

**HONG KONG**

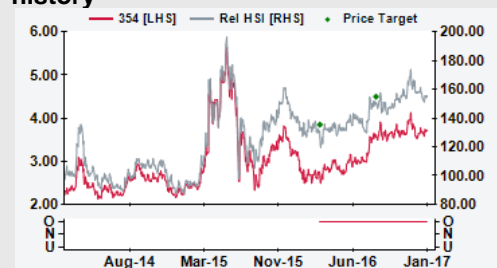
354 HK Outperform

Price (at 08:50, 26 Jan 2017 GMT) HK\$3.71

Valuation	HK\$	4.50
- PER		
12-month target	HK\$	4.50
Upside/Downside	%	+21.3
12-month TSR	%	+21.3
Volatility Index		High
GICS sector	Software & Services	
Market cap	HK\$m	8,869
Market cap	US\$m	1,143
Free float	%	85
30-day avg turnover	US\$m	3.8
Number shares on issue	m	2,391

Investment fundamentals

Year end 31 Dec	2015A	2016E	2017E	2018E
Revenue	m 5,129.1	6,021.5	7,478.8	9,071.6
EBIT	m 522.0	601.3	764.8	966.9
EBIT growth	% 30.4	15.2	27.2	26.4
Reported profit	m 280.1	412.6	493.4	627.8
Adjusted profit	m 280.1	412.6	493.4	627.8
EPS rep	Rmb 0.13	0.18	0.21	0.27
EPS rep growth	% 25.1	32.3	19.6	27.2
EPS adj	Rmb 0.13	0.18	0.21	0.27
EPS adj growth	% 25.1	32.3	19.6	27.2
PER rep	x 24.7	18.7	15.6	12.3
PER adj	x 24.7	18.7	15.6	12.3
Total DPS	Rmb 0.00	0.00	0.00	0.00
Total div yield	% 0.0	0.0	0.0	0.0
ROA	% 8.9	8.7	9.3	10.0
ROE	% 9.8	11.9	12.6	14.1
EV/EBITDA	x 11.4	10.7	8.3	6.6
Net debt/equity	% 9.7	16.0	18.8	15.5
P/BV	x 2.0	1.9	1.7	1.5

354 HK rel HSI performance, & rec history

Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, January 2017
(all figures in Rmb unless noted, TP in HKD)

Analyst(s)

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26 January 2017

Macquarie Capital Limited

Chinasoft International

Staffing up in Xi'an to Drive Sales

Conclusion

- We believe Chinasoft (CS) will utilise its employee base in Xi'an, which accounted for nearly a quarter of its total employees at end-2016, to support order growth from Huawei and multinational banks. Its lower cost base will allow CS to compete for solutions-based business, and raise its operating and ROE metric in FY17E.
- We reiterate our Outperform rating. We expect the company to see 24% YoY sales growth in FY17, with 20% EPS growth to Rmb0.21.

Impact

- Chinasoft has been expanding its employee base, reaching 40k employees (from 30k a year ago), with new staff mainly located at its Xi'an site and in Shenzhen. As the company expands in the western region, it will allow Chinasoft to compete for outsourcing projects that are more sensitive to headcount costs. Its customers will also be able to get better services as CS builds expertise along its key telco and financial customers.
- CS obtained 90% YoY growth with Huawei in 1H16; we expect full-year growth to be >50%, with a number of solution-based projects in its pipeline for FY17/18E.
- CS has also been generating traction with new financial customers, as it expands its servicing capability in Southeast Asia.

Earnings and target price revision

- We raise our FY17E and FY18E EPS by 2% to reflect stronger sales from Huawei, and customer base expansion; our TP remains HK\$4.50.

Price catalyst

- 12-month price target: HK\$4.50 based on a PER methodology.
- Catalyst: 1) Order gains from new customers; 2) rising revenue per employee metric, to offset the rise in labour costs; and 3) improved profitability from its JointForce platform.

