# **Thong Guan Industries Bhd**

## Spike in Costs = Spike in ASPs

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We believe the market is overly bearish on TGUAN. Its ASPs have matched and even exceeded hikes in resin prices which are seen to be flattening soon. Nevertheless, ASPs are expected to remain elevated with continued growth in Nanofilms and courier bags to sustain gross margins. Furthermore, share buy-backs indicate management's confidence of its prospects. Reiterate OUTPERFORM with unchanged TP of RM3.00 @ 13x PER on FY21E EPS of 23.1 sen.

Passing on costs. YTD, TGUAN has been able to raise ASPs across its products, namely c.20% for conventional stretch film (c.20% of revenue), and c.30% for Nano-stretch film (c.30% of revenue). The sharp rise in resin costs (15-20% YTD) has allowed TGUAN to raise ASPs accordingly, allowing them to comfortably pass on any higher costs. More importantly, customers are accepting the higher ASPs, especially for TGUAN's proprietary Nano-stretch films, which we deem as more price inelastic.

**Signs of flattening resin prices.** In our view, resin prices could peak some time in 2QCY21. Our channel checks indicate that resin suppliers are guiding flat prices for April, as US petrochemical plants are ramping up production post-deep freeze. That said, resin prices are likely to remain elevated for some time as the months-long disruption has left deep deficits throughout the global supply chain. For TGUAN, we maintain our CY21 average resin cost assumption of USD1,100/MT.

What if resin prices fall? As (i) TGUAN has always been able to secure resins at below-market prices (e.g. LLDPE @ USD1,100/MT vs. market's USD1,300/MT), and (ii) TGUAN only procures sufficient resins to fulfil demand, we don't think TGUAN will be stuck with higher-than-market resin costs. In fact, as ASPs lag resin costs, we see TGUAN benefiting from higher ASPs by being able to source resins at lower prices. A gradual decline (vs. sharp decline) in resin prices will be beneficial for TGUAN as they are better able to maintain their high ASPs. We take comfort that c.30% of revenue is composed of relatively more price-inelastic proprietary Nano-stretch films, where demand exceeds supply.

Margins to at least sustain. Since 2018, its gross margins have risen from 12% to 16% on the back of growth of higher-margin products, such as the Nano-stretch film and courier bags. We conservatively estimate TGUAN's gross margins to be at least 16% moving forward as they focus on value-added products and continue to expand their high margin products.

Refer overleaf on share buy-backs.

**Maintain FY21/FY22 estimates.** Assuming 8% CNP margin, we maintain our FY21E revenue/CNP of RM1.08b/RM87.4m, conservative relative to management's targets. We also maintain our FY22E revenue/CNP of RM1.2b/RM95m. FY21E/FY22E DPS of 4.6 sen/5.0 sen yield 2.1%/2.3%.

Reiterate OUTPERFORM with unchanged TP of RM3.00 on an ascribed Fwd. PER of 13x on our conservative FY21E EPS of 23.1 sen. The ascribed 13x PER is +1SD of its 5-year mean of 9.5x. We believe that TGUAN deserves the valuation premium for: (i) its growth prospects in the coming years and (ii) its ability to pass on costs and sustain margins. The current price implies Fwd. PER of 9.6x, similar to its 5-year mean, which we believe is unfair given its margin growth and commendable capacity expansion. TGUAN remains our top pick in the sector and we believe that the market is overly bearish on the stock. Hence, we recommend accumulating on the weakness.

