

24 September 2014

KINGDEE INT'L (268.HK)

Cost reduced, positive core profit expected

HONG KONG | SOFTWARE | COMPANY UPDATES

- Kingdee's 1H14 total revenue was slightly up 0.7% while gross profit rose 9% yoy. GPM increased from 74.7% last year to 80.9%. With sharply reduced operating expenses, profit attributable to stakeholders surged 846% yoy. Diluted EPS soared to RMB 2.97 cents.
- Revenue from cloud business surged 124% yoy, accounted for 5.4% of the total revenue.
- After further shifting the business to indirect sales channel, both the cost and expenses recorded significant drop yoy as well as to percentage to revenue.
- We upgrade Kingdee's rating to "BUY" with target price HK\$ 3.05, equivalent to 19.3x/18x of 2014 and 2015 forecasted EPS, plus HK\$ 0.35 net cash per share.

Financial Highlights

Kingdee announced its encouraging 1H14 result. Total revenue just slightly up 0.7% yoy to RMB 750 mn while gross profit up 9% yoy to RMB 606 mn. GPM was 80.9%, increased from 74.7% last year. Profit attributable to stakeholders surged 846% yoy to RMB 81.5 mn (2013: RMB 8.6 mn), meaning that the operating expenses had sharply reduced. Diluted EPS soared to RMB 2.97 cents (2013: RMB 0.332 cents).

How we view this

Mentioned in the last report, Kingdee obtained stable growth during these years but the cost and expenses were out of control. After further shifting its software sales business to indirect sales channel, it was able to reduce the cost, by cutting unnecessary headcount or administration expenses, thus improved both the GPM and NPM. We expect this will still be the case in the next few years, which the proportion of indirect sales revenue to total will continue to increase.

Investment Action

According to IDC, Kingdee was the largest application software provider for SMEs in mainland China, in 10 consecutive years. The good reputation will help in capturing SMEs' cloud business. Meanwhile, the PRC government is now promoting local software and servers, we believe more and more large company will turn to collaborate with Kingdee in enterprise software.

We upgrade Kingdee's rating to "BUY" with target price HK\$ 3.05, equivalent to 19.3x/18x of 2014 and 2015 forecasted EPS, plus HK\$ 0.35 net cash per share.

Key Financial Summary

FYE Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenue (RMB mn)	1,765	1,602	1,635	1,780	1,896
Net Profit (RMB mn)	(140)	127	290	310	314
EPS (HKD)	(0.07)	0.06	0.14	0.15	0.15
P/E (X)	(35.6)	39.6	17.6	16.4	16.2
BVPS (HKD)	0.78	0.86	0.99	1.14	1.29
P/B (X)	3.1	2.9	2.5	2.2	1.9
DPS (HKD)	0.00	0.00	0.00	0.00	0.02
Div. Yield (%)	0.0%	0.0%	0.0%	0.0%	0.9%

Source: PSR est.

*All multiples & yields based on current market price

Rating:

Buy

Upgraded to Buy

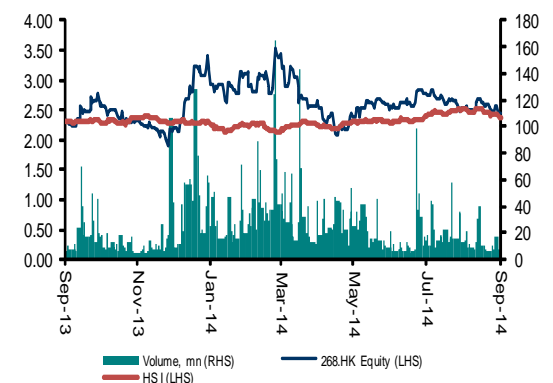
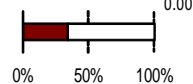
Target Price (HKD)	3.05
Forecast Dividend (HKD)	0.00
Closing Price (HKD)	2.46
Potential Upside	33.6%

Company Description

Kingdee International, founded in 1993, was a software and Internet service provider that served over one million SMEs in China and the Asia Pacific region. Its enterprise resource planning (ERP) software was ranked as No. 1 in the SME market in China.

