Plastic Packaging

Transiting To More Sustainable Packaging

NEUTRAL

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We maintain our NEUTRAL view on the sector. Near-term demand pick-up for plastic packaging remains moderate. There is potential for an increase in resin prices, but elevated labour and energy costs are keeping margins subdued. Easing resin cost amidst a soft global economy is leading players to cut selling prices to defend or even expand their market shares. Longer term, local producers are quite well capitalised and are investing to refocus on premium niche products such as nano stretch film which uses less raw materials to improve sustainability yet achieving similar or even better packaging performance, translating to better margins. Our sector top pick is TGUAN (OP; TP: RM2.86).

KPMG projects the global plastic packaging market to grow at a 5% CAGR from CY21 to CY26. We believe local plastic packaging players could grow at a faster pace as they gain exports market share from their higher-cost competitors. The cost advantages of local players stem from: (i) their growing economies of scale (as they scale up their operations), (ii) lower input costs, from land to labour, and (iii) strengthening bargaining power vs. their raw material suppliers given the rising order volume.

Resin prices have come off by c.7% to about USD970/MT in CY2023 (despite a brief uptick from Jul to Oct) (see Exhibit 1). The downward trend is largely driven by: (i) the increase in global resin production capacity, and (ii) a subdued global demand, especially from China, the world's largest producer and consumer of plastics products, and (iii) the lack of urgency for end-users to stock up due to falling product prices.

However, we suspect plastic packaging players are struggling to fully capitalise on the easing resin cost due to the slow demand up-tick for plastic packaging materials amidst a soft global economy. This is evidenced by the overall plastic packaging industry capacity utilisation of about 50%-60% currently (vs. 75%-80% prior to the pandemic). Consequently, exporters are willing to nudge their selling prices lower in tandem with the weaker resin cost to defend or to expand their market shares rather than raise selling prices.

Companies are struggling to fully pass on the higher input costs, notably from increased labour expenses resulting from a 25% minimum wage hike since May 2022, and electricity tariff hikes for the industrial and commercial segments. The full impact of the electricity tariff hikes at the beginning of the year became apparent after companies like **BPPLAS (MP; TP: RM1.23)**, **SCIENTX (MP; TP: RM3.75)** and **TGUAN** opted out from the Green Electricity Tariff (GET) program in Aug 2023, following the upward revision of the GET rate to 21.8 sen/kWh (from 3.7 sen/kWh). They are now subject to the common Imbalance Cost Pass-Through (ICPT) surcharge of 17.0 sen/kWh. These factors collectively weigh on their profit margins.

The overall market for plastic packaging is expected to remain moderate in the near term, with prospects for improvement in 2HCY24. Nonetheless, several factors may contribute to a potential increase in resin prices. These include: (i) upward pricing adjustments by resin suppliers, and (ii) geopolitical tensions such as the Red Sea crisis, which could also lead to escalated freight shipping costs. The current resin prices are at levels of USD1,000-1,100/MT (see Exhibit 1).

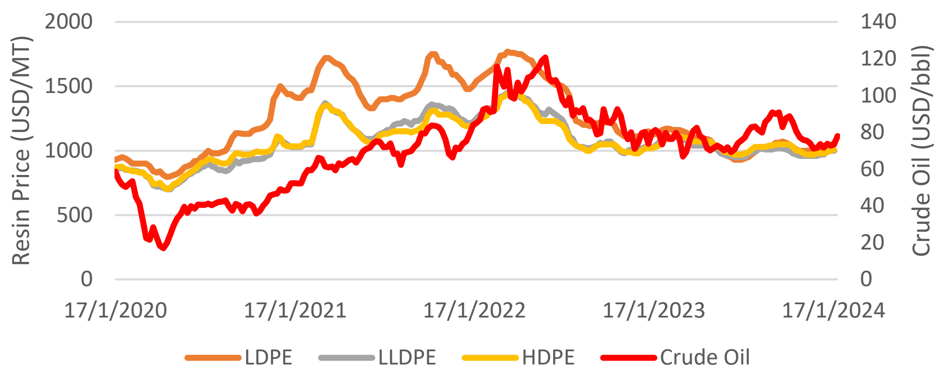
On a brighter note, local producers are reinventing themselves by focusing on high-value and hence high-margin products such as nano stretch film, mono film, shrink film, stretch hood. Some of these products also fit the bill of sustainable packaging. Innovation centred around downgauging (i.e. to make the film thinner) without compromising on strength (or even enhancing it), enabling the local players to gain traction in the international market given the environmentally-friendly attributes of the products. For instance, **BPPLAS** and **TGUAN** are drawing attention for their innovative nano stretch film technology, while **SLP (MP; TP: RM0.96)** is seeing an uptick in customer inquiries for its mono film, particularly, the fully recyclable MDO-PE film.

We take this opportunity to raise our FY24F earnings for **SLP** by 7% to RM16.8m to reflect: (i) recovering demand for its kitchen bags and garbage bags, and (ii) anticipated increase in orders for its mono film. Consequently, we adjust our DDM-derived TP by 12% to RM0.96 (from RM0.85) with the following changes: (i) revision in our FY24F dividend forecast to 5.5 sen (from 5.0 sen), and (ii) recalibrated WACC assumption to 7.8% (from 7.9%), having updated the beta value and cost of equity.

Our sector top pick is **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 its 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 **SLP** due to its focus on high-margin, non-commoditized products and strong financial position, enabling consistent and generous dividends. We like **BPPLAS** for its resilience in the Southeast Asia market, robust cash flows, and capacity expansion in premium stretch film and blown film. Additionally, we also like **SCIENTX** for its leading position as the largest flexible plastic packaging manufacturer in the region, as well as the strong demand for its affordable housing projects.

Exhibit 1: Resin and Crude Oil Prices



Source: Bloomberg, Kenanga Research

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Peer Table Comparison

Name	Rating	LastPrice (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.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
BP PLASTICS HOLDINGS BHD	MP	1.24	1.23	-0.8%	349.0	Y	12/2023	11.8	13.7	7.1%	16.3%	10.5	9.0	1.3	13.1%	5.5	4.4%
SCIENTEX BHD	MP	3.96	3.75	-5.3%	6,143.0	Y	07/2024	35.2	36.5	31.7%	3.6%	11.2	10.9	1.6	14.4%	11.0	2.8%
SLP RESOURCES BHD	MP	0.950	0.960	1.1%	301.1	Y	12/2023	3.8	5.3	-27.3%	40.0%	25.0	17.9	1.6	6.3%	5.0	5.3%
THONG GUAN INDUSTRIES BHD	OP	1.94	2.86	47.4%	768.0	Y	12/2023	21.9	26.0	-21.9%	18.4%	8.8	7.5	0.8	9.7%	2.3	1.2%
Sector Aggregate					**7,561.2**					**18.3%**	**6.7%**	**11.2**	**10.5**	**1.4**	**12.7%**		**3.4%**

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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