

# Hengan International

Fri, 04 Sep 2009

## Cheap wood pulp stock to boost margin **HOLD (unchanged)**

### Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (HK\$m)	5687	8002	10860	13779	17116
Net Profit (HK\$m)	1,110	1,434	1,935	2,381	2,828
EPS (HK\$)	1.018	1.253	1.587	1.940	2.319
EPS Δ%	57.9	23.2	26.6	22.3	22.8
P/E (x)	43.5	35.3	27.9	22.8	19.1
P/B (x)	9.45	7.79	6.00	5.36	5.06
EV/EBITDA (x)	34.9	27.9	19.3	15.7	13.2
Yield (%)	1.4	1.6	2.2	2.6	2.9
ROE (%)	27.1	23.7	24.1	25.0	25.2
ROCE (%)	18.9	18.3	19.8	20.5	21.9
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI E2-Capital

Ticker:	1044.HK	12 mth range:	HK\$18.6-49.5
Price:	HK\$44.25	Market cap:	US\$6,917.3m
Target:	HK\$44.43 (+0%)	Daily t/o, 3 mth:	US\$13.3m
		Free float %:	58.3%

### Key points:

- \* Better-than-expected 1H results due to low raw materials costs.
- \* 260,000 cheap wood pulp inventory to sustain gross margin.
- \* Well scheduled tissue capacity expansion.
- \* New paper diaper product to spur 2H sales.
- \* Consolidating Qinqin with existing networks.
- \* Earnings estimates revised up.
- \* Target price moved to HK\$44.43.
- \* HOLD unchanged.

### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+1.8	+17.0	+67.0
Actual price changes (%)	-0.6	+28.4	+66.4

	09F	10F	11F
Consensus EPS (HK\$)	1.618	1.925	2.242
Previous forecasts (HK\$m)	1776	1865	2103
Previous EPS (HK\$)	1.552	1.630	1.838

### Price Chart



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subject to market's need.

**Diapers to catch up.** Sales of paper diapers increased only 10.0% in 1H to HK\$990.1m. The management admitted the performance is somewhat below its own expectation and blamed it to a delay in launching new products. Nevertheless, the new product has been released in Jul. Market response during before trial was satisfactory. Therefore, the management expects growth of diaper business to pick up in 2H.

**Qinqin under consolidation.** Qinqin, the newly acquired subsidiary (51% interest in Dec 08) engaged in producing food and snacks, generated HK\$482.4m revenue and HK\$43.7m net profit (before minority interest) in 1H, compared with HK\$843.6m and HK\$53.3m in the full FY12/08A. The company plans to re-position Qinqin at mid & high-end market from mid-end and diversify sales channels from traditional distributors to Hengan's existing

network.

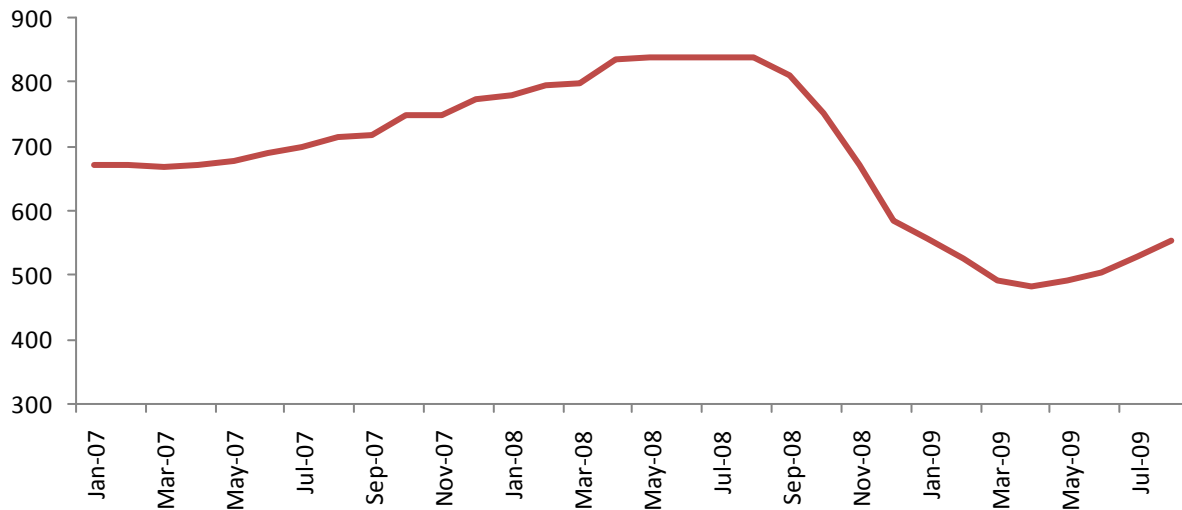
**Earnings forecast penciled up.** We have revised up our projection to accommodate better price trend following resilient raw materials costs and Hengan's 260,000 tonnes low-cost wood pulp inventory. The company will earn HK\$1934.8m in FY12/09F and HK\$2381.0m in FY12/10F. Accordingly, we lift our target price to HK\$44.43 based 28x FY12/09F P/E, which represents 0.8x PEG.

