

Yonyou (600588 CH)

Software localization adds uncertainty to cloud strategy

Yonyou reported in-line revenue growth of +17% YoY to RMB2.06bn in FY3Q22. However, net loss widened unexpectedly to RMB284mn mainly due to margin erosion. Yonyou delivered slowest cloud revenue growth of +22% YoY since the company adopted cloud-focus strategy in 2019. Meanwhile, license-based software business from large-sized enterprises was up +19% YoY. This could imply large-sized enterprises are less willing to adopt cloud model and increasing customization may drag Yonyou's margin further. Maintain HOLD.

- **FY3Q22 miss on margin.** Yonyou delivered in-line revenue growth of +17% YoY to RMB2,059mn. Net loss widened to RMB284mn (vs. -RMB88mn in 3Q21) mainly dragged by 1) GPM erosion (-8.2 ppts YoY to 49.9%) and 2) higher opex (+22% YoY to RMB1,394mn). Company attributed the bottom-line miss to the strategic expansion in sales/R&D workforce given increasing software localization demand. Yonyou has 25,276 staff (+23% YoY) in 3Q22. However, we observed that revenue generated per employee has declined for 6 consecutive quarters.
- **Revenue mix change suggest uncertainty in cloud migration strategy.** Yonyou delivered the slowest cloud revenue growth of +22% YoY to RMB1,247mn in 3Q22 (vs. +57% YoY in 2Q22) since the company launched cloud-focus strategy in 2019. Meanwhile, revenue from Software recorded unexpected YoY growth of +15% YoY to RMB795mn (was in declining trend since 2019) as revenue from large-sized enterprise was up +19% YoY. Cloud revenue contribution thus dropped to 61% in 3Q22 (vs. 69% in 2Q22). This could imply large-sized enterprises are unwilling to adopt cloud model.
- **Software localization demand from SOEs benefits top-line but not margin.** In FY3Q22, Yonyou recorded -8.2 ppts YoY in GPM. We believe Xinchuang demand from large-sized enterprises (mostly SOEs) will benefit Yonyou's top line growth. However, as these SOEs have higher requirement in software customization, a continue change in revenue mix will likely drag Yonyou's margin further. According to management, 95% of the sizable orders came from SOEs in 3Q22.
- **Maintain HOLD.** We cut FY22/23E net profit by 22/13% mainly to reflect a lower margin. Maintain HOLD with new target price of RMB23.51 (prior RMB19.81), based on higher 6.0x (prior 5.0x) FY23E EV/sales. We raised our target multiple considering the software localization trend and hence demand for Yonyou's ERP is solidified after the 20th Party Congress.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	8,525	8,932	10,390	12,667	15,011
YoY growth (%)	0%	5%	16%	22%	19%
Net profit (RMB mn)	989	708	535	830	1,051
EPS (RMB)	0.30	0.22	0.16	0.24	0.31
YoY growth (%)	-17%	-28%	-28%	55%	26%
Consensus EPS (RMB)	0.30	0.22	0.19	0.29	0.41
EV/sales (x)	9.8	9.5	7.9	6.4	5.3
P/E (x)	82.5	115.2	160.1	103.1	81.5
Dividend Yiled (%)	0.01	0.01	0.00	0.00	0.00
ROE (%)	12%	9%	5%	6%	7%
Net debt to equity	net cash	net cash	net cash	net cash	net cash

Source: Company data, Bloomberg, CMBIGM estimates

Hold (Maintain)

Target Price RMB23.51
(Previous TP RMB19.81)
Up/Downside -5.7%
Current Price RMB24.93

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Stock Data

Mkt Cap (RMB mn)	85,606
Avg 3 mths t/o (RMB mn)	516.25
52w High/Low (RMB)	40.33/ 16.28
Total Issued Shares (mn)	3,434

Source: Bloomberg

Shareholding Structure

Mr. Wang - Chairman	38.9%
HKSCC	7.2%
Mr. Guo - Vice Chairman	3.7%

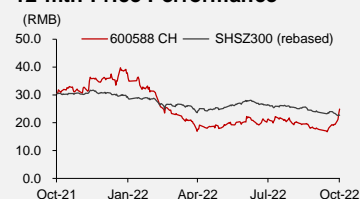
Source: Company data

Share Performance

	Absolute	Relative
1-mth	31.5%	37.9%
3-mth	10.1%	27.9%
6-mth	37.8%	42.6%

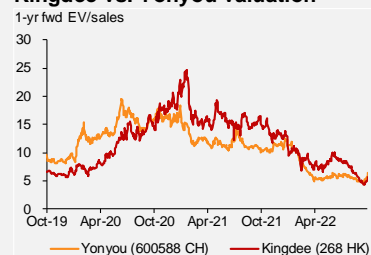
Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

