



Sep 1, 2014
Company Report
Rating: BUY
TP: HK\$ 3.27

H-Share price (HK\$)	2.82
Est. share price return	15.96%
Est. dividend yield	0.00%
Est. total return	15.96%

Previous Rating & TP	NA
Previous Report Date	NA

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Key Data

52Wk H/L(HK\$)	3.22/1.8
Issued shares (mn)	1,873
Market cap (HK\$ mn)	5,282
3-mth avg daily turnover (HK\$ mn)	13
Major shareholder(s) (%):	
Hony Capital Fund 2008 GP Ltd.	17.92
Chen Yuhong	15.18

Source(s): Company, Bloomberg, ABCI Securities

FY13 Revenue breakdown (%)

Software & hardware products	4.31
Professional services	48.56
Outsourcing services	44.20
Training	2.94
Sum	100.00

Source(s): Company, ABCI Securities

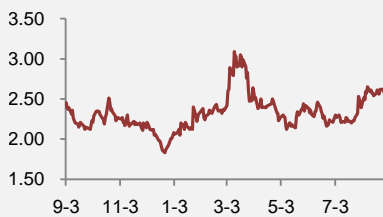
Share performance (%)

	Absolute	Relative*
1-mth	16.05	16.11
3-mth	16.53	9.34
6-mth	16.53	6.57

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

ChinaSoft Int'l (354 HK)

An ambitious IT service provider with high potentials; initiate BUY

- ChinaSoft is a China-based leading IT solution provider with strong expertise and quality client bases across banking, e-commerce and telecom industries. It will benefit from the booming internet finance and e-commerce in China
- As a cloud service provider and the only specialist with all-around solution capabilities in Ali-Cloud ecosystem, the Group is expected to benefit from China's expanding cloud market. Its strong 1H14 results imply high growth potentials.
- JointForce, its cloud-based crowdsourcing platform, aims to increase utilization rate while creating a virtual society for potential engineers, will help enlarge revenue and improve margins
- Initiate **BUY** with TP at HK\$ 3.27 based on 25x FY14E P/E

China's leading IT service provider with a quality client base and strong client relationships.

ChinaSoft International (CSI) is a leading global IT service provider based in China focusing on next-generation technologies in social, mobile, advanced analytics and cloud. It serves thousands of customers in major industries including public audit, social security, agriculture, banking, supply chain, drug administration, telecom and transportation services, where it enjoys a strong reputation and client relationships.

Strong 1H14 results indicated high growing potential. CSI's professional /outsourcing/emerging services sales grew by 24.3%/45.4%/335.2% YoY, boosting net profit up by 40% YoY to RMB 101.265mn. The burst of emerging services implicate early success of its SMAC (Social/Mobile/Analysis/Cloud) transition.

Expand new business in cloud and internet finance. The Group gains rapid progresses in cloud and internet finance. We expect these new businesses to be major revenue and performance drivers.

Near-future positive catalysts include: 1) China's mobile internet is expanding rapidly, reshaping existing business models and the industry value chain. CSI is well positioned to gain on these changes by providing valuable services; 2) As the sole all-around service provider under the Ali-Cloud ecosystem, CSI will benefit from growing demand in cloud services; 3) CSI's JointForce, a cloud-based crowdsourcing platform, is expected to increase its utilization rate and income sources while reducing its costs.

Initiate BUY with TP at HK\$ 3.27: Our 12-month TP is based on a PEG ratio of 1.0x and reflects a valuation of 25x FY14E P/E and 1.70x FY14E P/B. Our TP takes into account an EPS growth of 37.35% CAGR in 2014E-16E.

Risk factors: 1) Lower-than-expected development in cloud service and big data businesses; 2) Disappointing monetization from JointForce; 3) Intensifying competition with domestic peers; (4) Post-merger risks with Catapult; (5) No dividend record in 2012 and 2013.

Results and Valuation

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Turnover (RMB '000)	2,768,171	3,205,985	4,262,425	5,789,621	7,759,819
Chg (%.yoy)	23.37	15.82	32.95	35.83	34.03
Net Income (RMB '000)	133,189	148,301	183,393	245,663	358,123
Chg (%.YoY)	20.43	11.35	23.66	33.95	45.78
EPS (RMB)	0.077	0.082	0.102	0.137	0.199
Chg (%.YoY)	2.38	6.46	23.71	33.95	45.78
BVPS (RMB)	1.12	1.26	1.51	1.67	1.89
Chg (%.yoy)	(5.05)	12.59	20.09	10.40	13.17
DPS,RMB	-	-	-	-	-
P/E (x)	-	27.10	21.91	16.35	11.22
P/B (x)	-	1.77	1.47	1.34	1.18
Yield (%)	-	-	-	-	-
ROE (%)	7.29	7.07	7.35	8.57	11.17
ROA (%)	3.87	3.17	3.32	3.91	4.94

Source(s): Bloomberg, ABCI Securities estimates



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Investment highlights

1. Strong R&D capabilities with stable, high-quality customer bases

With 23,607 employees, ChinaSoft Intl (CSI) has the capability to provide comprehensive software and information services for multi-sector clients, including top level state-owned enterprises in the industries. Long-term servicing experiences with these clients have laid solid foundation for its operational cash flow.

Its product, ResourceOne (RI), the middleware platform software that provides application support for industry solutions, was recognized as the top brand among e-government application support platform products in China.

2. Enjoy advantages in vertical sectors with high entry barriers

The Group gained exclusive advantages in China's fiscal audit, social security, and agriculture industries; it was ranked top by market share in Banking IC card, union pay and supply chain markets, and gained leading position in drug administration, telecom, rail transport and airport fee payment services. Due to security reasons, these sectors have high entry barriers. The Group's experiences in these sectors actually enable the Group to raise performance standards, making it difficult for competitors to enter the market.

3. Leading cloud service providers in China; the sole all-around service provider under the Ali-Cloud ecosystem

With mobile internet booming in China, more companies have begun to initiate their own cloud services, creating huge demand in cloud migration and big data analysis.

The Group cooperates closely with Alibaba, the largest e-commerce platform in the world, and was the sole all-round solution provider under Alibaba's cloud platform and the first to provide cloud migration for thousands of clients of Alibaba. The Group is expected to expand its business to big data analysis with the strategic cooperation with Alibaba.

4. Benefit from China's mobile internet development

Mobile internet triggered huge demand for internet application innovations such as internet finance (e.g. mobile payment) and other mobile apps. Besides, with more Chinese cities beginning to implement the Smart City programs (China's national strategy of promoting urbanization by way of informatization, high-tech and environment-friendly measures), municipal system upgrades or cloud migration demand will benefit the Group - a top-level player who can provide IT services in internet finance, advanced data analysis and cloud computing.

5. High potentials from government supporting policies

After the Snowden incident, the Chinese government has actively encouraged domestic software providers to bid for public and governmental projects, and enhanced property protection in the software sector to ensure a healthy environment for software developers. All these measures will benefit the powerful domestic players within the whole sector.



