

# Chinasoft International (354.HK)

## Major Customer Strategy Supports Continued Growth

### Hong Kong | TMT | Company report

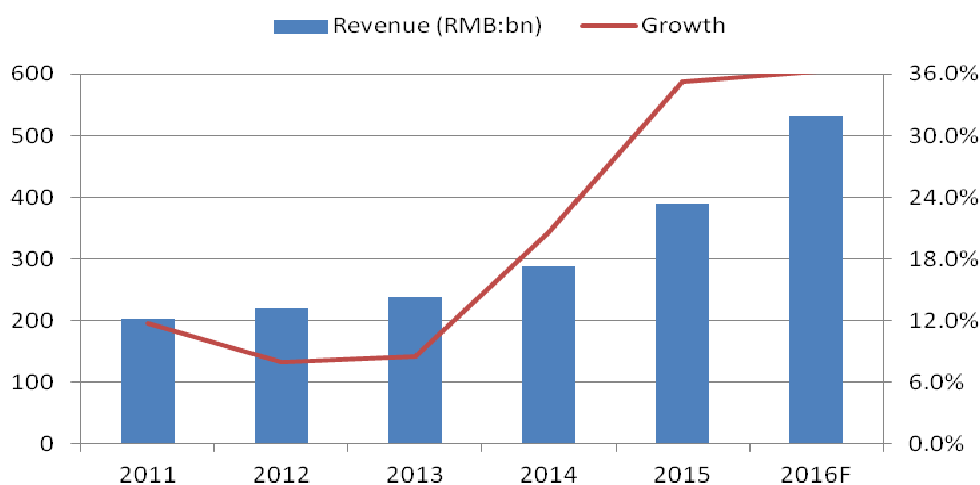
17 March 2016

### Major Customer Strategy Supports Continued Growth

The top five customers of Chinasoft International include Huawei, Microsoft, Tencent, HSBC and Bank of Communications, contributing to around 40% of total revenues of the Company. We expect the Company will maintain a continued growth of about 20% by virtue of business expansion of major customers and Chinasoft's larger share among them. To be specific, the Company, thanks to its status of the largest outsourcing service provider, successfully issued 3.97% strategic shares to Huawei. Such a closer association is expected to help it obtain more outsourcing business share from Huawei, increasing from 40% in 2014 to 50% in 2015. Furthermore, Huawei increased the average remuneration of outsourcing labour from Chinasoft International by 10% in 2015, and accelerated the repayment of the accounts payable to the Company, showcasing the Company is highly recognized by Huawei.

In 2015, Huawei maintained a rapid growth, with its revenues skyrocketing 35.3% to US\$60 billion. In accordance with the guidelines, its revenues will soar by 36.3% to US\$80 billion in 2016. We believe that Chinasoft International will significantly benefit from the growth and that its ability to serve large customers is also expected to enhance its bargaining power, thereby improving its profitability. Meanwhile, the Company is also projected to expand to more industries (such as cloud services and Industrial 4.0) and more overseas markets (such as India) by virtue of global enterprise customer resources of Huawei.

### Rapidly grown revenue of Huawei (RMB:bn)



Source: Phillip Securities (HK) Research

### JointForce Platform Rapidly Expands

The Company's JointForce Commerce Platform has been officially put into operation since June 2015, and the platform targets at IT services Taobao. As of the end of January 2016, the registered engineers of the platform reached 80,000, equivalent to three times the number of employees. Moreover, the total turnover from the platform is estimated to have exceeded RMB100 million in 2015, highlighting the rapid expansion of the platform.

