BCT Asia advisory

BURSA MidS

INITIATION REPORT *5 October 2017*

Name of PLC: *Kian Joo Can Factory Berhad (KJFC)*		***PLC Website:*** *www.kjcf.net*	
Business Summary: *Manufacture and distribution of tin and aluminium cans and investment holding*			
Top Three Shareholders: *Can-One Berhad*		*32.9%*	
EPF		*9.9%*	
Dato' See Teow Chuan		*8.9%*	
Market / Sector:	*Industrial Products*	***Stock Code:***	*3522*
		Bloomberg Ticker:	*KJC:MK*
Market Capitalisation:	*RM 1,345.8m*	***Recommendation:***	*HOLD*
Target Price:	*RM 3.20*	***Expected Capital Gain:***	*5.6%*
		Expected Div Yield:	*1.3%*
Current Price:	*RM 3.03*	***Expected Total Return:***	*6.9%*

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Key Stock Statistics	**2015**	**2016**	**2017F**	**2018F**
EPS (sen)	29.6	29.0	22.2	24.5
P/E (x)	10.2	10.5	13.7	12.3
Net Dividend/Share (sen)	2.0	4.0	4.0	4.0
NTA/Share (RM)	2.92	3.20	3.38	3.59
Book Value/Share (RM)	2.92	3.20	3.38	3.59
Issued Capital (mil shares)	444.2	444.2	444.2	444.2
52-weeks Share Price Range (RM)				2.77 - 3.08
Estimated free float				45%
Average volume (shares)				118,680

Per Share Data	**2015**	**2016**	**2017F**	**2018F**
Year-end 31 Dec				
Book Value/Share (RM)	2.92	3.20	3.38	3.59
Operating CF/Share (sen)	44.3	25.2	37.2	41.1
EPS (sen)	29.6	29.0	22.2	24.5
Net Dividend/Share (sen)	2.0	4.0	4.0	4.0
P/E (x)	10.2	10.5	13.7	12.3
P/Cash Flow (x)	6.8	12.0	8.1	7.4
P/Book Value (x)	1.0	0.9	0.9	0.8
Dividend Yield (%)	0.7	1.3	1.3	1.3
Payout Ratio (%)	6.8	13.8	18.0	16.3
ROE (%)	10.8	9.5	6.7	7.0
Net Gearing (%)	15.2	22.4	32.3	33.6

P&L Analysis (RM mil)	**2015**	**2016**	**2017F**	**2018F**
Revenue	1,601.89	1,717.71	1,756.95	1,851.19
EBITDA	242.45	249.51	225.13	270.69
Depreciation & amort	(66.57)	(74.51)	(87.10)	(103.57)
Net interest income	(13.05)	(19.20)	(25.91)	(30.83)
Associate & JV	(0.19)	-	-	-
Pre-tax Profit	162.65	155.80	112.12	136.29
Net Profit	131.31	128.61	98.51	109.00
EBITDA Margin (%)	15.1	14.5	12.8	14.6
Pre-tax Margin (%)	10.2	9.1	6.4	7.4
Net-Margin (%)	8.2	7.5	5.6	5.9

1. Investment Highlights/Summary

- Kian Joo Group, the largest packaging company within the ASEAN region, produces all types of tin cans, aluminium beverage cans, corrugated carton boxes and the provision of contract packing services.

- KJCF is uniquely positioned to offer one-stop packaging solutions. We like KJCF for its established business track record, market-leading position in an oligopolistic market structure, operational scale and technology advancement in production as well as its regional presence.

- Longer-term growth prospects are well underpinned by the addition of two new production lines (aluminium cans), expansion into Myanmar and export markets.

- For the immediate FY17-18, profit performance will still be adversely affected by rising costs of raw materials, weak pricing power amidst the current weak consumer sentiment, higher depreciation costs and finance charges associated with capacity and Myanmar expansion. These initiatives would only deliver meaningful positive impact from FY19 onwards.

- We initiate coverage with a Hold recommendation and a target price of RM3.20. In deriving our target price, we have pegged valuations to its book value of RM3.21.

