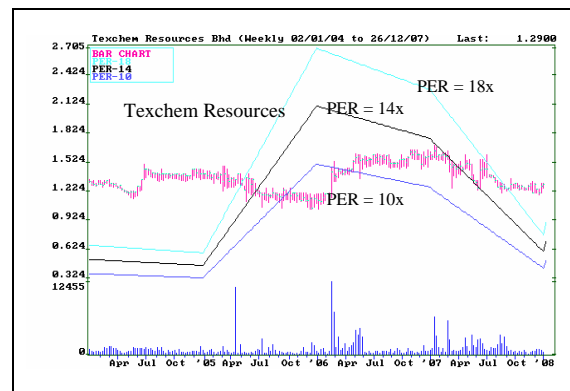


Date: 27 December 2007

Texchem Resources		Price:	RM1.29
		Market Capitalisation:	RM160.1m
		Board:	Main
		Sector:	Trading/Services
Stock Code:	8702	Recommendation:	HOLD

<u>Key Stock Statistics</u>	2006	2007F
EPS (sen)	13.1	9.9
P/E (x)	9.8	13.1
Dividend/Share (sen)	10.0	12.0
NTA/Share (RM)	0.98	0.99
Book Value/Share (RM)	1.38	1.40
Issued Capital (mil shares)	124.1	
52-weeks Share Price Range	RM1.18/1.70	
Major Shareholders:	%	
Texchem Holdings Sdn Bhd	31.4	
Texchem Corporation Sdn Bhd	20.5	
Tan Sri Dato' Seri Fumihiko Konishi	5.6	



<u>Per Share Data</u>	2004	2005	2006	2007F
Book Value (RM)	1.28	1.33	1.38	1.40
Cash Flow (sen)	24.0	40.5	39.4	37.8
Earnings (sen)	3.2	15.0	13.1	9.9
Dividend (sen)	8.0	10.0	10.0	12.0
Payout Ratio (%)	179.7	74.0	57.6	180.2
PER (x)	39.9	8.6	9.8	13.1
P/Cash Flow (x)	5.4	3.2	3.3	3.4
P/Book Value (x)	1.0	1.0	0.9	0.9
Dividend Yield (%)	6.2	7.8	7.8	9.3
ROE (%)	2.5	7.4	9.3	3.5
Net Gearing (%)	152.5	139.6	140.3	130.1

<u>P&L Analysis (RM mil)</u>	2004	2005	2006	2007F
Year-end: Dec				
Revenue	1,056.8	1,195.5	1,267.7	1,186.5
Operating Profit	23.5	33.8	39.5	36.4
Depreciation	(25.2)	(31.5)	(32.5)	(34.7)
Interest Expenses	(11.9)	(13.4)	(16.1)	(18.1)
Pre-tax Profit	11.0	26.7	22.5	22.9
Effective Tax Rate (%)	66.4	28.7	29.3	35.0
Net Profit	3.9	18.7	16.3	12.2
Operating Margin (%)	2.2	2.8	3.1	3.1
Pre-tax Margin (%)	1.0	2.2	1.8	1.9
Net-Margin (%)	0.4	1.6	1.3	1.0

1. Investment Highlights/Summary:

- Texchem was founded back in 1973 by its current Chairman and CEO, Tan Sri Dato' Seri Fumihiko Konishi. Today, Texchem Resources (Texchem) comprises four business divisions, namely: a) industrial division; b) packaging division; c) family care division; and d) food division.
- We expect 2007 earnings (excluding the gain on disposal of the FMCG business) to see a sharp contraction (-61.4% yoy) mainly due to lower contribution from the packaging division (affected by weaker demand) coupled with Texchem's high financial leverage. Nevertheless, we have projected earnings to rebound in 2008 on account of better operating results from the family care and food divisions as well as lower finance costs as Texchem gradually pares down its borrowing levels. For 2009, we have projected a net profit growth of 6.3% for the group.
- We value Texchem at RM1.37/share, based on a target CY08 PER of 14.5x. Together with our projected 2008 dividend per share of 12 sen, this suggests a potential total shareholder's return of 15.5%, which is roughly in line with our projected return for the market. Hence, we are initiating coverage on Texchem with a **Hold** recommendation.

