CIMB Research Report

Latexx Partners

Positive on the partnership

QUICK TAKES

10 May 2010

Syariah-compliant stock

OUTPERFORM	Maintained
RM3.51	Target: RM5.44
	Mkt.Cap: RM725m/US$221m
	Rubber Gloves

MALAYSIA

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Analyst briefing notes

Although there were no major surprises, we came away from Latexx's first-ever analyst briefing last Friday feeling positive about the company and its future prospects. The company gave a presentation on its background, performance to date and future plans. We continue to like the company for its aggressive expansion plans and move into premium products. We also reiterate our positive view on the company's JV agreement with Budev. Our OUTPERFORM call remains intact, along with our target price of RM5.44, which is pegged to a 30% discount to Top Glove's target P/E of 16.5x. Potential re-rating catalysts include higher earnings coming in from the company's expansion plans and move into premium segment.

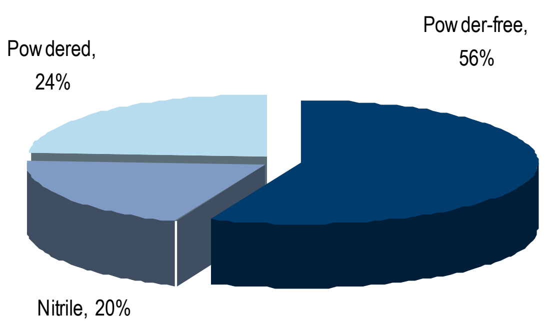
Highlights

First-ever briefing. Latexx's held its first-ever briefing last Friday. Around 45 analysts attended, mostly from the sell-side. The company was represented by its Executive Chairman & CEO, Mr. Low Bok Tek and Head of Corporate Services, Dr. Liew Lai Lai. Dr. Liew gave a comprehensive overview of Latexx's business, its recent 1Q10 performance and future plans. On top of that, we were also introduced to Mr. Michiel Paping, CEO of Budev BV. Michiel made a presentation on the JV company between Latexx and Budev, named Total Glove Company Sdn Bhd as well as explained about the agreement to produce protein-free gloves and its prospects into the glove market.

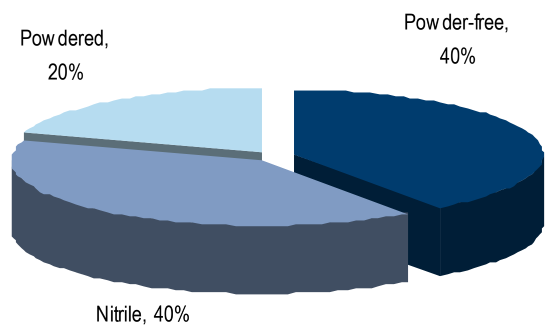
Moving to the premiums. Latexx is 100% OEM glove manufacturer. In 2009, 56% of its revenue came from powder-free natural rubber (NR) gloves, 24% from powdered gloves and 20% from nitrile gloves (Figure 1). The company remains focused on expanding its premium range. It targets to expand its nitrile range to 40% this year. As of 1Q10, 30% of revenue came from nitrile sales, 50% from powder-free and 20% from powdered. The US market contributes to 50% of sales (Figure 2).

Figure 1: Revenue contribution by product segments

2009

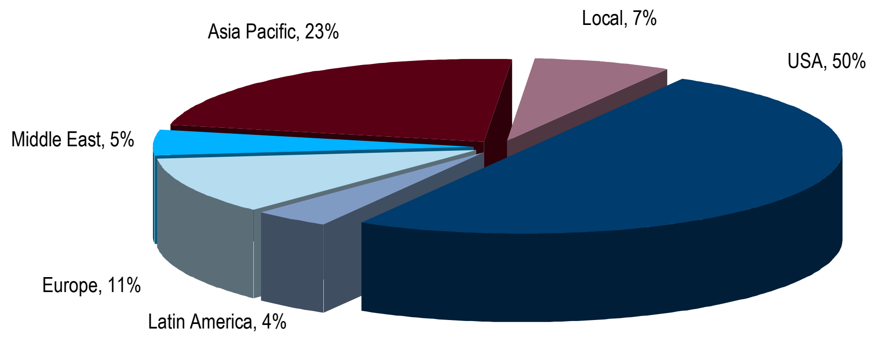


2010F



Source: Company

Figure 2: Revenue by geographical location



Source: Company

Expansion plans are on course. Latexx currently owns six glove factories with a total capacity of 6bn pieces per annum. Its expansion plans for Plant 1 are currently on track. The first phase of the 10 lines has now reached 80% completion, in line with its target completion by June this year. The balance of 20 lines will be completed on a staggered basis, 10 lines each by 3Q10 and 4Q10. All this will take its annual capacity to 9bn pieces by the end of 4Q10, which is in line with our forecast.

