Thong Guan Industries Bhd

Beaten Down Too Much

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OUTPERFORM ↔

Price:	**RM2.44**
Target Price:	**RM3.25** ↔

After a con-call with management, we came away feeling optimistic about FY21 as business remains busy (>80% utilization, save for PVC at c.60%) and order visibility is longer than usual (2m vs. 1m) on the back of lower resin prices (-5%) since its recent peak in December 2020. Going forward, the continued growth of their high-margin products will help sustain CNP margins of 7-8% in FY20-21. Lower FY20E CNP by 2.3%, while FY21 remains unchanged. A 25% share price correction since Nov-2020 implies an attractive 11x PER. Reiterate OP on unchanged TP of RM3.25 on 14.5x PER.

Prudent management of resin costs and forex risk. While resin costs have risen since bottoming in May 2020 (LDPE: +81%, LLDPE: +47%, HDPE: +48%), the spot prices do not directly translate into TGUAN's cost as they have been managing resin costs prudently: (i) taking delivery of old orders of LLDPE at USD860/MT (vs. spot price of USD1,030/MT) from the U.S. and LDPE at USD1,000/MT (vs. spot price of USD1,230/MT) from the Middle East, (ii) altering the resin composition of its products to achieve favourable costs, (iii) procuring from the spot market only whatever is necessary. *(refer overleaf)*

Busy start to FY21. The Group's stretch films (SF) (both conventional & premium) and garbage bags are seeing greater orderbook visibility of up to 2 months compared to the usual 1 month as local and European customers are buying more SF as they expand, while Japanese customers are stocking up on garbage bags to avoid shortages during the Chinese New Year holiday. Additionally, the courier bag business continues to fare well. *(refer overleaf)*

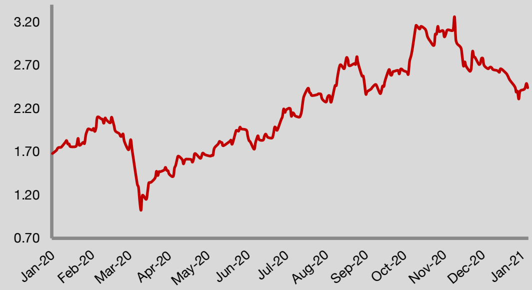
Elevated margins moving forward. We believe that the growing segments of premium-SF and courier bags augurs well for TGUAN as they continue transforming into a value-driven business. In the preceding quarters prior to the multi-year low resin prices in 2QCY20, TGUAN has consistently grown their margins. Although 4Q20 CNP margins (est.7%) may not be as attractive as 2Q/3Q20 (8%), we believe that moving forward, the more premium-product mix can help the group sustain GP margins of at least 16% and CNP margins of 7-8%.

Decrease FY20E CNP by 2.3% to reflect a weaker 4QFY20. Maintain FY21E CNP at RM85.2m. We are revising our FY20E CNP down by 2.3% from RM76.7m to RM74.9m to reflect a marginally weaker 4QFY20 QoQ, on a less favourable cost environment in 4QFY20 as LLDPE (70-80% of TGUAN's total resin consumption) prices rose 25% in 4QFY20.

Maintain OUTPERFORM with unchanged TP of RM3.25 on an ascribed PER of 14.5x to FY21E FD EPS of 22.4sen. We believe that the multiple of 14.5x is justified as: (i) its courier bag segment, which fetches GP margins of c.20% vs Group GP margin of 17%, is poised for growth as it serves blue-chip e-commerce customers in the US, (ii) its size and economies of scale allows it to absorb cost-pressures, and (iii) its healthy balance sheet and strong net cash position of RM120m support their implicit dividend pay-out ratio of 20-25%. Our FY21E DPS is 5.3sen, implying a dividend yield of 2.2%. The current price of RM2.44 implies a forward PER of 11x, which is below its 5-year historical mean of 12x and our ascribed 14.5x.

Risks to our call include: (i) Higher-than-expected resin prices, (ii) volatile foreign currency fluctuations, and (iii) lower-than-expected orderbook.

