



BUY M&G

Price: 27.95

Price Target: 33.52

Price Target Potential: 19.83%

Price Target Period: 12M



TEAM-BIG SIX

INVESTMENT HIGHLIGHTS



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1. M&G is the leader of the stationery market in China, having an annual revenue of 6.4 billion yuan as of 2017 while making a profit of 600 million yuan in the past six years. It has grown over 30% every year in the past six years. In 2016, the company's writing tool market share was more than 16%, far ahead of the second one. It has built a strong brand, channel and a solid position in the market.

2. The scale of China's traditional stationery industry is over 120 billion yuan, and the industry has entered into a mature stage, hence the growth rate is slowing down as well. Taking the stationery industry in Japan as an example, the growth rate of the industry will be in a downward trend, and the Matthew effect will emerge. In recent years, the number of loss-making enterprises in China's stationery industry has been increasing year by year due to the slow growth of income and the rapid increase of cost, and the trend of concentration can be well observed. As the leader of the industry, M&G can benefit from both the scale of the industry and the market concentration.

3. The company has set up many campus stores in recent years and has built a great reputation among students. By building a new retail model, "Jiumu Grocery", the company's channels and brands are expected to be improved to a higher level as well. M&G has changed itself from a simple stationary producer to a creator of the stationary culture, which meets the trend of the industry and gains the potentiality to grow in the future.

4. The company will benefit from the rapid growth of single stores, the expansion of categories and the upgrading of stores in short term. In the long run, the boom of office direct sales and a new model of retailing will further boost the overall revenue scale. The EPS is expected to be 0.90, 1.17 and 1.54 yuan respectively in 2018-2020.

Price Performance



Overview Market

Exchange	SSEC
Sector	Stationary
52 wk Price Range	20.67-33.62
3M Average Volume	CNY1.286B
Enterprise Value	CNY25.71B
Shares outstanding	0.92B
P/E	35.7
EPS T12M	0.78

FRAMEWORK FOR QUANTITATIVE AND QUALITATIVE ANALYSIS

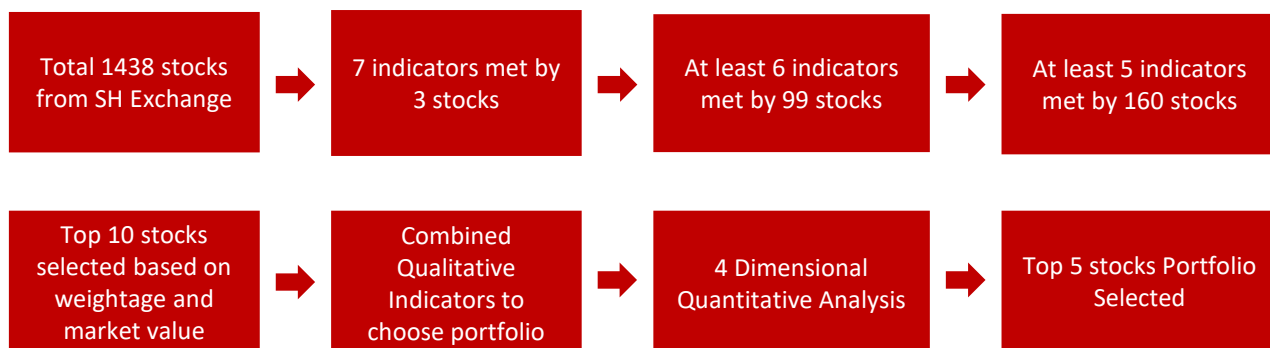
The mainland of China has two stock exchanges which are in Shenzhen and Shanghai. Contrary to Shenzhen which has grown 8 times since its establishment, the Shanghai Stock Exchange has grown over 20 times. Furthermore, the exchange market is much developed for the fundamentals to be effective in analyzing the stocks.

All the 1438 stocks currently listed in the market have been analyzed using the indicators from our framework of quantitative and qualitative analysis to select our portfolio of 5 stocks and ultimately choose the best stock among them.

Framework for Stock Analysis



The initial quantitative analysis is weighted for 30% as they are the fundamentals for financial indicators that determines the returns of stocks in many ways. The first 7 indicators were satisfied by only 3 stocks. But we re-analyzed the market to get 99 stocks that meet at least 6 quantitative indicators and 160 stocks that meet at least 5 indicators. We then filter these stocks applying individual weights from all 8 indicators, this time putting the market valuation and creating a higher benchmark that gave us the 10 stocks. Qualitative indicators are used along with quantitative indicators in order to identify the stocks for investment. Finally, we use the 4-dimensional analysis that gave us a thorough analysis to re identify the top 5 stocks best to invest from a portfolio perspective. .



Following table shows the impact each of the 8 quantitative indicators have on the performance of the stock.

