

17 September 2020

Materials | Containers & Packaging

D'nonce Technology (DNON MK)

Not Rated

Ready To Ride The Wave

Fair Value (Return): MYR0.91 (+53%)
Price: MYR0.595
Market Cap: USD39.5m
Avg Daily Turnover (MYR/USD) 3.34m/0.80m

- **MYR0.91 FV, 15x FY22F fully diluted P/E, +2.5SD from 1-year mean** – premised on accelerated demand growth for paper packaging in tandem with gloves capacity expansion, increasing demand from the E&E sector and improving financial health under the helm of a new management team. Our valuation is lower than the implied COVID-19-related peer valuation of 18x. We expect demand to remain strong in the near to medium term, with 2-year earnings CAGR of 105%, in view of elevated hygiene awareness globally.
- **Diversified engineering solutions provider.** D'nonce Technology offers end-to-end design solutions, complete box-build assembly, cleanroom services, supply chain management and precision polymer engineering services to customers in the healthcare, electrical and electronics (E&E) and manufacturing sectors. Since Jul 2019, it has been under the helm of a new management team, which has vast experience in working with multi-national corporations. Except for April, it has achieved a stronger performance under the helm of its current management.
- **Accelerated demand growth for paper packaging in tandem with gloves capacity expansion.** D'nonce is a direct beneficiary of global heightened demand for gloves, being a box packaging supplier to glove manufacturers. Its plant in the Sadao district, Thailand, which serves multiple glove manufacturers – Top Glove (TOPG MK, BUY, TP: MYR33.30), Sri Trang Gloves (STGT TB, NR), Mercator Medical Thailand, and Halyard – is running at full utilisation. As Top Glove and Sri Trang have announced multi-year capacity expansion plans in Sadao, D'nonce – which is among a handful of players in the district – is looking to expand its capacity further by 50% (expected commissioning by 4QCY20) to cater to customer expansion.
- **E&E sector growth is in line with increasing demand for data storage,** thanks to continuous technological advancements and the growing emphasis on cloud computing. Also, the global pandemic has led to a higher adoption of work-from-home practices, contributing to the surge in demand for memory cloud and disk drivers. The group is expected to benefit from the increased demand for cleanroom facilities in order to perform ultrasonic cleaning, rinsing and drying services. As capacity catering to the E&E sector is c.75% utilised, we believe there is still room for growth to ride this megatrend.
- **Solid balance sheet backed by better financial performance.** 1QFY21 (Apr) PAT of MYR3.8m surpassed FY18's figure, and made up c.85% of FY20 core earnings, despite FY18 and FY20 being a 16-month financial period. We expect the upcoming quarters to mirror (if not beat) the strong 1QFY21 performance, thanks to robust orders and ASP growth. On its balance sheet, net gearing is at 0.09x for 1QFY21 post some debt repayment.
- **Risks:** Plunge in demand for gloves upon commercialisation of a vaccine, sharp fluctuation in raw material prices, and heightened competition.

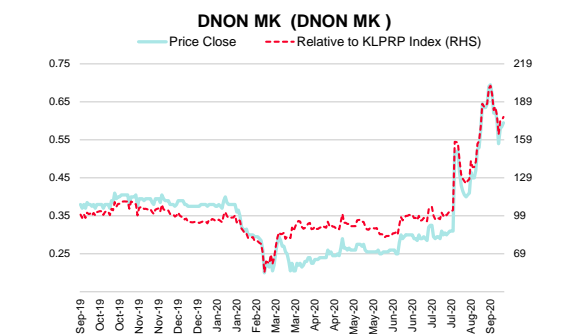
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	56.6	46.9	138.0	158.7	56.6
Relative	81.3	47.4	138.5	157.3	77.6
52-wk Price low/high (MYR)	0.20 – 0.70				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Apr-20	Apr-21F	Apr-22F
Total turnover (MYRm)	270	229	250	280
Recurring net profit (MYRm)	4	5	15	19
Recurring net profit growth (%)	65.1	19.0	232.0	26.5
Recurring P/E (x)	30.97	33.85	10.85	9.82
P/B (x)	1.3	1.3	1.2	1.2
P/CF (x)	18.07	na	10.43	8.89
Dividend Yield (%)	na	na	na	na
EV/EBITDA (x)	6.69	9.00	4.48	4.13
Return on average equity (%)	3.3	0.6	12.2	13.6
Net debt to equity (%)	26.5	13.3	1.3	net cash

