Seng Fong Holdings Berhad

Capacity expansion to drive growth

Summary

- **Largest natural rubber exporter in Malaysia, commanding c.15.0% of the total market share based on FY23 revenue of RM922.4m.**
- **Earnings are expected to grow exponentially in subsequent years, driven capacity and margin expansions.**
- **We initiate coverage on Seng Fong with BUY recommendation, based on a target price of RM1.90, representing a potential upside of 63.8% from the current share price, by pegging a multiple of 19.0x on the FY26F EPS forecast.**

Group Background

- Seng Fong Holdings Berhad, the largest natural rubber exporter in Malaysia's rubber processing industry, is headquartered in Malaysia. Established in 1989, the Group has grown and evolved into a leading manufacturer and exporter of processed natural rubber.

- The Group went public on the main market of Bursa Malaysia in 2022 and currently has a market capitalisation of more than RM800.0m.

- The Group principally engages in processing of cup lump into block rubber and sold directly to customers, majority of which are tyre manufacturers, and also sold to international rubber traders.

- Currently the Group is operating three factories all located in Gemas, Negeri Sembilan with a total production floor space of approximately 319k sqf and focused onto production of Standard Malaysia Rubber (SMR) grades rubbers.

- The Group operates as an export-oriented business. After obtaining an export license for block rubbers in 1989, Seng Fong successfully expanded into various international markets. Export sales now contribute 100.0% of the Group's revenue, with customers primarily located in China, Hong Kong, Singapore, and Taiwan.

- The Group's current capacity has reached approximately 180,000 metric tonnes (MT), a significant jump from 3,000MT in 1986 and 142,000MT at the time of listing in 2022.

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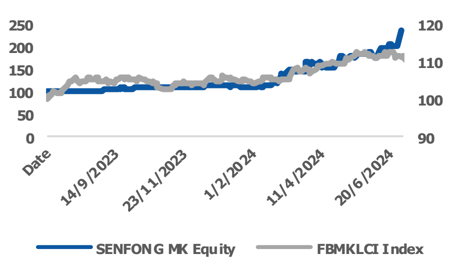
Recommendation:	**BUY**
Current Price:	**RM 1.16**
Previous Target Price:	**N/A**
Target Price:	**RM 1.90**
Upside/Downside:	**63.8%**

Stock information	
Board	MAIN
Sector	Industrial
Bursa / Bloomberg Code	5308 / SENFONG MK
Syariah Compliant	Yes
FTSE4Good Index	No
FTSE ESG Rating	N/A
Bloomberg ESG Rating	N/A
Shares issued (m)	721.7
Market Cap (RM' m)	837.1
52-Week Price Range (RM)	0.506-1.25
Beta (x)	0.5
Free float (%)	17.5
3M Average Volume (m)	3.2
3M Average Value (RM' m)	2.9

Top 3 Shareholders	**(%)**
Sumber Panji Sdn Bhd	59.2
E Tak Bin	7.6
Ambank M Bhd	3.0

Share Price Performance



	1M	**3M**	**12M**
Absolute (%)	35.7	43.2	124.2
Relative (%)	35.7	37.8	92.0

Gemas plant

Source: Seng Fong

Corporate Structure

Source: Seng Fong

Business Overview

- Seng Fong's core business revolves around the production and processing of natural rubber into block rubbers, which are then sold to their customers. Their main products include SMR grade rubber and Premium Grade block rubber.

- SMR block rubbers meet the technical specifications of the SMR Scheme as determined by the Malaysian Rubber Board (MRB). Premium Grade block rubbers are derivatives of SMR, containing the technical specifications of SMR grades but with additional value-added features.

