Ryan Zheng (SFC CE:BOB758) (852) 3519 1294 April 09, 2021 Friday

Market Wrap

HSI ▲1.16% HSCEI ▲0.35% Turnover HK$281.1 bn ▲32% (30-day average) SSE Composite ▲0.08% SZSE Component ▲0.08%

Sector tracking				Stock tracking			
1D	▲%	1Y	▲%	Shanghai Connect 1D	▲%	Shenzhen Connect 1D	▲%
Textiles	6.2	Parts	379.0	SHANDONG(568)	11.5	SHANDONG(568)	11.5
Beverage	3.8	Marine	293.5	SSY GROUP(2005)	10.7	POWERLONG CM(9909)	10.7
Equip	3.7	Household Prod	242.1	SHANDONG XINHUA(719)	8.0	SSY GROUP(2005)	10.7
Non-ferrous	3.6	Gold	228.8	HAOHAI BIOTEC(6826)	7.5	SHANDONG XINHUA(719)	8.0
Household Prod	3.5	Auto	224.8	KINGBOARD HLDG (148)	7.2	HAOHAI BIOTEC(6826)	7.5

Market Highlight

Blue Moon (6993 HK): China's Leading Liquid Laundry Detergent Maker

Blue Moon Group is a leading consumer-centric household care company in China. They develop, manufacture and market a wide selection of products under three categories: fabric care, personal hygiene and home care. Their liquid laundry detergent, liquid soap and concentrated liquid laundry detergent products had the largest market shares in their respective markets in each of 2017, 2018 and 2019, according to the Frost & Sullivan Report.

A trend-bucking robust growth in liquid soap sales despite slumped liquid laundry detergent sales amid the pandemic

As people refrained from going out to maintain social distancing, and some retail stores stayed closed or only partially reopened, consumers' demand for products declined since the COVID-19 pandemic in 1H20. In particular, the sales of fabric care products which mostly included liquid laundry detergent slid sharply by 9.4%, dragging down the overall revenue.

The group saw a rapid growth in personal hygiene and home care products sales as people wash hands and clothes more frequently and disinfect their homes regularly during the pandemic. It is expected the COVID-19 will help boost the long-term market penetration rate of disinfection products like hand sanitizers. The gross profit margin remained relatively stable at 64.5% for 2020 compared to 64.2% for 2019. Rising in global commodities in recent days may put pressure on the company's gross margin.

HK$ million	2020	2019	YoY
Revenue	6,996.3	7,049.9	(0.8)%
-fabric care products	5,595.9	6,177.6	(9.4)%
-personal hygiene products	835.7	418.5	99.7%
-home care products	564.7	453.7	24.5%
Gross profit	4,513.8	4,523	(0.2)%
Gross margin	64.5%	64.2%	0.3%
Net profit	1,309.4	1,079.6	21.3%
Net margin	18.7%	15.3%	3.4%
Online sales (%)	53.9%	47.2%	6.7%

Source: Company, Orient Securities (Hong Kong)

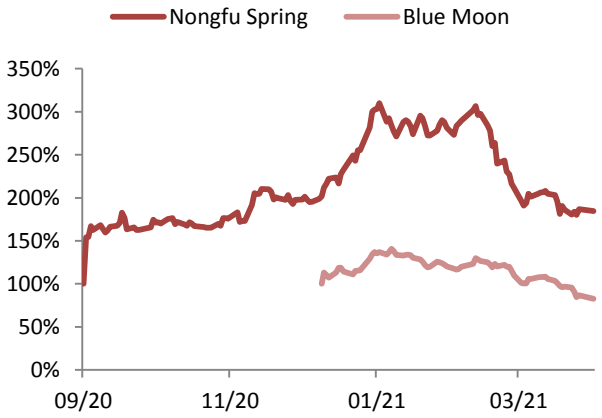
Comparisons of post-listing performance of recent IPOs

Blue Moon and Nongfu Spring are recently listed leading players in the consumer staples select sector. However, for the share price trend, Nongfu Spring doubled shortly after listing, while Blue Moon logged meagre gains, and slipped below its issue price recently.

Similarities: As giants in the consumer goods sector, both have a market share of 20%+ in their respective market segments with relatively high gross margins. Both distributed large surprise dividends before listing, and major shareholders have big shareholdings.

