

# Lee & Man Paper

Bloomberg: 2314 HK EQUITY | Reuters: 2314.HK

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DBS Group Research . Equity

8 Mar 2022

## BUY

Last Traded Price (7 Mar 2022): HK\$4.95 (HSI : 21,058)  
Price Target 12-mth: HK\$6.88 (39% upside) (Prev HK\$8.50)

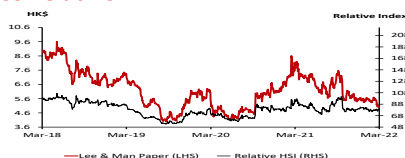
### Analyst

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### What's New

- FY2021 earnings results below market expectations due to lower-than-expected GP margin in 2H
- Expect net profit per tonne to drop in 1HFY22F but improve in 2HFY22F as demand recovers under the government's stimulus measures
- Revised down earnings by 18/16% for FY22/23F to reflect the lower-than-expected GP margin
- Despite a lower TP of HK\$6.88, maintain BUY for LMP's undemanding valuation, where the negatives are priced in

### Price Relative



### Forecasts and Valuation

FY Dec (HK\$m)	2020A	2021A	2022F	2023F
Turnover	25,868	32,511	34,414	36,247
EBITDA	5,763	5,405	6,283	6,670
Pre-tax Profit	4,322	3,794	4,424	4,703
Net Profit	3,524	3,123	3,633	3,870
Net Pft (Pre Ex) (core profit)	3,464	3,139	3,633	3,870
Net Profit Gth (Pre-ex) (%)	5.3	(9.4)	15.7	6.5
EPS (HK\$)	0.81	0.72	0.84	0.91
Core EPS (HK\$)	0.80	0.72	0.84	0.91
EPS Gth (%)	9.5	(11.3)	17.5	7.2
Core EPS Gth (%)	5.9	(9.3)	16.9	7.2
Diluted EPS (HK\$)	0.81	0.72	0.84	0.91
DPS (HK\$)	0.30	0.26	0.30	0.32
BV Per Share (HK\$)	6.54	7.17	8.00	8.60
PE (X)	6.1	6.9	5.9	5.5
CorePE (X)	6.2	6.9	5.9	5.5
P/Cash Flow (X)	5.5	5.5	4.0	4.5
P/Free CF (X)	13.5	16.1	7.7	7.7
EV/EBITDA (X)	5.9	6.7	5.4	4.9
Net Div Yield (%)	6.1	5.3	6.0	6.4
P/Book Value (X)	0.8	0.7	0.6	0.6
Net Debt/Equity (X)	0.4	0.4	0.3	0.2
ROAE(%)	13.5	10.5	11.1	10.9
Earnings Rev (%)			(18)	(16)
Consensus EPS (HK\$)			0.95	0.96
Other Broker Recs:		B:9	S:3	H:3

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

## Expect a better peak season in 2H22F

### Investment Thesis

Revised down FY22F containerboard net profit per tonne to HK\$526, but expect a better peak season in 2HFY22F. We expect the FY22F GP margin to slowly improve back to the 19% level, as better demand will allow raw material costs to be passed through. We expect ASP to grow by 5% and 1% in the full years of FY22 and F23F, respectively. We foresee a better peak season as demand recovers under the stimulus measures taken to boost economic activities.

Despite a lower TP of HK\$6.88, we maintain BUY for LMP's undemanding valuation, where the negatives are priced in. The company is trading at a 4.6x FY22F PE, which is below -1SD of its four-year average. It is also close to its previous low in Sep 2020 and we reckon the negatives are mostly priced in. Further share price drops should be limited at this point.

Better position with its pulp board capacity. LMP pulp capacity accounts for more than 20% of total procurement in 2021. The higher raw material control will serve as a safety net when commodity prices spike under the inflationary environment. LMP entered into agreements to acquire indirect control of Shunying and acquire the land in Cambodia at US\$98.7m. This move matches LMP's strategy to develop its pulp and paper manufacturing business overseas

### Valuation:

We reiterate a BUY recommendation on LMP with a lower TP of HK\$6.88. This is based on a 12-month rolling PE of 8.0x, or +0.5SD of its four-year historical average.

### Where we differ:

We are more optimistic on the recovery in net profit per tonne in FY23F and the outlook going forward. Our FY23F earnings estimates are 5% higher than the market estimate.