Negative factors

1. China's labor cost, especially programmers' wages and cost control implementation, are keys to earnings upgrade.
2. Smooth implementation of cloud services and JointForce will be important to the Group's future earnings growth. However, both are still at their initial stages of development and this entails great uncertainties.

Business Analysis

CSI is a leading IT service provider in Mainland China with multi-sector, cross-market and diversified experiences in IT services. The Group has profound accumulation and stable client bases in IT services industry, as well as the potential to actively expand business in new areas in the era of mobile internet. CSI's adopted SMAC (Social/Mobil/Analysis/Cloud) transition strategy years ago. Its 1H14 results implicated an early success of the strategy, with its professional/outsourcing/emerging services revenue growing by 24.3%/45.4%/335.2% (YoY); net profit rose 40%YoY to RMB101.265mn. The burst of emerging services (cloud services and mobile internet business) implied a high growth potential that will be brought about by its SMAC transition strategy.

1. Competitive IT service provider with multi-sector experiences

The Group has vast experiences with the government, manufacturing, financial institutions (banking and insurance), public services, telecommunications, high-tech and other industries. It can provide common as well as tailored solutions to specific industries. Besides, it actively updates its services based on the development of Internet technology.

The Group has gained exclusive advantages in China's fiscal audit, social security, and agriculture industries; it was ranked top in IC bank card, UnionPay and supply chain markets, and possesses a leading position in drug administration, telecom, rail transport and airport fee payment services. Due to security reasons, these sectors usually have high entry barriers. This enables the Group to set up high performance standards in which competitors find them hard to comply with.

Exhibit 1: CSI's development history

Year	2003	2005	2007-2008	2009-2010	2011	2012	2013	2014
Company Size	238	1055	4363	10940	14496	18946	23607	
Verticals Covered								Internet
						Electricity	Electricity	Electricity
					Insurance, Securities	Insurance, Securities	Insurance, Securities	Insurance, Securities
				Telecom	Telecom	Telecom	Telecom	Telecom
			Finance, Bank	Finance, Bank	Finance, Bank	Finance, Bank	Finance, Bank	Finance, Bank
		Hi-Tech	Hi-Tech	Hi-Tech	Hi-Tech	Hi-Tech	Hi-Tech	Hi-Tech
	Government, Manufacturing	Government, Manufacturing	Government, Manufacturing	Government, Manufacturing	Government, Manufacturing	Government, Manufacturing	Government, Manufacturing	Government, Manufacturing
Service Capabilities							SMAC	SMAC
				IT Consulting	IT Consulting	IT Consulting	IT Consulting	IT Consulting
			BPO	BPO	BPO	BPO	BPO	BPO
		IT Training	IT Training	IT Training	IT Training	IT Training	IT Training	IT Training
		ITO	ITO	ITO	ITO	ITO	ITO	ITO
	IT Solution	IT Solution	IT Solution	IT Solution	IT Solution	IT Solution	IT Solution	IT Solution
Region				Central, South America	Central, South America	Central, South America	Central, South America	Central, South America
			Japan	Japan	Japan	Japan	Japan	Japan
		USA	USA	USA	USA	USA	USA	USA
	China	China	China	China	China	China	China	China

Source(s): Company, ABCI Securities

Exhibit 2: CSI IT service's sector exposure

Professional Services Business (PSG)	Government	<ul style="list-style-type: none"> • Audit Management • Social Insurance & Benefits • State Owned Asset Mgmt 	<ul style="list-style-type: none"> • Food & Drug Management • Administrative Management • Policy Planning System 	<ul style="list-style-type: none"> • Online Audit Application • Public Portal 	General Solutions	• CRM	
	Manufacturing, Distribution	<ul style="list-style-type: none"> • ERP • MES • LES 	<ul style="list-style-type: none"> • Safety Production Mgmt • WMS • EAI 	<ul style="list-style-type: none"> • Product Code Tracking 		• OA	
	BFSI (Banking, Financial Services & Insurance)	<ul style="list-style-type: none"> • Payment System • Receivable System • Credit System • Bank Card System 	<ul style="list-style-type: none"> • Credit Card System • Risk Management System • Digital Marketing • Supply Chain Leverage 	<ul style="list-style-type: none"> • Insurance System • Digital Insurance System • Insurance Dev. Support • Reimbursement System 		• BI	
	Public Services	<ul style="list-style-type: none"> • One Card Access • AFC 	<ul style="list-style-type: none"> • ACC • Smart Transportation 	<ul style="list-style-type: none"> • Airport Operating System 		• Portal Group	
	Telecom	<ul style="list-style-type: none"> • Mobile Payment • Mobile Instant Communication • Mobile Community 	<ul style="list-style-type: none"> • Corporate Weibo • Mobile Application Store • One-Click Dial 	<ul style="list-style-type: none"> • Embedded Browser • Mobile Advertisement Platform 		• RFID	
	Electricity	<ul style="list-style-type: none"> • Material Management Solution 	<ul style="list-style-type: none"> • Marketing Management Solutions 			• GIS	
Core Products	Middleware Platform ResourceOne is based on SOA and Cloud <ul style="list-style-type: none"> • Popular in Government and Manufacturing Verticals • Named the Best Government Platform by CCID 5 Years In a row 		TopLink/TSA+ Platform <ul style="list-style-type: none"> • Used in UnionPay, Government, and Provinces Centers • Support Cross Regional Bank Card Online Transaction 		• Electronic System	Ticketing	

Source(s): Company, ABCI Securities

Exhibit 3: CSI's edges in vertical sectors

Within Verticals	Advantages
Audit	<ol style="list-style-type: none"> 1. Consulting and integration. 2. The sole provider of application platforms and core software developers. 3. Designated service providers across the country.
Social Security	<ol style="list-style-type: none"> 1. Core systems developer. 2. Sole partner of fund management systems. 3. Social security core platform vendor.
Agriculture	<ol style="list-style-type: none"> 1. Consulting and integration. 2. Application platform sole supplier and major software developers. 3. National "three-in-one" project integrator.
Drug Administration	<ol style="list-style-type: none"> 1. Strategic partners. 2. "3511" project core application developer.
Finance, Banks	<ol style="list-style-type: none"> 1. Has a broad customer base, covering the four major state-owned banks, postal savings banks, a number of joint-stock commercial banks, city commercial banks and foreign financial institutions in China, and etc. 2. #1 market share for Banking IC card; top three for payments; #1 for supply chain financial market; top 2 in postal; #1 in UnionPay business.
Telecom	<ol style="list-style-type: none"> 1. China's 1st wireless Internet platform design, development and operational service providers; also China's largest professional mobile client application development and adaptation service providers. 2. Leader in the emerging telecommunications market segments payments and mobile payments. 3. Strategic partners with Huawei and China Mobile.
Rail Transport	<ol style="list-style-type: none"> 1. Top 4 in automatic ticket checking system. 2. Internet application, using one ticket to change to any nationwide ticket.
Airport	<ol style="list-style-type: none"> 1. Leader in airport and service systems.

