



Equity Research | China | Paper

9 December 2016

## Rising prices boost earnings outlook

- Our latest conversation with Lee & Man Paper (“L&MP”) suggests that the earnings pressure since 3Q16 is likely short-lived, as the company is able to raise product prices from 4Q16.
- 2017 will see substantial capacity expansion, which would secure the company’s revenue growth, in our view.
- The over 20% correction in L&MP’s share prices in the past two months should have reflected the negatives, in our view. After trimming our FY16E/17E earnings by 5.2%/3.9% respectively, we lowered our price target to HKD7.0 (from HKD8.0), pegging on 1.5x FY17F PBR (prior 1.75x). Maintain BUY.

**Best price rally of paper products after the 2008 crisis.** Since late Nov-16, packaging paper products have experienced a significant price rally as a result of supply reduction on the back of capacity closure amid stricter regulatory environment in Northern China, higher material costs, earlier orders placed by box makers ahead of the Chinese New Year holiday, and stabilising consumption demand. According to our channel check, major packaging paper companies posted historical low level inventories of less than one week, which is their best performance since 2009.

**L&MP’s volume growth in 2017 and onwards.** According to the management, L&MP plans to add 220,000 tons new capacity for tissue product manufacturing in 2017, while the Vietnam project is expected to contribute 300,000 tons new containerboard production next year. Despite that the company’s land resources on hand provides leeway for further expansion in either products towards 2018, the expected rising gearing level induced by RMB depreciation might cloud the overall expansion progress, in our view.

**Overhang in the Vietnam project overdone.** The management indicated that all the regulatory approvals regarding to the Vietnam project are in the final stage. The schedule of starting a trial run target by end-2016 and commencing production in 1Q17 remains unchanged, according to the company.

**Revised down our earnings estimates on weak 3Q16.** In spite of the strong rebound of packaging paper prices since Nov and the higher-than-expected tissue paper margin performance, we expect L&MP’s 2H16 earnings to be dragged down by higher raw material costs in 3Q16. Hence, we revised down L&MP’s net profit estimate by 5.2% for FY16E and 3.9% for FY17E, respectively. Considering the stronger volume growth, we expect L&MP to post double-digit net profit growth next year.

## Lee & Man Paper (2314 HK)

**Buy**

(unchanged)

<b>Price Target</b>	<b>HK\$7.0</b>
(Revision)	(-12.5%)
(upside)	(14.9%)

EPS	2016E	2017E
revision	(-5.2%)	(-3.9%)

Close price HKD6.09

Market cap. HKD27,750 mn

Free float 31.38%

52-week range HKD3.90 – 7.32

3-mth ave. T/O HKD57.29 mn

Price as of 9 December 2016

Stock rel HSI performance (%)



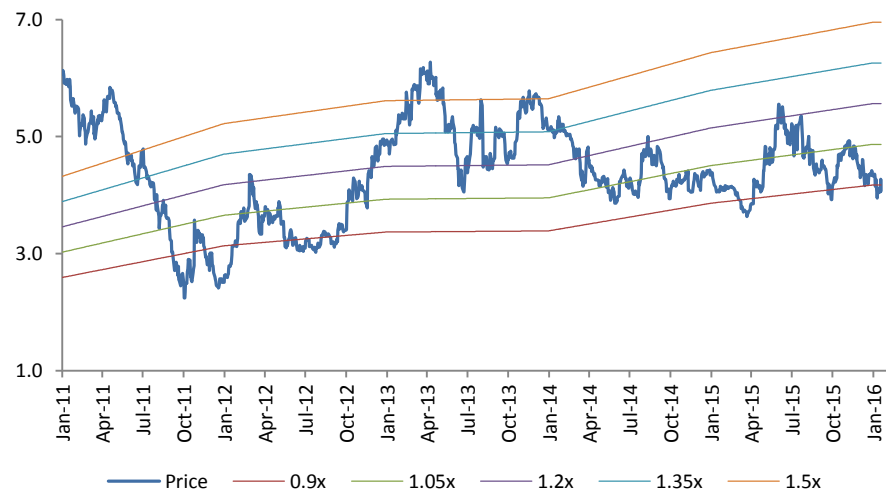
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**Higher ROE underpinned by solid core business, maintain BUY.** We believe the concerns regarding to the bearish expectation of 2H16 earnings and the slower progress of its Vietnam project have been priced in the current share price. Trading at 1.3x FY17F PBR, we believe the valuation is undemanding supported by its mid-teen ROE. Based our new target PBR multiple of 1.5x (prior 1.75x), we revised down our target price to HKD7.0 (from HKD8.0), maintain BUY.

