

China's paper manufacturing industry

Improving outlook

	Ticker	Mkt cap		Price	PER		PBR		EV/EBITDA		ROE	Yield	D/E
		(US\$m)	Ccy		2015E	2015E	2015E	2016E	2015E	2016E	2016E	2016E	2016E
Lee & Man	2314 HK	2.6	HKD	4.36	9.1	8.0	1.1	1.0	8.5	7.6	12.4	4.4	51.1
Nine Dragons	2689 HK	2.7	HKD	4.44	13.5	11.3	0.8	0.8	8.8	7.8	6.8	2.1	88.9

Source: FactSet

- **China's paper manufacturing industry is likely to benefit from further supply reduction and products margin expansion in 2016**
- **Packaging paper prospects remain stable relative to other paper products**
- **Both Lee & Man Paper and Nine Dragons Paper are likely to benefit amid an improving market environment while the valuations of these two companies look inexpensive from a historical perspective.**

Supply is reducing amid capacity shutdown and stricter environmental regulation:

Fixed asset investment growth in China's paper manufacturing industry slowed further in the first eleven months of 2015. According to the Ministry of Industry and Information Technology's (MIIT) plan, out of the total capacity that had been shut down, 7% exceeded their original plans of closing 30.49mn tons of capacity during the period between 2011 and 2014. In 2015, China had to shut down at least 10mn tons of capacity, representing approximately 6% of the total market supply in 2014. The stricter environmental regulation has accelerated industry consolidation, and as a result, the total number of enterprises fell back to the 2011 levels. Meanwhile, according to the data provided by the National Bureau of Statistics of China, production growth of the five major paper products has slowed further in the first ten months of 2015.

Consumption growth slowdown:

China's paper manufacturing industry was in rapid growth prior to 2011. Since then, sales growth had slowed to around low single-digits. According to the industry development plan, apparent consumption of paper products in China is projected to grow at a 4-5% CAGR during 2011 and 2015; however, the latest figure suggests that it was in fact only about 2-3%. The sales growth of paperboard for the first ten months of 2015 was reportedly above the industry average, though newsprint paper and coated duplex board paper posted declines.

Mixed earnings outlook:

Despite the prices of most of the domestic paper products have continued to trend down, the prices of packaging paper, including linerboard and corrugating medium, have remained largely stable since 2015. On the other hand, bleached hardwood kraft pulp prices have come down by one-fifth. According to industry data, the after-tax profits of the large enterprises saw a rebound during the first ten months of 2015, as compared to the same period a year ago.

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Company Rating Definition

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

Outperform	Relative Performance >10%
Neutral	Relative Performance is -10% to 10%
Underperform	Relative Performance <10%

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