2. Background:

• Corporate Profile

Founded back in 1973 by its current Chairman and CEO, Tan Sri Dato' Seri Fumihiko Konishi, Texchem Resources (Texchem) started off as a textile chemical trader. Over the years, the group has undergone various changes and diversifications. Today, the Texchem group is made up of four business divisions, namely: a) industrial division; b) packaging division; c) family care division; and d) food division. Texchem was listed on the Second Board of Bursa Malaysia in May 1993 and subsequently transferred to the Main Board in June 2001.

• Corporate Structure

Please refer to Appendix 1.

• Business

Industrial division

As mentioned above, the origin of the group began with the establishment of the industrial division, which remains as the largest revenue contributor to the group (see Chart 1). Essentially, this division markets and distributes industrial raw materials such as plastic resins, synthetic polymers, industrial chemicals, dyestuffs and textile auxiliaries. This division has sales offices and warehousing facilities in Malaysia, Singapore, Vietnam, Thailand, China and Indonesia.

Although this division was the largest revenue generator in 2006, it only contributed 35.5% to EBIT due to its razor thin margins. We note that EBIT margins have been on a downtrend, from 3.3% in 2001 declining to 2.6% in 2006. This was largely due to margin pressures arising from the competitive environment as well as pricing pressures from building a foothold in the overseas markets as Texchem had to ensure its products are competitively priced.

Packaging division

This division is housed under Texchem-Pack Holdings Ltd (TexPack), which was listed on the Singapore Exchange Securities Trading Ltd in Nov 2006. TexPack is basically a packaging solutions provider engaged in the design, manufacture and sale of a variety of plastic packaging products. These products range from thermoformed trays, precision injection moulded products, embossed carrier tapes to flexographic printing plates used for the printing of designs and artwork on a variety of packaging products.

Currently, TexPack's production facilities are located in Malaysia, Thailand, China and Vietnam while its customers are mainly from the semiconductor, consumer electronics and electrical, data storage and telecommunications industries.

In 2006, despite accounting for 20% of total revenue, TexPack was the largest EBIT contributor to the Group with a 56.1% contribution. The strong performance from the packaging division was due to stronger demand from the data storage and consumer electronics and electrical industries as well as the capacity expansion at its facility in China.

Family care division

Under the family care division, Texchem manufactures household insecticide products such as mosquito coils, mosquito mats, insecticidal aerosols, liquid and mat vaporisers. These products are marketed under brand names like "Fumakilla", "H2O" and "Vape". Similar with the above two divisions, the family care division also has manufacturing facilities located across the ASEAN region, which includes Malaysia, Indonesia, Thailand, Vietnam and Myanmar.

Aside from household insecticide products, this division was also involved in the trading of fast moving consumer goods (FMCG). However, this business was sold off earlier this year to DKSH Holdings for RM16m, resulting in an exceptional gain of RM6.2m.

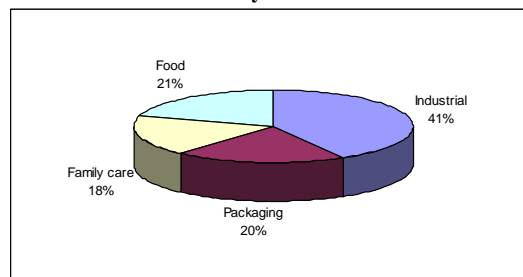
Food division

Under this division, Texchem produces a range of upstream and downstream products. Its upstream operations include seafood processing, which produces frozen marine products such as squid, cuttlefish, prawns, and soft shell crabs. In addition, via A.S.K. Andaman Ltd in Myanmar, Texchem manufactures and markets surimi (minced fish meat product) and fishmeal (high protein animal feed ingredient) products. A.S.K. Andaman also supplies Texchem's Malaysian operations with surimi raw materials that are then processed into surimi-based products, such as crab sticks and crab claws.

Further downstream is the Sushi King chain of restaurants. There are currently 42 outlets and management plans to increase this to 47 by the end of 2008.

Overall, while contributing 21% to 2006 revenue, this division was loss making last year mainly due to the high operating costs at its Myanmar plant.

Chart 1: FY06 Revenue by Division



Earnings Review

For the year FY12/06, revenue grew 6% yoy to RM1.3bn thanks to double-digit growth posted by the packaging and food divisions. Net profit (excluding exceptional gains), however, rose 29.3% yoy mainly due to stronger margins from the packaging division (better product mix and improved capacity utilisation rates), but offset slightly by higher losses of the food division.

