

Initiating Coverage – Latexx Partners *Outperform (TP: RM5.75)*

Picking up the play

- **Prospects for Latexx Partners Bhd (Latexx) are favourable as rising global healthcare needs should ensure its new capacity will be optimally utilised. Apart from that, its established relationship with its MNC clients will provide sustained sales and earnings growth. The company's two-pronged growth strategy going forward is to step up measured capacity expansions, develop new products to establish new clientele, and utilise new technology to create improved, higher-margin products.**
- **Industry remain buoyant**
With the consistent uptrend of global demand for gloves (+8-10% p.a), we believe demand for gloves is still greater than supply due to i) rising threat of health problems and increased hygiene awareness; ii) growing healthcare expenditure due to aging population, healthcare reform and regulatory change in many countries (e.g. US, China, India); and iii) rising production outsourcing trend by MNCs. The industry is consolidating, and is increasingly oligopolistic whereby smaller, inefficient players will be eliminated while bigger players will capture market share. Demand for gloves is expected at 150bn pieces in 2010, with 65% being latex gloves.
- **Valuation.** We project Latexx to post FY10 and FY11 EPS of 46.4 sen and 66.5 sen respectively driven by 1) capacities 2) increasing health awareness and regulatory reforms in countries like US, China, and India, and 3) higher sales of higher-margin products. Assigning FY11 PER of 8.6x, at 40% discount to Top Glove's target FY11 PER of 14.4x, to our FY11 EPS, our Target Price stands at RM5.75 with an upside potential of 55%. Hence, we initiate coverage on Latexx Partners with an Outperform recommendation.

Investment Data

Bloomberg

Price (16/07/10)
Expected capital gain
Expected yield

LTX.MK
RM3.71
55.0%
1.4%
56.4%

Major shareholders (as at May-10):

	%
BT Capital	23.49
Lembaga Tabung Haji	6.04
Best Time Venture	5.88
Teong Lian Aik	9.76
Low Bok Tek	4.62
Est. Free Float	50.21

Market capitalisation RM783.0m
Share in issue @ RM0.50 par 211.1m
52 week high/low RM4.95/RM1.13
3m average daily volume 1.4m shares

12-month consensus

Buys	1
Holds	0
Sells	0
FY10 Estimate (EPS sen)	37.0
FY11 Estimate (EPS sen)	47.0

	Old	New	
Stock Rating	-	Outperform	
Target Price	-	RM5.75	KLCI

1,336.65 pts

Financial Summary

FY Dec (RM m)	2008	2009	2010F	2011F	2012F
Turnover	223.3	328.4	606.6	839.1	985.2
EBITDA	24.1	66.8	127.4	149.2	168.3
Pretax Profit	15.2	51.8	98.9	142.6	160.3
Core Net Profit	15.2	51.3	97.9	140.4	157.1
EPS(sen)	7.2	24.3	46.4	66.5	74.4
EPS Growth (%)	213.4	237.5	90.7	43.5	11.8
PER (x)	51.5	15.3	8.0	5.6	5.0
P/NTA (x)	7.3	4.9	2.9	2.2	1.8
Gross DPS (sen)	-	2.0	3.2	6.0	7.4
Dividend Yield (%)	-	0.6	0.9	1.6	2.0
ROE (%)	13.4	35.8	46.5	40.4	35.9
Net Gearing (x)	0.5	0.4	0.4	0.3	0.2

Sources: Bloomberg, Alliance Research

KDN:PQ/PP1505(7766)(42)

INVESTMENT CASE

□ **Most extensive MNC client base**

Latexx Partners Bhd (Latexx) is one of the top 5 largest medical examination glove producers in Malaysia, with 4% global market share. Latexx has a clientele base of over 300 accounts worldwide, consisting of global glove brands, medical suppliers, resellers and distributors. It also has the highest number of MNC accounts in the industry, which allows for lower sales volatility given MNC orders are usually better-planned and more consistent. However, MNCs also demand reliable product and delivery quality. Hence, Latexx’s ability to attract MNC clients is a testament to its capabilities. Based on the company’s 1QFY10 results, MNCs contributed around 70% of the Company’s revenue.

