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CIMB Research Report

SECTOR UPDATE

4 January 2011

MALAYSIA

Rubber Gloves

Getting a handle on 2011

OVERWEIGHT Maintained

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- **Maintain OVERWEIGHT.** We reiterate our OVERWEIGHT weighting on the sector as cost and forex headwinds have brought down CY12 P/E to just 7.2x or 43% below the KLCI's 12.7x P/E. This is despite the sector's solid 3-year EPS CAGR of 16%, which is well supported by the 8-10% annual global demand growth. Also, demand is underpinned by structural trends such as improving hygiene standards in Asia and US healthcare reform. We expect the eventual moderation of latex prices to trigger a re-rating of the sector. Other potential catalysts are 1) increased outsourcing by MNCs, 2) the impact of price increases in the quarters ahead assuming no major adverse rubber or currency trends, and 3) takeover speculation surrounding small-cap glovemakers. We make no changes to our earnings numbers or target prices. All the glovemakers under coverage remain Outperforms, with Hartalega being the top pick.
- **Strong reaction to headwinds in 2010.** Cost and forex headwinds rocked the glove sector in 2010. On average, glove stocks are down 38.5% from their 52-week highs, ending the year 5.2% higher. The average 12-mth trailing P/E for the sector has fallen 17.6 multiple pts from their highs to 11.2x. The share price of the industry leader Top Glove ended the year 0.3% higher despite plummeting 31.6% from its 52-week high. Its 12-mth trailing P/E also took a dramatic turn for the worse, falling 6.2 multiple pts from its 52-week high to 14.2x.
- **Nitrile advantage comes into play.** Hartalega's share price has weathered the storm best, down by just 6.1% from its 52-week high and closing the year 28.2% higher. Nitrile glovemakers are less affected by rising rubber prices as nitrile price has appreciated more gradually, thereby reducing the time lag between cost increases and pass-through. This is because unlike rubber, nitrile is not a traded commodity and is less affected by speculation. Although nitrile is a petroleum derivative, its price is not directly correlated to crude oil because its raw materials are by-products of the oil refinery cracking process and not a raw material per se.
- **Growth prospects still bright.** Despite cost and forex headwinds, the glove sector still offers investors a 3-year EPS CAGR of 16%, higher than the KLCI's core EPS growth of 13.9% for 2011 and 13.2% for 2012. Demand growth for gloves is still robust and steady at 8-10% p.a. Due to its cost advantages and protein-free properties, nitrile glove demand is projected to grow above average at 15% p.a. between 2010 and 2015 to 74bn gloves. Although the recent reporting season was a letdown due to cost headwinds, we expect earnings in the quarters ahead to improve when rubber prices moderate and price revisions start to make an impact.

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
Adventa	ADV MK	O	2.40	3.14	120	9.5	7.8	8.3	1.2	14.6	4.2
Kossan	KRI MK	O	3.14	5.41	328	6.9	5.9	12.5	1.7	27.6	3.2
Hartalega	HART MK	O	5.35	8.43	635	9.4	8.3	18.4	3.2	38.9	3.7
Latexx	LTX MK	O	2.55	3.85	182	5.8	5.4	26.6	1.7	33.0	4.3
Supermax	SUCB MK	O	4.06	8.22	451	6.6	5.7	22.5	1.5	24.7	2.7
Top Glove	TOPG MK	O	5.05	7.27	1,019	11.7	10.1	9.7	2.3	21.2	3.7
Simple average						**8.3**	**7.2**	**16.3**	**1.9**	**26.7**	**3.6**

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

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3Q10 results roundup

Sector feels impact of latex and forex fluctuations

Glovemakers disappoint... Of the six stocks under our coverage, four (Adventa, Latexx, Supermax, and Top Glove) reported numbers below our expectations. Only two companies, Hartalega and Kossan, met expectations and none did better than expected. On average, the glove companies' net profit missed our forecasts by 10.7% and fell 6.7% short of consensus figures (Figure 1).

…due to high costs and weak US dollar. The shortfall in quarterly expectations was due to the 10.4% yoy drop of the US dollar to RM3.17:US$1 and high rubber prices. Rubber latex price jumped 55.7% yoy to RM7.20/kg. The unfavourable movement of both latex prices and forex rates has made it challenging for glovemakers to pass on costs in a timely manner. That said, even though latex prices are still rising (current price: RM9.81/kg), we believe price revisions will lead to better results in the quarters ahead for glovemakers, assuming there are no dramatic cost and forex fluctuations.

Figure 1: Results analysis for rubber glove stocks (RM m)

	Lastest	Financial performance		Net inc. vs Expectations		Above / Below	
Company	**Quarter**	**EBIT**	**Net profit**	**CIMB**	**Consensus**	**CIMB**	**Consensus**
Adventa	10/10 Q4	5.9	11.8	86.0%	85.0%	Below	Below
Hartalega	09/11 Q2	61.6	47.1	96.0%	100.0%	In line	Above
Kossan	09/10 Q3	40.1	28.6	97.0%	101.0%	In line	In line
Latexx	09/10 Q3	21.7	17.6	80.0%	80.0%	Below	Below
Supermax	09/10 Q3	36.9	38.1	90.0%	100.0%	Below	In line
Top Glove	11/11 Q1	44.3	36.1	87.0%	94.0%	Below	Below
Average		**35.1**	**29.9**	**89.3%**	**93.3%**	**Below**	**Below**

Source: CIMB Research, Bloomberg, Company

Price differential between nitrile and rubber gloves. Due to the latex price upswing, the price of powder-free nitrile gloves (US$31/1k) is currently less than their rubber equivalents (US$35/1k). This price differential is unprecedented and has caught the industry by surprise. This has resulted in plummeting earnings for companies dominant in the rubber glove segment such as Top Glove (Figure 2) due to the time lag between cost and price revisions.

Change in buying patterns. We gather that the emergence of the price differential has prompted traditional buyers of rubber gloves to switch to nitrile gloves. We understand from Hartalega, the world's largest nitrile glovemaker, that the switching phenomenon is highest in Europe due to high personal incomes and low base. For example, the value of the nitrile market in Europe is estimated at US$134m compared to US$323m in the US according to market research firm, D&B Malaysia.

Figure 2: Latest financial performance

	Lastest	Revenue % change		EBIT % change		Net profit % change	
Company	**Quarter**	**qoq**	**yoq**	**qoq**	**yoq**	**qoq**	**yoq**
Adventa	10/10 Q4	4.2%	22.0%	-40.8%	-19.5%	44.0%	120.2%
Hartalega	09/11 Q2	8.4%	37.0%	13.3%	46.6%	13.6%	42.3%
Kossan	09/10 Q3	7.5%	31.2%	4.8%	75.1%	-4.8%	85.8%
Latexx	09/10 Q3	-3.4%	60.7%	-15.1%	39.6%	-18.2%	23.5%
Supermax	09/10 Q3	0.1%	-1.0%	-11.7%	-6.8%	-16.9%	-5.1%
Top Glove	11/11 Q1	-9.2%	4.1%	5.0%	-49.2%	-20.0%	-44.7%
Average	**-**	**1.3%**	**25.6%**	**-7.4%**	**14.3%**	**-0.4%**	**37.0%**

Source: CIMB Research, Bloomberg, Company

Figure 3: Natural rubber and RM/US$ trends

Company	Lastest Quarter	Average during quarter NR (kg)	RM/US$	Rubber latex price chg % qoq	yoq	RM/US$ forex chg % qoq	yoq
Adventa	10/10 Q4	7.42	3.15	14.6%	57.7%	-2.2%	-8.8%
Hartalega	09/11 Q2	7.17	3.16	3.9%	56.6%	-4.6%	-10.8%
Kossan	09/10 Q3	7.17	3.16	3.9%	56.6%	-4.6%	-10.8%
Latexx	09/10 Q3	7.17	3.16	3.9%	56.6%	-4.6%	-10.8%
Supermax	09/10 Q3	7.17	3.16	3.9%	56.6%	-4.6%	-10.8%
Top Glove	11/11 Q1	7.11	3.21	-2.8%	49.9%	-3.4%	-10.6%
Average		**7.20**	**3.17**	**4.6%**	**55.7%**	**-4.0%**	**-10.4%**
Current		*9.81*	*3.06*				

Source: CIMB Research, Bloomberg, Company

Demand for gloves remains robust. Despite higher costs and a weak US dollar, glove companies recorded average revenue growth of 1.3% qoq and 25.6% yoy. In our view, this illustrates the industry's ability to weather cost inflation and forex fluctuations by passing costs on. While cost pass-through will take time, this is only a temporary lag and has no impact on the industry's long-term growth prospects. We gather from the management of some glove companies that overall medical glove demand remains robust at 8-10% p.a. Numbers vary slightly but the consensus view among the glovemakers is for annual demand growth of 15% for nitrile gloves and 10% for rubber gloves over the next five years.

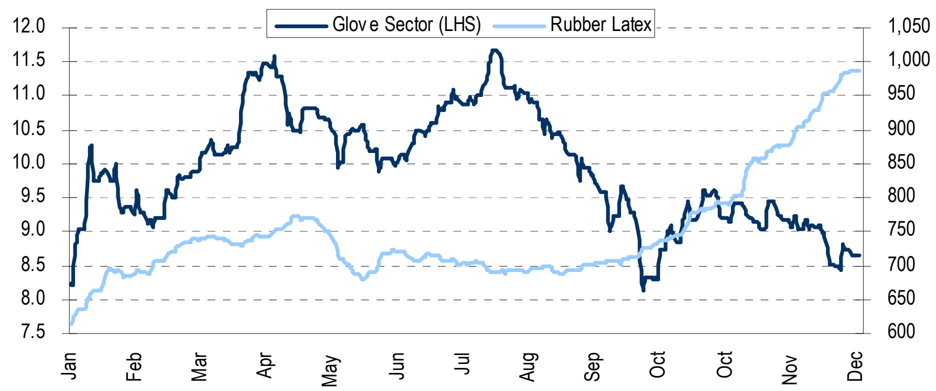
Review of 2010

Headwinds emerge in 3Q10

Glovemakers start year with a bang... The stock prices of glovemakers started the year on a good note, rising 25% by 14 Jan. Share prices were driven by expectations of a good 1Q results season. Investors were not disappointed. During the quarter to March 2010, net profit for the glove sector rose by 112.4% yoy and 23% qoq on average.

