

26 February 2016

Consumer Non-cyclical | Packaging

Thong Guan

Neutral (Maintained)

Positioned For Growth

Target Price:	MYR2.94
Price:	MYR2.98
Market Cap:	USD74.3m
Bloomberg Ticker:	TGI MK

While we believe that FY16 bears exciting earnings prospects for Thong Guan as it rolls out the final phase of its 3-year MYR100m capex plan to grow its packaging capacity, we think much of the positive news has already been priced in. Maintain NEUTRAL with a higher MYR2.94 TP (from MYR2.57, 1% downside) based on an unchanged 10x FY16F P/E.

New packaging capacities to anchor earnings. Thong Guan's anticipated 33-layer nano-technology line was commissioned in early-2016 and is likely to add an estimated 15,000-16,000 tonnes to stretch film capacity. This should bring total capacity to 73,000-75,000 tonnes pa. In addition, its 5-layer blown film line, with a capacity of 2,500 tonnes, is likely to be powered-up within the next few months. Thong Guan's two polyvinyl chloride (PVC) food wrap lines installed in early 2015 are also currently operating at near full capacity and management has guided that it may look to install more lines to cater for strong PVC wrap orders.

Innovation drive to improve margins. We are positive on Thong Guan's continuous drive towards innovation through investments in state-of-the-art technologies and research & development (R&D) efforts. This ought to help improve margins going forward. The new 33-layer stretch film line would enable the company to achieve increased volumes and better cost efficiencies while commanding higher ASPs. This is due to its higher value-add nature.

4Q15 earnings: in line

(MYRm)	4Q14	3Q15	4Q15	QoQ (%)	YoY (%)	Comments
Revenue	167.0	182.3	195.7	7.3	17.2	
EBIT	(4.2)	9.0	13.8	54.2	(430.6)	
EBIT Margin (%)	(2.5)	4.9	7.1			
Core Net Profit	(4.2)	8.5	12.8	50.2	406.0	In line with our expectation but exceeds consensus
Net Margin (%)	(2.5)	4.7	6.5			

Source: Company data, RHB

Maintain NEUTRAL. While we remain positive about Thong Guan's earnings growth prospects (3-year earnings CAGR of 37%), we think most of the positive news is already in the share price. We upgrade FY16F earnings by 15% on expectations of stronger sales volume from its packaging division and also introduce our FY18 forecasts. Maintain NEUTRAL with a higher MYR2.94 TP.

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)	740	712	902	919	924
Reported net profit (MYRm)	17.5	38.9	51.4	45.0	47.4
Recurring net profit (MYRm)	17.5	38.9	51.4	45.0	47.4
Recurring net profit growth (%)	(38.0)	122.2	32.4	(12.5)	5.3
Recurring EPS (MYR)	0.17	0.37	0.28	0.24	0.26
DPS (MYR)	0.07	0.13	0.14	0.08	0.08
Recurring P/E (x)	17.9	8.1	10.7	12.2	11.6
P/B (x)	0.92	0.80	1.11	1.05	0.98
P/CF (x)	na	3.80	6.37	8.61	7.86
Dividend Yield (%)	2.3	4.3	4.7	2.6	2.8
EV/EBITDA (x)	8.17	3.99	4.67	4.26	3.72
Return on average equity (%)	5.5	10.6	11.6	8.8	8.8
Net debt to equity (%)	1.5	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			14.3	(6.2)	0.0

Source: Company data, RHB

Share Data

Avg Daily Turnover (MYR/USD)	1.37m/0.32m
52-wk Price low/high (MYR)	1.68 - 3.45
Free Float (%)	39
Shares outstanding (m)	105
Estimated Return	-1%

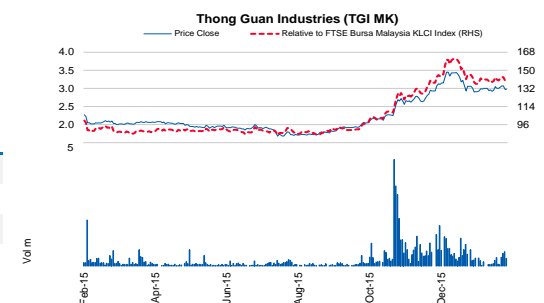
Shareholders (%)

