

17 August 2018

Technology | Software & Services

Kingdee

Still Our Top Pick

Buy (Maintained)

Target Price: HKD11.40
 Price: HKD8.28
 Market Cap: USD3,470m
 Bloomberg Ticker: 268 HK

Maintain BUY, with a new high-end of consensus TP of HKD11.40 from HKD12.70, 38% upside, as we cut our cloud revenue and earnings estimates. Investors may be slightly disappointed with Kingdee's 1H cloud revenue growth of only 26% YoY vs >60% previously. However this is mainly because its private cloud revenue growth slowed down, while the fast-growing public cloud revenue is deemed to have higher visibility and where earnings are more recurring in nature. Kingdee remains our sector Top Pick due to its new cloud service, which we believe is what future enterprise management systems should be like.

Slowdown in cloud revenue growth, but revenue quality improved. Kingdee's 1H revenue and profit are in line. However, cloud revenue only grew 26% YoY, while *Kingdee Cloud's* increased 43% YoY, ie much lower than in the past. It is mainly as Kingdee's public cloud revenue outpaced that of private cloud, which resulted in a greater difference between the revenues. Public cloud revenue has higher visibility and is more recurring in nature. Management attributed this to the increase in public cloud revenue YoY in 1H18. If it added back deferred revenue to compare cash revenue, the growth would still be above 60%. Overall, Kingdee is still guiding for 60% cloud revenue growth for 2H, which implies 45% growth for the full year. It still expects cloud revenue to account for 60% of total revenue by FY20.

Kingdee Cloud Galaxy – the enterprise system for the future. Kingdee Cloud Galaxy targets very large customers. As mentioned in our 14 Aug report [Heading To a New Era Of Enterprise Services](#), on its recently-launched *Kingdee Galaxy Cloud* service product, we came away impressed by its friendly and flexible interface, all-in-one integration, and powerful management reporting and customisation capabilities. What we like most is that the customisation on *Kingdee Cloud Galaxy* can be done very efficiently. 70% of the customisation can be done without coding, and customisation will not impact other functions. Based on this and our comparative analysis, we believe Kingdee has the best enterprise management cloud product/platform in China. We also think it will be just a matter of time for the product to be very successful.

Growth of traditional enterprise resource planning (ERP) business should be solid this year, before decelerating. We expect its traditional ERP business to continue recording low-teens growth in FY18 and 1H19. From 1H19 onwards, growth should slow down, as we could see more enterprise application suite clients switching to use *Kingdee Galaxy Cloud* instead.

Maintain BUY, with a slightly lower TP of HKD11.40. In our SOP valuation, we use an unchanged 15x P/E for its traditional ERP business, as well as the same 15x price-to-sales ratio for its cloud business. Our TP implies 44x FY18F P/E and 33x FY19 P/E (similar to its past 3-year forward P/E mean of 33x). We cut FY18-19 earnings by 3.2% and 5.7%.

Share Data

Avg Daily Turnover (HKD/USD) 358m/43.7m
 52-wk Price low/high (HKD) 3.12 - 11.1
 Free Float (%) 30
 Shares outstanding (m) 2,807
 Estimated Return 38%

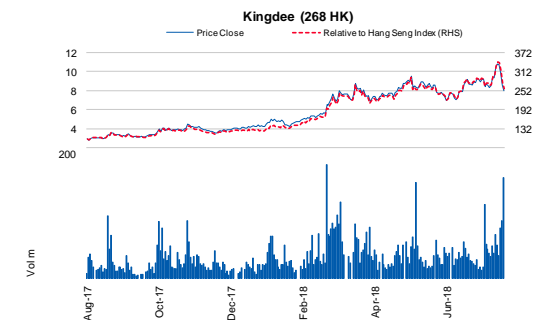
Shareholders (%)

Chairman Xu 27.0
 Oriental Gold 14.5
 JD.com 10.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	88.2	(12.3)	(3.6)	65.6	157.1
Relative	97.6	(7.2)	9.3	78.5	158.2

