Stock Digest

Company Update – Chin Well Holdings Bhd

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Positive Growth Despite Trade Uncertainties

Company Update

- Following the rising trade tensions between U.S. and China, Chin Well Holdings Bhd saw a rise in orders from the U.S. which is expected to be delivered in December. For now, however, we think that such orders will remain menial as further capital investments are required (i.e: new moldings) for the necessary machines to be in place before the group is able to accept more orders from the U.S. This is due to the different standard units of measurement used in U.S. fasteners (in inches), compared to that used in both South East Asia and Europe (in metric).

- In the meantime, Chin Well is reviewing the costs needed to ramp up its production capacity to the U.S. and we expect to see additional capex for the purchase of moldings to produce the INCH standard fasteners in due course. The group has allocated about RM12.0 mln (excluding the cost of new moldings) for CAPEX requirements in 2019.

- Meanwhile, fastening products exported into the U.S., from China has been slapped with additional 10% import tariffs from September 2018. The tariffs are also set to increase by another 15% by January 2019, resulting in a total of 25% tax on Chinese fasteners. In a bid to support foreign trade, China has increased its export rebate resulting in a slight drop in fasteners prices from China to compete with other makers.

- Consequently, Chin Well saw its European customers delaying larger orders amid the aforementioned uncertainties, albeit the group still expects to see the orders resuming ahead of the year-end festive seasons. We expect Europe to remain as one of Chin Well's key markets, although expansion efforts will be targeted to the U.S. market moving forward, in a bid to take advantage of potential supply gaps amid the rising trade tensions.

Financial Highlights

FYE June (MYR mln)	FY16A	FY17A	FY18A	FY19F	FY20F
Revenue	508.1	521.3	591.3	664.1	712.0
EBITDA	93.8	80.4	81.9	89.7	94.6
Net Profit	63.4	50.9	55.9	62.0	65.3
Revenue Growth (%)	*1.1*	*2.6*	*13.4*	*12.3*	*7.2*
EBITDA Growth (%)	*24.5*	*-14.3*	*1.9*	*9.6*	*5.5*
Net Profit Growth (%)	*55.6*	*-19.7*	*9.8*	*10.9*	*5.4*
EPS (sen)	21.5	17.3	19.0	21.1	22.2
P/E(x)	8.5	10.6	9.6	8.7	8.2
DPS (sen)	8.5	6.8	8.0	8.4	8.9
Dividend Yield (%)	4.6	3.7	4.4	4.6	4.9
P/BV (x)	1.1	1.0	1.0	0.9	0.9
ROE (%)	13.4	9.9	10.4	10.5	10.9

Source: Company Data & MSSB Research

Recommendation: HOLD

Share Price: 1.83

Target Price: 1.90

Expected Return: +3.6%

Expected Dividend Return: +4.4%

Expected Total Return: +8.0%

FBM KLCI: 1,688.4

Key Statistics

Bursa Code: 5007

Bloomberg Ticker: CWH MK Equity

Stock Information: Principally involved in the manufacturing and trading of fastening and wire products

Listing Market: Main Market

Share Issued (mln): 294.1

Market Capital (RM mln): 538.3

Par Value (RM): N/A

52 week high/low: RM2.00/RM1.49

Estimated free float: 21.7%

Beta (x): 0.81

3-month average volume ('000): 414.0

Major Shareholders:

Benua Handal Sdn Bhd	55.1%
Samarang UCITS	7.5%
AIA Bhd	3.8%

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Prospects

Moving forward, the group is looking to ramp up the capacity of its DIY fasteners, reinforcing bar (or rebar) connectors and wire mesh products which collectively contributes about 11.0% to the group's revenue currently, to 30.0% – 40.0% in four-to-five years' time. The group has earmarked about RM15.0 mln (for FY18-FY19) to upgrade its galvanizing wire production line, which will improve production output and reduce cost per unit. Chin Well also expects a wider range of product offerings and higher quality products after upgrading the wire production line. Currently, the group continues to receive consistent orders for galvanized wires from Australia, Canada, Dubai and India.

Further, there is also a potential for the South Asia, South-East Asia and the U.S. to become its key earnings growth driver. Chin Well expects increased wire mesh sales – contributed by potentially large orders from the Middle East and South Asia regions in FY19. Consequently, the group is planning to increase the production of new wire mesh products that could be used in the agriculture and infrastructure sectors.

The group has also begun the construction of its automated warehouse in Shah Alam, which is scheduled for completion by FY19. Chin Well is looking to set up a new business segment by providing a one-stop warehousing service in the near future, although contribution from the proposed business is not expected to be significant in the near term.

