

24 July 2020

Consumer Non-cyclical | Packaging

Scientex (SCI MK)

Neutral (Maintained)

Twin Engines Are Working Just Fine

Target Price (Return): MYR9.80 (+7%)
 Price: MYR9.17
 Market Cap: USD1,113m
 Avg Daily Turnover (MYR/USD): 2.35m/0.55m

- **Keep NEUTRAL with new SOP-derived MYR9.80 TP from MYR7.40, 7% upside.** Scientex's exposure to consumer staple packaging has helped to partly buffer it from the impact of COVID-19. Meanwhile, we expect its property margin to moderate moving forward due to higher land cost. A ramp-up in manufacturing production and new property launches should support earnings growth but it is not overly exciting. Hence, we believe the stock is fairly valued, currently trading at 11.8x P/E, close to its historical average.
- **Its manufacturing division's** exposure in consumer staple products has helped to partly buffer it from the impact of the COVID-19 pandemic. Through Daibochi, the group can now tap into the consumer segment, serving multinational companies in the fast-moving consumer goods (FMCG) space. The synergy between Scientex and Daibochi allows for bulk purchasing of raw materials, which has helped to lower costs. Since the acquisition of Daibochi, the division's operating margin has expanded to c.9% (1HFY20 (Jul)) from c.7% (FY18). We expect the operating margin to remain at the current level moving forward. We understand that there is a cost pass-through mechanism between Scientex and its customers, hence this should minimise the impact of resin price fluctuation. We project this division's earnings to organically grow by c.4% in FY21F, driven by the ramp-up in production of its existing capacity.
- **The company has revised down its property launch GDV target to MYR1bn (from MYR1.1bn) in FY20** on the back of a challenging market environment. We understand that it has launched MYR587.5m of GDV as at 3QFY20, falling short of expectations. Our operating margin assumption of the segment is c.29-30%, slightly lower compared to FY18-19's level of 32-33% as the group previously enjoyed lower land cost, but we believe it is not sustainable. We forecast Scientex's property division's earnings to grow c.14% in FY21, driven by new property launches and an economic recovery. Do note that growth is from a low base in FY20.
- **Maintain NEUTRAL** with new SOP-derived MYR9.80 TP. Our DCF valuation on Scientex's manufacturing unit implies 15.7x FY21F P/E or at 21% premium vs peer average – justified by the company's larger scale of operations. Meanwhile, we value the property division at a 55% discount to RNAV. We believe its relatively resilient earnings growth has already been priced in, with the stock now trading close to its historical average P/E of 12x.
- **We are revising our FY20F-21F earnings to MYR346m and MYR381m** (from MYR378m and MYR412m) after taking into account lower margin assumption, inclusion of Daibochi's contribution, and new property launches since our last report.
- **Risks.** A sharp decline/surge in raw material prices that could pose upside/downside risk to our earnings.

Analysts

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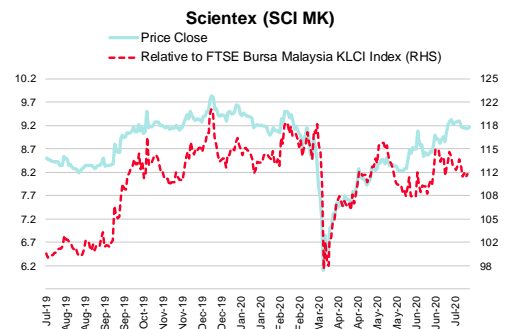


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(3.0)	4.6	13.6	(0.4)	7.8
Relative	(2.9)	(0.7)	(1.3)	(1.2)	12.0
52-wk Price low/high (MYR)	6.09 – 9.84				



Source: Bloomberg

Forecasts and Valuation	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Total turnover (MYRm)	2,603	3,247	3,456	3,666	3,882
Recurring net profit (MYRm)	271	343	351	390	430
Recurring net profit growth (%)	4.2	26.5	2.2	11.3	10.2
Recurring P/E (x)	16.45	13.38	13.09	11.76	10.67
P/B (x)	2.5	2.1	1.9	1.7	1.5
P/CF (x)	11.36	8.24	9.62	9.01	8.46
Dividend Yield (%)	2.2	2.2	2.3	2.6	2.8
EV/EBITDA (x)	12.73	9.73	8.76	7.72	6.76
Return on average equity (%)	16.6	17.3	14.9	15.0	14.9
Net debt to equity (%)	41.9	29.9	16.9	5.4	net cash

