

# Yonyou (600588 CH)

## Fundamentals improving but high R&D capitalization remains a concern

Yonyou reported 4Q23 and full-year financial results. For 4Q23, revenue came in at RMB4.1bn, up 12% YoY (4Q22: -8%), but was 8% short of Bloomberg consensus forecast, and net income was RMB63mn, worse than consensus of RMB925mn. The miss in revenue and net income can be attributed to slower-than-expected revenue growth in large enterprise business and worse-than-expected cost control, respectively, in our view. The already high and increasing R&D capitalization rate (50% in 2023) and still low cloud service ARR as % of cloud revenue (33% vs. 63% for Kingdee) remains a concern, which likely speak to a dampened profitability outlook over the long term, although Yonyou has demonstrated an ongoing recovery trend in fundamentals, with 2023 new contract value growth at 17.6% YoY (>26% YoY in 2H23) and subscription contract liability growth at 38.8% YoY. We lower TP to RMB12.33, based on 3.7x 2024E EV/sales (was 6.0x); maintain HOLD.

- Recovery of fundamentals ongoing although slower than market expectation.** The reorganization impacted Yonyou's financial performance in 2023, especially revenue from large enterprises, but the impact is gradually wearing off. Management highlighted an ongoing recovery in fundamentals: revenue generated from large enterprises was up 12% YoY in 2H23 (vs. -9% YoY in 1H23), and new contract value from large enterprises was up over 30% YoY in 2H23. In 2H23, overall cloud services revenue was RMB4.7bn, up 17.0% YoY (1H23: 2.0%; 2H22: 6.3%), and accounted for 74% of total revenue (2H22: 71%).
- High R&D capitalization and low ARR as % of cloud revenue remains a concern.** Although Yonyou's ARR growth remained healthy (+15% YoY to RMB2.4bn), ARR accounted for only 33% of cloud revenue (2022: 32%), which implies that the majority of Yonyou's cloud revenue is not charged on a subscription basis and is not recurring in nature, and this could be explained by Yonyou's customer mix that skews towards large-sized enterprises (67% of 2023 cloud service revenue). Also, in 2023, Yonyou increased R&D expenditure by 10% YoY to RMB3.2bn as the company continues to develop cloud-native products. However, R&D capitalization rate rose to a record high of 50% (vs. 36/48% in 2021/2022, and Kingdee's 32% in 2023). Yonyou needs to improve ARR contribution and further optimize R&D capitalization, to drive a better long-term profitability outlook, in our view.
- Lower TP to RMB12.33 and maintain HOLD.** We lower 2024-2025E revenue by both 2% and net profit forecast by 19-36% to reflect lower-than-expected cloud revenue growth and slower-than-expected profitability improvement. Maintain HOLD with a new target price of RMB12.33, based on 3.7x 2024E EV/sales, in line with two-year average minus two s.d.

### Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	9,262	9,796	11,201	12,550	13,757
YoY growth (%)	3.7	5.8	14.3	12.0	9.6
Net profit (RMB mn)	219.2	(967.2)	280.2	445.1	816.8
EPS (Reported) (RMB cents)	6.38	(28.29)	8.20	13.02	23.89
Consensus EPS (RMB)	0.00	0.00	0.16	0.33	1.43

Source: Company data, Bloomberg, CMBIGM estimates

**HOLD (Maintain)**

**Target Price** RMB12.33

(Previous TP) RMB16.45)

**Up/Downside** 3.2%

**Current Price** RMB11.95

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### Stock Data

Mkt Cap (RMB mn)	41,025.8
Avg 3 mths t/o (RMB mn)	408.4
52w High/Low (RMB)	26.38/9.92
Total Issued Shares (mn)	3433.1

