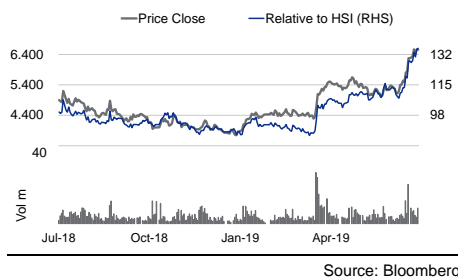


## Hong Kong

### ADD

Consensus ratings\*: Buy 8 Hold 0 Sell 0

Current price:	HK\$6.56
Target price:	HK\$7.90
Previous target:	HK\$7.90
Up/downside:	20.4%
CGS-CIMB / Consensus:	N/A
Reuters:	
Bloomberg:	2128 HK
Market cap:	US\$2,609m
	HK\$20,352m
Average daily turnover:	US\$3.22m
	HK\$25.69m
Current shares o/s:	3,102m
Free float:	31.5%
*Source: Bloomberg	



Price performance	1M	3M	12M
Absolute (%)	25.4	19.3	33.9
Relative (%)	21.1	26.1	35.9

Major shareholders	% held
Wong Luen Hei	68.4

### Analysts

#### Wong Chi Man

T (852) 3698 6317

E cmwong@chinastock.com.hk

#### Mark Lau

T (852) 3698 6393

E marklau@chinastock.com.hk

## China Lesso

### Investor meeting takeaways

- We held an investor meeting with management of China Lesso yesterday.
- One of key focus of investors is the investment plan for Lesso Home.
- Management explained that capex will come down going forward, as the phase of land acquisition has been largely completed.
- The Company is willing to increase the dividend payout ratio further.
- Existing business performed well in 1H19 with a solid gross margin.

### Land acquisition phase of Lesso Home largely completed

Between 2016 and 2018, China Lesso spent about RMB6bn to acquire land sites in the US, Canada, Thailand, Malaysia, Myanmar, etc., for the development of the Lesso Home business. The total area is about 4m m<sup>2</sup>. In the near term, the Company does not expect to have more large-scale land acquisition.

### Capex should come down gradually

In May 2019, ICBCI subscribed a US\$100m convertible loan (3% interest per annum) of Lesso Home, which is convertible to 9.1% of the enlarged share base of Lesso Home in three years. Although the Lesso Home business may still need capex of US\$100m–200m per year to build facilities and maintain operations, the business will need less financial support from the listco in the future, as Lesso Home will be able to raise funds through various channels, such as the ICBCI convertible loan. Meanwhile, capex for the existing business (plastic pipes, building materials and interior decoration products, etc.) will be about RMB1bn a year.

### Initial target: positive cash flow

For Lesso Home, the Company opened a small scale business in Malaysia (about 20,000 m<sup>2</sup>) in June. More will be opened late this year or early next year. As the business is still in the early stage of development, the initial target this year is to generate positive cash flow. In the first two years, the main target is to increase the occupancy rate and attract more customers.

### Intends to raise dividend payout ratio

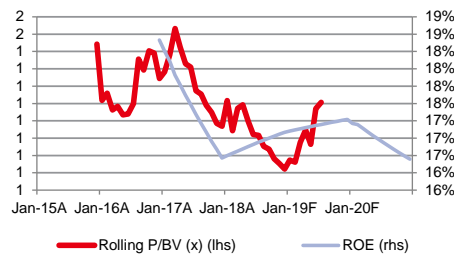
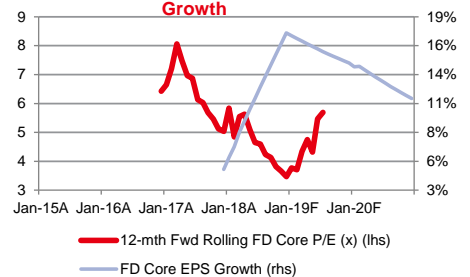
In 2018, the Company raised the dividend payout ratio to >30%, up from about 20% in previous years. Management reiterated its intention to increase the dividend payout ratio, as capex is going to decline gradually. The Company did not provide a specific target, but it will maintain the ratio at not less than 30%.