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (MYR)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
Malaysia	Recurring EPS	0.56	0.69	0.70	0.78	0.86
Consumer Non-cyclical	DPS	0.20	0.20	0.21	0.23	0.26
Scientex	BVPS	3.60	4.44	4.94	5.48	6.08
SCI MK	Return on average equity (%)	16.6	17.3	14.9	15.0	14.9
Neutral						
	Valuation metrics	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
	Recurring P/E (x)	16.45	13.38	13.09	11.76	10.67
	P/B (x)	2.5	2.1	1.9	1.7	1.5
	FCF Yield (%)	7.4	11.1	8.4	9.1	9.9
	Dividend Yield (%)	2.2	2.2	2.3	2.6	2.8
	EV/EBITDA (x)	12.73	9.73	8.76	7.72	6.76
	EV/EBIT (x)	15.38	11.63	10.50	9.12	7.88
	Income statement (MYRm)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
	Total turnover	2,603	3,247	3,456	3,666	3,882
	Gross profit	511	684	697	755	816
	EBITDA	416	563	598	642	689
	Depreciation and amortisation	(72)	(92)	(99)	(99)	(98)
	Operating profit	344	471	498	543	591
	Net interest	(11)	(16)	(12)	(6)	0
	Pre-tax profit	341	460	490	541	595
	Taxation	(66)	(105)	(118)	(130)	(143)
	Reported net profit	271	343	351	390	430
	Recurring net profit	271	343	351	390	430
	Cash flow (MYRm)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
	Change in working capital	38	86	(3)	(3)	(3)
	Cash flow from operations	392	557	477	509	543
	Capex	(65)	(48)	(90)	(90)	(90)
	Cash flow from investing activities	(703)	(299)	(94)	(94)	(94)
	Dividends paid	(56)	(100)	(105)	(117)	(129)
	Cash flow from financing activities	291	(173)	(121)	(104)	(124)
	Cash at beginning of period	192	172	258	519	830
	Net change in cash	(20)	85	261	311	324
	Ending balance cash	172	258	519	830	1,155
	Balance sheet (MYRm)	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
	Total cash and equivalents	172	258	519	830	1,155
	Tangible fixed assets	1,995	1,969	1,960	1,951	1,943
	Total investments	0	0	4	9	13
	Total assets	3,385	4,107	4,409	4,762	5,130
	Short-term debt	610	704	700	720	725
	Total long-term debt	324	270	270	270	270
	Total liabilities	1,566	1,709	1,743	1,801	1,846
	Total equity	1,820	2,399	2,666	2,961	3,284
	Total liabilities & equity	3,385	4,107	4,409	4,762	5,130
	Key metrics	Jul-18	Jul-19	Jul-20F	Jul-21F	Jul-22F
	Revenue growth (%)	8.3	24.8	6.4	6.1	5.9
	Recurrent EPS growth (%)	0.0	22.9	2.2	11.3	10.2
	Gross margin (%)	19.6	21.1	20.2	20.6	21.0
	Operating EBITDA margin (%)	16.0	17.3	17.3	17.5	17.7
	Net profit margin (%)	10.4	10.6	10.1	10.6	11.1
	Dividend payout ratio (%)	35.9	29.2	30.0	30.0	30.0
	Capex/sales (%)	2.5	1.5	2.6	2.5	2.3
	Interest cover (x)	32.0	30.3	40.6	84.7	(80,775.2)

