21.9	18.0	15.1	12.7
EV/Sales (x)	1.7	1.3	1.0	0.8	0.6
Dividend Yield (%)	0.00	0.00	0.00	0.00	0.00
ROE (%)	12%	12%	12%	13%	14%
Net debt to equity	net cash	net cash	net cash	net cash	net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$11.57
(Previous TP	HK\$11.35)
Up/Downside	+45.7%
Current Price	HK\$7.94

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Stock Data

Mkt Cap (HK\$ mn)	22,076
Avg 3 mths t/o (HK\$ mn)	219.93
52w High/Low (HK\$)	11.28/ 3.71
Total Issued Shares (mn)	2,905

Source: Bloomberg

Shareholding Structure

Chen Yuhong- Chairman	9.7%
Dan Capital	6.2%
CPS (share option scheme)	4.5%

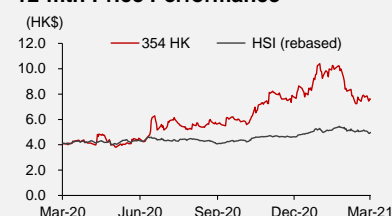
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-9.8%	-2.8%
3-mth	-2.4%	-7.7%
6-mth	35.1%	12.5%

Source: Bloomberg

12-mth Price Performance

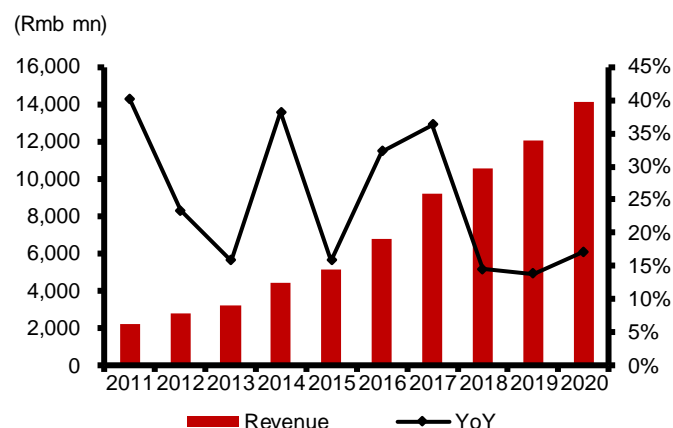


Source: Bloomberg

Auditor: Deloitte

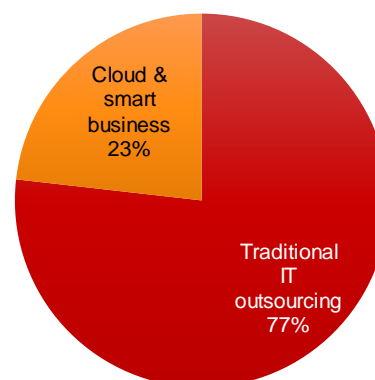
Focus Charts

Figure 1: Revenue and growth



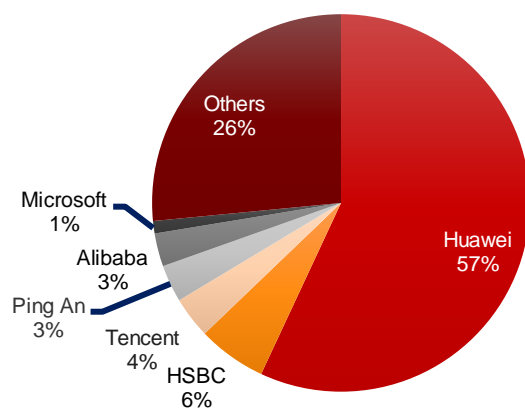
Source: Company data, CMBIS estimates

Figure 2: Revenue mix (2020)



