

China Lesso (2128 HK)

Improvement of pipe sales + upside on new business

We see several positive drivers on China Lesso: (1) the potential recovery of infrastructure spending and favourable weather should drive higher sales volume growth of plastic pipe in 2H19E; (2) increasing pricing power should continue to enhance gross margin; (3) on-track new business development should offer growth driver over the medium term. While share price gained >100% YTD (mainly driven by significant margin expansion in 1H19), it is still trading at only 7.4x/6.5x 2019E/20E consensus earnings.

- Plastic pipe business: capacity growth and upgrade to drive growth.** China Lesso doubled its annual sales volume of plastic pipe between 2012 and 2018. As at end-Jun 2019, the annual capacity of plastic pipe was 2.69mn tonnes. Going forward, China Lesso plans to expand its capacity by 150-200k tonnes annually. Besides, the Company is on-track to upgrade its existing capacity to achieve automation in order to increase the yield rate and reduce labour cost. For overseas market, China Lesso leased a piece of land in Indonesia to build capacity. We expect Southeast Asia will become another growth driver for the Company's plastic pipe business.
- Potential pickup of construction activities; limited impact on property weakness.** China Lesso expects the sales volume growth to improve given the pickup of construction activities following weakness in summer due to heavy rainfall. On the other hand, the potential weakness of property market will not have significant impact on the Company as the customers are the large property developers that are gaining market share. We expect China Lesso to deliver high single digit growth for the full year, versus 6.6% in 1H19.
- Resilient margin to continue on strong pricing power.** The economies of scale, nationwide distribution network and well diversified customer portfolio (largest customer accounts for only 2% of total revenue) are the keys to enable China Lesso to maintain strong pricing power. Gross margin was stable at 24-27% in 2010-2018, and further expanded to 28.7% in 1H19. Going forward, we expect the gross margin to remain resilient as the non-PVC product margin continues to improve on better competitive landscape.

Earnings Summary

(YE 31 Dec)	FY16A	FY17A	FY18A
Revenue (RMB mn)	17,221	20,360	23,734
YoY growth (%)	12.8	18.2	16.6
Net income (RMB mn)	1,922	2,293	2,492
EPS (RMB)	0.62	0.74	0.80
YoY growth (%)	18.8	19.4	8.7
EV / EBITDA (x)	8.6	7.0	6.3
P/E (x)	10.3	8.5	8.3
P/B (x)	1.8	1.4	1.4
Yield (%)	0.8	0.0	0.0
ROE (%)	18.3	18.6	17.6
Net debt / equity (%)	7.0	28.1	35.0

Source: Company data, CMBIS estimates

NOT RATED

Current Price

HK\$7.55

China Industrial

Wayne Fung, CFA

(852) 3900 0826

waynefung@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	23,423
Avg 3 mths t/o (HK\$ mn)	47.5
52w High/Low (HK\$)	7.84/3.68
Total Issued Shares (mn)	3,102

Source: Bloomberg

Shareholding Structure

Wong Luen Hei	68.49%
Others	31.51%

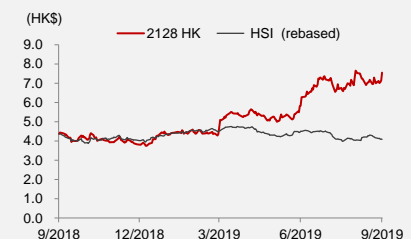
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	+3.6%	+2.2%
3-mth	+23.1%	+33.4%
6-mth	+64.0%	+79.9%