### Key Risks to Our View:

Slowing economic activities in China and a slowdown of the increase in domestic wastepaper prices will lead to a downtrend in ASP, which would affect the company's earnings.

### At A Glance

Issued Capital (m shrs)	4,332
Mkt Cap (HK\$m/US\$m)	21,443 / 2,742
Major Shareholders (%)	
Lee (Man Chun Raymond)	31.4
Lee (Man Bun)	31.4
Lee (Wan Keung Patrick)	9.6
Free Float (%)	27.7
3m Avg. Daily Val. (US\$m)	2.41
GICS Industry: Materials / Paper & Forest Products	



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**WHAT'S NEW****FY2021 earnings results below market expectations due to lower-than-expected GP margin**

**FY2021 earnings results below market expectations.** Lee & Man Paper's (LMP) net profit dropped 11% to HK\$3.3bn. This is due to the unexpected drop in its GP margin from 24.2% in 2HFY20 to 13.6% in 2HFY21. Full-year GP margin dropped to 17.5% in FY21 (2020: 22.2%). This is because LMP's average selling price (ASP) hike was not able to match the rising energy prices and intensifying inflationary pressures in 2H2021, as the demand slowed amid slower economic activities, especially in November and December 2021. Net profit per tonne was down 8.4% to HK\$513 in FY21. The board announced a final dividend per share of HK11 cents, with a lower payout ratio of 36% (prev 37%).

**No near-term catalyst, as the industry is moving into low season.** The earnings drop in 2HFY21 will lead to a tough position for LMP in the near term, as the company is having a tough time raising its ASP during the low season. Demand is reducing and orders are relatively conservative, while negative economic factors such as China property developers' default risk and China's stringent COVID policy and regulatory development towards new economy giants remain. With raw material costs increasing in the inflationary environment, reduced demand is likely to lead to a lower GP margin compared to previous years.

**Expect a better peak season in 2HFY22F.** However, our economists anticipate a further cut in interest rates in China and say the government stimulus measures are helping boost the economy and business activities. We expect to see a better peak season in 2HFY22F, due to: (1) The GP margin slowly improving back to the previous level, as better demand would allow costs to be passed through. It is unlikely that the situation similar to that of Nov and Dec 2021, where LMP was not able to further hike its ASP and, in some cases, cut selling prices to sustain the target volume, would occur. (2) Us being cautiously optimistic

about LMP's ability to hike its ASP, given its diversified and high-end products and the market share of the company – we expect ASP to grow by 5% and 1% in FY22 and F23F, respectively. (3) Its better position in terms of its pulp board capacity. LMP's pulp capacity accounts for more than 20% of total procurement in 2021. The higher raw material control will serve as a safety net when commodity prices spike under the inflationary environment.

**Revised down FY22/23F containerboard net profit per tonne to HK\$526/HK\$538 and tissue net profit per tonne to HK\$591/HK\$596.** Overall, we revised down our FY22/FY23F earnings forecast by 18/16% to reflect a lower-than-expected GP margin amid a worsened economic outlook with various market overhangs like the ongoing political tensions between the US and China governments, rising energy prices and intensifying inflationary pressures.

**Despite a lower TP of HK\$6.88, we maintain BUY for LMP's undemanding valuation, where the negatives are priced in.** The company is trading at a 4.6x FY22F PE, which is below -1SD of its four-year average. It is also close to its previous low in Sep 2020, and we reckon the negatives are mostly priced in. Further share price drops should be limited at this point. We maintain BUY with a slightly lower TP of HK\$6.88. It is based on a 12-month rolling PE of 8.0x or slightly below +0.5SD from the four-year historical average.

**Company Background**

Lee & Man Paper (LMP) is the second-largest containerboard manufacturer in China. Its major products are linerboards, high-performance corrugating medium, and coated duplex boards. The company also produces tissue paper.

