

Equity Research · Company

Light Manufacturing

Sitting pretty on solid growth

Strong momentum. C&S Paper, one of the “Big Four” tissue paper manufacturers in China, has been enjoying brisk growth since 2015, with operating revenue/net profit gaining 17.34%/30.66%, 28.74%/195.27% and 19.85%/47.81% in 2015, 2016 and 1H17, respectively.

China tissue paper market. Tissue paper consumption in China grew at a robust CAGR of 10.53% from 390,000 tons in 1985 to 8.68mn tons in 2016, with the percentage of toilet paper shrinking from above 90% to around 60% while facial tissue quickly picking up the slack. The Chinese tissue paper market is currently worth around RMB90bn, and looks set to grow at a pace of 8%-10% going forward, with non-toilet tissue beating the broader industry advancing at an estimated 15%-20%.

Looking ahead, C&S Paper’s sustainable growth hinges on four aspects.
(1) Profitability. The company has raised the proportion of its high gross margin non-toilet tissue products to 53.54%, with its deluxe “Natural Wood” series selling at a premium of 30-40%. **(2) Capacity.** On top of a current capacity of over 500,000 tons, some capacity expansion projects are to kick off in the near future targeting the high-end segment. **(3) Marketing.** A more than 1,000-strong marketing team (many of them poached from its rival GHY Paper) alongside over 1,700 dealers reach out to nearly 2,000 Chinese cities. **(4) Incentives.** Stock incentive plans are put in place to boost business performance.

Peer comparison. C&S Paper focuses on tissue paper, targeting different consumer groups with different offerings. The company has created a retail fortress through strategic partnerships with supermarket chains such as Walmart, Carrefour and PARKnSHOP. **Hengan (1044 HK)** is pursuing a flattened operational model featuring full delegation and decision-making autonomy. **Vinda (3331 HK)** is branching out into new areas such as paper diapers and sanitary towels. **GHY Paper**, a subsidiary of APP, one of the world’s largest pulp and paper companies, enjoys stable raw material supply and strong sales channels throughout 160 countries and regions on the back of its parent’s support.

Investment guidance. C&S Paper provided a guidance of RMB217mn-272mn for net profit attributable to the parent for the first three quarters of 2017. We project the company to net a profit of RMB353mn/465mn for 2017/2018, up 35.6%/31.7% YoY, corresponding to EPS of RMB0.47/0.61 and 30x/23x PER. The company currently has a valuation of RMB10.6bn. Maintain Buy.

Risk factors. Pulp price uptrend might carry forward while industry competition remains intense.

C&S Paper (002511 CH)

Rating

Buy

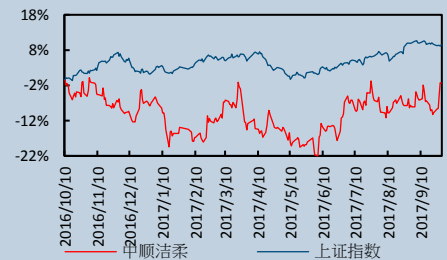
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Share price performance



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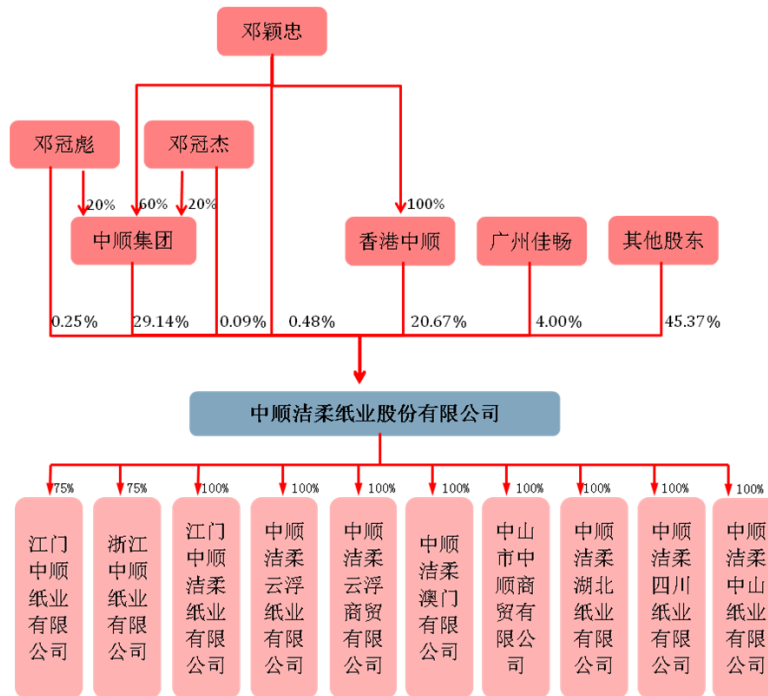
1. C&S Paper at a glance

1.1 Shareholding structure

C&S Paper Co., Ltd. (“C&S Paper”), one of the “Big Four” tissue paper producers in China, owns household brands such as C&S and SUN.

As of mid-2017, C&S Paper had a total share capital of RMB758mn, with Deng Yingzhong, Deng Guanbiao and Deng Guanjie holding a combined stake of 50.66% in the company. The Deng family has an indirect holding of 29.16% and 20.68% in C&S Paper through Zhongshun Group and C&S Hong Kong Co Limited, respectively.

Figure 1: C&S Paper’s shareholding structure



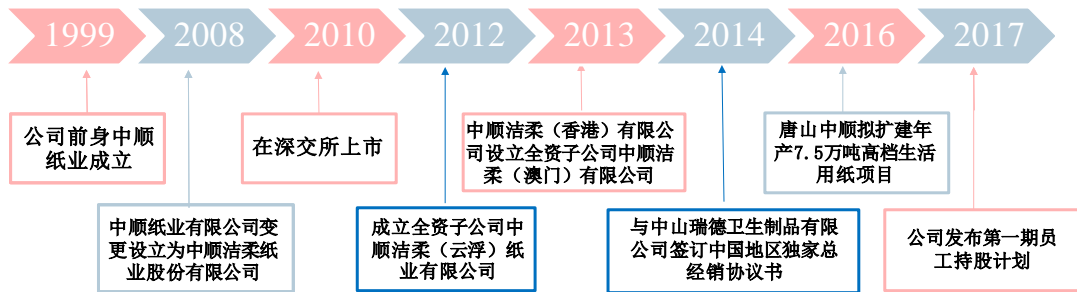
Source: Wind; company announcement; Research Dept, CSCI

1.2 Company history

C&S Paper floated on Shenzhen Stock Exchange in Nov. 2010, was the first of its kind to go public in China.

The company has set up production subsidiaries in Guangdong, Sichuan, Zhejiang, Hubei and Hebei, and has deepened and broadened its overseas procurement and financing pipeline by establishing C&S Hong Kong Co Limited.

Figure 2: C&S Paper's key milestones



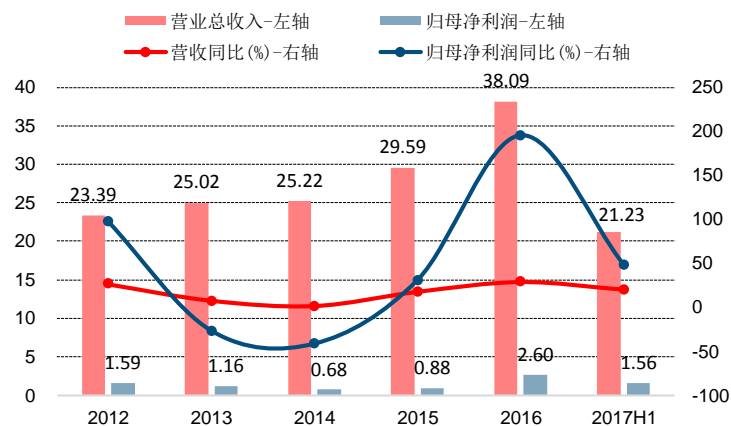
Source: company announcement; Research Dept, CSCI

1.3 Robust performance

C&S Paper had an operating revenue of RMB3.809bn in 2016—up 28.74% YoY, growing at a CAGR of 12.97% from RMB2.339bn in 2012—alongside RMB260mn of net profit attributable to the parent, up 195.27% YoY with a CAGR of 13.08% from RMB159mn in 2012. The company posted RMB2.123bn in operating revenue and RMB156mn in net profit attributable to the parent in 1H17, up 19.85% and 47.81% YoY, respectively.

According to the company's estimates, net profit attributable to the parent for the first three quarters of 2017 falls within a range of RMB217mn-272mn, demonstrating solid growth momentum.

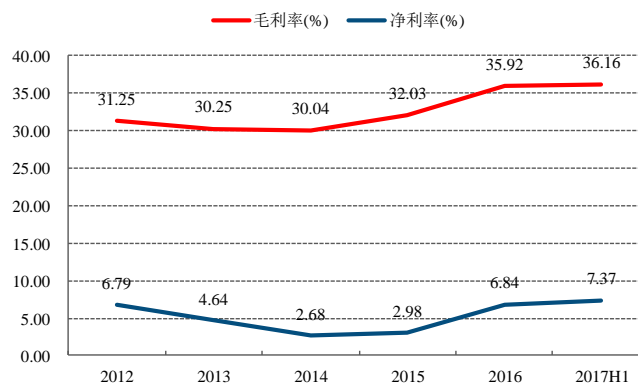
Figure 3: C&S Paper's operating revenue and net profit attributable to the parent, hundred million yuan, 2012-1H17



Source: Research Dept, CSCI

C&S Paper's gross margin steadily climbed from 31.25% in 2012 to 35.92% in 2016, up 3.89 pct YoY, and continued the uptrend into 1H17, up 1.52 pct YoY to 36.16%.

Affected by higher period expenses, the company's net profit margins encountered a drop from 2013 to 2014, before bouncing to 2.98% in 2015, up 0.3 pct YoY, followed by a 3.86 pct leap to 6.84% in 2016 and a 1.40 pct rise to 7.37% in 1H17.

