

Beijing Oriental Yuhong - A

2021 results: Upbeat sales volume, better-than-expected credit impairment, GP margin miss

Yuhong's 2021 net profit increased 24.1% YoY, to Rmb4.2bn, in line with the profit alert in mid-January. Higher-than-expected COGS was offset by better-than-expected overhead cost and credit impairment. SG&A as a percentage of sales revenue was 13.8% vs. JPMe of 15.5%. Credit impairment was Rmb251mn vs. JPMe of 476mn, as total outstanding of Rmb13.5bn came in below our estimate of Rmb19bn. Op-CF inched up 4% YoY, to Rmb4.1bn, supported by 4Q21 Op-CF of Rmb10.4bn (+114% YoY).

- 2021 results in a nutshell.** 2021 sales revenue increased 47% YoY, to Rmb31.9bn, in line with our estimate, driven by revenue growth of 48% and 44% in the waterproof material (sheet membrane and coating) and other business segments, respectively. Sales volume for waterproof material rose 51% YoY, to 1.5bn sq.m, 7% above JPMe. GP margin was 30% (waterproof material: 32%, other business: 24%) vs. JPMe of 33%. The final proposed dividend was Rmb0.3/share. 4Q21 sales revenue increased 9.5% QoQ, and the bottom line increased 34% QoQ. 4Q21 GP margin inched up 1.3ppt QoQ, to 29.7%. Please see Table 1 for a financial data summary.
- Waterproof material segment.** Unit COGS increased 10.1% YoY, to Rmb11.3/sq.m, with the price of key raw material bitumen (China spot) rising 20% YoY. Waterproof material ASP decreased 2.3% YoY, to Rmb16.7/sq.m, on product mix, as the revenue proportion of waterproof coating increased to 39% in 2021 vs. 35% in 2020.
- Op-CF and balance sheet.** 2021 Op-CF increased 4% YoY, to Rmb4.1bn. 4Q21 Op-CF gained 114% YoY, to Rmb10.4bn, vs. 3Q21's negative Op-CF of Rmb2.8bn. Credit impairment was 251mn, representing 1.9% of total outstanding receivable of Rmb13.5bn. Total outstanding receivable increased 45% YoY, driven by accounts receivable up 40% (to Rmb12.6bn) and other receivable up 168% YoY (to Rmb878mn). The increase rate of AR was lower than that of revenue, which met the company's stock incentive criteria. The net cash position increased to Rmb9.1bn at end-2021 vs. Rmb2.7bn one year earlier.

Overweight

002271.SZ, 002271.CH

Price: Rmb45.60

11 Apr 2022

Price Target: Rmb60.00

PT End Date: 31 Dec 2022

Asia Basic Materials

Addison Dai ^{AC}

(86-21) 6106 6320

addison.dai@jpmorgan.com

Bloomberg JPMA DAI <GO>

SAC Registration Number: S1730521010001

Linda Cong

(86-21) 6106 6356

linda.cong@jpmchase.com

SAC Registration Number: S1730520030007

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Table 1: Yuhong: Financial and operational data

Rmb mn	FY21	FY20	% YoY
Sales revenue	31,934	21,730	47.0%
COGS	22,397	13,867	61.5%
Gross profit	9,537	7,864	21.3%
Selling expense	2,218	1,788	24.1%
Admin expenses	1,645	1,261	30.5%
R&D expenses	559	464	20.6%
Operating profit	5,116	4,352	17.6%
Gains/(losses)	508	287	76.9%
Asset reversal/(impairment)	(265)	(264)	N.M.
Investment gains/(loss)	9	209	-95.9%
Others	(35)	(49)	N.M.
EBIT	5,332	4,535	17.6%
Net financing expense/(income)	232	380	-39.0%
Profit before tax	5,100	4,155	22.7%
Tax	887	769	15.4%
Profit	4,213	3,387	24.4%
MI	9	(2)	N.M.
Net profit to shareholders	4,205	3,389	24.1%
GP margin	29.9%	36.2%	-6.3ppt
SG&A % sales revenue	13.8%	16.2%	-2.3ppt
Sales revenue by product (Rmb mn):			
Waterproof sheet membrane	15,667	11,233	39.5%
Waterproof coating	9,820	6,014	63.3%
Waterproof engineering	4,028	3,304	21.9%
Others (sales of materials and other business)	2,419	1,180	105.0%
Total	31,934	21,730	47.0%
Major product GP margin (%):			
Waterproof sheet membrane	31.1%	39.2%	-8.1ppt
Waterproof coating	34.1%	41.2%	-7.1ppt
Waterproof engineering	28.4%	28.5%	-0.1ppt
Others (sales of materials and other business)	16.1%	19.8%	-3.7ppt
Waterproof material sales volume (mn sq.m)	1,526	1,009	51.2%
Waterproof material ASP (Rmb/sq.m)	16.7	17.1	-2.3%

