

Oriental Yuhong will take the lead in the tycoon era

——Key report points

The leading enterprises will welcome the best era

The new-type waterproof materials experienced the rapid compound growth of over 20% in sales volume from 2000 to 2014, which, on the one hand, is owing to the high investment growth speed in real estate, and on the other hand, is owing to the substitution to the traditional bituminous felt by new-type waterproof materials. Currently, though the substitution to the traditional waterproof materials has basically completed, the investment growth speed in real estate has already returned to rationality. But in recent two years, the stricter environmental-protection policy and the taxation policy reform has made small enterprises exit while the consumption upgrade (the overlapping real estate developer concentration ratio has rapidly enhanced) trend has been more and more significant. It is expected that the waterproof industry will welcome the new chance of national-standard products substituting the non-national standard products, and the effective market faced by the leading enterprises will enjoy a rapid growth. We adopt two methods to estimate the market capacity of waterproof industry is about 150 billion Yuan, wherein, the market occupancy rate of the company was only 7% in 2017, which has large development space.

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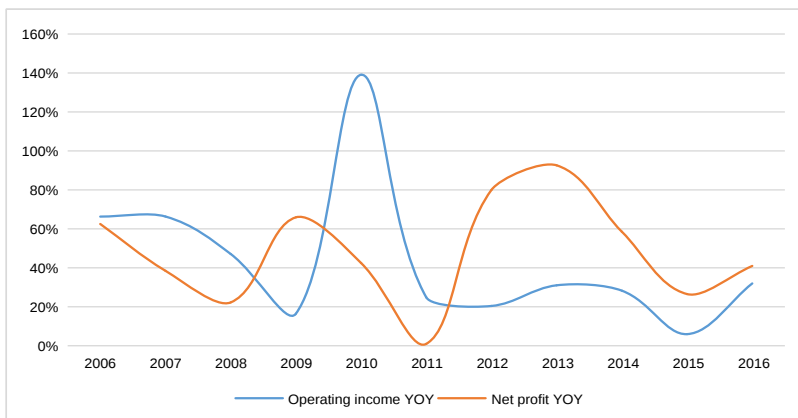
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Introduction

As the high-quality white horse object in the building material industry, Oriental Yuhong has been highly emphasized in the market. Since its listing in 2008, it has realized constant expansion in the sales areas (additional adding of Jinzhou, Huizhou, Tangshan and Xianyang) and sales fields (high-speed train, real estate developer cooperation, retail field) by aid of the power of capital market. From 2005 to 2016, it realized the business revenue of 40%, compound growth speed in attributable net profit of 46%, and the growth speed of net profit was lower than 20% only in 2011 and the revenue growth speed was lower than 20% only in 2015. Currently, the market concerns most about the problems including the influence of real estate industry growth speed on the company, transmission of the company in raw material price increasing and continuous growth based on scale enlargement of the company, therefore, we will give our own opinions in this report.

Figure 1 Large growth of revenue and profit based on listing



Data source: Wind, Changjiang Security Research Institute

more obvious. **See Yuhong for the industrial life cycle: the market scale if**

150 billion, the concentration ratio will be enhanced rapidly and the leading enterprises will welcome the best era.

In this process, Oriental Yuhong may become the largest winner. In view of the development history of Yuhong, it benefits from its own excellent enterprise culture and strong execution force. It can make timely adjustment on the market environment change to avoid strategic misjudgement in operation decision and implementation. After it is listed, it enhances its own competitiveness, intensifies the advantages in capital, scale, channel, brand and management, presents obvious advantage in waterproof material field, therefore, it will have higher growth speed than the industrial

growth speed in the future. **See the development history of Yuhong: have**

advantages in brand, capital, scale, channel and management, create growth moat.

