

07 Jun 2021 11:59:05 ET | 13 pages

# Chinasoft International (0354.HK)

## Citi Call Takeaways: Emerging Biz Growth Acceleration with Better Margin – Raise EPS Estimates

### CITI'S TAKE

We hosted an investor conference call for Chinasoft Int'l (CSI) mgmt today and encountered decent investor interest. Reiterate Buy on Chinasoft given its visible growth outlook and rev mix shifting to emerging biz with better margin, plus attractive valuation at ~18x 12m fwd PE (on 26% EPS CAGR in 2020-23E).

**Citi call takeaways** — Mgmt highlighted CSI has participated in the HarmonyOS construction since 2018 and is one of the 7 key players in the working committee of OpenAtom OpenHarmony (开放原子开源基金会), which makes CSI have the expertise in SDK (software development kit) and source code (源代码) to provide **i)** middleware to third parties; **ii)** hardware + software modules to smart device vendors (i.e., home appliance players) who like to adopt HarmonyOS and **iii)** IoT software development and Joint R&D. Huawei aimed to get 300mn smart devices installed with HarmonyOS by 2021E and the scale can gradually grow to 1bn+ units per mgmt. For smart device, CSI can charge Rmb10 for each HarmonyOS connect, aiming to have ~20% market share. CSI generated Rmb200mn rev related to HarmonyOS in 2020 and expects the rev to double each year in the following years.

**Business outlook** — Mgmt targets to achieve Rmb30bn revenue by 2023E (implied 29% rev CAGR in 2020-23E), within which 40% was contributed by emerging biz (implied 50%+ rev CAGR in 2020-23E), mainly driven by fast growth of cloud management service, enterprise digitalization, and HarmonyOS related biz. Huawei biz should remain solid with double-digit growth and overall GPM is expected to improve each year as rev mix shifting emerging biz with ~40% GPM (10ppts higher than legacy IT outsourcing biz). More takeaways on page 2.

**Implications** — In view of faster emerging biz development and better margin outlook, we have raised our FY21E-23E earnings by 7-8%. Our new TP is adjusted to HK\$13.1 (from HK\$10.5) based on 22x 12mth Fwd PE (from 18x), which is set at 1.5SD above the historical average valuation given faster biz growth. Our TP implies 0.8x PEG based on 26% EPS CAGR in 2020-2023E.

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RmbM)	(Rmb)	(%)	(x)	(x)	(%)	(%)
2019A	755	0.301	7.7	30.0	3.5	12.1	0.2
2020A	955	0.341	13.6	26.4	2.9	12.5	0.3
2021E	1,299	0.447	30.9	20.2	2.6	13.9	0.3
2022E	1,632	0.562	25.7	16.1	2.3	15.2	0.4
2023E	1,999	0.688	22.5	13.1	2.0	16.0	0.5

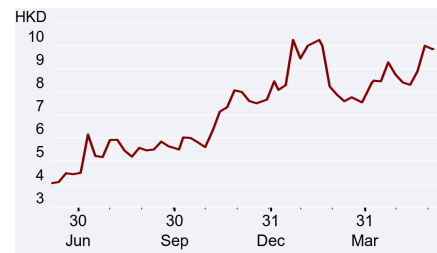
Source: Powered by dataCentral

### Buy

Price (07 Jun 21 16:10)	HK\$10.94
Target price	HK\$13.10↑
	from HK\$10.50
Expected share price return	19.7%
Expected dividend yield	0.3%
Expected total return	20.1%
Market Cap	HK\$31,788M
	US\$4,098M

### Price Performance

(RIC: 0354.HK, BB: 354 HK)



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**See Appendix A-1 for Analyst Certification, Important Disclosures and Research Analyst Affiliations.**

