

22 Apr 2019

Buy

Price
RM8.77

Target Price
RM9.99

Market Data

Bloomberg Code	SCI MK
No. of shares (m)	515.3
Market cap (RMm)	4,519.2
52-week high/low (RM)	9.48 / 6.51
Avg daily turnover (RMm)	2.5
KLCI (pts)	1,622.1

Source: Bloomberg, KAF

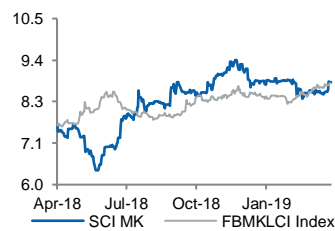
Major Shareholder (%)

Scientex Holdings Sdn Bhd	(21.4%)
Scientex Leasing Sdn Bhd	(9.6%)
Scientex Infinity Sdn Bhd	(8.4%)
Free Float	29.9

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	(0.5)	1.4	13.9
Rel Market (%)	4.5	7.7	32.6



Source: Bloomberg, KAF

Analyst

Damia Othman
(603) 2171 0507
damia@kaf.com.my

Scientex

Manufacturing segment to drive growth

We initiate coverage on Scientex with a BUY rating and TP of RM9.99 pegged to our CY19 SOP valuation. We expect FY19F earnings growth to be modest because of the equity dilution from the acquisition of a 62% stake in Daibochi. However, we expect earnings to accelerate in FY20F-FY21F with a CAGR of 15% driven entirely by the Manufacturing division (42%-54% of profit). This growth is expected to come from the first full-year contribution of recent M&As in the Manufacturing segment, i.e., the acquisition of KHPI and Daibochi. The deals are also expected to expand its blended margin. To be conservative, we assume flat sales for the Property division which traditionally has been resilient due to its exposure to the lower end market. With dividend payout policy of 30% net earnings, we project a GDPS of 20-22sen/share for FY19-FY21, implying a dividend yield of 2%-3%.

Financial Highlights

FYE Jul	2017	2018	2019F	2020F	2021F
Revenue (RMm)	2,403	2,627	2,854	3,063	3,281
Core net profit (RMm)	267	290	299	337	394
Core EPS (Sen)	57.2	59.6	58.0	65.4	76.5
EPS growth (%)	(46.9)	4.2	(2.6)	12.6	17.0
DPS (Sen)	16.0	20.0	20.0	21.0	22.0
Core PE (x)	15.3	14.7	15.1	13.4	11.5
Div yield (%)	1.8	2.3	2.3	2.4	2.5
ROE (%)	18.9	17.6	16.1	16.2	16.9
Net Gearing (%)	18.0	43.2	38.6	32.4	24.4
PBV(x)	2.7	2.4	2.3	2.1	1.8

Source: Company, KAF

Initiate with BUY rating and TP of RM9.99 based on SOP valuation

We initiate coverage on Scientex with a Buy rating and TP of RM9.99 based on SOP valuation. We peg the Manufacturing segment at 25x PE (in line with peers) and Property division at 1.2x PB (premium to peers given better operating margin) of our CY19 forecasts. With dividend payout policy of 30% net earnings, we project a GDPS of 20-22sen/share for FY19F-FY21F, implying a dividend yield of 2%-3%.

Manufacturing segment growth offset by weaker Property segment in FY19F

We expect earnings growth in FY19F to be modest at 3% YoY mainly driven by the Manufacturing segment as Scientex is expected to ramp up its Manufacturing segment utilisation rate to 70% (vs 55% in FY18) especially at its PE, BOPP and CPP plants which were expanded in 2016-17. This is expected to be partially offset by lower contribution from the Property segment given softer market sentiment, despite Scientex's plan to launch RM1.1b in GDV of affordable housing.

