

14 August 2018

Kingdee

Heading To a New Era Of Enterprise Services

Following Kingdee's launch last week of its Next Generation Cloud Service Platform, we raise our TP to HKD12.17, from HKD10.63, 11% upside, as we lift the price to sales multiple to 15x, from 12x, which we use to value its cloud business, to reflect Kingdee's product leadership.

- Our takeaways were generally positive; we were impressed by its friendly and flexible interfaces, all-in-one, all possible enterprise applications integrated in one platform, multi-angel and real-time management reporting and powerful yet easy-to-use customization capabilities;
- We don't expect the new product to bring in significant revenues in the short term as Kingdee needs time to gain new large clients and implement such services. We estimate the product will be quite successful over the long-run.

Key features of Kingdee's Next Generation Cloud Service Platform (a platform that integrates all enterprise applications). On the software as a service (SaaS) level, it contains finance, HR, procurement, manufacturing, CRM, logistics, distribution, financing and industry cloud. On the platform as a service (PaaS) level, it is an application development platform with operation support, and it contains communication, big data, AI, and IoT capabilities.

Key features include:

- User-friendly interfaces where users can customise their interface and communicate online, just by one click, with other users who are relevant on the page;
- Real-time management reporting which is very powerful and can provide multi-dimensional data;
- Customization capabilities.

This product brings more positives in the long- rather than short-term and it aims to target large enterprises. We learned that Kingdee expects an annual fee for this product well above CNY1m per customer. We see this pricing achievable, given that large customers usually need more functions and accounts (both are important pricing factors). However, we don't expect a significant revenue from this new product to kick in very soon, as we consider several obstacles: i) it is difficult to gain large customers as these are reluctant to make changes, as it involves many departments and functions within the organization; ii) Kingdee's competitor Yongyou, serves several large customers and maintains very sticky relationships with each of them; iii) the implementation of the services takes longer-time for larger customers, not accounting for other implementation issues which may future delay the process.

Maintain BUY, with a higher TP of HKD12.17 as we raise the valuation multiple for its cloud business from 12x to 15x FY19F P/S, to reflect our bullish view on the company's new generation cloud ERP. Our TP also implies 51x FY19F P/E.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	1,862	2,303	2,861	3,609	4,729
Reported net profit (CNYm)	214	310	317	430	594
Recurring net profit (CNYm)	189	260	317	430	594
Recurring net profit growth (%)	(13.0)	37.1	22.0	35.5	38.3
Recurring EPS (CNY)	0.07	0.09	0.11	0.15	0.21
DPS (CNY)	na	na	na	na	na
Recurring P/E (x)	147	104	85	63	46
P/B (x)	8.02	6.78	6.28	5.71	5.08
P/CF (x)	51.2	28.3	64.6	25.9	20.9
Dividend Yield	na	na	na	na	na
EV/EBITDA (x)	37.8	17.9	16.8	14.2	11.8
Return on average equity (%)	6.4	8.3	7.6	9.5	11.8
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			(3.5)	(3.1)	(6.7)

Source: Company data, RHB

Technology | Software & Services

Buy (Maintained)

Target Price: HKD12.17
 Price: HKD11.00
 Market Cap: USD4.610m
 Bloomberg Ticker: 268 HK

Share Data

Avg Daily Turnover (HKD/USD) 328m/41.8m
 52-wk Price low/high (HKD) 3.12 - 11.1
 Free Float (%) 30
 Shares outstanding (m) 2,807
 Estimated Return 11%

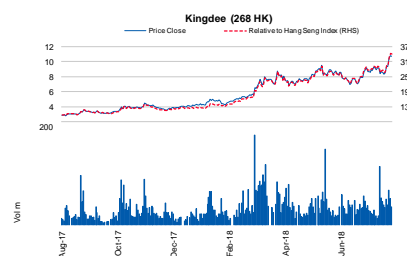
Shareholders (%)

Chairman Xu 27.0
 Oriental Gold Limited 14.5
 JD.com 10.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	150.0	19.7	42.9	124.9	259.5
Relative	156.6	21.8	53.1	131.3	255.6

Source: Bloomberg



Source: Bloomberg

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Financial Exhibits

Financial model updated on: 2018-08-13.

