

# Chinasoft (354 HK)

## Strong demand but labour cost weighs on margins

Chinasoft delivered strong FY1H21 top line at RMB8.3bn (+38% YoY), beat our estimate by 5% with cloud/ traditional IT outsourcing revenue growth of +73% YoY/ +26% YoY respectively. Net profit was at RMB518mn (+29% YoY), missed our forecast on lower-than-expected GPM and higher Opex (+52% YoY) as number of employees increased by +22% YoY to 83,138. We believe business growth outlook is strong but rising labor cost could weigh on margins.

- FY1H21 top line beat but margins disappoint with higher opex.** Chinasoft delivered strong revenue growth of +38% YoY to RMB8,341mn in FY1H21 that beat our estimate by 5%. However, operating profit was flattish YoY as 1) GPM improvement is not back to FY1H19 level and 2) opex increased at +52% YoY. Net profit was at RMB518mn, missed our forecast by 8% although other income grew at +74% YoY to RMB208mn (mainly related to gov't subsidies).
- Cloud business scaling up, traditional IT business recovering.** Chinasoft emerging business (cloud + Jointforce) grew fast at +73% YoY in FY1H21 to RMB2.1bn. This confirmed our view that Chinasoft is the key beneficiary to Huawei software/ cloud-centric business transformation strategy. According to IDC, Huawei IaaS + PaaS grew at +91% YoY in 1Q21 in China. For traditional IT outsourcing, revenue recovered from COVID-19 and grew at +26% YoY (16% CAGR in FY1H19-1H21). Ping An, China Mobile, Tencent, Alibaba have become key accounts that contribute >US\$100mn revenue annually.
- Rising labor cost hurts margin but +30% YoY net profit target unchanged.** Foreseeing strong business demand, Chinasoft increased number of employees by +22% YoY to 83,138 in FY1H21. This has resulted in lower IT outsourcing GPM and higher opex (+52% YoY to RMB1.9bn). Remuneration of employees increased by +46% YoY (1H21 low base) and we estimate that average monthly salary per employee rose by 8% CAGR in FY1H19-1H21E. Management expects FY2H21E GPM to improve YoY by streamlining IT service process with AI/ software factory implementation.
- Maintain BUY.** We maintained FY21E forecast but cut FY22-23E net profit by 2-5% to reflect increasing labor cost pressure. Maintain BUY with new target price of HK\$17.53 (prior HK\$18.45), based on unchanged 30x FY22E P/E.

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	12,042	14,101	18,166	22,352	26,825
YoY growth (%)	10%	15%	30%	24%	20%
Net profit (RMB mn)	755	955	1,214	1,536	1,810
EPS (RMB)	0.28	0.32	0.41	0.51	0.60
YoY growth (%)	10%	13%	27%	27%	18%
Consensus EPS (RMB)	0.28	0.35	0.45	0.57	0.73
PE (x)	24.6	21.9	29.4	23.2	19.7
EV/Sales (x)	1.7	1.3	1.7	1.4	1.1
Dividend Yield (%)	0.00	0.00	0.00	0.00	0.00
ROE (%)	12%	12%	13%	14%	15%
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\$17.53**  
 (Previous TP **HK\$18.45**)  
 Up/Downside **+29.3%**  
 Current Price **HK\$13.56**

### China Software & IT Services

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#### Stock Data

Mkt Cap (HK\$ mn)	38,413
Avg 3 mths t/o (HK\$ mn)	567.39
52w High/Low (HK\$)	16.28/ 5.16
Total Issued Shares (mn)	2,906

Source: Bloomberg

#### Shareholding Structure

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

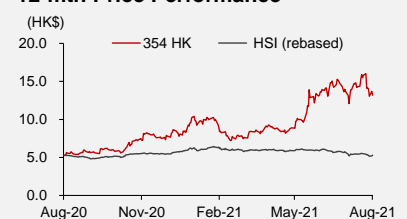
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	0.1%	9.0%
3-mth	54.1%	74.7%
6-mth	51.4%	84.7%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