### Existing business to maintain healthy growth in 1H19

For the plastic pipe business, management expects the gross margin to remain solid in 1H19 on the back of a relatively stable ASP, while cost pressure is limited. Volume growth is expected to outperform the industry average. For the building materials and interior decoration products business, the Company aims to achieve >30% revenue growth for the full year from a relatively low base. Since the scale of the environment protection business is still small, management expects to see very high double-digit revenue growth this year.

Financial Summary	Dec-17A	Dec-18A	Dec-19F	Dec-20F	
Revenue (Rmbm)	20,360	23,734	26,482	29,032	
Operating EBITDA (Rmbm)	3,263	3,953	4,397	4,787	
Recurring Net Profit (Rmbm)	2,021	2,402	2,722	3,038	
Core EPS (Rmb)	0.65	0.77	0.88	0.98	
Core EPS Growth	5.2%	18.8%	13.3%	11.5%	
FD Core P/E (x)	8.50	7.20	6.52	5.85	
DPS (Rmb)	0.18	0.30	0.31	0.34	
Dividend Yield	3.10%	5.17%	5.27%	5.87%	
EV/EBITDA (x)	6.77	5.61	4.90	4.02	
P/FCFE (x)	21.08	6.07	42.38	9.82	
Net Gearing	28.1%	35.0%	28.0%	14.3%	
P/BV (x)	1.33	1.22	1.04	0.90	
ROE	16.6%	17.0%	17.2%	16.5%	
% Change In Core EPS Estimates					
CIMB/consensus EPS (x)			1.03	1.03	0.00

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**BY THE NUMBERS**
**P/BV vs ROE**

**12-mth Fwd FD Core P/E vs FD Core EPS Growth**

**Profit & Loss**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F
<b>Total Net Revenues</b>	<b>20,360</b>	<b>23,734</b>	<b>26,482</b>	<b>29,032</b>
<b>Gross Profit</b>	<b>5,317</b>	<b>6,228</b>	<b>6,959</b>	<b>7,594</b>
<b>Operating EBITDA</b>	<b>3,263</b>	<b>3,953</b>	<b>4,397</b>	<b>4,787</b>
Depreciation And Amortisation	(647)	(758)	(833)	(915)
<b>Operating EBIT</b>	<b>2,616</b>	<b>3,195</b>	<b>3,564</b>	<b>3,872</b>
Financial Income/(Expense)	(147)	(310)	(319)	(259)
Pretax Income/(Loss) from Assoc.	(1)	117	186	218
Non-Operating Income/(Expense)	121	114	121	132
<b>Profit Before Tax (pre-EI)</b>	<b>2,633</b>	<b>3,160</b>	<b>3,602</b>	<b>4,013</b>
Exceptional Items	365			
<b>Pre-tax Profit</b>	<b>2,955</b>	<b>3,116</b>	<b>3,552</b>	<b>3,963</b>
Taxation	(689)	(789)	(873)	(974)
Exceptional Income - post-tax				
<b>Profit After Tax</b>	<b>2,266</b>	<b>2,327</b>	<b>2,679</b>	<b>2,989</b>
Minority Interests	27	46	43	49
Preferred Dividends				
FX Gain/(Loss) - post tax				
Other Adjustments - post-tax				
<b>Net Profit</b>	<b>2,293</b>	<b>2,492</b>	<b>2,722</b>	<b>3,038</b>
Recurring Net Profit	2,021	2,402	2,722	3,038