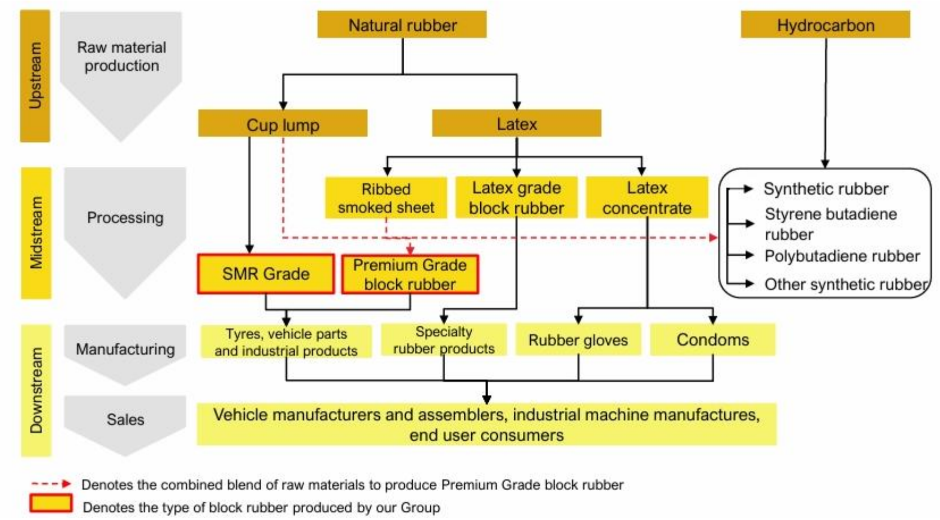
- Block rubber is processed using cup lump as the raw material. SMR grade rubber boasts high resistance to tearing and fatigue, high tensile strength, and low heat accumulation. Seng Fong sources cup lump and semi-processed rubber from both domestic and international rubber traders. Cup lump is obtained when fresh latex is extracted by tapping a long cut in a rubber tree, allowing the latex to drip into a plastic cup.

Raw material – Cup Lump

Source: Pinterest

- The block rubber produced by Seng Fong is sold directly to their customers, the majority of whom are tyre manufacturers and international rubber traders.

Seng Fong's Production Process



Source: Seng Fong

Source: Seng Fong

Products

SMR Grade Block Rubber

Source: Seng Fong

- SMR block rubbers adhere to the technical specifications outlined by the MRB. SMR are made from 100.0% natural rubber and are known for their high resistance to tearing and fatigue, exceptional tensile strength, and low heat accumulation.

- Current SMR Grades available include SMR5, SMRGP, SMR10CV, SMR10, SMR20CV, and SMR20, each characterized by distinct technical parameters and properties.

- SMR is produced by processing cup lump through a series of steps including pre-treatment for size reduction and removal of dirt in the wet processing line. The granular-sized cup lump is then dried and compressed into solid rubber blocks in the dry processing line, with standard dimensions of 330 mm by 670 mm by 170 mm, as specified by the MRB. Each block typically weighs approximately 33 kg to 35 kg.

Premium Grade Block Rubber

Source: Seng Fong

- Premium Grade block rubber is customised by blending additional components into SMR Grade based on customer specifications, resulting in unique properties and compositions. Unlike SMR, Premium Grade is not regulated by the MRB. Value added revolves around addition of specialised additives that ensure consistent properties, such as a narrow range of Mooney Viscosity.

- Seng Fong manufactures various Premium Grade block rubbers, including MSSR(RSS)-P and CRUCB, which are tailored to meet specific customer requirements. The demand for these rubbers is driven by downstream manufacturing benefits for customers, such as cost savings and reduced processing time. As a result, Premium Grade block rubber typically commands a price premium of around 2-3% compared to SMR Grade.

Customers

Source: Seng Fong

- As an export-oriented Group, Seng Fong holds the largest market share in Malaysia's rubber export sector, commanding c.18.0% of the total market share based on FY23 revenue of RM922.4m.

- Seng Fong's top 5 customers are primarily tyre manufacturers and rubber trading companies based in China, Hong Kong, Taiwan, and Singapore. These include Wanli Group International (tyre manufacturer), General Science (tyre manufacturer), XHY Tyre (tyre manufacturer), R1 International (rubber trader), and Westwater Group (rubber trader).

- Collectively, these top 5 customers contributed approximately 75-80% of Seng Fong's total revenue over the years.

Cost Plus model

- As a natural rubber processor, Seng Fong earns processing fees on SMR grade rubber. The Group employs a cost-plus model, allowing to pass on all production costs, including raw materials and freight costs, to customers.

Industry Overview

- Seng Fong operates within the block rubber processing industry, positioned in the midstream of the rubber industry value chain. The Group procure raw materials, blend and process them into block rubber, which is then sold to manufacturers of tires, vehicle parts, and industrial rubber goods.

