

# Chinasoft International

## Topline slowdown, margins improved; cut TP to HK\$3.0

### Results Review

#### 2015 results in line with expectations

Chinasoft reported **revenue of Rmb5.13bn (+16% YoY)**; and **adjusted net profits of Rmb212mn (+23% YoY)**.

#### Trends to watch

**Slowing growth of mature business TPG.** Chinasoft restructured to TPG (traditional professional offline) and IIG (Jointforce platform) business. The TPG is a mature business with +17% YoY growth, slowing clearly from > 30% in 2014. We expect the business will maintain similar growth as the IT outsourcing business is unlikely to pick up quickly.

#### Margin improvement of emerging Jointforce platform.

The Jointforce platform is doing well with IIG revenue +13% YoY and profit +32% YoY as it increases employee utilization and decreases project costs. However, the platform is at its early stage and still needs time to reveal the potential.

**Improved management leads to lower expenses and better cash flow.** Due to better cost control and utilization of Jointforce, Chinasoft's SG&A cost was 22.5% of revenue in 2015 (vs. 23.9% in 2014); and the operating cash flow +247% YoY.

#### Earnings forecast

We forecast revenue of Rmb5.9bn in 2016, Rmb6.6bn in 2017 (-8% from previous estimate for 2016); and adjusted net profits of Rmb267mn & Rmb320mn, or EPS of Rmb0.13 & Rmb0.15.

#### Valuation and recommendation

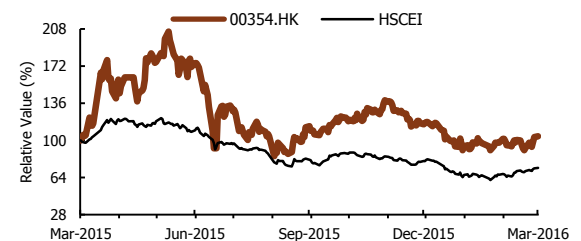
**We reaffirm our HOLD rating and trim our TP by 6% from HK\$3.2 to HK\$3.0 based on 20x 2016 P/E.**

#### Risks

Weak economic performance, uncertainties in new business.

### Maintain HOLD

Ticker	00354.HK
CICC investment rating	HOLD
Last close	HK\$2.86
CICC target	HK\$3.00
52wk price range	HK\$5.79~2.28
Market cap (bn)	HK\$6
Daily value (mn)	HK\$2.38
Shares outstanding (mn)	2,152
Free float (%)	100
Daily volume (mn sh)	19.77
Business sector	Software & Services



(Rmb mn)	2014A	2015A	2016E	2017E
Revenue	4,429	5,129	5,898	6,566
(+/-)	38.2%	15.8%	15.0%	11.3%
Net profit	200	280	267	320
(+/-)	34.9%	40.0%	-4.6%	19.8%
EPS	0.11	0.13	0.13	0.15
BPS	1.32	1.53	1.66	1.81
DPS	0.00	0.00	0.00	0.00
CPS	0.04	0.24	0.09	0.23
P/E	21.7	18.2	20.0	16.6
P/B	1.7	1.6	1.5	1.4
EV/EBITDA	10.2	10.4	9.1	10.9
Dividend yield	0.0%	0.0%	0.0%	0.0%
ROAA	4.0%	4.8%	4.0%	4.5%
ROAE	8.4%	9.8%	7.9%	8.7%