… and soar until July. Through the middle of 2010, rubber prices remained stable, with rubber latex hovering between RM7.00/kg and RM7.50/kg after the seasonally low wintering period in March-April. The stable operating environment, coupled with strong H1N1 demand, drove the combined market cap of glove stocks 43% higher to RM11.7bn by 16 July.

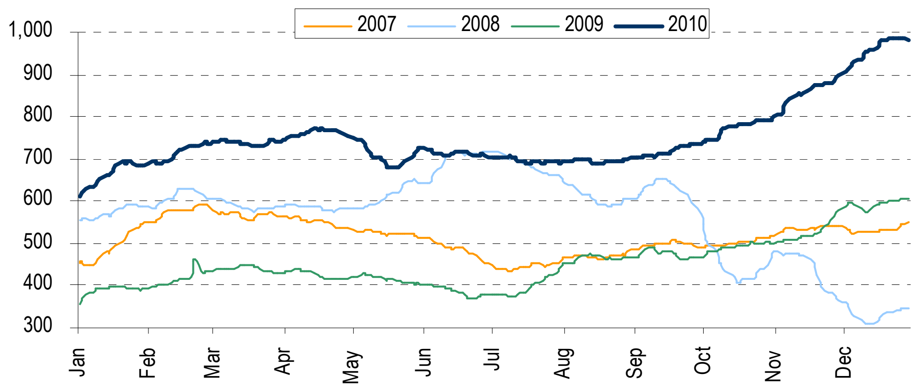
Figure 4: Glove sector's market cap (RM bn) and latex price (sen / kg) in 2010



Source: CIMB Research, Companies, Bloomberg

Headwinds emerge in Sep. Trouble started in the middle of July as supply fears sent rubber prices higher from RM7/kg to RM9/kg by Dec. (Figure 5). We note that in 2007-09, latex price had not spiked the way it has in 2010. In 2008, latex price fell in 4Q while in 2007 and 2009, prices were more stable. By Aug, some glovemakers in the low-end segment such as Top Glove were indicating that H1N1 demand was subsiding. The combination of higher costs and normalising demand caused a sell-off of glove stocks. By end-Sep, the combined market cap of the glovemakers was down 31% from their peak to RM8.1bn. The sector has since rebounded off its lows, finishing 2010 at RM8.7bn.

Figure 5: Latex's four-year price cycle (sen / kg)



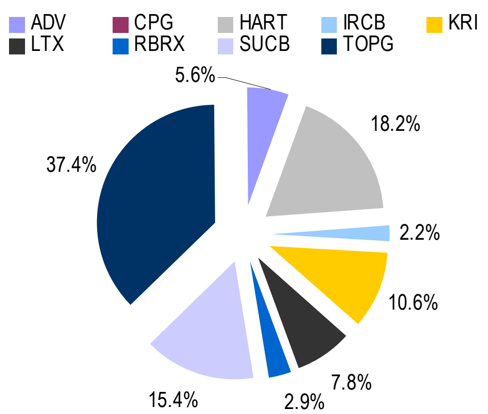
Source: CIMB Research, Companies, Malaysian Rubber Board, Bloomberg

Top Glove loses market share... Over the course of 2010, the glove sector has seen its composition change as investor switched out of Top Glove and small caps to Hartalega, Supermax, and Kossan. Top Glove, the world leader in low-end rubber gloves, started 2010 with 37.4% of the sector's market cap. At end-10, the company was still the world's largest glove company but its representation in the sector had fallen 1.8% pts to 35.6%. Latexx, meanwhile, lost some of its lustre as high rubber prices made its protein-reducing technology less viable. We recognised this and dropped Latexx as a top pick after its 3Q10 results in Nov. Investors also switched out of Adventa as surgical gloves cannot use nitrile as a substitute for rubber latex.

...but others gain. Hartalega, the world's largest nitrile glovemaker, increased its representation in the sector by 4.0% pts to 22.2% as the company's efficient cost structure helped it weather soaring rubber prices (Figure 6). While Supermax (25%) has lower nitrile capacity than Hartalega (83%) and Kossan (38%), the company aims to raise nitrile to 35% of capacity in the quarters ahead. It has been aggressive in communicating this message and investors switched into the stock, helping to raise its representation in the sector by 0.7% pts to 16.1%. Kossan also raised its representation by 0.7% pts to 11.3%. The company is most diversified with sizeable nitrile and rubber capacity, which we believe will enable it to meet market demand.

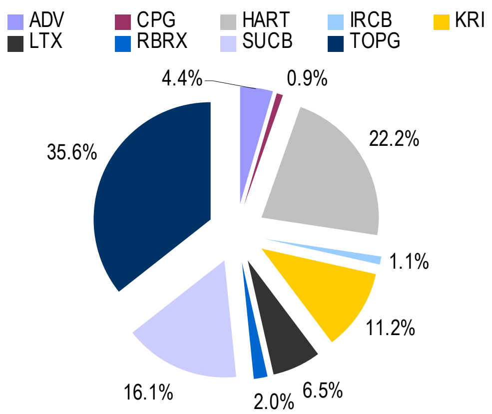
Figure 6: Glove sector's market cap composition (% of total market cap)

Glove sector composition – 4 Jan 2010



`Source: Bloomberg, Shanghai Futures Exchange

Glove sector composition – 31 Dec 2010



Source: Bloomberg, Tokyo Commodity Exchange

Figure 7: DuPont analysis of glove sector

Company	Adventa	Hartalega	Kossan	Latexx	Supermax	Top Glove
Latest quarter (12 months to)	10/10 Q4	09/11 Q2	09/10 Q3	09/10 Q3	09/10 Q3	11/11 Q1
Tax burden	117.4	78.7	78.0	90.9	92.0	81.9
Interest burden	84.2	98.7	94.6	93.7	113.6	99.6
EBIT margin	10.8	33.3	15.0	18.4	19.4	12.6
Asset utilisation	0.9	1.3	1.4	1.4	0.9	1.6
Equity multiplier	1.9	1.4	1.9	1.8	1.6	1.3
ROE %	17.6	48.0	29.9	39.8	30.2	21.4
5 yr avg ROE %	13.7	46.8	24.2	37.5	27.8	25.8
ROA %	9.4	34.2	16.0	22.1	18.8	16.6
5 yr avg ROA %	7.3	32.6	12.3	20.0	15.6	19.0

Source: CIMB Research, Companies, Bloomberg

DuPont analysis illustrates nitrile advantage. At 48%, Hartalega's ROE is the highest in the sector, thanks largely to its 33.3% EBIT margin, which is the highest in the industry and 13.9% pts higher than its closest competitor, Supermax (Figure 7). Nitrile gives Hartalega a leg-up on the competition because at current prices nitrile can be 20-30% more cost efficient than rubber.

Glovemakers take time to execute bonus issues. In 2010, glovemakers took advantage of bullish investor appetite for glove stocks to execute bonus issues instead of cash dividends and other corporate exercises such as Careplus's IPO on Bursa Malaysia's ACE market (Figure 8).

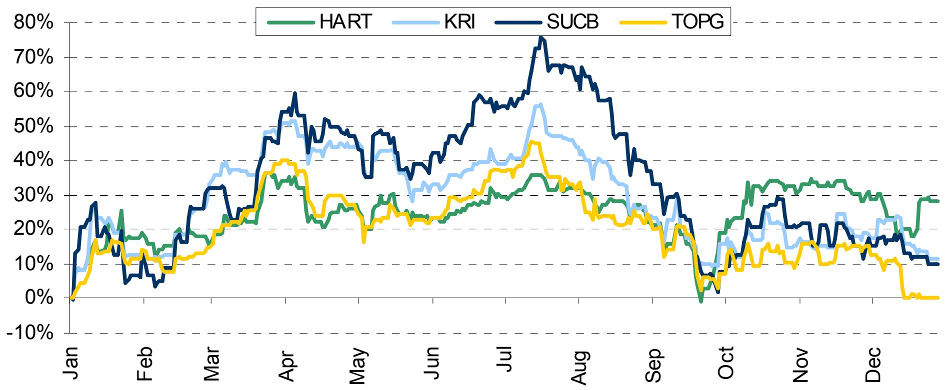
Figure 8: Summary of corporate exercises in 2010

Company	Corp. Exercise	Date of Anncmnt	Summary of offer terms	Tracking share prices (RM) Anncment	52wk High	% 52wk	Proceeds (RM m)	Share capital (m) New shrs	Total (ex)
Adventa	-	-	-	-	4.35	-	-	-	152.8
Careplus	IPO	6-Dec-10	0.23 / share	0.23	0.45	51%	15.0	65.1	210.0
Hartalega	Bonus	11-May-10	1 for 2 shares	5.19	5.70	91%	-	121.2	363.5
IRCB	Rights	11-Nov-10	0.20/shr ; 3 for 2	0.32	1.28	25%	71.0	355.2	592.0
Kossan	Bonus	21-Apr-10	1 for 1 shares	3.91	4.28	91%	-	159.9	319.7
Latexx	-	-	-	-	4.95	-	-	-	218.8
Rubberex	Split	25-Jan-10	1 into 2 shares	1.41	1.68	84%	-	100.4	202.1
Supermax	Bonus	3-Mar-10	1 for 4 shares	4.92	6.60	75%	-	67.9	340.1
Top Glove	Bonus	26-Apr-10	1 for 1 shares	6.50	7.38	88%	-	309.2	618.4
Average	**-**	**-**	**-**	**-**	**-**	**72%**	**-**	**-**	**-**

Source: CIMB Research, Companies, Bloomberg

Bird flu scare towards year-end. While 2009 saw the outbreak of H1N1 during 2Q09, there was no major bird flu news in 2010 until the end of Nov. On 19 Nov, Hong Kong's Department of Health diagnosed the first human case of bird flu (influenza A, H5N1) in seven years in a 59-year-old woman returning from mainland China. On 9 Dec, i.e. less than a month after the announcement, Hong Kong health officials lowered the country's bird flu health warning, scaling down its avian influenza warning from "serious" to "alert" because no new cases had been reported.

