## Lee \＆Man Paper［2314．HK］

Rivals results \＆guidance show the market is not as weak as expected．BUY．
Comments and guidance from Nine Dragons Paper［2689．HK］management during the results presentation，in our view，indicate that the industry environment was not as bad as the market expected despite the challenging environment，which somewhat supports our constructive view on Lee \＆Man Paper（LMP）．LMP will add 0.5 m tonnes of new packaging paper capacity in Vi－ etnam，so the Company＇s total annual packaging paper capacity will reach 6.53 m tonnes by the end of 2019，up $8.3 \%$ ．The expansion in Vietnam is for capturing opportunities from a re－location of manufacturing activities from China to Southeast Asia．LMP now has annual tissue paper capacity of 795，000 tonnes，and the Company＇s tissue paper products are a growth driver，mak－ ing a higher contribution to both top and bottom lines．We share the view that RMB depreciation， tariffs on imports of waste paper from the US and an increase in industry CAPEX will have a negative impact on LMP＂s profitability．We also believe the some investors still have concerns about the outlook for LMP，but it seems that there are no extra negative factors for being more cautious．LMP is now trading at $6.3 \times 2018 E$ PER and offers a $5.4 \%$ yield．We maintain our BUY rating on LMP with a target price of HK\＄10．03（based on $8 \times 2018 E$ PER，in line with its historical average and lower than the average of its listed peers）．

## Investment Highlights

More discipline in capacity expansion．Regarding capacity expansion，Nine Dragons Pa－ per has：a）delayed commercial production of a number of its new paper machines，b）removed the phase III expansion of the Quanzhou plant from the latest construction list，and c）set up no new paper production lines．The delay is to avoid over－investment，given tight raw material sup－ ply and increasing environmental protection controls．This is line with our view that the increase in capacity of the industry will be lower than some investors expect，given capacity closure and constraints on new supply．We reiterate our view that that containerboard prices are unlikely to drop significantly，given firm waste paper prices and more discipline from the leading players． Nine Dragons Paper management expects mid－Oct 2018 to be a window for ASP hikes，as downstream users will replenish inventory after the holidays in early Oct and to prepare for the peak season．We still maintain the view that market concerns about the supply／demand situation seem somewhat overdone．We believe that we are unlikely to see a sharp jump in profitability of paper makers，including LMP．But we don＇t expect a major deterioration in LMP＇s profitability in 2H 2018，given reduced pressure on the pricing environment due to less－than－expected industry capacity expansion．
Near－term cost hikes will finally be passed on．RMB depreciation and tariffs on imports of US waste paper will result in high production costs for paper makers．Nine Dragons Paper man－ agement believes that the Company can pass on the rising costs downstream even though the supply／demand dynamics this year are not as favourable as last year＇s．The negative factors affected the whole industry，and we still believe that the leading players，including LMP，will out－ perform the smaller paper makers．
Tissue paper remains a growth driver．Despite high pulp costs，the profitability of LMP＇s tissue paper business remained stable，given economies of scale．LMP management said to grow its tissue paper business，it will continue to adopt effective marketing strategies：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 spin－ ning off its tissue paper operation．We still maintain the view that the tissue paper operation is a medium－to long－term growth driver for LMP．

| Key Financials（in HKDm） | 2015 | 2016 | 2017 | 2018E | 2019E |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Revenue | 17，615．6 | 18，341．7 | 25，836．9 | 31，530．4 | 33，350．0 |
| Change（Yoy \％） | 3.0 | 4.1 | 40.9 | 22.0 | 5.8 |
| Gross Profit | 3，578．3 | 4，080．5 | 7，512．9 | 8，329．8 | 8，528．6 |
| Gross Margin \％ | 20.3 | 22.2 | 29.1 | 26.4 | 25.6 |
| Net Profit | 2，331．8 | 2，862．7 | 5，040．5 | 5，649．3 | 5，720．9 |
| Net Margin \％ | 13.2 | 15.6 | 19.5 | 17.9 | 17.2 |
| EPS（Basic） | 0.50 | 0.63 | 1.10 | 1.26 | 1.29 |
| Change（YoY \％） | 23.9 | 24.2 | 75.7 | 14.6 | 1.9 |
| DPS | \＄0．180 | \＄0．220 | \＄0．370 | \＄0．426 | \＄0．489 |
| ROE（\％） | 13.4 | 16.8 | 26.0 | 24.1 | 21.8 |
| Dividend Yield（\％） | 2.28 | 2.79 | 4.69 | 5.39 | 6.20 |
| PER（x） | 15.6 | 12.6 | 7.2 | 6.3 | 6.1 |
| PBR（ x ） | 2.1 | 2.1 | 1.6 | 1.4 | 1.3 |
| FCF Yield（\％） | 3．42\％ | 3．33\％ | 3．58\％ | 12．93\％ | 18．09\％ |
| Capex（m） | （2，849．5） | （3，800．0） | （3，600．0） | （2，600．0） | （1，500．0） |
| Free cash flow per share | о． 3 | 0.3 | 0.3 | 1.0 | 1.4 |
| Net Gearing（\％） | 65.6 | 73.0 | 58.5 | 49.3 | 37.4 |
| Sources：Company，CG |  |  |  |  |  |

