

Sinsoft Technology Group [1297.HK]

Exposure to the public sector and new initiatives are growth drivers. Maintain BUY.

IT services names, such as Sinsoft Technology (Sinsoft), have performed well on a YTD basis due to a re-rating of the sector, given: a) the increasing adoption of new technologies, such as cloud computing, and b) less impact by external factors. In addition to the private sector (enterprises and consumer), the public sector is expected to be a driver for IT investment in China, given the government's policy of promoting new technologies, such as the industrial internet. We believe that Sinsoft will be one of the beneficiaries of increasing IT spending by the public sector. Due to the tight liquidity environment, we also believe Sinsoft's new initiatives in financial services will be welcomed by SMEs. We maintain the view that Sinsoft's transformation from a product-based business model to a platform/services-based model will not only drive top-line growth of the Company, but also help improve the working capital structure of the Company. The market might remain volatile, given macro uncertainties, but we expect the IT services names to continue to outperform, given less exposure to the external economy and favourable industry trends. Sinsoft lags behind its peers, so we see further re-rating potential, given its lower valuation and new business development. Sinsoft is now trading at 14.2x 2018E PER and 12.2x 2019 PER, which doesn't look expensive compared with that of its peers. We raise our target price from HK\$3.15 to HK\$4.25 after raising our PER target from 12X to 16X.

Investment Highlights

Leveraging expertise and capability to drive future growth. Sinsoft announced on 21 Mar 2018 that it had formed a JV with Focus Technology [002315.CH] and Sample Technology [1708.HK] to provide information services, such as full trade process operations, data management, and decision analysis, for import and export enterprises. Sinsoft will hold 65% in the JV, while Focus Technology and Sample Technology will each hold a 17.5% stake. The JV will provide services for import and export enterprises, foreign trade integrated service providers, their related corporations, upstream and downstream, financial institutions, etc. The JV can cover the whole ecosystem by leveraging the strength of its JV partners, since Focus Technology has exposure to e-commerce, Nanjing Sample Technology is a custom equipment provider, and Sinsoft has exposure to corporates and is capable of providing data management and analytic solutions. Sinsoft has teamed up with several financial institutions, such as banks in Jiangsu, and launched financial services, based on analysis of export tax rebate data and other trade-related services, which helps small export companies shorten the time required to secure banking facilities. Due to deleveraging in the Chinese economy, market liquidity is getting tight, and SMEs are finding it difficult to secure banking facilities. Sinsoft's new initiatives are expected to gain popularity, as it solves major problems for SMEs. We also expect Sinsoft to leverage its expertise and capability to drive future growth.

The public sector is also a driving force of IT spending in China. The Chinese government will promote the carbon trading platform from the central to local levels in 2018, and Sinsoft is expected to benefit from the launch of the carbon trading system, given its first-mover advantage. The Ministry of Justice has published the "Establishment Guide for 12348 Legal Network of China (Public Legal Services Network of China)", which defines this platform as the basis for coordinating public legal services standards and technical specifications across the country, as well as the outline for public legal services informatization construction for different provinces and municipalities. Sinsoft won the bid for the public legal services network of China for the Ministry of Justice in 2017, which demonstrated Sinsoft's ability to meet the relevant needs. Leveraging the Company's advantages in the public legal and judicial administrative areas throughout the national market, together with relevant favourable policies and enormous market demand, Sinsoft will offer more enhanced judicial administrative-related products to drive revenue growth.

Active share buybacks. Sinsoft has carried out 11 share buybacks since Apr 2018, buying back 16.3m shares at average price of HK\$3.05. The market might remain volatile, given news flow on macro issues, such as trade. However, we maintain the view that the TMT non-hardware segment will be less affected by external factors. The potential share buy-back by Sinsoft may also provide support for its share price. Any share price correction will provide a good re-entry opportunity.