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	1,862	2,303	2,780	3,390	4,343
Reported net profit (CNYm)	214	310	307	405	563
Recurring net profit (CNYm)	189	260	307	405	563
Recurring net profit growth (%)	(13.0)	37.1	18.1	32.1	39.1
Recurring EPS (CNY)	0.07	0.09	0.11	0.14	0.20
DPS (CNY)	na	na	na	na	na
Recurring P/E (x)	111	79	67	51	36
P/B (x)	6.06	5.12	4.76	4.35	3.88
P/CF (x)	38.7	21.4	49.7	20.1	16.1
Dividend Yield	na	na	na	na	na
EV/EBITDA (x)	28.3	13.2	13.1	11.2	9.3
Return on average equity (%)	6.4	8.3	7.4	9.0	11.3
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			(5.0)	(7.5)	(10.0)

Source: Company data, RHB

Analyst

Yujie Li
 +852 2103 5680
li.yu.jie@rhbgroup.com



Financial Exhibits

Financial model updated on: 2018-08-16.

Asia	
Hong Kong	
Technology	
Kingdee	
Bloomberg	Bloomberg
Buy	Buy

Valuation basis

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

Key drivers

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

Key risks

The upside risk is better-than-expected growth of the cloud business.

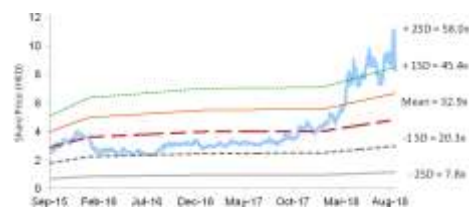
Its downside risks are:

- Bigger-than-estimated expenditure on its cloud business;
- The traditional ERP business faces margin pressure;
- Intensifying competition in the cloud business.

Company Profile

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

Tencent's 3-year forward P/E band



Source: Bloomberg

Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring EPS (CNY)	0.07	0.09	0.11	0.14	0.20
EPS (CNY)	0.07	0.11	0.11	0.14	0.20
BVPS (CNY)	1.20	1.42	1.53	1.68	1.88
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)	111	79	67	51	36
P/E (x)	98.2	66.0	66.8	50.5	36.3
P/B (x)	6.06	5.12	4.76	4.35	3.88
FCF Yield (%)	2.1	5.8	1.5	4.5	5.7
EV/EBITDA (x)	28.3	13.2	13.1	11.2	9.3
EV/EBIT (x)	59.9	24.6	31.4	24.9	18.9

Income statement (CNYm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover	1,862	2,303	2,780	3,390	4,343
Gross profit	1,514	1,876	2,282	2,798	3,590
EBITDA	527	786	892	1,079	1,334
Depreciation and amortisation	(278)	(365)	(521)	(595)	(680)
Operating profit	249	421	371	484	654
Net interest	(22)	(27)	(1)	(2)	(2)
Income from associates & JVs	(18)	(15)	(19)	(22)	(13)
Pre-tax profit	209	378	350	461	639
Taxation	6	(55)	(39)	(51)	(70)
Minority interests	(1)	(14)	(5)	(5)	(5)
Recurring net profit	189	260	307	405	563

Cash flow (CNYm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Change in working capital	103	163	(871)	(105)	(147)
Cash flow from operations	544	956	412	1,018	1,271
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)	(438)	(81)	(108)
Cash at beginning of period	2,401	2,220	2,552	1,990	2,327
Net change in cash	(181)	332	(561)	337	488
Ending balance cash	2,220	2,552	1,990	2,327	2,815

Balance sheet (CNYm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total cash and equivalents	2,220	2,552	1,990	2,327	2,815
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	6,504	7,076	7,918
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	2,174	2,335	2,604
Shareholders' equity	3,476	3,995	4,302	4,707	5,271
Minority interests	60	48	28	34	43
Total equity	3,536	4,043	4,330	4,741	5,314
Net debt	(723)	(1,203)	(642)	(979)	(1,467)
Total liabilities & equity	5,977	6,802	6,504	7,076	7,918

Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Revenue growth (%)	22.8	23.7	20.7	21.9	28.1
Recurrent EPS growth (%)	(16.6)	41.1	18.1	32.1	39.1
Gross margin (%)	81.3	81.5	82.1	82.5	82.7
Operating EBITDA margin (%)	28.3	34.1	32.1	31.8	30.7
Net profit margin (%)	11.5	13.5	11.0	11.9	13.0
Capex/sales (%)	5.7	(10.5)	3.6	2.9	2.3