Figure 1: Latexx Partners- Top 13 MNCs

- ❖ Ansell
- ❖ CardinalHealth
- ❖ Kimberly-Clark
- ❖ Mediflex
- ❖ Hartmann
- ❖ Medline
- ❖ McKesson
- ❖ BSN Medical
- ❖ Cypress Medical Products
- ❖ Microflex
- ❖ Broschdirect
- ❖ PSS World Medical
- ❖ Livingstone

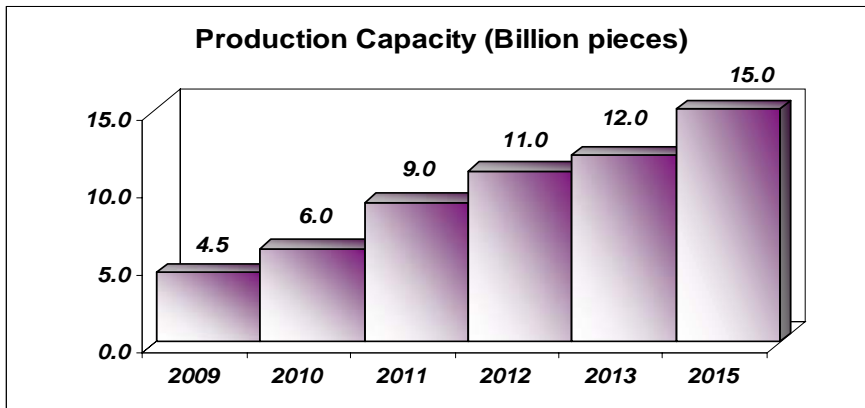
Compared to its rivals, Latexx Partners holds the highest MNC accounts. MNCs like Latexx Partners because of its: 1) track record on quality consistency in product and delivery; 2) effective operation and process control; 3) state of the art facilities; and 4) commitment.

Sources: Company

□ **Boosting capacity at the right timing**

Latexx Partners currently owns 6 glove factories with total capacity of 6bn pieces p.a. However, Latexx plans to boost its capacity to 9bn pieces of gloves by end-2010 and 15bn pieces by 2015. The capacity expansion to 9bn pieces is being implemented, with the construction of new plants 7 & 8 at a cost of RM70m per plant. The first 1bn pieces incremental capacity, fully catering for one of its MNC customer has already been completed in June 2010, while the other 2bn pieces incremental capacity will be ready by end-2010. The expansion will be financed via internally-generated funds.

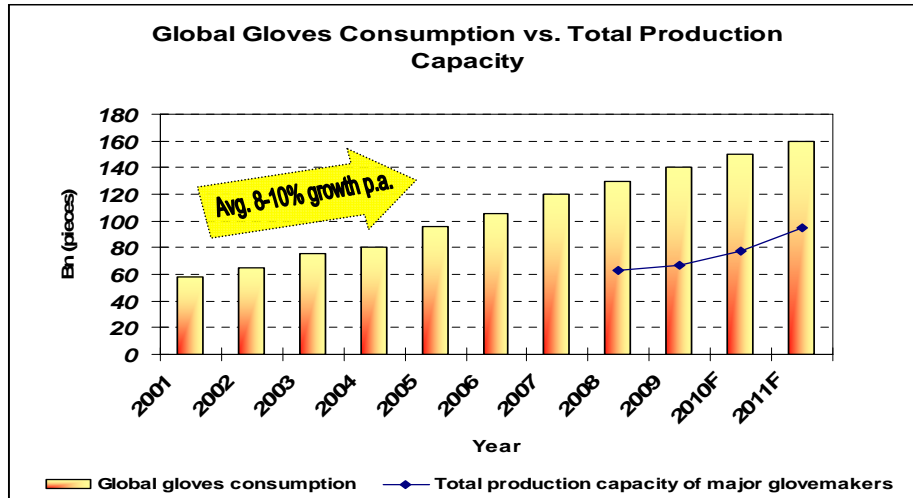
Figure 2: Latexx expansion plans



With its wise expansion plans to capture market demand, revenue for 2010 and 2011 are expected to surge by >30%.

Sources: Company

Figure 3: Global gloves consumption versus total production capacity of major local glovemakers



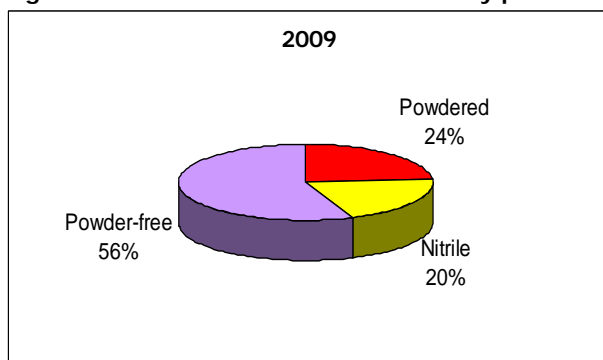
The sustained strong global demand for gloves will ensure Latexx utilization rates of >90% and mitigate overcapacity risk.