Internationally, the international tycoons such as Sika, Saint-Gobain and Owens Corning all engage in multi-category building material products, wherein, different products have synergistic effect, besides, the companies can better give play to the advantages in management, channel and scale. Yuhong positively promotes thermal insulation material, non-woven, decorative coating and mortar to accumulate

steadily, and break through its growth and ceiling value. **See Yuhong from an**

Industrial market space: one hundred billion capacity of the market with potential enhancement

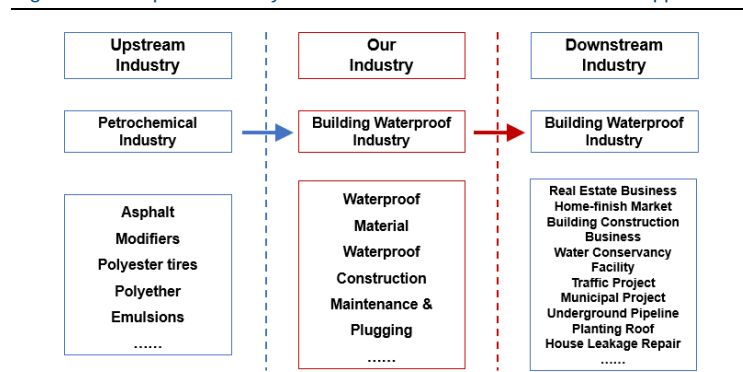
We adopt two methods to estimate the capacity of the waterproof material market

Method I:

The downstream demand of waterproof material industry is extensive, besides the house construction needs waterproof materials, the high-speed train, airport, bridge, tunnel, pipeline, rail transportation, hydraulic engineering and municipal engineering included in infrastructure construction all need waterproof materials. Wherein, the waterproof materials account for 0.5-1% for high-speed train investment while the waterproof materials account for a relatively large proportion in bridge and tunnel construction. For house construction, we consider no about the stock market, but assume the construction cost to be 2500 Yuan/square meter, and the waterproof material accounts for 1.2%.

According to the completed floor area of 4.22 billion square meters of house construction in the end of 2016, the newly-built houses are expect to drive the waterproof material demand of 126.6 billion Yuan; In view of infrastructure construction, only consider the demands of hydraulic engineering, transportation industry and storage industry on waterproof materials, assume the waterproof materials account for 0.5% of the fixed asset investment in hydraulic engineering, transportation industry and storage industry, it is expected that the infrastructure construction will drive the demand of waterproof materials of about 26.2 billion Yuan. Therefore, the market space of waterproof material is about 150 billion Yuan.

Figure 3: waterproof industry chain: the downstream has extensive application,



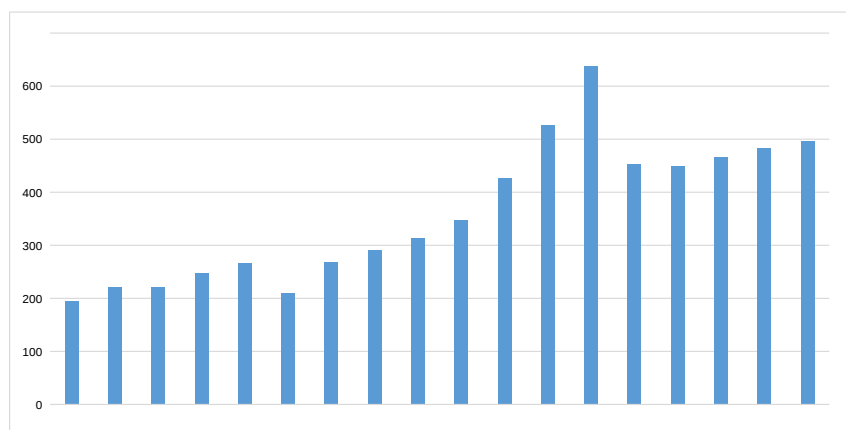
Data source: China Building Waterproof Industry Association, Changjiang Security

Method II:

Up to the end of 2015, there were 975 waterproof roll manufacturing enterprises with production licenses in total, besides, there were a large number of non-waterproof roll manufacturing enterprises and about 2000 qualified building waterproof material manufacturing enterprises. In addition, there were also a large number of unlicensed enterprises. According to the data of Building Waterproof Industry Association, the business revenue of scaled enterprises (having revenue of over 20 million Yuan) in

2016 was about 98.8 billion Yuan in total, involving over 560 enterprises. Considering the large number of small and medium-sized enterprises, it is estimated that the total industry scale is about 150 billion Yuan.