Source: Company data, RHB

Figure 1: Results review

	1H16	2H16	1H17	2H17	1H18	1H18	1H18	1H18	1H18
	Actual	Actual	Actual	Actual	Actual	YoY	HoH	Consensus	Diff
ERP business	718.3	803.1	771.8	963.4	924.0	19.7%	-4.1%		
Cloud	194.9	145.9	282.8	285.4	355.1	25.6%	24.5%		
Revenue	913.2	949.0	1,054.7	1,248.8	1,279.1	21.3%	2.4%	1,266.0	1.0%
YoY	20.5%	25.1%	15.5%	31.6%	21.3%			20.0%	
Cost of sales	(188.7)	(159.3)	(209.7)	(217.3)	(253.2)	20.8%	16.6%		
Gross profit	724.5	789.7	844.9	1,031.5	1,025.9	21.4%	-0.5%	1,000.1	2.6%
Gross profit margin	79.3%	83.2%	80.1%	82.6%	80.2%			80.9%	
Selling & distribution costs	(471.7)	(530.7)	(523.5)	(712.4)	(645.7)	23.4%	-9.4%		
Administrative expenses	(136.0)	(141.7)	(144.3)	(176.0)	(165.2)	14.5%	-6.1%		
R&D costs	(146.7)	(136.9)	(179.0)	(166.4)	(199.4)	11.4%	19.9%		
Total OPEX	(754.4)	(809.3)	(846.7)	(1,054.7)	(1,010.4)	19.3%	-4.2%		
Total OPEX as % of revenue	-82.6%	-85.3%	-80.3%	-84.5%	-79.0%				
Other income (VAT & others)	132.5	165.8	127.3	318.4	152.0	19.4%	-52.3%		
Operating profit	102.6	146.3	125.5	295.3	167.5	33.4%	-43.3%	174.0	-3.8%
Operating profit margin	11.2%	15.4%	11.9%	23.6%	13.1%			13.7%	
YoY	-21.1%	-30.8%	22.3%	101.8%	33.4%			38.6%	
Finance costs (net)	(17.5)	(4.5)	(14.1)	(13.1)	2.7	-119.5%	-121.0%		
Associates	(1.5)	(16.1)	(1.5)	(13.7)	(0.7)				
Other income (disposal gain)	-	-	-	-	-				
PBT	83.6	125.7	109.9	268.5	169.5	54.2%	-36.9%	147.0	15.3%
Income tax	41.6	(35.7)	(5.2)	(49.6)	(11.1)				
Effective tax rate	-49.8%	28.4%	4.7%	18.5%	6.6%				
MI	(9.6)	10.3	(1.7)	15.3	(11.4)				
Net profit - reported	134.8	79.7	106.4	203.6	169.8	59.5%	-16.6%	131.7	28.9%
Net profit margin	14.8%	8.4%	10.1%	16.3%	13.3%			10.4%	
YoY	47.2%	-36.8%	-21.1%	155.5%	59.5%			23.7%	

