

Huazhang Technologies (1673.HK) Date: 24 January 2017

Company		Huazhang Technology
Stock Code		1673 HK
# of shares	(m)	600.6
Closing Price	(HK\$/share)	2.6
Mkt cap	(HK\$m)	1,561.7
FY16A EPS	(HK\$)	0.054
FY16A BVPS	(HK\$)	0.534
FY16A DPS	(HK\$)	0.040

Source: The company

Positive earnings alert. Huangzhang Technology (1673 HK) issued a positive earnings alert, saying that its net profit for six months ended December 2016 would surge more than 100.0% as the group has been switching its business focus from the provision of industrial automation system equipment to the provision of consolidated papermaking industrial solution.

Proxy to the prosperous paper industry. On the backdrop of recovery in China paper industry, share prices performances of papermakers have been very strong recently. Share prices of Nine Dragon Papers (2689 HK), Lee & Man Paper (2314 HK) Shangdong Chenming (1812 HK) and Sunshine Paper (2002 HK) have surged two-folds YoY, 69.5% YoY, 97.2% YoY and 78.1% YoY, respectively. In our view, given the consolidation in China papermaking industry triggered by government's policies regarding eliminating redundant and outdated production capacities, weakening in RMB and strong demand for household paper and packaging materials, earnings outlook of China paper industry is positive for this year. As an upstream papermaking industrial and waste treatment turnkey solution provider, Huazhang Technology (1673 HK) is alternative proxy to the revival in China papermaking industry.

More orders are expected. Major paper producers have posted stunning growth in their earnings, for example, Sunshine Paper (2002 HK) 's net earnings surged more than two-folds; Shangdong Chenming (1812 HK)'s net earnings for nine months ended September 2016 surged 176.9% YoY; LEE & Man Paper (2314 HK)'s net earnings for 1H FY16A rose 27.7% YoY. Papermakers are likely to increase their capital expenditure for expanding or upgrading their production facilities given positive industrial outlook, recovery in profitability and more stringent pollution control standard. This would ultimately benefit Huazhang.

Vertical integration. At the end of December 2016, management of the group announced that its subsidiary, Zhejiang Huazhang, as purchaser, entered into a non-legally binding letter of intent with independent third parties vendors regarding potential acquisition of Hangzhou MCN Paper Tech (杭州美辰紙業技術有限公司) and Hangzhou Hao Rong Paper Tech (杭州豪榮科技有限公司). The target companies are engaging in the sales of headbox, which is an essential part of papermaking production line. It is a head tank which spreads the stock evenly along the width of the paper machine, accelerates the stock up to the machine operating speed and suspends the pulp fibers throughout the outgoing slurry. Hangzhou MCN Paper Tech and Hangzhou Hao Rong Paper Tech have patents and know-how in production of the headbox. If the acquisition be completed, Huazhang would possess one of the core technologies of paper making production line. Since most of the components for the production lines assembled and developed by the group are outsourced, GP commanded by its project segment has room to improve. As the group provides more self-develop/produced components into the production lines, GP of its project division would be enhanced. Thus, more acquisition for vertical integration by the group can be expected, in our view.

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