

03 April 2013

Rubber Glove

Resilient sales volume growth in 2012

NEUTRAL


We maintain a Neutral rating on the rubber glove sector. According to Malaysian Rubber Export Promotion Council (MREPC) in 2012, the total exports of rubber gloves, synthetic rubber (SR) and natural rubber (NR) combined rose 14.9% YoY. The overall demand for rubber gloves in 2012 remained resilient led by a solid double digit volume growth from nitrile gloves and a rebound in the sales volume of latex gloves due to the low latex price input. Moving into 2QCY13, the overall demand for rubber gloves is expected to be resilient, led by NR gloves although SR gloves, which had consistently been taking up the former's market share, will continue to show better growth prospects. However, re-rating catalysts for the sector are scarce as the stable volume growth and mildly positive weakening trend of the Ringgit vs. USD currency rate are expected to be negated by the minimum wage policy, and over the longer term, higher natural gas prices. Despite our neutral rating on the sector, we have two OUTPERFORM stocks under our coverage. Our top pick in the sector is Kossan Rubber Industries ("KOSSAN", TP: RM3.64). We are looking to upgrade Kossan's target price pending a company visit. Our tentative new target price for Kossan is RM4.05 based on 11x FY13 EPS, in line with its 6-year historical average, as opposed to RM3.64 currently. We also like Supermax as it is trading at a 25% discount to the sector's average and a wider 40% discount to its larger peers.

Natural and synthetic rubber gloves exports in 2012 rose. In 2012, the total exports of rubber gloves, synthetic rubber (SR) and natural rubber (NR) combined rose 14.9% YoY to 40.7b pairs and 3.6% to RM9.8b in value. In 2012, Malaysia exported 18.6 billion pairs of SR gloves or an increase of 26% YoY. Correspondingly, in terms of value, SR exports rose 14% YoY to RM4.1b in 2012. The solid growth was due to nitrile gloves. Exports of nitrile gloves in 2012 was 18.5 billion pairs (RM3.9b), making up 99% of the total value of SR gloves exported. However, we note that the exports of NR gloves have deteriorated in value to RM5.6b (-3% YoY) for the third consecutive year in 2012 despite the exports volume rising to 22.1 billion pairs (+7% YoY) due to the rapidly declining latex price input. The US and EU regions were the largest importers of Malaysian SR gloves in 2012 at 9.6 (+20% YoY) and 5.3 (+26% YoY) billion pairs of SR gloves (see Table 1). 51% of the SR gloves were exported to the US. The next largest destination for SR gloves was Germany, which overtook Japan in 2012. In terms of quantity, UK reported the highest growth of 41% YoY in 2012 followed closely by Australia (39%) and Japan (35%). Note that the top ten export destinations for SR gloves were all located in the developed countries except China. Correspondingly, in terms of NR, its exports performance in sales volume fell the most in Belgium, UK, Germany and Italy between 15% and 23%. Only France and Turkey recorded the highest sales volume of 10% and 30% respectively.

ASPs of SR gloves are expected to be more resilient compared to NR gloves. Typically, the ASP for natural rubber gloves will rise in tandem with the increase in the input raw material costs. Conversely, when feedstock cost falls, rubber glove players generally pass on the cost savings to their customers via lowering the ASPs. This has been the mutual agreement between the producers and their customers. We believe a glut and hence a price war in the nitrile segment is less likely, at least in the medium term, due to its resilient demand. In 2012, the ASPs of SR gloves were cheaper compared to NR gloves. For example, in 2012, SR powder-free examination glove ASP was at RM0.20 per pair compared to NR powder-free examination glove ASP of RM0.22 per pair. However, the shift in demand to nitrile, which rose >20% YoY in 2012, and a low single digit sales volume growth in latex gloves, are more likely to lead to a glut and ultimately a price war in the latex glove segment. As such, latex glove producers are currently more susceptible to any sharp increases in their ASPs as compared to nitrile glove makers.

Demand for gloves still intact, moving towards nitrile gloves. We believe that the average 10% demand p.a. for rubber gloves over the next few years is still intact. The overall demand is expected to continue to be led by NR gloves, although SR gloves had consistently been taking up the former's market share. While latex-based gloves or NR gloves are still dominant (as a percentage to the overall exports of rubber gloves) in Malaysia, the trend is moving towards SR gloves. This was evident from the lower NR:SR sales value ratio of 61:39 in 2011 to 57:43 in 2012, and the sales volume ratio of 58:42 in 2011 compared to 54:46 in 2012. The quantity of NR gloves exported in 2012 rose 7% to 22.2 billion pairs YoY due to the low cost of the raw material input. The demand and strong double-digit growth rate of gloves is expected to be continue driven by nitrile, we expect latex-based gloves to continue to register positive volume sales as well due to the stable latex price.