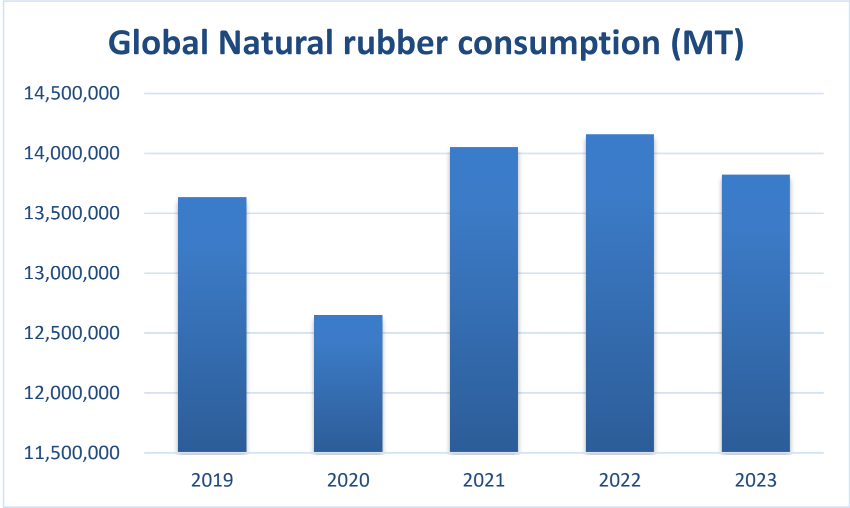
- Annually, Malaysia exports 70-80% of total domestic natural rubber production, with key destinations including China, India, and the US.

- According to the Malaysian Rubber Council, Malaysia ranks among the top 5 natural rubber exporters globally, following Thailand, Vietnam, Indonesia, and Cote d'Ivoire.

Source: Malaysian Rubber Council, Apex Securities

- In 2024, we anticipate an increase in export volumes, driven by strong figures observed over the first five months. This recovery is aligned with the resurgence in global manufacturing activities, particularly from China.

- On the back of the envelop calculation, Seng Fong held a 15% market share based on total production of SMR grade rubber in 2023 against the total exports of natural rubber in Malaysia during the year. We have gathered that management guided that the Group commands c.18% market share, solidifying its position as the largest natural rubber exporter in the country.



Source: Malaysian Rubber Council, Apex Securities

- In 2023, global rubber consumption experienced a decline, reflecting the sluggish global economic conditions.

- The top three consumption countries of natural rubber in 2023 were China (5.9m MT), India (1.4m MT), and Thailand (1.0m MT). These countries are among the top automotive manufacturers globally.

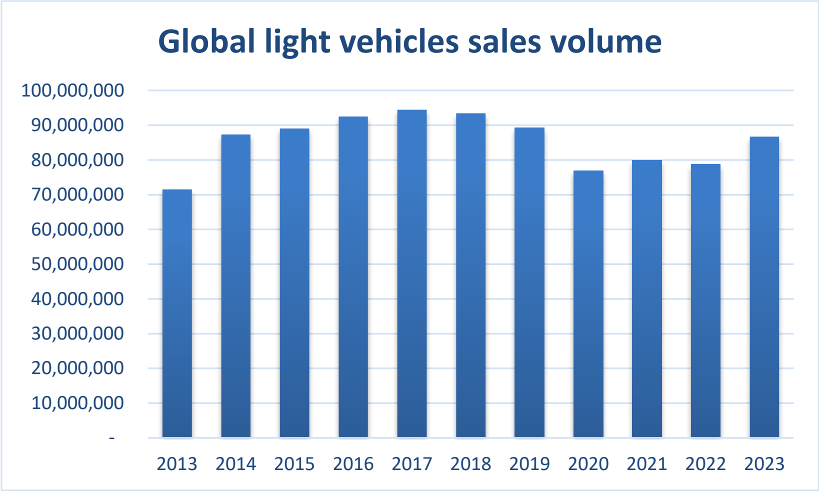
Automotive and Tyre manufacturing industry

- Approximately 70.0% of global natural rubber is utilised in the manufacturing of vehicle tires, making block rubber a crucial raw material driven by the global automotive industry.

