

22 May 2020

Thong Guan Industries Bhd

Situational Black Horse

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After a con-call with management, we view Thong Guan in a new light. We understand that it chalked up strong sales in the trying months of April and believe the Group could defy the Covid-19 pandemic by posting stronger YoY growth. Margins are also seen improving on better product mix from premium products, namely nano film and courier bags. Hence, we upgrade our earnings estimates by 38%/20% for FY20/FY21 on higher utilisation rates and margins. Upgrade call to **OUTPERFORM** (from UP) with a higher TP of **RM4.00**.

A strong 1QFY20, with robust demand momentum. 1QFY20 earnings made up 36% of our initial estimate, driven by strong sales volumes for main products, namely stretch film (+30% YoY) and industrial bags (+32% YoY). Going forward, the Group expect higher growth for its stretch film products targeting exports to European markets. Initially, we were concerned on demand from Europe given the severity of Covid-19 within the region, but management has clarified otherwise, suggesting that demand remains strong driven by beverage manufacturers. Meanwhile, the Group is actively expanding its options by pushing sales to more European countries within the region.

Minimal downtime despite the MCO. Management confirmed that the utilised capacity remained strong in April at 80%, despite having to manage with c.50% of its original labour force during that period. Sales momentum remained steadfast on sustained orders for stretch film, industrial bags and courier bags, while garbage bags and PVC film saw a dip in orders during the MCO period. As at May 20, its labour force is back to 100% pushing operations full-steam ahead to catch up with backlog orders for garbage bags. Although it faced minor hiccups during the MCO period, namely delivery issues at the US port for courier bags, the situation had since been rectified.

Moving up the margin train. The Group is confident that it can secure better margins YoY as they are focussing more on higher margin products, namely from increased demand for nano film and courier bags which command double-digit margins (vs. other products of low double digit or single digit). Courier bags are in demand currently given the increased demand for logistics packaging during this Covid-19 pandemic. Additionally, TGUAN is expecting their 5th nano line by 2HCY20 to keep up with demand for stretch film as existing lines are already working at full capacity. All in, we are expecting PBT margins to improve in FY20/FY21 to 9.4%/9.9% (from 8.1%/8.6%) vs. 9.3% in 1Q20, and 8.1% in FY19A.

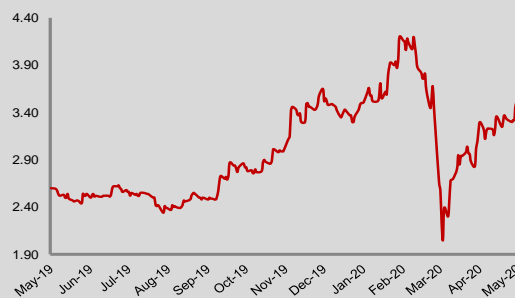
Increase FY20E/FY21E CNP by 38%/20% to RM69.7/RM78.3m. We are positive on its prospect post a con-call with management given that sales have remained strong during the MCO. As such, we are increasing our utilisation rate to 75-80% (from 65-75%) for FY20 and FY21 on top of improved margins on a better product mix. Consequently, this will translate to FY20E/FY21E CNP growth of 12%/12%. At current levels, FY20E/FY21E dividends of 9.0 sen/10.1 sen imply 2.5%/2.8% yield.

Upgrade to OUTPERFORM (from UP) with a higher Target Price of RM4.00 (from RM2.20) as we roll valuation to average FY20-21E EPS of 39.8 sen (from FY20E EPS of 27.4 sen) and a higher ascribed PER to 10.0x (-0.5SD to the 5-year historical valuations) from 8.0x (-1.0SD to the 5-year historical valuations) as we remain cautious of possible Covid-19 related hiccups. Our valuations are on the higher-end among plastic packagers under our coverage (-2SD to -1SD) as the Group's utilised capacity is the highest at 80% (vs. peers of 40-60% in FY20). We like TGUAN for its healthy balance sheet and strong net cash position of RM87m, a strong quality given that CY20 may be a challenging year, and the Group should have no issue committing to dividends.