Asia	
Hong Kong	
Technology	
Kingdee	
Bloomberg	Bloomberg
Buy	Buy

Valuation basis

We use SOP to value Kingdee to better reflect the value of its current loss-making cloud business.

Key drivers

- Recovery of traditional ERP business;
- Cloud ERP to penetrate into more customers.

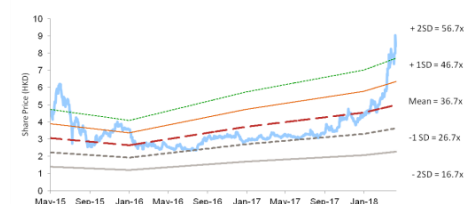
Key risks

Upside risk: better than expected growth from the cloud business; downside risk: more than expected spending for its cloud business; traditional ERP business faces margin pressure; intensifying competition in cloud business, and potential share dilution from the conversion of its convertible bond (CB).

Company Profile

Kingdee is a leading enterprise resource planning (ERP) software provider targeting small and medium enterprises (SMEs) through its well-known products, KIS and K/3. The company also provides cloud computing and mobile services for enterprises in China.

Kingdee's 3-year forward P/E band



Source: RHB

Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring EPS (CNY)	0.07	0.09	0.11	0.15	0.21
EPS (CNY)	0.07	0.11	0.11	0.15	0.21
BVPS (CNY)	1.20	1.42	1.54	1.69	1.90
Weighted avg adjusted shares (m)	2,888	2,807	2,807	2,807	2,807

Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring P/E (x)	147	104	85	63	46
P/E (x)	130	87	85	63	46
P/B (x)	8.02	6.78	6.28	5.71	5.08
FCF Yield (%)	1.6	4.4	1.2	3.5	4.4
EV/EBITDA (x)	37.8	17.9	16.8	14.2	11.8
EV/EBIT (x)	80.1	33.4	38.0	29.5	22.3

Income statement (CNYm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover	1,862	2,303	2,861	3,609	4,729
Gross profit	1,514	1,876	2,349	2,970	3,902
EBITDA	527	786	932	1,146	1,436
Depreciation and amortisation	(278)	(365)	(521)	(595)	(680)
Operating profit	249	421	412	552	756
Net interest	(22)	(27)	(19)	(23)	(31)
Income from associates & JVs	(18)	(15)	(31)	(40)	(52)
Pre-tax profit	209	378	362	488	673
Taxation	6	(55)	(40)	(54)	(74)
Minority interests	(1)	(14)	(5)	(5)	(5)
Recurring net profit	189	260	317	430	594

Cash flow (CNYm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Change in working capital	103	163	(883)	(114)	(172)
Cash flow from operations	544	956	420	1,046	1,298
Capex	(106)	242	(100)	(100)	(100)
Cash flow from investing activities	(513)	(65)	(535)	(601)	(676)
Proceeds from issue of shares	44	210	0	0	0
Dividends paid	(30)	0	0	0	0
Cash flow from financing activities	(212)	(559)	(442)	(84)	(117)
Cash at beginning of period	2,401	2,220	2,552	1,994	2,356
Net change in cash	(181)	332	(558)	362	505
Ending balance cash	2,220	2,552	1,994	2,356	2,861

Balance sheet (CNYm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total cash and equivalents	2,220	2,552	1,994	2,356	2,861
Tangible fixed assets	922	580	627	670	709
Intangible assets	775	817	785	747	704
Total investments	908	1,753	1,722	1,722	1,722
Total other assets	415	118	118	118	118
Total assets	5,977	6,802	6,538	7,187	8,110
Short-term debt	81	155	155	155	155
Total long-term debt	1,416	1,194	1,194	1,194	1,194
Total liabilities	2,441	2,759	2,197	2,409	2,726
Shareholders' equity	3,476	3,995	4,312	4,742	5,336
Minority interests	60	48	29	36	47
Total equity	3,536	4,043	4,341	4,778	5,383
Net debt	(723)	(1,203)	(645)	(1,008)	(1,513)
Total liabilities & equity	5,977	6,802	6,538	7,187	8,110

Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Revenue growth (%)	22.8	23.7	24.2	26.1	31.0
Recurrent EPS growth (%)	(16.6)	41.1	22.0	35.5	38.3
Gross margin (%)	81.3	81.5	82.1	82.3	82.5
Operating EBITDA margin (%)	28.3	34.1	32.6	31.8	30.4
Net profit margin (%)	11.5	13.5	11.1	11.9	12.6
Capex/sales (%)	5.7	(10.5)	3.5	2.8	2.1

Source: Company data, RHB

Figure 1: Detailed P&L

FYE Dec 31 (CNYm)	FY15	FY16	FY17	FY18F	FY19F	FY20F
	<i>Restated</i>	<i>Restated</i>	<i>Restated</i>	<i>Restated</i>	<i>Restated</i>	<i>Restated</i>
ERP business	1,348.7	1,521.4	1,735.3	1,924.4	2,068.7	2,203.2
Cloud service business	168.0	340.8	568.2	936.8	1,540.2	2,525.9
Total revenue	1,516.8	1,862.2	2,303.5	2,861.2	3,608.9	4,729.1
YoY	-1.9%	22.8%	23.7%	24.2%	26.1%	31.0%
Cost of sales	(290.2)	(348.0)	(427.0)	(512.2)	(638.8)	(827.6)
Gross profit	1,226.6	1,514.2	1,876.5	2,349.1	2,970.1	3,901.5
YoY	-3.9%	23.4%	23.9%	25.2%	26.4%	31.4%
Gross margin	80.9%	81.3%	81.5%	82.1%	82.3%	82.5%
Selling expenses	(766.3)	(1,002.4)	(1,235.9)	(1,516.5)	(1,847.8)	(2,340.9)
Admin expenses	(202.0)	(277.6)	(320.2)	(383.4)	(472.8)	(615.3)
R&D expenses	(196.4)	(283.6)	(345.3)	(434.9)	(544.9)	(704.6)
Other income	279.4	298.3	445.7	397.5	446.8	515.2
Operating profit	341.4	248.9	420.8	411.8	551.5	755.9
YoY	13.8%	-27.1%	69.0%	-2.1%	33.9%	37.1%
Operating margin	22.5%	13.4%	18.3%	14.4%	15.3%	16.0%
Finance costs (net)	(59.5)	(22.0)	(27.1)	(18.6)	(23.5)	(30.7)
Associates	(2.2)	(17.6)	(15.2)	(31.5)	(39.7)	(52.0)
Other income (disposal gain)	-	-	-	-	-	-
PBT	279.7	209.3	378.4	361.7	488.3	673.2
Income tax	(62.3)	5.9	(54.8)	(39.8)	(53.7)	(74.1)
Effective tax rate	22.3%	-2.8%	14.5%	11.0%	11.0%	11.0%
Profit from continuing operations	217.4	215.2	323.6	322.0	434.6	599.1
Profit from discontinued operations	(111.9)	73.7	-	-	-	-
MI	(0.2)	0.7	13.6	5.0	5.0	5.0
Net profit - reported	105.8	288.2	310.0	317.0	429.6	594.1
YoY	-46.3%	172.5%	7.6%	2.2%	35.5%	38.3%
Net profit margin - reported	7.0%	15.5%	13.5%	11.1%	11.9%	12.6%
Net profit - recurring	217.7	189.5	259.8	317.0	429.6	594.1
YoY	10.5%	-13.0%	37.1%	22.0%	35.5%	38.3%
Net profit margin - recurring	14.4%	10.2%	11.3%	11.1%	11.9%	12.6%