Figure 9: 2010 relative performance of Big 4 glovemakers



Source: CIMB Research, Companies, Bloomberg

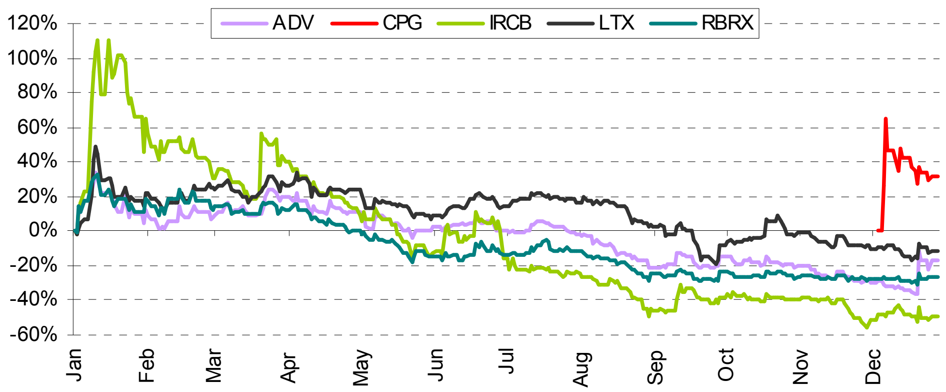
Cardinal Health enters China. While China remains a lucrative market for glovemakers, some companies such as Top Glove and Hartalega have said that penetrating the local scene is challenging as most of the gloves used in China are made of vinyl plastic. However, we believe this could change. On 30 Nov, Cardinal Health (CAH US, NR) completed the acquisition of Zuellig Pharma China or Yong Yu. Yong Yu is China's largest importer of healthcare supplies and has a distribution network to over 49,000 hospitals and clinics and more than 123,000 pharmacies in China. We believe the acquisition is positive for Malaysian glovemakers as it opens up the hard-to-penetrate Chinese market. Malaysian glovemakers' sales exposure to Cardinal ranges from 2% to 12.5% of sales and should increase as Cardinal makes inroads into China through Yong Yu (see our 2 Dec note entitled *Rubber Gloves – China access at hand*).

Careplus raises RM15m in IPO. Although most of the large glovemakers in Malaysia are already listed, there are a few small glovemakers that remain private companies. On 6 Dec, one of them, Careplus Group Bhd, was listed on Bursa Malaysia's ACE market. The company's shares surged 17.4% on its debut and added RM56m market cap to the glove sector. The company is the smallest listed glovemaker with 420m pieces of gloves in annual glove capacity in Senawang, Negeri Sembilan. Currently, all its operating lines manufacture rubber gloves. However, the company is looking to increase capacity to 1.65bn pieces of gloves by 1Q13 when it installs new lines capable of producing nitrile gloves.

Yule Catto acquires Polymer Latexx. On 13 Dec, private equity firm TowerBrook Capital Partners sold PolymerLatex to Yule Catto & Co Plc for €443m. When the transaction is completed, Yule Catto will be the world's largest supplier of nitrile. Yule Catto's unit, Synthomer already has a 130,000 mt p.a. nitrile plant in Kluang, Johor and the acquisition will add PolymerLatex's 10,000 mt p.a. nitrile latex plant in Pasir Gudang, Johor. While this consolidates the position of the world's two largest nitrile latex suppliers, we do not believe there will be price fixing for nitrile latex as the industry is fragmented due to the presence of suppliers in China, Taiwan, South Korea, Japan, and even Russia.

Adventa's takeover talk lifts the glove sector. As 2010 wound down, interest in the glove sector waned on the back of higher costs and lack of demand catalysts. However, on 23 Dec, glove stocks surged 11% on average after Bloomberg and local Malaysian press reported that a US private equity firm may be eyeing Adventa. The newspapers reported that the takeover price would be RM3.40 per share or 11x FY11 P/E. On that news, Adventa's share price shot up 30% and hit limit up. The next day however, in response to a Bursa Malaysia query, Adventa poured cold water on the takeover talk, saying that it was not in any acquisition discussions with a US firm. However, the company left the possibility of a takeover open by adding that it has received expressions of interest on an exploratory basis.

Figure 10: 2010 relative performance of smaller glovemakers



Source: CIMB Research, Companies, Bloomberg

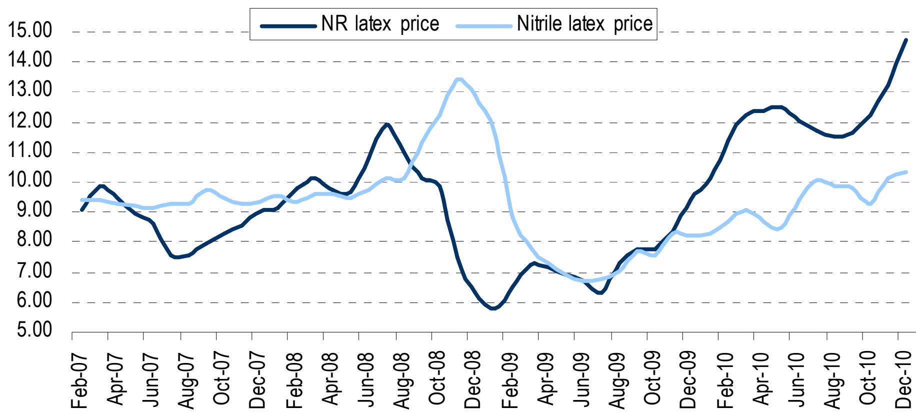
Key themes for 2011

The nitrile advantage

Shielded from high rubber prices. Nitrile glovemakers have been less affected by rising rubber prices as nitrile price has appreciated more gradually. For example, between May 2009 (when nitrile and rubber prices were both at RM6.72/kg, adjusted for total solid content or TSC) and Nov 2010, nitrile price increased by 54% to RM10.32/kg while rubber price jumped 119% to RM14.77/kg (Figure 11). We believe this is partly because unlike rubber, nitrile is not a traded commodity and is less affected by speculative trading. Also, while nitrile is a petroleum derivative, its price is not directly correlated to crude oil because its raw materials (butadiene and acrylonitrile) are by-products of the oil refinery cracking process. The gradual rise of nitrile enables glovemakers such as Hartalega to pass on costs more consistently, thereby reducing the time lag between costs and revenues.

Not just cheaper, but better too. From a product point of view, it is not difficult to see why glovemakers prefer nitrile to natural rubber 1) nitrile has better puncture, abrasion, oil and chemical resistance which enables glovemakers to earn a premium over comparable rubber gloves, 2) gloves can be made with lower wall thickness, helping manufacturers to optimise raw material costs, and 3) nitrile is free of protein and chemical accelerators, which shortens the manufacturing process and, in turn, lowers energy requirements. Nitrile glovemakers also benefit from purchasing nitrile in either US dollars or euros, which acts as a natural hedge against currency fluctuations.

Figure 11: NR (60% solid content) and nitrile (45% solid content) prices (RM / kg)



Source: Bloomberg, Companies

Less is more. Current production costs for nitrile gloves can be 20-30% lower compared to rubber as their lighter weight and lower raw material prices offset their higher raw material requirements. Nitrile gloves, being thinner at 3.5g, require 20% more raw material content as fillers would tear the gloves. Despite the higher requirement, the overall production cost for nitrile is still lower compared to rubber (Figure 12).

Figure 12: Production costs – natural rubber versus nitrile (for illustration only)

(For 1,000 gloves)	Rubber latex	Nitrile latex	Rubber vs. Nitrile	Comments and Remarks
Average glove weight (kg)	5.00	3.50	-30%	Nitrile gloves are usually lighter
Latex / nitrile content	73%	93%	20%	Nitrile content is higher because of the
	3.63	3.24	-11%	chlorination process to remove powder
Total solid content	60%	44%		Most common formulation used
Weight of latex / nitrile (kg)	6.04	7.36	22%	by Malaysian glove manufacturers
Latex / nitrile price (RM/kg)	9.87	5.81	-41%	Prices from Company and MRB for
				rubber latex (60% TSC) and nitrile
Total production cost	59.63	42.75	-28%	latex (45% TSC)

Note: MRB – Malaysian Rubber Board (31 Dec 2010)
Source: CIMB Research, Companies

Demand for nitrile gloves. We expect demand for nitrile gloves to grow by 15% p.a. up to 2015 (Figure 13) on the back of nitrile's cost advantage and protein-free properties. Currently, natural rubber powder-free gloves cost US$35 per 1,000 pieces or 13% higher than nitrile powder-free gloves (US$31 per 1,000 pieces). While this price differential may reverse in the future, we expect the demand for nitrile to remain robust due to its protein-free properties for which there is no substitute.

Figure 13: World glove demand

Demand (bn)	2009E	2010E	2011F	2012F	2013F	2014F	2015F	'10-'15 CAGR
Natural rubber	108.0	116.6	126.0	136.0	146.9	158.7	171.4	8.0%
Nitrile	32.0	36.8	42.3	48.7	56.0	64.4	74.0	15.0%
Subtotal	140.0	150.0	168.3	184.7	202.9	223.1	245.4	10.3%
Vinyl	74.4	80.0	86.0	92.5	99.4	106.8	114.9	7.5%
Total	**214.4**	**230.0**	**254.3**	**277.2**	**302.3**	**329.9**	**360.3**	**9.4%**

Demand (%)	2009E	2010E	2011F	2012F	2013F	2014F	2015F	% pts chg
Natural rubber	50.4%	50.7%	49.5%	49.1%	48.6%	48.1%	47.6%	-3.1%
Nitrile	14.9%	16.0%	16.6%	17.6%	18.5%	19.5%	20.5%	4.5%
Subtotal	65.3%	65.2%	66.2%	66.6%	67.1%	67.6%	68.1%	2.9%
Vinyl	34.7%	34.8%	33.8%	33.4%	32.9%	32.4%	31.9%	-2.9%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**-**

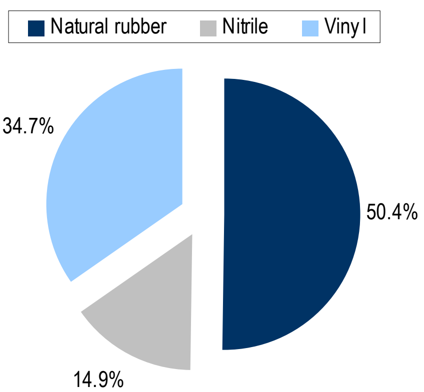
Source: CIMB Research, Companies, Bursa Malaysia

Rush for nitrile. Many glovemakers have been emphasising plans to increase nitrile production. Supermax has been the most aggressive, disclosing during its 3Q10 results briefing that it can increase nitrile production to 35% of installed capacity compared with 24% currently. Kossan and Latexx have also reiterated plans to continue expanding nitrile capacity to 50% and 60%, respectively over the next two years. Even Top Glove, the leader in the low-end natural rubber segment, wants to increase its nitrile capacity from 7% currently to 20-25% by Dec 2011.