Earnings to accelerate in FY20F-FY21F

We expect earnings growth to accelerate in FY20F-FY21F at a CAGR of 15% YoY mainly driven by the Manufacturing segment on the back of first full-year contributions from the recently acquired KHPI and Daibochi businesses as well as the newly commissioned stretch film plant in the US. Its blended margin is also expected to expand due to stronger product portfolios from FPP range; therefore, earnings contribution from the Manufacturing segment is expected to increase from 38% in FY18 to 48%-54% in FY20-FY21F. To be conservative, we assume flat sales for Property segment due to weak sentiment in the market.

Equity dilution after acquiring Daibochi

Scientex has just recently concluded the acquisition of Daibochi Berhad (Daibochi) in Apr-2019 through swapping 5.5 Daibochi shares for one Scientex share. Scientex has acquired 62% stake in Daibochi after issuing about 29m shares to complete the share swap, which is expected to result in equity dilution. Henceforth, we expect Scientex EPS to reduce slightly by 3% YoY in FY19 despite expected earnings growth of 3% YoY in FY19.

Company background

Flexible plastic packaging manufacturer and property developer

Scientex Berhad (Scientex) was established in 1968 as one of the largest producers of stretch film in the world and is a leader in flexible plastic packaging (FPP) manufacturing. Its manufacturing plants are located in Malaysia, Vietnam and the United States. Scientex is also a recognized property developer with projects in Johor, Melaka, Perak and Selangor.

To date, the group has generated close to RM2b in revenue within the Manufacturing segment and built more than RM4b worth of properties within the Property segment. Moving forward, the group aims to become a RM10b company by 2028 by increasing annual capacity to 1m MT from current 450k MT within the Manufacturing segment as well as building 50,000 affordable homes from 17,822 currently within the Property segment.

Investment thesis

Manufacturing segment expanding organically and through M&A

The Manufacturing division product range includes stretch films, custom films (e.g. Polyethylene (PE) film, cast polypropylene (CPP) film and biaxially-oriented polypropylene (BOPP) film) as well as specialty products (e.g. automotive interior, raffia, adhesives etc.) To date, the Manufacturing division has a total capacity of 450,000 MT/year with utilization rate of 70% across 18 facilities in Malaysia, Vietnam and United States.

Its most recent expansions in 2018 are 1) 100% acquisition of Klang Hock Plastic Industries Sdn Bhd (KHPI) for 99,000 MT/year capacity for FPP; 2) organically opened a new plant in Arizona, United States with 30,000 MT/year capacity of stretch films; and 3) triggered a mandatory general offer (MGO) and completed acquisition of 62% of Daibochi Berhad for its FPP businesses through share swaps of 5.5 Daibochi shares for one Scientex share.

Moving forward, management guided that the group is expected to continue expanding the Manufacturing segment through 70% M&A activities and 30% through organic growth. The expected benefits from expansion through M&As are the ability to operate synergistically be it through horizontal or vertical integration, sharing of industry knowledge by sharing Research and Development (R&D) materials, and expansion of clientele portfolio which is expected to enhance market share within the stretch films and FPP markets.

While through organic expansion, albeit having high operational costs short-term, it is expected to provide greater economies of scale and efficiencies in the mid to long run, while Scientex is actively increasing its sales volume through roadshows and client acquisition activities. Hence, we project a forward earnings CAGR of 18% for FY19F-FY21F for the Manufacturing segment.

Exhibit 1: Past M&A activities

Acquired	Date	Purchase Price (RMmn)	PER (x)	P/B (x)	Capacity (MT/year)	Product
Daibochi Berhad	Nov-18	5.5 Daibochi for 1 Scientex share	20	2.6	TBC	FPP
Klang Hock Plastics Industries Sdn Bhd	Feb-18	190.0	12.9	1.7	99,000	FPP
Mondi Consumer Packaging International	Aug-15	58.0	20.4	1.6	16,800	Consumer and industrial
Seacera Polyfilms Sdn Bhd	Nov-13	40.0	14.0	NA	500	BOPP film
GW Plastic Holdings Berhad	Oct-12	283.2	14.4	1.5	62,000	PE Film

