

Lee & Man Paper Manufacturing (02314.HK)

1H2022 results in line with consensus

China | Basic Materials

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Company Profile

Established in 1994, Lee & Man Paper Manufacturing (“LMP”) was listed on the Main Board of the Hong Kong Stock Exchange on September 2003. LMP manufactures linerboards of various grades and corrugating medium of different specifications used for different industrial packaging purposes. Over the years, in addition to boosting production scale, LMP has been relentless in pushing to form a vertically integrated operation that covers pulp making and recovered paper collection so as to assure it has stable raw material supply.

LMP currently has 5 paper mills, 3 tissue mills and 1 pulp factory in China. They are distributed in Zhongtang Town and Hongmei Town of Dongguan City, Guangdong Province, Changshu City, Chongqing Yongchuan District, Ruichang City, Jiangxi Province, etc. In addition, LMP also has production bases in Vietnam, Malaysia and Indonesia. As of the end of December 2021, the Company had an annual production capacity of over 8.695 million tons (~6.88 million tons of paper, ~180,000 tons of pulp, ~640,000 tons of pulp board and ~995,000 tons of tissue paper).

1H2022 results in line with consensus

LMP total revenue for the six months ended 30 June 2022 (1H2022) increased by 0.6% YoY to HK\$15.3bn. Net profit attributable to shareholders decreased by 58.8% to HK\$797mn, which is consistent with the results announced in July. The EPS was HK18.46 cents (1H2021: HK44.54 cents). Interim dividend of HK6.50 cents per share (1H2021: HK15 cents), decreased by 56.7% YoY.

During the period, mainland paper manufacturers’ profitability has been under pressure as a result of rising prices of raw materials such as wood pulp, energy, and high logistics and transportation costs, plus lockdown of cities amid the pandemic leading to weakened demand. The aggregate sales amounted decreased by 3.9% YoY to 2.96 million tons, with net profit per ton decreased by HK\$358 to HK\$292. The overall gross profit plunged 50.4% to \$1.656bn, while the overall gross profit margin fell 11.1ppt to 10.8% due to the significant increase in raw material prices. In terms of expenses, 1H2022 distribution and selling expenses were HK\$446mn, down 11.5% YoY, accounting for 2.9% of total revenue; General and administrative expenses were HK\$598mn, down 17.4% YoY, accounting for 3.9% of total revenue.

By segments, the packaging paper segment’s profit dropped 72.4% YoY to HK\$610mn, while segment’s revenue rose slightly by 0.6% YoY to HK\$13.051bn, accounting for 85.4% of the total revenue. The tissue paper business segment’s profit increased 24.8% YoY to HK\$286mn, while segment’s revenue declined 0.3% to HK\$2003mn, accounting for 13.2% of total revenue. The pulp segment’s profit rose 19.9 times YoY to HK\$60.22mn and segment’s revenue rose 16.1% to HK\$216mn, accounting for 1.4% of total revenue.

Buy

CMP HKD2.55

(Closing price as of 8 November)

Target HKD 3.70 (+45.1%)

COMPANY DATA

O/S SHARES (MN) :	4,309.565
MARKET CAP (HKD MN) :	11075.6
52 - WK HI/LO (HKD):	5.785/2.320

SHARE HOLDING PATTERN, %

Lee Man Chun	31.37%
Lee Man Bun	31.37%
Lee Wan Keung	10.07%

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

EUR mn	FY20	FY21	FY22E	FY23E
Revenue	25,868	32,511	33,011	33,812
Net profit	3,524	3,123	1,627	2,402
Reported EPS	0.81	0.72	0.38	0.55
P/E ratio, x	3.1	3.5	6.8	4.6
Dividend Yield, %	11.8%	10.2%	5.4%	8.0%

Source: Company reports, Phillip Securities Est.

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Investment Thesis

Looking ahead, China continues to tighten control over plastic packaging, giving room for using paper packaging as a substitute, while consumption behavior has changed amid the pandemic with more people shopping online, and correspondingly the demand for packaging paper has climbed. LMP continued to consolidate upstream resources and develop a vertical business model covering pulp-making and waste paper recycling, and plans to add pulp production lines at its plants in Jiangxi province and Chongqing, so as to enhance raw materials supply (the new production lines are expected to start operation in 2023). Regarding tissue paper business, LMP plans to establish a new plant in Guangxi province and expects to add new production line with annual capacity of 300,000 tons of bleached pulp by the end of next year at the earliest (total production capacity is around 1,000,000 tons). LMP is actively expanding its recycled pulp business and enhancing raw material deployment, which should be expected to mitigate the impact of rising raw material costs on profits in the long run. With the gradual easing of the pandemic in June, overall domestic consumer confidence is sluggish and we remain cautious about the degree of business recovery in the second half of the year (Q4 will be the traditional peak demand season), but the low valuation level to some extent reflects the company's weak fundamentals. LMP has its eye on the Southeast Asian market and has already established production capacity in countries such as Vietnam and Malaysia, that would enhance the revenue and production efficiency. Thus, LMP's profitability would be expected to improve in next year. We expect FY2023E-FY2024E EPS to be HK\$0.38 and HK\$0.55 respectively, with FY2023E PT of HKD3.70, implies a FY2023E P/E of 6.6x (~5-yrs historical average minus 1 std. deviation). Our investment rating is "Buy".

Risk factors

1) Significant fluctuations in raw material prices; 2) escalating trade tensions between the U.S. and China further dampening downstream demand; 3) faster than expected increase in industry capacity leading to price wars; and 4) FX rate risk.