## OUTPERFORM ←

Price: Target Price:

RM2.22 RM3.00 ←

### **Share Price Performance**



#### Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	TGI MK Equity
Market Cap (RM m)	839.8
Shares Outstanding	378.3
52-week range (H)	3.35
52-week range (L)	1.31
3-mth avg daily vol:	1,081,594
Free Float	48%
Beta	1.1

### **Major Shareholders**

Foremost Equals Sdn Bhd	39.3%
Prudential Unit Trust	2.6%
Employees Provident Fund Board	2.1%

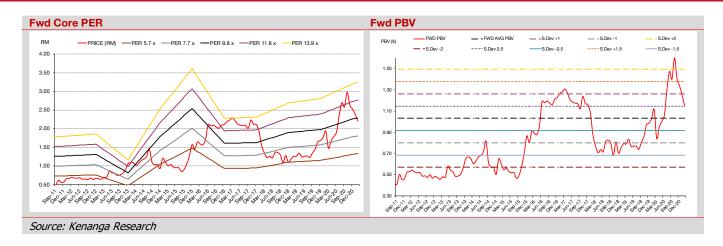
## **Summary Earnings Table**

FY Dec (RM m)	2020A	2021E	2022E
Turnover	960.6	1084.0	1177.4
EBIT	97.5	109.5	120.0
PBT	100.2	110.5	121.0
Net Profit (NP)	75.5	87.4	94.8
Core NP*	76.6	87.4	94.8
Consensus (NP)	N.M.	83.1	93.7
Earnings Revision	N.A.	N.A.	N.A.
Core EPS (sen)	20.2	23.1	25.1
EPS growth (%)	18	14	9
NDPS (sen)	4.0	4.6	5.0
Core PER (x)	11.0	9.6	8.9
BVPS (RM)	1.7	1.9	2.1
PBV (x)	1.3	1.2	1.1
Net Gearing (x)	N.Cash	N.Cash	N.Cash
Net Div. Yield (%)	1.8	2.1	2.3

**Share buy-backs.** In March 2021, management conducted their largest share buy-back (SBB) on record, having spent RM3.8m to purchase 1.9m shares at costs ranging from RM1.98 to RM2.08. We see this SBB as a vote of confidence from the management, as they continue expanding their capacity and raising ASPs. Note that the Group's last SBB was in June 2019, when it spent RM0.7m. In the quarter following the June 2019 SBB, PAT/CNP rose by 26%/73%.