## China Materials－ Paper

 BUY Close：HK\＄7．89（Sep 19，2018）Target Price：HK\＄10．1（＋28．0\％）

Share Price Performance


| Market Cap | US\＄4，445m |
| :--- | ---: |
| Shares Outstanding | $4,448 \mathrm{~m}$ |
| Auditor | Deloitte Touche <br> Tohmatsu |
| Free Float | $29.1 \%$ |
| 52 W range | HK\＄6．59－10．44 |
| 3M average daily T／O | US\＄7．3m |
| Major Shareholding | Raymond Lee <br> $(30.5 \%)$ |

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Figure 1：LMP＇s 2016 Interim Results highlights

| 2018 Interim Results Highlights（HKD m） | 1H 2015 | 2H 2015 | 1H 2016 | 2H 2016 | 1H 2017 | 2H 2017 | 1H 2018 | 2H 2018E |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Revenue | 8，695 | 8，920 | 8，369 | 9，973 | 11，440 | 14，397 | 16，369 | 15，161 |
| Cost of sales and services | －6，902 | －7，136 | －6，424 | －7，837 | －8，361 | －9，963 | －12，247 | －10，953 |
| Gross profit | 1，794 | 1，785 | 1，944 | 2，136 | 3，079 | 4，434 | 4，122 | 4，208 |
| Other income and other gains and losses | 148 | 293 | 310 | 258 | 344 | 379 | 524 | 276 |
| Distribution and selling expenses | －166 | －152 | －114 | －138 | －205 | －230 | －268 | －263 |
| Administrative expenses | －417 | －380 | －408 | －467 | －515 | －776 | －685 | －891 |
| Finance costs | －71 | －84 | －87 | －80 | －81 | －104 | －115 | －130 |
| JV \＆Associates | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Profit before tax | 1，288 | 1，462 | 1，645 | 1，709 | 2，621 | 3，703 | 3，578 | 3，200 |
| Income tax expense | －168 | －251 | －215 | －276 | －427 | －856 | －598 | －531 |
| MI | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Profit for the period | 1，120 | 1，212 | 1，430 | 1，432 | 2，194 | 2，847 | 2，980 | 2，669 |
| Owners of the Company | 1，120 | 1，212 | 1，430 | 1，432 | 2，194 | 2，847 | 2，980 | 2，669 |
| Gross margin（\％） | 20.6 | 20.0 | 23.2 | 21.4 | 26.9 | 30.8 | 25.2 | 27.8 |
| Operating margin（\％） | 15.6 | 17.3 | 20.7 | 17.9 | 23.6 | 26.4 | 22.6 | 22.0 |
| Net Margin（\％） | 12.9 | 13.6 | 17.1 | 14.4 | 19.2 | 19.8 | 18.2 | 17.6 |
| Source：Company，CGIS Research |  |  |  |  |  |  |  |  |

Figure 2：Key Assumptions for LMP

|  |  |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
|  |  |  |  |  |  |  |  |  |