… but it's not that easy. While rubber and nitrile technologies appear similar, not all the manufacturing equipment and processes are easily substituted. We believe the lack of interchangeability will mitigate excess supply for nitrile gloves. Some of the differences are 1) nitrile lines are 120-130 meters in length compared to 60-70 meters for rubber as nitrile takes longer to dry, 2) the properties of nitrile and rubber are different so technical know-how is not transferable, and 3) nitrile gloves are thinner, which means that rubber glove machinery is not ideal for manufacturing nitrile gloves.

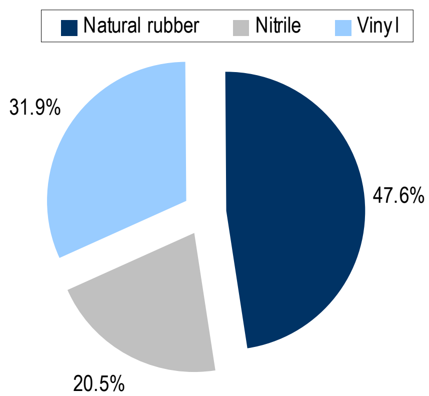
Figure 14: Evolution of global glove composition by material

2009 global glove composition



Source: CIMB Research, Companies, Bursa Malaysia

2015 global glove composition



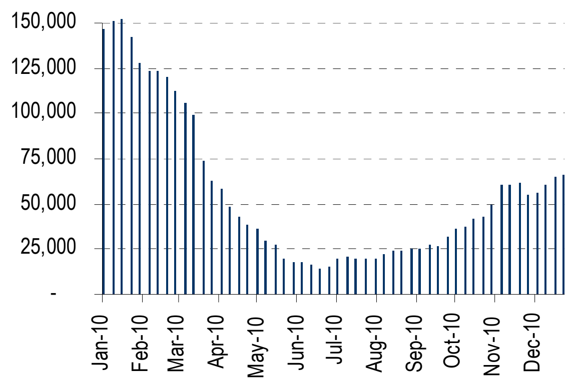
Source: CIMB Research, Companies, Bursa Malaysia

Handling the latex price upsurge

Supply from non-conventional sources. In 2011, we expect rubber prices to remain volatile until weather conditions normalise and regular tapping activity resumes. Data from the Association of Natural Rubber Producing Countries (ANRPC) suggest that there could be a rubber surplus of 100k-300k mt p.a. in 2011-13 due to additional supply from non-conventional sources. This development would be positive for the glove sector as 50-60% of production costs are latex-related. Potential non-conventional supply sources include 1) intensified tapping to catch the high price, 2) impact of high-yield and short-gestation clones, and 3) postponement of replanting.

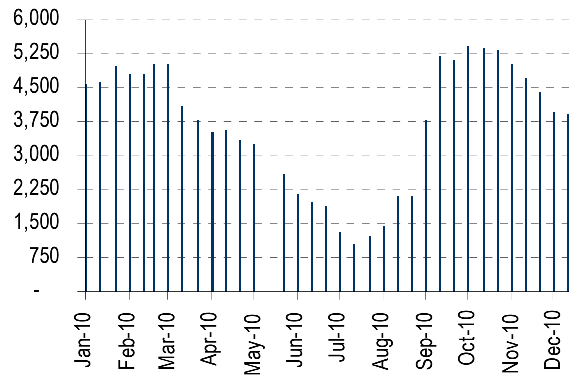
Figure 15: Rubber stocks monitored in China and Japan (available in warehouse)

Total net rubber stocks in Shanghai (mt)



Source: Bloomberg, Shanghai Futures Exchange

Total net rubber stocks in Tokyo (mt)

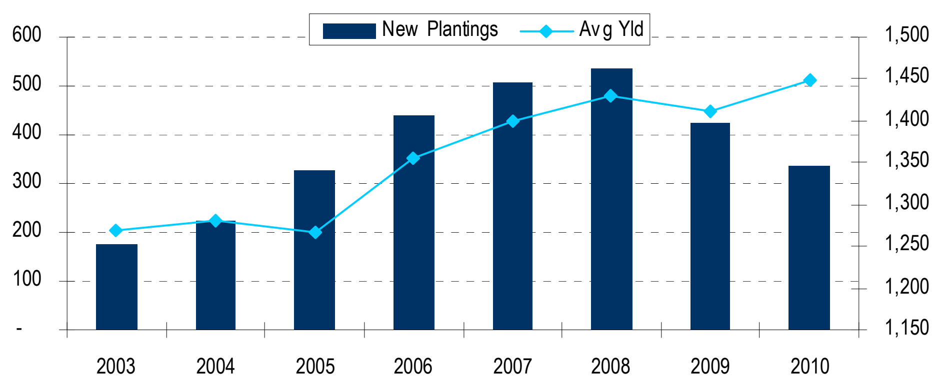


Source: Bloomberg, Tokyo Commodity Exchange

#1 – Intensified tapping to catch high prices. During periods of high prices, it is common for farmers to undertake short-term yield-enhancing measures to catch high prices and maximise profits. These include 1) using of latex stimulants, 2) using rain guards, and 3) harvesting before sunrise. According to Rubber Asia, tapping before sunrise can increase yields by 30%. This is due to lower field coagulum and better latex preservation from the cooler temperatures. Plantation companies using this method report that workers have reacted positively as labourers enhance tapping earnings and are free to work a second job.

 # 2 – Impact of new clones. New plantings and yield profiles have been on a rising trend since 2003, indicating higher crop productivity, acreage and supply to come. While first-generation rubber clones take 6-7 years to reach maturity, new high-tech clones mature in 4½ years. In Malaysia, 50% of new plantings achieve maturity in 4½ years but agricultural authorities aim to increase this to 70% by 2015 and 100% by 2020. Also, research is being done to increase yields from 1,450kg per hectare p.a. to 1,750 kg per hectare p.a. by 2015 (+21%) and 2,000kg per hectare p.a. by 2010 (+38%). While these programmes will eventually increase rubber supply, we stress that they will materialise over the next few years and not make an immediate impact.

Figure 16: New plantings and higher yield clones could shift supply curve ('000 mt / kg per ha)



Source: Association of Natural Rubber Producing Countries website

 # 3 – Postponement of replanting programmes. At RM9.81/kg of latex, we believe rubber plantation farmers can earn a cash profit of c RM8,595 per hectare p.a. after deducting processing, tapping and fertiliser costs (Figure 17). The numbers imply that farmers with 10 hectares can earn a profit of c RM85,950 p.a., which is a healthy level of earnings given that Malaysia's average per capita income is only RM22,000 p.a. Also, most farmers live in rural villages where the cost of living is below average. With earnings 290% above the national average, we believe farmers will postpone replanting programmes to maintain monthly incomes.

Figure 17: Cash profits earned by rubber plantation farmers

Per annum (RM)	Hectare	Acre (1)	% Costs
Cash revenues:-			
Yield (kg / ha)	1,500	607	-
Latex price (RM / kg)	9.81	3.97	-
	14,715	**5,957**	**-**
Cash costs:-			
Latex processing	-2,520	-1,020	41%
Labour for tapping	-2,400	-972	39%
Fertilizer costs	-1,200	-486	20%
	-6,120	**-2,478**	**100%**
Cash profit (2)	**8,595**	**3,480**	**-**

Source: Association of Natural Rubber Producing Countries website
1. One hectare = 2.47 acres
2. Excludes tax, non cash items such as depreciation, and overheads

Access to China in 2011 and beyond?

Cardinal Health opens Chinese market for glovemakers. While China's healthcare market is expected to increase from US$240bn (5% GDP) to US$600bn by 2021, glovemakers have had limited success penetrating the Chinese market because of its fragmented distribution network and low hygiene standards. Most gloves used in the Chinese healthcare sector are vinyl and Malaysian glovemakers manufacture rubber or nitrile gloves. We note that vinyl gloves are cheap, have low barrier protection and are not environmentally friendly. However, we believe this could change from 2011 onwards following Cardinal Health's (CAH US, NR) recent acquisition of Zuellig Pharma China or Yong Yu as the company is known in China.

China access at hand. Yong Yu is China's largest importer of healthcare supplies with a distribution network to over 49,000 hospitals and clinics and 123,000 pharmacies. We believe that Cardinal's acquisition will provide access to the Chinese healthcare industry for Malaysian glovemakers that are already working with Cardinal. These glovemakers include Adventa, Kossan, Latexx and Top Glove, as illustrated in Figure 18.

Figure 18: Estimated percentage of sales from Cardinal and length of relationship (RM m)

Glovemaker	Last FYE	Revenue	% of sales	Value	% Total	Relationship
Adventa Bhd	10/2009	282.7	2.0%	5.7	3.1%	5.0yrs
Hartalega Holdings Bhd	03/2010	571.9	-	-	-	-
Kossan Rubber Industries	12/2009	842.1	6.0%	50.5	28.0%	7.5yrs
Latexx Partners Bhd	12/2009	328.5	12.5%	41.1	22.8%	15.0yrs
Supermax Corp Bhd	12/2009	803.6	-	-	-	-
Top Glove Corp Bhd	08/2010	2,079.4	4.0%	83.2	46.1%	10.0yrs
Rubber glove sector	**-**	**4,908.3**	**3.7%**	**180.4**	**100.0%**	**9.4yrs**

Source: Companies, CIMB Research, Bloomberg

Established relationships would help secure new contracts. With well-established relationships with Cardinal averaging 9.4 years, the glove companies under our coverage are well-positioned to benefit from Cardinal's acquisition of Yong Yu. In our view, MNC distributors such as Cardinal have a strong incentive to protect their brands and will, therefore, source from existing contract manufacturers rather than from an unknown cheap alternative. Also, signing up a new OEM partner is time-consuming, which makes switching prohibitive as it involves 1) facility downtime, 2) supply disruption, and 3) detailed financial audits.

Latexx the biggest winner. Latexx stands to benefit the most from Cardinal Health's acquisition as it has the highest percentage of sales coming from Cardinal Health. Moreover, Latexx and Cardinal have a well-established relationship that dates back more than 15 years, long before Latexx was listed on Bursa Malaysia.

Industry consolidation

Tough conditions could lead to consolidation. The topic of industry consolidation is not new as Top Glove has indicated numerous times publicly that it is keen to use its RM346m cash pile for synergistic acquisitions. However, no transactions have materialised, which we believe is due to the wide gap in buyers' and sellers' valuation expectations. However, given the fast-rising latex price and excess capacity in the low-grade natural rubber powdered glove segment, valuation expectations could narrow and pave the way for consolidation.

