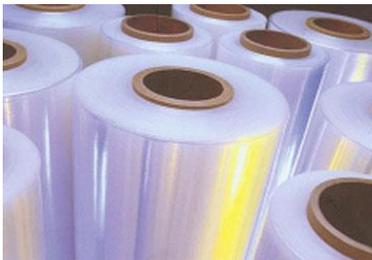


ESG

The Circular Economy's Implications on Plastic Sector

By Marie Vaz / msvaz@kenanga.com.my ;

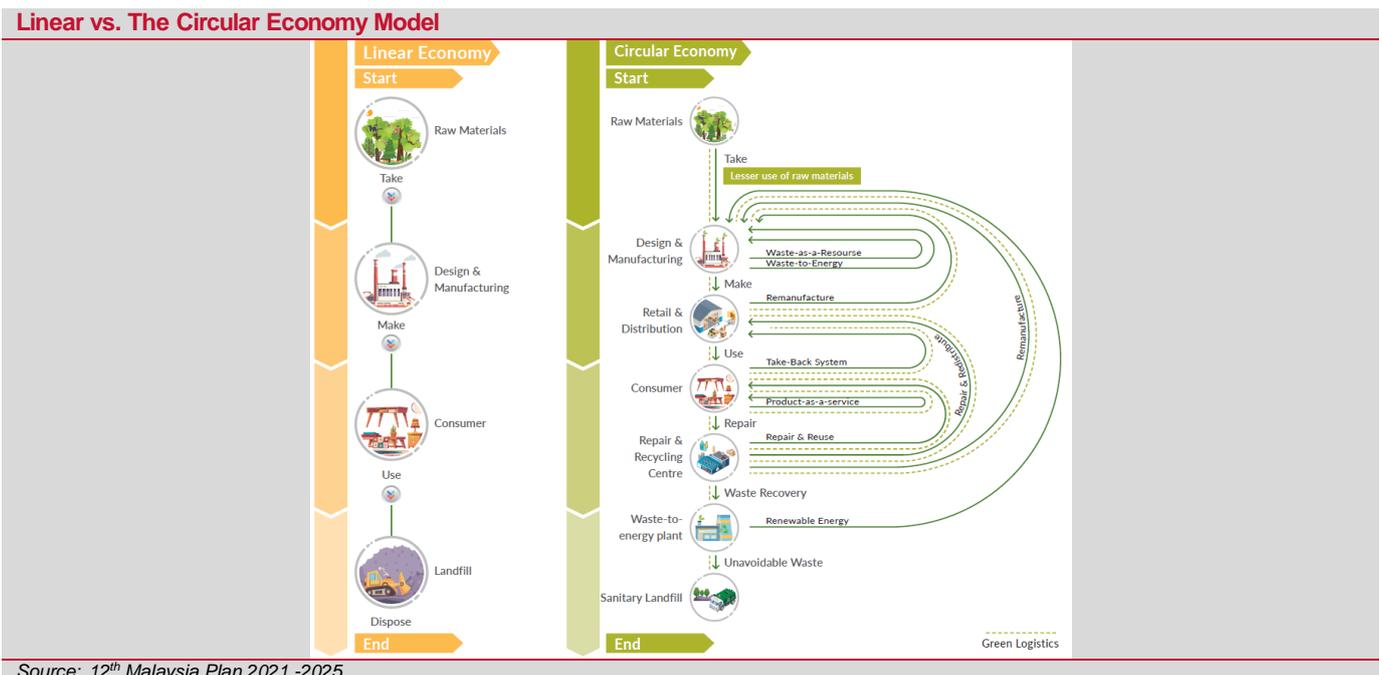
The recent 12th Malaysia Plan (MP) prioritised advancing sustainability, and highlighted Embracing the Circular Economy as one the game changers. Some stick-based measures introduced like the *Extended Producer Responsibility (EPR)* would incur cost on the part of the producer, while *discouraging use of single-use plastics* at eateries and public events would affect local demand, when implemented. That said, channel checks suggest that there may be opportunities for income generation for producers with the EPR if well executed. Positive measures from the 12th MP include the green-related incentive schemes (GTFS, GITA and GITE) could foster environmental solutions within the sector. The beneficiary of the whole transition to the circular economy are local waste recycling companies (such as TEXCYCL; NR). Plastic packagers can also benefit from the transition, with most already having biodegradable or degradable products, but demand for such products is not overly significant, likely due to the pricing factor (which can be up to 3-5x more expensive) and lack of policy-driven enforcement. A better approach adopted by most listed packagers is by switching to mono layer plastic products for easier recyclability, while some are beginning to utilise recyclable materials in their production. All in, we have applied a 5-9% ESG discount for packagers under our coverage to impute our Kenanga ESG scoring and Collected For Recycling (CFR) rates. Maintain NEUTRAL on the sector while our Preferred Pick is SCGM (OP; TP: RM2.97) for its above sector average material disclosures and high CFR rates for its raw material.



