

Chinasoft International (354.HK)

Expectable Sustainable Growth

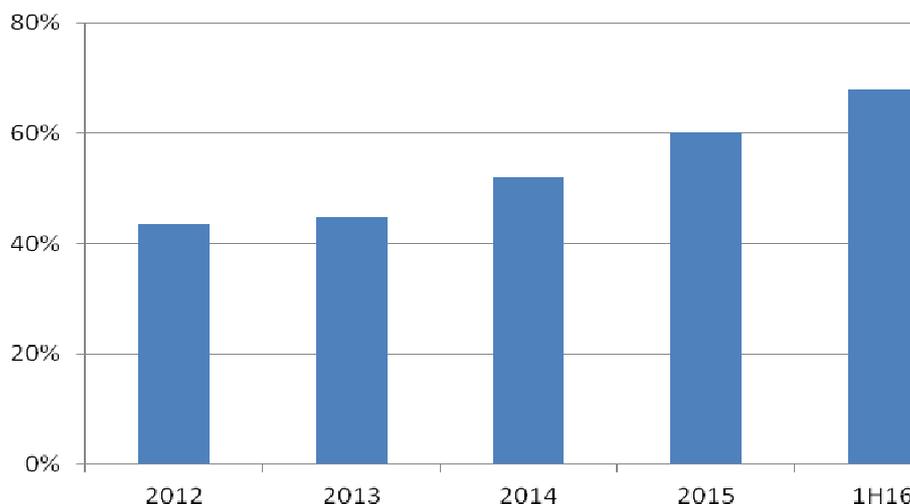
Hong Kong | TMT | Company report

25 October 2016

Amazing Performance in H1 2016

In H1, Chinasoft International Limited achieved a total revenue of RMB2.88 billion, increased by 20.8%. Revenue from TPG business increased by 30.5% y-o-y while that from IIG business dropped by 5.3% y-o-y, accounting for 79.3% and 20.7% of the total revenue, respectively. The net profit attributable to stockholders reached RMB240 million, soared by 69.1% y-o-y. Specifically, the growth in TPG business was mainly attributable to the increase from major customers. Service revenue from the top ten key accounts took up 68% of the total service revenue. After Huawei Technologies Co. Ltd., the company's largest key account, completed strategic investment of a 3.95% equity in early 2016, its revenue contribution has been rising and reached nearly 52% in H1.

Greatly increased contribution from top 10 customers



Source: Phillip Securities (HK) Research

In terms of profitability, TPG business, which had low gross profit margin, experienced an increase in business volume, dragging down the company's gross profit margin slightly by 0.6% to 27.8%. However, due to the scale effect, the company's marketing & administrative expense ratio drop by 1.4% to 17.4%. Additionally, other gains encouraged by subsidy income soared by 273% y-o-y to RMB48.11 million, contributing to a substantial growth in the company's net profit.

Major Customer Strategy Supports Continued Growth

The company's major customer strategy was further expanded. Currently, Huawei-related business remains the major driving force for growth. Furthermore, Huawei's increasing outsourcing demand brought about the company's rising bargaining power. The company became more capable of shouldering responsibility for overall customization and delivery in Huawei's tele-software, operations & maintenance of public cloud services, mobile payment, and other areas, highlighting its strong technical strength. More orders from Huawei are expected. Geographically, bilateral businesses between Huawei and the company covered around 30 countries. Huawei's global promotion of cloud computing and big data solutions will take the company's business to the global level.

Buy (Maintain)

CMP: HKD 3.72
(Closing price as at 20 Oct 2016)
TARGET: HKD 4.86 (+31%)

COMPANY DATA

O/S SHARES (MN) :	2,212
MARKET CAP (HKDMN) :	8,228
52 - WK HI/LO (HKD):	3.97/ 2.45

SHARE HOLDING PATTERN, %

Chen Yuhong :	12.24
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PRICE PERFORMANCE, %

