

14 August 2018

Hong Kong

EQUITIES

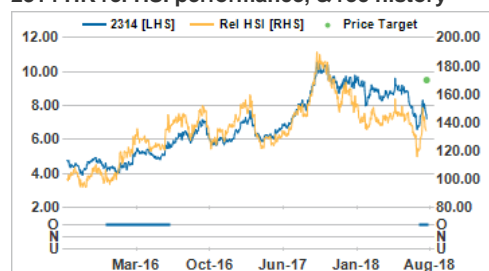
2314 HK Outperform
Price (at 13:00, 14 Aug 2018 GMT) HK\$7.47

Valuation	HK\$	9.50
- Price to Book		
12-month target	HK\$	9.50
Upside/Downside	%	+27.2
12-month TSR	%	+33.1
Volatility Index		Medium
GICS sector		Materials
Market cap	HK\$m	33,016
Market cap	US\$m	4,054
Free float	%	29
30-day avg turnover	US\$m	10.7
Number shares on issue	m	4,420

Investment fundamentals

Year end 31 Dec		2017A	2018E	2019E	2020E
Revenue	m	25,837	34,773	39,969	43,800
EBIT	m	5,786	6,012	5,847	5,643
EBIT growth	%	95.9	3.9	-2.7	-3.5
Reported profit	m	5,040	6,038	6,011	5,922
EPS rep	HK\$	1.11	1.36	1.35	1.33
EPS rep growth	%	77.9	21.8	-0.4	-1.5
PER rep	x	6.7	5.5	5.5	5.6
Total DPS	HK\$	0.28	0.43	0.45	0.45
Total div yield	%	3.7	5.7	6.0	6.0
ROA	%	14.8	12.3	9.6	7.6
ROE	%	26.1	25.3	21.5	18.6
EV/EBITDA	x	6.7	6.5	6.6	6.8
Net debt/equity	%	58.5	55.9	49.8	44.1
P/BV	x	1.5	1.3	1.1	1.0

2314 HK rel HSI performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, August 2018

(all figures in HKD unless noted)

Analysts

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Lee & Man Paper Manufacturing NDR: More px hikes; Overseas Acceleration

Key points

- ▶ LM's recent px hikes more than offset increased costs from 25% OCC tariff
- ▶ RPB a cheap alternative to US OCC. Coal-to-gas to push out small mills
- ▶ Reiterate OP – more price hikes/shutdowns soon, cheap valuation

Event

- We hosted a [1H18 post result](#) NDR with Lee & Man's CFO today (14 Aug). LM just hiked prices by Rmb 200/t and expect more hikes soon; thus margins could improve HoH even with the [US OCC 25% import tariff](#). Reiterate OP.

Impact

- **<2% cost impact from 25% US OCC tariff:** LM sees US OCC px cuts after China's 25% tariff; thus effective cost for US OCC is only +12%, to US\$290/t; with <20% of OCC mix from US (more EU/ Japan), the impact is <2%. LM has 2.2mnt of OCC import quota YTD (4mnt in FY17) which are mostly utilized.
- **Demand remains strong – more px hikes in 4Q:** In response to OCC tariffs, LM hiked Rmb 200/t last week, more than offsetting the cost. LM sees more px hikes from Sep due to peak season demand. LM do not see demand impact from packaging substitution or trade war yet – indirect export <7% for LM.
- **Accelerate recycled pulp project expansion:** To prepare for the ban on imported OCC by 2020, LM is looking for recycled pulp board (RPB) projects overseas – LM imported 80kt RPB from their Vietnam plant in 1H18 (+Rmb 300/t vs. US OCC) and are trying to source more RPB in SE Asia. Vietnam NP/t is ~20% higher than China's due to use of cheap mixed (#3) wastepaper.
- **Dongguan (DG) coal-to-gas conversion to push out small mills:** LM believe a more realistic timeline is by 2020 (vs. original end-18), as time is needed for government gas pipeline connections. LM plan HK\$600mn total capex to convert all mills in Hongmei, while opex should be +Rmb 300/t. LM see small mills in the region phasing out as they cannot afford the capex.
- **Capex raised – potential expansion in Taiwan/Myanmar:** FY18E capex raised to HK\$4.2bn – HK\$1.2-1.3bn for PM22 in Vietnam, HK\$800-900mn for tissue expansion, and HK\$300mn for coal-to-gas in Dongguan, while HK\$2bn is budgeted for M&A/greenfield overseas projects (e.g. RPB)

