

# Chinasoft Intl (0354.HK)

Reduce TP mainly on change to valuation base year to 2023 PE from long duration; Positive on GM recovery; Buy

Buy

**0354.HK**    12m Price Target: **HK\$7.50**    Price: **HK\$5.53**    Upside: **35.6%**

We are positive on Chinasoft Intl given its product mix upgrade and diversifying customer base; however, we cut our 12-m TP to HK\$7.50 (from HK\$10.85) as we (1) lower earnings by 3% / 4% / 4% / 3% for 2022-25E mainly on higher R&D and selling costs for intelligent cloud services and solutions business development and customer base expansion and (2) change our valuation methodology from a longer duration (2025E discount PE) to nearer-term PE (2023E PE), given macro uncertainties — such as ongoing trade tension (and given its largest customer is Huawei), and macro slowdown — are reducing longer term visibility. We set our target PE multiple at 14x — the same as for iSoftstone, given their similar OPM (7-9%) and earnings growth (30-32% YoY) — and in line with where Chinasoft Intl traded when its OPM and earnings growth have been at this level historically. Our prior target price implied 20x 2023E P/E. Maintain Buy.

**Customers expansion:** We expect the revenue contribution from its largest customer (Huawei) to continue to decline in coming years, falling to 44% by 2024E (vs. 54% in 2021A), given Huawei's revenue (-2% YoY in 9M22) and R&D investment (+8% YoY in 9M22) have slowed and with Chinasoft Intl's expanding into new customers: **(1)** internet companies, such as JD.com, who is increasing IT outsourcing in logistics business, or Baidu, which is developing automotive navigation, map, AI, etc. **(2)** government / SOEs, mainly on Xinchuang (IT application innovation), such as IoT basic software (OS customization and middleware), digitalization, etc. **(3)** telecom operators, for example China Telecom and China Mobile, who are new customers to Chinasoft Intl.; Chinasoft Intl's revenues from these two companies grew ~40% YoY in 1H22. This expansion should reduce Chinasoft's customer concentration risks. For comparison, for peer iSoftstone, we expect its Huawei revenues

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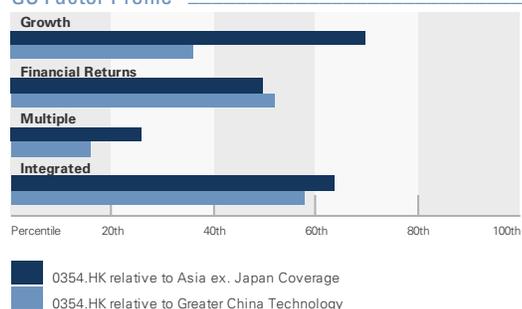
### Key Data

Market cap: HK\$16.1bn / \$2.1bn  
Enterprise value: HK\$12.3bn / \$1.6bn  
3m ADTV: HK\$63.0mn / \$8.0mn  
China  
Greater China Technology  
M&A Rank: 3  
Leases incl. in net debt & EV?: No

### GS Forecast

	12/21	12/22E	12/23E	12/24E
<b>Revenue (Rmb mn) New</b>	<b>18,398.1</b>	<b>22,509.3</b>	<b>26,738.9</b>	<b>30,962.5</b>
Revenue (Rmb mn) Old	18,398.1	23,030.2	26,698.6	30,880.6
EBITDA (Rmb mn)	1,177.1	1,528.9	1,926.1	2,491.3
<b>EPS (Rmb) New</b>	<b>0.41</b>	<b>0.42</b>	<b>0.50</b>	<b>0.63</b>
EPS (Rmb) Old	0.41	0.43	0.52	0.66
P/E (X)	23.0	12.3	10.3	8.1
P/B (X)	2.2	1.2	1.1	0.9
Dividend yield (%)	0.3	0.5	0.6	0.8
CROCI (%)	18.9	13.5	13.3	14.1
	<b>6/22</b>	<b>12/22E</b>	<b>6/23E</b>	<b>12/23E</b>
EPS (Rmb)	0.20	0.22	0.23	0.27

### GS Factor Profile



Source: Company data, Goldman Sachs Research estimates. See disclosures for details.

