BP Plastics Holding Berhad

Join the Rebound Momentum

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OUTPERFORM

Price : **RM1.65**
Target Price : **RM2.50**

We initiate coverage on BPPLAS with an OUTPERFORM rating and TP of RM2.50. BPPLAS is a key Polyethylene (PE) film manufacturer in Asia that produces premium stretch film and customized packaging film. We are bullish on BPPLAS for: (i) robust demand from export and local markets, and (ii) catalysts for both near- and long-term margin expansions. We also like BPPLAS for its attractive 5.4% dividend yield. We estimate FY21E and FY22E net profits of RM36.1m (YoY +22.4%) and RM39.4m (YoY +9%), respectively. Our TP is based on 13x PER on FY21E EPS of 19.2 sen.

Robust demand. BPPLAS recorded stronger growth in sales volume in 1QFY21 (+13% QoQ) compared to 4QFY20 (+2.8% QoQ) mainly driven by orders from existing customers in both export and local markets. That said, BPPLAS is gaining market share from its competitors. We understand that BPPLAS is able to cater to extra orders from customers with its average utilization rate of 75%, which is near 80%, upon which BPPLAS will expand capacity to continue catering to the robust demand. BPPLAS has budgeted capex of RM35.6m for FY21/FY22 to finance: (i) the acquisition of its 9th cast stretch film machine, and (ii) expansion of blown film capacity. The 9th cast stretch film machine will help to increase the cast stretch film production by 10%, to a total capacity to 120,000 MT per year.

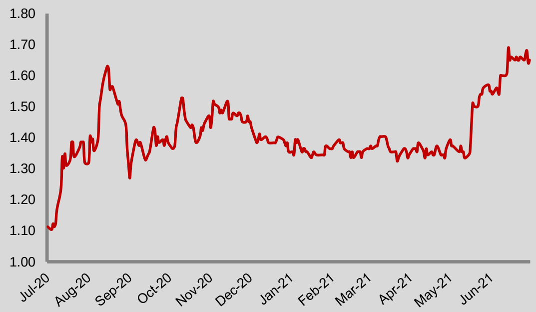
Near-term margin boost. Despite tight resin supply and high resin costs in 4QCY20 and 1QCY21 caused by supply chain disruptions, BPPLAS was able to secure a stable supply of resins from various suppliers. Like its peers, BPPLAS has also raised its ASPs in tandem with the spike in resin prices. Despite the recent falling resin costs, BPPLAS' ASPs remains elevated at the high levels seen in March 2021. Therefore, we expect BPPLAS to show margin expansion in 2QFY21 (results to be announced in Aug 2021).

Long-term margin boost. ASPs will gradually fall and eventually normalise after resin prices stabilise to a lower level. However, BPPLAS has manufacturing specialities in premium stretch film and customized PE blown film based on customers' requirements; thus, ASPs for these products tend to be sticky downwards. To expand its premium stretch film production capacity, BPPLAS will acquire its 9th cast stretch film machine (begins production in FY22). Thus, BPPLAS will be able to better defend its elevated margin with a portfolio of higher margin products. BPPLAS commands strong EBIT margins of about 12% vs. 10.1% for TGUAN and 9.8% for SCIENTX's manufacturing segment, most likely due to: (i) better operational cost efficiencies as BPPLAS' opex at 5.5% of revenue (in FY20) is lower than its peers, and (ii) better product mix.

Attractive dividend yield. BPPLAS is in a strong net cash position, when coupled with its ability to consistently generate healthy cash flows allow sustained dividend payouts. BPPLAS has consistently paid dividends of 4.0-8.0 sen from 2016 to 2020, with a payout ratio above 50% of net income. Therefore, we are positive that BPPLAS will continue to pay dividends of *at least* 8.0 sen for FY21. We are expecting DPS of 9.0 sen for both FY21 and FY22, representing yields of 5.5%.