Action and recommendation

- Chinasoft has been one of the top-10 buys (in terms of % holding) via the Shenzhen-Hong Kong Connect scheme, which started in December 2016. We expect further interest from mainland China investors, given its strong growth and its relationship with Huawei Technologies.
- We believe the company's business model is well fitted for the IT services upgrade expected by telecom and financial vendors. Upside catalysts are 1) clarity on its new customer growth; 2) improvement in its operating cash flows, or better working capital management; and, 3) new MNC customers accounting for a higher percentage of sales.

Analysis

Fig 1 Chinasoft – P&L (Rmb m)

Profit And Loss	2015	2016E	2017E	2018E
Sales Revenue	5,129	6,022	7,479	9,072
Gross Profit	1,523	1,706	2,116	2,483
COGS	3,606	4,316	5,363	6,588
EBITDA	666	758	974	1,221
Depreciation	51	60	75	91
Amortisation - Goodwill	0	0	0	0
Other Amortisation	93	96	135	163
Total EBIT	522	601	765	967
Net Interest Expense	93	90	90	102
Share of Associate P/L	0	0	0	0
Exceptions	0	0	0	0
Forex gains (loss)	0	0	0	0
Other pre-tax income	-10	33	-31	-45
Pre-Tax Profit	420	545	644	820
Tax Expense	87	82	97	123
Net Profit After Tax	333	463	548	697
Minority Interest	53	50	54	69

Source: Company data, Macquarie Research, January 2017

Fig 2 Chinasoft – P&L ratios

	2015A	2016E	2017E	2018E
Revenue Growth	16%	17%	24%	21%
EBITDA Growth	23%	14%	29%	25%
EBIT Growth	30%	15%	27%	26%
Gross Profit Margin	30%	28%	28%	27%
EBITDA Margin	13%	13%	13%	13%
EBIT Margin	10%	10%	10%	11%
Net Profit Margin	5%	7%	7%	7%

Source: Company data, Macquarie Research, January 2017

Fig 3 Chinasoft – Balance sheet (Rmb m)

Balance Sheet	2015	2016E	2017E	2018E
Cash	1,311	1,222	1,403	1,743
Receivables	1,429	1,759	2,227	2,752
Inventories	30	46	57	70
Investment	0	0	0	0
Fixed Assets	538	598	673	718
Goodwill	996	1,042	1,088	1,134
Other	2,045	2,888	3,466	3,968
Total Assets	6,348	7,555	8,913	10,385
Trade Payables	1,030	1,379	1,717	2,109
Short term Debt	1,387	1,755	2,138	2,423
Long Term Debt	263	98	113	128
Provisions	0	0	0	0
Other Liabilities	182	373	449	532
Total Liabilities	2,862	3,605	4,416	5,191
Shareholders Fund	3,247	3,660	4,153	4,781
Minority Interest	239	290	344	413
Other	0	0	0	0
Total S/H Equity	3,486	3,949	4,497	5,194
Total Liab & S/H Fund	6,348	7,555	8,913	10,385

Source: Company data, Macquarie Research, January 2017

Fig 4 Chinasoft – Working capital days

	2015A	2016E	2017E	2018E
Inventory days	3	4	4	4
A/R days	102	104	106	108
AP days	104	114	114	114
Total WC days	1	- 6	- 4	- 2

Source: Company data, Macquarie Research, January 2017

Fig 5 Chinasoft – Cash flow statement (Rmb m)

Cashflow Analysis	2015	2016E	2017E	2018E
EBITDA	666	758	974	1,221
Tax Paid	42	82	97	123
Change in Working Cap	332	535	681	735
Net Interest Paid	0	0	0	0
Others	-32	69	10	2
Operating Cash Flow	260	211	207	365
Acquisitions	0	0	0	0
Capex	338	211	241	227
Asset Sales	0	0	0	0
Others	13	-298	4	4
Investing Cash flow	-326	-509	-237	-223
Dividend (ordinary)	0	0	0	0
Equity Raised	0	0	0	0
Debt Movements	518	210	210	198
Others	0	0	0	0
Financing Cash flow	518	210	210	198
Net Chg in Cash/debt	454	-88	181	340
FCF	-79	0	-33	138