	1M	3M	1Y
CSI	0.56	20.33	7.44
HSI	1.52	13.83	6.07

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

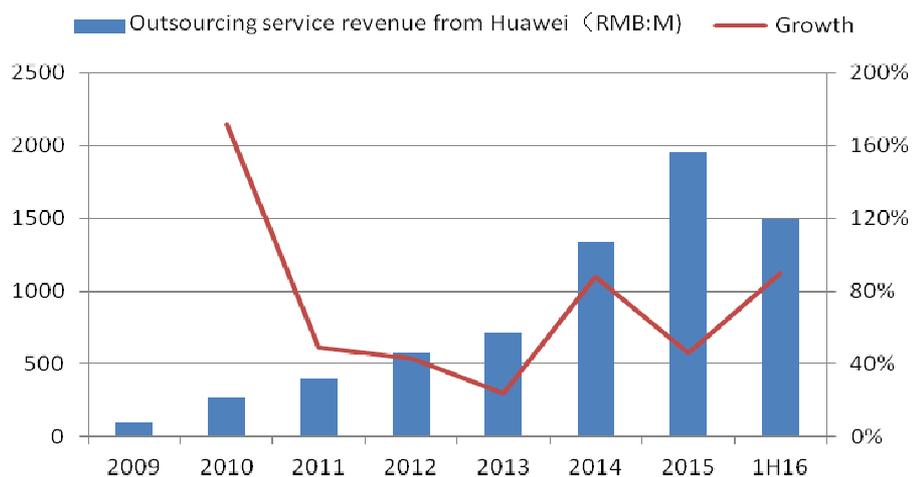
CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	4429	5129	6182	7578
Net Profit	200	280	415	520
EPS, CNY	0.11	0.14	0.19	0.24
PER, x	30.2	23.1	17.2	13.7
BVPS, CNY	1.33	1.57	1.76	2.00
P/BV, x	2.4	2.1	1.8	1.6
ROE, %	8.4	9.1	11.2	12.5
Debt/Equity (%)	97.87	82.10	81.82	81.82

Source: Company reports, Phillip Securities Est.

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In addition, the company's cooperation with other blue-chip clients, including HSBC, Tencent and Alibaba, will be gradually deepened. In early 2016, the company became HSBC's sole strategic partner in China. In addition, the company formed strategic ally with Tencent's QCloud to exclusively undertake customer services of IEG Joy Club. As for Ali Group, the company won the bid for AutoNavi, Youku Tudou Inc., UC, Hundsun Technologies Inc., and others. We believe that the revenue contribution from blue-chip clients will gradually grow. TPG business is expected to maintain a growth of more than 20%.

Rapidly grown revenue of from Huawei (RMB:bn)

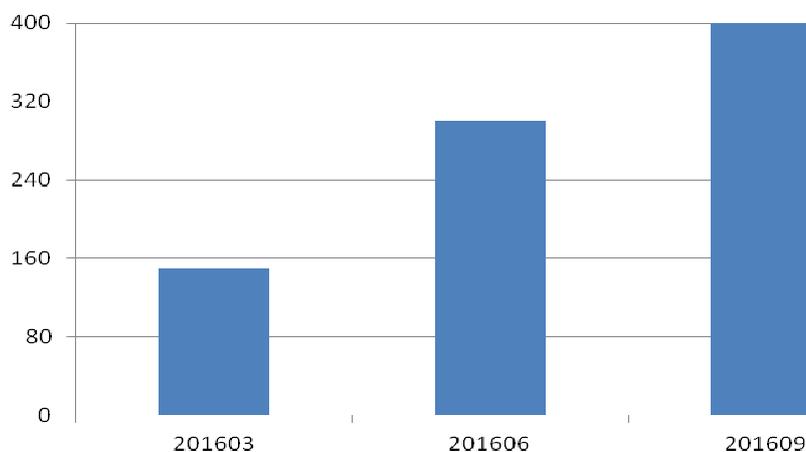


Source: Phillip Securities (HK) Research

JointForce Platform Rapidly Expands

Revolving around JointForce, the company has built an initial service ecosystem of IT Crowdsourcing Services + Cloud Services + SAAS Services + Business Services. By the end of September, there were 12,000 outsourcing enterprises, 2,500 IT vendors, 900 development teams and over 120,000 vendor engineers registering on JointForce platform. From January to September, demand released was worth up to RMB400 million.

