

Initiation Note Friday, January 21st, 2011

SCIENTEX BERHAD

BUY

Current Price	2.00
Target Price	2.31
Upside To Target	15.4%

Stock Codes

Masa	SCIENTX/4731
Bloomberg	SCI MK

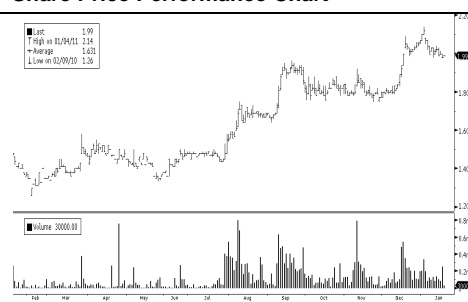
Stock & Market Data

FBMKLCI	1,566.5
Listing	Main Board
Sector	Industrial Product
Syariah Compliant	YES
Par Value (RM)	0.50
Issued Shares (mn)	215.4
Market Capitalisation (mn)	460.0
YTD Chg In Share Price	-3.4%
52-week Hi/Lo (RM)	2.14/1.26
6M Average Volume	159,692
Estimated Free Float	38.7%
Majority Shareholders	Lim Family (57.16%)

Key Indicators

ROA	14.6%
ROE	8.9%
Net Debt/Equity	10.82%
Price/NTA	0.8

Share Price Performance Chart



Investment Highlights

Two-core businesses model Scientex Bhd (Scientex) has two core businesses – manufacturing of industrial packaging products and property development in South Malaysia.

Capacity expansion The group is planning to expand its stretch film and PP strapping band production capacity to 120,000 MT and 24,000MT respectively. The group is spending additional RM18m to improve facilities in stretch film and strapping band.

Weaker USD and higher raw material prices to affect earnings We expect the group to face some margin squeeze on weaker USD and higher cost of raw materials. Nevertheless, the group is able to mitigate the impact by adjusting its selling prices based on its raw material prices' movement with one month of lag-effect and through improvement in efficiency to produce products with thinner layer.

Weaker USD & higher raw material prices to hurt manufacturing business Scientex exports over 90% of its manufacturing products abroad. Weak USD and rising raw material cost will have impact on its earnings. The group is able to mitigate the impact by adjusting its selling prices based on its raw material prices' movement with one month of lag-effect.

A combined on-going GDV of RM419.6m The group has a combined on-going GDV of RM419.6m and unbilled sales totalled RM158.3m. Its property developments in Pasir Gudang, Kulai, and Skudai are within the Islandar Development Region (IDR) or within the Secondary Promotion Area of the IDR.

Margin improved on better mix of property projects. Although EBITDA margin from manufacturing division was lower on weaker USD, higher margin from its Skudai project helped to lift overall EBITDA margin.

Target price of RM2.31 Pegging its manufacturing business against average PE multiple of 6x and 0.8x of P/RNAV for its property development business, we have derived a target price of RM2.31 for Scientex, using sum-of-part valuation. Our fair value of RM2.31 implies 15.3% upside from current level. Although Scientex do not have an official dividend policy, it has been distributing dividends since 2001 with an average payout ratio of more than 30% of its net income. Assuming that the group distribute one-third of its net profit to its shareholder, based on estimated EPS of 30.9sen and 43.2sen for FY11 and FY12, this would translate into a decent dividend yield of 5.1% - 5.7% respectively. Risk to our recommendation and target price include lower-than-expected cost pass through in its manufacturing business and slow sales of its property projects.

Background

Scientex Berhad (Scientex) was incorporated in 1968 as a polyvinyl chloride (PVC) leather cloth and sheeting manufacturer. It has expanded to produce stretch films, polypropylene (PP) and polyethylene (PE) woven and laminated bags, skin materials for automotive interior, components such as car seats, instrument panels and door trims. Scientex is the largest stretch film producer in Asia and within the top 10 largest producers of stretch film globally. To date, Scientex has manufacturing facilities in Malaysia and Vietnam. Scientex is having a twin-core businesses concept. Aside from manufacturing, the group has property development projects in South Malaysia.

