

## Sinsoft Technology Group [1297.HK]

### Inline 2014 results; outlook remains positive. Maintain BUY

Sinsoft Technology Group's (Sinsoft) 2014 results were in line with our and market expectations. Management remains positive on outlook for 2015 given: a) expanding geographical coverage of export tax software, b) strong growth of carbon management software, c) strong demand from government related projects and d) contribution from new business opportunity such as business with Ant Financial Services. Sinsoft should deliver solid earnings growth of 26.7%/26.0% in 2015E/2016E. We maintain the view that Sinsoft is a beneficiary of government's policy of reducing carbon emission and continuous investment in IT. We believe the current valuation of 17.1x 2015E still looks attractive. Potential co-operation with Alibaba should offer upside potential. Maintain **BUY** with a new target price of HK\$4.27 (based on 21x 2015E PER, higher than historical average but discount to its peers).

#### Investment Highlights

- Inline 2014 results.** Sinsoft's 2014 net profit was RMB134.5m, up 33% YoY vs RMB100.9m in 2013. The group's 2H14 net profit was RMB88.4m, 3% higher than our expectations of Rmb85.8m. Among all segments, carbon management solutions and e-Government solutions reported higher than expected turnover growth. Turnover of carbon management solutions segment and e-Government solutions segment were 33.1% and 3.0% higher than our expectations. The group reported gross margin of 59.0% in 2H14, lower than our expectations of 67.9% which was mainly dragged by drop in margin of carbon management solutions segment. Gross margin of carbon management solution dropped from 89.4% in 2013 to 60.5% in 2014 which is mainly due to dilution effect of a large size project with higher portion of hardware sales. Operating margin was 43.2% in 2H14, lower than our expectations of 44.9%, but improved sequentially from 42.3% in 1H14. Due to lower effective tax and lack of financial expenses, Sinsoft reported a net margin of 38.5%, higher than our forecasts of 36.3%. The group declared a final dividend of RMB0.019 per share.
- Management remains positive on outlook.** Management is upbeat on the group's operating performance in 2015 and the major segments such as exports tax software, carbon management solutions will report strong growth. The growth of e-Government solutions segment will report satisfactory growth due to continuous investment in IT by local governments. The business with Ant Financial Services is expected to make contribution in 2015. (more on next page)

Key Financials (in RMB m)	2012	2013	2014	2015E	2016E
Revenue	235.2	297.3	366.4	461.1	554.0
Change (yoy %)	21.3	26.4	23.2	25.9	20.1
Gross Profit	159.4	196.7	236.6	304.8	381.0
Gross Margin %	67.8	66.2	64.6	66.1	68.8
Net Profit	76.2	100.9	134.5	170.5	214.9
Net Margin %	32.4	34.0	36.7	37.0	38.8
EPS (Basic)	0.10	0.11	0.13	0.17	0.21
Change (yoy %)	29.72	12.35	14.13	26.74	26.02
DPS	\$0.000	\$0.015	\$0.019	\$0.050	\$0.062
ROE (%)	39.0	23.6	19.7	20.9	22.1
Dividend Yield (%)	-	0.53	0.67	1.75	2.21
PER (x)	n.a.	24.8	21.7	17.1	13.6
PBR (x)	9.1	4.7	3.9	3.3	2.8
FCF Yield (%)	na.a	6.51%	5.28%	7.56%	9.94%
Capex (m)	2.9	36.0	36.8	37.0	37.3
Free cash flow per sha	0.0	0.2	0.1	0.2	0.2
Net Gearing (%)	12.6	net cash	net cash	net cash	net cash

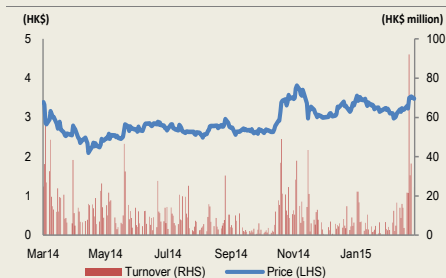
### TMT Sector-Software

# BUY

Close: HK\$3.48 (Mar 23, 2015)

Target Price: HK\$4.27 (+22.6%)

#### Share Price Performance



Market Cap	US\$463m
Shares Outstanding	1,032.3m
Auditor	Deloitte
Free Float	52.1%
52W range	HK\$2.10-3.81
3M average daily T/O	US\$1.2m
Major Shareholding	Founders & Management (50.4%)