For 9MFY12/07, revenue was down 3.5% yoy largely due to: a) lower revenue from the family care division (-24%

yoy) post the disposal of the consumer business; and b) a 13.3% yoy decline in revenue from the packaging division on the back of weaker demand. Net profit (excluding the gain on disposal of the FMCG business) slipped 74.6% yoy due to: a) a 4.3%-pt decline in EBIT margin for the packaging division as a result of lower capacity utilisation rates; and b) high financial leverage.

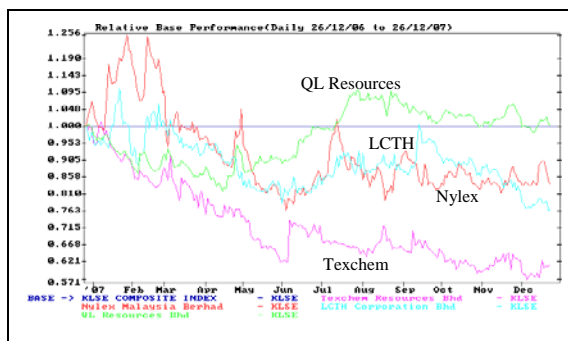
While Texchem does not have a dividend policy, we note that its dividend is generally on a rising trend with yields that are rather attractive. The total gross dividend per share (DPS) declared last year was 10 sen while YTD, Texchem has declared gross interim DPS totaling 12 sen (9.3% gross yield). We do not expect Texchem to declare a final DPS, in line with its practice in prior years.

3. Valuations:

Given Texchem's diversified business, we believe it does not have a directly comparable peer. However, for comparative purposes, we have set out below companies which have businesses that are roughly comparable with Texchem's own business divisions.

<u>Comparative Valuation</u>	<u>Texchem</u>	<u>Nylex*</u>	<u>LCTH</u>	<u>QL Res*</u>
Share Price (RM) @ 26 December 2007	1.29	1.52	0.51	3.72
Mkt. Cap (RM mil)	160.1	295.4	306.0	818.4
Ave. Daily Vol. (mil)	0.03	0.32	0.51	0.22
P/E FY05 (x)	13.3	14.8	8.0	15.6
P/E FY06 (x)	10.3	7.2	9.7	12.9
P/NTA (x) – FY06	1.3	2.6	1.1	2.8
Yield (%) – FY06	7.8	3.6	11.8	2.7

* FY06-07 for Nylex and QL Resources



4. Earnings Outlook:

We expect 2007 earnings (excluding the gain on disposal of the FMCG business) to see a sharp contraction (-61.4% yoy) due to the above-mentioned factors. That said, we have projected earnings to rebound in 2008 on account of: a) better EBIT from the family care division (+10% yoy) as contribution from overseas operations improve; b) stronger EBIT from the food division (+52.7% yoy) as its operation in Myanmar is expected to breakeven next year (note that the high percentage change in the food division is mainly

due to the low base effect); and c) lower finance cost as Texchem gradually pares down its borrowing levels. We have projected flat earnings for both the industrial and packaging division as despite a mixed outlook for the semiconductor and electronics industries (see Investment Risks section below), we believe the worst has passed. For 2009, we have projected a net profit growth of 6.3% for the group.

In our view, given that the industrial, family care and food divisions tend to be comparatively more stable than the packaging division, the latter could possibly be a key swing factor to the group's earnings. We note that FY06's strong net profit performance was largely due to the packaging division while FY07's performance was dragged by this same division.

As for dividends, given that Texchem does not have a dividend policy, we have assumed that Texchem will maintain its DPS of 12 sen for 2008 and 2009. We think this would be sustainable given that future capital expenditure (capex) is not expected to be significantly higher than current levels. Going forward, management has guided for annual capex of around RM35m (2006: RM33m), financed by a combination of borrowings and internally generated funds. For 2008, we gather that this amount would mainly go towards expanding its family care division facilities and relocating the packaging division's manufacturing facilities in Thailand to a new factory (currently, Texchem is renting factory space there).

5. Recent Developments:

On 6 Sep 2007, Texchem announced a conditional share purchase agreement with Mitsui Bussan Frontier Co. Ltd to acquire Mitsui's entire equity stake in NM for RM3m cash. NM is engaged in the trading of electronic component parts and general merchandise. This acquisition was completed in Oct 2007.