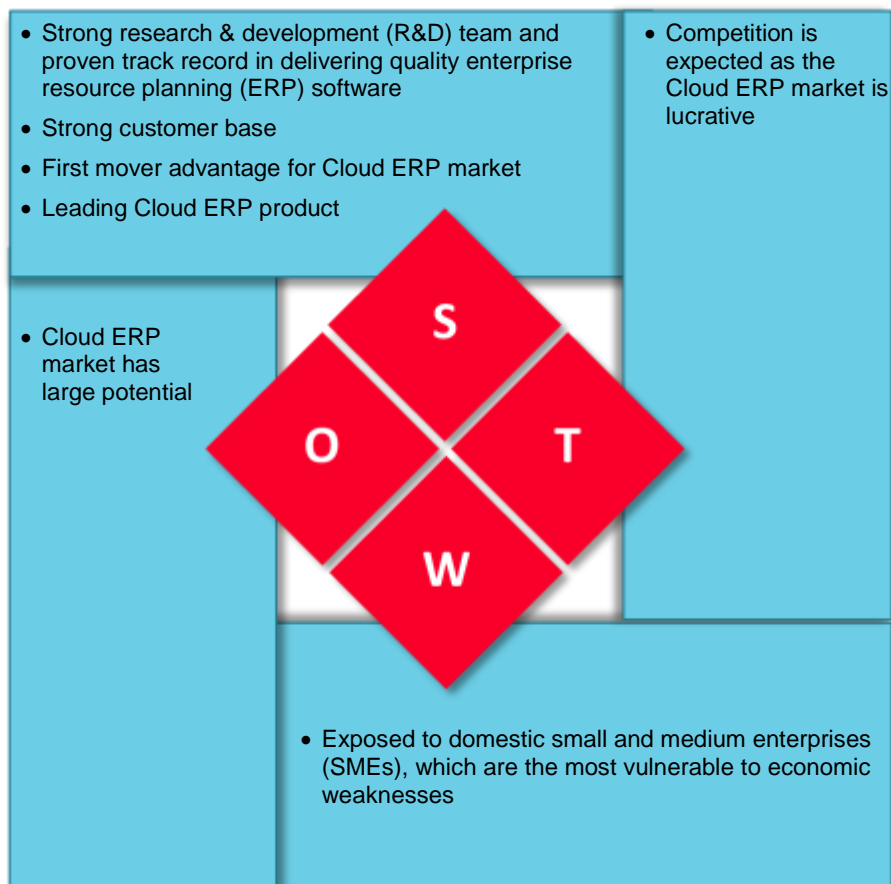
Source: RHB

Figure 2: SOP valuation

	FY19F profit (CNYm)	Multiple (x)	NAV (CNYm)	NAV (HKDm)	Kingdee's Stake	NAV/share (HKD)	Target Discount	TP (HKD)
ERP Business	362	15	5,430	6,408	100%	2.22	0%	2.22
	FY19F revenue (CNYm)	Price to sales (x)	NAV (CNYm)	NAV (HKDm)	Kingdee's Stake	NAV/share (HKD)	Target Discount	TP (HKD)
Cloud Business	1,540	15	23,103	27,261	100%	9.45	0%	9.45
	Net Cash Balance (CNYm)		NAV (CNYm)	NAV (HKDm)				
Net Cash as of end-FY17	1,250		1,250	1,475		0.50	0%	0.50
Total								12.17

Source: RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-04-12	Buy	10.6	8.6
2017-10-18	Buy	4.9	4.3
2017-08-18	Buy	3.9	3.3
2017-06-29	Buy	3.7	3.3
2017-03-17	Neutral	3.3	3.3
2016-08-19	Buy	3.8	3.0
2016-08-02	Buy	3.3	2.6
2016-03-21	Neutral	2.9	2.7
2015-08-21	Neutral	2.9	2.8
2015-03-19	Buy	3.1	2.8

Source: RHB, Bloomberg

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