Source: Company data, RHB

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-18	Apr-20	Apr-21F	Apr-22F
Malaysia	Recurring EPS	0.02	0.02	0.05	0.06
Materials	BVPS	0.45	0.45	0.48	0.48
D'nonce Technology	Return on average equity (%)	3.3	0.6	12.2	13.6
DNON MK					
Not Rated					
Valuation basis	Valuation metrics	Dec-18	Apr-20	Apr-21F	Apr-22F
15x FY22F fully diluted P/E	Recurring P/E (x)	30.97	33.85	10.85	9.82
	P/B (x)	1.3	1.3	1.2	1.2
	FCF Yield (%)	1.6	(1.2)	4.7	7.0
	EV/EBITDA (x)	6.69	9.00	4.48	4.13
	EV/EBIT (x)	11.96	21.28	6.27	5.61
Key drivers	Income statement (MYRm)	Dec-18	Apr-20	Apr-21F	Apr-22F
i. Accelerated growth in demand for paper packaging in tandem with capacity expansion of gloves;	Total turnover	270	229	250	280
ii. Growing demand from E&E sector in line with increasing demand for data storage;	Gross profit	105	99	108	122
iii. Sufficient space to cater for capacity expansion.	EBITDA	20	18	35	40
	Depreciation and amortisation	(9)	(10)	(10)	(11)
	Operating profit	11	8	25	30
	Net interest	(6)	(5)	(4)	(2)
	Pre-tax profit	5	2	22	27
	Taxation	(2)	(2)	(5)	(7)
	Reported net profit	3	1	15	19
	Recurring net profit	4	5	15	19
Key risks	Cash flow (MYRm)	Dec-18	Apr-20	Apr-21F	Apr-22F
i. Plunge in demand for gloves upon commercialisation of vaccine;	Change in working capital	(2.6)	(4.2)	(4.1)	(6.0)
ii. Sharp fluctuation in raw material prices;	Cash flow from operations	6.5	(0.7)	15.6	21.0
iii. Heightened competition.	Capex	(4.7)	(1.1)	(8.0)	(8.0)
	Cash flow from investing activities	(3.3)	0.1	(8.0)	(8.0)
	Cash flow from financing activities	(3.0)	(6.8)	(20.2)	(14.4)
	Cash at beginning of period	29.3	40.1	32.4	30.2
	Net change in cash	0.2	(7.4)	(12.5)	(1.4)
	Ending balance cash	29.5	32.1	19.9	28.8
Company Profile	Balance sheet (MYRm)	Dec-18	Apr-20	Apr-21F	Apr-22F
D'nonce Technology is a diversified engineering solutions provider that offer precision polymer engineering solutions, contract manufacturing services, and integrated supply chain products and services to customers in the healthcare, E&E, and manufacturing sector. It has manufacturing facilities in both Malaysia and Thailand.	Total cash and equivalents	40	32	30	36
	Tangible fixed assets	49	73	70	68
	Total investments	14	14	14	14
	Total assets	190	200	201	211
	Short-term debt	50	36	20	10
	Total long-term debt	15	13	12	10
	Total liabilities	96	79	63	53
	Total equity	94	121	138	158
	Total liabilities & equity	190	200	201	211
	Key metrics	Dec-18	Apr-20	Apr-21F	Apr-22F
	Revenue growth (%)	40.3	(15.2)	9.2	12.3
	Recurrent EPS growth (%)	50.5	(8.5)	212.1	10.5
	Gross margin (%)	39.1	43.2	43.4	43.7
	Operating EBITDA margin (%)	7.4	7.8	14.1	14.4
	Net profit margin (%)	1.0	0.3	6.0	6.8
	Capex/sales (%)	1.7	0.5	3.2	2.9
	Interest cover (x)	1.84	1.46	6.87	12.50

Source: Company data, RHB

Ready To Ride The Wave

A diversified engineering solutions provider

D'nonce offers end-to-end design solutions, complete box-build assembly, cleanroom services, supply chain management and precision polymer engineering services (thermoforming molding and plastic injection molding). It has manufacturing facilities in Malaysia and Thailand to serve customers mainly in the healthcare, E&E, and manufacturing sectors.

Its products include automation and electronic component trays, tapes and reels for printed circuit board (PCB) components, paper and plastic product packaging (corrugated carton box, paper reel, polyethylene die cut foam), to name a few. The three main segments are supply of packaging and polymer engineering solutions (81% of FY20 revenue), contract manufacturing (10%), and integrated supply chain services (9%). Among the key sectors served, healthcare is the largest profit contributor to the group.

Since Jul 2019, D'nonce has been helmed by a new management team, which has vast experience in working with MNCs. Except for the Apr 2020 quarter, the group has managed to clock in a stronger performance, under this management.