Source: Wind, Bloomberg, company data, CICC Research

Kai QIAN

kai.qian@cicc.com.cn  
 SAC Reg. No.: S0080513050004  
 SFC CE Ref: AZA933

Liping ZHAO

liping.zhao@cicc.com.cn  
 SAC Reg. No.: S0080113120016  
 SFC CE Ref: BEH709

## Financial summary

Financial statement (Rmb mn)	2014A	2015A	2016E	2017E	Financial ratios	2014A	2015A	2016E	2017E
<b>Income statement</b>					<b>Growth ability</b>				
Revenue	4,429	5,129	5,898	6,566	Revenue	38.2%	15.8%	15.0%	11.3%
COGS	-3,080	-3,606	-4,183	-4,685	Operating profit	39.2%	12.7%	6.9%	18.5%
Selling expenses	-220	-179	-218	-243	EBITDA	38.7%	9.4%	34.9%	-14.7%
Administrative expenses	-665	-745	-855	-919	Net profit	34.9%	40.0%	-4.6%	19.8%
Other ops income (expense)	59	29	35	39	<b>Profitability</b>				
Operating profit	352	397	424	502	Gross margin	30.5%	29.7%	29.1%	28.6%
Finance costs	-84	-93	-106	-118	Operating margin	7.9%	7.7%	7.2%	7.6%
Other income (expense)	0	0	0	0	EBITDA margin	11.1%	10.5%	12.3%	9.4%
Profit before income tax	297	420	321	384	Net margin	4.5%	5.5%	4.5%	4.9%
Income tax	-42	-87	-48	-58	<b>Liquidity</b>				
Minority interest	-55	-53	-5	-7	Current ratio	1.54	1.71	1.55	1.51
Net profit	200	280	267	320	Quick ratio	1.54	1.71	1.55	1.51
EBITDA	493	539	727	620	Cash ratio	0.35	0.50	0.20	0.14
Recurrent net income	172	212	267	320	Liabilities / assets	49.5%	45.1%	46.9%	46.7%
<b>Balance sheet</b>					Net debt / equity	19.7%	9.1%	29.5%	31.8%
Cash and bank balances	811	1,266	574	442	<b>Return</b>				
Trade and bill receivables	1,316	1,429	2,241	2,495	RoA	4.0%	4.8%	4.0%	4.5%
Inventories	0	0	0	0	RoE	8.4%	9.8%	7.9%	8.7%
Other current assets	1,467	1,651	1,679	1,817	<b>Per-share data</b>				
Total current assets	3,594	4,346	4,495	4,754	EPS (Rmb)	0.11	0.13	0.13	0.15
Fixed assets and CIP	336	538	1,023	1,443	BPS (Rmb)	1.32	1.53	1.66	1.81
Intangible assets and others	-239	-431	-916	-1,336	DPS (Rmb)	0.00	0.00	0.00	0.00
Total non-current assets	96	107	107	107	Cash flow per share (Rmb)	0.04	0.24	0.09	0.23
Total assets	5,344	6,348	6,876	7,437	<b>Valuation</b>				
Short-term borrowings	1,240	1,297	1,347	1,397	P/E	21.7	18.2	20.0	16.6
Trade and bill payables	0	0	0	0	P/B	1.7	1.6	1.5	1.4
Other current liabilities	1,089	1,242	1,556	1,754	EV/EBITDA	10.2	10.4	9.1	10.9
Total current liabilities	2,329	2,539	2,903	3,151	Dividend yield	0.0%	0.0%	0.0%	0.0%
Long-term borrowings	62	263	263	263					
Total non-current liabilities	314	323	323	323					
Total liabilities	2,643	2,862	3,226	3,474					
Share capital	88	96	96	96					
Retained profit	2,409	3,152	3,419	3,739					
Equity	2,497	3,247	3,514	3,834					
Total liabilities & equity	5,344	6,348	6,974	7,536					
<b>Cash flow statement</b>									
Pretax profit	297	420	321	384					
Depreciation & amortization	141	142	303	374					
Change in working capital	-441	138	-377	-194					
Others	77	-193	-59	-71					
Cash flow from operations	75	508	188	494					
Capital expenditure	-391	-469	-563	-676					
Others	-47	0	0	0					
Cash flow from investing	-438	-469	-563	-676					
Equity financing	0	0	0	0					
Bank borrowings	1,274	50	50	50					
Others	-1,038	0	0	0					
Cash flow from financing	236	50	50	50					
Foreign exchange gain (loss)	-2	0	0	0					
Net changes in cash	-129	89	-326	-132					

Source: Company data, CICC Research

## Company description

Chinasoft International Ltd. is an investment holding company which develops and provides information technology solutions, IT outsourcing and training services through its subsidiaries. It is organized into three major business segments: Professional Services, Outsourcing Services and Training. The company was founded by Yu Hong Chen in 2000 and is headquartered in Beijing.

