

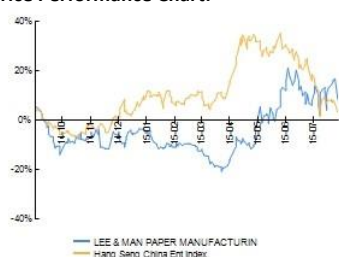
1 March, 2018

Outperform Unchanged

Market Data: 28 Feb

Closing Price (HK\$)	8.95
Price Target (HK\$)	10.50
HSCEI	12336.
HSCCI	4501
52-week High/Low (HK\$)	5.60/3.55
Market Cap (USD Mn)	4363
Market Cap (HK\$ Mn)	34208
Shares Outstanding (Mn)	4,606
Exchange Rate (RMB-HK\$)	1.27

Price Performance Chart:



Source: Bloomberg

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Improving fundamentals

LEE & MAN PAPER MANUFACTURING (2314:HK)

Financial summary and valuation

	2016	2017	2018E	2019E	2020E
Revenue (HKD million)	18,342	25,837	25,872	30,124	30,789
YOY (%)	4.1	40.9	0.1	16.4	2.2
Net income (HKD million)	2,863	5,040	5,548	6,208	6,398
YOY (%)	22.8	76.1	10.1	11.9	3.1
EPS (HKD)	0.61	1.10	1.21	1.36	1.40
Diluted EPS (HKD)	0.63	1.10	1.21	1.36	1.40
ROE (%)	17.0	23.0	21.6	20.8	18.8
Debt/asset (%)	52.5	50.0	50.1	54.2	59.1
Dividend Yield (%)	2.3	3.1	4.4	4.9	5.1
P/E (x)	14.5	8.2	7.5	6.7	6.5
P/B (x)	2.5	1.9	1.6	1.4	1.2
EV/EBITDA (x)	12.0	7.3	6.2	5.6	5.5

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised.

Lee & Man Paper Manufacturing announced 2017 net profit of HK\$5.0bn (+76% YoY) and EPS of HK\$1.10, in line with the company's guidance of 75% net profit growth. We remain optimistic on the company's long-term outlook, given its solid fundamentals and structural improvements in the paper industry. We maintain our EPS forecasts of HK\$1.21 in 18E (+10.0% YoY) and HK\$1.36 in 19E (+12.4% YoY), and introduce our 20E forecast of HK\$1.40 (+2.9% YoY). Our target price is unchanged at HK\$10.50. With 17% upside, we maintain our Outperform recommendation.

Margin expansion in 2H17. The company's total sales volume reached 2.75mt in 2H17 (vs 2.77mt in 1H17 and 2.96mt in 2H16), with an average selling price (ASP) of HK\$5,233/t (+HK\$1,104/t HoH; +HK\$1,864/t YoY). Its unit cost arrived at HK\$3,622/t in 2H17 (+HK\$603/t HoH; +HK\$974/t YoY), resulting in a unit gross margin of HK\$1,612/t (+HK\$501/t HoH; +HK\$890/t YoY). The strong margin expansion during the peak season reaffirms our view of a positive long-term structural change in the containerboard industry. We expect the margin expansion trend to continue in 2018.

Deleveraging. The company's net debt arrived at HK\$12.8bn in 2H17 (vs HK\$13.2bn in 1H17 and HK\$12.3bn in 2H16). Its gearing decreased from 71% in 1H17 to 59% at present. We note both Lee & Man and Nine Dragons Paper (2689:HK – BUY) are deleveraging, indicating that market leaders are strengthening their balance sheet.

Promising outlook for 2018. We expect the firm to record steady improvement in orders as the government introduces more stringent environmental regulations, such as environmental taxes, to crack down on outdated capacity, and making approvals for new capacity more difficult to obtain. We believe the new regulation on old corrugated cardboard (OCC) imports will decrease total OCC usage from 28mt in 17E to c.20mt in 18E, while the top-three paper producers, Nine Dragons Paper, Anhui Shanying Paper Industry (600567:CH – BUY), and Lee & Man Paper, account for 77% of total OCC imports. Meanwhile, we expect containerboard prices to bottom out as demand recovers in 2018. We note domestic containerboard prices rose by Rmb300/t this week, underpinned by demand recovery and low downstream inventories. We forecast Lee & Man's tissue paper capacity to increase from 0.5mt to 0.8mt in 2018E, amid management's positive profitability guidance.

Maintain Outperform. As the structure of the paper industry continues to improve, we remain bullish on Lee & Man's long-term outlook. We maintain our EPS forecasts of HK\$1.21 in 18E (+10.0% YoY) and HK\$1.36 in 19E (+12.4% YoY), and introduce our 20E forecast of HK\$1.40 (+2.9% YoY). Our target price is unchanged at HK\$10.50, representing 2x 18E PB and 9x 18E PE. With 17% upside, we maintain our Outperform recommendation.