Accelerated growth in packaging thanks to unprecedented gloves demand

D'nonce is a direct beneficiary of heightened worldwide demand for gloves, as it supplies box packaging to glove manufacturers. In view of the spike in daily new cases, as well as the fear of a potential second wave of COVID-19 infections in many countries, demand for gloves remains strong – since they are an important component of personal protective equipment (PPE), especially for the medical industry.

Having ventured into the Sadao district, Songkhla in Thailand since 2007, the group has a packaging box plant that is readily available to cater to demand from glove manufacturers such as Top Glove, Sri Trang Gloves, European glove producer Mercator Medical Thailand, and US glove maker Halyard. Over 90% of production capacity caters to the healthcare sector and, given the elevated demand for gloves, the plant is currently running at a full utilisation rate. Based on a rough estimation, it is one of the three major suppliers of box packaging in Sadao with about 30% market share, alongside a local and Japanese firm.

Glove manufacturers in Thailand such as Top Glove and Sri Trang have announced capacity expansion plans in their Sadao facilities over the next few years. This should benefit D'nonce, as it has the capability to expand in tandem with customer expansion, given that it has utilised about only two out of its existing 20 acres of land in Sadao. In fact, the group is looking to expand its capacity in Sadao by c.50% and invest in additional machines (lines) over the next few years, to improve productivity as well as optimise manpower. The plant is located close to its customers (Figure 3), giving it a competitive advantage in terms of delivery time, cost savings, and convenience to customers.

Our in-house base case assumption for the COVID-19 vaccine development is that a safe and effective vaccine would only be available in 1H21 under Emergency Use Authorisation (EUA), which is expected to lower glove demand in 2H21 – assuming new COVID-19 cases decline by then. That said, we believe it is impossible to determine if any of the vaccine candidates currently under trial will work, as even the most promising Phase 2 results may also fail in Phase 3, as denoted by the US Food & Drug Administration.

As such, demand for paper packaging is expected to remain robust in near term. Even with the normalisation of demand for gloves once a successful vaccine is commercialised, we believe the current pandemic is expected to bring about a new norm – which will involve greater attention to personal hygienic care. This may ultimately sustain demand for gloves, and, in turn, box packaging.

Growth in E&E segment in line with increasing demand for data storage

While demand from the healthcare sector accounted for c.35% of D'nonce's 1QFY21 revenue, the E&E sector contributed 56% of its 1QFY21 revenue, given growing demand from MNCs. Customers from the E&E sector are mainly semiconductor and memory driver manufacturers. For E&E customers, the group offers cleanroom services for precision tray and components, box-build assembly of critical clean components and the manufacturing of plastic components parts mainly used in PCB assembly. Memory drive components require ultra clean components, in order to have optimal performance.

Continuous technological advancements and an increasing emphasis on cloud computing have led to a surge in demand for data storage. At the same time, the global pandemic has led to a higher adoption of work-from-home practices, as companies implement social distancing standard operating procedures (SOPs) for their operations. This, in turn, has caused a surge in demand for memory cloud and disk drivers, in order to support the remote working culture. As such, the group is expected to benefit from the higher demand for cleanroom facilities, which are used to perform ultrasonic cleaning, rinsing and drying services. Also, it is also looking at a higher demand for high temperature electronics packaging. As capacity catered to the E&E sector is c.75% utilised, we believe the group has room for growth and is riding the growth of the E&E sector.

Solid balance sheet backed by better financial performance

Note that D'nonce's 1QFY21 PAT of MYR3.8m surpassed FY18 and made up c.85% of FY20 core earnings of MYR4.5m, despite FY18 and FY20 being a 16-month financial period. We expect the upcoming quarters to mirror (if not beat) the strong 1QFY21 performance, thanks to robust orders and a rise in ASP.

Financially, it has been paring down borrowings progressively since the change of management in Jul 2019. As at 1QFY21, net gearing improved from 0.26x in 2QFY20 to 0.09x in 1QFY21. Meanwhile, receivables turnover almost halved from 96 days in FY17 to 49 days in FY20 – which, in our view is positive for D'nonce. This implies the company has quality customers that are able to pay their debts quickly, thereby allowing it to have quicker access to funds, to grow its business or service debts.

While there is no indication of dividends so far, we believe the group's focus on business expansion and the paring down of debts may eventually reap higher returns moving, as it allocates resources to ride the sector's growth.

