

Declining pulp price to boost earnings

Not Rated

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	1,358.21	777.72	481.73	176.03	962.5
Net Profit (HK\$m)	106.8	78.4	135.3	213.0	263.5
EPS (HK\$)	0.168	0.103	0.148	0.234	0.280
EPS Δ%		(38.7)	43.7	58.1	19.7
P/E (x)	17.9	29.1			
P/B (x)		1.85			
EV/EBITDA (x)	12.7	14.6			
Yield (%)		0.0			
ROE (%)	23.1	8.1			
ROCE (%)	4.3	1.6			
N. Gear. (%)	355.5	41.0			

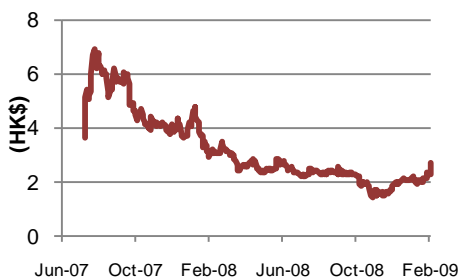
Source: Bloomberg

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+28.4	+77.8	+59.6
Actual price changes (%)	+32.4	+79.0	+11.0

	08F	09F	10F
Consensus EPS (RMB)	0.168	0.103	0.148
Previous forecasts (RMBm)	n.a.	n.a.	n.a.
Previous EPS (RMB)	n.a.	n.a.	n.a.

Price Chart



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Australia on Chinese (except Vinda) and Indonesian household paper exporters, with effect from 1 Jan 2009 to 31 Dec 2014. The latter, though will probably increase supply to domestic market, should not incur any material impact given that export represented only 9.5% of China's entire production in 2007.

Ticker:	3331.HK	12 mth range:	HK\$1.40-3.41
Price:	HK\$2.90	Market cap:	US\$336.0m
Target:	n.a.	Daily t/o, 3 mth:	US\$0.3m
		Free float %:	30.8%

Key points:

- * Steady growth of household paper industry.
- * Government policy to favor large players.
- * Vinda as the top household paper brand in China.
- * Apparent margin expansion in expectation, thanks to softening pulp price.

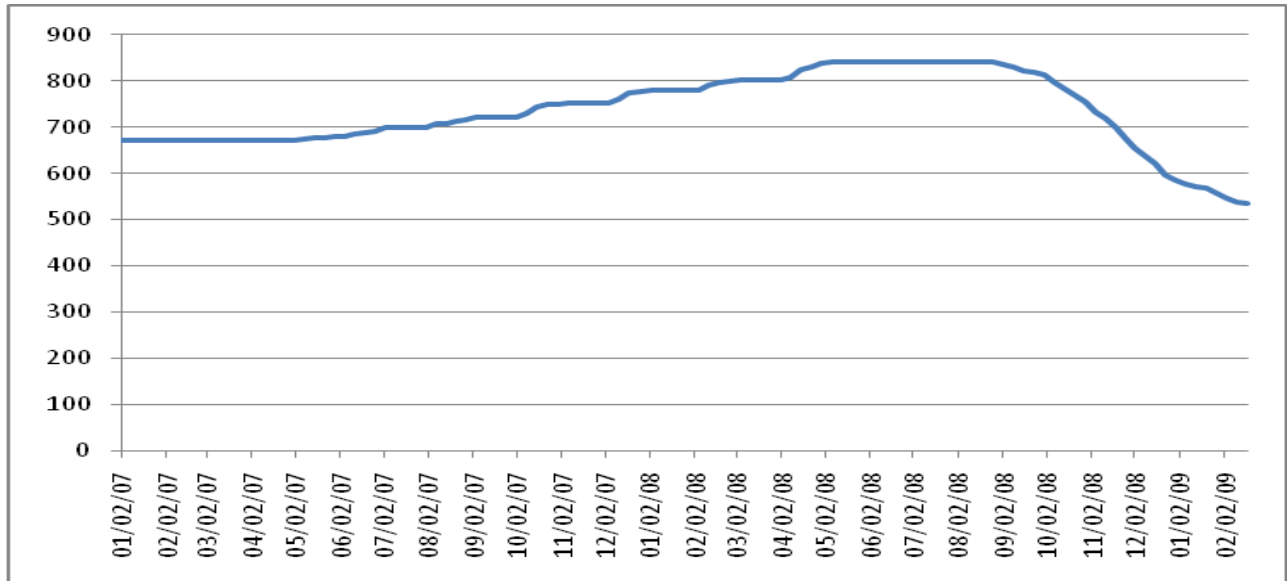
Household paper industry in the PRC

Steady outlook. Household paper (incl. toilet paper, tissue, kitchen towels and paper tableware) industry has been growing at ~10% since 2000 (CAGR: production 9.4%, consumption: 8.4%), roughly in line with China's GDP growth. In 2007, total production and consumption volume increased 8.1% and 7.3%, respectively, to 4.1m tonnes and 3.6m tonnes. Despite the present economy slowdown, we regard the market inelastic and expect it to maintain a middle / high single-digit growth rate this year. And long-term outlook is intact with momentum from penetration in developing regions and sales mix upgrading in developed regions.

Favorable trend for leaders. The government has been strengthening regulation and raising entry requirements for paper industry as an intention to conserve energy and reduce emission ("节能 减排"), forcing unqualified players, mainly small ones, to exit. We believe this trend will favor large players because of their abilities (e.g. funding, technology, experiences, etc) to meet those regulation requirements. The procedure (i.e. ruling-out small companies) accelerated during price hike of wood pulp from mid-07 to mid-08, which largely squeezed paper manufacturers' profitability. The number of registered household paper producers (raw paper) reduced by 100+ in 2007 to 380. Following the pulp price correction since mid-08, some small mills might resume operation. However we do not expect the government to loosen control and the overall picture is unchanged.