2. Company Background/Overview

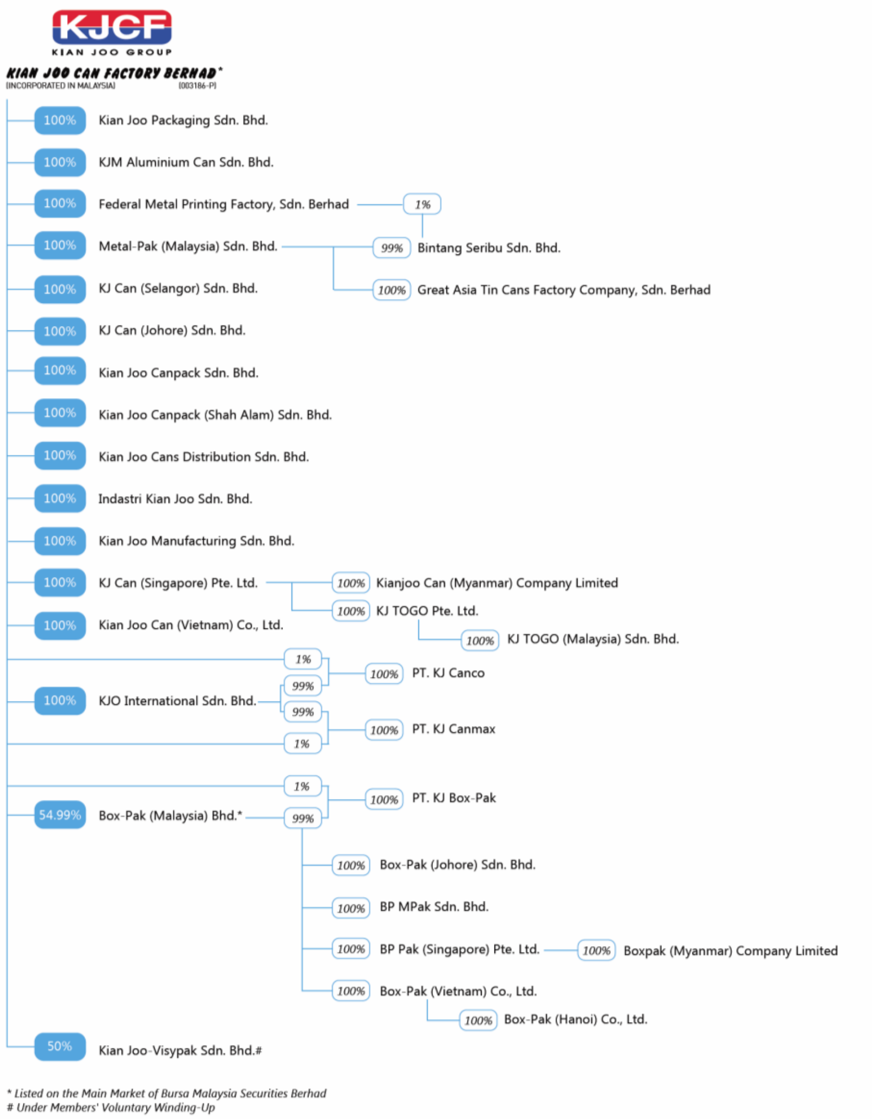
a) History

Founded by the late Mr See Boon Tay in 1956 with a few close friends, the company was incorporated under the name of Kian Joo Can Factory Limited on 18-Mar-1958. It was initially involved in the manufacturing of tin cans. Its carton box plant in Malaysia commenced operations in 1975.

The company later converted to a public listed company on 10-Sep-1984 and was listed on Bursa Securities (formerly known as Kuala Lumpur Stock Exchange) on 16-Nov-1984. KJCF is also the pioneer in the manufacturing of aluminium cans (1989) and aluminium slim cans (1999). It ventured to Vietnam through the setting-up of a general can factory in 2002. The carton factory in Vietnam was established in 2004.

Today, Kian Joo Group, the largest packaging company within the ASEAN region, produces all types of tin cans, aluminium beverage cans and containers, corrugated carton boxes, and other plastic products for the local and export markets.

b) Corporate structure



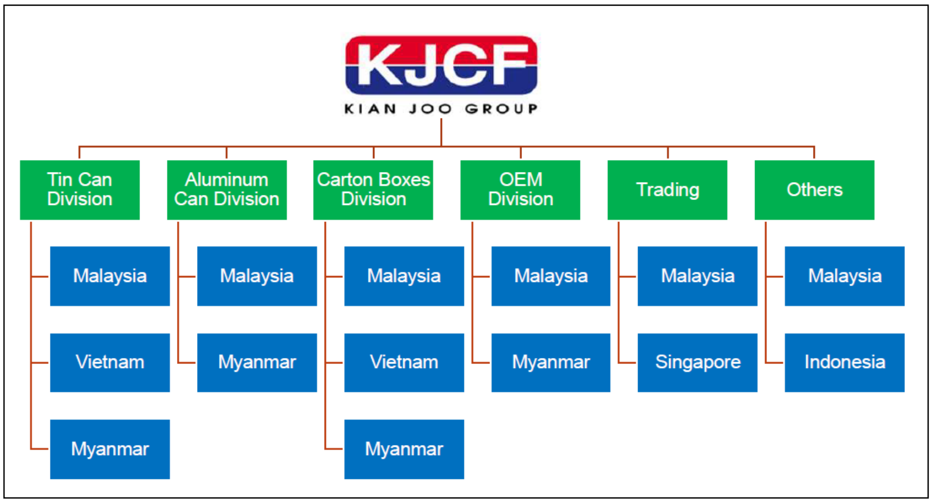
Source: Annual report

3. Business Operations

The Group is principally engaged in manufacturing and distributing of tin cans, aluminium beverage cans and corrugated fibreboard cartons, provision of contract packing services, letting of property and investment holding.

