

18 March 2016

Consumer Non-cyclical | Packaging

## Scientex

**Buy** (Maintained)

### Come Onboard a Profit Expansion Ride

We are excited about Scientex's multi-year expansion in its consumer packaging division which would more than quadruple its initial capacity by the end of 2016 and drive a 3-year earnings CAGR of 35% in FY15-18F. Maintain BUY with a SOP-derived MYR13.05 TP (from MYR10.68, 13% upside) as we revise up our sales volume assumptions for its packaging division to account for a higher average utilisation rate of 80% for FY16.

**Fast and furious.** Already the largest stretch film manufacturer in Asia and amongst the top three globally, Scientex is now embarking on a capacity expansion spree to grow its consumer packaging capacity through a series of acquisitions and organic expansions. We continue to highlight Scientex's impressive feat in building up its consumer packaging to 146,400 tonnes by end-2016, from just 30,000 tonnes in 2014 (CAGR of +121%).

**Exciting market opportunities.** Scientex's strategy to ramp up production of its BOPP film capacity by ten-fold bears favourable market opportunities as the bulk of the supply catered for local demand is currently imported. We think that the demand for such film would be anchored by its wide application across the F&B, electrical and electronics and pharmaceutical industries. Scientex's maiden venture into the CPP film production would also allow it to cross-sell the new product to its existing clientele due to the complementary nature of its products.

**Focus on affordable homes.** While the property sector remains soft, we think that management's focus on affordable housing could help to anchor earnings, as demand for this segment is more resilient. For FY16, management has targeted to launch around MYR600m worth of projects, which includes the rollout of the first phase of development on its recently acquired land in Pulai, Johor. These affordable homes are estimated to range between MYR200,000-400,000 per unit.

**Maintain BUY.** We raise our forecast by 5-17% for FY16-18 to account for a higher sales tonnage as we turn more confident on management's guidance to deliver on the guided sales volume. We have also put in a place a higher RNAV discount of 40% (from 30%) to account for the softer property market in Johor. We raise our SOP-derived TP to MYR13.05, valuing its manufacturing segment using DCF (WACC: 8%, terminal growth:2%) and the property segment based on a 40% discount to RNAV (from 30%) to account for the softer sentiment in the property market.

Target Price:	MYR13.05
Price:	MYR11.54
Market Cap:	USD648m
Bloomberg Ticker:	SCI MK

#### Share Data

Avg Daily Turnover (MYR/USD)	2.88m/0.68m
52-wk Price low/high (MYR)	6.58 - 11.5
Free Float (%)	28
Shares outstanding (m)	228
Estimated Return	13%

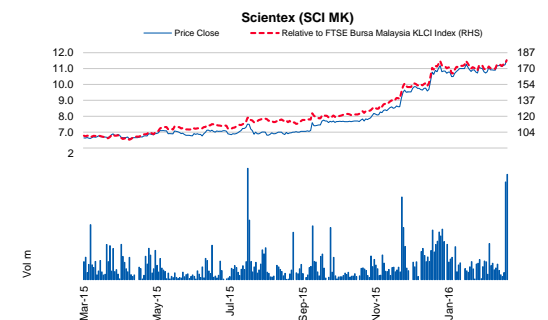
#### Shareholders (%)

Scientex Holdings SB	21.7
Scientex Leasing SB	10.2
Lim Teck Meng	8.3

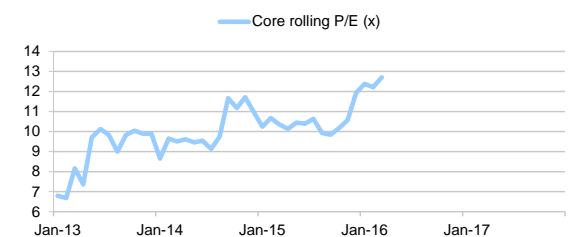
#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	18.4	5.7	26.1	64.2	70.7
Relative	17.8	3.4	23.3	62.9	75.4

Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Jul-14	Jul-15	Jul-16F	Jul-17F	Jul-18F
Total turnover (MYRm)	1,590	1,802	2,536	3,271	3,687
Reported net profit (MYRm)	148	158	244	326	385
Recurring net profit (MYRm)	146	158	244	326	385
Recurring net profit growth (%)	19.1	8.5	54.1	33.7	18.2
Recurring EPS (MYR)	0.66	0.70	1.07	1.43	1.69
DPS (MYR)	0.21	0.22	0.32	0.43	0.51
Recurring P/E (x)	17.5	16.5	10.8	8.1	6.8
P/B (x)	3.58	2.77	2.37	1.97	1.64
P/CF (x)	16.6	24.2	10.3	7.5	6.1
Dividend Yield (%)	1.8	1.9	2.8	3.7	4.4
EV/EBITDA (x)	11.5	14.7	7.5	5.4	4.2
Return on average equity (%)	22.1	19.1	23.7	26.6	26.1
Net debt to equity (%)	34.9	13.4	16.9	3.9	net cash
Our vs consensus EPS (adjusted) (%)			6.0	8.6	13.2

Source: Company data, RHB

#### Analyst

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## Financial Exhibits

Profit & Loss (MYRm)	Jul-14	Jul-15	Jul-16F	Jul-17F	Jul-18F	Cash flow (MYRm)	Jul-14	Jul-15	Jul-16F	Jul-17F	Jul-18F
<b>Total turnover</b>	<b>1,590</b>	<b>1,802</b>	<b>2,536</b>	<b>3,271</b>	<b>3,687</b>	<b>Operating profit</b>	<b>190</b>	<b>225</b>	<b>327</b>	<b>438</b>	<b>509</b>
Cost of sales	(1,274)	(1,414)	(1,978)	(2,553)	(2,885)	Depreciation & amortisation	53	(39)	52	64	69
<b>Gross profit</b>	<b>316</b>	<b>388</b>	<b>557</b>	<b>718</b>	<b>802</b>	Change in working capital	(36)	(34)	(50)	(51)	(29)
Gen & admin expenses	(91)	(117)	(165)	(196)	(210)	Other operating cash flow	(17)	-	-	-	-
Selling expenses	(41)	(52)	(75)	(95)	(96)	<b>Operating cash flow</b>	<b>190</b>	<b>152</b>	<b>329</b>	<b>452</b>	<b>549</b>
Other operating costs	5	6	9	11	13	Tax paid	(37)	(44)	(74)	(99)	(117)
<b>Operating profit</b>	<b>190</b>	<b>225</b>	<b>327</b>	<b>438</b>	<b>509</b>	<b>Cash flow from operations</b>	<b>154</b>	<b>108</b>	<b>255</b>	<b>352</b>	<b>431</b>
EBITDA	243	186	380	503	578	Capex	(66)	(100)	(240)	(100)	(70)
Depreciation of fixed assets	(53)	39	(52)	(64)	(69)	Other investing cash flow	(84)	63	(0)	-	-
<b>Operating profit</b>	<b>190</b>	<b>225</b>	<b>327</b>	<b>438</b>	<b>509</b>	<b>Cash flow from investing activities</b>	<b>(149)</b>	<b>(37)</b>	<b>(240)</b>	<b>(100)</b>	<b>(70)</b>
Net income from investments	4	4	3	4	4	Dividends paid	(58)	(48)	(73)	(98)	(115)
Interest expense	(7)	(8)	(7)	(10)	(3)	Increase in debt	(8)	(121)	247	(30)	(10)
<b>Pre-tax profit</b>	<b>186</b>	<b>221</b>	<b>323</b>	<b>432</b>	<b>510</b>	Other financing cash flow	(7)	23	(7)	(10)	(3)
Taxation	(35)	(59)	(74)	(99)	(117)	<b>Cash flow from financing activities</b>	<b>(73)</b>	<b>(146)</b>	<b>167</b>	<b>(138)</b>	<b>(128)</b>
Minority interests	(3)	(4)	(5)	(7)	(8)	Cash at beginning of period	152	84	91	273	387
<b>Reported net profit</b>	<b>148</b>	<b>158</b>	<b>244</b>	<b>326</b>	<b>385</b>	<b>Total cash generated</b>	<b>(68)</b>	<b>(75)</b>	<b>182</b>	<b>114</b>	<b>233</b>
<b>Recurring net profit</b>	<b>146</b>	<b>158</b>	<b>244</b>	<b>326</b>	<b>385</b>	<b>Implied cash at end of period</b>	<b>84</b>	<b>9</b>	<b>273</b>	<b>387</b>	<b>620</b>