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- Limited downside for gross margin.** Management highlights that a decline in gross margin is somewhat due to development cycle of the group and change in mix in carbon management solutions segment. Downside for gross margin is limited and the group will manage S,G&A expenses well. It is expected that the group's bottom line growth is at least the same as top line growth.
- Exports tax software segment continues to grow.** According to management, the geographical expansion of the exports tax software segment is on track. The group will see meaningful top line contribution from export tax software segment in other areas. Exports tax software in Jiangsu will continue to grow. Management believes exports tax software segment will report solid growth in 2015.
- Carbon management solutions.** Management also highlights outlook for carbon management solution segment remains positive given government policy of reducing carbon emission. The group is likely to see stronger growth in 2H14
- Business with Ant Financial Services.** Sinosoft & Ant Financial Services jointly launched the new financial product "Cheng Yi Dai" to provide unsecured credit loan services to small-and mid-cap enterprises. Sinosoft provides no guarantee for borrowers and Sinosoft will share interest income from Ant Financial Services. According to Sinosoft's management, the Cheng Yi Dai has commenced operation already. Cheng Yi Dai is expected to make contribution in 2015. Management reiterates that the group is working with Alibaba regarding new business development. We maintain the view that the further co-operation with Alibaba is a share price catalyst.

**Figure 1: Sinosoft Interim Results**

Year ended 31 Dec	2013		2014	
	1H	2H	1H	2H
Turnover	111	187	136	230
COGS	(34)	(66)	(36)	(94)
Gross profit	76	120	101	136
Other operating income	2	5	8	7
Selling and distribution costs	(7)	(12)	(11)	(15)
Administrative expenses	(11)	(18)	(21)	(13)
R&D	(17)	(12)	(19)	(15)
Other operating expenses	(10)	(3)	(1)	(1)
Operating profit	33	81	58	99
Finance costs	(1)	(0)	-	-
Profits from associates/JCEs	-	-	-	-
Income before tax	31	81	58	99
Income tax expense	(1)	(10)	(12)	(11)
Minority interests	-	-	-	-
Net profit	30	71	46	88
<b>Margins and Ratios:</b>				
Gross margin	69.0%	64.5%	73.9%	59.0%
Net margin	27.3%	37.9%	33.9%	38.4%
Effective tax rate	4.0%	12.5%	20.0%	11.0%

*Sources: Bloomberg, CGIHK Research estimates*

## Earnings forecast

### *Steadily growth*

- Despite lower than expected gross margin, we leave our earnings forecast for 2015 and 2016 remains unchanged given the group's track record in cost control. Sinosoft is projected to deliver earnings growth of 12%/28%/21% in 2014E/2015E/2016E, supported by a pick-up in turnover growth and tight cost control.
- We expect Sinosoft to report turnover growth of 25.9% YoY and 20.1% YoY respectively in 2015E and 2016E. The group's top line growth is supported by steady growth in export tax software segment and carbon management software.
- Expansion of geographical coverage will also create growth potential to Sinosoft's export tax software segment. Sinosoft's export tax software segment is expected to report growth of 31.4% and 26.9% respectively in 2014E and 2015E. Given policy supports, we expect Sinosoft's carbon management solutions segment to grow at 42.6% and 17.9% respectively in 2015E and 2016E.
- We expect gross margin to improve from 64.1% in 2013 to 66.1% in 2015, thanks to increasing contribution from higher margin products. Sinosoft has a healthy balance sheet with net cash on hand.