### Buy (Maintain)

CMP: HKD 2.64

(Closing price as at 15 Mar 2016)

TARGET: HKD 3.65 (+38%)

#### COMPANY DATA

O/S SHARES (MN) :	2,152
MARKET CAP (HKDMN) :	5,681
52 - WK HI/LO (HKD):	5.79/ 2.28

#### SHARE HOLDING PATTERN , %

Chen Yuhong :	12.97
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#### PRICE PERFORMANCE , %

	1M	3M	1Y
CSI	3.07	-14.60	8.03
HSI	-4.95	-10.66	22.25

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	3206	4429	5354	6554
Net Profit	148	200	276	364
EPS, CNY	0.08	0.11	0.14	0.17
PER, x	26.3	20.6	15.9	12.8
BVPS, CNY	1.23	1.33	1.62	1.70
P/BV, x	1.8	1.7	1.4	1.3
ROE, %	7.1	8.4	9.3	10.7
Debt/Equity (%)	91.42	97.87	90.48	90.48

Source: Company reports, Phillip Securities Est.

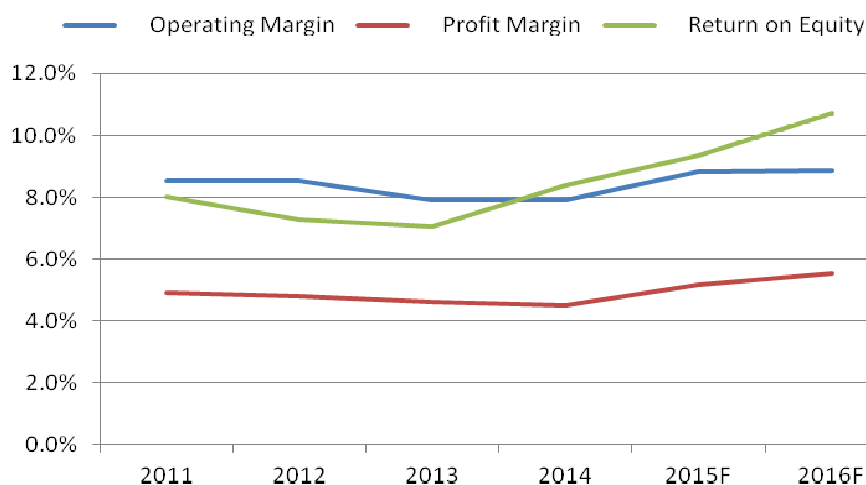
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### Earning capabilities have bottomed out



Source: Company reports, Phillip Securities (HK) Research

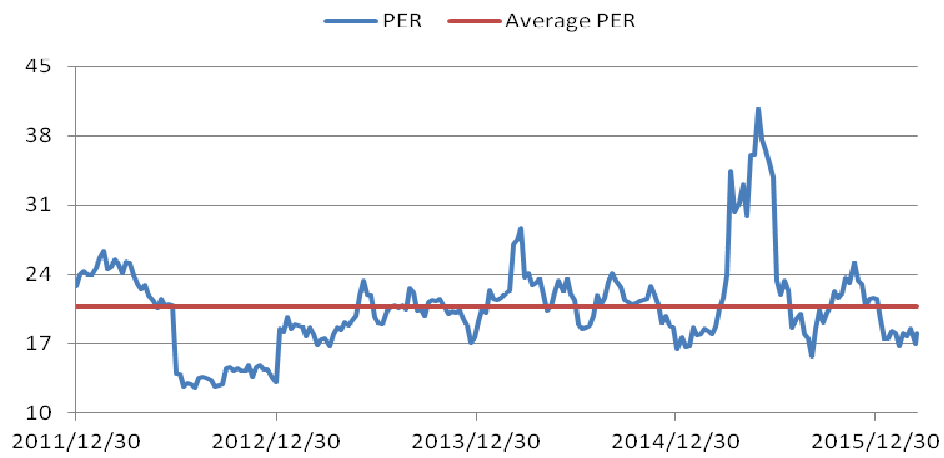
Overall, the platform adopts cloud + crowd-sourcing model to achieve interconnection between related industries and to help integrate resources and boost efficiency. In the future, the Company's revenues resulting from the platform will constantly increase with the gradual improvement in functions and efficient marketing of the platform in the future. Further, the platform's business is characterized by high gross profit margin, which is hoped to enhance the Company's earning capabilities.