Quantitative Analysis Criteria

Indicators	Formulas	Impact on Stock Performance	Criteria				
Liquidity	Liquid Liabilities/Liquid Assets	Higher Liquidity-Less Stock Returns	>=0.4 4	>=0.3 3	>=0.2 2	>=0.1 1	<0.1 0
Leverage	Long Term Debt/ Total Assets	Higher Leverage-Less Stock Returns	>34 0	>24 1	>14 2	>4 3	<4 4
Profitability	Operating Operating/Total Sales	Higher Profit-Higher Stock Returns	>33 4	>23 3	>13 2	>03 1	<03 0
Earnings Quality	(Operating Profit - Operating Cash Flow)/ Total Assets	Higher Earning Quality-Less Stock Returns	>=6% 0	>=4% 1	>=2% 2	>=0% 3	<0% 4
Operating Efficiency	Inventory/Sales	Higher Operating Efficiency-Less Stock Returns	>40% 0	>30% 1	>20% 2	>10% 3	<10% 4
Assets Turnover	Sales/Average Total Assets	Higher Assets Turnover-Higher Stock Returns	>1.5 4	>1.0 3	>0.5 2	>0 1	<0 0
Cashflow	Operating Cashflow/Total Assets	Higher Cashflow-Higher Stock Returns	>=80% 4	>=60% 3	>=40% 2	>=20% 1	<20% 0
Market Valuation (Price to Book Ratio)	Market Price per Share/Book Value per Share	Higher Market Valuation-Lower Stock Returns	>=3 0	>=2 1	>=1 2	>=0 3	<0 4

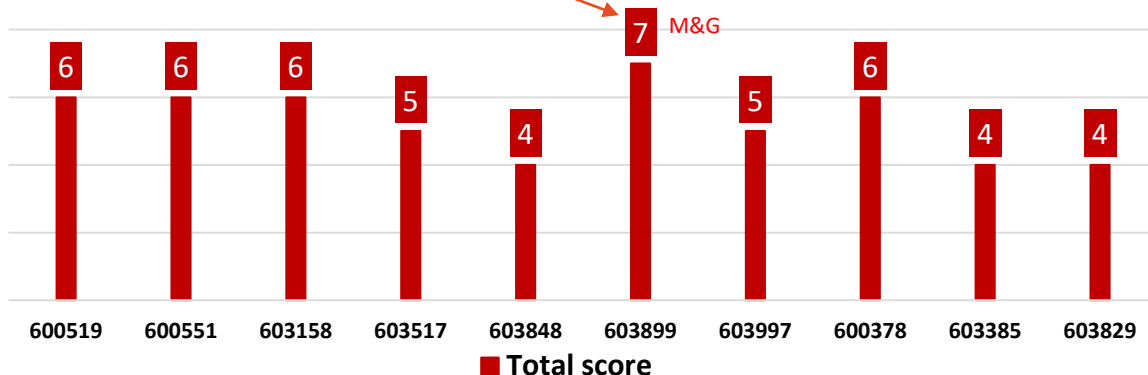
By setting the criteria for these indicators, we do a step by step filtration of the stocks using the indicators as shown in the table. M&G stock has been highlighted here in order to make a track of our final stock selection as we see later how this stock has consistently been in top list for investment.

STOCK NAME	Stock No.	Profitability	Leverage	Liquidity	Earning Quality	Operating Efficiency	Assets Turnover Ratio	Cashflow	Market Valuation	Total Marks
JUEWEI FOOD	603517.SH	4	2	4	2	3	3	2	2	22
M&G	603899.SH	3	1	4	1	3	4	4	2	22
HOTATA	603848.SH	4	2	2	1	4	3	2	3	21
KWEICHOW MOUTAI	600519.SH	4	1	3	2	3	2	2	2	19
NINGBO JIFENG AUTO PARTS	603997.SH	3	2	3	2	3	3	2	0	18
CZTL	603158.SH	3	1	3	3	3	2	1	1	17
CTYC	600378.SH	3	1	3	1	4	2	1	1	16
ROCOI	603829.SH	2	1	3	2	3	2	1	2	16
HUIDA SANITARY	603385.SH	3	2	3	1	3	2	1	0	15
TIME PUBLISHING	600551.SH	1	1	3	2	3	2	2	0	14

Qualitative Framework (30%)

Qualitative indicators shown on the table are thoroughly reviewed in order to give the scores for each of the 10 stocks we filtered from initial quantitative analysis.

Stock Codes	Industry	Market Share	Government Support	Price	Technology	Quality	Management Loyalty	Total Score
600519	1	1	1	1	0	1	1	6
600551	1	1	1	0	1	1	1	6
603158	1	1	1	1	0	1	1	6
603517	1	1	0	1	0	1	1	5
603848	0	1	0	1	1	1	0	4
603899	1	1	1	1	1	1	1	7
603997	0	1	0	1	1	0	1	5
600378	1	1	1	1	1	0	1	6
603385	1	1	0	1	0	1	0	4
603829	0	1	1	0	1	1	0	4