Source: Company data, RHB

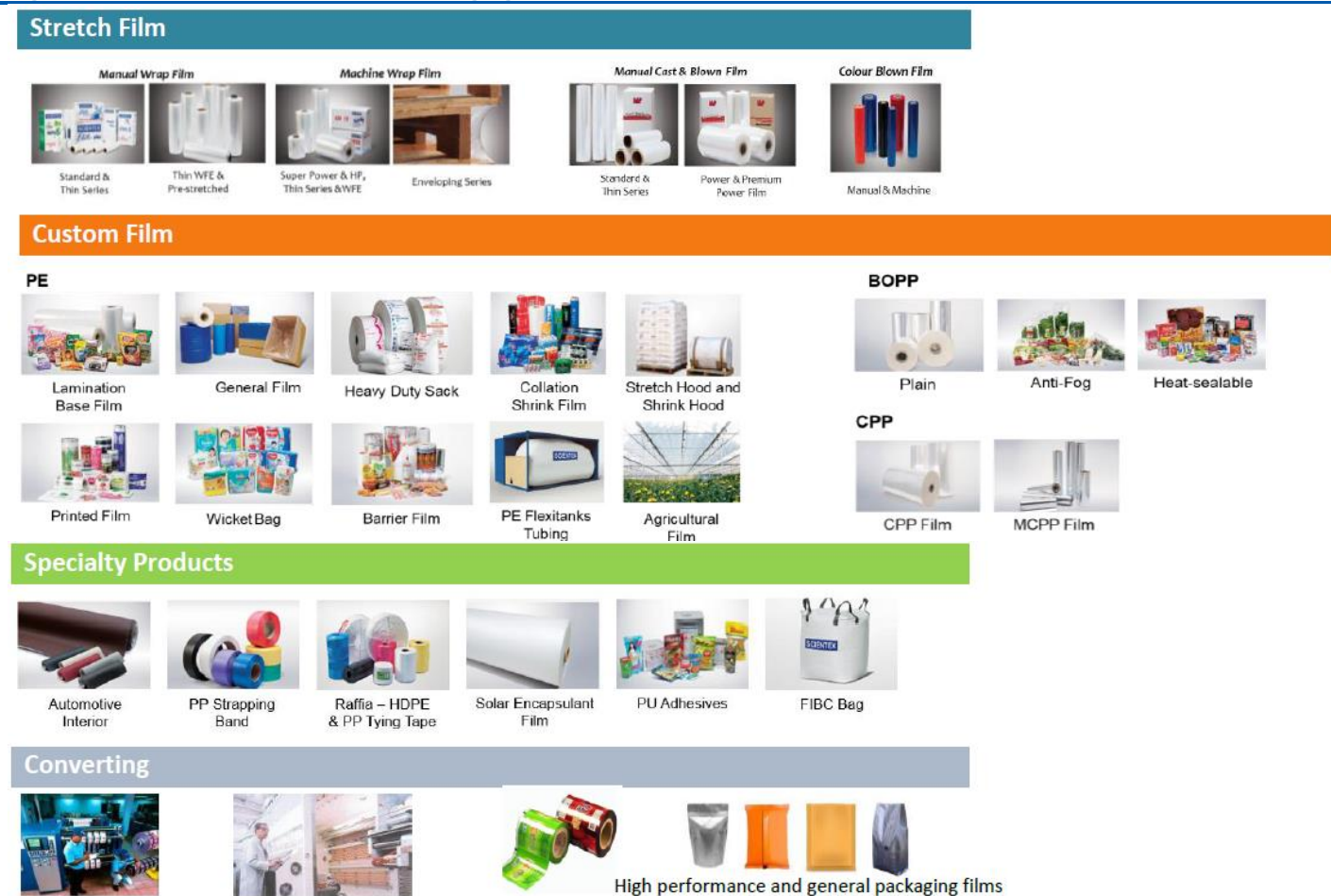
Business overview and COVID-19 impact

Scientex’s manufacturing division’s exposure to consumer staple packaging has helped to partly buffer it from the impact of COVID-19. The manufacturing unit was allowed to operate during the Movement Control Order (MCO), albeit, at reduced capacity. It also faced some logistics issues, especially from Korea and Japan during the MCO. However, with economic activities normalising, this should be resolved soon.

In Feb 2019, Scientex proposed to acquire a 42.4% (139m ordinary shares) equity stake in Daibochi for a purchase consideration of MYR22.5m or MYR1.60 per share, which was satisfied through a share swap of 1 new share for every 5.5 Daibochi shares. The offer price of MYR1.60 per share implied 20x P/E of Daibochi’s then FY17 earnings – slightly above sector valuation. Scientex later increased its stake in Daibochi to 61.89% through a mandatory general offer to Daibochi shareholders, which ended on 1 Apr 2019. The acquisition synergy allows for bulk purchasing of raw materials, which has helped to lower cost. Having Daibochi on board, Scientex could further diversify its product offering and exposure to downstream converting businesses.

