

## Kingdee (268 HK)

**Buy** (maintained)

Target price: HK\$3.41



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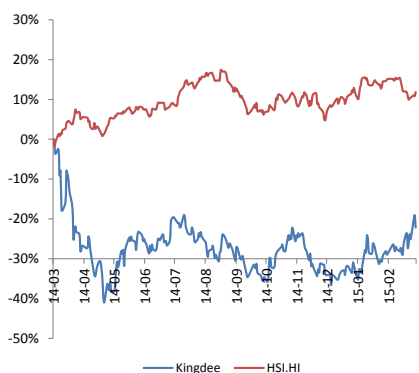
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### Stock performance



Source: Bloomberg

### Key data

Mar 20 close (HK\$)	2.95
Shares in issue (m)	2,577
Major shareholder	Xu Shaochun 30.69%
Market cap (HK\$ bn)	7.60
3M avg. vol. (m)	11.9
52W high/low (HK\$)	3.52 / 2.08

Source: Bloomberg

Strong earnings growth on improving profitability and upbeat outlook; raise TP to HK\$3.41

**FY14 results missed on a decline in government grants** FY14 net profit increased by 56% YoY to Rmb197m, below consensus of Rmb230m and our estimate, mainly due to a decrease of Rmb50m in government grants. FY14 revenue declined by just 3% to Rmb1,547m (in line), mainly due to the short-term impact of its indirect sales strategy.

**Margin expansion amid transition to indirect sales** Net margin rose 4.8pp to 12.7% in FY14 on a significant improvement in gross margin from 75.3% in FY13 to 82.5% in FY14. This was mainly thanks to the significant progress in its business transition from direct sales to high-margin indirect sales. Both its KIS and K/3 product lines have already fully transferred to third party distribution channels. Revenue contribution from indirect sales channels surged to 35% in FY14 from 28% in FY13. With this indirect sales strategy, the company has quit part of its labor intensive implementation service business and is now offering price discounts to partners to distribute software licenses. Implementation revenue therefore decreased, coming in down 23% YoY, and revenue from software license and maintenance services was flat, while software shipments saw double-digit growth. The revenue contribution from its low margin implementation segment declined from 27% in FY13 to 21% in FY14.

**Strong growth momentum in cloud services** Cloud service revenue posted a significant increase of 87% YoY to Rmb106m in FY14 from Rmb57m in FY13. The company now has a clearer strategy for its cloud business with four types of cloud service: mobile office cloud, finance cloud, ERP cloud and industry cloud. The company may begin to cooperate with a leading international cloud services provider in 2Q15. Revenue contribution from cloud services rose from 3.6% in FY13 to 6.9% in FY14. Management has given guidance for a 30% revenue contribution from its cloud services business by 2017.

**Upbeat outlook** FY14 results were in line with our estimates, apart from the change in non-core government grants. Management has said that government grants should be higher in FY15. With the completion of its sales channel transition, the company expects to regain stable growth in its ERP business, mainly driven by strong demand for ERP software from Chinese companies. The guidance of 30% revenue contribution from cloud services suggests the company expects a strong cloud services revenue CAGR of 100% in FY14-17. Net margin should continue to expand thanks to improvements in operating efficiency and economies of scale over the next two years. Meanwhile, management also stated that they aim to sell their software park property in Beijing this year (estimated CMV of Rmb1.92bn), which should further improve its balance sheet and lower financing costs.

**Maintain Buy and raise target price to HK\$3.41** We maintain our Buy rating on a positive outlook given healthy growth in its ERP business and strong momentum in cloud services, as well as the benefits from the likely disposal of the Beijing software park. We see further re-rating given its shift in focus to cloud services. We raise our SOTP-based target price from HK\$2.90 to HK\$3.41, representing a higher 17x 2015E P/E (up from 14x) for its core software business, after stripping out property items. Key risks include increasing staff costs, slow progress in cloud product promotion and property disposal delays.

### Stock valuation

	Turnover (Rmb m)	YoY (%)	Net profit (Rmb m)	* Adjusted net profit (Rmb m)	EPS (Rmb cents)	YoY (%)	P/E	P/B	ROE (%)	Net gearing (%)
2013	1,602	-9	126	92	4.8	N/A	49.4	3.6	7.2	32.9
2014	1,547	-3	197	143	7.4	53	32.3	3.2	9.9	15.9
2015E	1,886	22	298	245	11.1	51	21.4	2.8	13.3	1.3
2016E	2,329	24	392	338	14.6	31	16.3	2.5	15.1	cash
2017E	3,018	30	526	473	19.7	34	12.1	2.1	17.3	cash

Sources: Company data, GF Securities (HK)