Share Price Performance



KLCI	1,635.71
YTD KLCI chg	0.5%
YTD stock price chg	-3.6%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	TGI MK Equity
Market Cap (RM m)	926.8
Shares Outstanding	379.8
52-week range (H)	3.35
52-week range (L)	0.98
3-mth avg daily vol:	1,444,617
Free Float	52%
Beta	1.1

Major Shareholders

Foremost Equals Sdn Bhd	39.2%
Employees Provident Fund Board	2.1%
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	100.1	107.0
PBT	75.9	98.1	104.9
Net Profit (NP)	61.9	74.9	85.2
Core NP*	62.0	74.9	85.2
Consensus (NP)	n.m.	79.6	86.8
Earnings Revision	N/A	-2.3%	N/A
Core EPS (sen)	16.3	19.7	22.4
EPS growth (%)	29.2	20.8	13.7
NDPS (sen)	2.9	4.7	5.4
Core PER (x)	14.9	12.4	10.9
BVPS (RM)	1.6	1.7	1.9
PBV (x)	1.6	1.5	1.3
Net Gearing (x)	N. Cash	N. Cash	N. Cash
Net Div. Yield (%)	1.2	1.9	2.2

Prudent management of resin costs and forex risk. While resin costs have risen since bottoming in May 2020 (LDPE: +81%, LLDPE: +47%, HDPE: +48%), the spot prices do not directly translate into TGUAN's costs, as management has been prudent in managing resin cost namely: (i) taking delivery of old orders of LLDPE at USD860/MT (vs spot price of USD1,030/MT) from the US and LDPE at USD1,000/MT (vs spot price of USD1,230/MT) from the Middle East, (ii) altering the resin composition of its products to achieve favourable costs, (iii) procuring from the spot market only whatever is necessary. Moreover, due to disruptions in local SF supply, TGUAN has been passing on their higher SF costs faster than average (1-week vs the usual 1-month). As we believe such prudent measures would allow TGUAN to sustain GP margins of 16-17%, we maintain our assumptions of GP margins of 16-17% and CNP margins of 7-8% for FY20 and FY21. Moreover, we believe that the weakening USD against MYR will not have a material impact on TGUAN as they engage in natural hedging, matching their payables (resins and loans) with receivables (revenue).

Busy start to FY21. The Group's SF (both conventional & premium) and garbage bags are seeing greater order-book visibility of up to two months compared to the usual one month. Local and European customers are buying more SF as they expand, and Japanese customers are stocking up on garbage bags to avoid shortages during the Chinese New Year holiday. The Group is also seeing increased orders for courier bags which the Group aims to double to 14,000MT p.a. by year-end. For FY21, we expect SFs to contribute to 46% of revenue (40% conventional; 60% premium), and courier bags contributing 9% of revenue (vs currently 46% and 7-8%, respectively).

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Income Statement

FY Dec (RM m)	2017A	2018A	2019A	2020E	2021E
Revenue	832.1	861.6	935.1	971.7	1038.9
EBITDA	68.7	77.4	100.8	126.3	135.1
Depreciation	-18.3	-20.7	-24.4	-26.2	-28.0
EBIT	50.4	56.7	76.4	100.1	107.0
Int Exp.	0.9	-0.4	-0.3	-1.9	-1.3
Exceptionals	-0.6	-4.3	-0.2	0.0	0.0
PBT	50.7	52.0	75.9	98.1	104.9
Taxation	-8.0	-8.4	-12.0	-16.7	-16.8
Minority Interest	-0.8	0.1	-2.0	-6.5	-3.0
Net Profit	41.9	43.7	61.9	74.9	85.2
Core Net Profit	42.5	48.0	62.0	74.9	85.2

Balance Sheet

FY Dec (RM m)	2017A	2018A	2019A	2020E	2021E
Fixed Assets	186	208	261	258	270
Intangibles	0	0	0	0	0
Other FA	18	15	11	15	15
Inventories	147	172	186	166	178
Receivables	176	171	172	240	256
Other CA	1	3	0	1	1
Cash	156	170	228	257	273
Total Assets	685	739	859	936	994
Payables	127	102	111	146	157
ST Borrowings	59	88	92	82	72
Other ST liability	1	1	2	2	2
LT Borrowings	17	39	49	39	29
Other LT liability	5	5	10	10	10
MI/PPB	10	10	18	24	27
Net Assets	**466**	**495**	**578**	**632**	**697**
Share Capital	144	145	220	220	220
Reserves	322	350	357	412	477
S. Equity	**466**	**495**	**578**	**632**	**697**

Cashflow Statement

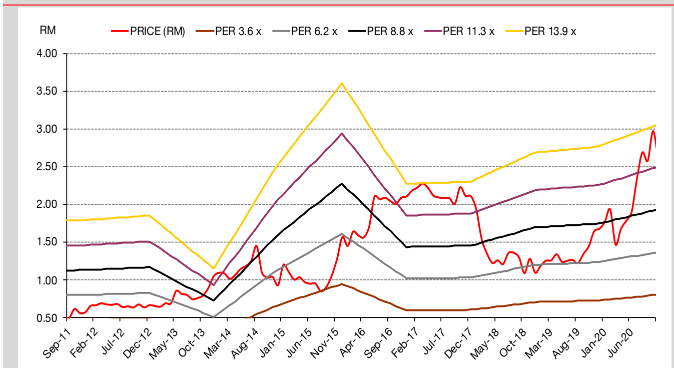
FY Dec (RM m)	2017A	2018A	2019A	2020E	2021E
Operating CF	46	25	79	101	98
Investing CF	-65	-44	-53	-45	-40
Financing CF	24	33	330	-40	-42