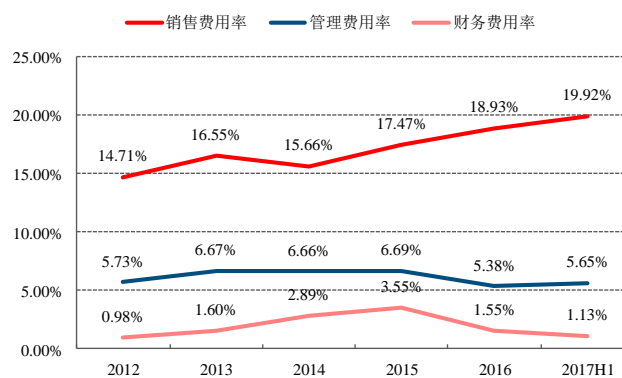
Figure 4: C&S Paper's gross margin/net profit margin, 2012-1H17


Source: Research Dept, CSCI

C&S Paper had a selling/administrative/financial expense ratio of 14.71%/5.73%/0.98% in 2012, gaining 2.76/0.96/2.57 pct to 17.47%/6.69%/3.55% in 2015, with administrative/financial expense ratio falling after 2015, while selling expense ratio still on the up due to marketing spend increases.

Period expense ratio was 25.87% in 2016, down 1.83 pct from 27.70% in 2015, with selling expense ratio up 1.46 pct YoY to 18.93% due to higher marketing and promotion spending, administrative expense ratio down 1.31 pct YoY to 5.39%, and financial expense ratio down 1.98 pct YoY to 1.55%—thanks mainly to a reduction in borrowing and exchange losses.

Period expense ratio rose 0.63 pct YoY to 26.73% in 1H17, mainly attributable to greater input in e-commerce sales and logistics, with selling expense ratio up 1.85 pct YoY to 19.93%, administrative expense ratio down 0.21 pct YoY to 5.66%, and financial expense ratio down 1.02 pct YoY to 1.14%, largely because of reduced borrowing.

Figure 5: C&S Paper's period expense ratios 2012-1H17


Source: company announcement; Research Dept, CSCI

Non-toilet tissue paper generated a revenue of RMB2.04bn in 2016, a surge of RMB489mn or 31.50% from RMB1.551bn in 2015, accounting for 53.54% of C&S Paper's 2016 revenue, up 1.12 pct from 52.42% in 2015, while toilet paper sales revenue was RMB1.648bn in 2016, up 23.68% from RMB1.332bn in 2015, accounting for 43.26% of 2016 revenue, down 1.77 pct YoY. This suggests an enhanced product mix.

Toilet and non-toilet tissue paper respectively had a gross margin of 30.90% and 41.91% in 2016, up 4.2 pct/3.99 pct YoY, respectively, with toilet/non-toilet tissue paper costs down 16.59%/23.06% YoY, which, alongside an increased proportion of non-toilet tissue paper sales, have helped push up overall gross margin.

Table 1: C&S Paper's gross margin by product category, hundred million yuan

	2012	2013	2014	2015	2016	2017H1
营业总收入	23.39	25.02	25.22	29.59	38.09	21.23
同比(%)	26.03	6.94	0.80	17.34	28.74	19.85
毛利率(%)	31.25	30.25	30.04	32.03	35.92	36.16
成品类 (分为卷纸和非卷纸类)	23.17	24.81	24.51	28.83	36.88	20.70
同比(%)	25.92	7.07	-1.21	17.65	27.89	21.28
占比(%)	99.04	99.16	97.18	97.45	96.80	97.51
毛利率(%)	31.62	30.48	30.81	32.74	36.99	36.95
卷纸	12.70	12.76	11.79	13.32	16.48	
同比(%)	19.59	0.49	-7.58	12.98	23.68	
占比(%)	54.28	51.01	46.77	45.03	43.26	
毛利率(%)	26.47	23.85	24.40	26.70	30.90	
非卷纸类	10.47	12.05	12.71	15.51	20.40	
同比(%)	34.56	15.05	7.63	21.99	31.50	
占比(%)	44.76	48.16	50.42	52.42	53.54	
毛利率(%)	37.86	37.50	36.76	37.92	41.91	
半成品			0.55	0.49	0.78	0.16
同比(%)			134.70	-10.23	57.36	-66.37
占比(%)			2.19	1.67	2.04	0.74
毛利率(%)			3.79	3.78	2.73	8.16

Source: Wind; Research Dept, CSCI

2. Global pulp market and China tissue paper industry

2.1 Global pulp supply/demand dynamics

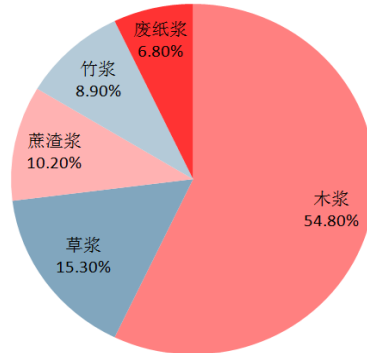
Producing 1 ton of tissue paper will consume 0.9-1 ton of pulp.

Wood pulp now makes up 54.80% of domestic pulp demand in tissue paper production, followed by straw pulp, bagass pulp and bamboo pulp, which respectively account for 15.30%, 10.20% and 8.90%.

As it stands, China's "Big Four" tissue paper producers (C&S Paper, Hengan, GHY Paper and Vinda) all offer tissue paper made of 100% virgin wood pulp, with C&S Paper boasting to rely on import for literally all of its pulp consumption, which constitutes 50%-60% of its production costs.

Pulp prices have been surging since the beginning of 2017, hitting an average RMB6,503 per ton in September, 17.62% higher than RMB5,529 per ton for August, driving up average tissue paper price to RMB8,203 per ton in September, up 14.31% from RMB7,176 per ton a month earlier.

Figure 6: Most of tissue paper made in China is made of wood pulp

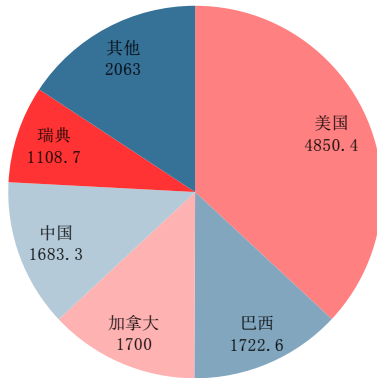


Source: GHY Paper's announcement; Research Dept, CSCI

The world produced 180.934mn tons of pulp in 2015, 0.23% less than that in 2014. The US had the largest pulp output of 48.504mn tons, down 1.22% YoY, accounting for 26.81% of global total, trailed by Brazil (17.226mn tons, up 4.62%, accounting for 9.52%), Canada (17mn tons, up 2.46%, accounting for 9.4%), China (16.833mn tons, down 4.05%, accounting for 9.3%) and Sweden (11.087mn tons, up 0.87%, accounting for 6.13%).

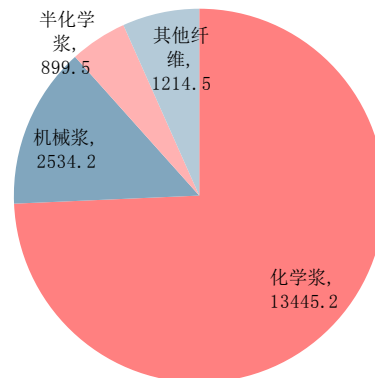
Global output of chemical/mechanical/semi-chemical/miscellaneous fiber pulp in 2015 was 134.452mn/25.342mn/8.995mn/12.145mn tons, up 0.27%, up 0.4%, down 0.94% and down 6.22% YoY, respectively, accounting for 74.31%/14.01%/4.97%/6.71% of total output.

Figure 7: Pulp output by country (0,000 tons)



Source: Research Dept, CSCI

Figure 8: Pulp output by category (0,000 tons)

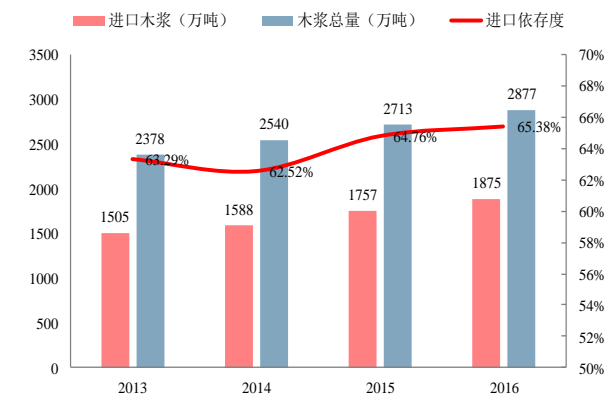


Source: Research Dept, CSCI

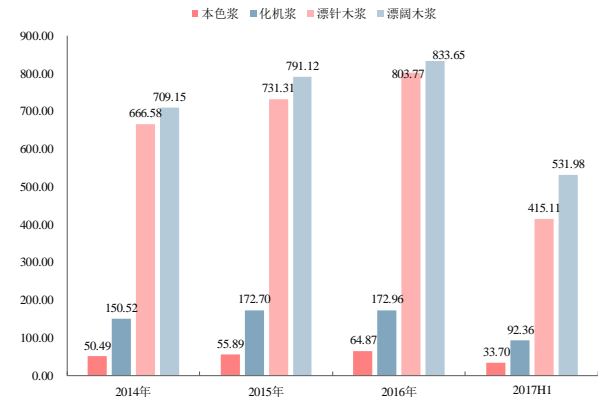
53.823mn tons of pulp were exported globally in 2015, down 0.12% YoY, with Latin America, North America and Europe respectively exporting 16.972mn/16.414mn/14.366mn tons—largely unchanged, up 1.44% and down 1.91% from 2014—accounting for 31.53%/30.49%/26.69% of global total. Asia/China was the largest pulp importing region/country in 2015, with an import volume of 26.265mn/19.83mn tons, up 0.34% and 10.35% YoY, accounting for 49.65%/37.49% of global total.

