

Hengan (1044.HK): TP Raised to HK\$98.60; Upgrade to Buy

Consumer Sector

25 March 2015

What's new. Hengan's FY14 EPS was up 5.4% y/y to HK\$3.18, 4% higher than market expectation on higher gross margin and subsidies income from government. A final dividend of HK\$1.15/share was declared, with total dividend of HK\$2/share for FY14, compared to HK\$1.85/share in FY13. While revenue growth continued to slow in 2H14, improving profitability was observed. Driven by decreasing raw material cost (particularly petrochemicals and wood pulp) in 2H14, gross margin increased 2ppts h/h, plus stable SG&A as % of revenue, EBIT was up 20% y/y in 2H14, with EBIT margin increased 4.5ppts h/h to 26.4% 2H14. We believe the margin expansion indicates clearer earnings growth outlook for Hengan. We raise our TP to HK\$ 98.60 (previously HK\$89.20) and upgrade the stock to Buy.

Sanitary napkins. The segment posted a solid 24% revenue growth in FY14 with 24% y/y increase in segment EBIT, which offsets the y/y EBIT decrease of the tissue paper and diaper segments. Gross profit margin improved 3ppts h/h to 70% in 2H14 thanks to soft petrochemical prices and further optimised product mix. Management expects growth to remain solid in FY15, given higher end products continue to deliver favourable sales growth. Additionally, management indicated that the overnight sanitary napkin product remains an untapped market in China. Sanitary napkin segment contributes 67% of Hengan's EBIT in FY14 (58% in FY13). The segment will be the main growth driver for Hengan, resulting in growth and margin expansion.

Diapers. Revenue growth in the diaper business slowed from 8% in 1H14 to 3% in 2H14 due to clearance of old low-end products, and segment EBIT dropped 11% y/y in FY14, partly due to higher initial expenses as the firm is penetrating maternity specialty stores and cooperating with online channels. Hengan's mid-range and mid-to-high-end products posted 11% sales growth in FY14 vs. 5% of overall segment revenue growth. We expect both growth and margin to further improve in FY15 on contribution from new channels, improving product mix and lower raw material cost in the diaper segment.

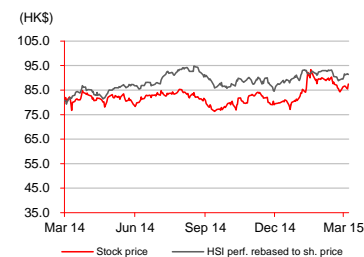
Tissue paper. Revenue growth slowed from 11% y/y in 1H14 to only 2% y/y in 2H14, as management prioritised probability over revenue growth without increasing promotions in 2H14. Soft wood pulp price in 2H14 and cutback on promotion helped EBIT margins stay at 8% in 2H14. In order to provide better service to distributors and boost sales growth, Hengan divided its sales force to tissue paper and non-tissue paper business. While we believe it is too early to call it a success, given revenue growth for the tissue business has been decreasing in the past three years, and overcapacity remains. After cutting back new capacity by half to 120k ton for FY14, Hengan halted its 240k ton of new tissue capacity in FY15, which indicated that the growth outlook remains uncertain.

Forecasts and valuation. We revise down our FY15E EPS estimates by 5% to HK\$3.83 due to further slowdown of revenue growth across business segments of Hengan in 2H14. However, the improving profitability in 2H14 driven by gross margin expansion and company's cutback in promotion give us faith in the earnings growth outlook going forward. Stock is trading at the bottom of three year forward P/E range. The optimised product mix should result in better margins and a positive trajectory for ROE. We maintain our target P/E multiple of 22x and roll over to our FY16E EPS of HK\$4.48, which gives our new TP of HK\$98.60, representing 13% upside. We upgrade Hengan from Neutral to Buy. Further upside could come from growth improvement for the diaper and tissue businesses.