Source: Company data, RHB

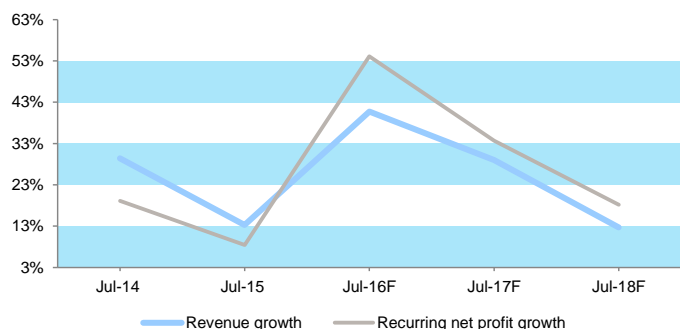
Source: Company data, RHB

Key Ratios	Jul-14	Jul-15	Jul-16F	Jul-17F	Jul-18F	Balance Sheet (MYRm)	Jul-14	Jul-15	Jul-16F	Jul-17F	Jul-18F
Revenue growth (%)	29.4	13.3	40.7	29.0	12.7	Total cash and equivalents	84	91	273	387	620
Operating profit growth (%)	29.8	18.6	45.4	33.9	16.1	Inventories	109	112	141	182	206
Recurring net profit growth (%)	19.1	8.5	54.1	33.7	18.2	Accounts receivable	243	322	458	591	667
Recurrent EPS growth (%)	16.3	6.2	52.4	33.7	18.2	Other current assets	105	136	136	136	136
Gross margin (%)	19.9	21.5	22.0	21.9	21.7	<b>Total current assets</b>	<b>541</b>	<b>661</b>	<b>1,009</b>	<b>1,297</b>	<b>1,629</b>
Operating EBITDA margin (%)	15.3	10.3	15.0	15.4	15.7	Total investments	47	66	68	72	76
Operating margin (%)	11.9	12.5	12.9	13.4	13.8	Tangible fixed assets	813	911	1,099	1,134	1,135
Recurring net profit margin (%)	9.2	8.8	9.6	10.0	10.4	Total non-current assets	860	977	1,167	1,207	1,211
Return on average assets (%)	11.1	10.4	12.8	13.9	14.4	<b>Total assets</b>	<b>1,400</b>	<b>1,638</b>	<b>2,176</b>	<b>2,504</b>	<b>2,840</b>
Return on average equity (%)	22.1	19.1	23.7	26.6	26.1	Short-term debt	263	150	236	221	216
Net debt to equity (%)	34.9	13.4	16.9	3.9	(11.1)	Accounts payable	272	308	424	547	616
Interest cover (x)	27	27	49	44	184	Other current liabilities	11	42	42	42	42
Capex/Free cash flow (%)	42.8	92.7	94.1	28.4	16.2	<b>Total current liabilities</b>	<b>547</b>	<b>500</b>	<b>702</b>	<b>810</b>	<b>874</b>
BVPS (MYR)	3.22	4.17	4.87	5.87	7.05	Total long-term debt	78	76	236	221	216
DPS (MYR)	0.21	0.22	0.32	0.43	0.51	Other liabilities	41	57	57	57	57
Dividend payout ratio (%)	31.3	31.4	30.0	30.0	30.0	<b>Total non-current liabilities</b>	<b>118</b>	<b>133</b>	<b>294</b>	<b>279</b>	<b>274</b>
Free cash flow per share (MYR)	0.40	0.03	0.07	1.10	1.58	<b>Total liabilities</b>	<b>665</b>	<b>633</b>	<b>996</b>	<b>1,088</b>	<b>1,148</b>