Earnings and target price revision

- Raise 18E EPS by 10% and cut 19-20E by 3-9% to factor in latest volume guidance and higher cost assumptions from import wastepaper/pulp

Price catalyst

- 12-month price target: HK\$9.50 based on a Price to Book methodology.
- Catalyst: 1) price hikes in late Aug; 2) environmental checks from Aug

Action and recommendation

- Reiterate OP – We believe [LM](#) has oversold (-15% in past week) on the [25% US OCC tariff](#) news. LM trading at just 5.5x 19E PE (LT ave. 8x), 22% ROE, 6% div yield. Mgmt share buyback could provide downside support.

Fig 1 Lee & Man – Changes to key metrics

Lee & Man - Key Metrics

	New	Old	Chg %
Rating	OP	OP	-
PO (HK\$)	9.5	9.5	0%
Current Price (HK\$)	7.2		
Upside:	32%		

Key Changes	FY17	FY18E			FY19E			FY20E		
	Actual	New	Old	% Chg	New	Old	% Chg	New	Old	% Chg
Key Drivers										
Total Blended										
Sales Vol (kt)	5,522	6,251	6,702	-7%	6,820	7,107	-4%	7,295	7,541	-3%
ASP (HK\$/t)	4,679	5,562	4,988	12%	5,860	5,256	11%	6,004	5,375	12%
Unit Cost (HK\$/t)	3,318	4,229	3,849	10%	4,710	4,139	14%	4,930	4,264	16%
GP/t (HK\$/t)	1,361	1,333	1,140	17%	1,150	1,117	3%	1,074	1,111	-3%
NP/t (HK\$/t)	913	966	822	17%	881	868	2%	812	868	-6%
Containerboard										
Sales Vol (kt)	5,167	5,670	6,000	-5%	6,030	6,300	-4%	6,426	6,654	-3%
ASP (HK\$/t)	4,471	5,241	4,613	14%	5,454	4,840	13%	5,592	4,935	13%
NP/t (HK\$/t)	910	957	814	18%	867	867	0%	800	861	-7%
Tissue Paper										
Sales Vol (kt)	352	581	700	-17%	790	806	-2%	869	886	-2%
ASP (HK\$/t)	7,724	8,698	8,196	6%	8,959	8,503	5%	9,049	8,673	4%
NP/t (HK\$/t)	953	1,054	891	18%	987	877	13%	900	875	3%
Key Financials (HK\$ mn)										
Revenue	25,837	34,773	33,435	4%	39,969	37,354	7%	43,800	40,534	8%
GP	7,513	8,335	7,639	9%	7,845	7,940	-1%	7,833	8,377	-6%
EBIT	6,497	7,373	6,744	9%	7,378	7,539	-2%	7,310	7,933	-8%
NPAT	5,040	6,038	5,509	10%	6,011	6,170	-3%	5,922	6,505	-9%
EPS (HK\$/sh)	1.11	1.36	1.24	10%	1.35	1.39	-3%	1.33	1.46	-9%

Source: Company data, Bloomberg, Macquarie Research, Aug 2018

Macquarie Quant View

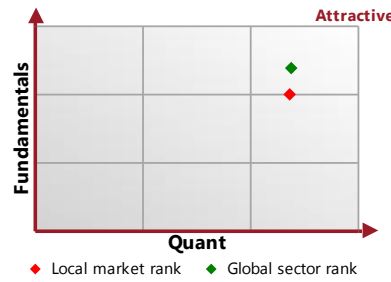
The Quant View page below has been derived from models that are developed and maintained by Sales and Trading personnel at Macquarie. The models are not a product of the Macquarie Research Department.

The quant model currently holds a reasonably positive view on Lee & Man Paper Manufacturing. The strongest style exposure is Earnings Momentum, indicating this stock has received earnings upgrades and is well liked by sell side analysts. The weakest style exposure is Price Momentum, indicating this stock has had weak medium to long term returns which often persist into the future.