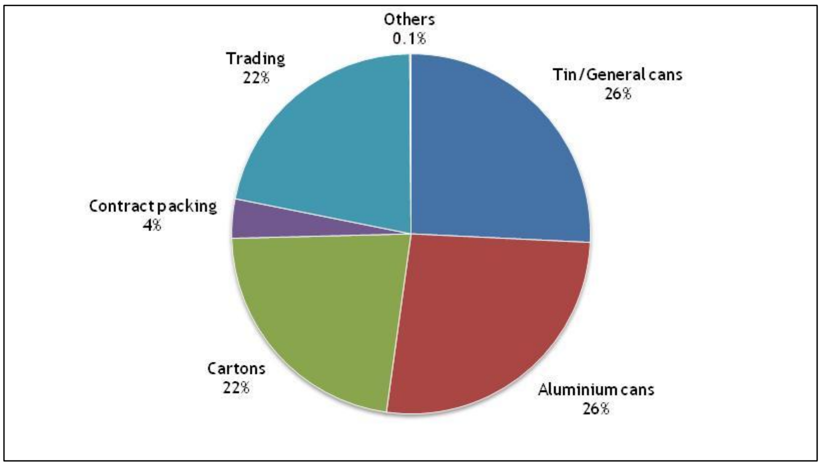
The scope of business activities is further elaborated as follow:-

i. Tin cans division - Manufacture and distribution of tin cans;
ii. Aluminium cans division - Manufacture and distribution of aluminium cans;
iii. Cartons division - Manufacture and distribution of corrugated fibreboard cartons;
iv. Trading division - Trading of the Group's products;
v. Contract packing division - Carbonated beverage contract packing service and packing of milk powder on original equipment manufacturer (OEM) basis; and
vi. Investment and property holding division

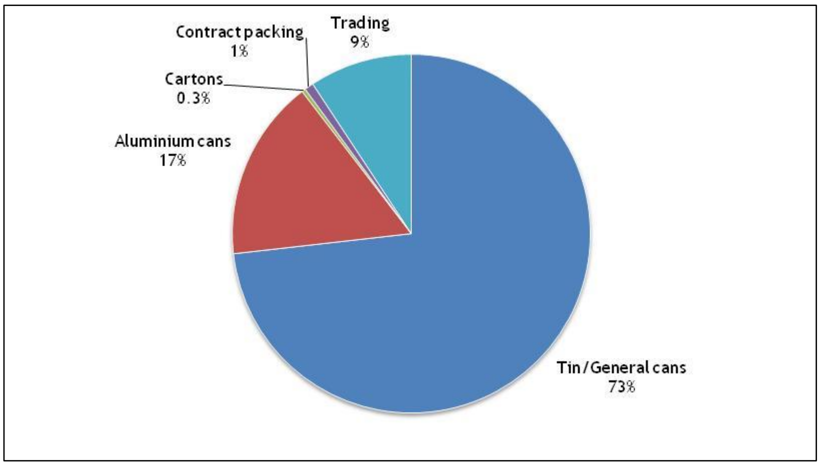


Source: Company

Turnover breakdown by segmental (FY16) (before inter-segment elimination)



Segment PBT breakdown by segmental (FY16)



a) Tin cans division

This division is principally involved in the manufacture of tin cans and components in Malaysia and Vietnam. The tin cans manufactured by the Group are supplied to a wide variety of industries including fast moving consumer goods (dry/processed food, confectionery, sweetened condensed milk), edible oil, industrial products (lubricant, paint and chemicals), battery jacket, aerosol and other products. This division accounted for 26% and 73% of group turnover and segment PBT in FY16 respectively.

In Malaysia, it currently operates from three locations in Batu Caves and Shah Alam (Selangor) and Tampoi (Johor). KJCF has another factory in Vietnam, located in Ho Chi Minh, Vietnam.

Most of the production output in Malaysia is for domestic consumption. The Malaysian Tin Cans Manufacturer Association which is the trade association representing this industry has twenty members. In Malaysia, KJCF has a market share of about 35-40% of the tin cans market and its major domestic competitors include Can-One Bhd and Johore Tin Bhd. In Vietnam, there are approximately fifteen manufacturers of tin cans.

b) Aluminium cans division

This division is in the manufacture of aluminium cans and components in Malaysia. Aluminium cans are used as primary packaging materials for single serve, ready to drink beverage products. KJCF produces various types of aluminium can sizes such as the standard 325ml can, slim 250ml can, slick can and others. The main customers of aluminium cans are in the beverage industry, which includes beer, carbonated soft drinks and ASEAN drink products. This division accounted for 26% and 17% of group turnover and segment PBT in FY16. KJCF currently operates from two locations in Batu Caves (Selangor) and Nilai (Negeri Sembilan).