Note: Calculated based on diluted shares; \* excluding gains from property

Figure 1: FY14 and 2H14 results summary

Rmb m	2012	2013	2014	Our estimates	YoY	1H13	2H13	1H14	2H14	YoY
<b>Turnover</b>	1765	1602	1547	1572	-3%	745	857	750	797	-7%
YoY (%)	(13)	(9)	(3)	(2)		(4)	(13)	1	(7)	
Cost of sales	(619)	(396)	(271)	(330)		(189)	(207)	(144)	(127)	
<b>Gross profit</b>	1147	1206	1276	1242	6%	556	650	606	670	3%
Gross margin (%)	65	75	82	79	7	75	76	81	84	8
Selling & marketing exp.	(1154)	(828)	(784)	(770)	-5%	(434)	(393)	(382)	(403)	2%
Admin exp.	(217)	(205)	(202)	(173)	-1%	(84)	(121)	(73)	(129)	7%
R&D costs	(200)	(233)	(223)	(220)	-4%	(126)	(106)	(112)	(111)	4%
Fair value on inv properties	61	1	5	0		0	1	0	5	
Other gains	260	297	230	282	-23%	150	147	98	132	-10%
<b>Operating profit</b>	(103)	239	300	360	26%	61	177	137	163	-8%
operating margin (%)	(6)	15	19	23	5	8	21	18	20	(0)
Finance income	7	9	24	8	171%	4	5	3	21	316%
Finance costs	(66)	(111)	(97)	(90)	-12%	(56)	(55)	(54)	(44)	-20%
Share in associates	0	(0)	(1)	0		0	(0)	0	(1)	
<b>Pre-tax income</b>	(162)	137	226	278	65%	9	127	87	139	9%
Taxation	(2)	(17)	(25)	(28)		(6)	(11)	(6)	(20)	
Taxiation rate (%)	(1)	13	11	10		68	9	7	14	
<b>Net profit</b>	(140)	126	197	250	56%	9	116	81	116	-1%
Net margin (%)	(8)	8	13	16	5	1	14	11	15	1
<b>Diluted EPS (Rmb cents)</b>	(6)	5	7	9	53%	0.3	5	3	4	-6%

Sources: Company data, GF Securities (HK)

Figure 2: Revenue breakdown by business (Rmb m)

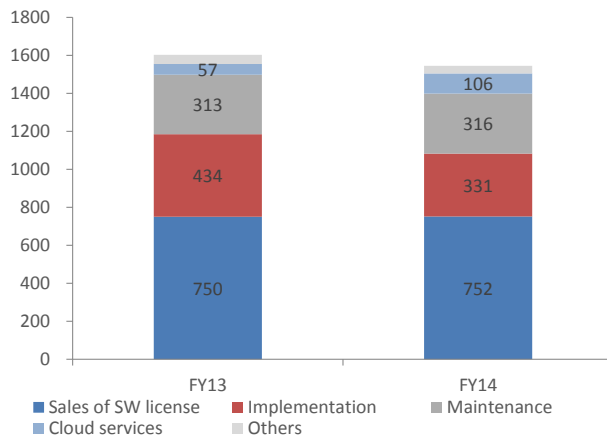
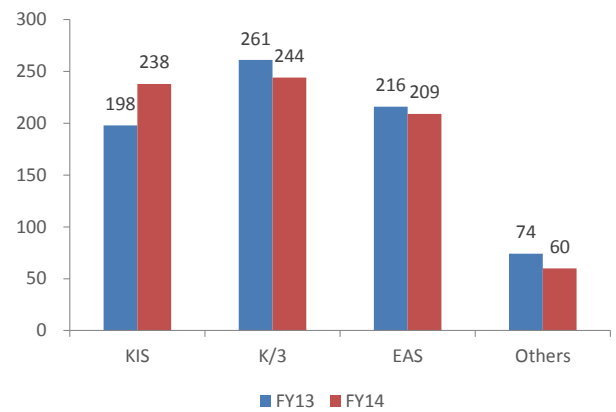


Figure 3: Software sales by segment (Rmb m)



Sources: Company data, GF Securities (HK)

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Figure 4: Revenue and gross margin forecasts

