

Hengan (01044.HK)

1H2022 sales growth above market expectation,
gross margin is expected to remain under pressure
China | Consumer

15 November 2022

Company Profile

Hengan founded in 1985, is a famous manufacturer of household paper and maternal & child hygiene products. The market shares of the three leading products, namely women's sanitary napkins, baby diapers, and household tissues, is among the best in the domestic market.

1H2022 sales bucked the trend and achieved growth of over 10%

For the six months ended 30 June 2022 (1H2022), Hengan's revenue increased by about 12.3% to RMB11,200.021mn, above market expectation. During the period, operating profit fell about 25.8% to RMB1885.753mn (1H2021: RMB2540.583mn). Although the Hengan's sales bucked the trend and achieved growth of over 10%, the striking depreciation of the RMB against the US dollar and HK\$ during the period resulted in a significant foreign exchange loss in the Hengan's operations (RMB367.797mn). Therefore, profit attributable to shareholders was RMB1,276.191mn (1H2021: RMB1,860.292mn), representing a decrease of 31.4% YoY. If deducting the operating foreign exchange loss, profit attributable to shareholders decreased by 10.9% YoY instead. Basic EPS was RMB1.098 (1H2021: RMB1.574), with an interim dividend decreased by 30% YoY to RMB0.70 per share (1H2021: RMB1.00).

During the period under review, rising raw material prices and operating costs have brought enormous pressure to the industry, which accelerated market consolidation of eliminating the weak and retaining the strong. The price of wood pulp, the main raw material of tissue paper, remained high during the period due to geopolitical upheavals, the epidemic and inflation. Overall gross profit slightly increased by 0.3% to RMB3,942.191mn (1H2021: RMB3,930.671mn), however, the overall gross profit margin dropped to 35.2% (1H2021: 39.4%).

By business segment, the sales of sanitary napkin business grew 3.3% to RMB3128.524mn (1H2021: RMB3029.97mn), accounting for around 27.9% (1H2021: 30.4%) of the Hengan's total revenue. However, the surge in petroleum and commodity prices has led to a price hike in petrochemical raw materials used in sanitary napkins, resulting in a YoY decrease of 4.7 percentage points in the gross profit margin of the sanitary napkin business to 65.3% (1H2021: 70.0%).

Although the coronavirus epidemic broke out in many regions, with the re-emergence of the epidemic, the national health awareness has further improved, and the demand for tissue paper continued to be strong. Meanwhile, as small and medium-sized tissue paper companies cannot withstand the soaring costs which affect their business development, Hengan has gained more market shares leveraging its strong capital strength and nationwide sales network. Thus, the revenue of Hengan's tissue paper business increased substantially by close to 25.0% to RMB5,842.612mn (1H2021: RMB4,696.522mn), accounting for 52.2% of the overall revenue (1H2021: 47.1%). However, affected by the sharp surge in wood pulp prices due to the tight supply of wood pulp and logistical disruption. High wood pulp prices exerted enormous pressure on the Hengan's gross profit in 1H2022, and the gross profit margin dropped to approximately 23.1% (1H2021: 29.2%).

Accumulate

CMP HKD32.90
(Closing price as of 10 November)
Target HKD 37.90 (+15.2%)

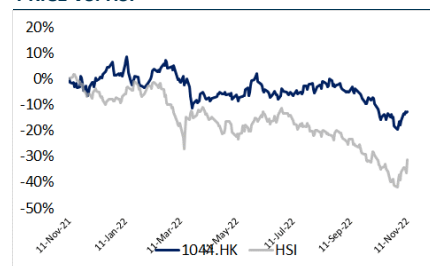
COMPANY DATA

O/S SHARES (MN) :	1162.120917
MARKET CAP (HKD MN) :	38233.8
52 - WK HI/LO (HKD):	41.73/30.10

SHARE HOLDING PATTERN, %

Mr. Hui Lin Chit	23.14%
Mr. Sze Man Bok	20.57%

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY21	FY22	FY23E	FY24E
Revenue	22,374	20,790	22,913	23,747
Net profit	4,595	3,274	3,286	3,849
Reported EPS	3.86	2.79	2.82	3.33
P/E ratio, x	7.1	9.6	10.7	9.1
Dividend Yield, %	8.8%	6.3%	5.9%	6.9%

Source: Company reports, Phillip Securities Est.