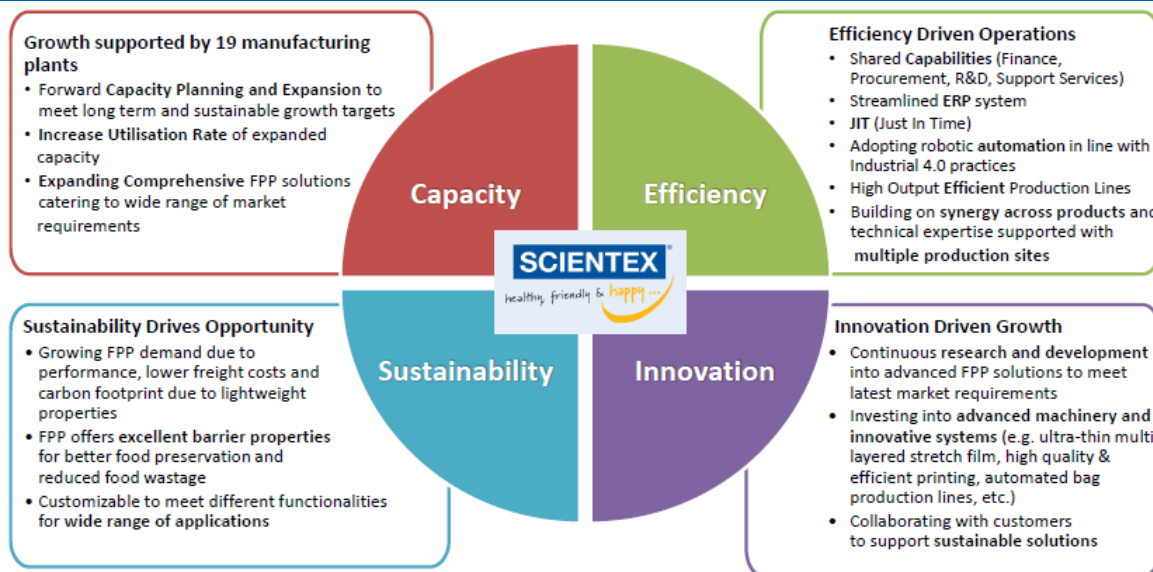
The group also supplies some of its products ie stretch film and custom film for industrial usage (Figure 1). Geographically, it has a presence in the US, Vietnam, Malaysia, Myanmar, Australia, Japan, Indonesia and Singapore etc, exporting to over 60 countries. We expect its margin to remain at the current level moving forward. We understand that there is a cost pass-through mechanism between Scientex and its customers, hence this should minimise the impact of resin price fluctuation. We project this division’s earnings to organically grow by c.4% in FY21F, driven by a ramp up in production of its existing capacity.

Figure 1: Scientex’s flexible plastics packaging products



Source: Company

Figure 2: Manufacturing - growth strategies



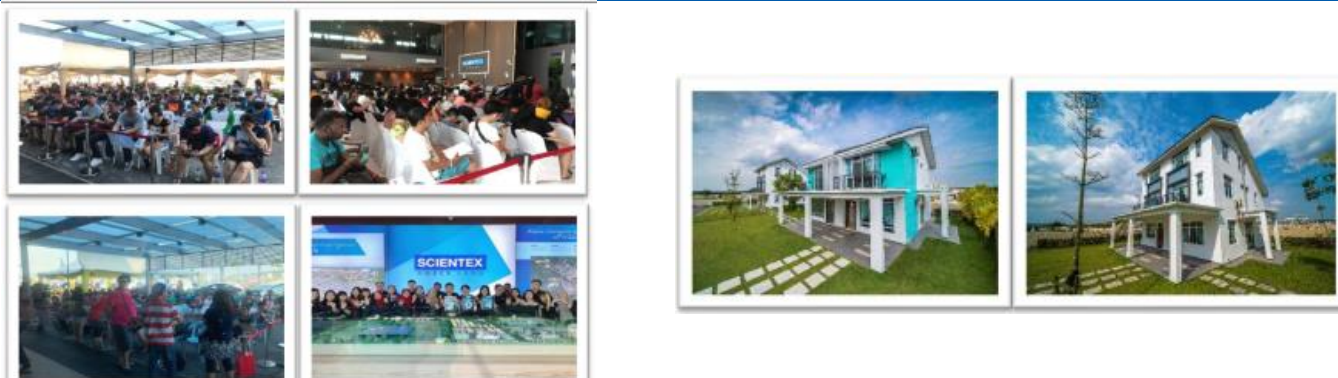
Source: Company

The property division’s focus remains on affordable housing with an emphasis on speed, cost and quality. The group is one the pioneers in implementing industrialised building system (IBS) in its property development in Malaysia. Through the use of this system, the group manage to reduce cost and shorten the construction period without affecting its quality. The company also has a good track record with a take-up rate of c.80% on average with most of its launches sold off upon completion. The group’s presence is mainly in the southern region of Peninsular Malaysia – it recently expanded to the Klang Valley and northern region.