Differences: 1) Nongfu Spring's revenue grew faster, while Blue Moon's turnover slowed considerably in 2019-20. 2) Nongfu Spring's IPO valuation implies P/E of 40X only, while Blue Moon is traded at P/E of 62X, which may exhaust later gains. 3) Nongfu Spring maintains controllable costs and stable profits, while Blue Moon's results varied with prices of raw materials.

Share prices since listing on the HKEX



Source: Bloomberg, Company, Orient Securities (Hong Kong)

Development Milestones

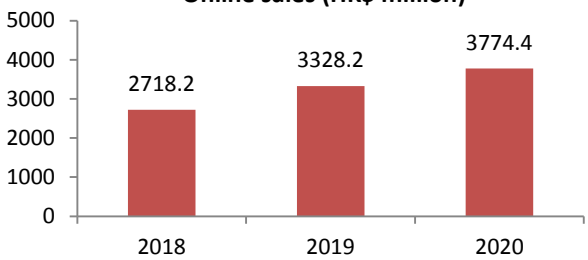
Blue Moon's history dates back to 1992 when kitchen cleanser spray was launched. It was one of the first brands engaged in the production of household cleaners in China. At that time, multinational consumer goods giants Unilever and Procter & Gamble had entered China's market. Luo Qiuping, one of the founders, obtained a master's degree in organic chemistry from the Chinese Academy of Sciences in 1987, and established Guangzhou Blue Moon Company in 1994.

Blue Moon's major revenue source comes from liquid laundry detergent owing to the first-mover advantage: Blue Moon caught the trend of consumption upgrade in China's laundry market. In 2008, Blue Moon introduced liquid laundry detergent, a ground-breaking product in China, while Unilever's OMO was late in arrival in 2009, and P&G's Tide and Ariel entered the market in 2010. By virtue of first-mover advantage and strong marketing (e.g., sports star Guo Jingjing's celebrity endorsement), Blue Moon quickly won consumer recognition. In 2010, Blue Moon achieved nearly 44% of the liquid laundry detergent market share, and held the number-one position ever since.

Withdrawal from the offline hypermarkets and focusing on their own and online channels: Blue Moon was intended to set up counters in offline hypermarkets to boost their brand image in 2015, but the price talks with RT-Mart collapsed. Later, distributors boycotted Blue Moon, hence Blue Moon have to withdraw from RT-Mart, Auchan, Carrefour and other hypermarkets. At that time, Hillhouse Capital, which had invested in JD.com, helped to bring about an exclusive agreement between JD.com and Blue Moon for online channels. Moreover, Blue Moon built their own "Moon House" store networks.

Market share plummeted since they gave up offline hypermarkets: After switching to online channels, online sales reached HK$3.774B in 2020, accounting for over half of the total revenue. However, their self-operated "Moon House" stores were not so welcomed by consumers. In 2017, the "Moon House" stores were closed. Meanwhile, Liby, Nice and other peers cooperated with offline hypermarkets to grab market share. Blue Moon's share of liquid laundry detergent market slumped from 38.7% to 24.4% in 2015-2019, with dominance fading away.

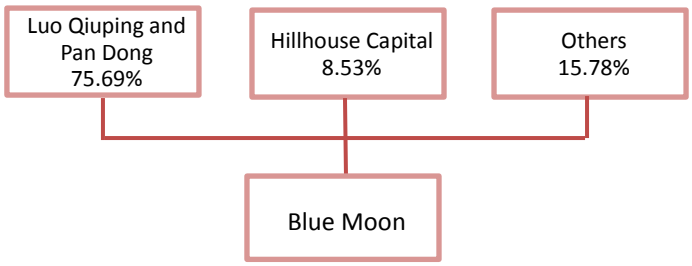
Online sales (HK$ million)



Blue Moon liquid soap gained surging popularity during SARS: The Blue Moon liquid soap in transparent packaging was launched in 2000. As most households in China were not in the habit of using liquid soap at that time, Blue Moon liquid soap got a lukewarm reception. With the outbreak of SARS in 2003, consumers' demand for sanitary products soared. Blue Moon seized the historical opportunity to quickly win the favour of consumers by donating liquid soap and promoting hand washing activities.