Foremost Equals SB	39.8
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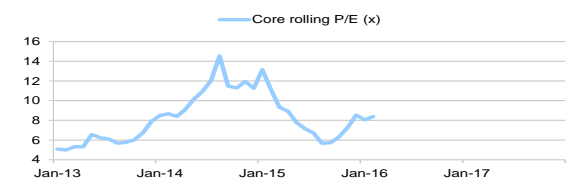
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(5.4)	(2.6)	12.5	73.3	31.9
Relative	(3.4)	(4.6)	14.1	67.3	40.6

Source: Bloomberg



Source: Bloomberg



Analyst

Christine Chua
 +603 9207 7620
christine.chua@rhbgroup.com

Financial Exhibits

Profit & Loss (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover	740	712	902	919	924
Cost of sales	(662)	(606)	(790)	(805)	(807)
Gross profit	78	106	112	114	117
Gen & admin expenses	(23)	(27)	(28)	(28)	(29)
Selling expenses	(25)	(25)	(29)	(29)	(29)
Other operating costs	(11)	(12)	1	1	1
Operating profit	19	42	57	58	60
EBITDA	38	64	80	82	87
Depreciation of fixed assets	(18)	(21)	(23)	(25)	(27)
Amortisation of intangible assets	(0)	(0)	-	-	-
Operating profit	19	42	57	58	60
Interest income	1	2	1	2	2
Interest expense	(1)	(1)	(1)	(1)	(1)
Pre-tax profit	19	43	57	58	62
Taxation	(0)	(4)	(6)	(13)	(14)
Minority interests	(1)	-	-	-	-
Reported net profit	17	39	51	45	47
Recurring net profit	17	39	51	45	47

Source: Company data, RHB

Key Ratios	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Revenue growth (%)	2.8	(3.8)	26.6	1.9	0.6
Operating profit growth (%)	(39.6)	118.9	33.8	1.7	4.8
Recurring net profit growth (%)	(38.0)	122.2	32.4	(12.5)	5.3
Recurrent EPS growth (%)	(38.0)	122.2	(24.4)	(12.5)	5.3
Gross margin (%)	10.6	14.9	12.4	12.4	12.7
Operating EBITDA margin (%)	5.1	8.9	8.8	9.0	9.4
Operating margin (%)	2.6	5.9	6.3	6.3	6.5
Recurring net profit margin (%)	2.4	5.5	5.7	4.9	5.1
Return on average assets (%)	3.5	7.2	8.5	6.5	6.5
Return on average equity (%)	5.5	10.6	11.6	8.8	8.8
Net debt to equity (%)	1.5	(13.2)	(32.9)	(35.1)	(38.1)
Interest cover (x)	16.9	31.8	64.5	70.1	68.7
Capex/Free cash flow (%)	(90.3)	31.5	34.8	47.1	43.0
BVPS (MYR)	3.25	3.70	2.68	2.85	3.03
DPS (MYR)	0.07	0.13	0.14	0.08	0.08
Dividend payout ratio (%)	42.1	35.0	50.0	32.0	32.0
Free cash flow per share (MYR)	(0.58)	0.54	0.31	0.18	0.22

