

22 October 2014

SINOSOFT TECH (1297.HK)

National policy favors the company

HONG KONG | SOFTWARE | COMPANY UPDATES

- Sinosoft's 1H14 revenue up 27.7% yoy while gross profit grew 39.4% yoy. GPM sharply increased 6.14 ppt. to 73.25% and net profit rose 52.7% yoy. EPS amounted to RMB 4.47 cents, no interim dividend.
- Benefited by the national policy on carbon emission trading, and cooperation with environmental protection companies, the carbon management solution is expected the future growth momentum.
- The PRC government supports to local IT service providers enabled the company to grab market share from foreign leading companies.
- We maintain the rating of Sinosoft as "Accumulate" and increase the target price to HK\$ 2.94, equivalent to 15x/12.7x of 2014 and 2015 forecasted EPS, plus cash per share of HK\$ 0.29.

Financial Highlights

The growth on Sinosoft speeded up in the 1H14. Revenue reached RMB 133 mn, up 27.7% yoy while gross profit grew 39.4% yoy to RMB 97 mn. Both of them were accelerated when compared to 2013 full year results. Gross profit margin sharply increased 6.14 ppt. to 73.25% and net profit rose 52.7% yoy to RMB 46 mn both showed better cost control in the first half. Earnings per share amounted to RMB 4.47 cents, no interim dividend.

How we view this

The accelerated revenue growth was mainly contributed by the growth on export tax software and carbon management solutions, which yearly grew 42.9% and 39.4% respectively. Margins also sharply improved in 1H14, but we expect the GPM to go down since the company used to put in heavy selling effort and promotions in the second half. Meanwhile, we are optimistic about the future growth on the carbon management solution due to the national policy on carbon emission trading. Sinosoft had collaborated with the subsidiary of China Energy Conservation and Environmental Protection Group (CECEP Group) to develop system and platform on the carbon related solutions.

Investment Action

Previously, the foreign IT solution companies, such as Oracle, IBM and Microsoft dominated the IT service market in mainland. But the PRC government had recently increased its concerns on the Internet information security, and tried to employ more local software, which allowed the local IT service providers to grab more market share. Thus, we maintain the rating of Sinosoft as "Accumulate" and increase the target price to HK\$ 2.94, equivalent to 15x/12.7x of 2014 and 2015 forecasted EPS, plus cash per share of HK\$ 0.29.

Key Financial Summary

FYE Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenue (RMB mn)	227	281	364	446	525
Net Profit (RMB mn)	76	101	147	174	200
EPS (HKD)	0.126	0.142	0.177	0.209	0.240
P/E (X)	20.6	18.3	14.7	12.4	10.8
BVPS (HKD)	0.386	0.872	0.745	0.913	1.107
P/B (X)	6.7	3.0	3.5	2.8	2.3
DPS (HKD)	0.112	0.019	0.025	0.030	0.034
Div. Yield (%)	4.32%	0.73%	0.97%	1.16%	1.31%

Source: PSR est.

*All multiples & yields based on current market price

Rating: **Accumulate**

Maintain at Accumulate

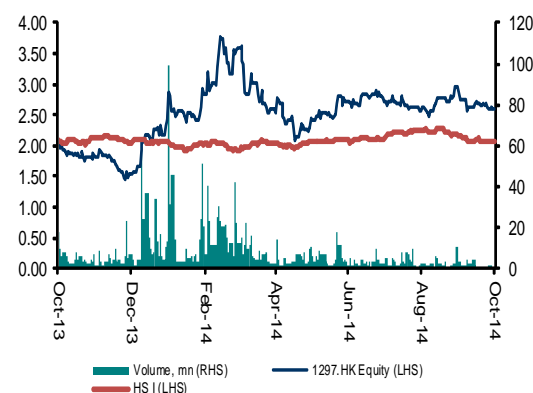
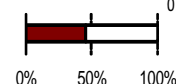
Target Price (HKD)	2.94
Forecast Dividend (HKD)	0.025
Closing Price (HKD)	2.59
Potential Upside	14.5%

Company Description

Sinosoft Tech was a mainland administrative software development company, which currently focused in the Jiangsu Province, one of the major exporting province. The company mainly engaged in providing the Export Tax Software, e-Government Solutions, Carbon Management Solutions and Systems Integration Solutions to government departments and large enterprises.