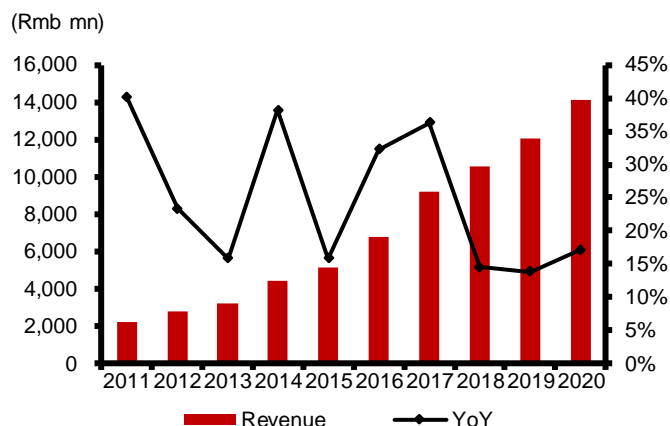
#### Auditor: Deloitte

#### Related Reports

- China Software & IT Services – “China cloud landscape changing” – 11 Aug 2021
- Chinasoft (354 HK) – “Huawei debut Harmony OS for smartphone” – 4 Jun 2021

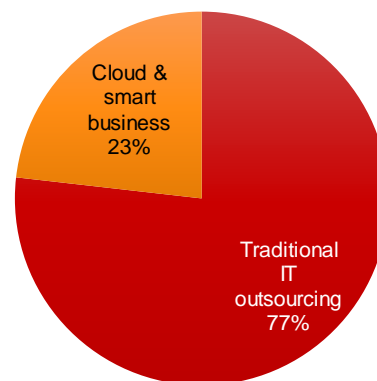
## Focus Charts

**Figure 1: Revenue and growth**



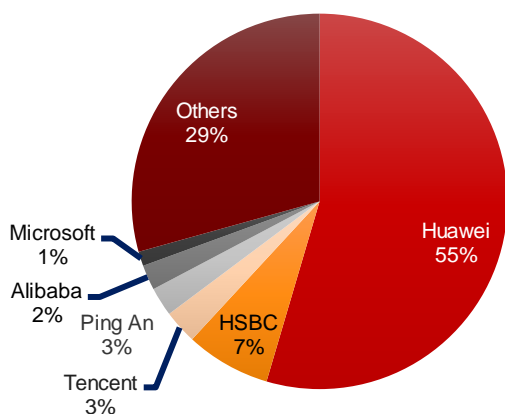
Source: Company data, CMBIS estimates

**Figure 2: Revenue mix (2020)**



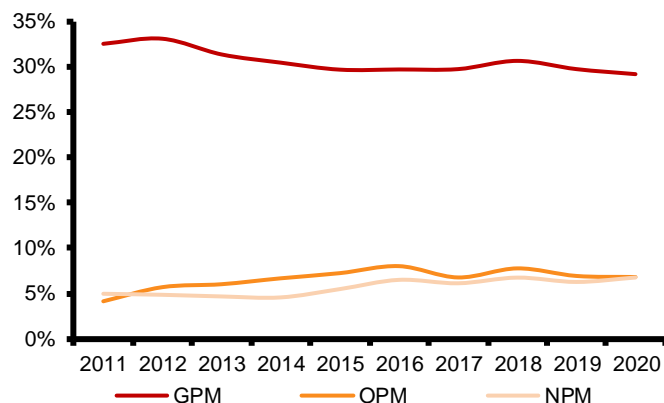
Source: Company data, CMBIS estimates

**Figure 3: Customer breakdown (2020)**



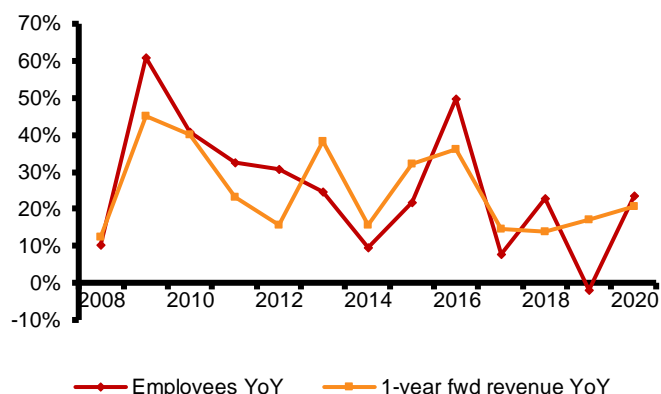
Source: Company data, CMBIS estimates

**Figure 4: Margins**



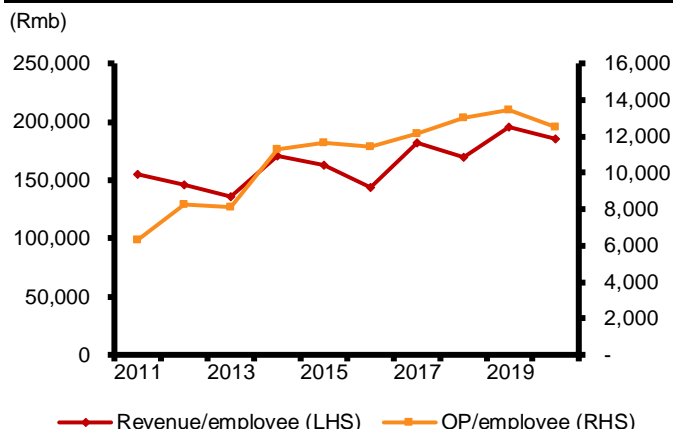
Source: Company data, CMBIS estimates

**Figure 5: Forward revenue and employees**



Source: Company data, CMBIS estimates

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



Source: Company data, CMBIS estimates

## FY1H21 results review

- **Revenue** was at RMB8,341mn (+38% YoY), beat our estimate by 5% and consensus by 4%.
- **Gross profit** was at RMB2,294mn (+39% YoY), above our estimate by 3% and consensus by 2%.
- **Gross margin** was at 27.5%, (+0.3 pct pts YoY), below our and consensus estimates by 0.5 pct pts
