

China / Hong Kong Company Update

Lee & Man Paper

Bloomberg: 2314 HK EQUITY | Reuters: 2314.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Aug 2022

BUY

Last Traded Price (8 Aug 2022): HK\$3.06 (HSI : 20,046)
Price Target 12-mth: HK\$4.72 (54% upside) (Prev HK\$6.88)

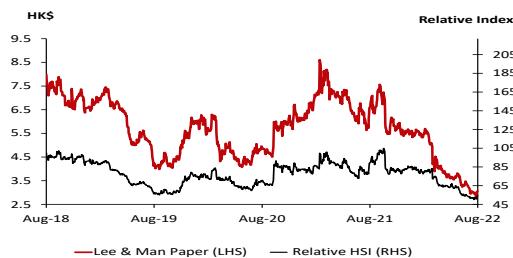
Analyst

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What's New

- 1HFY22 net profit declined 56.9%, in line with profit alert
- Worst seems over; expect containerboard demand recovery in 2HFY22 amid peak season
- Revised down 48%/46% in FY22F/FY23F to reflect lower-than-expected GP margin and sales volume
- Maintain BUY with a lower TP of HK\$4.72

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2020A	2021A	2022F	2023F
Turnover	25,868	32,511	31,746	32,867
EBITDA	5,763	5,405	4,022	4,389
Pre-tax Profit	4,322	3,794	2,333	2,584
Net Profit	3,524	3,123	1,902	2,121
Net Pft(Pre Ex)(core profit)	3,464	3,139	1,902	2,121
Net Profit Gth (Pre-ex) (%)	5.3	(9.4)	(39.4)	11.5
EPS (HK\$)	0.81	0.72	0.44	0.50
Core EPS (HK\$)	0.80	0.72	0.44	0.50
EPS Gth (%)	9.5	(11.3)	(38.5)	12.3
Core EPS Gth (%)	5.9	(9.3)	(38.8)	12.3
Diluted EPS (HK\$)	0.81	0.72	0.44	0.50
DPS (HK\$)	0.30	0.26	0.15	0.17
BV Per Share (HK\$)	6.54	7.17	7.65	7.99
PE (X)	3.8	4.3	6.9	6.2
CorePE (X)	3.8	4.2	6.9	6.2
P/Cash Flow (X)	3.4	4.8	3.1	4.2
P/Free CF (X)	8.4	27.8	8.1	11.9
EV/EBITDA (X)	4.5	5.1	6.6	6.0
Net Div Yield (%)	9.8	8.5	5.1	5.7
P/Book Value (X)	0.5	0.4	0.4	0.4
Net Debt/Equity (X)	0.4	0.4	0.3	0.3
ROAE(%)	13.5	10.5	6.0	6.3
Earnings Rev (%):		(48)	(46)	
Consensus EPS (HK\$)		0.47	0.60	
Other Broker Recs:	B:5	S:5	H:3	

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

Peak season incoming

Investment Thesis

Expect half-on-half containerboard demand recovery in 2HFY22 amid peak season. We expect the 2HFY22F GP margin to improve and expect net profit per tonne to increase 58% h-o-h to HK\$356, as better demand will allow raw material costs to be passed through. We foresee GP margin improvement hoh in 2H peak season, thanks to (1) easing inflationary environment, with better ability to pass on cost, (2) diversified high-end products, (3) further gain in market share from industry consolidation, and (4) Chinese government stimulus measures on boosting domestic economy.

Undemanding valuation, with negatives priced in. The company is trading at a 5.9x FY23F PE, -1SD of its four-year average. It is also close to its previous low in 2012, and we reckon the negatives are mostly priced in. In fact, we have seen Chinese government plans to boost domestic economy. We believe the stock has already seen the worst. With peak season upcoming, we expect share price to uphold by stronger demand.

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 agreements to acquire indirect control of Shunying and 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\$4.72. It is based on a 12-month rolling PE of 7.5x, the mean of its four-year historical average (previous 8.0x; +0.5SD).

Where we differ:

We are more optimistic on the recovery in net profit per tonne in 1HFY22F and FY23F and the outlook going forward.

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 (HKM/US\$m)	13,256 / 1,689
Major Shareholders (%)	
Lee (Man Bun)	31.5
Lee (Man Chun Raymond)	31.5
Lee (Wan Keung Patrick)	9.7
Free Float (%)	27.4
3m Avg. Daily Val. (US\$m)	3.7
GICS Industry: Materials / Paper & Forest Products	



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WHAT'S NEW**1HFY22 net profit declined 56.9%, in line with profit alert**

LMP 1HFY22 net profit declined 56.9%, in line with profit alert. LMP's sales increased 0.6% y-o-y to HK\$15.3bn, with a decline in sales volume of 3.2% in paper and 7.2% in tissue. The significant decline in net profit is due to the margin contraction – 10.8%, from 22.0% same period last year. During the period, the price of international pulp remained high and volatile given tight supply. With dampened demand because of anti-pandemic restrictions, most of the paper manufacturers in China were unable to pass the costs to their customers. The implied net profit per tonne for containerboard and tissue are HK\$226 and HK\$903 per tonne respectively. Interim DPS was announced at HK6.5 cents, with a 35% pay-out ratio (similar to previous years).

