

Analyst: Sam Ho

Main Board Listing- Research

理文造紙有限公司

Lee & Man Paper Manufacturing Limited [Stock Code: 2314]

Sponsor	: CLSA Equity Capital Markets Limited
Global coordinator, bookrunner and lead manager	: CLSA Limited
Co-lead managers	: BOCI Asia Limited Cazenove Asia Limited

Sector : Paper manufacturing

Business : Manufacture and sale of linerboard and corrugating medium

Total share offer: 187,500,000 shares
(25% of the enlarged share capital)

Placement: 168,750,000 shares (90%)

IPO: 18,750,000 shares (10%)

Greenshoe: 28,124,000 shares

Price: HK\$3.33-HK\$4.50 per share

Market cap. : HK\$2,500 million- HK\$3,375 million

Prospective FY2004 P/E: 10x-13.5x (fully-diluted)

Estimated NAV per share: HK\$1.58-HK\$1.87

Staffing: 1,659

Book opens: 10th September 2003

Book closes: 19th September 2003

IPO opens: 16th September 2003

IPO closes: 19th September 2003

Share registrar: Tricor Investor Services Limited

Receiving bank: Hang Seng Bank

Listing date: 26th September 2003

Business of Lee & Man Paper

The Company is principally engaged in the manufacture and sale of linerboard and corrugating medium. Its products target mid-to-high-end containerboard markets, and as of the latest practicable date, all of the Company's sales were to corrugators (producers of cardboard boxes).

The Company's production facilities at the Dongguan factory include, among others, its own power generation, water supply and wastewater-treatment facilities, its own pier and over 80,000 m² of storage area. As of the latest practicable date, the Company operated 4 paper machines (paper machines I to IV) at the Dongguan factory. Paper machines I to III have a total production capacity of 280,000 metric tonnes (MT) per year. Paper machine IV commenced operation in October 2002 and increased the total production capacity to 650,000 MT per year.

Major Shareholders after Listing

(Assuming the over-allotment option is not exercised)

Family trust of Mr. Lee Wan Keung, Patrick (chairman of the Company)

75.00%

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$704 million *(Based on HK\$3.92 per share which is the mid-point of the indicative price range and assuming the over-allotment option is not exercised)*

	HK\$ million
To spend as capex for the 1 st phase of the Changshu project in Yangtze River Delta region	340
To serve as working capital for the 1 st phase of the Changshu project	60
To repay debts	200
To serve as general working capital	104

Financial Highlights

	Year ended 31 st March		
	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000
Revenue			
Liner board	863,130	630,775	384,024
Corrugating medium	165,276	108,110	128,829
	<u>1,028,406</u>	<u>738,885</u>	<u>512,853</u>
Operating profit	<u>230,309</u>	<u>187,004</u>	<u>93,937</u>
Net profit	<u>213,076</u>	<u>175,520</u>	<u>78,842</u>
Dividend	30,000	-	-
Earnings per share	<u>HK\$37.88</u>	<u>HK\$31.20</u>	<u>HK\$14.02</u>

Strengths

- ✓ Demand for paper and board in China is large as paper and board production grew an average 4.7% p.a. during 1998 to 2002. From 2001 to 2002, production in China was up 8.3% and consumption rose 7.9%. Since China's paper and board production was 12.8% below its consumption in 2002, it is a net importer of paper and board.
- ✓ Being the 2nd-largest domestic player in terms of production volume with a market share of 3.2%, Lee & Man Paper is well positioned to grow faster than the rest of the highly-fragmented market (the largest player has a market share of 4.7% only), taking market share from imports and other smaller local players.
- ✓ Entry barrier of the industry is high as the business is highly capitalised, as machineries are expensive, costing about HK\$500 million for a single production line. In addition, it takes quite a long time to get regulatory and government approvals to set up a new containerboard production facility in Pearl River Delta region or Yangtze River Delta region.
- ✓ At the price range of HK\$3.33-HK\$4.50, Lee & Man Paper is valued at a prospective P/E range of 10x-13.5x, which is a bit rich for IPO of this size. Hung Hing (stock code: 0450) is trading at a prospective P/E of 11x while Leefung-Asco (stock code: 0623) was trading at a prospective P/E of 10x. Currently, the 4 production lines in Dongguan is running at 97% of utilisation rate with the remaining 3% for maintenance and product switching. Given that the first 2 phases of the Changshu factory will be completed by August 2004, total capacity will be expanded by 190,000 metric tonnes a year (30% of the current capacity), and thus earnings in FY2005 should increase substantially.

Weaknesses

- × The Company's profit margin is highly sensitive to fluctuations in OCC (old corrugated cardboard) and pulp prices, as it can only pass part of the increase in costs to its customers. Its gross margin was seen surging from 24.7% in FY2001 to 31.3% to FY2002 but then falling to 28.8% in FY2003.
- × Competition in the industry is intense and highly fragmented with many small players. However, with its large production capacity and product quality, the Company should face little direct competition from other small paper mills.

Recommendation: Trading buy