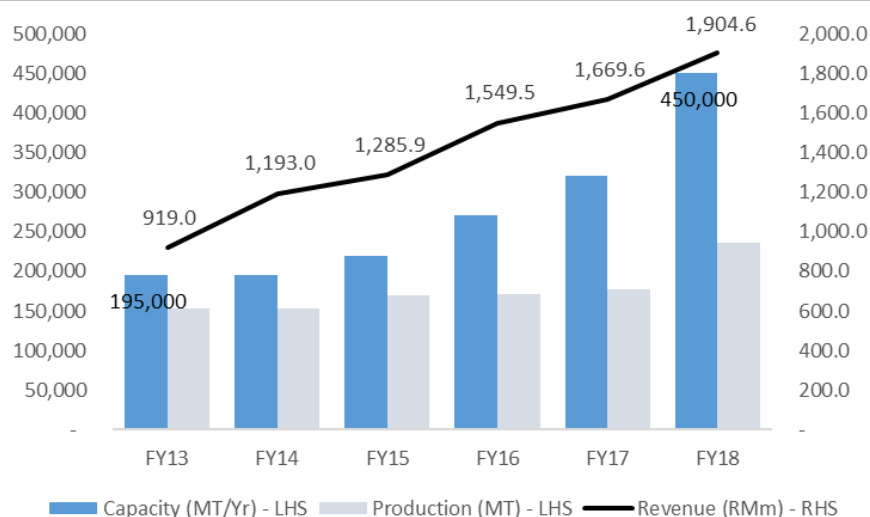
Source: Company, KAF

Exhibit 2: 2016/17 capacity expansion activities

Plant type	Pre-expansion Capacity (MT/year)	Post Expansion Capacity (MT/year)	Completion
PE Film	24,000	84,000	2017
BOPP film	6,000	60,000	2017
CPP Film	0	12,000	2016

Source: Company, KAF

Exhibit 3: Revenue increases in tandem with business expansion



Source: Company, KAF

Capturing the growing affordable housing market segment

The Property segment projects are mainly located in Johor, Melaka, Perak and recently Selangor. To date, it has launched a total Gross Development Value (GDV) of RM5b with remaining GDV of RM12b to support the segment growth plans for at least the next 10 years. Management believes the the current property supply in Malaysia is mainly in properties priced above RM500,000. In order to fill in the gap in property market for affordable housing, Scientex is focused on building houses priced between RM200,000 – RM500,000.

Note that Scientex’s core principles for its Property segment are “Speed, Cost and Quality;” the segment has been able to maintain a three-year historical operating margin of 30%. Management attributed this to its Industrial Building System (IBS) method and ability to acquire landbanks at discounted prices while unlocking its value through strategic development projects.

As of 1HFY19, Scientex has launched a total of seven projects with estimated GDV of RM500m for 1,000 units of houses. In 2HFY19, Scientex plans to launch another 2,500 units of houses across 11 project launches with projected GDV of RM600m, thereby bringing total GDV launch for FY19 to RM1.1b. Moving forward, Scientex plans to launch at least RM1.2b in GDV in FY20 to capture the vast demand of the affordable housing market with 4,600 units across 21 new project launches. This is to meet its target of building 50,000 affordable housing by 2028. However, to be conservative, we assume flat sales for the Property segment, which traditionally has been resilient due to its exposure to the lower end market.

Exhibit 4: Property segment GDV and progress

Project	Area (acres)	Target Market	GDV (RMm)	Completed GDV (RMm)	On-going and future projects (RMm)
Taman Scientex Pasir Gudang	1,100	Affordable	2,200	1,496	704
Taman Scientex Kulai	298	Affordable & Premium	1,100	519	581
Skudai: Taman Mutiara Mas	146	Premium	2,700	996	1,704
Ayer Keroh: Taman Scientex Heights	137	Affordable & Premium	740	449	291
Melaka: Scientex Durian Tunggal	406	Affordable	1,200	0	0
Taman Scientex Senai	371	Affordable	2,200	591	1,609
Taman Pulau Mutiara	661	Affordable	6,000	357	5,643
Ipoh: Scientex Klebang & Scientex Meru	80	Affordable & Premium	610	39	571
Scientex Rawang	66	Affordable	1,000	120	880
Total	3,265		17,750	4,567	11,983