Company Data

Raw Beta (Past 2yrs weekly data)	N/A
Market Cap. (HKD bn)	6,314
Enterprise Value (HKD mn)	7,004
52 week range (HKD)	1.80 - 3.69
Closing Price in 52 week range	0.00



Major Shareholders

1. Xu Shao Chun	30.29%
2. Templeton Investment Counsel, LLC	5.02%
3. FIL Limited	5.01%
4. FMR LLC	5.01%

Valuation Method

PE

Analyst

Kay Ng

kayng@phillip.com.hk

+852 2277 6751

Fig 1 1H14 financial highlights

RMB mn	1H14	1H13	% change
Revenue	750	745	0.68%
Software	396	366	8.36%
Implementation	139	167	-17.26%
Consulting	188	184	2.27%
Computers	27	28	-2.94%
Gross Profit	606	556	9.03%
GPM	80.85%	74.66%	8.30%
Profit attributable	81	9	845.64%
NPM	10.86%	1.16%	839.29%
EPS, diluted (cents)	2.970	0.332	794.58%

Source: Company report

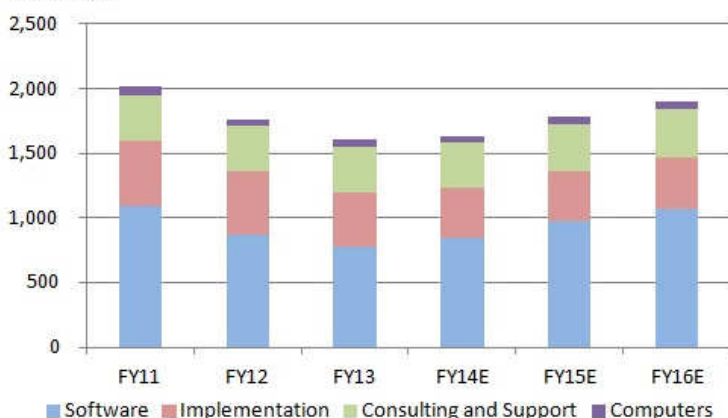
Revenue growth flat, software still the major source of income

The revenue growth of Kingdee missed our estimates, especially for solution implementation, which suffered -17% of negative growth. We thus cut the forecasted 2014 implementation revenue down 23% to RMB 380 mn, in believing the down trend to continue and slightly adjusted down 2.6% of the software revenue. Both 2015 and 2016 estimates have downward amendments.

Fig 2 Revenue mix estimates

RMB mn	FY11	FY12	FY13	FY14E	FY15E	FY16E
Software	1,088	874	770	847	974	1,071
Implementation	509	487	431	380	388	396
Consulting	347	354	352	360	368	377
Computers	79	51	48	48	50	52
	2,022	1,765	1,602	1,635	1,780	1,896

(RMB Mn)



Source: PSR, Company report

According to the company financial report, the SME ERP business obtained stable growth, which revenue from KIS software grew 29.6% yoy. However, for the LME business, EAS's revenue dropped 10.5% yoy that pullback the total growth on software section.

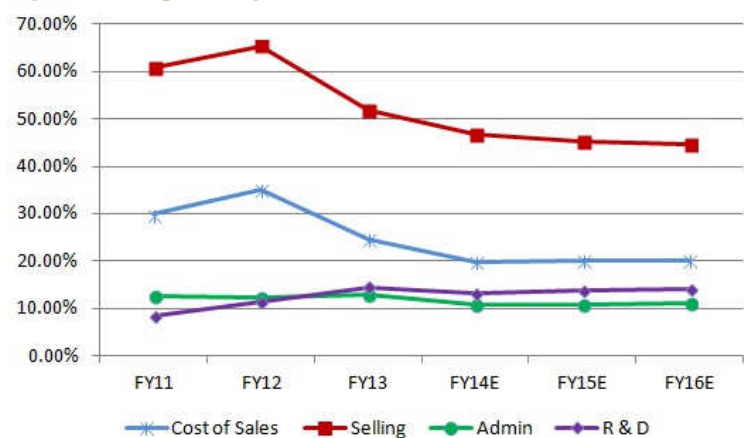
On the other hand, revenue from newly developed cloud business surged 124% yoy, accounted for 5.4% of total revenue, which the K/3 Cloud obtained nearly 3 times yearly growth. We believed instead of one time software sales revenue, the cloud business may be able to generate future revenue series from administration services or maintenance fee.