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0354.HK: Fiscal year end 31-Dec						Price: HK\$10.94; TP: HK\$13.10; Market Cap: HK\$31,788m; Recomm: Buy					
Profit & Loss (Rmbm)	2019	2020	2021E	2022E	2023E	Valuation ratios	2019	2020	2021E	2022E	2023E
Sales revenue	12,042	14,101	17,490	21,448	25,889	PE (x)	30.0	26.4	20.2	16.1	13.1
Cost of sales	-8,459	-9,983	-12,242	-14,926	-17,939	PB (x)	3.5	2.9	2.6	2.3	2.0
Gross profit	3,583	4,118	5,248	6,522	7,950	EV/EBITDA (x)	20.6	17.5	13.0	9.8	7.5
Gross Margin (%)	29.8	29.2	30.0	30.4	30.7	FCF yield (%)	2.9	4.3	4.4	5.0	6.3
<b>EBITDA (Adj)</b>	<b>1,264</b>	<b>1,421</b>	<b>1,796</b>	<b>2,280</b>	<b>2,819</b>	Dividend yield (%)	0.2	0.3	0.3	0.4	0.5
EBITDA Margin (Adj) (%)	10.5	10.1	10.3	10.6	10.9	Payout ratio (%)	7	7	7	7	7
Depreciation	-244	-264	-290	-327	-371	ROE (%)	12.1	12.5	13.9	15.2	16.0
Amortisation	-59	0	0	0	0	<b>Cashflow (Rmbm)</b>	<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
<b>EBIT (Adj)</b>	<b>961</b>	<b>1,157</b>	<b>1,505</b>	<b>1,953</b>	<b>2,448</b>	EBITDA	1,264	1,421	1,796	2,280	2,819
EBIT Margin (Adj) (%)	8.0	8.2	8.6	9.1	9.5	Working capital	-516	-206	-324	-545	-584
Net interest	-166	-151	-104	-99	-100	Other	7	-35	-215	-330	-460
Associates	0	-24	-20	-20	-20	<b>Operating cashflow</b>	<b>754</b>	<b>1,180</b>	<b>1,257</b>	<b>1,405</b>	<b>1,774</b>
Non-Op/Except/Other Adj	5	54	37	10	11	Capex	-105	-86	-94	-104	-114
<b>Pre-tax profit</b>	<b>799</b>	<b>1,035</b>	<b>1,418</b>	<b>1,845</b>	<b>2,339</b>	Net acq/disposals	-99	-3	0	0	0
Tax	-42	-87	-128	-221	-351	Other	-21	-145	-196	-235	-282
Extraord./Min.Int./Pref.div.	-2	7	8	9	10	<b>Investing cashflow</b>	<b>-224</b>	<b>-234</b>	<b>-290</b>	<b>-339</b>	<b>-397</b>
<b>Reported net profit</b>	<b>755</b>	<b>955</b>	<b>1,299</b>	<b>1,632</b>	<b>1,999</b>	Dividends paid	-48	-51	-68	-90	-114
Net Margin (%)	6.3	6.8	7.4	7.6	7.7	<b>Financing cashflow</b>	<b>-650</b>	<b>315</b>	<b>76</b>	<b>-90</b>	<b>-114</b>
Core NPAT	755	955	1,299	1,632	1,999	<b>Net change in cash</b>	<b>-121</b>	<b>1,261</b>	<b>1,042</b>	<b>976</b>	<b>1,264</b>
<b>Per share data</b>	<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Free cashflow to s/holders</b>	<b>650</b>	<b>1,094</b>	<b>1,162</b>	<b>1,302</b>	<b>1,660</b>
Reported EPS (Rmb)	0.301	0.341	0.447	0.562	0.688						
Core EPS (Rmb)	0.301	0.341	0.447	0.562	0.688						
DPS (Rmb)	0.020	0.024	0.031	0.039	0.048						
CFPS (Rmb)	0.300	0.422	0.433	0.484	0.611						
FCFPS (Rmb)	0.259	0.391	0.400	0.448	0.572						
BVPS (Rmb)	2.542	3.129	3.437	3.968	4.617						
Wtd avg ord shares (m)	2,459	2,522	2,905	2,905	2,905						
Wtd avg diluted shares (m)	2,512	2,797	2,905	2,905	2,905						
<b>Growth rates</b>	<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>						
Sales revenue (%)	13.8	17.1	24.0	22.6	20.7						
EBIT (Adj) (%)	4.6	20.4	30.1	29.8	25.3						
Core NPAT (%)	5.5	26.5	36.0	25.7	22.5						
Core EPS (%)	7.7	13.6	30.9	25.7	22.5						
<b>Balance Sheet (Rmbm)</b>	<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>						
Cash & cash equiv.	2,526	3,787	4,829	5,805	7,069						
Accounts receivables	3,297	4,580	5,681	6,966	8,409						
Inventory	54	51	51	51	51						
Net fixed & other tangibles	1,155	1,298	1,154	1,166	1,192						
Goodwill & intangibles	1,101	1,086	1,086	1,086	1,086						
Financial & other assets	2,611	2,285	2,046	1,890	1,688						
<b>Total assets</b>	<b>10,745</b>	<b>13,087</b>	<b>14,847</b>	<b>16,964</b>	<b>19,495</b>						
Accounts payable	1,229	1,753	2,203	2,687	3,229						
Short-term debt	1,547	368	368	368	368						
Long-term debt	928	1,421	1,421	1,421	1,421						
Provisions & other liab	508	768	855	956	1,070						
<b>Total liabilities</b>	<b>4,211</b>	<b>4,311</b>	<b>4,848</b>	<b>5,432</b>	<b>6,089</b>						
Shareholders' equity	6,468	8,753	9,984	11,526	13,411						
Minority interests	66	23	15	6	-4						
<b>Total equity</b>	<b>6,534</b>	<b>8,776</b>	<b>9,999</b>	<b>11,532</b>	<b>13,407</b>						
<b>Net debt (Adj)</b>	<b>-51</b>	<b>-1,997</b>	<b>-3,039</b>	<b>-4,015</b>	<b>-5,279</b>						
Net debt to equity (Adj) (%)	-0.8	-22.8	-30.4	-34.8	-39.4						