Source: Bloomberg

12-mth Price Performance

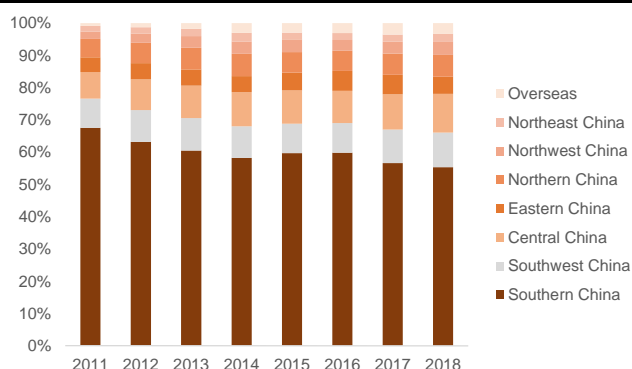


Source: Bloomberg

Auditor: Ernst & Young

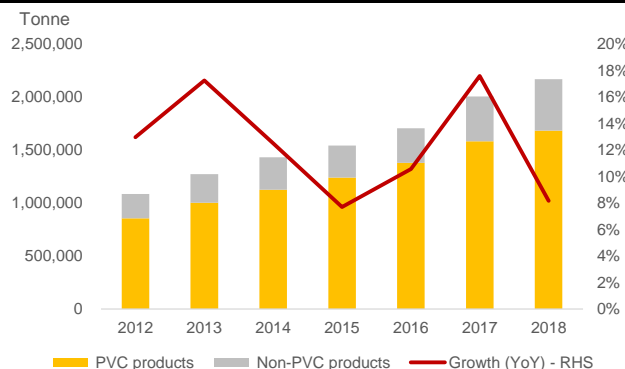
- Environmental protection business is small but growing fast.** China Lesso has continued to expand its environmental protection business. After the acquisition of 70% equity interest in Jiangsu Yongbao (mainly engaged in the provision of hazardous waste treatment services) in Oct 2018, China Lesso plans to leverage the technology to its other existing projects. The revenue contribution in 1H19 was RMB151mn, accounting for 80% of its full year revenue of RMB188mn in 2018.
- Lesso Home.** China Lesso grew its land bank in the overseas (including the US, Canada, Australia and some Southeast Asian countries) over the past few years. China Lesso plans to promote Lesso Home as the “one-stop specialized market for home furnishing products in the overseas market by helping the Chinese building material and home furnishing maker in building a cross-border platform for exhibition and promotion of their products. Rental income is the major source of revenue for China Lesso. As at end-Jun 2019, the investment properties amounted to RMB5.86bn. In 1H19, revenue was RMB137mn. We expect the revenue contribution will be much higher in a few years.
- Company background.** China Lesso is a large-scale industrial group that manufactures building materials and interior decoration products in China. The Company offers >10,000 types of products, including plastic piping system (made of PVC, PE, PP-R and other plastic resins), sanitary ware products and sanitary materials etc. They are widely applied to fields such as interior decoration, water supply, drainage, power supply and telecommunications, gas transmission, agriculture, aquaculture, floor heating and fire services.

Figure 1: Revenue breakdown by region



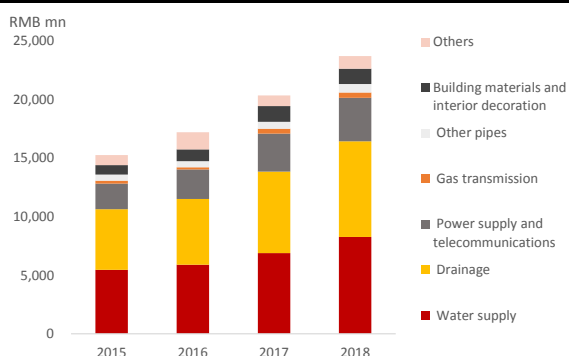
Source: Company data, CMBIS

Figure 2: Sales volume of plastic pipe



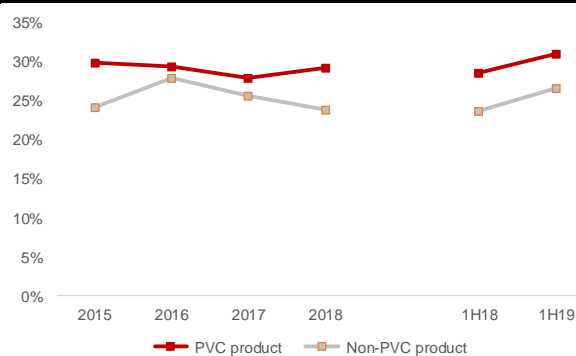
Source: Company data, CMBIS

Figure 3: Revenue breakdown by product



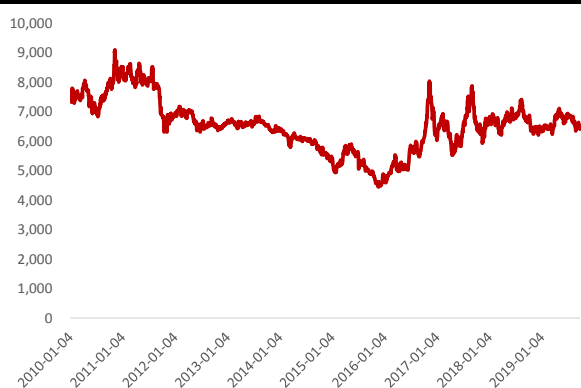
Source: Company data, CMBIS

Figure 4: China Lesso's plastic pipe gross margin



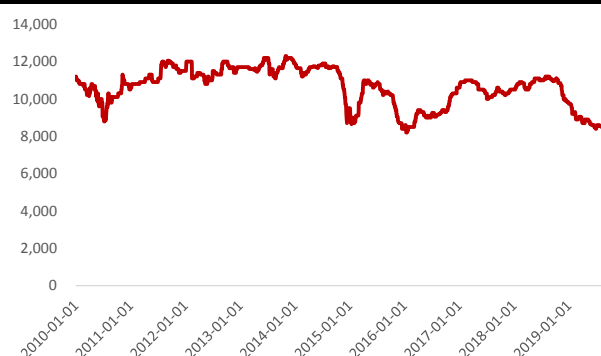
Source: Company data, CMBIS

Figure 5: China PVC price



Source: Wind, CMBIS

Figure 6: China high-density polyethylene (HDPE) price



Source: Wind, CMBIS

Figure 7: China Lesso land bank (as at end-2018)

Region	Site area / GFA (Sq ft)	Type	Lease term	Interest (%)
Thailand	3,557,955	Complex land	Freehold	75
US	3,347,896	Complex land	Freehold	100
US	4,755,918	Complex land	Freehold	100
US	723,302	Commercial building	Freehold	100
Canada	1,994,351	Industrial land	Freehold	100
Canada	1,750,241	Commercial land	Freehold	100
Canada	139,046	Commercial building	Freehold	100
Australia	2,320,699	Industrial land	Freehold	100
Australia	298,191	Industrial building	Freehold	100
China	1,392,982	Commerical land	Leasehold	100
China	221,825	Commerical land	Leasehold	100
	20,502,406			

Source: Company data, CMBIS

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst 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 that 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 stock(s) 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 stock(s) covered in this research report 3 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.

CMBIS Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIS

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.