

20 November 2023

Plastic Packaging

Plastics as An Enabler Across Sectors

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NEUTRAL



We came away from a recent engagement with Malaysian Plastics Manufacturers Association (MPMA) feeling positive on the long-term prospects of the plastics and packaging sector. Malaysian stretch film producers are here to stay, thanks to advanced technology, skilled labour and efficient raw material sourcing. The rising demand for food and beverage (F&B) packaging is a key growth catalyst for the industry. Meanwhile, sustainable packaging is gaining traction in Europe with the adoption of eco-friendly packaging solutions. Nevertheless, the sector is not spared the global economic slowdown over the short term. Hence, we reiterate our NEUTRAL view on the sector, and our sector top pick is TGUAN (OP; TP: RM3.05).

Plastics as an enabler across different subsectors. Plastics play a vital role in our daily lives in which we use them unthinkingly every day in various applications (see Exhibit 1). Their unparalleled versatility is crucial in supporting key industries, such as F&B packaging, electrical and electronic (E&E) components, automotive parts and construction materials (e.g. water tanks, baths, piping and ductwork). Notably, plastics packaging constitutes the largest market segment within this industry, making up 46% of CY22 total turnover (see Exhibit 2). This subsector encompasses both flexible packaging (e.g. films and bags) and rigid packaging (e.g. bottles and containers).

Key statistics of Malaysian plastics industry. The plastics industry in Malaysia recorded a substantial CY22 total turnover of RM63b, with more than 70% of this revenue attributed to exports (including both direct and indirect exports). The major export markets for Malaysian plastics industry include Europe, USA, Singapore, Australia and Japan. Often, such exports are indirect, for example as E&E exports including appliances, electrical components, or even medical devices, but also as automotive parts or household products and furniture. Direct exports of plastics products amounted closer to RM17b in CY22, mainly consisting of films and sheets (39%) and bags (28%), with other product categories being largely fragmented.

Malaysia is the leading stretch films producer in Asia. Malaysian manufacturers were among the first to invest in the production of stretch films which then consistently expand their operations, drive product innovations, and embrace technological advancements such as new formulations, resins or plant and equipment. Their continuous advances and capacity expansion have enabled them to gain scale and competitive edge in sourcing and pricing, be it for raw materials or equipment alike. The estimated annual production of stretch film in Malaysia is about 450,000 metric tons or 9% of global production or 32% within the Asia Pacific region. Notably, approximately 87% of Malaysia's production volume is exported, highlighting the competitiveness, superior quality and advancement of its film products. We expect Malaysia to sustain its edge in the global stretch film market, staying ahead of its competitors in the ASEAN region (e.g. Indonesia, Thailand, Vietnam), thanks to its innovative, high-quality production of stretch films, backed by a well-trained, skilled workforce proficient in handling advanced machinery.

The demand for stretch films is also set to rise due to the increased need for high-performance flexible packaging across various industries such as F&B, shipping, and logistics. Additionally, the demand for plastics packaging is expected to shadow the growth in population, income and international trade which involves additional packaging materials such as bubble wraps, palletising films, or simple cover to protect against the elements. Companies like **TGUAN**, **BPPLAS (MP; TP: RM1.23)**, and **SCIENTX (UP; TP: RM3.23)**, which export stretch films globally, are poised to benefit from such demand trends. Over and above rising product demand, we suspect some Malaysian exporters are also gaining market share in their overseas markets. Among these companies, we anticipate that **TGUAN** will experience the greatest advantage due to their substantial investment in innovative technology and advanced machinery, particularly in the realm of nano stretch films. Nano stretch films represent c.60% of **TGUAN**'s total stretch film production while stretch film accounts for about half of its total revenue.