Source: Company data, RHB

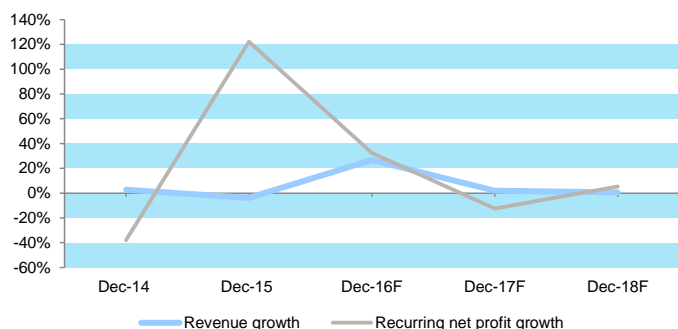
Cash flow (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Operating profit	19	42	57	58	60
Depreciation & amortisation	19	21	23	25	27
Change in working capital	(67)	21	15	(3)	(1)
Other operating cash flow	0	1	(1)	1	1
Operating cash flow	(29)	85	94	80	87
Interest received	(1)	(2)	(1)	(2)	(2)
Interest paid	1	1	(0)	(1)	(1)
Tax paid	(3)	(2)	(6)	(13)	(14)
Cash flow from operations	(32)	82	86	64	70
Capex	(29)	(26)	(30)	(30)	(30)
Other new investments	(0)	(0)	-	-	-
Other investing cash flow	7	7	2	2	2
Cash flow from investing activities	(22)	(20)	(28)	(28)	(28)
Dividends paid	(12)	(4)	(26)	(14)	(15)
Proceeds from issue of shares	52	0	79	-	-
Increase in debt	37	(40)	(7)	-	-
Other financing cash flow	(1)	(5)	0	1	1
Cash flow from financing activities	76	(49)	47	(14)	(14)
Cash at beginning of period	70	92	104	210	232
Total cash generated	22	14	105	22	28
Forex effects	1	1	-	-	-
Implied cash at end of period	93	107	209	232	260

Source: Company data, RHB

Balance Sheet (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total cash and equivalents	92	104	210	232	260
Inventories	193	159	168	171	172
Accounts receivable	115	117	138	141	142
Other current assets	9	3	5	5	5
Total current assets	408	383	521	549	579
Total investments	16	17	17	17	17
Tangible fixed assets	124	133	139	144	147
Total non-current assets	140	150	156	161	165
Total assets	548	533	678	711	743
Short-term debt	76	34	40	40	40
Accounts payable	98	79	125	127	128
Other current liabilities	0	0	0	0	0
Total current liabilities	175	114	165	167	168
Total long-term debt	21	17	5	5	5
Other liabilities	5	5	7	7	7
Total non-current liabilities	26	23	12	12	12
Total liabilities	200	137	177	179	179
Share capital	105	105	184	184	184
Retained earnings reserve	173	284	310	341	373
Other reserves	64	-	-	-	-
Shareholders' equity	342	390	494	525	557
Minority interests	5	7	7	7	7
Other equity	0	0	0	(0)	(0)
Total equity	347	397	501	532	564
Total liabilities & equity	548	533	678	711	743