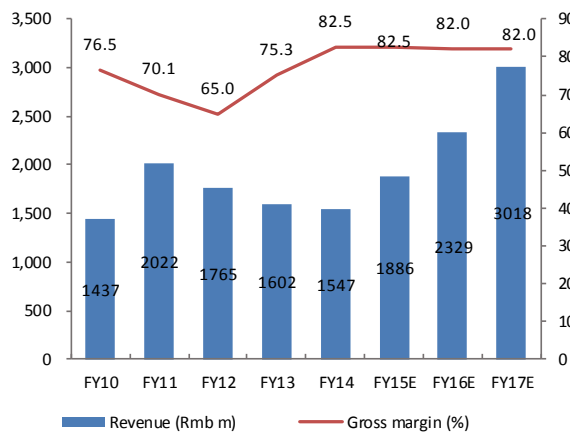
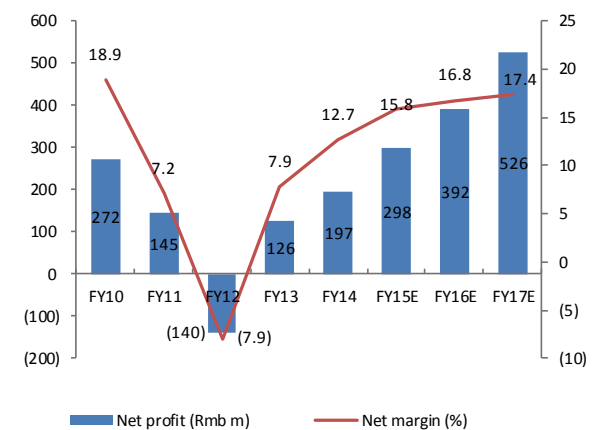


Figure 5: Net profit and net margin forecasts



Sources: Company data, GF Securities (HK)

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**Figure 6: Sum-of-the-parts valuation table**

Sum-of-the-parts	Valuation (Rmb bn)	Per share value (HK\$)	% of total	Remarks
Shenzhen software park	1.2	0.6	16%	60,000 sq m @ Rmb20,000 per sq m; completed in 2009 (Nanshan district)
Shanghai software park	0.4	0.2	5%	27,000 sq m @ Rmb15,000 per sq m; completed in 2008 (Zhangjiang district)
Beijing software park	1.9	0.9	26%	160,000 sq m @ Rmb12,000 per sq m; completed in 2013 (Shunyi district)
Software business	4.2	1.9	56%	Implying 2015 PER of 17x for core software business
<b>Subtotal</b>	<b>7.7</b>	<b>3.6</b>	104%	
Less debt*	(1.8)	(0.9)	-25%	
Add cash*	1.5	0.7	21%	
<b>Valuation</b>	<b>7.4</b>	<b>3.41</b>		

Sources: Company data, GF Securities (HK)

Figure 7: Financial statements

Income Statement						Balance Sheet					
Year end Dec (Rmb m)	2013	2014	2015E	2016E	2017E	Year end Dec (Rmb m)	2013	2014	2015E	2016E	2017E
Software license	750	752	920	1,116	1,344	Cash/ST Investments	999	1,521	1,808	2,058	2,690
Implementation	433	331	365	383	402	Account receivables	573	546	694	773	880
Maintenance	313	316	348	366	384	Inventory	4	4	6	7	9
Cloud service	57	106	212	424	848	Other Current Assets	4	33	4	4	4
Others	49	41	41	41	41	<b>Total current assets</b>	<b>1,580</b>	<b>2,103</b>	<b>2,512</b>	<b>2,842</b>	<b>3,583</b>
<b>Turnover</b>	<b>1,602</b>	<b>1,547</b>	<b>1,886</b>	<b>2,329</b>	<b>3,018</b>	Prop, plant & equipment	760	728	746	775	799
YoY (%)	(9)	(3)	22	24	30	Intangible assets	598	577	571	608	582
Cost of sales	(396)	(271)	(330)	(419)	(543)	Other LT Assets	990	985	985	985	985
<b>Gross profit</b>	<b>1,206</b>	<b>1,276</b>	<b>1,556</b>	<b>1,910</b>	<b>2,475</b>	<b>Total non-current assets</b>	<b>2,348</b>	<b>2,290</b>	<b>2,302</b>	<b>2,368</b>	<b>2,366</b>
Selling & marketing exp.	(828)	(784)	(933)	(1,141)	(1,479)	<b>Total Assets</b>	<b>3,928</b>	<b>4,393</b>	<b>4,814</b>	<b>5,210</b>	<b>5,949</b>
Admin exp.	(205)	(202)	(226)	(268)	(332)	ST Debt	420	546	546	546	546
R&D costs	(233)	(223)	(264)	(326)	(407)	Trade payables	435	384	546	602	886
Fair value on inv properties	1	5	-	-	-	Other Current Liabilities	96	96	96	96	96
Other gains	297	230	261	310	372	<b>Total current liabilities</b>	<b>952</b>	<b>1,029</b>	<b>1,188</b>	<b>1,244</b>	<b>1,528</b>
<b>Operating profit</b>	<b>239</b>	<b>300</b>	<b>393</b>	<b>484</b>	<b>628</b>	LT Debt	1,155	1,291	1,291	1,291	1,291
Finance income	9	24	25	29	36	Other LT Liab	66	74	74	74	74
Finance costs	(111)	(97)	(83)	(73)	(73)	<b>Total non-current liabilities</b>	<b>1,221</b>	<b>1,366</b>	<b>1,366</b>	<b>1,366</b>	<b>1,366</b>
Share in associates	(0)	(1)	-	-	-	Minority Interests	4	9	9	9	9
<b>Pre-tax income</b>	<b>137</b>	<b>226</b>	<b>335</b>	<b>440</b>	<b>591</b>	<b>Shareholders' Equity</b>	<b>1,750</b>	<b>1,989</b>	<b>2,250</b>	<b>2,591</b>	<b>3,047</b>
Taxation	(17)	(25)	(37)	(48)	(65)	<b>Total Equity &amp; liabilities</b>	<b>3,928</b>	<b>4,393</b>	<b>4,814</b>	<b>5,210</b>	<b>5,949</b>
MI	(7)	3	-	-	-	<b>BPS (Rmb)</b>	<b>0.67</b>	<b>0.74</b>	<b>0.84</b>	<b>0.97</b>	<b>1.14</b>
<b>Net profit</b>	<b>126</b>	<b>197</b>	<b>298</b>	<b>392</b>	<b>526</b>	YoY (%)	6	11	13	15	18
YoY (%)	n/a	56	51	31	34						
<b>Adjusted net profit</b>	<b>92</b>	<b>143</b>	<b>245</b>	<b>338</b>	<b>473</b>						
YoY (%)	n/a	56	71	38	40						
<b>EPS (Rmb cents)</b>	<b>4.8</b>	<b>7.4</b>	<b>11.1</b>	<b>14.6</b>	<b>19.7</b>						
YoY (%)	n/a	53	51	31	34						