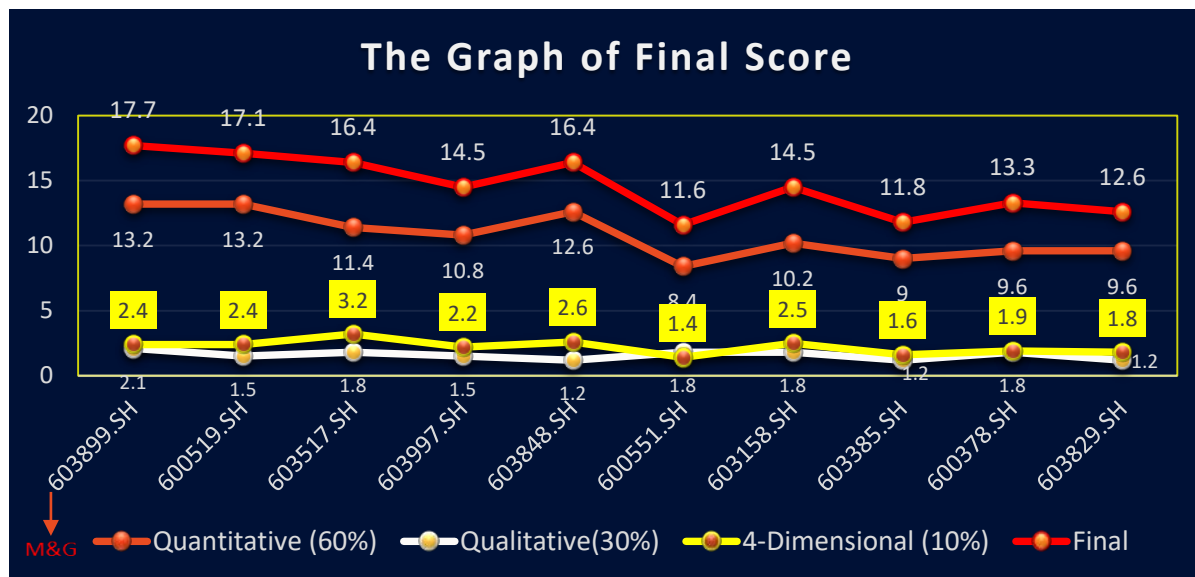
4-Dimensional Quantitative Analysis (10%)

The 4-dimensional indicators from quantitative analysis which are profitability, liquidity, operating efficiency, and cash flow helps us to select the top five stocks from those 10 stocks we analyzed using qualitative indicators.

Stock No.	Profitability	Score 1	Liquidity	Score 2	Operating Efficiency	Score 3	Cash flow	Score 4	Total score
M&G ← 603899.SH	25.35	3	0.48	10	19.29%	1	87.5%	10	24
600519.SH	90.43	10	0.31	2	17.00%	3	70.3%	9	24
603517.SH	35.70	8	0.44	9	13.14%	7	52.5%	8	32
603997.SH	32.10	6	0.34	4	16.23%	5	46.8%	7	22
603848.SH	40.61	9	0.22	1	5.62%	10	46.1%	6	26
600551.SH	12.26	1	0.37	6	18.23%	2	40.0%	5	14
603158.SH	32.45	7	0.40	8	14.88%	6	37.3%	4	25
603385.SH	28.22	4	0.37	5	16.99%	4	34.8%	3	16
600378.SH	30.05	5	0.33	3	6.73%	9	30.4%	2	19
603829.SH	21.52	2	0.40	7	10.12%	8	22.3%	1	18

Selecting the Stock with Best Performance.

We use the individual stock scores of each stock and weight it from the initial criteria set for quantitative and qualitative scores respectively in order to get the final score.



Top 5 Stocks of the Portfolio

Stock Companies	Industry	Stock code.	Scores			
			Quantitative (60%)	Qualitative (30%)	4-Dimensional (10%)	Final
Shanghai M&G Stationery Inc	Retail Office Suppliers	603899.SH	13.2	2.1	2.4	17.7
Kweichow Moutai Co Ltd	Beverages-Wine/Spirits	600519.SH	13.2	1.5	2.4	17.1
Juewei Food Co Ltd	Food-Meat Products	603517.SH	11.4	1.8	3.2	16.4
Ningbo Jifeng Auto Parts Co Ltd	Auto/Trek Prts&Equip-Orig	603997.SH	10.8	1.5	2.2	14.5
Guangdong Hotata Technology Group Co Ltd	Consumer Products-Misc	603848.SH	12.6	1.2	2.6	16.4

This is the process we chose our portfolio of 5 stocks as well as the top stock for investment which is Shanghai M&G Stationery Inc.

1-Introduction to M&G

Overall

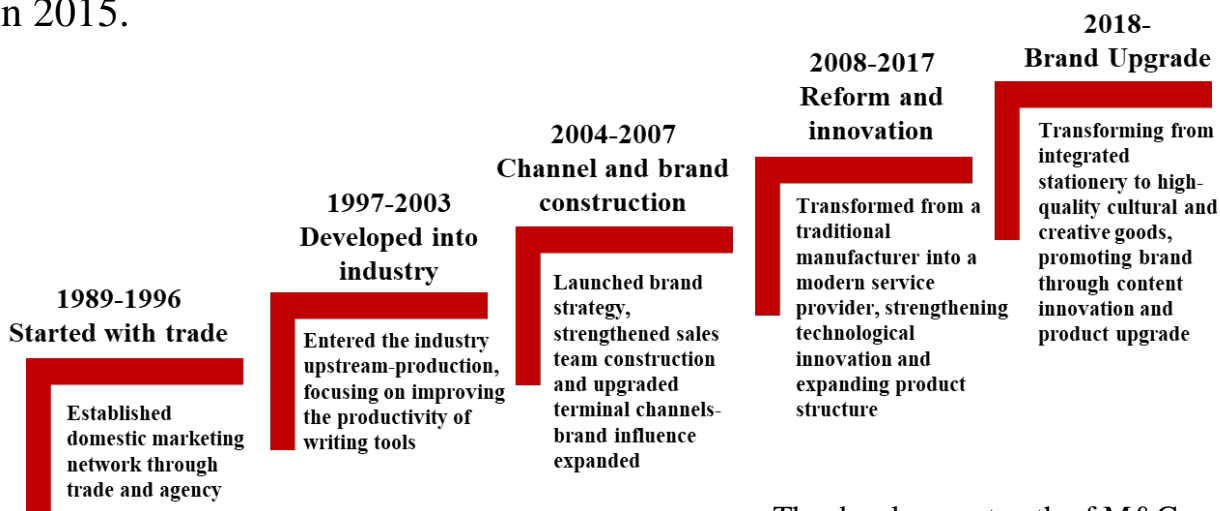
M&G stationery is a comprehensive stationery supplier with both value based service advantages. The company is mainly engaged in business of writing tools which can be categorized as student stationery, office stationery designs, research & development, manufacturing and sales. It includes over different 50 items having more than 5,000 varieties of stationery product line in the forefront of China.