Source: Company, KAF

30% dividend policy

Scientex has a dividend payout policy of at least 30% of reported earnings, hence the company is estimated to declare a GDPS of 20sen/share and 22sen/share for FY19F to FY21F, respectively. With projected net gearing of 24%-39%, we find Scientex to be able to deliver its 30% dividend payout policy as well as having some room for financing to support its expansion plans. Management guided that a comfortable net gearing for the group is 50%. At the current share price, the implied dividend yield is expected to be ~3% for FY19-FY20.

Key risks

Higher-than-expected resin prices

We find that 80% of the group cost of sales comes from the Manufacturing segment, of which about 70% is for raw material costs like fossil fuel resins. According to Bloomberg, the Low-Density Polyethylene (LDPE) resin spot price in South East Asia has reached a 10-year low of USD1,020/MT (-19% YoY) in Dec-2018. According to industry experts, the downtrend in resin price is due to lackluster global demand growth amid new capacity coming on-stream, coupled with the ongoing US-China trade war.

Hence, we project resin price of USD1,200/MT in our FY19F-FY21F costs assumptions, which is a 3% decline from FY18 resin price average of RM1,234/MT. However, given the uncertainty in the global markets, there's the risk of resin trading at higher-than-expected price, which may increase the group's cost of sales.

Exhibit 5: Resin spot CFR price in SEA trading at 10-year low



Source: Bloomberg, KAF

Soft property market

According to Rahim & Co (property consultant), the Malaysian property market is expected to further stagnate in 2019 and recovery is only expected in two years' time. This is due to low income growth, hence affecting consumers' affordability in receiving financing to buy residential properties especially for those priced above RM500,000. Considering that the Property segment contributed 65% of group operating income in FY18, the soft property market environment may result in reduced sales and earnings contributions. Even then, Scientex is targeting the affordable housing segment priced between RM200,000 – RM500,000 in order to meet the supply gap in the property market – a segment that is expected to be resilient in the current market downturn.

Financial summary

Earnings update

Scientex 1HFY19 core earnings were relatively flat at RM131m compared to RM130m during the same period a year ago on the back of higher operating profit in the Manufacturing segment (+13% YoY), offset by lower operating profit in the Property segment (-6% YoY). Manufacturing segment revenue increased to RM1.1b (+22% YoY) on the back of higher utilization rate at 70% (vs 50% in 1HFY18), new contribution from the newly acquired KHPI operations since 4QFY18 and stretch film plant from Arizona, USA. Property segment revenue, on the other hand, declined slightly to RM355m (-1% YoY) attributable to slower recognition in contributions due to timing of projects.

On a quarterly basis, 2QFY19 core earnings increased to RM74m (+30% QoQ) mainly due to higher Property segment operating income (+63% QoQ) as the recognition delays in 1QFY19 were offset in 2QFY19 as resilient demand for affordable homes is still apparent, pushing revenue up to RM218m (+58% QoQ). The quarterly earnings growth was also supported by higher operating income from the Manufacturing segment (+9% QoQ) for similar reasons as mentioned above.

Earnings outlook

We expect FY19F earnings growth to be modest because of the equity dilution from the acquisition of the 62% stake in Daibochi. FY19F earnings are expected to be contributed mainly by the Manufacturing segment as Scientex ramps up its utilization rate to 70% (from 55% in FY18); this is expected to be partially offset by slower Property segment contribution in light of weaker market sentiment in the sector.