Initiate with OUTPERFORM rating and Target Price of RM2.50, based on FY21E PER of 13x (+1.0SD of its 5-year mean of 9x). Our targeted PER of 13x is based on a 7% discount to peer TGUAN's ascribed PER of 14x and a 28% discount to peer SLP's ascribed PER of 18x.This discount is applied due to (i) weaker earnings growth relative to SLP and (ii) relative smaller size compared to TGUAN. TGUAN also commands a higher PER for its more aggressive long term expansion growth plans compared to BPPLAS. However, we think BPPLAS is grossly undervalued given: (i) the strong demand growth from export and local markets, (ii) solid balance sheet with cash per share of RM0.41 (as of March 2021), (iii) its ability to pass on higher resin costs, and (iv) better margin product mix. BPPLAS also offer attractive dividend yield of 5.5%, which is above the industry average of 2.5%.

Share Price Performance



KLCI	1,520.58
YTD KLCI chg	-6.6%
YTD stock price chg	14.5%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	BPP MK Equity
Market Cap (RM m)	309.6
Shares Outstanding	187.7
52-week range (H)	1.76
52-week range (L)	1.15
3-mth avg daily vol:	295,877
Free Float	23%
Beta	0.9

Major Shareholders

Lg Capital SdnBhd	43.2%
Tan See Khim	9.5%
Lim Chun Yow	9.3%

Summary Earnings Table

FYE Dec (RM m)	2020A	2021E	2022E
Turnover	316.6	380.9	399.9
EBITDA	50.3	56.0	62.7
PBT	38.9	44.6	49.2
Net Profit (NP)	29.7	36.1	39.4
Core NP	29.5	36.1	39.4
Consensus	N/A	N/A	N/A
Earnings Revision	N/A	N/A	N/A
Core EPS (sen)	15.7	19.2	21.0
Core EPS growth (%)	41.0%	22.4%	9.0%
NDPS (sen)	8.0	9.0	9.0
Core PER (x)	10.5	8.6	7.9
BVPS (RM)	1.1	1.2	1.3
PBV (x)	1.5	1.4	1.3
Net Div Yield (%)	4.8	5.5	5.5

Risks to our call include: (i) higher-than-expected resin cost, (ii) labour shortage, and (iii) strengthening of the Ringgit.

Investment Merits

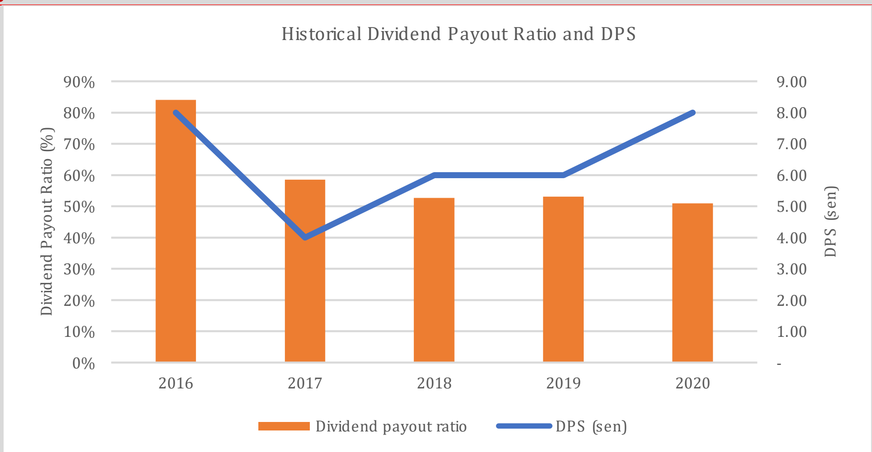
Sustaining existing customers amidst the pandemic. We understand that in 1QCY21, BPPLAS's sales quantity has increased 13% from 4QFY20, by sustaining orders from existing customers in Japan and locally. We suspect that this is partially due to subdued competition as we would not be surprised if smaller competitors have ceased operations in light of lockdown-induced production halts and sky-high resin costs, potentially culminating in cash flow problems for the weaker players. Moving forward, with a war-chest to expand its production capacity and ability to weather volatile resin costs, we believe BPPLAS will be able to gain greater market share from smaller competitors.