[^0]Figure 3：Earnings projection

| Income Statement（HKDm） | FY2015 | FY2016 | FY2017 | FY2018F | FY2019F | Cash Flow Statement（HKDm） | FY2015 | FY2016 | FY2017 | FY2018F | FY2019F |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Revenue | 17，616 | 18，342 | 25，837 | 31，530 | 33，350 | Net Income | 2，876 | 3，481 | 6，566 | 7，006 | 7，085 |
| Growth yoy\％ | 3．0\％ | 4．1\％ | 40．9\％ | 22．0\％ | 5．8\％ | Depreciation \＆Amort． | 858 | 927 | 1，096 | 1，183 | 1，233 |
| Gross Profit | 3，578 | 4，081 | 7，513 | 8，330 | 8，529 | Change in Working Capital | 365 | 593 | $(2,770)$ | $(1,023)$ | （468） |
| Growth yoy\％ | 16．5\％ | 14．0\％ | 84．1\％ | 10．9\％ | 2．4\％ | Cash from Ops． | 4，098 | 5，001 | 4，892 | 7，166 | 7，849 |
| Selling General \＆Admin Exp． | $(1,114)$ | $(1,127)$ | $(1,727)$ | $(2,107)$ | $(2,195)$ | 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 | － | － |  | － | － |
| Operating Income | 2，464 | 2，953 | 5，786 | 6，223 | 6，333 | Change in Investing Acitivities | （146） | （716） | 554 | $(1,171)$ | $(1,278)$ |
| Growth yoy\％ | n．a． | 19．9\％ | 95．9\％ | 7．5\％ | 1．8\％ | Cash from Investing | $(2,996)$ | $(4,516)$ | $(3,046)$ | $(3,771)$ | $(2,778)$ |
| Interest Expense | （154．9） | （167．2） | （185．3） | （245．2） | （250．0） | Net increase in bank borrowings | 1，523 | （716） | 1，531 | 300 | 300 |
| Interest and Invest．Income |  |  |  |  |  |  |  |  |  |  |  |
| Income／（Loss）from Affiliates | 0 | 0 | 0 | 0 | 0 | Issuance of Common Stock | 0 | 0 | 0 | 0 | 0 |
| Other Non－Operating Inc．（Exp．） | 13.2 | 22.3 | （69．2） | 0 | 0 | Common Dividends Paid | （739） | （939） | $(1,270)$ | $(1,771)$ | $(2,023)$ |
| Impairment of Goodwill | 0 | 0 | 0 | 0 | 0 | Special Dividend Paid | － | － | － | － |  |
| Gain（Loss）On Sale Of Invest． | 428 | 546 | 792 | 800 | 780 | Other Financing Activities | （957） | （517） | $(1,133)$ | $(1,072)$ | $(1,076)$ |
| Gain（Loss）On Sale Of Assets Income Tax Expense | （418） | （491） | $(1,283)$ | $(1,128)$ | $(1,143)$ | Cash from Financing | （174） | $(2,171)$ | （871） | $(2,543)$ | $(2,799)$ |
| Minority Int．in Earnings | 0 | 0 | 0 | 0 | 0 | Net Change in Cash | 928 | $(1,685)$ | 974 | 852 | 2，272 |
| Net Income | 2332 | 2863 | 5040 | 5649 | 5721 |  |  |  |  |  |  |
| Growth yoy\％ | 47．4\％ | 22．8\％ | 76．1\％ | 12．1\％ | 1．3\％ |  |  |  |  |  |  |
| Balance Sheet（HKDm） | FY2015 | FY2016 | FY2017 | FY2018F | FY2019F | Ratios | FY2015 | FY2016 | FY2017 | FY2018F | FY2019F |
| ASSETS |  |  |  |  |  | Profitability |  |  |  |  |  |
| Cash And Equivalents | 2，959 | 1，274 | 2，249 | 3，100 | 5，373 | Return on Assets \％ | 6．6\％ | 8．1\％ | 12．9\％ | 12．4\％ | 11．6\％ |
| Receivables | 4，869 | 4，960 | 6，776 | 8，269 | 8，746 | Return on Capital \％ | 6．7\％ | 8．0\％ | 13．2\％ | 13．2\％ | 12．4\％ |
| Inventory | 3，092 | 2，914 | 4，954 | 5，551 | 5，871 | Return on Equity \％ | 13．4\％ | 16．8\％ | 26．0\％ | 24．1\％ | 21．8\％ |
| Other Current Assets | 122 | 40 | 84 | 49 | 52 |  |  |  |  |  |  |
| Total Current Assets | 11，042 | 9，189 | 14，063 | 16，969 | 20，041 | Margin Analysis |  |  |  |  |  |
| Net Property，Plant \＆Equipment | 23，351 | 24，312 | 27，459 | 28，876 | 29，144 | Gross Margin \％ | 20．3\％ | 22．2\％ | 29．1\％ | 26．4\％ | 25．6\％ |
| Long－term Investments | － | － | － |  | － | SG\＆A Margin \％ | 6．3\％ | 6．1\％ | 6．7\％ | 6．7\％ | 6．6\％ |
