

Date: 1 August 2008

Texchem Resources <i>2Q Results Dragged By Associate Losses and High Tax Rate</i>	Price:	RM1.15
	Market Capitalisation:	RM142.7m
	Board:	Main Board
	Sector:	Trading Services
	Stock Code:	8702
	Recommendation:	HOLD

<u>Key Stock Statistics</u>	2007	2008F
EPS (est.)	14.4	4.6
P/E (est.)	8.0	24.9
Dividend/Share	12.0	12.0
NTA/Share (RM)	1.02	0.98
Book Value/Share	1.43	1.39
Issued Capital (mil shares)	124.1	
52-weeks Share Price Range	1.10 – 1.35	
<u>Major Shareholders:</u>	<u>%</u>	
Texchem Holdings	31.4	
Texchem Corporation	20.6	
Tan Sri Dato' Seri Fumihiko Konishi	5.6	

PE Band Chart



<u>Per Share Data</u>	2007	2008F	2009F	2010F
Book Value (RM)	1.43	1.39	1.40	1.43
Cash Flow (sen)	44.5	33.8	39.9	43.0
Earnings (sen)	14.4	4.6	9.7	11.8
Dividend (sen)	12.0	12.0	12.0	12.0
Payout Ratio	93.5	192.0	93.2	76.0
PER (x)	8.0	24.9	11.9	9.7
P/Cash Flow (x)	2.6	3.4	2.9	2.7
P/Book Value (x)	0.8	0.8	0.8	0.8
Dividend Yield (%)	10.4	10.4	10.4	10.4
ROE (%)	6.7	3.3	6.9	8.4
Net Gearing (%)	113.5	145.4	142.0	135.3

<u>P&L Analysis (RM mil)</u>	2007	2008F	2009F	2010F
Year-end: Dec				
Revenue	1,258.6	1,348.3	1,383.1	1,415.7
Operating Profit	41.6	39.2	41.6	43.3
Depreciation	(37.3)	(36.2)	(37.6)	(38.7)
Interest Expenses	(17.1)	(16.3)	(16.3)	(16.3)
Pre-tax Profit	29.7	13.9	20.7	25.4
Effective Tax Rate	26.7	50.0	30.0	30.0
Net Profit	17.9	5.7	12.0	14.7
Operating Margin	3.3	2.9	3.0	3.1
Pre-tax Margin	2.4	1.0	1.5	1.8
Net-Margin	1.4	0.4	0.9	1.0

1. Highlights:

2Q results disappoint again. For the second consecutive quarter, Texchem's 2Q results disappointed with 1H net profit of RM1.5m meeting just 12.4% of our net profit forecast. The key variances here were higher-than-expected associate losses and higher-than-expected effective tax rate (1H08: 67.7% vs. our assumption of 30%) as losses by certain subsidiaries could not be offset against the taxable profits made by other subsidiaries, as well as non-deductibility of certain expenses. As expected, Texchem declared a gross interim dividend of 6 sen (gross yield of 5.2%).

Qoq, net profit slipped 55.8% ... largely on the back of higher effective tax rate (2Q: 84.3% vs. 1Q:54.9%), which was due to the above reasons, and higher associate losses. We suspect the higher associate losses could partly have been due to the suspension of Malaysian seafood exports to the European Union (EU accounts for 70% of Seapack's, a subsidiary of Texchem Corp, exports). 2Q operating profit, however, was up 30.6% qoq following stronger contribution from the industrial division.

... but 1H pretax profit jumps 43.2% yoy. Excluding the RM6.2m exceptional gain in 2Q07 from the disposal of its FMCG business, 1H08 pretax profit rose 43.2% yoy. The better performance was due to: 1) revenue-led growth for the industrial division, which was, in part, due to contribution from a subsidiary that was acquired in 3Q07; and 2) margin expansion from the food division due to, we believe, better all-round performance from the seafood processing business and Sushi King chain of restaurants; partially offset by higher associate losses.

Risks. The risks include: 1) weaker-than-expected margins, which could be due to rising raw material prices or pricing pressures arising from intense competition (mainly for the industrial and packaging divisions); and 2) prolonged downturn in the global

economy, which would affect the semiconductor and consumer electronics sectors.

Forecasts. We have assumed the associate losses will continue at a run rate of RM3m/quarter for the next three quarters, although management expects to resume exports by year end. In addition, we raised our FY08 effective tax rate assumption to 50% from 30%. All in, we cut our FY08 and FY09 net profit forecasts by 53.5% and 12.5% respectively.