**Figure 1: Earnings revisions**

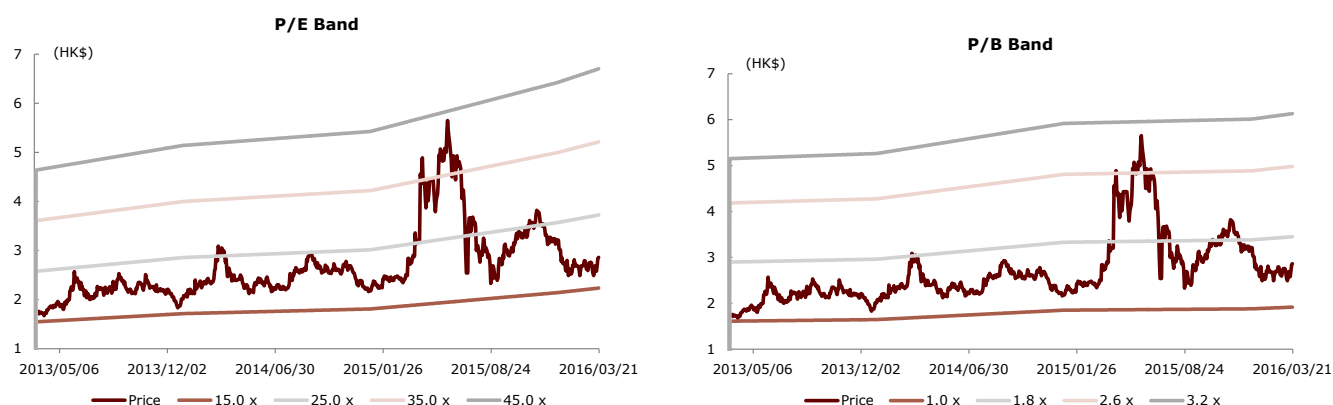
(in Rmb mn)	Before 2016E	After 2016E	+/- 2016E
<b>Revenue</b>	<b>6,431</b>	<b>5,898</b>	<b>-8.28%</b>
Gross profit	1,848	1,716	-7.17%
Operating profit	485	424	-12.54%
Net Profit contribute to shareholder	323	267	-17.40%
<b>Adjusted net profits</b>	<b>323</b>	<b>267</b>	<b>-17.41%</b>
Adjusted EPS HKD (Diluted)	0.18	0.14	-19.07%
Gross margin	28.7%	29.1%	0.4 ppt
Operating margin	7.5%	7.2%	-0.3 ppt
Net margin	5.0%	4.5%	-0.5 ppt

Source: Company data, CICC Research

**Figure 2: Financial reviews**

(Rmb mn)	1H15A	2H15A	YoY	HoH	2015A	YoY	2H as % of FY
Revenue	2,389	2,740	10.0%	14.7%	5,129	15.8%	53.4%
Gross profit	677	846	10.2%	24.9%	1,523	12.9%	55.5%
Operating profit	193	203	5.6%	5.2%	397	12.7%	51.3%
Net profit	140	140	42.1%	0.5%	280	40.0%	50.1%
<b>Fully-diluted EPS (Rmb)</b>	<b>0.07</b>	<b>0.07</b>	<b>27.1%</b>	<b>-1.5%</b>	<b>0.13</b>	<b>25.2%</b>	<b>50.1%</b>
Gross margin	28.4%	30.9%	0ppt	2.5ppt	29.7%	-0.8ppt	
Operating margin	8.1%	7.4%	-0.3ppt	-0.7ppt	7.7%	-0.2ppt	
Net margin	5.8%	5.1%	1.2ppt	-0.7ppt	5.5%	0.9ppt	