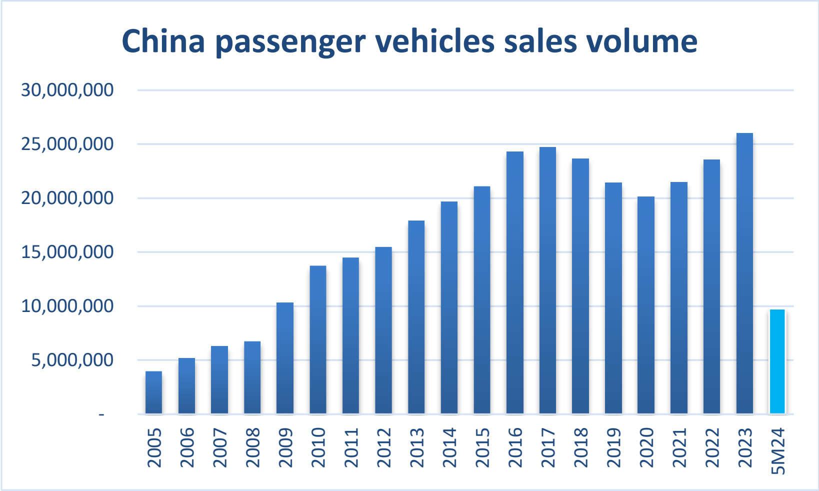
- While synthetic rubber is also used in tyre manufacturing alongside natural rubber, channel checks indicates that it cannot fully replicate the unique properties of natural rubber. Natural rubber, specifically cis-1,4-polyisoprene, contributes to high molecular weight, providing high tensile strength and low heat buildup.

- The rollout of electric vehicles (EVs) is expected to increase demand for tire replacements. EV tires experience approximately 20% faster wear and tear as compared to tyres used in internal combustion engine vehicles due to high instant torque of electric vehicles.

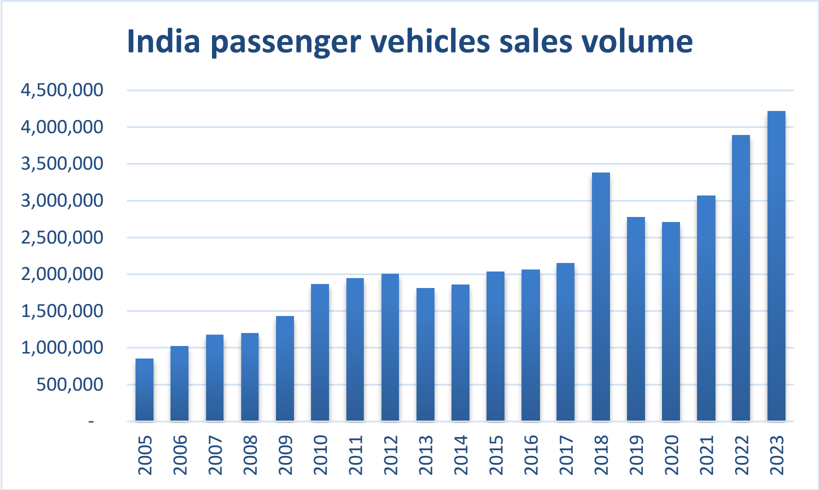
Selected countries vehicles sales data



Source: Bloomberg, Apex Securities



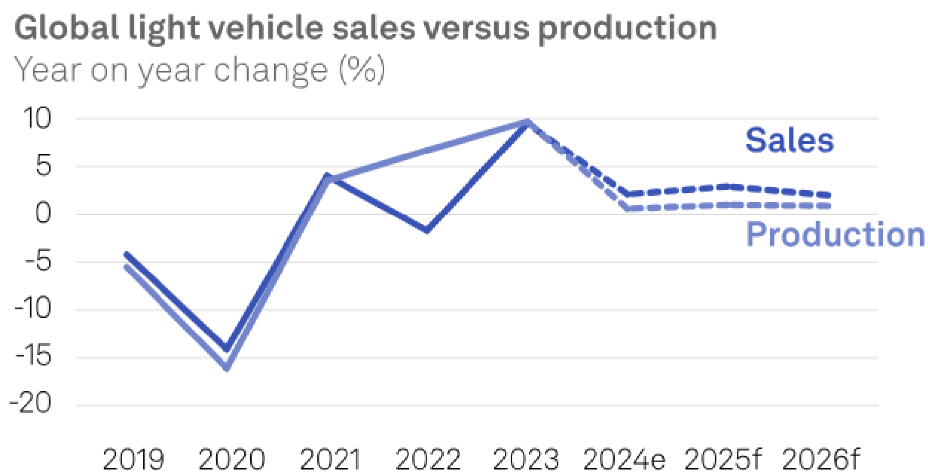
Source: Bloomberg, Apex Securities



Source: Bloomberg, Society of India Automotive Manufacturers, Apex Securities

- Seng Fong primarily supplies their products to tire manufacturing industries in China and India, both of which are the largest consumers of natural rubber globally. Above figures highlights automotive sales gradually grow over the year, indicating resilient demand worldwide.

