

19 March 2021

UG Healthcare (UGHC SP)

Selling Overdone; Maintain BUY

Healthcare | Medical Equipment & Devices

Buy (Maintained)

Target Price (Return): SGD0.75 (+25%)
Price: SGD0.60
Market Cap: USD273m
Avg Daily Turnover (SGD/USD) 3.95m/2.97m

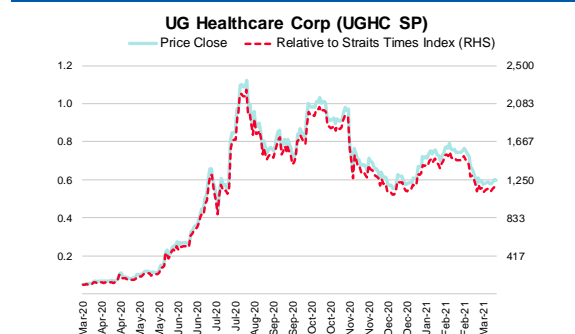
- **Keep BUY, with new DCF-derived SGD0.75 TP from SGD0.95, 25% upside and c.4% yield.** As the US plans to build its own gloves manufacturing plants, we expect long term nitrile gloves ASP to drop to USD40.00/1,000 pieces in the long run. Hence, we reduce our FY23F (Jun) earnings. UG Healthcare remains a value BUY due to: i) its share price falling 46% from peak, ii) valuation still attractive at 12.6x FY23F P/E (average: 15.5x), and iii) strong balance sheet with a net cash of SGD33m.
- **Satisfactory 1HFY21 results.** Recall that 1HFY21 core net profit surged 69x to SGD54.9m due to better ASP and sales volume. This is within our and consensus expectations. The company's cash has increased to SGD43.9m as of end-Dec 2020 (from SGD9.3m as of end-Jun 2020). As its total debts have declined to SGD11.3m (from SGD35.1m), it is now in a net cash position of SGD32.6m.
- **To add 500m capacity by end of next month.** As the current capacity is 2.9bn pieces pa (ppa), UGHC's total capacity will be boosted by 17% to 3.4bn ppa. For FY22F, the company plans to increase its capacity by 1.2bn ppa to 4.6 bn ppa.
- **We expect USD40.00 to be the long-term ASP for nitrile gloves.** As the US plans to build its own gloves manufacturing plants, we estimate that the cost of production to be at USD40.00. This should set the long-term global nitrile gloves price. When the ASP drops below USD40.00, US producers will stop producing, and in the long term, ASP should revert back to USD40.00.
- **Earnings estimates reduced.** We lower our FY23F nitrile gloves ASP to USD40.00/1,000 pieces. Hence, the blended gloves ASP for UGHC has been reduced to USD34.00. We assume the long-term volume mix to be 50% for nitrile and 50% for non-nitrile gloves.
- **TP lowered to SGD0.75.** We have reduced our long-term ASP assumptions to USD34.00 from USD45.00. We believe the near-term high ASP will encourage more competition in future. Additionally, we have rolled over our DCF methodology to start from FY22F. Our new TP reflects 16x FY23F P/E, which is close to the company's average P/E of 15.5x.
- **Still BUY as it is undervalued.** At SGD0.60, its share price has declined 46% from Jul 2020's peak. It is currently trading at 3.1x FY21F P/E. By using the expected trough EPS in FY23F, the stock is trading at 12.6x FY23F P/E (this is 19% discount or -1.3SD from its average of 15.5x).
- **Risks.** These include worse-than-expected gloves demand after the COVID-19 pandemic ends, lower-than-expected sales volume/USD, and higher-than-estimated raw material prices.

Analysts

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.7	(22.2)	7.2	(22.4)	1016.3
Relative	(8.6)	(30.1)	(2.9)	(48.0)	986.9
52-wk Price low/high (SGD)					0.05 – 1.12



