BP Plastics Bhd

Initiate Coverage

Stock Code: 5100

Price:	RM0.93
Market Capitalisation:	RM111.6m
Board:	Main Board
Sector:	Industrial Products
Recommendation:	BUY

Key Stock Statistics

FYE Dec	2004	2005F
EPS (sen)	12.3	15.4
P/E (x)	7.6	6.3
Dividend/Share (sen)	-	5.0
NTA/Share (RM)	-	0.65
Book Value/Share (RM)	-	0.67
Issued Capital (mil shares)	-	120.0
52-weeks Share Price Range		RM0.905 - RM1.26

Major Shareholders:

LG Capital	45.0%

Per Share Data

FYE Dec	2002	2003	2004	2005F	2006F
Book Value (RM)	-	-	0.5	0.65	0.8
Cash Flow (sen)	-	-	-	13.0	20.6
Earnings (sen)	6.5	8.9	12.3	14.9	17.3
Dividend (sen)	-	-	-	5.0	5.0
Payout Ratio (%)	-	-	-	33.6	28.8
PER (x)	14.3	10.5	7.6	6.3	5.4
P/Cash Flow (x)	-	-	-	7.1	4.5
P/Book Value (x)	-	-	-	1.4	1.2
Dividend Yield (%)	-	-	-	5.4	5.4
ROE (%)	-	-	-	25.5	24.4
Net Gearing (%)	-	-	-	17.1	Net Cash

P&L Analysis

FYE Dec (RMm)	2002	2003	2004	2005F	2006F
Revenue	47.7	64.9	122.1	156.3	187.0
Operating Profit	8.9	12.6	17.3	22.5	26.1
Depreciation	-2.1	-2.2	-3.2	-4.7	-5.1
Interest Expenses	-0.2	-0.2	-0.3	-0.4	-0.4
Pre-tax Profit	8.9	12.9	17.9	22.0	25.7
Effective Tax Rate	12.0	17.5	17.7	19.0	19.0
Net Profit	7.8	10.7	14.7	17.8	20.8
Operating Margin	18.8	19.5	14.2	14.4	13.9
Pre-tax Margin	18.6	19.9	14.6	14.1	13.7
Net Margin	16.3	16.4	12.1	11.4	11.1

Highlights

- Plastic packaging is one of the fastest growing segments of the Malaysian packaging industry, and has grown at an average rate of 23% over 2000-2003. In 2003, the industry was worth some RM1.3bn.
- BP Plastic (BPP) has managed to capitalised on this fast growing segment, building capacity to meet strong demand, both locally as well as from overseas. From 2000-2004, BPP's net profit grew at a CAGR of 38.9%.
- A key growth area for BPP has been its export markets which has grown at a CAGR of 87% over 2000-2004. We expect demand from the region to continue to fuel BPP's growth going forward, especially with AFTA now in place.

Recommendation

- We like BPP for its strong growth and cheap valuations. We expect BPP to record earnings growth of 17% - 21% over FY05-FY06 on the back of additional capacity and firmer selling prices. We have however projected EBIT margins of 14.4% for FY05 (14.2% in FY04) despite the fact that margins have held up well for 1H05, at 14.8%. We think that BPP could absorb some of the price increase in resins (+13% ytd for 2005).
- Despite its superior operational performance whereby PBT margin is nearly twice that of its nearest competitor, BPP continues to trade at a steep 26% discount to its peers' average PER.
- We see no justification for this given its strong and consistent delivery of earnings. For 1H05, it has achieved 59% of its FY05 projection and likely to surpass its IPO net profit forecast of RM16.7m for FY05. At a PER of 7.2x, BPP's base case fair value is pegged at RM1.26, giving the stock a 35% upside.
- Besides, BPP is also expected to pay a tax exempt dividend of 5sen per annum over FY05-06. This translates to an attractive dividend yield of 5.4%. **BUY**.

