

Chinasoft (354 HK)

FY1H22 beat, workforce restructuring in progress

Chinasoft delivered solid FY1H22 results with revenue/ net profit growth of +20%/ 10% YoY to RMB10bn/ RMB572mn respectively. GPM was under pressure (-2.8 ppts YoY to 24.8%) on pandemic resurgence and rising labor costs. Chinasoft maintained FY22E guidance although workforce restructuring is still in progress (employees no. +9.5% YoY, -1.0% HoH to 91,114). We are positive on revenue diversification in Cloud (+51% YoY) and non-Huawei (+29% YoY) businesses. Maintain BUY.

- **FY1H22 net profit beat but gross margin missed.** Chinasoft delivered strong revenue growth of +20% YoY to RMB10,025mn in FY1H22. Cloud Intelligent Services grew +51% YoY to RMB3.21bn while traditional IT service business was up +10% YoY to RMB6.81bn. GPM declined -2.8 pct pts YoY to 24.8%, below both our and consensus estimates. Company attributed the decrease to 1) large-scale resurgence of COVID-19 pandemic, 2) increase in mid-to high-end technical staff, and 3) rising labor costs. Operating profit was up +15% YoY as opex ratio dropped to 19.9% (vs. 22.4% in FY1H21). 45% of cost saved was related to lower share-based compensation. Net profit was RMB572mn (+10% YoY), beating consensus by 9%.
- **Changing revenue mix with increasing Cloud and non-Huawei revenue contribution.** Revenue diversification continued with strong Cloud Intelligent Services and non-Huawei revenue growth (+29% YoY to RMB4.76bn). These have partially offset Huawei weakness (+14% YoY to RMB5.26bn, 52.5% of FY1H22 revenue). In FY22E, Chinasoft targets to sign RMB2bn cloud-related contracts, accounting for 10% of Huawei's managed cloud service (MCS) market share.
- **No change in FY22E guidance although workforce restructuring in progress.** Chinasoft maintained FY22E guidance: revenue +20-30% YoY while net profit +10-20% YoY. However, given its labor-intensive business nature, reduced number of employees reflects slower FY23E growth. Employee number was 91,114 (9.5% YoY, -1.0% HoH). In absolute term, workforce number was down 925, compared to 92,039 as of 31 Dec 2021.
- **Maintain BUY.** We largely maintained FY22 earnings forecast but revised down FY23-24E net profit by 8-16% on more conservative estimates regarding Huawei business. Maintain BUY with new target price of HK\$7.79 (prior HK\$9.87) on 15x fully diluted FY23E P/E, in-line with three-year mean.

Earnings Summary

(YE 31 Dec)	FY20	FY21	FY22E	FY23E	FY24E
Revenue (RMB mn)	14,101	18,398	22,105	25,576	30,145
YoY growth (%)	17%	30%	20%	16%	18%
Net profit (RMB mn)	955	1,137	1,243	1,392	1,668
EPS (RMB)	0.32	0.36	0.40	0.44	0.53
YoY growth (%)	13%	13%	10%	12%	20%
Consensus EPS (RMB)	0.32	0.36	0.43	0.55	0.69
PE (x)	17.1	15.1	13.7	12.3	10.2
EV/sales (x)	1.0	0.7	0.5	0.4	0.3
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
ROE (%)	12%	11%	10%	10%	11%
Net debt to equity	net cash	net cash	net cash	net cash	net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$7.79
(Previous TP	HK\$9.87)
Up/Downside	+25.5%
Current Price	HK\$6.21

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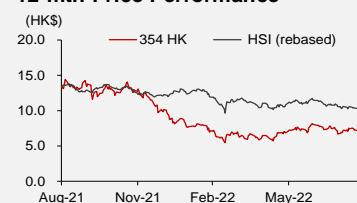
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Stock Data	
Mkt Cap (HK\$ mn)	18,885
Avg 3 mths t/o (HK\$ mn)	92.07
52w High/Low (HK\$)	14.71/ 5.26
Total Issued Shares (mn)	3,066
Source: Bloomberg	

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

Share Performance		
	Absolute	Relative
1-mth	-14.4%	-12.5%
3-mth	-10.1%	-7.7%
6-mth	-13.1%	-2.1%
Source: Bloomberg		