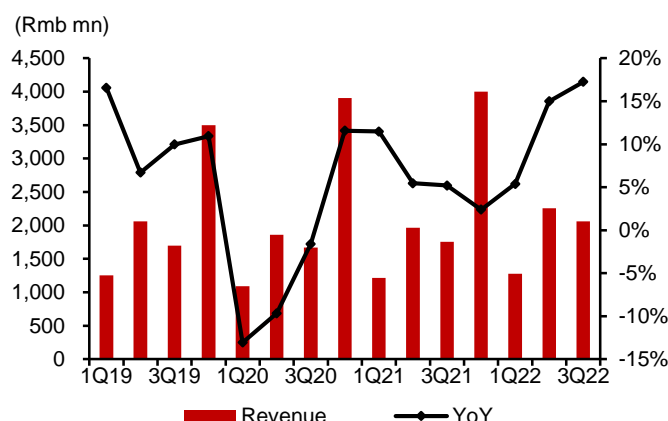
Kingdee vs. Yonyou valuation



Auditor: Deloitte

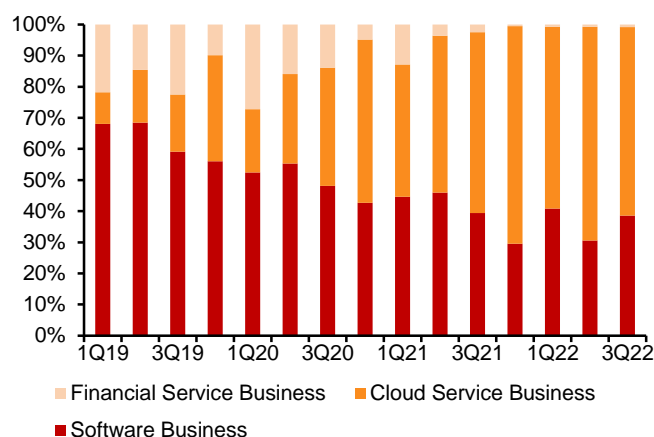
Focus Charts

Figure 1: Revenue and growth (Quarterly)



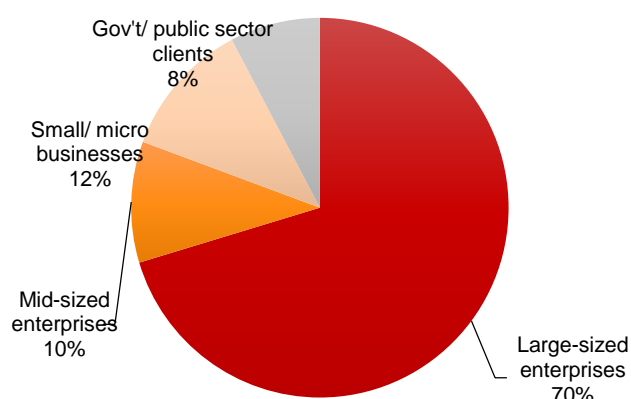
Source: Company data, CMBIGM estimates

Figure 2: Revenue mix (Quarterly)



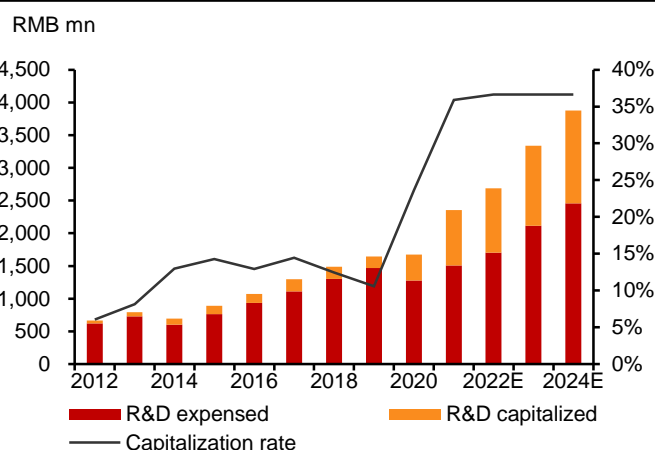
Source: Company data, CMBIGM estimates

Figure 3: Cloud service revenue mix (3Q22)