However, we expect earnings to accelerate in FY20F-FY21F at a CAGR of 15% driven entirely by the Manufacturing division (42%-54% of profit). This growth is expected to come from the first full-year contributions of recent M&A activities within the Manufacturing segment, with the acquisition of KHPI and Daibochi. The deals are also expected to expand its blended margin as FPP products from the newly acquired companies are expected to have higher product margins. To be conservative, we assume flat sales for the Property division, which traditionally has been resilient due to its exposure to the lower end market.

Earnings margin are expected to be sustainable at 11%-12% level on the back of low costs of resin and improved operational efficiencies from economies of scale as utilization rate is ramped up for the Manufacturing segment and implementation of IBS system within the Property segment. EPS growth, however, should be -3% for FY19F, attributable to equity dilution following the issuance of 28m new shares to complete the 62% acquisition of Daibochi in Apr-2019.

BUY rating and TP of RM9.99 based on SOP valuation

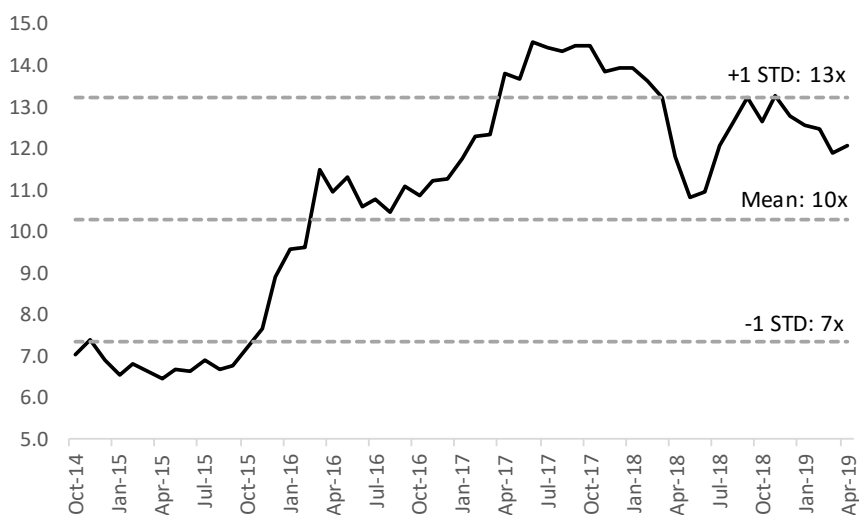
We initiate coverage on Scientex with a Buy call and TP of RM9.99 based on SOP valuation pegged to 25x PE of CY19F earnings for the Manufacturing segment (in line with peers) and 1.2x PB of CY19F book value for the Property segment (at a premium to peers' forward PB due to attractive net margin to peers). With dividend payout policy of 30% net earnings, we project a GDPS of 20-22sen/share for FY19F-FY21F, implying a dividend yield of 2%-3%.

Exhibit 6: Sum-of-Parts Valuation

Segment	Based on CY19	Valuation
Manufacturing	25x PE	3,546
Property	1.2x PB	1,603
	Equity value (RMmn)	5,149
	WAC (mn)	515
	Target Price (RM)	9.99

Source: KAF

Exhibit 7: Five-year forward PE Band chart



Source: KAF

Exhibit 8: Plastic Packaging Manufacturer Peers' comparison table

Companies	Share Price (RM)	Market Cap (RMm)	PER (x)		PB (x)		EPS Growth (%)		ROE (%)		Dividend Yield (%)	
			2018	2019	2018	2019	2018	2019	2018	2019	2018	2019
Daibochi Plastic & Packaging	2.00	654.7	43.5	23.5	3.3	3.2	(41.8)	84.8	17.3	18.8	1.4	2.4
Tomyapak Holdings Berhad	0.51	213.7	NA	56.7	1.1	1.1	>-100	>+100	2.0	4.2	0.0	0.4
SCGM Bhd	1.02	196.6	45.0	29.7	1.1	1.1	(81.7)	51.5	2.0	5.3	0.5	1.8
Thong Guan Industries Bhd	2.49	341.4	7.5	6.8	0.7	0.7	(4.6)	9.6	11.0	11.2	3.2	4.3
SLP Resources Bhd	1.27	402.5	15.9	15.7	2.2	2.0	14.3	1.3	15.3	15.0	2.4	3.4
Simple Average		361.8	28.0	26.5	1.7	1.6	(45.3)	94.4	9.5	10.9	1.5	2.4
Market Cap Weighted Avg		437.6	25.6	23.2	2.1	2.0	(35.0)	76.8	12.2	13.3	1.7	2.7

