

02 Apr 2024 19:36:13 ET | 14 pages

Chinasoft International (0354.HK)

Investor Call Takeaway: Robust Emerging Biz as Key Growth Engine

CITI'S TAKE

We hosted post-FY23 results investor call with Chinasoft Int'l. Key takeaways: 1) 2024 Guidance: 10-15%YoY rev growth (Legacy Biz: Flattish YoY, Emerging biz: 30%+ YoY growth), 0.5-1.0ppts GM improvement, declining opex ratio (non-GAAP). NI could partly drag from share-based compensation and other non-ops. 2) Both rev contribution and rev mix from Huawei should further decline as Chinasoft plans not to participate in low-margin outsourcing projects/orders from Huawei in FY24, but the ratio could rebound after 2025 along with its biz recovery. 3) Other emerging business includes overseas business ride on Huawei Cloud, growing telecom/automobile/smartphone customers. 4) Focus on shareholder return with increasing payout to 40% in medium-term and continuous share buyback. We introduce our FY26E and trim NI 2024-2025 estimates by 9/11% to factor in latest outlook, lower revenue/opex assumption. We lower TP to HK\$5.7 (from HK\$6.4) based on still 15x FY24E PE (+0.5SD above 5-year historical mean). Stay Buy.

FY24 Guidance — Chinasoft guided 10-15% YoY rev growth, which includes flattish YoY growth in Legacy biz and 30%+ YoY growth for emerging biz, 0.5-1.0ppts GM improvement, and declining opex ratio (non-GAAP). NI could partly drag from share-based compensation and other non-operating items. YoY growth of emerging biz should be primarily driven by Huawei smart cloud (~+10% YoY in FY24), consulting projects in ERP, Big data, database management (FY23 rev: ~Rmb2.8bn, +30% YoY in FY24), Harmony OS App Migration (~Rmb330mn rev contribution in FY24), computing center rent and operation (~Rmb200mn rev contribution in FY24) and Open Harmony projects (~Rmb230mn rev contribution in FY24). As per Co., their Chinese telcos customers (operators and tower) have contributed close to Rmb1bn revenue in FY23 and will likely grow 50%+ YoY this year, likely offsetting the decline in revenue from Huawei.

Outlook for business with Huawei – Chinasoft expects a decline in Huawei revenue in 2024 (likely Rmb500mn gap), coupled with declining rev mix, as Co. adopted strategy of shifting to higher-margin business and thus is not participating in low-margin outsourcing projects/orders from Huawei in FY24. Yet, Co. expects rev contribution from Huawei could gradually pick up after 2025, along with Huawei's gradual biz recovery and emergence of higher-margin projects like cloud and consulting. (Continued...)

Earnings Summary

Year to 31 Dec	Net Profit (RmbM)	Diluted EPS (Rmb)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2022A	759	0.252	-34.4	17.5	1.1	6.4	1.0
2023A	713	0.251	-0.5	17.6	1.1	6.0	1.6
2024E	1,007	0.342	36.5	12.9	1.0	8.3	2.8
2025E	1,271	0.432	26.2	10.2	1.0	9.8	3.7
2026E	1,579	0.536	24.2	8.2	0.9	11.3	4.9

Source: Powered by dataCentral

Buy

Price (02 Apr 24 16:10)	HK\$4.77
Target price	HK\$5.70↓ from HK\$6.40
Expected share price return	19.5%
Expected dividend yield	3.1%
Expected total return	22.6%
Market Cap	HK\$13,867M US\$1,772M