Figure 4: the scaled waterproof industry enterprises were 496 in October before 2015



Data source: Wind, Changjiang Security Research Institute (the caliber for scaled enterprises was adjusted)

Industrial competition pattern: the waterproof market concentration ratio in our country is far lower than that in overseas

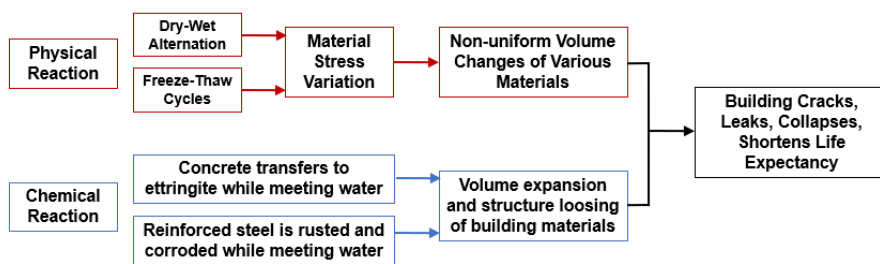
From an international perspective, the waterproof material industry concentration ratio in overseas is higher: in 2002, the total quantity of waterproof materials had reached to 1.5 billion square meters in America, but only 40 enterprises and about one hundred manufacturing enterprises were involved. The EPDM waterproof roll market having an annual output of 0.1 billion square meters was monopolized by two large companies: Xunshitong Company of over 5,000 square meters and Carlisle Companies of over 4,000 square meters. The waterproof material industry is similar in France, SOPREMA is the largest modified asphalt waterproof roll manufacturing enterprise in France, accounting for 35% of the market share in the plane house market of France.

The waterproof material enterprises in our country is disperse in Shandong, Hebei, Hunan and Guangdong with the form of industrial cluster, besides, there exists with large number of workshop-style enterprises. According to the statistics caliber of scaled enterprises, Oriental Yuhong accounts for 7% of the market share while other enterprises occupy a small proportion. In addition to few foreign-capital manufacturing enterprises in our country, the waterproof material enterprises in our country can be divided into five competitive echelons.

The first echelon is Oriental Yuhong with its scale far larger than that of other competitors; the second echelon involves COLSON, JOABOA, Hongyuan and

The building waterproof material quality and application effect directly affect the structural effect and service life of architectural engineering. Therefore, the waterproof materials are highly emphasized by the real estate developers and constructors. Besides the main architectural structure, waterproofing is the most important part to affect house quality, and is also the “pain point” of many consumers.

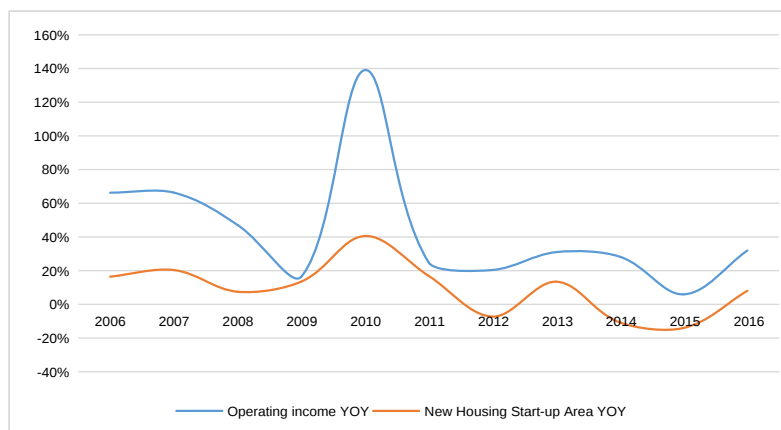
Figure 6: Know the importance of waterproof materials from the perspective of waterside