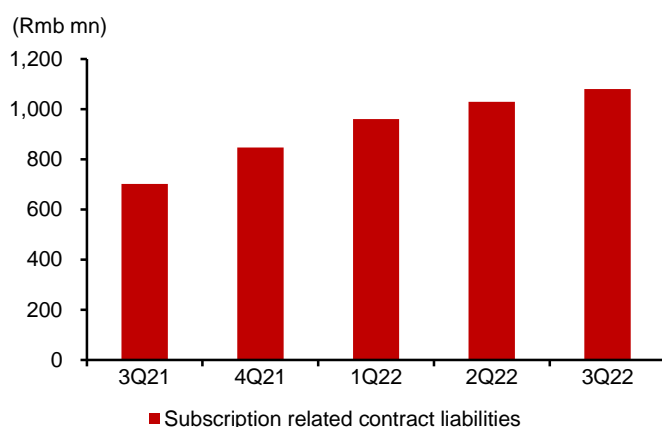
Source: Company data, CMBIGM estimates

Figure 4: R&D capitalization rate (Yearly)



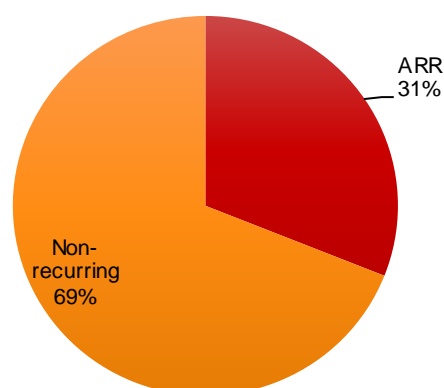
Source: Company data, CMBIGM estimates

Figure 5: Cloud contract liabilities (Quarterly)



Source: Company data

Figure 6: ARR as % of cloud service revenue



Source: Company data

FY3Q22 results review

- **Revenue** was RMB2,059mn (+17% YoY, -9% QoQ), in-line with our/ consensus estimates.
 - **Cloud** revenue was RMB1,247mn (+22% YoY, -20% QoQ), accounting for 61% of revenue.
 - **Software** revenue was RMB795mn (+15% YoY, +15% QoQ).
- **Gross profit** was RMB1,028 (+1%YoY, -26% QoQ), missed our estimate by 11% and consensus by 13%.
- **Gross margin** was 49.9%, (-8.2 pct pts YoY, -11.3 pct pts QoQ), missed our estimate by 5.9 pct pts and consensus by 6.9 pct pts.
- **Operating loss** was RMB366mn, compared to our operating loss estimate of RMB179mn.
- **Operating margin** was -17.8% (-10.7 pct pts YoY, -21.8 pct pts QoQ), missed our estimate by 9.1 pct pts.
- **Net loss** was RMB284mn, compared to our/ consensus net loss estimates of RMB112/ RMB128mn.
- **EPS** was -RMB0.08.

Figure 7: FY3Q22 results review

	Sep-21 3Q21	Jun-22 2Q22	Sep-22 3Q22			Sep-22 3Q22	versus	Sep-22 3Q22	versus
RMB mn	actual	actual	actual	YoY	QoQ	CMBI	CMBI	consensus	consensus
Revenue	1,756	2,258	2,059	17%	-9%	2,067	0%	2,088	-1%
Gross profit	1,020	1,383	1,028	1%	-26%	1,155	-11%	1,187	-13%
Gross margin	58.1%	61.2%	49.9%	-8.2 pct pts	-11.3 pct pts	55.9%	-5.9 pct pts	56.9%	-6.9 pct pts
Operating profit (adjusted)	-124	89	-366	n.a.	n.a.	-179	n.a.	n.a.	n.a.
Operating margin (adjusted)	-7.1%	4.0%	-17.8%	-10.7 pct pts	-21.8 pct pts	-8.7%	-9.1 pct pts	n.a.	n.a.
Net non-op	12	20	81			48			
PBT	-112	110	-285	n.a.	n.a.	-131	n.a.	-145	n.a.
Tax	0	-2	-1			12		17	
Minorities	24	30	2			7			
Net income	-88	137	-284	n.a.	n.a.	-112	n.a.	-128	n.a.
EPS RMB	-0.03	0.04	-0.08	n.a.	n.a.	-0.03	n.a.	-0.01	n.a.