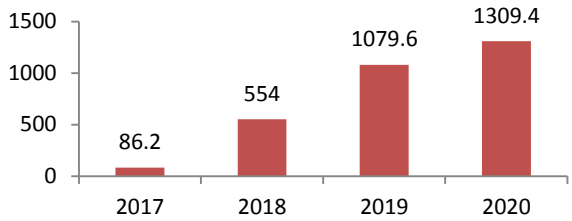
Hillhouse Capital invested in Blue Moon: Zhang Lei, Hillhouse Capital's CEO, is an important improver of Blue Moon's development. Zhang Lei encouraged Blue Moon to shift its business focus to liquid laundry detergent, a new product in China. Blue Moon received an angel round investment of US$45 million from Hillhouse Capital in 2010, and an additional US$1.03 million in the second year. As Blue Moon's valuation soared after the listing, Hillhouse Capital booked a cumulative investment income of over 20 times.

Shareholdings after listing



Pre-IPO surprise dividends caused controversy: Right before the listing in mid-2020, Blue Moon rushed to distribute HK$2.3 billion. In 2017-1H20, Blue Moon recorded a cumulative net profit of HK$2.022 billion, implying that all their earnings for the last three-and-a-half years were paid out.

Net Profit (HK$ million)

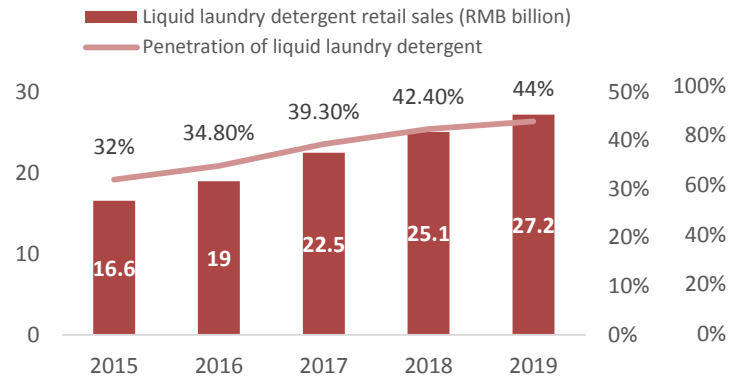


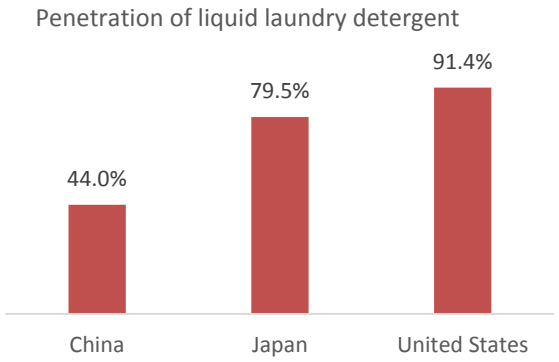
Continuous efforts in marketing after going public: Since detergent products became highly homogeneous, Blue Moon's strong brand awareness as a wide moat helped retain market share. As disclosed in the prospectus, over 50% of the IPO proceeds would be used to lift up the brand awareness and product penetration, and to further strengthen the sales and distribution network.

China's liquid laundry detergent market shows room for growth

As the largest segment of China's household care industry, the fabric care market logged retail sales of RMB 67.8 billion in 2019, accounting for 61.2% of the household care market. **With a shift from powder laundry detergent to liquid laundry detergent in the fabric care market, the liquid product saw a sharp rise in sales:** The retail sales of liquid laundry detergent surged to RMB27.2 billion at a CAGR of 13.1% in 2015-2019, while the powder one suffered a decline in sales with a CAGR of -0.6% during the period.

China's liquid laundry detergent market has a large potential for future growth compared with developed economies: The penetration rate of liquid laundry detergents was 44.0% in China as of 2019, way lower than that of other major economies such as Japan (79.5%) and the U.S. (91.4%), indicating that there would be headroom for the further substitution of powder laundry detergents by liquid laundry detergents. It is estimated that liquid laundry detergent will have a penetration rate of 58.6% by 2024, whilst the sales will grow at a CAGR of 13.6%.