Investment Risks

- Given its huge reliance on resin as a raw material, key risk to the stock lies in rising resin prices which will have an adverse impact on margins should BPP be unable to pass through cost increase to its customers. They have nevertheless managed to pass on cost so far.

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Background

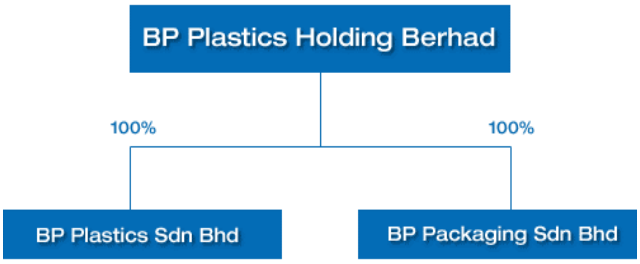
Company Profile

Located in Batu Pahat, BP Plastics (BPP) commenced operations in 1990 as a supplier of polyethylene bags to the garment and textile industries. In year 2000, BPP invested in a 5-layer cast stretch film machine (7-layer in 2003) which allowed it to produce high quality plastic stretched film.

Stretch film is a 100% Linear Low Density Polyethylene based film product used to unitise loads, to protect products during storage and shipment and also for wrapping agricultural silage.

Today, it manufactures and exports plastic packaging, including bags, sacks and films of the shrink and stretch variety. It serves the garment, furniture, rubber, building materials, food and electronic industries.

Corporate Structure

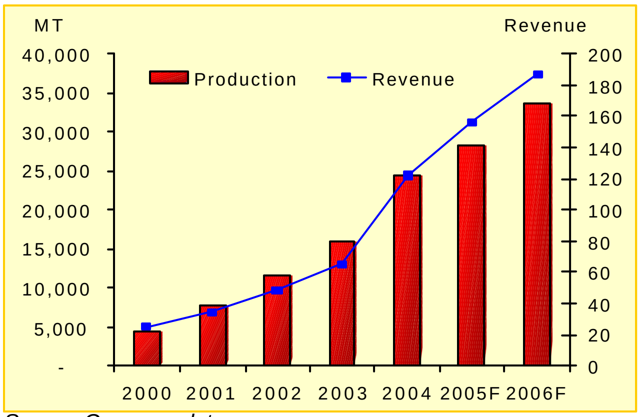


Source: Company data

Business

Operates near full capacity
BPP's core product, stretch film, can be produced either through blowing or casting. BPP is involved in both production processes and has a current annual capacity of 12,000MT of blown and 26,400MT of cast films. BPP operates on a 3-shift, 24-hour and 7-day week throughout the year and runs at utilization levels in excess of 80% for its 21 blown film and 2 cast film lines.

Chart 1: Production and revenue



Source: Company data

Exports, a major portion of revenue
The group derived some 57% of its FY04 revenue from the export markets. Its key export markets include Japan, Singapore and Australia. While a stronger Ringgit may affect revenue on the one hand, the implementation of AFTA has created an additional growth impetus as its products are made available across more ASEAN markets as well as priced more competitively. BP Plastics is planning to penetrate new markets like India and Vietnam soon, which should further drive its export growth.

Chart 2: Growing export sales

Source: Company data

Not reliant on a single customer
The group supplies its products to approximately 800 customers and hence is not reliant on any particular customer. Some of its major customers include Mitsubishi Shoji Corp, Dreamland, Lee Rubber Co Ltd, JMP Holdings Pte Ltd, MK Packaging Industries Pte Ltd, Parnassian Trading Co Ltd, CV Weekson, Signode Hong Kong Ltd, Ramatex Bhd and White Horse Bhd.

Strength lies in delivery and quality
BPP's competitive advantage lies in its in-house laboratory, testing facilities and capabilities to achieve quick customer requested sample prototype. The strength of its relationship with customers and its ability to meet high and stringent standards set by its customers particularly in the areas of delivery and quality, are also its core competencies.

