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ACE-bound Heng Huat goes further downstream to boost margins

Group wants to produce more value-added products to increase its profits

by **Wei Lynn Tang**
FD@bizedge.com

PENANG: Penang-based Heng Huat Resources Group Bhd is seeking to expand further downstream to produce better value-added products made of oil palm empty fruit bunches (EFB) as well as coconut husks to improve its profit margins.

The group, which is looking to list on the ACE Market, is launching its prospectus today.

Heng Huat processes coconut husks and oil palm EFB into biomass or long fibre for industrial use. It also turns these fibres into value-added products such as coconut fibre sheet — which serves as the raw material for mattress and cushion sheet — and palm briquette — an alternative for firewood. This segment contributes 70% to group revenue.

The group's downstream segment, in the manufacturing of mattresses, contributes the remaining 30% of revenue. This involves the manufacturing of mattresses and bedding accessories under its own brands: Fibre Star and Xiong Mao, utilising the very coconut fibre sheet it produces.

H'ng (right) with Kee at Heng Huat's office in Penang last Friday. The group, which is looking to list on the ACE Market, is launching its prospectus today.

In an interview with *The Edge Financial Daily*, Heng Huat's management shared that the group aspires to expand beyond just being a manufacturer of raw materials.

"We started from raw materials (long fibre), and will still treat this as our core. But now we want to produce more value-added products to increase our profits and margins," said managing director H'ng Choon Seng.

"An area of growth is in EFB, where we can develop and produce geotextile products such as palm fibre mat, for application in the plantation industry," H'ng said.

Kee Swee Lai, deputy managing director, explained that palm fibre mat, which is biogradeable, is able to protect the slopes from erosion while allowing vegetation to flourish.

"A lot of plantations need this; it's just a matter of what raw materials are used to make it. We use biomass; our palm fibre mat is biodegradable and will not harm the soil. Plus, it's able to save labour costs as fewer people are needed to manage the plantation [trees]," he said.

Kee noted that with re-plantations done every year, there is a huge market for geotextile products in Malaysia, and the group seeks to educate the planters on this.

The group targets to commercialise its geotextile products by the end of this year.

Meanwhile, the group is also upbeat on palm briquette, which it started selling to China (to manufacturing companies, power plants, and boilers) about a year ago. Currently, palm briquette only contributes 2.5% to group revenue, but the group foresees a huge potential in this.

Kee explained that from an EFB, 30% to 35% is extracted for long fibre use, while 48% to 50% is waste product of soft fibres. Heng Huat is utilising this "waste" to produce palm briquettes, which serve as an alternative and green fuel to substitute conventional fuels such as coal.

"There is no waste in our production of fibre and value-added products as you can see," he noted.

Established in 2007, Heng Huat started off manufacturing coconut fibre and coconut peat before venturing into oil palm fibre, primarily due to the unstable supply of coconuts.

"We are the pioneer in this integrated biomass material business model, where we have both upstream and downstream activities," said executive director Lim Ghim Chai.

Heng Huat currently has two coconut fibre production lines in Kelantan and 18 oil palm EFB fibre production lines in Kedah and Penang, with a total monthly production capacity of 546 tonnes of coconut fibre and 7,254 tonnes of oil palm EFB fibre respectively.

Lim said Heng Huat has a 47.4% share of the Malaysian market, based on its revenue from purely coconut and EFB fibre, and excluding other value-added products last year. Based on industry report, the Malaysian biomass material market is expected to grow at a compounded annual growth rate (CAGR) of 14.3% from 2013 to 2018.

Lim said Heng Huat's revenue has achieved a CAGR of more than 15% for the past three years. "However, gross profits had been flat as production cost rises every year, especially labour and energy costs," he said.

"But we try to be more cost-effective, and as such we try to produce our energy using our own soft fibre to generate steam [to power the generator]," he added.

For the financial year ended Dec 31, 2013, Heng Huat's net profit stood at RM9.7 million, on revenue of RM73.7 million, indicating a net margin of 13.2%.

According to the company, its listing proceeds will be mainly allocated for working capital and the repayment of bank borrowings.

According to Lim, the group has resorted to borrowings to fund its capital expenditure (capex) — RM56 million in the last three years.

"As such, part of our listing proceeds would be to repay bank borrowings. Post-listing, our gearing ratio is expected to reduce from 0.84 times [as at end of last year] to 0.5 times. And we seek to maintain it at this level [of 0.5 times]," he said.

"Moving forward, I do not think we need to spend such a big amount in capex anymore," he added.

The promoters of Heng Huat, led by H'ng, are expected to still hold up to 70% of the group post-initial public offering, with the remaining as free float.