Source: FactSet

### Shareholding Structure

Mr. Wang - Chairman	38.9%
HKSCC	7.9%

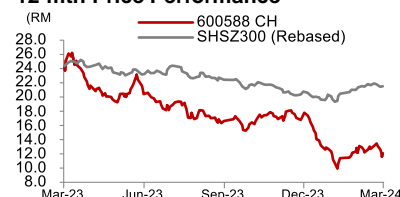
Source: Company data

### Share Performance

	Absolute	Relative
1-mth	-5.7%	-6.3%
3-mth	-32.8%	-34.8%
6-mth	-28.1%	-25.0%

Source: FactSet

### 12-mth Price Performance



Source: FactSet

Figure 1: Yonyou: CMBI forecast change

(RMB mn)	2024E			2025E			2026E		
	New	Old	%Diff	New	Old	%Diff	New	Old	%Diff
Sales	11,201	11,459	-2%	12,550	12,817	-2%	13,757	-	n/a
Gross profit	6,324	6,668	-5%	7,173	7,537	-5%	8,238	-	n/a
OP profit	147	361	-59%	297	494	-40%	730	-	n/a
PBT	330	515	-36%	524	650	-19%	961	-	n/a
Net profit	280	438	-36%	445	553	-19%	817	-	n/a
EPS	0.08	0.13	-36%	0.13	0.16	-19%	0.24	-	n/a
<b>Margins</b>									
GM	56.5%	58.2%	-174 bps	57.2%	58.8%	-165 bps	59.9%	-	n/a
OPM	1.3%	3.2%	-184 bps	2.4%	3.9%	-148 bps	5.3%	-	n/a
PBT margin	2.9%	4.5%	-155 bps	4.2%	5.1%	-90 bps	7.0%	-	n/a
Net margin	2.5%	3.8%	-132 bps	3.5%	4.3%	-77 bps	5.9%	-	n/a

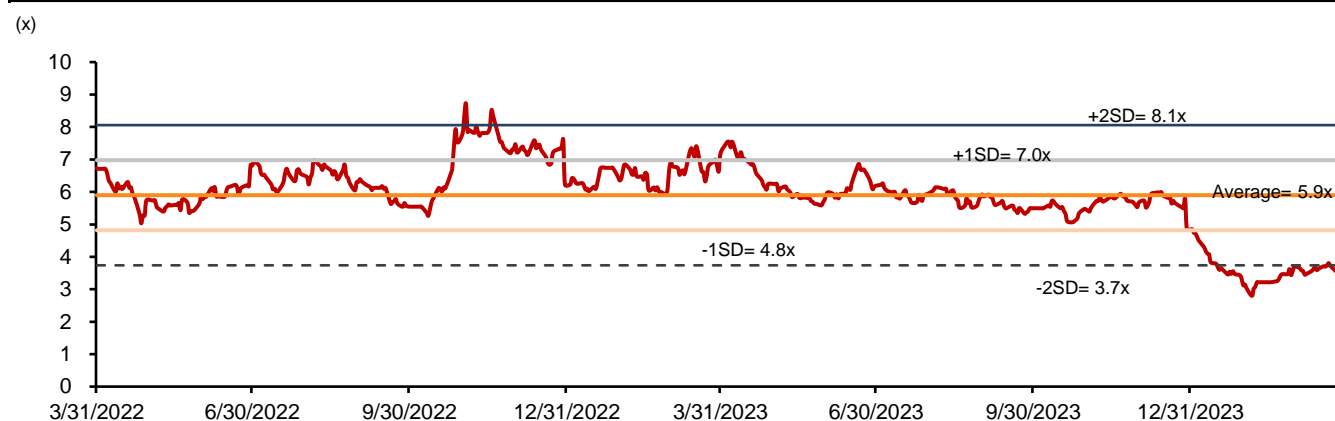
Source: CMBIGM estimates

Figure 2: Yonyou: CMBI forecast vs Bloomberg consensus

(RMB mn)	2024			2025			2026		
	CMBI	Street	Diff	CMBI	Street	Diff	CMBI	Street	Diff
Sales	11,201	11,993	-7%	12,550	14,427	-13%	13,757	17,754	-23%
Gross profit	6,324	6,874	-8%	7,173	8,496	-16%	8,238	10,636	-23%
OP profit	147	664	-78%	297	1,354	-78%	730	-	n/a
PBT	330	604	-45%	524	1,270	-59%	961	4,513	-79%
Net profit	280	522	-46%	445	1,117	-60%	817	2,246	-64%
EPS	0.08	0.17	-51%	0.13	0.33	-61%	0.24	1.44	-83%
<b>Margins</b>									
GM	56.5%	57.3%	-86 bps	57.2%	58.9%	-173 bps	59.9%	59.9%	-2 bps
OPM	1.3%	5.5%	-423 bps	2.4%	9.4%	-701 bps	5.3%	-	531 bps
PBT margin	2.9%	5.0%	-209 bps	4.2%	8.8%	-463 bps	7.0%	25.4%	-1843 bps
Net margin	2.5%	4.4%	-185 bps	3.5%	7.7%	-419 bps	5.9%	12.7%	-671 bps

Source: Bloomberg, CMBIGM estimates

Figure 3: Yonyou: EV/sales valuation band



Source: Bloomberg, CMBIGM estimates

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**Risks:**

Upside risks: 1) better-than-expected margin expansion driven by better-than-expected cost control; 2) better-than-expected cloud revenue growth driven by better-than-expected new contracts signed.

