STANDARD
&POOR'S

BP Plastics Holding

Recommendation: **HOLD**

Stock Code: **5100** | Bloomberg: **BPP MK** | Price: **MYR0.95** | 12-Month Target Price: **MYR1.01** | Date: **October 19, 2005**

Board: Main

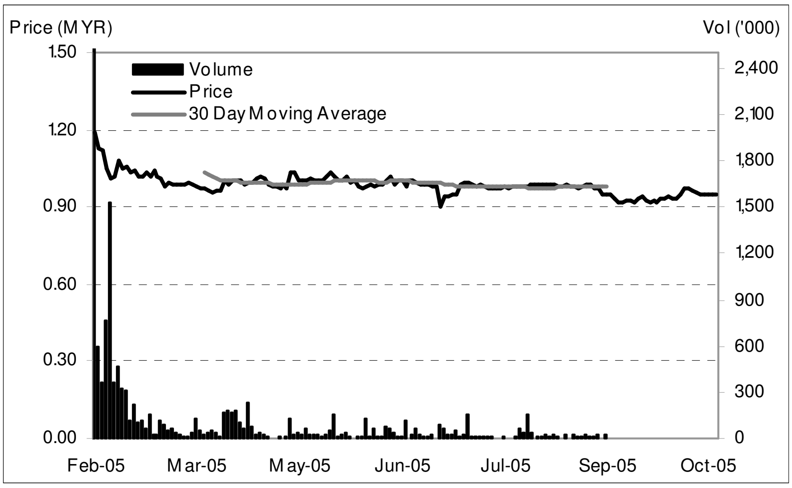
Sector: Industrial Products

GICS: Materials / Commodity Chemicals

Market Capitalization: MYR114.0 mln

Summary: BP Plastics Holding (BPP) is one of the leading producers of industrial plastic packaging bags and stretch films in Malaysia. Operating in a highly competitive environment, the group leverages on its advanced equipment & technologies, and a wide customer base to maintain its performance.

Analyst: Donovan Huang



Highlights

- With demand for plastic packaging in Asia growing at 1.5-2.0x GDP, BPP is constructing a new factory in Johor with its recent IPO proceeds, which will expand its annual capacity by 56% to 60,000 tons in 2006.
- Amid volatile plastic resin prices, gross margin fluctuated between 24-33% from 2000-04. Management reveals that unit gross profit has been relatively stable, suggesting the ability to pass on cost increases.
- Earnings were on an upward trend from 2000-04, with revenue CAGR of 49.1% and net profit CAGR of 38.9%. We project net profit of MYR18.7 mln for 2005 (+27.1% YoY) and MYR23.4 mln for 2006 (+25.4% YoY).

Investment Risks

- Risks to our recommendation and target price include relatively low earnings visibility complicated by volatile product prices, raw material costs and limited disclosure. We do not rule out that the possibility of high crude prices (feedstock for plastic resins) could depress margins and sag demand for plastic packaging products.
- Other potential risks include delays in the construction and operation of new capacity, the impact of MYR appreciation on export revenue, its short share trading history and relatively low share trading liquidity.

Recommendation

- We initiate coverage on BPP with a Hold recommendation and a 12-month target price of MYR1.01 based on a blend of the sector average valuation metrics of 7.2x 2005 EPS and 1.2x 2005 BV/share plus the projected net DPS of 5 sen, implying a 2005 PER of 6.5x.
- Trading at 6.1x 2005 EPS, the multiples of BPP appear to be relatively undemanding compared to 8.1x 2005 EPS for Scientex Packaging (SCIP MK, Not Ranked) and 7.3x 2004 EPS for Thong Guan (TGI MK, Not Ranked). We note that BPP had a higher operating margin of 14.9% in 2004, vs. 9.0% for TGI and 5.6% for SCIP and was in a net cash position as at end-Jun. 2005.
- While aggressive capacity expansion amid brisk demand appears to present a positive outlook in the near- to mid-term, we believe earnings momentum in a large part will depend on the ability to continuously pass on cost increases and management's savvy in predicting the pricing trend of plastic resins.
- Our valuation is constrained, however, by relatively low earnings visibility and weak sentiment towards the sector due to the difficulty in predicting resin prices and hence, the sustainability of profit margins. Nonetheless, we believe the projected 2005 dividend yield of 5.3% should help to support its share price.