In 2016, China produced 10.05mn tons of pulp (hardwood: 5.45mn tons; softwood: 30,000 tons; unbleached: 300,000 tons; mechanical: 4.27mn tons; non-wood: 5.91mn tons, -13.08% YoY), up 4.03% YoY, and imported 18.81mn tons of pulp (hardwood: 8.34mn tons, up 5.44% YoY; softwood: 8.04mn tons, up 9.99% YoY; unbleached: 650,000 tons, up 16.71% YoY; mechanical: 1.73mn tons, unchanged), up 6.2% YoY.

Consumption of different pulp types derived from respective output and import figures is as follows: hardwood–13.79mn tons; softwood–8.07mn tons; mechanical–6mn tons; unbleached–950,000 tons; non-wood–5.91mn tons.

Figure 9: China's pulp import (0,000 tons), 2013-2016


Source: sci99.com; Research Dept, CSCI

Figure 10: China's pulp import (0,000 tons), by category, 2014-1H17


Source: sci99.com; Research Dept, CSCI

Global chemical pulp production capacity grew at a 2006-2013 CAGR of 2.4% to roughly 25mn/30mn tons of softwood/hardwood pulp in 2013, a capacity increase of 2.215mn tons. From 2014 to 2015, Uruguay and China saw an estimated net growth of 3.5mn tons in chemical pulp production capacity, with global chemical pulp production capacity standing at around 58.5mn tons in 2015.

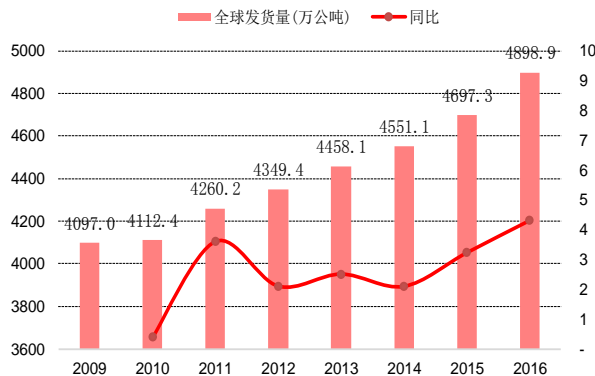
Hardwood pulp has been responsible for a majority of pulp production capacity increases since 2013, adding 1.975mn tons in 2013, compared with a same-year reduction of 510,000 tons for softwood pulp. So far this year, all newly added pulp production capacity is of hardwood pulp, with 1.75mn tons coming from Brazil's Fibria that probably won't hit the Chinese market until the end of this year, and an estimated 1.4mn tons from OKI of Indonesia's APP, with a mere 20,000 tons per month bound for the Chinese market. And as CMPC's No.2 paper machine in Brazil is being discontinued for four months for repair, supply will be cut back by about 400,000 tons accordingly. Around 2.75mn tons of the capacity increase will have an impact on pulp supply for China in 2017.

Table 2: Global chemical pulp production capacity increases in 2017

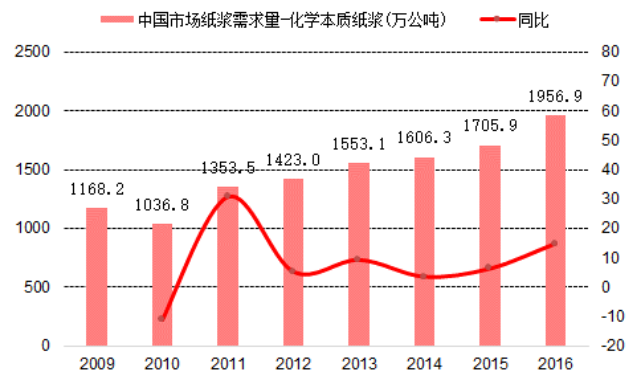
厂家	项目内容	产能 (万吨)	地点	投产时间
FIBRIA	阔叶浆	175	巴西	2017年9月
APP	阔叶浆	140	印尼	2017年6月
CMPC2	阔叶浆	-40	巴西	预计停产4月
合计		275		

Source: sci99.com; Research Dept, CSCI

According to the Pulp and Paper Products Council (PPPC), global chemical pulp shipments grew at a CAGR of 2%-4% from 2011 to 2016. Demands from China is a major driver of global pulp demand increases in recent years, jumping 14.71% YoY to account for 19.569mn tonnes of global chemical pulp shipment volume of 48.989mn tonnes in 2016.

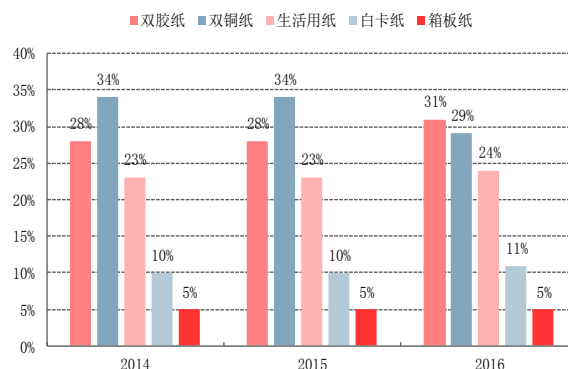
Figure 11: Global chemical pulp shipment growing at 2%-4% in recent years


Source: PPC; Research Dept, CSCI

Figure 12: Chemical pulp demand from China and its growth rate


Source: PPC; Research Dept, CSCI

Data show that in 2016, offset paper/dual coated paper/tissue paper/ivory board paper/cardboard paper respectively accounted for 31%/29%/24%/11%/5% of total pulp consumption in China.

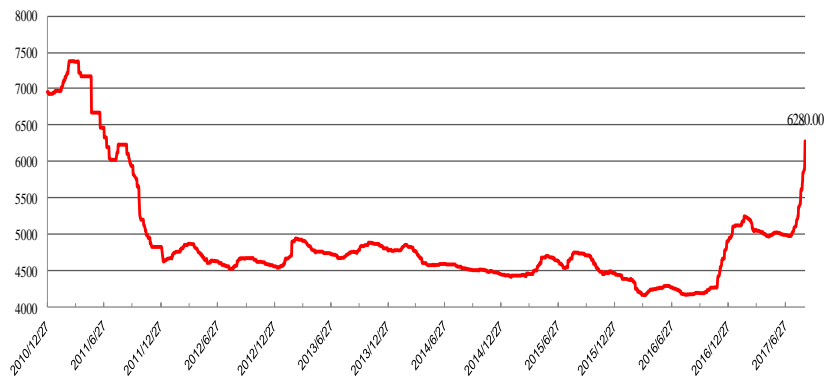
Figure 13: China's pulp consumption by category 2014-2016


Source: PPC; Research Dept, CSCI

Wood pulp price has been on the uptrend since Oct. 2016, soaring all the way from RMB4,951.5 per ton on Dec. 31, 2016 (up 11% YoY) to peak at RMB5,247.50 per ton in Feb. 2017, then easing back to RMB4,975.5 per ton on Jul. 17 before bouncing to RMB6,280 per ton as of Aug. 31. The average wood pulp price for 1H17 was RMB5,063.43 per ton, up 18.18% from RMB4,284.33 per ton the same period last year.

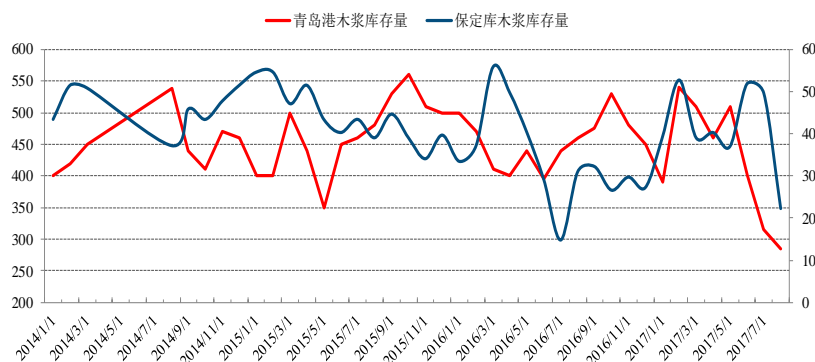
China's wood pulp inventory has been through high volatility since 2014, once hitting a high of 560,000 tons but starting to plunge entering June, with Qingdao Port recording a four-year low of 285,000 tons as of Aug. 31 while Baoding Port having an inventory of merely 22,300 tons—its lowest in nearly one year and second lowest in approximately four years.

Figure 14: Wood pulp price soaring in China (yuan per ton)



Source: sci99.com; Research Dept, CSCI

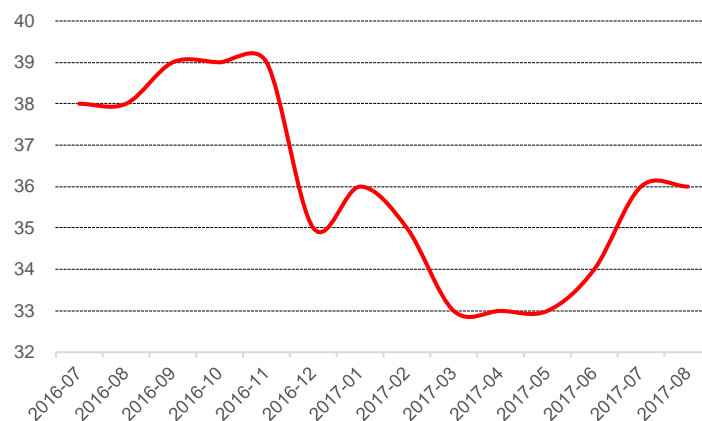
Figure 15: Wood pulp inventory at a historic low in China (0,000 tons)



Source: sci99.com; Research Dept, CSCI

Globally, the average level of wood pulp inventory came in at 36 days in July, up two days from the previous month and down three days than the same period last year, with softwood/hardwood pulp respectively registering a shipment volume/days of inventory of 1.97mn tons (1.989mn tons for June)/32 days and 1.882mn tons (2.35mn tons for June)/39 days.