Source(s): Company, ABCI Securities

2. Strong customer relationships and high expansion potentials

The Group has over 1,000 clients and has multi-dimensional relationships with world-class strategic partners, including Huawei, Microsoft, China Mobile, Alibaba and Hony Capital. Its major shareholder, Hony Capital, a prestigious Chinese PE company, has a strong investment experience in multiple industries, which helps further expand CSI's customer base and market share.

Exhibit 4: CSI's market position and client relationship

Client Cases/Sectors	Market Position / Role
<p>Government Auditing: Information System</p> 	<ul style="list-style-type: none"> • Sole strategic partner • Full solution provider, core application developers • 13 years of service experience
<p>Tobacco Industry</p> 	<ul style="list-style-type: none"> • Sole strategic partner • 11 years of working experience
<p>Banking Sector: UnionPay</p> <p>90 Countries and Regions</p> <p>World's Top 5 Credit Card Operators</p>  <p>121 member banks, 135 thousand businesses, 2.11 million POS terminals, 180,000 ATM machines</p>	<ul style="list-style-type: none"> • Sole local solution service provider • Total system integration and software development core applications • 11 years of working experience
<p>Telecommunication: Fetion of China Mobile (941. HK)</p> 	<ul style="list-style-type: none"> • Mobile Internet base core suppliers • Strategic partner with China Mobile's northern (including mobile payment) and southern Region • Comprehensive strategic partner of China Mobile Beijing and Shanghai Branch

Source(s): Company, ABCI Securities

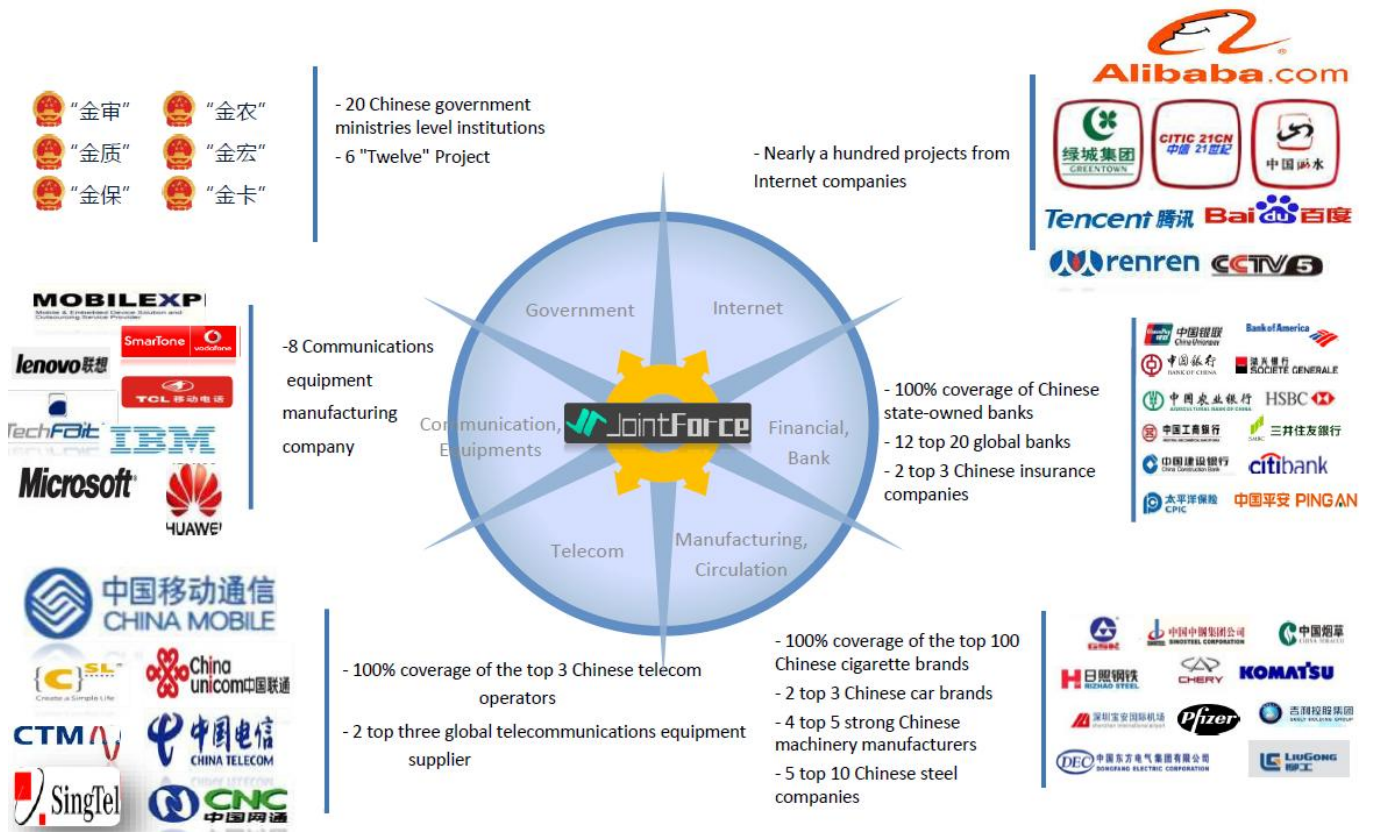


Exhibit 5: Overview of Hony Capital's investment projects (as of Aug 29, 2014)



Source(s): Company, ABCI Securities

Exhibit 6: Overview of CSI's client base



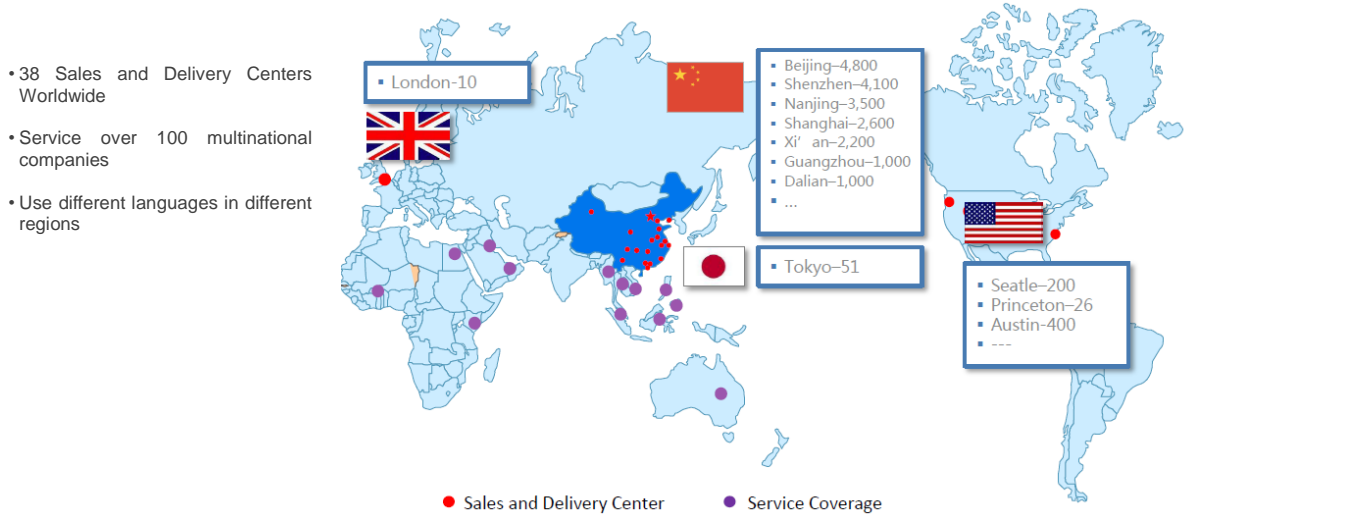
Source(s): Company, ABCI Securities

3. Strong global implementation capacity and business potential

ChinaSoft International has nearly 10 years of business experience in the global markets. It has established sales and delivery centers in 38 international cities and regions worldwide with a global delivery capability.

