

7 May 2018

Technology | Software & Services

Kingdee

Buy (Maintained)

Target Price: HKD10.63

Price: HKD7.79

Market Cap: USD3,249m

Bloomberg Ticker: 268 HK

Next Generation Of Cloud ERP Is Almost Ready

Maintain BUY, with a SOP-based TP of HKD10.63, offering a 36% upside. We attended Kingdee's product demonstration in Shenzhen last Friday, which targeted existing and potential customers as its key audience while showcasing many of the new functions and interfaces of its next generation Cloud ERP products. We also had the opportunity to talk to management, employees and customers. We like its new Cloud ERP offerings for its user-friendly interface, high level of staff involvement in day-to-day operations, useful features that facilitate business monitoring and decision making, real-time reporting of business and financial data, as well as its AI elements that improve efficiency. These new offerings are expected to be included in its next generation of Cloud ERP to be launched in 2H18, and we believe it would help the company gain more market share, especially from the mid-to-large customer segment. With more understanding of its product strategy, we are even more confident that the company will become the long-term winner and leader of China's large SaaS market. We suggest investors accumulate the stock during the market weakness, as uncertainties this year would likely create a good entry point.

We find the new product offerings to be very compelling in many aspects due to the following:

- User-friendly interface.** The new product features different interfaces for different users with different roles and responsibilities to enable handy operations of the system. We think the user-friendly interface can increase user acceptance and engagement besides saving the cost of customer service for Kingdee. We learnt from one employee at the site that 60% of the enquiries from traditional enterprise resource planning (ERP) users to its customers service team relate to how the product works;
- High level of staff involvement.** The new product emphasises on getting every employee – not just those in the finance department – in the organisation involved. This is done by helping them understand their respective roles in achieving the company's overall business and financial goals, and how that would reflect in their daily work. This also ensures all the relevant data entered into the system in a timely manner;
- Facilitating real-time business monitoring and decision-making.** We saw a very impactful demonstration of how Kingdee makes business monitoring, financial forecasting and daily management reporting possible and more efficient. For example, the system can access and leverage data from various functions to project cash flow for the next eight weeks on a rolling basis. And with a few more clicks, it showed the operational status of each team, office, and employee;
- Artificial intelligence (AI) element** such as using voice-based human machine interaction to increase efficiency in operating the system.

Key messages from investor meeting. Kingdee's president Mr Sun Yanfei and CFO Mr Bo Lin also had a brief Q&A session with investors and analysts. Here are the key takeaways:

- Management sees new trends in cloud ERP and enterprise application; while everyone in the organisation should be involved, with the finance aspect being present in every process of the business. Kingdee thinks this can only be realised by leveraging on the flexibility and mobility of the cloud application. This is why it built the next generation of cloud ERP to incorporate its understanding of what future cloud ERP and enterprise applications should be like;
- Kingdee is still quite confident in achieving a revenue CAGR of 60% for its cloud business until 2020;
- Kingdee is now using multiple vendors for IaaS (infrastructure as a service) to mitigate risks (such as from trade wars) and to optimise costs. Current vendors for IaaS include Amazon Web Services (AWS), Huawei Cloud, JD Cloud, and Kingsoft Cloud;
- Around 50% of Kingdee's Cloud ERP is sold through third parties. In general, it serves larger customers directly and uses third-party agents for its small- and micro-enterprise clients. It sees fast growth from third party indirect sales of Cloud ERP YTD. It might also use a hybrid cloud (a combination of private cloud and public cloud) to serve large customers – subscription fees for large customers average CNY500,000 pa, and the company expects this figure to increase over time, as its customers add more functions.

Maintain BUY, as our SOP valuation is based on its on-premises ERP business' 15x FY19F P/E and its cloud wing at a FY19F price-to-sales of 12x. Our HKD10.63 TP also implies 45x FY19F P/E. Kingdee deserves such a valuation, in our view, as it continues to roll out new initiatives that propel China's cloud ERP and software as a service (SaaS) market.

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)	96.5	68.4	56.1	41.4	29.9
P/B (x)	5.26	4.45	4.12	3.75	3.33
P/CF (x)	33.6	18.6	42.4	17.0	13.7
Dividend Yield	na	na	na	na	na
EV/EBITDA (x)	23.7	10.4	10.2	8.6	7.0
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) (%)			(5.1)	(4.9)	(8.8)

Source: Company data, RHB

Analyst

Yujie Li

+852 2103 5680

li.yu.jie@rhbgroup.com



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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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