Figure 1: Facilities in Malaysia and Thailand

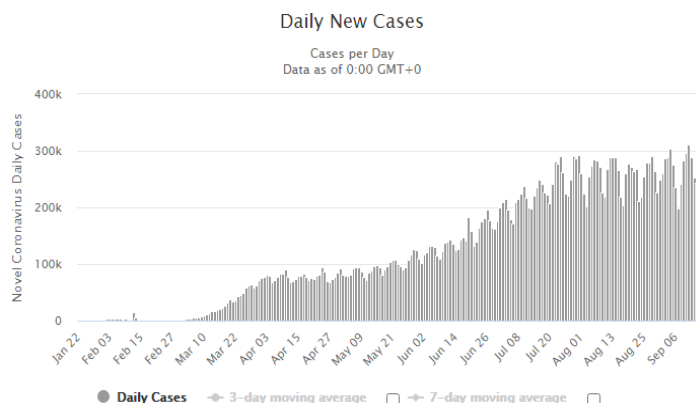
Facilities	Function
Malaysia	
Seberang Prai, Penang	HQ and provision of services for the E&E sector
Cheras, Kuala Lumpur	Production of PCB component tapes & reels
Kota Bahru, Kelantan	Manufacturing of carton boxes
Kulai, Johor	Manufacturing of carton boxes
Thailand	
Sadao district, Songkhla	Manufacturing of packaging boxes for gloves manufacturers
Uthai district, Ayutthaya	Provision of cleanroom services

Source: Company

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Figure 2: Daily new COVID-19 cases (global)