Source: Bloomberg, KAF

Exhibit 9: Small-cap Property Peers' comparison table

Companies	Share Price (RM)	Market Cap (RMm)	PER (x)		PB (x)		EPS Growth (%)		ROE (%)		Dividend Yield (%)	
			2018	2019	2018	2019	2018	2019	2018	2019	2018	2019
I-Bhd	0.42	425.5	7.6	8.8	0.4	0.4	(22.5)	(12.7)	6.7	7.3	0.0	4.8
Titijaya Land Bhd	1.50	410.3	4.8	NA	0.5	NA	>+100	NA	NA	NA	NA	NA
Crescendo Corporation Berhad	0.31	394.3	7.1	7.4	0.3	0.3	(40.9)	(4.7)	3.9	4.3	1.2	1.6
Ayer Holdings Berhad	1.32	368.8	10.7	NA	0.4	NA	(9.3)	NA	NA	NA	4.5	NA
Tambun Indah Land Bhd	4.60	344.3	17.1	32.9	0.7	NA	17.0	(48.0)	2.2	2.1	1.1	NA
Ibraco Berhad	0.80	344.6	6.2	8.0	0.6	NA	(33.7)	(22.7)	7.7	7.1	8.4	5.3
Simple Average		381.3	8.9	14.3	0.5	0.4	>+100	(22.0)	5.1	5.2	2.5	3.9
Market Cap Weighted Avg		383.9	8.7	7.8	0.5	0.1	>+100	(13.0)	2.7	2.7	2.4	1.7

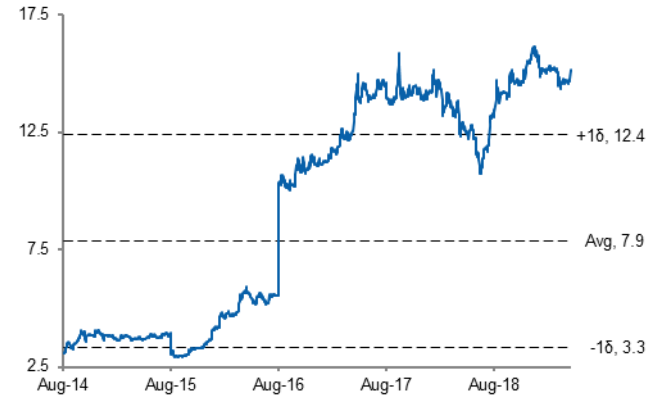
Source: Bloomberg, KAF

Exhibit 10: PB Band chart



Source: Company, KAF, Bloomberg

Exhibit 11: PE Band chart



Source: Company, KAF, Bloomberg

Income Statement

FYE Jul (RMm)	2017	2018	2019F	2020F	2021F
Revenue	2,403	2,627	2,854	3,063	3,281
EBITDA	399	436	488	543	631
Depreciation/Amortisation	(63)	(72)	(86)	(91)	(103)
Operating income (EBIT)	336	364	402	452	528
Other income & associates	7	8	9	10	11
Net interest	(14)	(11)	(12)	(13)	(14)
Exceptional items	(10)	0	0	0	0
Pretax profit	319	362	399	449	525
Taxation	(58)	(68)	(96)	(108)	(126)
Minorities/pref dividends	(4)	(4)	(4)	(5)	(5)
Net profit	257	290	299	337	394
Core net profit	267	290	299	337	394

