MACRO OPS

RESEARCH

Macro Ops Emerging Market Investment Idea Report 2021: Malaysia

Top Glove (BVA.SGX): 17% Returns In A Boring Glove Maker

Top Glove (BVA) is the world's largest nitrile, surgical, and natural rubber glove manufacturer. The company cranks out 90B gloves per year and employs 21K people servicing 2,000 customers in 195 countries. The company enjoyed steady double-digit revenue growth and 20%+ gross margins while generating ~20% ROC. The founder/chairman, Lim Wee-Chai, owns ~26% of the company. As of 2020, he's the 8th richest person in Malaysia by making rubber gloves.

A short-term COVID-19 scandal rocked the company and sent shares plummeting 43% since its October 2020 high. Yet during that time, BVA grew revenue by 305% and expanded GM to 65%. Thanks to the 43% haircut, investors can buy the world's largest glovemaker (~26% global share) for <4x EBIT and 2x revenue. On the other (glove) hand, its competitors trade for an average of 5x EBIT and 2.58x revenues. The company also issued a special dividend, allowing shareholders to capture ~18% returns at current prices.

Humble Beginnings & A Real Industrialist

Lim Wee-Chai and his wife founded BVA in 1991 with one manufactured product, one plant, and [$42K in life savings](). Chai came from a family of entrepreneurs and rubber-material aficionados. His parents owned and operated various rubber plantations. They made and sold the rubber in multiple markets. It's a family affair.

Chai's big bet paid off. Together, the couple turned $42K into $10B. Chai kept the company private for a decade before going public in 2001. The founder was called a "Real Industrialist" by Rizal Ishak, a glove manufacturing consultant. Ishak says of Chai, "Everything is funded well. He runs a very tight shop, no question."

Chai still owns 26% of the company and manages the day-to-day operations as founder and chairman of the business. He's also been buying up shares in the open market. The founder recently purchased 3.29M shares to bump his stake over 26% of the business. He now owns 2.1B shares.

BVA became the world's leading manufacturer of natural rubber gloves 13 years after its founding. Fourteen years later (2018) the company, became the world's leading surgical glove manufacturer. Finally, in 2020 BVA took the world's top spot as the leading nitrile glove maker. The trend is attractive. Find a market, take the lead and never look back.

One of BVA's successes has nothing to do with their business plan but instead their geographical location.

The *Garden Of Even* For Glove Makers

Malaysia is the best place to start a glove manufacturing business. Chai realized this in 1991. He listed the benefits of the country in a 2017 interview with *The Business Year* (emphasis mine):

> *"**Malaysia is ideal for rubber glove manufacturing** because we have the **raw materials**, **good technology**, and **production machinery**. We also have **high-quality control** in our manufacturing. Malaysia has **sound infrastructure** in terms of transportation, including seaports and airports, and communications. The country has a **relatively stable government**, and is a **safe country to operate in**. This stability is important for business. The level of entrepreneurship in Malaysia is high and the country has a **good banking system**. Hence, Malaysia has many advantages that help make us competitive."*

Malaysia produces 46% of the *world's* total rubber supply and leads the world in rubber product manufacturing.

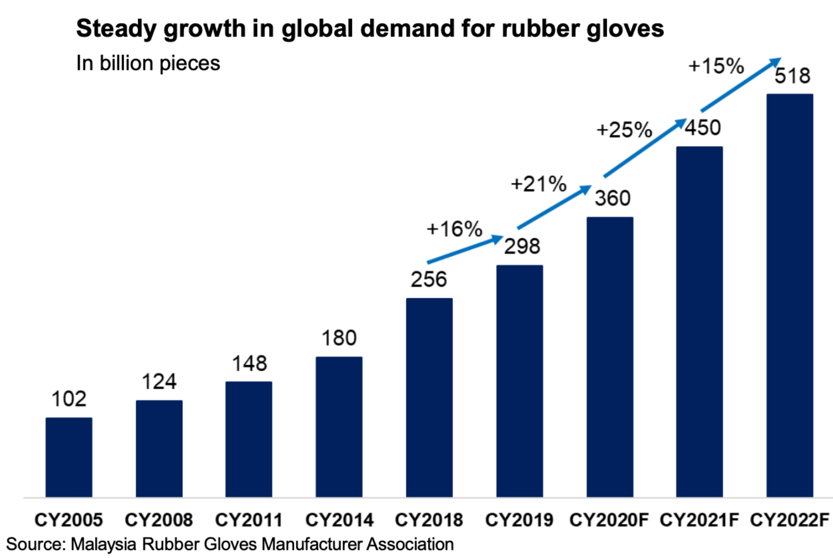
This is an underestimated moat. Competitors in other countries don't have access to Malaysia's ample rubber resources. And the company's so large it can simply acquire its local competitors and roll-up operations.

Who's Buying All These Gloves?

Let's address the virus-sized elephant in the room. COVID-19 pulled forward ***immense*** amounts of future glove demand in a short amount of time. BVA is a great example. The company grew revenues 161% and 293% over the last two quarters.