Figure 19: Top five shareholders of the glove companies under our coverage

Top Glove (float: 52%)	% held	Kossan (float: 41%)	% held
Tan Sri Lim Wee-Chai	34.2%	Lim family	51.8%
Matthews Capital	10.0%	KWAP	6.9%
KWAP	5.0%	Asian Small Coys	4.9%
Overlook Partners	4.8%	Investco	2.9%
		HLG funds	1.5%
Hartalega (float: 42%)	**% held**	**Latexx (float: 55%)**	**% held**
Kuan family	51.3%	Low Bok Tek	29.7%
Budi Tenggara	5.1%	Lian Aik Teong	9.4%
Abdul Hamid	0.3%	Tabung Haji	5.3%
Phaik Sim Chuah	0.2%	CIMB funds	2.5%
Supermax (float: 55%)	**% held**	**Adventa (float: 46%)**	**% held**
Dato' Seri Stanley Thai	35.4%	Low Chin Guan	41.2%
EPF	8.4%	Tabung Haji	9.4%
Skagen funds	2.0%	CIMB funds	2.8%
CIMB funds	1.6%	Wong Mei Koon	2.3%
American Century	1.4%		

Source: Bloomberg

Consolidation among large glove companies challenging. In our view, M&A amongst the large glove companies is challenging due to their family shareholdings (Figure 19). During our latest round of company visits, we got the impression that some of the larger glove companies are grooming the next generation and are not looking to exit the industry. However, if tough operating conditions persist, certain smaller glovemakers may seek to consolidate costs, pool resources, and enhance pricing power.

No lack of takeover interest in the sector... On 23 Dec, Bloomberg and the Financial Daily reported that a US private equity firm may be seeking to buy out Adventa at RM3.40 per share based on an 11x P/E multiple. Although Adventa refuted the report through a Bursa Malaysia filing, we believe that Adventa's management has been in exploratory discussions with investors who are keen to obtain exposure to the healthcare industry through the glove sector.

...especially for small glovemakers. Adventa is not the only glovemaker that has been the subject of takeover speculation. Latexx too has been linked to takeover talk due to its 40% nitrile glove capacity. The company's access to protein-reducing technology through its 51:49 Total Glove joint venture with Dutch R&D company Budev BV is also something that a new entrant would find valuable.

Industry leader lacks nitrile exposure. Currently, only 7-9% of Top Glove's glove sales are nitrile. We believe Top Glove will seek to enhance this capability given nitrile's cost advantage and medical professionals' preference for it. Management has indicated that it is comfortable with a 50% net gearing ratio. Based on Top Glove's latest results to 31 Aug (released on 15 Dec), we estimate that it can raise RM943m in additional debt financing.

Disease outbreaks would spur demand

Bird flu re-emerges in Japan and S Korea. While 2010 saw only one reported case of human bird flu (19 Nov in HK), the Shimane Prefecture in Tokyo culled 23,000 chickens on 1 Dec and South Korea slaughtered 100,000 birds on 31 Dec. In South Korea, officials also confirmed that swine flu infections have caused the death of one man.

Helping hand for medical glove demand. We expect health officials to remain cautious as bird flu is contagious and can be fatal to humans. An outbreak would be positive for rubber glove demand as Malaysia accounts for 65-70% of global supply. Utilisation rates are already healthy at 70-90% and if demand accelerates, delivery backlogs may lengthen from 2-3 months to five months, as was the case during 2009's H1N1 pandemic. During this period, Top Glove reported utilisation rates of above 90%. Also, the higher demand and order backlog would enable glovemakers to raise average selling prices.

Actions speak louder than words. In our view, a severe case of bird flu would catalyse the modernisation of China's healthcare sector. This would be positive for glove manufacturers as it would help to open up a market where currently, most hospitals use cheap vinyl gloves instead of the natural rubber or nitrile gloves used in more developed countries.

Top Glove is best positioned to benefit from disease outbreak. While a disease outbreak would be positive for the sector as a whole, we believe Top Glove stands to gain the most because 1) its 60-70% utilisation rate is the lowest in the sector, 2) 90% of Top Glove's products are entry-level natural rubber gloves commonly used in hospitals and clinics, and 3) 10% of the company's revenue comes from Asia where the latest human form of bird flu originated.

Key risks in 2011

Fast-rising rubber latex prices

With rubber and nitrile latex making up 55-60% of total production costs, managing the volatility of rubber prices is an important part of a glovemaker's business strategy. While most of this cost can be passed on as the glovemakers use the previous month's price when providing price quotations to customers, drastic and quick price changes can hurt margins because it lengthens the time lag between costs and price quotations.

Glovemakers mitigate unusual price fluctuations by re-pricing their glove products as frequently as possible. Some companies are doing this up to four times per month compared to once a month during periods of stable raw material prices. We note that because nitrile price has increased more gradually compared to rubber, glovemakers such as Hartalega have been able to weather higher costs better.

Foreign exchange rate volatility

On average, 95% of the glove industry's sales are exported, with transactions priced in either US$ or €. In 2010, the US$ and € depreciated by 10.6% and 17.5% respectively, against the ringgit. This was a concern as it contributed to margin contraction. In 2011 however, we believe that forex volatility will be less of an issue for the glove sector.

We note that our house forecasts for the RM/US$ and RM/€ exchange rate are 3.05 and 4.33 respectively by end-2011. The numbers imply a further 0.5% depreciation of the US$ but a 6.2% appreciation of the € against the ringgit. As for nitrile glovemakers such as Hartalega, they are less exposed to currency fluctuations as nitrile is quoted in US$ and acts as a natural currency hedge.

Losing market share to China

While China is predominantly a vinyl market, it is not unthinkable that its glove industry could one day become a formidable force. China has access to low-cost, skilled labour and has a large healthcare market that is expected to be worth US$600bn in 2021.

However, we do not believe that Malaysian glovemakers should feel threatened. The Malaysian industry is well entrenched and, in our view, will continue to dominate the world glove industry due to 1) long-term business relationships, 2) efficient cost structures, and 3) technical expertise that is difficult to replicate.

Since the early 1990s, Malaysian glovemakers have consistently improved glove technology, enhancing line capacity by 260% from 5,000 pieces of gloves per hour to 18,000 pieces of gloves per hour. We also believe that Malaysia's proximity to natural rubber domestically and in the region (Thailand and Indonesia) gives Malaysia an unmovable cost advantage as liquid latex is bulky, expensive to transport and can only be stored for about 12 months after being processed. We note that Thailand, Indonesia and Malaysia combined account for 90% of the world's rubber supply.

Also, medical gloves that are exported to the US and Europe are subject to high safety and health standards. In our view, this further impedes competition from the low-cost gloves that are manufactured in China. We believe that international healthcare companies have an incentive to protect their brand and image by maintaining relationships with existing contract manufacturers as switching costs are high and switching is a time-consuming process involving facility downtime, supply disruption and thorough company audits.

Instead of US and European healthcare companies switching to a low-cost alternative in China, we believe that MNCs will outsource more glove production to their existing partners in Malaysia.

Valuation and recommendation

Top Glove commands premium valuation. Although Top Glove's ROE of 21.4% is 9.8% pts lower than the sector average of 31.2%, the company's 12-month trailing P/E of 13.8x is 3.9 multiple pts higher than the sector average of 9.9x. The numbers illustrate that Top Glove's premium valuation is not purely driven by business fundamentals but is due to the stock's superior liquidity and market size (Figure 20).

Liquidity holds the key to market appreciation. For example, Top Glove's market cap of RM3.1bn is 2.2x the sector average of RM1.4bn. The company also commands a valuation premium because of its higher daily traded volume, which at RM6.1m is 31.1% higher than the sector's average of RM4.7m. This comparison illustrates the importance of liquidity in valuing the glovemakers under our coverage and explains why even though Hartalega and other glove companies under our coverage have better business fundamentals than the industry leader, we value them at a discount to Top Glove's target P/E.

Figure 20: Liquidity metrics of glovemakers under our coverage

Company	TTM P/E (x)	P/E prem/disc. (%)	Market cap (RM m)	Foreign Hldg (%)	Free Float (%)	5day ATV (RM '000)	TTM PAT (RM m)
Adventa	10.0	-30%	366.7	8.0%	46.3	7,475.6	35.8
Hartalega	11.3	-20%	1,944.6	5.0%	42.4	2,833.7	172.2
Kossan	8.9	-37%	1,004.0	7.2%	41.4	2,535.8	112.9
Latexx	6.7	-53%	558.0	6.6%	55.4	2,112.8	77.2
Supermax	7.6	-46%	1,380.7	19.7%	55.9	6,918.6	179.6
Top Glove	14.2	0%	3,122.7	32.0%	44.9	6,116.7	216.1
Average	**9.8**	**-31%**	**1,396.1**	**13.1%**	**47.7**	**4,665.5**	**132.3**

Source: CIMB Research, Companies, Bloomberg

Strong reaction to cost and forex headwinds. Cost and forex headwinds rocked the glove sector in 2010. On average glove stocks are down 38.5% from their 52-week highs, ending the year 5.2% higher. The average 12-mth trailing P/E for the sector has fallen 17.6 multiple pts from their highs to 11.2x. The share price of the industry leader Top Glove ended the year 0.3% higher despite plummeting 31.6% from its 52-week high. Its 12-mth trailing P/E also took a dramatic turn for the worse, falling 6.2 multiple pts from its 52-week high to 14.2x (Figure 21).

