

Recommendation: **BUY**

Stock Code: 4731

Bloomberg: SCI MK

Price: MYR1.28

12-Month Target Price: MYR1.47

Date: May 20, 2008

Board: Main

Sector: Industrial Products

GICS: Materials/Commodity Chemicals

Market Value - Total: MYR292.2 mln

Summary: Scientex is principally engaged in property development as well as manufacturing of industrial packaging products. It also produces polymer products for automotive interiors and adhesive materials for flexible food packaging. Scientex was listed on the Main Board in 1990.

Analyst: Alexander Chia, ACA



Highlights

- The recent privatization of Scientex's industrial packaging arm, Scientex Packaging (SciPack), will allow the enlarged group to achieve greater operational efficiency, costs savings and enhanced cross-selling efforts between the manufacturing divisions.
- We anticipate overall operating environment for industrial packaging industry to improve going forward. While oil price remains high, we understand cost pass-through is easier presently as customers are more receptive towards higher selling prices.
- For the property division, Scientex has a new revenue stream from FY08 (Jul.) onwards from its 250-acre Taman Scientex Kulai (TSK) project. Moreover, it will also continue developing its existing Taman Scientex Pasir Gudang (TSPG), where 600 acres of land are still available for development. The group consistently sells an average of 35 units a month. It focuses in building quality homes at affordable prices and fast delivery time.
- We expect FY08 and FY09 earnings at MYR32.1 mln (-8% YoY) and MYR40.1 mln (+25% YoY), respectively. The increase in FY09 is due to higher contribution from the packaging business in the absence of minority interest and sales from both its property projects.

Investment Risks

- Risks to our recommendation and target price include lower-than-expected cost pass-through in the industrial packaging division and slow sales of its property projects in Johor.

Key Stock Statistics

FY Jul.	2007	2008E
Reported EPS (sen)	18.0	16.3
PER (x)	7.1	7.9
Dividend/Share (sen)	3.0	6.0
NTA/Share (MYR)	1.49	1.49
Book Value/Share (MYR)	1.50	1.50
No. of Outstanding Shares (mln)	228.3	
52-week Share Price Range (MYR)	1.14 - 1.56	
Major Shareholders:	%	
Scientex Holdings Sdn Bhd	19.2	
Scientex Leasing Sdn Bhd	11.3	
Lim Teck Meng Sdn Bhd	7.3	

*Stock deemed Shariah compliant by the Securities Commission.

Recommendation

- We resume our coverage on Scientex with a Buy recommendation and a 12-month target price of MYR1.47 after including our FY09 dividend estimate of 7 sen.
- We derive our target price by pegging its FY09 EPS projection of 18.7 sen against a target PER multiple of 7.5x. The target multiple is a premium to the peers' average of 6.2x. We believe the premium is justified considering the operating environment for industrial packaging industry is generally improving and Scientex is expected to perform better going forward. Our target PER multiple is also within our valuation range of 6x-8x for smaller property companies under our coverage.
- Apart from the improving operating environment in industrial packaging business, Scientex has also been successful in its property development business. Despite the flagging Johor property market, it has successfully carved a niche with its strategy in building smaller but affordable houses, appealing to young families buying their first home. This is evident in the group's fairly steady annual contribution from the property division. Both TSPG and TSK projects will keep the group busy for at least the next eight years.
- Scientex is committed to its Corporate Social Responsibilities and has undertaken various initiatives pertaining to community wellbeing, environmental sustainability, human capital development as well as ensuring a healthy and safe workplace for all its employees.

Per Share Data

FY Jul.	2005	2006	2007	2008E
Book Value (MYR)	1.31	1.41	1.50	1.50
Cash Flow (sen)	22.7	25.3	29.1	24.5
Reported Earnings (sen)	11.9	15.0	18.0	16.3
Dividend (sen)	6.0	8.7	3.0	6.0
Payout Ratio (%)	36.6	50.5	12.0	27.3
PER (x)	10.7	8.5	7.1	7.9
P/Cash Flow (x)	5.6	5.1	4.4	5.2
P/Book Value (x)	1.0	0.9	0.9	0.9
Dividend Yield (%)	4.7	6.8	2.3	4.7
ROE (%)	9.6	11.4	12.9	10.6
Net Gearing (%)	29.9	24.3	15.8	17.3

* For FY05 to FY07, figures adjusted for share split and bonus issue.