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Global rank in Materials

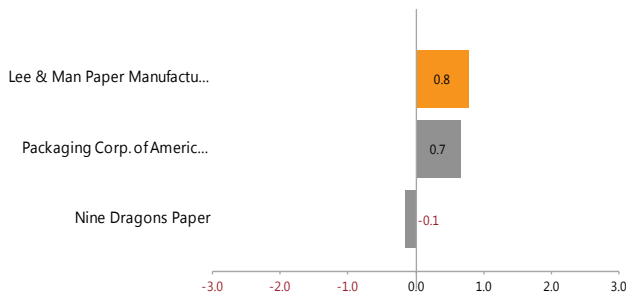
% of BUY recommendations	74% (14/19)
Number of Price Target downgrades	11
Number of Price Target upgrades	3



Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model. Two rankings: Local market (Hong Kong) and Global sector (Materials)

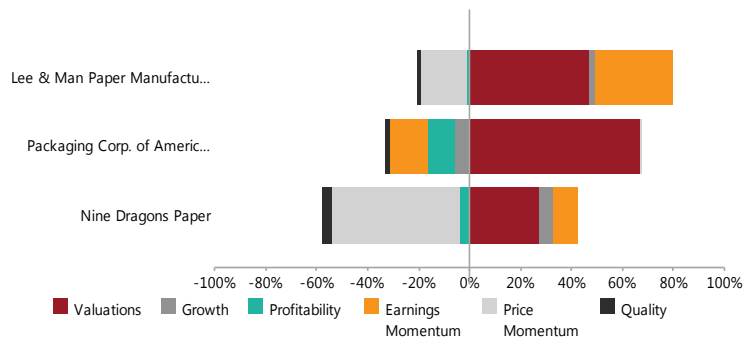
Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



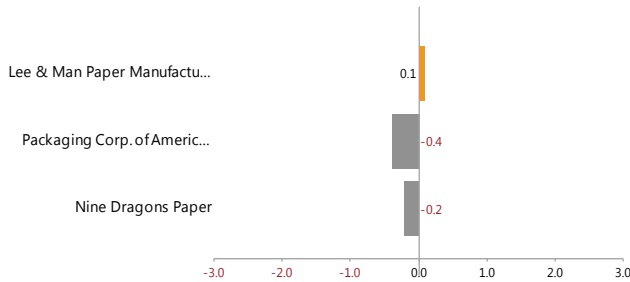
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



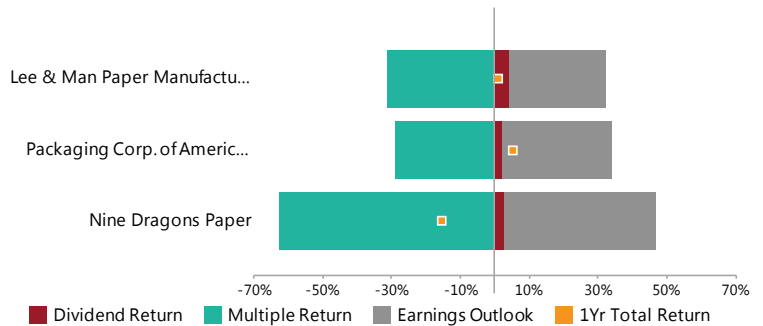
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



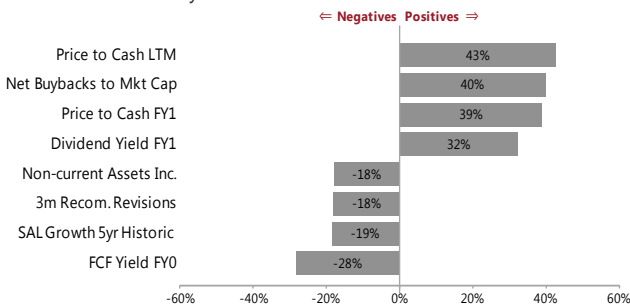
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



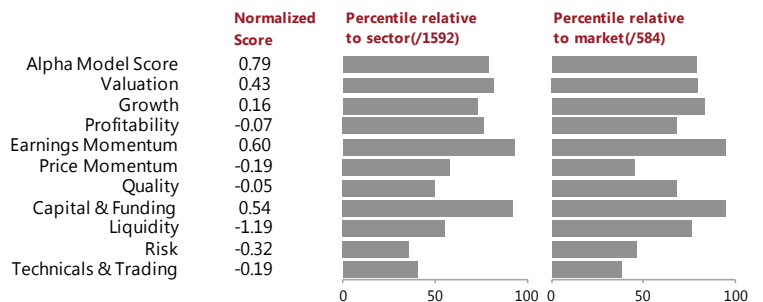
What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Quant. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpg@macquarie.com).