Cash Flow Statement						Financial Ratio					
Year end Dec (Rmb m)	2013	2014	2015E	2016E	2017E	Year end Dec	2013	2014	2015E	2016E	2017E
<b>Pretax profit</b>	<b>137</b>	<b>226</b>	<b>335</b>	<b>440</b>	<b>591</b>	<b>Margins</b>					
Tax Paid	(1)	(5)	(37)	(48)	(65)	Gross margin (%)	75.3	82.5	82.5	82.0	82.0
Depr/Amort	294	341	369	429	498	EBITDA margin (%)	33.0	41.4	40.4	39.2	37.3
Change in working capital	(8)	(25)	12	(24)	174	Operating margin (%)	14.9	19.4	20.8	20.8	20.8
Others	(7)	(31)	(4)	(16)	(16)	Net margin (%)	7.9	12.7	15.8	16.8	17.4
<b>Operational cash flow</b>	<b>415</b>	<b>507</b>	<b>675</b>	<b>781</b>	<b>1,182</b>	<b>Returns and profitability</b>					
Capex	(339)	(278)	(380)	(480)	(480)	ROE (%)	7.2	9.9	13.3	15.1	17.3
Assoc, MI, Invsmt	11	6	29	-	-	ROA (%)	3.2	4.7	6.5	7.8	9.4
<b>Investment cash flow</b>	<b>(328)</b>	<b>(272)</b>	<b>(351)</b>	<b>(480)</b>	<b>(480)</b>	<b>Working capital</b>					
Net Change in Debt	(17)	273	-	-	-	Receivables (days)	138.1	132.0	120.0	115.0	100.0
New Capital	16	13	-	-	-	Inventory (days)	3.6	5.3	5.3	5.3	5.3
Dividend	-	(30)	(37)	(51)	(71)	Payable (days)	119.2	96.6	90.0	90.0	90.0
Others	0	31	-	-	-	<b>Financial health</b>					
<b>Financing cash flow</b>	<b>(1)</b>	<b>287</b>	<b>(37)</b>	<b>(51)</b>	<b>(71)</b>	Current ratio (x)	1.7	2.0	2.1	2.3	2.3
FX and others	-	-	(0)	(0)	(0)	Net gearing (%)	32.9	15.9	1.3	cash	cash
Chg in Cash	86	522	287	250	632	<b>Others</b>					
Beginning cash	913	999	1,521	1,808	2,058	Dividend payout ratio(%)	-	15.2	15.0	15.0	15.0
<b>Ending cash</b>	<b>999</b>	<b>1,521</b>	<b>1,808</b>	<b>2,058</b>	<b>2,690</b>	Effective tax ratio(%)	12.6	11.3	11.0	11.0	11.0

Sources: Company data, GF Securities (HK)

## Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

### Company ratings

<b>Buy</b>	Stock expected to outperform benchmark by more than 15%
<b>Accumulate</b>	Stock expected to outperform benchmark by more than 5% but not more than 15%
<b>Hold</b>	Expected stock relative performance ranges between -5% and 5%
<b>Underperform</b>	Stock expected to underperform benchmark by more than 5%

### Sector ratings

<b>Positive</b>	Sector expected to outperform benchmark by more than 10%
<b>Neutral</b>	Expected sector relative performance ranges between -10% and 10%
<b>Cautious</b>	Sector expected to underperform benchmark by more than 10%

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