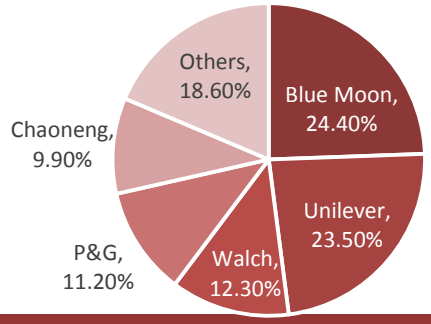
Source: Frost & Sullivan, Company, Orient Securities (Hong Kong)

With intense competition, Blue Moon's lead is narrowing

In terms of retail sales value, the five largest liquid laundry detergent makers in China accounted for a total market share of 81.4% in 2019. Blue Moon has been the top player in China's liquid laundry detergent market for 11 consecutive years. In 2019, Blue Moon enjoyed 24.4% of China's laundry detergent market, while the second place, Unilever accounted for 23.5%, implying a rather thin gap.

The fabric care industry does not have a high entry barrier and competition is intense as a result. Blue Moon's competitors include multinational consumer goods giants like Unilever, Procter & Gamble and Walch, as well as domestic brands like Liby that have taken root in offline channels.

China's liquid laundry detergent market share (by retail sales)



Source: Company, Orient Securities (Hong Kong)

Blue Moon's main products

Blue Moon has built a diverse portfolio of market-leading products under three categories: fabric care, personal hygiene, home care. In terms of retail sales value, Blue Moon ranked fourth in both the fabric care market and the personal hygiene market and ranked fifth in the home care market, all in terms of market size by retail sales value in China. Fabric care products contributed most of the group's total revenue, accounting for 80% in 2020.

	Categories	As a % of revenue (2019)
Fabric care products	Classic laundry, machine-wash laundry, pre-wash treatment, hand-wash laundry, travel pack, special laundry, stain remover, fabric disinfectant, fabric softener, laundry detergent for babies	80%
Personal hygiene products	Liquid soap	11.9%
Home care products	Toilet cleaning, utensil, fruit and vegetable wash, kitchen cleaning	8.1%

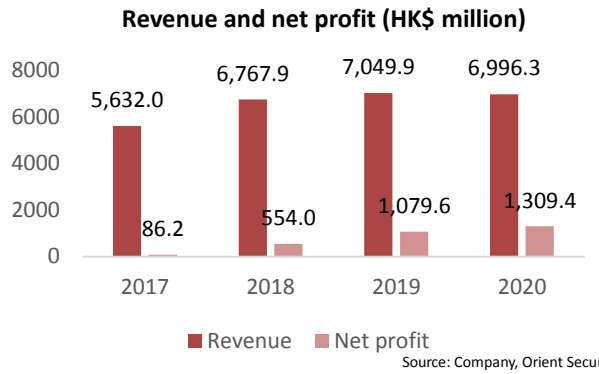
Single-brand strategy: The group's all products are sold under the brand "Blue Moon", while the peers like Unilever, Procter & Gamble and Nice set up a product matrix of multiple sub-brands. Procter & Gamble, for instance, has a bundle of sub-brands like Crest, Head & Shoulders, Rejoice, Pantene, Tide, Ariel, etc., covering soap, toothpaste, mouthwash, shampoo, conditioner, softener, etc. For virtue of a single brand, they can concentrate efforts on marketing a single brand. But they can neither adopt diverse pricing strategies and marketing methods according to the positioning of sub-brands and target customers, nor meet various needs of customer groups as much as possible.

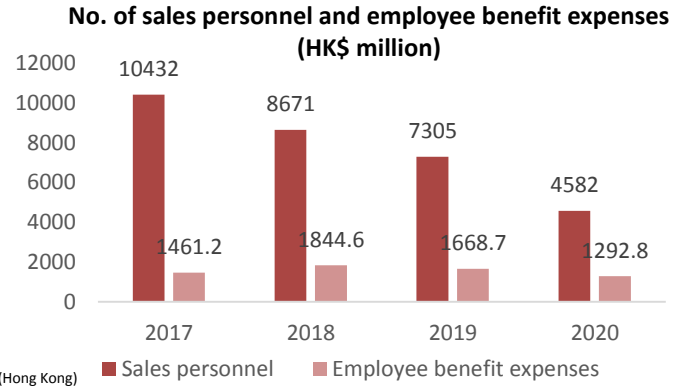
Source: Company, Orient Securities (Hong Kong)

The hidden danger in slower revenue growth despite a sharp rise in earnings

The company's prospectus shows that Blue Moon's revenue soared from RMB400 million to RMB4,300 million in 2007-2013, expanding at a CAGR of 49%. In 2017-2019, the group delivered revenues of HK$5,632 million, HK$6,767 million and HK$7,049 million, respectively, with a 3-year CAGR of 11.9%, while the net profits surged from HK$86.2 million to HK$1,079 million in 2017-2019, representing a CAGR of 254%.

