25 August 2020

Consumer Non-cyclical | Packaging

Daibochi (DPP MK)

Not Rated

Unlocking Its Full Potential

Fair Value (Return):	MYR3.85 (+35%)
Price:	MYR2.85
Market Cap:	USD223m
Avg Daily Turnover (MYR/USD)	0.39m/0.09m

- **MYR3.85 FV reflects an ascribed 20x P/E on 2021F EPS.** Daibochi's earnings hit a record high, benefiting from the integration of its processes with Scientex, which has resulted in lower variable and fixed costs. We expect a similar synergy from the MPP acquisition through increased capacity, wider customer network and reduced costs from pooling resources. In the longer term, with its strong MNC track record, better cost structure and continuous R&D, we expect it to record earnings CAGR of c.16% over FY20F-22F.
- **Safe haven.** With 85% of revenue contributed by the food & beverage (F&B) sector, we expect Daibochi's revenue base to remain stable amidst market uncertainty. Having several multinational companies (MNCs), eg Nestle, PepsiCo, Mondelez International and Mars, in its client portfolio also provide stability in terms of product demand and margins. The supply business to MNCs tends to have higher barriers to entry due to the research & development (R&D) and relationship-building required before receiving sizable orders. As such, Daibochi is able to offer earnings visibility and a more stable growth trajectory – which should be appreciated by the market given the volatile market conditions.
- **Hitting record earnings.** With the integration of its operations with Scientex (SCI MK, NEUTRAL, TP: MYR9.80), we are seeing some immediate results – Daibochi achieved record earnings with only nine months of core earnings in 9MFY20 of MYR37.6m – mainly driven by margin improvement. We expect the collaboration to continue to strengthen both companies' competitive advantage through combined technical expertise, product offerings and R&D over the longer term.
- **Greater than the sum of its parts.** We expect the company's performance to further improve as it integrates Mega Printing & Packaging (MPP) (refer to page 6 for more details) into its operations. Apart from increasing capacity and widening customer network, the MPP acquisition should also create cost synergies from the pooling of resources, which effectively optimises raw material sourcing and other fixed costs. MPP, which focuses on local customers, will complement Daibochi's predominantly multinational clientele. Product-wise, Daibochi's main focus will be on complex packaging while MPP concentrates on simple packaging structures. Wider offerings and strong operating leverage will likely aid in scaling up.
- **Well-positioned to further widen its reach.** In the longer term, we expect earnings to be driven by organic topline expansion and improved operating leverage as it ramps up production. With a strong track record with MNCs, more efficient cost structure and continuous R&D efforts, we believe the company will strive to secure new clients and new orders from existing clients. Daibochi recently shared that it will invest MYR60m in capacity expansion to support its long-term growth strategies. We expect it to record FY20F-22F earnings CAGR of c.16%.
- **Key risks.** Margin erosion from intense competition, loss of major customers and steep increases in raw material prices.

Forecasts and Valuation	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Total turnover (MYRm)	420	442	610	683	747
Recurring net profit (MYRm)	17	11	51	59	68
Recurring net profit growth (%)	(31.9)	(36.5)	362.5	15.9	15.6
Recurring P/E (x)	54.17	85.31	18.44	15.92	13.76
P/B (x)	4.6	4.5	3.9	3.3	2.8
P/CF (x)	26.21	24.08	14.90	11.25	9.93
Dividend Yield (%)	1.1	0.7	1.6	1.9	2.2
EV/EBITDA (x)	24.25	29.91	9.44	8.19	7.06
Return on average equity (%)	8.7	5.4	22.6	22.4	22.1
Net debt to equity (%)	21.7	19.1	13.4	6.6	net cash

Note: FY18-19 is annualized. The company change its financial year end to July (from Dec) starting May 2019

Source: Company data, RHB

Analyst

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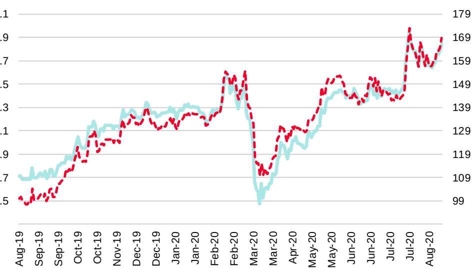
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	26.1	1.4	17.3	17.8	64.7
Relative	27.4	2.7	8.1	12.5	67.2
52-wk Price low/high (MYR)					1.47 – 2.95



Source: Bloomberg

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

Financial Exhibits

Asia
Malaysia
Consumer Non-cyclical
Daibochi
DPP MK
Not Rated

Valuation basis

P/E

Key drivers

i. Ongoing capacity expansion;
ii. Securing new big customers.

