

19 November 2018 | Briefing Note

Daibochi Berhad

Riding on the consolidation wave

INVESTMENT HIGHLIGHTS

- **Share swap with Scientex deemed fair**
- **In-line with industry trend of consolidation**
- **Near term outlook challenging, FY18F/FY19F PATAMI cut by 16.0%/16.6% to RM23.1m/RM25.7m**
- **Maintain NEUTRAL with lower TP of RM1.69 (previously RM2.00)**

Share swap with Scientex deemed fair. Scientex's offer values Daibochi shares at RM1.60 per unit and at a historical price-to-earnings ratio (PER) of 20x and price-to-book value (PBV) of 2.62x. Both are higher than Daibochi's 10 year average of PER at 17.1x and PBV at 2.3x. The PER of 20x is higher than its comparable peers' average of approximately 17.8x. Contrarily, the offer price represents a 18.8% discount to Daibochi's five-day weighted average share price of RM1.97. We think that the offer price is fair based on the indicative PER, PBV and the synergistic nature of the both businesses. Moreover, we expect Daibochi's near term outlook to be challenging due to high raw material prices, higher operating cost (increase in utilities and labour cost) as well as weaker foreign exchange rates in the emerging markets.

In-line with industry trend of consolidation. We also think that the merger comes at a time where the flexible packaging industry is consolidating. In August this year, the world's largest consumer packaging manufacturer, Amcor Ltd (market cap RM47.8b) that was founded in Australia, announced to take over its American peer Bemis Company, Inc (market cap RM18.3b) in a USD6.8b deal (RM28.4b). This is described as one of the biggest merger and acquisitions (M&A) in a rather fragmented packaging industry. To put things into perspective, Amcor's flexible packaging sales was RM27.2b in FYE June 2018. Consolidation occurs partially due to customers' increasing demand for a one-stop integrated supplier and cost effective and sustainable packaging products. As it is, Scientex is one of Daibochi's raw material suppliers. In the longer run, Daibochi may be able to save on raw material costs with higher bargaining power as a result of bulk purchase by being a subsidiary of a bigger entity. Both companies may also further expand their market presence by tapping onto each other's network.

5.5 Daibochi shares for 1 Scientex shares. Recall that Daibochi's 14 shareholders (including family members of the founder) have signed heads of agreement to swap a collective of 139.1m Daibochi shares representing 42.4% of its share base for RM222.5m. The exercise will be fulfilled through the issuance of new Scientex Bhd shares at the ratio of 5.5 Daibochi shares for 1 Scientex share. Scientex intends to maintain Daibochi's listing status, Daibochi's management and employees upon completion of the deal.

Maintain NEUTRAL
Adjusted Target Price (TP):RM1.69
(Previously RM2.00)


RETURN STATS	
Price (16 th November 2018)	RM1.71
Target Price	RM1.69
Expected Share Price Return	-1.2%
Expected Dividend Yield	+2.7%
Expected Total Return	+1.5%

STOCK INFO	
KLCI	1,706.38
Bursa / Bloomberg	8125 / DPP MK
Board / Sector	Main/ Industrial
Syariah Compliant	Yes
Issued shares (mil)	327.35
Market cap. (RM'm)	559.77
Price over NA	2.77
52-wk price Range	RM1.67– RM2.41
Beta (against KLCI)	0.40
3-mth Avg Daily Vol	0.02m
3-mth Avg Daily Value	RM0.04m
Major Shareholders (%)	
Chan Tian Low	10.34
Apollo Asia Fund Limited	9.38
Lim Koy Peng	8.48
Halley Sicav-Halley	5.89

Opportunity to be part of a bigger company. Scientex is one of the biggest stretch film and custom films manufacturers in the region with 13 plants in Malaysia, one in the United States and one in Vietnam. The implied swap price of RM8.80 per Scientex share values the company at ~12.5x FYE July 2019F PER from Bloomberg consensus. Although the manufacturing segment contributed 72% to Scientex's FYE July 2018 revenue, contribution to its PBT was 34.8%. It derived 28% of its sales from property development, which in turn churned out 65.2% of its PBT for FY18. For FY8, revenue rose 9.3%yoy to RM2.6b while net profit increased by 13.3%yoy to RM289.8m. Its net gearing stood at 0.43x. Scientex has been on an acquisition trail the past decade. Locally, it has acquired plastic film companies like Great Wall Plastic Industries Bhd, Seacera Polyfilms Sdn Bhd, Mondi Ipoh Sdn Bhd and Klang Hock Plastic Industries Sdn Bhd. Upon completion of the share swap, the Daibochi vendors are estimated to collectively own 4.9% in Scientex shares. Scientex has also laid out a long-term target for its revenue to hit RM10b by 2028 and we do not rule out further M&A given its track record.

