

Hengan (01044.HK)

FY2023 records solid growth,
premium high margin products continue to experience significant growth
China | Consumer

7 June 2024

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.

FY2023 still records solid growth

For the year ended 31 December 2023 (FY2023), Hengan's revenue increased by 5.1% to RMB23,768mn, above market expectation. During the year, operating profit increased significantly by 38.6% to RMB3,978mn (FY2022: RMB2,869mn). Although the depreciation of the Renminbi against the US dollar and the HK dollar during the year resulted in an operating foreign exchange loss after tax of RMB150mn, the loss was significantly reduced by about 83.6% compared with the operating FX loss before tax of RMB901mn in 2022. Therefore, profit attributable to shareholders of the Company was RMB2,801mn (FY2022: RMB1,925mn), representing a significant yoy increase of 45.5%. Excluding the operating FX loss after tax, profit attributable to shareholders of the Company increased by 4.3% yoy, mainly reflecting the improvement in the company's gross profit margin as a result of the decline in the cost of wood pulp and upgrades of products. Basic EPS was RMB2.415 (FY2022: RMB1.657), with full-year dividend RMB1.40 per share, unchanged yoy.

Buy

CMP HKD26.55
(Closing price as of 4 June)
Target HKD 35.18 (+32.5%)

COMPANY DATA

O/S SHARES (MN) :	1162.120917
MARKET CAP (HKD MN) :	30854.3
52 - WK HI/LO (HKD):	34.016.73/21.778

SHARE HOLDING PATTERN, %

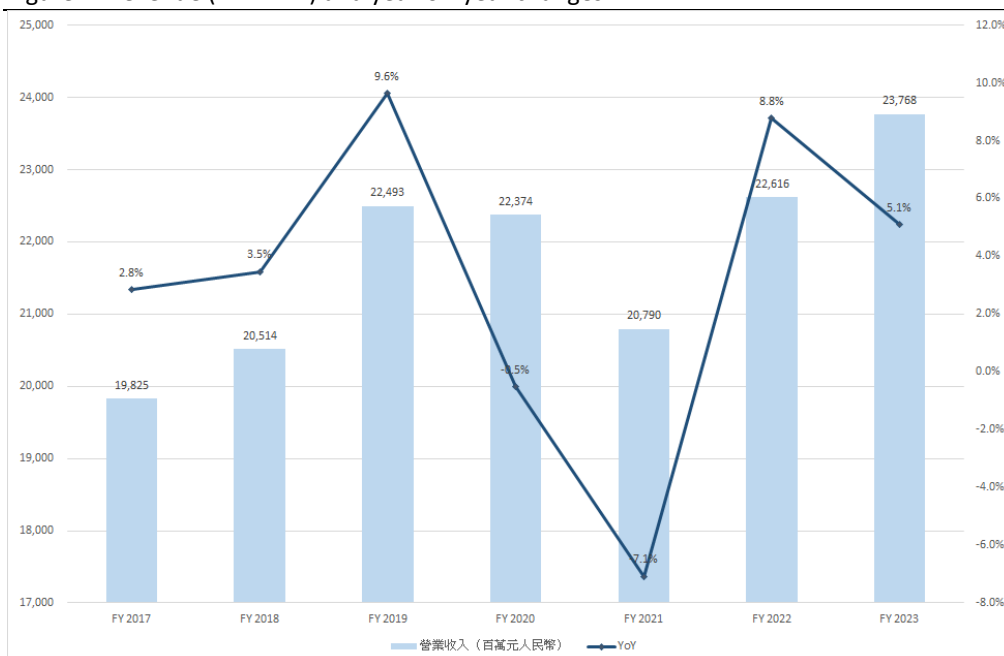
Mr. Hui Lin Chit	23.14%
Mr. Sze Man Bok	20.59%

PRICE VS. HSI



Source: Phillip Securities (HK) Research

Figure 1: Revenue (RMB mn) and year-on-year changes



Source: company financial report, PSHK

KEY FINANCIALS

RMB mn	FY22	FY23	FY24E	FY25E
Revenue	22,616	23,768	25,349	26,753
Net profit	1,925	2,801	3,186	3,443
Reported EPS	1.7	2.4	2.8	3.0
P/E ratio, x	14.2	10.0	8.7	8.0
Dividend Yield, %	6.1%	5.8%	5.7%	5.7%

Source: Company reports, Phillip Securities Est.

