

COMPANY NEWS

Digital China Holdings [861.HK; HK\$7.54 Not Rated] - The forgotten IT giant.

Market Cap: US\$1,064m; Free Float: 88.3%; 3-months Average Daily Turnover: US\$1.8m
Analyst: Mark Po

The Company. Digital China Holdings Limited (DCH), through its subsidiaries, distributes foreign brand information technology products and provides system integration service in China. DCH also develops and distributes networking products.

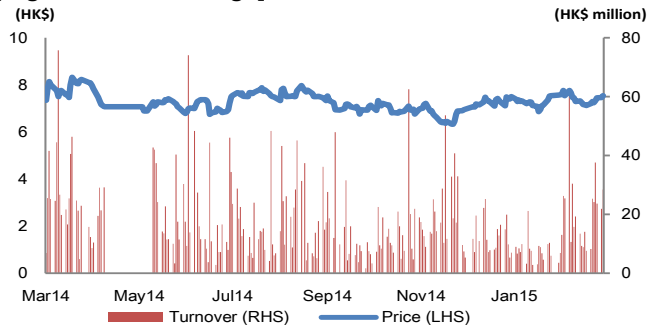
Since 2H13, DCH's distribution division was hit by weak end demand which was also a result of slow down in economic growth. DCH's distribution segment reported 5% YoY increase in turnover to HK\$9.89bn in 3Q14 which showed stabilization of DCH's distribution business as the group increased product offerings such as AMD CPUs and smartphones. DCH's system business is likely to report YoY growth in 4Q14 given low base effect and increasing contribution from products of domestic brands.

DCH's A-share listed subsidiary, Digital China Information Services Company Ltd. [000555.CH] (DCITS) is one of the largest IT services provider in China. Based on 2013 figures, DCITS was No.3 in overall IT services providers in China with 3.0% market share. DCITS also ranked No.1, No.2 and No.3 in government related sector, financial sector and telecom sector respectively. IT services segment is a growth area where companies such as DCH (through DCITS) and VST are making headway as they transform themselves to become more all-round service providers. Government, finance, telecom and manufacturing were among the top spenders in IT services in China. Currently ~60% of IT spending in China is on hardware, with the remaining ~40% on software and service. Since the IT spending ratio for hardware, software, and service is roughly 1:1:1 in developed countries such as the US, it is expected that there will be a shift in IT spending trends in China towards the optimal ratio. DCITS is well-positioned to capture the growth potential from increasing demand for IT services.

DCITS completed the acquisition of Zhongnong Xinda Information Technology Limited (ZXIT) in Jan 2015. ZXIT is principally engaged in IT services in rural areas. Through the acquisition, DCITS can expand its business and client base to local government agencies, enterprises and other organization in related to agricultural and agribusiness. ZXIT is of the few vendors who provide IT services and platform for land use rights registration. DCITS is also able to launch new business segment in related agricultural information technology and further develop and enhance profitability and sustainability.

DCH has signed a strategic cooperation agreement with Alibaba to provide related solutions and applications based on Alibaba's cloud infrastructure. DCH will provide SaaS and PasS on Alibaba's cloud computing platform. Both DCH and Alibaba will cooperate in Big Data scope and next-generation data driven applications. The cooperation with Alibaba is positive to DCH's cloud business

[Digital China Holdings]



Key Financials (in HK\$ m)	2012	2013	2014E	2015E
Revenue	70,319.4	69,089.9	67,808.8	69,380.9
Gross Profit	5,305.9	4,637.1	4,661.9	4,804.6
Gross Margin %	7.5	6.7	6.9	6.9
Net Profit	1,244.8	280.5	844.7	978.0
Net Margin %	1.8	0.4	1.2	1.4
EPS (Basic)	1.16	0.26	0.79	0.91
ROE (%)	19.4	3.9	9.8	10.7
Dividend Yield (%)	5.28	2.36	2.86	3.24
PER (x)	6.48	28.72	9.61	8.29
PBR (x)	1.21	1.07	0.94	0.87

Source: Bloomberg, Company Data.

development.

Apart from a stake in DCITS, DCH also holds 23.7% stake in HC International and 3.6% stake in Cogobuy. DCH is now trading at a substantial discount to the market value of its holdings in other TMT related names.

Our View. Due to its disappointing operating performance in 2013 and 2014, DCH was de-rated by the market. We share the concerns on outlook for the DCH's distribution business, which will cap near term share price performance. However, through DCITS, DCH is one the leading IT services providers in China. In terms of share price performance, DCH is one of the laggards during recent re-rating on the IT related names including Kingdee, Sinosoft and VST. We believe investors will put DCH back on their radar screen. DCH will announce 2014 results on 30 Mar 2015 and any sign of improvement of distribution business from 2014 results is expected to trigger upward share price performance.