Source: Official Website



In recent years, the company is continuously developing one-stop office service platform M&G Science Lip, retail brand Jiumu Sundries Club, e-commerce platform M&G technology and other emerging businesses. It all started from a comprehensive stationery supply to a high-quality creative and office solutions which has made an overall transformation of the company. Founded in 1989, it was listed on the Shanghai stock exchange in 2015.

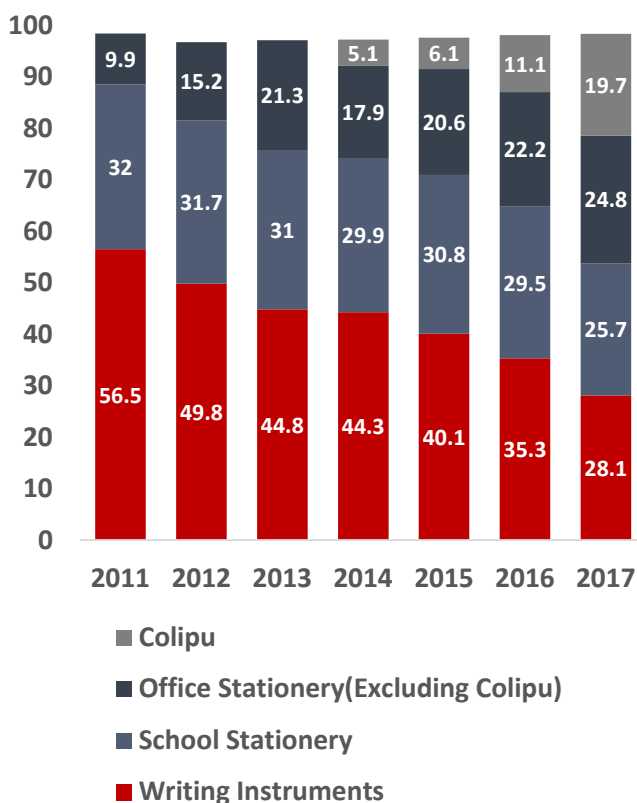


Source: Prospectus

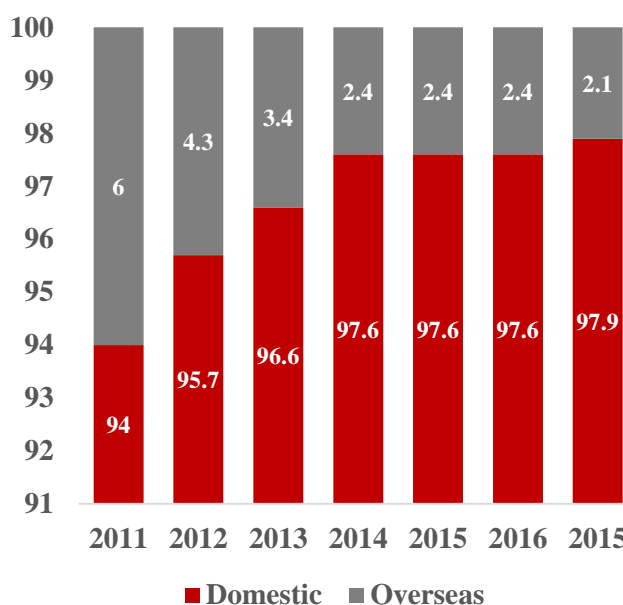
M&G stationery revenue mainly comes from the sales of stationery in the Chinese domestic demand market. Starting from writing tools, the company has been expanding highly in students stationery and office stationery market.

The emerging business of Morning Science and Lip (Office Direct Sales) has taken on a posture of being superior to others. In 2017, the income of writing tools, student stationery, and office stationery accounted for 28.1%, 25.7%, and 44.6% respectively. Among them, M&G Science and Technology Popularization accounted for 19.7%, an increase of 8.6% over the same period of last year. The development of M&G Science and Technology Popularization is mainly due to the rapid rise of domestic office direct selling market under the background of centralized purchasing and public bidding. From the regional structure, the company's products are mainly domestic sales (97.9% in 2017), less affected by trade wars and exchange rate fluctuations.