Downside risks: 1) slower-than-expected cloud revenue growth; 2) slower-than-expected margin expansion.

## Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
<b>Revenue</b>	<b>8,932</b>	<b>9,262</b>	<b>9,796</b>	<b>11,201</b>	<b>12,550</b>	<b>13,757</b>
Cost of goods sold	(3,461)	(4,041)	(4,826)	(4,878)	(5,376)	(5,519)
<b>Gross profit</b>	<b>5,471</b>	<b>5,221</b>	<b>4,970</b>	<b>6,324</b>	<b>7,173</b>	<b>8,238</b>
<b>Operating expenses</b>	<b>(4,916)</b>	<b>(5,213)</b>	<b>(6,066)</b>	<b>(6,177)</b>	<b>(6,876)</b>	<b>(7,508)</b>
Selling expense	(2,027)	(2,235)	(2,743)	(2,726)	(3,055)	(3,282)
Admin expense	(1,072)	(1,117)	(1,108)	(1,180)	(1,302)	(1,410)
R&D expense	(1,704)	(1,754)	(2,106)	(2,152)	(2,390)	(2,680)
Others	(113)	(106)	(108)	(119)	(129)	(137)
<b>Operating profit</b>	<b>555</b>	<b>8</b>	<b>(1,096)</b>	<b>147</b>	<b>297</b>	<b>730</b>
Interest expense	(79)	12	(68)	9	10	14
Other income/expense	298	227	254	174	216	217
<b>Pre-tax profit</b>	<b>774</b>	<b>247</b>	<b>(910)</b>	<b>330</b>	<b>524</b>	<b>961</b>
Income tax	(92)	(22)	(23)	(33)	(52)	(96)
<b>After tax profit</b>	<b>682</b>	<b>225</b>	<b>(933)</b>	<b>297</b>	<b>471</b>	<b>865</b>
Minority interest	25	(6)	(34)	(16)	(26)	(48)
<b>Net profit</b>	<b>708</b>	<b>219</b>	<b>(967)</b>	<b>280</b>	<b>445</b>	<b>817</b>

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
<b>Current assets</b>	<b>7,682</b>	<b>12,387</b>	<b>12,922</b>	<b>11,354</b>	<b>12,800</b>	<b>14,063</b>
Cash & equivalents	4,616	8,304	8,045	7,050	7,700	8,784
Restricted cash	1,572	2,634	3,059	2,519	3,005	3,092
Account receivables	407	531	552	590	696	743
Other current assets	1,088	918	1,266	1,194	1,399	1,443
<b>Non-current assets</b>	<b>9,647</b>	<b>11,168</b>	<b>12,599</b>	<b>12,803</b>	<b>12,799</b>	<b>12,637</b>
PP&E	2,529	2,531	2,619	2,603	2,562	2,528
Intangibles	1,862	2,838	3,872	4,785	5,690	6,431
Other non-current assets	5,256	5,799	6,108	5,414	4,547	3,679
<b>Total assets</b>	<b>17,329</b>	<b>23,555</b>	<b>25,521</b>	<b>24,157</b>	<b>25,598</b>	<b>26,700</b>
<b>Current liabilities</b>	<b>8,325</b>	<b>9,574</b>	<b>11,122</b>	<b>10,327</b>	<b>11,320</b>	<b>11,646</b>
Short-term borrowings	2,802	3,611	4,240	3,907	3,940	3,791
Account payables	654	832	1,007	888	1,020	1,010
Other current liabilities	2,219	2,569	2,936	2,813	3,260	3,481
Accrued expenses	2,649	2,563	2,940	2,719	3,100	3,364
<b>Non-current liabilities</b>	<b>1,078</b>	<b>1,463</b>	<b>2,596</b>	<b>1,746</b>	<b>1,750</b>	<b>1,708</b>
Long-term borrowings	390	826	1,910	1,061	1,065	1,023
Other non-current liabilities	688	637	685	685	685	685
<b>Total liabilities</b>	<b>9,403</b>	<b>11,037</b>	<b>13,718</b>	<b>12,073</b>	<b>13,070</b>	<b>13,355</b>
Share capital	3,271	3,434	3,419	3,419	3,419	3,419
Capital surplus	892	5,852	5,290	5,290	5,290	5,290
Retained earnings	3,489	3,369	2,198	2,478	2,923	3,740
Other reserves	(664)	(1,193)	(754)	(754)	(754)	(754)
<b>Total shareholders equity</b>	<b>6,987</b>	<b>11,461</b>	<b>10,152</b>	<b>10,433</b>	<b>10,878</b>	<b>11,695</b>
Minority interest	939	1,057	1,651	1,651	1,651	1,651
<b>Total equity and liabilities</b>	<b>17,329</b>	<b>23,555</b>	<b>25,521</b>	<b>24,157</b>	<b>25,598</b>	<b>26,700</b>