Near term, the recent aggressive interest rate cut by Bank Negara Malaysia (BNM) should help to improve affordability and be an additional boost to the company’s property wing. The recently announced House Ownership Campaign (HOC) impact will not be significant to the group as c.70% of its launches are priced below MYR300,000, in our view. The stamp duty waiver is only applicable for residential homes priced between MYR300,000 and MYR2.5m, and subjected to at least a 10% discount. Due to social distancing practices, we believe the timing of converting bookings into sales could take longer now as the process of signing the sales and purchase agreement (SPA) requires additional arrangements of physical present meetings.

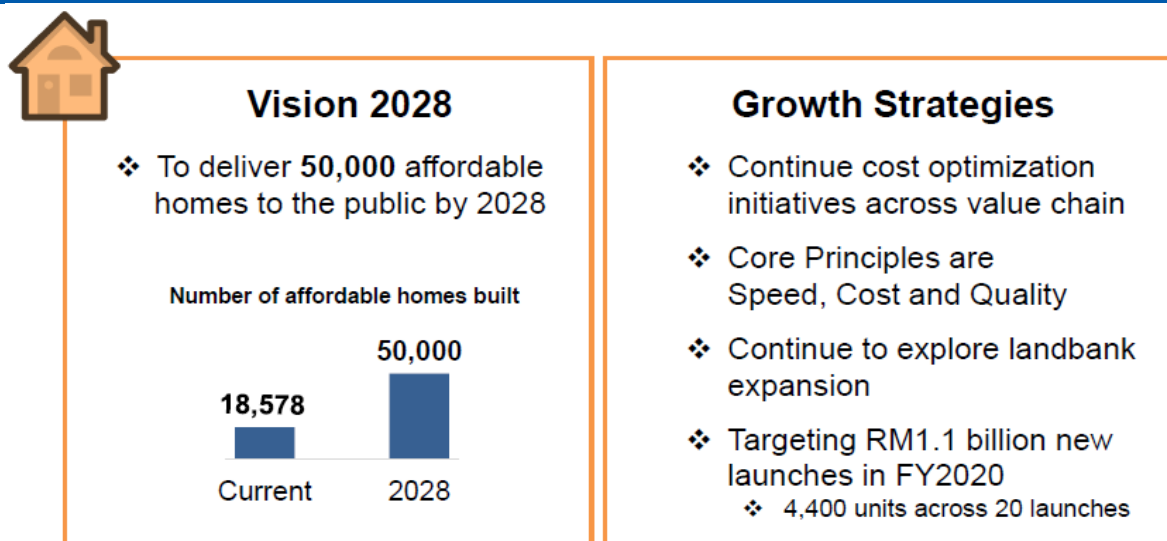
The company has revised down its property launch GDV target to MYR1bn (from MYR1.1bn) in FY20 on the back of a challenging market environment. The implementation of MCO disrupted Scientex’s planned launches, with MYR587.5m of GDV launched as of 3QFY20 – short of expectations. We forecast operating margin of this segment to be c.29-30%, slight lower compared to FY18-19 level of 32-33% as the group previously enjoyed lower land cost, but we believe it is not sustainable. We forecast Scientex’s property division’s earnings to grow c.14% in FY21, driven by new property launches and an economic recovery. Do note that growth is from a low base in FY20.

Figure 3: Scientex’s maiden launch in Pulau 2



Source: Company

Figure 4: Property – growth strategies



Source: Company

Figure 5: Property development

Project	Acres	Total GDV (MYRm)	Completed GDV (MYRm)	Remaining GDV (MYRm)
Taman Scientex Pasir Gudang	1,100	2,100	1,572	528
Taman Scientex Kulai	298	1,000	540	460
Taman Mutiara Mas (Skudai)	146	2,450	1,165	1,285
Taman Scientex Senai	371	2,800	628	2,172
Taman Pulai Mutiara	661	5,300	543	4,757
Taman Heights (Ayer Keroh)	137	1,070	449	621
Scientex Durian Tunggal	411	1,400	0	1,400
Scientex Klebang & Scientex Meru (Ipoh)	102	840	126	714
Scientex Rawang	66	860	0	860
Total	3,293	17,820	5,023	12,797