**Figure 12: Key Assumptions for Sinosoft**

	2010	2011	2012	2013	2014	2015F	2016F
<b>Turnover (Rmbm)</b>							
Export tax software and related services	23.1	30.6	39.0	67.7	91.1	119.6	150.5
e-Government solutions	34.0	61.6	63.1	75.7	90.9	107.2	126.5
Carbon management solutions	0.0	7.7	13.3	34.4	66.5	94.9	111.9
Information integration software	25.9	28.4	55.7	46.8	58.1	68.6	80.9
<b>YoY Change (%)</b>							
Export tax software and related services		32.0	27.6	73.7	34.4	31.4	25.9
e-Government solutions		81.2	2.4	20.0	20.0	18.0	18.0
Carbon management solutions	n.a.		72.6	158.8	93.7	42.6	17.9
Information integration software		9.7	96.0	(16.0)	24.3	18.0	18.0
<b>Gross margin (%)</b>							
Gross margin (%)	50.8	60.3	67.8	66.2	64.6	66.1	68.8
<b>Net margin (%)</b>							
Net margin (%)	29.0	30.3	32.4	34.0	36.7	37.0	38.8
<b>Cost (Rmbm)</b>							
S,G&A	(24.9)	(28.1)	(35.7)	(48.2)	(60.2)	(73.4)	(88.2)
R&D Expenses	(5.02)	(15.94)	(20.67)	(28.46)	(33.49)	(42.15)	(50.63)
Financial Expenses	(1.2)	(2.9)	(2.7)	(1.7)	-	(1.0)	(1.0)
<b>YoY Change (%)</b>							
S,G&A		13.1	26.9	35.0	24.9	22.0	20.1
R&D Expenses		217.7	29.7	37.7	17.7	25.9	20.1
Financial Expenses		144.6	(4.9)	(36.9)	(100.0)	n.a.	-

Sources: Company, CGIHK Research

**Figure 13: Earnings projection**

Income Statement (RMB m)	FY2012	FY2013	FY2014	FY2015F	FY2016F
<b>Revenue</b>	<b>235</b>	<b>297</b>	<b>366</b>	<b>461</b>	<b>554</b>
Growth yoy%	21.3%	26.4%	23.2%	25.9%	20.1%
<b>Gross Profit</b>	<b>159</b>	<b>197</b>	<b>237</b>	<b>305</b>	<b>381</b>
Growth yoy%	36.3%	23.4%	20.3%	28.8%	25.0%
Selling General & Admin Exp.	(56)	(77)	(94)	(116)	(139)
Others Operating Expenses/Items	(8)	(9)	3	(0)	(1)
<b>Operating Income</b>	<b>95</b>	<b>111</b>	<b>146</b>	<b>189</b>	<b>241</b>
Growth yoy%	n.a.	n.a.	31.8%	29.3%	27.4%
Interest Expense	(2.7)	(1.7)	0	(1.0)	(1.0)
Interest and Invest. Income	1.9	3.0	10.6	10.7	10.6
Income/(Loss) from Affiliates	0	0	0	0	0
Other Non-Operating Inc. (Exp.)	0	0	0	0	0
Impairment of Goodwill	-	-	-	-	-
Gain (Loss) On Sale Of Invest.	-	-	-	-	-
Gain (Loss) On Sale Of Assets	-	-	-	-	-
Income Tax Expense	(18)	(11)	(23)	(29)	(36)
Minority Int. in Earnings	0	0	0	0	0
<b>Net Income</b>	<b>76</b>	<b>101</b>	<b>135</b>	<b>170</b>	<b>215</b>
Growth yoy%	n.a.	n.a.	33.3%	26.7%	26.0%

Cash Flow Statement (RMB m)	FY2012	FY2013	FY2014	FY2015F	FY2016F
<b>Net Income</b>	<b>95</b>	<b>111</b>	<b>146</b>	<b>189</b>	<b>241</b>
Depreciation & Amort.	3	36	37	37	37
Change in Working Capital	(60)	(4)	(47)	(32)	(24)
<b>Cash from Ops.</b>	<b>38</b>	<b>143</b>	<b>136</b>	<b>194</b>	<b>254</b>
Capital Expenditure	(1)	(2)	(3)	(4)	(4)
Sale of Property, Plant, and Equipment	-	-	-	-	-
Change in Investing Activities	(76)	(87)	(303)	(158)	(70)
<b>Cash from Investing</b>	<b>(77)</b>	<b>(90)</b>	<b>(306)</b>	<b>(162)</b>	<b>(74)</b>
Net increase in bank borrowings	14	(82)	0	0	0
Issuance of Common Stock	0	308	0	0	0
Common Dividends Paid	0	(20)	(15)	(20)	(51)
Special Dividend Paid	-	-	-	-	-
Other Financing Activities	(4)	(22)	(3)	(8)	(13)
<b>Cash from Financing</b>	<b>11</b>	<b>184</b>	<b>(19)</b>	<b>(28)</b>	<b>(64)</b>
<b>Net Change in Cash</b>	<b>(28)</b>	<b>237</b>	<b>(188)</b>	<b>5</b>	<b>116</b>