Capacity expansion. BPPLAS has 29 machines currently (8 cast stretch machines and 21 blown film machines) with a total capacity of 102,000 MT/year in FY20/FY21 with an average utilization rate of 75% (current utilisation rate: 60-70%). BPPLAS is investing a total capex ofRM35.6m for both FY21/FY22, and with a strong net cash position of RM84.1m in FY20, BPPLAS will be funding the said capex with its internally generated cash. We estimate c.70% of the capex will be utilized in FY21 to acquire the 9th cast stretch machine, which will increase its total capacity from 102,000 MT/ year to 120,000 MT/year. We estimate that production will start in FY22. Accounting for the greater capacity, we are assuming BPPLAS's utilization rate to range between 65-70% in FY22. The objective of expanding capacity is to meet more demand as BPPLAS is gaining market share in the export market.

Near- and long-term catalysts to boost margins. We foresee that, **over the long term**, BPPLAS will expand their margins by: (i) pursuing growth in high margin products, and (ii) achieving higher operational efficiencies. BPPLAS has two main divisions – Industrial Packaging Division (Blown Film) and Stretch Film Division. BPPLAS' total production is 75% cast stretch films and 25% blown film. Currently, c.40% of its stretch film production consist of premium stretch films. We believe that, with their upcoming 9th cast stretch film machine, premium stretch films will make up an increasingly larger portion of their total revenue. As BPPLAS' customised blown packaging film and premium stretch film are considered high-margin products, where the latter commands 20-30% higher selling prices over conventional stretch film, the larger portion of said high-margin products of its total revenue will lift overall margins. Moreover, given that these products are client-specific in nature and have more stringent quality requirements, their selling prices tend to be sticky downwards, and with greater customer loyalty. Furthermore, the Group is also looking to lower operating cost (currently 5.5% of revenue) by striving to be more operationally efficient. Thus, we believe both improved product mix and operational cost efficiencies should provide BPPLAS sustainable long-term earnings growth impetus. **In the near term**, with its ASPs at elevated levels and falling resin costs (-20% from March 2021), we are expecting margin expansion in its 2QFY21.

Net cash position enables generous dividend payouts. BPPLAS has a robust balance sheet with no borrowings and a cash holding of RM84.1m. Given the strong net cash position, BPPLAS will be able to fund its FY21/FY22 capex of RM35.6m and dividend payment of c.RM16.9m for FY21. BPPLAS has a dividend policy to distribute a minimum of 40% of its net income. Over the past 5 years, BPPLAS has consistently surpassed the policy with payouts ranging between 51% and 84%. The Group had been giving out DPS of 4.0-8.0 sen with a 5-year average dividend payout ratio of 58.3%. Moving forward, we are assuming dividend payout ratios of 47% and 43% for FY21 and FY22, respectively, implying DPS of 9.0 sen for each year and yield of 5.5%.

Historical Dividend Payout Ratio and DPS

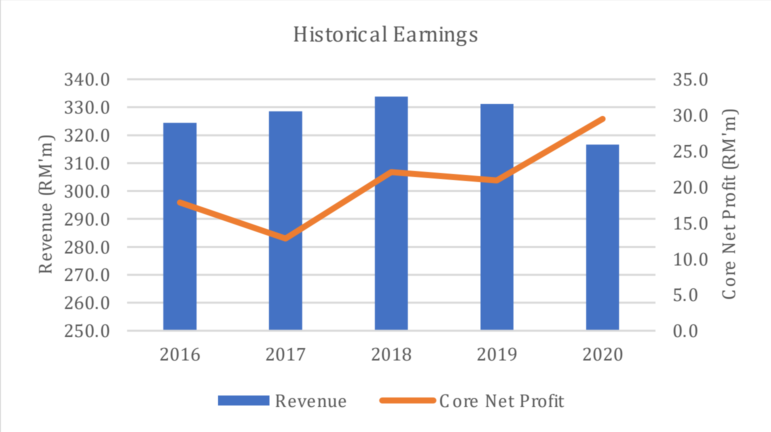


Source: Company, Kenanga Research

Financial performance

Historical earnings highlight. BPPLAS's revenue has been growing steadily at a 2-year CAGR of 1.4% in the period of FY16-FY18 and declined slightly in FY19-FY20 with a 2-year CAGR of -2.6%, likely due to: (i) declining resin prices, and (ii) unfavourable forex rate. In the past three years, BPPLAS's net margin has risen from 6.4% to 9.4% mainly due to better operational efficiencies and product mix.

