Plastics & Packaging

Seeking Convincing Margin Improvements

NEUTRAL

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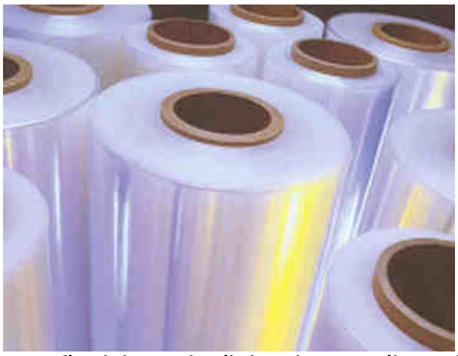
By Marie Vaz / msvaz@kenanga.com.my

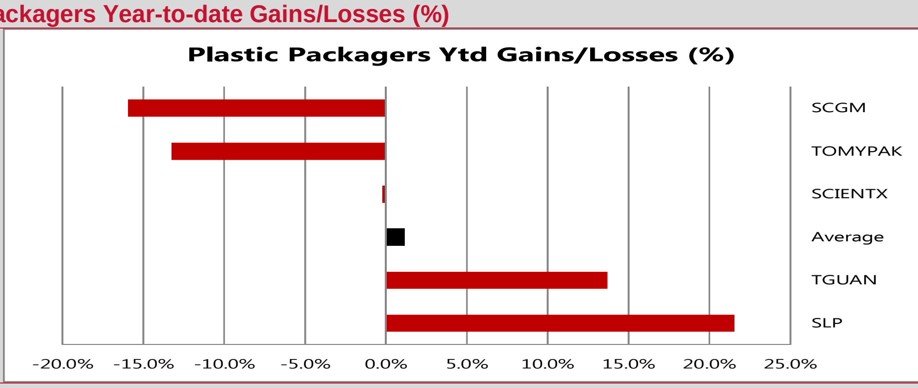
Maintain NEUTRAL. Plastic packagers had a rough patch in FY18 and 2019 thus far with mixed results, mostly due to volatile EBIT margins caused by rising cost for raw material, utilities, labour and fit-out cost, and a less favourable product mix. Only SLP (+22% YTD) and TGUAN (+14% YTD) saw YTD share price gains (at our report cut-off date of 20th September 2019) as their results met expectations. We believe plastic packagers are currently at the crossroads. This is because even after pricing in most of the current low resin cost levels of USD900-1,100/MT, we are of the opinion that formulating the right product mix would be a critical factor determining robust margin growth or regression under the challenging market environment. As such, EBIT margins in coming quarters are key factors and we may look to increase earnings estimates and valuations on consistent margins and earnings deliveries. We made no changes to earnings, but upgraded TGUAN to OP (from MP) on a higher TP of RM3.00 (from RM2.45) post increasing our valuations as we believe margins are gradually improving back to normalised levels of 6-8%, from lows of 4-5% in FY18. We maintain our sector call as we remain cautious on margin pressure, and believe that we have accounted for most of the foreseeable positive factors for now.



Mixed results. Plastic packagers' results were a mixed bag with three coming in below (SCGM, TOMYPAK and SCIENTX), and two within (SLP and TGUAN). This quarter is slightly worse off than the previous quarter when only two came in below (TOMYPAK and SCGM). The reason for the weak results were weaker top-line and higher-than-expected raw material and fixed costs, as well as weaker margins during the quarter. YoY-Ytd, TGUAN is the only stock among our plastic packagers that saw bottomline growth (+43%) due to better operating margins. SCGM, SCIENTX, SLP, and TOMYPAK all saw decline ranging from 1% to 789%, attributable to a variety of reasons such as higher raw material and finance cost, less favourable product mix, and higher effective tax rate. QoQ, most packagers saw flattish to declining bottom-lines (-2% to -946%) on weaker product mix and rising cost, while SLP was the only one that recorded CNP growth (+28%) on a better product mix and lower raw material cost. TOMYPAK continued to post losses albeit narrowing, while a recent auditors' report indicated that material uncertainty exist which may cast doubt on the Group's ability to continue as a going concern.

Top gainer SLP up 22% YTD. As of our report cut-off date (20th September 2019), SLP, our preferred pick during the quarter was the top gainer, up 22% YTD. We believe the strong results were due to results consistently meeting expectations while also commanding premium margins of 15% EBIT vs. other plastic packagers under our coverage of 5-7% (save for TOMYPAK). This was followed by TGUAN which appreciated 14% YTD as its results also met expectations. Meanwhile, SCIENTX, SCGM and TOMYPAK saw YTD declines as results came in below expectations.