12-mth Price Performance



Source: Bloomberg

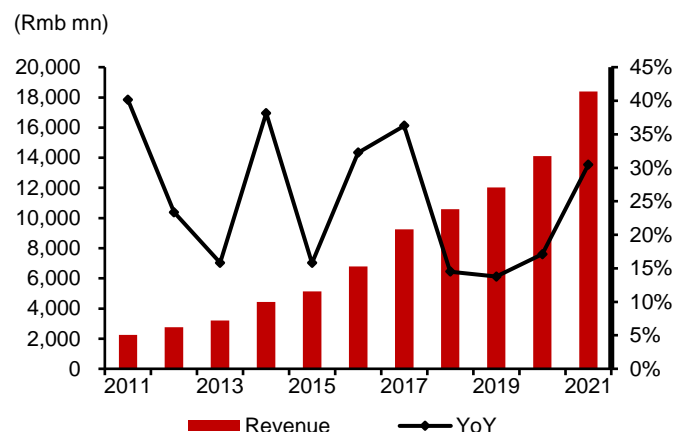
Auditor: Deloitte

Related Reports

1. China Software & IT Services – “A mixed outlook for China cloud amid rising China-US tension” – 4 Aug 2022 ([link](#))
2. Chinasoft (354 HK) – “Shenzhen to provide subsidies in building Harmony/ Euler ecosystem” – 15 July 2022 ([link](#))
3. Chinasoft (354 HK) – “Strong demand despite near-term margin pressure” – 30 Mar 2022 ([link](#))

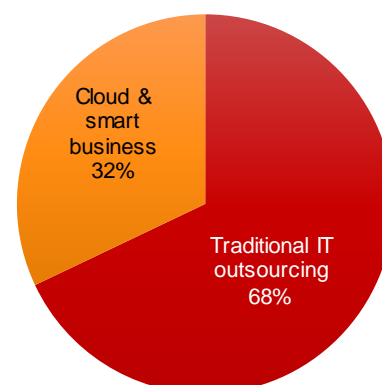
Focus Charts

Figure 1: Revenue and growth



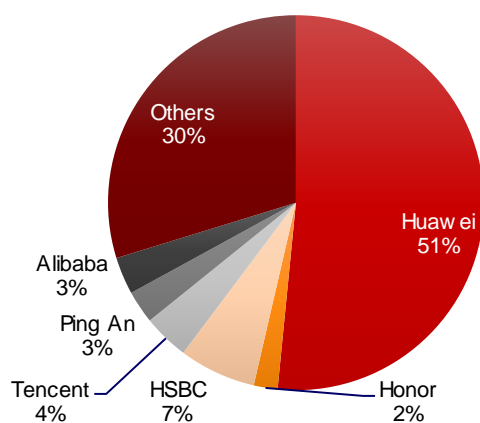
Source: Company data, CMBIGM estimates

Figure 2: Revenue mix (FY1H22)



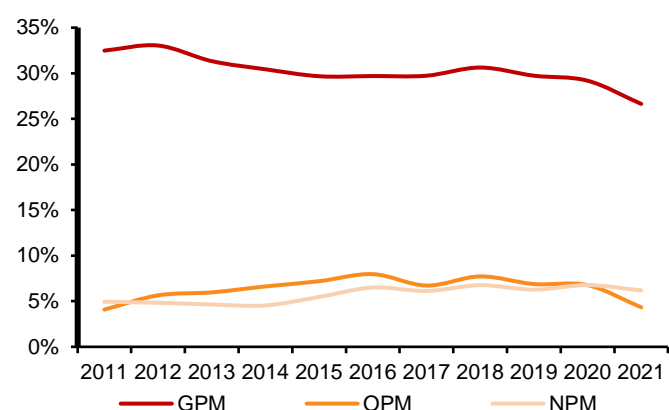
Source: Company data, CMBIGM estimates

Figure 3: Revenue mix by customer (FY1H22)