Kossan is our top pick. We believe Kossan's re-rating catalysts are gaining momentum via its maiden foray into Indonesia, potentially to expand its technical rubber products (TRP) division there, and also from its gloves expansion following its new land acquisition, which are positive news flows. Kossan is also trading at an attractive valuation of just 10x FY13 earnings as compared to Top Glove's 14.7x and Hartalega's 15.4x FY13 PER. The valuation gap should narrow going forward as (i) Kossan moves up the value chain by offering higher margin surgical and clean room gloves and (ii) the fact that Kossan's product mix contains less natural rubber glove, which makes it more sensitive to movements in the latex price. Judging from the recent acquisitions of Advanta and Latexx Partner at PERs of between 13.0x and 16.0x, Kossan also appears more attractive at its current valuations. This is because Kossan has a bigger market capitalisation and earnings base compared with both Advanta and Latexx Partner.

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Table 1 :Declining trend in latex but nitrile gloves gaining further momentum in 2012

Destination	2009 (million pairs)		2010 (million pairs)		2011 (million pairs)		2012 (million pairs)		2012 vs 2011	
	NR	SR	NR	SR	NR	SR	NR	SR	% NR chg	% SR chg
EU	8,042	1,513	8,526	2,449	6,351	4,437	5,865	5,352	(7.7)	20.6
USA	6,321	4,668	5,778	6,891	3,640	7,620	3,446	9,649	(5.3)	26.6
South America	3,151	72	3,054	90	2,868	173	3,106	175	8.3	1.2
East Asia	1,952	440	1,866	997	1,612	1,315	1,883	1,701	16.8	29.4
Non-EU countries	1,294	40	1,488	79	1,292	134	1,662	244	28.6	82.1
West Asia	1,050	35	1,080	55	1,152	86	1,328	147	15.3	70.9
Africa	810	16	954	33	958	73	1,516	65	58.2	(11.0)
ASEAN	580	51	628	65	564	178	811	154	43.8	(13.5)
Oceania	743	104	628	209	562	236	574	333	2.1	41.1
North America	929	330	959	556	821	471	890	618	8.4	31.2
South Asia	190	2	273	6	481	22	487	24	1.2	9.1
CIS Countries	311	14	314	30	289	46	514	127	77.9	176.1
Other	1	19	2	35	4	32	0	35	(90.0)	9.4
Total	25,374	7,304	25,550	11,495	20,594	14,823	22,082	18,624	7.2	25.6
Ratio as % of total (NR : SR)	78	22	69	31	58	42	54	46		

NR – natural rubber (latex based) SR – synthetic rubber (nitrile)

Source: Kenanga Research, Malaysian Rubber Export Promotion Council (MREPC)

Table 2 : ASP in 2010 and 2011 - ASPs per pair of nitrile SR powder-free examination cheaper compared to NR powder-free examination

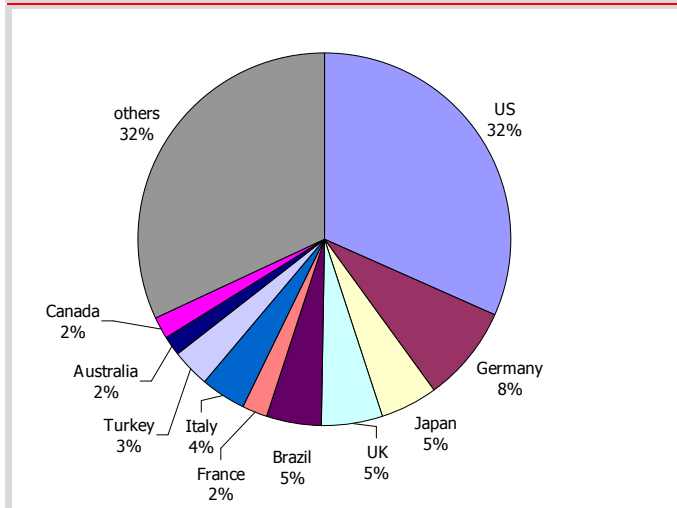
Average selling prices of gloves	2011	2012	% change
NR powdered surgical	0.592	0.587	(0.8)
NR powdered-free surgical	1.108	1.14	2.9
SR powdered-free surgical	1.63	1.596	(2.1)
NR powdered examination	0.189	0.166	(12.2)
NR powder-free examination	0.242	0.218	(9.9)
SR powdered examination	0.231	0.203	(12.1)
SR powder-free examination	0.223	0.203	(9.0)
NR clean room	0.506	0.514	1.6
SR clean room	0.403	0.452	12.2