However, there are hidden dangers behind the remarkable growth. The group logged 4.2% growth in revenue in 2018-2019, which lagged the industry and slowed down much. The rocketing growth in the group's profits was mainly attributable to 1) a notable gain in gross margin owing to declining costs of raw materials, and 2) a layoff of sales staff from 10,432 to 4,582 in 2017-2020, resulting in a steep drop in payrolls. Both of these factors are not sustainable in the long term.



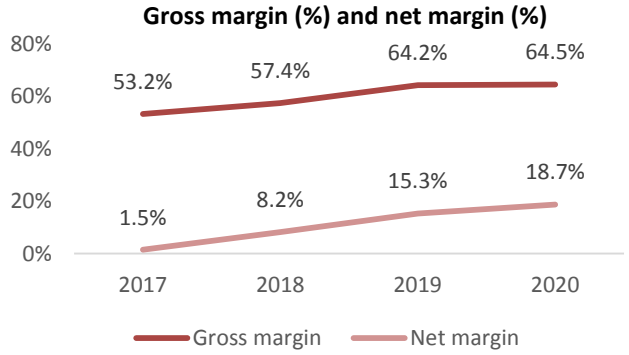


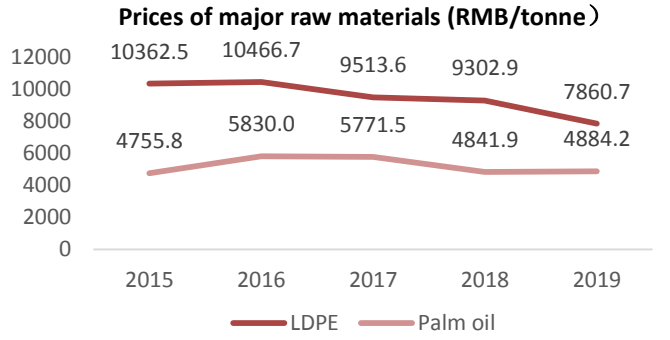
Source: Company, Orient Securities (Hong Kong)

Gross margin improvement was chiefly driven by the downturn in raw material prices

The group's gross margin rose from 53.2% to 57.4% in 2017-2018 and further climbed to 64.5% in 2020. The gain in gross margin was chiefly attributable to the slide in raw material prices. The principal raw materials they use in production are chemicals (a substantial amount of which is comprised of palm oil-based materials) and packaging materials (a substantial amount of which is comprised of LDPE-based materials). In 2019, chemicals and packaging materials accounted for 41.4% and 35% of their total costs of sales, respectively.

Net profit may barely sustain a high growth as gross margin will be under pressure when raw material prices bounce back in the future: Palm oil's prices slid with the increase in production capacity in Southeast Asia in recent years. Crude oil is one of the main raw materials of LDPE. The price of LDPE has been falling since 2017 as oil prices continued to plunge. However, the gross margin will be squeezed after raw materials rebounding since commodities are inherently cyclical. The massive growth of net profit was partly due to the steep rise in gross margin in recent years. It is expected that the striking growth of net profit may not be sustainable in the long run.



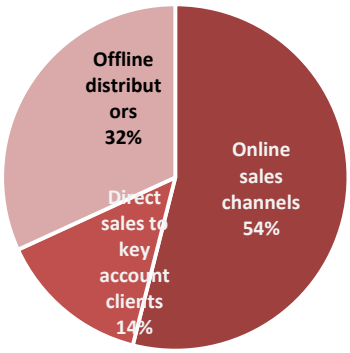


Source: Frost & Sullivan, Company, Orient Securities (Hong Kong)

Maintaining strong online sales and reigniting offline channels

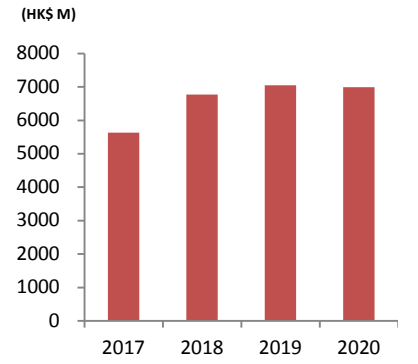
Blue Moon was forced to expand online channels since they suffered a setback in offline hypermarkets in 2015, which helped them gain first-mover advantages in online channels. Blue Moon from then on achieved leading market share on all major e-commerce platforms. 32.3% of China's liquid soap sales came from online channels. Online penetration of China's home care industry was 22.8% only, while 53.9% of Blue Moon's revenue stemmed from online orders in 2020.

