

Yunkang Group (2325 HK)

Healthy growth in non-COVID business

Yunkang Group reported 1H23 revenue of RMB476.9mn, down by 65.4% YoY, primarily due to the sharp decline of diagnostic testing demand for COVID-19 after China's reopening. The blended gross margin dropped to 38.1% in 1H23 (vs. 47.2% in 1H22), mainly due to the significant decrease in demand for COVID-19 tests. Moreover, the selling expense rate increased to 18.2% (+2.3 pts). As a result, the Company's attributable net profit decreased by 79.2% YoY to RMB48.7mn while the attributable net profit margin dropped from 17.0% in 1H22 to 10.2% in 1H23.

■ **Expanding service network to support future growth of non-COVID business.** In 1H23, revenue generated by Yunkang's non-COVID business rose 28.2% YoY. The solid growth was contributed by 1) Medical institution alliance network expansion. As of 30 June 2023, Yunkang has established 410 on-site diagnostic centers (vs. 398 at the end-2022), serving 1,167 medical institutions (vs. 840 at the end-2022); 2) Increased independent laboratories to cover more hospitals and healthcare facilities nationwide. In 1H23, two new independent laboratories were established in Changsha and Haikou and the total number of existing independent laboratories increased to 12. Besides, Yunkang actively promoted the transformation of several co-built PCR testing platforms which were established in response to the COVID-19 epidemic to carry out multiple non-COVID molecular testing such as viral hepatitis, respiratory infections, gastrointestinal infections, urinary and reproductive tract infections, and reproductive genetics. With increased on-site diagnostic centers and independent laboratories, we expect Yunkang's non-COVID business to grow in coming years.

■ **Efficient operations powered by cloud-based systems.** As the DRG/DIP medical insurance policy continued to proceed, hospitals emphasized efficiency and cost control. Yunkang launched 10 digital operation systems including sales management, human resources, training, settlement, general ledger, fixed asset, warehousing, logistics and customer service systems in 2022. With the digital systems, the Company provided standardized laboratory and logistics operating services to the hospitals which helps to improve co-built labs' operating efficiency and accuracy. As a result, we expect Yunkang to accelerate its cooperation with hospitals.

■ **Maintain BUY.** Considering the decreased diagnostic testing demand post-COVID-19, we lowered our estimates on the Company's revenue to RMB1,006mn/1,311mn in 23E/24E. We revised our DCF-based target price to HK\$16.01 (WACC: 9.6%, terminal growth rate: 3.0%).

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	1,697	3,756	1,006	1,311	1,702
YoY growth (%)	41.4	121.4	(73.2)	30.4	29.8
Net profit (RMB mn)	382	374	79	136	174
YoY growth (%)	46.8	(2.1)	(78.8)	71.7	27.6
EPS (Reported) (RMB)	0.76	0.66	0.13	0.22	0.28
YoY growth (%)	na	(14.1)	(80.6)	71.7	27.6
P/E (x)	na	20.7	87.8	51.1	40.1
Net gearing (%)	(32.4)	(5.8)	(36.8)	(34.7)	(34.1)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$16.01**
(Previous TP) HK\$23.21
Up/Downside **32.8%**
Current Price **HK\$12.06**

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Stock Data

Mkt Cap (HK\$ mn) 7,492.3
Avg 3 mths t/o (HK\$ mn) 4.2
52w High/Low (HK\$) 17.18/11.90
Total Issued Shares (mn) 621.3
Source: FactSet

Shareholding Structure

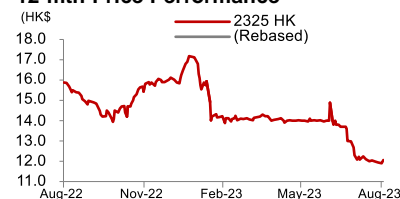
YK Development 40.3%
Daan International 33.8%
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-2.0%	NM
3-mth	-13.9%	NM
6-mth	-15.1%	NM

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,006	1,311	1,702	3,025	3,091	3,471	-66.8%	-57.6%	-51.0%
Gross profit	422	538	681	1,381	1,502	1,767	-69.4%	-64.2%	-61.5%
Net profit	79	136	174	598	696	861	-86.7%	-80.5%	-79.8%
EPS (RMB)	0.13	0.22	0.28	0.96	1.12	1.39	-86.7%	-80.5%	-79.8%
Gross margin	42.00%	41.00%	40.00%	45.67%	48.58%	50.91%	-3.67 ppt	-7.58 ppt	-10.91 ppt
Net Margin	7.89%	10.39%	10.21%	19.78%	22.53%	24.80%	-11.90 ppt	-12.15 ppt	-14.60 ppt

Source: Company data, CMBIGM estimates

Figure 2: Risk-adjusted DCF valuation

DCF Valuation (in RMB mn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
EBIT	116	181	223	284	360	479	633	829	1,078
Tax rate	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
EBIT*(1-tax rate)	98	154	189	241	306	408	538	705	916
+ D&A	195	224	245	260	272	307	344	382	420
- Change in working capital	828	(41)	(39)	(36)	(25)	-29	-32	-36	-39
- Capex	(300)	(300)	(300)	(300)	(300)	-339	-380	-421	-464
FCFF	822	37	96	166	253	347	470	629	833
Terminal value									13,089

Terminal growth rate	3.0%
WACC	9.6%
Cost of Equity	13.1%
Cost of Debt	3.5%
Equity Beta	1.0
Risk Free Rate	2.6%
Market Risk Premium	10.5%
Target Debt to Asset ratio	35.0%
Effective Corporate Tax Rate	15.0%