*major glovemakers: Top Glove, Supermax, Kossan Rubber, Hartalega & Latexx Partners
Sources: Companies, Alliance Research

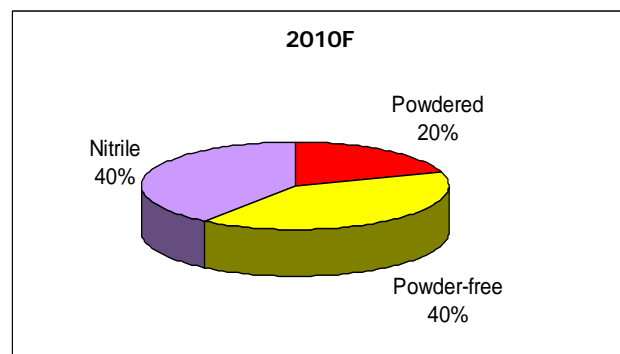
□ **Sales growth drivers: more higher-margin products, new product offerings and new clients**

- The company is realigning its product mix to focus more on those with higher margins, ie. nitrile gloves, which it wants to raise its sales contribution from 20% of group revenue in 2009 to 40% by end-2010. This shift was already evident in 1QFY10 as nitrile gloves accounted for 30% of revenue.
- Latexx has developed new 3.0g nitrile gloves, which are targeted for use in the non-medical sectors of food and manufacturing, given the rising hygiene and safety awareness and requirements in the operation of these sectors has caused a surge in demand of non-medical gloves. Moreover, the move allows Latexx to widen its revenue base as currently >90% of its revenue is contributed by the medical sector. These gloves, which are comparable with lower-end natural rubber gloves, will be priced at US\$30/1000 pieces as compared to regular medical-grade nitrile gloves at US\$34-US\$37/1000 pieces. Moving forward, we expect non-medical sectors to contribute about 8-10% to revenue and 5-8% to earnings p.a.
- A new and improved medical-grade 3.5g nitrile glove will also be introduced, but details are sketchy at present.

Figure 4: Latexx revenue contribution by product



Sources: Company



Sources: Company

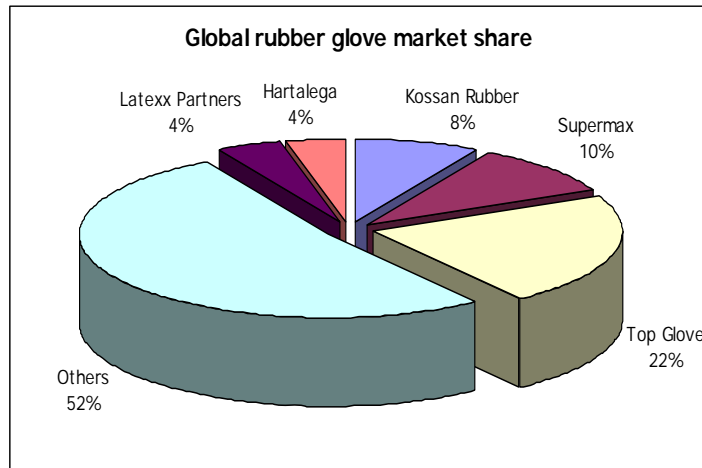
□ **JV to create competitive advantage via technological boost**

Latexx and Budev BV have set up a 50:50 JV, Total Glove Company Sdn Bhd (TG), to market and distribute natural latex gloves with non-detectable levels of protein and allergens. TG will commercialize the patented maximum protection latex (MPXX) technology for surgical and examination gloves. MPXX technology allows for the removal of protein allergens to near-zero levels. Management guided that the machine utilising this technology is expected to treat up to 60,000 pieces of gloves per hour. Latexx expects an additional US\$5-US\$6/1000 pieces premium over its regular-price US\$34/1000 pieces of Natural Rubber gloves. However, management did not reveal any projections as Latexx has yet to gauge market response for this product, and it expects contribution would be only at associate level. Hence we have excluded the JV from our forecasts for now; however, it is a potential catalyst for a surprise earnings upside.

□ **Industry prospects remain bright**

The rubber glove industry is an industry where Malaysia boasts market leadership and competitive advantage. Malaysia is the world's largest exporter of rubber gloves, supplying around 48% of global requirements. Despite potential competition from players in regional peers Thailand, Indonesia, and China, we expect Malaysia to remain competitive given its proximity to raw material sources, excellent logistics network, supportive government policies and stringent industry quality standards.

Figure 5: Estimated global rubber gloves market shares



Sources: Companies, Alliance Research

Malaysia's competitive advantages of proximity to raw material sources, excellent logistics network, supportive government policies and stringent industry quality standards should ensure sustained dominance in the glove industry.