- According to S&P Global, global light vehicle sales are projected to continue growing steadily at low single-digit rates in 2024E, 2025F, and 2026F. Growth is supported by expansion of markets in Southeast Asia and India.



Source: S&P Global

Investment Highlights

- **Largest natural rubber exporter in the country with strong track record of capacity expansions.** As the largest natural rubber exporter in Malaysia with c. 18.0% market share of total Malaysia's natural rubber exports, Seng Fong has a strong track record of capacity expansions. Since their IPO debut in 2022, the Group increased production capacity from 142,000MT/pa to the current 190,000 MT/pa. The expansion exceeds the capacity expected during IPO (166,000MT/pa) in view of the rising demand. To support growth, Seng Fong has added more manpower and introduced additional working shifts, extending production hours to 18 hours/day.

- **Capacity expansion remains a priority.** Going forward, Seng Fong are installing the Smart Rubber Manufacturing Equipment systems and expected to be fully installed by 3Q2025, we expect the capacity gradually increasing following an initial buffer period after system introduction. By 2030, the Group anticipates reaching a capacity of 250,000MT/pa, marking a 31.6% rise from the current capacity. In addition to automation, we envisage Seng Fong will be expanding capacity through acquisitions of land, production lines, or horizontal acquisitions to meet growing demands and enhance market share. Demand for Seng Fong's products remained robust, with a utilization rate exceeding 85.0% in recent years even after increasing production hours and securing new customers.

- **Margins expansions**. Seng Fong operates on a cost-plus model, allowing them to pass all production costs, including raw materials and freight costs onto customers to maintain stable margins. Additionally, the Group anticipates margin expansion through reduced overhead costs. To achieve this, Seng Fong has implemented solar and biomass systems to support operations, expecting to save RM5.4m annually with approximately 50-60% cost savings compared to previous expenditures. Additionally, the Group is in the process of replacing production processes with Smart Rubber Manufacturing Equipment systems across all three factories. This automation initiative integrates intelligent technology, digital control over existing processing lines, and incorporates robotic arms and automated guided vehicles. As a result, manual labor is expected to decrease by half, saving approximately RM1.5m in net costs from automation efforts.

- **Ride onto growth of China.** Seng Fong stands to benefit significantly from developments in its two largest consumer markets, China and India. China, a major global producer and consumer of tyres, is poised for healthy growth driven by economic recovery and advancements in electric vehicle (EV) technologies. The increasing adoption of EVs in China is expected to lead to a gradual shift from Internal Combustion Engine (ICE) vehicles to EVs, driving up demand in the tire market due to higher vehicle production rates. Transition to EVs also necessitates more frequent tyre replacements, as EV tyre wear out approximately 20% faster than those of ICE vehicles. The accelerated wear-out is attributed to quick torque application and the heavier mass of EV batteries, which increase tyre scrubbing and road abrasion, thereby shortening tyre lifespan. Additionally, according to several independent forecasts, one of Seng Fong's largest customers, General Science, is expected to demonstrate promising earnings growth prospects amidst economic recovery and expansion of market share. This underscores the positive outlook for Seng Fong, poised to capitalise onto growing demand and evolving market dynamics in both China and India.

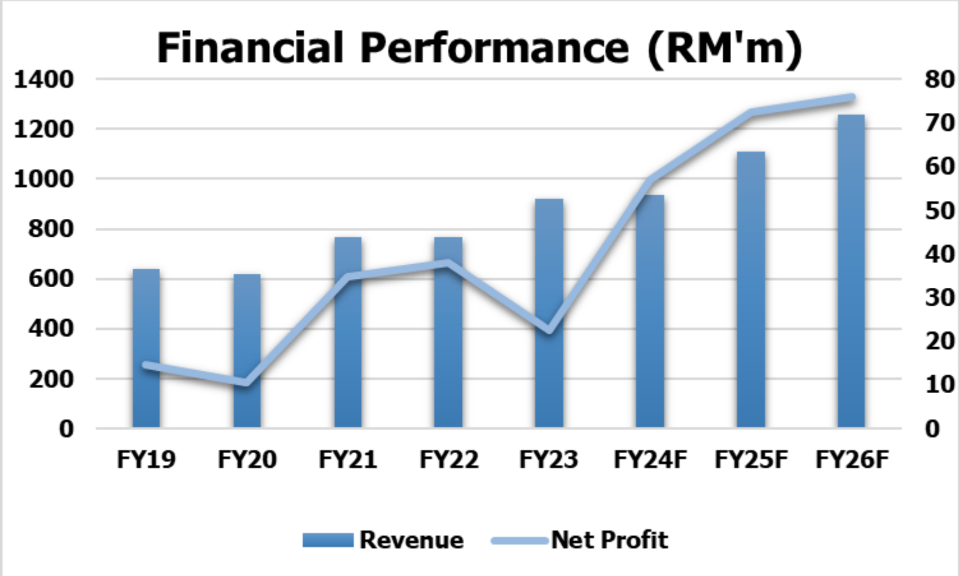
- **India automotive market growth.** Meanwhile, the Indian market is also one of Seng Fong's top customers, where the automotive sector shows strong prospects driven by economic growth and the development of highway infrastructure. The Indian government aims to expedite the construction of national highways to achieve a world-class road network by 2037, increasing the length of national highways from the current 146,000km to over 200,000km. This infrastructure development aligns with the prospects of automotive industry riding on the modernization and urbanisation trends, resulting in robust demand for tyres in India.