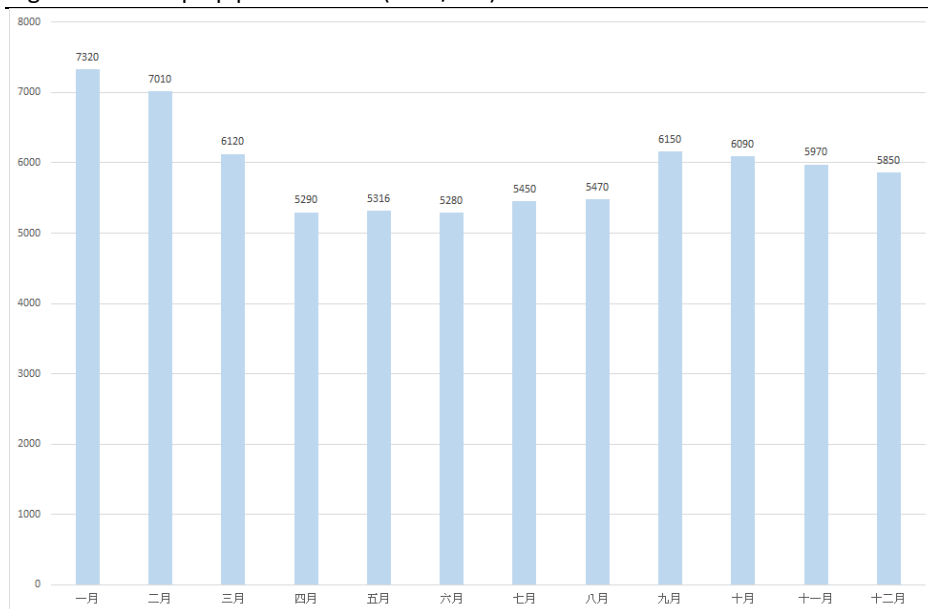
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During the year under review, raw material prices dropped in the second half of the year, leading to intensified market promotions and price competition. The decline in the price of wood pulp, the main raw material for tissue paper, in the second half of the year compared to the first half of the year, coupled with the robust growth in the company's upgraded products and premium product series resulted in a significant improvement in the gross profit of the tissue paper business. FY2023, the company's overall gross profit increased by 4.2% to RMB8,011mn (FY2022:RMB7,689mn). Although the gross profit margin was under pressure in the 1HFY2023, the overall gross profit margin for the full year still recorded at 33.7% (FY2022: 34.0%), almost consistent with last year. Gross profit the 2HFY2023 even significantly improved to 36.5% (2HFY2022: 32.8%). It is expected that in 2024, premium high margin products will continue to experience significant growth, leading to a continuous improvement in the gross profit margin.

Figure 2: Wood pulp price in 2023 (RMB/ton)



Source: 100ppi, PSHK

By business segment, despite fierce market competition and aggressive pricing and promotional strategies of other brands, the revenue of the company's sanitary napkin business increased by 0.4% to RMB6,178mn (FY2022: RMB6,156mn), accounting for 26.0% (FY2022: 27.2%) of the Group's overall revenue, outperforming the sales performance in the overall sanitary napkin industry. Benefiting from brand premiumisation and the steady increase in the proportion of upgraded products, as well as the decline in the price of petrochemical raw materials, the main raw material for sanitary napkins in the second half of the year compared with the first half of the year, the gross profit margin of the sanitary napkin business stood at 66.0% in the 2HFY2023, representing an improvement from 61.8% in the 1HFY2023, while the overall gross profit margin in FY2023 was 63.8%, decrease 3 percentage points yoy.

For the company's tissue paper business, the revenue increased remarkably by 12.2% to RMB13,748mn (FY2022: RMB12,248mn), outperforming the industry's average growth rate and maintaining a leading market share. The sales of the tissue paper business accounted for 57.8% of the company's overall revenue (FY2022:54.2%). Although the company moderately increased promotions in the 2HFY2023, resulting in higher promotional expenses, it benefited from product upgrades and the increased proportion of high-margin products, as well as a drop in wood pulp costs. As a result, the gross profit margin for the 2HFY2023 improved significantly from

17.7% in the 1HFY2023 to 26.1% (2HFY2022: 18.5%), while the gross profit margin for 2023 increased to 21.7%, (FY2022: 20.7%). The company's upgraded and premium tissue paper products achieved outstanding sales. Among them, the sales of the "Cloudy Soft Skin" series recorded sales of more than RMB1.30 billion, increased by around 26.6% and accounting for 12.0% of the overall tissue paper sales. In terms of the company's wet wipes business, the sales for the year were RMB931mn (FY2022:RMB842mn), recording a sales growth of nearly 10.5%, accounting for 6.8% of the overall sales of the tissue paper business (FY2022: 6.9%).