Data source: corporate report, Changjiang Security Research Institute

The real estate market occupies a larger proportion in the downstream demand of the company. Based on historical experience, the corporate revenue growth speed has large relation with the real estate market (In 2010, the high-speed train orders of the company increased rapidly owing to the concentrated construction of high-speed rails, which had certain particularity).

Figure 7: The corporate revenue growth speed has strong relation with real estate market



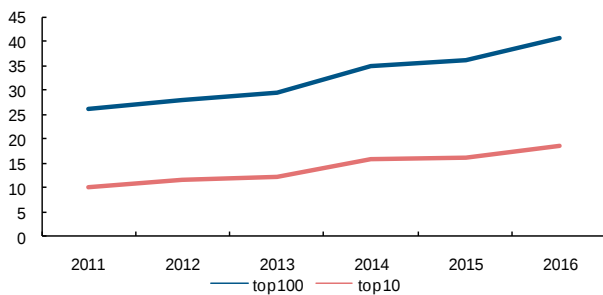
Data source: Wind, Changjiang Security Research Institute

In recent years, the concentration ratio of real estate developers has enhanced obviously. Wherein, the real estate enterprises of ten billion in 2016 reached to 131, increased by 27 compared with that in 2015, realized the sales volume of 5.7 trillion Yuan in total with the market share of nearly 50%, therefore, the industrial

concentration ratio accelerated. Besides, from the perspective of land market, the concentration ratio of the top ten real estate developers is higher.

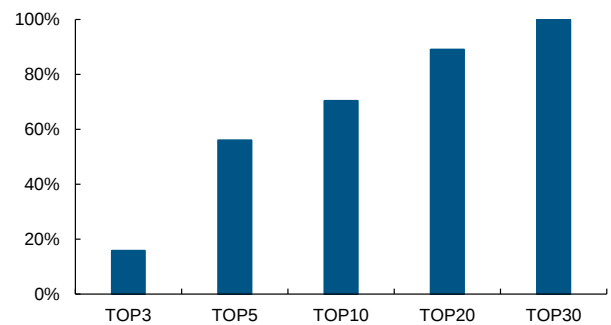
Meanwhile, as the house purchases have higher and higher requirement on house quality, the real estate developers face fiercer competition. The waterproof material occupies a small proportion in the construction cost (mainly applied in the fields of roof, external wall and basement), while the price difference between waterproof materials is within 10-20%. As the real estate developers pay more and more attention to house quality, they are not sensitive to waterproof material price.

Figure 8: The concentration ratio of real estate developers is enhancing year by year



Data source: China Index Academy, Changjiang Security Research Institute

Figure 9: The concentration ratio of TOP30 additional-adding lands of the Chinese real estate enterprises from January to October of 2017

