Plastics & Packaging

Lacking Pricing Power

NEUTRAL

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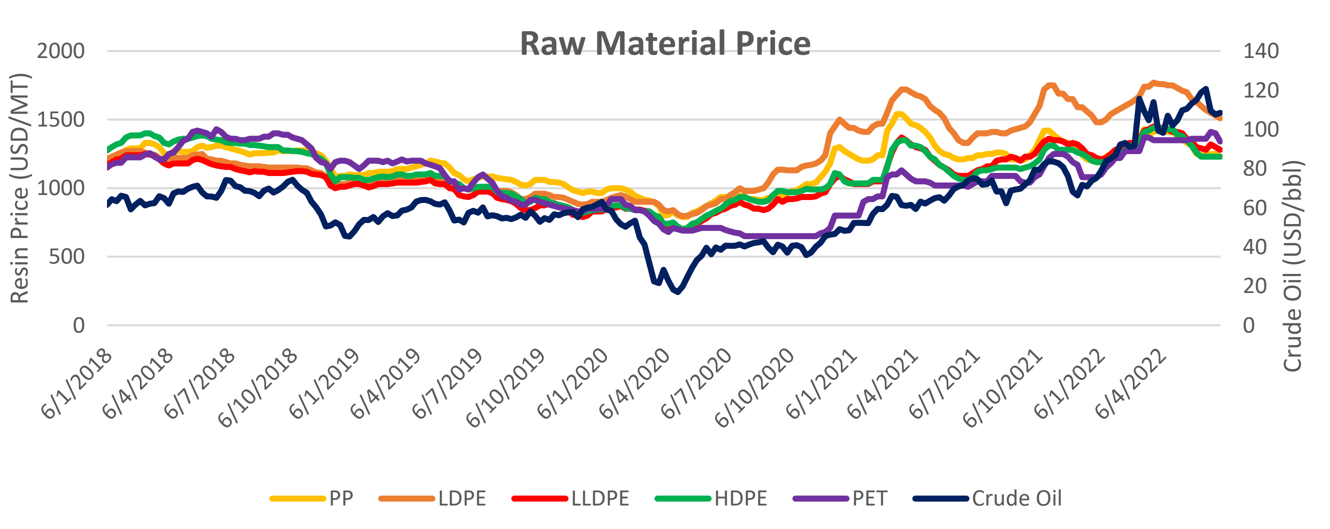
We reiterate our NEUTRAL view on the sector as packaging players are unable to fully pass on higher costs to end-users, resulting in margin erosion.The competition in the industry remains stiff as demand has yet to return to the pre-pandemic levels. While resin prices have softened in recent months, they are still significantly higher than a year ago. Not helping either, are higher labour, energy and transportation costs. Our top pick for the sector is TGUAN (OP, TP RM3.90) given its better growth prospects underpinned by a product mix that is skewed towards the higher-margin segments.

Topline growth negated by higher production cost. We project topline growth of 5-19% for packaging companies under our coverage in 2022 underpinned by: (i) a 10-15% increase in ASPs largely due to the cost-push factors; and (ii) volume growth driven by a recovery in demand on the re-opening of economies globally. However, the increase in ASPs will not be sufficient to fully absorb the higher input costs coming from: (i) sharply higher resin cost in tandem with the surge in crude oil prices; (ii) higher labour cost due to a 25% hike in the minimum wage from May 2022, and employers competing with each other for a limited pool of workers locally; and (iii) electricity tariff hikes of up to 17% for the industrial and commercial segments from Feb 2022.The competition in the industry remains stiff as the demand has yet to return to the pre-pandemic levels, as manifested in the current overall, industry utilisation rateof about 65-70% (vs. 75-80% prior to the pandemic).

Resin prices softening. The good news is resin prices have come off by c.12% to about USD1,340/MT from the recent peak in April 2022 (despite the sustained high crude oil price at about USD100/barrel). Indications are pointing towards more weakness in 3QCY22 as: (i) there is significant new resin manufacturing capacity coming on stream; and (ii) the weak demand from China (as the nation that practises zero Covid policy has yet to fully normalise from the disruptions arising from the intermittent lockdowns). We gathered from sources that the ASPs have yet to retrace in tandem with the lower resin price, especially for the non-commoditised/premium products.