Note: As of 31 Jan 2020
Source: Company data

Valuation and outlook

We have a NEUTRAL recommendation on Scientex. The company is fairly valued at the current level and we do not foresee any immediate catalyst to change our recommendation. Our current TP implies 12.9x P/E, in line with its historical average P/E of 12x. The current challenging environment may pose further downside risks to earnings. Our DCF valuation of Scientex's manufacturing unit implies 15.7x FY21F P/E. We believe the premium valuation over the sector average of c.13x P/E (Figure 6) is justified given its larger scale of operations. We value the property division at 55% discount to RNAV, which implies 9x FY21F P/E vs 9.9x sector average (Figure 7). We are forecasting 10% bottomline growth for the group to be fuelled by a ramp up in utilisation of its manufacturing unit and new property launches. Earnings contribution between the two divisions is almost evenly split with property and manufacturing contributing about 51% and 49% to the group's earnings.

Figure 6: Peer comparison – Plastics and Packaging

Company	FYE	Price 23-Jul-20 (MYR)	Mkt Cap (MYRm)	P/E (x)			Div. Yld (%)	ROE (%)	P/BV (x)	EV/EBITDA	PEG	NP Growth (%)	
				Actual	1 Yr Fwd	2 Yr Fwd						1 Yr Fwd	2 Yr Fwd
Scientex	July	9.14	4,710	13.3	13.0	11.7	2.3	14.9	1.9	8.7	1.1	2.3	11.1
Daibochi	July	2.71	887	58.2	18.3	16.5	2.3	23.1	4.1	10.4	1.5	217.9	11.1
Thong Guan Industries	Dec	4.57	851	13.8	12.1	11.3	2.2	11.8	1.3	6.9	1.6	13.3	7.0
SLP Resources	Dec	0.95	301	14.0	15.0	12.9	4.7	10.5	1.5	8.0	0.8	-6.5	15.8
SCGM	Apr	2.63	504	29.2	24.9	21.9	1.6	10.9	2.8		1.6	17.2	13.6
Tomypak Holdings	Dec	0.73	306	-26.4	-23.7	-38.3	0.3	-4.3	1.7	19.9	1.0	11.2	-38.0
Mkt. Cap Weighted Avg.			7,559	20.0	14.5	13.0	2.3	15.1	2.1	9.2			

Source: Bloomberg, RHB

24 July 2020

Consumer Non-cyclical | Packaging

Figure 7: Peer comparison – Property

	FYE	Price (MYR/s)	Target (MYR/s)	Mkt Cap (MYRm)	P/E (x)		EPS Growth (%)		P/BV (x) FY20F	P/CF(x) FY20F	ROE (%) FY20F	DY (%) FY20F	Rec
					FY20F	FY21F	FY20F	FY21F					
Sime Darby Property	Dec	0.64	0.88	4,353	18.9	12.7	(34.7)	48.8	0.4	8.0	2.4	3.1	Buy
UEM Sunrise	Dec	0.45	0.70	2,019	15.4	15.4	(49.9)	0.5	0.3	2.6	1.8	0.0	Buy
Matrix Concept^	Mar	1.83	2.22	1,527	6.7	7.5	(5.1)	(11.0)	0.9	4.4	13.5	6.0	Buy
Mah Sing	Dec	0.62	0.73	1,493	10.0	9.1	(29.5)	10.5	0.4	2.2	4.4	4.1	Buy
UOA Dev	Dec	1.69	1.80	3,323	11.3	13.3	(29.2)	(14.8)	0.6	4.6	5.8	6.5	Neutral
Eastern & Oriental^	Mar	0.40	0.45	573	16.3	12.1	(117.5)	34.9	0.3	2.8	2.0	2.5	Neutral
Paramount	Dec	0.85	0.93	522	18.6	9.4	(64.9)	97.9	0.4	1.2	38.9	2.4	Neutral
Tambun Indah	Dec	0.52	0.59	225	8.7	6.2	(37.8)	39.8	0.3	3.9	4.0	3.8	Neutral
Hua Yang^	Mar	0.26	0.26	92	22.7	13.8	89.3	64.1	0.2	5.7	0.7	0.0	Neutral
Sector Avg					11.0	9.9	(14.2)	12.1					

