

04 July 2019

Plastics & Packaging

Still Not Out Of The Woods

By Marie Vaz | msvaz@kenanga.com.my

NEUTRAL



Maintain NEUTRAL. While healthy top-line growth is expected to continue, a rising cost environment from raw material cost pressures, variability of favourable product mix and higher operating expenses are a bane to the sector. Average resin prices are currently in a range-bound mode and fluctuating between USD1,000/MT and 1,200/MT. However, we have factored in a more conservative resin cost estimate of USD1,200-1,400/MT given resin price volatility. The latest quarterly results season saw the sector continue to underperform the broader market with the top decliner being SCGM (-22.0% YTD). Bucking the trend though was top gainer TGUAN (+14.5% YTD) reporting improved operating margin and earnings. All in, we made no changes to our TPs and calls as we are comfortable with our valuations and earnings estimates given that we have priced in most of the foreseeable risk during the recent results season. Sector upsides are limited by the lack of re-rating catalyst and the margin-crimping high-cost environment.



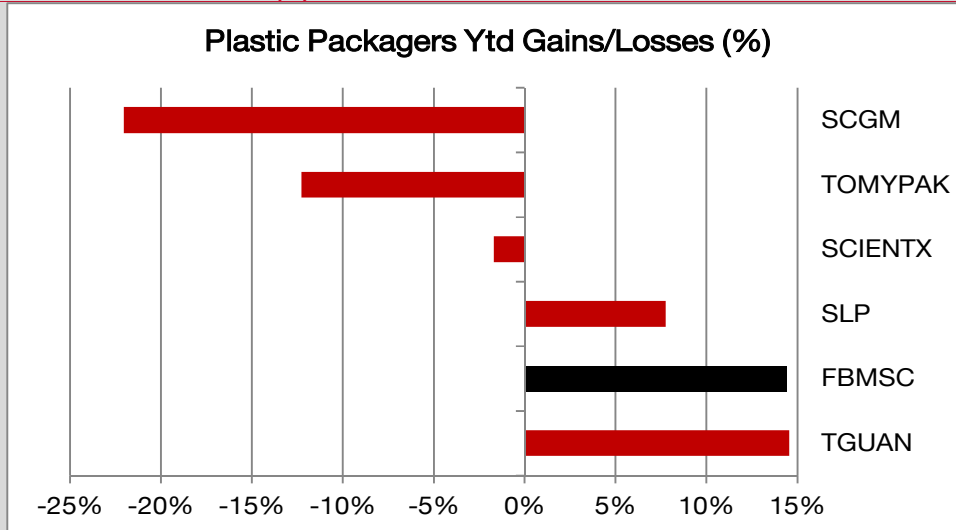
Mix 1QCY19 results. Plastic packagers' results were mixed with 2 below, and 3 within. The quarter saw fewer surprises vs. 4QCY18 when only 2 came within. TOMYPAK and SCGM came below due to weaker top-line and higher-than-expected raw material costs. Meanwhile, SCIENTX, SLP, and TGUAN were within expectations. YoY-Ytd, TGUAN is the only stock that recorded bottom-line growth (+55%) due to better operating margin. SCGM, SCIENTX, SLP, and TOMYPAK saw declines ranging 0.2% to 88% attributable to a variety of reasons such as higher raw material cost and finance cost, less favourable product mix, and higher effective tax rate. QoQ, SCIENTX saw CNP growth of 40% mainly due to its property

segment. SLP and TGUAN saw its CNP declined by 31% and 22% respectively due to reasons such as weaker top-line, higher tax-rate and weaker USD that translated to lower selling price. TOMYPAK widened its losses due to lower recognition of tax income while SCGM recorded losses on lower sales and higher operating expenses.