Source: RHB

Figure 2: Changes to our forecasts

(CNY m)	FY18F			FY19F			FY20F		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
ERP Business	1,924.4	1,952.2	1.4%	2,068.7	2,040.0	-1.4%	2,203.2	2,064.5	-6.3%
Cloud Service Business	936.8	827.9	-11.6%	1,540.2	1,350.1	-12.3%	2,525.9	2,278.2	-9.8%
Total Revenue	2,861.2	2,780.1	-2.8%	3,608.9	3,390.1	-6.1%	4,729.1	4,342.7	-8.2%
Cost of sales	(512.2)	(498.5)	-2.7%	(638.8)	(592.6)	-7.2%	(827.6)	(752.6)	-9.1%
Gross profit	2,349.1	2,281.6	-2.9%	2,970.1	2,797.5	-5.8%	3,901.5	3,590.1	-8.0%
<i>GPM</i>	82.1%	82.1%		82.3%	82.5%		82.5%	82.7%	
Selling expenses	(1,516.5)	(1,476.2)	-2.7%	(1,847.8)	(1,773.0)	-4.0%	(1,847.8)	(2,214.8)	19.9%
Admin expenses	(383.4)	(372.5)	-2.8%	(472.8)	(444.8)	-5.9%	(472.8)	(547.2)	15.7%
R&D	(434.9)	(453.1)	4.2%	(544.9)	(525.5)	-3.6%	(544.9)	(660.1)	21.1%
Others (VAT)	397.5	391.3	-1.6%	446.8	430.2	-3.7%	485.7	485.9	0.0%
Operating profit	411.8	371.0	-9.9%	551.5	484.5	-12.2%	755.9	653.9	-13.5%
<i>OPM</i>	14.4%	13.3%		15.3%	14.3%		15.3%	15.1%	
Finance costs (net)	(18.6)	(1.4)	-92.5%	(23.5)	(1.7)	-92.8%	(30.7)	(2.2)	-92.9%
Associates	(31.5)	(19.5)		(39.7)	(22.0)		(52.0)	(13.0)	
Other income (disposal gain)	-	-		-	-		-	-	
PBT	361.7	350.2	-3.2%	488.3	460.7	-5.7%	673.2	638.7	-5.1%
Income tax	(39.8)	(38.5)	-3.2%	(53.7)	(50.7)	-5.7%	(74.1)	(70.3)	-5.1%
Effective tax rate	11.0%	11.0%		11.0%	11.0%		11.0%	11.0%	
MI	5.0	5.0	0.0%	5.0	5.0	0.0%	5.0	5.0	0.0%
Net profit - reported	317.0	306.7	-3.2%	429.6	405.0	-5.7%	594.1	563.5	-5.2%
<i>NPM - reported</i>	11.1%	11.0%		11.9%	11.9%		11.9%	13.0%	
Net profit - recurring	317.0	306.7	-3.2%	429.6	405.0	-5.7%	594.1	563.5	-5.2%
<i>NPM - recurring</i>	13.5%	13.4%		14.5%	14.5%		14.5%	15.7%	

Source: RHB

Figure 3: 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	1,952.2	2,040.0	2,064.5
Cloud service business	168.0	340.8	568.2	827.9	1,350.1	2,278.2
Total revenue	1,516.8	1,862.2	2,303.5	2,780.1	3,390.1	4,342.7
YoY	-1.9%	22.8%	23.7%	20.7%	21.9%	28.1%
Cost of sales	(290.2)	(348.0)	(427.0)	(498.5)	(592.6)	(752.6)
Gross profit	1,226.6	1,514.2	1,876.5	2,281.6	2,797.5	3,590.1
YoY	-3.9%	23.4%	23.9%	21.6%	22.6%	28.3%
Gross margin	80.9%	81.3%	81.5%	82.1%	82.5%	82.7%
Selling expenses	(766.3)	(1,002.4)	(1,235.9)	(1,476.2)	(1,773.0)	(2,214.8)
Admin expenses	(202.0)	(277.6)	(320.2)	(372.5)	(444.8)	(547.2)
R&D expenses	(196.4)	(283.6)	(345.3)	(453.1)	(525.5)	(660.1)
Other income	279.4	298.3	445.7	391.3	430.2	485.9
Operating profit	341.4	248.9	420.8	371.0	484.5	653.9
YoY	13.8%	-27.1%	69.0%	-11.8%	30.6%	35.0%
Operating margin	22.5%	13.4%	18.3%	13.3%	14.3%	15.1%
Finance costs (net)	(59.5)	(22.0)	(27.1)	(1.4)	(1.7)	(2.2)
Associates	(2.2)	(17.6)	(15.2)	(19.5)	(22.0)	(13.0)
Other income (disposal gain)	-	-	-	-	-	-
PBT	279.7	209.3	378.4	350.2	460.7	638.7
Income tax	(62.3)	5.9	(54.8)	(38.5)	(50.7)	(70.3)
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	311.7	410.0	568.5
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	306.7	405.0	563.5
YoY	-46.3%	172.5%	7.6%	-1.1%	32.1%	39.1%
Net profit margin - reported	7.0%	15.5%	13.5%	11.0%	11.9%	13.0%
Net profit - recurring	217.7	189.5	259.8	306.7	405.0	563.5
YoY	10.5%	-13.0%	37.1%	18.1%	32.1%	39.1%
Net profit margin - recurring	14.4%	10.2%	11.3%	11.0%	11.9%	13.0%