Blue Moon plans to pick up offline sales in a few years: Blue Moon's products have been shelved in RT-Mart, Carrefour, etc. since the company reconciled with hypermarkets years later. Moreover, the strengthening of construction and transformation of offline channels was put on the agenda. The company currently has more than 1,400 offline dealers, 70% of which are in tier 3 cities and below. They plan to increase the number of dealers to about 2,100 by 2021, corresponding to 2,100 districts and counties in China.



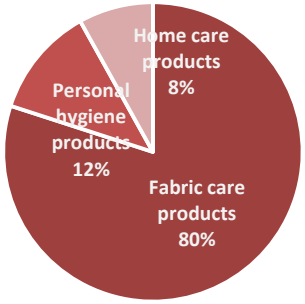
Source: Company, Orient Securities (Hong Kong)

Revenue



The group's revenue increased from HK$5.6 billion to HK$7 billion in 2017-2020, with a 4-year CAGR of 7.5%.

2020 revenue by segments



With the COVID-19 in 1H20, the group's liquid laundry detergent sales plunged, while the revenue contribution from products like liquid soap surged.

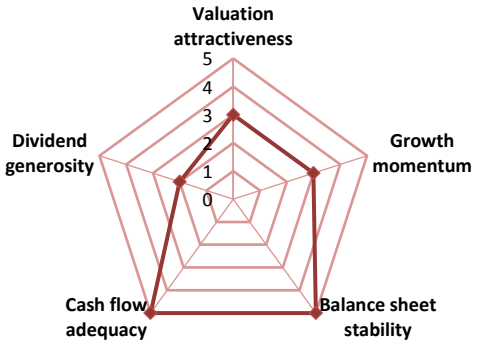
Financial Summary

(HK$ M)	2018	2019	2020
Revenue	6,768	7,050	6,996
Gross profit	3,886	4,523	4,514
Gross margin	57.4	64.2	64.5
EBIT	748	1,502	1,746
Net profit	554	1,080	1,309
Free cash flow	102	816	N/A
Capex	(89)	(180)	N/A
Net gearing (%)	25.7	(6.6)	(93.0)
EPS	0.1	0.2	0.3

The cost of raw materials slid in the past three years which drive up the gross margin and net margin. The group has a robust balance sheet with net cash position and positive free cash flow.

Strength

- Retaining the largest market share in China's liquid laundry detergent market for 11 consecutive years
- Revenue and profit both rose strongly in recent years
- Close cooperation with online retailers like JD.com boosted penetration of online channels
- Despite a slump in sales of liquid laundry detergent caused by the COVID-19, habits of using liquid soap and other disinfectant and cleaning products were developed



Weakness

- With a relatively narrow product portfolio, they highly rely on the sales of a single product, liquid laundry detergent, implying their weak capacity to fend off risks
- The rebound in commodity prices recently may bring pressure on gross margins
- A failure of entering offline hypermarkets for years and large layoff of sales staff in the past two years may result in erosion of offline share

Opportunity

- The penetration of liquid laundry detergent in China still lags behind that of developed countries, and therefore the trend of liquid laundry detergent to replace powder detergent is expected to extend in the future
- Demand for high-end cleaning products like concentrated liquid laundry detergent increased with China's consumption upgrade

Threat

- Fierce competition and strong peers in the cleaning market
- A further rise in the cost of raw materials

Key Risk

- Whether they can maintain the top position in the market under fierce competition
- It is difficult to manage crises and withstand risks for a single-brand company
- A considerable increase in raw material prices

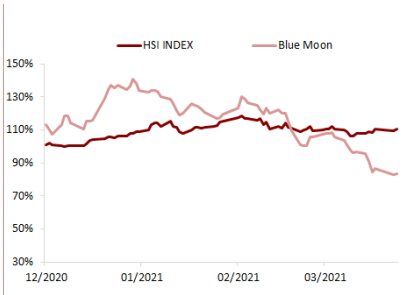
Valuation

P/E	33.1x
P/B	4.7x
Dividend yield	0.6%

Our Opinion

- A pretty high brand awareness with No. 1 market share for years, implying a strong brand fortress
- A leading position in online channels and close cooperation with online retailers such as JD.com
- There is intense competition in the daily chemical market
- The ultra-high growth in profits in recent years was partly owing to the downturn in commodity prices, layoffs and other unsustainable factors. Net profit may not be able to sustain the surge in the future

Relative Performance



The group's share price underperformed the Hang Seng Index in the most recent month.