Note: ^FY20F-21F valuations refer to those of FY21F-22F
Source: Bloomberg, RHB

Figure 8: Property segment's RNAV estimate

Projects	Remaining GDV	NPV @ 9%
Taman Scientex Pasir Gudang	528	68
Taman Scientex Kulai	460	72
Taman Mutiara Mas (Skudai)	1,285	208
Taman Scientex Senai	2,172	301
Taman Pulai Mutiara	4,757	711
Taman Heights (Ayer Keroh)	621	101
Scientex Durian Tunggal	1,400	180
Scientex Klebang & Scientex Meru (Ipoh)	714	116
Scientex Rawang	860	145
Unbilled sales		730
Shareholders' fund		1,167
Total		3,797
Share base		501
RNAV/share		7.59
Discount		55%
Equity value per share		3.41

Source: RHB

Figure 9: Manufacturing division's utilisation rate assumptions

	FY20F	FY21F	FY20F
Non-Daibochi	66%	68%	70%
Daibochi	77%	80%	83%

Source: RHB

Figure 10: SOP valuation

Divisions	Method	Valuation (MYRm)	Implied FY21F P/E (x)
Manufacturing	DCF (WACC:6.7%, TG:1.0%)	3,208.0	17.8
Property	RNAV (Discount of 55%)	1,708.7	9.0
Total Equity Value		4,916.7	
No. of shares (m)		500.6	
TP per share (MYR)		9.80	12.9

Source: RHB

3QFY20 results at a glance

3QFY20 revenue dropped 6.8% YoY and 15.5% QoQ as the property and manufacturing segments were affected by the impact of the COVID-19 pandemic. Scientex recorded a slightly better EBIT vs 3QFY19 due to an improvement in the manufacturing division's margin from better sales mix, cost control and production efficiency.

We believe earnings have bottomed in 3QFY20 and will improve in 4QFY20 after the shift to Conditional MCO starting early May. Manufacturing capacity should normalise as the limitation of workforce was removed. Restrictions have gradually lifted for construction activities and property buyers should be able to resume with their purchasing processes.

As of 30 Apr 2020, the company's net gearing was at a healthy 0.31x and management has set an internal target of not exceeding 0.5x. The company has a dividend policy of minimum 30% of net profit, which would translate to a dividend yield of 2.5%.

Figure 11: Results review

FYE Jul (MYRm)	3QFY19	2QFY20	3QFY20	QoQ (%)	YoY (%)	9MFY19	9MFY20	YoY (%)
Revenue	828.5	914.4	772.2	(15.5)	(6.8)	2,308.7	2,564.0	11.1
EBITDA	127.1	167.5	133.1	(20.5)	4.7	349.6	445.9	27.5
Depreciation	(24.0)	(26.7)	(26.6)	(0.3)	10.8	(67.1)	(80.1)	19.4
EBIT	103.1	140.8	106.4	(24.4)	3.3	282.5	365.7	29.4
<i>EBIT Margin (%)</i>	<i>12.4</i>	<i>15.4</i>	<i>13.8</i>			<i>12.2</i>	<i>14.3</i>	
Interest expense	(3.8)	(4.3)	(3.9)	(9.0)	2.6	(11.0)	(13.5)	22.6
Interest income	2.2	3.0	2.2	(26.3)	2.2	2.5	7.9	nm
Pretax profit	101.4	139.5	104.7	(24.9)	3.3	274.0	360.1	31.4
<i>Pretax Margin (%)</i>	<i>12.2</i>	<i>15.3</i>	<i>13.6</i>			<i>11.9</i>	<i>14.0</i>	
Tax	(25.3)	(33.7)	(28.7)	(14.9)	13.7	(66.7)	(90.8)	36.2
<i>Effective tax rate (%)</i>	<i>24.9</i>	<i>24.2</i>	<i>27.4</i>			<i>24.4</i>	<i>25.2</i>	
Minority Interest	3.3	8.3	6.4	(22.5)	94.4	7.0	21.2	nm
Net Profit	72.9	97.5	69.6	(28.6)	(4.5)	200.3	248.1	23.8
<i>Net Margin (%)</i>	<i>8.8</i>	<i>10.7</i>	<i>9.0</i>			<i>8.7</i>	<i>9.7</i>	

Source: Company data, RHB

Recommendation Chart



Date	Recommendation	Target Price	Price
2018-09-21	Neutral	7.40	8.74
2018-03-23	Neutral	8.69	8.15
2018-02-26	Neutral	9.07	8.49

Source: RHB, Bloomberg

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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