Source: Company data, CMBIGM

Figure 8: Revenue breakdown

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22
Software	564	1,023	797	1,660	542	903	692	1,183	522	690	795
Cloud Service	219	532	630	2,042	516	990	1,020	2,794	748	1,551	1,247
Financial Service	293	294	229	189	156	70	44	22	9	17	16
Total	1,089	1,862	1,669	3,905	1,214	1,963	1,756	3,999	1,279	2,258	2,059
YoY %											
Software	-33%	-27%	-20%	-15%	-4%	-12%	-13%	-29%	-4%	-24%	15%
Cloud Service	74%	54%	103%	72%	136%	86%	62%	37%	45%	57%	22%
Financial Service	8%	-1%	-40%	-45%	-47%	-76%	-81%	-89%	-94%	-76%	-63%
Total	-13%	-10%	-2%	12%	11%	5%	5%	2%	5%	15%	17%
Revenue mix											
Software	52%	55%	48%	42%	45%	46%	39%	30%	41%	31%	39%
Cloud Service	20%	29%	38%	52%	42%	50%	58%	70%	58%	69%	61%
Financial Service	27%	16%	14%	5%	13%	4%	2%	1%	1%	1%	1%
Cloud service metrics											
Cloud Service contract liab.				1,091	1,229	1,243	1,304	1,580	1,715	1,760	1,970
- Subscription contract liab.				473	492	n.a.	702	847	961	1,030	1,080
YoY								79%	96%	n.a.	54%

Source: Company data

Earnings revision

Figure 9: Yonyou earnings revision

RMB mn	2022E			2023E			2024E		
	New	Old	%Diff	New	Old	%Diff	New	Old	%Diff
Sales	10,390	10,382	0%	12,667	12,709	-0%	15,011	15,031	0%
Gross profit	6,105	6,318	-3%	7,473	7,785	-4%	8,853	9,287	-5%
OP Profit	465	636	-27%	765	959	-20%	1,012	1,331	-24%
PBT	657	788	-17%	977	1,128	-13%	1,236	1,500	-18%
Net profit	535	686	-22%	830	959	-13%	1,051	1,275	-18%
EPS	0.16	0.20	-22%	0.24	0.28	-13%	0.31	0.37	-18%
Margins									
GM	58.8%	60.9%	-210 bps	59.0%	61.3%	-225 bps	59.0%	61.8%	-281 bps
OPM	4.5%	6.1%	-165 bps	6.0%	7.5%	-151 bps	6.7%	8.9%	-211 bps
PBT margin	6.3%	7.6%	-126 bps	7.7%	8.9%	-116 bps	8.2%	10.0%	-175 bps
Net margin	5.1%	6.6%	-147 bps	6.6%	7.5%	-99 bps	7.0%	8.5%	-149 bps

Source: Company data, CMBIGM

Figure 10: Yonyou CMBI estimates vs. consensus

RMB mn	CMBI	2022E		CMBI	2023E		CMBI	2024E	
		Street	Diff		Street	Diff		Street	Diff
Sales	10,390	10,595	-2%	12,667	12,957	-2%	15,011	15,912	-6%
Gross profit	6,105	6,414	-5%	7,473	7,829	-5%	8,853	9,666	-8%
OP Profit	465	786	-41%	765	1,117	-31%	1,012	1,529	-34%
PBT	657	725	-9%	977	1,117	-13%	1,236	1,607	-23%
Net profit	535	662	-19%	830	984	-16%	1,051	1,437	-27%
EPS	0.16	0.20	-20%	0.24	0.29	-17%	0.31	0.42	-27%
Margins									
GM	58.8%	60.5%	-177 bps	59.0%	60.4%	-143 bps	59.0%	60.7%	-177 bps
OPM	4.5%	7.4%	-294 bps	6.0%	8.6%	-258 bps	6.7%	9.6%	-287 bps
PBT margin	6.3%	6.8%	-52 bps	7.7%	8.6%	-91 bps	8.2%	10.1%	-187 bps
Net margin	5.1%	6.2%	-110 bps	6.6%	7.6%	-104 bps	7.0%	9.0%	-203 bps