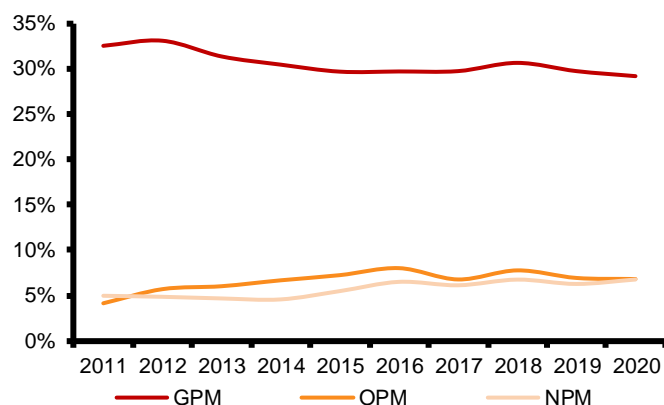
Source: Company data, CMBIS estimates

Figure 3: Customer breakdown (2020)



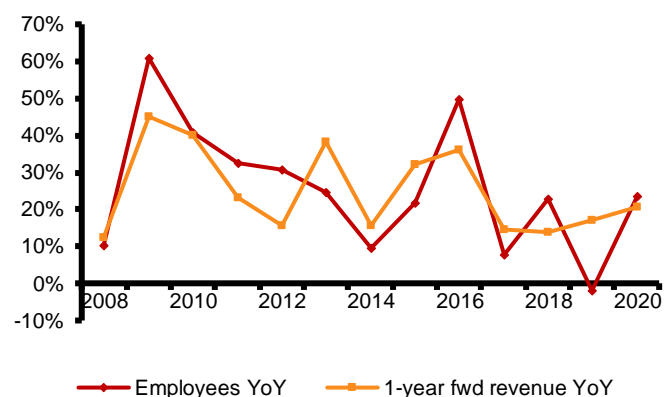
Source: Company data, CMBIS estimates

Figure 4: Margins



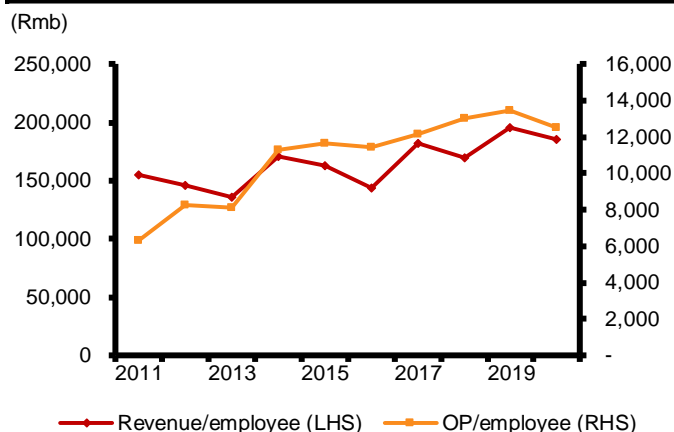
Source: Company data, CMBIS estimates

Figure 5: Forward revenue and employees



Source: Company data, CMBIS estimates

Figure 6: Revenue & operating profit per employee



Source: Company data, CMBIS estimates

FY20 results review

- **Revenue** was at RMB14,101mn (+17% YoY), in-line with our and consensus estimates.
- **Gross profit** was at RMB4,118mn (+15% YoY), in-line with our estimate but below consensus by 3%.
- **Gross margin** was at 29.2%, (-0.3 pct pts YoY), below our estimate by 0.3 pct pts and consensus by 0.6 pct pts.
- **Operating profit** was at RMB952mn (+15% YoY), in-line with our estimates.
- **Operating margin** was at 6.7%% (+0.2 pct pts YoY), below our estimate by 0.2 pct pts and consensus by 0.9 pct pts.
- **Net profit** was at RMB955mn (+26% YoY), beat our estimates by 8% and consensus by 3%.
- **EPS** was at RMB0.38 (+23% YoY), beat our and consensus estimates.