In Nov 2013, the Group acquired a premier provider of Microsoft integration services, Catapult, which positions itself at the forefront of the current "digitization" movement worldwide. The acquisition allowed CSI to leverage Catapult's capabilities in Social, Mobile, Analytical and Cloud (SMAC) and help the Group enlarge its global market, especially in markets with high GPM (gross profit margin) such as EU, U.S. and Japan.

Exhibit 7: CSI improves its global delivery ability in recent years



Source(s): Company, ABCI Securities

4. New business lines: Clouds/Internet finance and JointForce

1) Rapid progress in internet finance and cloud services

Triggered by the rapid expansion in the Chinese mobile internet and e-commerce, the Group made major progresses in the internet finance and cloud services businesses.

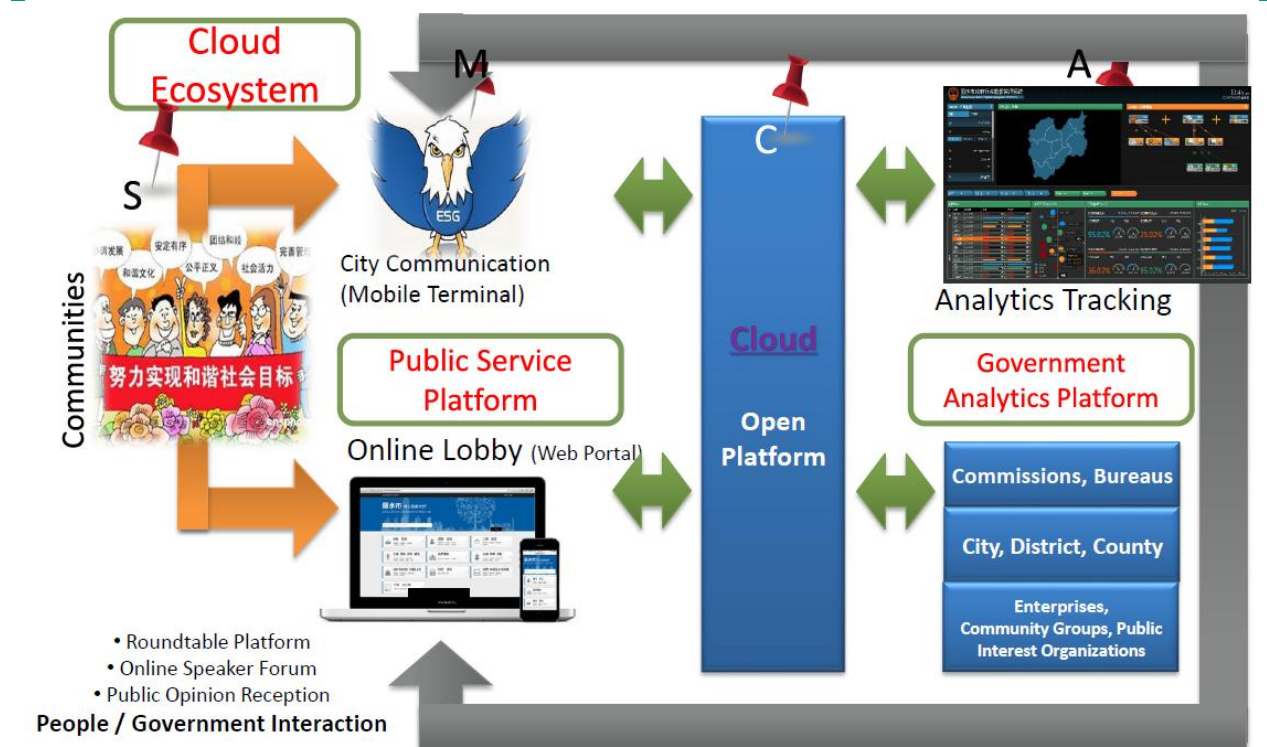
For cloud services, based on its strategic cooperation with Alibaba, the Group helps thousands of Alibaba's customers to migrate to Ali-Cloud. The Group has also established a government cloud for the Zhejiang Li Shui government.

All these projects (including the government ones) enabled the Group to build up a comprehensive docking capacity in Ali-Cloud platform. It is now the sole IT service provider who can provide all-around services in Ali-Cloud ecosystem.

For internet finance sector, the Group cooperated with CITIC 21CN, Alibaba's subsidy, to establish a platform to connect Ali-Pay with national pharmacy supply chain, and connect the supply chain with the national monitoring platform. This project will greatly expand the Group's operational capacity in internet finance, as the project is expected to cover more than 70,000 pharmacies in its initial trial.

Given the huge e-commerce business base and Alibaba's customer base, we believe that the Group's cooperation with Alibaba would help extend its customer base in the SME market. It would also propel development in its big data business and other IT innovations as the cooperation would generate a large amounts of useful data.

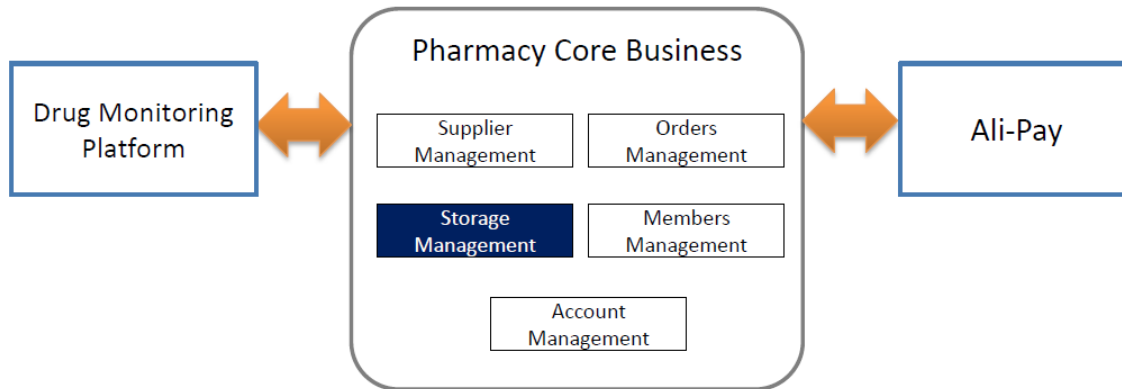
Exhibit 8: CSI's Cloud Service Case - Zhejiang Li Shui Government Cloud