Balance Sheet (RMB m)	FY2012	FY2013	FY2014	FY2015F	FY2016F
<b>ASSETS</b>					
Cash And Equivalents	53	288	103	201	317
Receivables	201	221	261	328	394
Inventory	1	1	1	1	2
Other Current Assets	63	70	277	277	277
<b>Total Current Assets</b>	<b>318</b>	<b>580</b>	<b>642</b>	<b>808</b>	<b>990</b>
Net Property, Plant & Equipment	7	7	9	9	8
Long-term Investments	-	-	-	-	-
Other Intangibles	-	-	-	-	-
Deferred Tax Assets, LT	-	-	-	-	-
Other Long-Term Assets	90	127	168	168	166
Goodwill	-	-	-	-	-
Accounts Receivable Long-Term	-	-	-	-	-
Total Long Term Assets	<b>98</b>	<b>135</b>	<b>177</b>	<b>177</b>	<b>174</b>
<b>Total Assets</b>	<b>416</b>	<b>714</b>	<b>819</b>	<b>985</b>	<b>1,165</b>
<b>LIABILITIES &amp; EQUITY</b>					
Accounts Payable	68	73	50	63	76
Accrued Exp.	-	-	-	-	-
Short-term Borrowings	82	0	0	0	0
Curr. Port. of LT Debt	-	-	-	-	-
Curr. Income Taxes Payable	-	-	-	-	-
Unearned Revenue, Current	-	-	-	-	-
Other Current Liabilities	18	5	6	7	7
<b>Total Current Liabilities</b>	<b>168</b>	<b>78</b>	<b>56</b>	<b>70</b>	<b>83</b>
Long-Term Debt	0	0	0	0	0
Def. Tax Liability, Non-Curr.	14	14	22	24	26
Other Non-Current Liabilities	0	0	0	0	0
<b>Total Liabilities</b>	<b>182</b>	<b>92</b>	<b>78</b>	<b>93</b>	<b>109</b>
Common Stock	0	8	8	8	8
Additional Paid In Capital	-	-	-	-	-
Retained Earnings	233	614	733	884	1,047
Treasury Stock	-	-	-	0	0
Comprehensive Inc. and Other	-	-	-	-	-
Minority Interest	0	0	0	0	0
<b>Total Equity</b>	<b>233</b>	<b>622</b>	<b>741</b>	<b>892</b>	<b>1,056</b>
<b>Total Liabilities And Equity</b>	<b>416</b>	<b>714</b>	<b>819</b>	<b>985</b>	<b>1,165</b>

Ratios	FY2012	FY2013	FY2014	FY2015F	FY2016F
<b>Profitability</b>					
Return on Assets %	21.1%	17.9%	17.6%	18.9%	20.0%
Return on Capital %	29.1%	21.9%	19.7%	21.0%	22.2%
Return on Equity %	39.0%	23.6%	19.7%	20.9%	22.1%
<b>Margin Analysis</b>					
Gross Margin %	67.8%	66.2%	64.6%	66.1%	68.8%
SG&A Margin %	15.2%	16.2%	16.4%	15.9%	15.9%
EBIT Margin %	41.1%	38.4%	42.9%	43.4%	45.5%
EBITDA Margin %	42.3%	39.2%	43.7%	44.1%	46.1%
Net Income Margin %	32.4%	34.0%	36.7%	37.0%	38.8%
<b>Asset Turnover</b>					
Total Asset Turnover	0.6x	0.4x	0.4x	0.5x	0.5x
Fixed Asset Turnover	2.4x	2.2x	2.1x	2.6x	3.2x
Accounts Receivable Turnover	1.4x	1.4x	1.5x	1.6x	1.5x
Inventory Turnover	333.6x	232.4x	354.4x	354.4x	354.4x
<b>Liquidity</b>					
Current Ratio	1.9x	7.4x	11.4x	11.6x	11.9x
Quick Ratio	1.9x	7.4x	11.4x	11.6x	11.9x
Avg. Days Sales Out.	311.6	271.2	259.6	259.6	259.6
Avg. Days Inventory Out.	1.1	1.6	1.0	1.0	1.0
Avg. Days Payable Out.	314.3	256.1	172.9	131.7	146.0
Avg. Cash Conversion Cycle	209.3	186.1	212.8	212.9	213.1
Net Debt to Equity	13%	net cash	net cash	net cash	net cash
<b>Growth Over Prior Year</b>					
Total Revenue	21.3%	26.4%	23.2%	25.9%	20.1%
Net Income	29.7%	32.4%	33.3%	26.7%	26.0%
Payout Ratio %	0.0%	0.0%	n.a.	14.6%	30.0%