- **Quarterly dividend.** The Group maintains a dividend policy of distributing 50.0% of Profit After Tax (PAT) to shareholders, paid out on quarterly basis. Looking ahead, our dividend forecast indicates a yield of approximately 4.0-5.0% based on the current share price.

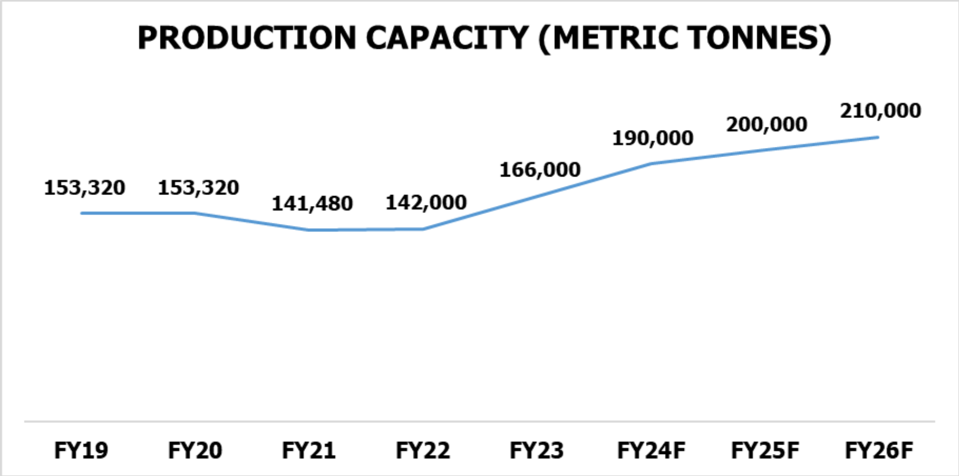
- **Huge untapped market.** Seng Fong current operations accounts to approximately 1%-2% of the total global natural rubber consumption of more than 13.5m MT in 2024, implying a large untapped market. Moving forward, we are optimistic about the Group's ability to capture additional market share by securing new customers and increasing capacity.

- **Cost plus approach to mitigate risks.** Seng Fong adopts a cost-plus approach in their sales strategy, allowing them to pass on all production costs, including raw materials and freight costs to customers. This strategy helps the Group mitigate risks associated with fluctuations in commodity prices and logistics costs.

Financial Highlights



Source: Seng Fong, Apex Securities



Source: Seng Fong, Apex Securities

- Over the past few years, the Group's financial performance closely mirrored their capacity expansion, demonstrating a close positive correlation between operation and financial performance. However, in FY23, the Group faced margin challenges primarily due to the high US interest rates environment, resulting in losses from forex hedge instruments. Additionally, increased minimum wages for workers posed challenges, with the inability to immediately pass these costs on to customers due to locked contracts (typically ranging from 6 to 12 months) impacted margins.

- Looking ahead, we anticipate a growth in Seng Fong's financial performance, driven by higher sales and margin expansions facilitated by capacity expansion. The Group also expects reduced forex risk with potential cuts in US interest rates. Moreover, lower overhead costs from utilising solar and biomass power systems, alongside reduced manpower requirements through automation, are expected to further bolster profitability.

