

# Hengan International

Bloomberg: 1044 HK EQUITY | Reuters: 1044.HK

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DBS Group Research . Equity

12 Jul 2022

**HOLD** (Downgrade from BUY)

Last Traded Price (11 Jul 2022): HK\$36.25 (HSI: 21,124)  
Price Target 12-mth: HK\$38.72 (7% upside) (Prev HK\$43.71)

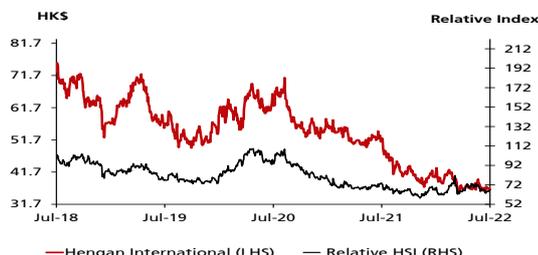
**Analyst**

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**What's New**

- Profitability remains under pressure given high raw material costs and escalating expenses
- Latest "618" festival scored a double-digit growth on prudent promotional costs proves Hengan's brand & product power
- Yet, margin challenge prompts our earnings cut. Downgrade to HOLD and revise TP to HK\$38.72

**Price Relative**



**Forecasts and Valuation**

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	22,374	20,790	21,745	22,786
EBITDA	5,869	3,709	3,758	4,049
Pre-tax Profit	5,961	4,330	4,199	4,456
Net Profit	4,595	3,274	3,171	3,366
Net Profit Gth (Pre-ex) (%)	17.6	(28.8)	(3.1)	6.2
EPS (RMB)	3.86	2.79	2.70	2.86
EPS (HK\$)	4.53	3.27	3.16	3.36
Core EPS (RMB)	3.86	2.79	2.70	2.86
Core EPS (HK\$)	4.53	3.27	3.16	3.36
EPS Gth (%)	17.6	(27.9)	(3.1)	6.2
Core EPS Gth (%)	17.6	(27.9)	(3.1)	6.2
Diluted EPS (HK\$)	4.53	3.27	3.16	3.36
DPS (HK\$)	2.93	1.98	2.06	2.18
BV Per Share (HK\$)	19.14	18.99	19.22	19.29
PE (X)	8.0	11.1	11.5	10.8
CorePE (X)	8.0	11.1	11.5	10.8
P/Cash Flow (X)	7.3	9.0	10.6	10.2
P/Free CF (X)	8.6	10.7	13.5	12.8
EV/EBITDA (X)	6.4	9.9	9.7	8.9
Net Div Yield (%)	8.1	5.5	5.7	6.0
P/Book Value (X)	1.9	1.9	1.9	1.9
Net Debt/Equity (X)	0.0	CASH	0.0	CASH
ROAE (%)	24.6	17.0	16.6	17.4
Earnings Rev (%)			(11.1)	(13.9)
Consensus EPS (RMB)			2.79	3.04
Other Broker Recs:		B:9	S:1	H:10

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

## Under pressure in the near-term

**Investment Thesis**

GP margin could only improve at a later stage. On the back of rising raw material costs and intense market competition, Hengan's GP margin decreased by 4.9ppt y-o-y to 37.4% in 2021. As prices of wood pulp and petrochemical materials remain at high levels, these could add pressure on 2022F profitability.

**New retail channel amongst the key drivers.** Revenue from e-commerce and new retail (e.g., O2O) accounted for 23.1% and c.10% of overall sales in 2021, respectively, and is expected to reach over 25% and over 10% this year. Continuous expansion in divisional sales should also fuel better performance ahead and support medium-term prospects.

**Big premiumisation trend.** More efforts towards high-end product innovation and brand building should support an expanding proportionate sales of premium products. Such initiatives should reinforce Hengan's overall growth potentials.

**Valuation:**

In view of high raw material costs and a low visibility in China's near-term economic performance, we take a more prudent view and revise down FY22F/23F earnings by 11.1%/13.9%. Our TP is lowered accordingly to HK\$38.72 as we continue to benchmark 12x FY22F PE, equivalent to 1SD below its average PE (previous TP: HK\$43.71).

**Where we differ:**

As raw material costs sustain at a high level while market competition stays intense, we expect the recovery of GP margin to take a slower pace. Our latest FY22F/FY23F GP margin are estimated at 36.2%/36.8% (FY21: 37.4%).