- **Operating profit** was at RMB423mn (+0% YoY), 31% below our and 48% below consensus estimates.
- **Operating margin** was at 5.1%% (-1.9 pct pts YoY), below our estimate by 2.8 pct pts and consensus by 5.1 pct pts.
- **Net profit** was at RMB518mn (+29% YoY), below our and consensus estimates by 8%.
- **EPS** was at RMB0.19 (+17% YoY), 2% below our estimate.

Figure 7: FY1H21 results review

354 HK RMB mn	1H20 Actual	2H20 Actual	1H21 Actual	YoY	HoH	1H21 CMBI	versus CMBI	1H21 Consensus	versus Consensus
Revenue	6,059	8,042	8,341	38%	4%	7,935	5%	8,020	4%
Gross profit	1,649	2,469	2,294	39%	-7%	2,222	3%	2,246	2%
<b>GPM</b>	<b>27.2%</b>	<b>30.7%</b>	<b>27.5%</b>	<b>0.3 pct pts</b>	<b>-3.3 pct pts</b>	<b>28.0%</b>	<b>-0.5 pct pts</b>	<b>28.0%</b>	<b>-0.5 pct pts</b>
Operating profit	421	531	423	0%	-20%	617	-31%	812	-48%
<b>OPM</b>	<b>6.9%</b>	<b>6.6%</b>	<b>5.1%</b>	<b>-1.9 pct pts</b>	<b>-1.6 pct pts</b>	<b>7.8%</b>	<b>-2.8 pct pts</b>	<b>10.1%</b>	<b>-5.1 pct pts</b>
PBT	442	593	576	30%	-3%	614	-6%	n.a.	n.a.
Tax	(45)	(42)	(59)	31%	42%	(54)	9%	n.a.	n.a.
Net income	401	554	518	29%	-6%	561	-8%	561	-8%
<b>NPM</b>	<b>6.6%</b>	<b>6.9%</b>	<b>6.2%</b>	<b>-0.5 pct pts</b>	<b>-0.7 pct pts</b>	<b>7.1%</b>	<b>-0.9 pct pts</b>	<b>7.0%</b>	<b>-0.8 pct pts</b>
EPS RMB cents	16.2	19.1	18.9	17%	-1%	19.3	-2%	25.5	-26%