Earnings Outlook

Growth being driven by export markets
BPP has managed to outpace the growth of the sector, growing at a much faster pace CAGR of 38.9% over 2000-2004. This was driven largely by the rapid expansion in its capacity, a result of strong demand for its products. A key growth area has been its export markets which has grown at a CAGR of 87% over 2000-2004. We expect the export markets to continue to drive growth for BPP given the strong demand in the region.

Ability to pass on prices to customers

Approximately 75% of BPP's operating cost consist of raw materials (comprising largely resins), which are sourced either locally (35%) or imported from Singapore, Saudi Arabia, Canada and USA (the remaining 65%). Resin prices have unfortunately risen significantly (+36% yoy in 2004), driven up by both higher oil prices as well as a global shortage. Nevertheless, BPP has managed to pass on most of the cost increase to its customers. EBIT margins have remained relatively stable over the past two quarters, reflecting this.

The decline in EBIT margin in FY04 to 14.2% against 19.5% in FY03, was however due to new investments made, in particular its new 4 metre cast stretch machine, which incidentally contributed to stronger top line growth.

Additional capacity by year end

BPP is boosting its capacity by 56% to a total combined capacity of 60,000MT by the end of the year with the completion of its new plant. This will include two additional lines comprising 4,800MT of blown and 16,800MT of cast capacity. Hence, in addition to firmer selling prices, additional capacity will fuel earnings growth for BPP going forward.

17%-21% earnings growth in FY05-06

We are expecting BPP to register earnings growth of 21% to a net profit of RM17.8m for FY05. This is slightly ahead of management's IPO forecast of RM16.7m. FY06 EPS growth of 17% will largely be fuelled by beefed up production from its RM30m new plant. We however expect resin prices to flatten out by then.

Valuations

Small in size, but excellent value proposition

We have pegged BPP against Second Boarder Scientex Packaging and Thong Guan which is listed on the Main Board. We understand that Scientex Packaging and Thong Guan have stretch film capacities of 60,000MT and 80,000MT respectively in 2005, which makes BPP the smallest amongst the lot in terms of annual production capacity. Based on its peers' average PER valuation of 7.2x for FY06 (we have assumed an earnings growth 15% due to the absence of consensus estimates), BPP is considerably cheap, trading at a 26% discount to its peers or only 5.4x FY06 EPS.

Comparative Valuation	**Thong Guan**	**Scientex Pack**
Share Price (RM) @ 23/9/05	1.90	2.00
Mkt. Cap (RM mil)	199. 9	157.6
Ave. Daily Vol. (mil)	0.0	0.0
P/E FY03 (x)	9.1	197.0
P/E FY04 (x)	7.4	16.1
P/E FY05 (x)	7.8	8.8
P/NTA	1.4	1.3
Yield	1.6	3.5

Superior but undervalued stretch film player

We see no justification for this steep discount as BPP is not significantly smaller than its peers, especially once additional capacity comes on stream next year. Besides, operation wise, BPP is far more superior. PBT margin for FY05 has averaged at 15.1% for BPP compared to 8.1% for Thong Guan and 5.3% for Scientex Packaging. We believe that this is due to BPP's continuous investment in leading edge machines hence offering its customers superior quality products and hence its ability to command better selling prices.

59% of IPO net profit forecast met

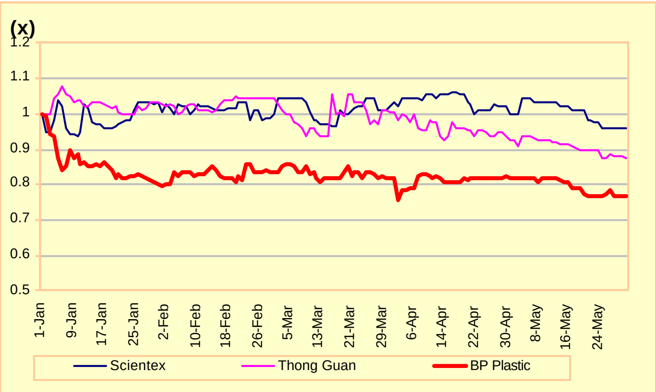
Also, note that management has projected a FY05 revenue and net profit forecast of RM165.1m and RM16.7m respectively. Todate, it has achieved a revenue of RM77.2m and a net profit of RM9.8m or 59% of its net profit forecast (55% of ours) for the first six months. Despite the recent spike in resin prices again, we understand that 3Q results will be equally as strong as in 1H05.