Expect containerboard demand recovery in 2HFY22 amid peak seasons. We expect the 2HFY22F GP margin to improve to 13-14% and expect net profit per tonne to increase 58% h-o-h to HK\$356: (1) better demand would allow costs to be passed through (2) we 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, (3) the industry consolidation should help LMP further gain market share and improve ASP during the peak season, and (4) the Chinese government stimulus measures on domestic consumption to boost economy.

Revised down 36%/34% in FY22F/FY23F earnings to reflect the lower-than-expected GP margin and sales volume. We have revised down the sales volume by 14%/15% to 5.4/5.6m tonnes to reflect slower demand amid worsened economic outlook in China. We have also lowered our margin recovery expectation from 19% to 12% in FY22F full year and expect GP margin to only recover to 14% level in FY23F. In term of net profit per tonne, we expect LMP's containerboard business to reach HK\$356 per tonne in 2HFY22F. This implies HK\$291 per tonne in FY22F, a 45.7%

decline y-o-y. We expect net profit per tonne to gradually improve by 20% to HK\$375 per tonne in FY23F, thanks to the margin improvement. For tissue product, we expect pulp price hike will slow down in 2H along with other raw materials prices and expect net profit per tonne of HK\$775/522 in FY22/23F.

Recovery delayed, but the worst is over. While we had anticipated a weak low season in 1HFY22, as the China domestic economy was expected to worsen, the significant gross margin contraction got us surprised, as the demand was continuously dampened by lockdown in China and international pulp price hikes due to the inflationary environment. While we have revised down our earnings and margin expectation, this does not change our view on a strong recovery in 2HFY22F.

Recommend BUY with a lower TP of HK\$4.72 Most importantly, the company is trading at a 5.9x FY23F PE, below -1SD of its four-year average. It is also close to its previous low in 2012, and we reckon the negatives are mostly priced in. In fact, we have seen that the Chinese government plans to boost domestic economy. We believe the stock has already seen the worst. With peak season upcoming, we expect share price to uphold by stronger demand. We maintain BUY with a slightly lower TP of HK\$4.72. It is based on a 12-month rolling PE of 7.5x, the mean of its 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

Interim Income Statement (HK\$m)

FY Dec	1H2021	2H2021	1H2022	% chg y-o-y	% chg h-o-h
Revenue	15,180	17,331	15,276	0.6	(11.9)
Cost of Goods Sold	(11,842)	(14,966)	(13,620)	15.0	(9.0)
Gross Profit	3,338	2,365	1,656	(50.4)	(30.0)
Other Oper. (Exp)/Inc	(972)	(844)	(672)	(30.9)	(20.3)
Operating Profit	2,365	1,521	984	(58.4)	(35.3)
Other Non Opg (Exp)/Inc	0	0	0	nm	nm
Associates & JV Inc	0	0	0	nm	nm
Net Interest (Exp)/Inc	(33)	(43)	(38)	(16.7)	10.3
Exceptional Gain/(Loss)	(63)	48	4	nm	(91.7)
Pre-tax Profit	2,269	1,526	950	(58.1)	(37.8)
Tax	(332)	(210)	(87)	(73.8)	(58.5)
Minority Interest	0	(1)	0	nm	(100.0)
Net Profit	1,873	1,250	797	(57.4)	(36.2)
Net profit bef Except.	1,936	1,204	793	(59.0)	(34.0)
EBITDA	2,365	1,521	984	(58.4)	(35.3)
Margins (%)					
Gross Margins	22.0	13.6	10.8		
Opg Profit Margins	15.6	8.8	6.4		
Net Profit Margins	12.3	7.2	5.2		

Source: Company, DBS HK

Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Containerboard output (m tons)	5.6	5.5	5.6	5.4	5.6
Tissue output ('000 tons)	663.0	686.0	660.0	581.8	581.8

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Paper	22,388	21,518	27,553	27,067	28,158
Pulp	2	34	228	301	332
Tissue	4,755	4,317	4,730	4,378	4,378
Total	27,144	25,868	32,511	31,746	32,867
Gross Profit (HK\$ m)					
Paper	3,515	4,166	3,481	2,436	3,097
Pulp	0	3	8	9	17
Tissue	564	513	334	438	525
Total	4,078	4,682	3,823	2,883	3,639
Gross Profit Margins (%)					
Paper	15.7	19.4	12.6	9.0	11.0
Pulp	17.6	8.9	3.3	3.0	5.0
Tissue	11.9	11.9	7.1	10.0	12.0
Total	15.0	18.1	11.8	9.1	11.1