They're slated to grow revenues ~200% YoY in what can only be described as an unsustainable top-line growth rate.

But put that aside. Glove demand had myriad revenue drivers before COVID crashed the party. According to BVA's latest investor presentation, there are five main growth drivers:



- Continued demand from medical staff (indispensable healthcare item)
- Increased hygiene standards and healthcare awareness
- Growing aging population
- Progressively stringent healthcare regulations
- The emergence of new threats (COVID, bird flu, etc.)

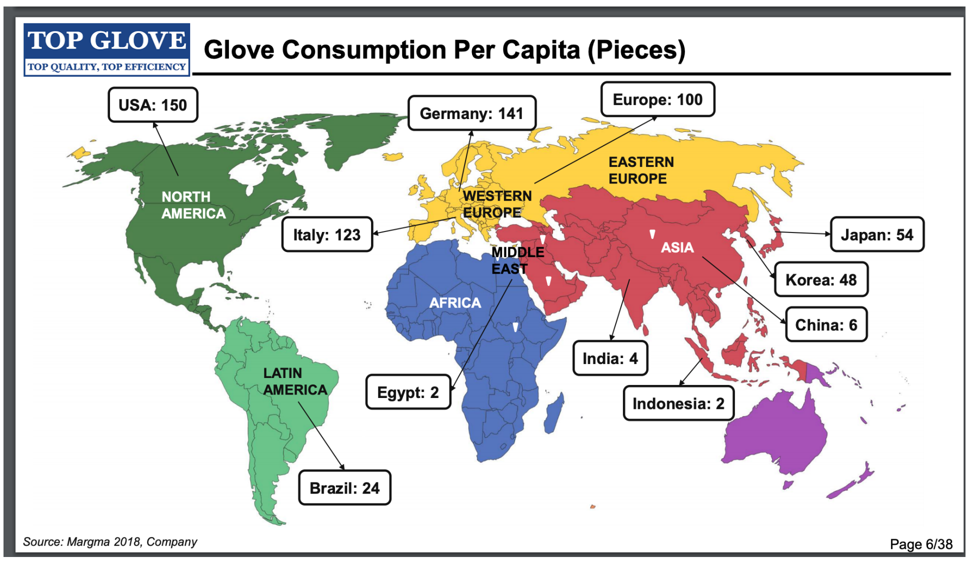
Due to the above tailwinds, the Malaysia Rubber Gloves Manufacturer Association estimates 518B glove pieces produced by 2022. That means 25% growth next year and 15% growth in 2021.

Rubber glove demand has grown at a ~23% CAGR since 2005. Here's what we *can't* do. We can't assume COVID-level growth into perpetuity. We can't value glove makers in a vacuum. Like cyclical companies, we'll need to estimate growth and demand over the next 5-10 years. Not just a short blip of rapid demand. What will spur the next decade of growth?

Barring another global epidemic, future glove demand will come from emerging markets. The math works like this. Developed countries account for 20% of the world's population yet 70% of global glove consumption.

In contrast, Developing countries account for 80% of the world's population and a mere 30% of global glove consumption.

Check out the world graph below from BVA's presentation:



On a per-capita basis, emerging markets have a *long way to go* to catch their developed nation neighbors. The US, for example, has 150 gloves/capita consumption. Compare that to China (6), India (4), Indonesia (2), and Brazil (24).

That's a **long runway** for continued glove demand from those nations, especially as governments accelerate healthcare protocols.

This brings us to our next point: habits.

Can Habits Lead To Sustainably Higher Demand?

A COVID vaccine will undoubtedly bring the world back to some level of "normal." But what about glove demand and usage? One argument is that COVID accelerated glove demand to the point where competitors will flood the market, raise prices and shrink margins. In turn, some also assume that glove demand will *rapidly* decline after COVID diminishes. "We don't need that many glove makers because people won't need as many gloves."

Habits are powerful things. According to healthline.com, it takes anywhere from 18 to 254 days for an action to translate into a habit. And on average, it takes 66 days for someone to create a new habit.

The measures put in place due to COVID are *well beyond* the minimum required habit inoculation.

Take restaurants, for example. Do you think restaurants will roll back their hygiene measures post-COVID? I like the idea of a waiter/waitress wearing a mask and/or gloves when handling food.

Said another way, **these non-medical measures might last longer than anyone thinks**. In turn, we'd see global glove demand continue at levels nobody thought would be sustainable.

Add to that the increased demand from emerging markets as they implement more extraordinary hygiene measures, and more people rise from poor to the middle class. All of a sudden, 15-20% sustained global glove demand seems realistic.

Why Top Glove?

Investors have their pick at a few glove makers. So why Top Glove? A few main reasons:

- Scale of Distribution
- Global Market Position
- Exceptional Founder
- Unbeatable R&D Investment

Scale of Distribution

The company has six distribution "hubs" in the US, Germany, China, Vietnam, Thailand, Malaysia, and Brazil. Plus an OEM manufacturer in *every* region. These distribution centers supply gloves to 195 countries and over 2,000 customers. Thanks to their scale of distribution, no single customer accounts for >4% of revenues.