Table 1: Plastic Packagers Year-to-date Gains/Losses (%)

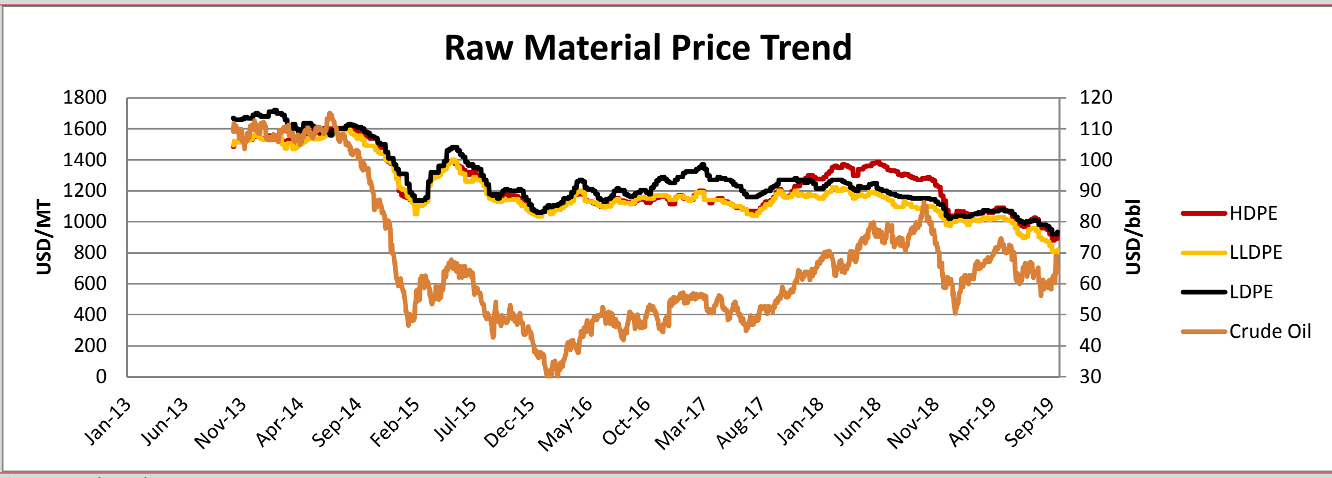


Source: Bloomberg

Focused on ramping up utilisation. Plastic packagers have been focusing on capacity expansion over the past three years, and are now focused on ramping up utilization to drive top-line growth. Going forward, we expect SLP to gradually increase annual capacity by 38% by FY21-22, while other packagers such as SCIENTX will focus on ramping utilisation, targeting 75% expansion over the next few years, while TOMYPAK plans to improving utilisation to c.67% by FY21 and SCGM can now focus on improving utilisation rates targeting 70% by end FY20 (from c.60% currently) after moving into a new factory in April 2019 (4Q19). Meanwhile TGUAN will continue to invest in R&D to improve sales and margins for existing products (i.e. stretch films).

Keeping an eye on margins. Margins and earnings improvements are crucial for plastic packagers that have seen declining earnings with some even recording operating losses (i.e. SCGM and TOMYPAK). Despite declining raw material cost, packagers' margins remain weak or flattish, with two packagers under our coverage falling into the red, due to inventory locked in at higher prices. To recap, resin cost has been on the declining trend since 2018 and is currently range bound between USD800-1,000/MT, while our full-year assumptions are slightly more conservative at USD900-1,100/MT. Even if raw material prices were to stabilise at current low levels, the positive effect may not be reflected immediately in the upcoming quarter due to existing resin inventory held at higher cost, while most packagers are still grappling with weaker product margins and additional cost incurred during the fit-out stages from on-going capacity expansion.