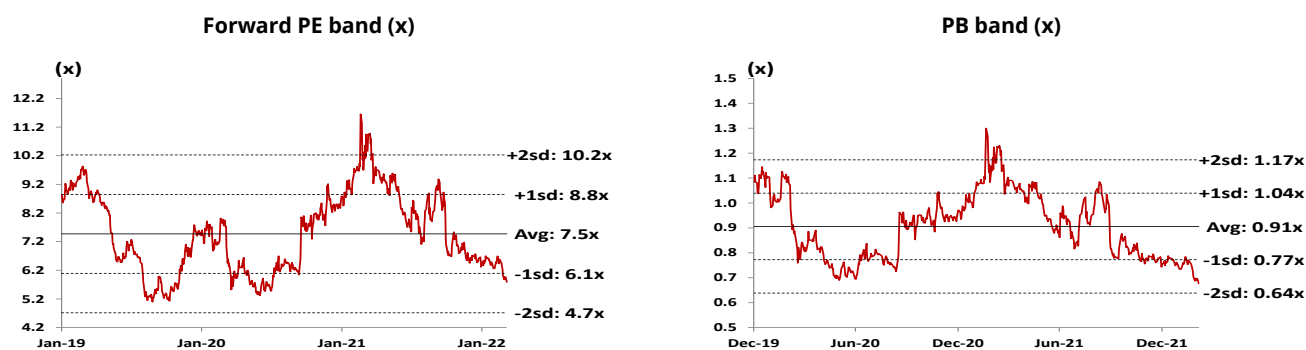
## Lee & Man Paper

### Income Statement (HK\$ m)

FY Dec	2020A	2021A	% cha v-a-v
Revenue	25,868	32,511	25.7
Cost of Goods Sold	(20,120)	(26,809)	33.2
<b>Gross Profit</b>	<b>5,748</b>	<b>5,703</b>	<b>(0.8)</b>
Other Opng (Exp)/Inc	(1,342)	(1,847)	37.7
<b>Operating Profit</b>	<b>4,406</b>	<b>3,856</b>	<b>(12.5)</b>
Other Non Opg (Exp)/Inc	0	0	nm
Associates & JV Inc	(9)	(1)	86.4
Net Interest (Exp)/Inc	(136)	(45)	67.1
Exceptional Gain/(Loss)	60	(16)	nm
<b>Pre-tax Profit</b>	<b>4,322</b>	<b>3,794</b>	<b>(12.2)</b>
Tax	(669)	(543)	(18.9)
Minority Interest	0	(1)	nm
<b>Net Profit</b>	<b>3,524</b>	<b>3,123</b>	<b>(11.4)</b>
Net Profit before Except.	3,464	3,139	(9.4)
EBITDA	5,763	5,405	(6.2)
<b>Margins &amp; Ratio</b>			
Gross Margins (%)	22.2	17.5	
Opg Profit Margin (%)	17.0	11.9	
Net Profit Margin (%)	13.6	9.6	

Source: Company, DBS HK

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## Lee & Man Paper

### Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Containerboard output (m tons)	5.6	5.5	6.1	6.3	6.5
Tissue output ('000 tons)	663.0	686.0	754.6	787.6	805.5

Source: Company, DBS HK

### Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
<b>Revenues (HK\$ m)</b>					
Paper	22,388	21,518	27,553	29,719	31,348
Pulp	2	34	228	6	6
Tissue	4,755	4,317	4,730	4,690	4,893
<b>Total</b>	<b>27,144</b>	<b>25,868</b>	<b>32,511</b>	<b>34,414</b>	<b>36,247</b>
<b>Gross Profit (HK\$ m)</b>					
Paper	3,515	4,166	3,481	3,923	4,138
Pulp	0	3	8	1	1
Tissue	564	513	334	375	465
<b>Total</b>	<b>4,078</b>	<b>4,682</b>	<b>3,823</b>	<b>4,299</b>	<b>4,604</b>
<b>Gross Profit Margins (%)</b>					
Paper	15.7	19.4	12.6	13.2	13.2
Pulp	17.6	8.9	3.3	13.0	13.0
Tissue	11.9	11.9	7.1	8.0	9.5
<b>Total</b>	<b>15.0</b>	<b>18.1</b>	<b>11.8</b>	<b>12.5</b>	<b>12.7</b>