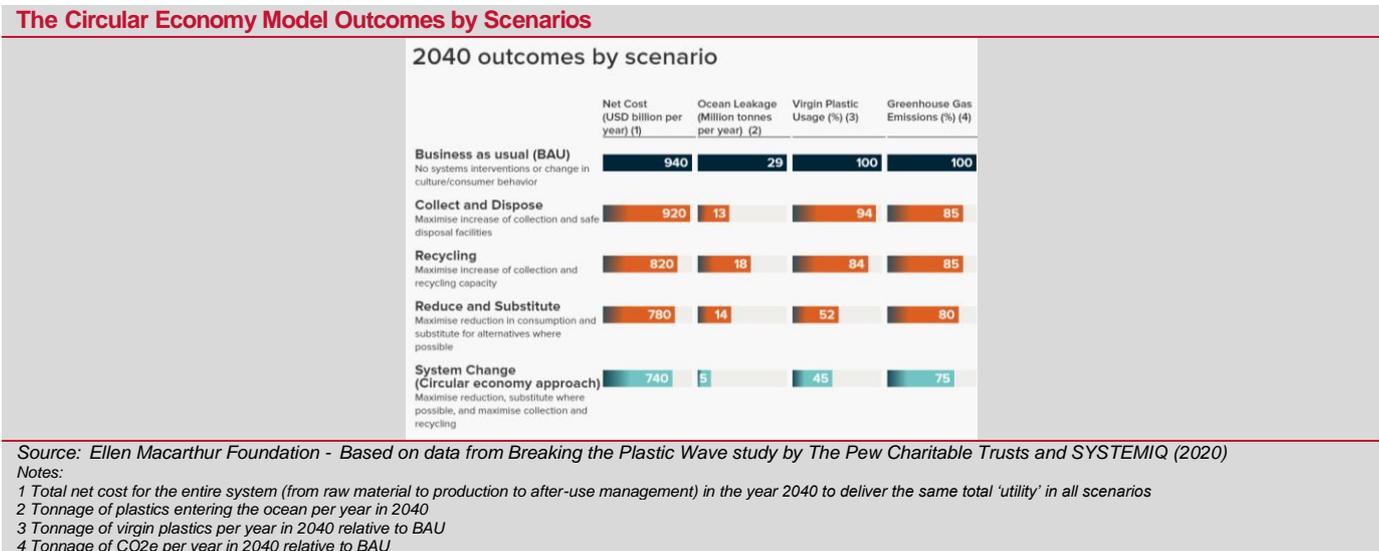
The recent 12th Malaysia Plan (announced on 27th September 2021) prioritised advancing sustainability, with one of the game changers being Embracing the Circular Economy. **The circular economy** is needed to extend the lifecycle of a product, particularly one as damaging to the environment as single-use products, which involves refurbishing, repairing, reusing, and recycling a product for as long as possible.

Sales turnover for the plastics sector increased by 2.3% to RM48.5b in CY20 (from RM47.4b in CY19), charting positive growth in spite of the Covid-19 pandemic, based on data from the Department of Statistics. As the plastic packaging sector is a significant contributor to the local economy, it stands to reason that priority and urgency should be

given through policy to aid the transition from a linear economy to plastic circularity.