### Institutional Investors Provides High Stock Margin of Safety

The fact that the Company has won more market shares of large customers reflects that its competitive edge in the domestic IT services is constantly improved, so we believe the Company will continuously benefit from the informatization of China, localization of IT, expanded off-shore IT outsourcing market, cloud computing in Mainland and other emerging businesses. Additionally, the improvement in the bargaining power and the efficiency of the platform will also enhance the Company's profitability, so its rapid performance growth is expectable.

Moreover, the Company is constantly recognized by large institutional investors. In the first half of 2015, majority stake was undertaken at HK\$3.68 to 3.93. In the second half of 2015, Huawei held strategic equity in the Company at HK\$2.8. Recently, the Company successfully issued convertible notes worth US\$70 million and due in 2019 to investors including Huarong International and Energetic Unity. The convertible new shares accounted for 7.8% of the enlarged share capital. The raised funds will improve the financial status, and what is more, the conversion price of HK\$3 further demonstrates the market recognition of the Company. We grant the Company a valuation corresponding to 22x EPS in e2015, with a target price of HKD3.65, and a rating of "Buy". (Closing price as at 15 Mar 2016)

### Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

### Risks

- Intensified market competition drags down profitability;
- Labor cost increases too quickly;
- Operation risk of Joint Force platform and cloud computing.

## Financials

FYE	2012	2013	2014	2015F	2016F
<b>Valuation Ratios</b>					
Price Earnings	27.6x	26.3x	20.6x	15.9x	12.8x
Price to Book	2.0x	1.8x	1.7x	1.4x	1.3x
<b>Per share data(RMB)</b>					
EPS Adjusted	0.08	0.08	0.11	0.14	0.17
Book Value Per Share	1.12	1.23	1.33	1.62	1.70
<b>Growth &amp; Margin</b>					
Revenue growth	-	15.8%	38.2%	20.9%	22.4%
Gross Profit growth	-	9.8%	34.2%	19.1%	25.3%
Net Profit growth	-	10.7%	34.9%	38.1%	31.6%
<b>Profitability Ratios</b>					
Gross Margin	33.1%	31.4%	30.5%	30.0%	30.7%
Net Profit Margin	4.8%	4.6%	4.5%	5.2%	5.5%
<b>Key Ratios</b>					
Return on Assets	4.2%	3.7%	4.0%	4.8%	5.6%
Return on Equity	7.3%	7.1%	8.4%	9.3%	10.7%
Effective Tax Rate	20.0%	2.4%	14.2%	15.0%	15.0%
Liability ratio	40.1%	47.8%	49.5%	47.5%	47.5%
<b>Income Statement(RMB: mn)</b>					
<b>Revenue</b>	<b>2,768</b>	<b>3,206</b>	<b>4,429</b>	<b>5,354</b>	<b>6,554</b>
- Cost of Goods Sold	1,853	2,201	3,080	3,748	4,542
<b>Gross Income</b>	<b>915</b>	<b>1,005</b>	<b>1,349</b>	<b>1,606</b>	<b>2,012</b>
- Selling, General & Admin Expenses	734	813	1,058	1,205	1,521
<b>Operating Income</b>	<b>236</b>	<b>254</b>	<b>350</b>	<b>474</b>	<b>582</b>
- Interest Expense	31	47	84	70	95
<b>Pretax Income</b>	<b>188</b>	<b>205</b>	<b>297</b>	<b>396</b>	<b>487</b>
- Income Tax Expense	38	5	42	59	73
<b>Income Before XO Items</b>	<b>150</b>	<b>200</b>	<b>255</b>	<b>336</b>	<b>414</b>
- Minority Interests	17	52	55	60	50
<b>Net Profit</b>	<b>133</b>	<b>148</b>	<b>200</b>	<b>276</b>	<b>364</b>

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 15 Mar 2016)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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