Manufacturing

Under its manufacturing division, stretch film and polypropylene (PP) strapping band are two main products. Other products include raffia, carton box, PVCD rigid film, tufted carpet mats, lamination film, woven bags, and auto interior products.

There are 8 production lines for stretch film business with a combined production capacity of 100,000 MT per annum. The stretch film plant is located at West Port, Port Klang, a strategic location for this business as it imports most of its raw material overseas and exports about 95% of its product abroad. Export destinations include East Europe, Korea, Taiwan, Japan, Russia, Thailand, Indonesia, Africa and other APAC countries. The stretch film business has contributed about 55% of the group's manufacturing revenue for FY10.

PP strapping band is manufactured by its 65% owned subsidiary – Pan Pacific Straptex Sdn Bhd, a JV with its Japanese partner – Tsukasa Chemical Industry Co Ltd. The plant is located in Melaka, equipped with 10 production lines with a combined capacity of 16,200MT per year. Its main customers are from Australia, Japan, Pakistan and locals. The business contributed about 10% of the group's manufacturing revenue for FY10.

Figure 1: Some of Scientex's manufacturing products



Capacity boost

Efficiency is the key of success for industrial packaging business (with relatively thin profit margin of about 5 – 7%). Scientex is investing heavily into machinery and equipments to improve efficiency and for better quality control. After a recent visit to its stretch film plant in Pulau Indah, Port Klang, we have witnessed the efficiency improvements from the streamlined plant structure, full automation from its machinery and equipments, and cost-saving from storage and transportation segments. As part of its growth strategies, Scientex is planning to further increase its stretch film production capacity to 120,000 MT per annum by FY2011. The group also plans to increase its PP strapping band's production capacity from the existing 16,200MT to 24,000MT in FY2013. The group is spending additional RM18m to improve facilities in stretch film and strapping band.

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Figure 2A: Stretch film annual capacity expansion plan

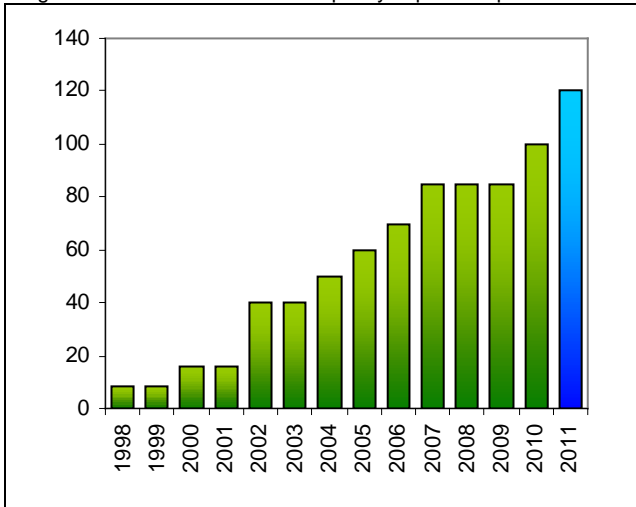
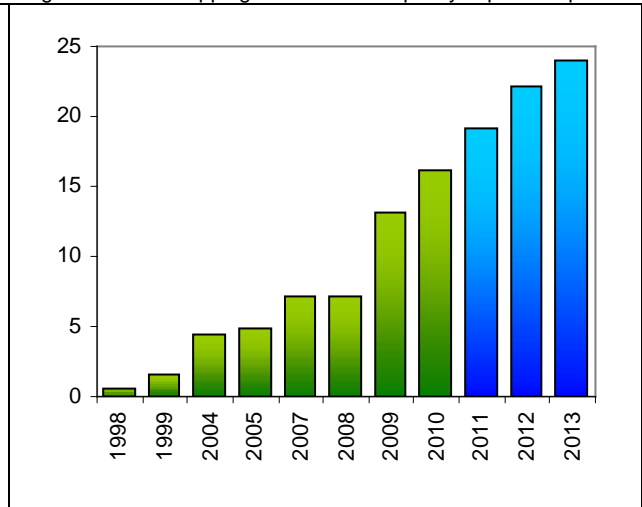


Figure 2B: PP strapping band annual capacity expansion plan



Weaker USD & higher crude oil price/ resin price

We expect the group's profit margin to be affected by weaker USD. With about 70% of its manufacturing businesses are exported mainly in USD, weakening USD is hurting its realized profit. USD is trading at 3.056 on 17 Jan 2011 compared to a year ago of 3.342, depreciated about 8.6% YoY. Resin accounted for about 70% of its total cost. As seen in Figure 3B, raw material prices move in tandem with crude oil prices, albeit at a smaller momentum. The group is importing most of its raw material aboard. Buying and selling in USD terms provide natural hedge to the currency. However, its margin will still be impacted by weaker USD on financial reporting wise. On the bright side, the group is able to mitigate the impact by adjusting its selling prices based on its raw material prices' movement with one month of lag-effect.