Source: Company data, CICC Research

**Figure 3: Historical P/E & P/B**


Source: Company data, Factset, CICC Research

Figure 4: Comparable valuations

Company	Stock Currency	Reporting Currency	Share Price (2016-03-21)	Market Cap (US\$ mn)	Rating	14A	P/E 15A/E	16E	14A	P/S 15A/E	16E
<b>China Internet</b>											
Chinasoft	HKD	Rmb	2.86	794	HOLD	21.7	18.2	20.0	1.1	1.0	0.9
<b>Conglomerate</b>											
Tencent	HKD	RMB	158.10	191,598	BUY	49.4	37.4	29.1	15.1	11.9	9.1
Baidu	USD	RMB	187.92	65,032	BUY	28.7	32.3	26.3	8.2	6.1	5.0
Alibaba	USD	RMB	76.25	188,788	HOLD	n.a	34.9	26.8	15.4	15.4	11.5
58.com	USD	USD	58.37	8,261	BUY	294.8	n.a	n.a	31.5	11.7	6.6
Sina	USD	USD	47.78	3,323	BUY	64.4	55.8	46.8	4.3	3.9	3.6
Sohu	USD	USD	53.04	2,051	BUY	n.a	n.a	n.a	1.2	1.1	1.1
NetEase	USD	RMB	147.84	19,326	HOLD	24.3	16.7	13.5	10.2	5.3	3.4
Qihoo	USD	USD	74.93	9,662	HOLD	31.0	22.8	17.2	6.9	5.1	3.7
<b>E-Commerce</b>											
Dangdang	USD	RMB	7.11	574	HOLD	34.6	n.a	101.9	0.4	0.3	0.3
VIP shop	USD	USD	12.29	7,148	BUY	40.0	23.2	17.7	1.9	1.2	0.9
JD.com	USD	RMB	27.08	37,464	BUY	3114.2	n.a	2349.5	2.0	1.3	0.9
Jumei.com	USD	USD	6.35	909		11.6	27.6	15.7	1.4	0.8	0.6
<b>Online Travel</b>											
Qunar	USD	RMB	35.15	4,657	BUY	n.a	n.a	n.a	16.5	7.2	4.1
Ctrip	USD	RMB	43.52	19,594	BUY	790.2	206.8	381.3	16.6	11.6	7.1
Tuniu	USD	RMB	11.13	1,402	BUY	n.a	n.a	n.a	2.5	1.1	0.7
<b>Online Game</b>											
Changyou	USD	USD	19.26	1,005	HOLD	1750.9	4.9	8.0	1.3	1.3	1.8
Taomee	USD	USD	3.63	138	HOLD	181.5	n.a	n.a	3.3	3.9	4.0
Poly Bona	USD	USD	13.58	880	BUY	66.9	n.a	n.a	3.5	n.a	n.a
YY	USD	RMB	59.80	422	BUY	20.1	n.a	n.a	5.5	3.7	2.8
Tian Ge	HKD	RMB	5.08	842		19.4	20.9	18.3	7.5	7.6	7.2
Net Dragon	HKD	RMB	22.50	1,429		33.1	n.a	69.2	9.4	7.5	5.7
Forgame	HKD	RMB	11.38	201		n.a	n.a	22.8	1.8	1.7	1.1
IGG	HKD	USD	3.61	641	HOLD	8.9	11.6	9.7	3.1	3.0	2.7
Boyya	HKD	RMB	2.89	285	HOLD	5.6	8.5	7.1	1.9	2.1	1.9
Ourgame	HKD	RMB	4.23	429	BUY	15.4	16.4	11.3	5.6	3.6	2.6
<b>Video</b>											
Youku	USD	RMB	27.48	5,282	HOLD	n.a	n.a	n.a	8.1	4.9	3.5
<b>Vertical portal</b>											
Phoenix New Media	USD	RMB	4.25	301	BUY	6.6	14.6	13.0	1.1	1.2	1.1
500.com	USD	USD	16.06	673		13.6	n.a	188.9	7.2	44.3	14.0
Soufun	USD	USD	5.78	2,747		10.5	n.a	n.a	4.0	3.2	2.4
BitAuto	USD	RMB	27.44	1,737		15.2	32.5	17.4	4.8	2.7	2.0
Autohome	USD	USD	28.21	3,197		27.3	20.3	17.9	9.9	6.2	3.3
51job	USD	USD	30.84	1,812		3.1	2.8	2.7	1.0	0.9	0.8
Jiayuan	USD	RMB	7.36	245	HOLD	5.6	3.8	2.2	2.5	2.1	1.9

Source: Company data, Bloomberg, CICC Research. Note: Companies without rating are not cover by CICC.