OUTPERFORM ↑

Price: **RM3.61**
Target Price: **RM4.00** ↑

Share Price Performance



KLCI 1,452.11
YTD KLCI chg -8.6%
YTD stock price chg 7.1%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	TGI MK EQUITY
Market Cap (RM m)	669.8
Shares Outstanding	185.5
52-week range (H)	4.32
52-week range (L)	1.95
3-mth avg daily vol:	637,824
Free Float	48%
Beta	1.3

Major Shareholders

Foremost Equals Sdn Bhd	40.1%
Employees Provident Fund Board	2.4%
Neoh Choo Ee & Company Sdn Bhd	1.9%

Summary Earnings Table

FY Dec (RM m)	2019A	2020E	2021E
Turnover	935.1	971.7	1038.9
EBIT	76.4	90.9	101.6
PBT	75.9	91.2	102.6
Net Profit (NP)	61.9	69.7	78.3
Core NP*	62.0	69.7	78.3
Consensus (NP)	n.m.	60.5	68.5
Earnings Revision	0%	+38%	+20%
Core EPS (sen)	33.4	37.5	42.1
EPS growth (%)	29.2%	12.4%	12.3%
NDPS (sen)	5.9	9.0	10.1
Core PER (x)	10.8	9.6	8.6
BVPS (RM)	3.2	3.5	3.9
PBV (x)	1.1	1.0	0.9
Net Gearing (x)	N.Cash	N.Cash	N.Cash
Net Div. Yield (%)	1.6	2.5	2.8

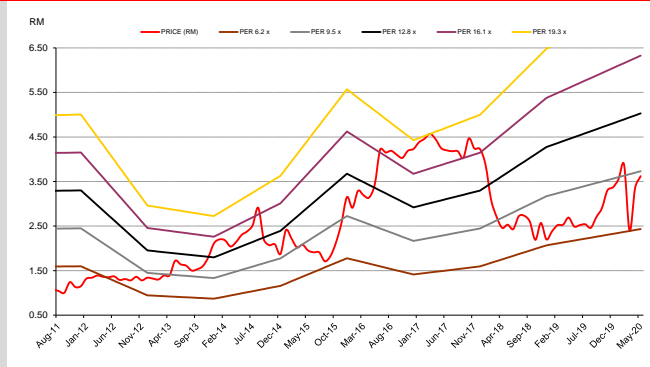
22 May 2020

Risks to our call include: (i) volatile plastic resin prices, (ii) foreign currencies fluctuations, and (ii) volatile margin.

Income Statement						Financial Data & Ratios					
FY Dec (RM m)	2017A	2018A	2019A	2020E	2021E	FY Dec	2017A	2018A	2019A	2020E	2021
Revenue	832.1	861.6	935.1	971.7	1038.9	Growth (%)					
EBITDA	68.7	77.4	100.8	117.5	129.8	Revenue	12.0	3.5	8.5	3.9	6.9
Depreciation	-18.3	-20.7	-24.4	-23.0	-24.6	EBITDA	-22.5	12.6	30.3	16.6	10.4
EBIT	50.4	56.7	76.4	94.6	105.1	EBIT	-29.9	12.4	34.7	23.8	11.2
Int Exp.	0.9	-0.4	-0.3	-3.2	-2.6	Pre-tax Income	-25.6	2.5	46.1	20.3	12.3
Exceptionals	-0.6	-4.3	-0.2	0.0	0.0	Net Income	-25.0	4.3	41.7	12.7	12.3
PBT	50.7	52.0	75.9	91.3	102.5	Core Net Income	-29.1	12.9	29.2	12.4	12.3
Taxation	-8.0	-8.4	-12.0	-15.5	-17.4	Profitability (%)					
Minority Interest	-0.8	0.1	-2.0	-6.1	-6.8	EBITDA Margin	8.3	9.0	10.8	12.1	12.5
Net Profit	41.9	43.7	61.9	69.7	78.3	EBIT Margin	6.1	6.6	8.2	9.7	10.1
Core Net Profit	42.5	48.0	62.0	69.7	78.3	PBT Margin	6.1	6.0	8.1	9.4	9.9
						Net Margin	5.1	5.6	6.6	7.2	7.5
						Effective Tax Rate	15.7	16.1	15.9	17.0	17.0
						ROE	9.4	9.1	10.7	11.5	11.9
						ROA	6.4	6.1	7.2	7.8	8.2
						DuPont Analysis					
						Net margin (%)	5.0%	5.1%	6.6%	7.2%	7.5%
						Assets Turnover	1.3	1.2	1.1	1.1	1.1
						Leverage Factor	1.5	1.5	1.5	1.5	1.5
						ROE (%)	9.4%	9.1%	10.7%	11.5%	11.9%
						Leverage					
						Debt/Asset (x)	0.11	0.17	0.16	0.13	0.10
						Debt/Equity (x)	0.16	0.25	0.24	0.18	0.14
						N.Debt/(Cash)	(80)	(43)	(88)	(129)	(162)
						N.Debt/Equity (x)	(0.17)	(0.08)	(0.15)	(0.20)	(0.23)
						Valuations					
						Core EPS (sen)	22.9	25.8	33.4	37.5	42.1
						NDPS (sen)	4.28	5.86	5.9	9.0	10.1
						BV/share (RM)	2.6	2.7	3.2	3.5	3.9
						Core PER (x)	15.8	14.0	10.8	9.6	8.6
						Net Div. Yield	1.2%	1.6%	1.6%	2.5%	2.8%
						PBV (x)	1.4	1.3	1.1	1.0	0.9

