

23 March 2018

Consumer Non-cyclical | Packaging

## Scientex

**Neutral** (Maintained)

Target Price: MYR8.69

Price: MYR8.12

Market Cap: USD1,011m

Bloomberg Ticker: SCI MK

### Twin Engines Powering Growth

Scientex's prospects would be supported by both of its operating divisions. The capacity expansion and ramp-up in utilisation rate should support manufacturing sales, and the resulting economies of scale ought to help expand its profit margins. Meanwhile, the property development business is expected to stay solid, given its strategy to focus on affordable housing. The recent proposed acquisition of KHPI is likely to expand Scientex's capacity by c.30%, and provide synergistic benefits from operational efficiencies and a larger customer base. The acquisition is expected to be completed by May. Its 1HFY18 results were below expectations due to the overly-optimistic assumption of the ramp-up in new production capacity. Post results, we trim FY18-20F net profits by 5-6%. Correspondingly, our SOP-derived TP is revised down to MYR8.69 (from MYR9.07, 7% upside). Reiterate NEUTRAL, as we believe the current valuation has priced in most of the positives.

**Results below expectations.** Scientex's 1HFY18 (Jul) net profit of MYR140m (+20% YoY) was below expectations, at 42% of our and consensus' forecasts. The negative deviation could be attributed to the overly-optimistic assumption of the ramp-up in new production capacity. YoY, 1HFY18 revenue grew 15% to MYR1.3bn, with both the manufacturing (+17%) and property development (+12%) divisions contributing to the healthy growth. The former was driven by the higher contributions from its flexible packaging products – thanks to its capacity expansion – while the latter was lifted by strong progress billing and encouraging take-up rates of its development projects.

**Double-pronged growth.** Scientex's earnings growth is expected to be supported by both operating divisions. The capacity expansion and ramp-up in utilisation rate should support manufacturing sales, and the resulting economies of scale ought to help expand its profit margins. Meanwhile, the property development business is expected to stay solid, given its strategy to focus on affordable housing. The recent proposed acquisition of Klang Hock Plastic Industries SB (KHPI) for a cash consideration of MYR190m is likely to expand Scientex's capacity by c.30% and provide synergistic benefits from operational efficiencies and a larger customer base. The acquisition is expected to be completed by May.

**Maintain NEUTRAL.** Post results, we trim FY18F-20F net profits by 5-6% after imputing more realistic assumptions on the ramp-up in production. As a result, our SOP-derived TP is revised down to MYR8.69 (from MYR9.07, 7% upside). Valuing its property development business at a 40% discount to RNAV derives an implied FY19F P/E of 19x for its manufacturing division. This represents a premium over the sector average of 16-17x, which we believe is justified given Scientex's larger scale. Accordingly, we believe valuations have priced in most of the positives. Note that the implied trading P/Es for the stock appear modest due to significant contributions from property development earnings. Key risks include a sharp fall in input costs and soft property market.

Figure 1: Scientex's results review

| FYE July (MYRm)   | 2QFY17 | 1QFY18 | 2QFY18 | QoQ (%) | YoY (%) | 1HFY17  | 1HFY18  | YoY (%) | Comments                                                    |
|-------------------|--------|--------|--------|---------|---------|---------|---------|---------|-------------------------------------------------------------|
| Revenue           | 586.2  | 658.7  | 634.8  | (3.6)   | 8.3     | 1,120.9 | 1,293.4 | 15.4    | Driven by both operating segments.                          |
| EBITDA            | 98.0   | 110.5  | 102.0  | (7.7)   | 4.1     | 182.0   | 212.5   | 16.8    |                                                             |
| Depreciation      | (15.4) | (17.3) | (17.1) | (1.1)   | 11.0    | (30.6)  | (34.4)  | 12.3    |                                                             |
| EBIT              | 82.6   | 93.2   | 84.9   | (8.9)   | 2.9     | 151.4   | 178.2   | 17.7    | Healthy growth across both operating divisions.             |
| EBIT Margin (%)   | 14.1   | 14.2   | 13.4   |         |         | 13.5    | 13.8    |         |                                                             |
| Pretax profit     | 81.8   | 92.6   | 85.4   | (7.8)   | 4.3     | 148.2   | 177.9   | 20.0    |                                                             |
| Pretax Margin (%) | 14.0   | 14.1   | 13.5   |         |         | 13.2    | 13.8    |         |                                                             |
| Tax               | (15.5) | (19.2) | (16.5) | (14.1)  | 6.2     | (28.9)  | (35.6)  | 23.2    |                                                             |
| ETR (%)           | 19.0   | 20.7   | 19.3   |         |         | 19.5    | 20.0    |         |                                                             |
| Minority Interest | 1.1    | 1.0    | 0.9    | (6.6)   | (17.7)  | 2.1     | 1.9     | (6.7)   |                                                             |
| Net Profit        | 65.2   | 72.4   | 68.0   | (6.1)   | 4.3     | 117.2   | 140.4   | 19.7    | Below expectations, at 42% of our and consensus' forecasts. |
| Net Margin (%)    | 11.1   | 11.0   | 10.7   |         |         | 10.5    | 10.9    |         |                                                             |

Source: Company data, RHB

| Forecasts and Valuations            | Jul-16 | Jul-17 | Jul-18F | Jul-19F | Jul-20F |
|-------------------------------------|--------|--------|---------|---------|---------|
| Total turnover (MYRm)               | 2,201  | 2,403  | 2,851   | 3,900   | 4,394   |
| Reported net profit (MYRm)          | 241    | 256    | 315     | 381     | 432     |
| Recurring net profit (MYRm)         | 241    | 256    | 315     | 381     | 432     |
| Recurring net profit growth (%)     | 55.4   | 6.2    | 23.1    | 20.9    | 13.4    |
| Recurring EPS (MYR)                 | 0.52   | 0.55   | 0.65    | 0.79    | 0.89    |
| DPS (MYR)                           | 0.16   | 0.16   | 0.20    | 0.24    | 0.27    |
| Recurring P/E (x)                   | 15.5   | 14.8   | 12.5    | 10.3    | 9.1     |
| P/B (x)                             | 3.18   | 2.47   | 2.24    | 1.94    | 1.69    |
| P/CF (x)                            | 10.0   | 18.1   | 9.9     | 11.5    | 7.9     |
| Dividend Yield (%)                  | 2.0    | 2.0    | 2.4     | 2.9     | 3.3     |
| EV/EBITDA (x)                       | 11.1   | 10.4   | 8.0     | 6.6     | 5.5     |
| Return on average equity (%)        | 22.8   | 18.9   | 19.1    | 20.2    | 19.9    |
| Net debt to equity (%)              | 29.9   | 17.2   | 7.9     | netcash | netcash |
| Our vs consensus EPS (adjusted) (%) |        |        | (3.2)   | 1.2     | (2.7)   |

Source: Company data, RHB

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