

## Lee & Man Paper [2314.HK]

### In-line 2017 Results. Tissue paper remains a growth driver.

Lee and Man Paper's (LMP) 2017 results were in line with previous guidance. During the results presentation, LMP management reiterated its positive view on the outlook for both containerboard and tissue paper operations. Even though management didn't release any concrete guidance on average selling prices or margin movement, it expects sales volume to pick up after the low season during Chinese New Year and pricing to hold up. LMP management believes that new capacity in the industry will be lower than the expectations of some investors, given environmental protection issues and import quotas for waste paper. New capacity in the industry will be absorbed by 2-3% YoY increase in annual demand. LMP will add 0.5m tonnes of new packaging paper capacity in Vietnam, so the Company's total annual packaging paper capacity will reach 6.53m tonnes by the end of 2019, up 8.3%. The capacity expansion in Vietnam is intended for capturing opportunities from the re-location of manufacturing activity from China to Southeast Asia. LMP didn't announce any expansion plan for containerboard machines in China. LMP had annual tissue paper capacity of 685,000 tonnes at the end of 2017. Total annual tissue paper capacity will reach 795,000 tonnes in mid-2018. At this stage, LMP's tissue paper products are a growth driver. LMP is selling the tissue paper on both an OEM basis and through its own brand, Hanky. The mix of tissue paper is 90%/10% OEM/Hanky in 2018. We maintain the view that LMP's basic investment theme remains on track. We still believe that the market has under-appreciated LMP's growth potential in the China tissue paper market and that concerns about new capacity in the industry are somewhat overdone. LMP is now trading at 7.3x 2018E PER. We maintain our BUY rating on LMP, with a new target price of HK\$12.52 (based on 10x 2018E PER, in line with its historical average and lower than the average of its listed peers).

#### Investment Highlights

- 2017 net profit jumped 76%.** LMP's turnover was HK\$25,836.9m in 2017, up 40.8% YoY, from HK\$18,347.1m in 2016. The turnover growth was driven mainly by a 44% YoY increase in the average selling price to about HK\$4,678 per tonne, as sales volume was down 1.9% YoY to 5.5m tonnes in 2017. LMP's gross profit margin was 29.1% in 2017, up from 22.2% in 2016. LMP's SG&A rose 35.2% YoY, because of higher selling expenses due to an increase in logistics costs. Interest expenses were up 11% YoY, from HK\$167.2m in 2016 to HK\$185.3m in 2017. Net profit was up 76% YoY, from HK\$2,862.7m in 2016 to HK\$5,040.3m in 2017. Net profit per tonne for containerboard was HK\$910 and that for tissue paper was HK\$953 per tonne. LMP declared a final dividend of HK\$0.20 for 2017, up from HK\$0.11 for 2016, implying a payout ratio of 34% in 2017. The Company's tissue paper business reported an operating profit margin of 18.9% in 2017, up from 8.6% in 2016. Tissue business accounted for 10.5% of LMP's total turnover in 2017. LMP had total annual tissue paper capacity of 685,000 tonnes at the end of 2017.
- Tissue paper remains a growth driver.** LMP's tissue paper capacity will increase to 795,000 tonnes per year by mid-2018. Despite high pulp costs, the profitability of LMP's tissue paper business remains stable, given its economies of scale. LMP will continue to adopt effective marketing strategies to grow its tissue paper business: a) selling its own-brand products, and b) promotion via online channels. LMP has three years' operating history in tissue paper manufacturing, which in our view, offers the Company the option of spinning off its tissue paper business. We still maintain the view that the tissue paper business is a medium- to long-term growth driver for LMP.
- Concerns about the containerboard paper segment overdone.** Despite concerns about an increase in new capacity in the industry, LMP management believes that the increase will be lower than what some investors expect. We believe that containerboard prices will be supported by ongoing pollution controls in China and the paper mills' strategy of maintaining prices by selling less volume. LMP management said that paper prices are unlikely to see a major correction. We still maintain the view that market concerns about the supply/demand situation seem overdone. The import quotas for waste paper released by Chinese government will also help constrain an increase in new capacity.