Source: Company data, CMBIS

## Earnings revision

Figure 8: Earnings revision

RMB mn	2021E			2022E			2023E		
	New	Old	%Diff	New	Old	%Diff	New	Old	%Diff
Sales	18,166	18,068	1%	22,352	21,825	2%	26,825	25,369	6%
Gross profit	5,339	5,349	-0%	6,643	6,523	2%	7,976	7,587	5%
OP Profit	1,076	1,306	-18%	1,499	1,741	-14%	1,738	1,966	-12%
PBT	1,303	1,297	0%	1,638	1,725	-5%	1,943	1,983	-2%
Net profit	1,214	1,215	-0%	1,536	1,616	-5%	1,810	1,847	-2%
EPS (RMB)	0.41	0.41	-0%	0.51	0.54	-5%	0.60	0.62	-2%
<b>Margins</b>									
GM	29.4%	29.6%	-21 bps	29.7%	29.9%	-17 bps	29.7%	29.9%	-17 bps
OPM	5.9%	7.2%	-130 bps	6.7%	8.0%	-127 bps	6.5%	7.8%	-127 bps
PBT margin	7.2%	7.2%	0 bps	7.3%	7.9%	-58 bps	7.2%	7.8%	-57 bps
Net margin	6.7%	6.7%	-4 bps	6.9%	7.4%	-53 bps	6.7%	7.3%	-54 bps

Source: Company data, CMBIS

Figure 9: CMBI estimates vs consensus

RMB mn	2021E			2022E			2023E		
	CMBI	Street	Diff	CMBI	Street	Diff	CMBI	Street	Diff
Sales	18,166	17,679	3%	22,352	21,672	3%	26,825	25,793	4%
Gross profit	5,339	5,311	1%	6,643	6,579	1%	7,976	7,907	1%
OP Profit	1,076	1,430	-25%	1,499	1,841	-19%	1,738	2,310	-25%
PBT	1,303	1,368	-5%	1,638	1,768	-7%	1,943	2,210	-12%
Net profit	1,214	1,257	-3%	1,536	1,634	-6%	1,810	2,081	-13%
EPS (RMB)	0.41	0.42	-3%	0.51	0.53	-3%	0.60	0.65	-6%
<b>Margins</b>									
GM	29.4%	30.0%	-65 bps	29.7%	30.4%	-64 bps	29.7%	30.7%	-92 bps
OPM	5.9%	8.1%	-216 bps	6.7%	8.5%	-179 bps	6.5%	9.0%	-247 bps
PBT margin	7.2%	7.7%	-56 bps	7.3%	8.2%	-83 bps	7.2%	8.6%	-133 bps
Net margin	6.7%	7.1%	-43 bps	6.9%	7.5%	-67 bps	6.7%	8.1%	-132 bps