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Buy

## Chinasoft Intl (0354.HK)

Rating since Jul 2, 2021

## Ratios &amp; Valuation

	12/21	12/22E	12/23E	12/24E
P/E (X)	23.0	12.3	10.3	8.1
P/B (X)	2.2	1.2	1.1	0.9
FCF yield (%)	2.6	(0.1)	10.4	1.3
EV/EBITDAR (X)	19.1	7.5	5.2	4.0
EV/EBITDA (excl. leases) (X)	19.1	7.5	5.2	4.0
CROCI (%)	18.9	13.5	13.3	14.1
ROE (%)	11.2	10.0	10.8	12.3
Net debt/equity (%)	(31.1)	(27.7)	(35.5)	(32.3)
Net debt/equity (excl. leases) (%)	(31.1)	(27.7)	(35.5)	(32.3)
Interest cover (X)	9.6	9.7	13.8	19.1
Days inventory outst, sales	2.1	3.0	2.9	2.9
Receivable days	104.5	103.0	100.0	99.0
Days payable outstanding	54.6	44.0	44.0	44.0
DuPont ROE (%)	9.8	9.5	10.3	11.6
Turnover (X)	1.1	1.3	1.3	1.4
Leverage (X)	1.5	1.4	1.4	1.3
Gross cash invested (ex cash) (Rmb)	11,906.3	13,528.6	15,337.4	17,501.5
Average capital employed (Rmb)	7,393.8	8,619.3	9,173.7	9,925.6
BVPS (Rmb)	4.17	4.37	4.84	5.44

## Growth &amp; Margins (%)

	12/21	12/22E	12/23E	12/24E
Total revenue growth	30.5	22.3	18.8	15.8
EBITDA growth	(11.3)	29.9	26.0	29.3
EPS growth	8.0	2.1	19.7	26.5
DPS growth	22.8	2.1	19.7	26.5
EBIT margin	5.2	4.7	5.5	6.6
EBITDA margin	6.4	6.8	7.2	8.0
Net income margin	6.2	5.4	5.4	6.0

## Price Performance



Source: FactSet. Price as of 1 Nov 2022 close.

## Income Statement (Rmb mn)

	12/21	12/22E	12/23E	12/24E
Total revenue	18,398.1	22,509.3	26,738.9	30,962.5
Cost of goods sold	(13,493.8)	(16,662.0)	(19,693.2)	(22,545.8)
SG&A	(2,699.1)	(3,275.6)	(3,760.6)	(4,311.0)
R&D	(1,249.3)	(1,523.8)	(1,801.2)	(2,050.0)
Other operating inc./(exp.)	-	-	-	-
<b>EBITDA</b>	<b>1,177.1</b>	<b>1,528.9</b>	<b>1,926.1</b>	<b>2,491.3</b>
Depreciation & amortization	(221.3)	(481.0)	(442.2)	(435.6)
<b>EBIT</b>	<b>955.8</b>	<b>1,047.9</b>	<b>1,483.9</b>	<b>2,055.7</b>
Net interest inc./(exp.)	(29.1)	(24.5)	(25.7)	(38.3)
Income/(loss) from associates	(10.2)	(30.6)	-	-
<b>Pre-tax profit</b>	<b>1,252.1</b>	<b>1,339.0</b>	<b>1,618.2</b>	<b>2,117.5</b>
Provision for taxes	(115.4)	(122.6)	(161.8)	(275.3)
Minority interest	0.2	0.2	0.2	0.2
Preferred dividends	-	-	-	-
<b>Net inc. (pre-exceptionals)</b>	<b>1,136.9</b>	<b>1,216.5</b>	<b>1,456.6</b>	<b>1,842.4</b>
Post-tax exceptionals	-	-	-	-
<b>Net inc. (post-exceptionals)</b>	<b>1,136.9</b>	<b>1,216.5</b>	<b>1,456.6</b>	<b>1,842.4</b>
<b>EPS (basic, pre-exception) (Rmb)</b>	<b>0.41</b>	<b>0.42</b>	<b>0.50</b>	<b>0.63</b>
<b>EPS (diluted, pre-exception) (Rmb)</b>	<b>0.38</b>	<b>0.40</b>	<b>0.48</b>	<b>0.60</b>
<b>EPS (basic, post-exception) (Rmb)</b>	<b>0.41</b>	<b>0.42</b>	<b>0.50</b>	<b>0.63</b>
<b>EPS (diluted, post-exception) (Rmb)</b>	<b>0.38</b>	<b>0.40</b>	<b>0.48</b>	<b>0.60</b>
DPS (Rmb)	0.03	0.03	0.03	0.04
Div. payout ratio (%)	6.2	6.2	6.2	6.2