投资摘要

理文造纸公布 2017 年利润为港币 5040 百万元，对应每股净利润 1.10 元（同比增长 76%），与公司之前不低于 75% 的增长目标一致。

2017 年下半年实现吨毛利扩张 在 17 年下半年，理文总销量将达到 275 万吨，相较于 17 年上半年的 277 万吨，16 年下半年的 296 万吨。吨售价将达到港币 5233 元，环比增加港币 1104 元，同比增加港币 1864 元。吨成本达到港币 3622 元，环比增加港币 603 元，同比增加港币 974 元，因此 17 年下半年的吨毛利为港币 1612 元，环比增加港币 501 元，同比增加港币 8910 元。旺季的吨毛利大幅度扩张肯定了我们长期看好箱板纸行业的结构性变化，并且我们认为吨毛利上涨将持续反映在即将到来的 2018 年。

杠杆大幅下降 理文净债务水平在 17 年年底到达港币 128.3 亿元，对比 1H17 的港币 132.2 亿元和 2H16 的 122.7 亿元。杠杆率也已经由上半年的 71% 下降到目前的 59%。纸业巨头在这轮造纸牛市中大幅下降杠杆巩固了自身的资产负债表

2018 新年肇始，前景可期 随着环保政策逐步趋严，如环保税的颁布、削减过剩产能以及产能批复更难获得的现状，我们认为理文造纸将持续受益并实现业绩的稳定上升。我们预测进口废纸新规将导致 2018 年的外废使用总量从 2017 年的 2800 万吨下降至 2000 万吨。同时，前四轮进口废纸审批列表显示，三家造纸企业龙头（玖龙、理文和山鹰）已占总外废进口量的 71%，这意味着小型厂商将不能再进口废纸并加速退出市场。华东地区的国废价格已从人民币 2000 元/吨回弹至人民币 2200 元/吨。我们预计箱板纸的价格暂时居于地位，并在 2018 年需求复苏后开始价格回升。理文造纸的卫生用纸产能将在 2018 年从 50 万吨上升至 80 万吨，同时在理文领导层认为卫生用纸将收获高利润率。

维持增持。由于造纸行业的结构性改善，我们长期看涨理文造纸。我们保持 17 年的每股收益港币 1.12 元（同比增长 78%），同时保持 18 年港币 1.21 元（同比增长 9%）。我们维持目标价港币 10.5 元，对应 18 年市净率 2 倍和市盈率 9 倍。基于 17% 的上浮，我们维持增持评级。

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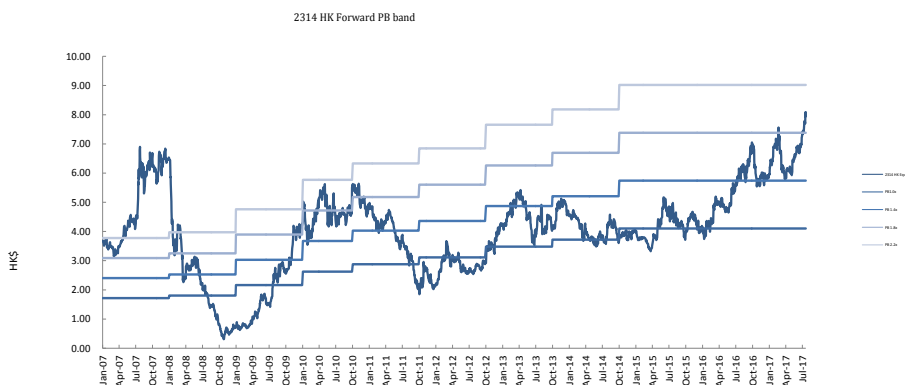
Appendix

Fig 1: 2H17 performance forecast

Unit data, HKD/T	1H2014	2H2014	1H2015	2H2015	1H2016	2H2016	1H2017	2H2017	2017
Volume, '000	2,400	2,663	2,680	2,760	2,670	2,960	2,770	2,751	5,521
ASP	3,510	3,301	3,245	3,232	3,134	3,369	4,130	5,233	4,680
ACP	2,853	2,697	2,575	2,585	2,406	2,648	3,018	3,622	3,319
GP	657	605	669	647	728	722	1,111	1,612	1,361
Other Income	64	90	55	106	116	87	124	138	131
SG&A	192	217	217	193	196	204	296	329	313
-SG	65	65	62	55	43	47	110	47	79
-Admin	127	152	155	138	153	158	186	282	234
EBIT/T	480	477	507	560	649	604	939	1,420	1,179
Finance cost	47	38	27	26	33	27	29	38	34
% of NP	12.5%	10.1%	6.3%	5.9%	6.1%	5.6%	3.7%	3.7%	3.7%
Tax	52	67	63	91	80	93	154	311	232
Effective tax %	12%	15%	13%	15%	13%	16%	16%	23%	20%
NP/T	380	372	418	439	536	484	792	1,035	913
NP, M HKD	913	992	1,120	1,212	1,430	1,432	2,194	2,847	5,040