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	31,746	32,867
Cost of Goods Sold	(22,051)	(20,120)	(26,809)	(27,895)	(28,297)
Gross Profit	5,093	5,748	5,703	3,852	4,571
Other Opgn (Exp)/Inc	(735)	(1,342)	(1,847)	(1,417)	(1,858)
Operating Profit	4,358	4,406	3,856	2,435	2,712
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	(9)	(1)	0	0
Net Interest (Exp)/Inc	(283)	(136)	(45)	(102)	(128)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(55)	60	(16)	0	0
Pre-tax Profit	4,020	4,322	3,794	2,333	2,584
Tax	(720)	(669)	(543)	(303)	(336)
Minority Interest	0	0	(1)	0	0
reference Dividend	(65)	(129)	(128)	(128)	(128)
Net Profit	3,236	3,524	3,123	1,902	2,121
Net Profit before Except.	3,290	3,464	3,139	1,902	2,121
EBITDA	5,706	5,763	5,405	4,022	4,389
Growth					
Revenue Gth (%)	N/A	(4.7)	25.7	(2.4)	3.5
EBITDA Gth (%)	N/A	1.0	(6.2)	(25.6)	9.1
Opg Profit Gth (%)	N/A	1.1	(12.5)	(36.9)	11.4
Net Profit Gth (%)	N/A	8.9	(11.4)	(39.1)	11.5
Margins & Ratio					
Gross Margins (%)	18.8	22.2	17.5	12.1	13.9
Opg Profit Margin (%)	16.1	17.0	11.9	7.7	8.3
Net Profit Margin (%)	11.9	13.6	9.6	6.0	6.5
ROAE (%)	13.6	13.5	10.5	6.0	6.3
ROA (%)	7.4	7.8	6.3	3.6	4.0
ROCE (%)	9.0	8.9	7.2	4.3	4.7
Div Payout Ratio (%)	35.1	37.0	36.1	34.8	35.0
Net Interest Cover (x)	15.4	32.4	86.3	23.8	21.2

Source: Company, DBS HK

Interim Income Statement (HK\$ m)

FY Dec	1H2020	2H2020	1H2021	2H2021	1H2022
Revenue	11,071	14,797	15,180	17,331	15,276
Cost of Goods Sold	(8,905)	(11,215)	(11,842)	(14,966)	(13,620)
Gross Profit	2,166	3,582	3,338	2,365	1,656
Other Oper. (Exp)/Inc	(443)	(873)	(972)	(844)	(672)
Operating Profit	1,723	2,709	2,365	1,521	984
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(81)	(89)	(33)	(43)	(38)
Exceptional Gain/(Loss)	0	60	(63)	48	4
Pre-tax Profit	1,642	2,680	2,269	1,526	950
Tax	(241)	(428)	(332)	(210)	(87)
Minority Interest	0	0	0	(1)	0
Net Profit	1,336	2,188	1,873	1,250	797
Net profit bef Except.	1,336	2,128	1,936	1,204	793
Growth					
Revenue Gth (%)	(14.5)	4.2	37.1	17.1	0.6
Opg Profit Gth (%)	(18.8)	18.9	37.3	(43.9)	(58.4)
Net Profit Gth (%)	(20.5)	40.6	40.1	(42.9)	(57.4)
Margins					
Gross Margins (%)	19.6	24.2	22.0	13.6	10.8
Opg Profit Margins (%)	15.6	18.3	15.6	8.8	6.4
Net Profit Margins (%)	12.1	14.8	12.3	7.2	5.2