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The sales of the Hengan's disposable diaper business rebounded, and the revenue increased by 2.2% to RMB633.513mn (1H2021: RMB619.668mn), accounting for 5.7% of the overall revenue (1H2021: 6.2%). As significant rise in the cost of sales caused by the price increase in petrochemical raw materials for disposable diapers during the period, but the increase in the proportion of sales of higher-margin "Q • MO" products offset part of the impact of rising costs on the overall business profitability. Thus, the gross profit margin of the disposable diapers business only dropped slightly to about 35.3% (1H2021: 36.2%).

Regarding other income and household products, the Hengan's revenue decreased by 2.0% YoY to RMB1595.372mn (1H2021: RMB1627.754mn), accounting for 14.2% of the overall revenue (1H2021: 16.3%). In which, medical products do not account for a significant portion of the overall revenue, but medical products have higher profit margin, which effectively increased the overall gross profit margin of other businesses by 7.2 percentage points to 20.4% (1H2021: 13.2%).

E-commerce channels maintained strong momentum

E-commerce channels (including Retail Integrated and New Channel) maintained a strong development momentum and the sales during the period soared over 30.0% to RMB2710.405mn (1H2021: RMB2004.757mn), accounting for 24.2% of the overall sales (1H2021: 20.1%). In which, other new sales channels (including online-to-offline (O2O) platform, community group-buying, etc.), with sales accounting for more than 10.0% of the overall sales. The tissue paper sales in e-commerce channel increased by more than 30.0%, accounting for more than 21.0% of the sales of tissue paper. Hengan's strived to strengthen the development of e-commerce and maternity sales channels. The proportion of sales of disposable diapers through e-commerce and maternity channels increased to more than 50.0% and more than 20.0%, respectively. The turnover of overseas channel (including Wang-Zhang Group business) was RMB1072.226mn (1H2021: RMB883.319mn), accounting for 9.6% of the overall sales (1H2021: 8.9%).

Investment Thesis

Since the overall operating environment was very challenging, and under the impact of lockdown and epidemic control measures, consumer sentiment in Mainland China became more cautious in the light of the epidemic. In addition, geopolitical upheavals affected the supply chain and exacerbated the rise in inflation, and given that the price of wood pulp is currently at a high level and the future trend is still uncertain, it is expected that the Hengan's gross profit margin will continue to be under pressure in 2H2022. However, part of the related downside and earnings risk may have already priced-in. Rising raw material prices and operating costs have brought enormous pressure to the industry, which accelerated market consolidation of eliminating the weak and retaining the strong. Meanwhile, Hengan's multi-channel sales development has certain advantages, upgraded products and premium product series can offset some of the impact of the spike in raw material prices, and the national health awareness has further improved, that Hengan's business still considered defensible and resilience to buck the trend. We expect FY2022E-FY2023E EPS to be RMB2.82 and RMB3.33 respectively, with PT of HKD37.90, implies a FY2022E P/E of 12.3x (~5-yrs historical average and one standard deviation below). Our investment rating is "Accumulate".

Risk factors

1) The price of raw materials continues to rise; 2) market competition intensifies; 3) channel development is not as expected; and 4) Sharp fluctuations in FX.

Financial

Consolidated Statement of Profit or Loss

Dec Y/E, RMB mn	FY19	FY20	FY21	FY22E	FY23E
Revenue	22,493	22,374	20,790	22,913	23,747
COGS	(13,804)	(12,918)	(13,018)	(14,821)	(14,980)
Gross Profit	8,689	9,456	7,772	8,093	8,767
Selling expenses	(3,203)	(3,469)	(3,154)	(3,624)	(3,679)
General & Admin exp	(1,285)	(1,364)	(1,373)	(1,469)	(1,513)
Others	1,479	1,769	1,298	1,619	1,680
Operating Profit	5,680	6,392	4,544	4,618	5,255
Finance costs, net	(633)	(426)	(171)	(285)	(191)
Share of result of a JV	-	(4)	(43)	(48)	(49)
Profit before tax	5,047	5,961	4,330	4,286	5,015
Income tax	(1,130)	(1,353)	(1,039)	(987)	(1,148)
Shareholders Net profit	3,908	4,595	3,274	3,286	3,849
Reported EPS, Diluted	3.28	3.86	2.79	2.82	3.33
DPS	2.48	2.90	2.06	1.77	2.09
Payout ratio	76%	75%	74%	63%	63%
Shares outstanding	1,190	1,189	1,175	1,165	1,157