Meanwhile, wire rod prices - a key input material, remains on the high side at US$711.4 per metric tonne (+6.6% Y.o.Y) as at October 2018, ahead of China's annual winter production cuts from October this year to March 2019. Consequently, inflated business costs (i.e: gas tariffs, labour costs) and high wire rod prices could limit earnings growth as Chin Well struggles to pass-on the additional costs amid the strong competition.

Nevertheless, we think that there are still pockets of opportunity for growth despite rising trade tensions following potentially higher DIY and bulk orders from U.S. customers, although we are cautious of the slowing orders from Chin Well's European customers due to increased competition from its Chinese peers.

Worldwide industrial fastener demand is expected to grow at a CAGR of 5.4% to US$116.5 bln by 2022, from US$84.9 bln in 2016, underpinned by positive demand from end-use industries and solid recovery in the construction and automotive segments in developed countries. (Zion Market Research)

Valuation and Recommendation

We maintain our **HOLD** recommendation on Chin Well with a slightly higher target price of RM1.90 (from RM1.85) by ascribing an unchanged target PER of 9.0x to a higher FY19 EPS of 21.1 sen after tweaking our depreciation adjustments, as most of the positives are already priced-in its current valuation, in our view. Key drivers of bottomline growth could include: i) stronger sales volume, ii) increasing orders from the U.S. market, and iii) improving production efficiency, albeit upsides could be limited by rising business costs, as well as slower orders from Europe.

The target PER is at a small premium to the valuation of its closest peer, **Tong Herr Resources Bhd,** premised on Chin Well's higher margins and the still positive growth outlook in the fasteners landscape globally.

Income Statement					
FYE June (MYR mln)	**FY16A**	**FY17A**	**FY18A**	**FY19F**	**FY20F**
Revenue	508.1	521.3	591.3	664.1	712.0
EBITDA	93.8	80.4	81.9	89.7	94.6
Depreciation & Amortisation	19.9	20.5	17.7	18.0	18.3
Net Interest Income/(Expense)	0.9	2.3	2.6	3.0	2.9
Pre-tax Profit	74.8	62.2	66.7	74.7	79.2
Effective Tax Rate	*15.3%*	*18.1%*	*16.3%*	*17.0%*	*17.5%*
Net Profit	63.4	50.9	55.9	62.0	65.3
EBITDA Margin	*18.5%*	*15.4%*	*13.8%*	*13.5%*	*13.3%*
Pre-tax Margin	*14.7%*	*11.9%*	*11.3%*	*11.2%*	*11.1%*
Net Margin	*12.5%*	*9.8%*	*9.5%*	*9.3%*	*9.2%*

Source: Company Data & MSSB Research

Balance Sheet					
FYE June (MYR mln)	**FY16A**	**FY17A**	**FY18A**	**FY19F**	**FY20F**
Total Assets	610.5	621.3	665.1	667.1	701.2
Fixed Assets	153.0	149.5	139.0	140.9	143.9
Current Assets	452.4	466.7	521.1	521.3	552.4
Other LT Assets	5.2	5.1	5.0	5.0	4.9
Current Liabilities	106.3	79.4	114.0	69.9	90.6
LT Liabilities	8.5	8.4	7.9	9.4	9.4
Share Capital	149.8	177.9	177.9	177.9	177.9
Total Equity	495.7	533.5	543.2	587.8	601.2
Minority Interests	N/A	N/A	N/A	N/A	N/A

Source: Company Data & MSSB Research

Per Share Data					
FYE June (MYR mln)	**FY16A**	**FY17A**	**FY18A**	**FY19F**	**FY20F**
Book Value (sen)	168.5	181.4	184.7	199.8	204.4
Cash Flow (sen)	25.8	1.4	-0.2	25.1	28.9
Net Earnings (sen)	21.5	17.3	19.0	21.1	22.2
Dividend (sen)	8.5	6.8	8.0	8.4	8.9
Payout Ratio (%)	39.5	39.3	38.2	40.0	40.0
Dividend Yield (%)	4.6	3.7	4.4	4.6	4.9
PER (x)	8.5	10.6	9.6	8.7	8.2
P/Cash Flow (x)	7.1	132.7	-752.0	7.3	6.3
P/Book Value (x)	1.1	1.0	1.0	0.9	0.9
ROA(%)	10.4	8.2	8.4	9.3	9.3
ROE (%)	12.8	9.5	10.3	10.5	10.9
Gearing (%)	12.2	9.0	13.5	4.0	6.8
Net Gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company Data & MSSB Research

Stock Price Performance vs KLCI

Price Performance	1 month	3 months	12 months
Absolute (%)	1.67%	18.06%	4.57%
Relative (%)	4.00%	23.53%	6.58%

Source: Bloomberg

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