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CIMB Research Report

Latexx Partners

One step closer

QUICK TAKES

9 June 2011

Syariah-compliant stock

TRADING BUY	Upgraded
RM2.27	Target: RM2.60
	Mkt.Cap: RM504m/US$167m
	Rubber Gloves

MALAYSIA

LTX MK / LATX.KL

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Latexx and YTY agree to merge

Upgrade from Neutral to TRADING BUY. Latexx has accepted YTY's offer to merge their glovemaking businesses in return for RM1.25bn in cash and shares. This works out to 9x FY12 P/E, in line with the sector. This is positive as Latexx's EPS will increase by an estimated 16% and it will become the world's largest nitrile glovemaker and the third most profitable in our universe. We expect the merger to pan out as YTL's original offer has been knocked down by 8%. For now, we retain our forecasts but raise our target from RM2.28 to RM2.60, based on 10.44x CY12 P/E after reducing the discount to Top Glove's 13.05x benchmark P/E from 30% to 20%. We upgrade Latexx from Neutral to TRADING BUY as this announcement and better results post merger may trigger a re-rating. But we caution that there are merger negotiation and execution risks.

The news

Latexx and YTY have agreed to merge their glovemaking businesses following Latexx's 18 May announcement that it had received a merger proposal from the latter. The deal is subject to due diligence and execution of a sales and purchase agreement (SPA). Latexx and YTY have six months to complete the transaction.

Proposed merger. The proposed merger will be carried out via the sale of YTY's four wholly-owned glovemaking subsidiaries to Latexx for RM1,250m (10.4x FY3/11 net profit) in exchange for cash and shares in the merged entity. The new offer of RM1,250m is 8% lower than YTY's original proposal of RM1,365m.

The transaction will be settled as follows:

- 30.0% of the purchase consideration or RM375m to be paid in cash
- the RM875m or 70% balance to be paid via 350m new shares at RM2.50 apiece, which is the 5-day volume weighted average price of Latexx shares before 17 May.

Figure 1: Latexx's key events since Jan 2011

Date (2011)	Closing Price	1 day Change	Key events and material announcements
27-Jan	2.80	8.5%	Edge Financial Daily writes an article entitled "Latexx to be privatised?"
28-Jan	n/a	n/a	Trading of shares are suspended until 5.00 p.m. on 31 Jan 2011
31-Jan	n/a	n/a	Navis proposes to acquire Latexx's glove business for RM852.03m
1-Feb	n/a	n/a	Latexx responds to Bursa query (Federal Territory day)
2-Feb	2.90	3.6%	Latexx's shares resume trading for first time since proposal announced
31-Mar	2.75	0.7%	Navis completes due-d and exclusivity period extended to 15 May 2011
16-May	2.40	-9.8%	Proposal aborted as parties could not agree on definitive terms
18-May-11	2.51	4.6%	Receives a merger proposal from YTY Industries Sdn Bhd
8-Jun-11	2.27	2.3%	Latexx and YTY agree to merge their glovemaking businesses

Source: Company, CIMB Research

Figure 2: Proforma side-by-side comparison

31-Mar-11	YTY	Latexx	Adj (1)	Merged Co.
Revenue (RMm)	580.1	465.9	-	1,046.0
EBIT (RMm)	148.9	82.4	-	231.2
EBIT margin (%)	25.7%	17.7%	-	22.1%
EBITDA (RMm)	177.7	93.2	-	270.9
EBITDA margin (%)	30.6%	20.0%	-	25.9%
Net profit (RMm)	120.4	62.4	(18.8)	164.0
FD EPS (sen)	-	22.7	-	26.2
EPS accretion/(dilution)				15.8%
Gloves (bn pieces)	8.2	8.0	-	16.2
Total assets (RMm)	429.4	411.9	356.3	1,197.5
Net assets (RMm)	233.7	249.2	-	482.8
Net debt (RMm)	85.6	(19.2)	356.3	422.6
Cash balance (RMm)	16.7	59.4	356.3	432.4
Net gearing (%)	36.6%	net cash	-	87.5%
Net debt / EBITDA (x)	0.48	net cash	-	1.56
RD ordinary shares (m)	350	275	-	625

Source: Company, CIMB Research

1. Assume RM375m financed by external borrowings at a 5% cost of funds

Merger terms. Latexx will be allowed to undertake due diligence of YTY subject to prior mutual agreement on the scope and duration of the due diligence. The acceptance of the offer is subject to, among others:

- execution of the SPA within 45 days from the acceptance of the offer
- Latexx shareholders' approval of exemption for YTY from mandatory general offer obligations as a result of receiving new Latexx shares
- all conditions met within six months (or mutually agreed extended period) from date of SPA.
- approval by the board and regulatory authorities.