Financial Data & Ratios

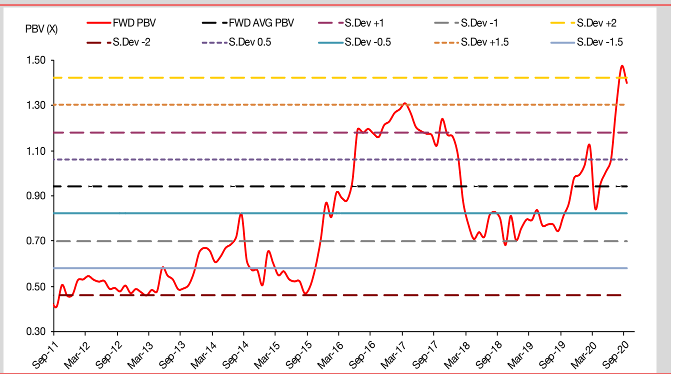
FY Dec	2017A	2018A	2019A	2020E	2021
Growth (%)					
Revenue	12.0	3.5	8.5	3.9	6.9
EBITDA	-22.5	12.6	30.3	25.3	6.9
EBIT	-29.9	12.4	34.7	31.1	6.9
Pre-tax Income	-25.6	2.5	46.1	29.3	6.9
Net Income	-25.0	4.3	41.7	21.1	13.7
Core Net Income	-29.1	12.9	29.2	20.8	13.7
Profitability (%)					
EBITDA Margin	8.3	9.0	10.8	13.0	13.0
EBIT Margin	6.1	6.6	8.2	10.3	10.3
PBT Margin	6.1	6.0	8.1	10.1	10.1
Net Margin	5.1	5.6	6.6	7.7	8.2
Effective Tax Rate	15.7	16.1	15.9	17.0	16.0
ROE	9.4	9.1	10.7	12.4	12.8
ROA	6.4	6.1	7.2	8.3	8.8
DuPont Analysis					
Net margin (%)	5.0	5.1	6.6	7.7	8.2
Assets Turnover	1.3	1.2	1.1	1.1	1.1
Leverage Factor	1.5	1.5	1.5	1.5	1.4
ROE (%)	9.4	9.1	10.7	12.4	12.8
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)	(136)	(173)
N.Debt/Equity (x)	(0.17)	(0.08)	(0.15)	(0.21)	(0.24)
Valuations					
Core EPS (sen)	11.2	12.6	16.3	19.7	22.4
NDPS (sen)	2.1	2.9	2.9	4.7	5.4
BV/share (RM)	1.3	1.3	1.6	1.7	1.9
Core PER (x)	21.8	19.3	14.9	12.4	10.9
Net Div. Yield (%)	0.9	1.2	1.2	1.9	2.2
PBV (x)	1.9	1.8	1.6	1.5	1.3

Source: Kenanga Research

Fwd Core PER



Fwd PBV



Source: Kenanga Research

Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) Hist.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net Div.Yld. (%) 1-Yr. Fwd.	Target Price (RM)	Rating
STOCKS UNDER COVERAGE																	
SCGM BHD	2.22	425.2	Y	04/2021	16.0%	13.3%	101.7%	21.2%	24.7	12.3	10.1	2.5	2.2	19.5%	3.2%	3.85	OP
SCIENTEX BHD	4.27	6,621.0	Y	07/2021	14.9%	0.8%	11.6%	5.1%	16.2	15.1	14.3	2.6	2.3	17.3%	6.0%	3.78	MP
SLP RESOURCES BHD	0.895	283.7	Y	12/2020	-12.9%	25.1%	-18.9%	22.7%	11.2	14.9	11.2	1.4	1.4	8.5%	6.1%	0.950	MP
THONG GUAN INDUSTRIES BHD	2.44	926.8	Y	12/2020	3.9%	6.9%	20.8%	13.7%	14.9	12.4	10.9	1.6	1.5	12.4%	1.9%	3.25	OP
TOMYPAK HOLDINGS	0.755	325.1	Y	12/2020	3.9%	6.7%	-84.8%	65.0%	N.A.	188.8	125.8	1.7	1.8	1.1%	0.0%	0.415	UP
Simple Average					**5.2%**	**10.6%**	**6.1%**	**25.6%**	**16.8**	**48.7**	**34.5**	**2.0**	**1.8**	**11.8%**	**3.4%**		

Source: Bloomberg, Kenanga Research

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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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