

Asian Daily

Chinasoft (0354.HK)

2H22 results missed, 2023 a year of recovery

Maintain OUTPERFORM

Previous Rating: OUTPERFORM

Target price (HK\$): 5.90

Previous target price (HK\$): 8.80

- 2H22 results missed, both revenue/Nl were 17%/68% below CSe. 2H22 GM was 21.2%, down 4.7 pp YoY, 4.2 pp below CSe, mainly due to fluctuations in demand from major customer (likely Huawei) leading to an increase in one-time costs. 2H22 ITO business declined 7% YoY while cloud business up 12% YoY.
- Management expects cloud intelligent business to continue to drive the growth for 2023, profit will recover given there were one-time expenses last year. The company aims for GM improvement driven by better mix, enhanced efficiency and improved quality in businesses.
- Mid-to-long term opportunities include MetaERP, AIGC applications such as Huawei Pangu Large Model, MSFT GitHub/Co-Pilot, Huawei Auto, Xinchuang, among others. The company has set its 2025 revenue target at Rmb35bn (implying a 20% CAGR from 2022).
- We cut our 2023/24E EPS by 33%/31% on lower revenue/GM estimate, introduce 2025E; cut our TP by 33% to HK\$5.9 (HK\$8.8), still based on +0.5 SD P/E of 16.1x 2023E EPS, supported by 25%/35% YoY for NI in 2023/24 on GM improvement/growth in new businesses. Potential Huawei ban remains the near-term overhang, but 2H recovery is likely on a low base and margin inflection.

FY22/2H22 results missed. Chinasoft reported FY22 revenue/Nl of Rmb20.0bn/759mn, +9%/-33% YoY, 10%/34% below CSe. 2H22 revenue/Nl was Rmb10.0bn/188mn, down 1%/70% YoY, 17%/68% below CSe. 2H22 GM was 21.2%, down 4.7 pp YoY, 4.2 pp below CSe. It declared final dividend of HK\$0.0567 per share (19% payout). GM miss was mainly due to fluctuations in demand from major customer (likely Huawei) leading to an increase in one-time costs. The company cut the number of employees by 11% in 2022, mainly in 2H22. Covid-19 pandemic impact is another factor, but we had previously factored in part of it.

For product mix, TPG grew 8% YoY to Rmb17.9bn (90% of revenue), IIG increased by 17% YoY to Rmb2.1bn (10% of mix), TPG growth is lower than prior CSe, but IIG is above. Cloud intelligent service increased 28% YoY to Rmb6.8bn, while IT outsourcing and solutions grew by 1.0% YoY only to Rmb13.2bn. We saw 2H22 ITO business decline 7% YoY while cloud business slowed down to 12% YoY. On segment margins, TPG declined 2.8 pp YoY to 4.5%, while IIG improved 0.1 pp YoY to 8.4%. Our check suggested the largest customer contribution has declined to below 50%.

Figure 1: FY22/2H22 results summary

FY						Half year					
Rmb mn	2021	2022	YoY%	2022E	Diff. %	Rmb mn	2H21	2H22	YoY%	2H22E	Diff. %
Sales	18,398	20,005	8.7%	22,117	-9.5%	Sales	10,057	9,980	-0.8%	12,092	-17.5%
GP	4,904	4,600	-6.2%	5,557	-17.2%	GP	2,610	2,118	-18.8%	3,075	-31.1%
OP	908	875	-3.7%	1,006	-32.9%	OP	470	191	-59.4%	522	-68.4%
PBT	1,252	830	-33.7%	1,260	-34.1%	PBT	676	219	-67.5%	650	-66.2%
NI	1,137	759	-33.2%	1,157	-34.4%	NI	619	188	-69.7%	585	-67.9%
GM	26.7%	23.0%	-3.7%	25.1%	-2.1%	GM	26.0%	21.2%	-4.7%	25.4%	-4.2%
OPM	4.9%	3.4%	-1.6%	4.5%	-1.2%	OPM	4.7%	1.9%	-2.8%	4.3%	-2.4%
NIM	6.2%	3.8%	-2.4%	5.2%	-1.4%	NIM	6.2%	1.9%	-4.3%	4.8%	-3.0%

Source: Company data, Credit Suisse estimates

2023 outlook. Management expects cloud intelligent business to continue to drive the growth for 2023, profit will recover given there were one-time expenses last year, including the pandemic impact. The company aims to improve GM through (1) increasing the proportion of high-margin and high-output-per-employee business, expanding cloud services and solutions, and integrating its capabilities with Huawei