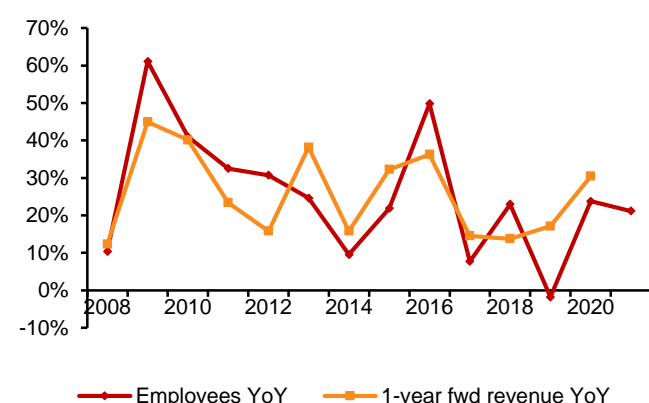
Source: Company data, CMBIGM estimates

Figure 4: Margins



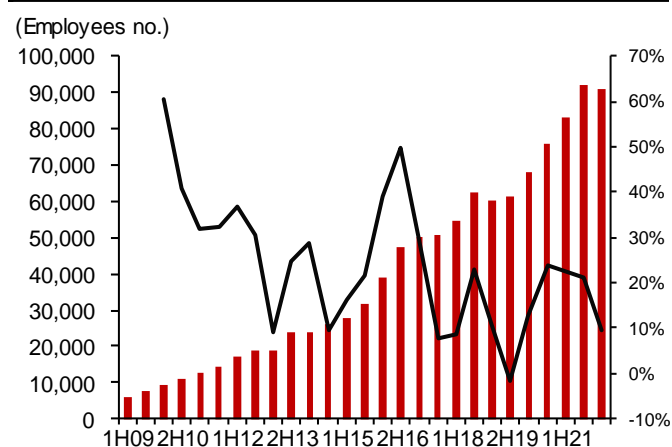
Source: Company data, CMBIGM

Figure 5: Forward revenue and employees growth



Source: Company data, CMBIGM

Figure 6: Chinasoft employee trend



Source: Company data, CMBIGM

FY1H22 results review

- **Revenue** was RMB10,025mn (+20% YoY), in-line with our and consensus estimates.
 - **Emerging business** (Cloud related) was up +51% YoY to RMB3.21bn.
 - **Traditional IT Services** was up +10% YoY to RMB6.81bn.
- **Gross profit** was RMB2,482mn (+8% YoY), in-line with our estimate but below consensus by 6%.
- **Gross margin** was 24.8%, (-2.8 pct pts YoY), **below** our estimate by -1.1 pct pts and consensus by -1.4 pct pts.
 - The decline in GPM was attributable to
 - 1) Large-scale resurgence of COVID-19 pandemic
 - 2) Increase in mid-to high-end technical talent pool
 - 3) Rising labor costs
- **Operating profit** was RMB485mn (+15% YoY), beating our estimate by 9% and consensus by 17%.
- **Operating margin** was 4.8% (-0.3 pct pts YoY), **above** our estimate by 0.3 pct pts and consensus by 0.8 pct pts.
- **Net profit** was RMB572mn (+10% YoY), in-line with our estimates and beating consensus by 9%.
- **EPS** was at RMB0.196 (+4% YoY).

Figure 7: FY1H22 results review

354 HK RMB mn	1H21 Actual	2H21 Actual	1H22 Actual	YoY	HoH	1H22 CMBI	versus CMBI	1H22 Consensus	versus Consensus
Revenue	8,341	10,057	10,025	20%	0%	9,624	4%	10,091	-1%
Gross profit	2,294	2,610	2,482	8%	-5%	2,483	0%	2,639	-6%
GPM	27.5%	26.0%	24.8%	-2.8 pct pts	-1.3 pct pts	25.8%	-1.1 pct pts	26.2%	-1.4 pct pts
Operating profit	423	374	485	15%	30%	443	9%	415	17%
OPM	5.1%	3.7%	4.8%	-0.3 pct pts	1.2 pct pts	4.6%	0.3 pct pts	4.1%	0.8 pct pts
PBT	576	676	610	6%	-10%	599	2%	n.a.	n.a.
Tax	(59)	(56)	(40)	-33%	-30%	(57)	-30%	n.a.	n.a.
Net income	518	619	572	10%	-8%	544	5%	522	9%
NPM	6.2%	6.2%	5.7%	-0.6 pct pts	-0.5 pct pts	5.7%	0.1 pct pts	5.2%	0.6 pct pts
EPS (RMB cents)	18.9	20.2	19.6	4%	-3%	17.7	11%	17.3	13%