Results weighed on share price performance. Plastic packagers' share price movements in 1HCY19 were mixed with SLP (+7.8%) and TGUAN (+14.5%) being the top gainers under our coverage as results met expectations. Meanwhile, SCIENTX (-1.7%), TOMYPAK (-12.3%) and SCGM (-22.0%) declined Ytd as recent results missed expectations on the back of compressed margins and volatile earnings. While the broader market has shown strong recovery (FBMSC +14.4% Ytd), the plastic packaging sector has yet to reciprocate and continues to underperform due to these concerns. We believe the sector requires strong earnings growth and consistent margins in subsequent quarters to see a recovery in share price performance. *Note: Our strategy cut-off date was on 21 June 2019.*

Focused on ramping up utilisation. Plastics packagers have been focusing on capacity expansion over the past three years and aims to ramp up utilisation to drive sales. For now, we expect SLP to gradually increase annual capacity by 58% by FY21. SCIENTX will continue focusing on ramping utilisation, targeting 75% over the next few years while TOMYPAK is also set on improving utilisation to c.67% by FY21. SCGM is working hard to increase capacity utilisation from current levels of c.50%. Meanwhile, TGUAN will continue to invest in R&D to improve sales and margins for existing products (i.e. Stretch Films).

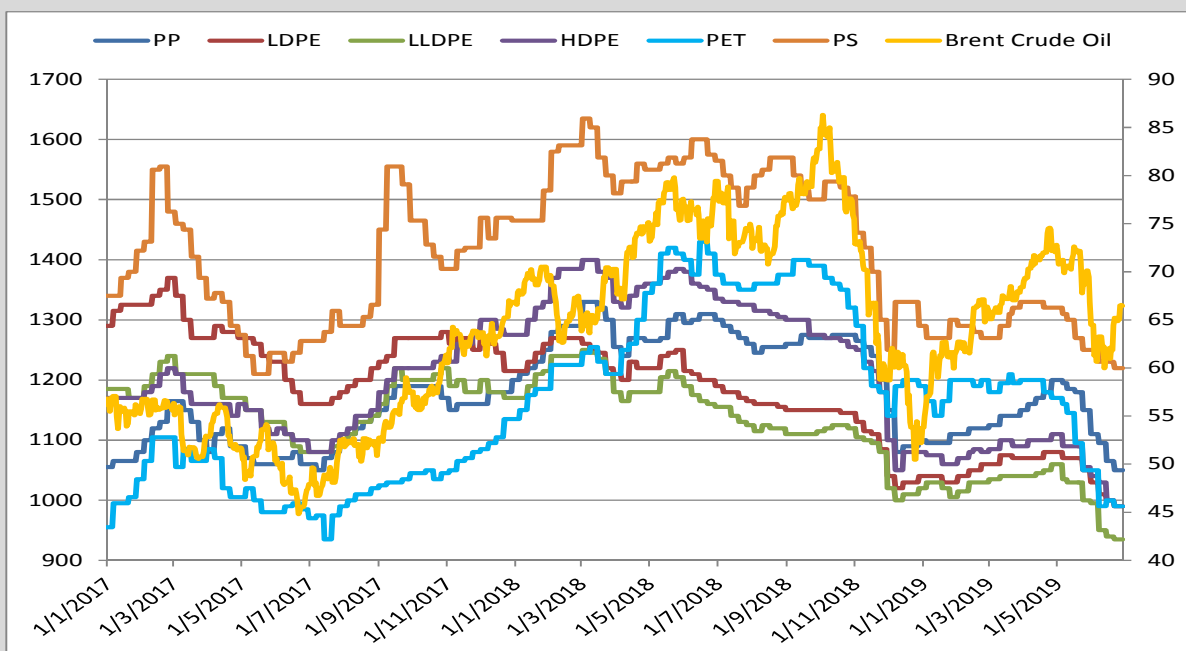
Table 1: Share Price YTD Gains/Losses (%)



Source: Bloomberg

Concerned on cost pressures. We are cautious on the cost outlook given the volatile raw material prices, the volatility of a favourable product mix and transition costs from expansion, resulting in margin compressions in recent quarters. Resin prices are currently ranging bound within the price zone of USD1,000-1,200/MT, but we are slightly more conservative estimating resin cost at USD1,200-1,400/MT as resin prices have been volatile and we do not discount the possibility of resin prices bouncing back. Note that resin is a by-product of crude oil and there is a possibility that prices may increase alongside crude oil prices as OPEC’s recent meeting in early July 2019 has vowed to extend production cuts, limiting oil production for another nine months to keep oil prices elevated. However, another crucial factor affecting resin price trends is the demand and supply dynamics of resin globally (i.e. increased supply may drive down prices further), thus making resin prices volatile at this juncture. Even if resin prices stabilise at current levels, we believe effect may not reflect immediately due to existing inventory of resin held at higher cost, while most packagers are still grappling with weaker product margins and additional cost incurred during the fit-out stages for capacity expansion. Most packagers recorded weaker EBIT margins YoY of -2ppts to -11ppts, save for SLP that has flattish margins. Meanwhile, TGUAN is the only packager that saw EBIT margin improvement of 2.7 ppts.