The sales of the company's disposable diaper business increased by 4.3% to RMB1,254mn (FY2022: RMB1,202mn), accounting for 5.3% (FY2022: 5.3%) of the company's overall revenue. In terms of gross profit margin, the price decrease in petrochemical raw materials for disposable diapers in the second half of the year led to an decrease in costs of sales, coupled with the increase in the proportion of sales of the higher-margin "Q · MO" products and premium adult disposable diapers helped increase the gross profit margin to more than 40.0% in the 2HFY2023, which is a significant improvement from 36.0% in the 1HFY2023. The gross profit margin of the diaper business in 2023 rose to 38.1% (FY2022: 36.9%).

Regarding other income and household products, the company's revenue for the year, which mainly includes revenues from raw material trading business, household products business, and Wang-Zheng Group in Malaysia, decreased by 14.0% yoy to RMB2,587mn (FY2022: RMB3,009mn). The decline was mainly due to the company's preference to reserve raw materials for the manufacturing of products and ensure reasonable profits from its raw material trading business. As a result, revenue from raw material trading business dropped significantly by 13.6% to RMB1.4 billion (FY2022: RMB1.6 billion).

E-commerce channels maintained strong momentum

The company's e-commerce and new retail channels (including Retail Integrated and New Channel) sales for the year soared over 17.7% to RMB7.16 billion (2022: RMB6.1 billion), bringing the proportion of e-commerce sales up to 30.1% (2022: 26.9%) of the company's overall sales. During the year, the tissue paper business in e-commerce and new retail channels (including Retail Integrated, community group-buying, etc.), with a sales growth of 26.1%, accounting for nearly 35.3% of the overall sales of tissue paper; new retail channels contributed 26.5% and 52.8% of contribution to the sales of sanitary napkin business and disposable diaper business respectively.

Investment Thesis

Despite a challenging operating environment, Hengan leverages its strong comprehensive competitive advantages and effective profit-focused sales strategies to continue expanding its market share and further solidify its robust business resilience. The company's three core business segments—tissue paper, sanitary napkins, and diapers—have maintained steady growth in revenue over the past two years. The decline in raw material prices in the second half of last year intensified industry marketing and price competition. However, the company prudently allocated promotional resources and continued to record significant growth in high-end, high-margin products. Gross profit margins are expected to remain stable. Hengan maintains a healthy financial condition with a significant improvement in its debt ratio to 69.8%, placing it in a net cash position. We expect FY2024E-FY2025E EPS to be RMB2.77 and RMB3.01 respectively, with PT of HKD35.18, implies a FY2024E P/E of 11.6x (~5-yrs historical average). Our investment rating is "Buy".

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	FY21	FY22	FY23	FY24E	FY25E
Revenue	20,790	22,616	23,768	25,349	26,753
COGS	(13,018)	(14,926)	(15,757)	(16,301)	(16,959)
Gross Profit	7,772	7,689	8,011	9,048	9,794
Selling expenses	(3,154)	(3,369)	(3,553)	(3,783)	(3,996)
General & Admin exp	(1,373)	(1,519)	(1,516)	(1,578)	(1,723)
Others	1,298	68	1,036	661	693
Operating Profit	4,544	2,869	3,978	4,347	4,769
Finance costs, net	(171)	(22)	(373)	(181)	(277)
Share of result of a JV	(43)	(14)	-	-	-
Profit before tax	4,330	2,833	3,605	4,166	4,491
Income tax	(1,039)	(884)	(798)	(956)	(1,031)
Shareholders Net profit	3,274	1,925	2,801	3,186	3,443
Reported EPS, Diluted	2.8	1.7	2.4	2.8	3.0
DPS	1.7	1.4	1.4	1.4	1.4
Payout ratio	61%	85%	58%	51%	46%