**Figure 1: PBR band**


Source: Bloomberg, CSCI Research estimates

**Figure 2: Peer valuation**

Company	Ticker	Ccy	Close (Local\$)	Mkt cap (US\$b)	PER (x)	2016E	2017E	EPS Growth (%)	2016E	2017E	PBR (x)	2016E	2017E	ROE (%)	2016E	2017E	EV/EBITDA (x)	2016E	2017E	Yield (%)	2016E	2017E	Net debt / Equity (%)	2016E	2017E	
<b>Paper</b>																										
<b>HK/China</b>																										
NINE DRAGONS PAP	2689 HK	HKD	7.4	4.4	12.0	10.8	59.1	14.9	11	11	6.1	10.6	8.8	7.9	11	87.1										
LEE & MAN PAPER	2344 HK	HKD	6.1	3.6	9.6	8.5	30.5	12.5	14	13	15.9	16.1	9.1	8.1	3.6	65.7										
SHANDONG CHEN-H	1812 HK	HKD	8.0	2.6	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A										
CHINA SUNSHINE	2002 HK	HKD	15	0.2	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A										
QXPAPER	3868 HK	HKD	2.0	0.4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A										
GREATVIEW ASEPTI	468 HK	HKD	3.9	0.7	13.8	12.7	7.3	8.0	2.0	19	14.5	15.2	8.4	7.8	5.3	(16.3)										
CHINA PACKAGING	1439 HK	HKD	11	0.2	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A										
SHANYING PAPE-A	600567 CH	CNY	3.5	2.3	50.3	26.5	N/A	98.5	16	15	3.9	6.5	13.4	115	0.6	N/A										
ZHEJIANG JING -A	002067 CH	CNY	7.0	1.1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A										
Average					214	14.6	32.3	33.5	15	14	10.1	12.1	9.9	8.8	2.6	45.5										
<b>Japan</b>																										
OJI HOLDINGS COR	3861 JP	JPY	495.0	4.4	19.0	14.1	13.6	38.1	0.7	0.8	3.8	5.7	8.7	8.9	2.0	N/A										
NIPPON PAPER GRO	3893 JP	JPY	N/A	N/A	N/A	N/A	(29.9)	N/A	N/A	N/A	3.0	N/A	N/A	N/A	N/A	N/A										
HOKUETSU KISHUP	3865 JP	JPY	676.0	12	18.5	14.9	4.0	28.3	0.7	0.7	3.9	4.7	8.4	7.8	18	N/A										
RENGO CO LTD	3941 JP	JPY	645.0	15	18.1	10.9	8.7	71.0	0.7	0.7	3.9	6.6	9.1	7.7	19	N/A										
Average					18.5	13.3	(0.9)	45.8	0.7	0.7	3.6	5.7	8.7	8.1	19	N/A										
<b>Europe/US</b>																										
INTL PAPER CO	IP US	USD	53.7	22.1	16.0	13.5	(7.5)	19.1	5.0	4.4	32.2	34.3	8.7	7.4	3.3	214.7										
PACKAGING CORP	PKG US	USD	87.3	8.2	18.1	15.5	7.5	17.0	4.7	4.2	26.6	27.8	9.3	8.5	2.6	129.4										
WESTROCK MWW LLC	MWV US	USD	N/A	N/A	N/A	N/A	22.4	9.6	N/A	N/A	11.9	12.6	N/A	N/A	N/A	80.6										
MONDI PLC	MNDI LN	GBP	16.3	9.9	13.8	13.3	4.1	3.9	2.8	2.5	21.7	19.7	8.2	8.0	3.5	39.5										
UPM-KYMMENE OYJ	UPM1V FH	EUR	22.2	12.6	13.6	13.7	6.6	(0.7)	14	13	10.7	10.0	7.1	7.2	4.2	16.0										
SMURFIT KAPPA GR	SKG ID	EUR	22.3	5.6	11.1	10.6	2.4	4.4	2.0	1.8	19.9	18.3	6.8	6.7	3.3	114.6										
DS SMITH PLC	SMDS LN	GBP	4.3	5.1	14.0	13.5	7.8	20.2	4.2	3.3	23.3	25.4	10.5	8.9	2.9	80.8										
Average					14.4	13.4	6.2	10.5	3.4	2.9	20.9	21.2	8.4	7.8	3.3	96.5										
Grand average					17.5	13.7	9.8	24.6	2.2	2.0	13.4	15.3	9.0	8.2	2.8	81.2										