Plastics packaging to replace traditional packaging in F&B. Currently, flexible and rigid plastics packaging are increasingly replacing traditional materials like paperboard, metal and glass. This shift is primarily driven by a compelling combination of convenience, as it can be rigid, flexible, printed on, yet light. This allows for significant transportation cost savings while concurrently enjoying lower production costs, as not much energy is required to convert resin to the final product (unlike glass packaging). The inherent lightweight and flexible nature of plastics enable the creation of diverse packaging solutions that cater to various shapes and sizes meeting evolving consumer needs, especially in F&B applications (see Exhibit 3). Beyond flexibility, plastics offer additional qualities such as durability, crucial barrier properties (i.e. resistance to oxygen, light and moisture) and effective sealing capabilities, ensuring food safety and preservation. All in all, the growing demand for processed and packaged food is likely to be a key driver for future growth in the plastics industry.

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Growing demand for sustainable packaging. In view of its popularity, there is rising environmental concerns over plastics. However, given how pervasive and essential plastic is in our modern world, rather than trying to get rid of plastics, the current focus is increasingly on how to manage waste. This, in turn, is leading to increased circular economy initiatives and the development of sustainable packaging solutions. Investment in innovative packaging trends is essential to enhance packaging solutions for efficient plastics waste collection, sorting, and recycling. Companies like **BPPLAS** and **TGUAN** are gaining traction with innovations such as nano stretch film, while **SLP (MP; TP: RM0.85)** is seeing an uptick in customer inquiries for its mono film, particularly the MDO-PE film. In fact, despite environmental challenges, plastics remain one of the most lightweight packaging materials with minimal carbon emissions, especially when compared to metal or glass. Managing post-use plastics waste poses a significant challenge, emphasizing the crucial role of environmental education in fostering consumer understanding and encouraging responsible behaviour in consumption, collection, recycling, and disposal.

Europe is expected to be the most attractive marketplace for innovative plastics packaging solutions due to its proactive approach in implementing stringent regulations and sustainability standards for plastic usage and waste management. Through policies like the Single-Use Plastics Directive and the Circular Economy Action Plan, Europe has been at the forefront of efforts aimed at reducing plastic waste and promoting sustainable alternatives. Simultaneously, European consumers are increasingly conscious of the environmental impact of plastics and are actively seeking packaging options that are sustainable, recyclable, and biodegradable. This growing emphasis on sustainability and increased consumer demand is spurring companies to adopt innovative, eco-friendly packaging solutions in the European market. In this context, we believe companies like **TGUAN** can expand its revenue within Europe by leveraging its nano stretch film technology, which aligns with the demand for sustainable packaging. In FY22, Europe accounted for 14% of **TGUAN**'s total sales.

Reiterate our NEUTRAL view on Plastics Packaging, with our sector top pick being **TGUAN** due to: (i) its earnings stability underpinned by a more diversified product portfolio and steadily growing clientele base, (ii) its aggressive push into the European and US markets with environmentally friendly products, and (iii) its expansion plans for premium products, such as nano stretch films, courier bags, food wraps and some industrial bags (wicketed bags, oil/flour/sugar bags).

We continue to favour niche products player **SLP** for its: (i) product mix which focuses on high-margin, non-commoditized products such as kangaroo pouches and mono films, and (ii) robust cash flows and a strong balance sheet (a net cash position), enabling consistent and generous dividend payments.

Under our coverage, we have two more stretch film players namely **BPPLAS** and **SCIENTX**, which are also developing innovative packaging solutions. We favour **BPPLAS** for its: (i) strong foothold in the SE Asia market which is expected to remain resilient despite global economic uncertainties, (ii) strong cash flows and balance sheet (a net cash position) that will enable it to weather downturns better, and (iii) long-term capacity expansion in high-margin premium stretch film and blown film products, positioning it to capitalise on the next up-cycle.