Figure 16: Days of wood pulp inventory dwindling worldwide



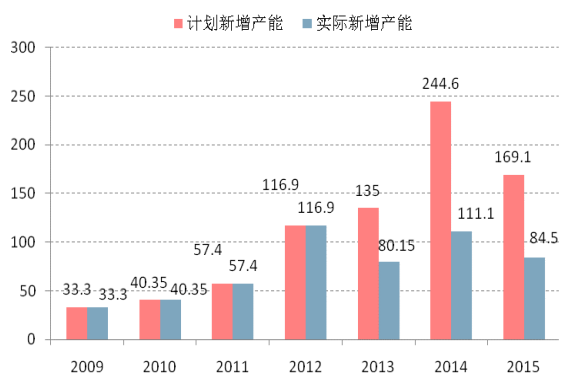
Source: sci99.com; Research Dept, CSCI

2.2 China tissue paper industry: capacity growth slows as non-toilet tissue consumption rises

In 2015, tissue paper production capacity increase in China stood at 845,000 tons, down 23.9% YoY. A capacity of 510,000/655,000 tons failed to hit the domestic tissue paper market as scheduled in 2014/2015.

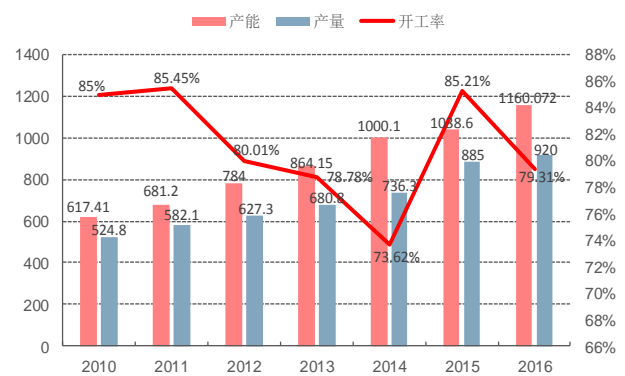
In 2016, China's tissue paper industry saw production capacity increase 11.70% YoY to 11.6mn tons, capacity utilization rate drop 5.90 pct YoY to 79.31%, output jump 3.95% YoY to 9.2mn tons, and a consumption of 8.68mn tons, up 3.96% YoY. Domestic tissue paper output and consumption respectively grew at a CAGR of 9.81% and 10.06% from 2010 to 2016.

Figure 17: Tissue paper production capacity additions (0,000 tons) 2009-2015



Source: China Paper Association; sci99.com; Research Dept, CSCI

Figure 18: Tissue paper production capacity and output (0,000 tons) 2010-2016



Source: sci99.com; Research Dept, CSCI

Table 3: Production capacity added/deferred by major tissue paper manufacturers in recent years (0,000 tons per year)

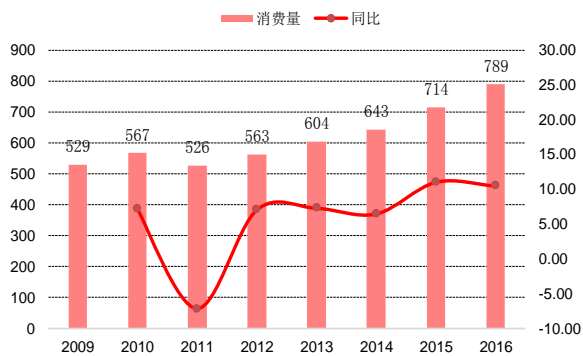
	2014 新增	2015 新增	2016 新增	2017 拟增	现有总产能	延期投放产能
金红叶	42.0	18.0			127.0 ¹	6.0
恒安	6.0	6.0	18.0	17.0	126.0 ²	24.0
维达	13.0	6.0	6.4		104.0	3.0
中顺洁柔	12.0	6.0	6.0	17.5	50.5	0.0
东顺	3.6	14.0	--	--	42.0	6.0
永丰余	5.0	2.5			17.5	2.5
理文造纸	2.5	12.0	24.0		35.5	0.0
太阳纸业	--	6.0	--	--	12	--
晨鸣纸业			--	--	10	
浙江景兴	--	6.0			7.2	--

Source: cnhpa.org; GHY Paper's announcement; Research Dept, CSCI

Domestic tissue paper consumption has been maintaining a 7%-8% growth rate since 2010, except for a negative growth in 2011 and an acceleration in 2013 due to overcapacity. In 2016, China imported 28,000 tons of tissue paper, almost

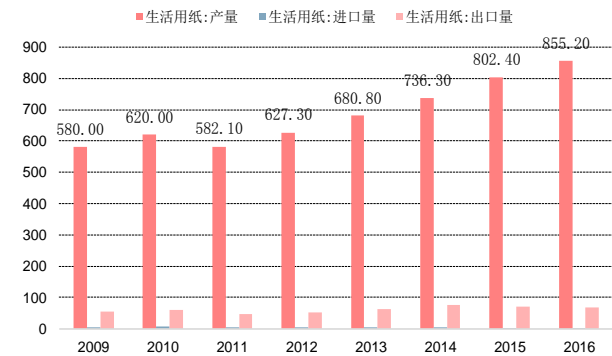
the same as a year earlier, and exported 692,000 tons, down 2.81% YoY, with a consumption of 7.876mn tons, up 10.50% YoY.

Figure 19: Tissue paper demand growth steady in China



Source: sci99.com; Research Dept, CSCI

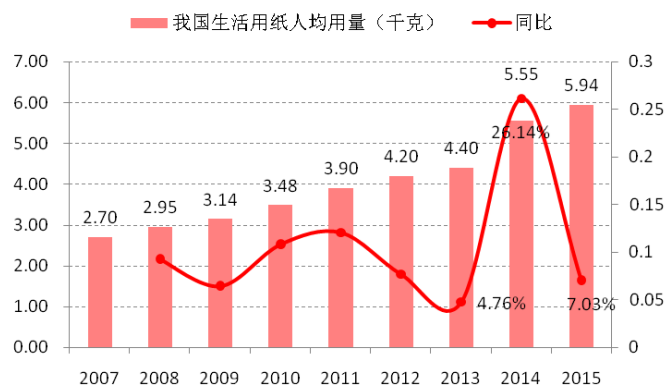
Figure 20: China self-sufficient in tissue paper



Source: sci99.com; Research Dept, CSCI

North Europe and North America have the highest annual tissue paper consumption per capita in the world, with Sweden leading at 24 kg and the US follows at 21.9 kg. South Korea, Japan and Taiwan are the three largest tissue paper consuming regions in Asia, consuming 19.7 kg, 13.8 kg and 10.1 kg per capita per annum, respectively, while the average Chinese only consumed 6.27 kg or RMB69 of tissue paper in 2016. According to RISI, global tissue paper consumption grew at an annual rate of under 4% from 2011 to 2015, compared with at least 6.6% for China, suggesting huge growth potential in the Chinese market.

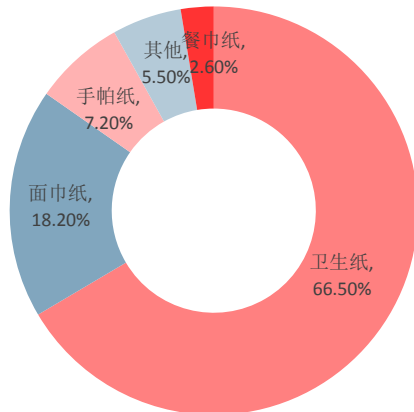
Figure 21: Annual per capita consumption of tissue paper in China



Source: China Paper Association; China Statistical Yearbook; Research Dept, CSCI

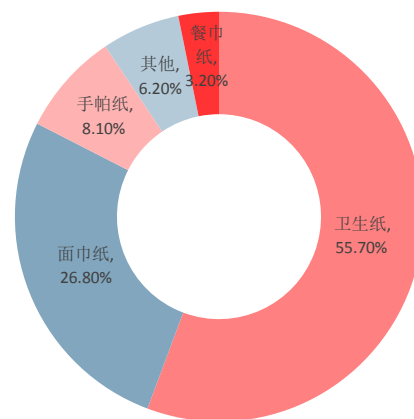
Tissue paper consumption in China grew at a CAGR of 10.53% from 390,000 tons in 1985 to 8.68mn tons in 2016, with the proportion of toilet paper falling from over 90% to around 60% while facial tissue quickly picking up the slack. The Chinese tissue paper market is worth around RMB90bn at the moment, and is expected to maintain a growth rate of 8%-10% going forward, with non-toilet tissue paper estimated to beat the wider tissue paper market with a growth rate of 15%-20%.

Figure 22: China tissue paper consumption composition 2010



Source: Wind; Research Dept, CSCI

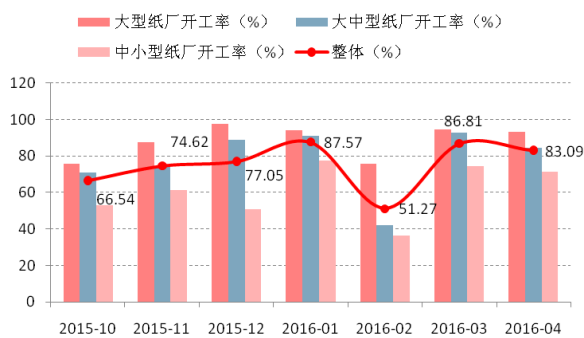
Figure 23: China tissue paper consumption composition 2016



Source: Wind; Research Dept, CSCI

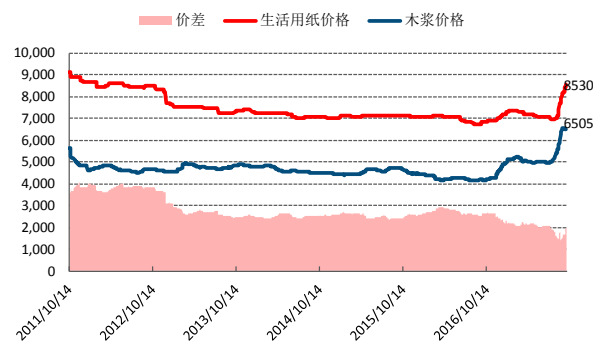
China's tissue paper industry still faces a supply glut, with a capacity utilization rate of 83% in 2016, pulling down tissue paper prices. However, there has been a price uptick since July, topping RMB8,500 per ton recently.