**Cash Flow**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F
<b>EBITDA</b>	<b>3,263</b>	<b>3,953</b>	<b>4,397</b>	<b>4,787</b>
Cash Flow from Inv. & Assoc.				
Change In Working Capital	(1,602)	(545)	566	258
(Incr)/Decr in Total Provisions				
Other Non-Cash (Income)/Expense				
Other Operating Cashflow	102	(967)	(566)	970
Net Interest (Paid)/Received	(147)	(310)	(319)	(259)
Tax Paid	(689)	(789)	(873)	(974)
<b>Cashflow From Operations</b>	<b>927</b>	<b>1,342</b>	<b>3,206</b>	<b>4,781</b>
Capex	(1,169)	(1,106)	(1,100)	(1,100)
Disposals Of FAs/subsidiaries				
Acq. Of Subsidiaries/investments				
Other Investing Cashflow	(2,529)	(683)	(450)	(350)
<b>Cash Flow From Investing</b>	<b>(3,698)</b>	<b>(1,789)</b>	<b>(1,550)</b>	<b>(1,450)</b>
Debt Raised/(repaid)	3,625	3,412	(1,231)	(1,500)
Proceeds From Issue Of Shares				
Shares Repurchased				
Dividends Paid	(473)	(785)	(838)	(935)
Preferred Dividends				
Other Financing Cashflow	250	(180)	(434)	(371)
<b>Cash Flow From Financing</b>	<b>3,401</b>	<b>2,447</b>	<b>(2,503)</b>	<b>(2,805)</b>
Total Cash Generated	630	1,999	(847)	526
<b>Free Cashflow To Equity</b>	<b>853</b>	<b>2,964</b>	<b>424</b>	<b>1,831</b>
<b>Free Cashflow To Firm</b>	<b>(2,542)</b>	<b>(32)</b>	<b>2,089</b>	<b>3,702</b>

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## BY THE NUMBERS... cont'd

### Balance Sheet

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F
Total Cash And Equivalents	4,452	6,452	5,605	6,131
Total Debtors	4,199	4,535	4,749	5,111
Inventories	3,228	3,521	3,800	4,000
Total Other Current Assets	269	375	375	375
<b>Total Current Assets</b>	<b>12,148</b>	<b>14,883</b>	<b>14,529</b>	<b>15,617</b>
Fixed Assets	7,156	7,479	7,797	8,037
Total Investments	4,089	6,035	6,622	7,139
Intangible Assets	258	621	621	621
Total Other Non-Current Assets	4,322	5,618	5,668	5,718
<b>Total Non-current Assets</b>	<b>15,825</b>	<b>19,753</b>	<b>20,707</b>	<b>21,516</b>
Short-term Debt	2,877	6,144	5,500	5,000
Current Portion of Long-Term Debt	0	0	0	0
Total Creditors	5,016	5,205	6,120	6,789
Other Current Liabilities	0	1,483	0	0
<b>Total Current Liabilities</b>	<b>7,893</b>	<b>12,832</b>	<b>11,620</b>	<b>11,789</b>
Total Long-term Debt	5,442	5,587	5,000	4,000
Hybrid Debt - Debt Component				
Total Other Non-Current Liabilities	230	299	316	346
<b>Total Non-current Liabilities</b>	<b>5,672</b>	<b>5,885</b>	<b>5,316</b>	<b>4,346</b>
Total Provisions	626	846	835	865
<b>Total Liabilities</b>	<b>14,190</b>	<b>19,563</b>	<b>17,771</b>	<b>17,000</b>
Shareholders' Equity	13,490	14,803	17,239	19,955
Minority Interests	294	270	227	178
<b>Total Equity</b>	<b>13,783</b>	<b>15,073</b>	<b>17,466</b>	<b>20,133</b>

### Key Ratios

	Dec-17A	Dec-18A	Dec-19F	Dec-20F
Revenue Growth	18.2%	16.6%	11.6%	9.6%
Operating EBITDA Growth	8.1%	21.1%	11.2%	8.9%
Operating EBITDA Margin	16.0%	16.7%	16.6%	16.5%
BVPS (Rmb)	4.35	4.77	5.56	6.43
Gross Interest Cover	11.60	7.80	8.34	10.58
Effective Tax Rate	23.3%	25.3%	24.6%	24.6%
Net Dividend Payout Ratio	24.0%	32.5%	30.2%	30.3%
Accounts Receivables Days	29.01	30.90	29.47	29.37
Inventory Days	72.48	70.36	68.44	66.58
Accounts Payables Days	80.36	76.09	83.17	82.02
ROIC (%)	25.6%	22.5%	23.4%	23.2%
ROCE (%)	13.9%	13.3%	13.2%	13.7%
Return On Average Assets	8.34%	8.56%	8.72%	9.11%

### Key Assumptions

	Dec-17A	Dec-18A	Dec-19F	Dec-20F
Sales volume (tonnes)	2,004,840	2,168,622	2,407,500	2,599,000
PVC	1,582,697	1,682,949	1,816,338	1,934,826
Non-PVC	422,143	485,673	591,162	664,174
ASP per tonne (RMB)	9,033	9,841	9,869	9,980
PVC	7,481	8,116	8,212	8,272
Non-PVC	14,853	15,820	14,961	14,958
Cost per tonne (RMB)	6,582	7,159	7,214	7,305
Gross profit per tonne (RMB)	2,451	2,682	2,656	2,676

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Disclaimer**

This research report is not directed at, or intended for distribution to or used by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject China Galaxy International Securities (Hong Kong) Co., Limited (“Galaxy International Securities”) and/or its group companies to any registration or licensing requirement within such jurisdiction.