Exciting dividend yields of 5.3%

Besides, capital appreciation, BPP also offers investors attractive dividend yields. Management projects a tax exempt dividend of 5sen for FY05 which translates to a yield of 5.4%. We expect dividends to be sustained into FY06 given its healthy operating cashflows, little capex and its projected net cash position in FY06.

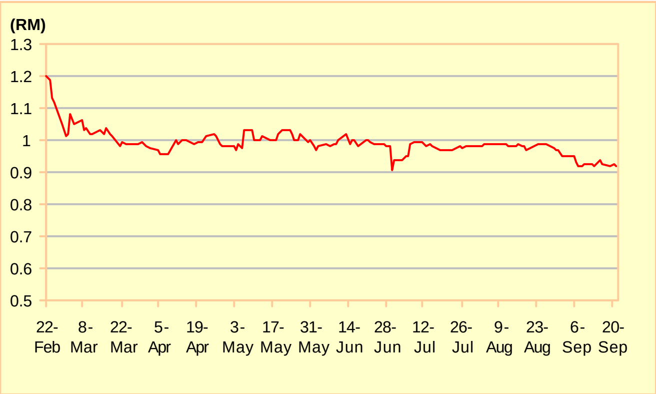
Relative Share Price Performance of Comparables

Chart 3: Relative price performance of peers



Source: Bloomberg

Chart 4: BPP's share price performance



Source: Bloomberg

Recent Developments

The company was listed on Bursa on 23rd February 2005 at RM1.20. Share price has since declined by 23%. The fall, in our opinion, is due to investors generally higher risk perception on small cap stocks. On the contrary, we believe that BPP offers investors strong growth potential as well as attractive yields.

P&L Statement

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Balance Sheet Statement

FYE Dec (RMm)	2002	2003	2004	2005F	2006F
Total Assets	-	-	-	112.6	131.1
Fixed Assets	-	-	-	62.8	62.7
Current Assets	-	-	-	52.0	70.6
Other LT Assets	-	-	-	-2.2	-2.2
Current Liabilities	-	-	-	21.8	25.5
LT Liabilities	-	-	-	12.9	12.9
Share Capital	-	-	-	60.0	60.0
Shareholders Funds	-	-	-	77.8	92.6

Cashflow Statement

FYE Dec (RMm)	2002	2003	2004	2005F	2006F
EBIT	-	-	-	37.4	44.8
Depn & amort	-	-	-	10.6	11.8
Cash int exp	-	-	-	-2.7	-2.9
Cash int inc	-	-	-	2.4	4.5
Working cap chg	-	-	-	-1.4	-1.4
Cash tax paid	-	-	-	-10.1	-12.6
Others	-	-	-	0	0
Operating Cashflow	-	-	-	36.3	44.1
Capex	-	-	-	-5	-5
Sale/(Purchase)	-	-	-	3	4
Others	-	-		0	0
Investing Cashflow	-	-	-	-5	-5
Debt raised/(repaid)	-	-	-	10.1	0
Equity raised/(repaid)		-	-	0.0	0
Dividends paid	-	-	-	-9.9	-11.9
Others	-	-	-	0	0
Financing Cashflow	-	-	-	0.2	-11.9
Free Cash Flow	-	-	-	31.3	39.1

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Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
TRADING BUY (TR BUY)	Total return is expected to exceed +10% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
HOLD	Total return is expected to be between –10% to +10% over a 12-month period
SELL	Total return is expected to be below -10% over a 12-month period
NOT RATED	HLGS does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

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