## Balance Sheet (Rmb mn)

	12/21	12/22E	12/23E	12/24E
Cash & cash equivalents	5,556.4	5,476.1	6,955.3	7,067.6
Accounts receivable	5,936.9	6,767.0	7,884.5	8,911.6
Inventory	162.6	202.6	229.1	265.1
Other current assets	1,863.7	1,863.7	1,863.7	1,863.7
<b>Total current assets</b>	<b>13,519.6</b>	<b>14,309.4</b>	<b>16,932.6</b>	<b>18,108.1</b>
Net PP&E	1,220.1	1,144.4	1,161.2	1,238.0
Net intangibles	192.9	138.9	97.2	68.0
Total investments	463.2	463.2	463.2	463.2
Other long-term assets	1,506.6	1,506.6	1,506.6	1,506.6
<b>Total assets</b>	<b>16,902.3</b>	<b>17,562.4</b>	<b>20,160.7</b>	<b>21,383.9</b>
Accounts payable	2,251.6	1,765.5	2,982.5	2,453.2
Short-term debt	917.4	917.4	917.4	917.4
Short-term lease liabilities	-	-	-	-
Other current liabilities	816.5	821.4	836.3	860.0
<b>Total current liabilities</b>	<b>3,985.6</b>	<b>3,504.4</b>	<b>4,736.1</b>	<b>4,230.7</b>
Long-term debt	1,020.9	1,020.9	1,020.9	1,020.9
Long-term lease liabilities	-	-	-	-
Other long-term liabilities	269.3	269.3	269.3	269.3
<b>Total long-term liabilities</b>	<b>1,290.1</b>	<b>1,290.1</b>	<b>1,290.1</b>	<b>1,290.1</b>
<b>Total liabilities</b>	<b>5,275.7</b>	<b>4,794.5</b>	<b>6,026.3</b>	<b>5,520.8</b>
Preferred shares	-	-	-	-
Total common equity	11,603.9	12,745.4	14,112.2	15,840.9
<b>Minority interest</b>	<b>22.6</b>	<b>22.5</b>	<b>22.3</b>	<b>22.1</b>
<b>Total liabilities &amp; equity</b>	<b>16,902.3</b>	<b>17,562.4</b>	<b>20,160.7</b>	<b>21,383.9</b>
Net debt, adjusted	(3,618.1)	(3,537.8)	(5,017.0)	(5,129.3)

## Cash Flow (Rmb mn)

	12/21	12/22E	12/23E	12/24E
Net income	1,136.9	1,216.5	1,456.6	1,842.4
D&A add-back	221.3	481.0	442.2	435.6
Minority interest add-back	(0.2)	(0.2)	(0.2)	(0.2)
Net (inc)/dec working capital	(987.1)	(1,356.2)	73.0	(1,592.4)
Other operating cash flow	591.2	-	-	-
<b>Cash flow from operations</b>	<b>962.1</b>	<b>341.2</b>	<b>1,971.6</b>	<b>685.4</b>
Capital expenditures	(287.2)	(351.3)	(417.3)	(483.3)
Acquisitions	(137.5)	-	-	-
Divestitures	-	-	-	-
Others	(44.6)	0.0	-	-
<b>Cash flow from investing</b>	<b>(469.3)</b>	<b>(351.3)</b>	<b>(417.3)</b>	<b>(483.3)</b>
Repayment of lease liabilities	-	-	-	-
Dividends paid (common & pref)	(51.8)	(70.1)	(75.0)	(89.8)
Inc/(dec) in debt	148.8	-	-	-
Other financing cash flows	1,240.0	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>1,337.0</b>	<b>(70.1)</b>	<b>(75.0)</b>	<b>(89.8)</b>
<b>Total cash flow</b>	<b>1,829.9</b>	<b>(80.3)</b>	<b>1,479.2</b>	<b>112.3</b>
Free cash flow	675.0	(10.2)	1,554.3	202.1

Source: Company data, Goldman Sachs Research estimates.

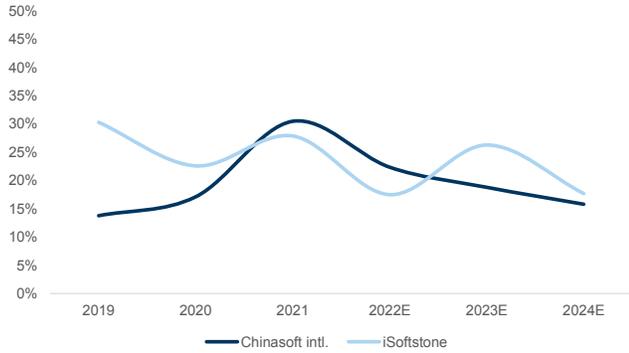
exposure to narrow to 30% by 2024E vs. 47% in 2021A. iSoftstone is also main supplier to BABA, which contributed 8% of its 2021 revenues.