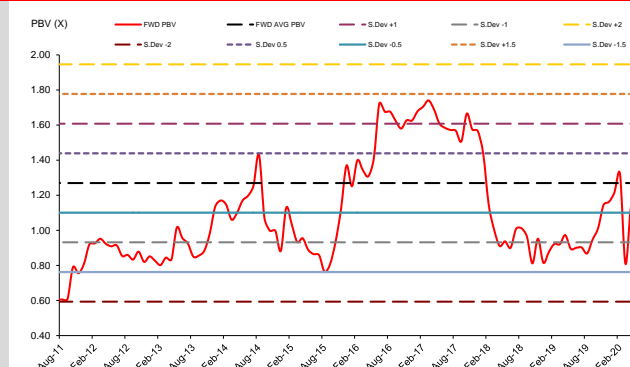
Source: Kenanga Research

Fwd Core PER



Source: Kenanga Research

Fwd PBV



22 May 2020

Peer Comparison

Name	Last Price	Market	Shariah	Current	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div. Yld. (%)	Target	Rating
	(RM)	Cap (RM'm)	Compliant	FYE	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	Price (RM)	
<u>STOCKS UNDER COVERAGE</u>																	
SCGM BHD	1.81	346.7	Y	04/2020	-2.8%	35.2%	213.6%	40.6%	N.A.	25.1	17.9	2.2	2.0	8.3%	1.6%	1.400	MP
SCIENTEX BHD	8.33	4,297.3	Y	07/2020	31.7%	17.2%	-4.9%	55.8%	14.6	16.1	10.3	2.5	2.0	13.9%	1.9%	6.50	MP
SLP RESOURCES BHD	0.84	264.7	Y	12/2020	11.0%	22.3%	-25.5%	57.0%	11.1	16.7	10.7	1.3	1.3	7.8%	6.1%	0.625	UP
THONG GUAN INDUSTRIES BHD	3.61	669.8	Y	12/2020	3.9%	6.9%	12.4%	12.3%	10.8	9.6	8.6	1.1	1.0	11.5%	2.5%	4.00	OP
TOMYPAK HOLDINGS	0.44	181.9	Y	12/2020	-13.3%	16.8%	n.m.	-144.3%	N.A.	N.A.	N.A.	1.3	1.3	-11.9%	0.0%	0.245	UP
Simple Average					6.1%	19.7%	39.1%	4.3%	12.2	16.9	11.9	1.7	1.5	6.1%	2.4%		

Source: Bloomberg, Kenanga Research

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22 May 2020

Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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