

## TRADE WISE

# Scientex invests in future growth

BY TAN SIEW MUNG

Scientex Bhd, which has managed to increase its profit every year since 2010, is ensuring that the momentum continues and is pinning its hopes on the US to spur growth.

Last November, the packaging manufacturer and property developer announced that it was investing US\$25 million (RM111.59 million) to set up its first US stretch film manufacturing plant in Arizona.

However, some quarters see Scientex's US move as ambitious amid the weak global economic conditions and continued uncertainty over what a Donald Trump presidency will mean for trade. In a Dec 28 report, TA Securities says the operating environment could be challenging due to the US government's protectionist measures and tough competition among the local stretch film players.

However, Scientex managing director Lim Peng Jin is unperturbed. He believes the group's proven track record puts it in good stead to face its competitors in the US.

"We are going to the US because we will be closer to our customers there. We will also save on freight costs; currently, it takes about six weeks to bring our products to the US," he tells *The Edge*.

He says Scientex has purchased a piece of land with an empty building and a rail link.

Another benefit is that it would no longer need to pay import duty of 4.2% on products manufactured and sold in the US.

Scientex would also benefit from lower raw material costs as plastic resins are cheaper in the US, given the lower shale gas prices.

Lim is unfazed by the high labour cost in the US as the proposed plant will involve "a whole lot of automation", reducing reliance on labour-intensive manufacturing practices.

He does not see a Trump presidency posing risks and believes the new government will continue to make the US a more favourable and competitive environment.

However, he is aware that the operating margin in the US will be lower due to the smaller number of players and less competition following the industry consolidation. If Scientex can achieve a bigger scale in the future, Lim believes margins will improve.

Scientex currently produces 150,000 tonnes of consumer packaging products a year, of which only 1% is exported to the US.

Demand for stretch film in Asia-Pacific is 650,000 tonnes, and for the US and North America market, 700,000 tonnes; if South America were included, it goes up to one

## Sales by segment



## EBIT by segment



Sources: Scientex, UOB Kay Hian



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million tonnes, according to Lim.

"We have been exporting to the US since 1997... we exported more when raw material prices were lower. We also know the customers," he says.

The group will start its US operations on a small scale with an annual capacity of 30,000 tonnes under Phase 1, or just a 3% share of the market, he points out.

"We will initially serve markets in the west coast such as California and San Francisco. If all goes well, we will ramp up production to 100,000 tonnes per year," Lim says.

The management is in the midst of completing the land deal and taking manufacturing equipment over to the US.

Lim expects the US venture to begin generating income in 2018 and break even in 2019.

He says Scientex will finance its expansion through internal funds and US dollar borrowings, adding that its exposure to currency fluctuations will be limited.

"From a business point of view, financing, assets and sales are all in US dollar terms, so I would say it is a natural hedging position," he says, adding that 75% of the group's export sales are denominated in US dollars.

Meanwhile, Scientex will take a breather from merger and acquisition (M&A) activities this year as it focuses on fully utilising its existing capacity in Malaysia.

The group has 13 plants, including the US plant. The utilisation rate for its industrial packaging segment ranges from 70% to 80%.

For consumer packaging, the utilisation rate is about 50% of the total capacity of 12,000 tonnes. Lim expects the group to take two years to fully utilise its capacity.

Southeast Asia is its major market for consumer packaging. As the population increases and living standards rise, the demand for flexible packaging will expand, compared with rigid packaging. He sees consumer packaging demand increasing 10% to 20% per year over the next ten years.

The group recently secured a major consumer packaging client from Japan.

While analysts agree that Scientex's expansion to the US could be a catalyst in the long term, they say the impact in the near term is limited as a gestation period is needed to make headway in the market.

An analyst from TA Securities is neutral on this venture as she expects near-term contribution from the US plant to be minimal.

"We see the establishment of the plant as a testament to the long-term commitment to customers in the US and to maintain existing business relationships with existing customers. (But) there is no change to our FY2017-FY2018 earnings projections as the plant is expected to start contributing from FY2019 onwards," she tells *The Edge*.

"Assuming that Scientex funds 80% of the establishment cost via borrowings, the group's net gearing will be little changed at 0.1 times for FY2017.

"It could be a strategic move for Scientex if it can increase its market share in the US. The key benefit is to diversify its export sales away from the saturating Japanese market. But it will be tough as local players are strong and have a large market share," she adds.