Cost reduced, brought the company sharp increase in profit

In 1H14, cost of sales decreased 24% yoy to RMB 144 mn that pushed up the GPM for 6.2 percentage points to 80.9%. At the same time, selling, administration and R&D expenses all reduced 12%, 14% and 11% on yoy respectively.

Actually, the ever increasing cost and expense had been a major challenge of Kingdee in these years. The company started to shift the software distribution channel from direct sales to indirect last year, which showed the effectiveness to cost control. In 1H14 it had further shifted to indirect sales channel, which sharply reduced the cost, by cutting unnecessary headcount or administration expenses, and thus improved both the GPM and NPM. We expect this will still be the case in the next few years, which the proportion of indirect sales revenue to total will continue to increase.

Fig 3 Costs as percentage of revenue estimates



Source: PSR, Company report

Valuation

According to IDC, Kingdee was the largest application software provider for SMEs in mainland China, for 10 consecutive years. We believe the good reputation on ERP software launching will help the company to capture SMEs' attention also in the newly developed cloud business. Meanwhile, although there was revenue drop on the LME service, with the state policy to promote local software and servers, we believe more and more large company will try on using Kingdee's service due to its goodwill on SME market.

Potential Risks

The growth on cloud business slows down;
 Cost and expenses rebound.

	FY12	FY13	FY14E	FY15E	FY16E
Valuation Ratios					
P/E (X)	(35.6)	39.6	17.6	16.4	16.2
P/B (X)	3.1	2.9	2.5	2.2	1.9
EV/EBITDA (X)	(68.0)	29.4	16.4	15.9	16.3
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.9%
Per share data (HKD)					
EPS	(0.07)	0.06	0.14	0.15	0.15
DPS	0.00	0.00	0.00	0.00	0.02
BVPS	0.78	0.86	0.99	1.14	1.29
Outstanding Shares (basic, mn)	2,516.34	2,523.74	2,566.65	2,566.65	2,566.65
Growth & Margins (%)					
Growth					
Revenue	-12.7%	-9.3%	2.1%	8.9%	6.5%
EBIT	-154.1%	-331.8%	79.0%	3.0%	-2.5%
Margins					
Gross profit margin	65.0%	75.3%	80.1%	79.9%	79.8%
EBT margin	-9.2%	8.5%	20.4%	20.1%	18.9%
Net Profit Margin	-7.9%	7.9%	17.7%	17.4%	16.6%
Key Ratios					
ROE (%)	-8.8%	7.2%	14.2%	13.2%	11.8%
ROA (%)	-3.5%	3.2%	6.9%	6.8%	6.5%
Income Statement (RMB mn)					
Revenue	1,765	1,602	1,635	1,780	1,896
Cost of revenue	(619)	(396)	(325)	(358)	(383)
Gross profit	1,147	1,206	1,310	1,422	1,513
Selling & Marketing expenses	(1,154)	(828)	(765)	(805)	(844)
Administrative expenses	(217)	(205)	(175)	(195)	(209)
R & D expenses	(200)	(233)	(218)	(247)	(266)
Other income, net	260	297	280	280	270
Fair value adjustments on investment propertie	61	1	(5)	(15)	(35)
Operating profit	(103)	239	427	440	429
Finance income	7	9	11	13	16
Finance expense	(66)	(111)	(105)	(95)	(86)
Associates & JV's	0	0	0	0	0
EBT	(162)	137	333	358	359
Taxation	(2)	(17)	(22)	(25)	(25)
Profit After Tax	(164)	120	311	333	334
Minority interest	24	7	(21)	(23)	(20)
Net Profit	(140)	127	290	310	314
EPS	(0.056)	0.050	0.113	0.121	0.122

Source: Company, PSR

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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2014 Phillip Securities (Hong Kong) Limited

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
JI Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005