Target Price
12m Rating

HK\$98.60
Buy
(13% upside)

Price Chart

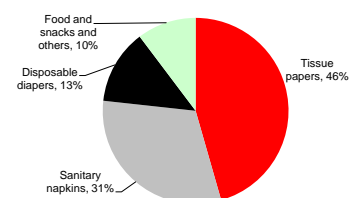


Key Data

Price – HK\$	87.50
52W high/low – HK\$	94.35/74.05
Mkt cap – HK\$m (US\$m)	107,136 (13,813)
Shares in issue – millions	1,224.4
Free float – %	59.5
3M avg. t/o – HK\$m (US\$m)	167.5 (21.6)
Major shareholder	
Tin Lee Investment	18.6%

Sources: Bloomberg and Sun Hung Kai Financial

FY14 revenues: HK\$23.8bn



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Figure 1: Hengan – earnings summary

Year end 31 Dec.	FY12	FY13	FY14	FY15E	FY16E
Revenue – HK\$m	18,524	21,186	23,831	27,328	31,057
Gross margin – %	44.9	45.1	46.1	47.6	47.3
EBIT margin – %	25.6	24.0	24.1	24.4	24.6
Net profit – HK\$m	3,519	3,721	3,916	4,707	5,513
Net-profit growth – %	32.8	5.8	5.2	20.2	17.1
Diluted EPS – HK\$	2.86	3.02	3.18	3.83	4.48
EPS growth – %	32.7	5.6	5.4	20.2	17.1
P/E – X	30.6	29.0	27.5	22.9	19.5
Dividend yield – %	1.9	2.1	2.3	2.7	3.2
P/B – X	7.6	6.5	6.1	5.5	4.9
Issued shares – m	1,229	1,229	1,229	1,229	1,229

Sources: Bloomberg and Sun Hung Kai Financial

Figure 2: Hengan – major assumptions

Revenue growth, %	FY12	FY13	FY14	FY15E-Old	FY15E-New	FY16E
Tissue paper	14.1	11.6	6.4	13.5	11.4	10.0
Sanitary napkins	19.5	21.5	24.4	20.0	23.0	20.0
Disposable diapers	(1.4)	9.4	5.3	17.3	11.0	12.4
Overall growth	8.6	14.4	12.5	16.1	14.7	13.6

Gross profit margin, %	FY12	FY13	FY14	FY15E-Old	FY15E-New	FY16E
Tissue paper	35.4	34.1	34.5	32.0	35.5	34.0
Sanitary napkins	65.8	66.3	68.5	67.0	69.5	67.0
Disposable diapers	42.9	44.5	45.3	46.5	46.0	45.0
Overall GPM	44.9	45.1	46.1	46.4	47.6	47.3