Source: Company data, CMBIGM, Bloomberg

Operating model

Figure 11: Revenue breakdown

RMB mn	2019	2020	2021	2022E	2023E	2024E
Revenues	8,510	8,525	8,932	10,390	12,667	15,011
Cost of sales	(2,942)	(3,321)	(3,461)	(4,285)	(5,193)	(6,158)
Gross Profit	5,567	5,204	5,471	6,105	7,473	8,853
<i>Gross margin</i>	<i>65.4%</i>	<i>61.0%</i>	<i>61.2%</i>	<i>58.8%</i>	<i>59.0%</i>	<i>59.0%</i>
R&D	(1,630)	(1,459)	(1,704)	(2,121)	(2,484)	(3,013)
SG&A	(3,023)	(2,496)	(3,099)	(3,376)	(4,058)	(4,626)
Operating Income	802	1,093	555	465	765	1,012
<i>Operating margin</i>	<i>9.4%</i>	<i>12.8%</i>	<i>6.2%</i>	<i>4.5%</i>	<i>6.0%</i>	<i>6.7%</i>
Non-Operating Income	602	33	219	192	212	224
Profit Before Tax	1,404	1,126	774	657	977	1,236
Income tax (expense) gain	(83)	(75)	(92)	(122)	(98)	(124)
Minorities	(138)	(63)	25	0	(49)	(62)
Net Income to Shareholders	1,183	989	708	535	830	1,051
<i>Net margin</i>	<i>13.9%</i>	<i>11.6%</i>	<i>7.9%</i>	<i>5.1%</i>	<i>6.6%</i>	<i>7.0%</i>
EPS (RMB)	0.36	0.30	0.22	0.16	0.24	0.31
DPS (RMB)	0.15	0.20	0.20	0.00	0.00	0.00

Source: Company data, CMBIGM

Figure 12: Operating model

RMB mn	2019	2020	2021	2022E	2023E	2024E
Revenue breakdown						
Software Business	5,195	4,044	3,320	3,309	3,093	3,045
Cloud Service Business	1,970	3,422	5,321	7,039	9,573	11,967
Financial Service Business	1,293	1,005	276	42	-	-
Others	52	54	14	-	-	-
Total	8,510	8,525	8,932	10,390	12,667	15,011
Revenue YoY						
Software Business	-7%	-22%	-18%	0%	-7%	-2%
Cloud Service Business	132%	74%	55%	32%	36%	25%
Financial Service Business	4%	-22%	-73%	-85%	-100%	0%
Blended	10%	0%	5%	16%	22%	19%
Revenue mix						
Software Business	61%	47%	37%	32%	24%	20%
Cloud Service Business	23%	40%	60%	68%	76%	80%
Financial Service Business	15%	12%	3%	0%	0%	0%

Source: Company data, CMBIGM

Figure 13: Quarterly operating model

RMB mn	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22E
Revenues	1,214	1,963	1,756	3,999	1,279	2,258	2,059	4,794
Gross Profit	572	1,244	1,020	2,634	628	1,383	1,028	3,067
Operating profit	-314	67	-124	926	-465	89	-366	1,207
Net profit (loss)	-13	228	-88	581	-393	137	-284	1,074
EPS (RMB)	-0.00	0.07	-0.03	0.18	-0.12	0.04	-0.08	0.31
Margins								
Gross margin	47%	63%	58%	66%	49%	61%	50%	64%
Operating margin	-26%	3%	-7%	23%	-36%	4%	-18%	25%
Net margin	-1%	12%	-5%	15%	-31%	6%	-14%	22%
Growth (QoQ)								
Revenues	-69%	62%	-11%	128%	-68%	76%	-9%	133%
Gross Profit	-79%	118%	-18%	158%	-76%	120%	-26%	198%
Operating profit	-127%	-121%	-287%	-846%	-150%	-119%	-510%	-430%
Net profit (loss)	-101%	-1858%	-139%	-759%	-168%	-135%	-306%	-479%
Growth (YoY)								
Revenues	11%	5%	5%	2%	5%	15%	17%	20%
Gross Profit	13%	15%	9%	-2%	10%	11%	1%	16%
Operating profit	-9%	-72%	-214%	-22%	-48%	34%	-195%	30%
Net profit (loss)	95%	-14%	-113%	-42%	-2856%	-43%	-207%	76%

Source: Company data, CMBIGM

Valuation

Yonyou (600588 CH, HOLD, TP RMB23.51)