Near term outlook challenging, FY18F/FY19F PATAMI cut by 16.0%/16.6% to RM23.1m/RM25.7m.

Following the release of Daibochi's 3QFY18 results, we have cut our earnings estimates in view of the weaker than expected performance from Myanmar and slower than expected recovery in profit margin. During the briefing, management has guided that it has taken measures to resolve the import issue from Daibochi Myanmar to Daibochi Malaysia so that it can continue to serve the price sensitive customers here. On a positive note, Daibochi Myanmar has started a new sizeable contract in November and is also looking to export to Thailand in FY19. Meanwhile, we expect its profit margin to be suppressed in the coming quarter due to the elevated raw material prices and slower than expected cost pass through to its customers.

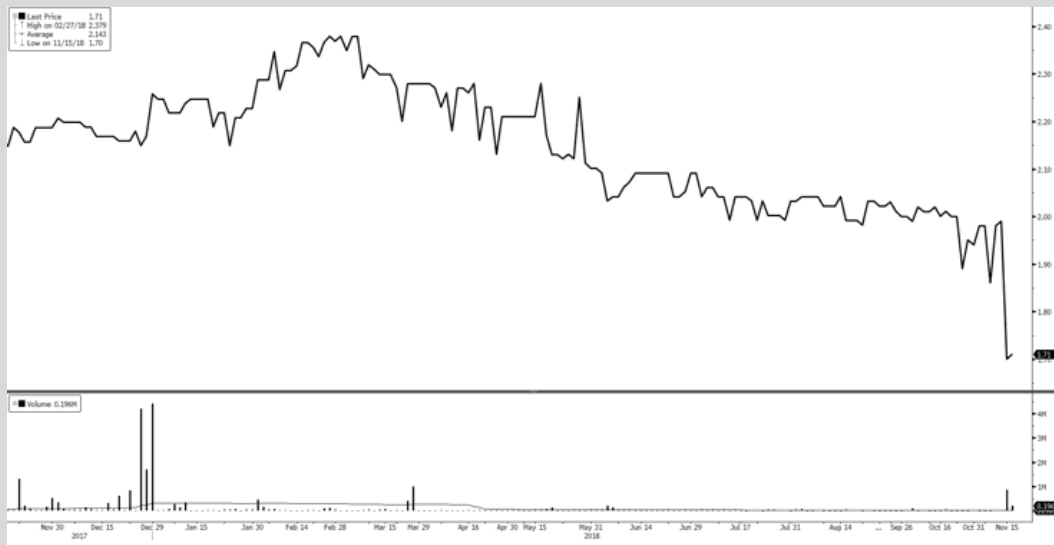
Maintain NEUTRAL with lower TP of RM1.69 (previously RM2.00) as a result of the adjustment in our profit forecast. We believe that Daibochi's outlook for the next six months should be intact. The corporate exercise is expected to be completed by July 2019. Our valuation method, based on the dividend discount model with a terminal growth rate of 3.2%, is unchanged for now. 

INVESTMENT STATISTICS

FYE Dec (RM'm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	345.0	371.2	388.7	439.0	473.3
Gross profit	51.9	49.2	39.9	39.9	42.2
Profit before tax	35.7	30.0	35.7	28.9	32.2
Income tax expense	(9.0)	-5.4	-8.7	-4.3	-4.8
Net profit	26.7	24.5	27.1	24.6	27.4
PATAMI	26.7	24.5	26.0	23.1	25.7
EPS (sen)	8.1	7.5	7.9	7.0	7.8
EPS growth (%)	-59.9	-8.3	6.0	-11.0	11.4
PER (x)	21.0	22.9	21.6	24.3	21.8
Net dividend (sen)	5.9	5.4	5.2	4.1	4.6
Dividend yield (%)	2.5	3.2	3.1	2.4	2.7
Gross profit margin (%)	15.0	13.3	10.3	9.1	8.9
Profit before tax margin (%)	10.4	8.1	9.2	6.6	6.8
Net profit margin (%)	7.7	6.6	7.0	5.3	5.4

Source: Company, MIDFR

DAILY PRICE CHART



Source: Bloomberg

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.