^price in RM per pair

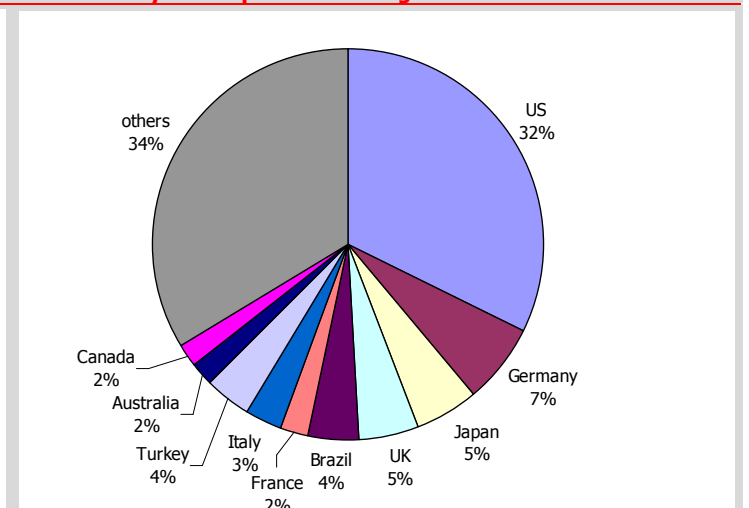
NR – natural rubber, SR – synthetic rubber (>90% nitrile)

Source: Kenanga Research, Malaysian Rubber Export Promotion Council (MREPC)

Top ten export destinations for rubber gloves in 2011

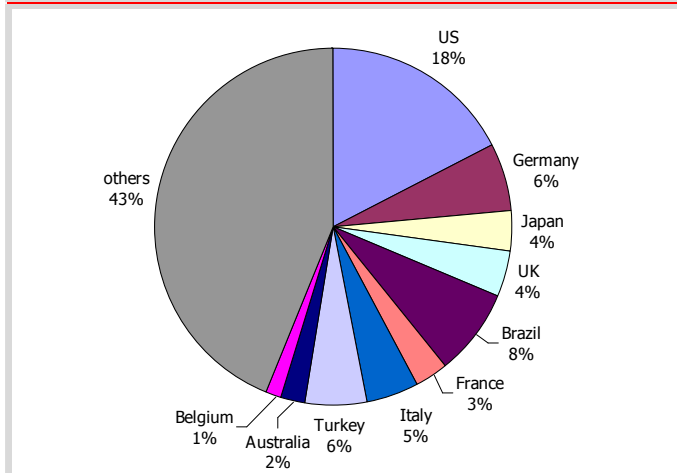


Top ten export destinations for rubber gloves in 2012 accounted for 68% of Malaysia's export of rubber gloves

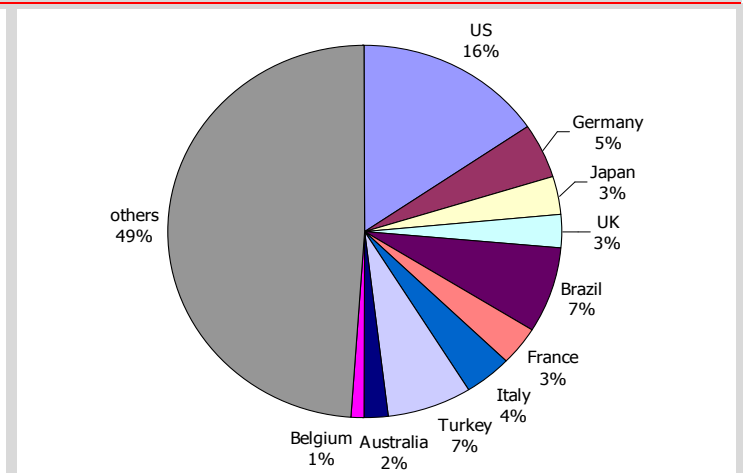


Source: Malaysian Rubber Export Promotion Council (MREPC)