For definitions of the items in this table, please click [here](#).

**What's Next** - Optimistic on the China Software Sector, Citi has organized a mgmt call with **Kingdee Software 金蝶软件 (268.HK)** at 3pm HKT on 9 Jun (Wed), in Mandarin. Dial-in: China +86 4008 428 338, HK +852 2112 1888. Pin: 555666#. More to follow.

Figure 1. Chinasoft - Earnings Revision Summary

YE: Dec	Revenue			Net profit		
Rmb mn	New	Old	% Chg	New	Old	% Chg
2021E	17,490	17,140	2.0%	1,299	1,207	7.6%
2022E	21,448	20,638	3.9%	1,632	1,524	7.1%
2023E	25,889	24,734	4.7%	1,999	1,875	6.6%

Source: Citi Research, Company Reports

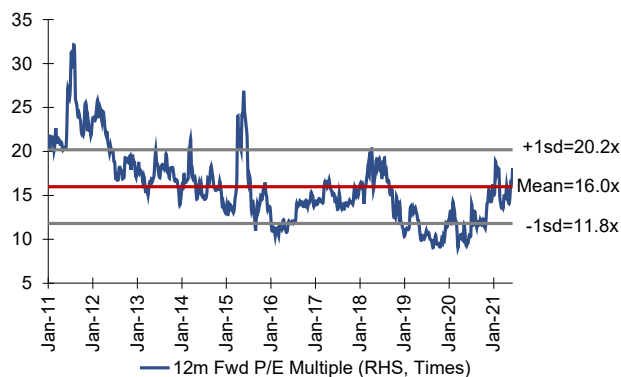
### More Takeaways from Management Call

Regarding HarmonyOS related biz model, CSI has taken 60% of the share in the R&D of Huawei's OS and related middleware. CSI can develop the middleware and charge related fees from the end-users in future.

As for **large customers**, mgmt highlighted that PingAn, Alibaba and Tencent will be the key accounts to reach USD1bn revenue by 2021E. More large customers are under development including China Mobile, Oppo, Vivo, etc.

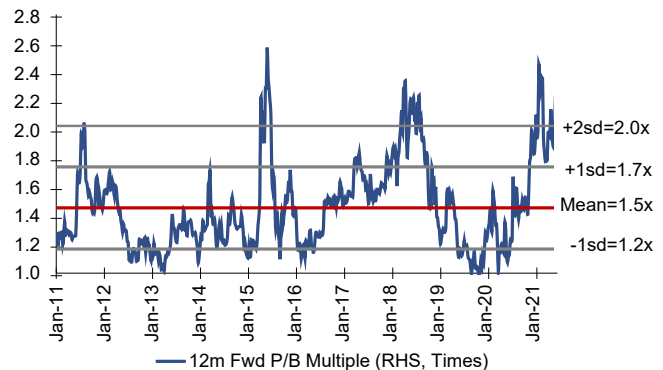
Looking into 2021E, mgmt targets to achieve ~30% yoy growth for both rev / net profit, with strong rev growth in 1Q21 (up ~50% yoy partly due to an easy base). Rev from Huawei and total number of employees should stay at double digits % growth.