Price Performance

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


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0354.HK: Fiscal year end 31-Dec						Price: HK\$4.77; TP: HK\$5.70; Market Cap: HK\$13,867m; Recomm: Buy					
Profit & Loss (Rmbm)	2022	2023	2024E	2025E	2026E	Valuation ratios	2022	2023	2024E	2025E	2026E
Sales revenue	20,005	17,117	19,203	22,083	25,545	PE (x)	17.5	17.6	12.9	10.2	8.2
Cost of sales	-15,405	-13,114	-14,568	-16,686	-19,277	PB (x)	1.1	1.1	1.0	1.0	0.9
Gross profit	4,600	4,003	4,635	5,396	6,268	EV/EBITDA (x)	7.3	9.5	6.6	4.5	3.6
Gross Margin (%)	23.0	23.4	24.1	24.4	24.5	FCF yield (%)	4.3	5.3	24.7	8.7	10.4
EBITDA (Adj)	1,230	1,074	1,484	1,833	2,240	Dividend yield (%)	1.0	1.6	2.8	3.7	4.9
EBITDA Margin (Adj) (%)	6.2	6.3	7.7	8.3	8.8	Payout ratio (%)	18	28	36	38	40
Depreciation	-445	-372	-421	-478	-545	ROE (%)	6.4	6.0	8.3	9.8	11.3
Amortisation	-55	0	0	0	0	Cashflow (Rmbm)	2022	2023	2024E	2025E	2026E
EBIT (Adj)	731	702	1,063	1,355	1,695	EBITDA	1,230	1,074	1,484	1,833	2,240
EBIT Margin (Adj) (%)	3.7	4.1	5.5	6.1	6.6	Working capital	-683	-523	1,679	-708	-845
Net interest	-113	-203	-205	-207	-209	Other	218	214	148	122	91
Associates	-23	-30	-20	-20	-20	Operating cashflow	765	765	3,311	1,247	1,487
Non-Op/Except/Other Adj	235	265	267	267	267	Capex	-197	-100	-110	-121	-133
Pre-tax profit	830	734	1,106	1,396	1,734	Net acq/disposals	-334	-507	668	0	0
Tax	-71	-21	-100	-126	-156	Other	-119	-281	-337	-405	-486
Extraord./Min.Int./Pref.div.	1	1	1	1	1	Investing cashflow	-650	-888	220	-526	-619
Reported net profit	759	713	1,007	1,271	1,579	Dividends paid	-80	-138	-239	-362	-483
Net Margin (%)	3.8	4.2	5.2	5.8	6.2	Financing cashflow	-781	-341	-444	-569	-692
Core NPAT	759	713	1,007	1,271	1,579	Net change in cash	-551	-464	3,087	152	176
Per share data	2022	2023	2024E	2025E	2026E	Free cashflow to s/holders	568	665	3,200	1,126	1,354
Reported EPS (Rmb)	0.252	0.251	0.342	0.432	0.536						
Core EPS (Rmb)	0.252	0.251	0.342	0.432	0.536						
DPS (Rmb)	0.046	0.071	0.123	0.164	0.214						
CFPS (Rmb)	0.254	0.269	1.125	0.424	0.505						
FCFPS (Rmb)	0.188	0.234	1.087	0.383	0.460						
BVPS (Rmb)	4.001	3.990	4.251	4.560	4.932						
Wtd avg ord shares (m)	2,909	2,757	2,943	2,943	2,943						
Wtd avg diluted shares (m)	3,016	2,847	2,943	2,943	2,943						
Growth rates	2022	2023	2024E	2025E	2026E						
Sales revenue (%)	8.7	-14.4	12.2	15.0	15.7						
EBIT (Adj) (%)	-23.6	-4.0	51.5	27.5	25.1						
Core NPAT (%)	-33.2	-6.1	41.2	26.2	24.2						
Core EPS (%)	-34.4	-0.5	36.5	26.2	24.2						
Balance Sheet (Rmbm)	2022	2023	2024E	2025E	2026E						
Cash & cash equiv.	5,005	3,788	6,875	7,027	7,203						
Accounts receivables	6,157	6,092	5,910	6,796	7,861						
Inventory	99	96	96	96	96						
Net fixed & other tangibles	1,595	2,231	2,258	2,307	2,381						
Goodwill & intangibles	1,124	1,180	1,180	1,180	1,180						
Financial & other assets	2,984	3,681	1,859	2,011	2,193						
Total assets	16,965	17,068	18,178	19,416	20,915						
Accounts payable	2,043	1,663	1,932	2,213	2,557						
Short-term debt	766	735	735	735	735						
Long-term debt	1,162	2,282	2,282	2,282	2,282						
Provisions & other liab	858	621	694	744	804						
Total liabilities	4,830	5,301	5,644	5,974	6,377						
Shareholders' equity	12,110	11,742	12,511	13,420	14,516						
Minority interests	25	24	23	23	21						
Total equity	12,135	11,767	12,534	13,442	14,537						
Net debt (Adj)	-3,077	-771	-3,859	-4,010	-4,186						
Net debt to equity (Adj) (%)	-25.4	-6.6	-30.8	-29.8	-28.8						
For definitions of the items in this table, please click here .											