In Malaysia, there are currently two manufacturers for aluminium cans in Malaysia, namely KJCF and CROWN Beverage Cans Malaysia Sdn Bhd. KJCF is the largest aluminium cans player in the market, with about a 70% share.

c) Cartons division

The cartons division is principally involved in the manufacture and distribution of paper boxes, cartons, general paper and board printing. Its factories are located in Malaysia and Vietnam. KJCF manufactures corrugated carton boxes for fast moving consumer goods, electronic and electrical products, footwear, furniture and others. This operation is pre-dominantly carried out by its 55%-owned Box-Pak (Malaysia) Bhd (BPMB), which is also listed on the Main Market of Bursa Malaysia Securities Berhad. This division accounted for 22% and 0.3% of group turnover and segment PBT in FY16.

In Malaysia, BPMB operates from two locations in Batu Caves (Selangor) and Senai (Johor). In Vietnam, it operates factories located in Ho Chi Minh and Honoi.

Due to the presence of the high number of corrugated cartons manufacturers in Malaysia and Vietnam, the competition in both markets is intense. In FY16, BPMB's factories in Malaysia and Vietnam each contributed RM111.55m and RM389.16m of the turnover of cartons division of RM500.71m.

d) Trading division

This division undertakes sales and marketing activities for the Group. It also acts as the centralised procurement centre for the importation of main direct materials of the Group. This division was set up primarily to consolidate the marketing efforts to sell products manufactured by the group in both local and export. The trading division in Malaysia deals with general cans whereas its Singapore division trades aluminium coil, general and aluminium cans as well as contract packaging services in international market. It was set up in 3QFY15 and achieved its first full year operation in FY16. This division accounted for 22% and 9% of group turnover and segment PBT in FY16.

e) Contract packing division

KJCF provides OEM manufacturing services / independent contract packing services to its customers (mainly the multinational companies). The main products packed by this division are carbonated single serve drinks and milk powder. The factories are located in Shah Alam (Selangor) and Nilai (Negeri Sembilan).

4. Financial Review

a) Revenue Breakdown by Segmental (RMm)

RMm	FY11	FY12	FY13	FY14	FY15	FY16	5Y CAGR
Tin cans	446.09	457.85	503.00	496.17	573.18	575.34	5.2%
Aluminium cans	360.35	404.28	464.85	475.15	537.10	590.51	10.4%
Cartons	248.70	264.33	300.14	343.04	451.75	500.71	15.0%
Contract packing	66.69	75.54	56.29	50.71	81.14	78.90	3.4%
Trading	-	-	-	-	56.21	485.67	
Elimination	(35.90)	(39.27)	(33.82)	(30.41)	(99.43)	(516.02)	
Others	0.11	0.11	0.11	0.12	1.95	2.60	
Total Turnover	**1,086.04**	**1,162.85**	**1,290.57**	**1,334.78**	**1,601.89**	**1,717.71**	**9.6%**

b) Turnover breakdown by geographical

RMm	FY11	FY12	FY13	FY14	FY15	FY16	5Y CAGR
Malaysia	660.18	687.33	731.33	945.49	1,081.67	939.66	7.3%
Vietnam	265.60	296.50	364.89	389.30	520.16	554.46	15.9%
Singapore	55.72	55.65	67.77	-	-	223.60	
Others	104.54	123.37	126.58	-	0.06	-	
Total Turnover	**1,086.04**	**1,162.84**	**1,290.57**	**1,334.78**	**1,601.89**	**1,717.71**	**9.6%**

- The cans division remains the main pillar and core contributor to the group's results. Both tins and aluminium cans divisions contributed equally to the group turnover in FY16. Historical growth had been driven by aluminium cans division due to capacity expansion, which registered a 5-year turnover CAGR of 10.4%.

- As KJCF is a key supplier of packaging materials to the food and beverage (F&B) sector, KJCF is an indirect proxy to the growth driver of food consumption sector. Demand for F&B products is steadily growing underpinned by domestic consumption, population growth and economic activities.

- KJCF has grown from strength to strength through careful execution of its expansion plans in terms of production capacity and geographical expansion. New capacity was added in FY12, FY14 and FY16. Underpinned by the progressive capacity expansion, its aluminium cans division grew its revenue by a CAGR of 10.4% to RM590.51m (FY16) from RM360.35m (FY11).