Figure 3A: RM vs. Crude oil movements

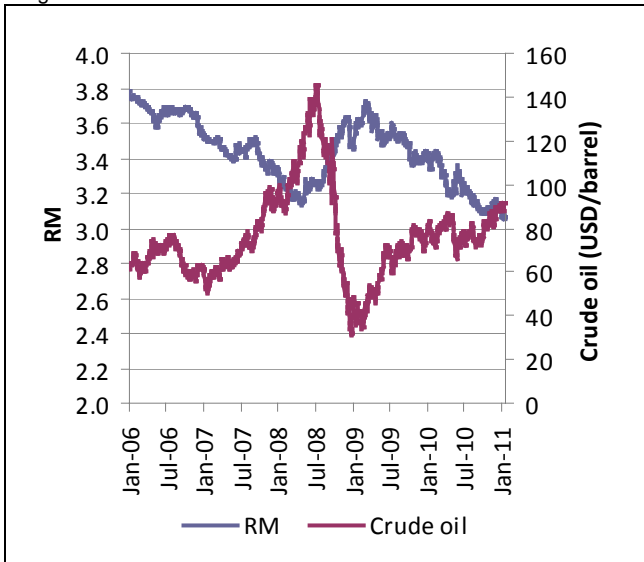
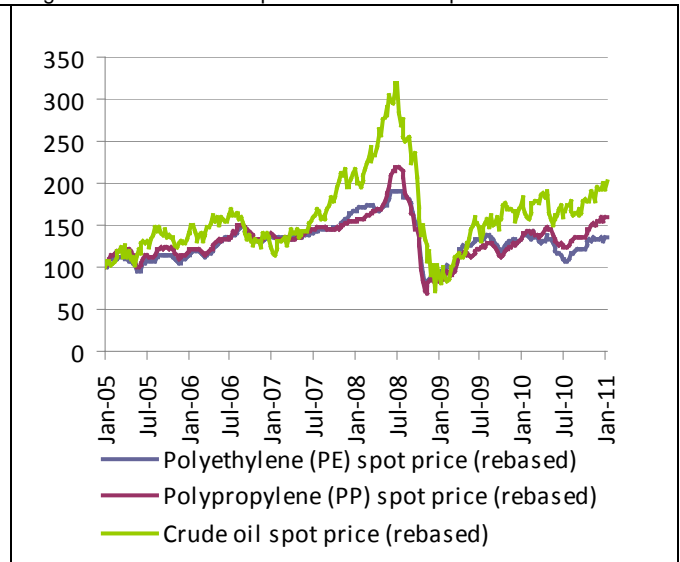


Figure 3B: Raw material prices vs. Crude oil prices movement

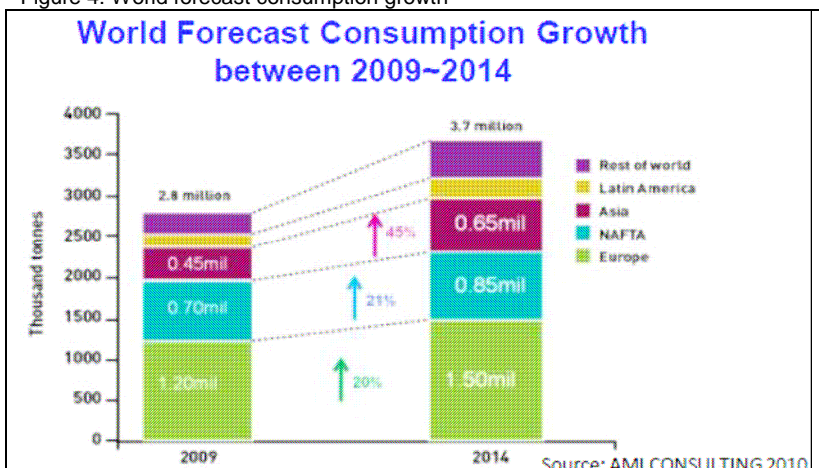


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Asia region's consumption is catching up