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Background

Corporate Profile

Scientex was incorporated in 1968 and started as a small manufacturer of polyvinyl chloride (PVC) leather cloth and sheeting. It has since transformed into a large Johor-based corporation with four core businesses – industrial packaging, polymer products for automotive industry, chemicals for food packaging industry and property development. It was listed on the Main Board of Bursa Malaysia in 1990 under the name Scientex Industries Berhad. It changed its name to Scientex Incorporated Berhad in 1995, before adopting its present name in 2008.

In 1996, it listed its industrial packaging arm, Scientex Packaging Bhd (SciPack) on the Second Board of Bursa Malaysia. In Jan. 2008, Scientex decided to privatize its 61.37%-owned SciPack to consolidate into a stronger single-listed platform to achieve greater operational efficiencies, costs savings and cross-selling ability.

Scientex offered a share-swap on a one-for-one basis for SciPack's remaining shares not owned by Scientex, at an issue price of MYR1.30 per Scientex share. As at Apr. 2, 2008, Scientex successfully acquired an additional 35.9%-stake in SciPack, resulting in Scientex holding a 97.3%-interest in SciPack. Scientex is now undertaking compulsory acquisition of the remaining shares in SciPack. The latter's listing was subsequently removed from Bursa Malaysia in Apr. 2008.

Scientex's board of directors is led by Independent Non-Executive Director, Tan Sri Dato' Mohd Sheriff Mohd Kassim. Half of the 8-member board comprises independent directors, exceeding the one-third or minimum two independent director requirement under the Bursa Malaysia listing rules. Major shareholders in Scientex are Scientex Holdings Sdn Bhd (19.2%), Scientex Leasing Sdn Bhd (11.3%) and Lim Teck Meng Sdn Bhd (7.3%), which are in turned owned by, among others, Lim Teck Meng (Executive Deputy Chairman), Lim Peng Jin (Managing Director) and Lim Peng Cheong (Non-Independent Non-Executive Director).

Corporate Structure



Source: Company data

Industrial Packaging

SciPack prides itself as one of the largest producers of stretch film in Asia. Apart from stretch films, it also produces polypropylene (PP) and polyethylene (PE) woven and laminated bags; Flexible Intermediate Bulk Containers (FIBC) bulk bags; PP strapping bands and corrugated carton boxes. Nonetheless, stretch films remain the main product category, contributing two-thirds of the industrial packaging revenue.

70% of its industrial packaging products are exported overseas to more than 60 countries. It has four manufacturing facilities in Malaysia and one in Vietnam. Presently, it has a combined production capacity of 122,800 mt per annum, up from 91,100 mt (+35%) in 2006. Utilization is currently approximately 60%.

In order to enhance its value-added offerings and to help mitigate rising raw materials costs, SciPack launched a new premium stretch film product under the brand "Elite" in Apr. 2007. The Elite stretch films are almost half as thick as conventional stretch films but possess comparable holding force, offering up to 50% savings on consumption and 30% on cost to consumers.

Polymer

The polymer division manufactures and distributes PVC leather cloth, PVC sheeting, skin materials for automotive interior and components such as car seats, instrument panels and door trims. It also produces automotive carpet mats.

Over 50% of polymer division sales are derived from overseas with Japan and Australia being the major markets. It supplies to leading automotive names and counts Honda, Toyota, Nissan, Subaru, Ford, General Motors, Mitsubishi, Kia, Hyundai, Naza, Proton, Perodua, Yamaha, Suzuki and Daihatsu as its clients.

Chemicals

Together with Mitsui Chemicals Polyurethanes, Inc. from Japan, Scientex has established the first polyurethane adhesive plant in ASEAN in 2002 to manufacture adhesive materials for flexible food packaging. The state-of-the-art facility, which is in Port Klang, produces high quality polyurethane adhesives under stringent quality controls.