Source: Company data, CMBIS

## Operating model

Figure 10: Operating model

RMB mn	2019A	2020A	2021E	2022E	2023E
Revenues	12,042	14,101	18,166	22,352	26,825
Cost of sales	(8,459)	(9,983)	(12,826)	(15,709)	(18,849)
Gross Profit	3,583	4,118	5,339	6,643	7,976
<i>Gross margin</i>	<i>29.8%</i>	<i>29.2%</i>	<i>29.4%</i>	<i>29.7%</i>	<i>29.7%</i>
R&D	(809)	(930)	(1,326)	(1,661)	(2,006)
SG&A	(1,813)	(2,031)	(2,874)	(3,436)	(4,186)
Operating Income	827	952	1,076	1,499	1,738
<i>Operating margin</i>	<i>6.9%</i>	<i>6.7%</i>	<i>5.9%</i>	<i>6.7%</i>	<i>6.5%</i>
Non-Operating Income	(28)	83	227	139	205
Profit Before Tax	799	1,035	1,303	1,638	1,943
Income tax (expense) gain	(42)	(87)	(90)	(106)	(137)
Minorities	2	(7)	(1)	(5)	(4)
Net Income to Shareholders	755	955	1,214	1,536	1,810
<i>Net margin</i>	<i>6.3%</i>	<i>6.8%</i>	<i>6.7%</i>	<i>6.9%</i>	<i>6.7%</i>
EPS (RMB)	0.31	0.33	0.41	0.51	0.60
Fully diluted EPS (RMB)	0.28	0.32	0.41	0.51	0.60
<b>Revenue breakdown</b>					
IT outsourcing	10,042	10,830	12,833	14,887	17,120
Emerging cloud business	2,000	3,271	5,333	7,466	9,705
Huawei	6,570	8,030	9,664	11,113	12,558
HSBC	880	830	872	872	872
Tencent	350	500	725	979	1,175
Alibaba	260	400	620	868	1,128
Ping An	300	450	698	977	1,172
Others	3,682	3,891	5,588	7,544	9,921
<b>Growth YoY</b>					
Revenues	14%	17%	29%	23%	20%
Gross profit	10%	15%	30%	24%	20%
Operating Income	1%	15%	13%	39%	16%
EPS	4%	7%	25%	25%	18%

Source: Company data, CMBIS

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

RMB mn	1H19	2H19	1H20	2H20	1H21	2H21E
Revenues	5,538	6,504	6,059	8,042	8,341	9,825
Gross Profit	1,567	2,016	1,649	2,469	2,294	3,046
Operating profit	426	401	421	531	423	654
Net profit (loss)	363	392	401	554	518	696
EPS (RMB)	0.15	0.16	0.16	0.19	0.19	0.24
<b>Margins</b>						
Gross margin	28.3%	31.0%	27.2%	30.7%	27.5%	31.0%
Operating margin	7.7%	6.2%	6.9%	6.6%	5.1%	6.7%
Net margin	6.5%	6.0%	6.6%	6.9%	6.2%	7.1%
<b>Growth (HoH)</b>						
Revenues	-4%	17%	-7%	33%	4%	18%
Gross Profit	-16%	29%	-18%	50%	-7%	33%
Operating profit	14%	-6%	5%	26%	-20%	55%
Net profit (loss)	2%	8%	2%	38%	-6%	34%
<b>Growth (YoY)</b>						
Revenues	15%	13%	9%	24%	38%	22%
Gross Profit	13%	9%	5%	22%	39%	23%
Operating profit	-3%	7%	-1%	32%	0%	23%
Net profit (loss)	1%	10%	11%	41%	29%	26%

Source: Company data, CMBIS

## Valuation

### Chinasoft (354 HK, BUY, TP HK\$17.53)

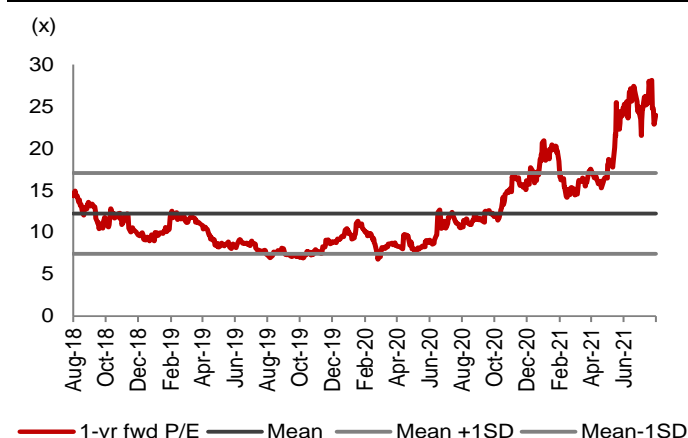
We have BUY rating on Chinasoft with target price of HK\$17.53, based on unchanged 30x FY22E P/E, in-line with Indian IT service providers. We believe Chinasoft deserves re-rating given accelerated growth and diversification in non-Huawei large enterprises.