Source(s): Company, ABCI Securities



Exhibit 9: CSI's Cloud Service Case –Citic 21CN Smart Pharma Cloud



Value for Pharmacies from Monitoring Platform:

- Compliance with national regulatory requirements GSP

CSI Profits from Monitoring Platform:

- The scanner t made for the drug monitoring, and maintenance fee for the application software

Value for Pharmacies from Ali-Pay:

- Expand mainstream Internet payment channels
- Members certification, customers analysis

CSI Profits from Ali-Pay:

- Transaction fee

Source(s): Company, ABCI Securities

Exhibit 10: CSI now enjoys complete cloud integration service capabilities

	<i>Design</i>	<i>Testing</i>	<i>Implementation</i>	<i>Operation</i>
SaaS	Project Implementation Plan	Finish testing for migration.	Gradually cover all government applications in different businesses of the bureau. All new application systems will be cloud based and according to standard plan.	Complete the transformation of government application cloud and utilize data centers to increase the quality of the services to citizens, government operations, and leadership decision-makings.
	Cloud Integration Design Plan			
	Standard Plan			
	Overall			
PaaS	Business Application	Build a cloud data sharing platform with cloud portal and cloud application building capabilities.	Build SOA platform to create a standardized cloud integration process based on services. Depending on scale, opening up PaaS platform to public.	Virtualization of intelligent scheduling engine, improving PaaS quick intelligence platform to scale.
	Business Support Platform			
	Infrastructure			
	Information Security			
IaaS	Operation and Maintenance Management	Build smart government, hardware, and security ecosystems.	Integrate more service resources to increase scale and build city wide data security and insurance system.	Smart government platform monitor and maintenance.
Consulting Design		Divide Project Construction Overall Integration		Joint Operations Operations and Maintenance
Consulting / Design <ul style="list-style-type: none"> • Provide cloud services, overall supervision and management of the whole process Cloud + Client Solutions <ul style="list-style-type: none"> • SMAC and client program overall planning 		Cloud Integration <ul style="list-style-type: none"> • Radar Cloud PAAS platform with its own intellectual property rights. • Cloud development, cloud running, cloud integrated environment, and connector to the ecosystem partners Cloud Application Delivery <ul style="list-style-type: none"> • Traditional solutions of SaaS, cloud application development Cloud Migration <ul style="list-style-type: none"> • Protection of information assets for both short- and long-term needs 		Joint Operations <ul style="list-style-type: none"> • Integrated service capabilities • Share Business Value Operations and Maintenance <ul style="list-style-type: none"> • Allows users to be worry-free.
The only all-around service providers under the Ali-Cloud ecosystem				

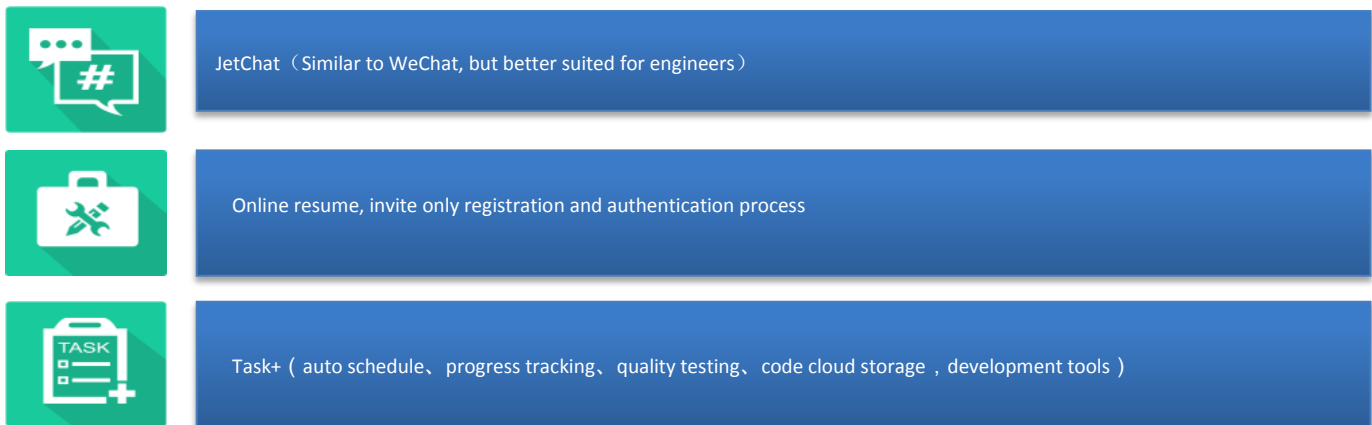
Source(s): Company, ABCI Securities

2) JointForce reduces costs and enlarges income source

CSI strategizes to move up the value chain and enhance its profitability. Accordingly, it will improve its revenues in experience-focused PSG (professional service group) and intelligence-focused ESG (emerging services group), while at the same time strengthen its efficiency-focused OSG (outsourcing service group).

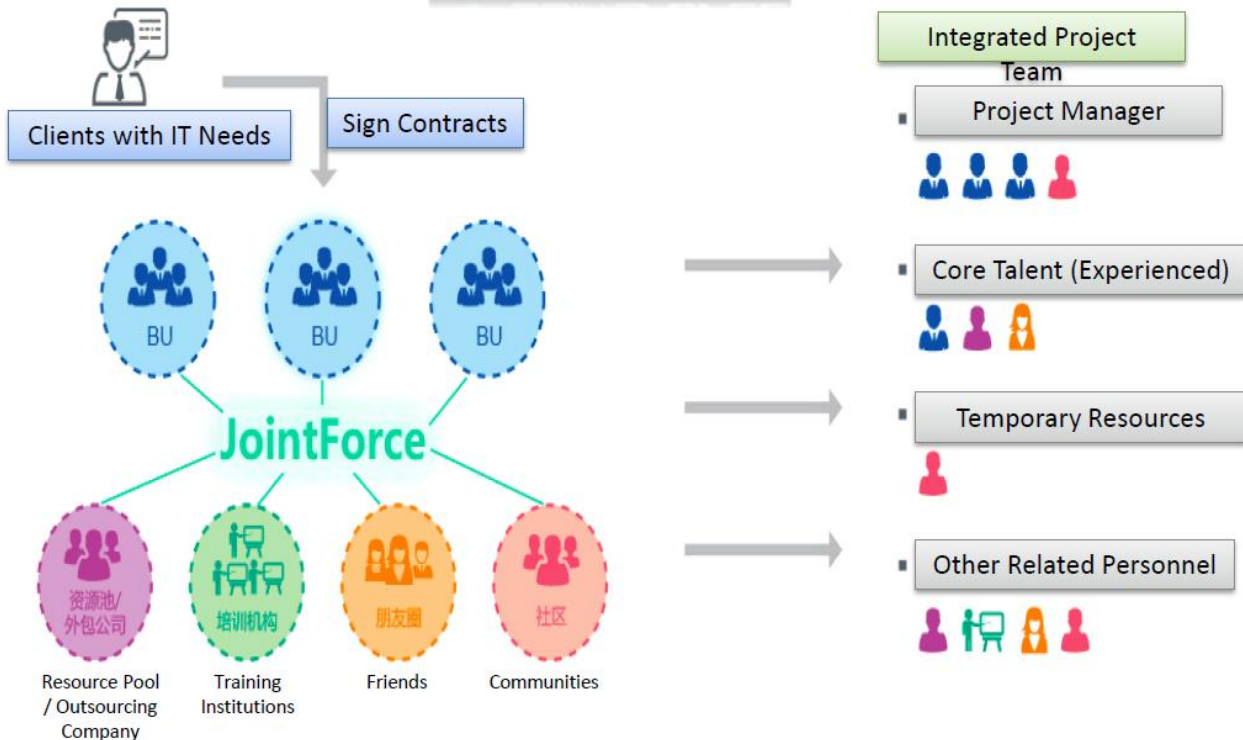
An important tool to achieve the above strategy is JointForce, a cloud-based crowdsourcing platform which connects CSI with outside IT service partners and enables CSI to distribute tasks more efficiently among broader engineers across different regions. This helps CSI to engage those potential clients who are geographically remote or hard to reach.

