

## 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 Nano-films 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.

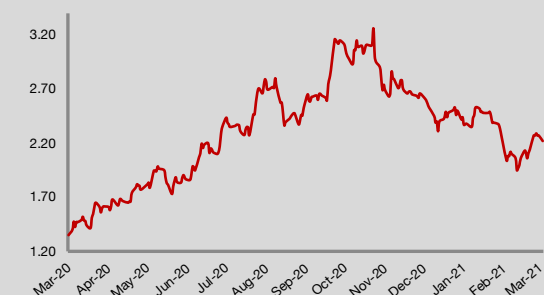
**Maintain FY21/FY22 estimates.** Assuming 8% CNP margin, we maintain our FY21E revenue/CNP of RM1.08b/RM87.4m, conservative relative to management's targets. We also maintain our FY22E revenue/CNP of RM1.2b/RM95m. FY21E/FY22E DPS of 4.6 sen/5.0 sen yield 2.1%/2.3%.

**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:** RM2.22  
**Target Price:** RM3.00 ↔

### Share Price Performance



KLCI	1,611.28
YTD KLCI chg	-1.0%
YTD stock price chg	-12.3%

### 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%

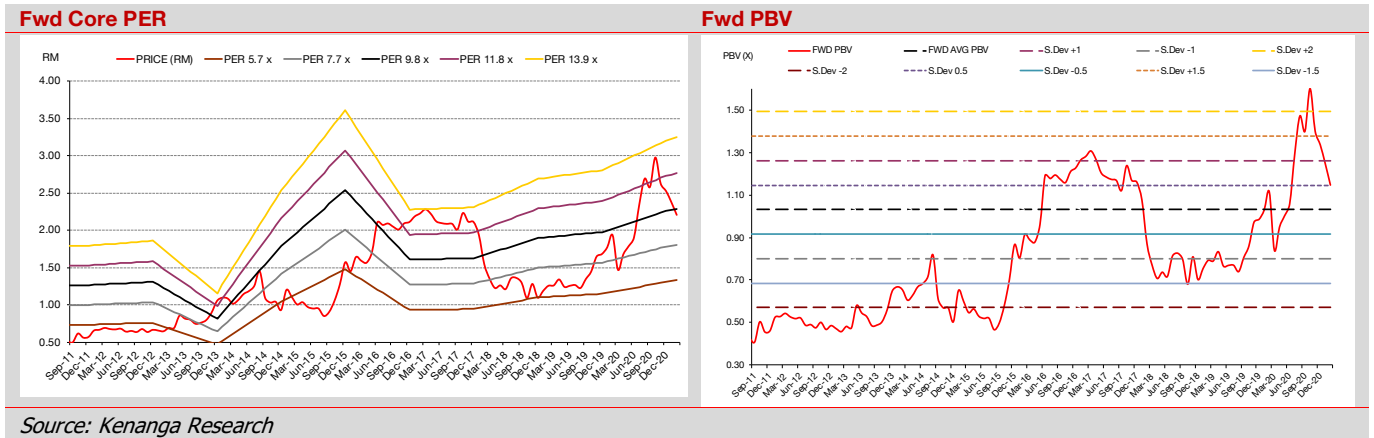
### Summary Earnings Table

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
<b>Net Profit (NP)</b>	75.5	87.4	94.8
<b>Core NP*</b>	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





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## 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)	
<b>STOCKS UNDER COVERAGE</b>																	
SCGM BHD	1.86	356.2	Y	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	Y	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	Y	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	Y	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	Y	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
<b>Simple Average</b>					<b>15.0%</b>	<b>8.4%</b>	<b>466.7%</b>	<b>23.1%</b>	<b>15.7</b>	<b>32.2</b>	<b>19.9</b>	<b>1.7</b>	<b>1.6</b>	<b>11.7%</b>	<b>2.9%</b>		

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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