Figure 5: Historical and forecasted financials

(in RMB mn)	2013A	2014A	2015A	2016E	2017E
<b>Revenue</b>	<b>3,206.0</b>	<b>4,429.2</b>	<b>5,129.1</b>	<b>5,898.5</b>	<b>6,565.9</b>
PSG	1,568.6	1,985.9			
OSG	1,388.4	2,026.3			
ESG	154.7	325.9			
Training	94.4	91.1			
TPG		3,237.8	3,780.7	4,347.8	4,782.6
IIG		1,191.4	1,348.4	1,550.7	1,783.3
Growth(YoY)	15.8%	38.2%	15.8%	15.0%	11.3%
PSG	8.0%	26.6%			
OSG	13.6%	45.9%			
ESG	0.0%	110.7%			
Training	0.8%	-3.4%			
TPG			16.8%	15.0%	10.0%
IIG			13.2%	15.0%	15.0%
Cost of sales	(2,200.8)	(3,080.0)	(3,605.9)	(4,182.8)	(4,684.8)
Growth rate	18.8%	40.0%	17.1%	16.0%	12.0%
<b>Gross profit</b>	<b>1,005.2</b>	<b>1,349.2</b>	<b>1,523.2</b>	<b>1,715.6</b>	<b>1,881.1</b>
Gross margin	31.4%	30.5%	29.7%	29.1%	28.6%
Growth rate	9.8%	34.2%	12.9%	12.6%	9.6%
SG&A	(814.2)	(1,056.5)	(1,155.2)	(1,327.2)	(1,418.2)
Growth rate	7.2%	29.8%	9.3%	14.9%	6.9%
Selling and marketing expenses	(175.4)	(219.8)	(178.6)	(218.2)	(242.9)
Administrative expenses	(512.2)	(664.8)	(744.5)	(855.3)	(919.2)
Research and development cost	(52.2)	(64.2)	(78.1)	(88.5)	(98.5)
Allowance for doubtful debts	(24.6)	(27.1)	(62.1)	(59.0)	(39.4)
Amortisation of intangible assets	(49.8)	(80.7)	(92.0)	(106.2)	(118.2)
Other operating income/(expense) – net	61.8	59.2	28.6	35.4	39.4
<b>Operating profit</b>	<b>252.9</b>	<b>351.9</b>	<b>396.7</b>	<b>423.9</b>	<b>502.2</b>
Operating margin	7.9%	7.9%	7.7%	7.2%	7.6%
Growth(YoY)	19.7%	39.2%	12.7%	6.9%	18.5%
Finance costs, net	(47.3)	(84.4)	(92.5)	(106.2)	(118.2)
Share of net results of associates	(0.6)	1.4	1.9	2.9	0.0
<b>Profit before income tax</b>	<b>204.9</b>	<b>297.2</b>	<b>420.0</b>	<b>320.6</b>	<b>384.1</b>
Growth rate	9.2%	45.1%	41.3%	-23.7%	19.8%
Income tax expense	(4.9)	(42.2)	(87.0)	(48.1)	(57.6)
Foreign exchange gain/(Loss)	(7.8)	(1.8)	10.2	0.0	0.0
<b>Net Profit</b>	<b>192.2</b>	<b>253.3</b>	<b>343.2</b>	<b>272.5</b>	<b>326.4</b>
Net margin	6.0%	5.7%	6.7%	4.6%	5.0%
Groth rate	28.5%	31.8%	35.5%	-20.6%	19.8%
Minority interests	(51.7)	(55.0)	(52.9)	(5.5)	(6.5)
<b>Net Profit contribute to shareholder</b>	<b>148.3</b>	<b>200.0</b>	<b>280.1</b>	<b>267.1</b>	<b>319.9</b>
Net margin	4.6%	4.5%	5.5%	4.5%	4.9%
Groth rate	11.3%	34.9%	40.0%	-4.6%	19.8%
<b>EPS Rmb (Basic)</b>	<b>0.08</b>	<b>0.11</b>	<b>0.14</b>	<b>0.13</b>	<b>0.16</b>
<b>EPS Rmb (Diluted)</b>	<b>0.08</b>	<b>0.11</b>	<b>0.13</b>	<b>0.13</b>	<b>0.15</b>
<b>Adjustments:</b>					
<b>Net Income</b>	<b>148.3</b>	<b>200.0</b>	<b>280.1</b>	<b>267.1</b>	<b>319.9</b>
Adjustments:					
Foreign exchange gain/(Loss)	0.0	(0.7)	(28.4)	0.0	0.0
Gain arising from FV changes	0.0	28.3	2.2	0.0	0.0
Gain on disposal of subsidiaries	0.0	0.0	111.7	0.0	0.0
Tax on the gain on disposal of subsidiaries	0.0	0.0	(17.2)	0.0	0.0
<b>Adjusted Net Income</b>	<b>148.3</b>	<b>172.4</b>	<b>211.7</b>	<b>267.1</b>	<b>319.9</b>
Net margin	4.6%	3.9%	4.1%	4.5%	4.9%
Growth%	-4.7%	16.2%	22.8%	26.2%	19.8%
<b>Adjusted EPS</b>					
<b>EPS Rmb (Basic)</b>	<b>0.08</b>	<b>0.09</b>	<b>0.11</b>	<b>0.13</b>	<b>0.16</b>
Growth%	-10.4%	10.4%	15.0%	26.2%	19.8%
<b>EPS Rmb (Diluted)</b>	<b>0.08</b>	<b>0.09</b>	<b>0.10</b>	<b>0.13</b>	<b>0.15</b>
Growth%	-4.7%	16.2%	9.8%	26.2%	19.8%
<b>EPS HKD (Basic)</b>	<b>0.11</b>	<b>0.12</b>	<b>0.13</b>	<b>0.15</b>	<b>0.18</b>
<b>EPS HKD (Diluted)</b>	<b>0.10</b>	<b>0.11</b>	<b>0.12</b>	<b>0.14</b>	<b>0.17</b>