Figure 21: Impact of high latex prices on glovemakers' share prices and P/E multiples

	Mkt Cap	Capacity	Stock's NTA valuation			52wk share price chg			52wk valuation chg: P/E (ttm)			
Company	(RMm)	(bn pcs)	Quarter	NTA/sh	P/NTA	Current	High	% Chg	Current	High	P/E Chg	% Chg
Adventa	367	5.3	10/10 Q4	1.5	1.7	2.4	4.4	-44.8%	10.0	35.0	-25.0	-71%
Careplus	75	0.5	10/11 Q3	0.1	0.0	0.4	0.5	-21.1%	8.3	10.4	-2.1	-20%
Hartalega	1,945	8.8	09/11 Q2	1.2	5.5	5.4	5.7	-6.1%	11.3	16.0	-4.7	-30%
IRCB	157	2.2	10/11 Q3	0.3	2.5	0.3	1.3	-79.3%	22.5	110.1	-87.7	-80%
Kossan	1,004	12.5	09/10 Q3	1.3	2.8	3.1	4.3	-26.5%	8.9	19.4	-10.5	-54%
Latexx	558	8.0	09/10 Q3	1.1	3.4	2.6	5.0	-48.5%	6.7	18.1	-11.3	-63%
Rubberex	170	6.0	09/10 Q3	1.4	1.1	0.8	1.7	-50.0%	11.6	16.2	-4.6	-28%
Supermax	1,381	17.6	09/10 Q3	2.0	2.6	4.1	6.6	-38.5%	7.6	14.4	-6.7	-47%
Top Glove	3,123	33.0	11/11 Q1	1.9	2.9	5.1	7.4	-31.6%	14.2	20.4	-6.2	-30%
Average	**975**	**10.4**	**-**	**1.2**	**2.5**	**2.7**	**4.1**	**-38.5%**	**11.2**	**28.9**	**-17.6**	**-47%**
High	**3,123**	**33.0**	**-**	**2.0**	**5.5**	**5.4**	**7.4**	**-6.1%**	**22.5**	**110.1**	**-2.1**	**-20%**
Low	**75**	**0.5**	**-**	**0.1**	**0.0**	**0.3**	**0.5**	**-79.3%**	**6.7**	**10.4**	**-87.7**	**-80%**

Source: CIMB Research, Companies, Bloomberg

Sector trades at even more attractive valuations. After the fall in share prices, the glove sector is trading at a CY12 P/E of just 6.8x, which is more than half of the 12.7x for the market. In our view, these valuations are undemanding given the sector's 3-year EPS CAGR of 16.3% which is well-supported by the steady global demand growth of 8-10% p.a. Also, the sector's earnings are backed by long-term structural trends such as 1) the modernisation of the healthcare sector in China and India, 2) increasing hygiene awareness in emerging countries, and 3) increased medical coverage for 32m uninsured Americans as part of the US healthcare reform bill.

Advantages of nitrile not well understood. In view of the nitrile advantages described above, we believe that companies with high nitrile exposure have 1) superior growth prospects, 2) higher security of cash flow, and 3) are better positioned to withstand protracted raw material price volatility. These advantages were not as apparent during previous economic cycles because earnings growth was capacity led. This, in our view, masked the inherent cost advantages of nitrile gloves. For example, during 2008-2009, we believe investors paid less attention to the threat of rising commodity prices including rubber because of the strong global demand generated by the H1N1 flu pandemic. If operating conditions stay bearish, we believe the market will begin to pay more attention to the nitrile glovemakers such as Hartalega.

Growth prospects still bright. Despite cost and forex headwinds, the glove sector still offers investors a 3-year EPS CAGR of 16%, higher than the KLCI's core EPS growth of 13.9% for 2011 and 13.2% for 2012. Demand growth for gloves is still robust and steady at 8-10% p.a. Due to its cost advantages and protein-free properties, nitrile glove demand is projected to grow above the sector's average at 15% p.a. in 2010-15 to 74bn gloves or 20.5% of total global demand (Figure 13 above).

Glovemaker's strategies for 2011

Although industry bellwether Top Glove is cautious about demand in the low-end rubber glove segment, other big-cap companies such as Hartalega, Supermax and Kossan are still bullish on the glove sector. Hartalega specifically expects the market for nitrile gloves to expand by 15%, which is above the 8-10% industry average. While the small-cap companies (Adventa and Latexx) are also optimistic on the industry, we believe that Adventa's shareholders would exit the sector if an attractive offer was on the table.

Adventa – This surgical glove specialist will focus on completing two projects 1) integrating the 1.3bn pieces of glove capacity that management commissioned during 4Q10 in Kota Bharu, Kelantan and 2) constructing its new 1.5bn nitrile glove plant in Kluang, Johor which is expected to be commissioned by 4Q10. We also believe that the company may restructure its operations in Uruguay, which have been set up to supply gloves to the Brazilian healthcare industry. In our view, substituting rubber with nitrile for surgical gloves would be more challenging as rubber is more elastic and is better suited for long and detailed surgical procedures. Potential re-rating catalysts include 1) higher OBM glove sales, 2) better product mix, and 3) takeover speculation.

Hartalega – The world's largest nitrile glovemaker is optimistic about nitrile glove demand. Management expects it to rise 15% to 42.3bn pieces of gloves in 2011. Hartalega's share of this market is c 20%, which suggests room for expansion. The company will spend 1Q11 integrating Plant 5 with its other factories in Bestari Jaya. This state-of-the-art plant has a line capacity of 35,000 pieces of gloves per hour, double the industry average. The company will also continue to refurbish old lines at

Plant 1 and 2, which were built in 1992 and 1997m respectively. Post refurbishment, we expect to see higher overall line speed and higher operational efficiency due to lower rejection rates and lower energy costs. This will add capacity of c. 1bn pieces of gloves even without a new plant. We also expect Hartalega to be aggressive in its public relations campaign against allegations of health and safety violations by the residents of Taman Suria, Bestari Jaya. We believe the following catalysts could trigger a re-rating of Hartalega's share price, 1) better operating efficiency, 2) higher output from refurbished lines, and 3) higher ASPs from selling higher quality gloves.

Kossan – The company is optimistic on the glove industry. We expect it to expand its MNC client base in 2011. Specifically, we understand that Kossan's management is in advanced discussions with a large Asian distributor for it to supply clean room gloves. Also, it is in talks with two of its existing MNC clients to add capacity. As at 30 Sep 2010, 43% of Kossan's capacity was nitrile. Given the company's aim to increase nitrile to 50% in the quarters ahead, we expect the company to be busy refurbishing and adding new nitrile lines in 2011. Potential re-rating catalysts for the stock include 1) new orders from Japanese and US OEM brands, 2) high utilisation rates, and 3) margin improvement from higher nitrile sales and productivity gains.

Latexx – In Mar 2010, Latexx signed a licensing agreement with Dutch R&D company Budev B.V. giving Latexx the exclusive rights to use Budev's protein-reducing technology to produce low protein rubber gloves. This was supposed to be the company's first OBM product. However, there have been no further developments on this matter and we believe Latexx has put this initiative on hold as rubber gloves are now more expensive than nitrile gloves, which are already protein-free. We expect renewed interest in this technology if rubber prices correct in 2011. Factors that could trigger a re-rating include 1) a better product mix, 2) demand for ultra-thin rubber gloves, and 3) resumption of its delayed capacity expansion programme.

Supermax – This Sungai Buloh-based company is optimistic about the glove industry as management expects the steady improvement of hygiene standards in Asia to lift demand for medical gloves. In 2011, we expect management to focus on 1) completing the refurbishment of its Sungai Buloh plant to manufacture surgical gloves, 2) finalising the low-tax regional distribution hub that management promised during its 3Q10 results briefing in Nov 10, 3) promoting its stock amongst US investors through the American Depositary Receipt programme that was completed on 20 Dec 2010, and 4) increasing nitrile capacity from 24% to 35% by refurnishing old lines, reconfiguring existing rubber lines and building new capacity. The stock could be catalysed by 1) higher nitrile glove sales, 2) refurbishment of the company's Sungai Buloh plant for the manufacture of surgical gloves, and 3) tax savings from the company's regional distribution hub in Malaysia.

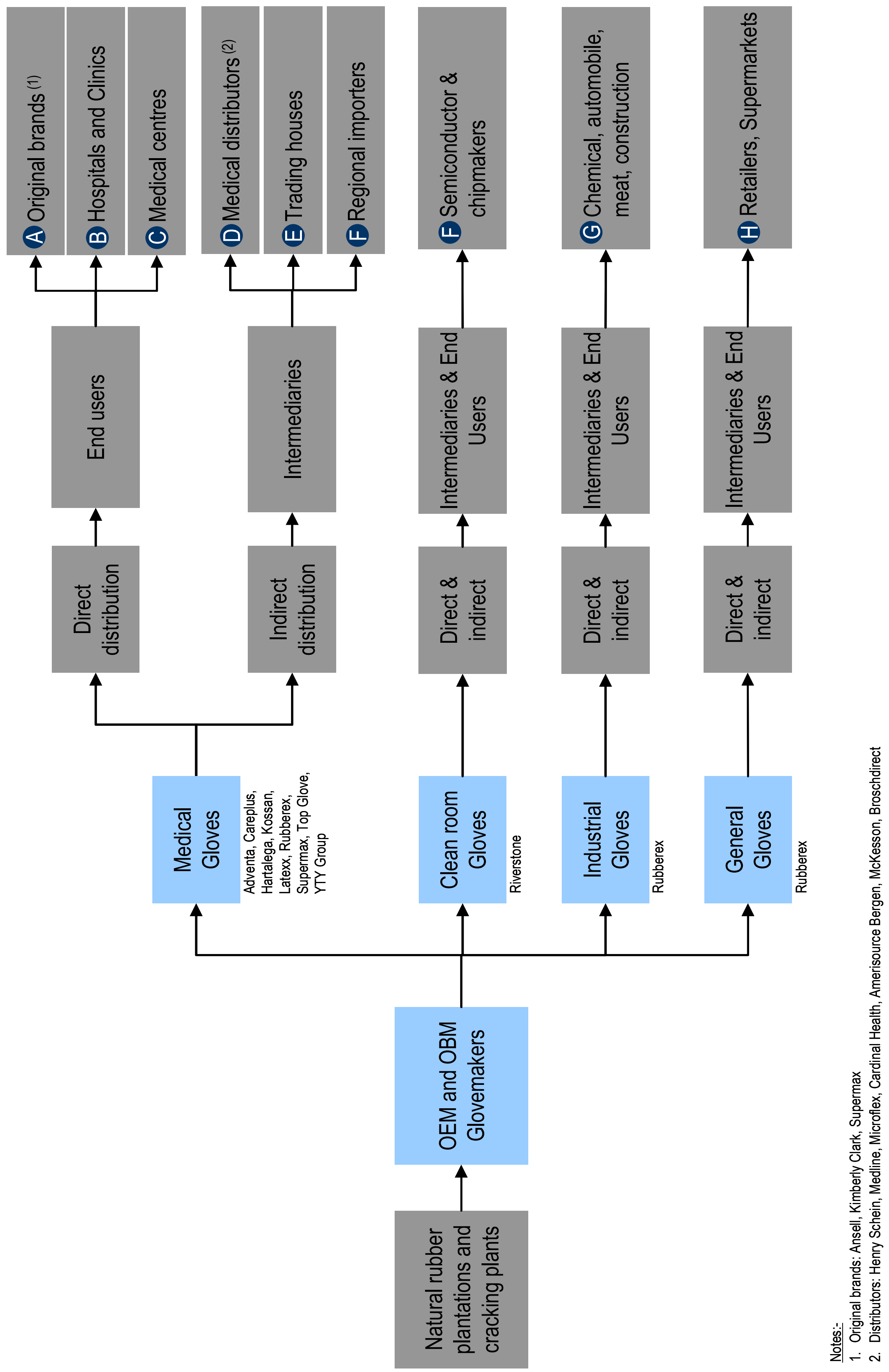
Top Glove – The world's largest glovemaker's biggest challenge in 2011 will be remodelling its business strategies to weather fast-rising latex prices. Management remains cautious on demand for low-end rubber gloves in 2011 and has indicated that, demand in this segment has normalised after the H1N1 outbreak. Unless there are demand catalysts such as a severe disease outbreak or a restocking of inventories, we do not expect Top Glove's utilisation rates to exceed its current 60-70%. The company has not detailed how it intends to revamp its business model. We believe more will be revealed at its annual general meeting on 11 Jan 2011. Nevertheless, management has indicated that it intends to increase nitrile capacity from 7-9% currently to 20% by end-2011. This will enable the company to enhance earnings through better margins. Potential re-rating catalysts include 1) distributors' restocking of inventories, which have been whittled down to as low as a month, 2) diversification of its product mix, and 3) commissioning of its two nitrile glove factories with a capacity of 1.5bn pieces of gloves each in FY11.