Source: Bloomberg

Forecasts and Valuation	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Total turnover (SGDm)	92	144	301	276	195
Recurring net profit (SGDm)	3	13	119	63	29
Recurring net profit growth (%)	(42.2)	434.6	790.1	(47.4)	(53.6)
Recurring P/E (x)	146.27	27.36	3.07	5.84	12.60
P/B (x)	8.7	7.0	2.3	1.7	1.5
P/CF (x)	na	28.76	3.27	6.18	14.85
Dividend Yield (%)	0.1	0.4	3.6	1.9	0.9
EV/EBITDA (x)	75.09	18.28	1.89	2.83	5.14
Return on average equity (%)	5.9	28.3	113.3	33.7	12.8
Net debt to equity (%)	78.3	47.9	net cash	net cash	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 Singapore Healthcare UG Healthcare UGHC SP Buy	Financial summary (SGD)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
	Recurring EPS	0.00	0.02	0.19	0.10	0.05
	DPS	0.00	0.00	0.02	0.01	0.01
	BVPS	0.07	0.08	0.26	0.35	0.39
	Return on average equity (%)	5.9	28.3	113.3	33.7	12.8
Valuation basis	Valuation metrics	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
	Recurring P/E (x)	146.27	27.36	3.07	5.84	12.60
	P/B (x)	8.7	7.0	2.3	1.7	1.5
	FCF Yield (%)	(4.1)	2.6	29.2	14.0	5.4
	Dividend Yield (%)	0.1	0.4	3.6	1.9	0.9
DCF	EV/EBITDA (x)	75.09	18.28	1.89	2.83	5.14
	EV/EBIT (x)	108.09	20.64	1.91	2.91	5.42
Key drivers	Income statement (SGDm)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
	Total turnover	91.7	144.2	300.9	276.2	195.4
	Gross profit	18.7	42.5	166.4	99.8	59.3
	EBITDA	5.3	21.3	149.0	80.9	40.4
	Depreciation and amortisation	(1.6)	(2.4)	(2.1)	(2.1)	(2.1)
Key risks	Operating profit	3.7	18.9	146.9	78.8	38.3
	Net interest	(1.6)	(2.0)	(2.3)	(2.5)	(2.5)
	Pre-tax profit	2.8	18.1	145.8	77.6	37.1
	Taxation	(0.5)	(3.0)	(24.8)	(13.2)	(6.3)
	Reported net profit	2.5	13.4	119.3	62.7	29.1
Company Profile	Recurring net profit	2.5	13.4	119.3	62.7	29.1
	Cash flow (SGDm)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
	Change in working capital	(8.4)	(6.0)	(7.8)	(5.0)	(6.0)
	Cash flow from operations	(6.6)	12.8	112.1	59.3	24.7
	Capex	(8.6)	(3.3)	(5.0)	(8.0)	(5.0)
	Cash flow from investing activities	(6.9)	(2.8)	(3.2)	(6.0)	(3.0)
	Dividends paid	(0.1)	(0.1)	0.0	0.0	0.0
	Cash flow from financing activities	10.8	(7.4)	10.0	10.0	10.0
	Cash at beginning of period	6.7	4.9	9.3	128.2	189.4
	Net change in cash	(2.7)	2.5	118.8	63.3	31.7
	Ending balance cash	4.0	7.3	128.1	192.6	222.1
	Balance sheet (SGDm)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
	Total cash and equivalents	4.9	9.3	128.2	189.4	220.9
	Tangible fixed assets	31.3	31.5	34.4	40.3	43.2
	Total investments	4.6	4.9	6.0	8.0	8.0
	Total assets	98.4	113.0	247.9	329.7	373.1
	Short-term debt	32.2	30.5	40.5	50.5	60.5
	Total long-term debt	6.4	4.8	8.0	8.5	8.5
	Total liabilities	55.2	58.7	89.6	114.5	132.0
	Total equity	43.2	54.3	158.3	215.1	241.0
	Total liabilities & equity	98.4	113.0	247.9	329.7	373.1
	Key metrics	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
	Revenue growth (%)	17.5	57.2	108.6	(8.2)	(29.2)
	Recurrent EPS growth (%)	(42.2)	434.6	790.1	(47.4)	(53.6)
	Gross margin (%)	20.4	29.5	55.3	36.1	30.3
	Operating EBITDA margin (%)	5.8	14.8	49.5	29.3	20.7
	Net profit margin (%)	2.7	9.3	39.7	22.7	14.9
	Dividend payout ratio (%)	21.2	10.9	11.0	11.0	11.0
	Capex/sales (%)	9.4	2.3	1.7	2.9	2.6
	Interest cover (x)	2.27	9.51	63.85	31.53	15.32

Source: Company data, RHB

Sector View: Nitrile Gloves ASP To Normalise Towards The Long-Term USD40.00 Level

We expect USD40.00 to be the long-term bottom ASP for nitrile gloves. This is calculated on per 1,000 pieces basis. As the US plans to build its own glove manufacturing plants, we estimate production cost at USD40.00 per 1,000 pieces of nitrile gloves. We expect the US' cost of production to set the bottom of future global nitrile glove prices. When ASP drops below USD40.00, US producers will stop producing and, in the long term, ASP should revert back to the USD40.00 level.