Figure 7: FY20 results review

354 HK Rmb m	2019 Actual	2020 Actual	YoY	2020E CMBI	versus CMBI	2020E Consensus	versus Consensus
Revenue	12,042	14,101	17%	13,966	1%	14,305	-1%
Gross profit	3,583	4,118	15%	4,120	0%	4,262	-3%
GPM	29.8%	29.2%	-0.6 pct pts	29.5%	-0.3 pct pts	29.8%	-0.6 pct pts
Operating profit	827	952	15%	963	-1%	1,093	-13%
OPM	6.9%	6.7%	-0.2 pct pts	6.9%	-0.2 pct pts	7.6%	-0.9 pct pts
PBT	799	1,035	30%	954	8%	1,006	3%
Tax	(42)	(87)	105%	(76)	15%	(82)	5%
Net income	755	955	26%	882	8%	924	3%
NPM	6.3%	6.8%	0.6 pct pts	6.3%	0.5 pct pts	6.5%	0.4 pct pts
EPS Rmb cents	30.7	37.9	23%	30.4	25%	35.1	8%

Source: Company data, CMBIS

Figure 8: FY2H20 results review

354 HK Rmb m	2H19 Actual	1H20 Actual	2H20 Actual	YoY	HoH	2H20 CMBI	versus CMBI	2H20 Consensus	versus Consensus
Revenue	6,504	6,059	8,042	24%	33%	7,907	2%	8,137	-1%
Gross profit	2,016	1,649	2,469	22%	50%	2,471	0%	2,535	-3%
GPM	31.0%	27.2%	30.7%	-0.3 pct pts	3.5 pct pts	31.3%	-0.6 pct pts	31.2%	-0.5 pct pts
Operating profit	401	421	531	32%	26%	542	-2%	596	-11%
OPM	6.2%	6.9%	6.6%	0.5 pct pts	-0.4 pct pts	6.9%	-0.3 pct pts	7.3%	-0.8 pct pts
PBT	409	442	593	45%	34%	512	16%	580	2%
Tax	(11)	(45)	(42)	276%	-8%	(30)	37%	(79)	-47%
Net income	392	401	554	41%	38%	481	15%	502	10%
NPM	6.0%	6.6%	6.9%	0.9 pct pts	0.3 pct pts	6.1%	0.9 pct pts	6.2%	0.8 pct pts
EPS Rmb cents	16.0	16.2	19.1	19%	17%	16.6	15%	19.0	0%

Source: Company data, CMBIS

Earnings revision

Figure 9: Earnings revision

RMB mn	2021E			2022E		
	New	Old	%Diff	New	Old	%Diff
Sales	17,308	16,712	4%	20,298	19,559	4%
Gross profit	5,120	4,993	3%	6,035	5,874	3%
OP Profit	1,247	1,263	-1%	1,492	1,507	-1%
PBT	1,234	1,183	4%	1,475	1,445	2%
Net profit	1,156	1,111	4%	1,383	1,356	2%
EPS (RMB)	0.39	0.38	4%	0.46	0.45	2%
Margins						
GM	29.6%	29.9%	-30 bps	29.7%	30.0%	-30 bps
OPM	7.2%	7.6%	-35 bps	7.4%	7.7%	-35 bps
PBT margin	7.1%	7.1%	5 bps	7.3%	7.4%	-12 bps
Net margin	6.7%	6.6%	3 bps	6.8%	6.9%	-12 bps

Source: Company data, CMBIS estimates

Figure 10: CMBI estimates vs consensus

RMB mn	2021E			2022E		
	CMBI	Street	Diff	CMBI	Street	Diff
Sales	17,308	17,372	-0%	20,298	20,727	-2%
Gross profit	5,120	5,242	-2%	6,035	6,323	-5%
OP Profit	1,247	1,379	-10%	1,492	1,635	-9%
PBT	1,234	1,271	-3%	1,475	1,546	-5%
Net profit	1,156	1,166	-1%	1,383	1,422	-3%
EPS (RMB)	0.39	0.42	-7%	0.46	0.52	-11%
Margins						
GM	29.6%	30.2%	-59 bps	29.7%	30.5%	-77 bps
OPM	7.2%	7.9%	-73 bps	7.4%	7.9%	-54 bps
PBT margin	7.1%	7.3%	-19 bps	7.3%	7.5%	-19 bps
Net margin	6.7%	6.7%	-3 bps	6.8%	6.9%	-5 bps