Historical Earnings



Source: Company, Kenanga Research

Moving forward, we are projecting revenue of RM380.1m in FY21 (20% rise from RM316.6 in FY20), which we think is achievable on the back of: (i) higher ASPs throughout 1HCY21, (ii) growing demand from its export markets, and (iii) greater market share. We are forecasting a 22% increase in core net profit to RM36.1m (FY20: RM29.5m) on the back of a lower effective tax rate, driven by BPPLAS' re-investment allowance.

Valuation

Initiate coverage with an OUTPERFORM rating and TP of RM2.50. We derived the target price of RM2.50 by applying a PER of 13x on FY21E earnings, where the 13x PER is +1.0SD above its 5-year mean. Against its peers, our ascribed PER of 13x is based on a 7% discount to TGUAN's ascribed PER of 14x and a 28% discount to SLP's ascribed PER of 18x. This discount is applied due to its smaller market cap relative to TGUAN and weaker earnings growth relative to SLP. To reiterate, we like BPPLAS for its: (i) revenue growth, driven by both higher demand for its products and capacity expansion, (ii) near- and long-term margin expansion from falling resin costs and better product mix, respectively, (iii) robust balance sheet, providing it ample cash for expansion, and (iv) net cash position, allowing BPPLAS to pay a sustainable dividend, yielding 5.5% in FY21 and FY22.

Key Risks include:

The volatility of raw materials. Plastic resins (such as HDPE, LDPE, and LLDPE) are derived from petrochemicals, which is derived from crude oil. Therefore, resin prices are subject to supply chain disruptions in the crude oil and petrochemical industries. For example, when crude oil prices fell c.73% between January and April 2020, resin prices across the board fell 15% to 20%. Subsequently, when the petrochemical crackers in Louisiana were struck by Hurricane Laura in August 2020 and deep-freeze throughout the following winter, the disruption to resin supply caused an acute shortage, causing a 15-25% increase in prices from January 2021 to March 2021. To mitigate the adverse impact of, and to take full advantage of said volatile raw material prices, BPPLAS source resins from different countries such as US, Middle East and Singapore.

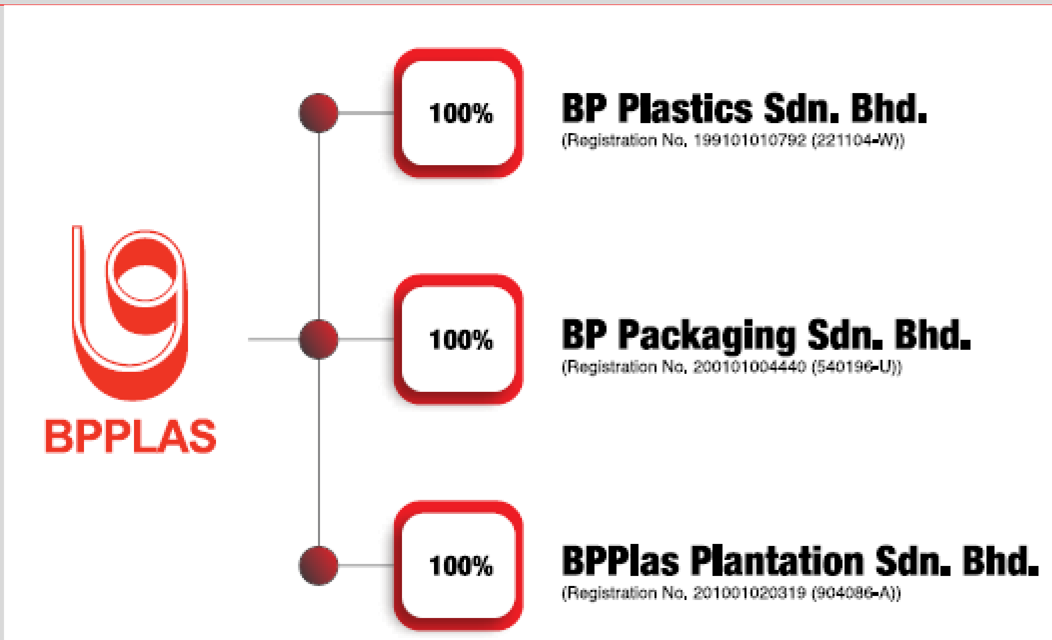
Labour shortage risks. Across the manufacturing industry, firms have been facing labour shortages due to: (i) government policies aimed at reducing reliance on foreign workers and (ii) lack of foreign workers due to the closure of borders. Similar to its peers, BPPLAS is finding it challenging to employ and retain sufficient local workers in lieu of foreign workers. Thus, to resolve the existing labour shortage problem and to mitigate future labour-related risks, BPPLAS is striving to automate as much of its production as possible.

