Thong Guan to build war chest before acquisition

Plastic packaging manufacturer has to acquire assets to grow the company but is reluctant to borrow

by Ooi Chia Shen

PLASTIC packaging manufacturer Thong Guan Industries Bhd needs to build its war chest before it can make any acquisition to grow the company. It currently does not have sufficient funds for such an exercise, and it is reluctant to borrow.

An industry observer says Thong Guan has to acquire assets as it is a faster way to grow its businesses and to remain competitive. However, the group is put off by the high valuation of the target companies.

Speaking to ***FocusM***, Thong Guan executive director Alvin Ang See Meng says the group has about RM40 mil cash and intends to accumulate more funds before making any acquisition in the near term.

"We do not have enough funds to support the acquisition at the moment. We are accumulating our capital to enable our acquisition plan to work. Last year, we decided to do a corporate exercise involving a rights issue, which raised some RM50 mil. However, the proceeds are utilised in [expanding] production capacity. If you want to go shopping, you must build up your war chest," he adds.

According to Ang, Thong Guan intends to acquire assets that complement or strengthen its existing core business. It also wants to grow its food and beverage division.

"We have undertaken a small investment over the past five years in our diversification into carrier bags manufacturing and the food and beverage business. They are contributing significantly, more than 20%, to the group's earnings. I believe these divisions will continue to register growth in profit," he adds.

Ang says the company will not go for bank borrowings unless the deal is attractive enough in terms of valuation or potential. "We do not want to go to the banks easily and damage our reputation if any proposed deal is not planned carefully," he adds.

An analyst with an investment bank says Thong Guan will have more opportunities to make acquisitions from the cash generated from its operations following the completion of its three-year expansion this year.

Besides Thong Guan, the other two major plastic packaging manufacturers are Scientex Bhd and BP Plastics Holdings Bhd. They have been reporting steadily growing revenues and earnings.

Kenanga Investment Bank Bhd, which believes the sector is fairly valued, says: "The latest Q4FY15 results were all above expectations mainly on better margins from favourable exchange rates. However, growth factors like near-term capacity and margin expansion are already priced in."

THONG GUAN INDUSTRIES BHD

KEY BOARD MEMBERS AND MANAGEMENT
DATUK SYED MANSOR SYED KASSIM BARAKBAH (chairman), **DATUK ANG POON CHUAN** (group MD), **DATUK ANG POON KHIM, DATUK ANG POON SEONG** and **ALVIN ANG SEE MENG** (executive directors)

MAJOR SHAREHOLDERS	
Foremost Equals Sdn Bhd	39.81%
MARKET CAP (May 5)	**RM330.6m**
SHARE PRICE (May 5)	**RM3.14**
52-WEEK HIGH (Jan 6, 2016)	**RM3.53**
52-WEEK LOW (Feb 29, 2015)	**RM1.65**
FINANCIAL RESULTS (Q4 ended Dec 31, 2015)	
REVENUE	**RM195.72m**
NET PROFIT	**RM15.52m**

Focusing on premium products

Thong Guan seeks to differentiate itself from its competitors selling conventional plastic packaging (industrial stretch films) by having its machines adopt 33-layer nanotechnology and five-layer blown film line. This will enable the group to produce plastic wraps with better resilience.

Ang says for the new plastics produced using the new technology, punctures do not spread out like in conventional plastic film. "It is like plywood effect, the higher the density, the stronger will be the film. Normally, you need longer wraps to roll up the product, [and] ours can be used to wrap the same product with a shorter length and this helps end-users to save cost," says Ang.

JONATHAN LOI/FocusM

If you want to go shopping, you must build up your war chest, says Ang

He adds that the group will sell the new stretch films at a 15% premium over the conventional film.

Despite the one-off expenditure to buy the machines using the new nanotechnology, Ang says the cost of production will be reduced over the long term.

Thong Guan has been reducing its reliance on the domestic market since 2013 due to low margins from the segment. Hence, bringing in new machines will enable the company to ensure production efficiency and make premium products, says Ang.

For FY15, Thong Guan posted a net profit of RM38.50 mil, more than double the RM17.48 mil achieved in FY14, despite a lower revenue of RM712.09 mil. Ang says it is normal to see a drop in revenue as the group has consolidated its customer base and low-margin products.

In a recent report, Kenanga Investment Bank research says it expects Thong Guan's revenue and bottom line to continue to grow, supported by capacity expansion into higher-margin products.

Ang says: "Now we need to educate the customers, resellers and distributors about the value of the new product we have to offer. We are the pioneer in thin film and now we want to be the pioneer in optimising the film for machine wrap division. We [have] just sold all the old lines and we are estimating the [number of] new machineries needed as the demand for the new products is still at the preliminary stage."

The group has set up a research and development (R&D) centre in Sungai Petani, Kedah, mainly to cater to overseas customers. "The idea is to provide a platform for prospective customers to look at the entire process of production and also end-products … this will increase their confidence in Thong Guan," Ang says.

The group is seeking to streamline its cost base by consolidating two of its plants in China. "We are adopting as much automation into the production line as we can to reduce our reliance on labour. We do not focus on revenue but look at the profit margin from the products," he states.

The domestic market's contribution to total sales has fallen to 5% from 30% two years ago. Thong Guan's biggest market is Japan, which accounts for 20% of total sales while Australia and New Zealand together account for 15%. FocusM