Source: Company data, CMBIS estimates

Operating model

Figure 11: Operating model

RMB mn	2019	2020	2021E	2022E	2023E
Revenues	12,042	14,101	17,308	20,298	23,530
Cost of sales	(8,459)	(9,983)	(12,189)	(14,263)	(16,517)
Gross Profit	3,583	4,118	5,120	6,035	7,013
<i>Gross margin</i>	<i>29.8%</i>	<i>29.2%</i>	<i>29.6%</i>	<i>29.7%</i>	<i>29.8%</i>
R&D	(809)	(930)	(1,290)	(1,518)	(1,775)
SG&A	(1,813)	(2,031)	(2,541)	(2,984)	(3,457)
Operating Income	827	952	1,247	1,492	1,743
<i>Operating margin</i>	<i>6.9%</i>	<i>6.7%</i>	<i>7.2%</i>	<i>7.4%</i>	<i>7.4%</i>
Non-Operating Income	(28)	83	(13)	(17)	16
Profit Before Tax	799	1,035	1,234	1,475	1,760
Income tax (expense) gain	(42)	(87)	(80)	(98)	(125)
Minorities	2	(7)	(2)	(5)	(5)
Net Income to Shareholders	755	955	1,156	1,383	1,639
<i>Net margin</i>	<i>6.3%</i>	<i>6.8%</i>	<i>6.7%</i>	<i>6.8%</i>	<i>7.0%</i>
EPS (RMB)	0.31	0.33	0.39	0.46	0.55
Fully diluted EPS (RMB)	0.28	0.32	0.39	0.46	0.55
Revenue breakdown					
IT outsourcing	10,042	10,830	12,238	13,706	15,488
Emerging cloud business	2,000	3,271	5,071	6,592	8,042
Huawei	6,570	8,030	9,355	10,571	11,840
HSBC	880	830	855	855	855
Tencent	350	500	700	945	1,229
Alibaba	260	400	580	783	1,018
Ping An	300	450	698	977	1,269
Others	3,682	3,891	5,121	6,167	7,319
Growth YoY					
Revenues	14%	17%	23%	17%	16%
Gross profit	10%	15%	24%	18%	16%
Operating Income	1%	15%	31%	20%	17%
EPS	4%	7%	19%	18%	19%

Source: Company data, CMBIS estimates

Figure 12: Semi-annual operating model

RMB mn	1H19	2H19	1H20	2H20	1H21E	2H21E
Revenues	5,538	6,504	6,059	8,042	7,756	9,552
Gross Profit	1,567	2,016	1,649	2,469	2,172	2,948
Operating profit	426	401	421	531	592	655
Net profit (loss)	363	392	401	554	539	617
EPS (RMB)	0.15	0.16	0.16	0.19	0.19	0.21
Margins						
Gross margin	28.3%	31.0%	27.2%	30.7%	28.0%	30.9%
Operating margin	7.7%	6.2%	6.9%	6.6%	7.6%	6.9%
Net margin	6.5%	6.0%	6.6%	6.9%	6.9%	6.5%
Growth (HoH)						
Revenues	-4%	17%	-7%	33%	-4%	23%
Gross Profit	-16%	29%	-18%	50%	-12%	36%
Operating profit	14%	-6%	5%	26%	11%	11%
Net profit (loss)	2%	8%	2%	38%	-3%	15%
Growth (YoY)						
Revenues	15%	13%	9%	24%	28%	19%
Gross Profit	13%	9%	5%	22%	32%	19%
Operating profit	-3%	7%	-1%	32%	41%	23%
Net profit (loss)	1%	10%	11%	41%	34%	12%

Source: Company data, CMBIS estimates

Valuation

Chinasoft (354 HK, BUY, TP HK\$11.57)