Key risks

i. Weak consumer spending;
ii. Sharp fluctuation of raw material prices.

Company Profile

Daibochi is a flexible packaging solutions provider in Malaysia and the ASEAN region.

Financial summary (MYR)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Recurring EPS	0.05	0.03	0.15	0.18	0.21
DPS	0.03	0.02	0.05	0.05	0.06
BVPS	0.62	0.63	0.74	0.86	1.01
Return on average equity (%)	8.7	5.4	22.6	22.4	22.1

Valuation metrics	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Recurring P/E (x)	54.17	85.31	18.44	15.92	13.76
P/B (x)	4.6	4.5	3.9	3.3	2.8
FCF Yield (%)	3.0	3.1	3.5	4.6	8.5
Dividend Yield (%)	1.1	0.7	1.6	1.9	2.2
EV/EBITDA (x)	24.25	29.91	9.44	8.19	7.06
EV/EBIT (x)	37.24	53.43	12.20	10.48	8.67

Income statement (MYRm)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Total turnover	420	442	610	683	747
Gross profit	49	45	122	137	149
EBITDA	41	33	103	118	130
Depreciation and amortisation	(14)	(14)	(23)	(26)	(24)
Operating profit	26	18	80	92	106
Net interest	(4)	(4)	(9)	(10)	(11)
Pre-tax profit	24	16	71	82	95
Taxation	(5)	(3)	(18)	(21)	(24)
Reported net profit	17	11	51	59	68
Recurring net profit	17	11	51	59	68

Cash flow (MYRm)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Change in working capital	(5.2)	1.7	(23.1)	(14.3)	(12.7)
Cash flow from operations	35.6	38.8	62.6	82.9	94.0
Capex	(7.3)	(9.5)	(30.0)	(40.0)	(15.0)
Cash flow from investing activities	(25.3)	(19.8)	(30.0)	(40.0)	(15.0)
Dividends paid	(10.6)	(6.9)	(15.2)	(17.6)	(20.3)
Cash flow from financing activities	(8.6)	(18.0)	73.2	(2.6)	(11.7)
Cash at beginning of period	16.7	18.3	18.6	124.4	164.7
Net change in cash	1.6	0.9	105.8	40.3	67.3
Ending balance cash	18.9	19.8	124.4	164.7	232.0

Balance sheet (MYRm)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Total cash and equivalents	18	19	124	165	232
Tangible fixed assets	139	139	146	160	151
Total investments	19	19	19	19	19
Total assets	366	365	493	567	643
Short-term debt	53	57	95	90	110
Total long-term debt	15	5	65	95	95
Total liabilities	141	135	225	255	280
Total equity	225	230	268	312	363
Total liabilities & equity	366	365	493	567	643

Key metrics	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Revenue growth (%)	10.2	5.4	37.9	11.8	9.4
Recurrent EPS growth (%)	(32.0)	(36.5)	362.5	15.9	15.6
Gross margin (%)	11.8	10.1	20.0	20.0	20.0
Operating EBITDA margin (%)	9.7	7.4	17.0	17.2	17.5
Net profit margin (%)	4.1	2.5	8.3	8.6	9.1
Dividend payout ratio (%)	61.4	63.4	30.0	30.0	30.0
Capex/sales (%)	1.7	2.1	4.9	5.9	2.0
Interest cover (x)	7.54	4.76	8.61	9.19	9.37

Source: Company data, RHB

Investment Thesis

Best mix of stable earnings – strong clientele base and exposure in F&B

Supported by sustained demand from F&B sector. With 85% of revenue contributed by the F&B sector, we expect Daibochi's revenue base to be more stable during this challenging time. Compared to other sectors, demand from the F&B sector has been less affected by the COVID-19 pandemic. Having several MNCs – Nestle, PepsiCo, Mars and Modelez International – under its client portfolio also provide stability in terms of product demand and margins. The supply business to MNCs also tends to have higher barriers to entry due to the R&D and relationship-building required before receiving sizable orders.