Key Financial Data

Dec Y/E	FY21	FY22	FY23	FY24E	FY25E
Valuation Ratio					
P/S ratio, x	1.2	1.2	1.2	1.1	1.0
P/E ratio, x	7.8	14.2	10.0	8.7	8.0
Dividend Yield, %	7.8%	6.1%	5.8%	5.7%	5.7%

Per share data (HKD)

EPS	3.41	1.87	2.65	3.04	3.30
BVPS	19.84	18.95	19.28	20.41	21.60
DPS (HKD)	2.06	1.61	1.53	1.53	1.53

Growth & Margin

Growth					
Revenue Growth	-7.1%	8.8%	5.1%	6.7%	5.5%
Gross Profit Growth	-17.8%	-1.1%	4.2%	12.9%	8.2%
Operating Profit Growth	-28.9%	-36.9%	38.6%	9.3%	9.7%
Net Profit Growth	-28.8%	-41.2%	45.5%	13.8%	8.1%
Margin					
Gross Profit Margin	37.4%	34.0%	33.7%	35.7%	36.6%
Operating Profit Margin	21.9%	12.7%	16.7%	17.1%	17.8%
Net Profit Margin	15.7%	8.5%	11.8%	12.6%	12.9%

Key Ratios

ROE	16.8%	9.9%	13.9%	15.1%	15.5%
ROA	7.5%	4.5%	6.8%	8.0%	8.8%
Debt/Equity	95.7%	87.2%	69.8%	58.0%	45.0%
Current Ratio	1.2	1.4	1.4	1.5	1.6

Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY21	FY22	FY23	FY24E	FY25E
Non Current Asset					
PPE	7,297	7,099	7,256	7,550	7,634
Others	7,727	7,129	6,150	6,118	6,087
Total Non Current Assets	15,024	14,229	13,406	13,668	13,720
Current Asset					
Inventory	4,162	4,545	4,352	4,599	4,656
Trade and other receivables	2,970	2,932	2,553	3,005	3,550
Bank balance and cash	18,247	18,667	18,190	16,661	14,889
Others	1,890	1,964	1,715	1,769	1,836
Total Current Assets	27,269	28,109	26,810	26,033	24,930
Total Assets	42,293	42,337	40,216	39,701	38,650
Non Current Liabilities					
Long-term debt	739	2,001	330	148	125
Other Non-current Liabilities	235	166	195	173	151
Total Non-current Liabilities	975	2,167	526	322	276
Current Liabilities					
Interest-bearing Borrowings	17,488	15,029	13,907	12,267	10,005
Trade payables	2,565	2,921	2,750	3,020	3,207
Others	1,984	2,445	2,403	2,423	2,383
Total Current Liabilities	22,037	20,394	19,060	17,710	15,595
Equity					
Shareholders' equity	19,037	19,524	20,396	21,413	22,504
Non-controlling interests	243	252	234	258	275
Total equity	19,280	19,776	20,630	21,670	22,779
Total Liabilities and Equity	42,293	42,337	40,216	39,701	38,650

Consolidated Statement of Cash Flow

Dec Y/E, RMB mn	FY21	FY22	FY23	FY24E	FY25E
CFO					
Profit before income tax	4,330	2,833	3,605	4,166	4,491
D&A add-back	871	887	900	903	924
Others	(1,378)	(2,361)	(1,015)	(1,511)	(1,828)
Net (inc)/dec working capital	781	2,450	385	(428)	(415)
Net cash flow from operating activities	4,604	3,810	3,875	3,129	3,172
CFI					
Purchase of PP&E	(781)	(1,245)	(1,470)	(1,165)	(976)
Others	3,457	(4,821)	5,054	144	2,570
Net cash flow from investing activities	2,676	(6,066)	3,584	(1,021)	1,594
CF					
Dividends paid	(2,706)	(1,627)	(1,627)	(1,624)	(1,610)
Others	(3,781)	(2,510)	(3,922)	(2,845)	(3,410)
Net cash flows from financing activities	(6,487)	(4,137)	(5,549)	(4,469)	(5,021)
Net Change in Cash	793	(6,393)	1,910	(2,361)	(254)
Cash and CE at Y/E	12,340	6,089	8,022	5,661	5,407

Current Price as of: June 4

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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