Figure 24: China's tissue paper production capacity utilization rates in recent years



Source: sci99.com; Research Dept, CSCI

Figure 25: Tissue paper prices on the up recently



Source: sci99.com; Research Dept, CSCI

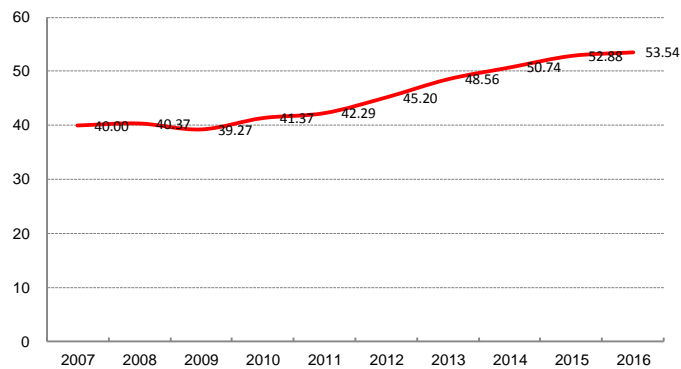
3. C&S Paper: moving upscale and ramping up capacity

3.1 Profitability improves on higher gross margin products

In 2016, toilet paper had a gross margin of 30.9%, representing 43.26% of C&S Paper's total revenue, while non-toilet tissue had a gross margin of 41.91%, accounting for 53.54% of the total revenue, up 1.25 pct YoY, suggesting an enhancement in the company's product lineup as it keeps launching higher margin products catering to upmarket needs.

Statistics show that C&S Paper's B2C facial tissue/toilet paper sales value reached RMB53mn/RMB29mn in August, accounting for 10.4%/9.8% of total market sales, up from 9.3%/8.8% in 1Q17.

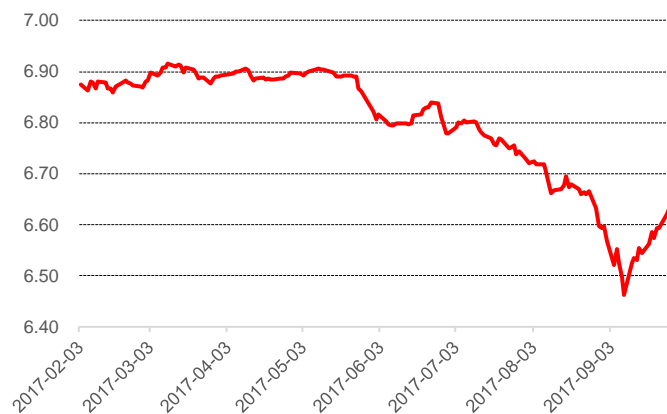
Figure 26: C&S Paper keeps on optimizing its product portfolio



Source: C&S Paper's website; Research Dept, CSCI

Yuan has been climbing against the dollar during the first nine months of 2017, with the USD/CNY exchange rate reaching 6.57 on Sep. 1, up 5.60% from the beginning of the year, welcome news for C&S Paper's pulp procurement despite a price uptick. Meanwhile, the company has established a global network of large pulp suppliers to ensure steady pulp supply.

Figure 27: USD/CNY exchange rate movements



Source: Wind; Research Dept, CSCI

3.2 Riding the unbleached tissue paper trend

As one of the "Big Four", C&S Paper has been relentlessly investing in product innovation to cement its leading position in the industry.

Table 4: C&S Paper's patented products

专利设计	图标	对比其他	优势
超迷你型纸手帕			超迷你尺寸 18cm*18cm，对比普通纸手帕尺寸 21cm*21cm 更小，减少边缘浪费，节约纸张，便于携带
易开口设计			弧形压线，一按即开口，抽取更方便。一次一抽，不重叠，减少浪费。用过后可当收纳盒

Source: C&S Paper's website; Tmall; Research Dept, CSCI

Recent years have seen unbleached tissue paper rising in the tissue paper industry, accounting for 1.6% of the tissue paper market in Feb. 2017, up a notable 166.67%. According to our grassroots survey, unbleached tissue paper is expected to capture a market share of around 10% going forward, representing a market size of RMB9-10bn in the context of a RMB90bn tissue paper market.

To better respond to this market trend, C&S Paper has launched a "Natural Wood" series made of 100% imported virgin wood pulp, well received by consumers.

Table 5: C&S Paper's new offerings

新品名称	图标	对比其他	优势
自然木系列			使用 100%原生木浆，柔韧度高，杂质少，产品质量达到行业内优等品

Source: C&S Paper's website; Tmall; Suning; Research Dept, CSCI







Table 6: C&S Paper's product lineup

品牌系列	产品	产品图	产品特点	类型
FACE 系列			可湿水纸质，超强韧度，全新使用感受	抽取式纸面巾、卷纸卫生纸、迷你型纸手帕、钱包式纸面巾
	LOTION 系列		添加保湿成分，丝般柔滑	迷你型纸手帕、抽盒装纸面巾、抽取式纸面巾
	C&S 系列		原生浆制造，自然洁白，不含荧光增白剂	C&S 橙色、C&S 金色、C&S 布艺、C&S 青春校园、C&S 蓝/棕面子
洁柔	厨房用纸		吸水吸油，洁净无油墨	抽取式料理用纸、盒装式料理用纸
	商消品		简约时尚，VIP 尊享受	抽取式面巾、小盘纸、餐巾纸
	湿巾		水刺无纺布、无酒精、无色素、无荧光剂	海藻精华抽取式湿纸巾、婴幼儿口手湿巾
	太阳特惠		原生浆制造，自然洁白，抽象设计，温暖感觉	抽取式纸面巾、卷纸卫生纸
	金太阳		不含荧光增白剂，温馨居家设计	抽取式纸面巾、卷纸卫生纸
太阳	纸卡通		卡通设计，活泼可爱，颜色丰富	抽取式纸面巾、迷你型纸手帕
	洁猫		温馨居家设计	卷纸卫生纸
	国际版		年轻个性时尚	抽取式纸面巾，纸手帕
	商用卷纸		简约时尚，天然无香	商用卷纸

Source: C&S Paper's website; Tmall; Suning; Research Dept, CSCI

The 18-pack “Natural Wood” series sells at RMB70, 30-40% pricier than the traditional C&S and Face series, thus providing higher gross margin. C&S Paper now looks to such high value-added products to weather the headwinds from intensified competition in the tissue paper market.

Table 7: The “Natural Wood” series sells at a premium of 30-40%

洁柔自然木系列		【天猫超市】洁柔自然木系列抽纸3层18包纸巾低白度餐巾纸整箱可食用纸巾 优等品质	
洁柔 C&S 系列		【天猫超市】洁柔抽纸金尊系列面巾纸卫生纸3层130抽整箱18包3层加厚 层层柔韧	
洁柔 face 系列		【天猫超市】洁柔抽纸面巾纸餐巾纸卫生纸3层120抽整箱18包轻松易开口 节约0浪费	

Source: Tmall; Research Dept, CSCI

3.3 Stepping up marketing and e-commerce

C&S Paper has a marketing team of more than 1,000 people, many of them poached from GHY Paper. Its sales network covers nearly 2,000 Chinese cities, still extending reach to more counties through its direct sales channels and to towns through dealership.

Table 8: C&S Paper’s sales channels

年份	经销商数量	覆盖城市	销售渠道
2015 年	1000 多家	2000 个城市	经销商, 直营卖场, 商消, 电商
2016 年	1000 多家	2000 个城市	经销商, 直营卖场, 连锁卖场, 商消, 电商
2017 年	1700 多家	2000 个城市	经销商, 直营卖场, 连锁卖场, 商消, 电商

Source: company announcement; Research Dept, CSCI

To better navigate the online shopping frenzy, C&S Paper has poured more money into e-commerce platforms such as Yihaodian and Tmall. It is worth noting that the company’s overall period expense ratio for 1H17 was 26.73%, a mere 0.63 pct increase YoY.

Figure 28: C&S Paper’s e-commerce presence



Source: C&S Paper’s website; Research Dept, CSCI

3.4 Ramping up production capacity

In 2009, C&S Paper had a tissue paper production capacity of 186,000 tons, including 41,000 tons in Zhongshan (Guangdong), 47,000 tons in Jiangmen (Guangdong), 28,000 tons in Jiaxing (Zhejiang), 25,000 tons in Xiaogan (Hubei) and 45,000 tons in Chengdu (Sichuan). As the company seeks to expand business foothold across China, more capacity has been added—including an increase of 25,000 tons in Tangshan (Hebei), a scale-up to 167,000 tons in Jiangmen, a ramp-up to 130,000 tons in Chengdu, and an addition of 120,000 tons in Yunfu (Guangdong)—taking its total annual production capacity to 505,000 tons.

Figure 29: C&S Paper’s seven major production bases in China



Source: C&S Paper’s website; Research Dept, CSCI

To preempt a demand gap amid robust sales growth, C&S Paper is eyeing further capacity expansion—including 120,000 tons in Yunfu and 25,000 tons in Tangshan—both targeting the high-end segment.