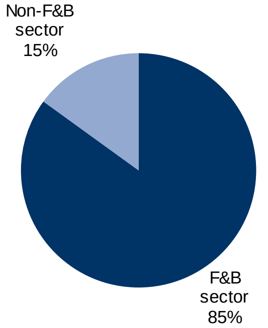
More cost competitive. With the integration of Scientex, Daibochi now has access to raw materials at more competitive prices, and we have started to see the impact in 1QFY20. For fluctuations in resin prices, the company now has cost pass-through mechanisms for most of its customers (c.85% of sales), which would help to minimise margin fluctuations. However, we note that there could be some time lag before fully passing on the cost. Daibochi may also benefit from lower resin prices – selected customers with whom the company passes on the savings may opt to waive a portion of it. Raw materials account for c.60-65% of the company's cost of sales. Resin prices have been on a declining trend, dropping 17% on average YTD vs 2019's average price – mainly due to lower crude oil prices. Daibochi also recently went through operating efficiency enhancements by streamlining its process with Scientex, which should help to reduce fixed costs and improve operating leverage. The company's EBIT margin improved to 11.6% vs 4.2% in 18MFY19, 9.7% in 2017 and 8.8% in 2016. As such, Daibochi achieved record earnings with only nine months of core earnings in 9MFY20 of MYR37.6m.

Synergistic effect – greater than the sum of its parts

Unlocking value. Daibochi has completed its integration process with Scientex. The two companies now share raw materials procurement, finance and support services, as well as production capabilities. Scientex and Daibochi also will have collaborative R&D and knowledge sharing to further strengthen their competitive advantage. Daibochi is now in the midst of implementing an enhanced production system to MPP's operations – this is expected to have been completed in 3QFY20. Besides increasing its capacity and widening its network of customers and suppliers, the MPP acquisition is also expected to derive synergies from pooling resources, further reducing fixed costs and bulk purchasing of raw materials. Despite having similar products, we expect very little cannibalisation between Daibochi and MPP. MPP focuses more on local customers and this should complement Daibochi that predominantly has multinational clientele. Daibochi's main focus will also be on complex packaging eg multi-layered/special requirements packaging while MPP concentrates on simple packaging structures eg single-layered or bi-laminated structures.

Organic growth to drive future earnings. After all the synergistic benefits kick in, we expect the company's performance to further improve, driven by organic topline expansion and improved operating leverage as it ramps up production. With its strong track record with MNCs, better cost structure, and continuous R&D efforts, we believe the company will strive in securing new clients and new orders from existing clients. Daibochi recently shared that it will be investing MYR60m in capacity expansion, involving the purchase of 13 new lines for printing, lamination and bagging processes to support its long-term growth strategies.

Figure 1: Sales breakdown by sector



Source: Company data

Figure 2: Some of Daibochi's customers

Source: Company data

Valuation and Recommendation

NOT RATED. The fair value of MYR3.85 is derived from 2021F earnings with a target P/E of 20x – in line with the FBMKLCI and 33% premium to peer average. The ascribed 20x target P/E is at +1SD or 19% premium vs its 5-year historical mean (16x). We believe the premium is justified given the company is in the midst of a transformation to unlock its full potential. As mentioned earlier, being part of a much bigger group, the company now should have better access to cheaper raw materials and greater customer reach. Systematic integration with Scientex would help Daibochi enhance its operating efficiency. The recent acquisition of MPP also would help the company to expand capacity and enjoy better economies of scale. The result of these synergies has started to show, with Daibochi's earnings growth, starting 1QFY20.

Historically, the company has always been trading at premium compared to peer average of 15.1x P/E (Figure 3), we believe that this is due to its exposure to MNCs as well as the F&B and fast moving consumer goods (FMCG) sectors, which offer a more stable revenue base. Under the current environment of a lot more uncertainties, stability will be even more appreciated by investors. The market is also anticipating stronger growth from Daibochi in the next two years, compared to peers. Margin wise, we believe Daibochi's PBT margin is slightly better at c.11% compared to the sector average of c.8-9%.

Figure 3: Peer comparison

Company	FYE	Price 17-Aug-20 (MYR)	Mkt Cap (MYRm)	P/E (x)			Div. Yld (%)	ROE (%)	P/BV (x)	EV/ EBITDA	PEG	NP Growth (%)	
				Actual	1-Yr Fwd	2-Yr Fwd	1-Yr Fwd	1-Yr Fwd	1-Yr Fwd	1-Yr Fwd		1-Yr Fwd	2-Yr Fwd
Scientex	Jul	9.50	4,901	14.7	13.5	12.0	2.2	15.0	2.0	9.9	1.0	9.0	12.5
Daibochi	Jul	2.79	913	59.9	18.9	17.0	2.2	23.1	4.2	10.7	1.5	217.9	11.1
Thong Guan Industries	Dec	5.41	1,007	16.3	13.2	12.1	2.0	12.6	1.6	7.7	1.3	23.0	9.5
SLP Resources	Dec	1.13	358	16.7	18.8	15.2	4.9	8.2	1.7	9.5	0.6	-11.4	23.6
SCGM	Apr	3.29	630	36.5	23.6	19.6	1.7	14.9	3.5	12.4	1.0	54.8	20.4
Tomypak	Dec	0.84	355	-30.6	60.6	40.8	0.2	-0.3	1.8	13.2	0.8	-150.4	48.7
Market Cap Weighted Avg.			**8,480**	**21.8**	**15.1**	**13.3**	**2.2**	**15.3**	**2.3**	**10.0**			