□ **Worry about industry gluts? Not now.** Although there are concerns of a glut in the rubber glove industry, we think this would not be the case so soon. We understand that most of our local rubber glove makers have sold forward their output by 3-5 months as hygiene awareness has risen globally, especially after the H1N1 pandemic. Global rubber glove demand for 2010 is estimated to reach 150bn pieces p.a., growing by 10bn pieces p.a. We understand that the gradual capacity expansion among rubber glove manufacturers in 2H10 would mainly aim to ease their capacity constraints, which arose when they held back on capacity expansion from mid-2008 to mid-2009 in view of the global economic downturn. Moving forward, we believe future capacity expansion for most of the glove players would be gradual and measured, rather than speculative and aggressive.

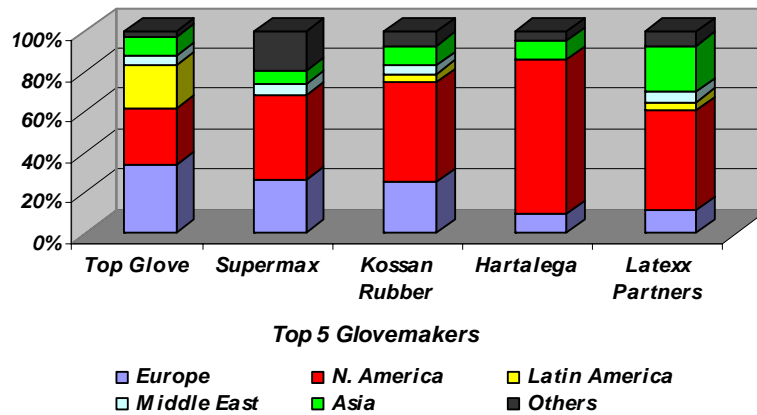
□ **Ease of cost-pass through due to favourable dynamics**

The inelasticity of demand for rubber gloves stems from the lack of viable substitutes, and the stringent quality requirements of users, particularly medical practitioners. This ensures that producers have significant pricing power and the strong ability of cost past-through to customers. Hence, producers would adjust selling price to reflect changes in latex prices and currency movements, although there may be some lag effect due to timing differences. On the cost side, management guided that 50% of latex purchases are bought spot and the remainder on forward contracts. 50% of Latexx's purchases are quoted in US\$ while the rest in RM.

□ **Catalysts for further re-rating**

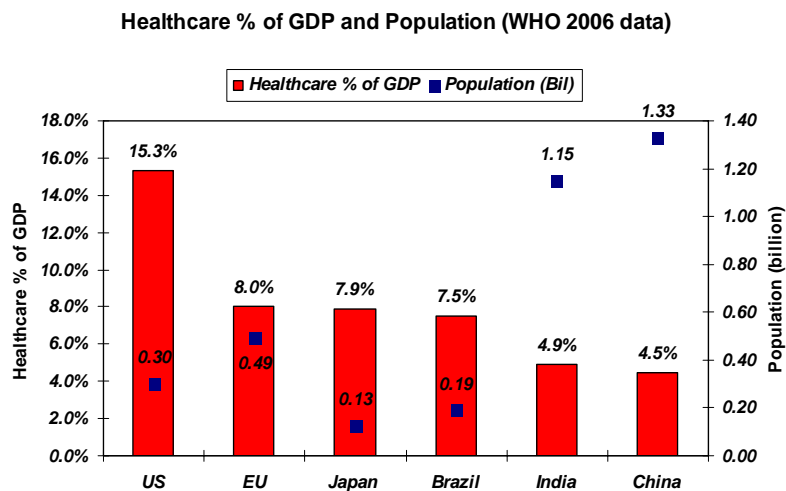
➤ **Huge potential from large untapped markets (i.e. China and India):** Latent demand from China and India exists given a growing middle-income segment and increasing health and hygiene awareness. Currently, Malaysian glove players have little exposure to countries in the Asia Region (some 6-10% exposure by sales). This is despite a wealth of untapped demand for medical consumables forecast to appear over the next 3 years following healthcare reforms in China, India, and other emerging markets. This has yet to be factored into our assumptions and increased demand from the region will be a positive lift-up for the Malaysian glove companies. Among the glove players, we see Latexx to benefit the most as >20% of its sales are derived from Asia.

Figure 6: Peers comparison- Sales by region



Sources: Companies

Figure 7: Healthcare spending by countries



We foresee potential wealth of untapped demand from China and India given healthcare reform.

Sources: WHO 2006 data, Alliance Research

- **Other catalysts:** Earnings surprises from JV company- Total Glove Company from sales of its new allergen-free gloves will spur investor interest on Latexx. Furthermore another disease outbreak at the scale of the last H1N1 epidemic could catalyze revenue and earnings as well.