Table 2: Resin and Crude Oil Prices



Source: Bloomberg

Table 3: Valuations

Company	Last Price (20/9/19)	Valuation Method	Valuation Basis (NEW PER)	Valuation Basis (OLD PER)	Current TP	Previous TP	New Call	Previous Call
Consumer								
SLP	1.41	PER	18.0x PER (4-year historical average) on FY20E EPS of 7.9 sen	Maintained	1.45	1.45	MP	OP
SCGM	0.975	PBV	1.35x PBV (-1.0SD to 4-year historical average)on FY20E BVPS of RM0.90	Maintained	1.20	1.20	MP	MP
TOMYPAK	0.49	PBV	0.88x PBV (-2.0SD to 4-year historical average) on FY20E BVPS of RM0.31	Maintained	0.270	0.270	UP	UP
Industrial								
SCIENTX	8.80	PER	16.0x PER on manufacturing segment	Maintained	9.45	9.45	MP	MP
TGUAN	2.49	PER	11.0x PER (-0.5SD to 4 -year historical average) on FY20E FD EPS of 27.2 sen.	9.0x PER (-1.0SD to 4-year historical average) on FY20E FD EPS of 27.2 sen.	3.00	2.45	OP	MP

Source: Bloomberg, Kenanga Research

Earnings unchanged but TGUAN our preferred pick on higher valuations. We made no changes to earnings, but upgraded TGUAN to OP (from MP) on a higher TP of RM3.00 *(refer to Table 3)* post increasing our valuations to 11.0x PER (-0.5SD), from 9.0x PER (-1.0SD). We believe TGUAN warrants better valuations having performed within expectations over the past six quarters after coming off from a weak earnings streak in 4Q17 and 1Q18, with EBIT margins gradually improving back to normalised levels of 6-8%, from lows of 4-5% in FY18. We will continue to monitor margin trends which rely on consistent low resin prices as well as a favourable product mix and thus are comfortable with our -0.5SD valuation level for now as we notice that its EBIT margin was down slightly (-0.4ppt) QoQ. We may look to up our valuations further should there be more consistent margin improvements.

Additionally, we lowered SLP's call to MP (from OP) as share price has done well, up 13% since our upgrade to OUTPERFORM on 5th August 2019.

Note that SCGM and SCIENTX results were announced post our Strategy cut-off date (20th September 2019) and as such our upgraded TPs and call are a reflection of the better earnings results on 24th September 2019 and 26th September 2019, and commensurate with current share price levels post our cut of date; SCGM (MP: TP:RM1.20, from UP; TP:RM0.805) and SCIENTX (MP: TP:RM9.45, from MP; TP:RM8.15).

Maintain NEUTRAL. Valuations are at average to -2.0SD to the 4-year PER and PBV averages which we believe are justifiable in light of weak earnings and margins over the past two years. SLP's ascribed valuation is the highest among its peers at historical average levels owing to its consistent earnings performance and superior margins of c.15% EBIT margins vs. peers of 4-7% which have also remained stable vs. peers when most plastic packagers are facing margin pressures. We maintain our sector call at NEUTRAL as we remain cautious on margin pressure for this sector, and believe that we have accounted for most positives for now. We may look to increase earnings estimates should resin prices maintain its current low levels, as well as upon consistent margins and earnings deliveries in upcoming quarters from better product mix.

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.

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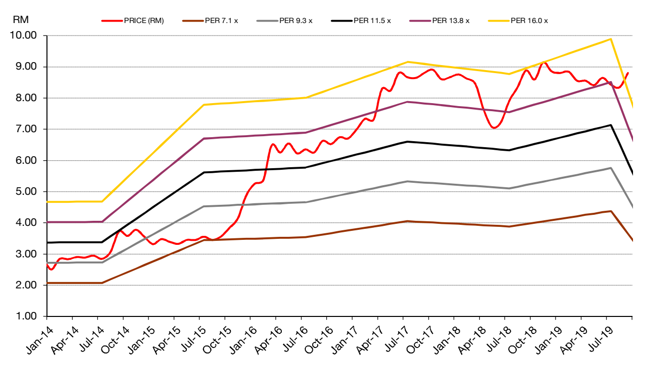
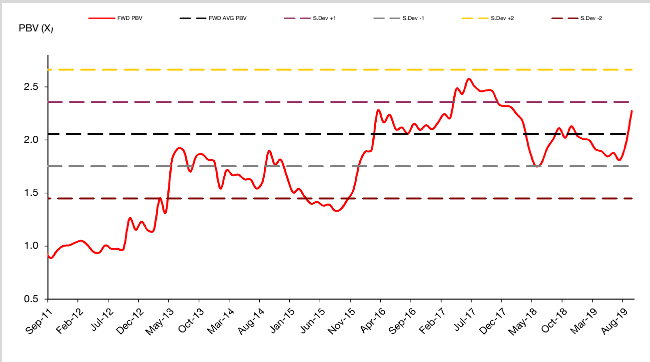
SCIENTX - Fwd PER Band