Terminal value (RMB mn)	5,757
Total PV (RMB mn)	8,004
Net debt (RMB mn)	-955
Minority interest (RMB mn)	7
Equity value (RMB mn)	8,952
# of shares (mn)	621
Price per share (HK\$)	16.01

Source: CMBIGM estimates

Figure 3: Sensitivity analysis

		WACC				
		8.6%	9.1%	9.6%	10.1%	10.6%
Terminal growth rate	4.0%	22.15	19.85	17.98	16.43	15.12
	3.5%	20.47	18.53	16.91	15.56	14.40
	3.0%	19.09	17.42	16.01	14.81	13.77
	2.5%	17.95	16.48	15.23	14.16	13.23
	2.0%	16.97	15.68	14.56	13.59	12.74

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	1,200	1,697	3,756	1,006	1,311	1,702
Cost of goods sold	(544)	(798)	(2,448)	(583)	(773)	(1,021)
Gross profit	656	899	1,308	422	538	681
Operating expenses	(333)	(448)	(864)	(329)	(377)	(476)
Selling expense	(219)	(273)	(312)	(181)	(233)	(299)
Admin expense	(105)	(152)	(387)	(101)	(128)	(163)
Others	(9)	(23)	(166)	(47)	(15)	(13)
Pre-tax profit	323	451	443	93	160	204
Income tax	(53)	(79)	(69)	(14)	(24)	(31)
Others	(10)	9	0	0	0	0
Net profit	260	382	374	79	136	174
Minority interest	5	1	(3)	0	0	0
Attributable net profit	255	381	377	79	136	174

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	1,435	1,743	4,168	2,886	2,873	3,030
Cash & equivalents	336	801	788	1,586	1,453	1,470
Account receivables	485	825	2,432	441	539	653
Inventories	25	42	41	16	20	25
Prepayment	351	44	119	55	72	93
Financial assets at FVTPL	150	0	643	643	643	643
Other current assets	89	31	146	146	146	146
Non-current assets	522	712	739	814	891	947
PP&E	277	485	421	528	607	665
Deferred income tax	40	36	54	54	54	54
Investment in JVs & assos	20	0	0	0	0	0
Intangibles	7	6	4	2	(0)	(2)
Financial assets at FVTPL	59	58	160	160	160	160
Other non-current assets	119	127	100	70	70	70
Total assets	1,957	2,455	4,907	3,700	3,764	3,977
Current liabilities	819	871	1,979	727	705	807
Short-term borrowings	421	208	364	364	264	264
Account payables	329	557	1,492	240	318	420
Tax payable	33	72	85	85	85	85
Other current liabilities	36	34	38	38	38	38
Non-current liabilities	71	133	388	378	368	358
Long-term borrowings	51	82	328	328	328	328
Obligations under finance leases	9	44	58	48	38	28
Deferred income	0	0	0	0	0	0
Other non-current liabilities	11	6	2	2	2	2
Total liabilities	890	1,004	2,367	1,105	1,073	1,165
Share capital	1	21	743	743	743	743
Other reserves	955	955	937	937	937	937
Retained earnings	92	475	853	908	1,003	1,125
Minority interest	18	(0)	7	7	7	7
Total shareholders equity	1,066	1,452	2,540	2,595	2,690	2,812
Total equity and liabilities	1,957	2,455	4,907	3,700	3,764	3,977

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	323	451	443	93	160	204
Depreciation & amortization	33	52	153	193	221	242
Change in working capital	(152)	(133)	(893)	828	(41)	(39)
Others	(0)	(1)	433	46	4	(4)
Net cash from operations	203	369	137	1,160	345	404
Investing						
Capital expenditure	(45)	(223)	(317)	(300)	(300)	(300)
Acquisition of subsidiaries/ investments	0	0	0	0	0	0
Net proceeds from disposal of short-term investments	(50)	174	(733)	0	0	0
Others	(96)	359	(203)	(1)	(1)	(1)
Net cash from investing	(191)	311	(1,254)	(301)	(301)	(301)
Financing						
Dividend paid	0	0	(48)	(24)	(41)	(52)
Net borrowings	286	(181)	401	0	(100)	0
Proceeds from share issues	(1)	(6)	0	0	0	0
Others	(24)	(28)	749	(38)	(36)	(34)
Net cash from financing	261	(215)	1,102	(61)	(177)	(86)
Net change in cash						
Cash at the beginning of the year	64	336	801	788	1,586	1,453
Exchange difference	(1)	0	1	0	0	0
Cash at the end of the year	336	801	788	1,586	1,453	1,470
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	77.1%	41.4%	121.4%	(73.2%)	30.4%	29.8%
Gross profit	119.2%	37.1%	45.4%	(67.7%)	27.3%	26.6%
Net profit	na	46.8%	(2.1%)	(78.8%)	71.7%	27.6%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	54.6%	53.0%	34.8%	42.0%	41.0%	40.0%
Return on equity (ROE)	28.2%	30.3%	18.7%	3.1%	5.2%	6.3%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	0.1	(0.3)	(0.1)	(0.4)	(0.3)	(0.3)
Current ratio (x)	1.8	2.0	2.1	4.0	4.1	3.8
Receivable turnover days	113.3	160.0	130.0	120.0	na	na
Inventory turnover days	13.0	10.0	8.6	8.1	na	na
Payable turnover days	106.0	150.0	150.0	150.0	na	na
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	na	na	20.7	87.8	51.1	40.1

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

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