**Intelligent cloud services and solutions:** For this higher GM business, we expect revenues to grow at +32% CAGR in 2022-24E (vs. +7% CAGR of IT outsourcing revenues), driven by consulting total solutions and cloud mgmt. services. The consulting total solutions includes digitalization for financial institutions, Xinchuang, and Harmony OS for various industries. This year, its Harmony OS business has been mainly used in the coal mining industry, and could expand to government, transportation, electricity, and oil and gas industries in 2023E. For cloud mgmt., the company is riding on localization and its comprehensive cloud platform partners (Huawei, China telecom carriers). We expect its market share in China to rise to 10% by 2024E (vs. 7% in 2021A).

# Chinasoft Intl. vs. iSoftstone in charts

**Exhibit 1: iSoftstone 9M22 revenues at 18% YoY vs. +20% YoY of Chinasoft Intl. 2022E revenues growth guidance**

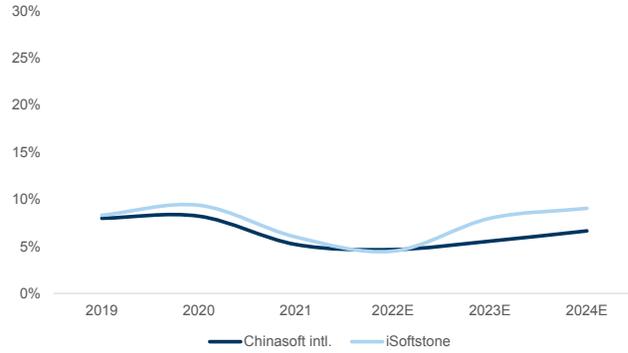
Revenues YoY: Chinasoft Intl. vs. iSoftstone



Source: Company data, Goldman Sachs Global Investment Research

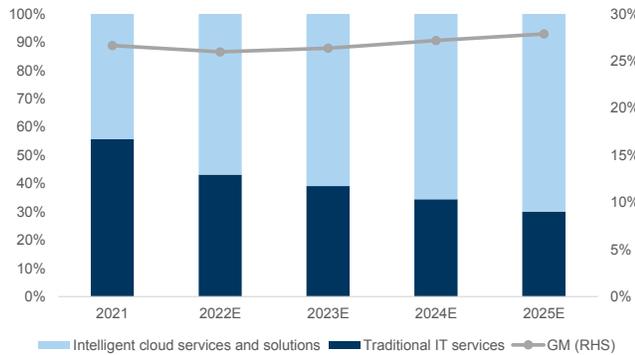
**Exhibit 2: OPM to trough in 2022E with product mix upgrade, diversifying customer base, and disciplined R&D investment**

OPM: Chinasoft Intl. vs. iSoftstone



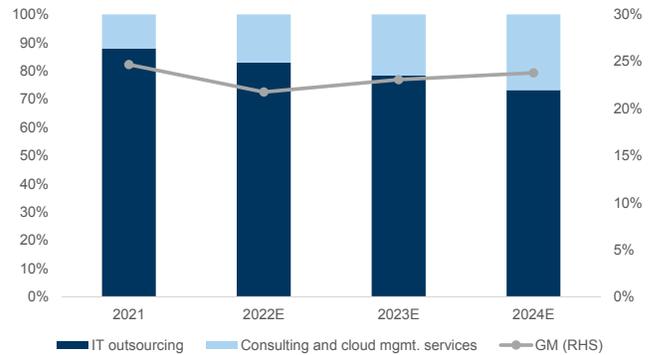
Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 3: Chinasoft Intl. GP mix by product and blended GM**



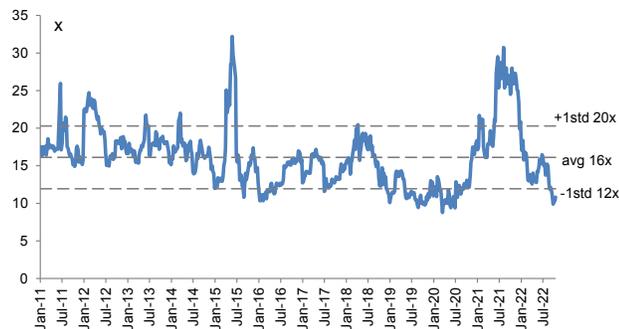
Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 4: iSoftstone GP mix by products and blended GM**



Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 5: Chinasoft Intl. 12M forward PE ratio**



Source: Bloomberg

**Exhibit 6: iSoftstone 12M forward PE ratio**



Source: Bloomberg

## Earnings revision and valuation

**Earnings revision:** We reduce net income by 3% / 4% / 4% / 3% for 2022-25E mainly on higher R&D and selling costs for the intelligent cloud services and solutions business development and customer base expansion. We continue to expect a GM recovery in coming years driven by product mix upgrade, in which we expect IT outsourcing to grow at 7% CAGR in 2022-24E, and intelligent cloud services and solutions to grow at 32% CAGR in 2022-24E.