Source: Company, DBS HK

## Lee & Man Paper

### Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	27,144	25,868	32,511	34,414	36,247
Cost of Goods Sold	(22,051)	(20,120)	(26,809)	(27,832)	(29,222)
<b>Gross Profit</b>	<b>5,093</b>	<b>5,748</b>	<b>5,703</b>	<b>6,582</b>	<b>7,025</b>
Other Opng (Exp)/Inc	(735)	(1,342)	(1,847)	(2,020)	(2,203)
<b>Operating Profit</b>	<b>4,358</b>	<b>4,406</b>	<b>3,856</b>	<b>4,563</b>	<b>4,821</b>
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	(9)	(1)	0	0
Net Interest (Exp)/Inc	(283)	(136)	(45)	(138)	(119)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(55)	60	(16)	0	0
<b>Pre-tax Profit</b>	<b>4,020</b>	<b>4,322</b>	<b>3,794</b>	<b>4,424</b>	<b>4,703</b>
Tax	(720)	(669)	(543)	(664)	(705)
Minority Interest	0	0	(1)	0	0
Preference Dividend	(65)	(129)	(128)	(128)	(128)
<b>Net Profit</b>	<b>3,236</b>	<b>3,524</b>	<b>3,123</b>	<b>3,633</b>	<b>3,870</b>
Net Profit before Except.	3,290	3,464	3,139	3,633	3,870
EBITDA	5,706	5,763	5,405	6,283	6,670
<b>Growth</b>					
Revenue Gth (%)	N/A	(4.7)	25.7	5.9	5.3
EBITDA Gth (%)	N/A	1.0	(6.2)	16.3	6.2
Opg Profit Gth (%)	N/A	1.1	(12.5)	18.3	5.7
Net Profit Gth (%)	N/A	8.9	(11.4)	16.3	6.5
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	18.8	22.2	17.5	19.1	19.4
Opg Profit Margin (%)	16.1	17.0	11.9	13.3	13.3
Net Profit Margin (%)	11.9	13.6	9.6	10.6	10.7
ROAE (%)	13.6	13.5	10.5	11.1	10.9
ROA (%)	7.4	7.8	6.3	6.8	7.1
ROCE (%)	9.0	8.9	7.2	7.8	8.1
Div Payout Ratio (%)	35.1	37.0	36.1	34.8	35.0
Net Interest Cover (x)	15.4	32.4	86.3	33.0	40.7

Source: Company, DBS HK

### Interim Income Statement (HK\$ m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	14,197	11,071	14,797	15,180	17,331
Cost of Goods Sold	(11,442)	(8,905)	(11,215)	(11,842)	(14,966)
<b>Gross Profit</b>	<b>2,756</b>	<b>2,166</b>	<b>3,582</b>	<b>3,338</b>	<b>2,365</b>
Other Oper. (Exp)/Inc	(477)	(443)	(873)	(972)	(844)
<b>Operating Profit</b>	<b>2,279</b>	<b>1,723</b>	<b>2,709</b>	<b>2,365</b>	<b>1,521</b>
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(171)	(81)	(89)	(33)	(43)
Exceptional Gain/(Loss)	(58)	0	60	(63)	48
<b>Pre-tax Profit</b>	<b>2,049</b>	<b>1,642</b>	<b>2,680</b>	<b>2,269</b>	<b>1,526</b>
Tax	(429)	(241)	(428)	(332)	(210)
Minority Interest	0	0	0	0	(1)
<b>Net Profit</b>	<b>1,556</b>	<b>1,336</b>	<b>2,188</b>	<b>1,873</b>	<b>1,250</b>
Net profit bef Except.	1,614	1,336	2,128	1,936	1,204
<b>Growth</b>					
Revenue Gth (%)	(10.4)	(14.5)	4.2	37.1	17.1
Opg Profit Gth (%)	(19.1)	(18.8)	18.9	37.3	(43.9)
Net Profit Gth (%)	(18.1)	(20.5)	40.6	40.1	(42.9)

### Margins

Gross Margins (%)	19.4	19.6	24.2	22.0	13.6
Opg Profit Margins (%)	16.1	15.6	18.3	15.6	8.8
Net Profit Margins (%)	11.0	12.1	14.8	12.3	7.2