Sources: The Company and Sun Hung Kai Financial

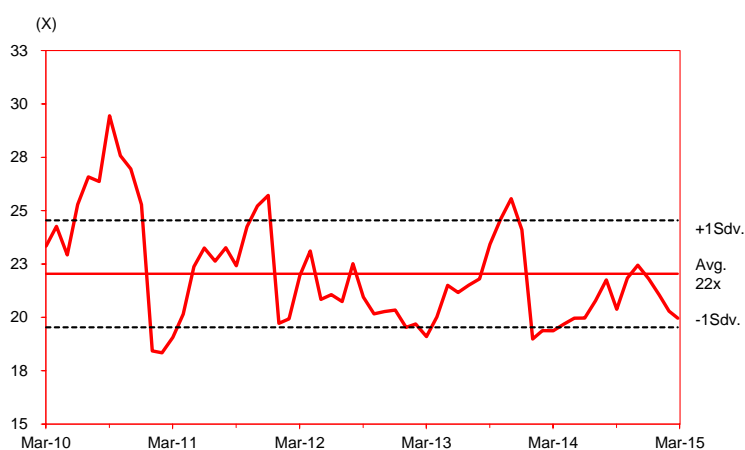


Figure 3: Hengan – results highlights

HK\$ m	1H12	2H12	FY12	1H13	2H13	FY13	1H14	2H14	FY14
Revenue	9,042	9,483	18,524	10,415	10,772	21,186	12,098	11,733	23,831
y/y (%)	10.4	7.0	8.6	15.2	13.6	14.4	16.2	8.9	12.5
Tissue paper	4,411	4,736	9,147	5,065	5,139	10,204	5,638	5,220	10,857
y/y (%)	12.5	15.6	14.1	14.8	8.5	11.6	11.3	1.6	6.4
Sanitary napkin	2,265	2,651	4,915	2,860	3,113	5,973	3,586	3,842	7,428
y/y (%)	22.5	17.0	19.5	26.3	17.4	21.5	25.4	23.4	24.4
Disposable diaper	1,321	1,364	2,685	1,432	1,506	2,938	1,546	1,549	3,095
y/y (%)	7.3	(8.5)	(1.4)	8.4	10.4	9.4	8.0	2.8	5.3
Food and snack	809	578	1,387	932	673	1,605	947	588	1,535
y/y (%)	(5.8)	(15.4)	(10.1)	15.1	16.4	15.7	1.6	(12.6)	(4.4)
Gross profit	3,999	4,316	8,315	4,711	4,848	9,559	5,434	5,554	10,988
y/y (%)	26.5	18.6	22.3	17.8	12.3	15.0	15.3	14.6	14.9
Overall gross margin (%)	44.2	45.5	44.9	45.2	45.0	45.1	44.9	47.3	46.1
Tissue paper	36.1	34.7	35.4	34.9	33.3	34.1	33.2	35.9	34.5
Sanitary napkin	64.1	67.3	65.8	65.1	67.4	66.3	66.9	70.0	68.5
Disposable diaper	41.6	44.2	42.9	43.5	45.5	44.5	44.2	46.4	45.3
Food and snack	37.9	38.6	38.2	42.6	41.9	42.3	42.6	42.1	42.4
SG&A	(2,046)	(2,093)	(4,139)	(2,511)	(2,738)	(5,248)	(3,261)	(3,141)	(6,402)
as % of rev.	(22.6)	(22.1)	(22.3)	(24.1)	(25.4)	(24.8)	(27.0)	(26.8)	(26.9)
EBIT	2,138	2,603	4,741	2,506	2,582	5,088	2,650	3,100	5,750
y/y (%)	58.5	33.9	43.9	17.2	(0.8)	7.3	5.7	20.1	13.0
EBIT margin (%)	23.6	27.5	25.6	24.1	24.0	24.0	21.9	26.4	24.1
Net profit	1,626	1,892	3,519	1,859	1,862	3,721	1,775	2,140	3,916
y/y (%)	37.6	29.0	32.8	14.3	(1.6)	5.8	(4.5)	14.9	5.2
Net margin (%)	18.0	20.0	19.0	17.8	17.3	17.6	14.7	18.2	16.4
Diluted EPS (HK\$)	1.32	1.54	2.86	1.51	1.51	3.02	1.44	1.74	3.18
y/y (%)	37.3	28.9	32.7	14.2	(1.7)	5.6	(4.6)	15.1	5.4

Sources: The Company and Sun Hung Kai Financial



Figure 4: Hengan- forward P/E

Sources: Bloomberg and Sun Hung Kai Financial

Figure 5: Hengan – China consumer staples peer comparison

Company	Stock code	Stock price (LC)	Mkt. cap (US\$m)	Ytd chg (%)	FY1 EPS growth (%)	FY2 EPS growth (%)	FY1 P/E (X)	FY2 P/E (X)	Div. yield (%)	Net-debt/equity (%)	ROE (%)
Hengan	1044.HK	87.50	13,815.4	8.0	21.8	17.6	23.5	20.0	2.3	(4.1)	22.9
Vinda	3331.HK	12.50	1,609.5	9.5	24.7	19.2	18.9	15.9	1.3	74.2	12.4
Want Want	151.HK	7.89	13,422.4	(22.8)	12.2	9.1	18.5	17.0	1.6	(11.4)	38.8
Tingyi	322.HK	17.22	12,444.2	(2.8)	21.5	12.5	23.1	20.6	1.6	35.5	15.1
Mengniu	2319.HK	35.35	8,932.9	10.5	21.6	18.4	21.5	18.2	0.7	16.6	11.7
C&S	002511.CH	12.92	844.5	31.8	37.8	35.3	50.7	37.4	N/A	27.3	5.2
Average					23.3	18.7	26.0	21.5	1.5	23.0	17.7