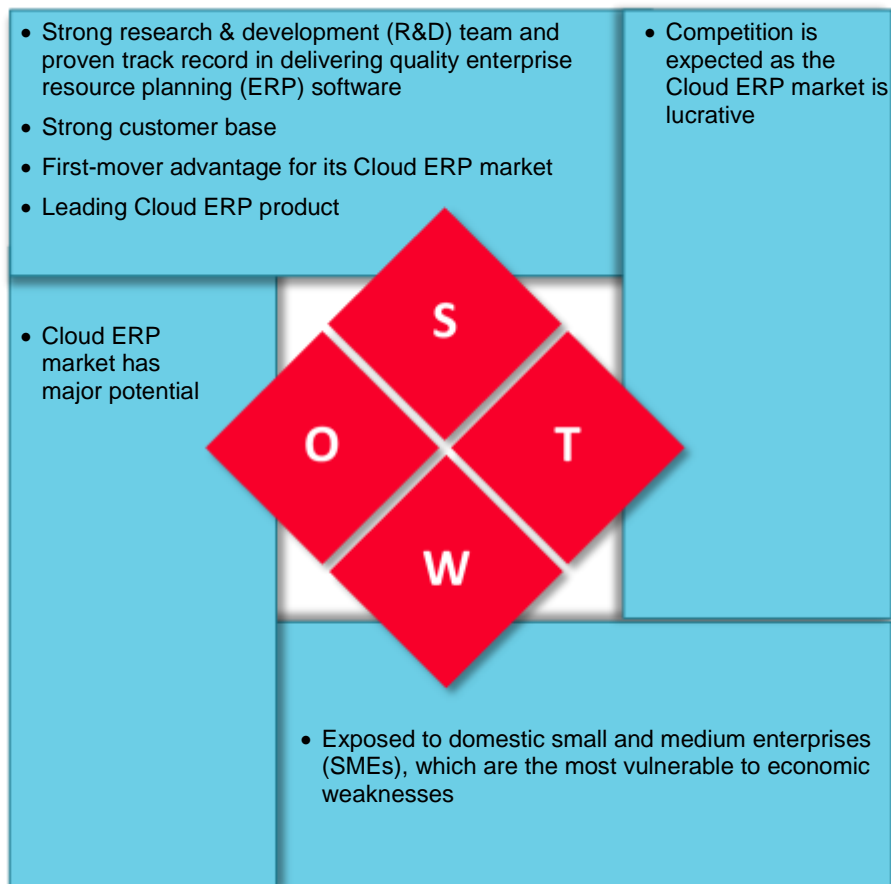
Source: RHB

Figure 4: SOP valuation

	FY19F profit (CNYm)	Multiple (x)	NAV (CNYm)	NAV (HKDm)	Kingdee's Stake	NAV/share (HKD)	Target Discount	TP (HKD)
ERP Business	398	15	5,967	6,862	100%	2.38	0%	2.38
	FY19F revenue (CNYm)	Price to sales (x)	NAV (CNYm)	NAV (HKDm)	Kingdee's Stake	NAV/share (HKD)	Target Discount	TP (HKD)
Cloud Business	1,350	15	20,252	23,289	100%	8.07	0%	8.07
	Net Cash Balance (CNYm)		NAV (CNYm)	NAV (HKDm)				
Net Cash as of end-FY17	2,449		2,449	2,817		0.95	0%	0.95
Total								11.40

Source: RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-08-14	Buy	12.2	10.1
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

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

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Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated: Stock is not within regular research coverage

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RHB Research Institute Sdn Bhd Level 3A, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur 50400 Malaysia Tel : +(60) 3 9280 8888 Fax : +(60) 3 9200 2216	RHB Securities Hong Kong Ltd. 12 th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	RHB Research Institute Singapore Pte Ltd. 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211
Jakarta	Shanghai	Bangkok
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