The revenue structure of M&G(Products)



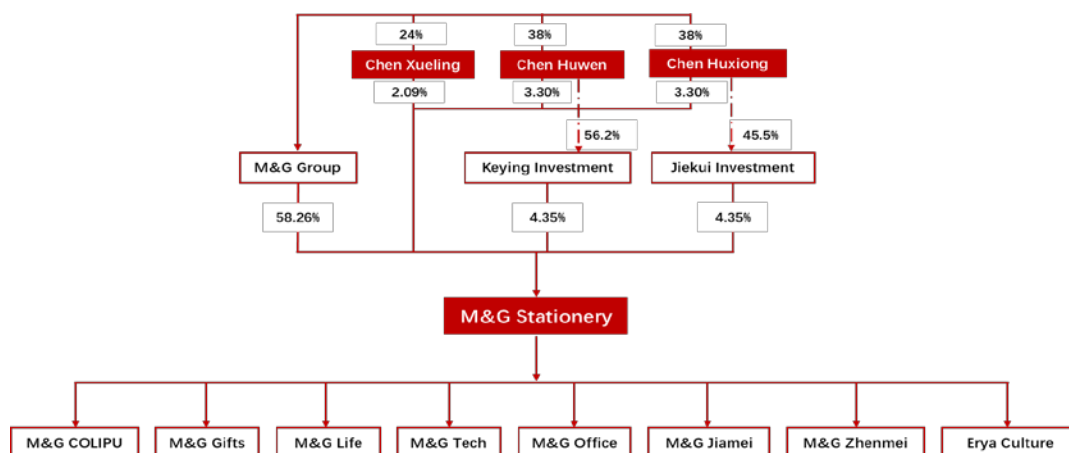
The revenue structure of M&G(Districts)



Source: Annual Reports

The Ownership Structure of M&G

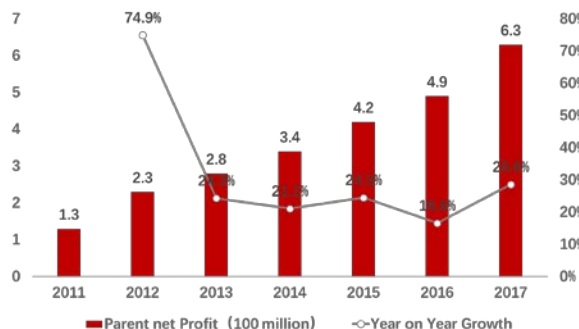
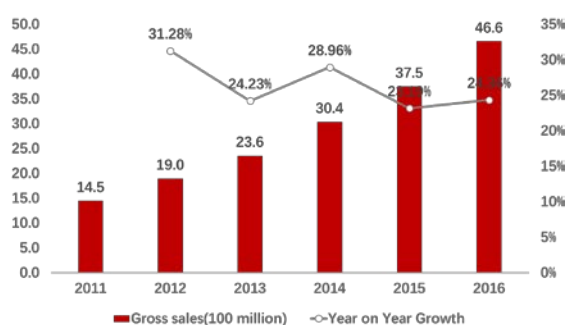
M&G Group as a controlling shareholder holds 58.26% of the company's share. Majority of the company ownership is held by Chen Xueling, Chen Huwen, and Chen Huxiong. The total direct/indirect shareholding ratios of the three people are 71.37%, who enjoy most of the control rights. Concentrated ownership structure is conducive to ensuring the consistency of decision-making and lays a foundation for the realization of the strategic objectives of the company.



Source: Company Prospectus

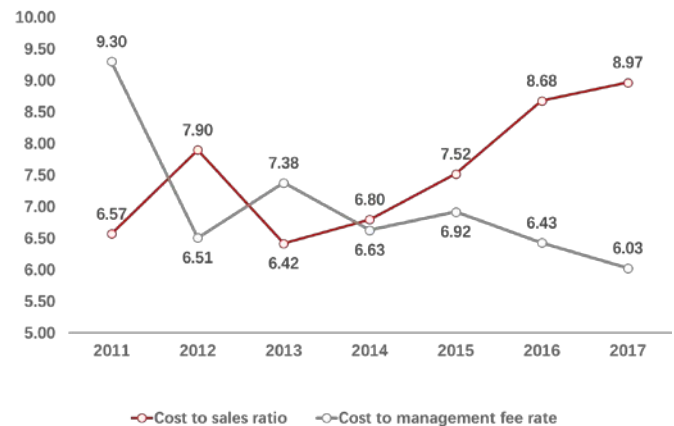
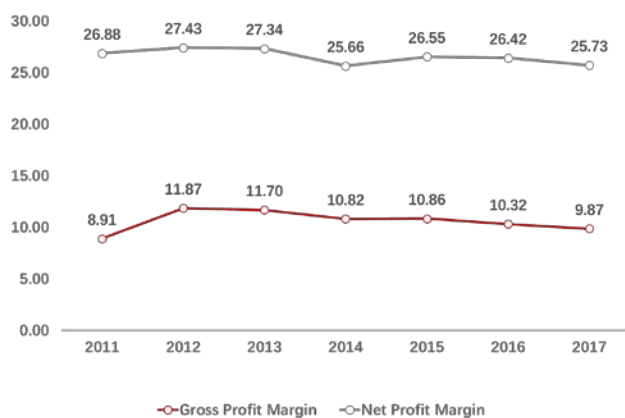
Revenues and Earnings

In 2011-2017, the company income / net profit CAGR was 28.0%/30.4%, and the scale was expanding continuously. In 2017, the company achieved a net revenue/return of 6.36/630 million yuan, an increase of 36.35%/28.6% year-on-year. The expansion of the scale is mainly due to the steady growth of traditional stationery retail business and the rapid development of new office direct sales business.



