

Latexx Partners

Gaining the upper hand on margin pressure

LTX MK / LATX.KL

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- Broadly in line; maintain OUTPERFORM.** Latexx's 1H10 results were largely in line with expectations. Annualised 1H net profit made up 84% of our forecast and 85% of consensus numbers but 2H should be stronger, thanks to its capacity expansion. Also within expectations was its second interim DPS of 2.5 sen (2Q09: 1.0 sen), which took YTD DPS to 5 sen, in line with our full-year forecast of 8.0 sen. We retain our earnings forecasts and target price of RM5.44 as we continue to value Latexx at a 30% discount to Top Glove's target P/E of 16.5x. The stock remains an OUTPERFORM, premised on the potential re-rating catalysts of improving earnings ability driven by its expansion and move towards premium products. Latexx remains one of our top picks for the rubber glove sector.
- Growth in bottomline despite slight margin erosion.** Latexx's 2Q sales volume increased 8% qoq to 1.4bn pieces. Almost 70% of sales went to the US market. Despite a slight EBIT margin slippage of 0.5% pt qoq due to a steep rise in latex prices and a depreciating US\$, its net profit improved 4%. Nitrile gloves made up 40% of sales during the quarter. 43% was in the form of powder-free natural rubber (NR) gloves and the remaining 17% came from powdered NR gloves.
- Demand still resilient.** More than 90% of Latexx's output is taken up by the medical industry, which makes demand for its products resilient. Despite the margin contraction evident in the recent results of several rubber glove manufacturers (Adventa, Top Glove and Latexx), we are not unduly worried as this is not the first time that glove manufacturers are facing this situation. In the past, glove manufacturers have demonstrated their ability to pass on higher latex and weaker US\$, albeit with a time lag of about 1-2 months. Across the board, rubber glove manufacturers still expect rising demand from traditional healthcare usage and new segments such as the food and services industry.
- Expansion plans remain intact.** Demand for Latexx's gloves remains good this year, going by the 90% utilisation of its production lines, similar to last year's 89.8%. In view of the growing demand especially from its numerous MNC customers, the company is holding firm to its capacity expansion plans. Its current expansion includes the addition of 20 lines by year-end, which will take its annual production capacity from 7bn pieces to 9bn pieces. The company's long-term plans involving two more factories could take its capacity to as much as 15bn pieces by 2015.

Results comparison

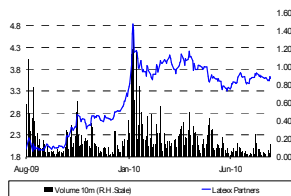
FYE Dec (RM m)	2QFY10	2QFY09	yoy % chg	qoq % chg	2QFY10 Cum	2QFY09 Cum	yoy % chg	Prev. FY10F	Comments
Revenue	134.5	74.4	80.7	6.6	260.7	144.7	80.1	565.1	Sales volume up 8% qoq
Operating costs	(109.0)	(61.5)	77.2	7.3	(210.6)	(120.6)	74.6	(456.5)	Higher raw material costs qoq
EBIT	25.5	12.9	97.4	3.8	50.1	24.2	107.2	108.6	Margins contracted qoq due to time lag in
EBITmargin (%)	19.0	17.4		(2.7)	19.2	16.7	15.1	19.2	passing on higher latex and weaker US\$
Interest expense	(1.4)	(1.5)	(7.4)	3.2	(2.8)	(3.6)	(23.9)	(7.9)	Borrowings of RM85.2m as at end-Jun 10
Interest & invt inc	0.0	0.0	107.1	(29.3)	0.1	0.0	97.2	0.1	Cash balance of RM47.6m as at end-Jun 10
Pretax profit	24.1	11.4	111.3	3.7	47.4	20.6	130.4	100.8	Broadly in line
Tax	(2.6)	(0.0)	nm	1.2	(5.1)	(0.0)	nm	(0.3)	Lower than statutory tax rate due to
Tax rate (%)	10.6	0.0		(2.4)	10.8	0.0	nm	0.3	utilisation of capital and reinvt allowances
Net profit	21.6	11.4	88.9	4.0	42.3	20.6	105.6	100.6	Annualised made up 84% of our estimate.
EPS (sen)	10.4	5.9	77.3	(2.2)	20.6	10.6	95.4	47.9	Expect stronger quarters ahead

Source: Company, CIMB Research

Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (RM m)	223.3	328.5	574.9	679.2	810.8
EBITDA (RM m)	24.1	66.7	120.6	153.7	181.9
EBITDA margins (%)	10.8%	20.3%	21.0%	22.6%	22.4%
Pretax profit (RM m)	15.2	51.8	101.6	130.8	154.8
Net profit (RM m)	15.2	51.3	100.6	129.5	153.2
EPS (sen)	7.8	25.3	47.6	61.3	72.6
EPS growth (%)	212.4%	224.2%	88.5%	28.8%	18.4%
P/E (x)	46.0	14.2	7.5	5.9	4.9
FD core EPS (sen)	5.5	18.7	36.6	47.1	55.8
FD core P/E (x)	65.0	19.2	9.8	7.6	6.4
Gross DPS (sen)	0.0	1.9	8.0	11.0	14.0
Dividend yield (%)	0.0%	0.5%	2.2%	3.1%	3.9%
P/BV (x)	5.8	4.1	2.8	2.0	1.5
ROE (%)	13.4%	35.3%	46.0%	39.7%	33.9%
Net gearing (%)	47.0%	43.0%	9.1%	N/A	N/A
Net cash per share (RM)	N/A	N/A	N/A	0.21	0.63
P/FCFE (x)	138.2	53.0	13.4	7.7	6.1
EV/EBITDA (x)	31.4	12.0	6.5	4.6	3.4
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			1.01	0.95	0.99

Price chart



Source: Bloomberg

Source: Company, CIMB Research, Bloomberg

Figure 1: Sector comparisons

	Bloomberg ticker	Recom.	Price (Local)	Target price (Local)	Mkt cap (US\$ m)	Core P/E (x) CY2010	Core P/E (x) CY2011	3-yr EPS CAGR (%)	P/BV (x) CY2010	ROE (%) CY2010	Div yield (%) CY2010
Latexx	LTX MK	O	3.59	5.44	241	7.5	5.9	43.9	2.8	46.0	2.2
Adventa	ADV MK	O	2.94	4.45	141	11.3	8.7	32.3	1.7	16.9	2.6
Hartalega	HART MK	O	8.10	12.73	623	11.2	9.4	19.1	4.3	44.4	3.0
Kossan	KRI MK	O	3.81	5.21	387	9.1	7.2	16.7	2.5	32.0	4.7
Supermax	SUCB MK	O	6.14	9.50	662	9.9	8.5	24.5	2.8	32.5	2.0
Top Glove	TOPG MK	O	6.24	8.90	1,224	13.0	11.6	15.3	3.4	28.9	3.1
Simple average						10.3	8.6	25.3	2.9	33.5	2.9

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB Research

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NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

TRADING SELL: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

TRADING BUY: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 3 months.

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STOCK RECOMMENDATIONS

OUTPERFORM: Expected positive total returns of 15% or more over the next 12 months.

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TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.

TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.

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TRADING BUY: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of +15% or better over the next 3 months.

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