Source: Company data, Macquarie Research, January 2017

Fig 6 Chinasoft – FCF forecasts (2015–25E, Rmb m)

	2015	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Sales	5,129	6,022	7,479	9,072	10,467	12,028	13,698	15,605	17,783	20,246	23,059
... Growth	16%	17%	24%	21%	15%	15%	14%	14%	14%	14%	14%
Gross Profit	1,523	1,706	2,116	2,483	2,791	3,134	3,496	3,977	4,498	5,141	5,874
... GP Margin	30%	28%	28%	27%	27%	26%	26%	25%	25%	25%	25%
Opex	1,001	1,105	1,351	1,516	1,622	1,733	1,852	2,055	2,288	2,555	2,846
... Opex ratio	20%	18%	18%	17%	16%	14%	14%	13%	13%	13%	12%
EBIT	522	601	765	967	1,168	1,402	1,644	1,922	2,210	2,586	3,028
Add: Depreciation	51	60	75	91	105	120	137	156	178	202	231
Add: Amortization	93	96	135	163	188	217	247	281	320	364	415
EBITDA	666	758	974	1,221	1,461	1,738	2,027	2,359	2,708	3,153	3,674
... Margin	13%	13%	13%	13%	14%	14%	15%	15%	15%	16%	16%
Other income	29	112	132	152	167	182	197	213	231	250	270
Less: Tax	87	82	97	123	149	179	211	247	284	334	393
Less: Minority Interests	53	50	54	69	83	101	118	138	159	187	220
Less: Change Working Capital	332	535	681	735	601	674	719	842	953	1,094	1,250
Less: Capex & inv in intangibles	272	120	150	136	145	167	190	217	247	281	321
Less: Reconciliation	-29	-141	-106	-132	-149	-168	-185	-204	-221	-242	-265
... Capex:Depreciation	5.4x	2.0x	2.0x	1.5x	1.4x	1.4x	1.4x	1.4x	1.4x	1.4x	1.4x
Free Cash Flow	-79	0	-33	138	465	603	778	906	1,053	1,248	1,486
... FCF Growth	-75%	-99%	7312%	-515%	237%	30%	29%	16%	16%	18%	19%
PV of FCF	-85	0	-30	112	338	394	455	476	496	527	563

Source: Company data, Macquarie Research, January 2017

Fig 7 Chinasoft – WACC, terminal value and DCF assumptions

WACC		DCF Valuation	
Risk Free Rate	3.0%	Sum of PV of FCF (RMB m)	3,242
Market Risk Premium	7.0%	Terminal Growth	3%
Equity Beta	1.3	PV of Terminal Value	6,846
Cost of Equity	12.3%	Enterprise Value	10,088
Cost of Debt (Pre-tax)	8.0%	Less: Net Debt/(cash) (1H16)	1,062
Cost of Debt (After tax)	15.0%	Total Equity Value (RMB m)	9,026
Target Debt weight	6.8%	Terminal as % total	68%
Target Equity weight	15.0%		
Tax Rate	85.0%	Total Equity Value (US\$m)	1,357
WACC	11.5%	Equity value per share (HKD\$)	4.50

Source: Macquarie Research, January 2017

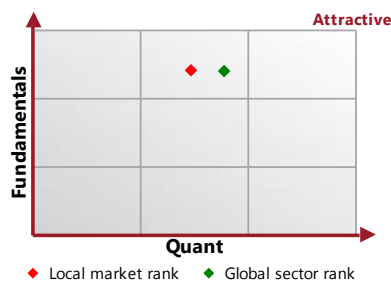
Macquarie Quant View

The quant model currently holds a neutral view on Chinasoft International. The strongest style exposure is Price Momentum, indicating this stock has had strong medium to long term returns which often persist into the future. The weakest style exposure is Valuations, indicating this stock is over-priced in the market relative to its peers.