Figure 2. Chinasoft - PE Bands



Source: dataCentral, Citi Research

Figure 3. Chinasoft - PB Bands



Source: dataCentral, Citi Research

Figure 4. Chinasoft - Interim Results

Rmb mn	1H18	2H18	1H19	2H19	1H20	2H20
<b>Total Revenues</b>	<b>4,814</b>	<b>5,771</b>	<b>5,538</b>	<b>6,504</b>	<b>6,059</b>	8,042
<i>YoY change</i>	16%	13%	15%	13%	9%	24%
Cost of sales and services	(3,424)	(3,917)	(3,971)	(4,487)	(4,410)	(5,572)
<b>Gross Profit</b>	<b>1,390</b>	<b>1,855</b>	<b>1,567</b>	<b>2,016</b>	<b>1,649</b>	<b>2,469</b>
<i>YoY change</i>	22%	15%	13%	9%	5%	22%
<i>GP Margin</i>	28.9%	32.1%	28.3%	31.0%	27.2%	30.7%
<b>Operating Expenses</b>						
Selling and distribution costs	(233)	(263)	(266)	(352)	(294)	(435)
<i>YoY change</i>	59%	18%	14%	34%	11%	24%
<i>as % of total revenue</i>	4.8%	4.5%	4.8%	5.4%	4.9%	5.4%
Administrative expenses (including R&D)	(680)	(1,151)	(833)	(1,172)	(896)	(1,336)
<i>YoY change</i>	3%	16%	22%	2%	8%	14%
<i>as % of total revenue</i>	14.1%	19.9%	15.0%	18.0%	14.8%	16.6%
Total Operating Expenses	(913)	(1,413)	(1,099)	(1,524)	(1,191)	(1,771)
<b>Profit from Operations</b>	<b>477</b>	<b>441</b>	<b>468</b>	<b>493</b>	<b>458</b>	<b>699</b>
<i>Operating margin</i>	9.9%	7.6%	8.5%	7.6%	7.6%	8.7%
Finance costs	(59)	(59)	(85)	(81)	(90)	(61)
Other income	19	45	60	117	126	187
Other expenses	(37)	(32)	(30)	(29)	(22)	(21)
Total other gains or losses (including impairments)	<b>(12)</b>	<b>(24)</b>	<b>(23)</b>	<b>(92)</b>	<b>(29)</b>	<b>(210)</b>
<b>Net profit before Tax</b>	<b>388</b>	<b>372</b>	<b>390</b>	<b>409</b>	<b>442</b>	<b>593</b>
Income Tax Expenses	(33)	(12)	(31)	(11)	(45)	(42)
<i>Effective tax rate</i>	-8.4%	-3.1%	-8.0%	-2.7%	-10.2%	-7.0%
Net profit	356	360	359	398	397	551
Net (income)/loss Attributable to Non-controlling interests	3	(3)	4	(6)	4	3
<b>Net Loss Attributable to Ordinary Shareholders of the Company</b>	<b>359</b>	<b>357</b>	<b>363</b>	<b>392</b>	<b>401</b>	<b>554</b>
<i>YoY change</i>	46%	12%	1%	10%	11%	41%
<i>NPM</i>	7.5%	6.2%	6.5%	6.0%	6.6%	6.9%

Source: Citi Research, Company Reports

# Bull/Bear: Chinasoft International (0354.HK)

## Bull/Bear: Chinasoft International (0354.HK)

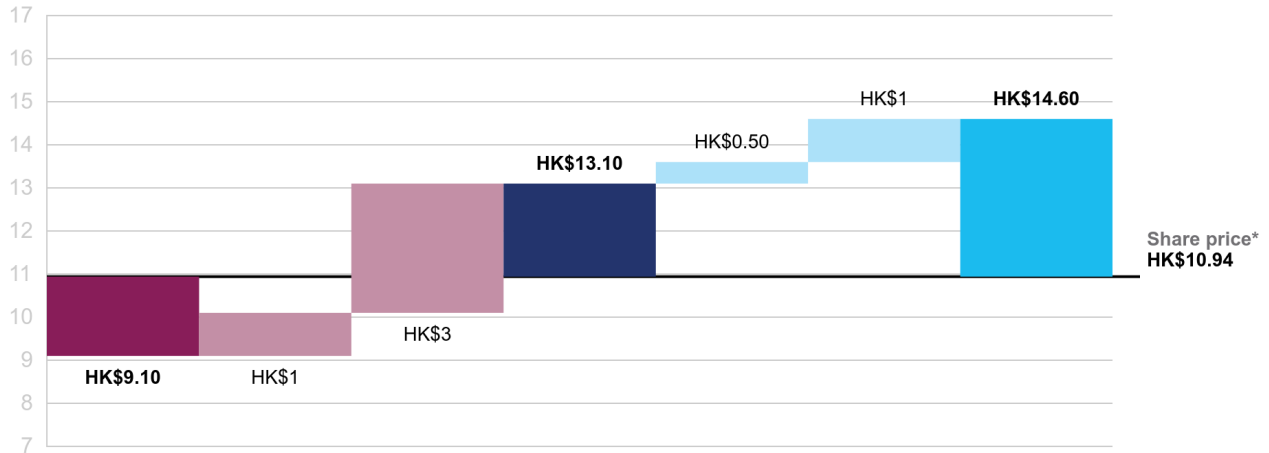


HK\$13.1 target price

20% expected share price return

Buy rating

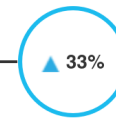
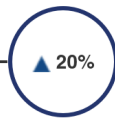
50pp Bull/Bear Spread