Company Data

Raw Beta (Past 2yrs weekly data)	N/A
Market Cap. (HKD bn)	2,674
Enterprise Value (HKD mn)	2,372
52 week range (HKD)	1.38 - 4.00
Closing Price in 52 week range	0.00



Major Shareholders

1. Xin Yingmei	47.70%
2. ALIBABA.COM LIMITED	13.32%
3. FIL Limited	9.94%

Valuation Method

PE

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Export tax software and carbon management business remained high growth

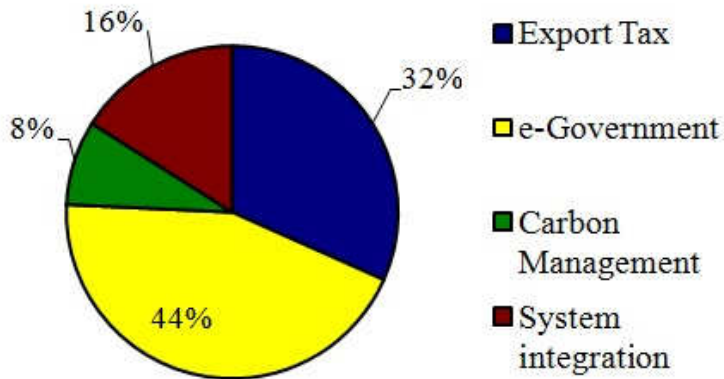
Sinosoft had obtained good results, revenue growth rate accelerated, which mainly contributed by the export tax software and carbon management solution business. The export tax business was once the largest revenue contributor before the merger of e-Government and information integration. The consulting and training services of export tax became significant sources of income.

The carbon management solution started at 2011 and achieved rapid growth in these years. According to company's listing prospectus, there were only three companies which provided carbon related monitoring software in 2012, and it was the only one provider in Jiangsu Province. It is expected the revenue from carbon management business will surpass the declining system integration business at the end of this year and gradually becomes the second largest revenue contributor to Sinosoft.

Potential Risks

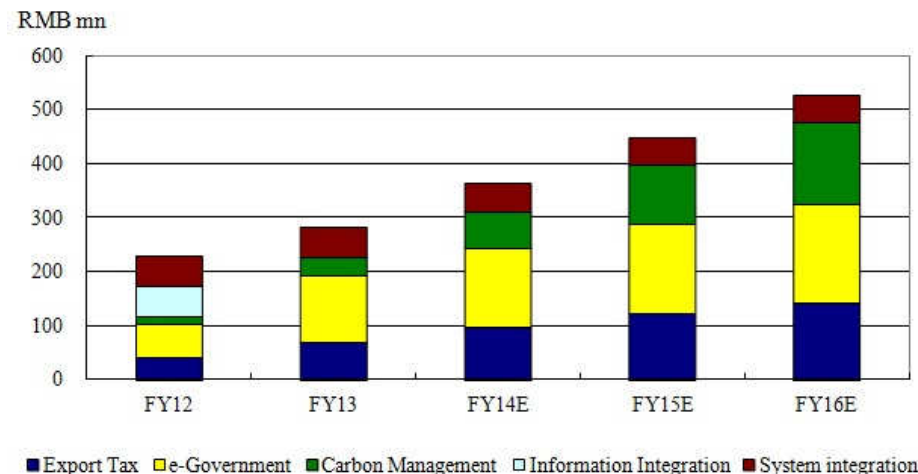
High competition on the integration solution business;
 The growth on carbon management solution slowdown.

Fig 1 1H14 Product Mix



Source: Company reports

Fig 2 Revenue mix estimates



Source: PSR est, Company reports

According to the China International Software & Information Service Fair (CISIS), it is predicted that the investment in information security by private companies will increase by 30% this year, while government and enterprises is projected to spend 7.8% more on software purchase.