2009: margin expansion. A major theme of household paper market in 2009 should be a sector-wide margin improvement due to the substantial drop in wood pulp price, which went down 36.4% from peak US\$840/tonne in Jul 2008 to US\$535/tonne in Feb 2009. Some other factors might include: 1) migration of demand to lower-end products during the downturn; 2) 2-45% anti-dumping duties imposed by

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



Source: Bloomberg

Vinda

Leading brand in China. The company is one of top 4 household paper manufacturers in China, together with Hengan (1044 HK, HK\$28.45, HOLD), Gold Hong Ye (subsidiary of APP group) and Zhongshun. The “Vinda” brand is well known, especially for toilet paper. We believe this strong brand equity provides a solid foundation to ground the company’s future growth.

Table 1: Top four household paper manufacturers in the PRC

Company	Capacity in 2008 (tonnes '000)	Major Brands
Vinda	300	維達 Vinda, 花之韻
Hengan	300	心相印, 柔影
Gold Hong Ye	360	唯潔雅, 清風, 真真
Zhongshun	240	潔柔, C&S, 太陽, 紫荷

Source: Companies data, China National Household Paper Industry Association

Table 2: Top household paper brands

Product category	Top five brands
Toilet paper	維達, 潔云, 心相印, 清風, 五月花
Tissue	舒潔, 心相印, 清風, 潔云, 妮飄

Source: China National Household Paper Industry Association

Growth drivers. A general trend is that the market is converging to strong brands. For Vinda’s FY12/09F in particular, growth drivers should include:

- ❑ Penetration in the Yangtze River Delta – the company completed construction of a 40,000 tonne plant in Longyou, Zhejiang province, to support its expansion in the Yangtze River Delta region. Operation launched in Oct 2008.
- ❑ New production lines – although the full-year plan is still under review after the financial crisis, the company will add 20,000 tonnes capacity in Jiangmen by end-Mar, bringing total to 320,000 tonnes (effective: 310,000 tonnes in FY12/09F).
- ❑ Product mix adjustment – in view of the demand shifting to lower-end market, the company has released more value-for-money products (e.g. double-layer paper instead of four-layer, economy package, etc).
- ❑ Softening pulp price – pulp accounts for ~50% of COGS. The company, as well as other major brands, has not adjusted its selling price yet. After taking into account the potential time lag due to old inventory, we expect considerable margin expansion since 4Q FY12/08F (~10pcp YoY enhancement in gross margin in 1H FY12/09F based on present pulp price). Although we do not expect this juicy margin to be sustainable, it will surely boost the company’s FY12/09F earnings.

Eyes on Liaoning. The company has total 6 plants, located in Xinhui (Guangdong), Jiangmen (Guangdong), Xiaogan

(Hubei), Deiyang (Sichuang), Longyou (Zhejiang) and Beijing. The management is considering Liaoning as the next target, where there are few sizable household paper producers. We agree that geographic expansion is an effective way to close / understand local markets and improve logistical efficiency.

Other movements. A new electronic scale has been developed and will be deployed soon, which will reduce raw material consumption during production. The management estimates the potential saving can be as much as ~RMB10m. In middle term, the company might outsource some production to third-party manufacturers to reduce its own capital investment on fixed assets.

Corporate governance. Xinhui Vinda Paper Enterprise Company Ltd, Vinda's predecessor, was established in 1991. The company itself was incorporated in 1999 and got listed in Hong Kong exchange in Jul 2007 via a global offering at HK\$3.68 per share. Major shareholders include Mr. Li Chao Wang / Mr. Dong Yiping / Mr. Yu Yifang (all executive directors of the company, 31.2% in aggregate), SCA Hygiene (18.8%), Cathay Capital (9.4%), Merrill Lynch (5.3%) and Prime Capital (5.1%).

Valuation. The counter is trading at 12.4x FY12/09F P/E, versus Hengan's 19.8x.

Table 3: P & L

Year to Dec (HK\$m)	05A	06A	07A	1H 07A	1H 08A
Turnover	925.9	1,358.2	1,777.7	848.5	1,184.8
Cost of sales	(677.5)	(1,018.0)	(1,411.8)	(662.7)	(963.0)
Gross profit	248.4	340.2	365.9	185.8	221.8
Other income	2.9	11.2	10.9	6.6	2.3
Selling and marketing costs	(102.5)	(130.3)	(175.2)	(88.0)	(81.6)
Administrative expenses	(51.5)	(62.0)	(78.6)	(32.1)	(49.3)
Operating profit	97.3	159.0	123.0	72.3	93.2
Finance income	0.8	1.5	22.7	3.2	1.5
Finance costs	(27.7)	(46.8)	(50.8)	(27.4)	(10.9)
Profit before income tax	70.5	113.7	94.9	48.1	83.8
Income tax expenses	(12.1)	(6.9)	(16.5)	(7.0)	(22.0)
Profit for the period	58.4	106.8	78.4	41.1	61.8
Attributable to:					
Equity holders of the Company	58.4	106.8	78.4	41.1	61.8
EPS - Basic (HK\$)	n.a.	0.168	0.103	0.064	0.068
EPS - Diluted (HK\$)	n.a.	0.168	0.103	0.064	0.068

Source: Company data and SBI E2-Capital

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