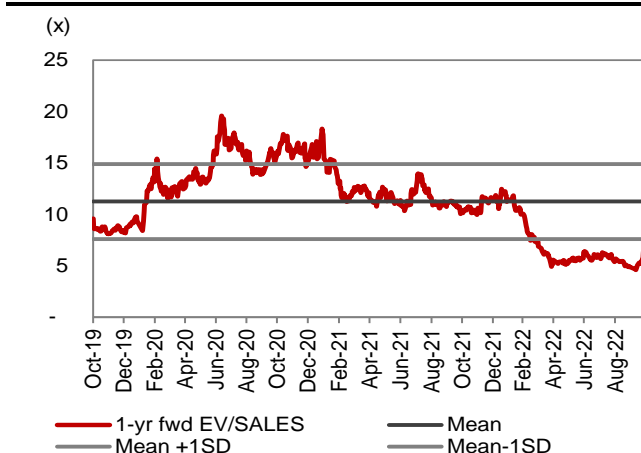
We maintain HOLD with new target price of RMB23.51 (prior RMB19.81), based on higher 6.0x (prior 5.0x) FY23E EV/sales. We raised our target multiple considering the software localization trend and hence demand for Yonyou's ERP is solidified after the 20th Party Congress.

Figure 14: Yonyou peers valuation comparison

Company	Ticker	Rating	Market Cap (US\$ mn)	Price (LC)	TP (LC)	EV/sales (x)		FCF margin (%)		Sales CAGR FY21-24E	EPS CAGR FY21-24E
						FY22E	FY23E	FY22E	FY23E		
Yonyou	600588 CH	HOLD	11,842	24.93	23.51	7.9	6.4	0%	5%	19%	12%
Kingdee	268 HK	BUY	5,339	12.06	23.83	7.3	5.9	0%	6%	19%	n.a.
Kingsoft Office	688111 CH	NR	17,245	270.30	N/A	29.4	22.3	39%	44%	28%	29%
SAP	SAP US	NR	120,099	97.76	N/A	4.3	4.0	11%	15%	9%	n.a.
Intuit	INTU US	NR	119,623	424.39	N/A	9.8	8.5	29%	28%	20%	28%
Xero	XRO AU	NR	7,429	76.74	N/A	11.9	9.2	-7%	2%	26%	71%
Workday	WDAY US	NR	39,611	154.73	N/A	7.4	6.1	26%	19%	20%	n.a.
ServiceNow	NOW US	NR	74,015	366.41	N/A	9.9	8.1	29%	31%	23%	115%
Salesforce	CRM US	NR	159,910	159.91	N/A	6.1	5.2	19%	20%	19%	8%
Mean						10.0	8.1	15%	18%	21%	45%
Median						9.1	7.5	19%	18%	20%	30%

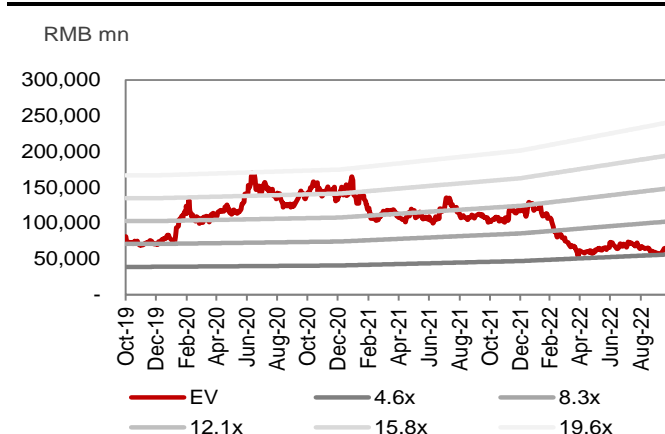
Source: Bloomberg, CMBIGM estimates

Figure 15: Yonyou 12M forward EV/sales chart



Source: Bloomberg, CMBIGM estimates

Figure 16: Yonyou 12M forward EV/sales band



Source: Bloomberg, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	8,525	8,932	10,390	12,667	15,011
Cost of sales	(3,321)	(3,461)	(4,285)	(5,193)	(6,158)
Gross profit	5,204	5,471	6,105	7,473	8,853
Selling exp	(1,537)	(2,027)	(2,247)	(2,654)	(3,024)
Admin exp	(959)	(1,072)	(1,129)	(1,404)	(1,602)
R&D exp	(1,459)	(1,704)	(2,121)	(2,484)	(3,013)
Other operating exp.	(156)	(113)	(143)	(167)	(202)
Operating profit	1,093	555	465	765	1,012
Finance costs	(110)	(79)	(28)	-	-
Other non-oper exp.	143	298	220	212	224
Pre-tax profit	1,126	774	657	977	1,236
Income tax expense	(75)	(92)	(122)	(98)	(124)
Minority interests	(63)	25	0	(49)	(62)
Net profit to shareholders	989	708	535	830	1,051