Source: Bloomberg

**Figure 3: Lee & Man Paper**

Income statement (HKD mn)						Cash flow statement (HKD mn)					
Year end: Dec	2013	2014	2015	2016E	2017E	Year end: Dec	2013	2014	2015	2016E	2017E
Revenue	16,970	17,099	17,616	18,669	21,368	EBIT	2,341	2,424	2,905	3,560	4,009
COGS	(14,084)	(14,028)	(14,037)	(14,319)	(16,039)	Depreciation & amortisation	680	833	871	1,348	1,390
Gross profit	2,886	3,072	3,578	4,349	5,329	Net interest	149	215	155	271	280
Selling expenses	(312)	(330)	(318)	(386)	(500)	Taxes paid	(244)	(305)	(418)	(500)	(567)
General and administrative	(622)	(709)	(797)	(951)	(1,234)	Changes in working capital	(1,280)	(256)	335	(684)	(815)
Other opex	380	426	428	547	415	Others	(373)	(369)	(305)	(543)	(561)
<b>EBITDA</b>	<b>3,021</b>	<b>3,256</b>	<b>3,776</b>	<b>4,907</b>	<b>5,399</b>	<b>Cash flow from operations</b>	<b>1,272</b>	<b>2,541</b>	<b>3,542</b>	<b>3,452</b>	<b>3,736</b>
Depreciation & Amortization	(680)	(833)	(871)	(1,348)	(1,390)	Capex	(2,272)	(2,050)	(3,000)	(3,600)	(2,200)
<b>EBIT</b>	<b>2,341</b>	<b>2,424</b>	<b>2,905</b>	<b>3,560</b>	<b>4,009</b>	Acquisitions	(50)	(296)	(16)	-	-
Interest income	10	16	10	12	12	Disposals	3	19	25	-	-
Interest expense	(159)	(231)	(165)	(283)	(293)	Others	(9)	8	6	-	-
JVs and associates	0	(0)	(0)	-	-	<b>Cash flow from investing</b>	<b>(2,328)</b>	<b>(2,318)</b>	<b>(2,986)</b>	<b>(3,600)</b>	<b>(2,200)</b>
Others	8	(35)	13	-	-	Dividends	(578)	(660)	(739)	(985)	(116)
<b>Pretax profit</b>	<b>2,192</b>	<b>2,209</b>	<b>2,750</b>	<b>3,289</b>	<b>3,728</b>	Issue of shares	(184)	(111)	(411)	-	-
Taxation	(244)	(305)	(418)	(500)	(567)	Change in debt	1,857	1,871	1,523	1,000	-
Minority interests	-	-	-	-	-	Others	-	-	(0)	0	-
<b>Net profit</b>	<b>1,948</b>	<b>1,904</b>	<b>2,332</b>	<b>2,788</b>	<b>3,161</b>	<b>Cash flow from financing</b>	<b>1,094</b>	<b>1,100</b>	<b>372</b>	<b>15</b>	<b>(1,116)</b>
Net profit (adjusted)	1,948	1,904	2,332	2,788	3,161	Change in cash	53	1,322	926	(132)	420
Basic EPS (HKD)	0.42	0.41	0.50	0.60	0.68	Free cash flow	(1,000)	491	542	(148)	1,536
Diluted EPS (HKD)	0.41	0.41	0.50	0.60	0.68						
DPS (HKD)	0.15	0.14	0.18	0.21	0.24						