Circular Economy model is the best option for now. A recent study by The Pew Charitable Trusts and SYSTEMIQ in the United States suggests that a recycling model or collect and dispose alone is not sufficient to treat the plastic problem. This does not account for the devastation of GHG emissions every time virgin plastics are produced. Considering that the Malaysian government has plans to discuss the viability of **carbon pricing (i.e. carbon taxes and the Emission Trading Scheme)**, the recommendation for the best carbon taxation system as mentioned in the 12th Malaysia plan would eventually increase the cost of virgin production due to higher emissions.



The Plan for Plastics

On a macro level affecting the plastic sector, the 12th MP aims to: (i) reduce GHG emissions intensity to GDP up to 45% by 2030 based on emissions intensity in 2005, (ii) encourage businesses to develop the circular economy and the sharing economy models, and (iii) enhance policies, regulations, green financing and economic instruments. Some of the sector specific measures mentioned are highlighted in the table below.

12th Malaysia Plan Measures related to the Plastics	
12 th MP measures	Comment
(-) <i>EPR – The Extended Producer Responsibility (EPR) is a policy approach which holds producers responsible for the treatment and disposal of post-consumer products, either through self-undertaking or financial contribution. This will in turn incentivise producers to reduce waste at source and promote the production of environment-friendly products.</i>	<i>The policy has been mentioned in the past, but is not being practiced. Implementation of EPR will be supported through the take-back system by producers or brand owners as well as the adoption of the user-pay and polluter-pay principles. Although EPR may appear to be a cost intensive approach on the part of the producer, channel checks suggest that this policy if implemented correctly could in fact be an additional income stream for companies. This would entail a massive recycling project from buying back waste from consumers and identifying reasonable collection points and recycling the waste to be reused.</i>
(-) <i>Single-use products will be discouraged (particularly for eateries and public events) - encouraged to utilise hygienic, environment-friendly and convenient alternative solutions, such as reusable, biodegradable or sturdy wares.</i>	<i>Most plastic packagers under our coverage already have environmentally friendly alternative but cite a lack of demand as environmentally friendly alternative can be costly. However, flexible plastic packagers like DAIBOCHI and TOMYPAK's clientele which include large MNCs are demanding for environmentally friendlier alternatives by 2025 and these companies are on track to achieve these targets.</i>
(+) <i>Economic instruments via green-related incentive schemes such as Green Technology Financing Scheme (GTFS), Green Investment Tax Allowance (GITA) and Green Income Tax Exemption (GITE).</i>	<i>These instruments when utilised will be leveraged to support businesses in producing green products and services. This would also incentivise more environmentally friendly solutions for or by plastic producers. More sharing economy models, including product-as-a service will be introduced to encourage sharing the use of products and services as well as facilities.</i>
(+) <i>Companies undertaking local waste recycling activities that are high-value added and use green technologies are eligible for Pioneer Status or Investment Tax Allowance under the Promotion of Investments Act 1986.</i>	<i>This is pertinent to the end-of-life use for plastic products. Most plastic packagers do not partake in this business as yet but with concrete incentive and policies in place, this could be an added income stream. For now, waste recycling companies will be the main beneficiaries for the transition to a circular economy.</i>
Conclusion: These suggestions within the 12th Malaysia Plan may have already been previously mentioned and loosely discussed, but there are hopes for deeper commitment to the implementation of these incentives in order to facilitate the Malaysian economy towards a circular model, or risk being left behind.	

Source: 12th Malaysia Plan 2021 -2025

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State of Affairs of Malaysian Plastic Packagers

Local listed plastic players under our coverage are in the transition phase and the process of developing environmental solutions such bio-degradable plastics, or mono layer plastics for easier recyclability. On top of that, plastic packagers, through product innovation and regular R&D, are constantly pushing to create thinner and more sustainable stretch film variants which utilises less raw material that are cheaper to produce.

SLP, TGUAN and SCGM have their own versions of biodegradable or degradable products on top of their transition to more recyclable plastics. However, demand for biodegradable products is not overwhelming or significant at this juncture, making up c.5-6% of company earnings. The lack of demand is largely attributable to the high costs which in some cases are 3-5x higher than normal plastic products, (in part attributable to the polylactic acid (PLA) component required) or the absence of policy and implementation on a national scale to enforce environmentally friendlier alternatives. Additionally, degradable products may not be the best solution as it may have other ramifications such as creating microplastics that are harmful to the environment.