Price (30-Mar-23, HK\$)		5.09	Est. pot. % chg. to TP	15.9
Mkt cap (HK\$/US\$ mn)	15,407 / 1,963	Blue sky scenario (HK\$)		7.1
Number of shares (mn)	3,027	Grey sky scenario (HK\$)		5.0
Free float (%)	86.4	Performance	1M	3M
52-wk range (HK\$)	8.17 - 4.83	Absolute (%)	(9.6)	(25.0)
ADTO-6M (US\$ mn)	16.9	Relative (%)	(12.9)	(29.1)
Year	12/22A	12/23E	12/24E	12/25E
Revenue (Rmb mn)	20,005.2	21,365.4	25,399.3	29,895.9
EBITDA (Rmb mn)	926.2	1,127.7	1,512.9	1,974.3
EBIT (Rmb mn)	675.4	901.5	1,281.0	1,733.0
Net profit (Rmb mn)	759.4	950.2	1,279.1	1,671.4
EPS (CS adj.) (Rmb)	0.25	0.3	0.39	0.49
Chg. from prev. EPS (%)	n.a.	(32.9)	(30.6)	n.a.
Consensus EPS (Rmb)	n.a.	0.48	0.56	0.52
EPS growth (%)	(34.4)	20.3	29.4	25.6
P/E (x)	17.7	14.7	11.4	9.1
Dividend yield (%)	1.1	0.6	0.6	0.6
EV/EBITDA (x)	11.3	8.6	6.2	4.4
P/B (x)	1.11	1.08	1.03	0.96
ROE (%)	6.4	7.6	9.4	11.2
Net debt/equity (%)	(25.3)	(29.3)	(29.3)	(30.2)

Source: Company data, Refinitiv, Credit Suisse estimates

Cloud; (2) leveraging AIGC to improve efficiency of code generation and empowering software factory to improve quality and efficiency; (3) ensuring quality of its foundational businesses and continuing to turn quality into value. From [our AIC takeaways](#), 2023 is likely a year of recovery for the market, it is also an inflection point for the company in terms of margins.

Mid-to-long term opportunities. (1) MetaERP would be the next Harmony; (2) ChatGPT/AIGC—Huawei Pangu Large Model, Microsoft GitHub and Co-Pilot AI, among others; (3) Auto—as the largest outsourcing partner to Huawei, but also to other NEV suppliers; (4) Xinchuang—telco operators achieved 50% YoY growth in 2021-22 and also see other SOE opportunities. The company has set its 2025 revenue target at Rmb35bn (implying a 20% CAGR from 2022 of Rmb20bn), 2027 of Rmb55bn and 2030 Rmb100bn.

Lower estimates/TP. We cut our 2023/24E EPS by 33%/31% to reflect slower revenue growth and lower GM, introduce our 2025E. We cut our TP by 33% to HK\$5.9, still based on 16.1x 2023E EPS, on 0.5 SD of historical average P/E, stay Outperform. We believe the potential Huawei ban remains the near-term overhang, but 2H recovery is likely on a low base and margin inflection.

Figure 2: Earnings change table

(Rmb,mn)	New			Prior			Var %		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	21,385	25,399	29,896	27,179	32,425	n/a	-21.4%	-21.7%	n/a
GP	4,930	5,999	7,208	6,789	8,235	n/a	-27.4%	-27.1%	n/a
OP	901	1,281	1,733	1,281	1,760	n/a	-29.6%	-27.2%	n/a
Tax	(119)	(166)	(223)	(130)	(173)	n/a	-9.1%	-4.1%	n/a
NI - GAAP	950	1,279	1,671	1,434	1,867	n/a	-33.7%	-31.5%	n/a
EPS - GAAP	0.30	0.39	0.49	0.45	0.56	n/a	-32.9%	-30.6%	n/a
Margins (%)									
GM	23.1%	23.6%	24.1%	25.0%	25.4%	n/a	-1.9%	-1.8%	n/a
OPM	4.2%	5.0%	5.8%	4.7%	5.4%	n/a	-0.5%	-0.4%	n/a
NM	4.4%	5.0%	5.6%	5.3%	5.8%	n/a	-0.8%	-0.7%	n/a

Source: Credit Suisse estimates

Research Analysts

Kyna Wong / 852 2101 6950
kyna.wong@credit-suisse.com

Clive Cheung / 852 2101 7069
clive.cheung@credit-suisse.com

Edward Liu / 852 2101 6734
edward.liu@credit-suisse.com

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Chinasoft (0354.HK)

Method: Our target price of HK\$5.9 for Chinasoft International is based on 16.1x (0.5SD of three-year historical average, in line with Huawei ITS peers) and 2023E EPS (earnings per share). Our OUTPERFORM rating is based on Chinasoft International's strong growth in IT services for enterprise clients including tech companies and banks, together with stabilised and improving margins. We also see largest customer risk likely priced in with further upside. The company's CDR listing could be supportive of a potential rerate.

Risk: Risks to our target price of HK\$5.9 and OUTPERFORM rating for Chinasoft International include: (1) weaker-than-expected demand in OSG/PSG, margin downsides from wage changes or client concentration risk, (2) weaker smart cloud growth, (3) volatility from key client business adjustment, (4) higher-than-expected opex for investment in R&D or new businesses, and (5) EPS dilution from an equity placement.

Companies Mentioned (Price as of 30-Mar-2023)

Chinasoft (0354.HK, HK\$5.09, OUTPERFORM[V], TP HK\$5.9)

Microsoft (MSFT.OQ, \$280.51)

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0354.HK	Closing Price	Target Price	
Date	(HK\$)	(HK\$)	Rating
02-Sep-20	5.72	5.80	N
18-Dec-20	7.50	7.30	
05-Feb-21	9.99	12.20	O
17-Jun-21	12.60	15.50	
24-Aug-21	13.56	15.60	
10-Jan-22	8.94	12.90	
30-Mar-22	6.99	9.70	
20-May-22	6.87	9.60	
31-Aug-22	6.17	8.80	



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This research report is authored by:

Credit Suisse (Hong Kong) Limited

Kyna Wong ; Clive Cheung ; Edward Liu

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