Lee & Man Paper Manufacturing (2314 HK, Outperform, Target Price: HK\$9.50)

Interim Results					Profit & Loss						
		2H/17A	1H/18E	2H/18E	1H/19E		2017A	2018E	2019E	2020E	
Revenue	m	14,397	15,300	19,473	17,586	Revenue	m	25,837	34,773	39,969	43,800
Gross Profit	m	4,434	3,668	4,668	3,452	Gross Profit	m	7,513	8,335	7,845	7,833
Cost of Goods Sold	m	9,963	11,633	14,805	14,134	Cost of Goods Sold	m	18,324	26,438	32,123	35,967
EBITDA	m	4,032	3,099	3,944	3,050	EBITDA	m	6,947	7,043	6,931	6,778
Depreciation	m	594	442	563	461	Depreciation	m	1,142	1,005	1,049	1,086
Amortisation of Goodwill	m	10	12	15	16	Amortisation of Goodwill	m	19	26	36	49
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	3,428	2,645	3,366	2,573	EBIT	m	5,786	6,012	5,847	5,643
Net Interest Income	m	-90	-81	-104	-98	Net Interest Income	m	-173	-185	-222	-260
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	369	599	762	674	Other Pre-Tax Income	m	710	1,361	1,531	1,667
Pre-Tax Profit	m	3,708	3,163	4,025	3,148	Pre-Tax Profit	m	6,323	7,188	7,156	7,050
Tax Expense	m	-667	-506	-644	-504	Tax Expense	m	-1,283	-1,150	-1,145	-1,128
Net Profit	m	3,040	2,657	3,381	2,645	Net Profit	m	5,040	6,038	6,011	5,922
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	3,040	2,657	3,381	2,645	Reported Earnings	m	5,040	6,038	6,011	5,922
Adjusted Earnings	m	3,050	2,668	3,396	2,660	Adjusted Earnings	m	5,059	6,064	6,047	5,971
EPS (rep)		0.67	0.60	0.76	0.59	EPS (rep)		1.11	1.36	1.35	1.33
EPS (adj)		0.67	0.60	0.76	0.60	EPS (adj)		1.12	1.36	1.36	1.34
EPS Growth yoy (adj)	%	114.2	35.0	13.2	-0.3	EPS Growth (adj)	%	77.8	21.8	-0.3	-1.2
						PE (rep)	x	6.7	5.5	5.5	5.6
						PE (adj)	x	6.7	5.5	5.5	5.6
EBITDA Margin	%	28.0	20.3	20.3	17.3	Total DPS		0.28	0.43	0.45	0.45
EBIT Margin	%	23.8	17.3	17.3	14.6	Total Div Yield	%	3.7	5.7	6.0	6.0
Earnings Split	%	60.3	44.0	56.0	44.0	Basic Shares Outstanding	m	4,522	4,448	4,448	4,448
Revenue Growth	%	44.4	33.7	35.3	14.9	Diluted Shares Outstanding	m	4,522	4,448	4,448	4,448
EBIT Growth	%	123.9	12.2	-1.8	-2.7						
Profit and Loss Ratios					Cashflow Analysis						
		2017A	2018E	2019E	2020E		2017A	2018E	2019E	2020E	
Revenue Growth	%	40.9	34.6	14.9	9.6	EBITDA	m	6,947	7,043	6,931	6,778
EBITDA Growth	%	78.3	1.4	-1.6	-2.2	Tax Paid	m	-1,283	-1,150	-1,145	-1,128
EBIT Growth	%	95.9	3.9	-2.7	-3.5	Chgs in Working Cap	m	-2,730	-2,462	-1,446	-1,061
Gross Profit Margin	%	29.1	24.0	19.6	17.9	Net Interest Paid	m	-173	-185	-222	-260
EBITDA Margin	%	26.9	20.3	17.3	15.5	Other	m	710	1,361	1,531	1,667
EBIT Margin	%	22.4	17.3	14.6	12.9	Operating Cashflow	m	3,472	4,607	5,650	5,997
Net Profit Margin	%	19.6	17.4	15.1	13.6	Acquisitions	m	-19	-26	-36	-49
Payout Ratio	%	25.0	31.2	33.1	33.2	Capex	m	-3,600	-4,200	-4,000	-4,000
EV/EBITDA	x	6.7	6.5	6.6	6.8	Asset Sales	m	0	0	0	0
EV/EBIT	x	8.1	7.7	7.9	8.2	Other	m	0	0	0	0
Balance Sheet Ratios						Investing Cashflow	m	-3,619	-4,226	-4,036	-4,049
ROE	%	26.1	25.3	21.5	18.6	Dividend (Ordinary)	m	-1,265	-1,892	-2,000	-1,980
ROA	%	14.8	12.3	9.6	7.6	Equity Raised	m	0	0	0	0
ROIC	%	15.9	14.5	12.1	10.5	Debt Movements	m	1,531	4,800	8,000	8,000
Net Debt/Equity	%	58.5	55.9	49.8	44.1	Other	m	0	0	0	0
Interest Cover	x	33.4	32.5	26.3	21.7	Financing Cashflow	m	266	2,908	6,000	6,020
Price/Book	x	1.5	1.3	1.1	1.0	Net Chg in Cash/Debt	m	119	3,289	7,614	7,967
Book Value per Share		4.8	5.9	6.8	7.6	Free Cashflow	m	-128	407	1,650	1,997
						Balance Sheet		2017A	2018E	2019E	2020E
						Cash	m	2,249	5,299	12,913	20,880
						Receivables	m	6,776	9,119	10,482	11,487
						Inventories	m	4,955	7,149	8,686	9,725
						Investments	m	37	37	37	37
						Fixed Assets	m	27,459	26,215	27,156	28,060
						Intangibles	m	0	0	0	0
						Other Assets	m	1,815	6,493	8,503	10,513
						Total Assets	m	43,290	54,311	67,777	80,701
						Payables	m	4,687	6,762	8,217	9,200
						Short Term Debt	m	6,026	6,626	10,626	14,626
						Long Term Debt	m	9,052	13,252	17,252	21,252
						Provisions	m	0	0	0	0
						Other Liabilities	m	1,609	1,609	1,609	1,609
						Total Liabilities	m	21,374	28,249	37,703	46,686
						Shareholders' Funds	m	21,916	26,062	30,073	34,015
						Minority Interests	m	0	0	0	0
						Other	m	0	0	0	0
						Total S/H Equity	m	21,916	26,062	30,073	34,015
						Total Liab & S/H Funds	m	43,290	54,311	67,777	80,701