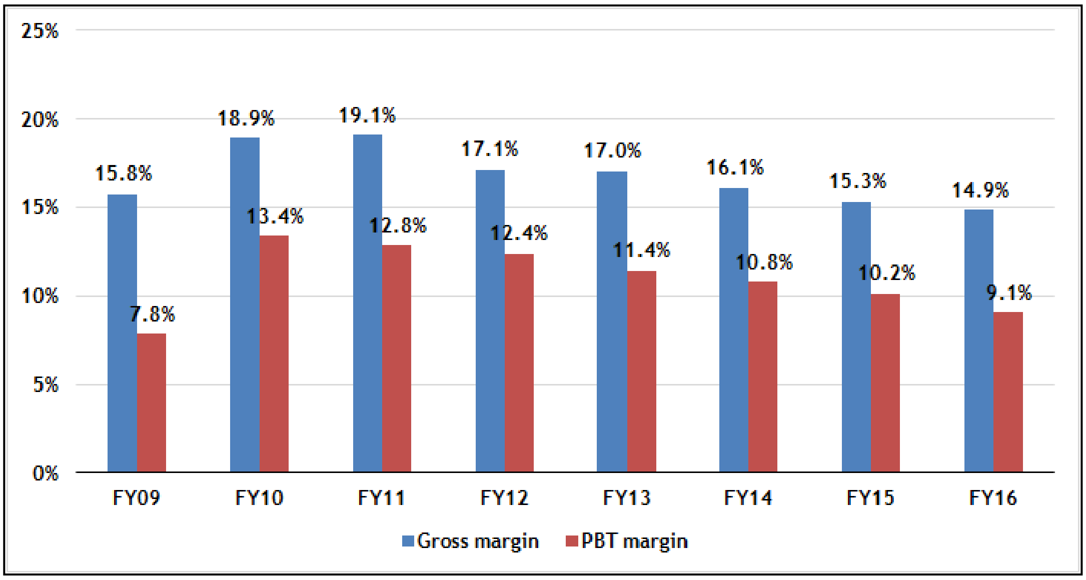
- Turnover of cartons division was boosted by the setting-up of a new carton box plant in Hanoi, which commenced operation in 3QFY13. As a result, the revenue derived from its cartons operation in Vietnam grew by a CAGR of 17.1% to RM389.16m (FY16). In comparison, revenue from the cartons operation in Malaysia only expanded at a slower CAGR of 9.3% to RM111.55m (FY16). In FY16, an investment of RM65.5m had been incurred on capex for Malaysia and Vietnam. Although turnover of cartons division in FY16 increased by 10.8% to RM500.71m, it has yet to reflect the capacity expansion.

- The trading division commencement operations since 3QFY15. This led to a significant jump in revenue of trading division, of which a substantial portion of the revenue was from tin cans and aluminium cans divisions. This resulted in a sharply higher inter-segment eliminations amounting to RM516.02m in FY16 from RM99.43m in FY15. During its first full year of operation, it recorded a segment PBT of RM14.40m (FY16) as compared with RM1.17m (FY15).

c) PBT Breakdown by Segmental (RMm)

RMm	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**
Tin cans	64.42	57.11	77.40	65.99	119.58	113.54
Aluminium cans	57.29	67.55	53.23	52.46	30.17	25.36
Cartons	17.58	22.37	14.25	10.47	11.70	0.53
Contract packing	0.59	(1.06)	2.92	3.40	6.86	1.26
Trading	-	-	-	-	1.17	14.40
Others	(0.39)	(1.93)	(0.31)	(0.03)	(6.33)	0.86
Elimination	-	-	-	-	(0.31)	(0.15)
Associate & JV	(0.01)	-	(0.10)	11.73	(0.19)	-
Total PBT	**139.49**	**144.04**	**147.39**	**144.03**	**162.65**	**155.80**
	-	-	-	-	-	-
PBT margin						
Tin cans	14.4%	12.5%	15.4%	13.3%	20.9%	19.7%
Aluminium cans	15.9%	16.7%	11.5%	11.0%	5.6%	4.3%
Cartons	7.1%	8.5%	4.7%	3.1%	2.6%	0.1%
Contract packing	0.9%	-1.4%	5.2%	6.7%	8.5%	1.6%
Trading					2.1%	3.0%
Total PBT	**12.8%**	**12.4%**	**11.4%**	**10.8%**	**10.2%**	**9.1%**

d) Historical Gross Margin Trend



- Prior to FY13, group profitability had been relatively stable. In FY13, although gross margin was largely maintained at 17.0%, PBT margin dipped to 11.4%. This was attributed to initial operating loss of new plant in Hanoi, recognition of derivative loss (RM4.35m), write-down on inventories (RM15.64m) and impairment loss on PPE (RM8.00m).