Source: Company, SWS Research

Fig 2: Lee & Man Paper forward PB band



Source: Bloomberg, SWS Research

Table 1: Consolidated Income Statement

(HK\$m)	2016	2017	2018E	2019E	2020E
Revenue	18,342	25,837	25,872	30,124	30,789
Cost of Sales	14,261	18,324	18,522	21,760	22,240
Gross Profit	4,081	7,513	7,350	8,364	8,549
Other Income	546	792	529	612	695
Distribution expenses	252	435	353	442	452
Administrative expenses	875	1,292	823	1,020	1,043
EBITDA	4,469	7,459	7,655	8,467	8,704
EBIT	3,521	6,508	6,703	7,514	7,749
Finance Costs	167	185	176	211	222
Profit before tax	3,354	6,323	6,527	7,303	7,527
Income tax expense	491	1,283	979	1,095	1,129
Minority interests	0	0	0	0	0
Profit for the year	2,863	5,040	5,548	6,208	6,398

Source: SWS Research

Table 2: Consolidated Cash Flow Statement

(HK\$m)	2016	2017	2018E	2019E	2020E
Profit before taxation	3,354	6,323	6,527	7,303	7,527
Plus : Depr. and amortisation	948	950	952	953	955
Finance cost	167	185	176	211	222
Losses from investments	0	0	0	0	0
Change in working capital	-369	-397	-426	-458	-493
Others	-491	-1,283	-979	-1,095	-1,129
CF from operating activities	4,654	5,534	6,712	7,346	7,572
CAPEX	-1,200	-800	-800	-800	-800
Other CF from investing activities	-160	-61	20	-201	1,123
CF from investing activities	-1,360	-861	-780	-1,001	323
Equity financing	0	0	0	0	0
Net change in liabilities	-186	3,186	4,158	5,491	6,403
Dividend and interest paid	-934	-1,265	-1,831	-2,049	-2,111
Other CF from financing activities	-8	-7	-6	-5	-4
CF from financing activities	-934	-1,265	-1,831	-2,049	-2,111
Net cash flow	2,360	3,408	4,102	4,296	5,784

Source: SWS Research

Table 3: Consolidated Balance Sheet

(HK\$m)	2016	2017	2018E	2019E	2020E
Current Assets	9,193	14,063	26,260	32,665	38,805
Bank balances and cash	1,274	2,249	13,642	17,938	23,722
Trade and other receivables	4,960	6,776	8,446	9,834	10,051
Inventories	2,914	4,954	4,123	4,844	4,951
Long-term investment	96	97	86	86	86
PP&E	24,312	27,459	23,473	23,334	23,194
Intangible and other assets	1,072	1,173	1,137	1,215	1,334

Total Assets	34,629	42,708	50,907	57,252	63,338
Current Liabilities	7,960	11,025	18,072	23,127	29,027
Borrowings	1,151	1,152	1,153	1,154	1,155
Trade and other payables	3,549	4,672	4,163	4,890	4,998
Other current liabilities	170	327	267	298	307
Long-term liabilities	10,213	10,334	7,445	7,881	8,384
Total Liabilities	18,173	21,359	25,517	31,008	37,411
Minority Interests	0	0	0	0	0
Shareholder Equity	16,823	21,916	25,633	29,792	34,079
Share Capital	114	113	113	113	113
Reserves	16,709	21,803	25,520	29,680	33,966
Total Liabilities and equity	34,629	42,708	50,907	57,252	63,338

Source: SWS Research

Table 4: Key Financial Ratios

	2016	2017	2018E	2019E	2020E
Ratios per share (HK\$)					
Earnings per share	0.61	1.10	1.21	1.36	1.40
Diluted EPS	0.61	1.10	1.21	1.36	1.40
Operating CF per share	1.02	1.21	1.47	1.61	1.66
Dividend per share	0.20	0.28	0.40	0.45	0.46
Net assets per share	3.62	4.71	5.51	6.41	7.33
Key Operating Ratios (%)					
ROIC	5.6	9.6	12.1	13.5	13.9
ROE	17.0	23.0	21.6	20.8	18.8
Gross profit margin	22.2	29.1	28.4	27.8	27.8
EBITDA Margin	24.4	28.9	29.6	28.1	28.3
EBIT Margin	22.0	23.0	24.0	24.0	25.0
Growth rate of Revenue (YoY)	4.1	40.9	0.1	16.4	2.2
Growth rate of Profit (YoY)	22.8	76.1	10.1	11.9	3.1
Debt-to-asset ratio	52.5	50.0	50.1	54.2	59.1
Turnover rate of net assets	1.1	1.2	1.0	1.1	1.2
Turnover rate of total assets	0.5	0.6	0.5	0.5	0.5
Effective tax rate (%)	14.6	20.3	15.0	15.0	15.0
Dividend yield (%)	2.3	3.1	4.4	4.9	5.1
Valuation Ratios (X)					
P/E	14.5	8.2	7.5	6.7	6.5
P/B	2.5	1.9	1.6	1.4	1.2
EV/Sales	2.9	2.1	1.8	1.6	1.5
EV/EBITDA	12.0	7.3	6.2	5.6	5.5

Source: SWS Research

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