Sources: Bloomberg and Sun Hung Kai Financial

Appendix: Financial statements and forecasts

P&L – HK\$ m	FY12	FY13	FY14	FY15E	FY16E
Revenues	18,524	21,186	23,831	27,328	31,057
Gross profit	8,315	9,559	10,988	13,019	14,693
EBIT	4,741	5,088	5,750	6,658	7,632
Finance costs	(240)	(364)	(640)	(586)	(514)
Tax	(1,001)	(1,245)	(1,369)	(1,593)	(1,866)
Net profit (shareholders)	3,519	3,721	3,916	4,707	5,513
Diluted EPS – HK\$	2.86	3.02	3.18	3.83	4.48
DPS – HK\$	1.70	1.85	2.00	2.38	2.78
Weighted avg. shares – m	1,230	1,230	1,230	1,230	1,230
B/S – HK\$ m	FY12	FY13	FY14	FY15E	FY16E
Cash & equivalents	9,544	10,689	15,250	16,262	17,812
Account receivables	1,870	2,184	2,455	2,596	2,950
Inventories	3,831	4,386	3,695	4,646	5,280
Net fixed assets	10,150	10,937	11,358	11,980	12,533
Total assets	29,205	40,190	42,577	45,293	48,374
Account payables	1,803	2,097	2,300	2,869	3,261
Short-term debt	7,441	13,233	15,164	15,164	15,164
Total current liabilities	10,821	16,915	18,986	19,764	20,379
Long-term debt	3,787	6,187	5,390	5,390	5,390
Total liabilities	14,797	23,272	24,514	25,291	25,907
Shareholders' equity	14,078	16,534	17,638	19,505	21,886
Minority Interests	330	385	425	497	581
Cash flow - HK\$ m	FY12	FY13	FY14	FY15E	FY16E
Pre-tax profit	4,539	5,015	5,343	6,371	7,463
Deprn. & amortization	559	703	708	781	886
WC	(1,157)	(766)	690	(314)	(373)
Operating cash flow	2,956	3,865	4,747	5,246	5,993
Capex	(2,469)	(1,308)	(1,832)	(1,393)	(1,429)
Investing cash flow	(2,993)	(5,218)	(3)	(808)	(798)
Financing cash flow	1,900	5,899	(183)	(3,426)	(3,645)
Net cash flow	1,862	4,546	4,561	1,012	1,550
Free cash flow (OCF – capex)	487	2,557	2,915	3,853	4,565
Ratios - %	FY12	FY13	FY14	FY15E	FY16E
Revenue growth	8.6	14.4	12.5	14.7	13.6
Gross profit margin	44.9	45.1	46.1	47.6	47.3
EBIT margin	19.3	25.6	24.1	24.4	24.6
Effective tax rate	(22.1)	(24.8)	(25.6)	(25.0)	(25.0)
EPS growth	32.7	5.6	5.4	20.2	17.1
Net debt to equity	11.7	(0.9)	(4.1)	(8.8)	(14.7)
ROA	13.4	9.4	9.5	10.7	11.8
ROE	26.6	22.8	22.9	25.3	26.6
Cash conversion cycle – days	97.5	105.5	87.9	74.2	74.9
A/R turnover - days	37.1	34.9	35.5	33.7	32.6
A/P turnover - days	60.5	58.4	62.5	65.9	68.4
Inventory turnover - days	120.9	129.0	114.8	106.4	110.7

Sources: The Company and Sun Hung Kai Financial



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