SCIENTX (through DAIBOCI) and TOMYPAK produce flexible packaging. Their clientele includes large MNCs such as Nestle, which is shifting to 100% recyclable and reusable packaging by 2025. This in turn has already pushed local plastic packagers to come up with alternatives such environmentally friendly packaging that can be reused and recycled moving towards a more circular economy. This bold step by large MNCs is a clear sign of credible demand for green plastic packagers due to ongoing public pressure on large MNCs which are the main clienteles for single-use plastic.

Environmentally Friendlier Plastic Innovations

Company	Environmentally Friendlier Products
SCGM	<ul style="list-style-type: none"> - Biodegradable and oxo-degradable and products - secondary reprocessing to repurpose plastic bags and trays to construction materials, road pavement and bicycle pavement - PET, a major raw material product used by SCGM can be commercially recycled through washing, re-melting and further reprocessed into usable PET resin
TGUAN	<ul style="list-style-type: none"> - TG Bio Series - made from green PE resins derived from renewable feedstock, wood chips tall oil, not just from any bio ingredients but a by-product of another industry - supporting the circular economy. - Re-Use programme - all of Thong Guan's products can technically be recycled, but it must be of high quality. The recyclability depends on the use of the product as well as the collection and cleaning system after use. - the Group has converted 422MT of material bag wastes into recycle resin.
SLP	<ul style="list-style-type: none"> - It uses up to 80% of recycled materials in the production of non-food related products such as fashion bags and shopping bags. The amount of recyclable materials used in manufacturing in FY20 was 9%. - 100% recyclable Polyolefin materials (PE), New Polyethylene ("NPE") and Oriented Polyethylene (OPE).
TOMYPAK	<ul style="list-style-type: none"> - Intensified product innovation with recyclable packaging product, developed mono material recyclable structures, bio-based materials, thinner lamination layer and composting materials resulting in lower plastics used as well as lower cost to customers. - invested in a recycling machine to convert plastic waste into resin pellets to be sold to third-party users
SCIENTX	<ul style="list-style-type: none"> - BioPBS (bio-based polybutylene succinate) film, a bio-based semi-crystalline polyester film, a barrier packaging solution that is degradable at room temperature with excellent sealant properties, barrier properties and has low odour. BioPBS film is suitable for various types of dry food like coffee capsules and tea leaves packing, and has been awarded certification for both 'OK Compost Home' and 'OK Compost Industrial' by TUV Austria. - The Group has also begin providing mono-material laminate FPP solutions for various food and beverage and household products with trials and development currently ongoing with various brand owners for disposable single serve stick packs and sachets as well as beverages packs. - 100% recyclable mono-material laminate packaging and polypropylene ("PP") strapping bands, which are produced using a set percentage of recycled materials. - Engage with external recycling services to convert non-recyclable waste into Processed Engineered Fuel. Non-recyclable production waste is delivered to a third-party waste-to-energy incineration facility and is free of asbestos, scheduled waste or any hazardous materials. The materials are converted into alternative fuel.
BPPLAS	<ul style="list-style-type: none"> - Technical collaboration and exploration on the potential use of new resins/polymers e.g. Post-Consumer Recycled plastics (PCR), which are more environmentally friendly and sustaining. - Investing in new machines and innovative technology, as well as embarking on continuous research and product development, to create versatile, light weight, economical and 100% recyclable products.

Source: Company

Potential in Waste Recycling Sector

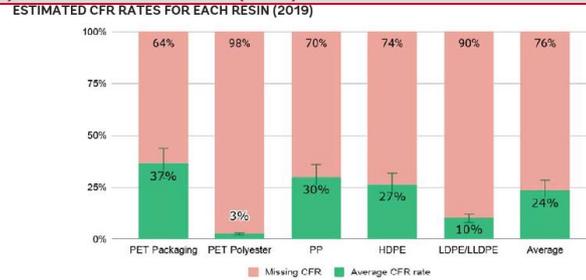
Trash to cash. A study conducted by *World Bank Group "Market Study for Malaysia: Plastics Circularity Opportunities And Barriers"* suggested that Malaysia's total value of recyclable material that could be unlocked is USD1.3b per year. However, only 19% of these materials are recycled, resulting in around USD1b to 1.1b income loss annually. Currently the rate of recycling for key plastic resins remains low in Malaysia at only 24% as at 2019, based on the study.

