Oriental Yuhong (002271.SZ)

A leap: has grown from the Chinese largest waterproofing system provider into the giant in functional building materials

How did Yuhong become the leading enterprise in the hidden engineering? Chinese building waterproofing market has a vast room due to the importance and wide application of waterproof materials in construction. The market size is estimated to reach ¥200 billion. In the past, the entry barrier of waterproofing industry was low, and the invisibility of waterproofing products makes it hard for customers to distinguish high quality products, also the cost of non-standard products was relatively low, resulting in the highly decentralized market with many small and medium-sized enterprises. In recent years, with consumption upgrading, the downstream consumers and real estate enterprises is paying more attention to the quality instead of cost and price of waterproof materials. Meanwhile, the stricter regulations make the industry more standardized. All these improvements highlight the advantages of leading enterprises and will further enhance the profession concentration degree in waterproofing industry. Yuhong is well ahead of competitors due to its comprehensive system of products (services), brand and marketing channel. The cornerstones of its success are the excellent entrepreneurs with efficient management, forward-looking strategies with successful capital operation, the partnership culture and partnership organization, attracting many talents and improving operation efficiency.

Yuhong has bright prospect in the functional building materials market. In benchmarking of Sika group, which is a giant (revenue: ¥40 billion; company's market value: ¥130 billion) in international building materials and chemicals market, Sika group's growth is based on the diversification of products, global expansion and successive M&A. Compared with Sika group, Yuhong has the similar development strategies in products, domestic expansion (expand cross region, which is different with Sika in Switzerland) and M&A. Yuhong is targeting at multi-category collaborative development, and is developing 2C business as well as 2B business, which will bring Yuhong new growth in mid-term and long-term. In the next 2-3 years, the increased concentration of real estate will accelerate Yuhong's growth in waterproofing system market. Launching new products and new production capacity will promote the sales of non-waterproofing products.

Investment advice: Yuhong has the leading edge in products (services), brand and marketing channel, supported by the excellent entrepreneurs and partnership cultures. There is the clear business logic of increasing concentration of waterproof industry as well as the Yuhong's expansion of non-waterproof products in mid-term. In benchmarking of Sika group, the industry growth ceiling is high. Meanwhile, the new business model that combines 2Band 2C business will make revenue growth more stable. . We estimate the EPS of Yuhong in FY2018-2020 to be RMB 1.92, 2.69 and 3.67 per share respectively. Current share price is trading at 19x/ 14x/ 10x P/E. We maintain our **BUY** rating for Yuhong.

Investment risks: (1) Dramatic drop in demand (2) Dramatic rise in the price of raw materials (3) development of the new products does not meet the market expectation

Investment Summary

	2016A	2017A	2018E	2019E	2020E
Revenue (RMB million)	7,000.23	10,292.97	14,591.16	19,668.04	25,573.89
YoY(%)	31.98%	47.04%	41.76%	34.79%	30.03%
EBITDA (RMB million)	1,386.90	1,743.23	2,387.66	3,163.03	4,248.63
Net profit (RMB million)	1,028.71	1,238.84	1,693.07	2,373.48	3,239.31
YoY(%)	40.97%	20.43%	36.67%	40.19%	36.48%
EPS (RMB per share)	1.165	1.405	1.92	2.691	3.673
P/E (x)	18.61	31.24	19.22	13.71	10.05
P/B (x)	3.47	5.17	3.82	2.99	2.3
EV/EBITDA (x)	13.41	20.41	13.09	9.74	7.28

Source：Company's financial reports, GF Securities Development Research Center