Financial

Consolidated Statement of Profit or Loss

Dec Y/E, HKD mn	FY19	FY20	FY21	FY22E	FY23E
Revenue	27,144	25,868	32,511	33,011	33,812
COGS	(22,051)	(20,120)	(26,808)	(29,162)	(28,957)
Gross Profit	5,093	5,748	5,703	3,849	4,855
Selling expenses	(612)	(718)	(1,009)	(970)	(917)
General & Admin exp	(1,163)	(1,164)	(1,564)	(1,545)	(1,577)
Impair. losses on receivables, net	(55)	60	(16)	(19)	(21)
Operating Profit	3,263	3,927	3,114	1,315	2,341
Others	1,082	574	757	893	915
Finance costs, net	(325)	(171)	(75)	(144)	(247)
Share of result of a JV	-	(8.8)	(1.2)	(1.2)	(1.2)
Profit before tax	4,020	4,321	3,794	2,063	3,008
Income tax	(720)	(669)	(543)	(307)	(478)
Shareholders Net profit	3,236	3,524	3,123	1,627	2,402
Reported EPS, Diluted	0.74	0.81	0.72	0.38	0.55
DPS	0.26	0.30	0.26	0.14	0.20
Payout ratio	35%	37%	36%	37%	37%
Shares outstanding	4,375	4,351	4,345	4,340	4,328

Key Financial Data

Dec Y/E	FY19	FY20	FY21	FY22E	FY23E
Valuation Ratio					
P/S ratio, x	0.4	0.4	0.3	0.3	0.3
P/E ratio, x	3.4	3.1	3.5	6.8	4.6
Dividend Yield, %	10.2%	11.8%	10.2%	5.4%	8.0%

Per share data (HKD)

EPS	0.74	0.81	0.72	0.38	0.55
BVPS	5.96	7.07	7.69	7.81	8.25
DPS (HKD)	0.26	0.30	0.26	0.14	0.20

Growth & Margin

Growth					
Revenue Growth	-15.7%	-4.7%	25.7%	1.5%	2.4%
Gross Profit Growth	-32.2%	12.9%	-0.8%	-32.5%	26.1%
Operating Profit Growth	-38.9%	20.3%	-20.7%	-57.8%	78.1%
Net Profit Growth	-34.4%	7.5%	-12.2%	-45.6%	45.8%
Margin					
Gross Profit Margin	18.8%	22.2%	17.5%	11.7%	14.4%
Operating Profit Margin	12.0%	15.2%	9.6%	4.0%	6.9%
Net Profit Margin	11.9%	13.6%	9.6%	4.9%	7.1%

Key Ratios

ROE	13.1%	12.4%	9.7%	4.8%	6.9%
ROA	7.5%	7.8%	6.3%	3.0%	4.2%

Consolidated Statement of Financial Position

Dec Y/E, HKD mn	FY19	FY20	FY21	FY22E	FY23E
Non Current Asset					
PPE	28,177	31,891	33,905	36,054	38,191
Others	2,830	2,907	3,546	4,536	5,435
Total Non Current Assets	31,007	34,798	37,451	40,590	43,626
Current Asset					
Inventory	3,571	4,350	5,705	6,256	6,235
Trade and other receivables	5,356	6,064	7,219	7,771	7,728
Bank balance and cash	2,919	1,185	1,909	1,623	452
Others	644	403	169	169	169
Total Current Assets	12,491	12,003	15,003	15,819	14,585
Total Assets	43,497	46,800	52,454	56,409	58,210
Non Current Liabilities					
Long-term debt	7,461	6,072	5,386	6,073	5,899
Other Non-current Liabilities	1,493	1,394	1,474	1,474	1,474
Total Non-current Liabilities	8,955	7,465	6,860	7,547	7,373
Current Liabilities					
Interest-bearing Borrowings	4,874	5,255	8,675	10,736	10,214
Trade payables	2,833	2,631	3,110	3,819	4,510
Others	753	699	406	406	406
Total Current Liabilities	8,460	8,585	12,190	14,961	15,130
Equity					
Shareholders' equity	26,082	30,743	33,395	33,893	35,698
Non-controlling interests	0	8	8	8	8
Total equity	26,083	30,750	33,403	33,901	35,707
Total Liabilities and Equity	43,497	46,800	52,454	56,409	58,210

Consolidated Statement of Cash Flow

Dec Y/E, HKD mn	FY19	FY20	FY21	FY22E	FY23E
CFO					
Profit before income tax	4,020	4,321	3,794	2,063	3,008
D&A add-back	442	312	288	174	187
Others	(1,161)	(1,103)	(777)	(307)	(478)
Net (inc)/dec working capital	1,654	392	(514)	(393)	755
Net cash flow from operating activities	4,956	3,923	2,792	1,537	3,472
CFI					
Purchase of PP&E	(2,326)	(2,332)	(2,313)	(2,322)	(2,324)
Others	(1,195)	(989)	(1,194)	(990)	(899)
Net cash flow from investing activities	(3,521)	(3,321)	(3,507)	(3,312)	(3,223)
CFF					
Dividends paid	(1,226)	(1,087)	(1,434)	(1,130)	(596)
Others	696	(1,247)	2,869	2,620	(824)
Net cash flows from financing activities	(530)	(2,334)	1,434	1,490	(1,420)
Net Change in Cash	905	(1,732)	719	(286)	(1,171)
Cash and CE at Y/E	2,919	1,185	1,909	1,623	452

Current Price as of: 8 November 2022

Source: PSHK Est.

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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