- For its tin cans division, PBT surged significantly to RM119.58m (FY15) from RM65.99m (FY14). In addition to organic profit growth, it was further boosted by forex gain of RM29.8m.

- KJCF's aluminium cans division has been reporting lower PBT and profitability since FY12. This was due to the significant investment in additional three lines over the last five years. The profitability was eroded by additional depreciation expenses, finance charges and other associated expenses. In addition, it was also adversely affected by market competition.

- PBT of cartons division plunged to RM0.53m (FY16) from RM11.70m (FY15) due to higher paper costs due to higher international prices and short supply of waste paper in the domestic market, which increased by 7% to 10% on average. The surplus capacity in the industry also restrained its ability to pass-through the cost increases to its customers.

- As a group, gross margin has been on declining trend since FY12. This was attributed to significant investments in various divisions such as the addition of three new aluminium cans lines, two 8-colour printing lines and expanded capacity in carton plants both in Malaysia and Vietnam. In total, the cumulative capex since FY13 after the present management took over KJCF, amounted to around RM860m. Due to commissioning of the latest two new production lines (aluminium cans division) and new plant and machinery in Malaysia and Vietnam (cartons division), KJCF also had to incur higher depreciation in FY15 (RM66.57m) and FY16 (RM74.51m) as compared with RM50.31m in FY14. In addition, the impact of rising raw material prices and weakening ringgit also caused the declining profitability during FY14-16. In FY16, profitability dipped further due to rising aluminium and tin plate prices.

- Profit swings could also be caused by non-operational items. In FY15, KJCF benefited from a net forex gain of RM35.27m. The strengthening of US$ increased the value of its US$ funds allocated for injection into its Myanmar subsidiary, which was subsequently made in FY16. KJCF attained a derivatives gain in FY16 (RM11.38m) from a loss in FY15 (RM10.42m). This was attributed to fair value adjustments on financial instruments that were used to hedge the risks against fluctuations in commodity price and US$ exchange rates.

5. Competitive Analysis

- The production of tin and aluminium cans requires operational scale to maintain its competitiveness. This includes a relatively high initial investment, working capital and operating leverage in managing the volatility of for raw materials risks. As the industry is industry in Malaysia is largely dominated by a few major producers, this creates a relatively higher barrier-to-entry to new players.

- KJCF is uniquely positioned to offer one-stop packaging solutions to the requirements of customers. Its strengths lie in its leading position in tin and cans manufacturing as well as regional presence in Vietnam. In Malaysia, KJCF has close to 35-40% of the tin cans market in Malaysia (collectively the three major producers control 80-85% of the market), while it has a dominant 70% share of aluminium can production in Malaysia.

- As the pioneering tin can manufacturer, KJCF commands certain competitive edge due to its long business track record and experience, products' quality and long-standing business relationship with customers and suppliers. Not only has KJCF pioneered the production of certain products such as aluminium cans, slim cans and 8-colour printing line in Malaysia, it has continued to maintain the leading position in the market. It remains the only producer capable of producing aluminium slim cans and equipped with 8-colour printing line in Malaysia.

6. Earnings Outlook

- As KJCF is a key supplier of packaging materials to the F&B sector, KJCF is an indirect proxy to the growth driver of food consumption sector. Demand for F&B products is resilient and steadily growing underpinned by domestic consumption, population growth and economic activities.

Turnover Breakdown by Segmental (RMm)

RMm	FY16	1H FY16	1H FY17	Chg
General cans	1,165.85	597.57	587.71	-1.6%
Cartons	500.71	243.51	258.16	6.0%
Contract packing	78.90	40.45	41.42	2.4%
Trading	485.67	199.93	283.39	41.7%
Others	2.60	1.16	1.62	39.6%
Elimination	(516.02)	(215.68)	(299.77)	39.0%
Total Turnover	**1,717.71**	**866.95**	**872.54**	**0.6%**

PBT Breakdown by Segmental (RMm)

RMm	FY16	1H FY16	1H FY17	Chg
General Cans	138.90	57.51	43.04	-25.2%
Cartons	0.53	3.48	(9.12)	n.m.
Contract packing	1.26	1.82	(0.90)	-149.4%
Trading	14.40	5.41	8.26	52.7%
Others	0.86	0.17	(1.45)	
Elimination	(0.15)	(5.00)	-	
Total PBT	**155.80**	**63.39**	**39.83**	**-37.2%**
PBT margin				
General cans	11.9%	9.6%	7.3%	
Cartons	0.1%	1.4%	-3.5%	
Contract packing	1.6%	4.5%	-2.2%	
Trading	3.0%	2.7%	2.9%	
Total PBT	**9.1%**	**7.3%**	**4.6%**	

- Tin cans market in Malaysia is a matured industry. The **tin cans division** will remain the largest profit contributor. Although there was no expansion in production line, there is room to expand its production output with its existing capacity.