Table 2: Resin and Crude Oil Prices



Source: Bloomberg

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Table 3: Valuations

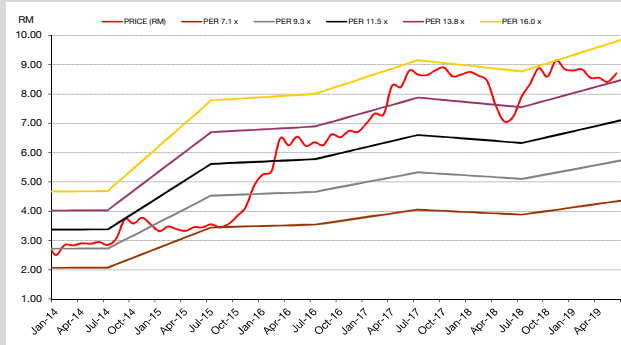
| Company | Last Price (21/6/19) | Valuation Method | Previous Valuation | TP | Call | Changes in Call/TP |
|---------|-------------------------|------------------|--|-------|------|--------------------|
| SCGM | 0.920 | PBV | 0.9x PBV (-2.0SD to 4-year historical average) on FY20E BVPS of RM0.91 | 0.805 | UP | Maintain Call/TP |
| SCIENTX | 8.70 | PER | 15.5x PER on manufacturing segment | 8.15 | MP | Maintain Call/TP |
| SLP | 1.25 | PER | 18.0x PER (4-year historical average) on FY19E EPS of 7.5 sen | 1.35 | MP | Maintain Call/TP |
| TGUAN | 2.52 | PER | 9.0x PER on FY19E FD EPS of 26.6 sen. | 2.40 | MP | Maintain Call/TP |
| TOMYPAK | 0.500 | PBV | 0.9x PBV (-2.0SD to 4-year historical average) on FY19E BVPS of RM0.48 | 0.430 | UP | Maintain Call/TP |

Source: Bloomberg, Kenanga Research

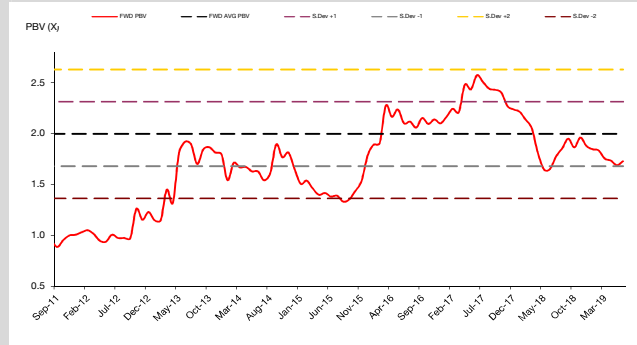
Maintain NEUTRAL. Valuations are at -0.5 to -2.0SD to the 4-year PBV average which we believe is justifiable in light of weaker earnings and margins. SLP's ascribed valuation is the highest among its peers at -0.5SD owing to its consistent earnings performance when most plastic packagers are facing margin pressure, but below its 4 year average as the macro fundamentals for the sector are not as favourable due to the volatile cost component and product mix. We see our valuations to be based on robust earnings estimates, which have priced in most of the foreseeable risk. We maintain our sector call at NEUTRAL and made no changes to TP and calls. Upside will likely be capped by the lack of re-rating catalyst and margin-crimping high-cost environment. We may look to increase earnings estimates should resin prices maintain a consistently lower trend, and upon more stable earnings deliveries in upcoming quarters.

Risks to our call include: (i) higher/lower-than-expected demand for plastic products, especially from importing countries, (ii) higher/lower-than-expected resin prices, and (iii) a sector re-rating due to macroeconomic factors.