Global Market Position

Top Glove is #1 in nitrile gloves, latex (powder/powder-free) gloves, surgical gloves and accounts for 25% of the global glove supply. The company generates 56% of its revenue from nitrile, 35% from latex-based gloves, and 4% from surgical.

This hasn't always been the case for BVA. The company shifted with market demands. In 2011, Nitrile gloves accounted for ~11% of glove volume. At the same time, latex powdered gloves accounted for 55% of glove volume. The change in volume demands brings higher margins as nitrile generates incrementally higher GM than latex.

An Exceptional Founder

Limi Wee-Chai is an exceptional leader. He puts his money where his mouth is and buys company stock when it falls. He even issued a *massive* special dividend that'll hit in November 2021. At the same time, Chai's not satisfied with share buybacks and dividends. There are many ways the company can invest its excess cash flow into the business.

Unbeatable R&D Investment

BVA's leading market position means nothing if it can't find ways to reinvest in the business to sustain its competitive advantage. To win the next decade in glove demand, BVA must invest heavily in facilities, new products, and R&D. Their founder is doing *just that*.

Wee-Chai's goal is to build two new factories a year and accelerate its R&D department. So far, they've turned R&D from a team of 20 to a small army of 160.

They've also increased operational efficiencies inside their factories. Here's Chai's take (emphasis mine):

> *"The main driving force behind this was the manufacturing improvements we implemented through digitalization. We have invested in automation, computerization, and the IoT, which resulted in higher quality while saving on the cost of more than 1,000 workers per year."*
>
> *"In the new factories, we use new machinery that will incorporate more digital aspects such as automated packing machines, automated warehouse management systems, and temperature sensors that control the content of the chemicals. We have real-time insight into the speed and production of the machinery, and we use cameras to detect glove defects faster than a human eye. We aim to build around two new factories each year with new machinery of higher quality and cost-efficiency."*

Given its size and scale, the company can invest more money into R&D and growth than their competition. For example, Wee-Chai already committed $2.4BUSD in capital expenditures over the next five years. They'll use the money for:

- enhancement of existing manufacturing facilities
- Industry 4.0 initiatives
- a gamma sterilization plant,
- land bank for future expansion,
- IT upgrades and workers' facilities.

It is this capital spending on growth and expansion that allows Top Glove to remain the global leader.

Seizing A Year of Ridiculous Profits

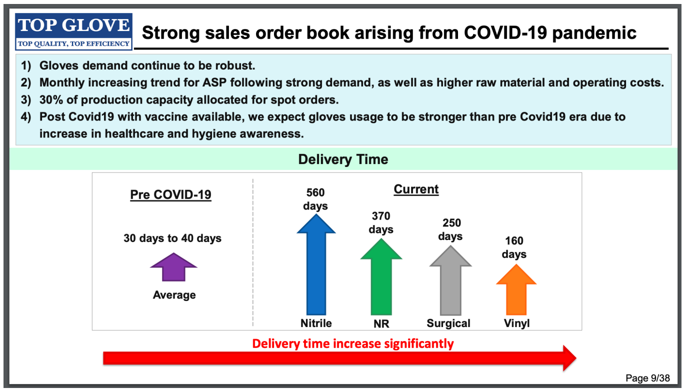
BVA's on pace to generate mind-boggling financials. Check out TIKR.com's 2021 estimates on the right:

Actuals & Forward Estimates	8/31/21 E	8/31/22 E
Revenue	5,220.14	3,446.98
% Change YoY	*198.4%*	*(34.0%)*
EBITDA	3,371.55	1,332.72
% Change YoY	*438.2%*	*(60.5%)*
% EBITDA Margins	*64.7%*	*38.8%*
EBIT	3,037.44	1,188.39
% Change YoY	*433.3%*	*(60.9%)*
% EBIT Margins	*58.4%*	*34.6%*
EBT Normalized	3,039.06	1,220.73
% Change YoY	*446.2%*	*(59.8%)*
% EBT Margins	*58.4%*	*35.5%*
Net Income Normalized	2,396.83	963.56
% Change YoY	*431.0%*	*(59.8%)*
% Net Income Margins	*45.9%*	*28.0%*
EPS Normalized	0.30	0.12
% Change YoY	*435.8%*	*(58.6%)*
EPS (GAAP)	0.30	0.11
% Change YoY	*428.7%*	*(61.8%)*
Dividend Per Share	0.16	0.06
% Change YoY	*459.1%*	*(60.4%)*

$3.3B in EBITDA on $5.2B in revenues. My goodness.

Investors should take next year's numbers, seal them in a bottle and frame them on the wall. It's unlikely the company will touch that level of performance in the next decade. I mean, check out these delivery lead times (below)!

But we don't *need* it to do that to win.



Wee-Chai understands this and recently announced a *major* special dividend for BVA shareholders.

In short, shareholders will get paid **fat** dividends for 2021's outlier year of profits: 70% payout ratio from 2Q - 4Q 2021. The dividend begins 2Q 2021.