Source: Company data, CMBIGM

Earnings revision

Figure 8: Earnings revision

RMB mn	2022E			2023E			2024E		
	New	Old	%Diff	New	Old	%Diff	New	Old	%Diff
Sales	22,105	22,124	-0%	25,576	27,283	-6%	30,145	32,412	-7%
Gross profit	5,357	5,695	-6%	5,916	7,044	-16%	6,990	8,479	-18%
OP Profit	944	918	3%	1,117	1,215	-8%	1,333	1,621	-18%
PBT	1,323	1,347	-2%	1,510	1,655	-9%	1,806	2,151	-16%
Net profit	1,243	1,249	-1%	1,392	1,520	-8%	1,668	1,978	-16%
EPS (RMB)	0.40	0.40	0%	0.44	0.48	-8%	0.53	0.63	-15%
Margins									
GM	24.2%	25.7%	-151 bps	23.1%	25.8%	-269 bps	23.2%	26.2%	-297 bps
OPM	4.3%	4.1%	12 bps	4.4%	4.5%	-9 bps	4.4%	5.0%	-58 bps
PBT margin	6.0%	6.1%	-10 bps	5.9%	6.1%	-16 bps	6.0%	6.6%	-65 bps
Net margin	5.6%	5.6%	-2 bps	5.4%	5.6%	-13 bps	5.5%	6.1%	-57 bps

Source: Company data, CMBIGM

Figure 9: CMBI estimates vs consensus

RMB mn	2022E			2023E			2024E		
	CMBI	Street	Diff	CMBI	Street	Diff	CMBI	Street	Diff
Sales	22,105	22,772	-3%	25,576	28,080	-9%	30,145	33,684	-11%
Gross profit	5,357	6,052	-11%	5,916	7,573	-22%	6,990	9,176	-24%
OP Profit	944	1,281	-26%	1,117	1,669	-33%	1,333	2,150	-38%
PBT	1,323	1,428	-7%	1,510	1,788	-16%	1,806	2,246	-20%
Net profit	1,243	1,311	-5%	1,392	1,645	-15%	1,668	2,078	-20%
EPS (RMB)	0.40	0.44	-10%	0.44	0.54	-18%	0.53	0.67	-21%
Margins									
GM	24.2%	26.6%	-235 bps	23.1%	27.0%	-384 bps	23.2%	27.2%	-405 bps
OPM	4.3%	5.6%	-136 bps	4.4%	5.9%	-158 bps	4.4%	6.4%	-196 bps
PBT margin	6.0%	6.3%	-28 bps	5.9%	6.4%	-47 bps	6.0%	6.7%	-68 bps
Net margin	5.6%	5.8%	-14 bps	5.4%	5.9%	-42 bps	5.5%	6.2%	-63 bps

Source: Company data, CMBIGM

Operating model

Figure 8: Operating model

RMB mn	2020	2021	2022E	2023E	2024E
Revenues	14,101	18,398	22,105	25,576	30,145
Cost of sales	(9,983)	(13,494)	(16,749)	(19,659)	(23,154)
Gross Profit	4,118	4,904	5,357	5,916	6,990
<i>Gross margin</i>	<i>29.2%</i>	<i>26.7%</i>	<i>24.2%</i>	<i>23.1%</i>	<i>23.2%</i>
R&D	(930)	(1,249)	(1,501)	(1,737)	(2,047)
SG&A	(2,031)	(2,699)	(2,996)	(3,465)	(4,085)
Operating Income	952	796	944	1,117	1,333
<i>Operating margin</i>	<i>6.7%</i>	<i>4.3%</i>	<i>4.3%</i>	<i>4.4%</i>	<i>4.4%</i>
Non-Operating Income	83	456	380	393	472
Profit Before Tax	1,035	1,252	1,323	1,510	1,806
Income tax (expense) gain	(87)	(115)	(82)	(119)	(139)
Minorities	(7)	(0)	(2)	(1)	(2)
Net Income to Shareholders	955	1,137	1,243	1,392	1,668
<i>Net margin</i>	<i>6.8%</i>	<i>6.2%</i>	<i>5.6%</i>	<i>5.4%</i>	<i>5.5%</i>
EPS (RMB)	0.33	0.37	0.40	0.44	0.53
Fully diluted EPS (RMB)	0.32	0.36	0.40	0.44	0.53
Revenue breakdown					
IT outsourcing	10,830	13,063	14,369	15,518	17,070
Emerging cloud business	3,271	5,335	7,736	10,057	13,075
Huawei	8,030	9,880	11,362	12,839	14,508
HSBC	830	1,180	1,180	1,180	1,180
Tencent	500	706	741	890	1,067
Alibaba	400	590	620	805	1,047
Ping An	450	550	660	792	950
Others	3,891	5,492	7,542	9,070	11,392
Growth YoY					
Revenues	17%	30%	20%	16%	18%
Gross profit	15%	19%	9%	10%	18%
Operating Income	15%	-16%	18%	18%	19%
EPS	7%	13%	7%	12%	20%