Source: Company data, J.P. Morgan.

Investment Thesis

We rate Yuhong OW. Yuhong is the #1 waterproof material (sheet membrane and coating) producer in China, with a 12% market share in 2020. We believe the company's waterproof segment (WS) revenue could rise at a 22% CAGR in 2021-25 (vs. the industry's market size CAGR of 9%) to underpin a market share of 25% in 2025. Leveraging the strong customer resources of WS, other business expansion (decorative and insulation material, build repairs, etc.) has proved successful, with revenue growth surpassing that of WS for the first time in 2020, driven by increasing product penetration and China's strong aftermarket refurbishment growth. In the long run, we foresee multiple industry demand growth opportunities, such as China's building code (waterproof) upgrades, growing retrofit demand upon the pile-up stocks of old buildings, and the government's push for rooftop solar, benefitting Yuhong as a top player.

Valuation

We project an earnings CAGR of 22% in 2021-23, driven by a revenue CAGR of 25%. Our Dec-22 PT of Rmb60 is based on a 24.5x 2023E P/E and assumes that the multiple will not deviate from the current 24.8x 2022E P/E. Our target valuation is slightly above the company's historical seven-year average plus 1 S.D of 23.5x. In our view, valuation could trade above mean reversion due to: (1) a market leadership firm-up in its core business; (2) other business expansion bolstered by product penetration increases and industry growth opportunities; and (3) a growing revenue contribution by the 2C business.

Risks to Rating and Price Target

Downside risks to our rating and price target include: (1) worse-than-expected delinquent payments of property developers, which would trigger write-offs of outstanding receivables – we estimate that an additional 10% increase in total outstanding receivables and an additional 10% increase in the write-offs of other receivables would adversely impact 2022E earnings by 7.4%; and (2) the company's failure to increase selling prices in order to thoroughly pass through raw material price inflation against the backdrop of a high-oil-price environment – we estimate that a 10% increase in fossil fuels and fossil fuel derivatives prices would adversely impact 2022E earnings by 9.3%.

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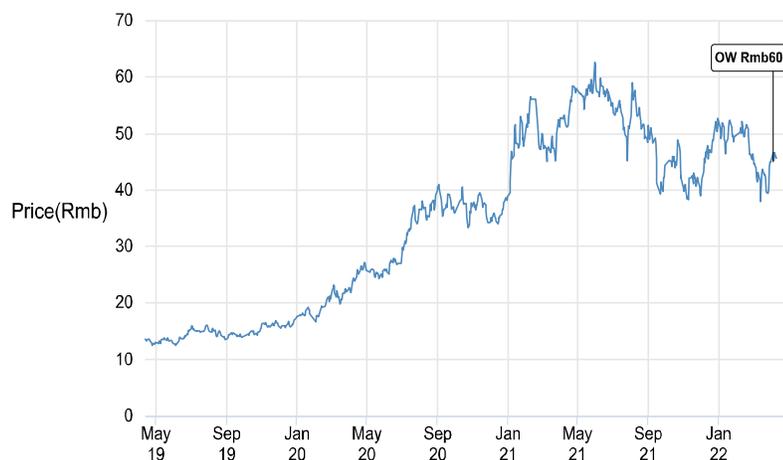
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Beijing Oriental Yuhong - A (002271.SZ, 002271 CH) Price Chart



Date	Rating	Price (Rmb)	Price Target (Rmb)
06-Apr-22	OW	44.89	60

Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Apr 06, 2022. All share prices are as of market close on the previous business day.

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