- For its **aluminium cans division**, it offers higher growth prospects. In FY16, KJCF commissioned another two new production lines, increasing its production lines to a total of 6 lines. As such, its aluminium can-making lines were running at lower production efficiency in FY16. It will take another 2-3 years to fill up the expanded capacity. Longer-term, as it continues to ramp up its production, profitability should benefit from higher production efficiency, lower units costs and absence of pre-operating costs. However, KJCF will have to incur higher depreciation charges and finance expenses during the gestation period.

  In 1HFY17, the PBT of general can division (both tin and aluminium cans combined) declined by 25.2% to RM43.04m due to additional costs, weak consumer sentiment in F&B sector in Malaysia and higher raw materials costs.

- Its **cartons division** will also benefit from expanded capacity with the commissioning of new plant and machinery in Malaysia and Vietnam in FY16. However, its profitability will be under pressure due to stiff competition, weak pricing and its inability to fully pass-on cost increase due to industry oversupply. It recorded a pretax loss of RM9.12m in 1HFY17 from a PBT of RM3.48m in 1HFY16.

- The capacity in the **beverage division (contract packing)** expanded in FY16 in anticipation of higher demand from customers and to cater for different packing configurations. However, its turnover contribution to the group is not significant.

- With the setting-up of the trading division, KJCF is taking a more aggressive and concerted effort in pursuing export markets.

- KJCF is in the midst of setting up a similar operation (encompassing tin cans, aluminium cans, corrugated cartons and contract packing) in **Myanmar**. It had acquired two pieces of industrial land in Thilawa Special Economic Zone. As at end-FY16, KJCF had invested US$23.5m in the equity of the Myanmar entities. Additionally, it will incur another RM350.0m to set up both manufacturing plants and production facilities in Myanmar.

  The construction work is currently in progress and the new plants are expected to commence operations in 2QFY18. KJCF intends to leverage on the existing customer base in Malaysia and Vietnam to kick start its operations in Myanmar. Demand for tin cans, aluminium cans and corrugated carton boxes are anticipated to increase when the growth momentum in Myanmar gathers pace. Longer-term, it intends to replicate its business model in Malaysia in Myanmar by having the production facilities of tin can, carton box and contract packing serving the customers there. As this is a greenfield investment in a new country, the gestation period for a meaningful contribution will take even longer.

- Profitability will remain challenging against the backdrop of rising raw material prices. The cost pressures will still persist, as commodity prices have swung back up since early-16. Based on the prices extracted from London Metal Exchange (LME), aluminium price increased by 17% to around US$1,700/mt in 2016. In 2017, it has since risen by another 20% to US$2,100. Tinplate is made of steel plates coated with tin. As such, the cost of tin plates is influenced by the steel price in the international market. Since 2HCY16, tin plate prices have been on an increasing trend. The cost of paper rolls, Paper which are the main raw material used in the production of cartons boxes, increased by 7% to 10% on average in 2016, and has remained at elevated price level in 2017.

  Although there is a cost pass-through mechanism in place with its MNC customers, there is always a time lag in implementation of selling price increases. The rising cost can be partially mitigated by the continuous improvement in operational efficiency.

7. Balance Sheet

RMm	FY12	FY13	FY14	FY15	FY16
PPE	657.23	731.18	874.66	1,005.63	1,268.36
Other LT assets	23.25	65.77	87.10	102.63	17.71
Current Asset	678.65	731.23	748.58	923.42	990.94
Current Liabilities	220.10	276.56	329.78	453.60	549.71
LT Liabilities	109.30	150.12	173.99	202.60	222.63
Shareholders' Funds	**970.90**	**1,037.45**	**1,138.90**	**1,295.07**	**1,422.44**
MI	58.82	64.04	67.66	80.41	82.23
Total cash and cash equivalent	133.68	146.38	123.41	198.91	150.45
Total borrowings	(182.64)	(232.99)	(302.35)	(395.65)	(468.52)
Net cash	**(48.96)**	**(86.60)**	**(178.95)**	**(196.74)**	**(318.07)**
Net gearing	**5.0%**	**8.3%**	**15.7%**	**15.2%**	**22.4%**
Capex	70.45	126.72	201.33	191.11	338.13
EBITDA	199.55	195.80	191.02	242.45	249.51

- Construction of new production line typically requires high capex. In FY16, KJCF spent in total RM169.41m in capex in the construction of two new production lines for aluminium cans and new plant and machinery for cartons division in Malaysia and Vietnam. The maintenance capex in spare parts also amounts to around RM25m p.a.