Top ten destinations for NR in 2011 in volume sales

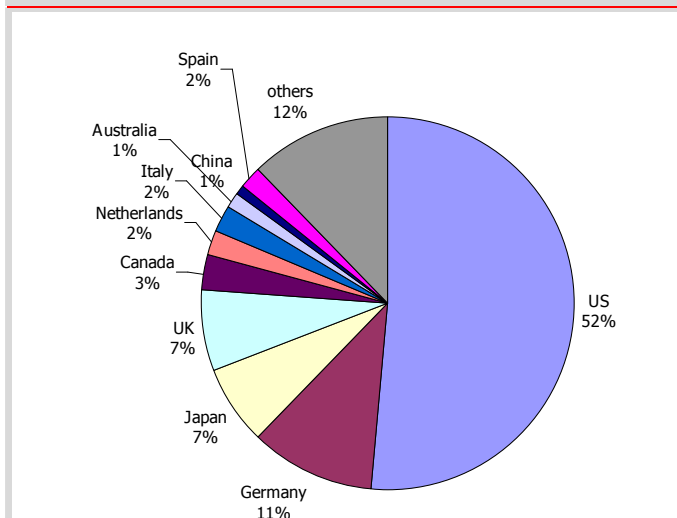


Top ten destinations for NR in 2012 in volume sales

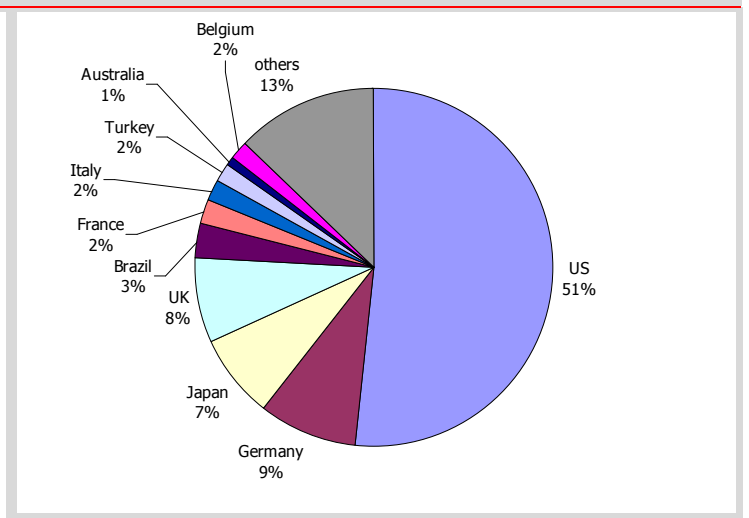


Source: Kenanga Research, Malaysian Rubber Export Promotion Council (MREPC)

Top ten destinations for SR in 2011 in volume sales



Top ten destinations for SR in 2012 in volume sales



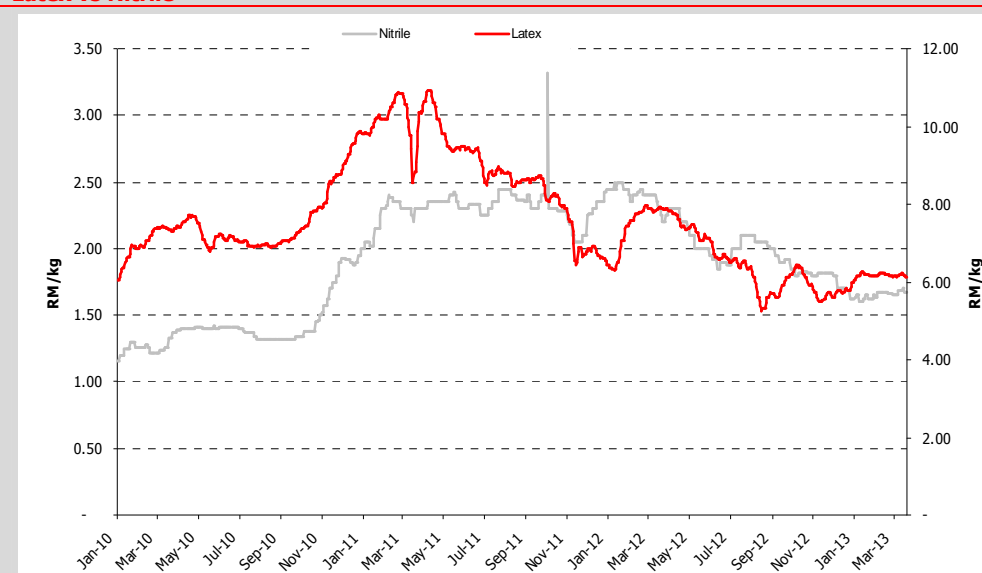
Source: Kenanga Research, Malaysian Rubber Export Promotion Council (MREPC)