Exhibit 11: JointForce's main features



Source(s): Company, ABCI Securities

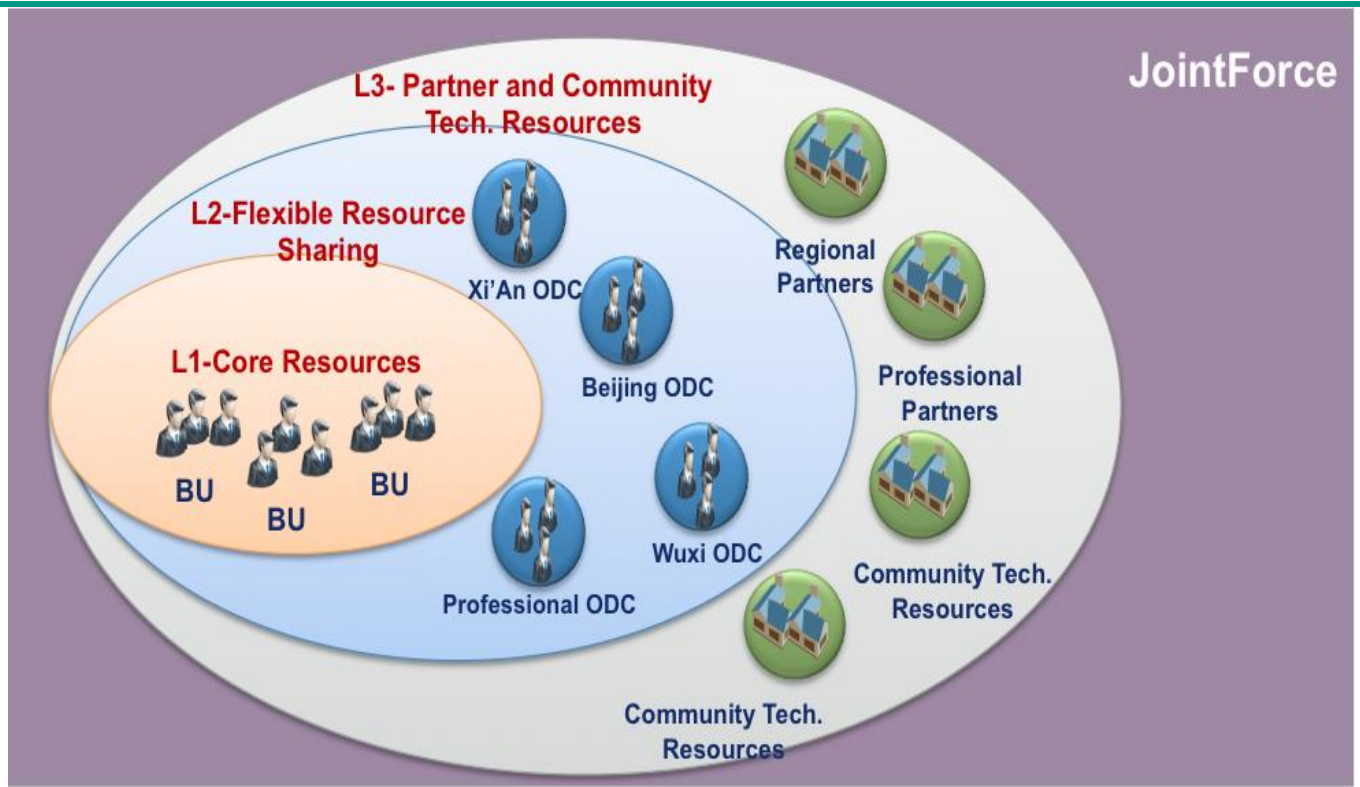
Exhibit 12: CSI plans to implement JointForce to improve working efficiency and reduce human costs



Source(s): Company, ABCI Securities



Exhibit 13: CSI's JointForce Platform



Source(s): Company, ABCI Securities

We predict that JointForce (expected to be publicly released in 4Q14) can benefit CSI by:

i. Increasing productivity

- Increase utilization rate and increase employee productivity through a flat organizational structure of its 23,000 employees
- Decrease hiring and control cost more effectively
- Find the best talent effectively

ii. Increasing revenue

- Services expand to smaller businesses (cheaper service for customers, and expand to long tail markets)
- Relies on regional partners through brands and resources to obtain orders, which are then subcontracted to regional partners. The Group receives revenue from the use of resources, quality control, and management.
- Allowing other companies to use the platform to divide the projects, find engineers, and use the platform to manage projects to ensure delivery.

iii. Providing other income sources (given a large enough scale)

- Tasks from smaller enterprises
- Advertisements
- Interests from unpaid online transactions



Peer comparison

Although there are many technology companies in the Hong Kong market, CSI is unique in its sector because it is the sole software provider of application platforms and core software developers with clients including industrial monopolists. This creates a high entry barrier for its competitors.

It has long-term software services experiences in large state-owned enterprises and government ministries, and has plenty of experiences in providing high-quality IT solutions and outsourcing services to international clients. Currently, it is the sole software provider with all-around services under the Ali-Cloud platform, which would add to its cloud services and big data analysis experiences.

Neusoft Group (600718.SH), a local player in the IT service sector with similar financial ratios as CSI in China, is the Group's main competitor. However, as of Aug 29, Neusoft's (A-share) historical/leading FY13/FY14E P/E recorded 41.4x / 38.2x, far greater than in CSI's 27.1x / 20.6x in Hong Kong market.