Key Financials (in HKDm)	2015	2016	2017	2018E	2019E
Revenue	17,615.6	18,341.7	25,836.9	28,024.6	29,828.7
Change (YoY %)	3.0	4.1	40.9	8.5	6.4
Gross Profit	3,578.3	4,080.5	7,512.9	7,873.4	8,111.0
Gross Margin %	20.3	22.2	29.1	28.1	27.2
Net Profit	2,331.8	2,862.7	5,040.5	5,638.7	5,717.9
Net Margin %	13.2	15.6	19.5	20.1	19.2
EPS (Basic)	0.60	0.63	1.10	1.23	1.25
Change (YoY %)	23.9	24.2	75.7	11.9	1.4
DPS	\$0.180	\$0.220	\$0.370	\$0.426	\$0.489
ROE (%)	13.4	16.8	26.0	24.1	21.9
Dividend Yield (%)	2.01	2.46	4.13	4.75	5.47
PER (x)	17.7	14.3	8.1	7.3	7.2
PBR (x)	2.4	2.4	1.9	1.7	1.5
FCF Yield (%)	3.02%	2.94%	3.15%	12.94%	14.98%
Capex (m)	(2,849.5)	(3,800.0)	(3,600.0)	(2,600.0)	(1,500.0)
Free cash flow per share	0.3	0.3	0.3	1.2	1.3
Net Gearing (%)	65.6	73.0	58.5	45.8	34.6

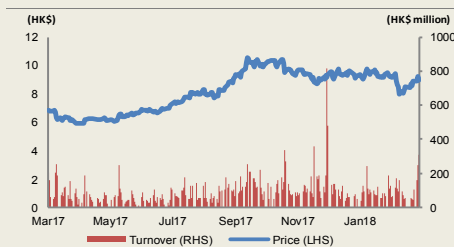
Sources: Company, CGIS Research estimates

## China Materials - Paper BUY

Close: HK\$8.95 (FEB 28, 2018)

Target Price: HK\$12.52

#### Share Price Performance



Sources: Bloomberg, CGIS Research

Market Cap	US\$5,146m
Shares Outstanding	4,505.4m
Auditor	Deloitte Touche Tohmatsu
Free Float	30%
52W range	HK\$5.9-10.52
3M average daily T/O	US\$14.4m
Major Shareholding	Lee Wan Keung (56.0%)

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**Figure 1: LMP's 2016 Interim Results highlights**

2016 Interim Results Highlights (HKD m)	1H 2015	2H 2015	1H 2016	2H 2016	1H 2017	2H 2017
Revenue	8,695	8,920	8,369	9,973	11,440	14,397
Cost of sales and services	-6,902	-7,136	-6,424	-7,837	-8,361	-9,963
<b>Gross profit</b>	<b>1,794</b>	<b>1,785</b>	<b>1,944</b>	<b>2,136</b>	<b>3,079</b>	<b>4,434</b>
Other income and other gains and losses	148	293	310	258	344	379
Distribution and selling expenses	-166	-152	-114	-138	-205	-230
Administrative expenses	-417	-380	-408	-467	-515	-776
Finance costs	-71	-84	-87	-80	-81	-104
JV & Associates	0	0	0	0	0	0
<b>Profit before tax</b>	<b>1,288</b>	<b>1,462</b>	<b>1,645</b>	<b>1,709</b>	<b>2,621</b>	<b>3,703</b>
Income tax expense	-168	-251	-215	-276	-427	-856
MI	0	0	0	0	0	0
<b>Profit for the period</b>	<b>1,120</b>	<b>1,212</b>	<b>1,430</b>	<b>1,432</b>	<b>2,194</b>	<b>2,847</b>
Owners of the Company	1,120	1,212	1,430	1,432	2,194	2,847
<b>Gross margin (%)</b>	<b>20.6</b>	<b>20.0</b>	<b>23.2</b>	<b>21.4</b>	<b>26.9</b>	<b>30.8</b>
<b>Operating margin (%)</b>	<b>15.6</b>	<b>17.3</b>	<b>20.7</b>	<b>17.9</b>	<b>23.6</b>	<b>26.4</b>
<b>Net Margin (%)</b>	<b>12.9</b>	<b>13.6</b>	<b>17.1</b>	<b>14.4</b>	<b>19.2</b>	<b>19.8</b>