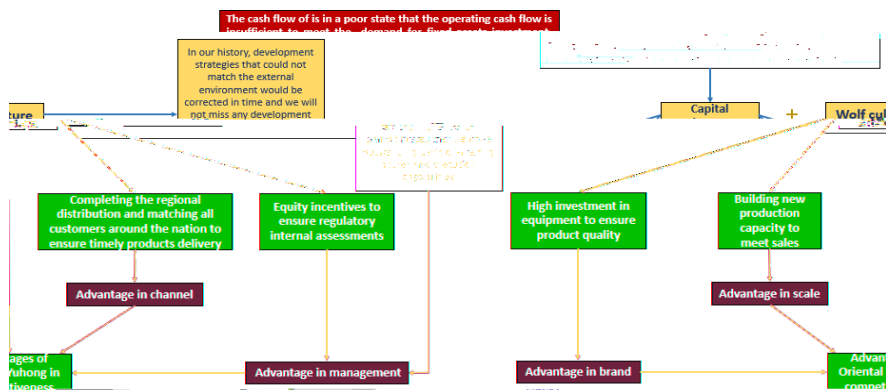


Data source: CRIC, Changjiang Security Research Institute

The multi-directional advantage creates growth moat

We think the core competitiveness of the company comes from two aspects: firstly, the wolf culture of the company; secondly, the first-mover advantage of listing. The waterproof industry has high requirement on capital. The company firstly realized listing in 2008 and then launched new production capacity constantly to realize multi-area layout, currently, it is far stronger than its competitions in competitiveness.

Figure 10: The competitiveness of the company is reflected by the enterprise culture and capital



Data source: corporate report, official website of the company, Changjiang Security Research Institute

Advantage I: wolf culture and incentive system

As the tycoon with absolute competitiveness in the waterproof industry, we think the wolf culture is reflected in two aspects: firstly, the decision-making capability of management layers and the executive force of the teams; secondly, the stock ownership incentive and bonus incentive are in place. The output per capita is obviously higher than that of its competitors.

Form 2: The output per capita (ten thousand Yuan) is obviously higher than that of other enterprises

Year	Oriental Yuhong	Kellen Share	Keshun Share
2014	138.98	94.02	88.56
2015	126.65	71.03	99.63
2016	128.85	67.58	101.34

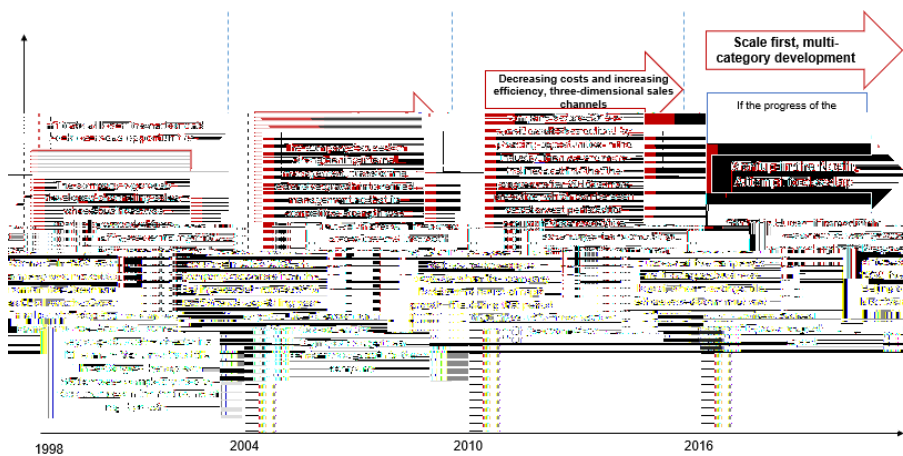
Data source: Wind, Changjiang Security Research Institute

Make decisions without hesitation and implement fast

The company owns excellent top management team and three-dimensional management architecture. In view of organizational architecture, the management tends to be flattened. For the key sales areas and key areas, the top management layers conduct direct management and control, such as Beijing Branch and Civil-use Building Material Company, which is beneficial to give play to the strong strategy execution capability of the company.

It can be seen from the development history of the company, the company can timely correct the development strategy according to actual situations, timely grasp the change in face of industrial pattern change and succeed in grasping the chances of large project construction, high-speed rail construction and cooperation with real estate developers thus to realize rapid development, which verifies its flexible decision-making capability and strong executive force.

Figure 11: The company experiences four development stages



Data source: corporate report, Changjiang Security Research Institute

The company realizes obvious enhancement in three stages in history from the perspective of market occupancy. Firstly, Olympic Games in 2006 and 2007; secondly, high-speed rail project in 2010 (in view of the sales volume of five major customers, the average sales scale was far higher than that in 2009; thirdly, the company adopted the PS strategy in 2016 to enlarge the revenue scale constantly.