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net profit	989	708	535	830	1,051
Depreciation/amortization	357	473	526	688	891
Change in working capital	605	146	(101)	762	616
Others	(337)	(23)	387	49	62
Net cash from operating	1,613	1,304	1,347	2,330	2,619
Capex	(592)	(1,030)	(1,335)	(1,663)	(1,983)
Other	(183)	921	(2,990)	592	790
Net cash from investing	(894)	(1,230)	(4,325)	(1,071)	(1,194)
Net borrowings	(1,950)	702	1,505	(401)	28
Dividend paid	(651)	(654)	-	-	-
Other	346	(1,108)	6,007	(49)	(62)
Net cash from financing	(2,256)	(1,060)	7,512	(450)	(33)
Net change in cash	(1,536)	(987)	4,533	808	1,392
Cash at beginning of the year	7,147	5,605	4,616	9,262	10,071
Exchange difference	(6)	(2)	14	-	-
Cash at the end of the year	5,605	4,616	9,163	10,071	11,463

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	8,773	7,682	13,490	15,103	17,327
Cash & equivalents	5,605	4,616	9,262	10,071	11,463
Account receivables	1,680	1,572	2,265	2,630	3,239
Inventory	423	407	410	666	728
Other current assets	1,065	1,088	1,553	1,736	1,897
Non-current assets	8,177	9,647	12,053	12,436	12,738
PPE	2,507	2,529	2,697	2,836	3,013
Intangible assets	785	1,862	2,571	3,407	4,321
Other non-current assets	4,885	5,256	6,785	6,193	5,404
Total assets	16,950	17,329	25,543	27,539	30,065
Current liabilities	7,950	8,325	10,329	11,525	12,991
ST borrowings	2,420	2,802	4,108	3,737	3,755
Account payables	549	654	808	966	1,159
Accrued expense	2,741	2,649	3,532	3,783	4,611
Other current liabilities	2,240	2,219	1,882	3,039	3,466
Non-current liabilities	453	1,078	1,372	1,342	1,352
LT borrowings	-	390	606	575	585
Other non-current liabilities	453	688	767	767	767
Total liabilities	8,403	9,403	11,701	12,866	14,342
Share capital	3,270	3,271	3,434	3,434	3,434
Capital surplus	1,096	892	6,109	6,109	6,109
Retained earnings	3,418	3,489	3,684	4,515	5,565
Other reserves	(242)	(664)	(1,224)	(1,224)	(1,224)
Minority interest	1,004	939	962	962	962
Total equity	8,547	7,926	12,966	13,797	14,847
Total liabilities and equity	16,950	17,329	24,667	26,663	29,190

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue mix					
Software Business	47%	37%	32%	24%	20%
Cloud Service Business	40%	60%	68%	76%	80%
Financial Service Business	12%	3%	0%	0%	0%
Growth (%)					
Revenue	0%	5%	16%	22%	19%
Operating profit	36%	-49%	-16%	64%	32%
EPS	-17%	-28%	-28%	55%	26%
Profit & loss ratio (%)					
Gross margin	61.0%	61.2%	58.8%	59.0%	59.0%
Operating margin	12.8%	6.2%	4.5%	6.0%	6.7%
Net profit margin	11.6%	7.9%	5.1%	6.6%	7.0%
Balance sheet ratio					
Current ratio (x)	1.10	0.92	1.31	1.31	1.33
Receivable turnover days	77	66	67	71	71
Inventory turnover days	10	17	14	16	17
Payable turnover days	60	69	69	28	28
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Profitability (%)					
ROE	11.7%	8.6%	5.1%	6.2%	7.3%
ROIC	18.6%	7.8%	4.6%	7.5%	10.3%
Per share data (RMB)					
EPS (RMB)	0.30	0.22	0.16	0.24	0.31
DPS (RMB)	0.20	0.20	0.00	0.00	0.00
BVPS (RMB)	2.61	2.42	3.78	4.02	4.32

Source: Company data, CMBIGM estimates

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