Balance sheet (HKD mn)						Key ratios					
Year end: Dec	2013	2014	2015	2016E	2017E	Year end: Dec	2013	2014	2015	2016E	2017E
Cash	711	2,033	2,959	2,826	3,246	Operating margin	17.0	18.0	20.3	23.3	24.9
Short term investments	-	-	-	-	-	EBITDA margin (%)	17.8	19.0	21.4	26.3	25.3
Accounts receivables	5,582	5,891	4,869	5,702	6,526	Effective tax rate (%)	11.1	13.8	15.2	15.2	15.2
Inventory	3,123	3,258	3,092	3,239	3,628	Revenue growth (%)	-	0.8	3.0	6.0	14.5
Other current assets	45	35	122	122	124	Net income growth (%)	-	(2.2)	22.4	19.6	13.4
<b>Total current assets</b>	<b>9,460</b>	<b>11,217</b>	<b>11,042</b>	<b>11,889</b>	<b>13,525</b>	EPS growth adj (%)	-	(1.8)	23.9	19.6	13.4
PP&E	20,830	22,465	23,351	25,604	26,413	DPS growth (%)	-	(2.1)	24.8	19.6	13.4
Intangible Assets	-	-	-	-	-						
Total investments	-	-	-	-	-	Efficiency ratios					
Other long term assets	905	1,055	1,206	1,206	1,206	ROE (%)	11.9	10.9	13.5	14.6	15.0
<b>Total long term assets</b>	<b>21,734</b>	<b>23,520</b>	<b>24,557</b>	<b>26,810</b>	<b>27,620</b>	ROCE (%)	10.5	9.9	10.7	12.0	12.7
<b>TOTAL ASSETS</b>	<b>31,195</b>	<b>34,737</b>	<b>35,599</b>	<b>38,699</b>	<b>41,144</b>	Asset turnover (x)	0.5	0.5	0.5	0.5	0.5
Short term debt	5,661	6,698	5,250	5,603	5,603	Op cash / EBIT (x)	0.5	1.0	1.2	1.0	0.9
Accounts payables	3,165	3,262	3,043	3,216	3,602	Depreciation / CAPEX (x)	0.3	0.4	0.3	0.4	0.6
Other current liabilities	83	357	156	278	293	Accounts receivable days	108.8	122.5	111.5	111.5	111.5
<b>Total current liabilities</b>	<b>8,909</b>	<b>10,317</b>	<b>8,449</b>	<b>9,097</b>	<b>9,498</b>	Accounts payable days	83.9	83.6	82.0	82.0	82.0
Long term debt	5,298	6,163	9,012	9,660	9,660						
Deferred tax	641	780	902	902	902	Leverage ratios					
Bonds payable	-	-	-	-	-	Net gearing (%)	62.7	62.0	65.6	65.3	57.0
Other long term liabilities	-	-	-	-	-	Net debt / EBITDA (x)	3.4	3.3	3.0	2.5	2.2
<b>Total long term liabilities</b>	<b>5,939</b>	<b>6,942</b>	<b>9,914</b>	<b>10,562</b>	<b>10,562</b>	Interest cover (x)	15.7	11.3	18.8	13.1	14.3
<b>TOTAL LIABILITIES</b>	<b>14,848</b>	<b>17,260</b>	<b>18,363</b>	<b>19,659</b>	<b>20,060</b>	Current ratio (x)	1.1	1.1	1.3	1.3	1.4
Shareholders' funds	16,346	17,477	17,236	19,040	21,085	Valuation					
Minority interests	-	-	-	-	-	PER (x)	14.7	15.0	12.1	10.1	8.9
<b>TOTAL LIAB AND EQUITY</b>	<b>31,195</b>	<b>34,737</b>	<b>35,599</b>	<b>38,699</b>	<b>41,144</b>	EV/EBITDA (x)	12.9	12.4	10.9	8.6	7.7
Net cash / (debt)	(10,249)	(10,828)	(11,304)	(12,436)	(12,016)	PBR (x)	1.8	1.6	1.6	1.5	1.3
						Dividend yield (%)	2.4	2.3	2.9	3.5	4.0

Source: Company, Bloomberg, CSCI Research estimates



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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Buy</b>	12-month absolute total return: $\geq 10\%$
<b>Hold</b>	12-month absolute total return: $> -10\%$ but $< 10\%$
<b>Sell</b>	12-month absolute total return: $\leq -10\%$

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