Form 3: The sales volume of five major customers before 2009 and 2010

2010		2009	
Customer name	Sales volume (ten thousand Yuan)	Customer name	Sales volume (ten thousand Yuan)
Beijing-Shanghai high speed railway passenger transport line	16438.93	Taiyuan-Zhongwei (Yinchuan) railway engineering	2864.36
China Vanke Limited Liability Company	10832.47	China Vanke Limited Liability Company	2423.75
Beijing-Shijiazhuang railway passenger transport line	7845.67	Beijing Rail Traffic Yizhuang Engineering	2000.1
Shanghai-Hangzhou railway passenger transport line	4618.77	Tianjin Oriental Yuhong Waterproof Technology Co., Ltd. (agent)	1528.68
Beijing-Guangzhou railway passenger transport line	4570.48	Wuhan-Guangzhou passenger transport line	1505.4

Data source: Corporate report, Changjiang Security Research Institute

The growth in 2007 and 2010 benefited largely from the construction chances of Olympic Games and High-speed rail construction, while in 2008 and 2011, when the market environment changed (the Olympic games project in 2008 was completed and the high-speed rail order in 2011 was delayed), the company timely adjusted the competitive strategy but still realized the constantly enhancement of market occupancy, which was hard-won and reflected the comprehensive competitiveness of the company.

The stock ownership incentive attracts senior talents

The company realizes stock ownership incentive on the senior managers and main technicians in 2012 and 2016. The vesting conditions for these two stock ownership incentives were all the compound growth speed of over 25% for successive four years, especially for the incentive aiming at medium and high-level managers and technicians involving 1,112 persons in 2016.

Form 4: Previous stock ownership incentive situations of the company

expansion but also is helpful to save transportation expense and satisfy the supply timeliness to the downstream enterprises.

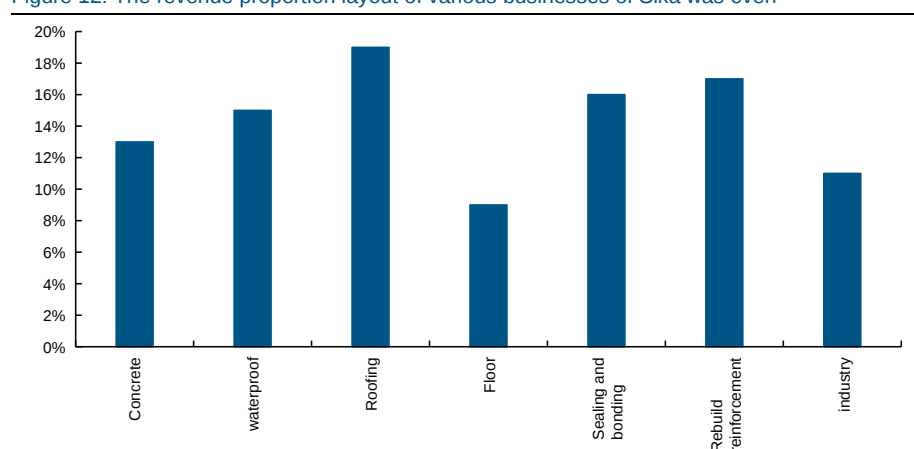
Form 6: Previous financing and fund raising projects since the company was listed

2008.8	2.29	First issue	The project of the waterproof roll of annual output of 10 million square meters and waterproof costing of 10,000 tons in Shanghai, the project of the waterproof roll of annual output of 10 million square meters, macromolecule waterproof roll of annual output of 5 million square meters and waterproof coating of annual output of 10,000 tons in Xuzhou

large scope to constantly its product line; in 2005, it raised the overall system solution (from roof to floor, key customer management, major engineering management), drove the sales volume to increase based on projects and made its products obtain larger advantage in cost and service optimization.