Source: Company, CGIS Research

**Figure 2: Key Assumptions for LMP**

	2012	2013	2014	2015*	2016	2017	2018F	2019F
<b>Turnover (HKD m)</b>								
Linerboard	9,418.0	13,166.0	13,237.0	13,576.0	14,334.0	20,120.0	19,114.0	18,158.3
Medium	1,073.0	1,356.0	1,547.0	1,547.0	1,240.0	1,407.0	1,804.3	2,528.3
Whiteboard	601.9	1,800.9	1,531.0	1,394.0	1,463.0	1,575.0	2,093.2	2,510.2
Pulp	331.1	647.4	710.0	674.9	303.0	16.0	8.0	0
Tissue Paper	0	0	74.1	423.8	1,001.7	2,718.9	5,005.2	6,631.9
Total	11,424.0	16,970.4	17,099.1	17,615.6	18,341.7	25,836.9	28,024.6	29,828.7
<b>YoY Change (%)</b>								
Linerboard		39.8	0.5	2.6	5.6	40.4	(5.0)	(5.0)
Medium		26.4	14.1	0	(19.8)	13.5	28.2	40.1
Whiteboard		199.2	(15.0)	(8.9)	4.9	7.7	32.9	19.9
Pulp		95.5	9.7	(4.9)	(55.1)	(94.7)	(50.0)	(100.0)
Tissue Paper					136.4	171.4	84.1	32.5
Total		48.6	0.8	3.0	4.1	40.9	8.5	6.4
<b>Gross margin (%)</b>								
Linerboard	17.1	17.0	18.0	20.3	22.2	29.1	28.1	27.2
Medium	17.5	17.5	18.6	20.8	22.3	29.5	28.5	27.5
Whiteboard	13.0	13.0	13.0	15.0	17.3	24.5	23.5	22.5
Pulp	17.0	17.0	17.0	20.0	22.3	29.4	28.4	27.4
Tissue Paper	18.0	15.4	17.4	19.4	19.4	22.4	21.4	20.4
Tissue Paper	0	0	25.0	25.0	28.0	28.0	28.0	28.0
Net margin (%)	11.6	11.5	11.1	13.2	15.6	19.5	20.1	19.2
<b>Cost (HKD m)</b>								
Cost of Sales	(9,473)	(14,084)	(14,028)	(14,037)	(14,261)	(18,324)	(20,151)	(21,718)
S,G&A	(660.2)	(934.0)	(1,038.9)	(1,114.2)	(1,127.3)	(1,726.6)	(1,872.8)	(1,993.4)
Financial Expenses	(70.1)	(148.9)	(214.6)	(154.9)	(167.2)	(185.3)	(199.1)	(203.0)
<b>YoY Change (%)</b>								
Cost of Sales		48.7	(0.4)	0.1	1.6	28.5	10.0	7.8
R&D		41.5	11.2	7.2	1.2	53.2	8.5	6.4
Financial Expenses		112.4	44.2	(27.9)	8.0	10.8	7.4	2.0
<b>CAPEX (HKD m)</b>								
CAPEX (HKD m)	1,600.0	2,242.5	2,093.3	2,849.5	3,800.0	3,600.0	2,600.0	1,500.0
<b>Net Gearing (%)</b>								
Net Gearing (%)	57.7	62.7	62.0	65.6	73.0	58.5	45.6	34.2
<b>Shipment (000 tonnes)</b>								
Linerboard	2,658	3,861	3,945	4,316	4,565	4,460	4,460	4,460
Medium	326	431	508	509	397	271	421	621
Whiteboard	176	519	437	425	454	376	526	664
Tissue Paper	0	0	10	48	141	352	600	795
<b>Shipment YoY Change (%)</b>								
Linerboard		45	2	9	6	(2)	0	0
Medium		32	18	0	(22)	(32)	55	48
Whiteboard		195	(16)	(3)	7	(17)	40	26
Tissue Paper					194	150	70	33
<b>ASP (HK\$)</b>								
Linerboard	3,543.3	3,410.0	3,355.4	3,145.5	3,140.0	4,511.2	4,285.7	4,071.4
Medium	3,291.4	3,146.2	3,045.3	3,039.3	3,123.4	5,191.9	4,932.3	4,685.7
Whiteboard	3,419.8	3,470.0	3,503.4	3,280.0	3,222.5	4,188.8	3,979.4	3,780.4
Tissue Paper	0	0	7,413.4	8,828.7	7,104.1	7,724.1	8,342.0	8,342.0
<b>ASP YoY Change (%)</b>								
Linerboard		(3.8)	(1.6)	(6.3)	(0.2)	43.7	(5.0)	(5.0)
Medium		(4.4)	(3.2)	(0.2)	2.8	66.2	(5.0)	(5.0)
Whiteboard		1.5	1.0	(6.4)	(1.8)	30.0	(5.0)	(5.0)
Tissue Paper					(19.5)	8.7	8.0	0