Key Stock Statistics

FY Dec.	2004	2005F
EPS (sen)	**13.1**	**15.6**
PER (x)	**7.2**	**6.1**
Dividend/Share (sen)	**0.0**	**5.0**
NTA/Share (MYR)	**0.55**	**0.66**
Book Value/Share (MYR)	**0.55**	**0.66**
Issued Capital (mln shares)	**120.0**	
52-week Share Price Range (MYR)	**0.91 – 1.26**	
Major Shareholders:	%	
LG Capital	**45.0**	

Per Share Data

FY Dec.	2002	2003	2004	2005F
Book Value (MYR)	NA	NA	0.55	0.66
Cash Flow (sen)	8.8	11.5	16.0	18.7
Earnings (sen)	7.0	9.5	13.1	15.6
Dividend (sen)	0.0	0.0	0.0	5.0
Payout Ratio (%)	0.0	0.0	0.0	32.1
PER (x)	13.6	9.9	7.2	6.1
P/Cash Flow (x)	10.7	8.2	5.9	5.1
P/Book Value (x)	NA	NA	1.7	1.4
Dividend Yield (%)	0.0	0.0	0.0	5.3
ROE (%)	NA	NA	23.7	23.8
Net Gearing (%)	NA	NA	0.0	4.5

All required disclosures appear on the last page of this report. Additional information is available upon request.

The McGraw-Hill Companies

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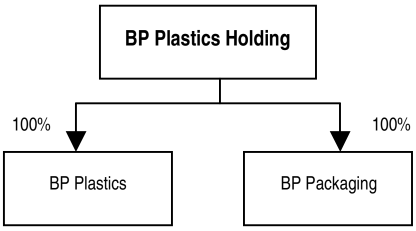
Background

Corporate Profile

BPP is an investment holding company with its subsidiaries principally engaged in the manufacturing and trading of plastic packaging products, including stretch films and plastic bags for industrial, commercial, logistics and warehousing usages. The group started operations in 1990, initially supplying polyethylene bags to the garment and textile industries. Over the years, the group has grown from a cottage plastic bag manufacturer into one of the largest ISO 9001:2000 certified producers of industrial plastic bags and stretch films in Malaysia. BPP was listed on the Main Board in Feb. 2005. Its largest shareholder, LG Capital (45.0%) is co-owned by its three related co-founders, including managing director Mr. Lim Chun Yow. The board of directors has yet to appoint its chairperson.

Corporate Structure



Source: Company data

Business

Generally, films and plastic bags can be extruded through two types of processes, namely cast or blown extrusion. BPP's stretch films are produced by the cast process, while its plastic bags are produced by the blown process, often referred to as blown products. Examples of blown products include shrink films, 3-layer lamination-based films, mattress covers/bags, garment bags and food packaging bags etc, which are produced according to customers' specification and supplied to various factories as plastic packaging materials.

Stretch films are made mainly from linear low-density polyethylene (LLDPE) and widely used to unitise loads, prevent goods from spillage, and provide safety and protection for palletised goods, particularly in the warehouse and logistics sector. While there are other ways to unitise and protect products during storage and shipment, the advantage of stretch films is that it can be used to wrap irregular loads with minimum effort (even by hand), in contrast to shrink/stretch hoods. In addition, the machineries to apply stretch films are cheaper than those for shrink and stretch hoods.

According to management, BPP's current product mix is approximately 70% stretch films and 30% blown products. Management believes its focus on stretch films provides economies of scale giving the group some advantages in purchasing plastic resins (raw materials) from the global petrochemical majors. Nonetheless, we note that the profitability of blown products for the group was nearly twice that of stretch films in 2004. The group currently has a combined annual capacity of about 38,400 tons running at an estimated utilisation rate of 70-80%. Constructing a new factory near its existing plant in Batu Pahat, BPP plans to expand its capacity by about 56% to 60,000 tons in 2006. Given its net cash position following its IPO, management believes the group could internally finance the estimated investment of MYR30 mln.