Figure 3: Estimated shareholding structure assuming full conversion of warrants

Pre merger (% in YTY / Latexx)		Cash (RMm)	Post merger (% in Merged-Co.)	
YTY shareholders	% held		YTY shareholders	% held
Oh Tiam Sing	41.3%	154.9	Oh Tiam Sing	23.1%
Moh Ung Nang	14.9%	55.9	Moh Ung Nang	8.3%
Dato' Eli Ching Siew	8.9%	33.4	Dato' Eli Ching Siew	5.0%
Lim Loi Heng	16.4%	61.5	Lim Loi Heng	9.2%
Wong Kok Wah	12.2%	45.8	Wong Kok Wah	6.8%
Others	6.3%	23.6	Others	3.5%
Total	100.0%	375.0	Total	56.0%
Latexx shareholders			Latexx shareholders	
BT Capital Sdn Bhd	22.3%	-	BT Capital Sdn Bhd	9.8%
Lembaga Tabung Haji	7.7%	-	Lembaga Tabung Haji	3.4%
Low Bok Tek	7.0%	-	Low Bok Tek	3.1%
Lian Aik Teong	9.3%	-	Lian Aik Teong	4.1%
Others	53.8%	-	Others	23.7%
Total	100.0%	-	Total	44.0%

Source: Company, Securities Commission, CIMB Research

More about YTY. The four YTY subsidiaries in question manufacture and distribute natural rubber and nitrile examination gloves. We gather from YTY's FY11 EBITDA margin of 30% (Figure 2) that the company's products are predominantly nitrile. We estimate that nitrile gloves make up 85-90% to the overall product mix. According to YTY's website, the company has a current production capacity of 8.2bn pieces of gloves p.a. and it aims to increase its capacity to 10.5bn pieces of gloves p.a. by 2012. YTY's headquarters and sales office are located in Tropicana, Petaling Jaya and its manufacturing facilities are located in Sitiawan, Perak. One of YTY's subsidiaries, Global Surgical Supplies Sdn Bhd owns 22.8 acres of vacant land. As at 31 Mar 2011, YTY had total assets of RM429.4m, net debt of RM85.6m, RM16.7m cash and RM233.7m net assets.

Figure 4: YTY's financial summary

YTY, FYE Mar (RMm)	2009	2010	2011	CAGR
Revenues	286.2	348.0	580.1	42.4%
COGS	(224.2)	(241.1)	(385.6)	n/a
Gross profit	62.0	106.9	194.5	77.1%
Gross profit margin (%)	21.7%	30.7%	33.5%	n/a
EBIT	37.9	79.5	148.9	98.2%
EBIT margin (%)	13.2%	22.8%	25.7%	n/a
EBITDA	57.9	100.5	177.7	75.2%
EBITDA margin (%)	20.2%	28.9%	30.6%	n/a
Pretax profit	33.4	75.4	142.9	106.7%
Tax	(6.7)	(10.4)	(22.5)	n/a
Tax rate (%)	-20.1%	-13.8%	-15.8%	n/a
Net profit	26.7	65.0	120.4	112.3%
Net profit margin (%)	9.3%	18.7%	20.7%	n/a

Source: Company, CIMB Research

Comments

YTY to have management control? Latexx's existing shareholders will end up with 44% of the merged company while YTY will have a larger stake of 56% because of its higher margins and a larger net profit base. We believe that this could pave the way for YTY's management to take a more proactive role in the merged entity.

The largest nitrile player after merger. We are positively surprised that the two parties have come to an agreement as we expected an extension given that Latexx's last deal with Navis failed to materialise. This latest proposal will create the largest nitrile glove player in the world and the third most profitable in our universe. The proposal values YTY at a historical P/E of 10.4x. Assuming FY12-13 earnings growth of 15% p.a. which is in line with demand growth for nitrile gloves, the deal values YTY at a CY12 P/E of 9.0x, in line with the sector's 9.1x valuation. We deem the valuation fair as YTY focuses on the nitrile segment, which gives it superior profitability and earnings growth visibility.