Exposure to foreign currency risk. BPPLAS is exposed to forex volatility as c.75% of the Group's sales are derived from exports. Moreover, above 70% of raw materials are purchased on foreign currencies, namely in USD. Although its efficient cost structure has provided the company with a natural hedge against forex fluctuations, it is still exposed to some degree of currency risks. A strengthening of USD against MYR will be favourable for BPPLAS, as most of the trade and other receivables are also denominated in USD. In the past years, BPPLAS has not incurred any large forex losses.

Company Background and Business Segments

BP Plastic Holding Berhad (BPPLAS) is an investment holding company, with subsidiaries namely BP Plastics Sdn Bhd, BP Packaging Sdn Bhd and BPPlas Plantation Sdn Bhd. BPPLAS' principal activity is to manufacture polyethylene (PE) stretch film and packaging bags for industrial, commercial, logistic and warehousing usages. The Group was founded in 1990 by three founders - Mr. Lim Chun Yow (MD), Mr. Tan See Khim (ED) and Mr. Hey Shiow Hoe (ED).

Corporate Structure



Source: Company

BPPLAS is a polyethylene film and bag manufacturer with two core divisions, namely the Industrial Packaging Division (Blown Film) and the Stretch Film Division. Stretch films are produced by the cast process while packaging bags are produced by the blown process. BPPLAS is capable of producing several high-quality packaging solutions to fulfil its various customers' needs. BPPLAS is proficient in producing premium grade Cast Stretch Machine Rolls and high-quality thin gauge "Infinity" Hand Rolls, which are both considered to have superior quality over the conventional cast stretch films. BPPLAS also produces premier quality and customized PE bags for different industrial packaging applications to improve packaging integrity and/or shelf life.

Cast Stretch Film

INFINITY®, a premium brand stretch film with features thinner and stronger than other stretch films. It can be wrapped manually or used with fully automated wrapping machine as well as hand machine stretch film.

Machine roll CLARITY® provide better packaging display effects and reading of bar code which maintain high gloss surface, less wrinkle and more transparent. It is used by a fully automated wrapping machine for logistic and warehousing purposes.

PRIORITY ®, Designed to be used on fully automated wrapping machine for securing heavy loads and loose items on a pallet for logistics and warehousing purposes.

R-Edge ™, premium cast stretch film with reinforced film edge to give unparalleled film performance experience. This thin gauge film means less material being used and can also be recycle making it environmentally friendly and cost-saving.

Other Cast Stretch Film

Source: Company

Industrial Packaging Division

PE collation shrink film is lighter and provides stability for products during transportation or storage purposes. It can be used for plastic bottles or canned beverages.

PE Shrink Hood and sheeting are used to protect products from dust and moisture. They are durable and able to withstand long hours of exposure to sunlight and extreme weather.

Printed FFS films are used for heavy-duty applications such as cooking oil, ice and others. It also can be used for light-duty applications like toiletries.