On 13 June 2007, Texchem announced that it had entered into a conditional share sale agreement with Texchem Corporation, an associate and substantial shareholder of Texchem, for the purchase of a 30% stake in PTTJ for RM8.4m cash. PTTJ is involved in the production and sale of mosquito coils in Indonesia. This acquisition was completed in Aug 2007.

On 13 Mar 2007, Texchem announced the disposal of its 51% stake in Sanko to TexPack for RM5.7m, which would be satisfied by the issuance of 8.2m new TexPack shares. In addition, TexPack has proposed to acquire a further 40% stake in Sanko from Sanko Japan for RM4.5m, satisfied by the issuance of 6.4m new TexPack shares. The proposed disposal and acquisition was completed in May 2007, resulting in a dilution of Texchem's stake in Texpack to 70.5% from 72.2%.

6. Investment Risks:

Generally, Texchem's industrial and packaging divisions face stiff competition in both the local and foreign markets. As a result, we believe these divisions will continue to face

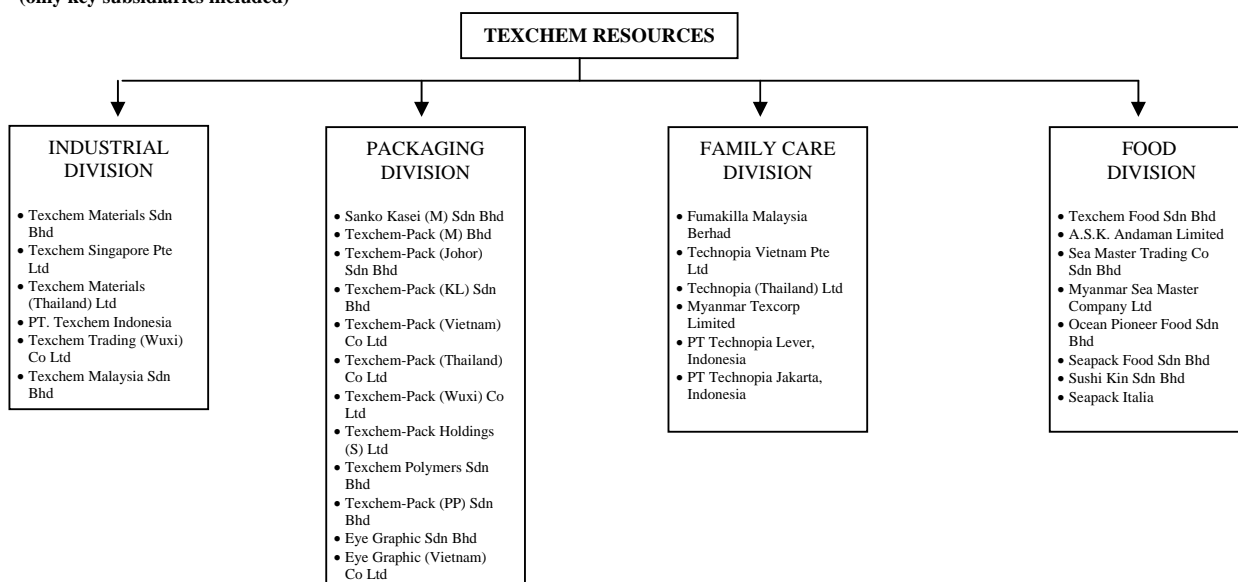
pricing pressure, which could lead to margin erosions especially if it is not able to pass on higher raw material/inventory costs.

Raw materials make up about 70-75% of TexPack's cost of sales while extruded plastic sheets, plastic resins and compounds account for about 60-65% of total raw materials. Given the high crude oil prices, this could lead to higher raw material costs for TexPack and together with the price pressures, margins could be severely squeezed. Nevertheless, two mitigating factors here are: a) some of TexPack's customers would designate either the grade of raw materials or the suppliers from whom TexPack are to purchase raw materials from and the price purchased would be directly negotiated between the customers and the suppliers; and b) the short product lifecycle (6-12 months) would allow TexPack to factor in the latest raw material prices when new products are launched.

Besides that, TexPack is heavily dependent on customers who are in the semiconductor, consumer electronics and electrical, data storage and telecommunications industries. In addition, the industrial division also supplies products to customers that are in the electronics and electrical sector (especially plastic resins). While we believe the semiconductor and electronics sectors could see some recovery (albeit at a modest rate) in 1H08, we expect the recovery to be short-lived and likely to trend downwards in 2H08 given: a) potentially slower economic growth and consumer spending in the US if the subprime woes continue; and b) tighter credit and lower consumer confidence, which have driven enterprises to cut spending on computer and telecommunication equipment.