**Key Risks to Our View:**

Higher-than-expected raw material prices; failure to regain sales growth momentum; challenges to improve product-mix.

**At A Glance**

Issued Capital (m shrs)	1,162
Mkt Cap (HKm/US\$m)	42,762 / 5,448
Major Shareholders (%)	
Hui (Lin Chit)	23.1
Sze (Man Bok)	20.6
Artisan Partners Limited Partnership	6.0
Free Float (%)	50.3
3m Avg. Daily Val. (US\$m)	9.63
GICS Industry: Consumer Staples / Household & Personal Products	



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## Hengan International

### WHAT'S NEW

**Tissue segment.** We believe the tissue segment has achieved a high single-digit y-o-y growth for 1H22 as high-end tissue series continue to outperform, in line with company expectations. The retail price of Cloud Sense, Hengan's premium tissue brand, demands >10% higher average selling prices (ASP) vs. ordinary tissue categories and has sustained double-digit growth. At the same time, improving health awareness has also prompted decent growth for wet wipes at a similar magnitude. Overall, it is expected that high-end products will contribute to >20% of tissue revenue in 2022F, and around 30% within the next two years.

While its pulp inventory that were sourced at lower prices during 2H21 had depleted, pulp prices have also ascended by over 10% in recent months, laying greater pressure on GP margin. However, Hengan is able to realise ASP stability through product upgrades and better control on promotional costs to safeguard brand image. By and large, rising per capita consumption of tissue products, ongoing consumption upgrades, increasing product diversification, expanding high-end series, and the emphasis on product quality will become the key driving forces for further expansion in the tissue segment.

**Feminine care & diaper segments.** Hengan has achieved a dominant place in mid-end feminine care products in China, including a high market acceptance of its sanitary napkin products in the lower-tier cities. In recent years, there has been a clear demand for upgraded products and functional products, of which the company will explore growth opportunities strategically and continue to expand its operating scale across 1<sup>st</sup>-tier cities. More time could be

required for high-end brand building, and a single-digit revenue growth is expected for 2022F. Higher prices for petrochemical raw materials so far this year could lift cost pressure though.

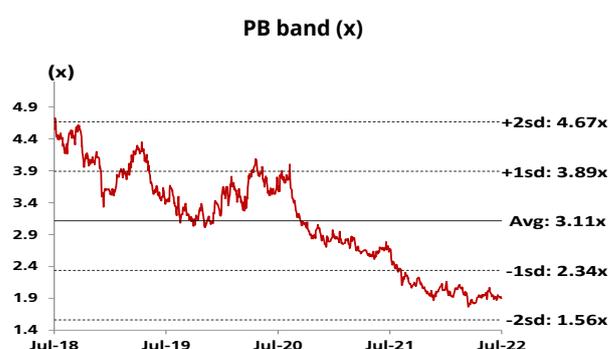
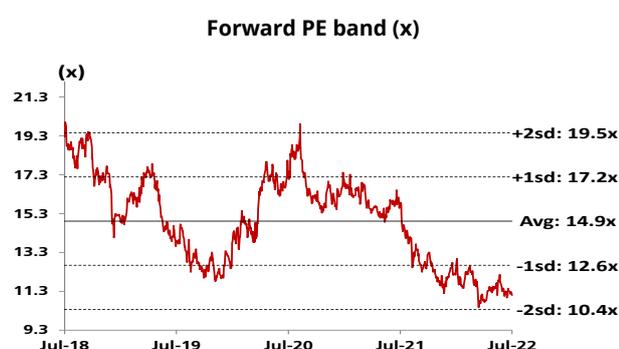
Turning to the diaper segment: given the more concrete product and brand image of Q•MO, the high-end product series that contributes >30% of diaper revenue, as well as an expected double-digit growth in incontinence products, the diaper segment could face a relatively less cost burden.

**2022 Outlook.** As prices of pulp and petrochemical materials linger at a high level YTD, Hengan's GP margin could remain under pressure. An increase in logistics / transportation costs and other SG&A expenses (e.g., staff option costs, marketing expenses), as well as RMB depreciation that results in forex losses (for sourcing; DPS payments, etc.) will further affect profitability this year. While we expect Hengan to achieve a single-digit growth in 2022F, its expansion in market share, sales channels, and high-end product-mix should reinforce good medium-term prospects.