Property

Scientex's property development activities are mainly focused in Johor, with a smaller scale of projects in Melaka. The division's flagship project is Taman Scientex in Pasir Gudang, Johor (TSPG), which has a Gross Development Value (GDV) of MYR1.2 bln. The TSPG project started in 1996 and has since generated over MYR500 mln sales from the 5,400 residential and commercial units built. The land area of TSPG covers 1,100 acres and 40% has been developed to date with the remainder to be developed gradually over time.

In Mar. 2007, the group acquired another 250 acres of land in Kulai for MYR33 mln in cash, with the intention to develop it into a mixed development named Taman Scientex Kulai (TSK). TSK is approximately 9 km from Kulai town and is adjacent to several existing housing areas. It also part of the Secondary Urban Promotion Area under the Iskandar Malaysia project. Scientex plans to build approximately 4,000 residential and commercial units with a Gross Development Value (GDV) of MYR500 mln over the next eight years. The first phase of TSK was launched in Mar. 2008 with 393 units of double-storey link houses, and response has been encouraging according to management.

Business

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Bloomberg: SCI MK

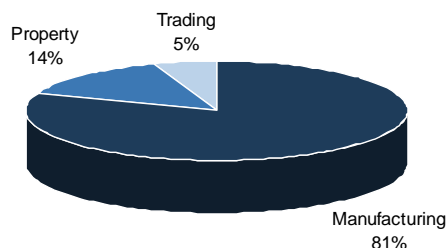
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Date: May 20, 2008

Scientex prices its double-storey link houses attractively at circa MYR110,000 per unit, appealing to local young families who are purchasing their first home. Each unit usually measures 16'x60' in size and Scientex is able to build and hand over within 12 months from signing of sale and purchase agreements. The group also develops smaller double-storey link houses measuring 14'x55' each with a price of MYR80,000 and cluster homes of 32'x65' each at MYR208,000.

FY07 (Jul.) revenue breakdown by divisions



Note: Manufacturing includes industrial packaging, polymer and chemicals

Source: Company data

Earnings Outlook

In FY07 the manufacturing businesses (industrial packaging, polymer and chemicals) contributed approximately 81% of revenue and 45% of operating profit while the property division's revenue and operating profit contribution were 14% and 52% respectively. The remainder was attributed to trading activities and investment holdings.

Raw materials for the manufacturing businesses are mainly resins (about 75% of raw materials costs), which closely track crude oil price. Profitability was affected in FY07 due to the spike in oil price that resulted in higher operating costs and the inability to fully pass on cost increases to customers. Some customers held back orders too. However, things have improved over the last two quarters where customers are resuming their purchases and are more receptive towards higher selling prices, considering that the prevailing high oil price impacts manufacturers across industries. Operating margin at Scipack recovered to 4.3% in 2QFY08 compared to 1.3% in 4QFY07. Nevertheless, we note that there is still a time-lag in cost pass-through of approximately two to three months.

The weaker US\$ has also affected earnings given the high proportion of exports. Nonetheless, this is partly mitigated by its purchases of raw materials which are mostly denominated in US\$, creating a natural hedge.

The privatization of Scipack is expected to yield greater costs savings as its chemicals and polymer manufacturing are currently undertaken at Scientex level. With all the operations under one roof going forward, we understand management is planning for greater cross-selling and collaboration efforts especially between the chemical food packaging and industrial packaging divisions.

As for the property development division, more launches are planned for both TSPG and TSK in the near future with management estimating sales of over 1,000 units a year for the next few years.

For FY08, we estimate revenue to increase 5% YoY to MYR647 mln, with operating profit to rise 11% YoY to MYR48 mln. The growth in revenue is attributed to higher sales in industrial packaging and better contribution from property development with the launch of TSK, while improved profitability is due to higher margins from the property division. We expect

manufacturing operating margin to remain at circa 4%-level. However, we believe net profit will dip to MYR32.1 mln (-8% YoY), as we project an effective tax rate of 13% vs a positive tax charge in FY07, which was caused by overprovision of tax expenses in the previous year. The group's effective tax rate is lower than the statutory rate as it enjoys tax incentives at the manufacturing division.