General Purpose Bag & Film

Air Cargo Sheet or Bag

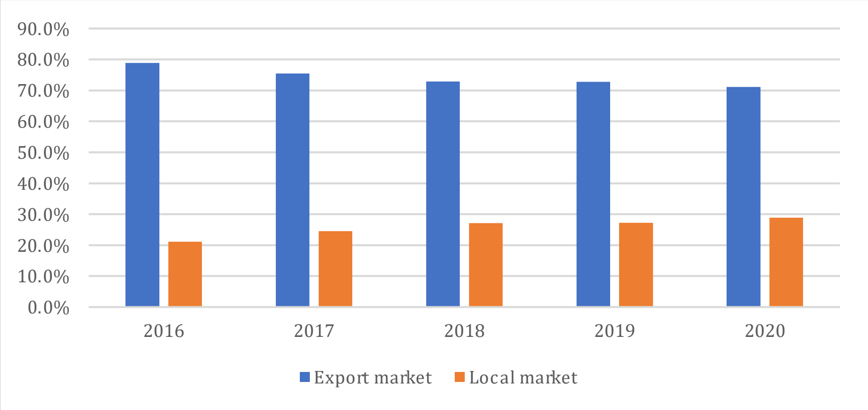
Mattress Cover

LDPE, LLDPE, HDPE Bag & Film

Source: Company

In terms of geographical breakdown, 75% of its sales are from exports and 25% are local. Management aims to increase exports to 80% of its group revenue by growing sales inJapan and other Asian countries. Its export customers are based in over 50 countries across Asia, Middle East, Europe and North America. In Asia. Japan, Korea, Hong Kong, Taiwan are particularly important markets. For exports, the Group deals with overseas distributors, whereas when selling locally, the Group mainly deals directly with end-users.

Historical Revenue Geographical Breakdown



Source: Company, Kenanga Research

Management Profile

Lim Chun Yow is the Managing Director of the Group since September 2004. He holds a degree in Bachelor of Science in Business Administration from Ohio State University, USA in 1985. He gained some experience as a Marketing Executive in a plastic manufacturing company in 1986. Later, he left and set up BP Plastics Sdn Bhd with two co-founders in 1991. He is currently the Honorary Chairman of Malaysian Plastics Manufacturers Association (MPMA) Johor Branch. He also sits on the board for several private limited companies.

Tan See Khim is the Executive Director of the Company in September 2004. He is also co-founder of BP Plastic Sdn Bhd that was established in 1991. He was involved in the sales, trading, marketing, distribution, resource planning and training in consumer products between 1983 and 1990. His experience and knowledge in sales have been instrumental towards the growth of the Company. He also sits on the board for several private limited companies.

Hey Shiow Hoe is also the Executive Director of the Group. He graduated with a Bachelor of Science in Industrial and Systems Engineering from Ohio State University, USA in 1986. He is also one of the co-founders of the Group. Presently, he is in the production teams which responsible for the strategic planning and total management of the manufacturing operations, infrastructure upgrading and development, technical improvement and support to the production team. He also sits on the board for several private limited companies.

Chua Yi Fon is the Financial Controller of the Group since May 2016. She graduated with a Bachelor of Commerce (Accounting & Finance) from the University of Melbourne, Australia. She is responsible for all aspects of the Group’s finance, accounting and reporting functions.

Income Statement

FY Dec (RM m)	2018A	2019A	2020A	2021E	2022E
Revenue	333.8	331.2	316.6	380.9	399.9
EBITDA	34.2	37.1	50.3	56.0	62.7
Depre& Amort	9.2	10.7	11.4	11.4	13.5
Other Income	1.7	2.0	2.0	2.3	2.4
PBT	25.0	26.3	38.9	44.6	49.2
Taxation	-3.7	-5.1	-9.3	-8.5	-9.8
PAT	21.4	21.2	29.7	36.1	39.4
Core Net Profit	22.1	20.9	29.5	36.1	39.4

Balance Sheet

FY Dec (RM m)	2018A	2019A	2020A	2021E	2022E
Fixed Assets	84.3	80.4	72.4	86.2	83.4
Other FA	1.0	6.5	6.3	6.1	6.0
Inventories	47.5	63.8	84.1	74.5	85.4
Receivables	42.3	38.8	40.8	47.3	49.4
Other CA	30.0	38.7	62.8	29.5	38.2
Cash	22.6	7.4	21.2	44.7	55.3
Total Assets	227.8	235.7	287.7	288.4	317.7
Payables	36.6	34.2	68.6	53.5	60.3
Other LT Liability	10.0	10.4	9.9	9.9	9.9
Net Assets	181.2	191.1	205.8	225.0	247.4
Shr. Equity	181.2	191.1	205.8	225.0	247.4
Total Equity	181.2	191.1	205.8	225.0	247.4