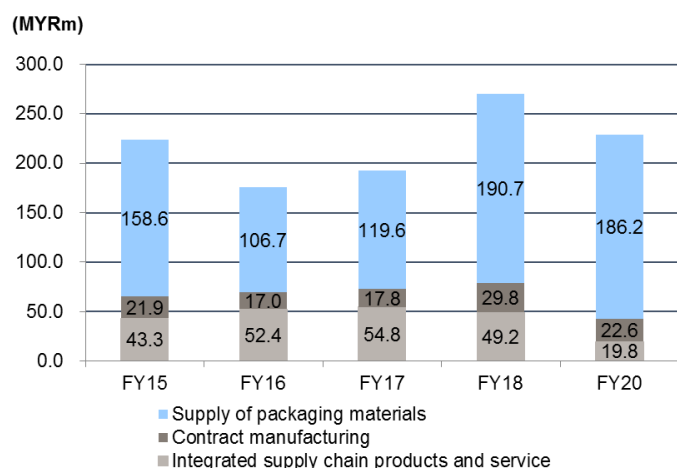
Source: Worldometer

Figure 3: D'nonce's plant is located near Thai gloves manufacturers' facilities



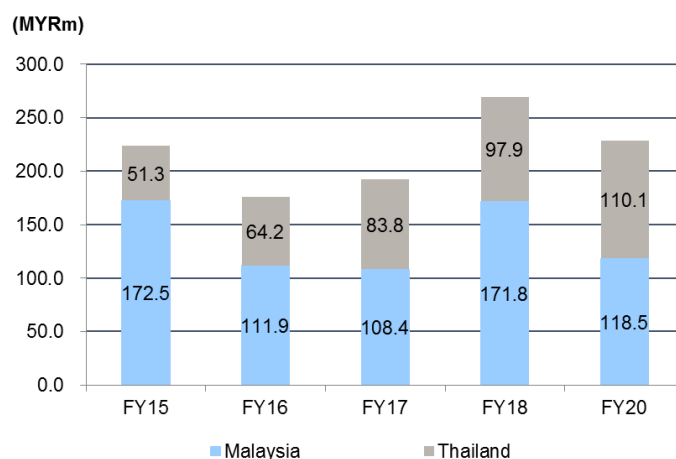
Source: Google Maps

Figure 4: Revenue by segment



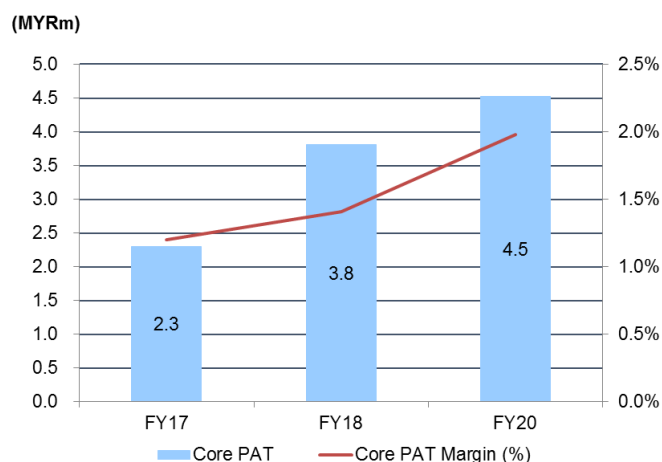
Source: Company data

Figure 5: Revenue by country



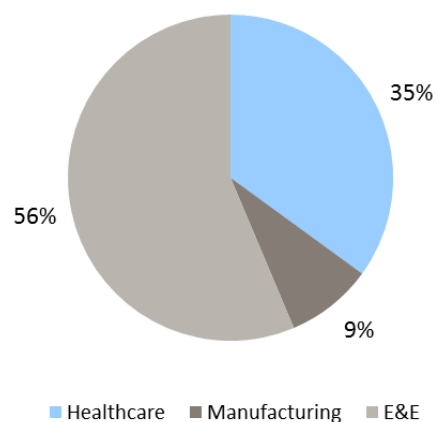
Source: Company data

Figure 6: Historical core PAT and margin trend



Source: Company data, RHB

Figure 7: 1QFY21 revenue by customer segment



Source: Company data

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Figure 8: Peer comparison

Company	FYE	Country	Price	Mkt Cap (USDm)	P/E (x)		Div. Yld (%)	ROE (%)	P/BV (x)	NP Growth (%)	
			15 Sep 20 (Local Currency)		1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	2 Yr Fwd
Plastic Packaging											
Tomypak Holdings	Dec	MY	0.75	78	55.5	37.3	0.3	(0.3)	1.7	(150.0)	48.7
SLP Resources	Dec	MY	0.95	73	16.0	13.0	5.8	8.2	1.5	(12.4)	23.6
Thong Guan Industries	Dec	MY	4.89	223	12.3	11.2	2.2	12.6	1.4	22.0	9.5
Daibochi	Jul	MY	2.80	222	18.8	16.7	2.0	22.9	4.0	212.6	12.7
SCGM ^	Apr	MY	2.96	137	21.7	18.0	1.9	14.9	3.2	53.4	20.4
Scientex	Jul	MY	9.05	1,130	13.0	11.6	2.3	15.0	1.9	7.4	12.5
Weighted Average					16.1	13.7	2.3	14.7	2.2		
D'nonce Technology	Apr	MY	0.60	39	12.4	9.8	0.0	12.2	1.4	232.0	26.5
Deemed COVID-19 related											
ACO Group ^	Feb	MY	0.44	32	15.0	13.9	1.4	n.a	n.a	13.8	7.9
Chemical Co Of Malaysia	Dec	MY	1.23	50	11.4	10.1	4.1	5.0	0.6	17.6	12.6
Hextar Global	Dec	MY	0.67	133	12.0	11.2	3.4	21.8	2.6	1,803.6	6.9
Karex ^	Jun	MY	0.79	190	76.9	48.4	0.6	2.1	1.5	4,467.2	58.9
Luxchem Corp	Dec	MY	0.83	180	20.1	18.4	2.7	12.1	2.3	(1.6)	9.6
Pecca Group ^	Jun	MY	1.21	51	13.2	11.7	4.4	9.6	1.3	92.2	13.5
Samchem Holdings	Dec	MY	0.87	57	10.2	8.7	4.6	14.8	1.4	(1.9)	16.7
SCGM ^	Apr	MY	2.96	137	21.7	18.0	1.9	14.9	3.2	53.4	20.4
Top Glove Corp	Aug	MY	8.43	16,608	45.2	13.1	1.2	46.8	19.6	317.6	243.4
Hartalega Holdings ^	Mar	MY	14.10	11,699	26.7	25.3	2.1	58.4	14.6	320.2	5.7
Kossan Rubber Industries	Dec	MY	11.70	3,622	20.6	14.9	1.7	42.2	7.9	224.1	38.3
Supermax Corp ^	Jun	MY	8.37	5,222	12.1	18.9	2.5	68.6	8.6	244.0	(35.9)
Comfort Glove ^	Jan	MY	4.06	573	15.4	12.9	0.5	39.1	4.9	365.1	19.4
KPJ Healthcare	Dec	MY	0.86	886	26.1	20.7	2.1	7.2	1.9	(33.6)	26.4
Apex Healthcare	Dec	MY	3.24	373	27.8	25.4	1.0	13.0	392.2	5.3	9.2
Pharmaniaga	Dec	MY	4.70	298	17.7	17.4	3.7	19.2	3.4	(146.6)	2.1
Weighted Average					31.7	18.1	1.7	50.3	18.0		

Note: ^FY20F-21F valuations refer to those of FY21F-22F

Source: Bloomberg, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-09-16			

Source: RHB, Bloomberg

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