### Company Background

Hengan is a manufacturer of personal hygiene products, including sanitary napkins, tissue paper, and disposable diapers. Its products are sold under well-known brands in China, such as Hearttex, Anler, Anerle, Elderjoy, etc. that ride on its well-established distribution network to foster better market share ahead.

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## Hengan International

### Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Tissue sales growth	12.3	(9.6)	(5.2)	6.0	6.0
Sanitary napkins sales growth	(1.6)	2.6	(8.1)	2.5	3.0
Disposable diapers sales growth	(6.3)	(0.9)	(14.5)	2.5	3.0
Others growth	42.8	27.0	(7.7)	5.0	5.0

Source: Company, DBS HK

### Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
<b>Revenues (RMB m)</b>					
Tissue	11,487	10,383	9,842	10,433	11,059
Sanitary napkins	6,487	6,655	6,117	6,269	6,458
Disposable diapers	1,439	1,426	1,219	1,250	1,287
Others	3,080	3,911	3,612	3,792	3,982
<b>Total</b>	<b>22,493</b>	<b>22,374</b>	<b>20,790</b>	<b>21,745</b>	<b>22,786</b>
<b>Gross Profit (RMB m)</b>					
Tissue	3,182	3,478	2,598	2,660	2,942
Sanitary napkins	4,560	4,751	4,312	4,326	4,520
Disposable diapers	583	565	460	460	487
Others	357	662	402	417	438
<b>Total</b>	<b>8,682</b>	<b>9,456</b>	<b>7,772</b>	<b>7,863</b>	<b>8,387</b>
<b>Gross Profit Margins (%)</b>					
Tissue	27.7	33.5	26.4	25.5	26.6
Sanitary napkins	70.3	71.4	70.5	69.0	70.0
Disposable diapers	40.5	39.6	37.7	36.8	37.8
Others	11.6	16.9	11.1	11.0	11.0
<b>Total</b>	<b>38.6</b>	<b>42.3</b>	<b>37.4</b>	<b>36.2</b>	<b>36.8</b>

Source: Company, DBS HK

## Hengan International

### Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	22,493	22,374	20,790	21,745	22,786
Cost of Goods Sold	(13,804)	(12,918)	(13,018)	(13,881)	(14,399)
<b>Gross Profit</b>	<b>8,689</b>	<b>9,456</b>	<b>7,772</b>	<b>7,863</b>	<b>8,387</b>
Other Opg (Exp)/Inc	(3,009)	(3,063)	(3,229)	(3,484)	(3,758)
<b>Operating Profit</b>	<b>5,680</b>	<b>6,392</b>	<b>4,544</b>	<b>4,380</b>	<b>4,628</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	(4)	(43)	(43)	(43)
Net Interest (Exp)/Inc	(633)	(426)	(171)	(137)	(129)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>5,047</b>	<b>5,961</b>	<b>4,330</b>	<b>4,199</b>	<b>4,456</b>
Tax	(1,130)	(1,353)	(1,039)	(1,008)	(1,070)
Minority Interest	(9)	(14)	(17)	(20)	(20)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>3,908</b>	<b>4,595</b>	<b>3,274</b>	<b>3,171</b>	<b>3,366</b>
Net Profit before Except.	3,908	4,595	3,274	3,171	3,366
EBITDA	5,327	5,869	3,709	3,758	4,049
<b>Growth</b>					
Revenue Gth (%)	9.6	(0.5)	(7.1)	4.6	4.8
EBITDA Gth (%)	(6.0)	10.2	(36.8)	1.3	7.7
Opg Profit Gth (%)	4.6	12.5	(28.9)	(3.6)	5.7
Net Profit Gth (%)	2.8	17.6	(28.8)	(3.1)	6.2
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	38.6	42.3	37.4	36.2	36.8
Opg Profit Margin (%)	25.3	28.6	21.9	20.1	20.3
Net Profit Margin (%)	17.4	20.5	15.7	14.6	14.8
ROAE (%)	22.6	24.6	17.0	16.6	17.4
ROA (%)	8.8	10.5	7.5	7.5	7.8
ROCE (%)	10.8	12.3	8.8	8.7	9.1
Div Payout Ratio (%)	68.5	64.6	60.7	65.0	65.0
Net Interest Cover (x)	9.0	15.0	26.6	31.9	35.9