SCIENTX - Fwd PER Band

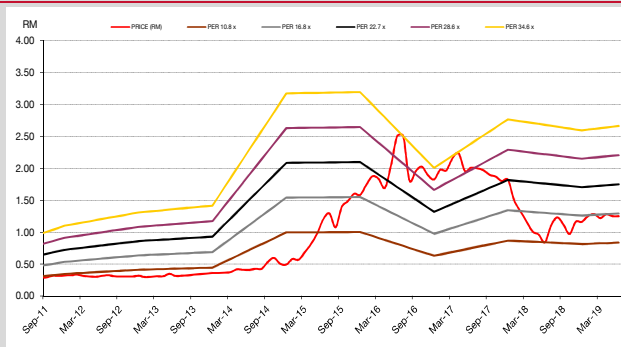


SCIENTX - Fwd PBV Band

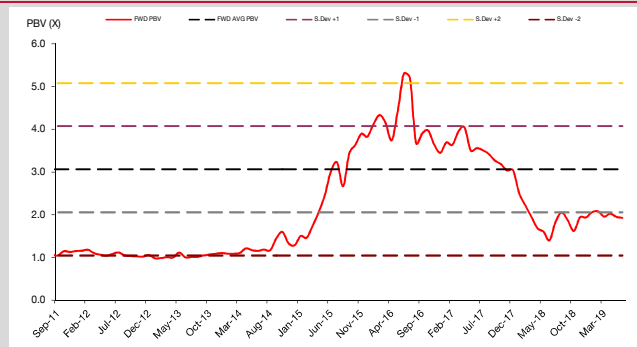


Source: Bloomberg, Kenanga Research

SLP - Fwd PER Band

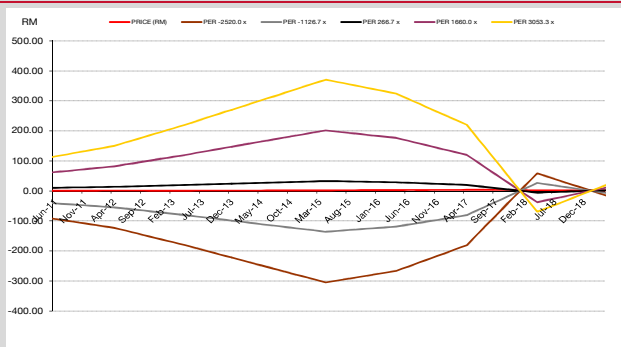


SLP - Fwd PBV Band

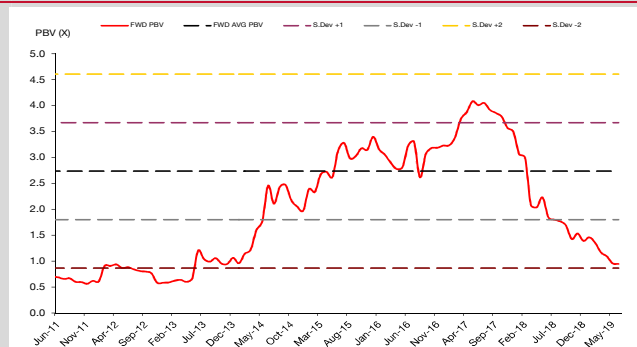


Source: Bloomberg, Kenanga Research

SCGM - Fwd PER Band

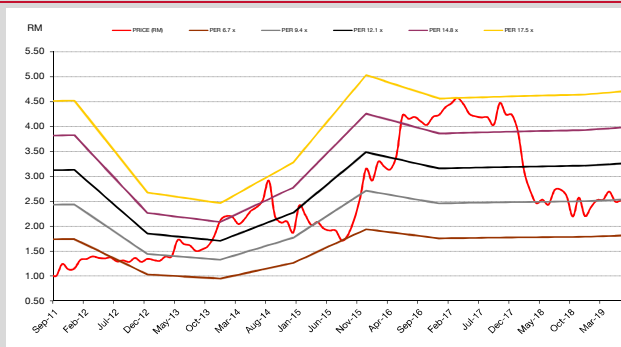


SCGM - Fwd PBV Band

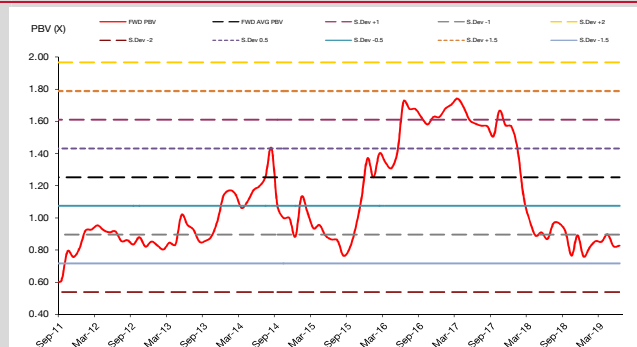


Source: Bloomberg, Kenanga Research

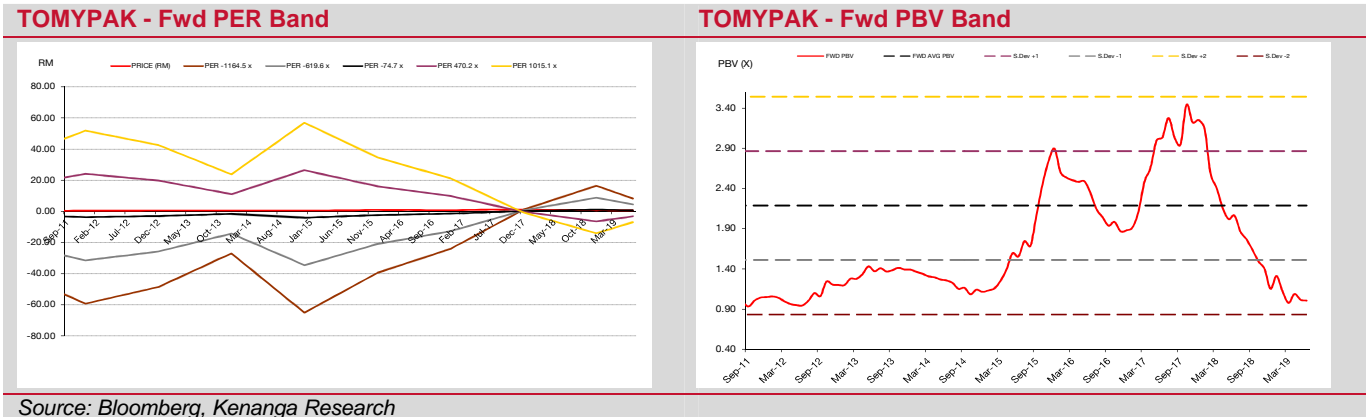
TGUAN - Fwd PER Band



TGUAN - Fwd PBV Band



Source: Bloomberg, Kenanga Research



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Peer Comparison

| Name | Last Price (21/6/19) | 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 | | | | | | | | | | | | | | | | | |
| SCGM BHD | 0.920 | 177.3 | Y | 04/2020 | 11.4% | 5.2% | 305.3% | 193.6% | N.A. | 123.1 | 41.9 | 1.1 | 1.0 | 0.9% | 1.1% | 0.805 | UP |