Source: Company data, RHB

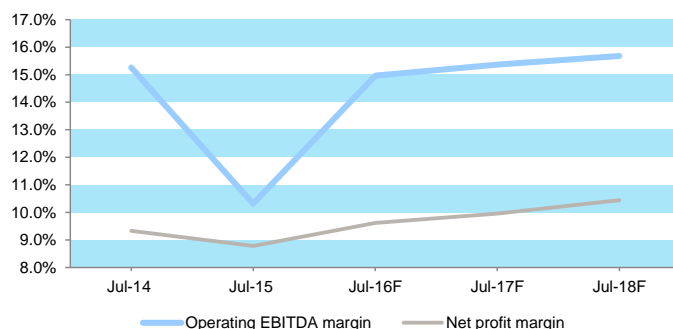
Source: Company data, RHB

Revenue growth vs Recurring net profit growth



Source: Company data, RHB

EBITDA margin vs Net profit margin



Source: Company data, RHB

## Come Onboard a Profit Expansion Ride

### Expansion-powered growth

We continue to highlight Scientex's impressive feat in building up its consumer packaging capacity through a series of acquisitions and organic expansion. By end-2016, Scientex's consumer packaging division capacity could reach 146,400 tonnes, from just 30,000 tonnes in 2014 (+121% CAGR).

We learned that Scientex's planned capacity expansion is well on track, as guided by management. For its Polyethylene (PE) division, two of the three lines have already been installed in its Rawang plant. A commercial production run of the PE lines is expected to start approximately at the end-FY16/early-FY17. This would bring its total PE capacity to 74,400 tonnes in 2016, from just 24,000 tonnes in 2014 (CAGR: +76%).

### Exciting market potential for BOPP and CPP films

The construction of its new biaxially oriented polypropylene (BOPP) plant facility would catapult Scientex's existing BOPP capacity by ten-fold to 60,000 tonnes pa. We think Scientex's venture into BOPP production bears exciting market opportunities as the bulk of the supply catered for local demand is currently imported.

We think Scientex is well-positioned to gain a market share among BOPP film users as it enjoys the advantage of:

- i) Quicker delivery times compared to imported films, and
- ii) More competitive pricing due to the economies of scales compared to other smaller players.

Scientex's new cast polypropylene (CPP) film plant in Malacca is already up and running since 2H 2015 and marks the group's entry into the CPP film-making business. CPP film is the inner sealing layer in a lamination-based packaging. It complements the group's existing products ie PE and BOPP films, which form the protective inner and outer layers of a flexible packaging respectively. The complementary function of the CPP films would allow the group to leverage on its existing clientele in Malaysia and South-East Asia to cross-sell its products.

### Focus on affordable housing in FY16

While the property market remains soft, we think that management's strategy to focus on landed affordable housing would help to anchor earnings. In FY16, Scientex is targeting to launch around MYR600m worth of projects (FY15: MYR667.4m), which would include the rollout of the first phase of development of its recently acquired land in Pulai, Johor. The development would be centred on affordable homes with an estimated price range of MYR200,000-400,000 per unit. This would help to recoup the land cost of its 326-acres of land in Pulai, Johor acquired at MYR219m in 2015, which was partly financed by internal funds and the issuance of a *sukuk murabahah*. We also understand that the demand for its Rumah Mampu Milik Johor (RMMJ) priced between MYR80,000-MYR180,000 per unit, launched in May 2015, has also been resilient.

**Figure 1: SOP-derived TP**

Divisions	Method	Valuation (MYRm)
Manufacturing	DCF (WACC: 8%)	2,413.4
Property	RNAV (Discount of 40%)	568.8
<b>Total Equity Value</b>		<b>2,982.2</b>
No. of shares (m)		228.4
<b>TP per share (MYR)</b>		<b>13.05</b>

Source: RHB

Figure 2: Scientex's DCF valuation for manufacturing segment

	FY16F	FY17F	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
Free cash flow to firm (FCFF)	(31.7)	59.4	126.3	173.8	185.6	181.9	190.3	200.3	204.9	219.8
PV of FCFF	(30.1)	51.1	98.2	122.1	117.9	104.4	98.7	94.0	86.9	84.3
<b>Sum of PV of FCFF</b>	<b>827.3</b>									
Terminal Value	3,778									
<b>PV of Terminal Value</b>	<b>1,829</b>									
Firm value	2,656.70									
Net debt (1QFY16)	(243)									
<b>Equity Value</b>	<b>2,413.4</b>									
WACC computation										
Risk free rate	4.3%									
Market risk premium	6.7%									
Beta	0.7									
Cost of Equity	9.3%									
Cost of debt (after-tax)	3.8%									
WACC	8%									
Implied FY17F P/E	14.8									