322/786

Global rank in
Software & Services

% of BUY recommendations 100% (6/6)
Number of Price Target downgrades 0
Number of Price Target upgrades 1

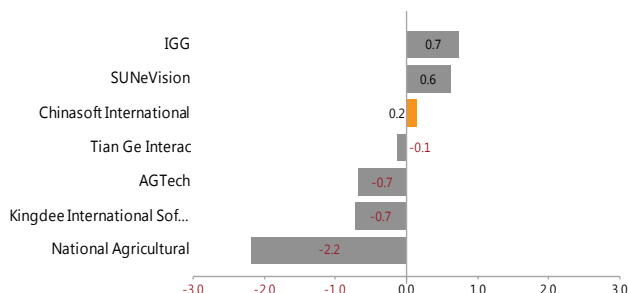


Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.

Two rankings: Local market (Hong Kong) and Global sector (Software & Services)

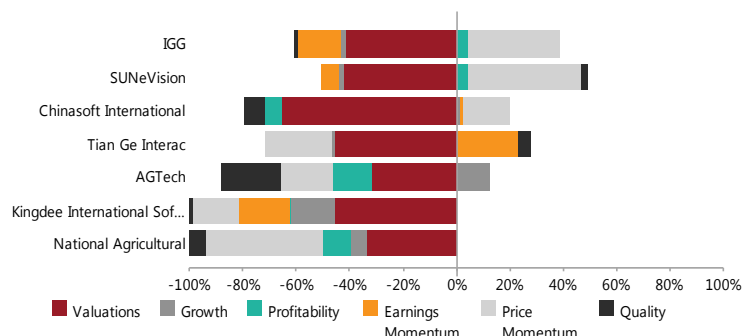
Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



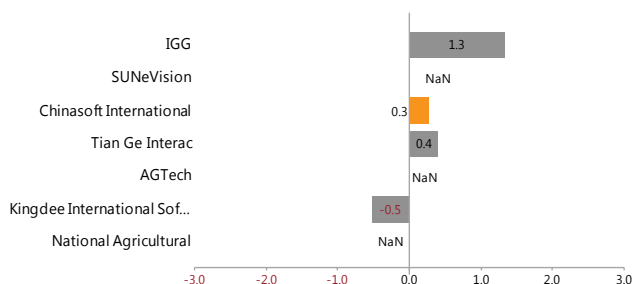
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



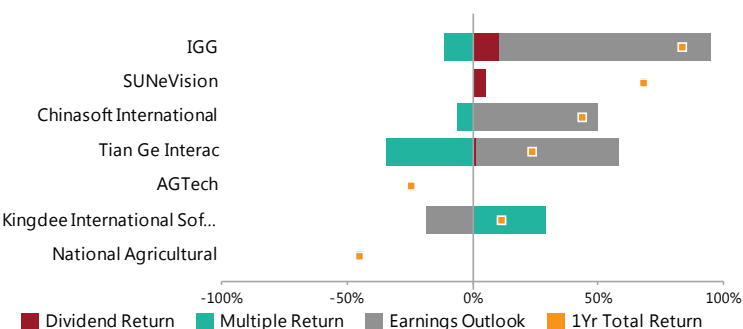
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



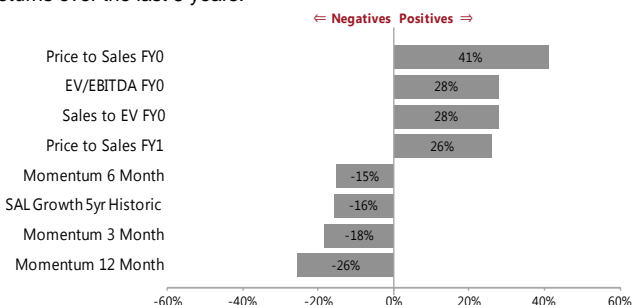
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