Nonetheless, we remain cautious as: (i) at the current level of about USD1,340/MT, resin prices are still significantly higher than an average of USD1,100/MT to USD1,200/MT in 2021; and (ii) packaging players may not immediately enjoy the benefit of lower resin cost as they are still carrying significant resin inventory at high prices.For 2022, we maintain our average resin price assumption ofUSD1,200/MT to USD1,300/MT (vs. YTD average of USD1,300/MT to USD1,400/MT). We assume margins of 8%-10% for packaging players in 2022 (vs. 10%-12% in 2021).

Resin and Crude Oil Prices



Source: Bloomberg, Kenanga Research

Our top pick for the sector is **TGUAN (OP; TP: RM3.90)** for: (i) strong demand and hence better ASPs for its non-commoditised nano stretch film and food wrap; (ii) its capacity expansion plan (completed in 1QCY22, raising capacity by c.30%), mainly catering to premium products (such as stretch films and courier bags) to fuel medium-term growth; and (iii) increased competition in the export market from a weak RM.

Meanwhile, we maintain MP call for BPPLAS with revised TP of RM1.31 based on unchanged FY22E EPS of 14.5 sen as we apply a lower PER of 9x (from 10x previously) which is at a 15% discount to the 1-year forward sector average PER of 10.6x (to reflect its negative earnings growth expectation for FY22).

Risks to our call include: (i) lower-than-expected demand for plastic products, (ii) higher-than-expected resin prices, (iii) labour shortage, (iv) higher-than-expected operating cost, and (vi) foreign currency risk.

Valuations

Company	Last Price @ 7th July 2022	Valuation Method	Valuation Basis (vs sector avg forward PER of 10.6x)	Key investment points	Current TP	Current Call	Previous TP	Previous Call
Consumer								
SLP	0.89	PER	14x PER (~30% premium to sector average) on FY22E EPS of 7.1sen	(i) net cash position (ii) niche products which fetch superior margins (iii) attractive dividend yield (iv) low trading liquidity	0.99	OP	1.18	OP
SCGM (Ceased Coverage)	2.29	PER	14x PER (~20% premium to sector average)on FY23E EPS of 18.0sen	(i) niche market segment focussing on growing demand for consumer packaging (ii) resilient demand (iii) In the midst of disposing of its entire packaging business, which has been valued at RM544.4m at an implied historical PER of 16.0x.	2.53	Not Rated		
Industrial								
SCIENTX	3.43	PER/PBV	SOP comprising: (i) 14x PER on manufacturing segment, (ii) 0.7x PBV on property segment	(i) largest market cap status (ii) better economies of scale	3.33	MP	4.15	MP
TGUAN	2.27	PER	13x PER (~20% premium to sector average) on FY22E EPS of 30.0sen.	(i) better product mix amid sustainable demand (ii) capacity expansion plan for its premium products (iii) highest forward earnings growth over the two FYs (iv) net cash position	3.90	OP	3.90	OP
BPPLAS	1.23	PER	9x PER (~15% discount to sector average) on FY22E EPS of 14.5sen	(i) facing more acute margin squeeze than its peers due to higher production costs (ii) steady dividend yield	1.31	MP	1.45	MP

Source: Bloomberg, Kenanga Research

Peer Comparison

Name	Last Price	Market	Shariah	Current	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div.Yld. (%)	Target	Rating
	(RM)	Cap (RM'm)	Compliant	FYE	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	Price (RM)	
STOCKS UNDER COVERAGE																	
BP PLASTIC HOLDING BHD	1.23	346.2	Y	12/2022	13.8%	7.8%	-12.1%	25.2%	7.5	8.5	6.8	1.5	1.4	16.8%	4.9%	1.45	UP
SCIENTEX BHD	3.43	5,319.9	Y	07/2022	5.4%	18.1%	-13.4%	44.0%	12.0	13.8	9.6	1.8	1.6	12.5%	2.2%	3.33	MP
SLP RESOURCES BHD	0.89	282.1	Y	12/2022	9.7%	5.5%	28.6%	9.3%	16.1	12.5	11.5	1.5	1.5	12.0%	6.2%	0.99	OP
THONG GUAN INDUSTRIES BHD	2.27	875.3	Y	12/2022	19.7%	20.4%	22.2%	21.2%	9.2	7.6	6.2	1.1	1.0	14.3%	2.4%	3.90	OP
Simple Average					**12.1%**	**13.0%**	**6.3%**	**25.0%**	**11.2**	**10.6**	**8.5**	**1.5**	**1.4**	**13.9%**	**3.91%**		

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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