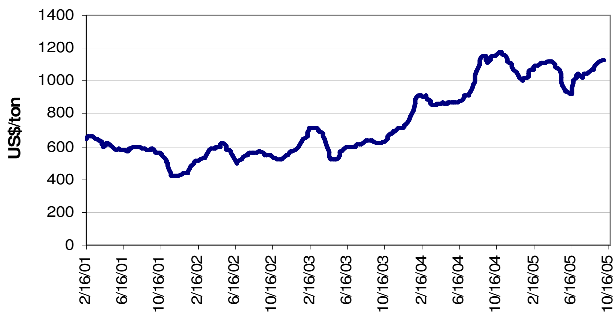
Plastics continue to be a packaging material of choice for a wide range of applications as it is malleable, versatile, lightweight, durable and largely recyclable. Driven by strong manufacturing activities and replacements for rival materials, the demand for plastic packaging in Asia ex-Japan is estimated to grow at 1.5-2x GDP. In particular, a robust 10-15% annual growth for stretch films is anticipated. However, we note that the industry is fragmented and highly competitive. In the BSF (bags, sacks and films) sector alone, in which stretch films and plastic bags belong there are about 455 manufacturers in Malaysia.

As such, the plastic packaging industry is moving towards greater capital-intensiveness and industry leaders are investing in high-end operations and large facilities to stay competitive. Apart from investing in state-of-the-art equipment to produce high quality products, BPP focuses on the stretch film sector, which is believed to be less competitive. In addition, the group boasts a wide customer base of about 800 companies in more than 16 countries worldwide. In 2004, exports accounted for about 55% of total revenue. According to Infocredit's estimate, the group had a domestic and export market share in the BSF category of 5.2% and 4.1%, respectively in 2003.

Earnings Outlook

BPP's product prices are largely determined on a cost-plus basis benchmarked to global plastic resins prices. The group sources approximately 35% of its raw material locally and imports the remaining 65% mainly from Singapore. Generally on a rising trend since 2001, we note that the LLDPE (main raw material) price has been relatively volatile, peaking in 4Q04, falling substantially thereafter and rebounding strongly in 3Q05 driven by the run-up in oil prices. We note that the Southeast Asia LLDPE price of US$1,130/ton as at early-Oct. 2005 was approaching the peak of 1,175/ton in 4Q04. Should oil prices sustain above US$60/bbl, we expect LLDPE price to maintain at the current high level or even climb higher. However, we believe the periodic fluctuations are likely to stay, as seen from the historical trend.

SE Asia LLDPE Price (Film Grade)



Source: Bloomberg, S&P Equity Research

As a result of the volatile raw material prices, BPP's gross margin fluctuated between 24-33% from 2000-04. Management reveals that unit gross profit has been relatively stable, suggesting the ability to pass on cost increases. We note that historical earnings have been on an upward trend since 2000. This together with aggressive capacity expansion amid brisk demand appears to present a positive outlook in the near- to mid-term. Nonetheless, we believe earnings momentum in a large part will depend on the ability to continuously pass on cost increases and management's savvy in predicting the pricing trend of plastic resins.

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Assuming an average utilisation rate of 73%, we expect BPP to see a 15.2% YoY increase in 2005 output. Further boosted by a 15.5% YoY rise in the estimated ASP, we forecast 2005 revenue of MYR162.4 mln, up 33.1% YoY. However, this growth is not expected to fully filter through to the bottomline, as we are assuming a lower gross margin of 23.5%, leading to a 27.1% YoY growth in our 2005 net profit estimate to CNY18.7 mln. We project 2006 net profit of MYR23.4 mln (+25.4% YoY), assuming a 21.4% YoY growth in output, relatively stable ASP (+1.7% YoY), and gross margin of 24.0%.

Valuation

Our target price derived from relative valuation is based on a combination of PER and P/BV comparisons of BPP's closest listed peers, in our view, Scientex Packaging, Thong Guan and China Flexible Packaging (CFLX SP, Not Ranked). Ascribing the average 2004 PER of 7.2x and 2004 P/BV of 1.2x to our projected 2005 EPS and BV/share for BPP, respectively, we arrive at a fair value of MYR1.01/share for BPP. As there is no consensus earnings forecast for Thong Guan, we have chosen to use the 2004 multiples of BPP's three peers.