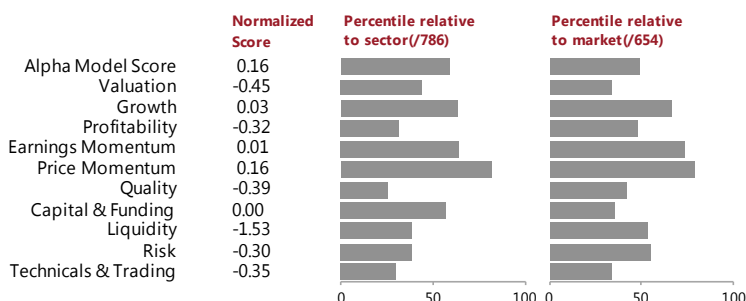
What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Research. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpq@macquarie.com)

Chinasoft International (354 HK, Outperform, Target Price: HK\$4.50)

Interim Results		1H/16A	2H/16E	1H/17E	2H/17E	Profit & Loss		2015A	2016E	2017E	2018E
Revenue	m	2,885	3,137	3,365	4,113	Revenue	m	5,129	6,022	7,479	9,072
Gross Profit	m	803	903	952	1,164	Gross Profit	m	1,523	1,706	2,116	2,483
Cost of Goods Sold	m	2,082	2,233	2,413	2,949	Cost of Goods Sold	m	3,606	4,316	5,363	6,588
EBITDA	m	325	433	438	536	EBITDA	m	666	758	974	1,221
Depreciation	m	23	37	34	41	Depreciation	m	51	60	75	91
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	41	55	61	74	Other Amortisation	m	93	96	135	163
EBIT	m	260	341	344	421	EBIT	m	522	601	765	967
Net Interest Income	m	-39	-51	-41	-50	Net Interest Income	m	-93	-90	-90	-102
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	45	-12	36	-66	Other Pre-Tax Income	m	-10	33	-31	-45
Pre-Tax Profit	m	266	279	339	305	Pre-Tax Profit	m	420	545	644	820
Tax Expense	m	-48	-34	-43	-53	Tax Expense	m	-87	-82	-97	-123
Net Profit	m	219	244	296	252	Net Profit	m	333	463	548	697
Minority Interests	m	18	-68	-24	-30	Minority Interests	m	-53	-50	-54	-69
Reported Earnings	m	236	176	272	222	Reported Earnings	m	280	413	493	628
Adjusted Earnings	m	236	176	272	222	Adjusted Earnings	m	280	413	493	628
EPS (rep)	fen	10.1	7.5	11.6	9.5	EPS (rep)	fen	13.3	17.6	21.1	26.8
EPS (adj)	fen	10.1	7.5	11.6	9.5	EPS (adj)	fen	13.3	17.6	21.1	26.8
EPS Growth yoy (adj)	%	50.4	14.0	14.9	25.8	EPS Growth (adj)	%	25.1	32.3	19.6	27.2
						PE (rep)	x	24.7	18.7	15.6	12.3
						PE (adj)	x	24.7	18.7	15.6	12.3
EBITDA Margin	%	11.3	13.8	13.0	13.0	Total DPS	fen	0.0	0.0	0.0	0.0
EBIT Margin	%	9.0	10.9	10.2	10.2	Total Div Yield	%	0.0	0.0	0.0	0.0
Earnings Split	%	57.3	42.7	55.0	45.0	Basic Shares Outstanding	m	1,993	2,140	2,140	2,140
Revenue Growth	%	20.8	14.5	16.7	31.1	Diluted Shares Outstanding	m	2,102	2,340	2,340	2,340
EBIT Growth	%	36.3	3.0	32.4	23.2						
Profit and Loss Ratios		2015A	2016E	2017E	2018E	Cashflow Analysis		2015A	2016E	2017E	2018E
Revenue Growth	%	15.8	17.4	24.2	21.3	EBITDA	m	666	758	974	1,221
EBITDA Growth	%	22.8	13.9	28.6	25.3	Tax Paid	m	-42	-82	-97	-123
EBIT Growth	%	30.4	15.2	27.2	26.4	Chgs in Working Cap	m	-332	-535	-681	-735
Gross Profit Margin	%	29.7	28.3	28.3	27.4	Net Interest Paid	m	0	0	0	0
EBITDA Margin	%	13.0	12.6	13.0	13.5	Other	m	-32	69	10	2
EBIT Margin	%	10.2	10.0	10.2	10.7	Operating Cashflow	m	260	211	207	365
Net Profit Margin	%	5.5	6.9	6.6	6.9	Acquisitions	m	0	0	0	0
Payout Ratio	%	0.0	0.0	0.0	0.0	Capex	m	-338	-211	-241	-227
EV/EBITDA	x	11.4	10.7	8.3	6.6	Asset Sales	m	0	0	0	0