Maintain OVERWEIGHT. Despite cost headwinds from fast escalating rubber latex prices and a weakening of the US dollar, we reiterate our OVERWEIGHT weighting on the rubber glove sector. We maintain our earnings numbers, make no changes to our target prices and continue to rate all the glovemakers under coverage as Outperforms. Potential re-rating catalysts for the sector include 1) the eventual moderation of rubber latex prices, 2) increased outsourcing by MNCs, 3) the positive impact of price increases, and 4) takeover speculation surrounding small-cap glovemakers.

Hartalega remains our top pick. While we believe Hartalega will outperform the sector in the quarters ahead as it is the largest nitrile producer, we retain our 13.05x target P/E valuation for the stock or a 10% discount to Top Glove's 14.5x target P/E due to its poorer share liquidity. Hartalega has the lowest free float among the glovemakers under our coverage at 42.4% compared to the sector average of 48.7%. But we think that the stock's actual free float is closer to 20-30% as we believe the company's top 10 shareholders are strategic investors. Should Hartalega's liquidity and size improve in the quarters ahead, we would take the opportunity to revise our valuation basis and target price.

APPENDICES…

Figure 1: Rubber glove value chain



Source: CIMB Research, Companies

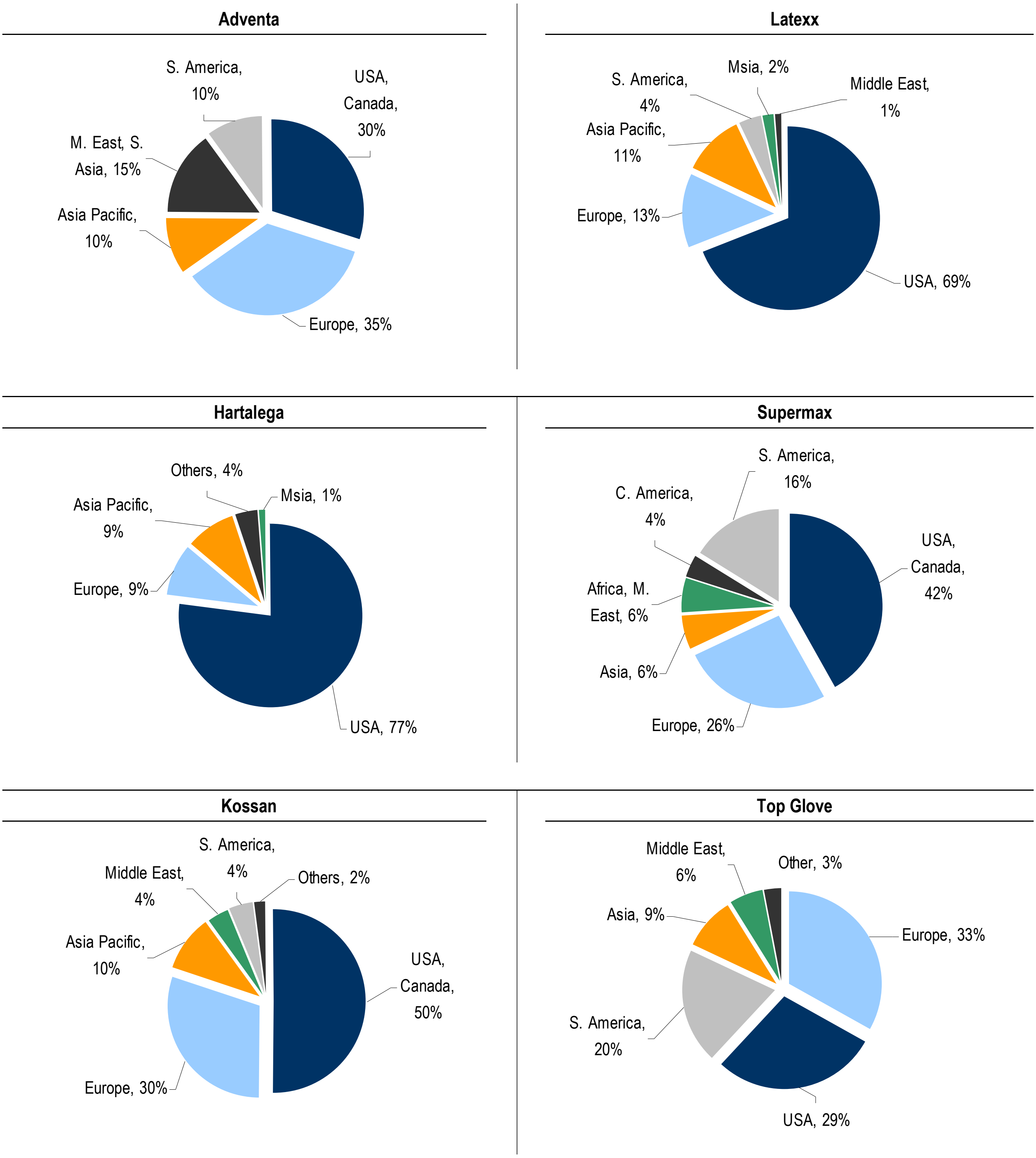
Figure 2: Location of major glovemakers

Notes:-

1. Supermax (Sungai Buloh); Hartalega (Ijok); Top Glove (Banting); Riverstone (Bukit Beruntung)
2. Rubberex (Kampung Bercham); Supermax (Lahat, Kamunting); Latexx (Kamunting); Top Glove (Kampung Tasek); Riversone (Taiping)

Source: CIMB Research, Companies' annual reports

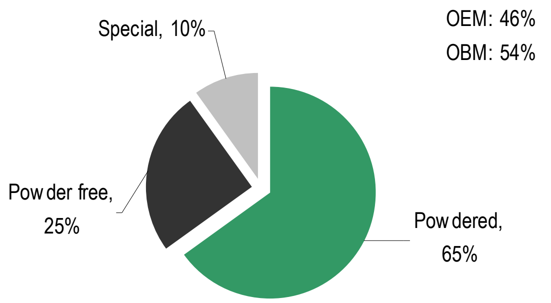
Figure 3: Geographical sales breakdown



Source: CIMB Research (latest investor presentations), Companies

Figure 4: Product mix

Adventa



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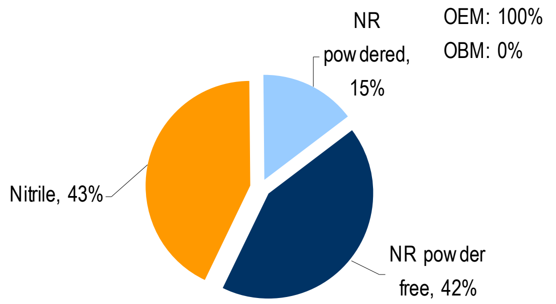

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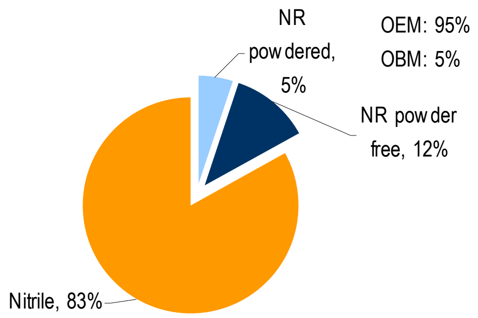

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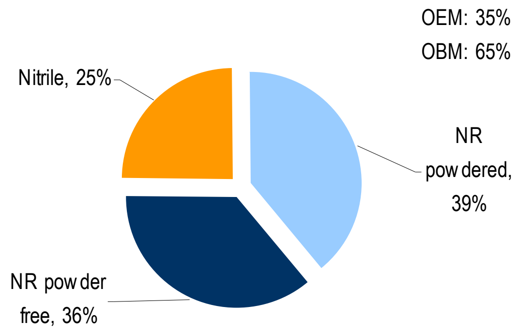

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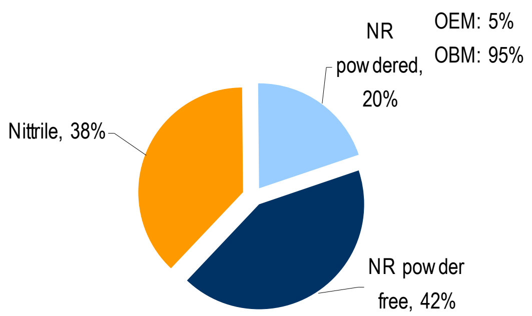
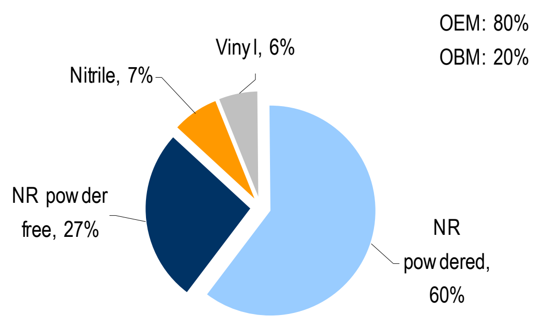