Table 9: C&S Paper's production capacity

单位: 万吨	2009 年产能	2016 年产能	2017-2018E 产能	未来新增产能
广东江门	8.8	16.7	16.7	
广东云浮		12	24	
浙江嘉兴	2.8	3.8	3.8	
湖北孝感	2.5	2.5	2.5	20
四川成都	4.5	13	13	
河北唐山		2.5	5	5
合计	18.6	50.5	65	

Source: C&S Paper's website; Research Dept, CSCJ

3.5 Stock incentives

In Oct. 2015, C&S Paper launched a restricted stock incentive plan to grant 19mn restricted shares in three tranches (30%/30%/40% after 12/24/36 months of the first granting), accounting for 3.90% of the company's share capital as of the date the plan was announced, on the precondition that operating revenue/net profit for 2016/2017/2018 should reach the target of RMB3.456bn/156mn, RMB4.037bn/238mn and RMB4.618bn/308mn, respectively.

Table 10: C&S Paper's restricted stock incentive plan

激励目标	较 2014 年营业收入同比 (%)	较 2014 年净利润同比 (%)	较上年营业收入同比 (%)	较上年净利润同比 (%)
2016 年激励目标	不低于 37	不低于 129	16.8	77
2016 年实际完成	51.06	285.80	28.74	195.27
2017 年激励目标	不低于 60	不低于 249	16.8	52.4
2018 年激励目标	不低于 83	不低于 352	14.4	29.5

Source: company announcement; Research Dept, CSCJ

With performance target beaten, C&S Paper issued 17.133mn/1.867mn restricted shares to 242/68 persons in Jan/Feb 2016 at RMB4.25/4.80 apiece, accounting for 3.52%/0.38% of the company's share capital as of the date the incentive plan was announced, and unlocked the first tranche of 5.51286mn restricted shares in 1H17, accounting for 1.09% of the company's current share capital.

In August, C&S Paper unveiled its first ESOP, covering nine of its core employees. As of Sep. 29, 2017, the ESOP had accumulated 14.77mn shares bought from the secondary market at RMB13.6503 apiece with a total value of RMB201mn, accounting for 1.95% of the company's share capital.

Table 11: C&S Paper's stock incentives

序号	持有人	职务	实际认购份额 (万份)	占持股计划总份额的比例
1	邓冠彪	总经理、副董事长	1400	17.95%
2	邓冠杰	董事、副总经理	700	8.97%
3	刘金锋	董事	1600	20.51%
4	周启超	副总经理	700	8.97%
5	其余核心骨干人员	-	3400	43.60%

Source: company announcement; Research Dept, CSCJ

4. C&S Paper vs. Hengan vs. Vinda vs. GHY Paper

4.1 Headline performance comparison

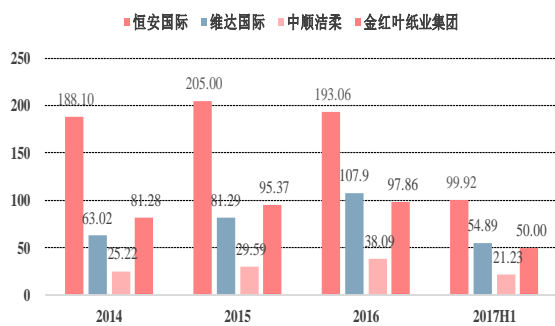
C&S Paper's operating revenue stood at RMB3.809bn in 2016, growing at a rate of 0.79% in 2014 (the lowest among the Big Four), 28.74% in 2016 (closing in on Vinda), and 19.85% in 1H17 (outperforming Vinda). The company has maintained a CAGR of 15.04% since 2013.

Hengan has been outdoing the other Big Four in terms of operating revenue (RMB19.306bn in 2016), but with much less impressive growth of -5.82% YoY in renminbi terms in 2016 and 1.53% in 1H17. The company has maintained a CAGR of 5.03% since 2013.

Vinda has been in second or third place among the Big Four by measure of operating revenue, with the fastest growth rate for the 2014-2016 period and the second fastest in 1H17 at 11.58% after C&S Paper. The company reported an operating revenue of RMB10.79bn in 2016, growing at a CAGR of 26.36% since 2013.

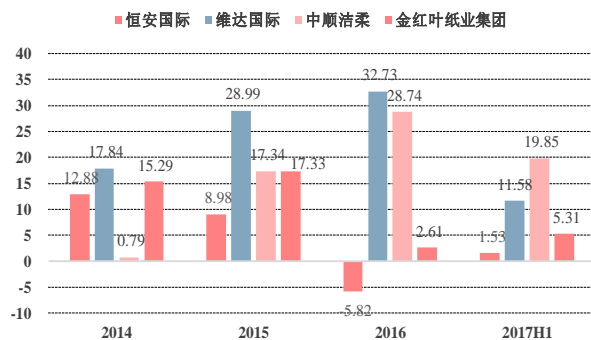
GHY Paper had an operating revenue of RMB9.786bn in 2016, about half that of Hengan, growing at a muted 2.61%/5.31% YoY in 2016/1H17, outpaced by C&S Paper. The company has maintained a CAGR of 11.55% since 2013.

Figure 30: Operating revenue comparison (hundred million yuan)



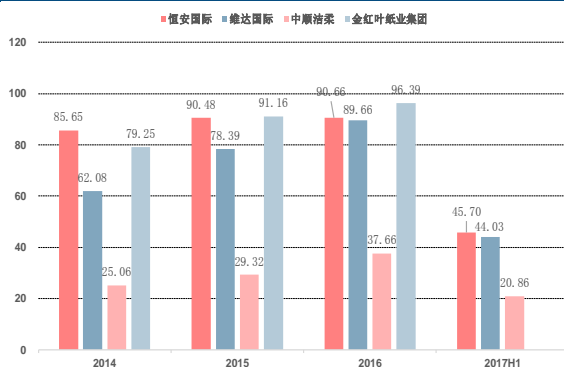
Source: Wind; Research Dept, CSCI

Figure 31: Operating revenue growth rate comparison (%)



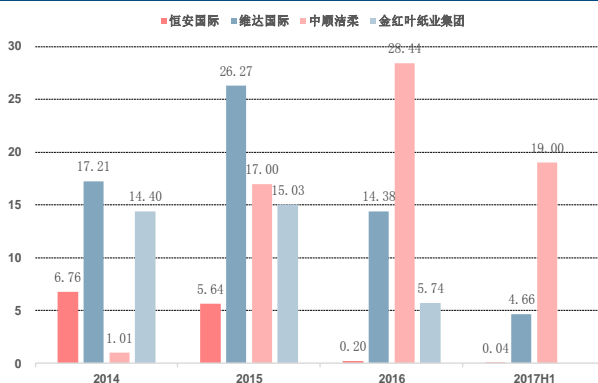
Source: Wind; Research Dept, CSCI

Figure 32: Tissue paper sales revenue comparison (hundred million yuan)



Source: Wind; Research Dept, CSCI

Figure 33: Tissue paper sales revenue growth rate comparison (%)

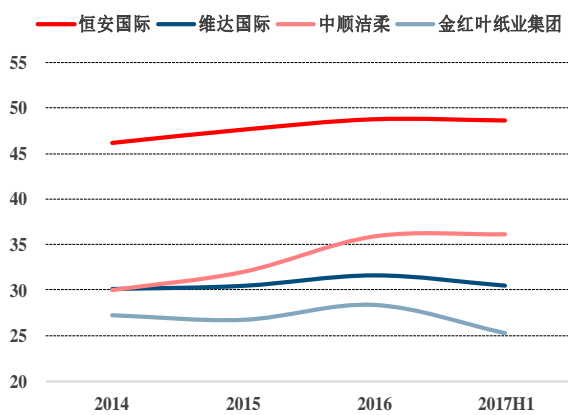


Source: Wind; Research Dept, CSCI

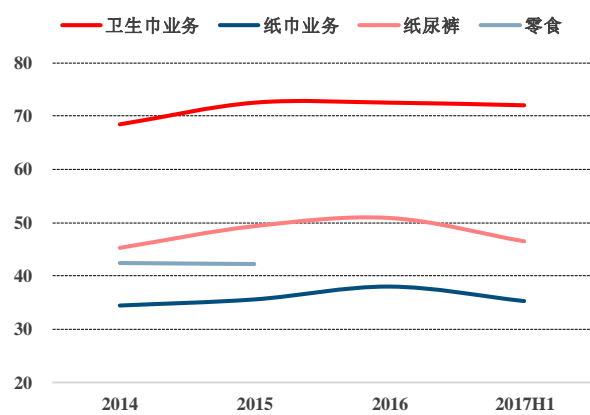
In terms of overall gross margin, Hengan benefited from its diversified product portfolio, seizing the first spot at 48.64% in 1H17, up 2.53 pct on 2014, followed by C&S Paper (36.16%), Vinda (30.53%) and GHY Paper (25.28%).

With regards to gross margin for tissue paper products, C&S Paper led the Big Four with a gross margin of 36.73% in 1H17, up 6.51 pct on 2014, trailed by Hengan, which was the champion for the 2014-2016 period thanks mainly to its high-end positioning.

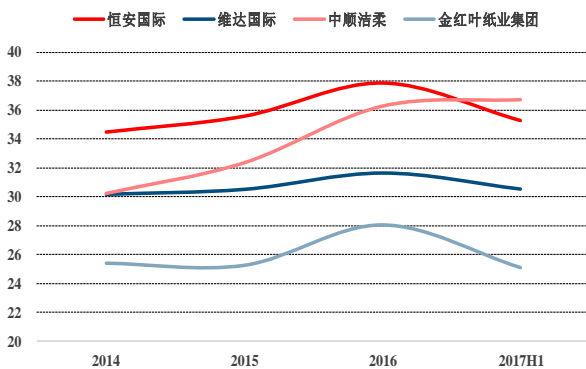
As to net profit margin, Hengan again is the clear winner, up 1.89 pct to 18.56% in 1H17 from 2014, while C&S Paper made the greatest progress, jumping 4.69 pct to 7.37% in 1H17 from 2014, compared with a slide from 7.43% in 2014 to 5.07% in 1H17 for Vinda and a mere 2.27% in 1H17 for GHY Paper.

