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THE WEEK OF MARCH 21 — MARCH 27, 2016
THE EDGE MALAYSIA

TRADE WISE

Scientex to deliver another record year?

BY **ALEX CHONG**

Scientex Bhd, which is due to release the results for its second quarter ended Jan 31, 2016 (2QFY2016), by the end of this month, has seen its share price rise 85.5% over the past year. And for investors wondering whether the stock has further upside, the company's plan to expand its plastic manufacturing business may offer a clue.

Scientex was one of the stocks featured under Stock with Momentum in *The Edge Financial Daily* last Wednesday as more than a million of its shares are changing hands daily. The counter has been actively traded, reaching an all-time high of RM12.08 last Friday. By comparison, the average daily trading volume in the past 200 days has only been 191,850 shares.

The last time Scientex saw such a high level of trading was in mid-December 2015, when it posted a 101.1% jump in net profit for its first quarter ended Nov 30, 2015 (1QFY2016). Since then, its share price has risen 33% to the current level in just three months.

Coincidentally, RHB Research, in its March 18 note, says it is excited about Scientex's multi-year expansion and is more confident that management can deliver the guided sales volume. The research house raised its target price by 22.2% to RM13.05 with a 13% upside potential.

To recap, Scientex's 1QFY2016 net profit of RM60.85 million, its highest quarterly net profit since listing, surpassed analysts' expectations. Three out of four research houses revised their target price upwards to between RM9.49 and RM10.68 from between RM6.91 and RM9.01 previously. UOB Kay Hian maintained its "buy" call and target price of RM12.50.

Incorporated in 1968 and majority-owned by the Lim family, Scientex was originally involved in the production of polyvinyl chloride (PVC) leather cloth for the automotive interior segment and sheeting for industrial and consumer products. Under the leadership of the second generation, Scientex has become a leading industrial plastic packaging manufacturer as well as an established property developer in southern Malaysia.

The key figure behind Scientex is managing director Lim Peng Jin, the youngest son of founder Lim Teck Meng, who began his chemical engineering career in Japan before joining the company in 1991. Under his stewardship, Scientex has a bold ambition to grow its market capitalisation to RM2.5 billion.

In addition to a gradual and organic expansion, Scientex has formed joint ventures with leading Japanese packaging companies and snapped up smaller companies in the industry to boost its manufacturing capacity and gain immediate access to a wider client base.

Chart 1
Scientex's share price peformance in the past 10 years

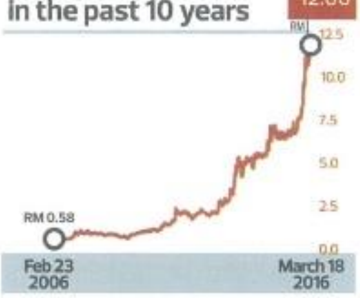

Chart 2
Manufacturing capacity ('000 tonnes)

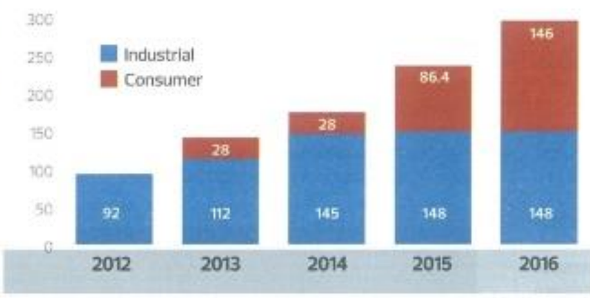

Chart 3
Operating income by segment (RM mil)

Chart 4
Scientex's 10-year financial performance

Manufacturing takes centre stage this year

In 2013, Scientex took over GW Plastics' companies for RM283 million. This boosted its industrial cast stretch film capacity by 34,000 tonnes and gave it an immediate annual production capacity of 28,000 tonnes of consumer packaging blown film.

In 2014, it unveiled an aggressive RM300 million expansion plan to increase its consumer packaging capacity fivefold to 150,000 tonnes by the end of this year (see Chart 2), citing the growing demand for flexible packaging in the regional food and beverage and fast-moving consumer goods industries. During the year, the company installed new blown film lines, adding another 20,000 tonnes to its consumer packaging capacity.

"Profit before tax (PBT) margin for our industrial packaging products is on average around 5% to 6%. In general, our consumer packaging products have a higher margin of 6% to 8% due to more value-added processes, such as printing and finishing processes," says Peng Jin via email.