Says UOB Kay Hian Securities (M) Sdn Bhd analyst Fong Kah Yan, "Based on the management's track record and experience, I think the execution should not be a problem. In the longer term, the US plant can be a catalyst as it can double the current capacity."

Fong thinks the counter is likely to trade range-bound this year. She recently downgraded the counter to "hold", with a lower target price of RM7 from RM7.40, after the group's 1QFY2017 net profit missed the research house's expectation.

"A concern is the manufacturing segment. Patience is needed for the capacity of the newly-commenced biaxially oriented polypropylene (BOPP) film manufacturing plant in Pulau Indah, Selangor, with an annual capacity of 60,000 tonnes, to be taken up," she says.

Scientex closed unchanged at RM6.75 last Friday, easing from its record high of RM6.90 on Nov 22 last year. Among the six analysts covering Scientex, five have a "buy" recommendation while sixth has a "hold", according to Bloomberg data. Their average target price is RM7.71.

TA Securities has the highest target price of RM8.50. The research house's analyst believes Scientex's earnings growth will continue to be supported by its consumer packaging earnings following the completion of its BOPP plant last September.

Scientex's net profit fell 14.45% year on year to RM52.06 million in the first financial quarter ended Oct 31, 2016 (1QFY2017) due to lower product margin and property sales. Lim attributed the decline to the start-up costs for the BOPP plant and the timing of its property sales.

## Property another pillar of Scientex

BY KATHY FONG

The country's property boom ended a long time ago, but Scientex Bhd's property business still flourishes, generating lucrative earnings for the group.

Property sales have been on a growth path for the past two years. Sales grew to RM500 million in 2014 from RM300 million in 2013. In 2015, it achieved sales of RM650 million.

The bulk of Scientex's revenue comes from its plastic packaging material manufacturing business but its property business is the main profit contributor.

The property division generated operating profit of RM187.8 million for the financial year ended July 31, 2016 (FY2016), up 7% from the previous financial year, compared with RM124.7

million from the manufacturing division.

For the first financial quarter ended Oct 31, 2016, the property division generated operating profit of RM45.08 million compared with RM23.75 million from the manufacturing division.

While other property developers have switched to a slower gear in view of the current soft market, the group has no intention to apply the brakes on land bank expansion or project launches.

The company has invested about RM400 million in replenishing its land bank over the past two years. At the end of December last year, Scientex announced that it had bought two parcels in Kulai, Johor, from Lee Rubber Ltd for total of RM123.6 million in cash.

"We have the (spare) cash, which was generated by our manufacturing business, so we are acquiring land

now. We are still looking for more to buy," managing director Lim Peng Jin tells *The Edge*.

He does not seem to be concerned about the current slowdown in the property sector. An engineer by training, Lim is certainly a veteran of the property development industry.

"We hit at the right demand — the affordable range," he says, adding that when the property market turned soft, Scientex concentrated on affordable homes.

"We have been in property development for 20 years. Our strategy is when the market is good, we focus on high-end products (RM1 million and above). Now, 95% of our new launches are of affordable homes," says Lim.

Scientex is better known for its plastic packaging material manufacturing business.

Interestingly, the company started in property development much earlier than its venture into plastic packaging materials.

"We have been through a few property cycles, like the financial crisis in 1997, when the interest rate was 12%," says Lim, assuring that the company knows how to survive a downturn.

"Our strategy is to increase the volume. Last year, we launched RM650 million worth of products and this year, we will launch RM700 million. Eventually, we want to increase to RM1 billion worth of new launches in three to five years. That is why we have acquired land bank," he adds.

Currently, Scientex is sitting on unbilled sales of RM650 million that could last for two financial years. The company has a total land bank of 2,500 acres, including 200 acres in Melaka.

While analysts who track the company usually do not pay much attention to the company's property business, Lim, believes that the property and manufacturing businesses complement each other, although they are vastly different in nature.

According to Lim, during an economic downturn, when land is cheap, the company can utilise the cash from the export of its plastic packaging products to increase its land bank at a low cost.

When the economy is on an upward trend, the property division generates a good profit and cash for investment in new manufacturing capacity.

"We have invested RM800 million since 2012 in expanding our manufacturing capacity because the property division has earned good profits," says Lim.