| Other Intangibles | － | － | － |  | － | EBIT Margin \％ | 14．0\％ | 16．1\％ | 22．4\％ | 19．7\％ | 19．0\％ |
| Deferred Tax Assets，LT | － | － | － | － | － | EBITDA Margin \％ | 18．9\％ | 21．2\％ | 26．6\％ | 23．5\％ | 22．7\％ |
| Other Long－Term Assets | 1，206 | 1，495 | 1，768 | 1，768 | 1，768 | Net Income Margin \％ | 13．2\％ | 15．6\％ | 19．5\％ | 17．9\％ | 17．2\％ |
| Goodwill | － | － | － | － | － |  |  |  |  |  |  |
| Accounts Receivable Long－Term | － | － | － | － | － | Asset Turnover |  |  |  |  |  |
| Total Long Term Assets | 24，557 | 25，807 | 29，227 | 30，644 | 30，912 | Total Asset Turnover | 0．5x | 0．5x | 0．6x | 0．7x | 0．7x |
| Total Assets | 35，599 | 34，996 | 43，290 | 47，613 | 50，953 | Fixed Asset Turnover | 0．7x | 0．7x | 0．9x | 1．0x | 1．1x |
|  |  |  |  |  |  | Accounts Receivable Turnover | 3.3 x | $3.7 x$ | 4．4x | 4．2x | 3.9 x |
| LIABILITIES \＆EQUITY |  |  |  |  |  | Inventory Turnover | 5．7x | 6.3 x | 5.2 x | 5．7x | 5．7x |
| Accounts Payable | 3，043 | 3，549 | 4，672 | 5，702 | 6，031 |  |  |  |  |  |  |
| Accrued Exp． | － | － | － | － | － | Liquidity |  |  |  |  |  |
| Short－term Borrowings | 5，250 | 4，240 | 6，026 | 6，026 | 6，026 | Current Ratio | 1.3 x | 1.2 x | 1.3 x | 1.4 x | 1．6x |
| Curr．Port．of LT Debt | － | － | － | － | － | Quick Ratio | 0．9x | 0．8x | 0．8x | 0．9x | 1．1x |
| Curr．Income Taxes Payable | － | － | － | － | － | Avg．Days Sales Out． | 100.9 | 98.7 | 95.7 | 95.7 | 95.7 |
| Unearned Revenue，Current | － | － | － | － | － | Avg．Days Inventory Out． | 64.1 | 58.0 | 70.0 | 64.3 | 64.3 |
| Other Current Liabilities | 156 | 170 | 342 | 360 | 396 | Avg．Days Payable Out． | 79.1 | 90.8 | 93.1 | 89.7 | 88.7 |
| Total Current Liabilities | 8，449 | 7，960 | 11，040 | 12，087 | 12，452 | Avg．Cash Conversion Cycle | 118.2 | 102.7 | 128.4 | 117.0 | 116.0 |
| Long－Term Debt | 9，012 | 9，307 | 9，052 | 9，352 | 9，652 | Net Debt to Equity | 66\％ | 73\％ | 59\％ | 49\％ | 37\％ |
| Def．Tax Liability，Non－Curr． | 0 | 0 | 0 | 0 | 0 |  |  |  |  |  |  |
| Other Non－Current Liabilities | 902 | 907 | 1，282 | 1，282 | 1，282 | Growth Over Prior Year |  |  |  |  |  |
| Total Liabilities | 18，363 | 18，173 | 21，374 | 22，721 | 23，386 | Total Revenue | 3．0\％ | 4．1\％ | 40．9\％ | 22．0\％ | 5．8\％ |
| Common Stock | 114 | 114 | 113 | 111 | 111 | Net Income | 22．4\％ | 22．8\％ | 76．1\％ | 12．1\％ | 1．3\％ |
| Additional Paid In Capital | － | － | － | － | － | Payout Ratio \％ | 35．7\％ | 35．1\％ | 33．6\％ | 33．7\％ | 38．0\％ |
| Retained Earnings | 17，122 | 16，709 | 21，803 | 24，781 | 27，456 |  |  |  |  |  |  |
| Treasury Stock |  |  |  |  |  |  |  |  |  |  |  |
| Comprehensive Inc．and Other | － | － | － | － | － |  |  |  |  |  |  |
| Minority Interest | 0 | 0 | 0 | 0 | 0 |  |  |  |  |  |  |
| Total Equity | 17，236 | 16，823 | 21，916 | 24，892 | 27，567 |  |  |  |  |  |  |
| Total Liabilities And Equity | 35，599 | 34，996 | 43，290 | 47，613 | 50，953 |  |  |  |  |  |  |

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BUY ：share price will increase by $>20 \%$ within 12 months in absolute terms
SELL ：share price will decrease by $>20 \%$ within 12 months in absolute terms
HOLD ：no clear catalyst，and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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[^0]:    Sources：Company，CGIS Research