In recent years, it has constantly enriched and upgraded its product line through R&D and acquisition, concentrated its objection on seven businesses of the building and industrial fields: concrete, waterproof, roof, terrace, sealing and adhesion, overhaul and reinforcement and industry (the automobile field). Wherein, the revenue proportion of all businesses was not over 20% with even layout.

Figure 12: The revenue proportion layout of various businesses of Sika was even



Data source: Bloomberg, Changjiang Security Research Institute

The company has begun to accumulate diversified businesses since 2011 to lay a foundation for long-term development.

In August of 2011, The company established the mortar production line of 0.4 million tons in the Woniushan production base of Xuzhou, started the production, sales and service of special mortars including glue for tile, joint mixture and diatom ooze, and all were put into operation in 2013;

In July of 2014, the company established the thermal insulation material graphite polystyrene board production line of 0.8 million steres in the Wuhu production base of Anhui, started the production, sales and service of thermal insulation materials, and some have been put into operation currently;

In April of 2015, it formally established Huashazi Company to mainly engage in sales of mortar products, wherein, glue for tile was the core product for key development;

In May of 2015, Huashazi Company acquired Changsha Luodi, expanded the diatom ooze market and enlarged the sales network to nine provinces including Guangdong, Fujian, Shanxi, Shannxi and so on.

In December of 2016, the company acquired DAWASIA and expanded the decorative coating business. Besides, the company will establish the production base and

enlarge the marketing network to further enrich the corporate operation structure and increase the profit sources.

Form 7: Product category expansion rhythm of the company in recent years

Glue for tile	It is mixed by concrete, graded joint sand and polymer additive, substituting the traditional cement mortar bonding mode to plaster tiles and stones, which saves labor, material and space, safe and reliable, not easy to fall off, has low cost in unit area	The company has engaged in the production and sales businesses of glue for tile and decorative mortar since 2013. Currently, it has production capacity of 0.4 million tons, will realize the production capacity of 0.4 million tons
Decorative mortar (diatom ooze)	The diatom ooze taking kieselguhr as the main raw material has good decoration and function, which is the indoor decoration material to substitute the wallpaper and emulsion varnish. It has the functions of formaldehyde removal, air purification, adjusting humidity to release negative oxygen ion, fire and flame retardance, self-cleaning of wall, disinfection and deodorization	
Thermal insulation material	The graphite polystyrene board is mainly used for external wall insulation and has the characteristics of good fireproof performance and low heat conductivity coefficient, good breathability, low cost under same thermal insulation effect and good environmental protection performance in the production process	The company has begun to establish the thermal insulation material production line since 2015 and has 0.8 million steres of production capacity under construction (some have been put into operation)
Decorative coating	The company acquires DAW, carries out decorative coating businesses and orientates at the medium and high-end market	The company acquired DAW ASIA in 2016

Data source: Corporate announcements Changjiang Security Research Institute

Profitability prediction and investment suggestions

The waterproof industry has entered the rapid enhancement stage of concentration ratio since 2016 (concentration ratio enhancement in the downstream+environmental protection eliminating the small enterprises), and the revenue growth speed of the company has enhanced, which shows that the industrial competition pattern is optimizing rapidly. In 2017, the company realized the business volume of 10.194 billion Yuan with a year-on-year increasing of 46.2%; the attributable net profit of 1.244 billion Yuan with a year-on-year increase of 20.95%. It is expected to present the phenomenon of polarization in 2018 and the high revenue growth speed of the company will be realized; in 2017, the net interest rate declined owing to the raw material price increasing and stock ownership incentive expense. In 2018, the company considers to increase the price, reduce the stock ownership incentive expense and dilute the expense based on enlarged scale, and it is expected to increase in performance.

It is expected that the company will realize the attributable net profit of 1.72 and 2.37 billion Yuan in 2018 and 2019, corresponding to the PE of 24 times and 18 times. The concentration ratio of downstream real estate is enhanced, the company may benefit most, its other businesses have development potential, and the purchasing rating is conducted as well.