Shareholders would receive nearly 17% return thanks to the dividend. To get there, we took FY 2021 net income estimates *minus* Q1 2021net income estimates ($673M).

That's not a bad return. And you get to own the world's leading glove manufacturer to boot!

2023 And Beyond

Malaysia's Rubber Association forecasted 518B glove units demanded by 2022. If BVA captures ~25% of global demand (their current market share), they will sell 130B glove products in 2022.

Let's do some ***very rough*** back-of-the-envelope math. Last year BVA made 90B glove units and generated $1.73B in revenue. That's roughly $0.02/unit produced. At ~$0.02/unit in 2022, BVA would generate $2.6B in revenue.

But the company's forecasting $3.44B in revenue by 2022. That means BVA's average price per unit will increase to $0.026. This makes sense given heightened COVID demand.

The company's estimating 34% EBIT margins, or roughly $1.2B. That's 8.3x EV/EBIT (12% yield).

After 2022, one can assume BVA follows global glove demand growth (which is ~12-15%/year). Assuming 15% in 2023, 10% in 2024 and 7% in 2025 we end 2025 with $4.67B in revenue.

We'll also assume EBITDA margins mean-revert towards 30% by 2025. That gives us $1.4B in EBITDA and $1B in NOPAT (10.4% yield).

Now let's flip our DCF to see the market's embedded expectations at the current stock price.

At SGD1.90/share, the market's assuming the company fails to grow revenue beyond 2022 while reverting EBITDA margins too *low* 20% at a 10% discount rate and 14x EBITDA exit multiple.

Other Shots on Goal

While the company's known for making gloves, they have additional shots on goal in new markets. Wee-Chai aims to create six new products a year. Some of these new products include:

- Wet donning, which enables users to put on gloves quickly, even if their hands are wet
- Bio green biodegradable Nitrile glove that biodegrades when it comes into contact with the soil
- HydraPlus Moisturizing Nitrile glove, which protects skin while improving hydration.

The company also entered the condoms market in 2018 with a $7M condom plant investment.

Why The Opportunity Exists

COVID proved a double-edged sword for Top Glove. While the company benefited from *record* sales and profits, the novel virus landed the company in the hot seat.

Top Glove's Malaysian facility became the *hottest* COVID infection site in the country, infecting over 2,400 workers. Top Glove was forced to shut down after an employee whistle blew on its disregard for COVID health policies.

The company also experienced labor issues and was banned from selling products in the US due to concerns over forced labor in their factories. Not to mention the general shutdown of their plants after their COVID outbreak.

Together, these issues brought share prices down 40%+ in the last three months. Notwithstanding the above risks, there are two more dangers in this investment:

1. Currency risk: weakening MYR benefits Top Glove (increases margins)
2. Raw Material risk: Raw materials account for ~46% of total costs. A steep rise in this cost bucket would force the company to raise prices or eat away existing margins.

Concluding Thoughts

Top Glove's business isn't worth 40% less today than it was three months ago. Yet that's what Mr. Market tells us. If anything, the company is worth more than they were in October 2020.

Investors can buy the business and receive ~17% return on their investment in special dividends. After that, they still own the world's leading glove manufacturer coming out of its most profitable years with ample cash reserves, a fortress balance sheet, and billions of dollars to expand capacity and create new products.

Wee-Chai increased his stake in the company during the price decline and now owns over 26%. Investor interests are aligned with someone that eats, sleeps, and breathes the rubber glove business.

Hextar Global (HEXTAR): Bad Legacy Business Hides Growing Agrochemicals Segment

Hextar Global (HEXTAR) engages in the manufacturing, formulation, repackaging, distribution, and agency of agrochemicals in Malaysia and internationally.

HEXTAR is a classical good co./bad co. investment idea. The company stumbled out of the gate after IPO'ing in 2009. There are three reasons the business underperformed. First, their products weren't competitive. Second, they had a weak brand name. Third, they over-diversified (read: di-worsified) into too many business segments.

The company shifted tone in 2017, selling its property development business and discontinuing its horticulture business in 2019. The company lasered its focus on its best (and fastest-growing) business segment: **agrochemicals.**

In 2019, then Halex bought Hextar Chemicals Limited (HCL). Halex changed their name to Hextar Global and drew a proverbial line in the sand. They would compete in the agrochemicals business without distraction.

This comes when food security and agriculture are of utmost importance to both developing and developed nations. HEXTAR has solid tailwinds and a long runway for growth. Past financials don't show the company's optimistic (and profitable) future.

Most of the initial leg-work research was from Buy Call's blog post (you can read here).

The Bull Thesis: Leading Crop Protector in Malaysia

Hextar is well-positioned to benefit from the ever-growing demand for secured food. The company controls 30% of the herbicide/pesticide market in Malaysia. And with their HCL acquisition, the company's perfectly positioned to capture more market share in the coveted Indochina regions.