Sources: Company, CGIS Research

**Figure 2: Earnings projection**

Income Statement (HKDm)	FY2015	FY2016	FY2017	FY2018F	FY2019F	Cash Flow Statement (HKDm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
<b>Revenue</b>	<b>17,616</b>	<b>18,342</b>	<b>25,837</b>	<b>28,025</b>	<b>29,829</b>	<b>Net Income</b>	<b>2,876</b>	<b>3,481</b>	<b>6,566</b>	<b>6,784</b>	<b>6,869</b>
Growth yoy%	3.0%	4.1%	40.9%	8.5%	6.4%	Depreciation & Amort.	858	927	1,096	1,183	1,233
<b>Gross Profit</b>	<b>3,578</b>	<b>4,081</b>	<b>7,513</b>	<b>7,873</b>	<b>8,111</b>	Change in Working Capital	365	593	(2,770)	(65)	(461)
Growth yoy%	16.5%	14.0%	84.1%	4.8%	3.0%	<b>Cash from Ops.</b>	<b>4,098</b>	<b>5,001</b>	<b>4,892</b>	<b>7,902</b>	<b>7,641</b>
Selling General & Admin Exp.	(1,114)	(1,127)	(1,727)	(1,873)	(1,993)	Capital Expenditure	(2,850)	(3,800)	(3,600)	(2,600)	(1,500)
Others Operating Expenses/Items	0	0	0	0	0	Sale of Property, Plant, and Equipment	-	-	-	-	-
<b>Operating Income</b>	<b>2,464</b>	<b>2,953</b>	<b>5,786</b>	<b>6,001</b>	<b>6,118</b>	Change in Investing Activities	(146)	(715)	554	(1,129)	(1,250)
Growth yoy%	n.a.	19.9%	95.9%	3.7%	1.9%	<b>Cash from Investing</b>	<b>(2,996)</b>	<b>(4,515)</b>	<b>(3,046)</b>	<b>(3,729)</b>	<b>(2,750)</b>
Interest Expense	(154.9)	(167.2)	(185.3)	(199.1)	(203.0)	Net increase in bank borrowings	20,439	(716)	1,531	300	300
Interest and Invest. Income						Issuance of Common Stock	0	0	0	0	0
Income/(Loss) from Affiliates	0	0	0	0	0	Common Dividends Paid	(739)	(939)	(1,270)	(1,782)	(2,049)
Other Non-Operating Inc. (Exp.)	13.2	22.3	(69.2)	0	0	Special Dividend Paid	-	-	-	-	-
Impairment of Goodwill	0	0	0	0	0	Other Financing Activities	(957)	(517)	(1,133)	(901)	(903)
Gain (Loss) On Sale Of Invest.	428	546	792	805	785	<b>Cash from Financing</b>	<b>18,742</b>	<b>(2,171)</b>	<b>(871)</b>	<b>(2,383)</b>	<b>(2,652)</b>
Gain (Loss) On Sale Of Assets						<b>Net Change in Cash</b>	<b>19,845</b>	<b>(1,684)</b>	<b>974</b>	<b>1,789</b>	<b>2,238</b>
Income Tax Expense	(418)	(491)	(1,283)	(968)	(981)						
Minority Int. in Earnings	0	0	0	0	0						
<b>Net Income</b>	<b>2332</b>	<b>2863</b>	<b>5040</b>	<b>5639</b>	<b>5718</b>						
Growth yoy%	47.4%	22.8%	76.1%	11.9%	1.4%						