**Table 1: 1H FY12/09A results highlight**

Year to Dec (HK\$m)	07A	08A	YoY change (%)	Remarks
Revenue	3,755.8	5,112.7	36.1	
Tissue paper products	1,816.7	2,203.6	21.3	stable prices though more promotions in 1H
Sanitary napkins	943.0	1,190.6	26.3	"Space 7 Series" maintained high growth
Disposable diapers	900.4	990.1	10.0	Growth was restricted due to delay in new product rollout
Food and snacks	-	482.4	n.a.	
Others	95.7	246.0	157.1	
Gross profit	1,471.8	2,301.9	56.4	Substantial gross margin gain in 1H
Operating profit	779.9	1,211.9	55.4	
Net profit	627.6	966.7	54.0	
			<b>(pcp)</b>	
Gross margin (%)	39.1	45.0	5.9	
Tissue paper products	29.6	41.4	11.8	Wood pulp market price dropped 37.5% in 1H
Sanitary napkins	58.7	59.3	0.6	Petrochemical cost declined following oil price; more sales from mid-to-high-end products
Disposable diapers	35.7	37.0	1.3	Decline in prices of petrochemicals and fluff pulp, better cost control and product mix enhancement
Food and snacks	-	38.2	n.a.	
Others	60.0	54.1	(5.9)	

Source: Company data and SBI E2-Capital

**Chart 1: FOEX PIX pulp BHKP price (US\$/tonne)**



Source: Bloomberg

**Table 2: P & L**

Year to Dec (HK\$m)	07A	08A	09F	10F	11F
Turnover	5,687.0	8,001.5	10,860.3	13,778.6	17,116.0
COGS	(3,410.7)	(4,799.0)	(5,945.1)	(7,623.6)	(9,634.1)
Gross profit	2,276.3	3,202.5	4,915.2	6,155.0	7,481.9
Other revenue	103.4	93.0	76.0	96.5	119.8
Administrative Expenses	(221.4)	(313.5)	(597.3)	(688.9)	(770.2)
Distribution costs	(902.4)	(1,451.0)	(1,954.9)	(2,480.1)	(3,080.9)
Operating profit	1,255.9	1,531.1	2,439.1	3,082.4	3,750.6
Finance costs	(95.0)	(66.9)	(85.4)	(83.9)	(83.2)
Interest Income	21.7	46.5	35.0	44.4	55.2
Profit before tax	1,182.6	1,510.7	2,388.7	3,042.9	3,722.6
Taxation	(175.5)	(166.0)	(394.1)	(578.1)	(781.7)
Minority Interests	(1.1)	(3.7)	(59.7)	(83.7)	(112.6)
Net profit	1,006.0	1,340.9	1,934.8	2,381.0	2,828.2
EPS – basic	0.923	1.172	1.587	1.940	2.168

Source: Company data and SBI E2-Capital

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