Sources: Company, CGIHK Research

## Valuation

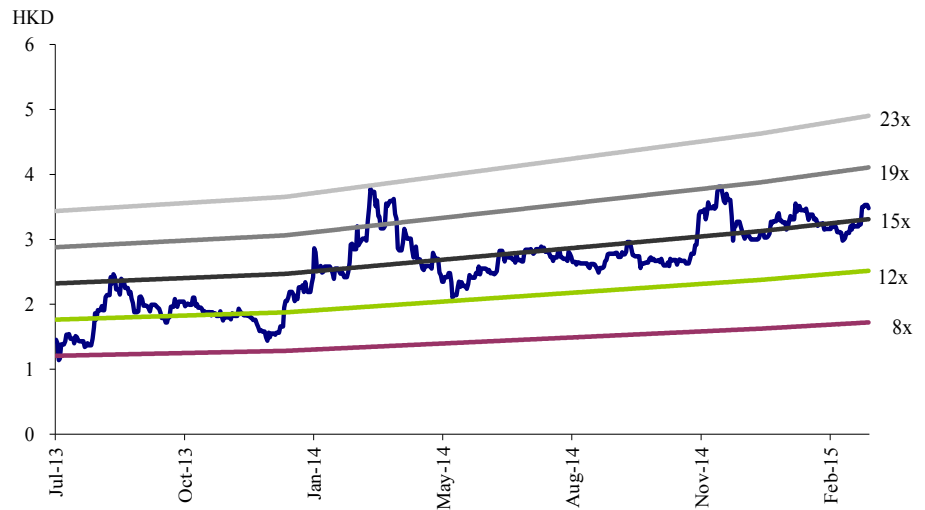
*Higher than historical average, but deep discount to A-share peers*

Sinsoft is trading at 17.1x 2015E PER, higher its historical average of 15x since listing in 2013. We maintain the view Sinsoft will still be able to achieve faster top and bottom line growth between 2015E and 2016E given: a) the steady growth of the exports tax software, b) increasing popularity of carbon management solution and c) expanding geographical coverage.

In terms of PER, Sinsoft is trading at a discount to A-share listed software developers, which are on an average 2015 PER of 54.2X. Sinsoft has first mover advantage in carbon management solutions software segment in China. Increasing contributions from carbon management solutions business and potential co-operation with Alibaba will support further re-rating potential. Current shares underperformance is not justified.

We are maintain the BUY rating on Sinsoft and raised the target price to HK\$4.27 based on 21x 2015E PER (higher than historical average of 15x). Our target PER is lower than its peers average of 2015 PER of 37.1x. Share price catalysts come from more news flow on government policy, M&A, strong operating performance and co-operation with Alibaba.