We note that BPP's 2004 operating margin of 14.9% is higher than the 9.0% for Thong Guan in 2004 and 5.6% for Scientex Packaging in FY05 (Jul.). While the multiples discount for BPP appears excessive compared to its two domestic peers, our valuation is constrained by relatively low earnings visibility and weak sentiment towards the sector due to the market's lack of conviction on the sustainability of profitability for the plastic manufacturers. At our target price, the implied 2005 PER of 6.5x represents a premium to the 5.3x for China Flexible Packaging, a leading Chinese manufacturer of shrinkage films listed in Singapore with a higher operating margin of 35.6% in FY04 (Oct.) and better share trading liquidity.

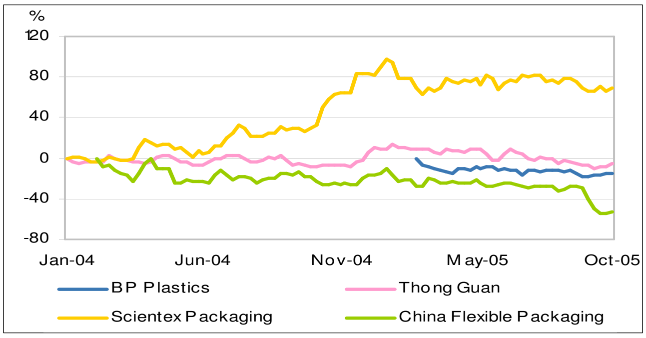
Comparative Valuation

	BPP	Thong Guan	Scientex Packaging*	CFLX*
Share Price (MYR) @ Oct. 18, 05	0.95	1.98	2.05	1.01
Mkt. Cap (MYR mln)	114.0	208.3	161.6	421.7
Ave. Daily Vol. ('000)	29	32	36	2,017
PER FY03 (x)	9.9	8.6	21.6	4.8
PER FY04 (x)	7.2	7.3	9.5	4.7
P/NTA	1.7	1.5	1.3	0.2
Yield (%)	0.0	2.5	3.4	4.1

*Note: Earnings are calendarized.

Source: Bloomberg, Company data

Relative Share Price Performance of Comparables



Source: Bloomberg, S&P Equity Research

Recent Developments

Aug. 2005: Reported 2Q05 revenue of MYR38.8 mln (+1.3% QoQ) and net profit of MYR4.9 mln (+0.1% QoQ). 1H05 net profit of MYR8.3 mln indicates that the group might exceed management's full year net profit forecast of MYR16.7 mln, given that the second half is historically stronger.

May 2005: Reported 1Q05 revenue of MYR38.3 mln and net profit of MYR4.9 mln. YoY comparison was not available as the group was listed in Feb. 2005.

Apr. 2005: Announced an interim tax-exempt dividend of 3 sen per share.

Profit & Loss

FY Dec. / MYR mln	2003	2004	2005F	2006F
Revenue	64.9	122.1	162.4	200.6
Operating Profit (EBIT)	13.1	18.1	23.2	29.3
Depreciation	-2.2	-3.2	-3.8	-5.3
Net Interest Income / (Expense)	-0.2	-0.3	-0.4	-0.4
Pretax Profit	12.9	17.9	22.8	28.9
Effective Tax Rate (%)	17.5	17.7	18.0	19.0
Net Profit	10.7	14.7	18.7	23.4
Operating Margin (%)	20.2	14.9	14.3	14.6
Pretax Margin (%)	19.9	14.6	14.0	14.4
Net Margin (%)	16.4	12.1	11.5	11.7

Source: Company data, S&P Equity Research

Balance Sheet

FY Dec. / MYR mln	2002	2003	2004
Total Assets	NA	NA	92.6
Fixed Assets	NA	NA	37.5
Current Assets	NA	NA	57.3
Other LT Assets	NA	NA	-2.2
Current Liabilities	NA	NA	17.7
LT Liabilities	NA	NA	12.9
Share Capital	NA	NA	56.0
Shareholders' Funds	NA	NA	62.0

Source: Company data, S&P Equity Research

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.
Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.
Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.
Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.
Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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