Source: Company data, CMBIGM

Figure 9: Semi-annual operating model

RMB mn	1H20	2H20	1H21	2H21	1H22	2H22E
Revenues	6,059	8,042	8,341	10,057	10,025	12,080
Gross Profit	1,649	2,469	2,294	2,610	2,482	2,875
Operating profit	421	531	423	374	485	459
Net profit (loss)	401	554	518	619	572	671
EPS (RMB)	0.16	0.19	0.19	0.20	0.20	0.21
Margins						
Gross margin	27.2%	30.7%	27.5%	26.0%	24.8%	23.8%
Operating margin	6.9%	6.6%	5.1%	3.7%	4.8%	3.8%
Net margin	6.6%	6.9%	6.2%	6.2%	5.7%	5.6%
Growth (HoH)						
Revenues	-7%	33%	4%	21%	0%	20%
Gross Profit	-18%	50%	-7%	14%	-5%	16%
Operating profit	5%	26%	-20%	-12%	30%	-5%
Net profit (loss)	2%	38%	-6%	20%	-8%	17%
Growth (YoY)						
Revenues	9%	24%	38%	25%	20%	20%
Gross Profit	5%	22%	39%	6%	8%	10%
Operating profit	-1%	32%	0%	-30%	15%	23%
Net profit (loss)	11%	41%	29%	12%	10%	8%

Source: Company data, CMBIGM

Valuation

Chinasoft (354 HK, BUY, TP HK\$7.79)

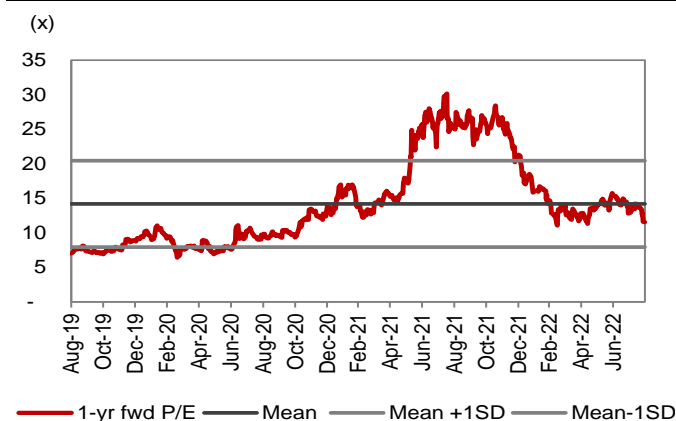
We cut FY23-24E net profit by 8-16% mainly to reflect slower Huawei revenue growth and lower margins. Maintain BUY with new target price of HK\$7.79 (prior HK\$9.87), based on 15x FY23E fully diluted EPS, in-line with three-year mean.

Figure 10: Peers' valuation

Company	Ticker	Rating	Mk Cap (US\$ mn)	Price (LC)	TP (LC)	P/E		ROE		Sales CAGR	EPS CAGR
						FY22E	FY23E	FY22E	FY23E	FY21-24	FY21-24
Chinasoft	354 HK	BUY	2,426	6.21	7.79	13.5	12.1	10.2	10.4	18%	12%
Digital China	000034 CH	NR	1,874	19.53	N/A	12.4	10.4	14.5	14.8	6%	13%
Infosys	INFO IN	NR	79,036	1492.05	N/A	27.4	25.3	30.1	30.7	10%	8%
Tata Consultancy	TCS IN	NR	147,162	3197.75	N/A	30.0	27.2	41.2	43.9	8%	7%
Mean						20.6	18.2	24.1	25.3	9%	12%
Median						20.0	17.8	22.3	22.8	9%	11%