Exhibit 14: Comparison of different internet/ online social media companies (as of Aug 29, 2014)

Ticker	Company	Price	Mkt Cap	P/E FY13(x)	P/E FY14E(x)	P/E FY15E(x)	EPS FY13 (RMB)	EPS FY14E (RMB)	EPS FY15E (RMB)
0354HK Equity	CSI-ABCI Est.	2.82	53	27.1	21.9	16.4	0.082	0.102	0.137
0354.HK	CSI	2.82	53	27.1	22.4	17.6	0.082	0.100	0.127
3888.HK	Kingsoft	22.20	263	31.9	27.9	20.1	0.552	0.630	0.875
1297.HK	Sinosoft Tech	2.56	26	17.8	16.7	13.1	0.114	0.122	0.155
1900.HK	China Its	1.28	21	11.3	10.6	15.0	0.090	0.096	0.068
1588.HK	CHANJET	16.00	9	17.0	-	-	0.747	0.000	0.000
0268.HK	KINGDEE INT'L	2.50	64	41.1	25.0	17.9	0.048	0.079	0.111
600536.SH	China National	27.35	135	97.7	165.8	107.3	0.2800	0.165	0.255
600588.SH	Yonyou Software	16.07	187	28.2	29.6	23.1	0.5700	0.544	0.695
600718.SH	Neusoft Corp	13.65	168	41.4	38.2	32.7	0.330	0.358	0.417
600797.SH	Insigma Tech	7.61	63	190.3	-	-	0.040	-	-
600570.SH	Hundsun Techn	31.49	195	60.6	50.7	39.7	0.520	0.621	0.793

Source(s): Bloomberg, WIND, ABCI Securities estimates

Valuation and Recommendation

Our projections of CSI's financial performance are based on:

- Strong R&D capacity and quality client bases
- The Group's leading position in developing governmental cloud services (with strategic cooperation with Alibaba), its own virtual community for engineers (based on its JointForce platform), internet finance services (i.e. CITIC 21CN's Smart Pharm Cloud), and high potentials in global IT service market (its subsidy Catapult Systems is Microsoft's premier partner).

While forecasting revenue and earnings for high-growth companies in evolving markets is fraught with risks, and all valuation methodologies are subject to the industry development and general equity market conditions, we believe P/E ratio (price/earnings) or PEG ratio provides reasonable gauges regarding the Group's value. As an IT service company, most of the Group's stock value is driven by its I/S financial sheet items, rather than the B/S sheet items.

In addition, in light of its leading position in China's high-growth IT service market, as well as the present market sentiments, we believe a 12-month P/E of 25x or PEG of 1.0x are reasonable values for the Group, while a 20~23x P/E or <1.0x PEG should be a conservative valuation to verify the BUY action.

We predicted that the Group's EPS will grow at a CAGR of 37.35% in 2014E-16E. However, its net profit growth would be lower at ~23.66% YoY in 2014E as the mobile internet market and cloud service are still at their initial stages of development and more spending is required to promote these services.

Considering CSI's high growth in revenue and net profit, we estimate its FY14E EPS growth to be 23.66% YoY, and a 1.0x PEG would suggest a FY14E P/E of 25x. Based on our FY14E P/E, we set the 12-month TP at HK\$ 3.27, which is 15.96% higher than the current price of HK\$ 2.82. CSI's strong fundamentals within a promising sector in China and robust growth potentials in business expansion prompt us to initiate coverage on the Group with a **BUY** rating.



Financial projections

Turnover and costs have remained to be major investors' concerns in China's IT sector since labour costs have been increasing over the past years. In our view, to promote their new services to existing clients or enlarge its shares in China's outsourcing markets, CSI has to provide favourable packages; besides, it will need to promote its JointForce platform in near term, and this may reduce its GPM by 1~2 ppts in the coming years. However, its GPM will remain stable when its new business in cloud and big data analysis mature.

Thanks to its promotional efforts and growing client demand, its revenue will enhance significantly. To maintain its edges in the industry, however, the Group will have to increase its R&D expenses. All these factors constitute the basic assumptions of our financial projections.

Exhibit 15: Key assumptions for revenue prediction and earnings outlook

Key Assumptions	2013A	2014E	2015E	2016E
Growth of sale of software and hardware products	-36%	10%	10%	10%
Growth of professional services	26%	35%	40%	40%
Growth of outsourcing services	16%	35%	35%	30%
Growth of training	1%	2%	2%	2%
Growth of turnover	15.8%	33.0%	35.8%	34.0%
GMP,%	31.35	31.50	28.50	27.30
Selling and distribution costs/Revenue	5.47%	5.75%	5.72%	5.85%
Administrative expenses growth	12.64%	13.00%	15.50%	15.50%
R&D costs expensed/Revenue	1.63%	1.84%	1.74%	1.79%
Effective Tax Rate, %	2	16	15	15

Source(s): Company, ABCI Securities estimates

Consolidated income statement (2012A-2016E)

FY Ended Dec 31 (RMB '000)	2012A	2013A	2014E	2015E	2016E
Sale of software and hardware products	216,776	138,058	151,864	167,050	183,755
Professional services	1,236,006	1,556,669	2,101,503	2,942,104	4,118,946
Outsourcing services	1,221,800	1,416,895	1,912,808	2,582,291	3,356,978
Training	93,589	94,363	96,250	98,175	100,139
Revenues	2,768,171	3,205,985	4,262,425	5,789,621	7,759,819
Cost of revenues	(1,852,830)	(2,200,799)	(2,919,761)	(4,139,579)	(5,641,388)
Gross profit	915,341	1,005,186	1,342,664	1,650,042	2,118,430
SG&A	(615,453)	(687,592)	(834,157)	(1,011,663)	(1,239,846)
Other income and gains	112,172	112,676	214,031	248,556	310,308
Pre-tax profit	187,716	204,918	294,476	389,823	568,276
Income tax	(37,574)	(4,890)	(47,116)	(58,473)	(85,241)
Net profit	150,142	200,028	247,360	331,349	483,035
Profit attributable to:					
Minority interests	16,953	51,727	63,967	85,687	124,912
Equity holders of the Company	133,189	148,301	183,393	245,663	358,123
EPS (Basic), RMB	0.080	0.084	0.104	0.139	0.202
EPS, Diluted, RMB	0.077	0.082	0.102	0.137	0.199
DPS, RMB	-	-	-	-	-

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2012A-2016E)