Key Financial Data

Dec Y/E	FY19	FY20	FY21	FY22E	FY23E
Valuation Ratio					
P/S ratio, x	1.6	1.5	1.5	1.5	1.5
P/E ratio, x	9.0	7.1	9.6	10.7	9.1
Dividend Yield, %	7.5%	8.8%	6.3%	5.9%	6.9%

Per share data (HKD)

EPS	3.67	4.61	3.41	3.08	3.63
BVPS	16.79	19.46	19.84	18.58	19.97
DPS (HKD)	2.48	2.90	2.06	1.93	2.28

Growth & Margin

Growth					
Revenue Growth	9.6%	-0.5%	-7.1%	10.2%	3.6%
Gross Profit Growth	10.9%	8.8%	-17.8%	4.1%	8.3%
Operating Profit Growth	4.6%	12.5%	-28.9%	1.6%	13.8%
Net Profit Growth	2.9%	18.1%	-27.4%	-1.0%	17.0%
Margin					
Gross Profit Margin	38.6%	42.3%	37.4%	35.3%	36.9%
Operating Profit Margin	25.3%	28.6%	21.9%	20.2%	22.1%
Net Profit Margin	17.4%	20.5%	15.7%	14.3%	16.2%

Key Ratios

ROE	22.2%	24.3%	16.8%	16.7%	18.5%
ROA	8.8%	10.5%	7.5%	7.7%	8.8%

Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY19	FY20	FY21	FY22E	FY23E
Non Current Asset					
PPE	7,822	7,571	7,297	7,339	7,437
Others	5,348	6,928	7,727	7,694	7,660
Total Non Current Assets	13,170	14,499	15,024	15,033	15,097
Current Asset					
Inventory	3,802	4,311	4,162	4,842	4,774
Trade and other receivables	3,651	3,375	2,970	3,483	3,530
Bank balance and cash	20,540	20,484	18,247	18,083	18,644
Others	2,074	1,772	1,890	1,903	1,914
Total Current Assets	30,068	29,941	27,269	28,311	28,862
Total Assets	43,239	44,441	42,293	43,344	43,959
Non Current Liabilities					
Long-term debt	1,247	2,493	739	722	523
Other Non-current Liabilities	176	225	235	221	205
Total Non-current Liabilities	1,423	2,718	975	943	728
Current Liabilities					
Interest-bearing Borrowings	20,361	18,344	17,488	17,470	16,873
Trade payables	2,224	2,244	2,565	2,819	2,930
Others	1,079	1,474	1,984	2,004	1,964
Total Current Liabilities	23,664	22,062	22,037	22,293	21,768
Equity					
Shareholders' equity	17,873	19,411	19,037	19,851	21,190
Non-controlling interests	279	250	243	257	274
Total equity	18,152	19,661	19,280	20,108	21,464
Total Liabilities and Equity	43,239	44,441	42,293	43,344	43,959

Consolidated Statement of Cash Flow

Dec Y/E, RMB mn	FY19	FY20	FY21	FY22E	FY23E
CFO					
Profit before income tax	5,047	5,961	4,330	4,286	5,015
D&A add-back	816	837	871	761	750
Others	(1,353)	(1,918)	(1,378)	(1,445)	(1,763)
Net (inc)/dec working capital	(1,094)	161	781	(940)	133
Net cash flow from operating activities	3,416	5,042	4,604	2,663	4,135
CFI					
Purchase of PP&E	(898)	(761)	(781)	(771)	(813)
Others	2,012	2,317	3,457	2,103	2,567
Net cash flow from investing activities	1,113	1,556	2,676	1,331	1,753
CFF					
Dividends paid	(2,617)	(2,915)	(2,706)	(1,997)	(2,065)
Others	(3,921)	(1,015)	(3,781)	(1,111)	(1,773)
Net cash flows from financing activities	(6,539)	(3,929)	(6,487)	(3,108)	(3,838)
Net Change in Cash	(2,009)	2,668	793	886	2,050
Cash and CE at Y/E	9,120	11,607	12,340	13,226	15,276

Current Price as of: November 10

Source: PSHK Est.

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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