Works on a structured cost-plus pricing model. As of 1Q10, raw materials made up 54% of Latexx's total costs. Latex prices have been on the rising trend since beginning of 2010 and reached all time high of RM7.72/kg last month. This was mainly due to seasonal rubber wintering season and speculative factors. Latexx believes that prices could come down soon with the end of wintering season this month as witnessed by the 7% drop in prices to RM7.16/kg last Friday. The company practices a structured cost-plus pricing model to pass on the volatile latex prices as well as uncertain RM:US$ movement. On top of that, it also purchases 50% of its latex requirement on contract basis in US$, which also provides for natural hedging.

Figure 3: Latex price trend (sen/kg)

Source: Bloomberg

Industry prospects remain bright. 90% of Latexx sales are to the medical sector. The company believes that the rubber glove industry prospects remain bright as normal industry demand growth of 8-10% per annum could be boosted by demand from health scares and improving best practices. On its long term strategy, the group aims to expand its market segment further into the food industry where it believes that there is a huge market for rubber gloves as well. It recently launched a 3.0g nitrile glove which are suitable for the use in food and industrial sectors. Also in the pipeline is the launch of a new 3.5g nitrile glove suitable for use in the medical sector.

Presentation by Budev

JV agreement in January. Recall that back in January, Latexx signed an agreement with Budev BV to produce, market and distribute protein-free NR gloves. Budev, a research and development company from Netherlands is the patent holder of the breakthrough technology used to reduce the major allergens that cause protein allergy in NR gloves. The company has granted the licence to commercialise the patented method or better known as maximum protection latex (MPXX) technology for NR surgical and examination gloves to Total Glove Company Sdn Bhd, the JV entity set up between Latexx and Budev. With the JV agreement, Latexx controls 50.01% of Total Glove while Budev holds the balance 49.99% (Figure 4).

Why Latexx? Budev explained that they have been looking for the right partner since the middle of last year and have been in talks with Latexx since September 09. Budev said it had chosen Latexx due to the glove manufacturer's good track record of quality and premium products as well as good name in the market with extensive MNC customer base. This in turn gives the JV company an advantage in pushing the new product to the market.

More on MPXX Technology. The MPXX technology encompasses a unique washing method aiming to eliminate all allergens including the ones clinically proven to cause latex allergy i.e. Hev b1, Hev b3, Hev b5 and Hev 6.02. Budev believes this technology could change the current industry norms and standards. It also expects strong demand especially from customers that still prefer natural rubber gloves but are afraid of the protein allergies.

Machine has arrived. The prototype machine arrived last week. Using this machine, a batch of washing process is expected to treat up to 60,000 pieces of gloves per hour.

Figure 4: Percentage of shares in Total Glove

Company	Share in Total Glove
Latexx Partners	50.01%
Budev BV	49.99%
Total	100.00%

Source: BMSB, CIMB Research

Comments

Positive about the company... The presentations were in line with our view. Latexx appears well on course for continued growth, thanks to its aggressive expansion plans as well as focus to move into the premium segment. We were, however, surprised but delighted to have Mr. Michiel Paping give us a better understanding about the new protein-free NR glove product and its prospects in the glove market.

.. and the JV. We reiterate our positive view on Latexx's tie up with Budev as the new technology will allow the JV entity, Total Glove Company Sdn Bhd to produce natural rubber gloves with undetectable level of protein which are currently not available in the global market. This will reinforce Latexx's edge as a premium rubber gloves producer in the global market.