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

Income Statement						Financial Data & Ratios								
FY Dec (RM m)	2018A	2019A	2020A	2021E	2022E	FY Dec	2018A	2019A	2020A	2021E	2022E			
Revenue	861.6	939.2	960.6	1084	1177.4	Growth (%)								
EBITDA	72.5	99.6	124.9	139.6	153.1	Revenue	3.5	9.0	2.3	12.8	8.6			
Depreciation	20.2	24.3	27.4	30.1	33.1	EBITDA	12.6	37.3	25.4	11.8	9.7			
EBIT	52.4	75.2	97.5	109.5	120.0	EBIT	12.4	43.7	29.6	12.3	9.6			
IntExp/(Income)	-0.4	-0.3	1.6	0.0	0.0	Pre-tax Income	2.5	45.2	32.7	10.3	9.6			
Associates P/L	0.0	0.5	1.0	1.0	1.0	Net Income	4.3	41.6	22.1	15.7	8.8			
PBT	52.0	75.5	100.2	110.5	121.0	Core Net Income	12.9	31.6	17.6	14.1	8.9			
Taxation	-8.4	-11.6	-19.6	-22.1	-24.2									
Minority Interest	-0.1	2.0	5.0	1.0	2.0	Profitability (%)								
PATAMI	43.7	61.8	75.5	87.4	94.8	EBITDA Margin	8.4	10.6	13.0	12.9	13.0			
Core PATAMI	49.5	65.1	76.6	87.4	94.8	EBIT Margin	6.1	8.0	10.2	10.1	10.2			
						PBT Margin	6.0	8.0	10.4	10.2	10.3			
Balance Sheet						Net Margin	5.7	6.9	8.0	8.1	8.			
FY Dec (RM m)	2018A	2019A	2020A	2021E	2022E	Effective Tax Rate	16.1	15.3	19.6	20.0	20.0			
Fixed Assets	201	264	295	340	374	ROE	10.0	11.3	11.8	12.2	12.0			
Intangibles	0	0	0	0	0	ROA	6.7	7.4	7.6	7.8	7.			
Other FA	23	8	9	9	10									
Inventories	172	198	210	225	241									
Receivables	171	180	195	210	227	DuPont Analysis								
Other CA	3	3	1	1	1	Net margin (%)	5.7%	6.9%	8.0%	8.1%	8.1%			
Cash	170	228	294	338	389	Assets Turnover (x)	1.2	1.1	1.0	1.0	0.9			
Total Assets	739	881	1004	1123	1240	Leverage Factor (x)	1.5	1.5	1.6	1.6	1.0			
						ROE (%)	10.0%	11.3%	11.8%	12.2%	12%			
Payables	98	129	168	215	247	,								
ST Borrowings	88	92	88	82	82	Leverage								
Other ST liability	5	6	3	3	3	Debt/Asset (x)	0.17	0.16	0.15	0.13	0.12			
LT Borrowings	39	49	58	61	64	Debt/Equity (x)	0.17	0.10	0.13	0.13	0.12			
Other LT liability	5	11	17	19	21	N.Debt/(Cash)	-42.7	-87.6	-147.4	-194.4	-242			
NCI	10	18	23	26	30	N.Debt/Equity (x)	-0.09	-0.15	-0.23	-0.27	-0.3			
Net Assets	495	577	646	716	792		-0.09	-0.13	-0.25	-0.21	-0.5			
						Valuations								
Share Capital	145	220	237	237	237	Core EPS (sen)	13.1	17.2	20.2	23.1	25.			
Reserves	350	356	409	479	555	NDPS (sen)	2.9	3.7	4.0	4.6	5.0			
S. Equity	495	577	646	716	792	BV/share (RM)	1.3	1.5	1.7	1.9	2.			
oq,	Core PER (x)	` '	17.0	12.9	11.0	9.6	8.9							
Cashflow Stateme	nt					. ,	1.3	1.7	1.8	2.1	2.3			
FY Dec (RM m)	2018A	2019A	2020A	2021E	2022E	Net Div. Yield	1.7	1.5	1.3	1.2	1.			
Operating CF	25	90	130	152	169	PBV (x)		1.5	1.5					
Investing CF	-44	-66	-52	-68	-65									
Financing CF	33	37	-14	-10	-10									



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Name P	Last Price	Market	Shariah Compliant	Current	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div.Yld. (%)	Target	Rating
	(RM)	Cap (RM'm)			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. 1-	1-Yr. Fwd.	Price (RM)	
STOCKS UNDER COVERAGE		<u> </u>															
SCGM BHD	1.86	356.2	Υ	04/2021	13.1%	16.1%	90.4%	1.7%	20.6	10.8	10.6	2.1	1.9	17.3%	3.7%	2.62	OP
SCIENTEX BHD	4.03	6,248.9	Υ	07/2021	14.0%	1.7%	7.8%	8.8%	15.3	14.2	13.1	2.6	2.2	16.7%	2.1%	3.75	MP
SLP RESOURCES BHD	0.845	267.8	Υ	12/2021	22.3%	11.7%	21.6%	9.6%	16.3	13.6	12.4	1.4	1.3	9.7%	6.5%	0.950	MP
THONG GUAN INDUSTRIES BHD	2.22	839.8	Υ	12/2021	12.8%	8.6%	14.1%	8.5%	11.0	9.6	8.9	1.3	1.2	12.2%	2.1%	3.00	OP
TOMYPAK HOLDINGS	0.565	243.3	Υ	12/2021	12.8%	3.8%	2200.0%	87.0%	N.A.	113.0	56.5	1.3	1.3	1.1%	0.0%	0.415	UP
Simple Average					15.0%	8.4%	466.7%	23.1%	15.7	32.2	19.9	1.7	1.6	11.7%	2.9%		

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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