Key Financials (in RMB m)	2015	2016	2017	2018E	2019E
Revenue	448.8	535.9	613.3	726.2	884.0
Change (yoy %)	22.5	19.4	14.4	18.4	21.7
Gross Profit	297.0	341.6	381.0	447.4	535.7
Gross Margin %	66.2	63.7	62.1	61.6	60.6
Net Profit	159.5	191.4	229.7	271.3	315.2
Net Margin %	35.6	35.7	37.5	37.4	35.7
EPS (Basic)	0.13	0.15	0.19	0.22	0.26
Change (yoy %)	(1.18)	19.97	20.01	18.76	16.82
DPS	\$0.023	\$0.023	\$0.028	\$0.044	\$0.051
ROE (%)	19.7	20.0	20.7	20.9	20.4
Dividend Yield (%)	0.75	0.75	0.89	1.42	1.65
PER (x)	24.3	20.2	16.9	14.2	12.2
PBR (x)	3.7	3.7	3.3	2.7	2.3
FCF Yield (%)	1.69%	1.37%	2.28%	6.83%	5.39%
Capex (m)	5.3	5.1	42.5	43.1	43.9
Free cash flow per share	0.1	0.0	0.1	0.2	0.2
Net Gearing (%)	net cash	net cash	net cash	net cash	net cash

Source: Bloomberg, CGIS Research

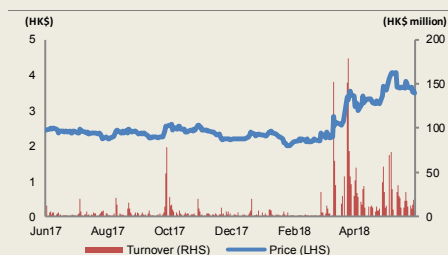
TMT Sector-Software

BUY

Close: HK\$3.49 (Jun 15, 2018)

Target Price: HK\$4.25 (+21.8%)

Share Price Performance



Source: Bloomberg.

Market Cap	US\$355m
Shares Outstanding	1,225.2m
Auditor	Baker Tilly
Free Float	53.1%
52W range	HK\$1.99-4.07
3M average daily T/O	US\$3.6m
Major Shareholding	Chairlady, Ms Xin Yingmei (45.7%)

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Figure 1: Earnings projection

Income Statement (RMB m)						Cash Flow Statement (RMB m)					
	FY2015	FY2016	FY2017	FY2018F	FY2019F		FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	449	536	613	726	884	Net Income	182	213	246	294	344
Growth yoy%	22.5%	19.4%	14.4%	18.4%	21.7%	Depreciation & Amort.	5	5	42	43	44
Gross Profit	297	342	381	447	536	Change in Working Capital	(110)	(158)	(180)	(34)	(146)
Growth yoy%	25.5%	15.0%	11.5%	17.4%	19.7%	Cash from Ops.	78	61	108	304	242
Selling General & Admin Exp.	(122)	(130)	(138)	(157)	(195)	Capital Expenditure	(5)	(2)	(9)	(10)	(11)
Others Operating Expenses/Items	7	2	3	4	3	Sale of Property, Plant, and Equipment	-	-	-	-	-
Operating Income	182	213	246	294	344	Change in Investing Activities	(101)	16	(218)	(148)	(148)
Growth yoy%	n.a.	17.1%	15.0%	19.9%	16.8%	Cash from Investing	(106)	15	(228)	(158)	(159)
Interest Expense	0	0	0	(1.0)	0	Net increase in bank borrowings	0	0	0	0	0
Interest and Invest. Income	7.7	7.9	6.8	13.0	12.0	Issuance of Common Stock	0	0	0	0	0
Income/(Loss) from Affiliates	0	0	0	0	0	Common Dividends Paid	(20)	(24)	(29)	(34)	(54)
Other Non-Operating Inc. (Exp.)	0	0	0	0	0	Special Dividend Paid	-	-	-	-	-
Impairment of Goodwill	-	-	-	-	-	Other Financing Activities	(8)	(6)	(3)	(4)	(6)
Gain (Loss) On Sale Of Invest.	-	-	-	-	-	Cash from Financing	(28)	(30)	(32)	(38)	(60)
Gain (Loss) On Sale Of Assets	-	-	-	-	-	Net Change in Cash	(57)	46	(152)	107	22
Income Tax Expense	(30)	(30)	(23)	(35)	(41)						
Minority Int. in Earnings	0	0	0	0	0						
Net Income	160	191	230	271	315						
Growth yoy%	18.6%	20.0%	20.0%	18.1%	16.2%						