What's more — Chinasoft expects overseas revenue from Huawei Cloud projects to be ~Rmb100-200mn, with GM of ~60% in FY24, much higher than overall blended margin, while Co. foresees a 50%+ overseas rev CAGR from this project in the next 3-5 years. In 2023, there were three major customers with US\$100mn+ revenue contribution, mainly from smartphone/finance industry, while their key telecom/automobile customers could reach this level soon. Revenue from major internet customers is still muted given soft macros. The Co. noted that they will focus in improving shareholder return through measures like continuous share buyback and increase in dividend payout. Co. expects dividend payout to grow to 40% in the medium term.

Implications — We introduce our FY26E and trim our earnings estimates in 2024-2025E by 9/11% to factor in the latest outlook and lower revenue/opex assumption. We lower our TP to HK\$5.7 (from HK\$6.4) based on 15x FY24E PE. We now forecast FY24 YoY revenue growth of 12% driven by 32% YoY growth in emerging biz and we forecast 41% YoY growth in NI owing to a low base, 0.75ppts gross margin improvement and opex ratio decline. We now model 36%/38%/40% dividend payout in FY24-26E. Maintain Buy. Upside catalyst in the near-term could be: P70 model launch ahead and Huawei developer conference in 3Q24.

Figure 1. Chinasoft International - Estimates Revision

(Rmb mn)	2024E			2025E		
	New	Old	Chg.	New	Old	Chg.
Sales	19,203	20,998	-9%	22,083	24,976	-12%
Gross profit	4,635	5,081	-9%	5,396	6,143	-12%
Opex	(3,572)	(3,885)	-8%	(4,041)	(4,570)	-12%
Operating profit	1,063	1,196	-11%	1,355	1,572	-14%
Pre-tax profit	1,106	1,217	-9%	1,396	1,566	-11%
Net income	1,007	1,108	-9%	1,271	1,426	-11%
EPS (Rmb)	0.34	0.38	-10%	0.43	0.49	-12%
Gross margin	24.1%	24.2%	-0.1%	24.4%	24.6%	-0.2%
Opex ratio	-18.6%	-18.5%	-0.1%	-18.3%	-18.3%	0.0%
Operating margin	5.5%	5.7%	-0.2%	6.1%	6.3%	-0.2%
Net margin	5.2%	5.3%	0.0%	5.8%	5.7%	0.0%