Source: Company, DBS HK

Lee & Man Paper**Balance Sheet (HK\$ m)**

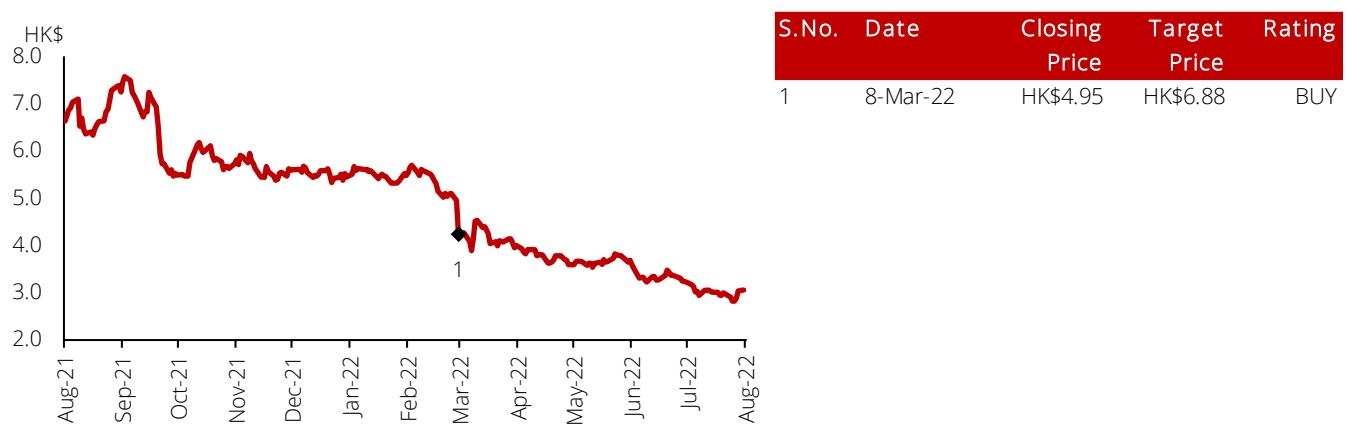
FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	28,177	31,891	33,905	34,918	35,242
Invts in Associates & JVs	98	159	91	91	91
Other LT Assets	2,732	2,748	3,455	3,455	3,455
Cash & ST Invts	2,920	1,185	1,909	1,905	1,643
Inventory	3,571	4,350	5,705	5,571	6,097
Debtors	5,818	6,368	7,219	6,630	7,193
Other Current Assets	182	99	169	169	169
Total Assets	43,497	46,800	52,454	52,739	53,890
ST Debt	4,874	5,255	8,675	9,075	9,575
Creditors	3,295	2,934	3,234	3,008	3,115
Other Current Liab	291	395	282	280	283
LT Debt	7,461	6,072	5,386	3,862	2,976
Other LT Liabilities	1,493	1,394	1,474	1,474	1,474
Shareholder's Equity	26,082	30,743	33,395	35,032	36,459
Minority Interests	0	8	8	8	8
Total Cap. & Liab.	43,497	46,800	52,454	52,739	53,890
Non-Cash Wkg. Capital	5,986	7,488	9,578	9,083	10,061
Net Cash/(Debt)	(9,416)	(10,142)	(12,152)	(11,032)	(10,907)
Debtors Turn (avg days)	78.2	86.0	76.3	79.6	76.8
Creditors Turn (avg days)	58.1	60.6	44.6	43.3	42.0
Inventory Turn (avg days)	63.0	77.1	72.7	78.2	80.0
Asset Turnover (x)	0.6	0.6	0.7	0.6	0.6
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	0.3
Net Debt/Equity ex MI (X)	0.4	0.3	0.4	0.3	0.3
Capex to Debt (%)	18.9	20.6	16.4	20.1	15.9
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	2,333	2,584
Dep. & Amort.	1,348	1,365	1,550	1,587	1,676
Tax Paid	(794)	(736)	(584)	(303)	(336)
Assoc. & JV Inc/(loss)	0	9	1	0	0
(Pft)/ Loss on disposal of FAs	7	5	57	0	0
Chg in Wkg.Cap.	1,655	392	(514)	199	(948)
Other Operating CF	(1,280)	(1,434)	(1,513)	420	124
Net Operating CF	4,956	3,923	2,792	4,236	3,100
Capital Exp.(net)	(2,326)	(2,332)	(2,313)	(2,600)	(2,000)
Other Invts.(net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(1,195)	(989)	(1,194)	0	0
Net Investing CF	(3,521)	(3,321)	(3,507)	(2,600)	(2,000)
Div Paid	(1,226)	(1,087)	(1,434)	(392)	(821)
Chg in Gross Debt	868	(1,009)	3,102	(1,124)	(386)
Capital Issues	(95)	(96)	(81)	0	0
Other Financing CF	(77)	(142)	(152)	(124)	(154)
Net Financing CF	(530)	(2,334)	1,434	(1,640)	(1,361)
Currency Adjustments	2	(3)	4	0	0
Chg in Cash	908	(1,735)	724	(4)	(261)
Opg CFPS (HK\$)	0.75	0.81	0.76	0.94	0.95
Free CFPS (HK\$)	0.60	0.37	0.11	0.38	0.26

Source: Company, DBS HK

Target Price & Ratings History

Source: DBS HK

Analyst: Patricia Yeung
Byron Lam

Lee & Man Paper

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

Completed Date: : 9 Aug 2022 13:02:25 (HKT)

Dissemination Date: 9 Aug 2022 13:42:43 (HKT)

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

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