Peers Comparison

Company	Market Group	FYE	Price (RM)	Market Cap (RM 'm)	P/E (x) FY23	P/E (x) FY24F	Gross DY (%)	Revenue RM 'm	Net Income RM 'm
Seng Fong Berhad	**MAIN**	**Jun**	**1.16**	**837.1**	**19.1**	**12.2**	**2.8%**	**937.0**	**22.6**
Hwa Fong Rubber Thailand PCL	Thailand	Dec	0.57	376.5	12.1	8.4	0.9%	393.8	31.2
Inoue Rubber Thailand PCL	Thailand	Sep	1.73	333.2	11.1	15.2	0.4%	701.5	30.1
Sri Trang Agro Industry PCL	Thailand	Sep	2.76	4232.3	N/A	14.2	0.5%	11009.1	-111.3
PT Kirana Megatara Tbk	Indonesia	Dec	0.06	485.0	N/A	N/A	N/A	2844.3	-58.4
Avg ex-Seng Fong Berhad					**11.6**	**12.6**	**0.0**	**3737.2**	**-27.1**

Source: Bloomberg, Apex Securities

- We gathered that there are no direct peers listed on Bursa Malaysia. Selected regional peers are trading at forward P/E of 12.6x is close to current valuations of Seng Fong.

Valuation & Recommendation

- We initiate coverage on Seng Fong and assigned a **BUY** recommendation with a fair value of **RM1.90**, based on a Price/Earnings (P/E) multiple of 19.0x pegged to FY26F EPS forecast. The P/E ratio is aligned with the Bursa Industrial Production industrial index, which is currently trading at a 19.0x 2-year forward P/E ratio. While the assigned P/E ratio is at a premium against selected regional peers, we reckon that it is justifiable premised to Seng Fong's stability in financial track record, potential robust earnings growth potential, leveraging onto automation processes as well as decent dividend yield projections.

- Based on our assigned target price of RM 1.90, this represents a potential upside of 63.8% from the current share price of RM1.16.

Key Risks

- **Slower than expected on expansions**. Our growth projections hinge on steady and healthy capacity expansions facilitated by the automation systems being installed in this and coming years. Any delays or operational challenges with the automation could potentially impact Seng Fong's ability to meet our earnings forecasts.

- **Forex exchange risk.** As an export-oriented Group, Seng Fong's sales and purchases are primarily denominated in USD. While the Group employs a hedging strategy to mitigate forex exchange risks, fluctuations in exchange rates can still have adverse effects, potentially resulting in financial instrument losses.

Financial Highlights

Income Statement

FYE Jun (RM m)	FY22	FY23	FY24F	FY25F	FY26F
Revenue	**768.2**	**922.4**	**937.0**	**1110.8**	**1258.8**
Gross Profit	**73.9**	**82.7**	**66.6**	**108.9**	**132.2**
EBITDA	**53.9**	**34.5**	**79.9**	**100.0**	**105.2**
Depreciation & Amortisation	-2.4	-2.6	-3.3	-4.4	-4.8
EBIT	**51.6**	**32.0**	**76.6**	**95.7**	**100.5**
Net Finance Income/ (Cost)	-1.5	-4.8	-6.4	-6.3	-6.7
Associates & JV	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**50.0**	**27.2**	**70.2**	**89.3**	**93.8**
Tax	-12.0	-4.6	-13.3	-17.0	-17.8
Profit After Tax	**38.0**	**22.6**	**56.9**	**72.4**	**76.0**
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	**38.0**	**22.6**	**56.9**	**72.4**	**76.0**
Exceptionals	0.0	0.0	0.0	0.0	0.0
Core Net Profit	**38.0**	**22.6**	**56.9**	**72.4**	**76.0**

Key Ratios

FYE Jun (RM m)	FY22	FY23	FY24F	FY25F	FY26F
EBITDA margin	7.0%	3.7%	8.5%	9.0%	8.4%
EBIT margin	6.7%	3.5%	8.2%	8.6%	8.0%
PBT margin	6.5%	2.9%	7.5%	8.0%	7.5%
PAT margin	5.0%	2.5%	6.1%	6.5%	6.0%
NP margin	5.0%	2.5%	6.1%	6.5%	6.0%
Core NP margin	5.0%	2.5%	6.1%	6.5%	6.0%
Dividend yield	1.8%	3.1%	4.3%	4.6%	4.6%
ROE	34.3%	13.2%	26.9%	29.7%	27.5%
ROA	14.5%	7.1%	15.3%	17.4%	16.6%
Net gearing	73.1%	15.0%	0.3%	18.0%	17.5%