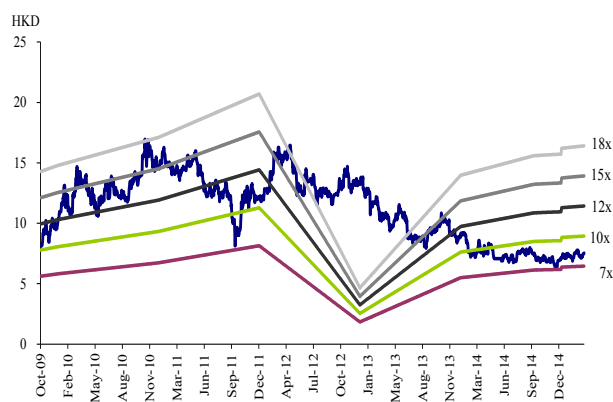
Catalysts. 2014 results announcement, news flow on co-operation with Alibaba & HC International [2280.HK] and Smart City projects.

Figure 1: Digital China market cap./market value of its stake in 3 listed companies.

Company	Ticker	Market Capitalization (HK\$m)	DCH's ownership	Market value of DCH's stake
DCITS	000555.CH	31,894.0	42%	13,535.8
HC International	2280.HK	5,264.6	24%	1,247.7
Cogobuy	400.HK	6,040.6	4%	217.5
Total				15,001.0
Digital China	861.HK	8,247.0	DCH's market cap./market value of its stake in 3 listed companies	
				55.0%

Source: Company Data, Bloomberg, CGIH

Figure 2: Digital China PE band



Source: Bloomberg, CGIH

Figure 3: Peer Comparisons

Ticker	Company	Price Lcy	Market Cap US\$m	PE			EV/EBITDA			P/B		ROE		ROA		Div yield	
				2015F	2016F	2014F	2015F	2016F	2013	2014F	2013	2014F	2013	2014F	2013	2014F	
HK Listed IT plays																	
861 HK	Digital China Holdings Ltd	7.54	1,063	8.3	7.6	11.3	9.9	8.8	1.0	0.9	3.9	9.8	0.4	3.1	2.4	2.9	
400 HK	Cogobuy Group	4.48	779	13.9	10.7	11.9	9.1	7.5	8.7	2.4	44.0	23.3	n.a.	8.9	n.a.	n.a.	
856 HK	Vst Holdings Ltd	2.80	551	6.2	5.5	6.7	6.1	5.7	1.1	1.0	15.7	15.9	4.9	5.0	4.2	4.8	
1184 HK	Sas Dragon Holdings Ltd	1.83	147	n.a.	n.a.	n.a.	n.a.	n.a.	1.4	n.a.	24.7	n.a.	5.3	n.a.	7.1	n.a.	
1588 HK	Chanjet Information Tech-H	15.72	440	14.8	12.3	18.9	n.a.	n.a.	2.3	2.1	22.4	11.5	n.a.	13.8	n.a.	2.7	
1297 HK	Sinosoft Technology Group Lt	3.77	502	17.4	14.4	10.9	8.8	n.a.	5.0	3.8	23.6	20.4	17.9	18.4	0.5	1.5	
2280 HK	Hc International Inc	7.89	679	13.4	9.1	10.8	7.2	5.5	n.a.	3.5	24.7	22.0	n.a.	10.4	0.0	n.a.	
268 HK	Kingdee International Sftwr	3.19	1,060	25.5	20.9	10.1	8.9	7.8	3.3	3.0	7.6	12.5	4.7	6.3	0.0	0.7	
354 HK	Chinasoft International Ltd	2.83	684	15.7	12.1	11.7	9.5	7.6	2.8	1.7	7.1	8.6	4.6	4.4	0.0	n.a.	
Average				14.4	11.6	11.5	8.5	7.2	3.2	2.3	19.3	15.5	6.3	8.8	2.0	2.5	
Overseas Listed Distributors																	
AVT US	Avnet Inc	47.12	6,426	9.6	9.0	6.9	6.5	6.2	1.4	1.3	11.0	11.6	5.2	5.6	1.3	1.4	
ARW US	Arrow Electronics Inc	64.67	6,185	9.7	9.4	7.3	7.0	6.6	1.5	1.3	9.8	13.3	4.1	4.8	0.0	0.0	
3702 TT	Wpg Holdings Ltd	40.65	2,158	9.8	n.a.	12.7	11.9	n.a.	1.6	1.5	12.2	14.8	3.7	4.1	n.a.	6.8	
ECM LN	Electrocomponents Plc	254.30	1,669	18.4	16.6	10.9	10.2	9.4	3.1	3.0	15.9	15.6	9.6	n.a.	4.6	4.6	
3036 TT	Wt Microelectronics Co Ltd	48.50	633	9.1	8.5	11.7	9.8	9.3	1.3	1.3	11.4	14.0	4.4	4.6	n.a.	6.6	
Average				11.3	10.9	9.9	9.1	7.9	1.8	1.7	12.1	13.9	5.4	4.8	2.0	3.9	
Overseas Listed Online Platforms																	
BABA US	Alibaba Group Holding-Sp Adr	84.25	207,677	30.1	22.5	33.1	24.3	17.9	9.5	9.5	n.a.	30.8	14.3	17.3	0.0	0.0	
JD US	Jd.Com Inc-Adr	29.00	40,074	89.1	46.1	n.a.	107.4	29.5	6.6	8.4	-165.4	-0.4	n.a.	-1.4	n.a.	0.0	
DANG US	E-Commerce China-Spon Adr -A	8.23	665	17.6	8.9	17.4	7.8	4.3	6.4	6.1	-21.8	15.2	1.9	1.8	0.0	0.0	
LITB US	Lightinthebox Holding-Adr	4.39	223	n.a.	n.a.	n.a.	170.0	n.a.	5.2	n.a.	n.a.	n.a.	-26.0	n.a.	0.0	n.a.	
JMEI US	Jumei International-Adr	16.18	2,316	18.1	13.3	23.3	12.5	8.4	21.9	3.8	52.1	14.1	18.8	8.6	0.0	0.0	
GSOL US	Global Sources Ltd	5.50	164	n.a.	n.a.	n.a.	n.a.	n.a.	1.0	n.a.	17.7	n.a.	4.1	n.a.	0.0	n.a.	
Average				38.7	22.7	24.6	64.4	15.0	8.4	7.0	-29.4	14.9	2.6	6.6	0.0	0.0	