Finally, as at 31 Dec 2006, Texchem's net gearing level stood at 1.4x while interest coverage was 4.5x in 2006. We believe the high gearing was mainly to finance its working capital needs, specifically, inventory, for the industrial division. In our view, the high financial leverage places Texchem at risk to an unexpected economic downturn while increasing earnings volatility.

**APPENDIX 1 : Texchem's Group Structure
(only key subsidiaries included)**



7. Balance Sheet:

<u>Balance Sheet and Other Financial Data (RM mil)</u>	<u>FY2004</u>	<u>FY2005</u>	<u>FY2006</u>
Total Assets	632.5	660.0	697.8
Fixed Assets	204.3	206.6	202.8
Current Assets	352.5	390.2	422.8
LT Assets	75.6	63.2	72.1
Current Liabilities	358.9	352.0	351.8
LT Liabilities	92.5	121.2	131.5
Share Capital	124.1	124.1	124.1
Shareholders Funds	159.2	165.4	171.8

As at end-Dec. 2006, the group's cash balance was RM65.6m while total debt was RM306.6m. Net gearing was 1.4x while net interest coverage was 4.5x. Nevertheless, we note that Texchem has been gradually paring down its debt levels and as at end-Sep 2007, total debt was down to RM243.8m while net gearing improved to 1.1x.

8. Recommendation:

We have valued Texchem based on an earnings-based valuation methodology given that we expect earnings to recover next year. Ascribing a target PER of 14.5x (based on Texchem's 3-year median PER) to Texchem's CY08 EPS, we obtain an indicative fair value of RM1.37. Together with our projected 2008 dividend per share of 12 sen, this suggests a potential total shareholder's return of 15.5%, roughly in line with our projected return for the market. Hence, we are initiating coverage on Texchem with a **Hold** recommendation.

IMPORTANT DISCLOSURES

This report has been prepared by RHB Research Institute Sdn Bhd (RHBRI) and is for private circulation only to clients of RHBRI and RHB Investment Bank Berhad (previously known as RHB Sakura Merchant Bankers Berhad). It is for distribution only under such circumstances as may be permitted by applicable law. The opinions and information contained herein are based on generally available data believed to be reliable and are subject to change without notice, and may differ or be contrary to opinions expressed by other business units within the RHB Group as a result of using different assumptions and criteria. This report is not to be construed as an offer, invitation or solicitation to buy or sell the securities covered herein. RHBRI does not warrant the accuracy of anything stated herein in any manner whatsoever and no reliance upon such statement by anyone shall give rise to any claim whatsoever against RHBRI. RHBRI and/or its associated persons may from time to time have an interest in the securities mentioned by this report.

This report does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. RHBRI recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. Neither RHBRI, RHB Group nor any of its affiliates, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report.

RHBRI and the Connected Persons (the "RHB Group") are engaged in securities trading, securities brokerage, banking and financing activities as well as providing investment banking and financial advisory services. In the ordinary course of its trading, brokerage, banking and financing activities, any member of the RHB Group may at any time hold positions, and may trade or otherwise effect transactions, for its own account or the accounts of customers, in debt or equity securities or loans of any company that may be involved in this transaction.

"Connected Persons" means any holding company of RHBRI, the subsidiaries and subsidiary undertaking of such a holding company and the respective directors, officers, employees and agents of each of them. Investors should assume that the "Connected Persons" are seeking or will seek investment banking or other services from the companies in which the securities have been discussed/covered by RHBRI in this report or in RHBRI's previous reports.

This report has been prepared by the research personnel of RHBRI. Facts and views presented in this report have not been reviewed by, and may not reflect information known to, professionals in other business areas of the "Connected Persons," including investment banking personnel.

The research analysts, economists or research associates principally responsible for the preparation of this research report have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

The recommendation framework for stocks and sectors are as follows : -

Stock Ratings

Outperform = The stock return is expected to exceed the KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

RHBRI is a participant of the CMDF-Bursa Research Scheme and will receive compensation for the participation. Additional information on recommended securities, subject to the duties of confidentiality, will be made available upon request.

This report may not be reproduced or redistributed, in whole or in part, without the written permission of RHBRI and RHBRI accepts no liability whatsoever for the actions of third parties in this respect.