| SCIENTEX BHD | 8.70 | 4,482.8 | Y | 07/2019 | 26.0% | 14.7% | -4.2% | 18.4% | 15.2 | 15.9 | 14.1 | 2.5 | 2.0 | 13.8% | 2.5% | 8.15 | MP |
| SLP RESOURCES BHD | 1.25 | 396.2 | Y | 12/2019 | 12.5% | 5.4% | -6.7% | 5.5% | 15.6 | 16.7 | 15.8 | 2.1 | 2.1 | 13.5% | 3.0% | 1.35 | MP |
| THONG GUAN INDUSTRIES BHD | 2.52 | 400.0 | Y | 12/2019 | 3.4% | 2.9% | 0.8% | 2.6% | 9.6 | 9.5 | 9.2 | 0.9 | 0.9 | 9.5% | 3.4% | 2.40 | MP |
| TOMYPAK HOLDINGS | 0.500 | 209.5 | Y | 12/2019 | 5.7% | 7.7% | -6.1% | -197.2% | N.A. | N.A. | N.A. | 1.4 | 1.0 | -3.3% | 0.0% | 0.430 | UP |
| Simple Average | | | | | 11.8% | 7.2% | 57.8% | 4.6% | 13.5 | 41.3 | 20.3 | 1.6 | 1.4 | 6.9% | 2.0% | | |

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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KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