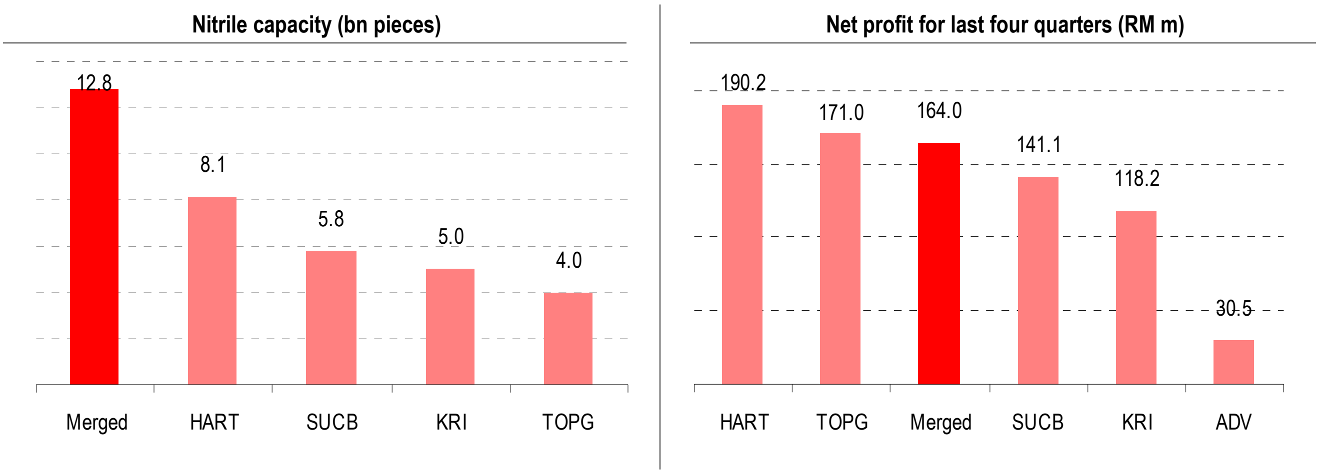
The combined capacity of 16.2bn pieces of gloves implies a nitrile capacity of 12.8bn pieces or a 36% market share. Assuming that Latexx borrows to finance the RM375m cash payment at a 5% interest rate, the merged company could earn a net profit of RM164.0m, the third largest behind Hartalega and Top Glove (Figures 5 and 6). However, Latexx will move from its current net cash position to 87.5% net gearing, which will also be higher than the sector. Hartalega and Top Glove have net cash while net gearing is 57% for Adventa, 35% for Supermax and 15% for Kossan.

Meets YTY's objectives. This proposal is an attempt by YTY to monetise its investment in the glovemaking industry, having failed to complete its secondary listing in 4Q10 and the disposal of its glovemaking businesses to private equity investors earlier this year. The merger proposal will enable YTY to realise liquidity upfront via the RM375m cash portion and have the balance of its equity in an existing listed vehicle with a large shareholding spread (Figure 3). This will allow it to monetise its investment over time without causing a significant movement in Latexx's share price and with minimum loss of value.

Narrows Hartalega advantage. With a nitrile capacity of 12.8bn pieces of gloves, the merged entity will have a larger nitrile capacity than Hartalega, which has a nitrile capacity of 8.1bn pieces of gloves. Both Latexx's and YTY's factories are located in Perak – Latexx in Kamunting and YTY in Sitiawan. Our analysis suggests that they are only 100km apart or a 1-2 hour commute by road. Note that our proforma net profit of RM164m does not take into account potential cost and revenue synergies arising from the merger.

We believe that synergies could arise from this merger as YTY's FY3/11 EBITDA margin of 30.6% is 10.6% pts higher than Latexx's (Figure 2), implying that YTY's management runs a tighter ship. While it may take time for the managements to align their goals and objectives, we believe that YTY's superior efficiency will help Latexx enhance its operational efficiency. Purely as an illustration, we estimate that a cost savings of 10% could raise the merged company's net profit to c.RM180m, surpassing Top Glove to become the second most profitable glovemaker after Hartalega.