Buy Call's blog mentioned five primary drivers of value creation:

1. Malaysian & Indonesian Market

Indonesia is the largest producer of palm oil in the world, followed by Malaysia. Both countries account for 84% of the world's palm oil production.

HEXTAR's agrochemical business supplies palm oil growers with much-needed fertilizer and crop protection.

The company won a contract award with Sime Darby Plantation to supply the grower with agrochemicals in Malaysia, Papua Guinea, and the Solomon Islands.

Indonesia is in the process of replanting ~2.8M hectares of palm oil trees. Replantation programs take *years* to implement and offer HEXTAR a sustainable, SaaS-like recurring revenue.

2. Distribution Agreement with Sumitomo Chemical Vietnam

Agriculture is vital to Vietnam's economy as it is a significant exporter of agricultural products. Main export crops include rubber, rice, and coffee (commodities we use every day).

HEXTAR signed a Distribution Agreement with Sumitomo Chemical Vietnam (SCV) in October 2020. The agreement gives HEXTAR exclusive herbicide distribution in Vietnam for the next five years

3. Improvement in Commodity Prices

Like any agrochemical company, HEXTAR is an indirect call-option on the underlying price of its primary commodity. In HEXTAR's case, that's palm oil and rubber.

The higher the commodity price, the better it is for HEXTAR's business. This makes intuitive sense. Higher commodity prices incentivize growers to increase production as they generate higher yields (read: margins) on their crops. This increases the demand for HEXTAR's agrochemical herbicides and pesticides.

4. Call Options on Agriculture Technology

HEXTAR has two call-options on the future of "AgTech":

- Drone sprayers: Drone sprayers offer myriad advantages to human/tractor spraying, including:
  - High-pressure spraying, efficient use of chemicals, more uniform spraying, reduced pesticide waste
- Biogas Engineering: Through its acquisition of Biogas Engineering Sdn Bhd, HEXTAR can harvest and convert methane gas from palm oil production and turn it into usable energy.

Malaysia's Agrochemical Industry: High Regulation = High Barriers

Herbicides and insecticides are the two most significant components of Malaysia's pesticides sector. As we mentioned earlier, palm oil is the biggest crop in both volume and dollar value.

In 2019, Malaysia spent roughly RM 4B in agriculture expenditures.

Malaysia's pesticide business is heavily regulated and thus prone to high barriers to entry. This is great for HEXTAR and its minority shareholders. The reason for the high barrier to entry is Malaysia's Pesticides Act of 1974. The Act *"ensures that companies dealing with pesticides obtain licenses from the Malaysia Pesticides Board and that pesticide products are both properly labeled and packaged and as effective and safe as they claim to be."*

To commercially market and sell pesticide products in Malaysia, companies need to obtain approval for product registration. This can take two years (depending on product type).

That sounds like a headache for a new pesticide company to enter voluntarily.

Since agrochemicals detract competition, there are only two ways the few players can gain an edge:

1. Having the best product (quality)
2. Having the best branding (consumer mind-share)

Think of Scotts Grass Seed. I have *never* used Scotts Grass Seed. But when I think of grass seed, I think of Scott's (SMG). That's a decisive advantage over the competition. Why? Because there could be a better product on the shelves. But if I don't notice (or *care* to notice), it doesn't matter.

With the HCL acquisition, HEXTAR is well-positioned to capture the lion's share of this uncompetitive market.

HCL: A Strong, Value-Add Acquisition

Halex bought HCL for RM 569M and changed its name to HEXTAR Global. The company split the payment between 97% stock issuance and 3% cash.

HEXTAR paid 13.75x HCL's 2017 earnings. HCL generated RM 325M in revenue and RM 43.4M in earnings (13% net margin).

Between 2015 and 2017, HCL grew revenue at a 17.53% CAGR and net income ~32% CAGR. That's a 0.43x PEG ratio purchased by HEXTAR. Not bad.

Management got an excellent price for a great business. The company paid ~37% discount to the average PE multiple for comparable companies (see table below):

Highest	34.64		162.32
Lowest	6.36		4.68
Simple average	16.63		59.71
Agreed PE Multiple	**13.75**		

PE ratios ranged between 6.36x and 35x.

This resulted from HEXTAR's long-standing efforts to reorient its business to what they do best: **agrochemicals**.

Type of products	Morocco	The Philippines	Indonesia	Taiwan	Thailand	Australia
Herbicides	-	2	43	7	5	22
Insecticides	1	2	55	7	6	6
Fungicides	-	5	26	7	2	2
Others(1)	-	2	29	-	-	1
Total	**1**	**11**	**153**	**21**	**13**	**31**

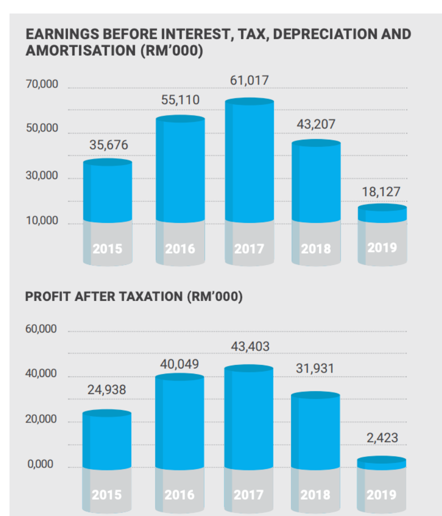
Note:

(1) Comprises of rodenticides and molluscicides.