P/E Band

The group's P/E is 33.1X, which is lower than its since-IPO average P/E of 46.2X.

P/B Band

The group's P/B is 4.7X, which is lower than its since-IPO average P/B of 6.5X.

Analyst Certification

I, Ryan Zheng (Zheng Kaien), being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that:

(1) all of the views expressed in this report accurately reflect my personal view about the subject company(ies) and its (or their) securities;

(2) no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report, or our Investment Banking Department;

(3) I am not, directly or indirectly, supervised by or reporting to our Investment Banking Department;

(4) the subject company(ies) do(es) not fall into the restriction of the quiet period as defined in paragraph 16.5(g) of SFC Code of Conduct;

(5) I and my associates do not deal in or trade in the stock(s) covered in this report within 30 calendar days prior to the date of issue of the report;

(6) I and my associates do not serve as an officer(s) of the listed company(ies) covered in this report; and

(7) I and my associates have no financial interests in relation to the listed company (ies) covered in this report.

Important Disclosure & Disclaimer

Orient Securities (Hong Kong) Limited does and seeks to do business with the company or companies covered in this report. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Orient Securities (Hong Kong) Limited and its affiliates, officers, directors, and employees may from time to time have long or short positions in securities, warrants, futures, options, derivatives or other financial instruments referred to in this report. Orient Securities (Hong Kong) Limited or its group companies may hold 1% or more of any class of common equity securities of the company(ies) mentioned in this report.

In no event will Orient Securities (Hong Kong) Limited or any other member of Orient Securities (Hong Kong) Limited be liable or responsible for loss of any kind, whether direct, indirect, consequential or incidental, resulting from the act or omission of any third party occurring in reliance upon the contents of this report.

Any information provided in this research report is for information purpose only and have no regards to the investment objectives, financial situation or risk tolerance level of any specific recipient and does not constitute any solicitation or any offer to buy or sell any securities or any other financial instruments. Before entering into any investment contract, individual should exercise judgment or seek for professional advice when necessary. Orient Securities (Hong Kong) Limited may not execute transactions for individual(s) in the securities/instruments mentioned.

Although the information in this report is obtained or complied from sources that Orient Securities (Hong Kong) Limited believes to be reliable, no representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness or reliability of the materials contained in this report. All price-related information is indicative only, and value of the investment(s) referred to in this report and the income from them may fluctuate because of changes in foreign exchange rates, market indexes, relevant operational / financial conditions of the company and other factors. Information contained in this report may change at any time and Orient Securities (Hong Kong) Limited gives no undertaking to provide notice of any such change. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur.

Orient Securities (Hong Kong) Limited may issue other reports that are inconsistent with the recommendations or views expressed in this report. This report reflects the different perspectives, insights and analytical methods of the analyst(s) and does not represent the views of Orient Securities (Hong Kong) Limited or its affiliates. The information, opinions and estimations contained in the report reflect only the judgment of the analyst(s) on the issuance date of this report and may be changed at any time without notice. Our sales staff, traders and other professionals may provide our clients and our proprietary trading department with verbal or written market commentary or trading strategies that are contrary to the recommendations or views expressed in this research report. Our proprietary trading and investment business units may make investment decisions that are contrary to the recommendations or views expressed in this report.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to any law, regulation, rule or other registration or licensing requirement.

Investment(s) in securities / financial instructions put through/execute outside Hong Kong are subject to the applicable laws and regulations of the relevant overseas jurisdiction, the entity issuing this research report and the analyst(s) authoring this research report are not subject to all the disclosures and other regulatory requirements in other countries.

This report may not be copied, reproduced, distributed, redistribute or published by any person for any purpose without the prior written consent of Orient Securities (Hong Kong) Limited. All rights are reserved.

In the preceding 12 months, Orient Securities (Hong Kong) Limited and its group of companies did not have investment banking relationship with the companies mentioned in this research report.

This research report provides information to our customers only.