- Despite the high capex requirement, KJCF should still remain in a healthy balance sheet position thanks to its strong EBITDA. As at end-FY16, its net gearing ratio remains at comfortable 0.22x. Its gearing is expected to expand further due to the investment RM350.0m for setting up of manufacturing plants and facilities in Myanmar in FY17-18. However, it is expected to hold around 0.3-0.4x due to its strong operational cash flow generation.

- As at end-FY16, its book value stood at RM3.20/share.

8. Dividend

	FY12	FY13	FY14	FY15	FY16
Interim (sen)	2.50	-	-	-	-
Final (sen)	2.50	2.50	-	2.00	4.00
Special (Interim and final) (sen)	7.50	3.75	-	-	-
Total net dividend (sen)	**12.50**	**6.25**	**-**	**2.00**	**4.00**
Net dividend (RMm)	55.52	27.76	-	8.88	17.77
Dividend payout (%)	46%	23%	0%	7%	14%

- The Group does not adopt any dividend policy. In FY16, its total dividend of 4.0 sen/share translates into a net yield 1.3%.

9. Recent Developments

- On 20-Jul-16, an indirect wholly-owned KJ TOGO Pte Ltd (KJ TOGO) was incorporated. The intended principal activity of KJ TOGO is investment holding. Subsequently on 11-Nov-16, KJ Togo incorporated a wholly-owned subsidiary in Malaysia, KJ Togo (Malaysia) Sdn Bhd (KJ TGM). The intended principal activity of KJ TGM is the manufacturing and distribution of aluminium cans and bottles.

- On 23-Sep-16, KJCF entered into a MOU with Togo (Hong Kong) Industries Limited (THKIL) for THKIL to potentially invest 30% in the equity of KJ TOGO, which will be the JV vehicle for the manufacture and distribution of different types of aluminium bottles for beverages in some Asian countries using advanced technology which THKIL holds the license.

- On 16-Aug-16, 55%-owned Box-Pak (Malaysia) Bhd (Box-Pak) announced a proposed rights issue with warrants on the basis of 1 Right share for 1 existing share together free detachable warrants on the basis of 1 Warrant for every 4 Rights shares subscribed. Subsequently, pricing for the rights issue and the exercise of the warrants were fixed at RM1.89/share and RM2.04/share respectively. The proceeds amounting to RM113.45m are intended for business expansion in Malaysia, business venture in Myanmar and repayment of short term bank borrowings and working capital. The rights issue with warrants was completed on 21-Mar-17.

10. Key Investment Risks

- KJCF's profitability is exposed to **forex risks** as its direct materials such as tin plates, aluminium coils and paper rolls are directly and indirectly denominated in US$. The risk exposure is partially offset by export proceeds, and the residual risks are managed by entering into forward contracts.

- Profitability is impacted by the **price of commodities**. The main cost components for the manufacture of tins cans, aluminium cans and cartons are the cost of tin plate (65-70% of cost of production), aluminium coils (70-80%) and paper rolls (65-70%). Hence, the rising prices could adversely affect its profit margin if input cost increase could not be passed-on.

- To a certain extent, KJCF is exposed to **supplier risk**. For tin plate, there is only one single supplier of tin plates in Malaysia and Vietnam, which is Perusahaan Sadur Timah Malaysia Berhad (Perstima). However, the importation of tin plates to Malaysia and Vietnam is permissible subject to import duty. Any petition by Perstima for anti-dumping protection against imports would increase the material cost if the anti-dumping petition is successful. The paper rolls are sourced locally by the Malaysian and Vietnam entities and the supply is usually controlled by a few integrated corrugated cartons manufacturers.

11. Valuation and Recommendation

- KJCF is uniquely positioned to offer one-stop packaging solutions to the requirements of customers. We like KJCF for its established business track record, market-leading position in an oligopolistic market structure, operational scale and technology advancement in production as well as its regional presence.

- Longer-term growth prospects are well underpinned by planned expansion programmes and strategies:-

    - The addition of two new production lines in aluminium cans division in FY16. As an indication, its previous four production lines generated a turnover of RM537.10m in FY15. Upon attaining optimum production run-rate, its six production lines of aluminium cans division could potentially achieve a turnover of RM800m;
    - More aggressive push into export markets; and
    - Expansion into Myanmar.

- However, for the immediate FY17-18, its profit performance will still be adversely affected by rising costs of raw materials, weak pricing power amidst the current weak consumer sentiment, higher depreciation costs and finance charges associated with capacity and Myanmar expansion. These initiatives would only deliver meaningful positive impact from FY19 onwards.

- We initiate coverage with a Hold recommendation and a target price of RM3.20. In deriving our target price, we have pegged valuations to its book value of RM3.21.

Share price chart of KJCF

Disclosures/Disclaimer

Investment ratings:
Buy (generally >10% upside over the next 12 months)
Hold (generally negative 10% downside to positive 10% upside over the next 12 months)
Sell (generally >10% downside over the next 12 months)

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