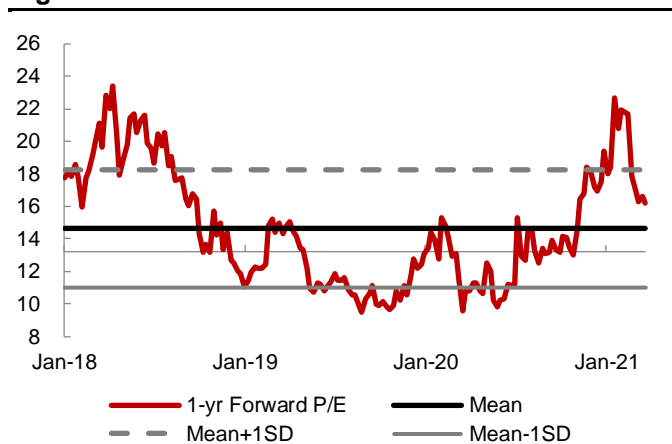
We have BUY rating on Chinasoft with target price of HK\$11.57, based on unchanged 22x FY22E P/E (50% premium to its five-year mean). We believe Chinasoft deserves re-rating given accelerating growth, improving margins and diversifying into non-Huawei large enterprises.

Figure 13: Peers' valuation

Company	Ticker	Rating	Mk Cap (US\$ mn)	Price (LC)	TP (LC)	P/E FY21E	P/E FY22E	ROE FY21E	ROE FY22E	Sales CAGR FY20-22	EPS CAGR FY20-22
Chinasoft	354 HK	BUY	3,425	9.25	11.57	18.0	15.1	12.4	13.2	20%	18%
Digital China	000034 CH	NR	1,689	16.83	N/A	10.8	8.0	17.3	19.0	14%	42%
Infosys	INFO IN	NR	80,319	1385.30	N/A	30.3	26.3	28.1	29.5	12%	16%
Tata Consultancy	TCS IN	NR	159,022	3158.55	N/A	35.7	29.9	37.9	42.1	9%	10%
Mean						24.1	23.1	19.2	24.4	26.4	14%
Median						29.0	25.2	30.3	26.3	28.1	29.5

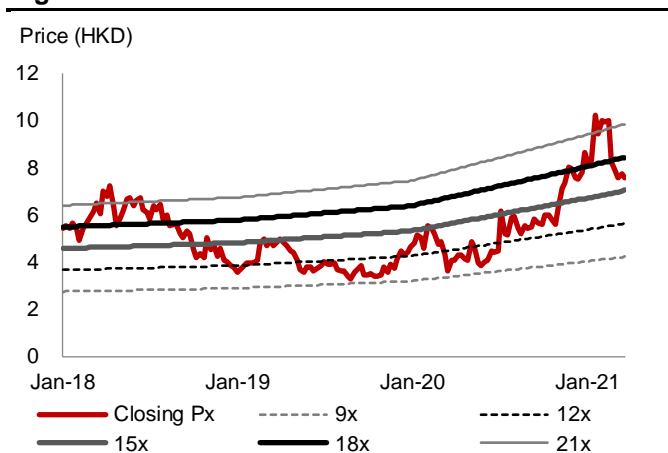
Source: Bloomberg, CMBIS estimates

Figure 14: 12M forward P/E band



Source: Company data, CMBIS

Figure 15: 12M forward P/B band



Source: Company data, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	12,042	14,101	17,308	20,298	23,530
Cost of sales	(8,459)	(9,983)	(12,189)	(14,263)	(16,517)
Gross profit	3,583	4,118	5,120	6,035	7,013
Selling exp	(618)	(729)	(878)	(974)	(1,129)
Admin exp	(1,196)	(1,302)	(1,663)	(2,010)	(2,327)
R&D exp	(809)	(930)	(1,290)	(1,518)	(1,775)
Other operating exp.	(134)	(205)	(42)	(40)	(39)
Operating profit	827	952	1,247	1,492	1,743
Finance costs	(166)	(151)	(155)	(194)	(206)
Other non-oper exp.	138	235	142	176	222
Pre-tax profit	799	1,035	1,234	1,475	1,760
Income tax expense	(42)	(87)	(80)	(98)	(125)
Minority interests	2	(7)	(2)	(5)	(5)
Net profit to shareholders	755	955	1,156	1,383	1,639