According to Applied Market Information (AMI) Consulting, a specialist market research and consulting company serving the global chemicals and plastics industries, the consumption of industrial packaging in Europe and US accounted for about 68% of the world consumption. However, the consumption in Asia region is growing significantly over the years. AMI Consulting is expecting a 45% growth in Asian consumption from 0.45m tonnes in 2009 to 0.65m tonnes by 2014. Being one of the prominent players in Asia, Scientex is in well position to capture higher demand of industrial packaging products in Asia.

Figure 4: World forecast consumption growth



Property Development

Back in 1993, Scientex has ventured into property developments in Johor. Currently, it has 4 property development projects in Johor and Melaka. Its flagship development projects are the 540 acres Taman Scientex Pasir Gudang and 220 acres Taman Scientex Kulai. The group has a combined on-going GDV of RM419.6m and unbilled sales totalled RM158.3m. Its property developments in Pasir Gudang, Kulai, and Skudai are within the Iskandar Development Region (IDR) or within the Secondary Promotion Area of the IDR. Scientex was previously focus on low to medium property development projects in Pasir Gudang and Kulai, Johor. With the land acquisition in Skudai, a close proximity to the city and is located within the Iskandar Development Region, we believe that the property development division is able to fetch higher margin.

Project	Land area (acres)	Remaining GDV (RMm)	On-going GDV (RMm)	Unbilled sales (RMm)	Takes up rate (%)
Taman Scientex Pasir Gudang	540.0	691.0	144.0	51.8	65%
Taman Scientex Kulai	220.0	287.5	70.5	38.0	83%
Taman Mutiara Mas, Skudai	145.0	602.9	151.0	51.4	55%
Taman Muzaffar Heights, Ayeh Keroh	120.0	218.2	54.1	17.1	76%
Total	1025.0	1799.6	419.6	158.3	

Figure 5: Property development projects in Johor



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Financial Highlights

In FY10, manufacturing business contributed about 78% of its total revenue while property development contributed the remaining 22%. In terms of segmental result, manufacturing business contributed about 53% while property development business accounted for the remaining 47%. In terms of margin, manufacturing businesses offer lower margin of about 5 to 7% while property development business offers about 28% in FY10.

Figure 6A: Revenue breakdown (FY10)

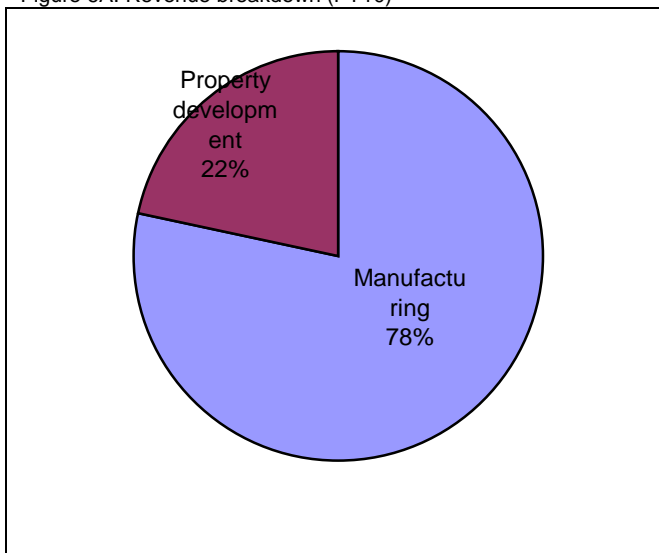
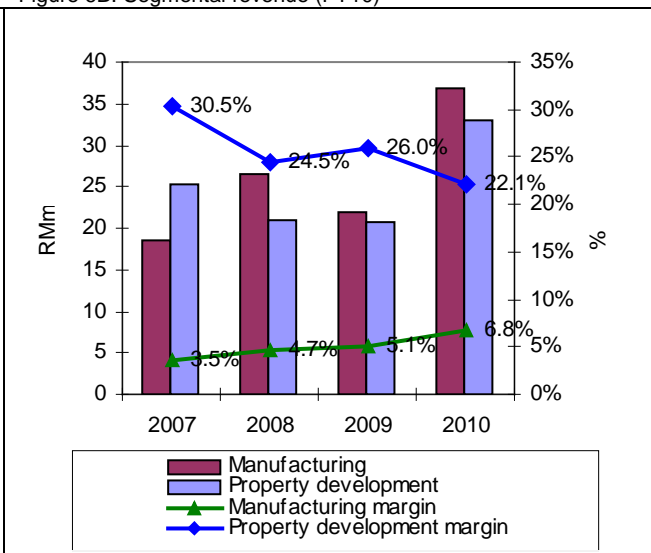