FINANCIAL/ EARNINGS REVIEW

□ Remarkable revenue and earnings growth

Figure 8 shows the remarkable 1QFY10 achievement from the company with an impressive net profit of +>100%yoy and +20%qoq to RM20.7m accounting for 21% of the consensus full year estimates. Topline hit 79% to RM126.2m from RM70.3m, underpinned by continuous strong glove demand, contribution from the additional 3 double formers production lines, which commenced its operation early this year, aggressive marketing strategy, consistent orders from MNCs as well as overall cost savings from economies of scale. Meanwhile, EPS rose to 10.5 sen from 4.7 sen. First interim tax exempt dividend of 2.5 sen was declared with ex-date and payable date on 16 June 2010 and 5 July 2010 respectively.

□ Cost passing power intact

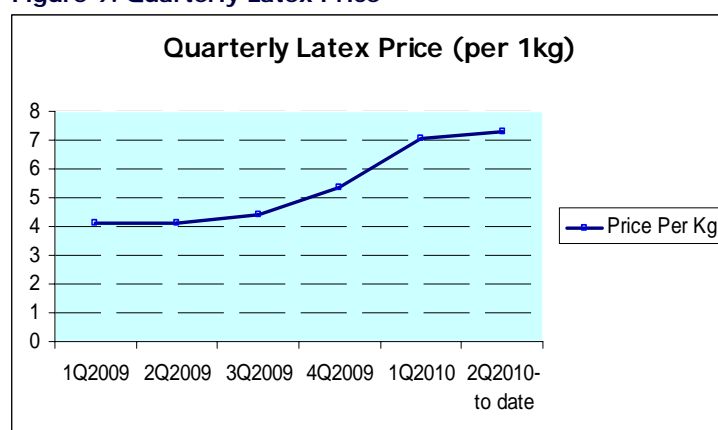
Latex pretax margin expanded by +5.4%pts yoy and +1.5%pts qoq to an all time high of 18.4%. This was despite average latex price surging by +70.3% yoy and +31.5% qoq to RM7.03/kg in 1QFY10. YTD, latex price gained +73.5% to RM 7.15/kg versus RM4.12/kg in 2009 (refer to Figure 9). On the other hand, average USD depreciated by -7% yoy and -1% qoq against MYR in 1QFY10 to RM3.37/USD. YTD, the USD weakened by -8% to RM3.30/USD compared to RM3.59/USD a year ago (see Figure 10). The strong pricing power of the glove producers is intact and cost pass-through ability will likely continue to be significant going forward.

Figure 8: Latexx Partners- 1QFY10 Results

EARNINGS REVIEW							
FY Dec (RM m)	2009 1Q	2009 4Q	2010 1Q	%YoY Chg	% QoQ Chg	2009 YTD	2010 YTD
Revenue	70.3	102.8	126.2	79.4	22.7	328.4	126.2
Operating expenses	(56.8)	(84.0)	(101.6)	(78.7)	(20.9)	(267.7)	(101.6)
Operating profit	13.5	18.8	24.6	82.4	30.7	60.8	24.6
Finance costs	(4.3)	(1.4)	(1.4)	(68.6)	(5.2)	(8.5)	(1.4)
Pretax profit	9.2	17.4	23.2	+>100	33.7	52.2	23.2
Taxation	(0.1)	(0.1)	(2.5)	->100	->100	(0.1)	(2.5)
Net profit	9.1	17.3	20.7	+>100	19.9	52.1	20.7
EPS (sen)	4.7	8.9	10.5	+>100	18.8	26.7	10.5
Operating margin (%)	19.2	18.3	19.5	0.3pts	1.2pts	18.5	19.5
Pretax margin (%)	13.0	16.9	18.4	5.4pts	1.5pts	15.9	18.4
Net margin (%)	13.0	16.8	16.4	3.4pts	-0.4pts	15.9	16.4
Effective tax rate (%)	0.0	0.7	10.9	10.9pts	10.2pts	0.3	10.9

