

Hengan (1044.HK)

Sanitary napkin business is expected to improve in 2H, e-commerce and other businesses grow fast

China | Consumer | Company report

6 November 2019

Investment Summary

Investment Highlights

Its interim revenue of FY2019 increased by 6.3% y.o.y., mainly driven by tissue paper and the other businesses. The sanitary napkin business was down 4.6% due to the impact of traditional channel reform, which is in line with our expectations. Traditional channel accounted for over 60% of sanitary napkin revenue. During the period, the company increased its efforts to transform the traditional sales channels, encourage small sales team to sell products directly to retailers and provide upgraded and premium products.

Although the reform has brought about an adjustment period to the sanitary napkin business, it is beneficial to business in the long run. At the same time, the business will be repositioned as feminine care product business, the new product line including cotton pads and makeup remover will be launched in the near future, and the mask will also be launched in 2H of this year.

During the period, GPM decreased by 2.3 ppt y.o.y. to 37.3%, mainly due to the increase in percentage share of other business, which is with lower GPM, by 3.7 ppt to 13.8%. Thanked to the fall in the price of wood pulp, GPM of the tissue paper business was only slightly reduced by 0.8 ppt y.o.y. to 25%.

We expect that the price of wood pulp will continue to fall and be at a low level in 2H of the year, and Hengan will continue to optimize the product mix and increase the proportion of high-margin products, offsetting the negative impact of increased market competition and potential depreciation of the RMB. We expect that GPM of the tissue paper business will improve significantly in 2H of the year. During the period, brand promotion was intensified, resulting in an increase of the percentage share of distribution costs and administrative expenses by 1.6 ppt y.o.y. to 18.8%.

The management team still maintains the guidance of mid-to-high single digit growth in revenue and tissue paper business this year. It also expects as the price of wood pulp falls, the price war of low-priced products such as roll paper will be more intense to seize market share in 2H. It plans not to directly reduce the product price, but will launch promotion activities.

In 1H, sales of e-commerce platforms for paper towels and disposable diapers were strong, driving the former's revenue grew by 7.4%, and the latter's decline narrowed to 7.4%. E-commerce platform accounted for over 40% of the sales of disposable diapers, and sales of e-commerce channel increased by more than 10% y.o.y. The overall e-commerce business revenue increased by more than 50% y.o.y., and the contribution to overall revenue increased by 6.1 ppt. to 19.4%. We maintain Buy rating with a target P/E of 18x and a target price of 70.6. (current price as of November 4, 2019)

Buy

CMP HKD56

(Closing price at 4/11/2019)

TARGET HKD 70.6(+26.1%)

COMPANY DATA

O/S SHARES (MN)	1189
MARKET CAP (HKDMN)	66622
52 – WK LO/HI (HKD)	48.6/72.4

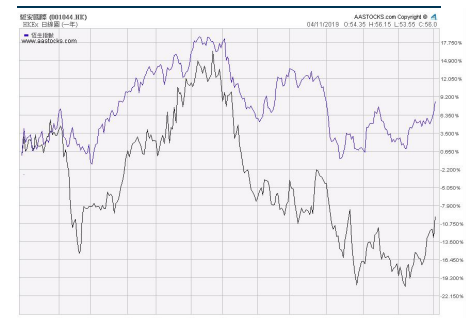
SHARE HOLDING PATTERN, %

Director Hui Lin Chit	20.32
Director Szeman Bok	19.82

PRICE PERFORMANCE, %

	1M	3M	1Y
Hengan	11.1	-1.1	-10.3
HSI	6.7	5.3	6.2

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18	FY19E	FY20E
Net Sales	20514	22155	23706	25128
Net Profit	3800	4156	4602	5048
EPS, RMB	3.2	3.5	3.9	4.2
PER, x	15.8	14.3	12.9	11.8
BVPS, RMB	14.1	15.3	16.5	17.8
P/BV, x	3.5	3.2	3.0	2.8
ROE, %	22.4%	24.1%	25.0%	25.7%

Source: Company reports, Phillip Securities Est.

Tracy Ku (2277 6516)
tracyku@phillip.com.hk

Investment Thesis, Valuation & Risk

We maintain Buy rating with a target P/E of 18x and a target price of 70.6. The risks that need to be watched include top-line growth rate missing from expectation, wood pulp prices fluctuating sharply, industry competition increasing significantly, and Ameba units missing sales target. (current price as of 4th November, 2019)

Figure: Historical P/E ratios



Source: Bloomberg, Phillip Securities

Financials

FYE	2017	2018	2019E	2020E	2021E
Valuation Ratios					
Price to Earnings (P/E)	15.8	15.8	14.3	12.9	11.8
Price to Book (P/B)	3.7	3.5	3.2	3.0	2.8
Per Share Data (RMB)					
EPS	3.1	3.2	3.5	3.9	4.2
Book Value Per Share	13.6	14.1	15.3	16.5	17.8
Dividend Per Share	2.1	2.2	2.4	2.7	3.0
Growth (%)					
Revenue	NA	13.5%	7.0%	6.0%	5.0%
Operating Income	NA	3.0%	8.5%	9.8%	8.9%
Net Profit	NA	0.1%	9.4%	10.7%	9.7%
Margins (%)					
Gross Profit Margin	41.8%	38.2%	38.7%	39.2%	39.7%
Operating Profit Margin	29.2%	26.5%	26.6%	27.3%	28.0%
Net Profit Margin	21.0%	18.6%	18.8%	19.4%	20.1%
Key Ratios					
ROE (%)	23.3%	22.4%	24.1%	25.0%	25.7%
ROA (%)	9.8%	8.3%	9.0%	9.3%	9.6%
Income Statement (RM)					
Revenue	18080	20514	22155	23706	25128
- Cost of Goods Sold	-10526	-12678	-13582	-14414	-15153
Gross Income	7554	7836	8573	9292	9975
-Operation Expenses	-3422	-3469	-3747	-3890	-3998
Operating Income	5272	5429	5889	6464	7040
Pretax Income	4961	4904	5365	5939	6515
- Minority Interest	7	7	8	9	10
Net Profit	3794	3800	4156	4602	5048

Source: Company, Phillip Securities (HK) Research Estimates
Exchange rate assumption is 0.8905
(Financial figures as at 4th November 2019)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005