Financial Status

RMB '000	2012	2013	2014E	2015E	2016E
Revenue	226,728	280,841	364,000	446,000	525,000
Export Tax	38,994	67,730	97,000	120,000	142,000
e-Government Solutions	63,103	122,482	145,000	166,000	182,000
Carbon Management	13,274	34,352	68,000	109,000	152,000
Information Integration	55,663	0	0	0	0
System Integration	55,694	56,277	54,000	51,000	49,000
Cost of Sales	(75,783)	(100,600)	(129,000)	(158,000)	(185,000)
Gross Profit	150,945	180,241	235,000	288,000	340,000
Value added tax refund	8,495	16,450	7,000	9,000	11,500
R&D	(20,667)	(28,462)	(35,000)	(43,000)	(53,000)
Selling & Distribution	(14,699)	(19,128)	(24,000)	(30,000)	(36,000)
Admin	(20,979)	(29,039)	(34,000)	(43,000)	(50,000)
Other incomes	3,336	7,191	16,000	15,000	15,000
Other expenses	(9,835)	(13,176)	(3,000)	(3,000)	(3,000)
	(54,349)	(66,164)	(73,000)	(95,000)	(115,500)
Operating income	96,596	114,077	162,000	193,000	224,500
Finance costs	(2,716)	(1,714)			
EBT	93,880	112,363	162,000	193,000	224,500
Taxation	(17,654)	(11,421)	(15,000)	(19,000)	(25,000)
Net Profit	76,226	100,942	147,000	174,000	199,500

Valuations

P/E (X)	20.6	18.3	14.7	12.4	10.8
P/B (X)	6.7	3.0	3.5	2.8	2.3
Dividend Yield (%)	4.32%	0.73%	0.97%	1.16%	1.31%

Per share HKD

EPS	0.126	0.142	0.177	0.209	0.240
DPS	0.112	0.019	0.025	0.030	0.034
BVPS	0.386	0.872	0.745	0.913	1.107
Outstanding Shares ('000)	750,000	883,981	1,032,258	1,032,258	1,032,258

Growth

Revenue	22.60%	23.87%	29.61%	22.53%	17.71%
Net Profit	29.72%	32.42%	45.63%	18.37%	14.66%

Margins

Gross profit margin	66.58%	64.18%	64.56%	64.57%	64.76%
Net Profit Margin	33.62%	35.94%	40.38%	39.01%	38.00%

Financial Status

RMB '000	2011	2012	2013H1	2013	2014H1
Non-current Assets					
Property, plant & equipment	9,393	7,470	6,727	7,457	8,915
Intangible assets	62,055	87,370	97,498	125,063	125,142
Available-for-sale financial assets	1,000	2,000	2,000	2,000	2,000
Deferred tax assets	696	952	1,226	0	0
	73,144	97,792	107,451	134,520	136,057
Current Assets					
Inventories	4,948	705	1,705	1,279	2,175
Trade and other receivables	128,150	200,784	216,031	220,892	251,895
Restricted deposit	0	0		70,000	100,000
Pledged bank deposits	51,453	63,306	62,741	0	880
Bank balances and cash	47,866	52,944	32,551	287,559	241,670
	232,417	317,739	313,028	579,730	596,620
Total Assets	305,561	415,531	420,479	714,250	732,677
Current Liabilities					
Trade payables	32,882	25,749	24,772	30,600	13,958
Other payables	29,514	42,353	50,708	42,458	39,568
Tax liabilities	8,203	17,701	2,938	5,228	5,769
Short term bank loans	69,378	82,312	80,698	0	
	139,977	168,115	159,116	78,286	59,295
Net Current Assets	92,440	149,624	153,912	501,444	537,325
Non-current liability	8,415	14,021	18,193	14,055	20,774
	157,169	233,395	243,170	621,909	652,608
Shareholders' Equity					
Share capital	8	8	8	8,232	8,232
Reserves	157,161	233,387	243,162	613,677	644,376
Total Equity attributable to Owner	157,169	233,395	243,170	621,909	652,608

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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