Total turnover from JointForce platform (RMB: mn)

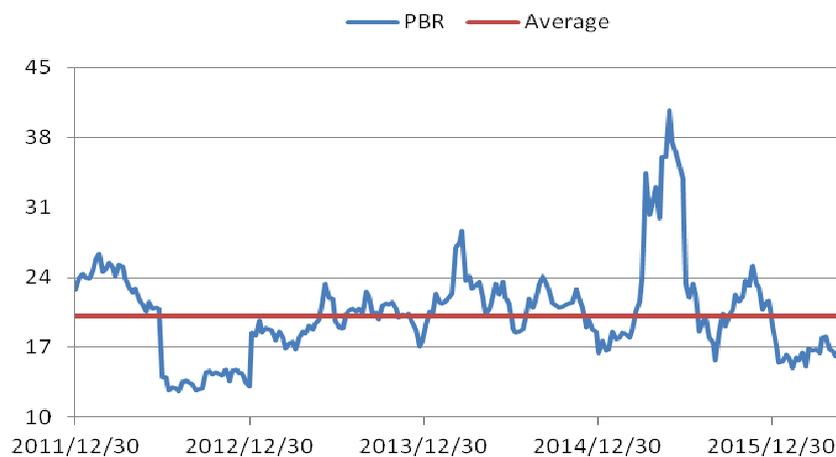


Source: Company reports, Phillip Securities (HK) Research

Although the revenue contribution from JointForce is relatively low for now, the company may attract more enterprise grade developers to station in the future as platforms such as online education, online recruitment, and online advertising expand and supply-chain finance and venture incubate, helping increase its

contribution. Further, the platform business is characterized by high gross profit margin, which is expected to increase the company's profit margin. Generally speaking, the company will continuously benefit from the considerable growth of 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 result growth is still anticipated. We give the company an estimation of 22.5x EPS in 2016 and the target price is HK\$4.86, with the "Buy" rating maintained. (Closing price as at 20 Oct 2016)

Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

Risks

- Intense competition that may result in decline in profitability;
- Excessive rise in labor costs;
- Operation risk of Joint Force platform and cloud computing.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	38.4x	30.2x	23.1x	17.2x	13.7x
Price to Book	2.6x	2.4x	2.1x	1.8x	1.6x
Per share data(RMB)					
EPS Adjusted	0.08	0.11	0.14	0.19	0.24
Book Value Per Share	1.23	1.33	1.57	1.76	2.00
Growth & Margin					
Revenue growth	15.8%	38.2%	15.8%	20.5%	22.6%
Gross Profit growth	9.8%	34.2%	12.9%	18.5%	23.0%
Net Profit growth	10.7%	34.9%	40.0%	48.4%	25.2%
Profitability Ratios					
Gross Margin	31.4%	30.5%	29.7%	29.2%	29.3%
Net Profit Margin	4.6%	4.5%	5.5%	6.7%	6.9%
Key Ratios					
Return on Assets	3.7%	4.0%	4.8%	6.2%	6.9%
Return on Equity	7.1%	8.4%	9.1%	11.2%	12.5%
Effective Tax Rate	2.4%	14.2%	20.7%	15.0%	15.0%
Liability ratio	47.8%	49.5%	45.1%	45.0%	45.0%
Income Statement(RMB: mn)					
Revenue	3,206	4,429	5,129	6,182	7,578
- Cost of Goods Sold	2,201	3,080	3,606	4,377	5,357
Gross Income	1,005	1,349	1,523	1,805	2,220
- Selling, General & Admin Expenses	813	1,058	1,161	1,267	1,546
Operating Income	254	350	409	599	748
Pretax Income	205	297	420	582	728
- Income Tax Expense	5	42	87	87	109
Income Before XO Items	200	255	333	495	619
- Minority Interests	52	55	53	79	99
Net Profit	148	200	280	415	520

Source: Company, Phillip Securities (HK) Research Estimates
 (Financial figures as at 20 Oct 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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