All figures in HKD unless noted.

Source: Company data, Macquarie Research, August 2018

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield, which is currently around 9%.

Macquarie – Asia/Europe

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Mazi Macquarie – South Africa

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

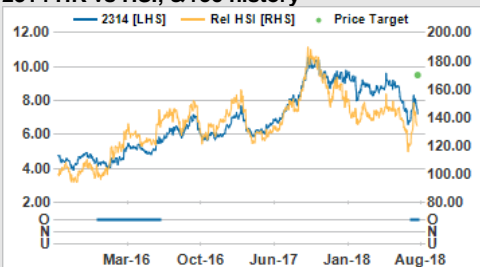
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 June 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	52.87%	61.26%	48.86%	47.54%	69.86%	46.61%	(for global coverage by Macquarie, 3.51% of stocks followed are investment banking clients)
Neutral	34.10%	27.25%	36.36%	46.72%	21.92%	43.22%	(for global coverage by Macquarie, 2.10% of stocks followed are investment banking clients)
Underperform	13.03%	11.49%	14.77%	5.74%	8.22%	10.17%	(for global coverage by Macquarie, 0.00% of stocks followed are investment banking clients)

2314 HK vs HSI, & rec history



(all figures in HKD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
Source: FactSet, Macquarie Research, August 2018

12-month target price methodology

2314 HK: HK\$9.50 based on a Price to Book methodology

Company-specific disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/research/disclosures.

Target price risk disclosures:

2314 HK: Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

Analyst certification:

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