### Exhibit 7: Earnings revisions

Rmb m	2022E			2023E			2024E			2025E		
	Old	New	Chg									
Revenues	23,030	22,509	-2%	26,699	26,739	0%	30,881	30,962	0%	36,091	36,211	0%
GP	5,895	5,847	-1%	7,059	7,046	0%	8,455	8,417	0%	10,128	10,093	0%
OP	1,095	1,048	-4%	1,554	1,484	-5%	2,138	2,056	-4%	2,899	2,822	-3%
Net income	1,259	1,217	-3%	1,518	1,457	-4%	1,916	1,842	-4%	2,517	2,452	-3%
EPS	0.41	0.40	-3%	0.50	0.48	-4%	0.63	0.60	-4%	0.82	0.80	-3%
<b>Margins</b>												
GM	26.3%	26.0%		27.4%	26.4%		28.3%	27.2%		28.8%	27.9%	
OPM	4.9%	4.7%		6.1%	5.5%		7.2%	6.6%		8.2%	7.8%	
NM	5.5%	5.4%		6.0%	5.4%		6.6%	6.0%		7.3%	6.8%	

EPS here is diluted EPS

Source: Goldman Sachs Global Investment Research

**Valuation:** We change our valuation methodology from a longer duration (2025E discount P/E) to nearer-term P/E (2023E), given macro uncertainties — such as ongoing trade tension (and given its largest customer is Huawei), and macro slowdown — are reducing longer term visibility. We set our target PE multiple at 14x — the same as for iSoftstone, given their similar OPM (7-9%) and earnings growth (30-32% YoY) — and in line with where Chinasoft Intl traded when its OPM and earnings growth have been at this level historically (detail below). Our prior target price implied 20x 2023E P/E. Maintain Buy.

- For OPM, our forecast for iSoftstone 2024E is 9%, similar to Chinasoft Intl. in 2016-2020, when Chinasoft Intl. avg. trading PE over 2015-19A was 14x. We model Chinasoft Intl. 2024-25E OPM at 7-8%, which is at a similar range.
- For NI growth, iSoftstone 2024E NI YoY growth is at 32%, similar to Chinasoft Intl. in 2017-18, when Chinasoft Intl. avg. trading PE in 2016-17 was 14x. We model Chinasoft Intl. 2024-25E avg. NI YoY at 30%, which is at a similar range.
- Our target PE multiple of 14x is also within Chinasoft Intl. historical trading range, which is between its avg. (16x) and avg.-1stv (12x) since the company listed, reflecting macro uncertainties and customers concentration risks.

**Downside risks:** (1) slower-than-expected diversification of its customer base, (2) stronger-than-expected competition, (3) slower-than-expected investments in R&D, and (4) slower-than-expected product mix upgrade.

# Disclosure Appendix

## Reg AC

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**Growth** is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

Financial Returns and Multiple use the Goldman Sachs analyst forecasts at the fiscal year-end at least three quarters in the future. Growth uses inputs for the fiscal year at least seven quarters in the future compared with the year at least three quarters in the future (on a per-share basis for all metrics).

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There are no company-specific disclosures for: Chinasoft Intl (HK\$5.53)

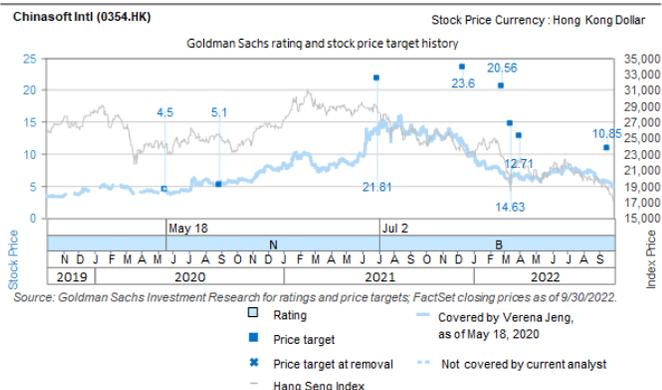
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Goldman Sachs Investment Research global Equity coverage universe

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	Buy	Hold	Sell	Buy	Hold	Sell
Global	48%	36%	16%	64%	59%	50%

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## Price target and rating history chart(s)



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