Figure 6B: Segmental revenue (FY10)

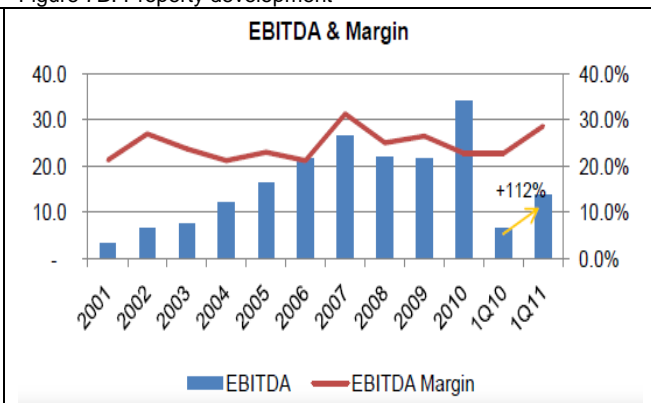


1QFY11's EBITDA margin for manufacturing business was 6.3% lower YoY on weaker USD despite increase in sales by 1.5% YoY. This is mitigated by higher EBITDA margin from property development business (+112% YoY) on better sales mix from Skudai's high-end project. We expect its Skudai project to contribute significantly in FY11 and FY12.

Figure 7A: Manufacturing



Figure 7B: Property development



Target price of RM2.31

Pegging its manufacturing business against average PE multiple of 6x and 0.8x of P/RNAV for its property development business, we have derived a target price of RM2.31 for Scientex, using sum-of-part valuation. Our fair value of RM2.31 implies 15.3% upside from current level. Although Scientex do not have an official dividend policy, it has been distributing dividends since 2001 with an average payout ratio of more than 30% of its net income. Assuming that the group distribute one-third of its net profit to its shareholder, based on estimated EPS of 30.9sen and 43.2sen for FY11 and FY12, this would translate into a decent dividend yield of 5.1% - 5.7% respectively. Risk to our recommendation and target price include lower-than-expected cost pass through in its manufacturing business and slow sales of its property projects.

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JUPITER SECURITIES RESEARCH

Sum-of-part valuation

Sum-of-part valuation	Valuation method	Value (RMm)
Manufacturing	Forward PE of 6x	224.5
Property development	0.8x P/RNAV	209.0
Cash		113.9
Debt		-50.4
Total RNAV (RMm)		496.9
No. of shares (m)		215.4
SOP per share (RM)		2.31

Peers comparison

Company	Last Price (RM)	Market Cap (RMm)	PE Ratio (x)		EPS (sen)		Dividend Yield (%)		ROE (%)	
			2011	2012	2011	2012	2011	2012	2011	2012
Scientex	2.01	462.3	6.5	5.8	30.9	34.3	5.1	5.7	13.9	13.3
BP Plastics	0.625	112.6	6.3	5.7	10.0	11.0	4.8	4.8	12.6	13.3
GW Plastics	0.795	187.6	8.5	6.6	9.4	12.0	NA	NA	NA	NA
Thong Guan	1.00	105.2	NA	NA	NA	NA	NA	NA	7.7	NA
KSL Holdings	1.93	753.8	10.2	7.7	19.0	25.0	2.7	2.4	13.2	8.8
Crescendo Corp	1.46	250.8	10.8	17.4	13.5	8.4	4.8	4.8	4.1	5.9