The combined company creates one of the most robust agrochemicals businesses in Malaysia and Indochina. For example, before the deal, HEXTAR sported 96 agrochemical products exported across five countries (Singapore, Vietnam, Taiwan, Pakistan, and Bangladesh).

HCL is an entirely different beast. The company has successfully registered 249 agrochemical products, and they export to >30 countries across the Asia Pacific, the Middle East/Africa, Latin America, and Australasia. Since 2015 the company has expanded exports to include New Zealand, Spain, Turkey, and Morocco.

HCL's acquisition completely transforms HEXTAR's financial statements. This is something algos and screeners won't find. Again, backward-looking data won't help the investor. Here's what I mean.



Between 2015 - 2017, HEXTAR (pre-HCL) went from RM 125M in revenue to RM 69M. During the same time, they grew net losses from RM 0.368M to RM 11.9M.

Now compare that to HCL's business:

- Revenue growth from RM 234M to RM 324M

- Profit after tax (PAT) growth from RM 25M to RM 43.4M during the same time frame.

How HEXTAR Captures Long-Term Value From HCL

The acquisition allows HEXTAR to merge its existing agrochemicals business into HCL's (much better) one. In doing so, management believes the "old" agrochemical business can resemble that of HCL. Here's why (via merger announcement):

- Old business (Halex) leverages HCL's customer network in >30 countries. This allows HEXTAR to cross-sell their "old" agrochemical products to HCL's existing customers.
- Plug into HCL's extensive R&D capabilities to create new value-added services like spectrometer analysis and product registration.
- Benefit from economies of scale and operational synergies via production processes and capacity, R&D investments, and general administrative functions.

The now larger company also benefits from better-negotiated prices from suppliers and customers for raw materials. But is this true? Did HEXTAR see those coveted synergies?

Narrative To Numbers

I'm skeptical whenever companies do large acquisition deals and promise "synergies" and "economies of scale." Yet HEXTAR walks the walk. The benefits of the HCL purchase flow through to the income statement.

For example, check out the company's last five consecutive quarterly revenue growth figures:

- 36.8%
- 26.4%
- 27.7%
- 33.5%
- 14.8%

Increased revenue from HCL's core business? Check.

Next, let's see if the company's gained synergies. If this is true, we'd see it in gross margin expansion as the company grows revenues (I.e., administrative spending consolidated, R&D investments via one channel, etc.).

Since the acquisition in April 2019, HEXTAR's increased Gross Margin 600bps (16% to 22%) and operating margin 300bps (from 10% to 13%).

Here are HEXTAR's thoughts on the acquisition in their 2019 annual report (emphasis mine):

> *"In overall, the Group had on 30 April 2019 witnessed a tremendous corporate milestone to solidify its position as* ***a leading and the biggest producer of agrochemicals in Malaysia.*** *The business combination had given the Group the ability to enhance the competitiveness in agrochemical business*

> *by increasing product range and extending distribution network especially the presence in the new markets."*

So far, management's walked the walk and talked the talk.

The New HEXTAR: Leading in Agrochemicals w/ Call Options

HEXTAR has three business segments:

- Agrochemicals
- Consumer products
- Smart Agriculture

The company's Consumer Products segment makes disposable healthcare products like wipes, tissues, and cotton-based products. This segment burned almost RM 8M in operating losses in 2018. In 2019 they only lost ~RM 2M on RM 26M in revenue. Over time as the company consolidates from two plants to one, we should see Consumer Products turn PAT profitable.

Smart Agriculture involves HEXTAR's investments in drone technology and 5G agriculture.

We won't cover these investments and assign a $0 value to this segment in our valuation for our purposes.

Whether this segment is worth $0 is up for debate (highly unlikely).

Valuation: Buy One, Get Two Free

With HEXTAR, you can pay for the agrochemicals business and get its two other segments (Consumer Products and Smart Agriculture) for free.

The best way to value HEXTAR is on an Agrochemicals basis only. Anything else we get for free is a cherry on top.

We'll start with 2019 revenues of RM 322M. The company's estimated to end FY2020 with RM 400M in revenue (20% growth). From there,e we're assuming an average revenue growth of 13% to get RM 590M by 2024 (~1.5x 2024 Sales).

Over time, HEXTAR's gross margins should resemble HCL (~22%-23%). This gives us RM 136M in gross profit. Operating expenses have averaged 8-9% in the last few quarters. Staying with that trend gets us RM 83M in EBIT by 2024 (9x EV/EBIT), RM 75M in pre-tax cash flow, and RM 60M in PAT.

Adding back D&A, NWC, and subtracting cap-ex gets us ~RM 70M in free cash flow (10% FCF yield).