As of Dec 31 (RMB'000)	2012A	2013A	2014E	2015E	2016E
PP&E	132,853	174,186	210,000	192,093	201,047
Intangible assets	159,330	280,649	329,150	304,900	317,025
Interests in associates	27,616	13,519	16,454	11,989	11,377
Other non-current assets	707,067	1,029,358	1,021,396	504,465	750,223
Total non-current assets	1,026,866	1,497,712	1,577,000	1,013,447	1,279,671
Inventories	23,989	19,883	21,312	28,948	38,799
Accounts receivable	1,039,396	1,146,646	1,491,849	2,026,367	2,715,937
Prepayments, deposits and other assets	1,038	1,009	1,024	1,016	1,020
Cash and cash equivalents	774,847	940,823	1,011,062	1,286,993	648,471
Other current assets	576,214	1,066,884	1,417,035	1,918,800	2,570,070
Current Assets	2,415,484	3,175,245	3,942,282	5,262,124	5,974,297
Total assets	3,442,350	4,672,957	5,519,282	6,275,572	7,253,968
Amounts due to customers for contract work	110,506	217,410	289,845	393,155	527,306
Trade and other payables	668,918	741,528	852,485	1,248,517	1,612,674
Bills payable	7,071	3,387	2,131	2,895	3,880
Taxation payable	39,312	28,303	33,808	31,055	32,431
Borrowings	309,300	471,328	390,314	430,821	410,568
Other short-term liabilities	208,358	9,269	13,267	17,337	23,652
Total current liabilities	1,343,465	1,471,225	1,581,850	2,123,780	2,610,512
Deferred tax liabilities	17,602	17,589	17,596	17,592	17,594
Borrowings	19,000	518,268	763,550	640,909	702,230
Other Non-current liabilities	0	224,674	224,674	224,674	224,674
Total non-current liabilities	36,602	760,531	1,005,820	883,175	944,497
Total liabilities	1,380,067	2,231,756	2,587,669	3,006,956	3,555,009
Total equity	2,062,283	2,441,201	2,931,613	3,268,616	3,698,959
Non-controlling interests	134,659	172,978	207,727	261,489	295,917
Equity of the firm	1,927,624	2,268,223	2,723,885	3,007,127	3,403,043
BVPS, Diluted	1.12	1.26	1.51	1.67	1.89

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2012A-2016E)

FY ended Dec 31 (RMB'000)	2012A	2013A	2014E	2015E	2016E
Profit before taxation	187,716	204,918	294,476	389,823	568,276
Adjustments for:					
Depreciation of property, plant and equipment	46,577	52,562	64,440	76,052	91,320
Amortization of intangible assets and prepaid lease payments	42,967	49,803	46,385	48,094	47,240
Finance costs	31,111	47,296	47,296	47,296	47,296
Interest income	(3,326)	(1,958)	(2,642)	(2,300)	(2,471)
Loss on disposal of property, plant and equipment	137	1,114	626	870	748
Impairment loss recognized in respect of goodwill	28,054	0	14,027	7,014	10,520
Other adjusted items	19,764	30,629	43,047	55,779	77,836
Operating cash flows before movements in working capital	353,000	384,364	507,654	622,627	840,765
Working Capital Changes					
Increase in trade and other receivables	(294,161)	(78,908)	(172,601)	(267,259)	(344,785)
Increase in amounts due to customers for contract work	54,364	106,904	72,435	103,310	134,151
Increase in amounts due from customers for contract work	(197,676)	(490,881)	(345,731)	(503,975)	(650,165)
Increase in trade and other payables	55,769	36,886	110,957	396,032	364,157
Decrease in inventories	416	4,106	(1,429)	(7,636)	(9,851)
Decrease in bills payable	(14,454)	(3,684)	(1,256)	764	985
Cash used in operations	(42,742)	(41,213)	170,028	343,863	335,258
Other adjusted items	(35,624)	(19,825)	(27,725)	(23,775)	(25,750)
Net cash generated from operating activities	(78,366)	(61,038)	142,304	320,088	309,508
Investing activities					
Acquisition of a subsidiary	0	(226,887)	(113,444)	(170,165)	(141,804)
Purchases of property, plant and equipment	(50,145)	(80,663)	(65,404)	(73,034)	(69,219)
Development costs paid	(41,619)	(59,689)	(50,654)	(55,172)	(52,913)
Purchase of software	(3,351)	(17,356)	(10,354)	(13,855)	(12,104)
Proceeds from disposal of property, plant and equipment	1,950	2,466	2,208	2,337	2,273
Interest received	3,326	1,958	2,642	2,300	2,471
Other adjusted items	(39,483)	(82,557)	(39,509)	(61,033)	(50,271)
Net cash used in investing activities	(129,322)	(462,728)	(274,514)	(368,621)	(321,567)
Cash flows from financing activities					
New bank loans raised	284,300	1,059,558	585,779	740,761	351,624
Repayment of borrowings	(151,200)	(413,504)	(423,528)	(460,368)	(1,104,870)
Other adjusted items	77,054	(361,988)	44,397	50,084	131,889
Net cash flows (used in)/generated from financing activities	210,154	697,570	206,648	330,477	(621,357)
Net increase in cash and cash equivalents	2,466	173,804	74,438	281,944	(633,416)
Cash and cash equivalents at beginning of the year	772,950	774,847	940,823	1,011,062	1,286,993
Exchange losses on cash and cash equivalents	(569)	(7,828)	(4,199)	(6,013)	(5,106)
Cash and cash equivalents at end of the year	774,847	940,823	1,011,062	1,286,993	648,471

Source(s): Company, ABCI Securities estimates

Financial ratio table (2012A-2016E)

FY Ended Dec 31	2012A	2013A	2014E	2015E	2016E
Gross margin, %	33.07	31.35	31.50	28.50	27.30
Operating margin, %	6.78	6.39	6.91	6.73	7.32
Net margin, %	5.42	6.24	5.80	5.72	6.22
ROE, %	7.29	7.07	7.35	8.57	11.17
ROA, %	3.87	3.17	3.32	3.91	4.94
Total Liability/Total Equity,%	66.92	91.42	88.27	91.99	96.11

Source(s): Company, ABCI Securities estimates

Risk factors

The downside risks to our valuation include competition from industry peers, culture integration with foreign staffs, human resources-related costs and lower-than-expected growth in cloud and big data sectors.

1. Peer competition

Competition from industry peers, both internal and foreign ones, constitute a major business risk in the big data and cloud business. Cloud services and big data application are still at their preliminary stages in China, which have encouraged many IT-service providers, King soft and Neusoft to compete. Peer competition may reduce the gross profit margin of the counter, or even reduce its potential market shares in the cloud service and big data markets.

2. Post-merger culture integration may take longer than expected and increase costs

It may take more effort and time for the counter to achieve international post-merger cultural integration with its overseas teams. The counter acquired Catapult Systems, expanded Microsoft business, and planned to enter the European and American Markets. However, if it cannot make full use of its overseas human resources, its overseas market development will be hindered and administrative cost will go up.

3. Increasing human resources-related cost may pressure margins

It may take ChinaSoft longer to stabilize its overall GPM if human resources-related costs of IT services and outsourcing business continue to grow at rates faster than its core revenue.

4. Lower-than-expected growth in cloud service and big data sector

ChinaSoft generates 49% and 44% of its revenues from professional services and outsourcing services in 2013. Though we expect fast growth in China's cloud service market and big data sector, growth in these two sectors may be lower than expected and affect profitability.

5. Disappointing results from JointForce

Smooth implementation of cloud services and JointForce are important to the Group's future earnings growth. However, both are still at their initial stages of development. Though the Group wishes to increase productivity and revenue through JointForce, it may fail or take longer than expected to realize its goal.

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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