Balance Sheet

FYE Jul (RMm)	2017	2018	2019F	2020F	2021F
Fixed assets	1,013	1,151	1,214	1,373	1,520
Intangible assets	12	59	59	59	59
Other long-term assets	545	897	997	997	997
Total non-current assets	1,625	2,169	2,332	2,491	2,638
Cash & equivalent	192	172	139	84	143
Stock	169	264	286	307	329
Trade debtors	426	527	572	614	658
Other current assets	166	233	233	233	233
Total current assets	953	1,195	1,230	1,239	1,363
Trade creditors	419	491	533	572	613
Short-term borrowings	301	610	460	360	310
Other current liabilities	23	24	24	24	24
Total current liabilities	744	1,125	1,017	956	947
Long-term borrowings	167	324	434	434	434
Other long-term liabilities	64	82	82	82	82
Total long-term liabilities	230	406	516	516	516
Shareholders' funds	1,535	1,764	1,960	2,188	2,469
Minority interests	68	70	70	70	70

Cash flow Statement

FYE Jul (RMm)	2017	2018	2019F	2020F	2021F
Pretax profit	319	362	399	449	525
Depreciation/Amortisation	63	72	86	91	103
Net change in working capital	(5)	31	(26)	(24)	(25)
Others	(54)	(72)	(84)	(95)	(112)
Cash flow from operations	323	392	375	422	491
Capital expenditure	(127)	(65)	(50)	(50)	(50)
Net investments & sale of fixed assets	0	(146)	(100)	(100)	(100)
Others	(126)	(492)	(104)	(105)	(105)
Cash flow from investing	(253)	(703)	(254)	(255)	(255)
Debt raised/(repaid)	(8)	365	(40)	(100)	(50)
Equity raised/(repaid)	0	0	0	0	0
Dividends paid	(103)	(56)	(103)	(108)	(113)
Others	133	(18)	(12)	(13)	(14)
Cash flow from financing	22	291	(155)	(221)	(178)
Net cash flow	91	(20)	(34)	(54)	59
Net cash/(debt) b/f	101	192	172	139	84
Net cash/(debt) c/f	192	172	139	84	143

Key Ratios

FYE Jul	2017	2018	2019F	2020F	2021F
Revenue growth (%)	9.2	9.3	8.7	7.3	7.1
EBITDA growth (%)	7.5	9.2	12.0	11.3	16.2
Pretax margins (%)	13.3	13.8	14.0	14.7	16.0
Net profit margins (%)	10.7	11.0	10.5	11.0	12.0
Interest cover (x)	24.0	33.9	34.0	34.8	36.9
Effective tax rate (%)	18.2	18.7	24.0	24.0	24.0
Net dividend payout (%)	29.1	33.6	34.5	32.1	28.8
Debtors turnover (days)	57	61	64	68	68
Stock turnover (days)	23	30	35	35	35
Creditors turnover (days)	65	63	65	66	66

Source: Bloomberg, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Disclaimer

This report has been prepared solely for the information of clients of KAF Group of companies. It is meant for private circulation only, and shall not be reproduced, distributed or published either in part or otherwise without the prior written consent of KAF-Seagroatt & Campbell Securities Sdn Bhd.

The information and opinions contained in this report have been compiled and arrived at based on information obtained from sources believed to be reliable and made in good faith. Such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made by KAF-Seagroatt & Campbell Securities Sdn Bhd as to the accuracy, completeness or correctness of such information and opinion.

Any recommendations referred to herein may involve significant risk and may not be suitable for all investors, who are expected to make their own investment decisions at their own risk. Descriptions of any company or companies or their securities are not intended to be complete and this report is not, and should not, be construed as an offer, or a solicitation of an offer, to buy or sell any securities or any other financial instruments. KAF-Seagroatt & Campbell Securities Sdn Bhd, their Directors, Representatives or Officers may have positions or an interest in any of the securities or any other financial instruments mentioned in this report. All opinions are solely of the author, and subject to change without notice.



Dato' Ahmad Bin Kadis
Managing Director
KAF-Seagroatt & Campbell Securities Sdn Bhd (134631-U)