Prospects for Scientex look to be improving in FY09, with a full year's contribution from Scipack. The privatization exercise is expected to complete by Jul. 2008. We estimate FY09 revenue and net profit to rise 7% YoY to MYR697 mln and 25%YoY to MYR40.1 mln respectively.

Our assumptions factor in an average 5% growth for its manufacturing division and property sales of approximately 800 units per annum. Our property unit sales assumption is lower compared to management's guidance, as we prefer take a more conservative approach in view of the economic and political uncertainties, and the generally subdued property market in Johor.

Valuation

Our 12-month target price is derived using relative PER valuation approach. We apply a target PER multiple of 7.5x against FY09 EPS of 18.7 sen which yields a 12-month target price of MYR1.47 after adding in a projected 7 sen dividend. We believe the 7.5x target PER appropriately reflects the manufacturing and property businesses within the group.

While the 7.5x target PER is higher than the industrial packaging average of 6.2x PER, this is justified as the industrial packaging industry is generally seeing improvements in their operating environment. Our target PER multiple is also within our valuation range of 6x-8x for smaller property companies within our coverage universe.

Comparative Valuations

	Scientex	Thong Guan	BP Plastics
Bloomberg Code	SCI MK	TGI MK	BPP MK
Share Price @ May 16, 2008	1.28	0.95	0.68
Mkt. Cap (MYR mln)	292.2	99.9	81.7
Ave. Daily Vol. ('000)	82	82	55
PER FY07 (x)	7.1	4.5	6.9
P/B	0.8	0.5	0.8
Yield (%)	4.7	3.3	7.4

Source: Bloomberg, Company data

Our dividend estimate of 6 sen in FY08 and 7 sen in FY09 is much higher than the 3 sen in FY07, as the group had also paid out a share dividend on the basis of one treasury share for every 50 shares held in FY07. We understand the group policy is to pay out approximately one-third of net profit as dividends to reward shareholders. We also do not discount the possibility of more share dividends in the future. Its currently has approximately 12.6 mln treasury shares. We note Scientex continues to actively buy back its shares from the open market.

In FY07, Scientex had a two-for-one share split and a one-for-two bonus issue, resulting in its share base increasing 3x to over 200 mln shares.

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Scientex

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Recent Developments

May 2008: Continuous share buyback activities, with treasury shares currently at 12.6 mln shares.

Apr. 2008: Scientex announced the removal of the listing of its subsidiary, SciPack.

Profit & Loss

FY Jul. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	586.3	613.1	646.8	689.2
Reported Operating Profit	47.3	43.8	48.4	49.8
Depreciation & Amortization	-19.9	-20.1	-20.4	-20.7
Net Interest Income / (Expense)	-3.4	-4.3	-4.1	-3.0
Reported Pre-tax Profit	44.4	40.2	45.3	47.8
Effective Tax Rate (%)	16.5	NM	13.0	13.0
Reported Net Profit	28.2	35.2	32.1	40.1
Reported Operating Margin (%)	8.1	7.1	7.5	7.2
Reported Pre-tax Margin (%)	7.6	6.6	7.0	6.9
Reported Net Margin (%)	4.8	5.7	5.0	5.8

Source: Company data, S&P Equity Research

Balance Sheet

FY Jul / MYR mln	2005	2006	2007
Total Assets	322.2	362.9	361.7
Fixed Assets	301.5	342.6	342.2
Current Assets	209.7	228.9	229.0
Other LT Assets	20.6	20.3	19.5
Current Liabilities	156.7	174.7	169.3
LT Liabilities	47.2	49.1	34.7
Share Capital	62.1	63.5	100.0
Shareholders' Funds	235.3	268.1	284.6

Source: Company data

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

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Recommendation and Target Price History

Date	Recommendation	Target Price
New	Buy	1.47
30-Oct-07	Not Ranked	
25-Jul-07	Hold	1.53
26-Mar-07	Hold	1.54
20-Mar-07	Hold	1.44
09-Jan-07	Hold	1.20
02-Oct-06	Hold	1.08
03-Jul-06	Hold	1.04
20-Jan-06	Hold	0.99