In August 2015, the company completed the acquisition of two polyethylene (PE) plants from Mondi Group for RM58 million. Meanwhile, its cast-polypropylene (CPP) plant in Melaka, which has an annual production capacity of 12,000 tonnes, began commercial production in December 2015. Altogether, its annual consumer packaging capacity increased by 26,400 tonnes to 86,400 tonnes in 2015.

Scientex has allocated RM21 million to add 12,000 tonnes of PE film capacity to its Rawang plant by the middle of this year when its new biaxially oriented polypropylene (BOPP) plant in Pulau Indah with a 54,000-tonne annual capacity is also slated to commence operations.

"With the majority of CPP and BOPP film supply in Malaysia currently imported from overseas, we believe there are significant import substitute opportunities for us, where local players can benefit from lower-priced film with quicker delivery times.

"At the same time, it is opportune for us to tap the growing regional demand for flexible packaging by the F&B industry, driven by a rapidly growing population and increasing urbanisation," Peng Jin explains.

Scientex's manufacturing business has recorded high double-digit growth in operating income due to its various acquisitions and expansion plans since 2013 (see Chart 3). Peng Jin says he is confident of Scientex's prospects and expects FY2016 earnings to be boosted by incoming contribution from its recent and upcoming expansion in consumer packaging capacity.

Property remains steady in soft market

Although manufacturing accounted for 71.4% of its total revenue in FY2015, Scientex derived 69.5% of its operating income from property development. This is because the 34% operating profit margin from property development is a lot higher than its 6% operating margin from manufacturing.

It is also worth noting that the property business has overtaken manufacturing as the larger earnings contributor since FY2011. Currently, Scientex has four ongoing property projects in Johor and one high-rise development in Melaka.

Despite the industry-wide slowdown, Scientex anticipates demand for its properties to be steady as 80% of its launches comprise affordable properties priced below RM500,000. The strong take-ups of about 80% in its recent launches pushed unbilled sales up to RM632 million as at end-October 2015, from RM584.9 million a quarter ago.

In FY2016, Scientex targets to launch projects with an estimated gross development value of about RM600 million. It recently acquired 326 acres in Pulai, Iskandar Malaysia, for RM218.97 million, which will increase its landbank to 1,200 acres and sustain its earnings potential over the medium to long term.

Kenanga, which has a contrarian "market perform" call on the stock versus a consensus "buy" call, says it remains cautious about Scientex's property business due to its Johor focus despite the earnings growth potential of its manufacturing business. The research house expects the ongoing sector slowdown to persist this year but Scientex's focus on affordable houses should provide some earnings resilience.

FY2016 earnings to normalise

Save for the year after the 2008 global financial crisis, Scientex has an impressive track record of having delivered higher year-on-year (y-o-y) earnings in the past 10 years (see Chart 4). FY2015 was another record year for Scientex — it posted an increase of RM9.7 million or 6.6% in net profit to RM158.2 million.

Nonetheless, included in the net profit of RM158.2 million was a revaluation gain of RM12.6 million on investment properties as well as a foreign exchange loss of RM27.2 million, arising from its RM207.9 million worth of low interest US dollar borrowings at the beginning of the year.

Despite deriving about half its sales from outside the country, the stronger US dollar hurt Scientex's bottom line as the ringgit weakened in FY2015. Throughout the year, Scientex aggressively paid down RM150 million worth of US dollar borrowings to RM55.9 million.

In FY2016, Peng Jin expects net profit to normalise, given that Scientex has reduced its US debt loans and adopted a new hedging position. As at end-October 2015, US dollar debts increased to RM99.6 million, accounting for 30.8% of total borrowings.

Its CPP plant in Melaka, which began production in December 2015, could contribute positively to its 2QFY2016 results while additional sales from its new BOPP plant in Pulau Indah, slated to commence production by mid-2016, could contribute positively to its 4QFY2016 results. All in, the effects of its RM300 million expansion plan would be fully reflected in its FY2017 and FY2018 accounts as it may take some time to fill up the new plants with sales orders.

Scientex has had in place a 30% dividend policy since 2011. That said, the stock is giving a dividend yield of only 1.8%, down from 3.4% a year ago, thanks to the sharp rise in the share price over the past year. However, Scientex says its main focus is growing the business and dividend payments are expected to increase, commensurate with growth and higher profits.

According to Bloomberg, there are three "buy" calls and one "hold" call on the stock. Analysts on average expect Scientex's net profit to grow 22.1% in FY2016 and 17.8% in FY2017, with the current price-earnings ratio of 14.1 times compressed to 11.5 times in FY2016 and 9.9 times in FY2017.