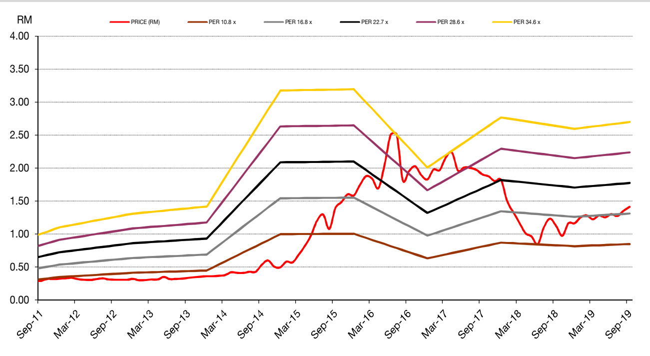


SCIENTX - Fwd PBV Band

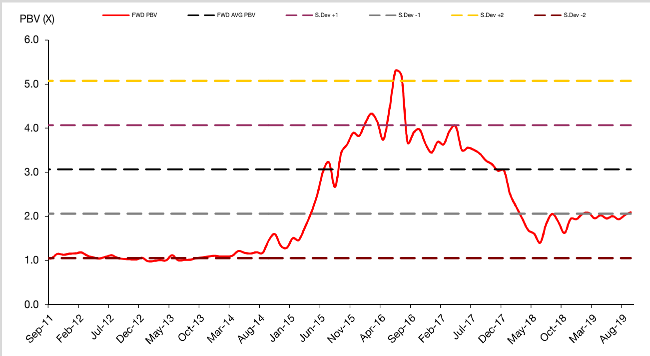


Source: Bloomberg, Kenanga Research

SLP - Fwd PER Band

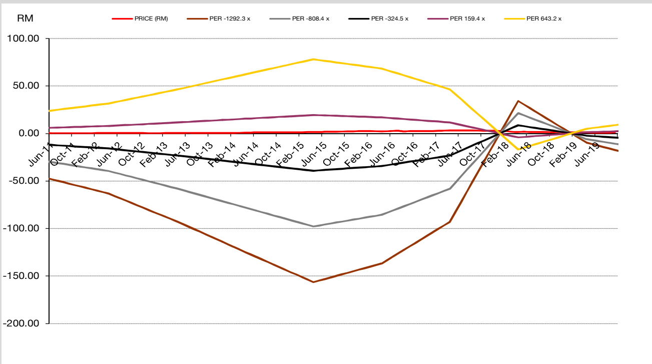


SLP - Fwd PBV Band

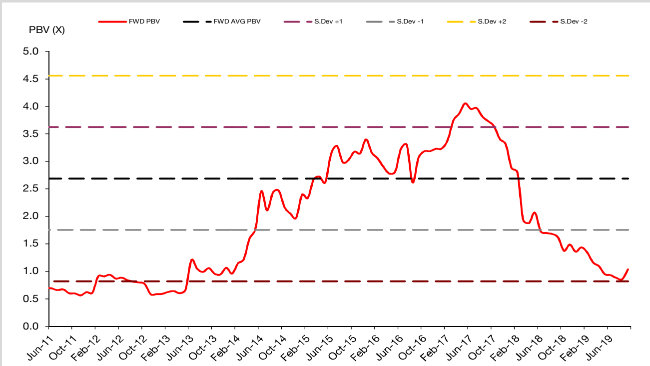


Source: Bloomberg, Kenanga Research

SCGM - Fwd PER Band

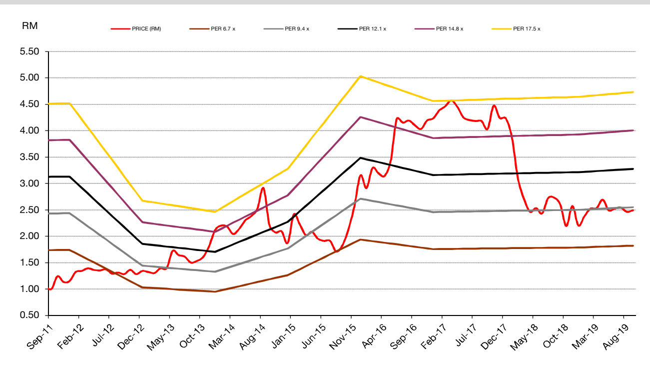


SCGM - Fwd PBV Band

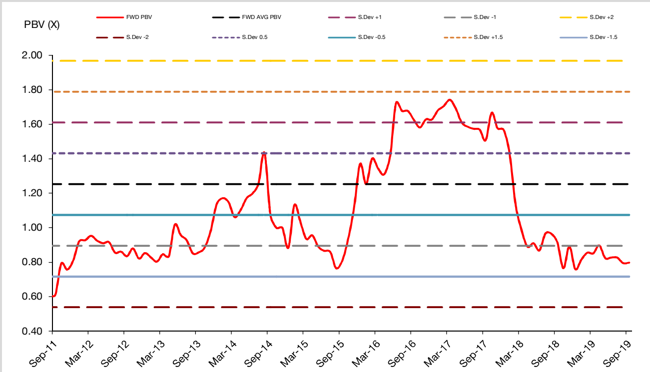


Source: Bloomberg, Kenanga Research

TGUAN - Fwd PER Band

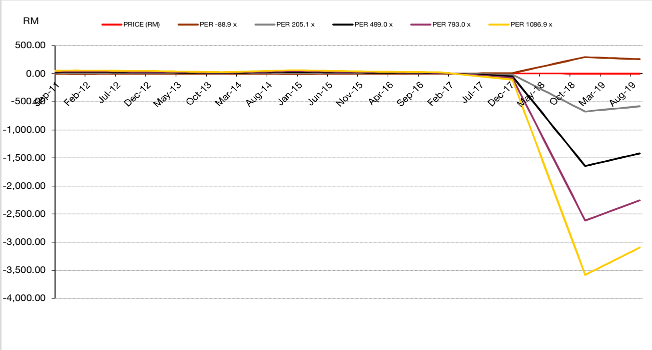


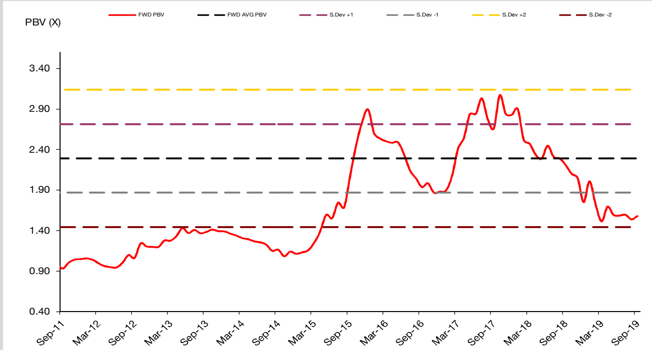
TGUAN - Fwd PBV Band



Source: Bloomberg, Kenanga Research

TOMYPAK - Fwd PER Band	TOMYPAK - Fwd PBV Band





Source: Bloomberg, Kenanga Research

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Peer Comparison