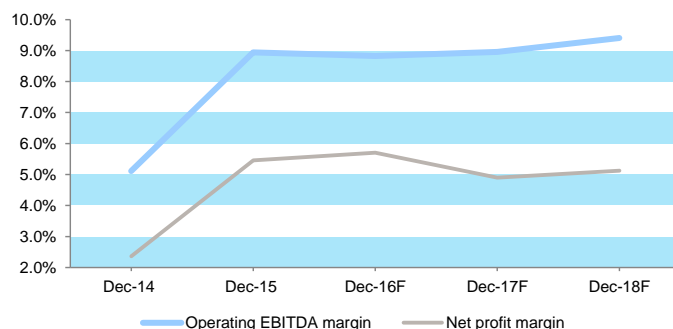
Source: Company data, RHB

Revenue growth vs Recurring net profit growth



Source: Company data, RHB

EBITDA margin vs Net profit margin



Source: Company data, RHB

Positioned For Growth

Figure 1 : Thong Guan's quarterly results review

FYE Dec (MYRm)	4Q14	3Q15	4Q15	QoQ (%)	YoY (%)	FY14	FY15	YoY (%)	Comments
Revenue	167.0	182.3	195.7	7.3	17.2	740.2	712.1	167.0	
EBITDA	0.7	15.2	18.4	20.8	2,585.8	37.7	54.0	0.7	
Depreciation & amortisation	(4.9)	(6.2)	(4.5)	27.3	(6.8)	(18.3)	(20.7)	(4.9)	
EBIT	(4.2)	9.0	13.8	54.2	(430.2)	19.3	33.3	(4.2)	
EBIT Margin (%)	(2.5)	4.9	7.1			2.6	4.7	(2.5)	Improved margins due to impact of a stronger USD on export revenue
Interest expense	(0.5)	(0.3)	(0.3)	(24.64)	31.7	(1.1)	(1.3)	(0.5)	
Interest income	0.2	0.4	0.9	145.3	384.0	0.6	2.2	0.2	
Other operating income	0.0	0.9	1.0	6.6	na	0.0	5.5	0.0	
EI	0.0	2.8	2.8	0.0	na	0.0	3.6	0.0	
Pretax profit	(4.5)	12.7	18.1	42.3	501.8	18.8	43.2	(4.5)	
Pretax Margin (%)	(2.7)	7.0	9.3			2.5	6.1	(2.7)	
Tax	0.3	(1.1)	(1.9)	(82.3)	(760.1)	(0.4)	(3.5)	0.3	
Effective tax rate (%)	(6.5)	(8.3)	(10.7)			(2.2)	(8.1)	(6.5)	
Minority Interest	0.1	(0.4)	(0.7)	(60.2)	(1,361.1)	(0.9)	(1.2)	0.1	
Net Profit	(4.2)	11.3	15.5	37.9	472.5	17.5	38.5	(4.2)	
Core Profit	(4.2)	8.5	12.8	50.2	406.3	17.5	34.9	(4.2)	Within our expectation, but above that of consensus
Net Margin (%)	-2.5	4.7	6.5			2.4	4.9	-2.5	

Source: Company data, RHB

Figure 2: TP ex-ICULS and warrants derivation

Full conversion of ICULS and warrants

FY16F net profit (MYRm)	51.4
Net interest income from warrant proceeds	1.4
Interest expense savings from conversion of ICULS	1.2
	54.1
Enlarged share base from full conversion of ICULS and warrants (m)	184.1
TP at unchanged 10x 2016F P/E:	2.94

Source: Company data

Figure 3: Thong Guan's DCF valuation

FYE Jul	FY16F	FY17F	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
EBIT	56.7	57.6	60.4	48.0	50.9	55.1	58.4	61.0	65.0	67.4
EBIT x (1-Tax)	51.0	51.8	46.5	36.5	38.7	41.9	44.4	46.3	49.4	51.2
Add: Depreciation & amortisation	22.9	24.7	26.6	27.7	29.5	31.6	33.7	35.7	38.1	40.6
Less: Capex	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)	(35.0)	(35.0)	(35.0)	(39.0)	(42.0)
Less: Working capital requirements	14.7	(3.5)	(0.9)	9.8	(1.4)	(3.8)	(9.1)	(1.0)	(2.4)	(0.8)
Unlevered FCF	58.6	43.1	42.1	44.0	36.8	34.6	33.9	46.1	46.0	49.0
PV of unlevered FCF	53.3	35.6	31.7	30.1	22.9	19.6	17.4	21.6	19.6	18.9
Sum of PV of unlevered FCF	270.6									