<b>CASH FLOW</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>
<b>YE 31 Dec (RMB mn)</b>						
<b>Operating</b>						
Profit before taxation	774	247	(910)	330	524	961
Depreciation & amortization	473	579	855	788	960	1,159
Tax paid	(92)	(22)	(23)	(33)	(52)	(96)
Change in working capital	146	(819)	338	112	163	297
Others	2	301	(350)	0	0	0
<b>Net cash from operations</b>	<b>1,304</b>	<b>286</b>	<b>(91)</b>	<b>1,197</b>	<b>1,594</b>	<b>2,320</b>
<b>Investing</b>						
Capital expenditure	(1,030)	(1,557)	(1,797)	(1,588)	(1,824)	(1,865)
Others	(200)	(2,296)	1,254	595	868	1,066
<b>Net cash from investing</b>	<b>(1,230)</b>	<b>(3,853)</b>	<b>(542)</b>	<b>(993)</b>	<b>(956)</b>	<b>(799)</b>
<b>Financing</b>						
Dividend paid	(654)	(344)	(205)	0	0	0
Net borrowings	702	1,077	1,829	(1,183)	37	(190)
Others	(1,108)	6,508	(1,253)	(16)	(26)	(48)
<b>Net cash from financing</b>	<b>(1,060)</b>	<b>7,241</b>	<b>372</b>	<b>(1,199)</b>	<b>11</b>	<b>(238)</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	5,605	4,616	8,304	8,045	7,050	7,700
Exchange difference	(2)	14	3	0	0	0
<b>Cash at the end of the year</b>	<b>4,616</b>	<b>8,304</b>	<b>8,045</b>	<b>7,050</b>	<b>7,700</b>	<b>8,983</b>
<b>GROWTH</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>
<b>YE 31 Dec</b>						
Revenue	4.8%	3.7%	5.8%	14.3%	12.0%	9.6%
Gross profit	5.1%	(4.6%)	(4.8%)	27.2%	13.4%	14.9%
Operating profit	(49.2%)	(98.6%)	na	na	102.3%	145.5%
Net profit	(28.4%)	(69.0%)	na	na	58.8%	83.5%
<b>PROFITABILITY</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>
<b>YE 31 Dec</b>						
Gross profit margin	61.2%	56.4%	50.7%	56.5%	57.2%	59.9%
Operating margin	6.2%	0.1%	(11.2%)	1.3%	2.4%	5.3%
Return on equity (ROE)	9.7%	2.4%	(8.9%)	2.7%	4.2%	7.2%
<b>GEARING/LIQUIDITY/ACTIVITIES</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>
<b>YE 31 Dec</b>						
Net debt to equity (x)	(0.2)	(0.3)	(0.2)	(0.2)	(0.2)	(0.3)
Current ratio (x)	0.9	1.3	1.2	1.1	1.1	1.2
Receivable turnover days	66.4	82.9	106.1	90.9	80.3	80.9
Inventory turnover days	17.0	18.5	20.2	18.6	18.7	19.1
Payable turnover days	69.0	75.1	37.5	28.9	29.7	26.8
<b>VALUATION</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>
<b>YE 31 Dec</b>						
P/E	55.2	187.2	ns	145.8	91.8	50.0
P/B	4.9	3.3	3.5	3.4	3.3	3.1
Div yield (%)	1.7	0.8	0.5	0.0	0.0	0.0

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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