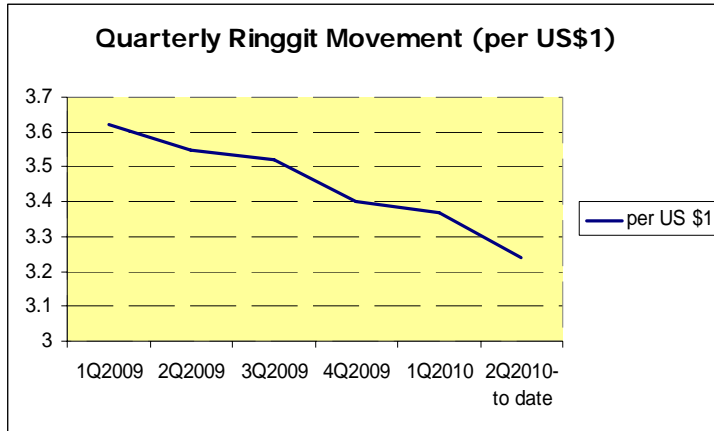
Source : Alliance Research

Figure 9: Quarterly Latex Price



Sources: Bloomberg, Alliance Research

Figure 10: Quarterly MYR/ USD

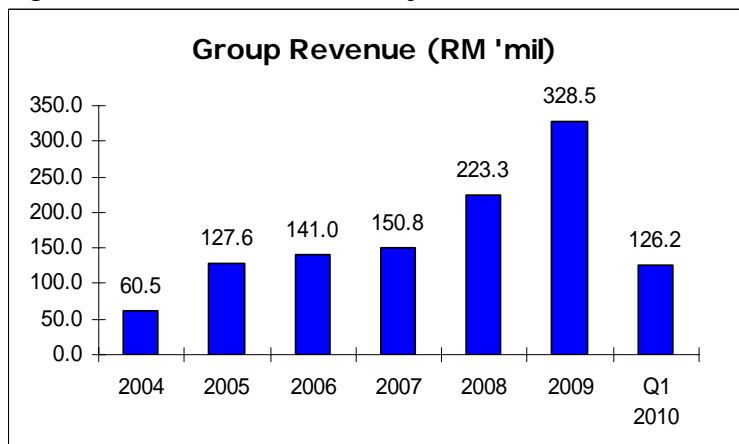


Sources: Bloomberg, Alliance Research

□ Sterling 2009 results

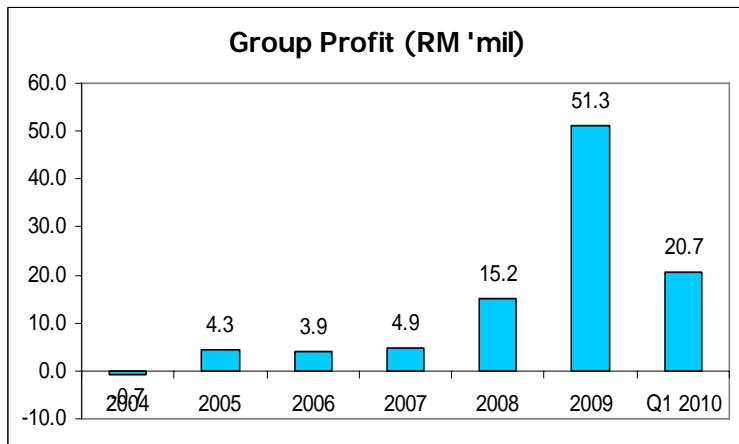
For the financial year 2009, the group revenue increased by RM105m to RM328.5m from RM223.2m, an increase of 47%. Pretax profit surged more than 100% to RM51.8m from RM15.2m. The significant increase in revenue was driven by capacity expansion and higher capacity utilization. The substantial improvement in profit was attributed to better margin derived from the change in product mix, with sales of more premium products, and overall cost savings from economies of scale and effective operation control.