Figure 12: Peers' valuation

Company	Ticker	Rating	Mk Cap (US\$ mn)	Price (LC)	TP (LC)	P/E		ROE		Sales CAGR FY20-22	EPS CAGR FY20-22
						FY21E	FY22E	FY21E	FY22E		
Chinasoft	354 HK	BUY	5,059	13.56	17.53	29.4	23.2	12.9	14.7	22%	28%
Digital China	000034 CH	NR	1,733	17.01	N/A	14.2	11.0	14.8	16.3	9%	25%
Infosys	INFO IN	NR	98,827	1720.85	N/A	37.5	32.9	28.4	28.9	13%	15%
Tata Consultancy	TCS IN	NR	180,126	3613.20	N/A	40.9	34.2	38.0	41.6	10%	11%
					<b>Mean</b>	<b>29.4</b>	<b>24.4</b>	<b>23.5</b>	<b>25.4</b>	<b>14%</b>	<b>20%</b>
					<b>Median</b>	<b>37.5</b>	<b>32.9</b>	<b>28.4</b>	<b>28.9</b>	<b>10%</b>	<b>15%</b>

Source: Bloomberg, CMBIS

Figure 13: 12M forward P/E band



Source: Company data, CMBIS

Figure 14: 12M forward P/B band



Source: Company data, CMBIS

## Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (RMB mn)	FY19A	FY20	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>12,042</b>	<b>14,101</b>	<b>18,166</b>	<b>22,352</b>	<b>26,825</b>	<b>Net profit</b>	<b>799</b>	<b>1,035</b>	<b>1,303</b>	<b>1,638</b>	<b>1,943</b>
Cost of sales	(8,459)	(9,983)	(12,826)	(15,709)	(18,849)	Depreciation/amortization	197	99	109	111	115
<b>Gross profit</b>	<b>3,583</b>	<b>4,118</b>	<b>5,339</b>	<b>6,643</b>	<b>7,976</b>	Change in working capital	(516)	(208)	(184)	32	(696)
Selling exp	(618)	(729)	(923)	(1,073)	(1,288)	Others	274	168	(90)	(106)	(137)
Admin exp	(1,196)	(1,302)	(1,951)	(2,363)	(2,899)	<b>Net cash from operating</b>	<b>754</b>	<b>1,095</b>	<b>1,138</b>	<b>1,675</b>	<b>1,224</b>
R&D exp	(809)	(930)	(1,326)	(1,661)	(2,006)	Capex	(105)	(150)	(150)	(150)	(150)
Other operating exp.	(134)	(205)	(63)	(48)	(46)	Others	(120)	(28)	234	(48)	(46)
<b>Operating profit</b>	<b>827</b>	<b>952</b>	<b>1,076</b>	<b>1,499</b>	<b>1,738</b>	<b>Net cash from investing</b>	<b>(224)</b>	<b>(178)</b>	<b>84</b>	<b>(198)</b>	<b>(196)</b>
Finance costs	(166)	(151)	(111)	(130)	(135)	Net borrowings	52	(661)	1,175	3	314
Other non-oper exp.	138	235	338	269	340	Dividend paid	0	(76)	(73)	(92)	(109)
<b>Pre-tax profit</b>	<b>799</b>	<b>1,035</b>	<b>1,303</b>	<b>1,638</b>	<b>1,943</b>	Others	(701)	1,444	(61)	5	4
Income tax expense	(42)	(87)	(90)	(106)	(137)	<b>Net cash from financing</b>	<b>(650)</b>	<b>707</b>	<b>1,041</b>	<b>(84)</b>	<b>209</b>
Minority interests	2	(7)	(1)	(5)	(4)	<b>Net change in cash</b>	<b>(119)</b>	<b>1,624</b>	<b>2,263</b>	<b>1,393</b>	<b>1,238</b>
<b>Net profit to shareholders</b>	<b>755</b>	<b>955</b>	<b>1,214</b>	<b>1,536</b>	<b>1,810</b>	Cash at beginning of the year	2,646	2,526	3,787	5,825	7,266
						Exchange difference	(1)	(363)	(225)	48	46
						<b>Cash at the end of the year</b>	<b>2,526</b>	<b>3,787</b>	<b>5,825</b>	<b>7,266</b>	<b>8,549</b>