Source: Company data, CICC Research

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V150902  
Editing: Jim SATKO

## Beijing

### China International Capital Corporation Limited

28<sup>th</sup> Floor, China World Office 2  
1 Jianguomenwai Avenue  
Beijing 100004, P.R. China  
Tel: (86-10) 6505-1166  
Fax: (86-10) 6505-1156

## Shenzhen

### China International Capital Corporation Limited – Shenzhen Branch

#2503, 25<sup>th</sup> Floor, China Merchants Bank Tower  
7088 Shennan Boulevard, Futian District  
Shenzhen 518040, P.R. China  
Tel: (86-755) 8319-5000  
Fax: (86-755) 8319-9229

## Shanghai

### China International Capital Corporation Limited – Shanghai Branch

32<sup>nd</sup> Floor Azia Center  
1233 Lujiazui Ring Road  
Shanghai 200120, P.R. China  
Tel: (86-21) 5879-6226  
Fax: (86-21) 5888-8976

## Singapore

### China International Capital Corporation (Singapore) Pte. Limited

#39-04, 6 Battery Road  
Singapore 049909  
Tel: (65) 6572-1999  
Fax: (65) 6327-1278

## Hong Kong

### China International Capital Corporation (Hong Kong) Limited

29<sup>th</sup> Floor, One International Finance Centre  
1 Harbour View Street  
Central, Hong Kong  
Tel: (852) 2872-2000  
Fax: (852) 2872-2100

## United Kingdom

### China International Capital Corporation (UK) Limited

Level 25, 125 Old Broad Street  
London EC2N 1AR, United Kingdom  
Tel: (44-20) 7367-5718  
Fax: (44-20) 7367-5719

#### Beijing Jianguomenwai Avenue Branch

1<sup>st</sup> Floor, Capital Tower  
6A Jianguomenwai Avenue  
Beijing 100022, P.R. China  
Tel: (86-10) 8567-9238  
Fax: (86-10) 8567-9235

#### Shanghai Defeng Road Branch

Room 1105, Building A  
299-1 Defeng Road, Fengxian District  
Shanghai 201400, P.R. China  
Tel: (86-21) 5879-6226  
Fax: (86-21) 6887-5123

#### Nanjing Hanzhong Road Branch

Section C, 30<sup>th</sup> Floor, Asia Pacific Tower  
2 Hanzhong Road, Gulou District  
Nanjing 210005, P.R. China  
Tel: (86-25) 8316-8988  
Fax: (86-25) 8316-8397

#### Xiamen Lianyue Road Branch

4<sup>th</sup> Floor, Office Building, Paragon Center  
1 Lianyue Road, Siming District  
Xiamen 361012, P.R. China  
Tel: (86-592) 515-7000  
Fax: (86-592) 511-5527

#### Chongqing Honghu Road (West) Branch

1<sup>st</sup> & 10<sup>th</sup> Floors, Ourui Lanjue Center  
Block 9, Honghu Road (W), New North District  
Chongqing 401120, P.R. China  
Tel: (86-23) 6307-7088  
Fax: (86-23) 6739-6636