Figure 34: Overall gross margin comparison (%)


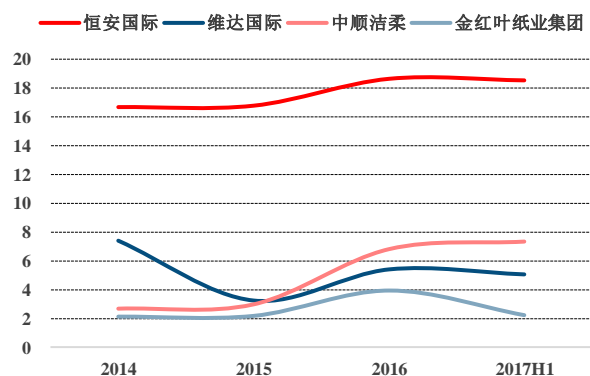
Source: Wind; Research Dept, CSCCI

Figure 35: Hengan's gross margin by business unit (%)


Source: Wind; Research Dept, CSCCI

Figure 36: Gross margin comparison (%) , tissue paper


Source: Wind; company announcements; Research Dept, CSCCI

Figure 37: Net profit margin comparison (%) ,


Source: Wind; Research Dept, CSCCI

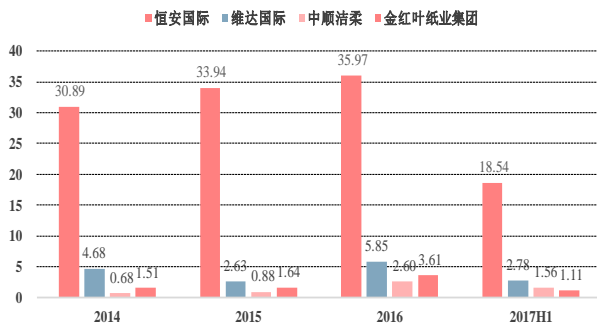
In 2016, C&S Paper crossed the RMB100mn mark to post RMB260mn in net profit attributable to the parent, soaring a whopping 195.45% YoY albeit still shy of half that of Vinda. The company has maintained a CAGR of 16.13% since 2013.

Hengan posted RMB3.597bn in net profit attributable to the parent in 2016, 6/10/12 times that of Vinda/GHY Paper/C&S Paper, up 5.98% YoY, further growing 13.39% YoY in 1H17. The company maintained a CAGR of 7.12% for 2013-2016.

Vinda reported a net profit attributable to the parent of RMB585mn in 2016, surging 122.43% following a 43.80% drop in 2015. The company recorded a CAGR of 11.06% for 2013-2016.

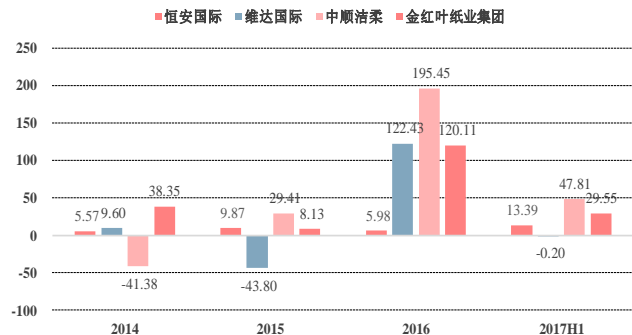
GHY Paper's 2013-2016 CAGR for net profit attributable to the parent was 49.00%, the highest of the Big Four.

Figure 38: Net profit attributable to the parent comparison (hundred million yuan)



Source: Wind; Research Dept, CSCJ

Figure 39: Comparison of growth rate of net profit attributable to the parent (%)



Source: Wind; Research Dept, CSCJ

4.2 Revenue breakdown comparison

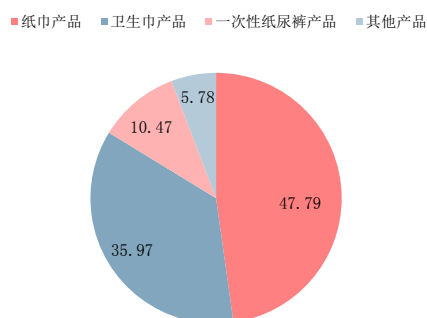
C&S Paper gets the bulk of its revenue from tissue paper, with toilet/non-toilet paper and semi-finished products accounting for 43.26%/53.54% and 2.04% of its offerings in 2016, making improvements in profitability on the back of ever increasing proportion of high gross margin products.

Likewise, Vinda drew 83.13% of its operating revenue from tissue paper in 2016, with toilet paper, facial tissue and paper handkerchiefs respectively responsible for 50.00%, 26.00% and 12.00% of its 2015 revenue.

Hengan mainly sells tissue paper, sanitary towels and paper diapers, which respectively accounted for 47.03%, 34.08% and 11.15% of the company's operating revenue for 2016.

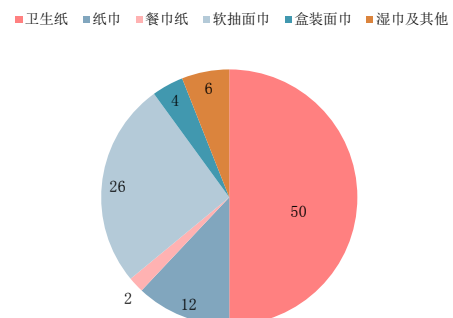
GHY Paper derives more than 98% of its operating revenue from tissue paper, with finished products making up more than 80% of its major offerings.

Figure 40: Hengan's revenue breakdown 2016

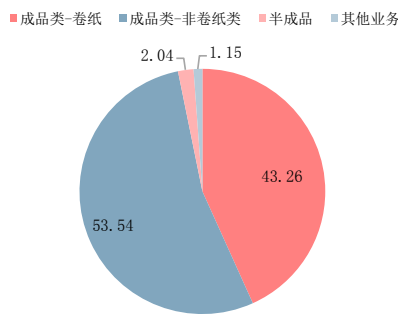


Source: Wind; Research Dept, CSCJ

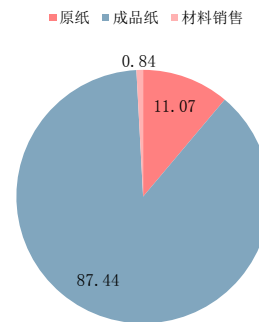
Figure 41: Vinda's revenue breakdown 2015



Source: Wind; Research Dept, CSCJ

Figure 42: C&S Paper's revenue breakdown 2016


Source: Wind; company announcement; Research Dept, CSCI

Figure 43: GHY Paper's revenue breakdown 2016


Source: Wind; Research Dept, CSCI

4.3 Capacity comparison

C&S Paper has been steadily stepping up capacity on top of its seven production subsidiaries located in Eastern, Western, Northern, Southern and Central China.

Hengan beefed up its production capacity from 900,000 tons in 2012 to an estimated 1.5mn tons in 2015, alongside 40 plus production subsidiaries across 15 provinces/cities/municipalities in China, enabling the company to quickly respond to market demands.

Vinda has scaled up its tissue paper production capacity from 620,000 tons in 2012 to 1.1mn tons in 2017, with its 14 production bases located in China, Taiwan, Malaysia and Australia, laying a solid foundation for the company's rising sales outside China.

GHY Paper saw its production capacity leap from 456,000 tons in 2011 to 1.32mn tons in 2016, and is eyeing a capacity boost in 2018 once its Suzhou-based TM13/14 comes on steam. The company has production bases in Tianjin, Shenyang, Chengdu, Wuhan, Fuzhou, Guangdong, Hainan and Qingdao.

Table 12: Production capacity comparison

	2013 年	2014 年	2015 年	2016 年	2017E
恒安国际	90	96	102	114	143
维达国际	70	89	95	104	110
中顺洁柔	33	44.5	47	47	50
金红叶	85.6	117	127	132	132

Source: Wind; Research Dept, CSCI

Figure 44: Hengan's capacity distribution



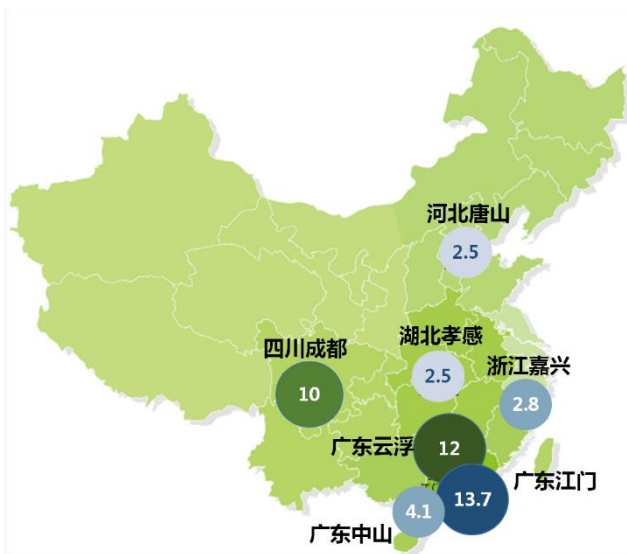
Source: Hengan's website; Research Dept, CSCI

Figure 45: Vinda's capacity distribution (in China)



Source: Vinda's website; Research Dept, CSCI

Figure 46: C&S Paper's capacity distribution



Source: C&S Paper's prospectus; Research Dept, CSCI

Figure 47: GHY Paper's capacity distribution



Source: GHY Paper's website; Research Dept, CSCI

4.4 Strategy comparison

C&S Paper targets different consumer groups with different products, and has created a retail fortress through its strategic partnerships with supermarket chains such as Walmart, Carrefour and PARKnSHOP.

Hengan is pursuing a flattened and platform-based operating model featuring full delegation and decision-making autonomy. The transformation has started to pay off, as seen by rising revenue and profit growth rate.