Figure 11: Latex Partners- Yearly Revenue



Sources: Company

Figure 12: Latex Partners- Yearly Profit



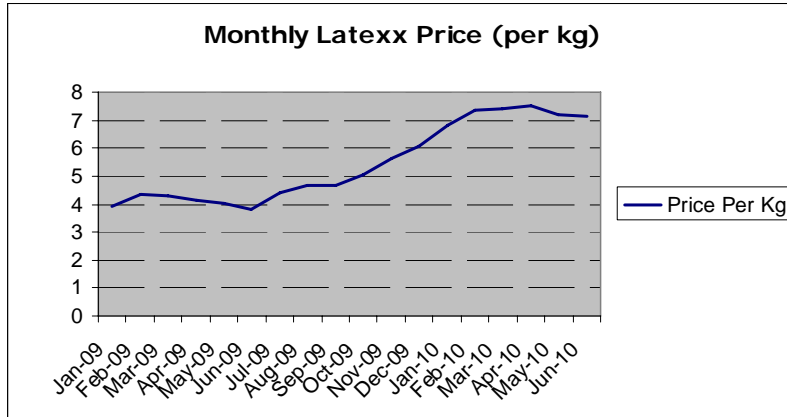
Sources: Company

KEY RISKS AND CONCERNS

□ **Volatility of latex prices**

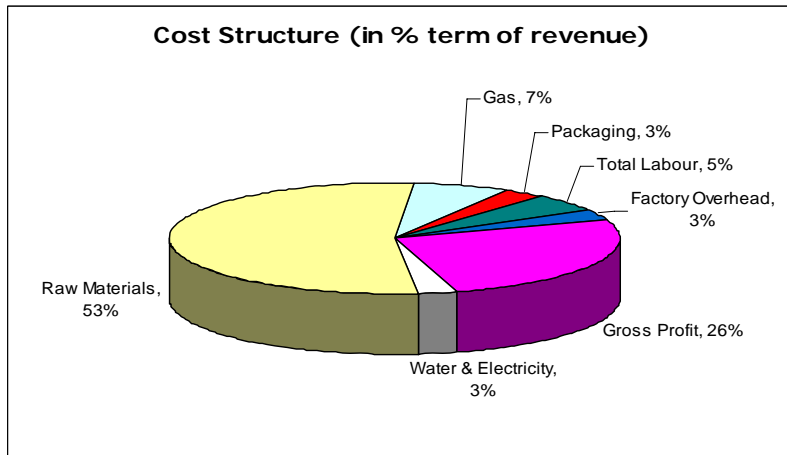
Natural latex is a major cost component for rubber glove manufacturers. Latex makes up about more than 50% of the glove manufacturers' costs. Even though the price of latex has been trending down lately from a high of RM7.50/kg in April 2010 to about RM7.14/kg recently, latex price volatility may result in difficulties in production planning as well as possible margin compression. However, we take comfort in knowing that most cost increases can be transferred to customers.

Figure 13: Monthly Latex Price



Sources: Bloomberg, Alliance Research

Figure 14: Latex Partners- Cost structure (in % term of revenue)

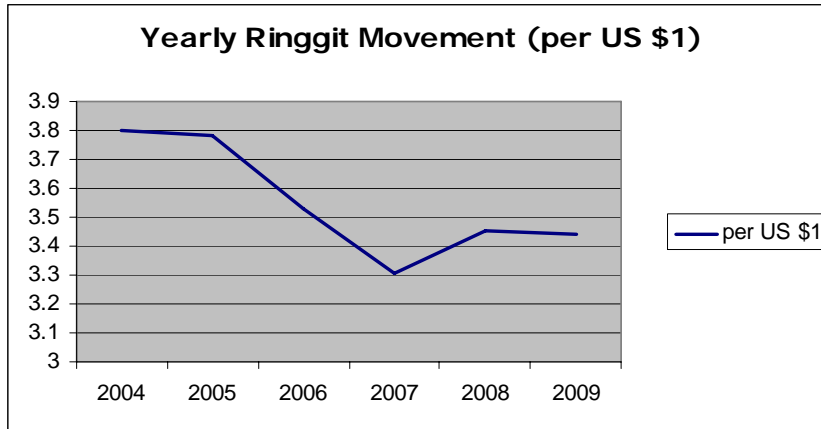


Sources: Company

□ **Forex exposure**

About 93% of Latexx production go to exports and most transactions are denominated in US\$. The weakening of RM will impact positively on revenue and the situation would be reversed should the RM appreciate. The RM/US\$ went to as low as RM3.16 last year, forcing most glovemakers to raise their selling prices to maintain their margins, including Latexx. Furthermore, 53% of the company's raw materials, especially latex, is imported, creating a natural hedge against RM/US\$ movements.

Figure 15: Yearly MYR/ USD

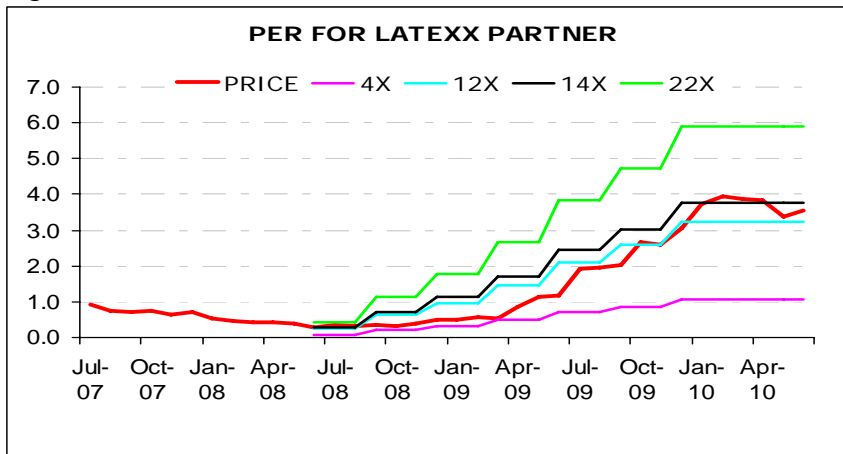


Sources: Bloomberg, Alliance Research

VALUATION

- We project Latexx to post FY10 and FY11 EPS of 46.4 sen and 66.5 sen respectively driven by 1) capacities 2) increasing health awareness and regulatory reforms in countries like US, China, and India, and 3) higher sales of higher-margin products. Assigning FY11 PER of 8.6x, at 40% discount to Top Glove's target FY11 PER of 14.4x, to our FY11 EPS, our Target Price stands at RM5.75 with an upside potential of 55%. Hence, we initiate coverage on Latexx Partners with an Outperform recommendation.