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Source: Citi Research

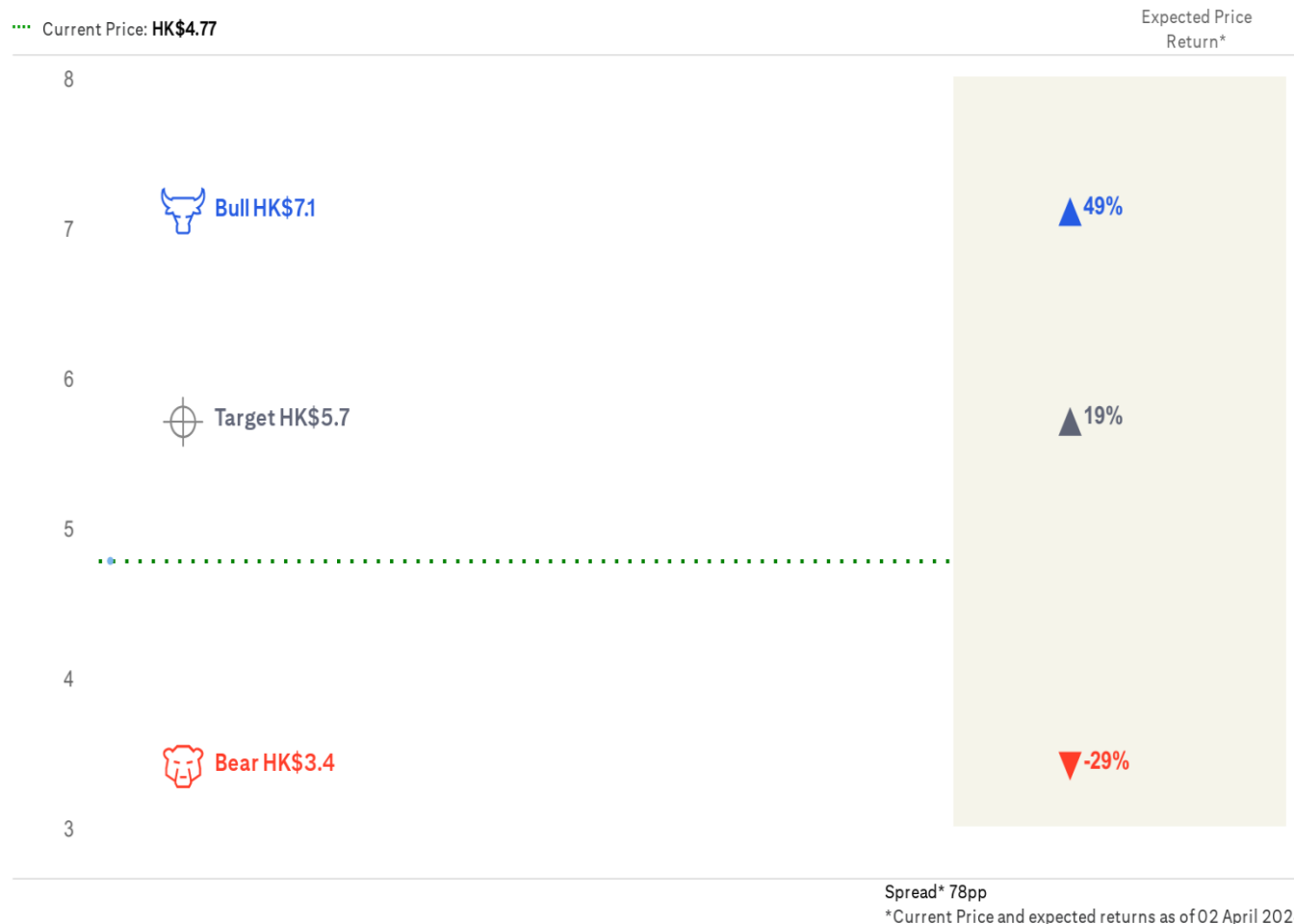
Figure 2. Chinasoft International - Revised Estimates Vs. Bloomberg Consensus and Citi Estimates

(Rmb mn)	2024			2025			2026		
	New	Cons	Diff.	New	Cons	Diff.	New	Cons	Diff.
Sales	19,203	21,962	-13%	22,083	25,461	-13%	25,545	28,385	-10%
Gross profit	4,635	5,381	-14%	5,396	6,320	-15%	6,268	7,124	-12%
Opex	(3,572)	(4,217)	-15%	(4,041)	(4,835)	-16%	(4,573)	(5,359)	-15%
Op. profit	1,063	1,164	-9%	1,355	1,485	-9%	1,695	1,765	-4%
Net income	1,007	1,090	-8%	1,271	1,332	-5%	1,579	1,576	0%
Ratio (%)									
Gross margin	24.1%	24.5%	-0.4%	24.4%	24.8%	-0.4%	24.5%	25.1%	-0.6%
Opex ratio	-18.6%	-19.2%	0.6%	-18.3%	-19.0%	0.7%	-17.9%	-18.9%	1.0%
Operating margin	5.5%	5.3%	0.2%	6.1%	5.8%	0.3%	6.6%	6.2%	0.4%
Net margin	5.2%	5.0%	0.3%	5.8%	5.2%	0.5%	6.2%	5.6%	0.6%