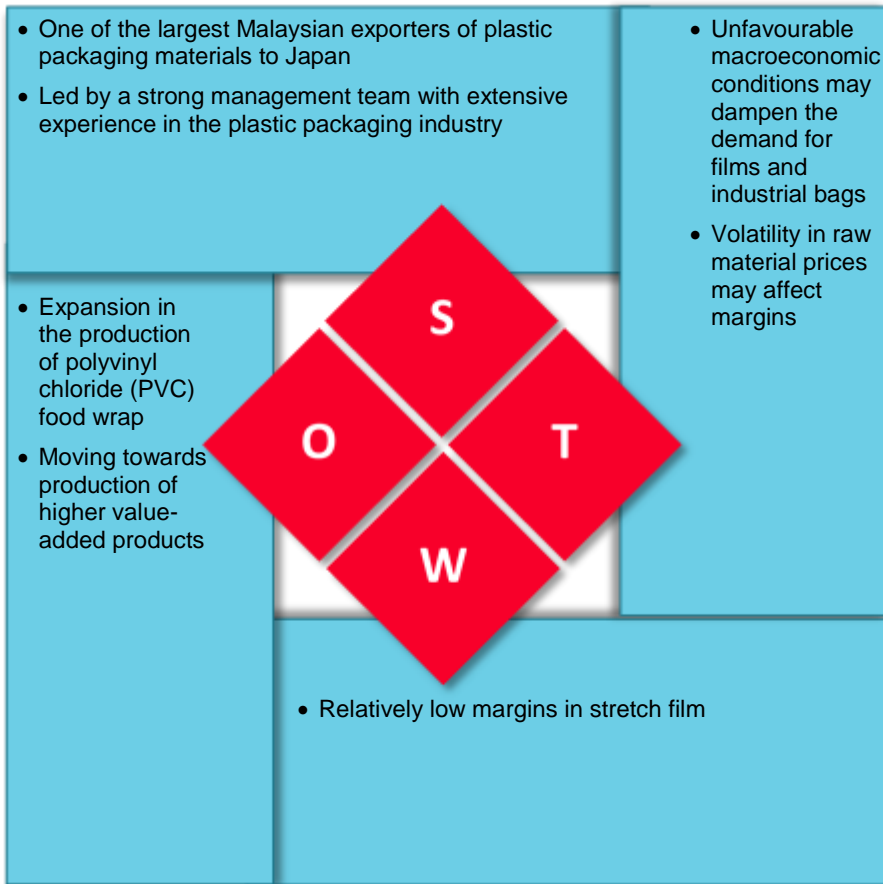
Terminal value	551.7
PV of Terminal value	213.3
Enterprise value	483.9
Add: net cash	52.3
Equity value	536.2

Equity value per share	2.91
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Risk-free	4.3%
Beta	1.0
Equity Risk Premium	6.7%
Cost of Equity	11.0%
Cost of Debt (after tax)	2.6%
WACC	10.0%
Tax rate	24%
Terminal growth	1.0%

Source: RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-12-11	Neutral	2.57	2.73
2015-11-20	Buy	2.57	2.41
2015-08-20	Neutral	1.77	1.80
2015-05-28	Neutral	2.05	1.95
2015-03-02	Neutral	2.03	2.05
2014-11-21	Buy	2.60	2.09
2014-09-15	Buy	2.60	2.25
2014-08-28	Buy	3.60	2.86
2014-08-27	Buy	3.60	2.86

Source: RHB, Bloomberg

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Kuala Lumpur	Hong Kong	Singapore
RHB Research Institute Sdn Bhd Level 11, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur Malaysia Tel : +(60) 3 9280 2185 Fax : +(60) 3 9284 8693	RHB Securities Hong Kong Ltd. 12 th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	RHB Research Institute Singapore Pte Ltd (formerly known as DMG & Partners Research Pte Ltd) 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211
Jakarta	Shanghai	Bangkok
PT RHB Securities Indonesia Wisma Mulia, 20th Floor Jl. Jenderal Gatot Subroto No. 42 Jakarta 12710, Indonesia Tel : +(6221) 2783 0888 Fax : +(6221) 2783 0777	RHB (China) Investment Advisory Co. Ltd. Suite 4005, CITIC Square 1168 Nanjing West Road Shanghai 20041 China Tel : +(8621) 6288 9611 Fax : +(8621) 6288 9633	RHB Securities (Thailand) PCL 10th Floor, Sathorn Square Office Tower 98, North Sathorn Road, Silom Bangrak, Bangkok 10500 Thailand Tel: +(66) 2 862 9999 Fax : +(66) 2 862 9799