Source: Company Annual Report 2016/2017

The company's profit margins has recently dropped slightly and profitability remained strong. In 2017, the company's gross margin / net interest rate was 25.73% / 9.87%, slightly lower; the sales cost was 8.97%, increased, mainly due to increase in brand investment, office direct sales, business warehousing and the increase of logistics. However, management cost rate decreased to 6.03% due to the optimization of the company's internal management mechanism.



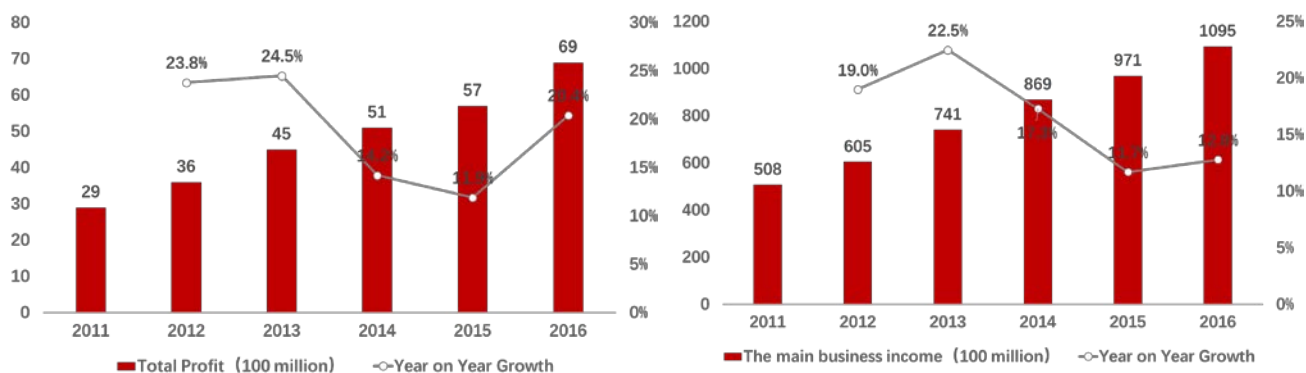
Source: Annual Report 2017

2-The Prospects of the Stationery Industry

The scale of the market is more than 100 billion yuan

The product categorization in the stationery industry includes writing tools, student stationery, office stationery, and other four categories supplies including various other sub-categories. According to the revenue and sales of stationery in M&G in 2007 the average factory price of most stationery products is less than 1 yuan which reflects a typical "small product" market. The target consumers of these stationary products include over 200 million students and about 100 million office workers.

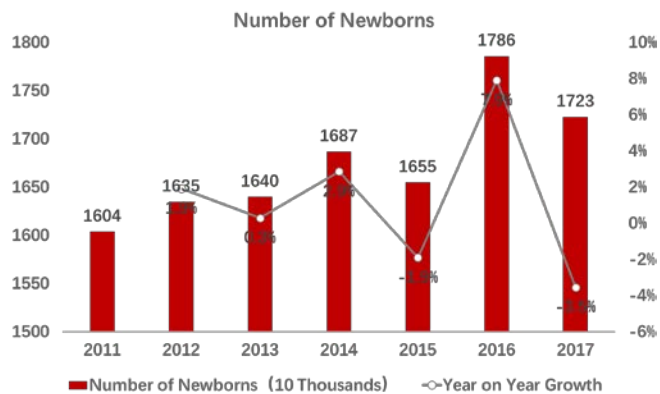
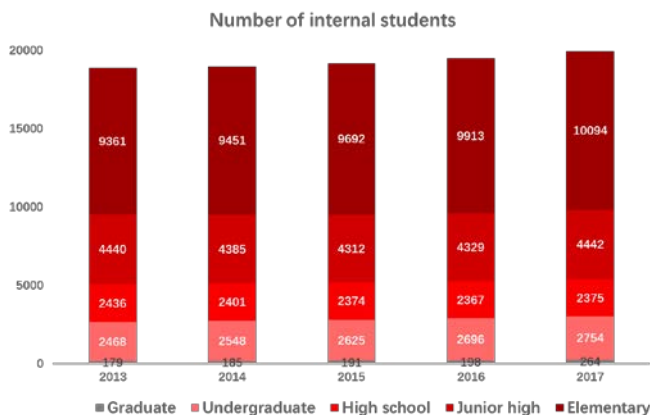
According to the statistics of the State Bureau of Statistics, in 2016, the total business income/profit of enterprises with cultural and educational office supplies increased from 20 million yuan to 109.5/69 billion yuan, which is an increase of 12.8%/20.4% over the same period of the same year. Considering a large number of small and medium-sized stationery enterprises in the market, it is estimated that the current market size is far beyond 120 billion yuan. From a growth rate perspective, after nearly 30 years of development, China's stationery industry has gradually entered a stable and mature stage.