Figure 5: Comparison of merged co's competitive position



Source: Company, CIMB Research

Figure 6: Malaysian glovemaking landscape – before and after the Latexx and YTY merger

Pre merger (RMm)	FYE	Capacity (bn)	Nitrile capacity	Revenues	EBIT	EBIT margin	Net profit	Net profit margin	Total assets
Adventa	Oct	5.0	-	365.7	29.9	8.2%	30.5	8.3%	415.5
Hartalega	Mar	9.0	8.1	734.9	245.7	33.4%	190.2	25.9%	631.3
Kossan	Dec	12.5	5.0	1,047.9	156.0	14.9%	118.2	11.3%	777.3
Latexx	Dec	8.0	5.4	465.9	82.4	19.4%	62.4	13.4%	399.2
Supermax	Dec	17.6	5.8	944.0	119.4	12.6%	141.1	14.9%	1,065.4
Top Glove	Aug	33.0	4.0	2,074.0	201.0	9.7%	171.0	8.2%	1,372.0
YTY	Mar	8.2	7.4	580.1	148.9	25.7%	120.4	20.7%	429.4
Average	**-**	**13.3**	**5.1**	**887.5**	**140.5**	**17.7%**	**119.1**	**14.7%**	**727.2**
Total	**-**	**93.3**	**35.7**	**6,212.4**	**983.3**	**-**	**833.7**	**-**	**5,090.2**

Post merger (RMm)	FYE	Capacity (bn)	Nitrile capacity	Revenues	EBIT	EBIT margin	Net profit	Net profit margin	Total assets
Adventa	Oct	5.0	-	365.7	29.9	8.2%	30.5	8.3%	415.5
Hartalega	Mar	9.0	8.1	734.9	245.7	33.4%	190.2	25.9%	631.3
Kossan	Dec	12.5	5.0	1,047.9	156.0	14.9%	118.2	11.3%	777.3
Merged Co.	-	16.2	12.8	1,046.0	231.2	22.1%	164.0	15.7%	1,197.5
Supermax	Dec	17.6	5.8	944.0	119.4	12.6%	141.1	14.9%	1,065.4
Top Glove	Aug	33.0	4.0	2,074.0	201.0	9.7%	171.0	8.2%	1,372.0
Average	**-**	**15.5**	**5.9**	**1,035.4**	**163.9**	**16.8%**	**135.8**	**14.1%**	**909.9**
Total	**-**	**93.3**	**35.7**	**6,212.4**	**983.3**	**-**	**814.9**	**-**	**5,459.1**

Source: Company, CIMB Research, Bursa Malaysia

Valuation and recommendation

Merged company could command better valuations. We believe that after the merger, Latexx's valuation could close in on Hartalega, which we currently value at 11.7x forward P/E or a 10% discount to Top Glove's benchmark P/E of 13.05x. Latexx is currently trading at 7.1x FY12 P/E. Factoring in the 350m new Latexx shares to be issued to YTY, our analysis suggests that after the merger, the value of the equity interest of Latexx's existing shareholders could rise by 27.7% assuming that the shareholders' interest in the merged entity is valued at 10.6x forward P/E or a 10% discount to Hartalega's target P/E (Figure 7).

Figure 7: Proforma valuation

Valuation matrix	Workings		
Merged Co. net profit (RMm)	A	164.0	
Hartalega fwd P/E (x)		11.7	
Discount to Hartalega (%)		10.0%	
Target P/E for Merged-Co. (x)	B	10.6	
Merge Co. proforma equity value (RMm)	C = A x B	1,733.3	
Per share (at 625m shares)		2.77	
Proforma distribution of equity		YTY	Latexx
Based on a FD basis (%)	D	56.0%	44.0%
Share of Merge Co.'s equity value (RMm)	E = C x D	970.1	763.2
Implied FY12 P/E (x)		n/a	11.0
Latexx current market cap	F	n/a	504.1
Add: Value of warrants	G	n/a	93.7
Current value of Latexx's equity	H = F + G	n/a	597.8
Implied FY12 P/E (x)		n/a	8.6
Premium / (discount)	I = (E/H) - 1	n/a	27.7%