Source: Bloomberg, CMBIGM

Figure 11: 12M forward P/E band



Source: Company data, CMBIGM

Figure 12: 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	22,105	25,576	30,145
Cost of sales	(9,983)	(13,494)	(16,749)	(19,659)	(23,154)
Gross profit	4,118	4,904	5,357	5,916	6,990
Selling exp	(729)	(943)	(1,127)	(1,304)	(1,537)
Admin exp	(1,302)	(1,756)	(1,868)	(2,161)	(2,547)
R&D exp	(930)	(1,249)	(1,501)	(1,737)	(2,047)
Other operating exp.	(205)	(159)	83	402	474
Operating profit	952	796	944	1,117	1,333
Finance costs	(151)	(100)	(110)	(89)	(98)
Other non-oper exp.	235	555	490	481	571
Pre-tax profit	1,035	1,252	1,323	1,510	1,806
Income tax expense	(87)	(115)	(82)	(119)	(139)
Minority interests	(7)	(0)	(2)	(1)	(2)
Net profit to shareholders	955	1,137	1,243	1,392	1,668

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net profit	1,035	1,252	1,323	1,510	1,806
Depreciation/amortization	170	221	140	123	126
Change in working capital	(533)	(887)	617	(656)	(856)
Others	480	376	284	(119)	(139)
Net cash from operating	1,153	962	2,364	858	937
Capex	(159)	(287)	(150)	(150)	(150)
Others	(32)	(242)	(601)	(53)	(51)
Net cash from investing	(192)	(530)	(751)	(203)	(201)
Net borrowings	217	173	216	205	264
Dividend paid	(52)	(70)	(93)	(104)	(124)
Others	196	1,274	(370)	1	2
Net cash from financing	362	1,377	(247)	102	142
Net change in cash	1,323	1,810	1,367	756	878
Cash at beginning of the year	2,526	3,787	5,556	7,277	8,086
Exchange difference	(62)	(40)	354	53	51
Cash at the end of the year	3,787	5,556	7,277	8,086	9,014

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	10,394	13,520	14,582	16,559	18,960
Cash & equivalents	3,787	5,556	7,277	8,086	9,014
Account receivables	4,580	5,894	5,396	6,261	7,372
Amount due from customers	1,904	1,741	1,571	1,840	2,161
Other current assets	123	328	337	372	413
Non-current assets	2,693	3,383	3,476	3,503	3,527
PPE	858	1,220	1,014	1,094	1,169
Intangible assets	1,086	1,037	1,021	968	917
Other non-current assets	749	1,126	1,440	1,440	1,440
Total assets	13,087	16,902	18,058	20,061	22,487
Current liabilities	2,718	3,986	5,169	5,886	6,767
ST borrowings	368	917	2,155	2,359	2,623
Account payables	1,753	2,252	2,745	3,214	3,775
Accrued expense	117	181	0	0	0
Other current liabilities	480	635	270	312	368
Non-current liabilities	1,592	1,290	215	215	215
LT borrowings	1,421	1,021	0	0	0
Other non-current liabilities	171	269	215	215	215
Total liabilities	4,311	5,276	5,384	6,100	6,982
Share capital	132	139	139	139	139
Capital surplus	4,735	6,294	6,223	6,223	6,223
Retained earnings	4,492	5,760	6,844	8,131	9,675
Other reserves	-605	-589	-554	-554	-554
Minority interest	23	23	22	22	22
Total equity	8,776	11,627	12,674	13,961	15,505
Total liabilities and equity	13,087	16,902	18,058	20,061	22,487

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue mix					
Emerging cloud business	17%	23%	29%	35%	39%
Traditional IT outsourcing	83%	77%	71%	65%	61%
Growth (%)					
Revenue	17%	30%	20%	16%	18%
Gross profit	15%	19%	9%	10%	18%
Operating profit	15%	-16%	18%	18%	19%
Net profit	26%	19%	9%	12%	20%
Profit & loss ratio (%)					
Gross margin	29.2%	26.7%	24.2%	23.1%	23.2%
Operating margin	6.7%	4.3%	4.3%	4.4%	4.4%
Net profit margin	6.8%	6.2%	5.6%	5.4%	5.5%
Balance sheet ratio					
Receivable turnover days	117	115	88	88	88
Amount due days	49	34	26	26	26
Payable turnover days	63	60	59	59	59
Current ratio (x)	3.82	3.39	2.82	2.81	2.80
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Profitability (%)					
ROE	12.5%	11.1%	10.2%	10.4%	11.3%
ROIC	13.5%	10.1%	11.9%	13.7%	14.8%
Per share data (RMB)					
EPS (RMB)	0.32	0.36	0.40	0.44	0.53
DPS (RMB)	0.03	0.03	0.03	0.03	0.04
BVPS (RMB)	2.93	3.68	4.04	4.46	4.95

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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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