Source: Bloomberg, Jupiter Research

Investment Highlights

YE 31 Jul	2008	2009	2010	2011F	2012F
Net Profit (RM mn)	47.7	37.5	60.3	66.6	74.0
NI Growth (%)		-21.5%	61.0%	10.4%	11.0%
EPS (sen)	22.2	17.4	28.0	30.9	34.3
DPS (sen)	8.0	5.0	9.0	10.2	11.3
NTA/Share (sen)	160.0	174.3	192.4	223.3	257.6
Net Cash/(Debt) per share	-0.19	-0.10	-0.21	0.00	0.29
Net Debt/Equity (%)	11.94	5.60	10.82	0.08	net cash
PER (x)	5.6	6.9	5.5	6.5	5.8
Dividend Yield (%)	6.4	4.2	5.8	5.1	5.7
ROE (%)	13.8	10.0	14.6	13.9	13.3
ROA (%)	7.7	6.4	8.9	9.2	9.1
P/NTA (x)	0.8	0.7	0.8	0.9	0.8

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JUPITER SECURITIES RESEARCH

Income Statements	2009	2010	2011F	2012F
Revenue	509.73	694.82	725.17	813.79
Cost of sales	(428.57)	(571.81)	(595.36)	(667.31)
Gross profit	81.17	123.01	129.81	146.48
Other income	11.61	12.45	14.00	15.00
Selling and distribution expenses	(23.90)	(28.31)	(29.01)	(32.55)
Administrative expenses	(26.39)	(37.15)	(39.16)	(44.35)
Operating profit	42.49	70.05	75.64	84.58
EBITDA	65.56	93.11	98.71	107.65
Depreciation	(23.07)	(23.07)	(23.07)	(23.07)
Amortisation	(0.50)	(0.50)	(0.50)	(0.50)
Finance costs	(1.90)	(1.26)	(1.50)	(1.50)
Share of profit of associates	1.47	1.97	2.00	2.10
Profit before tax	42.05	70.75	76.14	85.18
Taxation	(3.48)	(8.61)	(11.42)	(13.20)
Profit for the period / year	38.58	62.14	64.72	71.98
Minority interest	1.12	1.82	1.90	2.00
Net Income	37.46	60.32	66.62	73.98
Earnings per share	17.00	28.00	30.93	34.34
Gross Margin (%)	15.92	17.70	17.90	18.00
Operating margin (%)	8.34	10.08	10.43	10.39
Pretax Margin (%)	8.25	10.18	10.50	10.47
Net Margins (%)	7.35	8.68	9.19	9.09
Revenue Growth (%)	-22.4	36.3	4.4	12.2
Operating Profit Growth (%)	-28.3	64.9	8.0	11.8
Pre-Tax Profit Growth (%)	-26.8	68.3	7.6	11.9
Net profit Growth (%)	-21.5	61.0	10.4	11.0

Balance sheet	2009	2010	2011F	2012F
Prop, Plant & equipment	169.82	205.08	203.54	203.14
Land held for prop dev	170.51	216.68	215.15	213.00
Other LT asset	45.82	13.92	14.94	14.94
LT asset	386.15	435.68	433.63	431.08
Property development costs	38.66	54.40	70.18	71.86
Inventories	61.68	63.38	59.60	62.43
Trade Receivables	82.49	98.25	103.31	129.31
Cash and bank balances	15.62	23.35	58.50	113.89
Current asset	198.46	239.39	293.13	379.03
Short-term borrowings	14.45	42.02	36.40	30.20
Trade payables	111.42	125.18	115.23	127.09
Other ST liabilities	1.66	3.94	6.24	6.34
Current Liabilities	127.53	171.15	157.87	163.62
Long term borrowings	22.16	26.17	22.50	20.20
Other LT liabilities	23.69	26.95	26.95	26.95
LT Liabilities	45.85	53.12	49.45	47.15
Share Capital	115.00	115.00	115.00	115.00
Reserves	260.09	299.35	365.96	439.94
Shareholders Funds	375.09	414.35	480.96	554.94
Minority interest	36.14	36.45	38.48	44.39

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