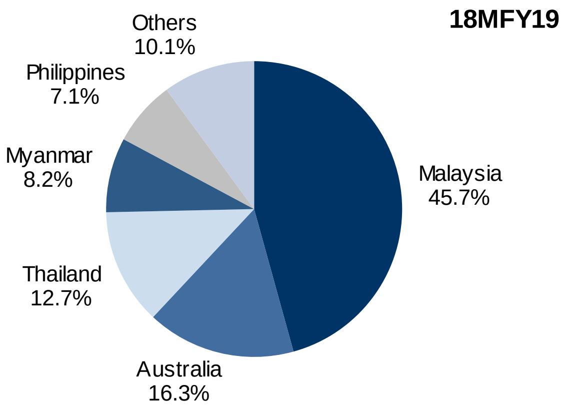
Source: Bloomberg, RHB

Financial Overview

9MFY20 results preview. The company has been showing significant earnings improvement in the past three quarters (Figure 7) as the Scientex-Daibochi integration synergy has started to produce results, aside from the consolidation of MPP's numbers (starting 1QFY20). The group's 9MFY20 core net profit of MYR37.6m has broken its previous record earnings and we expect this to continue, on the back of organic sales growth and margin improvement from the streamlining processes. Note that we will not be able to make YoY earnings comparison as the company has changed its financial year end to July (from December) starting May 2019, to coincide with Scientex.

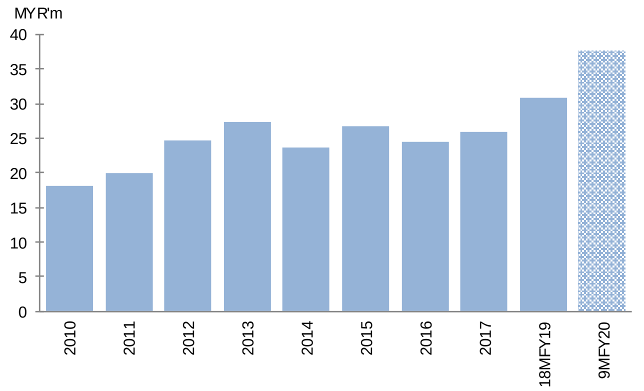
Daibochi's net gearing stood at a healthy level of 0.23x as at 30 Apr 2020. The company has projected a decent ROE of 23.1%, relatively better compared to peer average ROE of 15.3% (Figure 3).