This report (including any information attached) is issued by Galaxy International Securities, one of the subsidiaries of the China Galaxy International Financial Holdings Limited, to the institutional clients from the information sources believed to be reliable, but no representation or warranty (expressly or implied) is made as to their accuracy, correctness and/or completeness.

This report shall not be construed as an offer, invitation or solicitation to buy or sell any securities of the company(ies) referred to herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The recipient of this report should understand and comprehend the investment objectives and its related risks, and where necessary consult their own independent financial advisers prior to any investment decision.

Where any part of the information, opinions or estimates contained herein reflects the personal views and opinions of the analyst who prepared this report, such views and opinions may not correspond to the published views or investment decisions of China Galaxy International Financial Holdings Limited, its subsidiaries and associate companies (“China Galaxy International”), directors, officers, agents and employees (“the Relevant Parties”).

All opinions and estimates reflect the judgment of the analyst on the date of this report and are subject to change without notice. China Galaxy International and/or the Relevant Parties hereby disclaim any of their liabilities arising from the inaccuracy, incorrectness and incompleteness of this report and its attachment/s and/or any action or omission made in reliance thereof. Accordingly, this report must be read in conjunction with this disclaimer.

**Disclosure of Interests**

China Galaxy Securities Co., Ltd. (6881.HK; 601881.CH) is the direct and/or indirect holding company of the group of companies under China Galaxy International Financial Holdings Limited. China Galaxy International may have financial interests in relation to the subjected company(ies)’ securities in respect of which are reviewed in this report, and such interests aggregate to an amount may equal to or less than 1% of the subjected company(ies)’ market capitalization unless specified otherwise.

One or more directors, officers and/or employees of China Galaxy International may be a director or officer of the securities of the company(ies) mentioned in this report.

China Galaxy International and the Relevant Parties may, to the extent permitted by law, from time to time participate or invest in financing transactions with the securities of the company(ies) mentioned in this report, perform services for or solicit business from such company(ies), and/or have a position or holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto.

Galaxy International Securities may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the last 12 months, significant advice or investment services in relation to the investment concerned or a related investment or investment banking services to the company(ies) mentioned in this report.

Furthermore, Galaxy International Securities may have received compensation for investment banking services from the company(ies) mentioned in this report within the preceding 12 months and may currently seeking investment banking mandate from the subject company(ies).

China Galaxy International has procedures in place to eliminate, avoid and manage any potential conflicts of interests that may arise in connection with the production of research reports. The research analyst(s) responsible for this report operates as part of a separate and independent team to the investment banking function of Galaxy International Securities and procedures are in place to ensure that confidential information held by either the research or investment banking function is handled appropriately.

**Analyst Certification**

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

We are transferring the rating mechanism from “BUY, SELL, HOLD” to “ADD, REDUCE, HOLD”. Please refer to the definitions below.

**Explanation on Equity Ratings (Existing mechanism (will be replaced by new mechanism by 01/09/19))**

BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

**Explanation on Equity Ratings (New mechanism)**

ADD : The stock’s total return is expected to exceed 10% over the next 12 months.

REDUCE : The stock’s total return is expected to fall below 0% or more over the next 12 months.

HOLD : The stock’s total return is expected to be between 0% and positive 10% over the next 12 months.

**Copyright Reserved**

No part of this material may be reproduced or redistributed without the prior written consent of China Galaxy International Securities (Hong Kong) Co., Limited.

China Galaxy International Securities (Hong Kong) Co. Limited, CE No.AXM459

20/F, Wing On Centre, 111 Connaught Road Central, Sheung Wan, Hong Kong. General line: 3698-6888.