Exports of rubber gloves by usage in 2011 and 2012

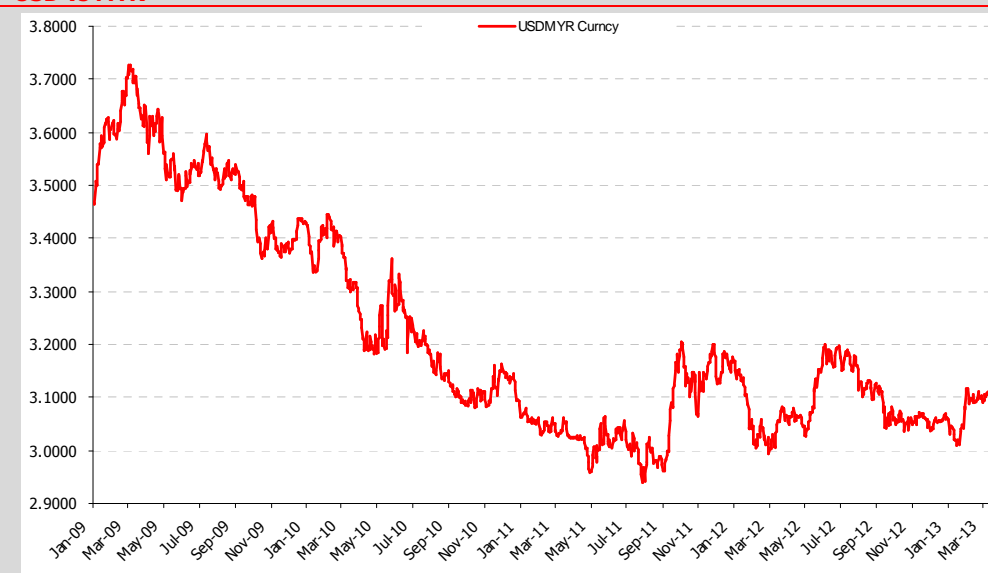
Type	2010		2011		2012		Value chg (%)	Quantity chg (%)
	Value (RMm)	Quantity (million pairs)	Value (RMm)	Quantity (million pairs)	Value (RMm)	Quantity (million pairs)		
Examination	6,245	32,939	6,673	30,766	6,977	35,900	4.6	16.7
Surgical	825	986	968	1,074	1200	1349	24.0	25.6
High Risk	219	616	216	413	103	275	(52.3)	(33.4)
Total medical gloves	7,289	34,541	7,857	32,253	8,280	37,524	5.4	16.3
Cleanroom	117	249	165	368	210	442	27.3	20.1
Household	512	417	609	398	564	394	(7.4)	(1.0)
Industrial	614	1,734	621	1,865	614	1,977	(1.1)	6.0
Food Grade	12	65	10	50	12	65	20.0	30.0
Others	26	66	159	470	83	320	(47.8)	(31.9)
Total non-medical gloves	1,281	2,530	1,564	3,151	1,484	3,199	(5.1)	1.5
Total	8,570	37,071	9,421	35,405	9,764	40,723	3.6	15.0

Source: Kenanga Research, Malaysian Rubber Export Promotion Council (MREPC)

Latex vs Nitrile



USD vs MYR



Source: Bloomberg, Kenanga Research

Malaysian Glove Sector Peer Comparison

NAME	Price	Mkt Cap	PER (x)			Est. Div. Yld. (%)	Historical ROE (%)	P/BV	Net Profit (RMm)			FY12 NP Growth (%)	FY13 NP Growth (%)	Target Price (RM)	Rating	
	(RM)		(RMm)	ACTUAL	1YR FWD				2YR FWD	ACTUAL	1YR FWD					2YR FWD
CORE COVERAGE																
HARTALEGA HOLDINGS BHD	4.99	3,659.21	18.1	15.9	14.2	2.7%	33.9%	5.87	201.40	229.20	256.50	13.8%	11.9%	5.12	Market Perform	
KOSSAN RUBBER INDUSTRIES	3.61	1,150.22	11.0	9.9	8.5	1.9%	18.8%	1.88	104.50	116.00	135.80	11.0%	17.1%	3.64	Outperform	
SUPERMAX CORP BHD	1.94	1,317.56	10.8	9.2	8.3	2.6%	14.8%	1.50	121.80	143.20	159.60	17.6%	11.5%	2.20	Outperform	
TOP GLOVE CORP BHD	5.63	3,487.34	17.2	15.5	14.0	2.8%	18.1%	2.77	202.70	225.20	248.70	11.1%	10.4%	6.00	Market Perform	

Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

- OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of 3% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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