Figure 4: Sales breakdown by customers' location



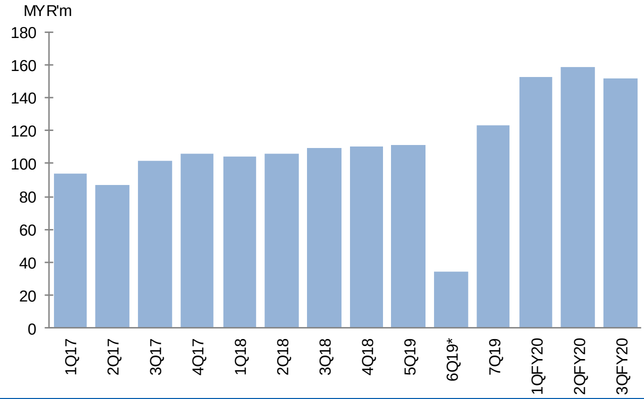
Source: Company data

Figure 5: Hitting record earnings in 9MFY20



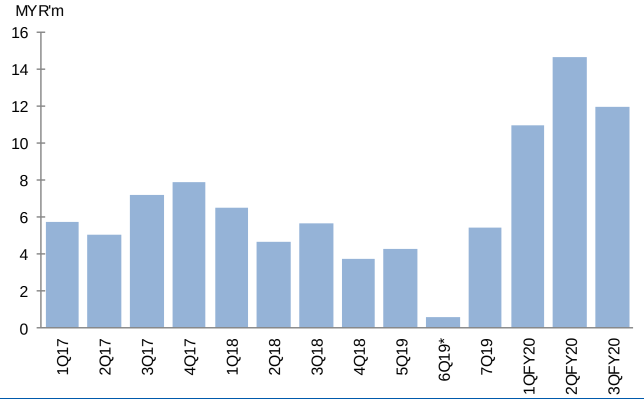
Source: Company data

Figure 6: Daibochi's quarterly revenue trend



Note: 6Q19 only reported 1 month's number, due to change of financial year.*
Note 2: Daibochi started to consolidate MPP's number in 1QFY20.
Source: Company data

Figure 7: Daibochi's core net profit trend



Note: 6Q19 only reported 1 month number, due to change of financial year.*
Note 2: Daibochi started to consolidate MPP's number in 1QFY20.
Source: Company data

Key Risks

Key risks for the company include:

i. **Customers concentration risk.** Based on 19MFY19 revenue, Daibochi's four biggest customers contributed c.46.9% of group revenue. Losing any of this customers would have material impact to its earnings.

ii. **Unfavourable FX fluctuation.** Given that the company exports some of its product to neighbouring countries within this region and Australia, it has exposure to the AUD, THB and USD. Since Daibochi is net exporter, it will benefit from a weaker MYR. Raw materials sourced are mainly in the MYR.

iii. **Loss of key management personnel.** The loss of key personnel with extensive knowledge and experience in the business may adversely affect the company's ability to maintain or improve its business performance.

iv. **Weaker-than-expected consumer sentiment.** The company has high exposure to the consumer sector – significant weakness in consumer demand is detrimental to Daibochi's earnings.

v. **Steep increase in raw material prices.** The company has a cost pass-through mechanism with most of its customers but there could be some time lag before it can fully pass the cost.

Business Overview

Daibochi is primarily involved in the manufacturing and converting of flexible packaging in the ASEAN region. The company has manufacturing plants in Malaysia and Myanmar as well as sales offices in Thailand, the Philippines and Australia. It supplies to several sectors such as food & beverage, FMCG, pharmaceutical and industrial uses. Daibochi holds several quality and food safety certifications such as ISO:9001, ISO:14001 and FSSC:22000. Its customers include MNCs such as Nestlé, Mondelēz International, PepsiCo, Mars, Dutch Lady and Hershey's as well as local companies like Mamee and Power Root (PWRT MK, BUY, TP: MYR2.80).

Figure 8: Packaging solutions offered by Daibochi for various applications

i. **High Barrier/Performance:** Coffee, Nuts, Potato Chips

ii. **Cost Effective Barrier:** Snacks, Biscuits, Wafer, Chocolates, Cakes

iii. **General Packaging:** Outer Pack, Noodles, Biscuits, Wafers

iv. **Specialty Applications:** Labelling, Ice-Cream, Frozen Food, Cereal Peel Seal, Seasoning Oil, Powder / Liquid Detergent, Shower Foam, Tobacco, Pet Food

Source: Company

Acquisition of MPP. Daibochi proposed to acquire MPP on 3 May 2019, and secured shareholder approval on 11 Jul 2019. This horizontal expansion allows it to widen its product offering and customer reach. Similar to Daibochi, MPP is also primarily involved in the manufacturing of downstream flexible packaging, mainly for F&B applications. The strategy moving forward is to have Daibochi and MPP focus on two different segment of products – Daibochi's main focus will be on complex packaging eg multi-layered/special requirements packaging while MPP concentrates on simple packaging structures eg single-layered or bi-laminated structures. MPP's focus on local customers will also complement Daibochi, which predominantly has multinational clientele.

Figure 9: Top 3 shareholders

Major shareholders	Equity stake
Scientex	61.89%
Apollo Asia Fund	9.38%
Public Mutual	6.37%

Source: Bloomberg

In Feb 2019, Scientex proposed to acquire 42.4% (139m ordinary shares) equity stake in Daibochi for a purchase consideration of MYR22.5m or MYR1.60 per share, which was satisfied through a share swap of 1 new share for every 5.5 Daibochi shares. The offer price of MYR1.60 per share, which implies 20x P/E of Daibochi's FY17 earnings, is slightly above sector valuation. Scientex later increased its stake in Daibochi to 61.89% through a mandatory general offer to Daibochi shareholders, which was ended on 1 Apr 2019.

Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-08-24			

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral: Share price may fall within the range of +/- 10% over the next 12 months
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