Lower top - line growth due to soft demand from Huawei  
Lower multiples on slower emerging business development



Higher top - line growth on faster cloud biz development  
Higher multiples on improving investor sentiment



Share price\*  
HK\$10.94

Source: Citi Research

\*Share price as of 7 Jun 2021 16:10



- Assume 10% higher top-line growth thanks to faster cloud business development.
- Higher multiple of 24x PE on improved investor sentiment.

HK\$14.6



- We used 22x 12mths Fwd PE to derive the target price.

HK\$13.1



- Assume 10% lower top-line growth due to soft demand from Huawei.
- Lower multiple of 16x PE on slower emerging business development.

HK\$9.1

## Chinasoft International

### Company description

Founded in 2000, Chinasoft International (CSI) is a leading IT services provider in China, chiefly offering industry IT solutions, IT outsourcing services, and cloud services to industries including finance, telecoms, internet, government, manufacturing, transportation, and education. CSI has built a strong customer base. CSI was listed on the HKex GEM Board in 2003 and transferred to the Mainboard Board in 2008.

### Investment strategy

We have a Buy rating on Chinasoft International. We believe the company will enjoy strong secular growth, benefiting from China's digitalization trend. Potential growth drivers for Chinasoft include: 1) Huawei's continued R&D spending on product innovation; 2) IT service expansion, which should cover more large customers; and 3) rapid growth in the emerging cloud-management business.

### Valuation

Our target price of HK\$13.1 is based on 22x 12mths fwd PE, set at 1.5SD above the historical nine-year (2011-20) average of 16x. We think the premium is justified by the shift in the company's revenue mix from its legacy businesses (IT solution and IT outsourcing) to emerging businesses (cloud intelligence services), which have stronger growth potential. It implies 0.8x PEG based on 26% EPS CAGR in 2020-23E at our target price.

### Risks

Although our Quant model assigns a High Risk rating to the Chinasoft stock based on its share price volatility in the past 12 months, we believe such a rating is not warranted given the company's solid track record in revenue growth. Key downside risks that could impede the stock from reaching our target price include: 1) a greater-than-expected business impact if the US imposes stricter sanctions on Chinasoft's largest customer Huawei; 2) slower-than-expected growth in new businesses, including cloud and Jointforce; and 3) faster-than-expected labor cost inflation.

## Appendix A-1

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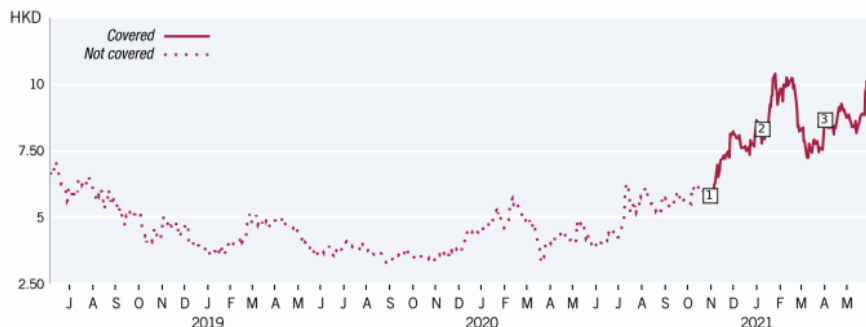
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Ratings and Target Price History  
Fundamental Research

Analyst: Daley Li  
Covered since October 30 2020



Date	Rating	Target Price	Closing Price	Date	Rating	Target Price	Closing Price	Date	Rating	Target Price	Closing Price
1 30-Oct-20 05:16:14	*1	*8.70	5.60	2 08-Jan-21 03:25:00	1	*10.00	8.08	3 06-Apr-21 13:30:06	1	*10.50	8.43

\*Indicates Change

Rating/target price changes above reflect Eastern Time

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	Buy	Hold	Sell	Buy	Hold	Sell
Citi Research Global Fundamental Coverage (Neutral=Hold)	57%	35%	8%	25%	66%	9%
% of companies in each rating category that are investment banking clients	64%	64%	55%	67%	62%	69%

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