Source: Company, DBS HK

## Hengan International

### Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	7,823	7,571	7,297	7,296	7,298
Invt in Associates & JVs	102	97	53	84	78
Other LT Assets	5,246	6,831	7,673	7,224	6,854
Cash & ST Invt	20,548	20,489	18,247	18,760	19,278
Inventory	3,803	4,311	4,162	4,221	4,261
Debtors	3,651	3,375	2,970	3,098	3,246
Other Current Assets	2,067	1,767	1,890	2,057	2,115
<b>Total Assets</b>	<b>43,239</b>	<b>44,441</b>	<b>42,293</b>	<b>42,740</b>	<b>43,131</b>
ST Debt	20,361	18,344	17,488	17,916	18,092
Creditors	2,224	2,244	2,565	2,738	2,840
Other Current Liab	1,079	1,474	1,984	1,483	1,619
LT Debt	1,247	2,493	739	887	813
Other LT Liabilities	176	225	235	230	235
Shareholder's Equity	17,873	19,411	19,037	19,263	19,329
Minority Interests	279	250	243	223	203
<b>Total Cap. &amp; Liab.</b>	<b>43,239</b>	<b>44,441</b>	<b>42,293</b>	<b>42,740</b>	<b>43,131</b>
Non-Cash Wkg. Capital	6,218	5,735	4,472	5,155	5,163
Net Cash/(Debt)	(1,061)	(348)	20	(43)	373
Debtors Turn (avg days)	52.7	57.3	55.7	50.9	50.8
Creditors Turn (avg days)	66.1	60.7	63.4	66.7	68.0
Inventory Turn (avg days)	104.3	110.2	111.6	105.5	103.3
Asset Turnover (x)	0.5	0.5	0.5	0.5	0.5
Current Ratio (x)	1.3	1.4	1.2	1.3	1.3
Quick Ratio (x)	1.0	1.1	1.0	1.0	1.0
Net Debt/Equity (X)	0.1	0.0	CASH	0.0	CASH
Net Debt/Equity ex MI (X)	0.1	0.0	CASH	0.0	CASH
Capex to Debt (%)	4.2	3.7	3.5	3.9	3.9
Z-Score (X)	3.1	3.3	3.4	3.4	3.4

Source: Company, DBS HK

### Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	5,047	5,961	4,330	4,199	4,456
Dep. & Amort.	(444)	(723)	(266)	(278)	(340)
Tax Paid	(1,130)	(1,353)	(1,039)	(1,008)	(1,070)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	33	15	0	0	0
Chg in Wkg.Cap.	(1,094)	161	755	(171)	(143)
Other Operating CF	1,004	980	244	680	662
<b>Net Operating CF</b>	<b>3,416</b>	<b>5,042</b>	<b>4,024</b>	<b>3,421</b>	<b>3,565</b>
Capital Exp.(net)	(898)	(761)	(640)	(729)	(732)
Other Invt. (net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	2,012	2,317	123	1,077	1,377
<b>Net Investing CF</b>	<b>1,113</b>	<b>1,556</b>	<b>(517)</b>	<b>348</b>	<b>645</b>
Div Paid	(2,617)	(2,915)	(1,989)	(2,061)	(2,188)
Chg in Gross Debt	(2,873)	(50)	(1,506)	175	(460)
Capital Issues	(808)	(788)	(912)	(770)	(820)
Other Financing CF	671	(177)	(909)	(650)	(273)
<b>Net Financing CF</b>	<b>(5,627)</b>	<b>(3,929)</b>	<b>(5,315)</b>	<b>(3,306)</b>	<b>(3,741)</b>
Currency Adjustments	61	(182)	(300)	50	50
Chg in Cash	(1,037)	2,487	(2,109)	513	518
Opg CFPS (RMB)	3.79	4.10	2.78	3.06	3.16
Free CFPS (RMB)	2.12	3.60	2.88	2.29	2.41

Source: Company, DBS HK

**Hengan International**

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	19-Aug-21	HK\$43.45	HK\$45.23	Hold
2:	9-Feb-22	HK\$39.70	HK\$47.32	Buy
3:	23-Mar-22	HK\$36.95	HK\$43.71	Buy

Source: DBS HK

Analyst: Mavis Hui  
Kay Tan

## Hengan International

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**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

Completed Date: 12 Jul 2022 16:20:54 (HKT)

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