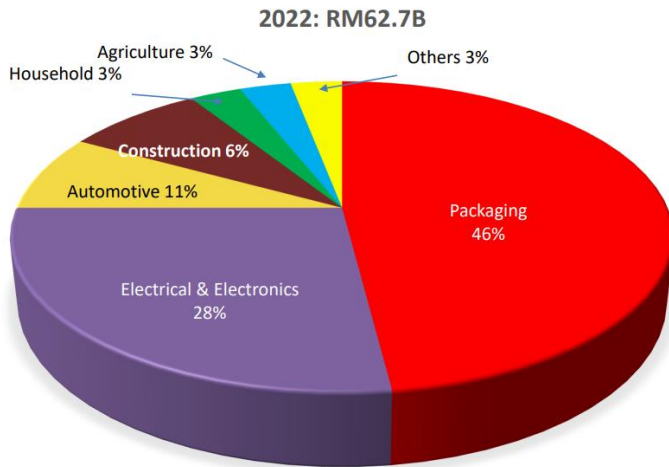
We also like **SCIENTX** for: (i) the expanding global market share of the local plastic packaging industry due to cost advantages compared to overseas competitors, (ii) its strong market position, being the largest flexible plastic packaging manufacturer in the region, and (ii) the robust demand for its affordable housing with overwhelming take-up achieved.

Exhibit 1: Plastics Supply Chain



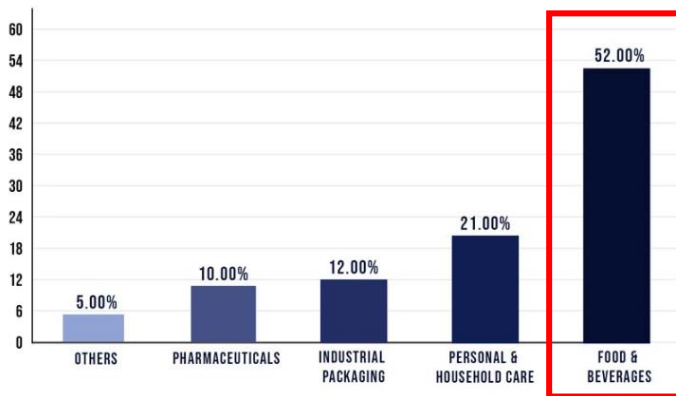
Source: MPMA

Exhibit 2: Major Market Segments



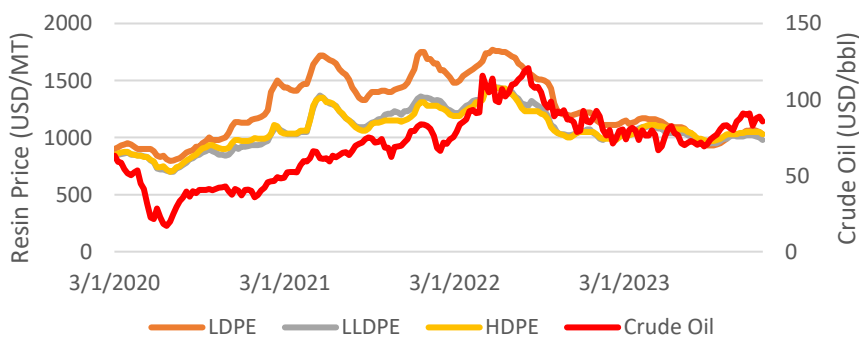
Source: MPMA

Exhibit 3: Plastics Packaging's Breakdown by Application, 2022 (%)



Source: MPMA, Precedence Research

Exhibit 4: Resin and Crude Oil Prices



Source: Bloomberg, Kenanga Research

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Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div. Yld. (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.				
Stocks Under Coverage																	
BP PLASTICS HOLDINGS BHD	MP	1.21	1.23	1.7%	340.6	Y	12/2023	11.8	13.7	7.1%	16.3%	10.3	8.8	1.3	13.6%	5.5	4.5%
SCIENTEX BHD	UP	3.66	3.23	-11.7%	5,676.9	Y	07/2024	35.2	36.5	18.3%	3.6%	10.4	10.0	1.5	16.0%	10.6	2.9%
SLP RESOURCES BHD	MP	0.850	0.850	0.0%	269.4	Y	12/2023	3.8	4.9	-27.3%	30.0%	22.5	17.3	1.4	6.3%	5.0	5.9%
THONG GUAN INDUSTRIES BHD	OP	1.88	3.05	62.2%	742.7	Y	12/2023	23.0	27.7	-17.9%	20.3%	8.2	6.8	0.8	10.2%	4.8	2.5%
Sector Aggregate					7,029.6					10.1%	6.9%	10.3	9.6	1.4	13.3%		4.0%

Source: 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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