Source: Bloomberg

Disclaimer

This research report is not directed at, or intended for distribution to or used by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject China Galaxy International Securities (Hong Kong) Co., Limited ("Galaxy International Securities") and/or its group companies to any registration or licensing requirement within such jurisdiction.

This report (including any information attached) is issued by Galaxy International Securities, one of the subsidiaries of the China Galaxy International Financial Holdings Limited, to the institutional clients from the information sources believed to be reliable, but no representation or warranty (expressly or implied) is made as to their accuracy, correctness and/or completeness.

This report shall not be construed as an offer, invitation or solicitation to buy or sell any securities of the company(ies) referred to herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The recipient of this report should understand and comprehend the investment objectives and its related risks, and where necessary consult their own independent financial advisers prior to any investment decision.

Where any part of the information, opinions or estimates contained herein reflects the personal views and opinions of the analyst who prepared this report, such views and opinions may not correspond to the published views or investment decisions of China Galaxy International Financial Holdings Limited and any of its subsidiaries ("China Galaxy International"), directors, officers, agents and employees ("the Relevant Parties").

All opinions and estimates reflect the judgment of the analyst on the date of this report and are subject to change without notice. China Galaxy International and/or the Relevant Parties hereby disclaim any of their liabilities arising from the inaccuracy, incorrectness and incompleteness of this report and its attachment/s and/or any action or omission made in reliance thereof. Accordingly, this report must be read in conjunction with this disclaimer.

Disclosure of Interests

China Galaxy International may have financial interests in relation to the subjected company(ies) the securities in respect of which are reviewed in this report, and such interests aggregate to an amount may equal to or more than 1 % of the subjected company(ies)' market capitalization.

One or more directors, officers and/or employees of China Galaxy International may be a director or officer of the securities of the company(ies) mentioned in this report.

China Galaxy International and the Relevant Parties may, to the extent permitted by law, from time to time participate or invest in financing transactions with the securities of the company(ies) mentioned in this report, perform services for or solicit business from such company(ies), and/or have a position or holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto.

China Galaxy International may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the last 12 months, significant advice or investment services in relation to the investment concerned or a related investment or investment banking services to the company(ies) mentioned in this report.

Furthermore, China Galaxy International may have received compensation for investment banking services from the company(ies) mentioned in this report within the preceding 12 months and may currently seeking investment banking mandate from the subject company(ies).

Analyst Certification

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

Explanation on Equity Ratings

- BUY : share price will increase by >20% within 12 months in absolute terms
- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

Copyright Reserved

No part of this material may be reproduced or redistributed without the prior written consent of China Galaxy International Securities (Hong Kong) Co., Limited.

China Galaxy International Securities (Hong Kong) Co. Limited, CE No.AXM459

Room 3501-3507, 35/F, Cosco Tower, Grand Millennium Plaza, 183 Queen's Road Central, Sheung Wan, Hong Kong. General line: 3698-6888.