Source: Prospectus

Number of students and newborns increases

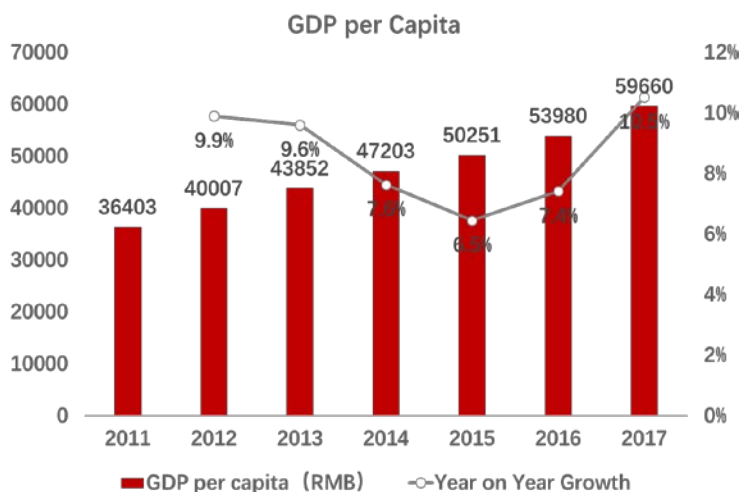
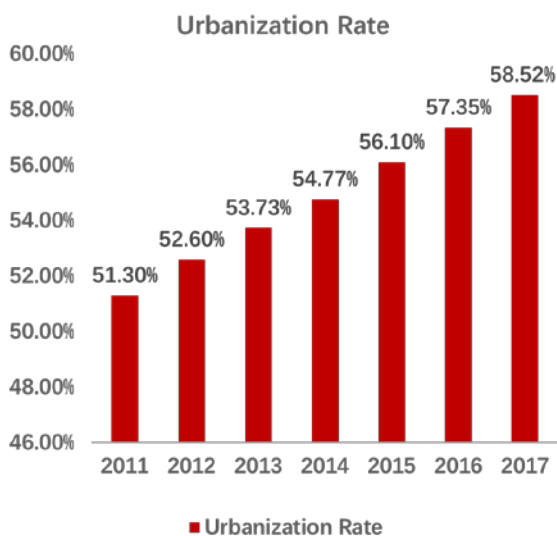
Statistics from the National Bureau of Statistics show that the total number of students in primary, junior, senior and university schools in 2016 was 210 million, a slight increase of 1.08% compared with 2015. The number of students in school tends to stabilize, laying the foundation for the stock demand of the student stationery market. In addition, thanks to the liberalization of the child policy in China. This gives a potentiality of this market to increase even more. In 2016/2017, the number of new births in China reached 170/180/million . We expect a new peak in student stationery demand in the next two to three years as these newborns get educated.



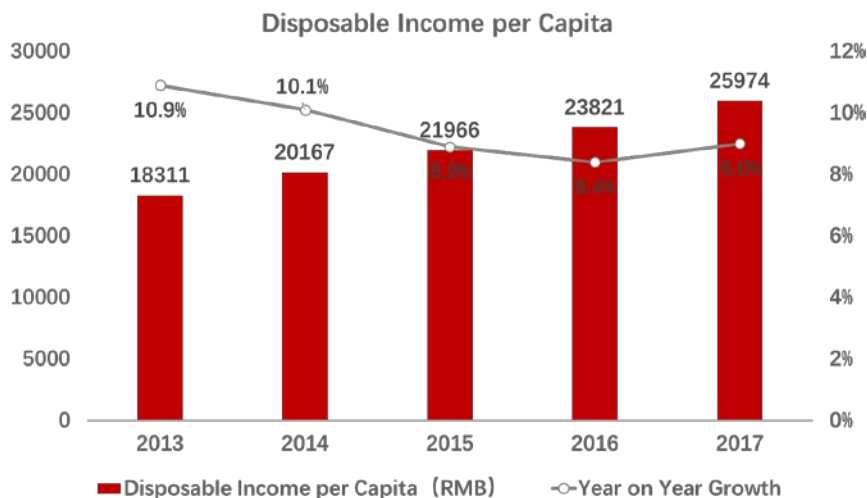
Source: State Statistical Bureau

Average Income in China will Increase in Future

According to the data of Competition Situation Analysis of China's Stationery Industry published by China Pen Association, the average consumption of stationery per capita in China is only 105 yuan per year, while the global average consumption level is about 240 yuan per year, and the average consumption per capita is less than half of the global average. According to the statistics of the State Bureau of Statistics, China's urbanization rate reached 58.5% in 2017, GDP per capita reached 59,000 yuan, and per capita disposable income of urban and rural areas was 32/11,000 yuan, respectively. People's living conditions are gradually improving. More attention is paid to education and culture, and the expenditure on cultural, educational and recreational activities will increase year by year.



Source: State Statistical Bureau



Source: State Statistical Bureau

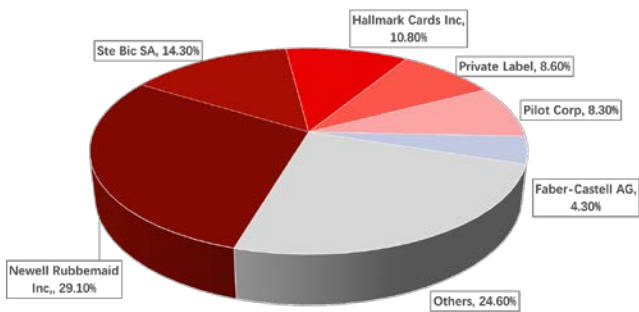
The Concentration of the Stationery Market will be Higher in the Future

According to the statistics of the Chinese Pen Industry Association, there are as many as 8,000 stationery manufacturers in China. 90% of stationery manufacturers have annual sales of less than 10 million yuan. On one hand, China's stationery industry started from imitating foreign products, which directly determined that no one enterprise has an absolute advantage in the product and the current competition is still mainly concentrated in low-end products where industry entry barriers are low, while on the other hand, stationery itself being a more stock keeping unit, and wide price band characteristics also make the follow-up market field development more dispersed.