Figure 14: Sinsoft PER trend



Sources: Bloomberg, CGIHK Research estimates

**Figure 15: Peer Comparison**

Ticker	Company	Price Lcy	Market Cap US\$m	PE			EV/EBITDA			P/B		ROE		ROA		Div yield	
				2014F	2015F	2016F	2014F	2015F	2016F	2013	2014F	2013	2014F	2013	2014F	2013	2014F
<b>HK Listed Software plays</b>																	
1297 HK	Sinosoft	3.48	463	21.7	17.1	13.6	9.1	9.1	7.5	4.6	3.6	23.6	20.6	17.9	18.3	0.5	1.7
268 HK	Kingdee	3.04	1,010	31.8	22.5	18.3	9.7	8.5	7.5	3.2	2.9	7.6	12.6	4.7	6.3	0.0	0.7
354 HK	Chinasoft	2.75	665	20.8	15.3	11.8	11.4	9.3	7.4	2.7	1.7	7.1	8.6	4.6	4.4	0.0	n.a.
861 HK	Digital China	7.47	1,054	9.5	8.2	7.6	11.3	9.8	8.8	1.0	0.9	3.9	9.8	0.4	3.1	2.4	2.9
856 HK	VST	2.85	560	6.3	5.6	5.1	6.8	6.2	5.8	1.1	1.0	15.7	15.9	4.9	5.0	4.1	4.7
1588 HK	Chanjet	15.18	425	14.3	11.9	n.a.	17.8	n.a.	n.a.	2.2	2.1	22.4	11.5	n.a.	13.8	n.a.	2.8
<b>Average</b>				<b>17.4</b>	<b>13.4</b>	<b>11.3</b>	<b>11.0</b>	<b>8.6</b>	<b>7.4</b>	<b>2.5</b>	<b>2.0</b>	<b>13.4</b>	<b>13.2</b>	<b>6.5</b>	<b>8.5</b>	<b>1.4</b>	<b>2.6</b>
<b>A-share Listed Software plays</b>																	
300253 CH	Shanghai Kingstar	150.04	5,276	169.0	100.9	60.3	211.0	126.9	65.6	42.7	34.6	13.9	21.4	12.3	n.a.	n.a.	n.a.
300166 CH	Beijing Orient National	57.59	2,631	75.2	55.2	n.a.	67.6	55.6	n.a.	14.2	10.6	10.3	14.7	9.6	13.0	0.0	0.3
600588 CH	Yonyou	42.82	8,073	63.7	50.4	45.8	56.1	43.1	38.6	12.6	10.2	17.6	17.6	6.9	8.7	n.a.	0.6
300271 CH	Beijing Thunisoft	57.34	1,401	53.4	40.3	31.2	50.3	37.6	29.7	8.9	7.6	13.2	14.4	10.1	n.a.	0.3	n.a.
600410 CH	Beijing Teamsun	31.59	3,261	163.7	51.8	32.8	95.0	40.9	19.6	8.7	8.6	1.8	5.0	0.9	2.4	n.a.	2.2
600718 CH	Neusoft	26.11	5,159	71.0	56.5	49.0	87.8	64.2	44.3	5.9	6.2	7.9	8.6	3.9	4.5	n.a.	0.5
000977 CH	Inspur Electronic Informat	59.60	4,603	66.4	44.1	32.3	73.4	54.8	n.a.	12.2	11.6	12.7	19.5	7.2	8.1	n.a.	0.4
300290 CH	Bringspring Science	35.55	778	90.5	59.3	41.1	n.a.	n.a.	n.a.	12.5	8.6	14.6	9.8	9.9	6.9	0.2	0.2
002063 CH	Ygsoft	30.49	2,266	39.3	29.1	23.5	42.1	29.1	23.1	7.9	7.2	23.6	18.4	18.6	18.7	n.a.	0.4
<b>Average</b>				<b>88.0</b>	<b>54.2</b>	<b>39.5</b>	<b>85.4</b>	<b>56.5</b>	<b>36.8</b>	<b>14.0</b>	<b>11.7</b>	<b>12.9</b>	<b>14.4</b>	<b>8.8</b>	<b>8.9</b>	<b>0.2</b>	<b>0.7</b>
<b>Overseas Listed Software plays</b>																	
SAP GY	SAP	66.57	89,322	18.6	17.4	16.2	13.5	12.9	12.0	4.1	3.8	22.1	20.6	10.0	11.0	n.a.	1.7
CRM US	Salesforce.Com	67.69	44,039	98.1	74.4	55.4	35.2	28.7	23.8	11.1	10.4	-13.4	11.5	-2.6	4.5	0.0	0.0
IBM US	IBM	162.88	160,995	10.2	9.8	8.9	8.3	8.2	7.6	13.6	8.4	79.1	102.0	9.9	12.6	2.6	2.9
ORCL US	Oracle	44.41	193,942	15.5	14.7	13.6	9.2	9.0	9.2	4.0	3.9	24.7	28.3	11.7	15.6	1.1	1.1
<b>Average</b>				<b>35.6</b>	<b>29.1</b>	<b>23.5</b>	<b>16.6</b>	<b>14.7</b>	<b>13.1</b>	<b>8.2</b>	<b>6.6</b>	<b>28.1</b>	<b>40.6</b>	<b>7.2</b>	<b>10.9</b>	<b>1.2</b>	<b>1.4</b>

Sources: Bloomberg, Company, CGIHK Research estimates for covered stocks

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