Source: Company, DBS HK

## Lee &amp; Man Paper

## Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	28,177	31,891	33,905	34,785	34,936
Invt in Associates & JVs	98	159	91	91	91
Other LT Assets	2,732	2,748	3,455	3,455	3,455
Cash & ST Invt	2,920	1,185	1,909	2,065	1,812
Inventory	3,571	4,350	5,705	6,039	6,723
Debtors	5,818	6,368	7,219	7,188	7,933
Other Current Assets	182	99	169	169	169
<b>Total Assets</b>	<b>43,497</b>	<b>46,800</b>	<b>52,454</b>	<b>53,792</b>	<b>55,120</b>
ST Debt	4,874	5,255	8,675	9,175	9,675
Creditors	3,295	2,934	3,234	3,261	3,435
Other Current Liab	291	395	282	288	294
LT Debt	7,461	6,072	5,386	3,062	1,141
Other LT Liabilities	1,493	1,394	1,474	1,474	1,474
Shareholder's Equity	26,082	30,743	33,395	36,523	39,093
Minority Interests	0	8	8	8	8
<b>Total Cap. &amp; Liab.</b>	<b>43,497</b>	<b>46,800</b>	<b>52,454</b>	<b>53,792</b>	<b>55,120</b>
Non-Cash Wkg. Capital	5,986	7,488	9,578	9,847	11,097
Net Cash/(Debt)	(9,416)	(10,142)	(12,152)	(10,172)	(9,003)
Debtors Turn (avg days)	78.2	86.0	76.3	76.4	76.1
Creditors Turn (avg days)	58.1	60.6	44.6	45.4	44.6
Inventory Turn (avg days)	63.0	77.1	72.7	82.1	85.1
Asset Turnover (x)	0.6	0.6	0.7	0.6	0.7
Current Ratio (x)	1.5	1.4	1.2	1.2	1.2
Quick Ratio (x)	1.0	0.9	0.7	0.7	0.7
Net Debt/Equity (X)	0.4	0.4	0.4	0.3	0.2
Net Debt/Equity ex MI (X)	0.4	0.3	0.4	0.3	0.2
Capex to Debt (%)	18.9	20.6	18.5	21.2	18.5
Z-Score (X)	2.6	2.4	2.4	2.6	2.6

Source: Company, DBS HK

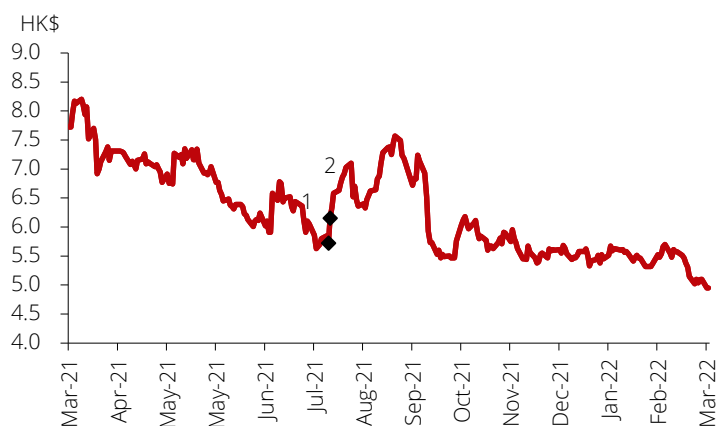
## Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	4,020	4,322	3,794	4,424	4,703
Dep. & Amort.	1,348	1,365	1,550	1,721	1,849
Tax Paid	(794)	(736)	(713)	(664)	(705)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	7	5	7	0	0
Chg in Wkg. Cap.	1,655	392	(1,355)	(494)	(1,201)
Other Operating CF	(1,280)	(1,425)	657	391	94
<b>Net Operating CF</b>	<b>4,956</b>	<b>3,923</b>	<b>3,940</b>	<b>5,379</b>	<b>4,739</b>
Capital Exp. (net)	(2,326)	(2,332)	(2,600)	(2,600)	(2,000)
Other Invt. (net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(1,195)	(989)	(921)	0	0
<b>Net Investing CF</b>	<b>(3,521)</b>	<b>(3,321)</b>	<b>(3,521)</b>	<b>(2,600)</b>	<b>(2,000)</b>
Div Paid	(1,226)	(1,087)	(1,174)	(633)	(1,427)
Chg in Gross Debt	868	(1,009)	2,734	(1,824)	(1,421)
Capital Issues	(95)	(96)	(95)	0	0
Other Financing CF	(77)	(142)	(1,161)	(166)	(143)
<b>Net Financing CF</b>	<b>(530)</b>	<b>(2,334)</b>	<b>305</b>	<b>(2,623)</b>	<b>(2,992)</b>
Currency Adjustments	2	(3)	0	0	0
Chg in Cash	908	(1,735)	724	156	(253)
Opg CFPS (HK\$)	0.75	0.81	1.22	1.36	1.39
Free CFPS (HK\$)	0.60	0.37	0.31	0.65	0.64

Source: Company, DBS HK

**Lee & Man Paper**

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	3-Aug-21	HK\$5.70	HK\$7.40	Buy
2:	4-Aug-21	HK\$6.15	HK\$8.50	Buy

Source: DBS HK

Analyst: *Patricia Yeung*  
*Byron Lam*

DBS HK recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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