Target 45sen EPS this year. Given its strong expansion plans and higher sales of premium products, Latexx believes it should be able to achieve a minimum EPS of 45sen this year. This is slightly below with our current FY10 EPS assumption of 48.6sen. Nevertheless, we still believe that there is considerable upside to our FY10-12 earnings forecast as they do not include revenue from the protein-free gloves JV where contributions to earnings and margins could come in as early as 4Q10. Latexx has already started the trial run on the prototype machine. We think more visibility on earnings contribution from the JV can be seen from 3Q this year.

Valuation and recommendation

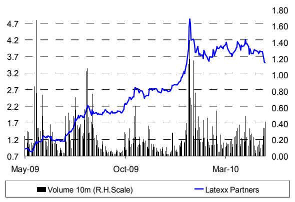
Maintain Outperform. We view the commencement of results briefings as a good move that will improve transparency and raise the company's profile. Although there were no major surprises, we came away from Latexx's first-ever analyst briefing last Friday feeling positive about the company and its future prospects. We continue to like Latexx for its aggressiveness and move towards the premium segment. We also believe that industry prospects for rubber glove remain favourable and Latexx is one of the key beneficiaries. 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. We maintain OUTPERFORM on Latexx, premised on the potential re-rating catalysts of favourable industry prospects and improving earnings ability driven by its expansion plans and move towards premium products.

Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (RM m)	223.3	328.4	565.1	682.8	807.3
EBITDA (RM m)	24.1	66.8	122.4	157.9	188.4
EBITDA margins (%)	10.8%	20.3%	21.7%	23.1%	23.3%
Pretax profit (RM m)	15.2	52.2	100.8	129.8	153.7
Net profit (RM m)	15.2	52.1	100.6	129.5	153.3
EPS (sen)	7.8	25.9	48.6	62.6	74.1
EPS growth (%)	212.4%	232.6%	87.5%	28.8%	18.4%
P/E (x)	45.0	13.5	7.2	5.6	4.7
FD core EPS (sen)	5.5	19.0	36.6	47.1	55.8
FD core P/E (x)	63.5	18.5	9.6	7.4	6.3
Gross DPS (sen)	0.0	1.9	8.0	11.0	14.0
Dividend yield (%)	0.0%	0.6%	2.3%	3.1%	4.0%
P/BV (x)	5.7	4.0	2.8	1.9	1.4
ROE (%)	13.4%	35.8%	46.5%	40.4%	34.3%
Net gearing (%)	47.0%	33.7%	31.5%	16.6%	3.4%
P/FCFE (x)	82.3	16.8	159.2	16.2	9.0
EV/EBITDA (x)	30.7	11.4	6.6	5.0	3.9
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			N/A	N/A	N/A

Source: Company, CIMB Research, Bloomberg

Price chart



Source: Bloomberg

Figure 5: 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	3.51	5.44	221	7.2	5.6	43.2	2.8	46.5	2.3
Adventa	ADV MK	O	3.11	5.44	142	10.0	7.5	31.5	1.7	19.7	3.1
Hartalega	HART MK	O	7.46	12.11	552	11.0	9.1	37.0	4.0	42.2	3.2
Kossan	KRI MK	O	7.35	10.43	359	8.7	7.0	16.7	2.3	31.2	2.0
Supermax	SUCB MK	O	6.30	11.90	522	8.1	7.0	24.5	2.3	32.5	2.4
Top Glove	TOPG MK	O	12.06	17.90	1,135	12.5	11.1	26.6	3.3	29.4	3.2
Simple average						**9.6**	**7.9**	**29.9**	**2.7**	**33.6**	**2.7**

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

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OUTPERFORM: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.	**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 stock's total return is expected to be within +/-5% of a relevant benchmark's total return.	**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.
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.	**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 stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 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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NEUTRAL: Expected total returns of between -15% and +15% over the next 12 months.	**NEUTRAL:** The industry, as defined by the analyst's coverage universe, has either (i) an equal number of stocks that are expected to have total returns of +15% (or better) or -15% (or worse), or (ii) stocks that are predominantly expected to have total returns that will range from +15% to -15%; both over the next 12 months.
UNDERPERFORM: Expected negative total returns of 15% or more over the next 12 months.	**UNDERWEIGHT:** 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 worse over the next 12 months.
TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.	**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.
TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.	**TRADING SELL:** 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 worse over the next 3 months.

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