EV/EBIT	x	14.6	13.5	10.6	8.4	Other	m	13	-298	4	4
Balance Sheet Ratios						Investing Cashflow	m	-326	-509	-237	-223
ROE	%	9.8	11.9	12.6	14.1	Dividend (Ordinary)	m	0	0	0	0
ROA	%	8.9	8.7	9.3	10.0	Equity Raised	m	0	0	0	0
ROIC	%	12.3	13.4	14.2	15.4	Debt Movements	m	518	210	210	198
Net Debt/Equity	%	9.7	16.0	18.8	15.5	Other	m	0	0	0	0
Interest Cover	x	5.6	6.7	8.5	9.5	Financing Cashflow	m	518	210	210	198
Price/Book	x	2.0	1.9	1.7	1.5	Net Chg in Cash/Debt	m	454	-88	181	340
Book Value per Share		1.6	1.7	1.9	2.2	Free Cashflow	m	-79	-0	-33	138
		2015A	2016E	2017E	2018E	Balance Sheet		2015A	2016E	2017E	2018E
						Cash	m	1,311	1,222	1,403	1,743
						Receivables	m	1,429	1,759	2,227	2,752
						Inventories	m	30	46	57	70
						Investments	m	0	0	0	0
						Fixed Assets	m	538	598	673	718
						Intangibles	m	996	1,042	1,088	1,134
						Other Assets	m	2,045	2,888	3,466	3,968
						Total Assets	m	6,348	7,555	8,913	10,385
						Payables	m	1,030	1,379	1,717	2,109
						Short Term Debt	m	1,387	1,755	2,138	2,423
						Long Term Debt	m	263	98	113	128
						Provisions	m	0	0	0	0
						Other Liabilities	m	182	373	449	532
						Total Liabilities	m	2,862	3,605	4,416	5,191
						Shareholders' Funds	m	3,247	3,660	4,153	4,781
						Minority Interests	m	239	290	344	413
						Other	m	0	0	0	0
						Total S/H Equity	m	3,486	3,949	4,497	5,194
						Total Liab & S/H Funds	m	6,348	7,555	8,913	10,385

All figures in Rmb unless noted.

Source: Company data, Macquarie Research, January 2017

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie – South Africa

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense

Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa^*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2016

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	57.53%	50.72%	45.57%	42.28%	60.58%	52.79%	(for global coverage by Macquarie, 8.71% of stocks followed are investment banking clients)
Neutral	33.90%	33.97%	43.04%	50.11%	37.23%	35.62%	(for global coverage by Macquarie, 8.05% of stocks followed are investment banking clients)
Underperform	8.56%	15.30%	11.39%	7.61%	2.19%	11.59%	(for global coverage by Macquarie, 4.63% of stocks followed are investment banking clients)

354 HK vs HSI, & rec history



(all figures in HKD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, January 2017

12-month target price methodology

354 HK: HK\$4.50 based on a PER methodology

Company-specific disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/research/disclosures.

Date	Stock Code (BBG code)	Recommendation	Target Price
24-Aug-2016	354 HK	Outperform	HK\$4.50
08-Mar-2016	354 HK	Outperform	HK\$3.85

Target price risk disclosures:

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