Balance Sheet (HKDm)	FY2015	FY2016	FY2017	FY2018F	FY2019F	Ratios	FY2015	FY2016	FY2017	FY2018F	FY2019F
<b>ASSETS</b>						<b>Profitability</b>					
Cash And Equivalents	2,959	1,274	2,249	4,038	6,276	Return on Assets %	6.6%	8.1%	12.9%	12.5%	11.8%
Receivables	4,869	4,960	6,776	7,350	7,823	Return on Capital %	6.7%	8.0%	13.2%	13.0%	12.3%
Inventory	3,092	2,914	4,954	4,878	5,192	Return on Equity %	13.4%	16.8%	26.0%	24.1%	21.8%
Other Current Assets	122	40	84	49	52	<b>Margin Analysis</b>					
<b>Total Current Assets</b>	<b>11,042</b>	<b>9,189</b>	<b>14,063</b>	<b>16,315</b>	<b>19,343</b>	Gross Margin %	20.3%	22.2%	29.1%	28.1%	27.2%
Net Property, Plant & Equipment	23,351	24,312	27,459	28,876	29,144	SG&A Margin %	6.3%	6.1%	6.7%	6.7%	6.7%
Long-term Investments	-	-	-	-	-	EBIT Margin %	14.0%	16.1%	22.4%	21.4%	20.5%
Other Intangibles	-	-	-	-	-	EBITDA Margin %	18.9%	21.2%	26.6%	25.6%	24.6%
Deferred Tax Assets, LT	-	-	-	-	-	Net Income Margin %	13.2%	15.6%	19.5%	20.1%	19.2%
Other Long-Term Assets	1,206	1,495	1,768	1,768	1,768	<b>Asset Turnover</b>					
Goodwill	-	-	-	-	-	Total Asset Turnover	0.5x	0.5x	0.6x	0.6x	0.6x
Accounts Receivable Long-Term	-	-	-	-	-	Fixed Asset Turnover	0.7x	0.7x	0.9x	0.9x	1.0x
Total Long Term Assets	<b>24,557</b>	<b>25,807</b>	<b>29,227</b>	<b>30,644</b>	<b>30,912</b>	Accounts Receivable Turnover	3.3x	3.7x	4.4x	4.0x	3.9x
<b>Total Assets</b>	<b>35,599</b>	<b>34,996</b>	<b>43,290</b>	<b>46,959</b>	<b>50,254</b>	Inventory Turnover	5.7x	6.3x	5.2x	5.7x	5.7x
<b>LIABILITIES &amp; EQUITY</b>						<b>Liquidity</b>					
Accounts Payable	3,043	3,549	4,672	5,068	5,394	Current Ratio	1.3x	1.2x	1.3x	1.4x	1.6x
Accrued Exp.	-	-	-	-	-	Quick Ratio	0.9x	0.8x	0.8x	1.0x	1.2x
Short-term Borrowings	5,250	4,240	6,026	6,026	6,026	Avg. Days Sales Out.	100.9	98.7	95.7	95.7	95.7
Curr. Port. of LT Debt	-	-	-	-	-	Avg. Days Inventory Out.	64.1	58.0	70.0	63.5	63.5
Curr. Income Taxes Payable	-	-	-	-	-	Avg. Days Payable Out.	79.1	90.8	93.1	91.8	90.7
Unearned Revenue, Current	-	-	-	-	-	Avg. Cash Conversion Cycle	118.2	102.7	128.4	118.1	117.0
Other Current Liabilities	156	170	342	360	396	Net Debt to Equity	66%	73%	59%	46%	34%
<b>Total Current Liabilities</b>	<b>8,449</b>	<b>7,960</b>	<b>11,040</b>	<b>11,453</b>	<b>11,815</b>	<b>Growth Over Prior Year</b>					
Long-Term Debt	9,012	9,307	9,052	9,352	9,652	Total Revenue	3.0%	4.1%	40.9%	8.5%	6.4%
Def. Tax Liability, Non-Curr.	0	0	0	0	0	Net Income	22.4%	22.8%	76.1%	11.9%	1.4%
Other Non-Current Liabilities	902	907	1,282	1,282	1,282	Payout Ratio %	35.7%	35.1%	33.6%	34.0%	38.6%
<b>Total Liabilities</b>	<b>18,363</b>	<b>18,173</b>	<b>21,374</b>	<b>22,087</b>	<b>22,749</b>						
Common Stock	114	114	113	113	113						
Additional Paid In Capital	-	-	-	-	-						
Retained Earnings	17,122	16,709	21,803	24,759	27,392						
Treasury Stock	-	-	-	-	-						
Comprehensive Inc. and Other	-	-	-	-	-						
Minority Interest	0	0	0	0	0						
<b>Total Equity</b>	<b>17,236</b>	<b>16,823</b>	<b>21,916</b>	<b>24,872</b>	<b>27,505</b>						
<b>Total Liabilities And Equity</b>	<b>35,599</b>	<b>34,996</b>	<b>43,290</b>	<b>46,959</b>	<b>50,254</b>						

Sources: Company Data, CGIS Research

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