Production cost in the US is likely to be higher than in Malaysia. The reason is that labour cost is higher in the US – with the minimum wage at USD7.25 per hour, equivalent to six times that of Malaysia's level. The cost to build a plant in the US is also much higher, as this is a time when commodities such as steel are nearing historical peaks.

Glove ASP should not fall off the cliff despite the optimism on vaccines. We do expect the demand for gloves for COVID-19 testing to decline – assuming that the pandemic will start to be contained in 2H21. However, some hospitals are using gloves during vaccinations as well – which should lead to new demand. Lastly, the demand for gloves outside of the medical industry is growing faster than expected. In the US, during 4Q20, the importing of items with Code 3962.20.10 "Gloves, seamless, of plastics" (which are polyvinyl chloride (PVC) gloves) have grown 93% YoY. We understand the surge was due to some consumers having no choice but to accept PVC gloves – such customers should shift towards nitrile gloves, once supply is available, which should support demand.

Why long-term ASP should not revert to pre-COVID level? Our assumption of USD40.00 is higher than the pre-pandemic range of USD20.00-25.00, for nitrile gloves. This is because prior to COVID-19, almost all glove suppliers were efficient producers, with costs below USD20.00. When COVID-19 spread across the globe, many new entrants came into the market and operated at higher costs – estimated between USD30.00 and USD45.00. During this current period of high-priced nitrile gloves at around USD100.00, such inefficient players are able to make a good profit. However, as prices have declined to around USD40.00, some US manufacturers should start to post losses. As such, the demand-supply dynamics should move closer back towards the equilibrium level.

Figure 1: Global gloves demand supply estimate

Pieces (bn)	2018	2019	2020F	2021F	2022F
Malaysia's Big-4	142.0	157.4	189.2	210.2	231.7
Growth (%)	11.8%	10.8%	20.2%	11.1%	10.2%
Sri Trang	21.0	27.0	33.0	38.0	49.1
Growth (%)	NA	28.6%	22.2%	15.2%	29.2%
China	7.0	9.0	18.0	37.0	56.0
Growth (%)	NA	28.6%	100.0%	105.6%	51.4%
Others	70.0	74.2	81.6	131.6	141.6
Growth (%)	NA	6.0%	10.0%	61.3%	7.6%
Estimated manufacturing capacity	240.0	267.6	321.8	416.8	478.4
Supply Growth	92.0	27.6	54.2	95.0	61.6
Supply Growth	62.2%	11.5%	20.3%	29.5%	14.8%
Global demand	256.0	263.0	333.9	419.4	476.0
Demand Growth	28.0	7.0	70.9	85.6	56.5
Demand Growth	12.3%	2.7%	26.9%	25.6%	13.5%
Surplus/(Deficit)	-16.0	4.6	-12.1	-2.7	2.4

Source: RHB

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Figure 2: Key assumptions

Key Assumptions	FY21F	FY22F	FY23F
Installed Year End Capacity (m ppa)	3,400	4,600	5,000
Blended ASP (USD per 1,000 pieces)	70	53	34
Average SGD/USD	0.74	0.74	0.74
Utilisation Rate	90%	90%	90%

Source: RHB

Figure 3: DCF valuation

FYE Jun (SGDm)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	Terminal
CFO	57	23	24	25	26	27	27	27	28	28	
+ Interest (1 - Tax Rate)	2	2	2	2	2	2	2	2	2	2	
- capital expenditure	(8)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	
Free cash flow to firm (FCFF)	51	21	21	22	23	24	24	24	24	25	468
Discount factor	0.94	0.88	0.82	0.77	0.72	0.68	0.63	0.59	0.56	0.52	0.52
PV of FCFF	48	18	18	17	17	16	15	14	14	13	243
Risk-free	2.9%										
Beta	0.42										
Cost of equity	6.3%										
WACC	6.3%										
Terminal growth	1.0%										
Enterprise value (SGDm)	432										
Cash	44										
- Debt	(11)										
Equity value (SGDm)	465										
No of shares (m)	616										
Fair value (SGD)	0.75										

Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2021-02-05	Buy	0.95	0.79
2020-11-06	Buy	1.39	0.97
2020-02-20	Buy	0.11	0.08
2019-08-28	Buy	0.10	0.06
2018-05-11	Buy	0.11	0.07

Source: RHB, Bloomberg

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Analyst	Company
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