Source: RHB estimates

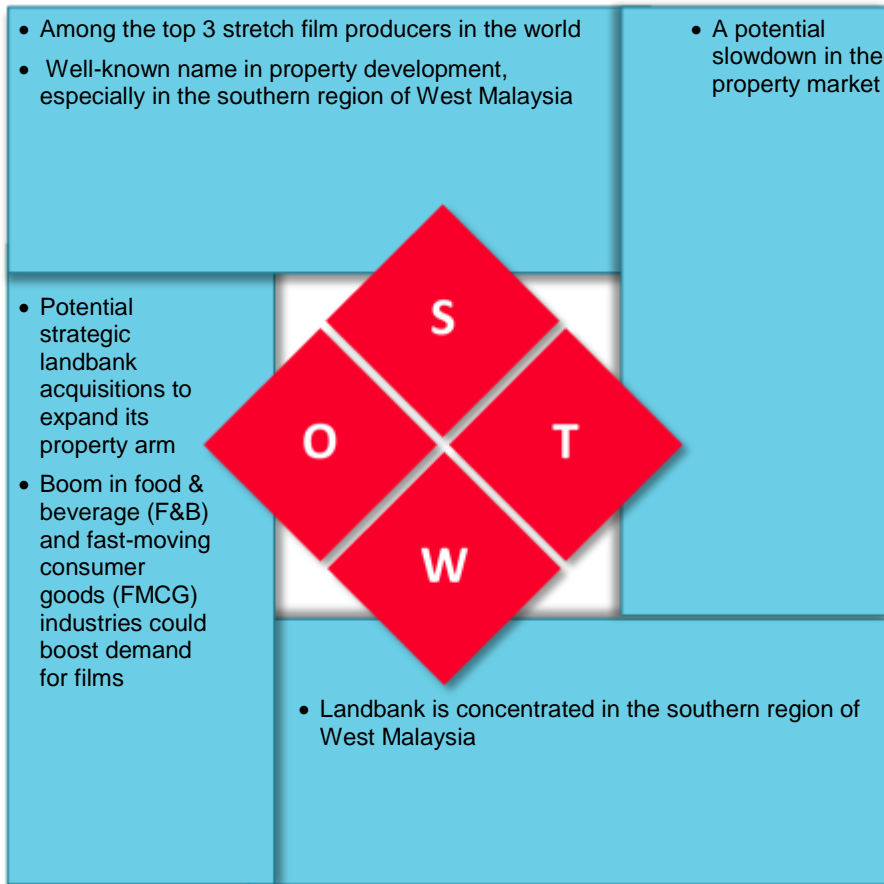
Figure 3: Peer comparison

Company	Bloomberg Ticker	Rec	TP MYR	Price MYR	Mkt Cap (MYRm)	P/E (x)		P/BV(x)		DY (%)		ROE (%)		3-Yr fwd CAGR
						FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17	
<b>Local peers</b>														
Thong Guan Industries	TGI MK	Neutral	2.94	3.23	340.0	10.0	13.2	1.2	1.1	4.3	2.4	11.6	8.8	0.3
BP Plastics	BPP MK	NR	NR	1.66	311.5	13.8	11.1	1.98	1.98	4.5	5.5	13.8	6.5	n.a.
Daibochi	DPP MK	Sell	1.65	2.18	595.7	15.0	18.8	3.12	2.92	3.0	3.2	16.1	16.1	2.4
<b>Average</b>					<b>415.7</b>	<b>12.9</b>	<b>14.3</b>	<b>2.1</b>	<b>2.0</b>	<b>3.9</b>	<b>3.7</b>	<b>13.8</b>	<b>10.5</b>	<b>1.3</b>
Scientex	SCI MK	Buy	13.05	11.54	2651	10.8	8.1	2.4	2.0	2.8	3.7	23.7	26.6	0.3

Data as of March 17, 2016

Source: RHB, Bloomberg

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-12-18	Buy	10.7	9.5
2015-09-30	Buy	8.3	7.1
2015-08-06	Buy	8.8	7.5
2015-06-30	Buy	7.9	6.9
2015-03-24	Buy	8.2	6.6
2014-12-18	Buy	8.6	7.0
2014-09-25	Buy	8.6	7.1
2014-08-10	Buy	7.2	6.0
2014-03-21	Buy	7.2	5.8
2014-03-12	Buy	6.4	5.7

Source: RHB, Bloomberg

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