At 10% FCF yield, HEXTAR passes the Bill Miller test of buying companies at >7% FCF yields (S&P average).

Risks

- **Customer Concentration**

HCL has a high customer concentration. As of 2017, its top four customers accounted for 29% of revenue. Losing one (or a few) of these customers will have heightened negative consequences to the top-line.

- **Foreign Exchange Risks**

HEXTAR imports most of its raw materials, which are denominated in USD.

- **Commodity Prices**

This is a given in any agriculture-related business. Lower palm oil and rubber prices will harm the company's revenues, margins, and profitability.

- **The impression of Herbicide / Pesticide Products**

Scan any Whole Foods, and you'll find droves of people armed with pitch-forks to defeat having pesticides in their food. In short, the organic movement is sweeping the nation. Organic markets remain a niche category in Malaysia/Singapore.

Said another way, it's not big enough to worry about it for the next 5-10 years. There's also an excellent PDF for anyone interested in the Malaysian organic food market. Read it here.

My E.G., Services (MYEG): Creating Malaysia's Digital Government

My E.G., Services (MYEG) is Malaysia's leading digital e-government and commercial services provider, acting as a bridge between government and citizens. The company brings governments into the 21st century offering digital-first solutions to otherwise mundane, out-of-date services. From drivers' license renewal to worker's permits and retail tax collection, MYEG allows governments to perform all these tasks in a digital-first environment. This saves government time, money and reduces complexity when interacting with citizens. As of 2019,

Digital government solutions are one of the stickiest businesses out there. Governments are slow to adopt new technologies, and when they do, they tend to stay with one provider for a *long* time.

MYEG provides these services in a one-stop portal. This allows the company to bundle and offer more excellent utility for consumers at lower prices. Everything you'd need to interact with your government is through the MYEG website. This reduces travel/traffic time while lowering costs and improving productivity.

As the country's largest e-government provider, MYEG can leverage its economies of scale to rapidly create new services at both the local and global levels to meet consumers' demands.

The company's currently expanding its platform to serve other regional governments, specifically the Philippines, Indonesia, and Bangladesh. These shots on goal diversify MYEG's revenues and reduce its single-source Malaysian dependence. MYEG also has a first-mover advantage in these four countries, which span 600M+ citizens.

Providing the “rails” for governments to engage in digital-first interactions is a fantastic business. MYEG generates ~73% gross margins, 50% EBIT margins with minimal capital expenditures. The company maintained ~30% ROC during the last decade while reducing SG&A expenses from 22% to 16%.

Unfortunately, Mr. Market agrees with our assessment and values the business appropriately (24x EV/EBIT and 25x normalized earnings). Nevertheless, MYEG is a great business to add to your watchlist. During the COVID-19 crash, investors had the opportunity to buy this business for <12x current EBIT.

The company has ample room to grow in both domestic and international markets. Their land-and-expand model leverages e-government solutions to bundle high-value commercial services at lower prices to consumers.

The company’s founder owns ~11% of the company directly and ~21% of the company indirectly. Also, the $6.8B emerging market fund Somerset Capital owns ~2% of the company. Interests are aligned.

Significant risks include currency fluctuations (USD, SGD, and IDR), governments taking an in-house approach instead of using a foreign company for their digital solutions, and customer concentration. Despite these risks, MYEG remains a fantastic business generating 50%+ incremental EBIT margins with minimal cap-ex.

The Rails of Digital Government & Commercial Verticals

Citizens interact with the government through four main channels: **phone, computer, kiosk, and in-person.** MYEG allows governments to meet their citizens at each of those channels. Besides their online portal, MYEG has 800+ kiosks and 100+ e-service centers to assist citizens and businesses.

There are two main types of services, and the company breaks them down by “anchor” and “other.” Anchor services include **Road Transport, Immigration,** and **Royal Malaysian Customs.** These anchor services include drivers’ license renewals, foreign worker’s permits/job matching, and collecting/transmitting retail tax data.

MYEG’s “Other” services assist the **Malaysia Department of Insolvency, Royal Malaysia Police, National Registration Department, City Hall, and Pusat Pungutan Zakat.** These agencies use MYEG to check bankruptcy statuses, handle summons checking/payments, and assist in collecting Zakat (tithe).

Despite the inherent stickiness within government services, MYEG makes 80% of its revenue from commercial services. In short, they leverage their digital-first government infrastructure to bundle commercial products/services to citizens. This lowers search costs for consumers and allows MYEG to offer better prices for more assistance.

Road Transport is an excellent example of MYEG’s land-and-expand service strategy. The company offers e-government solutions (license renewals, road tax renewals, etc.). There are three other (large) verticals the company can infiltrate: **Auto Loans, Motor Vehicle Transactional Portal,** and **Auto Insurance**. This is a highly profitable next step in MYEG’s business strategy.

The company has strong mindshare with Malaysian citizens since they use MYEG's services to interact with their government. It's not far from that point to offer auto insurance or auto loans through the same portal.