2. Recommendation:

Following the earnings revision, our fair value has been lowered to RM1.00 (from RM1.10), based on unchanged CY09 PER of 10x. However, we are maintaining our **Hold** call on the stock after we take into account the net dividend yield of 7.7%.

Table 2 : Earnings Review

FYE Dec (RMm)	2Q07	1Q08	2Q08	QoQ (%)	YoY (%)	1H07	1H08	YoY (%)	Comments
Revenue	306.1	347.1	386.4	11.3	26.2	611.2	733.4	20.0	Yoy growth due to stronger contribution from the industrial division, partially offset by the sale of the FMCG business (in May 2007).
Operating profit	9.4	8.0	10.5	30.6	10.9	15.7	18.5	17.6	Yoy lifted by the industrial and food divisions, which helped offset the lower contribution from the family care business. Qoq growth due to stronger performance from the industrial division.
Interest expense	(4.7)	(3.9)	(4.4)	13.1	(4.8)	(9.1)	(8.3)	(8.2)	
Associates	(1.2)	(0.1)	(3.0)	>100	>100	(1.7)	(3.1)	80.8	2Q mainly hit by, we believe, suspension of seafood exports to EU.
Exceptionals	6.2	0.0	0.0	nm	nm	6.2	0.0	nm	Relates to gain on disposal of the FMCG business.
Pre-tax profit	9.8	4.0	3.1	(23.0)	(68.6)	11.1	7.0	(36.7)	
Tax	(2.5)	(2.2)	(2.6)	18.3	2.6	(4.6)	(4.8)	4.1	
Minority interest	(0.7)	(0.7)	(0.0)	(98.1)	(97.9)	(0.9)	(0.8)	(13.4)	
Net profit	6.6	1.1	0.5	(55.8)	(92.9)	5.7	1.5	(73.1)	
Margins (%)									
Op profit	3.1	2.3	2.7			2.6	2.5		
Pre-tax	3.2	1.1	0.8			1.8	1.0		
Effective tax rate	25.8	54.9	84.3			41.2	67.7		Above statutory rate as losses by certain subsidiaries could not be offset against the taxable profits made by other subsidiaries as well as non-deductibility of certain expenses.
Net profit	2.1	0.3	0.1			0.9	0.2		
Segmental revenue									
Industrial	137.5	185.1	210.3	13.6	52.9	274.3	395.4	44.1	Higher yoy due to consolidation of subsidiary acquired in Oct 2007.
Packaging	51.9	58.0	57.7	(0.4)	11.1	107.3	115.7	7.8	
Family care	44.1	27.8	38.8	39.8	(11.9)	98.8	66.6	(32.5)	Lower yoy due to sale of the FMCG business.
Food	77.5	77.2	80.5	4.2	3.8	141.3	157.7	11.6	
Eliminations	(5.0)	(1.0)	(1.0)	(1.7)	(80.7)	(10.6)	(1.9)	(81.6)	
Total	306.1	347.1	386.4	11.3	26.2	611.2	733.4	20.0	
Segmental results									
Industrial	3.1	2.6	6.3	>100	>100	6.5	8.9	36.0	2Q yoy and qoq growth lifted by higher revenue and margin expansion.
Packaging	2.6	2.8	2.8	(0.1)	9.7	5.3	5.7	7.2	
Family care	4.1	2.1	1.4	(32.5)	(65.1)	5.7	3.6	(37.3)	
Food	0.8	1.9	1.5	(21.4)	80.0	0.5	3.3	>100	Yoy improvement due to, we believe, better all-round performance from the seafood processing business and Sushi King chain of restaurants
Eliminations	(1.2)	(1.4)	(1.6)	12.8	29.9	(2.3)	(3.0)	30.3	
Total	9.4	8.0	10.5	30.6	10.9	15.7	18.5	17.6	
Segmental margins (%)									
Industrial	2.3	1.4	3.0			2.4	2.2		Qoq expansion, we believe, was due to price adjustment to pass on higher cost and the absence of unrealised forex losses and allowance for doubtful debts, which affected 1Q margin.
Packaging	5.0	4.9	4.9			4.9	4.9		
Family care	9.4	7.7	3.7			5.8	5.4		Weak 2Q margin due to cost pressures.
Food	1.0	2.4	1.8			0.3	2.1		

Source: Company, RHBRI

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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 a Buy call. It is generally for investors who are willing to take on higher risks.

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

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