Source: Company, CIMB Research, Bursa Malaysia

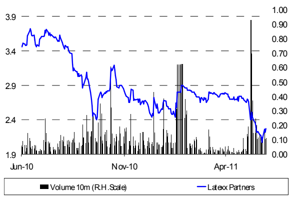
We expect the deal to materialise and both parties to execute the SPA in a timely fashion as YTY has accepted a lower offer of RM1,250m, an 8% discount to the original offer. As the merger will stir interest in Latexx, we now upgrade our recommendation from Neutral to TRADING BUY. We make no changes to our forecasts but raise our target price from RM2.28 to RM2.60 based on a higher P/E of 10.44x after reducing the discount to Top Glove’s benchmark P/E of 13.05x from 30% to 20%. The stock could be catalysed by this announcement and prospects of better operating results post merger.

Financial summary

FYE Dec	2009	2010	2011F	2012F	2013F
Revenue (RM m)	328.5	497.3	503.8	482.5	501.7
EBITDA (RM m)	66.7	101.5	104.0	111.3	126.4
EBITDA margins (%)	20.3%	20.4%	20.6%	23.1%	25.2%
Pretax profit (RM m)	51.8	84.8	83.2	86.7	97.8
Net profit (RM m)	51.3	70.4	66.6	69.4	78.2
EPS (sen)	23.1	31.7	30.0	31.2	35.2
EPS growth (%)	237.8%	37.1%	(5.4%)	4.2%	12.8%
P/E (x)	9.8	7.2	7.6	7.3	6.4
FD core EPS (sen)	18.5	25.3	23.9	24.9	28.1
FD core P/E (x)	12.3	9.0	9.5	9.1	8.1
Gross DPS (sen)	2.0	7.5	8.0	8.3	9.4
Dividend yield (%)	0.9%	3.3%	3.5%	3.7%	4.1%
P/BV (x)	3.0	2.1	1.7	1.4	1.2
ROE (%)	35.3%	34.6%	25.0%	21.4%	20.3%
Net gearing (%)	43.0%	20.0%	10.1%	1.1%	N/A
Net cash per share (RM)	N/A	N/A	N/A	N/A	0.13
P/FCFE (x)	36.7	13.6	11.6	9.1	7.0
EV/EBITDA (x)	8.6	5.4	5.1	4.6	3.8
% change in EPS estimates			N/A	N/A	N/A
CIMB/Consensus (x)			0.95	0.91	0.93

Source: Company, CIMB Research, Bloomberg

Price chart



Source: Bloomberg

Figure 9: Sector comparisons

	Bloomberg ticker	Recom.	Price (Local)	Target price (Local)	Mkt cap (US$ m)	Core P/E (x) CY2011	Core P/E (x) CY2012	3-yr EPS CAGR (%)	P/BV (x) CY2011	ROE (%) CY2011	Div yield (%) CY2011
Latexx	LTX MK	TB	2.27	2.60	167	7.6	7.3	3.6	1.7	25.0	3.5
Adventa	ADV MK	U	2.11	2.43	107	11.7	7.9	2.7	1.1	10.7	3.4
Hartalega	HART MK	O	5.46	7.18	658	10.2	8.9	12.8	3.5	38.2	5.2
Kossan	KRI MK	O	3.12	3.87	331	8.9	7.4	10.5	1.8	22.1	3.2
Supermax	SUCB MK	Buy	3.92	4.75	442	8.7	8.6	1.3	1.5	19.2	2.8
Top Glove	TOPG MK	U	5.33	4.76	1,092	23.3	14.6	4.8	2.7	12.1	2.6
Simple average						**11.7**	**9.1**	**6.0**	**2.1**	**21.2**	**3.5**

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

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RECOMMENDATION FRAMEWORK #1 *

STOCK RECOMMENDATIONS	SECTOR RECOMMENDATIONS
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.
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.	**TRADING SELL:** The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 3 months.

** This framework only applies to stocks listed on the Singapore Stock Exchange, Bursa Malaysia, Stock Exchange of Thailand and Jakarta Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.*

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RECOMMENDATION FRAMEWORK #2 **

STOCK RECOMMENDATIONS	SECTOR RECOMMENDATIONS
OUTPERFORM: Expected positive total returns of 15% or more over the next 12 months.	**OVERWEIGHT:** 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 12 months.
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.

*** This framework only applies to stocks listed on the Hong Kong Stock Exchange and China listings on the Singapore Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.*