#### Foshan Jihua 5<sup>th</sup> Road Branch

12<sup>th</sup> Floor, Trend International Business Building  
2 Jihua 5<sup>th</sup> Road, Chancheng District  
Foshan 528000, P.R. China  
Tel: (86-757) 8290-3588  
Fax: (86-757) 8303-6299

#### Ningbo Yangfan Road Branch

11<sup>th</sup> Floor, Building Five, 999 Yangfan Road  
Hi-tech Industrial Development Zone  
Ningbo 315103, P.R. China  
Tel: (86-574) 8907-7288  
Fax: (86-574) 8907-7328

#### Beijing Kexueyuan South Road Branch

6<sup>th</sup> Floor, Block A, Raycom Infotech Park  
2 Kexueyuan South Road, Haidian District  
Beijing 100022, P.R. China  
Tel: (86-10) 8286-1086  
Fax: (86-10) 8286 1106

#### Shenzhen Fuhuayilu Branch

Room 201, Annex Building  
Shenzhen Duty Free Commercial Tower  
6 Fuhua 1<sup>st</sup> Road, Futian District  
Shenzhen 518048, P.R. China  
Tel: (86-755) 8832-2388  
Fax: (86-755) 8254-8243

#### Guangzhou Tianhe Road Branch

40<sup>th</sup> Floor, Teemtower  
208 Tianhe Road  
Guangzhou 510620, P.R. China  
Tel: (86-20) 8396-3968  
Fax: (86-20) 8516-8198

#### Wuhan Zhongnan Road Branch

4301-B, Poly Plaza  
99 Zhongnan Road, Wuchang District  
Wuhan 430070, P.R. China  
Tel: (86-27) 8334-3099  
Fax: (86-27) 8359-0535

#### Tianjin Nanjing Road Branch

10<sup>th</sup> Floor, Tianjin Global Trading Center  
219 Nanjing Road, Heping District  
Tianjin 300051, P.R. China  
Tel: (86-22) 2317-6188  
Fax: (86-22) 2321-5079

#### Yunfu Xinxing Dongdi North Road Branch

2<sup>nd</sup> Floor, Service Building C1, Wens Science & Technology Garden, Dongdi North Road  
Xincheng Town, Xinxing County  
Yunfu 527499, P.R. China  
Tel: (86-766) 2985-088  
Fax: (86-766) 2985-018

#### Fuzhou Wusi Road Branch

38<sup>th</sup> Floor, Henglicheng Office Building  
No.128 Wusi Road, Gulou District  
Fuzhou 350001, P.R. China  
Tel: (86-591) 8625 3088  
Fax: (86-591) 8625 3050

#### Shanghai Middle Huaihai Road Branch

398 Huaihai Road (M)  
Shanghai 200020, P.R. China  
Tel: (86-21) 6386-1195  
Fax: (86-21) 6386-1180

#### Hangzhou Jiaogong Road Branch

1<sup>st</sup> Floor, Euro American Center  
18 Jiaogong Road  
Hangzhou 310012, P.R. China  
Tel: (86-571) 8849-8000  
Fax: (86-571) 8735-7743

#### Chengdu Binjiang Road (East) Branch

1<sup>st</sup> & 16<sup>th</sup> Floors, Shangri-La Center  
Block 9B, Binjiang Road (East)  
Chengdu 610021, P.R. China  
Tel: (86-28) 8612-8188  
Fax: (86-28) 8444-7010

#### Qingdao Middle Hongkong Road Branch

11<sup>th</sup> Floor, Shangri-La Center  
Block 9, Hongkong Road (M), South District  
Qingdao 266071, P.R. China  
Tel: (86-532) 6670-6789  
Fax: (86-532) 6887-7018

#### Dalian Gangxing Road Branch

16<sup>th</sup> Floor, Wanda Center  
6 Gangxing Road, Zhongshan District  
Dalian 116001, P.R. China  
Tel: (86-411) 8237-2388  
Fax: (86-411) 8814-2933

#### Changsha Chezhao Road (North) Branch

3<sup>rd</sup> Floor, Annex Building, Securities Tower  
459 Chezhao Road (North), Furong District  
Changsha 410001, P.R. China  
Tel: (86-731) 8878-7088  
Fax: (86-731) 8446-2455