Key Assumptions

FYE Jun (RM m)	FY22	FY23	FY24F	FY25F	FY26F
Production capacity (MT)	142,000	166,000	190,000	200,000	210,000
Utilization rate	85%	85%	88%	89%	89%

Valuations	FY26F
Core EPS (RM)	0.100
P/E multiple (x)	19.0
Fair Value (RM)	**1.90**

Source: Company, Apex Securities

Balance Sheet

FYE Jun (RM m)	FY22	FY23	FY24F	FY25F	FY26F
Cash	8.9	105.2	136.8	100.3	103.0
Receivables	74.0	77.4	91.3	103.5	108.6
Inventories	130.1	85.6	89.4	140.2	169.1
Other current assets	0.0	2.2	1.7	1.9	2.0
Total Current Assets	**212.9**	**270.5**	**319.2**	**345.8**	**382.7**
Fixed Assets	42.3	42.9	46.9	62.7	68.5
Intangibles	4.5	6.7	6.7	6.7	6.7
Other non-current assets	2.3	0.0	0.0	0.0	0.0
Total Non-current assets	**49.1**	**49.6**	**53.6**	**69.4**	**75.2**
Short-term Debt	83.7	126.0	132.3	138.9	145.9
Payables	53.0	9.6	13.7	14.7	15.8
Other Current Liabilities	0.0	3.5	2.0	2.3	2.4
Total Current Liabilities	**139.5**	**139.1**	**150.0**	**158.2**	**166.4**
Long-term Debt	6.2	4.8	5.1	5.3	5.6
Other non-current liabilities	5.5	5.2	6.1	8.0	9.3
Total Non-current Liabilities	**11.7**	**10.0**	**11.2**	**13.3**	**14.9**
Shareholder's equity	110.9	171.0	211.7	243.7	276.7
Minority interest	0.0	0.0	0.0	0.0	0.0
Total Equity	**110.9**	**171.0**	**211.7**	**243.7**	**276.7**

Cash Flow

FYE Jun (RM m)	FY22	FY23	FY24F	FY25F	FY26F
Pre-tax profit	**50.0**	**27.2**	**70.2**	**89.3**	**93.8**
Depreciation & amortisation	2.4	2.6	3.3	4.4	4.8
Changes in working capital	-26.7	-0.6	-12.6	-61.5	-32.9
Others	-9.9	-6.6	-11.6	-15.2	-16.7
Operating cash flow	**15.7**	**22.4**	**49.3**	**17.0**	**49.0**
Net capex	-13.1	-3.6	-7.2	-20.1	-10.6
Others	-2.3	0.1	0.1	0.1	0.1
Investing cash flow	**-15.5**	**-3.5**	**-7.1**	**-20.0**	**-10.5**
Dividends paid	-15.0	-25.9	-38.1	-40.3	-43.0
Others	10.2	102.4	28.4	6.9	7.2
Financing cash flow	**-4.8**	**76.5**	**-9.7**	**-33.5**	**-35.8**
Net cash flow	**-4.6**	**95.4**	**32.5**	**-36.5**	**2.7**
Forex	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
Beginning cash	13.5	8.9	104.3	136.8	100.3
Ending cash	**8.9**	**104.3**	**136.8**	**100.3**	**103.0**

APEX SECURITIES BERHAD – CONTACT LIST

APEX SECURITIES BHD

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Azfar Bin Abdul Aziz (ext 2031)
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Institutional Dealing Team:

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General Line: (603) 7620 1118

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Jayden Tan (ext 2069)
Chelsea Chew (ext 2070)
Tan Sue Wen (ext 2095)

RESEARCH RECOMMENDATION FRAMEWORK

STOCK RECOMMENDATIONS
BUY: Total returns* are expected to exceed 10% within the next 12 months.
HOLD: Total returns* are expected to be within +10% to – 10% within the next 12 months.
SELL: Total returns* are expected to be below -10% within the next 12 months.
TRADING BUY: Total returns* are expected to exceed 10% within the next 3 months.
TRADING SELL: Total returns* are expected to be below -10% within the next 3 months.
*Capital gain + dividend yield

SECTOR RECOMMENDATIONS
OVERWEIGHT: The industry defined by the analyst is expected to exceed 10% within the next 12 months.
NEUTRAL: The industry defined by the analyst is expected to be within +10% to – 10% within the next 12 months.
UNDERWEIGHT: The industry defined by the analyst, is expected to be below -10% within the next 12 months.

DISCLAIMER