Cash flow summary

YE 31 Dec (RMB mn)	FY19	FY20	FY21E	FY22E	FY23E
Net profit	799	1,035	1,234	1,475	1,760
Depreciation/amortization	197	99	102	108	112
Change in working capital	(516)	(208)	637	(307)	(586)
Others	274	168	(80)	(98)	(125)
Net cash from operating	754	1,095	1,893	1,179	1,160
Capex	(105)	(150)	(150)	(150)	(150)
Others	(120)	(28)	(42)	(40)	(39)
Net cash from investing	(224)	(178)	(192)	(190)	(189)
Net borrowings	52	(661)	1,333	180	321
Dividend paid	0	(76)	(69)	(83)	(98)
Others	(701)	1,444	2	5	5
Net cash from financing	(650)	707	1,266	102	227
Net change in cash	(119)	1,624	2,968	1,090	1,199
Cash at beginning of the year	2,646	2,526	3,787	6,757	7,888
Exchange difference	(1)	(363)	3	40	39
Cash at the end of the year	2,526	3,787	6,757	7,888	9,126

Balance sheet

YE 31 Dec (RMB mn)	FY19	FY20	FY21E	FY22E	FY23E
Current assets	8,198	10,394	12,963	14,852	17,186
Cash & equivalents	2,526	3,787	6,757	7,888	9,126
Account receivables	3,297	4,580	3,492	3,789	4,364
Amount due from customers	2,228	1,904	2,533	2,976	3,476
Other current assets	147	123	180	199	221
Non-current assets	2,547	2,693	2,780	2,821	2,859
PPE	802	858	987	1,069	1,145
Intangible assets	1,101	1,086	1,044	1,004	965
Other non-current assets	643	749	749	749	749
Total assets	10,745	13,087	15,742	17,674	20,046
Current liabilities	3,150	2,718	4,405	4,962	5,659
ST borrowings	1,523	368	1,820	1,924	2,112
Account payables	1,229	1,753	2,533	2,976	3,476
Accrued expense	106	117	0	0	0
Other current liabilities	291	480	52	62	72
Non-current liabilities	1,062	1,592	1,474	1,549	1,683
LT borrowings	928	1,421	1,303	1,378	1,512
Other non-current liabilities	134	171	171	171	171
Total liabilities	4,211	4,311	5,879	6,511	7,342
Share capital	116	132	132	132	132
Capital surplus	3,145	4,735	4,735	4,735	4,735
Retained earnings	3,677	4,492	5,579	6,878	8,419
Other reserves	-471	-605	-605	-605	-605
Minority interest	66	23	23	23	23
Total equity	6,534	8,776	9,863	11,163	12,703
Total liabilities and equity	10,745	13,087	15,742	17,674	20,046

Key ratios

YE 31 Dec	FY19	FY20	FY21E	FY22E	FY23E
Revenue mix					
Emerging cloud business	15%	17%	23%	29%	32%
Traditional IT outsourcing	85%	83%	77%	71%	68%
Growth (%)					
Revenue	14%	17%	23%	17%	16%
Gross profit	10%	15%	24%	18%	16%
Operating profit	1%	15%	31%	20%	17%
Net profit	5%	26%	21%	20%	19%
Profit & loss ratio (%)					
Gross margin	29.8%	29.2%	29.6%	29.7%	29.8%
Operating margin	6.9%	6.7%	7.2%	7.4%	7.4%
Net profit margin	6.3%	6.8%	6.7%	6.8%	7.0%
Balance sheet ratio					
Receivable turnover days	99	117	73	67	67
Amount due days	67	49	53	53	53
Payable turnover days	52	63	75	75	76
Current ratio (x)	2.60	3.82	2.94	2.99	3.04
Net debt to equity	net	net	net	net	net
Profitability (%)					
ROE	12%	12%	12%	13%	14%
ROIC	13%	13%	18%	22%	24%
Per share data (RMB)					
EPS (RMB)	0.28	0.32	0.39	0.46	0.55
DPS (RMB)	0.02	0.03	0.02	0.03	0.03
BVPS (RMB)	2.45	2.93	3.29	3.73	4.24

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CMBIS 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 CMBIS

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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