Balance Sheet (RMB m)						Ratios					
	FY2015	FY2016	FY2017	FY2018F	FY2019F		FY2015	FY2016	FY2017	FY2018F	FY2019F
ASSETS						Profitability					
Cash And Equivalents	121	277	240	459	424	Return on Assets %	17.7%	17.2%	17.4%	17.7%	17.3%
Receivables	382	607	814	882	1,074	Return on Capital %	19.7%	20.0%	20.7%	21.0%	20.4%
Inventory	2	13	2	2	3	Return on Equity %	19.7%	20.0%	20.7%	20.9%	20.4%
Other Current Assets	255	18	0	0	0	Margin Analysis					
Total Current Assets	759	916	1,056	1,344	1,501	Gross Margin %	66.2%	63.7%	62.1%	61.6%	60.6%
Net Property, Plant & Equipment	8	107	103	103	104	SG&A Margin %	16.0%	12.7%	15.2%	14.2%	14.7%
Long-term Investments	-	-	-	-	-	EBIT Margin %	42.3%	41.3%	41.1%	42.3%	40.3%
Other Intangibles	-	-	-	-	-	EBITDA Margin %	43.5%	42.2%	42.6%	43.6%	41.4%
Deferred Tax Assets, LT	-	-	-	-	-	Net Income Margin %	35.6%	35.7%	37.5%	37.4%	35.7%
Other Long-Term Assets	216	217	239	223	373	Asset Turnover					
Goodwill	-	-	-	-	-	Total Asset Turnover	0.5x	0.4x	0.4x	0.4x	0.4x
Accounts Receivable Long-Term	-	-	-	-	-	Fixed Asset Turnover	2.0x	1.7x	1.8x	2.2x	1.9x
Total Long Term Assets	224	325	342	326	477	Accounts Receivable Turnover	1.4x	1.1x	0.9x	0.9x	0.9x
Total Assets	983	1,240	1,398	1,670	1,978	Inventory Turnover	275.1x	41.9x	309.3x	309.3x	309.3x
LIABILITIES & EQUITY						Liquidity					
Accounts Payable	68	146	159	188	229	Current Ratio	9.6x	5.7x	6.0x	6.5x	6.0x
Accrued Exp.	-	-	-	-	-	Quick Ratio	9.6x	5.6x	6.0x	6.5x	6.0x
Short-term Borrowings	0	0	0	0	0	Avg. Days Sales Out.	310.5	413.6	484.4	443.5	443.5
Curr. Port. of LT Debt	-	-	-	-	-	Avg. Days Inventory Out.	1.3	8.7	1.2	1.2	1.2
Curr. Income Taxes Payable	-	-	-	-	-	Avg. Days Payable Out.	142.1	201.4	239.9	227.3	218.8
Unearned Revenue, Current	-	-	-	-	-	Avg. Cash Conversion Cycle	258.9	338.0	392.9	351.9	351.9
Other Current Liabilities	11	16	17	18	20	Net Debt to Equity	net cash	net cash	net cash	net cash	net cash
Total Current Liabilities	79	162	176	207	249	Growth Over Prior Year					
Long-Term Debt	0	0	0	0	0	Total Revenue	22.5%	19.4%	14.4%	18.4%	21.7%
Def. Tax Liability, Non-Curr.	24	43	42	46	50	Net Income	18.6%	20.0%	20.0%	18.1%	16.2%
Other Non-Current Liabilities	0	0	0	0	0	Payout Ratio %	18.1%	15.1%	15.0%	20.1%	20.0%
Total Liabilities	103	205	217	252	300						
Common Stock	8	10	10	10	10						
Additional Paid In Capital	-	-	-	-	-						
Retained Earnings	872	1,025	1,171	1,408	1,669						
Treasury Stock	-	-	-	-	-						
Comprehensive Inc. and Other	-	-	-	-	-						
Minority Interest	0	0	0	0	0						
Total Equity	880	1,035	1,181	1,418	1,679						
Total Liabilities And Equity	983	1,240	1,398	1,670	1,978						

Sources: Company, CGIS Research

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