Cashflow Statement

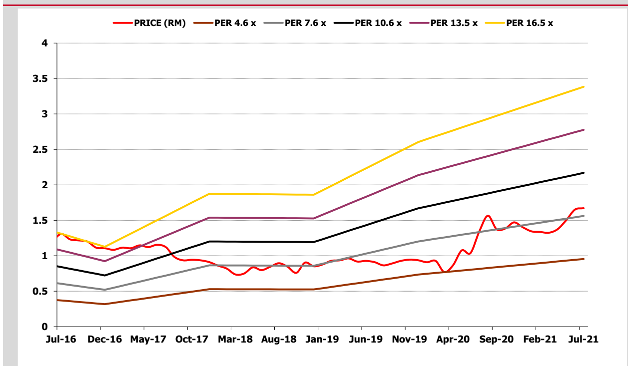
FY Dec (RM m)	2018A	2019A	2020A	2021E	2022E
Operating CF	36.9	16.8	58.8	44.7	55.3
Investing CF	-24.5	-10.7	-4.7	-25.0	-10.6
Financing CF	-7.5	-11.3	-15.0	-16.9	-16.9

Financial Data & Ratios

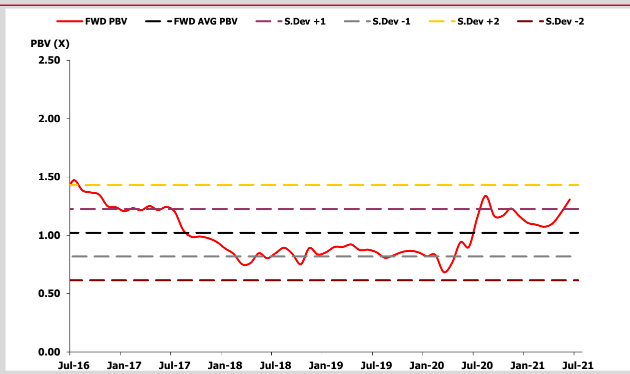
FY Dec	2018A	2019A	2020A	2021E	2022E
Growth (%)					
Revenue	1.6	-0.8	-4.4	20.3	5.0
EBITDA	36.1	8.2	35.8	11.2	12.1
PBT	61.3	5.3	47.7	14.5	10.4
Net Income	66.4	-0.7	39.9	21.7	9.0
Core Net Income	71.9	-5.2	41.0	22.4	9.0
Profitability (%)					
EBITDA Margin	10.3	11.2	15.9	14.7	15.7
PBT Margin	35.2	7.5	8.0	12.3	11.7
Core Net Margin	6.4	6.4	9.4	9.5	9.8
E. Tax Rate	14.7	19.5	23.8	19.0	20.0
ROE	12.2	10.9	14.3	16.0	15.9
ROA	9.7	8.9	10.2	12.5	12.4
DuPont Analysis					
Net Margin (%)	6.4	6.4	9.4	9.5	9.8
Assets Turnover (x)	1.5	1.4	1.1	1.3	1.3
Leverage Factor (x)	1.3	1.2	1.4	1.3	1.3
ROE (%)	12.2	10.9	14.3	16.0	15.9
Valuations					
Core EPS (sen)	11.8	11.1	15.7	19.2	21.0
DPS (sen)	6.0	6.0	8.0	9.0	9.0
BVPS (RM)	1.0	1.0	1.1	1.2	1.3
Core PER (x)	14.0	14.8	10.5	8.6	7.9
N. Div. Yield (%)	3.6	3.6	4.8	5.5	5.5
P/BV (x)	1.7	1.6	1.5	1.4	1.3

Source: Kenanga Research

Fwd PER Band



Fwd PBV Band



Source:Bloomberg, Kenanga Research

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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