Figure 16: Latexx Partners- PER chart



Sources: Bloomberg, Alliance Research

Figure 17: Peers Comparison

Glovemakers	Share Price @ 30/6/10(RM)	TP (RM)	Market Cap (m)	EPS (sen)		PER (x)		P/NTA (x)		ROE (%)		DPS (sen)	
				FY10F	FY11F	FY10F	FY11F	FY10F	FY11F	FY10F	FY11F	FY10F	FY11F
Top Glove	13.72	16.33	4236.09	88.8	113.4	14.4	11.3	3.8	3.1	27.3	28.4	31.1	39.7
Supermax	*5.84	7.40	1982.46	88.2	93.7	7.8	7.4	3.0	2.9	37.8	40.1	17.6	19.0
Hartalega	8.03	9.4	1945.77	59.1	52.2	12.8	15	5	3.2	35	28.9	20	20
Kossan Rubber	7.60	9.02	1214.99	81.7	114.9	9.2	6.5	3.3	3.1	27.5	29.6	7.9	12.2
Latexx Partners	3.49	5.75	736.61	46.4	66.5	8.0	5.6	2.9	2.2	46.5	40.4	3.2	6.0
Average						10.4	9.2	3.6	3.6				

Sources: Bloomberg, Alliance Research
* after ex-price.

Recommendation Framework

STOCK RECOMMENDATIONS

- OUTPERFORM** : The stock's total return is expected to exceed KLCI's total return by 10% or more in the next 12 months.
- MARKET PERFORM** : The stock's total return is expected to be within +10% or -10% of KLCI's total return.
- UNDERPERFORM** : The stock's total return is expected to be below KLCI's total return by 10% or more in the next 12 months.
- TRADING BUY** : The stock's total return is expected to exceed KLCI's total return by 10% or more within the next 3 months.
- TRADING SELL** : The stock's total return is expected to be below KLCI's total return by 10% or more within the next 3 months.
- NOT RATED** : Stock is not within our regular coverage

SECTOR RECOMMENDATIONS

- OVERWEIGHT** : The industry as defined by the analyst is expected to outperform the KLCI over the 12 months.
- NEUTRAL** : The industry as defined by the analyst is expected to perform in line with KLCI over the 12 months.
- UNDERWEIGHT** : The industry as defined by the analyst is expected to underperform the KLCI over the next 12 months.
- total return** = **capital gain + dividend yield**

Common Abbreviation

Adex = Advertising Expenditure	FCF = Free Cashflow	PEG = PE ratio to growth
bn = billion	FV = Fair Value	PER = PE ratio
BV = Book Value	FY = Financial Year	QoQ = Quarter on Quarter
CF = Cashflow	KLCI = Kuala Lumpur Composite Index	OP = Outperform
CAGR = Compounded Annual Growth rate	m = million	RM = Ringgit
Capex = Capital Expenditure	MoM = month on month	RM bn = RM billion
CY = Calendar Year	MP = Market Perform	RM m = RM million
Div yld = Dividend Yield	NAV = Net Assets Value	ROA = Return on Assets
DCF = Discounted Cashflow	NM = Not Meaningful	ROE = Return on Equity
		ROSF = Return on shareholders funds
DPS = Dividend Per Share	NTA = Net Tangible Assets	TP = Target Price
EBIT = Earnings Before Interest & Tax	NR = Not Rated	UP = Under Perform
EBITDA = EBIT before Depreciation and Amortisation	p.a. = per annum	
EPS = Earnings per share	PAT = Profit after tax	WACC = Weighted Average Cost of Capital
		YoY = Year on Year
EV = Enterprise Value	Pretax profit = Profit before tax	YTD = Year to date
1QFY12/07 = 1 st Quarter for FY Dec 07	PE = Price Earnings Ratio	
2HFY12/07 = 2 nd Half for FY Dec 07		

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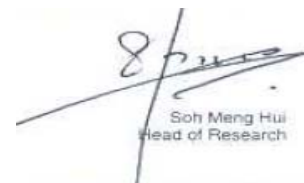
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Soh Meng Hui
Head of Research

Published and Printed by
ALLIANCE RESEARCH SDN BHD (290395-D)
Level 18, Menara Multi-Purpose
Capital Square
8, Jalan Munshi Abdullah
50100 Kuala Lumpur, Malaysia
Tel: +60(3) 2692 7788
Fax: +60(3) 2717 6622
Email: Allianceresearch@allianceinvestment.com.my