We see this in the Philippines with MYEG's latest service launch: **MYEG Insurance.** MYEG Insurance is an online insurance portal that allows citizens to purchase a wide range of insurance options based on their coverage requirements.

Their plan is simple. Leverage their current platform and substantial cash-flow to create services/products that citizens need yet don't have a reliable online option.

International Expansion: Philippines, Indonesia, and Bangladesh

One of MYEG's growth strategy's critical aspects is its ability to penetrate ancillary markets, specifically the Philippines, Indonesia, and Bangladesh. The company entered the Philippines in 2017, followed by Bangladesh and Indonesia in 2018.

MYEG's decided to enter new markets via a joint venture. This makes sense. Why would foreign governments allow non-local companies to provide digital solutions for their agencies? By partnering with local operators, MYEG gets its foot in the door and gives foreign agencies a chance to see the massive value-add their platform offers.

They did this in the Philippines with *MYEG Philippines.* The company owns 40%, with *IPCVI* owning 60%. The country offers 3.2x the population of Malaysia with roughly the same nominal GDP. Since launching in 2017, MYEG's partnered with the following Philippine agencies:

- National Bureau of Investigation
- Employment Administration Agency
- Lank Bank of The Philippines

MYEG leveraged its e-government solutions to offer other products/services, including micro-loans and insurance, as well as hardware/software leasing.

The company did the same thing in Indonesia by partnering with PT Cartenz. MYEG invested $10M for 40% of Cartenz in November 2018. This allowed MYEG to collaborate on real-time monitoring of retail sales transactions for tax purposes. The company's working with 80 local Indonesian governments and 5,000 retail outlets. MYEG is on pace to monitor 1M retail outlets in the next three years.

Finally, MYEG partnered with Control Data (BD) Ltd and My Paycheck Sdn Bhd in Bangladesh to offer retail tax monitoring. The company will leverage this offering to penetrate additional e-government/commercial services. Bangladesh is an attractive market with 170M people.

MYEG has ample growth runways both inside existing markets (Malaysia, Bangladesh, Indonesia, and the Philippines) and foreign markets.

COVID-19 Sparks Digital Government Shift

I don't want to spend too much time on this. It's apparent COVID-19 reinforced the importance of an online/digital government presence. E-government solutions meet the consumer where they're expecting to be met: on their phones or over the internet.

More governments adopting digital mandates will further benefit MYEG's top-line growth. This will enable the company to invest at incrementally higher rates than their competitors, allowing them to offer more bundled products/services at lower prices.

E-Government Is Highly Profitable

MYEG enjoyed high and sustained top-line growth. They sport a 5YR 40% revenue CAGR and a 43% 5YR net profit CAGR. At the same time, they've maintained 70%+ gross margins and 50%+ EBIT margins. This means each incremental dollar of revenue growth adds ~$0.40 to the bottom-line while enjoying 30% ROC.

Since 2014 the company's net earnings per share have grown from 1.4 Sen to 8.6 Sen.

MYEG also sports a strong balance sheet. The company has enough current assets to cover total liabilities and pays 30% of its profits out as dividends to shareholders.

Given the rise of COVID-19 and the government's efforts to provide online solutions, MYEG has plenty of room to expand revenues while maintaining 50%+ EBIT margins.

What's MYEG Worth?

Mr. Market's properly valued MYEG at ~25x normalized earnings. Yet when you account for the company's earnings growth its trades ~0.89x PEG.

Let's assume the company grows revenue ~13% over the next five years, reaching MYR 1B by 2024. We'll also take historical gross margins (~70%) and EBIT margins (~51%). This gets us MYR 755M in 2024 Gross Profit and MYR 545M in EBIT. Subtract income tax/interest expense, and you're left with MYR 518M in after-tax profits.

In other words, you can buy MYEG for <13x our estimate of 2024 NOPAT. This passes the Bill Miller filter of >7% earnings yield.

The company also scored an impressive **85** on our *MOCS* Rating. The company lost points due to headquarter, currency, and customer concentration risk.

Concluding Thoughts

There are a few significant risks with the MYEG thesis. First, the company's exposed to three types of currency risk (USD, SGD and IDR).

Second, there's no guarantee that other countries' governments will adopt MYEG's e-government platform. Andrew Rosenblum's TravelSky Tech thesis comes to mind here. Why would governments outsource such a critical role when they could a) develop their technology in-house or b) use a company inside their borders. Partnering with local businesses alleviates some of this issue.

Third, you can't mention a Malaysian stock without referencing share issuance risk. When it comes to external financing, Malaysian companies *love* issuing stock. MYEG's share count has stayed the same since 2010. A dramatic increase in outstanding shares would prove a red flag and reduce our ownership in this excellent business.

Finally, two customers account for 25% of the company's revenue. Losing one or both customers would seriously affect revenues and earnings.

Despite these risks, MYEG is a fantastic business trading at a reasonable price. The company commands its Malaysian market and is actively focused on diversifying its revenue streams in complimentary, high-population countries. We're keeping it on our watchlist, hoping for a correction to buy shares at >15% EBIT yield prices.