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Source: Bloomberg, Citi Research

Bull/Bear: Chinasoft International (0354.HK)



BULL Assumptions

Assume 10% higher top-line growth thanks to faster cloud business development
Higher multiple of 17x FY24E PE on improved investor sentiment (1SD above 5-year average)

BASE Assumptions

We use 15x FY24E PE to derive the target price (0.5SD above 5-year average)

BEAR Assumptions

Assume 10% lower top-line growth due to soft demand from Huawei
Lower multiple of 11x FY24E PE on slower emerging business development (0.5 SD below 5-year average)

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 intelligence business.

Valuation

Our target price of HK\$5.7 is based on 15x FY24E PE (~0.5SD above 5-year historical mean).

Risks

Although our Quant model assigns a High Risk rating to 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.

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Appendix A-1

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Chinasoft International (0354.HK)

Ratings and Target Price History
Fundamental Research

Analyst: Kyna Wong



	Date	Rating	Target Price	Closing Price
1	06-Apr-21 13:30:06	1	*10.50	8.43
2	07-Jun-21 11:59:05	1	*13.10	10.94
3	10-Aug-21 09:57:08	1	*18.50	15.30
4	30-Mar-22 20:37:28	1	*14.60	6.99

*Indicates Change

	Date	Rating	Target Price	Closing Price
5	22-May-22 19:24:12	1	*12.40	6.87
6	13-Apr-23 04:00:35	1	*6.40	5.22
7	17-Aug-23 18:38:14	1	*5.50	4.60
8	23-Oct-23 06:41:58	1	*6.80	5.85

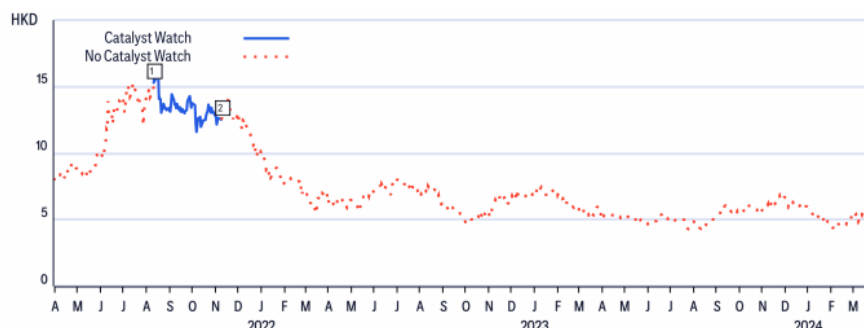
	Date	Rating	Target Price	Closing Price
9	11-Jan-24 05:38:30	1	*7.60	5.21
10	21-Feb-24 19:15:27	1	*6.40	4.93

Rating/target price changes above reflect Eastern Time

Chinasoft International (0354.HK)

Catalyst Watch Research

Analyst: Kyna Wong



	Date	Expected Direction	Duration	Action	Closing Price
1	10-Aug-21 09:57:08	Upside	90 Days	Open	15.30

	Date	Expected Direction	Duration	Action	Closing Price
2	08-Nov-21 03:21:19	Upside	90 Days	Close	12.52

Rating/target price changes above reflect Eastern Time

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Data current as of 31 Mar 2024	12 Month Rating			Catalyst Watch		
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% of companies in each rating category that are investment banking clients	48%	49%	37%	52%	44%	47%

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