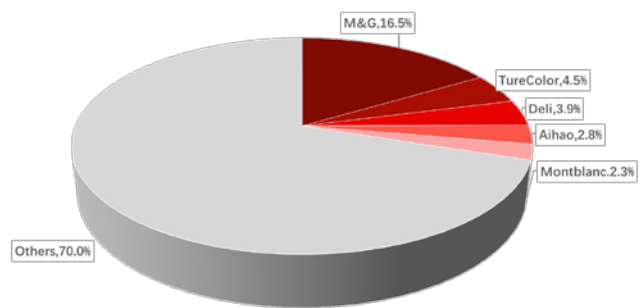


Main Stationery Enterprises in China

Source: Prospectus



The share of the USA's stationary market in 2015



The share of China's stationary market in 2015

Source: Prospectus

Writing tools started as an earliest form in China's stationary industry having the most perfect development system of the sub-industry. However, the current concentration level is still lagging behind the United States. According to Euromonitor data, the CR5 of the American writing tool market reached 71.1% in 2015, while the CR5 of China in 2016 was only 30%, there is still much room for improvement.

3-M&G's strength: Products, Channels, and Brands

Products

The production side of the company adopts the mode of "independent production mainly, OEM outsourcing production supplemented" and attaches importance to technology research and development in product manufacturing. At present, the company has independently mastered the main links of writing tool manufacturing technology and applied to all kinds of product manufacturing on a large scale.

For instance, writing tools, painting sticks, correction tapes, and other products are produced independently while some office stationery, some student stationery, and other products of the OEM modes, raw materials procurement are selected from the industry's high-quality suppliers.

Channels

The company uses an exclusive sales system to cooperate closely with the distributors as long-term partners. This makes the network efficient and stable, using exclusive sales system to cooperate closely with distributors, as a long-term stable partner, and strive to ensure the best interests of distributors.

- I. **Clear Distributor System:** At present, there are 31 first-class (provincial) partners, nearly 1200 second and third class, and the profit distribution system of “layer-by-layer input, layer-by-layer sharing” is clear and reasonable. The company only cultivates channel distributors in each regional market, forming a stable cooperative relationship.
- II. **Strict Assessments in Product exclusion:** The phenomenon of fleeing goods, terminal price system is strictly managed into the KPI assessment in order to achieve “exclusive” management, this strategy avoids competition between dealers while at the same time realizing the benefits of bundling.

In the construction of terminal network, the company through brand authorization and service support to complete the high coverage around the school at a lower cost, and through franchise stores to upgrade and constantly strengthen the quality of single store operation.

- I. **Rise in the coverage rate of school-side stores:** At present, the company has more than 76,000 retail terminal stores. The coverage rate of school-side business circles in China has reached more than 80%. The strengthening of terminal control is expected to expand the market share of its own products through exclusive sales policies.
- II. **Adopts a three-stage ladder retail terminal layout:** M&G transforms it into a standard model store by investing a small amount of money to provide store recruitment to ordinary stores. Chengguang rapidly increases market coverage at a lower cost, and then upgrades the income level of single stores through standard model stores to advanced model stores and then to franchise stores in a step by step process of infiltration.

Brands

Through years of marketing and brand promotion, Morning Stationery is currently a leader of the industry in terms of consumer mention rate, reputation and market positioning.

M&G's brand image and reputation in the business circle expanded much rapidly as it allowed ordinary stationery companies to provide signs printed with morning stationery trademarks freely further making teaching products reasonable in the product placement.

4-Valuation

We are projecting a target price of RMB 33.52 from the current market price of RMB 29.35(as on 12-Oct-2018) on SSE, giving the stock an upside of 14% in 12-month period. For Discounted cash flow we have arrived at Weighted Average Cost of Capital(WACC) of 7.66%. For WACC, we calculated Cost of Equity (COE) using the Risk Free Market rate(Rf) of 3.61% which is the current prevalent 10-year government bond rate and Market return rate (Rm) of 8%, which is estimated by many institutes. Beta value is 1.151 considering 3 year of market volatility. Cost of Debt is taken as 5.68% which is estimated by Tinysoft. Debt/Equity ratio for M&G stands at 0.51 as of Jun 2018. The stationary industry has big growth potential in the future, so we believe that as a company having a strong competitive edge in the industry, M&G will be able to grow with a terminal/horizon growth rate of 4%.

DCF SUMMARY

Particulars	Amount (RMB mn.)
WACC	7.62%
COE	8.61%
Beta	1.138
D/E Ratio	0.51
Cost of Debt	5.68%
Total DCF for 3 years	2428.59
Discounted Terminal value	28407.99
Total Value	30836.58
Number of shares (in millions)	920
Value per share (RMB)	33.52