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Current assets</b>	<b>8,198</b>	<b>10,394</b>	<b>12,912</b>	<b>14,975</b>	<b>17,642</b>	<b>Revenue mix</b>					
Cash & equivalents	2,526	3,787	5,825	7,266	8,549	Emerging cloud business	15%	17%	23%	29%	33%
Account receivables	3,297	4,580	4,317	4,270	4,952	Traditional IT outsourcing	85%	83%	77%	71%	67%
Amount due from customers	2,228	1,904	2,600	3,241	3,914	<b>Growth (%)</b>					
Other current assets	147	123	170	198	227	Revenue	14%	17%	29%	23%	20%
<b>Non-current assets</b>	<b>2,547</b>	<b>2,693</b>	<b>2,979</b>	<b>3,018</b>	<b>3,053</b>	Gross profit	10%	15%	30%	24%	20%
PPE	802	858	924	1,010	1,091	Operating profit	1%	15%	13%	39%	16%
Intangible assets	1,101	1,086	1,126	1,079	1,033	Net profit	5%	26%	27%	27%	18%
Other non-current assets	643	749	929	929	929	<b>Profit &amp; loss ratio (%)</b>					
<b>Total assets</b>	<b>10,745</b>	<b>13,087</b>	<b>15,892</b>	<b>17,993</b>	<b>20,695</b>	Gross margin	29.8%	29.2%	29.4%	29.7%	29.7%
<b>Current liabilities</b>	<b>3,150</b>	<b>2,718</b>	<b>4,727</b>	<b>5,384</b>	<b>6,290</b>	Operating margin	6.9%	6.7%	5.9%	6.7%	6.5%
ST borrowings	1,523	368	2,073	2,075	2,294	Net profit margin	6.3%	6.8%	6.7%	6.9%	6.7%
Account payables	1,229	1,753	2,600	3,241	3,914	<b>Balance sheet ratio</b>					
Accrued expense	106	117	0	0	0	Receivable turnover days	99	117	86	69	66
Other current liabilities	291	480	54	67	81	Amount due days	67	49	52	52	53
<b>Non-current liabilities</b>	<b>1,062</b>	<b>1,592</b>	<b>1,185</b>	<b>1,186</b>	<b>1,280</b>	Payable turnover days	52	63	73	74	75
LT borrowings	928	1,421	892	893	987	Current ratio (x)	2.60	3.82	2.73	2.78	2.80
Other non-current liabilities	134	171	293	293	293	Net debt to equity	net cash	net cash	net cash	net cash	net cash
<b>Total liabilities</b>	<b>4,211</b>	<b>4,311</b>	<b>5,912</b>	<b>6,570</b>	<b>7,570</b>	<b>Profitability (%)</b>					
Share capital	116	132	132	132	132	ROE	12%	12%	12.9%	14.4%	14.7%
Capital surplus	3,145	4,735	4,674	4,674	4,674	ROIC	13%	13%	14.8%	20.3%	22.2%
Retained earnings	3,677	4,492	5,681	7,125	8,826	<b>Per share data (RMB)</b>					
Other reserves	-471	-605	-530	-530	-530	EPS (RMB)	0.28	0.32	0.41	0.51	0.60
Minority interest	66	23	22	22	22	DPS (RMB)	0.02	0.03	0.02	0.03	0.04
<b>Total equity</b>	<b>6,534</b>	<b>8,776</b>	<b>9,979</b>	<b>11,423</b>	<b>13,125</b>	BVPS (RMB)	2.45	2.93	23%	29%	33%
<b>Total liabilities and equity</b>	<b>10,745</b>	<b>13,087</b>	<b>15,892</b>	<b>17,993</b>	<b>20,695</b>						



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