Vinda has branched out into areas such as paper diapers and sanitary towels. Its HKD1.144bn purchase of SCA's operations in mainland China, Hong Kong and Macau helped extend its product portfolio to adult, baby and feminine care. The company is diverging from being a tissue paper pure-play to securing a leadership position in all of its product categories.

GHY Paper—operating as a subsidiary of APP, one of the world's largest pulp and paper companies—enjoys stable raw material supply and strong sales channels throughout 160 countries and regions on the back of APP's support. The company mainly produces tissue paper, kitchen towel and wet paper towel occupying all price segments, with Breeze its main cash cow contributing more than 80% of its gross margin in recent years.

Table 13: Financial benchmarking

公司	恒安国际			金红叶			维达国际			中顺洁柔		
	2015	2016	2017H1	2015	2016	2017H1	2015	2016	2017H1	2015	2016	2017H1
公司业务描述	生活用纸主打品牌“心相印”			APP 旗下，主打品牌为“清风”，纸浆自供			爱生雅控股，主打品牌“维达”			主打品牌为“洁柔”		
生产 能力												
产能（万吨）	102	114	-	127	132	-	95	104	-	47	50	-
销量（万吨）	-	-	-	74.97	78.00	-	65.7	-	-	24.93	33.66	-
营业收入（亿元）	205	193.06	99.92	95.37	97.86	50	81.29	107.9	54.89	29.59	38.09	21.23
同比（%）	8.98	-5.82	1.53	17.33	2.61	5.31	28.99	32.37	11.58	17.34	28.74	19.85
业务 规模												
其中：生活用纸（亿元）	90.48	90.66	45.7	91.16	96.39	-	78.39	89.66	44.03	29.33	37.65	20.86
同比（%）	5.64	0.20	0.04	15.03	5.74	-	26.27	14.38	4.66	17.00	28.44	19.00
市场占比（%）	19.90	20.10	-	17.00	17.00	-	14.30	14.20	-	6.80	7.80	-
综合毛利率（%）	47.61	48.78	48.64	26.74	28.37	25.28	30.51	31.66	30.53	32.03	35.92	36.16
其中：生活用纸（%）	35.6	37.9	35.3	25.22	28.05	25.06	30.51	31.66	30.53	32.35	36.28	36.73
销售费用率（%）	18.21	19.27	18.59	18.94	17.86	15.62	16.13	17.2	17.22	17.47	18.93	19.93
盈利 能力												
管理费用率（%）	7.03	7.68	6.07	1.99	2.05	1.87	5.95	6.04	5.45	6.7	5.39	5.66
财务费用率（%）	1.91	1.79	2.35	3.52	3.95	4.98	1.11	1.37	1.52	3.54	1.55	1.14
归母净利润（亿元）	33.94	35.97	18.54	1.64	3.61	1.11	2.63	5.85	2.78	0.88	2.6	1.56
同比（%）	9.87	5.98	13.39	8.13	120.11	29.55	-43.8	122.43	-0.2	29.41	195.45	47.81
净利润率（%）	16.77	18.67	18.56	2.22	3.97	2.27	3.24	5.42	5.07	2.98	6.84	7.37
运营 能力												
应收账款周转率	9.59	7.54	3.64	7.6	6.31	2.84	8.58	8.71	3.88	7.64	7.8	3.99
库存周转率	3.36	2.77	1.62	5.46	5.7	2.84	3.06	3.97	2.09	2.96	4.25	2.52
偿债 能力												
资产负债率	54.4	56.77	59.25	64.71	63.32	62.74	60.43	56.62	53.74	46.44	40.25	38.93
流动比率	1.22	1.45	1.31	1.28	1.3	1.37	1.1	1.03	1.07	1.81	2.15	2.23

Source: Wind; Research Dept, CSCI

5. Investment guidance

C&S Paper provides a guidance of RMB217mn-272mn for net profit attributable to the parent for the first three quarters of 2017.

We project the company to net a profit of RMB353mn/465mn for 2017/2018, up 35.6%/31.7% YoY, corresponding to EPS of RMB0.47/0.61 and 30x/23x PER. The company currently has a valuation of RMB10.6bn. Maintain Buy.

Risk factor: Pulp price uptrend might carry forward while industry competition remains intense.

Table 14: C&S Paper's financial data

利润表	2015	2016	2017E	2018E	财务指标	2015	2016	2017E	2018E
营业收入	2,959.0	3,809.3	4,728.6	5,937.2	成长性				
减:营业成本	2,011.3	2,441.2	3,041.0	3,807.7	营业收入增长率	17.3%	28.7%	24.1%	25.6%
营业税费	12.8	34.5	42.6	53.4	营业利润增长率	9.9%	224.5%	36.7%	32.4%
销售费用	517.0	721.2	874.8	1,098.4	净利润增长率	30.7%	195.3%	35.7%	31.7%
管理费用	198.1	205.2	269.5	338.4	EBITDA 增长率	26.3%	51.5%	22.7%	20.9%
财务费用	104.6	59.2	60.0	55.0	EBIT 增长率	25.1%	87.5%	31.3%	27.5%
资产减值损失	21.7	25.9	-0.4	-0.4	NOPLAT 增长率	31.0%	94.4%	31.6%	27.5%
加:公允价值变动收益	-	-	-	-	投资资本增长率	-3.9%	-19.1%	43.9%	
投资和汇兑收益	6.4	1.9	2.0	2.0	净资产增长率	3.6%	10.8%	34.6%	
营业利润	99.9	324.1	443.2	586.7	利润率				
加:营业外净收支	17.7	10.7	10.0	10.0	毛利率	32.0%	35.9%	35.7%	35.9%
利润总额	117.6	334.8	453.2	596.7	营业利润率	3.4%	8.5%	9.4%	9.9%
减:所得税	29.4	74.4	99.7	131.3	净利润率	3.0%	6.8%	7.5%	7.8%
净利润	88.2	260.4	353.5	465.4	EBITDA/营业收入	12.2%	14.4%	14.2%	13.7%
资产负债表	2015	2016	2017E	2018E	EBIT/营业收入	6.9%	10.1%	10.6%	10.8%
货币资金	689.9	959.3	1,079.7	-	运营效率				
交易性金融资产	-	-	-	-	固定资产周转天数	271	210	160	118
应收账款	443.8	547.4	714.5	857.1	流动营业资本周转天数	83	39	60	
应收票据	2.1	1.3	125.6	52.3	流动资产周转天数	244	194	213	
预付账款	17.6	47.2	28.1	64.8	应收账款周转天数	48	47	48	48
存货	728.8	421.2	1,450.1	786.9	存货周转天数	83	54	71	68
其他流动资产	153.1	97.7	125.4	-	总资产周转天数	553	428	396	
可供出售金融资产	-	-	-	-	投资资本周转天数	380	262	230	
持有至到期投资	-	-	-	-	投资回报率				
长期股权投资	-	-	4.5	5.6	ROE	3.6%	9.7%	9.7%	
投资性房地产	22.9	22.1	22.1	22.1	ROA	1.9%	5.8%	6.0%	
固定资产	2,269.3	2,176.9	2,020.5	1,876.6	ROIC	4.8%	9.7%	15.8%	14.0%
在建工程	29.4	8.5	39.1	62.3	费用率				
无形资产	140.7	137.9	148.4	158.4	销售费用率	17.5%	18.9%	18.5%	18.5%
其他非流动资产	-	-	-	-	管理费用率	6.7%	5.4%	5.7%	5.7%
资产总额	4,544.3	4,512.5	5,891.7	-	财务费用率	3.5%	1.6%	1.3%	0.9%
短期债务	285.8	30.0	-	-	三费/营业收入	27.7%	25.9%	25.5%	25.1%
应付账款	576.6	700.1	894.2	1,104.8	偿债能力				
应付票据	5.6	25.8	11.9	17.8	资产负债率	46.4%	40.2%	38.4%	
其他流动负债	-	-	-	-	负债权益比	86.7%	67.4%	62.3%	
长期借款	130.0	-	353.7	-	流动比率	1.81	2.15	3.33	
其他非流动负债	-	-	-	-	速动比率	1.16	1.72	1.96	
负债总额	2,110.3	1,816.1	2,262.4	-	利息保障倍数	1.95	6.48	8.39	11.67
少数股东权益	-	-	-	-	分红指标				
股本	486.7	505.3	758.3	758.3	DPS(元)	0.03	0.78	0.14	0.18
留存收益	1,947.2	2,270.0	2,871.1	-	分红比率	28.6%	225.7%	30.0%	30.0%
股东权益	2,434.0	2,696.4	3,629.4	-	股息收益率	0.2%	5.5%	1.0%	1.3%
现金流量表	2015	2016	2017E	2018E	业绩和估值指标	2015	2016	2017E	2018E
净利润	88.2	260.4	353.5	465.4	EPS(元)	0.12	0.34	0.47	0.61
加:折旧和摊销	157.8	165.3	169.8	171.7	BVPS(元)	3.21	3.56	4.79	
资产减值准备	21.7	25.9	-	-	PE(X)	120.2	40.7	30.0	22.8
公允价值变动损失	-	-	-	-	PB(X)	4.4	3.9	2.9	
财务费用	78.8	47.3	60.0	55.0	P/FCF	333.8	33.9	-25.6	
投资收益	-6.4	-1.9	-2.0	-2.0	P/S	3.6	2.8	2.2	1.8
少数股东损益	-	-	-	-	EV/EBITDA	17.4	17.9	15.7	
营运资金的变动	172.4	477.8	-1,249.8	808.1	CAGR(%)	74.1%		73.7%	74.1%
经营活动产生现金流量	429.2	928.9	-668.5	1,498.2	PEG	1.6		0.4	0.3
投资活动产生现金流量	-120.2	-130.7	-52.5	-59.1	ROIC/WACC	0.4	0.9	1.4	1.3
融资活动产生现金流量	-365.3	-462.5	841.4	-	REP	4.8	4.5	2.1	

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Company Rating Definition

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

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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