As such, a transition to a circular economy would benefit recyclers. At present, most plastic recyclers are not listed. Among the listed players, (TEXCYCL: NR) engages in Scheduled Waste Recycling in Malaysia, specialising in industrial waste. The Group is currently able to process 31 (40%) of the 77 available waste codes in Malaysia and is able to either recover/reuse or recycle 95% of incoming waste. Other companies involved in the recycling space but not specific to plastic packagers include, (ANALABS; NR), and (HHHCORP; NR).

Imputing ESG into our Plastic Stocks' Valuations

We believe that the overall harmful impact of plastic packaging to the environment warrants a discount to current valuations. For starters, we are applying a maximum ESG discount of 10% based on: (i) our Kenanga ESG disclosure score, and (ii) the CFR rates for resin used by the packagers under our coverage (*refer to chart below*). Going forward, we will review the ESG discount penalty over time as we monitor these players' ESG progress, with hopes that plastic packagers will continue to make progress on ESG management as we recognise that rehabilitating and transitioning the sector to a circular model will take time.

Estimated Collected For Recycling (CFR) Rates For Each Resin (2019)



Source: World Bank Group "Market Study for Malaysia: Plastics Circularity Opportunities And Barriers"

Imputing ESG into Plastic Packagers Valuations

Company	Last Price	Kenanga ESG Score	Raw Material Used	ESG Discount (%)	Original Valuations (x)	New ESG Adjusted Valuations	Original TP (RM)	New ESG Adjusted TP (RM)	Old Call	New Call	Total Returns
TGUAN	2.71	53%	LLDPE, HDPE, LPDE	8%	14.0	12.9	3.70	3.40	OP	OP	27%
BPPLAS	2.60	51%	LLDPE, LDPE, HPDE	9%	13.0	11.8	3.15	2.85	OP	OP	14%
SLP	0.95	57%	LLDPE, HDPE, LPDE	7%	17.2	16.0	1.22	1.14	OP	OP	26%
TOMYPAK	0.575	42%	LLDPE, LDPE, HPDE	9%	1.3	1.1	0.570	0.516	MP	UP	-10%
SCIENTEX	4.54	48%	LLDPE, LDPE, HPDE	8%	15.5	14.3	4.62	4.42	MP	MP	-0.4%
SCGM	2.54	71%	PP and PET	5%	15.5	14.7	3.13	2.97	OP	OP	20%

Source: Kenanga Research, Company

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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 PLASTICS HOLDING BHD	2.60	487.9	Y	12/2021	29.8%	9.0%	53.7%	10.6%	16.6	10.8	9.7	2.4	2.1	20.7%	3.8%	2.85	OP
SCGM BHD	2.54	489.1	Y	04/2022	18.5%	12.6%	13.5%	6.0%	14.3	12.6	11.9	2.6	2.3	19.2%	3.1%	2.97	OP
SCIENTEX BHD	4.63	7,179.5	Y	07/2022	16.5%	10.4%	13.0%	15.5%	16.2	14.3	12.4	2.5	2.2	16.4%	2.1%	4.42	MP
SLP RESOURCES BHD	0.950	301.1	Y	12/2021	22.3%	3.1%	33.5%	4.7%	18.7	14.0	13.4	1.7	1.6	11.8%	5.8%	1.14	OP
THONG GUAN INDUSTRIES BHD	2.71	1,038.3	Y	12/2021	14.9%	10.9%	21.4%	8.6%	13.5	11.1	10.3	1.5	1.4	13.8%	1.7%	3.40	OP
TOMYPAK HOLDINGS	0.575	247.9	Y	12/2021	15.0%	5.5%	5800.0%	5.1%	2,478.8	42.0	40.0	1.3	1.3	3.1%	0.0%	0.516	UP
Simple Average					19.5%	8.6%	989.2%	8.4%	426.3	17.5	16.3	2.0	1.8	14.2%	2.76%		

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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