Name	Last Price (30/09/19) (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) Hist.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net Div.Yld. (%) 1-Yr. Fwd.	Target Price (RM)	Rating
STOCKS UNDER COVERAGE																	
SCGM BHD	0.975	186.7	Y	04/2020	11.4%	5.2%	314.3%	200.0%	N.A.	19.5	13.2	1.2	1.1	0.8%	1.0%	1.20	MP
SCIENTEX BHD	8.80	4,534.3	Y	07/2020	26.0%	14.7%	-4.2%	18.4%	14.2	12.2	9.9	2.5	2.1	14.5%	2.8%	9.45	MP
SLP RESOURCES BHD	1.41	446.9	Y	12/2019	12.5%	5.4%	-6.7%	5.5%	17.6	18.8	17.8	2.5	2.3	12.6%	3.2%	1.45	MP
THONG GUAN INDUSTRIES BHD	2.49	438.4	Y	12/2019	3.4%	2.9%	0.8%	2.7%	9.4	9.4	9.1	0.9	0.9	9.5%	3.6%	3.00	OP
TOMYPAK HOLDINGS	0.490	205.3	Y	12/2019	-2.5%	5.6%	-3.6%	-122.8%	N.A.	N.A.	N.A.	1.4	1.5	-7.5%	0.0%	0.270	UP
Simple Average																	

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