Top Glove



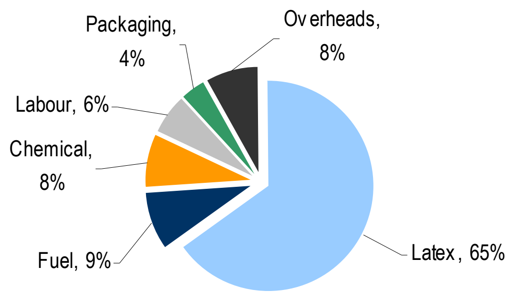
Source: CIMB Research (latest investor presentations), Companies

Figure 5: Cost structure

Adventa

Information not available

Latexx



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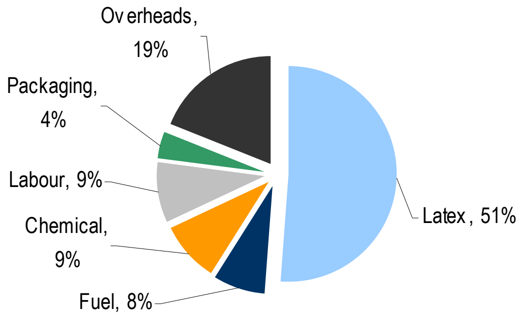

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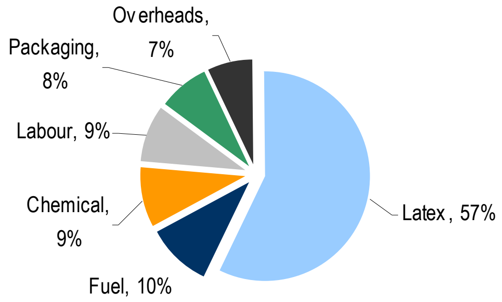

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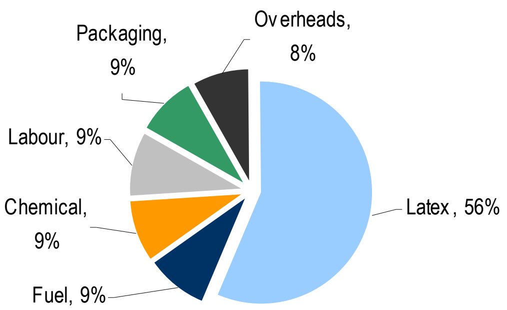
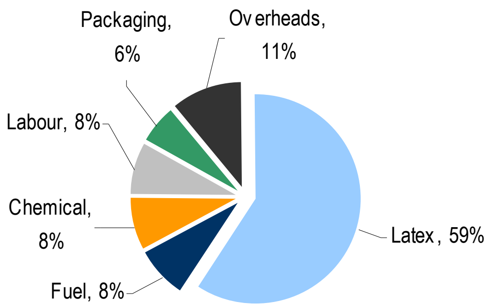
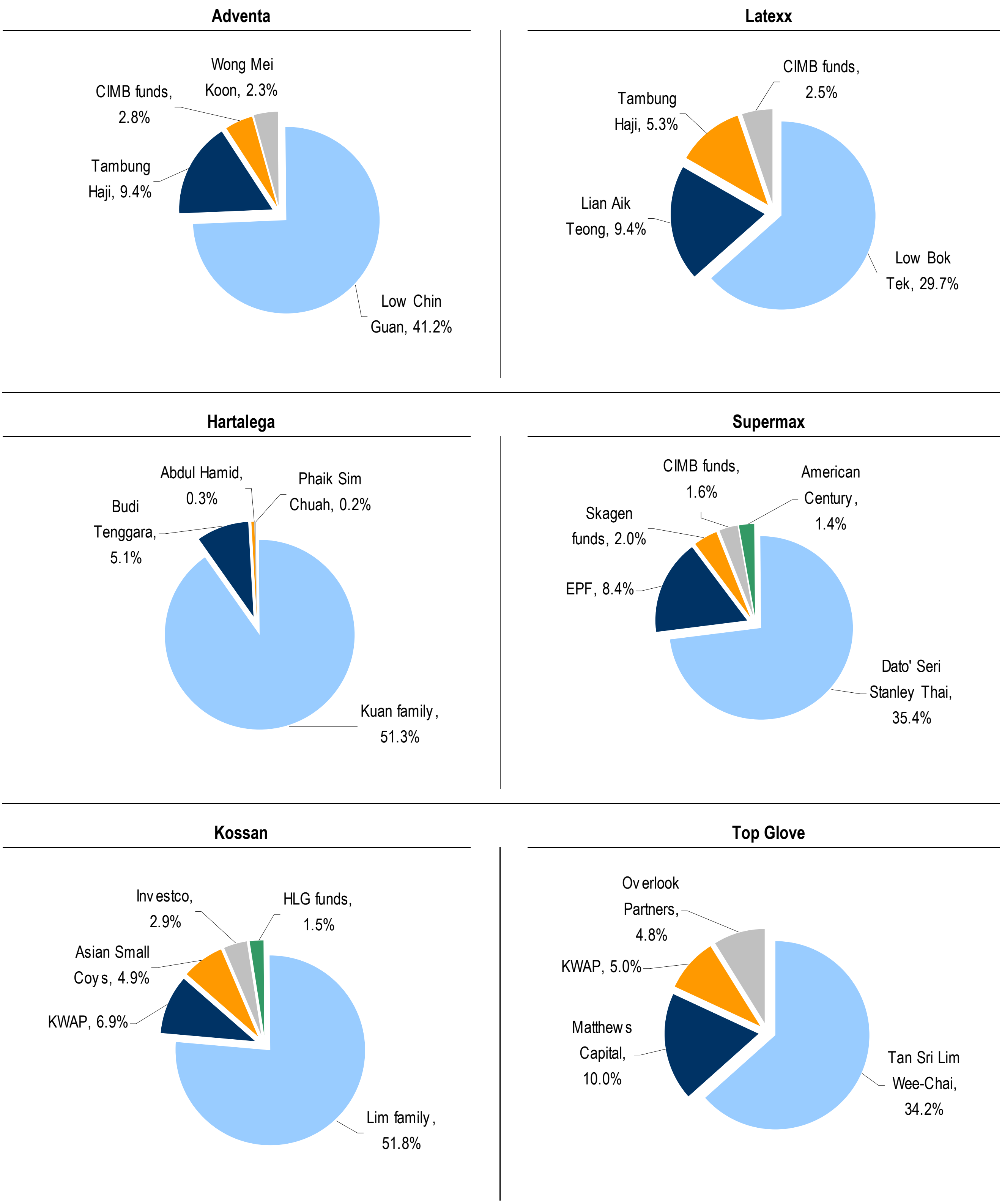


Top Glove



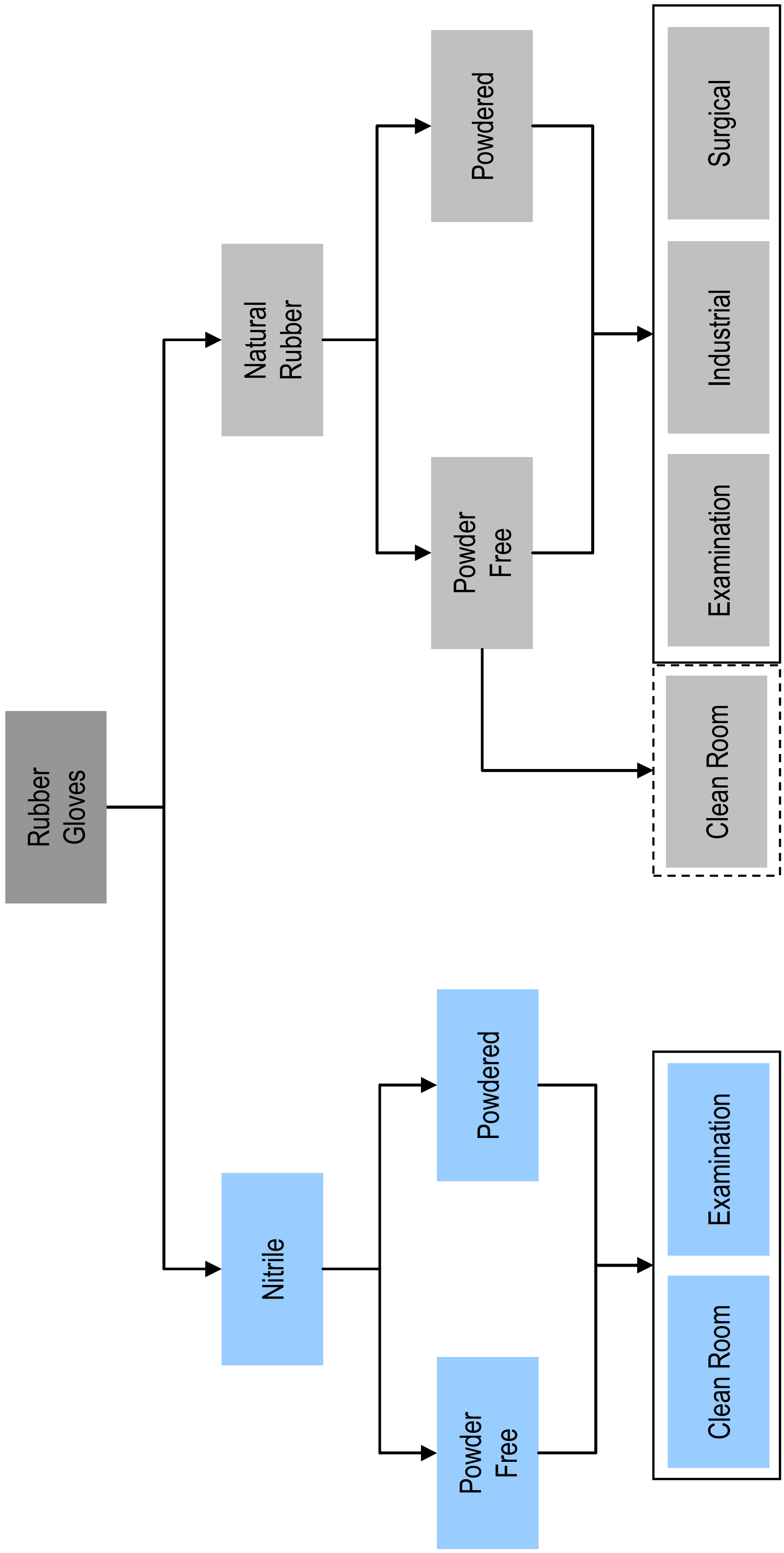
Source: CIMB Research (latest investor presentations), Companies

Figure 6: Shareholding structure



Source: CIMB Research, Companies

Figure 7: Rubber glove product segmentation



Source: CIMB Research, Companies, D&B Malaysia

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